

QATAR ECONOMIC REPORT

MAINTAINING STRONG ECONOMIC MOMENTUM IN AN INCREASINGLY CHALLENGING ENVIRONMENT

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• Strong growth momentum despite the contraction in energy prices

The Qatari economy grew by 6.1% in 2014 (almost similar to 2013) and is set to rebound to 7.1% in 2015 according to the International Monetary Fund. The strong performance of the past year was actually driven by an 11.8% expansion in the non-mining and quarrying sector which included a 17.7% year-on-year increase in the construction sector while the hydrocarbon sector shrank by 1.5% in 2014. Other non-energy growth drivers last year included financial services and the hotel and restaurant trade. The continuing influx of foreign workers and resultant rapid population growth is increasing local consumption and the demand for housing and financial services.

• Lower external surpluses amidst a slump in oil prices

Qatar's external sector came under pressure within the context of a slump in oil prices. The State's overall trade surplus contracted by 4.5% in 2014 as compared to a 3.1% growth in 2013, as per the Central Bank of Qatar, and the current account surplus fell to 26.1% of GDP in 2014, compared to 30.7% of GDP in 2013. A detailed look at the trade activity shows that total imports retreated by a tiny 1.0% year-on-year to reach US\$ 31.2 billion in 2014. Total exports declined by 3.7% in 2014 to reach US\$ 131.7 billion.

• Decrease in government surplus reflecting lower hydrocarbon revenues

Driven by a drop in hydrocarbon revenues, growth in Qatar's government balance has turned negative. According to data released by the IMF, the government surplus has decreased by 30% to reach US\$ 29.4 billion in FY 2014/2015, reversing the trend registered in the last few years, of which an increase of 53% recorded in the FY 2013/2014. Following a rise of 22.1% in FY 2013/2014, revenues went down by 9.1% to US\$ 96.6 billion in FY 2014/2015. On the other hand, expenditures totalled US\$ 67.3 billion in FY 2014/2015, up by 4.5% from the previous FY during which they had risen by 8.1%. Gross government debt is estimated at 31.5% of GDP as of March 2015.

• Contained inflation along with stability in money supply

Qatar's monetary conditions were marked during the first four months of the year 2015 by contained price pressures, a fall in international reserves, sustained low policy rates in the context of an accommodative monetary policy, and relative stability in monetary aggregates. Qatar's Consumer Price Index grew by a mere 0.9% year-on-year in April 2015, after rising by 3.0% on average in 2014, mainly due to the direct and indirect effects of falling oil and non-oil commodity prices and due to methodological changes adopted by Qatari authorities in compiling CPI data.

• Strong activity growth coupled with robust financial soundness

Qatar's banking sector registered yet another year of solid private sector activity growth in 2014 and so far this year. Measured by total assets of banks operating in Qatar, total sector activity reported a 10.4% growth before registering a tiny one in this year's first four months (+0.4%), reaching a total of US\$ 277.2 billion at end-April 2015. Financial soundness indicators continue to be robust, with a liquidity ratio of 23.1% of total deposits, a non-performing loan ratio of 1.7% of total loans, a capital adequacy ratio of 16.3% and ROAA of 2.1% and ROAE of 16.5%.

• Mixed price movements in capital markets

Qatar's capital markets saw mixed price movements over the first five months of 2015. The equity market registered price declines following strong price rally observed over the past couple of years, with Qatari stocks posting the highest earnings multiple in the MENA region by year-end 2014. The Qatar Exchange general index declined by 1.9% during the first five months of 2015, after rising by 18.4% in 2014. On the other hand, the fixed income market in Qatar witnessed mostly upward price movements, given the ample liquidity in the market and in the absence of new bond issues over the first five months of 2015.

The Qatari economy continued to perform relatively well, maintaining a strong growth momentum despite the contraction in energy prices. According to the International Monetary Fund, the Qatari economy grew by 6.1% in 2014 (almost similar to 2013) and is set to rebound to 7.1% in 2015. The strong performance of the past year was actually driven by an 11.8% expansion in the non-mining and quarrying sector which included a 17.7% year-on-year increase in the construction sector while the hydrocarbon sector shrank by 1.5% in 2014. Other non-energy growth drivers last year included financial services and the hotel and restaurant trade. The continuing influx of foreign workers and resultant rapid population growth is increasing local consumption and the demand for housing and financial services.

Qatar's non-hydrocarbon sector has been indeed the primary driver of growth in recent years, driven by infrastructure public spending and in line with Qatar's long term development strategy. Public spending has been considerably strong on the back of the government's desire to provide Qatar with World class infrastructure, health and education system, as well as outlays related to hosting the World Cup in 2022. It is worth mentioning that despite the significant public spending growth, Qatar's fiscal breakeven oil price remains among the lowest in GCC countries which is partly tied to prudent budgeting. The public finance balance remains in a surplus of 14.5% in FY 2014 and is forecasted to maintain a small surplus of 5.6% in FY 2015.

In parallel, the current account balance is being squeezed from both sides as contracting hydrocarbon revenues combine with growing imports stemming from large infrastructure projects and the expanding population. Still, it is worth highlighting that despite the fall in oil prices, Qatar's current account remained in surplus of 26.1% of GDP in 2014 (and is still expected at a surplus of 8.4% of GDP in 2015). The surplus is boosting official foreign exchange reserves which reached a high of US\$ 42.6 billion at end-December 2014.

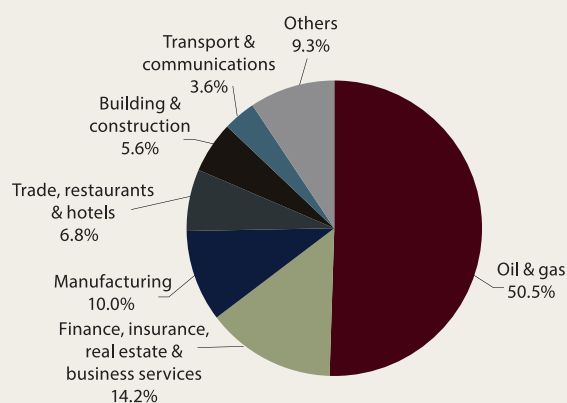
At the monetary level, monetary policy remains accommodative in the context of the peg to the dollar. In parallel, direct and indirect effects of falling oil and non-oil commodity prices have allowed consumer price inflation to trend down, with inflation set to reach new floor after sharp fall in 2014. As a matter of fact, the sharp fall in global commodity prices pushed down average inflation to 3% in 2014 and is likely to push it further down to 2% in 2015. The moderate inflation in 2014 actually took place despite a 35% yearly rise in the real estate index produced by the Central Bank. It is worth mentioning in this context that the disinflationary effect will be magnified by the strength of the dollar, in which many commodities are priced.

NOMINAL GDP AND REAL GROWTH RATES



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



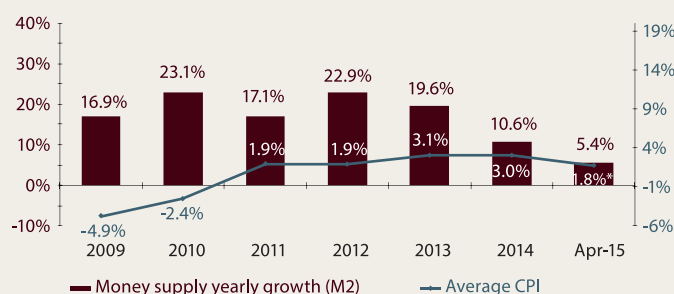
Sources: Central Bank of Qatar, Bank Audi's Group Research Department

Banking activity in Qatar maintained a sound growth amid strong financial standing. Measured by the consolidated assets of operating banks, total banking activity grew by 10.4% in 2014, but slowed down to 0.4% in the first four months of 2015. Credit growth is still high at 13.0% in 2014 and 2.9% in the first four months of 2015. Financial soundness indicators are good, with adequate capitalization, sound asset quality, acceptable liquidity and high profitability.

At the capital markets level, equity markets have been somehow volatile. Having managed to hold onto a positive gain (of 18.4%) in 2014, they are down by 1.9% for the year-to-date. Still, the Doha stock market remains a strong performer as it ranks third in the region by market capitalization. Qatar's 5-year CDS spreads which stay low compared to the stresses in 2011, have remained almost stable in 2014 and in the year-to-date period of 2015.

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



* IMF full-year forecast

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

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbons

Hydrocarbons sector slows down from previous year

Qatar's hydrocarbon industries witnessed a real contraction of 1.5% in 2014, against an expansion of 0.2% in 2013, according to official statistics. The country's diversification strategy, part of Qatar National Vision 2030, has been successful in supporting the non-hydrocarbons sector with the growth of the latter exceeding that of hydrocarbons for the third consecutive year. Furthermore, showing further evidence of the country's diversification efforts, the share of the hydrocarbon sector out of total GDP dropped from 57.0% in 2012 to 54.4% in 2013 to 50.5% in 2014. Export revenues from the hydrocarbon sector also contracted by 7.9% in 2014 compared to a 2.2% expansion in 2013, as per the IMF.

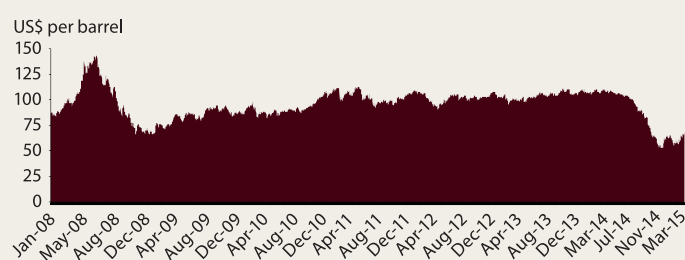
Moving to the production of hydrocarbons, Qatar's LNG production attained 77.8 million tons in 2014, down by a marginal 0.4% year-on-year, according to IMF data. This compares to production rises of 1.5% in 2013 and 0.7% in 2012. As for oil production, it continued its decreasing trend moving from 697.8 thousand barrels per day (bpd) in 2013 to 670 thousand bpd in 2014, a yearly decline of 3.9%.

Despite Qatar's diversification efforts set in the 2030 National Vision, the economy is still heavily dependent on hydrocarbons. For instance, oil and gas (including investment income from Qatar Petroleum) account for around 85% of fiscal revenues, and current external receipts and spending of hydrocarbon revenues are a key driver of the non-hydrocarbon economy. Also, it is worth adding that Qatar has the third-largest reserves of gas in the world and 80% of its LNG exports are under long-term contracts, the earliest of which expires in 2021.

Nonetheless, it is expected that the hydrocarbon sector would see growth in 2015 as a result of the completion of the first two trains of the Barzan North Field gas development, which is designed to produce gas feedstock for domestic power and water use. Barzan Gas Project is a vital project expected to sustain and fuel the ongoing and future major infrastructure projects in Qatar. The US\$ 10.3 billion project, being implemented by RasGas, would increase its overall production capacity to 11 billion standard cubic feet of sales gas per day and make it one of the world's biggest single gas processors. In parallel, Chinese companies have been increasingly active in the Qatari upstream sector with China National Offshore Oil Corporation and PetroChina involved in exploring for new gas finds off Qatar's north coast.

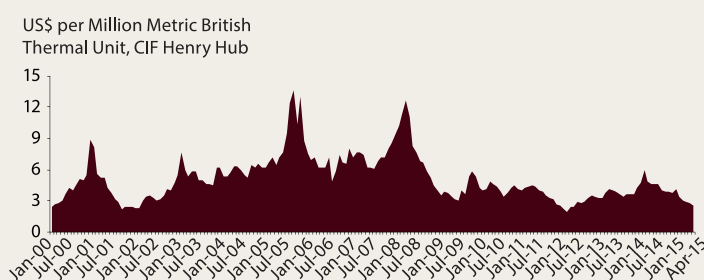
The majority of upstream investment in the next three years would focus on oil field redevelopments. Occidental Petroleum would enter the fifth phase of the Idd El Shargi field development after signing an agreement with Qatar Petroleum (QP) in mid-2013 to sustain oil production at around 100,000 barrels per day. QP is also budgeting US\$ 13 billion for the redevelopment of the Bul Hanine oil field.

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

NATURAL GAS PRICES



Sources: IMF, Bank Audi's Group Research Department

As a result of the lower hydrocarbons export prices, government revenue was negatively affected, contributing to curbing government spending. For instance, oil-related schemes such as the Al Karaana petrochemicals project are vulnerable and would be delayed until oil prices recover in 2017 to 2019, as per the Economist Intelligence Unit (EIU). Qatar's State-run oil marketing firm Tasweeq also reported plans to cut condensates exports by 150,000 barrels per day over the next two years.

In sum, falling oil prices make economic diversification even more crucial. The government would continue to invest heavily in infrastructure projects essential for promoting the non-hydrocarbons sector and turning Qatar into a regional financial and business hub.

1.1.2. Manufacturing

Robust growth with growing importance of economic diversification

Being a major component of Qatar's economic diversification efforts, the country's manufacturing sector contributed to 10.0% of aggregate output in 2014 and expanded by 5.2% annually to become the third largest contributor to GDP. The country's manufacturing sector is essential to diversify Qatar's economy by creating job opportunities for future generations, reducing the country's exposure to the hydrocarbons sector, and reinforcing the private sector.

Incentives offered to industrial facilities in Qatar allow for the creation of a strong industrial base that meets growing demand from the local market and allows it to compete internationally, as per the Gulf Organization for Industrial Consulting (GOIC). In fact, the value of Qatar's local investments in joint industrial projects was about US\$ 29.2 billion in 2014, with 35.4% of the total cumulative investments taking place in manufacturing industries.

Moving on to the Qatar National Vision 2030, the country aims to expand industries and services, which include manufacturing, with competitive advantages derived from hydrocarbon industries, develop economic activities in which Qatar can specialize, and form a knowledge-based economy characterized by innovation, entrepreneurship and excellence in education.

Within this context, Qatar Primary Materials Company's (QPMC) 60,000 ton capacity cement silo project at Mesaieed would be operational by November 2015, as per QPMC. The project would have 12 silos with 5,000 tons of storage capacity each, as per the same source. On the other hand, State-owned Qatar Petroleum and Royal Dutch Shell decided to halt their joint Al Karaana petrochemical project in Qatar. The companies stated in a joint statement that the decision was made after the project was deemed commercially unfeasible based on the price quoted to build the complex, amid the current economic climate in the energy industry. In December 2011, Qatar Petroleum and Shell agreed to build a US\$ 6.4 billion petrochemical complex in the Ras Laffan industrial city in Qatar, with the Qatari company holding an 80% stake and Shell a 20% stake.

1.1.3. Construction

Another good year for Qatar's realty sector

The construction sector in Qatar accounting for 5.6% of GDP continues to be supported by public spending and population growth. In fact, it is estimated to have expanded by 18.0% in 2014, against 13.6% in 2013, according to the Ministry of Development Planning and Statistics.

Moreover, Qatar's real estate price index expanded by almost 16 points in March 2015 from year-end 2014, and by 62 points year-on-year, according to the Central Bank of Qatar. According to the IMF, this is actually due to the fact that new housing supply is slow to accommodate demand from expatriates and the government continues to purchase land for infrastructure projects. In fact, real estate prices, and land prices in particular, have gone up quickly, especially in the second half of 2014. While the total number of real estate transactions has decreased from the 2013 peak, the total value of real estate transactions has dramatically increased, reflecting higher average prices and compositional changes. It is worthy to

note, however, that while the Doha market experienced sporadic price hikes, price growth was recently strongest outside the capital, given development projects and urbanization.

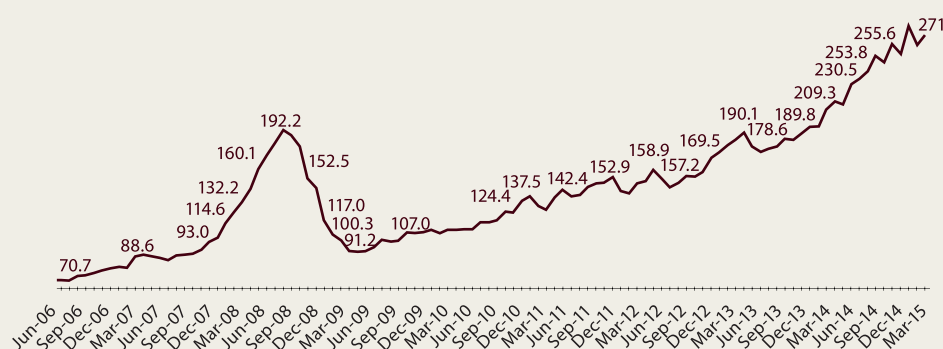
Some evidence also points to some speculative activity in the real estate market in anticipation of public investments, with real estate valuations appearing on the upper end of a range consistent with fundamentals. However, real estate prices are expected to face headwinds from the large loss of hydrocarbon wealth and related uncertainties and could thus witness a correction phase from current levels.

At the same time, the construction sector captured 14.2% of credit facilities advanced by the Qatari banking sector at end-April 2015. In details, loans to the construction sector grew by a yearly 11.2% in April. This is in line with credit growth to non-hydrocarbon sectors and is due to the large public investment program and associated population growth.

It is noteworthy that the Qatari authorities are looking to prioritize World Cup related infrastructure over energy and industrial schemes. With more material and manpower resources freed up by cancelling hydrocarbon and water and industrial projects, the Qatari authorities hope that the 2022-related construction project pipeline will be made smoother. This reallocation of resources is likely to define Qatari project activity over the medium term, with only a revival in oil prices likely to generate renewed appetite.

Simultaneously, a series of projects have started to materialize. For instance, the new Hamad International Airport opened in May 2014, expanding Qatar's airport capacity from 9 million passengers to an initial current capacity of 30 million passengers per year. Also among projects is the newly constructed Doha Exhibition and Convention Centre (DECC), which provides 90,000 sqm of exhibition space. There is a substantial amount of supply in the pipeline with over 44 hotels across all market sectors in varying stages of planning or construction, primarily in the luxury, upper upscale and upscale segments at large.

REAL ESTATE PRICE INDEX



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

1.1.4. Tourism

Positive performance in the sector serving the country's diversification strategy

Qatar's tourism sector plays a pivotal role in the country's economic diversification strategy. In 2014, the total number of tourists visiting Qatar registered 2.82 million with tourists from the GCC region accounting for the biggest share of 40% of total visitors, as per the Qatar Tourism Authority.

Looking at the first quarter of 2015, regional and international visitor arrivals amounted to 841,025 up by nearly 11% year-on-year. The GCC remained the largest arrivals' source market, whereby its number of visitors grew by 16% compared to the first quarter of 2014.

According to the World Travel and Tourism Council (WTCC), the direct contribution of travel and tourism to the country's GDP was US\$ 4.2 billion (2.0% of total GDP) in 2014. This number is forecasted to grow by 7.3% to US\$ 4.6 billion in 2015. Furthermore, this contribution is expected to increase by 4.7% per annum to US\$ 7.2 billion (1.7% of GDP) by 2025.

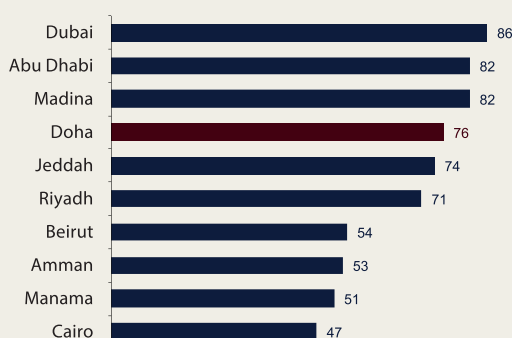
It is worth noting that travel and tourism investment was US\$ 1.6 billion in 2014 (2.3% of total investment). This is expected to increase by 14.9% in 2015, and by 7.7% per annum to stand at US\$ 3.9 billion in 2025 (2.5% of total), as per WTTC.

Figures by Ernst & Young for four and five star hotel performance in Doha show that occupancy was at 70% in 2014, up from 63% reported in 2013. The average room's rate stood at US\$ 235 last year, up by 1.0% from the year before. Consequently, the rooms' yield rose by an annual 13.6% to register US\$ 167 in 2014. In the first four months of 2015, occupancy was at 76%, up from 71% registered in the same period of 2014. Average room's rate reached US\$ 262 in the first four months of 2015, up from US\$ 237 in the corresponding period of 2014. Alongside, the rooms' yield stood at US\$ 200 in the aforementioned period of 2015, up by 18.5% from the same period of last year.

On another note, Qatar has plans to promote itself as a strong tourism hub in the Middle East through expanding its leisure and hospitality offers. In this context, the Qatar Tourism Authority has a target to attract around 7 million visitors per annum by 2030. The authority promoted a tourism strategy that comes along with the Qatar National Vision 2030 and the National Development Strategy 2011 to 2016 focusing on the need to decrease the reliance on the energy sector through economic diversification. This strategy highlights their approach to grow and develop the tourism and hospitality market.

As Doha looks forward to host the 2022 FIFA World Cup, Qatar is investing in infrastructure and tourism. This is mainly driven by both the World Cup and the nation's "Vision 2030" which involves projects like Doha Festival City, Doha Convention Centre, and Katara Towers among others. The World Cup is creating both challenges and opportunities for the city whereby the number of hotels being built is likely to

COMPARATIVE HOTEL OCCUPANCY RATES (%) *



* First 4 months of 2015, four and five star hotels

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

exceed Doha's need after the event. Currently, the city has 16,000 rooms, and is expected to have 60,000 by 2022, noting that 3,000 new rooms entered the market last year.

On a positive note, there was a huge investment in a new airport which would remain of benefit to the country even after the football event ends. Qatar's airport capacity rose from 9 million passengers to 30 million per annum (rising to 50 million passengers per year when fully operational).

Hence, it is clear that the tourism sector plays an essential role in diversifying the Qatari economy, with positive activity reflected in most of its indicators.

1.2. EXTERNAL SECTOR

Lower external surpluses amidst a slump in oil prices

Qatar's external sector came under pressure in 2014 within the context of a slump in oil prices. Qatar's external surpluses declined when compared to the previous year. In fact, the State's overall trade surplus contracted by 4.5% in 2014 as compared to a 3.1% growth in 2013, as per the Central Bank of Qatar, and the current account surplus fell to 26.1% of GDP in 2014, compared to 30.7% of GDP in 2013.

A detailed look at the trade activity shows that total imports retreated by a tiny 1.0% year-on-year to reach US\$ 31.2 billion in 2014. Total exports (including exports of domestic goods and re-exports) declined by 3.7% in 2014, the equivalent of US\$ 5.1 billion, to reach US\$ 131.7 billion. This reverses the upward trend that was prevailing since 2001, mainly due to a slump in oil prices. The decrease in total exports over the year 2014 is mainly attributed to a 13.8% year-on-year drop in exports during the fourth quarter of 2014 given lower exports of mineral fuels, lubricants and related materials.

The breakdown of Qatari exports by destination in 2014 indicates that Asia got the largest share in exports with US\$ 104.6 billion, or 79.4% of the total, noting that exports to this region have declined by 3.0% year-on-year. Asia was followed by the European Union with US\$ 11.7 billion (8.9% of the total), with exports to the European countries falling by 14.6% year-on-year, then Arab countries with US\$ 10.2 billion (7.8% of the total), with exports to these countries increasing by 6.8% year-on-year. Aggregate exports to the aforementioned countries accounted for circa 96.1% of total exports.

The trade balance reached a surplus of US\$ 100.6 billion in 2014, down by 4.5% relative to the previous year. The large drop in total exports led to declines in the exports-to-imports coverage ratio and in the trade balance to GDP ratio last year, as per the Central Bank of Qatar.

Qatar posted net deficits in its balances on services, incomes and transfers in 2014, amounting to US\$ 19.3 billion (+18.6%), US\$ 9.3 billion (-17.9%) and US\$ 17.1 billion (+12.2%), respectively. With regards to services, large transportation payments related to LNG exports offset significantly the State's travel receipts most of which are collected through its position as a transit hub between the West and Asia. In the incomes category, profit repatriation of foreign companies in Qatar remains the largest contributor to the negative balance. As to the transfers category, it is dominated by outward remittances of expatriates residing in Qatar which amounted to US\$ 17.8 billion in 2014, up by 8.8% from the previous year.

On the backdrop of lower oil prices, Qatar registered a 12.1% contraction in current account surplus in 2014, with the latter accounting for 26.1% of GDP as compared to 30.7% of GDP in 2013. As to the capital and financial balances, both recorded deficits of US\$ 5.5 billion and US\$ 46.9 billion respectively in 2014, with the latter recording a contraction of 5.6% relative to the previous year. This was mainly due to a decline in the negative balance of the direct investment from US\$ 8.9 billion in 2013 to US\$ 5.7 billion in 2014. Consequently, the balance of payments recorded a cumulative surplus of US\$ 1.4 billion in 2014, against a higher surplus of US\$ 9.1 billion a year earlier.

Going forward, the recent large drop in oil and natural gas prices would lead to a substantial deterioration of the fiscal and external balances, calling for intensification of diversification efforts and some fiscal consolidation in the medium term. In sharp contrast to previous years, the budget will be in deficit from 2016 onward and the current account surplus would largely be eliminated, as per the IMF.

1.3. PUBLIC SECTOR

Decrease in government surplus reflecting lower hydrocarbon revenues

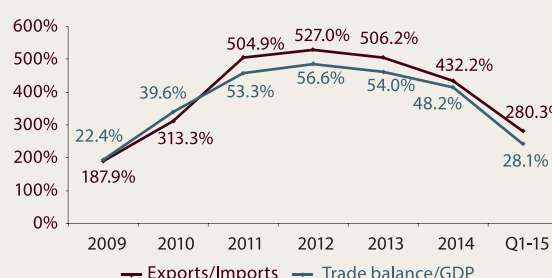
Driven by a drop in hydrocarbon revenues, growth in Qatar's government balance has turned negative. According to data released by the IMF, the government surplus has decreased by 30% to reach US\$ 29.4 billion in FY 2014/2015, reversing the trend registered in the last few years, of which an increase of 53% recorded in the FY 2013/2014.

Following a rise of 22.1% in FY 2013/2014, revenues went down by 9.1% to US\$ 96.6 billion in FY 2014/2015. Revenues stemming from hydrocarbons accounted for 47.1% of the total compared to a higher share of 57.2% in FY 2013/2014. At the same time, non-hydrocarbon revenues accounted for 52.9% of FY 2014/2015 total revenues. Detailed IMF data shows that the dollar value of hydrocarbon revenues decreased by 23.6% to account for 20.0% of the country's GDP in FY 2014/2015, following a rise of 10.0% in FY 2013/2014 during which they accounted for 26.1% of GDP. A lower growth rate was registered by the other types of revenue, including investment income from public enterprises, corporate tax revenues, and other non-tax revenues. In fact, the growth level of the above mentioned revenues decelerated from a level of 37.0% in FY 2013/2014 to a much lower one of 14.8% in FY 2014/2015. Within the context of renewed diversification efforts, the share of non-hydrocarbon revenues in the country's GDP has increased from 19.5% in FY 2013/2014 to 22.5% in FY 2014/2015. It is worth noting, however, that growth in this category was mainly driven by revenues from public enterprises at large.

On the other hand, expenditures totaled US\$ 67.3 billion in FY 2014/2015, up by 4.5% from the previous fiscal year during which they had risen by 8.1%. Around 70% of the total was allocated to current expenditures, almost equal to the share of 69% allocated in FY 2013/2014. The dollar value of the current expenditures as well as that of capital expenditures both progressed at a mild pace last year. In fact, the share of the latter out of the FY 2014/2015 GDP reached 10.9%, up from 10.1% in the previous fiscal year. In fact, the consistent growth in capital expenditures is in line with Qatar's ambitious diversification agenda through a large public investment program. At the same time, growth in current expenditures was restrained, mirroring the ongoing budget reforms and the significant progress made in setting up the macro-fiscal unit and the public investment department.

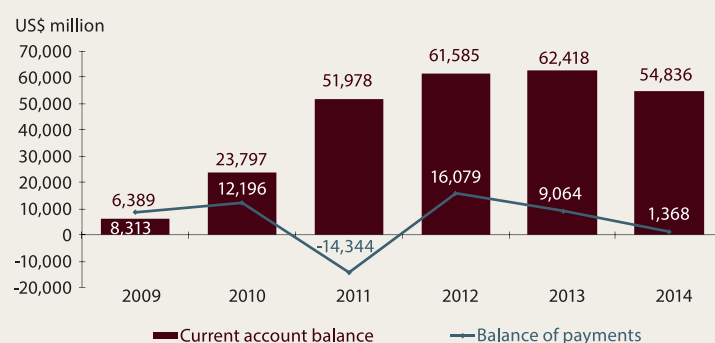
Gross government debt as of March 2015 is estimated at 31.5% of GDP. Net worth of the Qatari government remains, however, positive and 3-digit, when including the Qatar Investment Authority's (QIA) large assets.

FOREIGN SECTOR INDICATORS



Sources: Ministry of Development Planning and Statistics, IMF, Bank Audi's Group Research Department

CURRENT ACCOUNT AND BALANCE OF PAYMENTS



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

The fiscal balance has emerged at the end of FY 2014/2015 at around 14.5% of GDP. Looking forward, despite the short-term growth outlook being positive, lower oil prices are expected to lead to a substantial deterioration of the fiscal balance, with the IMF suggesting that the government budget could fall into a deficit from 2016 onwards.

Finally, according to IMF recommendations, the oil price slump highlights the need for specifying a clear medium-term fiscal framework, including contingency plans. The Ministry of Finance should formulate medium-term fiscal objectives and, accordingly, an annual budgeting process, so that spending overruns are eliminated.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Contained inflation along with stability in money supply

Qatar's monetary conditions were marked during the first four months of the year 2015 by contained price pressures, a fall in international reserves, sustained low policy rates in the context of an accommodative monetary policy, and relative stability in monetary aggregates.

Qatar's Consumer Price Index grew by a mere 0.9% year-on-year in April 2015, after rising by 3.0% on average in 2014, mainly due to the direct and indirect effects of falling oil and non-oil commodity prices and due to methodological changes adopted by Qatari authorities in compiling CPI data. The breakdown of the Consumer Price Index by segment showed in April 2015 that the tobacco segment rose by 14.1% year-on-year, followed by the education segment with +11.1%, the transport segment with +6.0%, the housing, water, electricity and gas segment with +3.0%, noting that the two latter segments have together a combined weight of 36.5%. The furnishings and household equipment segment increased by 0.9%, followed by the restaurants and hotels segment with +0.7%, the food and beverages segment with +0.3%, the clothing and footwear segment with +0.2%, and the health segment with +0.2%. In contrast, the recreation and culture segment reported a decline of 9.8% year-on-year, followed by the communication segment with -3.5% and the miscellaneous goods and services segment with -0.1%.

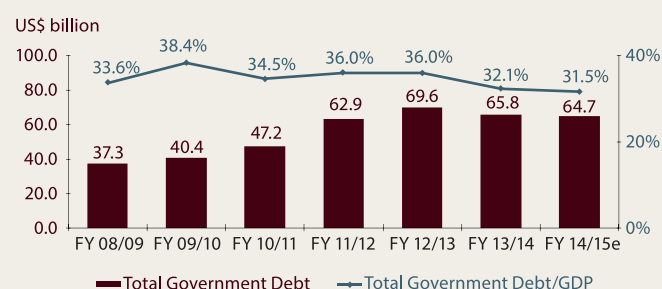
The Qatari authorities started in January 2015 compiling CPI data according to a new methodology. The new index shifts the basket weights from an old base year of 2007 to a new base year of 2013, and implements other methodological changes. In the new CPI, the "Classification of Individual Consumption According to Purpose" method has been used, which divides the prices basket into twelve main groups instead of eight groups. The main implication is a drop in the weight of housing, electricity, water, and gas from 32.1% to 21.9%, although it remains the highest in the basket. The reduction is partly explained by the change in methodology for the computation of rental, following the exclusion of imputed rental of owner-occupied dwellings. The weight for "Recreation and Culture" which includes expenditure incurred abroad in respect of transport, travel and tourism, increased from 4.1% to 12.7% in the 2013 base CPI. Finally, the weight for "Restaurants and hotels" rose from 3.7% to 6.1%.

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	FY 11/12	FY 12/13	FY 13/14	FY 14/15e
General government revenues	67.6	87.1	106.3	96.6
General government revenues/GDP	38.7%	45.0%	51.9%	47.1%
General government expenditures	49.8	59.6	64.4	67.3
General government expenditures/GDP	28.5%	30.8%	31.4%	32.5%
General government fiscal balance	17.8	27.5	42.0	29.4
General government fiscal balance/GDP	10.2%	14.2%	20.5%	14.5%

Sources: IMF, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department

In 2015, inflation could decelerate to 1.8%, according to the IMF, given the large drop in international commodity prices, including for food, and an appreciating US Dollar, although the rental market is likely to continue putting upward pressure on inflation given strong expatriate labor inflows.

With inflation remaining quite contained in 2015, the Qatar Central Bank maintained its policy lending and deposit rates unchanged so far this year, extending the trend that was prevailing over the past three years. Accordingly, the overnight lending rate stands currently at 4.50%, the repo rate at 4.50%, and the overnight deposit rate at 0.75%.

On the other hand, Qatar Central Bank's net international reserves reversed during the first four months of 2015 the upward trend that was prevailing over the past three years, registering a 4.6% decline since end-2014, the equivalent of US\$ 2 billion, to reach US\$ 40.7 billion at end-April 2015, driven by a 14.8% fall in balances with foreign banks. The QCB net international reserves covered around 41.7% of money supply in local currency at end-April 2015 as compared to 44.6% at end-2014.

The broader Money Supply (M2) expanded by a mere 0.1% during the first four months of 2015 to reach US\$ 138.7 billion at end-April 2015, following a 10.6% expansion in 2014. The shy US\$ 199 million variation in money supply during the first four months of 2015 compares to a money creation of US\$ 1.1 billion, resulting mostly from a surge in claims on private sector of US\$ 6.0 billion, an increase of US\$ 1.6 billion in net claims on the public sector and a fall of US\$ 6.5 billion in net foreign assets. The difference between the expansion in money supply on the one hand and money creation on the other hand, suggests a demonetization of monetary claims by US\$ 893 million during the first four months of 2015.

The Qatari Riyal continues to be pegged to the US Dollar at a rate of QR 3.64/US\$ 1 since July 2002. The authorities seem committed to maintaining the current exchange rate regime, arguing not only that Qatar's gas and oil exports are denominated in the US currency but also that the peg offers stability and reassurance to investors. The peg to the US dollar has served Qatar well in periods of both high and low oil prices by anchoring prices of tradables and providing stability to income flows and financial wealth, as per the IMF.

Going forward, the disinflationary pressures from abroad will dissipate and headline inflation is projected to increase modestly, as per the IMF. Future real estate price developments are uncertain since real estate prices may remain supported by the public investment program but will also face headwinds from the large loss of hydrocarbon wealth and related uncertainties.

1.4.2. Banking Activity

Healthy private sector deposit and lending growth coupled with robust financial soundness

Qatar's banking sector registered yet another year of solid private sector activity growth in 2014 and so far this year. This reflects a still healthy economic growth momentum across the country and ensuing liquidity at hand and new financing opportunities for Qatari lenders throughout 2014, and the impact of

EVOLUTION OF MONETARY SITUATION

Flows in millions of US\$	2010	2011	2012	2013	2014	4M-15
Net foreign assets	4,624	-12,742	1,538	22,926	4,946	-6,488
Foreign Assets	13,097	-6,633	18,843	18,575	10,058	-1,825
Foreign Liabilities	-8,472	-6,109	-17,305	4,351	-5,113	-4,664
Net Domestic Assets	9,011	25,173	17,992	-2,414	8,326	6,687
Claims on private sector	12,816	22,355	24,520	14,024	12,239	6,018
Net claims on public sector	2,470	9,670	3,246	-11,587	3,330	1,563
Other Items (net)	-6,275	-6,852	-9,774	-4,851	-7,243	-893
Broad Money (M2)	13,636	12,431	19,530	20,511	13,272	199
Money Supply (M1)	4,181	3,712	2,498	4,119	5,034	-415
Quasi-Money	9,454	8,720	17,032	16,393	8,238	614

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

dwindling hydrocarbons prices on the large public sector and its deposits and credit demand in the first few months of 2015. Measured by total assets of banks operating in Qatar, total sector activity reported a 10.4% growth before registering a tiny one in this year's first four months (+0.4%, due to lower inter-bank funding/placements), reaching a total of US\$ 277.2 billion at end-April 2015.

Activity growth in Qatar is to a good extent driven by customer deposits, which account for around 61% of total balance sheets. Sector-wide funding in Qatar benefits from an adequate core customer deposit base, which is mostly domestic. As a matter of fact, resident deposits account for close to 89% of the total deposit base nowadays in Qatar. Total deposits rose by 9.6% last year, and by a further 3.1% in this year's first four months to reach US\$ 170.3 billion at end-April 2015.

The rise in deposits during 2014 is mostly attributed to resident private sector deposits in local and foreign currencies, in addition to non-resident deposits. In contrast, public sector deposits slightly contracted on the overall, within the context of lower hydrocarbons prices as the year neared to an end. The same trend continued so far this year, noting that the public sector deposit contraction accentuated, especially at the level of time and saving foreign currency deposits.

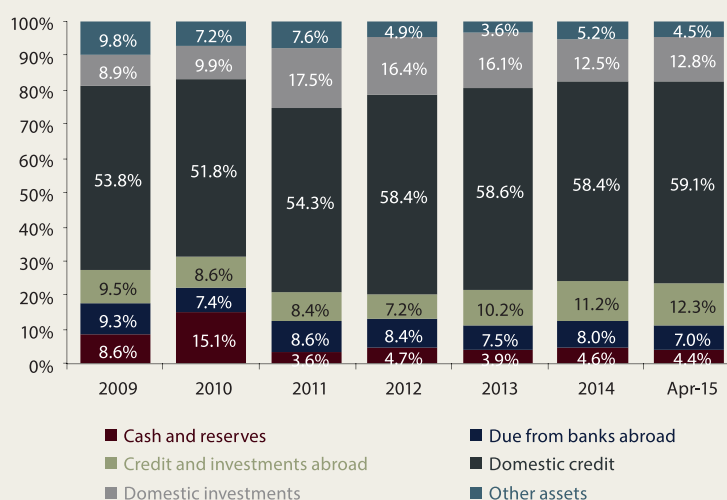
It seems that the authorities have been drawing down on their deposits to settle debt service payments and State obligations, all within the context of lower hydrocarbons prices impacting the accumulation of funds parked at Qatari banks. Last year, it was only the government sector that was responsible for the slight contraction in deposits, but this year, the other components, i.e. the government institutions and semi-government institutions, followed suit.

EVOLUTION OF BANKING ACTIVITY

US\$ million	2011	2012	2013	2014	4M-14	4M-15	Variation	
Var. Total assets	34,840	33,608	25,670	26,016	9,464	1,183	-87.5%	1.3%
% change	22.3%	17.6%	11.4%	10.4%	3.8%	0.4%	-3.4%	-1.0%
Var. Total deposits	15,611	25,949	24,813	14,475	9,863	5,160	-47.7%	-41.7%
% change	18.5%	26.0%	19.7%	9.6%	6.5%	3.1%	-3.4%	-10.1%
Var. Total credit facilities	24,473	28,864	18,342	20,554	6,000	5,229	-12.8%	12.1%
% change	28.3%	26.0%	13.1%	13.0%	3.8%	2.9%	-0.9%	-0.1%

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

In parallel, and with the aim of lengthening the duration of liabilities as part of Basle III requirements, banks are also resorting to the issuance of long-term bonds to alleviate the structural asset-liability duration mismatch due to the maturity gap between usually short-term deposit funding and long-term project financing.

Higher liquidity at hand and a healthy economic momentum have translated into accrued lending activity for banks operating in Qatar. As a matter of fact, total credit facilities grew by 13.0% in 2014 and by a further 2.9% in the first four months of 2015 to reach US\$ 183.9 billion at end-April 2015.

But a look at the detailed breakdown of those facilities reveals that similarly to developments on the funding side, lending activity to the public sector contracted both in 2014 and during the first four months of this year. This trend has started towards the last few months of 2014 and practically coincided with the start of the fall in hydrocarbons prices globally, and comes within the context of greater scrutiny of public sector borrowing by Qatari authorities which are also focusing on increasing prudence in debt management.

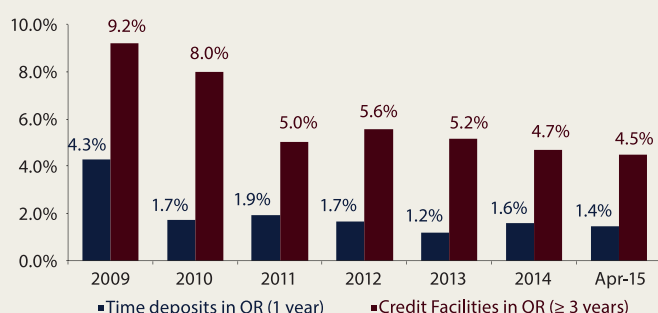
The surge in credit facilities to the private sector last year and so far this year is mostly attributed to the retail, general trade, services, and real estate and contracting sectors, which have contributed to the increased financial intermediation activity on behalf of banks operating in the country and to fuelling the non-hydrocarbons sector activity. Non-resident credit facilities also picked up some pace, accounting for around 29% of total credit facilities growth in 2014 and 49% of the increase registered so far this year. Their share out of total credit facilities outstanding has grown, but remains rather narrow at barely 11% of the total at end-April 2015.

Even though lending activity has been growing more or less faster than deposits throughout most of the covered period, liquidity buffers in the sector remain quite adequate, though seemingly slightly less so over the covered period, as private sector lending grew noticeably and bank placements declined. On the one hand, the credit facilities to deposits ratio reached 108.0% at end-April 2015, almost the same level as in 2014 and only slightly increasing from 104.9% at end-2013. Furthermore, the Central Bank announced during 2014 a cap of 100% on the loan-to-deposit ratio, with banks exceeding the limit required to reduce it over a period of three years or face a penalty.

On the other hand, banks' core readily available liquidity, consisting of reserves and placements at banks, reached 23.1% of total deposits at end-April 2015. While this ratio slightly declined this year due to a contraction in placements at banks abroad and domestically, it still remains sufficient to provide banks with a rather comfortable liquidity cushion should liquidity pressures arise.

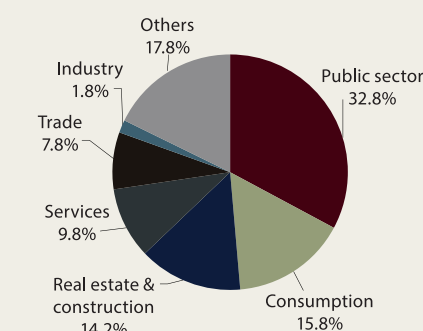
Along the same lines, banks operating in Qatar maintain remarkably good asset quality ratios. Only 1.7% of total loans were classified by the sector regulator as non-performing ones at end-2014 as per the latest available figures, down from 1.9% at the end of the previous year, although it is worth noting that this also reflects non-negligible risk-free government-related lending and healthy growth in total loans (i.e.

INTEREST RATES ON TERM DEPOSITS & CREDIT FACILITIES



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

CREDIT FACILITIES BY ECONOMIC ACTIVITY*



* End-April 2015

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

the ratio's denominator). Provisioning was further bolstered, with the loan provisions to non-performing loans ratio reaching 99.1% at year-end 2014.

Banks in Qatar also boast strong capitalization metrics. Banks are currently operating according to Basle III regulations, and major players reinforced their capitalization through hybrid issuances. The Basle III regulations, effective as of early 2014, introduced a minimum capital adequacy ratio of 12.5% (including a capital conservation buffer) and a new capital charge from 2016 for systemically important institutions. The regulatory capital to risk weighted assets ratio stood at a solid 16.3% at year-end 2014 as per the most recent IMF disclosures, bearing in mind that most of the regulatory capital consists of Tier 1 capital.

Last but not least, despite the relatively low interest rate environment and ensuing rather tight margins, the healthy quantity-effect driven by higher lending activity amid a solid economic momentum helped banks operating in Qatar maintain one of the highest profitability ratios in the region. Central Bank statistics indeed show that the sector-wide return on average assets ratio stood at 2.1% last year, and that the return on average shareholders' equity ratio reached 16.5% in 2014, both sticking to their previous year's levels and mirroring the increase in banks' bottom lines accompanying continued growth in activity and capitalization.

1.4.3. Equity and Bond Markets

Mixed price movements in capital markets

Qatar's capital markets saw mixed price movements over the first five months of 2015. The equity market registered price declines following the strong price rally observed over the past couple of years, with Qatari stocks posting the highest earnings multiple in the MENA region by year-end 2014. On the other hand, the fixed income market in Qatar witnessed mostly upward price movements, given the ample liquidity in the market and in the absence of new bond issues over the first five months of 2015.

In details, the Qatar Exchange general index declined by 1.9% during the first five months of 2015 to close at 12,048.26 at end-May 2015, mainly driven by some profit-taking operations after a strong price rally (+18.4%) observed over the year 2014, and given relatively less attractive market pricing ratios as Qatari stocks traded at a P/E of 15.45x at end-2014 as compared to an average P/E of 12.95x in the MENA region. Also, sustained low oil prices and news of high profile arrests and corruption probes at FIFA's governing body on suspicion of mismanagement and money laundering related to the award of rights to host the 2022 soccer World Cup in Qatar, triggered further price declines in the stock market. Price falls occurred despite the addition of two stocks (Ezdan Holding and Qatar Insurance) to the MSCI Qatar index in May 2015.

Within this context, it is worth highlighting that many drivers were behind the price rally in 2014: first, Qatar raised the foreign ownership limit on the Qatari bourse to 49% at end-May 2014; second, MSCI upgraded Qatar from "frontier market" status to "emerging market" status on June 2, 2014; third, MSCI increased in August 2014 the weightings of three Qatari companies (QNB, Industries Qatar and Qatar Islamic Bank) in its emerging market index; fourth, MSCI removed at end-November 2014 the adjustment factor for four stocks in its Emerging Markets index, and added Gulf International Services to the index.

On the backdrop of price declines over the first five months of 2015, the Qatar Exchange traded at end-May 2015 at a P/E of 13.24x as compared to 15.45x at end-2014. Also, it traded at a P/BV of 2.01x against 2.05x at end-2014. In addition, the Qatar Exchange registered at end-May 2015 a dividend yield of 4.21% against 3.72% at end-2014.

The market capitalization decreased by 5.1% during the first five months of 2015, moving down from US\$ 185.9 billion at end-2014 to US\$ 176.5 billion at end-May 2015. This came within the context of price declines and stability in the number of listed companies at 43 companies. The market capitalization as a percentage of GDP moved consequently down from 88.5% in 2014 to 86.3% at end-May 2015.

The total trading value amounted to US\$ 14.5 billion during the first five months of 2015, dropping by 43.2% relative to the corresponding period of the previous year. On the backdrop of a higher decline in

the total trading value than market capitalization, the annualized turnover ratio reached 19.7% during the first five months of 2015, down from 30.2% during the corresponding period of 2014.

At the level of the fixed income market, sovereign papers, high grade names and papers issued by financial institutions saw mostly upward price movements across the board during the first five months of 2015 within the context of ample liquidity at hand and in the absence of new issues, while also tracking rises in US Treasuries after the US Federal Reserve announced that “it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2% objective over the medium term”.

In details, sovereign papers maturing between 2020 and 2042 registered price rises between 0.88 pt and 7.00 pts over the first five months of 2015, with the highest price increases seen on the longer-end of the curve. Amongst quasi-sovereigns, Qatari Diar'20 was up by 1.75 pt. Prices of Qtel papers maturing between 2021 and 2043 rose by up to 3.00 pts. Also, financials like QNB and CBQ registered price increases between 0.19 pt and 2.88 pts. Within this context, sovereigns, quasi-sovereigns and financials witnessed year-to-date z-spread contractions across the board between 6 bps and 133 bps.

Qatar's five-year CDS spreads stood at 68 basis points at end-May 2015, down by 14 basis points since year-end 2014, following a 23 bps expansion in 2014, which underlines its low risk of default, noting that the Qatar CDS spreads are the third lowest in the region after Saudi Arabia (63 bps) and Abu Dhabi (60 bps), and are much below the average CDS spreads in the Middle East (213 bps) and emerging markets (486 bps).

Regarding credit ratings, Standard & Poor's affirmed in March 2015 the “AA” long-term and “A-1+” short term foreign and local currency sovereign credit ratings on the State of Qatar. The outlook is “stable”. In 2013-2014, Qatar's oil and gas sector expanded by about 2%, and the non-oil sector by 12%, resulting in average annual real GDP growth of about 6%, as per S&P. The rating agency projects slower real GDP growth of about 4% during 2015-2018 because the hydrocarbon sector would likely continue to stagnate. The non-oil sector, on the other hand, would remain buoyant, due to public investment and supported by the growing population. The “stable” outlook reflects S&P's view that Qatar's high economic wealth levels and strong external and fiscal positions would balance its institutional shortcomings and limited monetary flexibility over the next two years.

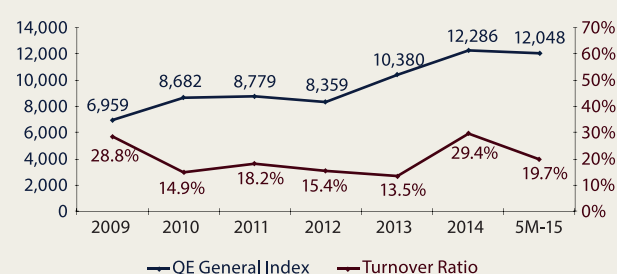
Going forward, the development of an active debt market in Qatar would have far-reaching benefits in deepening the financial infrastructure in Qatar. It would help to attract institutional investors to the State, and provide an important incentive for local investors to better manage their asset allocation process and therefore retain capital in the country. A well-developed debt market would also allow companies to diversify their sources of funding and reduce the cost of borrowing. A deep and liquid government securities market facilitates monetary policy transmission, finances infrastructure projects and promotes financial market development. In the absence of any fiscal imperative for a government to mobilize resources, regular issuance of government debt is nonetheless necessary to support the development of the debt market. The lengthening of the maturity profile of debt issuance will also encourage the emergence of a risk-free yield curve across the term structure, while the risk-free benchmark rate helps in turn in the pricing of other financial instruments.

CAPITAL MARKETS INDICATORS

	2010	2011	2012	2013	2014	May-15
Market Capitalization (US\$ billion)	123.7	125.6	126.3	152.6	185.9	176.5
Market Cap/GDP	98.8%	74.0%	66.4%	75.1%	88.5%	86.3%
Total value traded (US\$ billion)	18.5	22.9	19.4	20.6	54.8	14.5
Total number of shares (million)	2,094	2,303	2,428	1,938	4,440	1,310
No. of listed companies	43	42	42	42	43	43
% Chg. in QE general index	24.8%	1.1%	-4.8%	24.2%	18.4%	-1.9%
P/E ratio	12.5x	14.4x	13.0x	14.6x	15.5x	13.2x
P/BV ratio	2.5x	2.1x	1.9x	2.0x	2.1x	2.0x
Dividend yield	2.9%	4.0%	4.0%	3.9%	3.7%	4.2%
CDS spreads (bps)	88	127	82	59	82	68

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

CAPITAL MARKETS PERFORMANCE



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

2. CONCLUSION

Qatar is undoubtedly in a relatively good position to weather the recent fall in energy prices. The impact of lower oil prices in Qatar is mitigated by the primacy of LNG production in the hydrocarbon sector. While it is true that LNG prices are correlated to oil prices with a certain lag, production and sales volumes are assured by long term offtaker contracts.

In addition, there are important foreign reserves and QIA assets of above US\$ 300 billion to cover deficits whenever needed. Although the precise scale of the country's net international investment position is not known reflecting limitations in the coverage and quality of official statistics, the undeniably large external assets should allow the ambitious capital projects to continue, although a growing focus on prudence and prioritization is necessary. Under a downside scenario of a prolonged period of low energy prices that would impact natural gas prices eroding the government's fiscal position, Qatar's prudent budgeting and a relatively low debt burden somewhat mitigate these risks.

Having said that, the oil price collapse is set to have adverse spillover on growth as lower hydrocarbons export prices would have adverse effects on government revenue, which would somehow curb government spending at large. The annual IMF Article IV assessment of the Qatari economy issued in April 2015 cut the medium-term growth outlook to a range of 4%-5% against a range of 6%-7% made in June 2014. The relatively lower growth will be driven by the falls in oil-related activity in the wake of the sharp fall in global oil prices. The significant change is likely to provide the government with further incentives to diversify the economy away from the hydrocarbon sector through further improvements in the business environment, higher education quality and labor market reforms.

It is worth mentioning that Football's World governing body, FIFA, released a report in November 2014 that cleared Qatar of corruption allegations. Still, dawn raids by US and Swiss authorities on FIFA's annual congress in Zurich, where officials recently converged for a presidential vote, herald a period of uncertainty regarding the prospects of the 2022 World Cup. While it is more likely that games will go ahead as planned for the 2022 event, the risk of Qatar being stripped of the event is also not trivial especially within the context of recent crisis at FIFA.

An analysis of strengths and weaknesses are necessary for the assessment of Qatar's short to medium term outlook. At the level of strengths, we mention the significantly high level of wealth with GDP per capita at the World's highest level of over US\$ 100,000, the vast hydrocarbon reserves, the sustained macroeconomic stability, the low unemployment rate at less than 1%, the large net external creditor position, the relatively low fiscal breakeven oil price and the continuing economic diversification away from the hydrocarbon sector offsetting the growing weakness in the contribution to GDP growth of the oil and gas sector.

At the level of weaknesses, we mention the vulnerability to regional geopolitical turmoil, the relatively weak institutional transparency, the growth in government spending which could erode fiscal flexibility, the continuing slowdown in crude oil output, the relatively elevated inflation volatility and the possible spillovers of the current FIFA crisis on the 2022 World Cup prospects. But we believe that on the back of significant economic strength, institutional strength and fiscal strength along with a moderate susceptibility to event risks, Qatar's strengths outpace weaknesses and opportunities outweigh threats, suggesting a favorable outlook to Qatar's economic prospects.

To appropriately build on its strengths, Qatar has a number of challenges to face looking ahead. The current environment actually calls for the intensification of diversification efforts and some fiscal consolidation in the medium term. In its last Article IV mission report, the IMF praises the ongoing budget reform efforts, though such efforts need to be deepened further with a growing need for a clear medium-term fiscal framework. There is also scope for further upgrading the business environment, further stimulating private sector activity through fostering privatization and introducing labor market reforms for ensuring inclusive growth at large.

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