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IMF Country Report No.12/150

KUWAIT

2012 ARTICLE IV CONSULTATION

June 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 30, 2012, with the officials of Kuwait on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 30, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its June 15, 2012 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Annex/Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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KUWAIT

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

May 30, 2012

KEY ISSUES

Context. Macroeconomic outcomes were strong in 2011, supported by high oil revenues. However, the pace of recovery of non-oil economic activity continued to be moderate, with still weak, although improved, growth of banks' credit; inflation also remained moderate. The policymaking landscape changed significantly in recent months, and a new government and parliament are now in place. Kuwait ranks relatively low on essential elements for competitiveness and lags in the quality of its physical and social infrastructure relative to its GDP per capita level.

Outlook and risks. Economic recovery is expected to strengthen, led by increasing government expenditure—particularly in wages and capital outlays. High fiscal and external surpluses are expected to persist. Inflation is projected to moderate slightly, but inflation risk is on the upside. Risks for the outlook include low implementation rates of the capital budget and legislative bottlenecks, which could dampen the recovery. Like other countries, Kuwait is exposed to external risks, including the intensification of the European crisis, but these risks are manageable.

Macroeconomic policies. The near-term macroeconomic policy stance is expected to remain supportive. Kuwait has significant fiscal space, but rising public sector wage and pension costs and rapid population growth are expected to exert pressures on public finances in the medium term. If Kuwait is to preserve wealth equally for its future generations, fiscal consolidation will be needed in the medium term.

Financial stability. The banking sector remains resilient, but conditions in the investment companies sector have deteriorated. The authorities are encouraged to continue to be vigilant regarding existing and emerging risks, continue to enhance ICs supervision, and develop the needed tools for ICs resolution.

Statistics. Data provision has shortcomings, but is broadly adequate for surveillance. Further progress in the quality and timeliness of data is needed, particularly in the national accounts.

Approved By
Alfred Kammer and Taline Koranchelian

Discussions were held in Kuwait during April 11–30, 2012. The mission comprised Ms. Khamis (Head) and Messrs. Katayama, Medina, and Rodriguez (all MCD). The mission benefited from interactions with H.E. Central Bank Governor Mohammad Al-Hashel, H.E. Minister of Commerce and Industry Anas Al-Saleh, Undersecretary of Ministry of Finance Mr. Khalifa Hamada, other senior government and central bank officials, and representatives of parliament, the private sector, and civil society.

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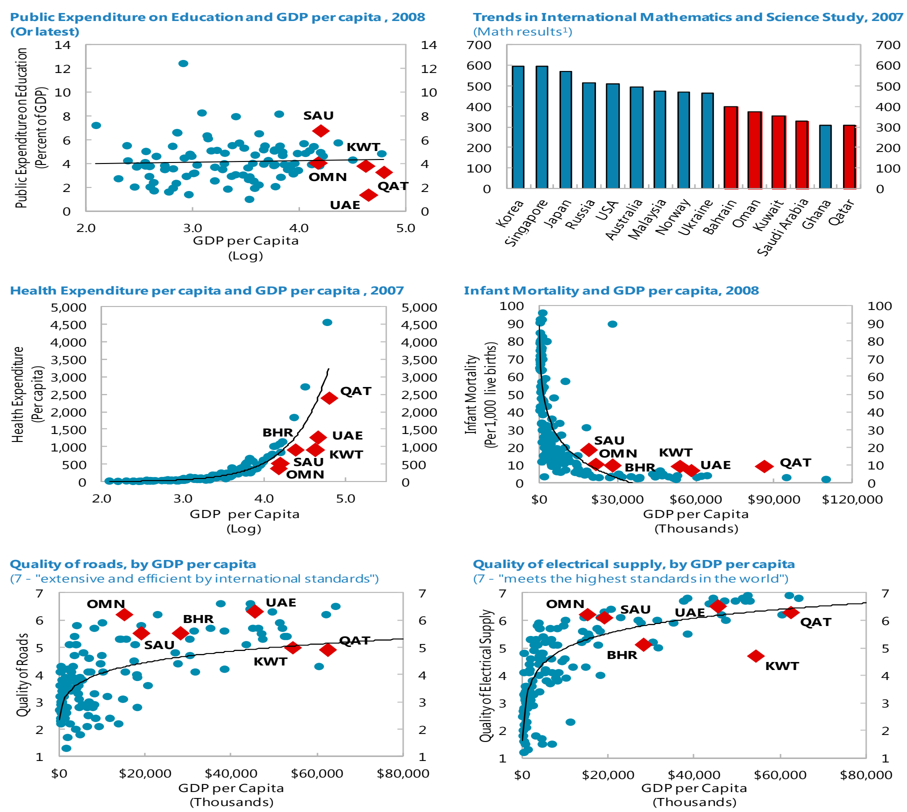
INTRODUCTION

1. **Kuwait had strong macroeconomic outcomes in recent years, but it still faces challenges to improve its physical and social infrastructure and to diversify its economic base.** Kuwait has posted fiscal and external surpluses for thirteen years in a row, and maintained a largely stable macroeconomic environment. Nevertheless, it fares relatively low in international comparisons as regards the quality of its infrastructure, health, and education, when compared with countries with similar GDP per capita level (Figure 1). The economy remains oil dominated and the private sector is largely dependent on government spending and expatriate labor. The labor market is highly segmented: Kuwaiti nationals work primarily in the public sector—about 80 percent of the Kuwaiti labor force is employed in the public sector—and Kuwaitis constitute only 7 percent of the private sector labor force, while expatriates are employed mostly in the private sector.[1]

Figure 1. Kuwait: Education, Health, and Infrastructure Indicators, 2007–09
(Unless otherwise specified)



Sources: Global Competitiveness Report 2008–09 (World Economic Forum); World Development Indicators; and International Association for the Evaluation of Educational Achievement (IEA).
[1] A global standardized test of students in grade 8.

[1] About 29 percent of total expatriate workers are employed as domestic workers and 64 percent work in other private sector activities. The remaining 7 percent are employed in the public sector.

2. **A four-year development plan (DP) was launched in FY 2010/11.** The DP is the first of a series of plans based on a strategic vision for 2035 that emphasizes investment in infrastructure, health, and education, and envisages significant co-participation of the private sector through the establishment of public shareholding companies. In addition, the Plan aims at diversifying Kuwait's economy by transforming the country into a regional financial and trade hub.

3. **The policymaking landscape changed significantly in 2011 and early 2012.** After six cabinet resignations in the past five years, the prime minister resigned in late 2011 and new parliamentary elections were held in early February 2012, producing significant gains for the opposition. A new government was formed shortly after.

RECENT DEVELOPMENTS

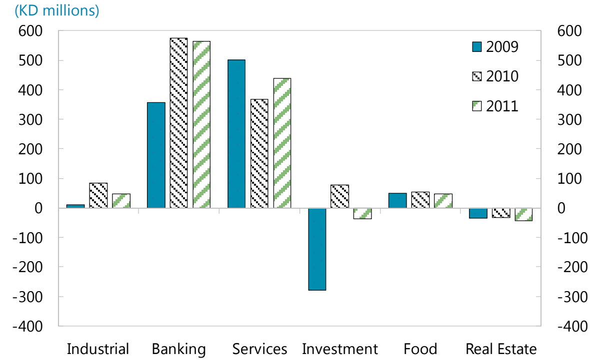
Oil sector has expanded, but non-oil sector recovery is still moderate

4. **Fiscal and external outcomes were strong in 2011.** Government expenditure continued to increase in FY 2011/12 (8 percent), reflecting a significant increase in the wage bill and capital expenditure (about 20 percent). The budget expansion was more than offset by the increase in oil revenue (35 percent) emanating from higher oil prices and production levels. Overall, fiscal and external surpluses are estimated to have reached more than 30 percent and 41 percent of GDP in 2011, respectively.

5. **Notwithstanding significant fiscal support over the past few years, the pace of recovery of non-oil economic activity after the 2008 global financial crisis has been moderate.** Non-oil growth in 2011 is estimated at about 4.5 percent, with still weak, although improved, growth of 2½ percent in banks' credit to the nongovernment sector. Corporate earnings declined in all sectors with the exception of services;[2] the banking sector maintained largely flat profits because of a buildup in provisions, and the investment and real estate companies sectors posted losses (Figure 2). At the same time, real estate transactions recovered in the residential and investment segments (Figure 3), but commercial real estate continued to suffer from low occupancy rates and declines in rental rates. Inflation remained moderate, at 4.7 percent.[3]

Figure 2. Corporate Earnings: Sectoral Performance, 2009–11

(KD millions)

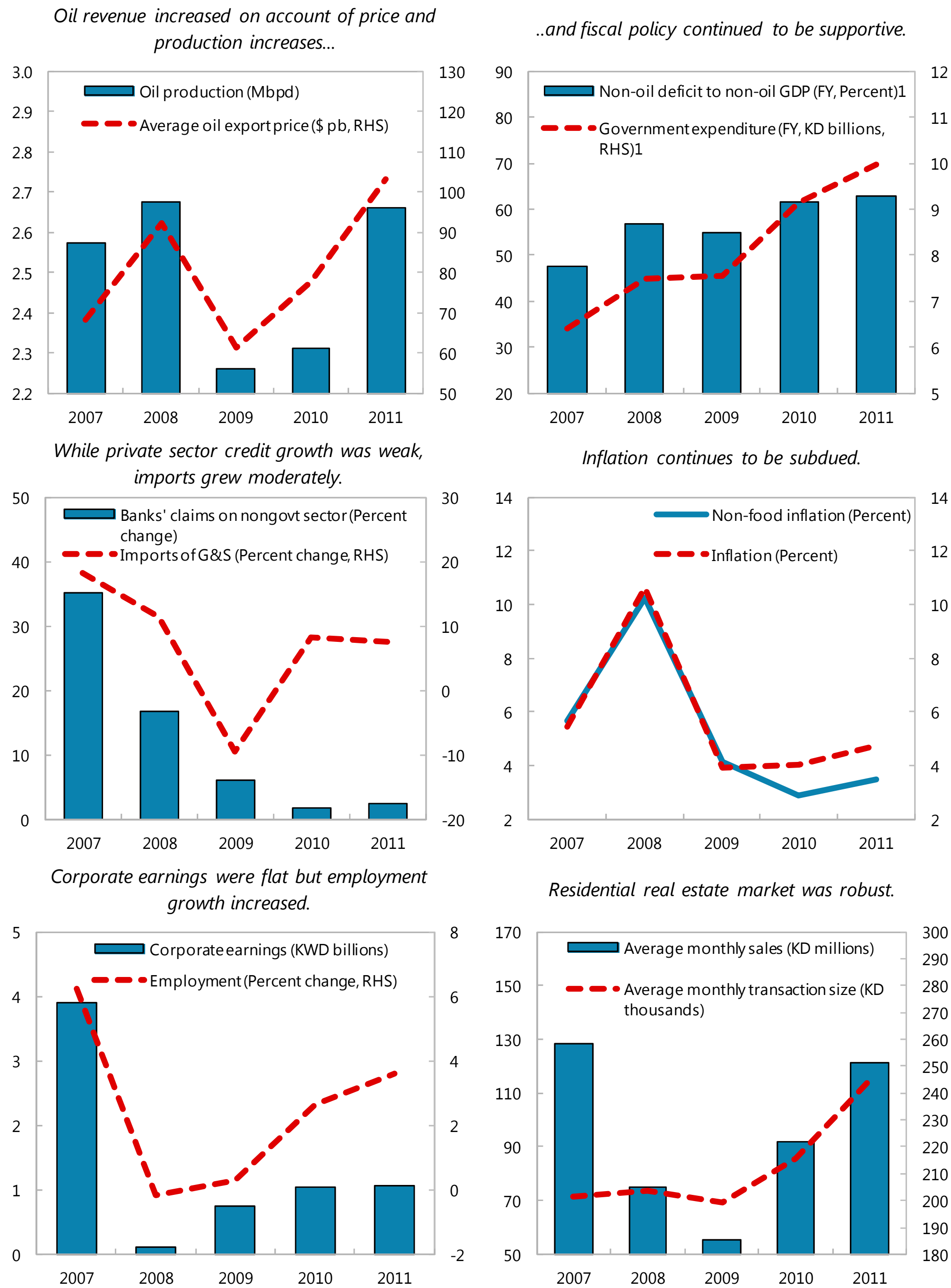


Source: National Bank of Kuwait.

[2] Based on data for listed companies.

[3] Recent international oil prices did not have an impact on the CPI because Kuwait has generous oil-related subsidies (fuel, electricity, and water) and retail oil-related prices are not adjusted with international price movements. The cost of these subsidies is reported explicitly in the budget.

Figure 3. Kuwait: Recent Economic Developments, 2007–11



Sources: Country authorities; and IMF staff estimates.

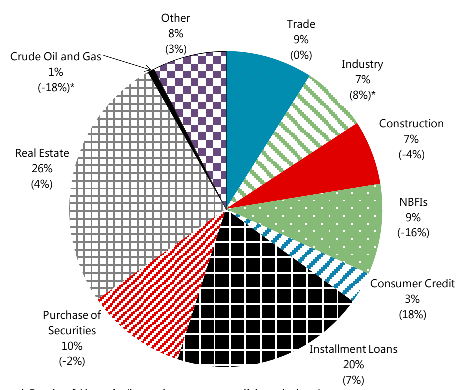
[1]After adjusting for investment income and pension fund capitalization.

Notes: Real estate and corporate earnings from National Bank of Kuwait. Corporate earnings for 2010 and 2011 reflect end-December data (and excludes extraordinary benefits of two large corporations). Employment growth for 2011 is based on end-December data.

The banking sector is strong but investment companies' conditions continued to worsen

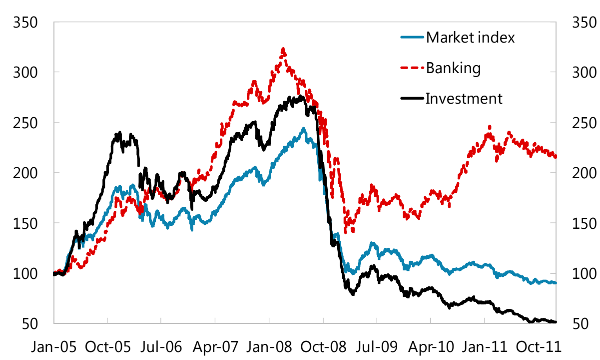
6. **The banking sector faced a mixed environment in 2011, but its financial soundness indicators (FSIs) remained sound.** On the one hand, liquidity conditions remained favorable and lending to some sectors, in particular industry and households, strengthened compared to 2010 (Figure 4). The sector remained profitable, although profits of the banks remained largely flat because of a buildup in provisions. Although they have slightly declined in 2011, banks' capital adequacy and leverage ratios remained robust, owing to capital injections and subordinated debt issuance in 2010. Bank liquidity improved substantially due to a combination of high retail deposit growth and still-moderate lending growth. Nonperforming loan (NPL) ratios continued to decline in 2011, reaching 7.3 percent in 2011 compared to their peak of 11.5 percent in 2009. The decline continued to be largely on account of write-offs of investment companies' (ICs) loans and loan repayments related to loan restructurings, and resulted in a reduction of the specific provisions to NPL ratio. On the other hand, some vulnerabilities in banks' asset quality remain: in addition to a lack of improvement in the real estate companies sector and a decline of 16½ percent in the domestic stock market, ICs continued to face difficulties, forcing banks to take large provisions. Banks' equity prices fell 5 percent in 2011, a much lower drop compared to the overall index (Figure 5).

Figure 4. Allocation of Banks' Credit Portfolio, 2011



Source: Central Bank of Kuwait (based on unconsolidated data).
* Growth in loan portfolio with respect to 2010.

Figure 5. Equity Prices, 2005–11 (Index; Jan. 1, 2005=100)



Sources: Kuwait Stock Exchange; and IMF staff estimates.

7. **Investment companies came under renewed pressures.** ICs have been under pressure since the beginning of the global financial crisis given their exposure to domestic, regional, and international equity and real estate markets and their dependence on short-term foreign lending.[4] While there was some initial progress in ICs restructuring in 2009–10, the sector has hit renewed setbacks due to adverse market conditions in 2011 and the re-emergence of global liquidity strains (see accompanying Selected Issues Paper). As a result, the sector posted losses in 2011 as opposed

[4] Stress tests conducted by staff in 2011 for 11 investment companies indicted that the companies tested had limited capacity to absorb adverse shocks.

to slight profits in 2010.[5] The creditor protection clause under the 2009 Financial Stability Law has only been utilized in one case so far;[6] only one restructuring was completed under the law, but it is yet to be seen if the restructuring plan will be executed successfully. Average equity prices of ICs declined almost 27 percent in 2011, which brings the cumulative decline vis-à-vis August 2008 to almost 79 percent.

OUTLOOK AND RISKS

Economic recovery expected to strengthen

8. **Economic recovery is expected to strengthen, led by increasing government expenditure.** Staff projects a 15 percent increase in government spending, including a 16 percent increase in the wage bill and a 30 percent increase in capital expenditure. Non-oil economic activity is expected to expand about 5½ percent in 2012, and fiscal and external surpluses are projected to remain over 30 percent and 40 percent of GDP, respectively. Inflation is expected to moderate slightly to 4.4 percent, due to a decline in global food inflation that is expected to offset a slight increase in nonfood inflation reflecting the impact of public sector wage increases. The high level of openness of the economy–a high elasticity of labor supply and a large share of imported goods in the consumption basket–should help contain inflationary pressures.

The economy remains exposed to external and domestic risks

9. **Similar to other countries, Kuwait is exposed to external risks, including the intensification of the European crisis.**

- Kuwait has accumulated a significant stock of financial assets, which provides it with a cushion to ease the impact of a temporary decline in oil prices. Nevertheless, a worsening of the crisis in Europe could result in a tail risk event of a protracted period of low oil global demand and prices, and a further tightening of global financial markets. If this risk materializes it could affect Kuwait's fiscal and external revenues and the private sector's debt roll-over risk, further weakening the financial situation of ICs.

- Adverse external shocks could also affect the valuation of Kuwait's cross-border investments, with a particular impact on ICs (see Box 1 and accompanying Selected Issues Paper).

- Geopolitical events that could affect Kuwait's oil export lines also constitute a risk.

[5] Based on data for listed companies. Only about half of the listed ICs published their annual financial statements at end-2011, suggesting that actual losses in the sector might be higher than what has been published so far.

[6] Two more companies have recently applied for protection from creditors, and the CBK is evaluating their financial condition in order to present a recommendation to the court.

Box 1. Kuwait: Private Sector Cross-Border Investments

Kuwait has sizable wealth held abroad; in addition to the Kuwait Investment Authority's (KIA) assets,[1] Kuwait's cross-border private sector investments were estimated at over $51 billion in 2010 (41 percent of 2010 GDP).[2] Based on available data, the geographic allocation of Kuwait's private sector cross-border assets is as follows:

Kuwait: Private Sector Investments Abroad

	US$ (billion)	As % of Total	As % of GDP
Total investment abroad	51.4	100.0	41.4
FDI	13.5	26.3	10.9
Portfolio investment	37.9	73.7	30.5
Debt securities	6.2	12.1	5.0
Equities	31.7	61.7	25.5

Sources: Consolidated Direct Investment Survey and Consolidated Portfolio Investment Survey, IMF

- The majority of investments are in the GCC (about 40 percent of portfolio investment and 50 percent of FDI), rendering Kuwait particularly vulnerable to financial market fluctuations in the region.[3]
- The private sector's exposure to the rest of the MENA region is relatively small (7 percent of portfolio investment and 20 percent of FDI). Accordingly, the impact of developments in Arab countries undergoing transition on Kuwaiti private sector investments is estimated to be limited.
- A confined event in the GIIPS (Greece, Ireland, Italy, Portugal, and Spain) would have a limited impact on Kuwait's private sector investment, as its exposure to these countries is relatively small.

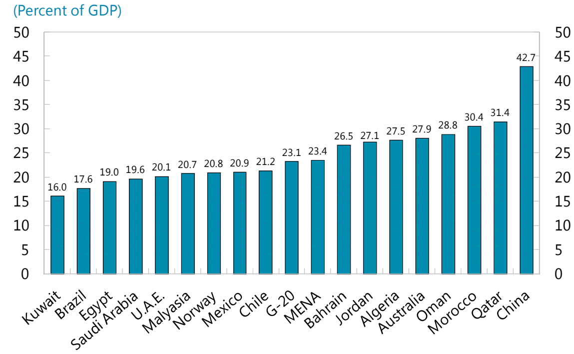
[1] The value and geographic and asset class allocation of KIA's assets are not published. Accordingly, the assessment noted below on geographic exposure risks is limited to private sector assets invested abroad.

[2] Private sector assets invested abroad are based on data provided in the IMF's Consolidated Portfolio Investment Survey (CPIS) and the Consolidated Direct Investment Survey (CDIS). The results of the two surveys can be found at www.imf.org.

[3] For example, the intensification of the European debt crisis could spill over to the rest of the world, including the GCC—the correlation between global and GCC regional financial markets has increased significantly since the global crisis because of high volatility.

10. **Low capital budget implementation rates could hamper the recovery and undermine the objectives of the DP.** The overarching issue for Kuwait is the ability of the government and parliament to push an agenda that improves the investment climate and promotes sustainable and inclusive growth. A lack of progress on this agenda could continue to slow down the implementation of the DP and, therefore, weaken the government-led recovery and private sector investment. Cross-country comparison indicates that Kuwait's overall investment levels are relatively low (Figure 6). These low levels indicate the need for an

Figure 6. Average Total Investment, 2005–11
(Percent of GDP)



Sources: Country authorities; and IMF staff calculations.

increase in investment rates if the required improvements in the country's physical and social infrastructure are to be achieved. On the public sector side, the implementation of the capital expenditure budget has been only in the 75–80 percent range in recent years, and is estimated to have fallen below this range in FY 2011/12. Project implementation has been generally delayed by red-tape and bureaucracy, an outdated legislative base, deficiencies in laws that have been passed in recent years, and delays in passing new legislation. Overall, slippage in capital expenditures could hamper the recovery; capital expenditure has high growth multipliers and also helps catalyze private investment, particularly in the context of the DP.

11. **The authorities stressed that the GCC is at a lower risk from global developments than are other regions.** The authorities broadly agreed with the staff assessment but noted that GCC countries were less at risk from global developments, as evidenced by healthy growth rates in the region. In this context, external risks for Kuwait were manageable in view of the large concentration of cross-border investments in the GCC.

Kuwait: Risk Assessment Matrix

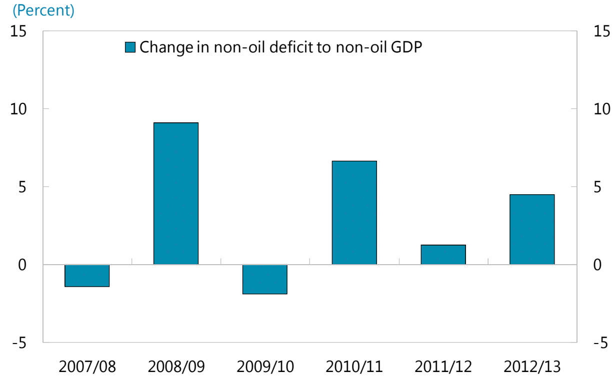
Nature/source of main threats	Likelihood of realization in the next three years	Expected impact on the economy if risk is realized
Worsening global and regional markets and financing conditions Kuwait's private sector (particularly ICs) and government have sizable external financial and real exposures. ICs continue to be dependent on foreign financing.	**Staff assessment: Low to medium** Stress in the Euro zone and regional developments could affect market valuation and financing conditions.	**Staff assessment: Low to medium** ICs could be significantly affected by this scenario. Banks' provisions would need to increase further, tightening domestic lending conditions due to higher risk aversion, with a potential negative impact on non-oil economic activity. But the banking system would likely remain sound, as banks have been provisioning for their lending to ICs for several years now. Impact on government's assets is expected to be manageable.
Large and prolonged decline in oil prices The economy remains highly dependent on oil for its fiscal and external revenues.	**Staff assessment: Low** A global recession followed by protracted slow growth would depress demand for energy and could lead to a sharp fall in oil prices.	**Staff assessment: Medium to High** While the government has buffers, some consolidation in expenditure would be required, which would affect non-oil activity.
A slowdown in the implementation of the DP Non-oil growth is highly dependent on government expenditures, particularly in the context of the DP.	**Staff assessment: Low** There have been significant delays in the implementation of the DP in the first two years of the plan. Furthermore, a number of recently-passed key laws proved to be deficient and now require amendments, and other needed legislation has been delayed.	**Staff assessment: Low to Medium** Further delays in the implementation of the DP and structural reforms would slow growth.

POLICY DISCUSSIONS

A. Near-Term Macroeconomic Policy Mix

12. **The near-term fiscal policy stance remains appropriately supportive.** Compared to the previous fiscal year, there is likely to be a fiscal stimulus of 4.7 percentage points in the non-oil primary deficit to non-oil GDP (Figure 7). The supportive fiscal stance is called for in view of still-moderate economic growth. But the recurrent nature of expenditure increases,[7] including those in FY 2012/13, raises concerns as regards fiscal management, as it increases the rigidity of the budget and the ability of the government to withdraw fiscal stimulus if needed. While inflation is projected to remain low, the authorities should be ready with a strategy for fiscal adjustment should inflationary pressures emerge. Such a strategy should safeguard the capital budget as much as possible to preserve the productivity of government spending, and should focus on containing the growth of current expenditures, particularly the wage bill, given their rapid increase in recent years. Revenue options could also be considered (par. 19).

Figure 7. Fiscal Impulse, 2007/08–2011/12
(Percent)



Sources: Country authorities; and IMF staff estimates.

13. **Monetary policy and liquidity conditions also remain appropriately supportive.** Policy interest rates are expected to remain historically low—consistent with Kuwait's high degree of free capital mobility, the currency basket peg, and low international interest rates.[8] Current liquidity conditions are supportive of a strengthening of private sector credit growth. In view of the limitations of monetary policy in the context of the exchange rate peg, fiscal policy should be the first line of defense but macroprudential policies (e.g., loan-to-deposit ratio, liquidity ratios, household debt-service ratio) could be utilized in managing domestic liquidity and credit conditions should inflationary pressures emerge.

14. **Assessments of the real exchange rate suggest that the Dinar is broadly in line with fundamentals.** The methods based on current account assessment give mixed results, as the underlying current account is: (i) somewhat higher than the norm suggested by the macro-balance approach (suggesting an undervaluation), but (ii) smaller than the norm suggested by the external sustainability approach (suggesting some overvaluation). The equilibrium real exchange rate

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[7] Namely, increases in public sector wages and the associated increases in social security transfers.

[8] It should be noted, however, that a 2009 study on GCC monetary policy, Bova and Senhadji find that, given the basket peg, Kuwait followed the U.S. monetary policy less closely than the other GCG countries.

approach suggests a slight undervaluation. Because deviations from the benchmarks are low or moderate, the analysis suggests that the real exchange rate is broadly in line with fundamentals.

Kuwait: Exchange Rate Assessment [1]

	MB [2]	ES [3]	ERER[4]
Underlying current account (A) [5]	31.5	31.5	…
Equilibrium current account (B)	25.1	42.2	…
Difference (A-B)	6.4	-10.7	…
Percentage of ER overvaluation (-)/undervaluation (+)	…	…	1.3

Source: IMF staff estimates.

[1] Current account figures are in percent of GDP. Overvaluation/undervaluation calculations are in percent. For details on the methodologies see *Kuwait: Selected Issues* IMF Country Report No. 11/218 (chapter II).

[2] Macro balance approach. Based on Beidas-Strom and Cashin (2011). *Are Middle Eastern Current Account Imbalances Excessive?* IMF WP 11/195.

[3] External sustainability approach. The equilibrium current account delivers a constant real per capita annuity after oil exports are exhausted. This calculation uses the same assumptions that the baseline fiscal sustainability analysis (Figure 10).

[4] Equilibrium real exchange rate approach. Based on an annual method consisting on a cointegration relationship between the real exchange rate and key fundamentals (terms of trade, investment income, and government expenditure).

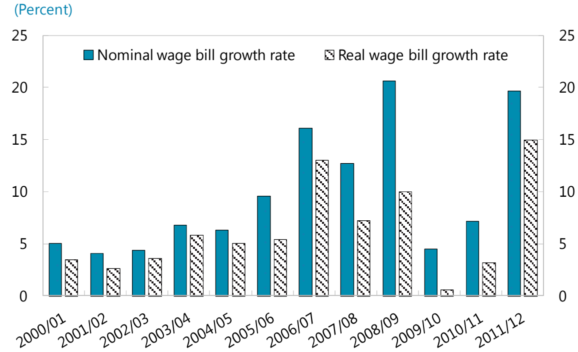
[5] 2017WEO projection.

B. Maintaining a Sustainable Medium- to Long-Term Fiscal Envelope While Improving the Efficiency and Welfare Impact of Government Expenditure

15. **Kuwait has significant fiscal space.** Kuwait has large fiscal buffers, thanks to 13 consecutive years of fiscal surpluses. In addition, while the FY 2011/12 fiscal breakeven oil price of $44 per barrel is much higher than the fiscal breakeven price of $17 per barrel just before the global financial crisis (FY 2007/08),[9] the ratio of the break-even price to current market prices remains similar to historical standards.

16. **Nonetheless, rising public sector wage and pension costs and rapid population growth are expected to exert pressures on public finances.** The average real and nominal growth rate of the public sector wage bill has more than doubled in the last six years (2006/07–2011/12), to 8 percent and 13 percent, respectively (Figure 8). The continuation of such a trend could put significant pressures on government finances—via higher wage

Figure 8. Wage Bill Growth Rate, 2000/01–2011/12
(Percent)



Sources: Country authorities; and IMF staff estimates.

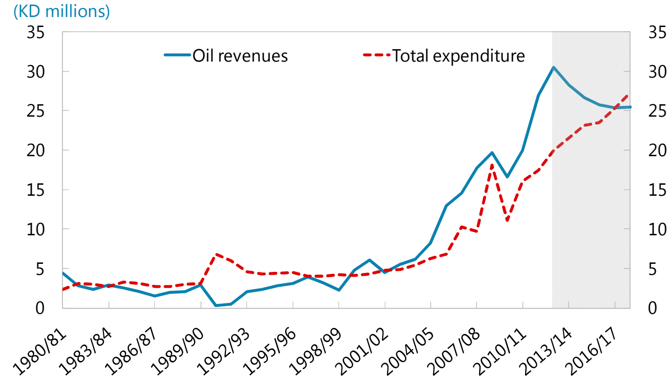
[9] Fiscal breakeven price calculations include investment income and profits from some public sector agencies not included in the budget (Kuwait Investment Authority, Kuwait Petroleum Corporation, and the Central Bank). An alternative calculation that accounts for transfers to the Future Generations Fund as an expenditure and excludes investment income from oil revenues results in a fiscal breakeven price of $36 and $66 for FY 2007/08 and FY 2011/12, respectively.

payments, government pension contributions, and an increase in the unfunded liabilities of the pension system—and would be difficult to reverse if oil prices were to decline significantly in the future. The cost of the pension system is onerous for Kuwait, particularly given its low retirement age (see Appendix I) and generous benefits.[10] Finally, rapid population and labor force growth—about 60 percent of the Kuwaiti population is under 24 years—is likely to put increasing pressures on public sector employment and the provision of public services.

17. **Kuwait is now at a crossroads as regards conserving wealth for its future generations.** Staff estimates indicate that government expenditure will exhaust all oil revenues by 2017, which means no portion of these revenues would be saved for future generations (Figure 9).[11] In this relation, medium-term benchmarks for government expenditure can help policymakers determine the fiscal envelope if they intend to pursue intergenerational equity in the distribution of oil resources. If Kuwait were to provide similar government expenditure per capita (in real terms) for its future generations, then fiscal consolidation would be needed in the medium term if current spending trends continue. Kuwait's non-oil primary deficit is already about 5 percent of GDP above the estimated baseline benchmarks indicated by intergenerational equity considerations (or about KD 2¾ billion), and some fiscal consolidation would be needed in the medium to long term (Figure 10, left panel). In this context, an adjustment of at least 12 percentage points of the non-oil primary deficit to GDP (or KD 7 billion against a projected expenditure of around KD 25 billion in FY 2016/17) would be needed by 2017. The need for medium-term fiscal consolidation would be smaller in the case of lower long-term population growth rates (around KD 2 billion by FY 2016/17), but larger and more urgent in a scenario of lower oil prices (Figure 10, right panel).

Figure 9. Oil Fiscal Revenues and Total Government Expenditure, 1980/81–2017/18

(KD millions)

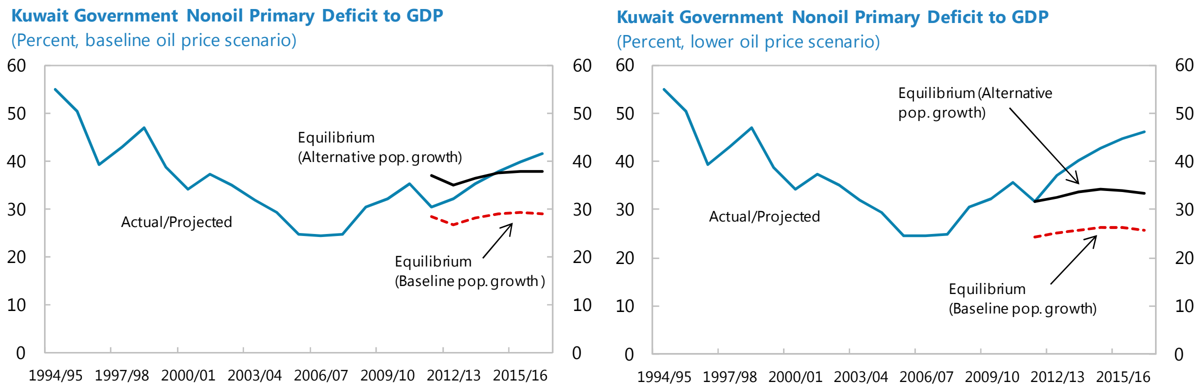


Sources: Country authorities; and IMF staff estimates.

[10] The last actuarial assessment, based on 2007 data, indicated unfunded liabilities in the order of KD 11 billion (23 percent of 2011 GDP). While, the central government has paid already over two-thirds of that liability and will complete the payments by FY 2014/15, recent wage increases will certainly add new unfunded liabilities.

[11] Projections assume a trend decline of oil prices in the medium term, from an average of $113 per barrel in 2012 to $91 per barrel by 2017.

Figure 10. Kuwait: Fiscal Sustainability Scenarios, 1994/95–2016/17[1]



Note: The baseline calculations assume long-term values of the real rate of return of assets, inflation, and population growth of Kuwaiti nationals of 4 percent, 2 percent, and 2 percent, respectively. Oil reserves are assumed to be depleted in 65 years and the oil price to be at $91 per barrel in 2017 and remain constant in real terms thereafter. The alternative calculation assumes long-term population growth of 1.4 percent (as forecasted for the whole population [i.e., nationals and expatriates] by the 2008 United Nations World Population Prospects for the period 2010-50).

Note: The lower oil price scenario assumes oil prices are 20 percent lower than in the scenario presented in the upper panel (which leaves the 2012 average at around $91 and the 2017 price at around $73).

Source: Kuwait Ministry of Finance; and IMF staff estimates.

[1] In this exercise, long-term sustainability assumes intergenerational equity by calculating a constant real per capita government expenditure path (and related non-oil deficit) that delivers a constant real per capita annuity to finance government expenditures after oil revenues are exhausted. The non-oil deficit calculations discussed above refer to the non-oil deficit excluding investment income.

18. **Overall, there is a need to improve the productivity and welfare impact of government spending.** In particular:

- ***Reallocating government expenditure toward capital expenditure,*** which has higher growth multipliers, would enhance non-oil GDP growth and strengthen the long-term sustainability of the fiscal accounts, while improving the productivity of government expenditure and contributing to the country's diversification objectives. The authorities should contain the growth of the public sector wage bill, consider increasing individuals' pension contributions to avoid a further buildup of unfunded liabilities, and avoid any new measures that could further increase current expenditures.

- ***Expenditure under the DP should focus on social and key physical infrastructure projects, keeping in mind project viability.*** In this regard, project design and implementation should focus on the strategic direction of the long-term vision for Kuwait, and should also take into account implementation capacity.

- ***Revisiting general energy subsidies.*** About 20 percent of government expenditures are in the form of untargeted oil-related subsidies and benefits (electricity, water, and fuel).[12] While staff recognizes the challenges of implementing subsidy reforms, the phased withdrawal of these subsidies should be part of a medium- to long-term fiscal reform program. Staff estimates that Kuwait's per capita energy consumption would decline by 27–41 percent in the long term if

[12] These subsidies have low growth multipliers, encourage excess consumption, and are received disproportionally by high-income population groups.

domestic oil prices reflected international levels (see accompanying Selected Issues Paper).[13] Savings that accrue to the government from the elimination of subsidies (about 7 percent of 2011 GDP or 140 percent of capital expenditures in FY 2011/12) could be partly used to provide targeted subsidies to the lower-income segment of the population.

19. **Medium-to-long-term fiscal reforms should also include the tax system.** Introduction of a VAT, which the authorities are planning in conjunction with GCC-wide VAT implementation by 2014, would be a step forward. Progress made so far in this area is welcome, but the authorities would need to further build the institutional capacity to ensure its effectiveness. Although the proposed rate (5 percent) is estimated to increase government revenues by only 2–3 percent of GDP in the short term, it could progressively contribute more as the non-oil sector continues to expand.[14] The authorities are also undertaking preparations for the introduction of a comprehensive income tax system.

20. **A fiscal rule could be useful for medium-term fiscal management.** Government expenditure remains largely driven by oil revenues (see Figure 8 above). In this context, while the authorities have made progress in strengthening the institutional and analytical underpinnings for fiscal policy—including the establishment of a macro-fiscal unit, the planned adoption of the GFSM 2001 standards, and ultimately a move to performance-based budgeting—the adoption of a medium-term budget framework and a well-designed fiscal rule could help contain pressures to increase government expenditure and improve the management of future oil cycles (see accompanying Selected Issues Paper). The authorities have requested TA from the IMF on implementing a multi-year budget framework.

21. **The authorities agreed broadly with the staff assessment but stressed implementation limitations.** While the authorities acknowledged the rigidity of government expenditures and agreed with the need to introduce revenue measures, they stressed pressures for higher government transfers given large fiscal surpluses. In this context, they thought it was unlikely that fiscal consolidation could be implemented in line with the staff-suggested path to achieve intergenerational equity by 2017. While subsidy reform was not under consideration at this time, the authorities were examining options to enhance government revenues, including improving the fee structure of government services and utility bill collection. The authorities emphasized recent improvements in developing the institutional framework for fiscal policy, and noted ongoing work with the World Bank on improving the project cycle and the preparation of a draft public tender law.

[13] U.S. retail prices excluding U.S. taxes, which are around 180 percent of Kuwait retail prices, are used as an international benchmark for the calculations.

[14] In coordination with the World Bank, Fiscal Affairs Department and Legal Department have provided technical assistance to Kuwait (TA) on VAT policy and administration in FY 2011/12 (the World Bank is providing extensive TA to Kuwait in this area).

C. Improving the Business Environment

22. **Kuwait ranks relatively low on essential elements for competitiveness.** In general, inefficient government bureaucracy and restrictive labor and education conditions—notably the quality of the education system and availability of high-quality specialized training services—are quoted by market participants as the most problematic factors for doing business in Kuwait (see accompanying Selected Issues Paper). Another area that needs immediate attention is Kuwait's ability to attract foreign direct investment, which in its present condition limits the benefits from the transfer of technology and knowhow that foreign ownership could bring.

23. **Kuwait also lags in basic corporate governance indicators**, such as the strength of auditing and financial reporting standards, the efficacy of corporate boards of directors, and the protection of minority shareholders' interest. In particular, weak corporate governance practices contributed to the buildup of vulnerabilities of ICs during the pre-crisis boom years and have resulted in significant challenges for the sector after the global crisis. The recently-established CMA has issued bylaws and new listing requirements that seek to strengthen corporate governance. Nevertheless, challenges remain in view of the nature of the ownership structure of ICs (largely family-owned) and the generally weak risk management practices and oversight role of the boards. On the banking sector side, the CBK has made important steps in improving corporate governance, including by focusing on risk management practices in banks, and is currently in the process of drafting new corporate governance guidelines for banks with a view to strengthen the oversight role of bank boards.

24. **Public sector wage policy is inconsistent with the government's labor policies and objectives of the DP.** Despite the imposition of minimum quotas for Kuwaiti employment in the private sector and the provision of financial incentives, Kuwaitis constitute only about 7 percent of the private sector labor force. This reflects the attractiveness of public sector employment—higher wages and benefits and lower working hours—and the mismatch between the Kuwaiti labor force's skills and the needs of the private sector. Given projected high rates of growth of the Kuwaiti labor force, such a growth—employment model would undermine economic diversification and impose unproductive budgetary costs. Staff estimates that about 74,000–112,000 Kuwaitis will enter the labor force in the next five years (2012–16), while the private sector is projected to create only about 17,000 jobs for Kuwaitis (see accompanying Selected Issues Paper). These dynamics would put pressure on the government to absorb about 11,000–19,000 youth per year, further straining government finances.

25. **Legislative and other reforms are needed.** To enhance the business environment there is a need to upgrade the education system to improve the quality of education and make it attuned to the needs of the business sector. On the financial and corporate sector sides, strengthening institutions' board member composition and role (e.g., by requiring a larger share of independent members), and enforcing the appropriate implementation of auditing and reporting standards should be priorities. On the legislative side, the authorities should proceed with modernizing legislation to enhance the business environment and increase the efficiency of government

procedures, taking into account best international practices. Overall, the authorities should avoid the pitfalls of recent legislative experience, where a number of laws that were passed proved to be deficient and now require amendment. Finally, the authorities are encouraged to undertake a comprehensive review of business procedures and requirements with a view to streamlining them.

26. **The authorities broadly agreed with the staff assessment, but stressed implementation challenges.** The authorities maintained that they had the needed skills and resources to implement structural reforms, but progress was constrained by the lack of political consensus on priorities for reform implementation.

D. Maintaining Financial Sector Stability

27. **The CBK has made significant progress in implementing the 2010 FSAP recommendations.** Specifically: (i) the CBK has completed the establishment of a financial stability office; (ii) the onsite supervision function has been strengthened;[15] (iii) the transition to risk-based supervision has now been completed;[16] (iv) seven ICAAP assessments have been completed so far, one is under review, and only two assessments remain to be done; (v) in addition to the stress tests that are conducted by the banks themselves, the CBK now conducts periodic stress tests that model stress events vis-à-vis credit, market, and liquidity risk and take into account scenarios of increasing severity; and (iv) off-site surveillance is now used systemically to identify risk areas and the work program for onsite inspections. Furthermore, emphasis has been placed on improving banks' corporate governance; new guidelines that are based on the World Bank's 2009 corporate governance assessment and Basel Committee recommendations are about to be finalized.

28. **The newly established CMA commenced its supervisory role in September 2011.** All ICs are now under dual supervision by the CBK[17] and CMA pending the separation of ICs' activities (i.e. lending versus other investment banking activities), and the CBK and the CMA meet regularly to ensure coordination based on the MoU that they have concluded on this issue. The CMA faced significant challenges in assuming its role initially, including due to the gridlock caused by the suspension of three of its commissioners in 2011 and the lack of adequate staffing, in both number and expertise. Nevertheless, the CMA appears to have resumed its activities at a normal pace more recently and has been active in enforcing its bylaws.

29. **The authorities should continue to be vigilant toward existing and emerging risks.** Specifically, the authorities should maintain their strategy of building precautionary provisions and retained profits by banks, continue to enhance ICs supervision, and develop the needed tools for ICs resolution. In this context:

[15] Twelve new staff have been hired and the inspection cycle has been shortened to 18 months.

[16] Importantly, an inspection work program related to risk management is at an advanced stage.

[17] CBK supervision only covers lending activities. Consequently, the regulations that had been issued in June 2010 on liquidity, leverage, and FX borrowing for implementation by June 2012 have been suspended.

- Banks should continue to build precautionary provisions and retain profits, both against ICs' loan portfolio and also vis-à-vis other weak and volatile sectors, particularly real estate and lending for the purchase of securities—the latter two sectors constitute 26 percent and 10 percent of banks' total loan portfolio, respectively.[18] Real estate companies have posted losses in the past three years while both domestic and regional stock markets have not yet recovered from the decline experienced as a result of the global financial crisis.

- The authorities are encouraged to modernize the legal framework for companies' restructuring/resolution, with special attention to financial institutions. In the absence of an adequate legal framework, the timeframe and the legal process for the restructuring of distressed but viable ICs, or the exit of non-viable ICs, is unclear. The current legal framework under the Companies Law is tilted toward liquidation (which tends to be a protracted process) and the creditor protection clause under the financial stability law has had a limited impact in facilitating the restructuring of distressed ICs; therefore, the formation of a committee, led by the Ministry of Commerce and Industry with the membership of the CBK and the CMA, to study proposals on this issue, is welcome. While the direct loan portfolio risk facing banks from conditions in ICs has declined in view of the ongoing buildup of bank provisions against these loans, the quick resolution of distressed ICs and the exit of non-viable ones will help ensure least cost resolution for all parties involved (including banks), limit negative spillovers within the ICs sector,[19] reduce banks' risk aversion and encourage lending, and strengthen investor sentiment. At the same time, the bailout of non-viable ICs should be avoided to limit moral hazard.

- The CMA has made substantial progress since its inception and has already overcome important challenges. It should continue to build up its staffing capacity so that it can fully meet its supervisory responsibilities. The CMA's intention to seek expertise in designing a strengthened framework for ICs regulation is welcome, but efforts should be accelerated to ensure that ICs are well regulated and supervised.

- The CBK and the CMA should continue to have effective discussions and coordination regarding the supervision of ICs.

30. **The independence of the CBK should be strengthened and preserved.** In developing a new and improved national legislative base, the authorities should continue to take into account the specific nature of the central bank's operations and the need to strengthen and preserves its independence. Specifically, international experience points to the following:

- *Central bank audit procedures.* Due to the need for specialized technical expertise, a qualified external auditor should audit the central bank's financial statements. Government audits, if at all required, should be limited to ex post audits of non-policy-related operational expenditures.

[18] The Central Bank requested banks in the past two years to build up precautionary provisions against their ICs portfolios, creating an additional cushion to absorb potential future losses.

[19] The lack of confidence in the sector as a whole has had a negative impact on otherwise healthy ICs as the sector saw substantial investor withdrawals and a significant impact on fee-based operations.

- *The budget of the central bank*. The central bank should be free to determine its annual budget. Ex post budget accountability should be limited to non-policy-related expenditure.
- *Public sector tendering regulations.* Procurement accountability is best carried out through a strong central bank board and an active audit committee with clear lines of accountability within the central bank. Public procurement laws do not make allowances for the special nature of the central bank and could thus unduly complicate procurement by the central bank.

31. **Developing the domestic debt market should help diversify financing sources and deepen financial intermediation.** Staff encourages the authorities to follow up on the recommendations of a recent IMF/AMF TA mission, in particular to establish a public—private sector task force to produce an action plan for the way forward, which should include the introduction of a regulated trading platform for fixed-income securities and the improvement of the regulatory framework.

32. **The authorities stressed their commitment to continuing implementation of the 2010 FSAP recommendations.** Specifically, senior CBK management follows up regularly on the implementation status of FSAP recommendations. As regards emerging financial sector risks, the CBK affirmed its intention to continue to encourage banks to retain profits and maintain the strategy of building precautionary provisions against all questionable portfolios in all sectors. The authorities affirmed continued cooperation between the CMA and the CBK to ensure smooth cooperation in ICs supervision. The CMA noted that it was seeking expert assistance in designing a regulatory framework for ICs.

E. Other Issues

33. **There has been significant progress in improving Kuwait's statistical system, but further improvements are needed.** In particular, the authorities have improved the timeliness of the CPI data, strengthened balance of payments, external debt, and IIP statistics, completed the 2011 national census, caught up with delays in the production of the national accounts at constant prices, and are currently in the process of implementing the new Balance of Payments Manual (BPM6) and strengthening national accounts statistics. The authorities are currently receiving technical assistance from the World Bank in the area of national accounts, and are encouraged to provide the needed resources to the Central Statistical Bureau to achieve further improvements in Kuwait's statistical system.

34. **The recent AML/CFT assessment indicates that there are a number of shortcomings in Kuwait's AML/CFT framework.** The assessment, which was published in September 2011, highlighted the lack of criminalization of terrorism financing and loopholes in the AML/CFT preventive, institutional, and supervisory frameworks. While the authorities have not adopted a new AML/CFT law yet, they have requested technical assistance from the Fund in this area.

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35. **The economic outlook for 2012 is broadly positive.** Economic recovery is expected to strengthen, led by high government expenditure—particularly wages and capital expenditure. High fiscal and external surpluses are expected to persist. Inflation is projected to moderate slightly due to a decline in global food inflation. Low implementation rates of the capital budget and legislative bottlenecks could, however, dampen the recovery.

36. **Near term economic policies should continue to remain supportive.** While the supportive fiscal stance is appropriate and has been called for in recent years in view of still-moderate economic growth and low inflationary pressure, the recurrent nature of expenditure growth increases the rigidity of the budget and complicates short-term fiscal management. Inflation is projected to remain low, but inflation risk is on the upside and the authorities should be ready with a strategy for fiscal adjustment if inflationary pressures build up. This strategy should safeguard the capital budget as much as possible. The real exchange rate is broadly in line with fundamentals.

37. **Kuwait has significant fiscal space but the country is now at a crossroads as regards conserving wealth for its future generations.** Kuwait's non-oil primary deficit is above the estimated baseline benchmarks that take into account intergenerational equity in the distribution of oil wealth. Furthermore, rising public sector wage and pension costs and rapid population growth are expected to exert pressures on public finances in the medium term. If Kuwait is to preserve wealth equally for its future generations, fiscal consolidation will be needed in the medium term.

38. **Overall, there is a need to improve the productivity and welfare impact of government spending.** Reallocating government expenditure toward capital expenditure would enhance non-oil GDP growth and improve the long-term outcomes of the fiscal accounts, while improving the productivity of government expenditure and contributing to the diversification objectives of the DP. In this connection, the authorities are encouraged to improve the government's capacity to implement the capital budget, contain the growth of the public sector wage bill, avoid a further buildup of the pension system's unfunded liabilities, and avoid new measures that would further increase current expenditures. The introduction of a VAT would be a step forward. The adoption of a medium-term budget framework and a well-designed fiscal rule could improve fiscal management. Finally, the phased retargeting of fuel-related subsidies to the most vulnerable segments of the population should be part of a medium- to long-term fiscal reform program.

39. **Legislative and other reforms are needed to improve Kuwait's business environment and employment opportunities for Kuwaitis.** Specific attention should be given to upgrading the education system to make it attuned to the needs of the business sector. Corporate governance should be enhanced by strengthening institutions' board member composition and member roles, and enforcing the appropriate implementation of auditing and reporting standards. On the legislative side, the authorities should proceed with modernizing legislation to enhance the business environment, taking into account best international practices to avoid the pitfalls of recent

legislative experience. Finally, the authorities are encouraged to undertake a comprehensive review of business procedures and requirements with the view to streamlining them.

40. **The authorities are encouraged to continue to be vigilant toward existing and emerging financial sector risks.** To this end, they should maintain their strategy of building precautionary provisions and retained profits by banks, continue to enhance ICs supervision, and develop the needed tools for ICs resolution. Furthermore, in developing a new and improved national legislative base, the authorities should continue to take into account the specific nature of the central bank's operations and the need to strengthen and preserve its operational independence.

41. **There has been significant progress in improving Kuwait's statistical system, but further improvements are needed.** In this regard, the authorities are encouraged to provide the needed resources to the Central Statistical Bureau.

42. **It is recommended that the next Article IV Consultation take place on a standard 12-month cycle,** in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96) (9/28/2010).

Table 1. Kuwait: Selected Economic Indicators, 2007–13

(Quota: SDR 1,381.1 million)
(Population: 3.58 million; Dec. 2010)
(Per capita GDP: $37,039; 2010 estimate)
(Poverty rate: n.a.)
Main exports: oil and gas

				Prel.	Proj.	Proj.	
	2007	2008	2009	2010	2011	2012	2013
Oil and gas sector							
Total oil and gas exports (billions of U.S. dollars)	59.1	82.6	48.9	61.8	96.7	114.4	105.4
Average oil export price (U.S. dollars/barrel)	68.4	92.2	61.5	77.7	103.3	113.4	109.0
Crude oil production (millions of barrels/day)	2.57	2.68	2.26	2.31	2.66	2.90	2.80
	(Annual percentage change, unless otherwise indicated)						
National accounts and prices							
Nominal GDP (market prices, in billions of Kuwaiti dinar)	32.6	39.6	30.5	35.6	47.2	54.3	53.6
Nominal GDP (market prices, in billions of U.S. dollars)	114.7	147.4	105.9	124.3	171.2	195.3	192.8
Real GDP (at factor cost)	6.4	4.3	-7.8	2.4	8.3	6.6	1.8
Real oil GDP	-4.7	5.4	-12.9	0.7	14.9	8.4	-3.4
Real non-oil GDP	15.3	2.7	-4.8	3.4	4.5	5.5	5.2
CPI inflation (average)	5.5	10.6	4.0	4.0	4.7	4.4	4.1
Unemployment rate (Kuwaiti nationals)	6.1	4.9	3.6	2.9	3.4	…	…
	(Percent of GDP at market prices)						
Investment and savings							
Investment	20.5	17.6	18.0	19.1	16.3	16.7	19.3
Public	3.3	3.5	4.8	5.3	4.9	5.4	6.6
Private [1]	17.1	14.1	13.2	13.8	11.4	11.3	12.7
Gross national savings	57.2	58.5	44.7	49.9	57.7	61.0	58.8
Public	55.2	46.8	50.6	49.3	50.7	51.5	50.0
Private [1]	2.1	11.7	-7.6	0.7	7.0	9.5	8.8
Savings/investment balance	36.8	40.9	26.7	30.8	41.4	44.2	39.5
	(Percent of GDP at market prices)						
Budgetary operations [2]							
Revenue	68.0	64.3	63.2	64.0	66.2	67.9	65.3
Oil	51.6	52.8	52.2	51.8	54.9	56.3	52.7
Non-oil, *of which:*	16.4	11.5	11.0	12.2	11.3	11.7	12.6
Investment income	13.1	8.7	8.1	8.8	8.5	9.0	9.8
Expenditures	28.1	48.6	35.0	41.7	35.6	36.9	40.2
Expense [3]	24.0	44.1	30.4	36.4	30.7	31.1	33.4
Capital	4.1	4.4	4.6	5.3	4.9	5.8	6.8
Balance	39.8	15.8	28.2	22.3	30.6	31.0	25.1
Domestic financing	-3.1	-4.6	-1.7	2.0	-0.5	-1.0	-1.0
External financing	-36.7	-11.2	-26.4	-24.3	-30.2	-30.0	-24.0
Total gross debt (calendar year-end) [5]	7.0	5.3	6.7	5.7	4.3	3.7	3.8
	(Changes in percent of beginning broad money stock)						
Money and credit							
Net foreign assets [6]	1.1	10.0	8.3	0.1	7.5	4.1	4.2
Claims on nongovernment sector	35.6	19.2	7.1	2.0	2.8	4.4	9.0
Broad money	19.3	15.6	13.4	3.0	8.5	8.6	9.2
Kuwaiti dinar 3-month deposit rate (year average; in percent)	5.2	3.3	1.4	0.8	0.8	…	…
Stock market unweighted index (annual percent change) [7]	24.7	-38.0	-10.0	-0.7	-16.4	11.0	
	(US$ billions, unless otherwise indicated)						
External sector							
Exports of goods	62.6	87.0	54.4	67.6	104.3	121.7	113.2
Of which: non-oil exports	3.5	4.4	5.5	5.8	7.6	7.3	7.8
Annual percentage change	6.4	25.1	26.5	5.7	30.0	-4.2	7.2
Imports of goods	-19.1	-22.9	-18.5	-20.1	-22.0	-23.3	-24.9
Annual percentage change	17.7	20.0	-19.2	8.3	9.4	5.9	6.9
Current account	42.2	60.2	28.3	38.3	70.8	86.4	76.2
Percent of GDP	36.8	40.9	26.7	30.8	41.4	44.2	39.5
External debt including private sector	57.6	60.5	45.5	31.1	…	…	…
International reserve assets 8/	15.9	16.7	17.7	18.7	23.0	24.8	26.5
In months of imports of goods and services	5.9	5.3	6.6	6.4	7.0	7.1	7.1
Memorandum items:							
Exchange rate (U.S. dollar per KD, period average)	3.52	3.72	3.48	3.49	3.63		
Nominal effective exchange rate (NEER, period average)	-2.1	2.9	-3.6	-0.3	0.3		
Real effective exchange rate (REER, period average)	-0.2	7.9	-1.2	0.9	1.5		
Sovereign rating (S&P)	AA-	AA-	AA-	AA-	AA		

Sources: Data provided by the authorities; and IMF staff estimates and projections.

[1] Also includes government entities.

[2] Kuwaiti fiscal year ending March 31, e.g. 2007 refers to fiscal year 2007/08.

[3] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund. In 2008/09, KD 5.5 were transferred. KD 1.1 billions are budgeted for each year from 2010/11 to 2014/15.

[4] Excludes investment income and pension recapitalization, and after transfers for FGF.

[5] Excludes debt of Kuwait's SWF related to asset management operations.

[6] Excludes SDRs and IMF reserve position.

[7] Change in the KSE as of May 9 2012 for 2012.

[8] Does not include external assets held by Kuwait Investment Authority.

Table 2. Kuwait: Summary of Government Finance, 2007/08–2013/14

					Est.	Budget, Est.	Proj.	
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2012/13	2013/14
				(Billions of Kuwaiti dinars)				
Revenue (includes grants) (A)	**23.3**	**24.0**	**20.1**	**24.7**	**32.4**	**13.6**	**36.8**	**35.0**
Taxes	0.4	0.3	0.3	0.3	0.3	0.0	0.4	0.4
Social contributions								
Grants								
Other revenue	23.0	23.7	19.8	24.3	32.1	13.6	36.4	34.6
Oil and gas	17.7	19.7	16.6	19.9	26.9	12.8	30.4	28.2
Investment income and transfer of profits of public entities[1]	4.5	3.2	2.6	3.4	4.2	0.0	4.9	5.3
Other [2]	0.8	0.7	0.6	1.0	1.0	0.8	1.1	1.1
Total expenditure (B=C+D)	**9.7**	**18.1**	**11.1**	**16.1**	**17.4**	**22.1**	**20.0**	**21.5**
Expense (C)	8.2	16.5	9.7	14.0	15.0	18.0	16.8	17.9
Compensation of employees	2.8	3.4	3.5	3.7	4.4	5.6	5.1	5.6
Purchases/use of goods & services [3]	1.8	1.9	1.9	2.1	2.4	3.2	2.9	3.2
Interest [4]	0.1	0.1	0.1	0.0	0.0		0.0	0.0
Subsidies and social benefits [5, 6]	2.4	9.7	3.1	5.7	6.7	7.7	7.2	7.3
Subsidies	1.5	2.6	1.8	2.5	2.4		2.8	2.8
Oil-related subsidies	1.4	2.6	1.8	2.5	2.4		2.8	2.8
Other subsidies	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Social benefits	1.0	7.1	1.3	3.2	4.2		4.4	4.6
Payments to social security fund	0.7	6.4	0.8	1.8	2.5		2.7	2.8
Transfers to social security fund	0.7	0.8	0.8	0.7	1.5		1.6	1.7
Fund recapitalization	0.0	5.6	0.0	1.1	1.1	1.7	1.1	1.1
Other social benefits	0.3	0.7	0.5	1.4	1.7		1.7	1.7
Oil-related	0.0	0.3	0.1	0.9	1.0		1.2	1.2
Others	0.3	0.4	0.4	0.4	0.7		0.5	0.5
Grants								
Expense not elsewhere classified	1.1	1.5	1.0	2.5	1.5	1.6	1.6	1.7
Net acquisition of nonfinancial assets (D)	1.4	1.6	1.5	2.0	2.4	4.1	3.1	3.6
Purchases of nonfinancial assets	1.4	1.6	1.5	2.0	2.4	4.1	3.1	3.7
Sales of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating balance [=A-C]	**15.1**	**7.5**	**10.4**	**10.6**	**17.4**	**-4.4**	**19.9**	**17.1**
Net lending / borrowing [=A-B]	**13.7**	**5.9**	**9.0**	**8.6**	**15.0**	**-8.5**	**16.8**	**13.4**
Non-oil balance	-4.0	-13.8	-7.6	-11.4	-11.9	-21.3	-13.7	-14.8
excluding investment income	-8.5	-17.1	-10.2	-14.7	-16.0	-21.3	-18.5	-20.1
excluding recapitalization of pension	-8.5	-11.4	-10.2	-13.7	-15.0	-19.6	-17.5	-19.0
excluding oil-related subsidies and benefits	-7.1	-8.6	-8.3	-10.3	-11.5		-13.4	-15.0
Financing	-13.7	-5.9	-9.0	-8.6	-15.0	8.5	-16.8	-13.4
				(Percent of GDP)				
Revenue (includes grants)	67.9	64.3	63.2	64.0	66.2	25.1	67.9	65.3
Total expenditure	28.1	48.6	35.0	41.7	35.6	40.8	36.9	40.2
Gross operating balance	43.9	20.2	32.7	27.6	35.5	-8.2	36.8	31.9
Net lending / borrowing	39.8	15.8	28.2	22.3	30.6	-15.7	31.0	25.1
Non-oil balance	-11.8	-37.0	-24.0	-29.5	-24.3	-39.3	-25.2	-27.6
excluding investment income	-24.8	-45.7	-32.1	-38.3	-32.8	-39.3	-34.3	-37.5
excluding recapitalization of pension	-24.8	-30.6	-32.1	-35.4	-30.5	-36.3	-32.3	-35.4
excluding oil-related subsidies and benefits	-20.5	-23.0	-26.0	-26.6	-23.5		-24.8	-28.0

Table 2. Kuwait: Summary of Government Finance, 2007/08–2013/14 (concluded)

	2007/08	2008/09	2009/10	Est. 2010/11	Est. 2011/12	Budget, Est. 2012/13	Proj. 2012/13	Proj. 2013/14
	(Percent of non-oil GDP)							
Revenue (includes grants)	157.8	158.8	133.1	147.7	176.6	68.0	184.0	160.6
Taxes	2.4	2.3	2.0	1.9	1.8	0.0	1.8	1.7
Other revenue	155.4	156.5	131.2	145.8	174.8	68.0	182.2	158.8
Oil and gas	119.8	130.3	110.0	119.5	146.5	63.9	152.4	129.6
Investment income	30.3	21.4	17.1	20.2	22.6	0.0	24.5	24.2
Other	5.2	4.8	4.1	6.0	5.6	4.1	5.3	5.0
Total expenditure	65.3	119.9	73.7	96.2	94.9	110.7	100.0	98.9
Expense	55.7	109.0	64.1	84.0	81.8	90.3	84.3	82.2
Compensation of employees	18.8	22.2	23.2	22.3	24.0	27.8	25.6	25.8
Purchases/use of goods & services	12.1	12.6	12.9	12.3	13.2	16.2	14.6	14.7
Interest	1.0	0.6	0.4	0.3	0.3	0.0	0.2	0.2
Subsidies and social benefits	16.5	63.9	20.8	34.0	36.3	38.3	36.0	33.6
Subsidies	9.9	17.2	12.2	14.9	13.2	0.0	14.1	12.7
Social benefits	6.6	46.7	8.6	19.1	23.1	0.0	21.9	20.9
Payments to social security fund	4.5	42.3	5.2	11.0	13.9	0.0	13.3	12.9
Other social benefits	2.1	4.4	3.4	8.1	9.3	0.0	8.6	8.0
Grants								
Expense not elsewhere classified	7.4	9.7	6.7	15.2	8.0	7.8	7.8	7.8
Net acquisition of nonfinancial assets	9.5	10.9	9.6	12.2	13.1	20.4	15.7	16.7
Gross operating balance	102.0	49.8	69.0	63.6	94.8	-22.2	99.7	78.4
Net lending / borrowing	92.5	38.9	59.4	51.4	81.8	-42.6	84.1	61.7
Non-oil balance	-27.3	-91.4	-50.6	-68.1	-64.7	-106.6	-68.3	-68.0
excluding investment income	-57.7	-112.8	-67.7	-88.3	-87.4	-106.6	-92.9	-92.1
excluding recapitalization of pension	-57.7	-75.5	-67.7	-81.8	-81.4	-98.3	-87.4	-87.1
excluding oil-related subsidies and benefits	-47.7	-56.8	-54.8	-61.5	-62.7		-67.2	-68.8
Memorandum items:								
Expenses excl. recapitalization of pension fund (percent of nonoil GDP)	55.7	71.7	64.1	77.5	75.9		78.8	77.2
Oil-related subsidies and benefits (percent of nonoil GDP)	10.0	18.7	12.9	20.3	18.7		20.2	18.3
Kuwait Crude oil price, USD per barrel	74.4	84.5	65.5	84.1	105.8	65.0	112.3	107.2

Sources: Ministry of Finance; Central Bank of Kuwait; and IMF staff estimates and projections.

[1] Excluded from the national budget presentation. Estimated by IMF staff.

[2] Includes UN (Iraq) compensations.

[3] Includes other miscellaneous expenditures in FY 07/08 and 08/09.

[4] Covers interest payments on the treasury bills and bonds, and on the DCP bonds. Only the latter is included in the national budget presentation.

[5] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the social security fund. In 2008/09, KD 5.5 were transferred. KD 1.1 billions are budgeted for each year from 2010/11 to 2014/15.

[6] The 2006/07 budget reflects KD195 million on account of a KD 200 one off grant transfer to each Kuwaiti citizen. The 2010/11 budget reflects KD 1,120 million on account of a KD 1,000 one off grant transfer to each Kuwaiti citizen.

Table 3. Kuwait: Summary Balance of Payments, 2007–13

	2007	2008	2009	Prel. 2010	2011	Proj. 2012	2013
	(US$ billions, unless otherwise indicated)						
Current account	42.2	60.2	28.3	38.3	70.8	86.4	76.2
Goods (trade balance)	43.4	64.0	35.9	47.6	82.4	98.4	88.3
Exports	62.6	87.0	54.4	67.6	104.3	121.7	113.2
Oil exports	59.1	82.6	48.9	61.8	96.7	114.4	105.4
Non-oil exports including re-exports[1]	3.5	4.4	5.5	5.8	7.6	7.3	7.8
Of which: re-exports	1.2	1.7	1.6	1.8	2.3	2.2	2.4
Imports	-19.1	-22.9	-18.5	-20.1	-22.0	-23.3	-24.9
Services	-3.2	-3.8	-2.3	-5.6	-7.5	-7.9	-8.4
Transportation	-0.1	-0.6	-1.4	-1.1	-0.7	-0.8	-0.8
Insurance	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Travel	-6.4	-7.3	-5.8	-6.2	-7.9	-8.4	-9.0
Other services	3.4	4.3	4.9	1.6	1.1	1.3	1.4
Investment income	12.4	10.7	7.7	9.4	11.1	11.8	13.8
Receipts	16.3	14.0	8.9	10.6	11.4	12.9	14.9
General government[2]	8.5	8.8	6.3	7.4	8.8	10.6	12.4
Other sectors[3]	7.8	5.1	2.6	3.2	2.6	2.3	2.4
Payments	-3.9	-3.2	-1.2	-1.2	-0.3	-1.1	-1.1
General government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-3.9	-3.2	-1.2	-1.2	-0.3	-1.1	-1.1
Current transfers[4]	-10.5	-10.7	-13.0	-13.1	-15.1	-16.0	-17.5
Capital and financial account	-33.4	-49.6	-25.6	-44.4	-59.8	-84.6	-74.5
Capital account[5]	1.5	1.7	1.0	2.1	3.5	3.6	3.7
Financial account	-34.9	-51.3	-26.6	-46.5	-63.4	-88.2	-78.2
Direct investment	-9.7	-9.1	-7.5	-4.7	-8.3	-10.1	-8.9
Abroad[6]	-9.8	-9.1	-8.6	-5.1	-8.7	-10.4	-9.3
In Kuwait	0.1	0.0	1.1	0.3	0.4	0.4	0.4
Portfolio investment	-34.9	-28.1	-8.2	-16.9	-9.3	-16.2	-8.7
Other investment (net)	9.7	-14.1	-10.9	-24.9	-45.7	-62.0	-60.6
Net errors and omissions[7]	-5.5	-10.0	-1.0	6.7	-6.7	0.0	0.0
Overall balance	3.3	0.7	1.7	0.6	4.3	1.7	1.7
Memorandum items							
Current account/GDP (in percent)	36.8	40.9	26.7	30.8	41.4	44.2	39.5
Current account (excl. oil)/GDP (in percent)	-14.7	-15.2	-19.5	-18.9	-15.2	-14.3	-15.1
Investment income/GDP (in percent)	10.8	7.3	7.3	7.6	6.5	6.1	7.1
WEO oil price (dollars per barrel)	71.1	97.0	61.8	79.0	104.0	114.7	110.0
Import growth (in percent)	17.7	20.0	-19.2	8.3	9.4	5.9	6.9
International reserve assets (US$ billions)[8]	15.9	16.7	17.7	18.7	23.0	24.8	26.5
In months of imports of goods and services	5.9	5.3	6.6	6.4	7.0	7.1	7.1

Sources: Central Bank of Kuwait; and IMF staff estimates.

[1] Also includes unrecorded oil exports.
[2] Kuwait Investment Authority, Kuwait Petroleum Corporation, Kuwait Fund for Arab Economic Development, Public Institute for Social Security, Kuwait Airways Corporation, and Bank of Savings and Credit.
[3] CBK, local banks, investment companies, exchange companies, insurance companies, and the nonfinancial private sector.
[4] From 2007, based on a new, more comprehensive methodology to estimate outward workers' remittances.
[5] Includes UN war compensation.
[6] For 2010, includes a projection of the net inflow from the sale for $10.6 billion of a foreign asset owned by a Kuwaiti compan
[7] Includes other unclassified private sector flows.
[8] Includes SDRs and IMF reserve position.

Table 4. Kuwait: Monetary Survey, 2007–13

End of period	2007	2008	2009	Prel. 2010	Proj. 2011	2012	2013
	(Millions of Kuwaiti dinars)						
Foreign assets (net) [1]	5,718	7,610	9,441	9,466	11,380	12,531	13,806
Central bank	4,327	4,510	5,009	5,183	6,397	6,880	7,354
Local banks	1,392	3,100	4,432	4,283	4,983	5,651	6,453
Domestic assets (net)	13,269	14,341	15,455	16,169	16,444	17,694	19,195
Claims on government (net)	-968	-2,675	-3,227	-2,441	-2,678	-3,226	-3,524
Central bank (net)	-920	-1,124	-1,165	-533	-682	-832	-727
Claims	0	0	0	0	0	0	0
Deposits	920	1,124	1,165	533	682	832	727
Local banks (net)	-47	-1,550	-2,063	-1,908	-1,996	-2,394	-2,797
Claims	1,912	1,985	1,922	1,910	1,887	1,887	1,887
Government debt bonds	0	0	0	0	0	0	0
Public debt instruments	1,912	1,985	1,922	1,910	1,887	1,887	1,887
Other claims	0	0	0	0	0	0	0
Deposits	1,959	3,535	3,984	3,818	3,883	4,281	4,684
Claims on nongovernment sector	21,822	25,460	27,019	27,527	28,237	29,455	32,161
Credit facilities	20,139	23,660	25,108	25,201	25,612	26,716	29,170
Local investments	1,683	1,800	1,911	2,326	2,626	2,739	2,991
Other items (net)	-7,585	-8,444	-8,336	-8,918	-9,115	-8,536	-9,443
Broad money [2]	18,987	21,950	24,896	25,634	27,824	30,225	33,001
Money	4,147	4,370	4,714	5,625	6,630	7,202	7,864
Quasi money	14,841	17,580	20,182	20,009	21,194	23,023	25,137
Of which: Foreign currency deposits	1,710	1,899	2,753	2,119	2,141	2,326	2,539
	(Annual percentage change)						
Foreign assets (net)	3.1	33.1	24.1	0.3	20.2	10.1	10.2
Central Bank	26.6	4.2	11.1	3.5	23.4	7.5	6.9
Local banks	-34.6	122.8	43.0	-3.4	16.3	13.4	14.2
Domestic assets (net)	27.9	8.1	7.8	4.6	1.7	7.6	8.5
Claims on government (net)	-953.4	176.4	-20.7	24.4	-9.7	-20.4	9.2
Claims on nongovernment sector	35.1	16.7	6.1	1.9	2.6	4.3	9.2
Other items (net)	-28.9	11.3	1.3	-7.0	-2.2	6.4	-10.6
Broad money	19.3	15.6	13.4	3.0	8.5	8.6	9.2
Money	16.8	5.4	7.9	19.3	17.9	8.6	9.2
Quasi money	20.0	18.5	14.8	-0.9	5.9	8.6	9.2
*Of which: f*oreign currency deposits	-23.8	11.1	45.0	-23.0	1.1	8.6	9.2
	(Change in percent of beginning of period broad money stock)						
Foreign assets (net)	1.1	10.0	8.3	0.1	7.5	4.1	4.2
Central bank	5.7	1.0	2.3	0.7	4.7	1.7	1.6
Local banks	-4.6	9.0	6.1	-0.6	2.7	2.4	2.7
Domestic assets (net)	18.2	5.6	5.1	2.9	1.1	4.5	5.0
Claims on government (net)	-6.8	-9.0	-2.5	3.2	-0.9	-2.0	-1.0
Claims on nongovernment sector	35.6	19.2	7.1	2.0	2.8	4.4	9.0
Other items (net)	-10.7	-4.5	0.5	-2.3	-0.8	2.1	-3.0
Broad money	19.3	15.6	13.4	3.0	8.5	8.6	9.2
Money	3.7	1.2	1.6	3.7	3.9	2.1	2.2
Quasi money	15.5	14.4	11.9	-0.7	4.6	6.6	7.0
Of which: Foreign currency deposits	-3.4	1.0	3.9	-2.5	0.1	0.7	0.7
Memorandum items:							
Non-oil GDP/M2	77.0	69.6	58.9	63.5	64.6	64.6	64.6
Foreign currency deposits/M2	9.0	8.7	11.1	8.3	7.7	7.7	7.7
Private credit/non-oil GDP	135.5	151.2	166.8	154.8	143.6	137.9	137.9

Sources: Central Bank of Kuwait; and IMF staff estimates.

[1] Excludes SDRs and IMF reserve position.

[2] Excludes deposits with financial institutions which are marginal.

Table 5. Kuwait: Illustrative Macroeconomic Baseline Scenario, 2007–17

	2007	2008	2009	Prel. 2010	Projections 2011	2012	2013	2014	2015	2016	2017
				(Percentage change, unless otherwise specified)							
Production and prices											
Nominal GDP (KD billions)	32.6	39.6	30.5	35.6	47.2	54.3	53.6	53.6	54.6	56.4	58.9
Nominal GDP	10.6	21.6	-23.1	16.9	32.5	15.0	-1.3	0.0	2.0	3.3	4.3
Nominal non-oil GDP	20.3	4.4	-3.9	10.9	10.5	8.6	9.2	8.8	8.8	9.0	9.1
Real GDP	6.4	4.3	-7.8	2.4	8.3	6.6	1.8	3.3	3.9	3.9	4.0
Real oil GDP	-4.7	5.4	-12.9	0.7	14.9	8.4	-3.4	0.5	2.2	2.2	2.3
Real non-oil GDP	15.3	2.7	-4.8	3.4	4.5	5.5	5.2	4.9	4.9	4.9	4.9
Kuwait crude export price (US$ per barrel)	68.4	92.2	61.5	77.7	103.3	113.4	109.0	102.0	96.6	93.0	90.8
Crude oil output (millions of barrels per day)	2.57	2.68	2.26	2.31	2.66	2.90	2.80	2.82	2.88	2.94	3.01
Consumer price index	5.5	10.6	4.0	4.0	4.7	4.4	4.1	4.0	4.0	4.1	4.1
				(Percent of GDP, unless otherwise specified)							
Public finance [1]											
Revenue, *of which*:	68.0	64.3	63.2	64.0	66.2	67.9	65.3	63.0	61.4	60.5	60.9
Oil and gas	51.6	52.8	52.2	51.8	54.9	56.3	52.7	49.5	46.8	44.5	42.7
Investment income [2]	13.1	8.7	8.1	8.8	8.5	9.0	9.8	10.7	11.7	13.2	15.5
Expenditure	28.1	48.6	35.0	41.7	35.6	36.9	40.2	42.9	42.7	44.4	45.8
Expense [3]	24.0	44.1	30.4	36.4	30.7	31.1	33.4	35.3	34.6	35.9	37.0
Capital	4.1	4.4	4.6	5.3	4.9	5.8	6.8	7.6	8.1	8.5	8.8
Fiscal balance (deficit -)	39.8	15.8	28.2	22.3	30.6	31.0	25.1	20.2	18.6	16.1	15.2
Exchange rates											
Exchange rates (US$ per KD, period average)	3.52	3.72	3.48	3.49	3.63	...	...	...	...	...	...
Nominal effective exchange rate	-2.1	2.9	-3.6	-0.3	0.3	...	...	...	...	...	...
Real effective exchange rate	-0.2	7.9	0.9	1.5	1.9	...	...	...	...	...	...
				(Percent of GDP, unless otherwise specified)							
Balance of payments											
Exports of goods and services excl. re-exports	59.7	62.4	56.9	61.9	66.9	67.8	64.6	61.9	59.7	57.6	55.6
Of which: oil and refined products	51.5	56.0	46.2	49.7	56.5	58.6	54.6	51.3	48.7	46.4	44.3
Imports of goods and services excl. re-exports	-24.6	-21.6	-25.2	-28.2	-23.2	-21.4	-23.2	-24.7	-25.7	-26.6	-27.3
Investment income (net)	10.8	7.3	7.3	7.6	6.5	6.1	7.1	8.4	9.7	11.8	14.7
Current account	36.8	40.9	26.7	30.8	41.4	44.2	39.5	35.8	33.2	31.7	31.5
Current account (excluding oil exports)	-14.7	-15.2	-19.5	-18.9	-15.2	-14.3	-15.1	-15.6	-15.5	-14.7	-12.8
				(Percent of GDP, unless otherwise specified)							
Saving-investment balance											
Final consumption	44.4	41.5	51.9	47.1	39.9	36.9	39.2	41.5	43.9	46.3	48.0
Government	14.0	13.4	18.5	16.7	13.9	14.2	16.1	17.7	18.9	19.9	20.8
Private	30.4	28.1	33.5	30.4	26.0	22.7	23.1	23.9	25.0	26.4	27.2
Gross domestic investment	20.5	17.6	18.0	19.1	16.3	16.7	19.3	21.2	22.1	22.7	23.7
Government	3.6	3.5	4.8	5.3	4.9	5.4	6.6	7.4	8.0	8.4	8.8
Private	16.9	14.1	13.2	13.8	11.4	11.3	12.7	13.8	14.2	14.3	14.9
Savings	57.2	58.5	43.0	50.0	57.7	61.0	58.8	57.0	55.4	54.4	55.1
Government saving	55.2	46.8	50.6	49.3	50.7	51.5	50.0	46.2	43.0	40.9	40.2
Private savings	2.1	11.7	-7.6	0.7	7.0	9.5	8.8	10.8	12.3	13.4	15.0

Sources: Kuwait authorities; IMF World Economic Outlook; and IMF staff estimates and projections.

[1] Fiscal year ending March 31.

[2] Includes profits of public enterprises.

[3] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund. In 2008/09, KD 5.5 were transferred. KD 1.1 billions are budgeted for each year from 2010/11 to 2014/15.

Table 6. Kuwait: Financial Soundness Indicators of the Banking Sector, 2006–11

(Percent unless specifed otherwise)[1]

	2006	2007	2008	2009	2010	2011
Capital adequacy						
Regulatory capital to risk-weighted assets	20.2	19.3	15.6	16.7	18.9	18.5
Regulatory Tier I capital to risk-weighted assets	17.7	17.2	14.3	14.9	17.3	16.9
Capital to assets	12.6	12.3	10.9	11.4	12.6	12.4
Loan composition and quality						
Oil/gas	0.7	0.8	0.9	1.2	1.2	1.1
Trade	11.8	10.4	10.2	10.6	10.0	10.5
Industry	5.0	5.9	6.8	6.5	7.0	7.1
Construction	13.4	12.6	11.9	11.4	12.7	12.1
Real estate	17.5	19.2	18.1	20.6	20.0	19.6
Equity purchase loans (corporate)	5.4	4.5	5.8	5.9	5.7	5.8
Agriculture/fishing	0.2	0.1	0.7	0.3	0.4	0.2
Financial Institutions	14.6	15.9	12.8	12.7	14.1	13.1
Of which: investment companies	5.3	7.9	7.5	8.0	8.7	6.1
Of which: banks	0.0	0.0	0.0	0.0	4.6	3.7
Public services	1.6	2.2	1.9	1.6	1.6	1.7
Households	20.3	19.1	16.0	16.1	16.3	17.0
Of which: credit card advances	1.0	0.8	0.6	0.5	0.5	0.5
Of which: installment loans	13.7	12.1	10.9	12.7	12.1	12.9
Of which: consumer loans	3.7	4.1	2.5	1.0	2.2	2.2
Of which: equity purchase loans (individuals)	1.8	2.1	2.0	1.9	1.4	1.4
Other	9.6	9.2	14.8	13.3	11.1	11.8
Gross non-performing loans to total loans	4.6	3.8	6.8	11.5	8.9	7.3
NPLs net of specific provisions to total loans net of specific provisions	2.5	2.1	4.9	7.4	6.1	5.3
Specific provisions to gross NPLs	47.4	47.2	29.0	38.3	33.9	29.5
NPLs net of specific provisions to Tier I capital	12.6	10.8	31.5	46.2	33.8	28.7
Loans to shareholders, parent companies, & directors to total loans	4.9	4.2	4.9	6.4	2.0	2.3
Large exposures to Tier I capital	147.6	141.6	212.4	165.1	124.3	105.3
Specific provisions to gross loans	2.2	1.8	2.0	4.4	3.0	2.1
Profitability						
Return on Average Assets (ROAA)[2]	2.7	3.3	0.8	0.7	1.2	1.1
Return on Average Equity (ROAE)[2]	20.1	24.3	6.5	6.1	9.1	8.1
Net interest income to gross income	33.9	29.0	36.6	44.5	49.9	47.6
Non-interest income to gross income	29.0	29.0	21.6	25.3	24.6	33.1
Trading and foreign exchange income to gross income	13.7	15.1	6.7	6.0	4.1	10.0
Non-interest expenses to gross income	27.6	23.9	26.4	36.9	37.7	36.1
Non-interest expenses to average assets[2]	1.4	1.5	1.6	1.9	1.6	2.1
Personnel expenses to non-interest expenses	50.7	49.6	48.0	42.9	48.7	36.8
Liquidity						
Core liquid assets to total assets[3]	29.3	26.9	20.8	20.4	17.7	22.1
Core liquid assets to short-term liabilities	38.6	34.1	28.0	28.6	27.8	36.3
Liquid assets to total assets	34.5	32.9	28.4	27.9	22.8	26.5
Liquid assets to short term liabilities	45.3	41.7	38.4	39.2	35.7	43.7
FX- loans to total loans	19.7	23.3	24.9	25.8	25.5	25.8
FX- deposits to total deposits	28.8	34.9	35.1	32.7	30.7	33.8
FX- liabilities to total liabilities	23.2	27.8	24.2	22.6	11.2	11.4
Deposits to assets	59.3	56.4	59.2	58.8	56.7	58.3
Loans to deposits	96.1	103.1	109.0	113.0	116.5	110.9
FX- loans to FX-deposits	65.5	68.9	77.3	89.1	96.8	84.6
Sensitivity to market risk						
Net open FX position (overall) as percent of Tier I capital	0.0	0.0	11.2	10.7	8.7	
Off-balance sheet operations as percent of assets	32.1	34.7	32.5	25.3	26.2	25.4
Gross asset position in derivatives as a percentage of tier I capital	77.9	90.9	71.1	46.9	33.6	
Gross liability position in derivatives as a percentage of tier I capital	77.9	91.0	71.1	46.8	39.4	
Equity exposure to capital	40.6	42.4	47.1	45.4	39.1	43.7

Source: Central Bank of Kuwait.

[1] Data is on consolidated basis.

[2] Averaging was not applied in 2006 indicators.

[3] Core liquid assets include: cash and cash equivalents, deposits with CBK, government securities, CBK bills, deposits with banks, certificate of deposits with other banks which mature within three months. The data was extracted from CBK prudential report.

Appendix I. Cross-country Statutory Retirement Ages and Life Expectancy at Retirement

	Earliest Eligibility Age	Statutory Retirement Age 2010	Life Expectancy after Statutory Retirement Age, 2010	Increase in Statutory Retirment Age by 2030 (planned or legislated)	Life Expectancy after Statutory Retirement Age, 2030
Advanced economies:					
Australia	65.0	65.0	17.4	2.0	19.2
Austria	60.0	65.0	17.9	…	18.6
Belgium	60.0	65.0	17.7	…	19.4
Canada	60.0	65.0	18.2	…	20.0
Cyprus	63.0	65.0	14.3	…	16.7
Czech Republic	58.8	61.8	18.8	3.2	22.0
Denmark	60.0	65.0	16.5	2.0	18.5
Finland	58.0	65.0	16.4	…	19.6
France	56.0	60.0	22.9	…	24.8
Germany	63.0	65.0	18.3	2.0	19.1
Greece	55.0	65.0	17.7	…	19.5
Iceland	60.0	67.0	15.4	…	16.9
Ireland	65.0	65.0	16.0	…	17.9
Italy	58.0	65.0	18.4	…	19.5
Japan	60.0	65.0	18.0	…	21.5
Korea	55.0	60.0	19.8	5.0	23.0
Luxembourg	57.0	65.0	17.8	…	18.7
Malta	61.0	61.0	19.6	4.0	23.6
Netherlands	65.0	65.0	15.9	2.0	18.3
New Zealand	65.0	65.0	17.3	…	18.6
Norway	67.0	67.0	15.2	…	16.6
Portugal	45.0	65.0	17.6	…	19.4
Slovakia	60.0	62.0	18.9	…	21.3
Slovenia	62.5	62.5	19.0	0.5	21.3
Spain	61.0	65.0	17.8	2.0	19.2
Sweden	61.0	65.0	17.0	…	19.4
United Kingdom	65.0	65.0	17.4	1.0	18.7
United States	62.0	65.8	16.3	1.0	17.3
Emerging market economies:					
Argentina	60.0	65.0	16.6	…	18.5
Brazil	53.0	65.0	13.3	…	15.2
Bulgaria	63.0	63.0	16.5	…	20.2
China	50.0	60.0	18.1	…	19.2
Estonia	58.0	63.0	18.3	…	21.2
Hungary	60.0	62.0	18.6	3.0	21.5
India	50.0	58.0	18.2	…	20.1
Indonesia	55.0	55.0	22.6	…	24.6
Latvia	60.0	62.0	18.9	…	21.1
Lithuania	62.5	62.5	21.1	…	22.3
Malaysia	55.0	55.0	22.9	…	25.1
Mexico	60.0	65.0	16.3	…	17.2
Pakistan	55.0	60.0	17.0	…	17.9
Philippines	55.0	60.0	17.4	…	19.4
Poland	60.0	65.0	16.1	…	19.1
Romania	58.3	63.3	16.9	1.8	19.2
Russia	50.0	60.0	21.1	…	22.9
Saudi Arabia	55.0	60.0	19.0	…	19.9
South Africa	61.0	61.0	16.4	…	19.8
Turkey	60.0	60.0	17.3	…	19.4
Ukraine	58.0	60.0	20.5	…	22.6
				…	
Average:	58.9	63.0	17.9	0.6	19.9
Advanced	60.1	64.2	17.7	1.0	19.7
Emerging	57.1	61.2	18.2	0.2	20.3
G20	57.8	62.4	18.2	0.6	20.0
Advanced	60.4	64.0	18.5	1.2	20.3
Emerging	58.9	63.0	17.9	0.0	19.7
Other GCC Countries:					
Bahrain	…	60.0	…	…	…
Kuwait	…	**55.0**	…	…	…

Sources: Cross-country data taken from the IMF paper *From Stimulus to Consolidation: Revenue and Expenditure Policies in Advanced and Emerging Economies* , page 65. The sources cited in that paper are: Country authorities, European Comission (2009), ILO (2010) UN (2010), OECD (2009e), Social Security Administration (2010), and IMF staff estimates. Data for Bahrain comes from country authorities.

Notes: Earliest eligibility age for pension benefits, including protected groups such as those in arduous or unhealthy employment that applies for new entrants to the labor force (some countries might have even earlier ages of eligibility for grandfathered groups). Legislated and planned increases in statutory retirement ages are included in the calculations for 2030.

Appendix II. 2010 FSAP Update Recommendations: Implementation Status

(As of May 2012)

Recommendation	Implementation status and details
General	
The CBK, CMA, and the Ministry of Commerce and Industry (MOCI) should clarify at the outset their respective supervisory responsibilities and initiate a coordination process to achieve efficient oversight architecture.	**Completed.** The CMA has assumed its supervisory role in September 2010. CMA bylaws have been passed, specifying its supervisory roles over ICs and an MoU delineating the supervisory responsibilities of and coordination process between CMA and CBK has been completed.
Establish at the CBK a financial stability unit (FSU) responsible for macro-prudential supervision.	**Implemented.** Significant progress has been made in this area. A new Financial Stability Office (FSO) has been formed drawing from interdepartmental competencies including supervision and macro economic analysis and is reporting directly to the Governor. In this relation, significant progress has been made on the analytical front and identification of tools that would be used to assess systemic risk. These include a quarterly off-site surveillance report, banking sector stress testing (developed during July-October 2010 with the assistance of a consulting firm), and an early warning system (EWS) that incorporates macro and micro economic and financial indicators that would be used to signal sector-wide weaknesses.
Banking Supervision	
Perform periodic stress tests including for real estate and other major sectoral credit risk concentrations, and review existing assessments of the way banks consider these risk concentrations in their internal capital adequacy assessment processes (ICAAPs).	**Implemented.** The CBK has made significant strides in its data collection and stress testing capacities with the help of an external consulting firm. Sectoral stress tests have been carried out by the CBK and the results were shared and discussed with banks. The CBK has completed an ICAAP manual based on the June 19, 2009 circular and have completed four ICAAP inspections in 2010, and three inspections in 2011. The eighth inspection is under follow up with two remaining ICAAP inspections to be completed.
Lower the maximum exposure limits on related parties and enhancing the legal framework to prohibit conflicts of interest concerning related party transactions.	**Not implemented.** The CBK noted that they have started to look into this issue. Moreover, they argued that they would like to avoid policy contradictions that could arise from lowering related

Recommendation	Implementation status and details
	lending limits and other policies that are directed at enhancing credit growth (e.g., relaxing the prudential loan/deposit ratio), particularly in light of the implementation of the Development Plan.
Complete the migration from compliance-based supervision to risk-based supervision.	**Completed.** An external consultant was appointed to assist the CBK modernize its supervisory framework into a risk based one, and perform ICAAP assessments. A "pilot" risk-based inspection was recently completed; and an inspection work program related to risk management is at an advanced stage, as well as a completed risk assessment methodology.
Continue strengthening the supervision capacity through further hiring and training.	**Ongoing.** An additional 12 on-site inspectors were recently hired. Staff in the banking supervision department have benefited over the last year from several trainings and seminars inside and outside Kuwait.
Shorten the on-site supervision cycle.	**Ongoing.** Progress has been made in shortening the on-site supervision cycle through a newly approved inspection plan to cover on-site work with all banks in an 18 month cycle.
Organize comprehensive ICAAP on-site examination.	Implemented. So far, seven ICAAP inspections have been completed, and one is in progress. The last two ICAAP inspections remain to be completed.
Investment Companies	
Strengthen regulations on (a) licensing (in particular "fit and proper" criteria); (b) permissible activities; (c) corporate governance, including requirements on internal organization, internal control, risk management, external auditors, and accountancy rules; and (d) prudential limits on leverage and liquidity/maturity mismatch.	**In progress.** The CMA bylaws seek to strengthen corporate governance in ICs by imposing approval of CMA for management, board members, and other key positions, including the compliance, internal controls, risk management, and AML/CFT officers. Minimum qualifications have been established for board members and key officers are required to pass a certain test specified by the CMA. New listing requirements for listed companies were also issued (compliance required by March 2012). In view of the transfer of supervisory responsibilities of ICs to the CMA, regulations issued by the CBK in June 2010 have been suspended and will only apply to finance companies that are fully under the

Recommendation	Implementation status and details
	supervision of the CBK. The new regulations set prudential limits on liquidity, leverage, and FX exposures and were to come to effect in June 2012. The CMA has not initiated yet any new regulations on these fronts.
Consideration could also be given to varying the minimum capital requirement depending on the activities and risks assumed by the entity.	Not implemented.
Financial Safety Net Framework	
Replace the blanket guarantee with a deposit insurance system which promotes market discipline, including by introducing a cap at a level that adequately protects depositors, but provides incentives to conduct due diligence. The authorities need to define a transition strategy, with a timetable, once conditions allow.	**Not implemented.** The authorities believe that it is still premature to remove the blanket guarantee. Furthermore, in view of the large deposit concentration in Kuwait (99% of depositors own only 20 percent of deposits), a standard deposit scheme would not be effective in guarding against bank runs.
Improve ELA, including by broadening collateral acceptance policies and establishing a valuation framework with haircuts for non-standard collateral.	**Not implemented.** Nevertheless, the CBK law allows the CBK to use any collateral it deems acceptable for emergency lending. Currently, the ELA comprises a wider range than government securities including traded shares and bonds of solvent commercial companies as well as commercial paper, but does not include other non-standard collateral.
Resolution Framework	
Overhaul the bankruptcy framework to adequately handle bankruptcies of banks and other financial institutions.	**Not implemented.** A taskforce headed by the Ministry of Commerce and Industry with CBK and CMA membership is studying a proposal for a workout legal framework for stressed ICs.

INTERNATIONAL MONETARY FUND

KUWAIT

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 30, 2012

Prepared By | Middle East and Central Asia Department

CONTENTS

ANNEX I. FUND RELATIONS

(As of May 31, 2012)

Membership Status: Joined September 13, 1962
Article VIII on April 5, 1963

		SDR Million	% Quota
II.	**General Resources Account:**	**SDR Million**	**% Quota**
	Quota	1,381.10	100.00
	Fund holdings of currency	967.41	70.05
	Reserve position in Fund	413.95	29.97
III.	**SDR Department:**	**SDR Million**	**% Allocation**
	Net cumulative allocation	1,315.57	100.00
	Holdings	1,445.56	109.78

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Lending to the Fund and Grants:** SDR million 34.8 (New Arrangements to Borrow)

Kuwait has made a contribution to the PRGF-HIPC Trust in support of Fund's concessional assistance to low-income countries. These include an interest-free deposit of SDR 4.2 million with a maturity at end-2018, and grant contributions to the PRGF-HIPC Trust. In addition, in July 2010, Kuwait provided a grant contribution of SDR 2.6 million to the general subsidy account of the PRGT.

Kuwait is a major donor to IMF TA and Training, contributing to two Regional Technical Assistance Centers (AFRITAC West and the Middle East Technical Assistance Center) and to all three Topical Trust Funds (Anti-Money Laundering/ Combating the Financing of Terrorism, Managing Natural Resource Wealth and Tax Policy and Administration). Kuwait also hosts and provides extensive financing and other support to the IMF-Middle East Center for Economics and Finance (CEF).

VII. **Exchange Rate Arrangement:**

Since May 2007, the Kuwaiti dinar has been pegged to an undisclosed currency basket, reverting to the exchange system before January 2003. Between January 1, 2003 and May 2007, the Kuwaiti dinar had been pegged to the U.S. dollar with a margin of 3.5 percent on either side around the parity exchange rate of 299.63 fils/U.S. dollar. Kuwait has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than those notified to the Fund pursuant to Decision 144-(52/51). On April 2, 2002 Kuwait notified the Fund, under Decision 144-(52/51), of exchange restrictions it introduced in order to implement UN Security Council resolutions 1373 (2001), 1333 (2000) and 1267 (1999).

VIII. **Article IV Consultations:**

- The last Article IV consultation was completed by the Executive Board on July 15, 2011. The staff report is available at: http://www.imf.org/external/pubs/cat/longres.aspx?sk=25106.0

IX. **FSAP Participation**

An FSAP Update was conducted in March 2010. It included an updated assessment of a selected number of Basel Core Principles. An FSSA report was discussed by the Executive Board along with the staff report for the 2010 Article IV consultation and it is available at: http://www.imf.org/external/pubs/cat/longres.aspx?sk=24096.0

X. **Technical Assistance:**

STA	Seminar on GDDS	February 2000
STA	National Accounts and Price Statistics	June 2001–June 2002
FAD	Restructuring Budget Processes	January/February 2002
FAD	A Program for Tax Reform	December 2002
MFD/LEG	Bank Insolvency	October 2004
FAD	Macro Fiscal Unit	February 2009
STA	External Sector Statistics	February 2009
STA	External Sector Statistics	December 2009
FAD/LEG	Value-Added Tax	October 2011
MCM	Arab Debt Market Development Initiative	March 2012

XI. **Resident Representative:** None

XII. Kuwait has consented to the quota increase under the Eleventh General Review of Quotas; it has accepted the Fourth Amendment of the Articles of Agreement.

ANNEX II. RELATIONS WITH THE WORLD BANK GROUP

(As of May 12, 2012)

The World Bank and the Government of Kuwait developed a four-year Country Partnership Strategy (CPS) 2010–13, which leverages the setup of a World Bank Country Office in Kuwait (inaugurated in January 2009).

The Kuwait CPS and program emphasize implementation of reforms. Hence all programs are grounded in the Government five-year plan, and are developed closely with the line ministry/agency as well as with the Ministry of Finance, which plays the coordinator role and the Bank's central counterpart.

The CPS focuses on Fee-Based Services laying the ground for Bank provision of advisory and analytical support to Kuwait. Program priorities are driven and guided by CPS and revolve around the following three pillars:

(i) Improving public sector performance, with activities in the areas of reforming procurement; improved governance including setting up an anti-corruption agency; fiscal management, including support for Value Added Tax implementation; energy reforms in renewable energy and increased efficiency; technical advice to stream line outdated procurement and project cycle regulation and practices, and support for several environmental initiatives.

(ii) Economic diversification through increased private sector development, with support for implementation of Kuwait's recently passed privatization law, support to Kuwait's Oil Company (KPC) as it implements an ambitious privatization program, TA for a number of public-private partnerships and the creation of a more conducive environment for private sector development and foreign direct investment, including activities with Kuwait's Foreign Investment Bureau (KFIB).

(iii) Human development, with a major program to support the quality of education, including having an international expert based in Kuwait. Potential Bank support in this area would also include social protection, labor and youth issues.

Activities for the FY 2012–13

I –Improving public sector performance

- **Governance TA – Phase III.** This is a third phase of a continuing Governance program that began in FY08 (Phase I completed in FY09, and Phase II – in FY11.) The scope of the project included review and/or assistance in drafting legislation pertaining to conflict of interest, and asset and income disclosure by public officials; advice and guidance on the creation of a well-functioning anticorruption agency including legal and institutional framework; development of the agency's strategic plan, operational manual and guidelines; and public awareness campaign. Program elements includes: (i) improving transparency and access to information through the preparation of Freedom of Information legislation; (ii) recommending revisions to the Civil Service Code of Conduct; and, (iii) introducing a comprehensive anticorruption law covering topics such as conflict of interest, asset recovery, whistleblower protection and the creation of an anticorruption agency. Analytical work under all three components was completed by late May 2011, and submitted to the Prime Minister's Office (PMO). Draft legislation is yet to be presented before Parliament.

- **Clean Development Mechanism (CDM)**. At the request of the Environment Protection Agency (EPA) the Bank has provided assistance in the development of a national CDM Strategy, a CDM portfolio and an outline of options for Kuwait to participate in an international post-Kyoto regime. This activity aimed also at assisting the EPA raise awareness and engage governmental and private sector stakeholders in a dialogue on carbon finance in general and the CDM more specifically, as well as providing training to potential project proponents and supporting identification of CDM project activities and other emerging carbon trading schemes. This activity has recently been completed.

- **Environmental Compliance Fund (ECF)**. This activity responds to a request from the Kuwait Supreme Council for the Environment, and subsequently from the Ministry of Finance, for World Bank support in promoting improved environmental performance from point-source/industrial polluters in Kuwait through the establishment of an ECF. Bank support is consisting of helping the EPA design an environment compliance system to assist the polluting enterprises reduce pollution to the level required by the national standards and guidelines. Such system would consist of the design of the following activities: (i) A Compliance Action Plan (CAP) to be prepared by each of the polluting enterprises to reduce pollution; and (ii) A Financing Window to be established in selected commercial banks to provide a combination of loans and grants to the polluting enterprises in order to implement part or all the activities in the compliance action plans (CAPs).

- **Power Sector Support**. This activity aimed at supporting the Ministry of Electricity and Water (MEW) develop an implementation strategy, a coordination mechanism, and implementation steps for the development of energy efficiency and large-scale solar power combining the strengths of public and private sectors. This activity has drawn to a conclusion and discussions are underway for a follow-up activity during which the Bank will support MEW implement the detailed action plans and defined specific projects recommended in phase one.

- **Project Cycle.** At the request of the Ministry of Finance, the World Bank is conducting a review of the government project cycle. The objective of this program is to explore ways of shortening the project cycle and improving current project management practices in Kuwait. As part of this activity, the Bank team has reviewed and analyzed a selection of projects in government entities at three stages: concept, implementation and evaluation. This review is helping identify bottlenecks and areas that need amendments in procedures or regulation/legislation. The Bank is also making recommendations to strengthen the capacity of the Government agencies to implement projects through adequate training.

- **Value Added Tax (VAT).** The World Bank is supporting efforts by the Kuwaiti Government to design and implement VAT - as part of Kuwait's GCC trade union obligations. Introducing VAT in Kuwait has four objectives: diversifying the sources of public revenues; supporting economic development programs by making available a steady stream of additional tax revenues; compensating the deficiency in customs duties resulting from the application of free trade agreements; and, improving taxation on luxury items. A parallel objective of this project is capacity building, which is where the involvement of the World Bank is critical. This will be achieved through intensive training in VAT basics, VAT specifics, VAT operations and modern techniques of tax administration, as well as through on-the-job training by the experts hired by the project. This focus on strengthening a critical public sector function – tax administration – in the context of fiscal reform makes the Bank a natural partner for the government. An international resident advisor has been placed in Kuwait for two years to work on this activity.

- **Solid Waste Management II**. This activity is a follow-up to a first phase solid Waste Management program, which aimed at improving Kuwaiti authorities understanding of the current challenges of the solid waste sector and incited them to promote reforms to enhance cost effectiveness of private sector participation, particularly in collection, sorting and recycling of waste. At the request of the Municipality of Kuwait City, the Bank is engaged through this second phase of the program to help implement the main recommendations of the first phase, namely: (i) preparation & implementation of a national priority project for the closure and rehabilitation of existing dumpsites, (ii) elaboration and adoption of a solid waste master plan consistent with Kuwait Land-Use Master plan, to identify national policy & investment priorities for the solid waste sector, (iii) completion & harmonization of existing legal instruments, starting with a Solid Waste Law, and (iv) establishment of a municipal solid waste agency under the municipality's authority.

- **Kuwait Environmental Action Plan**. This activity represents the Kuwaiti national component of the regional initiative for the Gulf Environment Action Program (GEPAP) launched in 2009 by the World Bank, at the meeting of the Gulf Cooperation Council (GCC) Environment Coordination Committee in Muscat, Oman. The objective of this activity is to support Kuwait's efforts focus on environmental sustainability that could generate financing and economic benefits in addition to protecting Kuwait's natural resources in line with the State's regional and national priorities; and to help establish clear, transparent and predictable environmental regulations that would improve the investment climate in Kuwait. The activity comprises three main components, which are: (i) Implementing a cost assessment of environmental degradation as a decision making tool for delineating policy and investment priorities based on economic and social costs of the various forms of environmental degradation; (ii) Carrying out a pollution load assessment as a decision support system for monitoring and enforcement of environmental regulations; and (iii) Strengthening the environmental impact assessment system as a preventive tool for reducing environmental and social impacts and risks.

- **Follow-up to the Country Procurement Assessment Report (CPAR)**. Building on the Bank's CPAR report for Kuwait, the Bank is supporting the MoF procurement team drafting a new comprehensive procurement law as first step in implementing the recommendations and action plan of the CPAR. The Bank team prepared and submitted a draft consolidated Public Procurement Law and is currently supporting the MoF in the ratification process. The Bank team is also providing comments on Tendering Legislation presented to the Parliament and discussing with MoF counterparts future capacity building support activities.

- **Sector Data Quality Assessment**. The activity aims to support the CSO data quality improvement. Scope of work involves an assessment of data standards and methods in the data-contributing agencies as well as an evaluation of actual performance of these agencies in meeting the current and best-practice standards.

- **Reorganization of State Property**. The objective of the activity is to assist the State of Kuwait in the strategic understanding of the institutional and regulatory issues related to state land policy management in Kuwait. This will entail a clear understanding of the roles and responsibilities of various entities involved in state land management and identifying the barriers and constraints to effective land management.

- **Assessment of 'Digital Oasis' project idea and support to the preparation of ICT-SME and Outsourcing Framework**. Kuwait's Central Agency for Information Technology (CAIT) has requested Bank Technical Assistance with: (i) the assessment of the feasibility of a 'Digital Oasis' project; and, (ii) the preparation of a framework for IT Outsourcing and the promotion of SME's in ICT - Effectively resuming TA work by the Bank in the sector. Bank is in the process of preparing proposals for re-engagement with CAIT

II –Economic diversification through increased private sector development

- **Public Authority for Transport.** In this activity the World Bank is supporting the Ministry of Commerce to establish a Public Authority for Transport (PAT) as decreed by the Council of Ministers. In this task the Bank is commenting on draft laws establishing the authority and providing options analysis for design, organization and governance of the authority, including help with drawing the new authorities' organizational structure and Operations Manual. Discussions are underway with the MoC on possible additions to the scope of work for the remainder of this program.

- **Public-Private Partnerships (PPP): Partnership Technical Bureau (PTB) Capacity Building.** The objective of this activity was to assist the PTB in the implementation of the BOT (build-operate-transfer) Law 7, 2008. More specifically, the task team (i) prepared operating BOT guidelines in line with the new Kuwait law and international best practice; and (ii) assisted the PTB in becoming a fully operational body by recommending a suitable organizational structure as well as provided ad hoc support in preparing and finalizing documents, including: procurement documents for recruiting transaction advisors, and requests for proposals. The first phase was completed in March 2010. Bank support during this second phase aimed at supporting PTB with the formal launch of the Kuwait PPP program (and the dissemination of the PPP guidebook), including preparation of a PPP policy note, the organization of a regional launch event; institutional and capacity development for PTB; and assistance in establishing a project development fund.

- **Kuwait Airways Privatization Support.** At the request of the Kuwait Investment Authority the World Bank provided support in the evaluation of technical proposals for the selection of a technical advisor to the Kuwait Airways Privatization Committee (KAPC). As part of this task the Bank was to review and comment on draft management and shareholder agreements. However, and due to the failed privatization attempt of Kuwait Airways and the government decision to restructure the company prior to its privatization, this activity is being canceled.

- **Kuwait Foreign Investment Bureau (KFIB) Support**. The World Bank is supporting KFIB in developing feasibility studies and master plan(s) for three new economic zones for foreign investors (Wafra, Abdali, and Shegaya).

- **Privatization Support. The Ministry of Finance asked for World Bank support in implementing a** recently passed Privatization Law. The Bank's support will focus initially on helping draft by-laws for the privatization law and policy (vision) statement to provide additional rationale and explanation for the draft by-laws. The proposed support also includes capacity building for the set-up of a Privatization Technical Bureau (PTB); Portfolio development; Transaction support, Public education, and support enhance corporate governance and Post-privatization reforms.

- **KPC Support**. The World Bank is supporting KPC with their privatization program in the following three areas: (i) helping KPC establish a Private Sector Involvement Follow-Up unit; (ii) Support to the preparation of an Options Guide for the private sector participation in some of the KPC activities; and (iii) providing technical support for private sector involvement in KPC activities through the establishment of a Petroleum Industrial Zone.

- **ROSC Insolvency & Creditor Rights.** Ministry for Commerce and Industry requested Bank's support in moving forward with a number of reforms to help improve Kuwait's investment climate starting with a review of Insolvency and Creditors Rights in Kuwait (ICR). The ROSC team presented its preliminary findings and recommendations, including a detailed comparative diagnostic of the Kuwait ICR framework in reference to the Bank's Principles on Effective Insolvency Systems. Among the Bank's primary recommendations is the need for new laws regulating Enterprise Rehabilitation and Liquidation. Discussions are ongoing for Bank further support on this front.

- **Preparation of a CDM Project for Kuwait Gulf Oil Company (KGOC) – the Central Gas Utilization Project**. Under this TA the supporting KGOC with the preparation of a CDM project: "KGOC Central Gas Utilization Project (CGUP)", which will capture and utilize associated gases that otherwise would have been flared. This TA is based on specific request from KGOC and will be delivered primarily in the form of support in preparing a CDM Project Design Document (PDD), selecting and contracting of a DOE for validation of the CDM activity, and submission of the CDM project for registration at the UNFCCC.

- **Support for the Industrial Bank of Kuwait (IBK).** IBK requested Bank support in improving internal procedures and business strategy. The Bank is organization a study tour for relevant IBK managers to learn how other successful industrial development banks operate and what changes they could undertake to improve their own internal procedures and business strategy.

II –Human development

- **Education Sector TA.** Building on the success of the *School Education Quality Improvement* (SEQI) Program - designed to support the Ministry of Education (MoE) to implement selected critical elements of its own 4-year Government Program, the World Bank is partnering with MoE in expanding the cooperation program to improve the output of the education process, including through work on curriculum, diversifying secondary education (Grades 10–12) and developing an education system for special needs and gifted students. The World Bank work in the education sector is further expanding to potentially include support the work of the National Center for Assessment and Evaluation (NCAE) as well as support for the development of a strong higher education sector strategy, which will include a sector review and benchmarking to regional and more global standards.

- **Development of Social Safety Net Strategic Framework.** Kuwait's Ministry of Social Affairs and Labor (MOSAL) requested World Bank support to develop a more coherent Social Safety Net Strategic Framework. The Bank team had since shared with MOSAL a proposal for the Bank to support the Government of Kuwait in undertaking an assessment of existing social policies and programs in Kuwait, and develop a Social Safety Net Strategic Framework consistent with international practices, and grounded within the socio-economic context of Kuwait.

- **Labor Market Information System (LMIS).** Under this activity the World Bank will support the GoK with the establishment of an LMIS through the set-up of institutional arrangements, processes, and tools for the collection, integration, analysis, policy formulation, and dissemination of labor market information.

ANNEX III. STATISTICAL ISSUES

(As of May 11, 2012)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. There is scope for improved compilation of the national accounts and balance of payments statistics through better coordination among statistical agencies. Timeliness, particularly for the national accounts, is an area of concern.

National Accounts and Production: Recent improvements of national accounts include: change of the base year for the constant price data to 2000 and the estimates of value added for subsidized goods and services of the public utilities sector through the use of input costs (the household expenditure survey was used previously). Continued progress, especially in the estimation of value added for the oil sector, requires the dedication of adequate resources and improved coordination between the Ministries of Planning, Oil, and Finance. The IMF's statistics department (STA) has provided technical assistance to the Ministry of Planning to improve national accounts and price data. It would be useful if the Central Bank of Kuwait (CBK) would publish oil sector information in the *Quarterly Statistical Bulletin* pertaining to output, refining, domestic consumption, export price for crude and refined products and the domestic price of petroleum products. These data are available from the Ministry of Oil. Timeliness of the data needs to be improved. In the last few years, delays in the production of price indexes caused long lags in the production of real GDP data.

Price statistics

CPI weights are based on the 1999–2000 household expenditure survey and were introduced into the index for a reference year of 2002. An improved monthly CPI based on a revised basket has been published in monthly CPI bulletins with about a one-month lag. The wholesale price index (WPI) needs to be developed into a producer price index (PPI) which is consistent with the national accounts and includes all domestically produced goods, ex-factory, for the export and the domestic market.

Government finance statistics: Annual GFS data are reported for publication in the *Government Finance Statistics Yearbook (GFSY)*. The major components of extrabudgetary revenues (investment income and transfers of profits of public institutions), extrabudgetary expenditures (interest on foreign debt and treasury paper), and financing operations conducted by two reserve funds are not reported. Data on investment income, and on interest on foreign debt and treasury paper, however, are usually provided to Article IV consultation missions.

The authorities have made some progress in fiscal data presentation, but the lack of a suitable classification of data on the execution of the budget remains a constraint on monitoring effectively fiscal developments during the year. The authorities' presentation is not yet fully compliant with the GFSM 2001 guidance, but progress is being made in terms of creating a new chart of accounts and moving reporting to an accrual basis.
Data on the operations of the Public Institute for Social Security are not made available. Sharing of information between various government agencies could be improved. STA has indicated to

the authorities that operations of the two reserve funds should be classified as part of government, as they perform activities for public policy purposes (management of debt and assets, and financing of the budget). An additional extension of coverage would be to report GFS in the form of the Statement of Sources and Uses of Cash for the consolidated central government. The authorities have also been briefed on the IMF's ongoing work to enhance the transparency of fiscal accounts and presentations detailed in the "Code of Good Practices on Fiscal Transparency" and were encouraged to adopt some of the practices recommended in the Code.

Monetary and financial statistics

The CBK reports monetary data to STA on a regular and timely basis based on the Standardized Report Forms (SRFs). CBK needs to work further to distinguish a number of investment companies that accept deposits from other investment companies that do not accept deposits. Investment companies that accept deposits should appropriately be classified as part of the depository corporations sector. In the current SRFs, all investment companies (including those that accept deposits) are classified as other financial corporations. However, the amount of deposits accepted by investment companies is considered as not significant.

Balance of payments statistics: The CBK compiles and disseminates detailed annual data in accordance with the methodology of the *BPM6*, while trade data estimates are disseminated monthly. However, data on capital flows of the nonfinancial private sector are limited. To improve coverage for inward foreign direct investment, the CBK is making efforts to obtain more data by surveying direct investment enterprises. The Central Statistical Office (CSO), working with the CBK, plans to implement the IMF's Coordinated Direct Investment Survey in 2010–11. This initiative should improve foreign direct investment statistics. Enhancements have been made in the estimation of travel services and communication services, but further improvements are needed in compilation practices and in the estimation of data on several service items and private transfers.

A major step forward in 2007 was the dissemination of IIP data for 2001 onwards in STA publications. However, the information on IIP data made available to staff is incomplete as it excludes the external assets held by the general government due to domestic legal constraints on dissemination (however, loans granted by the Kuwaiti Fund for Arab Economic Development and general government trade credits are included).

The CBK also participates in the Coordinated Portfolio Investment Survey (CPIS) with data reported for 2003 onwards, and in the recently introduced Coordinated Direct Investment Survey. These data are for the financial sector acting as end-investors or as intermediaries on behalf of residents and do not include holdings of foreign securities held by government agencies, which comprise the bulk of Kuwait's cross-border holdings.

In 2009, STA provided TA on improving external accounts data. The CBK has made good progress since then, particularly in the substantial revisions to report forms, including the separate reporting of financial transactions in the BOP and other changes in volume in the international investment position. It has also made progress in the estimation of remittances data. Yet, major delays and data gaps remain. In particular, major government entities do not

report quarterly data to the CBK in time to compile timely quarterly statistics. Trade data are compiled by the CSO annually and provided to the CBK with a time lag of well over one year. Furthermore, the response rate for the private nonfinancial sector is low.	
II. Data Standards and Quality	
Kuwait is one of the first GDDS participants. However, most of its metadata, with the exception of the real sector and socio-demographic metadata, have not been updated since October 2002. The CBK maintains its own webpage where it provides the following data to the public: money and banking statistics; balance of payments statistics; trade balance statistics; exchange rate; GDP by sector and expenditure at current and constant prices; public finance statistics; CPI and WPI; and security market indicators. Similarly, the Ministry of Planning has a webpage where the CSO publishes data on national accounts, prices, and other related statistics. The Ministry of Finance webpage includes detailed data for actual and estimated budget operations. In addition, the Kuwait Stock Exchange webpage provides data on stock market indices, volume and value of securities traded, as well as privatization schedules and other related information.	No data ROSC is available.

TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of May 11, 2012)

	Date of latest observation (dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality Methodological soundness[9]	Data Quality Accuracy and reliability[10]
Exchange rates	11/05/2012	11/05/2012	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[1]	31/03/2012	11/05/2012	M	M	M		
Reserve/base money	31/03/2012	11/05/2012	M	M	M		
Broad money	31/03/2012	11/05/2012	M	M	M		
Central bank balance sheet	31/03/2012	11/05/2012	M	M	M		
Consolidated balance sheet of the banking system	31/03/2012	11/05/2012	M	M	M		
Interest rates[2]	31/03/2012	11/05/2012	M	M	M		
Consumer price index	31/03/2012	11/05/2012	M	M	Q		
Revenue, expenditure, balance and composition of financing[3]—general government[4]	31/03/2011	18/04/2012	Q	Q	Q	Not published on Fund standards	Not published on Fund standards
Stocks of central government and central government-guaranteed debt[5]	31/03/2012	11/05/2012	M	M	M		
External current account balance	31/12/2011	18/04/2012	A	A	A		
Exports and imports of goods and services	31/12/2011	18/04/2012	A	A	A		
GDP/GNP	31/12/2010	20/09/2011	A	A	A		
Gross external debt	31/12/2010	7/07/2011	A	A	A		
International investment position[6]	31/12/2010	7/07/2011	A	A	A		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] Reflects the assessment provided in the data ROSC or the Substantive Update for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

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700 19th Street, NW
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IMF Executive Board Concludes 2012 Article IV Consultation with Kuwait

On June 15, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Kuwait on a lapse of time basis. Under the IMF's lapse of time procedures, the Executive Board completes the Article IV Consultations without convening formal discussions.

Background

The 2012 consultation discussions were held against the backdrop of significantly higher oil revenues for Kuwait, a product of higher global oil prices and an increase in oil production. The policymaking landscape changed significantly in 2011 and early 2012. After six cabinet resignations in the past five years, the Prime Minister resigned in late 2011 and new Parliamentary elections were held in early February 2012, producing significant gains for the opposition. A new government was formed shortly after.

Real Gross Domestic Product (GDP) growth in 2011 is estimated at around 8¼ percent, supported by a 15 percent increase in oil production. Higher oil revenues resulted in an increase in Kuwait's current account and fiscal surpluses to over 41 and 30 percent of GDP, respectively. Growth in non-oil economic activity was moderate and is estimated at about 4½ percent in 2011, primarily driven by higher government expenditure—the government's wage bill and capital expenditure are estimated to have increased by almost 20 percent in FY 2011/12. Banks' private sector credit growth continued to be weak, at about 2½ percent, held back largely by a decline in lending to investment companies (ICs).

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Headline inflation in 2011 increased to about 4¾ percent, from 4 percent in 2010, as food inflation increased to almost 9¼ percent (8¼ in 2010). On the other hand, nonfood inflation remained relatively subdued at 3½ percent, although somewhat higher than the almost 3 percent observed in 2010. Equity prices in the Kuwait Stock Exchange (KSE) came under renewed downward pressure and the stock market's unweighted index declined by almost 16½ percent—its fourth consecutive annual decline—although it showed some rebound in the first four months of 2012.

The financial sector faced a mixed environment in 2011. The banking sector remained well capitalized, liquidity conditions continued to be favorable, and lending to some sectors strengthened. Nevertheless, banks' profits remained largely flat due to a significant buildup in provisions. ICs hit renewed setbacks due to adverse market conditions and the reemergence of global liquidity strains. Average equity prices of ICs declined by almost 27 percent in 2011, which brought the cumulative decline vis-à-vis August 2008 to almost 79 percent.

Executive Board Assessment

In concluding the 2012 Article IV Consultation with Kuwait Executive Directors endorsed staff's appraisal, as follows:

The economic outlook for 2012 is broadly positive. Economic recovery is expected to strengthen, led by high government expenditure—particularly wages and capital expenditure. High fiscal and external surpluses are expected to persist. Inflation is projected to moderate slightly due to a decline in global food inflation. Low implementation rates of the capital budget and legislative bottlenecks could, however, dampen the recovery.

Near term economic policies should continue to remain supportive. While the supportive fiscal stance is appropriate and has been called for in recent years in view of still-moderate economic growth and low inflationary pressure, the recurrent nature of expenditure growth increases the rigidity of the budget and complicates short-term fiscal management. Inflation is projected to remain low, but inflation risk is on the upside and the authorities should be ready with a strategy for fiscal adjustment if inflationary pressures build up. This strategy should safeguard the capital budget as much as possible. The real exchange rate is broadly in line with fundamentals.

Kuwait has significant fiscal space but the country is now at a crossroads as regards conserving wealth for its future generations. Kuwait's non-oil primary deficit is above the estimated baseline benchmarks that take into account intergenerational equity in the distribution of oil wealth. Furthermore, rising public sector wage and pension costs and rapid population growth are expected to exert pressures on public finances in the medium term. If Kuwait is to preserve wealth equally for its future generations, fiscal consolidation will be needed in the medium term.

Overall, there is a need to improve the productivity and welfare impact of government spending. Reallocating government expenditure toward capital expenditure would enhance non-oil GDP growth and improve the long-term outcomes of the fiscal accounts, while improving the productivity of government expenditure and contributing to the diversification objectives of the DP. In this connection, the authorities are encouraged to improve the government's capacity to implement the capital budget, contain the growth of the public sector wage bill, avoid a further buildup of the pension system's unfunded liabilities, and avoid new measures that would further increase current expenditures. The introduction of a VAT would be a step forward. The adoption of a medium-term budget framework and a well-designed fiscal rule could improve fiscal management. Finally, the phased retargeting of fuel-related subsidies to the most vulnerable segments of the population should be part of a medium- to long-term fiscal reform program.

Legislative and other reforms are needed to improve Kuwait's business environment and employment opportunities for Kuwaitis. Specific attention should be given to upgrading the education system to make it attuned to the needs of the business sector. Corporate governance should be enhanced by strengthening institutions' board member composition and member roles, and enforcing the appropriate implementation of auditing and reporting standards. On the legislative side, the authorities should proceed with modernizing legislation to enhance the business environment, taking into account best international practices to avoid the pitfalls of recent legislative experience. Finally, the authorities are encouraged to undertake a comprehensive review of business procedures and requirements with the view to streamlining them.

The authorities are encouraged to continue to be vigilant toward existing and emerging financial sector risks. To this end, they should maintain their strategy of building precautionary provisions and retained profits by banks, continue to enhance ICs supervision, and develop the needed tools for ICs resolution. Furthermore, in developing a new and improved national legislative base, the authorities should continue to take into account the specific nature of the central bank's operations and the need to strengthen and preserve its operational independence.

There has been significant progress in improving Kuwait's statistical system, but further improvements are needed. In this regard, the authorities are encouraged to provide the needed resources to the Central Statistical Bureau.

Kuwait: Selected Economic Indicators, 2007–13

(Quota: SDR 1,381.1 million)
(Population: 3.58 million; Dec. 2010)
(Per capita GDP: $37,039; 2010 estimate)
(Poverty rate: n.a.)
Main exports: oil and gas

				Prel.	Proj.	Proj.	
	2007	2008	2009	2010	2011	2012	2013
Oil and gas sector							
Total oil and gas exports (billions of U.S. dollars)	59.1	82.6	48.9	61.8	96.7	114.4	105.4
Average oil export price (U.S. dollars/barrel)	68.4	92.2	61.5	77.7	103.3	113.4	109.0
Crude oil production (millions of barrels/day)	2.57	2.68	2.26	2.31	2.66	2.90	2.80
	(Annual percentage change, unless otherwise indicated)						
National accounts and prices							
Nominal GDP (market prices, in billions of Kuwaiti dinar)	32.6	39.6	30.5	35.6	47.2	54.3	53.6
Nominal GDP (market prices, in billions of U.S. dollars)	114.7	147.4	105.9	124.3	171.2	195.3	192.8
Real GDP (at factor cost)	6.4	4.3	-7.8	2.4	8.3	6.6	1.8
Real oil GDP	-4.7	5.4	-12.9	0.7	14.9	8.4	-3.4
Real non-oil GDP	15.3	2.7	-4.8	3.4	4.5	5.5	5.2
CPI inflation (average)	5.5	10.6	4.0	4.0	4.7	4.4	4.1
Unemployment rate (Kuwaiti nationals)	6.1	4.9	3.6	2.9	3.4	...	...
	(Percent of GDP at market prices)						
Investment and savings							
Investment	20.5	17.6	18.0	19.1	16.3	16.7	19.3
Public	3.3	3.5	4.8	5.3	4.9	5.4	6.6
Private[1]	17.1	14.1	13.2	13.8	11.4	11.3	12.7
Gross national savings	57.2	58.5	44.7	49.9	57.7	61.0	58.8
Public	55.2	46.8	50.6	49.3	50.7	51.5	50.0
Private [1]	2.1	11.7	-7.6	0.7	7.0	9.5	8.8
Savings/investment balance	36.8	40.9	26.7	30.8	41.4	44.2	39.5
	(Percent of GDP at market prices)						
Budgetary operations[2]							
Revenue	68.0	64.3	63.2	64.0	66.2	67.9	65.3
Oil	51.6	52.8	52.2	51.8	54.9	56.3	52.7
Non-oil, *of which:*	16.4	11.5	11.0	12.2	11.3	11.7	12.6
Investment income	13.1	8.7	8.1	8.8	8.5	9.0	9.8
Expenditures	28.1	48.6	35.0	41.7	35.6	36.9	40.2
Expense[3]	24.0	44.1	30.4	36.4	30.7	31.1	33.4
Capital	4.1	4.4	4.6	5.3	4.9	5.8	6.8
Balance	39.8	15.8	28.2	22.3	30.6	31.0	25.1
Domestic financing	-3.1	-4.6	-1.7	2.0	-0.5	-1.0	-1.0
External financing	-36.7	-11.2	-26.4	-24.3	-30.2	-30.0	-24.0
Total gross debt (calendar year-end)[4]	7.0	5.3	6.7	5.7	4.3	3.7	3.8
	(Changes in percent of beginning broad money stock)						
Money and credit							
Net foreign assets[5]	1.1	10.0	8.3	0.1	7.5	4.1	4.2
Claims on nongovernment sector	35.6	19.2	7.1	2.0	2.8	4.4	9.0
Broad money	19.3	15.6	13.4	3.0	8.5	8.6	9.2
Kuwaiti dinar 3-month deposit rate (year average; in percent)	5.2	3.3	1.4	0.8	0.8	...	...
Stock market unweighted index (annual percent change)[6]	24.7	-38.0	-10.0	-0.7	-16.4	11.0	...

Kuwait: Selected Economic Indicators, 2007–13 (concluded)

(Quota: SDR 1,381.1 million)
(Population: 3.58 million; Dec. 2010)
(Per capita GDP: $37,039; 2010 estimate)
(Poverty rate: n.a.)
Main exports: oil and gas

				Prel.	Proj.	Proj.	
	2007	2008	2009	2010	2011	2012	2013
	(US$ billions, unless otherwise indicated)						
External sector							
Exports of goods	62.6	87.0	54.4	67.6	104.3	121.7	113.2
Of which: non-oil exports	3.5	4.4	5.5	5.8	7.6	7.3	7.8
Annual percentage change	6.4	25.1	26.5	5.7	30.0	-4.2	7.2
Imports of goods	-19.1	-22.9	-18.5	-20.1	-22.0	-23.3	-24.9
Annual percentage change	17.7	20.0	-19.2	8.3	9.4	5.9	6.9
Current account	42.2	60.2	28.3	38.3	70.8	86.4	76.2
Percent of GDP	36.8	40.9	26.7	30.8	41.4	44.2	39.5
External debt including private sector	57.6	60.5	45.5	31.1	...	...	...
International reserve assets[7]	15.9	16.7	17.7	18.7	23.0	24.8	26.5
In months of imports of goods and services	5.9	5.3	6.6	6.4	7.0	7.1	7.1
Memorandum items:							
Exchange rate (U.S. dollar per KD, period average)	3.52	3.72	3.48	3.49	3.63	...	...
Nominal effective exchange rate (NEER, period average)	-2.1	2.9	-3.6	-0.3	0.3	...	...
Real effective exchange rate (REER, period average)	-0.2	7.9	-1.2	0.9	1.5	...	...
Sovereign rating (S&P)	AA-	AA-	AA-	AA-	AA	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.

[1] Also includes government entities.
[2] Kuwaiti fiscal year ending March 31, e.g. 2007 refers to fiscal year 2007/08.
[3] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund.
In 2008/09, KD 5.5 were transferred. KD 1.1 billion is budgeted for each year from 2010/11 to 2014/15.
[4] Excludes debt of Kuwait's SWF related to asset management operations.
[5] Excludes SDRs and IMF reserve position.
[6] Change in the KSE as of May 9 2012 for 2012.
[7] Does not include external assets held by Kuwait Investment Authority.