Comments on the GCC currency peg in MEES Weekly Outlook, 25 Aug 2017

Dr. Saidi's comments on GCC's currency peg are highlighted below:

"The implementation of monetary normalization [interest rate rises from record low levels] by the Fed means a rising path of interest rates and monetary tightening. With a strict peg, this means that the GCC countries will also have to raise interest rates. This conflicts with the need for the GCC to conduct a counter-cyclical policy including monetary loosening and lower interest rates in order to adjust to the 'new oil normal' and low oil prices," Nasser Saidi president of Dubai-based economic consultancy Nasser Saidi & Associates, tells MEES.

"The GCC needs to pursue independent exchange rate and monetary policies directed at dealing with the business cycle conditions of their main trade and investment partners, which are now the Asian countries and not the US and Europe. I am an advocate of the GCC moving to greater exchange rate flexibility through the adoption of a currency basket, with a band. This would allow the GCC to adjust to external and internal real and nominal shocks."

"Pegging to a currency basket allows for monetary policy independence and exchange rates that respond to macroeconomic shocks," says Mr Saidi who advocates a move to a currency basket that would include the US dollar, the Euro, the Japanese Yen, the UK pound and the Chinese Yuan whereby countries could have different weights for the currency components depending on their trade, investment, inflation and business cycle links to their main economic partners.

"Given the region's dependence on oil exports, I am in favor of oil-price augmented currency baskets, for example, including oil prices with a weight of 15-20% in the basket, that allow adjustment to terms of trade shocks/real shocks and imply a depreciation of GCC currencies given a decline in oil prices. This would help develop the non-oil sector and diversify exports," adds Mr Saidi.

"Adjustment to the new oil normal shock requires greater exchange rate flexibility but also requires growth of the non-oil sector and exports," says Mr Saidi. "So, successful implementation of current diversification plans, plus fiscal reform to diversify sources of government revenue, would provide the GCC countries with more ammunition to embark on a path of greater exchange rate flexibility."

To download and access the full article on Pages 8&9 of the MEES publication (Weekly Energy, Economic & Geopolitical Outlook, Vol. 60, No. 34), 25 Aug 2017), click here.