Macroeconomic outlook

Qatar: Non-oil growth to slip further as diplomatic row persists

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Overview and outlook

- **GDP growth is expected to pick up to 3.5% in 2018 from 1.2% in 2017, but this improvement is contingent on the startup of the much-delayed Barzan gas project, which could add 4% to oil sector GDP.**
- **Non-oil growth, by contrast, will remain under pressure as the GCC diplomatic rift disrupts investment, trade and the business climate. While the initial shock to the economy has passed, an intensification of the dispute presents a downside risk to growth.**
- **Financial sector flows have stabilized after government cash injections pushed up deposit growth. Further interest rate hikes will be needed to support the exchange rate peg, but risk tightening credit conditions at a time when the economy requires support.**
- **The 2018 budget allocates funds for food security schemes and sports stadia, but will not provide a large fresh stimulus to the economy. The fiscal deficit will narrow to a manageable 3% of GDP.**

Growth to pickup in 2018, but risks skewed to the downside

Our forecast for GDP growth in 2018 has been revised down to 3.5% from 4.0% before, driven by the continued fallout from the GCC diplomatic rift which shows few signs of resolution. (Chart 1.) This will still be a pickup from the 1.2% expected for 2017, with the rebound driven by the startup of the long-delayed Barzan gas project, which could boost real hydrocarbon sector GDP by 4%. (Chart 2.) Given the scope for further delay at Barzan and the potential for an intensification of the diplomatic dispute, the risks to our growth forecast are on the downside.

Non-oil growth in 2018 has been downgraded to 3.0% from 4.0% before, and is weaker than the 3.5% now expected for 2017. The initial shock to the economy from the dispute which started in June has passed, with imports returning close to pre-crisis levels, new trade routes established and capital flows more stable. But the economy remains under pressure. Corporate earnings have been hit, equity and real estate prices have slumped (chart 3), and the more difficult funding climate has put strain on banks and the currency peg.

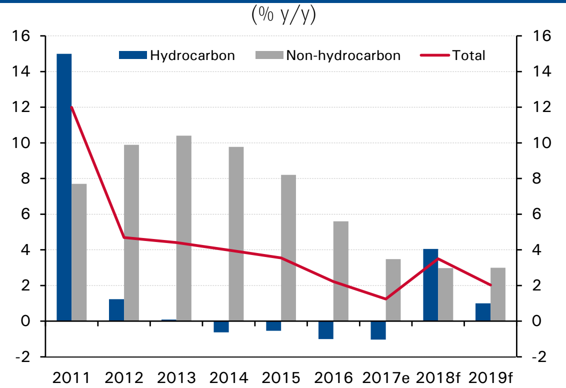
Table: Key economic indicators

		2016	2017f	2018f	2019f
Nominal GDP	$ bn	152.5	161.4	169.4	176.3
Real GDP	% y/y	2.2	1.2	3.5	2.0
- Oil	% y/y	-1.0	-1.0	4.0	1.0
- Non-oil	% y/y	5.6	3.5	3.0	3.0
Consumer price inflation	% y/y	2.7	0.5	2.5	2.5
Budget balance	% GDP	-9.0	-5.0	-3.0	-2.0

Source: Official sources, NBK estimates and forecasts

Chart 1: Real GDP growth

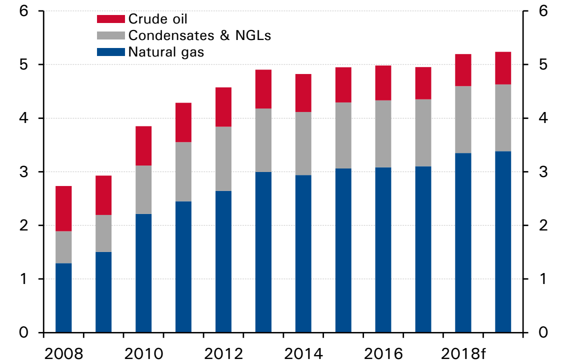
(% y/y)



Source: Thomson Reuters Eikon / NBK

Chart 2: Oil and gas production

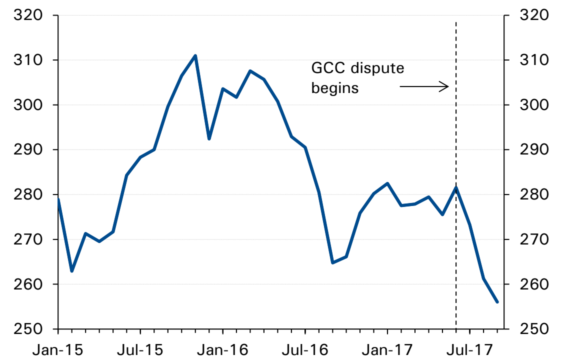
(million barrels of oil/oil equivalent per day)



Source: JODI, BP, OPEC, NBK

Chart 3: Real estate price index

(Index)



Source: QCB

Although trends are obscured by data issues, our view is that the flow of people and tourists into Qatar has also been significantly affected. The resident population was up 3% year-to-date in November, compared to 7-11% in the equivalent period in the previous five years. Population growth slipped to just 1.7% y/y, the slowest since 2011, though has been trending down for the past few years. (Chart 4.) Visitor arrivals were down 32% y/y in October, and down 74% y/y from the GCC. This weakness is likely to persist unless a resolution to the crisis is found.

More positively, the government's main source of revenues – oil and gas receipts – has been largely unaffected by the dispute (including the gas delivered via the Dolphin pipeline to the UAE), and it has recently bolstered its finances by the sale of stakes in various overseas firms. Activity is also cushioned by the long pipeline of infrastructure projects to which the authorities are committed both for the World Cup in 2022 and Vision 2030, including the metro (due 2019), Lusail Light Rail system (2020) and World Cup stadia. Meanwhile, there are plans to restart development of North Field gas deposits following the lifting of the 12-year moratorium, though the impact will likely fall beyond our forecast range. The latest 5-year development plan (2017-22) is being finalized.

Inflation very low, outlook clouded by possible VAT

Inflation – already low in 1H 2017 – fell in to negative territory in August and September for the first time since 2011 and is estimated at 0.4% for 2017 as a whole. (Chart 5.) Key to weak price pressures has been the slump in the housing component, at -5.4% y/y in October, driven by the broader correction in house prices which has arguably intensified since the summer. But 'core' inflation is also low, estimated at 0.8% for 2017 due to the still-strong currency (linked to the dollar peg) and weaker growth climate. Although food prices have risen due to the diplomatic dispute, the rise has not been as severe as feared.

A VAT was intended to be implemented (likely late) in 2018, which would add around 2% to the annual rate of inflation for one year. This is factored in to our forecast, but given the absence of preparations so far, the current need to support the economy and the manageable fiscal deficit, there is a good chance that implementation will be postponed. With base effects likely to push food inflation higher, the fading of downward prices pressures from the exchange rate and possibly VAT in 2H, we forecast inflation to pick up to 2.5% in 2018.

Budget outlines modest spending rise in 2018, deficit to narrow

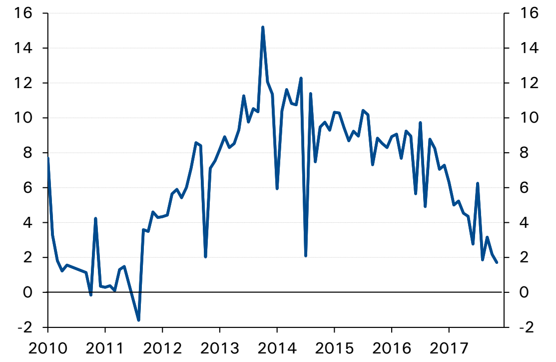
The fiscal deficit has been at manageable levels – and much lower than in some other GCC countries. The deficit is estimated to have narrowed to 5% of GDP in 2017 from 9% a year earlier, with higher revenues due to a y/y rise in oil and gas prices more than offsetting a modest increase in government spending. (Chart 6.) Hydrocarbon exports were unaffected by the diplomatic row, and accounted for around 85% of budget revenues. We estimate that spending had been cut by around 17% in 2016 which helped limit the deficit but also contributed to the slowing economy.

The government's budget for 2018 signals a 2% rise in spending, including a focus on food security projects in light of the trade embargo and a rising wage bill that reflects the launch of new schools and hospitals. But we think spending will overshoot, as it did in the previous two years. As has been typical, capital spending will account for nearly half of all outlays, with some QAR11 billion allocated to sports projects primarily stadia for the 2022 World Cup.

On the revenue side, we have also penciled in the introduction of excise duties and VAT later in the year, which combined could add just over 1%

Chart 4: Population growth

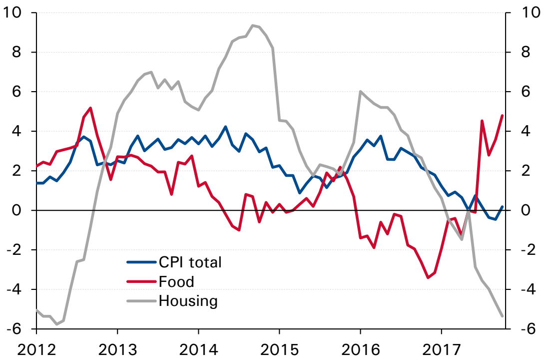
(% y/y)



Source: MDPS

Chart 5: Consumer price inflation

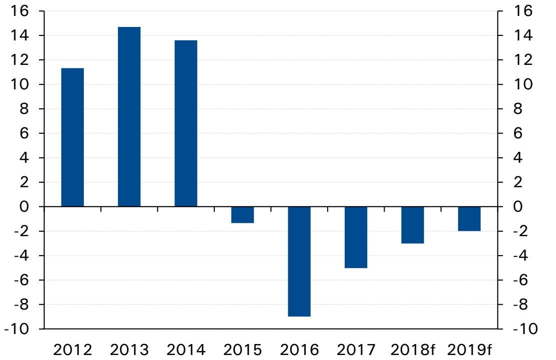
(% y/y)



Source: Thomson Reuters Eikon

Chart 6: Fiscal balance

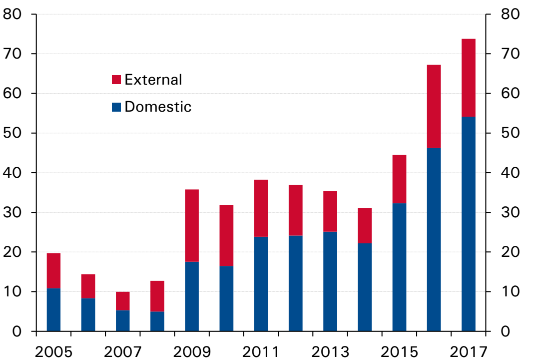
(% of GDP)



Source: Thomson Reuters Eikon / NBK

Chart 7: Central government debt

(% GDP)



Source: QCB / Thomson Reuters Eikon / NBK of GDP to receipts. But given the authorities' desire to support the economy, there is a good chance that these measures will be postponed. The net result is that the deficit is forecast to narrow to 3% of GDP in 2018 then to 2% in 2019, with oil and gas prices broadly steady.

Government debt levels continue to rise but bond yields still low

Despite talk of a sovereign bond issue in late 2017, the government has avoided tapping international markets since the giant $9 billion bond issue of May 2016. It has, however, increased its borrowing direct from local banks, which reached $87 billion in October from $71 billion at end-2016. Total government debt will stand at around $120 billion by end-2017, or 74% of GDP (see chart 7), which is high compared to many of its Gulf peers.

The government's credit rating has been downgraded once by each of the main rating agencies through 2017, one of which occurred before the crisis began. But the overall rating still stands at high investment grade – of AA- or equivalent – reflecting the relatively manageable fiscal deficit and strong asset position. The yield on the government's 2026 bond – previously one of the lowest among comparable maturity bonds in the region – stood at around 3.6% in early December, a 10-30 bps premium against Kuwait, Saudi and Abu Dhabi and up from around 3.2% pre-crisis. (Chart 8.)

Deposit flows now more stable after initial crisis-related shock

After an initial shock triggered by the diplomatic crisis, flows within the banking system have stabilized somewhat. Deposits of non-residents – including from the GCC – fell $13 billion (25%) between May and October, while private sector deposits also dipped. But this was more than offset by an inflow of $27 billion in public sector deposits, as the government looked to cushion the impact on the banking sector. The net impact of these flows has been to push overall deposit growth up to a very strong 17% y/y in October. (Chart 9.) Encouragingly, private sector deposits had returned to growth in September, while the pace of non-resident outflows has eased. But further government funding is likely should the need arise.

Credit growth accelerates, albeit driven by the public sector

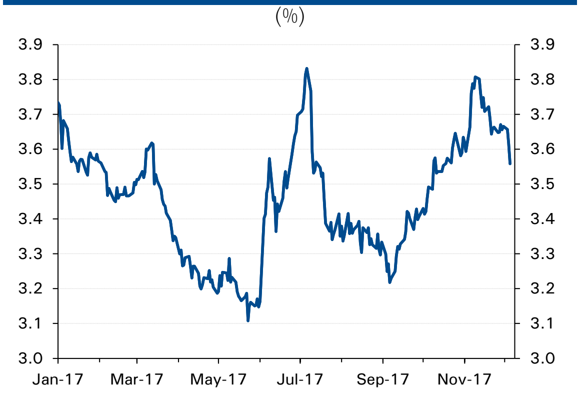
Despite the weaker operating environment, credit growth has remained robust, reaching a more than 1-year high of 16% y/y in October. (Chart 10.) But much of this strength relates to lending to the government, which surged 61% y/y in October and accounted for 22% of all lending compared to 16% a year earlier. Lending to the private sector has been softer, though stable, at around 7% y/y since the crisis began. Increased exposure to the government will likely reduce any rise in problem loans, but could eventually limit funds available to the private sector.

Market interest rates also edging higher as liquidity tightens

Government and central bank (QCB) deposit injections have helped to ease liquidity pressures in the banking system resulting from the exodus of foreign funds. Admittedly, 3-month interbank rates have risen more than 50 bps to 2.5% since 1H17. But much of this was related to the rise in policy interest rates in June, following the hike by the US Federal Reserve – though the rise since May was around 20-50 bps more than in other GCC countries. (Chart 11.)

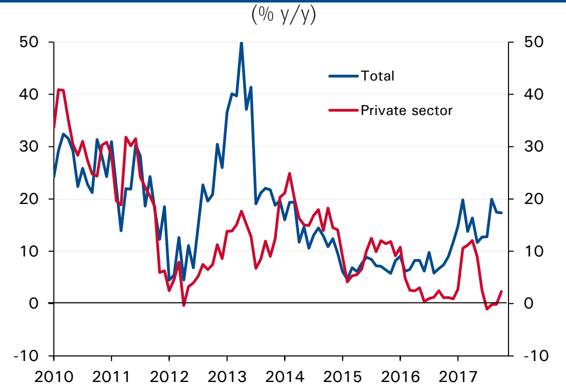
The QCB hiked its repo rate by 25 bps to 2.5% in December following the latest Fed hike, but left its other policy rates on hold. We expect 2 further

Chart 8: Yield on government 2026 bond



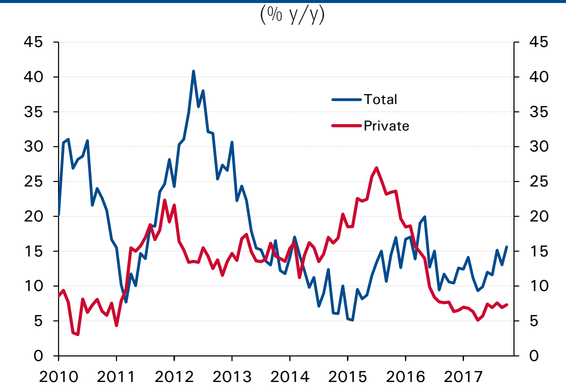
Source: Thomson Reuters Eikon

Chart 9: Deposit growth



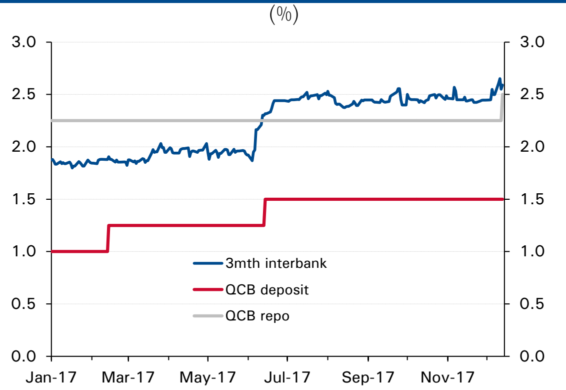
Source: QCB

Chart 10: Credit growth



Source: QCB

Chart 11: Interbank and policy interest rates



Source: Thomson Reuters Datastream

US interest rate rises in both 2018 and 2019. In the current climate, the QCB is likely to follow suit, in order to avoid inviting pressure on the riyal currency peg. But rate hikes risk tightening credit conditions at a time when the economy requires additional support.

The currency market continues to see some pressure. Some investors were said to be having difficulty obtaining US dollars at the official pegged rate of QAR3.64/$1 in the onshore market, with the QCB subsequently guaranteeing that investors in the stock market would be able to exchange riyals at the official rate. Liquidity in the market has since improved, with the gap between the onshore and offshore riyal rates narrowing and the 1-year forward rate back trading very close to the official rate, having been as much as 3.6% weaker in June. (Chart 12.)

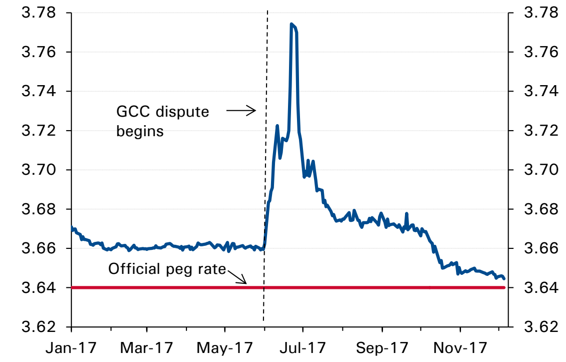
Given the costs and disruption that would follow, a change in the currency peg regime remains very unlikely. The authorities also have plenty of financial firepower at their disposal. The central bank's international reserves have fallen from $46 billion in May to $36 billion in October (under the new definition), but now appear more stable and still equate to 7 months of imports, which is well above levels traditionally considered adequate. (Chart 13.) Moreover, this does not include an estimated $300 billion plus in assets held by the Qatar Investment Authority – the sovereign wealth fund.

Stock market edges up from 7-year low

The main Qatar stock index has continued to lose ground in recent months, and by mid-December was down 23% year-to-date (ytd) and 19% since the diplomatic crisis began in June. (Chart 14.) This compares to ytd changes of +4% to -12% in other Gulf markets and also leaves the market near a 7-year low recorded in November. Poor performance reflects outflows of capital by overseas investors, the impact of the crisis on the economic outlook and corporate earnings, and broader regional concerns about geopolitics and low oil prices.

Chart 12: 12-month forward exchange rate

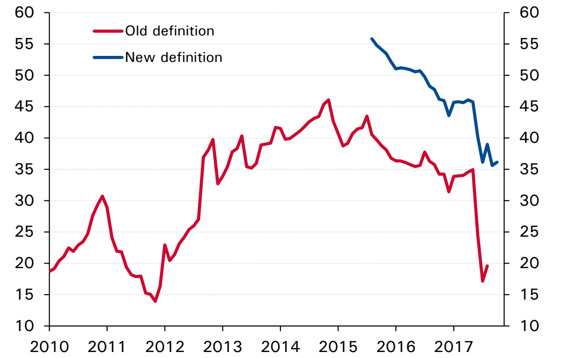
(QAR/US$)



Source: Thomson Reuters Datastream

Chart 13: QCB net foreign reserves

($ billion)



Source: Thomson Reuters Eikon / QCB

Chart 14: QE stock market

(index)

Source: Thomson Reuters Eikon

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