samba سامبا

Report Series

February 2010

GCC 2010 Outlook

Highlights

- Having stagnated at just under 1 percent in 2009, GCC real GDP growth is projected to rebound to 5 percent in 2010 as the benefits of stronger oil prices, a recovery in world growth and trade, and sustained domestic fiscal stimulus, feeds through. In addition, after contractions in 2009, a positive contribution by the regions' dominant hydrocarbons sectors will provide a major impetus to growth.

- The strength of GCC public finances will return as a theme in 2010 as we project that oil prices will hold on to recent gains to average $75/b, boosting fiscal and current account surpluses, and adding to the region's large external assets. Total GCC budget spending is likely to increase by 14 percent this year to a record $354 billion, as governments' continue to pursue expansionary fiscal policies.

- With GCC governments pushing ahead with their infrastructure investments, project activity will pick up, aided by improving access to capital markets and the slow return of bank financing. Private sector investment may be slower to recover given lingering concerns in some real estate and corporate sectors, as well as still strained, albeit improving, credit availability.

- GCC domestic credit growth fell sharply in 2009 as liquidity tightened and banks became increasingly risk averse in the face of rising non performing loans and deflated asset prices. However, the outlook for 2010 is more promising. With a stronger economic backdrop and improving liquidity, confidence and risk appetite should revive. In addition, GCC banks start the year well capitalized and well provisioned, providing a sound basis for growth.

- We do not expect a change in GCC exchange rate pegs, and thus anticipate a continuation of loose monetary policy in 2010 in line with our expectations for the US. As with the United States, we expect inflation will be muted in the GCC (3.5 percent), and consequently do not foresee a return of the exchange rate pressures that emerged in 2007-08 when GCC and US policy needs and business cycles were out of synch.

- From a macroeconomic perspective the foundations are in place for a sustained improvement in GCC equities during 2010, although markets may need time to assimilate the impact of Dubai's debt restructurings. It thus may not be until the second half of the year that GCC stock markets fully reflect the stronger economic environment and supportive policy stance.

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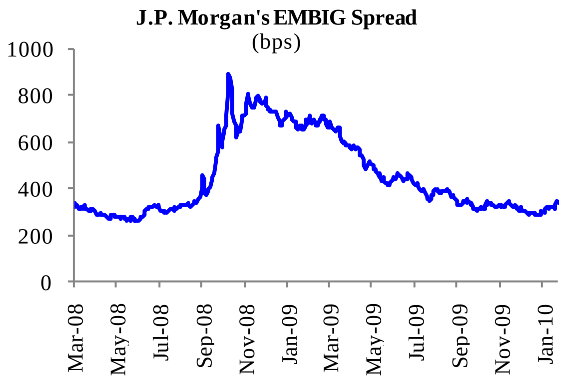
GCC: Key Macro Indicators and Forecasts					
Saudi Arabia	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	3.2	3.4	4.2	0.2	3.7
Nominal GDP ($ billion)	356.6	378.8	465.0	368.2	415.9
CPI (ave. % change)	2.2	4.1	9.9	4.4	4.0
Budget Balance (% GDP)	21.0	12.3	33.3	-3.0	-2.8
Current Account Balance (% GDP)	27.7	24.9	29.0	5.6	5.4
Oil production (mb/d)	9.15	8.72	9.12	8.08	8.20
Population (million)	23.7	24.2	24.8	25.4	26.0
UAE	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	9.4	7.4	7.4	-1.1	2.0
Nominal GDP ($ billion)	170.1	198.7	272.7	216.6	235.7
CPI (ave. % change)	9.3	11.1	12.3	1.5	2.0
Budget Balance (% GDP)	28.6	25.0	30.4	1.9	5.8
Current Account Balance (% GDP)	21.8	18.6	10.4	2.8	6.1
Oil production (mb/d)	2.53	2.52	2.55	2.25	2.33
Population (million)	4.2	4.5	4.8	4.6	4.6
Kuwait	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	6.3	4.5	5.6	-1.5	3.0
Nominal GDP ($ billion)	101.6	112.0	136.3	100.0	120.2
CPI (ave. % change)	3.1	5.5	9.7	4.0	4.5
Budget Balance (% GDP)	30.3	29.3	10.0	25.0	30.0
Current Account Balance (% GDP)	50.7	42.4	49.1	25.0	30.0
Oil production (mb/d)	2.54	2.44	2.57	2.26	2.30
Population (million)	2.8	2.9	3.0	3.0	3.0
Qatar	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	15.0	15.3	19.6	9.4	18.1
Nominal GDP ($ billion)	56.8	71.0	100.4	85.0	115.9
CPI (ave. % change)	11.8	13.7	15.2	-4.5	3.5
Budget Balance (% GDP)	9.0	11.8	8.5	2.0	6.2
Current Account Balance (% GDP)	30.6	30.1	27.0	9.7	21.8
Oil production (mb/d)	0.82	0.81	0.84	0.77	0.82
Population (million)	1.0	1.2	1.5	1.5	1.5
Oman	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	5.9	7.2	12.3	3.7	6.0
Nominal GDP ($ billion)	35.7	41.6	60.0	54.0	63.0
CPI (ave. % change)	3.4	5.9	12.6	3.6	4.0
Budget Balance (% GDP)	14.2	13.7	9.6	0.0	4.0
Current Account Balance (% GDP)	14.2	4.8	5.4	-6.0	0.0
Oil production (mb/d)	0.66	0.66	0.66	0.71	0.74
Population (million)	2.5	2.6	2.7	2.7	2.7
Bahrain	**2006**	**2007e**	**2008e**	**2009f**	**2010f**
Real GDP Growth (% change)	6.7	8.1	5.4	0.5	1.8
Nominal GDP ($ billion)	15.8	17.5	20.0	17.0	21.0
CPI (ave. % change)	2.1	3.3	5.5	2.5	2.5
Budget Balance (% GDP)	5.6	3.2	7.0	-4.0	-1.0
Current Account Balance (% GDP)	13.8	16.6	20.1	2.0	4.0
Oil production (mb/d)	0.18	0.18	0.18	0.18	0.18
Population (million)	0.7	0.8	0.8	0.8	0.8

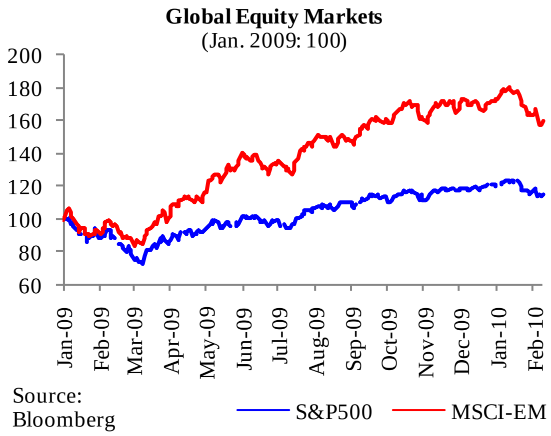
Source: IMF, IIF, National Accounts, Samba

World Economic Outlook	2009e	2010f	2011f
Real GDP growth (percent, annual)			
World	-0.6	3.8	3.7
US	-2.4	2.0	1.7
Japan	-5.3	1.8	1.2
Euro area	-3.9	1.2	1.3
Emerging Markets	2.4	5.9	6.0
Official policy rate (end period)			
US	0.25	0.25	1.25
Japan	0.10	0.10	0.50
Euro area	1.00	1.00	2.50
($/b, period average)			
WTI crude oil price	62.0	75.0	85.0

Source: Samba estimates and forecasts



Source: Bloomberg



Source: Bloomberg

Global Environment

A muted global recovery

We believe that the global economy is now through its trough and activity is expected to gather pace over the next six months. The relative health of emerging markets, allied to the healing of OECD credit markets and an associated rebound in trade, should allow for a moderate bounce-back in economic activity during the first half of 2010. However, much of the impetus for the recent upturn in activity in the OECD has been driven by the massive monetary and fiscal stimuli undertaken in 2008-09. Once these measures have run their course (and many are "one-off" in nature) then activity might begin to slow again as we move into the second half of 2010. In addition, some household and corporate debt is still large and global deleveraging still has some way to run. High levels of unemployment are also likely to persist, weighing on consumption and investment activity, and dampening the prospects for a robust recovery in autonomous (not-policy-induced) private demand. However, although there may be bumps along the way, we expect that world growth will recover to 3.8 percent in 2010, led by emerging markets, but will likely stall at around this level through 2011.

Financial markets are likely to be volatile

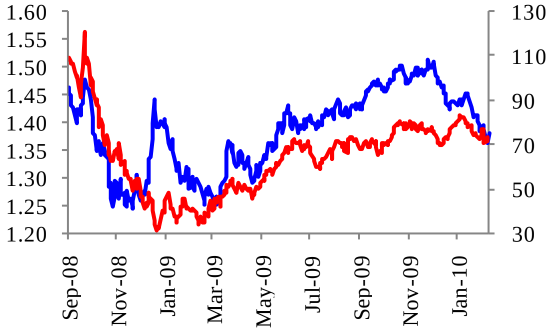
After a strong recovery during 2009, financial markets initially weakened at the start of 2010, reflecting in part concerns about whether economic activity will be vibrant enough to support a further increase in asset prices. Weaker growth could represent a major drag on financial institutions, compounding the problems they face with legacy assets. Also, the timing and form of central banks' exit from extremely accommodative policy, as well as the increasing burden of public debt, is weighing on investors' minds. A premature exit could endanger the global recovery while a delayed exit could encourage excessive risk taking. Looking ahead, we expect global equity markets to act in a more schizophrenic manner to the ups and downs in reporting of economic activity, alternating between worrying about deflation and inflation risks. However, despite the unprecedented amounts of monetary stimulus provided by central banks and recent signs of rising prices throughout the world, we believe that inflation should not be an issue this year.

Implications for the GCC

The events of the last 18 months have shown that the GCC economies have become increasingly integrated into the global economy. The region is thus likely to be affected by fluctuating sentiment in global markets during the year, including oil markets which have become closely correlated with global equities and the value of the US dollar.

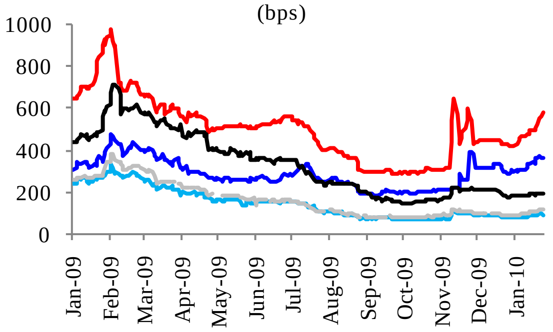
Oil prices: Supported by financial 'investors' oil prices staged a dramatic recovery during 2009 to average $62/b (albeit down 38 percent over 2008), despite weak fundamentals. Prices started 2010 in a volatile fashion, see sawing between $73-83/b in January/February, and this volatility is likely to

Eur/USD vs. Oil Prices



Source: Bloomberg

GCC: 5-Year CDS
(bps)



Source: Bloomberg

Ratings			
	Moody's	S&P	Fitch
Saudi	A1	AA-	AA-
UAE	Aa2	NR	NR
Abu Dhabi	Aa2	AA	AA
Qatar	Aa2	AA-	NR
Kuwait	Aa2	AA-	AA
Oman	A2	A	NR
Bahrain	A2	A	A

NR: not rated; Source: Ratings Agencies

continue as market sentiment on the global economy fluctuates. However, although downside risks remain, we expect that prices will hold on to recent gains to average $75/b in 2010 supported by the global recovery. Our price projection also assumes that OPEC continues to exercise output restraint in the face of still relatively weak oil demand, and large crude and products inventory (for more details see our report 2010 Oil Market Outlook and Implications for the GCC). This will dampen the expected growth recovery in the oil sectors of GCC members subject to OPEC quotas – Saudi, UAE, Kuwait and Qatar.

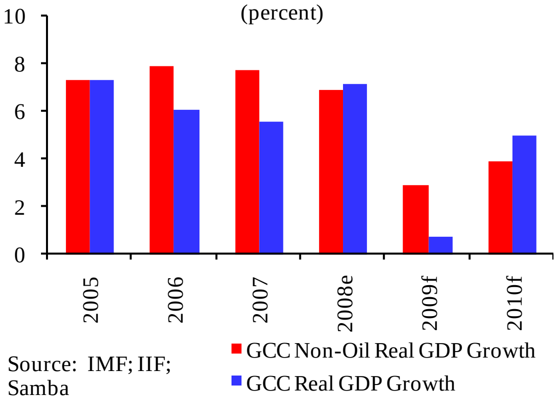
Capital flows: The GCC has benefited from a return of global risk appetite, the rally in equity markets, a decline in credit spreads, and the reopening of capital markets. Select GCC sovereigns and quasi sovereigns (Abu Dhabi, Qatar, Bahrain) were some of the most active issuers in the bond markets in late 2009, and Sukuk issuance has also revived. However, continued deleveraging by global banks is limiting the scope for a revival in cross border bank financing. This will dampen prospects for the GCC which is reliant on bank funding, particularly for large scale projects. In addition, regional concerns, such as corporate and bank defaults, real estate corrections and, most prominently, the proposed debt restructuring at government-owned Dubai World (DW), have led to a number of GCC corporate and bank downgrades by ratings agencies. This has the potential to dampen investor sentiment and stall the trend of improving capital market access by GCC entities, as well as raise financing costs. A well received resolution to the DW restructuring would do much to improve market sentiment.

Risk perception: In line with the recovery in financial markets and oil prices, market perceptions of risk in the GCC have improved strongly. CDS rates for GCC sovereigns have fallen back sharply from their highs 12 months ago, although concerns over Dubai's debt have led to a moderate uptick since mid-January, and CDS rates on Dubai are back over 550. In addition, while GCC sovereign credit ratings remain very strong, the uncertainty of sovereign support for the GCC's many government related entities (GREs) precipitated by the DW debt restructuring, has had an adverse impact on corporate ratings, mainly in the UAE. Many of these remain under review as ratings agencies re-evaluate their government support assumptions, and assess whether current ratings are appropriate, particularly as most are rated either at the sovereign level or benefit from very high support assumptions.

US monetary policy: We expect US inflation will remain in check, in large part due to widespread excess capacity and weak labour markets, and thus think it unlikely that the Federal Reserve will raise its federal funds rate in 2010. However, we do expect it will end quantitative easing. Given the exchange rate pegs to the US dollar, GCC monetary policy will similarly remain loose which will be helpful to the region's economic recovery.

Key risk is a double dip recession: The main risk facing the GCC is that of a stalling in global growth. This would result in lower oil prices and would likely prompt another sell off in global equity markets, and a tightening in credit markets. Growth prospects in the GCC would suffer as a result,

GCC: Real Economic Growth
(percent)



Source: IMF; IIF; Samba

although sustained government spending, drawing on large external assets, would help ensure that current positive momentum was sustained.

GCC Key Macro Indicators and Forecasts	2006	2007	2008	2009e	2010f
Real GDP Growth (% change)	6.1	5.6	7.2	0.8	5.0
Nominal GDP ($ billion)	736.7	819.6	1,054.4	840.8	971.7
CPI (ave. % change)	4.7	6.7	11.1	2.6	3.5
Budget Balance (% GDP)	22.5	17.7	25.3	2.3	4.9
Current Account Balance (% GDP)	28.6	25.1	25.1	6.8	10.2
Oil production (mb/d)	15.88	15.33	15.92	14.25	14.57
Population (million)	34.9	36.2	37.5	38.0	38.7

Source: IMF, IIF, National Accounts, Samba

Economic Developments and Outlook

GCC economies showed resilience in 2009

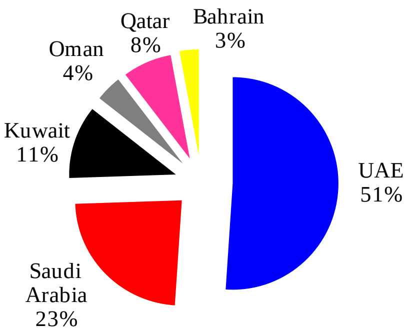
The GCC as a whole managed to weather the global slowdown reasonably well in 2009, posting an estimated real GDP growth rate of just under 1 percent. Key to this resilience was the robust policy response by GCC governments who pumped liquidity and support into regional banking systems to offset the sharp decline in capital flows and asset values. They also adopted strong counter cyclical fiscal policies, raising public spending to counter the slump in private sector activity. In this they were aided by recovering oil prices during the year which allowed most to also continue running fiscal and current account surpluses. As a result non-oil GDP growth was sustained helping moderate the negative impact of the steep drop in oil production and revenues as OPEC quotas were cut and annual average oil prices declined.

GCC Oil production				
m b/d	2007	2008	2009e	2010f
Saudi	8.72	9.12	8.08	8.20
Kuwait	2.44	2.57	2.26	2.30
UAE	2.52	2.55	2.25	2.33
Qatar	0.81	0.84	0.77	0.82
Oman	0.66	0.66	0.71	0.74
Bahrain	0.18	0.18	0.18	0.18
GCC	15.33	15.92	14.26	14.57

Source: PFC, Samba

Stand out performers in 2009 were Qatar and Oman which posted estimated growth rates of 9.4 and 3.7 percent, respectively. In contrast to the rest of the GCC, both countries benefited from positive growth in their hydrocarbons sectors. Surging LNG output in Qatar offset a decline in oil production while, not being constrained by OPEC quotas, Oman was able to continue to raise its oil output. Despite bearing the largest burden in terms of oil production cuts, Saudi Arabia's extremely strong fiscal policy response enabled real GDP remain in positive territory at 0.2 percent. This was not the case in Kuwait and the UAE where reduced oil production, combined with problems in their financial and real estate sectors, as well as debt issues in Dubai, resulted in GDP contractions. Bahrain's more diversified economy managed to post estimated growth of 0.5 percent.

GCC: $2.8 trillion Project Pipeline

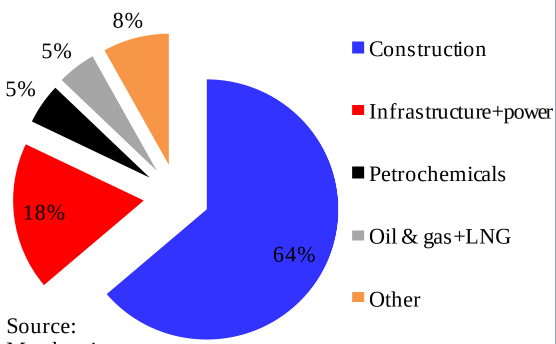


Source: MeedProjects

Growth should rebound to 5 percent in 2010

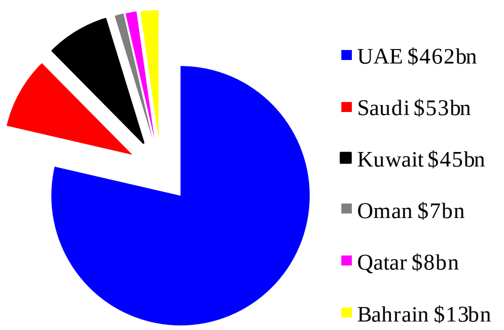
Prospects for 2010 are largely positive. With oil prices projected to average $75/b, GCC economies will be flush with revenues which can be used to finance the economic transformations currently underway. Announced

GCC: $2.8 Trillion Project Pipeline



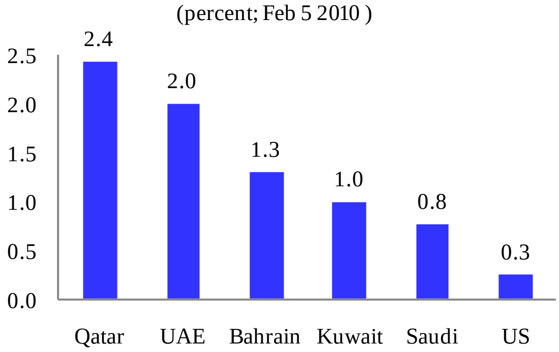
Source: Meedprojects

GCC projects on hold: $588.1 bn



Source: MeedProjects

GCC: 3M Interbank Rates
(percent; Feb 5 2010)



Source: Bloomberg

budgets in the region confirm the intentions of GCC governments to actively pursue their development and diversification agendas, with large spending planned on infrastructure projects. Although the scope to raise oil output will be limited for OPEC members given the still weak market fundamentals, some moderate production gains combined with increasing investment activity will ensure a return to oil sector growth.

Meanwhile growth in the non-oil sector is likely to pick up in response to the improving global environment and the sustained fiscal stimulus. However, it may take some time for private sector activity to fully recover. Lingering problems remain in some real estate and corporate sectors. In many cases consumer balance sheets are still stretched, and credit availability is likely to continue to be somewhat strained, curtailing prospects for private investment. Nonetheless, in most cases the situation will be measurably better than last year, and overall we expect a strong rebound in GCC real GDP growth to 5 percent in 2010. This figure is significantly boosted by our 18.1 percent projection for Qatar, which is driven by further scheduled large increases in LNG output. We also expect Oman to grow by 6 percent as additional oil output gains combine with sustained growth in its non-oil sector. While the dominant economy, Saudi Arabia, should rebound to grow by close to 4 percent, growth in the UAE will be held back by the ongoing problems in Dubai, where corporate deleveraging and restructuring against a backdrop of weak property prices and constrained credit will dampen prospects.

Project activity will pick-up

With project financing severely squeezed in 2009 as a result of the global credit crunch, many GCC governments began to shift priority infrastructure developments more fully into the public sector domain, particularly in Saudi Arabia. This should ensure financing, either directly or through capital markets - the Qatar and Abu Dhabi governments issued bonds worth $10 billion and $3 billion respectively in the latter part of 2009 to help fund planned projects. In addition, we believe there will be a slow but steady return of international bank financing, although this will initially focus on extremely strong project sponsors with government backing, such as the recent international bank financing component for Saudi Aramco's Jubail refinery project. More generally, greater attention will be paid to the viability of projects, particularly those in real estate, and the nature of any assumed government support for project sponsors.

Data from Meedprojects show that the GCC project pipeline remains ambitious, with an estimated $2.8 trillion of projects scheduled. Of this only a relatively limited 21 percent are on hold. The majority of these being construction projects in the UAE which has suffered most from a sharp real estate correction and its heavy reliance on borrowed funds. Elsewhere project activity should revive as public sector work picks up and private project sponsors, and their financiers, regain their confidence as economic growth recovers.

Box 1: GCC Real Estate Stabilization before Recovery

Available statistics from local financial institutions, international real estate firms, and press reports suggest that GCC real estate markets should stabilise in 2010. Given the extent of the correction so far, which has been deeper and faster than in developed countries, this is a view we share as improving economic conditions and liquidity should help put a floor under prices this year. In addition, anecdotal evidence and project data suggests that the oversupply being anticipated in some GCC real estate sectors is likely to be stretched out over the next few years on account of completion delays and project cancellations. That said, circumstances will vary between individual countries and emirates, with Dubai most at risk from further real estate weakness.

UAE: According to Colliers, house prices in Dubai have fallen 52 percent from their peak, but have been relatively stable since the second quarter of 2009. However, given the weak outlook for the Dubai economy this year there remains a risk that prices could still take another step down. Abu Dhabi's real estate correction has been less pronounced – figures suggest a 37 percent drop from their peak. As in Dubai, the supply of new residential accommodation has been curtailed which, combined with already high occupancy rates, stronger macroeconomic fundamentals and better investor sentiments, should set a floor on prices this year.

Saudi Arabia: Available information suggest that residential sales activity declined in 2009, with some location specific adverse impact on prices, but that rents held up; inflation data for 2009 imply that the rental component continued to rise during the year. Given the large and growing indigenous population, current shortage of housing, the improving economy, and anticipated introduction of a mortgage law, we expect to see some uptick in prices this year. However, office space appears to be in oversupply. Colliers estimates average office rental rates dropped between 7-17 percent throughout the kingdom in 2009, and projects a further decline of around 8 percent this year.

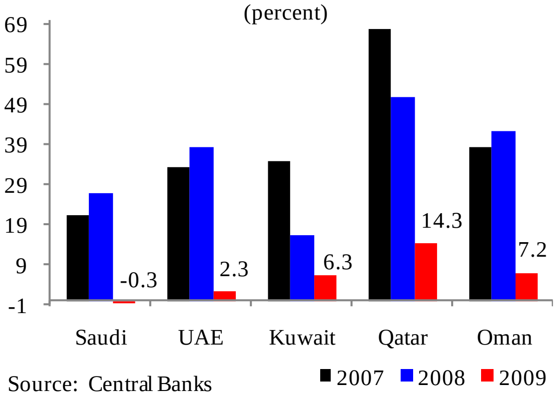
Qatar: Available reports suggest that house prices have fallen 30-40 percent from their peak, and there is some concern that a surge in both residential and office supply could stall any recovery this year, despite strong economic growth and expectations of sustained population growth. The outlook is somewhat mixed, but we believe that prices will stabilise this year.

Kuwait: According to research by local equity houses, the number of real estate transactions has declined by 65 percent, while values are down 62 percent, compared to peak levels in April 2008. However, by November 2009 markets were showing some signs of stabilizing, and local papers report that the consensus is for a recovery in 2010.

Bahrain: The Bahrain Real Estate Association has reported that real estate prices have fallen 10-15 percent from their peak levels. Local research suggests that while residential and office sales may still face downward pressure in 2010, rentals should hold steady given tight credit conditions that will make buying difficult.

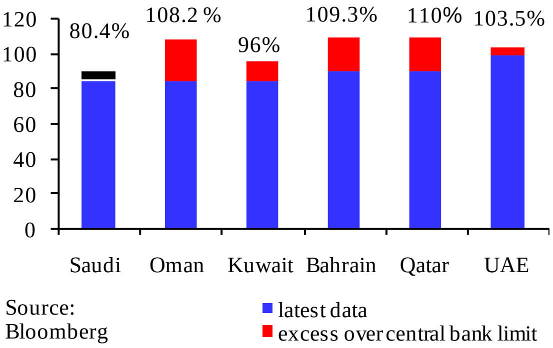
Oman: Reports indicate that strong endogenous demand helped prevent a significant decline in real estate prices last year despite tighter credit conditions. A similar trend is expected in 2010, although financing availability should improve and prices are likely to stabilise. Rents meanwhile continue to trend up.

GCC: Credit Growth
(percent)



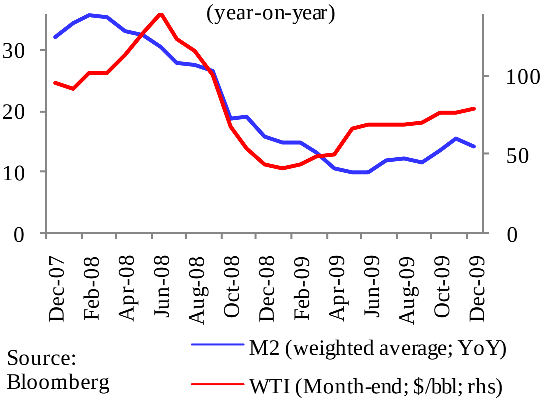
Source: Central Banks

Except in Saudi, aggregate bank loan/deposit ratios still breach regulatory limits



Source: Bloomberg

GCC: Money Supply Growth
(year-on-year)



Source: Bloomberg

Credit growth and liquidity are set to improve

Despite strong government intervention and support to banks (see Box), domestic credit growth fell sharply in the GCC during 2009 as liquidity tightened in response to the global credit crunch, and banks became increasingly risk adverse in the face of rising NPLs and deflated asset prices. Tighter bank lending conditions, combined with corporate and individual deleveraging, caused annual credit growth to drop to low single digits for all but Qatar, where credit grew by 14.3 percent. In contrast, credit growth essentially stagnated in Saudi Arabia, with central bank data showing a contraction of 0.3 percent in 2009.

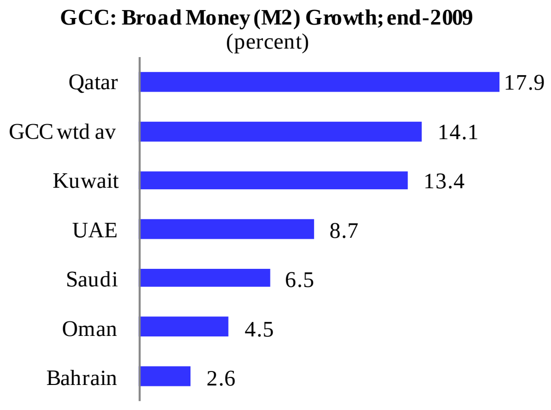
The outlook for 2010 is more promising as GCC governments spend increasing oil revenues and capital inflows improve – although banks' access to international wholesale funding markets may remain tight until the second half of the year. With a stronger economic backdrop, confidence and risk appetite should also recover. GCC banks start 2010 well capitalized and well provisioned providing a sound basis for growth. Interbank rates remain relatively low, although the UAE has seen a recent uptick due to concerns over debt restructuring, while rates in Qatar remain comparatively elevated given the authorities' decision to maintain higher policy rates in the face of previously soaring credit growth.

However, banks will continue to face some headwinds. With the notable exception of Saudi Arabia, aggregate loan to deposit ratios remain high and, while deposit growth is expected to strengthen, this may continue to hold back lending activity. Balance sheet strains could also remain an issue for some, particularly in Dubai where the DW restructuring still needs to be completed, and deleveraging will continue. Nonetheless, while we think that domestic credit growth will remain subdued in the UAE during 2010, it should strengthen to double digits in the rest of the GCC.

We expect that broad money growth in the GCC will revive this year in line with our assumption that average oil prices will be higher. Having surged to between 20-60 percent during 2008 when oil prices peaked, M2 growth rates fell steeply in 2009, even turning negative for a brief period in Qatar. However, having bottomed out in the second quarter of last year, growth rates have been picking up, with the GCC weighted average rising by around 15 percent at year end. We expect this trend will continue with GCC countries posting broad money growth rates of between 10-20 percent in 2010.

GCC inflation will increase moderately

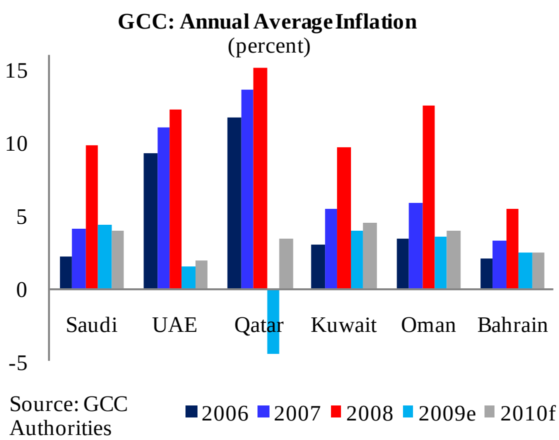
Having fallen steeply from 11.1 percent in 2009 to 2.5 percent in 2009, the rate of inflation in the GCC is expected to pick up again this year. However, the increase is likely to be mild, to 3.5 percent, and we do not expect to see a return to the exceptional rates of 2007-08. While GCC economies are projected to recover, aggregate demand growth will be modest, and credit growth comparatively restrained despite the accommodative monetary policy stance. In addition, after the sharp downturn in activity last year, capacity



Source: Bloomberg

Consumer Price Index Weights		
Percent	**Rents**	**Food**
Saudi	18	26
Kuwait	19	36
UAE	39	14
Qatar	31	13
Oman	15	30
Bahrain	26	20

Source: official statistics



Source: GCC Authorities

Box 2: GCC Liquidity Measures taken by Central Banks and Governments

Saudi Arabia: Interest rates have been cut, the reserve requirement has been lowered to 7 percent from 13 percent, $2-3 billion has been injected into the banking system in the form of dollar deposits, all bank deposits have been guaranteed, and the government extended $2.7 billion in credit to low income citizens having difficulty accessing loans.

UAE: Interest rates have been cut, the central bank has provided a $13.6 billion short term liquidity facility, allowed banks to withdraw up to 100 percent of their central bank reserves, and introduced a dollar swap facility. The government has guaranteed all deposits and interbank lending for three years, and injected $19 billion in the form of long-term bank deposits, with the option to convert into a loan to boost Tier 2 capital. The two largest mortgage finance companies have been merged and taken over by the federal government. The Abu Dhabi government has injected new capital worth $4.4 billion into five of its banks. A proposal to offer a federal government guarantee for bonds and medium-term notes issued by local banks is under consideration.

Kuwait: Interest rates have been cut, the central bank has injected funds into the banking system in the form of short-term deposits, the regulatory loan to deposit ratio has been raised from 80 to 85 percent, all bank deposits have been guaranteed, the rights issue in Gulf Bank was underwritten by the government, and the Kuwait Investment Authority has pumped cash into the stock exchange to help stabilize markets. In March 2009 the government approved a $5.2 billion Financial Stabilization law including a government guarantee of 50 percent of new loans extended by banks to local firms over two years, and a 15-year guarantee against any fall in banks' investment and real estate assets. Other measures allow the KIA to support banks that cannot raise fresh capital.

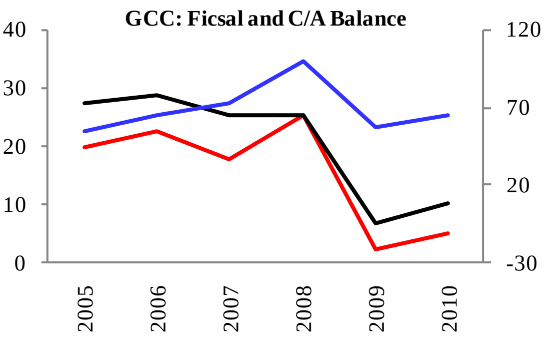
Qatar: Interest rates have been cut, the QIA is spending $5.3 billion on 10-20 percent of the capital of Qatari banks listed on the Doha stock market; $1.2 billion on buying listed shares within the investment portfolio of local banks to bolster their books after a collapse the stock market, and $4.1 billion on acquiring the real estate portfolios of nine local banks.

Bahrain: Interest rates have been cut, a new dollar swap facility introduced and the deposit guarantee scheme is to be raised to a maximum of 20,000 dinars ($53,000) from 15,000 dinars.

Oman: Interest rates have been cut, the reserve requirement was reduced from 8 to 5 percent, the loan to deposit ratio held at 85 percent rather than cut as planned to 82.5 percent. The central bank is lending $2 billion to banks to provide dollar liquidity, and the government has created a $390 million market stabilization fund to invest in local shares.

constraints have eased considerably in the region, particularly in real estate sectors.

Rents account for a large share of GCC consumer price indices (CPI) and thus developments in real estate have a major bearing on inflationary developments. This was clearly evident in Qatar and the UAE during 2009 when inflation dropped sharply (turning to deflation in Qatar) in line with the



Source: IMF; IIF; Samba

GCC: Budget Oil Price Assumptions				
$/bbl	**2007**	**2008**	**2009**	**2010**
Saudi	40	55	40	57
Kuwait*	36	50	35	43
Qatar*	40	55	40	55
Oman	40	45	45	50
Bahrain	40	40	60	60
WTI	72	100	62	75

Source: MEES, Samba *year starting April

GCC Fiscal Spending				
$bn	**2007**	**2008**	**2009e**	**2010f**
Saudi	124.5	138.9	146.9	161.6
UAE	40.6	49.8	60.6	70.8
Kuwait*	71.6	39.6	42.2	55.5
Qatar*	26.9	30.5	34.3	38.5
Oman	17.1	19.6	20.5	21.8
Bahrain	4.8	5.5	5.7	6.2
GCC	285.5	283.9	310.2	354.4

Source: Samba, IIF * year starting April

real estate down turn – rents account for 39 and 31 percent of the CPI in the UAE and Qatar respectively. The rental market in Saudi Arabia, which is primarily driven by expatriate inflows, has remained strong as the kingdom pushes ahead with its development agenda. The rental component of the Saudi CPI continued to rise in 2009, and this is likely to accelerate this year. However, elsewhere in the GCC we do not expect much pressure from rents.

In contrast, we expect that global food prices will increase this year, contributing to rising inflation rates throughout the region. We also expect some pick up in prices in response to rising trading partner inflation, which IMF research has identified as the main driving force of inflation in GCC economies given their dependence on imports and foreign labour to met domestic demand. However, such imported price pressures will be weak in view of our benign inflation outlook for the USA, Japan, Germany and UK which account for around 45 percent of GCC trade. At the same time, the dollar, to which GCC exchange rates are pegged, is expected to remain stable or strengthen on a trade weighted basis.

Public Finances

GCC public finances will strengthen

The strength of GCC public finances will return as a major theme in 2010 as oil prices hold on to recent gains, raising fiscal and current account surpluses, and adding to the region's large external savings. That said surpluses are expected to be significantly lower than in the boom years of 2005-08. Notably, Saudi Arabia's exceptionally large planned budgetary spending is expected to result in a second year of fiscal deficits in 2010 (2.8 percent of GDP – see Box). Although the kingdom accounts for about half of GCC fiscal spending in any one year, the region as a whole is still projected to post a fiscal surplus of near 5 percent of GDP in 2010, and a current account surplus of over 10 percent of GDP.

In 2010, GCC governments plan to maintain the expansionary fiscal policy of recent years, which has provided the main driver of growth in the region. We expect government spending will rise by around 14 percent this year to a record $354 billion, bolstered by stronger oil prices. A large proportion of this spending has been earmarked for infrastructure investments to support growth. As is customary, spending levels are expected to exceed the amounts presented in official budgets. However, given that most governments have based their budget revenues on oil price assumptions well below our $75/b projection for 2010 (see table), we should still see solid improvements in fiscal balances. Along with Saudi Arabia, Bahrain is likely to post a small deficit this year, but the rest of the GCC should see fiscal surpluses.

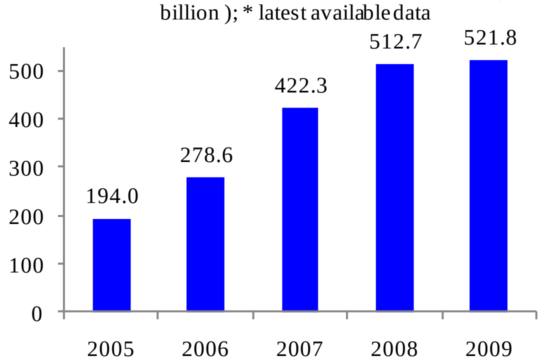
The GCC will continue to post healthy current account surpluses

In tandem with fiscal balances, the external balance of the GCC should improve as stronger oil and gas revenues, accompanied by a revival in

GCC Net Foreign Assets				
$bn	**2007**	**2008**	**2009e**	**2010f**
Saudi	273	403	400	423
UAE	412	272	356	399
Kuwait	335	295	329	363
Qatar	71	100	93	138
Oman	19	23	22	23
Bahrain	5	3	7	7
GCC	1115	1096	1207	1353

Source: IIF, Samba

GCC: Central Bank External Reserve Assets ($ billion); * latest available data



Source: Central Banks

GCC: Central Bank Reserve Assets excl. Gold				
$ billion	**2006**	**2007**	**2008**	**2009e**
Bahrain	2.8	4.2	3.1	3.6
Kuwait	12.6	16.7	17.1	18.5
Oman	5.0	9.5	11.6	11.4
Qatar	5.4	9.4	10.1	16.4
Saudi	225.2	305.3	440.0	436.0
UAE	27.6	77.2	30.8	35.9
GCC	**278.6**	**422.3**	**512.7**	**521.8**

Source: IIF, Central Banks, Bloomberg

Box 3: Saudi Arabia's 2010 Budget

The Saudi budget shows that the government has maintained its expansionary stance. The budget projects a deficit of $18.7 billion (larger than in the 2009 budget), based on revenue of $125.5 billion and spending of $144.2 billion. The oil price assumption is not revealed but we estimate this at around $57/barrel (Arab Light). This assumes that Saudi Aramco withholds the same proportion of oil revenue in 2010 as it did in 2009. Traditionally, both spending and revenue have been significantly higher than budgeted, and we think this will be the case in 2010. We therefore see spending increasing by around 10 percent compared to the 2009 actual outcome as capital spending growth is maintained and import costs rise in line with nonoil commodity prices. Revenue looks set to record an 11 percent increase compared to 2009, with oil prices and production both rising, and nonoil revenue recovering as trade picks up. Thus, we see a deficit of around the same nominal level as in 2009, though its relative size will fall to 2.8 percent of GDP from 3.3 percent in 2009.

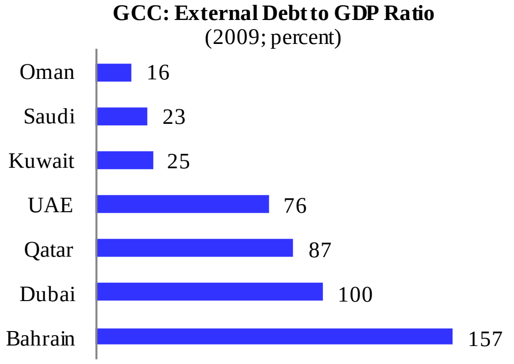
petrochemical and non-hydrocarbon exports, boost the current account position. Import costs will rise as commodity prices increase and volumes pick up in response to increasing economic activity and public investment. But this should not be enough to prevent all countries in the GCC positing current account surpluses. The largest is likely to be in Kuwait (30 percent of GDP), while Oman's current account will probably be more or less in balance. Robust imports will keep Saudi Arabia's surplus at around 5.4 percent of GDP, while expanding LNG and NGL exports in Qatar should push its current account surplus back over 20 percent of GDP. Rising oil revenues in Abu Dhabi combined with weak economic activity, and hence imports, in Dubai, should see the overall UAE surplus rise to 6 percent of GDP.

Reserves and SWF assets will be boosted

Healthy current account surpluses will allow the GCC states to continue growing their substantial external assets which have provided a vital buffer during the global slowdown. With the exception of Saudi Arabia, the bulk of GCC states foreign assets are managed through sovereign wealth funds (SWFs). Unfortunately, little information is publicly available on the assets under management by these SWFs. However, we believe that recovering global equity prices and replenishment from sustained current account surpluses resulted in an increase in value during 2009 which we expect will be repeated this year. Using data from the IIF we project that the GCC's net foreign asset position (i.e. external assets less external liabilities) improved by $111 billion in 2009, and will grow by another $146 billion this year to total around $1.35 trillion. Available data on GCC central bank reserves confirm this trend, with most GCC countries managing to build reserve levels during 2009 despite lower average oil prices.

With the possible exception of Dubai, external debt levels are manageable

Despite a strong increase in borrowing in recent years, external debt levels in the GCC remain manageable, and are in any case offset by large external assets (as noted above). However, individual circumstances vary. In particular



Source: IIF; Moody's; Samba

Dubai's debt has emerged as an area of concern. Although the UAE as a whole has substantial external assets, Dubai itself is less well endowed, and the request for a restructuring at the state-owned DW, together with uncertainty over the degree of support from the Federal government/Abu Dhabi, has brought into question its ability to meet its debt obligations. Accurate data is not readily available, but Dubai's debt is thought to stand at around 100 percent of GDP.

Elsewhere in the region, Bahrain's debt level stands out as being high at over 150 percent of GDP. However, this principally reflects the liabilities of its large offshore financial sector, and its net external asset position remains positive. Saudi Arabia, Oman and Kuwait have not been significant borrowers and maintain relatively moderate debt to GDP levels, estimated at between 16-25 percent of GDP at end 2009. In contrast, Qatar has borrowed heavily to transform itself into the world largest LNG exporter. It is now reaping the benefits of this vision with surging export revenues and one of the highest per capita incomes in the world. Its debt to GDP level has fallen from a high of 130 percent to around 87 percent at end-2009. However, the 2009 ratio represents a temporary uptick following a surge in sovereign bond issuance last year and a decline in nominal GDP as oil prices slumped. We expect the ratio to drop back to under 60 percent this year while at the same time Qatar's net external asset position will continue to strengthen.

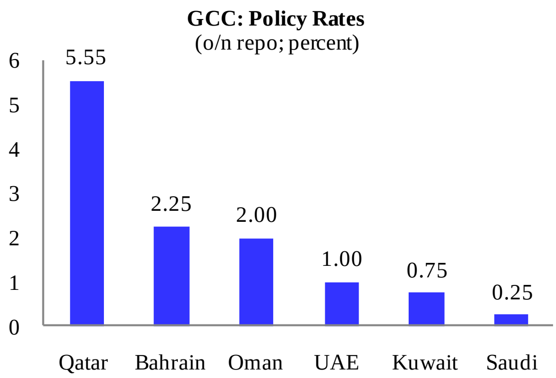
We do not expect any change in the GCC's exchange rate pegs to the US dollar over the next couple of years (with Kuwait retaining its peg to a dollar heavy basket of currencies).

Monetary policy

GCC policy rates will remain low

We do not expect any change in the GCC's exchange rate pegs to the US dollar over the next couple of years (with Kuwait retaining its peg to a dollar heavy basket of currencies). Despite continued progress towards the stated goal of Monetary Union involving Saudi Arabia, Kuwait, Qatar and Bahrain, announcements from GCC officials concede that this is still a long term project. In the meantime, efforts will continue to develop and build the necessary institutions and capacity to launch a viable single currency, starting with the central bank to be based in Riyadh.

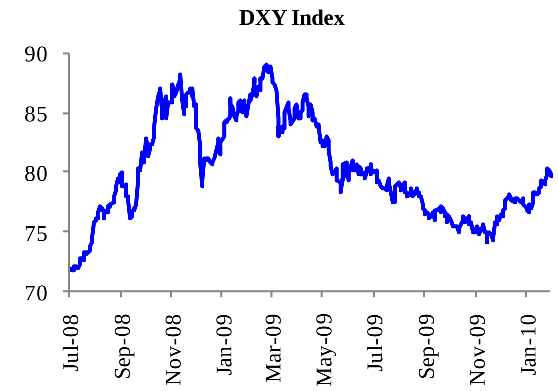
Given the retention of the dollar peg, GCC monetary policy will continue to be driven by the actions of the US Federal Reserve. We thus anticipate a continuation of low policy rates in 2010. As in the US, we expect inflation to be muted in the GCC, and thus do not expect a return of the exchange rate pressures that emerged in 2007-08 when GCC and US policy needs and business cycles were out of synch. Current forward markets continue to reflect confidence in the dollar peg and are not pricing in any significant revaluation pressure within the next 12 months.



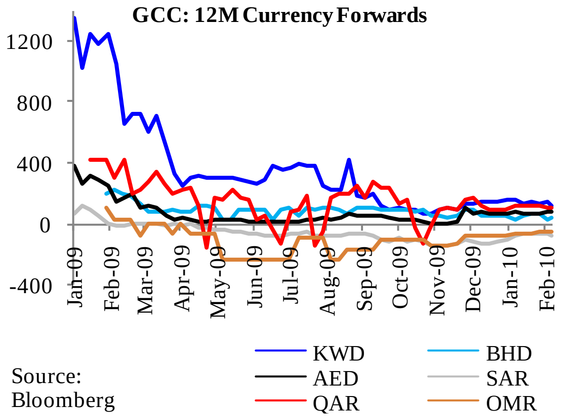
Source: Bloomberg

Dollar peg remains the best option for now

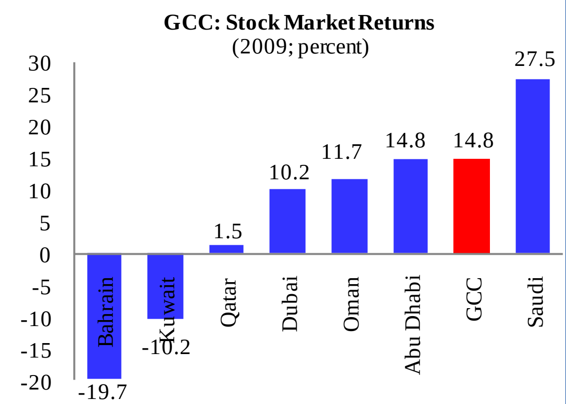
Nonetheless the exchange rate peg will continue to be an area of debate; particularly as the GCC recovery gathers pace over the next couple of years



Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

and inflationary pressures mount at a time when governments' will be reluctant to use fiscal policy to influence domestic activity given their ambitious investment and diversification programs. However, while we recognise the benefits of currency flexibility and an independent monetary policy, we hold the view that the dollar peg currently remains the best option for the GCC.

The dollar peg helps minimise exchange rate volatility, provides a credible and easily understood anchor for monetary policy, and simplifies trade and financial transactions, accounting and business planning. In addition, IMF research has shown that economic activity in the GCC is not particularly sensitive to changes in policy rates, thus weakening the interest rate transmission channel and the efficiency of an independent monetary policy. Instead, corporate sector investment and spending decisions depend to a large extent on actual and projected government spending.

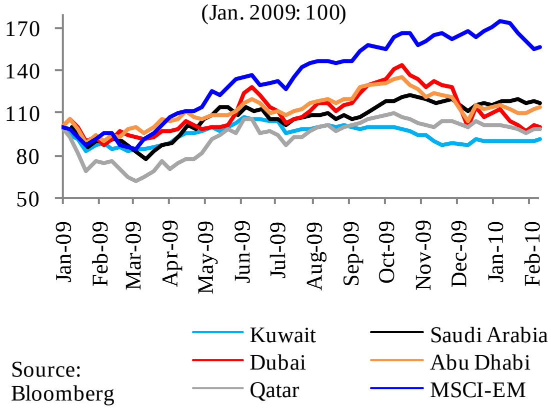
Clearly risks remain, especially if the dollar were to depreciate sharply against other major currencies. In addition, GCC authorities will need to monitor local liquidity conditions carefully to prevent a repeat of the unsustainable credit boom experienced by many in 2007-08. Most regional central banks track loans to deposit ratios and broad money growth, and rely on certificates of deposit, reserve requirements and prudential regulations (such as loan/deposits limits, caps on consumer loans etc) to manage liquidity. Such activities will need to be strengthened and better coordinated in the region, while banks need to take greater responsibility for their financial risks and strengthen their risk management practises. Further, the development of domestic bond markets would be a welcome addition, providing a mechanism to manage systemic and private sector liquidity more smoothly across cycles (i.e excess and tight liquidity conditions).

GCC Stock Markets

Despite some headwinds, stock markets recovered in 2009

In general, during 2009 GCC markets benefited from a global equities rally, recovering oil prices, and improving sentiment as it became clear that an unprecedented global policy response would prevent a financial meltdown, and shore up international capital markets. However, on a regional level, GCC markets continued to face headwinds. In particular, real estate corrections, tight credit conditions, declining corporate earnings, rising NPLs, and investor concerns over Dubai's debt problems and defaults at large family conglomerates, have all dampened market performance. Thus, while most GCC stock markets staged a strong recovery in 2009, they underperformed their emerging market global peers. We estimate that the weighted average return of GCC stock markets was 14.8 percent, with the best performing market being Saudi Arabia with a 27.5 percent rise, against 75 percent by the MSCI Emerging markets index. The GCC average was dragged down by declines in Bahrain (-19.7 percent) and Kuwait (-10.2 percent), reflecting problems in their heavily weighted financial sectors, including defaults by

GCC: Stock Market Performance
(Jan. 2009: 100)



Source: Bloomberg

Stock Market Capitalization			
	$ billion	% of GDP	P/E*
Saudi	333	90	16.2
UAE	102	47	9.3
Abu Dhabi	68	52	9.2
Dubai	34	39	9.5
Kuwait	93	93	13.4
Qatar	80	94	11.7
Oman	18	33	12.1
Bahrain	17	101	9.4
GCC	643	77	13.2

Source: Zawya, Samba estimates *trailing

Sector Weight in GCC Stock Market Indices			
	Financials	Telecom	Industry
Saudi	45.3	8.0	10.8
UAE	54.8	27.7	8.0
ADX	43.9	39.0	5.5
DFM	76.5	5.0	13.0
Kuwait	42.3	3.4	24.0
Qatar	71.4	0.0	25.9
Oman	51.7	9.5	23.0
Bahrain	79.2	14.6	1.8
	Basic materials	Con. goods	Con. services
Saudi	23.9	4.2	3.9
UAE	1.7	0.6	3.4
ADX	2.6	0.9	2.3
DFM	0.0	0.0	5.5
Kuwait	3.7	5.1	10.9
Qatar	0.0	0.2	2.4
Oman	0.6	2.6	1.7
Bahrain	0.0	0.4	4.0

Source: Bloomberg, Samba estimates

banks and investment houses.

Foundation is in place for a sustained rally in 2010

From a macroeconomic perspective, the foundation is in place for a sustained improvement in GCC equity markets during 2010. Regional economic activity is projected to pick up, boosted by healthy oil prices, a recovery in global growth and trade, sustained fiscal stimulus and accommodative monetary policy. Liquidity conditions are expected to improve, real estate sectors are stabilising and possibly returning to growth in some cases (Saudi Arabia) and, after relatively weak performances in 2009, corporate earnings should revive (consensus earnings growth for 2010 is around 23 percent). Having been held back by higher provisioning in 2009, bank earnings should also recover, although continued restructuring and deleveraging in Dubai may limit this for UAE banks. In addition, following an outflow of expatriates last year, concentrated mostly in the UAE, demographic trends should also be favourable in 2010.

In a global context GCC markets should remain attractive given their generally low debt levels, growing populations, considerable scope to expand consumer sectors, increasing external assets, and prospects for sustained current account surpluses. GCC authorities' have also learnt some hard lessons from the recent economic downturn, and are shifting towards a more sustainable and measured approach to development, particularly in real estate. In addition, the prospect of bubbles forming in some emerging market equities does not apply to the GCC where the potential for catch up remains strong. The trailing PE ratio for the GCC stands at 13.2 percent[1] compared with around 18 percent for emerging market equities. UAE valuations look particularly cheap, although future earnings growth is less promising given the more difficult macroeconomic environment in Dubai. After a long absence, GCC markets should also benefit from a revival in IPO activity during 2010, particularly in Saudi Arabia.

GCC markets will remain sensitive to developments in global equities, which are likely to be volatile within a positive upward trend. However, while we anticipate gains for the year as a whole, a number of factors may limit the upside potential for some of the region's stock markets. Both investor and corporate sentiment remains somewhat cautious in the GCC. The expectation is that the global recovery will become entrenched and oil prices will remain firm, but downside risks are significant, and this may prompt a still cautious approach by companies and banks, despite the strong stimulus being provided by GCC governments. In addition, until there is a resolution to the DW restructuring and more confidence in Dubai's ability to meet all its debt obligations, investor risk appetite could be dampened. Sustained weakness in Dubai's real estate sector will also be a lingering concern. It thus may not be until the second half of the year that GCC equity markets fully reflect the stronger economic growth prospects and higher oil revenues. Country performances will vary, with Saudi Arabia, Qatar and Oman likely to outperform.

[1] Zawya February 8, 2010

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