



بنك الكويت المركزي
CENTRAL BANK OF KUWAIT



THE THIRTY-FIFTH

ANNUAL REPORT

FOR THE FISCAL YEAR 2006/07

**The Annual Report of the Central Bank of Kuwait
for the Fiscal Year 2006/07**

INTRODUCTION

It pleases me to present the 35th Annual Report prepared by the Central Bank of Kuwait (CBK) on the fiscal year 2006/07, which provides a highlight of the main domestic monetary and banking developments, along with a summary of the main decisions, measures and operations undertaken by CBK through its departments and offices in the various banking and monetary areas, in addition to the most salient supervisory instructions, circulars, rules and regulations issued by CBK to all banking and financial sector units subject to its supervision. Finally, the report presents the auditors' report, along with the Balance Sheet and Profit and Loss Account of the CBK for the fiscal year 2006/07.

Within this context, CBK's efforts during the fiscal year 2006/07 focused on continuing to firm the bases of monetary stability in the country, and to nurture an atmosphere supporting the efficient operation of the local banking and financial system units. This confirms CBK's keenness on keeping abreast of the domestic, regional and international developments, and managing their reflections on the domestic monetary and banking conditions, for the benefit of the national economy.

The fiscal year 2006/07 witnessed important monetary and banking developments, among which was raising the exchange rate of the Kuwaiti Dinar (KD) against the US dollar to 289.14 fils/dollar on the 11th of May 2006 from 292.00 fils/dollar. This move was within CBK's eagerness to maintain the purchasing power of the KD and to contribute to curbing the imported inflationary pressures. Also, within its sustained endeavors towards enhancing the competitiveness of the KD and strengthening the attractiveness of the national currency as a store of domestic savings, the CBK raised on the 3rd of July 2006 the discount rate by a quarter percentage point from 6% to 6.25%. Additionally, in support of the principle of competitiveness and diversification of the banking and financial transactions between the domestic banking and financial

sector units, the CBK granted approval for both the National Bank of Qatar to open a branch in the State of Kuwait, and the Kuwait Real Estate Bank to fully convert into operating according to the provisions of Islamic Sharia.

In continuation of CBK's efforts towards providing information and data on the economic, monetary and banking developments of the State of Kuwait, as well as expanding and modernizing the monetary and banking databases of the banking and financial system in step with the domestic, regional and international developments, the CBK expanded the contents of its periodic statistical bulletins to encompass aggregate financial data and statistics on both the conventional investment companies and investment companies operating according to the provisions of Islamic Sharia. Furthermore, work is ongoing in the compilation of financial statistics on the exchange companies subject to CBK's supervision, in preparation for their publication along with data on plastic cards (credit cards and ATM cards) activities.

During the fiscal year 2006/07, the CBK continued its efforts toward developing the efficiency of its cadres, and enhancing their scientific and professional levels through local and international specialized training courses. Furthermore, the approval of the new salary scale for the staff of CBK's departments and offices during the mentioned fiscal year, will undoubtedly contribute to raising the efficiency of CBK's personnel, and retaining its national workforce and attracting more competent people to work for the CBK, thereby supporting the CBK's ability to fulfill its function on the one hand, and to keep pace with the relevant domestic, regional and international advancements on the other.

In closing, we pray the Almighty to grant success to our efforts and endeavors for achieving the benefit of our beloved homeland, under the patronage of His Highness the Emir, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, His Highness the Crown Prince, Sheikh Nawaf Al-Ahmed Al-Jaber Al-Sabah, and His Highness the Prime Minister, Sheikh Nasir Mohammad Al-Ahmad Al-Sabah may God protect them all.

Salem Abdulaziz Al-Sabah
Governor of the Central Bank of Kuwait

First: The Main Developments of Monetary Policy and Monetary and Banking Indicators:

This part of the report addresses the most salient, monetary and banking developments during the fiscal year 2006/07, within CBK's efforts in areas connected to drawing and implementing the monetary policy, with the purpose of reinforcing the atmosphere of monetary stability in the country, as well as establishing the conditions conducive to further strengthening the financial positions of the local banking and financial system units in the State of Kuwait, as follows:

1- Monetary Developments:

A- Money Supply:

Money Supply in its broad definition (M2) recorded a growth of KD 2605.4 million or 17.9% to KD 17130.1 million at end of the fiscal year 2006/07, against KD 14524.7 million at end of the fiscal year 2005/06. This growth in Money Supply (M2) resulted from the rise in both Quasi-money by KD 2428.8 million or 22.7% (from KD 10680 million to KD 13108.8 million) and Money (the narrow definition of money supply M1) by KD 176.5 million or 4.6% (from KD 3844.8 million to KD 4021.3 million).

Developments in Money Supply (M2) (KD Million)

End of Period	2004/05	2005/06	2006/07	Change from 2005/06 to 2006/07	
				Value	%
Money Supply (M2):	12392.4	14524.7	17130.1	2605.4	17.9
Money (M1), of which :	3386.6	3844.8	4021.3	176.5	4.6
Sight Deposits	2850.2	3268.7	3382.1	113.4	3.5
Quasi-Money:	9005.8	10680.0	13108.8	2428.8	22.7
KD Deposits	7731.6	8864.0	11667.8	2803.8	31.6
Foreign Currency Deposits	1274.2	1815.9	1440.9	- 385.0	-20.6

Regarding the factors affecting changes in money supply within the aggregate monetary survey of the CBK and local banks¹ during the fiscal year 2006/07, the above rise of KD 2605.4 million or 17.9% in Money Supply (M2) was essentially the result of the increase in both the net domestic assets of these institutions by KD 1198.8 million (11.9%) and their net foreign assets by KD 1406.5 million (31.7%). The increase in net domestic assets is essentially attributable to the rise in local banks' claims on the private sector by KD 3485.8 million or 25.5%. Furthermore, the increase in both the government accounts² with the CBK and deposits with local banks (by a total of KD 781.8 million or 53.3%), as well as in the other net claims of the CBK and local banks (by KD 1051.4 million or 23.3%) on the one hand, and the decline in the local banks' claims on the government (by KD 453.7 million or 18.8%) on the other, curbed the growth in net domestic assets. As for the above mentioned rise of KD 1406.5 million in net foreign assets during the fiscal year 2006/07, it is outcome of the increase in the CBK's net foreign assets by KD 3030.3 million or 106.5%, and the decline in the net foreign assets of local banks by KD 1623.8 million or 102.3%.

B- Domestic Interest Rates:

During the fiscal year 2006/07, CBK increased its discount rate only once, on the 3rd of July 2006, by 25 basis points raising the discount rate to 6.25% at end of the fiscal year 2006/07, against 6% at end of the previous fiscal year. This increase in the discount rate occurred in the light of CBK's continued monitoring of the domestic monetary and banking developments on the one hand, and the developments in interest rates on major currencies on the other. Furthermore, the decision to raise the discount rate was taken as part of CBK's persistent quest towards enhancing the competitiveness of the Kuwaiti dinar, and its sustained efforts towards strengthening the attractiveness of the national currency as a store of national savings.

1 Local banks encompass the commercial banks (National Bank of Kuwait, Commercial Bank of Kuwait, Gulf Bank, Al-Ahli Bank of Kuwait, the Bank of Kuwait and the Middle-East, Burgan Bank, the branch of the Bank of Bahrain and Kuwait, the branch of BNP-Paribas Bank, the branch of the HSBC Middle-East Bank, the branch of the Abu Dhabi National Bank, and the branch of Citibank), the specialized banks (the Kuwait Real-Estate Bank, and the Industrial Bank of Kuwait), in addition to banks operating according to the provisions of Islamic Sharia' (the Kuwait Finance House and Bubyana Bank).

2 Includes deposits of the ministries, governmental departments, and public institutions with attached budgets, as well as the Credit and Savings Bank

Regarding the interest rates on customers' KD and US dollar deposits with local banks, the CBK's increase of its discount rates during the fiscal years 2005/06 and 2006/07, along with its continual monitoring of local banks in this regard, contributed to raising the interest rates on customers' KD time deposits with these banks during the fiscal year 2006/07, compared with the previous fiscal year. Particularly, the averages of interest rates on the one-month and three-month KD deposits rose to 5.013% and 5.208% respectively during the fiscal year 2006/07, against 3.398% and 3.538% for these two terms respectively during the previous fiscal year.

On another front, the averages of interest rates on the one-month and three-month US dollar deposits rose to 4.556% and 4.652% respectively during the fiscal year 2006/07, against 3.159% and 3.329% for these two terms respectively during the previous fiscal year. Accordingly, the margins between the averages of interest rates on the KD and US dollar deposits for the one-month and three-month terms reached 0.45 percentage point and 0.55 percentage point respectively, in favor of KD deposits. In the same direction, the averages of interest rates on the KD interbank deposits rose during the fiscal year 2006/07, compared to the previous fiscal year.

Furthermore, an uptrend was witnessed during the fiscal year 2006/07 in the average interest rates on Public Debt Instruments, whereby the average of interest rates on the one-year Treasury Bonds rose from 4.42% during the fiscal year 2005/06, to 5.93% during the fiscal year 2006/07. The average interest rates on the two-year Treasury Bonds reached 6.25%, while the interest rate on Treasury Bonds for more than two-year maturity reached 6.47% during the fiscal year 2006/07.

C- The KD Exchange Rate:

The CBK continued during the fiscal year 2006/07 to apply the KD exchange rate policy adopted as of the beginning of 2003, by virtue of the Decree No. 266 for year 2002, which is based on pegging the exchange rate of the Kuwaiti dinar to the US dollar within specific margins ($\pm 3.5\%$) around the parity exchange rate (299.63 fils/dollar). In this regard, the CBK reduced the exchange rate of the US dollar against the KD by 2.86 fils (1%) to 289.14 fils/ dollar as of 11/5/2006. By this reduction, the CBK has exhausted the allowed margin (3.5%) for the upward

movement in the exchange rate of the Kuwaiti dinar against the exchange rate of the US dollar. The exchange rate of the US dollar against other major currencies witnessed pronounced fluctuations during the mentioned fiscal year, whereby the difference between the highest and lowest exchange rates of the US dollar reached 14.4%, against the pound Sterling, 11.5% against the Japanese yen, 9.8% against the Swiss franc, and 10.9% against the Euro.

**Developments in the Exchange Rate of the US dollar
Against the KD and Some Major Currencies**

Item	2005/06			2006/07		
	Highest Price	Lowest Price	Change	Highest Price	Lowest Price	Change (%)
Kuwaiti dinar (fils/US \$)	292.00	292.00	-	292.00	289.14	1.0
Sterling Pound/ US \$	0.5844	0.5216	12.0	0.5769	0.5045	14.4
Euro/ US \$	0.8565	0.7651	11.9	0.8285	0.7470	10.9
Swiss Franc/US \$	1.3248	1.1805	12.2	1.3088	1.1925	9.8
Japanese Yen/ US \$	121.385	104.575	16.1	121.965	109.425	11.5

D- Bank Credit:

The balances of the utilized cash portion of credit facilities extended by local banks to the various domestic economic sectors rose during the fiscal year 2006/07 by KD 3271.8 million (26.1%) to KD 15822.4 million at end of that fiscal year, compared with KD 12550.5 million at end of the fiscal year 2005/06. The mentioned fiscal year. This rise essentially resulted from the increase in the balances of these facilities extended to the Personal Facilities sector (by KD 1013.7 million or 19.5%), the Real-Estate sector (by KD 844.1 million or 31.3%), the Non-Bank Financial Institutions sector (by KD 623.5 million or 55.6%), the Industry sector (by KD 293.9 million or 62.4%), the Construction sector (by KD 212.7 million or 27%), and the Trade sector (by KD 204.7 million or 13.8%). As for the new KD credit facility agreements with residents during the fiscal year 2006/07, which reflect the changes in limits of existing credit facilities and the credit facilities extended to new clients, data indicate that the value of these facilities rose by KD 971.8 million or 14.9% to KD 7480.4 million during the fiscal year 2006/07, against KD 6508.7 million during the previous fiscal year.

E- Domestic Liquidity

Within the efforts aimed at regulating the level of domestic liquidity, the CBK used various monetary policy instruments during the fiscal year 2006/07 to withdraw excess liquidity, since the indicator of that liquidity, namely Money Supply in its broad definition (M2), rose during that fiscal year by KD 2.6 billion (17.9%), as mentioned above. In this regard, the CBK increased its offering of CBK Bonds (noting that it resumed issuing these Bonds since August 2005, as a monetary policy instrument) by KD 820 million, thereby raising their balance from KD 30 million at the start of the mentioned fiscal year to KD 850 million at its end. The CBK also expanded its acceptance of time deposits from the banking sector units, according to the deposit acceptance scheme (which CBK has applied since 1995, as a monetary policy instrument), thereby raising the balance of these deposits from KD 1.1 billion at the start of the mentioned fiscal year to KD 2.8 billion at its end (including securitization operations totaling KD 823 million). Accordingly, the balance of the reserve account at the CBK (encompassing the issued currency, local banks balances accounts, time deposits of local banks, and CBK Bonds) rose from KD 1.9 billion at the start of the fiscal year 2006/07 to KD 4.4 billion at its end, i.e. by KD 2.6 billion (138.8%)

F- Issuance of Public Debt Instruments:

During the fiscal year 2006/07, the CBK continued the efforts initiated since November 1987 in issuing Public Debt Instruments (Kuwaiti Treasury Bonds) on behalf of the Ministry of Finance, noting that the issuance of Treasury Bills was discontinued as of April 2005.

In this connection, during the fiscal year 2006/07, the CBK offered 25 issues of Treasury Bonds with a total nominal value of KD 2296.2 million (of which 18 issues of one-year maturity with a total nominal value of KD 1641.2 million, 2 issues of two-year maturity with a total nominal value of KD 220 million, 2 issues of three-year maturity with a total nominal value of KD 200 million, 2 issues of five-year maturity with a total nominal value of KD 135 million, and one issue of seven-year maturity with a total nominal value of KD 100 million). During the mentioned fiscal year, 24 previous Treasury Bond issues with a total nominal value

of KD 2318.4 million matured. As a result of the above developments, the outstanding balance of Public Debt Instruments (Kuwaiti Treasury Bonds) declined by KD 22.2 million or 1% to KD 2296.2 million at end of the fiscal year 2006/07, from KD 2318.4 million at end of the previous fiscal year. The outstanding balance of Public Debt Instruments holding at end of the fiscal year 2006/07 was essentially distributed between local banks by KD 1810.3 million (78.8%), and other institutions KD 485.9 million.

The fiscal year 2006/07 also witnessed the continued retirement of the Debt Purchase Bonds (which are bonds issued against the debts purchased according to Law No. 41 of 1993 and the amendments thereof), whereby the outstanding balance of these bonds reached KD 156.2 million at the end of the mentioned fiscal year, thus recording a decline of KD 211.5 million or 57.5% compared to their balance of KD 367.6 million at end of the previous fiscal year.

2 - Banking Developments:

A- The Aggregate Balance Sheet of Local Banks

The aggregate balance sheet of local banks (commercial, specialized and Islamic banks) reached KD 29.1 billion at end of the fiscal year 2006/07, against KD 23.39 billion at end of the fiscal year 2005/06, i.e. a rise of KD 5711.6 million or 24.4%. This rise was the outcome of several developments in the items of that balance sheet on both the assets and liabilities sides. The most significant of these developments can be highlighted as follows:

On the Assets Side:

- The rise in the balance of local banks' claims on the private sector by KD 3485.8 million (or 25.5%) to KD 17134 million at end of the fiscal year 2006/07, against KD 13648.2 million at end of the fiscal year 2005/06. This rise resulted from the increase in both the balances of the utilized cash portion of credit facilities extended by local banks to the domestic economic sectors by KD 3271.8 million (26.1%) to KD 15822.4 million at end of the fiscal year 2006/07 from KD 12550.5 million at end of the previous fiscal year on the one hand, and the

balances of other domestic investments by KD 213.9 million (19.5%) to KD 1311.6 million at end of the fiscal year 2006/07 against KD 1097.7 million at end of the previous fiscal year, on the other hand.

- The rise in the balance of local banks' claims on the CBK (accounts, deposits and bonds with the CBK) by KD 2497.4 million (210.5%) to KD 3684 million at end of the fiscal year 2006/07, against KD 1186.6 million at end of the previous fiscal year. This rise resulted essentially from the noticeable increase in the balances of local banks' time deposits with the CBK by KD 1676.6 million (154.5%) to KD 2762.1 million at end of the fiscal year 2006/07, against KD 1085.5 million at end of the previous fiscal year.
- The decline in the balance of local banks' claims on the government by KD 447.7 million (18.6%) to KD 1961.8 million at end of the fiscal year 2006/07, against KD 2409.4 million at end of the previous fiscal year. The largest portion (47.5%) of this decline reflects the decrease of the balance of Debt Purchase Bonds by KD 212.8 million or 58.4% to KD 151.5 million at end of the fiscal year 2006/07, against KD 364.3 million at end of the previous fiscal year. Also, the balance of local banks' holdings of Public Debt Instruments (Kuwaiti Treasury Bonds) declined by KD 234.9 million (11.5%) to KD 1810.3 million at end of the fiscal year 2006/07, against KD 2045.2 million at end of the previous fiscal year.
- The decline in the balance of total foreign assets of local banks by KD 19.6 million (0.5%) to KD 4268.7 million at end of the fiscal year 2006/07, against KD 4288.3 million at end of the previous fiscal year. This decline was the outcome of the decrease in both the balances of local banks' deposits with foreign banks by KD 451.1 million (16.2%), and other foreign assets by KD 16.9 million (17.1%) on the one hand, and the rise in the balances of both the foreign investments of local banks by KD 205.9 million (22.8%), and credit facilities extended to non-residents by KD 242.5 million (48%) on the other hand.

Aggregate Balance Sheet of Local Banks
(KD Million)

Items	2004/05	2005/06	2006/07
Assets:			
Cash	89.7	92.1	108.4
Balances (sight deposits) with CBK	178.0	69.8	68.1
Bonds held with the CBK	-	30.0	850.0
Time deposits with CBK	125.0	1085.5	2762.1
Local Interbank Deposits	891.2	1231.2	1213.0
Claims on the Government	2786.7	2409.4	1961.8
Public Debt Instruments	2254.7	2045.2	1810.3
Debt Purchase Bonds	532.0	364.3	151.5
Claims on the Private Sector	11108.8	13648.2	17134.0
Credit Facilities to Residents	10075.0	12550.5	15822.4
Other Domestic Investments	1033.9	1097.7	1311.6
Foreign Assets	3042.9	4288.3	4268.7
Deposits with Foreign Banks	1711.1	2782.0	2330.9
Credit Facilities to Non-Residents	461.6	504.9	747.4
KD Credit Facilities to Non-Residents	31.2	72.1	140.9
Foreign Currency Facilities to Non- Residents	430.4	432.8	606.5
Foreign Investments	813.2	902.5	1108.4
Other Foreign Assets	57.0	98.8	81.9
Other Assets	491.5	534.3	734.5
Assets = Liabilities	18713.8	23388.8	29100.5
Liabilities:			
Private Sector Deposits	11856.0	13948.7	16490.9
KD Deposits	10581.8	12132.7	15050.0
Foreign Currency Deposits	1274.2	1815.9	1440.9
Government Deposits	594.6	977.3	1552.0
Local Interbank Deposits	726.8	1104.1	1247.2
Shareholders' Equity	2381.8	2908.5	3315.7
Foreign Liabilities	1651.8	2700.9	4305.1
Deposits from Non-Resident Banks	1157.7	1539.7	2339.3
Other Non-Residents Deposits	404.9	1055.9	1851.1
Other Foreign Liabilities	89.3	105.3	114.7
Other Liabilities	1502.7	1749.3	2189.6
Contra Accounts:	3861.5	5047.2	6597.5
Bank Guarantees	2547.6	3344.5	4255.7
Documentary Credits	986.2	1327.3	1940.7
Bank Acceptances	327.8	375.4	401.0

On the Liabilities Side:

- The rise in the balances of the resident private sector's deposits with local banks by KD 2542.3 million (18.2%) to KD 16490.9 million at end of the fiscal year 2006/07, against KD 13948.7 million at end of the previous fiscal year. The

mentioned increase was the outcome the rise in balances of KD deposits by KD 2917.2 million (24%) to KD 15050 million at end of the fiscal year 2006/07, against KD 12132.7 million at end of the previous fiscal year, and the decline in foreign currency deposits by KD 375 million (20.6%) to KD 1440.9 million at end of the fiscal year 2006/07, against KD 1815.9 million at end of the previous fiscal year.

- The rise in the balances of government deposits with local banks by KD 574.7 million (58.8%) to KD 1552 million at end of the fiscal year 2006/07, against KD 977.3 million at end of the previous fiscal year
- The rise in the balances of shareholders' equity in local banks by KD 407.1 million (14%) to KD 3315.7 million at end of the fiscal year 2006/07, against KD 2908.5 million at end of the previous fiscal year.
- The increase in the balances of foreign claims on local banks by KD 1604.2 million (59.4%) to KD 4305.1 million at end of the fiscal year 2006/07, against KD 2700.9 million at end of the previous fiscal year. This increase was the outcome of the rise in the balances of both foreign banks' deposits with local banks by KD 799.6 million (51.9%), deposits of foreign non-bank entities by KD 795.2 million (75.3%) and other foreign liabilities by KD 9.4 million (8.9%).

B - Aggregate Balance Sheet of Investment Companies:

The total aggregate balance sheet of investment (conventional and Islamic) companies rose by KD 3336.5 million (32.8%) to KD 13483.8 million at the end of the fiscal year 2006/07 (for 73 companies) compared to KD 10147.3 million at end of the fiscal year 2005/06 (for 62 companies). This growth reflects several developments among the elements of assets and liabilities, which can be outlined in the following:

On the Assets Side:

- The "cash and balances" with local banks and investment companies rose by KD 368.1 million or 49.1% to KD 1117.6 million at the end of the fiscal year 2006/07 from KD 749.5 million at end of the previous fiscal year. This increase resulted essentially from the growth in the total balances of domestic investment accounts

with local banks and investment companies by KD 395.6 million (56.3%) to KD 1098.6 million at the end of the fiscal year 2006/07 from KD 703 million at end of the previous fiscal year.

Aggregate Balance Sheet of Local Investment Companies
(KD Million)

Items	Balances at Year-End		
	2004/05	2005/06	2006/07
Assets:			
Cash & Balances with Local Banks & Investment Companies	244.7	749.5	1117.6
Loans and Advances to Residents (Conventional Companies)	716.5	900.2	928.1
Domestic Financial Investments	1758.9	2958.5	4039.2
Domestic Non-financial Investments	228.1	505.1	491.3
Customers financing by Islamic financial instruments	400.8	470.3	699.0
Foreign Assets:	2940.8	3473.6	4814.8
Other Assets	410.5	1090.1	1393.8
Assets = Liabilities	6700.1	10147.3	13483.8
Liabilities:			
Capital and Reserve	2309.8	3854.7	4922.1
Financing from Residents:	1413.8	2467.0	3746.5
of which: Sukuk	-	59.3	90.9
Bonds	389.0	679.1	813.8
Foreign Liabilities	1600.6	1750.1	2489
Other Liabilities	986.9	1396.4	1512.4
Number of Companies	44	62	73

- The balances of domestic investments rose by KD 1118.5 million or 32.2% to KD 4585.4 million at the end of the fiscal year 2006/07 from KD 3466.9 million at end of the previous fiscal year. This rise was the result of the increase in the balances of domestic financial investments by KD 1080.7 million or 36.5% and the decrease in domestic non-financial investments by KD 13.8 million or 2.7%.
- The increase in the balances of credit facilities extended to residents (loans and advances, and customers financing by Islamic financial instruments) by KD 256.6 million or 18.7% to KD 1627.1 million at the end of the fiscal year 2006/07, from KD 1370.5 million at end of the previous fiscal year.
- The rise in the total balance of foreign assets by the equivalent of KD 1341.2 million or 38.6% to KD 4814.8 million at the end of the fiscal year 2006/07 compared to KD 3473.6 million at end of the previous fiscal year. This rise was essentially the outcome of the rise in foreign investments (financial and non-

financial investments) by the equivalent of KD 1291.8 million or 43.9%, and the decline in cash and balances with foreign banks and institutions by the equivalent of KD 43.7 million or 18%.

On the Liabilities Side:

- The increase in the balances of financing from residents (banking and financial sector institutions, in addition to non-financial institutions), by KD 1279.5 million or 51.8% to KD 3746.5 million at the end of the fiscal year 2006/07, compared to KD 2467 million at end of the fiscal year 2005/06. The largest portion of this rise (51.2%) resulted from the rise in the balance of financing from local banks by KD 753 million or 64.5%.
- The increase in the total balance of foreign liabilities by the equivalent of KD 738.9 million or 42.2% to KD 2489 million at the end of the fiscal year 2006/07, compared to KD 1750.1 million at end of the fiscal year 2005/06.
- The increase in the total balance of shareholders by equity KD 1067.4 million or 27.7% to KD 4922.1 million at the end of the fiscal year 2006/07, compared to KD 3854.7 million at end of the previous fiscal year.

Second: The Main Supervisory Measures and Instructions Issued by CBK

The CBK continued during the fiscal year 2006/07 monitoring and regulating the operations of the banking and financial system in the State of Kuwait, through the off-site supervision and on-site inspection of the banking and financial system units. These units encompassed as on 31/3/2007 the local commercial, specialized and Islamic banks (totaling 15 banks), investment companies (73 companies, of which 33 companies operate according to the provisions of the Islamic Sharia), exchange companies (39 companies) and investment funds (82 investment funds, of which 34 funds operate according to the provisions of the Islamic Sharia). In this regard, CBK issued during the fiscal year 2006/07, several circulars and, instructions to the banking and financial units subject to its supervision, most significant among which were the following:

- The circular issued on 10/4/2006 regarding amendment to item (10) of the instructions issued to local banks on combating money laundering and the financing of terrorism.
- The circular issued on 18/5/2006 regarding amendment to the rules and procedures for opening branches of local banks inside and outside the State of Kuwait, so that the validity of the approval for opening such branches will be one year.
- The circular issued on 12/6/2006 regarding amendments to the implementation of the maximum credit concentration ratios by foreign banks' branches operating in the State of Kuwait.
- The circular issued on 3/7/2006 regarding the amended rules and controls for the required experience under Article (68) of the Law No. 32 of year 1968 and its amendments.
- The circular issued on 26/9/2006 regarding the obligation to supply the customer with a copy of the contract concluded with the bank at the onset of the customers' relationship, as well as on renewal, rescheduling or amending the contract, in keeping with the standards set by the CBK for regulating the relationship between banks and their customers.
- The circular issued on 26/9/2006 concerning enhancing the aspects of internal control systems with regard to the application of certain information systems and general supervisory controls.
- The circular issued on 26/9/2006 regarding the standards regulating the relationship between the investment companies and their customers.
- The circular issued on 22/11/2006 requiring local banks to secure the legal guardian guarantee for liability-bearing transactions involving underage individuals.

- The circular issued on 24/1/2007 regarding the insurance fees borne by customers taking consumer and installment loans.
- The circular issued on 29/1/2007 to local banks and investment companies, regarding the rules and principles for the classification of credit facilities and the calculation of their provisions, whereby explanatory amendments were introduced to certain tables concerning the policy of credit facilities classification.
- The circular issued on 4/2/2007 to local banks and investment companies concerning prior notification to the CBK when their boards decide to list their shares on any foreign stock exchange.
- The circular issued on 12/3/2007 to local banks and investment companies concerning adjustment of the ratio of general allocation for credit facilities for which no allocations were made.
- The circular issued on 12/3/2007 introducing amendments to the rules and principles for extending consumer loans and other installment loans.

During the fiscal year 2006/07, the CBK continued its efforts towards regulating the relationship between customers and the banking and financial sector units, whereby the CBK issued a number of instructions to safeguard their customers' rights, monitor their abidance by CBK's instructions and apply fitting penalties to transgressors. Furthermore, the CBK continued during the fiscal year 2006/07 to follow up the measures applied by banks, investment companies, and exchange companies in observance of the national manpower ratios of the national manpower support program, and monitor the compliance by banking system units with the Revised Capital Adequacy Standard (Basel II) requirements, applied since 31 December 2005, within the three main pillars: minimum capital requirement, supervisory review process, and market discipline (public disclosure). Within this context, the CBK also participated in a specialized workshop on the 'Preparatory Measures for the Application of Basel II Agreement in Arab Countries' in the United Arab Emirates, along with participating in meetings with the British Financial Services Authority

(FSA), and the supervisory group for the application by the HSBC Bank of the Basel II requirements in the UK.

On another front, the CBK took part in many events and activities connected to Anti-Money Laundering /Combating the Financing of Terrorism (AML/CFT), whereby it participated in two working groups established by the National Committee for Combating Money Laundering and Terrorism Financing by virtue of the Decision No. 11/2004 of the Minister of Finance, with the purpose of reviewing the Law No. 35 of year 2002 regarding combating money laundering operations, and determining the training needs and the provision of technical assistance to the bodies represented in the National Committee for Combating Money Laundering and Terrorism Financing. Additionally, the CBK effectively contributed to the general meeting of the Financial Action Task Force (FATF), and the general meeting of the Middle-East North and Africa Region Financial Action Task Force (MENA FATF), along with partaking in the program for capability enhancing in regard to combating money laundering and terrorism financing. Also, CBK organized a symposium on Combating Money Laundering and Terrorism Financing during the period 26-27/11/2006, with the participation of the members of the National Committee for Combating Money Laundering and Terrorism Financing, and representatives from the banking and financial system units in the State of Kuwait, and the MENA FATF.

Third: Major Operations Performed by CBK

The fiscal year 2006/07 witnessed an increase in CBK activities connected to currency issuance, clearing operations, and transfers between local banks. The value of currency issued by CBK rose during the fiscal year 2006/07, as the average value of issued currency and coins reached KD 748.6 million during that fiscal year, compared with an average of KD 652.4 million during the previous fiscal year. During the fiscal year 2006/07, the balance of issued currency reached its highest (KD 821.4 million) in 19 October 2006 and its lowest (KD 620 million) on 21 August 2006. In the same direction, the average value of currency in circulation (expressing the value of issued currency minus cash balances in vaults of local banks) increased by KD 63.1 million (11%) from KD 576.1 million during the fiscal year 2005/06 to KD 639.2 million during the fiscal year 2006/07. During the fiscal year 2006/07, the balance of currency

in circulation reached its highest (KD 656.3 million) in December 2006 and its lowest (KD 562.9 million) in August 2006.

Regarding the settlement operations carried out between banks through CBK, using *Kuwait's Automated Settlement System for Inter-Participant Payments* (KASSIP), the total value of these operations during the fiscal year 2006/07 amounted to KD 153.9 billion, against KD 97.1 billion, during the previous fiscal year, i.e. an increase of KD 56.8 billion or 58.5%. Worth noting is that KASSIP was developed and updated to encompass the branches of foreign banks licensed to operate in the State of Kuwait. Accordingly, two new banks joined KASSIP during the fiscal year 2006/07, thus bringing to 17 the number of participants in that system.

Regarding the operations carried out through CBK Clearing Room, the total value of these operations rose during the fiscal year 2006/07 to KD 9473.4 million for 2052.9 thousand transactions (cheques), or an average of KD 4614.6 per transaction, compared with KD 9108.4 million for 1973.9 thousand transactions (cheques), or an average of KD 4614.4 per transaction, during the fiscal year 2005/06.

Within the application of the 'CBK Bonds' system, the CBK offered during the fiscal year 2006/07 twenty-nine issues of these Bonds with a total nominal value of KD 2081 million (of which 26 issues of 3-month maturity, with a total nominal value of KD 1554 million, and 3 issues of 6-month maturity, with a total nominal value of KD 527 million). Of these Bonds, 24 previous issues of 3-month maturity and with a total nominal value of KD 1261 million matured during the mentioned fiscal year. Accordingly, the outstanding balance of CBK Bonds rose by KD 820 million to KD 850 million at end of the fiscal year 2006/07, against KD 30 million at end of the fiscal year 2005/06.

Furthermore, during the fiscal year 2006/07, CBK processed on behalf of ministries and governmental institutions 8207 banking drafts amounting to KD 779.7 million, against 8249 banking drafts valued at KD 692.2 million during the previous fiscal year 2005/06.

The foreign banking transactions processed by CBK to the benefit of ministries and governmental institutions, in the form of documentary credits as well as bills and drafts for collection during the fiscal year 2006/07, are shown in the following table:

Particulars	No.	Value (in KD)
First- Documentary Credits:		
1- <u>Opened:</u>		
-Local	-	-
-Foreign	65	43701029/430
2- <u>Paid:</u>		
-Local	-	-
-Foreign	214	26252564/746
3- <u>Amended:</u>		
-Local	-	-
-Foreign	74	
Second- Collection Transactions:		
Bills for Collection		
a- Incoming	2	5118/595
b- Paid-up	2	5187/983
Third- Drafts for Collection:		
a- Collected	-	-
b- Purchased	109	571007/690

Fourth: Labor Force at CBK

Within the CBK's efforts toward enhancing the efficiency of the banking cadres in its various departments and offices, and raising their educational and professional capabilities, the CBK took several measures and decisions during the fiscal year 2006/07, most important among which were the following:

1. During the fiscal year 2006/07, 22 Kuwaiti graduates (of which 17 holding university degrees and 5 holding the diploma of applied sciences) were accepted as trainees for positions at CBK. Furthermore, during the same fiscal year, 72 individuals, of which 65 Kuwaitis (90.3%) were hired. Also, 33 Kuwaiti trainees who completed their training programs during the fiscal year 2006/07 were confirmed in their jobs at CBK. Accordingly, by the end of the fiscal year 2006/07, the total number of CBK staff reached 805 employees, of which 645 (80.1%) were Kuwaitis.

2. During the fiscal year 2006/07, the CBK participated in 83 specialized training courses in the State of Kuwait, and sent 380 of its employees to these courses. Furthermore, CBK sent 73 of its employees to 62 training courses abroad, in coordination with a number of specialized training bodies in the fields of banking, finance and economics.
3. During the fiscal year 2006/07, CBK sent 136 of its employees abroad on official assignment to attend 80 conferences and meetings of relevance to CBK's work, held at the Gulf, Arab and international levels.
4. During the fiscal year 2006/07, the CBK continued to send a number of staff members on scholarships abroad, to obtain masters and doctorate degrees.
5. During the fiscal year 2006/07, the CBK organized several specialized training programs for newly graduate Kuwaiti cadres, holders of university degrees or diplomas, to prepare and qualify them for work in the CBK's various departments and offices.

Fifth- Other Operations and Activities

During the fiscal year 2006/07, CBK carried out various operations and activities, of which:

- During the fiscal year 2006/07, the CBK continued its efforts towards ensuring the quality of currency notes in circulation, and withdrawing and destroying those notes which no longer fulfill CBK's minimum quality requirements. In this connection, the value of withdrawn and destroyed currency notes during the fiscal year 2006/07 reached KD 82.270 million.
- During the fiscal year 2006/07, the CBK continued preparing and publishing its various periodicals (monthly, and quarterly), after expanding the scope of its banking and financial statistics to encompass the local investment companies (conventional, Islamic) and local exchange companies. The CBK continued to publish its economic and annual reports in both Arabic and English, in addition to updating the contents of its internet homepage which contains various economic, monetary and banking information and statistics.

- The CBK organized during the fiscal year 2006/07, the Eighth Meeting of the Islamic Financial Services Council (IFSC), and the Fourth IFSC General Assembly, whereby the State of Kuwait presided over the Council for the year 2006 term. It is noted that the State of Kuwait is among the main founding member countries of IFSC, which was established in November 2002 in Kuala Lumpur, Malaysia. This Council aims to issue guidelines and standards for the supervision of Islamic financial institutions in line with both the provisions of Islamic Sharia and the international standards applied in this regard. The CBK also participated during the fiscal year 2006/07 in several domestic conferences and workshops, particularly the first World Islamic Finance & Investment Conference in the State of Kuwait under the title 'Capitalizing on Emerging International & Regional Growth Opportunities'.
- The CBK participated during the fiscal year 2006/07 in many international conferences of relevance to the work and activities of central banks. Particularly notable in this regard was the participation in the International Conference of Central Bank Auditors held during the period 2-6 October 2006 in Merida City, Mexico, which discussed the latest amendments to the core principles of effective banking supervision and their relevance to good corporate governance and supervisory measures. The CBK also participated in the symposium held for the regulatory sector in emerging economies in Washington D.C., USA, during the period 16-27 October 2006, under the sponsorship of the World Bank, the Federal Reserve Bank, and the International Monetary Fund (IMF). Additionally, CBK participated in the Conference on Preventing Crises in Emerging Markets organized and supervised by the IMF in Singapore, during the period 10-11 July 2006, and in the meetings of the Institute of International Finance (IIF) held in Zurich, Switzerland, during the period 30-31 March 2006.
- The CBK developed and modernized during the fiscal year 2006/07 its computer systems and programs, whereby a project was executed for documenting the security policies of the IT sector at the CBK, as a first interim step towards achieving compliance with the ISO 27001 standard. Added to this was the development of the system for protecting the safety of CBK mainframe internally and externally in line with the technological developments in this

area. Additionally, CBK database was upgraded to keep up with advances in that area.

- During the fiscal year 2006/07, the CBK organized many social activities and events to strengthen the relationship among employees in its various departments and offices, whereby the CBK organized for its staff a recreational day in Al-Shaab public park, as well as the traditional Ramadan evening get-together (*Ghabka*). Additionally, the CBK contributed to the Open Day of the ‘Compassionate Hearts’ campaign for blood donation, and the awareness campaign ‘CAN’ for combating cancer. It participated in the ‘Kuwait My Country Festival’ in cooperation with the Kuwait Teachers Association, and actively participated in the “12th Exhibition of Makers of the Economy and Job Opportunities” in cooperation with Kuwait University.

Sixth :

**The Central Bank of Kuwait Balance Sheet
and Profit & Loss Account for the Fiscal Year
Ended 31 March 2007**

AUDITORS REPORT

We have examined the financial statements of the Central Bank of Kuwait (CBK). Our examination included such tests of the accounting records and such other auditing procedures as we considered necessary. We obtained all the information and explanations which we deemed necessary for the purpose of our examination.

In our opinion, the financial statements give a true and fair view of the real financial position of the CBK on 31 March 2007 and of the results of its operations for the year then ended, in compliance with Law No. 32 of 1968 and amendments thereof.

Furthermore, in our opinion, proper books of account have been kept and the financial statements are in accordance therewith, and an inventory was duly carried out.

Bader Abdullah Al-Wazan

Register of Accountants & Auditors
License No. 62 A -
Bader & Partners
of PRICE WATERHOUSE COOPERS

Waleed Abdullah Al-Oseimi

Register of Accountants & Auditors
License No. 68 A -
Al-Aiban, Al-Osaimi & Partners
of ERNST & YOUNG

1 May 2007
State of Kuwait

CENTRAL BANK OF KUWAIT

BALANCE SHEET AS ON

Assets	Note	31 March 2006	31 March 2007
Gold		31,736,332	31,736,332
Cash, Current and Call Accounts in Foreign Currency with Banks and other Financial Institutions		272,188,909	325,925,543
Local KD-denominated Bonds and Public Debt Instruments		6,034,000	-
Deposits and Investments in Foreign Currency	3	2,682,985,585	5,660,348,600
Other Assets	4	17,096,033	33,724,533
		3,010,040,859	6,051,735,008
Accounts Managed by CBK on Behalf of the Government of the State of Kuwait, and Contra Accounts	10	2,886,730,630	2,645,639,944

31 MARCH 2007 (KD)

Equity and Liabilities	Note	31 March 2006	31 March 2007
Capital - Fully Paid Up		5,000,000	5,000,000
General Reserve Fund	5	213,297,582	248,005,727
Special Account	6	180,663,485	305,970,209
Profit for the Year		69,416,287	146,197,646
Currency Issued	7	668,183,939	747,551,642
CBK Bonds Issued		30,000,000	850,000,000
Government Accounts		490,622,770	697,796,244
Local Banks' Current Accounts and Deposits with CBK	8	1,156,550,988	2,833,991,755
International Institutions		140,149,473	140,158,142
Deposits on Documentary Credits	10	23,668,214	35,720,088
Other Liabilities	9	32,488,121	41,343,555
		3,010,040,859	6,051,735,008
Accounts Managed by CBK on Behalf of the Government of the State of Kuwait, and Contra Accounts	10	2,886,730,630	2,645,639,944

The attached notes from 1 to 13 constitute part of these financial statements.

CENTRAL BANK OF KUWAIT

**PROFIT & LOSS ACCOUNT FOR
THE FISCAL YEAR ENDED 31 MARCH 2007
(KD)**

	Note	2005/06	2006/07
Interest & Income from Investments		90,231,343	163,403,366
Interest and Commission Expenses		<u>(1,904,794)</u>	<u>(75,789)</u>
		88,326,549	163,327,577
Other Income		464,799	9,079,922
Operating Income		88,791,348	172,407,499
Operating Expenses	11	<u>(19,375,061)</u>	<u>(26,209,853)</u>
Net Profit for the year		<u>69,416,287</u>	<u>146,197,646</u>
Disposed of according to Article 17, of Law No. 32 of 1968 and its amendments, as follows:			
to the Government Account	5	34,708,144	99,203,373
to the CBK General Reserve Fund	5	<u>34,708,143</u>	<u>46,994,273</u>
		<u>69,416,287</u>	<u>146,197,646</u>

The attached notes from 1 to 13 constitute part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1- Activities:

The Central Bank of Kuwait (CBK) is incorporated by Law No. 32 of 1968 and amendments thereof. The CBK is a public institution with an independent juristic personality, and is entrusted with issuing the local currency on behalf of the State of Kuwait, ensuring the stability of the Kuwaiti currency and its free convertibility into other currencies, drawing the monetary and credit policies, and the supervision of the banking and financial system, in addition to serving as banker and financial advisor to the Government.

2- Significant Accounting Policies:

These financial data were prepared in accordance with Law No. 32 of 1968 and amendments thereof. The applied significant accounting policies are as follows:

(a) Gold:

In accordance with the Amiri Decree of 4 July 1978, gold is valued at KD 12.500 per fine ounce.

(b) Local Bonds and Public Debt Instruments:

Public Debt Instruments are recorded at purchase cost.

(c) Cost of Money Market Operations:

The cost arising from intervention operations in the money market (CBK Bonds issued and local banks deposits) are charged to the Ministry of Finance Account/cost of Supporting Money Market operations, according to the agreement between the Bank and the Ministry of Finance.

(d) Revenue Recognition:

Interest receivable is recognized on a time proportion basis, taking into account the principal outstanding and the interest rate applicable.

(e) Capital Expenditure:

Capital expenditure is charged to expenses in the year of authorization.

(f) Foreign Currencies:

In accordance with Article 48 of Law No. 32 of 1968 and amendments thereof, and the Amiri Decree of 4 July 1978, all cash assets and liabilities in foreign currencies are revalued at the exchange rates prevalent on the date of the preparation of the balance sheet, and the resulting gains or losses are taken to the special account.

3- Deposits and Investments in Foreign Currencies (KD):

	<u>2005/06</u>	<u>2006/07</u>
Deposits with Foreign Banks and Institutions	2,678,606,335	5,656,012,250
Central Bank Facilities to the International Bank for Reconstruction and Development	4,379,250	4,336,350
	<u>2,682,985,585</u>	<u>5,660,348,600</u>

4- Other Assets (KD):

	<u>2005/06</u>	<u>2006/07</u>
Interest Receivable on Deposits and Other Assets	12,110,084	25,797,518
CBK's Share in the Capital of the Industrial Bank of Kuwait	2,511,210	2,511,210
Prepaid Expenses	176,462	693,332
Advance Payments	131,621	79,957
Other Debit Balances	2,166,656	4,642,516
	<u>17,096,033</u>	<u>33,724,533</u>

5- General Reserve Fund:

In accordance with Article 17, paragraphs 3 (a) and (b), of Law No. 32 of 1968 and amendments thereof, the net profits of the CBK shall be paid into the General Reserve Fund until the balance of the fund amounts to twenty-five million Kuwaiti Dinars, unless the Board of Directors recommends and the Minister of Finance approves further increases in the balance of the Fund. In 1985, the Board recommendation to increase the balance of the fund to KD 179 million was approved by the Minister of Finance and Economy. In accordance with the Board decision dated on 5 May 2003, and the approval of the Minister of Finance on 7 May 2003, it was agreed to increase the balance of CBK General Reserve Fund by KD 116 million to KD 295 million, by transferring half of CBK net annual profits to the Fund balance. Accordingly, KD 46,994,273 will be transferred to the General Reserve Fund, bringing its balance to KD 295 million, following the approval of the CBK financial data by the Minister of Finance, and the financial effects thereof will appear in the following fiscal year.

6- Special Account (KD):

	<u>2005/06</u>	<u>2006/07</u>
Balance at Beginning of the Year	264,515,536	180,663,485
Net difference in foreign currency , resulting from revaluation of cash assets and liabilities in foreign currencies	<u>(83,852,051)</u>	<u>125,306,724</u>
Balance at End of the Year	<u>180,663,485</u>	<u>305,970,209</u>

The special account represents the net difference accumulated as a result of revaluation of cash assets and liabilities in foreign currencies, and the profit resulting from the withdrawal of currency notes from circulation, based on both Article 48 of Law No. 32 of 1968 and amendments thereof, and the Amiri Decree of 4 July 1978.

7- Currency Issued (KD):

	<u>2005/06</u>	<u>2006/07</u>
Net Currency Produced	1,062,030,279	1,080,735,142
Less: Currency in the CBK's Vaults	<u>(393,846,340)</u>	<u>(333,183,500)</u>
	<u>668,183,939</u>	<u>747,551,642</u>

Net currency produced represents the total of currency printed, reduced by currency destroyed.

8- Local Banks Current Accounts and Deposits with CBK (KD):

	<u>2005/06</u>	<u>2006/07</u>
Current Accounts	71,050,988	71,898,523
Deposits	1,085,500,000	1,939,500,000
Tawarruq (Collateralization) Operations (withdrawals)	-	822,593,232
	<u>1,156,550,988</u>	<u>2,833,991,755</u>

9- Other Liabilities (KD):

	<u>2005/06</u>	<u>2006/07</u>
Accrued Expenses	3,545,158	3,305,542
Other Credit Balances	18,772,350	33,112,925
Ministry of Finance, Cost of Supporting Money Market Operations (Note 2-C)	<u>10,170,613</u>	<u>4,925,088</u>
	<u>32,488,121</u>	<u>41,343,555</u>

Other credit balances include provisions for employees' leave pay and termination benefits, and credit accounts of banking and non-banking institutions.

The Balance of Ministry of Finance-Cost of Supporting Money Market Operations represents the remainder of funds transferred from the Ministry of Finance after charging the cost of supporting the money market operations carried out by CBK according to the agreement between CBK and the Ministry of Finance.

10- Accounts Managed by CBK on Behalf of the Government of the State of Kuwait, and Contra Accounts (KD):		
	2005/06	2006/07
a- Accounts Managed by the CBK on Behalf of the Government of Kuwait	2,829,959,708	2,583,105,275
b- Contra Accounts:		
Documentary Credits	31,570,222	48,782,464
Memorial Notes and Coins	1,649,182	1,548,324
Collections According to the Law No. 41 of 1993	23,551,518	12,203,881
	56,770,922	62,534,669
	2,886,730,630	2,645,639,944

On 31 March 2007, deposits of KD 35,720,088 (KD 23,668,214: 2006) were held against the documentary credits referred to above.

11- Operating Expenses (KD):		
	2005/06	2006/07
Employee Costs	12,372,286	19,750,406
Administrative and Computer Operation Costs	2,067,779	1,946,733
Purchases of Furniture, Equipment and Vehicles	307,994	183,787
Production and Shipment of Currency	2,029,619	866,252
Sundry Expenses	1,310,804	1,321,296
Construction Costs	1,286,579	2,141,379
	19,375,061	26,209,853

12- Compensation Claims:

The Board of Directors of the United Nations Compensation Committee issued its Decision No. 153 on 13 March 2002, approving the compensation of CBK for damages sustained as a result of the Iraqi occupation, for an amount of US \$ 117,797,000 equivalent to KD 36,266,162, from a total claim presented by CBK on 7 February 1994 for an amount of US \$ 245,756,758 equivalent to KD 73,132,296 as on the date of presenting the claim.

During the previous years, the CBK received partial payments of the approved compensation, totaled KD 16,096,180 after deducting the 3% Ministry of Finance share in the compensation. During the current year, an amount of KD 8,422,874 was received after deducting the 3% Ministry of Finance share in the compensation.

CBK records compensation amounts as other revenues, effective as on their date of receipt.

13- Promissory Notes Held:

On 31 March 2007, promissory notes held by the CBK in safe custody on behalf of international institutions totaled KD 452,903,838 (KD 424,884,853: 2006).

Contents	Page
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Introduction

First : The Main Developments of Monetary Policy and Monetary and Banking Indicators	13
1 - Monetary Developments	13
2 - Banking Developments	18
Second : The Main Supervisory Measures and Instructions Issued by CBK	23
Third : Major Operations Performed by CBK	26
Fourth : The Labor Force at CBK	28
Fifth : Other Operations and Activities	29
Sixth : The Central Bank of Kuwait Balance Sheet and Profit & Loss Account for the Fiscal Year Ended 31 March 2007	33
- Auditors Report	35
- Balance Sheet	36
Assets	36
Equity and Liabilities	37
- Profit & Loss Account	38
- Notes to the Financial Statements	39

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