

Qatar: National Development Strategy Review & Economic Update

Executive Summary

- Qatar's National Development Strategy (NDS) covering 2011-16 provides a frank analysis of the country's development prospects and challenges. Hydrocarbons will continue to dominate and underpin national prosperity but, with the completion of the last of the major hydrocarbons projects in 2012, the emphasis of the NDS is on developing the non-hydrocarbons sector.
- We project that real GDP growth will exceed 20 percent this year before slipping to 6 percent next and – in line with the NDS – hold at around 4-5 percent a year post-2012 as the non-hydrocarbon sector takes over as the engine of growth. This will be supported by the massive \$226 billion planned investment program, including \$95 billion from the central government.
- It seems clear that revenues from hydrocarbon exports will make Qatar a wealthy country, ensuring sustained fiscal and current account surpluses and a further build up in external assets even under adverse oil and gas price assumptions.
- Managing such wealth, promoting economic diversification and completing large scale infrastructure investments in time for the 2020 World Cup will present challenges. But the NDS provides reassurance that policy makers are prepared, and will take steps to mitigate potential inflationary pressures and to avoid wasteful spending.
- Recent data confirm the continued increase in hydrocarbon output and point to improving conditions in the non-hydrocarbon sector which should receive a further boost from the expansionary budget announced for 2011/12. Private credit growth is reviving, helped by recent interest rate cuts, and the stock market returned to positive territory in May. Inflation is on the rise, but remains muted overall (1.7 percent in March), due to sustained weakness in rents. That said, reports suggest that the real estate sector has begun to stabilise.

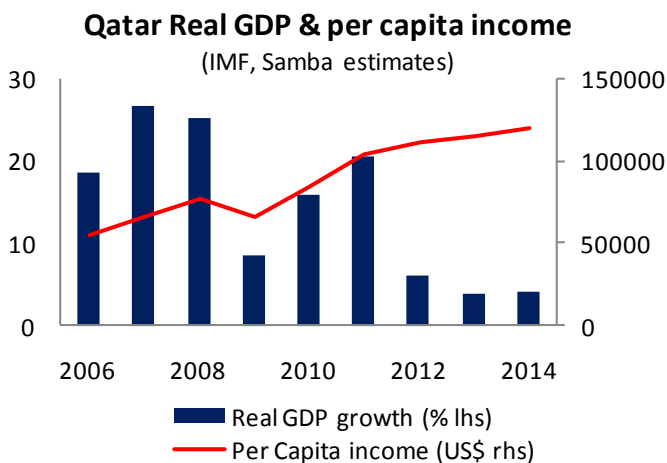
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Medium term growth prospects are favourable, although growth will slow sharply from the high double digits of the last decade as Qatar's 20 year hydrocarbon investment program comes to an end.

Post 2012 grow will be driven by the nonhydrocarbons sector



Qatar lays out its National Development Strategy

Medium growth prospects are healthy

The recently released National Development Strategy 2011-16 (NDS) provides a wealth of information and frank analysis of Qatar's development prospects and challenges. From an economic perspective the outlook presented through 2016 is favourable; a view we share and one which is mirrored in the IMF's recently released 2010 Article IV report. The NDS also confirms what we have already noted (see our June 2010 *Economic Monitor*): that once the 20 year hydrocarbon investment program comes to an end around 2012, real GDP growth rates will slow sharply from the high double digits of the last decade. However, at a projected 4-5 percent a year post-2012 real GDP growth will remain solid, and in nominal terms the economy will remain highly prosperous with national income conservatively projected to reach \$213 billion by 2016 (the IMF projects nominal GDP of \$224 billion by 2015) with an estimated per capita income of over \$114,000.

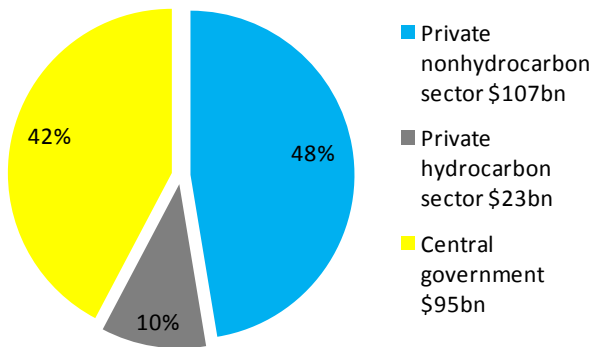
Medium-term Economic Projections

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------------|--------|---------|---------|---------|---------|---------|
| NDS | | | | | | |
| Real GDP growth (%) | 15.7 | 7.1 | 4.0 | 4.7 | 4.7 | 5.1 |
| Hydrocarbon GDP | 22.2 | 5.2 | -0.9 | 0.0 | -0.2 | 0.0 |
| Nonhydrocarbon GDP | 9.5 | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 |
| Nominal GDP (\$bn) | 150 | 168 | 180 | 193 | 209 | 213 |
| Population (millions) | 1.73 | 1.76 | 1.78 | 1.81 | 1.84 | 1.86 |
| GDP per capita (\$) | 86,864 | 95,373 | 101,401 | 106,854 | 113,324 | 114,469 |
| IMF | | | | | | |
| Real GDP growth (%) | 20.0 | 7.1 | 3.9 | 4.1 | 4.3 | |
| Hydrocarbon GDP | 29.5 | 5.7 | 0.0 | 0.0 | 0.0 | |
| Nonhydrocarbon GDP | 9.5 | 9.0 | 9.0 | 8.8 | 8.8 | |
| Nominal GDP (\$bn) | 160 | 181 | 196 | 209 | 224 | |
| GDP per capita (\$)* | 92,740 | 103,022 | 109,890 | 115,202 | 121,835 | |

Source: NDS, IMF * using NDS population data

A key factor in the medium-term projections is the recognition that the contribution from the hydrocarbon sector to growth will drop off dramatically as the 20 year gas based investment program comes to an end and the last of the major projects come on stream in 2012. This then leaves the non-hydrocarbon sector as the driver of future real GDP growth. In this respect, both the Qatari authorities and the IMF are projecting that expansion in non-hydrocarbons GDP will remain robust at around 9 percent a year through 2016. It is noteworthy that this is expected to be achieved in an environment of much slower population growth than in the past, with the NDS projecting that growth will slow to around 2 percent a year, bringing the population to just under 1.9 million by 2016. This has important

**NDS Projected Investment
2011-16 \$226bn**



Large scale private investment in the non-hydrocarbons sector is expected to drive longer term growth.

implications, as capacity in some areas (especially real estate) is already running ahead of demand, and future investments will need to be tempered to ensure they are able to generate a return.

Diversification is a priority...

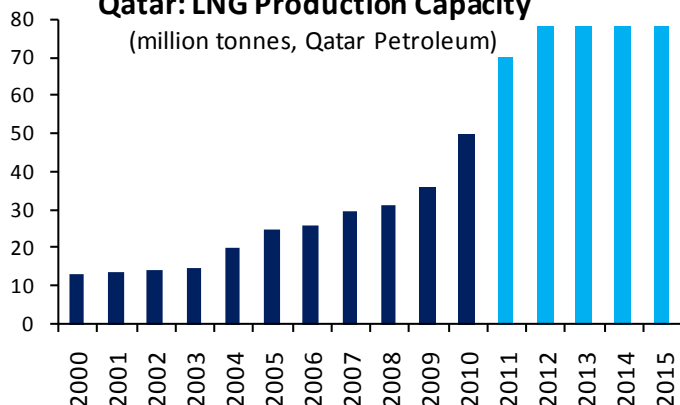
Achieving the projected rates of growth in the non-hydrocarbon sector will depend heavily on the successful implementation of the NDS which aims for greater diversification of the economy. In the short-term, prospects for strong non-hydrocarbon growth are clearly favourable given already planned large scale public infrastructure investments which will support the construction sector and have multiplier effects throughout the economy. The NDS expects public sector investment to peak in 2011-12 and suggests spending could reach \$95 billion over 2011-16. Much of this investment was planned irrespective of the World Cup bid, although hosting the event in 2022 will require additional investment in stadia and hotels. Much of this will likely take place beyond the NDS 2016 time frame. Given Qatar’s healthy public finances, realising such investment should be possible, although implementation and absorption constraints will need to be carefully monitored.

The bigger question is whether expected private investment in the non-hydrocarbons sector will materialise as envisaged. The NDS expects that private investment will drive growth and under its baseline scenario envisages \$107 billion will be invested in the non-hydrocarbon sector through 2016. This is a considerable sum, representing over 85 percent of current GDP. Much of this investment is expected to come from government linked companies such as Barwa, Qatar Diar and Qatalum which are expected to have ready access to finance. However, it would not be surprising if overall private investment levels fell short.

...but hydrocarbons will still dominate

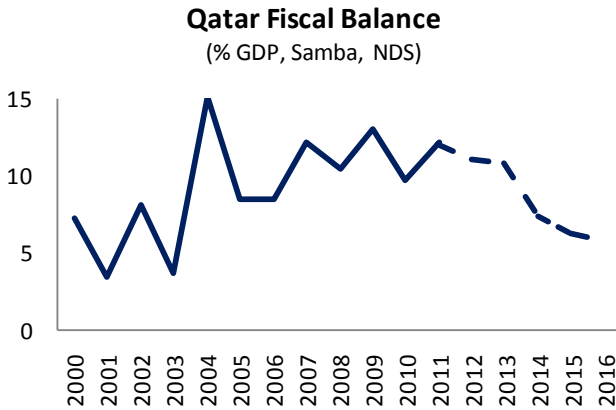
While the NDS expects an increasing role for the non-hydrocarbons sector, it realistically recognises that Qatar will remain dominated by the hydrocarbons sector – by 2016 its share of total GDP is expected to dip only moderately to about 42 percent, while government revenues and exports earnings will remain heavily dependent on oil and gas earnings. In terms of the non-hydrocarbons sector the authorities are hoping that expanding services activities will be a major driver of the economy accounting for close to 40 percent of GDP by 2016, with an emphasis on transportation, communications, business and financial services. Manufacturing activity is also projected to grow steadily in line with continued expansion in fertilizer, petrochemicals and metallurgy, accounting for 10 percent of GDP by 2016.

**Qatar: LNG Production Capacity
(million tonnes, Qatar Petroleum)**



Public finances will remain strong

The NDS does a good job in trying to frame the resource envelope available to Qatar and presents additional scenarios involving lower oil and gas price assumptions. Under the lower oil scenario prices are reduced by 14 percent to an average of \$74/b for 2011-16 relative to the baseline assumption of \$86/b, while in the lower gas price scenario prices are reduced by 30 percent. Under both, Qatar’s public finances remain healthy, albeit reduced, and the impact on economic activity is viewed as manageable. This conclusion is shared by the IMF which notes that fiscal sustainability is not an issue in the medium term, and has calculated that under current policies, growing income from Qatar’s sovereign wealth fund, the Qatar Investment Authority (QIA), combined with projected tax revenues would cover about 73 percent of total budget expenditure by 2015/16. Qatar aims to fully finance the budget from 2020 onwards from its non-hydrocarbon revenues.



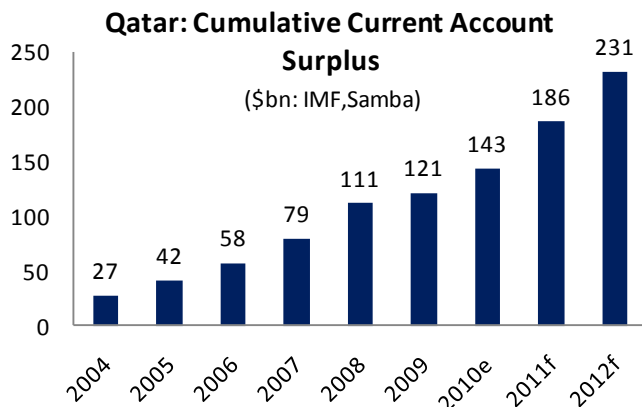
Qatar aims to fully finance the budget from 2020 onwards from its non-hydrocarbon revenues.

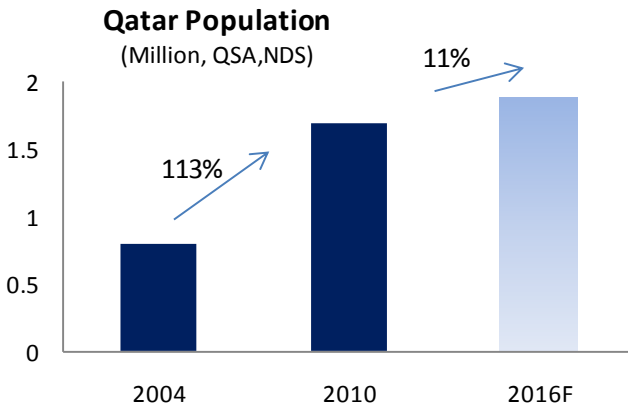
| | External Debt (US\$ billion) | | | | |
|-----------------------------|------------------------------|------|------|------|-------|
| | 2000 | 2005 | 2008 | 2009 | 2010 |
| Total external debt | 15.2 | 17.8 | 57.1 | 83.8 | 103.9 |
| Commercial bank liabilities | 0.6 | 2.9 | 23.7 | 29.8 | 34.3 |
| Government external debt | 5 | 3.7 | 3.9 | 16.5 | 17.4 |
| Government owned corporates | 9.4 | 10.1 | 25.4 | 34.3 | 46.5 |
| LNG related | 5.7 | 6.7 | 17.1 | 19.7 | 20.4 |
| Others | 0.2 | 1.2 | 4.2 | 3.2 | 5.6 |

Source: IMF

The NDS does not directly address external borrowing requirements but does indicate a growing debt burden which tops 90 percent of GDP by 2016. Under conventional debt analysis this level of debt would begin to raise concerns and it is notable that public debt has risen steeply in recent years – see table. Proper analysis is hampered by limited data, but assessments of debt service requirements suggest that Qatar’s debt burden is manageable and that there is little roll over risk. In addition, and perhaps most pertinently, continued large current account surpluses will allow for a sustained build up in the country’s external assets (the bulk held by the QIA) ensuring they continue to exceed Qatar’s external obligations by a wide margin.

That said the authorities will need to monitor debt levels carefully and ensure that activities of government owned companies do not lead to concerns. The debt problems in Dubai provide a salutary example of what can go wrong. And while (unlike in Dubai) the state can afford to bail out its enterprises; it would not be the most productive use of funds. Establishing a debt management office will thus be an important step to helping ensure prudent and productive investment.





The authorities are targeting education, training, and providing an enabling business environment in their efforts to move towards a high wage private sector economy.

Implementation issues

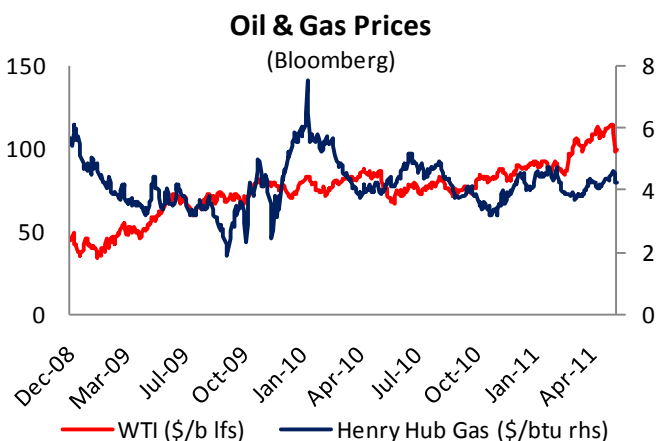
The NDS presents a sound understanding of the challenges and risks facing a small resource rich country (including issues surrounding the so called 'resource curse - see our report *The GCC: Increasingly Diversified Economies* for more details), and is realistic about Qatar's prospects. Combined with Qatar's past history of successfully steering the economy through the massive hydrocarbons investment program to its current position of wealth and stability, this bodes well for management of the next phase. However, the future challenges are in many ways more testing. Key amongst these will be the need to ensure new investments are productive and meet identified development needs and priorities, and that spending is managed so as not to generate undue inflationary pressures. Population dynamics will also be key and managing the transition to lower inflows of more skilled migrants will need to be carefully handled.

In addition, investing in external assets apart, promoting diversification of the economy is not straight forward. The authorities are rightly targeting education, training, and providing an enabling business environment in their efforts to move towards a high wage private sector economy. However, success will depend on individual Qataris responding to the incentives provided to acquire new skills and develop new businesses, and on attracting FDI inflows in an increasingly competitive regional environment.

Recent Economic Developments

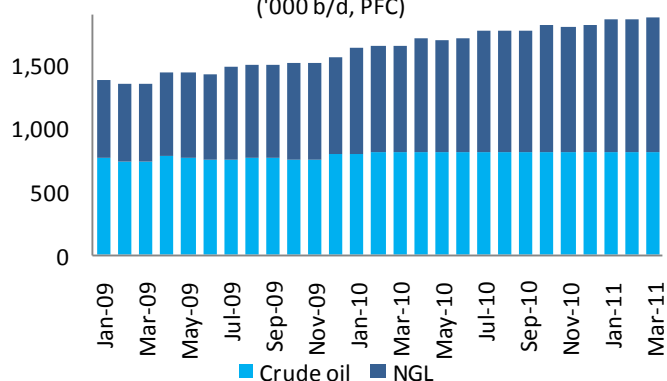
Hydrocarbon earnings are soaring

A combination of increased production and higher prices will ensure that Qatar's earnings from hydrocarbon exports continue to grow strongly. Oil prices have been volatile in recent weeks but on average (\$99/b through May 9) remain over 20 percent higher compared with 2010, and NGL prices have followed a similar trend. While Qatar's oil output has not increased significantly, NGL output has, and average combined output of the two has increased 7.5 percent in the first quarter. Last year the IMF estimated that Qatar earned \$38 billion from oil, NGL and refined petroleum product exports and we expect earnings from these sources will approach \$53 billion this year.



LNG export earnings are estimated to have reached \$21 billion in 2010 and will grow again on the back of increased volumes reflecting the completion of the last of the mega-trains. Projecting earnings for LNG is less straightforward as there is no one reference price. Spot gas prices remain relatively weak at

Qatar oil & NGL output
(’000 b/d, PFC)



Qatar announced budgets

| \$ billion | 2010/11 | 2011/12 | % change |
|-----------------|---------|---------|----------|
| Revenue | 35.0 | 44.6 | 27 |
| Expenditure | 32.4 | 38.4 | 19 |
| Current | 12.5 | 13.6 | 9 |
| Public projects | 12.0 | 15.9 | 33 |
| Fiscal Balance | 2.7 | 6.2 | 132 |

Spending in the 2011/12 budget continues to emphasise development in education, health and infrastructure.

\$4.2/mbtu (see chart), but much of Qatar’s LNG is sold on long-term contracts, often linked to oil prices. LNG prices also vary widely throughout the world. Available data on Japanese LNG prices show a strong rebound to \$14/mbtu so far this year from a low of \$8/mbtu in 2009 and an all time high of \$16/mbtu in late 2008. With Qatar expecting to increase exports to Japan this year, this bodes well for earnings. Overall we expect that LNG exports will grow to over \$30 billion this year, taking Qatar’s total export earnings to a projected \$90 billion.

2011/12 budget reflects sustained expansionary fiscal policy

Consistent with the objective of the NDS another expansionary budget has been approved for 2011/12 (starting April 1), based on a conservative oil price assumption of \$55/b. As in the past we expect both revenues and expenditures will exceed the announced budget as will the overall surplus. This we project at \$13.3 billion (8 percent of GDP) based on revenues of \$55.4 billion and expenditures of \$41.2 billion. Stronger state revenues from hydrocarbons are assured given higher oil prices (expected to average \$95/b) and another jump in LNG and NGL exports. Consistent with the overall diversification strategy, much of this revenue will be used to build up foreign assets, mainly through the QIA. Income from these investments has been rising in recent years and accounted for over a third of budget revenues in 2009/10, according to official estimates.

Qatar Fiscal Accounts

| \$ billion | 2008/09 | 2009/10 | 2010/11e | 2011/12f |
|----------------|---------|---------|----------|----------|
| Revenue | 38.7 | 42.5 | 46.4 | 54.5 |
| Hydrocarbon | 22.0 | 19.1 | 23.9 | 28.6 |
| Other revenue | 16.7 | 23.4 | 22.5 | 25.8 |
| Investment | 9.1 | 14.8 | 13.7 | 15.4 |
| Expenditure | 27.2 | 29.7 | 36.8 | 41.2 |
| Fiscal balance | 11.6 | 12.8 | 9.6 | 13.3 |
| % of GDP | 10.4 | 13.0 | 7.4 | 8.0 |

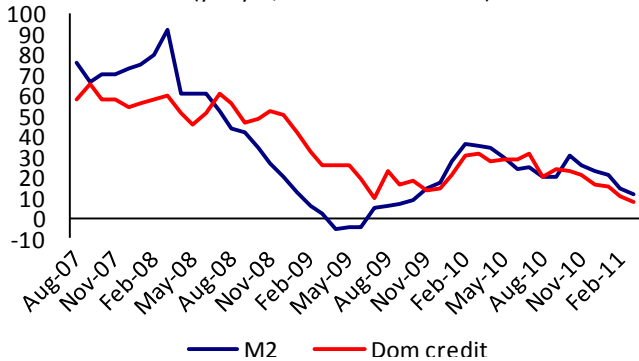
Source: national authorities, Samba

Meanwhile spending in the budget continues to emphasize development in education, health and infrastructure. Allocations for public sector projects are budgeted to rise 33 percent over the 2010/11 budget to almost \$16 billion, with \$7.7 billion earmarked for education and health and \$1.4 billion for housing. Spending on salaries and wages are budgeted to rise by 10.2 percent. Overall spending is budgeted to increase 19 percent this year which will help support economic activity and growth.

Growth remains world beating

Available estimates suggest that real GDP grew by around 16 percent in 2010, while nominal GDP grew by around 30 percent

Qatar: M2 & Domestic Credit
(y-o-y %, Qatar Central Bank)



Real GDP is expected to grow by over 20 percent in 2011 as the remaining large gas related projects come on stream, before slowing to 6 percent in 2012.

to reach \$116 billion. The principal driver of nominal growth was the rebound in the hydrocarbons sector which rose 57.7 percent in according to official data, driven by higher prices and production. Manufacturing also recovered strongly following a contraction in 2009 to expand by 20.7 percent, as did electricity and water (up 15.4 percent). However, residual strains in the economy were apparent as growth remained muted in some sectors (trade, hospitality, finance and real estate services) while building and construction saw another decline (see table). Looking ahead we would expect strong performances in most sectors this year and next as public infrastructure spending accelerates and the hydrocarbons sector posts further output gains. Real GDP is expected to grow by over 20 percent in 2011 as the remaining large gas related projects come on stream, before slowing to 6 percent in 2012.

Qatar Nominal GDP % change y-o-y

| | 2006 | 2007 | 2008 | 2009 | 2010 | % of GDP |
|-------------------------|-------------|-------------|-------------|--------------|-------------|------------|
| Hydrocarbons | 41.4 | 28.0 | 29.1 | -23.1 | 57.7 | 55.7 |
| Manufacturing | 40.3 | 11.9 | 45.9 | -25.3 | 20.7 | 7.3 |
| Electricity & Water | 34.5 | 30.8 | 36.8 | -10.0 | 15.4 | 1.0 |
| Construction | 7.1 | 181.8 | 50.3 | -20.7 | -5.4 | 5.2 |
| Trade, hospitality | 26.9 | 61.1 | 33.6 | 15.8 | 8.3 | 5.5 |
| Trans. & Commun. | 51.8 | 51.3 | 56.6 | 7.1 | 12.7 | 5.5 |
| Fin. Real est. business | 40.1 | 40.2 | 39.5 | 13.8 | 6.9 | 9.9 |
| Government Services | 55.5 | 8.1 | 57.3 | 36.3 | 5.7 | 10.1 |
| Total GDP | 40.6 | 33.5 | 37.1 | -11.2 | 30.8 | 100 |
| Non-hydrocarbons GDP | 39.4 | 41.4 | 47.6 | 2.4 | 7.7 | 44.3 |

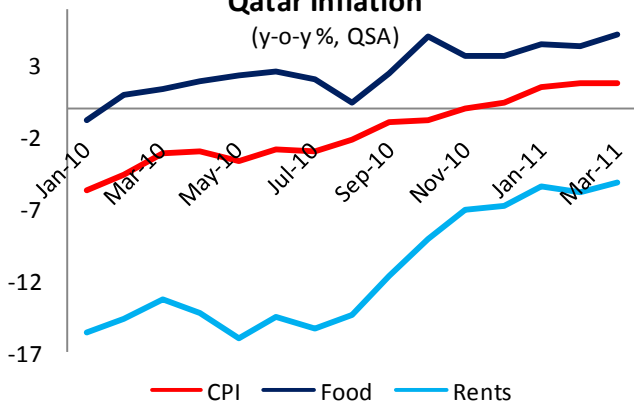
Source: Qatar Statistics Authority

Inflation is on the rise

Recent data confirm that prices are on the rise following two years of deflation. Year-on-year inflation rose to 1.7 percent in March, with prices in nearly all components of the consumer price index (CPI) showing increases of between 5-8 percent, with food up 5.2 percent. The exception is the heavily weighted rental component, accounting for 31 percent of the CPI, which continued to decline (-5.1 percent). This decline has kept the overall inflation rate down, although as previously noted the weakness in rents may be overstated as the survey used is mainly confined to new contracts or those currently available for occupancy.

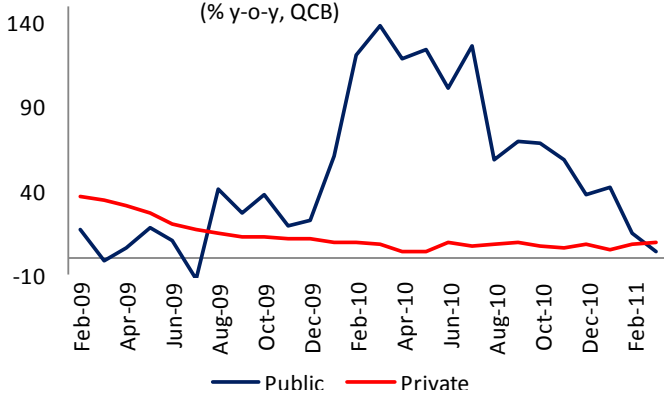
We continue to project that average annual inflation will rise to 3 percent this year, with a further rise to 4.5 percent in 2012. Rents are likely to remain a drag, but reports from real estate firms point to increasing evidence of stabilisation in office and residential property, and recent CPI data confirm a slowing in price declines. At the same time, higher commodity prices and a weakening dollar are raising inflationary pressures which could be accentuated by increased public spending and rising

Qatar Inflation
(y-o-y %, QSA)



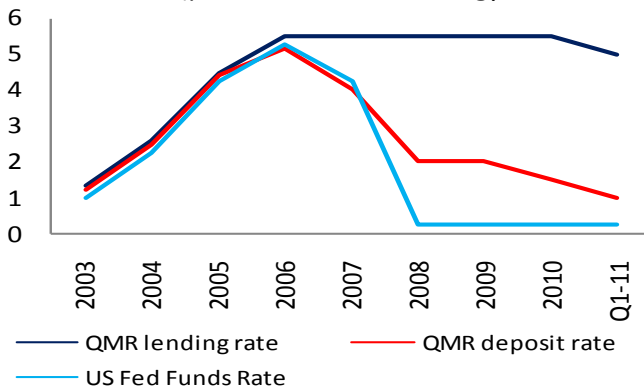
Domestic Credit Growth

(% y-o-y, QCB)



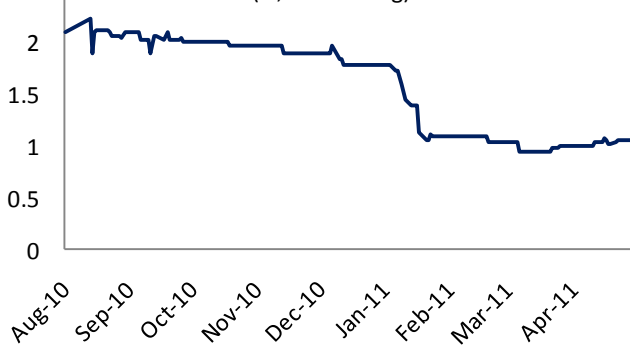
Qatar & US Policy Interest Rates

(percent, QNB, Bloomberg)



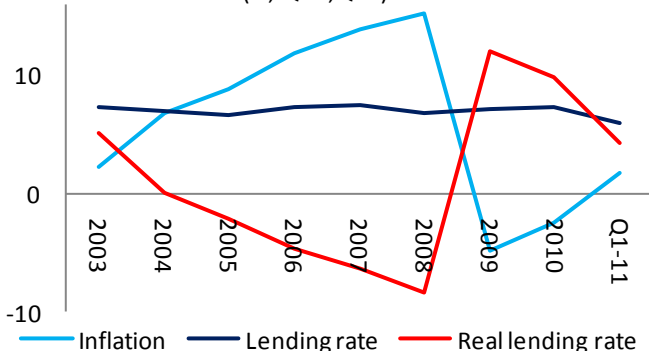
Qatar 3m Interbank rate

(%, Bloomberg)



Real lending rates have started to drop

(%, QNB, QSA)



aggregate demand as Qatar pushes ahead with its large investment and diversification program. In this context, the Qatar central bank will need to keep a close eye on credit growth and liquidity conditions to prevent a repeat of 2006-08 when soaring credit contributed to double-digit inflation rates.

Domestic credit growth remains positive

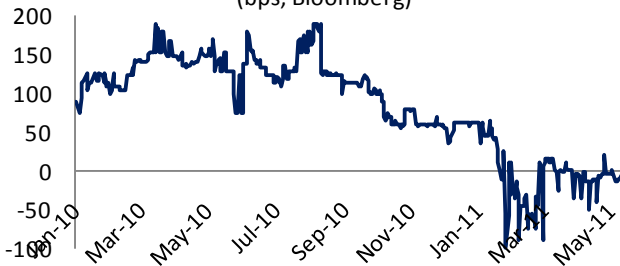
Government led measures to strengthen bank balance sheets and heavy borrowing by government-owned enterprises have helped keep domestic credit relatively buoyant through 2010, particularly when compared with the rest of the region. That said, having surged by nearly 40 percent in 2010, credit to the public sector has stalled in the first quarter of this year (4 percent y-o-y) and overall domestic credit growth dipped to 7 percent compared with 16.7 percent for 2010. However, the large borrowing by public entities during 2010 has somewhat distorted the picture and perhaps more notable and encouraging is the pickup in private credit growth. This was running at around 9 percent in March, and the authorities will be hoping that this trend continues. In addition, we expect government owned entities will resume borrowing again as they begin to implement the large diversification and investment program.

In addition, credit growth would probably be stronger were it not for the unrest in the broader MENA region which has introduced some uncertainty, despite Qatar's own stable and prosperous environment. The recent policy changes on Islamic banking may also be having a dampening effect. However, the authorities are keen to see a revival of private sector activity and are pressing ahead with the establishment of a national Credit Bureau, and have reduced central bank policy interest rates by another 50 basis points in April (taking the overnight deposit rate to 1 percent), in part as an effort to persuade banks – which remain somewhat hesitant – to explore lending opportunities. The move may also be aimed at deterring short-term capital inflows as the authorities seek to manage liquidity in the financial system. Back in January the central bank issued QR50bn in local bonds as a way of soaking up excess liquidity and boosting bank balance sheets.

Interbank rates have fallen in response to recent developments with 3-month rates holding at around 1 percent in early May, according to Bloomberg data, down from the 2 percent plus prevailing during 2010. Real lending rates have also started to trend down, and we expect that domestic credit growth will revive throughout the year as the non-hydrocarbons sector begins to pick up speed, including in the building and construction sector. Banks are in relatively good shape (stress test by the IMF indicate that they are resilient to credit and

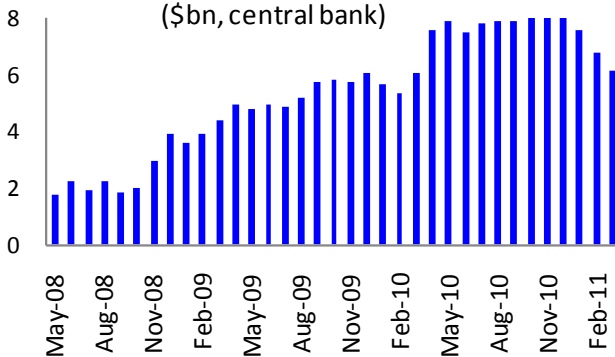
Qatar: 12M forward exchange rate

(bps, Bloomberg)



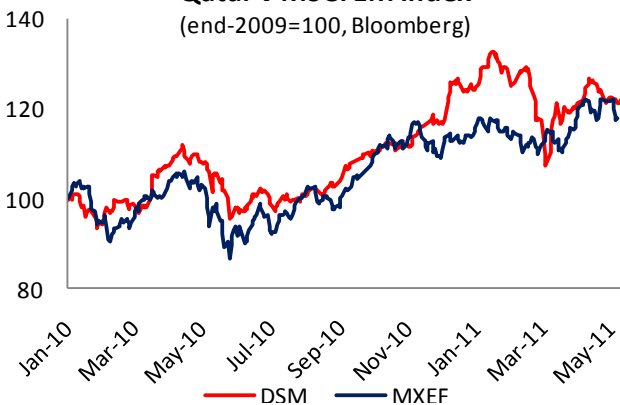
Qatar: Non-resident Bank Deposits

(\$bn, central bank)



Qatar v MSCI EM Index

(end-2009=100, Bloomberg)



market risks¹) and have room to expand their balance sheets. We thus expect a return to double digit loan growth this year and next as government related companies borrow to fund planned development projects.

Exchange rate and capital flows

Some earlier mild pressure on the exchange rate peg appears to be dissipating as 12 month forward rates trend back towards par (see chart). Non-resident bank deposits have also started to fall having surged during 2010, in part reflecting the reduction in Qatar’s interest rates. With inflation in Qatar currently muted we do not expect the exchange rate peg will come under pressure this year. However, in view of the planned large increases in spending the authorities will need to be vigilant and, given the pegged exchange rate regime, will have to rely on macroprudential instruments to manage the credit cycle and counter potential surges in capital flows.

Stocks are recovering

The Doha stock exchange is still recovering ground following a selloff in the wake of unrest in neighbouring Bahrain and the broader MENA region in general. However, as of early May the market was back in positive territory year-to-date, and continued to perform more or less in line with the MSCI Emerging market index. Speculation remains high that Qatar will itself be upgraded to the Emerging Markets Index in June. At that time, the MSCI group will decide if Qatar has made sufficient reforms to its settlement systems and foreign ownership limits to qualify. However, it will also take into account investors desire to add Qatar which makes the outcome somewhat uncertain. Inclusion in the MSCI Index would draw in more investment and help boost liquidity and stability in the market. Even without inclusion, the prospects for further market gains this year appear strong as public spending rises and growth surges ahead.

| Qatar | 2009 | 2010 | 2011f | 2012f |
|---------------------------------------|------|-------|-------|-------|
| Nominal GDP (\$bn) | 98.3 | 129.8 | 166.2 | 184.1 |
| Real GDP growth (% change) | 8.7 | 16.0 | 20.5 | 6.0 |
| Inflation (average %) | -4.9 | -2.5 | 3.0 | 4.5 |
| Current account (% GDP) | 10.2 | 16.8 | 25.6 | 24.5 |
| Fiscal balance (% GDP) | 13.0 | 7.4 | 8.0 | 7.5 |
| External debt (% GDP) | 85.2 | 80.0 | 67.4 | 64.7 |
| y-o-y growth in M2 (%) | 15.6 | 23.1 | 11.8* | |
| y-o-y growth private sector credit(%) | 10.8 | 7.6 | 9.1* | |

* Q1 2011, f Samba forecast

¹ Tests show that recapitalisation needs of the banking system would be 2-3 percent of GDP under a severe combined stress of a 20 percent increase in NPLs and a 50 percent drop in the value of investments.

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