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MENA Economic Outlook

3Q 2015

- GCC nonoil growth steady as economies weather lower oil prices
- Lower oil prices to push fiscal balances into deficit in this year and next
- Higher US policy rates likely by the end of the year, with GCC to follow

MENA Economic Outlook
3Q 2015

Contents

MENA outlook

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GCC weathers lower oil prices well; MENA lags moderate world growth

Overview and outlook

- **GCC growth to maintain a healthy pace as economies weather lower oil prices; nonoil growth expected at 5% in 2015 and 2016.**
- **Lower oil prices are likely to push fiscal balances into deficit in this year and next; still, government spending remains supportive.**
- **Moderate global growth precludes any rally in oil prices, though robust US recovery means Fed rate hikes are near.**

Mid-2015, our GCC economic outlook remains positive as we see confirmation with incoming data. The GCC economies generally appear to be weathering the decline in oil prices fairly well, with a combination of fiscal consolidation (albeit modest in most cases) and drawing down of ample reserves. More significant fiscal reforms have been put on the table but will require more time.

Oil prices managed to rebound some 30% from their lows earlier in the first half of 2015, and appear to have stabilized in the $55-65/bbl region for now. Prices are still not expected to see any significant rally in the next year or two. The conditions that led to their decline in 2014 are still with us: soft world demand, ample supplies led by US shale and new technologies, OPEC sticking with its production quotas, and no disruption from geopolitics. To top all that, potential Iranian supply is waiting in the wings, should a deal be struck in the ongoing nuclear discussions.

Lower oil prices will, of course, take a toll on nominal GDP (slow production growth and lower oil prices); however, we still expect the GCC economies to post very solid performances in their nonoil sectors where we look for growth to average a little under 5.5%, led by Qatar which should post non-oil growth of over 9%. The drivers continue to be solid consumer sectors, supported by good employment conditions, as well as steady spending on infrastructure, primarily by governments.

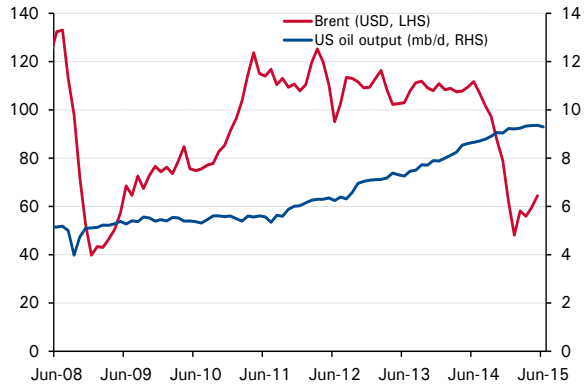
Inflation should remain fairly tame and not be an issue for the central banks in the medium term. A benign world pricing environment is helping, where food and other commodity prices are nowhere under pressure. Furthermore, most of the Gulf currencies are moving up with the strong US dollar and thus keeping the lid on import prices.

GCC economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	1,622	1,637	1,432	1,574
Real GDP	% y/y	3.5	3.8	3.6	3.6
- Oil	% y/y	0.1	0.6	0.9	0.6
- Non-oil	% y/y	6.0	5.9	5.2	5.4
Inflation	% y/y	2.4	2.4	2.7	3.0
Budget balance	% of GDP	9.5	2.1	-11.3	-7.0

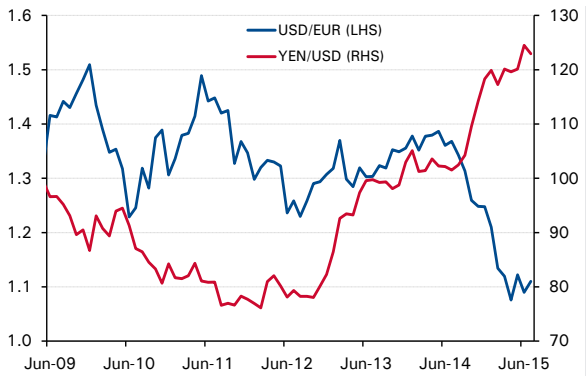
Source: National sources, NBK estimates

Chart 1: Brent oil price and US output



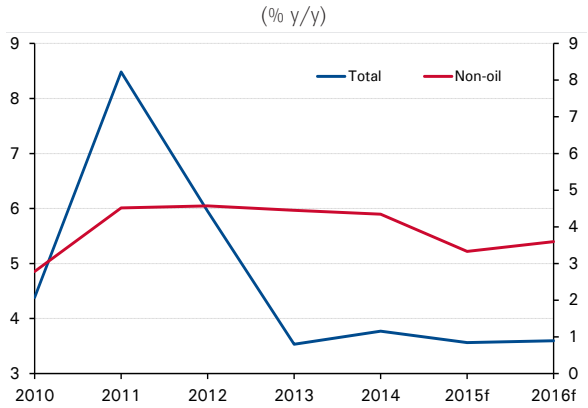
Source: EIA, Thomson Reuters Datastream

Chart 2: Exchange rates



Source: Thomson Reuters Datastream

Chart 3: GCC real GDP



Source: National sources, NBK estimates

Lower oil prices have primarily affected fiscal positions, but as mentioned above, for the most part the gaps have been easily handled so far; this is in large part thanks to reserves accumulated during the last few years when prices exceeded $100/bbl.

The regional geopolitical environment has suffered some setbacks in recent months from a series of terrorist attacks in MENA (Egypt, Tunis) and the GCC (KSA, Kuwait); but these have highlighted known risks and appear to have had limited impact on business sentiment and on financial markets.

Though GCC and MENA equity markets had a positive second quarter, they mostly mirrored lackluster world markets; the exception was the Saudi Arabian market, which benefitted handsomely this year from a much awaited, albeit limited, initiative to open up the market to foreign investors in June 2015.

Egypt's economy remains on the right track, though improvement appears very gradual. We expect growth to have come in at 4.3% in FY14/15 and to pick up slightly to 4.5% in FY15/16. Financial help from the GCC has been critical to shore up the country's external and fiscal deficits. Meanwhile, growth has been helped by an ambitious investment program that includes infrastructure projects as well as power generation and oil sector initiatives.

Meanwhile, global economic growth remains moderate, with the IMF recently revising its forecast for 2015 down slightly to 3.3% (from 3.5%). The outlook, largely unchanged from the last World Economic Outlook in April 2015, is for improving growth in advanced economies and slowing growth in emerging markets. With the world economy still performing below average, the prospects are for a continued weak demand environment for oil prices.

Advanced economies are now seeing accelerating growth, with the US in the lead. Despite weaker 1Q15 data, the US recovery now looks on track; as a result, higher policy rates in the US are now generally expected before the end of the year. While the Fed claims to be more data-driven than before, and while US data has been more supportive of a start to monetary policy "normalization" later this year, the ongoing Greek crisis and more volatile Chinese markets, may inject some caution and, as a result, could delay Fed action.

For GCC countries, pegged or quasi-pegged to the US currency and hence to US monetary policy, a rate hike by the Fed ought to be followed by policy rate hikes by GCC central banks within 3-6 months. Our baseline is for the Fed to raise rates this year rather than next, starting in September. This could mean higher policy interest rates for the GCC by early next year.

Bahrain outlook

Moderate growth ahead; budget worries persist

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Overview and outlook

- Real GDP growth to slow in 2015 amid a decline in oil GDP growth.
- CPI inflation expected to remain steady in 2015 at 3.0%, even amid gains in housing inflation. Subdued food inflation should keep overall inflation in check.
- The budget deficit is set to widen to 13-16% of GDP in 2015 and 2016.
- Credit growth is holding well.
- The stock market continues to hover around high levels on improved business optimism.

Real GDP to slow, with moderate growth in non-oil GDP

We expect growth in economic activity to slow down from 4.5% year-on-year (y/y) in 2014 to around 2% in 2015, on flagging oil GDP growth and constrained non-oil sector growth. (Chart 1).

Oil sector growth should decline on lower oil production and prices. Non-oil GDP is poised to grow moderately helped by strong fiscal spending and GCC funds aimed at financing housing and infrastructure projects. The GCC has promised funds worth around $10 billion spread over 10 years, to help bolster Bahrain's economy. However, non-oil GDP growth remains vulnerable to internal political concerns. These concerns are somewhat weighing on business optimism, and hindering the potential for stronger gains in the financial services sector (the biggest contributor to the economy after oil), as well as the construction and tourism sectors.

Against a meager economic recovery and low oil prices, concerns over Bahrain's ability to finance its burgeoning fiscal deficits have been on the rise. In early February, S&P downgraded Bahrain's long-term sovereign debt rating from BBB to BBB-. Government debt has ballooned since 2009 and is expected to stand at around 50% of GDP in 2015.

Consumer price inflation expected to average 3% in 2015

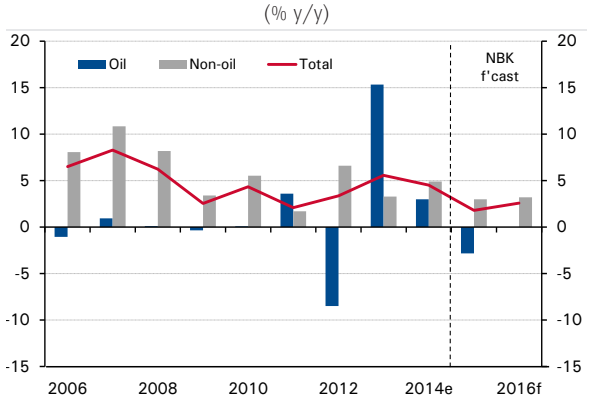
Headline inflation remained comfortable in May at 2.4%, as ongoing gains in housing inflation were offset by relatively weak food inflation. Housing inflation steadied at 7.7% y/y and food inflation was at 2.9% y/y, during the same period. (Chart 2). Subdued economic activity, soft food inflation and a gradual moderation in housing rent inflation will help keep the overall inflation rate steady in the period ahead. We expect the headline

Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	32.7	33.8	30.4	32.7
Real GDP	% y/y	5.6	4.5	1.8	2.6
- Oil	% y/y	15.3	3.0	-2.8	0.0
- Non-oil	% y/y	3.3	4.9	3.0	3.2
Inflation	% y/y	3.2	2.7	3.0	3.0
Budget balance	% of GDP	-3.1	-4.7	-15.5	-12.5

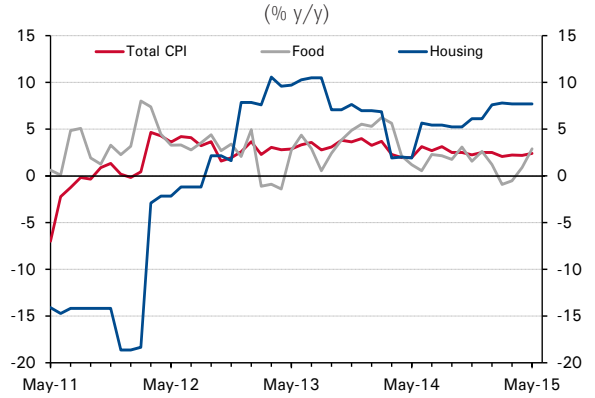
Source: National sources, NBK estimates

Chart 1: Real GDP



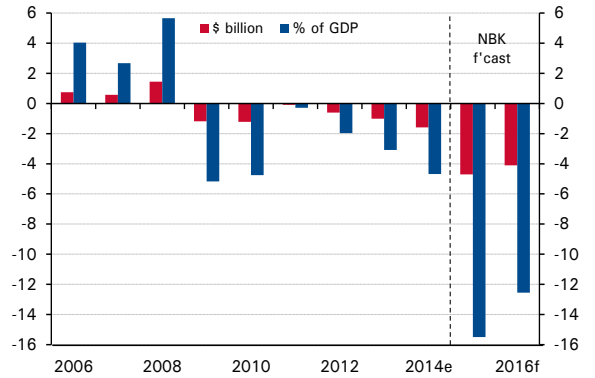
Source: Central Informatics Organization, NBK estimates

Chart 2: Consumer price inflaiton by sector



Source: Central Informatics Organization

Chart 3: Budget balance



Source: Bahrain Ministry of Finance, NBK estimates

inflation rate to average around 3.0% in 2015, slightly higher than the annual average figure of 2.7% in 2014.

Budget deficit to widen further on lower oil revenues

Bahrain is set to log in one of the largest budget deficits in the GCC region, with the country's breakeven oil price estimated at around $120 per barrel, coupled with high levels of government spending.

Any significant curtailment in public spending is unlikely in the near future. Public wages and subsidies (politically sensitive areas of spending) make up two-thirds of total government spending. Given the current political status quo, any major cuts in these two areas could stir the pot.

Consequently, with fiscal spending forecast to remain high amid dwindling oil revenues, we expect the fiscal deficit to swell from around 4% of GDP in 2014 to around 15% in 2015 (Chart 3).

Current account balance to post a temporary deficit in 2015

The current account is projected to post a deficit of around 2% of GDP in 2015, on the back of lower oil export receipts. The deficit however is expected to be short-lived. We forecast the balance to edge back on to positive turf in 2016, on the back of higher oil prices and stronger growth in non-oil exports. (Chart 4.)

Bank credit growth

Credit growth witnessed a gradual recovery during most of 2014. (Chart 5.) It is important to note that credit growth has been distorted ever since the Central Bank of Bahrain reclassified some of its financial institutions in May of 2014.

Business loans growth, relative to the growth in personal loans, appears to have been more affected by the central bank's reclassification. (Chart 5). Adjusting for the reclassification (dotted red line on chart 5); business loan growth seems to be witnessing a gradual recovery on the back of newly launched or re-launched projects.

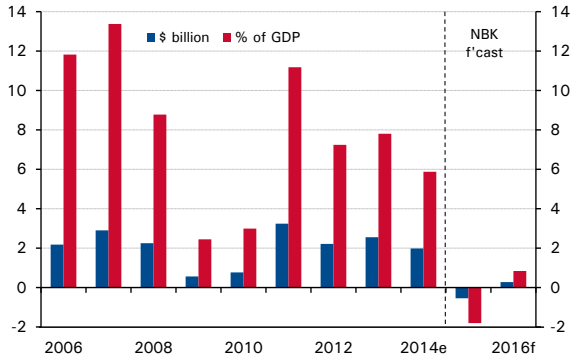
Growth in the broad M2 money supply measure remains healthy, even amid lower oil prices. In April 2015 it stood at 6.6% y/y. (Chart 6.) The rather healthy levels of liquidity could be attributed to the relatively accommodative monetary policy: the Central Bank of Bahrain (CBB) has maintained its one-week policy rate at 0.5%, slightly above the US Federal Fund's target rate of 0.25%.

The banking sector continues to struggle to eke out positive gains in asset growth. Total commercial bank asset growth remained in negative territory after contracting by around 1.0% y/y in April, as wholesale bank assets continued to decline. (Chart 7). Growth in wholesale bank assets, which make up around 60% of total assets (as of 2014), fell by 3.2% y/y in April. (Chart 8.) The more domestically-orientated retail banks, however, continue to paint a more positive picture: asset growth was up 2.7% y/y in April.

Bahrain stock market has seen healthy gains thus far in 2015

The Bahrain All Share Index has maintained relatively higher levels since mid-2014 (Chart 9) on reassurances that business sentiment is slowly but surely improving. Although the index recently came off the highs it witnessed at the end of 2014, it still remains comparatively high.

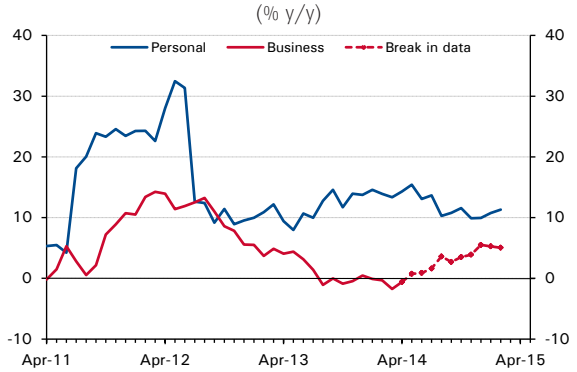
Chart 4: Current account balance



Source: Bahrain Ministry of Finance, NBK estimates

Chart 5: Private sector credit *

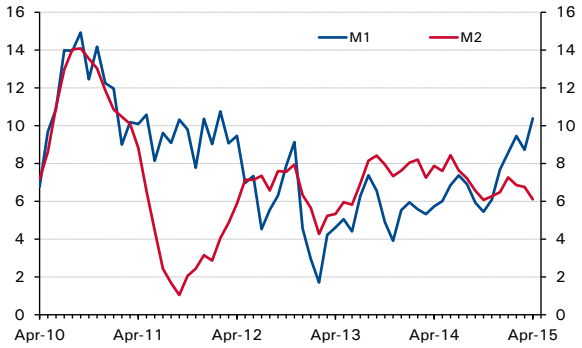
(% y/y)



Source: Central Bank of Bahrain, * excludes securities

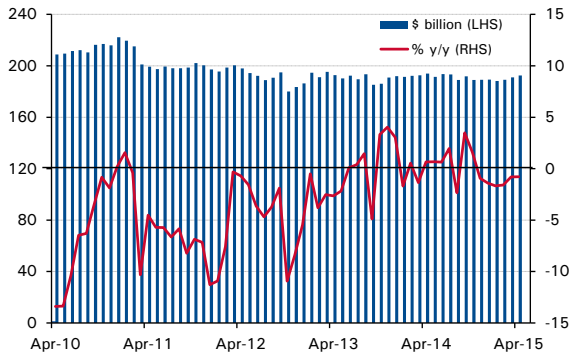
Chart 6: Money supply

(3-month moving average % y/y)



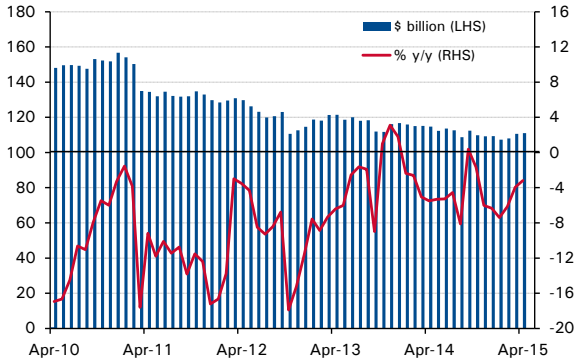
Source: Thomson Reuters Datastream

Chart 7: Commercial bank assets



Source: Central Bank of Bahrain

Chart 8: Wholesale bank assets



Source: Central Bank of Bahrain

Chart 9: Stock market index

(all share index)

Source: Thomson Reuters Datastream

Kuwait outlook

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Nonoil growth steady at 5%, despite lower oil prices

Overview and outlook

- **Nonoil growth to maintain a healthy pace as project implementation improves; nonoil growth expected at 5% in 2015 and 2016.**
- **Lower oil prices likely to push fiscal balance into deficit in FY15/16, but fiscal and external buffers remain more than adequate.**
- **Consumer sector growth to remain solid, but to moderate its pace.**
- **Inflation is likely to end 2015 up slightly, but remains contained thanks to a stronger dinar and low global inflation.**

Kuwait's economic growth is set to maintain a healthy pace despite last year's collapse in oil prices. Growth, which picked up since 2013, is being supported by the accelerated implementation of the government's development plan and a robust consumer sector. Ambitious capital spending targets have boosted aggregate investment and should continue to do so in 2015 and 2016.

The parliament's recent approval of the five-year development plan for 2015-2020 as well as the FY15/16 capital spending budget confirm the commitment to the ambitious investment spending targets. We think the capital spending outlook will remain unchanged in the current low oil price environment.

While lower oil prices have had a significant impact on Kuwait's fiscal and external positions, the country continues to enjoy substantial buffers that allow it to stay the course in the medium term. Indeed, Kuwait is expected to register a deficit in FY15/16, its first in over a decade. However, a sovereign wealth fund estimated at over 300% of GDP ($550 billion), among the highest in the region, will allow Kuwait to easily finance a deficit without having to make deep cuts in spending.

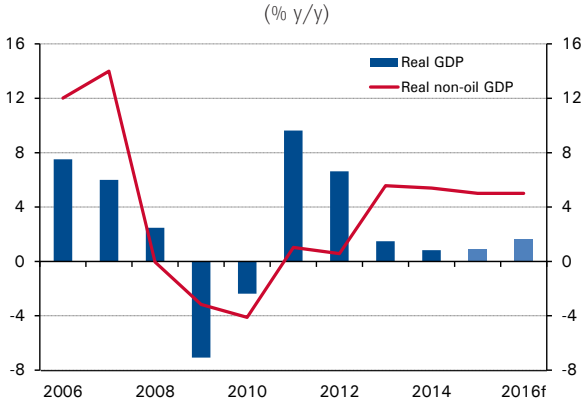
Still, lower oil prices have highlighted the longer term sustainability challenges for Kuwait. As such, the government has rekindled efforts to introduce vital fiscal reform. Those include a broader corporate income tax and a value added tax (VAT), though neither is likely before 2019. A new subsidy reform initiative is also expected, which could include a cash transfer to lower income households. The parliament is also currently deliberating on an ambitious wage bill reform initiative which aims to standardize pay across the public sector and to increase central control over the government's wage bill. We think authorities are serious about

Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	KD bn	49.9	47.8	35.8	40.1
Nominal GDP	USD bn	176	168	119	134
Real GDP growth	% y/y	1.5	0.8	0.9	1.6
- Oil	% y/y	-0.8	-1.9	-1.6	-0.7
- Non-oil	% y/y	5.6	5.4	5.0	5.0
Inflation	% y/y	2.7	3.0	3.5	3.5
Budget balance	% of GDP	25.9	8.2	-3.9	0.1

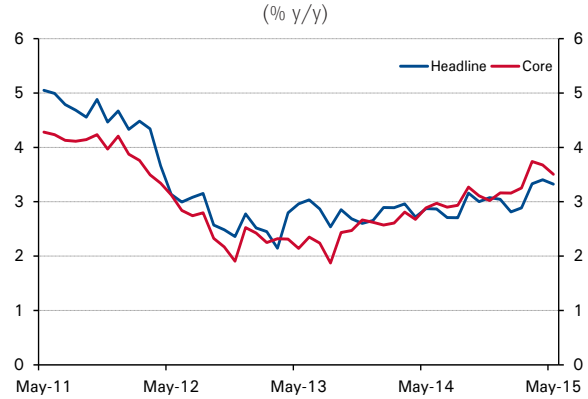
Source: Central Bank of Kuwait, Ministry of Finance, Central Statistical Bureau, NBK estimates

Chart 1: Real GDP



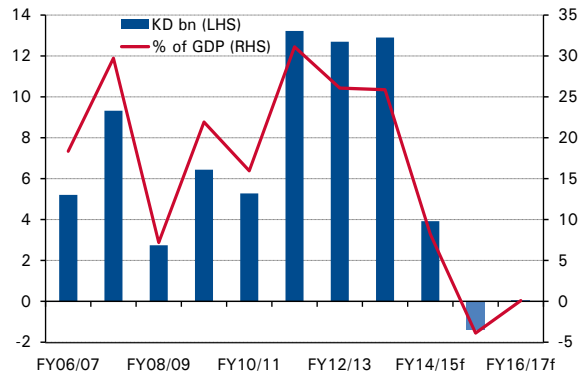
Source: Central Statistical Bureau, NBK estimates

Chart 2: Consumer price inflaiton



Source: Central Statistical Bureau, NBK estimates

Chart 3: Budget balance



Source: Ministry of Finance, Central Statistical Bureau, NBK estimates

addressing the long term fiscal challenges facing the country and doing so in a gradual manner that does not derail the pace of growth.

Nonoil growth at 5%, supported by public investment drive

The nonoil economy has registered a healthy growth rate since 2013, and we expect it to maintain growth around 5% in 2015 and 2016. The most recent available official data on GDP growth indicates that Kuwait's nonoil economy grew by 5.6% in 2013. We think that pace of growth was largely maintained in 2014, supported by an accelerating pace of project implementation and a robust consumer sector.

There are signs that nonoil activity may have eased slightly in Q1 from the strong pace seen in 2013 and early 2014, though this trend appears temporary and should be short-lived. Private credit growth was lower in 2014 thus far in 2015, following several years of accelerating growth. Private credit grew by 5.7% y/y through April 2015, down from growth of 8.1% in 2013 and 6.2% in 2014. Business credit (excluding personal facilities and the nonbank financial sector) alone slowed to 5% y/y from 7.9% in 2013. The lower figures are largely due to the write-off of Family Fund loans by banks and to the pay-down of legacy debt by some corporates in 2014. Adjusting for these factors, we think growth has been relatively steady through April 2015 at around 8% y/y where it should close the year.

Investment boosted by government development plan

The solid pace of growth has been driven and supported by investment spending, itself due to improved implementation of the government development plan. The plan calls for both government and private investment in a host of large infrastructure projects. Following some delay in prior years, 2014 saw a pickup in the pace of implementation, with project awards rising notably in 2014. Further progress should be seen in the coming period following the legislative approval earlier in 2015 of the broad investment plan for the coming five years (2015-2020), as well as the FY15/16 capital spending budget.

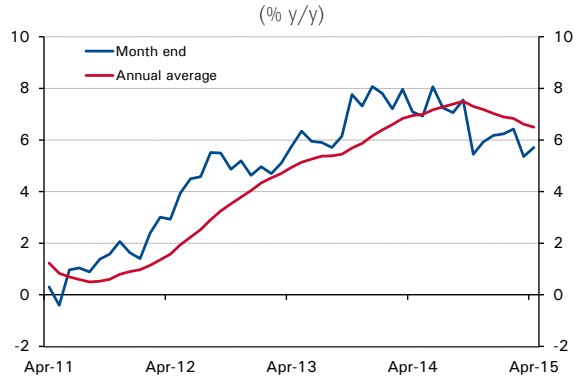
The 2015-2020 development plan targets around KD 34 billion in new project spending in various sectors including oil, power generation, transportation and housing. Most of the projects in the plan have already been approved individually and have been on the government's drawing board for several years.

The government also seeks to improve the business environment and to boost private sector participation in the economy. This will be done largely through the public-private partnership (PPP) investment model. Legislation passed in 2014 should lead to better regulation of the PPP initiatives. The new law replaced the Partnerships Technical Bureau (PTB) with the Kuwait Authority for Partnership Projects (KAPP). The new body has greater independence and executive powers and should manage PPP initiatives more effectively.

Consumer sector set to continue to moderate

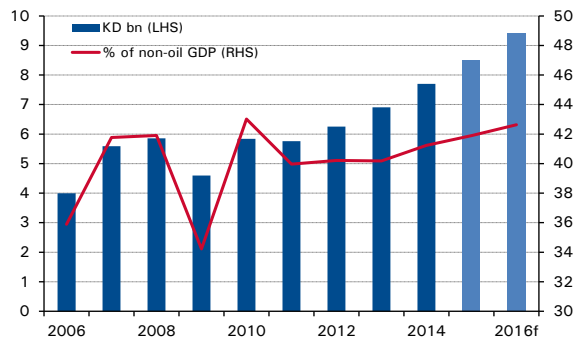
Growth in the consumer sector has been resilient and consistent, though we expect growth to continue to moderate. The sector will remain a key driver of the nonoil economy. Household income growth has remained supportive, with hiring among Kuwaitis and skilled expats steady. As a result, consumer spending and household borrowing growth have been healthy despite some moderation over the last year.

Chart 4: Private credit



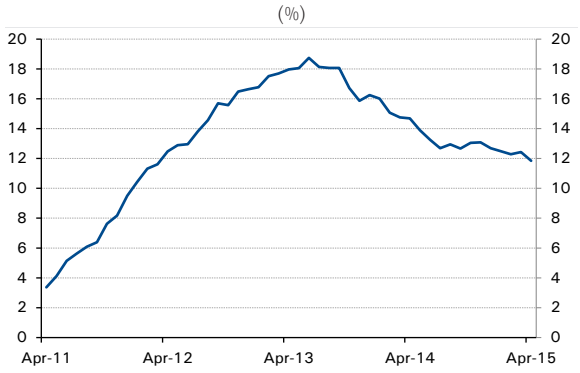
Source: Central Bank of Kuwait

Chart 5: Aggregate investment



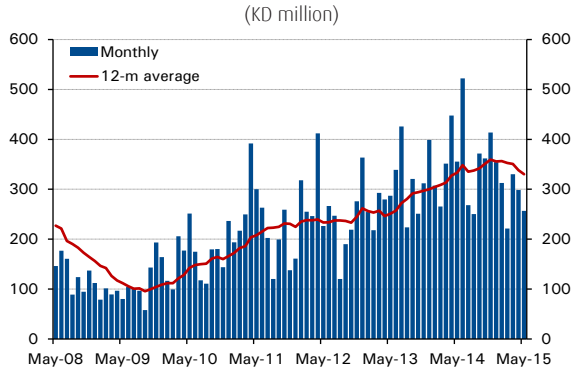
Source: Central Statistical Bureau, NBK estimates

Chart 6: Household debt growth



Source: Central Bank of Kuwait

Chart 7: Real estate sales



Source: Ministry of Justice

Card spending growth eased slightly to 12.6% y/y in 1Q15, its slowest pace in three years. The figure points to some slowing in the consumer sector though the pace remains healthy. Personal loan growth also slowed to a three-year low though it remained quite healthy too at 11.8% y/y in April 2015. The positive outlook in other sectors of the economy and continued support from current government spending should help support continued robust growth in the sector.

Real estate market cooled in early 2015

Real estate sales growth cooled thus far in 2015 following strong growth in 2014, though the commercial sector was an exception. The residential and investment sectors both cooled, with sales during the first five months of 2015 shrinking by 18% and 22% compared to the previous year. This followed very strong growth in 2014, with sales of investment properties rising by nearly 30% last year. Meanwhile, the commercial sector continued to register positive growth in sales during the first five months of 2015, as the KD volume of registered transactions was up 4.9% y/y.

Inflation has picked up on domestic pressures

Inflation continued to pick up with upward pressures coming largely from domestic sources. Headline inflation came in at 3.3% y/y in May 2015, up from 2.9% a year before on stronger housing inflation. "Core" inflation (excluding food) was slightly higher at 3.5% y/y. Consumer price growth has been on a moderate uptrend over the last two years but has remained subdued thanks to low international inflation. We expect inflation to average around 3.5% by the end of 2015 on accelerating domestic activity. Particularly, we expect housing inflation to cool off later this year.

Fiscal deficit expected in FY15/16 on lower oil prices

Kuwait is expected to record its first deficit in 16 years in FY15/16 as a result of the decline in the price of oil. According to the recently approve budget, government spending is expected to be lower in FY15/16 by around 9-13%; but most of the cuts should be in items that would leave the outlook for the domestic economy unchanged. In particular, investment spending plans will be largely unchanged.

Brent has recovered somewhat since it bottomed early in 2015, averaging $58 per barrel thus far in 2015. Still, the price remains nearly 40% lower than a year ago. Oil revenues are expected to be 37% lower in FY15/16 at KD 14.1 billion, producing a deficit of around 3.9% of GDP.

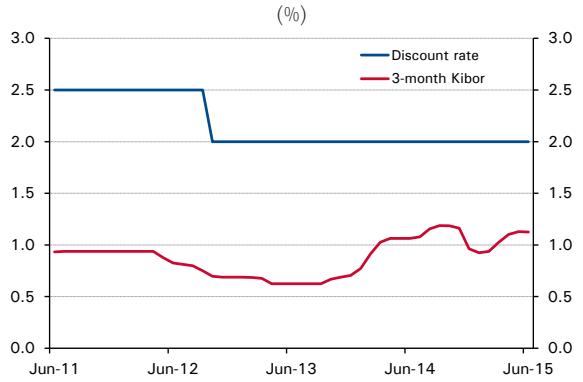
The dinar has strengthened along with the stronger dollar

The Kuwaiti dinar (KWD) had strengthened substantially in 2014, as a result of the stronger US dollar; it has since retreated somewhat, though the KWD is still up compared to a year ago. The dinar is pegged to a basket of 4-5 major currencies, with the US dollar having the largest weight among them. The JP Morgan trade-weighted index of the dinar shows the currency up by around 3.4% y/y, having declined somewhat since it peaked in March 2015.

Stock market moves sideways so far this year

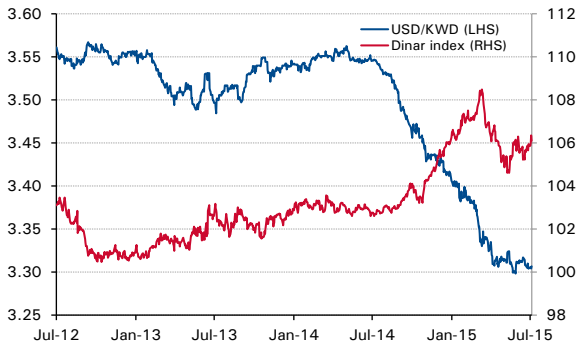
Kuwait equities have yet to recover following the market's retreat late last year in the wake of weaker oil prices. The market made an initial but short-lived recovery earlier in 2015. The Kuwait Stock Exchange's value-weighted index (IXW) was down by 4.9% year-to-date (ytd) in early July. Over the same period, the MSCI total return index is down by 2.4% ytd.

Chart 8: Interest rates



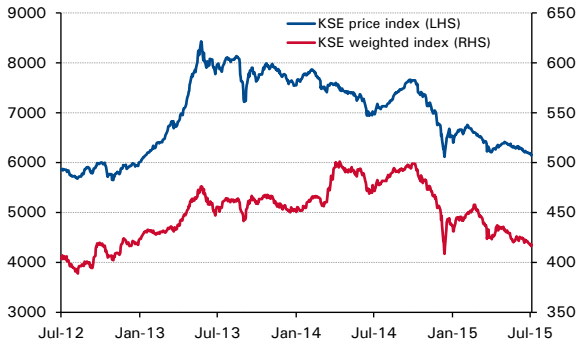
Source: Central Bank of Kuwait, Thomson Reuters Datastream

Chart 9: Exchange rate



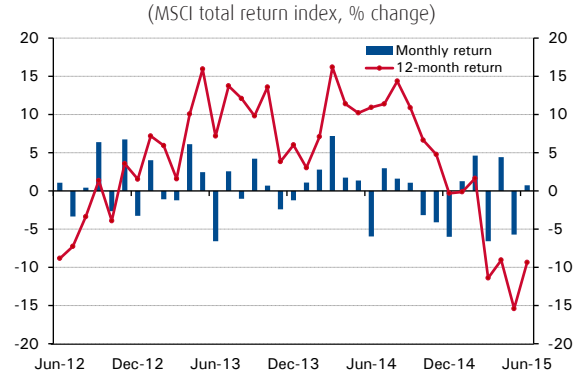
Source: JP Morgan, Thomson Reuters Datasream

Chart 10: Stock market indices



Source: Kuwait Stock Exchange, Thomson Reuters Datastream

Chart 11: Stock market total returns



Source: MSCI, Thomson Reuters Datastream

Oman outlook

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Growth seen rising to 4.0% in 2015 as fiscal deficit widens

Overview and outlook

- GDP growth is seen accelerating to 4% in 2015 before moderating to 3.7% in 2016; nonoil growth to average 6%.
- CPI Inflation at -0.4% y/y in May is expected to stay modest.
- Fiscal and current account surpluses are expected to shift into deficit in 2015-2016.
- Credit growth is expected to remain healthy against a stable economic backdrop.
- The Muscat securities exchange remains vulnerable to external shocks.

Last year's sharp decline in oil prices has exposed the vulnerability of Oman's economy. With one of the highest breakeven oil prices in the GCC, Oman is likely to see a sizeable fiscal deficit this year and the next. Despite this, we expect Oman to avoid deep cuts in spending in the near term, choosing to maintain a supportive fiscal stance. We think that the government can comfortably finance deficits in the near term thanks to its sovereign wealth fund, strong credit standing, and low debt levels.

Real GDP is expected to grow by 4% in 2015 and 3.7% in 2016, driven by a strong non-oil performance. With lower oil prices highlighting the need to diversify the economy, authorities are keen to go ahead with their ambitious projects pipeline. As a result, project spending is expected to remain at high levels, which is seen supporting non-oil growth in the near term. The recent decision to scrap a crude oil production cap and push for a steady rise in oil output will also see growth in the oil sector pick up slightly.

Diversification and urbanization to drive non-oil growth

Oman's non-oil growth is expected to remain healthy over the next two years, though it will moderate slightly to around 6%. An ambitious diversification plan will help sustain the upbeat pace in the non-oil economy. Oman's non-oil growth will be primarily driven by its ambition to develop its logistics and tourism sectors and reduce dependence on hydrocarbon revenues.

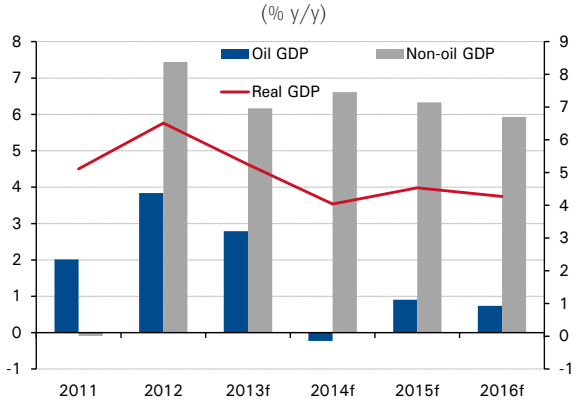
The government expects to invest OMR 3.2 billion in 2015, of which OMR 1.7 billion will be geared towards non-oil projects. Although slightly less than 2014's spending as weaker revenue prospects may streamline invest-

Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	78	78	65	73
Real GDP	% y/y	4.6	3.5	4.0	3.7
- Oil	% y/y	2.8	-0.2	0.9	0.7
- Non-oil	% y/y	6.2	6.6	6.3	5.9
Inflation	% y/y	1.1	1.0	1.0	2.5
Budget balance	% of GDP	0.9	-1.2	-16	-11

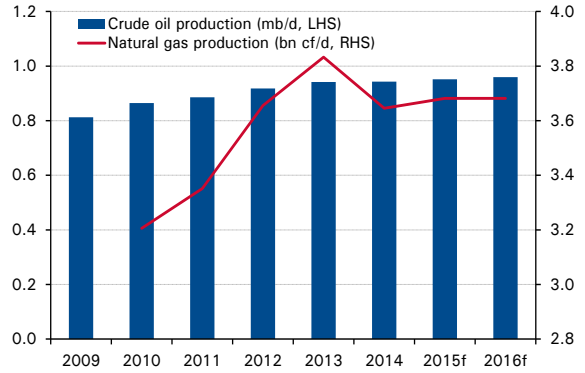
Source: National Center for Statistics and Information, NBK estimates

Chart 1: Real GDP



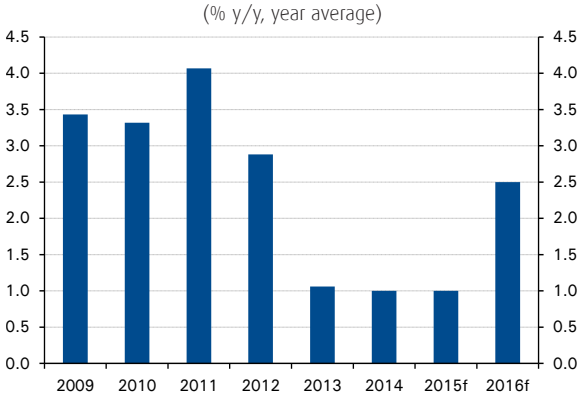
Source: National Center for Statistics and Information, NBK estimates

Chart 2: Hydrocarbon production



Source: National Center for Statistics and Information, NBK estimates

Chart 3: Consumer price inflation



Source: National Center of Statistics and Information, NBK estimates

-ments, it is in line with past expenditures and reaffirms the government's commitment to implementing its stated development plans.

Current and future government projects intend to capitalize on Oman's topography and geographic location, targeting downstream oil sectors, transportation, and tourism sectors. Unlike its GCC neighbors, the construction sector does not show prominence due to the country's still nascent private sector. A fast growing population, however, could see that changing.

Rapid population growth in recent years driven in large part by strong demand for expat labor has provided support to the real estate sector. The population has grown by 48% since 2010 to 4.1 million in 2014. Of the 1.7 million expats residing in Oman, 1.6 million of them are actively employed by the private sector. As a result, the real estate sector accounted for 10% of nominal GDP in 2014, up 6.3% year-on-year, driven by increases in rents and activity.

Credit growth expected to remain robust

Resident private credit activity will continue to benefit from Oman's healthy non-oil outlook. Private credit to the non-financial sector grew by 12.5% in 2014, driven by lending to construction and manufacturing, while personal loans increased by 9.5%. As a result, private credit growth in Oman kept a strong pace in 2014, averaging 9.5%. This pace has been maintained through April 2015, as it is expected to do throughout 2015 supported by robust economic activity.

Oman scraps oil production cap

With oil prices at current levels, authorities have sought to soften the impact by bolstering oil and gas output through a focus on development. As a first step, the cap imposed on oil output was scrapped and upstream hydrocarbon development prioritized. Output in the oil and gas sector is expected to pick up slightly over the next two years, averaging growth of 0.8%.

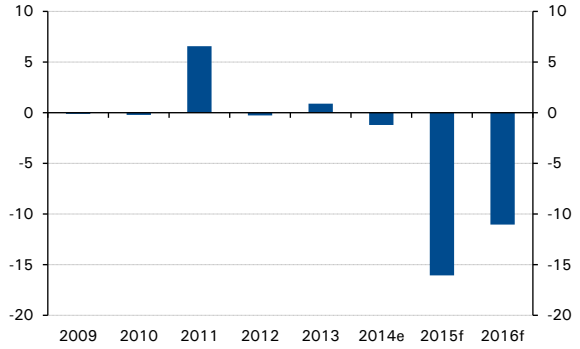
Crude oil production averaged 943,000 barrels per day (b/d) in 2014, up a mere 0.2% year-on-year (y/y). The government is targeting crude and condensate output of 980,000 b/d in 2015, in an effort to offset lower oil prices. Most of the boost in output will be dependent on Petroleum Development Oman (PDO), the state's largest producer, responsible for 69% of average daily production. PDO output had been capped at 570,000 b/d until the recent request by the oil minister to increase production to 600,000 b/d by 2019 and maintain that level for the following 10 years.

In an effort to support the continued development of the oil sector, Oman is looking to spend OMR 1.5 billion on oil and gas projects in 2015, up from 2014's expenditures of OMR 1.2 billion. Its current expansion plans target total oil output of 1 million b/d in the next year or two. Investment will focus on the development of PDO's fields and enhanced oil recovery (EOR) activities.

Gas production, on the other hand, is expected to remain steady for the next two years, but will see a large boost once the BP Khazan project comes online in 2017. In the meantime, gas supply continues to lag behind demand in the sultanate. With Oman relying heavily on gas for oil extraction and electricity at its two main power generators, and power demand seen growing at 7-8% per year until 2020, the natural gas gap is expected to grow. The gap is being addressed by gas imports from Qatar,

Chart 4: Budget balance

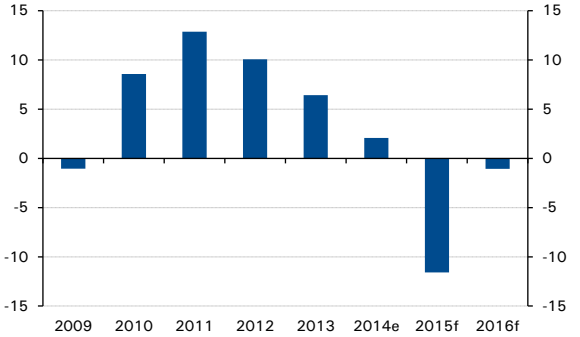
(% GDP)



Source: National Center for Statistics and Information, NBK estimates

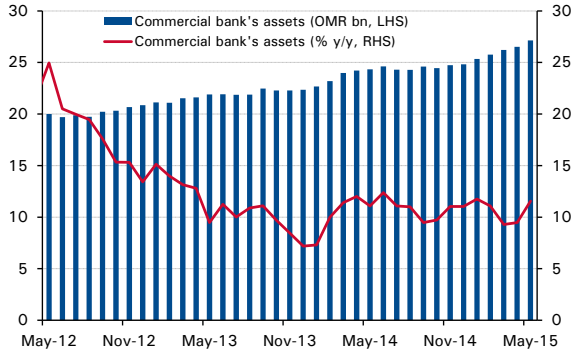
Chart 5: Current account balance

(% GDP)



Source: National Center for Statistics and Information, NBK estimates

Chart 6: Commercial bank assets



Source: Central Bank of Oman

Chart 7: Credit to private sector

(% y/y)

Source: Central Bank of Oman

while talks with Iran on building a new gas pipeline aim to help meet future demand growth.

A fiscal deficit is inevitable but comfortably financed

The Omani government is expected to post a deficit this year and the next owing to lower oil prices and modest increases in oil production. The 2015 budget, based on an oil price of $75-$80 per barrel, estimates a deficit of OMR 2.5 billion. A deficit of OMR 4 billion is more likely given that oil prices are lower than official projections; also, expenditures are seen remaining elevated in pursuit of the country's development goals and politically sensitive expenditures are maintained.

Hydrocarbon revenues contracted by 3.9% in 2014 to reach OMR 13.7 billion, leading Oman to post a deficit of 1.2% of GDP. Omani crude oil averaged $103.7 per barrel in 2014. Oman's breakeven price of oil is estimated at $105-110.

Oman is well equipped to handle the strain on its budget. In addition to drawing on reserves and donor grants, the government will likely seek funding from debt markets and international lenders taking advantage of its low debt levels and healthy credit rating to support spending. The Central Bank of Oman plans to borrow OMR 600 million this year on behalf of the treasury. Included is the country's first ever sukuk, planned for mid-2015.

The government may also take other steps to ease the burden on its purse. Oman recently cut natural gas subsidies to some industrial producers. Further subsidy cuts are also being considered with the focus on consumer goods and energy. Energy subsidies accounted for 74% of the OMR 2 billion spent on subsidies in 2014. The government is also looking to privatize some public sector companies in the oil sector.

Low inflation will persist in 2015 and grow gradually in 2016

Consumer price inflation is expected to remain modest over the next two years as inflationary pressures remain subdued. Inflation is seen averaging around 1% in 2015 and 2.5% in 2016. The strong US dollar and OMR will help contain imported inflation, as will lower international food prices. Some upward pressure will come from the robust growth in population and healthy non-oil activity. Pick-ups in domestic demand, wages, and the consumption of services and real estate are expected.

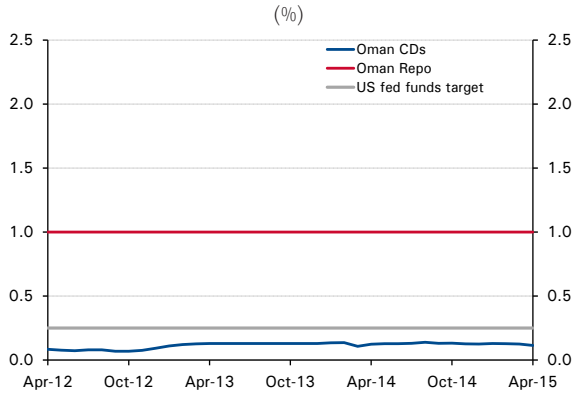
Steep shift in the trade balance will lead to a current deficit

The current account balance is projected to shift into deficit in 2015 and 2016 following the sharp drop in oil prices. Weaker oil prices will more than offset the decline in import prices, driving the trade balance into deficit. The services deficit will continue to expand, albeit at a slower pace as projects aimed at boosting tourism and transport come to fruition. Meanwhile, further growth in the expatriate population will see remittances grow, thus widening the transfers deficit.

The stock market will still be vulnerable to external shocks

Omani stocks were heavily affected by the decline in global oil prices along with equities across the GCC. Concern about the sustainability of the government's fiscal situation and the economic outlook drove stocks lower in 2014, erasing all gains made earlier in 2014. The index has recovered somewhat since.

Chart 8: Policy rates



Source: Central Bank of Oman

Chart 9: Muscat Securities Market

Source: Muscat Securities Market

Qatar outlook

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Economic growth to remain robust in spite of lower energy prices

Overview and outlook

- Growth is forecast to remain strong at 6.5% per annum over the next two years, driven by double-digit growth in the non-hydrocarbon sector and underpinned by the government's development plan.
- Inflation is likely to rise albeit gradually to 3.2-3.5% in 2015-16.
- Elevated government spending on projects and declining revenues should narrow the fiscal surplus from 10.8% of GDP in 2014 to 2.2% of GDP by 2016.
- Overall deposit and credit growth slowed down in 2014 due to a contraction in public sector borrowing and deposits; private sector credit grew by a robust 22.2% y/y in April.
- The Qatar Exchange Index (QE) has been negatively affected by the recent FIFA World Cup scandal and investigations into Qatar's bid.

Underpinned by government spending on the country's $210 billion development plan, the non-hydrocarbon sector will continue to be the driver of economic growth in Qatar. Fiscal and current account surpluses are expected to narrow over the next two years owing to the dramatic decline in oil prices. The rate of accumulation of net external assets is therefore expected to slow down as well. Despite softer energy prices, the fiscal stance should remain relatively expansive, however, with the government continuing to spearhead economic growth through execution of its time-sensitive World Cup and associated infrastructure plans. Inflation is set to rise, albeit gradually, stoked by rising rents but restrained by soft international food and commodity prices, the latter also reflecting a stronger US dollar.

Economic growth to remain robust on account of burgeoning non-hydrocarbon sector activity

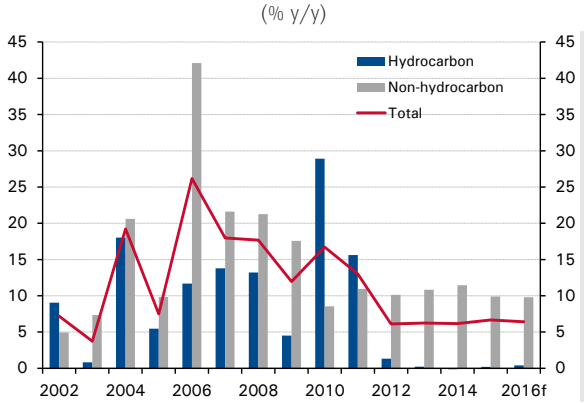
Real GDP growth is forecast to remain strong at 6.5% per annum over the next two years due to continued expansion of the country's non-hydrocarbon sector. The decline in energy prices of 42.2% for oil (Brent) and 31.6% for natural gas (World Bank composite index) since June 2014 should not materially impact growth in the short-to-medium term, though it may lead to a re-prioritization of capital projects. (Chart 2.)

Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	202.7	212.1	200.5	215.4
Real GDP	% y/y	6.4	6.2	6.5	6.4
- Oil	% y/y	0.1	-2.3	0.2	0.4
- Non-oil	% y/y	11.3	12.0	9.0	9.8
Inflation	% y/y	3.1	3.0	2.1	2.6
Budget balance	% of GDP	15.6	10.8	1.6	2.2

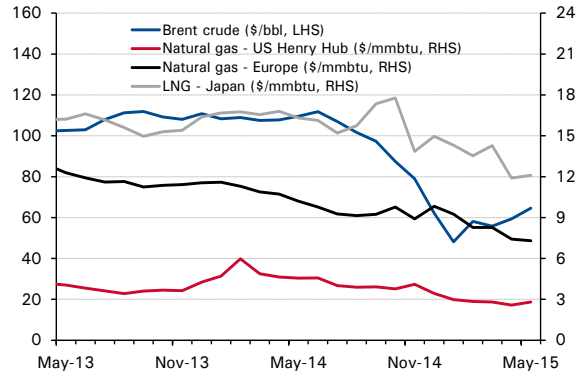
Source: Ministry of Development Planning & Stats (MDP&S), Qatar Central Bank, NBK estimates

Chart 1: Real GDP



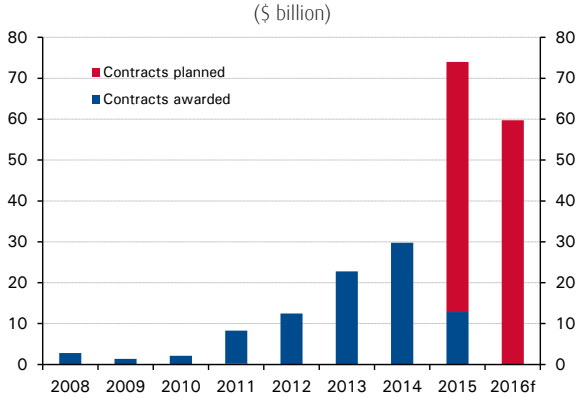
Source: MDP&S, NBK estimates

Chart 2: Energy prices



Source: Thomson Reuters Datastream, World Bank

Chart 3: Qatar projects market



Source: MEED Projects

Output gains from the non-hydrocarbon sector are expected to be broad-based, with construction, financial and government services, and trade and hospitality leading the way with growth of above 10% y/y. based, with construction, financial and government services, and trade and hospitality leading the way with growth of above 10% y/y.

Central to the economic outlook is execution of the government's 5-year, $210 billion infrastructure development plan, which is expected to proceed in spite of the decline in energy prices. $29 billion worth of contracts were awarded in 2014—30% more than in 2013—and we expect momentum to further increase in 2015 on the back of the $13 billion worth of contracts for strategic projects awarded in 1Q15. These include the $28.8 billion Qatar Integrated Railway and the $14.6 billion local roads and drainage program. (Chart 3.) Other high-profile projects that should gain further traction in 2015-16 include the $33.0 billion Lusail Mixed-Use Development, the $10.3 billion Barzan gas production facility and the $7.0 billion New Doha Port.

Two notable projects that will not be pursued are the Al-Karaana and Al-Sejeel petrochemical complexes, costing $6.4 billion and $5.6 billion, respectively. These two projects would have, on completion, provided a further boost to the country's downstream hydrocarbon sector but were deemed commercially unfeasible in light of the decline in energy prices.

The hydrocarbon sector itself will be looking to the 1.4 billion cubic feet per day (bcf/d) Barzan gas production facility to provide an incremental boost to the sector's output in 2015-16. Barzan was the last project sanctioned before the 2005 moratorium on gas extraction from the country's giant North Field was put in place. The boost to output is expected to be in the order of 0.2-04% of GDP, and mainly as a result of increased volumes of gas by-products such as condensates and natural gas liquids (NGLs). These have largely taken over from crude oil as the predominant liquid fuels products. (Chart 4.)

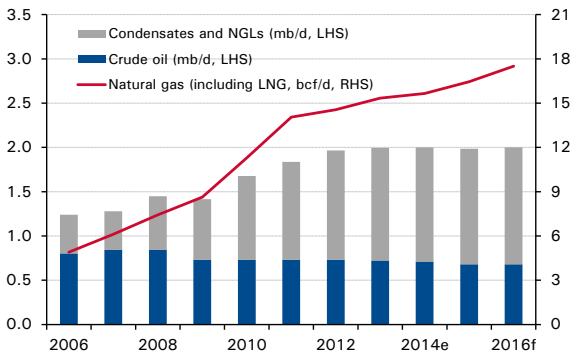
Inflation likely to rise gradually, with rental inflation restrained by softer food and commodity prices

Headline inflation is expected to rise gradually over the forecast period, from an expected 2.1% in 2015 to 2.6% in 2016. (Chart 5.) Inflation reached 3.0% in 2014 but a reclassification and rebasing of Qatar's consumer price index at the turn of the year has made historical comparisons difficult. In the new index, the weights for housing, water and electricity, for example, have been reduced to 21.9% from 30.9%. Nevertheless, while the impact of rental inflation has been somewhat reduced in the new index, the overall trajectory continues to be upward in view of rising demand and limited supply. Property prices had increased by 29.6% y/y as of April, according to the country's real estate price index. (Chart 6.) Domestic inflationary impulses will be offset to a certain extent by continuing softness in international food and commodity prices. Imported inflation will also be restrained by a strengthening US dollar, to which the Riyal is pegged.

Fiscal surpluses expected to narrow on lower energy prices

Qatar's budget surplus is forecast to narrow from an expected 10.8% of GDP in 2014 to 1.6% and 2.2% of GDP in 2015 and 2016, respectively. (Chart 7.) This is primarily the result of the decline in energy prices, with hydrocarbon receipts likely to drop by 33% in 2015. Softer energy prices will also feed through into the non-hydrocarbon sector, where

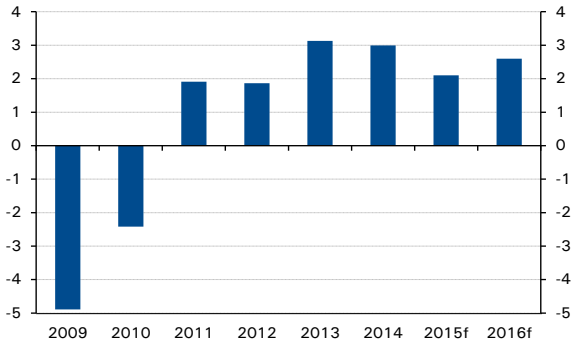
Chart 4: Hydrocarbon sector output



Source: BP, JODI, OPEC, NBK estimates

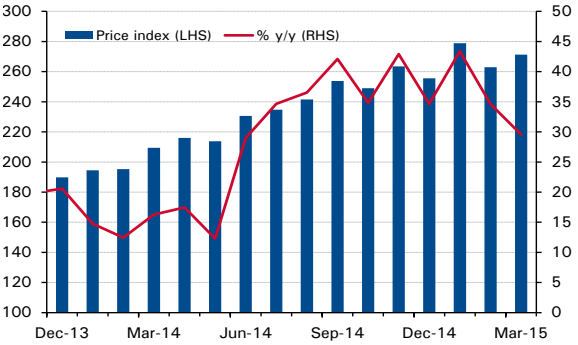
Chart 5: Consumer price inflation

(% y/y, year average)



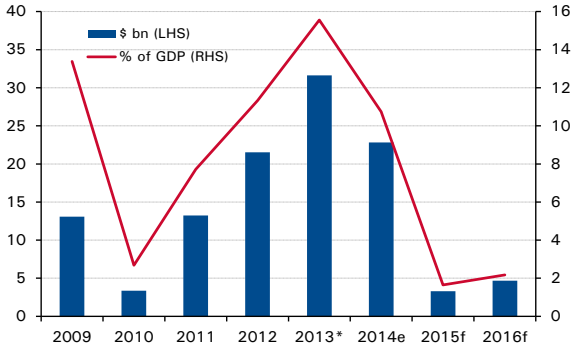
Source: MDP&S

Chart 6: Real estate price index



Source: Qatar Central Bank (QCB), Qatar Ministry of Justice (MOI)

Chart 7: Fiscal balance



Source: Qatar Central Bank (QCB), NBK estimates

the revenues from many downstream hydrocarbon and manufacturing products are indirectly linked to energy prices. Having said that, project and corporate activity in the country is buoyant, which should help state coffers with greater revenues from taxes.

On the expenditures side, fiscal consolidation should be expected. However, the authorities will no doubt be constrained by their commitment to the development plan and to diversifying the country's economic base-something which may take on even greater urgency in view of the oil price decline. Commercially unfeasible projects, however, such as the two petrochemical projects mentioned above have already been shelved. Other non-core projects may also be side-lined.

Central government debt has been declining as government-issued bonds and sukuk mature

Gross central government debt, meanwhile, dropped in 2014 to 21.6% of GDP from 34.7% of GDP in 2013. This has largely been a reflection of maturing government-issued bonds and sukuk. (Chart 8.) The government is also channelling more of its surpluses towards capital and development spending. Debt issuance, however, in the form of T-bills and bonds continues apace as the authorities manage liquidity and further develop the domestic debt market.

The current account surplus is likely to narrow; international reserves up in April but still down -11.7% on last November's high

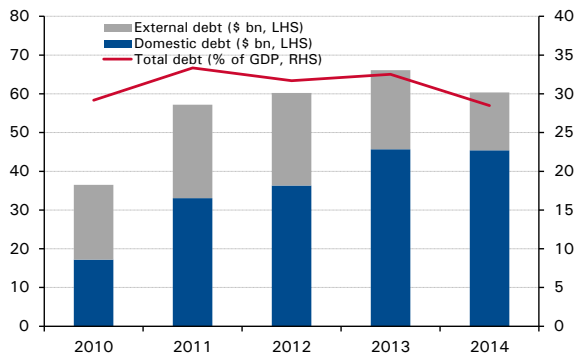
Qatar's current account surplus, which, as a percentage of GDP, has been in double-digits since 2010, is forecast to narrow to 4.4% of GDP and 3.1% of GDP in 2015 and 2016, respectively. (Chart 9.) Slowing export growth has already negatively impacted the country's international reserves, which at $39.1 billion in April, were still down by -11.7% from their 2014 peak of $46.1 billion last November. Having said that, April was the second month in succession that reserve levels had increased in line with improving energy prices. On a year-on-year basis, reserve growth was now in positive territory after three months of contraction, increasing by 0.4% y/y. (Chart 10.)

While bank credit to the public sector has been contracting, lending to the private sector has been accelerating

Credit growth has been moderating over the last year owing to a slowdown and contraction in public sector borrowing. The most recent data showed overall bank credit expanding by 12.1% y/y in April, with credit to the public sector contracting by -9.6% y/y. (Chart 11.) The public sector has been scaling back its need for credit as the government applies stricter oversight of borrowing by its various government entities and while the authorities pay back debt accumulated through their domestic bond issuance program. The public sector's share of total credit has dropped to 37%, having been as high as 46% in November 2012.

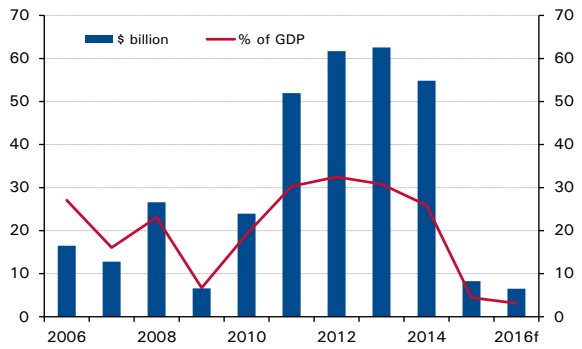
In contrast, bank lending to the private sector has been very robust, climbing to 22.2% y/y as of April. Increases in credit growth of over 20% annually are being recorded across most sectors, from general trade and industry to consumption and contracting. And the outlook over the next few years is very positive in view of the opportunities available for private enterprises to participate in the country's development plan ahead of the World Cup in 2022. Banks have also been expanding credit lines to overseas entities; credit outside Qatar grew by 58.6% y/y in April and accounts for almost 11% of total bank credit.

Chart 8: Central government debt (gross)



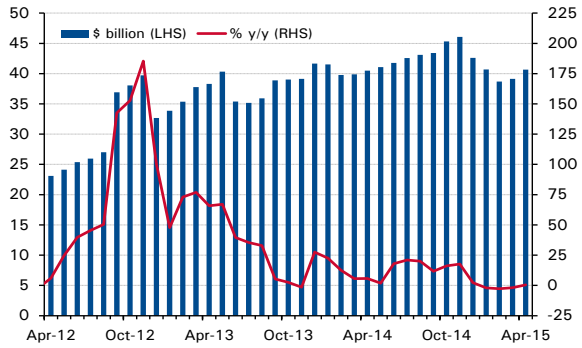
Source: Qatar Central Bank

Chart 9: Current account balance



Source: Qatar Central Bank, NBK estimates

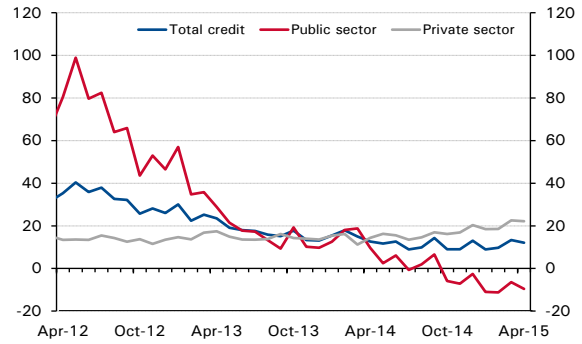
Chart 10: International reserves



Source: Qatar Central Bank

Chart 11: Bank credit

(% y/y)



Source: Qatar Central Bank

Bank asset growth has consequently slowed as a result of the contraction in public sector borrowing

The pace of asset accumulation by commercial banks has slowed down noticeably over the last two years. Growth in foreign assets (investments and monies due from banks abroad) has also slowed. As of end-April, total assets stood at $277 billion (equivalent to 131% of GDP), an increase of 6.8% y/y (Chart 12.)

Declining government deposits over the last few months

Deposit growth has slowed considerably over the last year as a result of the decline in energy prices and its impact on public sector deposit accumulation in particular. Total banking sector deposits grew by 5.1% y/y as of end-April, with public sector deposits contracting for the fifth month running, by -8.4% y/y, and private sector deposits increasing by 5.5% y/y. (Chart 13.) With deposit growth trailing credit growth, the Qatari banking sector's loans-to-deposits ratio reached 109% in April.

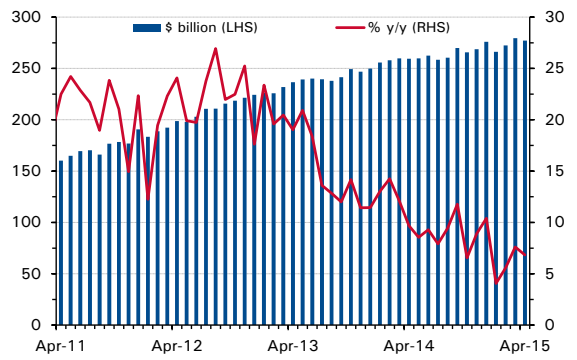
Qatari domestic rates will rise in line with the expected increase in US rates albeit with a lag

With the Qatari riyal pegged to the US dollar, domestic interest rates tend to be closely aligned with US interest rates. (Chart 14.) The US Federal Reserve is expected to raise rates sometime before the end of the year, which will likely mean that Qatar's key lending and deposit rates will follow suit, possibly with a lag of several months.

Subdued stock market performance in 2015 further weighed down by the FIFA corruption scandal

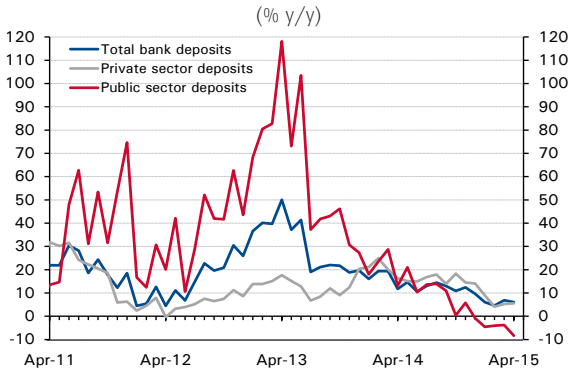
In relation to its GCC peers and indeed to its performance in previous years, the Qatar stock market, the third largest in the region by market capitalization, has been relatively subdued in 2015. Having looked like it was finally clawing its way back into positive territory, the Qatar Exchange Index (QE) instead retreated, declining by 3.2% year-to-date (17 June) to 11,884 after the FIFA corruption scandal erupted and concerns of impropriety over the awarding of the World Cup to Qatar emerged. (Chart 15.)

Chart 12: Bank assets



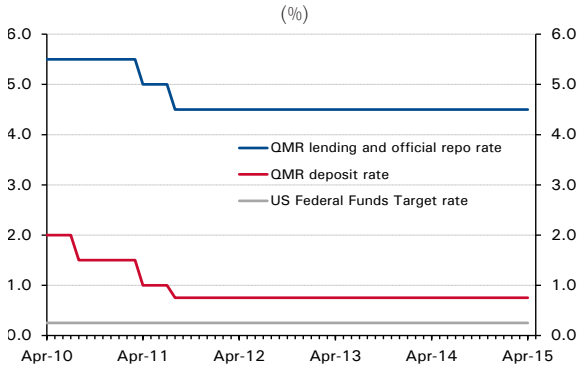
Source: Qatar Central Bank

Chart 13: Bank deposits



Source: Qatar Central Bank

Chart 14: Key policy rates



Source: Qatar Central Bank

Chart 15: Qatar stock exchange

Source: Qatar Central Bank

Saudi Arabia outlook

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Economy supported by robust oil output and public spending

Overview and outlook

- **Headline growth is forecast to slow from 3.5% in 2014 to 3.2% in 2015, with the oil and non-oil sectors growing by 1.9% and 4.0% respectively in 2015.**
- **Inflation is expected to remain muted at around 2.1% in 2015 thanks largely to subdued international food prices.**
- **Government spending will continue to support the economy even at the expense of budget deficits.**
- **Government reserves are likely to be drawn down to finance the deficit; domestic debt issuance is also an option.**

Saudi Arabia's economic growth is projected to slow slightly in 2015 to 3.2%, from 3.5% in 2014. Output gains from the oil sector, along with firm government spending, particularly in terms of capital spending, are the main drivers of a macroeconomic outlook for 2015, which has slightly improved from our previous forecast. Nevertheless, non-oil growth is expected to moderate but remain healthy, supported by stimulative government fiscal policy that aims to broaden and deepen the non-oil economy, stimulate the private sector and deliver substantial improvements to infrastructure, Saudi employment, and education levels—even at the expense of expected fiscal deficits in 2015 and 2016. While the kingdom's substantial domestic and foreign reserves have been accessed to finance the deficit, the government intends to tap the debt markets for additional support. The recent opening of the Saudi bourse to foreign investment should also provide additional liquidity and support asset prices. Inflationary impulses, meanwhile, remain contained on account of continuing softness in international food prices.

Oil sector GDP in 2015 to get a boost from rising crude oil production

Saudi oil production in 2015 has surged to levels not seen since 1980. Output has averaged 10 million barrels per day (mb/d) so far in 2015 as the kingdom responds to a rebound in demand. (Chart 2.) Output of downstream oil products such as diesel, gasoline and jet fuel, for example, (though considered part of non-oil GDP) has also been boosted by gains in refinery runs at the SATORP refinery, which reached full capacity in 2014 and the YASREF refinery, which was commissioned in late 2014 and which delivered its first cargo of refined products earlier this year. Further gains in output are expected in 2015.

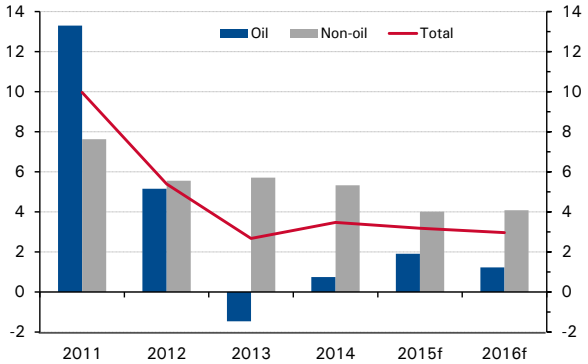
Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	744	746	672	723
Real GDP growth	% y/y	2.7	3.5	3.2	3.0
- Oil	% y/y	-1.5	0.7	1.9	1.2
- Non-oil	% y/y	5.7	5.3	4.0	4.1
Inflation	% y/y	3.5	2.7	2.1	2.6
Budget balance	% of GDP	6.5	-2.3	-20.9	-14.6

Source: SAMA, CDSI, NBK estimates

Chart 1: Real GDP

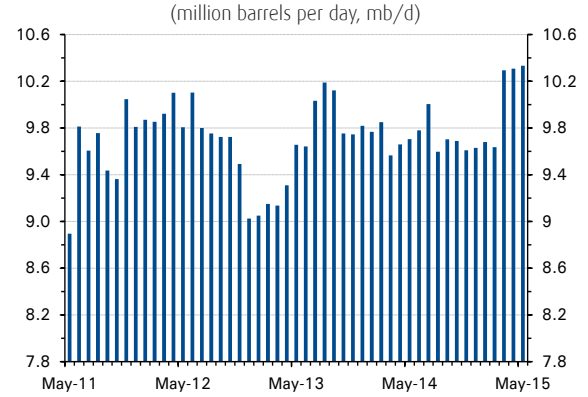
(% y/y)



Source: Central Dep. of Statistic & Information (CDSI), NBK estimates

Chart 2: Crude oil production

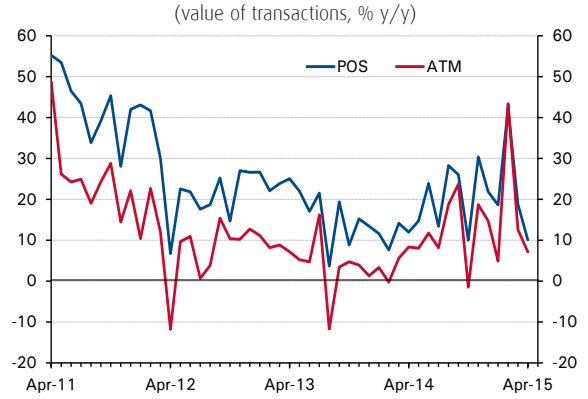
(million barrels per day, mb/d)



Source: OPEC, Joint Organizations Data Initiative (JODI)

Chart 3: ATM and point of sale transactions

(value of transactions, % y/y)



Source: Saudi Arabian Monetary Agency (SAMA), NBK estimates

The non-oil economy continues to benefit from firm government spending, strong domestic consumption and healthy bank lending

Government spending continues to be the linchpin of the non-oil economy, buffering it from an anticipated slowdown brought about by lower oil prices. Spearheaded by the government's investment and diversification plan, estimated at $1.1 trillion and which aims to stimulate employment, consumer demand and private sector activity, non-oil sector output is forecast to grow around 4.0% in 2015 and 2016, from 5.3% in 2014. (See Chart 1.)

Key metrics of consumer and business activity such as point-of-sale transactions (POS), the Purchasing Managers' Index (PMI) and private sector credit growth continue to point to a buoyant, albeit slowing, non-oil sector. The latest data on POS transactions and cash withdrawals showed increases of 10.1% y/y and 7.2% y/y in April, respectively. (Chart 3.) May's headline PMI figure of 57.0, while still comfortably above the 50.0 no-change level, was the lowest in a year as non-oil private sector firms noted a softening in output and exports. (Chart 4.)

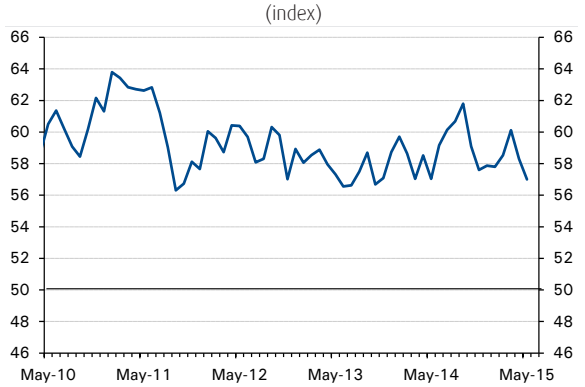
Similarly, private sector credit growth, despite moderating over the last six months, was still a healthy 10% y/y in April in line with steady economic activity. (Chart 5.) Credit to the construction, commerce and manufacturing sectors, for example, was increasing in the region of 8.0-13.0% y/y at the end of 1Q15, while mortgage and real estate lending, to both consumers and businesses, expanded by a robust 26.9% y/y at the end of 1Q15. (Chart 6.)

Government reforms aimed at tackling unemployment look to be progressing, albeit slowly

Addressing the high unemployment rate among Saudi nationals and Saudi youth especially as well as the small proportion of nationals in the private sector has been one of the government's main priorities in recent years. Labor market reforms introduced in 2011 including the 'Nitaqat' program, which imposed 'Saudization' quotas on private sector companies, have yielded broadly positive results: the overall unemployment rate among Saudi nationals has declined from 12.2% in 1Q12 to 11.6% in 4Q14 (Chart 7.); Saudi female participation levels have improved to 17.6% in 2H14 from 14.7% in 1H12; and the number of Saudis employed in the private sector has increased from 10.9% in 2011 to 15.2% in 2013. (Chart. 8.) The rate of employment growth of Saudi nationals in the private sector has been higher than that of expatriates. Meanwhile, compliance with the Nitaqat program has risen to 85% among participating private sector companies, although this represents only 25% of firms registered under the scheme at the Ministry of Labor. The remaining majority of firms are classified as SMEs (small and medium size enterprises), with a much smaller number of employees.

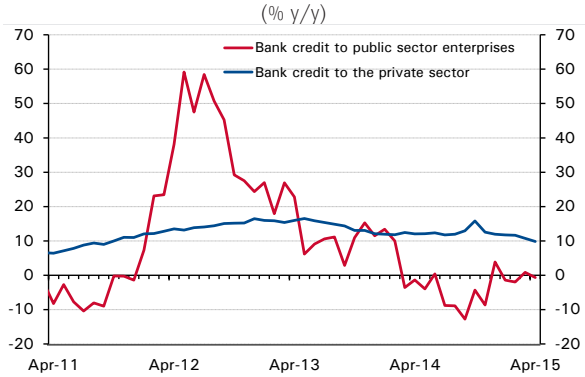
Efforts to address the problem of youth unemployment (ages: 20-29), however, have been less successful. The unemployment rate remains stubbornly high at 27.8%, and is unlikely to fall substantially without significant improvements in the overall quality of the education system; the skills and competiveness of university graduates need to improve to meet industry and private sector standards.

Chart 4: Purchasing Managers' Index



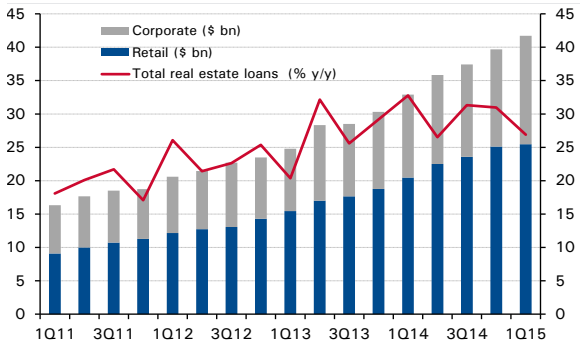
Source: Markit, HSBC

Chart 5: Bank credit growth



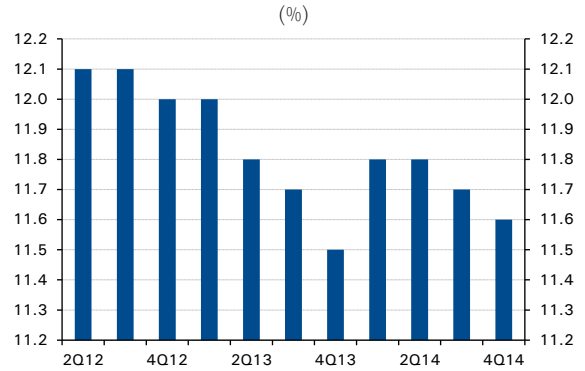
Source: SAMA

Chart 6: Bank real estate lending



Source: SAMA

Chart 7: Unemployment



Source: SAMA, Ministry of Labor

Inflation to remain muted in 2015, rising gradually in 2016 on higher international food prices and domestic housing costsn

The most recent monthly data, for May, showed that inflation in the food and beverages category, the component with the greatest weight of 21.7% in the Saudi cost of living index, and the transportation and restaurants and hotels categories was in the low single digits. (Chart 9.) International food and commodity prices especially have been relatively subdued, helping to keep a lid on otherwise rising costs in the housing category; housing inflation reached 3.1% y/y in May as the kingdom continues to suffer from a shortage of units thanks to rising demand for affordable housing. We expect headline inflation to slow further, from 2.7% in 2014 to 2.1% this year before rising to 2.6% in 2016.

Elevated spending and lower oil revenues push the fiscal account into deficit

Having recorded only its third fiscal deficit since 2002 last year, of 2.3% of GDP, this year and next should see further deterioration in the kingdom finances as a result of lower oil revenues and higher expenditures. (Chart 10.) The fiscal deficit is likely to widen markedly in 2015, to an estimated -21.0% of GDP as a result of burgeoning capital expenditures and one-time costs relating to King Salman's accession bonus (worth around $32 billion or 7.0% of non-oil GDP) and the 13th Islamic month in 2015 as well as the military intervention in Yemen. The ultimate bill for the latter is undetermined.

Reserves down and debt issuance likely as the government looks to finance part of its deficit

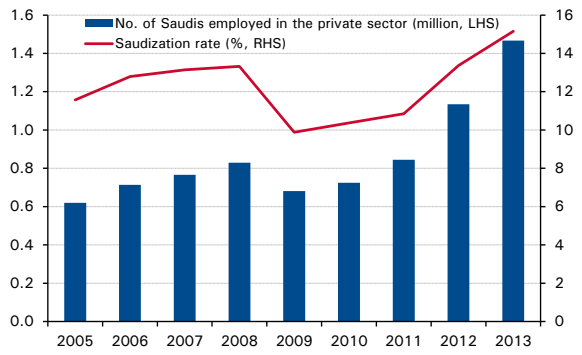
With their spending elevated, the authorities have clearly expressed their intention to continue to act as the lynchpin of the non-oil economy, cushioning it from the effects of the drop in oil prices-even at the risk of fiscal deficits and some reserve depletion. Reserves, in the form of the government's deposits at the central bank, were down by 20.4% y/y to $312.8 billion in April. (Chart 11.) In percentage terms, the bulk of the drawdown this year has come from the reserve account that the government maintains for capital projects, which declined by 16.7% ($19.5 bn).

Nevertheless, the authorities look likely to resort to debt issuance (bonds and sukuk) in order to help finance part of the fiscal deficit. With public debt as low as 1.6% of GDP at the end of 2014—a legacy of years of fiscal surpluses—the government has ample fiscal room to maneuver.

Twin deficits expected in 2015 as the current account swings into deficit as well

Saudi Arabia is expected to record a deficit in its current account in 2015 and 2016, of -7.3% of GDP and -4.5% of GDP, respectively. (Chart 12.) While oil export revenues are likely to be higher than previously forecasted in view of the ramp up of oil production and exports so far in 2015, the decline in oil prices coupled with a still considerable import bill and outflow of remittances and financial aid will weigh significantly on the current account.

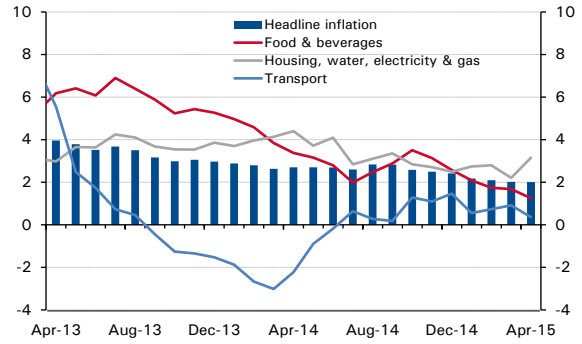
Chart 8: Saudization



Source: CDSI, Ministry of Labor

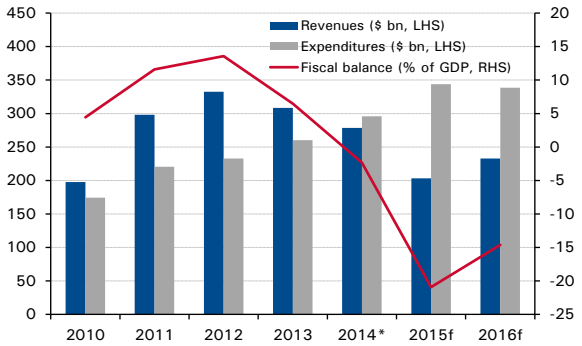
Chart 9: Consumer price inflation

(% y/y)



Source: CDSI

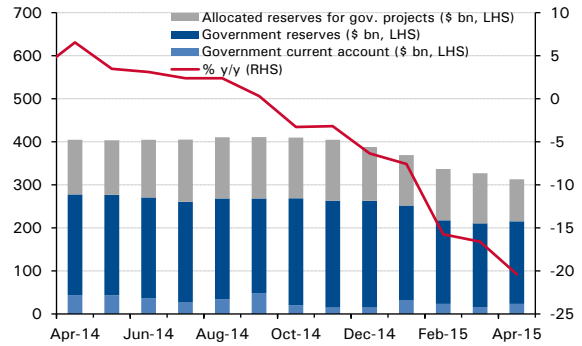
Chart 10: Fiscal balance



Source: SAMA, NBK estimates

Chart 11: Central government accounts at SAMA

(% of GDP)



Source: SAMA

Foreign reserves decline on elevated spending in the context of lower foreign exchange receipts

A drawdown in foreign investments and foreign currency deposits abroad in order to finance domestic spending and defend the exchange rate peg has seen the kingdom's foreign reserves decline by 7.0% y/y to $686 bn last April. (Chart 13.) Still, with the equivalent of 32 months of imports in reserve and oil prices likely to rise over the next year, the kingdom should possess adequate buffers to ride out the current period of low prices. Furthermore, demand for local currency should get a welcome boost by the opening up of the Saudi bourse to foreign investment.

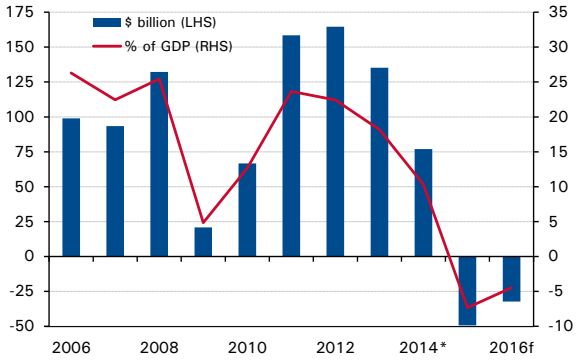
Monetary policy remains accommodative, but interest rates likely to increase in line with a rise in US rates during the next 12 months

Monetary policy has remained accommodative in the context of the currency peg to the US dollar. Mirroring the path of the US Federal Fund's rate, currently at 0.0%-0.25%, SAMA's key interest rates, the reverse repo and repo, have remained unchanged at 0.25% and 2.0% respectively since late 2009. (Chart 14.) SAMA is expected to follow the Federal Reserve's lead and raise its policy rates sometime over the next 6-12 months, albeit with a lag of a few months.

Saudi equities withstand concerns over low oil prices and regional security to rally on the bourse's opening up to foreign investment

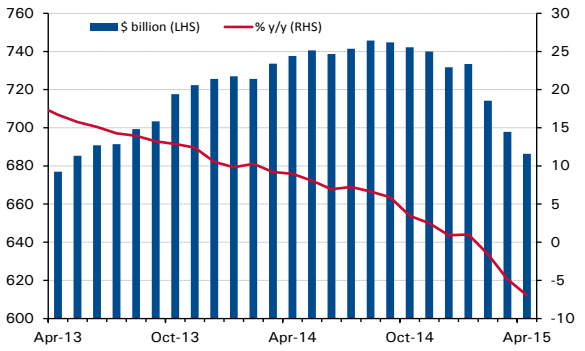
The Saudi stock market has outperformed regional bourses in 2015, with the general index, the Tadawul All-Share Index (TASI), increasing by 14.5% year-to-date (17 June) to 9,543. (Chart 15.) The market has seemingly overcome earlier worries about low oil prices and the kingdom's military intervention in Yemen and instead looked ahead to the potential entry of foreign investors starting from June. Entry of qualified financial investors (QFI) on 15 June should catalyze greater portfolio inflows over time, especially once Saudi equities are included in emerging market indices such as the MSCI.

Chart 12: Current account balance



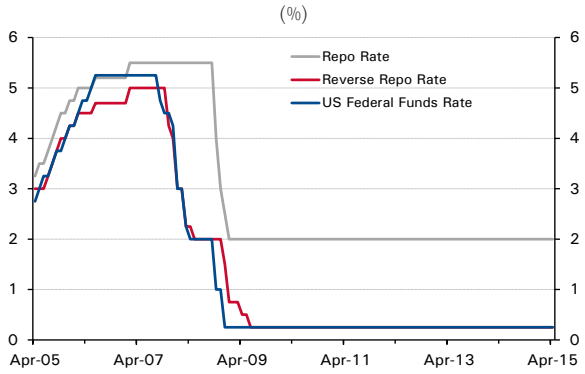
Source: SAMA, * provisional estimates

Chart 13: Foreign reserves



Source: SAMA

Chart 14: Policy rates



Source: SAMA

Chart 15: Tadawul All-Share Index

Source: Thomson Reuters Datastream

UAE outlook

Non-oil sector helps keep economy afloat amid lower oil prices

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Overview and outlook

- Moderate real GDP growth expected thanks to robust non-oil sector. Non-oil GDP growth projected between 5-6% in 2015 and 2016 on stronger tourism, real estate and construction sectors.
- Business sentiment sees a slight boost following the new and much welcomed company law.
- CPI inflation accelerated in 1H15 on higher rental and utility costs; expected to ease in 2H15 and average closer to 3.5% for the year.
- Small fiscal deficit is expected in 2015 on the back of lower oil prices and high spending levels.
- Credit growth remains in recovery mode but constrained by tighter lending restrictions.
- The main stock market indexes have lacked catalysts recently, but remain at relatively high levels.

Steady and firm real GDP growth in non-oil sector

Real economic growth in the UAE is projected to log in moderate rates of 3-4% year-on-year (y/y) in 2015 and 2016, as a strengthening non-oil sector continues to offset weaker oil GDP growth. (Chart 1.)

Oil GDP growth is expected to remain constrained in the near-to-medium term by weak global oil market conditions. Oil GDP is forecast to slow down from 4.0% y/y in 2014 to a mere 0.3% y/y in 2015, and come in flat in 2016. Non-oil sector growth is projected to remain resilient at rates of 5-6% y/y in 2015 and 2016. This sector will continue to be led by the booming tourism, real estate and construction (particularly in transport and hospitality) sectors, especially as the Dubai Expo 2020 draws closer.

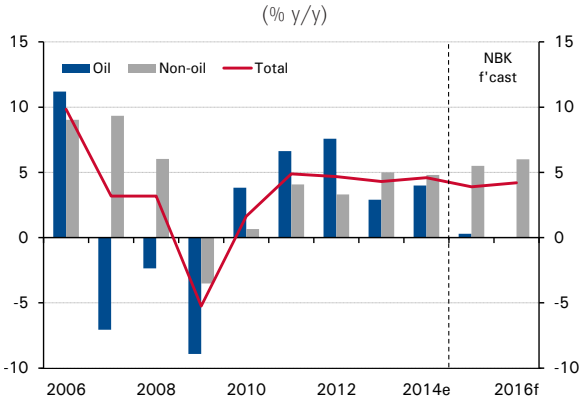
The Markit Purchasing Managers' Index (PMI) maintained its downward trend in June. It fell for the second straight month, from 56.4 in May to 54.7. The headline index was led lower as most components including new orders and output fell during the same period. (Chart 2). The moderation is likely related to the stronger US dollar (and thereby Dirham), affecting Dubai's relatively open economy, and more recently the Ramadan and summer lull. The outlook on both domestic and external demand however, remains strong.

Key economic indicators

		2013	2014	2015f	2016f
Nominal GDP	USD bn	387.2	399.4	359.1	399.7
Real GDP	% y/y	4.3	4.6	3.9	4.2
- Oil	% y/y	2.9	4.0	0.3	0.0
- Non-oil	% y/y	5.0	4.8	5.5	6.0
Inflation	% y/y	1.1	2.3	3.5	3.5
Budget balance	% of GDP	7.2	3.0	-1.3	0.4

Source: Official source, NBK estimates

Chart 1: Real GDP

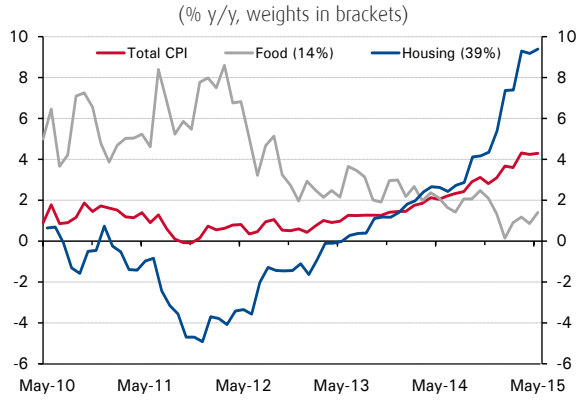


Source: UAE National Bureau of Statistics, NBK estimates

Chart 2: Markit Purchasing Managers' Index

Source: Markit

Chart 3: Consumer price inflation by sector



Source: Thomson Reuters Datastream

The corporate sector is forecast to strongly benefit from the long-awaited changes in the companies' law. One of the changes includes lowering the minimum percentage of equity that a company needs to float, from 55% to 30%. This should lead to an increase in initial public offering (IPO) activity, as the 55% requirement was deemed too high by entrepreneurs reluctant to divest too much from their own businesses. Furthermore, the UAE is also in the final stages of drafting a foreign investment law that would allow 100% foreign ownership of businesses in certain sectors.

Concerns of real estate bubble in Dubai eased further in early 2015

The rate of appreciation in residential property prices in Dubai eased throughout 2014 and early 2015, coming off the alarming highs seen at the end of 2013. The slowdown in residential prices was more pronounced in the second half of 2014. Higher transaction fees, the imposition of mortgage caps and greater housing supply have helped tame price rises. In that environment, sellers became more willing to lower prices to meet buyers' expectations. According to Asteco, a major real estate services company, prices of apartments in Dubai rose by a mere 3% y/y in the first quarter of 2015, while villa prices declined by 5% y/y. (Chart 4.)

Local authorities have reiterated time and again, that they will continue to closely monitor developments in the property sector to prevent "bubbly" conditions. Additional housing stock, together with the strict vigilance exercised by the local authorities, should help prevent a repeat of the exuberant price behaviour witnessed in 2013. According to Asteco, 12,000 apartment units and 2,000 villa units are expected to be delivered in 2015, almost double the estimated number of units that were delivered in 2014.

The appreciation in asset prices, real estate and equity, has helped indebted companies (government-related entities in particular) to repay some debt ahead of schedule, meet their repayment deadlines and/or renegotiate better terms. Debt rollovers have made it easier for some companies to activate and re-activate new projects.

Consumer price inflation accelerated in 1H 2015

Headline inflation has made significant gains in 2015 so far, on higher inflationary pressures from the housing component. In May, inflation in the consumer price index (CPI) climbed to a record high of 4.3% y/y after housing costs (primarily housing rents as well as utility costs) soared by 9.4% y/y. Housing inflation has been on an upward trend since the end of 2013 on the back of a recovering residential property sector. (Chart 3.) The one-off hike in electricity and water tariffs (for both nationals and expatriates) at the start of 2015 and the removal of the rental cap in Abu Dhabi, has also contributed to the acceleration in housing inflation.

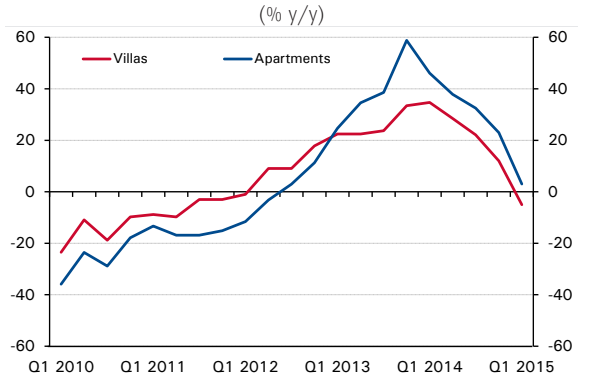
However, upcoming new housing supply and the fading effect of the one-off hike in utility tariffs, should lead to some correction in the housing inflation component.

A stronger US dollar and lower commodity prices are also expected to apply some downward pressure on the headline inflation rate. Still, the acceleration in CPI inflation in 1H15 means we now expect it to average higher in 2015 than our earlier forecast, closer to 3.5%.

Small fiscal deficit expected as spending rises and revenues fall

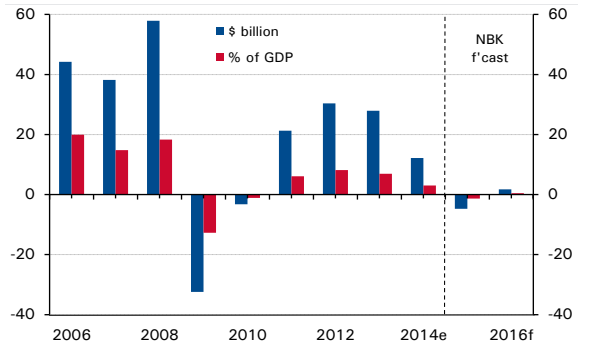
The UAE's 2015 fiscal balance (assuming a breakeven oil price of $70/b)

Chart 4: Residential property sales prices



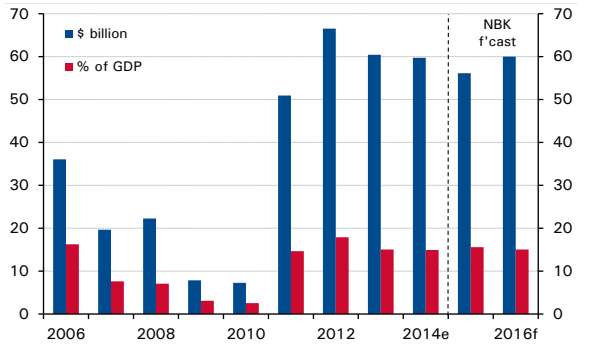
Source: Asteco

Chart 5: Budget balance



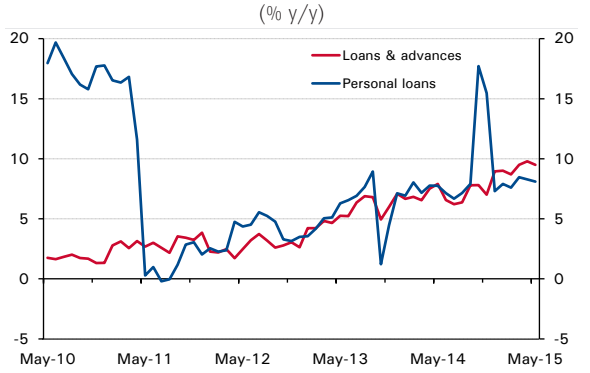
Source: UAE National Bureau of Statistics, NBK estimates

Chart 6: Current account balance



Source: UAE National Bureau of Statistics, NBK estimates

Chart 7: Bank lending



Source: Central Bank of the UAE

is forecast to dip into a slight deficit amidst higher spending levels and lower oil revenues. The fiscal balance is projected to slip from around a surplus of 3% of GDP in 2014, to a deficit of approximately 1.3% in 2015. (Chart 5.) However, with abundant financial reserves, which make up a staggering 200% of GDP, it is unlikely that the UAE economy will engage in significant fiscal consolidation at least in the medium-term. Both Dubai and Abu Dhabi are scheduled to maintain their high levels of public spending. Public spending in Dubai is expected to rise even further in the run-up to the Expo 2020 event and as a large portion of its maturing debt becomes due around the same period.

Should the UAE be pressured to do some fiscal consolidation or budget cuts, then we may see reductions in the subsidy levels (5% of GDP in 2013) and Abu Dhabi federal services (7% of GDP in 2013).

Current account surplus to remain stable over the next two years

The current account surplus is expected to hover around 15% of GDP in 2015 and 2016. Lower oil export earnings and higher imports are projected to be offset by stronger non-oil export earnings, especially from the tourism and real estate sectors. (Chart 6.)

The recent Iran-West nuclear framework, if it leads to an actual agreement and to the removal of sanctions, could be a boon for UAE trade, particularly in the non-oil sector. The UAE is Iran's biggest non-oil trading partner and Iran's biggest source of imported goods.

Bank credit growth remains constrained but continues to recover

Growth in loans & advances and personal loans inched lower in May, but continued to trend upwards on strong non-oil sector activity and a positive economic outlook. Growth in loans & advances eased from 9.8% y/y in April to a still strong 9.5% y/y in May. Personal loan growth also slowed in May, from 8.3% y/y in April to 8.1% y/y. (Chart 7.)

Growth in deposits slowed down quite significantly from 7.2% y/y in April to 4.8% y/y in May. As a result, the loan-to-deposit ratio edged up slightly from 91.9% to 92.4% during the same period.

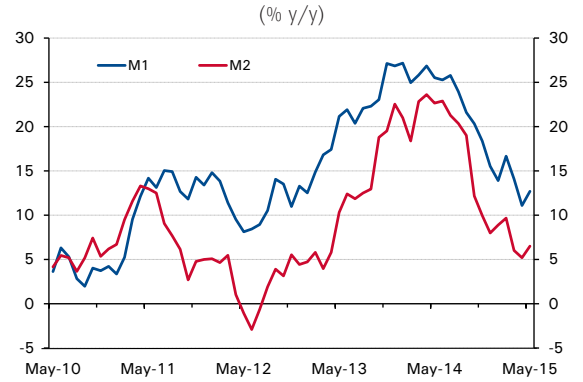
Annual growth in the broad M2 money supply has been trending downwards since mid-2014, mainly due to a high base. (Chat 8.) In May however, we saw a slight uptick, as it rose from 11.1% y/y in April to 12.7% y/y in May. Monetary policy remains accommodative: the UAE's three-month and one-month interbank rates have remained low and below 1% in 2014 and 1H 2015. (Chart 9.)

Market performances remain solid

The main Abu Dhabi and Dubai indices continue to hover at high levels thanks to strong investor confidence. (Chart 10.) The new companies law passed by the UAE government in early April, a potential Iran nuclear deal and possible increase in the foreign ownership limit, further underscored that confidence.

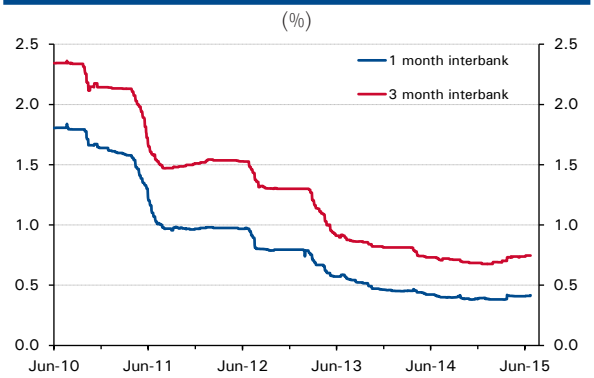
The UAE's safe haven status, improving corporate debt environment and robust economy, have all helped keep investor sentiment afloat. The main credit default swaps, good indications of the level of risk within an economy, have remained relatively low. (Chart 11.) The CDS on five-year Dubai and Abu Dhabi government debt stood at 198 and 60 basis points respectively, at the end of June 2015.

Chart 8: Money supply



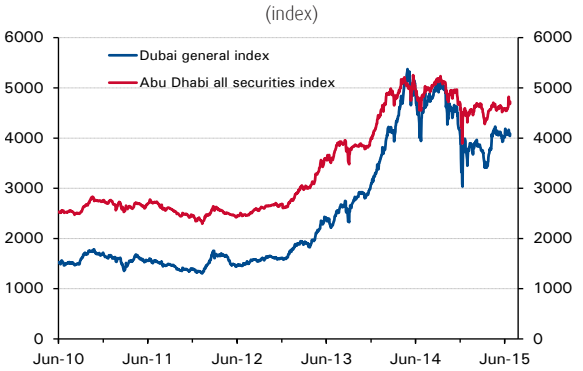
Source: Thomson Reuters Datastream

Chart 9: Interbank rates



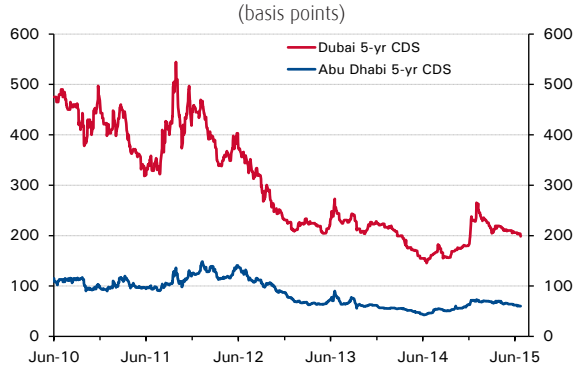
Source: Thomson Reuters Datastream

Chart 10: Stock market indices



Source: Thomson Reuters Datastream

Chart 11: Credit default swaps



Source: Thomson Reuters Datastream

Egypt outlook

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Economic growth fastest since revolution, vulnerabilities remain

Overview and outlook

- Economic activity is picking up, with the pace of real growth expected to reach 4.3-4.5% in FY14/15 and FY15/16.
- Improved political stability, GCC financial support and a government-led investment initiative has been driving the recovery.
- Fiscal sustainability in the medium term remains a concern, though fiscal reforms are moving forward.
- Pressure on the external position is still a challenge to the pound's USD-peg, though GCC official support has been critical.

The acceleration in economic growth appears to have been sustained despite a soft patch in 1Q15. The pace of real growth is set to surpass 4% for the first time since 2010, boosted by a more stable political environment, financial support from GCC allies and improving business confidence. A strong public sector investment drive has been a key source of growth, with a number of government-led capital spending initiatives underway (including the expanded Suez Canal).

Various recent data support the recovery story, including real GDP growth, the Purchasing Managers' Index (PMI), private credit growth and employment. While some of these figures, including the PMI, have shown some softness in 1Q15, the overall picture continues to indicate a gradual recovery in economic activity. Private credit in particular has been strong, with growth in real terms rising to its highest level in over seven years.

The risks for Egypt remain significant, though they have been receding. While the political and security situation has improved significantly, they remain somewhat vulnerable. The other uncertainty is the country's large fiscal deficit which has yet to improve despite some subsidy reforms implemented a year ago. Large GCC donations have helped shore up public finances, but those are unlikely to be sustained in the medium term. Still, markets remain confident that authorities are taking the necessary reform steps, with Egypt's recent USD bond issuance a good example of that.

Recovery has been picking up pace

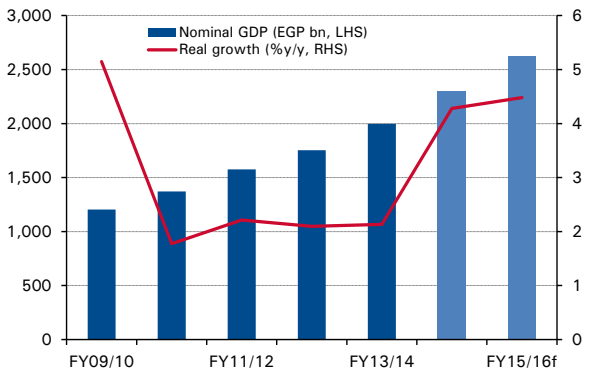
Economic growth has continued to improve in recent months. Real GDP growth accelerated to 4.3% year-on-year (y/y) in 4Q14 and for 2014 as a

Key economic indicators

		FY12/13	FY13/14	FY14/15f	FY15/16f
Nominal GDP	EGP bn	1,753	1,998	2,307	2,635
Nominal GDP	USD bn	268	286	312	338
Real GDP growth	% y/y	2.1	2.1	4.3	4.5
Inflation	% y/y	9.8	8.2	13.0	9.0
Budget balance	% of GDP	-13.6	-12.3	-12.0	-11.0

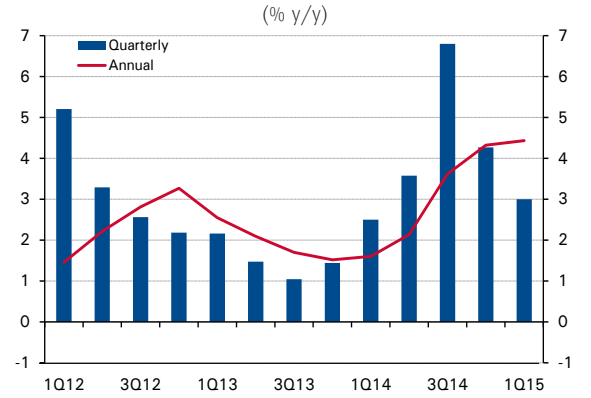
Source: Central Bank of Egypt, Ministry of Finance, Ministry of Planning, NBK estimates

Chart 1: GDP



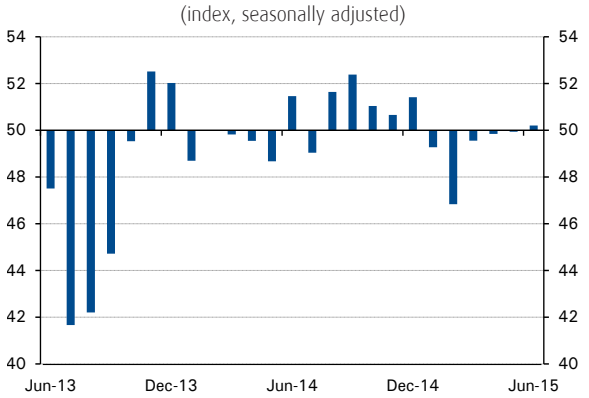
Source: Ministry of Planning, NBK estimates

Chart 2: Real GDP



Source: Ministry of Planning, Thomson Reuters Datastream

Chart 3: Purchasing Managers' Index



Source: Markit

whole. More recent data indicate that the economic recovery remains on track despite some softness in 1Q15. Growth is expected to come in at 4.3-4.5% in FY14/15. In FY15/16, we think growth will maintain this pace before improving further thereafter.

Improving activity has been led by robust private sector growth. Private sector growth accelerated to 6.6% in 2014, approaching pre-Arab Spring levels. The numbers benefited from strong basis effects in 3Q14, particularly in the tourism sector.

Investment spending has also been picking up, though levels remain subdued. Aggregate investment (nominal) rose by 20% in 2014, with nearly half of the growth coming from the private sector. Aggregate investment rose to around 13.5% of GDP during 2014, up marginally from 12.9% in 2013. By comparison, investment before the Arab Spring averaged a higher 20% of GDP.

An investor conference in March 2015 in Sharm El-Sheikh was a resounding success and should provide further support to investment as well as to external reserves. Investment initiatives of around $175 billion were announced, most of those to be implemented within five years. An additional $6 billion in CBE (Central Bank of Egypt) deposits were also pledged by GCC allies, to provide much needed short term support. The bulk of investment plans were in oil & gas ($21 billion), power generation ($43 billion) and urban development ($58 billion).

Credit growth has also been accelerating, seeing its strongest month in nearly five years in March 2015. The pace has picked up to 16.2% y/y. When adjusted for Egypt's relatively high inflation rate, credit grew by 5.8% y/y, the fastest pace in over seven years. Growth in lending to the corporate sector has been particularly strong thus far in 2015 compared to a year ago.

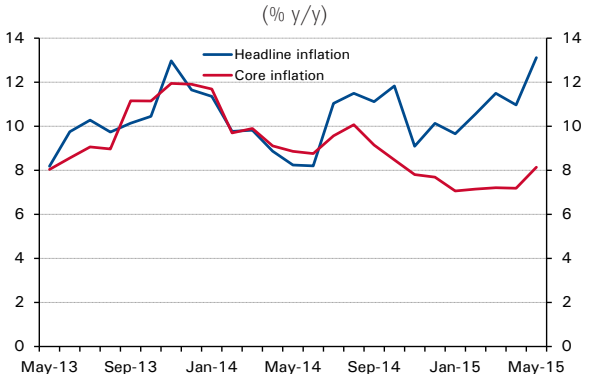
Markit's Purchasing Managers' Index (PMI) has shown some softness in 1Q15, but this appears to be temporary. The index fell below the critical 50 mark in January and remained there for several months. Though the index improved to 50.2 by June compared to a low of 46.8 seen in February, it remained weaker than most of the second half of 2014. According to the survey, activity in exports and tourism was hit by insecurity in Libya and weakness from Russia.

Tourism and construction activity bore the brunt of 1Q15 weakness. Indeed, while tourism has recovered from 2013 lows, the sector has more lately been weighed down by domestic and regional security concerns and a weak euro (keeping Europeans at bay). The number of tourists during 1Q15 rose by only 6.9% compared to double digit growth in 2014. More importantly, tourist-nights actually dropped by 8.4% y/y during the first three months of 2015. Figures in March alone were more upbeat, indicating the slump may have passed.

Manufacturing has been a key source of growth

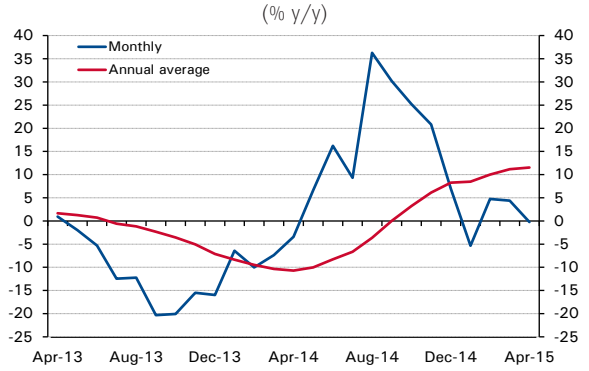
Manufacturing has been the main engine of growth over the last year. The sector, which accounts for around a fifth of GDP and includes oil refining, saw growth accelerate to 16% in 2014 and contributed more than half of the gain in output. Other growing sectors include hotels and restaurants, real estate services, construction, and retail trade.

Chart 4: Consumer price inflation



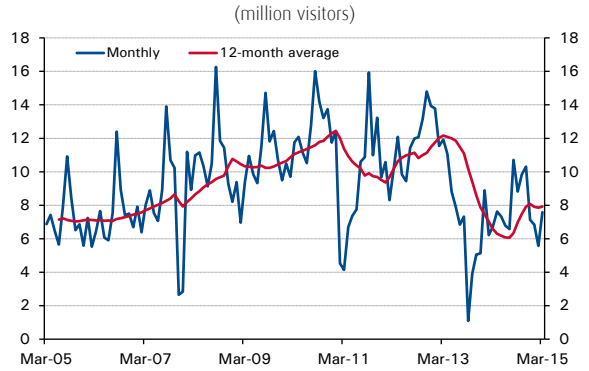
Source: Central Bank of Egypt, Thomson Reuters Datastream

Chart 5: Production index



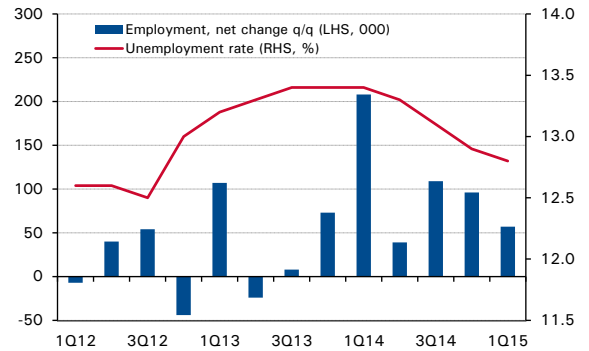
Source: Ministry of Planning, Thomson Reuters Datastream

Chart 6: Tourism



Source: CAPMAS, Thomson Reuters Datastream

Chart 7: Employment



Source: CAPMAS, Thomson Reuters Datastream

Inflation has been higher on EGP devaluation

Inflation has accelerated over the last year. The government's move to raise fuel prices in mid-2014, as it sought to cut subsidies, was partly responsible for higher prices. However, the devaluation of the pound earlier this year led, once again, to inflationary pressures. Inflation rose to 13.1% y/y in May 2015 compared to a low of 8.2% y/y a year before. Inflation is expected to peak around mid-2015 before easing thereafter.

Fiscal deficit remains high despite reform hopes

The budget deficit remains a key risk to the outlook. Egypt's fiscal position has deteriorated further over the last year, widening to a 12-month trailing 13.7% of GDP through April 2015; the comparable figure a year ago was 10.8%. The figure is expected to narrow somewhat by the end of the FY14/15 fiscal year in June 2015, to around 12.5% of GDP.

Spending growth has continued to outpace growth in revenues. Spending has risen to over 34% of GDP, up as much as six percentage points since 2010. Meanwhile, revenues (excluding grants) have dropped from 20% of GDP to around 18%. There does not appear to have been a turnaround in trend over the last two years in either.

Grants provided by GCC allies have offered some relief since mid-2013, but those have declined over the last few months. They accounted for as much as 4.8% of GDP in FY13/14, but have declined to 2.3% in the last 12 months through April 2015 and are likely to decline further in FY15/16.

The current government is committed to fiscal reforms, as revealed by last year's fuel price hikes. Further subsidy reform is expected, including the introduction of a fuel ration card. The government also plans to take steps to boost revenues with measures such as a value-added-tax (VAT). However, the recent scrapping of new taxes on dividends and capital gains means some critical fiscal reform will be delayed.

External pressures have receded, though imbalances remain

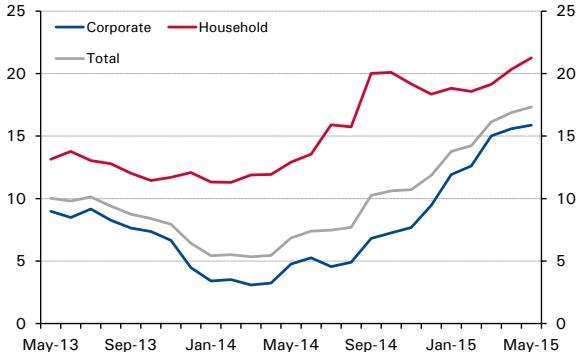
The current account deficit has deteriorated through 1Q15 largely on a decline in official transfers, though weaker oil exports and strong import growth were also to blame. While Egypt continues to benefit from GCC deposits at the CBE, grants to the government have declined. The deficit widened to 3.4% of GDP on a 12-month trailing basis, its worst level in two years.

Egypt's trade balance widened by 25% over the last year through March 2015 as a result of solid imports growth and a decline in oil exports. At the same time, official transfers have virtually gone to zero (they accounted for 3.6% of GDP a year ago). While growth in service receipts (which include tourism revenues) and worker remittances has been healthy, they only offset some of the deterioration in the trade balance.

Higher foreign direct investment (FDI) has helped shore up Egypt's external position. FDI rose to its highest quarterly level since 2008 in 1Q15, helping to offset some of the deterioration in the current account. Egypt is expected to continue to benefit from higher FDI on the heels of the March investor conference. Indeed, Siemens recently signed a $9 billion project for a wind farm. However, FDI levels remain far below pre-2009 levels.

Chart 8: Private credit

(% y/y)



Source: Central Bank of Egypt, Thomson Reuters Datastream

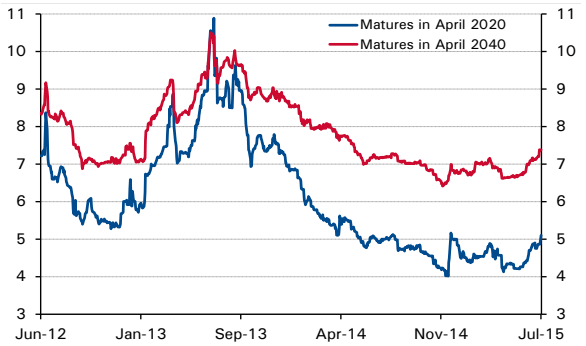
Chart 9: Fiscal balance

(% of GDP, 12-month trailing)

Source: Ministry of Finance, Thomson Reuters Datastream

Chart 10: USD sovereign bond yeilds

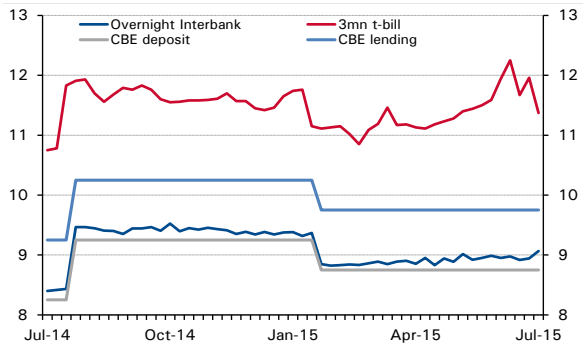
(%)



Source: Thomson Reuters Datastream

Chart 11: Interest rates

(%, weekly)



Source: Central bank of Egypt, Thomson Reuters Datastream

Foreign currency bond yields and CDS sustain declines

Country risk has remained contained as reflected by the decline in Egypt's sovereign yields. Yields on USD denominated sovereign debt due in 2020 and 2040 have been sable at relatively low levels, reaching 4.6% and 6.9%, respectively, in early June 2015. The country's credit default swap (CDS) has also been relatively stable at just over 300 basis points.

Official reserves are stable, supporting the pound

Official reserves held by the CBE have increased in recent months, thanks largely to a $6 billion deposit by GCC allies in April 2015. Reserves stood at $19.6 billion by the end of May 2015, or around 3.6 months of imports. Official support, capital controls, and a decline in the value of the pound in January helped reduce the pressure on reserves.

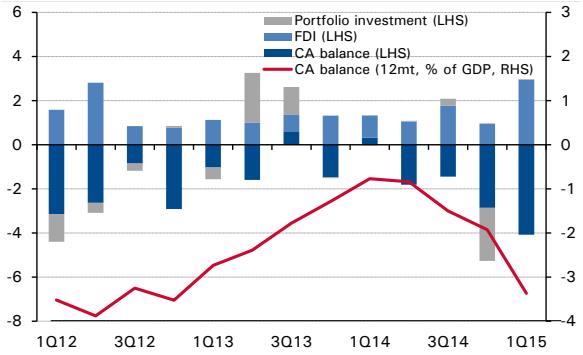
The CBE allowed the Egyptian pound (EGP) to depreciate against the US dollar in February and again in early July. The moves helped counter the strength of the dollar over the last year, which has seen the pound gain against all other currencies. Even after the recent devaluations, the pound remains up on trade-weighted terms compared to a year ago. According to the JP Morgan EGP index, the pound was still up 6.3% y/y in early July 2015.

Stock market underperformed thus far in 2015

After a strong 2014, Egypt's stock market has underperformed since it peaked in January 2015. The MSCI total return index was down by nearly 4.7% through June 2015. Softer economic data in 1Q15 and the new capital gains tax appear to have weighed on equities.

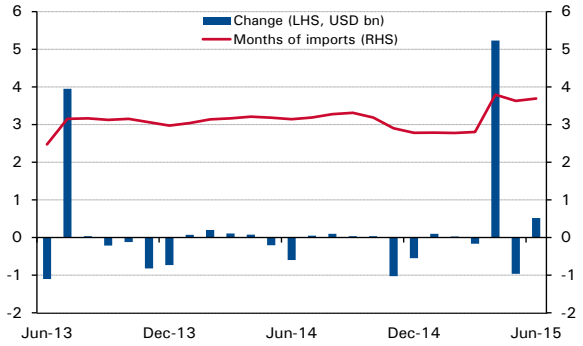
Chart 12: Balance of payments

(LHS: USD billion; RHS: % of GDP)



Source: Central Bank of Egypt, Thomson Reuters Datastream

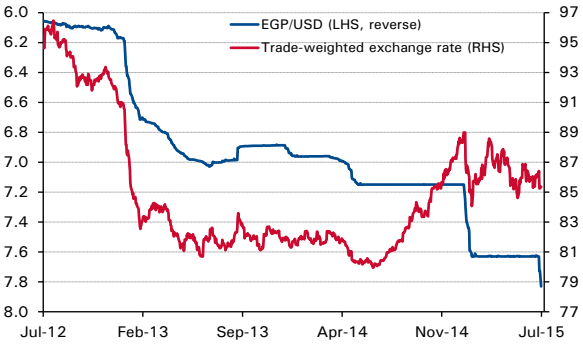
Chart 13: Official reserves



Source: Central Bank of Egypt, Thomson Reuters Datastream

Chart 14: Exchange rate

(LHS; EGP/USD; RHS: index)



Source: Thomson Reuters Datastream

Chart 15: Stock exchange

(EGX30)

Source: Thomson Reuters Datastream

Regional economic data and forecasts

	Unit	2010	2011	2012	2013	2014	2015f	2016f
Bahrain								
Nominal GDP	USD bn	25.6	29.1	30.6	32.8	33.8	30.4	32.7
Real GDP	% y/y	4.3	2.1	3.4	5.6	4.5	1.8	2.6
Oil sector	% y/y	0.1	3.6	-8.5	15.3	3.0	-2.8	0.0
Non-oil sector	% y/y	5.5	1.4	6.9	3.3	4.9	3.0	3.2
Budget balance	% of GDP	-4.8	-0.3	-2.0	-3.1	-4.7	-15.5	-12.5
Current account balance	% of GDP	3.0	11.1	7.2	7.8	5.9	-1.8	0.8
Inflation	% y/y	2.0	-0.4	2.8	3.2	2.7	3.0	3.0
Kuwait								
Nominal GDP	USD bn	115.5	154.0	174.2	176.0	167.9	119.4	133.8
Real GDP	% y/y	-2.4	9.6	6.6	1.5	0.8	0.9	1.6
Oil sector	% y/y	-1.1	15.6	10.3	-0.8	-1.9	-1.6	-0.7
Non-oil sector	% y/y	-4.1	1.0	0.6	5.6	5.4	5.0	5.0
Budget balance	% of GDP	16.1	31.1	26.0	25.9	8.1	-3.9	0.1
Current account balance	% of GDP	32.0	43.6	45.3	40.5	31.7	11.5	13.9
Inflation	% y/y	5.3	4.7	2.8	2.7	3.0	3.4	3.5
Oman								
Nominal GDP	USD bn	5.8	69.4	77.4	78.2	77.8	65.5	74.6
Real GDP	% y/y	4.8	0.9	5.8	4.6	3.5	4.0	3.7
Oil sector	% y/y	5.4	2.0	3.8	2.8	-0.2	0.9	0.7
Non-oil sector	% y/y	4.3	-0.1	7.4	6.2	6.6	6.3	5.9
Budget balance	% of GDP	3.6	7.4	0.5	1.6	7.1	-13.8	-8.6
Current account balance	% of GDP	8.6	12.9	10.1	3.3	2.1	-11.8	-1.1
Inflation	% y/y	3.3	4.0	2.9	1.1	1.1	1.0	2.5
Qatar								
Nominal GDP	USD bn	125.2	171.4	189.8	203.2	212.2	186.2	210.1
Real GDP	% y/y	16.7	13.0	6.2	6.4	5.9	6.7	6.4
Oil sector	% y/y	28.9	15.6	1.3	0.2	-1.5	1.4	0.4
Non-oil sector	% y/y	8.6	10.9	10.1	10.8	11.5	9.9	9.8
Budget balance	% of GDP	2.7	7.7	11.3	15.6	10.7	1.8	2.2
Current account balance	% of GDP	19.1	30.3	32.5	30.8	25.8	4.4	3.1
Inflation	% y/y	-2.4	1.9	1.9	3.1	3.0	2.1	2.6
Saudi Arabia								
Nominal GDP	USD bn	526.8	669.5	733.9	744.3	746.2	672.0	723.1
Real GDP	% y/y	98.9	10.0	5.4	2.7	3.5	3.2	3.0
Oil sector	% y/y	312.6	13.3	5.2	-1.5	0.7	1.9	1.2
Non-oil sector	% y/y	46.0	7.6	5.6	5.7	5.3	4.0	4.1
Budget balance	% of GDP	4.4	11.6	13.6	6.5	-2.3	-20.9	-14.6
Current account balance	% of GDP	13.9	15.0	14.5	13.9	12.7	10.2	10.7
Inflation	% y/y	3.8	3.7	2.9	3.5	2.7	2.1	2.6
UAE								
Nominal GDP	USD bn	286.1	348.5	373.4	387.2	399.4	359.1	399.7
Real GDP	% y/y	1.6	5.2	6.9	4.3	4.6	3.9	4.2
Oil sector	% y/y	3.8	6.6	7.6	2.9	4.0	0.3	0.0
Non-oil sector	% y/y	0.7	4.5	6.6	5.0	4.8	5.5	6.0
Budget balance	% of GDP	-1.1	6.1	8.1	7.2	3.0	-1.3	0.4
Current account balance	% of GDP	2.5	14.6	17.8	15.6	15.0	15.6	15.0
Inflation	% y/y	0.9	0.8	0.7	1.1	2.0	3.5	3.5
Egypt (fiscal year)								
Nominal GDP	USD bn	234.5	261.7	267.9	285.9	311.5	337.3	372.0
Real GDP	% y/y	1.8	2.2	2.1	2.1	4.3	4.5	5.0
Private sector	% y/y	1.3	2.4	3.0	2.9	NA	NA	NA
Public sector	% y/y	3.0	2.0	0.6	0.8	NA	NA	NA
Budget balance	% of GDP	-10.0	-10.6	-13.6	-12.3	-12.0	-11.0	-8.4
Current account balance	% of GDP	-2.6	-3.9	-2.4	-0.8	NA	NA	NA
Inflation	% y/y	11.8	7.3	9.8	8.2	13.0	9.0	8.0

International data

	Unit	2010	2011	2012	2013	2014	2015f	2016f
Brent crude oil spot price (year average)	USD p/b	79.5	111.2	111.6	108.7	99.0	55.0	65.0
CRB commodity price index	Index	520.3	482.0	484.1	457.3	437.8	-	-
Eur/USD	1$ = €	0.747	0.773	0.758	0.736	0.83	-	-
US Fed Fund Rate	%	0.25	0.25	0.25	0.25	0.25	-	-
MSCI World stock market index	Index	1,280	1,183	1,339	1,661	1,729.9	-	-
World real GDP (IMF)	% y/y	5.4	4.2	3.4	3.4	3.4	3.3	3.8
MENA real GDP (IMF)	% y/y	5.1	4.5	4.9	2.3	2.4	2.7	3.7

Source: Thomson Reuters Datastream, official sources, NBK estimates

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