

# Middle East Macro Monthly

## Staying bullish on Iraq

- In this monthly, we take a closer look at the Iraq credit story. Iraqi external bonds (28s) have underperformed regional peers and are trading at a discount relative to their historical values. While this reflects a significant rise in headline risk in the past year, we believe the worst news has been priced in and there is potential upside going forward.
- Our argument rests on the view that the two major political risks facing Iraq are unlikely to deteriorate significantly from here. We believe civil war and the violent fragmentation of Iraq is an unlikely scenario. Instead, we anticipate that continued stability in the south will be conducive to a ramp up in oil production, supporting the country's positive fiscal trajectory and, ultimately, its credit risk.
- The first major political risk facing Iraq is the rise in sectarian violence. We believe that this is likely to remain a relatively manageable and containable insurgency for a number of reasons, including: i. the likelihood of success in co-opting the Sunni tribal leadership against militant insurgents, ii. the possibility of change following general elections, scheduled for April 30, iii. the lack of economic viability of a separate Anbar province, and iv. the continued dormancy of Shia militias.
- The second political risk is of a military escalation of the KRG-Baghdad standoff. We believe there is a high likelihood of independent Kurdish exports in the near term, not least because it is in their economic interest to do so even if Baghdad does cut the KRG out of their federal budgetary allocation, in our view. However, this will not lead to conflict because the Kurds are unlikely to make a full bid for independence at this time due to i. lack of international support for a Kurdish state, and ii. the ongoing lack of resolution to the question of the disputed territories, particularly Kirkuk.
- We anticipate that ongoing stability in the south will allow the government to ramp up oil exports by around 500kbpd in 2014. This is based on increased export capacity, as well as anticipated production rises in some key Southern fields.
- One growing risk to production targets and the credit story is disaffection of the Southern, oil-producing governorates from Baghdad. The row over extra allocations in the budget which has flared in recent weeks speaks of the risk of direct action by the south for a greater say over their own oil industries, including potential strikes and shut-ins.

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*With thanks to*  
Adrian Thomas

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

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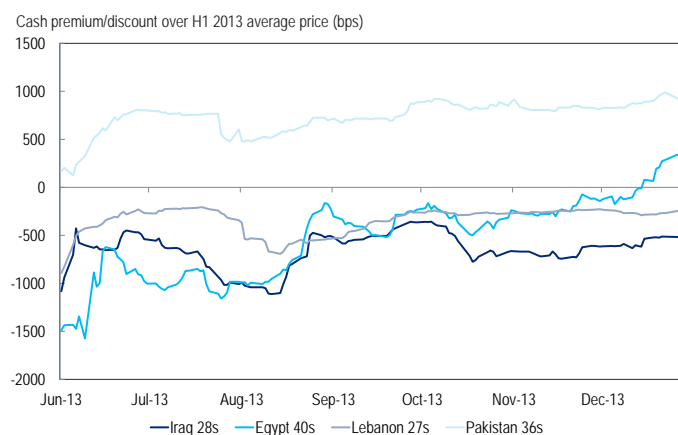
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## Staying bullish on Iraq

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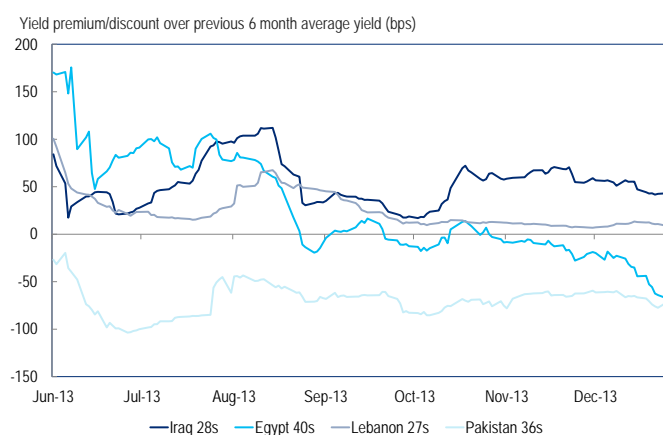
Headline risks in Iraq picked up in the course of 2013, with sectarian violence rising dramatically as the entire Levant region became seriously unsettled by the sectarian war raging in Syria. Domestic politics continued its slide into acrimony as Prime Minister Nouri al-Maliki furthered his consolidation of power amidst accusations by his opponents that his leadership was becoming increasingly majoritarian and even dictatorial. Within this context, tensions between the Kurdish Regional Government (KRG) in Erbil and the federal government in Baghdad also continued to ramp up as the former stayed the course towards energy independence. Even the silver lining of the Iraq credit story – its massive oil reserves and ramp up in production – did not shine as brightly last year, as oil exports remained stagnant.

Figure 1. Iraq 28s are cheaper relative to their H1 2013 cash price levels



Source: Bloomberg, Citi Research

Figure 2. The yield on Iraq 28s is high relative to the preceding 6-month moving average



Source: Bloomberg, Citi Research

This lacklustre performance was reflected in markets, with Iraq's 28s underperforming regional peers. The bonds today are trading at a discount of around 500 bps relative to their average cash price in the first half of 2013, and yielding around 50bp more than their average over the past six months. This performance is in contrast with many other regional bonds, such as those of Egypt and Lebanon, which have traded more favourably in recent months.

In this note we argue that there is value in Iraq's external debt. In our view, the headline risks have been priced in, leading to a lag in performance, but we do not expect these risks to deteriorate, and anticipate that we may even see a moderation in 2014. At the same time, we believe that the fundamentals, particularly on the oil story, are set to improve this year, creating the basis for a bull case for Iraqi debt.

### Sectarian violence is unlikely to spiral into widespread civil war or disintegration of the federation

In the past year, there has been a marked rise in sectarian violence in Iraq, mainly perpetrated by Sunni extremists targeting other ethnic groups (but especially Shia), Iraqi security forces and state infrastructure (including the Iraq-Turkey Pipeline). The rise in violence is in part a consequence of the civil war raging in neighbouring Syria. The nature of that conflict has fanned sectarian tensions and given the space for Jihadi extremist groups to thrive, not just in Syria, but across the Levant. Indeed, the emergence of the Islamic State in Iraq and the Levant (ISIL), an al-Qaeda affiliated group with operations in Syria, Lebanon and Iraq, is evidence of the regionalisation of the concerning rise in sectarianism and Sunni militant extremism.

But the success ISIL and others have had in resurrecting a Sunni insurgency in Iraq also reflects home-grown factors. For instance, it is arguably a function of the weakened capacity by the state to prevent it, particularly since the withdrawal of US troops at the end of 2011. Perhaps more importantly, it reflects the wider deterioration in sectarian relations in Iraq since the US withdrawal, which has, in turn, broken the already fragile alliance between Sunni tribal leaders and the Iraqi government. This alliance, forged as part of the broader 'Surge' strategy that put an end to the civil war of 2006/2007, was termed the Sunni Awakening and saw the powerful Sunni tribes join forces with the Iraqi government (and US troops) to overpower and defeat the Sunni insurgents. The alliance was based on the agreement that the Sunni population would have a fair say in political and economic matters at the national level.

Since the withdrawal of US troops, however, the Sunni population complains that the government has reneged on this agreement. Tribal leaders feel that they have been abandoned by the government and are subjected to reprisal attacks by insurgents. Nouri al Maliki, the Prime Minister, has been accused of waging an anti-Sunni campaign, including mass arrests, the persecution and prosecution of senior Sunni politicians, including the Vice President Tariq al Hashimy, who was convicted of murder and terrorism charges (and who fled to Ankara), and former finance minister Rafi el-Issawi, who resigned from his position amid much acrimony last spring.

Sunni protests against Prime Minister al-Maliki's perceived majoritarian rule began over a year ago, and despite a crackdown in April, continued until the end of the year mainly in the form of an encampment in the Anbar provincial capital Ramadi. This was raided by Iraqi troops in late December, resulting in the arrest of a senior Sunni MP (and the killing of his brother). The result was a violent backlash against Iraqi security forces, who were forced out of Ramadi and Fallujah (Anbar's second city), which have since been overrun by ISIS and tribal fighters.

At this critical stage, with Fallujah still in the hands of ISIS, does this mark the beginning of Iraq's second civil war in a decade, spreading to the Southern oilfields and signaling the country's potential disintegration? We believe the answer is no, for several reasons.

- Firstly, PM Nouri al Maliki appears to be (belatedly) heeding the lessons learned during the 2006/2007 civil war (as well as the advice of the United States and other regional powers) and has so far refrained from an all-out military assault on Fallujah. Instead, he has been attempting to revive the Sunni Awakening and rebuild bridges with the Sunni tribal leadership. Despite a massive gap of mutual trust, there are signs that the Sunni leadership is responding to this and accepting material support from the Iraqi government (weapons and money) to fight the insurgents.
- Second, we believe that general elections scheduled for April 30 may well produce a change in leadership, and the opportunity for a new government to forge stronger ties between sectarian groups in Iraq. Provincial elections held last spring saw Al Maliki's State of Law Coalition lose ground, not only in terms of the total vote, but also in terms of its ability to form strategic coalitions after the vote. While things may well be different in parliamentary elections, the depth of dissatisfaction with Maliki's rule and the willingness of other parties within the ruling National Alliance (particularly the Islamic Supreme Council of Iraq – ISCI) to exploit it and forge new alliances with Maliki's opponents does not, in our view, augur well for the Prime Minister and his State of Law coalition in the upcoming elections.

- Third, in our view the ultimate goals of the Sunni leadership in the Anbar province are to increase provincial autonomy while at the same time achieving a greater say in the political and economic matters of the Iraqi federation. While cessation and/or the overthrow of the Shia-led government in Baghdad may be a goal of the ideologue Jihadi groups, this is not a goal of the Sunni political class, particularly given the fact that the country's wealth and the source of the province's revenues is oil, all of which resides outside the province. This increases the chances of a political deal and limits the risk of Iraq's fragmentation.
- Finally, the civil war in 2006/2007 saw deadly fighting between and amongst Sunni insurgents, Iraqi security forces, an occupying US military force, and Shia militias. Today, two of these elements have all but disappeared. First, US troops have withdrawn completely from Iraq, eliminating a *causis belli* for would-be insurgents across the Iraqi spectrum. Second, the largest and most dangerous Shia militias, the Mehdi Army (of Moqtada Al Sadr) and the Badr Brigades (the former militant wing of ISCI), have disbanded.

### **We believe KRG exports will go ahead, but that risks will be contained**

Amid disagreement and acrimony between Baghdad and Erbil over the extent of autonomy the Kurdish Regional Government (KRG) can exercise over its hydrocarbon resources, the KRG has been crawling towards independent oil exports for several years. After the long-anticipated completion of an independent oil pipeline and the signing of a comprehensive (yet confidential) energy agreement with Ankara, the Kurds finally started pumping oil to the Turkish port of Ceyhan which the KRG says it will begin selling on to the market at the end of January.

There is still some residual uncertainty as to whether exports will actually take place, with some observers arguing that the pumping of Kurdish crude to Ceyhan is designed to strengthen the Kurdish hand in ongoing negotiations over an oil and budget settlement with Baghdad. Turkey's position on whether it will allow the sale has been ambivalent at best, with Baghdad threatening legal action if it does (Turkey and Baghdad have signed an agreement whereby Turkey recognises Baghdad's authority over all Iraqi oil exports). And Baghdad has threatened to cut off the Kurdish budget allocation (17% of the federal budget) if it goes it alone and does not export its crude via the State Oil Marketing Organisation (SOMO).

We believe that, on the balance of probabilities, oil exports will likely go ahead and sooner, rather than later. Turkey has clear strategic geo-economic interests in importing Kurdish oil and, in particular, gas, which we have outlined in our note [Middle East Macro Monthly - What Does Peace in Turkey Mean for Iraq?](#) (28 March 2013). And the threat of withholding the Kurdish share of the budget is, in our view, insufficient to deter the KRG.

The KRG complain that they have never received their allocation fully, and typically get around 10% of the budget. With federal exports at around 2.4mbpd, this implies that the Kurds are better off financially going it alone so long as they export anything north of 240,000 barrels per day, which they intend to achieve in pretty short order. Indeed, they expect to be exporting over 400,000 barrels per day by the end of the year, rising to over a million in the course of the next few years. The financial upside, therefore, is potentially significant. What's more, the KRG will have achieved independence of revenues, be free to pay its oil companies and its *peshmerga* fighting force, and can deny Baghdad a major leverage tool (the state budget). In other words, while on the surface drastic, the threat of being cut out of the federal budget is not, in our view, sufficiently grave to deter KRG exports from a financial point of view.

A potential risk of independent Kurdish exports is that this could quickly lead to greater efforts by the KRG to establish full independence from Baghdad and, in turn, result in a military conflict between the Kurds and the federal government. We believe this scenario is remote for the following reasons:

- A bid for independence by the Kurds would require the support of neighbouring states, especially Turkey. We do not believe that such support is forthcoming at the moment, with regional powers preferring to keep Iraq intact.
- There has been no progress on the resolution of the status of the disputed territories, especially Kirkuk. The KRG is unlikely to separate and leave these territories to the federal government, nor is it likely, in our view, to annex them militarily prior to declaring independence (we think such a move would provoke an undesirable military and diplomatic backlash against the KRG). A resolution of the status of these territories is thus a necessary precursor to any steps for full Kurdish independence.

The downside scenario of a militarisation of the conflict is highly remote, in our view, given the low likelihood of a full Kurdish bid for independence, and the limited capacity of the Iraqi military to fight a war against the *peshmerga* while the Sunni insurgency rages on.

There is, of course, an upside scenario where the KRG and Baghdad reach an agreement and that oil exports from the KRG go ahead with Baghdad's blessing, perhaps even within the context of an agreement on a national oil law. This is the 'win-win-win' scenario the Turks have been pushing for. We would, however, deem this a low-likelihood scenario, given the fundamental disagreement between Erbil and Baghdad over the question of oil autonomy. In our view, only a change of government in April may move this issue on if it results in a change of government in Baghdad.

Our base case scenario for 2014 is therefore that independent Kurdish exports begin, and that as a result, allocations to the Kurds out of the federal budget could well be suspended. Baghdad is also likely to pursue legal action against the KRG, Turkey and buyers of Kurdish crude, a long and drawn out process with unpredictable outcomes. The impact on the Iraqi federal budget in this scenario would be negligible, if not positive: The Kurds have not been contributing to the budget anyway in well over a year, and cutting their allocation would save the federal budget significant sums of money. Our base case on this issue is therefore benign from an investor perspective.

### The upside to the oil story

Oil production and exports in 2013 were largely unchanged from the previous year, at around 2.4mbpd, with expected increases hampered by a loss of Kurdish output, sabotage of the ITP, poor weather in the south, and infrastructure bottlenecks. However, we expect 2014 to see a jump in Iraqi oil exports from the south for two reasons.

The first is the expected expansion of export capacity out of Al Basra in the south as the Iraqi Crude Oil Export Expansion project (ICOEE) progresses broadly on track. 2012 saw the installation of two Single Point Mooring systems (SPMs) near the Al Basra Oil Terminal (ABOT), which itself has four loading berths. To date, these two SPMs have been pumping a combined 800,000 barrels per day, well below their capacity of 1.9mbpd (due to technical reasons). This has complemented the existing export capacity at ABOT, which is around 1.7mbpd. Taking into account the 400,000bpd capable of being exported through the Khor Al Ayama oil terminal nearby, total export capacity out of the South has stood at a maximum of 2.9mbpd.

Last autumn, the second phase of the ICOEE began, with the installation of a further two SPMs. This required that two of the four existing berths at ABOT be shut while the Central Metering and Manifold Platform (CMMP) was put in place, resulting in a dramatic reduction in crude exports in September and October. This reduced the yearly average, but the installation of the 2 new SPMs will see an additional 900,000bpd in nameplate export capacity added this spring, with a further 900,000bpd available to come on line as soon as the wreckage of a nearby tanker is cleared. This brings theoretical export capacity from the South up from 3.9mbpd to 5.7mbpd. In reality, though, available capacity is likely to increase more modestly, from 2.9mbpd to 3.3mbpd this spring. That said, the requirements to enable the remaining capacity are relatively minor compared with the infrastructure work already carried out, and a more rapid rise in actual capacity increases is possible and likely should production rise to require it.

Figure 3. Iraq's southern export capacity is expanding quickly

	2013		2014	
	Potential Capacity	Actual Capacity	Potential Capacity	Actual Capacity
Al Basrah Oil Terminal	1700	1700	1700	1700
Basrah SPMs				
1	900	400	900	400
2	900	400	900	400
3			900	400
4			900	
Khor al-Amaya	400	400	400	400
<b>Total</b>	<b>3900</b>	<b>2900</b>	<b>5700</b>	<b>3300</b>

Source: Citi Research

The second reason we expect a rise in exports is that we anticipate production to increase in a number of fields this year. Production in Kirkuk could rise by between 100,000 and 150,000 bpd this year thanks to a BP-led project, while in the South, a number of fields will either be coming on line or increasing production. The most important of these include the Rumaila, West Qurna 1 and 2, Majnoon and Zubair fields, which are targeting a combined production increase of 700,000 bpd in 2014.

In all, Iraq is targeting a rise in production of around 1mbpd in 2014, although for several reasons we think this is an ambitious target and is unlikely to be met. Delays in the supply of infrastructure by the government, including pipelines from field to export facilities and refineries, will continue to be a challenge for oil companies trying to meet their targets. Security concerns around the ITP also mean we think it would not be prudent to factor in a rise in Kirkuk production just yet. And a dispute over additional allocations to oil provinces in the draft 2014 budget may result in strikes and other actions disrupting supply from some of the main southern producing regions. All told, we are factoring in an increase of around 500,000bpd in 2014, which we think is achievable, and which nonetheless represents significant potential upside to Iraq's credit story.

## The Global Backdrop<sup>1</sup>

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**We are raising our global forecasts this month, and expect above-average expansion in coming years**

**We continue to upgrade AE growth prospects, with downgrades to EMs**

**We expect a modest further slowdown in China's growth this year...**

**...but China's growth remains highly credit-dependent...**

**...and the authorities face a major dilemma between reform, rebalancing and their likely growth targets**

**Other EM countries face nearterm growth downside...**

**...as the hoped-for export boost from AE recovery disappoints**

**We are pushing up our global growth forecasts this month**, and look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 in [Prospects for Economies and Financial Markets in 2014 and Beyond](#), 2 December 2013. This year will, we expect, mark a return to sustained above-average global growth rates, whereas global growth has been below average for three consecutive years (2011-13) and in five of the last six years. There continues to be a marked divide between the trend to forecast upgrades among advanced economies (AEs) and downgrades among emerging markets (EMs). We have cut 1½% off our 2014 and 1¼% of our 2015 EM forecasts in total since mid-2011, with notable downgrades this month to Turkey, Brazil and Venezuela. By contrast, as since early 2013, we continue to lift our forecasts for AE growth, with further upgrades this month to forecasts for the US, Euro area, UK and Sweden.

**In China, recent data point to a modest slowdown**, with slightly lower GDP growth in Q4-13 (7.7%YoY versus 7.8% in Q3) plus softer data for industrial production and fixed asset investment in the last month or two<sup>2</sup>. We expect GDP growth to edge down from 7.7% in 2013 to about 7.3% in 2014, the lowest since 1990. There seems to be a positive mood in Beijing over reform prospects and some reform momentum seems underway<sup>3</sup>. However, we continue to have major worries over China's medium-term growth outlook. There is still little sign the economy is genuinely rebalancing away from the investment-intensive and credit-led growth of recent years. Far from becoming less credit-dependent, the rise in private debt/GDP over the last four quarters (19.2pp) is far greater than the prior four quarters (6.6pp). The ratio now comfortably exceeds recent peaks in the US and euro area and can now be considered one of the greatest credit booms in any country over recent decades. China's credit boom is helping to sustain rapid GDP growth, at the rising cost of potential bad losses, credit excesses and resource misallocation. The authorities now seem to be seeking to deflate this credit boom, for example tolerating higher bond yields and seeking to rein in the shadow banking sector. However, in our view there is a fundamental tension between the reform agenda and the desire for growth of at least 7%. If, at some point, the authorities genuinely seek to rein in the credit boom, then the economy probably will face considerable further downside risks. Moreover, China's medium-term growth prospects face the further challenge of worsening demographics.

**Various other EM countries face a more immediate crunch** between worsening growth, sticky inflation, worsening current account balances and, as advanced economy growth picks up, less benign global liquidity conditions. The recovery in advanced economies is still not generating much export boost for emerging markets. Moreover, EM exports are no longer outperforming world trade as much as previously, in part reflecting the erosion of cost-competitiveness over recent years. Resultant worries over prospects for growth and current account balances are prompting a rolling series of EM market strains and currency weakness (hence lifting inflation prospects). We expect a further series of EM rate hikes, some in response to currency-induced inflation worries and in some cases to limit currency weakness, thereby reinforcing downside growth risks.

<sup>1</sup> This is a summary of the Overview from [Global Economic Outlook and Strategy - January 2014](#). 22 January 2014.

<sup>2</sup> See "[China Macro Flash - 2013 GDP: Flat Growth With Weaker Bias](#)", Minggao Shen and Shuang Ding, 20 January 2014, Citi.

<sup>3</sup> See "[China Macro View - Beijing Trip Notes: Reform Hopes](#)", Johanna Chua and David Lubin, 16 January 2014, Citi.

**The US and UK are heading for growth of 3%+ in 2014-15...**

**...becoming the first major advanced economies to recover strongly from recent boom/bust cycles**

**We expect modest growth in Japan and the euro area, with Japan underperforming consensus**

**We expect the ECB will loosen a bit further, without doing enough to fully avert risks of a long inflation undershoot or to remove risks of mild deflation**

**We expect Portugal will seek a PCCL, but there is chance that – like Ireland – the country will initially seek a “clean” exit from its current programme**

**Unless there is further debt restructuring, the periphery will only get back to fiscal sustainability if nominal GDP growth accelerates sharply**

**Among advanced economies, we expect a sizeable disparity between the US and UK** (both likely to grow by about 3% YoY in 2014-15), **versus Japan and the euro area** (likely to grow by 1-1½% in 2014-15). Details differ, but common themes for the US and UK are that monetary policy remains loose (ultra-low policy rates and large QE), while headwinds from deleveraging, poor credit availability and fiscal drag have receded markedly. For both, we expect the jobless rate will hit the central bank's guidance threshold by mid-14 and probably quite soon. We are advancing the first UK rate hike from H1-2015 to Q4-2014, although we still expect the Fed will be on hold until well into 2015. The prospective turn in the US policy cycle probably has global implications. The US and UK are also of interest (as with Iceland) as evidence advanced economies can recover from recent major boom/bust credit cycles to solid growth (albeit after several years) as long as sufficient stimulus is in place, banks are recapitalised and background conditions (eg supply-side flexibility) are in place. While the level of real GDP in the US and UK will probably stay well below the rising pre-crisis trend, these countries' experience suggests “secular stagnation” (ie persistent low growth of real and nominal GDP) is not an inevitable post-bubble feature<sup>4</sup>. It can be avoided through policy choices.

**For Japan, we expect growth to undershoot consensus** because of sizable fiscal drag from the consumption tax hike (even with temporary offsets), with an insufficiently aggressive monetary response. We do expect the BoJ to loosen further, but only once adverse effects from the consumption tax hike become evident around midyear. For the euro area, we are again lifting our GDP growth forecasts with marked upgrades among Spain, Portugal and Ireland (for 2014-15, plus Germany (for 2015). Fiscal policy will be roughly neutral this year, whereas periphery countries faced heavy fiscal drag in 2011-12.

**Nevertheless, the euro area recovery is likely to remain modest**, with persistently high unemployment and ample slack keeping inflation below 1%YoY in both 2014 and 2015. Even if inflation remains slightly above zero (which is our base case), such low inflation rates are a symptom of persistently depressed economy. We believe the ECB could justifiably loosen policy far more aggressively than it has done but think the ECB will continue to act tentatively, cutting the refi rate target to (or very close to) zero and setting a slightly negative deposit rate — but probably not doing widespread asset purchases or seeking to directly weaken the euro unless sustained deflation does occur.

**In the nearterm, we expect that periphery spreads will fall further**, amidst low ECB rates and expansionary liquidity. Nevertheless, we remain worried about longer-term fiscal trends in periphery countries. Even with better real GDP growth, we expect mild deflation in Italy, Spain, Greece and Portugal in coming years. As far as we can tell, the ECB seems willing to tolerate mild periphery deflation, as a means to regain competitiveness while it keeps overall CPI inflation below 2%. However, unless deflation is accompanied by very rapid real GDP growth, nominal GDP growth for periphery countries is likely to stay low. Hence, we expect general government gross debt/GDP ratios to keep rising in all periphery countries except Ireland in 2014-16, remaining well above 2013 levels. Ireland is a possible exception, as the very large export sector may ensure sufficient nominal GDP growth to bring public debt/GDP slightly lower even in 2014. But, even Ireland's fiscal path remains vulnerable to external shocks. Current policies are unlikely to restore fiscal sustainability in the other periphery countries in coming years.

<sup>4</sup> See “[Global Economics View - Secular Stagnation: Only If We Really Ask For It](#)”, Willem Buiter and Ebrahim Rahbari, 13 January 2014, Citi.

## Developed Market Economic Forecasts

Figure 4. 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
<b>Global</b>	3.3	3.4	3.6	3.0	3.1	3.4	0.7	0.6	0.3	-3.1	-2.7	-2.5
<i>Based on PPP weights</i>	3.7	3.8	4.1	3.5	3.6	3.9	0.4	0.3	0.1	-3.2	-2.8	-2.6
<b>Industrial Countries</b>	2.3	2.2	2.3	1.6	1.6	1.6	0.1	0.2	0.1	-3.8	-3.0	-2.8
United States	3.1	3.1	3.2	1.5	1.7	2.2	-1.9	-1.6	-1.8	-4.6	-3.9	-3.9
Japan	1.6	1.0	1.2	2.6	1.6	1.6	0.4	0.3	0.8	-8.0	-6.2	-5.8
Euro Area	1.1	1.3	1.4	0.9	0.8	1.2	2.5	2.6	2.6	-2.5	-2.0	-1.6
Canada	2.5	2.7	2.7	1.3	1.9	2.0	-3.7	-3.2	-2.7	-0.3	0.2	0.2
Australia	2.7	2.8	2.9	3.0	2.1	2.5	-4.0	-4.1	-4.3	-3.0	-2.1	-1.4
New Zealand	3.2	2.7	2.5	2.1	2.2	2.3	-4.7	-4.8	-3.8	-1.0	0.0	0.7
Germany	2.0	2.1	1.8	1.5	1.8	1.9	6.5	6.0	5.3	0.0	0.0	0.0
France	0.9	1.1	1.4	1.2	1.3	1.5	-0.8	-0.1	0.3	-3.6	-3.1	-2.7
Italy	0.3	0.3	0.4	0.5	-0.3	0.4	1.3	1.6	1.9	-2.8	-2.7	-2.5
Spain	0.9	1.1	1.4	-0.2	-0.1	0.1	1.0	1.4	1.5	-5.8	-4.8	-4.0
Greece	-1.9	-0.4	1.1	-2.7	-2.4	-1.4	1.9	2.4	2.9	-3.5	-2.4	-2.1
Ireland	2.1	2.2	3.5	0.3	0.9	1.0	8.6	7.8	8.0	-4.7	-3.0	-2.2
Portugal	0.2	0.8	0.7	-0.4	-0.9	-0.2	2.2	2.5	2.6	-4.6	-3.8	-3.1
Netherlands	0.5	0.9	1.2	1.2	1.3	1.4	10.4	9.4	8.9	-2.6	-1.9	-1.2
Belgium	1.2	1.3	1.4	1.0	1.0	1.1	-0.1	0.6	0.8	-2.6	-1.5	-1.0
Denmark	1.2	1.5	1.8	1.5	1.7	1.8	5.8	5.0	4.7	-1.8	-1.5	-1.0
Norway	2.0	2.4	2.6	2.0	2.1	2.1	12.2	12.5	12.8	11.8	11.0	10.0
Sweden	2.3	2.7	2.8	0.5	1.8	2.4	5.9	5.6	5.6	-1.6	-1.0	-0.3
Switzerland	2.0	2.0	2.2	-0.2	0.9	1.1	12.9	12.7	13.7	0.6	0.8	1.2
United Kingdom	3.3	3.2	2.7	1.8	1.9	2.2	-2.9	-3.1	-3.0	-5.3	-4.0	-2.4

Source: National sources and Citi Research

Figure 5. G3 Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 22 January 2014

	22-Jan-14	1Q 14F	2Q 14F	3Q 14F	4Q 14F	1Q 15F	2Q 15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	2.84	2.85	2.95	3.15	3.25	3.40	3.50
Euro Area: US\$/€	1.36	1.37	1.39	1.40	1.40	1.40	1.41
Euro Repo Rate	0.25	0.25	0.00	0.00	0.00	0.00	0.00
10-Yr. Bunds (Period Average)	1.75	1.75	1.70	1.70	1.80	1.90	1.90
Japan: Yen/US\$	104	105	106	107	108	110	111
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Average)	0.67	0.65	0.55	0.70	0.85	0.95	1.05

### Industrialised Countries 10-Year Yield Spreads (Period Average)

	Spread vs. US\$						Spread vs. Germany					
	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15
<b>United States</b>	NA	NA	NA	NA	NA	NA	111	112	137	153	153	158
<b>Japan</b>	-221	-232	-237	-238	-238	-243	-110	-120	-100	-85	-85	-85
<b>Euro Area</b>	-111	-112	-137	-153	-153	-158	NA	NA	NA	NA	NA	NA
Canada	-34	-20	-20	-15	-15	-15	77	92	117	137	137	143
Australia	136	148	138	133	133	133	247	260	275	285	285	291
New Zealand	179	209	209	225	235	261	290	321	347	377	388	419
France	-43	-47	-72	-88	-88	-93	66	65	65	65	65	65
Italy	97	68	33	7	7	-8	206	180	170	160	160	150
Spain	88	63	23	-13	-13	-33	197	175	160	140	140	125
Netherlands	-79	-77	-102	-118	-118	-123	30	35	35	35	35	35
Belgium	-51	-52	-67	-88	-88	-93	58	60	70	65	65	65
Austria	-76	-77	-102	-118	-118	-123	33	35	35	35	35	35
Finland	-90	-92	-117	-133	-133	-138	19	20	20	20	20	20
Ireland	39	-2	-37	-53	-63	-73	148	110	100	100	90	85
Denmark	-101	-102	-127	-143	-143	-148	8	10	10	10	10	10
Switzerland	-175	-187	-210	-226	-230	-239	-66	-75	-73	-73	-77	-81
United Kingdom	5	20	20	20	31	25	114	132	158	173	183	183

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 Outlook<sup>5</sup>

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**Commodity prices are broadly expected to remain tempered in 2014 after a difficult environment for most of 2013** whereby average futures contracts fell 5-10%. Macroeconomic headwinds, particularly across EM, should continue to hinder demand growth this year, while rising output and swelling inventories are continuing to loosen fundamental balances in the petroleum, staple grains and industrial metals sectors. Investor and fund flows are also expected to stay generally unsupportive across commodity indices and exchange traded funds (ETFs). Citi estimates half the record institutional and retail net redemptions of cUS\$50bn last year were during 4Q 13; enhanced by heightened geopolitical risk where gold rebounded and oil market net long positioning hit all-time highs on the back of massive OPEC and non-OPEC supply disruptions as a potential US conflict with Syria neared. To be clear, precious metal ETFs were the primary driver at c55% of aggregate 2013 net outflows. Citi's forward outlook for 2014 also suggests ongoing weakness for net investor flows but for the size, scale and pace of retrenchment to be much less severe given the much lower baseline to begin the year.

**With the unfolding of the super cycle sunset, individual and specific commodity underliers are likely to show a wider dispersion** as market specific supply/demand factors and tail risks dictate varying price paths. This is most visible in energy and agriculture markets, but is also taking shape in base metals, whereby the preeminent sovereign consumer, China, rebalances to be much less commodity intensive. The history of commodity cycles is they are supply-side-based, with investors, following a herd mentality, oscillating between over-investment and too much supply and under-investment and too little supply. This pattern is unlikely changing. Beginning in 2012 but crystalising in 2013, physical balances pointed to a cyclical trough for prices as the fruits of new supply were to be reaped over the next several years — in a fillip of the high price environment of the previous decade.

**Agriculture and soft commodity cycles are the briefest with the shortest lead times** and the ability for producers to adjust planting intentions on a 1-2 year basis. For benchmark grains, Citi expects the heightened price and spread volatility both in the US and globally, that was particularly exacerbated from 2010-1H'13 to reduce dramatically. Cereal prices since 2H'13 have eased markedly as supplies are being replenished on bumper harvests and expectations of stock builds this year across the board for corn, wheat, soy; a trend likely to carry over into 2015/16. This is already feeding through in lower inflation components across EM and DM economies. Given the large global inventory surplus across the board this year, grain prices are likely to favor consumers as opposed to producers and trading levels are likely to remain compressed and low for the next several quarters.

**The base metals cycle is somewhat stickier and can take a half-decade or more to incentivise new production capacity.** Given the scale and complexity, it often takes years before a new mine comes online. Many of these markets — absent nickel — still suggest new sources of supply after substantial upstream investments were made in the past decade. This has already weighed on aluminum prices, which refuse to budge from a tight \$1,800-\$2,000/t range just above marginal producer costs. Short-term copper prices remain supported by the continued drawdown in LME inventories and rising levels of cancelled warrants, which has pushed the cash copper-3M spread into backwardation since mid-December despite a healthy 8% growth in mine supply in 2013. However, much of this is likely driven by collateralised financing demand (particularly given current credit tightness in China). A bearish tail risk is the Chinese government significantly cracks down on this shadow banking activity, allowing for significant volumes of

<sup>5</sup> This summarises Commodity Market Outlook from [Global Economic Outlook and Strategy - January 2014](#). 22 January 2014.

copper to be dumped into the world market. Concerns over further price upside also reside with China which has recently announced a push on grid investments, but also has significant new smelter and refining capacity coming online, plus improving utilisation rates at existing plants, which should buttress refined production growth. But the demand picture is still mixed. Although new budgets for energy infrastructure spending have looked positive, much of the cable requirement driven by planned first quart spending have already been fabricated through 4Q'13. In affinity to last year, we expect energy spending in China to be front-loaded this year with investment tailing off in 2H'14. Over the medium term, the industry is rapidly canceling projects potentially accelerating the time when the base metals markets tighten. Meanwhile, Indonesia's new ban on nickel ore exports is tightening that market rapidly despite large inventories in China, the main importer.

**Oil and gas historically took significantly longer to mobilise capital.** But the unconventional revolution — harnessing shale resources plus deep water and oil sands — is different in two significant respects: it is occurring in OECD countries, with few market impediments compared to resource nationalistic EMs; and it is unleashing a new low-cost supply that is fairly ubiquitous globally, setting the stage potentially for a long period of relatively low cost resources. This is evidenced by official agencies as well as Citi forecasting muted demand growth of only 1-m b/d this year; well below non-OPEC supply growth projection. This should reduce the 'call-on-OPEC' to balance the market below its stated output targets of 30-m b/d. New infrastructure build-out across North America, where the US continues to ramp up production, should continue to push oil to the coasts and increasingly pressure policy makers to open up oil for direct exports. The US is already the world's largest petroleum product exporter and later this year will likely leapfrog Russia on a net basis as well. As commodity super cycles and correlations are typically led by the energy sector, the outlook for oil prices to average below \$100/bbl this year has the additional benefit of reducing upstream costs for other energy-intensive commodity activity such as mining and farming. This places an additional weight on those markets until physical cycles begin tightening again later this decade.

Figure 6. Commodities Price Forecast\*

		Point Prices																			
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014E	Q2 2014E	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014	2015E	2016E	2017E	2018E
Energy				5Y Cyclical																	
NYMEX WTI	USD/bbl	97.0	92.5	81.0	108.0	97.6	97.0	89.0	97.0	88.0	91.0	83.0	90.0	81.0	94.1	98.0	92.8	86.3	83.0	78.0	80.0
ICE Brent	USD/bbl	100.0	97.5	85.0	112.0	109.3	100.0	95.0	100.0	95.0	95.0	90.0	95.0	90.0	111.7	108.7	97.5	92.5	90.0	85.0	85.0
Henry Hub Natural Gas	USDMMBtu	3.70	3.80	N/A	3.55	3.85	3.70	3.60	3.70	3.90	4.20	4.50	4.50	4.80	2.75	3.73	3.70	4.50	4.90	4.90	5.50
Base Metals				LT Price																	
LME Aluminum	USD/MT	1,730	1,900	2,200	1,827	1,808	1,780	1,820	1,850	1,880	1,925	1,940	1,960	1,975	2,049	1,808	1,835	1,950	2,000	2,100	2,200
LME Copper	USD/MT	6,700	6,400	6,200	7,096	7,169	6,800	6,700	6,600	6,500	6,500	6,600	7,000	7,200	7,945	7,169	6,650	6,825	7,500	7,800	8,000
LME Lead	USD/MT	2,250	2,300	2,200	2,116	2,135	2,250	2,000	2,150	2,300	2,350	2,100	2,200	2,370	2,072	2,135	2,175	2,255	2,350	2,400	2,360
LME Nickel	USD/MT	17,500	18,000	20,000	13,996	13,968	17,000	16,500	17,000	17,500	18,000	18,500	19,000	20,500	17,592	13,968	17,000	19,000	23,000	24,000	24,000
LME Tin	USD/MT	22,500	23,500	20,000	21,284	22,917	22,000	21,500	22,000	24,000	25,000	24,000	23,000	24,000	21,108	22,917	22,375	24,000	25,000	24,000	23,000
LME Zinc	USD/MT	1,800	1,950	2,100	1,896	1,929	1,840	1,850	1,850	1,900	2,000	2,050	2,000	2,150	1,963	1,929	1,860	2,050	2,250	2,300	2,320
Precious Metals				LT Price																	
COMEX Gold	USD/T. oz	1,220	1,280	1,050	1,330	1,274	1,250	1,230	1,260	1,280	1,300	1,340	1,360	1,400	1,669	1,274	1,255	1,350	1,370	1,400	1,420
Silver	USD/T. oz	20.0	20.7	16.5	21.5	20.8	20.2	20.0	20.4	20.7	21.2	21.9	22.4	23.2	31.2	20.8	20.3	22.2	22.5	23.0	23.1
Platinum	USD/T. oz	1,500	1,525	1,763	1,456	1,398	1,500	1,525	1,550	1,575	1,625	1,640	1,660	1,675	1,552	1,398	1,538	1,650	1,700	1,750	1,850
Palladium	USD/T. oz	800	860	780	729	725	775	825	830	850	900	900	950	950	645	725	820	925	925	950	925
Bulk Commodities				5Y Cyclical																	
Hard Coking Coal (benchmark Asia)	USD/MT	150	160	200	145	152	155	160	160	165	170	170	170	170	211	159	160	170	180	190	200
Thermal Coal Asia (NEWC)	USD/MT	85	80	105	77	84	82	77	75	80	88	84	82	85	94	84	79	85	85	90	100
Iron Ore Spot (TSI)	USD/MT	135	115	81	133	135	130	120	115	115	115	100	95	90	128	135	120	100	90	90	90
Agriculture																					
CBOT Corn	US\$/bu	420	390	N/A	512	430	440	450	430	380	420	450	505	505	695	578	425	470	515	N/A	N/A
CBOT Wheat	US\$/bu	610	655	N/A	650	655	615	635	655	655	650	640	635	635	750	584	640	640	615	N/A	N/A
CBOT Soybeans	US\$/bu	1,265	1,000	N/A	1,405	1,304	1,260	1,250	1,135	1,075	1,050	1,050	1,000	1,100	1,465	1,406	1,180	1,050	1,075	N/A	N/A
CBOT Rice	USD/cwt	15.5	15.3	N/A	15.6	15.5	15.4	15.3	15.4	15.0	14.4	14.2	14.1	14.1	14.9	15.5	15.3	14.2	N/A	N/A	N/A
NYB-ICE Cotton	US\$/lb	79.0	77.8	N/A	85.6	80.3	79.0	78.0	80.5	75.0	75.0	75.0	75.0	75.0	80.0	83.3	78.0	75.0	N/A	N/A	N/A
Sugar#11	US\$/lb	18.0	18.0	N/A	16.7	17.7	18.0	18.0	18.0	18.0	18.5	18.5	18.5	18.5	21.6	17.5	18.0	18.5	N/A	N/A	N/A
ICE Coffee	US\$/lb	120	130	N/A	118	110	120	125	130	133	130	130	130	130	175	126	128	130	N/A	N/A	N/A
ICE Cocoa	USD/MT	2,600	2,700	N/A	2,420	2,706	2,550	2,550	2,700	2,600	2,600	2,600	2,600	2,600	2,348	2,405	2,600	2,600	N/A	N/A	N/A

Source: Citi Research, \*subject to revision

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## Country Section

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## Bahrain

### ■ Key developments on the month

- Government hits the ‘reset button’ on National dialogue
- Economic indicators recovering, as opposition activity pushed outside the capital;
- We raise our growth forecast for 2013 to 4.3%YoY from 3.8% previously.

### ■ 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

### Hopes for National Dialogue revived after Crown Prince intervenes

**In early January, the government announced a formal suspension of the National dialogue, which the 5 opposition groups had been boycotting since last September over the arrest of opposition leaders and the alleged heavy-handed suppression of the ongoing anti-government protest movement.**

Shortly afterwards, however, 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, thereby raising the hopes of a negotiated solution to Bahrain's current political impasse.

### Three reasons to be optimistic

**There are three reasons to be relatively optimistic about the new phase of the national dialogue.** 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 Jan). The previous national dialogue had failed to even agree a broad agenda after one year.

### Opposition remains cautious, and potential for unrest continues ahead of F1

**The opposition leadership has expressed ‘cautious optimism’, while grass-root activists reportedly remain sceptical amid ongoing security operations against protesters (Reuters 22 Jan).** Indeed, given the failure of previous attempts at dialogue, and the mutual accusation by participants of a lack of good faith in negotiations, it is certainly too early to predict the outcome of the latest initiative. Meanwhile, the potential for ongoing unrest, which may well rise, as it has over the past 3 years, with the approach of the Bahraini formula 1 event in April, is still there.

### 2013 GDP data points to increased momentum

**The economy expanded 4.6%YoY in 3Q 2013 with support coming almost equally from both the oil and nonoil sectors, bringing growth for the year to date to 4.7%.** This puts 2013 GDP on course to beat 2012 (3.5%), and we have revised up our GDP growth estimate for 2013 to 4.3% (from 3.8% previously) on higher-than-expected output in the oil sector. Part of the pick-up in economic numbers is also down to a base effect, as economic activity in the wake of the 2011 protests stumbled. While the Bahrain Economic Development Board (EDB) latest economic quarterly is also looking for growth to be driven by hydrocarbons, they are more optimistic than we are, looking for headline growth of 4.8% in 2013.

**Additional impact of unrest on economy will 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 two 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 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.

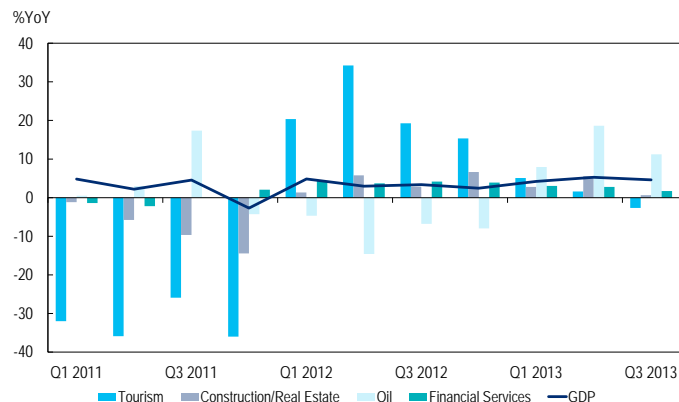
**Inflation likely to fall further in 2014**

**Headline inflation has begun to pick up in the last few months of 2013 on the back of stronger food and transport costs.** While easing back, price growth in November at 3.6%YoY (3.8% in October) has remained close to highs for the year. On the month, inflation declined 0.1%MoM, with significant deflationary impulses from Transport and Miscellaneous Goods & Services. With only one month of 2013 data remaining, we continue to believe inflation will reach 3.3%YoY for the whole year, up from 2.8% in 2012. Our expectation is above the latest Bahrain Economic Development Board Q4 Economic Quarterly of 3.0%. For next year we look for inflation to fall back to 2.3% partly on a weaker outlook for food prices from the Citi Commodities team, but also on base effects from the rental subcomponent, which was elevated throughout this year. 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.

**The tourism recovery continues**

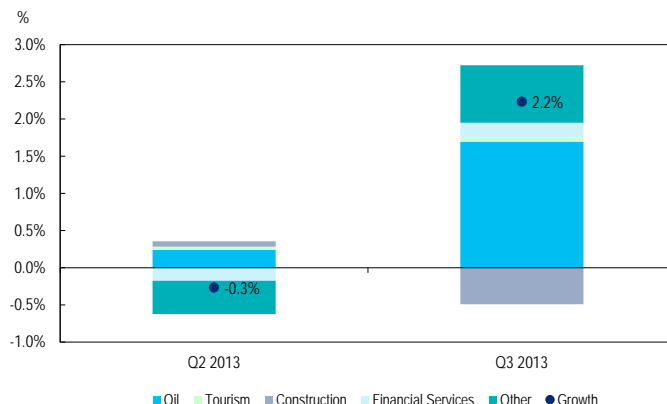
**Tourism continues to be affected by the unrest.** According to data from Ernst and Young, while showing some signs of recovery, occupancy and room rates are still significantly below the levels recorded prior to 2011. After two months over the summer and Ramadan where hotel occupancy levels fell to near record lows (28% in July), they jumped back up to 42% in September – staying at 46% for October and November. At the same time room rates have remained relatively stable since the summer. Political developments in the coming year will likely determine how sustainable the tourism recovery will be.

Figure 7. Economic growth has been adversely impacted by the unrest



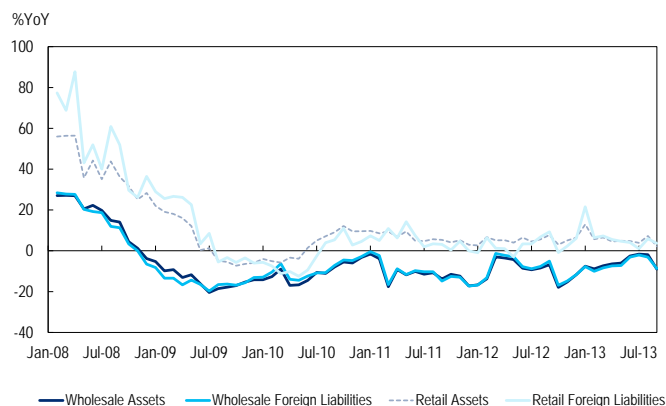
Source: Haver Analytics, Citi Research

Figure 8. Though the economy has shown some signs of recovery



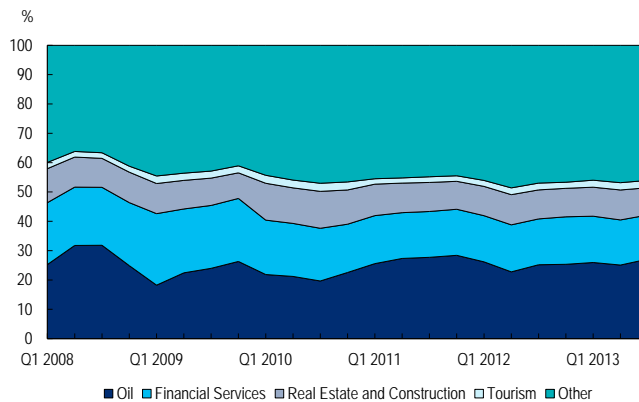
Source: Haver Analytics, Citi Research

Figure 9. The offshore banking system remains hard hit



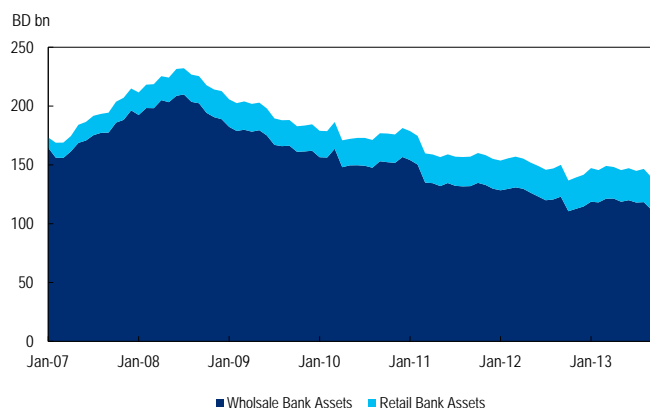
Source: Haver Analytics, Citi Research

Figure 10. The financial sector is a major pillar of the economy



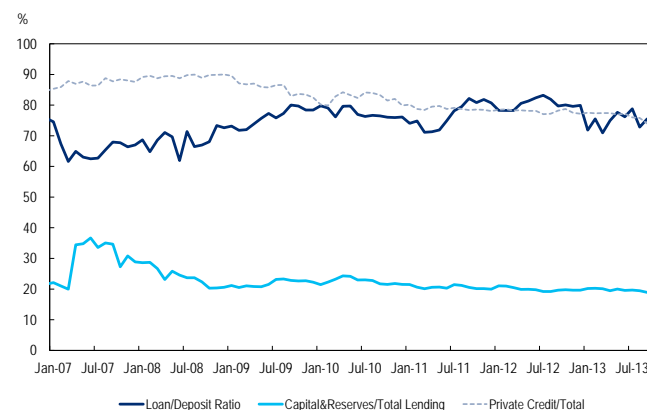
Source: Haver Analytics, Citi Research

Figure 11. Offshore banks are around 90% of the banking assets



Source: Haver Analytics, Citi Research

Figure 12. Retail bank indicators still appear robust



Source: Haver Analytics, Citi Research

Figure 13. Bahrain Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	21.7	25.6	22.9	25.6	29.0	30.3	34.9	37.6	40.3
Nominal GDP, local currency bn	8.2	9.7	8.6	9.7	10.9	11.4	13.2	14.2	15.2
GDP per capita, US\$	21,072	22,983	19,192	20,482	22,401	22,973	25,485	26,370	27,202
Share of oil in GDP (real)	24.0	22.7	22.0	21.1	21.4	19.0	19.2	18.4	17.7
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
<b>Economic Activity</b>									
Real GDP, % yoy	8.3	6.2	2.5	4.3	2.1	3.4	4.3	4.0	4.1
Real per capita GDP, % yoy	-0.2	-1.8	-4.0	-0.7	-1.1	1.4	0.3	0.0	0.1
Real non-oil GDP, % yoy	10.9	8.2	3.4	5.5	1.7	6.6	4.0	5.0	5.0
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	-	5.1	1.6	1.0	0.2	2.6	3.8	1.9	2.1
CPI, % avg	3.3	3.5	2.8	1.9	-0.4	2.8	3.3	2.3	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	10.0	10.0	10.0
Credit to private sector, % total deposits	58.7	65.3	64.7	60.8	63.0	61.7	61.7	61.7	61.7
Private sector deposits, % yoy	42.8	18.5	6.6	10.2	2.6	4.6	10.0	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	0.30	0.30	0.30
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
<b>Balance of Payments, USD bn</b>									
Current account	2.8	2.1	0.4	0.6	3.0	2.0	1.8	0.9	-0.6
% of GDP	12.7	8.1	1.7	2.3	10.3	6.4	5.3	2.4	-1.5
Trade balance	2.7	3.1	2.3	2.5	7.5	6.5	5.8	4.9	3.5
Exports	13.6	17.3	11.8	13.6	19.6	19.7	20.3	20.3	19.8
o/w oil, % total exports	79.2	79.6	75.1	74.6	78.8	76.9	76.4	75.2	73.3
Imports	10.9	14.2	9.6	11.2	12.1	13.2	14.5	15.4	16.3
Service balance	1.8	1.7	1.9	2.1	1.3	1.3	1.7	1.7	1.6
Income balance	-0.3	-0.9	-2.4	-2.4	-3.8	-3.8	-3.8	-3.8	-3.8
o/w outward remittances, % GDP	6.8	6.9	6.1	6.4	7.1	6.8	6.2	6.1	5.9
FDI, net	0.1	0.2	2.0	-0.2	-0.1	0.0	0.3	0.3	0.3
<b>Public Finances, % of GDP</b>									
Government revenues	24.9	27.7	19.8	22.5	25.8	26.6	23.8	22.1	20.1
o/w oil revenues	20.0	23.6	16.4	19.2	22.7	23.2	20.6	18.8	16.7
Government expenditure	22.3	21.3	24.1	27.3	26.1	28.6	26.0	25.4	25.5
o/w capital expenditures	6.0	5.3	4.5	7.9	4.0	6.5	5.9	5.7	5.6
Government balance	2.7	6.4	-4.3	-4.8	-0.3	-2.0	-2.2	-3.3	-5.5
non-oil balance, % of non-oil GDP	-21.9	-22.8	-25.7	-30.3	-31.5	-33.4	-29.1	-27.5	-26.9
Breakeven oil price (fiscal), US\$/barrel	62.42	72.84	79.00	100.23	112.31	122.68	121.11	126.30	136.02
Public debt	16.3	12.6	21.4	29.8	32.6	41.0	35.6	33.0	30.8
Cumulative government balance since 2000	25.5	31.9	27.5	22.8	22.5	20.5	18.3	15.1	9.6
Net debt (public debt net cumulative balance)	-9.2	-19.3	-6.1	7.0	10.1	20.5	17.2	18.0	21.2
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	29.8	36.3	35.0	37.5	36.5	39.3	40.9	42.2	42.6
External debt / GDP	137.1	141.6	152.8	146.2	125.9	129.9	117.1	112.1	105.6
External debt / XGS	-	-	225.8	212.4	161.1	174.6	201.4	208.0	215.0
External Assets	8.3	10.5	11.1	11.8	12.4	15.4	17.4	19.2	20.1

Source: National Sources, Citi Research Estimates

# Egypt

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## ■ Key developments on the month

- Following the successful constitutional referendum, the military's political roadmap to a new political dispensation will continue to unfold in 2014. .
- And even with periodic upsurges in violence, we still expect the political transition to be completed by year-end.

## ■ Key macro drivers

- Gulf support has helped stabilise the exchange rate and eased, but not eliminated, foreign exchange shortages.
- As the political situation stabilises in 2014, the government plans to use Gulf support to part fund a big push in capital spending.
- But a more coherent economic policy remains elusive, notably a medium- to long-term strategy to reduce the fiscal deficit.

## Summary Analysis

### Greater political stability in 2014

**Despite periodic upsurges in violence in early 2014, the successful holding of the constitutional referendum now means the military's political roadmap for Egypt is moving forward.** With a reasonable turnout and a strong "yes" vote, the outcome of the referendum may well persuade General Abdelfattah el Sisi's to stand in presidential elections which we think will be held before mid-year.

**This would then allow parliamentary elections to be held in 2H 2014 completing the political transition.** But while the vote for the president could potentially coalesce around Mr el Sisi if he chooses to run, we expect that the parliamentary vote is quite widely split over a range of parties. This would mean that a coalition government of some sort will have to be formed by the president, an outcome which is likely lead to a strong presidency.

**This outcome is also likely to be supported by most foreign governments.** But it is clear that the political environment has changed in recent months, with the Gulf States now taking the lead in supporting Egypt's political transition while Western powers have apparently lost influence as they took their time in deciding the position they should take over political developments since June.

### The need to keep the Islamist political community on side

**It is also possible that the current level of bombings and violent incidents subsides given the major clampdown on the Muslim Brotherhood (MB) currently under way.** But pushing the MB underground raises the risk of returning to the low level insurgency of the 1990s. Attempts by the MB to re-ignite protests against the new political regime have had some success, although it seems from opinion poll data that the MB is increasingly seen as the cause of the political violence and instability which has undermined some of its support. There certainly seems strong support within Cairo for the return to normality on the streets, which opinion poll data also indicates is a strong factor behind support for an el Sisi presidential bid. But political divisions remain polarised in Egypt.

**But despite the clampdown on the MB, the military is keen to keep significant elements of the Islamist political community on side during the transition.** Without this, any democratic transition will lack wider political legitimacy. This seems to be working, with the Nour party supporting the transition, while blaming the MB for putting paid to the Political Islam Project and allowing it to succeed the MB as the main Islamic political voice in the country.

**The re-emergence of a fragile economic stability...**

**The shift in external political support has also been positive for the economy as Gulf states, led by Saudi Arabia, have provided significant external support for the new government.** This has allowed the Central Bank of Egypt (CBE) to stabilise reserves and reduce foreign currency shortages which has translated into a more stable EGP since July. But it is also clear that the economy remains very weak with consumption under pressure and investment low.

**At present, the current government seems to be banking on a policy where further inflows from the Gulf in 2014 allow it to push ahead with infrastructure spending.** This should help boost growth, and coupled with the emergence of greater political stability should allow investment and tourism start to recover in 2H 2014 and into 2015.

**...but a more comprehensive reform programme is still desperately needed**

**But even if a slow pick-up in growth is possible in 2014, we still think that a new government will have to think more comprehensively about economic policy at some point.** In particular, the root cause of many economic problems remains the fiscal deficit which has been widening steadily since 2008 and looks set to remain firmly in double digits in 2014. The fiscal deficit rose to 11.2% of GDP in calendar year 2012 and provisional data for 1H 2013 show that there could be a worse outcome this year.

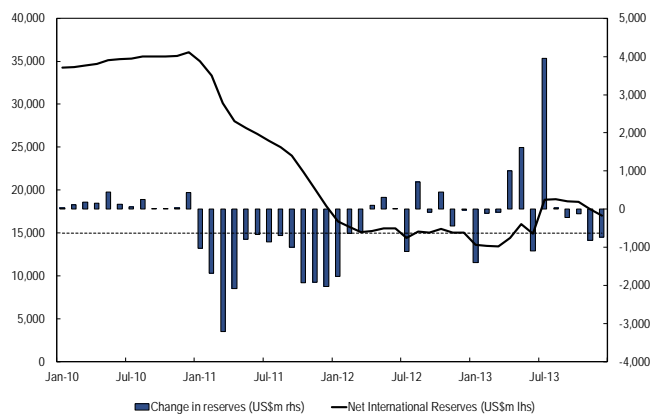
**On a more positive note, with only modest EGP depreciation expected in 2014 and a still weak growth environment we think that inflation is unlikely to rise sharply.** While it could be argued that the CBE's cuts in the Overnight Deposit Rate (ODR) in 2013 were premature given the rise in inflation in late 2013 back into double digits, we think that, once the hump is passed, inflationary pressures will start to ease during 2014 allowing further cautious cuts in the ODR to help support growth and to ease the local cost of funding the deficit.

**But a longer-term solution to reducing the fiscal deficit is only possible with real reform.** This would involve a programme to reduce subsidies on food and energy, firm control of the public sector wage bill and the return of growth to boost domestic revenue collection. As such, while there may be a modest fall back in the deficit going forward, the prospects for more fundamental fiscal consolidation seem unlikely for some time, in our view, given the current political agenda.

**A homegrown reform programme**

**Having said that, the provision of Gulf support means that such difficult choices can be put off and the government can continue to operate in muddle-through fiscal mode, probably well into 1H 2015.** But at some point, the government will have to think about a more comprehensive reform programme. While this could potentially be based around a deal with the IMF, we think it is more likely to be a homegrown economic reform programme with IMF buy-in and more logical external financing, of which a large part would be Gulf funding. But whichever route is chosen, the goal would be for external support to help fund infrastructural spending, which should start to help boost growth, investment and employment in 2015, while outlining a slow programme of fiscal consolidation over the medium term.

Figure 14. Reserves tentatively start to stabilise in 2H 2013



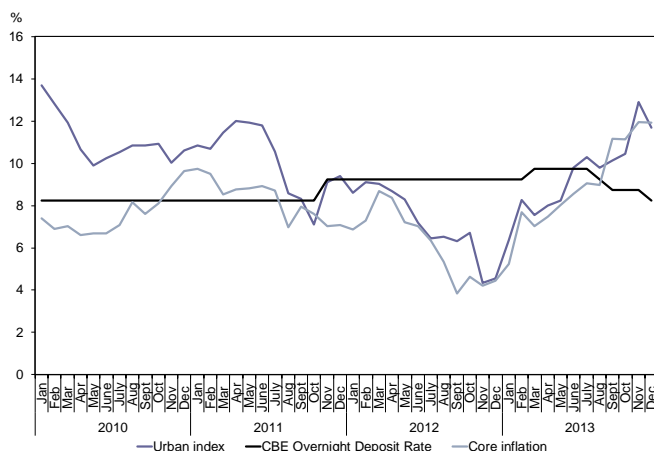
Source: Central Bank of Egypt, Haver Analytics

Figure 15. The EGP also starts to stabilise against USD since mid-2013



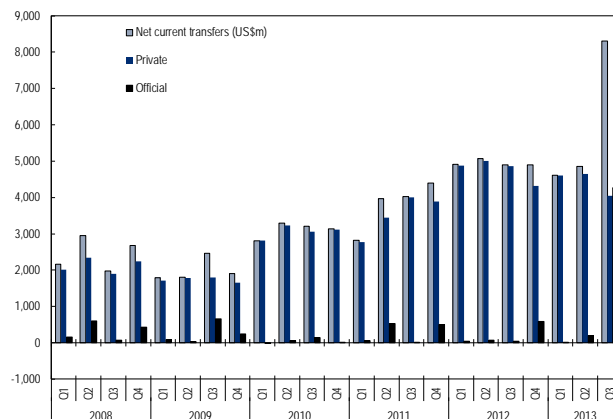
Source: Reuters

Figure 16. The CBE has cut rates, despite the rise in inflation in 2H 2013



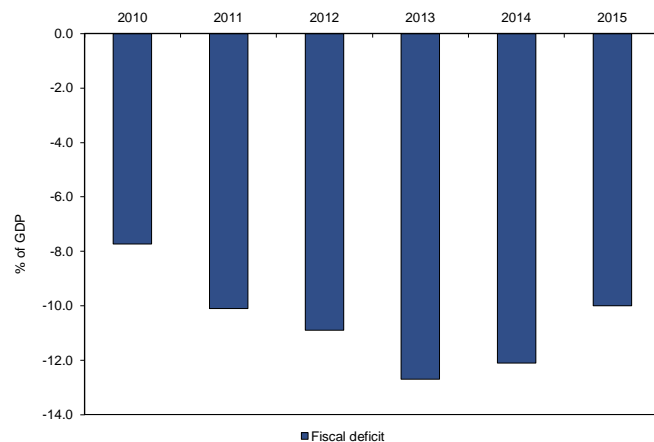
Source: Central Bank of Egypt, Haver Analytics and Citi forecasts for 2H 2013

Figure 17. Robust transfers have limited the deterioration in the current account and helped support consumption



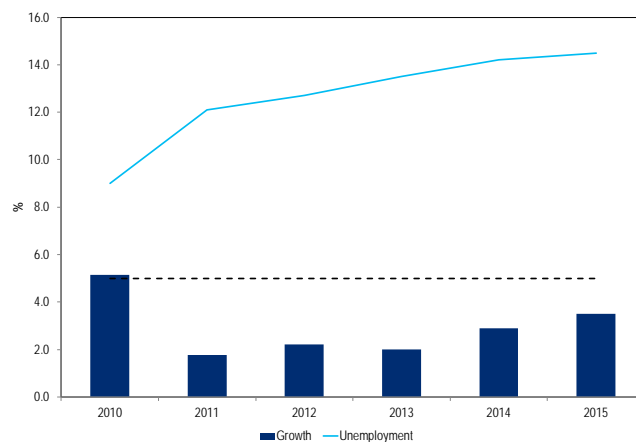
Source: Central Bank of Egypt, Haver Analytics

Figure 18. The fiscal deficit remains large and is a problem



Source: Haver Analytics and Citi forecasts for 2013-15

Figure 19. A weak recovery may now be possible in 2014-15



Source: Haver Analytics and Citi forecasts for 2013-15

Figure 20. Egypt Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	132.2	164.8	188.0	214.4	231.0	254.4	250.0	265.1	277.3
Nominal GDP, local currency bn	744.8	895.5	1,042.2	1,206.6	1,371.0	1,542.3	1,719.2	1,894.4	2,091.0
GDP per capita, US\$	1,783	2,187	2,454	2,755	2,919	3,164	3,060	3,192	3,284
Population, mn	74.1	75.4	76.6	77.8	79.1	80.4	81.7	83.1	84.4
<b>Economic Activity</b>									
Real GDP, % yoy	7.1	7.2	4.7	5.1	1.8	2.2	2.0	2.9	3.4
Real per capita GDP, % yoy	5.4	5.4	3.0	3.4	0.1	0.6	0.4	1.2	1.8
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	6.9	18.4	13.2	10.6	9.5	4.7	11.7	6.6	7.2
CPI, % avg	9.5	18.3	11.8	11.1	10.1	7.1	9.5	7.3	6.9
Policy interest rate, %, eop	8.75	11.50	8.25	8.25	9.25	9.25	8.25	7.50	7.00
Credit extension to private sector, % yoy	10.0	12.0	3.0	6.7	6.1	7.6	3.0	4.5	5.8
Credit to private sector, % total deposits	48.9	50.1	44.5	42.8	43.7	42.7	-	-	-
Private sector deposits, % yoy	11.8	12.1	-1.6	6.7	6.1	7.6	-	-	-
JOD/US\$, eop	5.53	5.50	5.48	5.81	6.03	6.36	6.95	7.35	7.65
JOD/US\$, avg	5.64	5.44	5.55	5.63	5.94	6.07	6.87	7.15	7.54
<b>Balance of Payments, USD bn</b>									
Current account	0.2	-1.3	-3.2	-5.6	-7.6	-7.6	-4.2	-3.5	-6.2
% of GDP	0.2	-0.8	-1.7	-2.6	-3.3	-3.0	-1.7	-1.3	-2.2
Trade balance	-20.8	-26.8	-22.5	-27.7	-28.2	-33.8	-31.6	-31.2	-31.2
Exports	24.5	29.8	23.1	25.0	27.9	25.9	24.9	26.3	27.6
Imports	45.3	56.6	45.6	52.7	56.1	59.7	56.5	57.4	58.8
Service balance	12.7	15.7	11.3	9.6	5.4	6.4	2.9	2.1	3.1
Income balance	-	-	-	-	-	-	-	-	-
FDI, net	10.9	7.6	6.1	5.2	-1.1	3.5	5.7	2.0	5.0
<b>Public Finances, % of GDP</b>									
Government revenues	27.6	27.8	27.7	25.1	22.0	22.6	20.7	21.4	22.7
Government expenditure	32.8	34.1	34.2	32.9	32.1	33.5	33.4	33.5	32.8
o/w capital expenditures	3.4	3.8	4.2	4.0	2.9	2.3	-	-	-
Government balance	-5.2	-6.4	-6.6	-7.7	-10.1	-10.9	-12.7	-12.1	-10.0
Public debt	64.2	53.5	54.0	59.8	69.0	79.4	79.9	80.5	80.1
Government's deposits with banks	11.4	10.5	11.0	9.6	8.8	7.9	-	-	-
Net debt (public debt net cumulative balance)	52.8	43.0	43.0	50.2	60.2	71.5	-	-	-
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	32.8	32.1	33.3	35.0	33.7	38.8	40.0	40.5	40.7
External debt / GDP	24.8	19.5	17.7	16.3	14.6	15.3	16.0	15.3	14.7
External debt / XGS	68.8	55.6	73.0	70.9	71.1	81.1	91.8	91.5	86.4
External Assets	-	-	-	-	-	-	-	-	-

Source: National Sources, Citi Research Estimates

# Iraq

## ■ Key developments on the month

- KRG steams ahead with bid for oil independence, despite Baghdad threats;
- Fallujah crisis highlights rise in sectarian violence, but civil war still unlikely;
- Emerging threat to production targets from southern disaffection.

## ■ Key macro drivers

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

## Summary Analysis

### KRG steams ahead with bid for oil independence

**In line with our expectations, the KRG appears to be finalising its push for independent oil exports, much to the chagrin of Baghdad.** On January 8, the KRG announced on its website that its first parcel of 2 million barrels of crude would be ready for sale by the end of January, and that sales would ramp up through the year, reaching 10-12 million barrels by December 2014, implying exports in the region of 330kbpd-400kbpd. That said, Turkey's position on whether sales will indeed commence remains ambiguous: despite allowing the flow of crude from Kurdistan, Turkish energy minister Taner Yildiz recently went on record saying that the oil is being stored in tanks and would not be sold without Baghdad's consent. On the whole, developments to us suggest that independent exports are imminent, although whether the KRG receives direct payment in the near term remains doubtful (we expect an escrow arrangement pending a final Baghdad-Erbil agreement on exports).

### Baghdad's threats unlikely to deter KRG ambitions

**Baghdad has reacted strongly, threatening the KRG and Ankara with legal action and has pushed through cabinet a draft budget that precludes the KRG from receiving its constitutionally allocated 17% share of Iraqi expenditures unless it resumes and maintains exports through the ITP at an average of 400,000 bpd in 2014.** As we argued in the opening note of this edition, we believe that it is in the KRG's financial interest to push ahead with independent exports despite this threat, added to which is the further incentive of an independent revenue source. Moreover, we do not believe that independent exports will lead to military conflict given the low likelihood of a full bid for independence by the Kurds, and the preoccupation of the Iraqi security forces with developments in the Anbar province. This reinforces our view that it is likely that Kurdish export sales will indeed commence in the coming weeks, despite Baghdad's protests.

### Rise in sectarian violence unlikely to lead to civil war

**Despite the rise in sectarian strife in the Anbar province, we believe the risk of a renewed civil conflict in Iraq remains limited.** Although the Sunni insurgency has undoubtedly strengthened over the past year, notably with the rise of the Islamic State in Iraq and the Levant (ISIL), there are emerging signs that PM Nouri al-Maliki is reviving the 'Sunni awakening', an alliance between the government and Sunni tribal leaders, which helped defeat the insurgents after the civil war of 2006/2007. The immediate objective of the awakening is to expel the insurgents from Fallujah and the parts of Ramadi that have been overrun. While there is considerable distrust of the government by Sunni tribal leaders, it is not in their interests to see Anbar fall to the insurgents and they are thus likely to co-operate, in our view.

**Upcoming elections hold chance for change**

**Another reason why we do not expect all out civil war along the lines of 2006/2007 is that, for the time being at least, Shia militias such as the Mehdi army and the Badr brigades remain dormant.** Moreover, upcoming general elections could well result in a change of government, a potentially positive development given that PM Nouri al Maliki is blamed for fuelling sectarian divisions with his majoritarian style of governing. We therefore maintain our view that the violence will remain contained within the Anbar province, Baghdad and the disputed territories, far away from the majority of oil infrastructure, limiting the economic fallout.

**We expect oil production to rise in 2014**

**Oil production and exports in 2013 were largely unchanged from the previous year, at around 2.4mbpd, with expected increases hampered by a loss of Kurdish output, sabotage of the ITP, poor weather in the south, and infrastructure bottlenecks.** However, we expect 2014 to see a jump in Iraqi oil exports for three reasons. The first is the expected expansion of export capacity out of Al Basra in the south. During September and October, infrastructure upgrades shut in a significant portion of Iraq's oil exports. However, these upgrades will see the export capacity from the South in principle double to over 5.6mbd in the coming year or two, providing plenty of headroom for production increases out of the Southern oil fields. The second reason we expect a jump in oil exports is the predicted rise in production from some of Iraq's major southern oil fields, including Majnoon (which came online in September), Garraf and Halfaya. Finally, as mentioned earlier, we expect to see Kurdish independent exports in 2014, although the extent to which the benefits of such exports will be captured at the federal level remains unclear.

**Basra unrest halted, but southern disaffection a real risk going forward**

**Last November, severe unrest in Basra, with violence directed at foreign oil workers, disrupted production in a number of major oil fields in the South.** As we expected, the unrest proved to be short lived and security measures have restored calm in the area, but we do still see risks of rising disaffection in the Southern, oil-rich regions (see [Iraq Macro Flash - Immediate Fallout From Basra Violence Likely To Be Limited, But May Signal Future Obstacles To Production Targets](#), November 14). The latest sign of this disaffection is a row that has broken out between the governors of the oil exporting provinces and the federal government. A law raising the extra budgetary allocation to oil-producing regions from US\$1 per barrel to US\$5 per barrel was suspended in December by the constitutional court, pending review. Meanwhile, the draft budget approved by Cabinet in January includes the US\$1 payment, rather than the US\$5 expected by the southern governorates. The promise of a US\$5 allocation had been critical in quelling the momentum behind decentralising forces in these provinces, which had been trying to wrest greater autonomy from the powers in Baghdad. The government's reneging on that promise raises the risk that these voices will once again rise, and that demands, backed potentially by strikes and other disruptions to production, may plague output targets for 2014 and maybe beyond.

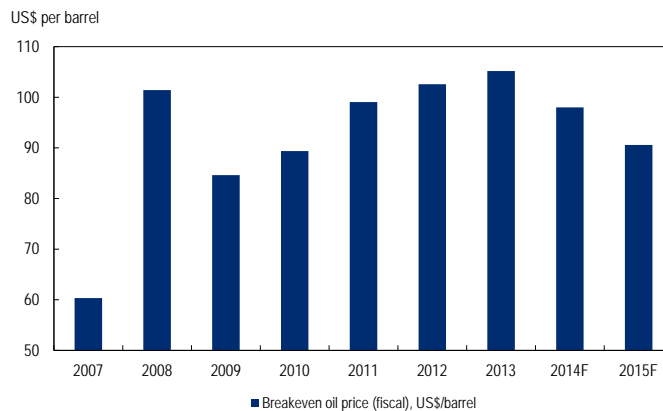
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Figure 21. Oil production on track to ramp up in near term



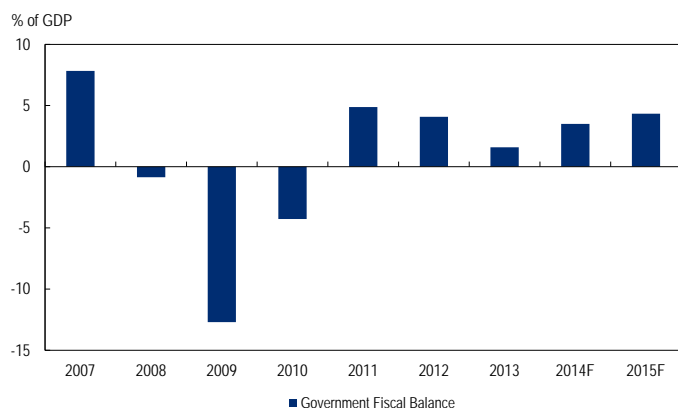
Source: Bloomberg, Citi Research

Figure 22. The fiscal breakeven oil price remains elevated



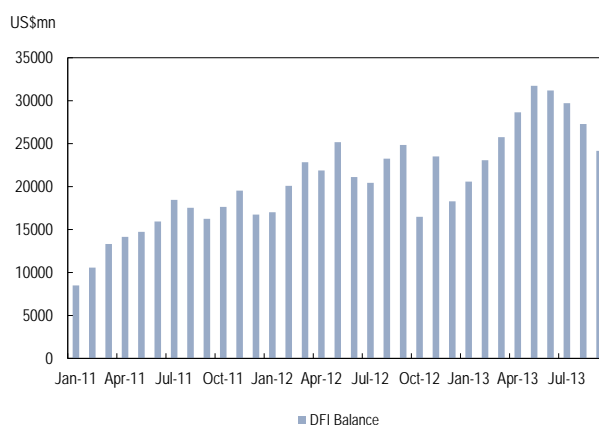
Source: Haver Analytics, Citi Research estimates

Figure 23. Fiscal performance should remain solid



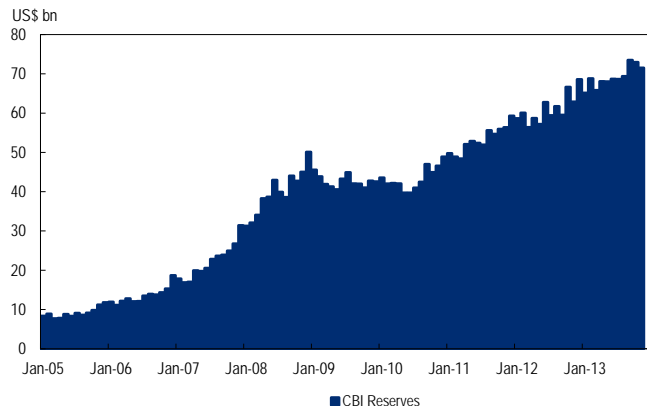
Source: Haver Analytics, Citi Research estimates

Figure 24. Balances at DFI account remain strong



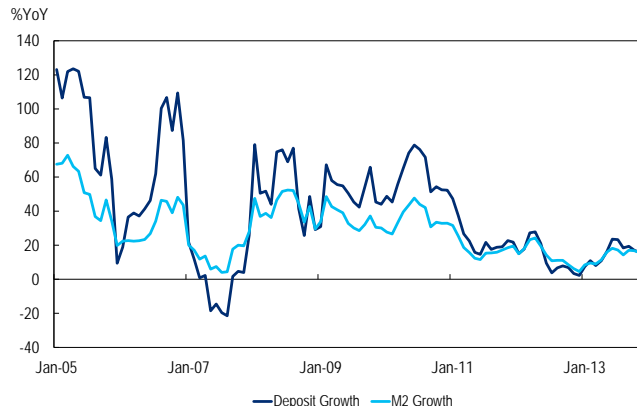
Source: IAMB, Committee of Financial Experts

Figure 25. Central bank reserves have settled around US\$70bn



Source: Haver Analytics, Citi Research

Figure 26. Monetary growth has eased recently



Source: Haver Analytics, Citi Research

Figure 27. Iraq Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	91.7	135.6	113.6	135.9	181.2	213.0	230.6	267.4	313.5
Nominal GDP, local currency bn	111,455.8	157,026.1	130,642.2	158,521.5	211,310.0	247,775.7	268,242.8	311,014.8	364,574.5
GDP per capita, US\$	3,190	4,607	3,766	4,389	5,708	6,545	6,908	7,811	8,928
Share of oil in GDP (real)	43.0	45.4	43.5	40.9	42.1	44.7	44.3	46.5	48.2
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
<b>Economic Activity</b>									
Real GDP, % yoy	1.4	6.6	5.8	5.9	8.6	8.4	3.1	10.4	11.6
Real per capita GDP, % yoy	-1.0	4.1	3.2	3.1	5.9	5.7	0.5	7.7	8.9
Real non-oil GDP, % yoy	-2.8	2.2	9.5	10.8	8.0	8.0	10.0	10.0	15.0
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	4.7	6.8	-4.4	3.3	6.0	3.6	2.7	4.2	6.0
CPI, % avg	32.6	2.8	-2.8	2.4	5.6	6.1	1.8	3.6	6.0
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	-	-	-	-	-	-	-	-	-
IOD/US\$, eop	1,213	1,168	1,153	1,170	1,167	1,164	1,165	1,163	1,163
IOD/US\$, avg	1,253	1,189	1,156	1,167	1,171	1,164	1,162	1,163	1,163
<b>Balance of Payments, USD bn</b>									
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	4.7	14.5	17.8	13.5	13.8	12.8
Trade balance	23.0	34.0	4.1	14.4	39.0	44.8	38.3	44.5	48.3
Exports	39.6	63.7	39.4	51.8	79.7	90.3	89.2	101.6	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
<b>Public Finances, % of GDP</b>									
Government revenues	54.0	56.4	46.2	46.4	49.5	48.2	44.4	43.5	41.3
o/w oil revenues	47.4	47.8	35.9	37.8	45.7	44.1	40.3	39.6	37.3
Government expenditure	46.1	57.3	58.9	50.7	44.6	44.1	42.8	40.0	36.9
o/w capital expenditures	9.9	17.4	12.8	15.2	13.0	15.3	14.9	13.5	12.1
Government balance	7.8	-0.9	-12.7	-4.3	4.9	4.1	1.6	3.5	4.3
non-oil balance, % of non-oil GDP	-85.2	-117.4	-92.9	-85.3	-84.2	-81.7	-72.3	-66.4	-57.8
Breakeven oil price (fiscal), US\$/barrel	60.3	101.4	84.6	89.4	99.1	102.6	105.2	98.0	90.6
Public debt	116.1	72.6	84.0	52.2	40.2	34.1	30.0	22.3	14.7
Cumulative government balance since 2000	7.8	7.0	-5.7	-10.0	-5.1	-1.0	0.6	4.0	8.4
Net debt (public debt net cumulative balance)	-	-	-	-	-	-	-	-	-
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
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	32.4	26.9	23.5	22.1	17.1	13.9
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	189.3	229.4

Source: National Sources, Citi Research Estimates

## Jordan

### ■ Key developments on the month

- 2014 budget narrowly approved with 13% rise in expenditures, fiscal position remains vulnerable;
- Rumblings of discontent with further anticipated electricity tariff hikes;
- 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

**2014 budget passed by parliament with 12% rise in expenditures**

**The Jordanian budget was narrowly passed by the lower house of parliament amid protest 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 12% 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 rise in line with historical experience (as a rate of around 6%), we are forecasting a budget deficit more than double the official target, at JD2.5bn, or Over 10% 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.

**Fiscal vulnerability remains, but FX position has recovered strongly**

**Jordan's fiscal position remains vulnerable despite an improvement in the headline deficit number, which narrowed to 6.9% on a 12-month rolling basis in October last year, from 9.7% a year earlier.** The improvement, however, is entirely down to an increase in international grants, with the total pledged to the Jordanian Government in the first ten months of 2013 standing at JD550m. Grants stood at just JD97m in the same period last year, and at JD327m for the entire year. Excluding grants, the deficit remained wide, at 10.3% of GDP, from 10.9% last year. Indeed, international support has become increasingly important to the Kingdom's economic position, with the United States also providing a sovereign debt guarantee on a recent issuance.

**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\$13.1bn in November last year, from US\$7.9bn at the end of 2012. 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.

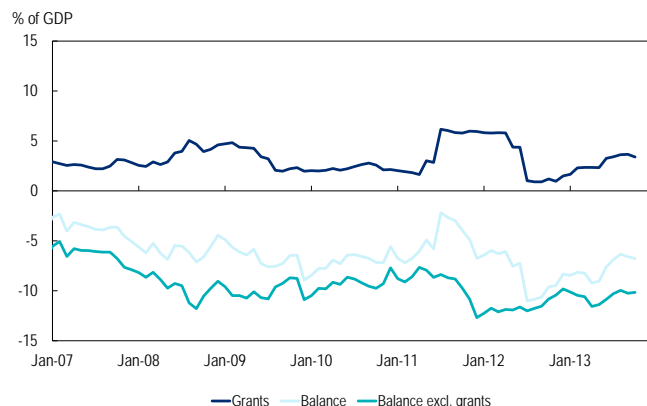
**Refugee crisis has an ambiguous impact  
on the macro-economy**

**Jordan's economy has been affected by a wave of around 500,000 refugees from Syria, although the net impact is unclear.** 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.

**Expect continued sluggish growth**

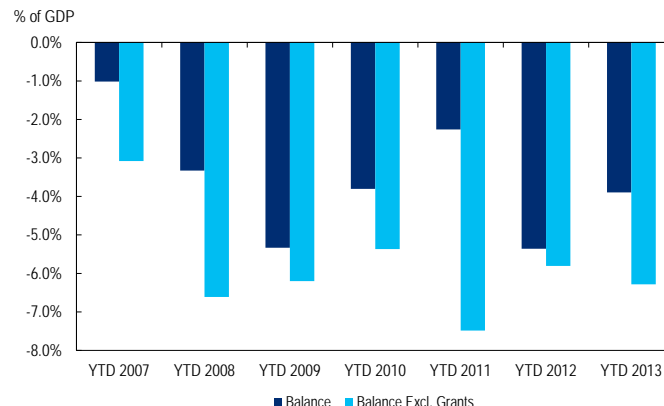
**Continued weak external demand, low levels of foreign and domestic investment, falling remittances and a sharp rise in refugee inflows from Syria are all adding to a gloomy economic picture.** The fiscal and external balances remain wholly unsupportive of domestic growth in our view. While the recovery in FX reserves is encouraging, this is largely due to improved sentiment and lower dollarisation, factors which are easily reversed. Moreover, the reduced dollarisation has not resulted in an increase in domestic credit, perhaps for the very reason that it may prove short-lived. We expect growth to be picked up in 2014 on the back of improved regional sentiment and, in particular, a rise in foreign direct investment, but anticipate that medium term growth will be range bound in the 4%-4.5% range in the medium term, below the level required to generate enough jobs to reduce domestic unemployment.

Figure 28. The fiscal bottom line has remained problematic...



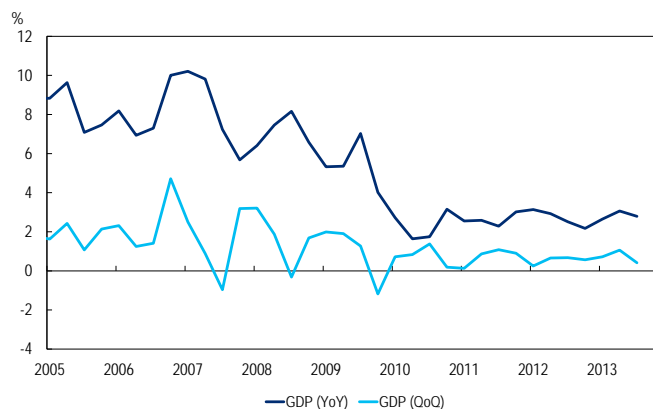
Source: Haver Analytics, Citi Research

Figure 29. ...and would be weaker still if grants were excluded



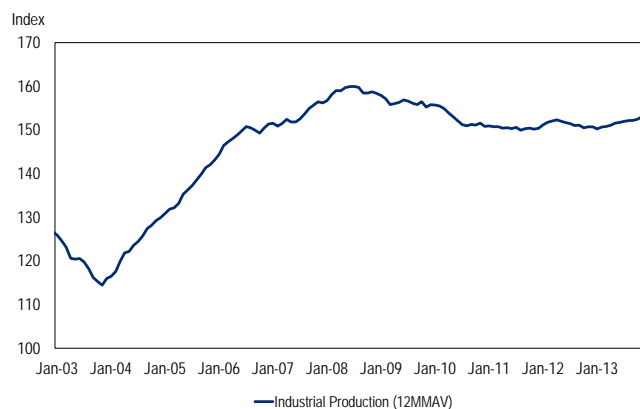
Source: Haver Analytics, Citi Research

Figure 30. Growth has begun to slow ...



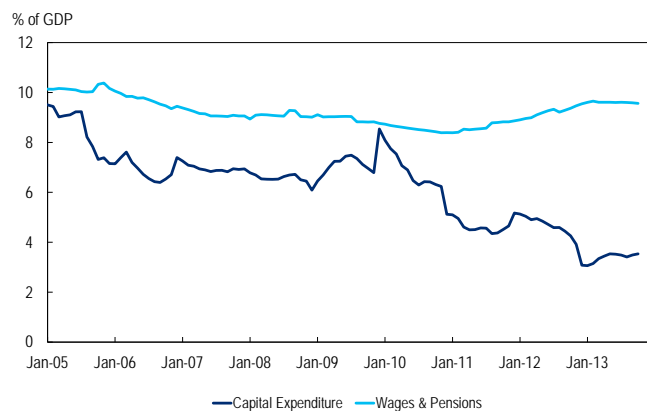
Source: Haver Analytics, Citi Research

Figure 31. ... and industrial production has been stalled since 2008



Source: Haver Analytics, Citi Research

Figure 32. Capital expenditures have stabilised ...



Source: Haver Analytics, Citi Research

Figure 33. ... while reserves are beginning to grow again



Source: Haver Analytics, Citi Research

Figure 34. Jordan Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	17.1	22.0	23.9	26.5	28.8	30.9	32.7	35.0	37.6
Nominal GDP, local currency bn	12.1	15.6	16.9	18.8	20.4	21.9	23.2	24.8	26.7
GDP per capita, US\$	3,026	3,722	3,866	4,104	4,284	4,404	4,475	4,594	4,739
Population, mn	5.7	5.9	6.2	6.5	6.7	7.0	7.3	7.6	7.9
<b>Economic Activity</b>									
Real GDP, % yoy	8.2	7.2	5.5	2.3	2.6	2.7	3.0	4.0	4.5
Real per capita GDP, % yoy	3.8	2.6	0.9	-2.0	-1.6	-1.4	-1.2	-0.2	0.3
<b>Prices, Money &amp; Credit</b>									
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	3.6	5.0
Policy interest rate, % eop	7.00	6.25	4.75	4.25	4.50	5.00	4.25	4.25	4.50
Credit extension to private sector, % yoy	14.5	14.7	7.2	7.1	7.2	4.7	10.0	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
<b>Balance of Payments, USD bn</b>									
Current account	-2.9	-2.1	-1.2	-1.9	-3.5	-5.4	-5.0	-5.0	-4.5
% of GDP	-16.8	-9.3	-5.2	-7.1	-12.0	-17.4	-15.2	-14.2	-11.9
Trade balance	-6.5	-7.2	-6.3	-6.8	-8.8	-10.5	-11.1	-11.6	-11.8
Exports	5.7	7.9	6.4	7.0	8.0	7.9	8.3	8.7	9.6
Imports	12.2	15.1	12.7	13.9	16.8	18.4	19.4	20.3	21.3
Service balance	0.0	0.4	0.7	1.2	0.7	1.1	1.2	1.3	1.3
Income balance	0.7	0.7	0.5	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4
FDI, net	2.6	2.8	2.3	1.6	1.4	1.5	1.5	1.6	1.7
<b>Public Finances, % of GDP</b>									
Government revenues	32.7	30.4	26.7	24.9	26.5	23.1	22.9	22.4	21.9
Government expenditure	37.8	34.8	35.7	30.4	33.2	31.4	31.1	32.6	31.8
<i>o/w capital expenditures</i>	6.9	6.1	8.5	5.1	5.2	3.1	4.0	5.0	5.0
Government balance	-5.1	-4.4	-8.9	-5.6	-6.8	-8.3	-8.2	-10.1	-9.9
Public debt	70.9	58.2	62.2	63.4	68.9	76.8	80.7	85.6	89.5
Government's deposits with banks	17.6	15.7	14.8	15.7	13.3	15.3	15.2	14.9	14.6
<i>Net debt (public debt net cumulative balance)</i>	53.3	42.5	47.5	47.7	55.6	61.5	65.5	70.6	74.9
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	14.9	13.8	14.3	16.3	17.3	18.9	19.8	20.8	21.9
External debt / GDP	87.3	62.9	59.7	61.4	60.2	61.2	60.6	59.5	58.1
External debt / XGS	161.0	111.4	130.2	128.5	131.8	139.1	141.3	143.6	141.7
External Assets	-5.5	-7.5	-8.3	-9.7	-13.2	-18.5	-23.5	-28.5	-33.0

Source: National Sources, Citi Research Estimates

# Kuwait

## ■ Key developments on the month

- New government unlikely to change underlying political dynamic;
- Momentum on subsidies review may be lost as a result of political changes;
- Strong fiscal outturns mask rising expenditures and looming fiscal risks.

## ■ 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

### Kuwait reviews subsidies

**Tensions between the National Assembly and the government led to another change of government in early January, with a number of ministers who had been or who were scheduled for a parliamentary questioning (grilling) being removed from their positions.** 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 the economic prospects of the country. 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 a US\$104bn development plan, were dashed when parliamentarians soon began targeting cabinet ministers for 'grillings'. 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 going forward, with continued negative impact on economic policy-making.

**One potential negative consequence of the reshuffle could be a loss in momentum in Kuwait's recently announced intention to review the country's subsidies programme, which costs the public purse US\$16bn, around one-fifth of total expenditures.** Shortly before the reshuffle, 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 (September 23). 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](#), September 30).

**The initiative is entirely welcome, in our view, and is the first among what we believe will be many such initiatives across the GCC to rationalise expenditures in the face of rising fiscal pressures in coming years.** However, as we have argued, such initiatives will be unpopular, and do risk raising political and social tensions. In the case of Kuwait, the primary concern is the historically acrimonious relationship between the national assembly and the government. The former tends to prefer populist measures that extend the benefits of the Kuwaiti citizenry, and thus any suggestion the government may be doing something contrary to this objective may be met with renewed hostility from the national assembly. Moreover, any measures to rationalise subsidies are likely to require parliamentary approval. The ability, therefore, of the government to carry through any recommendations made by the panel on subsidy reform is thus uncertain, in our view.

**Fiscal outturns are expected to be very robust this year**

**We believe the government is on track to achieve a surplus of around KD21.6bn for this calendar year, around 37% of expected GDP, up from 33% of GDP last year.** (Note that we have revised our GCC fiscal figures to include investment income across the board for the sake of consistency and accuracy). That said, we do have concerns regarding the quality of government expenditure growth in the past fiscal year. Indeed, the entirety of expenditure growth was attributable to a rise in current expenditure as capital expenditures stayed flat. The rise in current expenditures was attributable in roughly equal part to wages, an increase in purchases of goods and services, and a sharp rise in transfers (subsidies). We believe both the rate and the quality of expenditure increases in Kuwait represent a significant challenge to public finances going forward. For this reason, we would welcome progress on the initiative to review subsidies.

**Weak credit growth likely to continue into 2014**

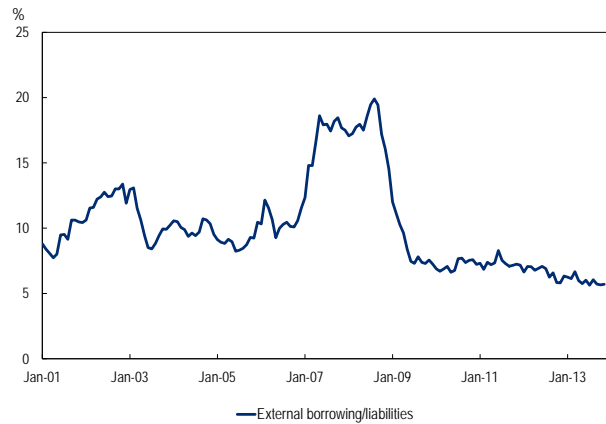
**Lending growth continues to be sluggish in 2013.** Total credit extended up to November rose by just 3% compared with the same period a year earlier. This is way off the highs prior to the 2008 financial crisis when credit extension reached close to 40%. While lending to the public sector has begun to improve, it remains firmly entrenched in negative territory. However, lending is likely to remain weak until there is a significant recovery in private sector credit, which makes up more than 90% of total bank lending; in the near term this seems unlikely with private credit growth stuck at a sub 5% rate. On the flip side, the weak loan growth has allowed the loan deposit ratio to stabilise below 80%.

Figure 35. Lending to the government continues to be anaemic



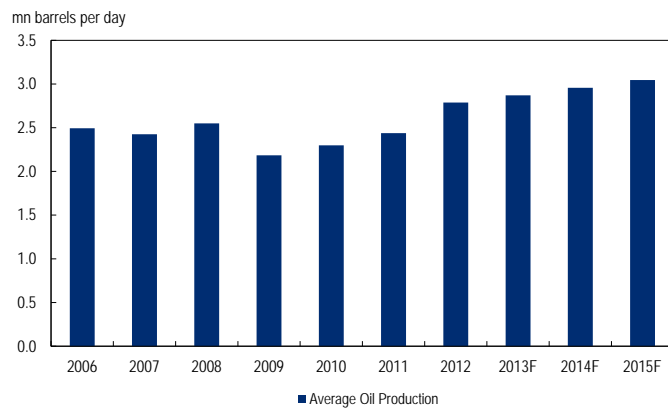
Source: Haver Analytics, Citi Research

Figure 36. Foreign liabilities remain moderate



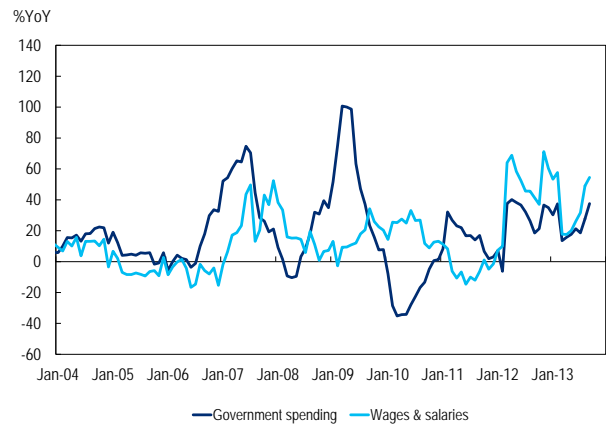
Source: Haver Analytics, Citi Research

Figure 37. Oil production remains relatively stagnant



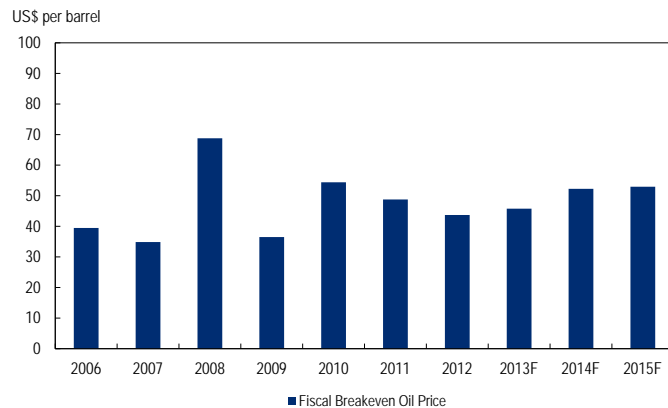
Source: Haver Analytics, Citi Research estimates

Figure 38. Government spending has picked up



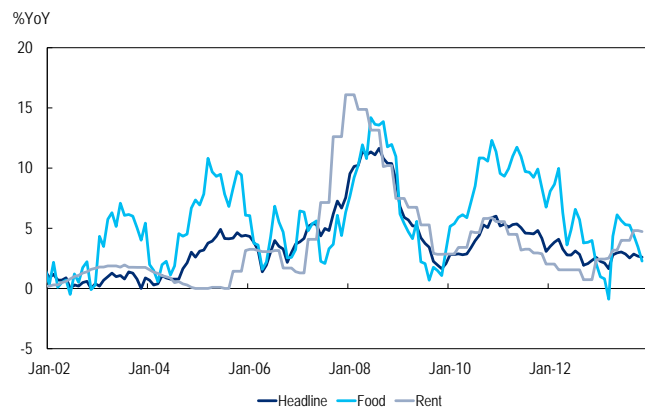
Source: Haver Analytics, Citi Research

Figure 39. Fiscal breakeven rising but still relatively prudent



Source: Haver Analytics, Citi Research estimates

Figure 40. Food prices have eased



Source: Haver Analytics, Citi Research

Figure 41. Kuwait Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	112.3	136.6	105.2	118.5	152.8	176.9	202.2	207.3	208.7
Nominal GDP, local currency bn	32.6	39.6	30.5	34.4	44.3	51.3	58.6	60.1	60.5
GDP per capita, US\$	43,971	50,563	36,898	39,610	48,908	54,947	60,992	60,696	59,346
Share of oil in GDP (real)	-	-	-	56.3	59.4	58.5	57.8	57.3	56.9
Average oil production (mbpd)	2.43	2.55	2.18	2.30	2.44	2.79	2.87	2.96	3.05
Population, mn	2.6	2.7	2.9	3.0	3.1	3.2	3.3	3.4	3.5
<b>Economic Activity</b>									
Real GDP, % yoy	-	-	-	-	9.3	16.1	4.2	3.8	3.9
Real per capita GDP, % yoy	-	-	-	-	4.7	12.7	1.2	0.8	0.8
Real non-oil GDP, % yoy	-	-	-	-	4.3	3.5	6.0	5.0	5.0
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	7.5	9.0	2.1	6.0	3.1	2.6	2.9	3.8	5.0
CPI, % avg	5.5	10.6	4.0	4.0	4.7	2.9	2.6	3.3	5.0
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	2.0	2.0	2.0
Credit to private sector, % total deposits	107.4	102.7	96.1	96.2	91.8	86.9	84.5	82.0	79.7
Private sector deposits, % yoy	20.0	16.0	13.5	2.8	7.8	6.3	5.0	5.0	5.0
Bank capital & reserves, % total loans	20.2	17.9	18.0	21.0	21.8	21.7	23.3	25.1	27.1
3 month inter-bank rate, %, eop	3.62	3.15	1.14	0.98	0.90	0.66	0.66	0.66	0.66
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
<b>Balance of Payments, USD bn</b>									
Current account	41.9	57.8	29.1	37.8	66.2	79.2	103.1	102.7	99.7
% of GDP	37.3	42.3	27.6	31.9	43.3	44.8	51.0	49.5	47.8
Trade balance	43.2	61.4	36.9	48.9	79.7	96.8	118.2	119.8	118.1
Exports	63.5	83.5	55.9	68.7	101.5	119.2	142.9	147.0	148.0
o/w oil, % total exports	94.4	95.0	89.9	92.1	93.9	94.7	94.2	92.7	90.6
Imports	20.3	22.0	19.0	19.8	21.8	22.5	24.7	27.2	29.9
Service balance	-3.2	-3.7	-2.3	-6.9	-7.9	-9.6	-10.5	-11.6	-12.7
Income balance	12.6	10.3	7.9	8.7	8.9	9.2	9.0	8.7	8.9
o/w outward remittances, % GDP	-8.5	-7.0	-11.0	-10.0	-8.3	-8.6	-7.7	-7.6	-7.7
FDI, net	-9.5	-8.4	-7.4	-1.1	-7.7	-5.5	-6.0	-5.5	-5.2
<b>Public Finances, % of GDP</b>									
Government revenues	54.8	63.8	56.3	64.4	66.5	70.1	73.4	70.5	70.6
o/w oil revenues	48.3	57.2	47.5	54.7	57.8	60.7	63.3	62.5	61.0
Government expenditure	29.8	46.1	36.9	47.2	38.4	37.6	36.5	38.4	41.1
o/w capital expenditures	12.6	30.4	17.1	23.5	19.8	20.8	20.0	21.5	23.5
Government balance	25.0	17.7	19.4	17.2	28.1	32.5	36.8	32.1	29.5
non-oil balance, % of non-oil GDP	-48.9	-97.2	-55.3	-80.7	-75.5	-75.4	-76.4	-85.6	-85.2
Breakeven oil price (fiscal), US\$/barrel	34.86	68.80	36.48	54.40	48.80	43.72	45.79	52.24	52.96
Public debt	12.4	10.2	11.1	11.2	8.4	6.2	5.6	5.9	6.5
Cumulative government balance since 2000	137.0	154.7	174.1	191.2	219.4	251.9	288.7	320.8	350.3
Net debt (public debt net cumulative balance)	-124.6	-144.5	-162.9	-180.1	-210.9	-245.6	-283.1	-314.9	-343.9
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	57.6	52.9	45.7	41.1	35.0	28.6	31.5	34.6	38.1
External debt / GDP	51.2	38.7	43.5	34.7	22.9	16.2	15.6	16.7	18.2
External debt / XGS	90.7	63.4	81.7	59.8	34.5	24.0	22.0	23.5	25.7
External Assets	219.1	261.3	321.5	349.8	387.6	453.8	533.0	636.1	738.7

Source: National Sources, Citi Research Estimates

# Lebanon

## ■ Key developments on the month

- Sectarian violence rises, Saudi Grants US\$3bn to Lebanese army;
- Cabinet formation breakthrough held up by FPM;
- Oil and gas bidding round postponed yet again.

## ■ 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

Sectarian violence rises, but civil war unlikely

**Lebanon's sectarian tensions continue to flare against a backdrop of the Syrian civil war and ongoing domestic political stasis.** One development of particular concern is the recent emergence of Al Qaeda-linked extremist attacks, including that against the Iranian embassy late last year, and a Beirut car-bomb for which the Islamic State in Iraq and the Levant (ISIL) claimed responsibility, underpinning the risk of a regional sectarian conflict engulfing the entire Levant. That said, we maintain that a descent into all-out civil war in the near term remains unlikely, mainly due to the overwhelming military superiority of Hizbollah. We also continue to view sovereign risk as relatively stable despite the obvious deterioration in country risk, mainly due to the stability in the Lebanese banking system (see [Lebanon Macro View - What's behind those Lebanese remittances?](#) 30 October).

Escalation could reflect frustration with Iran diplomatic breakthrough

**We think this escalation is rooted in two recent developments.** The first is the Syrian government's recent spate of military success, particularly in the strategic Qalamoun offensive which is heavily supported by Hizbollah troops. The second is the diplomatic progress being made by the P5+1 and Iran, which has frustrated Iran's regional detractors. While we still think a descent into civil war in Lebanon is unlikely, the recent widening of targets could be the start of a worrying escalation in the proxy war, and does spell risks for Lebanon's internal stability.

Saudi Arabia grants Lebanese army US\$3bn in aid

**Saudi Arabia has granted the Lebanese army US\$3bn in financial support.** The announcement came shortly after the assassination of former finance minister Mohamad Chatah, a Sunni politician and staunch critic of the Assad regime. In our view, the objective of this support is to bolster the Lebanese army's capacity in the face of domestic militant groups, the most potent of which is Hizbollah, which Saudi Arabia has long opposed. In the current polarised environment, however, the possibility that this strategy may lead to the army trying to reassert military control over the country spells significant risks, in our view. As we have long argued, the broader stability of Lebanon rests in large part on the status quo in the balance of power – any attempts to shift this may unleash more widespread violence, in our view.

Cabinet breakthrough held up by row over rotations

**Local press reports suggest that Prime Minister designate Tammam Salam may be making headway in reaching a deal on a new cabinet (The Daily Star, January 22).** International pressure as well as concerns regarding Lebanon's apparent slide into sectarian strife and economic difficulty could be forging a compromise on the central issue of representation, with the 9-9-6 formula, until now pushed by Hizbollah and rejected by the centrists and March 14, being re-packaged into an 8-8-8 formula (no explicit veto) where March 14 and March 8 each have recourse to an additional centrist vote if need be. The finalisation of a deal remains elusive at the time of writing, however, due to the refusal of the Free Patriotic

Movement (FPM), led by Michel Aoun, to accept a rotation of ministerial portfolios. The FPM controls the Energy and Telecommunications ministries, and has signaled its reluctance to relinquish these, ostensibly until new parliamentary elections have been completed.

**In the meantime, policy-making capacity remains extremely limited.** This is not the first time that Lebanon has lacked a government for an extended period of time: indeed, it took Nagib Mikati five months to form the previous government. However, there are a number of critical differences that make the current political impasse particularly detrimental to the country's socio-economic stability. First, the level of violence and insecurity in Lebanon has risen dramatically. Second, the lack of a government has coincided with a de facto lack of parliament, as the boycott by March 14 and affiliates has prevented parliament convening since its term was extended in June due to lack of quorum. Day-to-day management of the country's affairs, such as approval of civil servant salaries, has become difficult and often reliant on presidential decree.

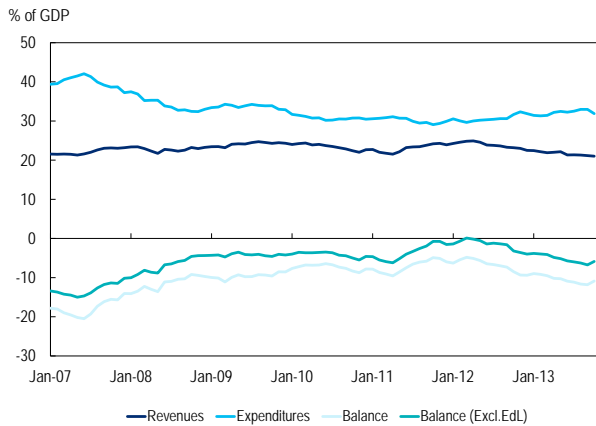
Coming end of president's term adding to political stasis

**A looming threat that may deepen Lebanon's constitutional crisis is the approaching end of the president's term, with no alternative candidate so far identified.** Although President Sleiman's term does not end until next May, the prospect of a presidential vacuum in the event that the parties fail to agree on a (Maronite) candidate to replace Mr Sleiman is adding to the political stasis. An extension of Mr Sleiman's term is possible, but the issue is yet another example of the seeming inability of Lebanese politics to move forward in the current charged climate, not least due to events in neighbouring Syria.

Lebanon's oil and gas plans a victim of the political gridlock

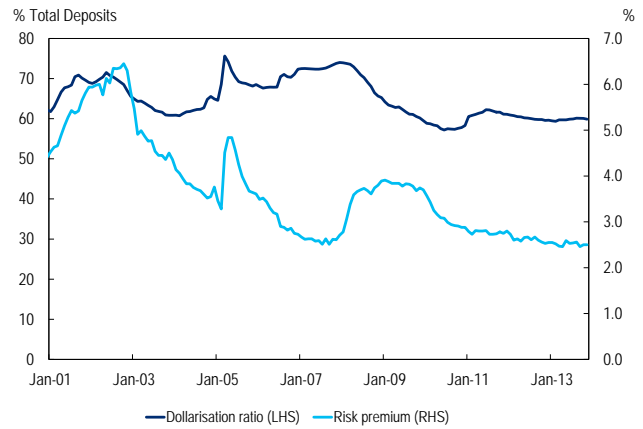
**One victim of the lack of government will likely be Lebanon's attempts to develop its potentially substantial offshore oil and gas resources.** Last February saw the launch of the much-anticipated tendering process of Lebanon's first offshore exploration blocks. We believe that exploitation of Lebanon's oil and gas potential could be a game-changer: the country's energy paucity is a major drag on the economy. It is in part responsible for its domestic electricity crisis, with brown-out rationing costing the economy billions of dollars a year. High fuel costs are also the main cause of the hole in Electricité du Liban's (EdL) finances, which drains around 4% of GDP out of the annual government budget. And the fuel importation bill (well over 10% of GDP per year) is a key driver of the current account deficit, making the economy highly dependent on continued capital inflows (deposits). A cheap domestic source of gas could, therefore, spur a major transformation in the country's economic fortunes. This appears, however, unlikely to progress in the current political climate, and has been three-times delayed, most recently in January to mid-April. We believe it is likely to be delayed yet again.

Figure 42. Fall in expenditures, rise in revenues, narrowing the deficit



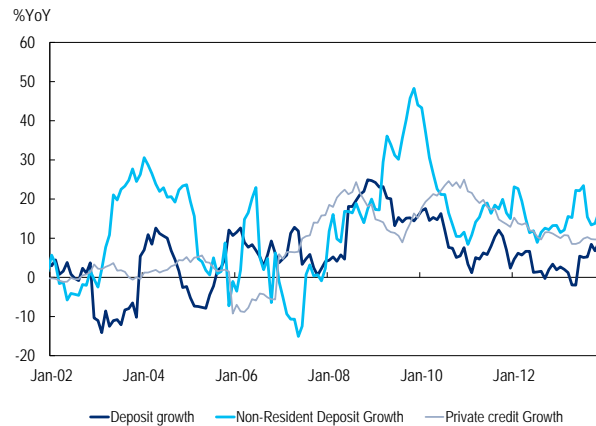
Source: Haver Analytics, Citi Research

Figure 43. Rise in dollarisation, LBP deposit premium over USD stable



Source: Haver Analytics, Citi Research

Figure 44. Banking growth indicators have eased in recent months



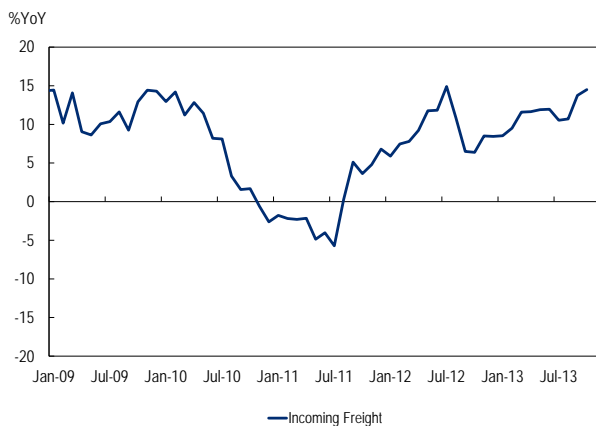
Source: Haver Analytics, Citi Research

Figure 45. Passenger arrivals continue to disappoint



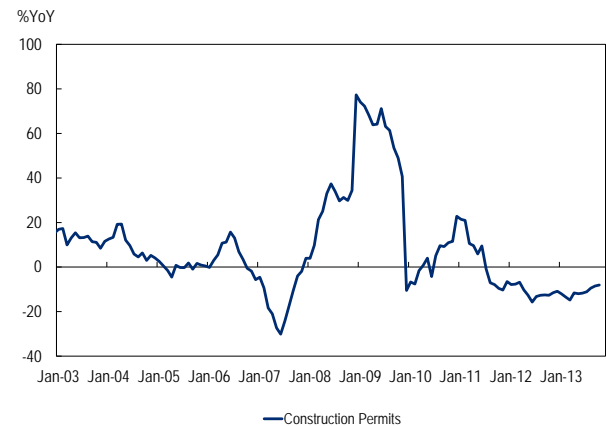
Source: Haver Analytics, Citi Research

Figure 46. Incoming freight volumes have picked up recently



Source: Haver Analytics, Citi Research

Figure 47. Construction permits (sq. metre) are weak



Source: Haver Analytics, Citi Research

Figure 48. Lebanon Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	24.6	28.8	35.1	38.0	40.1	43.0	45.3	48.1	51.1
Nominal GDP, local currency bn	37,050	43,465	52,974	57,300	60,419	64,800	68,325	72,444	77,091
GDP per capita, US\$	6,538	7,572	9,111	9,726	10,126	10,647	11,006	11,441	11,936
Population, mn	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.2	4.3
<b>Economic Activity</b>									
Real GDP, % yoy	9.3	9.1	10.3	8.0	2.0	2.5	1.4	2.0	2.4
Real per capita GDP, % yoy	9.3	7.7	8.9	6.6	0.7	0.5	-0.5	0.0	0.4
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	6.0	5.5	3.4	4.6	3.1	10.1	0.8	5.7	5.0
CPI, % avg	4.1	10.8	1.2	4.0	5.1	6.4	2.0	3.4	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	20.0	20.0	20.0
Credit to private sector, % total deposits	26.1	26.8	25.1	27.9	29.1	29.6	29.6	29.6	29.6
Private sector deposits, % yoy	12.4	14.9	19.5	12.0	6.5	6.8	20.0	20.0	20.0
Bank capital & reserves, % total loans	15.9	15.3	14.9	15.5	16.9	18.3	19.4	20.5	21.5
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
<b>Balance of Payments, USD bn</b>									
Current account	-1.4	-4.1	-6.7	-7.6	-4.9	-1.7	-2.1	-2.5	-3.1
% of GDP	-5.6	-14.4	-19.2	-20.0	-12.1	-3.9	-4.5	-5.3	-6.0
Trade balance	-7.9	-11.0	-11.2	-12.3	-13.9	-14.6	-15.3	-17.2	-19.2
Exports	4.0	5.3	4.7	5.5	6.0	6.2	6.5	6.9	7.2
Imports	11.9	16.3	15.9	17.7	19.9	20.8	21.9	24.1	26.5
Service balance	3.0	4.1	2.8	2.6	6.7	9.9	10.9	11.9	13.1
Income balance	0.7	0.4	-0.2	-0.5	-0.2	0.4	-0.5	-0.5	-0.5
FDI, net	1.9	3.3	3.7	3.8	2.7	1.4	1.2	1.1	1.0
<b>Public Finances, % of GDP</b>									
Government revenues	23.6	24.3	24.0	22.1	23.3	21.9	20.8	20.6	20.4
Government expenditure	34.0	34.4	32.4	29.8	29.1	31.0	30.9	30.0	29.0
o/w capital expenditures	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	-10.0	-9.3	-8.7
Public debt	158.8	144.1	125.7	118.5	115.7	114.3	118.4	121.0	122.4
Government's deposits with banks	42.2	43.0	50.2	52.3	58.0	62.2	64.9	67.3	69.6
Net debt (public debt net cumulative balance)	116.7	101.1	75.5	66.2	57.7	52.0	53.5	53.7	52.8
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	28.8	30.2	35.6	37.3	40.6	44.6	46.8	49.2	51.6
External debt / GDP	117.1	104.7	101.3	98.0	101.2	103.8	103.3	102.3	101.0
External debt / XGS	169.0	132.3	164.8	173.4	158.3	157.2	151.6	146.1	140.8
External Assets	-47.1	-48.2	-50.5	-53.7	-58.5	-60.2	-62.2	-64.8	-67.9

Source: National Sources, Citi Research Estimates

# Oman

## ■ Key developments on the month

- 2014 budget announced, in line with our views;
- 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

Significant erosion in public finances going forward

**Oman' has announced a 2014 budget that anticipates a 5% increase in expenditures and a budget deficit of 6% of GDP.** We maintain our forecast of 3.4% of GDP deficit, given that we see oil prices higher than the US\$85 per barrel upon which the budget is based, but 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\$118 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 are expecting 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 remains 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 in order 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, November 30).

High likelihood of debt issuance in coming months

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

**Growth and job creation are key goals of the government, but are constrained by gas shortages**

**A relatively small economy and lack of jobs are the major constraints on employment, and job creation through growth and diversification is therefore a key priority of the government.** A major obstacle to growth is the country's relatively poor hydrocarbon endowment. Crude oil production is recovering owing to enhanced recovery efforts, but gas remains in limited supply, with around half of Oman's total output dedicated to LNG exports under long-term contracts. According to the US Energy Information Agency, Oman exported 408 bcf of gas in 2009, and consumed 520 bcf, implying total gas demand of 928 bcf. Total production was around 875 bcf, and growing rapidly. The shortfall in gas is made up in imports, mainly from Qatar through the Dolphin pipeline. The lack of gas severely constrains power generation, with outages occurring during peak season (summer), and is constraining the sultanate's ability to expand industrial production. Work has begun on the GCC grid, which will allow Oman to import energy from its neighbours, but this will not be completed for a number of years.

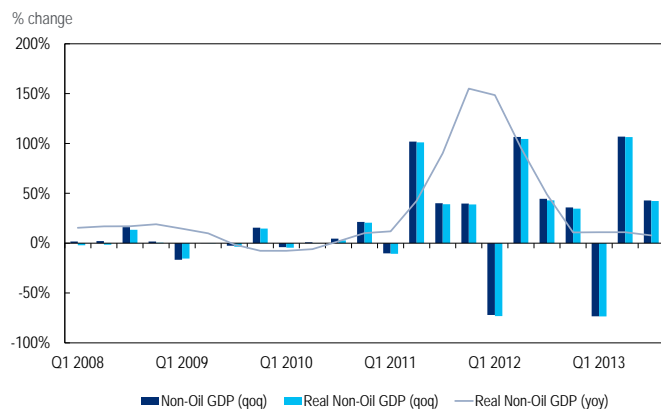
**Meanwhile, the tourism industry remains largely unaffected by the unrest**

**After the typical lull in hotel activity in July and August, September saw 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. In November occupancy rates jumped to 83%, while room rates remained reasonably robust at US\$208. 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 to build momentum gradually in 2014**

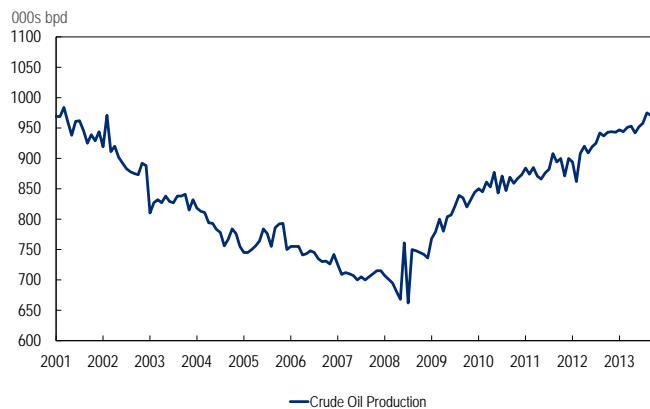
**Credit growth continues to be stuck in the single digits/low teens with no immediate signs of a return to the 50%YoY rates experienced in 2008.** While credit growth remains weak, it is likely that we have passed the trough with credit momentum in both the private and government sectors beginning to build. In particular the private sector is needed to push forward credit growth, given it dominates bank lending with almost 90% of bank credit.

Figure 49. Quarterly data shows drop in non-oil GDP



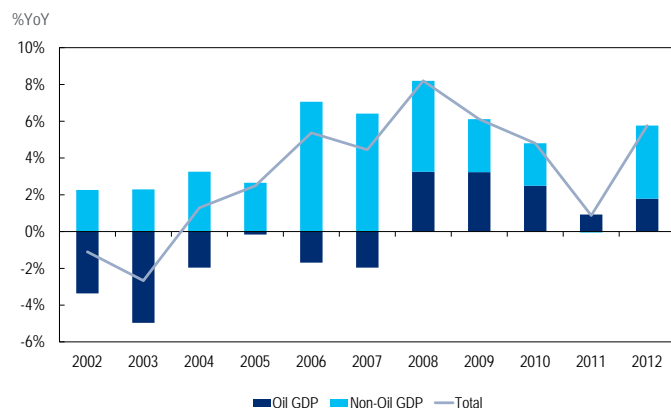
Source: Haver Analytics, Citi Research

Figure 50. Oil production continues to pick up



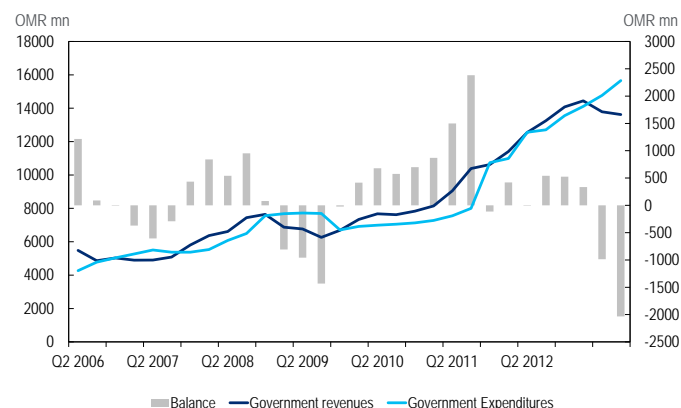
Source: Bloomberg

Figure 51. Non-oil GDP remains the engine for growth in Oman



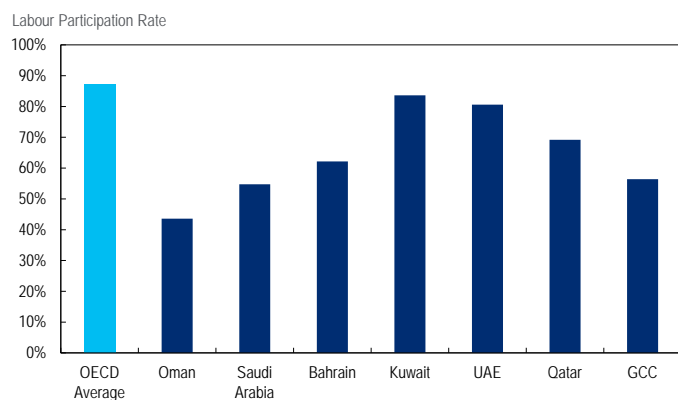
Source: Haver Analytics, Citi Research

Figure 52. Sharp rise in expenditures hurts government balance



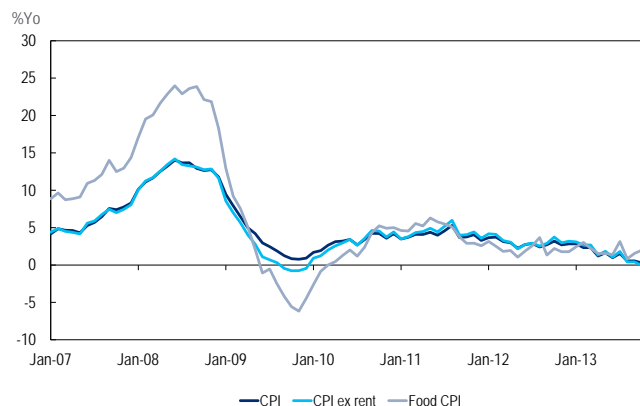
Source: Haver Analytics, Citi Research

Figure 53. Job participation lowest in GCC



Source: OECD, national statistics bureaus, Citi Research

Figure 54. Inflationary pressures remain subdued



Source: Haver Analytics, Citi Research

Figure 55. Oman Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	41.9	59.9	53.4	53.4	53.4	53.4	87.6	94.4	100.8
Nominal GDP, local currency bn	16.1	23.4	18.5	22.6	26.9	30.0	33.7	36.3	38.8
GDP per capita, US\$	15,259	20,887	18,015	17,438	16,881	16,180	25,324	26,126	26,703
Share of oil in GDP (real)	28.1	26.6	26.0	27.2	27.5	26.9	26.0	25.1	24.2
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
<b>Economic Activity</b>									
Real GDP, % yoy	10.4	14.6	9.5	-0.5	1.5	7.1	6.7	6.7	6.7
Real per capita GDP, % yoy	2.8	9.6	6.0	-3.7	-1.7	2.7	1.7	2.2	2.1
Real non-oil GDP, % yoy	11.9	14.9	3.1	6.3	5.4	9.6	8.0	8.0	8.0
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	8.3	11.8	0.9	4.2	3.3	2.8	0.7	2.7	3.0
CPI, % avg	5.9	12.5	3.6	3.2	4.0	2.9	1.3	2.0	3.0
Policy interest rate, %, eop	6.02	1.97	2.00	2.00	2.00	1.00	2.00	2.00	2.25
Credit extension to private sector, % yoy	38.8	40.5	5.0	6.2	13.0	14.9	15.0	10.0	10.0
Credit to private sector, % total deposits	94.0	98.8	98.0	90.9	85.9	87.6	87.6	83.8	80.1
Private sector deposits, % yoy	37.4	20.1	2.6	10.6	11.0	12.3	15.0	15.0	15.0
Bank capital & reserves, % total loans	22.4	19.5	19.4	19.7	18.4	18.9	20.0	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
<b>Balance of Payments, USD bn</b>									
Current account	2.5	5.0	-0.5	5.0	9.0	8.1	9.1	7.7	6.3
% of GDP	5.9	8.4	-0.9	9.4	16.8	15.2	10.3	8.1	6.2
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	8.8	8.6	9.9	10.7	13.5	15.1	9.4	8.9	8.5
FDI, net	3.4	2.4	1.4	-0.3	-0.5	0.1	0.6	0.3	0.1
<b>Public Finances, % of GDP</b>									
Government revenues	36.7	32.7	36.4	35.0	39.5	46.9	42.0	39.7	36.9
o/w oil revenues	28.4	26.1	28.3	28.5	33.6	40.1	35.7	33.5	30.8
Government expenditure	33.3	32.4	36.2	31.5	39.9	45.1	42.2	43.1	42.3
o/w capital expenditures	9.5	9.8	12.8	10.8	11.0	9.6	9.4	9.6	9.9
Government balance	3.4	0.3	0.2	3.5	-0.4	1.7	-0.2	-3.4	-5.4
non-oil balance, % of non-oil GDP	-43.7	-51.2	-45.1	-44.8	-64.3	-72.3	-66.9	-65.5	-60.6
Breakeven oil price (fiscal), US\$/barrel	63.62	98.35	62.04	70.56	112.29	108.07	110.07	118.43	120.56
Public debt	6.9	4.8	6.0	6.1	7.2	8.8	6.5	6.9	6.5
Cumulative government balance since 2000	13.3	13.7	13.9	17.3	16.9	18.7	18.5	15.1	9.6
Net debt (public debt net cumulative balance)	-6.4	-8.9	-7.8	-11.2	-9.8	-9.9	-12.0	-8.1	-3.1
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	10.1	13.3	12.7	11.5	13.7	15.3	15.6	16.0	16.0
External debt / GDP	24.1	22.1	23.7	21.6	25.6	28.6	17.9	17.0	15.9
External debt / XGS	38.3	33.6	43.4	29.9	27.7	27.8	29.5	28.3	26.3
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

- Credit growth decelerates, but banking trends remain unfavourable;
- Inflation remains subdued, but pressures from housing on the rise.

### ■ 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

### Credit growth has decelerated sharply

**Credit growth in Qatar has decelerated sharply.** Total credit growth fell to just 12% YoY in November, from 27% a year earlier. This has been mainly due to a slowdown in lending to the government, which rose by just 10% in November, compared with over 50% a year earlier.

### Slow-down in credit growth does not allay all concerns regarding banking sector

**The slow-down in lending growth does not, however, allay our concerns regarding lending trends in the banking sector and their potential impact on future credit quality.** 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 rising

**Inflation remains subdued, but we see pressures building, particularly from the housing market.** Headline inflation remained low, at 2.7% in December. However, the resurgence of inflation in the housing sector does indicate a potential acceleration in overall price levels going forward. Since the beginning of 2009 property prices and rents had been on a steady decline, keeping overall inflation subdued, and sometimes even negative. In the past 15 months, however, rent inflation has registered in positive territory on a YoY basis, although it has been steady in the 5% range. While we continue to see fundamental weakness in the real estate market emanating from a large supply overhang which will 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 the CPI going forward.

**Too early to judge policy shifts from change in Emir**

**We believe that it is still too early to judge whether significant shifts in policy are to be expected as a result of the abdication of the former Emir, Sheikh Hamad bin Khalifa al Thani, in favour of his 33-year old son Sheikh Tamim.** We remain aware that the institutional weakness inherent in monarchies across the Gulf region means that government and policy is very much dictated by the political leadership, and not by the bureaucracy. This makes for nimble policy-making on the one hand, but for policy unpredictability on the other, particularly when the leadership changes. We point out two areas where we think there is potential uncertainty going forward.

**One potential area of change is in domestic political reform**

**The first is domestic political reform.** In 2003, Qatar adopted a new constitution that called for a partially elected consultative council, but the vote has yet to be held. After several delays, the elections, which will see 30 of the 45 available seats publicly contested by universal suffrage, are due in the second half of 2013. Constitutionally, the council's role is similar to Kuwait's national assembly, notably in its ability to monitor government through no-confidence votes. Kuwait's experience in recent years highlights the risk of political gridlock inherent in such a system, presenting a potential challenge for Sheikh Tamim and government policy in the medium term.

**The second is in foreign policy, particularly role in Egypt and Syria**

**The second is foreign policy.** Sheikh Hamad bin Jassim, the current PM and Foreign Minister, has been a key architect of Qatar's foreign policy and has worked hard in asserting Qatar's interests regionally and internationally through aggressive efforts in international diplomacy. Were he to step down, questions are likely to arise regarding Qatar's regional role. It is clear that developments in Egypt have forced Qatar to take a step back there, but whether this will translate into a shift in foreign policy is not yet clear.

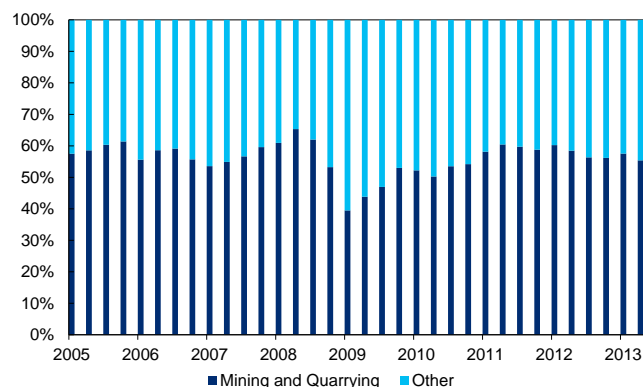
**Housing sector should get support from World Cup, regional developments, but will remain plagued by oversupply, in our view**

**We believe the housing sector will get a boost from the substantial infrastructure spend that is under way in Qatar ahead of the 2022 World Cup.** 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 (see below). This should help contain inflationary pressures for the foreseeable future.

**Construction leads growth as the gas sector levels off**

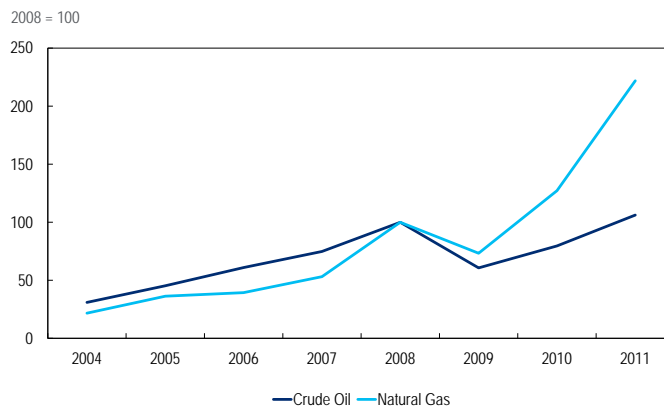
**Available data suggest that construction and infrastructure development will be the key drivers of growth in the wider economy in the coming decade,** as the oil sector levels off. Economic growth slowed sharply in the second quarter of 2012 to just 4.9%YoY, compared with 21% for the same period last year. However, the overall growth figures are somewhat misleading, in that they are skewed by the expected plateau in Qatari gas production (overall oil and gas growth was just 0.7%). The non-oil economy performed considerably better, growing by 8.5% in Q2 YoY, compared with 5.9% for the same period last year. The construction sector was the main driver of growth, though the transport sector and manufacturing also saw strong gains. The recent discovery of 2.5 trillion cubic feet of natural gas further boosts Qatar's already abundant natural gas reserves.

Figure 56. Natural resources still a major part of activity



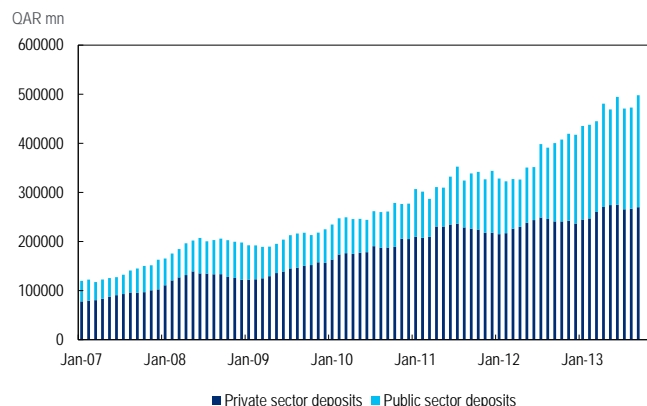
Source: Haver Analytics, Citi Research

Figure 57. But LNG IP surging relative to crude



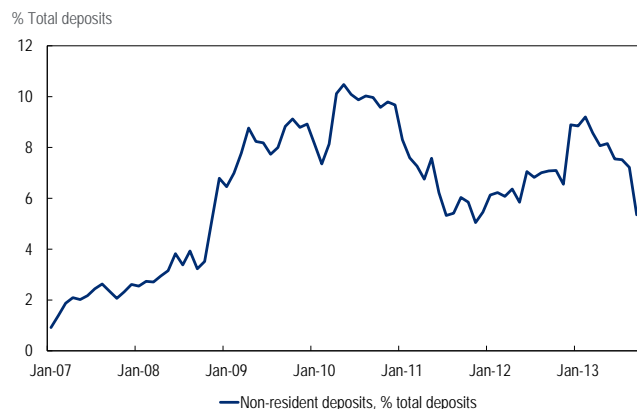
Source: Haver Analytics, Citi Research

Figure 58. Public sector deposits a major source of bank funding



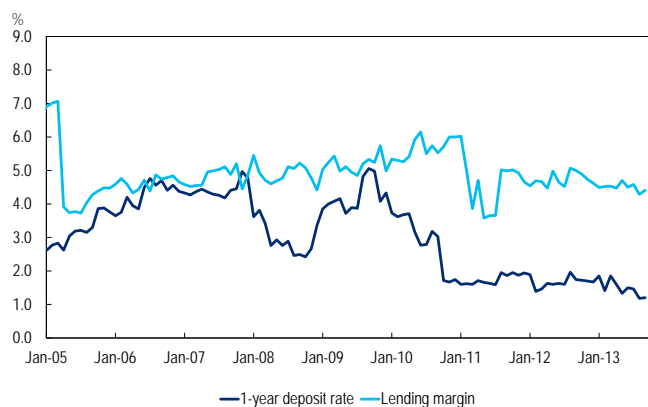
Source: Haver Analytics, Citi Research

Figure 59. Non-resident deposit growth has begun to ease



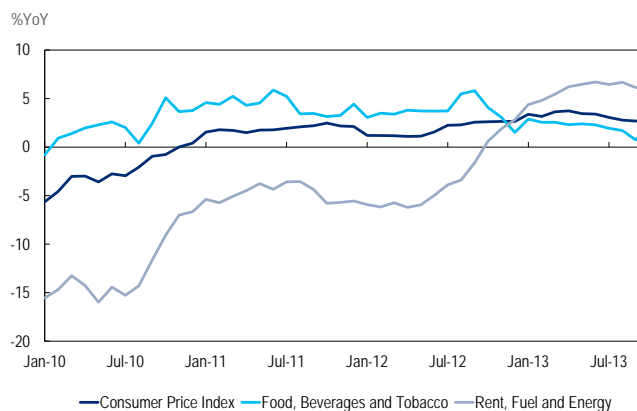
Source: Haver Analytics, Citi Research

Figure 60. Lending margins have stabilised



Source: Haver Analytics, Citi Research

Figure 61. Rising rent continues to put pressure on CPI



Source: Haver Analytics, Citi Research

Figure 62. Qatar Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	79.7	115.3	97.8	125.1	171.5	192.4	204.9	218.8	234.0
Nominal GDP, local currency bn	290.2	419.6	356.0	455.4	624.2	700.3	745.7	796.4	851.9
GDP per capita, US\$	85,712	104,982	80,294	92,546	114,241	118,688	117,011	115,707	114,605
Share of oil in GDP (real)	44.7	43.0	40.2	44.4	45.5	43.5	41.2	38.9	36.7
Average oil production (mbpd)	-	-	-	-	-	-	-	-	-
Population, mn	0.9	1.1	1.2	1.4	1.5	1.6	1.8	1.9	2.0
<b>Economic Activity</b>									
Real GDP, % yoy	18.0	17.7	12.0	16.7	13.0	6.2	5.6	5.9	6.1
Real per capita GDP, % yoy	6.3	-0.3	0.9	5.2	1.7	-1.6	-2.2	-2.0	-1.7
Real non-oil GDP, % yoy	21.6	21.3	17.6	8.6	10.8	10.0	10.0	10.0	10.0
<b>Prices, Money &amp; Credit</b>									
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	15.0	15.0	15.0
Credit to private sector, % total deposits	66.0	75.4	71.9	62.2	62.6	56.4	51.9	47.7	43.9
Private sector deposits, % yoy	-	19.1	28.2	30.9	6.3	8.6	25.0	25.0	25.0
Bank capital & reserves, % total loans	-	96.2	98.0	104.4	96.5	96.1	98.5	100.7	107.0
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
<b>Balance of Payments, USD bn</b>									
Current account	11.5	26.6	6.4	23.8	52.0	61.6	60.9	55.8	48.5
% of GDP	14.4	23.1	6.5	19.0	30.3	32.0	29.7	25.5	20.7
Trade balance	23.3	42.2	25.6	53.9	87.4	102.2	98.9	96.9	93.0
Exports	44.5	67.3	48.0	74.8	114.3	133.0	137.4	145.0	153.1
o/w oil, % total exports	86.4	88.2	85.7	82.6	85.3	82.2	77.6	72.4	66.1
Imports	21.1	25.1	22.5	20.9	26.9	30.8	38.5	48.1	60.1
Service balance	-3.9	-3.8	-3.9	-5.8	-9.5	-14.0	-15.4	-16.9	-18.6
Income balance	-4.2	-6.8	-9.4	-12.9	-13.3	-12.1	-12.7	-13.4	-14.0
o/w outward remittances, % GDP	5.6	4.7	7.3	6.5	6.0	5.6	6.0	6.5	7.0
FDI, net	-	-	-	-	-5.9	-2.2	-2.4	-2.6	-2.9
<b>Public Finances, % of GDP</b>									
Government revenues	40.6	33.6	47.5	34.3	35.7	40.0	39.1	38.6	37.8
o/w oil revenues	24.4	19.1	23.3	21.3	24.9	24.8	22.7	20.9	18.8
Government expenditure	29.7	23.8	34.2	31.6	27.9	28.2	31.0	34.4	36.6
o/w capital expenditures	11.7	8.0	11.0	9.7	8.1	7.3	7.2	7.4	7.6
Government balance	10.9	9.8	13.4	2.7	7.7	11.8	8.1	4.2	1.2
non-oil balance, % of non-oil GDP	-27.9	-20.6	-17.9	-39.3	-42.2	-30.8	-31.9	-33.5	-32.1
Public debt	8.2	9.2	34.9	42.9	37.9	36.3	38.2	37.4	36.7
Cumulative government balance since 2000	68.2	78.0	91.4	94.1	101.8	113.6	121.7	125.9	127.1
Net debt (public debt net cumulative balance)	-60.0	-68.9	-56.5	-51.1	-63.9	-77.3	-83.5	-88.5	-90.3
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	42.5	58.0	80.5	109.0	131.8	157.3	166.0	188.0	188.0
External debt / GDP	53.4	50.3	82.3	87.1	76.9	81.8	81.0	85.9	80.3
External debt / XGS	88.5	81.9	161.0	140.1	108.3	110.1	120.9	129.6	122.8
External Assets	45.2	71.8	78.2	102.0	153.9	216.3	277.2	332.9	381.4

Source: National Sources, Citi Research Estimates

## Saudi Arabia

### ■ Key developments on the month

- Potential rise in oil production in Iraq and Iran spell downside risks to Kingdom;
- Public finances to remain robust, but longer-term concerns emerge;
- Enforcement of Nitiqat in full swing.

### ■ 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

### Risks to oil production and forecasts from regional developments

**Oil production declined in the final months of 2013, bringing the yearly average production to 9.5mbpd, in line with our forecasts.** We expect production to decline slightly in 2014, and we are forecasting an average for 2014 of 9.2mbpd. The drop in production will reflect the slight softening in oil prices that we are forecasting going forward, along with increased production elsewhere in the region, most notably Iraq, where we anticipate an increase of around 500kbpd in exports next 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.

### Public finances will remain strong in near term

**That said, public finances and external balances are expected to remain robust in the near term:** we forecast the current account surplus to remain in double digits in 2014, while we expect the fiscal surplus to narrow from around 10% this year to a still healthy 5% in 2014. That said, we think rising expenditures and an expected leveling off in oil revenues present a challenge in the medium- to long-term. We expect the fiscal breakeven oil price to rise to over US\$90 per barrel in 2014 and to continue to rise, resulting in forecast deficits as early as 2016. Although Saudi has ample resources to finance expected deficits from current cash reserves, the outlook does underscore the need for structural reform to set public finances on a long-term sustainable footing.

### Consumer spending still growing strongly

**Available indicators point to a continued surge in consumer spending.** Point of sales transaction in the 12 months to November last year increased in value and volume by 20% and 24% respectively over the same period a year earlier. Q3 GDP figures show that private consumption grew at a healthy annual rate of over 6%. One factor behind the strong growth in consumer spending is the rise in consumer lending. Total consumer lending by Saudi banks grew by over 18% in the year to end-Q3 2013, compared with the same period a year earlier. Interestingly, this is despite a steady decline in credit card borrowing, with consumers taking out more home loans and other personal loans to fuel consumption.

### Nitiqat programme one factor behind surge in consumer growth

**The rise in consumer spending does also reflect 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 Saudization in the past year.

**Nitiqat has reduced the number of foreign workers in the Kingdom dramatically**

**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 in the Kingdom, according to the minister of labour. This process stepped up a gear after the grace period ended in November, and security forces have begun a widely reported campaign of rounding up suspected illegal immigrants, in some cases leading to violent confrontations. These first aftershocks have led to more undocumented migrants handing themselves in to the authorities for deportation. There are currently many thousand immigrants from various countries, including Arab countries such as Egypt and Jordan, awaiting deportation from the Kingdom.

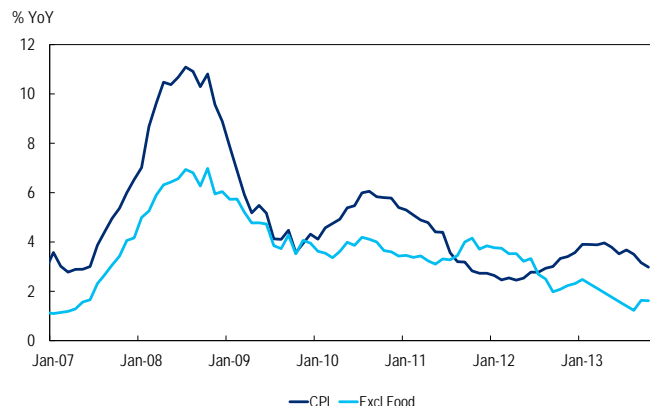
**...and forcing the hiring of Saudis**

**The second thing that has happened is that companies operating in Saudi Arabia have upped their hiring of Saudi nationals in order 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.

**Nitiqat policy necessary, if controversial**

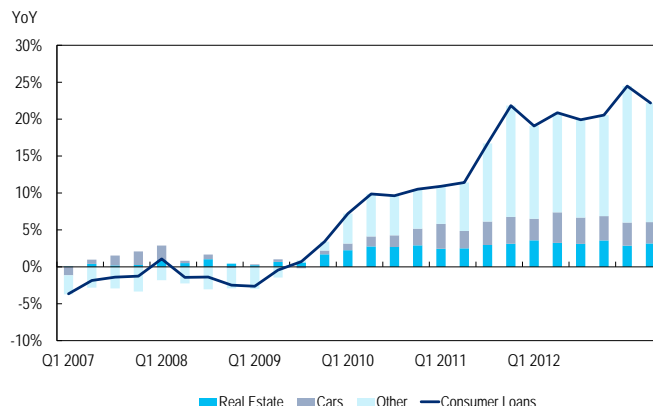
**The Nitiqat programme, in our view, is necessary to tackle the question of socio-economic sustainability of growth in Saudi Arabia.** Unemployment officially stands at under 12%, but the job participation rate is very low, at around 50% of the adult population. There are cultural reasons for this, including the question of women in the workplace, but Saudi Arabia, like other Gulf states, generally suffers from a skewed labour market where cheap, skilled foreign labour has taken precedence over the hiring of more expensive, less skilled local labour. 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 63. Inflation begins to pick back up but remains subdued



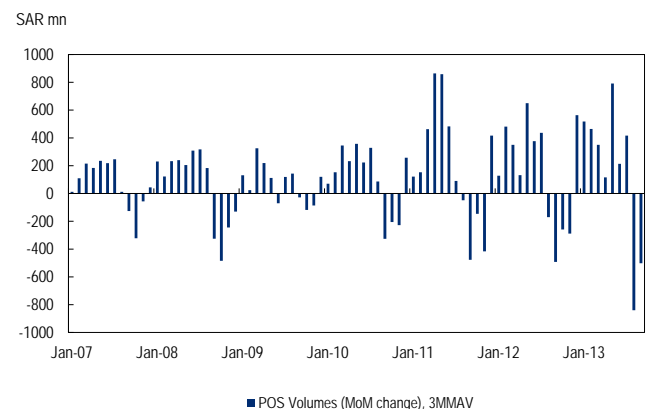
Source: Haver Analytics, Citi Research

Figure 64. Consumer lending has picked up sharply



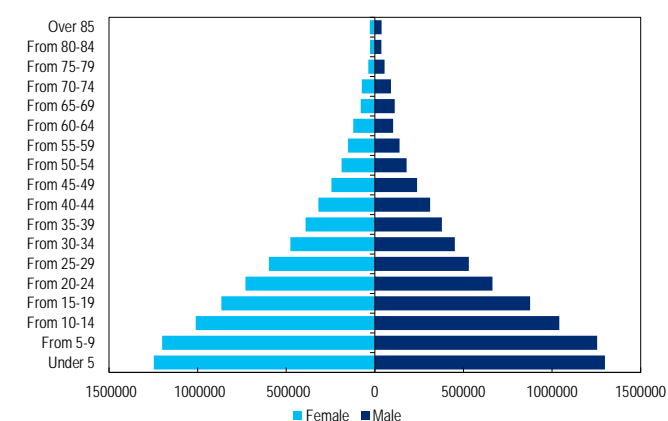
Source: Haver Analytics, Citi Research

Figure 65. Point of sales transactions remain robust



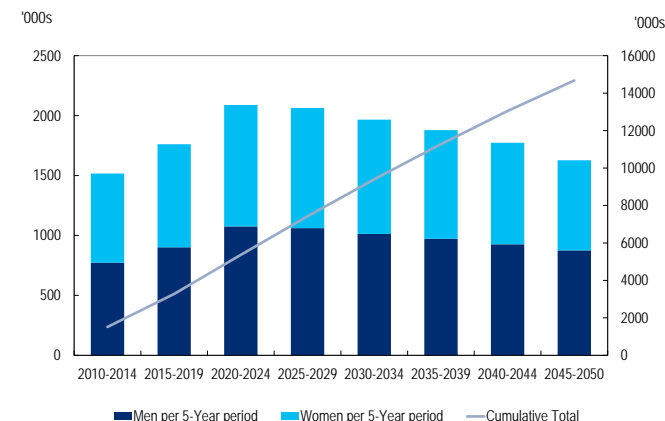
Source: Haver Analytics, Citi Research (3MMA)

Figure 66. Demographic imbalance is acute



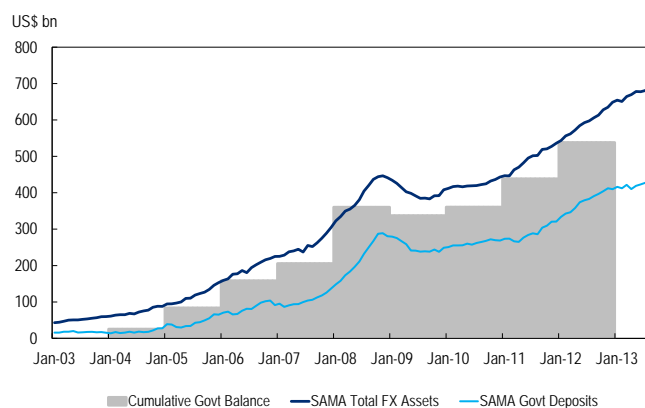
Source: SAMIRAD, Citi Research

Figure 67. Almost 2 million people coming to job market every 5 years



Source: SAMIRAD

Figure 68. Government assets stand at around US\$500bn



Source: Haver Analytics, Citi Research

Figure 69. Saudi Arabia Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
Nominal GDP, US\$ bn	415.6	519.4	429.0	526.8	669.5	733.8	764.7	812.6	865.6
Nominal GDP, local currency bn	1,558.8	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,867.9	3,048.0	3,246.6
GDP per capita, US\$	17,111	20,861	16,811	20,178	25,645	27,559	28,154	29,332	30,632
Share of oil in GDP (real)	25.4	24.4	22.0	20.7	21.2	21.3	19.5	17.9	16.5
Average oil production (mbpd)	8.69	9.21	8.05	8.25	9.24	9.77	9.50	9.20	9.00
Population, mn	24.3	24.9	25.5	26.1	26.1	26.6	27.2	27.7	28.3
<b>Economic Activity</b>									
Real GDP, % yoy	6.0	8.4	1.8	6.4	8.6	5.1	6.1	5.8	6.2
Real per capita GDP, % yoy	3.4	5.8	-0.6	4.0	8.6	3.1	4.0	3.7	4.1
Real non-oil GDP, % yoy	10.0	9.8	5.3	9.6	8.0	4.9	8.5	8.0	8.0
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	6.5	8.9	4.3	5.4	2.7	3.6	3.0	3.9	4.3
CPI, % avg	4.1	9.9	5.1	5.3	3.9	2.9	3.5	3.4	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	20.0	15.0	15.0
Credit to private sector, % total deposits	77.7	84.2	75.4	75.4	74.7	76.2	76.2	73.0	70.0
Private sector deposits, % yoy	20.9	16.7	8.4	7.0	16.5	12.2	20.0	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
<b>Balance of Payments, USD bn</b>									
Current account	94.3	133.0	21.5	67.4	159.3	165.7	134.5	106.4	75.8
% of GDP	22.7	25.6	5.0	12.8	23.8	22.6	17.6	13.1	8.8
Trade balance	151.6	212.7	105.8	154.3	245.5	247.5	221.7	201.3	178.5
Exports	233.1	313.4	192.2	251.0	364.5	388.2	383.5	387.4	392.4
o/w oil, % total exports	88.1	89.7	84.8	85.8	87.1	87.0	82.9	77.9	71.7
Imports	81.5	100.6	86.4	96.7	119.0	140.7	161.8	186.0	213.9
Service balance	-46.7	-65.9	-65.2	-66.1	-66.5	-62.4	-68.6	-75.5	-83.0
Income balance	6.4	9.2	8.6	7.0	9.7	11.0	9.1	9.1	9.2
o/w outward remittances, % GDP	-3.8	-4.0	-6.0	-5.0	-4.1	-3.9	-3.4	-3.3	-3.1
FDI, net	24.2	43.0	38.6	33.1	19.7	16.6	18.2	20.1	22.1
<b>Public Finances, % of GDP</b>									
Government revenues	42.2	57.5	34.0	39.4	46.1	47.1	43.7	40.0	35.9
o/w oil revenues	36.1	50.4	27.0	33.9	41.2	41.6	37.6	33.6	29.4
Government expenditure	29.9	26.7	37.1	33.1	32.9	31.7	33.7	35.1	35.5
o/w capital expenditures	7.6	6.7	11.2	10.1	11.0	9.5	10.2	10.8	11.1
Government balance	12.2	30.8	-3.0	6.3	13.2	15.4	10.0	5.0	0.4
non-oil balance, % of non-oil GDP	-48.4	-44.3	-51.2	-50.6	-57.8	-53.2	-50.3	-48.0	-44.8
Breakeven oil price (fiscal), US\$/barrel	47.95	38.28	69.50	65.41	75.38	71.12	80.29	91.62	101.03
Public debt	11.7	12.4	11.3	10.9	8.3	8.0	6.9	5.9	5.0
Cumulative government balance since 2000	62.1	92.9	89.9	96.2	109.4	124.8	134.8	139.8	140.2
Net debt (public debt net cumulative balance)	-50.4	-80.5	-78.6	-85.4	-101.1	-116.8	-127.9	-133.9	-135.3
<b>Foreign Assets &amp; Liabilities, USD bn</b>									
External debt	75.8	83.2	89.4	93.7	90.1	87.8	90.4	90.5	95.0
External debt / GDP	18.2	16.0	20.8	17.8	13.5	12.0	11.8	11.1	11.0
External debt / XGS	30.4	25.8	44.3	35.8	24.0	22.0	23.6	23.4	24.2
External Assets	308.7	441.0	462.0	528.7	688.1	853.7	988.3	1,094.7	1,170.5

Source: National Sources, Citi Research Estimates

## United Arab Emirates

### ■ Key developments on the month

- Expo 2020 could fuel real estate volatility;
- Dubai Group concludes restructuring, risks linger in Dubai public debt;
- Sharjah gets an Investment Grade rating.

### ■ 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

**Expo could fuel real estate volatility in Dubai**

**Dubai's award of Expo 2020 in late November capped another year of strong economic performance in the emirate, fuelling investor confidence and driving a steep recovery in asset prices.** The Dubai Financial Market all-shares index gained over 80% in value in the course of 2013, and the real estate market continues to surge, with Cluttons data showing that the average selling price of mid-range villas rose 42% during 2013. Much of this rise occurred in the first six months of the year, with property values rising by a more modest 20% per year (annualised rate) in the second half. That said, we believe that the award of Expo may fuel further exuberance in the market, which has been accompanied by the announcement of a large number of new real estate projects. For now, construction activity remains contained to new developments in prime locations, such as on the Palm or in the Downtown area. Should we see a surge in construction activity in less prime areas, accompanied by aggressive off-plan sales strategies, we believe the potential for further property-led volatility in the Dubai economy will become increasingly likely. Dubai Expo could, in our view, be a trigger for such activity.

**We believe hosting the event will provide stimulus to the economy**

**We believe hosting the event will provide stimulus to the economy in the construction phase (2015-2020) 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.**

**That said, we caution against overstating the economic benefits of hosting the Expo.** We expect direct expenditure on the event to amount to around a relatively modest 1% of GDP per year between now and 2020. However, 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.

#### Dubai Group concludes debt restructuring

**Dubai Group, the private equity arm of Dubai Holdings that has been in long-running negotiations with mainly bank creditors to restructure US\$10bn in debt, announced this month that a deal had been finalised.** Under the deal, US\$6bn of the debt will be rescheduled, with secured lending being deferred to 2016 and unsecured lending to 2024 (Reuters, Jan 23). The deal marks the closing of the last of the major debt renegotiations in the emirate since the global financial crisis rattled the Dubai economy in 2008/2009.

#### 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.

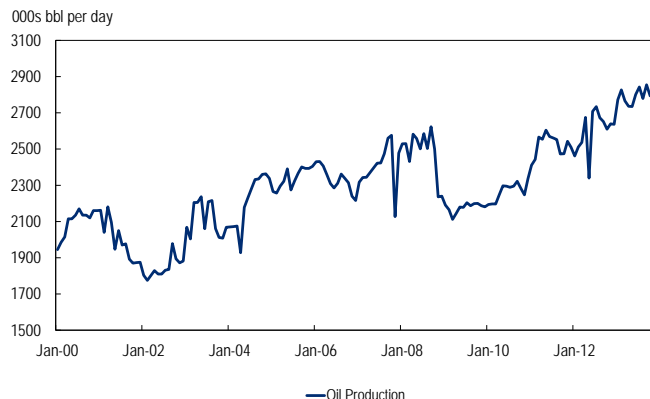
#### Sharjah gets a rating

**Standard & Poor's and Moody's both assigned ratings to the Emirate of Sharjah this month.** The government of Sharjah immediately stated that it had not made any firm decision to issue debt, but the decision to go ahead with a rating suggests there is an intention to do so in the near future should financial conditions allow. The emirate received a long-term foreign currency rating of 'A' from S&P, and 'A3' (one notch lower) from Moody's. This puts Sharjah 3-4 notches below the agencies' ratings for Abu Dhabi.

#### IG ratings flatter debt bearing capacity of Sharjah

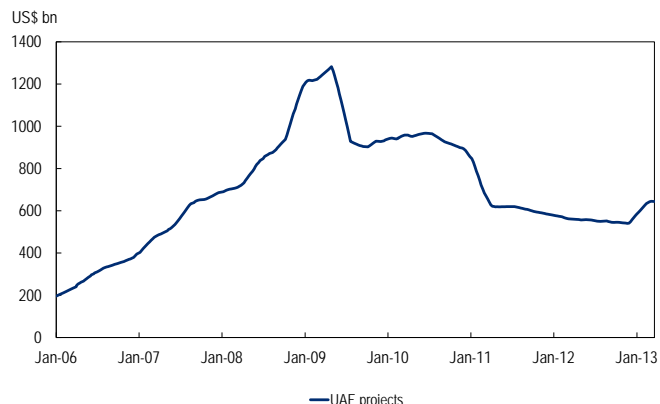
**That said, we believe that the solid investment-grade rating for Sharjah flatters its debt-servicing capacity.** Sharjah's economy is one-fifth that of Dubai's, its government revenues are one-tenth those of Dubai's and its ability to raise revenues is greatly restricted by the federal structure and the internal mobility of UAE residents. Its ability to service debt out of its own resources is thus constrained by its size, and we would expect any future issuance to be limited.

Figure 70. Abu Dhabi oil output has increased through 2013



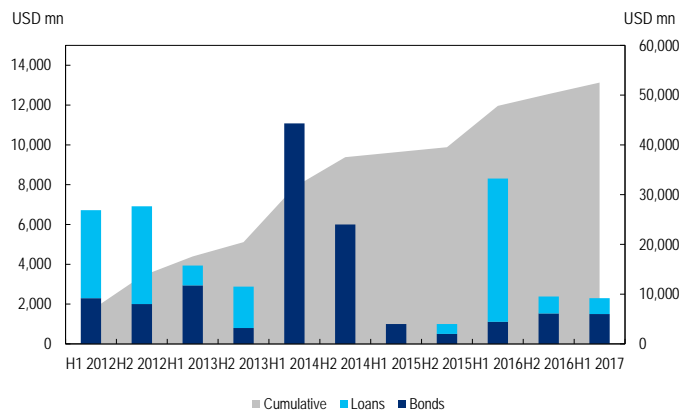
Source: Bloomberg

Figure 71. Value of projects under way has begun to pick up in the UAE



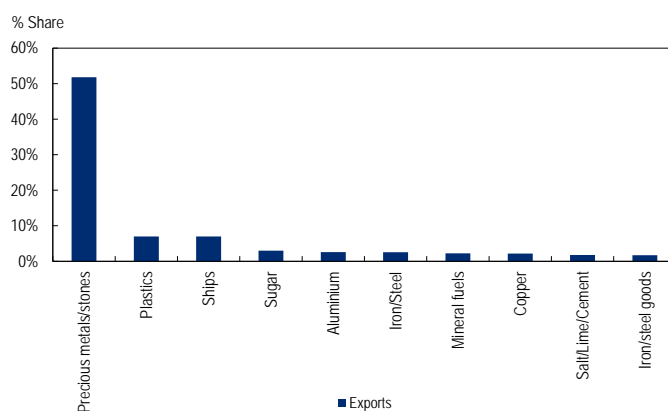
Source: MEED, Citi Research (12-wk moving average)

Figure 72. Dubai's debt refinancing requirements are lumpy



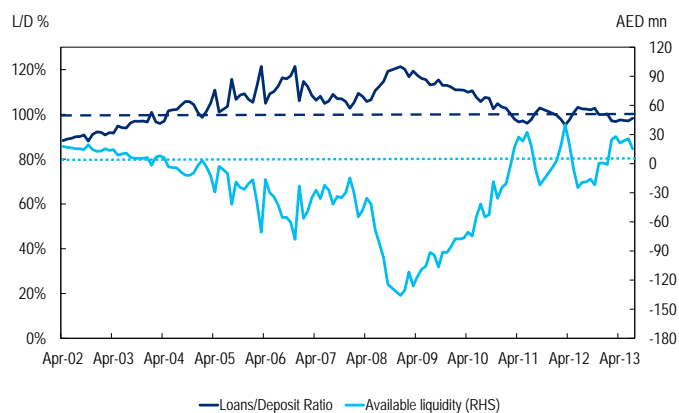
Source: Bloomberg, Dealogic, Citi Research

Figure 73. Gold dominates UAE non-oil exports



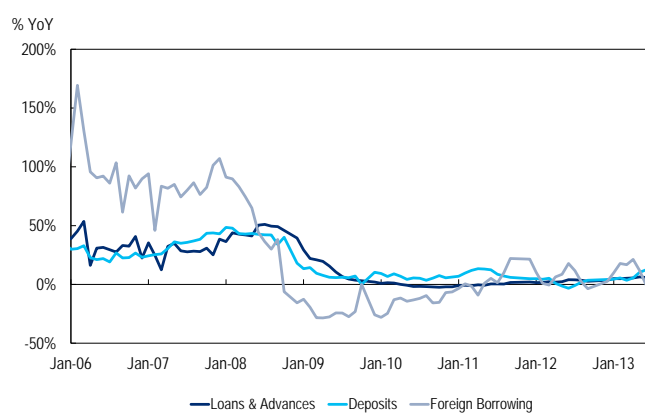
Source: National Bureau of Statistics (2010)

Figure 74. Bank liquidity is much improved, despite a recent fall



Source: Haver Analytics, Citi Research

Figure 75. External leverage has been in decline since 2008



Source: Haver Analytics, Citi Research

Figure 76. United Arab Emirates Economic Indicators (with Abu Dhabi and Dubai)

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
<b>Summary Data</b>									
<b>ABU DHABI</b>									
Nominal GDP, US\$ bn	148.5	192.0	145.8	174.3	230.5	248.2	254.8	263.7	269.2
Nominal GDP, local currency bn	545.4	705.2	535.3	640.0	846.7	911.6	935.7	968.3	988.7
GDP per capita, US\$	87,579.3	105,107.0	74,077.5	84,342.9	106,266.5	108,957.0	106,528.3	104,986.6	102,098.8
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	39.4	38.6	37.5	36.2
o/w oil revenues	22.3	17.6	29.2	27.0	23.8	23.4	23.4	23.3	23.5
Government expenditure	22.3	17.6	29.2	27.0	23.8	23.4	23.4	23.3	23.5
o/w capital expenditures	0.9	1.9	5.2	4.2	3.2	3.2	3.2	3.3	3.3
Government balance	19.1	29.8	7.2	10.9	16.4	16.0	15.2	14.2	12.7
non-oil balance, % of non-oil GDP	-26.9	-20.4	-28.1	-30.8	-33.9	-32.2	-29.3	-26.6	-24.3
Breakeven oil price (fiscal), US\$/barrel	27.5	22.0	42.7	47.3	52.0	52.1	51.5	51.4	51.2
<b>DUBAI</b>									
Nominal GDP, US\$ bn	84.4	93.4	80.4	82.9	85.9	91.4	99.6	109.9	116.9
Nominal GDP, local currency bn	310.1	342.9	295.4	304.6	315.4	335.8	365.7	403.5	429.4
GDP per capita, US\$	55,169	56,728	47,918	47,049	46,389	45,910	46,467	47,671	47,152
Share of oil in GDP (real)	1.9	1.9	1.9	1.7	1.5	1.5	1.4	1.3	1.2
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	-2.7	3.5	3.3	4.4	5.7	6.1	6.4
Real per capita GDP, % yoy	9.2	-3.8	-4.6	-1.4	-1.6	-3.0	-1.7	-1.4	-1.1
Real non-oil GDP, % yoy	3.6	-2.7	3.7	3.5	4.4	5.8	6.2	6.5	6.5
Government revenues	8.3	9.5	9.6	9.8	10.4	9.1	8.9	8.8	8.9
o/w oil revenues	2.2	2.5	1.6	1.6	1.7	1.0	1.1	1.0	0.9
Government expenditure	8.5	11.1	13.6	10.9	10.7	9.2	8.8	8.5	8.5
o/w capital expenditures	2.9	4.2	4.6	2.9	2.3	1.8	1.5	1.5	1.4
Government balance	-0.3	-1.6	-4.0	-1.1	-0.3	-0.2	0.1	0.3	0.4
non-oil balance, % of non-oil GDP	-2.5	-4.1	-5.7	-2.8	-2.1	-1.2	-1.0	-0.7	-0.4
<b>UNITED ARAB EMIRATES</b>									
<b>Prices, Money &amp; Credit</b>									
CPI, % yoy	11.7	6.6	1.2	0.9	0.8	1.1	1.1	1.3	1.6
CPI, % avg	11.1	12.3	1.6	0.9	0.9	0.7	1.1	1.3	1.6
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	1.80	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
<b>Balance of Payments, USD bn</b>									
Current account	15.5	66.9	7.9	13.7	80.9	115.5	114.8	102.5	90.1
% of GDP	6.0	21.2	3.1	4.8	23.2	30.1	28.0	23.3	19.1
Trade balance	46.5	107.1	42.1	55.2	135.8	175.6	179.0	173.6	168.9
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	132.1	149.7	158.3	166.2	174.5	192.0	220.8	253.9
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 77. Long-Term Economics 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	3.1	3.1	3.2	2.7	2.2	1.1	1.5	1.7	2.2	2.3	2.2	-2.3	-1.9	-1.6	-1.8	-1.7	-1.4	-5.8	-4.6	-3.9	-3.9	-3.8	-3.8	NA	NA	NA	NA	NA	NA
Japan	1.7	1.6	1.0	1.2	1.2	1.0	0.3	2.6	1.6	1.6	0.7	1.0	0.7	0.4	0.3	0.8	1.0	1.0	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	98	107	112	115	115	115
Euro Area	-0.4	1.1	1.3	1.4	1.5	1.5	1.4	0.9	0.8	1.2	1.7	1.8	2.2	2.5	2.6	2.6	2.5	2.3	-2.9	-2.5	-2.0	-1.6	-1.4	-1.1	0.75	0.72	0.71	0.71	0.71	0.71
Canada	1.8	2.5	2.7	2.7	2.6	2.4	0.9	1.3	1.9	2.0	2.0	2.0	-3.5	-3.7	-3.2	-2.7	-2.5	-2.5	-0.9	-0.3	0.2	0.2	0.2	0.4	1.03	1.12	1.12	1.12	1.11	1.10
Australia	2.3	2.7	2.8	2.9	3.0	3.1	2.4	3.0	2.1	2.5	2.4	2.4	-3.2	-4.0	-4.1	-4.3	-4.6	-4.6	-1.2	-3.0	-2.1	-1.4	-1.0	-1.5	1.03	1.12	1.12	1.12	1.11	1.10
New Zealand	2.7	3.2	2.7	2.5	1.7	1.9	1.1	2.1	2.2	2.3	2.3	2.2	-3.7	-4.7	-4.8	-3.8	-3.6	-3.3	-2.0	-1.0	0.0	0.7	1.2	1.5	1.22	1.17	1.17	1.20	1.25	1.31
Germany	0.5	2.0	2.1	1.8	1.6	1.5	1.5	1.5	1.8	1.9	1.9	1.9	6.8	6.5	6.0	5.3	4.9	4.5	0.2	0.0	0.0	0.0	0.0	-0.2						
France	0.2	0.9	1.1	1.4	1.7	1.8	1.0	1.2	1.3	1.5	1.3	1.5	-1.6	-0.8	-0.1	0.3	0.1	-0.2	-4.1	-3.6	-3.1	-2.7	-2.3	-1.8						
Italy	-1.8	0.3	0.3	0.4	0.5	0.6	1.3	0.5	-0.3	0.4	1.1	1.4	0.9	1.3	1.6	1.9	2.2	2.4	-3.1	-2.8	-2.7	-2.5	-2.6	-2.3						
Spain	-1.2	0.9	1.1	1.4	1.3	1.4	1.5	-0.2	-0.1	0.1	0.5	0.8	1.0	1.0	1.4	1.5	1.7	1.8	-6.9	-5.8	-4.8	-4.0	-3.4	-2.9						
Greece	-3.4	-1.9	-0.4	1.1	1.4	1.3	-0.9	-2.7	-2.4	-1.4	-0.4	0.8	0.7	1.9	2.4	2.9	3.3	3.2	-3.6	-3.5	-2.4	-2.1	-1.5	-1.3						
Ireland	0.0	2.1	2.2	3.5	3.9	4.0	0.7	0.3	0.9	1.0	1.0	1.0	8.4	8.6	7.8	8.0	8.4	8.6	-7.0	-4.7	-3.0	-2.2	-2.2	-1.7						
Portugal	-1.6	0.2	0.8	0.7	0.9	1.0	0.4	-0.4	-0.9	-0.2	0.6	1.0	0.4	2.2	2.5	2.6	2.7	2.7	-6.0	-4.6	-3.8	-3.1	-2.7	-2.7						
Netherlands	-1.0	0.5	0.9	1.2	1.6	1.9	2.5	1.2	1.3	1.4	1.5	1.8	10.2	10.4	9.4	8.9	8.4	7.9	-3.5	-2.6	-1.9	-1.2	-0.2	1.1						
Belgium	0.2	1.2	1.3	1.4	1.9	2.1	1.1	1.0	1.0	1.1	1.6	2.0	-1.7	-0.1	0.6	0.8	0.6	0.4	-3.1	-2.6	-1.5	-1.0	-0.5	0.1						
Switzerland	2.0	2.0	2.0	2.2	2.0	2.0	-0.2	-0.2	0.9	1.1	1.2	1.2	12.2	12.9	12.7	13.7	14.0	14.0	0.2	0.6	0.8	1.2	1.2	0.9	0.93	0.90	0.91	0.91	0.91	0.91
China	7.7	7.3	7.0	7.5	7.3	7.0	2.6	3.3	3.7	3.8	4.0	3.8	2.2	2.0	1.5	0.8	0.5	0.5	-2.0	-2.0	-1.5	-1.5	-1.5	-1.5	6.15	6.01	6.00	6.01	6.03	6.05
India	4.8	5.6	6.7	7.3	7.4	7.5	6.5	6.0	5.0	5.0	5.0	5.0	-2.3	-2.3	-2.1	-1.9	-1.8	-1.6	-6.9	-6.7	-6.3	-6.1	-5.8	-5.8	58.6	61.8	59.7	57.2	55.8	54.4
Indonesia	5.7	5.3	5.5	5.7	5.9	5.7	7.0	6.4	5.7	5.4	5.3	5.5	-3.3	-2.9	-2.4	-2.1	-1.9	-1.8	-2.2	2.2	-1.7	-1.9	-2.0	-2.0	10449	11950	11738	11201	10502	9802
South Korea	2.8	3.7	4.0	4.1	3.7	3.8	1.3	2.1	3.1	3.1	3.0	2.9	5.7	4.0	3.1	2.4	1.7	0.7	0.9	1.0	1.6	1.9	2.0	1.8	1095	1035	1001	985.6	986.6	987.6
Poland	1.5	3.1	3.6	3.6	3.5	3.2	0.9	1.4	2.8	2.7	2.5	2.5	-1.8	-2.4	-3.4	-4.4	-4.6	-4.3	-4.2	5.6	-2.3	-2.2	-2.2	-2.2	4.20	4.08	3.96	3.90	3.90	3.90
Russia	1.4	2.6	2.7	2.9	3.0	3.0	6.8	5.6	4.9	4.6	4.4	4.1	1.6	1.1	0.8	-0.4	-1.4	-2.3	-2.0	-4.3	-4.9	-1.4	-1.4	-1.4	31.9	34.1	35.1	35.5	35.5	35.5
Turkey	4.0	2.5	3.5	3.8	4.0	4.0	7.5	7.3	7.6	7.0	6.1	5.8	-7.1	-5.9	-6.4	-5.9	-5.4	-4.9	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	1.91	2.24	2.23	2.20	2.12	2.04
South Africa	1.8	2.8	3.5	3.9	3.7	3.5	5.8	5.6	5.5	5.8	6.0	5.3	-5.9	-5.2	-4.9	-4.7	-4.6	-4.7	-4.4	-4.3	-4.4	-4.2	-4.0	-3.8	9.65	11.04	10.54	10.20	10.04	9.87
Argentina	5.3	3.0	2.0	-2.0	3.5	3.0	10.6	13.0	13.8	50.0	30.0	20.0	-0.6	-0.4	-0.4	3.0	1.0	1.0	-2.3	-3.1	-2.3	0.0	-0.5	-1.0	5.4	9.1	11.5	17.7	24.7	26.7
Brazil	2.3	1.8	2.0	2.5	3.0	3.0	6.2	6.1	5.7	5.5	5.5	5.5	-3.5	-3.3	-3.0	-3.0	-3.0	-3.0	-3.6	-3.9	-2.7	-3.2	-3.2	-3.3	2.16	2.49	2.57	2.53	2.40	2.27
Mexico	1.2	3.8	4.0	4.4	4.5	4.6	3.8	4.4	3.8	3.6	3.6	3.6	-1.7	-2.0	-1.7	-1.3	-1.4	-1.5	-2.4	-3.5	-2.5	-2.0	-2.0	-2.0	12.8	12.8	12.4	12.3	12.3	12.3
Venezuela	1.5	-1.0	1.9	1.9	1.9	1.9	38.7	67.3	79.5	60.0	60.0	60.0	3.2	3.8	3.6	3.0	3.0	3.0	-11.8	-11.0	-10.1	-11.9	-11.9	-11.3	5.99	10.58	19.80	31.28	49.43	78.10
Bahrain	4.3	4.0	4.1	4.1	4.1	4.2	3.3	2.3	2.0	2.0	2.0	2.0	5.3	2.4	-1.5	-5.9	-8.7	-9.6	-2.2	-3.3	-5.5	-7.9	-9.9	-10.9	0.38	0.38	0.38	0.38	0.38	0.38
Egypt	2.0	2.9	3.4	4.1	4.5	4.0	9.5	7.3	6.9	9.0	11.2	10.5	-1.7	-1.3	-2.2	-3.4	-3.5	-3.0	-12.7	-12.1	-10.0	-9.5	-7.9	-7.9	6.87	7.15	7.54	7.72	7.90	8.22
Iraq	3.1	10.4	11.6	8.2	7.9	7.6	1.8	3.6	6.0	6.0	6.0	6.0	13.5	13.8	12.8	9.1	6.3	5.1	1.6	3.5	4.3	2.3	1.2	1.8	1162	1163	1163	1163	1163	1163
Israel	3.2	3.4	3.5	4.5	4.5	4.0	1.6	2.3	3.0	3.0	3.0	3.0	2.6	1.9	0.7	2.8	3.9	4.1	-3.6	-3.0	-2.5	-2.5	-2.5	-2.5	3.61	3.48	3.66	3.68	3.57	3.45
Jordan	3.0	4.0	4.5	4.3	4.1	4.0	5.5	3.6	5.0	5.0	5.0	5.0	-15.2	-14.2	-11.9	-9.7	-7.5	-5.3	-8.2	-10.1	-9.9	-9.7	-9.5	-9.3	0.71	0.71	0.71	0.71	0.71	0.71
Kuwait	4.2	3.8	3.9	2.2	2.2	2.3	2.6	3.3	5.0	5.0	5.0	5.0	51.0	49.5	47.8	43.4	40.0	38.8	36.8	32.1	29.5	23.9	18.7	15.3	0.28	0.29	0.29	0.29	0.29	0.29
Lebanon	1.4	2.0	2.4	2.3	3.3	3.2	2.0	3.4	5.0	5.0	5.0	5.0	-4.5	-5.3	-6.0	-6.8	-5.2	-3.8	-10.0	-9.3	-8.7	-8.0	-6.9	-5.8	1507	1508	1508	1508	1508	1508
Oman	6.7	6.7	6.7	6.8	6.1	4.5	1.3	2.0	3.0	3.0	3.0	3.0	10.3	8.1	6.2	4.2	3.6	4.9	-0.2	-3.4	-5.4	-8.1	-9.8	-10.0	0.38	0.39	0.39	0.39	0.39	0.39
Qatar	5.6	5.9	6.1	6.3	6.6	6.8	3.1	3.0	3.5	4.5	5.0	5.0	29.7	25.5	20.7	15.4	9.7	5.2	8.1	4.2	1.2	-2.4	-5.3	-5.9	3.64	3.64	3.64	3.64	3.64	3.64
Saudi Arabia	6.1	5.8	6.2	6.7	6.8	6.8	3.5	3.4	4.1	4.3	4.6	5.0	17.6	13.1	8.8	5.2	3.2	3.2	10.0	5.0	0.4	-3.3	-6.0	-7.1	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	1.3	1.6	1.9	2.2	2.7	28.0	23.3	19.1	14.5	10.7	7.8	NA	NA	NA	NA	NA	NA	3.67	3.67	3.67	3.67	3.67	3.67

Source: Citi Research Forecasts. Note: We use PCE Deflator for the US.

**Notes**

## Appendix A-1

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