

QATAR ECONOMIC REPORT

AN INCREASINGLY CHALLENGING MACRO PROFILE AMID AN ARENA OF LARGE FINANCIAL BUFFERS

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- **Sound pace of economic activity though relatively moderating relative to pre-oil collapse**
Qatar's domestic economy is currently characterized by a robust, albeit moderating, pace of economic activity, reflecting the continuing large spending on infrastructure in preparation for hosting the 2022 FIFA World Cup, while tight liquidity and fiscal concerns are increasingly emerging. Within this context, real GDP growth was estimated at 3.3% in 2015 and is forecasted at 3.4% in 2016 according to the recently issued IMF World Economic Outlook. The majority of the components of GDP are recording positive growth, with the non-oil sector being mainly driven by the construction, transport and communications and services sectors.
- **Eroded current account surplus leading to a deficit in the balance of payments**
Within the context of a continuous slump in oil prices, Qatar's foreign trade figures showed a contraction in exports by 39.0% alongside an 8.5% decline in imports in 2015 compared to 2014, contributing to a 48.9% decrease in the foreign trade surplus. Subsequently, Qatar exhibited a significant contraction in its current account surplus by 72.2% in 2015, leading to a deficit in the balance of payments of US\$ 5.5 billion in 2015 for the first time since 2011, against a surplus of US\$ 1.3 billion in 2014.
- **Decline in hydrocarbon receipts taking its toll on government balance**
Qatar's government balance continued deteriorating over the past year, amidst a decline in hydrocarbon receipts. The budget balance emerged at around 10.3% of GDP at the end of FY 2015/2016, against 18.1% in FY 2014/2015, according to the IMF. In parallel, public debt as a percentage of GDP is estimated at 35.8% of GDP in FY 2015/2016, up from 31.7% of GDP in FY 2014/2015.
- **Slight contraction in money supply along with stability in key policy rates**
Qatar's monetary conditions were marked during the first quarter of the year 2016 by an uptick in inflation on the back of subsidy cuts, a slight contraction in broader money supply (M2) amidst reduced liquidity in the banking system, and stability in key policy rates despite the US monetary policy tightening. Qatar's Consumer Price Index grew by 3.1% on average during the first quarter of 2016, after rising by 1.7% on average in 2015, mainly due to higher utility bills, phased in since the summer, and a 30% fuel price increase introduced mid-January 2016. The broader Money Supply (M2) contracted by 2.9% during the first quarter of 2016 to reach US\$ 139.0 billion at end-March 2016.
- **Tightening bank domestic liquidity but overall financial standing remains robust**
Qatar's banking sector has had to face some liquidity challenges in the past few months against the backdrop of a seemingly prolonged period of low oil prices, with the government deposit base shrinking and putting pressure on liquidity levels. It nonetheless managed to pull out decent activity growth last year and so far in 2016, and maintains healthy capitalization, asset quality and profitability ratios. The NPLs/Total loans ratio reached 1.6% at end-2015. In parallel, banks maintain more than adequate capital levels should pressures arise, with a regulatory capital to risk weighted assets ratio of 15.6%. The ROAA and ROAE ratios remain relatively robust at 2.0% and 16.2% respectively in 2015.
- **Mixed price trends on Qatar's capital markets this year**
The equity market remained under downward price pressures since the beginning of the year in a protracted era of low oil prices. On the other hand, the Qatari fixed income market saw mostly price gains so far this year, tracking US Treasuries move after the US Federal Reserve left interest rates unchanged and remained ambiguous about an interest rate hike. The Qatar Exchange general index extended its downward trajectory during the first four months of 2016, falling by 2.3% to close at 10,186.18 at end-April, after dropping by 15.1% in 2015. 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 year-to-date.

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

Qatar's domestic economy is currently characterized by a robust, albeit moderating, pace of economic activity, reflecting the continuing large spending on infrastructure in preparation for hosting the 2022 FIFA World Cup, while tight liquidity and fiscal concerns are increasingly emerging. Within this context, real GDP growth was estimated at 3.3% in 2015 and is forecasted at 3.4% in 2016 according to the recently issued IMF World Economic Outlook. The majority of the components of GDP are recording positive growth, with the non-oil sector being mainly driven by the construction, transport and communications and services sectors. The construction sector in particular is booming, continuing to attract a large influx of foreign workers, even though there have been some layoffs both in the public and private sectors.

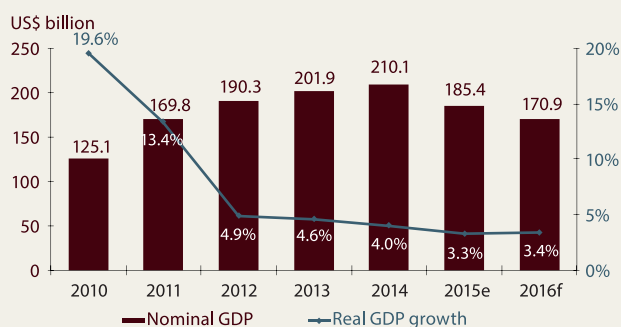
Having said that, persistent low prices and changing LNG market conditions are significantly weakening Qatar's external and fiscal positions. Within the context of a decline in the ratio of exports to imports from 406.8% in 2014 to 271.2% in 2015, the trade balance as a percentage of GDP, which used to account for 45.5% in 2014, retreated to 26.3% in 2015, driving down the current account surplus by 72.2%, moving from US\$ 49.4 billion to US\$ 13.8 billion. Qatar's primary export is Liquefied Natural Gas (LNG), mostly sold on long-term contracts linked to the oil price.

In parallel, the fiscal surplus went down from US\$ 38 billion in FY 2014/2015, the equivalent of 18.1% of GDP, to US\$ 19 billion in FY 2015/2016, the equivalent of 10.3% of GDP. In parallel, public debt to GDP rose from 31.7% to 35.8% respectively. It is worth noting that while Qatar's government debt is relatively low compared to peers, the IMF notes in its latest report that contingent liabilities from State-owned companies would probably account for another 20% of GDP. It is worth mentioning as well that the government intends to increasingly tap debt markets instead of drawing on the assets of the Qatar Investment Authority.

The government continues its attempt to pursue fiscal reforms, many of which were initiated in early 2015. The government has reduced energy spending, as well as travel and office expenses for government employees. Project proposals and budget requests are being more closely scrutinized, even as departments have more flexibility to shift spending between different line items, while non-core functions are being outsourced. The government's previous efforts to rein in current spending, downscale the investment program and reform public finances give credibility to its planned fiscal adjustment, even as the exact composition of current expenditures is unclear.

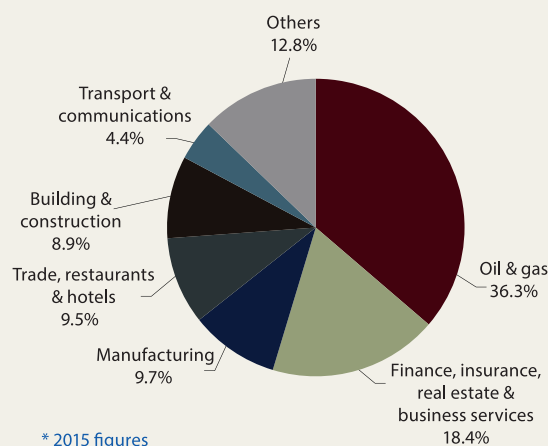
At the monetary level, liquidity has been tightening on lower windfalls and higher financing needs, prompting increased recourse to borrowing and drawdown of government deposits and FX reserves in the absence of a major policy adjustment. Central Bank net international reserves went down from

NOMINAL GDP AND REAL GROWTH RATES



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



* 2015 figures

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

US\$ 42.6 billion at end-2014, the equivalent of 44.6% of money supply in domestic currency to US\$ 36.3 billion in February 2016, the equivalent of 35.5% of money supply in domestic currency. The yearly money supply growth went down from 10.6% in 2014 to 3.4% in 2015 and to a negative -0.4% on an annual basis in March 2016. In parallel, average CPI inflation dropped to a low of 1.7% in 2015, against 3.3% in 2014, while a relative uptick was reported again in the first quarter of the year amid rising domestic fuel prices.

At the banking level, a solid banking system continues to support strong credit growth in Qatar. Driven by credits to construction and real estate sector sectors, services, trade and consumption, total credit facilities to the economy grew by 15.1% in 2015 and by a further 3.2% in the first quarter of 2016 despite the fact that deposit growth has been slowing down reaching 8.2% in 2015 and a mere 1.7% in the first quarter of 2016. It is worth mentioning that deposit interest rates have nearly doubled over the past year, even as banks have sharply increased reliance on foreign funding. Despite tougher operating conditions, the Qatari banking system's financial standing allows it to cope well, on the back of Tier 1 capital of 15.6% of risk weighted assets and non-performing loans to total loans ratio of 1.6% along with a healthy return on assets of 2%.

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 under pressure given relatively low global energy prices

Qatar's hydrocarbon resources and wealth remained one of the pillars of its economic strength in 2015. Nonetheless, the country's economic policy was focused on diversifying away from hydrocarbons during the past year, despite reliance on oil and gas earnings to finance the government-led diversification drive. In fact, the hydrocarbon sector's share out of total GDP dropped from 54% in 2013 to 51% in 2014, and reached 36% in 2015.

Moreover, the country's nominal oil and gas GDP reached QR 219.9 billion (US\$ 60.4 billion) in 2015, down from QR 390.7 billion (US\$ 107.3 billion) in 2014. The hydrocarbon sector contracted by 0.1% year-on year in real terms during 2015, compared to a 7.7% expansion in the non-hydrocarbon sector.

Qatar's gas production rose from 160.3 billion cubic meters (bcm) in 2014 to 165.6 billion bcm in 2015, and is forecast to reach 168.9 bcm in 2016. Gas production in Qatar would remain rather flat as LNG exports grow at the same pace, while an increase in domestic gas consumption would be met by the Barzan project. The Barzan gas development would come on stream in 2016 and add 1.4 billion standard cubic feet per day of production of sales gas for local use when it reaches full capacity.

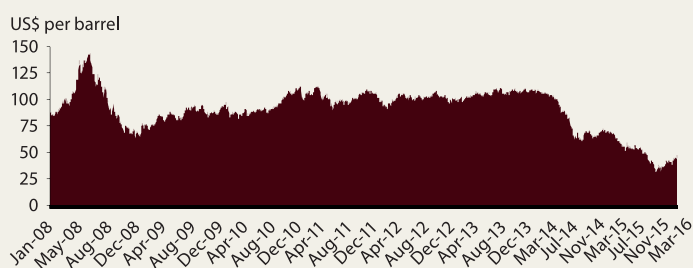
In parallel, the country's proven gas reserves are estimated at 24.5 trillion cubic meters (tcm) in 2016, against 24.7 tcm in the past year. The natural gas reserves to production ratio, indicating the time reserves would last, is estimated at 145.2 years compared to 149.1 years in 2015.

As for oil production, it continued its downward course, falling by 2.3% from 670.0 thousand barrels per day (bpd) in 2014 to 655 thousand bpd in 2015. The Laffan Refinery 2 (LR-2) condensates refinery is expected to come on stream in Q4 2016 and would have a production capacity of 146,000 bpd. In total, Qatar's overall crude refining capacity would be 484,700 bpd by 2017. The country's proven oil reserves are estimated at 24.5 billion barrels in 2016, compared to 25.0 billion barrels in 2015. The reserves to production ratio is estimated at 34.2 years in 2016, down from 35.1 years.

It is important to add that Qatar is expected to see reduced investment in its oil and gas sector over the coming quarters as it attempts to diversify its economy under the 2030 National Vision plan. The majority of upstream investment over the next three years would focus on oil field redevelopments.

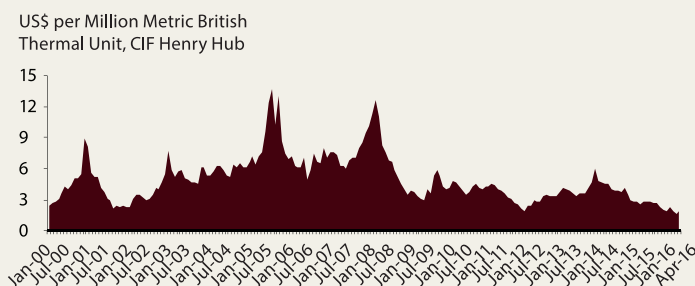
On another note, the Qatari government adequately weathered the drop in energy prices, amidst the prudent management of its hydrocarbon windfall. This enabled the government to maintain one of the lowest fiscal breakeven oil prices in the GCC, second to Kuwait, while accumulating significant external

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

NATURAL GAS PRICES



Sources: IMF, Bank Audi's Group Research Department

assets through the Qatar Investment Authority. These assets could act as a buffer in the current period of a prolonged downturn in hydrocarbon prices. Despite the latter, the government is expected to increase its borrowing in the medium-term in order to finance its large infrastructural needs and its fiscal needs, as the steep decline in hydrocarbon prices has adversely affected revenues.

The country's infrastructure development program, as set out in the 2030 National Vision, was largely unaffected so far by the oil price slump that began in mid-2014. However, persistently low oil prices would place the government under heightened pressure in 2016 and lead it to refocus its capital spending on projects that are deemed critical to economic diversification and the successful staging of the 2022 World Cup.

Last but not least, the global energy price crisis has definitely impacted Qatar's economic performance. Thus, it is crucial that the Qatari authorities continue to prudently manage their hydrocarbon wealth in order to invest in world class infrastructure, build efficient delivery mechanisms for public services, create a highly skilled and productive labor force, and support the development of entrepreneurship and innovation capabilities.

1.1.2. Manufacturing

Growth in the sector with key projects serving economic diversification

Qatar is focusing on developing the sector noting that it is a major factor in the country's diversification strategy. The real gross value added in the manufacturing sector is estimated to have grown by 3.5% year-on-year last year. Qatar's manufacturing sector took over 9.7% of the country's GDP at current prices in 2015, yet down from 10.1% in the previous year.

Several projects took place over the past year to enhance the sector and improve its contribution to the country's GDP. In 2015, The Ministry of Energy and Industry marked achievements in many fields, especially the completion of all infrastructure and service works for the Doha New Industries Area. In the field of industrial development management, the ministry studied 30 investment opportunities in the field of small and medium industries with investors in the private sector. The ministry also developed the national industrial development strategy aiming to raise the contribution of the manufacturing sector. Furthermore, the ministry prepared a comprehensive study about the current situation of private factories. 47 new industrial facilities were registered last year and entered production phase. The capital invested in those facilities reached around US\$ 274.7 million.

On a similar note, the Wakrah project is one of the largest logistics and industrial projects in the Qatar's southern area. It came to promote competitiveness in the commercial sector and encourage the private sector to contribute effectively to the National Development Strategy in accordance with Qatar National Vision 2030.

Furthermore, when looking at manufacturing and refining, Qatar Petroleum has developed plans to achieve a better utilization of Qatar's natural resources of hydrocarbons. The company was able to overcome significant barriers related to technical aspects, infrastructure and logistics, among others. The sector spanned a number of projects such as Zekreet Gasoline Project, Umm Al Houl Independent Water and Power Project, the condensate refinery project Laffan Refinery 2 and others. Additionally, Qatar Petroleum holds the management of Ras Laffan and Mesaieed Industrial Cities, and ensures their development through construction and development of infrastructure for the new expansions in petrochemical industries and providing them with the support services as part of the five-year plan for industrial cities.

In conclusion, the manufacturing sector, ranking third in terms of contribution to the country's GDP is one of the pillars of the country's economic diversification away from hydrocarbons. Several projects taking place are ensuring its key position in the country's economy.

1.1.3. Construction

Strong sectoral activity despite relative moderation this year

The construction sector in Qatar has maintained in 2015 the same noticeable momentum of the year before. However, it seems to enter, as of beginning 2016, a phase of moderation as a result of fiscal tightening in the context of low oil prices.

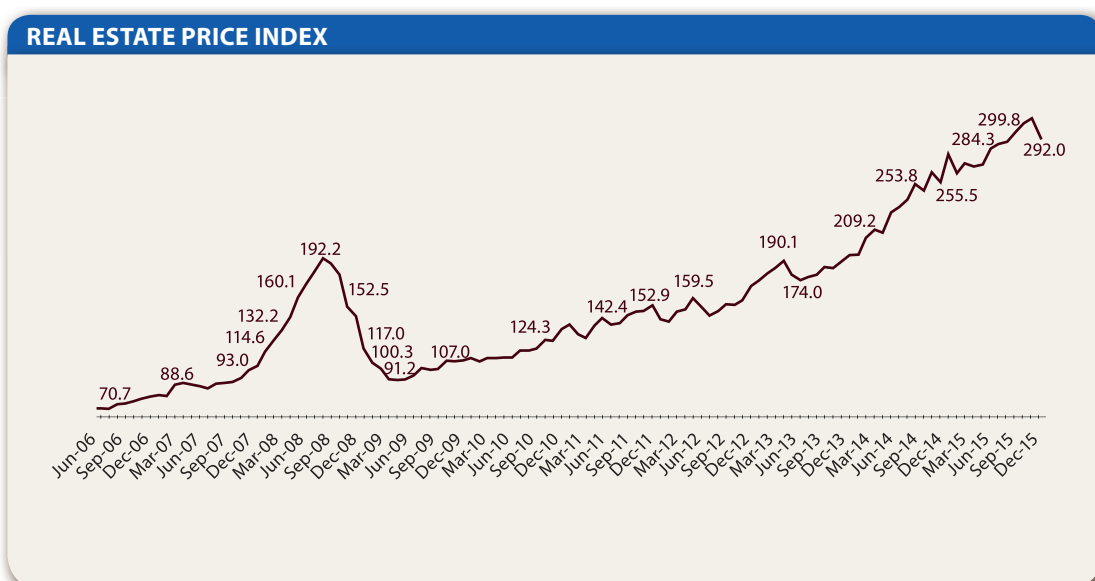
In fact, during the year 2015, Qatar's construction sector grew by 18.0%, against a growth level of 17.8% reported in 2014. At the same time, the real estate price index expanded by almost 37 points from year-end 2014. Along the same lines, and according to CBRE, a 7% year-on-year rise in residential rentals has been reported over the year in Qatar.

Moreover, the construction sector captured 4.8% of credit facilities advanced by the Qatari banking sector at end-March 2016, same as in March 2015, while loans to the construction sector grew by a yearly 16.0% in March.

However, data compiled by MEED hints to a delay in investments decisions by the government as of beginning 2016. In fact, according to the same source, the value of transport and construction projects in the first quarter of 2016 was down by 92% year-on-year, and 70% quarter-on-quarter, at US\$ 830 million. This was the first time that the award of construction contracts has fallen below US\$ 1 billion since Qatar won the 2022 football World Cup host nation bid in 2010.

This is probably the result of low oil prices and their impact on State revenue. Delays in construction are indicative of the tightening fiscal stance in Qatar. Add to this the new trend of late payments, which is exerting pressure on already strained corporate cash flows. Indeed, the number of commercial disputes, often involving overdue invoices climbed to almost 30 in 2015, up from around five a year a decade ago. Crucially for contractors, the delayed payments lead sub-contractors and suppliers to face lower profit margins and are simply not able to commit to schemes if late payment becomes more widespread.

Looking forward, the construction industry is expected to continue to grow, over the coming few years, although at a slower pace than peak years such as 2014, as investment would still flow in preparation for the FIFA World Cup 2022. According to BMI, non-residential building will be the primary driver of growth, followed by residential building and transport infrastructure.



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

1.1.4. Tourism

Tourism sector continues to play a pivotal role in the country's diversification strategy

Qatar's tourism industry maintained its role in the country's diversification strategy over the past year, as the government and private industry continued to invest in the sector. The hosting of international sports events like the 2022 FIFA World Cup in addition to business tourism which is growing due to increased exhibitions play a supportive role in the growth of the sector, despite some concerns over regional instability.

In details, direct contribution of travel and tourism to the country's GDP was US\$ 5.2 billion in 2015 (2.8% of GDP) and is expected to grow by 4.3% in the current year, as per the World Travel & Tourism Council (WTCC). In this context, leisure travel spending captured a higher share of the direct travel and tourism GDP when compared to business travel spending.

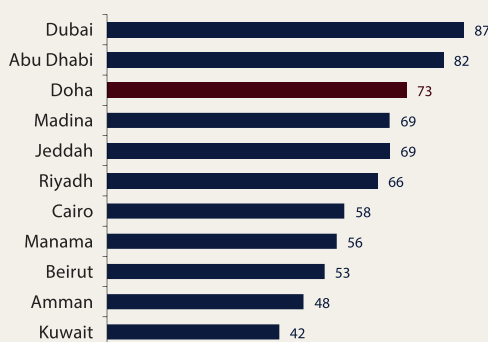
Furthermore, travel and tourism investment registered US\$ 1.8 billion (2.2% of total investment) in 2015, up from US\$ 1.6 billion in 2014. This is forecasted to rise by 17.5% in 2016, as per WTCC.

Looking at the first quarter of 2016, a total of 822,626 people entered Qatar, declining by 2% from the same period last year due to fewer visitors from non-GCC Arab countries, the Americas, Europe and Asian countries, as per the Qatar Tourism Authority (QTA). Nonetheless, the number of international tourists classified as those on "leisure visit visas" including tourist visas, family visit visas, personal visit visas and transit visas, increased by 6% from January to March 2016, compared to the same period last year. This increase was mainly driven by a rise in the number of tourists from Gulf countries. These rose by a yearly 11% in the first quarter of 2016. Travelers from Saudi Arabia, United Arab Emirates and Bahrain rose by yearly 16%, 14% and 2% respectively.

Looking at the performance of four and five star hotels in Doha, occupancy was at 69% in 2015, slightly under its level of 70% in 2014. The average room's rate stood at US\$ 240 last year, up by 2.1% year-on-year. This left the rooms' yield at US\$ 166 in 2015, unchanged from its level in the previous year. In the first quarter of 2016, a slowdown in the performance was encountered, whereby occupancy rate stood at 73% down from 76% in the same period of last year. Alongside, the average room rate declined by a yearly 14.7% to stand at US\$ 227 in the aforementioned period of this year. Hence, the rooms' yield fell by 18.5% from US\$ 204 in 1Q2015 to US\$ 166 in 1Q2016.

In conclusion, it is clear that Qatar has a well-developed tourism sector that is continuously benefiting from ongoing investment and transport infrastructure improvement. Despite a deterioration in some of the sector's indicators, the outlook is promising as Qatar becomes a more popular travel destination with the approach of the FIFA 2022 World Cup and the implementation of its 2030 Vision focusing on diversification and emphasizing the role of tourism in implementing it.

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



* First quarter of 2016, four and five star hotels

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

1.2. EXTERNAL SECTOR

Eroded current account surplus leading to a deficit in the balance of payments

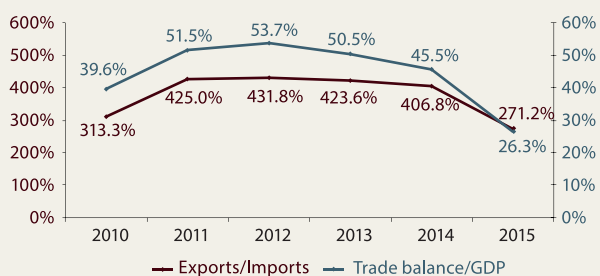
Within the context of a continuous slump in oil prices, Qatar's foreign trade figures showed a contraction in exports by 39.0% alongside an 8.5% decline in imports in 2015 compared to 2014, contributing to a 48.9% decrease in the foreign trade surplus, according to the Central Bank of Qatar. In fact, Qatar's trade surplus contracted from US\$ 95.6 billion in 2014 to US\$ 48.8 billion during 2015, to reach the equivalent of 26.3% of Qatar's GDP, from 45.5% of GDP. As such, Qatar's foreign trade activity posted a net contraction in terms of volume, as the sum of exports and imports went down by 33.0% moving from US\$ 157.8 billion to US\$ 105.8 billion during the same period. Accordingly, the exports-to-imports coverage ratio fell from 406% in 2014 to 271% in 2015, its lowest level since 2009.

Going further into details, total exports (including exports of domestic goods and re-exports) reached a total of US\$ 77.3 billion in 2015, a decline by US\$ 49.4 billion compared to 2014 figures, within the context of the significant drop in oil prices impacting oil exports. The breakdown of exports by category, according to the Ministry of Development Planning and Statistics, suggests that exports of mineral fuels and lubricants posted the most significant decline of 43.1% year-on-year to make up 83.4% of total exports (down from 90.9% in 2014), followed by manufactured goods with a decline of 13.7%, chemicals with a drop of 5.4% and crude materials except fuels with a decline of 5.4%. On the other hand, the main item to have displayed a significant increase was machinery and transport equipments from US\$ 77 million in 2014 to US\$ 2.0 billion in 2015. The geographic distribution of domestic exports indicates that 20.7% of total exports went to Japan, followed by South Korea with 17.6% of the total, India with 11.9%, China with 6.8%, UAE with 5.6% and Singapore with 4.6% of total domestic exports.

At the level of imports, a total of US\$ 28.5 billion was registered in 2015, compared to US\$ 31.1 billion in 2014, a decline of 8.5%. The breakdown of imports by category suggests that imports of machinery and transport equipment posted the highest share of 45.4% of total imports, followed by manufactured goods with a share of 13.1%, miscellaneous manufactured goods with 12.9% and food and live animals with 8.9% of total imports. The breakdown of imports by country of origin shows that 11.5% of the inward merchandise in 2015 came from China, followed by USA with 10.9% of the total, UAE with 8.8%, Germany with 7.5%, Japan with 6.5%, and UK with 5.7% of total imports.

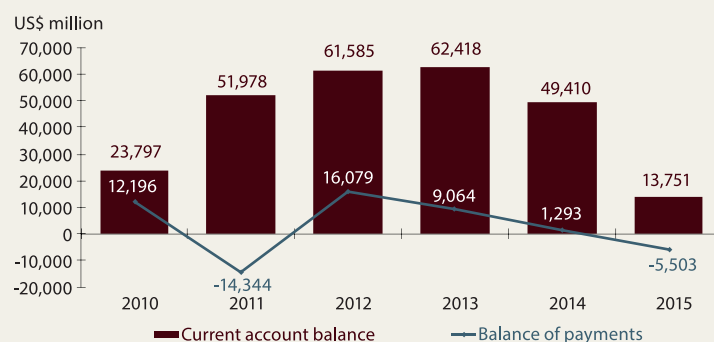
On the other side of the external sector, Qatar posted net deficits in its balances of services, income and transfers in 2015, yet at a lower trend compared to 2014, amounting to US\$ 15.8 billion (-18.4%), US\$ 3.6 billion (-61.7%) and US\$ 15.7 billion (-10.3%), respectively. With regards to services, 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 income category, profit repatriation of foreign companies in Qatar remains the largest contributor to the negative balance. As to the transfers' category, the latter is dominated by outward remittances of expatriates residing in Qatar which amounted to US\$ 12.0 billion in 2015, up by 8.6% from the previous year.

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

Under these circumstances, Qatar exhibited a significant contraction in its current account surplus by 72.2% in 2015, from US\$ 49.4 billion to US\$ 13.8 billion, with the latter accounting for 7.4% of GDP as compared to 23.5% of GDP in 2014. As to the capital and financial balances, both recorded lower deficits of US\$ 737 million and US\$ 18.9 billion respectively in 2015, with the latter recording a contraction in deficit of 56.6% relative to the previous year. This was mainly due to two factors. First, the direct investment category reported a negative balance of US\$ 3.0 billion in 2015, yet down by 48.3%. Second, the portfolio investment posted a negative balance of US\$ 16.5 billion in 2015, down from a deficit of US\$ 19.9 billion. Consequently, the balance of payments recorded a deficit of US\$ 5.5 billion in 2015 for the first time since 2011, against a surplus of US\$ 1.3 billion in 2014.

1.3. PUBLIC SECTOR

Decline in hydrocarbon receipts taking its toll on government balance

Qatar's government balance continued deteriorating over the past year, amidst a decline in hydrocarbon receipts. The budget balance emerged at around 10.3% of GDP at the end of FY 2015/2016, against 18.1% in FY 2014/2015, according to the IMF. In fact, the government balance significantly fell to post a surplus of US\$ 19 billion in FY 2015/2016 from a surplus of US\$ 38 billion in the previous fiscal year.

In fact, revenues are estimated to have dropped by 18.6% to reach US\$ 80.4 billion in FY 2015/2016, after a slight increase in FY 2014/2015. The structural shock to the oil market affected Qatar's revenues since hydrocarbon receipts constitute a major share of total revenues. Actually, revenues stemming from hydrocarbons accounted for an estimated 45% of the total in FY 2015/2016 compared to a higher share of 49% in FY 2014/2015. Within the context of renewed diversification efforts, non-hydrocarbon revenues accounted for around 54% of total revenues in FY 2015/2016, higher than the 51% attained in the past fiscal year.

In parallel, expenditures totaled US\$ 61.4 billion in FY 2015/2016, up by 1.1% from the previous fiscal year during which they reached US\$ 60.8 billion. Tentative moves by government officials to restraint current spending were implemented to accommodate rising capital expenditure as the World Cup draws near.

The Qatari authorities are cutting spending by merging ministries and reviewing programs. Utility and fuel prices were also raised, with further hikes in the pipeline. In addition, fee hikes for public services and sin taxes are being considered, and a VAT (already agreed with other GCC countries) is expected to be implemented in 2018. These measures would be sufficient to improve public finances in the coming years, even if oil prices were to remain at current levels, as per Moody's.

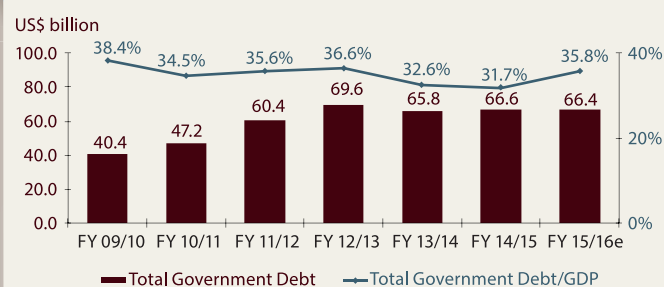
Having chosen not to tap public foreign assets, the country plans new external debt issuance on top of a recent syndicated loan amounting to US\$ 5.5 billion to finance its fiscal deficit. It is worth mentioning that public debt as a percentage of GDP is estimated at 35.8% of GDP in FY 2015/2016, up from 31.7% of GDP in FY 2014/2015.

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	FY 12/13	FY 13/14	FY 14/15	FY 15/16e
General government revenues	78.8	96.4	98.8	80.4
General government revenues/GDP	41.4%	47.7%	47.0%	43.4%
General government expenditures	57.9	62.6	60.8	61.4
General government expenditures/GDP	30.4%	31.0%	28.9%	33.1%
General government fiscal balance	20.9	33.8	38.0	19.0
General government fiscal balance/GDP	11.0%	16.7%	18.1%	10.3%

Sources: IMF, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department

In conclusion, the Qatari government has the ability to maintain fiscal buffers and control the impact of the fall in oil prices. Nonetheless, the country should make sure it continues its prudent macroeconomic management, while showing further evidence of institutional strength via a more credible fiscal and economic policy response to the deterioration of the fiscal balance and fiscal buffers.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Uptick in inflation along with stability in key policy rates

Qatar's monetary conditions were marked during the first quarter of the year 2016 by an uptick in inflation on the back of subsidy cuts, a contraction in broader money supply (M2) amidst reduced liquidity in the banking system, and stability in key policy rates despite the US monetary policy tightening.

In details, Qatar's Consumer Price Index grew by 3.1% on average during the first quarter of 2016, after rising by 1.7% on average in 2015, mainly due to higher utility bills, phased in since the summer, and a 30% fuel price increase introduced mid-January 2016. The breakdown of the Consumer Price Index by segment over the first quarter of 2016 shows that the culture and recreation segment rose by 8.9%, followed by the education segment with +7.1%, the housing, water, electricity and gas segment with +5.7%, the furnishings and household equipment segment with +1.8%, the transport segment with +1.7%, the restaurants and hotels segment with +1.0%, the clothing and footwear segment with +0.4% and the communication segment with +0.2%. In contrast, the food and beverages segment reported a decline of 1.5% on average over the first quarter of 2016, followed by the medical services segment with -0.3%. In 2016, inflation is expected to reach 2.4%, according to the IMF, mainly due to subsidy cuts.

The Qatari riyal remained pegged to the US dollar at a rate of QR 3.64/US\$. 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. Despite the peg, the Central Bank of Qatar didn't respond in December 2015 to the US Federal Reserve's decision to raise its target range for the federal funds rate by 25 bps for the first time in almost a decade, stating that the Central Bank did not cut rates to the same level as the US Fed after the 2008 global financial crisis. Accordingly, key policy rates in Qatar remained stable, with overnight lending rate standing 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 reached US\$ 36.3 billion at end-February, slightly down from US\$ 36.8 billion at end-December 2015. This followed a tangible fall of 13.8% in 2015, the equivalent of US\$ 5.9 billion, mainly driven by a 14.2% drop in foreign securities (the equivalent of US\$ 4.1 billion) and a 14.6% decrease in balances with foreign banks (the equivalent of US\$ 1.9 billion). The QCB net international reserves covered around 35.5% of money supply in local currency at end-February 2016 as compared to 36.2% at end-2015 and to a much higher ratio of 44.6% at end-2014.

EVOLUTION OF MONETARY SITUATION

Flows in millions of US\$	2011	2012	2013	2014	2015	2M-16
Net foreign assets	-12,742	1,538	22,926	4,946	-21,283	-9,987
Foreign Assets	-6,633	18,843	18,575	10,058	1,398	-4,285
Foreign Liabilities	-6,109	-17,305	4,351	-5,113	-22,681	-5,702
Net Domestic Assets	25,173	17,992	-2,414	8,326	26,052	5,488
Claims on private sector	22,355	24,520	14,024	12,239	16,913	232
Net claims on public sector	9,670	3,246	-11,587	3,330	16,310	6,142
Other Items (net)	-6,852	-9,774	-4,851	-7,243	-7,171	-886
Broad Money (M2)	12,431	19,530	20,511	13,272	4,769	-4,498
Money Supply (M1)	3,712	2,498	4,119	5,034	733	2,503
Quasi-Money	8,720	17,032	16,393	8,238	4,036	-7,002

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

The broader Money Supply (M2) contracted by 2.9% during the first quarter of 2016 to reach US\$ 139.0 billion at end-March 2016 within the context of tightening banking sector liquidity due to lower oil prices. This followed a 3.4% expansion in Money Supply (M2) in 2015. The US\$ 4.8 billion variation in money supply in 2015 compares to a money creation of US\$ 11.9 billion, resulting mostly from a surge in claims on private sector of US\$ 16.9 billion, an increase of US\$ 16.3 billion in net claims on the public sector and a fall of US\$ 21.2 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\$ 7.2 billion in 2015.

Looking forward, inflation is set to pursue an upward trajectory, due to higher expected construction activity, continued population growth, and given that Qatar has allowed starting May 1, 2016 its domestic gasoline and diesel prices to fluctuate on a monthly basis in response to changes in global markets. That being said, future gasoline and diesel prices would be based on a formula that takes regional prices, global levels, and production and distribution costs within Qatar into account.

1.4.2. Banking Activity

Tightening domestic liquidity but overall financial standing remains robust

Qatar's banking sector has had to face some liquidity challenges in the past few months against the backdrop of a seemingly prolonged period of low oil prices, with the government deposit base shrinking and putting pressure on liquidity levels. It nonetheless managed to pull out decent activity growth last year and so far in 2016, and maintains healthy capitalization, asset quality and profitability ratios.

Measured by total assets of banks operating in Qatar, sector activity grew by a healthy 10.7% in 2015, a similar growth rate when compared to the previous year, and by a further 1.9% in the first quarter of 2016 to reach the equivalent of US\$ 311.5 billion at end-March 2016.

On the funding side, the total deposit base reported an 8.2% rise last year and an additional 1.7% increase in 1Q2016 to reach the equivalent of US\$ 181.7 billion, with the increases nonetheless deemed healthy in absolute terms. Non-resident funds contributed the most to the deposit increase, be it from the private sector or banks abroad, outpacing resident deposit growth last year and this year as well (in 2016, resident funds slightly contracted). It seems Qatari banks are relying on foreign deposit collection, which has increased markedly as of the second half of 2015. Non-resident deposits (i.e. non-bank private sector funds) rose by 1.8x last year and by 1.3x in the first quarter of 2016. The share of non-resident deposits in the total deposit base of Qatari banks more than doubled from 8.0% at end-2014 to 17.4% at end-March 2016.

In further details, resident private sector deposits grew in 2015 at a slower pace than during the previous year (+9.2% against +14.1%) as corporate deposits more than offset the contraction in retail funds, before contracting in 1Q2016 (-4.9%), as deposits in foreign currencies and time and saving local currency deposits retreated (and the slight pick up in retail deposits failed to offset shrinking corporate deposits). Public sector deposits contracted by 8.3% last year and practically stalled this year, leaving the bulk of deposit growth to the non-resident sector as almost all public sector components reported a contraction in funds.

On the asset utilization side, the top two contributors to activity growth were domestic credit and credit outside Qatar (the latter last year more than this year), which have so far been little affected by tightening domestic liquidity as Qatari banks managed to compensate by tapping foreign funds. Qatar is indeed stable politically and benefits from favorable security conditions and the government has a high investment grade rating, all of which encourages foreigners to park some of their funds with its banking sector.

Total credit facilities grew by a solid 15.1% last year and by a further 3.2% in this year's first quarter to reach the equivalent of US\$ 212.3 billion at end-March 2016, knowing that the domestic economy has massive funding needs amid relatively healthy non-hydrocarbon sector growth and World Cup 2022-related construction and infrastructure spending, among others.

Qatari banks extended further credit to borrowers abroad (+38% last year and a mild +1.8% in 1Q2016) and to borrowers in Qatar (+12.7% last year and +3.4% in 1Q2016). Among the latter, real estate and consumption loans contributed the most to the increase last year (35% and 23% respectively of total domestic credit growth), followed by general trade and contractors. This year however, it was the public sector (and particularly the government directly) that was the top contributor to lending activity growth.

With lending activity growth outpacing deposit growth throughout the covered period, banking sector liquidity in Qatar has been under pressure. As a matter of fact, the credit facilities to deposits ratio stood at 116.8% at end-March 2016 (115.1% at end-2015 and 108.2% at end-2014). This has been accompanied by rising interbank rates (for instance, the three-month Qatar Interbank Offered Rate rose to its highest level since 2011 in March) and by the cancellation of the QCB Tbs auctions generally aimed at mopping up excess liquidity between January and March 2016. In parallel, banks' core readily available liquidity, consisting of reserves and placements at banks, almost stagnated throughout the covered period. It thus could not match the increase in deposits and this led to a decline in the core liquidity ratio (measured as a percentage of total deposits) from 27.3% at end-2014 to 24.3% at end-March 2016.

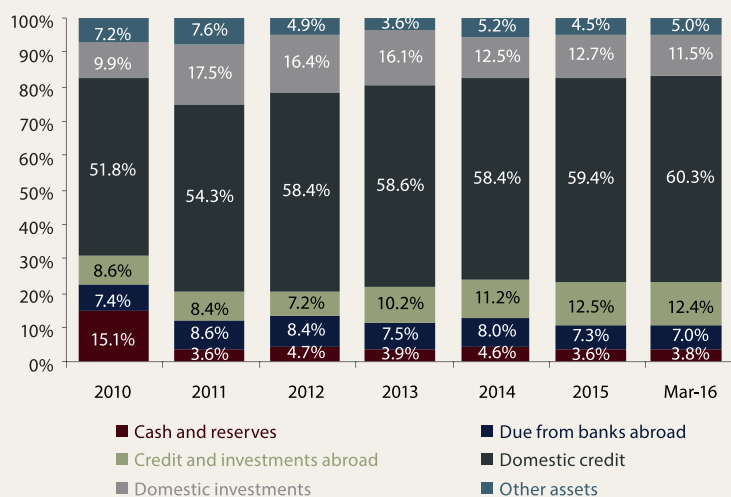
While tightening domestic liquidity could pose risks to the asset quality outlook, given that public sector outflows might impact banks' ability to roll over or restructure loans and thus triggering impairment charges across the sector, NPLs ratio remain quite favorable in absolute and relative terms. The NPLs/Total loans ratio reached 1.6% at end-2015 as per the latest QCB figures, against 1.7% at end-2014. Moreover, provisioning coverage remains sufficient, with NPL provisions covering almost 80% of NPLs and loan provisions fully covering NPLs.

EVOLUTION OF BANKING ACTIVITY

US\$ million	2012	2013	2014	2015	Q1-15	Q1-16	Variation Q1/Q1
Var. Total assets	33,608	25,670	26,016	29,659	3,630	5,846	61.1%
% change	17.6%	11.4%	10.4%	10.7%	1.3%	1.9%	0.6%
Var. Total deposits	25,949	24,813	14,475	13,513	5,459	3,093	-43.3%
% change	26.0%	19.7%	9.6%	8.2%	3.3%	1.7%	-1.6%
Var. Total credit facilities	28,864	18,342	20,554	27,052	6,217	6,612	6.4%
% change	26.0%	13.1%	13.0%	15.1%	3.5%	3.2%	-0.3%

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

BANKING SECTOR ASSET COMPOSITION



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

In parallel, banks maintain more than adequate capital levels should pressures arise, with a regulatory capital to risk weighted assets ratio of 15.6% at end-2015, the bulk of which is comprised of Tier 1 capital (more than 95%). Last but not least, profitability ratios remain robust despite the more difficult operating environment for banks. Spreads remained under pressure due to higher funding costs (net interest to average total assets ratio moving gradually down from 2.6% in 2012 to 2.2% in 2015) but loan growth continues to be healthy and there were no major provisioning surprises recently. Net interest income accounts for practically three quarters of total income in Qatar, and despite the rise in banking activity and equity, the ROAA and ROAE ratios remain relatively robust at 2.0% and 16.2% respectively in 2015.

1.4.3. Equity and Bond Markets

Equities down in a protracted low oil price era, bond prices up tracking US Treasuries move

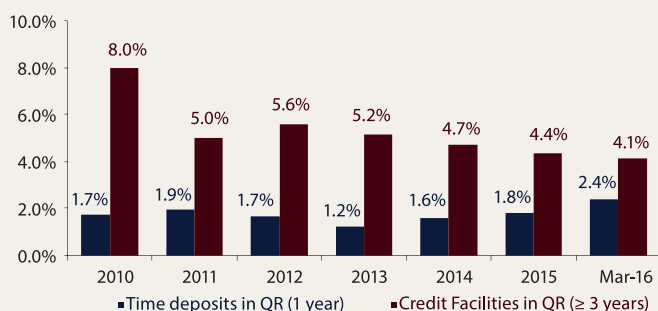
Qatar's capital markets saw mixed price trends over the first four months of 2016. The equity market remained under downward price pressures in a protracted era of low oil prices. On the other hand, the Qatari fixed income market saw mostly price gains so far this year, tracking US Treasuries move after the US Federal Reserve left interest rates unchanged and remained ambiguous about an interest rate hike.

In details, the Qatar Exchange general index extended its downward trajectory during the first four months of 2016, falling by 2.3% to close at 10,186.18 at end-April, after dropping by 15.1% in 2015. This was mainly driven by weaker investor sentiment in a low oil price environment and the failure of the world's biggest oil producers to reach an agreement on capping production at the Doha summit on April 17, 2016. Also, Qatar Financial Markets Authority announced in March 2016 that investors must limit their holdings in publicly-traded banks and financial firms to 5%, or 10% with a Central Bank waiver, signalling that shareholders who exceed the said limit via direct or indirect ownership have five years to comply with the caps. This put further pressures on investor sentiment and Qatari equity prices. Within this context, it is worth highlighting that extended price falls in the Qatari Exchange took place despite relatively attractive market pricing ratios, as Qatari stocks traded at a P/E of 13.2x at end-April 2016 as compared to an average market capitalization-weighted P/E of 17.8x in the MENA region. Also, they traded at a P/BV of 1.68x against an average market capitalization-weighted P/BV of 2.12x in the region.

The number of listed companies in the Qatar Exchange reached 44 companies at end-April 2016, up from 43 companies at end-2015, following the listing of Qatar First Bank in April 2016. This combined with price declines led to a 0.7% retreat in the market capitalization over the first four months of 2016 to reach US\$ 151.0 billion at end-April 2016, following an 18.3% drop in 2015. Yet, the market capitalization as a percentage of GDP managed to move up slightly from 82.0% in 2015 to 83.6% at end-April 2016.

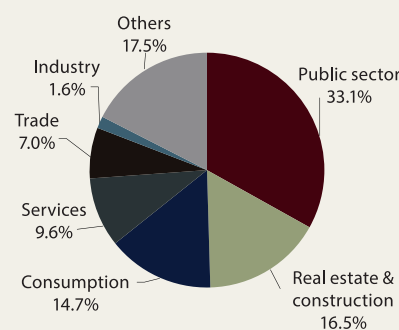
On the back of undermined investor sentiment, the total trading value amounted to US\$ 7.7 billion during the first four months of 2016, dropping by 28.5% relative to the corresponding period of the previous year. Given a higher decline in the total trading value than market capitalization, the annualized turnover ratio reached 15.3% during the first four months of 2016, moving down from 17.9% during the corresponding period of 2015.

INTEREST RATES ON TERM DEPOSITS & CREDIT FACILITIES



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

CREDIT FACILITIES BY ECONOMIC ACTIVITY*



* End-March 2016

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

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 four months of 2016, tracking US Treasuries move after the US Federal Reserve left interest rates unchanged and signalled a "cautious" approach to raising interest rates. This followed mostly downward price movements in 2015.

In details, sovereign papers maturing between 2020 and 2042 registered price gains between 0.19 pt and 8.00 pts over the first four months of 2016, with the highest price increases seen on the longer-end of the curve. Amongst quasi-sovereigns, Qatari Diar'20 was up by 0.38 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 5.13 pts. As to the cost of insuring debt, Qatar's five-year CDS spreads stood at 99 bps at end-April 2016, up by 6 bps since year-end 2015, following an 11 bps expansion in 2015, yet still underlining its low risk of default. It is worth noting that the Qatar CDS spreads are the second lowest in the region after Abu Dhabi (94 bps), and much below the average CDS spreads in the Middle East (337 bps) and emerging markets (554 bps).

As to credit ratings, Standard & Poor's affirmed in March 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". S&P expects that the country's huge infrastructure investment program would support growth over 2016-2019 and that the large net asset position would be maintained. Also, Fitch ratings affirmed in March Qatar's long-term foreign and local currency IDRs at "AA" with a "stable" outlook. The "AA" ratings reflect Qatar's large sovereign assets, the government's fiscal adjustment efforts, a large hydrocarbon endowment and one of the world's highest GDP per capita. Finally, Moody's confirmed in May the Government of Qatar's long-term issuer and senior unsecured debt ratings at "Aa2" and assigned a "negative" outlook. The ratings confirmation is supported by the expected continued strong growth performance, extraordinarily high levels of wealth, an institutional framework that is effective in implementing reforms, comparatively lower vulnerability to the oil price shock, a fiscal policy that will shield sizable buffers and benefits from an established sovereign yield curve, as well as institutional experience and capacity to issue debt. The "negative" outlook reflects Moody's view that the risk of a stronger-than-envisaged deterioration in core credit metrics outweighs the prospects of faster improvements than currently expected.

Regarding new issues so far this year, Qatar's Ahli Bank raised in April 2016 US\$ 500 million from the sale of a five-year bond at 260 basis points over midswaps. Also, Ezdan Holding raised US\$ 500 million in May 2016 through the sale of a five-year Sukuk. The wakala-structured transaction carries a profit rate of 4.375%.

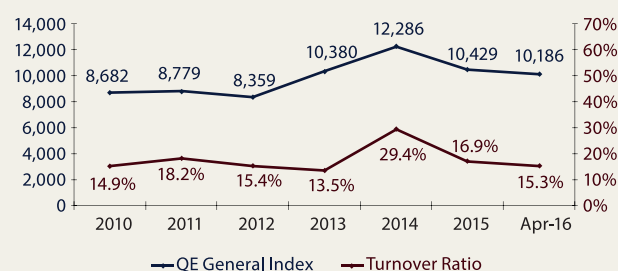
Looking forward, given the domestic liquidity squeeze and Qatar's fiscal deficits, caused by lower hydrocarbon prices and high infrastructure expenditures, the government may tap international debt markets to finance its needs.

CAPITAL MARKETS INDICATORS

	2011	2012	2013	2014	2015	Apr-16
Market Capitalization (US\$ billion)	125.6	126.3	152.6	185.9	152.0	151.0
Market Cap/GDP	74.0%	66.4%	75.6%	88.5%	82.0%	83.6%
Total value traded (US\$ billion)	22.9	19.4	20.6	54.8	25.7	7.7
Total number of shares (million)	2,303	2,428	1,938	4,440	2,302	833
No. of listed companies	42	42	42	43	43	44
% Chg. in QE general index	1.1%	-4.8%	24.2%	18.4%	-15.1%	-2.3%
P/E ratio	14.4x	13.0x	14.6x	16.2x	11.5x	13.2x
P/BV ratio	2.1x	1.9x	2.0x	2.1x	1.6x	1.7x
Dividend yield	4.0%	4.0%	3.9%	3.7%	5.2%	3.8%
CDS spreads (bps)	127	82	59	82	93	99

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

CAPITAL MARKETS PERFORMANCE



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

2. CONCLUSION

Having said that, what is the near term outlook of the Qatari economy? With many of Qatar's LNG contracts linked to oil prices, lower oil and spot LNG pricing mean that Qatar is receiving less for its LNG than before. Moreover, global LNG supply is set to grow 50% by 2020, outpacing material demand growth and favoring LNG buyers in negotiations with sellers. It is estimated that Qatar's market share would shrink from 31% in 2014 to 21% in 2020. Lowering oil prices, weakening LNG spot prices and the moratorium on expansion of North gas field production and export capacity will continue to weigh on Qatar's exports receipts in the coming years. Still, supported by continued government spending on infrastructure projects, the Qatari economy is expected to maintain healthy growth in the medium term, albeit below potential growth, with the targeted economic diversification enabling broader based expansion for the country.

Within this context, growing fiscal deficits are likely to be financed through borrowing, whether in the local or external markets, or drawing down on existing buffers (i.e. government deposits and FX reserves). But given the relatively low indebtedness and the acceptable fiscal balance, Qatar's fiscal sustainability is not at risk. As a matter of fact, Qatar's potential fiscal space remains largely untapped – whether by raising revenues through taxation or reducing spending. According to the IMF's latest Article IV Consultation report, Qatar could raise approximately 2% of its non-hydrocarbon GDP by broadening the corporate income tax, 1.5% by introducing a low rate VAT (at 5%), and another 4.5% by reducing administrative expenses and removing water and electricity subsidies. As such, much of Qatar's fiscal outlook hinges on the authorities' willingness and ability to take some of these measures in the short to medium term.

At the banking level, with an average bank loans to deposits ratio of 117% and rising pressures on banks liquidity, banks are likely to increase their reliance on longer-term market funding while the government could provide support should bank liquidity become too constraining (as in 2009). While low oil prices may dampen economic growth ultimately impacting asset quality, the proactive stance on prudential regulation keeps the banking system well positioned to withstand an increasingly challenging operating environment. At the monetary policy level, while Qatar's Central Bank chose not to mirror the US Federal Reserve's raising of the policy rate in December 2015, Qatar will need to follow suit if the Fed continues to tighten monetary policy within the context of the currency peg to the US dollar.

The analysis of Qatar's short to medium term outlook actually requires a careful examination of positive drivers and potential risks. At the level of positive drivers we mention the fact that Qatar is among the richest countries in the world on a per capita basis, the possession of the world's third largest reserves of natural gas making it the world's largest LNG exporter, the significantly large net foreign assets estimated at circa 200% of GDP, the strong financial soundness of the domestic banking system and the ongoing economic diversification away from hydrocarbon sector.

At the level of weaknesses and risks, we mention the vulnerability to regional geopolitical risk, the relatively weak institutional transparency with the main gap being the availability of data on the international investment position, the possibility of an erosion in fiscal flexibility as government expenditure increases, the constrained monetary policy due to the riyal's peg to the dollar, notwithstanding the continuing high economic dependence on oil and gas that averaged 75% of current external receipts and 80% of budget revenues over the past five years.

In conclusion, we believe that Qatar's strengths outpace weaknesses and opportunities outweigh threats, suggesting a continuing favorable outlook to Qatar's economic prospects. Still, it is important for Qatari policy makers within this context to reduce the economy's vulnerability to the slowdown in the hydrocarbon sector. The main medium term challenge for the Qatari economy is the persistence of the sharp drop in global oil and gas prices, in addition to intensifying competition in the gas market. As continued weakness in oil markets could adversely impact hydrocarbon revenues, economic growth and financial sector health, while increasing gas market competition in the medium term may further weaken growth, it is important for Qatar to plan and implement structural adjustment policies that would further foster the non-hydrocarbon sector and increasingly improve the competitiveness of the domestic economy and its business environment attractiveness at large.

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