QATAR ECONOMIC REPORT

MITIGATING THE ADVERSE EFFECTS OF SUSTAINED LOW HYDROCARBON PRICES

TABLE OF CONTENTS

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- Economic activity relatively slowing down but still non-recessionary

Qatar's economic activity has fallen as the economy faces up to sustained low hydrocarbon prices. Headline growth has declined to the slowest pace since 2003, registering 2.7% in 2016 amid a stagnant hydrocarbon sector output reflecting in large measure the effects of a self imposed moratorium on additional output from the giant North Field. Fiscal adjustment and tighter banking liquidity actually took a toll on non-hydrocarbon activity in 2016. There was a particular sharp slowdown in manufacturing and transport, offset by strong outturns in construction, wholesale and retail trade and financial services. For 2017, real GDP growth is forecasted to slightly rise to 3.4% by the IMF, in light of the higher forecast for hydrocarbon prices and Qatar's competitive edge in LNG production.

- Current account balance tumbling into deficit for the first time since 1998

Due to the impact of low oil prices on hydrocarbons export revenue and the stagnant hydrocarbon sector output, Qatar witnessed a sharp deterioration in current account balance, shifting from a surplus of US$ 13.8 billion in 2015 (8.4% of GDP) to a deficit of US$ 8.3 billion in 2016 (5.3% of GDP) for the first time since 1998, while the capital and financial accounts have improved, as outflows eased substantially in the past two years. Qatar's foreign trade figures showed a contraction in exports by 25.9% alongside a 12.1% rise in imports in 2016, contributing to a 48.1% decrease in the foreign trade surplus. In parallel, the fiscal budget balance posted a deficit of 4.1% of GDP in 2016, compared to a surplus of 5.6% of GDP in 2015, interrupting a long history of fiscal surpluses, mainly tied to low hydrocarbon prices in the oil and gas markets.

- Tighter monetary conditions despite sustained low inflation level

Qatar's monetary conditions were characterized during the first quarter of the year 2017 by a continuous low inflation level despite subsidy cuts, monetary policy tightening following US interest rate hikes on the back of a fixed exchange rate regime, and a sustained comfortable level of net international reserves. In details, Qatar's Consumer Price Index remained low during the first quarter of 2017, growing by 1.0% on average year-on-year, despite subsidy cuts. This followed a slight uptick in inflation in 2016, as the latter averaged 2.7%, owing primarily to higher energy costs associated with the government's subsidy cuts. On the other hand, Qatar Central Bank's net international reserves reached US$ 33.9 billion at end-March 2017, up from US$ 31.3 billion at end-2016, yet down from US$ 36.8 billion at end-2015. The broader Money Supply (M2) expanded by 4.2% during the first quarter of 2017 to reach US$ 142.4 billion at end-March 2017, following a net contraction in 2016.

- Surge in bank lending to the public sector funded by external liabilities amid dampened liquidity

Qatar's banking sector has been witnessing decent activity amid tough conditions in recent times, with the dampened liquidity in the past couple of years related to the decline in hydrocarbon prices putting pressure on lenders' funding base and impacting private sector lending while curbing profitability. Nonetheless, the sector remains financially sound and apt to weather low hydrocarbon prices with sufficient capital adequacy, asset quality, liquidity and profitability buffers. Furthermore, funding conditions somewhat improved in the past few months with the relative increase in commodities prices. Measured by total assets of banks operating in Qatar, total sector activity grew by 13.5% last year and by a further 1.6% in the first quarter of this year to reach the equivalent of US$ 352.3 billion at end-March.

- Equities under downward price pressures, bond prices up tracking US Treasuries move

Qatar's capital markets witnessed mixed price movements over the first four months of 2017. The Qatar Exchange came under downward price pressures, following price stability in 2016, while the fixed income market posted mostly upward price movements, tracking US Treasuries move, along with extended contractions in five-year CDS spreads. In details, the Qatar Exchange general index fell by 3.6% over the first four months of 2017 to close at 10,064.35 at end-April 2017, after posting a shy rise of 0.1% in 2016. As to the cost of insuring debt, Qatar's five-year CDS spreads continued to underline the very low risk of default, contracting by 21 bps during the first four months of 2017 to reach a 19-month low level of 59 bps at end-April 2017.

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Qatar has generated in 2016 its first twin deficits in 18 years, while activity has fallen as the economy faces up to sustained low hydrocarbon prices. Headline growth has declined to the slowest pace since 2003, registering 2.7% in 2016 amid a stagnant hydrocarbon sector output reflecting in large measure the effects of a self imposed moratorium on additional output from the giant North Field. Fiscal adjustment and tighter banking liquidity actually took a toll on non-hydrocarbon activity in 2016. There was a particular sharp slowdown in manufacturing and transport, offset by strong outturns in construction, wholesale and retail trade and financial services.

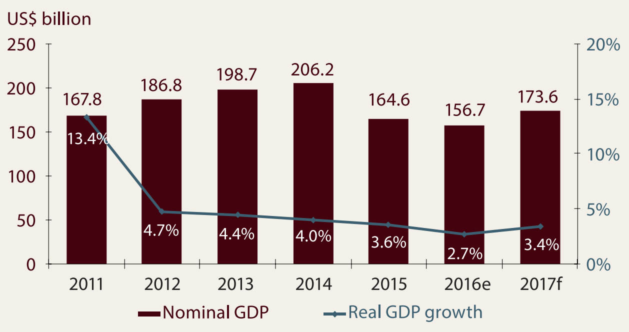
At the public finance level, the budget balance posted a deficit of 4.1% of GDP in 2016, compared to a surplus of 5.6% of GDP in 2015. The 2016 budget deficit actually interrupted a long history of fiscal surpluses, as low hydrocarbon prices persist in the oil and gas markets. Such a deficit is observed despite the considerable reduction in current expenditures. Excluding wages and salaries, the 2016 current expenditures relatively halved compared to fiscal year 2014, reflecting numerous consolidation measures, namely utility price increases, the merger of several ministries, a substantial efficiency drive in government related entities receiving transfers and reduced social benefits including foreign medical treatment. Having said that, the government finances remain manageable, despite the deterioration in the central government budget.

Mirroring low hydrocarbon prices, the external current account position has posted a deficit of 5.3% of GDP in 2016, compared to a surplus of 8.4% in 2015. The deterioration of the current account balance has also been accompanied by reduced financial outflows, particularly the public sector's accumulation of foreign assets. However, Qatar's comfortable net external creditor position provides a satisfactory cushion to absorb the impact on the economy. A large sovereign fund with some US$ 335 billion in assets is helping to anchor confidence in financial markets and the currency peg.

At the monetary level, the Central Bank international reserves relative to domestic currency Money Supply (31.9%) or relative to months of imports (12.7) remained adequate. Inflation has generally risen since the start of 2016, with much of this increase being a result of higher utility bills and fuel subsidy cuts. There has been indeed an uptick in inflation averaging 2.7% in 2016. The growth of real estate prices moderated in 2016, as a result of increased supply of new properties.

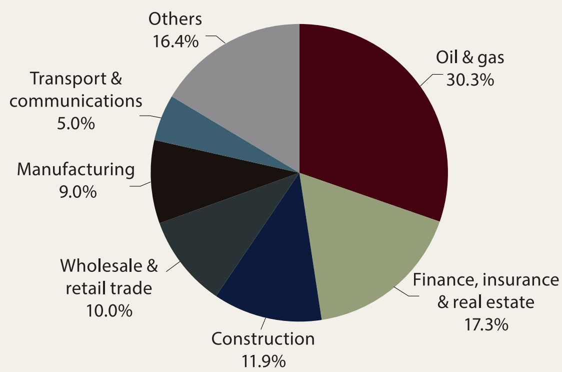
Qatar's banking sector remained well capitalized, with favourable asset quality on the back of relatively stable sources of funds. Non-performing loans stand at less than 2% of total loans and regulatory capital registered 16% of risk-weighted assets. However, liquidity ratios continue to remain relatively tight in view of the decline in public sector deposits. In this tighter liquidity environment, banks have obtained funding abroad through market placements and non-resident deposits. Meanwhile, credit has continued

NOMINAL GDP AND REAL GROWTH RATES



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



* 2016 figures

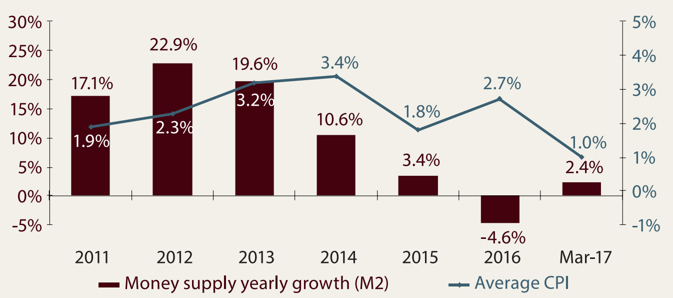
Sources: Central Bank of Qatar, Bank Audi's Group Research Department

to expand, mainly through funding to the public sector. The portfolio of credit facilities rose by 12.1% in 2016, while deposits grew by 11.8% during the year.

At the capital markets level, equity markets reported a standstill, while fixed income markets registered a slight improvement. The Qatar Exchange general index maintained in 2016 its end-2015 level, amid a net decline in value traded. The latter dropped by 26% in 2016, moving from US$ 25.7 billion to US$ 19.0 billion. Relative to market capitalisation, the turnover ratio dropped to 12.2% in 2016 to reach almost a decade low. However a net improvement in market perception of sovereign risks was observed, with the CDS spreads dropping from 93 basis points at end-2015 to 80 basis points at end-2016 and to a low of 59 basis points by the end of April 2017.

The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address Qatar's near-term economic outlook looking forward.

MONEY SUPPLY AND INFLATION



Sources: Central Bank of Qatar, IMF, Bank Audi's Group Research Department

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbons

Qatar's hydrocarbon sector stagnant in 2016 in tandem with lingering oil prices

In tandem with lingering oil prices, Qatar's hydrocarbon sector was stagnant in 2016, with the country's economic policy focused on diversification away from hydrocarbons. Nonetheless, fiscal revenue and foreign receipts remained highly dependent on oil and gas revenue in the past year, and hydrocarbons constituted a major chunk of Qatar's GDP.

As a resulting of the declining energy prices and Qatar's diversification policies away from oil, the hydrocarbon sector's share out of total GDP dropped from 53% in 2014 to reach 39% in 2015 and 30% in 2016. Furthermore, the country's nominal oil and gas GDP attained US$ 46.2 billion last year, down from US$ 63.5 billion in 2015. The hydrocarbon sector contracted by 1.0% year-on-year in real terms during 2016, compared to a 5.6% expansion in the non-hydrocarbon sector.

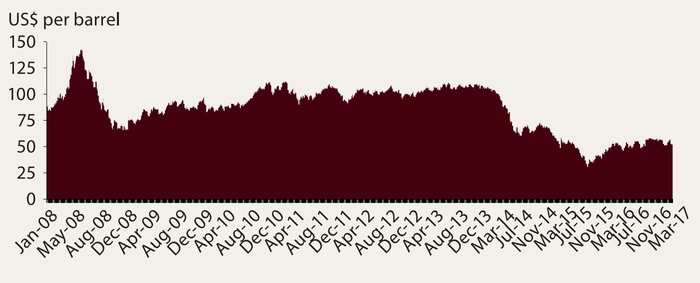
As for gas production, the latter fell from 180.9 billion cubic meters (bcm) in 2015 to 180.4 billion bcm in 2016. It is important to add that the Gulf country delayed the start up of the Barzan gas project after discovering a leak in the gas pipeline, with the first phase scheduled to come online in mid-2017. Thus, Qatar is estimated to produce 185.9 bcm in 2017 down from the original target of 187.0 bcm, before rising to a forecast of 190.6 bcm in 2018.

In parallel, the country's proven gas reserves were estimated at 24.3 trillion cubic meters (tcm) in 2017, against 24.5 tcm in the past year. The natural gas reserves to production ratio, indicating the time reserves would last, was recently estimated at 130.8 years.

Moving on to crude oil production, Qatar remained on a downward course with production falling by 1.1% annually from 663 thousand barrels per day (bpd) in 2015 to 656 thousand bpd in 2016. Moreover, Qatar's oil production fell further in April 2017 to attain 618 thousand bpd. It is worth mentioning that the largest oil project in Qatar is the US$ 13 billion investment planned for the Bul Hanine field, which is due to be redeveloped in order to boost production by 50,000 bpd. The intent of the project is to boost output from around 40,000 bpd to 90,000 bpd and extend field life by drilling some 150 wells by 2028. While the figure is minimal in comparison to Qatar's total oil output, the project should support stable production volumes at the field for 25 years, offering production longevity.

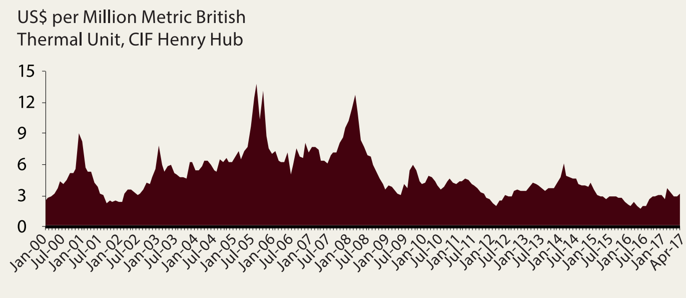
Oil output in Qatar is expected to decline over the next five years, as crude production continues to fall. Output would be supported by field redevelopment projects, NGL production from the Ras Laffan refinery expansion and condensates from gas fields. On the other hand, the country joined OPEC members in curtailing production during the first half of 2017 in order to shift the global glut of crude and bring higher, more stable prices. Qatar has committed to cut 30,000 barrels per day of output.

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

NATURAL GAS PRICES



Sources: IMF, Bank Audi's Group Research Department

In conclusion, despite the oil price collapse, Qatar continues to spend heavily on infrastructure, as set out in the 2030 National Vision, with the country investing heavily in capital projects to accelerate economic diversification. The latter would remain nonetheless reliant on oil and gas earnings to finance the government-led investment drive.

1.1.2. Manufacturing

Manufacturing sector supporting the non-oil economic activity

As part of its diversification strategy, Qatar's manufacturing sector played a role in supporting the government's efforts last year. The Gulf country's manufacturing sector constituted 9.0% of the country's GDP at current prices in 2016, despite contracting by 1.0% year-on-year last year to reach QR 78.9 billion (US$ 21.7 billion).

The country's manufacturing producer price index (PPI), an index that measures the average change in selling prices received by domestic producers of goods and services over time, declined by 14% year-on-year in 2016.

On another note, with the completion of the ongoing development of warehousing and logistics parks and other related infrastructure projects, Qatar is set to emerge as a major food-manufacturing hub in the GCC region, as per the Gulf Organization for Industrial Consulting. Given the rapidly growing population and rising demand for food, Qatar is putting a lot of focus on developing the booming local food manufacturing industry, which has grown to over US$ 25 billion employing over 257,000 people in 2,063 factories operating in the food manufacturing sector in 2016.

In parallel, in order to keep up with rapidly growing demand, the Qatari government outlined plans to make sizable investments in its power and water infrastructure in the period up to 2021 (prior to the hosting of the FIFA World Cup in 2022). The planned upgrades include the building of 140 new electricity substations and the addition of over 2,000 MW of capacity in the next five years. Despite years of surging demand for electricity in Qatar, no new power plant was built since construction on the 2,700 MW Ras Laffan C independent water and power project facility began in 2008.

Thus, major investment flows into commercial construction and transport networks, as the country prepares to host the FIFA 2022 World Cup, are expected to have positive spillovers on Qatar's manufacturing sector. Modern infrastructure in the country would only enhance the current state of the sector, and attract further investor flows into the sector. All of the latter would lead to a diversified economy that gradually reduces its dependence on hydrocarbon industries, enhances the role of the private sector and maintains its competitiveness.

1.1.3. Construction

Strong sectoral activity amidst diversification efforts

The construction sector in Qatar has maintained robust growth in 2016 amidst government attempts to diversify the economy away from the hydrocarbons sector.

In fact, during the year 2016, Qatar's construction sector grew by 14.0%, against a growth of 18.0% reported in 2015. The construction sector accounted for 11.9% of GDP in 2016, while the real estate price index fell by 3 points as of March-2017 from year-end 2016. According to CBRE, a 5% year-on-year decline in residential rentals has been reported over the year in Qatar.

In parallel, the real estate and construction sector captured 22.5% of credit facilities advanced by the Qatari banking sector at end-March 2017, slightly lower than the 24.1% registered in March 2016, while loans to the construction sector grew by a yearly 4.0% at as end-March 2017.

The government announced US$ 200 billion in spending on capital projects over 2014-2018, the majority of which is concentrated in the transport and construction sector including the Doha metro and the Doha port project. This underpins Qatar's fiscal commitment to realize its infrastructure program.

As foreign investors are lured into the market to secure major projects in the run up to the 2022 FIFA World Cup, supply is outpacing demand with overcapacity in the market leading to lower occupancy rates across the office and hotel segments.

The effects on the retail segment were observed as well, and are expected to be felt more in the long term. The shortage of skilled labor and inflated costs of building materials remain key concerns for businesses operating in the market as well.

In order to mitigate the rising costs some contractors are facing, the government created a single buying source to import materials into the country run by a government subsidiary, which in turn sells on to the contractors.

Looking forward, high levels of spending would persist in the medium term as Qatar continues to develop the non-hydrocarbon sector. However, rising construction costs would add further strain, as the growing demand for both materials and labor in Qatar and regionally would lead to price increases and a scope for a scaling of the project pipeline to a more sustainable level.

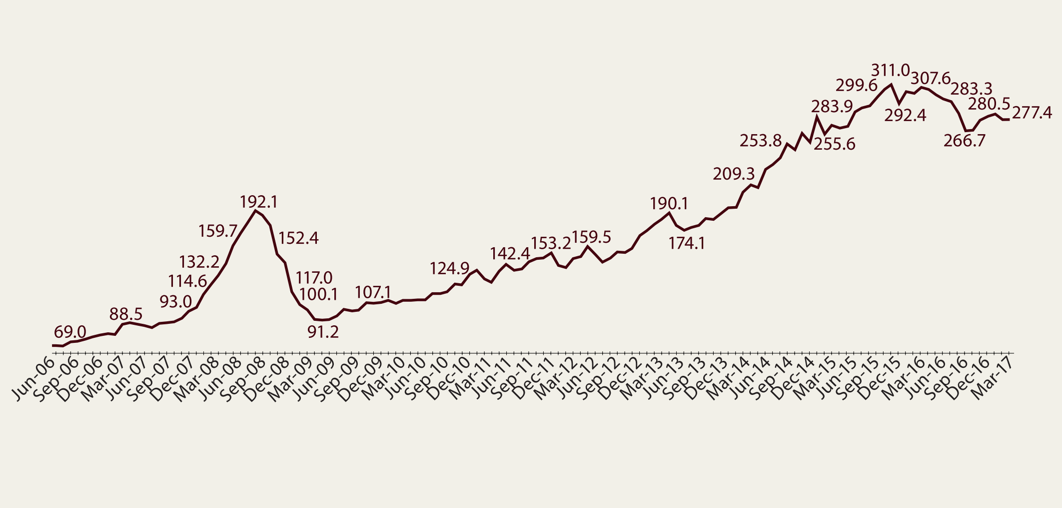
1.1.4. Tourism

Tourism sector continues its positive contribution to the economy despite slowdown in hospitality indicators

Qatar's tourism industry was identified as one of the key areas of diversification of the economy. The sector was earmarked as a pivotal alternative contributor to the country's GDP, as the government continues to be committed to develop the sector in an era of global oil price slump. In this context, the Qatari government plans to invest up to US$ 45 billion in the long-run in order to implement the Tourism Vision 2030 which focuses on attracting up to ten million visitors annually by 2030. This comes along as the country prepares to host several international sports events like the 2022 FIFA World Cup which encourages investment in the sector and promotes its visibility.

According to the World Travel & Tourism Council (WTCC), direct contribution of travel and tourism to Qatar's GDP was US$ 5.2 billion in 2016 (3.4% of the total GDP) and is expected to grow by around 7.7%

REAL ESTATE PRICE INDEX



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

in 2017. In details, leisure travel spending contributed to around 58% of the direct travel and tourism GDP, while business spending took over the remaining share. Additionally, travel and tourism investment stood at US$ 1.7 billion (2.4% of total investment) in 2016, down from US$ 1.8 billion in the previous year. WTCC forecasts this contribution to expand by 13.6% in 2017.

It is worth noting that around 3.5 million people entered Qatar in 2016, whereby visitors from the GCC took over the greatest share of arrivals, followed by other Asians including Oceania, Europeans, other non-GCC Arab nationals, Americans and Africans.

However, the performance of the four and five star hotels in Doha was negative in 2016 when compared to 2015, as per EY. Occupancy registered 63% in 2016, slightly under its level of 65% in 2015. The average room's rate was US$ 213 last year, down from US$ 249 in 2015. This left the rooms' yield at US$ 136 in 2016, down by a yearly 16.6%. In the first quarter of 2017, the slowdown in the hospitality sector's performance continued, whereby occupancy rate stood at 70.3% down from 71% in the same period of last year, and the average room rate declined by a yearly 11.5% to stand at US$ 185 in the aforementioned period of this year. Hence, the rooms' yield contracted by 12.8% from US$ 149 in the first quarter of 2016 to US$ 130 in the corresponding period of 2017.

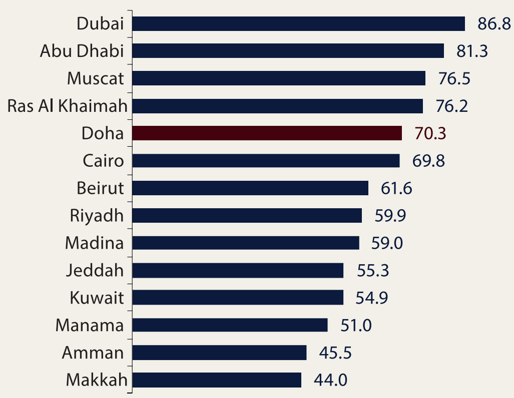
Having said that, Qatar's tourism sector continued to be a pillar in the country's diversification strategy, despite some declines in the indicators of the hospitality sector. The country continues, as part of its national tourism strategy, to attempt to boost the number of international tourists and promote sustainable tourism, as well as growing business and medical travel. In this context, the government took steps to reduce barriers to entry and visitors of a number of countries can now receive tourist visas upon arrival.

1.2. EXTERNAL SECTOR

Current account balance tumbling into deficit for the first time since 1998

Due to the impact of low oil prices on hydrocarbons export revenue and the stagnant hydrocarbon sector output, Qatar witnessed a sharp deterioration in current account balance, shifting from a surplus of US$ 13.8 billion in 2015 (8.4% of GDP) to a deficit of US$ 8.3 billion in 2016 (5.3% of GDP) for the first time since 1998, while the capital and financial accounts have improved, as outflows eased substantially in the past two years. As such, the balance of payments recorded a deficit of US$ 5.6 billion in 2016, against a slightly lower deficit of US$ 5.5 billion in 2015.

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



* First quarter of 2017, four and five star hotels

Sources: Ernst & Young, Bank Audi's Group Research Department

In fact, Qatar's foreign trade figures showed a contraction in exports by 25.9% alongside a 12.1% rise in imports in 2016, contributing to a 48.1% decrease in the foreign trade surplus, according to the Central Bank of Qatar. In fact, Qatar's trade surplus contracted from US$ 48.8 billion in 2015 to US$ 25.3 billion during 2016, to reach the equivalent of 16.2% of Qatar's GDP (from 29.6% of GDP in 2015). As such, Qatar's foreign trade activity posted a net contraction in terms of volume, as the sum of exports and imports went down by 15.7% moving from US$ 105.8 billion in 2015 to US$ 89.2 billion in 2016. Accordingly, the exports to imports coverage ratio fell from 271% in 2015 to 179% in 2016, a historical low level for Qatar.

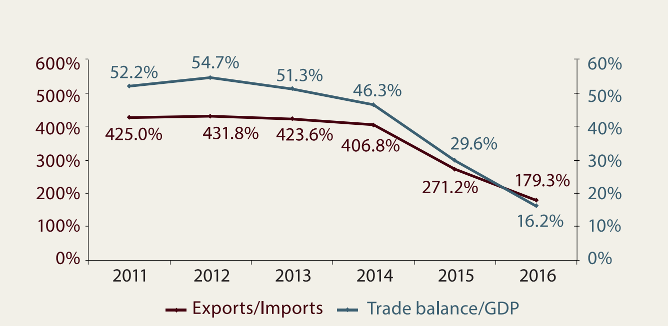
Going further into details, total exports (including exports of domestic goods and re-exports) reached a total of US$ 57.3 billion in 2016, a decline from US$ 77.3 billion in 2015. The breakdown of exports by category, according to the Ministry of Development Planning and Statistics, suggests that among the major categories, exports of mineral fuels and lubricants posted the most significant decline of 27.7% year-on-year to make up 81.5% of total exports (down from 83.4% in 2016), followed by chemicals with a drop of 19.0%, manufactured goods with a decline of 17.5%, and crude materials except fuels with a drop of 14.6%. On the other hand, the main items to have displayed a significant increase were miscellaneous manufactured articles with a rise of 11.3% and beverages and tobacco from US$ 1.9 million in 2015 to US$ 6.9 million in 2016. The geographic distribution of domestic exports indicates that 19.1% of total exports went to Japan, followed by South Korea with 15.7% of the total, India with 12.9%, China with 7.8%, UAE with 6.6% and Singapore with 5.2% of total exports.

At the level of imports, a total of US$ 31.9 billion was registered in 2016, compared to US$ 28.5 billion in 2015. The breakdown of imports by category suggests that imports of machinery and transport equipment posted the highest share of 44.4% of total imports, followed by miscellaneous manufactured goods with 16.2%, manufactured goods with a share of 15.9%, and food and live animals with 8.9% of total imports. The breakdown of imports by country of origin shows that 14.3% of the inward merchandise in 2016 came from USA, followed by China with 10.4% of the total, Germany with 9.3%, UAE with 9.1%, Japan with 6.7%, and Saudi Arabia with 4.3% of total imports.

In parallel, Qatar posted net deficits in its balances of services, income and transfers in 2016, to US$ 16.4 billion (+3.7%), US$ 1.1 billion (-68.9%) and US$ 16.2 billion (+3.0%), respectively. In the income category, profit repatriation of foreign companies in Qatar remains the largest contributor to the negative balance, yet with a slump in profit repatriation from firms working in the oil sector. As to the transfers' category, the latter is dominated by outward remittances of expatriates residing in Qatar, which amounted to US$ 11.8 billion in 2016, slightly down by 1.7% from the previous year. On another hand, capital and financial balances recorded a surplus of US$ 3.8 billion for the first time since 2009. This was mainly due to two factors: the portfolio investment that posted a surplus of US$ 6.1 billion in 2016, against a deficit of US$ 16.5 billion in 2015, and other investment balance that reported a surplus of US$ 5.6 billion in 2016, against a smaller surplus of US$ 0.7 billion in 2015. Finally, direct investments abroad reported a negative balance of US$ 7.9 billion in 2016, relative to another negative balance of US$ 4.0 billion in 2015.

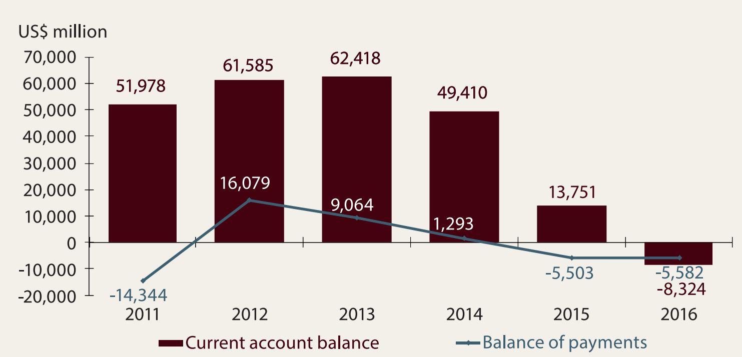
1.3. PUBLIC SECTOR

FOREIGN SECTOR INDICATORS



Sources: Central Bank of Qatar, IMF, Bank Audi's Group Research Department

CURRENT ACCOUNT AND BALANCE OF PAYMENTS



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

Drop in hydrocarbon receipts widening fiscal deficit

Qatar witnessed a significant widening of the fiscal deficit amidst low oil prices in 2016. The fall in hydrocarbon receipts exerted pressure on Qatar's government balance, amidst efforts to diversify the economy away from hydrocarbons.

The budget balance emerged at around -4.1% of GDP at the end of 2016, against 5.6% in 2015, according to the IMF. In fact, the government balance slumped to post a deficit of US$ 6.4 billion in 2016, down from a surplus of US$ 9.2 billion in the previous year.

In details, revenues are estimated to have dropped by 38.7% to reach US$ 47.5 billion in 2016 down from US$ 77.6 billion in 2015, after a witnessing a similar drop in 2015. Oil revenues, which constitute a major share of total revenues, fell by 60% in 2016 compared to values registered 2015. Actually, revenues stemming from hydrocarbons accounted for an estimated 29% of the total in 2016 compared to a higher share of 40% in 2015.

In parallel, expenditures totaled US$ 53.9 billion in 2016, down by 21.1% from the previous fiscal year during which they reached US$ 68.4 billion. This occurred within the context of efforts by government officials to restrain current spending and limit non-essential public works in order to accommodate rising capital expenditure as the World Cup draws near.

Fiscal consolidation is evident in the country as the Qatari government introduced a new system under which a committee at the Ministry of Energy and Industry sets the price of oil at the start of each month based on changes in the international energy market.

The authorities have been financing the 2016 fiscal deficit mainly through domestic and foreign borrowing, without drawing down their sovereign wealth fund. In 2016, Qatar raised a total of US$ 14.5 billion of external debt and issued US$ 2.6 billion of domestic bonds and Sukuk.

Total government debt increased by 29.7% to reach US$ 74.6 billion in 2016 up from US$ 57.5 billion in end-2015. It is worth mentioning that public debt as a percentage of GDP is estimated at 47.6% of GDP in 2016, up from 34.9% of GDP in 2015.

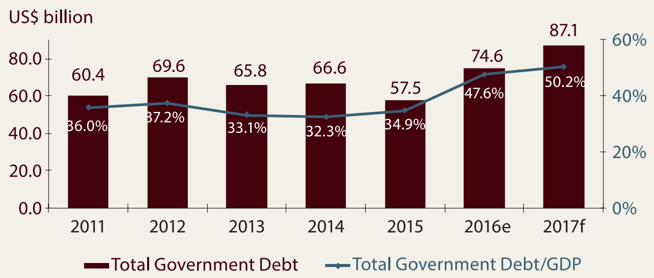
In sum, the Qatari government is attempting to maintain fiscal buffers and control the impact of the fall in oil prices using prudent fiscal policies. Fiscal and external balances are projected to improve only moderately in the near to medium term. In 2017, the central government deficit is expected to decline, amidst efforts to restrain spending as Qatar is implementing important investment projects. According to the IMF, the fiscal deficit is expected to reach 3.1% of GDP in 2017. Fee hikes for public services and sin taxes are being considered, and a VAT (already agreed with other GCC countries) is expected to be implemented in 2018.

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2014	2015	2016e	2017f
General government revenues	100.4	77.6	47.5	50.6
General government revenues/GDP	48.7%	47.1%	30.3%	29.1%
General government expenditures	68.9	68.4	53.9	56.0
General government expenditures/GDP	33.4%	41.5%	34.4%	32.3%
General government fiscal balance	31.5	9.2	-6.4	-5.5
General government fiscal balance/GDP	15.3%	5.6%	-4.1%	-3.1%

Sources: IMF, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Tighter monetary conditions despite sustained low inflation level

Qatar's monetary conditions were characterized during the first quarter of the year 2017 by a continuous low inflation level despite subsidy cuts, monetary policy tightening following US interest rate hikes on the back of a fixed exchange rate regime, and a sustained comfortable level of net international reserves.

In details, Qatar's Consumer Price Index remained low during the first quarter of 2017, growing by 1.0% on average year-on-year, despite subsidy cuts. This followed a slight uptick in inflation in 2016, as the latter averaged 2.7% (as compared to an average of 1.8% in 2015), owing primarily to higher energy costs associated with the government's subsidy cuts. In fact, gasoline prices were adjusted upwards by 30% in January 2016. The increase in domestic fuel prices was followed in May 2016 by the implementation of a regular price adjustment mechanism.

The breakdown of the Consumer Price Index by segment shows over the first quarter of 2017 that the transport segment rose by 6.2% year-on-year, followed by the education segment with +3.0%, the miscellaneous goods and services segment with +1.6%, and the furnishings and household equipment segment with +1.4%. In contrast, the restaurants and hotels segment reported a yearly decline of 2.7% on average over the first quarter of 2017, followed by the food and beverages segment with -0.9%, the clothing and footwear segment and the housing, water, electricity and gas segment with -0.3% each, the culture and recreation segment and the medical services segment with -0.2% each, and the communication segment with -0.1%. In 2017, inflation is forecast to remain low, averaging 2.6%, according to the IMF.

The Qatari riyal remained pegged to the US dollar at a rate of QR 3.64/US$ 1, and the Qatari authorities remained committed to maintaining the current fixed exchange rate regime as it has simplified the conduct of macroeconomic policy and provided a credible anchor for economic stability. Within this context, interest rate hikes by the US Federal Reserve entailed monetary policy tightening in Qatar for the first time since August 2011. The Central Bank of Qatar raised the overnight deposit rate by 25 bps in December 2016 and March 2017, tracking US Federal Reserve move, to reach a current 1.25% as compared to 0.75% at end-2015. Concurrently, the Central Bank of Qatar lifted the overnight lending rate by a quarter of a percentage point in December 2016 and March 2017 to reach 5.00% at present, up from 4.50% at end-2015.

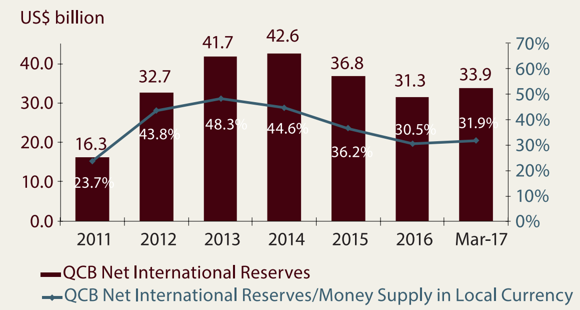
On the other hand, Qatar Central Bank's net international reserves reached US$ 33.9 billion at end-March 2017, up from US$ 31.3 billion at end-2016. This followed a significant fall of US$ 5.5 billion in 2016, mainly driven by a US$ 4.9 billion drop in foreign securities, despite the issuance of a US$ 9 billion multi-tranche bond in June 2016, as Qatar drew down on both its international reserves and its domestic and external borrowings to finance its first twin fiscal and current account deficits in 18 years amid a slump in oil

EVOLUTION OF MONETARY SITUATION

Flows in millions of US$	2012	2013	2014	2015	2016	Q1-17
Net foreign assets	**1,538**	**22,926**	**4,946**	**-21,283**	**-29,270**	**1,375**
Foreign Assets	18,843	18,575	10,058	1,398	8,304	2,484
Foreign Liabilities	-17,305	4,351	-5,113	-22,681	-37,574	-1,109
Net Domestic Assets	**17,992**	**-2,414**	**8,326**	**26,052**	**22,721**	**4,325**
Claims on private sector	24,520	14,024	12,239	16,913	5,651	1,009
Net claims on public sector	3,246	-11,587	3,330	16,310	17,895	3,602
Other Items (net)	-9,774	-4,851	-7,243	-7,171	-825	-287
Broad Money (M2)	**19,530**	**20,511**	**13,272**	**4,769**	**-6,548**	**5,700**
Money Supply (M1)	2,498	4,119	5,034	733	391	1,786
Quasi-Money	17,032	16,393	8,238	4,036	-6,939	3,914

Sources: Central Bank of Qatar, Bank Audi's Group Research Department

EXCHANGE MARKET INDICATORS



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

receipts. That being said, the QCB net international reserves covered around 31.9% of money supply in local currency at end-March 2017, as compared to 30.5% at end-2016 and 36.2% at end-2015.

The broader Money Supply (M2) expanded by 4.2% or the equivalent of US$ 5.7 billion during the first quarter of 2017 to reach US$ 142.4 billion at end-March 2017, mainly driven by a US$ 3.9 billion expansion in quasi-money. A closer look at factors affecting money supply (M2) shows that net claims on the public sector grew significantly by US$ 3.6 billion during the first quarter of 2017, as the Qatari authorities continued to rely on domestic borrowing to fund the country's shortfalls; the claims on the private sector remained moderate, rising by US$ 1.0 billion, on the back of a tighter liquidity in the banking system as a result of lower hydrocarbon fiscal and external revenues amid lower oil prices; and net foreign assets expanded by US$ 1.4 billion. This followed a US$ 6.6 billion contraction in money supply (M2) in 2016, the equivalent of 4.6%, mainly driven by a surge in foreign liabilities as banks increasingly sought to attract non-resident deposits and wholesale funding.

Looking forward, further subsidy cuts, a moderate recovery in global commodity prices, and the introduction of a VAT would continue to drive the overall price level, while the subdued growth prospects in Qatar would keep inflation low. In parallel, significant dollar appreciation and higher interest rates in the US may entail further monetary policy tightening in Qatar, given the Qatari riyal peg to the US dollar.

1.4.2. Banking Activity

Surge in bank lending to the public sector funded by external liabilities amid dampened liquidity

Qatar's banking sector has been witnessing decent activity amid tough conditions in recent times, with the dampened liquidity in the past couple of years related to the decline in hydrocarbon prices putting pressure on lenders' funding base and impacting private sector lending while curbing profitability. Nonetheless, the sector remains financially sound and apt to weather low hydrocarbon prices with sufficient capital adequacy, asset quality, liquidity and profitability buffers. Furthermore, funding conditions somewhat improved in the past few months with the relative increase in commodities prices.

Measured by total assets of banks operating in Qatar, total sector activity grew by 13.5% last year and by a further 1.6% in the first quarter of this year to reach the equivalent of US$ 352.3 billion at end-March. The increase in balance sheet throughout the covered periods was driven mostly by higher lending, and to a lesser extent by higher funds parked at banks abroad (2016) or at the QCB (1Q2017), suggesting higher funds collected were channeled first and foremost towards lending (to the public sector), and then to maintain liquidity buffers.

Underneath the surge in lending activity lies a change in the direction of funds. As a matter of fact, while in 2015 the non-domestic public sector (i.e. private sector as we will label it including credit outside Qatar) got 95% of the 15.1% increase in total credit facilities, last year and the first few months of this year saw it differently. Last year, total credit facilities almost sustained their overall increase with +12.1%, but only 39% of it was attributed to the private sector, leaving the bulk to the public sector which has been having rising financing needs. As for the first quarter of this year, only 31% of new loans were attributed to the private sector, with total credit facilities rising by 1.9% between December 2016 and March 2017 to reach the equivalent of US$ 235.0 billion.

The surge in public sector lending is attributed to the government itself both last year and so far this year, while semi-government institutions saw a contraction in lending volumes, bearing in mind that the State has been implementing fiscal consolidation measures to rein in budget deficits. Among private sector beneficiaries of new loans, the real estate and contracting sectors benefited the most, followed by other sectors (including services and industry) and retail loans.

Also at the asset utilization side of banks' balance sheets, reserves and deposits at banks in Qatar and abroad have increased. Such core liquidity has accounted for 29% of the total asset increase in 2016 and for a lower 9% so far in 2017. The core liquidity ratio, dividing the sum of the above by total deposits according to our calculations, moved from 23.8% at end-2015 to 27.2% at end-2016 and to 26.5% at end-March 2017, depicting an overall improvement in liquidity ratios, which compare favorably to regional and international averages, despite the difficult operating conditions. One can add to this core liquidity the domestic government securities banks hold, and which can be repo-ed with the QCB if needed during times of stress.

However, another measure of liquidity, the credit facilities to deposits ratio, remains elevated at close to 115% at end-March 2017, reflecting tight liquidity conditions at large in the sector. It is worth noting that the QCB had set a deadline for compliance to a 100% loan-to-deposit ratio by end-2017 (deposit side including only customer deposits and not long-term wholesale funds which have recently been a source of funding). The Ministry of Development Planning and Statistics said in its last Qatar Economic Outlook that the QCB may be forced to postpone this deadline until end-2018 due to liquidity constraints.

At the level of liabilities, the surge in lending activity was visibly funded by foreign deposits and market funding rather than by the resident sector as was the tradition. With the government a major depositor suffering from a cash crunch, banks have resorted to non-resident deposits, inter-bank loans and market funding from abroad to raise funds and finance the government itself, thus exposing the sector further to swings in global credit conditions and market sentiment. Foreign liabilities rose from 23% of total liabilities at end-2014 to 28% at end-2015 and to 35% today. In contrast, resident deposits saw a retreat last year before renewing with growth in 2017, likely favored by the increase in oil prices in recent months.

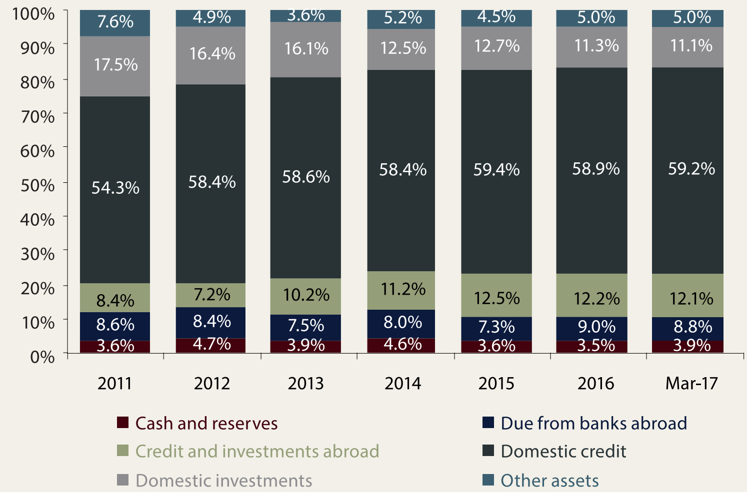
On the overall, the total deposit base rose by 11.8% last year and by a further 3.6% in 1Q2017 to reach the equivalent of US$ 206.8 billion at end-March 2017. Last year the rise in non-resident deposits more than offset a contracting resident depositor base, and going more into details the public sector deposits contracted more than the private sector ones rose. However, so far in 2017 the resident base picked up

EVOLUTION OF BANKING ACTIVITY

US$ million	2013	2014	2015	2016	Q1-16	Q1-17	Variation Q1/Q1
Var. Total assets	25,670	26,016	29,659	41,211	5,846	5,443	-6.9%
% change	11.4%	10.4%	10.7%	13.5%	1.9%	1.6%	-0.3%
Var. Total deposits	24,813	14,475	13,513	21,049	3,093	7,105	129.7%
% change	19.7%	9.6%	8.2%	11.8%	1.7%	3.6%	1.8%
Var. Total credit facilities	18,342	20,554	27,052	24,897	6,612	4,442	-32.8%
% change	13.1%	13.0%	15.1%	12.1%	3.2%	1.9%	-1.3%

Sources: Central Bank of Qatar, Bank Audi's Group Research Department

BANKING SECTOR ASSET COMPOSITION



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

some steam and accounted for three quarters of the total deposit base increase (mostly resulting from the private sector but also the public sector).

While lending surged in the covered periods, banks have maintained more than comfortable asset quality metrics. The NPLs to total loans ratio stood at a low 1.3% at end-2016 as per the latest available data, down from 1.6% at end-2015, and amongst the most favorable ratios in the world. Banks also maintain ample provisions against their NPLs with the relevant ratio at circa 80%. Capitalization is satisfactory, with the Basel III regulatory capital ratio at 16.1% at end-2016 (15.6% at end-2015), the bulk of which is comprised of Tier 1 capital (above requirements). Finally, while banks' bottom lines have been pressured by higher cost of funds and pressures on asset yields and provisions, profitability ratios remain comparatively adequate, partly owing to a structurally low cost-to-income ratio of less than 30%, with the sector-wide ROAA at 1.7% in 2016 and the ROAE at 14.5%.

1.4.3. Equity and Bond Markets

Equities under downward price pressures, bond prices up tracking US Treasuries move

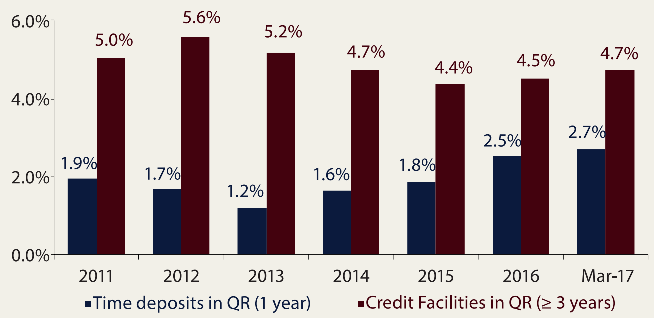
Qatar's capital markets witnessed mixed price movements over the first four months of 2017. The Qatar Exchange came under downward price pressures, following price stability in 2016, while the fixed income market posted mostly upward price movements, tracking US Treasuries move, along with extended contractions in five-year CDS spreads.

In details, the Qatar Exchange general index, which is a capitalization weighted index of the 20 most highly capitalized and liquid stocks traded on the Qatar Exchange, fell by 3.6% over the first four months of 2017 to close at 10,064.35 at end-April 2017, after posting a shy rise of 0.1% in 2016.

Equity price drops came at the image of several unfavourable company-specific and market-specific factors. First, the second phase of Qatar's upgrade by FTSE Russell to secondary emerging market status, which stoked foreign institutional demand and triggered some price gains over the first two months of 2017, was completed in March 2017, triggering some profit-taking operations; second, Brent oil prices dropped by 11.3% over the first four months of 2017, given that OPEC delegates downplayed the chance that the cartel and other producing countries would deepen their output cuts on their upcoming meeting on May 25, 2017; third, some unfavourable first quarter earnings and relatively higher valuations weighed on investor sentiment. In fact, the combined net profit of all listed companies stood at QR 10.7 billion during the first quarter of 2017 as compared to QR 10.8 billion during the corresponding period of 2016, down by 1%. Also, Qatari stocks traded at a P/E of 14.2x at end-April 2017, as compared to a lower ratio of 13.8x at end-December 2016. The dividend yield reached 3.55% at end-April 2017 versus 3.76% at end-December 2016.

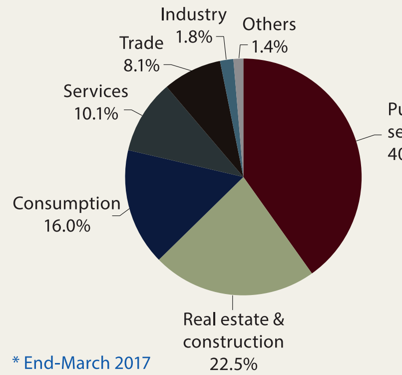
The number of listed companies in the Qatar Exchange remained unchanged at 44 companies at end-April 2017 relative to end-2016. This combined with equity price drops resulted into a 3.7% decline in the market capitalization over the first four months of 2017, moving from US$ 154.8 billion at end-2016 to

INTEREST RATES ON TERM DEPOSITS & CREDIT FACILITIES



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

CREDIT FACILITIES BY ECONOMIC ACTIVITY*



Sources: Central Bank of Qatar, Bank Audi's Group Research Department

US$ 149.0 billion at end-April 2017. This followed a small increase in the market capitalization of 1.9% in 2016 that came within the context of a mere increase in the Qatar Exchange general index and the listing of Qatar First Bank in April.

The total trading value on the Qatar Exchange amounted to US$ 7.5 billion during the first four months of 2017, dropping by a slight 1.8% relative to the corresponding period of the previous year. The total number of traded shares increased by 1.5% year-on-year to reach 845.1 million shares over the first four months of 2017, up from 832.6 million shares during the corresponding period of 2016. The total number of transactions reached 323,792 transactions during the first four months of 2017 versus 419,146 transactions during the same period of 2016. That being said, the turnover ratio, measured by the annualized trading value to market capitalization, reached 15.2% during the first four months of 2017. This compared to a relatively similar ratio of 15.3% during the corresponding period of 2016.

At the level of the fixed income market, sovereign papers, high grade names and papers issued by financial institutions saw mostly upward price movements during the first four months of 2017, tracking rises in US Treasuries after the US President unveiled his preference for a low-interest rate monetary policy. This followed mostly downward price movements in 2016.

In details, the sovereign curve performed strongly during the first four months of 2017, with papers maturing between 2021 and 2046 registering price gains of 0.63 pt to 6.38 pts, along with Z-spreads contractions of up to 45 bps. Qatari Diar'20 closed up by 0.50 pt and saw a 33 bps contraction in bid Z-spreads. Qtel papers maturing between 2023 and 2043 rose by up to 4.25 pts. Also, financials such as Commercial Bank of Qatar, Qatar National Bank, Ahli Bank Qatar and International Bank of Qatar registered price increases ranging between 0.38 pt and 2.63 pts. As to the cost of insuring debt, Qatar's five-year CDS spreads continued to underline its very low risk of default, contracting by 21 bps during the first four months of 2017 to reach a 19-month low level of 59 bps at end-April 2017. This followed a contraction of 13 bps in 2016. It is worth noting that the Qatar CDS spreads are the third lowest in the region after Abu Dhabi (41 bps) and Kuwait (50 bps), and much below the average CDS spreads in the Middle East (198 bps), emerging markets (182 bps) and global markets (181 bps).

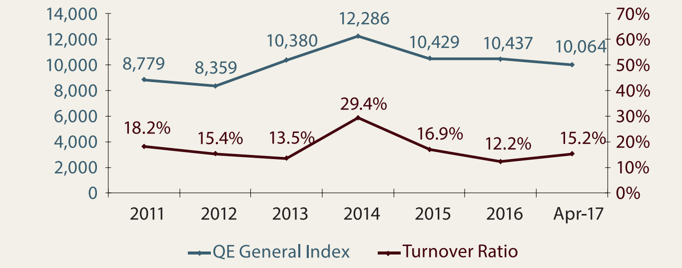
As to new bond issues, Qatar tapped in June 2016 the international bond markets for the first time in five years, raising US$ 9 billion through the sale of US$ 3.5 billion five-year notes priced to yield 120 bps over US Treasuries, US$ 3.5 billion 10-year bonds priced at 150 bps over US Treasuries and US$ 2 billion worth of 30-year papers priced at 210 bps spread, noting that the size of the offer was almost double than the original to benefit from lower pricing ahead of a US Federal Reserve interest rate hike. Following this large bond issue, the Qatari government announced recently that it has no plans to launch an international bond or Sukuk issue in 2017, while continuing to make domestic issues of bonds to cover its budget deficit. In fact, the Central Bank of Qatar sold in April 2017 circa QR 5.58 billion of domestic bonds, with issuance heavily focused on the long end of the yield curve. It sold QR 150 million worth of three-year bonds at a yield of 2.75%, QR 800 million worth of five-year bonds at 3.35%, QR 1.7 billion worth of seven-year bonds at 4.0%, and QR 2.9 billion worth of 10-year bonds at 4.5%.

CAPITAL MARKETS INDICATORS

	2012	2013	2014	2015	2016	Apr-17
Market Capitalization (US$ billion)	126.3	152.6	185.9	152.0	154.8	149.0
Market Cap/GDP	67.6%	76.8%	90.2%	92.3%	98.8%	91.8%
Total value traded (US$ billion)	19.4	20.6	54.8	25.7	19.0	7.5
Total number of shares (million)	2,428	1,938	4,440	2,302	1,977	845
No. of listed companies	42	42	43	43	44	44
% Chg. in QE general index	-4.8%	24.2%	18.4%	-15.1%	0.1%	-3.6%
P/E ratio	13.0x	14.6x	16.2x	11.5x	13.8x	14.2x
P/BV ratio	1.9x	2.0x	2.1x	1.6x	1.6x	1.6x
Dividend yield	4.0%	3.9%	3.7%	5.2%	3.8%	3.6%
CDS spreads (bps)	82	59	82	93	80	59

Sources: Qatar Exchange, IMF, Bloomberg, Bank Audi's Group Research Department

CAPITAL MARKETS PERFORMANCE



Sources: Qatar Exchange, Bank Audi's Group Research Department

In parallel, Qatar Reinsurance Co. launched in February 2017 a US$ 450 million perpetual bond with a yield of 4.95%. Also, Ezdan Holding Group issued in March 2017 a five-year US$ 500 million bond at a coupon of 4.875%. Ahli Bank of Qatar issued in April 2017 a five-year US$ 500 million bond at 260 bps over midswaps.

As to credit ratings, Standard & Poor's revised to "negative" from "stable" its outlook on the long-term sovereign credit ratings on the State of Qatar. At the same time, it affirmed the "AA" long-term and "A-1+" short-term ratings. The "negative" outlook reflects, according to S&P, the risk that Qatar's external position could deteriorate further should the rapid growth in external debt continue to outpace external liquid asset growth, thereby reducing the buffer provided by its sizable external assets.

Looking forward, the IMF considers developing the local currency debt market an important policy priority for Qatar. Among other benefits, further development of the domestic market can help reduce Qatar's reliance on foreign funding as Qatar advances its diversification agenda and prepares for the FIFA 2022 World Cup. Qatar has made significant efforts to develop its domestic government securities market but further progress is still needed. In fact, the lengthening of the maturity profile of debt issuance would help the emergence of a risk-free yield curve across the term structure, which would serve as a reference for pricing other financial instruments, as per the IMF.

2. CONCLUSION

Looking ahead, the pace of economic activity growth will be largely influenced by the trends in the oil market and their direct and indirect impact on domestic demand. For 2017, real GDP growth is forecasted at 3.4% by the IMF, premised on the continued growth of non-hydrocarbon sectors. The short to intermediate outlook appears more favourable than that at the same period of last year in light of the higher forecast for hydrocarbon prices and Qatar's competitive edge in LNG production. In the medium term, Qatar's economic expansion is expected to be partially driven by spending relating to the government's national development strategy. Projects include the Hamad International airport, GCC and internal rail links, Doha Port, reservoirs and water treatment plants, industrial zones, and new stadiums and other facilities related to the 2022 FIFA World Cup.

At the public finance level, the authorities are expected to pursue limited fiscal adjustment measures in 2017 in order to reign in the budget deficit. The fiscal consolidation measures planned in 2017 include further subsidy cuts, an increase in public fees and taxes and the implementation of VAT. The IMF expects the central government balance to post smaller deficits of about 3.1% in 2017 and 0.6% in 2018, in tandem with a slight recovery in hydrocarbon prices to return to surpluses as hydrocarbon exceeds the government's expected fiscal breakeven hydrocarbon price of US$ 66 per barrel. As the government will continue to finance both its fiscal deficits and its infrastructure projects through debt, both on the domestic and international markets, the debt-to-GDP ratio is set to exceed 50% of GDP in the near term.

At the foreign sector level, external liquidity is manageable, with gross external financing needs around 27% of GDP in 2017 in view of the forecasted current account deficit and debt repayments. The current account balance is forecasted to move from deficits to surpluses of 0.7% and 0.6% of GDP respectively in 2017 and 2018, on the back of a relative recovery in hydrocarbon prices.

At the monetary level, with the tightening of domestic liquidity conditions pushing up interest rates, Qatari interest rates are set to rise steadily through to 2018, tracking the projected increases in the Fed's rates. The currency peg constrains the ability of the Central Bank to use monetary policy for promoting growth and controlling inflationary expectations. It is expected that further subsidy cuts, strong demand for housing and the government's heavy spending on World Cup related public works will continue to drive up consumer price inflation to 2.6% in 2017 and 5.7% in 2018.

The analysis of Qatar's short to medium term outlook actually requires a careful examination of strengths and opportunities relative to the threats and challenges. At the level of the former, we mention the large hydrocarbons reserves relative to the size of the population, the substantial financial reserves and moderate government debt levels, the high income per capita with Qatar among the richest countries in the world and the comfortable international liquidity position.

At the level of risks constraining the outlook, we mention the relatively low hydrocarbon prices with ongoing dependence on LNG exports, the relatively nascent institutional framework, the limited disclosure of data on public finances and assets under management by the Qatar Investment Authority, the widened geopolitical risks and the rising private sector external debt.

Having said that, Qatar is well positioned to mitigate the adverse effects of sustained lower hydrocarbon prices, considering its substantial financial buffers. Still, given the uncertain outlook for the gas sector later this decade and beyond, the development of the non-hydrocarbon sector is critical. To diversify and achieve its aspirations for a "knowledge driven economy" as per the Qatar National Vision 2030, Qatar will have to raise the productivity of its investments, in both human and physical capital, and undertake structural reforms to improve the business environment at large.

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