Qatar

The limits of diversification

The Qatari economy is struggling to find new sources of growth beyond the hydrocarbon sector. Given the stability of hydrocarbon production and the ending of the infrastructure investment cycle, economic growth is likely to hit a record low in 2019. Over the medium term, the introduction of new LNG production capacity is likely to bolster the economy. Against the background of a sluggish economy, inflation is likely to be dragged into negative territory by the on-going fall in real estate prices. This said, the public finances and external accounts remain solid and are likely to improve further as the gas rent increases over the medium term.

The economic slowdown continues

Despite attempts to diversify, economic growth remains dependent on the hydrocarbon sector. The rest of the economy has not managed to generate sustainable and significant growth. Over the past decade the Qatari economy has seen three phases of growth. Real GDP growth was above 15% per year between 2007 and 2011 thanks to the steady increase in hydrocarbon production, mainly LNG. Over the following four years, the non-hydrocarbon sectors of the economy, particularly construction and services, were the main growth engine. Between 2012 and 2015 growth averaged 4.2% per year. Since 2016, growth has dropped by a further notch, and averaged 1.7% per year between 2016 and 2018. These mediocre performances were due to a number of factors: the stagnation of hydrocarbon GDP, the end of the project cycle with the completion of the main infrastructure projects, the consequences of the embargo and the weakness of the real estate sector.

The latest economic data confirm the weak performance of the Qatari economy. GDP in the hydrocarbon sector, representing 48% of total GDP, fell by 1.9% in Q2 2019, taking its average fall over the previous 12 months to 0.4%. This reflects the dependence of this segment of the economy on gas production; since 2015, gas production has been stable whilst, in the absence of any new discoveries, oil production has been in steady decline. Non-hydrocarbon GDP fell 1.1% y/y in Q2 2019. The construction and real estate sectors (accounting for around 15% of GDP) shrank by 2.1%. This reflected the regional depression in the real estate sector. Throughout the Gulf, abundant supply of real estate faced with soft demand has resulted in a decline in activity in this sector. At the same time, the end of the project cycle, and in particular the completion of the bulk of the infrastructure planned for the football World Cup in 2022, has naturally resulted in a slowdown in the construction sector. Reflecting the mediocre performances of the construction industry and the non-hydrocarbon segment in general, growth in Qatar's total population has slowed significantly since 2015. The expatriate population, which accounts for more than 80% of the Emirate's total population, increased by an average of only 2.5% per year between 2016 and 2018, compared to a figure of over 10% in previous years.

Although its economic importance is more symbolic than real, the tourism sector has struggled to expand since mid-2017 and is facing a steep decline in tourists from other Gulf states. Although visitor numbers appear to have recovered since the beginning of the year, the number of arrivals to the country in the year to the end of Q1 2019, at 12 million, was well below the figures of more than 19 million seen up to 2016. Symbolising of this steady slowing of the non-hydrocarbon economy, growth in the financial services sector has fallen steadily since 2015. This sector saw growth of only 3.4% y/y in Q1 2019, from an average of over 10% prior to 2016.

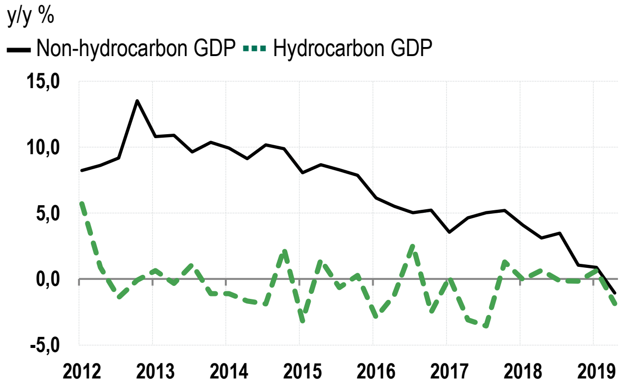
In the short term, prospects are mixed, and are likely to confirm the regime of much slower growth that began in 2016. The hydrocarbons sector is unlikely to see any significant changes given that no new production is coming on stream. Moreover, Qatar left OPEC at the beginning of the year and therefore does not follow

1- Forecasts

	2017	2018	2019e	2020e
Real GDP growth (%)	1.7	1.4	1.0	2.3
Inflation (CPI, year average, %)	0.3	0.2	-0.5	1.5
Gen. Gov. balance / GDP (%)	-5.8	0.5	1.0	2.3
Gen. Gov. debt / GDP (%)	50	48	47	46
Current account balance / GDP (%)	3.8	8.7	5.1	3.9
External debt / GDP (%)	100	101	107	98
Forex reserves (USD bn)	14	26	28	29
Forex reserves, in months of imports	2.3	4.4	4.4	4.5
Exchange rate USDQAR (year end)	3.64	3.64	3.64	3.64

e: BNP Paribas Group Economic Research estimates and forecasts

1 - Real GDP Growth



Sources: Qatar Planning and Statistics Authority, BNP Paribas anymore its policy of regulating oil production. We expect hydrocarbon sector GDP to grow very slightly – by 0.5% in 2019 and 2% in 2020, with the coming on stream of the Barzan gas project, intended to meet rising domestic energy demand. The performance of the rest of the economy is likely to remain modest. The bulk of activity is likely to be related to growth in government spending, particularly investment spending. We would note, however, that at the regional level, the positive effects of public spending on the whole economy have diminished. It seems that after years of sustained growth in government investment, the economy's ability to absorb it has been reduced. Growth in the non-hydrocarbon economy looks set to slow further, to 1.5% in 2019 (from 3.0% in 2018), before climbing to 2.5% in 2020.

All in all, we expect total GDP growth of 1.0% in 2019, its weakest level for twenty years, followed by a slight recovery to 2.3% in 2020.

Support from the hydrocarbons sector over the medium term

Over the medium term there are two factors that will support economy activity. The World Cup will bring a temporary economic boost, at least in the services sector, although its impact on non-hydrocarbon GDP growth should not be overestimated. The main risk is at the geopolitical level. The Gulf region is currently a nexus of significant regional tensions, and any increase in political risk in the area has an unfavourable effect on economic activity, particularly in the services sector. The construction sector meanwhile should benefit from the additional activity created by the Qatar National Vision 2030 plan. This covers investment in infrastructure and real estate equivalent to USD 16 bn in order to boost economic activity from 2022 onwards. This raises the question of the match-up between investment and the needs of the local market.

The second source of economic support will come from increased investment in the LNG sector, with the aim of increasing Qatar's export capacity by 40% by 2023-24. The economic rationale of the project is strong given the medium-term growth prospects in this market (notably in Asia).

Negative inflation

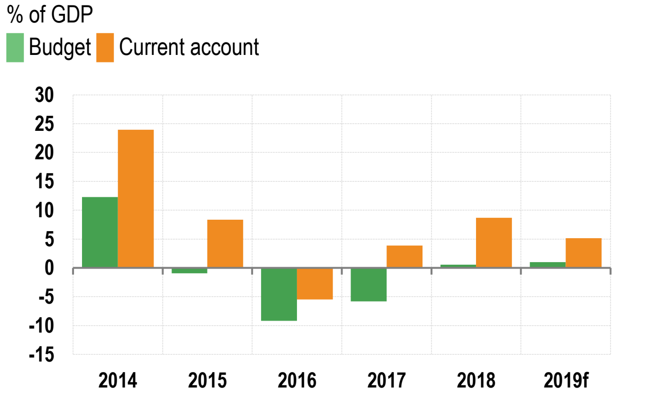
In common with other Gulf states, consumer price inflation has fallen sharply due to the on-going fall in real estate prices. The housing component of the price index (22% of the total) has fallen steadily since the end of 2016 (dropping an average of 2.1% since the beginning of the year). We expect an average inflation rate of -0.4% in 2019. There could be a return to positive territory next year with the possible introduction of VAT. However, if we look at regional precedents, its rate and scope are likely to be limited, thus reducing its effect on the general level of prices. In 2020, average inflation is likely to be 1.5%.

Solid fundamentals

Despite these depressed economic conditions and the unfavourable regional political climate, Qatar remains financially solid. After three years of deficits linked to falling oil prices, the government moved back into surplus in 2018 (0.5% of GDP). Control of public spending is likely to produce further surpluses in 2019 and 2020 (1.0% and 2.3% of GDP respectively). The solvency of public finances remains comfortable, given modest government debt (41% of GDP in 2018, though 78% if one includes public companies), access to capital markets on favourable terms (the risk premium on foreign currency bonds is currently 53bp, one of the lowest in the region) and the government's foreign currency assets, which are estimated at more than 1.6 times GDP. Similarly, external balances are solid, with recurrent current account surpluses (8.7% of GDP in 2018).

In the banking sector, the negative consequences of the embargo that began in 2017 have been compensated by the substantial public support (deposits from the central bank and the government) and then the return of foreign depositors, particularly from Asia. However, the rapid growth in the banks' net external liabilities should be noted. Given the rapid increase in lending to the public and private sectors (17% and 9% y/y respectively in June 2019 according to the IMF) and the decline in deposits (-1.9% y/y), a growing share of resources comes from abroad. The country's banks thus had a net external liabilities position of USD 73 bn (39% of GDP) in June 2019.

3- Back to surpluses



Source: BNP Paribas

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