Macroeconomic outlook

Qatar: Growth downgraded as GCC dispute hits an impasse

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Overview and outlook

- We have revised GDP growth down to 1.8% this year – the weakest since 1994 – on fallout from the GCC dispute. But growth in 2018 will pick up sharply to 4.0% if, as scheduled, the giant Barzan gas project comes on stream.
- Available data shows tourism, trade and capital flows have been severely affected, while imported food costs have risen. With no near-term negotiated settlement in sight, non-oil growth is now expected at 4.0% this year, and steady in 2018.
- The impact on the financial sector has been cushioned by the injection of government funds into the banking system, though banks still face headwinds from tighter liquidity, higher interest rates and a weaker operating environment.
- The fiscal deficit is expected to narrow to a relatively comfortable 3% of GDP next year. The government's credit rating has been downgraded, but yields on public debt have eased back and pressure on the riyal has diminished.

Headline growth for 2017 lowered as dispute with neighbors persists

We have revised down our forecast for overall economic growth in 2017 to 1.8% from 2.5% before (chart 1). The downgrade is driven by the fallout from the diplomatic dispute with Qatar's Gulf neighbors, and leaves growth at a 23-year low.

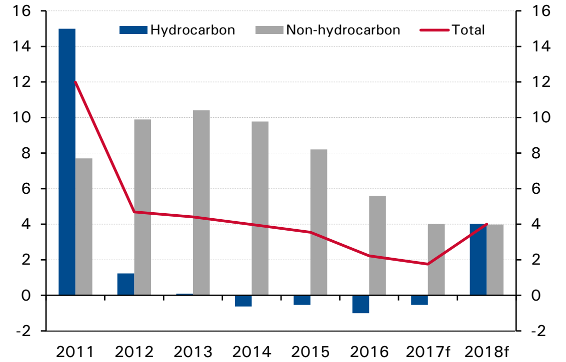
Non-oil growth is lowered to 4.0% from 5.3% before, with the extended dispute so far causing major disruption to trade and tourism, a spike in food prices, currency and stock market pressures, credit rating downgrades, and damage to corporate earnings. The government has also repatriated funds from overseas to support the domestic financial sector. Although some of these pressures have stabilized, attempts to resolve the dispute have yielded little so far and the cost of regional isolation could grow over time, especially as attention on the country builds ahead of the 2022 World Cup. Meanwhile, growth in the hydrocarbon sector in 2017 has also been lowered, to -0.5% from -0.3%, on tighter-than-expected discipline with respect to crude output targets.

Table: Key economic indicators

		2015	2016	2017f	2018f
Nominal GDP	$ bn	164.6	152.5	162.7	171.9
Real GDP	% y/y	3.6	2.2	1.8	4.0
- Oil	% y/y	-0.5	-1.0	-0.5	4.0
- Non-oil	% y/y	8.2	5.6	4.0	4.0
Consumer price inflation	% y/y	1.8	2.7	0.5	2.5
Budget balance	% GDP	-1.0	-9.0	-5.0	-3.0

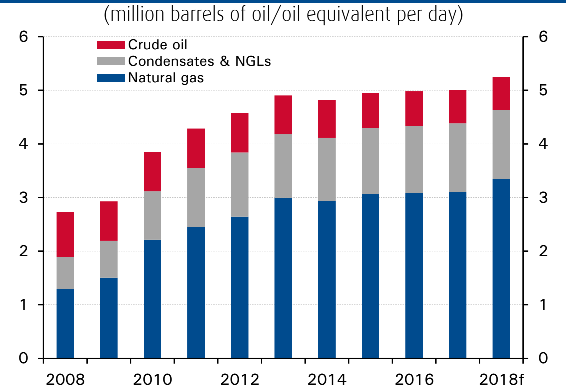
Source: Official sources, NBK estimates

Chart 1: Real GDP growth
(% y/y)



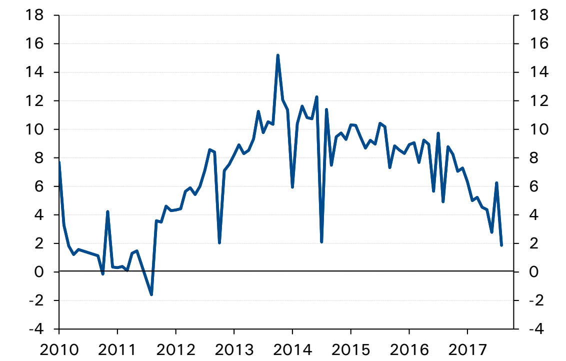
Source: Thomson Reuters Eikon / NBK

Chart 2: Oil and gas production
(million barrels of oil/oil equivalent per day)



Source: JODI, BP, OPEC, NBK

Chart 3: Total population
(% y/y)



Source: MDPS

Looking into 2018, however, GDP growth is forecast to improve sharply to 4.0%, from 3.1% before. The main driver is the anticipated startup of production from the giant Barzan gas project at the end of this year. This could add some 5% to hydrocarbon sector GDP when fully on stream (chart 2). The project has already been substantially delayed, however, and further delay would affect the forecast. Crude oil production – small by comparison to gas – is expected to be broadly flat in compliance with the OPEC agreement to restrict output that has been rolled in to 2018. The recent lifting of the 12-year moratorium on new North Field gas projects is unlikely to affect growth over the forecast period.

Growth in the non-hydrocarbon sector is seen stable next year at 4.0%, but below the 5.0% forecast previously. This is less than half the rate seen in 2012-16. In the absence of a resolution to the current crisis, business conditions will remain disrupted and there is potential for more serious turbulence if political tensions escalate. Population growth, already weakening, is likely to slow further (chart 3). On the positive side, however, exports of natural gas (including to the UAE) will be largely unaffected and there are no signs of a slowdown in government infrastructure spending beyond those previously planned due to the drop in oil prices. It is also possible that the government will delay reform measures that might crimp demand.

Food prices jump, but overall inflation to remain low

The trade blockade resulted in a sharp rise in food price inflation to 4.5% y/y in July from -0.1% in June, driven by a combination of supply shortages and increased transit costs as supply chains were re-routed (chart 4). But food price inflation eased back slightly in August, to 2.8%. Inflation overall fell into negative territory at -0.4% y/y in August from 0.2% in July with most non-food categories seeing softer figures. We attribute this mostly to a weakening in demand due to the deteriorating growth climate including possibly population outflows, which may have affected housing rents. As it is, the residential property market remains weak (chart 5).

Some pick-up in inflation is likely going forward, but given the low starting point and weaker economy, it will probably remain below 1% y/y for the rest of 2017 and average just 0.5% for the year as a whole. Next year, inflation is forecast to average 2.5%, boosted by base effects, slightly firmer growth, a weaker US dollar pushing up import costs and the implementation of a 5% VAT which is presumed to be introduced in September and lift the y/y inflation rate by around 2%.

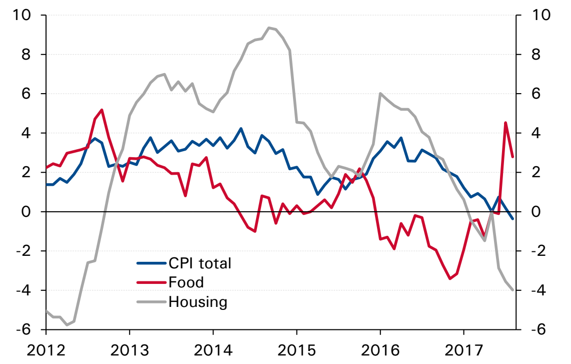
Fiscal restraint to continue this year but the deficit should narrow on higher oil and gas revenues

The fiscal deficit is seen narrowing to 5.0% of GDP this year from 9.0% of GDP in 2016 (chart 6). The improvement is due to an 18% rise in revenues driven by rising oil and gas prices (though oil and gas output will be broadly flat in volume terms). Hydrocarbon receipts account for around 85% of total budget revenues. Large non-oil revenue raising measures are not scheduled until 2018. These include excise duties (worth up to 0.2% of GDP) and VAT (up to 1% of GDP). The latter is assumed to be implemented in September next year.

We estimate that spending was cut by around 17% in 2016 in pro-rata terms – i.e. after accounting for the short budgeting year in 2015 due to a change in reporting arrangements – as the government looked to address the large deficit and recalibrate its outlays with the new, low oil price climate. The budget for 2017 targeted a further small cut in spending of 2%, but given contingency spending linked to the dispute (including

Chart 4: Consumer price inflation

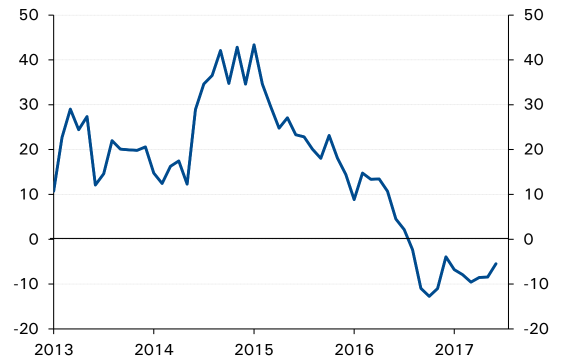
(% y/y)



Source: MDPS

Chart 5: Real estate price index

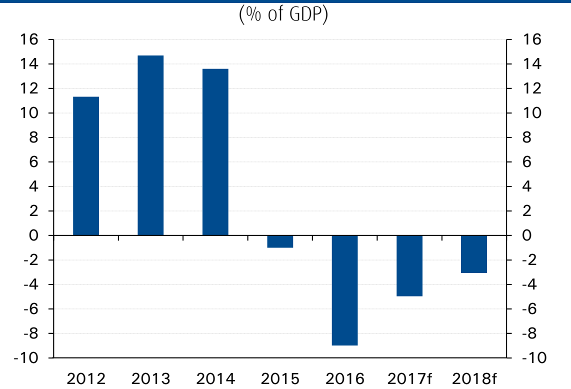
(% y/y)



Source: QCB

Chart 6: Fiscal balance

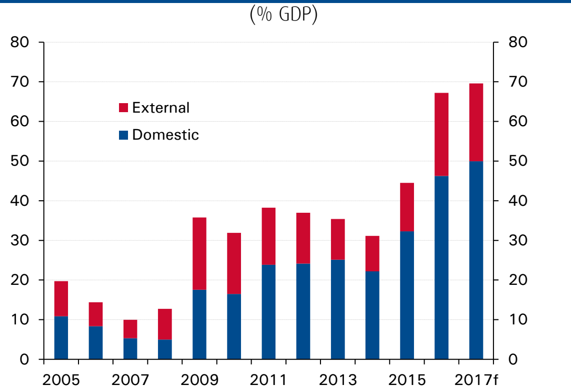
(% of GDP)



Source: Thomson Reuters Eikon / NBK

Chart 7: Central government debt

(% GDP)



Source: QCB / Thomson Reuters Eikon / NBK higher import costs), the need to maintain investment spending at high levels, as well as better revenue conditions, we expect a small increase in spending of 4% or so. The deficit is seen narrowing further to 3.0% of GDP in 2018 as a modest rise in spending is more than offset by rising hydrocarbon and non-hydrocarbon sector revenues.

No fresh external debt issued by the government in 2017

The government has been leaning on debt to finance its deficit rather than drawing down its vast reserves managed by the Qatar Investment Authority, estimated at $320 billion (around 200% of GDP) in June. Outstanding central government external debt stood at $32 billion in June (20% of 2017 GDP), and domestic debt – including direct bank lending to the government – worth a much larger $78 billion (48% of GDP). (See Chart 7.) The government has avoided additional sovereign issuance so far in 2017, following its massive $9 billion bond issue last May. But it has borrowed an additional $5 billion direct from local banks.

Qatari government debt continues to be ranked as high investment grade by the main rating agencies. However, the diplomatic dispute has seen the ratings taken down a notch by both S&P and Fitch (both to AA-), with a negative outlook implying the prospect of further downgrades. The yield on the government's 2026 bond, having initially jumped when the crisis broke, has now eased back and remains low at 3.3% – only marginally above similar maturity issues in both Saudi and Kuwait. Pressure on the riyal has also fallen, with the 1-year forward rate back close to pre-crisis levels.

Credit growth accelerates despite headwinds from crisis and higher interest rates

Despite the worrisome geopolitical backdrop and rising interest rates (see below), there has been little sign so far of a material slowdown in credit growth. In fact, credit growth picked up to 15.2% y/y in August, well above its average both for the first six months of the year and last year (chart 8). Within the total, credit to the private sector stood at 7.6% y/y in August, slightly above its 1H total. One possible factor behind the recent upturn could be corporates borrowing in foreign currency to replace a loss in funding from overseas.

But more visible signs of stress from deposit data

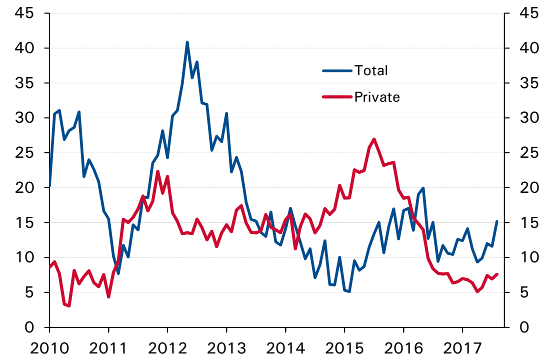
But the impact of the crisis has been more visible on the deposit side. Although headline deposit growth surged to 20% y/y in August, this masked a notable difference across sectors (chart 9). Private sector deposits plunged QAR28 billion between May and August, leaving them down 0.2% y/y. Non-resident deposits fell by an even larger QAR36 billion – with some of this driven by the withdrawal of funds by blockading countries. But these declines were more than offset by a QAR95 billion jump in public sector deposits, which surged 70% y/y in August, as the government looked to mitigate the impact on the domestic banking sector. Although more recent data has not yet been released, there was a sharp $10 billion drop in the QCB's net international reserves between May and June.

Market interest rates also edging higher as liquidity tightens

There are also signs of rising liquidity pressures in the banking system, where foreign funds account for a sizeable 32% of total liabilities. Three-month interbank interest rates climbed from 1.94% at end-May to 2.43% in mid-September, while rates on 3-month t-bills issued by the central bank (QCB) rose to 2.25% in early September from 1.85% in June. The

Chart 8: Credit growth

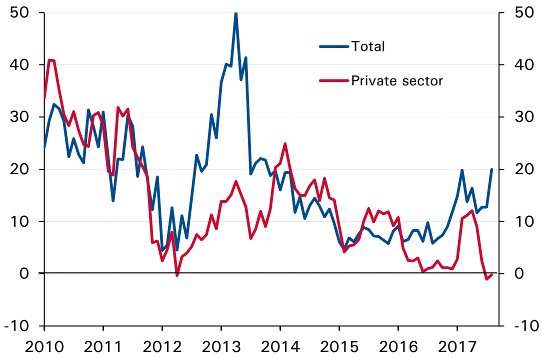
(% y/y)



Source: QCB

Chart 9: Deposit growth

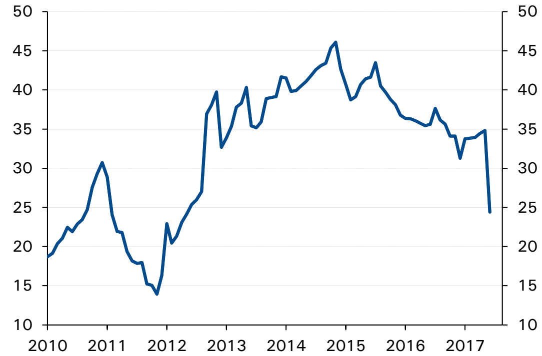
(% y/y)



Source: QCB

Chart 10: QCB net foreign reserves

($ billion)



Source: QCB

Chart 11: Interbank rates

(%, 3-month rate)

Source: Thomson Reuters Datastream

QCB increased its funds at local banks by $10 billion between May and July (this eased back to $7 billion by August) and a number of Qatari banks are now reported to be in talks with foreign lenders about possible bond issues or private placements. While capitalization levels among banks remains strong and non-performing loans are low by regional standards, the concern is that tightening credit conditions will hit sector profits, reinforce the damage to economic growth and potentially impact key infrastructure projects.

Market interest rates have also been lifted by higher policy rates over the past year. The QCB has lifted its benchmark lending and deposit rates by 50 bps and 75 bps, respectively, since last November, reflecting the 75 bps hike in the US Fed funds target rate. Expectations are that the next Fed hike may not come until 2018, but in the current uneasy geopolitical climate, the QCB is likely to have to follow suit to avoid an increase in speculative pressure on the riyal. A change in the currency peg regime remains very unlikely.

Stocks see renewed falls as hopes for early end to crisis are dashed

Having dropped nearly 10% in the days following the start of the diplomatic siege in June, the main QE Index of shares reversed some of these losses in July, but has since erased all of these gains and plunged to a five-year low. The index was down some 20% year-to-date in mid-September, compared to a small gain for the GCC region overall. As well as a lack of enthusiasm over the prospect for oil prices, the market has suffered as it became clear that an early negotiated settlement to the crisis was unlikely, with investors also deterred by rating agency downgrades.

Chart 12: Qatar 2026 government bond yield

(%)

Source: Thomson Reuters Datastream

Chart 13: 12-month forward exchange rate

(QAR/US$)

Source: Thomson Reuters Datastream

Chart 14: QE stock market

(index)

Source: Thomson Reuters Eikon

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