



بنك الكويت المركزي
CENTRAL BANK OF KUWAIT



**THE THIRTY-FOURTH
ANNUAL REPORT**

FOR THE FISCAL YEAR 2005/06

**The Annual Report of the Central Bank of Kuwait
for the Fiscal Year 2005/06**

INTRODUCTION

The Central Bank of Kuwait (CBK) pursued in the fiscal year 2005/06 its efforts in areas connected to drawing and implementing the monetary policy, as well as supervising and overseeing the local banking and financial system units. These efforts came within the endeavor to firmly establish the atmosphere of monetary stability in the State of Kuwait, and further strengthen the financial positions of the local banking and financial system units. CBK's efforts in these areas reflect its keenness to keep pace with domestic, regional and world developments and to deal with their reflections on the monetary and banking conditions in the State of Kuwait.

In regard to drawing and implementing the monetary policy, the CBK continued during the fiscal year 2005/06 its efforts aimed at enhancing the competitiveness of the Kuwaiti dinar (KD) and firmly establishing its attractiveness as a store of domestic savings. These efforts were aimed at securing an appropriate margin in favor of the interest rates on the KD compared to the interest rates on major international currencies, particularly the US dollar to which is pegged the exchange rate of the KD within defined margins. The significance of these efforts is manifest in the light of the developments in the domestic economic, monetary, and banking conditions on the one hand, and the sustained rise in the interest rates on the major international currencies on the other.

In this connection and within the efforts aimed at developing the domestic money market, the CBK resumed in August 2005 the application of the 'CBK Bonds' system, after introducing certain amendments to it, so as to enhance the role of that instrument in absorbing excess domestic liquidity. The most significant of these amendments was the extension of the maturity period of those Bonds to a period not exceeding one year instead of 91 days. It is noted that the CBK Board of Directors endorsed on 16/12/1978 a system for the issuance of tradable bonds known as 'CBK Bonds' according to

specific rules. The CBK used these bonds in regulating domestic liquidity until the issuance of Law No. 50 of 1987, which empowered the government to contract public debt; accordingly, the CBK bonds were replaced by the issuance of Public Debt Instruments in the form of Treasury Bills and Bonds.

On another front, the CBK continued during the fiscal year 2005/06 its efforts in the supervision of the local banking and financial system units, whereas these efforts encompassed off-site monitoring and on-site inspection, the issuance of instructions and regulations aimed at firming the bases of financial stability and soundness, and reinforcing sound professional practices in this sector's units. Within this context, the CBK undertook during the fiscal year 2005/06 the application of the revised capital adequacy standard (Basle II) unto the domestic commercial banks, effective 31 December 2005, i.e. one year ahead of the date scheduled by the Basel's Committee for its application. The Basle II standard encompasses the application of a standardized approach in the measurement of credit and operational risks, and is based on three pillars, which are: minimum capital requirements, supervisory review, and market discipline (public disclosure). The application of the revised capital adequacy standard (Basle II) contributes to providing an incentive to banks to apply the best practices in terms of managing and monitoring the various types of risks they are confronted with, while continuing to abide by the minimum capital adequacy ratio set by CBK at 12%, whereas the recommended ratio by Basle Committee for Banking Supervision is 8%. It is noted that the State of Kuwait is considered the first Arab country to apply the revised capital adequacy standard (Basle II).

In this context, the CBK continued during the fiscal year 2005/06 its efforts aimed at boosting competition among the banking and financial system units, by allowing foreign banks to open branches in the State of Kuwait, whereby three branches of foreign and GCC banks were entered in CBK's register of commercial banks, namely the branch of the HSBC Bank in August 2005, the branch of the Abu Dhabi National Bank in November 2005, and the branch of the "Citibank- New York" bank in March 2006. The permission for foreign banks to open branches in the State of Kuwait comes in light of the amendments introduced to certain provisions of Law N0. (32) of 1968 concerning Currency, the Central Bank of Kuwait and the Organization of Banking Business, by the issuance of Law N0. (28) of 2004 which allows foreign banks to open branches in the State of Kuwait.

On another front, the CBK continued during the fiscal year 2005/06 its efforts aimed at developing its Information Technology programs and systems, and the use of new systems in line with the technological developments, with a view to enhancing the efficiency of operation in CBK's various departments and offices. In this regard, the CBK pursued work in the innovation of a 'Business Intelligence' system which will provide a flexible and developed working environment for operating the systems concerning the storage, retrieval, treatment and analysis of data and statistics in the CBK's database. Additionally, emergency plans were developed through the innovation of a new 'Enterprise Storage System-Ess', which links the main operating sites with backup sites inside and outside the State of Kuwait, for the continual and automated updating of CBK's databases.

Furthermore, the CBK continued during the fiscal year 2005/06 its efforts in the areas connected with developing the efficiency of its banking cadres and enhancing their scientific and professional levels, along with preparing and publishing its various periodicals and reports in both Arabic and English, and developing the content of its internet homepage.

This Annual Report highlights the most significant domestic monetary and banking developments in the State of Kuwait during the fiscal year 2005/06, in addition to CBK's most significant decisions, measures and operations in regard to monetary and banking issues, and the most notable instructions, circulars, supervisory rules and regulations issued by the CBK to the banking and financial sector units, and last the Auditors' Report, and CBK's balance sheet and profit and loss account for the fiscal year 2005/06.

First: The Main Monetary and Banking Developments:

This part of the report addresses the CBK's efforts in drawing and implementing the monetary policy aimed at firming the atmosphere of monetary stability, 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. The following are the most significant monetary and banking developments during the fiscal year 2005/06:

1- Monetary Developments:

A- Money Supply:

Money Supply in its broad definition (M2) recorded a growth of KD 2132.3 million or 17.2% to KD 14524.7 million at end of the fiscal year 2005/06, against KD 12392.4 million at end of the fiscal year 2004/05. This growth in Money Supply resulted from the rise in both Quasi-money by KD 1674.1 million or 18.6% (from KD 9005.8 million to KD 10680 million) and Money (the narrow definition of money supply M1) by KD 458.2 million or 13.5% (from KD 3386.6 million to KD 3844.8 million).

Regarding the factors affecting changes in money supply within the aggregate monetary position of the CBK and local banks ¹ during the fiscal year 2005/06, the above rise of KD 2132.3 million or 17.2% in Money Supply (M2) was essentially the result of the increase in the net domestic assets of these institutions by KD 1260.5 million (14.3%) and their net foreign assets by KD 871.8 million (24.5%). The mentioned increase in net domestic assets is essentially attributable to the rise in local banks' claims on the private sector by KD 2539.4 million or 22.9%. Furthermore, the increase in the government accounts with the CBK and deposits with local banks² (by KD 172.6 million or 13.3%), and in the other net claims of the CBK and local banks (by KD 735.1 million or 19.5%) on the one hand, and the decline in the local banks' claims on the government (by KD 371.2 million or 13.3%) on the other, curbed the growth rate of net domestic assets. The above mentioned rise of KD 871.8 million in net foreign assets during the fiscal year 2005/06 is attributable to the increase in both the CBK's net foreign assets by KD 675.6 million or 31.1%, and the net foreign assets of local banks by KD 196.3 million or 14.1%.

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 Bank of Bahrain and Kuwait branch, the branch of BNP-Paribas Bank, the branch of the HSBC Middle-East Bank, and the branch of the Abu Dhabi National Bank), 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 Credit and Savings Bank

B- Domestic Interest Rates:

The CBK continued its efforts in monitoring the developments in interest rates on the Kuwaiti dinar in the domestic market, so as to ensure their consistency with domestic economic and monetary developments on the one hand, and their alignment with trends in interest rates on major currencies, on the other. In this connection, the CBK made during the fiscal year 2005/06 three consecutive increases to its discount rate, on the 3rd of July, 3rd of October, and 2nd of November 2005. These raises totaled 75 basis points, thus bringing the discount rate to 6% at end of the fiscal year 2005/06, against 5.25% at end of the previous fiscal year.

Additionally, the CBK made 8 consecutive increases in the intervention rate (the rate which CBK offers to the local banking and financial units against holding their deposits with the CBK), totaling 132 basis points, to 4.88% at end of the fiscal year 2005/06, against 3.56% at end of the previous fiscal year. This increase was in continuance of the CBK's policy of maintaining the competitiveness of the KD as a store of national savings, in the light of the sustained upward trends in interest rates on the international currencies, ahead of which the US dollar.

Within this context, regarding the interest rates on customers' KD and US dollar deposits with local banks, the above mentioned increases in both the discount and intervention rates, along with the CBK's continual monitoring of local banks, contributed to raising the interest rates on customers' KD time deposits with local banks during the fiscal year 2005/06, compared with the previous fiscal year. Particularly, the averages of interest rates on the one-month and three-month KD deposits rose to 3.398% and 3.538% respectively during the fiscal year 2005/06, against 1.494% and 1.673% for these two terms respectively during the previous fiscal year.

Also, the averages of interest rates on the one-month and three-month US dollar deposits rose to 3.199% and 3.367% respectively during the fiscal year 2005/06, against 1.280% and 1.411% for these two terms respectively during the previous fiscal year. Accordingly, the margins between the averages of interest rates on KD and US dollar deposits for the one-month and three-month terms reached 0.20 point and 0.17 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 2005/06, compared to the previous fiscal year.

Furthermore, an uptrend was witnessed during the fiscal year 2005/06 in the average interest rates on Public Debt Instruments, whereby the average of interest rates on the one-year Treasury Bonds rose from 3.59 percentage point during the fiscal year 2004/05, to 4.42% during the fiscal year 2005/06.

C- The KD Exchange Rate:

The CBK continued during the fiscal year 2005/06 to apply the KD exchange rate policy adopted as of the beginning of 2003, which is based on pegging the exchange rate of the Kuwaiti dinar to the exchange rate of the US dollar within specific margins around the parity exchange rate. In this regard, the exchange rate of the US dollar was stable against the KD during the mentioned fiscal year at 292.0 fils/dollar, i.e. 7.63 fils (2.5%) below the parity exchange rate (299.63 fils/dollar), which is within the allowed ($\pm 3.5\%$) fluctuation band around the parity exchange rate. The exchange rate of the US dollar against other major currencies witnessed more pronounced fluctuations during the mentioned fiscal year, whereby the difference between the highest and lowest exchange rates of the US dollar reached 16.1% against the Japanese yen, 12.2% against the Swiss franc, 12%, against the Sterling pound, and 11.9% against the Euro.

D- Bank Credit:

The balances of the utilized cash portion of credit facilities extended by local banks to the various domestic economic sectors rose by KD 2475.6 million (24.9%) to KD 12550.5 million at end of the fiscal year 2005/06, compared with KD 10075 million at end of the fiscal year 2004/05. This rise resulted from the increase in the balances of these facilities extended to the Personal Facilities sector (by KD 996.1 million or 23.7%), the Real-Estate sector (by KD 564.2 million or 26.5%), the Non-Bank Financial Institutions sector (by KD 289.4 million or 34.8%), the "Others" sector (by KD 211.4 million or 43%), the Trade sector (by KD 192.8 million or 14.9%), and the Construction sector (by KD 183.2 million or 30.2%). As for the distribution of new KD credit facility agreements with residents during the fiscal year 2005/06, 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 2089.2 million or 47.3% to KD 6508.7 million during the fiscal year 2005/06, against KD 4419.5 million during the previous fiscal year.

E- Issuance of Public Debt Instruments:

The CBK continued during the fiscal year 2005/06, its efforts in the issuance of Public Debt Instruments (Kuwaiti Treasury Bills and Bonds) on behalf of the Ministry of Finance.

During the mentioned fiscal year, ten previous issues of Treasury Bonds with a total nominal value of KD 921 million reached maturity. Accordingly, the outstanding balance of Treasury Bills was extinguished at end of the fiscal year 2005/06. In this connection, the CBK offered during the fiscal year 2005/06, 24 issues of one-year Treasury Bonds with a total nominal value of KD 2318.4 million. During the mentioned fiscal year, 14 previous Treasury Bond issues with a total nominal value of KD 1509 million matured. Accordingly, the outstanding balance of Treasury Bonds rose at end of the fiscal year 2005/06 by KD 809.4 million or 53.6% to KD 2318.4 million, against KD 1509 million at end of the previous fiscal year

As a result of the above developments, the outstanding balance of Kuwaiti Treasury Bills and Bonds declined by KD 111.6 million or 4.6% to KD 2318.4 million at end of the fiscal year 2005/06, from KD 2430 million at end of the previous fiscal year. As for the distribution of the outstanding balances of public debt instruments among the various institutions holding them, relevant data indicate that local banks continued to garner the largest portion (88.2%) of the total balance of public debt instruments at end of the fiscal year 2005/06.

The fiscal year 2005/06 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 367.6 million at the end of the mentioned fiscal year, thus recording a decline of KD 168.1 million or 31.4% compared to their balance of KD 535.8 million at end of the previous fiscal year.

2 - Banking Developments:

The aggregate balance sheet of local banks (commercial, specialized and Islamic banks) reached KD 23388.8 million at end of the fiscal year 2005/06, against KD 18713.8 million at end of the fiscal year 2004/05, i.e. a rise of KD 4675 million or 25%. 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 2539.4 million (or 22.9%) to KD 13648.2 million at end of the fiscal year 2005/06, against KD 11108.8 million at end of the fiscal year 2004/05. This rise resulted from the increase in the balances of both the utilized cash portion of credit facilities extended by local banks to the domestic economic sectors by KD 2475.6 million (24.6%) to KD 12550.5 million at end of the fiscal year 2005/06, from KD 10075 million at end of the previous fiscal year on the one hand, and the balances of other domestic investments by KD 63.8 million (6.2%) to KD 1097.7 million at end of the fiscal year 2005/06, against KD 1033.9 million at end of the previous fiscal year, on the other hand.
- The rise in the balance of total foreign assets of local banks by KD 1245.4 million (40.9%) to KD 4288.3 million at end of the fiscal year 2005/06, against KD 3042.9 million at end of the previous fiscal year. This rise was the outcome of the increase in the balances of local banks' deposits with foreign banks by KD 1070.9 million (62.6%), the foreign investments of local banks by KD 89.3 million (11%), the balances of credit facilities extended to non-residents by KD 43.3 million (9.1%) and other foreign assets by KD 49.1 million (73.5%).
- The rise in the balance of local banks' claims on the CBK by KD 882.6 million (291.3%) to KD 1185.6 million at end of the fiscal year 2005/06, against KD 303 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 960.5 million (768.4%) to KD 1085.5 million at end of the fiscal year 2005/06, against KD 125 million at end of the previous fiscal year.

- The decline in the balance of local banks' claims on the government by KD 377.3 million (13.5%) to KD 2409.4 million at end of the fiscal year 2005/06, against KD 2786.7 million at end of the previous fiscal year. The largest portion (44.5%) of this decline reflects the decrease of the balance of Debt Purchase Bonds by KD 167.7 million or 31.5% to KD 364.3 million at end of the fiscal year 2005/06, against KD 532 million at end of the previous fiscal year. Also, the balance of local banks' holdings of Public Debt Instruments (Kuwaiti Treasury Bills and Bonds) declined by KD 209.6 million (9.3%) to KD 2045.2 million at end of the fiscal year 2005/06, against KD 2254.7 million at end of the previous fiscal year.

On the Liabilities Side:

- The rise in the balances of the resident private sector's deposits with local banks by KD 2092.6 million (17.7%) to KD 13948.7 million at end of the fiscal year 2005/06, against KD 11856 million at end of the previous fiscal year. The mentioned increase resulted from the rise in balances of KD deposits by KD 1550.9 million (14.7%) to KD 12132.7 million at end of the fiscal year 2005/06, against KD 10581.8 million at end of the previous fiscal year, and the rise in foreign currency deposits by KD 541.7 million (42.5%) to KD 1815.9 million at end of the fiscal year 2005/06, against KD 1274.2 million at end of the previous fiscal year.
- The rise in the balances of shareholders' equity in local banks by KD 526.7 million (22.1%) to KD 2908.5 million at end of the fiscal year 2005/06, against KD 2381.8 million at end of the previous fiscal year.
- The rise in the balances of government deposits with local banks by KD 382.7 million (64.4%) to KD 977.3 million at end of the fiscal year 2005/06, against KD 594.6 million at end of the previous fiscal year
- The increase in the balances of foreign claims on local banks by KD 1049.1 million (63.5%) to KD 2700.9 million at end of the fiscal year 2005/06, against KD 1651.8 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 382 million (33%), other foreign deposits by KD 651 million (160.8%) and other foreign liabilities by KD 16.1 million (18%).

Second: The Main Supervisory Measures and Instructions Issued by the CBK

CBK pursued during the fiscal year 2005/06 its efforts in the supervision and oversight of the banking and financial system units, through the off-site supervision and on-site inspection of these units, within its sustained endeavors towards maintaining the safety and soundness of the banking and financial activity in the State of Kuwait. These units encompassed as on 31/3/2006 the local commercial, specialized and Islamic banks (15 banks), investment companies (62 companies, of which 26 companies operating according to the provisions of the Islamic Sharia), exchange companies (39 companies), investment funds (70 investment funds, of which 27 funds operating according to the provisions of the Islamic Sharia). In this regard, during the fiscal year 2005/06, CBK issued several circulars, instructions and regulations to the banking and financial units subject to its supervision, most significant among which were the following:

- The circular issued on 30/5/2005 to local banks, concerning providing the CBK, on a regular quarterly basis, with data on local banks staff (by nationality and job level) for monitoring local banks' abidance by the established national manpower ratios.
- The circular issued on 10/7/2005 to local banks, concerning deriving guidance from the principles issued by the Basel Committee for Banking Supervision in April 2005, in regard to the establishment of the follow-up (compliance) unit and its functions in banks.
- The circular issued on 12/7/2005 to local banks, concerning foreign investment funds whose units are marketed by local banks inside Kuwait.
- The circular issued on 16/10/2005, concerning updating the CAMEL methodology used in rating the performance of banks.
- The circular issued on 23/10/2005 to local banks and investment companies, concerning separating the domestic securities' portfolios managed for third parties' account from the foreign securities and investment instruments' portfolios managed for third parties' account, whereby the former will be subject to the rules and procedures set by the management of the Kuwait Stock

Exchange, while the latter will continue to be subject to the rules and procedures set by the CBK.

- The circular issued on 2/11/2005 to local banks and investment companies, concerning the functioning of the Ci-Net company database on customers who were granted consumer and other installment loans and against whom legal measures were taken, as of 1/1/2006.
- The circular issued on 7/11/2005, concerning the rules and regulations regarding the required experience according to Article (68) of the Law No. 32 of year 1968 and amendments thereof.
- The circular issued on 12/12/2005 to local conventional banks, concerning the application of the revised capital adequacy standard (Basel II) as of 31 December 2005.
- The circular issued on 24/1/2006 to auditors of local banks and registered investment companies, informing them that their responsibilities include ascertaining the abidance of these institutions by the correct and fair implementation of International Accountancy Standards (International Standards for Financial Statements).
- The circular issued on 7/2/2006, to local banks and investment companies, defining the maximum set limit of consumer loans and other installment loans granted to a single customer and setting a maximum limit for the repayment period of the last installment of this type of loans.
- The circular issued on 9/3/2006 to local conventional banks and branches of foreign banks regarding providing the CBK with copies of the endorsed policies and measures regarding the application of the second and third pillars of the revised capital adequacy standard (Basle II).
- The circular issued on 22/3/2006 regarding the set of guidelines applied by the CBK in the review of banks' applications for exemption from the established maximum limits of financial investments.

- The circular issued on 23/3/2006 regarding providing the CBK with data on the banks' estimated budgets and future work plans, attached to end-of-year closing financial statements.

Furthermore, the CBK continued during the fiscal year 2005/06 its efforts in following up the measures applied by banks, investment companies, and exchange companies regarding their observance of the national manpower ratio established by virtue of the provisions of Article (71-bis) of Law No. 32 of 1968, and their abidance by the provisions of Law No. 19 of 2000 concerning supporting national manpower, along with monitoring the compliance of banks with the rules regarding single ownership in excess of 5% of any Kuwaiti bank's capital.

Third: Major Operations Performed by the CBK

CBK carried out, during the fiscal year 2005/06, various banking activities in connection with currency issuance, clearing operations, and transfers between local banks. The value of currency issued by CBK rose during the fiscal year 2005/06, as the average value of issued currency and coins reached KD 652.4 million during that fiscal year, compared with an average of KD 598.7 million during the previous fiscal year. During the fiscal year 2005/06, the balance of issued currency reached its highest (KD 723.4 million) in November 2005 and its lowest (KD 559.5 million) in September 2005. 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 34 million (6.5%) from KD 524.3 million during the fiscal year 2004/05 to KD 558.3 million during the fiscal year 2005/06. During the fiscal year 2005/06, the balance of currency in circulation reached its highest (KD 584.6 million) in October 2005 and its lowest (KD 514.7 million) in August 2005.

Regarding the operations carried out through the CBK Clearing Room, the total value of these operations rose during the fiscal year 2005/06 to KD 9108.4 million for 1974 thousand transactions (cheques), or an average of KD 4614.4 per transaction, compared with KD 7617.6 million for 1848 thousand transactions (cheques), or an average of KD 4122.3 per transaction, during the fiscal year 2004/05.

Regarding the settlement operations carried out between banks through the CBK, using *Kuwait's Automated Settlement System for Inter-Participant Payments* (KASSIP), the total value of these operations during the fiscal year 2005/06 amounted to KD 97.1 billion, against KD 70.1 billion, during the previous fiscal year, i.e. an increase of KD 27.1 billion or 38.6%. Worth noting is that KASSIP was developed and updated to encompass the branches of foreign banks licensed to operate in the State of Kuwait.

Furthermore, during the fiscal year 2005/06, CBK processed, on behalf of ministries and governmental institutions, 8249 banking drafts amounting to KD 692.2 million, against 8268 banking drafts valued at KD 629.1 million during the previous fiscal year 2004/05.

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 2005/06, are shown in the following table:

Particulars	No.	Value (in KD)
First- Documentary Credits:		
1- <u>Opened:</u>		
-Local	-	-
-Foreign	65	21,200,012/497
2- <u>Paid:</u>		
-Local	-	-
-Foreign	183	30,983,472/646
3- <u>Amended:</u>		
-Local	-	-
-Foreign	41	
Second- Collection Transactions:		
Bills for Collection		
a- Incoming	15	20,930/834
b- Paid-up	17	27,587/683
Third- Drafts for Collection:		
a- Collected	151	541,978/693
b- Purchased	-	-

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 scientific and professional capabilities, the CBK took several measures and decisions during the fiscal year 2005/06, most important among which were the following:

1. During the fiscal year 2005/06, 47 Kuwaiti graduates (of which 34 holding university degrees and 13 holding the diploma of applied sciences) were accepted as trainees for positions at the CBK. Furthermore, during the same fiscal year, 84 individuals, of which 75 Kuwaitis (89.3%) were hired. Also, 41 Kuwaiti trainees who completed their training programs during the fiscal year 2005/06 were confirmed in their jobs at the CBK. Accordingly, by the end of the fiscal year 2005/06, the total number of CBK staff reached 814 employees, of which 650 (79.8%) were Kuwaitis.
2. During the fiscal year 2005/06, the CBK participated in 137 specialized training courses in the State of Kuwait, and sent 583 of its employees to these courses. Furthermore, CBK sent 87 of its employees to 79 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 2005/06, CBK sent 170 of its employees abroad to attend 105 conferences and meetings of relevance to CBK's work, held at the Gulf, Arab and international levels.
4. During the fiscal year 2005/06, the CBK sent a number of staff members on scholarships abroad, to obtain masters and doctorate degrees.
5. During the fiscal year 2005/06, 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.
6. The organizational structure of the Information Technology (IT) Sector was developed to encompass the IT Strategic Planning Department at CBK, the

Information and Operation Systems Department, and the Information Security Unit.

Fifth- Other Operations and Activities Performed by the CBK

- During the fiscal year 2005/06, the CBK held events of relevance to its activities, of which the Seminar on “Corporate Governance for Board Members of Financial Institutions in the State of Kuwait” jointly organized with the Kuwaiti Banks Union, during the period 15-16/11/2005. Lecturers in the seminar were a select group of experts from International Financial Specialized institutions, such as the Institute of International Finance (IIF), the World Bank, the Institute of Advanced Legal Studies, and the London School of Economics and Political Sciences, in addition to international consulting institutions in the strategic management of financial services. Also the CBK organized in cooperation with the MENA FATF (Middle East and North Africa Financial Action Task Force), the IMF, and the World Bank, a training workshop from 17-21 December 2005, addressed to the AML/CFT (Anti-Money Laundering /Combating the Financing of Terrorism) assessors. The workshop counted the participation of MENA region specialists from the financial and legal fields and executive bodies, in addition to specialists from the CBK, the Public Prosecution, the Ministry of Interior, the Ministry of Trade and Industry, and the General Customs Authority.
- Within its role as a financial advisor to the government, the CBK provided advice on numerous issues of relevance to its activities, particularly in regard to the project laws drafted by the government and deliberated by the National Assembly, as well as on issues connected to CBK’s role in the projects concerning development plans, and the government’s work programs. Within this context, and according to the Council of Ministers’ decision No. 719 issued on 3/7/2005, for the formation of a work group headed by CBK’s governor, and counting in its membership representatives from certain governmental bodies, along with experts and specialists, for the purpose of studying the issue of developing the State of Kuwait into a regional financial and trading center, the CBK provided technical support to the activities of that group during the fiscal year 2005/06.

- During the fiscal year 2005/06, 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 2005/06 reached KD 279.9 million.
- During the fiscal year 2005/06, the CBK continued preparing and publishing its various periodicals (monthly, quarterly) as well as 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.

Sixth :

**The Central Bank of Kuwait Balance Sheet
and Profit & Loss Account for the Fiscal Year
Ended 31 March 2006**

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 2006 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 Abdul-Wahab Al-Oseimi

Register of Accountants & Auditors
License No. 68 A -
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of ERNST & YOUNG

1 May 2006
State of Kuwait

CENTRAL BANK OF KUWAIT

Balance Sheet As On

Assets	Note	31 March 2006	31 March 2005
Gold		31,736,332	31,736,332
Cash, Current and Call Accounts in Foreign Currency with Banks and other Financial Institutions		272,188,909	214,616,795
Local KD-denominated Bonds and Public Debt Instruments		6,034,000	-
Deposits and Investments in Foreign Currency	3	2,682,985,585	1,962,831,700
Other Assets	4	17,096,033	13,179,118
		3,010,040,859	2,222,363,945
Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts	10	2,886,730,630	3,306,463,837

31 MARCH 2006 (KD)

Equity and Liabilities	Note	31 March 2006	31 March 2005
Capital - Fully Paid Up		5,000,000	5,000,000
General Reserve Fund	5	213,297,582	199,210,110
Special Account	6	180,663,485	264,515,536
Profit For the Year		69,416,287	28,174,945
Currency Issued	7	668,183,939	626,111,682
CBK Bonds Issued		30,000,000	-
Government Accounts		490,622,770	700,725,710
Local Banks' Current Accounts and Deposits with the CBK	8	1,156,550,988	311,465,169
International Institutions		140,149,473	37,841,005
Deposits on Documentary Credits	10	23,668,214	20,810,081
Other Liabilities	9	32,488,121	28,509,707
		3,010,040,859	2,222,363,945
Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts	10	2,886,730,630	3,306,463,837

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 2006
(KD)**

	<u>Note</u>	<u>2005/06</u>	<u>2004/05</u>
Interest & Income from Investments		90,231,343	50,728,862
Interest and Commission Expenses		<u>(1,904,794)</u>	<u>(4,705,131)</u>
		88,326,549	46,023,731
Other Income		464,779	230,871
Operating Income		88,791,348	46,254,602
Operating Expenses	11	<u>(19,375,061)</u>	<u>(18,079,657)</u>
Net Profit for the year		<u>69,416,287</u>	<u>28,174,945</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	14,087,473
to the CBK General Reserve Fund	5	<u>34,708,143</u>	<u>14,087,472</u>
		<u>69,416,287</u>	<u>28,174,945</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 difference between the nominal value of obligations arising from intervention operations in the money market (CBK Bonds issued and local banks deposits) and amounts paid in settlement of these obligations 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 taken to the special account.

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

	<u>2005/06</u>	<u>2004/05</u>
Deposits with Foreign Banks and Institutions	2,678,606,335	1,958,452,450
Central Bank Facilities to the International Bank for Reconstruction and Development	4,379,250	4,379,250
	<u>2,682,985,585</u>	<u>1,962,831,700</u>

4- Other Assets (KD):

	<u>2005/06</u>	<u>2004/05</u>
Interest Receivable on Deposits and Other Assets	12,110,084	8,218,800
CBK's Share in the Capital of the Industrial Bank of Kuwait	2,511,210	2,511,210
Prepaid Expenses	176,462	126,847
Advance Payments	131,621	222,665
Other Debit Balances	2,166,656	2,099,596
	<u>17,096,033</u>	<u>13,179,118</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, half of the annual profits are transferred to the General Reserve Fund, following the approval of the CBK financial data by the Minister of Finance, and the financial effects thereof appear in the following fiscal year.

6- Special Account (KD):

	<u>2005/06</u>	<u>2004/05</u>
Balance at Beginning of the Year	264,515,536	250,223,818
Net difference in foreign currency , resulting from revaluation of cash assets and liabilities in foreign currencies	(83,852,051)	11,395,659
Profit resulting from withdrawal of currency notes from circulation (fourth issue)	-	2,896,059
Balance at End of the Year	<u>180,663,485</u>	<u>264,515,536</u>

The special account represents the net difference accumulated as a result of revaluation of cash assets and liabilities in foreign currencies, and profit resulting from the withdrawal of currency notes from circulation, based on 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>2004/05</u>
Net Currency Produced	1,062,030,279	1,087,161,435
Less: Currency in the CBK's Vaults	(393,846,340)	(461,049,753)
	<u>668,183,939</u>	<u>626,111,682</u>

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

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

	<u>2005/06</u>	<u>2004/05</u>
Current Accounts	71,050,988	186,465,169
Deposits	1,085,500,000	125,000,000
	<u>1,156,550,988</u>	<u>311,465,169</u>

9- Other Liabilities (KD):

	<u>2005/06</u>	<u>2004/05</u>
Accrued Expenses	3,545,158	2,695,010
Other Credit Balances	18,772,350	25,814,697
Ministry of Finance, cost of supporting money market operations (Note 2-C)	10,170,613	-
	<u>32,488,121</u>	<u>28,509,707</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 the amount of KD 30,000,000 transferred from the

Ministry of Finance after charging the cost of supporting the money market operations carried out by the Bank according to the agreement between the Bank and the Ministry of Finance.

10- Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts (KD):

	<u>2005/06</u>	<u>2004/05</u>
a- Accounts Managed by the CBK on Behalf of the Government of Kuwait	2,829,959,708	3,239,299,318
b- Contra Accounts:		
Documentary Credits	31,570,222	44,006,763
Memorial Notes and Coins	1,649,182	1,586,704
Collections According to the Law No. 41 of 1993	23,551,518	21,571,052
	<u>56,770,922</u>	<u>67,164,519</u>
	<u>2,886,730,630</u>	<u>3,306,463,837</u>

On 31 March 2006, deposits of KD 23,668,214 (KD 20,810,081: 2005) were held against the documentary credits referred to above.

11- Operating Expenses (KD):

	<u>2005/06</u>	<u>2004/05</u>
Employee Costs	12,372,286	11,404,078
Administrative and Computer Costs	2,067,779	1,344,599
Purchases of Furniture, Equipment and Vehicle	307,994	962,692
Production and Shipment of Currency	2,029,619	1,083,814
Sundry Expenses	1,310,804	1,173,880
Construction Costs	1,286,579	2,110,594
	<u>19,375,061</u>	<u>18,079,657</u>

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 the 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 the 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 Ministry of Finance 3% 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 2006, promissory notes held by the CBK in safe custody on behalf of International Institutions totaled KD 424,884,853 (KD 386,535,254: 2005).

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