



QATAR ECONOMIC REPORT

CONVERGING TOWARDS MORE SUSTAINABLE ECONOMIC GROWTH ON THE BACK OF STRONG FINANCIAL CUSHIONS

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- Growth slowing down but non-hydrocarbon sectors start flourishing
Qatar's economy which has been recording impressive double-digit growth rates for the past 6 years, has slowed down relatively in 2012. Real GDP growth is set to moderate to 6% in 2012, according to the IMF, driven by the slowdown in real hydrocarbon output. Still, an overall level of optimism continues to pervade the Qatari private sector. Qatar is indeed resorting to its vast fiscal space to implement large spending programs including, among others, roads, port, airport and metro, all aimed at fostering growth in non-hydrocarbon sectors in the middle run.
- Inflation rate at contained levels
Monetary conditions were marked during the first few months of 2012 by a considerable pick-up in international reserves after the net decline of 2011, a small contraction in monetary aggregates and a contained level of inflation rate. Qatar's Consumer Price Index grew by 1.2% on average during the first quarter of 2012, after rising by 1.9% in 2011. The Central Bank's net international reserves reached US\$ 23.1 billion at end-April 2012, up from US\$ 16.3 billion at year-end 2011, after having fallen by 46.9% in 2011. The broader Money Supply (M2) contracted slightly by 1.7% during the first four months of 2012 after expanding by 17.1% in 2011.
- Qatar's fiscal accounts remained in a highly comfortable zone
Despite the large public spending program implemented in fiscal year 2011/2012 in the aim of maintaining strong growth in the non-hydrocarbon sector in the medium term, the State's public surplus actually edged up by 44.4% to reach US\$ 15.6 billion (8.9% of GDP) as per the IMF, with a rise in the revenue base exceeding that of expenditures on account of an increase in hydrocarbon production and prices. Within this environment, Qatar earmarked a record budget for fiscal year 2012/2013, with US\$ 49.2 billion in spending, of which it allocates significant outlays on infrastructure in the run-up to the 2022 World Cup.
- Fast bank lending growth amidst growing domestic financing needs
Qatar's banking sector witnessed good activity growth in 2011 and so far this year driven by rising public sector financing needs for infrastructure and development spending. Measured by total bank assets, banking activity grew by 22.3% throughout the year 2011 and by a further 4.2% in the first four months of 2012. The sector remains financially sound, with good core readily available liquidity, strong return on average assets of 2.7%, adequate equity base with a capital to risk-weighted assets ratio of 20.6% and very good asset quality with a non-performing loans ratio of 1.7% at year-end 2011.
- Mixed performance on Qatari capital markets
While the Qatar Stock Exchange posted decline in prices, the Qatari debt papers were on the rise following drops in US Treasury yields, timely debt repayments and successful new bond issues in the region that left a positive impact on regional fixed income markets at large. The Qatar Exchange general index reported a drop of 4.1% during the first five months of 2012 to close at 8,416.8 at end-May 2012, following a small rise of 1.1% in 2011. In parallel, the CDS spread, denoting fixed income market risk perception, remained almost stable year-to-date at 132 basis points, after a net expansion of 39 basis points in 2011 within the context of growing credit risks at the global level.
- Overall outlook favorable despite external risks
The average real GDP growth of circa 6% per annum over the next six years as forecasted by the International Monetary Fund, despite the moratorium on new hydrocarbon development following the completion of mega gas projects, is considered significantly sound, especially that it is set to be triggered by the non-hydrocarbon sector which is apt to grow by close to a double-digit growth over the years ahead on the back of large government investment in infrastructure at large. Although Qatar faces a number of challenges looking ahead, its overall risks are believed to be quite manageable, on the back of adequate financial cushions and policy framework.



Qatar's economy which has been recording impressive double-digit growth rates for the past 6 years, making it the fastest growing economy worldwide over the period, has slowed down relatively in 2012. As LNG production is constant within the context of a moratorium on development of new hydrocarbon projects until 2015, real GDP growth is set to moderate to 6% in 2012, according to the IMF, driven by the slowdown in real hydrocarbon output. The earlier rapid expansion in the LNG sector that has characterized the past half decade has come to an end because of a self-imposed moratorium on behalf of the State of Qatar.

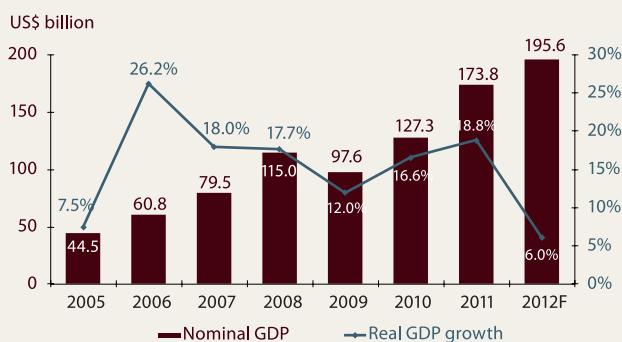
Still, an overall level of optimism continues to pervade the Qatari private sector. Qatar is indeed resorting to its vast fiscal space to implement large spending programs including, among others, roads, port, airport and metro, all aimed at fostering growth in non-hydrocarbon sectors in the middle run. Within the context of a strict scrutiny by FIFA to ensure timely progress on World Cup projects, preparations of the World Cup 2022 are underway despite some complaints of relatively slow progress in this respect.

It is worth noting that Qatar was able to weather over the past few years the global financial crisis, the regional turmoil and the fiscal driven global distress, maintaining high growth, large external account surpluses and elevated fiscal surpluses. As LNG exports are subject to long term contracts of 20 to 30 years, Qatar's exposure to oil and gas related volatility remains mitigated. Inflation has remained contained as well, despite buoyant economic activity, with the average CPI rate set at a single digit rate over the past 3 years. Rising food costs have been actually offset by further large falls in rentals and miscellaneous items.

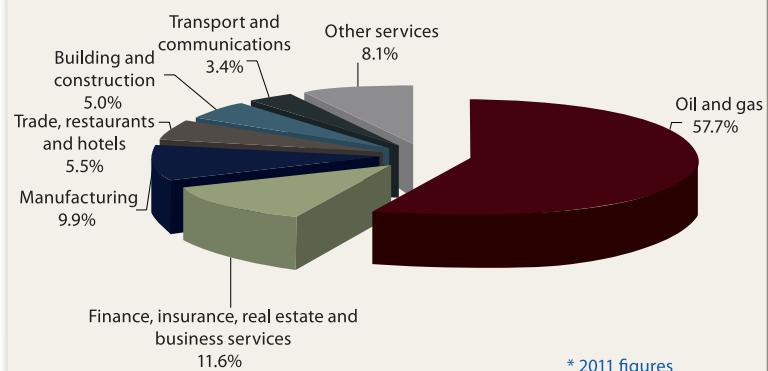
At the monetary level, Qatar is reporting a slowing down money supply growth within the context of moderating capital inflows and recent deficits in the balance of payments. The ceiling on banks remunerated deposits with the Central Bank resulted in a significant drawdown on Qatari Money Rate deposits and a reduction in the Central Bank foreign exchange reserves. QCB net international reserves dropped from US\$ 30.7 billion in 2010 to US\$ 16.3 billion in 2011 and then back to US\$ 23.1 billion at end-April 2012. The balance of payments recorded a deficit of US\$ 10 billion in 2011, the largest in the recent economic history of the Qatari state.

At the banking sector level, it is clear that the recent significant growth in bank lending has put an end to a period of deleveraging that started with the outburst of the global financial turmoil and is now increasingly supporting real growth in the economy. The US\$ 7.1 billion of new credit facilities to the economy in the first four months of 2012 represent eight times the growth in lending over the corresponding period of 2011. On the back of a bank loans to deposits ratio at a high of 123% by end-April, and within the context of an expected pick-up in Treasury bills issuance and growing European deleveraging, renewed pressures on credit creation are likely to see the light in the period ahead.

NOMINAL GDP AND REAL GROWTH RATES



GDP BREAKDOWN BY ECONOMIC ACTIVITY*

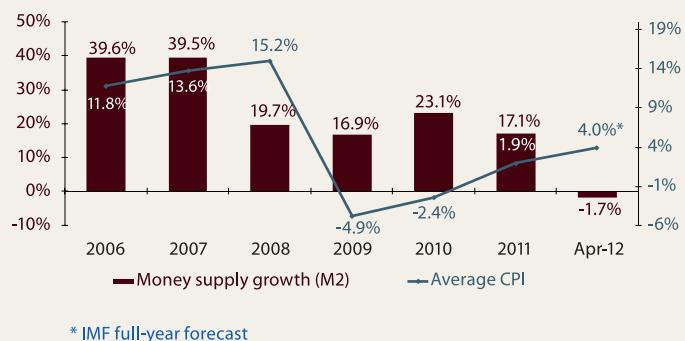




At the capital markets' level, markets are bearing witness to a status-quo at both equity and fixed income levels. The Qatar Exchange general index reported a drop of 4.1% during the first five months of 2012, following a small rise of 1.1% in 2011. While the market has quite attractive valuation ratios with a P/E of 11.5 times and a P/BV of 1.9 times, it is still suffering from a lack of efficiency and liquidity. At a 17.6% of annual turnover to market capitalization, the equity market is lagging behind international and emerging markets' benchmarks that stand at above the 100% threshold. At the fixed income market level, the CDS spread remained almost constant at 132 basis points year-to-date, after a net expansion of 40 basis points in 2011 within the context of growing credit risks at the global level.

Below is an overview of the major sectors of economic activity, including the real sector, the external sector, the public sector and the financial sector. The concluding remarks are left to the short and medium term prospects, with an assessment of positive drivers and major risks to the overall outlook.

MONEY SUPPLY AND INFLATION



Sources: Central Bank of Qatar, IMF, Bank Audi's Group Research Department

CDS SPREADS (5-YEAR)



Sources: Reuters Knowledge, Bloomberg, Bank Audi's Group Research Department



1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbons

Oil and gas production at record high levels

The hydrocarbon sector has witnessed an outstanding year in 2011 but is expected to slow down significantly in 2012 and beyond. Real hydrocarbon GDP growth rate reported 31.1% in 2011 but would retreat to 2.9% in 2012 according to the IMF, as LNG production remains constant due to the self-imposed moratorium on new hydrocarbon projects. The oil and gas sectors accounted for about 58% of GDP in 2011, comprising around 90% of export earnings.

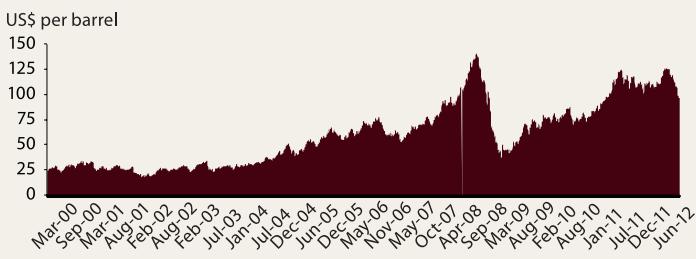
Qatar has the third largest proven reserves of natural gas in the world (884.5 trillion cubic feet at end-2011) with a share of 12% of the total, following Russia (21.4%) and Iran (15.9%), according to BP Statistical Review of World Energy. Qatar produced 146.8 billion cubic meters of natural gas in 2011, according to BP, up by 25.8% relative to the previous year, mainly to compensate for declines in production in Libya and UK. Accordingly, Qatar was the fifth largest producer of natural gas in 2011 and it consumed 23.8 billion cubic metres. It is worth mentioning that the Reserves-to-Production ratio (R/P) of natural gas in Qatar exceeds 100 years.

Qatar exported 102.6 billion cubic metres of Liquified Natural Gas in 2011, up by 34.8% relative to the previous year, as per BP. The breakdown of exports by region showed that Asia pacific captured 48.6 billion cubic metres of Qatar's exports of LNG, followed by Europe & Eurasia with 43.4 billion cubic metres, North America with 6.5 billion cubic metres, Middle East with 2.4 billion cubic metres and South and Central America with 1.7 billion cubic metres.

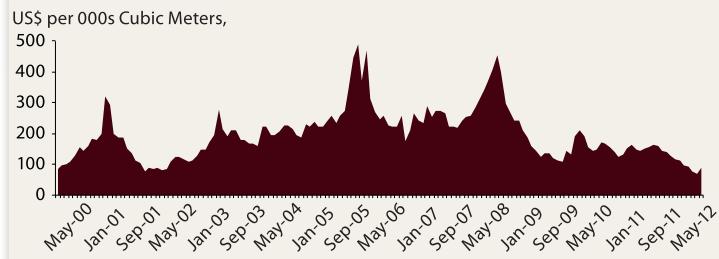
Qatar's 20-year investment program, which focused on a strategy to commercialize its large natural resources, culminated in 2011. Qatar has placed a moratorium on development of new hydrocarbon projects until 2015 to give itself time to assess its production performance and carry out a comprehensive study of its offshore North Field, where its gas is produced. Accordingly, further significant investment in hydrocarbons must await expiration of the moratorium on development in the North Field. It is worth mentioning that the moratorium could set the gas producing economy back, particularly in the face of rising competition from operations in the United States and Australia.

In fact, rapid development of American shale gas reserves has transformed the United States from a major buyer of Qatari gas to a global competitor. In addition, Japanese group Inpex and French oil group Total gave the go-ahead for a US\$ 34 billion Liquified Natural Gas export project that will see Australia overtake Qatar by 2017 as the world's top LNG exporter, with the majority of production going to Japan, according to Nooz. These market developments would put great downward pressure on future natural gas prices, though in the medium-term, Qatar is somewhat isolated from volatility in prices due to its long term contracts.

CRUDE OIL PRICES



NATURAL GAS PRICES



Sources: IMF, Bank Audi's Group Research Department

Sources: IMF, Bank Audi's Group Research Department



On the other hand, Qatar had 24.7 thousand million barrels of proved oil reserves at end-2011, accounting for 1.5% of the world's reserves, as per BP. Qatar's oil production reached a record high level of 1,723 thousand barrels per day in 2011, up by 8.2% relative to the previous year, mainly to compensate for the shortfall in Libyan oil production, while Qatar's consumption reached 238 thousand barrels per day. It is worth noting that R/P ratio of oil in Qatar is quoted at 39.3 years. According to the EIU, crude production capacity is expected to rise in the coming period, largely because of expansion at the Al Shaheen oilfield.

Last but not least, Qatar launched in November 2011 the US\$ 10.3 billion Barzan project, a joint venture between Qatar Petroleum and ExxonMobil, to supply the local Qatari market with natural gas, with first-phase production of 700,000 million cubic feet per day (mmcf/d) due to come online in the third quarter of 2014. A second phase will start up in the first quarter of 2015, taking total capacity to 1.4 bcf/d.

Also, Qatargas signed an Engineering, Procurement and Construction (EPC) contract with Samsung Engineering for a Diesel Hydrotreater unit that will further enhance production, by 54,000 barrels per stream day (BPSD) of ultra low sulphur diesel fuel, at the Qatargas-operated Laffan Refinery. The DHT Unit, which is aiming to produce diesel with less than ten parts per million (ppm) sulphur content to strict European specifications, will be built and integrated into the existing Laffan Refinery by 2014.

Looking forward, the principal risks ahead for the hydrocarbon sector in Qatar are lower oil and gas receipts as a result of a decline in global demand, and potential disruption in transportation of Liquefied Natural Gas (LNG) due to increased geopolitical tensions. The government, however, has adequate financial cushions and a policy framework in place to mitigate the impact, while price risk is considerably limited since Qatar's hydrocarbon exports are delivered under long-term contracts.

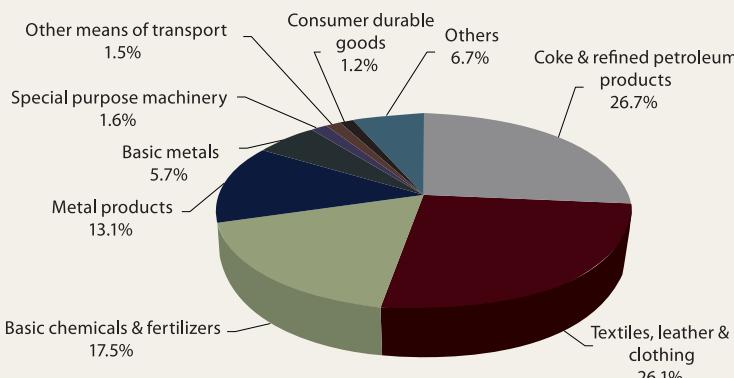
1.1.2. Manufacturing

Growth underpinned by wider investment diversification

The manufacturing sector, which accounts for 10% of GDP, managed to report a real growth of 4.5% in 2011, following several years of double-digit growth rates. However, the sector remains one of the pillars in the government's strategy of diversifying the economy away from hydrocarbons as it still makes up the second highest share of GDP after oil and gas. While last year's activity was mainly centered on petrochemicals, the Qatari government embarked on a sub-sector diversification by initiating investments in solar energy and agribusiness along with the aforementioned segment.

Pertaining to petrochemicals, Qatar Petroleum and Shell signed an agreement in late 2011 to set up a US\$ 6.4 billion petrochemical plant with the capacity to produce 1.5m tonnes/year (t/y) of mono-ethylene glycol and 300,000 tons per year of linear alpha olefins by 2017. Qatar Petroleum will hold an 80% stake in the new plant, and Shell the remainder. This is Shell's third major investment in Qatar, after Pearl GTL (gas-to-liquids) and the Qatargas 4 LNG project, which went on stream in early 2011. In parallel, global

BREAKDOWN OF MAIN INDUSTRIES*



* 2011 figures

Sources: Oxford Economics, Bank Audi's Group Research Department



food security concerns have been shaping the government policies in Qatar. Recognizing the importance of fertilizers on the food supply chain, Qatar, being a major supplier, has called fertilizer producers to develop their capacities and diversify their manufacturing facilities in order to produce more quantities at affordable prices.

Concerning agribusiness, Qatar has continued to purchase farmland overseas, where Hassaad Food Company, the agricultural arm of the Qatar Investment Authority (QIA), has acquired an additional 40,000 ha of agricultural land in Western Victoria, bringing the company's total holdings in Australia up to 250,000 ha. Qatar is also pressing ahead with a plan to set up a "farm city" to grow and process some of its own food. The plan is to be executed on a public-private partnership model, with the Qatar Chamber of Commerce and Industry (QCCI) entrusted with its implementation. Companies at the city will be allowed to export their products after meeting local needs. The plan runs parallel to efforts, already under way, to expand domestic farming by utilising the latest arid-zone agricultural practices and new technologies for harvesting in the desert. Currently, the country has only 1.6% of its land under cultivation, with agriculture contributing a mere 0.1% to GDP according to the UN Food and Agriculture Organisation.

1.1.3. Construction

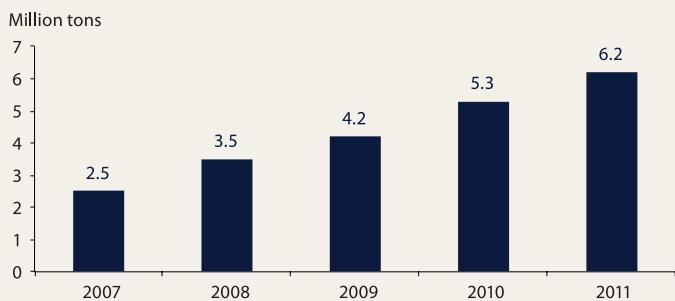
Buoyant activity after signs of slowdown

Since its selection to host the World Cup, activity within Qatar's construction sector was stirring in commotion in preparation for the event, on the back of the government's strategy involving the development of infrastructure. As a matter of fact, the construction sector, which accounts for almost 5% of GDP, recovered in 2011 after two years of consecutive declines.

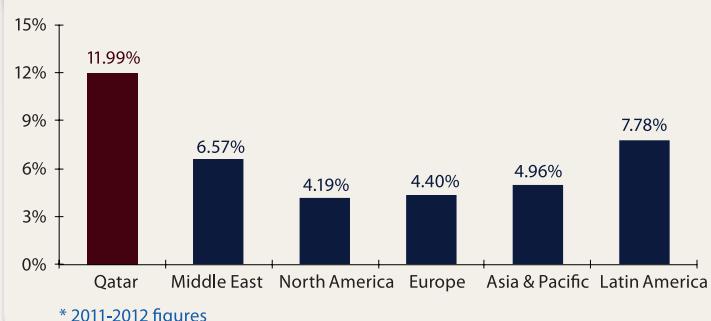
With regards to the real estate market performance in the current year, demand for residential property remains high, which has led to slight increases in rental prices. Occupancy levels are generally high in the State of Qatar. As for residential sales rates, there appears to be a greater optimism from potential purchasers and investors. The levels of over supply that were seen in Doha's office segment are grinding down due to an increase in demand, mostly driven by large government and financially related parties. The retail market remains stable year-to-date, but the market outlook remains fundamentally sound, as demand continues to outstrip supply, resulting in minimal vacancy rates.

The Central Bank lowered its interest rates to kick start lending to the private sector, a significant amount of which would be allocated to construction activities. Accordingly, lending to the construction sector which includes contracting and real estate, increased by 33% to hit US\$ 25.4 billion, following a rise of 30% a year earlier, as per Central Bank data. During the first quarter of 2012, the aforementioned lending edged up by 4.5% year-to-date, as per the same source. It is worth noting that lending to the real estate sector had witnessed a squeeze due to regulations imposed by the Qatar Central Bank which limits the exposure of the banking sector to the property market to not more than 15% of their total customer deposits, adding to an already tight market as banks were already adopting a more cautious stance towards lending following the 2008-09 global economic downturn. Yet, the government quickly moved to shore up confidence in the property market, which has encouraged banks to loosen lending practices,

QATAR CEMENT PRODUCTION



COMPARATIVE RENTAL YIELDS *





especially in anticipation of a major boost to the sector in the run-up to the 2022 football World Cup.

In details, Qatar's construction activity involves around four major projects. The first encompasses directly-related World Cup expenditures. After winning the bid, the government announced that it will spend US\$ 4 billion on the construction of nine stadia while upgrading the existing ones. Each facility will have the capacity to accommodate 45,000 spectators. The first phase which is to be completed by August 2012 is the development of a 10,000 seat stadium, practice facilities and training areas. The second phase will include a 75-room hotel, multi sports area, and related sporting amenities.

Second is the US\$ 11.1 billion Doha Airport, with its first phase set to kick start operations in late 2012 while awaiting for the second in 2015. The upgraded facility, which could be one of the region's major aviation hubs, would initially have a capacity of 24 million passengers and 750,000 tons of cargo a year with both rising to 50 million and 2 million tons respectively by 2015.

Third, the new Doha Port, valued at US\$ 8.2 billion, will replace the existing one located in the downtown of the capital with the first phase to be completed in 2016 while awaiting full completion in 2030. Indeed, the facility is being developed in three phases. The first phase will provide the port with an initial capacity of two million Twenty foot Equivalent Unit (TEU) from 2014. The second phase will not begin until 2020, while the third and final phase will commence in 2030. Once completed, it will have a total cargo-handling capacity of 6 million TEU and will spread across an area of 26.5 square kilometers adjacent to Doha city.

Fourth is the US\$ 25 billion rail plan. The massive project includes plans for a high-speed long distance rail link, driverless four-line Metro service for Doha and freight lines. The plans also include the West Bay People Mover, and over ground rail system designed to distribute passengers around Doha's tower district. The initial push will be to develop the Doha Metro Red Line that runs between Messaieed in the South with Al Khor in the North as it is much needed for the World Cup.

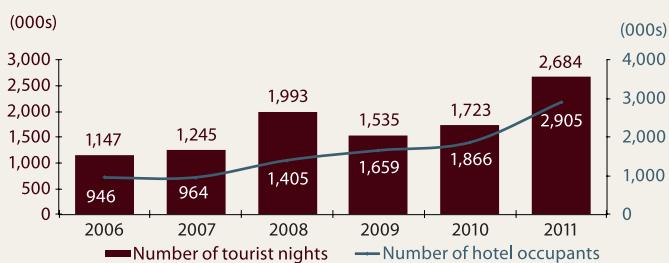
Looking forward, Qatar's construction activity is set to remain on an upward path in preparation to host one of the world's major sporting events, a fact even more compounded should the State win the bid to host the Olympic Games in 2024. Overall, construction output is expected to increase by 8.5% in 2012, 11.8% in 2013 and 12.4% by 2021. The sector's funding yet remains an issue as it risks facing a financing squeeze on the back of European banks' retrenchment at large.

1.1.4. Tourism

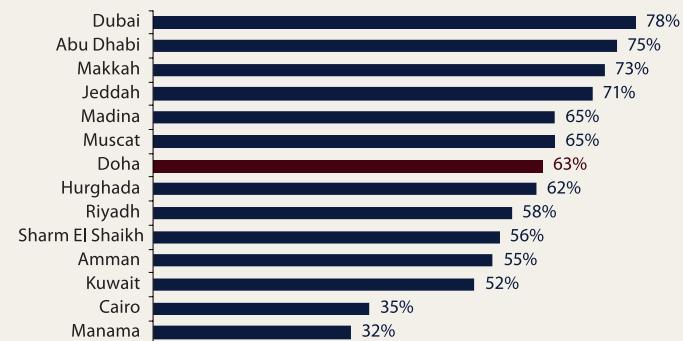
Maintaining expansionary stance

Activity within Qatar's tourism sector was on an upward path in 2011 on the back of preparations for the World Cup coupled with benefits from redirected tourism due to the conflicts that struck several countries across the Middle East and North Africa region.

EVOLUTION OF TOURISTIC ACTIVITY



COMPARATIVE HOTEL OCCUPANCY RATES*





Qatar indeed saw an upsurge in the number of visitors to reach 1.8 million in the year 2011. The breakdown of hotel guests by country of origin showed that the lion's share was that of GCC countries, accounting for 26% of the total in 2011, as per the QSA. Visitors from the Gulf region increased by 34.2% to reach 771,710 in 2011 as per the same source. The number of international arrivals also increased in 2011 within the context of a perception of Qatar as a safe haven from the regional turmoil coupled with significant business activity in the country in line with its rising income per capita.

Figures for hotel sector performance within Doha according to Ernst and Young showed an average hotel occupancy rate of 63% in 2011, somewhat maintaining the same rate as in 2010, while several countries across the region were reporting double-digit declines. Still, demand seems to have increased further as the number of touristic nights rose significantly but was accompanied by an additional supply of 1,600 rooms to the market which drove the number of available rooms up by 11.7% in 2011, as per the Qatar Statistics Authority (QSA). In parallel, the increase in touristic nights drove the revenues collected by four and five stars hotels up by 19.3% to US\$ 762.9 million in 2011, compared to US\$ 639.8 million in 2010, as per the Qatar Tourism Authority (QTA).

Indeed, the business segment of tourism still accounts for the bulk of the sector's activity with 72% of incomers in 2011 visiting Qatar for corporate reasons. In parallel, each visitor typically stays on an average of 2.5 to 3 days and spends an average of US\$ 395 per stopover. Within this context, the government was prompted to launch campaigns such as "48 hours in Qatar" to capture this short-stay segment and encourage business travelers to stay an extra two days in Qatar. In January 2012, during the World Travel Awards event, Doha was voted "World's Leading Business Travel Destination"; Qatar Airways was named "World's Leading Airline - Business Class" and Regency Travel & Tours won the "World's Leading Travel Agency".

Subsequent to winning the bid for the World Cup, the country has committed a total of US\$ 80 billion to infrastructure and commercial related investments with US\$ 17 billion to be paid in the coming five years. The direct spending on building stadia will be just under US\$ 4 billion, with the first venue to be built by 2015. A total of 77 new hotels and 42 serviced apartments are expected to be inaugurated in preparation for the World Cup. An average of 5,000 rooms per year should be added to the market. A sharp increase to 30,000 rooms is expected for next year, up from a current stock of 15,025 rooms.

The direct contribution of travel and tourism to Qatar's GDP reached US\$ 1.2 billion (0.6% of GDP) in 2011, as per the World Travel and Tourism Council. It is expected to rise by 8.3% in 2012, thus reflecting considerable economic activity generated by industries such as hotels, travel agents, airlines and other passenger transportation services. Indeed, Qatari authorities are aggressively investing in the travel and tourism sector with a target to raise its contribution to 6.4% of GDP by 2021, one year prior to the World Cup, though oversupply remains an issue to be considered after the 2022 prospective peak.

1.2. EXTERNAL SECTOR

External accounts shielded by soaring hydrocarbons export earnings

Qatar's external sector managed to weather the regional turmoil and the European crisis, benefitting from a price effect but most importantly from a significant quantity effect. As a matter of fact, the State's overall trade activity increased by 27.5% to reach US\$ 135.6 billion in 2011 with the surplus going up by 48% to US\$ 76.8 billion as the rise in exports exceeded significantly that of imports, according to the IMF. Consequently, this drove the increase in the current account surplus from 26% of GDP in 2010 to 28% of GDP in 2011 especially with new LNG, GTL and to a lesser extent oil production, coming on stream at a time of elevated global prices.

A detailed look at the trade activity shows that total exports reached US\$ 106.2 billion in 2011, rising by 34.3% from 2010. LNG and related exports (propane, butane and condensates), which account for almost 58% of the total, increased by 42.3% to attain US\$ 61.9 billion in 2011 with the majority destined for Asia, while debt-stricken Europe comes at a much-distant second. Particularly, demand for Qatari LNG from Japan increased sharply and exports were more pronounced since the earthquake that crippled many of the country's nuclear plants. As a result, growing demand has pushed up LNG prices with Asian spot



prices rising by nearly two-folds. Furthermore, other hydrocarbon exports, namely refined petroleum products and crude oil totaled US\$ 35.2 billion in 2011, up by 21.1% as per IMF estimates. As for non-hydrocarbon exports, which increased by 40.1% to US\$ 9.0 billion, their growth was mainly driven by those of petrochemical products and that account for around 70% of the aforementioned category. On the other hand, imports progressed by 7.8% to reach US\$ 29.4 billion in 2011. Such a rise reflects a healthy consumption within the context of the enacted wage increase and the rise in the country's income per capita. Qatar's imports originated mainly from Europe, followed by Asia, the UAE and the United States.

On the invisibles sides of the external sector, Qatar registered deficits in its balance on services, incomes and transfers in 2011 amounting to US\$ 9.5 billion (+17.0%), US\$ 3.7 billion (+125%) and US\$ 15.0 billion (+75%), respectively. With regards to services, large transportation payments related to LNG exports offset significantly the State's travel receipts most of which are collected through its position as a transit hub between the West and Asia. In the incomes category, profit repatriation of foreign companies in Qatar remains the largest contributor to the negative balance. As to the transfers category, it is dominated by outward remittances of expatriates residing in Qatar which amounted to US\$ 10.5 billion in 2011, up by 7.9% from the previous year as per the IMF.

As to the capital and financial balances, both recorded deficits of US\$ 2.1 billion and US\$ 56.5 billion in 2011 respectively, with such shortfalls recorded on account of three factors. First, Qatar multiplied its overseas aid to US\$ 730 million in 2011. Second, the Central Bank limited the remuneration on commercial banks deposits which pushed the latter to reduce interest rates from their part, thus leading to a decline in non-resident deposits. Third, the government, as well as sovereign wealth funds embarked on significant investments abroad which created a leakage in the country's financial accounts. Consequently, the balance of payments recorded a cumulative deficit of US\$ 10.0 billion in 2011, against a surplus of US\$ 12.4 billion a year earlier, as per the IMF.

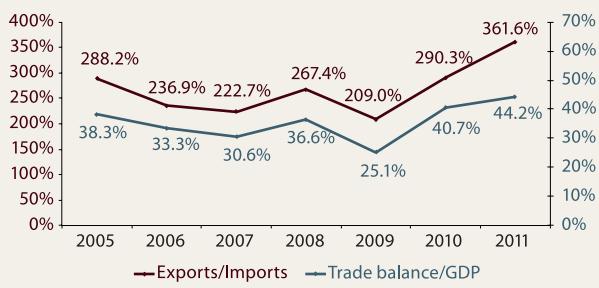
Looking forward, Qatar's external accounts seem to be more or less exposed to oil and gas-related volatility. Still, such risks were partially mitigated through the long-term contracts (20-30 years) of LNG exports concluded with several partners. A quasi-constant level of LNG, condensates and related products exports would maintain hydrocarbons revenues at close to their current level, but with the growing needs at the level of imports, the external sector surpluses should gradually retreat but remain within comfortable boundaries.

1.3. PUBLIC SECTOR

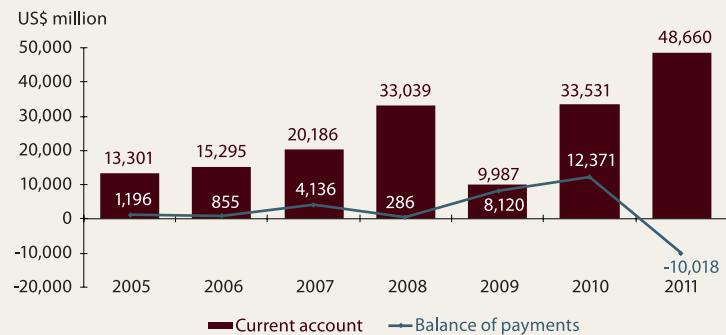
Growing hydrocarbon revenues boost public finances despite record spending

In a phase of widespread turmoil across the region, Qatar's fiscal accounts remained in a highly comfortable zone despite the large public spending program it implemented in fiscal year 2011/2012 in the aim of maintaining strong growth in the non-hydrocarbon sector in the medium term. The State's public surplus actually edged up by 44.4% to reach US\$ 15.6 billion (8.9% of GDP) as per the IMF, with a rise in the

FOREIGN SECTOR INDICATORS



CURRENT ACCOUNT AND BALANCE OF PAYMENTS





revenue base exceeding that of expenditures on account of an increase in hydrocarbon production and prices. It is worth mentioning that Qatar's fiscal year extends from April to March.

During fiscal year 2011/2012, higher hydrocarbon revenues led to a 33.7% rise in total fiscal revenues to reach US\$ 60.9 billion, as per the same source. The former, consisting of oil and LNG related revenues and accounting for circa 50% of total revenues, progressed by approximately 18% on a yearly basis, within the context of rising oil prices and gas export volumes. Other fiscal revenues, including investment income from public enterprises (of which investment income of state-owned hydrocarbon enterprises), corporate tax revenues and other non-tax revenues, reported a staggering increase of almost 60%, recovering from a contraction in the previous fiscal year. It is worth noting that most of the non-hydrocarbon revenues were generated by the investment income from public enterprises accounting for around 56% of the aforementioned category. In parallel, the government introduced a withholding tax according to which resident entities are responsible for withholding tax from payments to non-resident entities and individuals not having a permanent establishment in Qatar. The obligation to withhold also applies to Qatari companies whether or not they are taxable on their own income. The measure widened the tax base and generated more revenue from foreign businesses at large.

At the same time, government expenditures increased by 30.2% to reach US\$ 45.3 billion in fiscal year 2011/2012, with an 8% rise in current expenditures, as per IMF figures. As a matter of fact, the latter increased on account of the government's enacted rise of 60% of wages of state civilian employees, and of 50-120% for military staff. These large wage increases come within the context of avoiding any contagion effect from the regional turmoil, even though Qatar has not encountered any social unrest thus far. Undeniably, this was the heftiest wage increase since 2001 and it is estimated that it will add US\$ 2.7 billion a year to the government's wage bill. Nonetheless, the government spending strategy has also emphasized development projects, in line with its public investment plan according to the National Development Strategy 2011-2016 and in preparation for the World Cup. Hence, capital expenditures increased by 30% in fiscal year 2011/2012, thus mirroring efforts of diversifying the economy away from hydrocarbons.

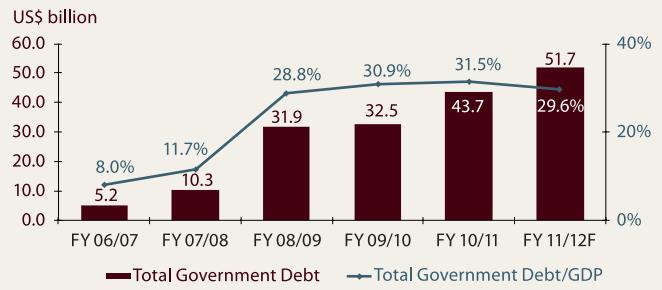
As a matter of fact, the increase in total revenues more than offset the rise in total expenditures, enlarging the fiscal surplus to 8.9% of GDP in fiscal year 2011/2012. The non-hydrocarbon balance yet remained in the negative territory, while improving from the one seen a year earlier as it accounted for 10.8% of GDP in fiscal year 2011/2012, compared to 16.5% in fiscal year 2010/2011 and reflecting the effective efforts of the government in diversifying the economy in general and the non-hydrocarbon revenue base in particular. The negative balance highlights the need for further diversification in years ahead to shield the government accounts from hydrocarbon price volatility. It is worth recalling that LNG production reached a maximum capacity in 2011 somewhat weighing on the revenue base until the end of the LNG moratorium in 2015.

Within such an environment, Qatar earmarked a record budget for fiscal year 2012/2013, with US\$ 49.2 billion in spending of which it allocates significant outlays on infrastructure in the run-up to the World Cup. Based on a conservative average oil price of US\$ 65 per barrel, the overall surplus would reach US\$ 7.7 billion, the equivalent of 8% of GDP, as per the Ministry of Finance.

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	FY06/07	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12F
General government revenues	24.0	30.9	48.9	32.4	45.5	60.9
General government revenues/GDP	36.6%	35.0%	44.2%	30.8%	32.8%	34.8%
General government expenditures	17.6	21.8	33.2	29.6	34.8	45.3
General government expenditures/GDP	26.8%	24.7%	30.0%	28.1%	25.1%	25.9%
General government fiscal balance	6.4	9.2	15.8	2.8	10.8	15.6
General government fiscal balance/GDP	9.8%	10.4%	14.3%	2.7%	7.8%	8.9%

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department

Sources: IMF, Bank Audi's Group Research Department



1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Inflation rate at contained levels

Monetary conditions in Qatar were marked during the first few months of 2012 by a considerable pick-up in international reserves after the net decline of 2011, a small contraction in monetary aggregates and a contained level of inflation rate.

Qatar's Consumer Price Index grew by 1.2% on average during the first quarter of 2012, after rising by 1.9% in 2011, boosted by large salary increases for Qatari public-sector workers, rising international commodity prices affecting Qatar's import basket, immigration and generally expansionary domestic monetary and fiscal conditions. According to the IMF, the inflation rate is expected to average 4.0% in 2012 as rents stabilize due to a gradual decline in excess capacity in real estate and as the implementation of large investment projects lead to some overheating pressures.

The breakdown of the Consumer Price Index by segments during the first quarter of 2012 actually showed that the negative rental inflation was more than offset by a general increase in all other components of the CPI basket. In fact, the rent, fuel & energy segment dropped by 5.9%, while the miscellaneous goods and services segment posted the highest increase of 7.5%, followed by the education, culture and recreation segment with 5.1%, the furniture & furnituring segment with 4.5%, the clothing and footwear segment with 4.0%, the food, beverages and tobacco segment with 3.3%, the transport and communication segment with 2.3% and the medical services segment with 1.9%.

On the back of a contained inflation rate level, the Qatar Central Bank cut its policy lending and deposit rate twice in 2011, which contributed to boosting private sector credit growth, but the QCB didn't take any action so far in 2012. The 2011 moves had brought down the overnight lending rate to 4.50% from 5.50%, the repo rate to 4.50% from 5.55%, and the overnight deposit rate to 0.75% from 1.50%.

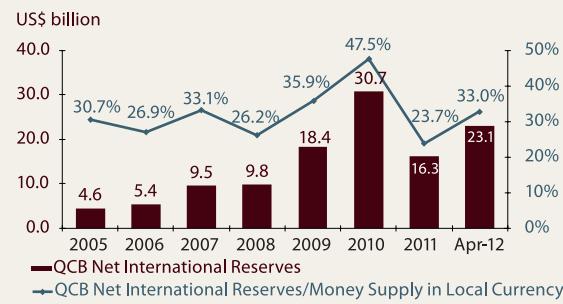
On the other hand, Qatar Central Bank's net international reserves reached US\$ 23.1 billion at end-April 2012, up by 41.7% from US\$ 16.3 billion at year-end 2011, after falling by 46.9% during 2011 due to a significant fall in deposits of local banks at the QCB. The QCB net international reserves covered around 33.0% of money supply in local currency at end-April 2012 as compared to 23.7% at end-2011.

The broader Money Supply (M2) contracted slightly by 1.7% during the first four months of 2012 to reach US\$ 83.7 billion at end-April 2012, after expanding by 17.1% in 2011. The US\$ 1.5 billion variation in money supply during the first four months of 2012 compares to a money creation of US\$ 0.9 billion, resulting mostly from a decrease of US\$ 2.0 billion in net claims on the public sector, a US\$ 9.1 billion increase in claims on private sector and a drop in net foreign assets of US\$ 6.2 billion. The difference between the contraction in money supply and money creation, amounting to US\$ 2.3 billion, suggests a demonetization of monetary claims during the first four months of 2012.

EVOLUTION OF MONETARY SITUATION

Variations (US\$ million)	2007	2008	2009	2010	2011	4M-12
Net foreign assets	53	-3,455	-471	4,624	-12,742	-6,232
Foreign Assets	10,559	2,889	6,068	13,097	-6,633	8,847
Foreign Liabilities	-10,506	-6,344	-6,540	-8,472	-6,109	-15,079
Net Domestic Assets	11,915	11,770	9,009	9,011	25,173	4,769
Claims on private sector	16,169	19,776	1,231	12,816	22,355	9,118
Net claims on public sector	-1,081	-564	13,494	2,470	9,670	-2,020
Other Items (net)	-3,173	-7,441	-5,716	-6,275	-6,852	-2,329
Broad Money (M2)	11,968	8,316	8,538	13,636	12,431	-1,463
Money Supply (M1)	1,990	2,784	617	4,181	3,712	1,973
Quasi-Money	9,977	5,532	7,920	9,454	8,720	-3,436

EXCHANGE MARKET INDICATORS





The Qatari Riyal continues to be pegged to the US Dollar at a rate of QR 3.64/US\$ 1. The authorities are committed to maintaining the current exchange rate regime, given that Qatar's gas and oil exports are denominated in the US currency and that the peg offers monetary stability and reassurance to investors. Within this context, the Central Bank of Qatar would need to develop a formal liquidity management framework to facilitate a more proactive strategy in fine-tuning liquidity, according to the IMF.

Looking ahead, the main issue for monetary authorities would be to support credit growth - particularly project related - without fuelling inflationary pressures or attracting short-term capital inflows. The QCB rising challenge is indeed to monitor the risk of rising inflation and be ready to use liquidity tools and macro-prudential measures to well manage the tradeoffs between inflation and capital inflows.

1.4.2. Banking Activity

Fast lending growth amidst growing domestic financing needs

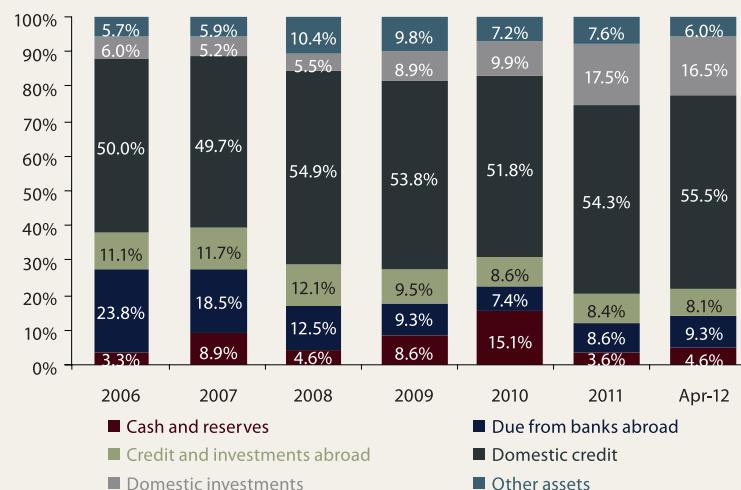
Qatar's banking sector witnessed another phase of stellar activity growth in 2011 and so far this year in an overall booming economy driven by rising public sector financing needs for infrastructure and development spending and a corollary growing private sector in an enhanced business environment. Qatari banks, known for their domestic focus, have fared particularly well in a regional environment marked by politico-security troubles and a global environment characterized by concerns on banks' exposures to troubled European sovereigns. Measured by total assets of commercial banks operating in Qatar, banking activity grew by 22.3% throughout the year 2011 and by a further 4.2% in the first four months of 2012 to reach a record high of US\$ 199.8 billion at end-April.

EVOLUTION OF BANKING ACTIVITY

US\$ million	2007	2008	2009	2010	2011	4M-10	4M-11	4M/4M 2011/2010
Var. Total assets	28,806	29,555	18,128	27,358	34,840	4,298	8,025	86.7%
% change	55.3%	36.5%	16.4%	21.3%	22.3%	2.8%	4.2%	1.5%
Var. Total deposits	12,843	12,438	9,446	16,463	15,611	7,312	-4,178	-157.1%
% change	38.8%	27.1%	16.2%	24.3%	18.5%	8.7%	-4.2%	-12.9%
Var. Total credit facilities	15,947	22,543	7,644	12,089	24,473	776	7,075	812.0%
% change	56.6%	51.1%	11.5%	16.3%	28.3%	0.9%	6.4%	102.4%

Sources: Central Bank of Qatar, Bank Audi's Group Research Department

BANKING SECTOR ASSET COMPOSITION



Sources: Central Bank of Qatar, Bank Audi's Group Research Department



Qatar's banking sector activity has been actually favored by a rise in banks' deposit base and surging lending volumes within the context of growing domestic investments in the covered period. Bank deposits, accounting for about half of the sector's consolidated balance sheet, registered a strong increase and grew by 18.5% in 2011, yet contracted slightly in the beginning of 2012 from new highs reached at year-end 2011 before renewing with their upward trajectory thereafter and reaching US\$ 95.7 billion at end-April 2012.

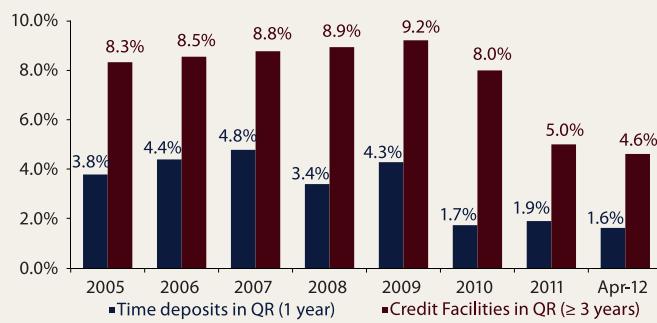
The variations in the banks' deposit base over the covered period remain driven by the public sector and which account for 28% of total deposits at end-April 2012. In fact, public sector deposits surged last year within the context of growing government revenues from the hydrocarbons sector in an overall strongly performing economy and accounted for almost 95% of total deposit growth in the sector. This year, Qatari banks slight retreat in deposits is mostly visible in the decline of the government or government related institutions' foreign currency deposits. It is worth noting that non-resident deposits, accounting for no more than 6% to 7% of total deposits, were on a downward trajectory in 2011 within the context of gradually declining domestic interest rates. They only seem to be recuperating moderately so far in 2012, with the year witnessing a slight rise in local currency time deposit rates.

The most significant driver of banks' balance sheet in Qatar these days is the continuing surge in banks' lending activity. Credit facilities extended by banks operating in Qatar now account for close to 60% of total assets and are thus the largest component in balance sheets. Credit facilities grew by 28.3% in the year 2011 and by a further 6.4% in this year's first four months to reach a high of US\$ 118.3 billion at end-April. The noticeable rise in Qatari banks' lending activity is being favored by rising domestic public sector borrowing - especially on behalf of government institutions - recording a 44.7% rise throughout the year 2011 and an additional 15.3% growth in the first four months of 2012. Domestic public sector borrowing, representing 40% of total borrowings at end-April 2012, altogether accounted for practically 90% of credit facilities growth so far this year, reflecting public authorities' ever-increasing resort to local banks for the financing of their expansionary projects. In parallel, bank credit facilities extended to the private sector rose by a significant 19.3% in 2011 on the back of a surge in real estate and retail loans, which continued this year but was offset by a contraction in banks' exposure to the services sector and lead to a practical standstill in their overall private sector lending portfolio year-to-date.

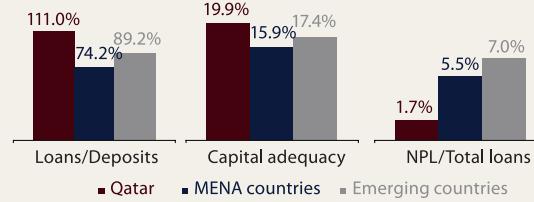
Still, with the Qatari regulator aiming to contain banks' risk appetite, the reserve requirement ratio was raised earlier this year from 1.5% to 2.5%, with banks asked to comply in a two-year timeframe. Also, the Central Bank reduced the cap on retail lending to Qatari nationals, the repayment period, the monthly installments paid by clients, and capped the margin on retail lending, among others. But the salary increases for nationals is seemingly offsetting the latter rules and is likely to have been behind noticeable rises in retail lending volumes year-to-date.

Anyhow, the robust growth in bank lending to the public sector stands as a major factor behind the rise in the credit facilities to deposits ratio to a high of 123.2% at end-April 2012 (111.0% at end-2011), thus standing well in excess of the Central Bank limit of 90%. Nonetheless, banks are increasingly tapping the wholesale funding market, seeking longer term financing for some infrastructure projects ahead of

INTEREST RATES ON TERM DEPOSITS & CREDIT FACILITIES



COMPARATIVE FINANCIAL SOUNDNESS INDICATORS*



* 2011 or latest available



the 2022 World Cup, with well capitalized Asian banks stepping in at a time when European banks are retrenching from the region. Wholesale funding, namely inter-bank funding and debt securities, now account for about a third of total funding, a share nearly doubling over the past few years, thus potentially exposing banks to volatile market conditions. Still, banks in Qatar continue to display good core readily available liquidity, with cash and bank balances with the Central Bank and other banks at 38% of customer deposits and 18% of total assets, a share that would rise further when including domestic government securities (reaching 35% of total assets).

At the level of operating performance, the strong surge in credit facilities extended by banks translated into a rise in the net interest income to total income ratio from 48.2% in 2010 to 53.0% in 2011, supporting their bottom line growth. The latter almost offset the solid rise in balance sheet aggregates and allowed the sector to almost maintain its profitability ratios at comparatively high levels. Qatari banks' return on average assets ratio stood at 2.7% in 2011 as per the latest Central Bank statistics, against 2.6% in 2010, while the return on average equity ratio reached 18.6% last year, against 19.9% in the previous year on account of a sharp rise in banks' equity base during 2011.

In fact, following the Qatar Investment Authority's latest round of capital injection into local banks and QNB's US\$ 3.5 billion rights issue during 2011, Qatari banks' equity base grew considerably and bolstered further the sector's regulatory capital to risk-weighted assets ratio to 20.6% in 2011 (16.1% in 2010), the bulk of which is Tier 1 (19.9% in 2011), and which remains close to double the minimum requirement. Such comparatively high capital adequacy ratios demonstrate banks' shock-absorption capacity and ability to participate in upcoming large scale projects falling within the State's development strategy.

Along the same lines, we note that local banks enjoy what is most likely one of the best asset quality metrics in the broader region. In spite of the sharp hike in banks' lending portfolios over the past few years, the non-performing loans to total loans ratio stood at a low of 1.7% at year-end 2011, down from 2.0% at year-end 2010, comparing favorably to international benchmarks, with the provisioning coverage ratio at a high of 87.2% at end-2011. It is worth reminding that the overall asset quality metrics of the sector remain subject to relatively high credit concentration, albeit to solid government related parties, and growing exposure to construction and realty markets, though the regulator's imposed ceiling for lending to this sector to 1.5 x Tier 1 capital could help curb banks' sector exposure at large. It is worth mentioning that loans to real estate and contractors accounted for circa 22% of total bank loans as of end-April 2012.

In sum, Qatari banks continue to benefit from the strong drive for development, mainly on behalf of domestic authorities. The steady income per capita growth and persisting public sector revenue increase are translating into higher deposit volumes and allowing banks to cater to the funding needs of an expanding economy, though customer deposits are having a hard time keeping pace with new lending extension, which is forcing banks to resort to alternative market funding channels. Still, with their robust capitalization, strong asset quality metrics and adequate liquidity levels, Qatari banks are well positioned to benefit from the forthcoming expansion trajectory of the world's most promising emerging markets.

1.4.3. Equity and Bond Markets

Mixed performance on Qatari capital markets

The capital markets in Qatar saw mixed movements since the beginning of 2012. While the Qatar Stock Exchange posted decline in prices, the Qatari debt papers were on the rise following drops in US Treasury yields, timely debt repayments and successful new bond issues in the region that left a positive impact on regional fixed income markets at large.

Indeed, the Qatar Exchange general index reported a drop of 4.1% during the first five months of 2012 to close at 8,416.8 at end-May 2012, following a small rise of 1.1% in 2011, noting that the Qatar Exchange was the only bourse in the region reporting a price increase last year amidst regional turmoil, underpinning the robustness of the Qatari economy. The drop in prices in the Qatar Exchange during the first five months of 2012 compares to an average 10.7% increase in Arab stock markets prices, as per the S&P Pan Arab Composite Index, as some regional bourses rebounded from their record low levels in 2011 and benefited from a surge in crude oil prices.



Qatar's market capitalization fell by 1.3% during the first five months of 2012, moving down from US\$ 125.6 billion at end-2011 to US\$ 124.0 billion at end-May 2012 within the context of a drop in prices that was coupled with stability in the number of listed companies at 42. The market capitalization represented 67.8% of GDP at end-May 2012, down from 72.3% in 2011.

The total trading value amounted to US\$ 9.1 billion during the first five months of 2012, falling by 24.0% relative to the corresponding period of the previous year. On the backdrop of a decline in the market capitalization and a higher fall in total trading value, the annualized turnover ratio registered 17.6% during the first five months of 2012, down from 23.4% during the corresponding period of 2011.

In an attempt to provide investors with a deeper view of the stock market performance, the Qatar Exchange launched in April 2012 a number of new equity indices that complement the existing QE Index. In fact, a total return version of the QE index was disseminated, measuring price performance and income from dividends, thus representing the total return earned in a portfolio tracking the underlying price index. The Qatar Exchange introduced as well All Share and sector indices, a series that provides investors with an overall market benchmark and enhanced tools to evaluate sector performance. The changes to the index methodology and the launch of new indices are the first step towards further product development in the Qatari market.

It is worth mentioning that the Qatar exchange has currently a frontier status at MSCI, noting that the latter has delayed in June 2012 a decision to lift the Qatari bourse to emerging market status due to limitations on foreign holdings in locally traded stocks. The index provider stated that the very low foreign ownership limit levels imposed on Qatari companies is expected to be the only remaining impediment to the reclassification of the MSCI Qatar Index to Emerging Markets.

As to the fixed income market, Qatari papers were on the investors' radar screen during the first five months of 2012. Prices of sovereign papers, high grade names like Qtel and Qatari Diar and papers issued by financial institutions like QNB and CBQ followed an upward trajectory, mainly supported by drops in international benchmark yields, timely debt repayment, orderly loan restructuring and successful new bond issues in the region, despite lingering concerns about Europe's debt crisis. Qatar's five-year CDS spread currently stands at around 132 basis points, with a very tiny rise of 5 basis points since year-end 2011 when it expanded by 39 basis points, which underlines its low risk of default, noting that the Qatar CDS spread is among the lowest in the region.

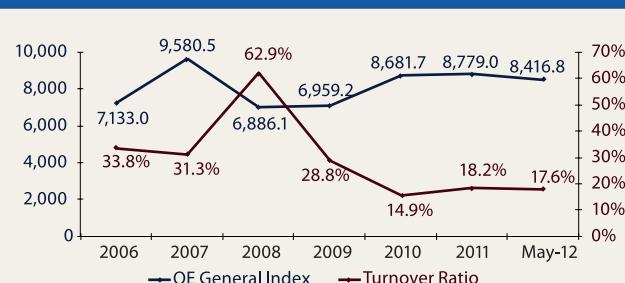
As to new issues, Qatar has raised US\$ 5 billion in November 2011 through the issuance of its first sovereign conventional bond issue since 2009, capitalizing on international investors' appetite for safe havens as the European debt crisis destabilized global markets. The international bond sale, the biggest from the Gulf in 2011, attracted demand of circa US\$ 9.5 billion. In details, Qatar sold US\$ 2 billion in five-year bonds at a yield of 3.184%, US\$ 2 billion of 10-year bonds at a yield of 4.63% and US\$ 1 billion of 30-year bonds yielding 5.825%.

Regarding forthcoming bond issues, Qatar has recently signaled its intention to re-enter the Islamic bond market through the sale of Sukuk. In fact, the State of Qatar has mandated in May 2012 five banks to help arrange a new sovereign Sukuk, which would be Qatar's first Islamic bond in almost ten years.

CAPITAL MARKETS INDICATORS

	2007	2008	2009	2010	2011	May-12
Market Capitalization (US\$ billion)	95.5	76.7	87.9	123.7	125.6	124.0
Market Cap/GDP	120.1%	66.6%	90.1%	97.1%	72.3%	67.8%
Total value traded (US\$ billion)	29.9	48.2	25.3	18.5	22.9	9.1
Total number of shares (million)	3,411	3,894	3,450	2,094	2,303	1,103
No. of listed companies	40	43	44	43	42	42
% Chg. in QE general index	34.3%	-28.1%	1.1%	24.8%	1.1%	-4.1%
P/E ratio	21.8x	16.4x	13.5x	14.8x	11.7x	11.5x
P/BV ratio	4.1x	3.5x	2.5x	2.2x	1.8x	1.9x
Dividend yield	1.8%	3.6%	3.0%	3.2%	3.7%	3.6%
CDS spreads (bps)	32	218	100	88	127	141

CAPITAL MARKETS PERFORMANCE





2. CONCLUSION: THE POSITIVE AND NEGATIVE DRIVERS TO THE OUTLOOK

Despite growing external risks, the overall outlook for the Qatari economy looking ahead seems quite favorable. The average real GDP growth of circa 6% per annum over the next 6 years as forecasted by the International Monetary Fund, despite the moratorium on new hydrocarbon development following the completion of mega gas projects, is considered significantly sound, especially that it is set to be triggered by the non-hydrocarbon sector which is apt to grow by close to a double-digit growth over the years ahead on the back of large government investment in infrastructure at large. Average inflation is yet set to remain within the moderate one-digit rates in years ahead, as rents stabilize due to a gradual contraction in the excess capacity currently prevailing in real estate.

Within this environment, what are the principle drivers and risks to the outlook? The positive drivers are tied to the country's large wealth, with income per capita approximating the US\$ 100,000 threshold, the absence of socio-economic pressures with the official unemployment rate estimated at less than 1%, the post-Fukushima transition away from nuclear that is increasing global demand for gas, the strong net external creditor position of the State of Qatar, the ambitious spending program with 40 percent of total expenditure expected to be allocated to capital expenditure over the medium term, the easy monetary and credit conditions supporting recent banking activity, the well capitalized banking sector with good financial standing and the development of money and bond markets facilitating liquidity management at large.

Principle risks ahead are tied to a number of challenges as well. First, the possibility of declining oil and gas prices as a result of a protracted sluggishness in global demand driven by the amplification of Eurozone problems could have an adverse effect on Qatar's fiscal and current account surpluses. Other risks are tied to a possible disruption in transportation of Liquefied Natural Gas (LNG) due to increased geopolitical tensions especially in the event of a closure by Iran of the Strait of Hormuz. Not less importantly are the new potential sources of LNG supply, particularly from Australia and North America, which could lead to lower gas export prices. Also, a possible tightening of global liquidity impacting Qatar through its financial system that has expanded again its real estate lending portfolio rises among risk challenges, notwithstanding the fact that local banks are already stretched with a loan to deposit ratio of 124%, i.e. quite above the regulatory ceiling set by the Central Bank.

But such risks are believed to be quite manageable on the overall. Government authorities are indeed increasingly saving, building buffers for different shocks. They set an objective of fully financing the budget from 2020 onwards from Qatar's non-hydrocarbon revenues. The adequate financial cushions that the government enjoys and the policy framework in place should mitigate potential risks at large. The Qatari corporate sector, in turn, seems to be well cushioned to withstand different types of risk, of which interest rate and income shocks in general.

To further strengthen the management of risks at the horizon, a number of actions and measures are widely recommended to the State of Qatar. Among those we mention further diversifying the economy away from hydrocarbon sectors and enhancing its productivity and competitiveness. The IMF also recommends the establishment of a macro fiscal unit aiming at developing a medium term spending framework that would optimize the use of government spending. There is also the need to strengthen the supervision of the real estate sector loans and foster the transparency of the real estate market at large. Notwithstanding the room for efficiency gains through the reduction of direct and indirect subsidies and the opportunities for deeper pension reforms. Any significant developments along those realms cannot but reinforce further the resilience and efficiency of the Qatari economy, markets and sectors of activity looking ahead.



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