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A Glimpse into the Impact of Digital Transformation on Financial Stability, the Foremost Global Developments and Monetary Policy Trends

Contents

Preface

This fourth edition titled "A Glimpse into the Impact of Digital Transformation on Financial Stability, the Foremost Global Developments and Monetary Policy Trends" as of September 2023 is one of the quarterly series the Central Bank of Kuwait (CBK) has been issuing since November 2022. **The first part hereof titled "The Impact of Digital Transformation on Financial Stability"** addresses the digital transformation in the Local and global banking industry, opportunities and advantages for the banking system, the significant challenges and risks, the role of central banks in mitigating financial stability risks, and the CBK's efforts to foster digital transformation. **The second part titled "The Foremost Global Developments and Monetary Policy Trends"** provides a brief on the global developments and monetary policy trends of selected central banks, and the CBK's monetary policy directions. This is the third issue in 2023.

Keeping abreast with the best global trends of central banks in enhancing disclosure and transparency, CBK issues a series of quarterly reports that cover selected economic, monetary and banking topics and help raise awareness on the CBK's efforts to maintain monetary and financial stability. **The first issue (November 2022) titled "An Overview of the Key Economic, Monetary and Banking Developments"** shed the light on foremost developments in the State of Kuwait, and the key indicators in some selected countries. **The second issue (February 2023) titled "An Overview on Inflation, Monetary Policy and Sustainable Finance"** elaborated on the key indicators of monetary policy trends of advanced economies, the gradual tightening of CBK monetary policy, and the green finance (sustainable). **The third issue (May 2023) titled "CBK Efforts on AML/CFT and Customer Protection"** highlighted the CBK's supervisory role and efforts on AML/CFT and the protection of customers' rights.

I. Impact of Digital Transformation on Financial Stability

This part of the report highlights the digital transformation in the global and local banking system, opportunities, advantages, challenges and risks related to digital transformation, the role of central banks in mitigating financial stability risks, and the CBK's efforts to support digital transformation.

1 A Bit on Digital Transformation

The term "Digital Transformation" is now widely used in all developed and developing countries. It is necessary to differentiate between the two terms "digitization" and "digital transformation".

Digitization

in broad sense is the process of enabling, improving or developing existing systems by taking advantage of advanced technologies and methods to facilitate access to, storage, processing and analysis of, information and increase productivity, quality and cost reduction.

Digitization

is the process of making information available and accessible in a digital format.

Digital Transformation

can be defined as the process of integration of digital technology into every area of businesses to provide value added products and services to customers. Institutions adopt innovative digital technologies to make cultural and operational shifts that adapt better to changing customer demands.

Digital transformation

is the process of creating new business applications that integrate digital data and digital applications.

Digital transformation is not just adopting new technologies but, instead, it is a comprehensive process driven by vision, leadership and innovation that work together to enable an institution to constantly adapt to the ever-changing environment. It aims to build a technical and operational foundation to manage customer expectations and needs in the best possible way.

The last decades have witnessed radical changes in digital transformation driven by the massive revolution in communications and information technology, which led to a new era called the Fourth Industrial Revolution. This revolution brought about tremendous transformations in the global economy and reshaped many traditional industries.

In addition, the Coronavirus (COVID-19) pandemic accelerated digital transformation. Experimental results showed that countries with best communications and information technology infrastructure were more successful in mitigating the economic shock of the pandemic through shifting their economic activity online.

Available statistics issued by the United Nations Conference on Trade and Development (UNCTAD) indicate that the size of the digital economy constituted more than 15.0% of the total global GDP during 2022, and it is estimated to contribute 30.0% of the global GDP and create 30.0 million jobs by 2030.

Size of the Digital Economy of the Global GDP

2022	2030
%15.0	%30.0

2 Digital Transformation in Global Banking System

In the recent period, global interest in expanding the scope of financial inclusion has increased and became a priority for policy makers, financial regulatory & supervisory authorities and development agencies. Digital technology has gained momentum due to the potential of the new financial services that enhance financial inclusion in terms of facilitating convenient and prompt access by all segments of society to financial services and products to meet their needs at reduced cost, facilitating financing, supporting self-employment, enabling small and micro enterprises to invest and expand due to availability of finance, reducing poverty and achieving social prosperity that promote sustainable economic growth.

Digital technologies are one of the basic factors to enable digital transformation in the banking industry. These technologies provide many benefits such as: Appropriate cost, operational efficiency and flexibility, enhanced data analytics, and easy data sharing. Innovations such as FinTech, Artificial Intelligence (AI), Big Data, Blockchains, and mobile devices have contributed to provide financial services at a significantly faster, cheaper, more transparent and easier to use, thus expanding financial inclusion. Due to the growing interest in FinTech, the global FinTech lending market (excluding China) has witnessed continued growth since 2015, with total transaction volume nearly doubling from USD 60.0 billion in 2017 to USD 113.0 billion in 2020.

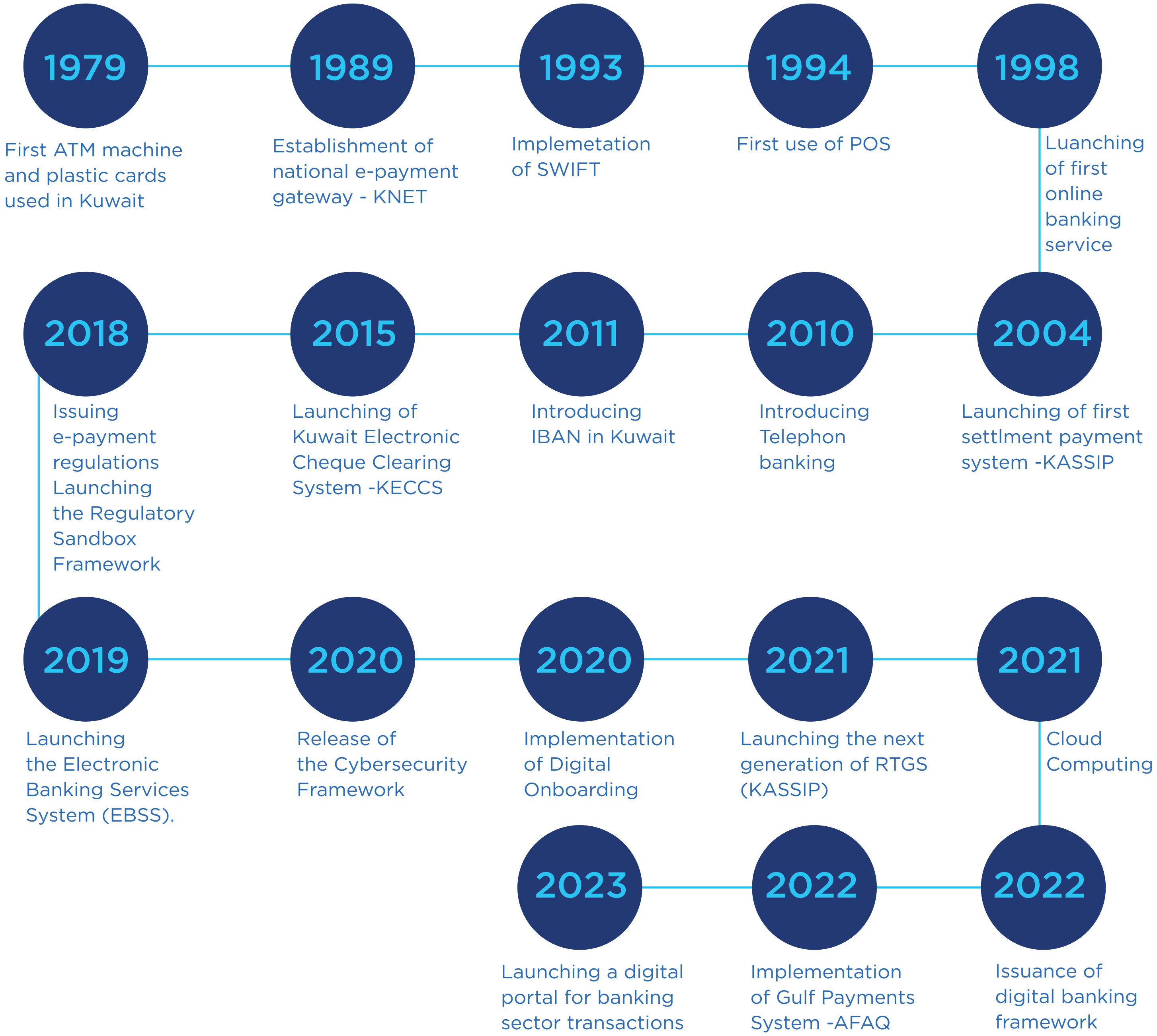
Global FinTech Lending Market

2017	2020
USD 60.0 Billion	USD 113.0 Billion

3 Digital Transformation in the Local Banking Sector

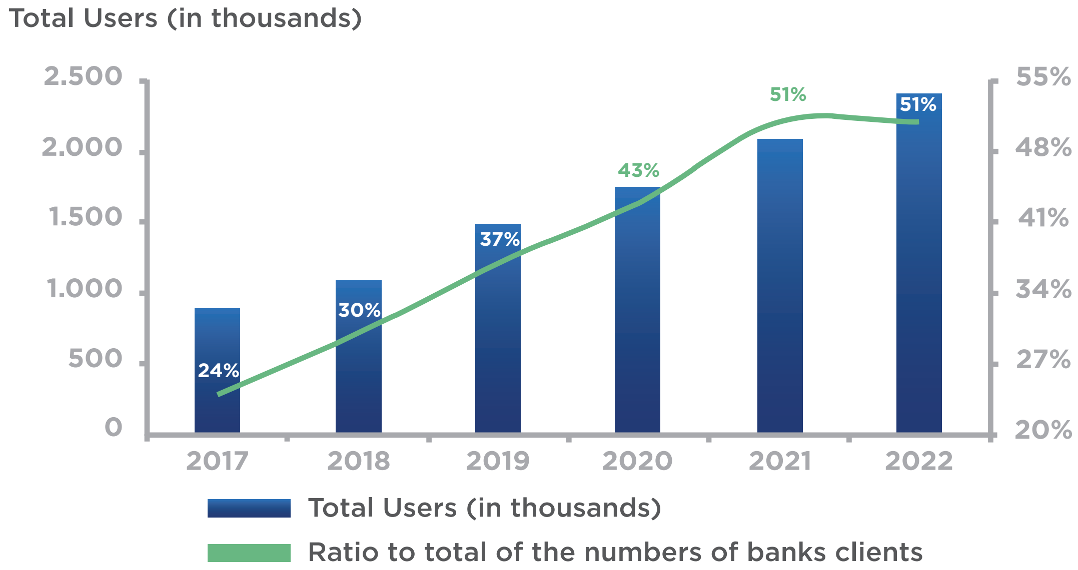
The banking system in the State of Kuwait is keen to keep pace with digitalization to develop and improve the services provided to customers. Since 1979, local banks began to provide digital banking services. These services increasingly spread in the middle of the first decade of this century, as shown in the following figure:

Figure 1: Development of Digital Banking Services in Local Banks



The Coronavirus pandemic has led to a great local demand of digital banking services, as available data indicate that the current percentage of local banks' digital banking services users reached 51.0% of the total number of bank customers during 2022, against 24.0% during 2017. The following figure indicates the development of the numbers and percentages of the users of the banking services:

Figure 2: Development of the Number of Users of Banking Services



Local banks have experienced many developments related to providing digital services, notably:

• Online Banking:

Local banks provided online banking platforms to enable customers to perform financial transactions through their computers or smart mobile phones. Banks allowed customers to conduct almost any traditional banking service through applications and without requiring them to visit their bank branches.

• Embracing Artificial Intelligence Technology (AI):

Some banks in the State of Kuwait have implemented AI technology to boost customer service. This technology enabled banks to use chatbots to provide immediate assistance to customers, thus increasing their satisfaction and reducing wait times. By using AI technologies, banks can analyze and evaluate customers data to provide them with optimal solutions, and make better decisions to improve their overall performance.

Enhancing Payment Systems:

In recent years, the electronic payment system in the State of Kuwait has witnessed a notable development. The trend of using advanced payment systems was observed before 2020 and has accelerated significantly during the pandemic period due to closures and social distancing measures. **CBK supported and encouraged the use of such systems** to keep abreast with the technological developments and reduce traditional ways of relying on cash transactions. Therefore, CBK issued in 2018 instructions regarding the regulations of the electronic payments of funds to regulate the processes and technologies adopted by existing and emerging projects in this area. From this standpoint, e-Wallets have emerged that enable users to make payment transactions with their phones, mobile devices and smart watches.

"Apple Pay" service was launched in the Kuwaiti market after tests were conducted by Kuwaiti banks and Shared Electronic Services Company (K-NET) to ensure the highest security and privacy standards. CBK has previously approved similar digital payment services, namely "Samsung Pay" and "Fitbit Pay", that have been operating in the Kuwaiti market for years, and with "Apple Pay", the main global digital payment services are now present in the State of Kuwait.

Kuwait: E-Payment Systems (KWD million)

	2019	2020	2021	2022
Value of POS Transactions	10803.2	9475.5	13652.0	16601.4
Value of Payment Gateway Transactions	2286.6	6093.3	10347.2	14773.2

In this context, it is worth to mention CBK efforts to elevate the efficiency of payment systems in the State of Kuwait for the benefit of the national economy, such as:

- **Real Time Gross Settlement System (KASSIP):** It is a system for processing interbank payments based on the net derived from other settlement systems and payment transactions, which are real-time transactions of payment orders, money transfers or immediate payments. Transactions sent by the participants, namely local banks, branches of foreign banks and the Central Bank of Kuwait (CBK) as settlement agent and participant, are settled separately.

- **Electronic Banking Services System (EBSS):** CBK has developed a system that serves government entities to ensure prompt processing, accuracy and efficiency of financial transactions for the participants, whereby these entities can make financial transfers and receive responses automatically and in real time. In addition, financial transfers and account balances shall be tracked directly with no need to refer to CBK.

- In the context of developing the cross-border payment system, the second group of local banks joined the **GCC Cross-border Payment System (AFAQ)** in the State of Kuwait. This system is optimized to process remittances in local GCC and other currencies in a short time and at reduced costs to customers in a safe and stable environment.

In general, it is expected that electronic payment systems in the State of Kuwait will continue to grow and that individuals and companies will be encouraged to use digital payment methods through providing a supportive environment within a cybersecurity framework that ensures low risks.

Digital Banks:

The Kuwaiti banks have established affiliated digital banking units, one targeting youth segment and the other targeting unbanked individuals, within the CBK banking framework for regulating and facilitating digital banking services that allows **the establishment of stand-alone digital banks according to a set of models, including:**

- **Digital Banking Unit:** It is a digital banking unit within a traditional bank and shares with it the same balance sheet but under a different trademark.

- **Banking as a Service:** It is a partnership between a licensed bank and a digital institution. It is an outsourcing agreement where the digital institution provides banking services to customers through the bank without the need to enter into long and expensive procedures to obtain a license for opening a bank. These types of banks provide customers with innovative financial services at lower costs. These banks are able to attract customers by accessing other party's customer database, obtain new sources of revenue, such as service fees and commissions, as well as increase their sales through third-party's platforms.

4 Opportunities and Benefits for the Banking System

As customers became more interested in digital banking, it is imperative to respond to the growing consumer demands for more efficient ways to perform banking transactions untraditionally. **Digital transformation provides opportunities for the banking sector, such as:**

- Reducing the need for physical infrastructure helps to **lower operating costs for financial institutions,** whether through reducing the number of branches or the number of employees.
- **Promoting competition, providing innovative products and services,** and increasing the ability of real-time data analysis to predict customer future needs.
- **Increasing consumers' ability to access financial services remotely** without being restricted by time or place considerations.
- **Increasing job opportunities for individuals with high technical skills,** and creating new career opportunities by attracting talent to work remotely, as remote work has become a norm for certain types of financial institutions.
- **Achieving better financial savings and improving efficiency of economic operations,** such as supply chains, by reducing the lead time of transactions to a few hours or days.
- **Emerging economies may also benefit from digital finance** to settle payments easily. All it takes to access payments is an account with a mobile operator serving even unbanked citizens across borders.
- **Increasing financing capacity of companies,** as companies in smaller countries can penetrate neighboring and international markets to obtain financing for their innovative ideas.

5 Challenges and Risks

Despite the great opportunities that digitization and digital transformation offer to financial activities, there are still many imbedded serious risks and challenges that can affect financial stability, some of which can be address as follows:

The spread of innovative products and services makes it difficult to manage and monitor banks' operational risks due to their reliance on third parties or their partnerships in the field of technology, i.e. cloud computing, data services, and other related services.

Due to heavy reliance on technological infrastructure, cybersecurity, data security, privacy and cybercrime risks became part of the banking system's operational risks, as they can lead to financial and reputational negative effects.

Intense competition resulting from the spread of advanced FinTech companies that provide more efficient and cost-effective services. Therefore, banks try to maintain their advanced position in the competition by either cooperating with or acquiring these companies.

The demand for large financial investments to establish and develop the technological infrastructure. This is a continuous process to keep abreast with the rapid technical developments. For example, in 2022, North American banks are expected to spend nearly half of their total IT budget on new technology, while European banks are expected to spend about a third.

Crypto-assets and decentralized finance, with their potential to hide identities, have raised concerns among supervisory authorities regarding financial stability, market integrity, investor and consumer protection, and anti-money laundering. Assessing exposure to relevant risks and their potential cross-border impacts is a difficult task that requires extensive strengthening of central banks' monitoring capabilities.

Regarding workforce size, challenges may arise when human resources with good experience in digital transformation are rare, in addition to the challenges arising from reducing the size of the workforce in banks as a result of converting to digital services, reducing the number of branches and ceasing the need for some jobs, which could negatively affect the Gross Domestic Product.

6 Role of Central Banks in Mitigating Risks

In light of the opportunities and benefits of digital transformation to the banking system, and considering the aforementioned challenges and risks, it is the responsibility of the regulatory and supervisory authorities to create a balance between supporting banks to adopt digital transformation and maintaining financial stability. This can be achieved by establishing comprehensive legislative, regulatory and supervisory frameworks to encourage innovation, enhance the growth of the industry, and allow the growth of digitization business models in a competitive environment on the one hand, and ensure customer protection, strengthen prudent control standards, establish sound supervisory practices, and maintain monetary and financial stability on the other hand. In general, mitigating these risks is an ongoing and complex challenge for regulators and central banks. Below some of the challenges and ways to overcome them:

- **Full understanding of the digital finance fundamentals,** complexities and the way it affects business models, as well as identification of risks help to formulate an integrated digital finance policy and increase central banks' ability to supervise and regulate.

- **Increasing the ability to adapt and keep abreast with the technological developments,** and create an advanced infrastructure to enhance the absorption of digital finance. Moreover, adopting SupTech helps develop frameworks for interaction between central banks and entities subject to their supervision and create a leap in internal and external audit capabilities.

- Regulatory authorities need to **strengthen the capacity** of their staff to provide technical support to the industry.

- **The need to address some gaps in legislative and regulatory frameworks,** as crypto-assets, decentralized finance, artificial intelligence, and cyber threats have highlighted the limitations of the current regulatory framework. In some cases, legislation is incomplete or inadequate, and in other cases there are obvious regulatory gaps.

- **The need to strengthen cooperation between central banks** and between them and other concerned parties at international, regional and local levels, given the special nature of financial technologies and their potential to cross traditional borders without restrictions.

- **Overcoming the barriers to financial markets growth.** This challenge can be met by supporting sustainable integration of digital finance into the economy. Also, facilitating the establishment of FinTech ecosystems at national and international levels is a must. In addition, overcoming the challenges to cross-border payments and encouraging the transition to "green" digital services are key activities to overcome this challenge.

7 CBK Efforts to Support Digital Transformation

CBK believes that technological advancement has become a cornerstone to achieving comprehensive and sustainable development. It also believes in the importance of continuous business development that helps to perform its duties to the fullest thus maintaining financial and monetary stability. Therefore, CBK encourages and supports local digital transformation. The first step towards a smooth digital transformation is to strengthen supervisory capabilities and internal methods by adopting appropriate tools to implement digital transformation within the bank. CBK is currently enhancing the capabilities of its staff, and improving the abilities of its technical team as well as the local banking sector through programs that broaden their knowledge and adoption of the latest tools.

CBK's role in supporting advanced FinTech is highlighted in the instructions and procedures it issues to provide a supportive environment for innovation in line with the best practices of digital and technical transformation, within a framework that allows the use of these innovative products and services and verify their efficiency and safety without jeopardizing the stability of the financial system. In addition to the previously mentioned efforts of CBK in enhancing digitization with regard to electronic payments, setting the digital banking framework and creating a favorable environment for the establishment of digital banks, **CBK has exerted efforts and completed many digital transformation projects during the recent period, including:**

- **Launching the Regulatory Sandbox,** which is one of 48 regulatory environments around the world. The Regulatory Sandbox Framework targets companies and individuals who are willing to provide innovative products or services, whether they are based on or related to electronic payment operations, or other innovative products and services based on new or innovatively applied technology, in order to support innovative initiatives in this field and enable them to serve the national economy and provide the opportunity for providers of innovative financial products and services to present their innovations.

- A testament to CBK's vision of the importance of digital transformation, CBK has issued a circular to Kuwaiti banks regarding **the preparation of the "Shaping the Future" Strategy,** that includes each bank's vision and strategic goals concerning the development of its banking products and services using advanced, high-quality and secure financial technologies at a lower cost in order to serve the community. CBK has evaluated and discussed the presented strategies with the relevant banks and sent them the appropriate directions to be considered.

- CBK's instructions obligated companies and financial institutions that practice electronic payment and settlement activity to amend their situations by obtaining CBK approval and coordinating with the Ministry of Trade and Industry whom granted the license. As for companies and financial institutions that were established after the issuance of the instructions, they are obliged to register in the CBK's registry of E-Payment Service Providers (EPSPs) and their agents before providing any products or services related to electronic payment in the local market.

- **Within the framework of cybersecurity requirements** set by CBK for the Kuwaiti banking system that aims to develop an integrated framework for dealing with cyber threats, many Kuwaiti banks (8 local banks) have obtained ISO 27001: 2013 for Information Security Management Systems, while the rest of the Kuwaiti banks are working on meeting the requirements in the near future. This standard is considered one of the key international standards that regulate the construction and implementation of policies and procedures of information security, in order to meet the necessary specifications to enhance protection of data and information centers in the banking sector. The application of this standard help to develop and monitor available protection systems through studying them, assessing their importance, evaluating expected risks and providing technical or operational solutions to manage risks effectively and efficiently.

- **As for capacity building and development,** and within the Kafa'a initiative undertaken by the CBK in collaboration with local banks and Kuwait Institute of Banking Studies (KIBS), CBK has designed the "Risk Management Leaders" Program and the "Cybersecurity Leaders" Program to build highly qualified national cadres and provide them with the necessary knowledge to progress in their careers and ready them with the necessary skills for the labor market in line the ever-changing needs of the financial and banking industry.

- **CBK is participating in the government's work program for the 17th legislative term in a project titled "Opening an Incubator for Innovations in Financial Technology (FinTech)".** This project falls within the second axis of the program: Economic Agenda - Developing and Promoting Prioritized Sectors - Financial Services Sector, and it is expected to be completed in the second year of the program (2024/2025). This project comes as part of CBK ongoing effort to provide a supportive environment for innovation, in line with the best practices of digital and technical transformation, and within a framework that allows the use of these innovative products and services and verify their efficiency and security without exposing the financial system to risks.

Finally, the important role played by the banking sector to develop economies depends on the extent of effectiveness and advancement of this sector. Therefore, it is essential to keep abreast with the technological innovations in the financial sector, that has become a global trend in both advanced and developed economies. As banks race to adapt the modern approach to provide financial services, it is necessary to assess opportunities and risks due to the surrounding challenges. CBK searches for opportunities and developments in the space of advanced technologies to reap the fruits of their implementation. At the same time, CBK keeps in mind the challenges and risks that could result from these developments and opportunities.

II. The Foremost Global Developments and Monetary Policy Trends

This section briefly reviews the foremost global developments based on the World Economic Outlook report issued in July 2023, the monetary policy trends of central banks in some selected advanced economies (United States, Euro Area), and emerging economies in Asia (China, Thailand), as well as CBK's monetary policy trends.

1 Most Prominent Global Developments and Monetary Policy Trends in Selected Economies

The global economy continues to gradually recover from the COVID-19 pandemic and Russian-Ukrainian war, as supply chain disruptions have returned to pre-pandemic levels, and energy and food prices have come down sharply, allowing global inflation pressures to ease faster. Therefore, the International Monetary Fund (IMF) forecast for 2023, in the World Economic Outlook- WEO update issued in July 2023, was higher than predicted in the April 2023 WEO. The IMF raised its forecast for:

Global economic growth by	To	Up from
0.2%	**3.0%** in 2023	**2.8%** in its previous assessment report

The IMF expected that global inflation rate to fall by 0.2% to 6.8% in 2023 (against 7.0% according to its April 2023 WEO). These indicators suggest that the global economy is headed in the right direction, and that **the monetary policies of major central banks have begun to bear fruit as global inflation started to decline.**

In light of CBK thorough monitoring of central banks' monetary policy trends in many economies, and considering the difference of the main objectives of these banks, following are some of these trends:

A Key Monetary Policy Trends in Some Advanced Economies (US and Euro Area):

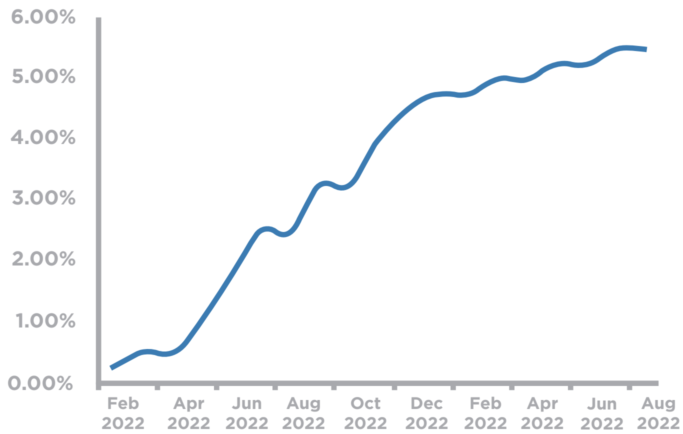
• As for the Federal Reserve

promoting maximum employment and achieving price stability are the main objectives of the Federal Reserve's monetary policy, or the so-called "Fed's Dual Mandate". The third goal is achieving moderate long-term interest rates. The 2.0% inflation target is key to the Federal Reserve's vision for medium-term stable prices in the US economy. As global inflationary wave sweeping the world, inflation rate in the US economy climbed above its target levels. Consequently, the Federal Reserve began following a tightening monetary policy as of March 2022 and made series of interest rate raises starting with a quarter of a percentage point from 0.25% to 0.50% on March 16, 2022, until it reached 5.50% at the end of July 2023, i.e. an increase by 525 basis points. Moreover, inflation rate declined on an annual basis to 3.2% in July 2023, against 8.5% in March 2022, while core inflation rate (excluding food and energy) fell to 4.7%, the lowest rate since October 2021, in July 2023 against 6.5% in March 2022.

Figure 1 : Inflation Rate in USA

Source: Bureau of Labor Statistics, US Department of Labor.

Figure 2: Federal Funds Rate



Source: Federal Reserve.

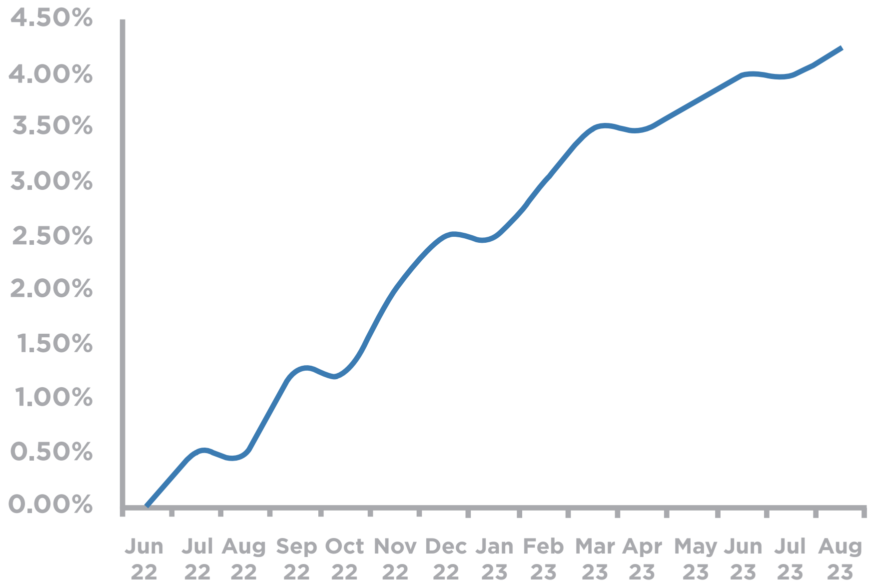
• As regards the European Central Bank (ECB),

the key objective are to maintain stable and reliable currency that preserves its value, and ensure the price stability conduced to economic growth. In order to achieve these goals, ECB began tightening its monetary policy in July 2022 by raising the interest rate on the main refinancing operations from 0% to 0.5%. While ECB continued to address high inflation in the Euro Area, the interest rate reached 4.25% in August 2023, i.e. a rise by 425 basis points. Despite the continuous increases in interest rates, inflation remains well above its 2.0% target. Data indicated a decline in inflation rate (on an annual basis) in the Euro Area from 7.4% in March 2022 to 5.3% in July and august 2023. Meanwhile, the core inflation rate increased from 3.0% in March 2022 to 5.3% in August 2023 and lower than 5.5% in the previous month.

Figure 3: Inflation Rate in Euro Area

Source: European statistics office, Eurostat.

Figure 4:
Main Refinancing Operations Rate



Source: European Central Bank.

B Foremost Monetary Policy Trends in Some Emerging Economies (Asia):

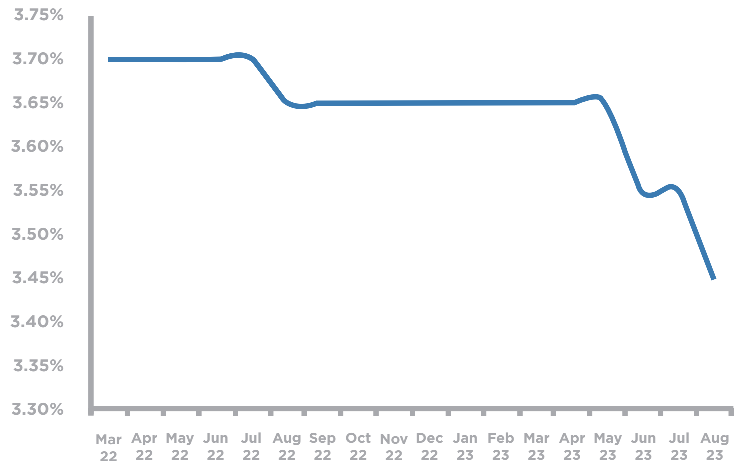
• With regard to China Central Bank,

its primary objective is to safeguard the value of the currency “Renminbi” and thereby promote economic growth. Data on the Chinese economy indicate that the second largest economy in terms of GDP is suffering from a slowdown and decline in prices on an annual basis in July 2023, as the headline inflation rate reached -0.3% after recording its highest value of 2.8% in September 2022. Meanwhile, the core inflation rate was 0.8% in July 2023, against 1.1% in March 2022. China’s economy is suffering from a real estate crisis, drop in exports, and decline in consumer spending. Therefore, the monetary policy of the Bank attempted to create a balance between supporting economic growth and reducing financial risks. Moreover, the Bank has reduced the interest rate on one-year loans (a key interest rate used as a standard that determines lending rates to companies and families) to 3.45% on August 21, 2023, against 3.55% since June 20, 2023. It is worth noting that the interest rate on one-year loans reached 3.70% in March 2023, **indicating the adoption of accommodative monetary policy in an attempt to support economic recovery in the post-pandemic stage, unlike the situation in advanced economies as previously stated.**

Figure 5: Inflation Rate in China

Source: National Bureau of Statistics of China.

Figure 6: 1-Year Loan Prime Rate

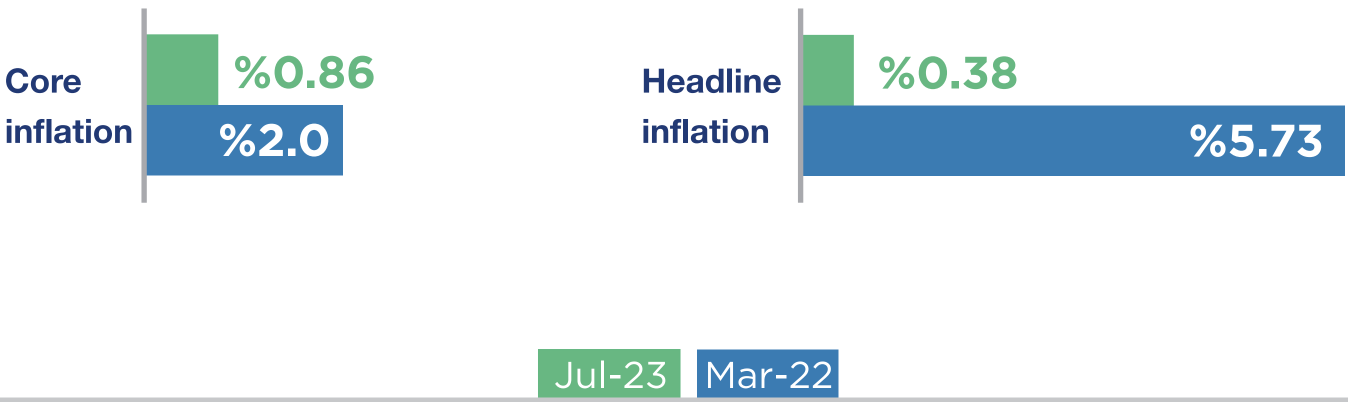


Source: People’s Bank of China.

• As for the Bank of Thailand,

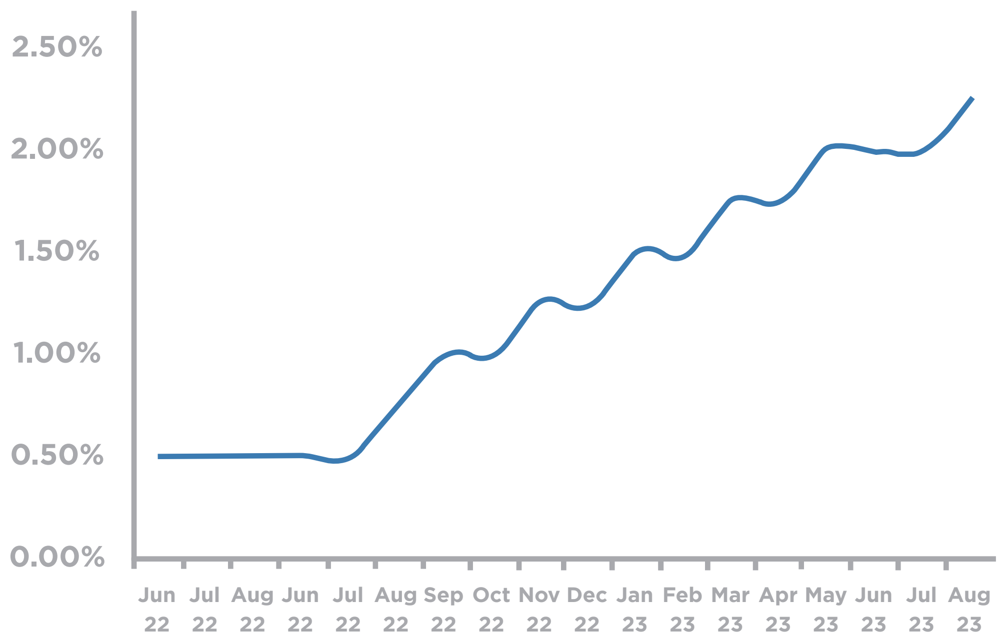
the medium-term monetary policy objective for 2023 is to maintain headline inflation within the target range (1.0%-3.0%) as an important precondition for sustainable economic growth. Data indicate a decline in core inflation (on an annual basis) to 0.38% in July 2023, against 5.0% in January 2023. Despite the decrease in the inflation rate, the Thai Central Bank continued to follow its tightening monetary policy which it started since August 10, 2022, as it raised the policy rate by 175.0 basis points to 2.25% on August 2, 2023 aiming to increase economic recovery and achieve sustainable economic growth.

Figure 7: Inflation Rate in Thailand



Source: Bureau of Trade & Economic Indices, Ministry of Commerce, Thailand.

Figure 8: Policy Rate (Prime Interest Rate)



Source: Bank of Thailand.

Objectives	▸ Promote employment. ▸ Price stability. ▸ Moderate long-term interest rates	▸ A stable and reliable currency that retains its value. ▸ Maintain price stability to achieve economic growth.	▸ Maintain the stability of the value of the currency “renminbi” to promote economic growth	▸ Maintain headline inflation within the target range (%3.0-%1.0) as an important precondition for sustainable economic growth.
Target	Targeted Inflation (2.0%)			Targeted Inflation (1.0% - 3.0%)

In the above context, it can be said that the motives behind central banks’ decision-making regarding monetary policy differ. Many international experiences indicate that the main motivation for most central banks in making decisions during the last period was to control the rise in inflation rates that reached highest levels in decades and bring inflation to targeted rates without negatively affecting economic growth or entering into recession. Also, many central banks strive to maintain the value of their local currencies to support sustainable economic growth and maintain appropriate employment rates. Therefore, monetary policy requires central banks to follow a prudent approach in confronting the challenges posed by the global economy to achieve monetary and financial stability. In general, **central banks make their decisions in light of their monetary policies’ objectives and local economic data.** **This was mainly reflected in the disparity between using an accommodative monetary policy or a tightening monetary policy, timing of decision-making and use of available main tools,** i.e. the amount of movements in key interest rates (discount rate or bank rate), the ratio of reserve requirement, and the open market operations.

2 CBK's Monetary Policy Directions

CBK decisions regarding formulation and implementation of monetary policy are in line with the CBK's elaborate balanced and gradual approach that aims to consolidate the foundations of monetary and financial stability within the banking and financial sector units, maintain the attractiveness of the national currency as a lucrative and reliable store for local savings, and foster an environment conducive to economic sustainable growth. Within CBK's thorough follow-up of economic and monetary developments and indicators in the international markets, the geopolitical developments and impact on the global economic conditions, and according to the necessary responses to these developments based on the nature of the Kuwaiti economy, CBK has activated and enhanced all available tools to achieve its goals. In this regard, CBK did not follow other central banks policies by increasing interest rates rapidly and continuously during the monetary tightening cycle.

Law No. (32) of 1968 concerning Currency, the Central Bank of Kuwait and the Regulation of Banking amendments thereof

Article 15: Objectives of the Central Bank

1. Exercise of the privilege of the issue of currency on behalf of the State.
2. Endeavor to secure the stability of the Kuwaiti currency and its free convertibility into foreign currencies.
3. Endeavor to direct credit policy in such a manner to assist the social and economic progress and the growth of national income.
4. Control the banking system in the State of Kuwait.
5. Serve as Banker to the Government.
6. Render financial advice to the Government.

Since March 2022, CBK has raised its discount rate nine times by a cumulative 275 basis points (7 times by 25 basis points, and twice by 50 basis points):

	Date	Press Release Regarding the Decision of Raising Discount Rate
2022	16 March	by %0.25 from %1.50 to %1.75
2022	4 May	by %0.25 from %1.75 to %2.00
2022	15 June	by %0.25 from %2.00 to %2.25
2022	27 July	by %0.25 from %2.25 to %2.50
2022	10 August	by %0.25 from %2.50 to %2.75
2022	21 September	by %0.25 from %2.75 to %3.00
2022	6 December	by %0.50 from %3.00 to %3.50
2023	25 January	by %0.50 from %3.50 to %4.00
2023	26 July	by %0.50 from %4.00 to %4.25

It is worth noting that its is due to CBK's prudent precautionary and regulatory policies and measures that consider the future outlook, CBK was able to direct banks to strengthen their financial buffers and thus empowering the banking sector to increase its ability to face external shocks and continue serving the national economy efficiently despite highly stressed operating conditions. This was evident by the high rates of financial soundness indicators of Kuwaiti banks, as at the end of June 2023; capital adequacy (18.4%), liquidity coverage ratio (163.3%) and net stable funding ratio (113.4%) which are well above the minimum regulatory threshold as determined by CBK instructions. These indicators are supported by asset quality standards, as the ratio of net non-performing loans to net loans maintained its lowest level of 1.1% (the ratio dropped to a historical low of 1.0% at the end of March 2023). The results of these indicators emphasis that the banking sector in the State of Kuwait is capable of facing future challenges associated with monetary tightening from a position of strength.

As a result of CBK's efforts, the IMF in its final statement issued on June 5, 2023 within the context of Article IV consultations with the State of Kuwait praised the effectiveness of CBK's monetary policy as well as other policies, noting that the Central Bank's prudent regulatory measures have contributed to maintain financial stability of the Kuwaiti banking system. The IMF also praised the fixed KWD exchange rate regime, considering it an appropriate framework for monetary policy. The IMF said that this framework provides the CBK with some monetary policy autonomy and has enabled it to deliver low and stable inflation for many years. The statement also included that the continuing to maintain the central bank independence is crucial to achieve the objectives of monetary policy. The statement indicated that the impact of the bouts of global banking sector turbulence on Kuwaiti banks was limited, reflecting locally and regionally oriented business models and strong prudential supervision by CBK. The Fund also praised CBK's monetary policy tightening that contained inflation, and other government policies that provided subsidies and managed prices.

As for domestic inflation rate developments (calculated based on Consumer Price Index (CPI) "base year 2013=100"), the annual inflation rate increased to 3.75% in July 2023, compared to July 2022. This rise was mainly due to the increase in inflation rates for the following groups: Housing Services, Food and Beverage, Household Furnishing and Equipment Maintenance, and Clothing & Footwear by 33.2%, 16.7%, 11.4%, and 8.0%, respectively, of the total Kuwaiti consumer spending, respectively. Moreover, it can be said that there is a relative stability in prices, due to CBK's prudent monetary policy, and the effective government food support policies and food security including the four dimensions (food availability, access to food, utilization and stability).

In brief, it can be said that CBK's monetary policy directions consider the global economic conditions and have distinctive features in order to suit the nature of the Kuwaiti economy, fulfill CBK's objectives, and serve the requirements of the national economy during the coming period.

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