INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/327

KUWAIT

December 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KUWAIT

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 2015 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 25, 2015 consideration of the staff report that concluded the Article IV consultation with Kuwait.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 25, 2015, following discussions that ended on September 21, 2015, 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 November 4, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Kuwait.

The document listed below will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Washington, D.C.

Press Release No. 15/545
FOR IMMEDIATE RELEASE
December 2, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Kuwait

On November 25, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Kuwait.

The decline in oil prices has adversely affected Kuwait's fiscal and current account balances and slowed growth in 2014–15. With high financial buffers and substantial borrowing space, the government can smooth the fiscal adjustment in response to the decline in oil prices, and continue to support growth through sizable investment spending. Real non-oil GDP growth is projected to slow in 2015 and 2016, and pick up to 4 percent in the medium term, supported by government investment in infrastructure and private investment. Average inflation is projected to increase to 3.4 percent in 2015 and will remain broadly stable at that level over the medium term, given limited global inflation.

The fiscal and external positions are projected to deteriorate further in 2015 and 2016, and improve somewhat over the medium term as oil prices and production recover partially. The oil price decline has increased the urgency of diversifying the economy and creating high productivity jobs is a priority to reduce Kuwait's dual dependency on oil revenue and expatriate workers. The government is focusing on reforms to contain current expenditure, prioritize capital expenditure and pursue with policies aimed towards increasing the role of private sector investment and job creation for nationals.

[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.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that Kuwait's large fiscal and external buffers have cushioned the macroeconomic impact of the fall in oil prices and will facilitate adjustment in the period ahead. Accordingly, Directors encouraged the authorities to take advantage of the available policy space to pursue gradual, sustained reforms to safeguard fiscal sustainability, promote export diversification, and boost private sector participation in the economy.

Directors underscored the need for fiscal consolidation through higher non oil revenue mobilization, expenditure restraint, and further subsidy and public sector wage reforms. In particular, they supported the authorities' plans to introduce a value-added tax and a business profits tax. Directors also recommended combining domestic and external financing sources to maintain capital spending and preserve the social safety net.

Directors agreed that the pegged exchange rate regime has served Kuwait well and delivered monetary stability. While welcoming the general soundness of the banking system, they encouraged the central bank to remain vigilant and develop its macroprudential policy framework to further strengthen financial sector stability. Continued close oversight of nonbanks should also remain on the policy agenda.

Directors stressed the critical importance of further promoting private employment for Kuwaiti nationals to reduce demands on the budget and transform the country's development model. Accordingly, they recommended deeper labor market reforms as well as additional efforts to modernize education and training. Directors also encouraged the authorities to implement further reforms to diversify the economy by improving the business environment, stepping up privatization, and strengthening governance.

Directors welcomed Kuwait's progress in upgrading its regime against money laundering and the financing of terrorism. They also commended efforts to improve the quality and availability of key economic statistics.

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[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Kuwait: Selected Economic Indicators, 2011–16

(Quota: SDR 1,381.1 million)
(Population:4 million; Dec. 2014)
(Per capita GDP: $43,119; 2014 estimate)
(Poverty rate: n.a.)
(Main export: oil)

			Prel.	Proj.		
	2011	2012	2013	2014	2015	2016
Oil and gas sector						
Total oil and gas exports (billions of U.S. dollars)	96.7	112.9	108.6	97.6	51.8	51.0
Average oil export price (U.S. dollars/barrel)	103.3	107.1	105.5	98.0	52.7	51.5
Crude oil production (millions of barrels/day)	2.66	2.98	2.93	2.87	2.83	2.89
	(Annual percentage change, unless otherwise indicated)					
National accounts and prices						
Nominal GDP (market prices, in billions of Kuwaiti dinar)	42.5	48.7	49.9	49.0	36.4	37.8
Nominal GDP (market prices, in billions of U.S. dollars)	154.0	174.1	175.8	172.4	121.7	125.2
Real GDP (at factor cost)	10.6	7.7	1.0	0.0	0.3	2.4
Real oil GDP	15.6	10.3	-0.8	-1.9	-1.4	2.0
Real non-oil GDP	3.4	3.4	4.2	3.2	3.0	3.0
CPI inflation (average)	4.9	3.2	2.7	2.9	3.4	3.4
Unemployment rate (Kuwaiti nationals)	4.7	4.7	4.7	5.0		
	(Percent of GDP at market prices)					
Investment and savings						
Investment	13.5	12.8	14.2	15.5	21.8	22.5
Public	4.7	3.6	3.9	4.6	7.6	8.0
Private[1]	8.9	9.3	10.4	10.9	14.3	14.6
Gross national savings	57.1	58.7	56.6	46.8	32.2	31.6
Public	57.1	56.9	55.1	51.0	30.5	28.2
Private [1]	0.0	1.7	1.5	-4.3	1.7	3.4
	(Percent of GDP at market prices)					
Budgetary operations [2]						
Revenue	74.2	71.7	72.2	63.5	53.9	53.0
Oil	64.8	61.2	59.0	49.0	38.1	37.5
Non-oil, *of which:*	9.4	10.6	13.2	14.4	15.8	15.4
Investment income	6.1	7.1	8.8	9.8	12.8	12.6
Expenditures	38.2	40.1	37.5	46.1	51.2	50.9
Expense [3]	33.6	36.4	33.4	40.9	43.3	43.0
Capital	4.5	3.6	4.1	5.1	7.9	7.9
Balance	36.1	31.7	34.8	17.4	2.8	2.1
Balance (after transfer to FGF and excl. inv. income)	24.7	10.1	11.7	-4.4	-12.5	-12.8
Domestic financing	-0.2	-1.9	-0.8	-0.3	-0.5	0.7
External financing (change in buffers)	-24.5	-8.3	-11.0	4.7	12.9	12.1
Non-oil balance (percent of non-oil GDP) [4]	-97.3	-105.5	-87.9	-97.0	-89.0	-87.0
Total gross debt (calendar year-end) [5]	4.6	3.6	3.1	3.2	4.4	4.2

Kuwait: Selected Economic Indicators, 2011–16 (concluded)

(Quota: SDR 1,381.1 million)
(Population:4 million; Dec. 2014)
(Per capita GDP: $43,119; 2014 estimate)
(Poverty rate: n.a.)
(Main export: oil)

			Prel.	Proj.		
	2011	2012	2013	2014	2015	2016
	(Percent change; unless otherwise indicated)					
Money and credit						
Net foreign assets [6]	22.0	20.6	11.1	4.0	4.6	3.8
Claims on nongovernment sector	2.3	3.1	7.2	5.2	4.7	4.6
Kuwaiti dinar 3-month deposit rate (year average; in percent)	1.1	1.0	0.8	0.8	...	...
Stock market unweighted index (annual percent change) [7]	-16.4	2.1	27.2	-13.4	...	...
	(Billions of U.S. dollars, unless otherwise indicated)					
External sector						
Exports of goods	102.8	119.7	115.8	104.8	58.7	58.3
Of which: non-oil exports	6.1	6.7	7.2	7.3	6.9	7.3
Annual percentage change	15.3	9.5	6.6	1.3	-5.0	5.8
Imports of goods	-22.6	-24.2	-25.6	-27.4	-25.7	-26.1
Current account	65.7	78.7	69.5	53.8	12.5	11.2
Percent of GDP	42.7	45.2	39.5	31.2	10.2	8.9
International reserve assets [8]	26.0	29.0	32.2	32.3	33.0	33.3
In months of imports of goods and services	7.5	7.7	8.3	7.6	8.2	8.1
Memorandum items:						
Exchange rate (U.S. dollar per KD, period average)	3.62	3.57	3.53	3.52	...	...
Nominal effective exchange rate (NEER, period average)	0.5	1.6	1.0	1.5	...	...
Real effective exchange rate (REER, period average)	1.7	3.2	0.8	2.0	...	...
Sovereign rating (S&P)	AA	AA	AA	AA	...	...

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

[1] Also includes government entities.

[2] Based on fiscal year cycle which starts on April 1 and ends on March 31.

[3] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund.

[3] In 2008/09, KD 5.5 billion was transferred. KD 1.1 billion is budgeted for each year from 2010/11 to 2014/15.

[4] Excludes investment income and pension recapitalization.

[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.

INTERNATIONAL MONETARY FUND

KUWAIT

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 4, 2015

KEY ISSUES

Context. With persistently lower oil revenues over the medium term, Kuwait is facing a more challenging policy environment as it needs to adjust spending while continuing to diversify the economy to create jobs for the growing young national population. Large financial buffers and space to borrow provide cushion to smooth the adjustment, which the authorities have been able to initiate by implementing diesel subsidy reforms. The 2015/16 budget appropriately curtails current expenditure growth while increasing capital spending on infrastructure. The new five-year Development Plan (DP) (2015–19) provides direction for prioritizing capital expenditure, encouraging private investment and creating jobs for nationals in the private sector.

Outlook and risks. Real non-oil GDP growth is projected to slow in 2015 and 2016 on account of slower consumption and private investment activity, and pick up to 3.5-4 percent in the medium term, supported by government investment in infrastructure and private investment. The main downside risks to the outlook arise from lower global oil demand and prices, slow implementation of the DP, and regional geopolitical uncertainty.

Macroeconomic policies. The fiscal and external positions are projected to deteriorate further in 2015 and 2016, and improve slightly over the medium term as oil prices and production recover partially. The government needs to implement gradual but sustained adjustment of current spending, and improve the efficiency of capital expenditure to strengthen non-oil growth and ensure intergenerational equity. Monetary policy settings and the peg to a basket of currencies remain appropriate for the Kuwaiti economy.

Financial sector. Banks are in a strong position to weather the challenges of lower oil prices and slower growth. The Central Bank of Kuwait (CBK) has continued to strengthen regulation and supervision of the banking system to safeguard financial stability. Enhancing the macroprudential policy framework would underpin systemic stability as economic activity moderates.

Economic diversification. Reforms are needed for improving the business environment, governance indicators, and education and skills of nationals, and for creating the appropriate incentive frameworks to increase employment of nationals in the private sector.

Approved By
Aasim M. Husain
Taline Koranchelian

Discussions were held in Kuwait City during September 9–21, 2015 The staff team comprised Messrs, Ananthakrishnan Prasad (head), Gazi Shbaikat, Sergio Rodriguez, Ali Al Reshan (HQ support), and Ms. Dominique Fayad (all MCD). The team met with the Deputy Prime Minister and Minister of Finance Al-Saleh and his economic advisory team, Minister of Planning and Development Al-Subaih, Minister of Education Al-Essa, Advisor to the Amiri Diwan, Governor of the Central Bank of Kuwait Al-Hashel, the Undersecretary of the Ministry of Finance, Members of the Committee on Budget and Finance, National Assembly, other senior government and central bank officials and representatives from the private sector and financial community. Messrs. Husain (MCD) and Faras (OED) joined some of the meetings. Diana Kargbo-Sical, Ben Piven and Juan Carlos Flores provided administrative and research support from headquarters.

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APPENDICES

CONTEXT

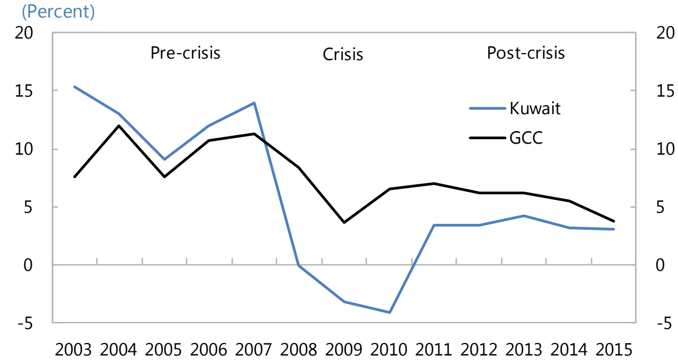
1. **Kuwait is facing the oil price shock from a position of strength.** The decline in oil prices has adversely affected Kuwait's fiscal and current account balances and slowed growth in 2014/15. With high financial buffers—estimated by staff at about 320 percent of GDP at end-2014—and substantial borrowing space, the government intends to smooth the fiscal adjustment in response to the decline in oil prices, and continue to support growth through large investment spending. The authorities reduced current expenditure in 2015 including by partially abolishing diesel subsidies. They are committed to continuing with subsidy reforms, and introducing corporate tax and wage reforms, in a phased manner over the medium term.

Status of Staff Recommendations Made in the 2014 Article IV Consultation	
Containing fiscal spending, in particular public wage bill, and reallocating spending toward capital.	Public wage reform is under study. The government has reduced allowances for government travel and overseas health expenses. The DP (2015–19) has prioritized projects according to national priorities. The 2015/16 budget envisages an increase in capital expenditure. The government is embarking on public expenditure management reform with World Bank technical assistance (TA).
Phased removal of energy and electricity subsidies.	The government eliminated diesel and kerosene subsidies effective January 2015, and increased the price of aviation fuel. It is currently undertaking an impact study for gasoline subsidy reforms for phased implementation.
Introducing corporate tax for domestic companies.	The government is considering a proposal for business profits tax designed with the help of Fund TA.
Strengthen budget framework.	In line with the recommendations of the Fund and the World Bank TA, modernization of the tax administration system continues. The macro-fiscal unit is operational with the support of the Fund resident advisor. Fund TA has recommended a framework for establishing a fiscal rule that is currently being studied by the Ministry of Finance.
Establish a more formal macroprudential framework and a coordinating mechanism to assess incipient risks.	The CBK and other government agencies are working on establishing a framework to deal with crisis management.
Expand and refine macroprudential toolkit, strengthen early warning system, and conduct macro stress tests of banks.	At the request of the authorities, Fund TA has focused on expanding the macroprudential toolkit. Further TA is envisaged to assist the central bank in enhancing systemic risk monitoring and developing a deposit insurance mechanism. The CBK is undertaking periodic macro stress tests of banks.
Enhancing investment companies' (ICs) resolution, developing needed tools to do it, and coordinating between CBK and CMA on ICs' supervision.	Coordination exists between CBK and Capital Markets Authority (CMA), but there is no formal committee.
Improving governance and auditing/reporting standards for investment companies.	No change in the status regarding the implementation of the new corporate governance guidelines with effect from June 2016.
Improving liquidity management framework and developing debt markets.	The CBK is issuing Treasury Bills. The government is considering among other options, issuing domestic debt to finance the fiscal deficit .
Developing the non-oil tradable sector and supporting employment of nationals in the private sector.	Bye-laws for foreign investment and small and medium enterprises (SMEs) and on the new Direct Investment Promotion Law have been issued; the National Fund for SMEs Development was established last year.
Modernizing restructuring resolution.	Bankruptcy law is still under preparation.
Improving AML/CFT framework.	Kuwait was removed from the FATF list of countries with strategic Anti Money laundering (AML)/Combating Financing of Terrorism (CFT) deficiencies in February 2015.

RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

2. **The Economy continued to grow in 2014, albeit at a lower rate, reflecting some slowdown in investment activity.** The estimated slowdown in non-oil growth to 3.2 percent in 2014 and 3 percent in 2015 (4.2 percent in 2013), has been driven by moderating activity across sectors. Oil production declined by 1.9 percent and 1.4 percent, respectively in 2014 and 2015, due partly to the closure of a neutral zone oilfield in the latter half of 2014 and a temporary suspension of operations in a few fields for technical reasons in May this year. This has reduced overall real GDP growth to around zero in 2014–15. Average inflation increased slightly to 3 percent in 2014, and edged up to 3.8 percent in August 2015, driven mainly by housing rents (Figure 1).

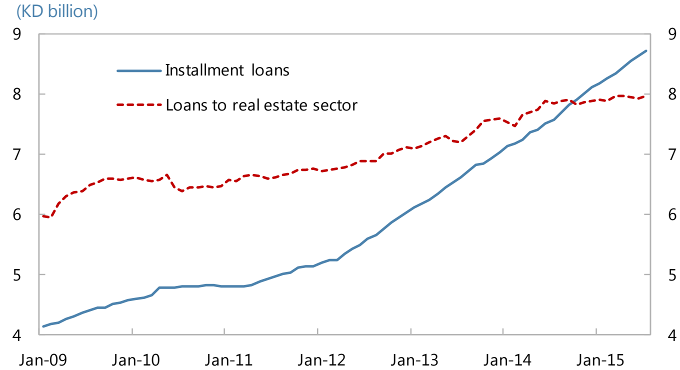
Kuwait: Real Non-oil GDP Growth, 2003–15
(Percent)



Sources: Country authorities; and IMF staff calculations.

3. **Financial market conditions are subdued.** Stock prices declined by about 24 percent y-o-y at end-September 2015, reflecting global financial market volatility, and regional geopolitical and domestic economic uncertainties. Corporate sector profitability remained stable in the first half of 2015. The CBK kept its discount rate, the key benchmark rate for lending, unchanged at 2.0 percent. Growth in banks' deposits and credit to the private sector edged down to 6.5 percent and 5.5 percent, respectively, in July 2015 (y-o-y) (Figure 2). One half of banks' local credit is to real estate, including installment loans which grew at 15 percent y-o-y in July 2015. The average value of real estate appears to be softening, but there are no signs yet of a correction trend. As of July 2015, prices across the residential and investment property segments have seen average prices fall in year-on-year terms by 6 and 7 percent, respectively, while prices in the commercial segment have increased by 5 percent.

Kuwait: Bank Credit to Real Estate Sector, 2009–2015
(KD billion)



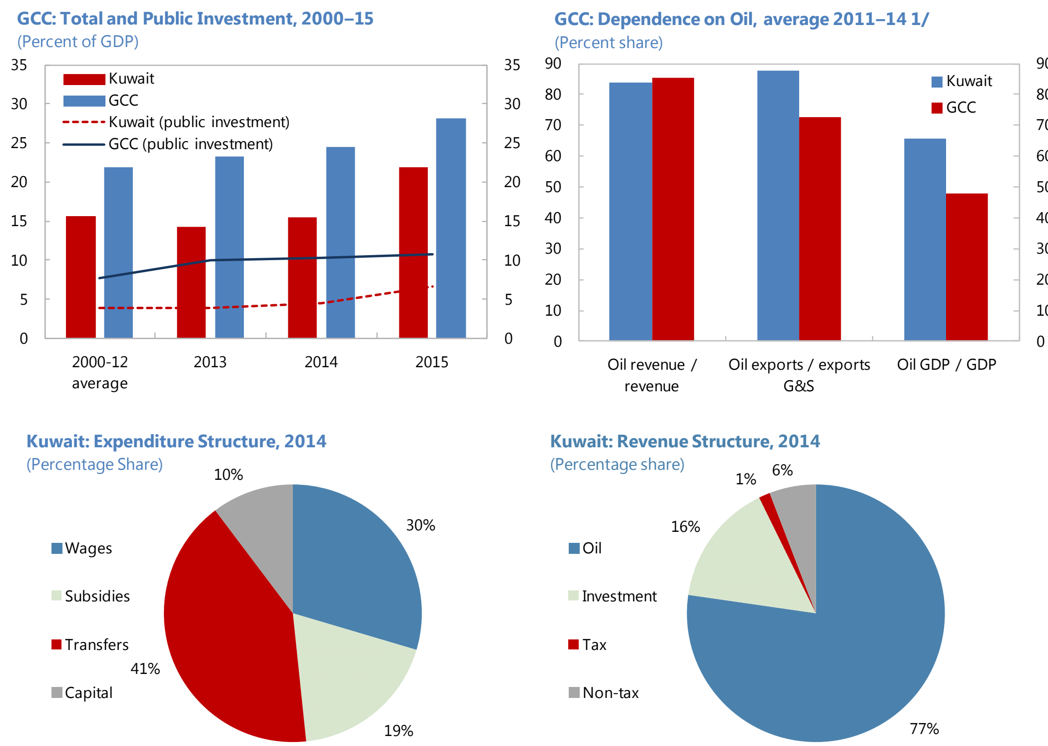
Source: Haver.

4. **The banking sector is well regulated and has shown resilience to the oil price shock.** The sector had a capital adequacy ratio of 16.9 percent (Basel III definition), nonperforming loans ratio of 2.8 percent, and provisioning ratio of 172 percent on a consolidated basis at end-June 2015. Banks' return on assets and equity increased, respectively, to 1.1 percent and 8.9 percent at end-March 2015 (1.0 percent and 7.4 percent in 2013), reflecting lower provision expenses, and profit growth of subsidiaries and branches abroad (Figure 3). The banking system's exposure to

investment companies (ICs) diminished to 2.8 percent of banks' total lending, amid ICs ongoing downsizing of balance sheets (Figure 4).

5. Lower oil revenue caused the fiscal and external positions to deteriorate sharply in 2014/15. In the government's presentation, after mandatory transfers to the Future Generations Fund (FGF) of 25 percent of total revenues, and excluding investment income, the fiscal balance declined to a deficit of 4.4 percent of GDP in 2014/15 from a surplus of 11.7 percent in 2013/14.[1] Under the IMF presentation, which does not take into account transfers to the FGF and includes staff's estimate of investment income, the overall fiscal balance also narrowed sharply to a surplus of 17.4 percent, compared to a surplus of 34.8 percent in 2013/14 (Figure 5). The government increased diesel and kerosene prices and reduced subsidies on aviation fuel effective January 2015, with estimated savings of 0.3 percent of GDP annually. The current account surplus fell to 31.2 percent of GDP in 2014 from 39.5 percent in 2013.[2]

Kuwait: Oil Dependence and Budget Structure



Sources: Country authorities; and IMF staff calculations.
1/ Oil revenue for Qatar excludes profit and tax income derived from oil.

[1] By law, a minimum of 10 percent of total revenue is transferred to the FGF. In each of the years during 2012–14 the government decided to transfer 25 percent.

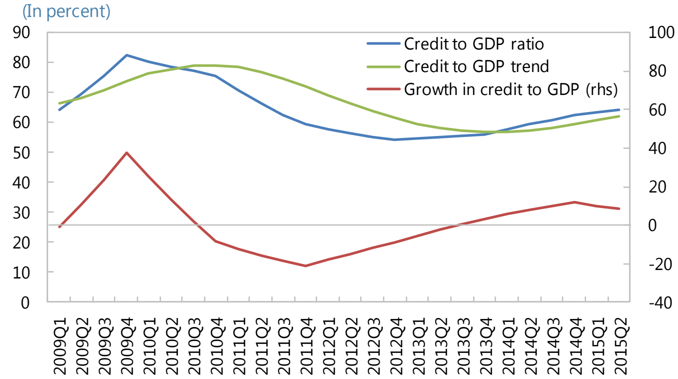
[2] Fiscal data are based on fiscal year cycle which starts on April 1. Annual GDP data series were converted to fiscal year cycle to calculate fiscal indicators. All other indicators presented in the report including balance of payments are based on calendar year cycle.

MACRO-FINANCIAL OUTLOOK AND RISKS

6. Investment in infrastructure projects will support non-oil growth in the medium term. A number of contracts have been awarded since 2014 in the oil sectors to upgrade fuel and to increase refining capacity, and implementation is already underway in several key projects including in the power generation and health sectors. The decline in oil price is, however, weighing on confidence and could negatively affect private consumption and investment. Against this background, staff project non-oil GDP growth to be slightly lower in 2015–16 and thereafter increase to 4 percent over the medium term as the impact of large investments in 2015 takes effect. High government buffers, a strong and liquid banking system, and a profitable corporate sector, provide the enabling environment for growth. Kuwait's credit cycle shows that credit growth is currently at its trend trajectory, mitigating concerns of a build-up of financial risks from excessive credit expansion.[3] Average oil production is projected to increase by 2 percent a year in the medium term, consistent with the planned new investment to increase crude capacity. Overall, GDP growth will recover from 0.3 percent in 2015 to about 2.8 percent over the medium term. Average inflation is projected to increase to 3.4 percent in 2015 and will remain broadly stable at that level over the medium term, given limited global inflation. The authorities agreed with staff's assessment and projections.

Kuwait: Credit Cycle, 2009–15

(In percent)



Sources: Country authorities; and IMF staff calculations.

7. Growth prospects will hinge on efficient implementation of the Development Plan 2015–19 (Risk Assessment Matrix). The authorities noted that the improved relationship of the administration with the parliament bodes well for the execution of the DP, which will also benefit from the new public private partnership (PPP) law. Implementation of projects in the Plan is under monthly monitoring at the cabinet level and periodic review by the parliament. Besides, the authorities are monitoring payments to contractors to ensure that contracts are executed without delays. Staff also noted potential risks to the authorities' oil upstream and downstream expansion strategy in view of the recent loss of market share, global developments and potential transitioning of growth in China.[4] The authorities anticipate a quick recovery of their market share through

[3] Although the credit/GDP ratio rose by 5 percentage points over the year ending 2015Q2, that mostly represented a recovery from weak credit growth in the past. As of end 2015Q2, the credit gap (deviation of credit/GDP ratio from its backward-looking estimated trend) was about 1.1 percentage points.

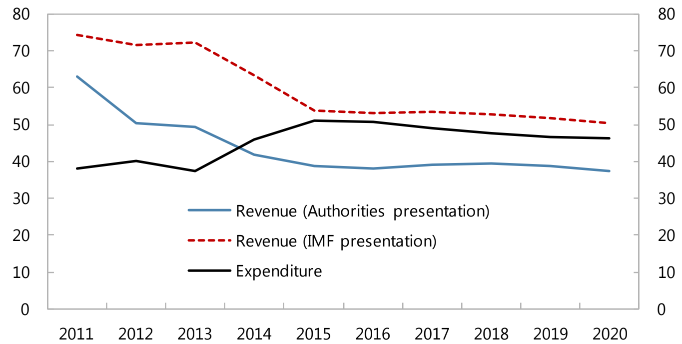
[4] The authorities have initiated an investment program to increase crude oil production capacity from 3 mbd to 4 mbd by 2020, and expand the capacity of their refineries and the petrochemicals complex. The investment program in the oil sector amounts to about KD27 billion during 2015–20 in upstream and downstream projects.

diversification of export destinations in Africa and South America, and increased exports to Europe especially from clean refinery projects.

8. **Staff shared the authorities' view that the peg to a basket remains appropriate for the Kuwaiti economy, as it continues to provide a nominal anchor.** The authorities are fully committed to the current exchange rate regime. As of July 2015, the Kuwaiti dinar depreciated against the U.S. dollar by about 6.8 percent (y-o-y), whereas the nominal effective exchange rate appreciated by 3.1 percent during the same period. Staff's external assessment suggests that under current policies, the current account is weaker than the level consistent with fundamentals by about 11 percent of GDP. Under appropriate fiscal policies, which would entail achieving larger fiscal surpluses, the gap would be closed over the medium term, and the current account balance would strengthen to a level that is in line with fundamentals (Appendix II). Over the longer term, as the economy diversifies, staff suggested that the benefits of exchange rate flexibility may increase, which the authorities acknowledged.

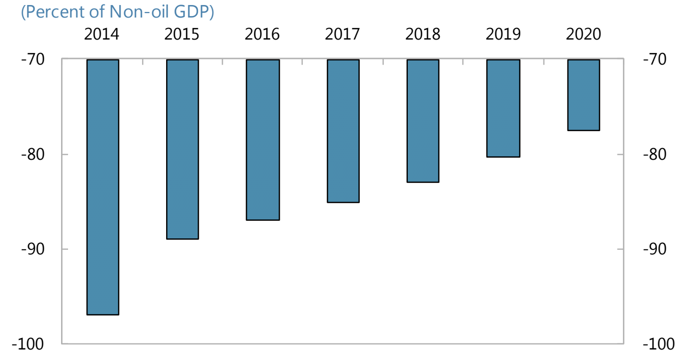
9. **The fiscal balance based on the authorities' presentation is projected to remain in deficit over the medium term.** Despite this accounting deficit, which will cumulatively reach KD26.2 billion (US$94 billion) and create financing needs of similar amount during 2015–20, the government will continue to accumulate fiscal buffers of $35 billion during 2015-20, as it adheres to the fiscal rule of transferring 10 percent of total revenue to the FGF and retaining investment income in the fund. The fiscal stance, measured by the non-oil primary balance as a share of non-oil GDP shows an improvement over the medium term in the baseline as spending growth is assumed to be contained to about 5 percent annually.[5] The sharp fiscal consolidation in 2015 can be explained by the normalization of one-off spending in 2014 and a decline in the subsidy bill.[6] Capital spending is budgeted to increase by

Kuwait: Overall Balance under IMF and Authorities Presentations, 2011–20
(Percent of GDP)



Sources: Country authorities; and IMF staff calculations.

Kuwait: Fiscal Stance (Non-oil Primary Balance) 2014–20
(Percent of Non-oil GDP)



Sources: Country authorities; and IMF staff calculations.

[5] The baseline for 2015-20 is based on the approved 2015 budget and announced policies by the authorities to contain the wage bill, cut non-essential spending, and includes saving in the subsidy bill as a result of the diesel reform in 2014 and the decline in international prices. The baseline also assumes that project implementation under the 2015-19 DP will improve compared to the previous plan.

[6] One off spending represents settling a delayed subsidy payment to the Kuwait Petroleum Company, aid to Egypt, and seed money for a new severance fund at the social security.

over 20 percent this year reflecting the acceleration of mega projects implementation, and is projected to grow by 4 percent annually over the medium term.

10. The authorities are considering debt financing of the budget deficit and are weighing the pros and cons of various options to determine the optimal mix. Drawdown from the General Reserve Fund (GRF), as was done in 2014/15, would be consistent with the GRF's role as the Treasurer as well as the stabilization fund. There may also be merit in issuing domestic debt, which could help catalyze the development of a liquid local-currency debt market. However, any issuance of domestic debt would need to consider the cost of debt relative to the expected risk and return on the GRF, and more importantly, its impact on the central bank's foreign exchange reserves, and the capacity of the banking system to absorb government debt without crowding out private credit. Depending on the rating and terms of borrowing, issuing foreign currency debt abroad could constitute an additional option that would not affect central bank reserves. Staff favored a mix of drawdown of buffers, and issuance of domestic and foreign debt to balance the tradeoffs between costs and benefits. The government has requested TA on public debt management, which staff supports.

11. While banks have significant direct and indirect exposures to real estate and equity markets, their high capital and provisioning buffers should enable them to withstand shocks. Given the interlinkages in the financial system, abrupt changes in market conditions could pose a risk to the financial system and the economy during periods of stress. The upward trend in wholesale funding, although from a low base, and the geographical diversification of assets are being monitored by the CBK to limit potential spillover risks from the region. The CBK is proactively monitoring and mitigating risks with macroprudential tools. The corporate sector in Kuwait appears well positioned to weather shocks, including from the recent fall in oil prices, with most sectors displaying comfortable levels of debt servicing capacity as measured by the interest coverage ratio. Staff's

Kuwait: Major Exposures of Banking System

(At end-June 2015, KD billions)

	Real Estate	Equity	Consumer Loans and Credit Cards (Households)
Direct			
Real Estate Loans	9.2		
Investments	0.8	2.3	
Installment Loans (Households)	7.8		1.7
Equity Purchase Loans		2.8	
Total Direct	17.8	5.1	1.7
Indirect			
Collaterals	22.1	8.3	
Total	39.9	13.4	1.7
Total Assets		68.6	
Shareholders Equity		8.6	
Regulatory Capital		7.6	
Regulations	Loan-To-Value (LTV) Ratio for residential property only: 50 percent for undeveloped land purchase, 60 percent for existing property purchase, 70 percent for construction use only. Maximum Installment loan value (all residential properties) is KWD 70,000 and these loans are also subject to a DSTI of 40% (and DSTI of 30% for retired	Lending to KSE Trading shares should not exceed 10% of total credit facilities portfolio extended to the resident customers, or 25% of the bank's capital in its comprehensive concept, whichever is lower.	Consumer loans are subject to a maximum amount of KWD 15,000 and a DSTI of 40% (and DSTI of 30% for retired persons).

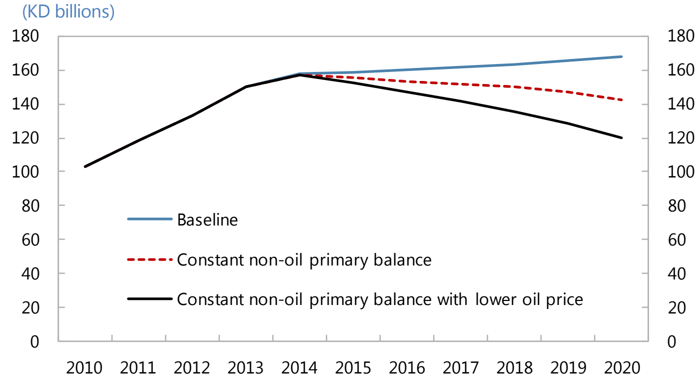
Sources: CBK; and IMF staff estimates.

stress tests show limited but non-trivial aggregate risks to corporate profitability from interest rate shocks.[7] Household investments in the local equity market would face adverse wealth effects from the decline in stock prices. ICs, by the nature of their business model, would face valuation losses from their investments in the local equity market.

12. Stress tests conducted by staff suggest continued overall banking sector resilience. A few banks, however, turn out to be more sensitive than others and could require additional capital under severe stress scenarios (Box 1). Banks are subject to macroprudential regulation, particularly with regard to their real estate and equity market exposures. Staff and the authorities agreed that there is further scope to better identify and mitigate spillovers through the financial sector, and to continue to build buffers of the banking system. Although the probability of realization of large shocks is low, this calls for strengthening the resolution framework for banks, which is work-in-progress at the central bank. In addition, strengthening the macroprudential policy framework, and refining the early warning system and toolkit, would enable a more systematic assessment and prevention of systemic risk. In particular, focused attention on collation of real estate indicators is warranted to monitor property market risks.

13. A sustained decline in oil prices presents a major downside risk to the medium-term outlook. Financial buffers could decline under adverse oil price scenarios. A lower oil price over the medium term ($10 below WEO projections) would shift the overall fiscal surplus into deficit starting in 2015 (under the IMF presentation), reaching 4.2 percent by 2020. If such an oil price shock is combined with an unchanged fiscal stance from 2014 (that is, the government does not tighten spending) the deficit would reach about 16 percent of GDP by 2020 resulting in a decline in financial buffers of around KD46 billion by 2020 (Figure 6). The authorities indicated their commitment to maintain capital spending in the budget and reduce inefficient current expenditure, to prevent stagnation of growth. If oil prices decline further, they would focus cuts on the current spending side.

Kuwait: Financial Buffers Managed by KIA, 2010–20
(KD billions)



Sources: Country authorities; and IMF staff calculations.

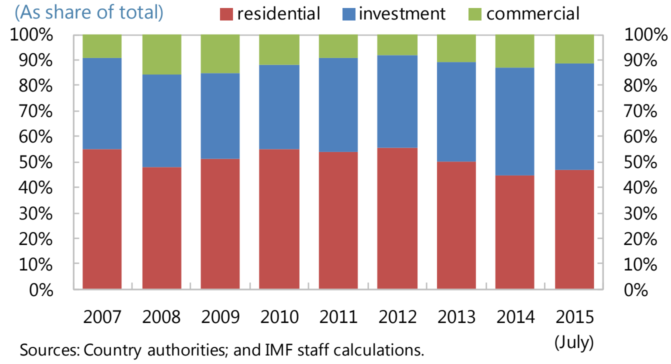
[7] In 2014, 68 (out of 130) companies accounting for 66 percent of the debt had ICR > 1 (i.e., companies that generate operating profits larger than their interest payment commitments). A shock that increases the interest rate by 200 basis points (bps) reduces the number of firms with ICR > 1 to 57. A 500 bps interest shock reduces the number firms with ICR > 1 to 52; these companies hold 50 percent of total debt.

Box 1. Addressing Risks from Real Estate Exposures Through Macroprudential Policies

The three key components of Kuwait's real estate market are residential, investment and commercial real estate properties. Commercial real estate constituted the remaining share. During 2014, total deals worth KD4.3 billion were recorded in the real estate market, registering an annual average increase of 27 percent since 2009. The number of units sold also showed an average annual increase of 11 percent during the same period.

Kuwait: Property Sales, 2007–15

(As share of total)

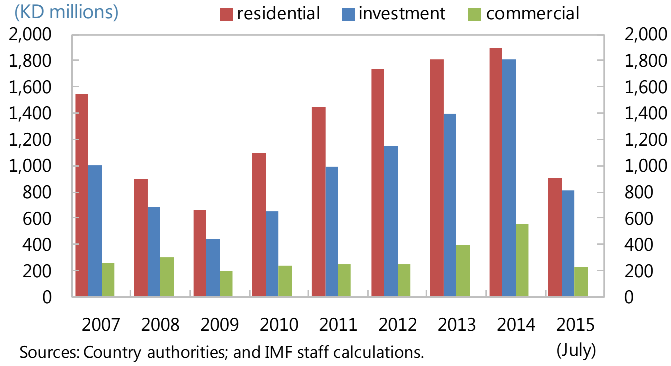


Sources: Country authorities; and IMF staff calculations.

Banks have significant direct exposure to real estate markets. The share of local banks' loans to the real estate sector was 25 percent of total loans at end-July 2015. In addition, banks' installment loans to households for purchase of homes constituted 28 percent of total loans. Furthermore, 40 percent of the total collateral of banks is tied to real estate, mainly in the commercial and investment segments

Kuwait: Property Sales, 2007–15

(KD millions)



Sources: Country authorities; and IMF staff calculations.

The CBK has taken steps to address potential risks in the private residential real estate market. In the residential real estate segment, installment loans are limited by a debt-service to income ratio (DSTI) of 40 percent and a ceiling on loan amount of KD70,000 with a maximum tenor of 15 years. A capital risk weight of 100 percent also applies to installment loans. In November 2013, the CBK introduced limits on the loan-to-value (LTV) ratio for financing extended by banks, investment companies and finance companies to individuals to purchase or develop residential property. An LTV limit of 50 percent applies to the purchase of undeveloped land, 60 percent to the purchase of existing property and 70 percent to housing construction in residential areas. The new regulation, however, is not applicable to unsecured installment loans used to buy or renovate first homes. Effective December 2014, the CBK issued regulations to tighten the treatment of real estate collateral by phasing out credit mitigation by 10 percent annually yearly over 5 years.

14. **Other downside risks include regional geopolitical uncertainty that could impact growth prospects.** Conflicts in the region could intensify further and worsen overall business confidence. Additionally, the removal of sanctions on Iran's oil exports could add downward pressure to world oil prices, clouding the profitability of Kuwait's investments being undertaken in the oil sector. The authorities were optimistic that continued investments in mega projects would help maintain confidence, crowd in private investments and preserve growth.

Box 2. Stress Testing the Kuwaiti Banking System to Oil-Macro Financial Shocks

Staff's macro-credit risk model suggests that some macroeconomic and bank- level variables are key determinants of NPL ratios in Kuwait. The analysis is based on 7 Kuwaiti banks (5 conventional and 2 Islamic), which account for 92 percent of total banking system assets, using a System GMM dynamic panel approach with year dummy variables to control for fixed effects and NPL data from the authorities. The analysis focuses on banks where sufficient data are available from 2000 to 2014. Results indicate that the NPL ratio exhibits strong auto-correlation, with non-oil private sector growth, real equity prices growth and real estate prices growth (investment) statistically significant and with the expected sign.

Kuwait: Determinants of NPLs	Coeff.
NPL $_{t-1}$	0.961
Real Non-Oil private Sector Growth $_{t-1}$ (%)	-0.027
Real Equity Prices Growth $_{t-1}$ (%)	-0.019
Real Estate Prices Growth - Investment $_{t-1}$ (%)	-0.011

To test banks' resilience, moderate and severe stress scenarios combining real and financial shocks were considered. Staff's sensitivity analysis is based on 2 scenarios from 2015 to 2017, characterizing moderate and severe deterioration in combined growth, equity and real estate prices, based on historical lows in Kuwait.

Stress test results indicate that the banking system, overall, holds sufficient buffers to absorb losses under severe macro scenarios. Overall, the combined capital of banks in the sample would remain above the central bank's regulatory prescribed minimum under the moderate scenario, with the NPL ratio rising to about 9.3 percent and a capital adequacy ratio at 16.7 percent two years after the shock. However, under a severe stress scenario, the capital of 5 out of 7 banks would fall below the prescribed regulatory minimum. The additional capital requirements of the 5 banks would amount to KD1.26 billion in 2016. At an aggregate level, the capital adequacy ratio would fall to 9.7 percent, below the regulatory minimum standard.

Kuwait: Stress Test Results of the Banking System

	Historical	Moderate Scenario			Severe Scenario		
	2014	2015	2016	2017	2015	2016	2017
Assumptions							
Real non-oil private sector growth (%)	4.1	-4.7	0.0	0.0	-8.0	0.0	0.0
Real equity price growth (%)	-15.7	-22.6	0.0	0.0	-60.0	10.0	15.0
Real estate prices (investment) growth (%)	11.4	-20.0	0.0	0.0	-30.0	-10.0	10.0
Impact							
Nonperforming loans (% of total loans)	2.9	3.6	8.5	9.3	3.6	18.1	17.7
Capital adequacy ratio	16.2	17.4	16.5	16.7	17.2	9.7	10.4
Recapitalization to achieve 12.5% CAR							
Mn KWD	0	0	0	0	0	1,260	1,044
% of total assets	0	0	0	0	0	2.3	1.9
% of 2014 GDP	0	0	0	0	0	2.6	2.1

Sources: Country authorities; and IMF staff calculations.

POLICY DISCUSSIONS

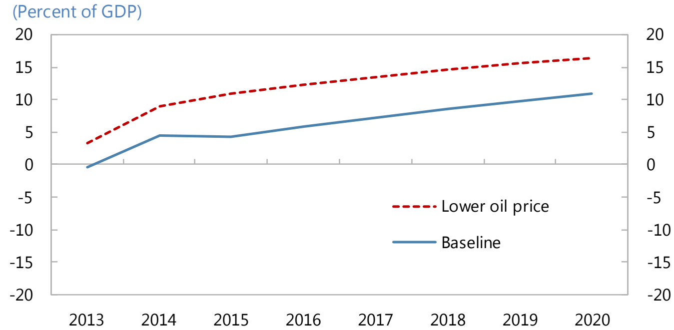
Staff and authorities agreed on the priority reform areas that would lead to a gradual but sustained fiscal consolidation, maintain financial stability, and sustain long-term growth through diversification and generating jobs for nationals.

A. Fiscal Consolidation and Expenditure Composition

15. Staff and the authorities agreed that gradual and sustained fiscal adjustment should commence without delay. The government's high financial buffers and ample borrowing space will enable it to comfortably finance the shortfall in the budget. Nevertheless, to maintain confidence in the economy, preserve buffers, and reduce fiscal risks, fiscal adjustment plans should be expeditiously formulated and communicated, and the adjustment initiated. At current policies in the baseline projections, the fiscal balance will diverge from the intergenerational equity level by 4 percent of GDP in 2015 and widen to about 11 percent by 2020.[8] This will create an external current account gap of similar magnitude. Delays in adjustment would result in a worsening fiscal position that would require a larger adjustment in the future, especially if oil prices fall further. For instance, if long-term oil prices were to decrease by $10 below current levels in the medium term, the gap would rise to over 16 percent of GDP by 2020.

Kuwait: Deviation of Overall Balance from PIH, 2013–20 1/

(Percent of GDP)



Source: IMF staff calculations.

1/ Difference between actual overall balance and level recommended by the Permanent Income Hypothesis (PIH).

16. In view of Kuwait's large buffers, the authorities could choose a relatively long horizon over which fiscal adjustment may be undertaken to mitigate the impact on growth. An adjustment of 1 percent of GDP annually relative to the baseline over the medium term would be appropriate and feasible (see next sections) to close the fiscal gap over a cycle of 10 years under current oil price assumptions. Staff recommended to start the adjustment in 2016 and underscored the importance of not only a gradual and sustained pace of adjustment, but also sequencing the composition of fiscal consolidation to minimize its impact on growth.[9] Staff and the authorities agreed that a gradual path would help manage fiscal risks from further oil price decline, as well as other social and political expectations.

17. Staff and the authorities agreed that achieving fiscal sustainability will require measures to contain expenditure growth and increase non-oil revenues. The savings from these reforms, which include subsidy and wage reforms, and VAT and business profits tax, would be about

[8] Intergenerational equity level of the non-oil primary fiscal deficit is derived from the permanent income hypothesis which estimates a constant real per-capita annuity of the sum of discounted values of future oil revenue receipts and financial assets. The calculations are sensitive to assumptions on future oil prices, population growth, inflation, and discount rates. For further discussion, see [Macroeconomic Policy Frameworks for Resource-Rich Developing Countries; IMF Policy Paper; 2012](#).

[9] Most studies, including those that focus on the GCC, find that the fiscal multiplier is larger for capital than current spending and that tax multipliers are usually found to be smaller than spending multipliers particularly in the longer-term. See, for example, Espinoza and Senhadji, 2011, and Cerisola et al., 2015.

1 percent of GDP in 2016 and increase to over 7 percent of GDP by 2020. Staff supports this proposed reform package and the projected size of adjustment as at it would bring the fiscal position closer to benchmark levels indicated by intergenerational equity considerations, without significant impact on growth.

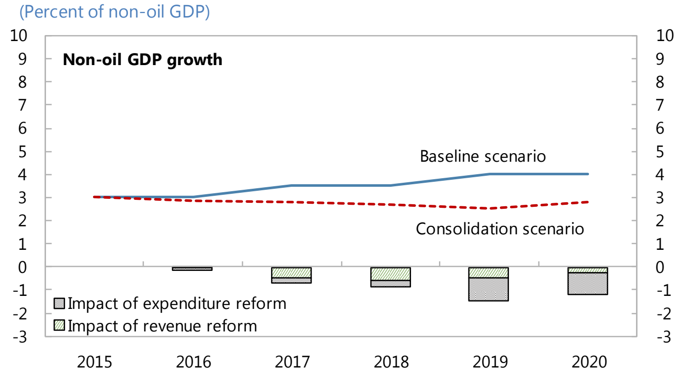
Kuwait: Expected Fiscal Saving from Proposed Fiscal Measures, 2015–2020
(Percent of GDP)

	2015	2016	2017	2018	2019	2020
Corporate tax 1/	0.0	0.0	1.5	0.4	0.8	1.2
VAT 2/	0.0	0.0	0.0	1.5	1.5	1.5
Subsidies 3/	0.0	1.0	1.0	1.0	3.7	3.6
Wage 4/	0.0	-0.1	0.2	0.5	0.8	1.0
Transfers 5/	0.0	-0.5	-0.4	-0.4	-0.4	-0.3
Total net saving	0.0	0.4	2.3	3.0	6.4	7.0
Overall balance (baseline scenario)	2.8	2.1	4.3	5.3	5.1	4.2
Overall fiscal balance (reform scenario)	2.8	2.5	6.6	8.3	11.5	11.1
Distance from PIH (baseline)	4.3	5.8	7.3	8.6	9.8	10.9
Distance from PIH (reform)	4.3	5.4	5.0	5.6	3.4	3.9

Source: IMF staff calculations.
1\ Assumed implementation date is fiscal year 2017/18 based on information from the authorities. Saving projected by IMF TA is KD 500-800 million. Saving assumed in table at 600 KD phased over three years.
2\ Based on estimates at the GCC level. Implementation is assumed to start in 2018/19 based on information from the authorities.
3\ Represents gasoline subsidies reform which is planned to start in 2016/17 and electricity which is projected by the authorities to start in 2018/19. Staff assumed that electricity tariff change will follow a graded system whereby small consumers will remain subsidized (saving will be half the current electricity subsidy bill).
4\ Assumes government introduces wage reform in 2016/17 with the initial cost of the rescaling salaries of KD 350 (projected by the consulting firm in charge of preparing the reform proposal) phased over two years. Saving will accrue as a result of capping wage increase to inflation rate.
5\ Staff assumed that half of the saving from the gasoline subsidy removal will be transferred to protect low income groups.

18. The proposed consolidation path is consistent with a broadly steady non-oil growth trajectory. The fiscal stance, measured as the non-oil balance in relation to non-oil GDP, would improve steadily by about 4.7 percentage points annually during 2016-20. Using estimates for the revenue and current spending multipliers, staff projects that the potential impact of the revenue reform could reduce non-oil growth by about 0.2 percent in 2020, while current spending reform will reduce growth by about 1 percent.[10] The overall impact of both reforms will be around 1.2 percent by 2020 and fades out thereafter. However, other factors such as efficiency gains (which have not been included in the calculations) could offset the adverse impact on growth. In addition, these reforms would bring additional benefits; for example, containing public sector employment and future wage growth will support efforts to increase the employment of nationals in the private sector and diversification efforts.

Kuwait: Growth Impact of Fiscal Consolidation, 2015–20
(Percent of non-oil GDP)



Source: IMF staff calculations.

19. The government should take advantage of current low global energy prices to strengthen efforts to reform domestic energy prices. A gradual reform of energy pricing (with estimated fiscal/quasi-fiscal cost of 7.2 percent of GDP in 2015), accompanied by establishment of a social safety net and other mitigating measures and a well-designed communication strategy to get the buy-in of the middle class, would generate substantial savings. Staff's analysis shows that in the longer-term, energy price reform would benefit growth by increasing efficiency in the economy and creating space for higher public and private investment (Box 3). One-off effects on inflation should be manageable. Productive activities more sensitive to energy costs, particularly the transport sector,

[10] Staff applied estimates of the multipliers that were recently used in an interdepartmental exercise to assess the impact of additional fiscal adjustment on real non-oil growth at the GCC level: 0.4 for revenue and 0.6 for current spending and assumed the multiplier impact is phased over three years.

would be able to adjust to higher energy prices more easily if the reform is gradual. The government plans to introduce gasoline subsidy reforms by the end of this year. Reform of electricity and water subsidies will require legal changes, which the government expects to introduce to parliament by end-2015.

20. Public wage reform should, among other things, cap annual salary increases at the inflation rate and contain expansion in the wage bill. The government is considering a reform to standardize the wage structure in the public sector and provide a framework to limit wage growth, effective FY 2016/17. The initial cost of salary alignments will be about KD350 million (0.9 percent of 2016-GDP), while the saving would be backloaded. The government plans to approve the new civil service law before end-2015 and spread out the initial cost over the next two years. The authorities agreed with staff's suggestion that in designing the reform they should consider clauses to limit explicitly public employment growth and arbitrary increases in wages, and that they should should be mindful of the impact of such a rule on the formation of inflation expectations in the economy. Staff also suggested the inclusion of an escape clause to hold wage growth below inflation when macroeconomic circumstances warrant.

21. Efforts to raise non-hydrocarbon revenue need to commence. Introducing a business profit tax (BPT) on the net profits of all companies operating in Kuwait and simplifying the current tax structure would potentially increase revenues by KD500–800 million (1.3 to 2.1 percent of 2016-GDP). The authorities indicated that they expect to introduce a draft BPT law in the next session of the parliament. Implementation of the value added tax (VAT), which is also being discussed at the GCC–level, could yield an additional 1–2 percent of non-oil GDP. With the GCC having recently approved a VAT framework, staff encouraged the authorities to move ahead expeditiously with its implementation. The authorities indicated that they prefer to move in unison with the rest of the GCC in introducing the VAT, but they would be prepared to move by themselves if the coordination process becomes excessively prolonged.

22. Staff welcomed the government's decision to move to top-down budgeting beginning FY 2016/17 and to a medium-term budgeting framework starting in fiscal year 2017/18. These reforms, besides providing better oversight and discipline to the budget planning and execution processes, would also build momentum to strengthen capital investment planning and prioritization towards high-growth sectors. Moreover, an overall Public Financial Management Committee, chaired by the Minister of Finance, has been established to guide and supervise public financial management reforms. A decision has also been made for full roll-out and implementation of the Government Financial Management Information System during FY 2016/17.

Box 3. Subsidy Reform in Kuwait: Long-Term Growth Benefits Outweigh Short-Term Inflation Costs

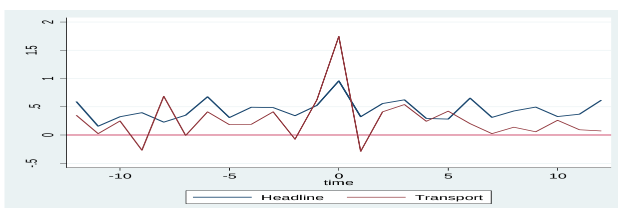
Low domestic energy prices represent a significant cost for the Kuwaiti economy. Kuwait's on-budget costs of low energy prices (including water) were about KD3.7 billion (7.6 percent of GDP) in 2014; 35 percent corresponds to petroleum products subsidies. The opportunity cost for selling energy products (gasoline, diesel, natural gas, and electricity) at prices below international prices is estimated at $12.7 billion (7.4 percent of GDP) in 2014; lower energy prices in 2015 reduce the estimated cost to $9.3 billion (7.2 percent of GDP).[1/]

A number of countries in the MENA region have initiated energy price reforms. Qatar has increased gasoline prices; Bahrain and Saudi Arabia have increased electricity tariffs for industries; Kuwait has increased diesel and kerosene prices and is studying a proposal to increase electricity prices; Bahrain and Oman have increased natural gas prices for industrial users. Most recently the UAE introduced a pricing mechanism for setting fuel prices against an international benchmark. Among non-GCC energy exporters, Iran and Yemen, and among oil importers, Egypt, Jordan, Mauritania, Morocco, Sudan, and Tunisia, have initiated subsidy reforms. Among energy exporting countries outside the MENA region, Malaysia, and Nigeria are successful cases of energy price reforms.

The increase in diesel price in January 2015 does not appear to have impacted headline inflation. While assessing the pass-through of diesel prices to headline inflation requires a more detailed and technical analysis, data as of May 2015 seems to suggest that the 100 percent diesel price increase in January 2015 has not had any significant impact on inflation so far. Transport prices did not increase in January, fell in March, and increased slightly in May (0.16 percent). Headline inflation during 2015 appears to follow the pattern observed during the second half of 2014.

The inflation response to previous domestic price shocks also permits to anticipate a modest impact on domestic inflation if energy prices were raised in Kuwait. In particular, pass through from shocks to the CPI sub-indices to headline inflation appears moderate.

Kuwait. Largest Monthly Inflation Shocks, 2005–15
Average Monthly Inflation 12 Months Before and After the Shock



Source: IMF Staff Calculations

Inflation shock defined as the 10 percent largest monthly inflation in each component of the CPI observed during 2005 -2015. Chart displays average of 10 percent largest values.

Preliminary estimates suggest that in the long-term Kuwait could generate net permanent savings in the range of 1.6–2.2 percent of GDP even if consumers are fully compensated for price increases.[2/] The estimate reflects opportunity costs of 7.4 percent of GDP for subsidies on gasoline, diesel, electricity, and natural gas; price elasticity for energy consumption in the range of (-0.3, -0.5); and assumes that energy prices are aligned with US pre-tax gasoline prices. If net savings from the reform were invested, Kuwait GDP could further increase between 0.06 percent of GDP and 0.08 percent of GDP. To the extent consumers are less than fully compensated, the fiscal gains from energy price reform could be even larger.

1/ The estimated opportunity cost uses as reference, gasoline and diesel US pre-tax prices published by the IEA, Henry Hub gas prices, and average electricity tariff for all sectors published by the US EIA.

2/ Estimated net savings are equivalent to the deadweight loss —the loss for the society, from selling products in the domestic market at prices lower than world prices, which lead to consumption levels that are higher than what would be at world prices in the context of a demand that responds negatively to prices.

B. Strengthening Financial Stability

23. The CBK has strengthened regulations to safeguard financial stability. Banks are under Basel III regulations for capital, including a framework for DSIBs, liquidity, and leverage. In the real estate sector, banks are subject to loan-to-value (LTV) ratio since November 2013, to a segment of individuals who purchase or develop residential property, besides debt-service-to-income ratio (DSTI) that already existed.

24. Macroprudential tools can help mitigate potential risks posed by banks' high exposures to the real estate sector. Some weakening of real estate activity appears underway in the commercial and investment segments, but the residential real estate segment reportedly remains firm. The latter is regulated by DSTI and maximum loan limits. While investment and commercial real estate financing is less regulated, rules regarding the treatment of real estate collateral, which encouraged this type of lending, are being phased out. The authorities agreed with staff's views that that it is important to ensure that macroprudential policy measures are reviewed constantly to ensure that they do not exacerbate any property price correction, while preempting the buildup of excessive risks related to real estate exposures. In addition, heightened supervisory vigilance needs to be maintained to ensure that real estate exposures are appropriately classified and adequately provisioned. Staff encouraged the authorities to construct real estate indices and suggested that other indicators, such as both the average and distribution of LTV and DSTI ratios, be compiled to calibrate measures at different phases of the credit cycle.

25. Given ICs' interconnectedness to the rest of the financial system, close monitoring of their activities, strengthened regulatory oversight, and further consolidation to strengthen this sector are warranted. A formal macroprudential coordination mechanism encompassing nonbank financial institutions would facilitate more systematic identification of systemic risks. Key improvements would involve: (i) assigning a macroprudential policy mandate and a delineation of its powers; (ii) establishing a formal financial stability coordination committee headed by the central bank, comprised of all financial system regulators, including the capital markets authority, the insurance supervisor, and the Ministry of Finance; (iii) ensuring appropriate accountability mechanisms; and (iv) elevating to a legal requirement the exchange of information.

26. Efforts to implement and further strengthen the AML/CFT and anticorruption frameworks in Kuwait are continuing. The decision by FATF in February 2015 to remove Kuwait from the list of countries subject to its monitoring process under its ongoing global AML/CFT compliance process and the issuance of the bylaws in March 2015 for the Anti Corruption Authority are welcome developments. Going forward, staff encouraged the authorities to build on these efforts, including through enhancing financial analysis and improving the quality of suspicious transaction reports, and continuing the effective implementation of the United Nations Security Council Resolution 1373 against terrorism financing.

C. Labor Market Reform and Diversification

27. Staff emphasized the need for creating the right incentives for nationals to take up jobs in the private sector. Staff projections indicate that growth in the number of new labor market entrants rises every year given the demographic profile and rising participation rates. With less than a quarter of the new entrants expected to find jobs in the private sector, the government will face a trade-off between continuing to absorb the remaining entrants and therefore allow the wage bill to rise further, or seeing unemployment among nationals rise. To address this challenge, current labor market structures need to have the right incentive framework to create a skilled domestic workforce and lead to a self-sustained expansion in employment of nationals in the private sector. They need to be underpinned by educational and training reforms and active labor policies to improve skills, pay and productivity in the private sector.

Kuwait: Labor Market and Wage Projections for Nationals

		Scenario I: Higher Unemployment*	Scenario II: Higher Wage Bill**
	2014	2020	2020
Labor Force	433	569	569
Employed in Public	320	350	416
Employed in Private	91	124	124
Unemployed	22	94	29
Unemployment rate (in percent)	5.0	16.6	5.0
Wage Bill/GDP	12.4	14.4	16.9

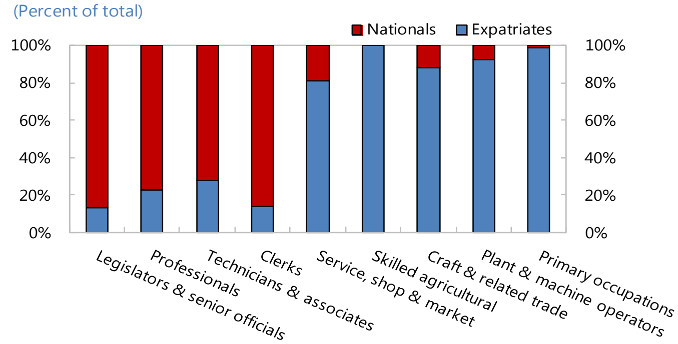
Source: IMF staff calculations.

* Assumptions: Labor force grow by 4.6 annually, as in previous years, public employment grow by 1.5 percent and wage by 3.3 percent, and share of Kuwaitis in the private sector increases by 2 percent annually as in previous years but at a slower pace given the more recent slowing trend.

** Same as in baseline except public employment of nationals increases to 4.5 percept annually to keep unemployment constant.

28. Staff's empirical analyses suggest the existence of complementarities between expatriate and national labor that underscore the importance of treading gradually in any efforts to cap expatriate labor. Major differences between expatriates and nationals in skill compositions, wage structures, and sectors of work suggest a low degree of substitutability (Figure 7). Heavy reliance on expatriate workers will continue and should be reduced gradually in tandem with growth in the national population and size of the labor force and development of skills of nationals.

Kuwait: Employment by Occupational Skills, 2014
(Percent of total)



Source: Labour Force Survey.

29. The authorities recognize the challenges in diversifying the economy and the need to improve the business environment and governance indicators (Figure 8). Recent efforts include finalizing foreign investment and SMEs by-laws, and streamlining registration and licensing procedures for investors. The establishment of Kuwait Direct Investment Promotion Authority has resulted in additional foreign direct investment into Kuwait. International experience suggests that, in addition to creating an economic environment favorable for doing business, Kuwait needs to implement policies to encourage firms to expand domestic operations and develop export markets, enhance infrastructure, and support workers in acquiring the necessary skills and education.

30. A more robust nonfinancial corporate sector would help the diversification process. Ex-post profitability (return on assets) has remained stable but at low levels, particularly when compared with other countries, including GCC peers. Companies appear undervalued; lower price to earnings ratios than in peer countries may point to weaker confidence in Kuwait's business environment that the authorities are seeking to improve. Further deepening of asset markets to provide companies alternative means of financing and investment, improving the investment climate in the economy, including by reducing costs of doing business in Kuwait, increasing privatization efforts, strengthening corporate governance and anti-corruption efforts, establishing bankruptcy procedures, and better data availability to investors, would contribute to better performance of the corporate sector.

Other issues

31. There has been significant progress in improving Kuwait's statistical system, and staff encouraged the authorities to further their efforts in all areas of economic data. Priority areas include improving national accounts and compiling quarterly estimates of GDP, compiling real estate indicators and conducting annual labor market surveys.

STAFF APPRAISAL

32. High financial buffers provide cushion to continue to support growth in the medium term through public investment. The decline in oil prices has adversely affected Kuwait's fiscal and current account balances and slowed growth in 2014–15. Overall GDP growth will recover from 0.3 percent in 2015 to about 2.8 percent over the medium term as oil production is projected to increase by 2 percent a year on account of planned investment to increase crude capacity. Non-oil sector growth is projected to increase to 4 percent over the medium term as the impact of large investments in 2015 takes effect. Risks to the growth outlook stem mainly from uncertainty about the future oil market outlook, slow execution of the DP, and an escalation of regional tensions that could undermine confidence.

33. Gradual fiscal consolidation in the medium term would reduce vulnerabilities and bring the fiscal stance closer to benchmark levels indicated by intergenerational equity considerations, while preserving growth. Delays would result in a worsening fiscal position that would require a larger adjustment in the future, especially if oil prices fall further. In the meantime, the choice of how to finance the fiscal deficit should carefully weigh the pros and cons of various options, including drawing down buffers, and raising domestic and external debt.

34. Achieving the desirable fiscal position will require measures to contain expenditure growth and increase non-oil revenues. Adjustment of current spending by implementing wage reform and continuing with subsidy reform, prioritizing and improving the efficiency of capital expenditure, and expanding non-oil revenues by implementing business profits tax and value added tax, should form central elements of the fiscal consolidation strategy. Successful formulation and implementation of medium-term fiscal policy require establishing a medium-term budget framework that is integrated with the macroeconomic framework, and improving the public financial management system.

35. The banking system has shown resilience to oil price shocks. The CBK has continued to strengthen regulation and supervision of the banking system to safeguard financial stability, and banks are in a strong position to weather the challenges of lower oil prices. Banks capital adequacy ratios are high, profitability and provisioning have increased, and asset quality has improved. Strengthening the macroprudential policy framework, and refining the early warning system and toolkit, would enable a more systematic assessment and prevention of systemic risk. Focused attention on collation of real estate indicators is warranted to monitor property market risks.

36. The peg to a basket remains appropriate for the Kuwaiti economy, as it continues to provide a nominal anchor. Nevertheless, fiscal consolidation will be needed to bring the exernal balance to a level consistent with fundamentals and support the peg over the long-term. In the future, as the economy diversifies, more flexibility in the exchange rate might become appropriate.

37. Creating the right incentives for nationals to take up jobs in the private sector is crucial. Implementing labor market policies and structural measures to increase incentives for private sector-based employment for nationals that reduces the fiscal burden, establishes a flexible, skilled national workforce, and supports diversification would form part of this strategy. Efforts need to be underpinned by educational and training reforms and labor policies to improve skills, pay and productivity in the private sector.

38. Further structural reforms will help diversification efforts. In addition to creating an economic environment favorable for doing business, Kuwait needs to implement policies to encourage firms to expand domestic operations and develop export markets, enhance infrastructure, and support workers in acquiring the necessary skills and education. Further deepening of asset markets to provide companies alternative means of financing and investment, improving the investment climate in the economy, including by reducing costs of doing business in Kuwait, increasing privatization efforts, strengthening corporate governance and anti-corruption efforts, establishing bankruptcy procedures, and better data availability to investors, would contribute to better performance of the corporate sector and help diversification efforts.

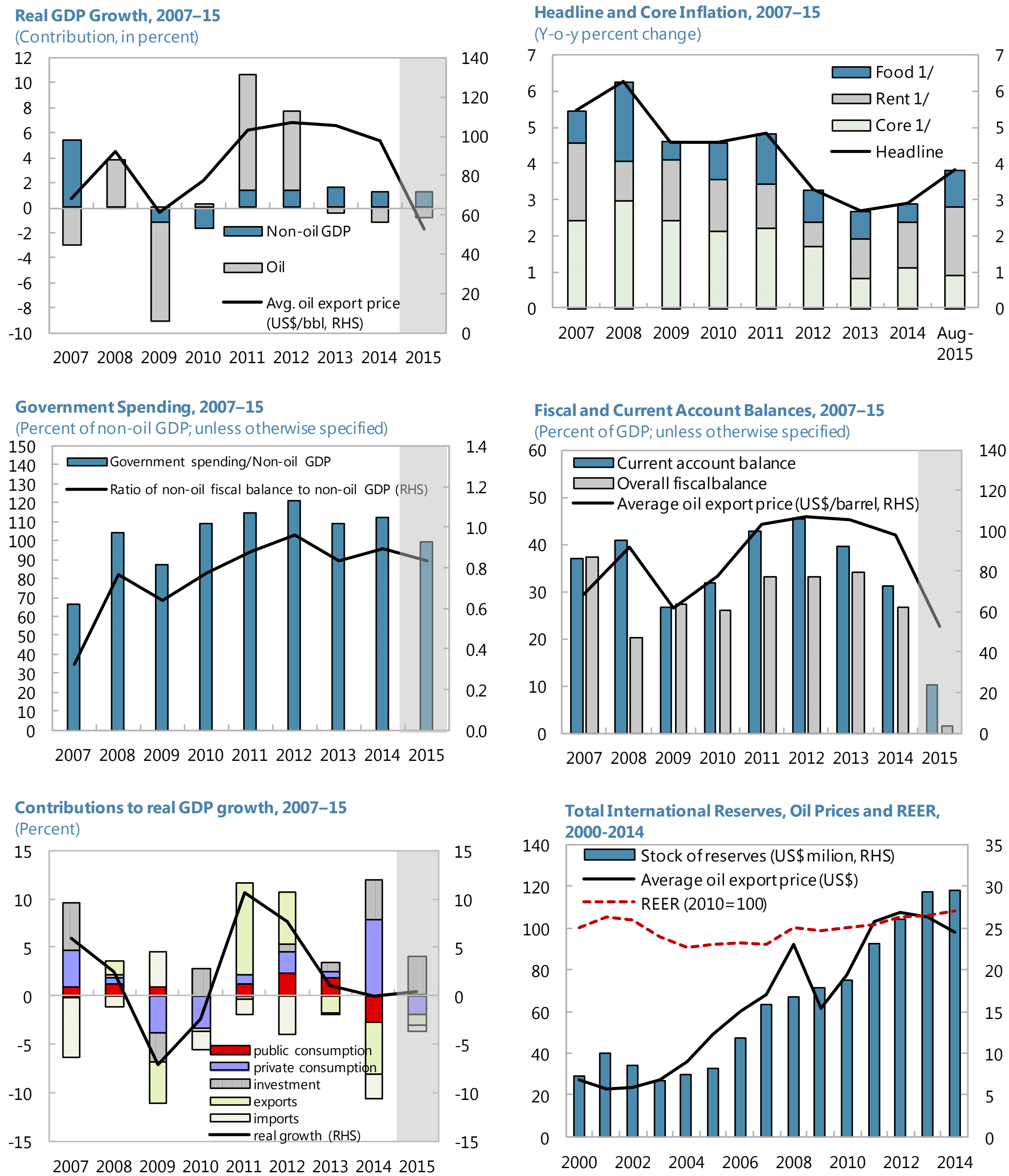
39. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Kuwait: Risk Assessment Matrix[1]			
Nature/source of main threats	**Likelihood of Risk**	**Expected impact on the economy if risk is realized**	**Recommended Policy Response**
Persistently low energy prices triggered by supply factors reversing only gradually, and weaker demand. Increased volatility due to uncertainty about the persistence of the oil supply shock and the underlying drivers of the price decline.	**Medium** **Medium**	**High** Fiscal and external revenues would fall further, and private sector confidence is likely to decline. Economic, credit, and asset price cycles move closely with oil price developments. The impact of oil prices on government revenues and expenditures could affect liquidity and credit growth in the banking system, but strong starting liquidity position of banks would help ensure a stable funding base.	The substantial fiscal and financial buffers built-up by Kuwait would allow the government to avoid knee-jerk cuts in government spending. However, with the decline in oil prices expected to persist, the government will need to commence implementing medium-term fiscal consolidation to bring spending into line with lower revenues. If prices decline further on a sustained basis, the consolidation will need to be faster and deeper. Develop a medium-term fiscal policy framework that is underpinned by a medium-term macroeconomic framework and a medium-term expenditure framework. Strengthen efforts toward diversification to reduce oil dependence and increase employment opportunities for nationals in the private sector. The CBK should ensure adequate liquidity in the banking system in case of an unanticipated liquidity shock.
Sharp asset price adjustment and decompression of credit spreads.	**High**	**Medium** Surges in market volatility and increased financial market distortions could pose funding, market and credit risks for ICs and banks. The local equity market can be affected by adverse movements in global financial conditions, imposing negative wealth effects on households' investments in local stocks. The real estate market is driven mainly by local demand-supply conditions, including land availability. Banks' exposure to the real estate and local equity market remains considerable.	Monitor the health of ICs and complete the restructuring of loss making ICs.

Kuwait: Risk Assessment Matrix (concluded)			
Nature/source of main threats	**Likelihood of Risk**	**Expected impact on the economy if risk is realized**	**Recommended Policy Response**
		Banks have limited, though increasing, wholesale funding, and foreign assets in the form of bank deposits and investments. ICs have large exposures to global and regional financial and real estate markets, and continue to be dependent on foreign financing. The Kuwait Investment Authority (KIA) also has substantial foreign investments, but the impact on KIA's assets is expected to be manageable. The nonfinancial corporate sector would get affected to the extent bank credit slows down and consumers reduce demand.	Establish a macroprudential framework and a coordinating mechanism to assess incipient systemic risks, and adjust macroprudential policies as needed to limit risks to the financial system. Further developing domestic bond market to provide corporates with alternate means of financing and investment, improving the domestic investment climate, reducing costs of doing business in Kuwait, strengthening corporate governance, and establishing bankruptcy procedures, would strengthen the corporate sector.
Heightened risk of fragmentation/state failure/security dislocation in the Middle East and some countries in Africa, leading to a sharp rise in oil price volatility and migrant flows, with negative global spillovers.	**Medium**	**Low** Oil prices could increase as a result of heightened tensions and conflict in the Middle East and create a positive impact on fiscal and current account balances. Disruptions in global financial markets could lead to temporary liquidity tightening in banks, force further deleveraging of ICs, and reduce credit growth of banks.	Complete the restructuring process of loss-making ICs. Establish a macroprudential framework and a coordinating mechanism to assess incipient risks and adjust macroprudential policies as needed to limit risks to the financial system.
Slow and inefficient implementation of the Development Plan (DP) 2015–19.	**Medium**	**Medium** Public expenditure misallocation and inefficiency would affect incentives and overall productivity and growth.	Integrate the DP into a medium-term fiscal framework to ensure continued implementation. Monitor the implementation of capital expenditure. Improve performance of the budget through a public expenditure review to support prioritization of public spending and strengthen anti-corruption efforts.
Severe property price correction	**Low**	**Medium** Banks have high exposure to the real estate sector but are highly capitalized and provisioned to absorb severe shocks.	Macroprudential tools can help mitigate potential risks. Construct real estate indices to help calibrate measures.

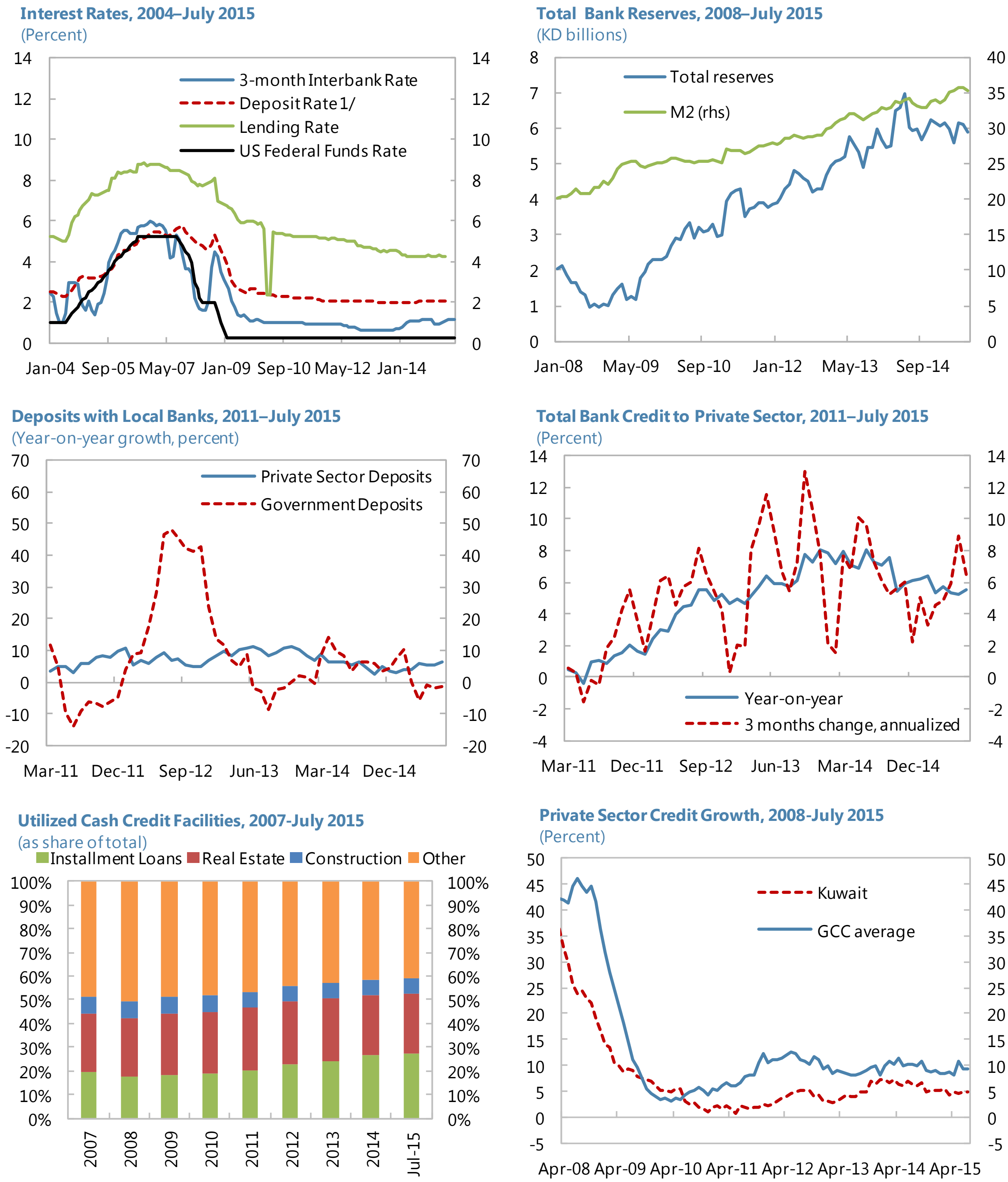
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Figure 1. Kuwait: Recent Macroeconomic Developments



Sources: Country authorities; EDSS; Haver; and IMF staff calculations.
1/ Contribution to headline CPI inflation.

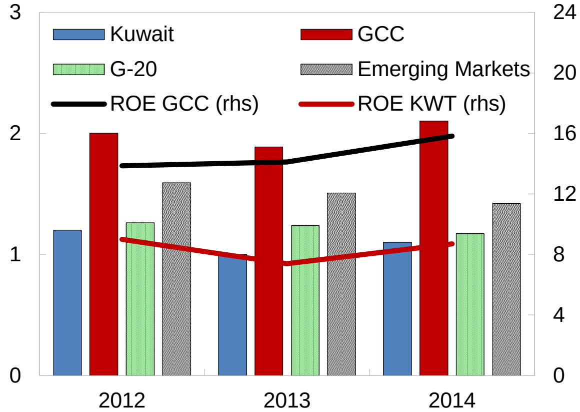
Figure 2. Kuwait: Monetary Developments



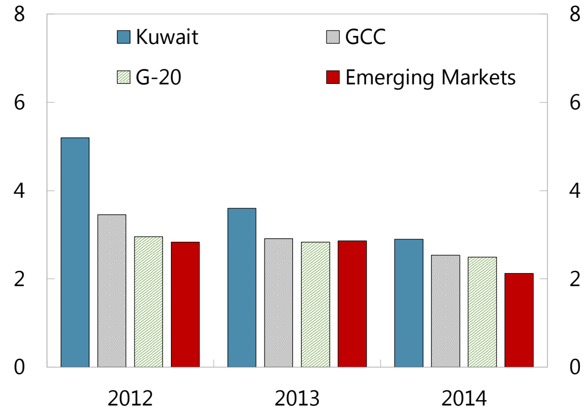
Sources: Country authorities; EDSS; Haver; and IMF staff calculations.
1/ Weighted average.

Figure 3. Kuwait: Financial Developments

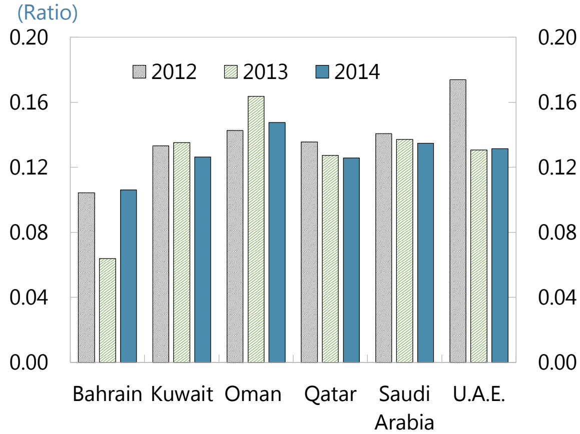
Return on Assets, 2012–14
(Percent)



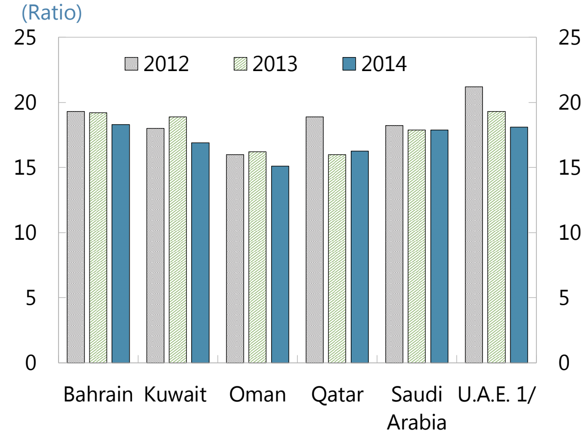
Nonperforming Loans, 2012–14
(Percent of total loans)



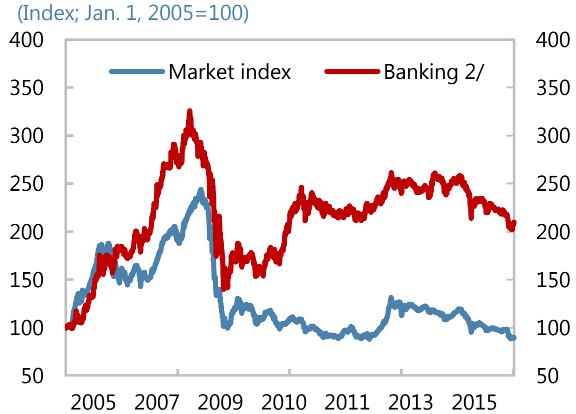
Leverage Ratio, 2012–14
(Ratio)



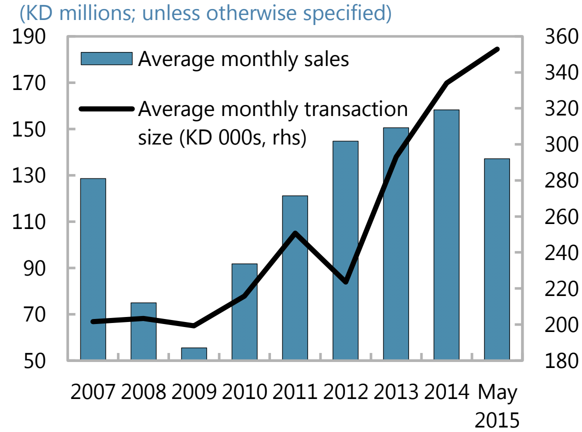
Capital Adequacy Ratio, 2012–14
(Ratio)



Equity Prices, 2005–September 2015
(Index; Jan. 1, 2005=100)



Real Estate Statistics, 2007–May 2015
(KD millions; unless otherwise specified)



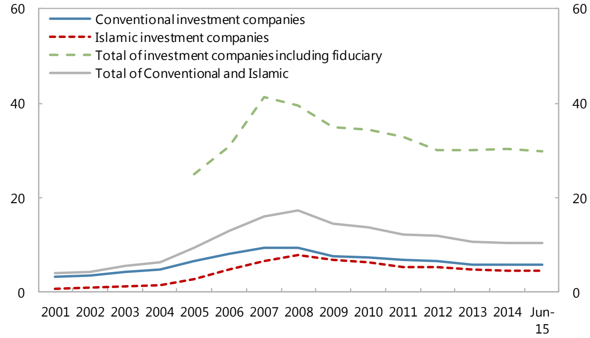
Sources: Country authorities; Kuwait Stock Exchange; NBK reports; and IMF staff estimates.
1/ Local banks only.
2/ Previous banking index has been discontinued and the new index starts from May 12, 2012.

Figure 4. Kuwait: Investment Companies Operations

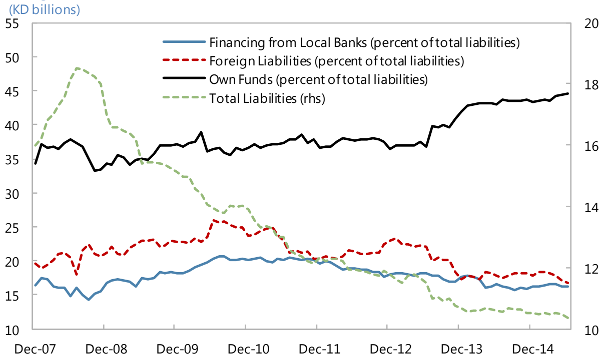
Investment Companies' Operations, 2002–2015
(KD billions)

	2002	2005	2007	2008	2009	2010	2011	2012	2013	2014	June 2015
Investment companies											
Conventional											
Number	27	33	40	46	46	46	44	43	42	40	38
Assets	3.5	6.7	9.4	9.5	7.6	7.3	6.9	6.6	5.9	5.8	5.9
Islamic											
Number	11	23	38	53	54	54	51	50	50	49	48
Assets	0.9	2.8	6.6	7.8	7.0	6.5	5.4	5.2	4.8	4.7	4.5
Conventional + Islamic											
Number	38	56	78	99	100	100	95	93	92	89	86
Assets	4.3	9.4	16.0	17.3	14.6	13.7	12.3	11.9	10.7	10.5	10.4
Off-balance sheet											
Assets		15.5	25.4	22.2	20.4	20.6	20.6	18.2	19.5	19.7	19.5
Total Assets	4.3	25.0	41.4	39.5	35.0	34.3	32.9	30.0	30.2	30.3	29.9
Percent of GDP		105.9	127.0	99.7	114.9	103.7	77.1	61.8	60.5	61.6	79.6
Percent of banking assets		115.6	116.4	100.7	86.9	82.9	74.4	63.8	58.6	54.6	51.9

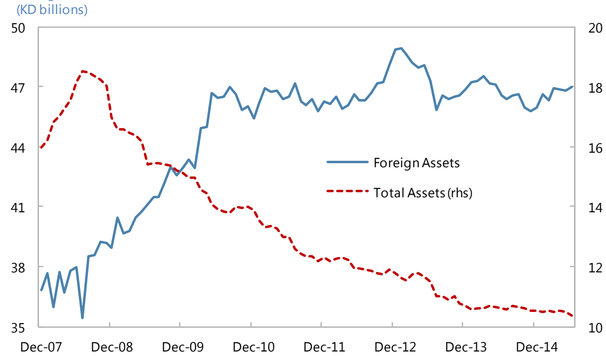
Assets, 2001–June 2015
(KD billions)



Foreign Liabilities, 2007–June 2015
(KD billions)

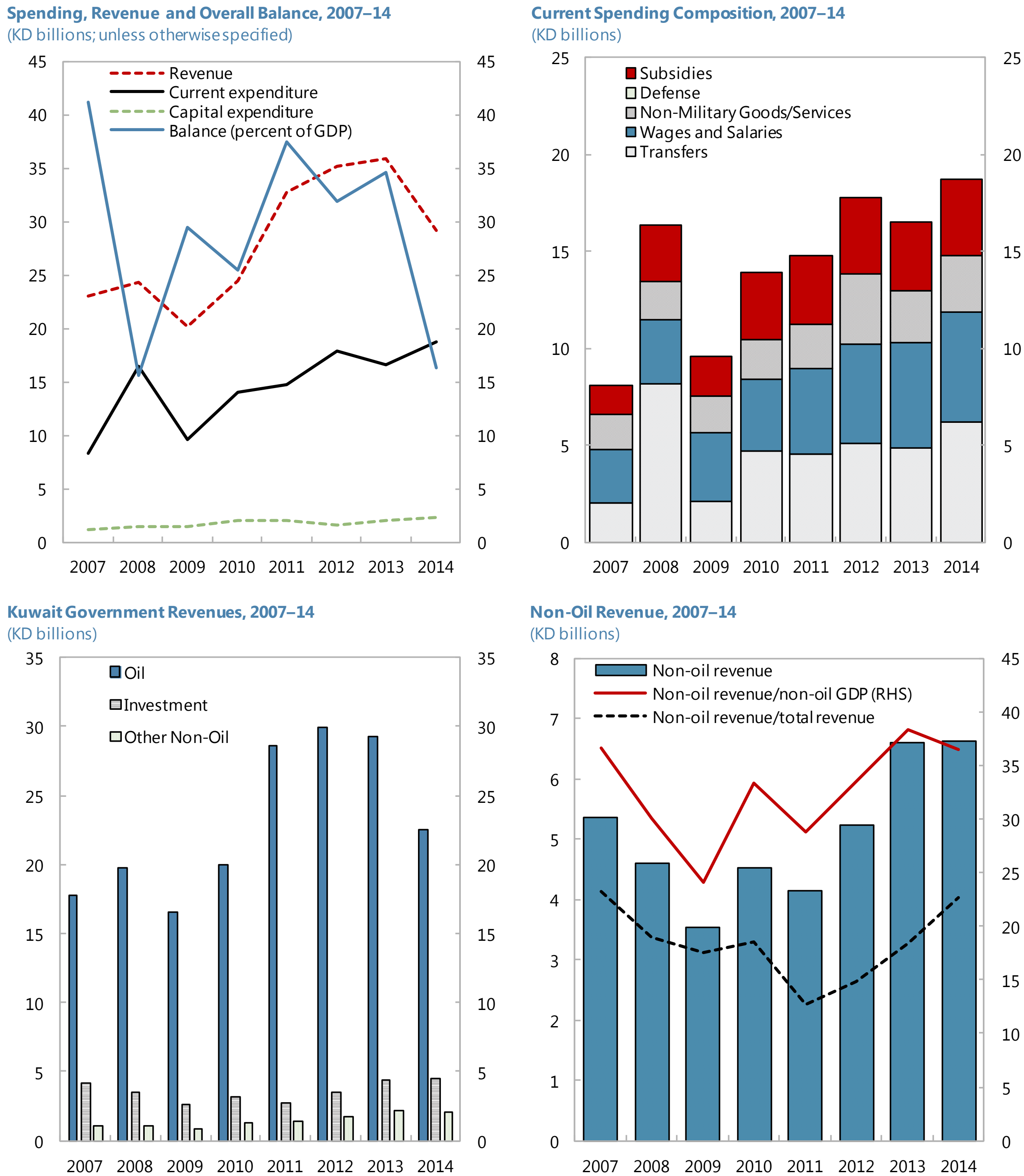


Foreign Assets, 2007–June 2015
(KD billions)



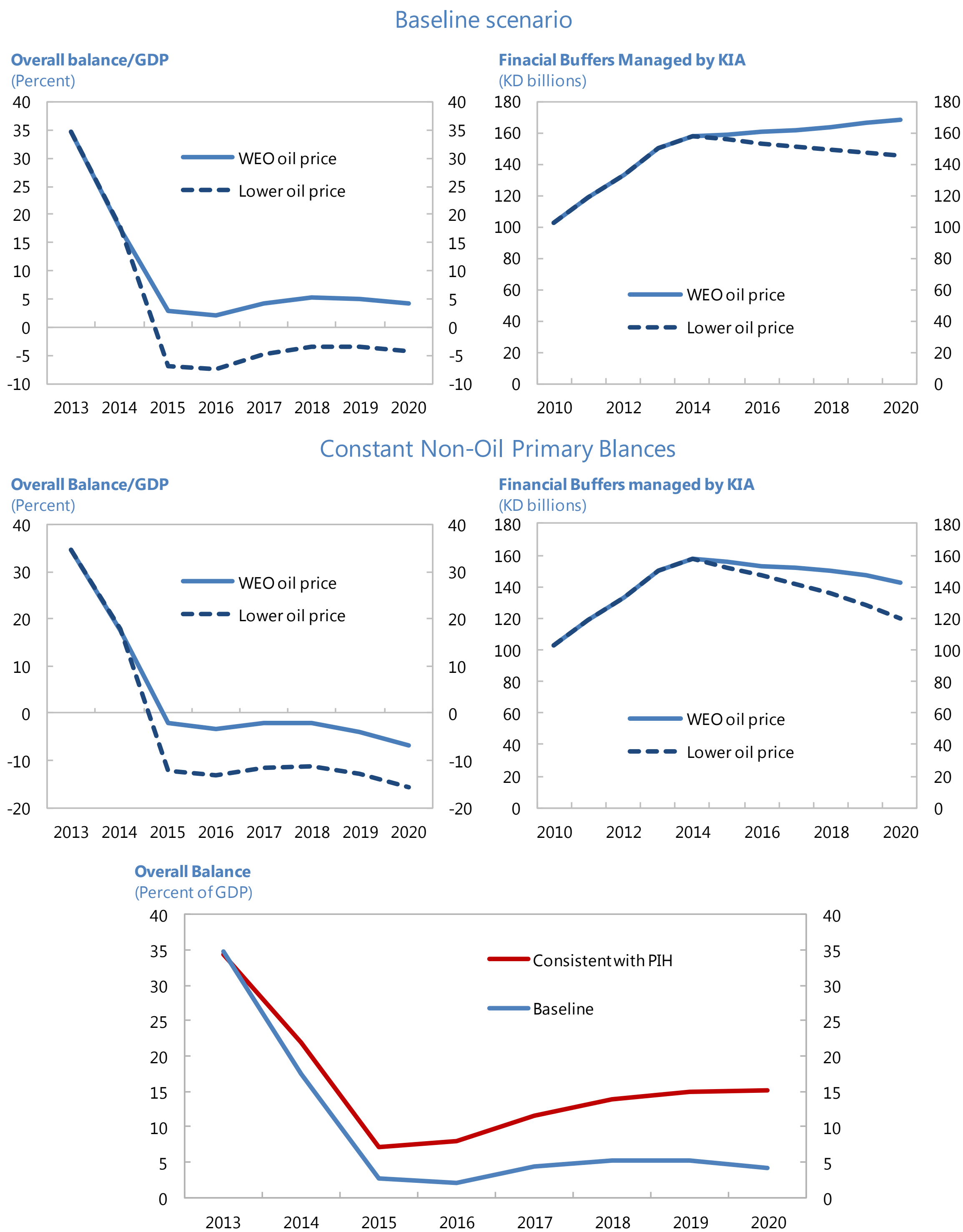
Sources: Country authorities; and IMF staff calculations.

Figure 5. Kuwait: Fiscal Developments



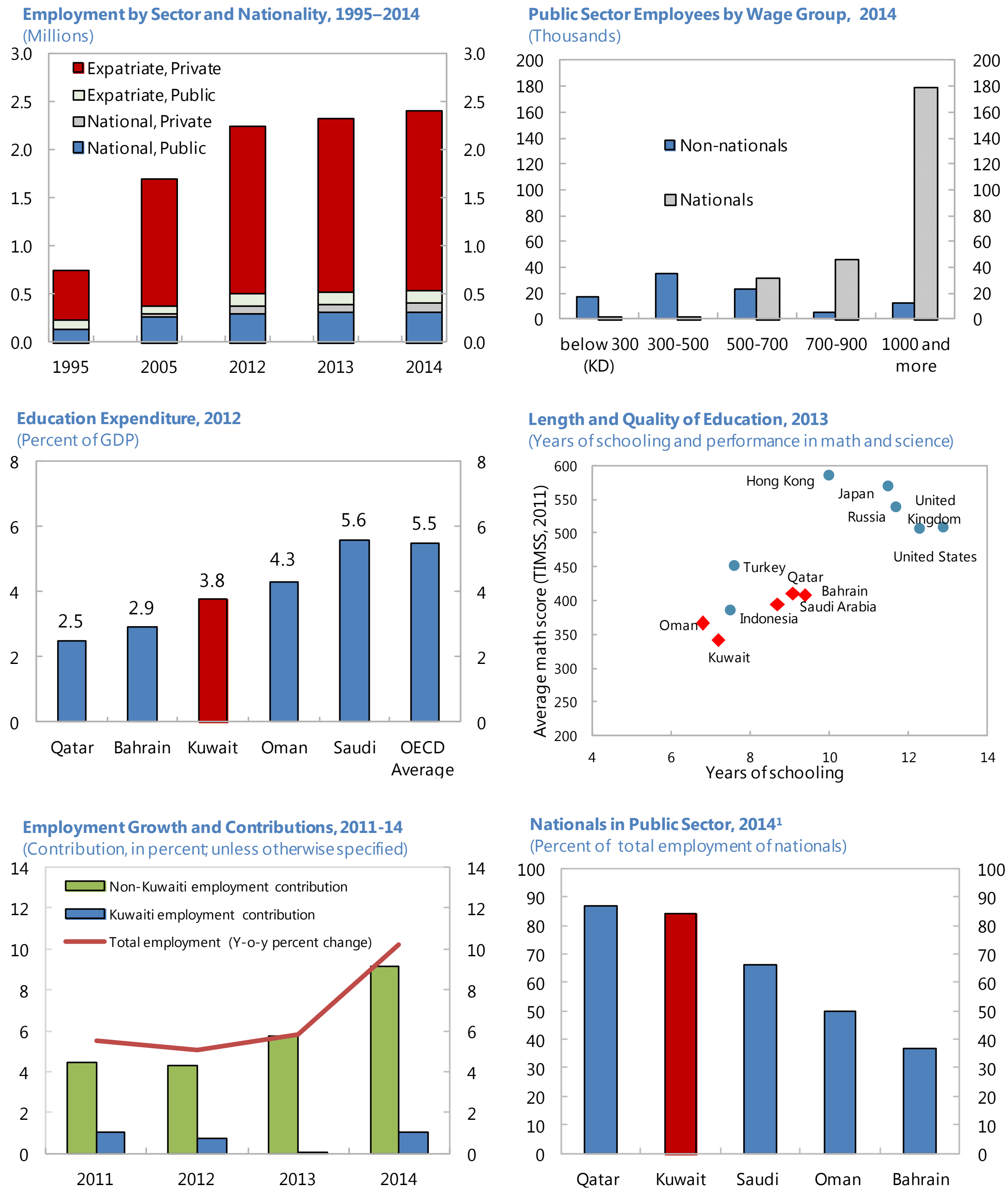
Sources: Country authorities; and IMF staff calculations.

Figure 6. Fiscal Position Under Different Scenarios



Source: IMF staff calculations.

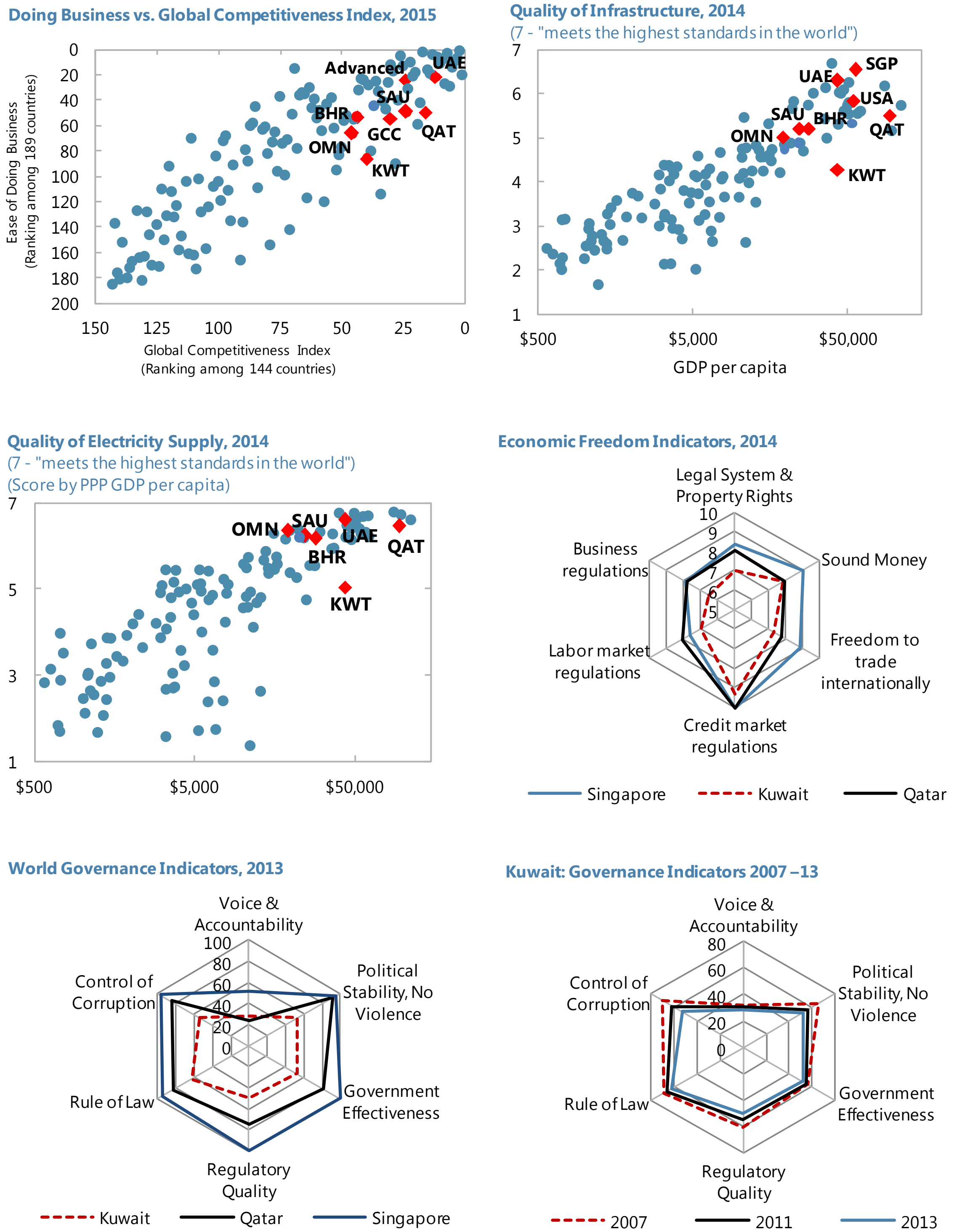
Figure 7. Kuwait: Labor Market Indicators



Sources: Country authorities; UNDP; and IMF staff calculations.

[1] Data compiled from "Comparing the Employment-Output Elasticities of Expatriates and Nationals in the Gulf Cooperation Council", forthcoming IMF working paper; and Kuwait's Labour Force Survey, 2014.

Figure 8. Kuwait: Institutions and Governance



Sources: World Bank: *World Governance Indicators*; Fraser Institute: *Economic Freedom in the World*; UNDP: Human Development Index, TIMSS.

Table 1. Kuwait: Selected Economic Indicators, 2011–2020

(Quota: SDR 1,381.1 million)
(Population:4 million; Dec. 2014)
(Per capita GDP: $43,119; 2014 estimate)
(Poverty rate: n.a.)
(Main export: oil)

			Prel.	Proj.						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Oil and gas sector										
Total oil and gas exports (billions of U.S. dollars)	96.7	112.9	108.6	97.6	51.8	51.0	57.2	63.0	66.8	68.9
Average oil export price (U.S. dollars/barrel)	103.3	107.1	105.5	98.0	52.7	51.5	56.7	61.3	63.7	64.6
Crude oil production (millions of barrels/day)	2.66	2.98	2.93	2.87	2.83	2.89	2.94	3.00	3.06	3.12
(Annual percentage change, unless otherwise indicated)										
National accounts and prices										
Nominal GDP (market prices, in billions of Kuwaiti dinar)	42.5	48.7	49.9	49.0	36.4	37.8	41.7	45.6	49.0	52.2
Nominal GDP (market prices, in billions of U.S. dollars)	154.0	174.1	175.8	172.4	121.7	125.2	138.0	150.7	162.3	172.6
Real GDP (at factor cost)	10.6	7.7	1.0	0.0	0.3	2.4	2.6	2.6	2.8	2.8
Real oil GDP	15.6	10.3	-0.8	-1.9	-1.4	2.0	2.0	2.0	2.0	2.0
Real non-oil GDP	3.4	3.4	4.2	3.2	3.0	3.0	3.5	3.5	4.0	4.0
CPI inflation (average)	4.9	3.2	2.7	2.9	3.4	3.4	3.5	3.5	3.5	3.6
Unemployment rate (Kuwaiti nationals)	4.7	4.7	4.7	5.0						
(Percent of GDP at market prices)										
Investment and savings										
Investment	13.5	12.8	14.2	15.5	21.8	22.5	21.9	21.5	21.3	21.5
Public	4.7	3.6	3.9	4.6	7.6	8.0	7.6	7.2	7.0	6.8
Private[1]	8.9	9.3	10.4	10.9	14.3	14.6	14.3	14.3	14.4	14.7
Gross national savings	57.1	58.7	56.6	46.8	32.2	31.6	33.3	34.2	34.5	34.4
Public	57.1	56.9	55.1	51.0	30.5	28.2	29.6	30.1	29.4	28.0
Private [1]	0.0	1.7	1.5	-4.3	1.7	3.4	3.7	4.1	5.1	6.5
(Percent of GDP at market prices)										
Budgetary operations [2]										
Revenue	74.2	71.7	72.2	63.5	53.9	53.0	53.4	52.9	51.9	50.3
Oil	64.8	61.2	59.0	49.0	38.1	37.5	38.7	39.2	38.6	37.5
Non-oil, *of which:*	9.4	10.6	13.2	14.4	15.8	15.4	14.7	13.8	13.2	12.8
Investment income	6.1	7.1	8.8	9.8	12.8	12.6	12.0	11.3	10.8	10.5
Expenditures	38.2	40.1	37.5	46.1	51.2	50.9	49.0	47.6	46.7	46.1
Expense [3]	33.6	36.4	33.4	40.9	43.3	43.0	41.6	40.5	39.8	39.4
Capital	4.5	3.6	4.1	5.1	7.9	7.9	7.5	7.2	6.9	6.8
Balance	36.1	31.7	34.8	17.4	2.8	2.1	4.3	5.3	5.1	4.2
Balance (after transfer to FGF and excl. inv. income)	24.7	10.1	11.7	-4.4	-12.5	-12.8	-9.9	-8.3	-8.0	-8.6
Domestic financing	-0.2	-1.9	-0.8	-0.3	-0.5	0.7	-0.8	-0.8	-0.5	-0.6
External financing (change in buffers)	-24.5	-8.3	-11.0	4.7	12.9	12.1	10.7	9.1	8.5	9.2
Non-oil balance (percent of non-oil GDP) [4]	-97.3	-105.5	-87.9	-97.0	-89.0	-87.0	-85.2	-83.1	-80.4	-77.6
Total gross debt (calendar year-end) [5]	4.6	3.6	3.1	3.2	4.4	4.2	3.8	3.5	3.3	3.1
(Percent change; unless otherwise indicated)										
Money and credit										
Net foreign assets [6]	22.0	20.6	11.1	4.0	4.6	3.8	5.2	5.4	6.4	6.5
Claims on nongovernment sector	2.3	3.1	7.2	5.2	4.7	4.6	4.8	4.9	5.1	5.3
Kuwaiti dinar 3-month deposit rate (year average; in percent)	1.1	1.0	0.8	0.8	…	…	…	…	…	…
Stock market unweighted index (annual percent change) [7]	-16.4	2.1	27.2	-13.4	…	…	…	…	…	…
(Billions of U.S. dollars, unless otherwise indicated)										
External sector										
Exports of goods	102.8	119.7	115.8	104.8	58.7	58.3	65.0	71.3	75.6	78.3
Of which: non-oil exports	6.1	6.7	7.2	7.3	6.9	7.3	7.8	8.3	8.8	9.4
Annual percentage change	15.3	9.5	6.6	1.3	-5.0	5.8	7.0	6.6	6.2	6.1
Imports of goods	-22.6	-24.2	-25.6	-27.4	-25.7	-26.1	-27.2	-28.4	-29.6	-30.9
Current account	65.7	78.7	69.5	53.8	12.5	11.2	15.6	19.1	21.3	22.2
Percent of GDP	42.7	45.2	39.5	31.2	10.2	8.9	11.3	12.6	13.1	12.9
International reserve assets [8]	26.0	29.0	32.2	32.3	33.0	33.3	34.3	35.3	36.9	38.5
In months of imports of goods and services	7.5	7.7	8.3	7.6	8.2	8.1	8.0	7.9	7.9	7.9
Memorandum items:										
Exchange rate (U.S. dollar per KD, period average)	3.62	3.57	3.53	3.52	…	…	…	…	…	…
Nominal effective exchange rate (NEER, period average)	0.5	1.6	1.0	1.5	…	…	…	…	…	…
Real effective exchange rate (REER, period average)	1.7	3.2	0.8	2.0	…	…	…	…	…	…
Sovereign rating (S&P)	AA	AA	AA	AA	…	…	…	…	…	…

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

[1] Also includes government entities.

[2] Based on fiscal year cycle which starts on April 1 and ends on March 31.

[3] In 2006/07 KD 2 billion was transferred to partly cover the actuarial deficit of the Public Pension Fund.

[3] In 2008/09, KD 5.5 billion was transferred. KD 1.1 billion is budgeted for each year from 2010/11 to 2014/15.

[4] Excludes investment income and pension recapitalization.

[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, 2013/14–2020/21

					Proj.			
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
				(Billions of Kuwaiti Dinars)				
Revenue (includes grants) (A)	**35.9**	**29.1**	**19.8**	**20.6**	**22.8**	**24.6**	**25.8**	**26.7**
Taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5
Other revenue	35.5	28.7	19.4	20.1	22.3	24.1	25.4	26.2
Oil and gas	29.3	22.5	14.0	14.6	16.5	18.2	19.2	19.9
Investment income and transfer of profits of public entities [1]	4.4	4.5	4.7	4.9	5.1	5.2	5.4	5.6
Other [2]	1.8	1.7	0.7	0.7	0.7	0.7	0.7	0.8
		1.136						
Total expenditure (B=C+D)	**18.6**	**21.1**	**18.8**	**19.7**	**20.9**	**22.1**	**23.3**	**24.5**
Expense (C)	16.6	18.8	15.9	16.7	17.7	18.8	19.8	20.9
Compensation of employees	5.4	5.7	5.9	6.2	6.5	6.9	7.2	7.7
Purchases/use of goods & services [3]	2.7	2.9	3.1	3.3	3.5	3.8	4.1	4.4
Interest [4]	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Subsidies and social benefits [5, 6]	6.8	7.6	5.3	5.5	5.9	6.3	6.6	6.8
Subsidies	2.8	2.4	2.0	2.1	2.3	2.6	2.7	2.8
Oil-related subsidies	2.8	2.4	2.0	2.1	2.3	2.6	2.7	2.8
Other subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	4.0	5.2	3.3	3.4	3.6	3.7	3.9	4.0
Payments to social security fund	2.8	3.1	2.0	2.1	2.1	2.2	2.3	2.3
Transfers to social security fund	1.7	2.0	2.0	2.1	2.1	2.2	2.3	2.3
Fund recapitalization	1.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Other social benefits	1.2	2.1	1.3	1.4	1.4	1.5	1.6	1.7
Oil-related	0.6	1.3	0.4	0.4	0.4	0.5	0.5	0.5
Others	0.6	0.8	0.9	1.0	1.0	1.1	1.1	1.1
Expense not elsewhere classified	1.6	2.5	1.7	1.7	1.8	1.8	1.9	1.9
Net acquisition of nonfinancial assets (D)	2.0	2.4	2.9	3.1	3.2	3.3	3.5	3.6
Purchases of nonfinancial assets	2.0	2.4	3.0	3.1	3.2	3.3	3.5	3.6
Sales of nonfinancial assets	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Gross operating balance [=A-C]	**19.3**	**10.3**	**3.9**	**3.9**	**5.0**	**5.8**	**6.0**	**5.8**
Net lending / borrowing [=A-B]	**17.2**	**8.0**	**1.0**	**0.8**	**1.8**	**2.5**	**2.6**	**2.2**
Overall excluding 10 % trasfer and Inv. Income	5.8	-2.0	-4.6	-5.0	-4.2	-3.9	-4.0	-4.6
Non-oil balance	-12.0	-14.5	-13.0	-13.8	-14.7	-15.7	-16.7	-17.7
excluding investment income	-16.4	-19.0	-17.7	-18.6	-19.8	-21.0	-22.1	-23.2
excluding recapitalization of pension	-15.3	-17.9	-17.7	-18.6	-19.8	-21.0	-22.1	-23.2
excluding oil-related subsidies and benefits	-11.9	-14.2	-15.3	-16.2	-17.1	-17.9	-18.9	-19.9
Financing	-5.8	2.0	4.6	5.0	4.2	3.9	4.0	4.6

Table 2. Kuwait: Summary of Government Finance, 2013/14–2020/21 (concluded)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
				Proj.				
				(Percent of GDP)				
Revenue (includes grants)	72.2	63.5	53.9	53.0	53.4	52.9	51.9	50.3
Taxes	0.8	0.9	1.1	1.1	1.0	1.0	0.9	0.9
Other revenue	71.4	62.6	52.8	51.9	52.4	52.0	50.9	49.4
Oil and gas	59.0	49.0	38.1	37.5	38.7	39.2	38.6	37.5
Investment income and transfer of profits of public entities	8.8	9.8	12.8	12.6	12.0	11.3	10.8	10.5
Other	3.6	3.7	1.9	1.7	1.6	1.5	1.5	1.4
Total expenditure	37.5	46.1	51.2	50.9	49.0	47.6	46.7	46.1
Expense	33.4	40.9	43.3	43.0	41.6	40.5	39.8	39.4
Compensation of employees	10.9	12.4	15.9	15.9	15.3	14.8	14.5	14.4
Purchases/use of goods & services	5.4	6.3	8.3	8.4	8.2	8.2	8.2	8.4
Interest	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Subsidies and social benefits	13.7	16.6	14.4	14.1	13.8	13.5	13.2	12.9
Subsidies	5.7	5.3	5.4	5.3	5.5	5.5	5.5	5.4
Oil-related subsidies	5.7	5.3	5.4	5.3	5.4	5.5	5.5	5.3
Other subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	8.1	11.2	9.0	8.8	8.4	8.0	7.7	7.5
Payments to Social Security Fund	5.7	6.7	5.4	5.3	5.0	4.7	4.5	4.4
Transfers to Social Security Fund	3.5	4.4	5.4	5.3	5.0	4.7	4.5	4.4
Fund recapitalization	2.2	2.4	0.0	0.0	0.0	0.0	0.0	0.0
Other social benefits	2.4	4.5	3.6	3.5	3.4	3.3	3.2	3.1
Oil-related	1.3	2.8	1.0	1.0	1.0	1.0	1.0	1.0
Others	1.1	1.7	2.6	2.5	2.4	2.3	2.2	2.2
Expense not elsewhere classified	3.2	5.5	4.5	4.4	4.1	3.9	3.7	3.6
Net acquisition of nonfinancial assets	4.1	5.1	7.9	7.9	7.5	7.2	6.9	6.8
Gross operating balance	38.8	22.5	10.7	10.0	11.8	12.4	12.1	10.9
Net lending / borrowing	34.7	17.4	2.8	2.1	4.3	5.3	5.1	4.2
Overall excluding 10 % trasfer and Inv. Income	11.7	-4.4	-12.5	-12.8	-9.9	-8.3	-8.0	-8.6
Non-oil balance	-24.3	-31.6	-35.3	-35.4	-34.4	-33.9	-33.5	-33.3
excluding investment income	-33.1	-41.5	-48.1	-48.1	-46.4	-45.1	-44.3	-43.8
excluding recapitalization of pension	-30.9	-39.1	-48.1	-48.1	-46.4	-45.1	-44.3	-43.8
excluding oil-related subsidies and benefits	-23.9	-30.9	-41.7	-41.8	-40.0	-38.6	-37.9	-37.5
				(Percent of nonoil GDP)				
Revenue (includes grants)	205.7	157.6	99.8	95.9	97.9	97.4	94.0	89.1
Total expenditure	106.8	114.4	94.7	92.1	90.0	87.6	84.7	81.7
Gross operating balance	110.5	56.0	19.7	18.1	21.7	22.9	21.9	19.3
Net lending / borrowing	98.9	43.2	5.1	3.8	7.9	9.7	9.3	7.4
Non-oil balance	-69.1	-78.6	-65.4	-64.2	-63.1	-62.3	-60.7	-59.0
excluding investment income	-94.2	-102.9	-89.0	-87.0	-85.2	-83.0	-80.3	-77.5
excluding recapitalization of pension	-87.9	-97.0	-89.0	-87.0	-85.2	-83.0	-80.3	-77.5
excluding oil-related subsidies and benefits	-68.2	-76.8	-77.3	-75.7	-73.4	-71.1	-68.6	-66.4
Memorandum items:								
Expenses excl. recapitalization of pension fund (percent of nonoil GDP)	88.9	95.7	80.1	77.8	76.3	74.5	72.1	69.7
Oil-related subsidies and benefits (percent of nonoil GDP)	19.8	20.2	11.8	11.3	11.8	12.0	11.7	11.2
Kuwait Crude oil price, USD per barrel	103.6	86.7	52.4	52.8	57.8	61.9	63.9	64.6

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

[1] Excluded from the national budget presentation. Estimated by Fund 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 billion was transferred. KD 1.1 billion is budgeted for each year from 2010/11 to 2014/15.

[6] The 2006/07 budget reflects KD 195 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, 2011–16

				Prel.	Proj.	
	2011	2012	2013	2014	2015	2016
	(Billions of U.S. dollars, unless otherwise indicated)					
Current account	**65.7**	**78.7**	**69.5**	**53.8**	**12.5**	**11.2**
Goods (trade balance)	80.2	95.4	90.2	77.4	33.0	32.2
Exports	102.8	119.7	115.8	104.8	58.7	58.3
Oil exports	96.7	112.9	108.6	97.6	51.8	51.0
Non-oil exports including re-exports[1]	6.1	6.7	7.2	7.3	6.9	7.3
Of which: re-exports	1.0	1.3	1.5	1.5	1.4	1.5
Imports	-22.6	-24.2	-25.6	-27.4	-25.7	-26.1
Services	-8.9	-12.3	-14.8	-17.5	-16.7	-17.1
Transportation	-1.1	-2.6	-4.0	-4.0	-3.8	-3.9
Insurance	0.0	0.0	0.0	0.0	0.0	0.0
Travel	-7.7	-8.8	-9.4	-10.9	-10.4	-10.6
Other services	-0.1	-0.8	-1.5	-2.6	-2.5	-2.6
Investment income	9.2	12.7	13.3	14.6	15.5	16.1
Receipts	10.6	14.0	14.6	16.1	17.1	17.6
General government[2]	7.5	9.1	11.4	12.8	13.5	13.7
Other sectors[3]	3.1	4.9	3.2	3.4	3.6	4.0
Payments	-1.4	-1.3	-1.4	-1.4	-1.4	-1.4
General government	0.0	0.0	-0.7	-0.8	-0.7	-0.7
Other	-1.4	-1.3	-0.7	-0.6	-0.6	-0.6
Current transfers[4]	-14.8	-17.1	-19.1	-20.7	-19.4	-20.0
Capital and financial account	**-57.3**	**-76.5**	**-64.2**	**-53.0**	**-11.7**	**-10.9**
Capital account[5]	3.4	4.2	4.5	4.0	3.9	4.0
Financial account	-60.7	-80.8	-68.7	-57.0	-15.6	-14.9
Direct investment	-7.5	-3.9	-15.2	-12.6	-2.8	-2.5
Abroad[6]	-10.8	-6.7	-16.6	-13.1	-3.3	-3.0
In Kuwait	3.3	2.9	1.4	0.5	0.5	0.5
Portfolio investment	-7.7	-23.9	-21.2	-41.7	-14.7	-16.4
Other investment (net)	-45.5	-53.0	-32.2	-2.8	1.8	4.0
Net errors and omissions[7]	-4.0	1.1	-2.0	-0.7	0.0	0.0
Overall balance	**4.5**	**3.3**	**3.3**	**0.0**	**0.8**	**0.3**
Memorandum items						
Current account/GDP (in percent)	42.7	45.2	39.5	31.2	10.2	8.9
Current account (excl. oil)/GDP (in percent)	-20.1	-19.7	-22.2	-25.4	-32.3	-31.9
Investment income/GDP (in percent)	6.0	7.3	7.5	8.6	12.9	13.0
WEO oil price (dollars per barrel)	104.0	105.0	104.1	96.2	51.6	50.4
Import growth (in percent)	15.5	7.3	5.5	7.1	-6.1	1.6
International reserve assets (billions of U.S. dollars)[8]	26.0	29.0	32.2	32.3	33.0	33.3
In months of imports of goods and services	7.5	7.7	8.3	7.6	8.2	8.1

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 Kuwait company.

[7] Includes other unclassified private-sector flows.

[8] Includes SDRs and IMF reserve position.

Table 4. Kuwait: Monetary Survey, 2011–16

End of period	2011	2012	2013	Prel. 2014	Proj. 2015	2016
			(Millions of KD)			
Foreign assets (net) [1]	11,468	13,827	15,359	15,971	16,713	17,352
Central bank	6,401	7,323	8,250	8,588	8,800	8,887
Local banks	5,067	6,505	7,109	7,383	7,914	8,465
Domestic assets (net)	16,279	15,842	17,199	17,650	18,406	19,285
Claims on government (net)	-2,904	-3,814	-4,189	-4,340	-4,508	-4,231
Central bank (net)	-682	-543	-635	-616	-1,086	-779
Claims	0	0	0	0	0	0
Deposits	682	543	635	616	1,086	779
Local banks (net)	-2,222	-3,271	-3,554	-3,723	-3,422	-3,452
Claims	1,887	1,684	1,502	1,563	1,576	1,576
Government debt bonds	0	0	0	0	0	0
Public debt instruments	1,887	1,684	1,502	1,563	1,576	1,576
Other claims	0	0	0	0	0	0
Deposits	4,009	4,955	5,057	5,286	4,998	5,028
Claims on nongovernment sector	28,144	29,021	31,099	32,706	34,237	35,795
Credit facilities	25,612	26,797	28,911	30,737	32,175	33,639
Local investments	2,533	2,224	2,188	1,969	2,062	2,155
Other items (net)	-8,961	-9,365	-9,710	-10,717	-11,323	-12,279
Broad money [2]	27,747	29,669	32,558	33,621	35,119	36,637
Money	6,366	7,654	8,677	9,253	9,671	10,101
Quasi money	21,381	22,015	23,882	24,367	25,447	26,536
Of which: Foreign currency deposits	2,078	2,272	3,122	2,891	3,007	3,119
			(Annual percentage change)			
Foreign assets (net)	22.0	20.6	11.1	4.0	4.6	3.8
Central Bank	23.4	14.4	12.7	4.1	2.5	1.0
Local banks	20.3	28.4	9.3	3.9	7.2	7.0
Domestic assets (net)	3.2	-2.7	8.6	2.6	4.3	4.8
Claims on government (net)	-2.6	-31.3	-9.8	-3.6	-3.9	6.1
Claims on nongovernment sector	2.3	3.1	7.2	5.2	4.7	4.6
Other items (net)	0.7	4.5	3.7	10.4	5.7	8.4
Broad money	10.2	6.9	9.7	3.3	4.5	4.3
Money	23.6	20.2	13.4	6.6	4.5	4.4
Quasi money	6.8	3.0	8.5	2.0	4.4	4.3
Of which: foreign currency deposits	-0.1	9.3	37.4	-7.4	4.0	3.7
			(Change in percent of beginning of period broad money stock)			
Foreign assets (net)	8.2	8.5	5.2	1.9	2.2	1.8
Central bank	4.8	3.3	3.1	1.0	0.6	0.2
Local banks	3.4	5.2	2.0	0.8	1.6	1.6
Domestic assets (net)	2.0	-1.6	4.6	1.4	2.2	2.5
Claims on government (net)	-0.3	-3.3	-1.3	-0.5	-0.5	0.8
Claims on nongovernment sector	2.5	3.2	7.0	4.9	4.6	4.4
Other items (net)	-0.2	-1.5	-1.2	-3.1	-1.8	-2.7
Broad money	10.2	6.9	9.7	3.3	4.5	4.3
Money	4.8	4.6	3.4	1.8	1.2	1.2
Quasi money	5.4	2.3	6.3	1.5	3.2	3.1
Of which: Foreign currency deposits	0.0	0.7	2.9	-0.7	0.3	0.3
Memorandum items:						
Non-oil GDP/M2 (in peercent)	51.9	52.4	52.8	54.0	55.5	57.3
Foreign currency deposits/M2 (in percent)	7.5	7.7	9.6	8.6	8.6	8.5
Private credit/non-oil GDP (in percent)	144.0	135.5	132.0	138.8	137.1	135.9

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. Financial Soundness Indicators of the Banking Sector, 2006–15

(Percent unless specified otherwise)[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mar-15
Capital adequacy										
Regulatory capital to risk-weighted assets	20.2	19.3	15.6	16.7	18.9	18.5	18.0	18.9	16.9	16.9
Regulatory Tier I capital to risk-weighted assets	17.7	17.2	14.3	14.9	17.3	16.9	16.0	17.1	15.6	15.6
Capital to assets	12.6	12.3	10.9	11.4	12.6	12.4	12.6	12.2	11.1	10.8
Loan composition and quality										
Oil/gas	0.7	0.8	0.9	1.2	1.2	1.1	1.6	1.5	2.2	2.2
Trade	11.8	10.4	10.2	10.6	10.0	10.5	12.1	13.0	12.8	12.9
Industry	5.0	5.9	6.8	6.5	7.0	7.1	7.9	7.8	7.3	7.4
Construction	13.4	12.6	11.9	11.4	12.7	12.1	12.6	12.2	11.9	11.7
Real estate	17.5	19.2	18.1	20.6	20.0	19.6	19.2	18.9	18.5	18.3
Equity purchase loans (corporate)	5.4	4.5	5.8	5.9	5.7	5.8	3.5	3.4	3.0	3.0
Agriculture/fishing	0.2	0.1	0.7	0.3	0.4	0.2	0.3	0.3	0.4	0.3
Financial Institutions	14.6	15.9	12.8	12.7	14.1	13.1	11.2	10.4	11.9	12.1
Of which: investment companies	5.3	7.9	7.5	8.0	8.7	6.1	4.3	4.0	3.1	3.2
Of which: banks	0.0	0.0	0.0	0.0	4.6	3.7	6.7	5.7	8.0	8.1
Public services	1.6	2.2	1.9	1.6	1.6	1.7	2.6	1.8	2.2	2.4
Households	20.3	19.1	16.0	16.1	16.3	17.0	19.4	20.0	20.2	20.2
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	13.2	14.4	14.8	14.9
Of which: consumer loans	3.7	4.1	2.5	1.0	2.2	2.2	2.9	3.0	2.9	2.8
Of which: equity purchase loans (individuals)	1.8	2.1	2.0	1.9	1.4	1.4	2.9	2.6	2.6	2.5
Other	9.6	9.2	14.8	13.3	11.1	11.8	9.5	10.7	9.7	9.5
Gross non-performing loans to total loans	4.6	3.8	6.8	11.5	8.9	7.3	5.2	3.6	2.9	2.8
NPLs net of specific provisions to total loans net of specific provisions	2.5	2.1	4.9	7.4	6.1	5.3	3.8	2.5	1.9	1.7
Total provisions to gross NPLs	…	…	…	…	…	…	95.1	134.6	163.9	168.6
Specific provisions to gross NPLs	47.4	47.2	29.0	38.3	33.9	29.5	26.9	31.7	…	…
NPLs net of specific provisions to Tier I capital	12.6	10.8	31.5	46.2	33.8	28.7	22.4	13.9	11.2	10.4
Loans to shareholders, parent companies, & directors to total loans	4.9	4.2	4.9	6.4	2.0	2.3	2.6	6.3	3.6	3.8
Large exposures to Tier I capital	147.6	141.6	212.4	165.1	124.3	105.3	100.4	87.2	97.1	104.6
Specific provisions to gross loans	2.2	1.8	2.0	4.4	3.0	2.1	1.4	1.2	1.0	1.0
Profitability										
Return on Average Assets (ROAA) [2]	2.7	3.3	0.8	0.7	1.2	1.1	1.2	1.0	1.1	1.1
Return on Average Equity (ROAE) [2]	20.1	24.3	6.5	6.1	9.1	8.1	9.0	7.4	8.7	8.9
Net interest income to gross income	33.9	29.0	36.6	44.5	49.9	47.6	48.1	49.9	47.1	47.1
Non-interest income to gross income	29.0	29.0	21.6	25.3	24.6	33.1	33.4	32.8	30.8	30.8
Trading and foreign exchange income to gross income	13.7	15.1	6.7	6.0	4.1	10.0	14.9	10.4	12.5	13.2
Non-interest expenses to gross income	27.6	23.9	26.4	36.9	37.7	36.1	34.0	37.2	33.4	33.4
Non-interest expenses to average assets [2]	1.4	1.5	1.6	1.9	1.6	2.1	1.9	1.9	1.6	1.5
Personnel expenses to non-interest expenses	50.7	49.6	48.0	42.9	48.7	36.8	39.0	41.7	47.3	47.7
Liquidity										
Core liquid assets to total assets [3]	29.3	26.9	20.8	20.4	17.7	22.1	21.0	22.5	24.7	26.3
Core liquid assets to short-term liabilities	38.6	34.1	28.0	28.6	27.8	36.3	34.8	30.3	32.7	35.1
Liquid assets to total assets	34.5	32.9	28.4	27.9	22.8	26.5	27.3	25.4	30.7	32.7
Liquid assets to short term liabilities	45.3	41.7	38.4	39.2	35.7	43.7	45.2	34.1	40.6	43.6
FX- loans to total loans	19.7	23.3	24.9	25.8	25.5	25.8	28.1	28.2	26.0	30.6
FX- deposits to total deposits	28.8	34.9	35.1	32.7	30.7	33.8	34.6	30.7	37.0	37.3
FX- liabilities to total liabilities	23.2	27.8	24.2	22.6	11.2	11.4	14.5	…	…	…
Deposits to assets	59.3	56.4	59.2	58.8	56.7	58.3	63.3	62.2	59.4	58.6
Loans to deposits	96.1	103.1	109.0	113.0	116.5	110.9	100.5	99.5	103.6	103.6
FX- loans to FX-deposits	65.5	68.9	77.3	89.1	96.8	84.6	81.5	91.4	72.8	85.1
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	26.3	27.8	28.5	28.7
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	37.5	35.3	29.6	28.0

Source: Central Bank of Kuwait.

[1] Data are 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, certificates of deposit with other banks which mature within three months. The data were extracted from CBK prudential report.

Appendix I. Public Sector Debt Sustainability Analysis

Kuwait Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

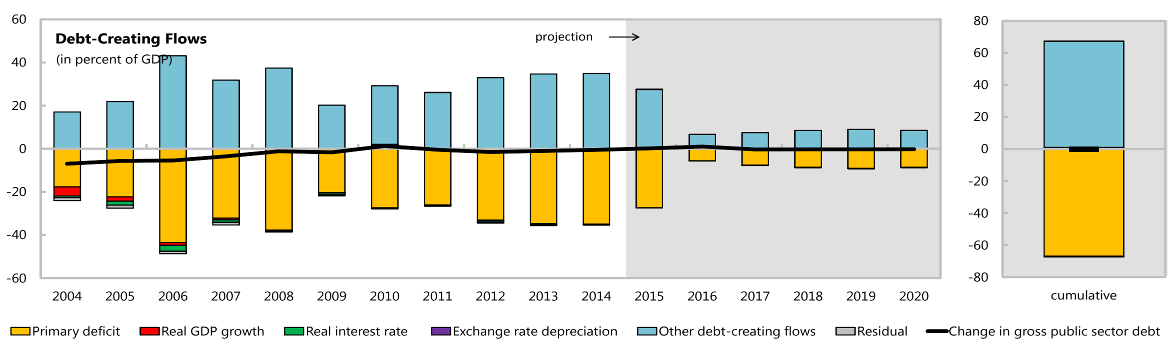
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	10.0	3.6	3.1	3.2	4.2	3.9	3.6	3.3	3.1
Public gross financing needs	-28.1	-34.3	-34.7	-27.2	-5.3	-7.2	-8.2	-8.8	-8.3
Real GDP growth (in percent)	6.1	7.7	0.8	0.1	1.2	2.5	2.7	2.7	2.9
Inflation (GDP deflator, in percent)	9.7	6.4	1.5	-1.7	-24.4	5.6	5.7	5.6	4.0
Nominal GDP growth (in percent)	16.8	14.6	2.3	-1.5	-23.5	8.2	8.6	8.5	7.0
Effective interest rate (in percent) [4/]	3.4	2.2	2.0	2.1	2.1	2.8	3.5	3.7	3.6

As of August 22, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		na
5Y CDS (bp)		na
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.8	-1.0	-0.5	0.2	1.0	-0.3	-0.3	-0.3	-0.2	0.0	
Identified debt-creating flows	-2.1	-0.6	-0.1	0.0	1.0	-0.3	-0.3	-0.3	-0.2	-0.1	
Primary deficit	-29.0	-34.7	-35.0	-27.4	-5.6	-7.6	-8.6	-9.1	-8.6	-67.0	-0.11
Primary (noninterest) revenue and grants	65.1	72.1	71.8	68.5	57.4	56.1	55.8	55.1	54.0	346.9	
Primary (noninterest) expenditure	36.2	37.4	36.8	41.1	51.8	48.6	47.2	46.0	45.3	279.9	
Automatic debt dynamics [5/]	-1.8	-0.5	0.0	0.1	1.1	-0.2	-0.2	-0.2	-0.1	0.5	
Interest rate/growth differential [6/]	-1.8	-0.5	0.0	0.1	1.1	-0.2	-0.2	-0.2	-0.1	0.5	
Of which: real interest rate	-0.8	-0.2	0.0	0.1	1.1	-0.1	-0.1	-0.1	0.0	1.0	
Of which: real GDP growth	-1.0	-0.3	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.4	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	28.6	34.6	34.9	27.4	5.5	7.5	8.5	9.0	8.5	66.4	
Privatization (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Asset accumulation	28.6	34.6	34.9	27.4	5.5	7.5	8.5	9.0	8.5	66.4	
Residual, including asset changes [8/]	-0.7	-0.5	-0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.1	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

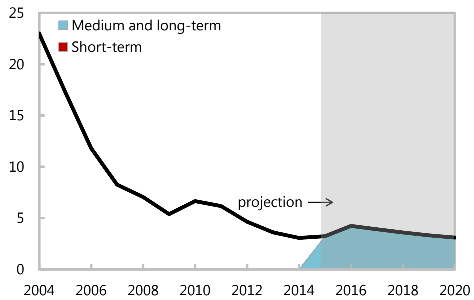
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

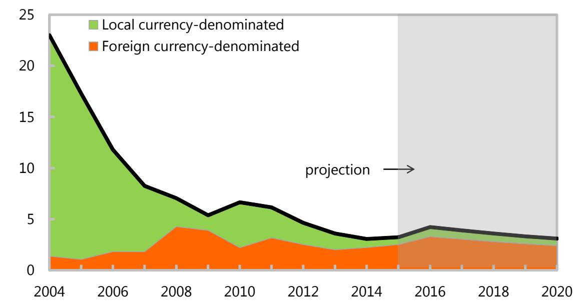
Kuwait Public Sector Debt Sustainability Analysis (DSA) – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



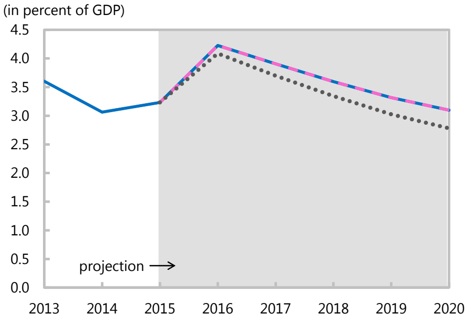
By Currency
(in percent of GDP)



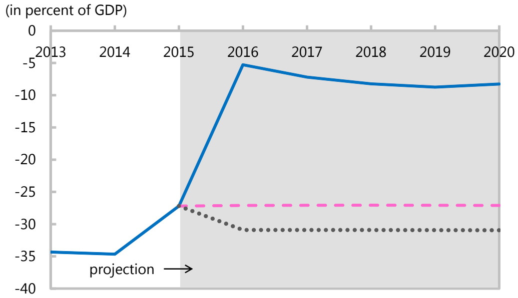
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	0.1	1.2	2.5	2.7	2.7	2.9
Inflation (GDP deflator)	-1.7	-24.4	5.6	5.7	5.6	4.0
Primary Balance	27.4	5.6	7.6	8.6	9.1	8.6
Effective interest rate	2.1	2.1	2.8	3.5	3.7	3.6
Constant Primary Balance Scenario						
Real GDP growth	0.1	1.2	2.5	2.7	2.7	2.9
Inflation (GDP deflator)	-1.7	-24.4	5.6	5.7	5.6	4.0
Primary Balance	27.4	27.4	27.4	27.4	27.4	27.4
Effective interest rate	2.1	2.1	2.8	3.5	3.7	3.6

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	0.1	4.6	4.6	4.6	4.6	4.6
Inflation (GDP deflator)	-1.7	-24.4	5.6	5.7	5.6	4.0
Primary Balance	27.4	31.3	31.3	31.3	31.3	31.3
Effective interest rate	2.1	2.1	2.8	3.5	3.7	3.6

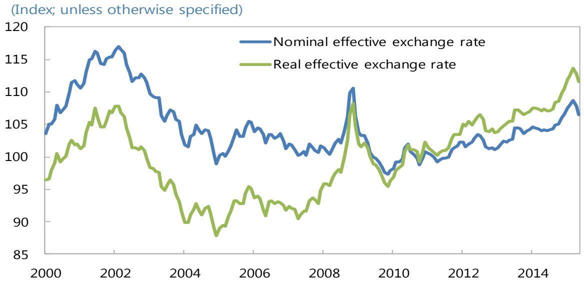
Source: IMF staff calculations.

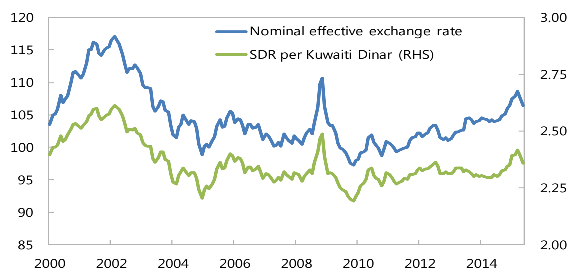
Appendix II. External Sector Assessment

Kuwait's external position is consistent with medium-term fundamentals under appropriate policies. Estimates from the external sustainability approach suggest that the current account balance in 2015 and the medium term are lower than levels consistent with fundamentals, largely reflecting lower than optimal savings of exhaustible hydrocarbon revenues for future generations. Under appropriate fiscal policies, i.e. higher fiscal surpluses, the current account balance would be in line with fundamentals. The peg to an undisclosed currency basket remains appropriate for Kuwait as it continues to provide a credible nominal anchor.[1]

The external position remained strong and the exchange rate appreciated in 2014. The current account surplus ended at 31 percent of GDP in 2014, about 10 percentage points less than in 2013—mainly due to lower oil prices. Central bank reserves have remained stable between 6 and 7.5 months of imports over the past few years (7 months of imports in 2014). Total external debt stood at 23percent of GDP at end-2014. Assets in the sovereign wealth fund are estimated by staff at 320 percent of GDP, and the non-government net international investment position was US$122 billion (62 percent of GDP) at end 2014. The nominal effective exchange rate for Kuwait appreciated 2.3 percent during 2014; it depreciated 3.3 percent against the US dollar, but appreciated 2.1 percent against the SDR. As of May 2015, Kuwait's nominal effective exchange rate appreciated 2.2 percent (y/y); it depreciated against the US dollar about 6.8 percent (y/y), but appreciated against the SDR 2.6 percent.

Kuwait: Selected Exchange Rates, 2000–May 2015
(Index; unless otherwise specified)





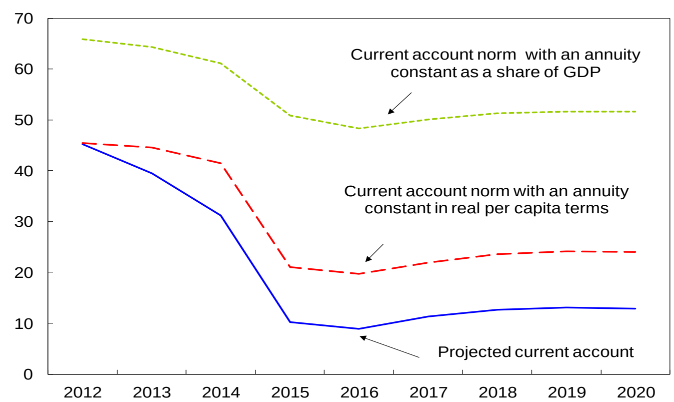
Source: IMF staff calculations.

The external sustainability approach, based on the permanent income model (PIH), suggests that the current account surpluses are too low to equitably support the consumption of future generations.[3] The PIH approach is the preferred method for Kuwait because, rather than reflecting traditional competitiveness issues, a current account gap reflects suboptimal saving of hydrocarbon revenues. The implied current account norm estimated by this method (based on a constant real per-capita annuity), is 21 percent of GDP in 2015 which compares with a current account surplus under the baseline estimated at 10.2 percent of GDP, i.e. the estimated current account gap is 10.8 percent of GDP. The gap remains broadly unchanged during the projection period (11.1 percent of GDP in 2020). Since external imbalances in Kuwait stem largely from the government sector, higher savings should occur through fiscal consolidation rather than exchange rate adjustments.

The macro-balance approach based on the External Balance Assessment – Lite (EBA-Lite) indicates that the current account balance is consistent with fundamentals. This approach uses regression analysis for a large cross-section of countries to predict the current account consistent with a range of structural and policy factors, and estimates the impact of changes in these factors on the norm. Imposing a fiscal policy consistent with intergenerational equity —which implies a fiscal balance that is 4 percent of GDP stronger than the baseline in 2015— brings the current account norm to 11 percent of GDP, which basically eliminates the current account gap –the estimated gap is -0.7 percent of GDP in 2015. A general caveat: while this model has the advantage of multilateral consistency, it is estimated on a wide group of countries and may not fully capture all features of undiversified commodity exporters such as Kuwait.[4]

Kuwait: External Sustainability's Current Account Norms vs. Projections

(Percent of GDP; 2012-20)



Source: Staff calculations and projections

1/ The decision to peg the Kuwaiti dinar to an undisclosed currency basket in May 2007 was motivated by the depreciation of the US dollar against other major currencies and the potential impact of increasing inflationary pressures from imported goods. See Box 3 in The GCC Monetary Union –Choice of Exchange Rate Regime, IMF (2008).

3/ The approach calculates the current account required for the net present value (NPV) of hydrocarbon and investment income to equal the NPV of imports net of non-hydrocarbon exports. To support intergenerational equity the economy would need to choose a path for imports —and hence a current account norm—by accumulating net foreign assets at an appropriate pace. As with any analytical tool, results are sensitive to the choice of assumptions made (for instance, oil prices, return of assets, and population growth) as well as the targeted transfer to future generation (annuity).

4/ Reported Coefficient of Determination (R-Squared) and Root Mean Squared Error (RMSE) are 0.40 and 0.07, respectively. In particular, the estimated coefficient that captures the impact of the fiscal balance on the current account is 0.479, which appears low for an economy like Kuwait. See presentation EBA-Lite in External Sector Assessment, November 2014 by R. Chen.

Appendix III. Summary of FSAP Recommendations Updates as of 6/30/2015

No.	Recommendation	Status	Update
1	Clarify regulatory and supervisory responsibilities for financial institutions between the CBK, CMA and MOCI and initiate coordination for transition process to new oversight architecture.	Completed	A Memorandum of Understanding (MOU) was signed with Capital Markets Authority. Amendments to be made to the MOU in respect of the joint issues between Ministry of Commerce and Industry and Central Bank of Kuwait, are under consideration.
2	Perform periodic stress tests of real estate and other major sectoral credit risk concentrations and review existing assessment of the way banks consider these risk concentrations in their ICAAP.	Completed	The Financial Stability Office performs regular stress tests and ICAAP on all Kuwaiti banks. The Supervision Sector revises stress tests and ICAAP prepared by banks.
3	Extend viability assessment to all systemically important ICs.	Completed	Whereas the supervisory responsibility on the investment companies was shifted to the Capital Markets Authority, we have informed the Capital Markets Authority in order to take the necessary action from its side. It is noteworthy that the Central Bank of Kuwait has issued its Circular in respect of the Supervisory Standards on Financing Companies dated 26/01/2012.
4	Complete integration of ICAAP in an on-site manual and start on-site examination on ICAAP in one bank as a pilot project.	Completed	The On-site Supervision Department prepared a manual for the work procedures to include the Internal Capital Adequacy Assessment Process (ICAAP). A professional team was formed to undertake laying down an inspection program with the specific purpose to focus on the local banks for examining the ICAAP therewith.
5	Finalized qualitative and quantitative staffing enhancement program for the banking supervision department.	Completed	The qualitative and quantitative capabilities of all staff working in the Supervision Sector shall be developed on regular basis.
6	Enhance framework for macroprudential surveillance by establishing the FSU and initiate integrated supervision of systematically important sectors.	Completed	Financial Stability Office was established and its functions and responsibilities were determined to guarantee a stable and a strong financial system. On the other hand, building and development of the Macroprudential Toolkit was discudded with the IMF during the last technical assisstance mission (from 29/4 to 11/05/2015). The toolkit included (1) Countercyclical buffers (2) Real estate index (3) and Liquidity monitoring tools (4) and D-SIBs.
7	Strengthen corporate governance rules by applying "fit and proper" test on board and management of new conventional banks.	Completed	Article (68) of Law NO. (32) of 1968 refers to the conditions to be met by a person who becomes a Board Member of a bank or executive authority, in addition to the resolution passed by the Central Bank of Kuwait Board of directors in this respect.
8	Issue directive on conflict of interest requiring board members and senior management and staff to abstain from participating in decisions on credit granting in their favor and reduce the individual and aggregate limit for credit to related parties.	Completed	CBK has issued its instructions on "Instructions concerning Rules and Standards of Corporate Governance in Banks" in 20/6/2012. Nontheless, Follow-up is coordinated jointly between On-Site and Off-site Supervision in this regard.
9	Continue the migration process from compliance-based supervision to risk-based supervision.	Completed	Risk-based supervision system has been implemented in the supervision Sector. In both on-site inspections, and Off-site Surveillance System (OSS).
10	Introduce quantitative and qualitative regulation to better monitor ICs' financial soundness and improve corporate governance. Develop new licensing regime for ICs.	Completed	A comprehensive study was prepared about the evaluation and classification of investment companies according to the level of risk on the basis of six qualitative factors (Stage One). Since investment companies are no longer subject to the supervision of Central Bank of Kuwait, (Stage Two) corporate governance instructions for Finance companies, was issued in September 2013.
11	Establish funding and operational arrangements for deposit insurance and cap coverage.	In Progress	IMF is providing Technical Assisstance on this issue. (deposit insurance and resolution framework)
12	Establish an MOU on financial crisis management between key agencies such as the CBK, MOF, CMA, and KIA.	In Progress	A work team from Central Bank of Kuwait that includes the Financial Stability Office, Supervision Sector, Economic Research Department, Foreign Operations Department and the Legal Office was formed.
13	Consider widening collateral acceptance for ELA operations.	Completed	Collateral acceptance was widened for Emergency Lending Assistance operations for banks, under the Central Bank of Kuwait Board Resolution No. (91/377/2011) in its session held on 18/12/2011. The list of guarantees, issued under Central Bank of Kuwait Board Resolution dated 17/02/1979, was annulled.
14	Establish a special resolution regime that sets out a set of distinct bankruptcy.	In Progress	IMF is providing Technical Assisstance on this issue. (deposit insurance and resolution framework)
15	Formulate long-term plan for debt/sukuk market development, and start implementing it with a short-term market.	Excluded	Excluded because of being within the functions of Capital Markets Authority.

INTERNATIONAL MONETARY FUND

KUWAIT

November 4, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By Middle East and Central Asia Department

CONTENTS

FUND RELATIONS

(As of October 7, 2015)

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

General Resources Account:	**SDR Million**	**% Quota**
Quota	1,381.10	100.00
Fund holdings of currency	976.94	70.74
Reserve position in Fund	404.19	29.27

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	1,315.57	100.00
Holdings	1,447.10	110.00

Outstanding Purchases and Loans: None

Financial Arrangements: None

Lending to the Fund and Grants: SDR million 33.04 (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 a grant contribution of SDR 0.1 million to the PRGF-HIPC Trust.

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 (a), 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).

Article IV Consultations:

The last Article IV consultation was completed on December 5, 2014 (SM/14/292—Published December 9, 2014). The staff report is available at:
http://www.imf.org/external/pubs/cat/longres.aspx?sk=42501.0

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

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	Value-Added Tax	October 2011
FAD	Macro-Fiscal Unit	September 2012
FAD	Tax Policy and Administration	April 2013
LEG	Central Bank Law	April 2013
LEG	Central Bank Law	September 2013
FAD	Macro-Fiscal Unit (resident advisor)	October 2013
LEG	Central Bank Law	January 2014
FAD	Tax Policy and Administration	February 2014
MCM	Macroprudential Policy	March 2014
FDA	Fiscal Rule	February 2015
STA	National Accounts Statistics	March 2015
MCM	Deposit Insurance System	September 2015
FAD	Tax Policy and Administration	September 2015
LEG	AML/CFT ongoing TA project	May 2012-15

Resident Representative: None

Kuwait has consented to the quota increase under the Fourteenth General Review of Quotas.

RELATIONS WITH THE WORLD BANK

(As of August 19, 2015)

The World Bank and the Government of Kuwait developed a rolling four-year Country Partnership Strategy (CPS), which leverages the setup of a World Bank Country Office in Kuwait (inaugurated in January 2009). The Kuwait program emphasizes implementation of reforms. Hence all activities 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 current Reimbursable Advisory Services (RAS) program is structured around the following three strategic themes:

(i) ***Improving public sector performance –*** so that public services are delivered transparently, efficiently and effectively. Key activities under this pillar include Bank support in the areas of reforming public finance and governance including; tax administration modernization, strengthening state property institutions and management, streamlining outdated procurement and project cycle regulations and practices, and capacity building efforts in the area of public finance management and financial accountability.

(ii) ***Economic diversification -*** Aiming to support reform efforts geared towards transforming Kuwait into a commercial and financial hub with diversified economic activities and the creation of a more conducive business environment for private sector development and foreign direct investment. Bank activities under this theme include: supporting the design and implementation of an insolvency and creditors rights framework, support in establishing the new Competition Protection Authority and the National Fund for SME Development.

(iii) ***Human development,*** with a major program to support the quality of education. Bank support in this area also includes social protection, labor and potentially health policy reforms.

ACTIVITIES FOR FY15 AND BEYOND

Counterpart Agency – Basic Activity Data	*Activity Description*
I. IMPROVING PUBLIC SECTOR PEFORMANCE	
Ministry of Finance (MoF) Tax Modernization – Phase II (P150889)	The World Bank is supporting efforts by the Kuwaiti Government to modernize tax administration. This activity aims to continue capacity building support started during the first phase through intensive training in tax operations and modern techniques of tax administration, as well as through on-the-job training by experts.
Municipality of Kuwait (MoK) Solid Waste II (P122085)	The Bank's current engagement assists with implementation of the recommendations of the previous phase, which helped improve authorities' understanding of the current challenges in the solid waste sector: (i) preparation & implementation of a national priority (BOT) project for the closure and rehabilitation of existing dumpsites, (ii) elaboration and adoption of a solid waste master plan consistent with the Kuwait Land-Use Master plan, (iii) completion & harmonization of existing legal instruments, starting with a Solid Waste Law, and (iv) establishment of a municipal solid waste agency.
General Administration of Customs (GAC) Customs Modernization Support (P154838)	Building on diagnostic work requested by MoF and presented to the Kuwait General Administration of Customs (GAC) and MoF, the Bank has been asked to proceed with finalizing a RAS agreement. The proposed RAS aims at supporting GAC with reform and modernization programs, based on best practice, and geared towards improving logistics and border management performance to further facilitate trade while still ensuring regulatory compliance, border security and revenue.
II. ECONOMIC DIVERSIFICATION	
Ministry of Finance Insolvency and Creditors Rights – Phase II (P144858)	The Ministry of Commerce and Industry (MoCI) requested support to reform Kuwait's investment climate. Following a review of Insolvency and Creditors Rights (ICR), the Bank recommended developing new laws to regulate Enterprise Rehabilitation and Liquidation in Kuwait. The Bank is now supporting: (i) the development of a functional workout framework to help recovery of Investment Companies and the enterprise sector; (ii) reforms to improve liquidation and rehabilitation procedures; and (iii) improvements to professional development in commercial judicial specialization. An official delegation of the Ministry of Finance as the main counterpart took place in June 2015. H.E. the Minister of Finance requested to have the program transferred to the Ministry for it to be under his direct leadership and supervision.
Kuwait Direct Investment Promotion Authority (KDIPA)	KDIPA has requested technical assistance from the Bank to develop a feasibility study and master plan(s) for three new economic zones for foreign investors. The Bank is supporting KDIPA through the selection of a

Economic Zone Development and Investment Promotion (P125939)	private firm or consortium – to be contracted directly by KDIPA – to prepare feasibility studies and master planning. The Bank is also helping KDIPA organize a study tour to visit successful international economic zones.
Kuwait Competition Protection Agency (KCPA) Competition Agency Support (P147532)	The World Bank is providing a comprehensive technical assistance program to support the establishment of a Competition Protection Authority in Kuwait and to tackle key challenges at the beginning of CPA's operation. The components of the World Bank technical assistance are: 1) Legal review and amendments of the Competition Law 2) Institutional Set-up 3) ICT environment and Business Architecture 4) Regulatory and procedural framework for Mergers, Authorizations/Cartel Exemptions, Market Definition 5) Competition Advocacy and Sector-specific competition policy assessments 5) Cooperation with sector regulators and other public institutions.
The Kuwait National Fund for SME Development SME Fund Support – Phase III (P154183)	Building on the previous Bank engagements with Kuwait SME Fund - Phase I and Phase II - the Bank is exploring ways to support the Fund with organizational set-up and implementation (Phase III). To this effect, the World Bank is proposing a two-year programmatic-approach project, focusing on: (i) organizational set-up and IT architecture, (ii) SME business environment, (iii) SME business development, (iv) entrepreneurship culture development, and (v) data collection, and monitoring and evaluation. The Bank proposes to conduct annual reviews assessing progress, and confirming with the client following year approach and activities.
Kuwait Direct Investment Promotion Authority (KDIPA) Doing Business Reform	In response to the continued slide in ranking in the Doing Business Report, KDIPA requested the Bank to organize a workshop to provide members of the recently formed Doing Business committee the opportunity to better understand the components of the Doing Business Report and how best to tackle reforms aiming at improving Kuwait's business environment. The visit will also help the Bank team scope a potential RAS engagement to support KDIPA's reform effort.
III. **HUMAN DEVELOPMENT**	
Ministry of Education (MOE) School Education Quality Improvement (SEQI) – Phase II (P154848)	Building upon the success of the First School Education Quality Improvement (SEQI 1) Technical Cooperation Program, which has been designed to support the Ministry of Education (MOE) and the National Center for Education Development (NCED) in the implementation of selected critical elements of its five-year Integrated Education Reform Program (IERP). The World Bank's work has expanded to support: (i) curriculum development and enhancement; (ii) effective teaching; (iii) school effectiveness; (iv) system accountability and effectiveness and (v) education policy, decision-making and implementation support.
Central Statistics Bureau (CSB) Labor Market Information System - Phase II (LMIS) (P150074)	Building on the success of Phase I, the CSB has expressed interest in extending the program. In Phase II, the Bank team would: (i) support the implementation of the Kuwait Labor Force Survey, with emphasis on providing additional capacity building; (ii) assist CSB's effort to integrate LF database; (iii) fine-tune the technical work, including enhancements to the

	Kuwait Key Labor Market Indicators and the Kuwait Occupational Projection System; and (iv) develop a diagnostic report of the Kuwait Labor market.
Ministry of Finance (MoF) Reorganization of State Property (P151988)	This project builds on the diagnostics phase, which helped the State of Kuwait in the strategic understanding of the institutional and regulatory issues related to state land policy management. The Bank is in the process of preparing a proposal to support a recently formed inter-ministerial committee tasked with preparing for the establishment of the Land Authority.
Kuwait Institute for Scientific Research (KISR) Support for the set-up of Disaster Risk Management System.	At the request of the Kuwait Institute for Scientific Research, the Bank is exploring ways to support the establishment of the decision support center for sustainable development and environmental crisis.
Kuwait Capital Market Authority (CMA) CMA Support	At the request of the CMA the Bank is in the process of preparing a proposal to support CMA in the areas of Corporate Governance and Capacity Building.
Kuwait Authority for Partnership Projects (KAPP) Public-Private Partnerships Project Guidebook	The potential reengagement with Kuwait Authority for Partnership Projects (formally known as PTB) came about after the PPP law (law 116/2014) and Executive Regulations were passed early 2015. KAPP requested the Bank's urgent support on revising the PPP Project Guidebook that was previously prepared by Aijaz and Paul Noumba in 2009. Overall, the one-year engagement covers 3 main components (i) inception report – comprehensive review of the new PPP law, (ii) Revised Guidebook, and (iii) Consultation and Dissemination of the revised Guidebook.
Kuwait National Assembly (KNA) KW Parliamentary Strengthening	At the request of the Speaker of the National Assembly and other senior parliamentarians, the Bank team focused on exploring the possibility of developing a multi-year program of parliamentary support and strengthening that can serve as a model throughout the region. Conversations with the National Assembly have focused upon strengthening the technical capacity of the parliament and several key committees. They have also focused upon providing regular technical inputs on topics of particular interest and/or relevance to parliament, along with potential reforms in transparency and information management.
Kuwait Environment Protection Authority (KEPA) Environmental Compliance Fund II Kuwait GEPAP	The Bank is in the process of preparing follow up activities for both: (i) the ECF Phase I work; and (ii) in support of the implementation of the first phase of the GEPAP National component activity (recently completed). A more strategic engagement with KEPA on an environment strategy for Kuwait is also being discussed.

STATISTICAL ISSUES

(As of October 14, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Despite further improvements in the current year, 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 and fiscal accounts, is an area of concern.
National Accounts and Production: Past improvements of national accounts include: change of the base year for the constant price data to 2010 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. The main priority is to produce quarterly national accounts. 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. Recent improvements in the compilation of statistics are expected to reduce publication lags and produce quarterly data. **Price statistics** CPI weights are based on the 2007 household expenditure survey and were introduced into the index for a reference year of 2007. 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. The PPI development has been ongoing, and the PPI is expected to be published by end-2014.
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 interest on foreign debt and treasury paper are usually provided to Article IV consultation missions, but the regular provision of data on investment income is lacking. 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. The Capital Markets Authority needs to collate and disseminate information related to investment companies.

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, implemented the IMF's Coordinated Direct Investment Survey in 2010-12. 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 (with the exception of loans granted by the Kuwaiti Fund for Arab Economic Development and general government trade credits). This data is expected to be reported to the Fund by the Executive Director for Kuwait at the time of the upcoming Article IV board meeting.

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, delays and data gaps remain. In particular,

<table>
<tr><td colspan="2">coordination among major government entities is needed to provide quarterly data to the CBK in time to compile timely quarterly statistics. Trade data are compiled by the CSO annually and from 2013, on a quarterly basis. Furthermore, the response rate for the private nonfinancial sector is low.</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>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.</td><td>No data ROSC is available.</td></tr>
</table>

Table Of Common Indicators Required for Surveillance

(As of October 14, 20115)

	Date of latest observation (For all dates in table, please use format (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]	Memo Items:[8] Data Quality Accuracy and reliability[10]
Exchange rates	13/10/2015	13/10/2015	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[1]	30/07/2015	29/9/2015	M	M	M		
Reserve/base money	30/07/2015	29/09/2015	M	M	M		
Broad money	30/07/2015	29/09/2015	M	M	M		
Central bank balance sheet	30/07/2015	29/09/2015	M	M	M		
Consolidated balance sheet of the banking system	30/07/2015	29/09/2015	M	M	M		
Interest rates[2]	30/07/2015	29/09/2015	M	M	M		
Consumer price index	31/08/2015	01/10/2015	M	M	Q		
Revenue, expenditure, balance and composition of financing[3]—general government[4]	31/03/2015	19/09/2015	Q	Q	Q	Not published on Fund standards	Not published on Fund standards
Stocks of central government and central government-guaranteed debt[5]	31/12/2014	10/09/2015	M	M	M		
External current account balance	31/12/2014	06/07/2015	A	A	A		
Exports and imports of goods and services	31/03/2015	06/04/2015	Q	Q	Q		
GDP/GNP	31/12/2014	31/08/2015	A	A	A		
Gross external debt	31/12/2014	09/04/2015	A	A	A		
International investment position[6]	31/12/2014	10/09/2015	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. Data made available to staff is incomplete as it excludes the external assets held by the general government (with the exception of loans granted by the Kuwaiti Fund for Arab Economic Development and general government trade credits)

[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 (published on …, and based on the findings of the mission that took place during…) 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.

Statement by Mr. Beblawi, Executive Director for Kuwait,
and Mr. Faras, Advisor to Executive Director
November 25, 2015

On behalf of the Kuwaiti authorities, we thank staff for the constructive discussions during the Article IV mission and the high quality reports. We also appreciate the focus of the consultation on assessing potential macro-financial risks from low oil prices, as well as fiscal and financial developments, and proposing adequate policy recommendations. The authorities were in general agreement with staff's conclusions and recommendations, particularly with regard to achieving a gradual but sustained fiscal consolidation, maintaining financial stability, and supporting long-term growth through economic diversification and job creation for nationals.

Overview

As an important oil producer, Kuwait has been negatively impacted by the sharp decline in oil prices during the second half of 2014, which led to a deterioration in the fiscal and current account balances and a decline in growth. The Kuwaiti authorities acknowledge that low oil prices may persist over the medium term. They have launched immediate reforms aimed at ensuring fiscal sustainability and intergenerational equity, while supporting economic growth and sustaining the welfare of citizens. Moreover, prudent policies over the past years and the accumulation of high financial buffers in two sovereign wealth funds enable Kuwait to continue to support growth in the medium term through public investment. The new 2015–19 Development Plan entails investments of around KD 34 billion and wide-ranging structural reforms in the economy. It aims at providing direction for prioritizing capital expenditure, encouraging private investment and creating jobs for nationals in the private sector.

Recent Economic and Financial Developments

Although growth was muted in 2014, due to the decline in oil sector activity, non-oil GDP grew at a healthy rate of about 3 percent. This trend is expected to continue in 2015. Inflation remained moderate.

Financial market conditions were subdued. Although the stock market index declined by about 24 percent y-o-y at end-September 2015, affected by volatility in global financial markets and regional geopolitical instability, corporate sector profitability remained stable.

As expected, the fiscal and external balances have deteriorated after the collapse in oil prices. The 2014/15 fiscal balance turned into a deficit for the first time following fifteen consecutive years of surpluses.

Fiscal Policies

The fiscal balance has turned into a deficit of 4.4 percent of GDP in 2014/15 from a surplus of 11.7 percent in the previous year. The authorities acknowledge the need for a structural fiscal adjustment to reverse spending and revenue trends. They also consider that the ample financial buffers and borrowing space should be used to implement gradual and sustained fiscal adjustments, while mitigating any negative impact on growth.

To ensure fiscal sustainability, the authorities intend to undertake measures to contain growth in spending and increase non-oil revenues. The measures under consideration include subsidy and wage reforms and introducing VAT and a business profits tax, with associated savings estimated by staff to amount to 1 percent of GDP in 2016 and increase to 7 percent in 2020. The Government has already started implementing these measures by lifting subsidies on diesel and kerosene and raising jet fuel price. It also presented to Parliament a plan on public wage reform, prepared a draft law for business profit tax, and recently set a VAT framework along with other GCC countries. Implementation of the planned measures is expected to result in a considerable improvement in the fiscal stance, measured by the non-oil primary balance as a share of non-oil GDP, by about 20 percentage points over the medium term.

Moreover, important further progress was achieved in the budgeting process as the government has decided to move to top-down budgeting in FY 2016/17 and to a medium-term budgeting in FY 2017/18, both of which will help in improving budget planning and execution processes. In addition, the budgeting process will be further strengthened by the planned establishment of an overall Public Financial Management Committee and the implementation of the Government Financial Management Information System.

Financial Sector Policies

The banking sector is well-capitalized, well-regulated and enjoys high provisioning buffers. This renders the sector resilient to shocks from the real estate and equity markets and a further decline in oil prices, as confirmed by the results of the stress tests conducted by staff. The Central Bank of Kuwait (CBK) is closely monitoring potential risks and stands ready to address them using macroprudential tools. The CBK is continuously strengthening its regulations and macroprudential tools to preserve financial stability and mitigate potential risks from real estate and equity markets. Banks are under Basel III regulations for capital, including a framework for domestic systemically important banks, liquidity, and leverage, and they are subject to loan-to-value and debt-service-to-income ratios in the real estate sector. Investment companies, which have been through difficulties since the financial crisis, are now closely monitored by the CBK and the Capital Market Authority. The authorities agree with staff recommendations to implement a formal macroprudential coordination mechanism to identify potential systemic risks arising from nonbank financial institutions.

Continued progress was made in strengthening the AML/CFT framework, based on which the Financial Action Task Force (FAFT) has removed Kuwait from the list of countries subject to its monitoring process. At the same time, the authorities strengthened the anticorruption framework by issuing the bylaws and recently making the Anti Corruption Authority operational.

Labor Market Reform and Diversification

As is the case in other oil-producing countries, the public sector has become the main employer of nationals in Kuwait with higher wages than the private sector. This phenomenon created a dual labor market and a challenge for the government to encourage nationals to work for the private sector.

The authorities concur with staff that creating the right incentives for nationals is crucial to raise their employment in the private sector. Accordingly, the 2015–19 Development Plan establishes a number of mechanisms to create more job opportunities for nationals in the private sector including through: supporting private investment to boost the share of the private sector in economic activity; establishing the National Fund for SMEs Development; raising mandatory national labor ratios, and moving forward with a comprehensive privatization program. At the same time, the Development Plan encourages the private sector to invest more in high-tech and capital intensive industries to match the qualifications of the highly educated national labor force and lowers reliance on low-skilled expatriates. With technical assistance from the World Bank, the authorities have set up a new Labor Market Information System to provide more accurate, detailed and up-to-date information to better match supply and demand in the labor market.

To further advance diversification, the authorities are focused on structural reforms to improve the business environment and create more business opportunities to stimulate domestic investors and attract foreign ones. A number of developments have been accomplished in the last two years in this regard including: the recent establishment of the National Fund for SMEs Development; the creation of the Direct Investment Promotion Authority; issuance the Privatization bylaws; and establishment of the ICT Authority and the Transportation Authority. The authorities strive for a more robust and dynamic corporate sector that is essential for the diversification process. Issuing the new corporate law was a step in this direction.

As recognized by staff, the Central Statistical Bureau has witnessed significant improvements in recent years to enhance the quality and frequency of data through the application of international standards and conducting new surveys that provide better insight in a number of sectors.

Concluding Remarks

The authorities place a high priority on ensuring fiscal sustainability and intergenerational equity and successfully diversifying the economy through well-designed, gradual, and sustained reforms. The authorities recognize that the recent sharp decline in oil prices provides them with an opportunity to implement reforms without delay. They are keenly aware of the difficulty related to implementing these reforms, given potential political and social resistance. They are exerting a great effort to better communicate the objectives of the reform plans with the public and Parliament, knowing that with oil prices expected to remain low in the medium term, any delay in reform will be at a higher cost in the future.