

Press Statement

by His Excellency the Governor of the Central Bank of Kuwait on the foremost local monetary and banking developments and the CBK's general policies

The Governor of the Central Bank of Kuwait (CBK), Basel A. Al-Haroon, released a statement on the foremost local monetary and banking developments, and the CBK's endeavors in response to the turbulence in the international markets and the repercussions of the recent geopolitical conditions and their impacts on the national economy.

Monetary Policy Instruments and Goals

The local economic and financial data reveal the monetary and financial stability in the State of Kuwait, though the adverse events seen since the first quarter of last year, giving rise to higher inflation and tight or contractionary policy. To contain such repercussions, Central banks use the **available instruments** that include raising interest/discount rates in order to achieve a set of **intermediate goals**, e.g. decelerating credit and reducing the money supply, towards the **ultimate goals**, namely fighting inflation and reducing aggregate demand. The conduct of such policy varies from one country to another based on the economic nature of each country and the availability of policy instruments.

Transmission Mechanism of Monetary Policy

- The so-called channels of transmission mechanism of monetary policy are important in assessing to the extent final goals are achieved. The monetary authorities must accurately estimate the timing of their decisions, which affect the nominal and real economic variables. This requires a good understanding of the channels through which the impact of their decisions is transmitted to their final goals, given the long period between decision-making and its effects on these goals. The most important of these channels are the interest rate, credit developments and exchange rate.

- The CBK's decisions on **formulation and implementation of monetary policy** are informed by a **gradual and balanced approach** aimed at consolidating monetary and financial stability of the CBK-regulated entities, preserving attractiveness of the national currency as a lucrative store of domestic savings, and providing an environment supportive of sustainable economic growth. As part of the CBK's continuous monitoring of the economic, monetary and banking indicators and data locally and globally, and the geopolitical repercussions as well as the global trends of interest rates, CBK has, since March 2022, raised **the discount rate nine times by 275 basis points**, as CBK decided to raise the discount rate by 25 basis points six consecutive times during the months of March, May, June, July, August and September of 2022 to 3.0%, and raise the discount rate by 50 basis points twice on 6 December 2022 and 25 January 2023 to become 4.0%. On 26 July 2023, CBK raised the discount rate by 25 basis point to become 4.25%.

Money Supply

- The **money supply in its narrow sense (M1)** declined on an annual basis by KWD 1.3 billion or 10.1% bringing its total to KWD 11.4 billion at the end of June 2023 compared to KWD 12.7 billion at the end of June 2022, due to the decrease in the balance of demand deposits in KWD by KWD 1.2 billion or 12.0%, as accounts for 84.1% of the decline in M1. On the other hand, local liquidity or **money supply in the broad sense (M2)** increased by KWD 1.7 billion or 4.4% on an annual basis to KWD 39.7 billion in June 2023 compared to KWD 38.0 billion at the end of June 2022. This rise in M1 was the result of an increase in the quasi-cash (KWD savings deposits and KWD time deposits) by KWD 2.9 billion or 11.6%, and a decrease in M1 by KWD 1.3 billion or 10.1%.

Inflation

- CBK's review of the **local inflation within the indicators of the monetary stability** takes into account that the inflation in the State of Kuwait is affected by the structure of the economy and its openness to the outside world and dependence on foreign markets for meeting the consumer needs. Thus, the domestic price rates affected by the changing prices of goods imported from the country of origin as a result of fluctuating exchange rates of the currencies of those countries against the Kuwaiti Dinar. To limit the said effects, CBK pegs the Kuwaiti Dinar to an undisclosed weighted basket of currencies that supports the Kuwaiti economy. This basket gives CBK a relative flexibility in managing monetary policy compared to countries whose currencies are directly pegged to the US Dollar. In this context, the balanced and gradual approach applied by CBK to its monetary policy to consolidate the monetary and financial stability, as well as the other government policies, **have contributed to containing inflation and mitigating its effects on the local economy**, as the annual inflation rate slowed down from all-time high 4.71% in April 2022 to 3.8% in June 2023. Despite the slowdown in inflation rate, it remained stable (3.7%) in March, April, and May, and slightly increased to 3.8% in June 2023. A comparison of the domestic inflation rate with that of the most important trading partners with the State of Kuwait reveals the relative stability of domestic prices and the exchange rate of KWD against the major currencies.

Interest Rate Channel

- The interest rate channel is a key transmission mechanism affected by changes in the monetary policy. This channel is represented in the interest rate declared by CBK, which affects lending cost, consumption and investment decisions, as well as deposits level. The margins between the interests on the local currency (KWD) and foreign currency (USD) also play an important role in directing the State's savings. CBK seeks to maintain an acceptable margin in favor of KWD in order to attract KWD deposits.

- **The existing margins between the interest rates on deposits in KWD and USD are still in favor of deposits in KWD.** In this context, the existing margin between the weighted averages of interest rates on customer deposits with local banks in both KWD and USD for one-month term deposits was 0.6429 percentage point in June 2023, compared to 0.5830 percentage point in June 2022, while the margin for 3-month term deposits was 0.6424 percentage point in June 2023, compared to 0.3824 percentage point in June 2022.
- **On the side of the margins between the weighted average interest rates on the outstanding balances of credit facilities and time deposits in KWD with local banks for "residents and non-residents",** banking data indicates that these margins slightly decreased to record 2.3429% in June 2023 compared to 2.3725% in June 2022.

Credit

- The overall raising the interest rate affected the growth of credit facilities, but it was muted on the loan portfolio with local banks. Balances of credit facilities (for residents and non-residents) recorded a slowdown in annual growth from a high of 11.1% in April 2022 to 3.9% at the end of June 2023 to KWD 53.0 billion compared to KWD 51.0 billion at the end of June 2022. The outcome of the prudent instructions regulating personal credit facilities was reflected in the stable regularity in general in this portfolio, as the balance of regular loans reached 98.5% of the total portfolio as of December 2022.
- Due to the prudential policies and the supervisory policies, CBK was able to direct banks to strengthen their financial buffers and fortify the banking sector to withstand shocks so that it remains able to serve the national economy with high efficiency even under stressful conditions. **Indicators of the financial soundness of Kuwaiti banks** as at the end of March 2023 reveal that levels of Capital Adequacy Ratio (19.0%), Liquidity Coverage Ratio (158.1%) and Net Stable Funding Ratio (113.7%), are all well above the required minimum. Moreover, non-performing loan ratio, which is an indicator of asset quality, maintained its historically low level of 1.5%. **All these ratios prove that the banking sector in the State of Kuwait is able to face future challenges related to monetary tightening from a position of strength.**

Deposit

- The resident private sector's deposits increased by KWD 1.7 billion or 4.7% on an annual basis to KWD 37.9 billion at the end of June 2023 compared to KWD 36.2 billion at the end of the corresponding month last year; most of this increase resulted from KWD deposits (accounting for 95.6% of resident private sector's deposits), which increased by KWD 1.7 billion or 4.7% from KWD 34.5 billion at the end of June 2022 to KWD 36.2 billion at the end of June 2023. Meanwhile, deposits in foreign currencies (accounting for 4.4% of resident private sector's deposits) decreased by 0.7% from KWD 1.68 billion at the end of June 2022 to KWD 1.67 billion at the end of June 2023.
- Structure of the deposit portfolio with local banks mutedly changed, as the residents' demand deposits in KWD declined by KWD 1.4 billion or 12.0% to KWD 9.6 billion at the end of June 2023 compared to KWD 11.0 billion at the end of the corresponding month last year. On the other hand, residents' term deposits in KWD increased by KWD 4.0 billion KWD or 24.5% to KWD 20.3 billion at the end of June 2023 compared to KWD 16.3 billion at the end of the corresponding month last year, viewed as an increase in domestic savings.

CBK's Balanced and Gradual Approach of Monetary Policy

- CBK did follow in the footsteps of the global central banks that raised interest rates during the monetary tightening cycle, which began in March 2022, and led to threats to financial stability. Against the backdrop of the turbulence that swept the banking sector in some developed economies, and the repercussions thereof on the trends of global monetary policy in the second half of this year, indicating the near end of the monetary tightening cycle in some global economies, CBK adopts the balanced approach to consolidate monetary stability, maintains the attractiveness of the national currency as a reliable store of domestic savings, and enhances the atmosphere conducive to sustainable economic growth. Meanwhile, **CBK strives to enhance the financial stability of the units of the banking and financial sector, taking into account the**

continuous review of economic, monetary and banking indicators that support the current course of monetary policy, in light of the lag effect of previous decisions on those indicators.

Monetary Stability and Financial Stability

- The CBK's monetary policy takes into account the trade-off between the goals of **monetary stability and financial stability**, and adopts a balanced and gradual approach in tightening monetary policy by regulating the variables and monetary aggregates associated with the growing domestic demand, liquidity and credit, in a way that helps preserve the disposable income of citizens, without slowing down the economic growth and country's development plans, and without prejudice to the growth of deposits and credit facilities.

CBK's efforts and policies

- Due to the **CBK's effective monetary policy and other policies**, the International Monetary Fund (IMF) commended on the CBK's continuous efforts in its concluding statement dated 05 June 2023, within the framework of Article IV consultations with the State of Kuwait, noting that the prudent supervisory measures of CBK have contributed to maintaining the financial stability of the Kuwaiti banking system. The IMF also praised the KWD exchange rate regime that remain an appropriate anchor of monetary policy and will deliver low and stable inflation in the coming years. In addition, the IMF stressed the importance of maintaining the independence of the CBK to achieve its monetary policy objectives. The IMF also noted that the impact of global banking sector turbulence on Kuwaiti banks was limited, reflecting their domestically or regionally oriented business models and strong prudential oversight by the CBK. It also praised the role of the CBK's monetary policy tightening in containing Inflation, as well as other government policies in the form of subsidies and administered prices.

Disclosure & Transparency

- CBK continues its endeavors to enhance the disclosure and transparency practices that it has been following in all its works in general, and its monetary policy decisions in particular. CBK clearly announced its objectives and the grounds of its decisions by issuing **nine press releases** regarding discount rate decisions since March 2022, which were published on its website and Kuwait News Agency "KUNA". Besides, CBK issued **four explanatory press releases** in November 2022 regarding the global and local economic developments, in December 2022 clarifying the developments of CBK's monetary policy during 2022, in March 2023 regarding the collapse of some US banks, affirming resilience of the Kuwaiti banking system and the limited exposure to the collapsed banks, and this statement regarding the foremost global and local economic developments.
- CBK has started publishing a **series of quarterly special bulletins**, covering some carefully selected economic, monetary and banking topics to raise awareness and introduce in a brief and simplified manner the CBK's efforts in maintaining monetary and financial stability. **The first edition** titled "Overview on the CBK Efforts in Area of AML/the Most Prominent Economic, Monetary and Banking Developments" was issued in November 2022 and addressed the most prominent global economic developments, and the pace of movement of some global and regional central banks with the monetary policy of US Federal Reserve, as well as the local economy and monetary and banking developments, in line with the CBK's intention to shed the light on its future directions, the grounds of its decisions, and the extent to which it copes with the tightened monetary policies adopted by the most central banks around the world. **The second edition** titled "Overview on Inflation, Monetary Policy and Sustainable Finance" was issued in February 2023 and presented some special issues on inflation and monetary policy, and the CBK instructions on green or sustainable finance. **The third edition** entitled "Overview on the CBK Efforts in Area of AML/CFT and Customer Protection" was issued in May 2023 and **included an illustrative framework on the trade-off between the goals of monetary stability and financial stability.**

- In August 2022, CBK launched a series of episodes on "Apple Podcast" channel and rebroadcast on YouTube to enrich the economic culture and raise financial and banking awareness among the various segments of society. By providing such service, CBK is considered among the ranks of developed countries. So far, 10 episodes have been issued in this series that addresses inflation, cybersecurity, open banking, submitting complaints and grievances, modern financial technologies, money laundering and terrorist financing crimes, financial stability reports, definition of the balance of payments, economic statistics issued by CBK, a seminar on empowering women in the Kuwaiti banking sector and CBK, and the reports issued by CBK.

Financial Technology

- In light of the **growing importance of technology in the banking and financial sector**, CBK continues its efforts towards developing cross-border payment systems and adopting the latest technologies in order to improve efficiency, reduce reliance on financial systems and external payment platforms, and reduce the cost of transfer. In this context, CBK has, in cooperation with the other GCC central banks, implemented the GCC cross-border payment system (AFAQ) that connects Real Time Gross Settlement Systems (RTGSS) of GCC member states. **In addition, CBK is looking forward to establishing an Innovation Hub to accommodate the technical activities related to information security, cybersecurity and information systems in the CBK-regulated entities.**
- Keen to keep pace with the advancement of **electronic payment** and provide the regulatory frameworks, CBK has promulgated the final instructions regulating the electronic payment of funds in May 2023. These instructions provided for the requirements to be met by existing and emerging financial institutions to practice the activities of electronic payment, electronic money or the operation of electronic payment systems according to five types of licenses commensurate with the size and nature of the activity. The CBK instructions also included the requirements and controls that must be adhered to by those institutions throughout the practice of the activity in the areas of governance, the general framework of risk management, AML/CFT, cybersecurity,

business continuity and customer protection, with the aim to preserve the integrity and stability of payment systems in the State of Kuwait.

Supportive Environment for Foreign Banking

- Coping with **liberalization of financial services**, a legislative amendment has been made pursuant to the Law No. 28 of 2004 to the provisions of Article 56 of the Law No. 32 of 1968 on Currency, the Central Bank of Kuwait and the Regulation of Banking and its amendments. The said amendment permitted the opening of branches of foreign banks in the State of Kuwait, in response to the request to liberalize financial services contained in the new agreement of the World Trade Organization. Permission was limited to the opening of one branch for a foreign bank, in accordance with the relevant principles, rules and controls set by the CBK's Board of Directors. Therefore, CBK developed a set of these principles, rules and controls in line with international standards including those issued by the Basel Committee on Banking Supervision.
- CBK's monitoring of the positive effects on banking activity in the State of Kuwait revealed that the positive effects can be maximized if opening of more than one branch of a foreign bank is permitted, as an increasing competition between national banks and branches of foreign banks shall motivate all banks to provide more diverse and premium services, and stimulate the banking sector to provide new and innovative services and products.
- To **stimulate competition and improve the performance of the banking sector**, the Law No. 3 of 2014 was issued amending some provisions of the Law No. 32 of 1968, permitting the opening of more than one branch of a foreign bank. CBK issued a circular on 25/03/2014 to all foreign banks operating in the State of Kuwait to invite banks wishing to open branches in the State of Kuwait to provide CBK with branching plans, including the number of branches, areas of presence and the dates of establishment.

Green Finance

- As per of its efforts to bolster the green finance, CBK issued in November 2022 a circular to local banks regarding the guidelines on sustainable finance. This step came in light of the **growing global attention to sustainable finance**. CBK also reviews the reports of local banks on their commitment to sustainable finance standards and principles, rendering financing products and tools that are compatible with green finance activities, and applying the principle of sustainability to the bank's operations and internal activities by measuring the carbon impact from buildings and branches, improving waste management, and adopting water and energy efficiency standards. Banks are also required to consider the significant impact of their decisions related to lending and investment on the environmental, social and governance standards.

The Governor concluded the statement by confirming the CBK's readiness to act, whenever appropriate, and direct the various monetary policy instruments in order to bolster an environment inducing to sustainable economic growth and preserve the competitiveness and attractiveness of the national currency as a lucrative store of domestic savings, while maintaining the monetary stability and financial stability.

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