Monetary policy in Qatar and Qatar's attitude towards the proposed single currency for the Gulf Cooperation Council

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1. Monetary policy in Qatar, 1940s-2002

A review of the monetary situation, 1940s-1993

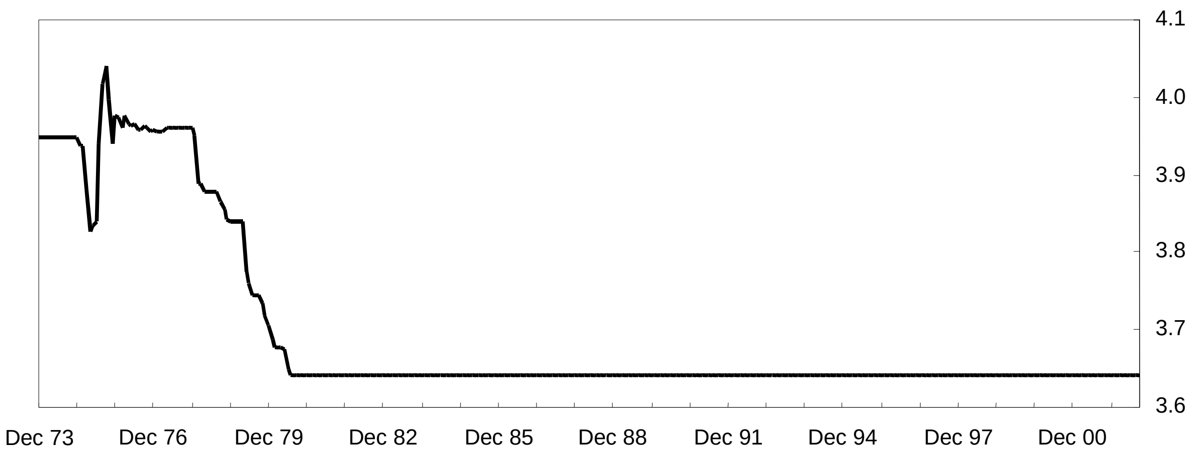
Until the early 1970s Qatar was under British influence, and so had all the economic features of the countries linked to the sterling currency area. For most of this period, Qatar did not have its own national currency and remained dependent on foreign banks. The first such bank was a branch of the Eastern Bank (now known as Standard Chartered), which opened in 1950. The situation changed in 1965 when the first domestic bank, Qatar National Bank, was established. Subsequently:

- In March 1966 a currency agreement signed between Qatar and Dubai established the Qatar and Dubai Currency Board. A new currency, the Qatar-Dubai riyal, replaced the foreign currencies in circulation in the second half of 1966.
- In September 1971 Qatar gained independence. When Dubai merged with the United Arab Emirates in May 1973, the government issued Law no 7 establishing the Qatar Monetary Agency and granting it the powers of a central bank. The Qatari riyal replaced the Qatar-Dubai riyal as the national currency.
- In April 1974, Decree no 72 declared that the Qatari riyal would continue to be pegged to the US dollar in the same manner as the Qatar-Dubai riyal.
- In March 1975 the basis for the riyal peg was changed from the US dollar to the Special Drawing Right (SDR) at a rate of 4.7619 riyal per SDR with a marginal variation of ±2.25%. The exchange rate against the US dollar was determined on the basis of its exchange value against the SDR as determined by the IMF. The exchange rate of the riyal against other currencies was fixed according to their exchange rates against the dollar in international money markets.

Graph 1

Riyal exchange rate

Against the US dollar



- In the latter half of 1975 the SDR depreciated against the dollar, and the marginal variation was increased to ±7.25%. The Monetary Agency determined the daily value of the riyal using the US dollar as an intervention currency.
- Since 1980, the riyal has been fixed at 3.64 to the US dollar.
- In August 1993 the Qatar Central Bank (QCB) was established.

Monetary policy after 1993

Monetary policy objectives

According to the law establishing it, QCB's main monetary policy objectives are to:

- direct monetary policy and banking credit in order to realise the objectives of state economic policies;
- issue the currency;
- take actions necessary to stabilise the value of the currency and its free conversion to other foreign currencies;
- regulate and supervise banks and financial institutions;
- function as a banker for the government;[1]
- act as a bank for all the banks operating in the state; and
- manage the reserves allocated as cover for the currency.

In practice, QCB handles most central banking functions including currency board arrangements. QCB is required to maintain 100% foreign reserve cover for domestic currency issued.[2] Since the reserve cover has remained above 100%, QCB has been able to adopt a relatively active monetary policy, with domestic interest rates higher than world rates. A new law is being drafted, giving QCB more independence.

The structure of the banking system is shown in Table 1. The banking sector comprises the central bank (QCB) and 15 commercial banks: seven branches of foreign banks, five domestic commercial banks, two Islamic banks and the government-owned Qatar Industrial Development Bank, which funds small and medium-sized business projects.

Monetary policy instruments

Exchange rate policy

As noted above, the riyal has been fixed at 3.64 to the US dollar since June 1980. This de facto peg was formalised in July 2001, replacing the earlier formal peg to the SDR within relatively wide margins. The dollar peg has provided an anchor for macroeconomic policy and a reference point for stability and confidence.

Interest rate policy

Up to mid-1995, QCB imposed limits on deposit and loan rates by applying a base rate structure. In August 1995, QCB removed the limits that used to be imposed on interest rates on loans, allowing rates to be market-determined. In April 1997, QCB raised the discount and rediscount rate from 5.5% to 5.75% and encouraged commercial banks to consider this rate as a benchmark for interest rates on

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1 In practice, Qatar National Bank, half-owned by the government, handles most government operations.

2 The cover can be lowered for up to six months.

deposits so that the maximum rate would not increase more than 1% above the new discount rate. In April 1998, QCB freed interest rates on deposits with maturity of 15 months and longer. In December 1998, the cap on interest rates on deposits with maturity ranging between 12 and 15 months was eliminated. And starting from February 2000, interest rates on both deposits and loans became fully market-determined. However, long-term rates for small projects are subsidised.

The fixed exchange rate vis-à-vis the US dollar has kept domestic interest rates closely in line with those prevailing in the United States with a modest positive differential (around 75 basis points). The base interest rate (the central bank repo rate) was reduced on successive occasions during 2001 to 2.50% and was further reduced in 2002 (Table 2).

Table 1

Commercial banks operating in Qatar, May 2002

Bank	Head office, branches and foreign exchange offices	Year established
Domestic banks		
Qatar National Bank SAQ	30	1964
Doha Bank Ltd	15	1978
Commercial Bank of Qatar QSC	13	1975
Qatar Islamic Bank SAQ	11	1982
Al-Ahli Bank of Qatar QSC	9	1984
Qatar International Islamic Bank	7	1990
Grindlays Qatar Bank[1]	1	2000
Qatar Industrial Development Bank	1	1997
Foreign banks		
Arab Bank PLC	3	1958
Mashreq Bank PSC	1	1971
Bank Paribas	1	1973
HSBC	3	1954
Standard Chartered Bank PLC	1	1950
United Bank Ltd	1	1970
Bank Sederat Iran	1	1970
Total	**98**	

[1] Owned 60% by local shareholders and 40% by Standard Chartered Bank.

Source: Qatar Central Bank.

Credit policy

Credit policy in Qatar is very well regulated. Regulations are listed in special directions from QCB to banks. The most important of these are:

- banks are not allowed to lend more than 20% of the total value of a real estate project;
- bank credit to any one country should not exceed 20% of the bank's capital and reserves;
- lending limit to a single board member is set at 7% of capital base, with an aggregate of 35% for all board members;
- lending to external auditors is prohibited;

- commercial lending to senior officials is not allowed; and
- lending limits for major shareholders are set at 5% of capital.

Non-performing loan classification criteria have been tightened and banks are required to appoint independent auditors to assess provisioning levels. Industrial credits are provided by the Industrial Development Bank, the only specialised bank in Qatar.

There is no limit on lending to the government in the QCB law. However, QCB's balance sheet shows that there is no direct lending from the QCB to the government. The only claims on the government that appear on its balance sheet are the subscriptions to international financial institutions. Therefore, most of the government's financing is obtained from the commercial banks. Banks hold most of the government's domestic debt in the form of treasury bills and bonds (about 89% in April 2002). The share of commercial banks' credit to the government rose from 38% in 1996 to about 50% in April 2002. About 80% of the total credit comes from Qatar National Bank (50% of whose capital is held by the government).

QCB lends to banks through repo operations and recently through the Qatar monetary market rate mechanism. When the stability of the banking system is at risk, QCB acts as a guarantor to the banking system (cases of Mashreq Bank in the mid-1980s, and Al-Ahli Bank in the beginning of 2000).

Open market operations

Repo operations have been the main monetary instrument employed recently and are mainly used to inject liquidity into the banking system. The main tools used to conduct the repo operations are government bonds, as QCB has not issued its own paper. Government bonds were previously sold by QCB, on behalf of the Ministry of Finance, to commercial banks. The main purpose behind the issuance of these securities was to securitise some parts of the commercial banks' debt to the government. Although the ***four*** issues were pure government debt management operations,[3] commercial banks used these securities to conduct repo operations. The terms and conditions of the first issue (June 1999) made it clear that these securities are tradable between banks operating in Qatar during the first year and among individuals, companies and banks afterwards. A primary dealer structure was introduced within the market. However, securities were neither traded between banks or among individuals and companies.

The repo operation is a process where QCB repurchases government securities from commercial banks, under a condition that these banks are committed to repurchase these securities again after 14 or 30 days. Repo operations are used at the initiative of individual commercial banks. The size of any operation is limited by a ceiling set by QCB. The repo rate is linked to the US federal funds rate as the Qatari riyal is pegged to the US dollar. When there is a change in the federal funds rate, the repo rate is changed accordingly. Table 2 shows the development of the QCB rate during the last three years.

Required reserve ratio

The required reserve ratio (RRR) has been mainly used by QCB for prudential purposes, and recently as a supporting instrument to complement and reinforce repo operations and the recently introduced QMR (discussed below). Until September 1995, banks were required to hold uniform reserve requirements of 1.5% on foreign and domestic currency time and savings deposits, remunerated at 2% below QCB's base rate. The reserve requirements on demand deposits were set at 10% and were unremunerated, while Islamic banks were required to hold 15% which, based on Islamic law, also remained unremunerated.

Effective September 1995, the current and call accounts (demand deposits) of all commercial and Islamic banks were redefined and a unified reserve requirement of 19% was applied to all demand deposits, with reserve requirements on time and savings deposits eliminated.

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[3] In order for the bond issue to be considered a monetary operation, the incoming funds have to be under the control of QCB, rather than available to the government for spending, which is the case in Qatar.

Table 2

Qatar: Main economic indicators

	1999	2000	2001	2001	2002		
				Q4	Q1	Q2	Q3
Population (thousands)	562	579	597	–	–	618	–
Inflation (%)	2.2	1.7	1.4	0.8	0.4	0.4	–0.1
Gross Domestic Product[1]							
million QR	45,111	59,893	58,794	13,730	13,795	17,840	19,300
(% change)	20.8	32.8	–1.8	–7.2	1.8	27.7	8.2
oil sector	20,644	34,950	33,180	7,430	7,430	10,800	12,000
non-oil sectors	24,467	24,943	25,614	6,300	6,545	7,040	7,300
Public finance (mn QR)							
Total revenue	15,256	23,428	19,318	–	–	–	–
Total expenditure	17,336	18,294	19,268	–	–	–	–
Balance	–2,080	5,134	50	–	–	–	–
Monetary							
QCB rate (%)	5.50	6.65	2.50	2.50	2.50	2.40	2.20
Money supply (M1)(mn QR)	4,179	4,449	5,219	5,219	5,649	6,697	6,310
(% change)	–0.9	6.5	17.3	9.5	8.2	18.6	–5.8
M2 (mn QR)	25,982	28,756	28,754	28,754	28,863	29,569	30,481
(% change)	11.4	10.7	0.0	1.5	0.4	2.4	3.1
Foreign assets (net)	5,497	13,276	14,098	14,098	16,330	16,825	16,618
Total deposits	30,809	36,345	42,518	42,518	45,070	44,251	43,430
Private deposits	*24,268*	*27,083*	*27,014*	*27,014*	*27,148*	*27,703*	*28,712*
Total credit	28,541	27,913	34,011	34,011	35,935	34,549	33,907
Private credit	*15,640*	*17,252*	*17,481*	*17,481*	*17,513*	*17,949*	*18,632*
Balance of payments[1]							
Trade balance	18,062	31,538	27,243	9,126	5,212	6,843	7,028
Exports (FOB)	26,258	42,202	39,567	12,401	8,776	9,832	10,067
Imports (FOB)	–8,196	–10,664	–12,324	–3,275	–3564	–2,989	–3,039
Current account balance	7,903	19,925	15,520	5,860	3,411	4,542	4,802
Capital account balance	1,043	–6,858	–5,558	–818	4,031	–252	–1,306
Overall balance	8,946	13,067	9,962	5,042	–620	4,290	3,496
Doha Securities Market							
Shares number (thousands)	28,167	31,611	51,015	13,805	17,804	29,547	20,498
Shares value	1,232	868	1,504	507	701	1,127	827
Number of deals	13,964	12,225	15,771	4,469	4,929	7,977	9,951
Index	1,341.0	1,233.3	1,692.2	1,692.2	1,690.6	2,087.2	2,237.8

In February 2000, the RRR was set at only 2.75% of deposits. RRR is calculated based on an average and reserve shortfalls are penalised at a rate of triple the repo rate. This has induced banks to hold on average higher excess reserves. Currently, required reserves are unremunerated in Qatar.

Prudential ratios

QCB uses different prudential ratios, the most important of which are the loans to deposit ratio and the liquidity ratio. These ratios are mainly used to penalise excessive lending. The liquidity ratio has recently been set at 100%, and the loans to deposit ratio is set at 95%. The loans to deposit ratio is below QCB's guideline, while the liquidity ratio is above QCB's minimum specified limits.

The Qatar monetary market rate

The QMR is a very recent monetary instrument, implemented in April 2002. Through this instrument, banks can borrow from and deposit funds at QCB at rates set by it. The QMR will be an outlet for surplus funds of banks when liquidity is excessive; in this way banks are allowed to deposit surplus liquidity at the central bank at a rate specified by QCB. Also, it is a source of liquidity to banks when the money market is tight. This mechanism is expected to bring about a market rate that reflects the supply of and demand for excess reserves. As such, it is a function of many macroeconomic and monetary variables.

The discount window

The discount window, one of the least used tools of monetary policy, is available to QCB according to the 1993 legislation establishing it. QCB determines the conditions under which credits are to be extended to banks in general and shall declare from time to time its rates for discounts, rediscounts, loans and advances. This tool is currently not operating.

Qatar's payment system

The payment system consists of the set of rules, institutions, and technical mechanisms for the transfer of money. It comprises a network of banks, central banks, securities firms, service providers, and industry-owned utilities that ensures both the smooth transfer of funds for business and financial transactions and the timely settlement of securities transactions. The main features of the payment system in Qatar are:

- QCB introduced the RTGS payment system (as the premier system for handling large-value and same day payments) in January 2001, using a SWIFT message switching platform complying with SWIFT standards.
- QCB's main applications of SWIFT are systems for clearing and settlement, book-entry security, issuing currency, investment and foreign exchange.
- National ATM and Point of Sale Switch (NAPS) reconciliation transactions consist of two forms of local and regional settlement systems employed in Qatar; the first is ATM transactions, and the second is point of sale transactions. NAPS is available in all GCC countries, Egypt and Lebanon.
- Debt management transactions (bidding, settlements) and transfers of securities ownership are executed using SWIFT.
- Some banks have introduced a fully automated e-banking service for customers in Qatar.
- Some banks in Qatar have introduced a WAP (wireless through mobile) service.

The main instruments used in the Qatar payment system are cash, cheques, credit transfers, direct debits and payment cards (credit and debit cards).

The role of QCB in the operation of the payment system depends upon the four functions (user, member, provider, guardian of the public interest) of QCB in the system. These have a major role to play in the successful implementation of the key responsibility of QCB of achieving and maintaining monetary stability.

2. Qatar's attitude towards the proposed single currency for the GCC

Since the early 1980s, the GCC countries have taken important steps towards economic and financial integration, resulting in the free movement of national goods, labour and capital across these countries. The GCC authorities have indicated similar policy preferences in a number of areas over the years. In particular, they have shown a desire for maintaining price and nominal exchange rate stability as well as for an open trade regime and liberal capital flows.

Since the 1990-91 regional conflict, increased attention has been devoted to fiscal adjustment supported by structural and institutional reforms to encourage diversification and sustained growth. Nonetheless, some important differences, particularly in the fiscal area, have appeared in economic performance and policy preference.

In October 2001, the GCC countries decided to peg their currencies to the US dollar by the end of 2002. The Qatari Government has officially pegged its currency to the US dollar since July 2001.

However, it is not decided yet whether the common currency peg would be a hard or a soft peg, or even whether to extend the present currency board-type arrangement in place in most of these countries to the common central bank to support a hard peg. The second step is to decide upon the initial exchange rate of the common currency to the US dollar.

A unified regional customs tariff at a single rate of 5% will become effective in January 2003. Qatar imposes a 4% tariff duty on most imports, none on food, 100% on alcohol and 50% on tobacco.

Economic performance criteria and institutional requirements will be established by no later than 2005 for the needed policy convergence to support effective monetary union among the GCC countries. The European Central Bank will provide help on this issue. Policy coordination in key areas is essential to avoid an undesirable policy mix between individual member countries' fiscal policies and regional monetary stance.

A Technical Committee (from the central banks and finance ministries of the GCC countries) has been established, to follow up all the requirements of issuing the common currency on time. This Committee reports to the Governors' Committee.[4]

Finally, given Qatar's excellent economic outlook in light of the deepened regional integration, the Qatari authorities fully support the economic and financial integration among the GCC countries.

[4] The first meeting of the Technical Committee with the European Central Bank was held in October 2002.