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" An Empirical Investigation "**

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Banking Performance and Economic Growth in Qatar: An Empirical Investigation *

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Abstract

The main objective of this study is to examine empirically the relationship between commercial banking performance and economic growth in Qatar. This study aims at examining functional relationships between bank's profit, from one hand and between the real sectors such as GDP, foreign interest rates, government revenues, government expenditures' and bank's equity effect on the other hand. Different statistical exercises including stability tests for structural stability of the model and causality experiments were conducted.

Granger causality tests were performed on all variables, and bank equities, variable was found to Granger cause banks profit, GDP Granger causes bank profit indirectly through bank equities. The other variables were insignificant at acceptable levels.

The statistical findings indicated that the predictability of these models is highly accurate and could be applied to similar countries or institutions.

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1- Introduction

The relationship between financial growth and economic development remains a controversial issue. This study assumes that the financial system (mostly banks) can contribute significantly to economic development.

This assumption will not be accepted by everyone. The views on the role of financial institutions in development differ. There are analysts who insist that financial institutions are only one among several components of techniques available for a country to promote its economic growth [4], [2], [3].

There are others who hold the view that financial institutions are not only necessary; but also provide a sufficient basis for growth [4], [5], [6], [7]. The moderates who lie in between assign a degree of importance to financial institutions in economic development [8], [9], [10], [11], [12]. In this regard, Schumpeter was probably the first economist to study the relationship between financial intermediation and real development [13]. He regarded banks, and enterpreneurship, as two key agents of development. He gave importance to money, capital and credit in fostering entrepreneurial activity. Adelman has reviewed the contribution of financial sector for economic growth using data in developing countries.

They found the level of development of financial institutions to be the best indicator of a country's real development potential. Similar results were reported by: different studies, [2], [14], [10], [9], [15], [16], [7], [12], [16], [17], [19].

According to these studies, the association between commercial bank's assets and real growth was measured

using rank correlation analysis according to GDP per capita and banking ratio (Bank assets/GDP). The association analysis, by relating the independent ordinal ranking according to GDP per capita and banking ratio (bank assets/GDP), indicated a positive and highly significant correlation coefficient.

2- Objectives and Methodology of the Study:

The main objective of this study is to examine empirically the relationship between banking performance and economic growth in Qatar. This study aims at examining functional relationships between bank's profits, from one hand, and between the real sectors such as GDP, foreign rate of interest, government revenues, government expenditures and banks equity effect on the other hand. Different statistical exercises including stability tests for structural stability of the model and causality experiments will be conducted.

This study will be based on regression analysis modeling, applying Ordinary Least Square Techniques (OLS). Annual data for the years 1996-1997 will be used. The sample will be reduced if data for some of the variables included in the model is not available. The study focuses on examining the performance of the four conventional commercial banks i.e. Qatar National Bank, Doha Bank Ltd. Commercial Bank of Qatar, and Al-Ahli Bank of Qatar. The Islamic banks and the specialized credit institutions are excluded. A historical background of commercial banking in Qatar is presented in section (3), while section (4) examines major economic and financial indicators for Qatar. In section (5) the behavioral equations of the model is formulated in section 5 and statistical findings are presented in section (6). The summary and policy implications of the model are presented in section (7).

3- Evolution of the banking sector in Qatar:

The sophistication of the banking sector, is an element of a developed economy. Qatar's economy was primitive and underdeveloped, in the early days. Pearl fishing was the main source of income. Thus, transactions were minimal and were mainly done in cash. Modern banking activities did not exist in the region until the early fifties. Since the Gulf was under British influence, British banks were the first to start operations in the region.

The Eastern Bank (now called the Standard Chartered Bank) was the first bank to start operations in Qatar on January 21, 1950, soon after production and exports of oil. The Eastern Bank monopolized the banking sector for some years and was assigned the role of the government bank. A second British bank opened a branch in Qatar in 1954. The British Bank of the Middle East started operations on February 28, 1954. Two years later, a third British bank, the Ottoman Bank (later called the Grindlays Bank) began its operations. This was followed by two Arab banks - the Arab Bank and the Lebanese Bank (renamed later Al-Mashrek) beginning their operations in 1957 and 1960.

The first national bank, Qatar National Bank (QNB) was established on January 1, 1965 with a capital of 14 million Indian Rupees. The bank was equally owned by the government and private investors.

The seventies saw an increase in the number of national banks operating in Qatar. The Commercial Bank of Qatar and the Doha Bank Limited started operations in 1975 and 1979. This was followed by Qatar Islamic Bank, the first Islamic bank to begin operations in 1983. Al-Ahli Bank of

Qatar opened in 1984 followed by Qatar Islamic International Bank in 1990.

Qatar's banking sector is supervised by the Qatar Central Bank (QCB). This was incorporated in 1993 after it took over the responsibilities of the former Qatar Monetary Agency. QCB has introduced major international standards applicable to banking supervision and regulations, and has implemented an automated link with local banks (QCB-link) to enhance its ability to monitor banks in a timely and accurate manner. In 1997, all domestic automated teller machines (ATM) and points of sale (POS) machines were linked to the first element of the GCC Net, linking the ATM and POS switch systems of the Qatari and Kuwaiti banking systems.

The following section highlights certain financial indicators concerning the performance of Commercial banks in Qatar. Table (1) shows that total assets of Qatari banks amounted to QR 38,459 million in 1997, as against QR 33,885 and QR 34,249 million in 1996 and 1995 respectively. Total credit facilities touched QR 26,582 million in 1998 compared to QR 25,210 million in the previous year. (Table 2) Public sector credit accounted to 45% in 1997 compared with 47% and 42% in 1996 and 1995 respectively.

The customer deposits in commercial banks have shown rapid growth during the last few years. Total deposits amounted to QR 24,642 million in 1997 compared with QR 22,048 and QR 19,885 million in 1996 and 1995 respectively (Table 3). Private sector deposits accounted for 71.9% of total deposits in 1997. Among them the share of time and saving deposits for private sector exceeded 61% of total deposits in 1997, while demand deposits for the private sector represented 10.8% of total deposits for the same year.

Table (1)
Total Assets of Commercial Banks in QR Million

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
Balance with Banks	195.1	153	297	174	276
Overdraft	6,259	7,003	7,819	8,836	9,501
Bills Discounted	585	472	406	279	280
Loans & Advances	11,881	13,189	12,838	13,576	15,432
Domestic investments	1,486	1,516	1,531	1,584	2,392
Fixed Assets	225	251	229	208	235
Other Assets	646	722	962	903	1,559
Total Assets	30,399	31,323	34,249	33,885	38,459

Source: Qatar Central Bank, Quarterly Statistical Bulletins, March 1998, March 1998 P.20.

Table (2)
Distribution of Credit Facilities by Sector: 1984 - March 1998
(QR million)

	1994	1994	1995	1996	1997	% Change	Q1 1998	% Change*
Public Sector	8,807	2,419	8,926	11,062	11,409	3.1%	12,746	12.0%
Merchandise	4,389	1,206	4,293	4,147	4,408	6.3%	4,392	-0.5%
Industry	205	56	310	301	378	25.9%	331	14.1%
Agriculture	91	25	30	14	17	16.8%	17	24.6%
Housing & Construction	325	89	550	665	315	-52.6%	438	9.6%
Lands	122	34	120	109	154	42.0%	167	46.7%
Transportation	283	78	265	260	271	4.2%	291	2.5%
Personal	3,335	916	3,814	3,337	5,806	74.0%	5,842	47.1%
Professional	94	26	108	95	79	-16.4%	74	-27.4%
Other	657	180	732	1,280	1,059	-17.2%	1,098	-2.5%
Total domestic credit facilities	18,306		19,147	21,268	23,897	12.4%	25,396	14.9%
Credit facilities outside Qatar	2,357		1,916	2,261	1,316	-41.8%	1,186	-44.6%
Total Credit Facilities	20,663		21,063	23,530	25,212	7.2%	26,582	9.7%

Source Qatar Central Bank, Quarterly Statistical Bulletin, March 1998, p.26

* Percent change from Q1 1998.

Table (3)
Balance of Payments, 1993-97

(QR Million)

	1993	1994	1995	1996	1997*	% Change
Exports	11,280	10,851	12,984	13,952	16,932	21.4
Imports	-6,126	-6,122	-11,008	-9,406	-14,597	55.2
(1) Trade Account Balance	5,154	4,729	1,940	4,546	2,335	-48.6
(2) Services, Private and Official Transfer, net	-7,553	-6,556	-9,801	-9,083	-9,695	6.7
(3) Current Account Balance(1+2)	-2,399	-1,827	-7,861	-4,537	-7,360	62.2
(4) Net Capital Transfers, Private and Official	2,377	-138	4,815	2,629	5,215	98.4
(5) Overall Balance(3+4)	-22	-1,965	-3,046	-1,908	-2,145	12.4
(6) Change in Reserves (Increase -)	22	1,965	3,046	1,908	2,145	12.4

* Estimates

Source Qatar Central Bank, Quarterly Statistical Bulletin, March 1998, P.35

4- Major economic and financial indicators

The GDP recorded a growth rate of only 0.3% in 1998 and touched QR33,551 billion, showing an increase of 1.5% and 11.3% in 1997 and 1996 respectively (Table 4). The non-oil sector showed a growth rate of 2% in 1998, compared to 2.5%, in 1997.

The finance, insurance & real estate sectors contributed to 10.4% in 1997, compared with 10.4% and 10.9% in 1996 and 1995 respectively. Notwithstanding this economic growth, consumer price inflation (CPI) was under control at 2.8% in 1997, compared to 7.4% and 3% in 1996 and 1995 respectively. Inflation for 1998 is estimated at 2%.

Table (4)
Major Economic Indicators

In QR Million	1994	1995	1996	1997*	1998*
Gross Domestic Product:	26,843	29,622	32,976	33,464	33,551
Oil Sector	8,583	10,933	12,773	12,750	11,300
Non-Oil Sector	18,260	18,689	20,203	20,714	22,251
Consumer Price Index (% Change)	1.3	3.0	7.4	2.8	2.0*

* Preliminary.

5- Model specification and stability tests:

5.1 The model:

As stated earlier, the main objective of our model is to bring a link between real and financial variables. Similar models were applied for different studies (see Khatib, 1987

and Huybens 1998). These models examined the relationship among some real variables (growth rate of GDP, gross consumption and total expenditures from one hand and other financial variables, such as total domestic credit bank's excess liquidity and interest rates on the other hand. Ellis, (1998) also applied similar methodology. In our model, we intend to focus on examining the nature of association between bank's total profit and real variables. The methodology applied is similar to the above mentioned studies, but different in its objectives and variables tested.

In formulating our model, we assume that the bank's profit is a function of GDP, bank's total shareholders equity, bank's capital, interest rate variable, government revenues and government expenditure. As far as the cost variable is concerned, the LIBOR is used as a proxy for domestic rate of interest. In addition, the Eurodollar will be tested as an independent variable. Given the above theoretical considerations, the behavioral equation of our model, will be formulated as follows:

$$BP = f(GDP, BEQ, BCAP, EUOD, GREV, GEXP) + U1 \quad \text{--(1)}$$

Where BP is the bank's total profit,

GDP is Gross Domestic Product,

BEQ is total bank's shareholders equity,

BCAP is banks capital,

EUOD is the Eurodollar rate of interest,

GREV is government revenues,

GEXP is government expenditures,

U1: is random error.

Equation (1) could be written in the following form:

$$BP = a_0 + a_1 GDP + a_2 BEQ + a_3 BCAP + a_4 EUROD + a_5 GREV + a_6 GEXP + U \text{ -----(2)}$$

Where a_1, a_2, \dots are the coefficients of the independent variables, a_0 is a constant term. It is expected that all coefficients with the exception of the constant variable are positively related to the dependent variable.

Rewriting equation (2) in the log function gives the following:

$$\ln(BP) = B_0 + B_1 \ln(GDP) + B_2 \ln(BEQ) + B_3 \ln(BCAP) + B_4 \ln(EUROD) + B_5 \ln(GREV) + B_6 \ln(GEXP) + U \text{(3)}$$

Specifying, the equation in its logarithmic form makes it easier to determine the elasticities of the coefficients.

Finally, it is worth mentioning that all data are calculated on annual basis. Bank's profit is the sum of all commercial banks net profit for each year. Total shareholders equity for the banks is the total of subscribed capital, statutory reserves, general reserves and retained earnings. Bank's capital is the paid prescribed capital for the four banks, GDP is the Gross Domestic Product at current prices. UROD is the interest rate of the Eurodollar in London Market. Government expenditures and government revenues are as reported in government statistics.

5.2 Stability Tests:

The question of the stability of the function in question is an important one. For the equation to be used effectively, it has to depend on a few independent variables and to be stable over times. A relationship is said to be stable if the

regression coefficients are statistically invariant with time.

One of the more frequently used tests of stability is the Chow test (Show, 1970), the data of the sample is divided into two parts at a prior chosen point. The two regressions with the full sample one used as a reference, are compared using an F-ratio to find out whether a significant shift occurred in the function. The statistical formula used is as follows:

$$F = \frac{(RSS_r - RSS_{u1} - RSS_{u2})/K}{(RSS_{u1} + RSS_{u2})/(T - K)}$$

Where RSS_r is residuals sum of squares for the whole sample, $RSS_{u1,2}$ is the residuals sum of squares for subperiods 1 and 2.

T is total number of observations,

And k is the number of parameters estimated.

F will be compared to a tabulated value with k and $(T-k)$ degrees of freedom.

If F is $>$ than the tabulated value, we reject the null-hypothesis, and conclude that the equation is not stable.

5.3 Granger Causality Test:

This test answers the question of whether a causal relationship exists between the dependent variable (bank's profit and the independent variables. Granger causality test assumes that information relevant to the prediction of the respective variables, BP, GDP, BEQ, BCAP, EUROD, GREV and GEXP, is contained solely in the time series data of these variables. The test involves estimating the regressions of each variable, on the other variables past observations.

An F test is then applied on the residuals of the regressions, and the value is compared to tabulated F values. If the computed F value exceeds the critical f value of chosen level of significance, we reject the null hypothesis, and conclude that a causality relation exists.

6- Model Results and Estimations:

Equations (2) and (3) were estimated using the Ordinary Least Squares (OLS) method of estimation, and the corrected OLS methods. The Cochrane-Orcutt (CORC) iterative procedure to adjust for serial correlation when needed, was applied.

Equation (2) was estimated, and the results are shown on table (5). The R^2 adjusted (which measures the goodness of fit) is v.good, with 96% of the variance in the dependent variable is explained by the set of the independent variables. The Durbin-Watson statistics imply the absence of serial correlation, and the F value for the equation is significant. This means that the six independent variables together affect the banks profit (the dependent variable). Only total bank equities came significant with a priori sign, while all the other independent variables were insignificant and some with wrong signs. When the dependent variable was regressed on GDP and total bank equities, the goodness of fit improved. Both independent variables were significant and came with the correct sign. The F-value of the equation has improved and was found to be significant. All equations were found to be stable over the period of time in question. Table (7) and (8) depict the results of stability tests on equation (2).

As for equation (3), it was estimated with six independent variables (see first and second rows), after excluding both

government expenditures and revenues (rows three and four). The Eurod variable was then excluded (see row five and six), and last, total banks capital was excluded (rows seven and eight) from the independent variables set in this exercise, it was found that R^2 has exceeded 98% of the variance in the dependent variable. The Durbin-Watson statistics in (OLS) method indicated the existence of serial correlation among variables. When Corrected (OLS) method was used, D-W statistics has improved, and no sign of serial correlation was existed. The F- value for all equations were good. As for the coefficients of the independent variables, it was found that the coefficients of total bank equity and GDP were significant in all cases with the correct sign. Other coefficients were insignificant and some came with wrong signs.

A Granger Causality test was performed for all variables, both in level and in logarithmic forms. It was found that total banks equities (BEQ) Granger Cause banks profit (BP), while GDP did not. GDP was found to Granger Cause BEQ, which means that there exists an indirect Causality from GDP to BP through BEQ. These results were consistent in both equations.

7- Conclusions and Closing Remarks:

Commercial banks play an important role in any economy. Profits are a major motive for these institutions. Six independent variables were applied. They were total banks equities, total banks prescribed capital, an interest rate variable, total government revenues and total government expenditures. It was found that only GDP and banks equities were significant and with the prior signs.

All equations were found to be stable, and no structural

instability for the time period was found. Granger Causality tests were performed on all variables, and banks equities was found to Granger Cause banks profit, GDP Granger Cause banks profit indirectly through banks equities. The policy implication to be derived from such analysis is the validity of these models and its ability in examining the nature of associations between monetary and financial indicators and other real economic variables. It was found that the predictability of these models is highly accurate and could be applied to similar countries or institutions.

Table (5)
Equation (2) Results
OLS Method of Estimation)

$$BP = \alpha_0 + \alpha_1 GDP + \alpha_2 BEQ + \alpha_3 BCAP + \alpha_4 EUROD + \alpha_5 GREV + \alpha_6 GEXP$$

α_0	α_1	α_2	α_3	α_4	α_5	α_6	R ²	F	D-W	Validity
-1.34 (-0.06)	0.0001 (0.06)	0.10 (2.72)	0.03 (0.23)	0.19 (0.07)	-0.000 (-0.05)	0.003 (1.40)	0.968	160	2.40	Stable
-1.20 (-0.06)	(0.002) (1.98)	0.09 (2.84)	0.07 (0.51)	0.05 (0.019)	-	-	0.968	239	2.11	Stable
-0.86 (-0.09)	0.002 (3.18)	0.09 (3.23)	0.07 (0.54)	-	-	-	0.969	331	2.11	Stable
-0.77 (-0.08)	0.002 (3.21)	0.11 (18.3)	-	-	-	-	0.97	509	2.15	Stable

Table (6)
Equation (3): Results (OLS Method of Estimation)
 $\ln BP = B_0 + B_1 \ln GDP + B_2 \ln (BEQ) + B_3 \ln (BCAP) + B_4 \ln (EUROD) + B_5 \ln (GEXP) + B_6 \ln (GREV)$

B0	B1	B2	B3	B4	B5	B6	R ²	D-W	F Statistics	P (rho-Value)
-2.17 (-3.42)	-0.24 (-0.67)	1.02 (5.79)	-0.22 (-1.56)	0.02 (0.25)	0.02 (0.11)	0.38 (1.62)	0.988	1.28	431	-
-1.98 (-2.79)	-0.21 (-0.62)	0.74 (3.49)	0.07 (0.37)	0.003 (0.02)	-0.07 (0.044)	0.47 (1.96)	0.990	1.85	440	0.36 (2.01)
-2.94 (-7.08)	0.29 (3.10)	0.91 (5.60)	-0.23 (-1.57)	0.03 (0.27)	-	-	0.987	1.33	629	-
-2.84 (-5.96)	0.33 (3.30)	0.64 (3.29)	0.02 (0.14)	0.008 (0.07)	-	-	0.989	1.96	569	1.27 (1.63)
-2.95 (-7.23)	0.30 (3.93)	0.90 (5.81)	-0.23 (-1.59)	-	-	-	0.988	1.32	867	-
-2.84 (-6.08)	0.33 (3.89)	0.64 (3.40)	0.026 (0.14)	-	-	-	0.989	1.96	740	0.27 (1.66)
-3.23 (-8.56)	0.37 (5.57)	0.67 (14.05)	-	-	-	-	0.987	1.18	1234	-
-2.82 (-6.39)	0.32 (4.43)	0.67 (13.05)	-	-	-	-	0.990	1.95	1024	0.27 (1.72)

Where BP = sBank's Profit, GDP = Gross Domestic Product, BEQ = Total Banks equity, BACAP = s Bank's capital, Eurod = Eurodollar rates of interest, GEXP = Government Expenditures, GREV = Government Revenues. () = t statistics.
 * (Applying Coc-Or (method to correct for autocorrelation).

Table (7)
Results of Stability Test
equation (2) Point (1982)

	F-Value
Row (1)	0.128
Row (2)	0.247
Row (3)	0.334
Row (4)	0.468

Table (8)
Results of Stability Test
equation (3) Point (1982)

	F-Value
Row (1)	0.268
Row (2)	0.671
Row (3)	0.249
Row (4)	0.661
Row (5)	0.278
Row (6)	0.646
Row (7)	0.094
Row (8)	0.851

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Obs	BP	GDP	BEQ	BCAP	EUROD
1965	1.845000	NA	15.84500	14.0000	NA
1966	2.003000	848.000	17.10300	14.0000	6.120000
1967	3.029000	974.000	19.20500	14.0000	5.460000
1968	5.496000	1082.000	23.53600	14.0000	6.360000
1969	7.196000	1220.000	29.47700	14.0000	9.760000
1970	8.178000	1313.000	36.25600	14.0000	8.520000
1971	7.619000	1850.000	42.19500	14.0000	6.580000
1972	8.526000	2172.000	48.90000	14.0000	5.460000
1973	10.69000	2615.000	57.49100	14.0000	9.240000
1974	26.50800	7895.000	81.89900	14.0000	11.01000
1975	35.44200	9877.000	123.1410	38.0000	6.990000
1976	46.19800	13017.00	162.9400	38.0000	5.580000
1977	51.87600	14322.00	207.7170	43.0000	6.050000
1978	57.34000	15709.00	254.4950	57.0000	8.780000
1979	61.95100	21783.00	321.1180	70.37400	12.01000
1980	86.51500	28631.00	423.7380	101.0000	14.06000
1981	128.0660	31527.00	532.4412	138.5000	16.82000
1982	151.6560	27652.00	661.0030	153.5000	13.16000
1983	143.2680	23542.00	772.0430	181.5000	9.600000
1984	147.8060	24404.00	887.6210	192.7500	10.78000
1985	144.7750	22398.00	1028.808	264.7500	8.340000
1986	145.0330	18393.00	1129.2411	264.7500	6.770000
1987	234.5840	19824.00	1308.789	264.7500	7.110000
1988	251.6800	21979.00	1515.136	275.6760	7.910000
1989	268.9390	24208.00	1735.461	342.7500	9.100000
1990	284.4980	26865.00	1844.843	342.7500	8.210000
1991	200.8130	25560.00	2063.989	342.7500	5.890000
1992	374.7970	27832.00	2346.423	452.2500	3.770000
1993	354.2290	26050.00	2627.140	563.4370	3.240000
1994	343.0550	26843.00	2914.754	598.5940	4.680000
1995	393.7130	29622.00	3153.090	717.1880	5.970000
1996	454.6770	32976.00	3404.981	827.9300	5.440000
1997	544.2610	33964.00	3858.268	880.6640	5.660000

BP=total banks profit in (millions Riyals), GDP=Gross Domestic Product (million of Riyals), BEQ=total banks equities, BCAP= total banks prescribed capital (million Riyals), EURO=rate of interest on Eurodollars (Percentage).