INTERNATIONAL MONETARY FUND

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KUWAIT

April 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KUWAIT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 25, 2019 consideration of the staff report that concluded the Article IV consultation with Kuwait.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 25, following discussions that ended on January 21, 2019, with the officials of Kuwait on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 8, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Kuwait.

The document listed below will be separately released.

Financial Stability System Assessment (FSSA)

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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April 3, 2019

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IMF Executive Board Concludes 2019 Article IV Consultation with Kuwait

On March 25, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the 2019 Article IV consultation with Kuwait.[1] The discussion included the Financial System Stability Assessment (FSSA) of Kuwait.

Growth has resumed, and the current account rebounded thanks to higher oil prices. Hydrocarbon output rose by 1.2 percent in 2018 after contracting a year earlier. Buoyed by a rebound in confidence and government spending, non-oil growth has accelerated to 2.5 percent. After the first deficit in more than two decades in 2016, the current account shifted back into surplus in 2017 and reached an estimated surplus of 12.7 percent of GDP in 2018. Inflation fell to a multiyear low of 0.7 percent due to falling housing rents, easing food prices, and a strengthening dinar.

While the overall fiscal balance has improved, financing needs remain large. Higher oil revenues and investment income boosted the overall balance. However, the underlying fiscal position—non-oil balance less investment income in percent of non-oil GDP—indicates a modest loosening in FY17/18 and FY18/19. Fiscal financing needs—overall balance after compulsory transfers to the Future Generations Fund (FGF) and excluding investment income—remain large. Delays in the passage of a new debt law have rendered the government unable to issue debt since October 2017. As a result, it has had to draw on the General Reserve Fund assets for financing.

The banking sector reports sound indicators, and credit is recovering from a slow start in 2018. The systemwide capital adequacy ratio reached 18 percent in September 2018, and liquidity ratios were comfortably within regulatory requirements. Profits rose and asset quality improved, with NPLs net of specific provisions falling to a historical low. The Central Bank of Kuwait (CBK) raised the repo rate, a benchmark for deposits, several times but has kept the policy lending rate at 3 percent since March 2018. As a result, bank lending interest rates have risen by less than deposit rates. Coupled with ample liquidity—a by-product of deposit growth and

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

government debt redemption in 2018—this is supporting a credit recovery. Private sector loans grew 4.1 percent year-on-year in December 2018 on the back of household, construction, and oil sector borrowing.

Executive Board Assessment[2]

Executive Directors noted that growth is expected to strengthen and the underlying fiscal position to gradually improve over the medium term. Given the volatility of oil prices and the exhaustible nature of oil resources, Directors underscored the need for timely and well-sequenced fiscal and structural reforms to reduce Kuwait's dependence on oil, boost government saving, and create more private sector jobs.

Directors called for deeper fiscal reforms to ensure adequate savings for future generations. They encouraged the authorities to tackle spending rigidities and increase non-oil revenue while boosting capital outlays to improve infrastructure and raise potential growth. They underscored the need to tackle the large public sector wage bill, noting that public sector wages should be gradually aligned with those in the private sector to incentivize nationals to seek private sector opportunities and support competitiveness. Directors also encouraged the authorities to proceed with the introduction of GCC-wide excises and VAT.

Directors emphasized that a robust fiscal framework and strong fiscal governance are vital to bolstering fiscal policy credibility. Directors stressed that enhanced fiscal transparency, an improved public procurement framework, and greater spending efficiency would help increase government accountability, cut waste, and reduce Kuwait's vulnerability to corruption.

Directors welcomed the banking system's sound position and commended the authorities for prudent regulation and supervision. To further enhance financial sector resilience, Directors encouraged the authorities to implement the recommendations of the FSSA. In particular, they saw scope to further enhance the crisis management framework, notably by establishing a special resolution regime for banks and unwinding the blanket guarantee of deposits once the preconditions are met. They also encouraged the authorities to strengthen liquidity management, bolster systemic risk oversight, and called for a gradual relaxation of the interest ceilings. Directors encouraged the authorities to further strengthen the AML/CFT framework.

Directors stressed the need for structural reforms to improve the business environment, support entrepreneurship, and foster productivity. In particular, they saw scope for further easing of administrative procedures, facilitating trading across borders, and efforts to promote competition.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

They also called for a more enabling environment for SMEs and startups, by enhancing their access to finance, facilitating participation in public tenders, and training entrepreneurs.

Directors concurred that the pegged currency regime remains appropriate, with the peg to a basket of currencies continuing to provide an effective nominal anchor. Directors noted that the recommended fiscal adjustment would largely close the current account gap over the medium term.

Kuwait: Selected Economic Indicators, 2014–24

					Est.	Projections					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Oil and gas sector											
Total oil and gas exports (billions of U.S. dollars)	97.6	48.5	41.5	49.6	65.7	58.3	59.6	60.2	60.9	62.1	63.6
Average oil export price (U.S. dollars/barrel)	96.5	49.0	41.0	53.4	70.6	61.5	61.4	60.6	60.1	60.2	60.6
Crude oil production (millions of barrels/day)	2.87	2.86	2.95	2.70	2.74	2.79	2.86	2.93	2.99	3.05	3.11
National accounts and prices	(Annual percentage change, unless otherwise indicated)										
Nominal GDP (market prices, in billions of Kuwaiti dinar)	46	34	33	36	43	41	43	45	47	49	52
Nominal GDP (market prices, in billions of U.S. dollars)	163	115	109	120	141	137	143	150	156	163	172
Real GDP [1]	0.5	0.6	2.9	-3.5	1.7	2.5	2.9	2.9	2.5	2.7	2.9
Real oil GDP	-2.1	-1.7	3.9	-7.2	1.2	2.0	2.5	2.5	2.0	2.0	2.0
Real non-oil GDP	4.9	4.2	1.4	2.1	2.5	3.0	3.5	3.4	3.2	3.7	4.0
CPI inflation (average)	3.1	3.7	3.5	1.5	0.7	2.5	2.7	4.7	3.9	3.0	3.0
Unemployment rate (Kuwaiti nationals)	5.0	4.7	3.3	3.3	...	...	...	...	...	...	...
Budgetary operations [2]	(Percent of GDP)										
Revenue	67.4	52.3	52.8	58.9	60.9	58.6	58.0	58.7	57.2	55.8	54.6
Oil	51.9	35.4	34.5	38.0	43.7	40.1	39.2	37.8	36.8	35.9	35.1
Non-oil, *of which:*	15.4	16.9	18.3	20.9	17.1	18.4	18.9	20.8	20.4	19.9	19.4
Investment income	10.6	13.3	14.6	16.5	13.0	13.9	14.3	14.7	13.9	13.5	13.0
Expenditures [3]	48.8	52.7	52.3	50.8	48.3	50.5	51.0	51.9	51.9	51.7	51.1
Expense	43.3	45.0	44.2	42.6	40.6	42.3	42.6	43.3	43.4	43.1	42.7
Capital	5.4	7.7	8.1	8.2	7.7	8.2	8.4	8.6	8.6	8.5	8.4
Balance	18.6	-0.3	0.5	8.1	12.6	8.0	7.0	6.7	5.2	4.2	3.4
Balance (after transfers to FGF and excl. investment income)	2.3	-17.5	-17.9	-12.6	-5.2	-10.4	-11.6	-12.3	-13.0	-13.5	-13.7
Non-oil balance excl. investment income (percent of non-oil GDP) [4]	-102.5	-88.3	-83.8	-86.5	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3
Excluding oil-related subsidies and benefits (percent of non-oil GDP)	-81.2	-77.5	-74.8	-77.4	-77.2	-76.4	-75.8	-72.8	-70.8	-69.3	-67.7
Total gross debt (calendar year) [5]	3.4	4.7	10.0	20.7	14.8	17.8	21.0	26.2	31.1	34.7	38.4
Money and credit	(Percent change; unless otherwise indicated)										
Net foreign assets [6]	3.6	-2.1	8.7	-3.1	10.0	2.7	5.6	7.5	6.1	6.5	6.9
Claims on nongovernment sector	5.2	7.6	2.9	2.8	4.1	6.1	6.7	8.0	7.2	7.1	7.4
Kuwaiti dinar 3-month deposit rate (year average; in percent) [7]	0.8	0.8	1.1	1.5	2.3	...	...	...	...	...	...
External sector	(Billions of U.S. dollars, unless otherwise indicated)										
Exports of goods	104.5	54.5	46.5	55.1	71.6	64.6	66.3	67.3	68.4	70.2	72.3
Of which: non-oil exports	7.0	6.0	5.0	5.6	5.9	6.3	6.7	7.1	7.5	8.1	8.7
Annual percentage change	-2.8	-14.1	-15.7	10.6	6.6	6.2	6.1	6.1	6.1	7.1	8.1
Imports of goods	-27.0	-26.5	-27.0	-29.5	-31.3	-32.5	-33.7	-35.2	-36.6	-38.2	-40.1
Terms of Trade (ratio, annual percent change)	-12.2	-42.5	-12.5	21.9	23.1	-11.0	0.1	-0.7	-0.2	-0.3	0.1
Current account	54.4	4.0	-5.1	7.1	18.0	10.2	11.4	11.9	10.4	10.0	9.5

Percent of GDP	33.4	3.5	-4.6	5.9	12.7	7.4	8.0	8.0	6.6	6.1	5.5
International reserve assets [8]	32.3	28.3	31.2	33.5	37.0	37.2	38.8	41.1	43.0	45.3	47.9
In months of next year's imports of goods and services	7.4	6.5	6.5	6.6	7.0	6.8	6.8	7.0	7.0	7.1	7.2
Memorandum items [7]:											
Exchange rate (U.S. dollar per KD, period average)	3.52	3.32	3.31	3.31	3.31	...	...	...	...	...	...
Nominal effective exchange rate (Percentage change)	1.5	3.1	0.9	0.8	-0.4	...	...	...	...	...	...
Real effective exchange rate (Percentage change)	2.0	5.0	2.7	0.8	-2.7	...	...	...	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.

[1] Calculated on the basis of real oil and non-oil GDP at factor cost.

[2] Based on fiscal year cycle, which starts on April 1 and ends on March 31.

[3] Starting FY 2016/17, there has been a reclassification of expenditure items.

[4] Excludes investment income and pension fund recapitalization.

[5] Excludes debt of Kuwait's SWF related to asset management operations.

[6] Excludes SDRs and IMF reserve position.

[7] For 2018, based on latest available data.

[8] Does not include external assets held by Kuwait Investment Authority.

INTERNATIONAL MONETARY FUND

KUWAIT

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

March 8, 2019

KEY ISSUES

Context. Growth has strengthened, and fiscal and external positions improved thanks to higher oil prices. The increased uncertainty about oil price prospects though underscores the need to reduce dependence on oil and increase savings for the future. The key priority is to build national consensus around equitable and well-sequenced reforms to underpin fiscal consolidation and promote the private sector. To gain broad support, reforms should improve the quality of public services, strengthen governance, and be supported by a vigorous communications campaign. Ample financial assets and low debt allow Kuwait to undertake the needed reforms from a position of strength.

Outlook and risks. Non-oil growth is expected to strengthen, as infrastructure projects accelerate and credit recovers. Lower oil prices in 2019 will dampen the overall fiscal balance. However, the underlying fiscal position (non-oil balance excluding investment income) should gradually improve over the medium term thanks to expected new taxes, repricing of government services, and spending restraint. Fiscal financing needs will remain large reflecting mandatory transfers to the Future Generations Fund (FGF). Downward risks stem from a sustained drop in oil prices, delays in reforms, tighter global financial conditions, and heightened tensions in the region.

Macroeconomic policies. While authorities' efforts to strengthen the fiscal accounts are welcome, more ambitious reforms will be needed to secure adequate savings for future generations and reduce financing needs. Reforming the public wage bill, subsidies, and transfers, raising non-oil revenue, and enhancing the fiscal policy framework and governance would support fiscal consolidation and increase the efficiency of spending on human and physical capital.

Financial stability. Prudent regulation and supervision by the Central Bank of Kuwait (CBK) have helped keep banks resilient. Further efforts should focus on strengthening cross-border supervision, enhancing the crisis management and liquidity forecasting frameworks, and deepening capital markets.

Private-sector led growth. Creating jobs for the large number of nationals joining the labor force over the next decade hinges on the emergence of a vibrant private sector. This requires reducing the role of the public sector in the economy through privatization and public-private partnerships (PPPs), lowering the high public-private wage premia, and improving the business environment.

Approved By
Aasim M. Husain and Edward Gemayel

Discussions were held in Kuwait during January 8–21, 2019. The team comprised Ali Alreshan, Botir Baltabaev, Anastasia Guscina and Azim Sadikov (all MCD). Mohammed Zaher supported the mission from headquarters. Aasim Husain (MCD), Amina Lahreche (MCM, FSAP mission chief), and Maya Choueiri (OED) attended some of the meetings. The mission met with Minister of Finance Al-Hajraf, Governor of the Central Bank of Kuwait Al-Hashel, Minister of State for Economic Affairs Al Aqeal, and Amir's Economic Advisor Al-Ibrahim, other senior officials, and private sector representatives. Research assistance was provided by Jawed Sakhi and Erik Roos. The team also benefited from editorial support by Diana Kargbo-Sical.

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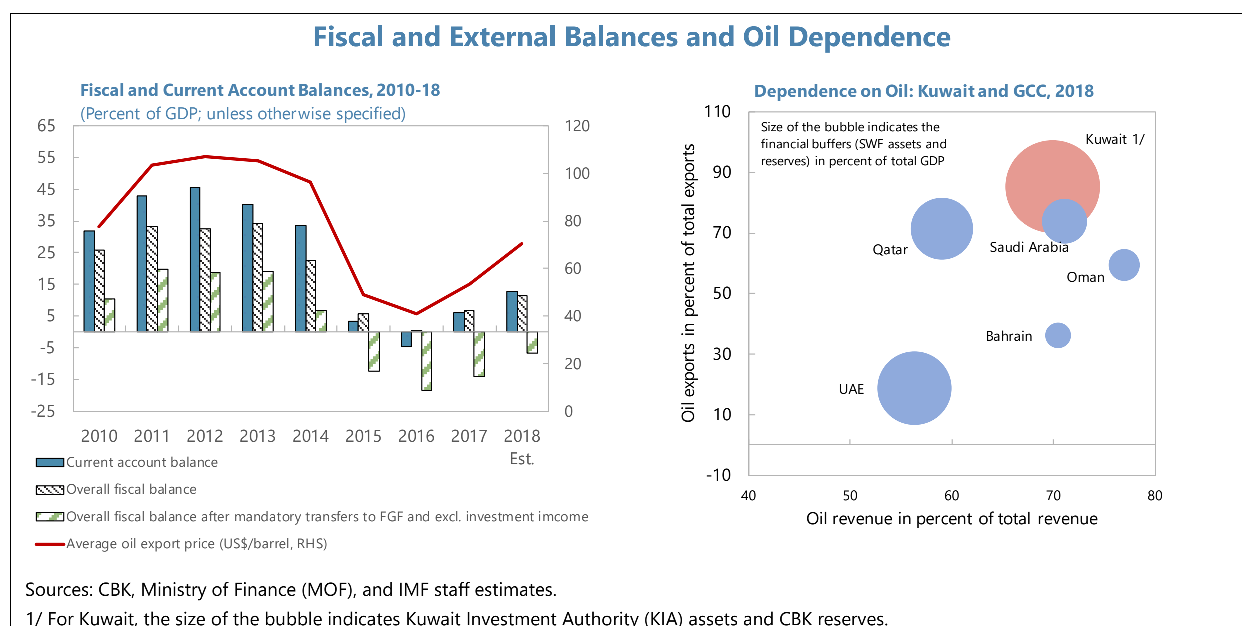
CONTEXT

1. Oil dependency underscores the need to persevere with fiscal and structural reforms. Higher oil prices in 2017–18 lifted growth and fiscal and external balances. The windfall is proving temporary though as prices have declined since October.

Fiscal and External Balances and Oil Dependence



Sources: CBK, Ministry of Finance (MOF), and IMF staff estimates.
1/ For Kuwait, the size of the bubble indicates Kuwait Investment Authority (KIA) assets and CBK reserves.

2. The key challenge is to formulate a reform package that could gather broad support. In response to the 2014–15 oil price shock, the government initiated reforms to raise government savings and boost the private sector. It took some steps to rationalize employment benefits, reduce energy and water subsidies, and improve the business climate (Annex I). However, subsequent discussions in parliament led to scaling back of the electricity and water price increases and shelving of a business profit tax proposal. Approval of the Gulf Cooperation Council (GCC)-wide value-added tax (VAT) and excises and of a new debt law has been delayed, and tensions with parliament led to resignations of four ministers in late December.

3. Ample financial assets accumulated thanks to past policies allow Kuwait to face its challenges from a position of strength. Large KIA assets and CBK reserves, estimated at 428 percent of GDP, and substantial borrowing space underpin Kuwait's demonstrated resilience to shocks and allow for gradual adjustment.

RECENT DEVELOPMENTS

4. Growth has resumed, and the current account rebounded thanks to higher oil prices. Staff estimate that hydrocarbon output rose by 1.2 percent in 2018 after contracting a year earlier. Buoyed by a rebound in confidence and government spending, non-oil growth has accelerated to 2.5 percent. After the first deficit in more than two decades in 2016, the current account shifted

back into surplus in 2017 and reached an estimated surplus of 12.7 percent of GDP in 2018. Inflation fell to a multiyear low of 0.7 percent due to falling housing rents, easing food prices, and a strengthening dinar.

5. While the overall fiscal balance has improved, financing needs remain large. Higher oil revenues and investment income boosted the overall balance, expected to reach 12.6 percent of GDP in FY18/19.[1] However, staff's measure of the underlying fiscal position—non-oil balance less investment income in percent of non-oil GDP—indicates a modest loosening in FY17/18 and FY18/19. Fiscal financing needs—overall balance after compulsory transfers to the FGF and excluding investment income—remain large. Delays in the passage of a new debt law have rendered the government unable to issue debt since October 2017. As a result, it has had to draw on the General Reserve Fund (GRF) assets for financing.

Fiscal Developments, FY2015/16–18/19

(In percent, on a fiscal year basis, unless otherwise noted)

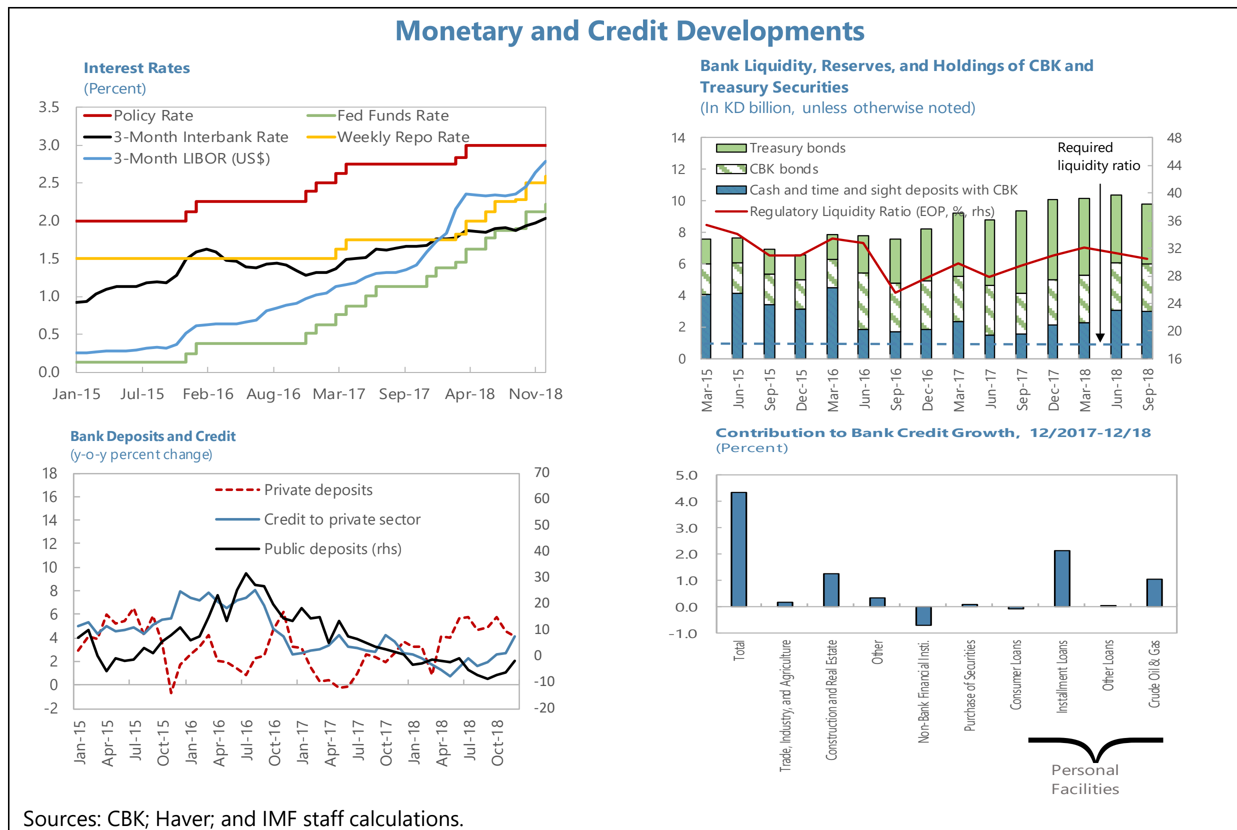
	2015/16	2016/17	2017/18	2018/19	2015/16	2016/17	2017/18	2018/19
	Percent of GDP				Percent of Non-oil GDP			
Revenue	52.3	52.8	58.9	60.9	94.2	91.0	109.7	121.1
Oil	35.4	34.5	38.0	43.7	63.7	59.5	70.9	87.0
Non-oil	16.9	18.3	20.9	17.1	30.5	31.5	38.9	34.1
Expenditure 1/	52.7	52.3	50.8	48.3	94.8	90.2	94.7	96.1
Current	45.0	44.2	42.6	40.6	81.0	76.1	79.3	80.8
Capital	7.7	8.1	8.2	7.7	13.8	14.0	15.3	15.3
Overall balance	-0.3	0.5	8.1	12.6	-0.6	0.9	15.0	25.0
Excluding oil and investment income	-49.0	-48.6	-46.4	-44.1	-88.3	-83.8	-86.5	-87.8
Excluding fuel subsidies	-43.0	-43.4	-41.5	-38.8	-77.5	-74.8	-77.4	-77.2
Overall balance (after transfers to FGF and excl. investment income) 2/	-17.5	-17.9	-12.6	-5.2	-31.6	-30.9	-23.5	-10.3
Memo items:								
Nominal GDP (KD billion)	34.1	33.9	37.8	42.0				
Nominal non-oil GDP (KD billions)	18.9	19.6	20.3	21.3				
Break-even oil price (U.S. $/barrel)	47.5	43.4	45.2	48.3				
Break-even oil price (after transfers to FGF and excl. investment income)	72.9	69.5	78.7	76.9				
Stock of KIA assets (calendar-year basis) 3/	456	477	465	403				

Sources: CBK, Ministry of Finance; and IMF staff estimates.
1/ Starting FY2016/17, there has been a reclassification of expenditure items.
2/ Excludes revenue transferred to the FGF (4.8 percent of GDP) and investment income (13 percent of GDP) in 2018/19.
3/ Figures for all years are staff estimates based on inflows into FGF (10 percent of revenues excl. investment income), outflows from GRF to close the financing gap, and assumptions on the return on KIA assets.

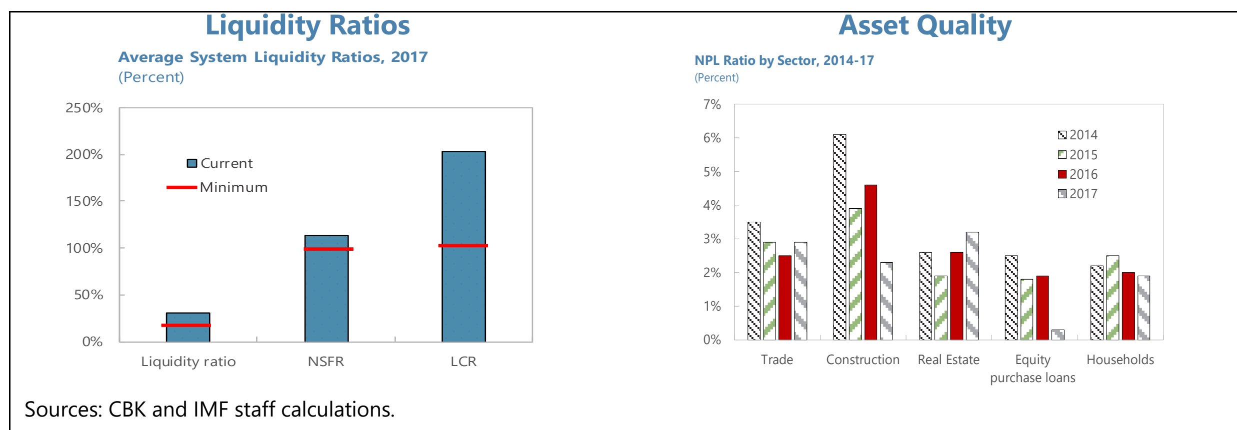
6. Credit is recovering from a slow start in 2018. As the U.S. Federal Reserve raised the Fed Funds rate, the CBK deployed various monetary policy instruments to maintain the dinar's attractiveness while supporting lending. The CBK raised the repo rate, a benchmark for deposits, several times but has kept the policy lending rate at 3 percent since March 2018. As a result, bank lending interest rates have risen by less than deposit rates. Coupled with ample liquidity—a by-product of deposit growth and government debt redemption in 2018—this is supporting a credit recovery. Private sector loans grew 4.1 percent year-on-year in December on the back of household, construction, and oil sector borrowing.

[1] The fiscal year runs from April through March.

7. Banks report sound indicators. The systemwide capital adequacy ratio (CAR) reached 18 percent in September 2018, and liquidity ratios were comfortably within CBK's requirements. Asset quality has improved, with NPLs net of specific provisions falling to a historical low. Profits rose in 2018 though the reduced spread between lending and deposit rates signals lower interest rate margins going forward.

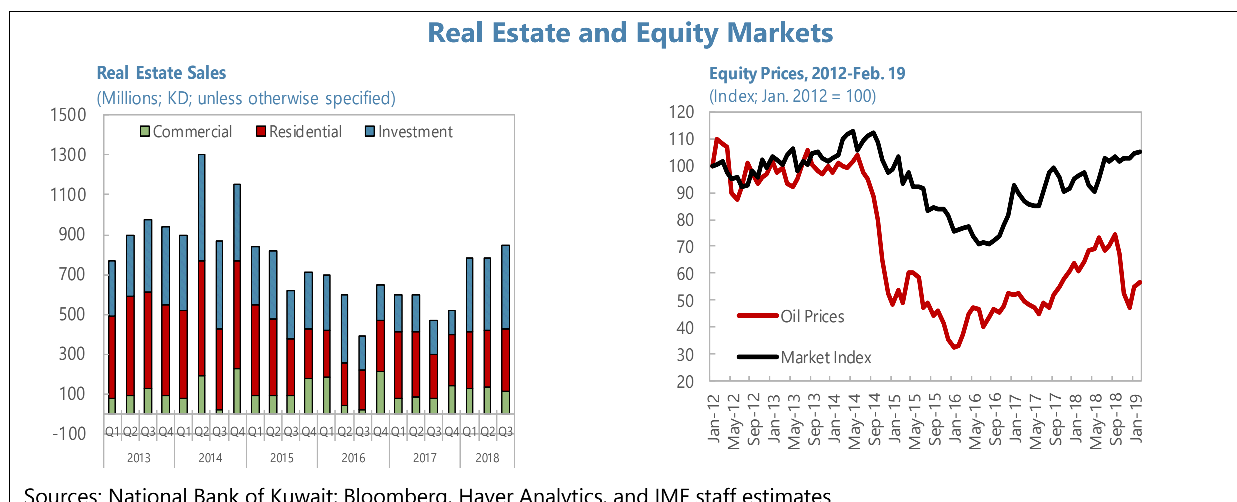


Sources: CBK; Haver; and IMF staff calculations.



Sources: CBK and IMF staff calculations.

8. Real estate is recovering, and equity markets have outperformed regional peers. The sales of investment and residential properties rebounded since mid-2018. Kuwaiti stocks outperformed other Gulf Cooperation Council (GCC) markets, and market capitalization rose, especially following the March 2018 announcement of Kuwait's inclusion in the FTSE Russell Emerging Market Index.



Sources: National Bank of Kuwait; Bloomberg, Haver Analytics, and IMF staff estimates.

OUTLOOK AND RISKS

9. Medium-term prospects are broadly favorable.

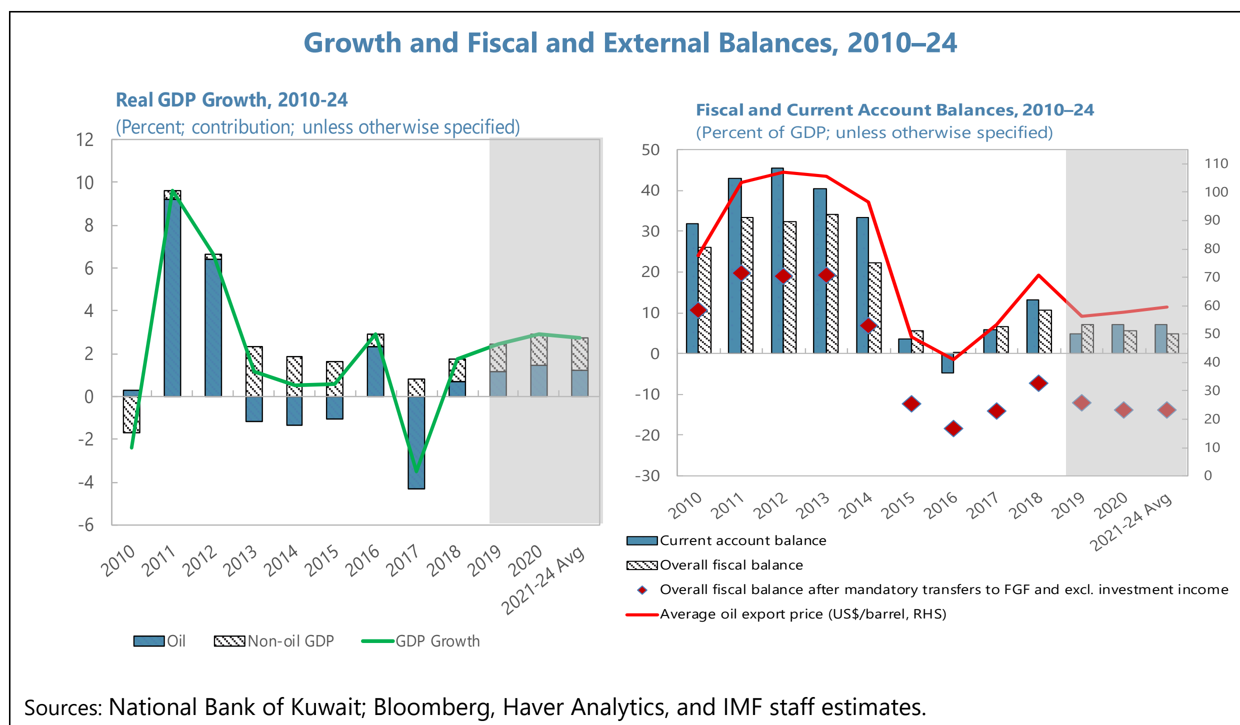
- ***Growth is expected to strengthen***. The recent OPEC+ decision to cut production is expected to hold oil output to 2 percent growth in 2019, which should rebound to 2.5 percent in 2020 given the spare capacity. Propelled by accelerated capital project execution, non-oil growth is projected to increase to 3 percent in 2019 and 3½ percent in 2020. Once the headwinds from new taxes expected over the medium term wear off, non-oil growth could reach 4 percent. Inflation should pick up to 2.5 percent in 2019–20 as the deflationary factors in 2018 unwind. As growth strengthens, and capital projects come on stream, credit growth should pick up, aided by ample bank liquidity and the recent easing of lending limits on personal loans.[2]

- ***The underlying fiscal position is projected to gradually improve***. Staff's baseline scenario assumes an average oil price of US$61.5 per barrel in 2019–20, falling very slightly to US$60.6 over the medium term. It also envisages the introduction of excises on tobacco and sugary drinks in FY2020/21 and a VAT in FY2021/22, small increases in fees for government services, and some current spending restraint. As a result, the underlying fiscal position (non-oil fiscal balance excluding investment income) should improve by about 12½ percentage points of non-oil GDP by FY2024/25. However, the overall balance will deteriorate by about 9 percentage points of GDP over the same period, reflecting lower projected oil revenues than in 2018.

[2] Borrowers can now borrow up to 25 times their net monthly salary or a maximum of KD 25,000, up from 15 times or a maximum of 15,000 KD previously.

- ***Financing needs will remain large***. The authorities' principal measure of fiscal balance—overall balance after compulsory transfers to the FGF and excluding investment income—will average 12½ percent of GDP deficit over the medium term. This will give rise to cumulative net financing needs of US$116 billion over the next 6 years.

Growth and Fiscal and External Balances, 2010–24



Sources: National Bank of Kuwait; Bloomberg, Haver Analytics, and IMF staff estimates.

Financing Needs, FY2018/19–24/25
(In percent of GDP, unless otherwise noted)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	Cumulative 2019/20-24/25
Overall balance	12.6	8.0	7.0	6.7	5.2	4.2	3.4	
Overall balance (after transfer to FGF and excl. inv. income) 1/	-5.2	-10.4	-11.6	-12.3	-13.0	-13.5	-13.7	
Non-oil balance excl. investment income (percent of non-oil GDP)	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3	
Net financing needs (in KD billion)	2.2	4.3	5.1	5.6	6.2	6.7	7.2	35.2
Domestic (net issuance)	-1.2	1.0	1.0	1.0	0.7	1.0	1.0	5.7
External (net issuance)	0.0	0.7	1.8	1.8	1.8	1.8	1.8	9.7
Drawdown of GRF	3.3	2.6	2.3	2.8	3.7	3.9	4.4	19.8
Public debt 2/	14.8	17.8	21.0	26.2	31.1	34.7	38.4	
Stock of KIA assets 2/ 3/	403	425	418	410	402	392	379	
Stock of GRF assets 2/ 3/	57	54	48	41	33	25	16	
Stock of FGF assets 2/ 3/	346	371	370	369	369	367	364	
Current account balance 2/	12.7	7.4	8.0	8.0	6.6	6.1	5.5	

Sources: Ministry of Finance, and IMF staff estimates.

1/ Excludes 10 percent of total revenue transferred to the FGF and investment income.

2/ On a calendar-year basis.

3/ The stock of KIA assets are staff estimates and projections.

10. A sustained drop in oil prices and delays in reforms are the main sources of risk (Annex II). Oil prices could decline if global trade tensions were to heighten and global growth were to weaken. A sustained drop would generate unfavorable macro-financial dynamics, with twin deficits, large financing needs, and tightening credit conditions. Asset quality could deteriorate, and liquidity could start to dry up. Delays in fiscal and structural reforms could also slow growth and increase fiscal deficits at a time when the global environment has become more challenging and financial conditions have tightened. Should investors' appetite for exposure to Kuwait wane under these conditions, the government and banks could face higher funding costs and rollover risks. If these risks were to materialize, the authorities could, as they have done in the past, draw on Kuwait's large financial assets to meet financing needs and mitigate the impact on the financial sector and the economy. Heightened security tensions and a challenging geopolitical environment in the region are an additional source of risk that could dampen confidence, investment, and growth.

11. The authorities broadly shared staff's views on the outlook and risks. Discussions took place against the backdrop of oil prices recovering from their late-2018 slump. The authorities believed that, if sustained, this would translate into significantly stronger fiscal and external balances. Nonetheless, they built the FY2019/20 budget on a conservative $55 per barrel oil price assumption. Staff's calculations show that, everything else unchanged, a $10 per barrel higher/lower oil price in 2019 would imply 5 and 6.5 percent of GDP improvement/worsening in Kuwait's fiscal and external balances compared to the baseline.

POLICY DISCUSSIONS

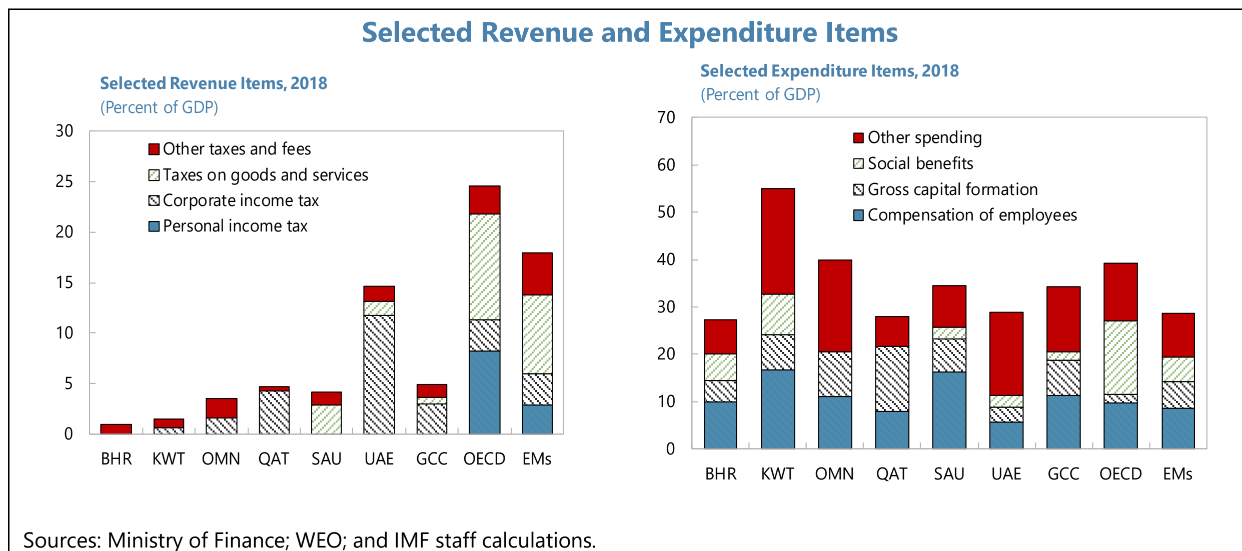
A. Bolstering Long-term Fiscal Sustainability

12. The authorities are making an effort to strengthen the fiscal accounts. They agreed with staff that the adjustment should be primarily expenditure-based, supported by non-oil revenue mobilization. Government spending as a share of GDP in Kuwait rose fastest in the GCC during the period of high oil prices and is currently the highest in the region. At the same time non-oil revenues are low, even by regional standards.

- ***Containing spending while cutting inefficiencies***. Facing opposition to reforming the wage bill, subsidies, and transfers, the government has identified a menu of streamlining measures that could be implemented with greater social acceptance. Staff supported plans to (i) close loopholes in administration of various transfers, (ii) modernize procurement, (iii) limit grants to priority sectors, and (iv) improve capital project selection and execution.

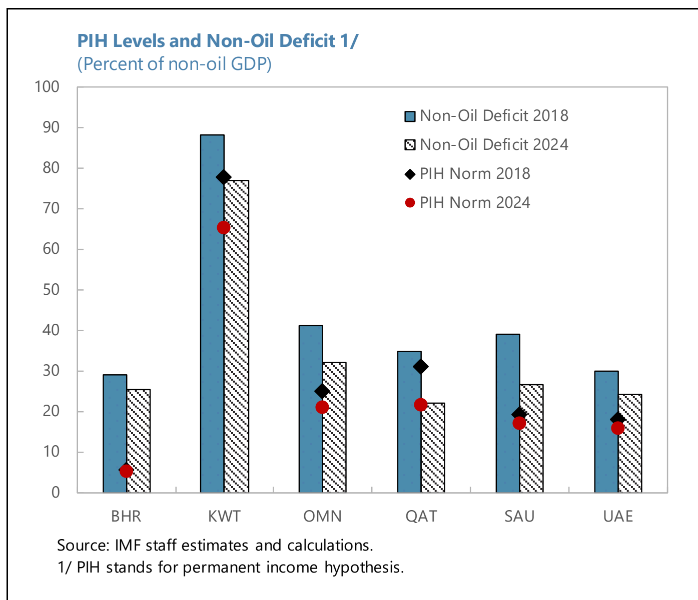
- ***Increasing non-oil revenue***. The Kuwaiti authorities are experiencing delays in introducing the VAT and excises on tobacco and sugary drinks, which were agreed with other GCC countries in 2015-16. In the meantime, the government has explored alternative means to boost non-oil revenue. These include: (i) repricing government services, (ii) enforcing penalties on businesses not meeting quotas on hiring Kuwaitis, and (iii) strengthening revenue collection, including for utilities. While welcoming the progress in identifying revenue options, staff encouraged the

authorities to redouble efforts to secure parliamentary support for the excises and the VAT, which Saudi Arabia, the UAE, and Bahrain have already implemented. With the low 5 percent rate, the VAT would have a moderate and temporary adverse impact on growth and inflation, but would yield stable revenue, help upgrade tax administration, and contribute to more informed policy-making (Annex VI). Given VAT's complexity and scope, staff recommended speeding up the preparatory work, especially in administration capacity, to avoid implementation delays.



Sources: Ministry of Finance; WEO; and IMF staff calculations.

13. Kuwait needs deeper reforms to secure adequate savings for future generations. Even if implemented fully and on time, the fiscal measures under consideration would not close the intergenerational equity gap. The non-oil fiscal balance would fall well short of estimated levels needed to ensure equally high living standards for future generations—a gap of 11.6 percent of non-oil GDP by 2024. More ambitious fiscal consolidation will be critical to close this gap, which would also reduce financing needs and ensure long-term debt sustainability (Annex III).



Source: IMF staff estimates and calculations.
1/ PIH stands for permanent income hypothesis.

14. A comprehensive, well-designed fiscal and structural reform package could garner broad social consensus. Such a package would support sustained fiscal consolidation, build on contributions from key stakeholders, introduce targeted compensatory measures to protect the vulnerable, and boost growth-enhancing infrastructure spending. Crucially, to gain broad support, the package would include reforms to foster a private sector that creates jobs for Kuwaitis

who are no longer able to be absorbed into the public sector, improve the efficiency and quality of public services, and strengthen government accountability. A vigorous communications campaign to explain reforms will be key.

15. Staff proposed a fiscal reform path that would gradually close the intergenerational savings gap over the next decade. It entails measures to tackle current spending rigidities and increase non-oil revenue while boosting capital outlays. Most of the adjustment would come from spending, which would decline to about 75 percent on non-oil GDP by 2024—broadly the level Kuwait sustained in 2000–10. The proposed adjustment would have modest costs for short-run growth and inflation, which would dissipate over time as higher investment and structural reforms bear dividends (Annex IV, Figure 5).

- ***Curtailing the public wage bill***. The authorities concurred that reforming the large public wage bill (17 percent of GDP) should be an essential component of fiscal adjustment. Staff encouraged them to implement comprehensive reform that centralizes compensation policy, harmonizes the public wage grid structure, better aligns public sector wages with those in the private sector, and fosters merit-based compensation. Reducing the high public-private wage premia and limiting public employment growth would generate fiscal savings and incentivize nationals to seek opportunities in the private sector. In this regard, staff cautioned that the early civil service retirement bill recently approved by parliament would make public employment even more attractive while being costly for the budget. Staff agreed with the authorities that scaling down the government's role as the employer of choice for Kuwaitis should be accompanied by efforts to boost private sector opportunities.

- ***Gradually phasing out subsidies and transfers***. Despite earlier reforms, at almost 6 percent of GDP, the fuel, electricity, and water subsidy bill remains large. Not only are these subsidies costly, they also encourage excessive consumption and inefficient investment and, being untargeted, disproportionately benefit the well-off. There is also scope to rationalize transfers (9 percent of GDP), by consolidating programs, improving targeting, and better enforcing eligibility criteria. Raising awareness about the budgetary costs, distortions, and distributional impact of subsidies and transfers would help build consensus for reforms, which should include measures to protect the most vulnerable. The

Prices for Energy Products: GCC and the United States
(October 2018 or latest available)

	Gasoline	Diesel	Electricity
	(U.S. dollars per liter)		(U.S. dollars per KWh)
Bahrain	0.53	0.42	0.04
Kuwait 1/	0.35	0.38	0.02
Oman	0.61	0.75	0.04
Qatar	0.58	0.56	0.05
Saudi Arabia	0.54	0.13	0.10
UAE	0.68	0.75	0.12
GCC average (excl. Kuwait)	0.59	0.52	0.07
U.S. Prices	0.83	0.87	0.13

Sources: Prices for GCC countries come from country authorities and are averages for 90 and 95 octane gasoline. U.S. gasoline (average for mid and high grade) and diesel prices come from the U.S. Energy Information Agency (EIA) and are adjusted for taxes. Electricity tariffs for the United States include taxes and come from EIA.

1/ For Kuwait, nationals were exempt from the August 2017 electricty price increases. The overall price is a weighted average of differentiated prices across different sectors.

authorities were not planning policy changes at this time and preferred focusing on better controlling eligibility requirements to contain cost.

- ***Broadening the coverage of the profit tax and introducing excises on luxury goods***. Applying the profit tax to domestic companies would raise non-oil revenue while leveling the playing field for all firms operating in Kuwait. An excise tax on luxury goods would contribute to a more socially-balanced adjustment mix, and so would, as an alternative, an income tax on high-income individuals.

- ***Rebalancing spending toward capital with improved implementation***. The authorities agreed that increasing capital outlays is essential for raising potential growth. This should be complemented by reforms to improve project planning, selection, and execution.

Estimated Fiscal Savings Under the Baseline and Adjustment Scenarios 1/

(In percent of GDP)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Baseline reforms						
Strengthen social transfers administration	0.0	0.0	0.0	0.2	0.5	0.6
VAT and excises	0.0	0.2	1.7	2.1	2.1	2.2
Total	**0.0**	**0.2**	**1.7**	**2.3**	**2.6**	**2.7**
Additional reforms under the adjustment scenario						
Fuel price reform	0.1	0.2	0.3	0.4	0.7	0.7
Electricity and water subsidy	0.3	0.7	1.0	1.3	1.7	2.0
Corporate tax and/or PIT on wealthy	0.0	0.0	0.7	0.7	0.7	0.7
Wage and benefits control	0.1	0.1	0.4	0.7	0.9	1.3
Goods and services spending savings	0.1	0.3	0.6	0.8	1.0	1.2
Household compensation	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4
Capital expenditure	-0.2	-0.4	-0.4	-0.7	-0.7	-0.8
Other 2/	0.0	0.0	0.0	0.0	0.1	0.2
Total	**0.3**	**0.7**	**2.3**	**2.9**	**4.0**	**5.0**

Source: Ministry of Finance, Kuwait's Vision, and IMF staff estimates.

1/ See Annex IV for details on the baseline and adjustment scenario assumptions used to derive these estimates.

2/ Other includes changes in interest payments, investment income and fees, and automatic changes associated with changes in inflation and growth.

16. The authorities plan to bring the non-oil fiscal deficit down more gradually than recommended by staff. Far-reaching reforms would require a new social consensus, with the current generation foregoing some of its benefits for the sake of future ones. While Kuwait has ample buffers to implement the needed reforms very gradually, staff warned that proceeding too slowly would raise the risk that a greater and more abrupt adjustment may be needed down the road if adverse shocks materialize.

B. Enhancing Policy Frameworks

17. Strengthening fiscal governance would improve macroeconomic outcomes (Box 1). Staff commended the authorities for the planned adoption of the GFSM2014 and encouraged them to improve the timeliness of fiscal reporting; expand coverage to off-budget entities and contingent

liabilities; and increase transparency of oil revenue management. A more comprehensive and timely picture of the underlying fiscal position would strengthen policymaking, while greater transparency over revenues and their use would underpin government's accountability and public confidence. Given the potential for large efficiency and quality gains, the government could consider a focused Public Expenditure Review of education and healthcare spending. Staff noted that higher public investment should be accompanied by reforms to improve its efficiency through more robust medium-term planning, project selection and execution. Staff and authorities agreed that promptly implementing the new procurement law would deliver better value for money. Staff welcomed the authorities' recently released anti-corruption strategy and encouraged further efforts to strengthen the operational independence and capacity of the Anti-Corruption Agency (ACA), which is administering the asset declaration regime. Steps to improve fiscal governance would also help reduce vulnerabilities to corruption.

18. A robust fiscal framework would help anchor fiscal policy. The 3-year expenditure ceilings introduced in FY2017/18 stretched the planning horizon beyond annual budgets and helped limit spending procyclicality. However, government spending planned for FY2019/20, if executed fully, would breach the corresponding year expenditure cap. Staff urged the government to introduce and abide by new medium-term ceilings and anchor them to a long-term fiscal policy objective (e.g., based on intergenerational equity benchmarks). Setting a time-consistent path for an intermediary target, such as non-oil primary balance, would help delink spending from oil revenues. The authorities expressed interest in working with staff to study various fiscal rule options for Kuwait. Sound fiscal finances also require comprehensive analysis and management of fiscal risks, including those stemming from public pensions, state-owned enterprises, and public-private partnerships. In this regard, it would be important to develop a contingent liabilities framework.

19. Approval of the debt law would allow the government to resume market borrowing. Staff's baseline assumes that parliament will authorize borrowing in FY2019/20. If the approval is delayed, to sustain mandatory transfers to the FGF, the government will have to continue drawing exclusively on the GRF for financing. This will precipitate faster drawdown of GRF buffers than in the baseline although total KIA assets would continue to increase in nominal terms. Once the government returns to the market, increasing the tenor of bonds would help build a long-term yield curve, while issuing sovereign Sukuk would widen the investor base.

20. The authorities are strengthening the institutional framework for debt management and capital market development. Staff welcomed the establishment of an asset-liability management committee, between the MOF, the CBK, KIA, and the Kuwait Petroleum Corporation. Along with improved coordination, this will help in forming a more systematic view of asset-liability management, weighing costs and benefits of borrowing and investment, including the implications on GRF liquid buffers, central bank reserves, domestic liquidity, and debt market development. In this regard, publishing an issuance calendar and moving to market-based auctions to allow for price discovery would help deepen debt markets.

Box 1. Fiscal Governance

Recent progress notwithstanding, there is significant scope to further strengthen fiscal governance. The authorities have taken important steps, including enhancing fiscal statistics, enacting a new public procurement law, and adopting an anti-corruption strategy. Future reforms should focus on three areas: fiscal transparency, procurement framework, and spending outcomes.

Fiscal Transparency

Fiscal transparency is key to boosting accountability and policy credibility. While there is transparency with respect to legislative oversight and public access to key fiscal data, the quality and coverage of fiscal reporting could be further improved. Periodic fiscal reports by the MOF could include a more in-depth overview of developments, assessment of fiscal policy stance, and government's financing strategy and reconcile outturns and approved budgets. Adopting an Integrated Financial Management Information System would facilitate timely and accurate oversight of budget implementation. There is also scope to strengthen transparency of oil wealth management, by disclosing information on the value chain from the point of extraction to how revenues make their way through the government and KIA's financial operations. In this regard, the authorities are encouraged to join the Extractive Industries Transparency Initiative. Staff recommended conducting a Fiscal Transparency Evaluation to develop a comprehensive roadmap to address transparency needs.

Public Procurement

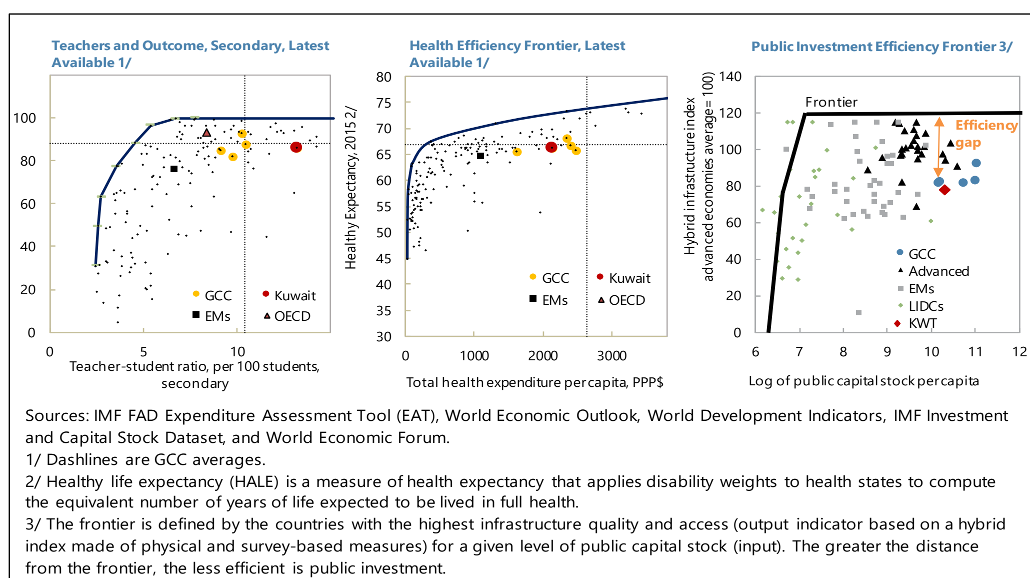
Implementing the new procurement law would help deliver value for money and suppress opportunities for corruption. Given the large size of public procurement in Kuwait, losses due to inefficiencies and abuses can be costly.[1/] A new procurement law enacted in 2016 marked a major milestone toward modernizing public procurement. The law aims to promote competition, transparency, and equal treatment, and lays the ground for establishing dedicated procurement bodies in public organizations, adopting modern approaches to bid evaluation, introducing life-cycle-costing and other non-price criteria, instituting an enhanced complaint mechanism, and facilitating small and medium enterprise (SME) participation in public tenders. Next steps include developing implementing regulations, introducing e-procurement[2/] and framework agreements, strengthening internal controls, and building capacity of the procurement workforce.

Spending Outcomes

Socioeconomic outcomes should better correspond to high levels of public outlays.

- **Education.** Kuwait spends more per student than most countries, but outcomes point to lower quality of education in key areas and indicate mismatches between existing curricula and the skills demanded in the private sector. To address these deficiencies, the authorities are upgrading the curriculum, building capacity to train teachers, and planning to introduce a Teacher Certification program. To increase spending efficiency, they could also consider bringing the teacher and nonteaching staff headcount (per student) closer to levels consistent with Kuwait's peers.
- **Healthcare.** Kuwait achieved significant improvements in health outcomes over the past 20 years, particularly in extending life expectancy and reducing infant mortality. However, it spends more than double the EM average on healthcare, while health outcomes are only marginally above the EM average, suggesting ample room for efficiency gains.[3/] Savings could be generated by tightening eligibility for treatment abroad, increasing out-of-pocket spending (from an average of 13 percent to the EM and OECD averages of 15–20 percent), and promoting private sector participation through privatization and public-private partnerships.
- **Public Investment.** The quality of infrastructure in Kuwait lags many of its peers, reflecting low efficiency and the level of spending. Reforms to strengthen public investment management should focus on, (i) improving the medium-term planning of sustainable levels of investment; (ii) enhancing the evaluation and selection of projects; and (iii) implementing projects in a timely and cost-effective way. To that end, staff encouraged the authorities to undertake a Public Investment Management Assessment that would assess infrastructure governance and support institution building.

Box 1. Fiscal Governance (concluded)



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, World Development Indicators, IMF Investment and Capital Stock Dataset, and World Economic Forum.
1/ Dashlines are GCC averages.
2/ Healthy life expectancy (HALE) is a measure of health expectancy that applies disability weights to health states to compute the equivalent number of years of life expected to be lived in full health.
3/ The frontier is defined by the countries with the highest infrastructure quality and access (output indicator based on a hybrid index made of physical and survey-based measures) for a given level of public capital stock (input). The greater the distance from the frontier, the less efficient is public investment.

1/ Government spending on goods and services and capital projects is about 16 percent of GDP.
2/ Gains from e-procurement could be large—economies that adopted it reported efficiency gains of 10-20 percent (World Bank, 2017).
3/ Reducing the efficiency gap between low-performing and best-performing OECD countries at similar levels of spending in half would increase life expectancy by over one year. Achieving this through higher spending, in contrast, would require an increase of over 30 percent. IMF (2014).

C. Safeguarding Financial Stability

21. Prudent regulation and supervision have helped keep the banking sector resilient. The current FSAP found banks to be resilient to various stress test scenarios, including protracted credit, liquidity, and market shocks. The main vulnerabilities stem from high concentration of loans, large depositors, common exposures (particularly in the real estate sector), and interconnectedness of the financial system. Staff welcomed the CBK's continuous calibration of macroprudential tools to carefully balance financial stability and credit growth, and its plans to upgrade stress-testing techniques and early warning indicators. Staff noted that, as banks enhance their assessment of credit risk to wider segments of the economy, a gradual relaxation of interest rate ceilings[3] would allow them to better price these risks and expand lending to new market segments.

22. The already strong supervisory regime could be further improved. The CBK regularly updates its supervisory framework to incorporate international best practices. Further refinements could include enhancing the consolidated supervision framework, strengthening cross-border supervision, and better integrating on- and off-site supervision. To reduce the risk of inconsistent interpretation of Shariah compliance, the authorities have proposed draft amendments to the CBK law establishing a centralized Shariah Board at the CBK.

[3] The spread over the CBK discount rate cannot exceed 300 basis points for consumer and installment loans, 250 for corporate loans with maturity under 1 year and 400 for maturities of more than 1 year.

23. The CBK is developing options to strengthen its systemic risk oversight and crisis management frameworks. In line with FSAP recommendations, it has prepared a draft law assigning the CBK an explicit financial stability mandate and creating a Financial Stability Committee to establish a formal coordination mechanism between the CBK, Capital Markets Authority, MOF, and Ministry of Commerce and Industry. Reforms should also focus on enhancing the corrective action framework, establishing a special resolution regime for banks, mandating bank recovery planning, and unwinding the blanket guarantee of deposits once the preconditions are met (see ¶25 of the FSSA report), as these would promote market discipline and allow for orderly resolution in case of bank failure.

24. The ample liquidity environment offers an opportunity to enhance the liquidity management framework. With IMF's assistance, the CBK is reviewing its liquidity forecasting framework to improve its accuracy and extend the forecast period. Information-sharing arrangements between the CBK and the relevant agencies would be essential in that regard. Gradually reducing the current ample liquidity in the system will be needed to incentivize banks to manage their balance sheets effectively and provide an impetus for interbank market development. This would reduce the reliance of banks on the CBK as the first port of call in the event of non-emergency liquidity needs, a role normally assigned to money or bond markets.

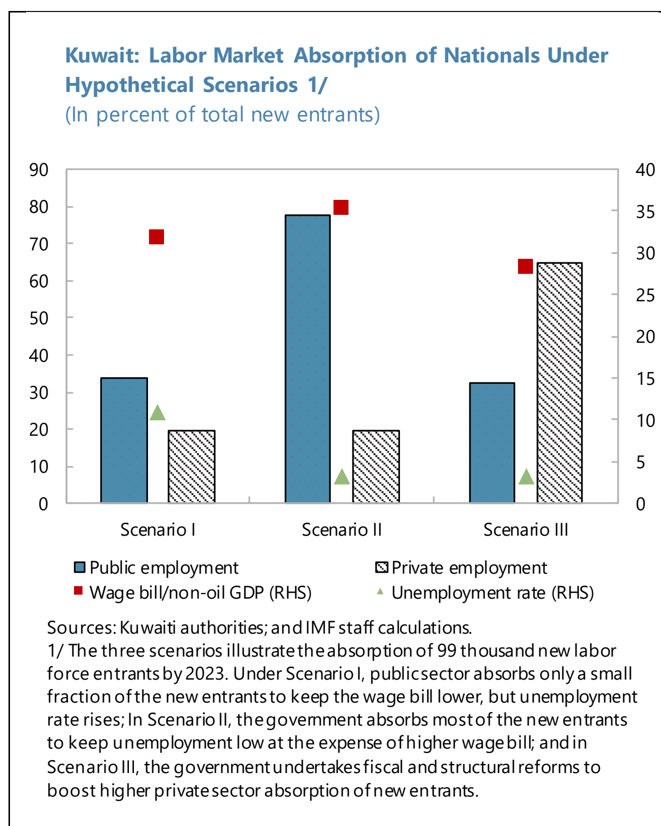
25. The authorities are fully committed to the peg to an undisclosed basket of currencies. The peg has provided an effective nominal anchor as well as limited exchange rate flexibility during a period of dollar strength. Staff's external sector assessment suggests an 8 percent of GDP current account gap, which would close under the staff's proposed fiscal consolidation path (Annex V). Staff noted that, as the economy diversifies over the longer term, the benefits of greater exchange rate flexibility may increase.

26. The authorities are strengthening the AML/CFT framework. In preparation for the mutual evaluation by the FATF and MENAFATF in 2021, they conducted the ML/TF national risk assessment (NRA) with assistance from the World Bank. The next step is to develop a plan for addressing the risks identified by the NRA and move towards risk-based AML/CFT efforts. No withdrawals of correspondent banking relationships have been detected, and the effective AML/CFT framework remains key to containing future risks. The authorities are improving coordination between members of the National AML/CFT Committee, with the Financial Intelligence Unit preparing a memorandum of understanding with the ACA. Further mobilizing anti-money laundering measures, including on prevention of offences and a more effective use of financial intelligence, would support anti-corruption efforts.

D. Boosting Private Sector-led Growth

27. A vibrant private sector is the only sustainable solution to creating enough jobs for the large number of Kuwaiti youth entering the labor market. Given the limited scope for public sector jobs going forward, the private sector needs to absorb most of the 99 thousand Kuwaiti nationals (21 percent of the current Kuwaiti labor force) expected to enter the job market in the next

5 years. Structural reforms that promote entrepreneurship, foster productivity and competitiveness, and encourage private initiative will be paramount. Incentivizing nationals to seek private sector opportunities will require managing expectations about limited public sector jobs and aligning public wages with those in the private sector. The authorities concurred with staff's views.



Sources: Kuwaiti authorities; and IMF staff calculations.
1/ The three scenarios illustrate the absorption of 99 thousand new labor force entrants by 2023. Under Scenario I, public sector absorbs only a small fraction of the new entrants to keep the wage bill lower, but unemployment rate rises; In Scenario II, the government absorbs most of the new entrants to keep unemployment low at the expense of higher wage bill; and in Scenario III, the government undertakes fiscal and structural reforms to boost higher private sector absorption of new entrants.

28. A more conducive business environment will support a dynamic private sector. Staff commended the authorities on the recent streamlining of registration and licensing, including digitalizing administrative procedures, and relaxing restrictions on foreign direct investment. There was agreement that eliminating excessive regulations, easing the cost of trading across borders, enhancing competition, improving access to land, and further reducing restrictions on foreign ownership will be key to Kuwait's efforts to attract domestic and foreign investment (Annex VII).

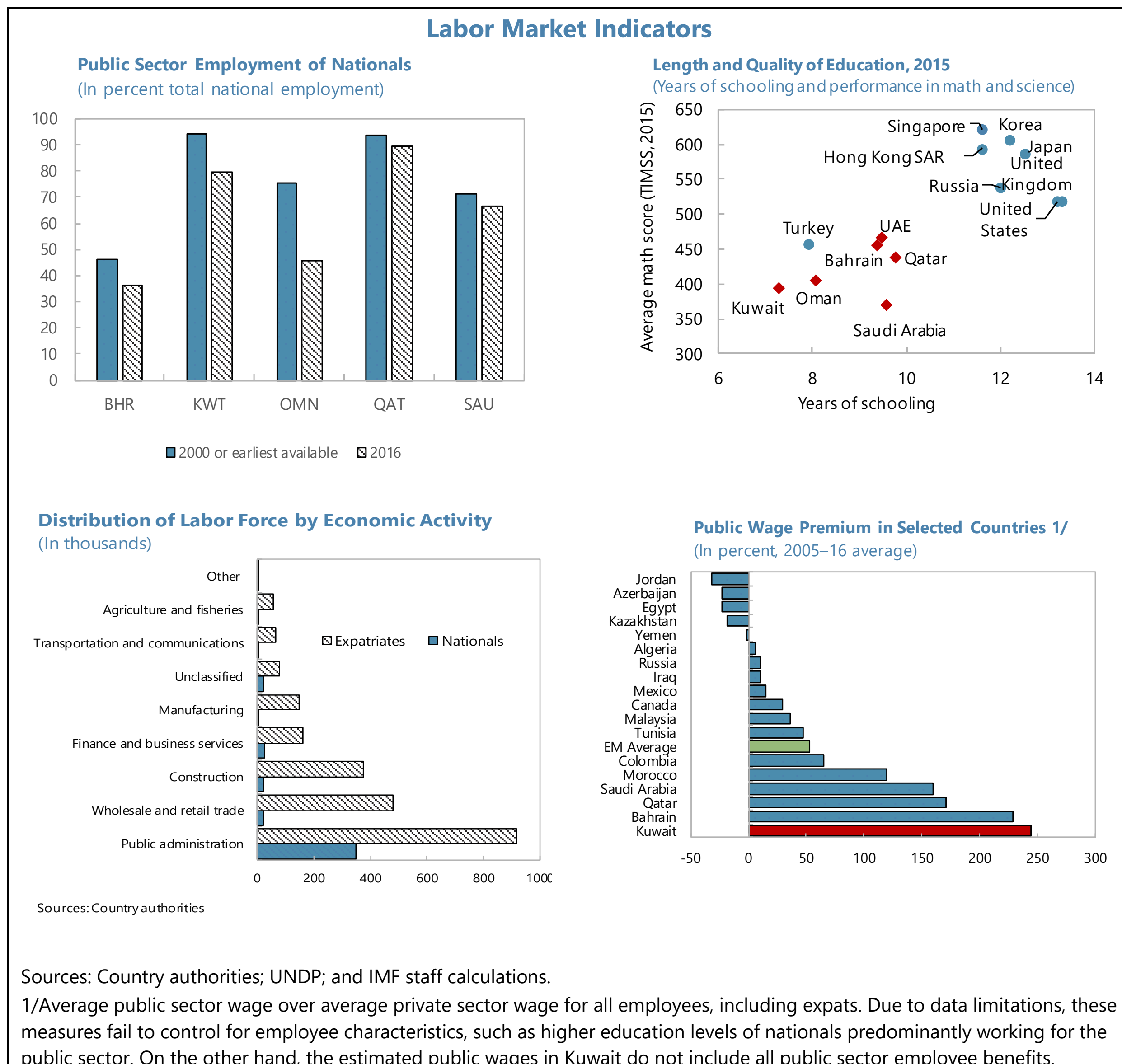
29. Increasing the private sector's role in the economy would improve competitiveness. Despite progress in building stronger legal and institutional frameworks in recent years, privatization and PPPs have yet to gather momentum, though several projects are in the pipeline. Given their significant potential to boost private sector development, the authorities plan to accelerate the execution of privatization and PPP projects. Staff emphasized the importance of ensuring transparent and competitive execution to limit contingent liabilities for the government.

30. Education and labor market reforms would boost Kuwaitis' employment in the private sector. Comprehensive education reform, including enhanced vocational training, would help produce a better-skilled and more productive workforce. Staff cautioned that encouraging the private sector to hire Kuwaitis through quotas may not be a sustainable solution as it would likely raise the cost of doing business. Staff also advised to revamp public wage subsidies for nationals working in the private sector to make the subsidies time-bound and targeted toward younger Kuwaitis.

31. The authorities' focus on SMEs is appropriate given their job creating potential (Box 2). The revised definition of SMEs based on number of employees and asset size is welcome and should help the authorities to conduct proper diagnostics of obstacles for SME development and ways to create an enabling environment. With the recent changes in its mandate, the National

Fund for SME Development, in addition to lending, will be able to provide equity finance, train entrepreneurs, and promote better integration of SMEs into supply chains. The Kuwait Stock Exchange is planning to set up a venture capital platform to help startups raise funds locally.

32. Steadfast implementation of structural reforms would yield large growth dividends. Staff estimates that rebalancing government spending towards growth-enhancing investment, strengthening governance, and encouraging the private sector to play a bigger role in the economy could raise Kuwait's non-oil growth potential to 5 percent, from 4 percent currently (Figure 5).



Sources: Country authorities; UNDP; and IMF staff calculations.

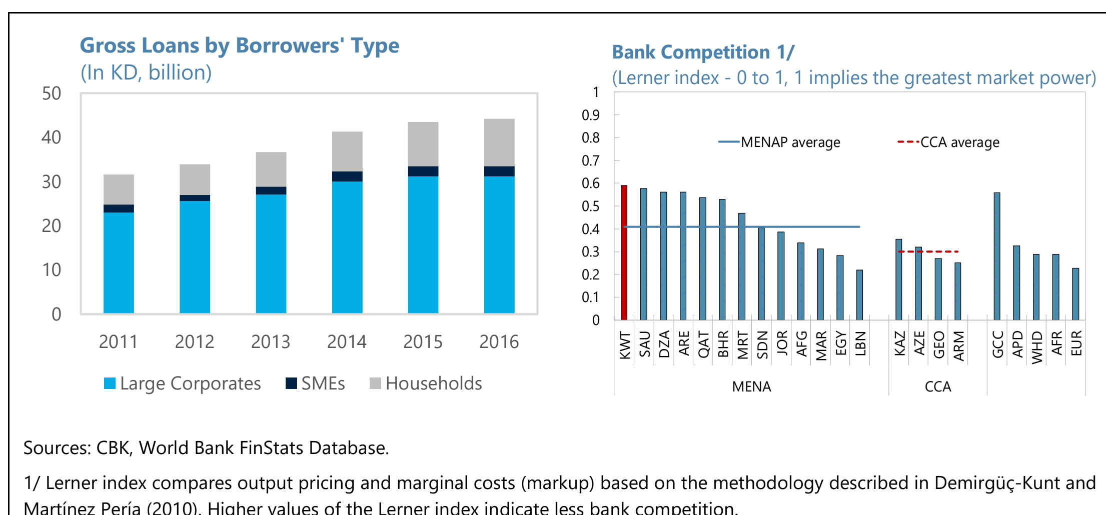
1/Average public sector wage over average private sector wage for all employees, including expats. Due to data limitations, these measures fail to control for employee characteristics, such as higher education levels of nationals predominantly working for the public sector. On the other hand, the estimated public wages in Kuwait do not include all public sector employee benefits.

Box 2. Access to Finance for SMEs

Financial inclusion of SMEs is the authorities' policy priority. Given the limited availability of public sector jobs relative to the size of the cohort entering the workforce, the national development program has placed SMEs at the center of the sustainable growth and job creation strategy.

The authorities have taken steps to encourage SME lending. The CBK's regulations give preferential risk weights for SME loans (75 percent versus standard 100 percent). In 2013, the authorities set up the National Fund for SME Development to provide up to 80 percent of funding to eligible SMEs.

Despite these efforts, SME access to finance is lagging. Only 2.5 percent of total bank credit goes to SMEs. While demand factors may be partly responsible, the 2017 WBG Business Confidence survey of mostly mid-sized and small enterprises found access to finance to be the second largest constraint to doing business, after obtaining licenses.



Sources: CBK, World Bank FinStats Database.

1/ Lerner index compares output pricing and marginal costs (markup) based on the methodology described in Demirgüç-Kunt and Martínez Pería (2010). Higher values of the Lerner index indicate less bank competition.

Enhancing SME access to finance in a sustainable manner requires a multi-pronged approach.[1] On the regulatory side, relaxing interest rate caps would allow banks to properly price risk and extend credit to wider segments of the economy. In turn, more lending to SMEs would reduce high concentration of loans in banks. Facilitating alternative means of financial services delivery, including FinTech—provided they are appropriately regulated—would foster competition in the financial sector and boost access to finance. On the institutional side, an electronic registry of movable assets and a full-fledged credit bureau for commercial lending would help mitigate credit information asymmetry. Revamping the insolvency law would strengthen parties' legal rights. On the strategic side, shifting the focus of the National Fund from direct financing toward on-lending through financial intermediaries, training of entrepreneurs, and developing risk-sharing instruments, such as partial credit guarantee schemes and equity finance vehicles, would help more effectively promote financial inclusion of SMEs.

[1] See Staff Paper, "Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia."

E. Statistics

33. **Enhancing the coverage, quality, and timeliness of statistics is essential for informed policy making**. The Central Statistical Bureau (CSB) has improved the methodology used to construct volume movements for product subsidies in national accounts. It has also started disseminating quarterly GDP from early 2018. Staff encouraged the authorities to boost support to the CSB, including for building technical capacity, and strengthen data provision arrangements.

STAFF APPRAISAL

34. The economy has strengthened, but oil price uncertainty presents a risk. Higher oil prices lifted growth and external and fiscal balances in 2017-18. Growth should gradually increase over the medium term supported by capital projects and a nascent credit recovery. The broadly favorable outlook however is clouded by the risk of a sustained drop in oil prices. Kuwait's long-term prospects and proven resilience to external shocks could be eroded by delays in reforms.

35. Kuwait needs to reduce dependence on oil and create more private sector jobs. This requires persevering with fiscal and structural reforms to boost savings for future generations and transform Kuwait from a public sector and oil-driven economy to one led by the private sector. Kuwait's large financial buffers and low debt provide space to implement the needed reforms from a position of strength.

36. The key challenge is to build consensus around a comprehensive reform package. The package should include reforms to promote the private sector and socially-equitable and well-sequenced measures to underpin fiscal consolidation. To secure broad support, which will be instrumental for sustained implementation and durable gains, the package should build on contributions from main stakeholders, provide targeted compensation to the vulnerable, improve public services, strengthen government's accountability, and be supported by a vigorous communications campaign.

37. Deep fiscal reforms would ensure adequate savings for future generations. More ambitious fiscal consolidation than currently envisioned by the authorities is needed to close the intergenerational savings gap. It should tackle current spending rigidities and increase non-oil revenue while boosting capital outlays to improve infrastructure and raise potential growth. Expenditure measures should focus on reforming the large public wage bill and gradually phasing out subsidies and transfers in favor of targeted mechanisms. Public sector wages should be gradually aligned with those in the private sector to reduce public-private wage premia and public employment growth should be curtailed. This would generate fiscal savings and incentivize nationals to seek private sector jobs and entrepreneurship opportunities. The recently approved early civil service retirement bill however could threaten these objectives. The government should redouble its efforts to secure parliamentary approval to avoid further delays in introducing the GCC-wide excises and VAT.

38. A robust medium-term fiscal framework is vital to bolstering fiscal policy credibility. New medium-term expenditure ceilings should be introduced to entrench spending discipline and allow budget planning beyond the annual cycle. Anchoring fiscal policy on clearly specified targets would help establish policy predictability and resist spending pressures when oil prices rise, thus preventing spending procyclicality and ensuring durable gains from adjustment.

39. Fiscal governance should be further strengthened. Reforms should aim to enhance fiscal transparency, modernize public procurement, and improve spending efficiency. These would

increase government's accountability, cut waste, improve the delivery of public services, and reduce Kuwait's vulnerabilities to corruption.

40. Further institutional and legal reforms are needed to enhance debt management. Staff urged the authorities to secure parliament's authorization to resume borrowing. Staff supports authorities' plans to increase the tenor of bonds and issue a sovereign Sukuk to help build a long-term yield curve in dinars and expand the investor base. Government's borrowing and investment decisions should be guided by an integrated asset-liability management framework that assesses the risk-return trade-offs as well as broader macro-financial implications.

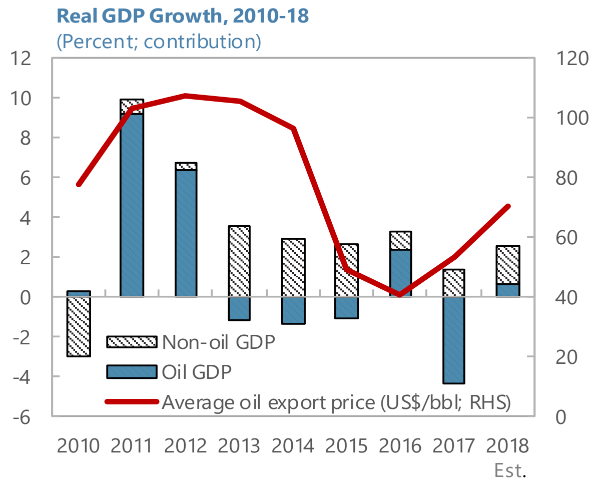
41. The peg remains appropriate. It has provided an effective nominal anchor. Staff's recommended fiscal adjustment would close the current account gap over the medium term.

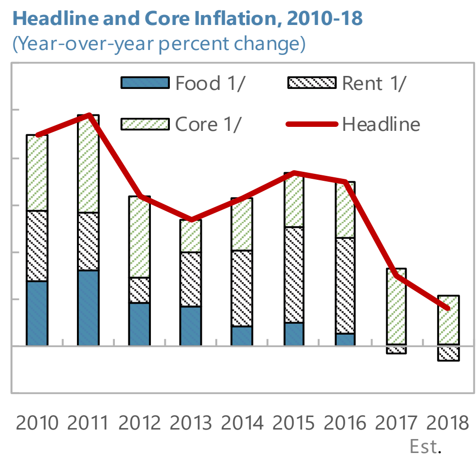
42. Reforms to bolster financial sector resilience and development should continue. CBK's prudent supervision as well as initiatives to identify emerging risks are commendable. To promote market discipline, the authorities should enhance the corrective action framework, establish a special resolution regime for banks, and unwind the blanket guarantee of deposits. The interest rate ceiling should be gradually relaxed to allow banks to better price credit risks and expand lending to new market segments. Reducing the current ample liquidity is important to allow the interbank market to develop.

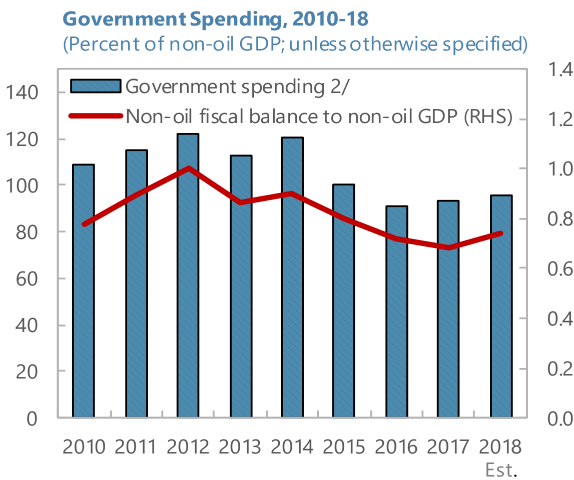
43. Job-rich private sector growth hinges on improving the business climate. Given the more limited scope for public employment going forward, a vibrant private sector must emerge to absorb the large number of Kuwaitis entering the labor market over the next decade. This requires structural reforms that incentivize entrepreneurship, foster productivity, and prepare young graduates for in-demand jobs. Notwithstanding recent progress, further steps are needed to reduce excessive regulations, promote competition, ease trading across borders, and facilitate access to land. The authorities' focus on nurturing SMEs and startups, by enhancing their access to finance, including through venture capital and credit guarantee schemes, training entrepreneurs, and facilitating participation in public tenders, is welcome given their job creating potential.

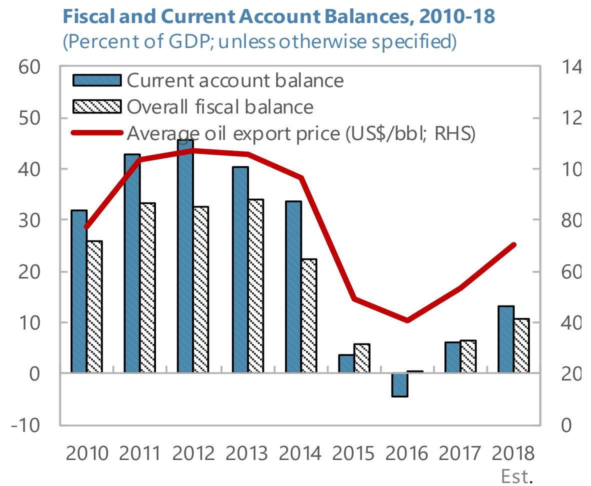
44. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

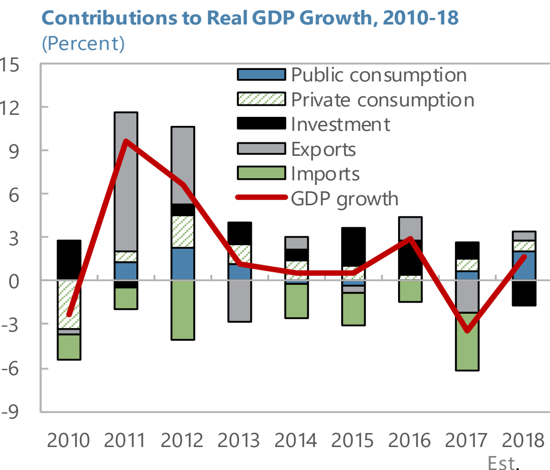
Figure 1. Macroeconomic Developments

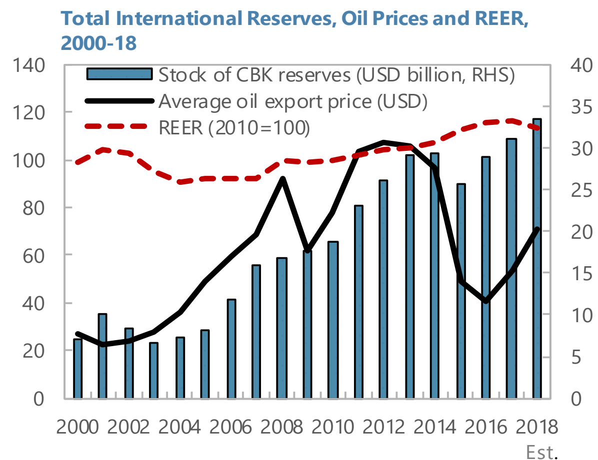










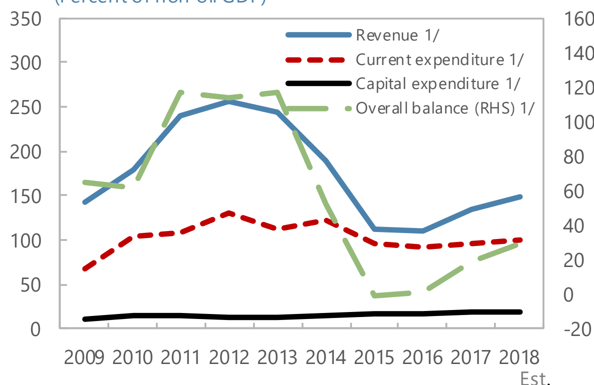


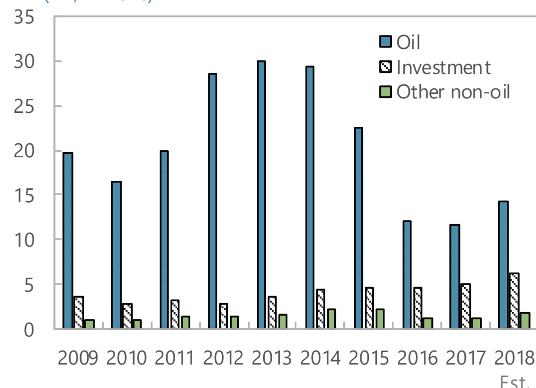
Sources: Country authorities; INS; Haver; and IMF staff calculations.

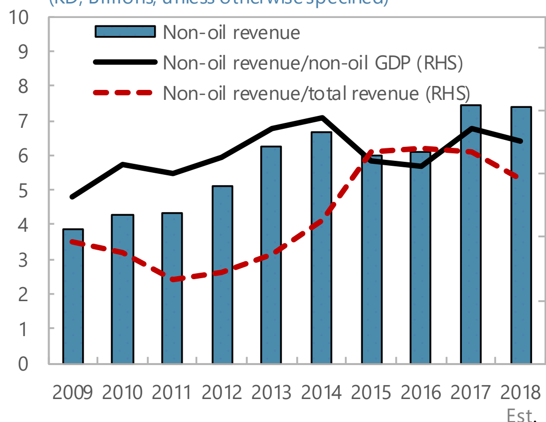
1/ Contribution to headline CPI inflation.

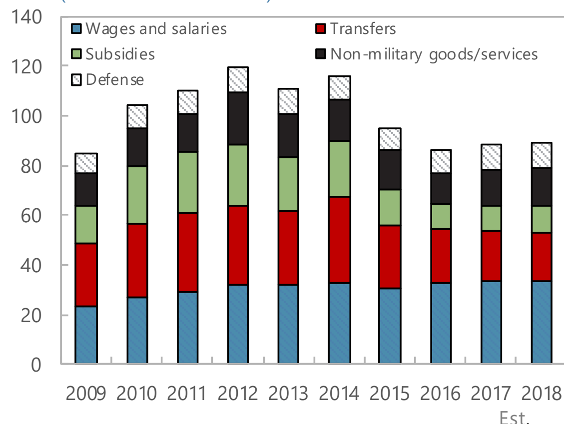
2/ Calendar year.

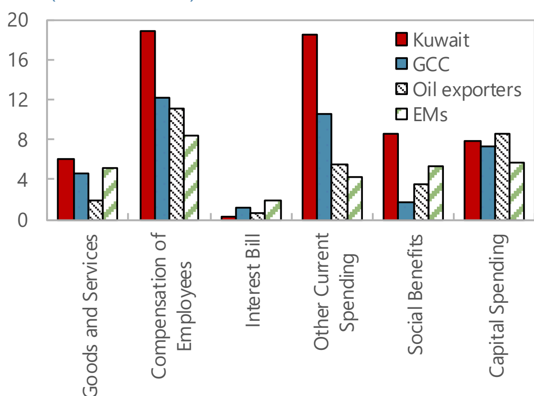
Figure 2. Fiscal Developments

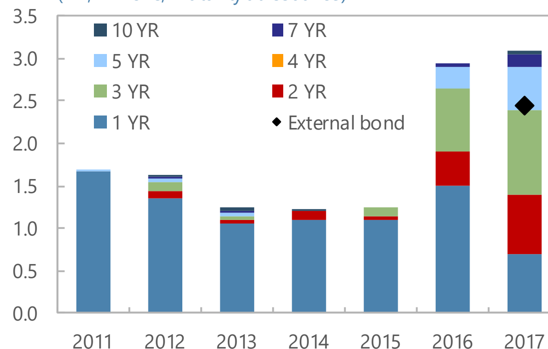






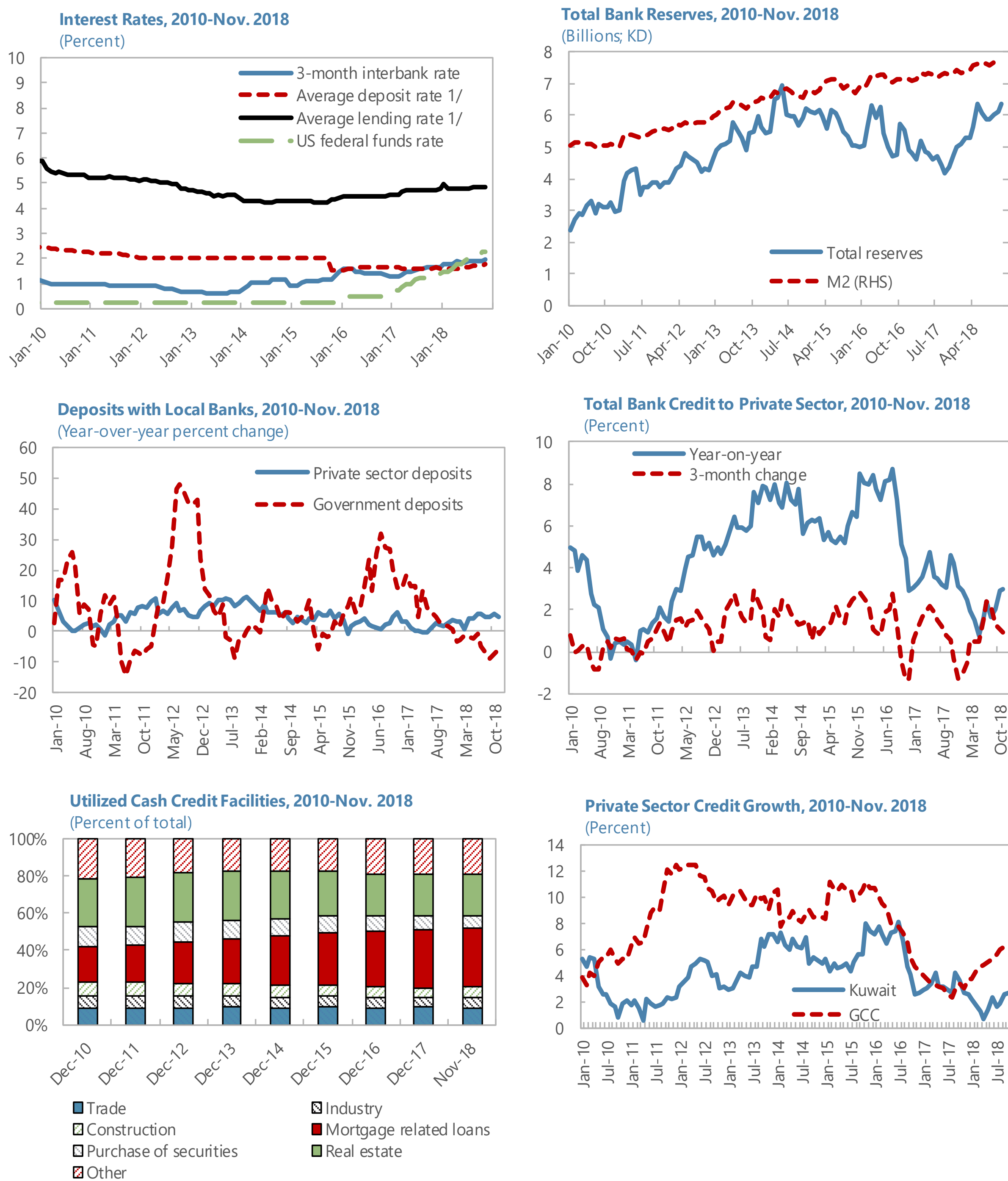






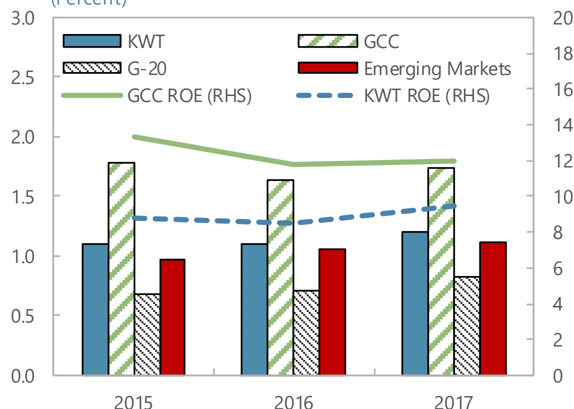
Sources: WEO; Country authorities; CBK; MOF; and IMF staff calculations.
1/ Calendar year for non-oil GDP; fiscal year for revenue; current expenditure, capital expenditure, and the overall balance.

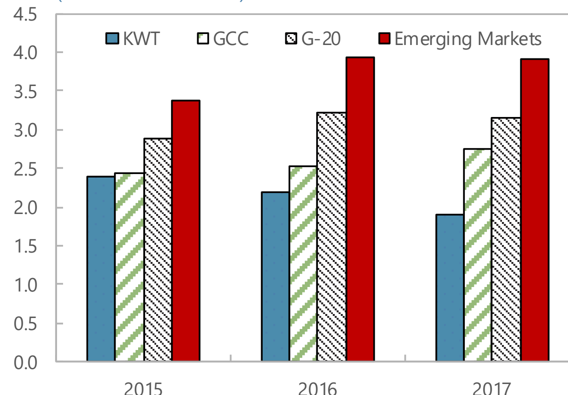
Figure 3. Monetary Developments

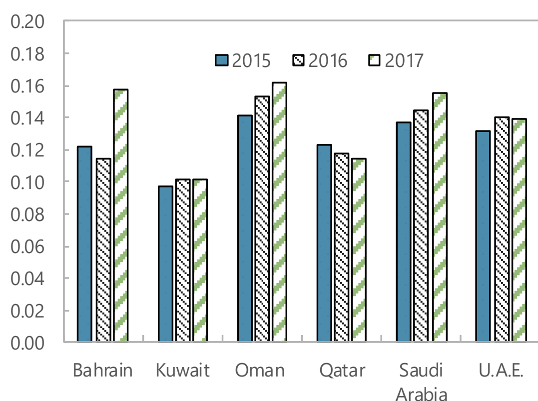


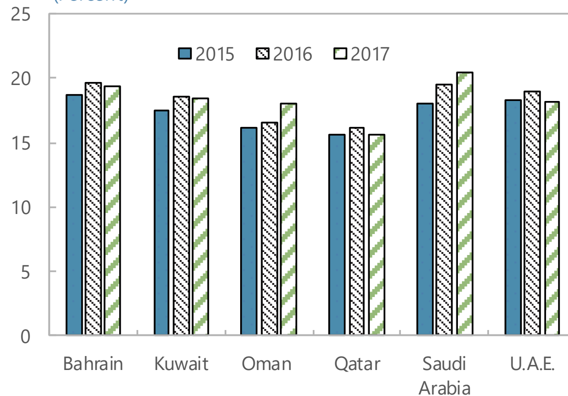
Sources: Country authorities; Haver; and IMF staff calculations.
1/ Weighted average.

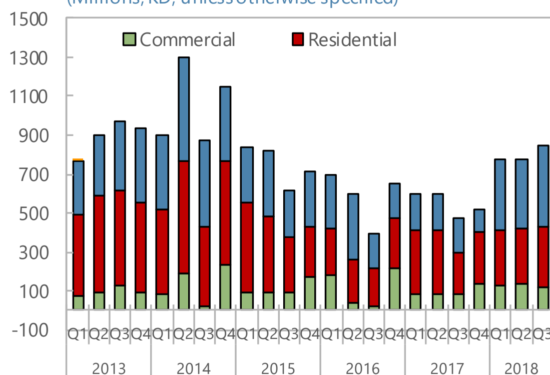
Figure 4. Financial Sector and Asset Developments 1/

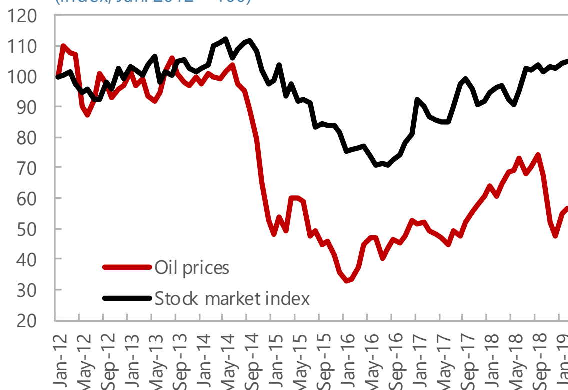






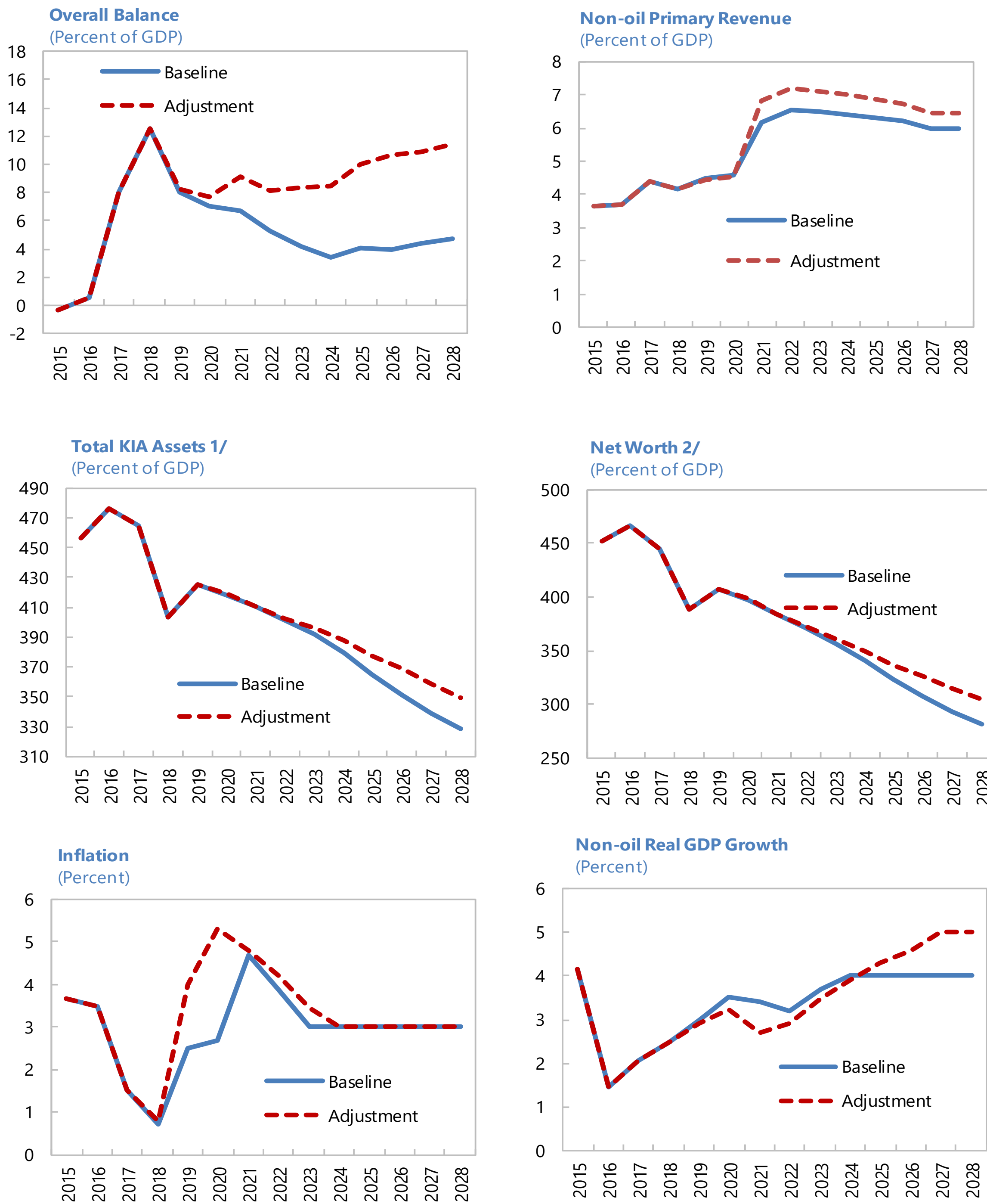






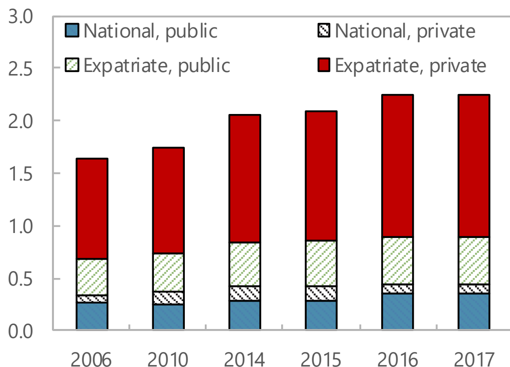
Sources: Country authorities; Bloomberg; NBK; and IMF staff estimates.
1/ Local banks only. Includes interbank loans.

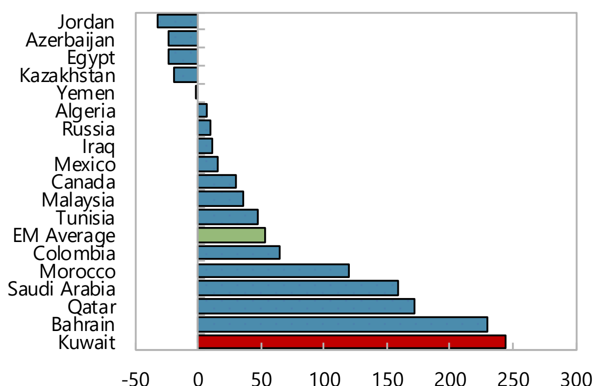
Figure 5. Economic Outcomes Under Baseline and Reform Scenarios

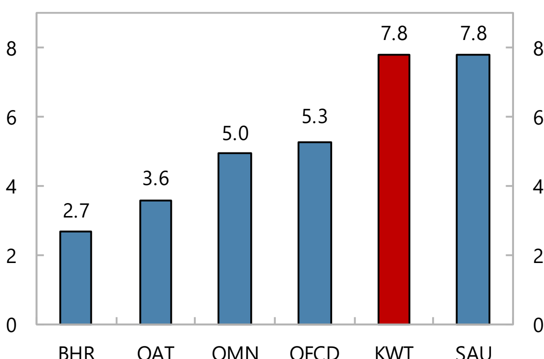


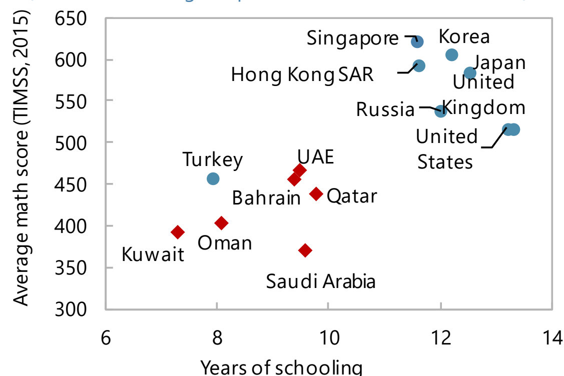
Source: IMF staff calculations.
1/ KIA assets are based on staff estimates and projections.
2/ Defined as KIA assets minus government debt. Debt financing under baseline and adjustment scenarios is assumed to be the same.

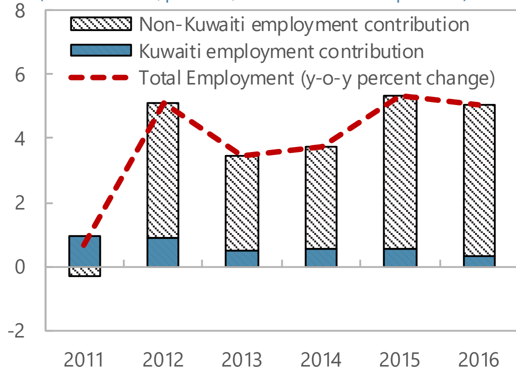
Figure 6. Labor Market Trends





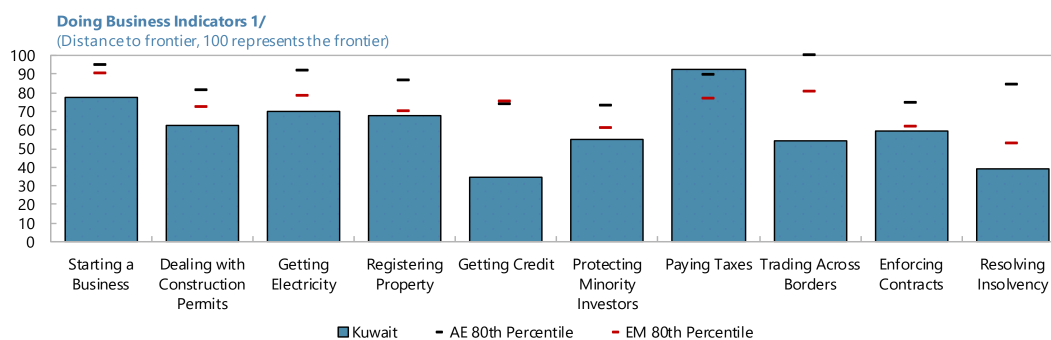


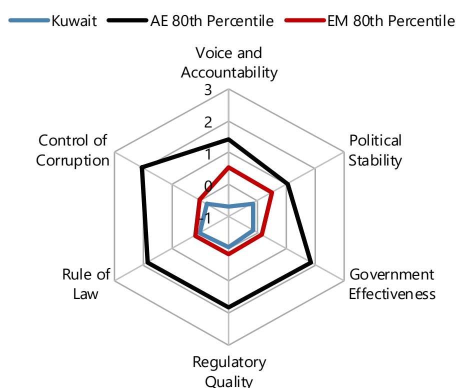


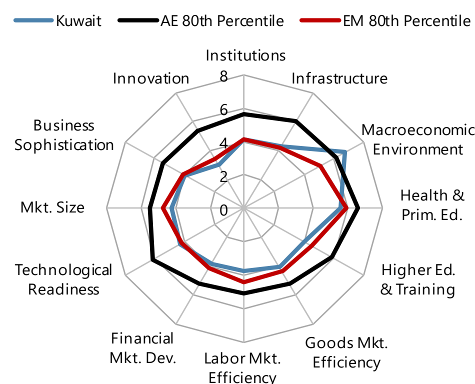


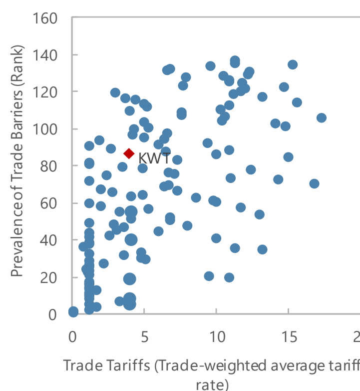
Sources: Country authorities; UNDP; and IMF staff calculations.
1/Average public sector wage over average private sector wage for all employess, including expats. Due to data limitations, these measures fail to control for employee characteristics, such as higher education levels of nationals predominantly working for the public sector. On the other hand, the estimated public wages in Kuwait do not include all public sector employee benefits.

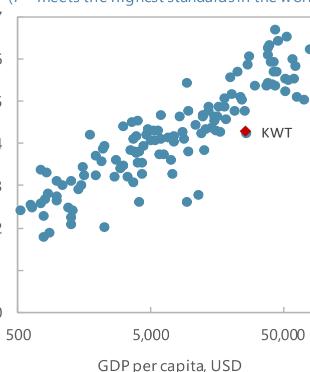
Figure 7. Institutions and Governance

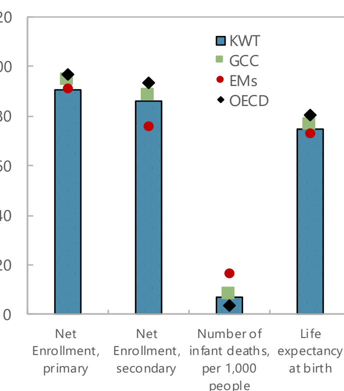












Sources: World Bank *Doing Business Indicators*; *Worldwide Governance Indicators*; World Economic Forum; World Economic Outlook.

1/ Survey-based indicators reflect investors' perceptions on the business environment.

2/ Survey-based indicators summarize perceptions of quality of governance; higher score indicates better governance. Estimates of governance range from approximately -2.5 (weak) to 2.5 (strong).

3/ Uses both official data and survey responses from executives on areas of competitiveness; higher is better.

4/ Indices on the prevalence of trade barriers ranking and subcomponents are based on WEF's quantitative and qualitative assessment of the trade environment. These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints, and information availability.

Table 1. Kuwait: Selected Economic Indicators, 2014–24

					Est.	Projections					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Oil and gas sector											
Total oil and gas exports (billions of U.S. dollars)	97.6	48.5	41.5	49.6	65.7	58.3	59.6	60.2	60.9	62.1	63.6
Average oil export price (U.S. dollars/barrel)	96.5	49.0	41.0	53.4	70.6	61.5	61.4	60.6	60.1	60.2	60.6
Crude oil production (millions of barrels/day)	2.87	2.86	2.95	2.70	2.74	2.79	2.86	2.93	2.99	3.05	3.11
	(Annual percentage change, unless otherwise indicated)										
National accounts and prices											
Nominal GDP (market prices, in billions of Kuwaiti dinar)	46	34	33	36	43	41	43	45	47	49	52
Nominal GDP (market prices, in billions of U.S. dollars)	163	115	109	120	141	137	143	150	156	163	172
Real GDP [1]	0.5	0.6	2.9	-3.5	1.7	2.5	2.9	2.9	2.5	2.7	2.9
Real oil GDP	-2.1	-1.7	3.9	-7.2	1.2	2.0	2.5	2.5	2.0	2.0	2.0
Real non-oil GDP	4.9	4.2	1.4	2.1	2.5	3.0	3.5	3.4	3.2	3.7	4.0
CPI inflation (average)	3.1	3.7	3.5	1.5	0.7	2.5	2.7	4.7	3.9	3.0	3.0
CPI inflation (eop)	3.0	3.0	2.6	1.0	1.1	2.8	3.0	6.0	3.2	2.8	2.8
Unemployment rate (Kuwaiti nationals)	5.0	4.7	3.3	3.3	...	...	...	...	...	...	...
	(Percent of GDP at market prices)										
Budgetary operations [2]											
Revenue	67.4	52.3	52.8	58.9	60.9	58.6	58.0	58.7	57.2	55.8	54.6
Oil	51.9	35.4	34.5	38.0	43.7	40.1	39.2	37.8	36.8	35.9	35.1
Non-oil, *of which:*	15.4	16.9	18.3	20.9	17.1	18.4	18.9	20.8	20.4	19.9	19.4
Investment income	10.6	13.3	14.6	16.5	13.0	13.9	14.3	14.7	13.9	13.5	13.0
Expenditures [3]	48.8	52.7	52.3	50.8	48.3	50.5	51.0	51.9	51.9	51.7	51.1
Expense	43.3	45.0	44.2	42.6	40.6	42.3	42.6	43.3	43.4	43.1	42.7
Capital	5.4	7.7	8.1	8.2	7.7	8.2	8.4	8.6	8.6	8.5	8.4
Balance	18.6	-0.3	0.5	8.1	12.6	8.0	7.0	6.7	5.2	4.2	3.4
Balance (after transfer to FGF and excl. investment income)	2.3	-17.5	-17.9	-12.6	-5.2	-10.4	-11.6	-12.3	-13.0	-13.5	-13.7
Domestic financing (net)	-0.7	-1.2	6.5	1.8	-2.7	2.4	2.3	2.2	1.4	2.0	1.9
External financing (net)	-1.6	18.8	11.4	10.8	7.9	8.0	9.3	10.1	11.6	11.5	11.8
Non-oil balance excl. investment income (percent of non-oil GDP) [4]	-102.5	-88.3	-83.8	-86.5	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3
Excluding oil-related subsidies and benefits (percent of non-oil GDP)	-81.2	-77.5	-74.8	-77.4	-77.2	-76.4	-75.8	-72.8	-70.8	-69.3	-67.7
Total gross debt (calendar year) [5]	3.4	4.7	10.0	20.7	14.8	17.8	21.0	26.2	31.1	34.7	38.4
	(Percent change; unless otherwise indicated)										
Money and credit											
Net foreign assets [6]	3.6	-2.1	8.7	-3.1	10.0	2.7	5.6	7.5	6.1	6.5	6.9
Claims on nongovernment sector	5.2	7.6	2.9	2.8	4.1	6.1	6.7	8.0	7.2	7.1	7.4
Kuwaiti dinar 3-month deposit rate (year average; in percent)	0.8	0.8	1.1	1.5	2.3	...	...	...	...	...	...
Stock market unweighted index (annual percent change)	-3.8	-16.5	-0.2	12.8	11.8	...	...	...	...	...	...
	(Billions of U.S. dollars, unless otherwise indicated)										
External sector											
Exports of goods	104.5	54.5	46.5	55.1	71.6	64.6	66.3	67.3	68.4	70.2	72.3
Of which: non-oil exports	7.0	6.0	5.0	5.6	5.9	6.3	6.7	7.1	7.5	8.1	8.7
Annual percentage change	-2.8	-14.1	-15.7	10.6	6.6	6.2	6.1	6.1	6.1	7.1	8.1
Imports of goods	-27.0	-26.5	-27.0	-29.5	-31.3	-32.5	-33.7	-35.2	-36.6	-38.2	-40.1
Terms of Trade (ratio, annual percent change)	-12.2	-42.5	-12.5	21.9	23.1	-11.0	0.1	-0.7	-0.2	-0.3	0.1
Current account	54.4	4.0	-5.1	7.1	18.0	10.2	11.4	11.9	10.4	10.0	9.5
Percent of GDP	33.4	3.5	-4.6	5.9	12.7	7.4	8.0	8.0	6.6	6.1	5.5
International reserve assets [7]	32.3	28.3	31.2	33.5	37.0	37.2	38.8	41.1	43.0	45.3	47.9
In months of next year's imports of goods and services	7.4	6.5	6.5	6.6	7.0	6.8	6.8	7.0	7.0	7.1	7.2
Memorandum items:											
Exchange rate (U.S. dollar per KD, period average)	3.52	3.32	3.31	3.31	3.31	...	...	...	...	...	...
Nominal effective exchange rate (Percentage change)	1.5	3.1	0.9	0.8	-0.4	...	...	...	...	...	...
Real effective exchange rate (Percentage change)	2.0	5.0	2.7	0.8	-2.7	...	...	...	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.

[1] Calculated on the basis of real oil and non-oil GDP at factor cost.

[2] Based on fiscal year cycle, which starts on April 1 and ends on March 31.

[3] Starting FY2016/17, there has been a reclassification of expenditure items.

[4] Excludes pension fund recapitalization.

[5] Excludes debt of Kuwait's SWF related to asset management operations.

[6] Excludes SDR holdings and IMF reserve position.

[7] Does not include external assets held by Kuwait Investment Authority.

Table 2a. Kuwait: Summary of Government Finance, 2014/15–2024/25
(Billions of Kuwaiti Dinars)

	2014/15	2015/16	2016/17	2017/18	Est. 2018/19	Projections 2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
					(Billions of Kuwaiti Dinars)						
Revenue (includes grants) (A)	**29.2**	**17.8**	**17.9**	**22.3**	**25.7**	**24.5**	**25.3**	**26.8**	**27.2**	**27.9**	**28.7**
Taxes	0.4	0.5	0.6	0.5	0.5	0.6	0.7	1.4	1.7	1.8	1.9
Other revenue	28.8	17.4	17.3	21.8	25.2	23.9	24.7	25.4	25.5	26.1	26.9
Oil and gas	22.5	12.1	11.7	14.4	18.5	16.8	17.1	17.3	17.5	17.9	18.5
Investment income and transfer of profits of public entities 1/	4.6	4.5	4.9	6.2	5.5	5.8	6.2	6.7	6.6	6.7	6.9
Other 2/	1.7	0.8	0.7	1.1	1.2	1.3	1.4	1.4	1.4	1.5	1.5
Total expenditure (B=C+D) 3/	**21.1**	**18.0**	**17.7**	**19.2**	**20.4**	**21.1**	**22.3**	**23.7**	**24.7**	**25.8**	**26.9**
Expense (C)	18.8	15.4	15.0	16.1	17.2	17.7	18.6	19.8	20.7	21.5	22.5
Compensation of employees	5.7	5.8	6.7	6.8	7.1	7.5	7.9	8.5	9.1	9.6	10.2
Purchases/use of goods & services	2.9	3.1	2.1	3.1	3.2	3.4	3.6	3.8	4.0	4.1	4.2
Interest	0.0	0.0	0.0	0.2	0.3	0.3	0.4	0.5	0.6	0.7	0.8
Subsidies and social benefits	7.6	4.8	4.5	4.8	5.4	5.3	5.4	5.6	5.7	5.8	5.9
Subsidies	2.4	1.7	1.6	1.5	1.9	1.7	1.8	1.8	1.9	1.9	2.0
Oil-related subsidies	2.4	1.7	1.6	1.5	1.9	1.7	1.8	1.8	1.9	1.9	2.0
Other subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	5.2	3.1	2.9	3.3	3.5	3.5	3.7	3.8	3.8	3.9	3.9
Payments to social security fund	3.1	1.9	2.1	2.2	2.3	2.3	2.4	2.5	2.5	2.5	2.5
Transfers to social security fund	2.0	1.9	2.1	2.2	2.3	2.3	2.4	2.5	2.5	2.5	2.5
Fund recapitalization	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other social benefits	2.1	1.2	0.8	1.1	1.2	1.2	1.2	1.3	1.3	1.4	1.4
Oil-related	1.3	0.4	0.2	0.3	0.4	0.3	0.4	0.4	0.4	0.4	0.4
Others	0.8	0.8	0.6	0.8	0.8	0.9	0.9	0.9	1.0	1.0	1.0
Expense not elsewhere classified	2.5	1.7	1.7	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3
Net acquisition of nonfinancial assets (D)	2.4	2.6	2.8	3.1	3.2	3.4	3.7	3.9	4.1	4.3	4.4
Gross operating balance [=A-C]	**10.4**	**2.5**	**2.9**	**6.2**	**8.6**	**6.8**	**6.7**	**7.0**	**6.6**	**6.4**	**6.3**
Net lending / borrowing [=A-B]	**8.1**	**-0.1**	**0.2**	**3.1**	**5.3**	**3.3**	**3.1**	**3.1**	**2.5**	**2.1**	**1.8**
Transfers to FGF	2.5	1.3	1.3	1.6	2.0	1.9	1.9	2.0	2.1	2.1	2.2
Investment income	4.6	4.5	4.9	6.2	5.5	5.8	6.2	6.7	6.6	6.7	6.9
Overall balance (after transfers to FGF and excl. investment income) 4/	1.0	-6.0	-6.1	-4.8	-2.2	-4.3	-5.1	-5.6	-6.2	-6.7	-7.2
Non-oil balance	-14.4	-12.2	-11.5	-11.3	-13.2	-13.4	-14.0	-14.2	-15.0	-15.8	-16.7
excluding investment income	-19.0	-16.7	-16.5	-17.6	-18.7	-19.3	-20.3	-20.9	-21.6	-22.6	-23.5
excluding recapitalization of pension	-17.9	-16.7	-16.5	-17.6	-18.7	-19.3	-20.3	-20.9	-21.6	-22.6	-23.5
excluding oil-related subsidies and benefits	-14.2	-14.7	-14.7	-15.7	-16.4	-17.2	-18.1	-18.7	-19.4	-20.3	-21.1
Financing (net)	**-1.0**	**6.0**	**6.1**	**4.8**	**2.2**	**4.3**	**5.1**	**5.6**	**6.2**	**6.7**	**7.2**
Domestic	-0.3	-0.4	2.2	0.7	-1.2	1.0	1.0	1.0	0.7	1.0	1.0
External	**-0.7**	**6.4**	**3.9**	**4.1**	**3.3**	**3.3**	**4.1**	**4.6**	**5.5**	**5.7**	**6.2**
External bonds	0.0	0.0	2.4	0.0	0.0	0.7	1.8	1.8	1.8	1.8	1.8
Reserve funds	-0.7	6.4	1.5	4.1	3.3	2.6	2.3	2.8	3.7	3.9	4.4

Sources: MOF; CBK; and IMF staff estimates and projections.

1/ Excluded from the national budget presentation. Estimated by IMF staff.

2/ Includes UN (Iraq) compensations

3/ Starting FY2016/17, there has been a reclassification of expenditure items.

4/ Excludes 10 percent of total revenue transferred to the Future Generation Fund and investment income.

Table 2b. Kuwait: Summary of Government Finance, 2014/15–2024/25

(Percent of GDP)

					Est.	Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
					(Percent of GDP)						
Revenue (includes grants)	**67.4**	**52.3**	**52.8**	**58.9**	**60.9**	**58.6**	**58.0**	**58.7**	**57.2**	**55.8**	**54.6**
Taxes	1.0	1.4	1.7	1.4	1.3	1.3	1.5	3.1	3.6	3.5	3.5
Other revenue	66.4	50.9	51.2	57.5	59.6	57.2	56.5	55.6	53.6	52.3	51.0
Oil and gas	51.9	35.4	34.5	38.0	43.7	40.1	39.2	37.8	36.8	35.9	35.1
Investment income and transfer of profits of public entities 1/	10.6	13.3	14.6	16.5	13.0	13.9	14.3	14.7	13.9	13.5	13.0
Other 2/	3.9	2.2	2.0	3.0	2.9	3.1	3.1	3.0	3.0	2.9	2.9
Total expenditure 3/	**48.8**	**52.7**	**52.3**	**50.8**	**48.3**	**50.5**	**51.0**	**51.9**	**51.9**	**51.7**	**51.1**
Expense	43.3	45.0	44.2	42.6	40.6	42.3	42.6	43.3	43.4	43.1	42.7
Compensation of employees	13.1	17.1	19.6	18.1	16.8	17.9	18.1	18.7	19.1	19.3	19.4
Purchases/use of goods & services	6.7	9.0	6.3	8.1	7.6	8.1	8.2	8.4	8.3	8.2	8.0
Interest	0.1	0.1	0.1	0.4	0.7	0.7	0.9	1.1	1.3	1.5	1.6
Subsidies and social benefits	17.6	14.0	13.2	12.8	12.7	12.6	12.5	12.2	11.9	11.6	11.2
Subsidies	5.7	5.0	4.7	4.1	4.5	4.2	4.1	4.0	3.9	3.9	3.8
Social benefits	11.9	9.0	8.6	8.7	8.2	8.5	8.4	8.2	8.0	7.7	7.4
Payments to Social Security Fund	7.1	5.6	6.2	5.9	5.4	5.6	5.5	5.5	5.2	5.0	4.7
Transfers to Social Security Fund	4.6	5.6	6.2	5.9	5.4	5.6	5.5	5.5	5.2	5.0	4.7
Fund recapitalization	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other social benefits	4.8	3.4	2.3	2.9	2.8	2.9	2.8	2.8	2.8	2.7	2.7
Oil-related	3.0	1.1	0.6	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.7
Others	1.8	2.3	1.7	2.1	1.9	2.0	2.0	2.0	2.0	2.0	1.9
Expense not elsewhere classified	5.9	4.8	4.9	3.1	2.9	3.0	2.9	2.9	2.7	2.6	2.4
Net acquisition of nonfinancial assets	5.4	7.7	8.1	8.2	7.7	8.2	8.4	8.6	8.6	8.5	8.4
Gross operating balance	24.0	7.3	8.6	16.3	20.3	16.2	15.4	15.3	13.8	12.7	11.9
Net lending / borrowing	18.6	-0.3	0.5	8.1	12.6	8.0	7.0	6.7	5.2	4.2	3.4
Transfers to FGF	5.7	3.9	3.8	4.2	4.8	4.5	4.4	4.4	4.3	4.2	4.2
Investment income	10.6	13.3	14.6	16.5	13.0	13.9	14.3	14.7	13.9	13.5	13.0
Overall balance (after transfers to FGF and excl. investment income) 4/	2.3	-17.5	-17.9	-12.6	-5.2	-10.4	-11.6	-12.3	-13.0	-13.5	-13.7
Non-oil balance	-33.3	-35.7	-34.0	-30.0	-31.2	-32.1	-32.2	-31.1	-31.5	-31.7	-31.7
excluding investment income	-43.9	-49.0	-48.6	-46.4	-44.1	-46.1	-46.4	-45.8	-45.4	-45.2	-44.7
excluding recapitalization of pension	-41.4	-49.0	-48.6	-46.4	-44.1	-46.1	-46.4	-45.8	-45.4	-45.2	-44.7
excluding oil-related subsidies and benefits	-32.8	-43.0	-43.4	-41.5	-38.8	-41.1	-41.5	-41.0	-40.7	-40.6	-40.2
Financing (net)	-2.3	17.5	17.9	12.6	5.2	10.4	11.6	12.3	13.0	13.5	13.7
Domestic	-0.7	-1.2	6.5	1.9	-2.7	2.4	2.3	2.1	1.3	1.9	1.8
External	-1.6	18.8	11.4	10.8	8.0	8.0	9.3	9.9	11.2	11.1	11.4
External bonds	0.0	0.0	7.1	0.0	0.0	1.7	4.1	3.9	3.7	3.5	3.3
Reserve funds	-1.6	18.8	4.3	10.8	8.0	6.4	5.2	6.1	7.6	7.6	8.1
					(Percent of nonoil GDP)						
Revenue (includes grants)	**166.9**	**94.2**	**91.0**	**109.7**	**121.1**	**108.9**	**105.9**	**104.2**	**99.4**	**95.4**	**92.0**
Total expenditure	**120.8**	**94.8**	**90.2**	**94.7**	**96.1**	**94.0**	**93.1**	**92.3**	**90.3**	**88.3**	**86.1**
Gross operating balance	59.6	13.2	14.9	30.4	40.3	30.2	28.1	27.3	24.0	21.7	20.0
Net lending / borrowing	46.1	-0.6	0.9	15.0	25.0	14.9	12.8	12.0	9.1	7.2	5.8
Non-oil balance	-82.6	-64.3	-58.6	-55.8	-62.0	-59.7	-58.7	-55.3	-54.8	-54.2	-53.4
excluding investment income	-108.8	-88.3	-83.8	-86.5	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3
excluding recapitalization of pension	-102.5	-88.3	-83.8	-86.5	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3
excluding oil-related subsidies and benefits	-81.2	-77.5	-74.8	-77.4	-77.2	-76.4	-75.8	-72.8	-70.8	-69.3	-67.7
Memorandum items:											
Expenses (percent of nonoil GDP)	107.4	81.0	76.1	79.3	80.8	78.7	77.8	77.0	75.4	73.7	71.9
Expenses excl. recapitalization of pension fund (percent of nonoil GDP)	101.1	81.0	76.1	79.3	80.8	78.7	77.8	77.0	75.4	73.7	71.9
Oil-related subsidies and benefits (percent of nonoil GDP)	21.3	10.8	9.1	9.1	10.6	9.3	8.9	8.5	8.1	7.9	7.7
Kuwait crude oil price, USD per barrel	84.6	47.0	44.1	57.7	68.3	61.5	61.2	60.5	60.1	60.3	60.9
Total gross debt (percent of GDP)	3.4	4.7	10.0	20.7	14.8	17.8	21.0	26.2	31.1	34.7	38.4

Sources: MOF; CBK; and IMF staff estimates and projections.

1/ Excluded from the national budget presentation. Estimated by IMF staff.
2/ Includes UN (Iraq) compensations
3/ Starting FY2016/17, there has been a reclassification of expenditure items.
4/ Excludes 10 percent of total revenue transferred to the FGF and investment income.

Table 3. Kuwait: Summary Balance of Payments, 2014–24

	2014	2015	2016	2017	Est. 2018	Projections 2019	2020	2021	2022	2023	2024
	(Billions of U.S. dollars, unless otherwise indicated)										
Current account	**54.4**	**4.0**	**-5.1**	**7.1**	**18.0**	**10.2**	**11.4**	**11.9**	**10.4**	**10.0**	**9.5**
Goods (trade balance)	77.5	27.9	19.5	25.6	40.3	32.1	32.6	32.1	31.8	31.9	32.2
Exports	104.5	54.5	46.5	55.1	71.6	64.6	66.3	67.3	68.4	70.2	72.3
Oil exports	97.6	48.5	41.5	49.6	65.7	58.3	59.6	60.2	60.9	62.1	63.6
Non-oil exports including re-exports	7.0	6.0	5.0	5.6	5.9	6.3	6.7	7.1	7.5	8.1	8.7
Of which: re-exports	1.5	1.4	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.3	2.4
Imports	-27.0	-26.5	-27.0	-29.5	-31.3	-32.5	-33.7	-35.2	-36.6	-38.2	-40.1
Services	-18.1	-20.0	-20.0	-22.8	-24.1	-25.0	-25.9	-26.8	-27.7	-28.8	-30.0
Transportation	-3.9	-3.8	-3.6	-4.2	-4.5	-4.6	-4.8	-5.0	-5.2	-5.4	-5.6
Travel	-11.4	-12.6	-11.9	-12.2	-12.9	-13.4	-13.9	-14.4	-14.9	-15.5	-16.2
Other services	-2.7	-3.6	-4.6	-6.4	-6.7	-7.0	-7.2	-7.5	-7.7	-8.0	-8.3
Investment income	15.7	12.7	12.8	19.0	16.7	17.9	19.2	20.9	20.2	20.4	20.5
Receipts	16.3	16.5	18.0	21.3	18.5	19.8	21.3	23.0	22.6	22.9	23.3
General government[1]	13.0	13.1	14.2	17.9	14.8	15.9	17.1	18.7	18.4	18.8	19.2
Other sectors[2]	3.3	3.4	3.8	3.4	3.7	4.0	4.2	4.3	4.1	4.1	4.1
Payments	-0.7	-3.8	-5.2	-2.3	-1.8	-1.9	-2.0	-2.1	-2.4	-2.5	-2.8
General government	0.0	0.0	0.0	0.0	-0.5	-0.6	-0.7	-0.7	-0.9	-1.0	-1.2
Other	-0.7	-3.8	-5.2	-2.3	-1.3	-1.3	-1.4	-1.4	-1.5	-1.5	-1.6
Current transfers	-20.7	-16.6	-17.3	-14.7	-14.9	-14.8	-14.4	-14.2	-13.9	-13.6	-13.2
Capital and financial account	**-52.4**	**-11.1**	**8.6**	**-20.0**	**-14.5**	**-10.0**	**-9.8**	**-9.6**	**-8.5**	**-7.6**	**-6.9**
Capital account[3]	3.8	-0.3	-0.5	-0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Financial account	-56.2	-10.8	9.1	-19.6	-14.5	-10.1	-9.9	-9.7	-8.5	-7.6	-6.9
Direct investment	11.4	-5.1	-4.1	-7.8	-7.7	-7.5	-7.4	-7.2	-7.0	-6.8	-6.6
Abroad	10.5	-5.4	-4.5	-8.1	-8.0	-7.8	-7.7	-7.6	-7.5	-7.4	-7.2
In Kuwait	1.0	0.3	0.4	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.6
Portfolio investment	-62.0	-33.1	-18.8	-18.8	-13.5	-8.6	-8.0	-7.4	-5.9	-4.7	-3.2
Other investment (net)	-5.4	27.2	32.1	7.0	6.6	6.1	5.5	5.0	4.4	3.9	2.9
Net errors and omissions[4]	-2.0	3.1	-0.7	15.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**0.0**	**-3.9**	**2.8**	**2.4**	**3.5**	**0.2**	**1.6**	**2.3**	**1.9**	**2.3**	**2.6**
Memorandum items											
Current account/GDP (in percent)	33.4	3.5	-4.6	5.9	12.7	7.4	8.0	8.0	6.6	6.1	5.5
Current account (excl. oil)/GDP (in percent)	-26.5	-38.8	-42.5	-35.5	-33.8	-35.1	-33.7	-32.3	-32.4	-31.9	-31.5
Investment income/GDP (in percent)	9.6	11.1	11.7	15.9	11.8	13.1	13.4	14.0	13.0	12.5	11.9
WEO oil price (dollars per barrel)	96.2	50.8	42.8	52.8	68.3	59.2	59.0	58.1	57.6	57.6	58.0
International reserve assets (billions of U.S. dollars)[5]	32.3	28.3	31.2	33.5	37.0	37.2	38.8	41.1	43.0	45.3	47.9
In months of imports of goods and services	7.4	6.5	6.5	6.6	7.0	6.8	6.8	7.0	7.0	7.1	7.2

Sources: Central Bank of Kuwait; and IMF staff estimates.

[1] KIA, Kuwait Petroleum Corporation, Kuwait Fund for Arab Economic Development, Public Institute for Social Security, Kuwait Airways Corporation, and Bank of Savings and Credit.

[2] CBK, local banks, investment companies, exchange companies, insurance companies, and the nonfinancial private sector.

[3] Includes UN war compensation.

[4] Includes other unclassified private-sector flows.

[5] Includes SDR holdings and IMF reserve position.

Table 4. Kuwait: Monetary Survey, 2014–24

End of period	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
	(Millions of KD)										
Foreign assets (net) [1]	15,971	15,633	16,997	16,473	18,121	18,613	19,650	21,119	22,412	23,862	25,503
Central bank	8,588	7,774	8,693	9,330	10,408	10,457	10,946	11,640	12,216	12,914	13,692
Local banks	7,383	7,859	8,305	7,143	7,713	8,155	8,704	9,480	10,196	10,948	11,810
Domestic assets (net)	17,649	18,606	18,531	20,304	20,148	21,975	23,643	25,633	27,705	29,786	32,085
Claims on government (net)	-4,340	-5,153	-4,370	-3,433	-4,339	-3,429	-2,637	-1,879	-1,105	-693	44
Central bank (net)	-616	-854	-978	-1,755	-1,584	-1,591	-1,665	-1,769	-1,855	-1,960	-2,076
Claims	0	0	0	0	0	0	0	0	0	0	0
Deposits	616	854	978	1,755	1,584	1,591	1,665	1,769	1,855	1,960	2,076
Local banks (net)	-3,723	-4,299	-3,393	-1,678	-2,755	-1,837	-972	-110	750	1,266	2,120
Claims	1,563	1,580	3,287	5,059	3,862	4,912	5,912	6,912	7,912	8,572	9,572
Public debt instruments	1,563	1,580	3,287	5,059	3,862	4,912	5,912	6,912	7,912	8,572	9,572
Deposits	5,286	5,879	6,679	6,737	6,617	6,749	6,884	7,022	7,162	7,306	7,452
Claims on nongovernment sector	32,706	35,177	36,201	37,199	38,720	41,077	43,825	47,337	50,754	54,340	58,340
Credit facilities	30,737	33,210	34,307	35,372	36,906	39,153	41,772	45,119	48,376	51,794	55,607
Local investments	1,969	1,967	1,894	1,827	1,814	1,924	2,053	2,218	2,378	2,546	2,733
Other items (net)	-10,717	-11,417	-13,300	-13,461	-14,233	-15,673	-17,545	-19,825	-21,943	-23,860	-26,299
Broad money [2]	33,620	34,239	35,528	36,777	38,269	40,588	43,293	46,752	50,118	53,648	57,588
Money	9,253	9,091	9,504	9,797	10,030	10,640	11,352	12,261	13,146	14,075	15,112
Quasi money	24,367	25,148	26,024	26,980	28,239	29,948	31,941	34,491	36,971	39,573	42,476
Of which: Foreign currency deposits	2,891	3,591	2,922	2,734	2,617	2,766	2,941	3,166	3,385	3,614	3,870
	(Annual percentage change)										
Foreign assets (net)	3.6	-2.1	8.7	-3.1	10.0	2.7	5.6	7.5	6.1	6.5	6.9
Central Bank	4.1	-9.5	11.8	7.3	11.6	0.5	4.7	6.3	5.0	5.7	6.0
Local banks	3.1	6.4	5.7	-14.0	8.0	5.7	6.7	8.9	7.6	7.4	7.9
Domestic assets (net)	2.9	5.4	-0.4	9.6	-0.8	9.1	7.6	8.4	8.1	7.5	7.7
Claims on government (net)	-3.6	-18.7	15.2	21.4	-26.4	21.0	-23.1	-28.8	-41.2	-37.3	-106.3
Claims on nongovernment sector	5.2	7.6	2.9	2.8	4.1	6.1	6.7	8.0	7.2	7.1	7.4
Other items (net)	9.8	6.5	16.5	1.2	5.7	10.1	11.9	13.0	10.7	8.7	10.2
Broad money	3.3	1.8	3.8	3.5	4.1	6.1	6.7	8.0	7.2	7.0	7.3
Money	6.6	-1.7	4.5	3.1	2.4	6.1	6.7	8.0	7.2	7.1	7.4
Quasi money	2.0	3.2	3.5	3.7	4.7	6.1	6.7	8.0	7.2	7.0	7.3
Of which: Foreign currency deposits	-7.4	24.2	-18.6	-6.5	-4.3	5.7	6.3	7.7	6.9	6.8	7.1
	(Change in percent of beginning of period broad money stock)										
Foreign assets (net)	1.7	-1.0	4.0	-1.5	4.5	1.3	2.6	3.4	2.8	2.9	3.1
Central bank	1.0	-2.4	2.7	1.8	2.9	0.1	1.2	1.6	1.2	1.4	1.5
Local banks	0.7	1.4	1.3	-3.3	1.5	1.2	1.4	1.8	1.5	1.5	1.6
Domestic assets (net)	1.5	2.8	-0.2	5.0	-0.4	4.8	4.1	4.6	4.4	4.2	4.3
Claims on government (net)	-0.5	-2.4	2.3	2.6	-2.5	2.4	2.0	1.8	1.7	0.8	1.4
Claims on nongovernment sector	4.9	7.3	3.0	2.8	4.1	6.2	6.8	8.1	7.3	7.2	7.5
Other items (net)	-2.9	-2.1	-5.5	-0.5	-2.1	-3.8	-4.6	-5.3	-4.5	-3.8	-4.5
Broad money	3.3	1.8	3.8	3.5	4.1	6.1	6.7	8.0	7.2	7.0	7.3
Money	1.8	-0.5	1.2	0.8	0.6	1.6	1.8	2.1	1.9	1.9	1.9
Quasi money	1.5	2.3	2.6	2.7	3.4	4.5	4.9	5.9	5.3	5.2	5.4
Of which: Foreign currency deposits	-0.7	2.1	-2.0	-0.5	-0.3	0.4	0.4	0.5	0.5	0.5	0.5
Memorandum items:											
Non-oil GDP/M2 (in percent)	50.7	54.8	54.8	54.6	54.8	54.5	54.3	54.0	53.8	53.6	53.3
Foreign currency deposits/M2 (in percent)	8.6	10.5	8.2	7.4	6.8	6.8	6.8	6.8	6.8	6.7	6.7
Private credit/non-oil GDP (in percent)	191.7	187.4	185.8	185.1	184.8	185.6	186.5	187.4	188.2	189.1	190.0

Sources: CBK; and IMF staff estimates.

[1] Excludes SDRs and IMF reserve position.

[2] Excludes deposits with financial institutions, which are marginal.

Table 5. Kuwait: Financial Soundness Indicators of the Banking Sector, 2007–18

(Percent unless specified otherwise)[1]

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Sep-18
Capital adequacy												
Regulatory capital to risk-weighted assets	19.3	15.6	16.7	18.9	18.5	18.5	18.9	16.9	17.5	18.6	18.4	18.0
Regulatory Tier I capital to risk-weighted assets	17.2	14.3	14.9	17.3	16.9	16.0	17.1	15.6	16.1	16.7	16.5	16.1
Capital to assets	12.3	10.9	11.4	12.6	12.4	12.6	12.2	11.1	11.8	12.8	12.8	12.4
Loan composition and quality												
Oil/gas	0.8	0.9	1.2	1.2	1.1	1.6	1.5	2.2	2.4	3.4	4.3	5.2
Trade	10.4	10.2	10.6	10.0	10.5	12.1	13.0	12.8	11.7	11.8	11.9	11.3
Industry	5.9	6.8	6.5	7.0	7.1	7.9	7.8	7.3	6.9	6.7	6.5	6.3
Construction	12.6	11.9	11.4	12.7	12.1	12.6	12.2	11.9	12.0	12.3	11.6	11.2
Real estate	19.2	18.1	20.6	20.0	19.6	19.2	18.9	18.5	17.5	16.6	16.6	15.5
Equity purchase loans (corporate)	4.5	5.8	5.9	5.7	5.8	3.5	3.4	3.0	3.0	2.9	2.6	2.8
Agriculture/fishing	0.1	0.7	0.3	0.4	0.2	0.3	0.3	0.4	0.3	0.3	0.2	0.4
Financial Institutions	15.9	12.8	12.7	14.1	13.1	11.2	10.4	11.9	14.0	13.3	11.8	12.4
Of which: investment companies	7.9	7.5	8.0	8.7	6.1	4.3	4.0	3.1	2.9	2.6	2.0	2.1
Of which: banks	0.0	0.0	0.0	4.6	3.7	6.7	5.7	8.0	10.5	9.8	8.8	9.3
Public services	2.2	1.9	1.6	1.6	1.7	2.6	1.8	2.2	2.2	1.8	1.8	1.8
Households	19.1	16.0	16.1	16.3	17.0	19.4	20.0	20.2	20.5	20.7	20.9	21.5
Of which: credit card advances	0.8	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	…	0.4
Of which: installment loans	12.1	10.9	12.7	12.1	12.9	13.2	14.4	14.8	15.5	16.1	16.8	17.7
Of which: consumer loans	4.1	2.5	1.0	2.2	2.2	2.9	3.0	2.9	2.5	2.4	2.3	2.1
Of which: equity purchase loans (individuals)	2.1	2.0	1.9	1.4	1.4	2.9	2.6	2.6	2.5	2.2	1.8	1.7
Other	9.2	14.8	13.3	11.1	11.8	9.5	10.7	9.7	9.6	10.3	11.7	11.7
Gross non-performing loans to total loans	3.8	6.8	11.5	8.9	7.3	5.2	3.6	2.9	2.4	2.2	1.9	2.0
NPLs net of specific provisions to total loans net of specific provisions	2.1	4.9	7.4	6.1	5.3	3.8	2.5	1.9	1.6	1.5	1.3	1.4
Total provisions to gross NPLs	…	…	…	…	…	95.1	134.6	163.9	204.8	236.9	230.2	214.3
NPLs net of specific provisions to Tier I capital	10.8	31.5	46.2	33.8	28.7	51.6	34.0	11.2	9.5	8.3	7.2	7.9
Loans to shareholders, parent companies, & directors to total loans	4.2	4.9	6.4	2.0	2.3	2.6	6.3	3.6	3.7	3.8	3.7	3.0
Large exposures to Tier I capital	141.6	212.4	165.1	124.3	105.3	100.4	87.2	97.1	101.1	94.7	105.5	112.7
Specific provisions to gross loans	1.8	2.0	4.4	3.0	2.1	1.4	1.2	1.0	0.8	0.7	0.6	0.7
Profitability												
Return on Average Assets (ROAA)	3.3	0.8	0.7	1.2	1.1	1.2	1.0	1.1	1.1	1.1	1.2	1.3
Return on Average Equity (ROAE)	24.3	6.5	6.1	9.1	8.1	9.1	7.4	8.7	8.8	8.5	9.5	10.4
Net interest income to gross income	29.0	36.6	44.5	49.9	47.6	48.1	49.9	47.1	47.6	49.9	49.5	49.3
Non-interest income to gross income	29.0	21.6	25.3	24.6	33.1	33.4	32.8	30.8	30.5	22.1	21.9	20.0
Trading and foreign exchange income to gross income	15.1	6.7	6.0	4.1	10.0	14.9	10.4	12.5	12.1	6.8	6.0	5.0
Non-interest expenses to gross income	23.9	26.4	36.9	37.7	36.1	34.0	37.2	33.4	31.8	29.6	27.7	25.0
Non-interest expenses to average assets	1.5	1.6	1.9	1.6	2.1	1.9	1.9	1.6	1.5	1.4	1.4	1.4
Personnel expenses to non-interest expenses	49.6	48.0	42.9	48.7	36.8	39.0	41.7	41.1	49.3	53.4	56.0	55.3
Liquidity												
Core liquid assets to total assets [2]	26.9	20.8	20.4	17.7	22.1	21.0	22.5	24.7	24.3	24.1	23.7	22.9
Core liquid assets to short-term liabilities	34.1	28.0	28.6	27.8	36.3	34.8	30.3	32.7	31.7	31.4	30.9	29.8
Liquid assets to total assets	32.9	28.4	27.9	22.8	26.5	27.3	25.4	30.7	29.8	30.1	31.0	30.9
Liquid assets to short term liabilities	41.7	38.4	39.2	35.7	43.7	45.2	34.1	40.6	38.9	39.1	40.5	40.3
FX- loans to total loans	23.3	24.9	25.8	25.5	25.8	28.1	28.2	26.0	30.5	29.1	30.6	30.0
FX- deposits to total deposits	34.9	35.1	32.7	30.7	33.8	34.6	30.7	37.0	38.8	33.2	37.8	36.0
FX- liabilities to total liabilities	27.8	24.2	22.6	11.2	11.4	14.5	18.9	18.8	30.2	…	…	28.8
Deposits to assets	56.4	59.2	58.8	56.7	58.3	63.3	62.2	59.4	59.2	58.4	59.1	58.2
Loans to deposits	103.1	109.0	113.0	116.5	110.9	100.5	99.5	103.6	108.3	108.9	106.5	109.3
FX- loans to FX-deposits	68.9	77.3	89.1	96.8	84.6	81.5	91.4	72.8	85.3	95.7	86.3	91.2
Sensitivity to market risk												
Net open FX position (overall) as percent of Tier I capital	0.0	11.2	10.7	8.7	…	10.2	8.1	7.7	18.0	…	…	…
Off-balance sheet operations as percent of assets	34.7	32.5	25.3	26.2	25.4	26.3	27.8	28.5	28.2	32.1	32.2	32.0
Gross asset position in derivatives as a percentage of tier I capital	90.9	71.1	46.9	33.6	…	41.1	65.3	75.0	139.7	…	…	…
Gross liability position in derivatives as a percentage of tier I capital	91.0	71.1	46.8	39.4	…	40.9	65.1	75.0	139.7	…	…	…
Equity exposure to capital	42.4	47.1	45.4	39.1	43.7	37.5	35.3	29.6	28.1	24.8	21.9	22.1

Source: CBK.

[1] Data are on consolidated basis.

[2] Core liquid assets include: cash and cash equivalents, deposits with CBK, government securities, CBK bills, deposits with banks, certificates of deposit with other banks which mature within three months.

Annex I. Status of Staff's 2017 Article IV Recommendations

Recommendations	Current Status
Implement gradual fiscal consolidation and shift expenditure composition toward growth-enhancing investment.	Staff's measure of the underlying fiscal position—non-oil balance less investment income in percent of non-oil GDP—indicates a minor loosening in FY17/18 and FY18/19. In GDP terms though, current expenditure declined slightly, supported by lower wage bill and spending on goods and services. The gains were partially offset by a rising subsidy bill (due to higher oil prices) and higher interest payments. The share of capital outlays in total expenditure has remained broadly unchanged.
Further reform energy and water subsidies.	Following significant electricity and water price increases in 2017, the authorities focused their efforts on revenue collection.
Introduce excises, VAT, and a business profit tax for domestic companies, and improve tax administration. Adjust prices of government services.	The GCC-wide excises and VAT are pending parliament's approval. The authorities expect to receive parliament's authorization for excises and implement them in FY2020/21. The VAT is likely to be postponed until FY2021/22. The IMF has recently provided technical assistance on the VAT. The government raised fees for some services, including for work permits and health care fees for expatriates.
Establish a medium-term fiscal framework and improve public financial management.	The government introduced 3-year rolling expenditure ceilings in 2017, but they have been discontinued in the FY2019/20 budget.
Further improve business environment to foster diversification (business climate, privatization, competition).	The authorities have made progress in streamlining registration and licensing, digitizing administrative procedures, and relaxing restrictions on FDI. Going forward, they intend to focus on removing excessive regulations, easing the cost of trading across borders, enhancing competition, and improving access to land.
Further strengthen AML/CFT and anticorruption frameworks.	The authorities completed the ML/TF national risk assessment with assistance from the World Bank. The authorities are implementing recommendations of the recent IMF diagnostic of the effectiveness of the AML/CFT regime. They are also improving coordination between members of the National AML/CFT Committee.
Strengthen insolvency regime and crisis management framework and develop special resolution regime for banks.	The authorities received TA in these areas from both the IMF and the World Bank, and the recent FSAP covered these issues extensively.
Establish framework to operationalize macro-prudential measures.	The CBK has a functioning macro-prudential framework. It has recently eased limits on consumer lending.
Further develop and extend a liquidity forecasting framework.	The CBK is working to enhance its liquidity forecasting framework. The IMF is providing assistance to the CBK to strengthen its liquidity forecasting tool and operational framework and improve the effectiveness of liquidity management.
Develop a medium-term debt management strategy, introduce regular market-based auctions, increase coordination between MOF, CBK, and KIA.	A draft debt law is pending parliament's approval. It would extend the borrowing limit and allow issuing debt instruments with maturities up to 30 years (from the current limit of 10 years). The government is preparing a draft law that would allow government Sukuk issuance.
Further improve national accounts; produce quarterly national accounts; rebase CPI.	The Central Statistical Bureau has rebased CPI data using weights from the 2013 household survey. It has also started disseminating quarterly GDP from early 2018.

Annex II. Risk Assessment Matrix[1]

Nature/source of main threats	Likelihood of Risk/Time Horizon	Expected impact on the economy if risk materializes	Recommended Policy Response
		External risks	
Large and protracted decline in oil prices	**Medium/Short to Medium Term**	**High** Fiscal and external balances would deteriorate given the high share of oil in fiscal revenues and exports. Higher government financing needs, especially if seen as sustained, could trigger a repricing of external borrowing. Private sector confidence would likely weaken, FDI inflows and non-oil growth would decline. However, substantial financial buffers and ample borrowing space would allow the government to conduct countercyclical fiscal policy and mitigate contractionary effects. Lower oil prices would have a contractionary effect on financial liquidity. Should the government resort to domestic financing, there would be a risk of crowding out private sector credit. Volatility in equity markets and a further softening in the real estate markets could impair banks' assets.	While financial buffers provide policy space for gradual fiscal adjustment, more ambitious fiscal consolidation is needed. The impact of fiscal consolidation on economic activity should be mitigated by rebalancing spending toward growth-enhancing investment. Government measures to encourage private investment and boost non-oil activity should accelerate, including improving the business climate. Financing strategy should consider the need to maintain adequate liquidity in banks. CBK liquidity management capabilities should be enhanced, and continued supervisory vigilance is needed to identify emerging financial stability risks to facilitate a timely response. The government should continue reforms to reduce Kuwait's dependence on oil.
Tighter global financial conditions	**High/Short term**	**Medium** Government external borrowing could become more expensive. Recourse to domestic borrowing to finance budget deficit would risk crowding out private credit. Banks and investment companies (IC) dependent on foreign funding would face higher costs. Sharp increases in interest rates could trigger corrections in GCC equity and real estate markets, and, with many banks and ICs invested in these markets, pose risks to financial stability.	The large external buffers could be deployed to finance the fiscal deficit and mitigate impact on the financial system. The CBK should further enhance the surveillance of banking stability risks.

Nature/source of main threats	Likelihood of Risk/Time Horizon	Expected impact on the economy if risk materializes	Recommended Policy Response
		External risks	
Weaker than expected global growth and rising protectionism	**Low to Medium/Short to Medium Term**	**Direct impact is limited** Direct impact is limited, but there could be large indirect impact through lower oil prices and FDI.	See the recommended response to lower oil prices above.
Intensification of geopolitical risks	**Medium/Short to Medium Term**	**Medium** Would mainly operate through oil prices and regional contagion. Confidence shock could trigger capital outflows.	See the recommended response to lower oil prices above. The authorities could lean on Kuwait's large financial buffers to moderate the impact of the shock. Enhanced surveillance of financial system would help spot systemic risks early on. The CBK should stand ready to inject liquidity in the system and respond through monetary and prudential measures to capital outflows.
		Domestic risks	
Slower and less effective implementation of the planned reforms.	**Medium/Medium to Long Term**	**High** Lower investor confidence and investment that would undermine non-oil growth prospects and hinder diversification. Prospects for employment in the private sector would weaken, and concerns about higher unemployment could prompt the government to create public sector jobs.	Strengthen the ongoing efforts to build national consensus for key fiscal and structural reform. Strengthen anticorruption efforts and improve the quality of public spending with focus on boosting infrastructure and enhancing efficiency in the delivery of public services. Expedite public financial management reforms, with focus on transparency and public accountability.
Severe property price correction	**Low**	**Medium** Though banks have substantial loss absorption capacity in terms of capital and loan loss provisioning, the losses could be significant given high exposures to the real estate sector, both directly and indirectly through collateral and common exposures.	Macro-prudential tools to limit exposures to real estate should be supported by improved real estate statistics. This will support monitoring of developments in the sector and enhanced techniques to capture banks' direct and indirect exposures to the real estate sector to facilitate timely supervisory response. Strengthen crisis preparedness and management framework.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Public Sector Debt Sustainability Analysis

Table 1. Kuwait: Public Debt Sustainability Analysis (DSA)-Baseline Scenario

(In percent of GDP unless otherwise indicated on a calendar-year basis)

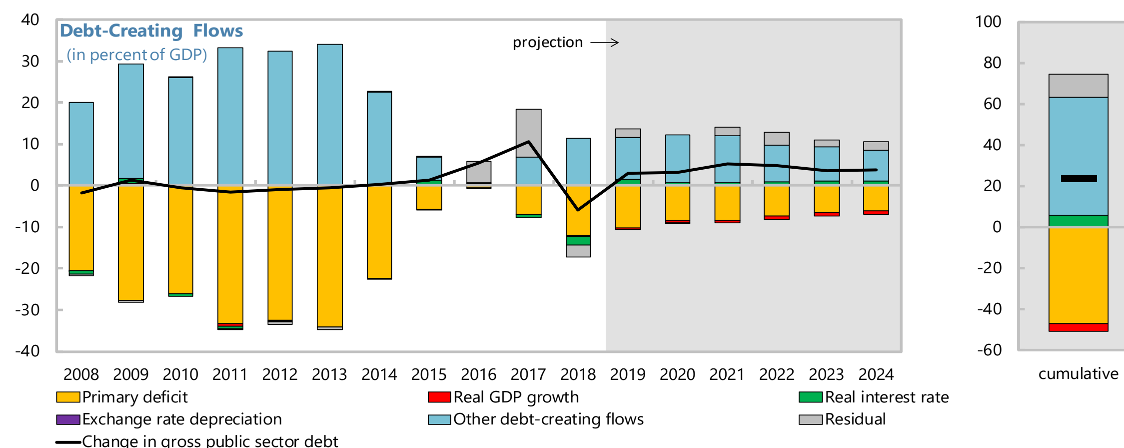
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	5.3	20.7	14.8	17.8	21.0	26.2	31.1	34.7	38.4
Public gross financing needs	-21.7	-5.7	-11.1	-5.5	-6.1	-6.0	-3.8	-4.1	-3.9
Real GDP growth (in percent)	1.6	-3.5	1.7	2.5	2.9	2.9	2.5	2.7	2.9
Inflation (GDP deflator, in percent)	-0.2	13.7	15.4	-5.2	1.5	1.7	1.7	1.9	2.2
Nominal GDP growth (in percent)	1.7	9.7	17.4	-2.9	4.4	4.6	4.3	4.7	5.1
Effective interest rate (in percent) [4/]	2.6	4.2	3.7	4.8	5.2	5.5	5.3	5.5	5.5

As of February 01, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		352
5Y CDS (bp)		na
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.3	10.7	-5.9	3.0	3.2	5.3	4.9	3.6	3.7	23.6	
Identified debt-creating flows	-0.1	-0.9	-3.1	1.0	3.3	3.1	1.7	2.0	1.5	12.4	
Primary deficit	-22.5	-7.0	-12.0	-10.2	-8.5	-8.3	-7.4	-6.6	-6.0	-47.0	7.5
Primary (noninterest) revenue and grants	66.4	58.4	58.4	59.9	58.2	58.5	57.6	56.2	55.0	345.3	
Primary (noninterest) expenditure	43.9	51.5	46.4	49.7	49.7	50.2	50.1	49.6	49.0	298.3	
Automatic debt dynamics [5/]	0.1	-0.5	-2.4	1.2	0.1	0.2	0.3	0.2	0.1	2.2	
Interest rate/growth differential [6/]	0.1	-0.5	-2.4	1.2	0.1	0.2	0.3	0.2	0.1	2.2	
Of which: real interest rate	0.1	-0.8	-2.1	1.6	0.6	0.8	0.9	1.1	1.1	6.0	
Of which: real GDP growth	-0.1	0.3	-0.3	-0.4	-0.5	-0.6	-0.6	-0.8	-1.0	-3.9	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	22.4	6.6	11.3	10.0	11.6	11.2	8.8	8.3	7.4	57.3	
Privatization/Drawdown of deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Asset accumulation requirement	22.4	6.6	11.3	10.0	11.6	11.2	8.8	8.3	7.4	57.3	
Residual, including asset changes [8/]	0.4	11.6	-2.8	2.0	-0.1	2.2	3.2	1.6	2.2	11.2	



Sources: CBK, MOF, and IMF staff estimates.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

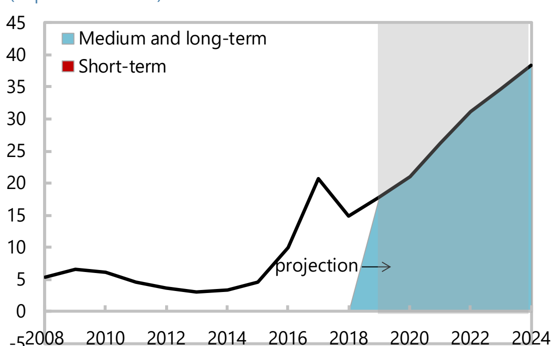
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year. The debt stabilizing primary balance under the assumed asset accumulation of 7.4 percent of GDP in 2024 is equal to 7.5 percent. Under no asset accumulation, the debt-stablizing primary balance would have been 0.14 percent of GDP.

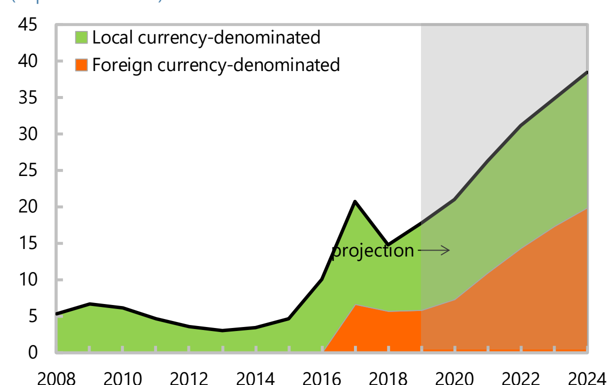
Figure 1. Kuwait: Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



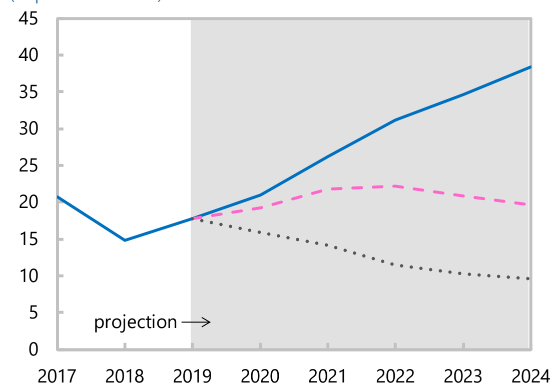
By Currency
(in percent of GDP)



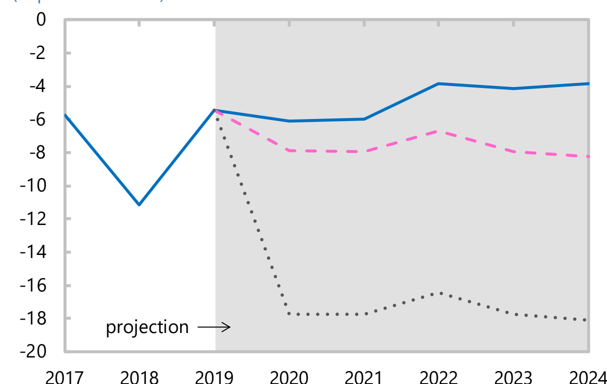
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	2.9	2.9	2.5	2.7	2.9
Inflation	-5.2	1.5	1.7	1.7	1.9	2.2
Primary Balance	10.2	8.5	8.3	7.4	6.6	6.0
Effective interest rate	4.8	5.2	5.5	5.3	5.5	5.5
Constant Primary Balance Scenario						
Real GDP growth	2.5	2.9	2.9	2.5	2.7	2.9
Inflation	-5.2	1.5	1.7	1.7	1.9	2.2
Primary Balance	10.2	10.2	10.2	10.2	10.2	10.2
Effective interest rate	4.8	5.2	6.0	6.3	7.3	8.4

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	1.0	1.0	1.0	1.0	1.0
Inflation	-5.2	1.5	1.7	1.7	1.9	2.2
Primary Balance	10.2	20.1	20.1	20.1	20.1	20.1
Effective interest rate	4.8	5.2	7.3	9.5	13.8	17.2

Source: IMF staff.

Annex IV. Baseline and Adjustment Scenarios

I. Assumptions

1. Baseline Scenario is based on enacted and announced policies and reforms and assumes modest expenditure restraint.

- Introduction of excises in FY2020/21 and the VAT in FY2021/22, which are estimated to generate non-oil revenue of about 2.2 percent of GDP by FY2024/25.
- Strengthen social transfers administration: policies to close the existing loopholes and strictly enforce eligibility requirements should yield savings of 0.6 percent of GDP by FY2024/25.
- Spending restraint: public wages are assumed to grow with inflation, while employment expands at an annual rate of 2 percent; transfers are assumed to grow with inflation; spending on goods and services expands in line with non-oil GDP.
- Capital expenditure is assumed to grow in line with non-oil GDP.

2. Adjustment Scenario assumes a gradual reduction of expenditure to about 75 percent of non-oil GDP by FY2024/25. The target is derived from a historical norm and would contribute to a gradual reduction of the gap from intergenerational equity level of the non-oil primary balance.

- Fuel prices are assumed to gradually increase starting from FY2019/20 to reach cost recovery levels by FY2024/25 (elimination of fuel subsidy), saving 0.7 percent of GDP.
- Water and electricity tariffs are assumed to increase gradually to cut the subsidy in half by 2024, resulting in savings of 2 percent of GDP by the end of the forecast period.
- The wage bill is assumed to evolve based on constant public employment and compensation growing more slowly than inflation. Inflation is projected to be higher in the adjustment scenario due to the reduction in fuel, water, and electricity subsidies. Compensation growth below inflation is consistent with staff's advice to introduce flexibility in the wage-setting mechanism. The expected savings from the wage bill restraint amount to 1.3 percent of GDP by FY2024/25.
- Better procurement and waste reduction would generate savings of 1.2 percent of GDP in spending on goods and services by FY2024/25.
- Introduction of a profit tax on domestic companies and/or excises on luxury goods (or a tax on high-income individuals) starting FY2021/22 with estimated additional revenue of 0.7 percent of GDP by FY2024/25.
- Introducing compensatory schemes to mitigate the adverse effects of reforms on vulnerable households amounting to 0.4 percent of GDP by FY2024/25.
- Debt issuance is assumed unchanged compared to the baseline. As a result, the adjustment scenario produces much slower drawdown of assets.
- Accelerating capital spending, to grow at 1 percent above nominal non-oil GDP growth, at a cost of 0.8 percent of GDP by FY2024/25.
- Debt issuance is assumed unchanged compared to the baseline. As a result, the adjustment scenario produces much slower drawdown of GRF assets.

Table 1. Kuwait: Baseline Adjustment Scenario
(Percent of GDP, unless otherwise noted)

	2015	2016	2017	Prel. 2018	Projections 2019	2020	2021	2022	2023	2024	Cumulative 2019-24
Baseline Scenario											
Overall balance	-0.3	0.5	8.1	12.6	8.0	7.0	6.7	5.2	4.2	3.4	
Overall balance after transfers to FGF and excl. investment income	-17.5	-17.9	-12.6	-5.2	-10.4	-11.6	-12.3	-13.0	-13.5	-13.7	
Non-oil balance excl. investment income											
(Percent of non-oil GDP)	-88.3	-83.8	-86.5	-87.8	-85.7	-84.7	-81.3	-78.9	-77.2	-75.3	
Non-oil revenue	3.6	3.7	4.4	4.2	4.5	4.6	6.2	6.6	6.5	6.4	
Primary spending	52.6	52.2	50.4	47.6	49.8	50.1	50.8	50.6	50.2	49.5	
(1) Total government debt	4.7	10.0	20.7	14.8	17.8	21.0	26.2	31.1	34.7	38.4	
(2) Total buffer by the KIA [1/]	456.3	476.6	464.8	403.2	425.0	418.1	410.4	401.9	391.7	379.4	
Net government financial assets (2-1)	451.7	466.6	444.1	388.4	407.2	397.1	384.2	370.8	356.9	341.0	
Current account balance	3.5	-4.6	5.9	12.7	7.4	8.0	8.0	6.6	6.1	5.5	
International reserves (in months of next year's imports)	6.5	7.1	7.0	7.3	7.1	7.1	7.3	7.3	7.4	7.5	
Credit to the private sector (percentage change)	7.6	2.9	2.8	4.1	6.1	6.7	8.0	7.2	7.1	7.4	
Real GDP growth (percent,yoy)	0.6	2.9	-3.5	1.7	2.5	2.9	2.9	2.5	2.7	2.9	
Real oil GDP growth (percent, yoy)	-1.7	3.9	-7.2	1.2	2.0	2.5	2.5	2.0	2.0	2.0	
Real non-oil GDP growth (percent, yoy)	4.2	1.4	2.1	2.5	3.0	3.5	3.4	3.2	3.7	4.0	
Inflation (percent)	3.7	3.5	1.5	0.7	2.5	2.7	4.7	3.9	3.0	3.0	
Fiscal Adjustment Under the Baseline:											
Annual change in overall balance to GDP	-18.9	0.9	7.6	4.5	-4.6	-1.0	-0.3	-1.5	-1.0	-0.8	-9.1
Annual change in non-oil primary balance to non-oil GDP	14.3	4.4	-2.6	-1.3	2.1	1.0	3.4	2.4	1.7	1.8	12.4
Fiscal Anchor:											
Distance of projected NOPB from PIH (% non-oil GDP)				14.4	13.1	13.3	13.2	12.0	11.1	11.6	
Fiscal Adjustment Scenario											
Overall balance	-0.3	0.5	8.1	12.6	8.3	7.7	9.1	8.2	8.3	8.5	
Overall balance after transfers to FGF and excl. investment income	-17.5	-17.9	-12.6	-5.2	-10.0	-10.7	-9.8	-9.9	-9.4	-8.8	
Non-oil balance excl. investment income											
(Percent of non-oil GDP)	-88.3	-83.8	-86.5	-87.8	-83.8	-81.2	-75.3	-72.0	-68.4	-65.3	
Non-oil primary revenue	3.6	3.7	4.4	4.2	4.5	4.5	6.8	7.2	7.1	7.0	
Primary spending	52.6	52.2	50.4	47.6	49.1	48.6	48.5	47.7	46.1	44.6	
(1) Total government debt	4.7	10.0	20.7	14.8	17.7	20.7	25.9	30.7	34.2	37.8	
(2) Total buffer by the KIA	456.3	476.6	464.8	403.2	425.0	419.0	410.6	402.6	395.7	387.9	
Net government financial assets (2-1)	451.7	466.6	444.1	388.4	407.3	398.3	384.6	372.0	361.5	350.1	
Current account balance	3.5	-4.6	5.9	12.7	8.0	9.0	9.9	9.3	9.5	9.6	
International reserves (in months of next year's imports)	6.5	7.1	7.0	7.3	7.1	7.1	7.3	7.3	7.5	7.5	
Credit to the private sector (percentage change)	7.6	2.9	2.8	4.1	7.1	8.5	7.6	7.3	7.3	7.4	
Real GDP growth (percent)	0.6	2.9	-3.5	1.7	2.4	2.8	2.6	2.4	2.6	2.8	
Real oil GDP growth (percent, yoy)	-1.7	3.9	-7.2	1.2	2.0	2.5	2.5	2.0	2.0	2.0	
Real non-oil GDP growth (percent, yoy)	4.2	1.4	2.1	2.5	2.9	3.2	2.7	2.9	3.5	3.9	
Inflation (percent)	3.7	3.5	1.5	0.7	4.0	5.3	4.8	4.2	3.5	3.0	
Fiscal Adjustment Under the adjustment Scenario											
Annual change in overall balance to GDP	-18.9	0.9	7.6	4.5	-4.3	-0.6	1.4	-0.9	0.1	0.1	-4.1
Annual change in non-oil primary balance to non-oil GDP	14.3	4.4	-2.6	-1.3	4.0	2.6	5.9	3.3	3.6	3.1	22.5
Fiscal Anchor:											
Distance of projected NOPB from PIH (% non-oil GDP)				14.4	9.1	9.6	6.3	5.3	4.1	3.3	

Sources: IMF staff estimates.

1/ Staff estimates and projections.

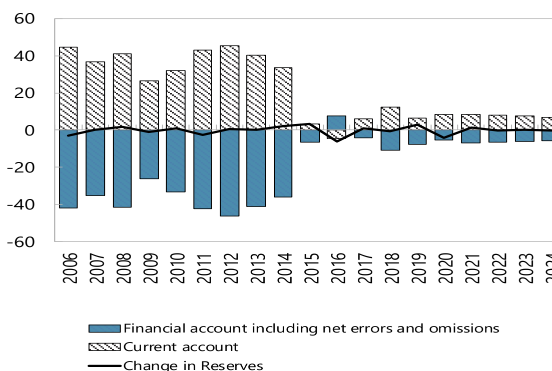
Annex V. External Sector Assessment

While the external position improved in 2018, helped by higher oil prices, it remains weaker than implied by fundamentals and desirable policies. Staff's recommended fiscal adjustment would bring the current account to a level consistent with fundamentals. The dinar's peg to a basket of currencies has served Kuwait well.

1. The current account (CA) continued to strengthen in 2018. The CA balance returned to surplus in 2017 after recording its first deficit in many years in 2016. It is estimated to have reached 12¾ percent of GDP in 2018 but expected to decline in 2019 on account of lower oil prices. Staff estimates that investment income reached a record high of about US$19 billion in 2017, helped by robust performance in Kuwait Investment Authority's (KIA) global investments. It should remain broadly stable over the medium term.

Current and Financial Account Balances

(Percent of GDP)

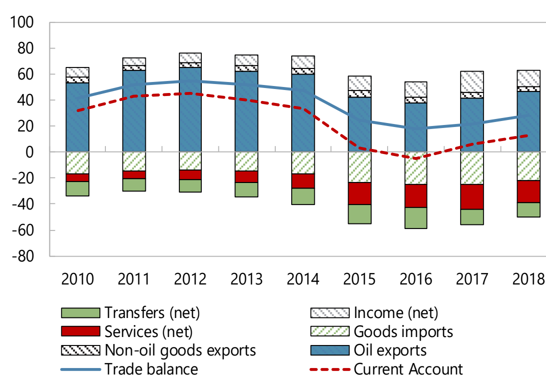


Sources: Country Authorities; and IMF staff calculations.

Contributions to Current and Financial Accounts

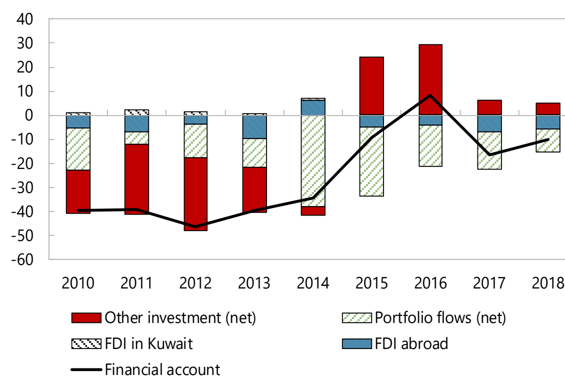
Contribution to the Current Account, 2010-2018

(Percent of GDP)



Contribution to the Financial Account, 2010-2018

(Percent of GDP)



Sources: Country Authorities; and IMF staff calculations.

2. The capital and financial account (FA) registered net outflows in 2018. FA mirrors the CA as it largely reflects the accumulation (or use) of Kuwait's foreign assets held by the KIA. Higher oil exports restored the past trend of foreign assets accumulation, resulting in a reversal from inflows of about US$9 billion in 2016 to estimated outflows of US$14½ billion in 2018.

3. CBK's gross international reserves are broadly adequate. CBK's foreign reserves amounted to $33.5 billion (28 percent of GDP, 6.6 months of imports, 28 percent of broad money) at end-2017. They are forecast to reach $37 billion by end-2018 or about 102 percent of the IMF's reserve adequacy metric.[1]

4. CBK's reserves are complemented by government's large foreign assets held by the KIA. Staff estimates that KIA's total assets reached about 400 percent of GDP at end-2018, with roughly 85 percent of it in the FGF, which accumulates savings for future generations, and the remainder in the GRF, which can be drawn for government financing and replenishing CBK reserves. Both funds are mainly invested in foreign assets.

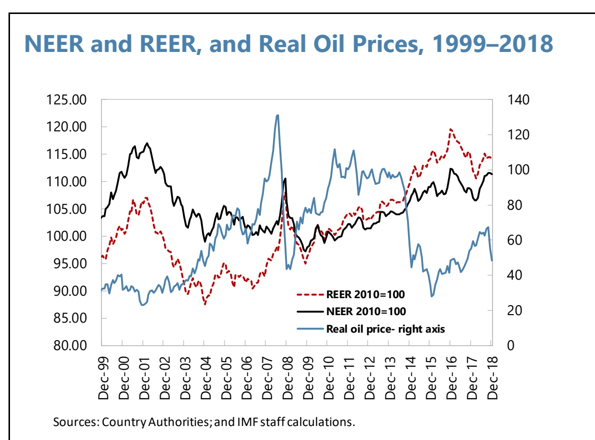
Kuwait: Foreign Reserve Adequacy

	2015	2016	2017	Est. 2018
	(in millions of USD)			
External short-term debt	19797	20333	21601	23334
Other liabilities (portfolio and other investment liabilities less short-term debt) 1/	25219	25540	44768	43865
Broad Money	113829	117562	121235	126760
Exports of goods and services	60476	52100	60225	76984
CBK Gross International Reserves	28334	31173	33525	37036
KIA Assets (staff estimates)	522985	521366	555595	568723
ARA metric	28413	28174	33580	36147
Foreign Reserves as a % of the ARA metric (in percent) 2/	**100**	**111**	**100**	**102**
Foreign Reserves (including KIA) as a % of the ARA metric (in percent) 2/	**1940**	**1961**	**1754**	**1676**
Foreign Reserves in percent of GDP	**25**	**28**	**28**	**26**
Foreign Reserves in percent of broad money	**25**	**27**	**28**	**29**
Foreign Reserves in months of next year's imports of goods and services	**6.5**	**6.5**	**6.6**	**7.0**

1/ Based on the IMF's calculation of reserves recommended for fixed exchange rate regimes.
2/ As a rule of thumb, reserves within 100-150 percent of the new ARA metric are considered adequate.

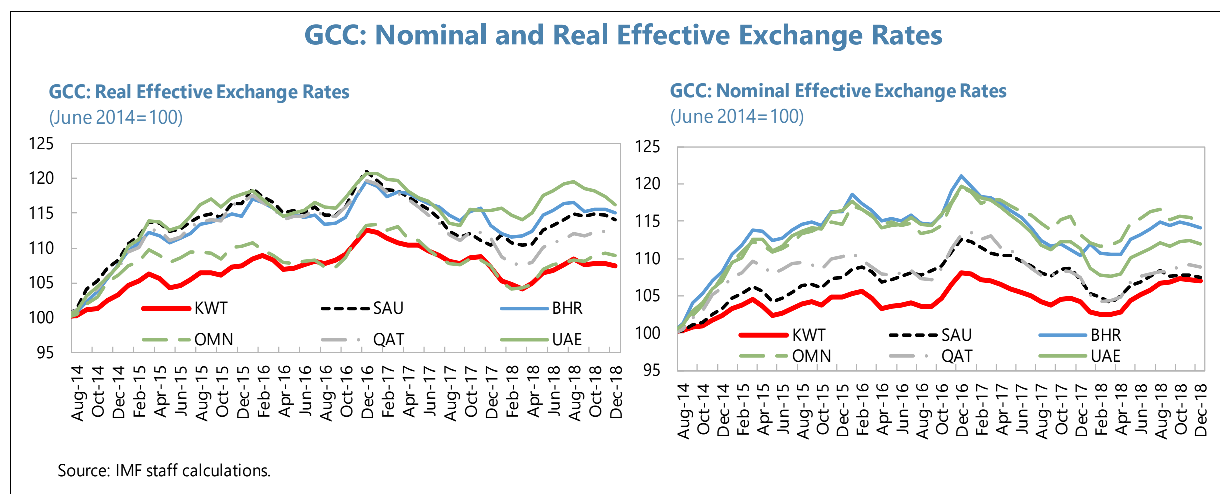
5. The exchange rate regime is a peg to an undisclosed basket of currencies. The current arrangement, in place since May 2007, has served Kuwait well, providing an effective nominal anchor as well as limited exchange rate flexibility. While the NEER has remained largely unchanged over the past few years, the REER has experienced a long-term trend appreciation, which has been less pronounced than in other GCC countries.

NEER and REER, and Real Oil Prices, 1999–2018



Sources: Country Authorities; and IMF staff calculations.

[1] The Fund's composite metric that measures the adequacy of precautionary reserves (developed for emerging markets). It is based on the relative risk weights for each source of foreign exchange drain drawing on the 10th percentile of observed outflows from Emerging Markets (EMs) during exchange market pressure episodes. Reserves in the range of 100-150 percent of the composite metric are considered broadly adequate for precautionary purposes.



6. The CA surplus, though sizeable, is below the level needed to ensure equitable consumption for future generations. As Kuwait is projected to run persistent CA surpluses in the medium term, assessment of the "sustainability" of the external sector should not be guided by the need to stabilize the net foreign assets position (as in most other countries) but by the objective to save adequately for future generations. The permanent income model (PIH) is thus the preferred method for assessing Kuwait's external sector sustainability, as the CA gap reflects suboptimal saving of hydrocarbon revenues rather than traditional competitiveness issues.[2,3] The current account norm implied by a constant real per-capita annuity (under the baseline) is a surplus of 20.8 percent of GDP in 2018, resulting in an estimated current account gap of about 8 percent of GDP. It is forecast to fall to 6 percent of GDP over the medium term. Because this imbalance is largely driven by suboptimal saving by the public sector, the current account gap should be closed through fiscal consolidation. Indeed, closing the PIH fiscal gap (estimated at about 7 percent of GDP in 2024) as proposed by staff would fully eliminate the estimated current account gap over the long term.

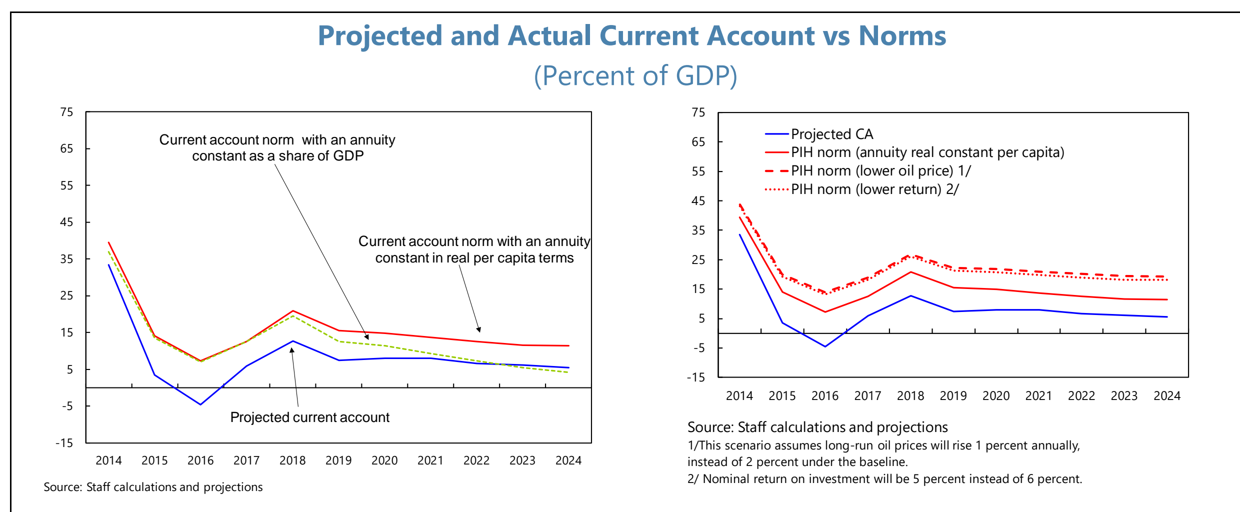
7. The revised External Balance Assessment-lite (EBA-lite 2.0) methodology is not well suited for an undiversified exporter such as Kuwait. Imposing a fiscal surplus 7 percent of GDP higher than projected under the baseline, a level consistent with intergenerational equity, would imply a current account norm of about 33½ percent of GDP under the EBA-lite 2.0 model. The corresponding current account gap would be substantial, about 21 percent GDP, with the policy gap explaining only 3 percentage points. However, the EBA-lite 2.0 model features an unusually large

[2] The approach calculates the current account required for the net present value (NPV) of hydrocarbon and investment income to equal the NPV of imports net of non-hydrocarbon exports. To support intergenerational equity, the economy would need to choose a path for imports—and hence a current account norm—by accumulating net foreign assets at an appropriate pace. As with any analytical tool, results are sensitive to the choice of assumptions made (for instance, oil prices, return of assets, and population growth) as well as the targeted transfer to future generation (annuity).

[3] The PIH model used here is conceptually similar to the consumption allocation rule model of the revised EBA-Lite methodology.

residual for Kuwait (18 percent of GDP out of the 21 percent of GDP current account gap).[4] Given the large residual, staff has instead used the CA-gap estimate from the PIH model for the CA-gap-based REER assessment.

Projected and Actual Current Account vs Norms
(Percent of GDP)



Source: Staff calculations and projections
1/This scenario assumes long-run oil prices will rise 1 percent annually, instead of 2 percent under the baseline.
2/ Nominal return on investment will be 5 percent instead of 6 percent.

Current and Fiscal Account Actuals and Norms
(In percent of GDP, unless otherwise specified)

External sustainability approach (2018)		
	Annuity real per capita	**Annuity constant to GDP**
Current account estimated	12.7	12.7
Current account norm	20.8	19.5
Current account gap	-8.1	-6.8
Fiscal balance estimated	12.6	
Fiscal balance norm	17.8	
Fiscal balance gap	-5.2	
EBA-lite 2.0 approach (2018)		
	Model-based CA gap	**Using PIH-based CA gap**
Current account estimated	12.7	12.7
Current account norm	33.5	33.5
Policy gap	-3.1	-3.1
CA-Fitted	30.4	
Current account gap	-20.8	-8.1
Residual	-17.7	
Real effective exchange rate (2018, percent)		
	REER Elasticity	***REER Gap (+overvaluation)***
PIH (real per capita)/CA model (adjusted)	-0.53	15.2
REER model	-	-2.8
Source: IMF Staff calculations		

[4] The macro-balance approach based on the EBA-Lite 2.0 employs a regression analysis for a large cross-section of countries to predict the current account consistent with a range of structural and policy factors and estimates the impact of changes in these factors on the norm. While the EBA-lite model has the advantage of multilateral consistency, it is however estimated on a wide group of countries and may not fully capture all features of undiversified commodity exporters such as Kuwait.

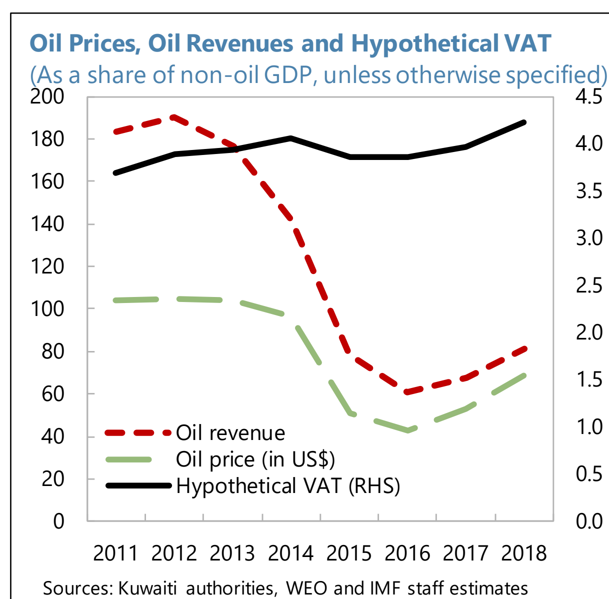
8. Staff assesses the external position to be weaker than implied by fundamentals and desirable policies. The REER model based on EBA-lite 2.0-like fundamentals suggests a small undervaluation of about 3 percent. However, applying EBA-lite 2.0 elasticities to the PIH-based CA gap implies an overvaluation of about 15 percent. Given that the latter better captures Kuwait's features of an undiversified commodity exporter and mindful of the sensitivity of the results to assumptions, staff considers the dinar to be overvalued between 5–15 percent.

9. REER depreciation would have a limited impact on the CA in Kuwait. This simply reflects the structure of exports dominated by oil and the very limited substitutability of imports by domestic products. The latter is due to significant share of imported labor and intermediate inputs in domestic production, making exchange rate depreciation somewhat ineffective in compressing imports. Instead, the CA gap should be closed by the recommended fiscal adjustment, which would not only close the CA gap but also be reflected in a more depreciated REER.

Annex VI. Macroeconomic Implications of the VAT in Kuwait

A. Introduction

1. Kuwait is highly susceptible to oil price volatility. Oil revenues account for about 70 percent of government revenues. The sharp drop in the oil price in 2014–16 led to a substantial loss of revenues and deterioration of fiscal balances. While the rebound in prices during 2017–18 brought relief, the subsequent decline in the fourth quarter of 2018 highlights the need to boost non-oil revenues.



2. The government plans to introduce a VAT along with excises as per the Gulf Cooperation Council (GCC) agreement.[1] The agreed VAT rate is 5 percent, with zero rate applied on exports. The agreement also allows zero rating or exempting education, health, real estate, local transport, and certain financial services. Among GCC countries, Saudi Arabia, the UAE, and, most recently, Bahrain have introduced the VAT. Implementation in Kuwait has been delayed though, as ratification of the VAT agreement by the National Assembly has stalled for over a year.

3. There are compelling arguments in favor of a VAT in Kuwait. First, as a tax on consumption, the VAT provides stable source of fiscal revenues. Second, the VAT is a more neutral tax than corporate and personal income taxes and does not distort decisions to invest and work. Third, the VAT encourages savings, which are essential for preserving adequate wealth for future generations in Kuwait. Fourth, information obtained through VAT declarations will help authorities to better understand the input-output structure of the economy and contribute to more informed policy-making. Finally, the VAT will facilitate further upgrading of Kuwait's tax administration.

4. The VAT will slow growth and increase inflation, but the impact will be moderate and temporary. The VAT could raise between 2.0 to 3.3 percent of GDP in revenues depending on the extent of exemptions. Staff analysis shows that the VAT, if introduced in April 2021, could knock 1.4 percentage points off non-oil growth in 2022 and push inflation up by 3.2 percentage points in 2021.[2] The revenue yield would be lower and the impact on growth and inflation milder if

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[1] Although the GCC agreement stipulates the VAT and excises (on tobacco, alcohol and sugary drinks), this note focuses on the former given its larger and more systemic impact on the economy.

[2] The VAT will have the most severe impact on non-oil growth in the second year of introduction (2022), when the full-year impact materializes, and 100 percent tax collection is achieved. The impact on non-oil growth in 2021 will be milder, -0.6 percentage point for the VAT with exemptions and -1 percentage point without exemptions.

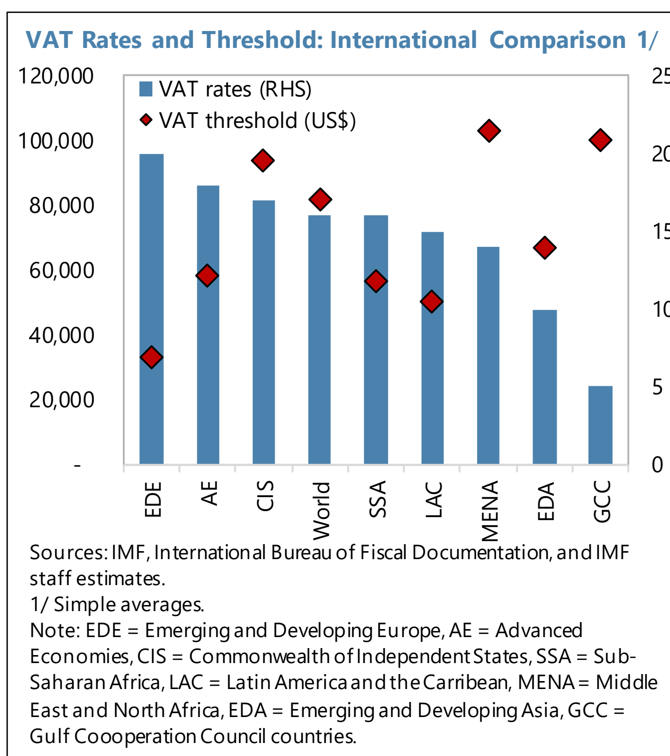
exemptions were to be granted—the VAT would shave 0.8 percentage points off non-oil growth in 2022 and raise inflation by 1.9 percentage points 2021. The adverse effects on non-oil growth and inflation would fully fade by the fourth and third year of the tax, respectively. The VAT is a regressive tax, and well targeted social assistance may be needed to compensate its adverse impact on the most vulnerable groups (Mansour *et al.*, 2018).

B. The impact of the VAT on macroeconomic outcomes

5. Two scenarios are considered: *VAT with no exemptions* and *VAT with extensive exemptions*. Both scenarios assume that the VAT will be introduced in April 2021 (the start of FY2021/22) and exports will be zero rated. Under the first scenario—*VAT with no exemptions*—consumption of all goods and services is taxed without exception. The second scenario—*VAT with exemptions*—assumes that several sectors will be either zero-rated or exempted as permitted by the GCC agreement (Table 1).

6. Exemptions should be applied as sparingly as possible. At 5 percent, the GCC VAT rate is low, while the threshold of US$100,000 is high by international standards. Exemptions would erode the revenue potential of the VAT, undermine its neutrality, distort production decisions, and complicate administration. For example, businesses producing both taxed and exempt output would need complex apportionment rules to determine creditable business overheads and general expenses. Given these concerns, exemptions should be limited to i) 'out-of-scope' non-commercial activities (e.g., public health and education services); ii) small business activities where majority of companies fall below the threshold; and iii) services that are difficult to tax, such as margin-based financial services and life insurance (Mansour *et al.*, 2018).

VAT Rates and Threshold: International Comparison 1/



Sources: IMF, International Bureau of Fiscal Documentation, and IMF staff estimates.
1/ Simple averages.
Note: EDE = Emerging and Developing Europe, AE = Advanced Economies, CIS = Commonwealth of Independent States, SSA = Sub-Saharan Africa, LAC = Latin America and the Carribean, MENA = Middle East and North Africa, EDA = Emerging and Developing Asia, GCC = Gulf Coooperation Council countries.

Table 1. Kuwait: Staff Assumptions to Estimate VAT Revenue Yields 1/

(Percentages, unless otherwise specified)

REVENUE BASE	Percent of GDP	VAT rate	VAT yield (% GDP)	TOTAL (% GDP)
GDP less goods exports	53.9	5.0	2.7	5.1
Imports	48.1	5.0	2.4	

ESTIMATIONS		**ASSUMPTIONS**		**REVENUE LOSS (% GDP)**	
		VAT 2/ (no exemptions)	**VAT (exemptions)**	**VAT 2/ (no exemptions)**	**VAT (exemptions)**
Production approach	***(% GDP)***	***Share***	***Share***	***(% GDP)***	***(% GDP)***
Sectors exempted					
Agriculture and fisheries	0.5	0.0	100.0	0.0	0.0
Mining (non-oil)	0.3	100.0	100.0	0.0	0.0
Financial institutions	9.6	0.0	100.0	0.0	0.5
Insurance	0.4	0.0	100.0	0.0	0.0
Public administration and defense	11.3	100.0	100.0	0.6	0.6
Education	6.2	0.0	100.0	0.0	0.3
Health	3.1	0.0	100.0	0.0	0.2
Imputed bank service charges	-6.5	100.0	100.0	-0.3	-0.3
Imports exempted (HS codes in bracket) 3/					
Food & non-alcohol (01-23)	3.9	0.0	100.0	0.0	0.2
Pharmaceuticals (30)	1.2	0.0	100.0	0.0	0.1
Metals and metal articles (72-83) 4/	2.8	100.0	100.0	0.1	0.1
Investment goods (84-86) 4/	7.8	100.0	100.0	0.4	0.4
Special vehicles (8705) 4/	0.6	100.0	100.0	0.0	0.0
Services imports	20.0	100.0	100.0	1.0	1.0
Subtotal	**55.1**	-	-	**1.8**	**3.1**
REVENUES (percent of GDP)		**-**	**-**	**3.3**	**2.0**
Expenditure approach	***(% GDP)***	***Share***	***Share***	***(% GDP)***	***(% GDP)***
Components exempted					
Private consumption	43.5	10.0	40.0	0.2	0.9
Public consumption	25.1	0.0	40.0	0.0	0.5
Investment	29.1	100.0	100.0	1.5	1.5
Exports of services	4.3	15.0	25.0	0.0	0.1
Subtotal	**101.9**	-	-	**1.7**	**2.9**
REVENUES (percent of GDP)		**-**	**-**	**3.4**	**2.2**

Sources: Kuwaiti authorities, UNCTAD and IMF staff estimates.

1/ Based on 2017 nominal GDP.

2/ Under VAT with no exemptions, there would still be sectors that do not contribute to final VAT collections. These are intermediate inputs, which are usually eligible for refunds and public administration services (e.g., police, defence etc.) provided on non-commercial basis.

3/ As oil export revenues are channeled to the economy through public spending, part of which will be used to consume foreign GDP as imports, VAT should be applied to goods imports as well. VAT on services imports are assumed to be paid at destination, hence are excluded from potential revenues.

4/ These import categories are assumed to be investment goods or intermediate inputs.

Impact on Fiscal Revenues

7. The VAT could yield 2–3 percent of GDP in revenues depending on the use of exemptions. The yield was estimated by applying the 5 percent tax rate on production and expenditure components of GDP using the assumptions in Table 1. For *VAT with no exemptions*, the estimated yield amounts to about 3.3 percent of GDP. The GCC agreement allows countries to exempt or zero-rate several sectors of domestic consumption, such as education, health, real estate, local transport and certain financial services. Under staff's assumptions regarding such exemptions (Table 1), the *VAT with exemptions* could yield 2 percent of GDP in revenues. The results are broadly in line with potential VAT revenues estimated by Mansour *et al.* (2018), who use input-output model of domestic consumption. Staff has used these revenue estimates to assess the VAT's negative impulse on non-oil growth.

Impact on Non-oil Growth

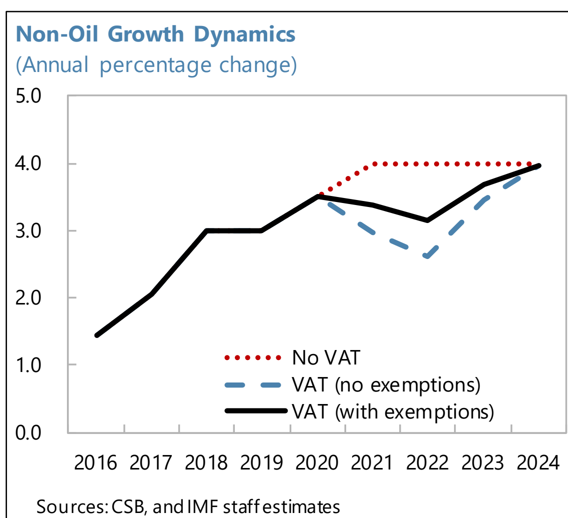
8. Expenditure multipliers were used to assess the impact on growth. Tax multipliers should be used to assess the impact of VAT on non-oil growth. However, estimates of tax multipliers for Kuwait or other GCC countries are not available, as these countries have had no consumption or income taxes on households. Nevertheless, current expenditure multipliers could be used here—the VAT introduction would have a similar effect to public wage cuts as they both work through the economy by reducing consumption. Espinoza and Senhadji (2011) and Cerisola *et al.* (2015) found that current spending multipliers in the GCC ranged between 0.2 and 0.4 in the short term (one year) and were about 0.7 over the medium term (three years). Updated estimates using data through 2015 produced similar results with a current spending multiplier of 0.3 in the short term, and no statistically significant effect beyond one year (IMF, 2016). The analysis in this note uses a short-term multiplier of 0.3 and a long-term multiplier of 0.4.

Table 2. Estimated Fiscal Multipliers for the GCC, 1990-2015 [1]
Impact on Non-oil GDP

	Capital Spending	Current Spending
Espinoza & Senhadji (2011)		
Short-term	0.2 – 0.3	0.2 – 0.4
Medium-term	0.6 – 1.1	0.3 – 0.7
Cerisola et al. (2015)		
Medium-term	1.4	0.7
IMF (2016)		
Multipliers (1990 - 2015)		
Short-term	0.4	0.3
Medium-term	1.6	0.3

Source: Staff estimates.
[1] The fiscal multiplier indicates the amount non-oil GDP would change if government spending changes by one unit.

9. The VAT would have the greatest impact on growth in 2022. In 2022, the first full year of the impact, non-oil growth would be about 0.8 percentage point lower under the *VAT with exemptions* scenario than if no VAT were introduced. If no exemptions were granted, non-oil growth could be down further 0.6 percentage point. The contractionary impact will continue in the third year due to lagged effects. The headwind would dissipate by the fourth year, with non-oil growth returning to its potential 4 percent rate.

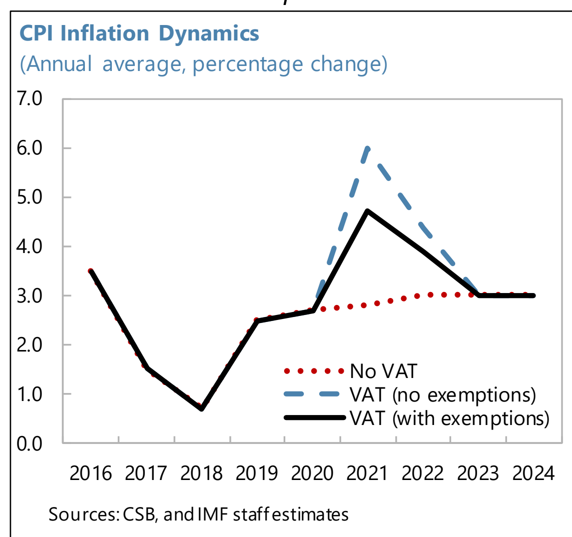


Impact on inflation

10. The VAT's impact on inflation will depend on supply and demand elasticities and the extent of exemptions. In competitive markets, firms have a difficult time passing cost increases to consumers and may be forced to absorb them. Conversely, in imperfectly competitive markets, firms may be able to pass on cost hikes to consumers (Benedek *et.al.*, 2015). Consumers' reaction to higher prices would also determine the pass-through. Estimates of price elasticities of supply and demand are not available for Kuwait. Staff has assumed a full pass-through given that Kuwait is a price taker in international markets and local product markets are, for the most part, imperfectly

competitive. The inflationary impact of the VAT has been estimated by shocking the affected components of the CPI basket with the 5 percent tax rate in April 2021. In the *VAT with no exemptions* scenario, all CPI basket items are assumed to be impacted. For the *VAT with exemptions* scenario, goods and services assumed to be exempted from the tax account for about 36 percent of the basket.

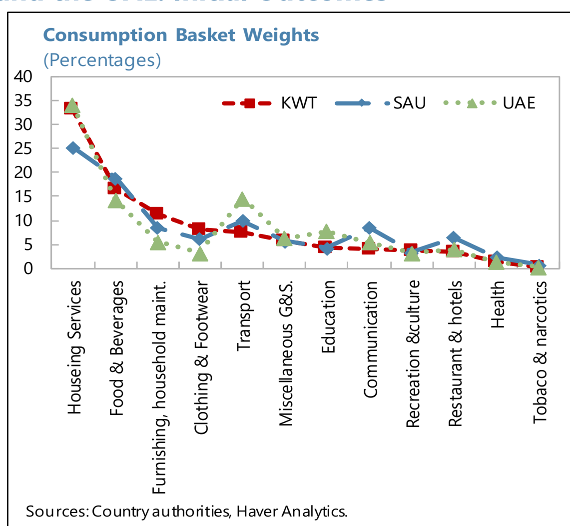
11. Inflation would rise in the first year of the VAT introduction. Prices could jump by 5 percent in the month the VAT is introduced under the *VAT with no exemptions* scenario and 3.3 percent under the *VAT with exemptions* scenario. Under the former, average inflation could rise to 6 percent in 2020, while it could reach 4.7 percent under the latter. These estimates contrast with staff's projection of 2.5 percent average inflation had there been no VAT reform. These annual average estimates are higher than what has been observed in Saudi Arabia and the UAE—2½ and 3 percent respectively—mainly due to higher projected underlying inflation of 2½ percent in Kuwait at the time of VAT reform (Box 1). Base effects from the year of VAT introduction will keep inflation in the second year higher than under the no VAT scenario.



12. The inflationary impact should fully dissipate by the third year. Three factors will contribute to this. First, once the one-off effects of the VAT disappear, prices for imported goods and services, which make up a large part of the CPI basket, would be expected to follow international levels. Second, the contractionary effects of the VAT will weigh on aggregate demand, dampening persistence in inflation. Finally, the credible exchange rate peg will anchor inflation expectations. In an unlikely event of persistently high inflation after the VAT introduction, the Central Bank of Kuwait could tighten the monetary policy stance to stave off the second-round effects. The dinar's peg to a basket of currencies (as opposed to a hard peg) provides a degree of monetary policy flexibility.

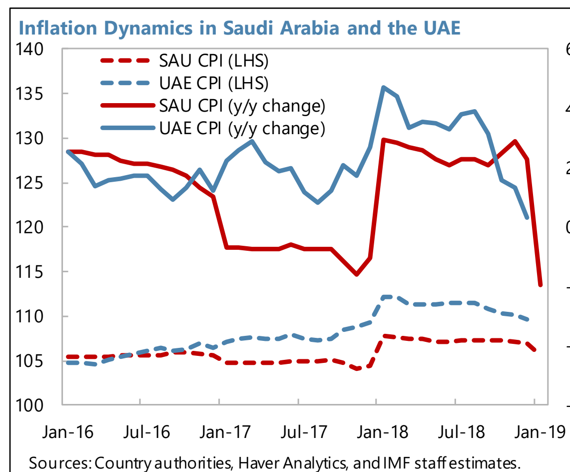
Box 1. The VAT in Saudi Arabia and the UAE: Initial Outcomes

Saudi Arabia and the UAE introduced the GCC-wide VAT in January 2018. While it is still early to assess its impact on non-oil activity, the inflationary and revenue impacts could be analyzed to draw lessons for Kuwait. Inflation dynamics in Kuwait following the VAT introduction would be expected to mimic that of Saudi Arabia and the UAE given similar CPI baskets and the structure of economies. Revenue yields can also be comparable depending on the extent of exemptions.



Sources: Country authorities, Haver Analytics.

Consumer prices in Saudi Arabia jumped by 3½ percent when the VAT was introduced. As a result, yoy inflation rose to 3 percent in January 2018 from -1 in December 2017. However, not all of the price increase can be attributed to the VAT given that energy prices were raised (as part of subsidy reforms) in the same month. Since then, inflation gradually fell through 2018, reaching -1.9 percent in January 2019.



Sources: Country authorities, Haver Analytics, and IMF staff estimates.

Consumer prices rose by 2.6 percent in the UAE with the introduction of the VAT. Yoy inflation reached 4.7 percent in January 2018, up from 2.7 percent in December 2017. It has trended downwards since, falling to 0.3 percent in December 2018, suggesting that the inflationary impact may have dissipated.

Staff expects Saudi Arabia and the UAE to collect about 1¾-2 percent of GDP in VAT. Both countries are expected to raise about 1½ percent of GDP in revenues in 2018, but the VAT yield is expected to increase as tax administration improves over the medium term.

C. Policy Conclusions

13. The VAT would bring important benefits for Kuwait, while its costs will be moderate and short-lived. It will promote revenue diversification, contribute to fiscal adjustment, and strengthen tax administration and overall policy-making. While there are contractionary and inflationary costs, this note shows that they will be moderate and temporary.

14. Further delays in VAT introduction could become costly for Kuwait. Key stakeholders should therefore intensify consultations to overcome the current impasse over the VAT. In the meantime, technical preparations for the eventual introduction of the VAT and excises should continue, most importantly, building administrative capacity and laying out the communications strategy, both with the public and businesses. Delays in the VAT (and excises) reform would put Kuwait at the risk of falling behind its fellow GCC members. Finally, it is important to reassess and, strengthen as needed, social assistance programs to mitigate the negative impact of the VAT on the most vulnerable groups.

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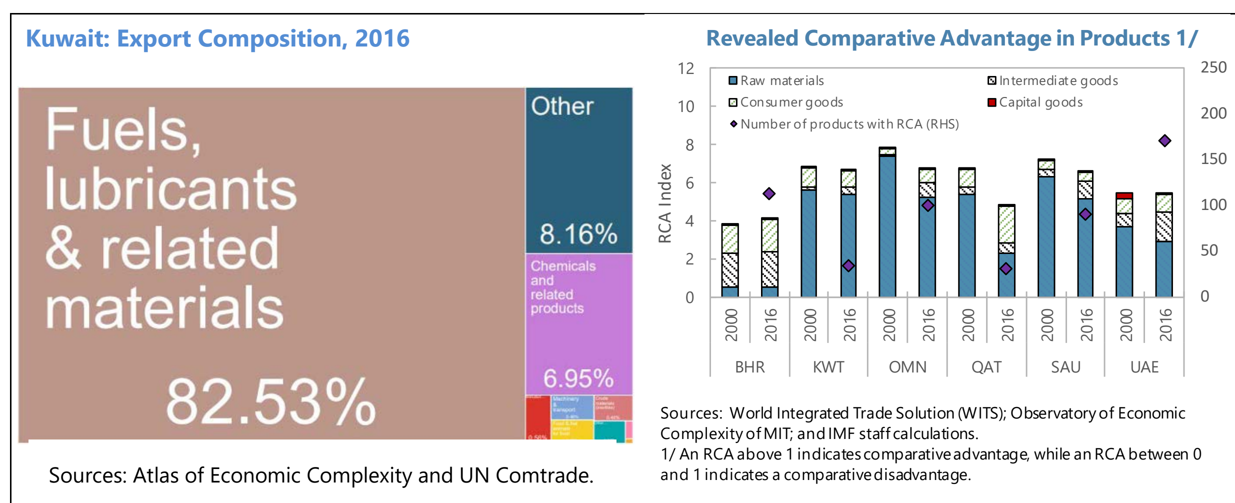
Annex VII. Exports and FDI as Engines of Growth and Diversification[1]

A. Introduction

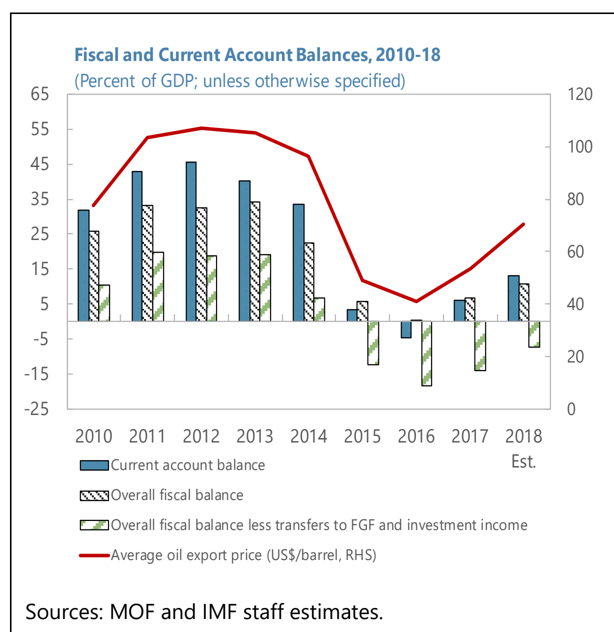
1. Kuwait remains a heavily resource-based economy. Its exports are concentrated in hydrocarbons and related products (83 percent), reflecting large oil reserves. Furthermore, while some other GCC countries are moving toward producing intermediate goods, Kuwait continues to primarily rely on exports of raw materials, with little value added beyond extraction.



Sources: Atlas of Economic Complexity and UN Comtrade.

Sources: World Integrated Trade Solution (WITS); Observatory of Economic Complexity of MIT; and IMF staff calculations.
1/ An RCA above 1 indicates comparative advantage, while an RCA between 0 and 1 indicates a comparative disadvantage.

2. The 2014 oil price shock heightened the need to diversify the economy. While Kuwait's large financial assets help cushion the economy, the high susceptibility of fiscal and external accounts to oil price fluctuations, as demonstrated in 2014–16, calls for greater efforts to reduce oil dependence. This is also necessitated by the need to create private sector jobs for a large number of labor force entrants over the next decade. To address these challenges, the authorities' Vision 2035 envisages transforming Kuwait from a public sector- and oil-driven economy to a more diversified private sector-driven economy with jobs for nationals.



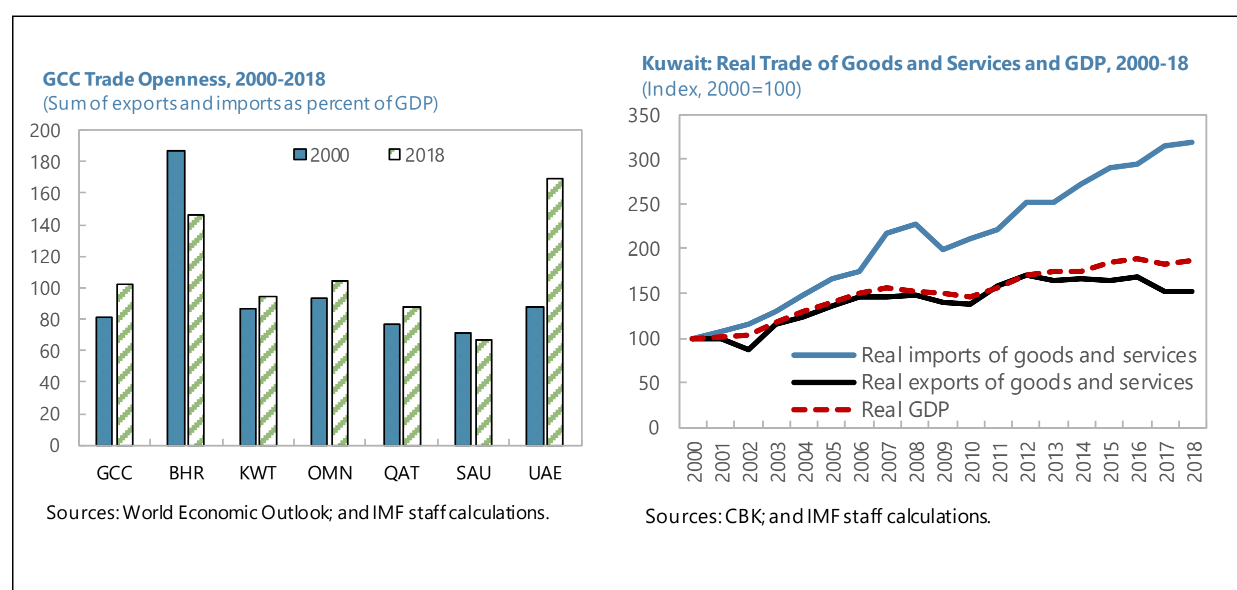
Sources: MOF and IMF staff estimates.

[1] Prepared by Anastasia Guscina and Botir Baltabaev, drawing on a paper prepared by IMF staff "Trade and Foreign Investment—Keys to Diversification and Growth in the GCC."

3. We find that Kuwait has ample potential to boost non-oil exports and FDI inflows. To that end, reforms should focus on making the operating environment more enabling to non-oil exports and FDI, including by easing non-tariff trade and foreign ownership restrictions, aligning public sector wages with labor productivity, and further improving the quality of education and infrastructure.

B. Recent Trends in Trade and FDI

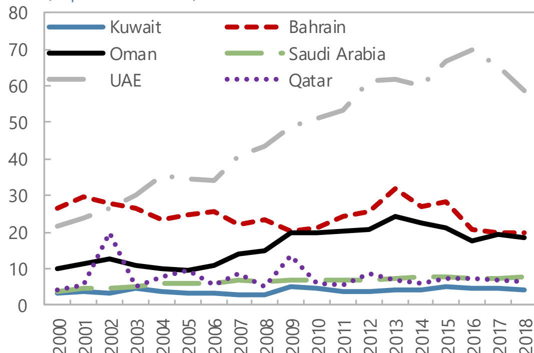
4. Kuwait is actively engaged in trade which has expanded steadily. The ratio of exports and imports of goods and services to GDP exceeded 95 percent in 2018, well above the 50 percent average in emerging economies. This largely stems from Kuwait's oil output, which is mostly exported, and the lack of non-oil production, necessitating imports. Over the past two decades, the volume of goods and services trade grew at an average annual rate of 5.1 percent, higher than the real GDP growth rate of 4.1 percent.



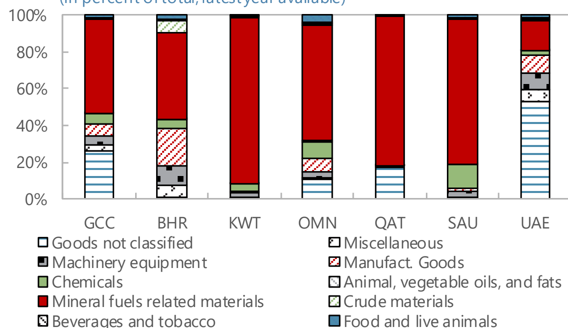
5. Kuwait's non-oil exports of goods and services are low compared to GCC peers (Figure 1). With non-oil exports flat as percent of GDP over the past two decades, Kuwait's exports remain among the least diversified in the GCC—its non-oil exports amounted to 4.5 percent of GDP and 9 percent of total exports in 2017. Exports of services (particularly communication) expanded rapidly in 2002-09 but dwindled after the global financial crisis, even as imports of services (mostly travel and transportation) continued to expand. The value-added and product diversification of exports remain relatively low. Export quality, a proxy for the value added and estimated based on unit value of exports, is low compared to EM and regional averages. Herfindahl-Hirschmann Index (HHI), which measures the degree of product concentration, shows that Kuwait's exports are highly concentrated, while exports of other GCC countries are somewhat more homogeneously distributed among products.

Figure 1. Kuwait: Recent Trends in Trade

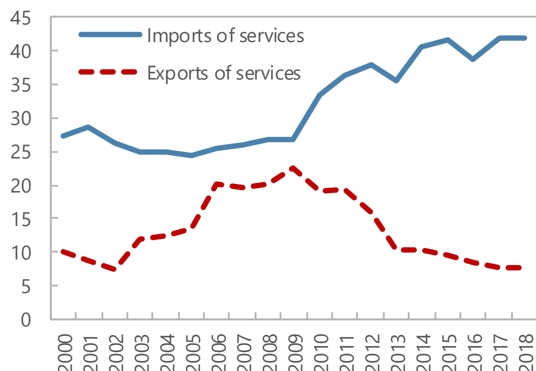
GCC Non-hydrocarbon Exports, 2000-18
(In percent of GDP)



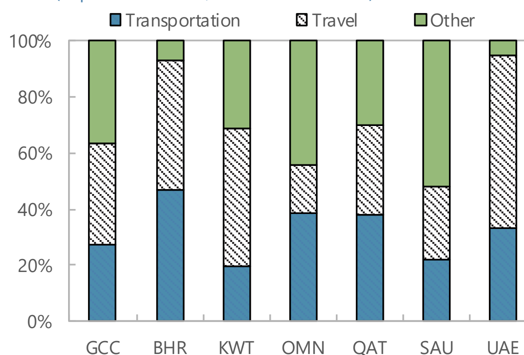
GCC Exports of Goods
(In percent of total, latest year available)



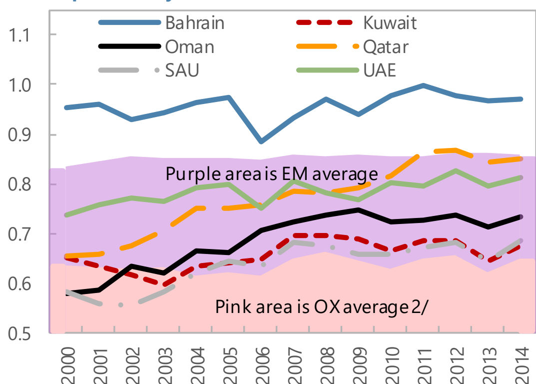
Kuwait Exports and Imports of Services, 2000-18
(In percent of non-oil GDP)



GCC Imports of Services
(In percent of total, latest data available)

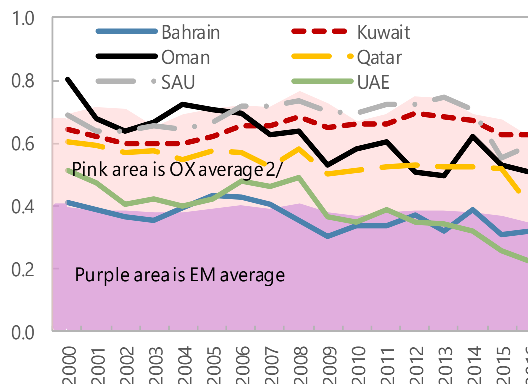


Export Quality, 2000-2014 1/



Sources: IMF, Export Diversification and Quality Dataset; national authorities.
1/ Higher index indicates higher export quality.
2/ Oil exporter include Algeria, Angola, Azerbaijan, Chad, Republic of Congo, Ecuador, Equatorial Guinea, Gabo, Iran, Iraq, Kazakhstan, Nigeria, and Russia.

GCC Export Concentration Index, 2000-2016 1/

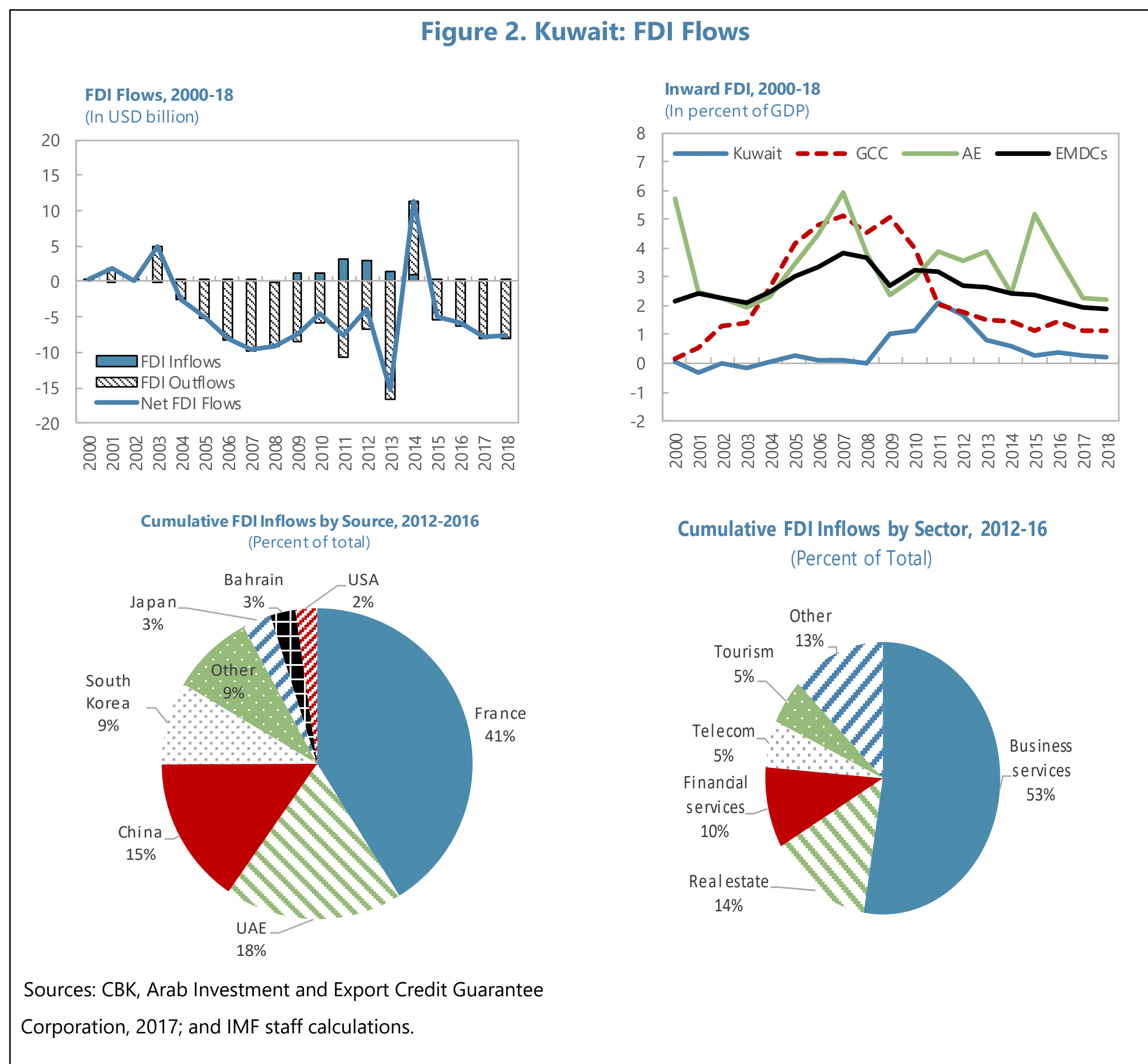


Sources: UNCTAD.
1/ Lower index indicates lower concentration and higher diversification.
2/ Oil exporters (OX) comparator sample is driven by data availability and indudes Azerbaijan, Brunei Darussalam, Iran, Iraq, Kazakhstan, Democratic Republic of Timor-Leste, Turkmenistan, and Yemen.

Sources: CBK, and IMF staff calculations.

6. Kuwait is a net investor in the rest of the world (Figure 2). As a capital abundant country that invests part of its large oil revenues abroad, Kuwait does not need foreign investment for capital augmentation. It would benefit greatly though through other channels, as FDI would facilitate technology, knowledge, and business practices transfer, increase market competition, and enhance productivity. Except for a short-lived surge in 2009-12, fueled primarily by foreign acquisitions in the telecommunications sector, inward FDI has been low. FDI inflows are also heavily concentrated in certain sectors, with business services accounting for more than a half of total inflows.

Figure 2. Kuwait: FDI Flows



Sources: CBK, Arab Investment and Export Credit Guarantee Corporation, 2017; and IMF staff calculations.

C. Trade and Investment Environment

7. Kuwait trails its peers on enabling trade in part due to high non-tariff barriers, (Table 1). Kuwait has free trade with other members of the GCC customs union. However, intra-regional trade remains low due to the lack of complementarities between countries with similar economic structures. While GCC common external tariffs are low, non-tariff restrictions are

prevalent in Kuwait. The World Economic Forum's (WEF) 2017 Global Competitiveness Index places Kuwait among countries that maintain restrictive non-tariff trade barriers. In particular, the WEF's Global Enabling Trade Report, which scores 136 countries in terms of market access, border administration, infrastructure, and operating environment, ranks Kuwait in the bottom 25th percentile. Time and cost to import and export (documentary and border compliance), predictability of procedures, openness to foreign participation, and quality of infrastructure are areas where Kuwait falls behind regional and global comparators.

8. Kuwait took steps to lower regulatory impediments to FDI, but some restrictions remain. Under the new FDI law, the government has established a "one-stop shop" to streamline registration and licensing procedures for foreign investors. The new FDI law allows for tax and customs duties relief, land and real estate allocations, and permission to recruit foreign labor. To attract FDI, Kuwait has also established special economic zones (SEZ), which offer independent, more liberal regulations and developed infrastructure. However, openness to foreign investment outside SEZs remains low compared to peers, mainly due to restrictions on foreign ownership and onerous licensing and registration requirements. Businesses also point to prohibition of land ownership by non-GCC citizens among the impediments to FDI.

9. Improved governance and rule of law would make Kuwait more attractive to FDI. Foreign investors need assurance that the law would be enforced in a consistent, timely, and nondiscriminatory manner and that dispute settlement mechanisms and good corporate governance practices are in place. Inconsistent interpretation and arbitrary application of rules may create opportunities for corruption and act as an impediment for trade and FDI. While Kuwait has signed treaties that protect rights of foreign investors, regulatory ambiguities[2] can give rise to discretion, which could discourage entry by foreign firms (Heuser and Mattoo, 2017). Reforms should also focus on modernizing the legal system, as courts are perceived as slow, and the arbitration and mediation mechanisms, which could reduce the load for courts, are not well utilized. Finally, better corporate governance would help allay investors' concern about the lack of an independent board, insufficient oversight and scrutiny of key enterprise risks, and weak transparency and disclosure practices (S&P Global, 2017).

[2] For example, the licensing requirements are not predefined.

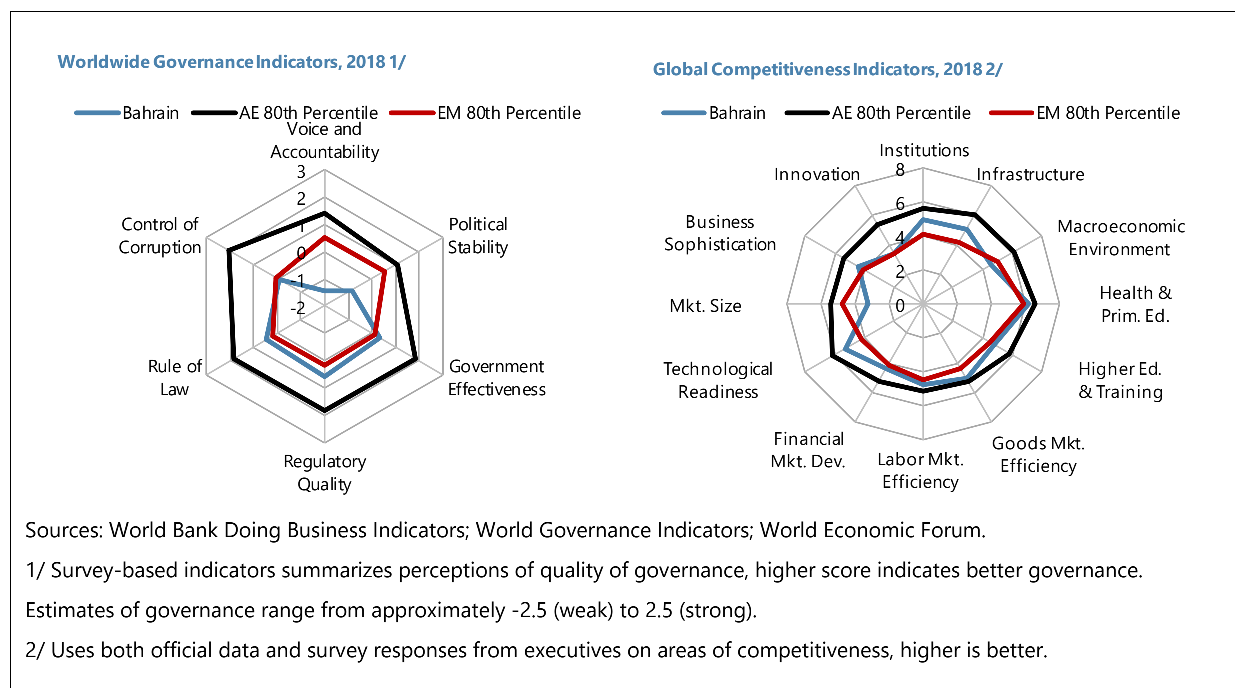
Table 1. Kuwait: Enabling Trade Index and Subcomponents, 2016 1/

(Highest performing and lowest performing 25th percentiles are marked in green and red, respectively)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Overall rank (out of 136):	**42**	**115**	**46**	**43**	**67**	**23**
Domestic market access:	**59**	**66**	**25**	**71**	**81**	**70**
Tariff rate (%)	4	4	4	4	4	4
Tariff rate ranking	52	54	60	55	58	56
Share of duty free imports (%)	42	39	60	34	27	36
Foreign market access:	**109**	**132**	**118**	**134**	**125**	**131**
Tariff rate faced (%)	5	5	5	5	5	5
Tariff rate ranking	116	125	118	126	131	**129**
Border administration ranking:	**58**	**90**	**48**	**46**	**83**	**25**
Customs services index	56	64	77	87	63	2
Efficiency in clearance process	41	56	62	21	69	12
Time to import (documentary)	101	107	63	89	112	58
Time to import (border compliance)	72	123	81	99	126	72
Cost to import (documentary)	81	114	31	129	119	111
Cost to import (border compliance)	80	108	69	119	121	116
Time to export (documentary)	68	81	67	57	113	51
Time to export (border compliance)	99	101	83	60	96	58
Cost to export (documentary)	113	109	85	96	82	104
Cost to export (border compliance)	18	118	54	90	59	102
Irregular payments and bribes	26	77	37	12	32	6
Time predictability of import procedures	36	107	52	22	58	6
Customs transparency index	109	66	39	66	96	66
Infrastructure ranking:	**34**	**56**	**41**	**23**	**36**	**6**
Availability and quality of transport infrastructure	40	71	32	25	31	2
Availability and quality of transport services	36	65	50	24	47	13
Availability and use of ICTs	22	42	54	29	40	19
Operating environment ranking:	**23**	**68**	**30**	**10**	**39**	**9**
Protection of property	30	76	31	19	32	22
Efficiency and accountability of government	23	71	33	11	29	2
Access to finance	23	46	33	8	44	17
Openness to foreign participation	13	123	89	52	117	30
Physical security	52	47	6	10	57	2

Sources: World Economic Forum, The Global Enabling Trade Report, 2016; and IMF staff calculations.

1/ The World's Economic Forum's "Enabling Trade Index" assesses the extent to which 136 countries have in place institutions, policies, infrastructures, and services facilitating the flow of goods over border and to their destination. These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints, and information availability. They may also not reflect more recent important structural transformations.



Sources: World Bank Doing Business Indicators; World Governance Indicators; World Economic Forum.

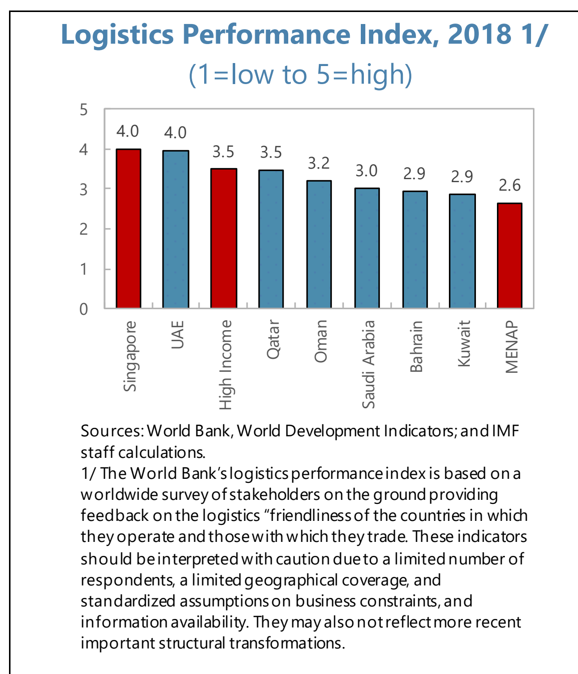
1/ Survey-based indicators summarizes perceptions of quality of governance, higher score indicates better governance. Estimates of governance range from approximately -2.5 (weak) to 2.5 (strong).

2/ Uses both official data and survey responses from executives on areas of competitiveness, higher is better.

10. Reforms to promote competition, including in sectors dominated by public entities, would encourage private investment. Kuwait has passed a competition law and established a Competition Protection Bureau to safeguard free commerce, bar monopolies, and supervise mergers and acquisitions. A subcomponent of the World Bank's regulatory quality index shows however that market competition is weak in Kuwait, pointing to implementation and enforcement issues (Casoria 2017, Dabbah 2007, and Daudpota 2015). The law does not apply to the government or government-controlled entities, which given their dominance in the economy and coupled with procurement practices that give preferential treatment to local suppliers, could create an uneven playing field for foreign companies. Reform efforts should therefore focus on promoting competition, improving transparency in government decisions, and reducing the size of the public sector. Kuwait is trying to address the latter through privatization.[3]

[3] In 2016, the government announced that nearly 60 percent of public sector companies are earmarked for privatization and allowed the private sector to acquire shares of up to $9 billion.

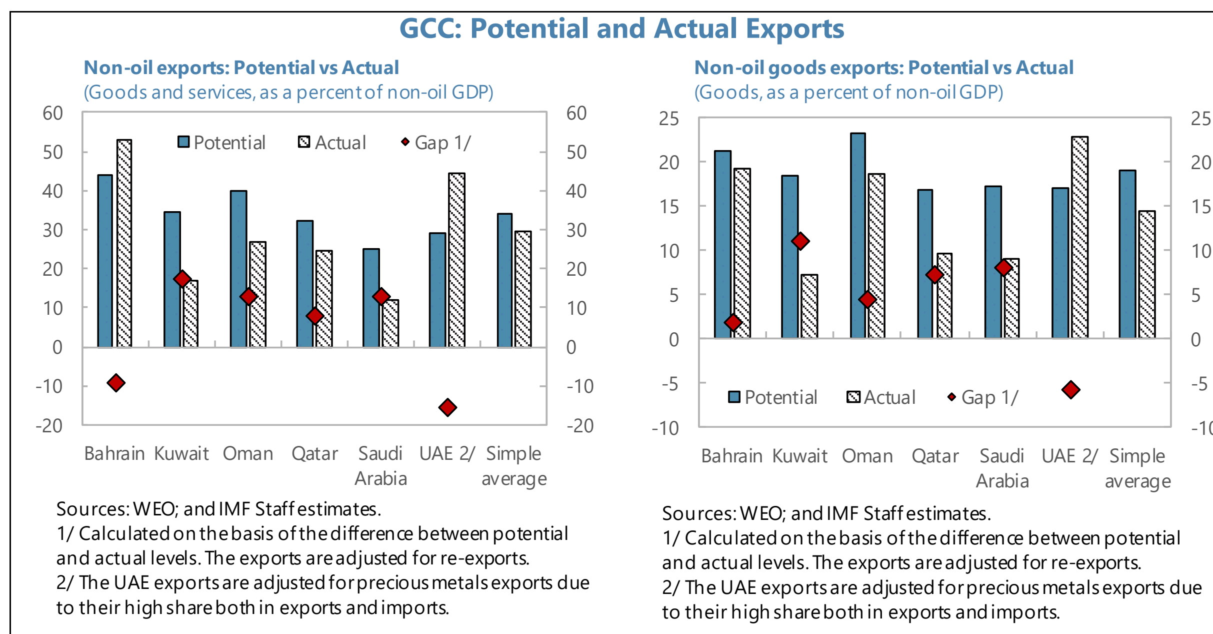
11. Adequate infrastructure and skilled workforce are essential for an enabling trade and investment environment. Kuwait lags other GCC countries in the World Bank's Logistics Performance Index (LPI)—a composite of country's scores on six dimensions: customs, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness. As the empirical analysis in Section D shows, human capital is a key determinant of export performance and FDI. Faced with pressures to provide employment for new job seekers among nationals, Kuwait has tightened regulations for hiring of foreign nationals, especially for high-skilled jobs. While the desire for Kuwaitization of the labor force is understandable, these restrictions could discourage FDI, ultimately hurting authorities' efforts to create jobs for nationals.



Sources: World Bank, World Development Indicators; and IMF staff calculations.
1/ The World Bank's logistics performance index is based on a worldwide survey of stakeholders on the ground providing feedback on the logistics "friendliness of the countries in which they operate and those with which they trade. These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints, and information availability. They may also not reflect more recent important structural transformations.

D. Quantifying Potential Non-Oil Exports and FDI

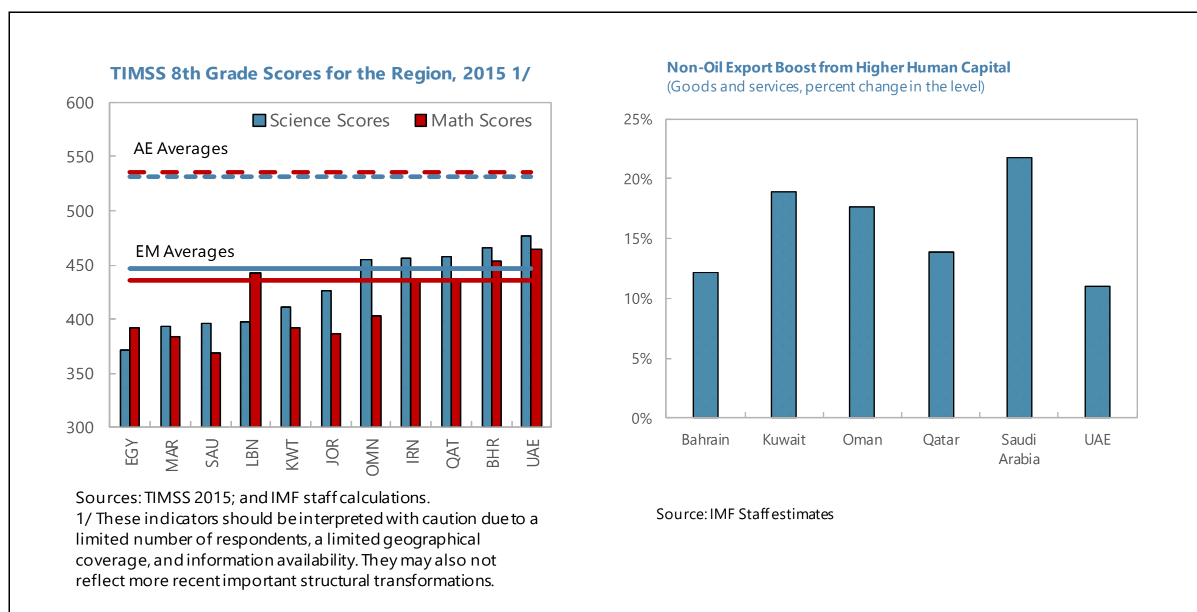
12. Our analysis points to a large potential to boost Kuwait's non-oil exports. Using a sample of non-commodity exporters and the coefficients from the regression identifying determinants of country exports (IMF, 2018b; Rahman *et al.*, 2015), we estimated Kuwait's potential non-oil exports given its economic and institutional fundamentals, such as country size, income level, human capital, macroeconomic stability, the real effective exchange rate (REER), trade openness, and infrastructure. We found that Kuwait has one of the largest non-oil exports gaps in the GCC.



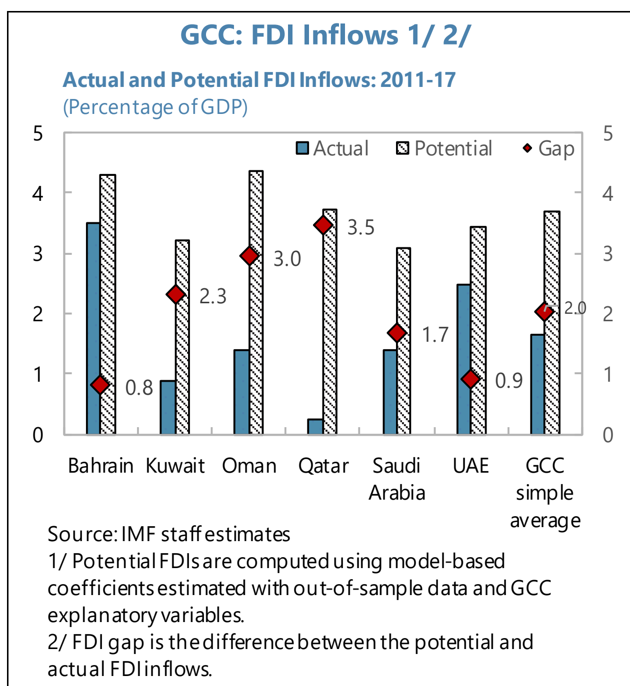
Sources: WEO; and IMF Staff estimates.
1/ Calculated on the basis of the difference between potential and actual levels. The exports are adjusted for re-exports.
2/ The UAE exports are adjusted for precious metals exports due to their high share both in exports and imports.

Sources: WEO; and IMF Staff estimates.
1/ Calculated on the basis of the difference between potential and actual levels. The exports are adjusted for re-exports.
2/ The UAE exports are adjusted for precious metals exports due to their high share both in exports and imports.

13. Labor market and education reforms could boost Kuwait's non-oil export potential. The regression results suggest that nonoil-exports would rise in response to competitiveness gains and improvements in human capital. In a fixed exchange rate regime, competitiveness gains can be achieved by lowering unit labor costs. In Kuwait's context, containing relatively high wages, which are partly driven by generous public-private wage premia, would be one obvious solution (IMF, 2017). Over the longer term, equipping the new generation of workers with knowledge and skills to master modern technologies would help Kuwait move up to higher value-added goods and services. Education reform will be critical, as Kuwait lags AEs in outcomes, especially in STEM education (IMF, 2017), despite significant spending.



14. Empirical results show that Kuwait could attract more FDI than currently. An empirical study of FDI determinants found that trade openness (the ratio of total trade to GDP), growth, quality of legal systems, and human capital have positive and statistically significant impact on FDI inflows in non-commodity exporters (IMF, 2018b; Walsh *et al.*, 2010). Using the regression coefficients from that study, we estimate Kuwait's FDI gap at 2.3 percent of GDP in 2017. The results suggest that improving the investment climate and labor markets would be among the most effective ways to boost FDI. For example, further removing restrictions on FDI and



upgrading the legal environment and education to the advanced economy average would increase Kuwait's FDI potential by 0.3 percentage point of GDP.

E. Conclusion

15. A diversified economy would reduce Kuwait's exposure to volatile oil revenues and help create private sector jobs. FDI can play in instrumental role in boosting Kuwait's non-oil exports by facilitating access to foreign markets, bringing modern management practices and technical know-how, enhancing market competition, and augmenting worker skills.

16. To realize Kuwait's non-oil export and FDI potential, the authorities should prioritize:

- *Investing in human capital,* including by reforming the education system so that it can equip Kuwaitis with knowledge and skills demanded in the global economy;
- *Implementing labor market reforms* to reduce unit labor costs and strengthen competitiveness;
- *Further enhancing the legal framework* to increase predictability and protection, including for minority investors, provide dispute prevention and resolution mechanisms, and strengthen public governance;
- *Improving the business climate*, including by easing foreign ownership restrictions; enhancing corporate governance; lowering restrictions on foreign workers;
- *Reducing non-tariff barriers to trade and trade costs*, including by streamlining and automating border procedures;
- *Reducing the role of the public sector in the economy* and raising the efficiency of public investment.

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INTERNATIONAL MONETARY FUND

KUWAIT

March 11, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Middle East and Central Asia Department with inputs from other departments and the World Bank

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FUND RELATIONS

(As of January 31, 2019)

https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberKey1=560&date1key=2099-12-31

Kuwait has made a contribution to the PRGF-HIPC Trust in support of Fund's concessional assistance to low-income countries. This includes an interest-free deposit of SDR 4.2 million maturing in 2024 and a grant contribution of SDR 0.1 million to the PRGF-HIPC Trust.

Exchange Rate Arrangement:

Since May 2007, Kuwait's exchange rate arrangement has been a conventional peg against an undisclosed currency basket. Kuwait has accepted the obligations of Article VIII, Sections 2 (a), 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than those notified to the Fund pursuant to Decision 144-(52/51). On April 2, 2002, Kuwait notified the Fund, under Decision 144-(52/51), of exchange restrictions it introduced to implement UN Security Council resolutions 1373 (2001), 1333 (2000) and 1267 (1999).

Article IV Consultations:

The last Article IV consultation was completed on January 12, 2018 (Country report 18/21—Published January 26, 2018). The staff report is available at https://www.imf.org/en/Publications/CR/Issues/2018/01/29/Kuwait-2017-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-45592

FSAP Participation

Last FSAP Update was conducted in March 2010. It included an updated assessment of a selected number of Basel Core Principles. An FSSA report was discussed by the Executive Board along with the staff report for the 2010 Article IV consultation and it is available at: http://www.imf.org/external/pubs/cat/longres.aspx?sk=24096.0.

The current FSAP mission took place in April-May 2018, and the FSSA report will be considered by the Executive Board along with the staff report for the 2019 Article IV consultation. The FSAP focused on financial sector oversight, including banking supervision, financial safety nets, and systemic risk and liquidity. It also covered capital markets development and supervision and SME access to finance.

Technical Assistance since 2014:

LEG	Central Bank Law	January 2014
FAD	Tax Policy and Administration	February 2014
MCM	Macroprudential Policy	March 2014
FAD	Fiscal Rule	February 2015
STA	National Accounts Statistics	March 2015
MCM	Deposit Insurance System	September 2015
FAD	Tax Policy and Administration	September 2015
LEG	AML/CFT ongoing TA project	May 2012–16
FAD	Establishing a Debt Management Office	November 2015
FAD	Debt Management Strategy	January 2016
MCM	Bank Stress Testing	May-June 2016
FAD	Macro-Fiscal Unit	November 2016
MCM	Crisis Management and Resolution	April-May 2017
FAD	Macro-Fiscal Unit	May 2017
STA	Government Finance Statistics	April-May 2018
STA	Government Finance Statistics	September-October 2018
LEG	AML/CFT Diagnostic	October 2018
FAD	Tax Policy and Administration	October-November 2018
STA	National Accounts Statistics	January 2019
MCM	Monetary Policy Operations	February 2019

Resident Representative: None

Kuwait has consented to the quota increase under the Fourteenth General Review of Quotas.

RELATIONS WITH THE WORLD BANK

(As of January 16, 2019)

The World Bank and the Government of Kuwait developed a rolling four-year Country Partnership Strategy (CPS), which leverages the setup of a World Bank Country Office in Kuwait (inaugurated in January 2009). The Kuwait program emphasizes implementation of reforms. Hence all activities are grounded in the Government's five-year plan and are developed closely with the line ministry/agency as well as with the Ministry of Finance, which plays the role of a coordinator and key Bank counterpart. The current Reimbursable Advisory Services (RAS) program is structured around the following four strategic themes under the latest 2016–20 Country Partnership Strategy:

(i) ***Public sector performance and citizen accountability -*** Bank support in this area aims at ensuring that public services are delivered transparently, efficiently, and effectively and that citizen accountability is enhanced. Key activities under this pillar include Bank support of a public expenditure and financial accountability (PEFA) project and an engagement to support the development of a guidebook for public private partnerships. Other pipeline engagements focus on Public Expenditure Review (PER), support to the State Audit Bureau as well as Public Financial Management (PFM). The latter is designed as a programmatic multi-year engagement to improve the quality of fiscal policies and the system of procedures governing public financial management in the country.

(ii) ***Private sector development -*** Aims to support reform efforts geared towards transforming Kuwait into a trade and financial hub with diversified economic activities and the creation of a more conducive business environment for private sector development and foreign direct investment. Bank activities under this theme include: enhancing the institutional effectiveness of the Competition Protection Authority, improving the business environment and analysis of Kuwait's trade outcomes in terms of diversification opportunities. Upcoming work for the Kuwait Direct Investment Promotion Authority includes investment road map and diversification opportunities.

(iii) ***Human development -*** major program to enhance the quality of education as well as support in social protection, labor, and health. The education program is the flagship program and has evolved into a $35 million multi-year strategic partnership between the Bank and the Ministry of Education in support of education reforms with emphasis on improving the quality of teaching and learning in schools. The Bank also is also planning a strategic engagement with the General Secretariat of the Supreme Council for Planning and Development on labor market reforms.

(iv) ***Infrastructure Development and Urban Management -*** aims to make significant improvements in Kuwait's infrastructure and urban management sectors, including land management and the environment. Current engagements include a multi-year land management modernization project with the Ministry of Finance and the State Property Sector, a disaster risk management project with the Kuwait Institute for Scientific Research, and solid waste management and planning with Kuwait Municipality.

Ongoing Activities for FY17 and Beyond

Counterpart Agency – Basic Activity Data	Activity Description
I. PUBLIC SECTOR PERFORMANCE & CITIZEN ACCOUNTABILITY	
Ministry of Finance PEFA Capacity Building and PFM Reforms (P157053)	The Bank is providing further support on the PEFA framework and in light of the revisions undergone to PEFA.
Ministry of Finance Kuwait National ML/TF Risk Assessment (P159136)	The aim of this one-year project is to assist Kuwait's efforts to enhance the capacity of relevant AML/CFT Kuwaiti agencies in carrying out an assessment of money laundering and terrorism financing (ML/TF) risks and developing risk-based action plans to mitigate these risks, through the Bank's National Money Laundering / Terrorist Financing Risk Assessment (NRA) tool.
II. PRIVATE SECTOR DEVELOPMENT	
Kuwait Direct Investment Promotion Authority Doing Business Reform (P155328)	In response to a continuing decline in ranking in the Doing Business Report, the Kuwait Direct Investment Promotion Authority (KDIPA) requested the World Bank Group's support on government-led measures to improve the country's business environment in areas measured by the World Bank's Doing Business Report. Their approach to the World Bank was motivated by the Kuwaiti government's own moves towards creating a more open, business-friendly and transparent environment for foreign and local firms to operate. KDIPA led a series of workshops with the support of the World Bank Doing Business team to provide members of the Doing Business committee (Permanent Committee for Streamlining the Business Environment) the opportunity to better understand the Doing Business indicators, methodology and recommendations for reforms in areas measured by Doing Business
Kuwait Competition Protection Agency Phase II: Implementation of Competition Program in Kuwait (P162614)	The goal of the Phase II Implementation is to have, by the end of the program, a fully functional, efficient, and effective Competition Protection Authority capable of carrying out its mandate and able to foster better functioning markets, productivity of firms, better services and prices for consumers, and an overall increase in private sector competitiveness. The four components include: (i) Designing and implementing a model competition framework; (ii) Embedding pro-competition principles in key sectors of the economy; (iii) Fostering agency effectiveness for the CPA; and (iv) Operational Setup, Automation and IT architecture.
III. HUMAN DEVELOPMENT	
Ministry of Education School Education Quality Improvement (SEQI) – Phase II (P154848)	This engagement is the flagship project of the Kuwait Country Program and builds on the earlier success of the School Education Quality Improvement (SEQI 1) Technical Cooperation Program, designed to support the Ministry of Education and the National Center for Education Development in the implementation of a comprehensive education reform program. The current engagement consists of five main components: (i) curriculum development and enhancement; (ii) effective teaching; (iii) school effectiveness; (iv) system accountability and effectiveness and (v) education policy, decision-making and implementation support.

Counterpart Agency – Basic Activity Data	Activity Description
IV. INFRASTRUCTURE AND URBAN MANAGEMENT	
Ministry of Finance Program for Modernization of Land Management in Kuwait (P151988)	This engagement builds on an earlier diagnostics phase which supported the State of Kuwait in developing a strategic understanding of the institutional and regulatory issues related to state land policy management. The current multi-year engagement on modernizing land administration builds on the work of this earlier phase and received formal approval from the Ministry of Finance in the third quarter of FY16. The engagement seeks to modernize the land management system in the country.
Municipality of Kuwait Solid Waste II (P122085)	This current engagement with the Kuwait Municipality related to solid waste focuses on: (i) the preparation and the implementation of a national priority project for the closure and rehabilitation of existing dumpsites, (ii) the elaboration and adoption of a solid waste master plan consistent with the Kuwait Land-Use Master Plan, (iii) the completion and harmonization of existing legal instruments, starting with a Solid Waste Law, and (iv) the establishment of a Municipal Solid Waste Agency.
Kuwait Authority for Partnership Projects Public-Private Partnerships Project Guidebook (P157147)	This reengagement with Kuwait Authority for Partnership Projects (KAPP) came about after the PPP law (law 116/2014) and Executive Regulations were passed early 2015. KAPP requested the Bank's urgent support on revising the PPP Project Guidebook that was previously prepared by Aijaz and Paul Noumba in 2009. Overall, the one-year engagement covers 3 main components (i) inception report – comprehensive review of the new PPP law, (ii) revised guidebook, and (iii) consultation and dissemination of the revised guidebook.

STATISTICAL ISSUES

(As of February 22, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Despite improvements in the current year, there is scope to enhance the compilation of the national accounts and balance of payments statistics, including through better coordination and data-sharing among government agencies. Timeliness, particularly for the national and fiscal accounts, remains an area of concern.
National Accounts and Production: Kuwait's national accounts are compiled by the Central Statistical Bureau (CSB). A number of areas could be improved based on international best practice, as suggested below. Annual GDP estimates are derived from regular annual surveys by five major industries: agriculture, manufacturing, construction, trade, and financial services. However, the list of establishments in the business register is outdated as it is based on the 2000 establishment census. The authorities are encouraged to conduct a new establishment census and implement a contemporary benchmark to rebase the GDP time-series to ensure structural changes in Kuwait's economy are reflected in published estimates. A joint IMF-Arab Monetary Fund technical assistance mission in January 2019 reviewed the compilation of annual national accounts estimates, including financial intermediation, and assisted the CSB in preparation of a detailed action plan to further enhance national accounts statistics. The mission recommended: i) strengthening coordination and data exchange between the CSB and the Central Bank of Kuwait; ii) improving GDP estimates for holding companies; and iii) including non-observed economic activities in GDP. **Price statistics:** The Consumer Price Index (CPI) is published monthly (last observation for October 2018). The weights were revised in June 2017 based on the 2013 Household Income and Expenditure Survey. The Producer Price Index (PPI) covers selected Mining and Quarrying and Manufacturing industries as well as Utilities. The PPI should be further developed by updating the weights from the 2010 base year, by extending coverage to include services and construction and by compiling separate indexes for the domestic and export markets. Improvements in these dimensions are under consideration in coordination with other GCC countries. **Government finance statistics:** Kuwait reclassified the budget according to the *Government Finance Statistics Manual* 2001 (GFSM 2001) starting fiscal year 2016-17. IMF Statistics Department (STA) TA missions assisted the Ministry of Finance (MoF) in updating the classification according to the GFSM 2014 and compiling annual GFS data for Budgetary Central Government according to the international standards. TA missions stressed the need for intra-annual data for a better follow-up on the execution of the budget to enhance the monitoring of fiscal developments during the year. The major components of extra-budgetary revenues (investment income and transfers of profits of public institutions), extra-budgetary expenditures (interest on foreign debt and treasury paper), and operations conducted by the Future Generations Fund (FGF) and General Reserve Fund (GRF) of the Kuwait Investment Authority (KIA) are not reported. Data on interest on foreign debt and treasury paper are usually provided to Article IV consultation missions, but the regular provision of data on investment income is lacking. Data on the operations of the Public Institute for Social Security are not made available. Sharing of information between various government agencies could be improved. STA indicated to the authorities that the FGF and GRF should be classified as part of government, as they perform activities for public policy purposes (management of debt and assets and financing of the budget). An additional extension of coverage would be to report the GFS in the form of the Statement of Sources and Uses of Cash for the consolidated central government. The authorities have also been briefed on the IMF's ongoing work to enhance the transparency of fiscal accounts and presentations detailed in the "Code of Good Practices on Fiscal Transparency" and were encouraged to adopt some of the practices recommended in the Code.

Monetary and financial statistics: The CBK reports sectoral balance sheet data for the Central Bank, other depository corporations (ODCs), and other financial corporations (OFCs) to STA based on the Standardized Report Forms (SRFs). A future work should be on expanding the coverage of the ODC sector by including investment companies as well as expanding the coverage of the OFCs by including insurance companies and other financial intermediaries.

Financial Surveillance: Kuwait started to report financial soundness indicators (FSIs) to STA for public dissemination in December 2017. 20 FSIs for deposit-takers (12 core and 8 encouraged) are being reported.

External Sector Statistics: The CBK compiles and disseminates quarterly balance of payments and international investment position (IIP) data, in accordance with the BPM6. Enhancements have been made in the estimation of travel services and communication services, but further improvements are needed in compilation practices and in the estimation of data on several service items and private transfers.

The IIP data requires improvements as it excludes most of general government's external assets which are held by the KIA in the FGF and GRF. Only loans granted by the Kuwaiti Fund for Arab Economic Development and general government trade credits are reported. The full IIP data, including external assets held by the KIA, is traditionally reported to the Fund by the Executive Director for Kuwait at the time of the Article IV Board meeting.

The CBK also participates in the Coordinated Portfolio Investment Survey (CPIS) with data reported for 2003 onwards, and in the Coordinated Direct Investment Survey. Kuwait is successfully reporting inward and outward direct investment data. As for CPIS data, these data are for the financial sector acting as end-investors' or as intermediaries on behalf of residents and do not include holdings of foreign securities held by government agencies, which comprise the bulk of Kuwait's cross-border holdings.

The CBK has improved external accounts data in recent years, particularly in the substantial revisions to report forms, including the separate reporting of financial transactions in the BOP and other changes in volume in the international investment position. It has also made progress in the estimation of remittances data. Yet, delays and data gaps remain. In particular, better coordination among key government entities is needed to provide quarterly data to the CBK in time to compile timely quarterly statistics. Merchandise trade data estimates are compiled and disseminated on a monthly/quarterly/annual basis by the Central Statistical Bureau (CSB).

II. Data Standards and Quality

Kuwait participates in e-GDDS since 2000 but has not implemented a National Summary Data Page centralizing the dissemination of key macroeconomic statistics. Its metadata were last updated in 2010 and 2011.

Table of Common Indicators Required for Surveillance
(Last updated February 22, 2019)

	Date of latest observation (For all dates in table, please use format (mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates	Nov 2018	Jan 2019	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	Nov 2018	Jan 2019	M	M	M
Reserve/base money	Nov 2018	Jan 2019	M	M	M
Broad money	Nov 2018	Jan 2019	M	M	M
Central bank balance sheet	Nov 2018	Jan 2019	M	M	M
Consolidated balance sheet of the banking system	Nov 2018	Jan 2019	M	M	M
Interest rates[2]	Nov 2018	Jan 2019	M	M	M
Consumer price index	Oct 2018	Dec 2018	M	M	M
Revenue, expenditure, balance and composition of financing[3]—general government[4]	2016	Oct 2016	A	A	A
Stocks of central government and central government-guaranteed debt[5]	Dec 2014	Sep 2015	M	M	M
External current account balance	Q3 2018	Jan 2019	Q	Q	Q
Exports and imports of goods and services	Q3 2018	Jan 2019	Q	Q	Q
GDP/GNP	Dec 2017	Dec 2018	A	A	A
Gross external debt	Dec 2014	Apr 2015	A	A	A
International investment position[6]	Q3 2018	Jan 2019	A	A	A

[1]Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents. Data made available to staff is incomplete as it excludes the external assets held by the general government (except for loans granted by the Kuwaiti Fund for Arab Economic Development and general government trade credits)

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Hazem Beblawi, Executive Director of Kuwait,
Maya Choueiri, Senior Advisor; and Fouad Al-Kohlany, Advisor
March 25, 2019

On behalf of the Kuwaiti authorities, we would like to thank staff for their continued constructive engagement with Kuwait. The authorities appreciate the helpful discussions which focused on further strengthening macroeconomic and financial stability, as well as boosting private sector-led growth.

Recent developments

Growth resumed in 2018, supported by an increase in both oil and non-oil activity, the latter owing to a rebound in confidence and government spending. The fiscal and external accounts also posted large surpluses, reflecting higher international oil prices. The banking sector reported sound indicators and credit is recovering. The authorities share staff's view that medium-term prospects are broadly favorable. The ample financial buffers accumulated owing to prudent policies in the past years, as well as low-debt levels enabled Kuwait to face challenges to its economy from a position of strength. Notwithstanding this strong performance, the authorities are strengthening the fiscal accounts, safeguarding financial stability, and further developing the non-oil economy and private sector job creation, guided by the Kuwait Vision 2035 and the National Development Plan (NDP). Kuwait is a constitutional emirate with an elected parliament and appointed government. Accordingly, consensus-building and broad social acceptance are essential for carrying out reforms in the country.

Fiscal policy and reforms

While the fiscal position is strong, the authorities are aware that increasing capital spending consistent with the NDP, reducing financing needs, and ensuring intergenerational equity warrant containing expenditure and mobilizing non-oil revenue. In addition to adopting the conservative budget oil price of $55 pbl, well below the current and projected oil price, the authorities are containing the growth of current expenditure, improving the targeting of transfers, controlling the eligibility requirements of benefits, and working toward cutting operating costs. These measures follow the significant increases in electricity and water prices in 2017. Several streamlining measures are also underway, including modernizing procurement, limiting grants to priority sectors, and improving the selection and implementation of capital projects.

On the revenue side, the GCC-wide excises and VAT are awaiting parliamentary approval, expected in FY20/21, and FY21/22, respectively. In preparation for the VAT introduction, the authorities are improving capacity at the Ministry of Finance and preparing the necessary infrastructure, and appreciate the technical support received from the Fund in this regard. In

the meantime, in order to enhance non-hydrocarbon revenue, the government repriced government services, enforced penalties on businesses not meeting the Kuwaiti hiring quotas, and strengthened revenue collection, including for utilities.

The authorities take note of staff's proposed fiscal reforms that would gradually close the intergenerational savings' gap over the next decade. They acknowledge the importance of curtailing the public wage bill, gradually phasing out subsidies and transfers, and improving project planning, selection, and execution. They consider, however, that garnering broad public support is essential for the success of their more far-reaching fiscal reforms. They plan to bring down the non-oil fiscal deficit down, more gradually than recommended by staff, while building this support.

The Kuwaiti authorities have taken important steps to strengthen their policy frameworks. These include enhancing fiscal statistics and enacting a new public procurement law to promote competition and transparency, and attract foreign investors. Moreover, the Kuwait Anti-Corruption Authority (Nazaha) collaborated with the UNDP, the General Secretariat of the Supreme Council for Planning and Development, and the United Nations Office on Drugs and Crime (UNODC) in developing and adopting a national anti-corruption strategy. Following the introduction of three-year expenditure ceilings in FY17/18—which stretched the planning horizon beyond annual budgets and helped limit spending procyclicality—the authorities expressed interest in Fund support to consider various fiscal rule options for Kuwait. In order to strengthen the institutional framework for debt management and capital market development, Kuwait has established an asset-liability management committee[1]. The authorities welcome staff's acknowledgement that the committee will enhance coordination and help in forming a more systematic view of asset-liability management. They take note of staff's recommendation to further strengthen fiscal governance by enhancing fiscal transparency, modernizing public procurement, and improving spending efficiency.

Monetary and financial sector policies

The Central Bank of Kuwait (CBK) has aimed to ensure that monetary conditions remain supportive of economic growth and financial stability. As the U.S. Federal Reserve raised the Fed Funds rate, the CBK deployed various monetary policy instruments to maintain the dinar's attractiveness, while supporting lending. The authorities share staff's assessment that the current basket pegged exchange rate regime continues to serve Kuwait well and provides an effective nominal anchor for monetary policy.

The asset-liability management committee includes representatives from the Ministry of Finance, the Central Bank, Kuwait Investment Authority, and the Kuwait Petroleum Corporation.

The Kuwaiti banking system is sound, liquid, and profitable. The systemwide capital adequacy ratio reached 18 percent in September 2018, and liquidity ratios were comfortably within the CBK requirements. Asset quality has improved, with NPLs net of specific provisions falling to a historical low. The authorities welcome staff's assessment that prudent regulation and supervision by the CBK have helped to keep banks resilient. They are very appreciative of the Financial System Stability Assessment (FSSA) and welcome its finding that Kuwaiti banks would be resilient to various stress test scenarios, including protracted credit, liquidity, and market shocks. Since the last FSAP, the CBK has taken several steps to strengthen the banking sector's crisis management framework. The FSSA acknowledges this progress, notably that a bank-specific insolvency framework has been incorporated into the draft commercial insolvency law; the framework for Emergency Liquidity Assistance (ELA) has been improved; and the CBK is contemplating the establishment of a stand-alone bank resolution unit, independent of supervision. The authorities take note of staff's advice to put in place a more comprehensive, structured, and formalized framework for corrective actions and bank recovery and resolution. With regards to the recommendation to gradually unwind the existing blanket guarantee on deposits, the authorities consider that more complete technical assistance is needed to reach a comprehensive deposit insurance solution, particularly concerning Islamic banking, which represents a large share of the banking sector

The CBK considers that the interest rate ceilings aim at protecting consumers and facilitating greater Small and Medium Enterprise (SME) access to finance and are, therefore, binding in a positive way. It took note of staff's advice to gradually relax the ceilings to allow banks to better price credit risks and expand lending to new market segments. The CBK conducts risk-based financial sector supervision, is in constant communication with foreign regulators to exchange views, and requests details on foreign branches and subsidiaries. To further strengthen its systemic risk oversight and crisis management frameworks, in line with the FSAP recommendations, the CBK has prepared a draft law assigning itself an explicit financial stability mandate and creating a Financial Stability Committee. The Committee would establish a formal coordination mechanism between the CBK, Capital Markets Authority, Ministry of Finance, and Ministry of Commerce and Industry. In an effort to enhance the liquidity management framework in an environment of ample liquidity, the CBK is reviewing its liquidity forecasting framework with Fund assistance in order to improve its accuracy and extend the forecast period.

Boosting private sector-led growth

The authorities agree with staff's view that the more limited scope for public employment going forward puts a premium on structural reforms that promote private sector development, diversification, and job creation. The Kuwait NDP aims at creating employment for Kuwaitis through private sector-led economic diversification, improving human capital development, and strengthening institutions.

The authorities are fully aware of the need to support SMEs and develop startups given their job creating potential. They are working on enhancing their access to finance, including through venture capital and credit guarantee schemes, training entrepreneurs, and facilitating participation in public tenders. The National Fund for SME Development, as well as the supporting legal and institutional framework, are key parts of the authorities' efforts to support the creation of jobs for Kuwaitis in the private sector. The National Fund helps Kuwaiti entrepreneurs in more than just funding their business ideas, but also providing a series of services, including working with business development centers and universities in business incubation, capacity building, and encouraging better integration of SMEs into supply chains.

The authorities established a one-stop-shop for investors and launched an online service for establishing and registering companies, streamlining administrative procedures, and relaxing restrictions on foreign direct investment. They are committed to pursue the reform of the business environment, enhance public private partnerships, create incentives for entrepreneurship, foster productivity and competitiveness, and encourage private initiative and investment.