TAIB Securities W.L.L.
GCC Economic Outlook 2012

March 2012

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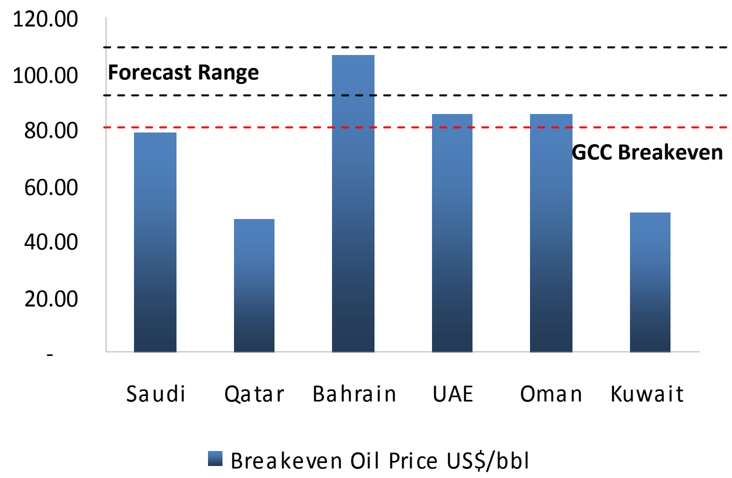
GCC: Petro-dollars to underpin Government Spending

Combined GCC coverage economies are poised for 4.0% real GDP growth in 2012, outpacing global GDP growth of 3.3% (IMF). The broader economic theme remains unchanged – firm oil price outlook underpins fiscal expansion and breakaway from tradition of saving oil wealth, allowing the continuing era of "Big Government" spending.

Budgetary breakeven oil prices are continuing to nudge upwards (estimated weighted average GCC oil breakeven price is US$85/bbl). Barring the risk of slower world economic growth due to continuing Eurozone sovereign risk, Arab oil blends price outlook remains firm, particularly with geopolitical risks of a transitional government in Iraq and US–Iran tensions. This should lead to fiscal surpluses extending to a consolidated ~8% of GDP for the GCC assuming an average price of US$100/bbl. In our view, this will continue to underscore government expenditure to shore up the non-oil economy through diversification going forward.

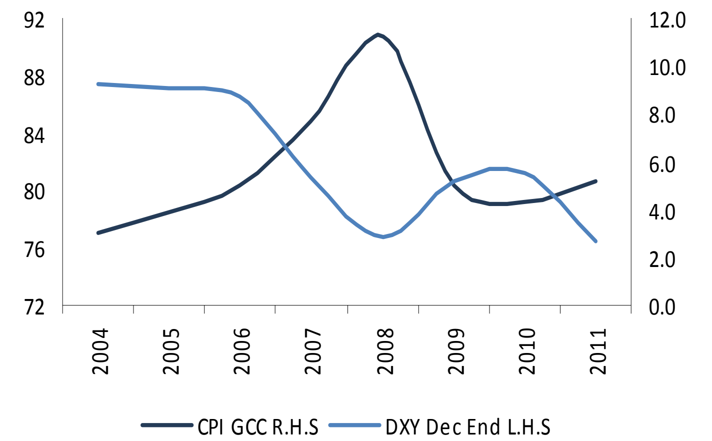
Inflationary pressures will likely remain moderate as fiscal surpluses allow continuing subsidization of staples. Moreover, world food prices are forecast to decline by 14% in 2012 according to the World Bank, playing into our moderate inflationary outlook.

Fiscal Breakeven Oil Price US$/bbl



Source: Bloomberg & TAIB Research

Dollar Index Vs. GCC Inflation



Source: Bloomberg & TAIB Research

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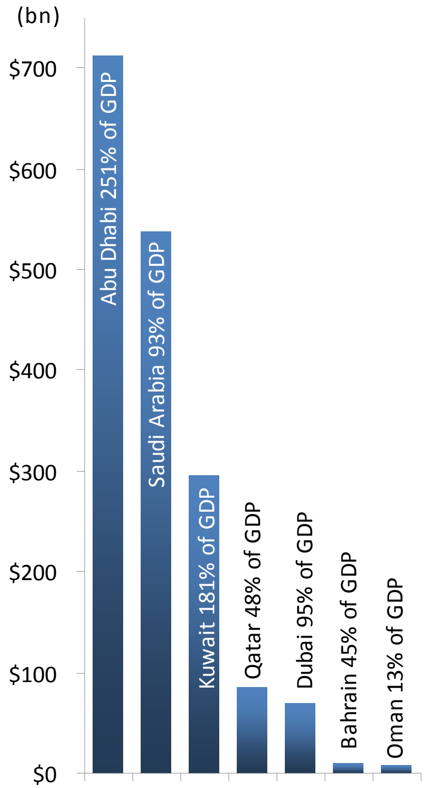
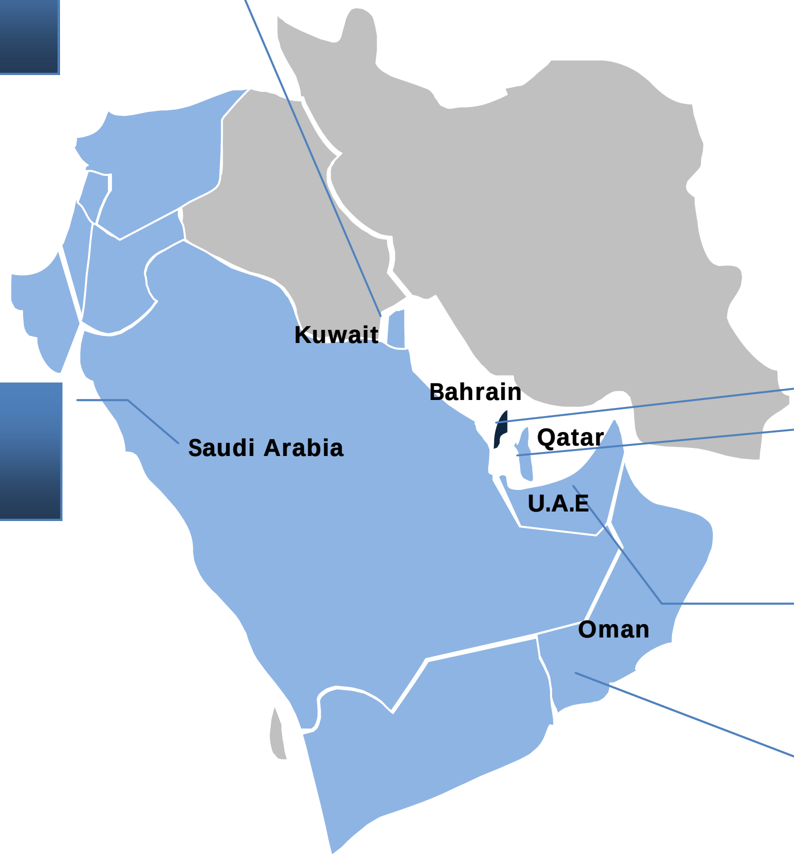
GCC to become a US$1.4tn Economy in 2012



GCC SWFs accounts for 35% of total sovereign wealth assets and ranges from 13%-251% of nominal GCC GDPs

Kuwait	
GDP/Capita (US$)	41,169
GDP Growth (%)	5.40
CPI Inflation (%)	6.20

Saudi Arabia	
GDP/Capita (US$)	25,159
GDP Growth (%)	4.50
CPI Inflation (%)	5.32



Bahrain	
GDP/Capita (US$)	24,412
GDP Growth (%)	3.10
CPI Inflation (%)	1.75

Qatar	
GDP/Capita (US$)	77,337
GDP Growth (%)	6.80
CPI Inflation (%)	4.41

U.A.E	
GDP/Capita (US$)	56,025
GDP Growth (%)	3.50
CPI Inflation (%)	2.52

Oman	
Nominal GDP (US$)	24,991
GDP Growth (%)	4.80
CPI Inflation (%)	3.80

Arab Spring is likely to lead GCC Governments to break away from the tradition of saving petro-dollars with wealth deployed to undertake populist measures and diversify economic growth drivers away from oil. Downside risk to oil demand will have to be reweighed in lieu of contained inflationary pressures in India and policy tilt for economic growth in China. China and India may rebalance the inflation vs. growth tradeoff where easing policy rates may dilute the impact of lower developed market demand.

Source: Bloomberg & SWF Institute

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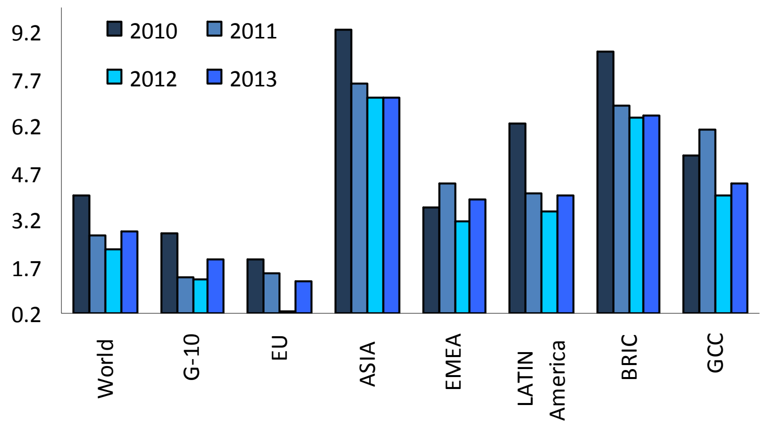
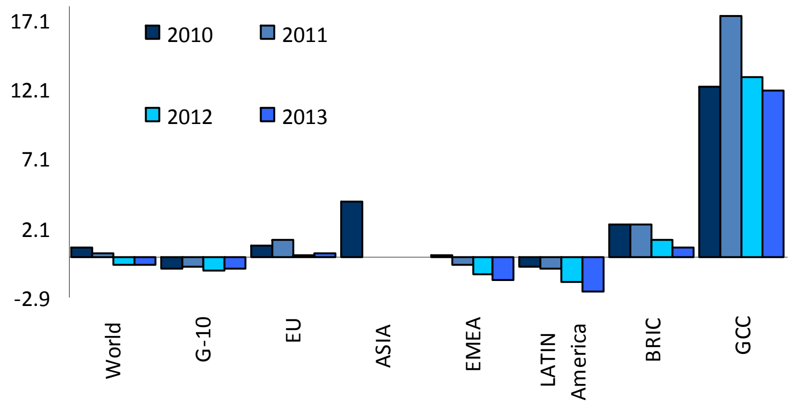
GCC Eco metrics trump global numbers!

Regional Real GDP growth (%)



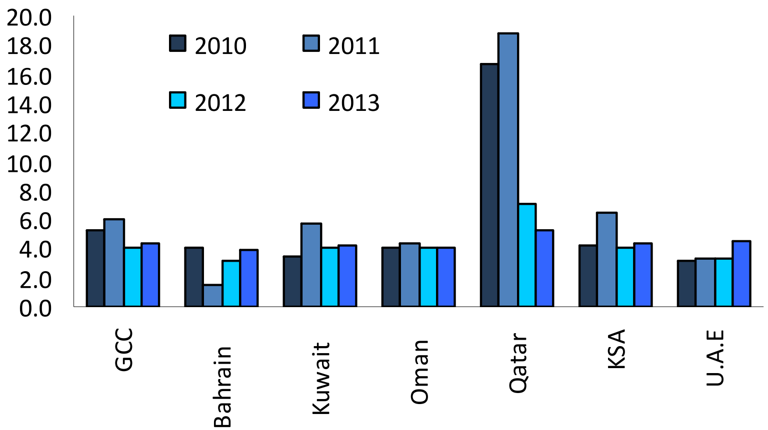
IMF expects real GDP growth for GCC to log in at 4% for 2012 as Qatar comes off super normal growth. GCC will remain one of the fastest growing regions in the world only behind BRIC countries.

Regional Current a/c as % of GDP



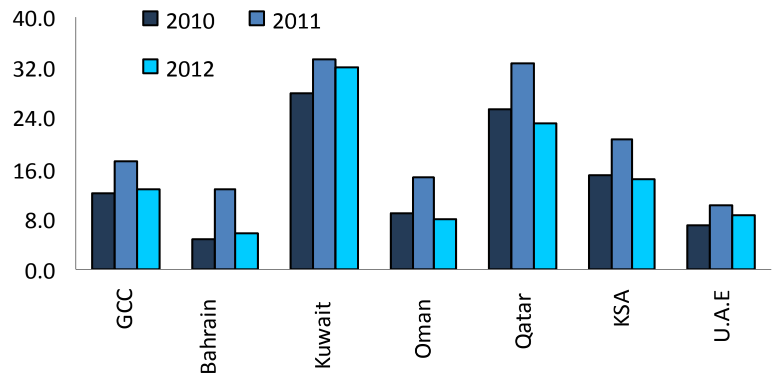
GCC consistently trumps the global stage with current account surpluses. While developed markets pose risk to moderating oil demand, we see coordinated supply cuts and Asian monetary policy response to favor growth in 2012.

GCC Real GDP growth (%)



Post online status of gas export projects, Qatari eco growth should normalize between 5%-7% under a moratorium while still topping regional growth. IMF expects UAE and Bahrain to lag regional growth, dropping below 4% for 2012.

GCC Current a/c as % of GDP



IMF expects GCC current account surplus to come in at 12.85% of GDP for 2012. Kuwait is likely to top the GCC with a current account surplus of 32% of GDP driven by surging oil prices.

Source: IMF & Bloomberg

Inflation Outlook – Benign to Moderate

Our inflationary outlook for GCC economies remains benign to moderate as lower food prices and currency peg balance off the impact of higher government spending.

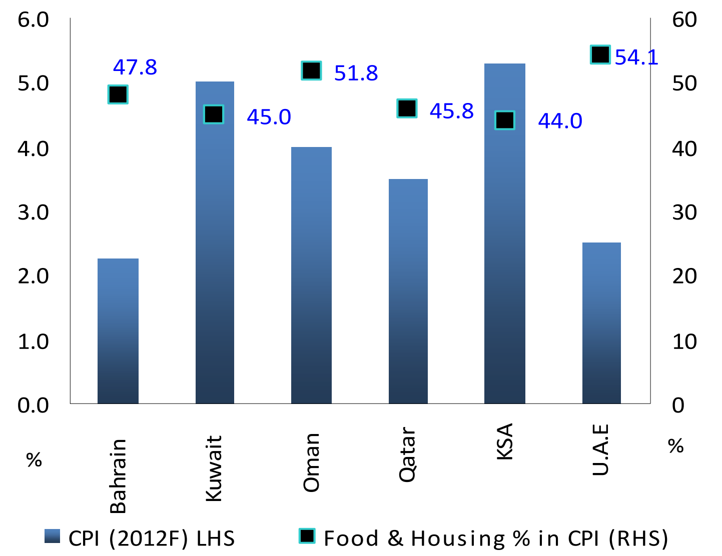
The risk on - risk off investment climate in the backdrop of “modest to moderate pace” in economic activity within the U.S. places upside risk on the side of the US$. Recall the U.S. benchmark 10 year U.S. treasury yields have declined by more than 30% post the S&P rating cut in August 2011.

GCC interest rate outlook should remain balanced in favor of growth as US Monetary Policy remains “accommodative” till 2014.

World Bank estimates world staple prices to decline by 14% for 2012. Leading outlook targets a decline of 3%-9% through 2013-2015 lending credence to our inflation outlook. Food weights account for 13%-30% across CPI baskets in the GCC.

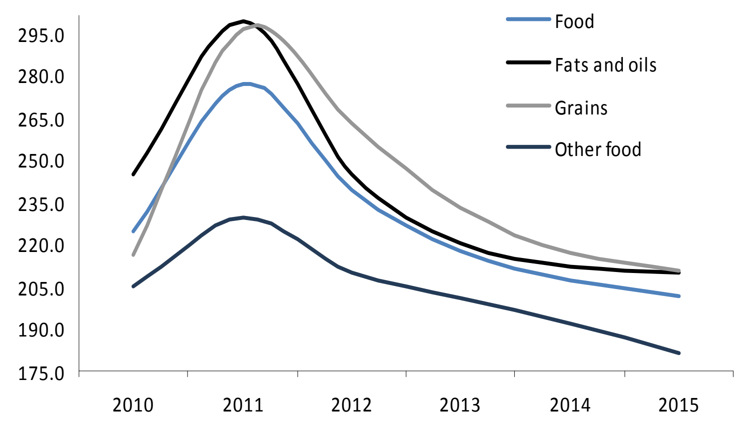
Monetary expansion and subsequent credit growth provide upside risk to inflation. That said, liquidity management through central bank intervention, tighter prudential regulations and continuing subsidies may counter inflationary pressures.

CPI Estimates with Food & Housing Weights



Source: Country statistics & Bloomberg

World Bank Food Indices



Source: World Bank

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GCC Demographics: Managing the Youth Dividend

While the combined GCC population is less than 1% of the world population, the region is one of the wealthiest with average per capita income in excess of US$30,000. IMF expects this figure to rise to about US$34,000 by 2014.

25% of the GCC's population is less than 14 years old while the median age is a low 26.5 years – a factor which can work for the GCC over the long term. BRIC countries leveraged low median age to help sustain high growth rates; however age now poses risk to sustainable growth for some with median age now at: India (26.2 years), China (35.5 years), Brazil (29.3 years) and Russia (38.7 years).

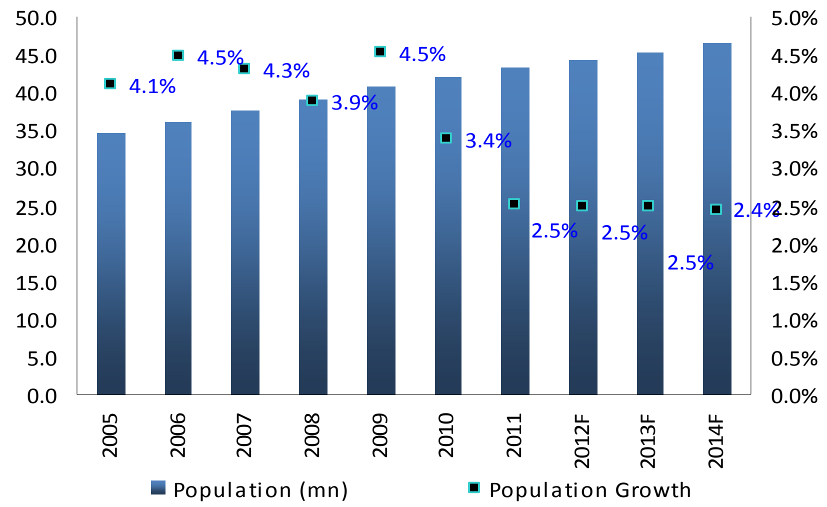
<u>GCC Age Structure:</u>

0-14	25%
15-64	73%
above 65	2%
Median Age	***26.5 Years***

The challenge for GCC economies, as they look to diversify away from oil-driven growth, is to fully utilize this potential "youth dividend." ILO in 2009 indicated that the GCC youth unemployment rate was nearly double the global rate of 12.8%.

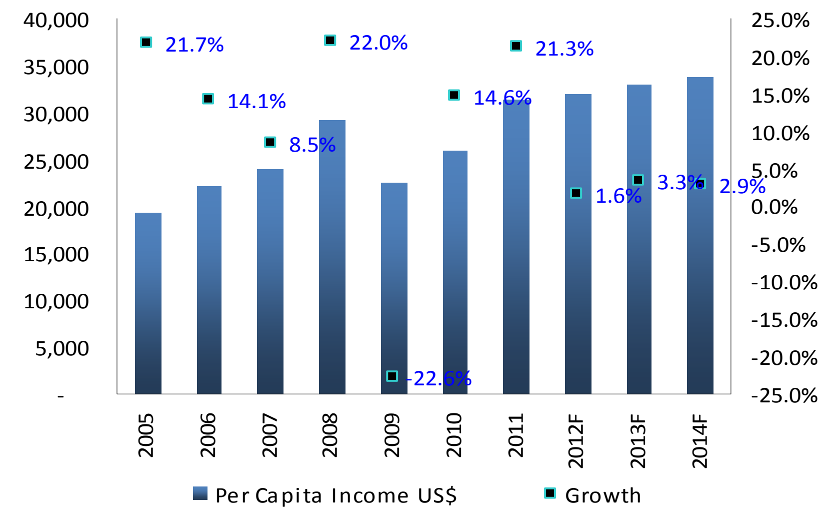
Understandably, GCC fiscal spend packages in the aftermath of the Arab Spring pays due attention to job creation and education, in an effort to increase workforce Arabization.

Population vs. Growth



Source: IMF & TAIB Research

Increasing Wealth



Source: IMF & TAIB Research

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GCC Consumers have the last say!

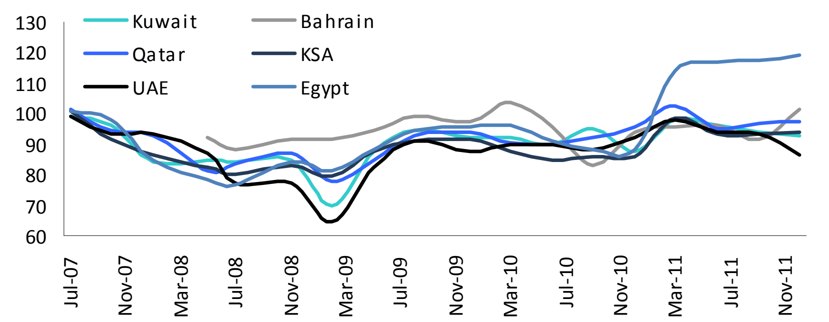
Consumer confidence proxy shows sequential GCC-wide declines with the exception of Bahrain. UAE remains notable where consumer confidence has declined to a new low in Dec’11. 39% of consumers within the UAE view the present situation as a bad time to buy consumer durables while 32% feel the general economic condition has deteriorated. Consumer confidence in Bahrain has rebounded from its trough range between Dec’10 to Sep’11.

Consumer expectations regarding outlook on finances and overall economy show improvement for Qatar and Saudi Arabia but remain below the Mar’11 highs. UAE consumer expectations continue to weaken, reaching levels last seen during Dec’09 (soaring Dubai debt default concerns). Expectations have also improved sharply in Bahrain in Dec’11 but remain below the high posted in Mar’10.

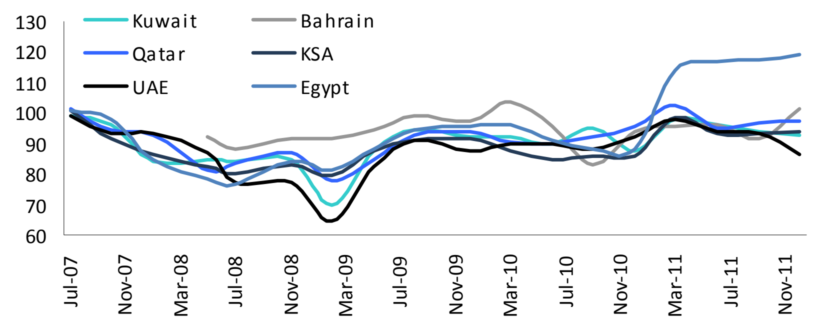
Confidence surrounding job markets shows improvement in Dec’11 for Qatar and Saudi Arabia with improving job availability and income growth. UAE measure shows continuing weakness in Dec’11 but still above its 2 year low in Feb’09. Employee confidence has declined in Bahrain, falling to an all time low in Dec’11.

Across the breadth of the GCC, over a 58 month period, all countries have shown a decline in confidence where we believe social unrest and geopolitical risk have outweighed solid underlying economic outlook. That said, improvement in expectations across Qatar and KSA dovetail our expectations of improving overall eco metrics.

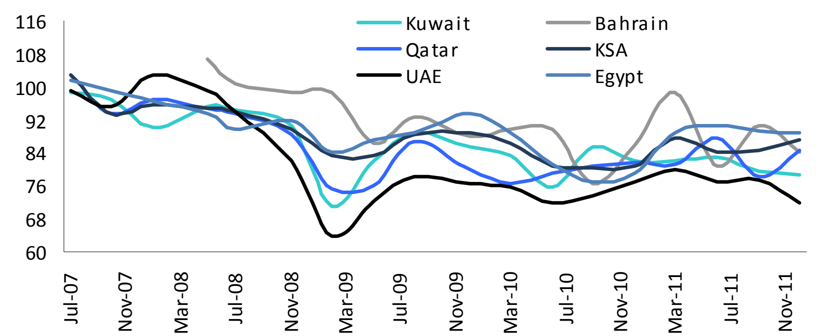
Consumer Expectation Index



Consumer Confidence Index



Employees Confidence Index



Source: Bayt, (YouGov)

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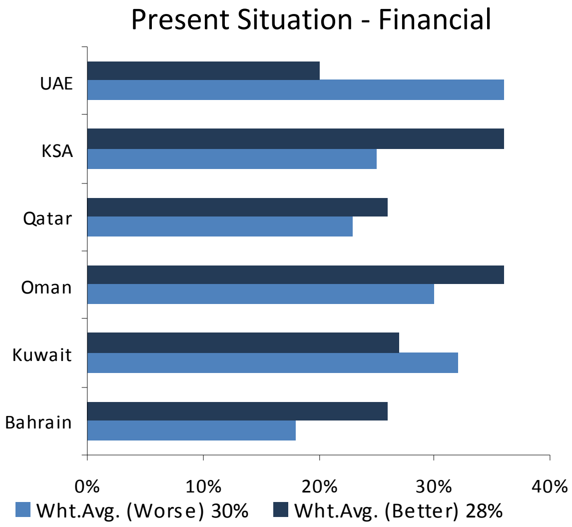
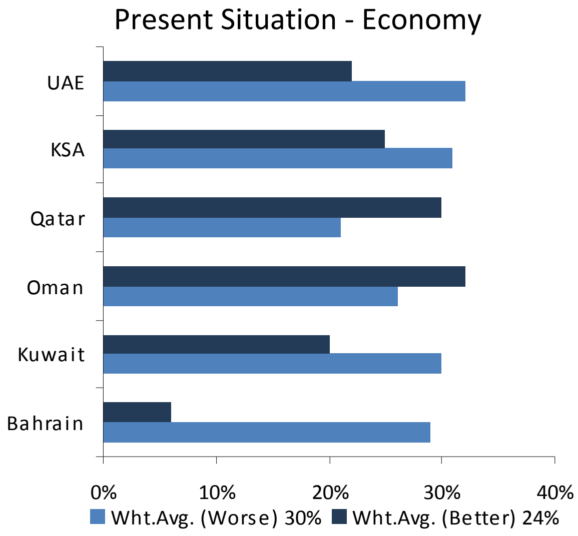
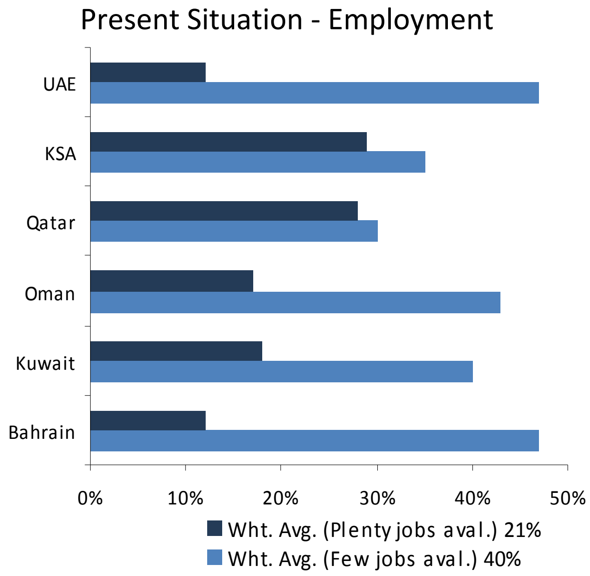
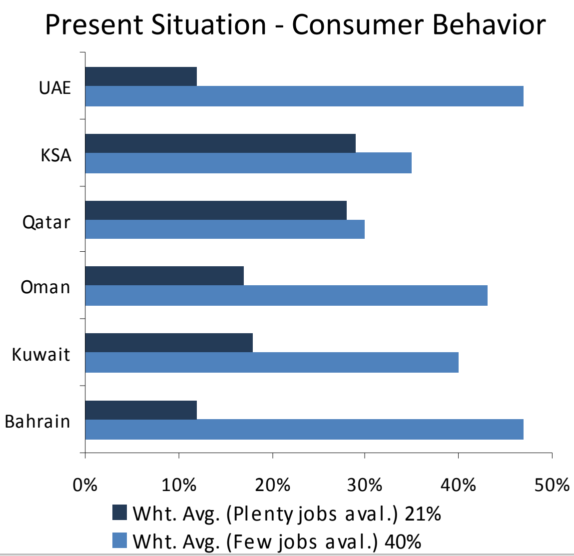
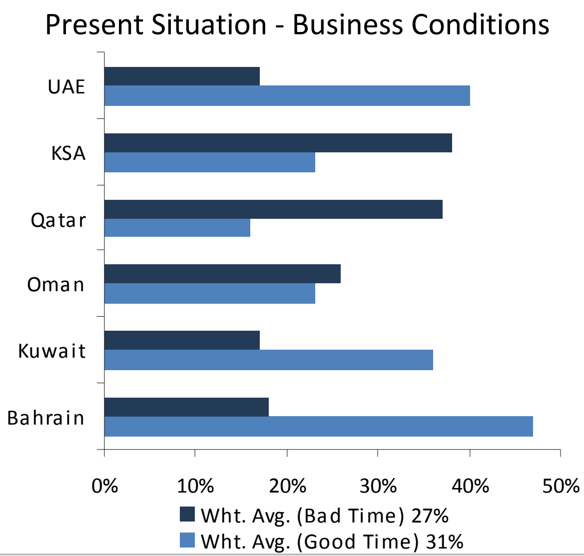
GCC Consumer Confidence Chart Bank - I

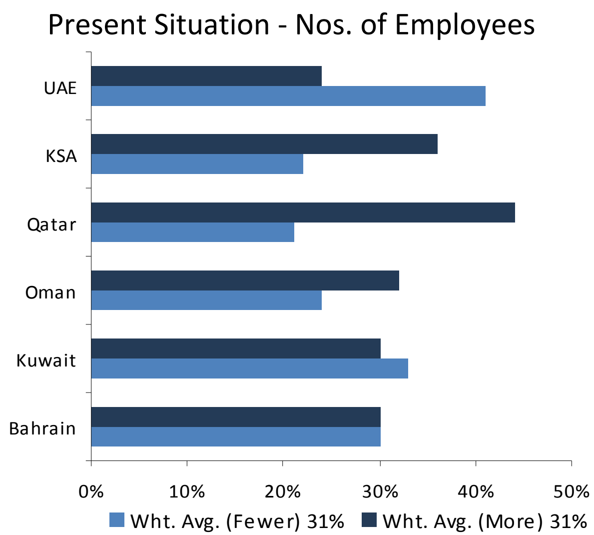






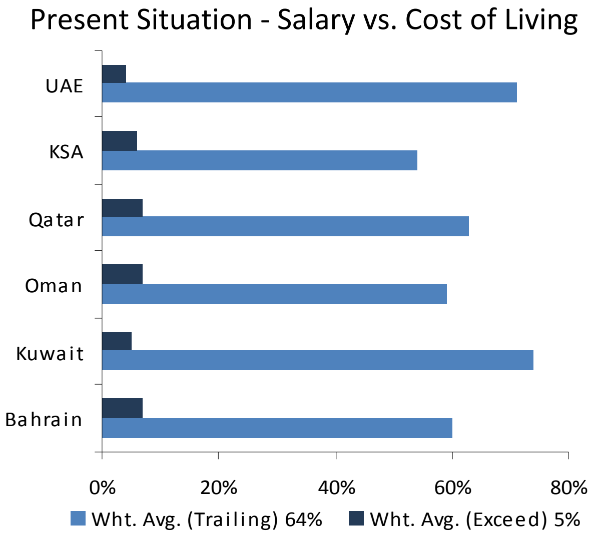


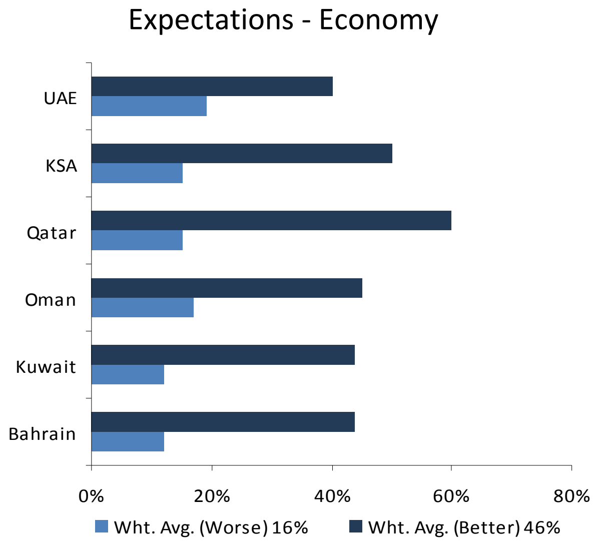


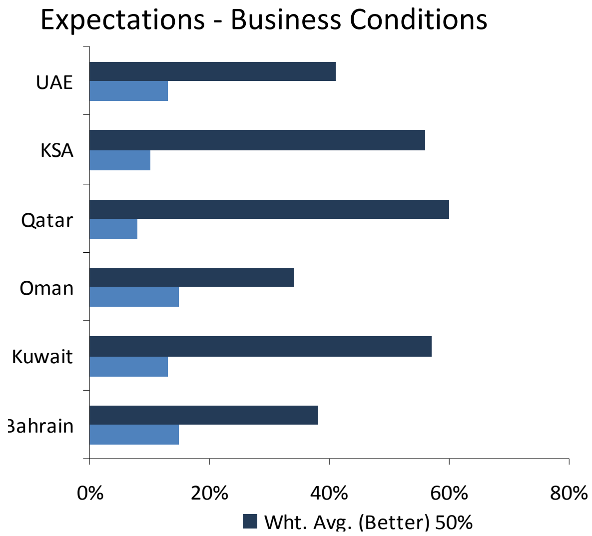


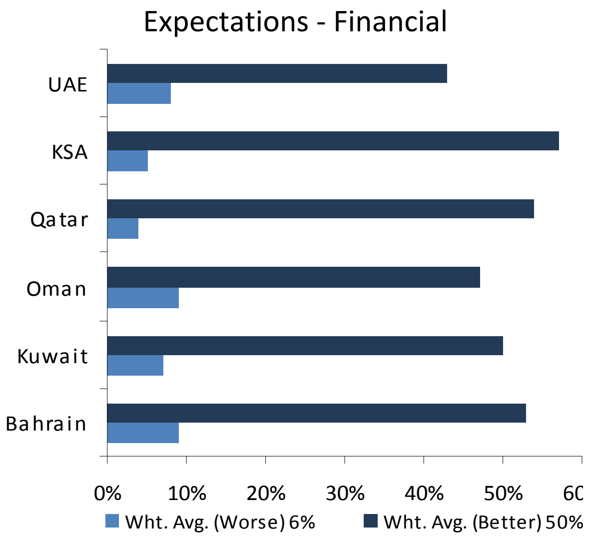
Source: Bayt, (YouGov)

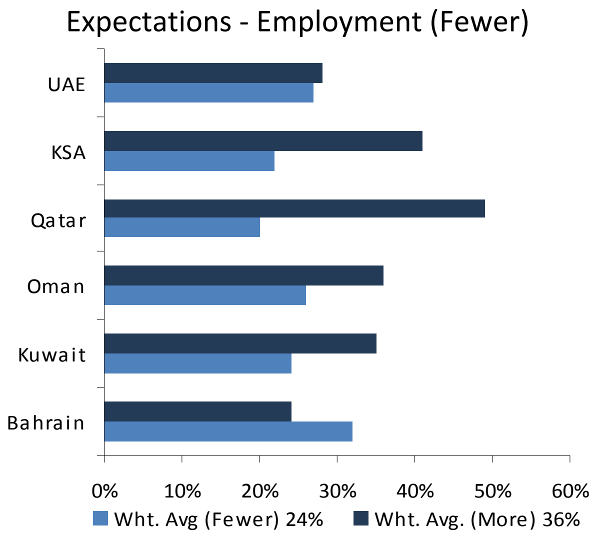
GCC Consumer Confidence Chart Bank - II











Source: Bayt, (YouGov)

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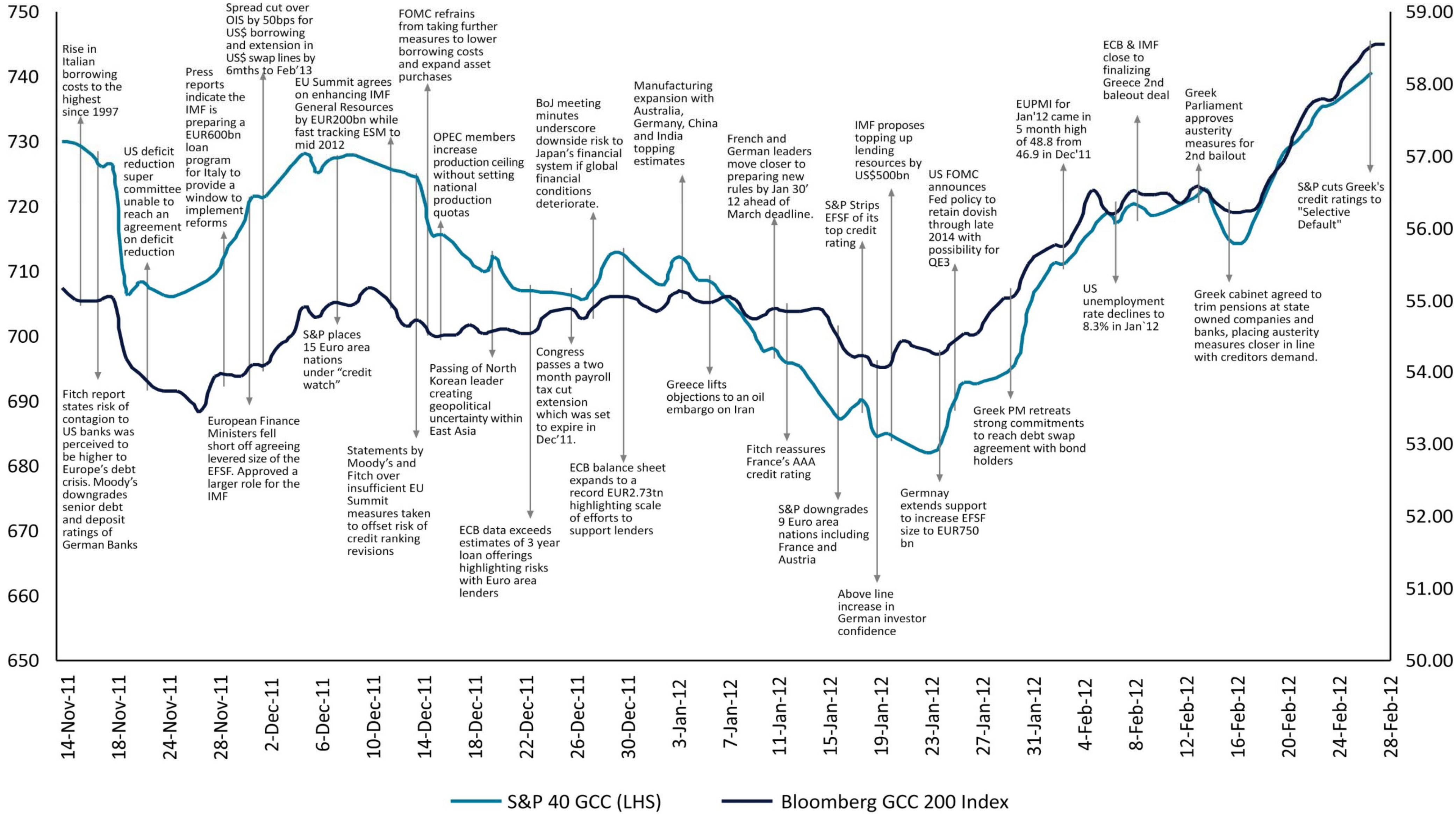
Global Events Timeline – Market Reaction



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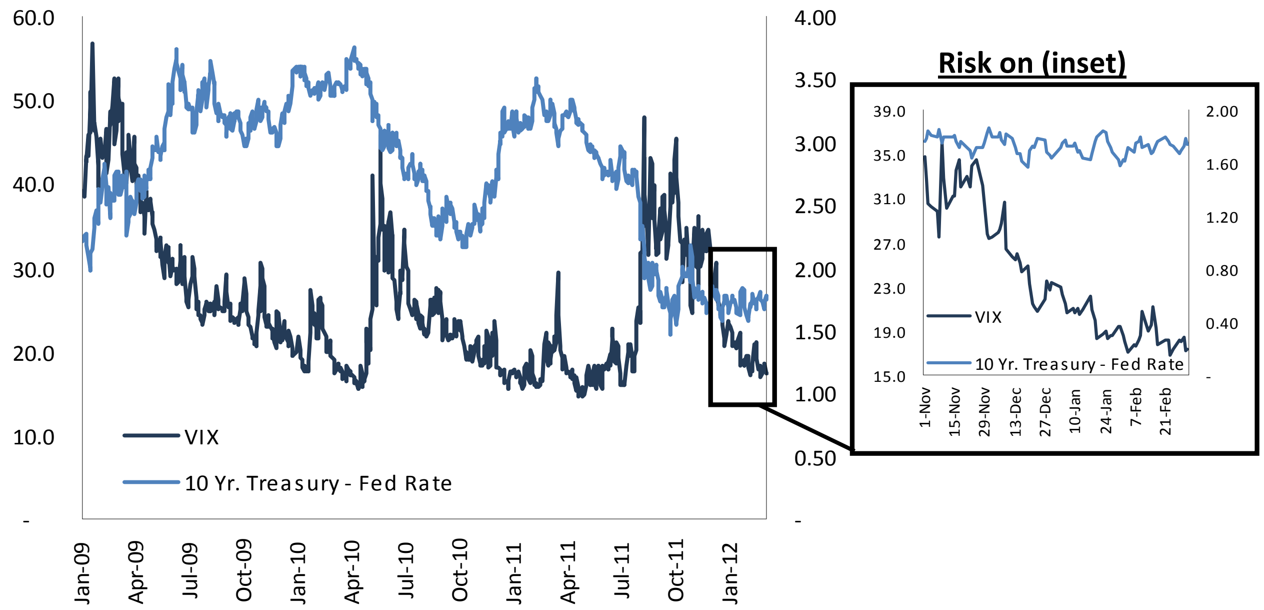
Source: Bloomberg, DataStream & TAIB Research

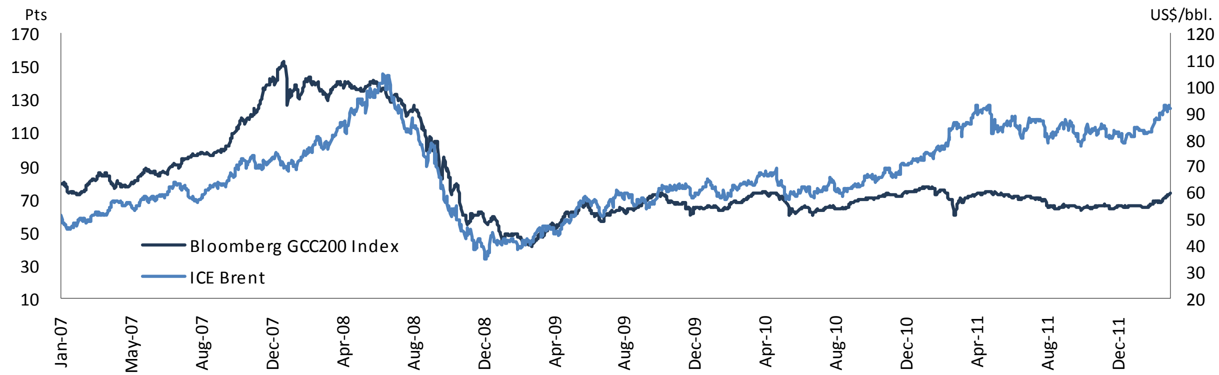
The Genesis of Global Equity Performance

Proxy for Risk Tolerance – US 10Yr Treasury – Fed Rate vs. VIX Index



Source: US Department of Treasury, Bloomberg & TAIB Research

Bloomberg GCC200 Index vs, Oil Prices (ICE Brent)



Source: Bloomberg & TAIB Research

-Equities are off to their best start in years, backed by signs that global manufacturing is resilient in withstanding the risk of European sovereign debt fallout.

-Markets have also moved to price in the U.S. Federal Reserve's pledge to maintain near-zero interests rates till 2014 versus previous guidance of 2013

-U.S. Housing data is showing signs the housing market is past trough while employment is recovering in the U.S.

-As a proxy for risk tolerance, VIX versus 10 year treasury – Fed Funds rate is again expanding, showing signs of continuing positive run for equities

-Over CY12, we expect business cycles to diverge where high oil prices can gradually disconnect globally aligned monetary policy response.

-Firm oil price outlook and space to continue with subsidies should ensure GCC economies remain on track while corporate earnings are likely to be buoyed by higher hydrocarbon prices and derivative product margin expansion

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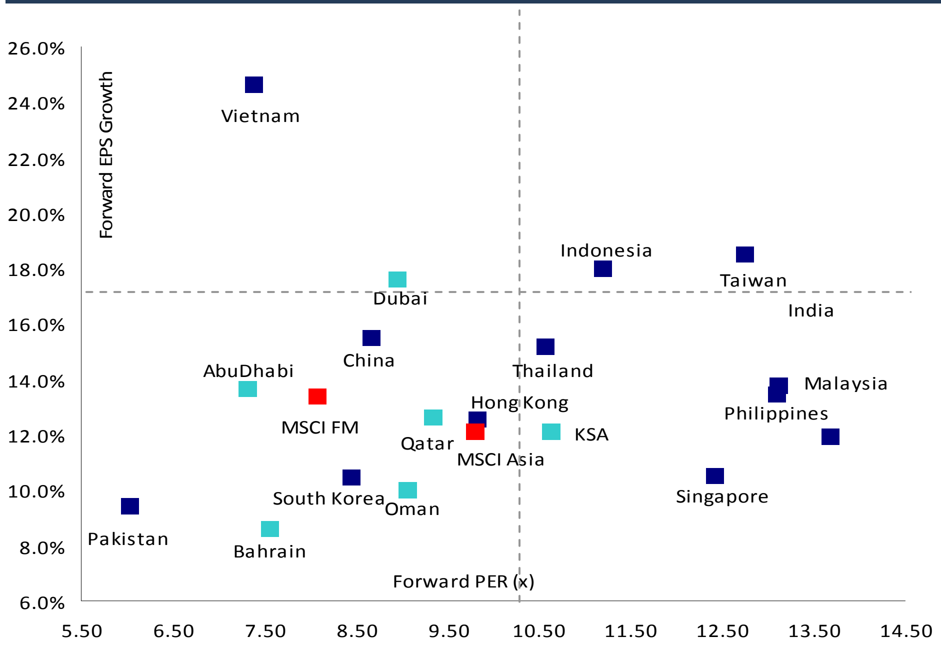
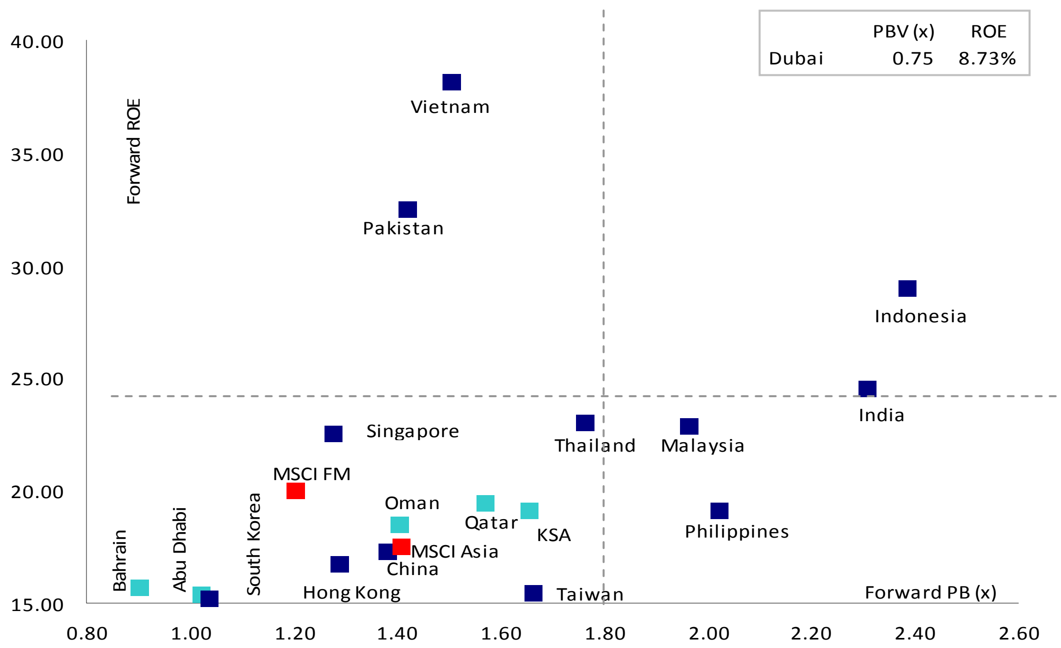
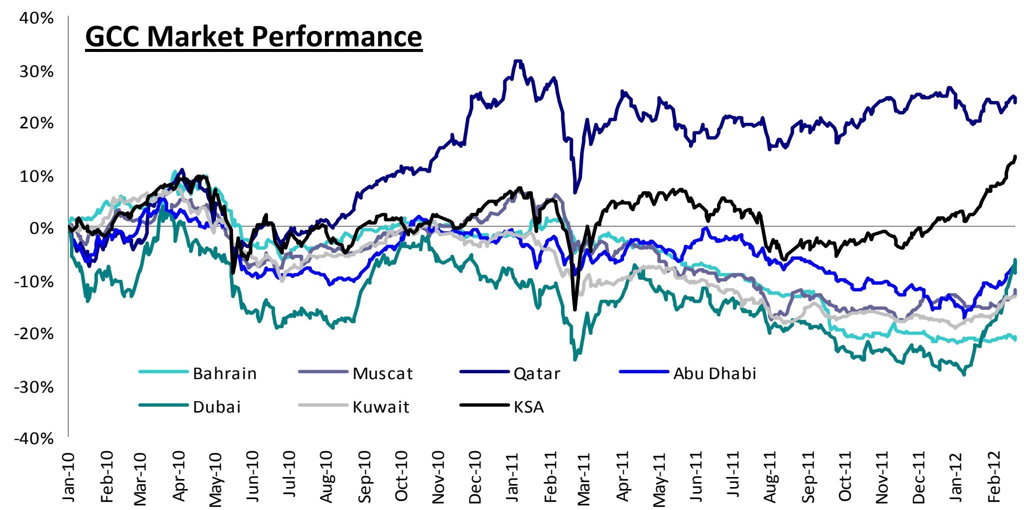
Are GCC markets headed for premium multiples?





GCC markets have narrowed the discount to Asian markets. Since 2008, PER discount has narrowed from 50% to 15% currently as corporate profitability improves within the backdrop of strong regional economic growth underpinned by distributed petro-wealth. As economic metrics trump global numbers, GCC markets may look to be placed with premium valuations going forward. Potential political/social unrest poses the key risk to this thesis.



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Source: Bloomberg & TAIB Research (Valuation Based on Forward Consensus)

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Saudi Arabia – Can money buy everything?

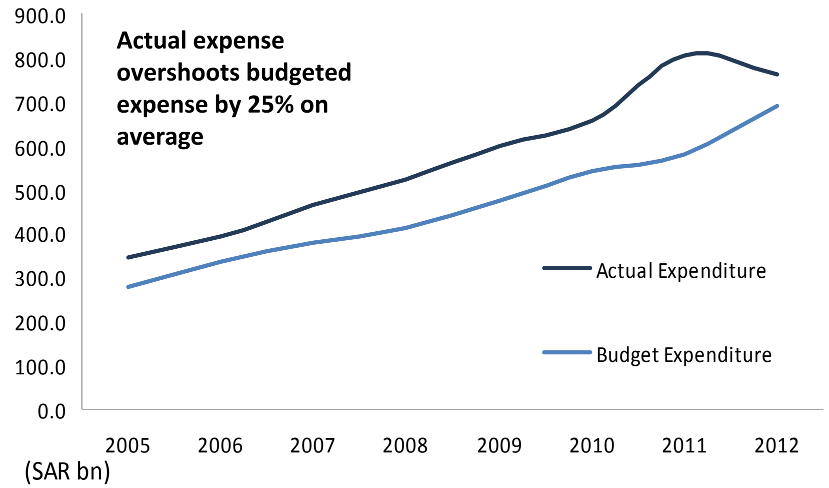
Ratings	Moody's	S&P	Fitch
	Aa3	AA-	AA-

Saudi Arabia has for now trumped pockets of protest with stimulus measures. Windfall oil revenues underpinned fiscal expansion where despite SAR224bn in additional spending, fiscal surplus still came in at 11% of GDP in 2011 (vs. budgeted deficit of 1.9% of GDP). Thematically, we expect more of the same as the Government moves ahead with announced measures.

2012 fiscal surplus as a % of GDP has been forecasted at 0.5% (SAR12bn). We view targets as conservative – over the last 5 years, expenditures have overshot targets by 25% on average. In our view, total expenditures are likely to log in at SAR759bn implying a "Break Even" oil price of US$78/bbl. We expect running Persian Gulf blend prices to remain firm as waning western demand is likely to be balanced by synchronized production cuts and growth oriented policy response out of Asia. US Iran standoff also poses upside risks.

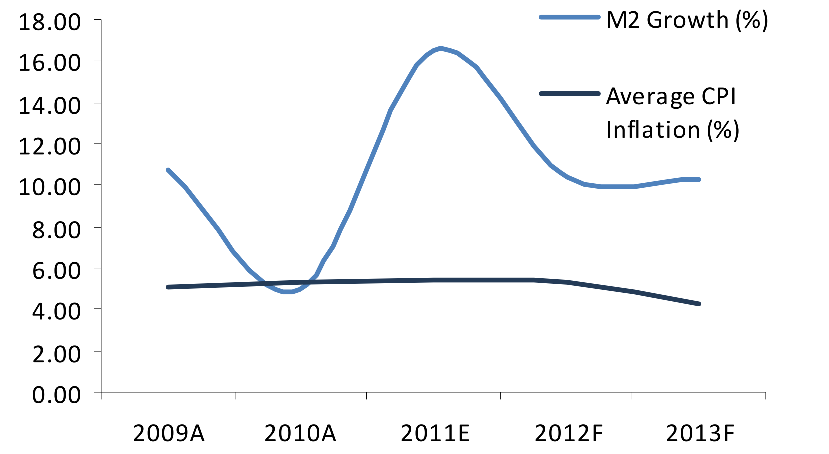
2012 GDP growth is estimated at 4.5% with CPI to average 5.3% (relatively high but should be mitigated by in-control commodity prices). Given the pegged exchange rate, interest rates are expected to be inline with the US. Fiscal spend, particularly on housing, will have significant spillover effect due to backward linkages to various sectors. We see momentum buildup in Real Estate & Contracting, Cement and Transport sectors.

Saudi Arabia Actual vs Budgeted expenditure



Source: MoF KSA and TAIB Research

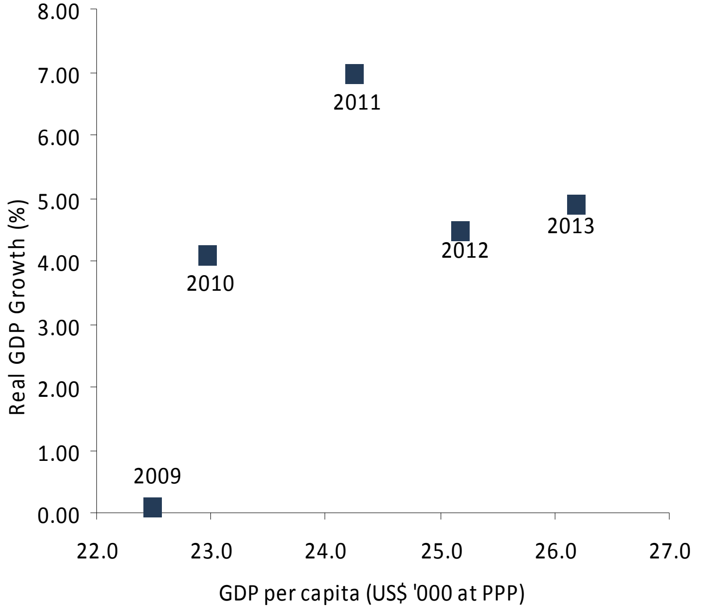
Flat CPI despite high M2 growth

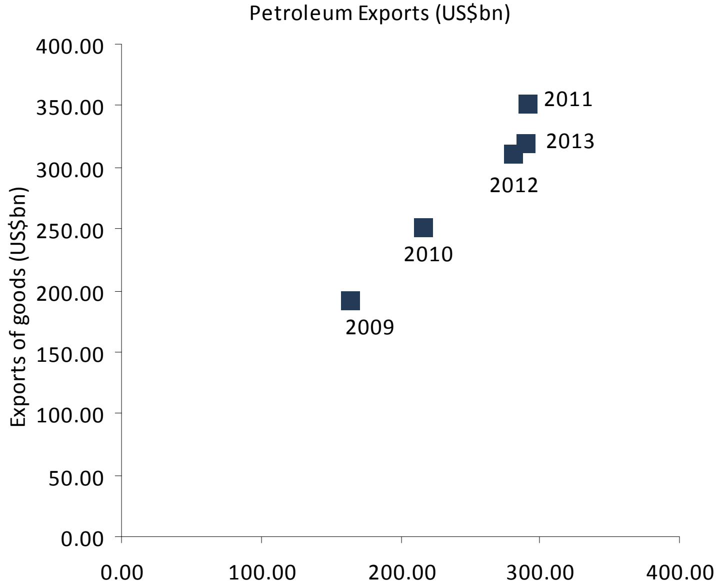


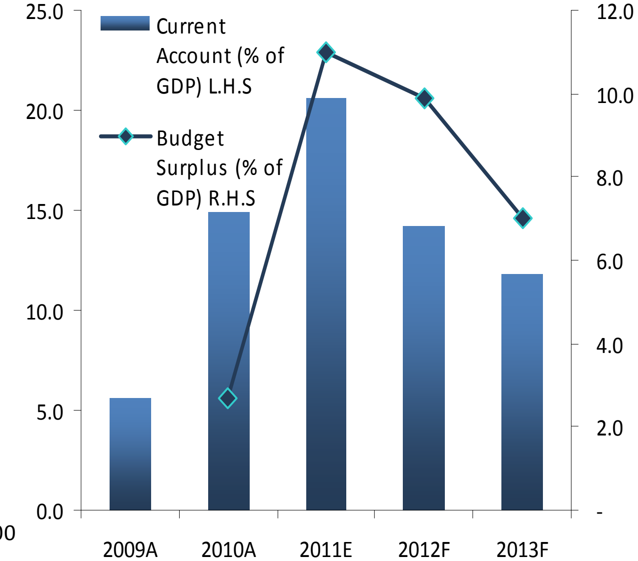
Source: Bloomberg

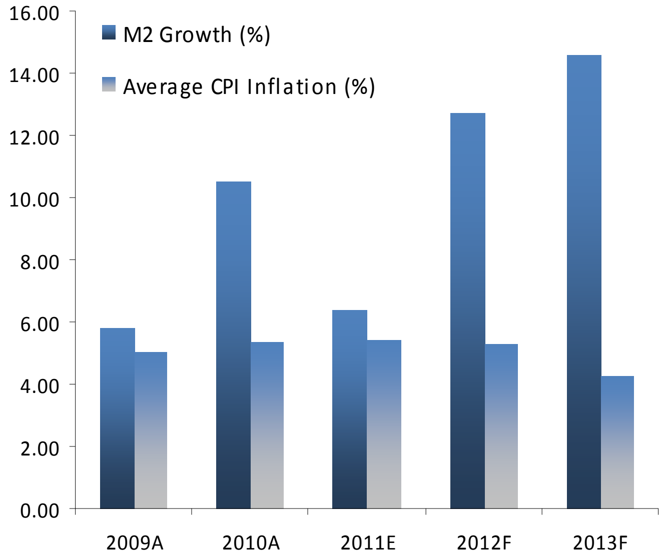
Saudi Arabia – Chart Bank

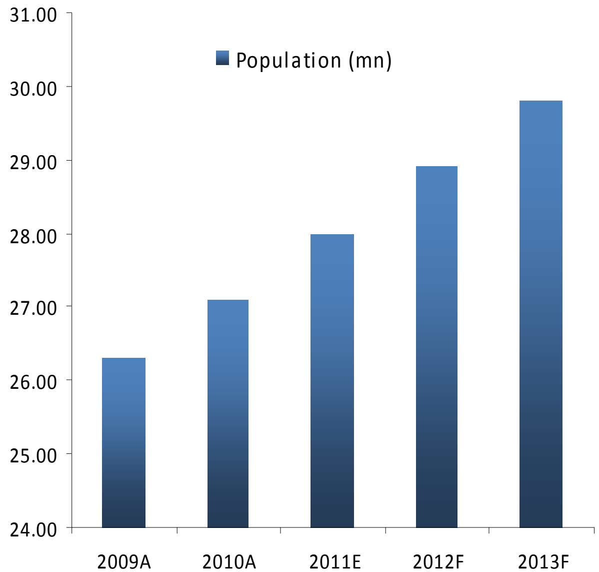
Saudi Arabia Key Eco Metrics

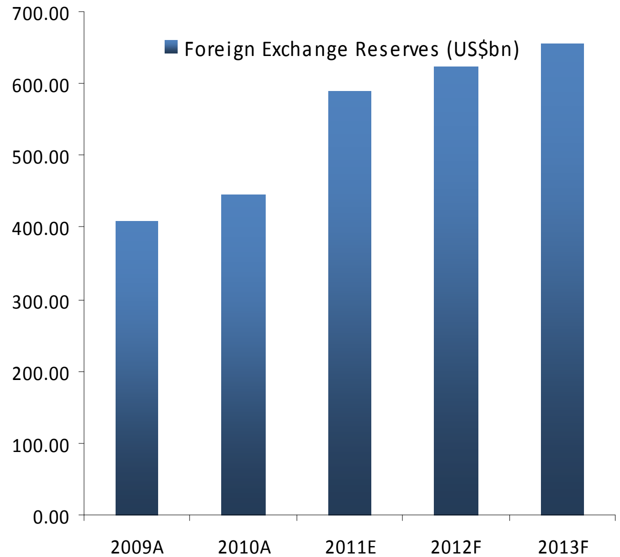












Source: IMF, EIU, Bloomberg & TAIB Research

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Qatar: Coming off Super Normal Growth!

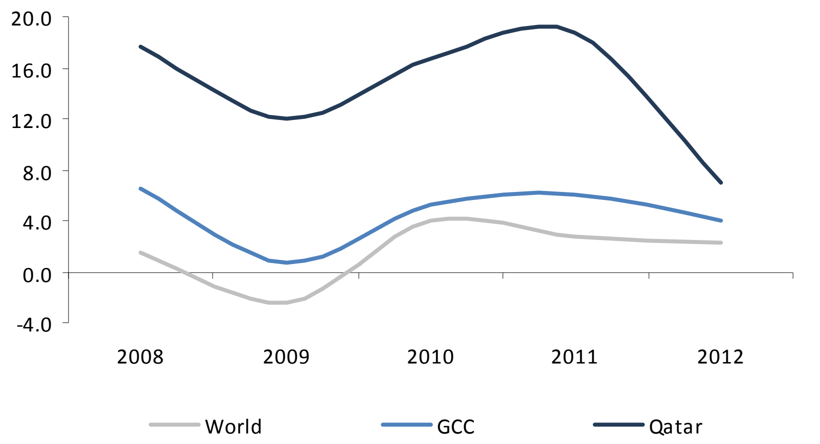
Ratings	Moody's	S&P	Fitch
	Aa2	AA	-

With LNG trains coming online, Qatar has posted super normal GDP growth over the last few years. While growth outlook normalizes within the 5%-7% range through moratorium years until 2015 (moratorium development of new hydrocarbon projects), Qatar is still poised to outperform GCC peer group.

Locked-in export contracts and firm hydrocarbon price outlook lend credence to a sustained fiscal surplus in 2012 (datastream places destination flex volumes at 30MT/year). Hydrocarbon growth will likely normalize to around 3%; however the IMF expects non-hydrocarbon real economic growth to accelerate to 9% with continued infrastructure spending. As a result, real GDP growth is expected at 6.8% for 2012.

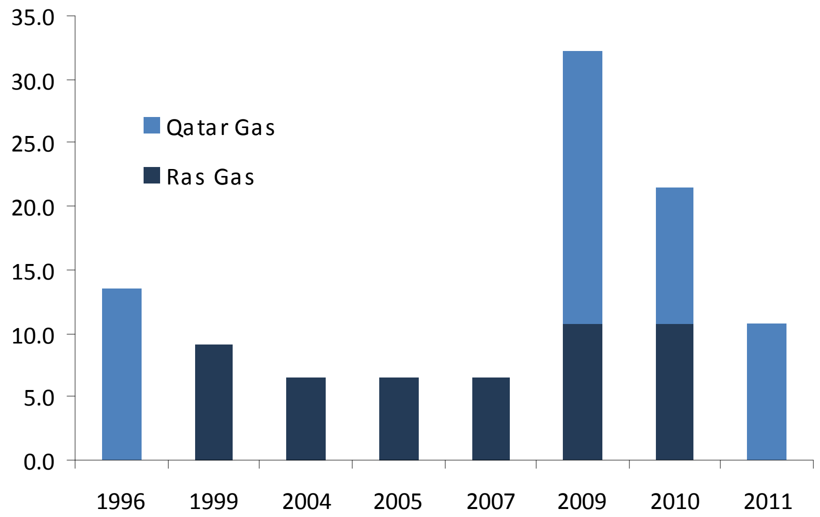
Inflation outlook remains in check as excess real estate should keep rentals depressed while decline in staple prices and currency peg should be supportive of a benign inflationary outlook (IMF expects CPI of 4.1% in 2012). Upside risk to inflation include brisk clip in credit expansion which may require prudent liquidity management (tighter reserve requirements and issuance of treasuries). In this regard, M2 growth has averaged 20% through the last three years while banking sector advances have increased by more than 20% (CAGR) in the same time frame.

Normalized Qatar growth still beats the GCC



Source: Bloomberg

Qatar LNG Capacity Additions– BM^3



Source: EIA

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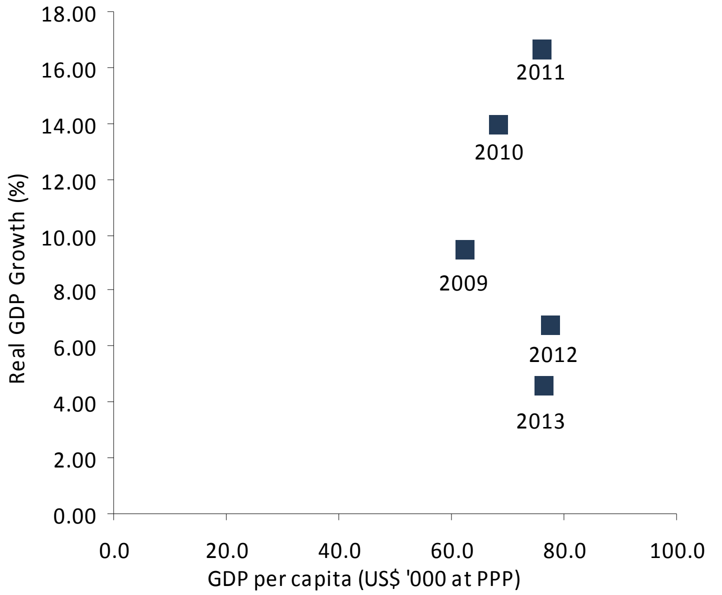
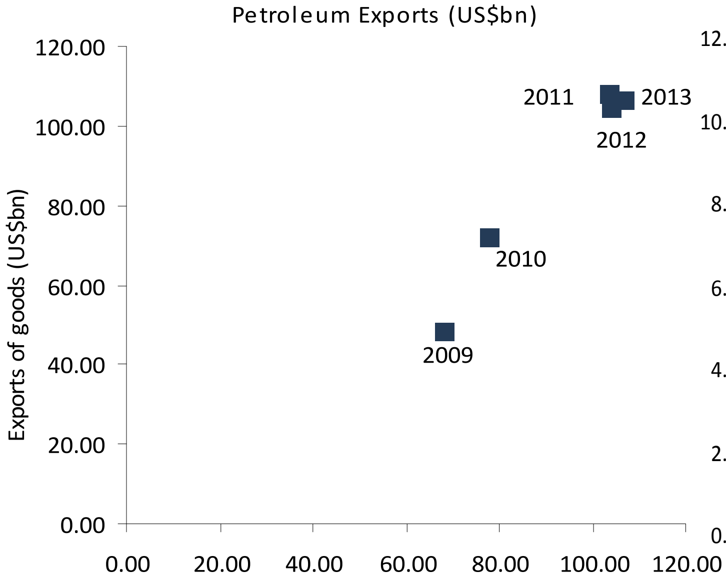
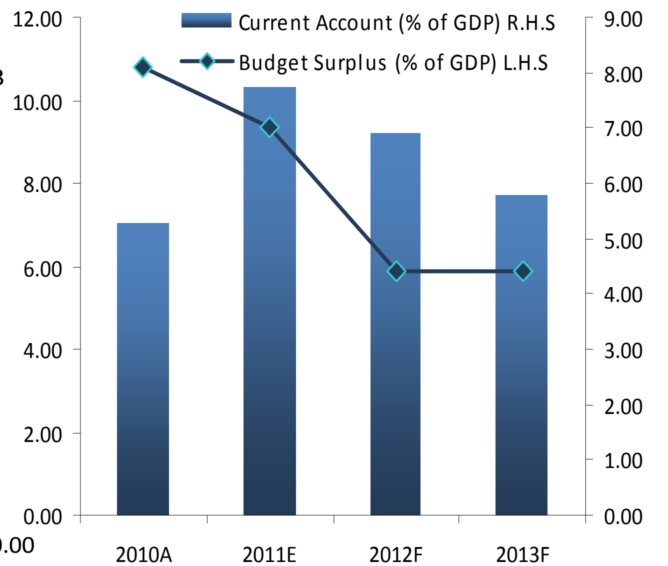
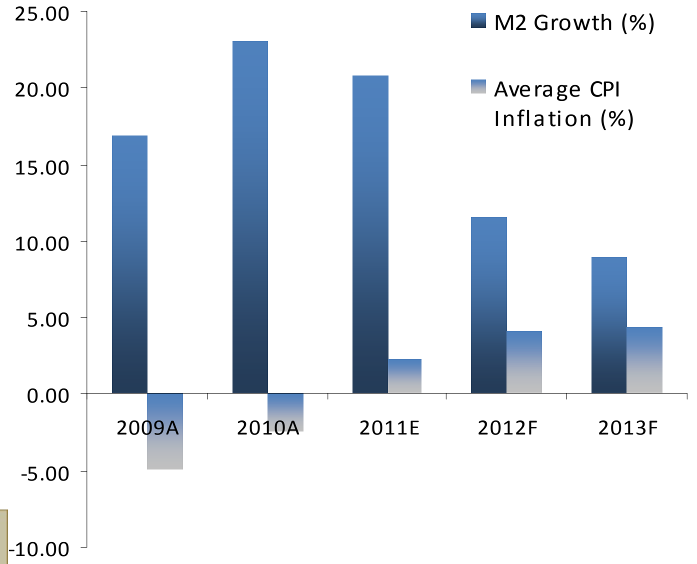
Qatar – Chart Bank

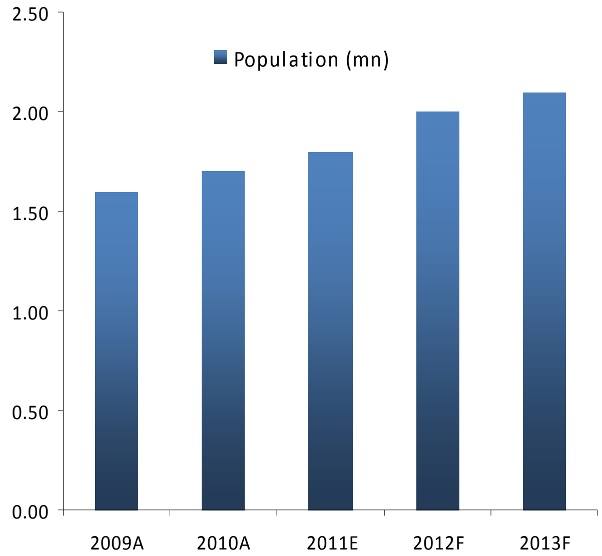
Qatar Eco Metrics

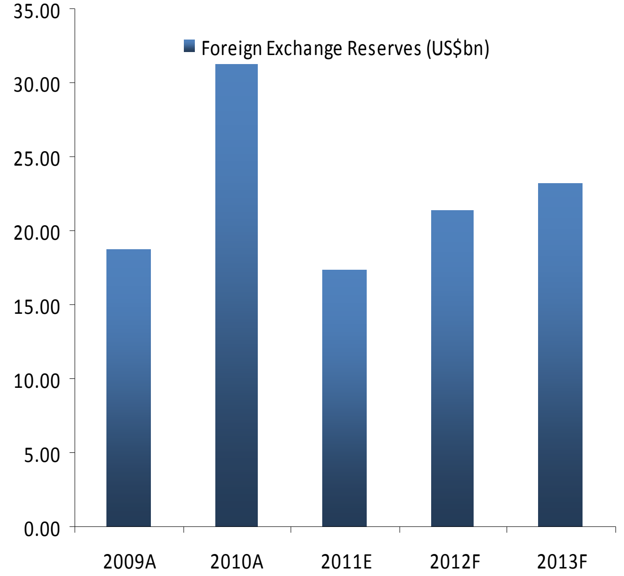












Source: IMF, EIU, Bloomberg & TAIB Research

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Kuwait – Huge Twin Surpluses

	Moody's	S&P	Fitch
Ratings	-	AA	-

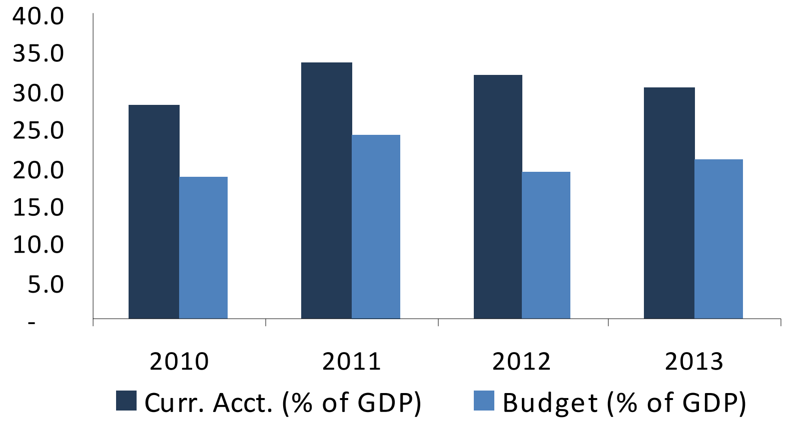
Enhanced oil production is expected to lift GDP growth to 4.4% in 2011 which, in lockstep with strong crude prices, is expected to result in hefty current account and fiscal account surpluses of 33.5% and 24.0% of GDP respectively. However, CPI is expected to have averaged at 6.2% in 2011, up from 4.1% in 2010.

Despite potential lower crude production, in order to accommodate for higher Libyan oil flows, Kuwait's GDP growth is expected at 5.4% for the next year. However, lingering strains in the financial sector coupled with failure to fully deliver on capital spending due to political tensions, is expected to be a major road block for growth in the non-oil sector.

That said, the Current and Fiscal surpluses for 2012 are projected at 30.3% and 19.3% of GDP, respectively, which can potentially be diverted to Kuwait's sovereign wealth fund.

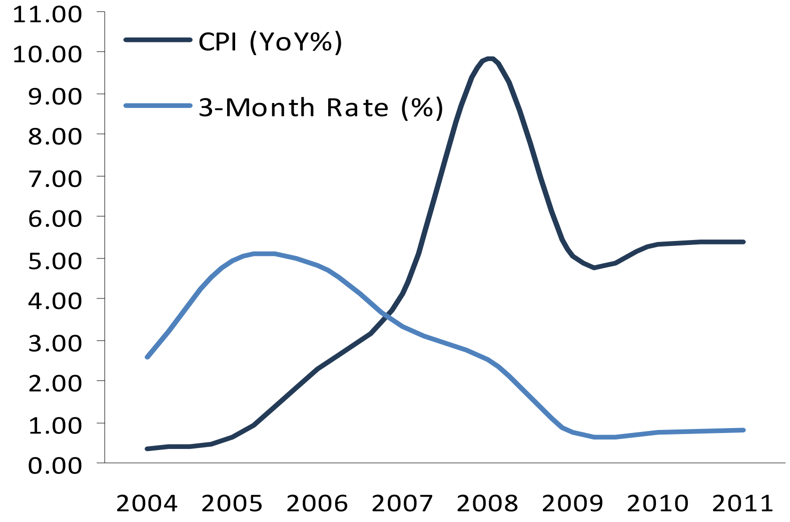
Considering that inflation has been an issue in 2011, extensive subsidies will likely continue which coupled with lower food prices should curtail CPI to a more manageable level of 3.35% in 2012. This would gel with Kuwait's sizeable CA and fiscal surpluses and overall government policy to check social unrest .

Sizeable CA and Fiscal Surpluses



Source: Bloomberg

CPI Inflation vs. 3Month Rate (%)



Source: Bloomberg

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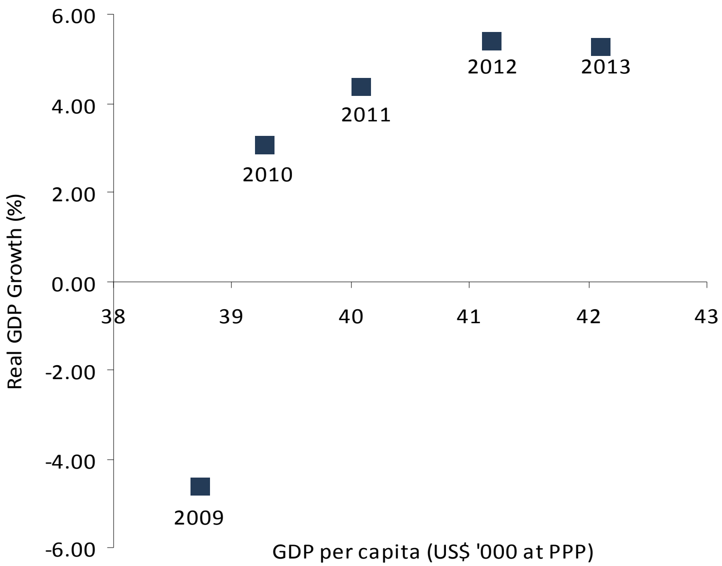
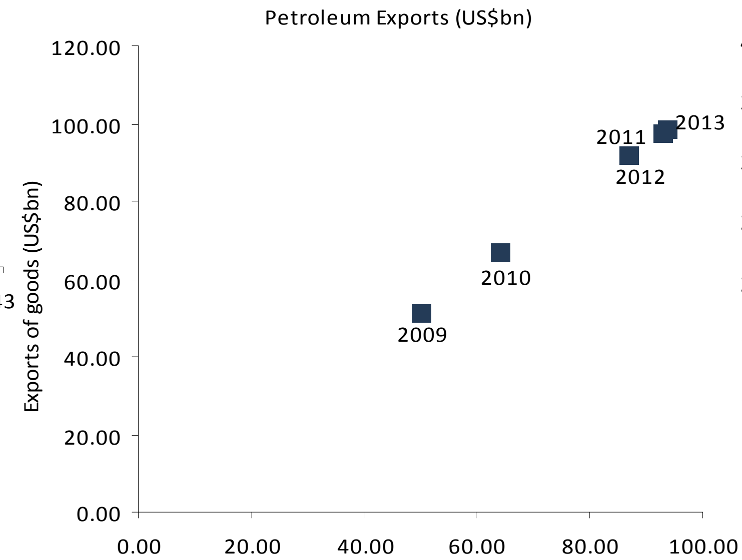
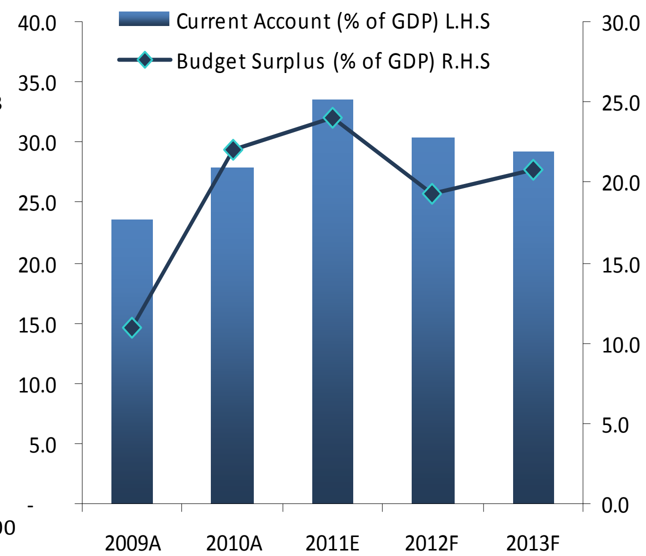
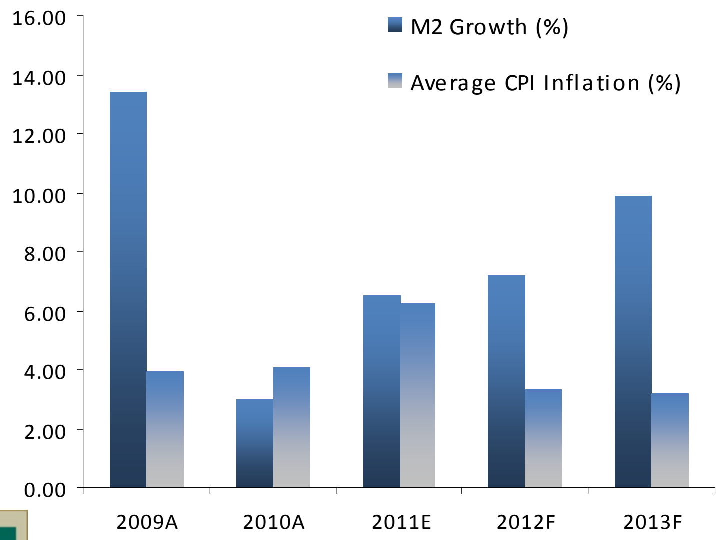
Kuwait – Chart Bank

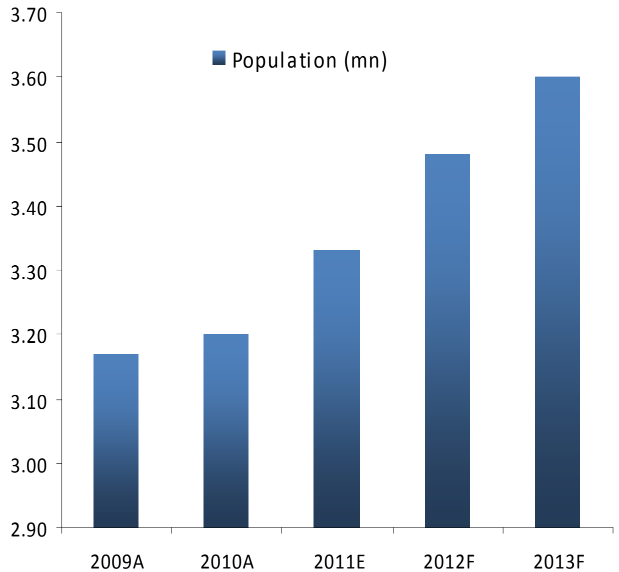
Kuwait Eco Metrics

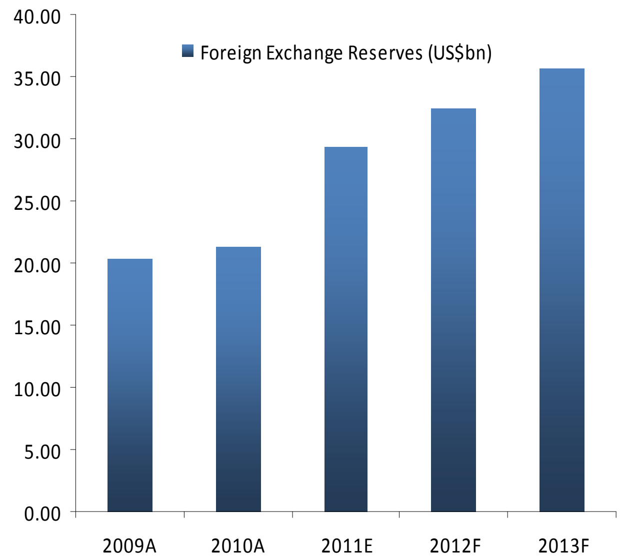












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Source: IMF, EIU, Bloomberg & TAIB Research

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UAE – Continuing with Deleveraging & Consolidation

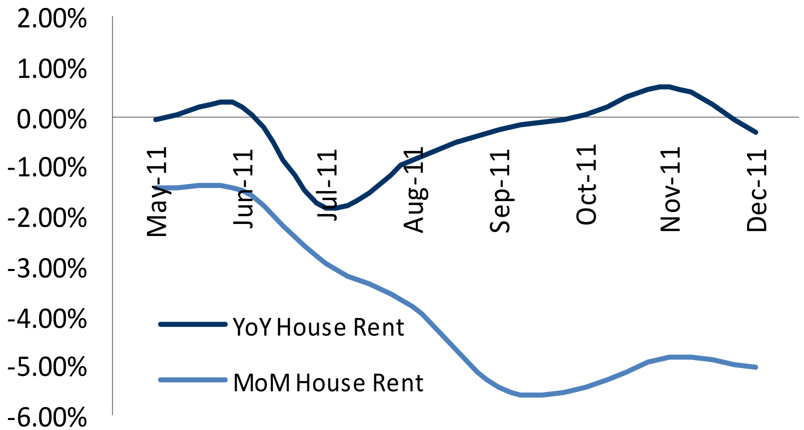
	Moody's	S&P	Fitch
Abu Dhabi	Aa2	AA	AA
Dubai	Aa2	-	-

The process of economic consolidation and balance sheet deleveraging continued in 2011, with GDP growth placed at 3.3% and inflation averaging 2.5%. Higher oil prices were countered by continuing real estate weakness, particularly in Dubai. Regarding the latter however, UAE rental inflation has started to pick up sequentially from Oct'11.

As consumer and business confidence has fallen over the last few months, UAE banks' deposits have flattened over the last few months while banks still appear reluctant to lend aggressively despite improved capital adequacy and benign inflation. The Loan to Deposit ratio was last recorded at 102% and ensuring steady credit growth is likely to be a consideration for the central bank.

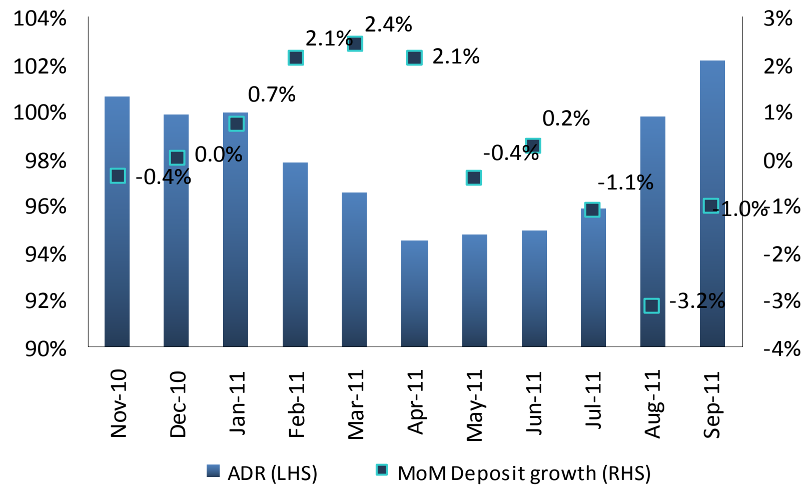
Pace of GDP growth is likely to continue the trend seen in the last few years with a growth of 3.50% in 2012. Same goes for average CPI as UAE focuses on economic consolidation while interest rates are expected to stay unchanged, inline with the US. A strong external account could be used to fund expansion of Sovereign Wealth Funds particularly by Abu Dhabi although, alternatively, state funding could again be required as real estate sector dynamics remain on the weaker side as several SOEs face debt repayments.

House Rent: YoY deflation but MoM recovery



Source: UAE Statistics & TAIB Research

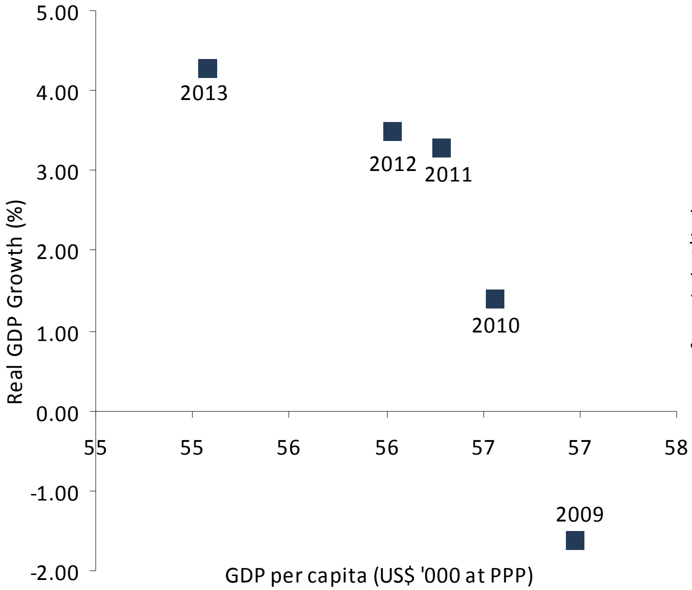
ADR climbing on de-growth in deposits

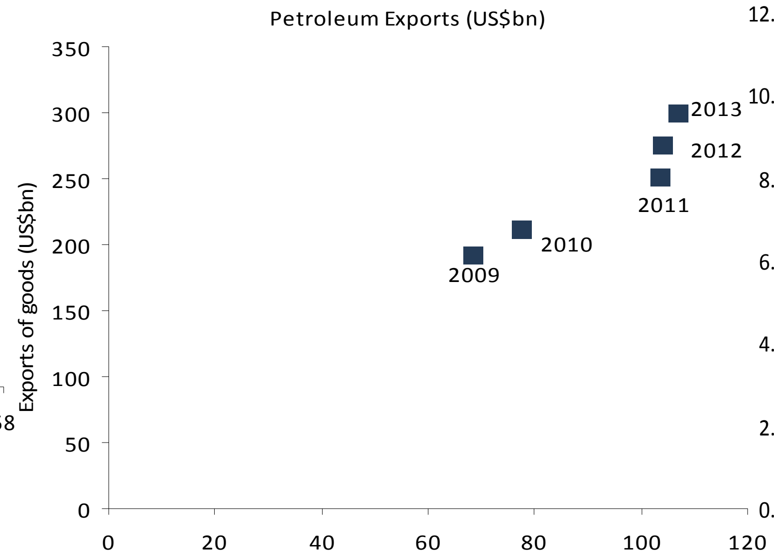


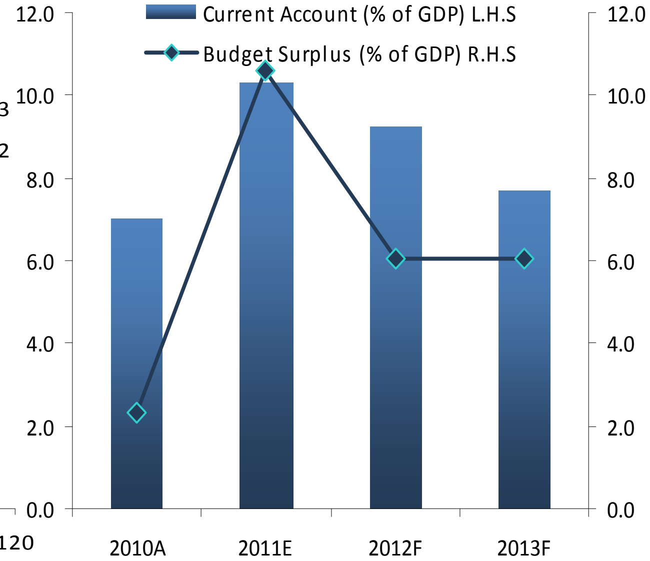
Source: UAE Central Bank and TAIB Research

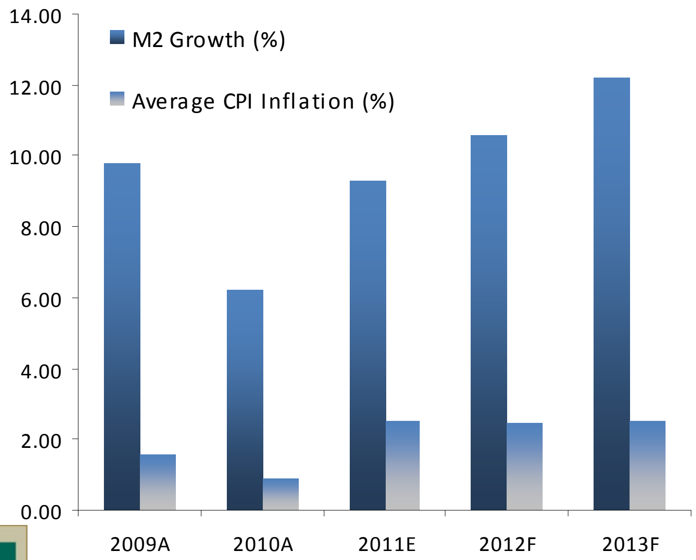
UAE – Chart Bank

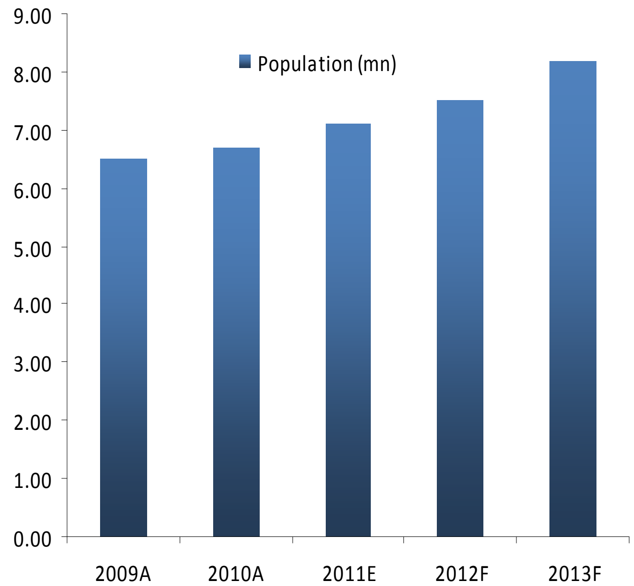
UAE Eco Metrics

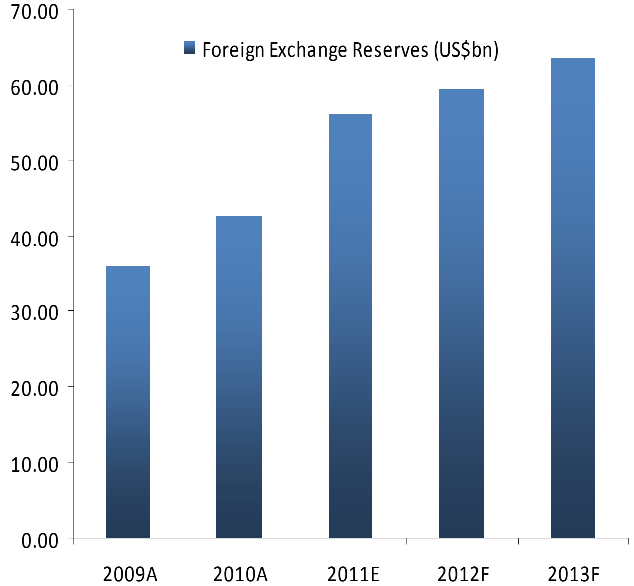












Source: IMF, EIU, Bloomberg & TAIB Research

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Oman – Risks remain with high oil price partiality

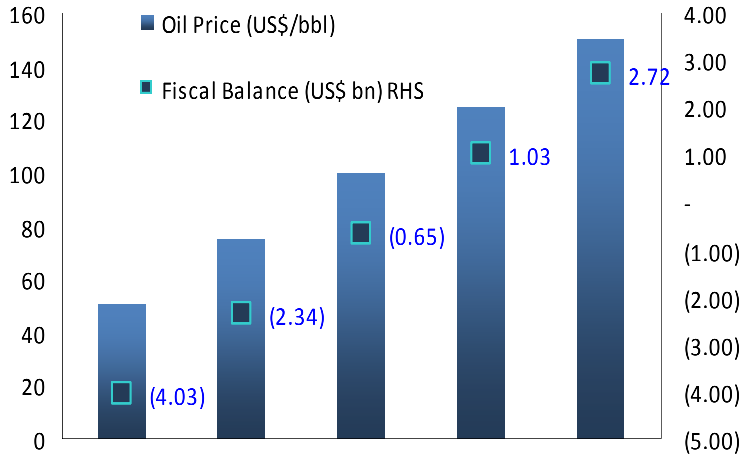
Ratings	Moody's	S&P	Fitch
	A1	A	-

Oman has projected a fiscal deficit for 2012 but if oil prices remain firm at current levels, sizeable current and fiscal surpluses are on the cards. Moreover, considering Oman is not an OPEC member, it will retain flexibility to take unilateral advantage of oil price fluctuations. High oil export concentration to Asia (80%) should provide a buffer in case of slower developed world demand.

Last year's fiscal spend (particularly infrastructure and public sector employment plan) should have spillover effects in 2012 and influence overall growth. While GCC countries in 2011 announced a US$10bn aid program for Oman to upgrade housing infrastructure, impetus to growth should largely come from domestic means as the country attempts to diversify away from oil (focus on manufacturing and tourism development).

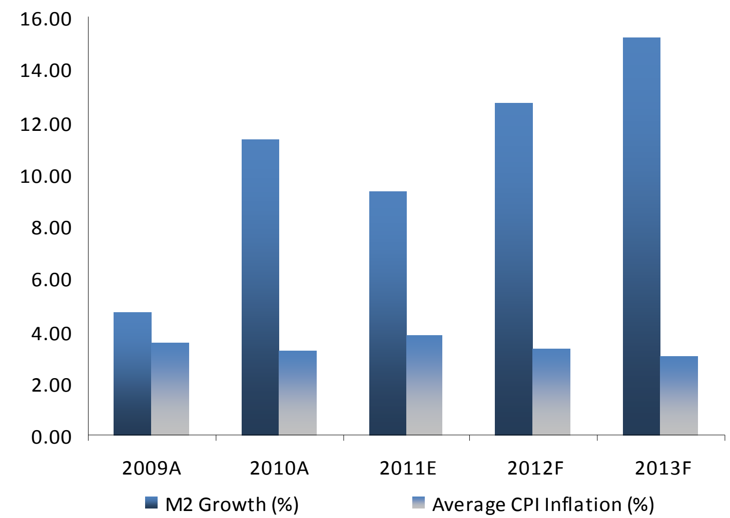
2011 GDP and CPI are estimated to have increased by 4.4% and 3.8%, respectively. The 2012 budget now projects expenditures and revenue at OMR10bn and OMR8.8bn, respectively, leading to a budget shortfall of OMR1.2bn or 5.4% of GDP. However, this assumes an oil price estimate of US$75/bbl. If oil price remains firm, the twin current and fiscal balances are projected to remain in surplus. GDP growth is projected at 4.8% in 2012 while CPI is estimated to increase by 3.3%.

Fiscal Balance sensitivity to Oil Price



Source: MoF Oman & TAIB Research

M2 vs. CPI



Source: EIU

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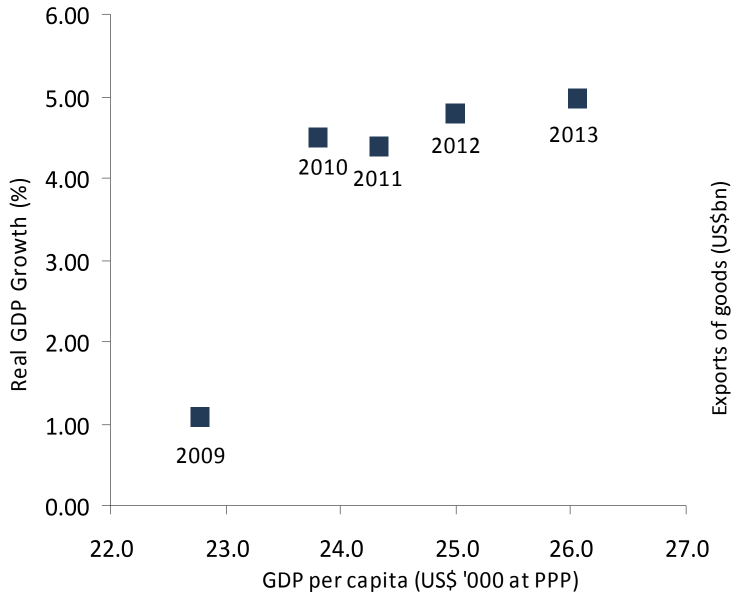
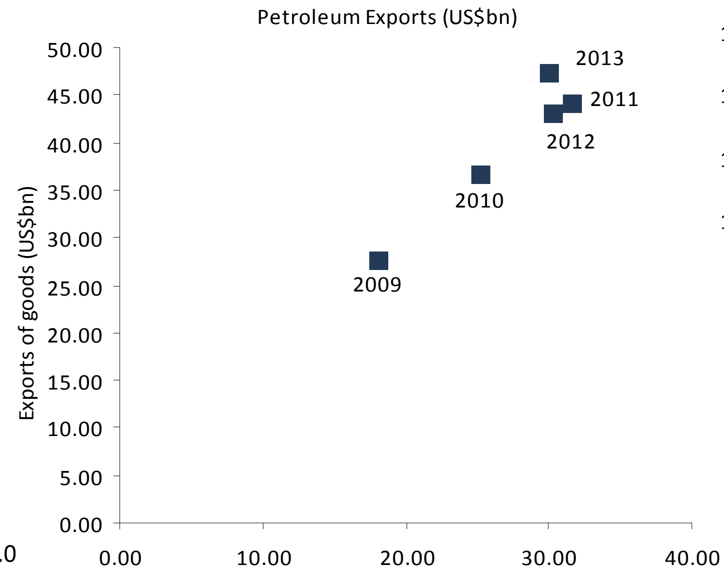
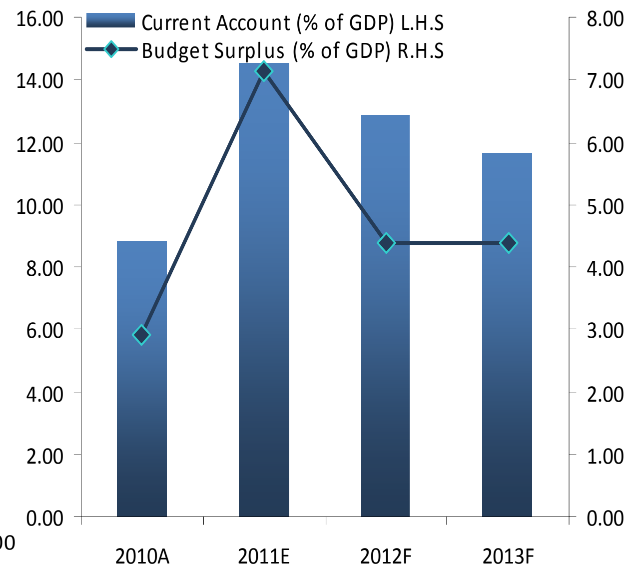
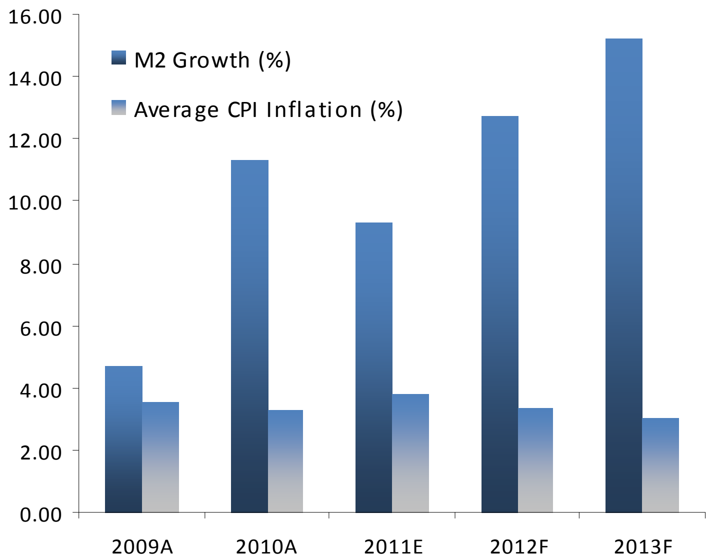
Oman – Chart Bank

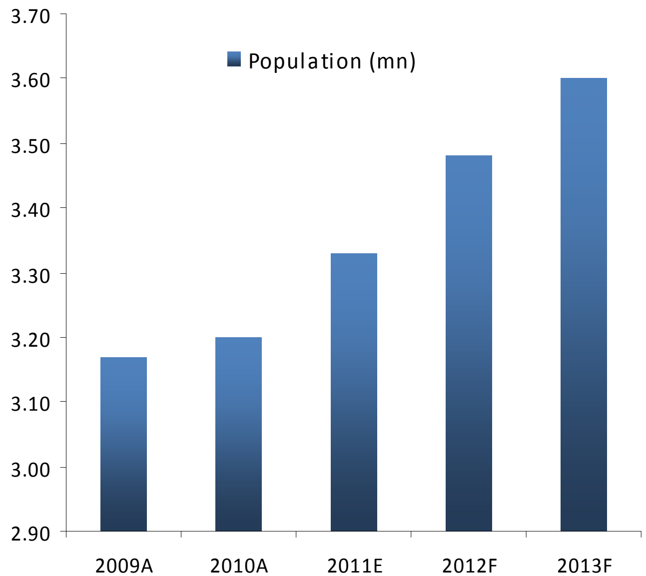
Oman Eco Metrics

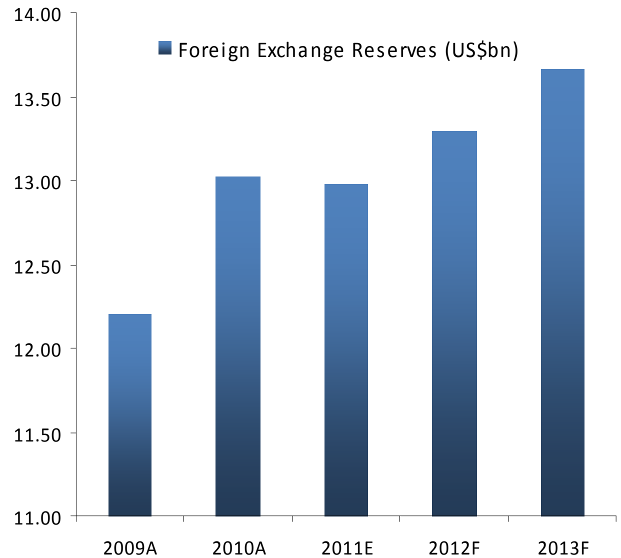












Source: IMF, EIU, Bloomberg & TAIB Research

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Bahrain – Medium term oil & gas policy overhaul

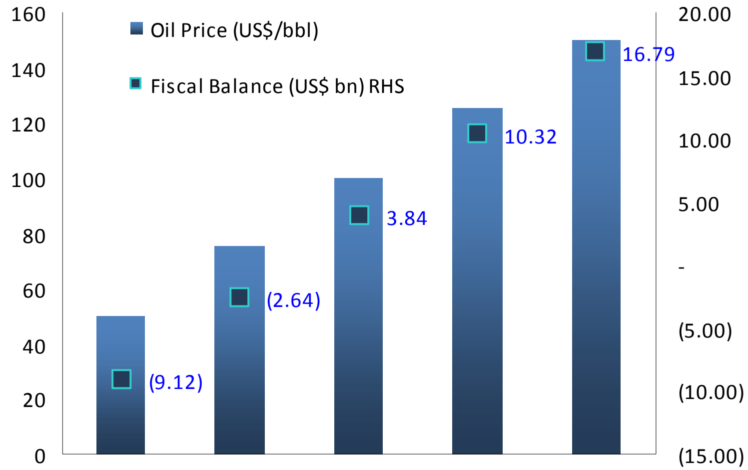
Ratings	Moody's	S&P	Fitch
	Baa1	BBB	BBB

We believe Bahrain will continue to lag regional peers with continuing high fiscal spend over the medium term leading to highest "break even oil price". That said policy overhaul within the oil and gas sector over a firm hydrocarbon price outlook should underscore improving economic metrics. Recall, Bahrain has undertaken aggressive onshore development while re-entering offshore Bahrain.

Despite the social unrest that affected the economy during 1QCY11, Bahrain is expected to have posted GDP growth of 1.8% in 2011, underpinned by higher production from key aluminum and hydrocarbon sectors. Cash splash following the riots is expected to have further enhanced consumption while lower rentals kept average inflation at 1.0%.

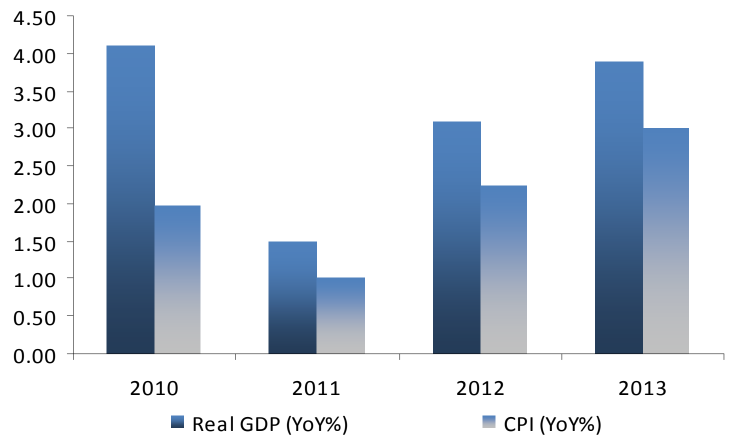
While the current account posted an estimated surplus of 12.6% in 2011, the budget balance is in deficit at 9.75% following the 2011 enhanced fiscal spend program. 2012 GDP growth should rebound to 3.3% with CA surplus projected at 13.7% of GDP, Bahrain may need to rely on external flows to balance its fiscal deficit which is projected at 9.9% of GDP (relatively weak credit ratings are a risk as evidenced by the highest CDS spreads in the region). Similar to Oman, GCC countries have announced a US$10bn package for housing infrastructure development in Bahrain.

Fiscal Balance sensitivity to Oil Price



Source: MoF Bahrain & TAIB Research

Growth on subdued trajectory



Source: MoF Bahrain & TAIB Research

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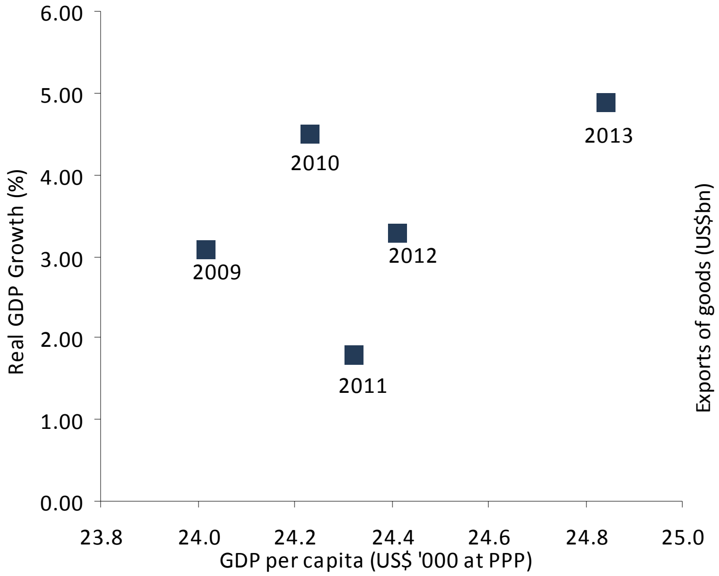
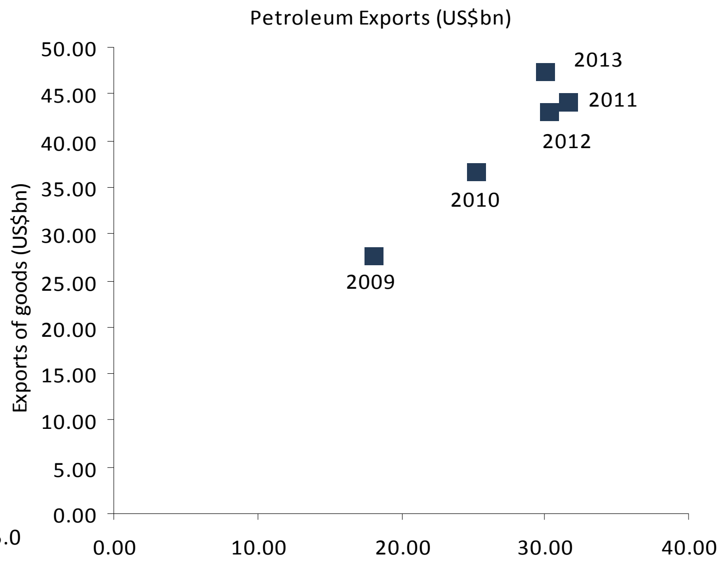
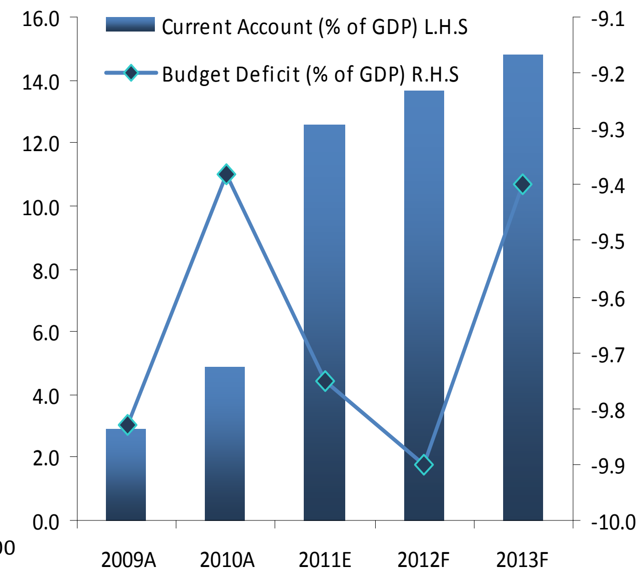
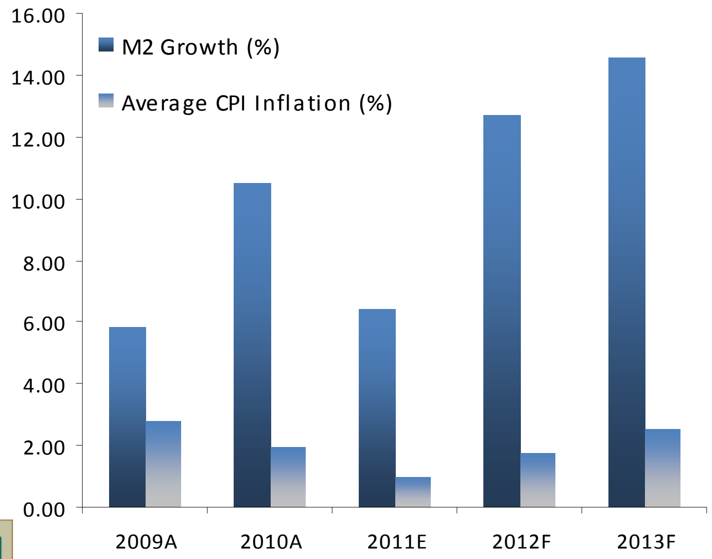
Bahrain – Chart Bank

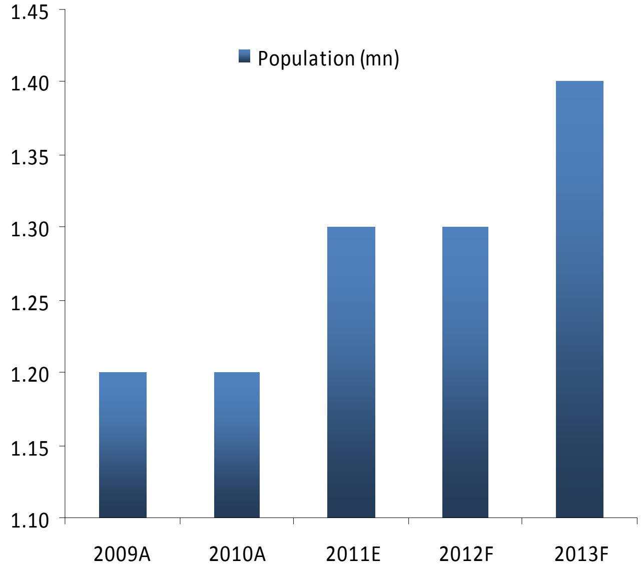
Bahrain Eco Metrics

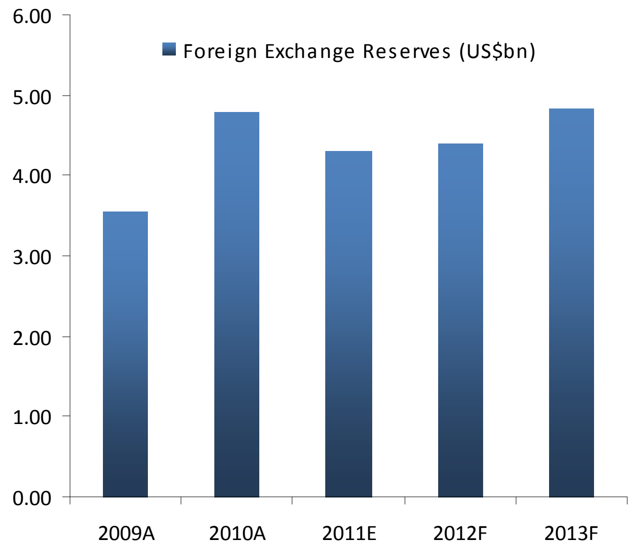












Source: IMF, EIU, Bloomberg & TAIB Research

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