Economic Update
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Macroeconomic outlook

Qatar: Non-oil activity cools but public investment to continue to drive growth

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Overview and outlook

- **Growth is forecast to slow to 2.9% in 2016 from 3.5% in 2015 due to further cooling in non-hydrocarbon sector activity.**
- **Non-hydrocarbon sector growth should average 5.5% y/y in 2017-18 and remain supported by government spending.**
- **Qatar is expected to post its first fiscal deficit in years, of around -5.0% of GDP this year, despite laudable efforts at fiscal consolidation.**
- **Domestic and external debt issuance is helping the government plug the fiscal shortfall but also causing public debt to rise.**
- **Overall credit growth is slowly rebounding (11.2% y/y in Oct) but private sector credit activity is lagging.**
- **Non-resident deposit inflows have supported total bank deposit growth (7.4% y/y in Oct), but liquidity remains tight, with the LD ratio up at almost 119% and interbank rates still elevated at 1.8%.**
- **Qatari equities were buoyed by the OPEC supply cut deal, but concerns linger over corporate earnings and tighter liquidity.**

Qatari economic growth continues to slow as the effects of the oil price downturn filter beyond the oil and gas sectors and into the non-hydrocarbon sector. Government spending, the lynchpin of the economy, is expected to contract in 2016 for the second year in a row while the authorities continue their fiscal consolidation, merging ministries, scaling back infrastructure projects and cutting subsidies on domestic fuel and utilities in a bid to contain a widening fiscal deficit. Spending will still remain elevated by historical standards, however, helping to support infrastructure development and diversification and meet the country's Vision 2030 and World Cup 2022 goals. Fiscal deficits will continue to be financed primarily through bond issuance, pushing central government debt well above 50% of GDP. With the outlook for oil prices improving in 2017-2018, bank credit and deposit growth are also expected to pick up by 2018 and liquidity constraints to ease somewhat, though banks' reliance on foreign deposits and rising borrowing costs represent near-term challenges.

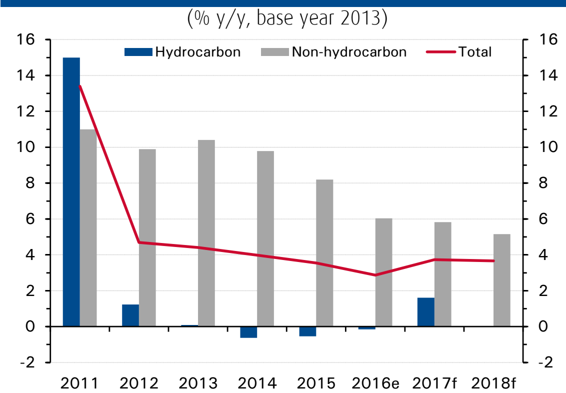
Table: Key economic indicators

		2015	2016e	2017f	2018f
Nominal GDP	$ bn	164.6	161.1	183.1	199.7
Real GDP	% y/y	3.5	2.9	3.7	3.7
- Oil	% y/y	-0.5	-0.2	1.6	2.1
- Non-oil	% y/y	8.2	6.0	5.8	5.2
Consumer price inflation	% y/y	1.9	2.9	2.3	3.4
Budget balance	% GDP	1.3	-5.0	-2.6	-1.7

Source: Official sources, NBK estimates

Chart 1: Real GDP

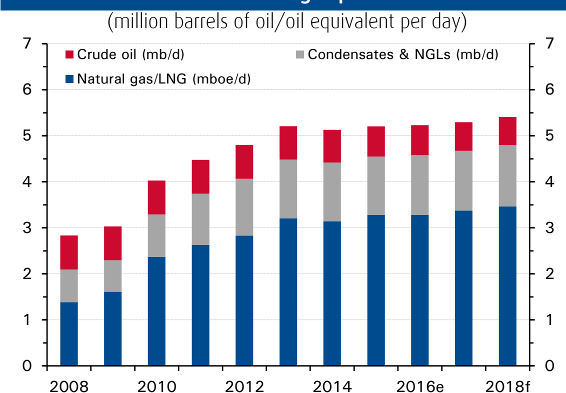
(% y/y, base year 2013)



Source: Ministry of Development Planning & Stats (MDP&S), NBK est.

Chart 2: Oil and gas production

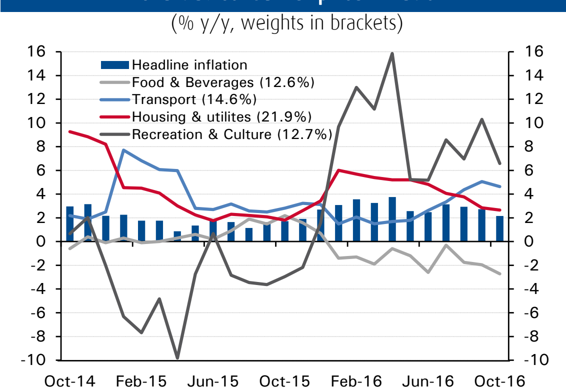
(million barrels of oil/oil equivalent per day)



Source: JODI, BP, OPEC, NBK estimates

Chart 3: Consumer price inflation

(% y/y, weights in brackets)



Source: MDP&S

Non-oil economy cools on tighter government investment spending; hydrocarbon sector gains limited to the launch of the Barzan facility

Following the full completion of Qatar's LNG facilities in 2011-12, economic growth in the country has largely been driven by expansion in the non-hydrocarbon sector, with government infrastructure investment the key driver. Led by average annual double-digit increases in the construction, manufacturing, financial services and trade and tourism sectors over the last five years, the non-hydrocarbon sector has grown by an impressive 10% y/y on average since 2011. This is easily the most robust growth in the GCC. With the oil price decline most pronounced in 2015, however, non-hydrocarbon growth moderated to 8.2% as the government pared back capital spending; projects, especially non-essential and non-FIFA-related, were streamlined, downgraded or cancelled altogether in an effort to maintain a tighter grip on spending. High profile infrastructure projects such as the Lusail Mixed-Use Development ($45 billion), the Qatar Integrated Railway ($40 billion), the Ashghal local roads and drainage program ($14.6 billion) and the new Hamad Port ($7.4 billion) are far too integral to Qatar's $200 billion development plan and have thus largely been spared. The cost-cutting exercise should reach its full extent in 2016 before the authorities loosen the purse strings somewhat in 2017-2018 in line with an expected rebound in oil prices and hence oil revenues. Non-hydrocarbon growth will likely moderate over the forecast period and average 5.5% y/y. (Chart 1.)

Meanwhile, sources of potential growth in the hydrocarbon sector will be limited to the full commissioning of the $10.3 billion Barzan gas production facility; the attainment of maximum LNG output capacity and continued declines in crude oil production from the country's ageing oil fields. Crude production was down to 0.65 mb/d in 2016, having reached as high as 0.85 mb/d in 2007. (Chart 2.)

However, the Barzan facility, which is expected to produce up to 1.4 billion cubic feet per day (bcf/d) of natural gas mainly for domestic power and water consumption, has been delayed, pushing back the expected output gains for the hydrocarbon sector to 2017 and 2018. Real output is therefore expected to contract in 2016, by -0.2%, before rising in 2017 and 2018, by 1.6% and 2.1%, respectively. (See Chart 1.)

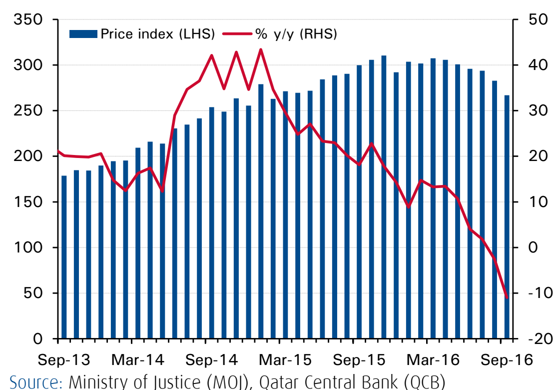
Headline inflation moderates due to deflation in food and rental prices; transport costs expected to pick up as subsidies withdrawn

Inflation in the consumer price index (CPI) eased in 2016 due to declines in international food and commodity prices as well as falling domestic rental costs. And this came despite the rise in transportation costs in 2016 (14.6% of CPI basket) which followed the government's hike in gasoline prices (cut to energy subsidies). Headline inflation fell to 2.2% y/y last October, having been as high as 3.3% y/y the previous February following the fuel hikes. (Chart 3.) December 2016 saw another round of fuel price increases as the government stepped up its efforts to equalize domestic and international fuel prices.

Meanwhile, inflation in the housing, water and electricity component of the CPI (21.9% of the CPI) slowed during 2016, from a high of 6.0% in February to a low of 2.7% y/y in October; the housing market is currently experiencing oversupply, triggering the moderation in rental inflation. The trend is echoed in the falling value of properties, with the country's real estate price index (REPI) showing a decline of -11.0% y/y by the end of 3Q16. (Chart 4.)

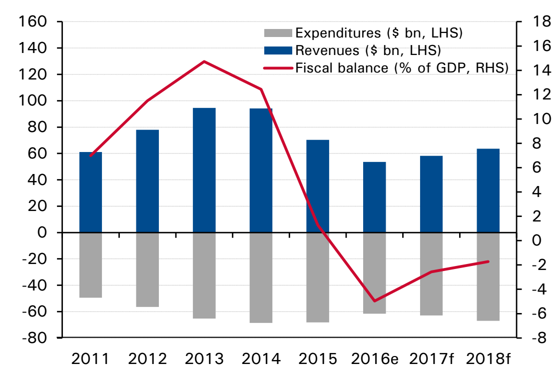
Looking ahead, we expect headline inflation to slow further from an

Chart 4: Real estate price index



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

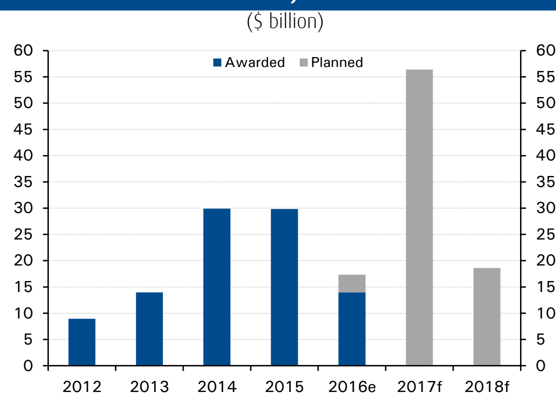
Chart 5: Fiscal balance



Source: QCB, NBK estimates

Chart 6: Project awards

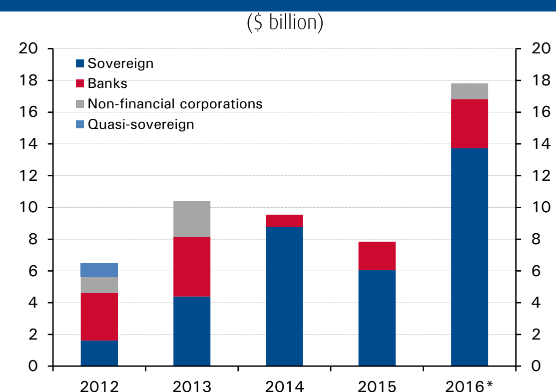
($ billion)



Source: MEED Projects, *as of 13 December 2016

Chart 7: Bonds & Sukuk issuance

($ billion)



Source: Thomson Reuters Zawya, *as of 6 December 2016

expected 2.9% in 2016 to 2.3% in 2017 before rising to 3.4% in 2018 in line with an improvement in economic growth.

Qatar's first fiscal deficit in 16 years is expected in 2016 despite laudable efforts to control spending

Sharply reduced oil and gas revenues since 2014 (-30% y/y on average) have motivated the authorities to embark on a concerted round of fiscal consolidation. But this will not be enough to forestall Qatar's first fiscal deficit, equivalent to -5.0% of GDP, in 2016. (Chart 5.) Nevertheless, the government's efforts to get a handle on spending have not been in vain: current expenditures have been curtailed through a combination of cuts in the number of ministries, lay-offs of expatriates and freezes in public sector pay; subsidies on fuel, water and electricity have all been reduced; and non-essential infrastructure projects have been scaled back or shelved entirely. According to MEED Projects, the value of projects awarded in 2016 dropped by 53%, from $29.8 billion in 2015 to $13.9 billion in 2016. (Chart 6.) As a result, 2016 could see total expenditures contract by as much as -9.7% y/y, the biggest cut in years. The deficit is expected to narrow in 2017 to -2.6% of GDP and in 2018 to -1.7% of GDP thanks to rising energy prices and revenues.

The government has tapped the debt markets, increasing the public debt

The government has increasingly sought to shift the burden of deficit financing away from its foreign reserves and towards the debt markets, where it actively participated to the tune of $13.7 billion in 2016. (Chart 7.) The largest sovereign issuance was a $9.0 billion triple-tranche USD-denominated international bond in May. Along with $4.7 billion in sovereign domestic bonds and sukuk plus a $5.0 billion syndicated loan secured earlier in the year, recourse to the debt markets has helped Qatar's finances and injected much-needed liquidity into the banking system.

In spite of rising debt issuance, the country's international reserves continued to decline. In the year to October 2016, net international reserves were down by $2.7 billion to $34.1 billion. (Chart 8.) The reserves are estimated to provide the equivalent of 6.7 months of import cover, which is more than twice the 3 months recommended by the IMF for fixed exchange-rate regimes.

Gross government debt (domestic and external debt) is projected to increase from an expected 60% of GDP in 2016 to 68.6% of GDP by end-2018. (Chart 9.)

Fiscal buffers appear sufficient for the time being, however, given that the government could also draw on an estimated $335 billion worth of assets under management at the Qatar Investment Authority (QIA), the country's sovereign wealth fund.

Credit growth boosted by public sector financing demands but reduced deposit flows have led to a tightening in bank liquidity

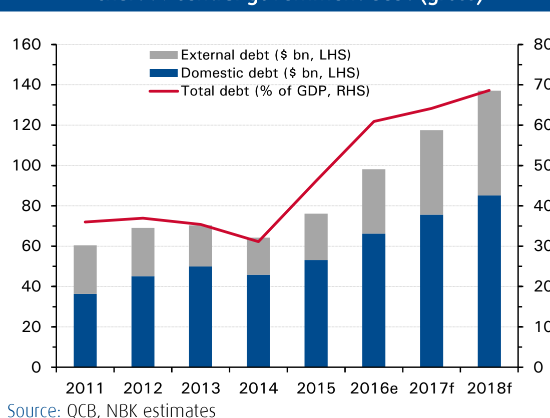
In 2016, total credit growth rebounded from the single digit lows of early 2015 to come in at a robust 11.2% y/y last October. (Chart 10.) Much of this was driven by the public sector (+16% y/y) as the government rekindled its appetite for bank credit.

In contrast, private sector credit growth was on a downward trajectory for much of 2016, slowing to 7.7% y/y last October. Demand from industry, contractors and retail consumers has been especially weak for much of

Chart 8: International reserves (net)

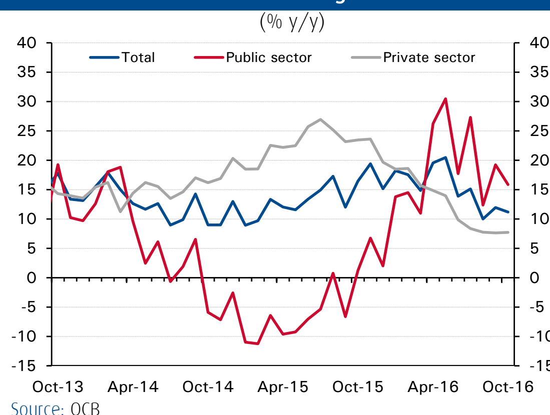
Source: QCB

Chart 9: Central government debt (gross)



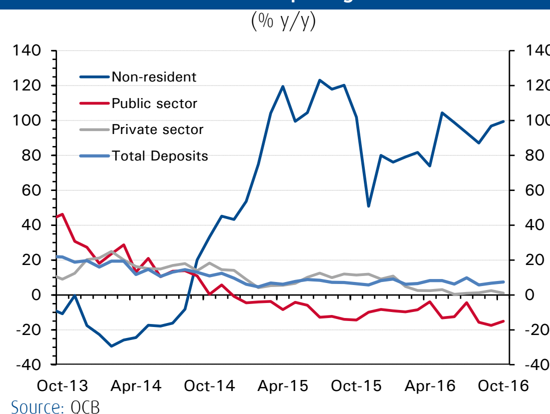
Source: QCB, NBK estimates

Chart 10: Credit growth



Source: QCB

Chart 11: Deposit growth



Source: QCB

the year as the effects of the oil price downturn filter through into the consumer sector and as the demand for further real estate projects recedes.

Meanwhile, deposit flows into the banking system, especially government-related deposits, have been hit hard by the decline in oil prices since mid-2014. As of last October, deposit growth looked to be improving, however, rising to 7.4% y/y, mainly on the back of increased non-resident deposit inflows, which almost doubled y/y. Private sector deposits were up only 1.1% y/y, while the public sector deposit base was still 15% smaller than a year earlier. (Chart 11.)

With deposit growth trailing credit growth, tight liquidity in the Qatari banking sector has been a key concern. The sector's loan-to-deposit ratio (LD) reached 118.7% in October, close to February's high of 119.9%, and interbank rates were still relatively elevated by the end of December at around 1.8% for the 3-month QIBOR (Chart 12.)

Given that deposits from non-residents (mainly from the GCC and Asia) in the banking system have almost doubled in the span of a year and that monies due from Qatari banks to overseas banks have increased by almost 24%, concerns about over-reliance by Qatari banks on foreign funds have once more resurfaced. Indeed, the net foreign liability position of Qatari banks was up at $43.8 billion in October, equivalent to 166.0% of foreign assets, which is a record high. (Chart 13.)

The QCB follows the US Fed's lead and raises its benchmark rates by 25 bps in 2016

In view of the riyal's peg to the US dollar, Qatari domestic interest rates tend to be closely aligned with US interest rates. Following the US Fed's lead, the Qatar Central Bank (QCB) finally raised its benchmark lending and deposit rates by 25 bps on 15 December to 4.75% and 1.0%, respectively; the QCB had resisted raising its rates in December 2015 when the US Fed began normalizing monetary policy. (Chart 14.)

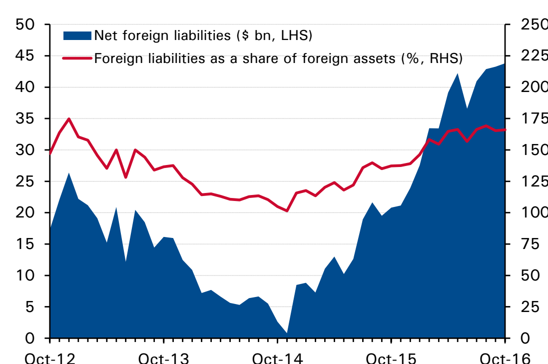
Qatari equities buoyed by higher oil prices but corporate earnings and liquidity concerns linger

Qatar's benchmark stock index, the Qatar Exchange Index (QE), had a topsy-turvy 2016, reaching a high of 11,408 in mid-August (+9.4% since the start of the year) ahead of its inclusion in the FTSE Emerging Markets Index before falling to a low of 9,636 (-7.6% since the start of 2016) at the end of November as market sentiment turned noticeably less bullish in response to a combination of weaker-than-expected corporate earnings and banking sector liquidity worries. (Chart 15.) The index was back up to 10,436 on 30 December (+0.07% since the start of 2016), buoyed by November's OPEC output cut deal, which gave oil prices a major boost.

Chart 12: Interbank rates (QIBOR)

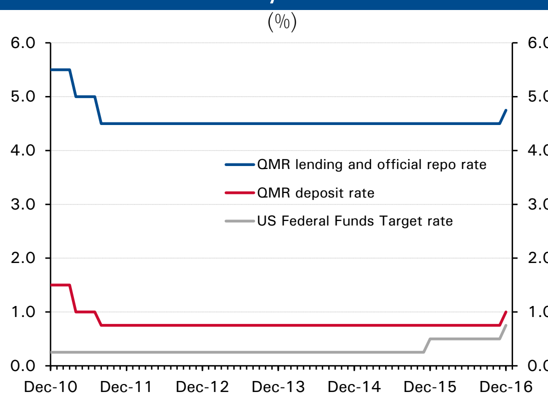
Source: Thomson Reuters Datastream

Chart 13: Banks' foreign liabilities



Source: QCB

Chart 14: Key interest rates



Source: QCB

Chart 15: Qatar Exchange

Source: Thomson Reuters Datastream

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