QATAR ECONOMIC REPORT

THE RELATIVE SUCCESS OF COUNTERCYCLICAL POLICIES AMID A TOUGH REGIONAL ENVIRONMENT

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- Relative macro resilience to noticeable regional pressures

  Helped by the authorities' strong support, Qatar has remained broadly resilient to regional pressures. Real GDP growth, which reported 2.1% in 2017 and expected at 2.6% in 2018, is still supported by World Cup-related infrastructure spending while domestic liquidity has normalized. The recent uplift in hydrocarbon prices has been also favorable to the Qatari economy, since more than 90% of its budget revenues are tied to activities of the hydrocarbon sector. The direct economic and financial impact of the recent tensions with key GCC countries is relatively fading. While economic activity was somewhat affected, this has been mostly transitory and new trade routes were quickly established.

- Current account swinging back into surplus mostly led by surging trade surplus

  Within the context of a partial recovery in global energy prices, Qatar witnessed a tangible improvement in its current account balance, shifting from a deficit of US$ 8.3 billion in 2016 (-5.4% of GDP) to a surplus of US$ 6.4 billion in 2017 (3.8% of GDP), mainly backed by a relative improvement in the trade surplus. Qatar's foreign trade figures showed a net expansion in exports by 17.8% alongside a 3.7% contraction in imports, contributing to a 44.8% hike in the foreign trade surplus. Yet, the services, income and transfers accounts remained firmly in deficit, reflecting the impact of the boycott on various components of the balance of payments. As such, the balance of payments recorded a deficit of US$ 17.9 billion in 2017, against a deficit of US$ 5.6 billion in 2016, mainly due to a net deterioration in capital and financial accounts.

- Fiscal position underpinned by a narrower fiscal deficit in 2017

  In light of the economic blockade, Qatar's fiscal consolidation pace has undoubtedly slowed down in 2017, as the government faced some of the increased cost of imports and postponed some non-oil revenue measures in a bid to support economic activity and sentiment. Yet within this context, the fiscal position managed to defy the regional blockade and recorded a tangible drop in the public deficit by 30.4% in 2017 relative to 2016, as a result of an adequate drop in public expenditures that has been more significant than that of public revenues.

- Extended slump in international reserves along with subdued inflation level

  In the middle of a boycott imposed by four Arab States on Qatar since June 2017, the country's monetary conditions were marked over the year 2017 by a subdued inflation, extended slump in international reserves and foreign currency liquidity due to capital outflows, and a further monetary policy tightening in response to interest rate hikes by the US Federal Reserve. In details, consumer prices remained subdued in Qatar over the year 2017, averaging 0.4%, and grew by a yearly 0.7% during the first quarter of 2018, given the mixed impact of the regional boycott.

- Banking sector weathering regional spillovers and renewing with deposit growth in recent months

  The Qatari banking sector has witnessed tough times last year as a result of the economic blockade imposed by peer GCC countries towards mid-year, but weathered capital outflows and emerging difficulties quite well. Banks are now recovering from a period of weakness and funding pressures have eased owing to the recent stabilization of non-resident deposits after withdrawals made headlines at the onset of the blockade. Qatari authorities played a major role in countering pressures on the banking sector by tapping the QIA to provide liquidity and keep the economy on steady footing. All in all, banking sector activity pulled out a positive performance with total assets growing by 8% in 2017 and by a further 2.3% in the first quarter of 2018 to reach the equivalent of US$ 383 billion at end-March.

- Equity price falls coupled with expansion in CDS spreads in 2017, followed by a relative correction year-to-date

  Qatar's equity markets came under downward price pressures in 2017, before bouncing back during the first four months of 2018 amid signs showing that the damage to the Qatari economy from an embargo imposed by other Arab States has been less serious than feared. As to the cost of insuring debt, Qatar's five-year CDS spreads, which measure the markets perception of sovereign risk, contracted by 16 bps during the first four months of 2018 to reach 89 bps at end-April, following a 25 bps expansion in 2017.

The Qatar Economic Report can be accessed via internet at the following web address: http://www.bankaudigroup.com

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Helped by the authorities' strong support, Qatar has remained broadly resilient to the regional blockade. Real GDP growth, which reported 2.1% in 2017 and expected at 2.6% in 2018, is still supported by World Cup-related infrastructure spending while domestic liquidity has normalized. The recent uplift in hydrocarbon prices has been also favorable to the Qatari economy, since more than 90% of its budget revenues are tied to activities of the hydrocarbon sector. The direct economic and financial impact of the recent tensions with key GCC countries is relatively fading. While economic activity was somewhat affected, this has been mostly transitory and new trade routes were quickly established.

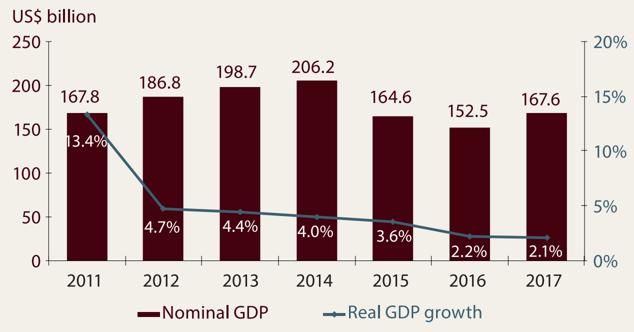
Still, the boycott has exacerbated the vulnerabilities in the country's external balances. Although the current account has returned to surplus in 2017 (3.8% of GDP against a deficit of 5.4% in 2016), thanks to a slight recovery in LNG exports, the country's international reserves declined by 13.6% in 2017 (a cumulative decline of 35.2% since the collapse in oil prices in 2014). International reserves which used to account for 22.4 months of imports at end-2014 now account for 14.7 months of imports at end-2017. Still, the significant foreign assets under the management of the Qatar Investment Authority, which are reported to be around US$ 340 billion in 2017 (almost two times GDP), provide the country with the capacity to absorb exogenous shocks and mitigate concentration risks arising from the dependence on hydrocarbons.

At the fiscal level, the availability of fiscal buffers has allowed a gradual fiscal consolidation in the Emirate. Within the context of lower revenues and expenditures at the same time, the government deficit to GDP ratio contracted from 9.2% in 2016 to 5.8% in 2017. The Qatari authorities' policy response to low oil prices since 2015 has been relatively strong and included reining in current expenditures, merging line ministries and executing various cost saving initiatives in government-related entities. Having said that, gross government debt remains moderate, albeit now on the rise, with an estimated 54% of GDP in 2017 (46.5% of GDP in 2016). But if we were to account for the debt of government-related entities, overall public debt would probably reach circa 85% of GDP.

At the monetary level, headline inflation remains subdued, essentially due to lower rental prices. The average CPI inflation actually reported 0.4% in 2017 (a yearly 0.7% in March 2018). Monetary conditions moderately tightened in 2017, due partly to US monetary policy stance, with higher interbank interest rates on the overall. Money supply growth proved to be pronounced in full-year 2017 at 21.3% (a yearly 16.1% in March 2018).

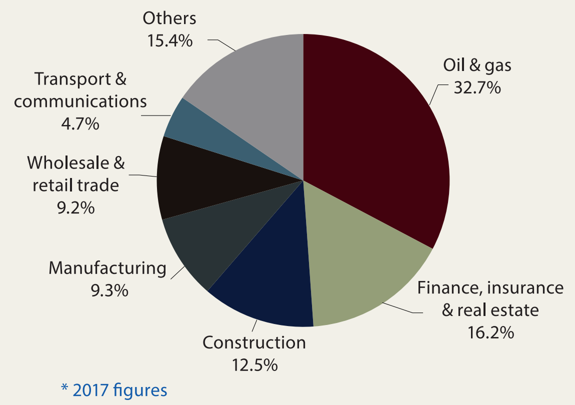
At the financial sector level, financial services and insurance remained broadly resilient despite sharp capital outflows that followed the outbreak of the Gulf crisis, which were offset by the government's financial support. The government has taken measures to support confidence in the banking system,

NOMINAL GDP AND REAL GROWTH RATES



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

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



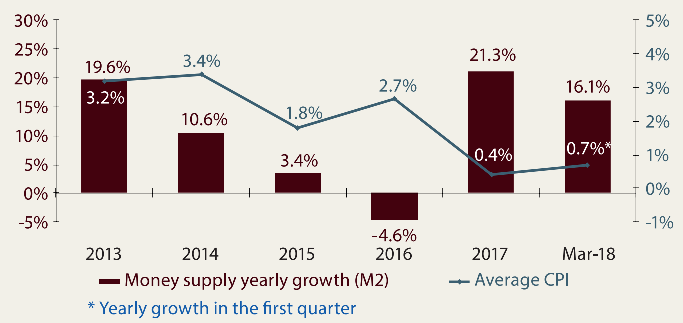
Sources: Central Bank of Qatar, Bank Audi's Group Research Department

including the repatriation into the domestic banking system of US$ 43 billion (26% of GDP) in public sector - mostly QIA - assets. Total deposits grew by a sound 13.2% in 2017, while credit facilities rose by 8.5%. Capital adequacy is high at circa 17% of total risk weighted assets in 2017, with favorable asset quality yet with high loans to deposits ratio of more than 110% constraining overall liquidity. In brief, a robust regulatory framework and effective supervision have helped ensure the resilience of the financial system.

Qatar's capital markets, which were under pressure in 2017, reported some upside in the first four months of 2018. The CDS spreads, which measure the markets perception of sovereign risk, underwent a 25 bps expansion in 2017, followed by a 16 bps contraction year-to-date. Stock market prices, which regressed by 18.3% in 2017, registered a 6.9% rise in the first four months of 2018. Qatar's equity market yet suffers from weak liquidity and large inefficiencies within the context of low turnover ratios, with the annual value traded representing a mere 13.3% of market capitalization.

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

Hydrocarbon sector remains stagnant despite relatively higher energy prices

With Qatar's economic policy focused on diversification away from hydrocarbons, the country's hydrocarbon sector remained stagnant last year, despite the relatively higher energy prices.

The Qatari hydrocarbon sector's share out of total GDP dropped from 53% in 2014 to reach 32.7% in 2017, as part of the country's diversification policy away from oil. Moreover, Qatar's nominal hydrocarbon GDP attained US$ 54.8 billion in 2017, up from US$ 46.2 billion in 2016. The latter contracted by 1.1% annually in real terms during 2017, compared to a 1.0% contraction in 2016.

Gas production in the Gulf country remained almost unchanged in 2017, marginally declining from 182.8 billion cubic meters (bcm) in 2016 to 182.2 billion bcm in 2017. It is worth noting that the Barzan gas project would drive a small amount of growth in gas output from 2018 onwards feeding the domestic market.

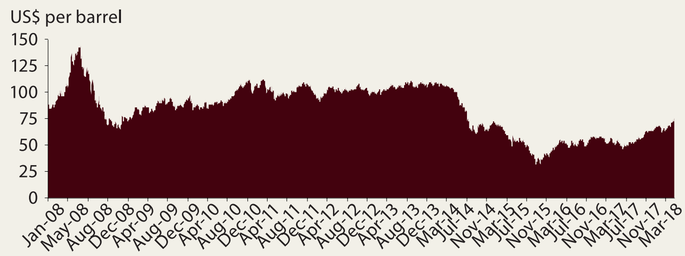
At the same time, the country's proven gas reserves were estimated at 24.1 trillion cubic meters (tcm) in 2018, against 24.3 tcm in the past year. Within this context, Qatar's North Field holds the vast majority of Qatari gas reserves, as well as liquids in the form of condensate and natural gas liquids (NGLs).

Qatar's crude oil production averaged 634 thousand barrels per day in 2017, down from 651 thousand barrels per day in 2016, according to the IIF. This decline in crude oil production over recent years took place due to the country's compliance with the OPEC production cuts. As for crude oil reserves, Qatar had 25,244 million barrels of proven reserves in 2017, as per the US Energy Information Administration.

As such, oil production would remain stable in 2018, before a slight increase over the 2019-2021 period, as per BMI Research. New oil output from the redevelopment of the Bul Hanine field, with phase 1 likely to add 40,000 b/d by 2020. Furthermore, with Qatar's selection of Total to take over from Maersk Oil at the Al-Shaheen field in July 2017, new investment would support stable output. Further upside to oil production may materialize from redevelopment work at other oil fields, with both the Al Rayyan and Karkara structures being studied for development.

Last but not least, the revenues from the country's hydrocarbon sector continue to support Qatar's expenditures in preparation for World Cup 2020. The country's spending on the non-oil sector is also part of the 2030 National Vision, with Qatar investing heavily in capital projects to accelerate economic diversification.

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

1.1.2. Manufacturing

Manufacturing sector continues supporting Qatar's non-oil sector

Qatar's manufacturing sector continued playing a central role in supporting the authorities' efforts last year, as part of its diversification strategy. The Gulf country's manufacturing sector made up 9.3% of the country's GDP at current prices in 2017, whilst growing by 2.9% year-on-year last year to reach QR 81.0 billion (US$ 22.2 billion).

Moreover, 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, showed an increase of 21.4% year-on-year due to various positive and negative changes in the eleven sub-groups products, where seven sub-groups recorded an increase and the other four a decline.

The major sub-groups that witnessed an increase were refined petroleum products (+26.7%), basic metals (+26.5%), basic chemical products (+13.3%), and other chemical products and fibers (+6.4%). On the other hand, the sub-group that came mostly under pressure was cement and other non-metallic products (-5.6%).

Despite the ongoing diplomatic crisis of Qatar with some of its neighbors in the GCC, a pickup was witnessed in the number of new plants in the manufacturing sector. The country also managed to attract huge investments into its manufacturing sector, as per the Ministry of Energy and Industry.

In a bid to encourage the local industry and small and medium enterprises, Qatar has provided incentives for industries such as fee exemption on equipment, raw materials, and machine parts. Additionally, the "Own Your Factory in 72 Hours" initiative was launched by the government, which further supported the manufacturing sector, making it one of the most attractive investment opportunities in Qatar. The initiative aims at fast-tracking the establishment of more manufacturing companies and factories in Qatar. Under the initiative, 63 investors were shortlisted for setting up factories in the country worth a total of QR 2.5 billion (US$ 686.5 million).

Against a backdrop of uncertainty in its food security environment, Qatar is working on boosting its agricultural and livestock sectors, primarily through building capacity. In August 2017, the Qatar Islamic Bank announced funding worth QR 1.6 billion (US$ 435.8 million) to finance a 530,000 sqm food security facility at Hamad Port outside of Doha. The country's initiatives to increase food production capacity fall under the broader framework of the Qatar National Food Security Program launched in 2012. The plan targets increasing the number of farms from 1,400 to 3,000, and meeting at least 60% of the domestic food demand from local suppliers by 2024.

1.1.3. Construction

Growth in the construction sector though at a slower rate

Qatar's real estate sector continued to register growth though at a slower rate during 2017 in line with the measures to diversify the economy and support the development of the non-oil sector. However, the regional boycott and weak investor sentiment continue to limit a revival in the property sector.

In details, the country's construction sector registered a growth of 11.2% in 2017, down from a growth of 14.0% in the previous year. Yet, the share of the sector in GDP improved from 11.9% in 2016 to 12.5% in 2017.

In terms of prices, Qatar's real estate prices remained almost stable in the first quarter of 2018, when compared to the previous quarter. The real estate price index stood at 252.1 at end-March 2018, nearly unchanged from its level at end-2017, yet declining from its March 2017 levels.

It is worth noting that the combined value of Qatar's real estate transactions in the first quarter of 2018 reached over QR 4 billion, witnessing a marginal decline compared to the corresponding period last year, mainly due to a fall in prices of real estate properties. However, the decline in prices led to corrections in rentals almost across the country making residential, commercial and retail spaces more affordable and competitive.

In a look at the residential sector, a total of 1,200 housing units were delivered in the first quarter of 2018 bringing the total residential stock to 287,325. Cost consolidation in both the private and public sectors contributed to limited staff allowances and new employment opportunities. Furthermore, Qatar's residential capital values have been declining for the last two years. However, the rate of decline appears to have slowed over the last 12 months.

In the office sub-sector, subdued demand continues to drive down property prices and rents across the board, despite a mild resurgence in economic activity. Due to weak demand, landlords are offering incentives in order to fill vacancies, which includes longer rent free periods and lower rents, as per BMI.

Conditions in the retail market are supportive thanks to strong consumer footfalls and an uptick in household spending that is driving retail sales. A robust demand for retail formats from domestic and international retailers is observed as a result, as per the same source.

In parallel, the real estate and construction sector took a share of 23.3% of credit facilities advanced by the Qatari banking sector at end-March 2018, marginally higher than the 22.5% registered at end-March 2017.

In conclusion, the real estate market is turning a corner after years of bullish performance. The correction in the real estate prices and rentals is bringing new opportunities and investment theme to the market. The sector, which remains one of the highest contributors to the country's GDP, maintained its growth though at a slower rate than the previous years.

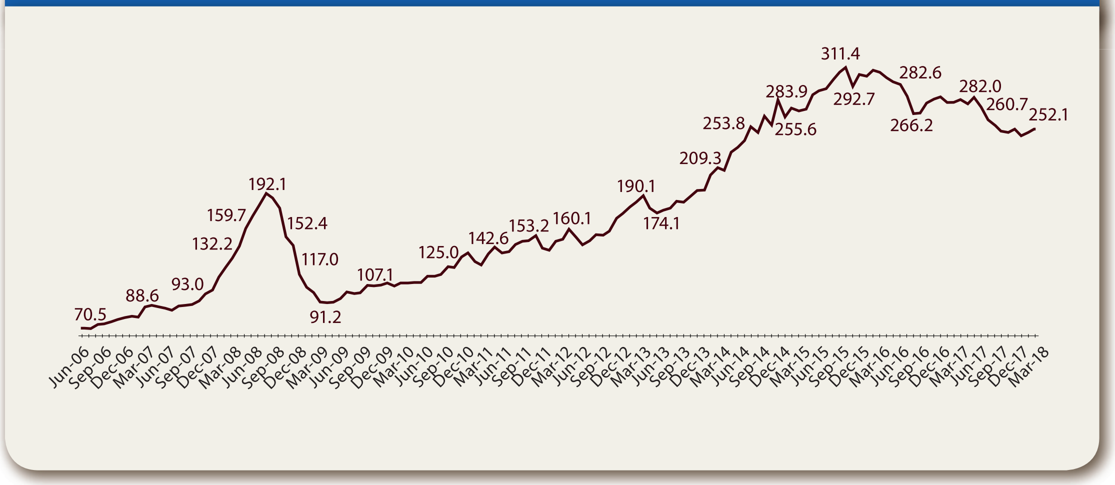
1.1.4. Tourism

Tourism remaining a pillar of diversification despite a downturn in indicators

The fundamentals of the Qatari tourism industry remain positive, despite a setback in some of its indicators. As part of the crucial economic diversification efforts to reorient the economy away from hydrocarbon dependence, the government has earmarked tourism as a crucial sector under the Vision 2030.

According to the World Travel & Tourism Council (WTTC), direct contribution of travel and tourism to Qatar's GDP was US$ 5.5 billion in 2017 (3.3% of the total GDP) and is expected to fall by around 2.0% in 2018. In details, leisure travel spending contributed to around 60.4% of the direct travel and tourism GDP, while business spending took over the remaining share. Moreover, travel and tourism investment stood

REAL ESTATE PRICE INDEX



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

at US$ 1.7 billion (2.4% of total investment) in 2017, nearly unchanged from its level in the previous year. WTTC forecasts this contribution to expand by 9.2% in 2018.

Tourism is one of the sectors that were hit by the persistent GCC tensions whereby around 40% of all tourist arrivals into Qatar originate from the Arab Gulf, along with aviation seeing a substantial slowdown in activity. These sectors are directly impacted by the shutdown of borders. It is worth noting as well that international arrivals declined by 20% in 2017 to reach a total of 2.3 million.

However, the Qatar Tourism Authority (QTA) has responded actively to the diplomatic and economic embargo. The government has relaxed visa restrictions to people from over 80 countries in a bid to bolster tourism and compensate for tourist losses from Saudi Arabia and the UAE. These measures were initially expected to be rolled in gradually over a number of years but the embargo has expedited the process.

On another note, the performance of the four and five star hotels in Doha was negative in 2017 when compared to 2016, as per EY. Occupancy registered 59.3% in 2017, under its level of 62.3% in 2016. The average room rate was US$ 176 last year, down from US$ 194 in 2016. This left the rooms' yield at US$ 104 in 2017, down by a yearly 13.7%. In the first quarter of 2018, the slowdown in the hospitality sector's performance continued, whereby occupancy rate stood at 63.1% down from 74.5% in the same period of last year, and the average room rate declined by a yearly 6.8% to stand at US$ 150 in the aforementioned period of this year. Hence, the rooms' yield contracted by 21.1% from US$ 120 in the first quarter of 2017 to US$ 94 in the corresponding period of 2018.

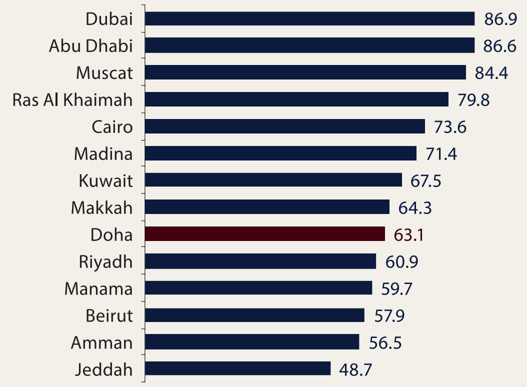
Finally, Qatar's tourism sector remains one of the main contributors the country's diversification strategy, however the economic and political embargo placed upon Qatar by neighboring countries did put some negative pressure on the indicators of the sector.

1.2. EXTERNAL SECTOR

Current account swinging back into surplus mostly led by surging trade surplus

Within the context of a partial recovery in global energy prices in the fourth quarter of 2017 and amid contracting imports associated with the regional blockade and therefore lower economic growth, Qatar witnessed a tangible improvement in its current account balance, shifting from a deficit of US$ 8.3 billion in 2016 (-5.4% of GDP) to a surplus of US$ 6.4 billion in 2017 (3.8% of GDP), mainly backed by a relative improvement in the trade surplus. Yet, the services, income and transfers accounts remained firmly in deficit, reflecting the impact of the boycott on various components of the balance of payments. As such, the balance of payments recorded a large deficit of US$ 17.9 billion in 2017, against a deficit of US$ 5.6 billion in 2016, mainly due to a net deterioration in capital and financial accounts.

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



* First quarter of 2018, four and five star hotels

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

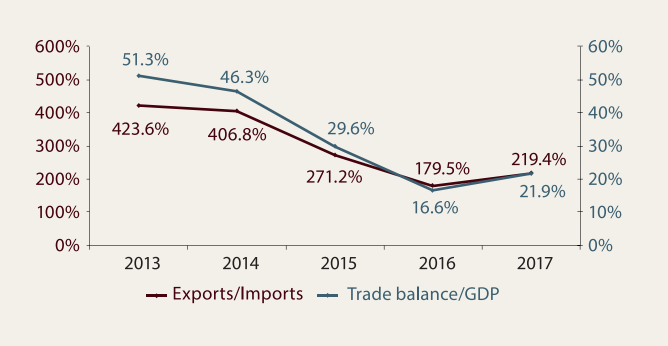
In fact, Qatar's foreign trade figures showed a net expansion in exports by 17.8% alongside a 3.7% contraction in imports in 2017 compared to 2016, contributing to a 44.8% hike in the foreign trade surplus, according to the Central Bank of Qatar. As such, Qatar's trade surplus went up from US$ 25.4 billion in 2016 to US$ 36.7 billion in 2017, to reach the equivalent of 21.9% of Qatar's GDP (from 16.6% of GDP in 2016). Accordingly, the exports to imports coverage ratio went up from 180% in 2016 to 219% in 2017.

Going further into details, total exports reached a total of US$ 67.5 billion in 2017, an increase from US$ 57.3 billion in 2016, on the back of a relative recovery in hydrocarbon activity during the second half of the year due to higher energy prices and strong production of natural gas. In addition, Qatar's goods exports to the boycotting countries are initially limited (around 10% of total exports) as most of its gas receipts come from Asian (Far East) customers. As such, 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 increase of 21.6% year-on-year to make up 84.2% of total exports, followed by manufactured goods with a rise of 15.9%, and machinery and transport equipments with an increase of 13.9%. On the other hand, the main items to have displayed a decline were crude materials with 8.8% and chemicals and related products with a retreat of 6.0%. The geographic distribution of domestic exports indicates that 17.1% of total exports went to Japan, followed by South Korea with 15.8% of the total, India with 12.3%, China with 10.7%, Singapore with 9.3% and UAE with 3.8% of total exports.

At the level of imports, a total of US$ 30.8 billion was registered in 2017, compared to US$ 31.9 billion in 2016. It is worth mentioning that the boycott's impact on imports has been short-lived since Qatar has found alternative sources of goods that previously arrived from boycotting countries, yet at higher prices. The breakdown of imports by category suggests that imports of machinery and transport equipment posted the highest share of 42.7% of total imports, followed by miscellaneous manufactured goods with 14.7%, manufactured goods with a share of 13.7%, and food and live animals with 9.9% of total imports. The breakdown of imports by country of origin shows that 16.3% of the inward merchandise in 2017 came from USA, followed by China with 11.4% of the total, Germany with 6.9%, UAE with 5.4%, Japan and India with 5.3% of total imports each.

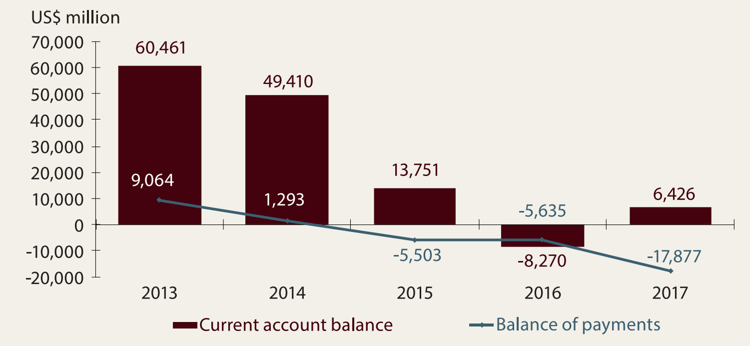
On the other side of the external sector, Qatar posted net deficits, yet in smaller volumes, in its balances of services, income and transfers in 2017, to record US$ 13.7 billion (from US$ 16.4 billion), US$ 0.4 billion (from US$ 1.1 billion) and US$ 16.2 billion (unchanged relative to 2016) respectively. It is worth mentioning that the income account suffered from increased payments on the growing foreign debt stock and lower profit repatriation flows. As to the transfers' category, the latter is dominated by outward remittances of expatriates residing in Qatar, which amounted to US$ 12.6 billion in 2017, up by 6.5% from the previous year. On another hand, capital and financial accounts recorded a shift from a surplus of US$ 3.8 billion in 2016 to a large deficit of US$ 25.5 billion. This was mainly due to other investment balance that reported a shift from a surplus of US$ 5.6 billion in 2016 to a large deficit of US$ 33.2 billion in 2017, mainly as a result of large outflows of non-resident funding from the country related to the boycotting countries removing deposits they had in Qatar.

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

1.3. PUBLIC SECTOR

Fiscal position underpinned by a narrower fiscal deficit in 2017

In light of the economic blockade, Qatar's fiscal consolidation pace has undoubtedly slowed down in 2017, as the government faced some of the increased cost of imports and postponed some non-oil revenue measures in a bid to support economic activity and sentiment. Yet within this context, the fiscal position managed to defy the regional blockade and recorded a tangible drop in the public deficit by 30.4% in 2017 relative to 2016, as a result of an adequate drop in public expenditures that has been more significant than that of public revenues.

Going further into details, budget execution for 2017 showed that actual public revenues went down by 6.1%, from QR 170.9 billion (US$ 46.9 billion) in 2016 to QR 160.5 billion in 2017 (US$ 44.1 billion), on the back of a decline in oil and gas revenues by 5.7% relative to 2016 level (constituting 82.7% of total public revenues) on the one hand, and weaker non-hydrocarbon revenues by 7.7% due to delayed implementation of some revenue-enhancing measures in light of the economic blockade on the other hand. The measures that were planned for 2017, such as added-value tax implementation, water and electricity tariff hikes, and increases in government fees and the stamp duty on real estate, are now expected to be implemented in 2018.

On the spending front, total public expenditures went down by 11.6%, from QR 221.7 billion in 2016 (US$ 60.9 billion) to QR 195.9 billion in 2017 (US$ 53.8 billion), below the 2017 budget expenditures target of QR 198.5 billion. In fact, the decline in public spending was triggered by a 19.8% drop in major projects expenditures, the biggest outlays (40% of expenditures), and an 11.1% decline in wages and salaries, as the government continues to enhance the efficiency of public spending and benefits from cost savings from the consolidation of ministries in previous years.

As such, the public deficit significantly fell to QR 35.4 billion in 2017 (US$ 9.7 billion or 5.8% of GDP) from a deficit of QR 50.8 billion in 2016 (US$ 14.0 billion or 9.2% of GDP), yet still above the 2017 budget deficit target of QR 28.4 billion (or US$ 7.8 billion). It is worth mentioning that the public deficit has been financed by a combination of domestic and external financing. As such, the public debt went up by 26.6% in 2017 from US$ 70.9 billion as at end-2016 (or 46.5% of GDP) to US$ 89.8 billion as at end-2017 (or 54.0% of GDP).

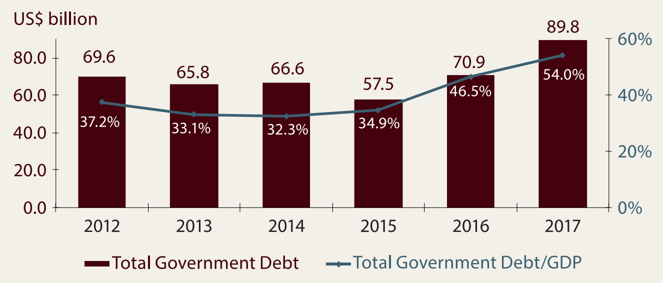
Within this context, Qatar's 2018 budget continues with gradual fiscal consolidation, with emphasis on new tax measures (VAT and excises), fees for the use of government services, contained current expenditure, and efficient and higher capital expenditure. The budget plan projects slightly higher spending and a marginally smaller deficit than 2017 budget. Based on an average oil price of US$ 45 per barrel, unchanged from the 2017 budget, hydrocarbon revenues are projected to increase only marginally by 2.3% relative to 2017 budget figures to QR 133.1 billion. Together with a 4.9% growth in non-hydrocarbon revenues, official budget projections put total government revenues at QR 175.1 billion, up 2.9% from the 2017 budget. At the same time, 2018 state budget envisages an increase in the total spending by 2.4% year-on-year to QR 203.2 billion. The lion's share of total spending (QR 97.5 billion or 48% of total) will be allocated to capital expenditures. Spending on wages and salaries is expected to

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2015	2016	2017
Public revenues	50.4	46.9	44.1
Public revenues/GDP	30.6%	30.8%	26.3%
Public expenditures	51.9	60.9	53.8
Public expenditures/GDP	31.6%	39.9%	32.1%
Fiscal balance	-1.5	-14.0	-9.7
Fiscal balance/GDP	-0.9%	-9.2%	-5.8%

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

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department grow the fastest at 8.8% and reach QR 52.2 billion on the back of the opening of new schools, educational facilities, healthcare centers and hospitals. As a result, the Qatari authorities expect a fiscal deficit of QR 28.1 billion (or 4.4% of GDP) slightly down from the QR 28.4 billion budgeted deficit in 2017, yet the budget deficit could be narrower in 2018 if oil prices remain stable close to current levels excluding any over-expenditure at large.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Extended slump in international reserves along with subdued inflation level

In the middle of a boycott imposed by four Arab States on Qatar since June 2017, the country's monetary conditions were marked over the year 2017 by a subdued inflation, extended slump in international reserves and foreign currency liquidity due to capital outflows, and a further monetary policy tightening in response to interest rate hikes by the US Federal Reserve.

In details, consumer prices remained subdued in Qatar over the year 2017, averaging 0.4%, and grew by a yearly 0.7% during the first quarter of 2018, given the mixed impact of the Saudi-led boycott, whereby it has pushed up food prices and import costs, while putting deflationary pressures on some sectors like tourism and housing. The latter was reflected by a significant fall in the real estate price index of 7.4% on average in 2017 and 10.9% year-on-year during the first quarter of 2018.

The breakdown of the Consumer Price Index by segment in 2017 shows that the transport segment rose by 7.3% year-on-year, reflecting an increase in global oil prices, followed by the education segment and the medical services segment with +2.2% each, the food and beverages segment with +1.9%, the furnishings and household equipment segment with +0.4%, and the miscellaneous goods and services segment with +0.2%. In contrast, the housing, water, electricity and gas segment reported a yearly decline of 3.0% on average in 2017, followed by the culture and recreation segment with -2.0%, the restaurants and hotels segment with -1.4%, the clothing and footwear segment with -1.1%, and the communication segment with -0.6%.

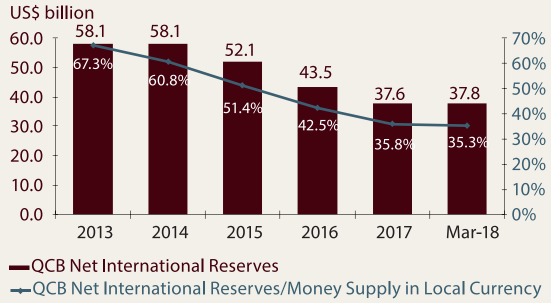
The Qatari riyal remained pegged to the US dollar at a rate of QR 3.64/US$ 1. The Qatari authorities remain committed to maintaining the peg, on the grounds that hydrocarbons exports are denominated in US dollars and the peg offers reassurance to investors. Within this context, Qatari interbank interest rates continued to track interest rate hikes by the US Federal Reserve. The Central Bank of Qatar raised the overnight deposit rate twice in 2017 by a cumulative 50 bps to reach 1.50% at end-December, and lifted it further by 25 bps in March 2018 to reach 1.75% at present. Concurrently, the Central Bank of Qatar raised the overnight lending rate by a quarter of a percentage point in March 2017 to stand at 5.00% at present.

EVOLUTION OF MONETARY SITUATION

Flows in millions of US$	2013	2014	2015	2016	2017	Q1-18
Net foreign assets	**22,926**	**4,946**	**-21,283**	**-29,270**	**-4,143**	**-7,540**
Foreign Assets	18,575	10,058	1,398	8,304	-27,464	4,424
Foreign Liabilities	4,351	-5,113	-22,681	-37,574	23,320	-11,965
Net Domestic Assets	**-2,414**	**8,326**	**26,052**	**22,721**	**33,205**	**7,084**
Claims on private sector	14,024	12,239	16,913	5,651	10,967	5,078
Net claims on public sector	-11,587	3,330	16,310	17,895	11,080	3,643
Other Items (net)	-4,851	-7,243	-7,171	-825	11,158	-1,637
Broad Money (M2)	**20,511**	**13,272**	**4,769**	**-6,548**	**29,062**	**-456**
Money Supply (M1)	4,119	5,034	733	391	-1,445	3,433
Quasi-Money	16,393	8,238	4,036	-6,939	30,507	-3,888

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

In parallel, Qatar Central Bank's international reserves and foreign currency liquidity fell from US$ 43.5 billion at end-2016 to US$ 37.6 billion at end-2017, and reached US$ 37.8 billion at end-March 2018, in response to capital outflows caused by sanctions imposed by other Arab States on Qatar since June 2017, and as the country drew upon its international reserves to defend the currency peg and finance its fiscal deficit. The US$ 5.9 billion contraction in international reserves and foreign currency liquidity over the year 2017 came within the context of a US$ 16.8 billion fall in total official reserves and a US$ 10.9 billion growth in other liquid assets in foreign currencies. That being said, the QCB international reserves and foreign currency liquidity covered around 35.8% of money supply in local currency at end-2017 as compared to 42.5% at end-2016, and reached 35.3% at end-March 2018.

The broader Money Supply (M2) expanded by 21.3% or the equivalent of US$ 29.1 billion in 2017 to reach US$ 165.8 billion at end-2017, mainly supported by a US$ 26.4 billion expansion in deposits in foreign currencies and a US$ 4.1 billion rise in Qatari riyal denominated time deposits, while the money supply (M1) contracted by US$ 1.4 billion. A closer look at factors affecting money supply (M2) shows that net claims on government grew by US$ 11.1 billion in 2017, as the Qatari authorities continued to rely on domestic borrowing to fund the country's shortfalls; the claims on the private sector rose by US$ 11.0 billion, amid eased funding pressures at Qatari banks on the back of liquidity injections by the Central Bank and public sector deposits, particularly from Qatar Investment Authority; while net foreign assets dropped by US$ 4.1 billion over the year amid capital outflows.

Looking forward, interest rates in Qatar would continue to track the US monetary tightening given the Qatari riyal peg to the US dollar. The IMF expects inflation to peak at 3.9% in 2018, its highest level in a decade, as the impact of the Value Added Tax being introduced during the second half of 2018 would mostly be felt in that year, according to the Fund.

1.4.2. Banking Activity

Weathering blockade spillovers well and renewing with deposit growth in recent months

The Qatari banking sector has witnessed tough times last year as a result of the economic blockade imposed by peer GCC countries towards mid-year, but weathered capital outflows and emerging difficulties quite well. Banks are now recovering from a period of weakness and funding pressures have eased owing to the recent stabilization of non-resident deposits after withdrawals made headlines at the onset of the blockade. Qatari authorities played a major role in countering pressures on the banking sector by tapping the QIA to provide liquidity and keep the economy on steady footing. All in all, banking sector activity pulled out a positive performance with total assets growing by 8% in 2017 and by a further 2.3% in the first quarter of 2018 to reach the equivalent of US$ 383.2 billion at end-March.

On the funding side, non-resident deposits and dues to banks abroad suffered the most over the course of the year 2017, with outflows mostly related to the boycotting countries withdrawing deposits they had in Qatar, but the drag has eased considerably since the fourth quarter. While liquidity injections by the Central Bank and public sector deposits (especially from the sovereign wealth fund) have offset fleeing capital, the alleviation of pressures on banks' funding base reduced the need for exceptional support, with banks mobilizing funding from non-GCC sources (likely from Asia among other sources). Non-resident deposits and dues to banks abroad resumed their upward trend in recent months with positive growth registered in the first quarter, while resident deposits more than compensated for the declines last year.

On an aggregated basis, total deposits at banks rose by 13.2% in the 12 months to December 2017 (the equivalent of US$ 26.4 billion) as foreign currency private sector deposits helped total private sector deposits grow by US$ 3.5 billion and time and saving public sector deposits surged to allow public sector deposits to rise by US$ 35.6 billion. On the other hand, non-resident deposits shrank by US$ 12.7 billion. So far this year, resident deposits almost stabilized after capital outflow pressures abated and non-resident deposits grew by US$ 2.6 billion in the first quarter.

With authorities providing a major boost during difficult times, the deposit mix was altered. As at end-March 2018, non-resident deposits accounted for 18% of total deposits while the share reached a higher 25% at end-2016. Similarly, private sector deposits now account for 45% of the total versus 49% at end-

2016, leaving a much larger share to the public sector with 38% of the total versus 26% prior to the blockade.

Part of the excess liquidity was as usual channeled towards lending to the economy at large, despite banks being generally cautious with regards to additional risk in difficult times. As a matter of fact, total credit facilities extended by banks in Qatar rose by a decent 8.5% last year and by a further 2.9% in this year's first quarter to reach the equivalent of US$ 257.5 billion at end-March 2018, yet noting that credit growth reached double-digit rates in each of the previous few years. Over the entire covered period, credit facilities to non-residents shrank, leaving the resident sector the sole recipient of new funds.

But a close look actually reveals that the public sector (particularly the government itself) was the major recipient of new credit facilities as authorities sought to boost economic activity and with works underway for the FIFA 2022 World Cup. The public sector accounted for more than half of new domestic credit in the 15 months period spanning between December 2016 and March 2018, followed by the real estate sector and the services sector.

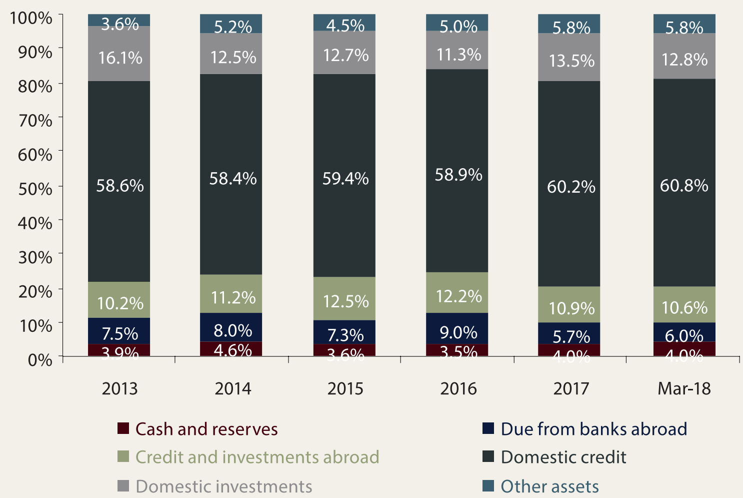
With deposits growing faster than loans last year, the credit facilities to deposits ratio went down from 115.5% at end-2016 to 110.7% at end-2017, before rising again this year to 114.1% at end-March 2018. Such levels remain elevated and are putting pressure on liquidity. The Central Bank yet introduced a new loan-to-deposit requirement of 100% that came into effect in January of this year. Another measure of liquidity and perhaps a more important one, the core liquidity to deposits ratio, deteriorated last year before improving again this year as liquidity pressures faded. Core liquidity, which we measure as the sum of cash (domestic and abroad) and deposits at banks (domestically and abroad) and at the Central Bank,

EVOLUTION OF BANKING ACTIVITY

US$ million	2014	2015	2016	2017	Q1-17	Q1-18	Variation Q1/Q1
Var. Total assets	26,016	29,659	41,211	27,721	5,443	8,555	57.2%
% change	10.4%	10.7%	13.5%	8.0%	1.6%	2.3%	0.7%
Var. Total deposits	14,475	13,513	21,049	26,416	7,105	-410	-
% change	9.6%	8.2%	11.8%	13.2%	3.6%	-0.2%	-3.7%
Var. Total credit facilities	20,554	27,052	24,897	19,707	4,442	7,244	63.1%
% change	13.0%	15.1%	12.1%	8.5%	1.9%	2.9%	1.0%

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

declined from 27.2% of total deposits at end-2016 to 21.9% of total deposits at end-2017. The ratio rose back to an acceptable level of 23.1% at end-March 2018, reflecting banks' adequate liquidity position on the overall despite recent pressures.

Asset quality metrics remain sound with the NPLs/total loans ratio slightly deteriorating from 1.3% at end-2016 to 1.6% at end-2017 but remaining very low in both absolute and relative terms. Furthermore, provisioning coverage strengthened further with provisions accounting for 83% of NPLs at end-2017. One must note that new and tighter regulations on retail and government lending introduced in recent years are likely to have supported the loan performance of Qatari banks. At the retail level, regulations limit household indebtedness and notable salary increases for Qatari nationals have had a positive impact on retail NPLs. At the government level, Central Bank rules require banks to obtain Ministry of Finance approval for loans to Qatari GREs, preventing excessive leverage and reducing refinancing risks for those entities.

Along the same lines, capitalization of banks in Qatar remains intact, with banks maintaining sufficient capital buffers to counter potential pressures on their capital base. Official figures put the capital adequacy ratio at 16.8% at end-2017 (16.1% at end-2016), the bulk of regulatory capital being composed of Tier 1 capital. The IMF yet noted that Basel IV, once implemented, will significantly increase risk-weights, hence impacting capital ratios, credit risk management, pricing, processes and disclosure.

Last but not least, profitability remains supported by the sector's strong efficiency and low cost-to-income ratio. Almost stable net interest margins coupled with a slower credit growth and economic slowdown lead to a decline in profitability ratios to nonetheless acceptable levels, with the ROAA ratio moving from 1.7% in 2016 to 1.5% in 2017 and the ROAE ratio moving from 14.5% to 13.9%.

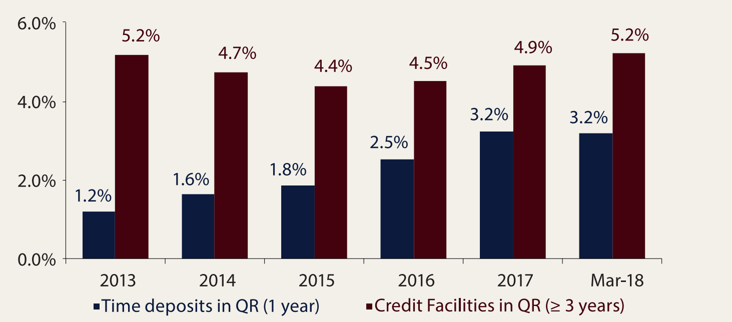
1.4.3. Equity and Bond Markets

Equity price falls coupled with expansion in CDS spreads in 2017, followed by a relative correction year-to-date

Qatar's equity markets came under downward price pressures in 2017, before bouncing back during the first four months of 2018 amid signs showing that the damage to the Qatari economy from an embargo imposed by other Arab States has been less serious than feared. In parallel, Qatar's fixed income market saw mixed price movements in 2017, and witnessed price falls across the board during the first four months of 2018, tracking US Treasuries move.

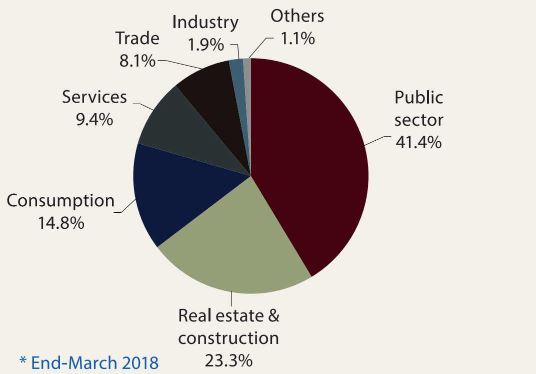
In details, the Qatar Exchange general index, which is a capitalization weighted index of the 20 most highly capitalized and liquid stocks traded on the Qatar Exchange, fell by 18.3% in 2017 to close at 8,523.38 at the end of the year, mainly driven by lingering concerns about Qatar's diplomatic rift after four Arab States cut on June 5, 2017 diplomatic ties with Qatar and moved to close off access to the Gulf country, in addition to unattractive market pricing ratios, as the Qatari stocks traded at a P/E of 16.5x in 2017 as compared to a P/E of 15.6x in 2016. This triggered capital outflows and prompted some non-Qatari banks to reduce their exposure to Qatar, while raising concerns about the country's foreign trade. Within this context, 41 out of

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

45 listed stocks registered price falls in 2017, while only four stocks posted price gains, noting that equity price drops took place despite a 1.1% yearly increase in the combined net profit of all 45 listed companies in 2017.

Following significant price drops in 2017, the Qatar Exchange saw a price rebound during the first four months of 2018, as reflected by a 6.9% rise in the QE general index, mainly supported by signs that Qatar's economy is starting to recover from a boycott imposed by other Arab States, and given healthy oil price gains, and an increase in foreign ownership limit of some bluechips, which is set to leave a positive impact on the stocks' weightings on emerging market indices, in addition to a 2.9% yearly rise in the combined net profit of all 45 listed companies during the first quarter of 2018.

The number of listed companies in the Qatar Exchange rose from 44 companies at end-2016 to 45 companies at end-2017. This combined with equity price drops resulted into a 16.2% decline in the market capitalization in 2017, moving from US$ 154.8 billion at end-2016 to US$ 129.7 billion at end-2017, before rising to US$ 139.9 billion at end-April 2018 mainly supported by equity price gains and stability in the number of listed companies during the first four months of 2018.

The total trading value on the Qatar Exchange declined by 4.0% in 2017 to reach US$ 18.2 billion, and fell by 17.7% year-on-year during the first four months of 2018 to stand at US$ 6.2 billion. The total number of traded shares surged by 24.7% in 2017 to reach 2,465 million shares, while the total number of transactions dropped by 16.4% in 2017 to reach 834,394 transactions. That being said, the turnover ratio, measured by the annualized trading value to market capitalization, reached 14.0% in 2017 as compared to 12.2% in 2016, and was quoted at 13.3% during the first four months of 2018 as compared to 15.2% during the corresponding period of 2017.

At the level of the fixed income market, Qatari papers saw mixed price movements in 2017, yet came under downward price pressures during the first four months of 2018, tracking US Treasuries move amid steady US economic growth and rising inflation expectations that stoked bets that the US Federal Reserve would raise interest rates three or possibly four times in 2018.

In details, sovereigns saw price falls across the board during the first four months of 2018, with papers maturing between 2019 and 2046 registering price declines ranging between 1.76 pt and 10.08 pts. Ooredoo papers maturing between 2018 and 2043 recorded price decreases of 0.61 pt to 9.67 pts. RasGas'19 and '20 closed down by 2.69 pts and 1.39 pt respectively. Also, financials like Commercial Bank of Qatar, Qatar National Bank, Qatar Islamic Bank, Ahli Bank Qatar, Al Khaliji Bank and International Bank of Qatar registered price decreases of up to 1.92 pt during the first four months of 2018.

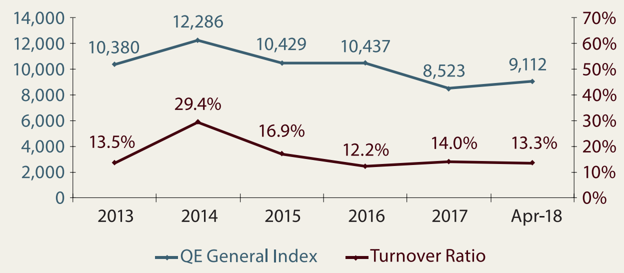
As to the cost of insuring debt, Qatar's five-year CDS spreads, which measure the markets perception of sovereign risk, contracted by 16 bps during the first four months of 2018 to reach 89 bps at end-April. This followed a 25 bps expansion in 2017. It is worth noting that the Qatar CDS spread is the third lowest in the region after Kuwait (60 bps) and Abu Dhabi (63 bps), and is way below the average CDS spreads in the Middle East (197 bps), emerging markets (144 bps) and global markets (125 bps).

CAPITAL MARKETS INDICATORS

	2013	2014	2015	2016	2017	Apr-18
Market Capitalization (US$ billion)	152.6	185.9	152.0	154.8	129.7	139.9
Market Capitalization/GDP	76.8%	90.2%	92.3%	101.5%	77.4%	81.3%
Total value traded (US$ billion)	20.6	54.8	25.7	19.0	18.2	6.2
Total number of shares (million)	1,938	4,440	2,302	1,977	2,465	930
No. of listed companies	42	43	43	44	45	45
Change in QE general index	24.2%	18.4%	-15.1%	0.1%	-18.3%	6.9%
P/E ratio	14.6x	16.2x	11.5x	15.6x	16.5x	13.1x
P/BV ratio	2.0x	2.1x	1.6x	1.1x	1.3x	1.5x
Dividend yield	3.9%	3.7%	5.2%	5.2%	4.5%	4.6%
Five-year CDS spreads (bps)	59	82	93	80	105	89

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

CAPITAL MARKETS PERFORMANCE



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

As to new bond issues, Qatar raised, in April 2018, US$ 12 billion from the sale of US$ 3 billion of five-year notes at a yield of 135 bps over US Treasuries as compared to an initial price guidance of 170 bps over UST, 10-year US$ 3 billion notes at 170 bps over US Treasuries as compared to an initial price guidance of 200 bps over UST, and 30-year US$ 6 billion notes at 205 bps over US Treasuries as compared to an initial price guidance of 230 bps over UST. The bond issue attracted US$ 53 billion of orders.

As to credit ratings, Moody's changed in July 2017 the outlook on Qatar's rating to "Negative" from "Stable" and affirmed the long-term issuer and senior unsecured debt ratings at "Aa3". The key driver for the outlook change to "Negative" is the economic and financial risks arising from the ongoing dispute between Qatar and a group of countries, including its fellow GCC neighbors Bahrain, Saudi Arabia and the UAE, according to Moody's. Also, Fitch downgraded in August 2017 Qatar's long-term Issuer Default Ratings to "AA-" from "AA" with a "negative" outlook, citing Qatar's diplomatic and logistical isolation by some of its neighbours.

In parallel, Standard & Poor's affirmed in February 2018 its "AA-/A-1+" long-term and short-term foreign and local currency sovereign ratings on Qatar, with "Negative" outlook. The "Negative" outlook primarily reflects the geopolitical and economic risks from Qatar's boycott by several Arab countries over the next 12 months, as per S&P.

Looking forward, efforts to further deepen domestic financial markets to promote saving and offer borrowing and investment opportunities remain important. The IMF considers that deepening domestic financial markets, especially domestic government and corporate bond markets, should be a priority reform area to support non-hydrocarbon private sector growth.

2. CONCLUSION

Looking ahead, the Emirate's expenditure plans suggest the Qatari government remains committed to the World Cup. Within this context, the absence of any major delays/cancellations will continue to soften the impact of the regional blockade. The government's infrastructure program is expected to support economic growth in addition to investment related to a new petrochemicals refinery. The government has also announced measures to help boost growth in the tourism sector and support the labor supply, including a visa-free entry program for 80 nationalities.

At the public finance level, the fiscal balance is estimated to post a surplus of 2.8% of GDP in 2018, after a couple of years of net deficits. It is worth mentioning that the fiscal consolidation measures planned include further subsidy cuts, an increase in public fees and taxes and the implementation of VAT. Still, the risks to the fiscal outlook remain considerable, such as lower forecasted revenues and spending overruns, especially government spending on infrastructure projects to boost the economy in addition to military spending. The 2022 World Cup should maintain fiscal challenges over the next three years, but capex (10.5% of GDP) should decrease firmly after the completion of the stadiums in a longer term.

At the external sector level, the current account balance is likely to benefit from increasing international oil prices and will remain in surplus over the next few years. According to the forecasts of the IMF, the current account surplus would amount to 2.5% of GDP in 2018 and 1.8% of GDP in 2019. The trade surplus is set to remain above 20% of GDP over the years ahead, providing a permanent support to the current account balance on the overall.

At the financial sector level, it is likely that the financial system would remain sound looking ahead. Still, it is believed that tighter domestic liquidity is the major risk this year should Qatari banks experience more challenging access to international debt markets. Having said that, further non-resident deposit outflows are expected to be gradual, limiting the likelihood that substantial additional support from the government to the banks would be needed. At the monetary level, the currency peg is likely to be maintained, despite the fact that the fixed exchange rate of the Qatari riyal to the US dollar leads to limited monetary flexibility.

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 hydrocarbon reserves relative to the size of the population with Qatar holding the third largest proven natural gas reserves and being the largest LNG exporter, the high income per capita (the seventh largest worldwide), the substantial financial reserves and moderate government debt, and the comfortable international liquidity position with a net creditor position for the government.

At the level of risks constraining the outlook, we mention the high geopolitical risk factors due to tensions with key GCC countries, the relatively low hydrocarbon prices within the context of ongoing reliance on LNG exports, the relatively mild institutional framework, the shortcomings with regard to transparency and the rising government related entities and private sector external debt.

While those risk factors are real challenges, we believe strengths outpace weaknesses and opportunities outweigh threats at the horizon. In its latest Article IV Consultation Mission report, the IMF raises a number of challenges to consolidate the overall macro/financial outlook. Within this context, continuing gradual fiscal consolidation over the medium term would help ensure adequate saving of the exhaustible hydrocarbon wealth for future generations. Effective prioritization and sequencing of fiscal reforms is important to preventing fiscal fatigue, with the rising need for a medium term fiscal framework and enhanced asset-liability management at large.

DISCLAIMER

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