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- Credit Cards
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- Real Estate
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- Forex
- Debt / Money
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# Kuwait drops dollar peg in blow to Gulf currency union

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KUWAIT: Kuwait unshackled its dinar from the tumbling US dollar on Sunday and switched the exchange rate mechanism to a basket of currencies, throwing plans for currency union with other Gulf Arab oil producers into disarray.

Kuwait's central bank, which battled speculators for weeks to defend the peg, said the dollar's slide against other currencies had forced it to break ranks with fellow Gulf states to contain inflation from the rising cost of some imports.

The move stunned Gulf currency markets and volumes dried up. The impact would be clearer on Monday when global markets open, said Steve Brice, chief Middle East economist at Standard Chartered Bank in Dubai. Oman and Bahrain, the two smallest Gulf economies, and Saudi Arabia, the largest Arab economy, said they planned to stand by their pegs.

There was no comment from the central bank of the United Arab Emirates, whose currency is likely to take centre stage on Monday as prospects for a single currency evaporate. Kuwait was still committed to monetary union, the central bank governor said, after changing the dinar's rate to \$0.228806, an appreciation of about 0.37%.

"The massive decline in the dollar's exchange rate against main currencies... has contributed to the increase in local inflation rates and this step is part of the central bank's efforts to curb inflationary pressure," Sheikh Salem Abdul-Aziz al-Sabah said.

Kuwait was named as the top candidate for a revaluation in a poll of analysts in March and markets piled pressure on the dinar, betting that the central bank would allow an appreciation as the dollar slid to record low against the euro in April.

The decision to abandon a currency basket adopted in 2003 to prepare for monetary

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union, caught markets and fellow central bankers unawares. "At the Central Bank of Oman, we did not know about this," the bank's executive president Hamood Sangour al-Zadjali said.

"There was a position by the leaders of all Gulf countries to remain pegged to the dollar and we have abided by that decision." Oman cast the first doubts on the monetary union project last year when it said it would not meet the 2010 deadline. The project now appeared to be in even greater jeopardy, said Brice.




"One of the criteria of monetary union was a common monetary policy. Now, of course, we don't have that," he said. "We didn't think the single currency was likely, at least by the 2010 deadline, and we are getting less convinced that it is going to happen at all. This move reduces even further the likelihood."

Kuwait's central bank governor said his country was still committed to monetary union and was only acting in the "national interest" to contain inflation. "Until the completion of all the requirements to achieve the currency union and the launch of the Gulf currency, the Central Bank of Kuwait will continue to adopt the basket system." The statement did not say what currencies were in the basket.

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