

Middle East Macro Monthly

Trip notes from Cairo

- We took investors to Cairo between June 22 and June 24, where we met with the ministries of finance, investment and planning, the Central Bank of Egypt (CBE), foreign diplomatic missions in Cairo, the World Bank, local think tanks, economists, banks, political analysts and journalists.
- We believe Egypt will likely experience a security dividend in the near to medium term, as a reduction in security concerns will encourage greater investment and consumption, helping lift key economic indicators.
- But Egypt's fiscal challenge remains significant, with expenditure growth the culprit for a widening of the deficit by 6% of GDP (to 14% today) since the January 2011 revolution. Addressing this fiscal slippage will thus require emphasis on expenditure constraint, in our view, rather than the current emphasis in Cairo on revenue raising measures.
- Current plans for expenditure constraint and the associated structural reforms appear to be loosely defined at present. Targets are, in our view, unambitious, with minimal likely savings to the budget in the near term. For example, a cornerstone of current fiscal policy is the reduction in subsidies for petroleum products, despite these representing just 15% of the total subsidy bill, and offering a potential saving of 1-1.5% of GDP at most.
- The prospects for deeper reform hinge, in our view, on the extent to which such reforms are required as a condition of further investment and support by the Gulf States. An investor conference is being organized for later in the year where the Egyptian economic plans will be presented and debated, so we should know more about the new administration's policies then. However, we think the plan will likely be focused on growth and investment opportunities, rather than on addressing structural reform.
- Looking ahead, the current FX regime, ongoing security issues, energy constraints, lack of capacity for implementation of key projects, and the lack of structural reform will all act as a drag on growth in the medium term.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Trip notes from Cairo

We took investors on a 6-day trip through Cairo, Amman and Beirut (June 22-27). We published the highlight trip notes from Amman last week ([Iraq Macro Flash - Key Takeaways from Amman Meetings](#)). In this note, we present the key findings from our trip to Cairo.

Between 22-24 June, we met with the ministries of finance, investment, and planning, the Central Bank of Egypt (CBE), foreign diplomatic missions in Cairo, the World Bank, local think tanks, economists, banks, political analysts and journalists.

We came away thinking that a modest economic recovery was likely due to a security dividend that should see investment and consumption tick-up, but that plans on how to address the country's major structural weakness, particularly on the fiscal side, were less clear. We do not expect much progress on the policy front (other than the possible adjustment of petroleum subsidies) before the investor conference being planned by the Gulf States, probably towards the end of the year.

The security dividend

The police and army presence in and around Egypt's main cities has been beefed up in the past year, and this has had a significant impact on the security situation, according to those we spoke to. President Sisi's leadership is widely expected to continue to focus on security issues, both from a political perspective, but also from an economic one: there are great hopes in Egypt that a 'security dividend' will soon boost the economy, spurring domestic and foreign investment, as well as consumer confidence. Indeed, there was a sense among some of those we saw that security was the key to solving Egypt's economic problems, and that a return to stability would set Egypt on a virtuous spiral of higher growth, stronger government revenues, reduced debt and rising FX reserves.

We agree that there is a significant security dividend to benefit the economy, but see this as a purely cyclical phenomenon. For longer-term sustainable growth and debt dynamics, we believe Egypt must make progress on structural reforms and, most importantly, fiscal reform (see below).

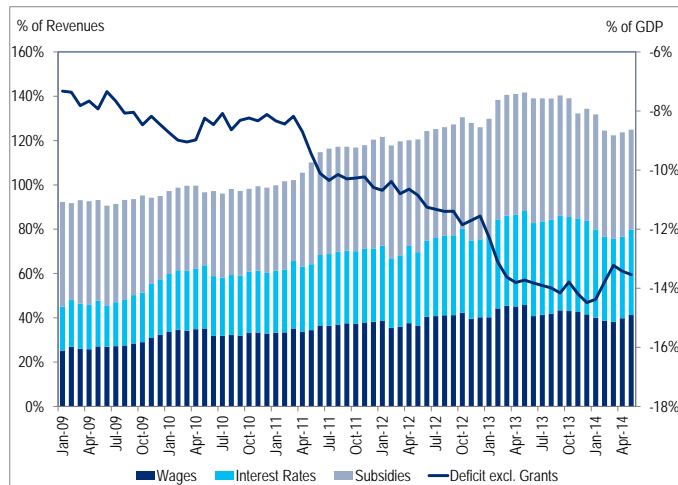
While the general mood was one of optimism on the security question, there are a couple of important caveats to point out. First, there was a sense among some we spoke to that the drive to maintain security risked reverting the political climate to one of general repression of dissent. The imprisonment of youth activists in the past few months and the perceived clamp down on the press, as evidenced by the conviction and lengthy sentences given to three Al Jazeera reporters while we were there, are among some of the examples cited. Some expressed concerns that this could deter investment and aid flows from the West, which are typically sensitive to these kinds of issues.

Second, there is an ever-present risk of terrorist attacks. The day after we left Cairo, four bombs exploded on the Cairo metro, and this week two more went off near the presidential palace. Attacks against security personnel also continue outside Cairo. All this is likely to continue to deter tourism in Egypt, which accounts for 20% of the economy. It may also prove a political liability to President Sisi's administration in the longer term if it is unable to successfully stem the violence.

The Fiscal Challenge

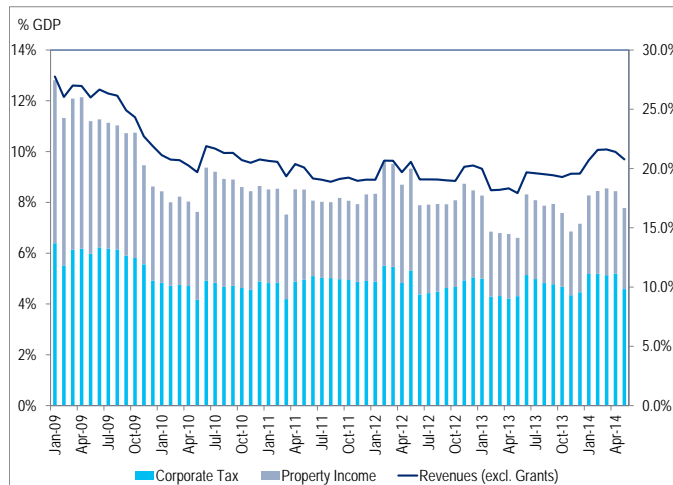
Egypt's fiscal deficit has ballooned since the January 2011 revolution. At the end of 2010, the fiscal deficit excluding grants (on a 12-month rolling basis) was 8% of GDP. By May this year, the deficit was 14% of GDP (Figure 1). The widening in the deficit primarily reflects an increase in government expenditure, particularly on wages and subsidies, which, together with interest payments, have risen to around 120% of government revenues (from under 100% pre-2011).

Figure 1. Widening deficit driven by expenditure rises....



Source: Citi Research

Figure 2. Not by revenue declines



Source: Citi Research

The Egyptian authorities are aware of the fiscal challenge they are facing and those we met spoke of a plan to raise revenues through a series of measures, including the recent 5% rise in corporate tax, the 10% capital gains tax financial investments, a property tax, potential rises in sales tax, the introduction of VAT, and a clamp down on tax evasion and the informal economy.

We believe that these revenue-raising measures are unlikely to succeed in addressing the fiscal imbalances. Firstly, raising taxes risks reducing tax compliance and could counter efforts to bring more of the informal sector into the real economy. Second, higher taxes could well reduce investment and economic growth, making them counterproductive to efforts to raise income. Third, the desire to reduce the size of the formal sector was not articulated into an effective plan, as far as we could see, with efforts concentrated in the finance ministry as they have been over the past decade, with little effect. Finally, we do not consider revenues to be the primary driver of Egypt's swelling deficit: revenues fell sharply from mid-2009 to mid-2010, but have been fairly stable since the January 2011 revolution.

On the expenditure side, we were repeatedly told of plans to rationalize subsidies, particularly on petrol at the pump. Here, the emphasis is on the introduction of 'smart cards' that will give each Egyptian an allowance (possibly linked to the size of his or her car's engine) of subsidized petrol each month, beyond which drivers will have to buy fuel at the market rate. These smart cards are being piloted, but putting them into operation is hampered by a number of technical difficulties (not least the need to link a number of separate databases to allow the identification and means testing of drivers) and is not expected until later this year at the soonest.

It is worth noting that petrol at the pump represents only around 10% of the subsidy bill, so even an elimination of petrol subsidies would likely bring a benefit of 1-1.5% of GDP to the budget, maximum. There was very little by way of concrete plans to rationalize other subsidies, such as diesel, Butane gas, food etc. which make up 90% of the subsidy bill and are politically sensitive. Moreover, other big tickets expenditure, most notably wages, were not being considered by we spoke to.

Added to the relatively paltry expected savings, as subsidies are phased out there is a clear consensus that direct cash transfers (conditional or unconditional) should be made to protect Egypt's needy. Again, efforts here face difficulties (ie. identifying the needy), but the upshot to us is that the net savings from the kinds of subsidy reforms being discussed are likely to be small and take some time to materialize.

Prospects for deeper reform?

The Egyptian Government's desire to carry out structural economic reforms is balanced against political considerations of how these reforms affect the country's social and political stability, which we think will remain the priority of the Sisi administration. Hence, the lack of deeper action of expenditure rationalization and the greater emphasis on revenue-boosting measures.

The pressure for reform, therefore, will have to come from external factors, particularly those financing the government deficit. Domestically, the financing burden rests largely with the local banking system and the Central Bank of Egypt. In our view, both of these are unlikely to be a force for reform, as they are within the system and are unlikely to threaten to withdraw funding or impose conditionality on their lending.

The onus then falls to external factors. These include the Gulf countries, which have provided around \$20bn in economic assistance to Egypt since last summer and which have considerable leverage over policy-makers. Here it is difficult to gauge the extent to which they will seek meaningful structural reform. On the one hand, there is a clear desire, particularly at the ministerial level within the Gulf countries, to ensure that money given to Egypt is spent wisely and put to the best economic use. On the other, at a leadership level, political considerations rooted in regional geopolitical dynamics are the overriding motivation for assisting Egypt, regardless of the policy framework.

We are unlikely to know which of these forces is stronger until the investor conference, which has been called for by Saudi Arabia and is likely to take place soon after parliamentary elections this autumn (probably November). Egypt is in the process of preparing an economic plan (in consultation with international consultants) that will be presented and discussed at this conference. This will include the details of key reforms the government intends to undertake.

In our view, the investor conference is likely to prioritise the enabling of greater investment opportunities and growth, rather than the addressing of deep-rooted structural imbalances, such as the subsidy programme or the wage bill. This will likely suit Gulf investors and the Egyptian authorities. However, whether this comforts financial investors, despite the enhanced growth prospects, remains to be seen.

An alternative external anchor for reforms could be the IMF. Here, there were mixed views. Many of those we spoke to said that Egypt was likely to engage with the IMF after parliamentary elections. However, most agreed that strict conditionality would not be acceptable politically, and since the benefits of an IMF programme to Egypt rest in the conditionality of that programme (the funding is small relative to Egypt's current sources) we believe there is little prospect of, or point to, a full IMF programme. A possible scenario might be that a homegrown economic programme endorsed by the investor conference could then receive the IMF stamp of approval, perhaps through a Precautionary and Liquidity Line (PLL), as was the case with Morocco in 2012. This would, however, fall short of a full programme which would act as an anchor for structural reform.

The economic outlook

We left Cairo convinced that a security dividend backed by continued Gulf support will likely produce a modest cyclical economic recovery in the near to medium term. That said, there are a number of headwinds that remain in place that are likely to be a drag on this recovery.

One is the impact of the security situation on tourism, as mentioned earlier. This is largely out of the hands of the authorities, but the rise in terrorist activity threatens the recovery of one of the key sectors of the Egyptian economy.

Another headwind is the exchange rate regime and uncertainty regarding the potential for a sharp devaluation in the Egyptian pound. In our discussions, it was clear that expectations were that current restrictions on transfer and convertibility would be eased in the next 6-12 months. This would go a long way to encouraging portfolio and FDI inflows, particularly if it was accompanied by stability in the foreign exchange rate. However, we remain mindful of the Central Bank's weak net FX position (net of foreign deposits and aid plus the arrears owed to the IOCs – estimated at around \$6bn), and thus the ability of the authorities to maintain current valuations with a much weakened Central Bank balance sheet. In any case, resolution of this issue is a key challenge to attaining potential growth, in our view.

A third issue is energy. Egypt's gas deficit means that more investment is required in oil and gas, as well as the energy sector, but subsidized rates for electricity and domestic gas usage deter this investment. While some progress appears to be being made with respect to adjusting tariffs for industrial usage, the general view was that more needs to be done (not least resolving the arrears situation with IOCs) to encourage investment, without which energy shortages will remain a serious constraint on growth and, potentially, political stability.

Yet another issue is the implementation capacity of the private sector when it comes to some of the big projects being planned to galvanize the economy. Previous stimulus packages, which have focused on infrastructure upgrades, have been implemented largely by public sector or military contractors, diminishing their effectiveness somewhat in terms of stimulating private sector growth. However, greater reliance on the private sector is constrained by lengthy, burdensome procurement procedures which will delay implementation, and by the fact that only a limited number of private enterprises have the scale to implement such projects. We heard suggestions from some private sector representatives that a fast track approval system should be implemented to ensure timely execution, but we see a risk here that handing contracts to a limited set of elites without sufficiently robust checks could lead to perceptions that Egypt is reverting to the crony capitalism of the Mubarak regime that in large part motivated the January 2011 revolution.

Last, but certainly not least, are the structural weaknesses and lack of reform drive that we discussed above, and which are likely to act as a constraint on growth in the medium to long term.

The Global Backdrop¹

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Our global growth forecasts are unchanged, with various revisions among individual countries

World trade growth remains sluggish, and EM exports are no longer outperforming versus world trade growth...

Continued weakness in world trade could pose downside risks to EM growth

Even though credit growth has slowed, China's private debt/GDP ratio is still rising rapidly...

...and, with growth slowing, the authorities have recently introduced new credit easing and the trend of one-way FX appreciation may be over

The authorities' dilemma between growth and financial stability is likely to intensify

We leave our global growth forecasts (at current FX rates) unchanged this month, at 3.0% for 2014 and 3.5% for 2015. Our forecast still implies a pick-up from last year's pace (2.5%). Our aggregate 2014 AE growth forecast is unchanged from six months ago (at 2.0%), while our 2015 AE forecast is up from 2.1% six months ago to 2.4% last month and 2.5% this month. By contrast, over the past six months, we have cut our aggregate 2014 EM growth forecast from 4.9% to 4.5%, while leaving our 2015 EM growth forecast at 5.0%.

We still have concerns at prospects for EM growth and imbalances, and this is likely to be reflected in a general trend of EM currency depreciation versus the USD over 6-12 months² plus easing measures in some specific countries. One set of downside risks comes from the ongoing weakness in world trade growth and reduced EM export outperformance. To be sure, the last few months' trade data may be distorted by the adverse US weather plus the unwinding of prior over-invoicing by China's exporters. But, even if we focus just on import data, global volume growth remains sluggish. A key factor behind this is the reduced import intensity of AE economic growth. Moreover, EM exports are no longer significantly outperforming world trade and AE exports. The overall result is that, even though global output growth is back to the pre-crisis norm, world trade growth remains roughly half the pre-crisis norm, and EM export growth is roughly one third the pre-crisis norm. A range of factors probably lies behind this, including the shift to less-import intensive AE growth caused by sluggish growth in spending on consumer durables and investment³, plus shifts in relative AE/EM cost competitiveness caused by the trend of EM real exchange appreciation in recent years and expansion of low-cost energy in the US. World trade growth may pick up a bit during this year, but we suspect that these factors will ensure that world trade growth remains modest. All this poses downside risks to growth in export-oriented EMs.

A second set of worries – recently highlighted by the IMF's Article IV Report on China – concerns its ability to achieve its stated aims of rapid economic growth (close to the authorities' 7.5% target for 2014) while scaling back the huge credit stimulus of recent years. China's private sector debt/GDP ratio surged, with the ratio exceeding recent peaks in the US and euro area, both of which have since fallen. Moreover, with nominal GDP growth slowing, the private debt/GDP ratio rose by more in the last four quarters than in the prior four quarters. Despite the authorities' stated aim of reducing China's credit dependence, credit growth remains high, with total social financing rising 15-16%YoY in May – roughly twice nominal GDP growth – hence implying the private debt/GDP ratio is probably still rising rapidly. With China's GDP growth likely to slow to about 7%YoY in Q2, the authorities have already implemented modest stimulus measures⁴, with further easing in coming months. In addition, we suspect the relentless RMB appreciation trend of recent years is probably over. We do forecast the RMB to appreciate slightly in coming months, but even so we expect the end-2014 level (RMB6.09/\$) to show a slight depreciation from end-13 (RMB 6.05/\$). Nor do we expect much change in the RMB/USD rate on average in 2015-18. Even so, the dilemma between downside growth risks and medium-term financial stability risks will probably intensify. We expect GDP growth to slow below 7%YoY during 2015. And, if the authorities do respond by renewed credit easing this would probably reinforce

¹ This is a summary of the Overview from [Global Economic Outlook and Strategy - June 2014](#), 25 June 2014.

² See "Foreign Exchange Forecasts", Jeremy Hale et al, 20 June 2014, Citi.

³ See "Global Economics View: [The Long-Run Decline in Advanced-Economy Investment](#)", Willem Buiter et al, 11 June 2014, Citi.

⁴ See "China Macro Flash: [Monetary Data Suggest Prudent Policy with an Easing Bias](#)", Shuang Ding and Minggao Shen, 12 June 2014, Citi.

Even after the recent ECB easing, consensus forecasts for euro area inflation continue to fall...

...and we continue to look for inflation to markedly undershoot compared to ECB and consensus forecasts

The persistent inflation undershoot is likely to prompt further ECB easing, with ABS purchases near term and – probably – QE around year-end

The UK remains our biggest above-consensus growth forecast...

...and the BoE is likely to hike earlier, faster and further than markets price in

Fed hiking, though still quite distant, also may eventually be greater than markets currently price in

future downside risks to growth and credit quality. Downside risks to China's growth would spill over into a range of other countries, both AEs and EMs.

In the Euro area, it is too early to see the full effects of the ECB's recent easing, especially the TLTRO. But, we suspect the measures will not be enough to lift the economy out of a sluggish growth trend and persistent inflation undershoot. There has been a modest loosening in financial conditions since the ECB meeting, with the Euro Stoxx index up roughly 1%, narrower intra-EMU sovereign spreads and the trade-weighted euro down roughly 1%. But recent business surveys remain lacklustre, while consensus inflation forecasts have continued to fall in. With modest economic growth, the large output gap, plus falling import prices, we continue to expect that inflation will markedly undershoot consensus and ECB forecasts. Indeed, even with the recent rise in oil prices, we are leaving our euro area inflation forecasts for 2014-15 unchanged, at 0.6% and 0.9% respectively. Our forecasts remain below the ECB's downwardly revised outlook presented in early-June, which is for CPI inflation of 0.7%YoY in Q3-14, 1.1% in 2015 and 1.4% in 2016.

This outlook is very different to 2010-12, when inflation repeatedly overshot ECB forecasts, and those persistent inflation overshoots played a big role in the ECB's reluctance to loosen as aggressively as the Fed and BoE in that period (and indeed to tighten in 2011). Now, with inflation persistently undershooting its forecasts and the target, we continue to expect the ECB will ease further. Following Draghi's comment that the ECB "*decided to intensify preparatory work related to outright purchases in the ABS market to enhance the functioning of the monetary policy transmission mechanism*" we look for ABS purchases to start soon – most likely in Q3. Subsequently, we continue to expect the lower inflation outlook will prompt the ECB to implement large-scale QE (i.e. unsterilized asset purchases) around year-end, with an initial target of perhaps €1000bn spread over a year. We have tried to build possible effects of this into our economic forecasts. Our growth/inflation forecasts would face further downside risks if ECB action is not forthcoming, unless some other factor improves financial conditions markedly.

The UK remains one of our major above-consensus growth forecasts. We continue to look for GDP growth of about 3.5%YoY in both 2015 and 2016. By contrast, the consensus looks for YoY GDP growth of 3.0% this year with a slowdown to 2.6% in 2015. Some aspects of the UK recovery story are similar to US, with marked improvements in private sector balance sheets and credit availability. In addition, the various headwinds that have capped US growth over the last few quarters are absent in the UK: fiscal policy has been roughly neutral since mid-2012 while key mortgage rates have fallen markedly since late-2012. With strong economic growth and the jobless rate falling rapidly, the UK MPC is moving towards an early rate hike. We continue to look for the first hike to come in Q4 this year, with rates then rising faster and further than markets project in a benign response to the rapid upturn in growth and closing of the output gap.

In the US, we believe that the Q1 weakness is not representative of the economy's underlying momentum, and we expect a solid rebound in the economy in coming quarters. Moreover, inflation is likely to drift higher in coming months as the disinflationary effects of sequestration on health care costs and last year's weakness in commodity prices fade. Indeed, in contrast to the euro area, we are slightly lifting our US 2014-15 inflation forecasts this month. We still forecast the first Fed hike to come in mid-15 and – whereas market pricing implies that policy rates in 2015-16 will be below the median of FOMC members – we expect an extended tightening cycle that eventually carries rates up to roughly 3% on average in 2017-18. This implies a marked divergence with the long period of loose ECB policy that probably lies ahead.

Developed Market Economic Forecasts

Figure 3. Citi's Global Economic Forecasts

	GDP Growth (% YoY)			CPI Inflation (% YoY)			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F
Global	3.0	3.5	3.7	2.9	3.1	3.4	0.8	0.6	0.3	-3.7	-3.2	-2.9
<i>Based on PPP weights</i>	3.4	3.9	4.1	3.3	3.5	3.9	0.5	0.4	0.0	-3.7	-3.3	-3.0
Industrial Countries	2.0	2.5	2.5	1.6	1.7	1.5	0.0	0.1	0.0	-4.6	-3.8	-3.4
United States	2.2	3.2	3.2	1.6	1.9	2.2	-2.1	-1.5	-1.8	-6.4	-5.6	-5.6
Japan	1.5	0.9	1.2	2.8	1.7	1.6	-0.2	-0.3	0.0	-8.0	-6.2	-5.8
Euro Area	1.2	1.8	1.9	0.6	0.9	1.2	2.8	2.8	2.8	-2.6	-2.3	-1.7
Canada	2.3	2.7	2.7	2.0	2.0	2.0	-2.8	-2.8	-2.5	-0.1	0.3	0.4
Australia	3.4	3.0	3.1	2.7	2.5	2.4	-1.9	-2.2	-2.4	-3.1	-1.8	-1.0
New Zealand	3.5	2.9	2.4	2.1	2.2	2.2	-4.2	-5.4	-5.0	-1.6	-0.4	0.5
Germany	2.2	2.5	2.5	1.2	1.8	2.2	6.9	6.6	6.1	0.1	0.2	0.0
France	0.7	1.3	1.7	0.7	1.2	1.4	-0.7	-0.1	0.4	-4.2	-3.6	-2.8
Italy	0.2	1.1	1.1	0.3	-0.2	0.3	1.9	2.0	2.1	-3.0	-2.8	-2.1
Spain	1.3	1.9	2.2	-0.2	0.0	0.5	0.6	0.5	0.6	-5.7	-4.9	-3.9
Greece	-0.6	1.2	1.4	-1.6	-1.6	-1.0	2.1	2.4	2.4	-2.4	-2.7	-2.0
Ireland	2.8	3.4	2.8	0.8	1.0	1.1	9.6	10.3	9.4	-5.1	-2.5	-1.8
Portugal	1.2	2.0	1.9	-0.3	-0.7	-0.3	0.5	0.7	0.9	-4.2	-3.0	-2.4
Netherlands	0.6	1.4	1.7	0.3	1.1	1.5	10.9	10.3	9.8	-2.8	-2.2	-1.7
Belgium	1.3	1.5	1.6	0.6	1.1	1.8	1.0	1.7	1.8	-2.4	-1.9	-1.2
Denmark	1.3	1.6	1.8	1.0	1.5	1.8	6.8	5.7	5.4	-1.3	-2.7	-1.7
Norway	2.0	2.2	2.5	2.0	2.1	2.1	11.4	11.7	12.0	11.0	11.0	10.0
Sweden	2.4	2.7	2.8	-0.1	1.0	2.2	6.3	6.0	6.1	-1.6	-0.8	-0.3
Switzerland	2.1	2.6	2.7	-0.2	0.8	1.1	11.1	10.2	9.9	0.7	1.1	1.7
United Kingdom	3.5	3.6	2.8	1.6	1.9	2.1	-4.0	-4.0	-4.1	-5.6	-3.7	-1.5

Figure 4. G3 Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 25 June 2014

	25-June	3Q 14F	4Q 14F	1Q 15F	2Q 15F	3Q 15F	4Q 15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.75	1.00
10-Yr. Treasuries (Period Ave.)	2.59	2.70	2.90	3.00	3.05	3.15	3.20
Euro Area: US\$/€	1.36	1.38	1.36	1.35	1.36	1.37	1.39
Euro Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15	0.15
10-Yr. Bunds (Period Average)	1.33	1.45	1.50	1.50	1.55	1.55	1.60
Japan: Yen/US\$	102	105	107	108	109	109	110
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Average)	0.58	0.60	0.55	0.70	0.80	0.85	0.75

Industrialised Countries 10-Year Yield Spreads (Period Average)

	Spread vs. US\$						Spread vs. Germany					
	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15
United States	NA	NA	NA	NA	NA	NA	128	127	142	152	152	162
Japan	-203	-212	-237	-232	-227	-232	-75	-85	-95	-80	-75	-70
Euro Area	-128	-127	-142	-152	-152	-162	NA	NA	NA	NA	NA	NA
Canada	-31	-30	-25	-20	-15	-15	96	96	117	132	137	147
Australia	117	147	137	143	158	168	244	274	280	295	310	331
New Zealand	189	204	204	204	209	220	317	331	346	356	362	382
France	-84	-77	-102	-112	-112	-122	42	50	40	40	40	40
Italy	30	13	-22	-32	-32	-42	156	140	120	120	120	120
Spain	7	13	-22	-32	-32	-42	133	140	120	120	120	120
Netherlands	-104	-102	-117	-127	-127	-137	22	25	25	25	25	25
Belgium	-82	-72	-92	-102	-102	-112	44	55	50	50	50	50
Austria	-97	-97	-117	-127	-127	-137	29	30	25	25	25	25
Finland	-107	-97	-117	-127	-127	-137	19	30	25	25	25	25
Ireland	-21	-17	-62	-72	-72	-82	105	110	80	80	80	80
Portugal	86	63	8	-2	-2	-12	212	190	150	150	150	150
Greece	322	303	258	223	223	188	448	430	400	375	375	350
United Kingdom	11	20	15	15	10	5	137	147	157	167	162	168

Note: Spreads calculated on annual basis (except those of the United Kingdom, Canada, Australia and New Zealand over the United States). Source: Citi Research

Commodities Market Outlook⁵

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Commodities price weakness in May reversed in June as geopolitics boosted the energy complex. Gold prices also snapped back \$75/t oz. this month as central banks continue to indicate loose monetary policy persisting and regional political tensions have escalated in Iraq. Year-to-date total returns for commodities continue to eclipse world equity index and Treasury returns. Cumulative net inflows into commodity investment vehicles represent a 12% recovery after a record c\$50bn in net redemptions during 2013, while assets under management have been boosted to c\$400bn after a 22% slide last year.

Headlines out of Iraq have the oil market on edge, as the world would struggle to replace the lost oil if Iraq were to go the way of Libya. But the current turmoil could result in more rather than less oil coming out of Iraq in the near and medium term through accelerating exports from the Kurdish region and a continuation of robust southern exports. Yet this may not translate into weakness in prices. The current Iraqi turmoil comes on top of the resurgence in Russia/Ukraine tensions and ongoing stand-off in Libya and the seemingly deteriorating situation in Nigeria. The “fear premium” has fed through into oil prices, yet physical crude differentials have remained largely unaffected since the invasion of Mosul by ISIS and margins are still painfully weak. Moving into 3Q markets should tighten as refinery runs pick up and oil demand seasonally peaks. Iraq thus remains the big bull risk in the market right now, but Citi’s base case view is for minimal disruptions to Southern oil flows. Iran and the P5+1 failed to reach a deal over the nuclear program and oil sanctions, and will resume on 2 July. We expect prices to average ~\$111/bbl in 3Q but see them significantly higher if turmoil spreads and erupts in Southern Iraq.

High European gas inventories continue to affect the market in a similar manner as what took place in 2012 in North America. UK’s NBP price evolution has highlighted how weak European gas demand is. More broadly, the increased interconnectedness of the global market is illustrated in how the LNG benchmark JKM (Japan-Korea Marker) has also fallen from a winter peak to the lowest since Fukushima. Prices in UK’s NBP and Asia’s JKM are expected to remain low until late this summer possibly, when winter supply concerns reemerge. A strong price rebound is unlikely unless gas supply from Russia to Europe via Ukraine was effectively cut for a prolonged period. While the North American gas market remains separated from gas markets globally, the US government took steps to boost LNG exports in the latter part of this decade, proposing eliminating step one of the three-step approval process, which would effectively allow project sponsors with financing backing and experience to accelerate the construction of terminals and is supportive of US gas exports and long-term prices. In the short term, the market awaits how the summer will unfold. Bal-2014 prices seem range-bound between ~\$4.3 and ~\$4.8, with the end-Oct’14 storage targeting a low ~3.4-Tcf.

The last month has been one of mixed blessings for base metals. We believe optimism over aluminium and zinc is somewhat misplaced, with LME draws being read as consumption-driven, rather than what we believe to be trader-driven in order to support physical premiums. Aluminium production continues to grow, driven recently by restarting idled Chinese capacity plus newly commissioned capacity. For zinc, a concentrate market in significant oversupply, combined with over 1 million tonnes of Chinese zinc smelter over capacity amid slowing Chinese construction activity, does not point to a bullish supply/demand picture just yet. Copper continues to labour under copper financing concerns in the port of Qingdao. We believe fears over the future of repo-based collateralized commodity financing are overstated, with financing still apparently attractive in other more trusted port locations. We

⁵ This summarises Commodity Market Outlook from [Global Economic Outlook and Strategy - June 2014](#), 25 June 2014.

Our modestly constructive view on gold appeared to unfold in earnest this month on Fed Chair Janet Yellen's outlook for US rates to remain low for the foreseeable future, weighing on the US dollar, boosting inflation expectations and with growing concerns over escalating violence in Iraq. We continue to expect gold prices to trend above \$1,300/oz. during 2H'14. Newsflow of settlements between the AMCU and South Africa's PGM miners has taken some of the gloss off the recent strike related price rally. However, platinum and palladium prices remain well supported, with both markets facing a sizable deficit this year after more than five months of South African strikes, combined with strong auto sector demand for both metals.

We now believe iron ore prices are around the lowest they are likely to reach this year. We expect prices to remain more stable in H2 in the first half due to two main factors: (1) Chinese steel demand should improve both fundamentally and seasonally from September; (2) Australian supply growth was concentrated in Q2 this year but is not expected to see another significant increase in the second half.

Thermal coal prices have continued to grind lower, as expected. We expect prices to increase moderately from August or September as Chinese demand improves and India resumes importing in size post-monsoon. Flat coking coal spot prices in the past two months is expected to continue in July as production curtailments remain modest and Chinese mills are unlikely to restock given weak demand, though we forecast thermal prices to rise slightly to \$122 in Q3 (Q2: \$120).

		Point Prices																					
		0-3M	6-12M			Q3 2013	Q4 2013	Q1 2014	Q2 2014E	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014E	2015E	2016E	2017E		
Energy				5Y Cyclical																			
NYMEX WTI	USD/bbl	103.0	103.0	81.0	108.0	97.6	99.0	103.0	107.0	99.0	101.0	96.0	104.0	97.0		94.1	98.0	102.0	100.0	83.0	78.0		
ICE Brent	USD/bbl	110.0	110.0	85.0	112.0	109.3	107.8	110.0	111.0	108.0	106.0	103.0	108.0	103.0		111.7	108.7	109.0	105.0	90.0	85.0		
Henry Hub Natural Gas	USD/MMBtu	4.70	4.85	5.50	3.55	3.85	5.20	4.63	4.80	4.90	4.50	4.40	4.50	4.60		2.75	3.73	4.90	4.50	4.90	4.90		
Base Metals				LT Price																			
LME Aluminum	USD/MT	1,790	1,820	2,200	1,827	1,815	1,752	1,840	1,780	1,800	1,830	1,860	1,890	1,900		2,049	1,888	1,795	1,870	1,950	2,100		
LME Copper	USD/MT	6,770	7,000	6,200	7,096	7,161	7,005	6,740	6,750	6,800	6,900	7,000	7,200	7,500		7,945	7,352	6,825	7,150	7,700	8,000		
LME Lead	USD/MT	2,170	2,300	2,200	2,196	2,134	2,127	2,115	2,150	2,250	2,350	2,100	2,200	2,370		2,072	2,158	2,160	2,255	2,350	2,400		
LME Nickel	USD/MT	19,000	22,000	21,000	13,996	13,980	14,693	18,530	18,700	19,400	22,000	23,000	24,000	26,500		17,592	15,105	17,830	23,875	26,500	26,000		
LME Tin	USD/MT	23,000	24,500	20,000	21,284	22,951	22,622	23,135	23,500	24,000	25,000	24,000	23,000	25,000		21,108	22,340	23,315	24,250	25,000	24,000		
LME Zinc	USD/MT	2,070	2,130	2,100	1,896	1,932	2,027	2,075	2,050	2,100	2,150	2,200	2,250	2,300		1,963	1,940	2,065	2,225	2,300	2,350		
Precious Metals				LT Price																			
COMEX Gold	USD/T. oz	1,280	1,360	1,050	1,330	1,274	1,292	1,285	1,300	1,320	1,340	1,350	1,360	1,400		1,669	1,416	1,300	1,365	1,380	1,400		
Silver	USD/T. oz	20.2	21.4	16.5	21.5	20.8	20.5	19.6	20.0	20.4	20.9	21.4	22.2	23.0		31.2	24.0	20.1	21.9	22.5	23.0		
Platinum	USD/T. oz	1,480	1,525	1,763	1,456	1,397	1,429	1,445	1,500	1,525	1,525	1,565	1,640	1,675		1,552	1,490	1,475	1,600	1,710	1,800		
Palladium	USD/T. oz	820	860	780	729	725	745	815	830	850	875	900	900	925		645	728	810	900	935	980		
Bulk Commodities				5Y Cyclical																			
Hard Coking Coal (Spot)	USD/MT	120	130	200	143	142	122	113	120	135	145	150	155	160		91	148	148	122	153	180	190	
Thermal Coal Asia (NEWC)	USD/MT	72	80	90	77	82	79	73	72	80	82	78	75	80		94	84	76	79	85	90		
Iron Ore Spot (TSI)	USD/MT	95	100	81	133	135	120	102	95	100	98	92	85	85		128	135	104	90	80	83		
Agriculture																							
CBOT Corn	USD/bu	440	380	N/A	512	430	450	480	440	380	420	450	500	505		695	578	440	470	515	N/A		
CBOT Wheat	USD/bu	620	620	N/A	650	655	616	650	620	620	620	610	600	600		750	684	630	600	615			

11

Country Section

Bahrain

■ Key developments on the month

- Progress on national dialogue remains slow;
- Growth comes in at 5.3%, significantly higher than expectations.

■ Key macro drivers

- Economic growth drivers look weak, and public finances appear stretched;
- Political uncertainty set to act as drag on prospects for the foreseeable future;
- Actual and potential support from Saudi Arabia crucial to an otherwise negative outlook.

Summary Analysis

No progress on National dialogue

Hopes that an end to the ongoing unrest was in sight were raised in January, when Crown Prince Salman bin Hamad al-Khalifa, upon the instructions of King Hamad, met with opposition leaders to agree the resumption of talks under a new guise. Since then, there has been no progress on talks, although we still believe there are reasons to be cautiously optimistic. Firstly, the role played by Crown Prince Salman in reviving the talks suggests that the more moderate and reformist elements within the ruling family are now playing a greater role in influencing government policy on the political crisis that has gripped the kingdom for the past three years. Second, the government has agreed to be directly involved in negotiations with the opposition, a key sticking point under the first round of talks. And finally, five discussion points have already been agreed, including: i) parliamentary approval of governments, ii) the powers and composition of the upper house of parliament, iii) the electoral map, iv) the independence of the judiciary and police and v) security issues (Reuters 22 January). The previous national dialogue had failed to even agree a broad agenda after one year.

But escalation in violence suggests limited scope for breakthrough

The continuation of violence has been at a grassroots level and has been condemned by opposition leadership. This leads us to believe that the control opposition leadership exerts over the protests is limited, and that the impact of any dialogue between leaders on violence at the street level is questionable.

2013 GDP data points to increased momentum

The economy continued to expand in Q4 2013, with support once again coming almost equally from both the oil and non-oil sectors. Growth slowed to 5.4%YoY in Q4, and while this was higher than the previously reported 3Q number (4.6%), Q3 data was actually revised up significantly to 5.7%. This brought the full year 2013 number to 5.3%, which was higher than both our and the more optimistic Bahrain Economic Development Board (EDB) expectations. For 2014 the EDB is looking for headline GDP growth of 3.7%, which is slightly below our expectations of 4%.

Additional impact of unrest on economy should be small

Looking ahead, the incremental economic impact of the ongoing political unrest is likely to diminish, in our view. The political unrest of the past three years has already been a drag on economic growth and has raised fiscal vulnerabilities as the government has responded with additional expenditure. Disruption to Bahrain's Formula One race has also had a negative impact. These factors are all already included in our economic and fiscal forecasts. At the same time, support from Saudi, both political and economic, has been crucial in shoring up investor confidence.

Growth should remain in the 3.5%-4.5% range for the foreseeable future

We expect non-oil growth to slow down somewhat, due mainly to base effects, but oil production to stabilise, resulting in medium-term growth in the 3.5% to 4.5% range. Upside risks to this outlook include a resolution of the country's ongoing political turmoil (still unlikely in the near term, in our view, despite the latest initiative) and greater-than-expected assistance from Gulf neighbours, including

Saudi Arabia. This may include, for example, an increase in the allocated share of output from the shared Abu Saafa oil field, which would dramatically boost Bahrain's domestic production.

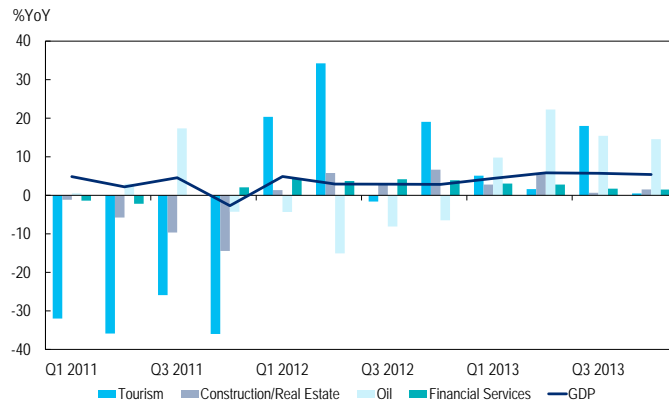
Inflation likely to fall further in 2014

The almost continuous decline in inflation since the start of the year took a pause in May. Coming in at 2%YoY it was unchanged compared to April, though the trends in the underlying components continued to evolve. Weakness in food prices remained a theme in May, while evidence of a pick-up in transport costs began to show more signs of being entrenched, even though at low levels. The latest Bahrain EDB Q1 2014 Economic Quarterly points to inflation remaining unchanged at 3% for 2014 and 2015. We continue to believe that inflation will ease through the rest of 2014, reaching 2.5% for the year as a whole. This is partly on the weaker outlook for food prices from the Citi Commodities team, but also on base effects from the rental subcomponent, which was elevated throughout 2013. In 2015, we expect price growth to ease further – with the full year number coming in at about 2%. In our view, the recovery in the real estate market is driven by a regional real estate recovery, led by Dubai, and does not necessarily reflect a change in Bahrain's underlying real-estate fundamentals.

Tourism continues to struggle

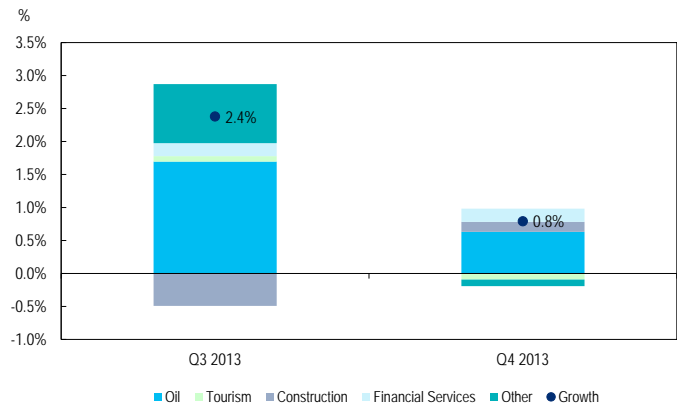
May was a weak month for hotels in Bahrain. Hotel occupancy rates fell to 46%, the weakest level since December, and down from the peak of 61% in February. While this is a disappointing development, occupancy is still above the average of the last three years, which shows that there are some signs of recovery, albeit gradual. Nevertheless, occupancy rates have only breached 50% four times in the past two years, whereas most other countries in the region have seen occupancy rates closer to 70-80%. And while room rates picked up in May to US\$210/night, this was not as high as previous years. It is still difficult to determine how sustainable the gradual improvements will be over the longer term. Political developments in the coming year will likely determine how sustainable any tourism recovery will be, as will developments in nearby Iraq.

Figure 6. Economic growth has been adversely affected by the unrest



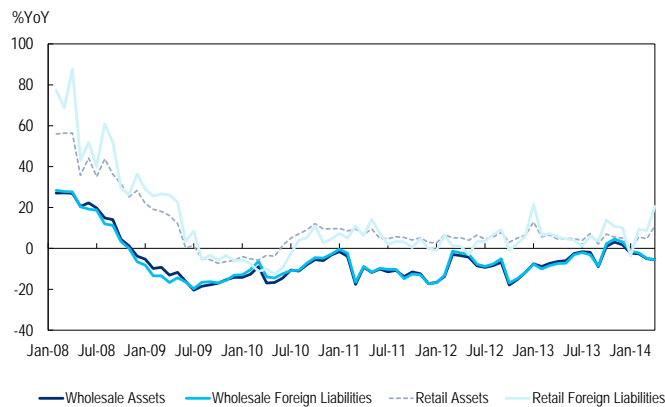
Source: Haver Analytics, Citi Research

Figure 7. Though the economy has shown some signs of recovery



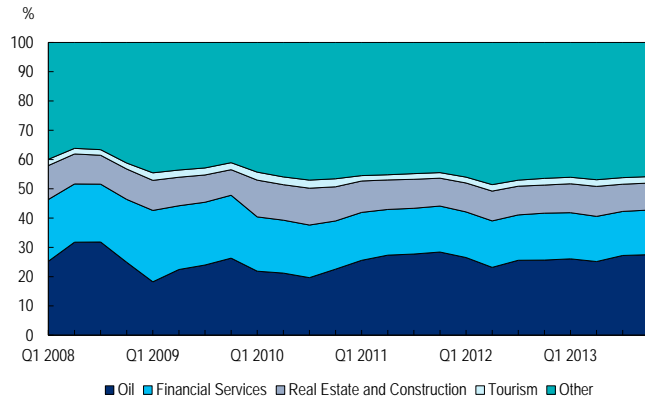
Source: Haver Analytics, Citi Research

Figure 8. The offshore banking system remains hard hit



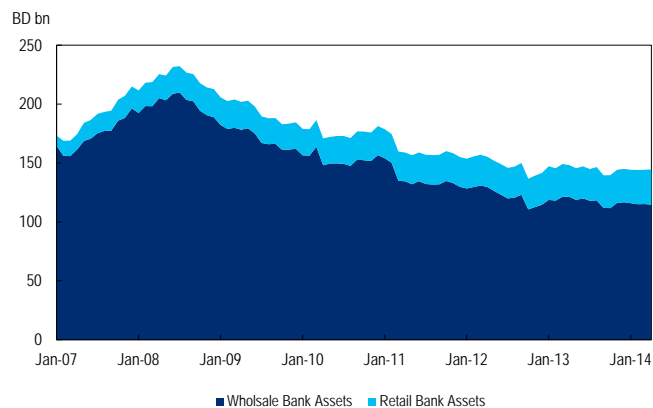
Source: Haver Analytics, Citi Research

Figure 9. The financial sector is a major economic pillar



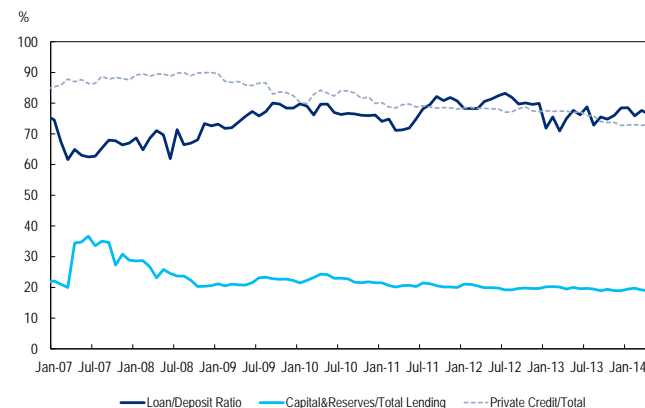
Source: Haver Analytics, Citi Research

Figure 10. Offshore banks are around 90% of banking assets



Source: Haver Analytics, Citi Research

Figure 11. Retail bank indicators still appear robust



Source: Haver Analytics, Citi Research

Figure 12. Bahrain Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	21.7	25.6	22.9	25.6	29.1	30.3	32.7	35.0	37.4
Nominal GDP, local currency bn	8.2	9.7	8.6	9.7	11.0	11.4	12.3	13.2	14.1
GDP per capita, US\$	21,072	22,983	19,192	20,482	22,489	22,969	23,856	24,563	25,193
Share of oil in GDP (real)	24.0	22.7	22.0	21.1	21.4	19.0	20.8	20.0	19.2
Average oil production (mbpd)	0.18	0.18	0.18	0.18	0.18	0.17	0.18	0.18	0.18
Population, mn	1.0	1.1	1.2	1.3	1.3	1.3	1.4	1.4	1.5
Economic Activity									
Real GDP, % yoy	8.3	6.2	2.5	4.3	2.1	3.4	5.3	4.0	4.0
Real per capita GDP, % yoy	-0.2	-1.8	-4.0	-0.7	-1.1	1.4	1.2	0.0	0.0
Real non-oil GDP, % yoy	10.9	8.2	3.4	5.5	1.4	6.7	3.2	5.0	5.0
Prices, Money & Credit									
CPI, % yoy	-	5.1	1.6	1.0	0.2	2.6	4.0	2.0	2.0
CPI, % avg	3.3	3.5	2.8	1.9	-0.4	2.8	3.3	2.5	2.0
Policy interest rate, %, eop	4.00	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Credit extension to private sector, % yoy	38.5	43.6	-0.7	6.2	15.0	6.2	6.6	10.0	10.0
Credit to private sector, % total deposits	58.7	65.3	64.7	60.8	63.0	61.7	57.1	57.1	57.1
Private sector deposits, % yoy	42.8	18.5	6.6	10.2	2.6	4.6	9.0	10.0	10.0
Bank capital & reserves, % total loans	28.9	20.6	22.2	21.5	20.0	19.6	18.9	18.0	17.1
3 month inter-bank rate, %, eop	4.90	2.40	0.40	0.30	0.30	0.30	0.20	0.20	0.20
BHD/US\$, eop	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38
BHD/US\$, avg	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38
Balance of Payments, USD bn									
Current account	2.8	2.1	0.4	0.6	3.0	2.0	2.2	1.9	0.5
% of GDP	12.7	8.1	1.7	2.3	10.3	6.4	6.8	5.5	1.3
Trade balance	2.7	3.1	2.3	2.5	7.5	6.5	7.3	6.4	5.2
Exports	13.6	17.3	11.8	13.6	19.6	19.7	20.9	20.9	20.5
o/w oil, % total exports	79.2	79.6	75.1	74.6	78.8	76.9	73.1	71.7	69.7
Imports	10.9	14.2	9.6	11.2	12.1	13.2	13.6	14.4	15.3
Service balance	1.8	1.7	1.9	2.1	1.3	1.3	1.4	1.6	1.6
Income balance	-0.3	-0.9	-2.4	-2.4	-3.8	-3.8	-4.3	-4.3	-4.3
o/w outward remittances, % GDP	6.8	6.9	6.1	6.4	7.0	6.8	6.6	6.5	6.4
FDI, net	0.1	0.2	2.0	-0.2	-0.1	0.0	-0.1	0.3	0.3
Public Finances, % of GDP									
Government revenues	24.9	27.7	19.8	22.5	25.7	26.6	23.9	22.2	20.2
o/w oil revenues	20.0	23.6	16.4	19.2	22.6	23.2	21.1	19.3	17.3
Government expenditure	22.3	21.3	24.1	27.3	26.0	28.6	27.2	26.7	27.0
o/w capital expenditures	6.0	5.3	4.5	7.9	4.0	6.5	3.9	3.8	3.7
Government balance	2.7	6.4	-4.3	-4.8	-0.3	-2.0	-3.3	-4.5	-6.8
non-oil balance, % of non-oil GDP	-21.9	-22.8	-25.7	-30.3	-31.4	-33.4	-33.1	-31.3	-30.6
Breakeven oil price (fiscal), US\$/barrel	62.60	72.67	79.00	100.23	112.31	122.68	126.77	132.38	142.65
Public debt	16.3	12.6	21.4	29.8	32.5	36.8	43.2	46.6	48.2
Cumulative government balance since 2000	22.8	29.2	24.8	20.1	19.8	17.8	14.5	10.0	3.2
Net debt (public debt net cumulative balance)	-6.5	-16.6	-3.4	9.7	12.7	19.0	28.8	36.6	44.9
Foreign Assets & Liabilities, USD bn									
External debt	29.8	36.3	35.0	37.5	36.5	38.0	42.3	40.6	41.4
External debt / GDP	137.1	141.6	152.8	146.2	125.4	125.7	129.4	115.8	110.8
External debt / XGS	173.7	172.9	225.8	212.4	161.1	168.9	177.1	194.3	202.1
External Assets	8.3	10.5	11.1	11.8	12.4	15.4	17.4	19.6	21.5

Source: National Sources, Citi Research Estimates

Egypt

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■ Key developments on the month

- The new president will push ahead with three major goals: improving the security situation; consolidating his power base prior to the parliamentary elections; and putting in place policies to kick start the economy.

■ Key macro drivers

- Gulf support has helped stabilize the exchange rate and eased, but not eliminated, foreign exchange shortages.
- The broad outlines of a new policy direction are now possible to discern, but a key element will remain the level of Gulf support available to partly fund a big push in capital spending.
- This could morph into a more coherent economic policy with a medium-term strategy to reduce the fiscal deficit.

Summary Analysis

Consolidating political power

Following his victory in the May presidential election, we think Abdelfattah el Sisi will now focus his attention on three issues. The first, which draws mostly on his military background, will be to restore the security situation in the country. This is arguably not only important as part of the country's economic recovery, but a key plank in maintaining popularity.

Part of this should be the ongoing clampdown on the Muslim Brotherhood (MB). But pushing the MB underground raises the risk of returning to the low level insurgency of the 1990s. And despite the clampdown, the president is keen to keep significant elements of the Islamist political community on side during the transition to preserve his wider political legitimacy.

This also ties in with his second goal, to build a wider political power base capable of performing well in parliamentary elections, which will probably be held in September. Given the weak and fragmented nature of the current political parties, none looks as if it can mount a successful campaign to secure a parliamentary majority. But with a couple of new parties being formed by supporters of the president and his ability to appoint 27 MPs, the goal will be to construct a supportive parliamentary alliance.

Even if the security clampdown is at the expense of some democratic values, the eventual political outcome is also likely to be supported by most foreign governments. But it is clear that the political environment has changed markedly in the last year, with the Gulf States now taking the political and economic lead in supporting Egypt's political transition, while US and European influence has diminished as they have struggled to react to political developments since June 2013.

A technocratic government to start with

Despite the vagueness of his policy pronouncements to date, the third goal of the president will be to kick start the economy. In this respect, he seems keen on keeping a technocratic government and eschewing pressure to appoint more populist ministers. In fact, by keeping Ibrahim Mahleb as prime minister and Hani Kadri Dimian as finance minister, the government does seem to have strong echoes of those from the late Mubarak period. Moreover, it is now possible to identify some potential broad policy themes that the president's first government will pursue which also have echoes of the end of Mubarak era.

First, we are all in this together. So an important strand of policy should be to raise taxes on the richer segments of society, notably through a wealth tax, capital gains and property taxes. But those paying may also be given the ability to stress where they want them spent in a broad sense – from a list of hospitals or schools for example. This would be supported by the implementation of a full VAT tax.

The second is growth with social justice. While the government is still formally only forecasting growth of 3.2% in the coming fiscal year, it will be hoping for a higher rate. But publicly it will also argue that it is interested in more than just the headline rate of growth. Instead, the government's growth-oriented agenda should also have a strong emphasis on social justice. Again, this reinforces our view that the government will only warily tackle the issue of food subsidies.

Third, Gulf support and the military. Although the 2014/15 budget is unlikely to include high levels of Gulf support, to meet its ambitious growth agenda, it would need major Gulf government financial support and private investment. This should be focussed on projects such as the building of low-cost housing or improving health and education facilities in the country. Another key agent that we think will be used to drive the investment agenda in coming years will be the army, which is one of the few institutions in the country, which has the logistical capacity to support the ambitious investment agenda.

A formal reform programme may emerge

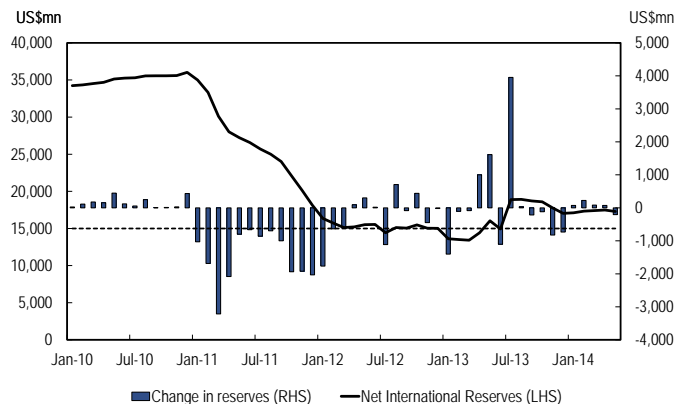
Over time, many of these themes could potentially be brought together in a more formal home-grown economic programme. Essentially, this should be a programme of technocratic reform, with bringing down the fiscal deficit and subsidy reform at the heart of it. But with additional underpinning themes: the involvement of the military; growth yes, but with social justice; the need for many to make a sacrifice to support growth; and finally, probably a strong anti-corruption strand.

And while Gulf states may push for greater non-Gulf involvement in this programme, with a potential donor conference on the cards, we think other pledges of support will be harder to drum up. However, when this full home-grown reform programme has been running for some time government, the government will probably open negotiations with the IMF to crowd in wider financial support. In the meantime, it will likely continue to use the IMF to help technical aspects of reform such as the introduction of VAT or subsidy reform.

The need for reality

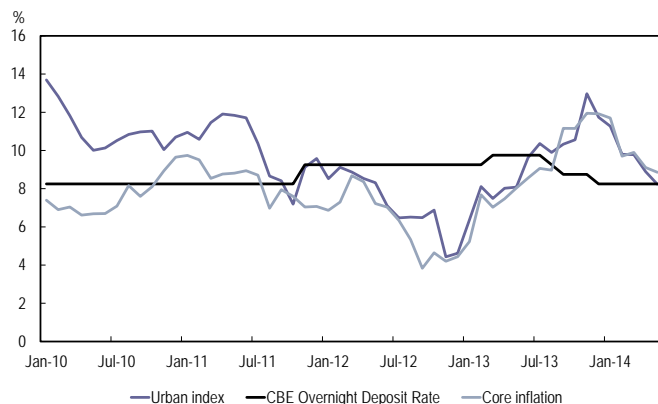
But the need for reality must also remain paramount. Even if an ambitious reform agenda along these lines is put in place, the reality remains that the state of the economy is still precarious, as shown by the weakening of the EGP since early April. Moreover, the government could face a major test in the coming months in the form of an energy crunch this summer: the usual air-conditioning demand surge will highlight how power demand growth has risen much faster than investment in the sector in the last decade and the need to reform the sector, notably the role of subsidies. These potential mini-crises, coupled with a weak civil service and a politically divided country, mean that the realities of running the country should also quickly take hold as the success of the president's election victory fades away.

Figure 13. Reserves have stabilised since late 2013, but remain low



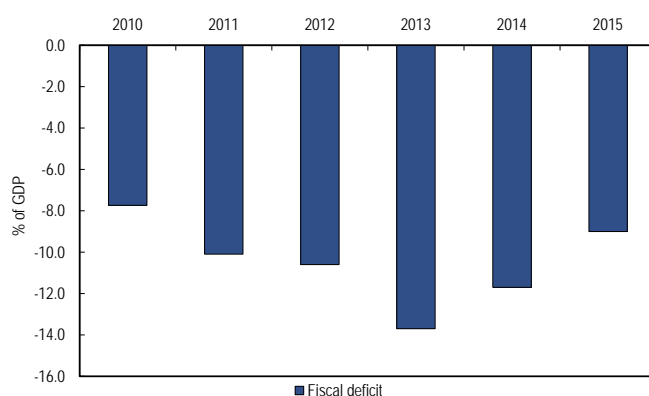
Source: Central Bank of Egypt, Haver Analytics

Figure 15. Inflation has moved back in line with monetary policy in 1H 2014



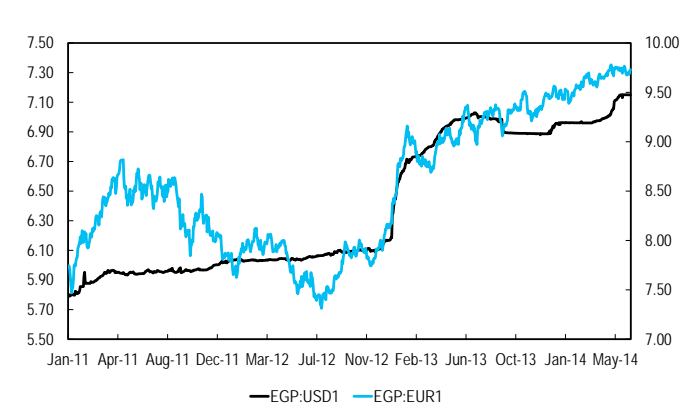
Source: Central Bank of Egypt, Haver Analytics and Citi forecasts for 2H 2013

Figure 17. The fiscal deficit remains large and is a problem



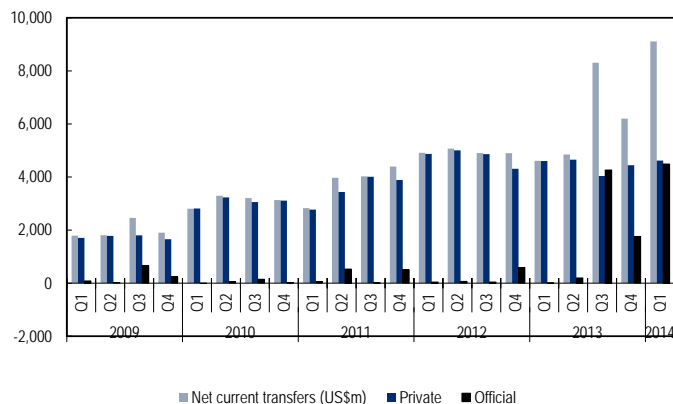
Source: Haver Analytics and Citi forecasts for 2013-2015

Figure 14. EGP – Downward steps against the US dollar



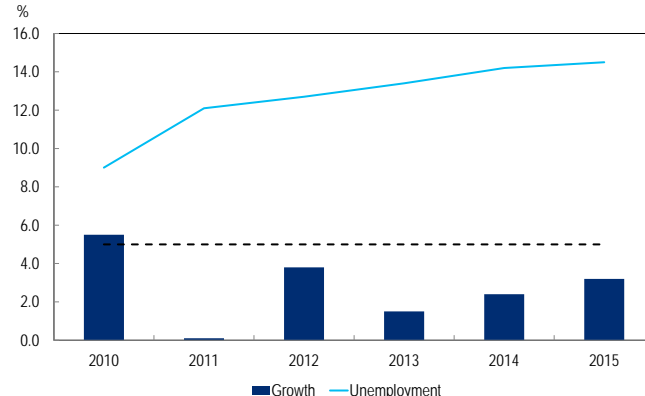
Source: Reuters

Figure 16. Robust transfers have limited the deterioration in the current account and helped support consumption



Source: Central Bank of Egypt, Haver Analytics

Figure 18. A slow recovery may now be possible in 2014-15



Source: Haver Analytics and Citi forecasts for 2013-15

Figure 19. Egypt Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	132.2	164.8	188.0	214.4	231.0	259.9	254.5	270.8	281.4
Nominal GDP, local currency bn	817.4	976.8	1,123.8	1,307.5	1,461.4	1,663.3	1,887.1	1,928.8	2,115.9
GDP per capita, US\$	1,783	2,187	2,454	2,755	2,920	3,233	3,114	3,260	3,334
Population, mn	74.1	75.4	76.6	77.8	79.1	80.4	81.7	83.1	84.4
Economic Activity									
Real GDP, % yoy	-	6.0	4.6	5.5	0.1	3.8	1.5	2.4	3.2
Real per capita GDP, % yoy	-	4.3	3.0	3.8	-1.6	2.1	-0.1	0.8	1.5
Prices, Money & Credit									
CPI, % yoy	6.9	18.4	13.2	10.6	9.5	4.7	11.7	7.3	7.2
CPI, % avg	9.5	18.3	11.8	11.1	10.1	7.1	9.5	7.9	6.5
Policy interest rate, %, eop	8.75	11.50	8.25	8.25	9.25	9.25	8.25	8.00	7.50
Credit extension to private sector, % yoy	10.0	12.0	3.0	6.7	6.1	7.6	6.4	6.3	7.6
Credit to private sector, % total deposits	48.9	50.1	44.5	42.8	43.7	42.7	37.7	-	-
Private sector deposits, % yoy	11.8	12.1	-1.6	6.7	6.1	7.6	6.4	-	-
EGP/US\$, eop	5.53	5.50	5.48	5.81	6.03	6.36	6.95	7.30	7.65
EGP/US\$, avg	5.64	5.44	5.55	5.63	5.94	6.07	6.87	7.12	7.52
Balance of Payments, USD bn									
Current account	0.2	-1.3	-3.2	-5.6	-7.9	-10.7	-3.3	-6.8	-6.4
% of GDP	0.2	-0.8	-1.7	-2.6	-3.4	-4.1	-1.3	-2.5	-2.3
Trade balance	-20.8	-26.8	-22.5	-27.7	-28.5	-36.8	-30.2	-33.2	-31.7
Exports	24.5	29.8	23.1	25.0	27.9	23.2	25.1	25.9	27.5
Imports	45.3	56.6	45.6	52.7	56.5	59.9	55.3	59.1	59.2
Service balance	12.7	15.7	11.3	9.6	5.4	6.3	2.9	2.5	3.5
Income balance	-	-	-	-	-	-	-	-	-
FDI, net	10.9	7.6	6.1	5.2	-1.1	6.7	5.3	-0.1	3.0
Public Finances, % of GDP									
Government revenues	27.6	27.8	27.7	25.1	22.0	22.1	23.1	21.7	22.4
Government expenditure	32.8	34.1	34.2	32.9	32.1	32.8	36.8	33.4	31.4
o/w capital expenditures	3.4	3.8	4.2	4.0	2.9	2.3	2.3	-	-
Government balance	-5.2	-6.4	-6.6	-7.7	-10.1	-10.6	-13.7	-11.7	-9.0
Public debt	64.2	53.5	54.0	59.8	69.0	77.7	78.6	79.0	79.1
Government's deposits with banks	11.4	10.5	11.0	9.6	8.8	7.7	9.8	-	-
Net debt (public debt net cumulative balance)	52.8	43.0	43.0	50.2	60.2	70.0	68.8	-	-
Foreign Assets & Liabilities, USD bn									
External debt	32.8	32.1	33.3	35.0	33.7	38.8	45.8	39.3	35.6
External debt / GDP	24.8	19.5	17.7	16.3	14.6	14.9	18.0	14.5	12.6
External debt / XGS	68.8	55.6	73.0	70.9	71.1	85.9	105.1	89.2	75.4
External Assets	-	-	-	-	-	-	-	-	-

Source: Citi Research

Iraq

■ Key developments on the month

- ISIS's advance into Baghdad and south is unlikely, oil fields look safe for now;
- Maliki government greatly weakened by crisis;
- KRG independence moves closer.

■ Key macro drivers

- Oil production ramp-up to lead to strong growth;
- Very large infrastructure requirements present non-oil sector opportunity;
- Politics and security present significant downside risks to outlook.

Summary Analysis

ISIS advance represents heightened security challenge for Baghdad and regional powers

The fall of Mosul and other advances made by the Islamic State in Iraq and Sham (ISIS) in the past fortnight represent a significant escalation in militant activity and presage what is likely to be a heightened and sustained level of military conflict between Iraqi security forces and Sunni insurgents in the days and weeks to come. The economic and political significance of some of the territories claimed by ISIS, including most recently the Baiji oil refinery, the country's main source of refined petroleum products, means that prompt efforts to recapture lost ground are likely to be a priority for the Iraqi government in the near future. Moreover, regional and international powers have expressed alarm given the unexpected military success of the al-Qaeda-affiliated group and the threat it poses to regional stability.

Further Advance into Baghdad and South unlikely, in our view

In our view, the ISIS advance has likely run its course in terms of territorial gain, and we consider the likelihood that Baghdad and the South of the country will be overrun by the extremist Sunni group to be minute. The reasons for this include: 1) the fact that the territories that have fallen to ISIS/ Islamist control are where the Shia population make up a small percentage of the total, whereas in Baghdad and the South they are the majority, 2) security forces and militia in Baghdad and the South are much stronger than was the case in the areas where insurgents have seen recent success, 3) the scale of operations that would be required to take a city like Baghdad, a city five times the size of Mosul, would be significant, and 4) there is international support for Baghdad and likely a concerted effort to prevent ISIS from making any progress in its capture.

ISIS unlikely to be able to consolidate its gains

Going forward, the real question in our view is whether the Islamists have the ability to consolidate the territorial gains they have recently made, both from the point of view of administering captured territories and in terms of resisting the likely military counteroffensive. On the former, we believe the lack of independent income sources from most of the conquered areas means that their economic viability outside of the framework of the Iraqi federal structure is doubtful. Moreover, ISIS's extreme governing style has been seen to alienate local populations in Syria, and the same may well prove true of Iraq. In terms of the military counteroffensive, aimed at pushing ISIS back from territories gained, we believe the prospects are much more uncertain.

Military counter-offensive fraught with risk

Baghdad needs to ensure that the conflict does not escalate into an all-out civil war, and thus is wary of employing Shia militias and foreign reinforcements against ISIS. At the same time, Baghdad will likely need the support of Sunni tribal leaders and militias in its fight against ISIS, something that is

likely to prove a significant challenge in the current politically divisive atmosphere. While it is important to note that the advance of ISIS and other Sunni militias in recent weeks does not represent a broader uprising by the Sunni community, grievances with Baghdad within this community run deep and it appears unlikely that Sunnis will mobilise in large numbers against ISIS until some of these issues are addressed.

Maliki government greatly weakened by crisis

Consequently, we believe the Maliki government has been greatly weakened by the crisis, and we believe that PM al Maliki is now less likely to emerge as the head of the new Iraqi government, following April's inconclusive elections. This is because: 1) Maliki is being held partly responsible for creating the divisive atmosphere in which ISIS has thrived, or at the very least that Maliki is unlikely to be perceived a figure who can build bridges with the alienated Sunni community, 2) Maliki's image as a strongman has been tarnished given the military's failure to secure key cities, and 3) international support for Maliki appears to have diminished significantly for the above reasons.

Consensual approach required to resolve conflict

Indeed, the rise of Sunni militant extremism underscores the need for the Shia-led Iraqi government to engage more constructively with the Sunni community. Such engagement was a key element of the 'Sunni Awakening' strategy that, alongside the 'surge' by the US military, helped end Iraq's civil war in 2008. In short, we believe that confronting ISIS requires Baghdad to seek the support of a broad spectrum of Iraqi society, something that is likely to have a bearing on the ongoing coalition politics and efforts to form a government following recent inconclusive elections.

Little impact of crisis so far on sovereign creditworthiness

Despite the gravity of the situation from a security perspective, we do not believe these events materially affect Iraqi sovereign creditworthiness. We maintain our view that the fighting will remain limited to the north and is unlikely to lead to the disintegration of Iraq. Importantly, it is also unlikely to affect Iraq's southern oil infrastructure. Although we cannot discount the threat of terrorist attacks on infrastructure, a sustained shutdown of oil production appears unlikely at this point. Oil revenues continue to grow in line with recent gains in production and export capacity, bolstering debt servicing capacity.

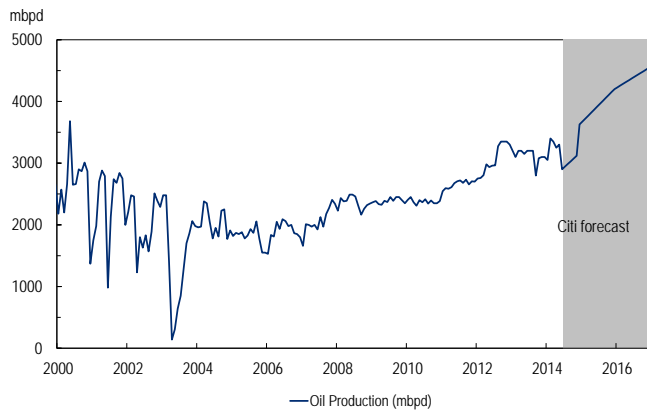
Kurdish independence now more likely

We do believe, however, that the prospects for Kurdish independence have increased markedly as a result of recent developments. Not only has this process gained significant momentum in recent months with the initiation of independent oil exports from the Kurdish region, but the territorial gains made by the KRG in disputed territories have moved the facts on the ground in favour of the Kurds, significantly in terms of their bargaining power with Baghdad. While this may be used to arrive at a permanent deal with Baghdad over such things as oil exports and the budget, we believe it has also given added momentum to the drive towards full independence, as evidenced by recent comments made by the KRG leadership to that effect.

Supreme Court ruling does not presage sustained Kurdish oil exports

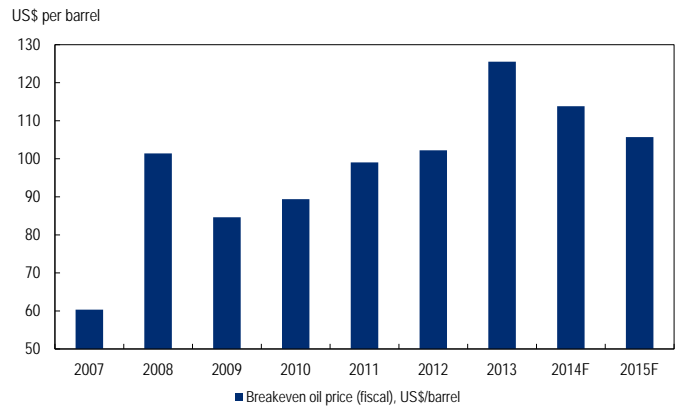
A June 24th the Iraqi Supreme Court rejected a request by the Federal Ministry of Oil to bar Kurdish exports on the basis that it contravened the legal process, which would require the court to first establish the illegality of such exports before doing so. This does not resolve the issue of the constitutionality of such exports, but merely states that to bar them before doing so would be in contravention of the legal process. It would therefore be premature to conclude that sustained Kurdish exports are imminent on the basis of this ruling, especially as Baghdad's international legal challenge is not affected by it (see [macro flash](#)).

Figure 20. Oil production on track to ramp up in near term



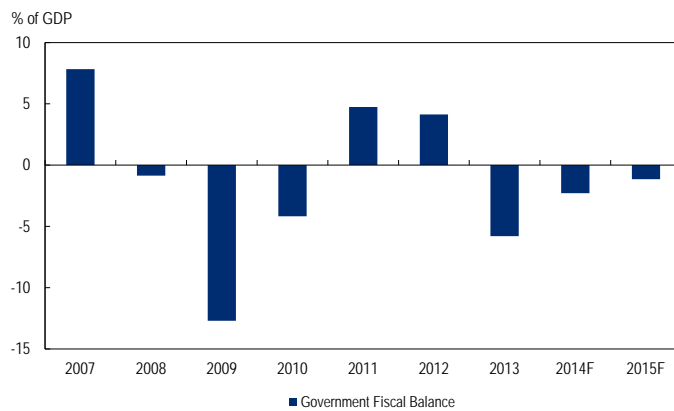
Source: Bloomberg, Citi Research

Figure 21. The fiscal breakeven oil price remains elevated



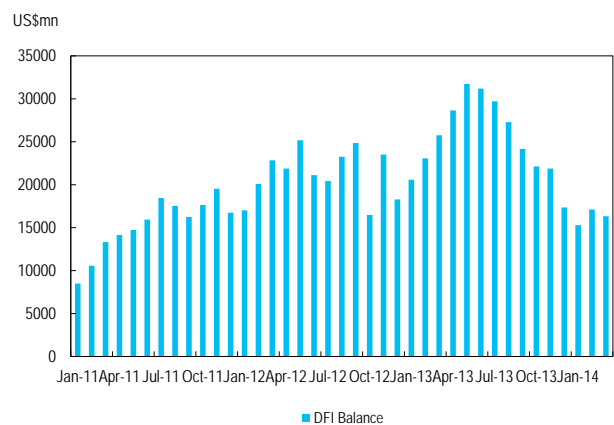
Source: Haver Analytics, Citi Research estimates

Figure 22. Fiscal performance should improve going forward



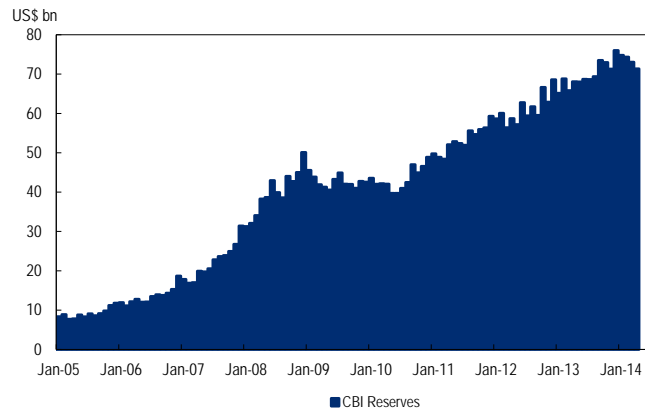
Source: Haver Analytics, Citi Research estimates

Figure 23. Balances at DFI account remain strong



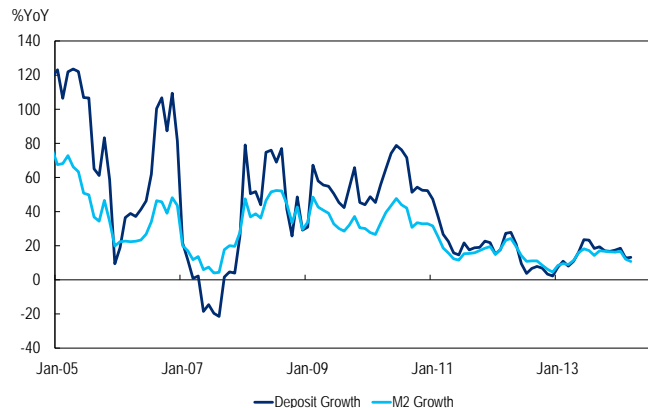
Source: IAMB, Committee of Financial Experts

Figure 24. Central bank reserves have settled around US\$75bn



Source: Haver Analytics, Citi Research

Figure 25. Monetary growth has stabilised



Source: Haver Analytics, Citi Research

Figure 26. Iraq Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	91.7	135.6	113.6	138.9	186.3	216.6	234.8	272.0	318.7
Nominal GDP, local currency bn	111,455.8	157,026.1	130,642.2	162,064.6	217,327.1	251,907.7	272,802.4	316,111.1	370,315.3
GDP per capita, US\$	3,190	4,607	3,766	4,487	5,871	6,655	7,032	7,946	9,076
Share of oil in GDP (real)	43.0	45.4	43.9	41.6	42.2	44.1	43.6	45.9	47.6
Average oil production (mbpd)	2.07	2.36	2.39	2.38	2.66	3.06	3.13	3.63	4.20
Population, mn	28.7	29.4	30.2	31.0	31.7	32.5	33.4	34.2	35.1
Economic Activity									
Real GDP, % yoy	1.4	6.6	5.8	5.5	10.2	10.3	3.1	10.4	11.6
Real per capita GDP, % yoy	-1.0	4.1	3.2	2.8	7.5	7.5	0.6	7.6	8.8
Real non-oil GDP, % yoy	-2.8	2.2	8.7	9.8	9.1	6.7	4.0	6.0	8.0
Prices, Money & Credit									
CPI, % yoy	4.7	6.8	-4.4	3.3	6.0	3.6	3.1	2.0	5.0
CPI, % avg	20.8	2.7	-2.2	2.4	5.6	6.1	1.9	2.5	5.0
Policy interest rate, % eop	20.00	15.00	7.00	6.00	6.00	6.00	6.00	6.00	6.00
Credit extension to private sector, % yoy	27.5	52.8	17.3	77.1	34.0	28.2	25.0	25.0	25.0
Credit to private sector, % total deposits	-	-	-	-	-	-	-	-	-
Private sector deposits, % yoy	-	-	-	-	-	-	-	-	-
Bank capital & reserves, % total loans	-	-	-	-	-	-	-	-	-
3 month inter-bank rate, % eop	-	-	-	-	-	-	-	-	-
IQD/US\$, eop	1,213	1,168	1,153	1,170	1,167	1,164	1,165	1,162	1,162
IQD/US\$, avg	1,253	1,189	1,156	1,167	1,171	1,164	1,162	1,162	1,162
Balance of Payments, USD bn									
Current account	20.0	28.4	-1.3	6.3	26.2	38.0	31.1	36.9	40.2
% of GDP	21.9	20.9	-1.1	4.6	14.1	17.5	13.3	13.6	12.6
Trade balance	23.0	34.0	4.1	14.4	39.0	44.8	38.3	44.6	48.3
Exports	39.6	63.7	39.4	51.8	79.7	90.3	89.3	101.7	112.2
o/w oil, % total exports	94.9	96.9	92.4	94.2	96.2	96.7	96.6	97.0	97.3
Imports	16.6	29.8	35.3	37.3	40.6	45.5	51.0	57.1	63.9
Service balance	-4.0	-6.1	-6.4	-7.0	-8.1	-4.1	-4.5	-5.0	-5.5
Income balance	1.5	3.5	3.1	1.6	-0.2	0.1	0.1	0.1	0.1
FDI, net	1.0	1.8	1.5	1.3	1.7	2.6	3.1	3.4	3.8
Public Finances, % of GDP									
Government revenues	54.0	56.4	46.2	45.4	48.1	47.4	42.3	42.8	40.6
o/w oil revenues	47.4	47.8	35.9	37.0	44.4	43.4	39.6	39.0	36.7
Government expenditure	46.1	57.3	58.9	49.6	43.4	43.3	48.1	45.1	41.8
o/w capital expenditures	9.9	17.4	12.8	14.9	12.6	15.1	13.9	12.6	11.3
Government balance	7.8	-0.9	-12.7	-4.2	4.7	4.1	-5.8	-2.3	-1.2
non-oil balance, % of non-oil GDP	-85.2	-117.4	-92.9	-81.9	-79.6	-78.8	-81.2	-74.9	-65.7
Breakeven oil price (fiscal), US\$/barrel	60.3	101.4	84.6	89.4	99.1	102.2	125.5	113.8	105.7
Public debt	116.1	72.6	84.0	51.0	39.1	33.5	36.7	33.9	30.1
Cumulative government balance since 2000	7.8	7.0	-5.7	-9.9	-5.2	-1.0	-6.8	-9.1	-10.3
Net debt (public debt net cumulative balance)	-	-	-	-	-	-	-	-	-
Foreign Assets & Liabilities, USD bn									
External debt	103.2	95.5	93.2	44.1	48.8	50.0	51.0	45.8	43.6
External debt / GDP	112.5	70.5	82.0	31.7	26.2	23.1	21.7	16.9	13.7
External debt / XGS	255.0	146.5	223.9	80.8	59.1	54.7	57.1	45.1	38.8
External Assets	23.3	51.7	50.6	57.0	83.3	121.3	152.4	189.4	229.5

Source: Citi Research

Jordan

■ Key developments on the month

- ISIS advance raises security concerns;
- 2014 budget calls for sharp growth in spending;
- FX reserve position improves significantly, but on the back of transient factors.

■ Key macro drivers

- Weak public finances with limited revenue capacity;
- Growth expected to stay fairly depressed in medium term;
- Political risk to remain relatively high as reform process continues.

Summary Analysis

ISIS advance in Iraq raises security threats for Jordan

The advance of ISIS in Iraq has raised significant security concerns for Jordan. In particular, the control of border towns has fallen to ISIS and allied Sunni militias in the past few days, prompting the Jordanian government to reinforce its border militarily. The fear for Jordan is two-fold. First, the direct threat of an advance of ISIS-led jihadists into Jordanian territory. Second, the flow of weapons and personnel from Iraq into Jordan, potentially aiding some elements within Jordan that may harbor sympathies for ISIS.

Economy already affected by war in Syria

Jordan's economy has already been affected by the conflict in Syria, with almost 600,000 refugees crossing the border since fighting began. On the one hand, the refugees, most of whom live in Jordanian urban centres, put further strain on Jordan's limited resources. On the other, their presence, along with that of the NGO community which has swelled as a result of the conflict, is supporting domestic demand and motivating an increase in aid flows to the kingdom. Recently released data shows that the economy grew just 2.8%YoY in 2013, reflecting ongoing regional and domestic instability, weak external demand, and elevated energy costs.

2013 budgetary outturns improve on back of grants, expenditure cuts

Final fiscal numbers for 2013 show a sharp contraction in the fiscal deficit to 5.6% of GDP, from 8.3% a year earlier. About half of this contraction was due to the more than doubling in grant inflows during the course of the year as Jordan leveraged its important geopolitical role and called upon regional allies and the US to bolster its financial position. The remainder was due to a contraction in spending, most evident in the last couple of months of 2013 since Abdullah Ensour's new government came into office.

We believe these fiscal gains are likely to be short-lived as the 2014 budget envisages

We believe these fiscal gains are likely to be short-lived as the 2014 budget envisages. The budget was narrowly passed by the lower house of parliament amid protests from several MPs, some of which called for the resignation of the government. The budget has stirred controversy, primarily because it envisages a cut to subsidies (particularly energy subsidies) while at the same time expanding overall expenditure. Total expenditures are expected to rise to JD8.1bn, a 15% increase on 2013, leading to a deficit of JD1.1bn, or 4.5% of GDP. This is based on what we consider an optimistic assumption that revenues will rise in line with expenditures. On our more cautious view that revenues will come down from 2013 levels due to an expected fall in grants, we forecast a budget deficit of JD2.4bn, or 9.8% of GDP.

The fiscal loosening is at odds, in our view, with the goals of the country's IMF programme

The fiscal loosening is at odds, in our view, with the goals of the country's IMF programme, which stress above all the need for greater fiscal consolidation. Indeed, the IMF late last year waived two key missed targets (on primary deficit and losses at NEPCO) in order to push through a disbursement of funds under its 36-month US\$2.1bn stand-by agreement. While it is not unusual for the IMF to waive performance targets, we believe that Jordan is benefitting from international support as a result of its central role in dealing with the spillover of the conflict in Syria (particularly the refugee crisis), as well as its general geo-strategic regional importance. Indeed, the sharp rise in foreign aid registered so far this year is testament to the international community's interest in maintaining the country's economic stability. The underwriting of the kingdom's recent US\$1.25bn bond issue by the US government is another case in point.

Jordan's FX reserve improvement reflects transient factors

Jordan's FX reserve position has improved significantly over the past year, despite ongoing external imbalances. Total FX reserves rose sharply to US\$13.4bn in January, from US\$8.8bn a year earlier. This is despite a continued widening in the current account deficit, to over 11% of GDP in Q3, and sluggishness in capital inflows. Indeed, the balance of payments has remained in a net negative position, and the build-up of FX reserves reflects mainly two exceptional factors. First, there has been a significant de-dollarisation in the economy, with the ratio of FX to dinar deposits falling from 32% to 27% in the first 11 months of the year. Second, the FX reserves reflect the IMF disbursements under the programme.

Energy to continue to be a major source of weakness in the economy

A significant source of economic weakness is energy, including Jordan's reliance on fuel imports, and the large losses at the state electricity provider due to subsidised domestic energy tariffs. Gas imports from Egypt, which used to account for 80% of Jordan's electricity generation feedstock, have been disrupted by repeated terrorist attacks in the Sinai Peninsula. Supplies from Egypt had in any case dwindled due to the latter's own energy crisis, forcing Jordan to import more expensive diesel from elsewhere. Aside from foreign assistance, we see little relief to Jordan's energy predicament in the near to medium term.

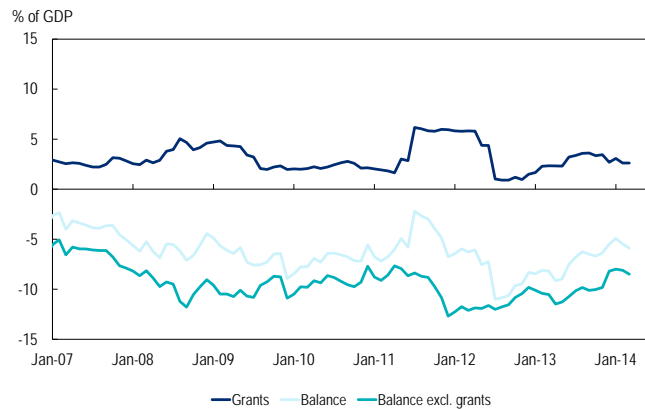
Government has been forced to go ahead with implementation of tariff hikes

This means the government has little alternative but to move forward with a controversial IMF-backed 5-year plan to lift domestic energy subsidies. Indeed, the first phase of the plan, which sees tariff rises for industry and commerce, not individuals, began in August. The issue remains emotive, as evidenced by the hostile reception the 2014 budget received in parliament, and is widely reported to be deeply unpopular on the street. An attempt to raise electricity tariffs a year ago sparked widespread unrest, causing the government to reverse its decision. Conscious of these and other economic pressures, the IMF relaxed some of the programme's targets, including the target for losses at the state-owned electricity company NEPCO, and the rate at which electricity tariffs are expected to rise over the course of the programme.

Inflation picked up in May

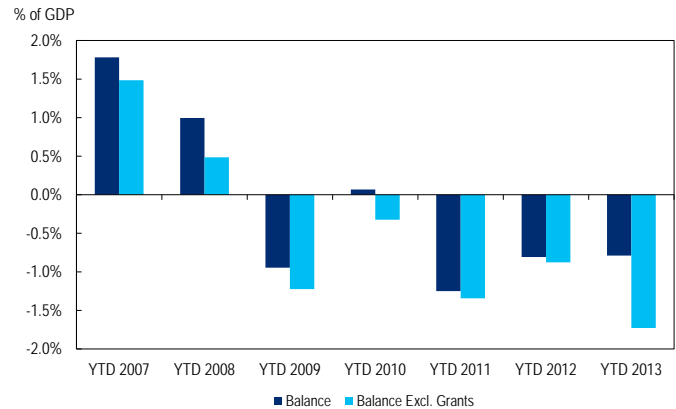
Inflation jumped in May to 3.7%YoY from 3.2% reported in April. The main inflationary impulse came from a jump in transportation costs which rose 5.5%YoY (3% in April). On the margin there were also increases in housing costs, but this contributed only 1%pt extra to the headline rate. Having said this, food costs, which take up the majority of the CPI basket, remains relatively well constrained. Hence, we still retain our expectation that inflation will come in at 3.5% for 2014.

Figure 27. The fiscal bottom line has remained problematic...



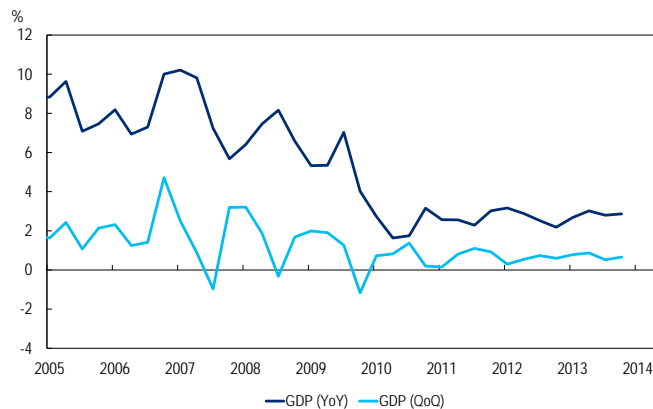
Source: Haver Analytics, Citi Research

Figure 28. ...and would be weaker still if grants were excluded



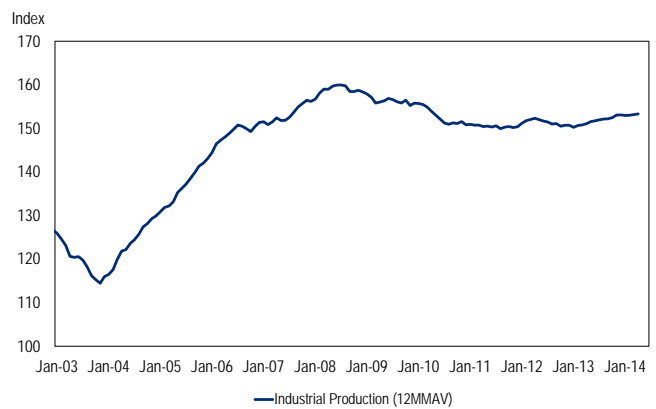
Source: Haver Analytics, Citi Research

Figure 29. Growth has begun to slow ...



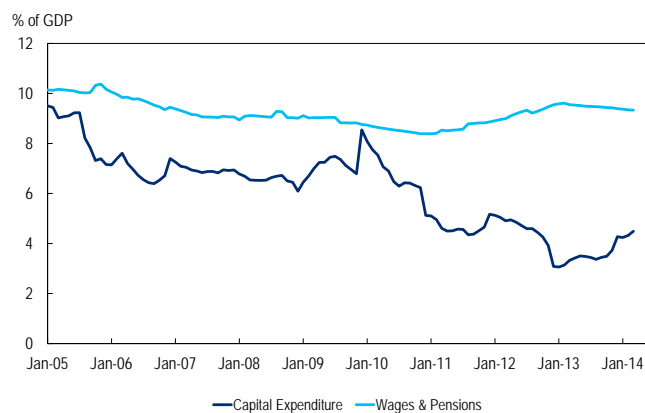
Source: Haver Analytics, Citi Research

Figure 30. ... and industrial production has been stalled since 2008



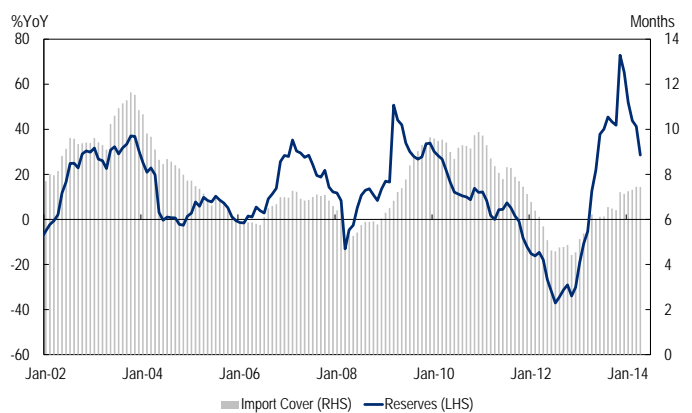
Source: Haver Analytics, Citi Research

Figure 31. Capital expenditures have stabilised ...



Source: Haver Analytics, Citi Research

Figure 32. ... while reserves are continuing to grow



Source: Haver Analytics, Citi Research

Figure 33. Jordan Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	17.1	22.0	23.9	26.5	28.8	30.9	33.6	35.8	38.5
Nominal GDP, local currency bn	12.1	15.6	16.9	18.8	20.4	21.9	23.8	25.4	27.3
GDP per capita, US\$	3,026	3,722	3,866	4,104	4,284	4,404	4,593	4,699	4,848
Population, mn	5.7	5.9	6.2	6.5	6.7	7.0	7.3	7.6	7.9
Economic Activity									
Real GDP, % yoy	8.2	7.2	5.5	2.3	2.6	2.7	2.8	4.0	4.5
Real per capita GDP, % yoy	3.8	2.6	0.9	-2.0	-1.6	-1.4	-1.4	-0.2	0.3
Prices, Money & Credit									
CPI, % yoy	5.1	9.1	2.7	6.1	3.3	7.2	2.7	5.0	5.0
CPI, % avg	4.7	13.9	-0.7	5.0	4.4	4.8	5.5	3.5	5.0
Policy interest rate, % eop	7.00	6.25	4.75	4.25	4.50	5.00	4.50	4.25	4.50
Credit extension to private sector, % yoy	14.5	14.7	7.2	7.1	7.2	4.7	7.1	10.0	10.0
Credit to private sector, % total deposits	-	-	-	-	-	-	-	-	-
Private sector deposits, % yoy	9.5	12.5	12.9	12.0	8.7	1.9	10.0	10.0	10.0
JOD/US\$, eop	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71
JOD/US\$, avg	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71
Balance of Payments, USD bn									
Current account	-2.9	-2.1	-1.2	-1.9	-3.5	-5.4	-3.8	-3.6	-3.0
% of GDP	-16.8	-9.3	-5.2	-7.1	-12.0	-17.4	-11.3	-10.2	-7.9
Trade balance	-6.5	-7.2	-6.3	-6.8	-8.8	-10.5	-11.5	-12.1	-12.3
Exports	5.7	7.9	6.4	7.0	8.0	7.9	7.9	8.3	9.2
Imports	12.2	15.1	12.7	13.9	16.8	18.4	19.4	20.4	21.4
Service balance	0.0	0.4	0.7	1.2	0.7	1.1	1.3	1.3	1.4
Income balance	0.7	0.7	0.5	-0.1	-0.2	-0.3	-0.2	-0.3	-0.3
FDI, net	2.6	2.8	2.3	1.6	1.4	1.5	1.8	1.9	2.0
Public Finances, % of GDP									
Government revenues	32.7	30.4	26.7	24.9	26.5	23.1	24.2	21.5	21.0
Government expenditure	37.8	34.8	35.7	30.4	33.2	31.4	29.7	31.1	30.4
o/w capital expenditures	6.9	6.1	8.5	5.1	5.2	3.1	4.3	5.0	5.0
Government balance	-5.1	-4.4	-8.9	-5.6	-6.8	-8.3	-5.5	-9.6	-9.4
Public debt	70.9	58.2	62.2	63.4	68.9	76.8	78.0	82.8	86.4
Government's deposits with banks	17.6	15.7	14.8	15.7	13.3	15.3	20.1	19.7	19.3
Net debt (public debt net cumulative balance)	53.3	42.5	47.5	47.7	55.6	61.5	57.9	63.0	67.1
Foreign Assets & Liabilities, USD bn									
External debt	14.9	13.8	14.3	16.3	17.3	18.9	19.9	20.8	21.9
External debt / GDP	87.3	62.9	59.7	61.4	60.2	61.3	59.2	58.2	56.9
External debt / XGS	161.0	111.4	130.2	128.5	131.8	139.3	145.1	147.5	145.7
External Assets	-5.5	-7.5	-8.3	-9.7	-13.2	-18.5	-22.3	-26.0	-29.0

Source: National Sources, Citi Research Estimates

Kuwait –

■ Key developments on the month

- Government spending rose 23% in 2013, highlighting need to address subsidies;
- 2014/2015 budget approved by cabinet, modest growth, requires National Assembly ratification;
- Parliamentarians quit after move to 'grill' PM rejected.

■ Key macro drivers

- High growth potential, US\$104bn development plan;
- Politics remains a major obstacle to implementation of plan;
- Public finances robust, underpinning sovereign strength.

Summary Analysis

Government spending rose 23% in 2013

Government expenditures rose 23%YoY in 2013, taking the cumulative rise in spending over the past two years to almost 70%. The largest component of the rise related to 'miscellaneous expenditure and transfer payments', which relates to social spending and subsidies, which increased 31%YoY and represented 50% of total government expenditure. The rise in social spending reinforces our long-standing concerns regarding Kuwait's fiscal trajectory and in particular the quality of expenditure, although the relatively low level of overall expenditure and the high level of revenues means that double-digit surpluses are likely through to the end of the decade (taking into account off-budget revenues in the form of investment receipts).

Rising expenditures highlight need to address subsidy reform

The figures test the Kuwaiti government's resolve to address the subsidy issue that has been described as 'unsustainable' by the country's Prime Minister.

Shortly before a cabinet reshuffle in January, a panel had been set up by the Minister Of Finance (now gone) with the intention of streamlining subsidies (mainly fuel and energy) to the more needy, reducing inefficiency and waste, in line with recommendations made by the IMF in the concluding statement of its Article IV consultation with Kuwaiti Authorities (23 September). The new finance minister, Al-Saleh, has, however, re-affirmed the ministry's commitment to push ahead with the review, which we believe will help maintain confidence in Kuwait's public finances. Kuwait remains in a relatively comfortable fiscal position, even compared with its oil-rich GCC peers, but plateauing oil revenues and rising expenditures do pose a threat to the fiscal outlook in the medium to long term. This is true of most Gulf oil exporters, as we have recently argued ([Middle East Macro Monthly - Why the GCC's Structural Challenges Matter](#), 30 September).

2014/2015 budget approved by cabinet, requires National Assembly ratification

The 2014/2015 budget has been approved by cabinet and envisages a sharp slowdown in spending growth, to just 3.2% according to reports (Reuters, 30 January). The budget has yet to be approved by parliament, which has demonstrated a more populist tone and is likely to push for greater social spending in the medium term. We forecast spending growth of 5.4%, although we believe risks to this number are to the upside given recent experience.

Tentative progress on development plan, but question marks remain

Some tentative steps forward on development spending have been made, but questions remain. In February, the government approved a US\$12bn bid for the Clean Fuels Project (CFP) which involves an overhaul of Kuwait's existing refineries. The project forms part of the US\$6bn slated towards infrastructure spending in the next two years, and its approval is a positive sign that momentum is

returning to Kuwait's stalled US\$104bn development plan. However, also in February, the national assembly put into doubt two major contracts previously awarded by the government – one relating the GDF-Suez Azzour water and power plant, and one relating to Airbus contracts for Kuwait Airways – which acts as a reminder of the ongoing execution risks that the political atmosphere in Kuwait involves.

We expect ongoing tensions between the National Assembly and government, despite cabinet reshuffle

More generally, we expect tensions between the National Assembly and the government to remain a feature of Kuwait's political landscape for the foreseeable future, despite the change in government in January. Kuwait has had numerous governments in the past decade, and this is the sixth government to be headed by Prime Minister Sheikh Jaber al Sabah since his appointment in December 2011. Continued bad relations between the government and parliament are a major obstacle to policy-making in Kuwait, and are a drag on its economic prospects. Hopes that a relatively pro-government parliament elected last summer (following an opposition boycott) would lead to a better working relationship and, importantly, progress on the implementation of the US\$104bn development plan, were dashed when parliamentarians soon began targeting cabinet ministers for 'grillings'. As such, we do not believe that the current cabinet is likely to resolve the underlying problems that plague the relationship between the government and law-makers, and expect further political stasis and instability, with continued negative impact on economic policy-making.

Parliamentarians move to 'grill' PM in potential sign of escalating political tensions

Indeed, in May five parliamentarians resigned after their move to question Prime Minister Sheikh Jaber al-Sabah over the state of the housing market in Kuwait was rejected. The episode reflects the populist instinct of some of Kuwait's parliamentarians, and the obstacles facing a normalisation of relations between the National Assembly and the government.

Weak credit growth likely to continue in 2014

Lending growth continued to be sluggish at the start of 2014. Although total credit growth increased in March, at 6.9%YoY it merely retraced the recovery path that came to an abrupt halt when credit growth eased in February. The February data showed the fragility of the recovery in lending. While lending to the public sector was still in negative territory in March, at -1.5%YoY it is on the cusp of returning to positive growth for the first time in almost two years. The real weakness continues to come from the private side, which makes up more than 90% of total bank lending. It too has recovered from the disappointing February number, rising to 7.4%YoY which is, in fact, the highest growth rate in almost 4.5 years. However, this remains significantly below the highs recorded in early 2008 which private sector credit extension hit 37.4%YoY. It remains to be seen whether the March data is the start of a wider trend of improving credit, or whether lending will stall again, as it did in February. On the flip side, the weak loan growth has allowed the loan deposit ratio to stabilise at around 80%.

Inflation remains contained

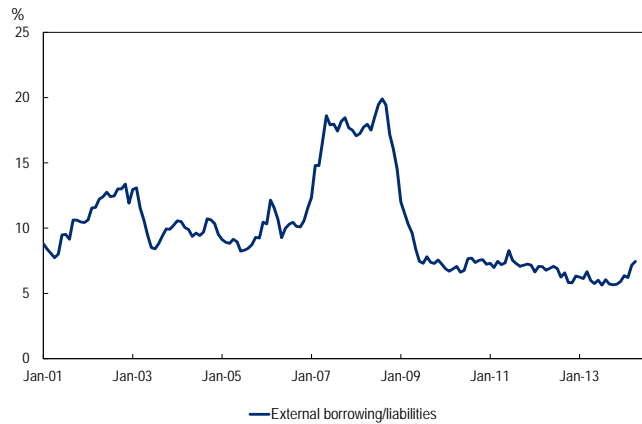
Inflation has remained well contained since the statistical office rebased the index last year. In May, inflation gave back some of the losses between March and April, by rising to 2.7%YoY – a net loss of 1%pt. There were small inflationary impulses from Communication and Misc Goods & Services. We are looking for inflation to rise gradually for the rest of the year, bringing 2014 inflation to 3%, and then picking up again about 4% in 2015.

Figure 34. Lending to the government has picked up



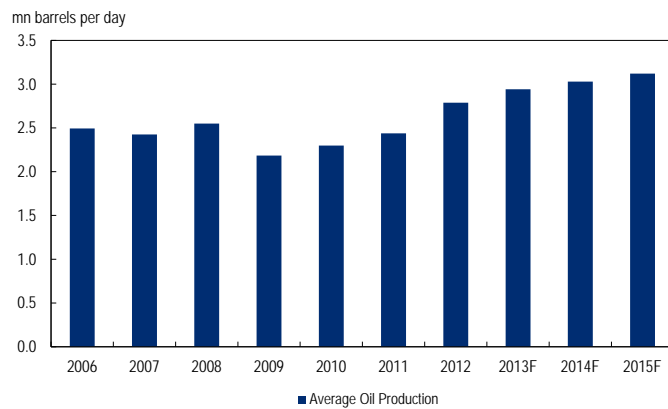
Source: Haver Analytics, Citi Research

Figure 35. Foreign liabilities remain moderate



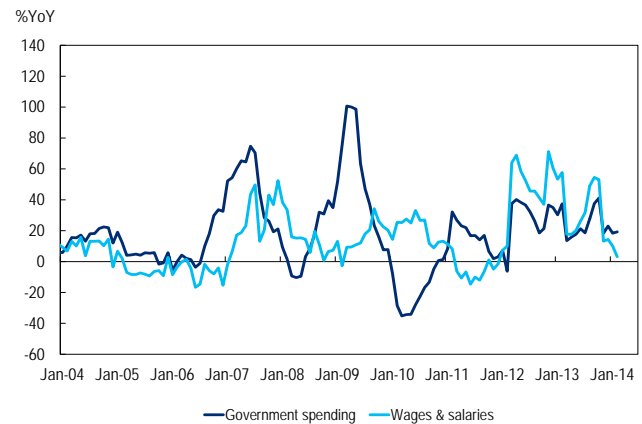
Source: Haver Analytics, Citi Research

Figure 36. Oil production remains relatively stagnant



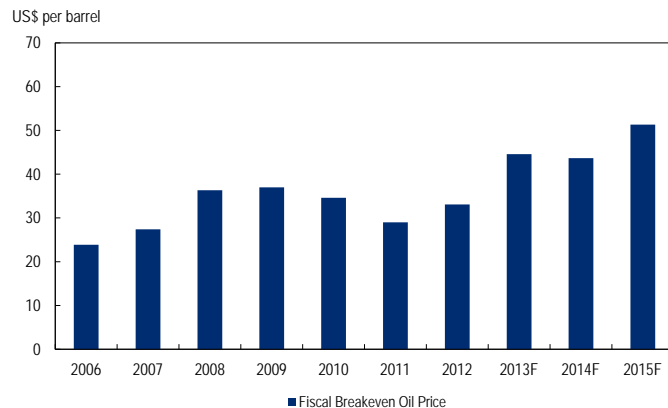
Source: Haver Analytics, Citi Research estimates

Figure 37. Government spending has stabilised



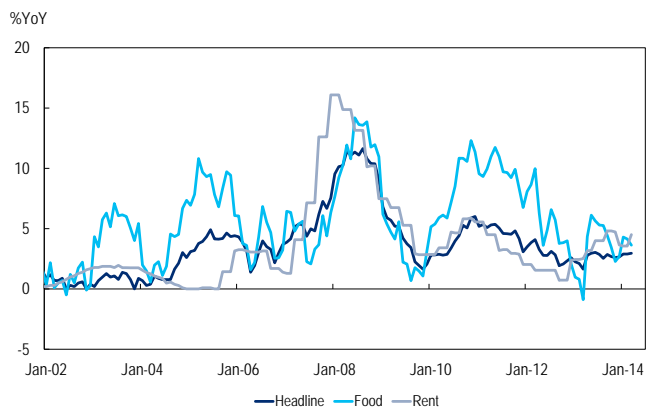
Source: Haver Analytics, Citi Research

Figure 38. Fiscal breakeven rising but still relatively prudent



Source: Haver Analytics, Citi Research estimates

Figure 39. Food price inflation remains elevated



Source: Haver Analytics, Citi Research

Figure 40. Kuwait Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	112.3	136.6	105.2	118.5	152.8	176.9	191.3	210.4	211.8
Nominal GDP, local currency bn	32.6	39.6	30.5	34.4	44.3	51.3	55.5	61.0	61.4
GDP per capita, US\$	43,971	50,563	36,898	39,610	48,908	54,947	57,706	61,608	60,218
Share of oil in GDP (real)	53.9	55.4	51.9	53.6	56.1	57.7	57.6	57.2	56.7
Average oil production (mbpd)	2.43	2.55	2.18	2.30	2.44	2.79	2.94	3.03	3.12
Population, mn	2.6	2.7	2.9	3.0	3.1	3.2	3.3	3.4	3.5
Economic Activity									
Real GDP, % yoy	6.0	2.5	-7.1	-2.4	10.2	8.3	5.7	3.8	3.9
Real per capita GDP, % yoy	0.3	-3.1	-11.9	-7.0	5.5	5.2	2.6	0.8	0.8
Real non-oil GDP, % yoy	15.3	2.7	-4.8	15.7	4.3	4.1	6.0	5.0	5.0
Prices, Money & Credit									
CPI, % yoy	7.5	9.0	2.1	6.0	3.1	2.6	2.7	3.5	4.0
CPI, % avg	5.5	10.6	4.0	4.0	4.7	2.9	2.6	3.0	4.0
Policy interest rate, %, eop	6.25	3.75	3.00	2.50	2.50	2.00	2.00	2.00	2.00
Credit extension to private sector, % yoy	35.1	16.6	6.2	1.9	2.6	2.8	7.2	2.0	2.0
Credit to private sector, % total deposits	107.4	102.7	96.1	96.2	91.8	86.6	85.4	83.0	80.6
Private sector deposits, % yoy	20.0	16.0	13.5	2.8	7.8	6.8	9.9	5.0	5.0
Bank capital & reserves, % total loans	20.2	17.9	18.0	21.0	21.8	22.4	22.5	24.3	26.1
3 month inter-bank rate, %, eop	3.62	3.15	1.14	0.98	0.90	0.66	0.70	0.70	0.70
KWD/US\$, eop	0.27	0.28	0.29	0.28	0.28	0.28	0.28	0.28	0.28
KWD/US\$, avg	0.28	0.27	0.29	0.29	0.28	0.28	0.28	0.29	0.29
Balance of Payments, USD bn									
Current account	41.9	57.8	29.1	37.8	66.2	78.8	72.6	85.0	81.2
% of GDP	37.3	42.3	27.6	31.9	43.3	44.6	37.9	40.4	38.3
Trade balance	43.2	61.5	36.9	48.9	79.7	95.6	90.9	104.4	102.0
Exports	63.5	83.5	55.9	68.7	101.5	119.6	117.2	133.3	133.9
o/w oil, % total exports	94.4	95.0	89.9	92.1	93.9	95.0	94.3	93.5	91.6
Imports	20.3	22.0	19.0	19.8	21.8	24.0	26.3	28.9	31.8
Service balance	-3.2	-3.7	-2.3	-6.9	-7.9	-9.4	-12.5	-13.7	-15.1
Income balance	12.6	10.3	7.9	8.7	8.9	9.7	11.3	9.3	9.6
o/w outward remittances, % GDP	-8.5	-7.0	-11.0	-10.0	-8.3	8.6	7.9	7.3	7.4
FDI, net	-9.5	-8.4	-7.4	-1.1	-7.7	-5.0	-6.1	-5.5	-5.1
Public Finances, % of GDP									
Government revenues	55.3	64.5	58.3	66.2	68.4	72.3	66.3	68.1	64.1
o/w oil revenues	48.3	57.2	47.5	54.7	57.8	60.7	52.9	54.2	53.0
Government expenditure	25.3	28.1	39.3	35.4	28.3	33.0	37.5	35.9	37.6
o/w capital expenditures	1.8	2.3	3.2	3.6	2.8	2.9	3.0	10.0	3.2
Government balance	30.0	36.4	19.0	30.8	40.1	39.4	28.8	32.2	26.5
non-oil balance, % of non-oil GDP	-40.8	-54.1	-59.1	-51.3	-44.9	-57.0	-65.7	-63.0	-72.7
Breakeven oil price (fiscal), US\$/barrel	27.41	36.32	36.99	34.61	29.01	33.07	44.58	43.66	51.31
Public debt	12.4	8.6	12.6	10.9	7.8	5.7	5.1	4.9	5.3
Cumulative government balance since 2000	153.8	190.2	209.2	240.0	280.1	319.5	348.3	380.5	407.0
Net debt (public debt net cumulative balance)	-141.4	-181.6	-196.6	-229.1	-272.3	-313.8	-343.2	-375.6	-401.6
Foreign Assets & Liabilities, USD bn									
External debt	57.6	52.9	45.7	41.1	35.0	33.7	37.1	40.8	44.9
External debt / GDP	51.2	38.7	43.5	34.7	22.9	19.1	19.4	19.4	21.2
External debt / XGS	90.7	63.4	81.7	59.8	34.5	28.2	31.6	30.6	33.5
External Assets	219.1	261.3	321.5	349.8	387.6	453.8	532.6	605.2	690.1

Source: National Sources, Citi Research Estimates

Lebanon

■ Key developments on the month

- Crisis of governance set to continue for foreseeable future;
- Public finances likely to continue slide in the current low-growth environment;
- Banking system remains resilient, and supports sovereign credit.

■ Key macro drivers

- Weak public finances and high government debt supported by local banks;
- Growth driven by real estate, tourism and financial services;
- Political instability remains a key risk.

Summary Analysis

Vacuum in presidency continues

The presidential vacuum continues in Lebanon with no consensus candidate having emerged since the expiry of President Sleiman's term at the end of May. According to the Taif agreement, the country's president must be chosen from the Maronite community. Candidates, who are elected by parliament, must receive the backing of two-thirds of the lawmakers in the first round of voting. Failing that, assuming a quorum of two thirds of parliamentarians is present, the backing of a simple majority would be required in the second round. In April, Samir Geagea, the Lebanese Forces leader and March 14 candidate, failed to attract the requisite level of votes, and no other candidate has been put forward since.

Likely that parliament will be extended yet again in the absence of parliamentary elections

A number of candidates have been mooted, including the serving Governor of the Banque du Liban, Riad Salame, but the prospects of resolving the issue before the autumn appear slim. Indeed, we believe that it is likely, given the current polarized political environment, that the vacuum in the presidential palace could drag on well beyond that time, and that, in all cases, there is a large likelihood that parliamentary elections, due by November, will not be held. In such a scenario, it would be necessary to extend the term of the current parliament once again, perhaps by another 18 months or longer.

Lebanon's crisis of governance will continue for the foreseeable future

The bottom line is that the crisis of governance that is currently gripping Lebanon is likely to drag on for some time. After a new parliament is elected, a new government would have to be formed, which took almost two years last time round. So we could be years away from a government with an electoral mandate. Added to this the likelihood that any eventual government is likely to continue to be crippled by the internal bickering and weaknesses that have characterized recent governments, and the outlook for policy-making in Lebanon seems grim to us.

Lack of policy direction evident in salary scale debate

The lack of direction of policy is evident in the current debate regarding the increase in public salary pay scale. In 2012, an inflation adjustment to public sector salaries was made, contributing to a widening of the fiscal deficit by around 3% of GDP. A further increase in public sector salaries of a similar order of magnitude is currently under discussion by parliament, as are a number of measures on the revenues side that are intended to compensate, including raising taxes of various kinds. While we have no view on the merits of the pay scale increase, other than to note this is the first such increase in over two decades, our concerns are three fold.

Salary scale increase raises concerns regarding fiscal and economic outlook

Firstly, at a time when the fiscal deficit has widened to almost 10% of GDP and the public debt has reversed its falling trend, the timing of a rise in the wage bill appears to us to send a negative message regarding the government's efforts to maintain fiscal discipline. Second, revenues raising measures such as

tax increases risk applying the brakes on an economy which is barely growing, hit by various internal and external shocks in recent years. Finally, the willingness of the government to contemplate structural reforms in parallel to the salary pay increase is virtually non-existent, reflecting the weak policy-making environment described above. Hence, all discussion of public sector reform, including the civil service, the burdensome Electricite du Liban and privatization, to name a few, is currently not taking place and is unlikely to do so in the current political climate. In our view, it follows that Lebanon's structural weaknesses are unlikely to be resolved any time for the foreseeable future.

Lack of structural reform mean debt dynamics can only improve with growth

The lack of structural reform means that Lebanon's fiscal dynamics remain hostage to the country's growth prospects. Until recently, debt to GDP had been on the decline as the fiscal deficit (and government borrowing) increased at a rate slower than GDP. Indeed between 2007 and 2010, real GDP growth average over 9% per annum, with nominal GDP over 16%. In the past four years, by contrast, real GDP growth has registered under 2% per annum. Combined with the fiscal slippage that began in 2012, the effect has been a steady rise in the debt to GDP ratio. To reverse this, in the absence of structural reforms, GDP growth has to revert to pre-2011 levels which, in the current political and security environment both domestically and regionally, would appear very difficult to achieve.

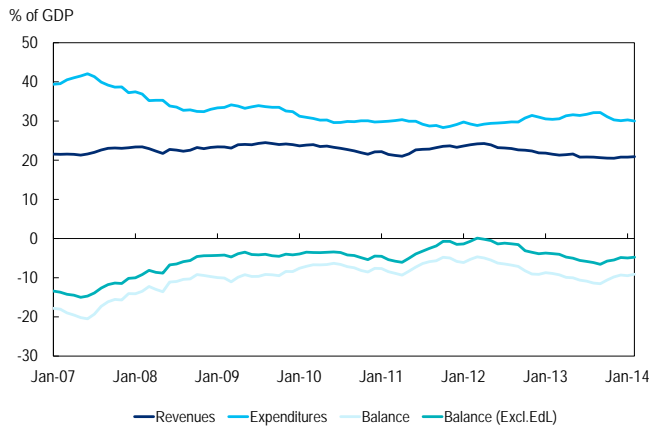
Domestic security concerns have risen with spate of suicide bombings

Indeed, domestic security concerns have heightened in recent weeks as international terrorism appears to be on the rise in Lebanon. In June there were two suicide attacks perpetrated by foreign nationals, allegedly part of a wider network related to Sunni militants in Syria (including ISIS), one of which occurred in the heart of Beirut. These attacks follow a similar pattern of attacks that took place late last year targeting Shia interests in the country, including the bombing of the Iranian embassy in November. Such attacks are markedly different to the kind of political violence and assassinations to which many Lebanese have become almost inured to over the past decade, and the impact on confidence and the economy is likely to be significant, in our view.

Despite all this, we remain bullish on the sovereign given the resilience of the banking sector

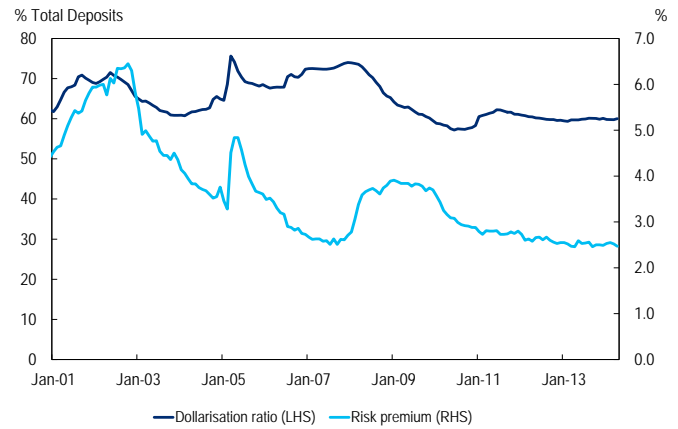
While the fiscal, economic and political picture look difficult, our view remains that the slide in country risk does not necessarily signal a slide in sovereign risk. This is because we believe the stability of the sovereign risk profile rests on the robustness of the Lebanese banking sector and its ability to continue funding the government. Banking sector indicators remain robust. Overall deposit growth was 7% yoy in February, with non-resident deposit growth remaining in the double digits (11%). The dollarisation ratio remained stable at under 60%, and the risk premium on Lebanese Lira deposits has likewise hardly moved in recent months. In our view, the banking sector remains sound and liquid and retains significant capacity to continue financing the Lebanese sovereign through the purchase of government securities. This keeps sovereign risk in check, despite an evidently deteriorating country risk profile (see [Lebanon Macro View - The gap widens between country and sovereign risk](#))

Figure 41. Fall in expenditures, rise in revenues, narrowing the deficit



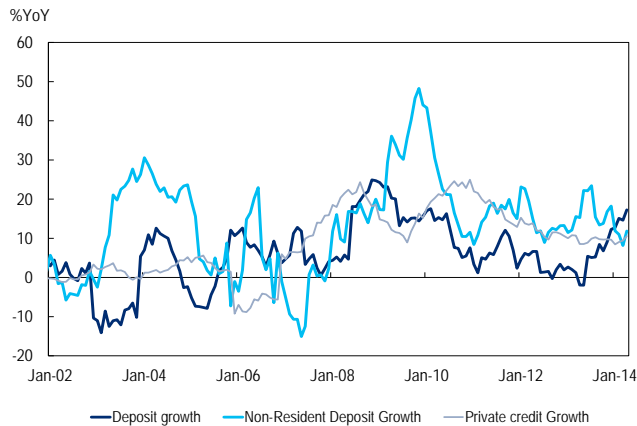
Source: Haver Analytics, Citi Research

Figure 42. Rise in dollarisation, LBP deposit premium over USD stable



Source: Haver Analytics, Citi Research

Figure 43. Banking growth indicators have eased in recent months



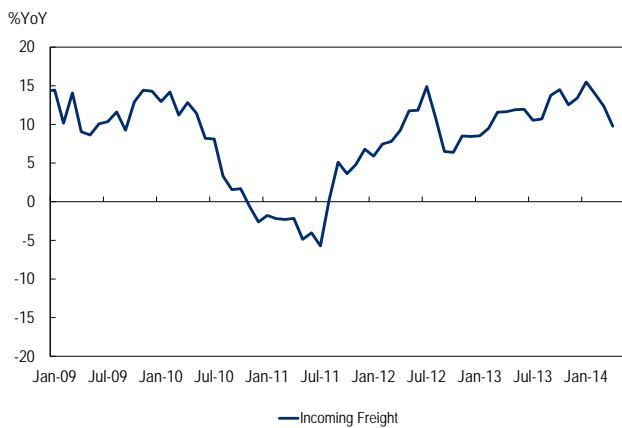
Source: Haver Analytics, Citi Research

Figure 44. Passenger arrivals continue to disappoint



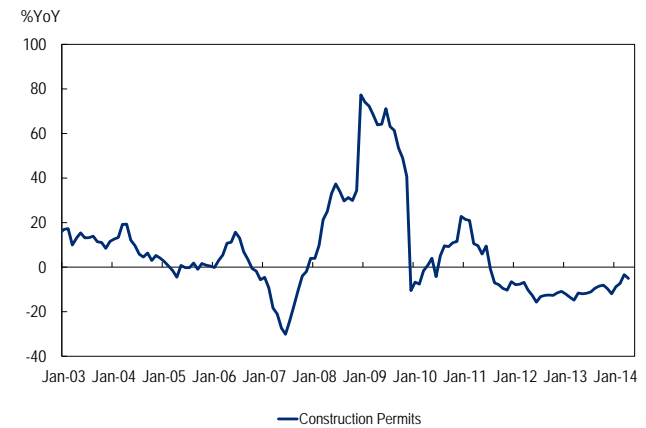
Source: Haver Analytics, Citi Research

Figure 45. Incoming freight volumes have dipped



Source: Haver Analytics, Citi Research

Figure 46. Construction permits (sq. metre) remain weak



Source: Haver Analytics, Citi Research

Figure 47. Lebanon Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	24.6	28.8	35.1	38.0	40.1	43.0	45.3	47.6	50.3
Nominal GDP, local currency bn	37,050	43,465	52,974	57,300	60,419	64,800	68,325	71,816	75,766
GDP per capita, US\$	6,538	7,572	9,111	9,726	10,126	10,647	11,006	11,342	11,731
Population, mn	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.2	4.3
Economic Activity									
Real GDP, % yoy	9.3	9.1	10.3	8.0	2.0	2.5	1.4	1.1	1.5
Real per capita GDP, % yoy	9.3	7.7	8.9	6.6	0.7	0.5	-0.5	-0.9	-0.5
Prices, Money & Credit									
CPI, % yoy	6.0	5.5	3.3	4.7	3.0	10.1	1.1	6.0	5.0
CPI, % avg	4.1	10.8	1.2	4.0	5.0	6.6	2.1	3.5	5.0
Policy interest rate, %, eop	12.00	12.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Credit extension to private sector, % yoy	15.9	18.6	15.2	25.0	12.9	10.6	9.7	20.0	20.0
Credit to private sector, % total deposits	26.1	26.8	25.1	27.9	29.1	29.6	29.8	29.8	29.8
Private sector deposits, % yoy	12.4	14.9	19.5	12.0	6.5	6.8	6.8	20.0	20.0
Bank capital & reserves, % total loans	15.9	15.3	14.9	15.5	16.9	18.3	17.9	19.1	20.2
3 month inter-bank rate, %, eop	-	-	-	-	-	-	-	-	-
LBP/US\$, eop	1,512	1,508	1,503	1,501	1,506	1,504	1,503	1,508	1,508
LBP/US\$, avg	1,512	1,507	1,504	1,502	1,506	1,504	1,507	1,508	1,508
Balance of Payments, USD bn									
Current account	-1.8	-3.2	-4.4	-5.1	-6.3	-6.7	-7.2	-7.5	-7.9
% of GDP	-7.2	-11.1	-12.5	-13.3	-15.7	-15.6	-15.8	-15.8	-15.7
Trade balance	-5.2	-7.3	-7.4	-8.1	-9.2	-9.8	-10.2	-11.5	-12.8
Exports	2.7	3.5	3.1	3.6	3.6	3.7	3.9	4.1	4.3
Imports	7.9	10.8	10.5	11.8	12.8	13.5	14.2	15.6	17.1
Service balance	2.0	2.7	1.9	1.7	4.8	5.5	6.1	6.7	7.4
Income balance	0.5	0.3	-0.2	-0.3	-0.1	0.2	-0.5	-0.5	-0.5
FDI, net	1.9	3.3	3.7	3.8	2.7	3.1	2.8	2.5	2.3
Public Finances, % of GDP									
Government revenues	23.6	24.3	24.0	22.1	23.3	21.9	20.8	20.8	20.7
Government expenditure	34.0	34.4	32.4	29.8	29.1	31.0	30.1	30.6	31.1
<i>o/w capital expenditures</i>	1.5	1.2	1.0	1.2	1.1	1.1	1.1	1.1	1.1
Government balance	-10.4	-10.1	-8.4	-7.6	-5.8	-9.1	-9.3	-9.9	-10.4
Public debt	171.0	163.2	145.6	138.4	133.9	134.2	140.1	143.1	146.1
Government's deposits with banks	42.2	43.0	50.2	52.3	58.0	62.2	69.4	72.6	75.7
<i>Net debt (public debt net cumulative balance)</i>	128.9	120.2	95.4	86.1	75.9	72.0	70.7	70.5	70.4
Foreign Assets & Liabilities, USD bn									
External debt	28.8	30.2	35.6	37.3	40.6	45.3	47.6	50.0	52.5
External debt / GDP	117.1	104.7	101.3	98.0	101.2	105.5	105.0	104.9	104.4
External debt / XGS	254.8	199.5	248.4	261.4	249.0	267.7	258.1	248.8	239.7
External Assets	-48.4	-50.2	-53.4	-57.8	-64.1	-70.8	-78.0	-85.5	-93.4

Source: National Sources, Citi Research Estimates

Oman

■ Key developments on the month

- Oman signs preliminary gas deal with Iran;
- Fiscal trajectory remains a concern, we expect debt issuance in coming months;
- Tourism sector picking up.

■ Key macro drivers

- Demographic imbalance fuelling political uncertainty;
- Public finances weaker than most GCC peers;
- Potential economic growth constrained by energy supply shortage.

Summary Analysis

Oman-Iran ink preliminary gas deal

After years of discussion, Oman and Iran have signed a preliminary deal to build a natural gas pipeline through which Iran will provide the sultanate with 1 billion of cubic feet (bcf) of gas per day. This should potentially ease one of Oman's most significant constraints on growth (see below). That said, the viability of the deal actually being implemented depends largely on the success of ongoing P5+1 talks with Iran, as the current sanctions on Iran preclude the necessary international contractors and financial institutions from bringing the project to life. The deal was signed during a recent visit by Iranian President Rouhani to Oman.

Significant erosion in public finances is likely

Official statistics show that Oman's budget closed 2013 in a modest surplus position of 1.2% of GDP. This outperformance relative to our forecast (we had previously anticipated a small deficit of 0.2%) was down mainly to lower government expenditure than expected. As a result, we reduce our deficit forecast for next year from 3.4% of GDP to 1.5%, but continue to stress our concerns regarding the sultanate's fiscal trajectory. The rate of expenditure growth in recent years has been concerning, particularly current expenditures (mainly wages and subsidies) which have risen by 122% in the two years between 2010 and 2012. We believe this rate of growth is unsustainable and has already increased Oman's fiscal vulnerabilities substantially as the breakeven oil price has crept up to US\$113 per barrel this year, from US\$70 in 2010.

Limited financing options may force action on public finances

Oman's financing options are fairly limited. Its fiscal reserves are probably insufficient to finance the growing deficits in the medium term. Its low debt to GDP level means it has some headroom to borrow in international markets, but we expect financing conditions for emerging markets to tighten next year as Fed tapering kicks in. Ultimately, we think Oman has little option but to carry out reforms of its public finances. On the expenditure side, this would mean rationalisation of the burgeoning wage and subsidy bills. On the revenue side, this would mean diversifying into non-oil sources of income, notably taxes. The net impact of these measures is likely to be negative for the public, with a higher tax burden and slowing economy, and could well spark some measure of social unrest, although the popularity of Sultan Qaboos is widely perceived to be strong.

Signs that such action is imminent

There are signs that Oman is already considering such measures. The Shura council recently recommended that the government consider imposing taxes on natural gas and on foreign workers' remittances to bolster public finances. Finance Minister Darwish al Balushi told the Shura council that such measures would be considered, and that options also included borrowing, drawing down reserves or cutting expenditure (Reuters, 30 November).

**High likelihood of debt issuance
in coming months**

We therefore believe that it is increasingly likely that Oman could issue commercial debt in capital markets in the coming months, and that its financing gap will likely make it a regular issuer in the market.

**Meanwhile, the tourism industry remains
largely unaffected by the unrest**

After the typical lull in hotel activity in July and August, we have seen occupancy rates move back up to more normal levels. Ramadan falling in July/August also probably exerted downward pressure on occupancy levels during the summer months. With occupancy and room rates hitting or close to historical highs, tourism appears to be in rude health. Tourism remains one of Oman's key diversification sectors, given that it is relatively labour-intensive and thus provides for greater job opportunities than more capital-intensive sectors.

**Credit expansion gradually building
momentum**

Credit growth remains relatively robust, averaging close to 10% over the past year. Indeed, the Omani banking sector is a bright spot in the economy, with revenues growth in double digits and net profits in a number of local banks surging.

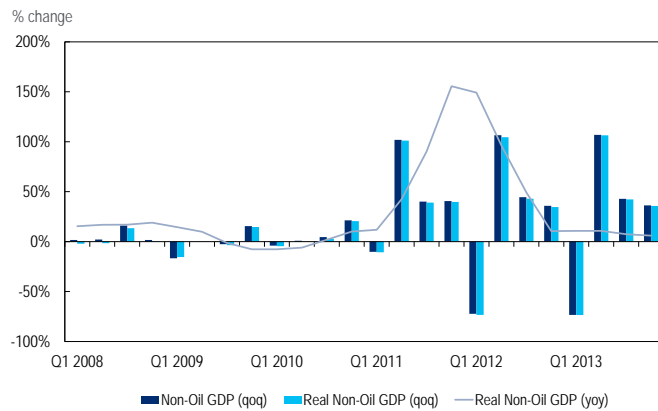
Inflation remains well contained

Inflation rose to 1.6%YoY in April, double the reported number for March. This was due to the contribution of significant inflationary impulses from Furnishings, Household Equipment & Routine Household Maintenance (+0.2%pt) and Communication (+0.3%pt). At the same time, Food, Transport and Health costs (all +1%pt) helped push the headline rate up. In spite of this, inflation is still well below the historical average. In particular, food prices have been subdued with much of the easing in the headline rate over the last month down the prices of food and non-alcoholic beverages. And after the price-driven unrest in 2011, it may be some relief inflation has not shown the dynamism of previous years. At the same time while food prices have not moved out of a relatively tight range since 2011, policy makers are likely to keep a close eye on developments in this space. It was also announced on 25 June that the decision to scrap price controls of most products was going to be suspended due to public unhappiness at the move. The original announcement did not change our view that 2014 and 2015 inflation would come in at 1.5% and 3%, respectively (2013: 2.1%), so our view remains unchanged. However, liberalizing prices would allow a more market based economy to thrive.

**Reducing reliance on foreign labour
is not without risks**

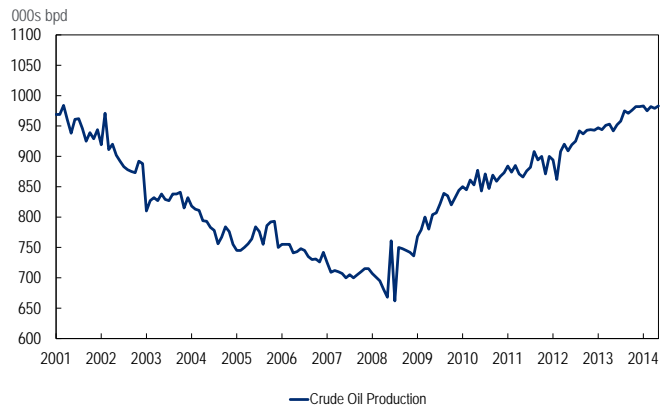
With the goal to reduce its reliance on foreign labour, Oman has announced that from 1 July it will enforce a ban on expatriates who look to switch jobs within two years of starting the job for which they attained their visa. It is reported that expatriates in the private sector make up close 40% of the total workforce; the aim to bring it to 33%. The aim is to raise the proportion of locals in the private sector while also raising productivity given the likely shortfall in labour. At the same time, a tighter labour market could negatively affect economic growth and increase price pressures.

Figure 48. Quarterly data shows drop in non-oil GDP



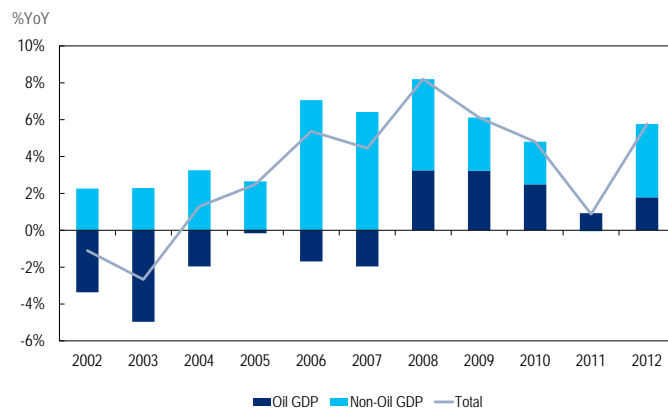
Source: Haver Analytics, Citi Research

Figure 49. Oil production continues to pick up



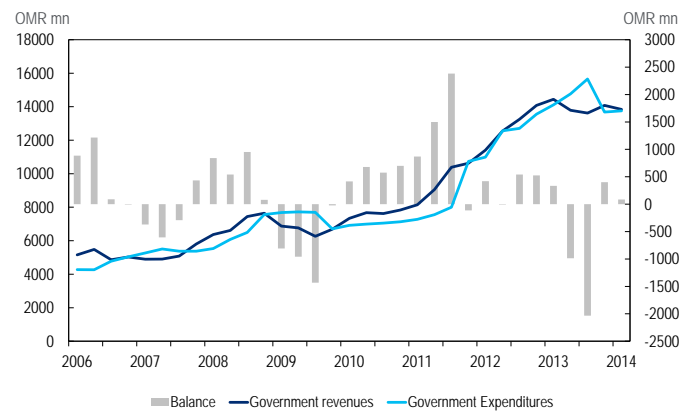
Source: Bloomberg

Figure 50. Non-oil GDP remains the engine for growth in Oman



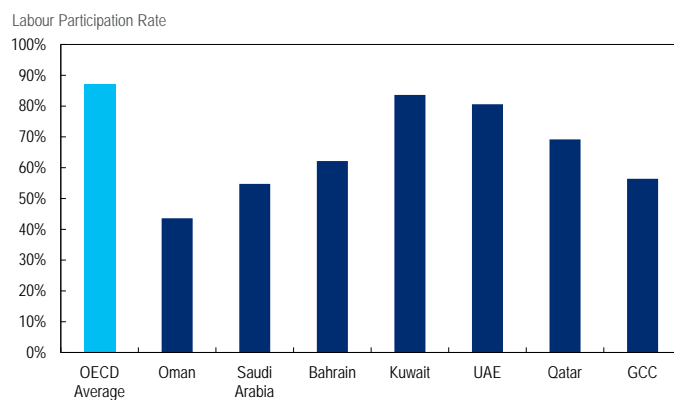
Source: Haver Analytics, Citi Research

Figure 51. Sharp rise in expenditures hurts government balance



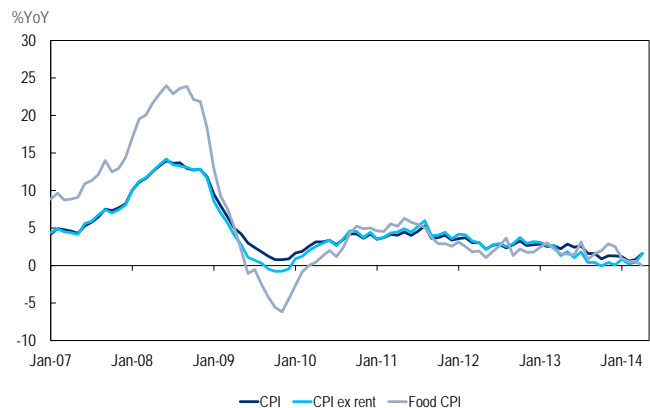
Source: Haver Analytics, Citi Research

Figure 52. Job participation lowest in GCC



Source: OECD, national statistics bureaus, Citi Research

Figure 53. Inflationary pressures remain subdued



Source: Haver Analytics, Citi Research

Figure 54. Oman Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	42.0	59.9	53.4	53.4	53.4	53.4	84.3	89.8	94.8
Nominal GDP, local currency bn	16.2	23.4	18.6	22.5	26.7	29.8	32.4	34.6	36.5
GDP per capita, US\$	15,326	20,887	18,015	17,438	16,881	16,180	24,363	24,858	25,097
Share of oil in GDP (real)	45.8	45.4	45.8	46.1	46.6	45.7	44.7	44.0	43.2
Average oil production (mbpd)	0.71	0.72	0.81	0.86	0.88	0.92	0.95	0.98	1.01
Population, mn	2.7	2.9	3.0	3.1	3.2	3.3	3.5	3.6	3.8
Economic Activity									
Real GDP, % yoy	4.5	8.2	6.1	4.8	0.9	5.8	3.4	4.7	4.7
Real per capita GDP, % yoy	-2.7	3.4	2.7	1.4	-2.3	1.4	-1.3	0.2	0.1
Real non-oil GDP, % yoy	9.2	9.1	5.3	4.3	-0.1	7.4	5.5	6.0	6.0
Prices, Money & Credit									
CPI, % yoy	8.2	11.8	0.9	4.2	3.4	2.8	1.3	2.0	3.0
CPI, % avg	5.9	12.5	3.6	3.2	4.0	2.9	2.1	1.5	3.0
Policy interest rate, %, eop	6.02	1.97	2.00	2.00	2.00	1.00	1.00	2.00	2.25
Credit extension to private sector, % yoy	38.8	40.5	5.0	6.2	13.0	14.9	6.8	10.0	10.0
Credit to private sector, % total deposits	94.0	98.8	98.0	90.9	85.9	87.6	85.1	81.4	77.9
Private sector deposits, % yoy	37.4	20.1	2.6	10.6	11.0	12.3	9.3	15.0	15.0
Bank capital & reserves, % total loans	22.4	19.5	19.4	19.7	18.4	18.9	19.9	20.0	20.0
3 month inter-bank rate, %, eop	-	-	-	-	-	-	-	-	-
OMR/US\$, eop	0.38	0.39	0.38	0.39	0.39	0.39	0.39	0.39	0.39
OMR/US\$, avg	0.38	0.38	0.38	0.38	0.39	0.39	0.38	0.39	0.39
Balance of Payments, USD bn									
Current account	2.5	5.0	-0.5	5.0	9.0	8.1	9.1	7.7	6.3
% of GDP	5.8	8.4	-0.9	9.4	16.8	15.2	10.8	8.5	6.6
Trade balance	10.3	17.0	11.6	18.7	25.6	26.5	23.6	22.7	21.9
Exports	24.7	37.7	27.6	36.6	47.0	52.1	53.0	56.6	60.8
o/w oil, % total exports	63.4	65.0	56.2	60.6	62.7	61.6	60.4	57.3	52.4
Imports	14.3	20.7	16.0	17.9	21.5	25.6	29.4	33.8	38.9
Service balance	-3.4	-4.0	-3.9	-4.4	-5.3	-5.8	-4.7	-4.8	-5.0
Income balance	-0.8	-2.8	-2.9	-3.6	-4.1	-4.5	-3.6	-3.7	-3.9
o/w outward remittances, % GDP	8.7	8.6	9.9	10.7	13.5	15.1	9.8	9.4	9.0
FDI, net	3.4	2.4	1.4	-0.3	-0.5	0.1	0.6	0.3	0.1
Public Finances, % of GDP									
Government revenues	35.9	32.6	35.9	34.7	39.7	45.2	43.4	41.4	38.9
o/w oil revenues	27.4	25.6	28.0	28.4	33.6	38.3	37.7	35.8	33.3
Government expenditure	33.2	32.3	36.1	31.6	40.2	45.5	33.5	33.1	32.9
o/w capital expenditures	9.5	9.7	12.7	10.8	11.1	9.7	8.7	9.0	9.4
Government balance	2.7	0.3	-0.1	3.1	-0.4	-0.3	9.9	8.4	6.1
non-oil balance, % of non-oil GDP	-43.1	-50.2	-45.0	-45.1	-63.4	-71.8	-52.4	-49.5	-46.7
Breakeven oil price (fiscal), US\$/barrel	65.22	98.33	62.77	71.52	112.30	113.80	80.87	82.40	83.88
Public debt	6.8	5.4	6.1	7.2	8.8	10.6	7.1	7.4	7.0
Cumulative government balance since 2000	12.8	13.2	13.0	16.1	15.7	15.5	25.3	33.7	39.7
Net debt (public debt net cumulative balance)	-6.0	-7.8	-7.0	-9.0	-7.0	-4.8	-18.2	-26.3	-32.7
Foreign Assets & Liabilities, USD bn									
External debt	10.1	13.3	12.7	11.5	13.7	15.3	13.9	14.1	14.1
External debt / GDP	24.0	22.1	23.7	21.6	25.7	28.6	16.4	15.6	14.8
External debt / XGS	38.3	33.6	43.4	29.9	27.7	27.8	26.1	24.8	23.1
External Assets	17.0	22.0	21.4	27.2	36.2	44.3	53.4	61.0	67.3

Source: National Sources, Citi Research Estimates

Qatar

■ Key developments on the month

- Growth comes in at 6.5% in 2013, slightly higher than our expectations;
- Diplomatic spat resolved in new GCC accord;
- Plans to reduce number of World Cup 2022 stadia will not affect overall investment drive.

■ Key macro drivers

- Strong government expenditure to drive growth in the medium term;
- Risk of misallocation of capital in aggressive project pipeline;
- Proactive and wealthy government mitigates risks.

Summary Analysis

World Cup controversy unlikely to have significant impact on Qatari economy either way

In recent weeks, Qatar's hosting of the World Cup in 2022 has been questioned after increasing calls for FIFA to re-hold the vote, following press revelations of alleged irregularities in the bidding process and concerns regarding possible corruption among FIFA officials. The Qatari authorities have robustly rejected the claims, and have unveiled the plans for the second World Cup stadium, construction of which will begin shortly. We do not have a view on the possibility of the tournament being awarded elsewhere. However, if this were to happen, we believe any impact on the Qatari economy would be limited. In the near term, construction activity may experience some decline as ongoing projects are potentially curbed. In the longer term, however, we have always been unconvinced about the economic benefits to Qatar of hosting the World Cup. Were it awarded elsewhere, we consider the long-term loss to the economy to be limited, with the potential upside that capital that would have been allocated to World Cup-related projects could be redistributed elsewhere in the economy.

Economy remains resilient on the back of public spending, construction

The economy continued to slow in 4Q13 with growth easing to 5.6%YoY from 6.9% reported in the 3Q. Despite this slowdown, growth for 2013 came in at 6.5%YoY – higher than our expectations (5.9%). As was the case in 2012, the majority of growth in 2013 came from the non-mining and quarrying sectors. On the sectoral breakdown the strongest performances came from Construction, Trade, Restaurants & Hotels and Government Services. There are a significant number of public investment projects underway and in planning (see our latest [MENA Projects Tracker](#)) and this has supported growth in construction. We believe that the construction sector will continue to have a significant influence on headline growth going forward. We think that growth in 2014 and 2015 will be close to 6% while the Ministry of Development Planning and Statistics, believes GDP growth will be 6.3% this year, and 7.8% in 2015.

Credit growth still slowing

Credit growth in Qatar continues to slow down. Total credit growth fell to just 13%YoY in December, from 26% a year earlier. This has been mainly due to a slowdown in lending to the government, which rose by just 9% in December, compared with over 27% a year earlier. Lending to the private sector has remained stable at around 15% for the last five months.

Slowdown in credit growth does not allay all concerns regarding banking sector

Despite the slowdown in lending growth and continued buoyant deposit growth, the loan to deposit ratio remains stubbornly in excess of 100%. Moreover, question marks persist over the quality of the loan growth in the past two years and possible implications for future asset performance. The growth has been fuelled by high levels of government deposits and has been directed mainly at the public sector, making the banking sector a conduit for credit to government institutions. While we have few concerns over the creditworthiness of the

government itself, the extent of leverage in the public sector has consequently risen, and the commercial rationale for many of the infrastructure projects and other investments that the bank funds could potentially be financing has, in many cases, yet to be demonstrated, in our view. Moreover, the rising share of consumer and real estate lending, with stagnant corporate lending, is also a cause for concern. First, it highlights the limited role the private sector plays in the economy. Second, the rise in personal and real estate borrowing also speaks to a relatively high credit risk profile in private sector lending, and is potentially fuelling some of the imbalances in the Qatari economy.

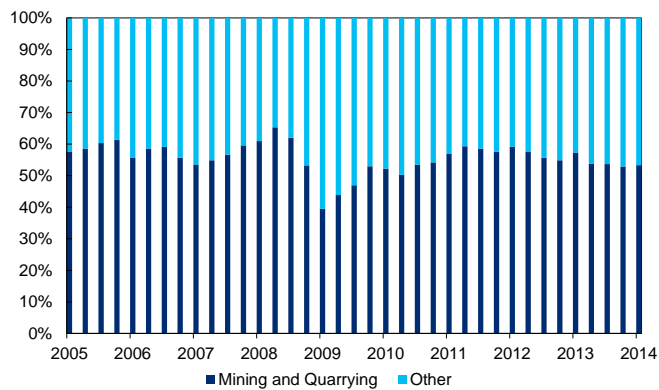
Inflationary pressures from housing market are becoming more apparent

Inflation remains subdued, but we see pressures building, particularly from the real estate market. Inflation jumped in May to 3.4%YoY from 2.8% in April. The main inflationary impulses came from Rent, Fuel & Energy as well as Transport and Communications costs. Since the beginning of 2009, property prices and rents had been on a steady decline, keeping overall inflation subdued, and sometimes even negative. For almost two years, however, rent inflation has registered in positive territory on a YoY basis. In May, Rent, Fuel and Energy prices rose 7%YoY from 6.3%, continuing the rising trend since it hit an apparent trough in January 2014 at 4.8%. While we continue to see fundamental weakness in the real estate market emanating from a large supply overhang which will likely be exacerbated with the completion of further ambitious projects, prices have recovered in the past year, owing mainly to the surge in the Dubai property market, in our view, which acts as a weathervane for property investor sentiment in the region. We expect prices to continue to rise over a one- to two-year horizon, putting further upward pressure on CPI inflation going forward. Our expectation is that 2014 inflation will come in at 3%, close to the 3.1% reported in 2013. We are pretty much in agreement with the Qatari authorities who are looking for 3% in 2014 and 3.4% in 2015 (Citi: 3.5%)

Housing sector should get support from World Cup; plans to reduce number of World Cup stadia should not affect overall project pipeline significantly

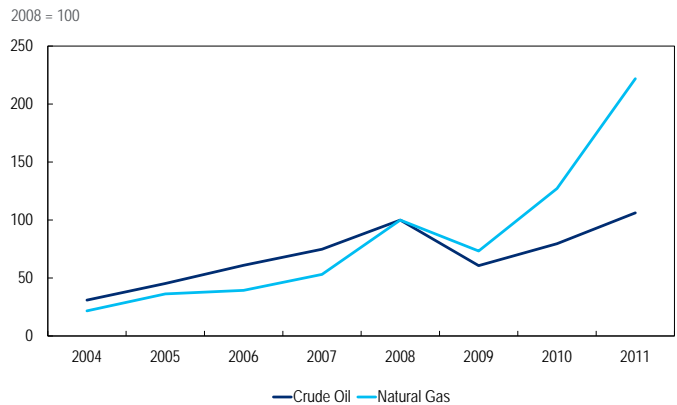
We believe the housing sector will get a boost from the substantial infrastructure spend that is underway in Qatar ahead of the 2022 World Cup. Recently announced plans to reduce the number of World Cup stadia being built from 12 to eight will not affect overall investments significantly, in our view, which include a wide array of infrastructure projects. Moreover, insofar as property prices are correlated in the region, particularly in the Emirate states of the eastern peninsula (UAE, Qatar and Bahrain), we expect to see some support from developments in the Dubai property sector. That said, we believe overall pricing should remain soft due to the substantial supply overhang and risk of further large-scale development completions. This should help contain inflationary pressures for the foreseeable future. As preparations for the World Cup in Brazil have shown, implementation can be a concern. Doha's new Hamid International Airport, was originally slated to soft open in April 2013. It was only in January 2014 that cargo operations began. While significant resources are being, and will be, deployed to boost Qatar's effort, given the number of infrastructure projects expected to be underway in the run up to 2022, we remain wary of implementation risk.

Figure 55. Natural resources still a major part of activity



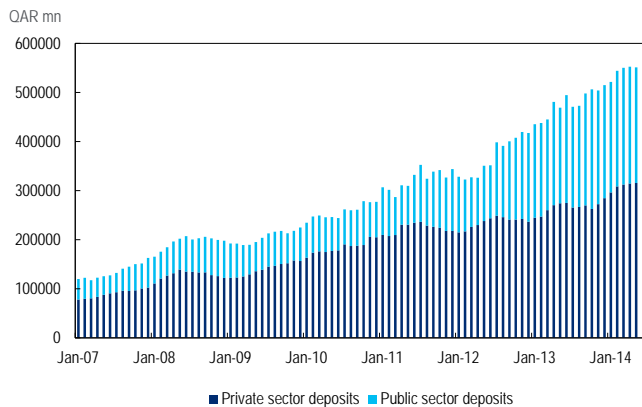
Source: Haver Analytics, Citi Research

Figure 56. But LNG IP surging relative to crude



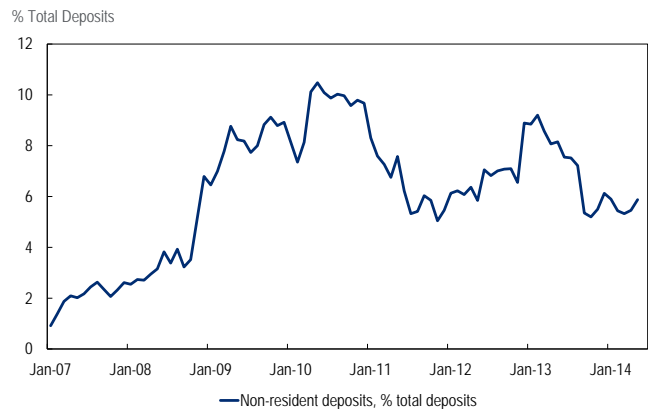
Source: Haver Analytics, Citi Research

Figure 57. Public sector deposits a major source of bank funding



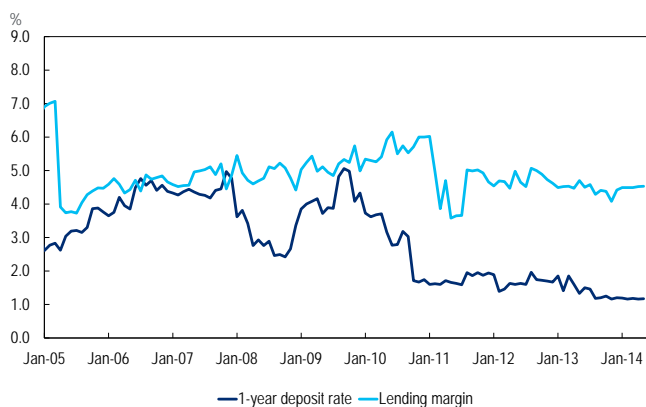
Source: Haver Analytics, Citi Research

Figure 58. Non-resident deposit growth has begun to ease



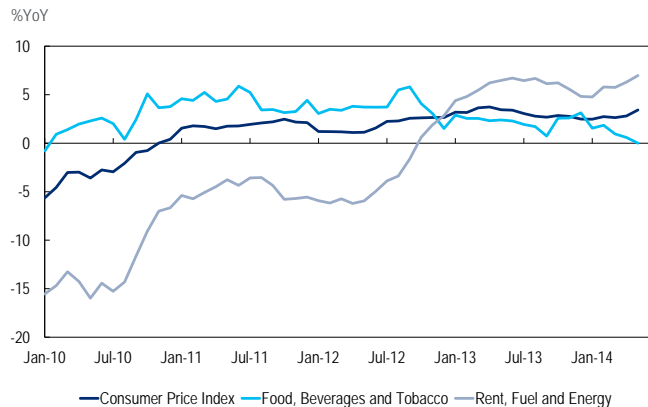
Source: Haver Analytics, Citi Research

Figure 59. Lending margins have stabilised



Source: Haver Analytics, Citi Research

Figure 60. Rising rent continues to put pressure on CPI



Source: Haver Analytics, Citi Research

Figure 61. Qatar Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	79.7	115.3	97.8	125.1	171.5	192.4	202.5	216.1	231.1
Nominal GDP, local currency bn	290.2	419.6	356.0	455.4	618.1	691.4	736.9	786.8	841.4
GDP per capita, US\$	85,712	104,982	80,294	92,546	114,241	118,688	115,635	114,314	113,188
Share of oil in GDP (real)	44.7	43.0	40.2	44.4	45.5	43.3	40.7	38.4	36.2
Average oil production (mbpd)	-	-	-	-	-	-	-	-	-
Population, mn	0.9	1.1	1.2	1.4	1.5	1.6	1.8	1.9	2.0
Economic Activity									
Real GDP, % yoy	18.0	17.7	12.0	16.7	13.0	6.2	6.5	5.9	6.2
Real per capita GDP, % yoy	6.3	-0.3	0.9	5.2	1.7	-1.7	-1.4	-1.9	-1.7
Real non-oil GDP, % yoy	21.6	21.3	17.6	8.6	10.8	10.3	11.4	10.0	10.0
Prices, Money & Credit									
CPI, % yoy	13.7	13.2	-10.0	-0.1	2.2	2.6	2.7	3.0	4.0
CPI, % avg	13.6	15.2	-4.9	-2.4	1.9	1.9	3.1	3.0	3.5
Policy interest rate, %, eop	5.55	5.55	5.55	5.55	4.50	4.50	4.50	4.50	4.75
Credit extension to private sector, % yoy	-	45.1	10.8	7.6	19.2	13.5	13.5	15.0	15.0
Credit to private sector, % total deposits	66.0	75.4	71.9	62.2	62.6	56.4	53.5	49.2	45.3
Private sector deposits, % yoy	-	19.1	28.2	30.9	6.3	8.6	20.3	25.0	25.0
Bank capital & reserves, % total loans	-	96.2	98.0	104.4	96.5	96.1	102.9	105.6	112.5
3 month inter-bank rate, %, eop	5.75	2.83	2.25	1.56	1.50	1.05	1.05	1.05	1.05
QAR/US\$, eop	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64
QAR/US\$, avg	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64
Balance of Payments, USD bn									
Current account	11.5	26.6	6.4	24.0	52.0	62.0	62.6	63.5	58.0
% of GDP	14.4	23.1	6.5	19.1	30.3	32.2	30.9	29.4	25.1
Trade balance	23.3	42.2	25.6	54.0	87.4	102.2	105.5	105.1	103.2
Exports	44.5	67.3	48.0	75.0	114.3	133.0	136.9	144.5	152.4
o/w oil, % total exports	86.4	88.2	85.7	82.4	85.3	82.2	77.9	72.7	66.4
Imports	21.1	25.1	22.5	20.9	26.9	30.8	31.5	39.3	49.2
Service balance	-3.9	-3.8	-3.9	-5.8	-9.5	-14.0	-16.3	-17.9	-19.7
Income balance	-4.2	-6.8	-9.4	-12.9	-13.3	-12.1	-11.3	-11.9	-12.5
o/w outward remittances, % GDP	5.6	4.7	7.3	6.5	6.0	5.3	5.5	5.9	6.4
FDI, net	-	-	-	-	-5.9	-2.2	-7.2	-7.9	-8.7
Public Finances, % of GDP									
Government revenues	40.6	33.6	47.5	34.3	36.0	40.5	39.6	39.1	38.3
o/w oil revenues	24.4	19.1	23.3	21.3	25.1	25.1	23.0	21.2	19.1
Government expenditure	29.7	23.8	34.2	31.6	28.2	28.5	31.4	34.9	37.1
o/w capital expenditures	11.7	8.0	11.0	9.7	8.2	7.4	7.2	7.5	7.7
Government balance	10.9	9.8	13.4	2.7	7.8	11.9	8.2	4.2	1.2
non-oil balance, % of non-oil GDP	-27.9	-20.6	-17.9	-39.3	-41.4	-30.4	-32.5	-34.2	-32.7
Public debt	14.3	30.5	40.8	45.6	40.3	36.6	31.6	30.5	30.0
Cumulative government balance since 2000	68.2	78.0	91.4	94.1	101.9	113.8	122.0	126.2	127.3
Net debt (public debt net cumulative balance)	-53.9	-47.5	-50.6	-48.4	-61.6	-77.3	-90.4	-95.7	-97.4
Foreign Assets & Liabilities, USD bn									
External debt	59.2	81.2	110.4	151.0	182.2	231.7	236.0	230.4	226.9
External debt / GDP	74.3	70.5	112.9	120.7	106.3	120.4	116.6	106.6	98.2
External debt / XGS	123.2	114.8	220.8	193.7	149.7	162.1	159.4	159.4	148.9
External Assets	44.2	70.8	77.2	101.0	153.0	215.3	277.9	341.4	399.3

Source: National Sources, Citi Research Estimates

Saudi Arabia

■ Key developments on the month

- ISIS advance shifts focus to Saudi reserves;
- Fundamentals should remain positive, but longer-term concerns emerge;
- Concerns arise regarding success of Nitiqat.

■ Key macro drivers

- Government expenditure remains key economic driver;
- Demographic imbalance necessitates push on labour reform;
- Mortgage law expected to unleash pent-up demand in housing and beyond.

Summary Analysis

Saudi crude production falls, but supported by exports to the US, despite surging US domestic production

As the advance of ISIS in Iraq poses a theoretical (but small) risk of disruption in global oil supplies, the focus has turned on Saudi Arabia's ability to make up any potential shortfall in Iraqi exports. Saudi oil production has been in the 9.6mbpd-10mbpd range since mid-2013, while capacity remains at around 12.5 mbpd. The Kingdom has never pumped more than 10mbpd on a sustained basis, and the ease with which it can cover any Iraqi crude losses is thus uncertain. That said, heightened concerns about global supply risks suggest a firm underpinning to Saudi production, in our view, which we believe is likely to be sustained in the near term.

Public finances and external balances will remain comfortable in the near term

Earlier this year, we raised our expected average 2014 production for Saudi Arabia from 9.2mbpd to 9.5mbpd (on par with 2013) as a result. We expect public finances and external balances to remain robust in the near term, with a likely current account surplus of 14.8% this year, real GDP growth of 4.8%, and a fiscal surplus of 6.2%. That said, we think rising expenditures and an expected levelling off in oil revenues and production present a challenge in the medium- to long-term. We forecast the fiscal breakeven oil price will rise to close to US\$100 per barrel in 2015 and will continue to rise, resulting in forecast deficits as early as 2016. Although Saudi has ample resources to finance expected deficits from current cash reserves, we think the outlook does underscore the need for structural reform to set public finances on a long-term sustainable footing.

Production likely to fall in medium term

That said, we do see downward bias in Saudi production in the medium term. In our view, this bias will reflect a slight softening in oil prices that we forecast, along with increased production elsewhere in the region, most notably Iraq, where we anticipate an increase of around 500kbpd in exports this year. The ongoing talks between the P5+1 and Iran may, in our opinion, result in an easing of some sanctions on oil exports. If this were to happen, it would represent an additional downside risk to Saudi production and our economic forecasts.

The advance of ISIS is causing significant security concerns in Saudi Arabia.

As in Jordan and elsewhere in the region, the advance of ISIS is causing significant security concerns in Saudi Arabia. The fall of Iraqi towns along the Jordanian border has alarmed Saudi authorities, who have an adjacent lengthy border of their own with Iraq. The Saudi army has sent reinforcements to the frontier, which is secured by a high-tech fence. Saudi authorities are also concerned regarding possible agitation of radical elements domestically who may have sympathies with ISIS. The Kingdom has struggled with militant Islamists in the past, most notably Al Qaeda in the Arabian Peninsula, and it is feared that the success of ISIS in Iraq could potentially embolden such elements, who have been subdued in recent years. A number of ISIS fighters have been recruited from across the Muslim world, including Saudi Arabia.

Consumer spending still growing strongly

Available indicators point to a continued surge in consumer spending. Point of sales transaction, for example, reached record levels May, growing almost 15% yoy. We believe this reflects the government's drive to raise domestic standard of living. Shortly after the outbreak of regional unrest, King Abdullah announced a slew of social spending and reforms aimed at increasing Saudi employment and income. These range from wage rises in the public sector to unemployment benefits under the Hafiz programme, all of which are fuelling a rise in consumer spending. Perhaps the most profound reform taking place, however, is that of the Saudi labour market, which, under the guise of the Nitiqat programme, has begun an aggressive programme of Saudisation in the past two years.

Nitiqat reducing illegal immigrants

Since the Nitiqat programme was introduced, two things have happened. First, the drive to register all foreign labour has resulted in the forced exit of over a million illegal immigrants from the kingdom, according to the Labour Minister. This process stepped up a gear after the grace period ended last November, and security forces began a widely reported campaign of rounding up suspected illegal immigrants, in some cases leading to violent confrontations. These aftershocks have led to more undocumented migrants handing themselves in to the authorities for deportation. There are many thousands of immigrants from various countries, including Arab countries such as Egypt and Jordan, awaiting deportation from the kingdom.

...and forcing the hiring of Saudis

The second thing that has happened is that companies operating in Saudi Arabia have upped their hiring of Saudi nationals to avoid fines and sanctions up to and including revocation of licence. According to Labour Minister Adel Fakieh, over 300,000 jobs have become available to Saudi nationals owing to the programme in the past year. The two factors together mean employment among Saudi youth is likely to be rising strongly, bolstering domestic demand.

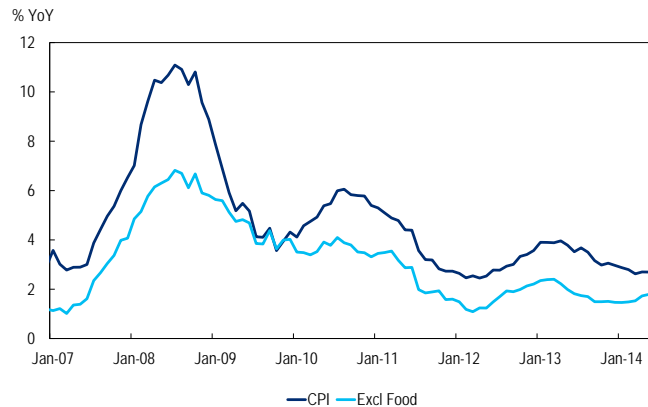
But concerns arise regarding its effectiveness

Despite a reported fall in the number of illegal immigrants and the rise in Saudi hiring, concerns are arising regarding the effectiveness of the Nitiqat programme. Indeed, remittance outflows have continued to grow significantly, suggesting overall employment of non-nationals remains robust. Moreover, widespread reports of systemic abuse, primarily through the hiring of Saudi 'ghost workers', undermine some of the potential benefits of the programme, in our view.

Nitiqat policy necessary, if controversial

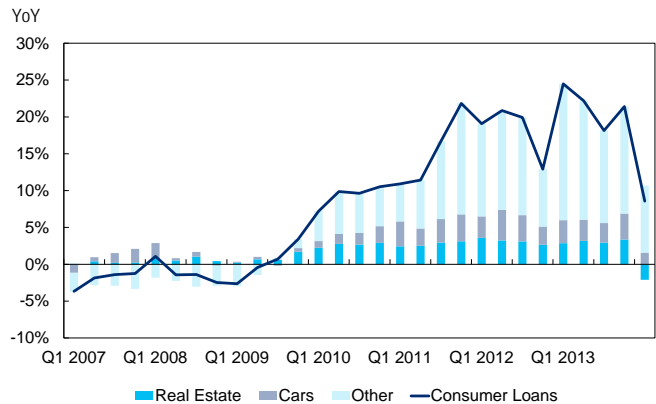
The Nitiqat programme, in our view, is necessary to tackle the question of socio-economic sustainability of growth in Saudi Arabia. The exclusion of Saudis from the workforce is, in our view, unsustainable. To redress this issue, the government has made efforts to raise skill levels, and at the same time, through the Nitiqat programme, is raising the cost of hiring foreign workers and compelling business to hire locally. There is little doubt that this is leading to certain distortions in the economy: the construction sector, for example, has been hard hit as it is difficult to hire Saudis as builders, and other industries will have to pass on the rising labour costs to the consumer. But the intention and effect is to get Saudis into jobs, and failure to achieve this would have far greater negative consequences for socio-economic stability in the future, in our view.

Figure 62. Inflation remains subdued



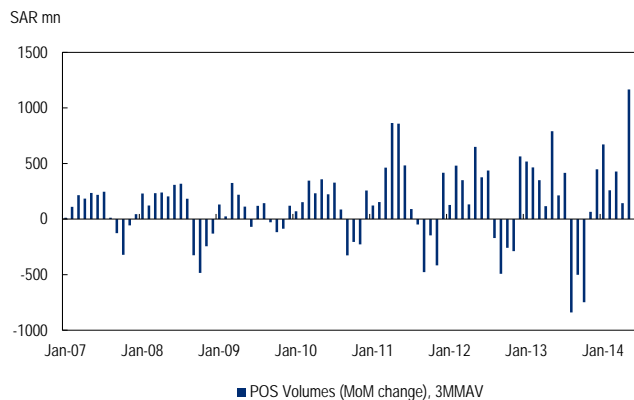
Source: Haver Analytics, Citi Research

Figure 63. Consumer lending growth falls dramatically in 1Q14



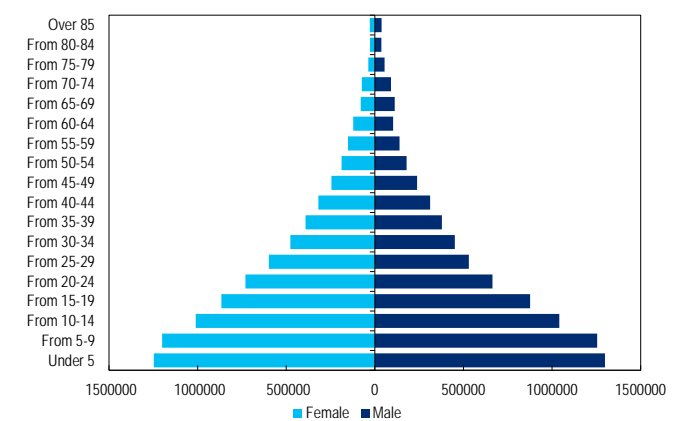
Source: Haver Analytics, Citi Research

Figure 64. Point of sales transactions remain robust



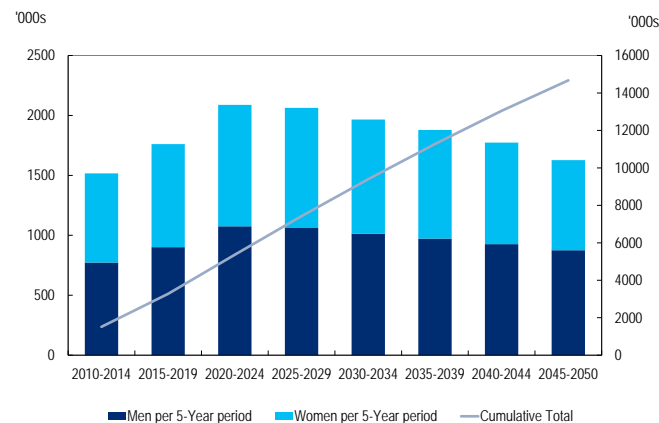
Source: Haver Analytics, Citi Research (3MMA)

Figure 65. Demographic imbalance is acute



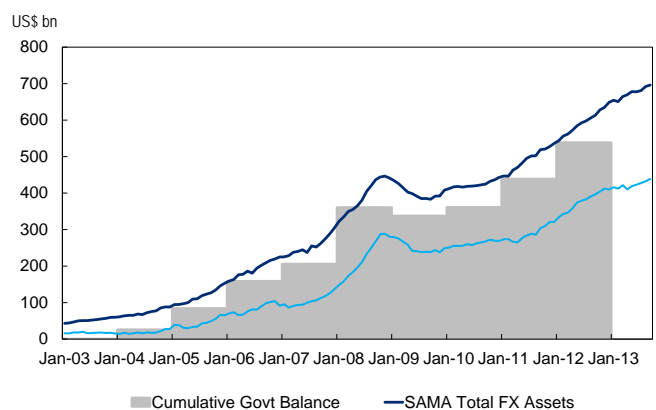
Source: SAMIRAD, Citi Research

Figure 66. Almost 2 million people coming to job market every 5 years



Source: SAMIRAD

Figure 67. Government assets stand at around US\$500bn



Source: Haver Analytics, Citi Research

Figure 68. Saudi Arabia Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	415.6	519.4	429.0	526.8	669.5	733.8	745.2	784.7	827.6
Nominal GDP, local currency bn	1,558.8	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,794.8	2,943.1	3,104.1
GDP per capita, US\$	17,111	20,861	16,811	20,178	25,645	27,559	27,436	28,323	29,287
Share of oil in GDP (real)	25.8	24.8	22.4	21.1	21.6	21.6	20.7	19.7	18.1
Average oil production (mbpd)	8.69	9.21	8.05	8.25	9.24	9.77	9.50	9.50	9.25
Population, mn	24.3	24.9	25.5	26.1	26.1	26.6	27.2	27.7	28.3
Economic Activity									
Real GDP, % yoy	6.0	8.4	1.8	6.4	8.6	5.8	3.8	4.8	5.9
Real per capita GDP, % yoy	3.4	5.8	-0.6	4.0	8.6	3.7	1.8	2.7	3.8
Real non-oil GDP, % yoy	10.0	9.8	5.3	9.6	8.0	5.8	5.0	6.0	8.0
Prices, Money & Credit									
CPI, % yoy	6.5	8.9	4.3	5.4	2.7	3.6	3.0	4.0	4.3
CPI, % avg	4.1	9.9	5.1	5.3	3.9	2.9	3.5	3.5	4.1
Policy interest rate, %, eop	5.50	2.50	2.00	2.00	2.00	2.00	2.00	2.50	2.50
Credit extension to private sector, % yoy	20.6	27.9	-0.6	4.8	11.0	16.4	12.1	15.0	15.0
Credit to private sector, % total deposits	77.7	84.2	75.4	75.4	74.7	76.2	76.8	73.6	70.5
Private sector deposits, % yoy	20.9	16.7	8.4	7.0	16.5	12.2	10.1	20.0	20.0
Bank capital & reserves, % total loans	22.9	21.7	25.8	26.3	25.8	24.3	23.3	23.3	23.3
3 month inter-bank rate, %, eop	4.04	2.51	0.77	0.75	0.78	1.00	0.96	0.96	0.96
SAR/US\$, eop	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
SAR/US\$, avg	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Balance of Payments, USD bn									
Current account	94.3	133.0	21.5	67.4	159.3	165.7	135.3	116.0	73.5
% of GDP	22.7	25.6	5.0	12.8	23.8	22.6	18.2	14.8	8.9
Trade balance	151.6	212.7	105.8	154.3	245.5	247.5	225.3	208.2	173.2
Exports	233.1	313.4	192.2	251.0	364.5	388.2	376.8	382.4	373.6
o/w oil, % total exports	80.8	65.6	146.4	65.1	59.1	81.9	89.6	86.7	82.3
Imports	81.5	100.6	86.4	96.7	119.0	140.7	151.5	174.2	200.3
Service balance	-46.7	-65.9	-65.2	-66.1	-66.5	-62.4	-64.9	-71.4	-78.5
Income balance	6.4	9.2	8.6	7.0	9.7	11.0	10.8	9.4	9.6
o/w outward remittances, % GDP	-3.8	-4.0	-6.0	-5.0	-4.1	-3.9	-4.6	-3.6	-3.5
FDI, net	24.2	43.0	38.6	33.1	19.7	16.6	14.2	15.7	17.2
Public Finances, % of GDP									
Government revenues	42.2	57.5	34.0	39.4	46.1	47.1	40.5	42.5	38.4
o/w oil revenues	36.1	50.4	27.0	33.9	41.2	41.6	38.6	35.9	31.6
Government expenditure	29.9	26.7	37.1	33.1	32.9	31.7	33.1	36.3	37.1
o/w capital expenditures	7.6	6.7	11.2	10.1	11.0	9.5	10.5	11.2	11.6
Government balance	12.2	30.8	-3.0	6.3	13.2	15.4	7.4	6.2	1.3
non-oil balance, % of non-oil GDP	-48.4	-44.3	-51.2	-50.6	-57.8	-53.2	-51.7	-53.2	-49.6
Breakeven oil price (fiscal), US\$/barrel	47.95	38.28	69.50	65.41	75.38	71.12	88.57	88.93	98.42
Public debt	15.1	11.6	10.4	6.9	3.9	3.3	2.9	2.5	2.1
Cumulative government balance since 2000	62.1	92.9	89.9	96.2	109.4	124.8	132.2	138.4	139.7
Net debt (public debt net cumulative balance)	-47.0	-81.4	-79.5	-89.3	-105.5	-121.5	-129.2	-135.9	-137.5
Foreign Assets & Liabilities, USD bn									
External debt	75.8	83.2	89.4	94.1	90.6	88.3	92.5	96.0	101.8
External debt / GDP	18.2	16.0	20.8	17.9	13.5	12.0	12.4	12.2	12.3
External debt / XGS	30.4	25.8	44.3	36.0	24.1	22.1	23.8	25.1	27.2
External Assets	308.7	441.0	462.0	528.7	688.1	853.7	989.1	1,105.1	1,178.6

Source: National Sources, Citi Research Estimates

United Arab Emirates

■ Key developments on the month

- Property market surge draws parallels with previous cycle, but significant differences apparent;
- Mixed signals regarding trajectory of housing market;
- Corporate leverage down, but risks linger;

■ Key macro drivers

- Abu Dhabi fiscal strength supportive of long-term growth;
- Dubai's hub position to drive long-term growth;
- Dubai exposed to turn in global conditions.

Summary Analysis

Property market surge draws parallels with previous cycle

As Dubai's property market booms and large-scale projects are announced, parallels are emerging with the property bubble that affected the emirate six years ago. While we have for some time been highlighting our concerns regarding the sustainability of asset price inflation, we consider that Dubai today is much more resilient to such shocks than it was at the height of the previous cycle in mid-2008, for three main reasons.

We see three differences this time round

First, the banking system is more sound and liquid. In contrast to mid-2008, bank liquidity is less vulnerable to exogenous shocks and is likely to remain supportive of local asset markets. Second, Dubai has made considerable progress on deleveraging and smoothing debt maturities. Refinancing risk among some of Dubai's most significant Government Related Entities (GREs) has been significantly reduced. Finally, rising property prices have not, to date, led to a significant rise in construction and leverage.

But risks still exist

Despite the differences, we also recognise that Dubai is a dynamic and fast-changing economic landscape. Signs may emerge that construction activity is responding to potential speculative demand in the real estate market, and that this is leading to oversupply issues and rising corporate sector leverage. In such circumstances, we believe vulnerability to exogenous shocks is likely to creep back into Dubai's economy.

Mixed signals regarding trajectory of housing market

There are mixed signals regarding the trajectory of house prices and the real estate market at present. Cluttons' data suggest there has been a levelling off in residential prices in 2014, with the international property consultancy arguing that measures taken by the authorities, particularly the cap on mortgage values, have been successful in cooling the market. But data from Jones Lang Lasalle's Q1 Dubai property market report suggests that prices continue their upward trajectory, albeit at a somewhat reduced pace. Either way, rates are up around a third on average across Dubai, with some areas seeing prices in excess of the 2008 peak. The number of announced projects and the sharp rise in land transactions over the past year and during the first quarter (value of transactions rose 57% yoy) suggest to us that the momentum remains driven by strong investor confidence, and we expect further gains in future.

We believe hosting Expo 2020 will provide modest stimulus to the economy

We believe hosting Expo 2020 will provide stimulus to the economy in the construction phase (2015-20) and during the event itself, and could also enhance Dubai's global brand, further reinforcing its strong position as regional hub. That said, we caution against overstating the economic benefits of hosting the Expo. We expect direct expenditure (US\$7bn) on the event to amount to around a relatively modest 1% of GDP per year between now and 2020. This is not very large, and in

the context of the US\$670bn of projects underway in the UAE, is not a significant stimulus in our view. Moreover, the effectiveness of the impact of this expenditure on the local economy is likely to be limited and short-lived, as the majority of contractors and workers preparing and managing the event will be foreign. Moreover, we think the government expenditure directed towards the Expo will need to be diverted, at least in part, from other areas of spending to avoid an excessive build-up of debt. Finally, the legacy economic value of the event is highly uncertain, as the unutilised buildings from the Shanghai World Expo 2010 attest.

Tourism impact will be pronounced

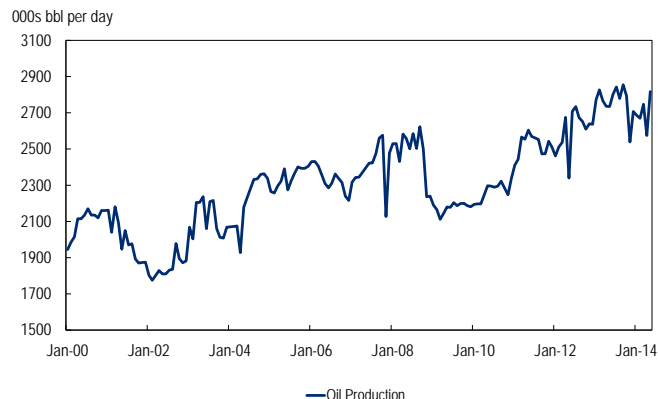
The event will be held during the peak tourism season between October 2020 and April 2021, and the authorities are expecting around 18m foreign visitors.

At the current rate of growth, Dubai's existing tourism infrastructure (including hotels and transportation) will be capable of accommodating this level of visitors, particularly as Abu Dhabi will provide additional capacity. In our view, the visitor numbers will not be a net increase in tourism – much non-Expo related tourism is likely to be squeezed out by the event. Effectively, Expo should mean a bumper tourism season of close to 100% occupancy, but Dubai runs at remarkably high occupancy levels during the peak season anyway, so the overall impact should be somewhat less than the visitor numbers imply. According to data from Ernst & Young, occupancy barely dips below 80% on average throughout the year. There are significant declines to 50-60% occupancy during the hot summer months of July and August, but these are almost immediately followed by strong rebounds back to the 80% territory for the rest of the year. More remarkable is that the average price per room has not only recovered to levels prior to the Arab Spring but is now at an almost five-year high.

Restructurings reduce risks in public sector leverage, but do not eliminate them

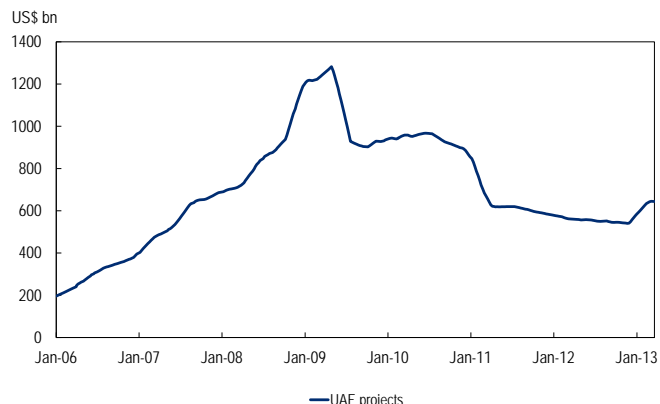
Public sector leverage in the emirate remains high, at over 100% of GDP according to the IMF, but the successful debt restructurings of the past few years have smoothed out the repayment schedules for this debt, which had previously been highly concentrated and short term. While making the debt burden more manageable, this does not, however, remove all refinancing risk in the emirate, in our view. The pushing out of maturities in many instances is designed to afford time for Dubai's holding companies to see a recovery in their underlying asset values. Repayments are to be made using the proceeds of asset sales when this happens. In many cases, these assets are held internationally and/or were purchased at the peak of the global economic cycle in 2006/2007, leaving repayments on Dubai's debt hostage to long-term valuation risk.

Figure 69. Abu Dhabi oil output be volatile in H1 2014



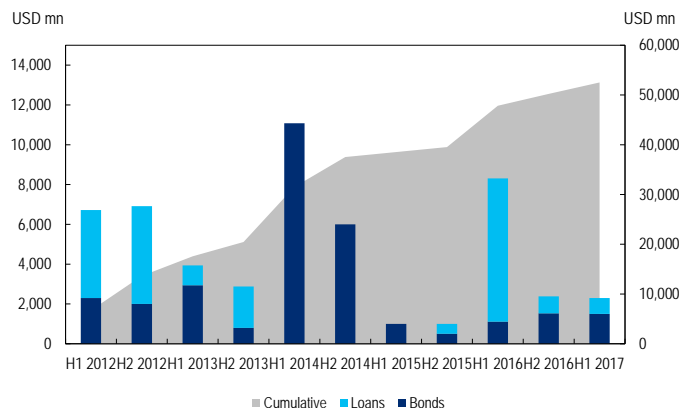
Source: Bloomberg

Figure 70. Value of projects under way has begun to pick up in the UAE



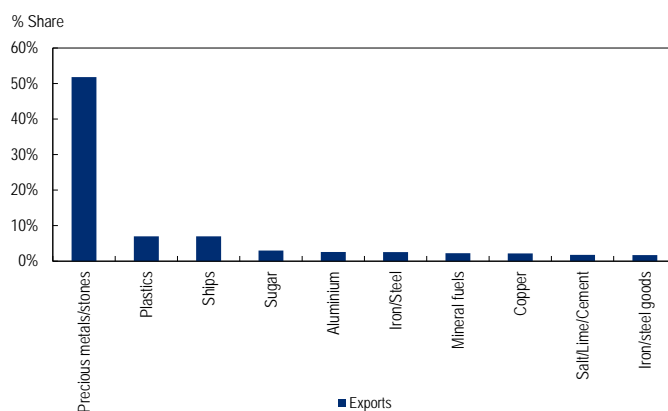
Source: MEED, Citi Research (12-wk moving average)

Figure 71. Dubai's debt refinancing requirements are lumpy



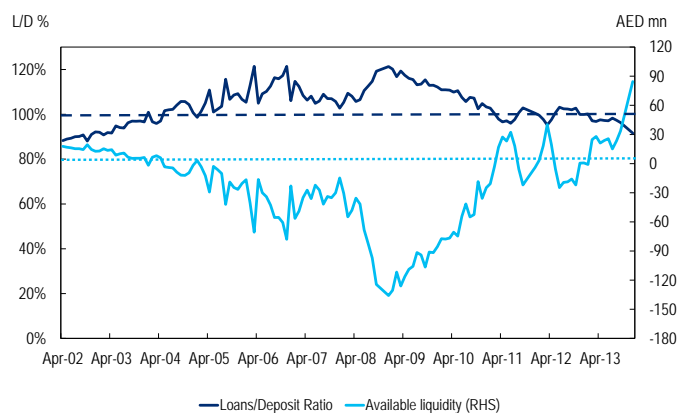
Source: Bloomberg, Dealogic, Citi Research

Figure 72. Gold dominates UAE non-oil exports



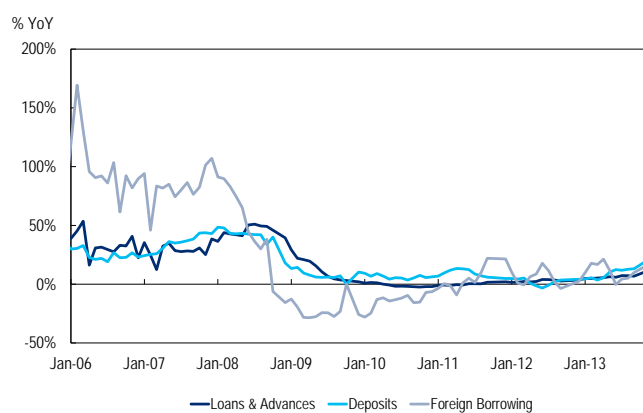
Source: National Bureau of Statistics (2010)

Figure 73. Bank liquidity is much improved, despite a recent fall



Source: Haver Analytics, Citi Research

Figure 74. External leverage has been in decline since 2008



Source: Haver Analytics, Citi Research

Figure 75. United Arab Emirates Economic Indicators (with Abu Dhabi and Dubai)

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
ABU DHABI									
Nominal GDP, US\$ bn	148.5	192.0	145.8	174.3	230.5	247.7	259.5	266.9	272.0
Nominal GDP, local currency bn	545.4	705.2	535.3	640.0	846.7	909.7	953.2	980.1	999.0
GDP per capita, US\$	87,579.3	105,107.0	74,077.5	84,342.9	106,266.6	108,733.4	108,509.7	106,269.3	103,163.4
Share of oil in GDP (real)	56.4	57.0	51.6	51.8	52.9	52.0	50.9	49.6	48.4
Average oil production (mbpd)	2.4	2.5	2.2	2.3	2.5	2.6	2.6	2.6	2.6
Population, mn	1.7	1.8	2.0	2.1	2.2	2.3	2.4	2.5	2.6
Real GDP, % yoy	5.4	6.4	-4.9	6.5	9.3	5.6	4.2	3.7	2.5
Real per capita GDP, % yoy	-2.1	-1.2	-11.7	1.4	4.1	0.6	-0.8	-1.2	-2.4
Real non-oil GDP, % yoy	8.9	4.9	6.9	6.1	6.7	7.7	6.5	6.5	5.0
Government revenues	41.4	47.4	36.4	37.9	40.2	39.5	37.9	37.0	35.8
o/w oil revenues	22.3	17.6	29.2	27.0	23.8	23.5	23.0	23.0	23.2
Government expenditure	22.3	17.6	29.2	27.0	23.8	23.5	23.0	23.0	23.2
o/w capital expenditures	0.9	1.9	5.2	4.2	3.2	3.2	3.2	3.2	3.3
Government balance	19.1	29.8	7.2	10.9	16.4	16.0	14.9	14.0	12.6
non-oil balance, % of non-oil GDP	-26.9	-20.4	-28.1	-30.8	-33.9	-32.7	-29.4	-27.0	-24.7
Breakeven oil price (fiscal), US\$/barrel	27.5	22.0	42.7	47.3	52.0	52.1	51.5	51.4	51.2
DUBAI									
Nominal GDP, US\$ bn	84.1	94.2	79.2	81.6	84.7	89.9	97.0	107.1	113.9
Nominal GDP, local currency bn	308.8	345.8	290.8	299.5	311.2	330.3	356.3	393.2	418.5
GDP per capita, US\$	54,952	57,201	47,170	46,270	45,773	45,161	45,282	46,455	45,948
Share of oil in GDP (real)	1.9	1.9	1.9	1.8	1.6	1.5	1.4	1.4	1.3
Average oil production (mbpd)	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Population, mn	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.3	2.5
Real GDP, % yoy	17.5	3.5	-4.3	2.8	3.0	4.1	4.7	6.1	6.4
Real per capita GDP, % yoy	9.2	-3.8	-6.1	-1.4	-1.9	-3.3	-2.7	-1.4	-1.1
Real non-oil GDP, % yoy	3.6	-4.3	3.7	3.2	4.1	4.8	6.2	6.5	6.5
Government revenues	8.3	9.4	9.8	10.0	10.5	9.2	9.2	9.0	9.1
o/w oil revenues	2.2	2.5	1.6	1.7	1.8	1.1	1.1	1.0	0.9
Government expenditure	8.6	11.0	13.9	11.1	10.8	9.4	9.0	8.7	8.7
o/w capital expenditures	2.9	4.1	4.6	3.0	2.3	1.8	1.6	1.5	1.5
Government balance	-0.3	-1.6	-4.1	-1.1	-0.3	-0.2	0.1	0.3	0.4
non-oil balance, % of non-oil GDP	-2.5	-4.1	-5.8	-2.9	-2.1	-1.2	-1.0	-0.7	-0.4
UNITED ARAB EMIRATES									
Prices, Money & Credit									
CPI, % yoy	11.7	6.6	1.2	0.9	0.8	0.9	1.7	2.0	2.4
CPI, % avg	11.1	12.3	1.6	0.9	0.9	0.7	1.1	2.0	2.4
Policy interest rate, %, eop	-	1.50	1.00	1.00	1.00	1.00	1.00	1.00	1.25
Credit extension to private sector, % yoy	43.3	48.5	-0.8	-0.4	1.4	-0.3	5.0	7.0	7.0
Credit to private sector, % total deposits	68.6	80.0	73.7	68.7	68.3	62.4	59.6	58.0	56.4
Private sector deposits, % yoy	48.2	25.2	4.9	7.1	3.6	-1.2	10.0	10.0	10.0
Bank capital & reserves, % total loans	20.9	17.9	25.5	28.1	28.3	29.1	30.1	30.7	31.3
3 month inter-bank rate, %, eop	-	-	1.89	2.14	1.52	1.30	0.81	1.60	1.75
AED/US\$, eop	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
AED/US\$, avg	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
Balance of Payments, USD bn									
Current account	15.5	22.7	7.9	7.4	74.3	108.6	107.3	93.8	80.0
% of GDP	6.0	7.2	3.1	2.6	21.3	28.3	26.2	21.4	17.0
Trade balance	46.5	62.9	42.1	49.0	129.2	168.7	171.4	164.9	158.9
Exports	178.6	239.2	191.8	213.5	302.0	350.1	371.0	394.4	422.8
o/w oil, % total exports	41.3	42.7	35.4	35.0	37.0	33.7	31.2	28.8	25.6
Imports	132.1	176.3	149.7	164.6	172.8	181.4	199.6	229.5	263.9
Service balance	-26.0	-33.8	-27.3	-30.4	-43.7	-48.9	-53.7	-59.1	-65.0
Income balance	4.2	4.2	3.3	0.1	0.1	0.1	2.0	1.6	1.2
o/w outward remittances, % GDP	3.4	3.2	3.7	3.7	3.2	3.2	3.2	3.2	3.2
FDI, net	-0.4	-2.1	1.3	3.5	5.5	6.7	3.0	3.0	3.0

Source: National Sources, Citi Research Estimates

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Figure 76. Long-Term Economic Forecasts

	GDP growth						CPI Inflation						Current Account % GDP						Fiscal Balance % GDP						Exchange Rate vs. U.S. Dollar					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
United States	1.9	2.2	3.2	3.2	2.7	2.2	1.1	1.6	1.9	2.2	2.3	2.2	-2.4	-2.1	-1.5	-1.8	-1.7	-1.4	-7.3	-6.4	-5.6	-5.6	-5.4	-5.4	NA	NA	NA	NA	NA	NA
Japan	1.5	1.5	0.9	1.2	1.2	1.0	0.4	2.8	1.7	1.6	0.7	1.0	0.7	-0.2	-0.3	0.0	0.2	0.2	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	98	104	109	111	113	114
Euro Area	-0.4	1.2	1.8	1.9	1.9	1.8	1.4	0.6	0.9	1.2	1.4	1.7	2.4	2.8	2.8	2.8	2.6	2.5	-3.0	-2.6	-2.3	-1.7	-1.2	-0.9	0.75	0.73	0.73	0.71	0.70	0.70
Canada	2.0	2.3	2.7	2.7	2.6	2.4	0.9	2.0	2.0	2.0	2.0	2.0	-3.2	-2.8	-2.8	-2.5	-2.0	-1.9	-0.9	-0.1	0.3	0.4	0.4	0.4	1.03	1.09	1.11	1.10	1.10	1.10
Australia	2.4	3.4	3.0	3.1	3.2	3.2	2.4	2.7	2.5	2.4	2.4	2.4	-3.2	-1.9	-2.2	-2.4	-2.8	-2.8	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2	1.03	1.09	1.11	1.10	1.10	1.10
New Zealand	2.8	3.5	2.9	2.4	2.6	2.7	1.1	2.1	2.2	2.2	2.2	2.4	-3.4	-4.2	-5.4	-5.0	-5.4	-6.6	-2.9	-1.6	-0.4	0.5	1.2	2.2	1.22	1.15	1.16	1.19	1.26	1.35
Germany	0.5	2.2	2.5	2.5	2.4	2.2	1.5	1.2	1.8	2.2	2.3	2.4	7.6	6.9	6.6	6.1	5.9	5.5	0.0	0.1	0.2	0.0	0.0	0.0						
France	0.4	0.7	1.3	1.7	2.0	1.9	1.0	0.7	1.2	1.4	1.4	1.5	-1.4	-0.7	-0.1	0.4	0.1	-0.1	-4.3	-4.2	-3.6	-2.8	-1.9	-1.1						
Italy	-1.8	0.2	1.1	1.1	0.9	0.7	1.3	0.3	-0.2	0.3	0.9	1.3	1.0	1.9	2.0	2.1	2.0	2.0	-2.8	-3.0	-2.8	-2.1	-1.6	-1.2						
Spain	-1.2	1.3	1.9	2.2	1.9	1.8	1.5	-0.2	0.0	0.5	0.6	0.8	0.8	0.6	0.5	0.6	0.6	0.6	-7.1	-5.7	-4.9	-3.9	-3.2	-2.7						
Greece	-3.9	-0.6	1.2	1.4	1.5	1.6	-0.9	-1.6	-1.6	-1.0	-0.3	0.9	0.8	2.1	2.4	2.4	2.4	2.3	-12.7	-2.4	-2.7	-2.0	-1.6	-1.0						
Ireland	-0.3	2.8	3.4	2.8	3.0	3.0	0.4	0.8	1.0	1.1	1.6	1.7	6.6	9.6	10.3	9.4	8.7	7.8	-7.2	-5.1	-2.5	-1.8	-1.1	-0.3						
Portugal	-1.4	1.2	2.0	1.9	1.9	2.0	0.4	-0.3	-0.7	-0.3	0.2	0.7	0.5	0.5	0.7	0.9	1.3	1.5	-5.0	-4.2	-3.0	-2.4	-2.0	-1.5						
Netherlands	-0.8	0.6	1.4	1.7	2.0	2.1	2.6	0.3	1.1	1.5	1.6	1.8	10.8	10.9	10.3	9.8	9.4	9.0	-2.4	-2.8	-2.2	-1.7	-1.3	-0.9						
Belgium	0.2	1.3	1.5	1.6	2.0	2.1	1.2	0.6	1.1	1.8	1.6	1.9	-1.6	1.0	1.7	1.8	1.6	1.3	-2.7	-2.4	-1.9	-1.2	-0.4	0.5						
Switzerland	2.0	2.1	2.6	2.7	2.0	2.0	-0.2	-0.2	0.8	1.1	1.2	1.2	12.0	11.1	10.2	9.9	10.5	10.5	0.2	0.7	1.1	1.7	1.7	0.9	0.93	0.90	0.92	0.91	0.91	0.91
China	7.7	7.3	7.0	7.5	7.3	7.0	2.6	2.6	3.2	3.8	4.0	3.8	2.0	2.0	1.5	0.8	0.5	0.5	-1.9	-2.1	-2.0	-2.0	-2.0	-2.0	6.15	6.16	6.03	6.01	6.02	6.04
India	4.7	5.6	6.5	7.0	7.1	7.1	5.9	5.5	5.0	4.5	4.5	4.5	-1.7	-1.9	-2.0	-2.0	-2.0	-2.1	-6.9	-6.7	-6.5	-6.2	-5.9	-5.5	58.6	60.5	62.3	62.3	59.5	56.4
Indonesia	5.8	5.3	5.5	5.6	5.8	5.7	6.4	6.5	6.7	6.0	5.3	4.8	-3.3	-2.8	-2.4	-2.5	-2.2	-1.7	-2.2	-2.4	-2.2	-1.9	-2.0	-2.0	10449	11724	12003	11653	10915	10149
South Korea	3.0	3.9	4.0	4.4	3.6	3.8	1.3	1.9	2.9	3.1	3.0	2.9	6.1	4.7	3.0	2.3	1.6	0.8	1.0	0.9	1.5	1.7	1.9	1.7	1095	1034	1007	973.5	975.8	980.8
Poland	1.6	3.4	3.6	3.6	3.5	3.2	0.9	0.3	2.0	2.7	2.5	2.5	-1.3	-1.7	-2.7	-3.5	-3.6	-3.3	-4.3	5.2	-2.7	-2.6	-2.6	-2.6	4.20	4.20	4.20	4.01	3.96	3.93
Russia	1.3	1.0	2.3	2.6	2.6	2.6	6.8	7.1	6.1	6.0	5.7	5.4	1.5	2.7	1.9	0.6	-0.4	-1.4	-2.1	-4.4	-4.9	-1.4	-1.4	-1.4	31.9	35.7	37.8	37.2	37.0	36.9
Turkey	4.0	3.5	3.5	3.8	4.0	4.0	7.5	8.6	7.9	7.3	7.1	6.7	-7.9	-5.3	-5.4	-5.1	-5.0	-4.9	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	1.91	2.16	2.26	2.39	2.38	2.36
South Africa	1.9	2.0	2.8	3.3	4.3	4.1	5.8	6.5	5.8	5.5	5.9	5.9	-5.8	-4.9	-4.2	-3.4	-3.1	-2.7	-4.3	-4.2	-4.2	-3.7	-3.0	-2.0	9.65	10.75	11.00	10.79	10.68	10.58
Argentina	3.0	0.0	1.0	-2.0	3.5	3.0	10.6	NA	31.8	42.5	40.0	25.0	-0.7	-1.1	-1.2	3.0	1.0	1.0	-1.9	-2.4	-2.4	0.0	-0.5	-1.0	5.4	8.8	11.8	18.2	25.8	31.0
Brazil	2.3	0.9	1.2	2.5	3.0	3.0	6.2	6.4	6.4	5.9	5.5	5.5	-3.7	-3.8	-3.9	-4.0	-3.9	-3.9	-3.3	-3.9	-3.4	-3.4	-3.3	-3.3	2.16	2.33	2.55	2.67	2.78	2.90
Mexico	1.1	3.0	4.0	4.4	4.5	4.6	3.8	4.0	3.6	3.6	3.6	3.6	-2.1	-2.4	-2.2	-1.7	-2.0	-2.3	-2.4	-3.5	-2.5	-2.0	-2.0	-2.0	12.8	13.0	13.0	12.7	12.5	12.4
Venezuela	1.3	-1.0	1.9	1.9	1.9	1.9	38.5	61.7	82.5	60.0	60.0	60.0	3.3	4.1	5.1	3.0	3.0	3.0	-11.9	-11.2	-10.3	-12.0	-12.1	-11.5	5.99	9.15	19.80	31.28	49.43	78.10
Bahrain	5.3	4.0	4.0	4.0	4.1	4.1	3.3	2.5	2.0	2.0	2.0	2.0	6.8	5.5	1.3	-3.4	-6.4	-7.5	-3.3	-4.5	-6.8	-9.4	-11.5	-12.6	0.38	0.38	0.38	0.38	0.38	0.38
Egypt	1.5	2.4	3.2	5.2	4.1	3.6	9.5	7.9	6.5	9.0	11.2	10.5	-1.3	-2.5	-2.3	-2.1	-2.2	-2.3	-13.7	-11.7	-9.0	-8.1	-7.1	-6.8	6.87	7.12	7.52	7.76	8.16	8.59
Iraq	3.1	10.4	11.6	8.2	7.9	7.6	1.9	2.5	5.0	5.0	5.0	5.0	13.3	13.6	12.6	9.0	6.2	5.1	-5.8	-2.3	-1.2	-3.0	-4.0	-3.3	1162	1162	1162	1162	1162	1162
Israel	3.2	3.2	3.5	4.5	4.5	4.0	1.5	1.0	3.0	3.0	3.0	3.0	2.5	1.9	1.7	2.9	4.0	4.1	-2.7	-3.0	-2.5	-2.5	-2.5	-2.5	3.61	3.51	3.68	3.81	3.68	3.53
Jordan	2.8	4.0	4.5	4.3	4.1	4.0	5.5	3.5	5.0	5.0	5.0	5.0	-11.3	-10.2	-7.9	-5.7	-3.4	-1.1	-5.5	-9.6	-9.4	-9.2	-9.0	-8.8	0.71	0.71	0.71	0.71	0.71	0.71
Kuwait	5.7	3.8	3.9	2.7	2.8	2.8	2.6	3.0	4.0	4.5	4.5	4.5	37.9	40.4	38.3	33.7	30.0	28.3	28.8	32.2	26.5	22.5	19.0	17.2	0.28	0.29	0.29	0.29	0.29	0.29
Lebanon	1.4	1.1	1.5	2.2	3.3	3.2	2.1	3.5	5.0	5.0	5.0	5.0	-15.8	-15.8	-15.7	-5.8	-4.2	-2.7	-9.3	-9.9	-10.4	-10.9	-9.7	-8.5	1507	1508	1508	1508	1508	1508
Oman	3.4	4.7	4.7	5.8	5.3	4.2	2.1	1.5	3.0	3.0	3.0	3.0	10.8	8.5	6.6	4.4	3.8	5.3	9.9	8.4	6.1	3.1	1.0	0.4	0.38	0.39	0.39	0.39	0.39	0.39
Qatar	6.5	5.9	6.2	6.4	6.6	6.8	3.1	3.0	3.5	4.5	5.0	5.0	30.9	29.4	25.1	20.3	15.4	11.8	8.2	4.2	1.2	-2.5	-5.5	-6.0	3.64	3.64	3.64	3.64	3.64	3.64
Saudi Arabia	3.8	4.8	5.9	6.1	6.7	6.8	3.5	3.5	4.1	4.3	4.6	5.0	18.2	14.8	8.9	2.8	-0.8	-2.2	7.4	6.2	1.3	-3.6	-6.5	-7.7	3.75	3.75	3.75	3.75	3.75	3.75
UAE	3.7	4.0	4.0	4.4	4.4	4.4	1.1	2.0	2.4	2.9	3.5	4.1	26.2	21.4	17.0	12.2	8.2	5.1	NA	NA	NA	NA	NA	NA	3.67	3.67	3.67	3.67	3.67	3.67

Source: Citi Research Estimates. Note: For inflation we use PCE Deflator in the US, GDP deflator in Ireland.

Notes

Appendix A-1

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