CENTRAL BANK OF KUWAIT

THE TWENTY SIXTH

ANNUAL REPORT

FOR THE FISCAL YEAR 1997/98

The Annual Report of the Central Bank of Kuwait
for the Fiscal Year 1997/98

INTRODUCTION

During the fiscal year 1997/98, the efforts of the Central Bank of Kuwait (CBK) and monetary policy directions focused on strengthening monetary stability in the country so as to enhance the elements and opportunities for self-generated growth in the domestic economy. This was within the CBK efforts in drawing and implementing the monetary policy, along with overseeing and supervising the credit policy of local banks[*] and investment companies subject to its supervision.

The CBK also pursued its endeavours in the monitoring of economic and monetary developments locally and internationally, and the preparation of the necessary reports and studies for assessing the directions of these developments and analyzing their reflection on the local monetary and banking conditions in particular and the economic conditions in general, and consequently drawing and implementing appropriate policies and measures for addressing these developments as may best serve the interest of the domestic economy.

In line with CBK's concern with the problem of adjusting its computer systems to make them year 2000 compatible, and within its sustained efforts in that area since the previous fiscal year (1996/97), the CBK completed during the fiscal year 1997/98 the necessary amendments for year 2000 compatibility to a number of main applied systems in its departments.

This report provides an outline of the significant domestic monetary and banking developments during the fiscal year 1997/98, followed by a brief review of the most important measures taken and operations performed by the CBK during that period, then the Auditors Report on the CBK balance sheet statement as on 30 June 1998, and the profit and loss account of its activities for the fiscal year then ended, as follows:

(*) The term local banks in this report covers commercial banks, specialized banks and the Kuwait Finance House.

First : The Main Monetary and Banking Developments

1- Monetary Developments:

Within its sustained efforts in drawing and implementing the monetary policy and directing the credit policy of banks and domestic investment companies so as to maintain the monetary stability in the country, the CBK carries out a continual follow-up of the domestic monetary and banking developments through a number of main monetary and banking aggregates and indicators. The following are among the most significant monetary developments during the fiscal year 1997/98:

A- The Domestic Interest Rates:

In furtherance of the monetary stability in the country, the CBK is keen to keep the KD interest rates both in line with the developments in international interest rates on major currencies, and consonant with the requirements of the domestic economic conditions. Consequently, the CBK continued during the fiscal year 1997/98 to monitor the developments in domestic interest rates and assess their conformity with the monetary policy objectives. In light of these developments, the CBK decided to raise the discount rate by a quarter percentage point from 7.25% to 7.50%, effective 9 November 1997.

It is noteworthy in this regard that the domestic interest rates structure links the maximum limits of interest rates on KD lending transactions to the discount rate within specific margins (which remained unchanged since their application on 25 April 1993). By virtue of the CBK decision on 30 January 1995, the floor of interest rates on KD deposits and savings accounts was abrogated and their determination was left to the interaction of supply and demand forces, as well as competition in the market of these deposits.

Available data on the developments in domestic interest rates show that the interest rates on customer KD deposits with local banks displayed limited changes during all quarters of the fiscal year 1997/98. For example, the average interest rates on three-month customer deposits rose to 6.58% during the fourth quarter of the fiscal year 1997/98 from 6.40% during the corresponding quarter of the previous fiscal year, i.e. by 0.18 percentage point.

Data on the average interest rates on customer deposits with local banks show that the margins favouring the KD between the averages of interest rates on these deposits in KD on the one hand, and in US dollar on the other hand, during the fiscal year 1997/98, reached 0.90 percentage point (between 6.26% and 5.36%), 1.07 percentage point (between 6.51% and 5.44%), 1.16 percentage point (between 6.65% and 5.49%), 1.15 percentage point (between 6.77% and 5.62%) for the one-month, three-month, six-month, and twelve-month terms respectively.

The average interest rates on the interbank KD deposits of local banks during the fiscal year 1997/98 were in general higher than their previous fiscal year levels. Their rise was particularly eminent during the second and third quarters of that year before decreasing slightly during its fourth quarter. For example, the average interest rates on three-month deposits reached 7.23% during the fiscal year 1997/98 compared to 7.01% during the previous fiscal year, i.e. an increase of 0.22 percentage point.

The average interest rates on the three-month and six-month Kuwaiti Treasury Bills remained almost stable at their previous fiscal year levels. The average interest rates for the above mentioned terms reached 6.96% and 7.13% respectively during the fiscal year 1997/98, from 6.96% and 7.14% respectively during the previous fiscal year.

B- Money Supply:

Available data show that money supply in its broad definition (M2) stood at KD 7550.7 million at end of the fiscal year 1997/98 compared to KD 7663.3 million at end of the previous fiscal year, i.e. a decrease of KD 112.6 million or 1.5%. This decrease is totally attributable to the marked decrease of KD 139.7 million or 10% in Money (the narrow definition of money supply M1), while Quasi-money recorded a slight increase not exceeding KD 27.1 million (0.4%). The mentioned decrease in Money (M1) was, in turn, totally ascribable to the tangible decline of KD 141.6 million (13.7%) in sight deposits (within the private sector deposits with local banks). Meanwhile, currency in circulation decreased slightly by not more than KD 2 million or 0.5% (from KD 355.8 million to KD 357.8 million).

As for money supply components, the balances of private sector deposits with local banks amounted to KD 7192.9 million at end of the fiscal year 1997/98, i.e. a decrease of KD 114.6 million or 1.6%, below its level of KD 7307.5 million at end of the previous fiscal year. This decrease is the outcome of the decrease in foreign currency deposits by KD 333.2 million or 26.1% (from KD 1278.1 million to KD 944.9 million), and the growth in KD deposits by KD 218.6 million or 3.6% (from KD 6029.4 million to KD 6248 million). The growth in KD deposits was in turn the outcome of the increase in term deposits (KD 312.3 million or 8.1%), certificates of deposit (KD 46.9 million or 383.7%) as well as the increase in savings deposits by KD 1 million (or 0.1%) on the one hand, against the above mentioned decrease in sight deposits on the other.

Concerning the factors affecting changes in money supply within the aggregate monetary position of the CBK and local banks at end of the fiscal year 1997/98, the above mentioned decrease in money supply (M2) totalling KD 112.6 million was the outcome of the decrease in net foreign assets by KD 707.7 million on the one hand and the increase in net domestic assets of these institutions by KD 595.1 million on the other hand. The decrease in net foreign assets was the outcome of the decrease in net foreign assets of local banks by KD 870.4 million, and the increase in net foreign assets of the CBK by KD 162.7 million. The most significant developments in net domestic assets was the marked increase in the claims of local banks on the private sector (most of which in credit facilities) by KD 1140.5 million, and the substantial decrease in claims on the government by KD 260.6 million. This decrease was the outcome of the redemption of a portion of the local banks portfolio of Debt Purchase Bonds together with the Purchase Bonds of the Real Estate Portfolio of the Kuwait Finance House by KD 367.8 million, in addition to the increase in the holdings of these banks of Public Debt Instruments by KD 148.9 million, and the settlement of the CBK holdings of these instruments valued at KD 42 million.

C- The KD Exchange Rate:

The CBK pursued the implementation of the KD exchange rate policy based on tying the KD exchange rate to a special basket of currencies of countries with major trade and financial relations with the State of Kuwait. Throughout more than twenty-three years of application, this policy proved its effectiveness in maintaining the relative stability of the KD exchange rate against the major currencies, thereby contributing to alleviating the pressure on domestic prices caused by imported inflation. Under this policy, the relative stability of the KD exchange rate against the US dollar, compared to the exchange rates of major currencies, was more pronounced during the fiscal year 1997/98 compared to the previous fiscal year.

The relative stability in the KD exchange rate during the fiscal year 1997/98 is concluded from comparing the movements of the US dollar exchange rate against the Kuwaiti dinar on the one hand, and against the major currencies on the other hand. This comparison shows that the movements of the US dollar exchange rate against the Kuwaiti dinar were within very narrow margins, as the highest and lowest exchange rates of the US dollar against the dinar did not exceed 0.83% and 0.32% during the fiscal year 1997/98. Meanwhile, the US dollar fluctuated by much higher rates against other major currencies, as the highest and lowest exchange rates of the US dollar against these currencies reached, for example, 6.94% and 1.97% against the Deutsche mark, 6.86% and 2.12% against the French franc, 5.77% and 2.33% against the Swiss franc, 5.22% and 3.62% against the Japanese yen, and 2.57% and 3.22% against the Sterling pound.

D- Bank Credit:

During the fiscal year 1997/98, the CBK pursued its supervisory efforts in guiding and rationalizing the credit policies of banks and investment companies, so as to ensure their abidance by the CBK instructions regarding the rules, principles, controls and procedures for extending credit facilities.

The following table shows the value of KD-denominated credit facilities (including consumer loans) extended by local banks to residents during the fiscal year 1997/98 compared to the previous fiscal year, and their relative distribution by sector. These agreements reflect the limits of KD credit facilities extended to new clients or the increase in the limits of credit facilities extended to existing ones.

Particulars	1997/98		1996/97	
	Value (KD Million)	Relative Importance (%)	Value (KD Million)	Relative Importance (%)
Total Extended Credit Facilities:	**2720.7**	**100.0**	**2678.1**	**100.0**
Trade	820.2	30.2	563.2	21.0
Personal Facilities	547.7	20.1	583.8	21.8
Real Estate	320.9	11.8	350.4	13.1
Construction	269.2	9.9	267.9	10.0
Non-bank Financial Institutions	234.1	8.6	218.9	8.2
Consumer Loans	223.5	8.2	351.2	13.1
Industry	155.0	5.7	154.8	5.8
Others	150.1	5.5	188.0	7.0

As highlighted in that table, the KD credit facilities extended to residents during the fiscal year 1997/98 totalled KD 2720.7 million, i.e. an increase of KD 42.6 million or 1.6%, compared to KD 2678.1 million during the previous fiscal year. Trade came in the forefront of the sectors benefiting from this increase (KD 820.2 million or 30.2%), followed by personal facilities (KD 543.8 million or 20.1%), real estate (KD 320.9 million or 11.8%), construction (KD 269.2 million or 9.9%), non-bank financial institutions (KD 234.1 million or 8.6%), consumer loans (KD 223.5 million or 8.2%), industry (KD 155 million or 5.7%) and the “Others” sector (KD 150.1 million or 5.5%).

The balances of utilized cash credit facilities extended to residents in KD and foreign currencies totalled KD 4665.4 million at the end of the fiscal year 1997/98, i.e. an increase of KD 1016.2 million or 27.8% above its level of KD 3649.2 million at end of the previous fiscal year. As for the sectoral distribution of these balances, personal facilities came first (KD 1659.4 million or 35.6%, out of which consumer loans amounted to KD 534.4 million or 11.5% of the total), followed by trade (KD 819 million or 17.6%) real estate (KD 788.5 million or 16.9%), industry (KD 451.8 million or 9.7%), “Others” sector (KD 334.8 million or 7.2%), construction (KD 333 million or 7.1%), non-bank financial institutions (KD 269 million or 5.8%) and, finally, the agriculture and fisheries sector (KD 9.9 million or 0.2%).

E- Issuing Public Debt Instrument:

During the fiscal year 1997/98, the CBK issued -on behalf of the Ministry of Finance- 33 issues of three-month and six-month Treasury Bills with a total nominal value of KD 2111.3 million. Meanwhile, 37 issues of these bills with a nominal value of KD 2501.8 million matured during the same year. Thus, the outstanding balance of Treasury Bills fell by KD 390.5 million (31.6%) to a nominal value of KD 847 million at end of the fiscal year 1997/98.

Furthermore, the CBK made fourteen issues of one-year and two-year term Treasury Bonds whose total value stood at KD 1010 million, with an interest rate of 7.25% for the one-year term and 7.375% for the two year-term. Meanwhile, eleven previous Treasury Bond issues of a nominal value of KD 960 million matured, bringing the outstanding balance of Treasury Bonds to KD 1195.4 million, i.e. an increase of KD 50 million (4.4%).

As a result of the above developments, the outstanding balance of public debt instruments (Treasury Bills and Bonds) declined to KD 2042.4 million at end of the fiscal year 1997/98, i.e. a decrease of KD 340.5 million or 14.3% below its level of KD 2382.9 million at end of the previous fiscal year.

2- Banking Developments:

During the fiscal year 1997/98, local banks continued strengthening their structures, in terms of relying on more developed professional bases with regard to sources and uses of funds, within the framework of a sustainable balanced growth. The characteristics of this professional structure are clearly evidenced in the direction taken by these banks for the continual enhancement of their financing role in the domestic economy through expanding the extension of bank credit to all sectors of the domestic economy, while abiding by the CBK instructions and regulations concerning the rules and principles for the provision of such facilities and aimed at rationalizing the credit policies of these banks. Noticeable too during the fiscal year 1997/98 was the direction followed by local banks to increase their operations in the money market for the purposes of borrowing or using funds, particularly through the local interbank deposits on the one hand and the foreign interbank deposits on the other.

Available data show that the aggregate balance sheet of local banks amounted to KD 12883.4 million at end of the fiscal year 1997/98, thus recording a marked growth of KD 939.2 million or 7.9%, compared to its level of KD 11944.2 million at end of the previous fiscal year. This growth is attributable to a number of developments in the elements of this balance sheet on both sides of assets and liabilities. The following are the most significant among these developments:

- The marked rise in claims on the private sector by KD 1140.5 million or 28.9% to KD 5092.8 million at end of the fiscal year 1997/98, compared to KD 3952.3 million at end of the previous fiscal year. This rise was the outcome of the total increase in both the balances of utilized cash credit facilities extended to the domestic economic sectors by KD 1016.2 million or 27.8% (from KD 3649.2 million to KD 4665.4 million) and the investments of local banks in local shares and bonds by KD 124.3 million (41%). Worthy of note is that this rise in claims on the private sector and the increase in both above mentioned components of these claims, namely cash credit facilities and investments in local shares and bonds, led to the rise in their relative importance in the total assets to 39.5%, 36.2% and 3.3% respectively at end of the fiscal year 1997/98 compared to 33.1%, 30.6% and 2.5% respectively at end of the previous fiscal year.

- The marked decrease in claims on the government by KD 218.6 million or 4.9% to KD 4210.3 million at end of the fiscal year 1997/98, compared to KD 4428.9 million at end of the previous fiscal year. This decrease resulted from the declined in the balances of both Debt Purchase Bonds by KD 329 million or 13.3% (from KD 2471.4 million to KD 2142.4 million) and Purchase Bonds of the Real Estate Portfolio of the Kuwait Finance House by KD 38.6 million or 19.7% (from KD 195.9 million to KD 157.3 million). Consequently, the sum of the balances of both types of bonds decreased by KD 367.5 million or 13.8% (from KD 2667.2 million to KD 2299.7 million) on the one hand, while the holdings of Public Debt Instruments (Treasury Bills and Bonds) increased by KD 148.9 million or 8.5% (from KD 1761.7 million to KD 1910.6 million) on the other hand. Accordingly, the relative importance in the total assets decreased for both the total claims on the government and the Debt Purchase Bonds (together with the Purchase Bonds of the

Real Estate Portfolio) to 32.7% and 17.8% respectively, but rose for Public Debt Instruments to 14.8% at end of the fiscal year 1997/98, compared to 37.1%, 22.3% and 14.7% for these three elements respectively at end of the previous fiscal year.

- The tangible decrease in foreign assets by KD 216.5 million or 9.8% to KD 1987.9 million from KD 2204.4 million. This decrease was the outcome of the decline in both the credit facilities extended to non-residents (by KD 130.1 million or 13.4%), and deposits with foreign banks (KD 87.6 million or 11.8%), along with a slight increase (KD 1.3 million or 0.3%) in the foreign investments of local banks.

- The decrease in private sector deposits with local banks by KD 114.6 million or 1.6% (from KD 7307.5 million to KD 7192.9 million). This decrease was the outcome of the tangible decline in foreign currency deposits by KD 333.2 million or 26.1% (from KD 1278.1 million to KD 944.9 million) on the one hand, and the increase in KD-deposits by KD 218.6 million or 3.6% (from KD 6029.4 million to KD 6248 million) on the other. The above mentioned increase in KD deposits represents the sum of the increase in term deposits (KD 312.3 million or 8.1%), certificates of deposit (KD 46.9 million or 383.7%) and savings deposits (KD one million or 0.1%), and the decrease in sight deposits (KD 141.6 million or 13.7%).

- The increase in shareholders' equity by KD 114.8 million or 8.9% to KD 1407.2 million at end of the fiscal year 1997/98 from KD 1292.5 million at end of the previous fiscal year.

- The marked rise in foreign liabilities by KD 653.9 million or 83.1% (from KD 786.7 million to KD 1440.6 million), totally ascribable to the increase in foreign banks deposits with local banks by KD 666.6 million or 93.7%.

Second: Significant Measures Taken and Supervisory Instructions Issued by the CBK

During the fiscal year 1997/98, the CBK continued to take measures and issue instructions as needed in enhancing the tools and methods for overseeing and supervising the banking and financial units subject to its supervision, along with directing their credit policy, so as to ensure their abidance by the sound professional banking and financial practices in conformity with the objectives of the monetary policy regarding the achievement of monetary stability in the country and the enhancement of the soundness of its banking system. In this regard, the CBK is keen on keeping these measures and instructions consonant with its efforts in regulating the levels of domestic liquidity and in maintaining the relative stability of both the KD exchange rate against major currencies and the domestic interest rates on the dinar. In this context, the CBK issued during the fiscal year 1997/98 a number of decisions and instructions to the banking and financial units subject to its supervision. The following were among the most significant of these decisions and instructions:

1- The circular issued on 18 August 1997 to banks and local investment and exchange companies concerning the adjustment of their existing information systems to incorporate the amendments necessary in their computer systems so as to make them year 2000 compatible. Attached to this circular was the general framework of a plan for the management of year 2000 project. The framework encompasses three main steps - namely the project management phases, the definition of external risks to be taken into consideration, and other operational matters- and obligates the above banks and companies to report quarterly to the CBK, as of 30 September 1997, on the progress achieved in making their information systems year 2000 compatible.

2- The circular issued on 23 September 1997 to all investment companies whose objectives include lending in general. This circular concerned the exemption of credit facilities extended for financing the purchase of securities within the privatization programme from the ban previously imposed on these companies by virtue of the CBK instructions issued on 14 May 1997, while abiding by the principles provided by the instructions with regard to rationalizing and regulating the credit policy of investment companies.

3- The circular issued on 14 October 1997 to local banks within the framework of the application of the new domestic liquidity system according to the maturity ladder approach, and which obligates these banks to maintain 20% of their customers KD-deposits in the form of Kuwaiti Treasury Bills and Bonds.

The new liquidity system relies on scaling assets and liabilities according to the maturity ladder approach; thus, matching future monetary inflows with future monetary outflows on both sides of assets and liabilities, over specific periods.

According to these instructions, liquidity for a bank is defined as "its ability to meet any decrease on the liabilities side and to finance any increase on the assets side". This definition reflects the primary dependence of liquidity on observing the rule of matching assets with liabilities by maturity, so as to avoid any current or future financing pressures.

These instructions defined the time-scale of maturities (terms), according to which the future monetary flows of a bank's assets are matched with the future monetary flows of its liabilities. These terms are eight, ranging from "spot" where an obligation is due but remains outstanding on the date of preparing the statement, to the "over-one-year" term. These instructions also defined the basis for the classification of assets and liabilities according to the maturity ladder approach, and set maximum limits for liquidity gaps, i. e. the discrepancy between the maturities of assets and liabilities, as follows:

	Term	**Maximum Cumulative Gap**
(1)	7 days and less	10%
(2)	One month and less	20%
(3)	Three months and less	30%
(4)	Six months and less	40%

However, the CBK may impose tighter gap limits on any bank in light of its financial position.

A significant portion of these instructions pointed out to the banks responsibility in enhancing their ability to follow up their liquidity positions, so as to ensure the adequacy of their internal arrangements and controls for liquidity management in creating the financial resources needed to cover any financial outflows during both normal and difficult times. This calls on banks to set up their internal policies with regard to liquidity according to the maturity ladder approach, and in compliance with the minimum requirements regarding the availability of an efficient computer systems that provides all necessary information in the measurement and management of monetary flows and liquidity requirements on the one hand, along with developing an internal policy regarding liquidity (which could be part of a general policy for treasury management) endorsed by the board of directors of the concerned bank, on the other hand.

4- The instructions issued on 10 November 1997 to local banks with regard to fighting money laundering and suspect operations.

5- The circular issued on 22 December 1997 to local banks and domestic investment companies instructing them to present to the CBK at the end of each fiscal year the justifications for continuing to hold their own shares. The circular obligates banks wishing to acquire a portion of their own shares to submit a complete study highlighting the importance of such acquisition and the effects thereof, while observing the procedure to be followed in obtaining CBK's approval in this regard. The circular also instructed local banks and companies which hold a portion of their own shares, to submit to the CBK a quarterly statement indicating the number of such shares purchased or disposed of and the value of the corresponding transactions.

6- The circular issued on 9 June 1998 to local banks extending credit risk centralization data to include credit cards issued with limits exceeding KD 10 thousand, effective end of August 1998.

7- The circular issued on 23 June 1998 to local banks within CBK's monitoring of the measures taken by banking institutions with regard to achieving year 2000 compatibility. The circular stipulated the necessity to complete the relevant adjustment of all main computer applications by end of the first quarter of 1999, and obligated each bank to instruct its external auditors to review the bank's preparedness regarding year 2000 compatibility, and report the findings to the CBK.

Third: Major Operations Performed by the CBK

1- The monthly average volume of currency and coins issued during the fiscal year 1997/98 amounted KD 413.5 million. The volume of issued currency reached its highest level during that fiscal year (KD 481 million) in February 1998, and its lowest level (KD 373.6 million) in August 1997.

2- The total value of the banking sector operations carried out through the CBK Clearing Room during the fiscal year 1997/98 decreased slightly to KD 4.4 billion, i.e. an average KD 2522.4 per transaction, from KD 4.6 billion, i.e. an average KD 2612 per transaction during the fiscal year 1996/97.

3- During the fiscal year 1997/98, the CBK processed 8693 banking drafts amounting to KD 478.3 million compared to 8680 drafts valued at KD 602.4 million during the previous fiscal year.

4- During the fiscal year 1997/98, the CBK continued issuing public debt instruments -on behalf of the Ministry of Finance - thus making 33 issues of three-month and six-month Treasury Bills valued at KD 2111.3 million, and fourteen issues of one-year and two-year Treasury Bonds valued at KD 1010 million. Meanwhile, 37 Treasury Bill issues valued at KD 2501.8 million, and eleven Treasury Bond issues valued at KD 960 million matured during the same fiscal year, as mentioned above.

5- The CBK buying and selling transactions with banks and investment companies in the secondary market for Public Debt Instruments during the fiscal year 1997/98 reached 14 transactions for buying Treasury Bills valued at KD 282.6 million, 21 transactions for selling Treasury Bills valued at KD 254.3 million) and nine transactions for buying Treasury Bonds valued at KD 356.3 million, while no transactions were carried out for selling Treasury Bonds. Furthermore, the CBK concluded 22 agreements valued at KD 232 million with the above mentioned institutions for the repurchase of these instruments. Consequently, the volume of CBK's buying and selling transactions in the secondary market for Public Debt Instruments, in addition to repurchase operations, reached KD 1125.2 million.

6- During the fiscal year 1997/98, the CBK processed all foreign banking transactions, on behalf of ministries and government bodies, namely documentary credits as well as bills and drafts for collection, as shown in the following table (value in KD):

Particulars	No.	Value
First- Documentary Credits:		
1- Opened:		
-Foreign	130	104,648,480/178

-Local	2	4,189,715/752
2- Paid:		
-Foreign	269	52,179,905/638
-Local	1	304,198/320
3- Amendments**:**		
-Foreign	99	-
-Local	1	-
Second- Collection Transactions:		
Bills for Collection		
- In-coming	223	1,177,843/805
- Paid-up	126	484,506/095
Third- Drafts for Collection:		
- Collection	303	247,068/536
- Purchased		

Fourth: The Labour Force at the CBK

In its endeavours to upgrade the efficiency of staff members, qualify national bankers and increase the percentage of Kuwaiti staff in the total labour force, the CBK pursued during the fiscal year 1997/98 its efforts in developing human resources, through continuing to adopt employment and training policies that aim to attract qualified Kuwaiti cadres to join the bank and encourage them to take up work in the local banking industry. In addition to the CBK efforts in upgrading its organizational structure by establishing new sections within some of its offices and departments, preparing and endorsing job descriptions reflecting the latest amendments to the minimum requirements for such jobs, along with introducing new job titles, numerous developments in manpower at the CBK occurred during the fiscal year 1997/98, most significant among which were the following:

1- The total labour force at the CBK numbered 686 (of which 470 Kuwaitis) at end of the fiscal year 1997/98, compared to 664 (of which 450 Kuwaitis) at end of the previous fiscal year, reflecting a rise in the percentage of Kuwaitis in the CBK to 68.5% from 67.8%, and a decrease in the percentage of expatriates (including unskilled labour) to 31.5% from 32.2%. If unskilled labour are excluded (numbering 67) from the comparison, the percentage of Kuwaitis reaches 75.9%. On the other hand, the percentage of Kuwaitis in leadership and supervisory posts at the CBK stood at 95.2%.

2- During the fiscal year 1997/98, 60 staff members were appointed at the CBK, of which 43 Kuwaitis (71.7%). Also, 24 Kuwaiti graduates holding university degrees and six Kuwaiti graduates holding the diploma of applied sciences were accepted as trainees for grooming in their relevant jobs at the CBK. Meanwhile, 23 Kuwaiti trainees were confirmed in the jobs they were nominated for in the CBK departments and offices during that fiscal year. Of those trainees, 6 were among those accepted in the training programmes for the fiscal year 1996/97; the remaining 17 were among those accepted for training during the fiscal year 1997/98.

3- Within the context of the CBK annual training plan reflecting the bank's training requirements which are determined through the joint cooperation of its departments and offices, 25 training programs were prepared and implemented during the fiscal year 1997/98, and 230 staff members benefited from these in-house training programmes delivered by specialized bodies, as well as from programmes implemented by CBK specialist staff with long experience in their field.

With regard to the specialized training courses organized by the CBK for its staff members during the fiscal year 1997/98 in cooperation with other institutions in Kuwait and abroad, 34 staff members were sent to attend 29 of such courses at international banking institutions abroad; meanwhile, 79 CBK staff members were sent on 40 specialized training courses held in cooperation with training institutions in Kuwait.

Regarding CBK participation in conferences and meetings held at the international, Arab and Gulf countries levels in the areas of economics, banking, finance and other areas of relevance to the CBK activity, 44 staff members of the CBK took part during the fiscal year 1997/98 in 28 of such official conferences and meetings.

4- In the area of the educational and training activities held in cooperation with the Institute of Banking Studies (IBS) during the fiscal year 1997/98, 11 Kuwaiti staff members of the CBK were on IBS enrollment for the two-year high diploma in banking studies, (four of them were in the first year and seven in the second year); noting that non-Kuwaiti staff are not allowed to be enrolled in the IBS. Meanwhile, four staff members obtained the above mentioned IBS diploma during that period. A total of 14 staff members benefited from the special educational syllabi presented by the IBS to the banking and financial sector according to the free selection syllabus system; additionally, one staff member participated in the advanced syllabus under that system.

Concerning the specialized banking training courses, English language courses and short courses presented by the IBS, 53 staff members of the CBK were sent to attend these programs during the fiscal year 1997/98.

Fifth :

The Central Bank of Kuwait Balance Sheet As at the End of the Fiscal Year 1997/98, and Its Profit & Loss Account for that Year

REPORT OF THE AUDITORS

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 state of affairs of the CBK on 30 June 1997 and of the results of its operations for the year then ended, in compliance with Law No. 32 of 1968 as amended by Law No. 130 of 1977.

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.

Waleed Abdulla Al-Osaimi

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

21 July 1998

State of Kuwait

BALANCE SHEET AS ON

Assets :	Note	30 June 1998	30 June 1997
Gold		31,732,140	31,732,140
Cash, and Current and Call Accounts in Foreign Currency with Banks and Financial Institutions		152,125,375	152,378,710
Investments and Deposits in Foreign Currency	3	811,089,970	811,089,970
Deposits, Loans and Current Accounts with Local Banks and Financial Institutions in KD	4	5,826,334	6,844,469
Local Bonds in Kuwaiti Dinars and Public Debt Instruments	5	-	41,842,190
Other Assets	6	5,909,207	5,339,272
		1,165,821,184	**1,048,973,416**
Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts	12	**4,648,518,592**	**5,280,719,194**

30 JUNE 1998 (KD)

Capital and Liabilities	Note	30 June 1998	30 June 1997
Capital - Fully Paid Up		5,000,000	5,000,000
General Reserve Fund	7	179,000,000	179,000,000
Special Account	8	110,738,780	104,598,597
Profit For the Year		42,116,091	44,587,717
Currency Issued	9	405,157,942	407,097,673
Government Accounts		405,157,942	224,570,338
Local Banks' Accounts and Deposits with the CBK	10	206,217,885	59,636,537
International Institutions		2,182,115	5,717,822
Deposits on Documentary Credits	12	22,331,703	4,084,026
Other Liabilities	11	16,922,064	14,680,811
		1,165,821,184	**1,048,973,416**
Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts	12	**4,648,518,592**	**5,280,719,194**

The attached notes from 1 to 15 constitute a part of these financial statements.

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 30 JUNE 1998

	Note	1997/98 (Ending 30 June)	1996/97 (Ending 30 June)
Interest & Income From Investments		59,416,034	52,470,969
Interest and Commission Expenses		(4,095,679)	(516,154)
Provisions Against Bad Debt & Investments No Longer Required		(852,299)	2,613,086
		54,468,056	54,567,901
Other Income		307,169	291,146
Operating Income		**54,775,225**	**54,859,047**
Operating Expenses	13	**12,659,134**	**10,271,330**
Profit For the Year to be Transferred to the Ministry of Finance in Accordance with Article 17, paragraph 3(b), of Law No. 32 of 1968 amended by the Law No. 130 of 1977		**42,116,091**	**44,587,717**

The attached notes from 1 to 15 constitute a part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1- Activities:

The Central Bank of Kuwait (CBK), is incorporated in Kuwait by Law No. 32 of 1968 as amended by Law No. 130 of 1977. The CBK is a public institution with an independent juristic personality, and is entrusted with the issue of the local currency on behalf of the State of Kuwait, the security of the stability of the Kuwaiti currency and its free convertibility into other currencies, directing the monetary and credit policies, the supervision of the banking system and serving as banker and financial advisor to the Government.

2- Significant Accounting Policies:

These financial statements have been prepared in accordance with Law No. 32 of 1968 as amended by Law No. 130 of 1977. The applied significant accounting policies are as follows:

(a) Gold:

In accordance with the Amiri Decree of 9 July 1978, gold is valued at KD 12.500 per fine ounce.

(b) Investments:

1- **Short-term Investments:** Kuwaiti treasury bills owned by the CBK are stated in the balance sheet at cost, adjusted for unamortised discount.

2- **Long-term Investments:** Long-term investments which comprise bonds of foreign governments and Kuwaiti Dinar local bonds are stated at cost, adjusted for any premium or discount as appropriate, with provision for any permanent decline in value on an individual basis.

(c) Revenue Recognition:

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

(d) Capital Expenditure:

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

(e) Foreign Currencies:

In accordance with Article 48 of Law No. 32 of 1968 (as amended by Law No. 130 of 1977) and the Amiri Decree of 9 July 1978, all assets and liabilities in foreign currencies at the balance sheet date are translated into Kuwait Dinars at the year end rates of exchange and resulting gains or losses are taken to a special account.

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

	30 June 1998	30 June 1997
Deposits with Banks and Foreign Institutions	939,775,091	806,554,720
Bonds of Foreign Governments	4,597,650	4,535,250
	944,089,970	**811,089,970**

4- Deposits & Loans in KD with Local Banks and Financial Institutions (KD):

	30 June 1998	30 June 1997
Loan	6,678,633	6,844,469
Provision for Doubtful Debt	(852,299)	-
	5,826,334	6,844,469

5- Local Bonds in KD & Public Debt Instruments (KD):

	30 June 1998	30 June 1997
Kuwaiti Treasury Bills	-	41,142,947
Local Bonds in KD	-	699,243
	-	41,842,190

6- Other Assets (KD):

	30 June 1998	30 June 1997
Interest Receivable on Deposits and other Assets	1,929,276	1,535,009
CBK's Share in the Capital of the Industrial Bank of Kuwait	2,511,210	2,511,210
Other Debit Balances	1,350,437	1,187,916
Prepaid Expenses	118,284	105,137
	5,909,207	5,339,272

7- General Reserve Fund:

In accordance with Article 17, paragraphs 3(a) and 3(b), of Law No. 32 of 1968 (as amended by Law No. 130 of 1977) the net profit 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 Fund. In 1985, the Board recommendation to increase the fund to KD 179 million was approved by the Minister of Finance and Economy.

8- Special Account (KD):

	30 June 1998	30 June 1997
Balance at Beginning of the Year	104,598,597	127,802,067
Net Profit (loss) on Foreign Exchange Resulting From Revaluation of Assets and Liabilities in Foreign Currencies	(6,140,183)	(23,203,470)
Balance at End of the Year	**110,738,780**	**104,598,597**

The special account represents the net profit accumulated as a result of revaluation of all 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 (as amended by Law No. 130 of 1977) and the Amiri Decree of 9 July 1978.

9- Currency Issued (KD):

	30 June 1998	30 June 1997
Net Currency Produced	1,045,777,526	1,215,907,134
Less : Currency in the CBK's Vaults	640,619,584	808,809,566
	405,157,942	**407,097,568**

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

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

	30 June 1998	30 June 1997
Current Account	110,717,885	59,636,537
Deposits	95,500,000	-
	206,217,885	**59,636,537**

11- Other Liabilities (KD):

	30 June	30 June

	1998	1997
Accrued Expenses	1,395,085	840,800
Other Credit Balances	15,526,979	13,840,011
	16,922,064	**14,680,811**

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

12- Accounts Managed by the CBK on Behalf of the Government of the State of Kuwait and Contra Accounts:

	30 June 1998	30 June 1997
a- Accounts Managed by the CBK on Behalf of the Government	4,471,251,424	5,171,731,692
b- Contra Accounts:		
Letters of Credit	143,607,803	91,807,839
Memorial Notes and Coins	1,390,359	1,467,568
Forward Transactions on Behalf of the Kuwait Investment Authority	6,154,426	6,088,159
Repayments According to the Law No. 41 of 1993	26,114,580	9,623,936
	177,267,168	108,987,502
	4,648,518,592	**5,280,719,194**

On 30 June 1997, deposits of KD 4,084,026 (against KD 3,801,724 on 30 June 1996) were held against the letters of credit referred to above.

13- Operating Expenses (KD):

	30 June 1998	30 June 1997

Employee Costs	8,469,031	7,780,108
Administrative and Computer Costs	1,103,731	938,830
Purchases of Furniture, Equipment and Vehicles	594,124	397,127
Production and Shipment of Currency	1,511,754	186,396
Sundry Expenses	980,494	968,869
	12,659,134	**10,271,330**

14- Compensation Claims:

The CBK has submitted a claim amounting to KD 73,132,296 to the Public Authority for the Assessment of Compensation for losses suffered as a result of the Iraqi invasion and occupation of the State of Kuwait.

15- Promissory Notes Held:

On 30 June 1998, promissory notes held by the CBK in safe custody on behalf of international institutions totaled KD 391,736,079 (against KD 416,376,658 on 30 June 1997).