

Middle East Macro Monthly

Iraq On The Eve of Elections: A Conversation With Professor Toby Dodge

- On Wednesday 23 April, Citi hosted a conference call with Professor Toby Dodge entitled Iraq on the Eve of Elections: The economic and political outlook. Professor Dodge is Director of the Middle East Centre and Professor of International Relations at the LSE. He is also Consulting Senior Fellow at the International Institute for Strategic Studies (IISS). Dr Dodge has been researching the politics of Iraq and the wider Middle East for almost two decades and is considered one of the world's leading experts in Iraqi politics. As such, Dr Dodge has acted as an advisor and consultant to key decision-makers on Iraq, including as an occasional advisor to General David Petraeus during his tenure as the commander of US forces in the country.
- Iraqi parliamentary elections are taking place against a backdrop of sectarian and political violence, a continued stalemate between the KRG and Baghdad over oil exports and the 2014 federal budget, and a highly fractured and polarised political landscape.
- Key takeaways from the call include:
 - Professor Dodge sees no clear winner emerging from the elections, and expects a prolonged period of horse-trading between political groupings to take place. He does not expect a government for a number of months.
 - The elections are the incumbent Prime Minister's to lose, according to Professor Dodge. His rivals on the Shia and Kurdish sides have already begun to set out their conditions for supporting a new Maliki government.
 - Much, however, depends on the electoral turnout of Maliki's State of Law coalition – anything around 95 seats would put Maliki in a driving position to form the new government. Below that, more concession and a wider coalition will be needed to make up the necessary majority.
 - One of the outcomes of the horse trading may be an export deal for Kurdish crude. While the Kurdish leadership remains opposed to another Maliki term, it may accept an oil deal in return for support of this. On Maliki's side, compromise is more likely in a low electoral result.
 - A crisis scenario from the elections would be that violence undermines the result, or that the result is not accepted by one of the main contenders.
 - Professor Dodge expects that violence is likely to continue rising post elections, though oil production is unlikely to be affected.

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

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On Wednesday 23 April, Citi hosted a conference call with Professor Toby Dodge entitled **Iraq on the Eve of Elections: The economic and political outlook**. Professor Dodge is Director of the Middle East Centre and Professor of International Relations at the LSE. He is also Consulting Senior Fellow at the International Institute for Strategic Studies (IISS). Dr Dodge has been researching the politics of Iraq and the wider Middle East for almost two decades and is considered one of the world's leading experts in Iraqi politics. As such, Dr Dodge has acted as an advisor and consultant to key decision-makers on Iraq, including as an occasional advisor to General David Petraeus during his tenure as the commander of US forces in the country.

The call took place exactly one week before Iraqi Parliamentary elections were due to take place. Sectarian violence has risen dramatically over the past 18 months, to 2006 levels according to UN estimates. The dispute between the KRG and Baghdad has resulted in a stalemate over Kurdish exports and the federal budget. This has been happening against a background of an increasingly divisive political scene, particularly since the withdrawal of US troops at the end of 2011. Meanwhile, after eight years of self-governing under Prime Minister Maliki, the provision of basic services by the state remains poor and the economic prospects of the average Iraqi bleak. This is at a time when oil revenues of the Iraqi state have almost tripled. It's against this backdrop that Iraqis go to the polls next week.

Our discussions suggest an outright winner is unlikely to emerge from the elections given Iraq's fragmented political scene. The coming months will likely be taken up with frantic horse-trading among political groupings to piece together a parliamentary majority and a coalition government. What deals emerge from this process and the government that is ultimately formed will have a potentially large bearing on sectarian tensions, regional relations and economic prospects.

Below is the edited transcript of the conference call, in which we discussed the likely outcome of elections and their impact on the future trajectory of Iraqi politics and the economy.

Farouk Soussa: Professor Dodge, this is the first set of parliamentary elections that Iraq will hold since the 2011 troop withdrawal by the United States. How do you see the prospects for a free and fair election in the current environment?

Professor Toby Dodge: We don't know the outcome and I don't think the major political players engaged in the election know the outcome either, so we're not going to see mass vote rigging and I think that's an understanding in Baghdad and globally. But there are profound problems certainly. As you alluded to in your introduction violence is up, about 700 people a month are being murdered. The government has lost control of Anbar in the North West of Iraq especially Fallujah, a major city in Anbar. Beyond that there will be, I would have thought, sporadic and minor electoral fraud with vote buying and there have been some problems with the electronic card that has been issued to all voters. But that said I think the thing to focus on is that while this will be a rough and ready electoral campaign, I think once the votes are counted and the seats have been taken that will represent the political will of those that went to the polls and voted.

Farouk Soussa: Walk us through the upcoming elections and who the key contenders are and what their prospects are.

Professor Toby Dodge: I think the thing to keep in mind is if we compare it to previous Iraqi elections, the electoral field is much more fractured. We have six electoral coalitions broadly, three seeking to mobilise the Shia vote; and three trying to mobilise the Sunni vote. And then we have the Kurdish parties as well.

Firstly, this election is for Prime Minister Nouri al-Maliki to lose. He comes from the Daawa Islamic Party and he has created State of Law coalition. Political wisdom in Iraq and especially Baghdad expects them to get the largest slice of the parliamentary seats but not the dominant slice. Coming up after them is the party run by Muqtada al-Sadr, the radical Shia Islamist; and behind them another Shia Islamist party run by the Supreme Council for the Islamic Revolution in Iraq by a junior cleric called Ammar al-Hakim. Those are the three dominant Shia parties.

If we then switch over to the main parties competing for the Sunni votes, unlike in 2010 where the coalition Iraqiya got 91 seats, the single largest number of seats, the Sunni political parties have been fractured in a three way split. I think the most popular Sunni politician at the moment is Osama al-Nujaifi, who's currently the speaker of the Iraqi parliament and he has a very strong electoral base in Mosul, Iraq's third largest city in the North West; then we have a former interim Prime Minister, the past leader of the Iraqiya coalition Ayad Allawi who's running the Wataniya or 'Nation' coalition; and then finally we have a current deputy prime minister Saleh al-Mutlaq who's running the Al Arabiya coalition.

Finally we have the Kurdish coalitions dominated by the Kurdistan Democratic Party run by Massoud Barzani. We also have the Patriotic Union of Kurdistan of Jalal Talabani, the current President of Iraq who remains in a coma. And finally we have the challenger, the 'Change' or Goran Party. I think broadly the Kurdish vote will go to the Kurdistan Democratic Party with the Goran coming in second, but I think in the aftermath of the elections they can be roughly treated as a united coalition and in bargaining with Baghdad to get the maximum outcome.

The magic number is 165 seats needed for a majority. No-one will get close to that but you could say that the three main Shia parties together may get about 140 seats within the parliament. The crucial thing to look for is the seats that State of Law and the Prime Minister Nouri al-Maliki get: you could see this whole election within the Shia population as a referendum on Prime Minister Nouri al-Maliki. Speaking to senior politicians in Baghdad and senior policymakers in Washington, no-one is sure how many seats State of Law will get, but the estimates say it could range from the high-60s through to about 100. If we were looking for a golden figure, the figure that puts Maliki centrally in the negotiating seat to form the next government, I would say it would be about 95.

But bearing in mind State of Law got 89 in the last elections, almost certainly what we're looking at in the aftermath of the elections on 30th April is a period of very prolonged negotiations between all the major seat-getters, where yet again another government of national unity will be formed and the cabinet seats will be parcelled up amongst those parties.

Farouk Soussa: You said the golden figure for State of Law to return to power is 95, and that estimates for their performance in the upcoming elections range from around 60 to 100. Where would you yourself expect them to end up?

Professor Toby Dodge: I think that's a very difficult question and no-one knows the answer to so let me take a guess – I would say that he will be in the mid to high-80s.

Farouk Soussa: What would that mean in your opinion in terms of the prospects for another Maliki term?

Professor Toby Dodge: If we compare that to 2010, Maliki had 89 seats, but his Shia rivals, the Sadrists and the Supreme Council had 70. Maliki has undoubtedly benefited from a fear amongst the majority Shia population that Al-Qaeda in Iraq is on the upsurge, and that that sectarian violence is rising, and he has posed as the

'securocrat', the hard man, the only person who can guarantee stability and I think broadly that has won him traction in the intra-Shia competition. He seems the only man that can control the security file and deliver law and order and in doing so he has distanced himself from the inability of the government to deliver electricity, the inability of ordinary Iraqis to feel the benefit of oil income. I do think he's in a strong position and one indication of this is that the other political parties within the Shia block have begun to set out their negotiating stall and say this is what we need from Maliki to let him stay in power. So the assumption is in Baghdad at the moment that Maliki will have a strong enough position to survive as Prime Minister and therefore negotiations depending on the vote itself may start from that position.

Farouk Soussa: But there are those who are outspokenly against a third term for Maliki, including the Sadrists. Would he be able to get their support through horse-trading?

Professor Toby Dodge: Well, it's quite interesting, if you look again back at the 2010 elections, those took place two years after Maliki used the Iraqi army to crush the Sadrists in Basra. Sadr and Maliki were in a blood feud, almost a fight for survival, but after the March 2010 elections, before the November compromise, Sadr was pressured into backing Maliki. Who pressured him? Iran. It would be easy to overstate Iran's influence but I think Iran will play the role of a kingmaker and may cajole the Sadrists into swinging behind a third Maliki term.

Farouk Soussa: How about the Kurds? What are their negotiating demands and, more generally, what kind of outcomes might one expect from this horse trading?

Professor Toby Dodge: Massoud Barzani has been passionate in his opposition to Nouri al Maliki, but because the stalemate over Kurdish oil exports and the budget, there is a possible room for a bargain where Barzani pushes for greater Kurdish financial independence, i.e. the right to pump oil through the pipeline to Turkey. And Maliki may be in a position of vulnerability such that he will accept some form of compromise, some form of joint management of the state oil marketing organisation, some form of escrow account outside Iraqi territory where Kurdish oil revenues go into, as a price for him remaining in government.

If we look at the other key parties, Sadr will remain implacably opposed to Maliki and may well then not engage in the dividing of the cabinet spoils. Ammar al-Hakim has already said that he would want as a price for backing Maliki the Health Ministry, possibly the Electricity Ministry or another service ministry.

Farouk Soussa: You talk about the possibility on a compromise on Kurdish oil exports and perhaps other concessions that might be made by Nouri al-Maliki in order for him to stay in power. Similar concessions were made in 2010 under the Erbil Agreement but were never implemented. Does it not seem a tall order for the political groupings to regain trust that any future deals will actually be adhered to?

Professor Toby Dodge: I completely agree. Rather amazingly the Erbil Agreement wasn't written down, it wasn't a legal document and so al-Maliki could quite effectively circumvent it and undermine it. One would assume that this time one would get written agreements that would go past through parliament and become law. Certainly that's what the Kurds spent a great deal of time doing with the Iraqi constitution in 2005 only to see it undermined. So one would assume that they would push to guarantee their 17% of the budget whilst seeking a compromise on oil exports. I expect that will be the big negotiating point, whether they can either independently sell that oil or that oil can be sold through the state oil marketing organisation with a heavy representation from the Kurdish regional government and

then the money kept in an escrow account that neither the Iraqi government or the Kurdish regional government control. That's the only type of compromise I could imagine that Baghdad and Erbil would agree to.

Farouk Soussa: What about the outlook for sectarian violence? How do you think these elections are going to impact that and do you think that violence key to investors, do you think that violence could spread to the south oil-producing regions?

Professor Toby Dodge: Let's look at the drivers of violence first, why this has steadily increased from 2012 onwards. I think there are three reasons for that.

First, undoubtedly the political structures have excluded key sections of society, by which I mean the Sunnis, who have been marginalised from 2005 onwards. In 2010, because Iraqiya did so well, key Sunni politicians were included in power, but have since been targeted and excluded from government. It is this that has alienated the Sunni population today and created a fertile ground for radical politics, for the recruiting of young men into violent organisations like al Qaeda but not only al Qaeda.

Second, despite totalling over a million men spread between the Ministry of Interior, the Ministry of Defence and the Prime Minister's counter terrorism force, the armed forces have been unable to quell the violence. I think this is due to Nouri al-Maliki's centralisation of power, most notably his seizure of the National Intelligence Service and the subsequent purging of those intelligence operatives that he didn't trust, which greatly weakened the institution. So although you have this large army, you don't have the ability for the army to harvest and act on intelligence, rendering it blind in its operations.

The final thing driving sectarian violence forward is the sectarian rhetoric of key political figures on both the Sunni and the Shia sides.

Now the pressing point of those three drivers of violence is that I see no solutions to any of them in the aftermath of these elections, so I do think sectarian violence will remain on the increase.

Now to answer your question directly: will that spread to the south? I think that rests on the ability of the radical offshoot of the Sadrist movement Asaib al-Haq to penetrate the southern oilfields. This organisation is now reengaging in serious sectarian violence, especially in and around Baghdad, and much depends on the extent to which the Iraqi security forces can keep them out of the southern oilfields. To date I think they have managed to do that, though there have been bomb attacks down in Basra over last summer but I don't see, even with the situation getting worse and worse in Baghdad, that significantly destabilising the oilfields in the far south.

Farouk Soussa: Ok. Operator, could you open the call to questions from callers?

Caller 1: Hi, thank you for the call Professor Dodge. I have two questions; one is on the elections, what is a crisis scenario? Then my second question is what is the relationship between the election outcomes and debt payments?

Professor Toby Dodge: I think the crisis scenario for the elections is either that violence becomes that much higher running up to the election day, i.e. over the next week that large amounts of Iraqis can't get to the polls. Now I think the numbers of people voting in Anbar is going to be low, as low as possibly 20% of those entitled to vote because the violence has been so dominant, but I don't think that necessarily stops the elections, so I don't see that violence at this stage can knock the elections off course. What could happen and what looks like it might have happened in 2010 but the United Nations stopped it happening was that the major players i.e. Nouri al

Maliki and State of Law doesn't accept the outcome, in which case you could see Maliki possibly declaring a state of emergency and suspending the rule of law and ruling as a more overtly authoritarian ruler. So the two headlines for the crisis scenario would be levels of violence stopping significant people voting in Baghdad mainly, I think that's what would undermine the elections; or Nouri al-Maliki not accepting the outcome after the elections or possibly another key player probably Massud Barzani not accepting the outcome, but at the moment I see no evidence of either of those dominating.

To answer your second question directly I don't think the debt issue is linked to the elections. I think the holders of government debt hold debt that the government has accepted and is not a critical political issue.

Caller 2: Apparently Mr. al-Sadr is hanging out in Iran. Is that in fact true and what role active or implicit is he playing in the election process?

Professor Toby Dodge: Excellent, two good questions. I think the first question is if al Sadr came back. Al Sadr is technically studying to become a more senior Shia religious figure in the Iranian holy city of Qom but he came back from Iran to Iraq in March to launch the election campaign and has been in Iraq ever since. Now there was that moment when he threatened to resign but that was more about disciplining his own members of parliament and showing his discontent with their role in backing a highly unpopular pensions law that gave parliamentarians very lavish pensions. He came back and he has given a series of keynote electoral speeches that have damned Nouri al-Maliki as an incompetent dictator and have pleaded with the population to go out and vote, so he's a key figure in these elections. He is mobilising his party. The Sadrists got 40 seats on their own last time so I assume they will get a fair haul, but I think they will be the second dominant Shia party after State of Law.

Caller 3: I have a question regarding the relevant political players. The common view on Iraq is actually to focus on these three religious or ethnic communities but I would like to look beyond this: what kind of interest groups behind these political parties could be the drivers?

Professor Toby Dodge: It's a fascinating question and I broadly agree with its underlying supposition that simply looking at Iraqi politics through the lens of religion and ethnicity is by far too blunt an analytical tool. I would begin by saying that the main struggle for power is actually internal to the Shia community: you've got al Sadr, Hakim and Maliki fighting for the Shia vote. The Kurds are certainly playing a balancing role but the Sunnis are not really a major contender for power. Moreover, very few if any political parties running in the elections are running on a rational policy-based platform. Nearly all the politicians have tried to avoid the anger and the alienation of their potential constituencies from the Iraqi state because the Iraqi state has failed to deliver. They do this by playing the sectarian ideology, so the politicians themselves are hiding behind the rather thin veneer of sectarian politics.

That said if I follow the logic of your question and then I go into the Iraqi economy and seek to identify major economic players, they are few and far between and they are almost all now tied to unfair access to state resources. To broaden out to external players, although clearly the Middle East is currently in the midst of what we could see as a new cold war with Saudi Arabia, Turkey and the other Gulf players trying to maximise their interests vis-à-vis Iran and using sectarian rhetoric to do that, I don't think the Saudis and the Gulf players have that much influence. If we were looking for an opposition, a counterbalance to Iran in Iraq, it would be Turkey.

Caller 4: Can you please comment what kind of a government you are expecting to be formed, what are the chances of a majority government dominated by the three Shia parties and alienating the others and what this might imply for the whole of Iraq as a federation and obviously for the Kurdish situation?

Professor Toby Dodge: That's a very good question and I think Nouri al-Maliki and State of Law have campaigned and made it very clear that what they want is a majoritarian government made up of the three main Shia parties. I don't think that will happen to be frank. I think they will need to reach out to the Kurds to get the majority they need in parliament so I think the chances are that we are heading towards another government of national unity similar to the government that ruled from May 2006 to March 2010. In that case you'll have the Shia political parties dominant and Nouri al-Maliki dominant within that, with a secondary role for the Kurdish parties and a very minor role for the Sunni parties if the Sunni vote is fractured and turnout is low. I think you could say that would result in business as usual in terms of cabinet posts not being allocated in terms of competency or even honesty, but being divvied up in terms of the power of the parties at the ballot box. That will then give government sclerosis and incoherence a great surge, corruption will remain dominant and Maliki, as he has done since 2006, will seek to circumvent the cabinet and the ministers to increase his control on government at a sub-cabinet level.

Caller 5: I wanted to ask a question on what you think the Turkish attitude is to further Kurdish independence? If push came to shove and the Kurds and the central government in Baghdad could not see eye to eye on Kurdish oil exports, do you think the Turks will facilitate or hinder such exports?

Professor Toby Dodge: That's a great question because I think Ankara's attitude has changed over the last four or five months. As you know the independent leg of the pipeline into Turkey has given the Kurdish regional government the ability to pump oil into Turkey separate from Iraqi government control, and while that pipeline was being built there was a Turkish government acceptance that this was ok. But I think over the last couple of months, the reason why the majority of that oil hasn't been sold is that there has been a hardening of the Turkish position and a realisation rather late in the day of the destabilising effect greater Kurdish regional government autonomy in Iraq would have for Turkey's own Kurdish problem. So I think the Kurdish government and in conjunction with a lot of pressure from Washington has realised that it can't push ahead with an independent export capacity through Turkey for Kurdish oil and some deal needs to be done between Baghdad and Erbil with Ankara broking it.

Now as you know more than me I suspect the Turkish energy demand and the reduction of the costs of the energy demand will be greatly delivered by oil and gas coming out of the Kurdish regional government but I think at the moment at least Ankara has cooled on the idea and the reason, one of the reasons they were so hot on the idea last year, is they were very angry with Nouri al-Maliki, seeing him aligning much more clearly after the 2010 elections with Tehran. I think they have eased off on that and they can now see the region in a broader geostrategic way that has tempered their push for Kurdish regional government financial autonomy.

Now this may change and it may change I think in two ways. If the violence continues to get worse in Baghdad and Nouri al-Maliki stays as prime minister and continues under sectarian exclusion of the Sunni population Turkey may once again look at Erbil as not only a buffer but look at the Iraqi state as finished and then encourage Erbil's greater financial dependence on Turkey and not on Iraq. At the moment they're not doing that. They have rowed back from that solution but I don't think that view within the AKP or within the Turkish cabinet has gone away. I just think it has been tempered by the ramifications of the chain of events that would set off if they continue to run with it.

Farouk Soussa: We'll leave it at that. Professor Dodge, it has been a great pleasure and thank you to all the callers who have called in and especially thank you to Professor Dodge for your very insightful views on this call today. Thank you very much everyone.

The Global Backdrop¹

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With inflation likely to stay well below the ECB's target for an extended period, we continue to expect the ECB to cut the refi rate in the coming months and to set a slightly negative deposit rate.

Export-oriented countries, especially EM, continue to face challenges from sluggish world trade growth and the erosion of EM export outperformance

These broad trends are likely to persist, in our view...

Our global growth forecasts are little changed this month, at 3.1% for 2014 (unchanged from last month) and 3.5% for 2015 (up a tenth), at current exchange rates. We expect US growth will rebound to 3%+ QoQ SAAR in Q2 and beyond as adverse weather effects in Q1 fade, while the UK is our biggest above-consensus growth call among the major economies. Conversely, our 2014-15 growth forecasts are a bit below consensus for Brazil, Japan, South Africa and China.

Inflation is likely to continue to undershoot the ECB's target markedly in 2014-16 and further downgrades to official inflation forecasts are likely to prompt the ECB to loosen further, first via lower rates and then probably by QE. Our base case is for easing in June, but the ECB may act in May. In addition, we now also expect that the low inflation outlook will prompt the ECB to implement QE later this year, with an initial asset purchase programme of €1tn, focused mainly on government debt. We expect that QE will succeed in loosening financial conditions through a range of channels. But, with the euro supported by large current account surplus plus inflows of portfolio and FDI capital, we expect that the stimulus from QE will come mainly through reduced borrowing costs and asset price gains in the euro area rather than significant euro weakness. We lift our euro area growth forecasts by 0.2-0.3 percentage points per year for 2015-17, with a more modest upgrade (0.1-0.2 pp each year) to our inflation forecasts.

We still worry about downside growth risks in export-oriented emerging markets, given sluggish world trade growth and erosion of the prior export outperformance of EMs. Although many EM markets have been buoyed recently by renewed capital inflows, export-oriented EMs continue to face a difficult challenge from sluggish world trade growth and the erosion of EM export outperformance. During 1998-2007, world trade growth (goods) averaged 6.6% YoY, twice world industrial production growth (3.3% YoY). Moreover, EM export growth outpaced world trade, with EM exports rising 9.6% YoY on average (i.e. roughly three times global IP growth) and exports by Asian EMs rising 12.2% YoY (i.e. nearly four times global IP growth). Even with faster global growth, world trade trends are still not returning to the pre-crisis norm. While CPB data show global IP growth in the three months ended February, above the pre-crisis average, world trade growth is well below the pre-crisis norm. Moreover, the gap between EM and AE export growth has fallen markedly in the last couple of years, with EM export volume in the three months ended February only just exceeding AE export growth. Even accepting that recent Chinese trade data may be distorted by the unwind of prior over-invoicing, the disparity in export growth between EMs and AEs has been low for a couple of years. So, as well as the drop in the world trade Beta, it also seems that the EM exports are no longer gaining market share significantly.

We believe a range of factors accounts for these shifts, including the erosion of EM export cost-competitiveness through real exchange rate appreciation, lower US energy costs, reduced spending in AEs on import-intensive items such as capital goods and IT hardware, as well as the lack of further significant progress in cutting global tariffs in recent years². We expect these broad trends will persist, hence keeping the ratio of world trade growth to output growth – and the gap between EM and AE export growth – well below the pre-crisis norms.

¹ This is a summary of the Overview from *Global Economic Outlook and Strategy - April 2014*, 30 April 2014.

² See "Why is World Trade So Sluggish?", *Prospects for Economies and Financial Markets in 2014 and Beyond*, Willem Buiter et al, December 2013.

...posing further downside risks to growth prospects in many EM countries

These trends pose a major challenge to export-oriented EMs. The assumption that under normal conditions, world trade grows about twice as fast as output, and that EM exports gain market share is, we believe, deeply embedded in assumptions of global economic prospects. If this no longer holds, then significant further downside may lie ahead for EM growth.

So far, China's economy has slowed modestly, but credit growth remains high

China's authorities are likely to provide new stimulus to prevent a sustained slowdown in growth below 7%YoY. China's economy slowed less than we expected in Q1, with GDP growth of 7.4%YoY, but we still have major worries over the medium-term sustainability of China's credit-intensive and investment-intensive growth model. Total social financing (a broad credit measure) remains fairly strong, rising 16-16.5%YoY in March. But, even with this impulse, nominal GDP growth slowed to 7.9%YoY in Q1, the lowest since mid-2009. Our base case is that policy measures will provide a renewed impulse from credit and investment in coming months, preventing a sustained slowdown in real GDP growth below 7%YoY³. However, such a scenario would further inflate China's private debt burden, adding to worries about a sharper eventual slowdown if and when the authorities do seek to rein in credit growth.

If China's exchange rate continues to weaken significantly, this could have important implications for the global outlook

In this context, the recent weakness in China's exchange rate deserves close monitoring. China's FX rate is heavily managed and has weakened by about 3% versus the USD since mid-February, the greatest depreciation for many years. We assume the authorities are seeking to dent speculative inflows. In this case, depreciation is unlikely to extend much further. Conversely, if the authorities do allow significant further near-term FX depreciation, then this might be a sign that they are seeking to cushion GDP growth against a much sharper near-term deflation of the credit bubble. In turn, such a scenario might have significant effects on a range of other countries, worsening export competitiveness among Asian neighbours and providing a renewed disinflationary impulse for advanced economies.

We still expect BoJ loosening, but now believe it is likely to be delayed until the autumn

We do still expect the BoJ to loosen policy further, but it now seems likely that easing will be delayed until the autumn – whereas previously we expected it around mid-year. The BoJ's continued optimism over growth prospects suggests that easing is unlikely until it is clear that the consumption tax hike has caused a lasting slowdown in growth, rather than just a temporary dip as pre-emptive "rush" demand in Q1 unwinds in Q2. The surge in retail sales (up 8.2% between December and March – the biggest gain since early 1997) increases the likelihood of a sharp drop in sales in Q2. But the same factor may also make the BoJ more willing to discount such weakness as temporary and wait to see how the economy progresses during Q2 and into Q3. Easing, we expect, will come via a mix of expanded asset purchases focused on JGBs and ETFs.

³ See "[China Macro Flash: Growth Fell in 1Q with Downside Risk for 2Q](#)", Shuang Ding and Minggao Shen, 16 April 2014.

Developed Market Economic Forecasts

Figure 1. Citi's Global Economic Forecasts

| | GDP Growth (% YoY) | | | CPI Inflation (% YoY) | | | Current Balance (% of GDP) | | | Fiscal Balance (% of GDP) | | |
|-----------------------------|--------------------|-------|-------|-----------------------|-------|-------|----------------------------|-------|-------|---------------------------|-------|-------|
| | 2014F | 2015F | 2016F | 2014F | 2015F | 2016F | 2014F | 2015F | 2016F | 2014F | 2015F | 2016F |
| Global | 3.1 | 3.5 | 3.7 | 2.9 | 3.1 | 4.2 | 0.7 | 0.6 | 0.2 | -3.7 | -3.2 | -2.9 |
| <i>Based on PPP weights</i> | 3.4 | 3.9 | 4.1 | 3.3 | 3.6 | 4.9 | 0.5 | 0.3 | 0.0 | -3.7 | -3.3 | -3.0 |
| Industrial Countries | 2.1 | 2.4 | 2.5 | 1.5 | 1.6 | 1.6 | 0.0 | 0.0 | -0.1 | -4.6 | -3.7 | -3.3 |
| United States | 2.6 | 3.2 | 3.2 | 1.4 | 1.8 | 2.2 | -2.0 | -1.5 | -1.8 | -6.4 | -5.6 | -5.6 |
| Japan | 0.9 | 1.0 | 1.2 | 3.0 | 1.6 | 1.6 | -0.2 | -0.3 | 0.0 | -8.0 | -6.2 | -5.8 |
| Euro Area | 1.3 | 1.8 | 1.9 | 0.6 | 0.9 | 1.2 | 2.5 | 2.3 | 2.2 | -2.6 | -2.1 | -1.6 |
| Canada | 2.3 | 2.7 | 2.7 | 1.8 | 2.0 | 2.0 | -3.2 | -2.8 | -2.6 | -0.1 | 0.3 | 0.4 |
| Australia | 2.9 | 2.9 | 3.1 | 2.7 | 2.5 | 2.4 | -2.5 | -2.4 | -2.4 | -3.0 | -2.1 | -1.4 |
| New Zealand | 3.2 | 2.7 | 2.4 | 2.1 | 2.2 | 2.2 | -4.2 | -5.4 | -5.0 | -1.6 | -0.4 | 0.5 |
| Germany | 2.2 | 2.4 | 2.4 | 1.3 | 1.8 | 2.1 | 6.7 | 5.5 | 4.4 | 0.0 | 0.0 | 0.0 |
| France | 1.0 | 1.5 | 1.8 | 0.8 | 1.3 | 1.4 | -0.6 | 0.1 | 0.5 | -3.9 | -3.2 | -2.5 |
| Italy | 0.6 | 1.1 | 1.0 | 0.3 | -0.2 | 0.2 | 1.3 | 1.2 | 1.6 | -2.9 | -2.7 | -2.0 |
| Spain | 1.0 | 1.6 | 2.0 | 0.0 | 0.2 | 0.4 | 0.8 | 0.7 | 0.6 | -5.8 | -4.5 | -3.5 |
| Greece | -0.8 | 1.2 | 1.6 | -1.6 | -1.7 | -1.0 | 1.9 | 2.4 | 2.4 | -2.6 | -2.6 | -2.1 |
| Ireland | 1.8 | 3.1 | 2.8 | 0.8 | 1.0 | 1.1 | 8.7 | 9.0 | 8.3 | -5.5 | -3.0 | -2.3 |
| Portugal | 1.5 | 2.0 | 1.7 | -0.5 | -0.7 | 0.0 | 2.2 | 2.5 | 2.6 | -3.8 | -2.8 | -2.3 |
| Netherlands | 1.3 | 1.4 | 1.8 | 0.5 | 1.3 | 1.5 | 10.1 | 9.9 | 9.5 | -3.0 | -1.7 | -0.9 |
| Belgium | 1.3 | 1.5 | 1.6 | 0.4 | 1.0 | 1.8 | 1.1 | 1.7 | 1.9 | -2.3 | -1.9 | -0.9 |
| Denmark | 1.0 | 1.5 | 1.8 | 1.5 | 1.7 | 1.8 | 6.8 | 5.8 | 5.5 | -1.3 | -2.4 | -1.4 |
| Norway | 1.9 | 2.1 | 2.4 | 2.0 | 2.1 | 2.1 | 11.2 | 11.5 | 11.9 | 11.9 | 11.0 | 10.0 |
| Sweden | 2.6 | 2.7 | 2.9 | 0.1 | 1.3 | 2.2 | 5.9 | 5.6 | 5.6 | -1.6 | -1.0 | -0.3 |
| Switzerland | 2.2 | 2.0 | 2.2 | 0.1 | 1.0 | 1.1 | 12.2 | 11.3 | 11.8 | 0.7 | 0.9 | 1.3 |
| United Kingdom | 3.5 | 3.6 | 2.5 | 1.7 | 1.9 | 2.1 | -3.5 | -3.6 | -3.6 | -5.6 | -3.8 | -1.7 |

Source: National sources and Citi Research

Figure 2. G3 Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 30 April 2014

| | 2Q 14F | 3Q 14F | 4Q 14F | 1Q 15F | 2Q 15F | 3Q 15F | 4Q 15F |
|---------------------------------|--------|--------|--------|--------|--------|--------|--------|
| United States: Federal Funds | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.75 | 1.00 |
| 10-Yr. Treasuries (Period Ave.) | 2.85 | 3.05 | 3.25 | 3.40 | 3.45 | 3.50 | 3.55 |
| Euro Area: US\$/€ | 1.40 | 1.37 | 1.35 | 1.35 | 1.37 | 1.38 | 1.39 |
| Euro Repo Rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 10-Yr. Bunds (Period Average) | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.80 | 1.80 |
| Japan: Yen/US\$ | 104 | 105 | 107 | 108 | 110 | 111 | 113 |
| Call Money | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 10-Yr. JGB (Period Average) | 0.55 | 0.70 | 0.85 | 0.95 | 1.05 | 1.15 | 1.10 |

Industrialised Countries 10-Year Yield Spreads (Period Average)

| | Spread vs. US\$ | | | | | | Spread vs. Germany | | | | | |
|----------------------|-----------------|-------|-------|-------|-------|-------|--------------------|-------|-------|-------|-------|-------|
| | Current | 2Q 14 | 3Q 14 | 4Q 14 | 1Q 15 | 2Q 15 | Current | 2Q 14 | 3Q 14 | 4Q 14 | 1Q 15 | 2Q 15 |
| United States | NA | NA | NA | NA | NA | NA | 120 | 127 | 147 | 168 | 173 | 178 |
| Japan | -208 | -232 | -237 | -243 | -248 | -243 | -88 | -105 | -90 | -75 | -75 | -65 |
| Euro Area | -120 | -127 | -147 | -168 | -173 | -178 | NA | NA | NA | NA | NA | NA |
| Canada | -26 | -25 | -20 | -20 | -10 | -10 | 94 | 102 | 127 | 147 | 163 | 168 |
| Australia | 125 | 158 | 148 | 138 | 133 | 133 | 245 | 285 | 295 | 305 | 306 | 311 |
| New Zealand | 171 | 209 | 209 | 220 | 215 | 220 | 291 | 336 | 357 | 387 | 388 | 398 |
| France | -70 | -77 | -97 | -128 | -133 | -138 | 50 | 50 | 50 | 40 | 40 | 40 |
| Italy | 42 | 33 | -7 | -68 | -73 | -78 | 162 | 160 | 140 | 100 | 100 | 100 |
| Spain | 37 | 38 | 3 | -48 | -53 | -58 | 157 | 165 | 150 | 120 | 120 | 120 |
| Netherlands | -86 | -102 | -122 | -143 | -148 | -153 | 34 | 25 | 25 | 25 | 25 | 25 |
| Belgium | -57 | -67 | -87 | -118 | -123 | -128 | 63 | 60 | 60 | 50 | 50 | 50 |
| Austria | -96 | -102 | -122 | -153 | -158 | -163 | 24 | 25 | 25 | 15 | 15 | 15 |
| Finland | -90 | -97 | -117 | -143 | -148 | -153 | 30 | 30 | 30 | 25 | 25 | 25 |
| Ireland | 14 | 13 | -27 | -88 | -93 | -98 | 134 | 140 | 120 | 80 | 80 | 80 |
| Portugal | 101 | 83 | 43 | -18 | -23 | -28 | 221 | 210 | 190 | 150 | 150 | 150 |
| Switzerland | -186 | -192 | -212 | -233 | -241 | -246 | -66 | -65 | -65 | -65 | -68 | -68 |
| United Kingdom | -1 | 0 | 15 | 5 | 10 | 10 | 119 | 127 | 163 | 173 | 183 | 188 |

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 Outlook⁴

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Commodities are measurably outperforming equities and bonds year-to-date taking a pole position across macro asset classes for the first time since 1H'08. It is also clear investors are again beginning to take commodities seriously as a portfolio diversifier for all of the reasons they rose as a substantial part of investor portfolios during the first half of the last decade. After a record c\$50bn in passive investment net redemptions in 2013, some new monies have entered the sector so far this year. While c\$150bn shy of the recent AUM peak in April 2011, data for both flows and market capitalisation suggest some stabilisation for prices after a particularly bearish 2013. Even so, relatively slack demand for commodities is still accompanying tepid global and problematic Chinese economic growth for the rest of 2014 and into 2015. The slowdown in EM, where GDP growth is particularly commodity-intensive, is also problematic, as are the implications for commodity demand in commodity-importing countries where there are demand headwinds. We still expect price cheer to be generally capped in a lower range environment.

Oil markets are currently trading at the seasonal low for global crude demand but the Russia-Ukraine crisis is now at the top of a long list of geopolitical risks (i.e. Libya, South Sudan, Nigeria and Iran) that are supporting prices even as the physical market reflects seasonal softness. Russian oil exports have not been disrupted, but investor buying of waterborne Brent has picked up markedly in recent weeks. The Ukraine crisis continues to escalate, with the market starting to become concerned that sanctions on energy exports could be a real possibility. Bottoming refinery runs in Europe, the FSU and Asia and jetty maintenance in the North Sea are doing little to bring down Brent flat price, which has been trading in mid-April around \$110/bbl, up from the Q1 average of \$108/bbl. Citi's bearish Q2 fundamental view is, however, playing out in physical markets, with the May-June Brent spread expiring in carry and physical crude differentials weakening. But flat price remains a different animal, one dominated by geopolitics and headlines for now. Beyond Ukraine, supply disappointments in recent weeks have come from Libya, Kazakhstan, South Sudan and Nigeria.

European gas fundamentals remain exceptionally bearish but the Black Sea crisis is helping support prices and physical disruptions remain a possibility. Storage levels are now at a 21-bcm y/y surplus. A potential cut-off of Russian gas is the big driver of prices, which are very sensitive to newsflow. Summer gas needs could be met if there was a short-term stoppage of Russian flows, but the real issue would be a cut-off in winter due to a prolonged stoppage, yet Citi sees this as unlikely due to the significant costs involved for all parties. The arrival of spring has not changed the US supply-demand outlook, where inventories remain low and the supply-demand balance appears to be tight, giving prices a lift in the last few weeks. Recent weekly gas storage injection figures came out largely lower than market expectation. Looking ahead, the end-October 14 storage remains below the 5-year average, giving support to prices. Globally we expect LNG prices to remain in the high-\$14/MMBtu from April to June and in the mid-\$15/MMBtu from July to September. Most Japanese buyers seemed to have filled their demand to early June. In addition, the new Papua New Guinea LNG project is proceeding ahead of schedule which should increase LNG supply in Asia. Longer term, while Canada has approved more LNG projects, other approved projects have struggled to progress. However, the prospect looks brighter for Petronas' Northwest LNG, where FID could take place in 2015.

⁴ This summarises Commodity Market Outlook from *Global Economic Outlook and Strategy - April 2014*, 30 April 2014.

Copper has picked up from March lows, supported by better than expected Chinese refined copper imports for the month, and a pick-up in Chinese copper product fabrication rates in the same month, driven perhaps by the first major China Grid Corporation tender hitting the market in March. Given the largest Grid Corporation tender of the year is being placed in July, plus the government introducing modest targeted stimulus packages, we remain moderately constructive towards copper, with prices now expected to average near \$6,800/t for the year. The stand-out performer remains Nickel, with LME 3-month prices reaching \$18,600/t in trading on 24 April, 34% up on levels at the start of the year. We continue to believe there is more short-term upside for nickel prices. Consumer support has also been clearly apparent as nickel prices accelerated through April. Indeed, ferronickel producers are now reporting being sold out well into June. We now expect to see prices push well above \$19,000/MT in the short term on combined investor and consumer momentum, with trading levels projected to scale north of \$20,000/MT during 2H 14.

Thermal coal prices have been range-bound over the past month. We do not anticipate a major move within the next few months, but forecast prices to ease somewhat further. Miners in Australia continue to increase volumes in order to reduce unit costs, the Indonesian government's greater enforcement efforts are expected to have limited impact on exports, and normal exports have resumed in Colombia and South Africa. On the demand side, India and China are key and while we expect better demand from both in the latter part of the year, import demand over the next few months should remain subdued.

| | | Point Prices | | | | | | | | | | | | | | | | | | | |
|--------------------------|-----------|--------------|--------|-------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--------|--------|--------|--------|--------|--------|--------|
| | | 0-3M | 6-12M | | Q3 2013 | Q4 2013 | Q1 2014 | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | 2012 | 2013 | 2014E | 2015E | 2016E | 2017E | 2018E |
| Energy | | | | 5Y Cyclical | | | | | | | | | | | | | | | | | |
| NYMEX WTI | USD/bbl | 98.0 | 96.0 | 81.0 | 108.0 | 97.6 | 98.0 | 98.0 | 102.0 | 90.0 | 93.0 | 86.0 | 92.0 | 84.0 | 94.1 | 98.0 | 97.0 | 88.8 | 83.0 | 78.0 | 80.0 |
| ICE Brent | USD/bbl | 103.0 | 102.5 | 85.0 | 112.0 | 109.3 | 108.0 | 103.0 | 106.0 | 99.0 | 97.0 | 93.0 | 97.0 | 93.0 | 111.7 | 108.7 | 104.0 | 95.0 | 90.0 | 85.0 | 85.0 |
| Henry Hub Natural Gas | USD/MMBtu | 5.00 | 4.90 | 5.50 | 3.55 | 3.85 | 5.20 | 4.90 | 4.90 | 4.80 | 4.50 | 4.40 | 4.50 | 4.60 | 2.75 | 3.73 | 5.00 | 4.50 | 4.90 | 4.90 | 5.50 |
| Base Metals | | | | LT Price | | | | | | | | | | | | | | | | | |
| LME Aluminum | USDM/T | 1,770 | 1,820 | 2,200 | 1,827 | 1,815 | 1,752 | 1,740 | 1,780 | 1,800 | 1,830 | 1,860 | 1,890 | 1,900 | 2,049 | 1,888 | 1,770 | 1,870 | 1,950 | 2,100 | 2,200 |
| LME Copper | USDM/T | 6,650 | 6,800 | 6,190 | 7,096 | 7,161 | 7,005 | 6,650 | 6,700 | 6,800 | 6,800 | 7,000 | 7,200 | 7,500 | 7,945 | 7,352 | 6,785 | 7,125 | 7,700 | 8,000 | 8,200 |
| LME Lead | USDM/T | 2,100 | 2,300 | 2,200 | 2,116 | 2,134 | 2,127 | 2,050 | 2,150 | 2,250 | 2,350 | 2,100 | 2,200 | 2,370 | 2,072 | 2,158 | 2,145 | 2,255 | 2,350 | 2,400 | 2,360 |
| LME Nickel | USDM/T | 17,200 | 20,000 | 21,000 | 13,996 | 13,980 | 14,693 | 16,500 | 17,450 | 17,800 | 20,000 | 20,500 | 22,000 | 23,500 | 17,592 | 15,105 | 16,610 | 21,500 | 24,500 | 26,000 | 25,000 |
| LME Tin | USDM/T | 23,000 | 24,500 | 20,000 | 21,284 | 22,951 | 22,622 | 22,900 | 23,000 | 24,400 | 25,000 | 24,000 | 23,000 | 25,000 | 21,108 | 22,340 | 23,130 | 24,250 | 25,000 | 24,000 | 23,000 |
| LME Zinc | USDM/T | 2,040 | 2,130 | 2,100 | 1,896 | 1,932 | 2,027 | 2,010 | 2,050 | 2,100 | 2,150 | 2,200 | 2,250 | 2,300 | 1,963 | 1,940 | 2,045 | 2,225 | 2,300 | 2,350 | 2,320 |
| Precious Metals | | | | LT Price | | | | | | | | | | | | | | | | | |
| COMEX Gold | USD/T, oz | 1,320 | 1,360 | 1,050 | 1,330 | 1,274 | 1,297 | 1,310 | 1,330 | 1,340 | 1,340 | 1,350 | 1,360 | 1,400 | 1,669 | 1,416 | 1,320 | 1,365 | 1,380 | 1,400 | 1,420 |
| Silver | USD/T | 20.6 | 21.4 | 16.5 | 21.5 | 20.8 | 20.5 | 20.4 | 20.8 | 21.0 | 21.5 | 21.9 | 22.4 | 23.2 | 21.2 | 24.0 | 20.7 | 22.3 | 22.5 | 23.0 | 23.1 |
| Platinum | USD/T, oz | 1,470 | 1,525 | 1,763 | 1,456 | 1,397 | 1,428 | 1,445 | 1,500 | 1,525 | 1,525 | 1,565 | 1,640 | 1,675 | 1,552 | 1,490 | 1,475 | 1,600 | 1,710 | 1,800 | 1,960 |
| Palladium | USD/T, oz | 820 | 860 | 780 | 729 | 725 | 745 | 800 | 830 | 850 | 875 | 900 | 900 | 925 | 645 | 728 | 805 | 900 | 935 | 980 | 980 |
| Bulk Commodities | | | | 5Y Cyclical | | | | | | | | | | | | | | | | | |
| Hard Coking Coal (Spot) | USDM/T | 120 | 130 | 200 | 143 | 142 | 122 | 117 | 130 | 135 | 145 | 150 | 155 | 160 | 191 | 148 | 130 | 153 | 180 | 190 | 200 |
| Thermal Coal Asia (NEWC) | USDM/T | 75 | 80 | 90 | 77 | 82 | 79 | 72 | 72 | 80 | 88 | 84 | 82 | 85 | 94 | 84 | 76 | 85 | 85 | 90 | 100 |
| Iron Ore Spot (TSI) | USDM/T | 105 | 100 | 81 | 133 | 135 | 120 | 110 | 102 | 100 | 98 | 92 | 85 | 85 | 128 | 135 | 108 | 90 | 80 | 83 | 85 |
| Agriculture | | | | | | | | | | | | | | | | | | | | | |
| CBOT Corn | USD/bu | 470 | 390 | N/A | 512</ | | | | | | | | | | | | | | | | |

14

Country Section

Bahrain

■ Key developments on the month

- Formula 1 race proceeds successfully, despite demonstrations and car bomb in Manama;
- Progress on national dialogue remains slow;
- Growth comes in at 5.3%, significantly higher than expectations.

■ Key macro drivers

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

Summary Analysis

Formula 1 race held successfully, despite ongoing unrest

The unrest in Bahrain continues, with the Formula 1 race in April providing a focal point for protests, as expected. The race, a significant component in the country's bid to attract foreign tourism and investment, went ahead successfully, despite opposition marches and the explosion of a car bomb on the day of the main event. But the impasse between government and opposition persists. Hopes that an end to the ongoing unrest was in sight were raised in January, when Crown Prince Salman bin Hamad al-Khalifa, upon the instructions of King Hamad, met with opposition leaders to agree the resumption of talks under a new guise.

Three reasons to be optimistic about prospects for talks

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

But escalation in violence suggests limited scope for breakthrough

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

2013 GDP data points to increased momentum

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

Additional impact of unrest on economy should be small

Looking ahead, the incremental economic impact of the ongoing political unrest is likely to diminish, in our view. The political unrest of the past three years has already been a drag on economic growth and has raised fiscal

vulnerabilities as the government has responded with additional expenditure. Disruption to Bahrain's Formula One race has also had a negative impact. These factors are all already included in our economic and fiscal forecasts. At the same time, support from Saudi, both political and economic, has been crucial in shoring up investor confidence.

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

We expect non-oil growth to slow down somewhat, due mainly to base effects, but oil production to stabilise, resulting in medium-term growth in the 3.5% to 4.5% range. Upside risks to this outlook include a resolution of the country's ongoing political turmoil (still unlikely in the near term, in our view, despite the latest initiative) and greater-than-expected assistance from Gulf neighbours, including Saudi Arabia. This may include, for example, an increase in the allocated share of output from the shared Abu Saafa oil field, which would dramatically boost Bahrain's domestic production.

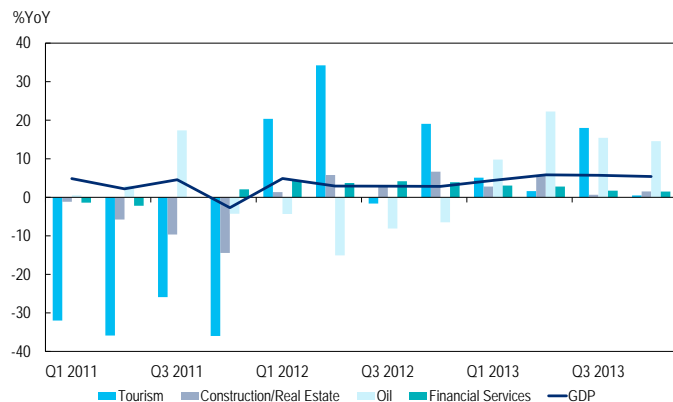
Inflation likely to fall further in 2014

Inflation eased significantly in March after holding above 3% for the last six months. Inflation fell to 2.3%YoY from 3.7% in February and a recent high of 4% in December. Most categories remained broadly stable, though the main driver of the decline was Housing, Water, Electricity, Gas and Other Fuels on base effects from March 2013. The YoY contribution for this category declined from 1.3%pt in February to 0.4%pt in March. The latest Bahrain EDB Q1 2014 Economic Quarterly points to inflation remaining unchanged at 3% for 2014 and 2015. With only three months of the year gone, it is difficult to draw precise conclusions. However, we continue to believe that inflation will fall back through 2014, reaching 2.5% for the year, partly on the weaker outlook for food prices from the Citi Commodities team, but also on base effects from the rental subcomponent, which was elevated throughout 2013. In 2015, we expect price growth to ease further – with the whole year number coming in at about 2%. In our view, the recovery in the real estate market is driven by a regional real estate recovery, led by Dubai, and does not necessarily reflect a change in Bahrain's underlying real-estate fundamentals.

Tourism continues to struggle

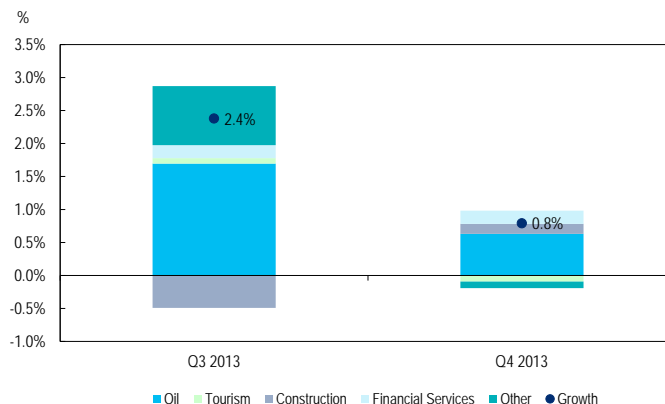
Tourism continues to be affected by the unrest. February saw the hotel occupancy rate rise to among the highest levels in the last few years to 61% according to data by Ernst & Young. Occupancy has only breached 50% four times in the past two years. Whereas most other countries in the region have seen occupancy rates closer to 70-80%. Despite this positive sign, it is difficult to determine how sustainable this development is over the longer term. Political developments in the coming year will likely determine how sustainable the tourism recovery will be.

Figure 4. Economic growth has been adversely impacted by the unrest



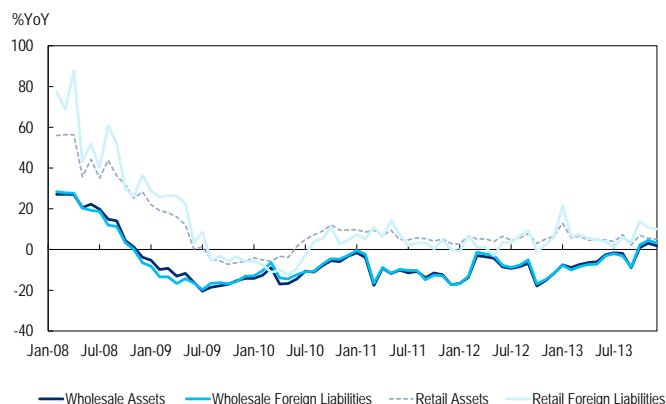
Source: Haver Analytics, Citi Research

Figure 5. Though the economy has shown some signs of recovery



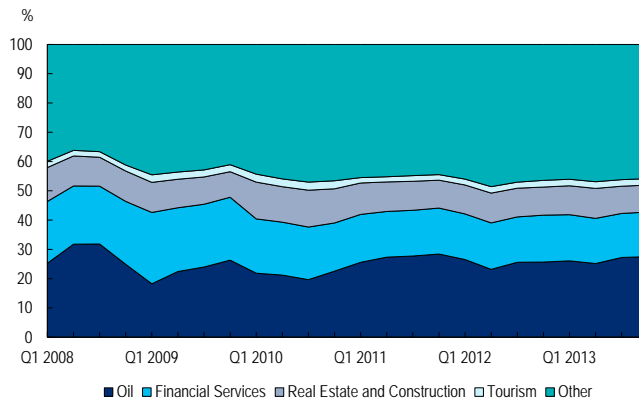
Source: Haver Analytics, Citi Research

Figure 6. The offshore banking system remains hard hit



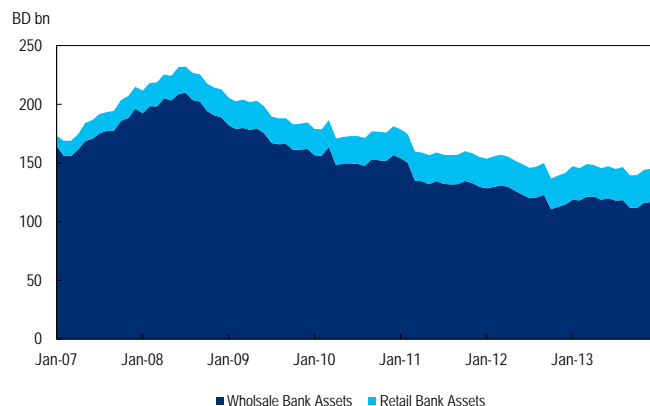
Source: Haver Analytics, Citi Research

Figure 7. The financial sector is a major pillar of the economy



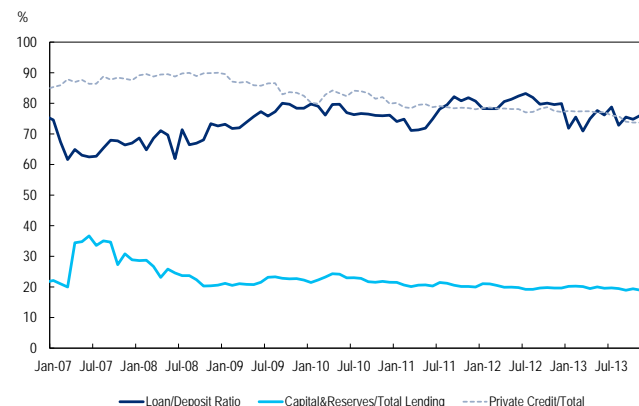
Source: Haver Analytics, Citi Research

Figure 8. Offshore banks are around 90% of the banking assets



Source: Haver Analytics, Citi Research

Figure 9. Retail bank indicators still appear robust



Source: Haver Analytics, Citi Research

Figure 10. Bahrain Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 21.7 | 25.6 | 22.9 | 25.6 | 29.1 | 30.3 | 32.7 | 35.0 | 37.4 |
| Nominal GDP, local currency bn | 8.2 | 9.7 | 8.6 | 9.7 | 11.0 | 11.4 | 12.3 | 13.2 | 14.1 |
| GDP per capita, US\$ | 21,072 | 22,983 | 19,192 | 20,482 | 22,489 | 22,969 | 23,856 | 24,563 | 25,193 |
| Share of oil in GDP (real) | 24.0 | 22.7 | 22.0 | 21.1 | 21.4 | 19.0 | 20.8 | 20.0 | 19.2 |
| Average oil production (mbpd) | 0.18 | 0.18 | 0.18 | 0.18 | 0.18 | 0.17 | 0.18 | 0.18 | 0.18 |
| Population, mn | 1.0 | 1.1 | 1.2 | 1.3 | 1.3 | 1.3 | 1.4 | 1.4 | 1.5 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 8.3 | 6.2 | 2.5 | 4.3 | 2.1 | 3.4 | 5.3 | 4.0 | 4.0 |
| Real per capita GDP, % yoy | -0.2 | -1.8 | -4.0 | -0.7 | -1.1 | 1.4 | 1.2 | 0.0 | 0.0 |
| Real non-oil GDP, % yoy | 10.9 | 8.2 | 3.4 | 5.5 | 1.4 | 6.7 | 3.2 | 5.0 | 5.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | - | 5.1 | 1.6 | 1.0 | 0.2 | 2.6 | 4.0 | 2.1 | 1.9 |
| CPI, % avg | 3.3 | 3.5 | 2.8 | 1.9 | -0.4 | 2.8 | 3.3 | 2.5 | 2.0 |
| Policy interest rate, %, eop | 4.00 | 0.75 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Credit extension to private sector, % yoy | 38.5 | 43.6 | -0.7 | 6.2 | 15.0 | 6.2 | 6.6 | 10.0 | 10.0 |
| Credit to private sector, % total deposits | 58.7 | 65.3 | 64.7 | 60.8 | 63.0 | 61.7 | 57.1 | 57.1 | 57.1 |
| Private sector deposits, % yoy | 42.8 | 18.5 | 6.6 | 10.2 | 2.6 | 4.6 | 9.0 | 10.0 | 10.0 |
| Bank capital & reserves, % total loans | 28.9 | 20.6 | 22.2 | 21.5 | 20.0 | 19.6 | 18.9 | 18.0 | 17.1 |
| 3 month inter-bank rate, %, eop | 4.90 | 2.40 | 0.40 | 0.30 | 0.30 | 0.30 | 0.20 | 0.20 | 0.20 |
| BHD/US\$, eop | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 |
| BHD/US\$, avg | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 2.8 | 2.1 | 0.4 | 0.6 | 3.0 | 2.0 | 2.2 | 1.9 | 0.5 |
| % of GDP | 12.7 | 8.1 | 1.7 | 2.3 | 10.3 | 6.4 | 6.8 | 5.5 | 1.3 |
| Trade balance | 2.7 | 3.1 | 2.3 | 2.5 | 7.5 | 6.5 | 7.3 | 6.4 | 5.2 |
| Exports | 13.6 | 17.3 | 11.8 | 13.6 | 19.6 | 19.7 | 20.9 | 20.9 | 20.5 |
| o/w oil, % total exports | 79.2 | 79.6 | 75.1 | 74.6 | 78.8 | 76.9 | 73.1 | 71.7 | 69.7 |
| Imports | 10.9 | 14.2 | 9.6 | 11.2 | 12.1 | 13.2 | 13.6 | 14.4 | 15.3 |
| Service balance | 1.8 | 1.7 | 1.9 | 2.1 | 1.3 | 1.3 | 1.4 | 1.6 | 1.6 |
| Income balance | -0.3 | -0.9 | -2.4 | -2.4 | -3.8 | -3.8 | -4.3 | -4.3 | -4.3 |
| o/w outward remittances, % GDP | 6.8 | 6.9 | 6.1 | 6.4 | 7.0 | 6.8 | 6.6 | 6.5 | 6.4 |
| FDI, net | 0.1 | 0.2 | 2.0 | -0.2 | -0.1 | 0.0 | -0.1 | 0.3 | 0.3 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 24.9 | 27.7 | 19.8 | 22.5 | 25.7 | 26.6 | 25.4 | 23.7 | 21.7 |
| o/w oil revenues | 20.0 | 23.6 | 16.4 | 19.2 | 22.6 | 23.2 | 22.0 | 20.1 | 18.0 |
| Government expenditure | 22.3 | 21.3 | 24.1 | 27.3 | 26.0 | 28.6 | 27.8 | 27.2 | 27.6 |
| o/w capital expenditures | 6.0 | 5.3 | 4.5 | 7.9 | 4.0 | 6.5 | 6.3 | 6.2 | 6.1 |
| Government balance | 2.7 | 6.4 | -4.3 | -4.8 | -0.3 | -2.0 | -2.3 | -3.5 | -5.9 |
| non-oil balance, % of non-oil GDP | -21.9 | -22.8 | -25.7 | -30.3 | -31.4 | -33.4 | -32.9 | -31.2 | -30.4 |
| Breakeven oil price (fiscal), US\$/barrel | 62.60 | 72.67 | 79.00 | 100.23 | 112.31 | 122.68 | 121.11 | 126.30 | 136.02 |
| Public debt | 16.3 | 12.6 | 21.4 | 29.8 | 32.5 | 39.8 | 41.3 | 44.1 | 41.3 |
| Cumulative government balance since 2000 | 22.8 | 29.2 | 24.8 | 20.1 | 19.8 | 17.8 | 15.5 | 11.9 | 6.1 |
| Net debt (public debt net cumulative balance) | -6.5 | -16.6 | -3.4 | 9.7 | 12.7 | 22.0 | 25.8 | 32.1 | 35.3 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 29.8 | 36.3 | 35.0 | 37.5 | 36.5 | 39.0 | 40.8 | 41.9 | 42.3 |
| External debt / GDP | 137.1 | 141.6 | 152.8 | 146.2 | 125.4 | 128.7 | 124.8 | 119.5 | 113.2 |
| External debt / XGS | 173.7 | 172.9 | 225.8 | 212.4 | 161.1 | 173.0 | 170.8 | 200.5 | 206.5 |
| External Assets | 8.3 | 10.5 | 11.1 | 11.8 | 12.4 | 15.4 | 17.4 | 19.6 | 21.5 |

Source: National Sources, Citi Research Estimates

Egypt

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■ Key developments on the month

- Following the holding of the constitutional referendum, the military's political roadmap to a new political dispensation will continue to unfold in 1H 2014.
- 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 holding of the constitutional referendum now means the military's political roadmap for Egypt is moving forward. The next important step in this will be the holding of presidential elections on 26/27 May to be followed by parliamentary elections, probably in July or August.

While the final list of presidential candidates is not due to be published until 2 May, we would expect the former military leader, Abdelfattah el Sisi to be on it. Moreover, we think that the parliamentary vote will be quite widely split over a range of parties, meaning 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 political and economic lead in supporting Egypt's political transition, while US and European influence has diminished as they have struggled to react to political developments since June 2013.

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) that is underway. But pushing the MB underground raises the risk of returning to the low level insurgency of the 1990s. Attempts by the MB to reignite 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 positions remain deeply polarised in Egypt.

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 it 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 with a strong social dimension. 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 more comprehensive reform programme still 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.

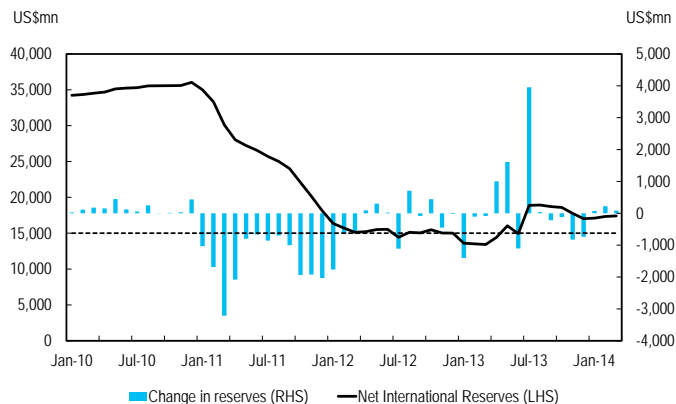
On a more positive note, with only modest EGP depreciation expected in 2014 and a still weak growth environment, we think that inflation is unlikely to rise sharply. While, it could be argued that the CBE's cuts in the Overnight Deposit Rate (ODR) in 2013 were premature given the rise in inflation in 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 crucially, energy, firm control of the public sector wage bill and the return of growth to boost domestic revenue collection. Solving the energy subsidy issue is a particularly difficult problem, but has to become a policy priority, in our view, however difficult. 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

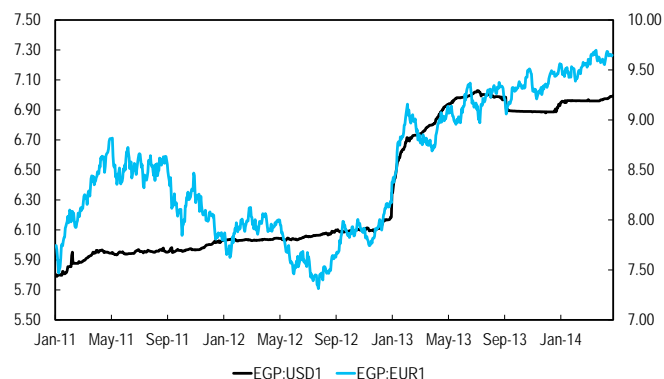
Having said that, the provision of Gulf support means that such difficult choices can be put off and the government can continue to operate in "muddle through" fiscal mode, probably well into 1H 2015. But at some point, the government will have to think about a more comprehensive reform programme. While this could 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 socially important 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 11. Reserves have stabilised since late 2013, but remain low



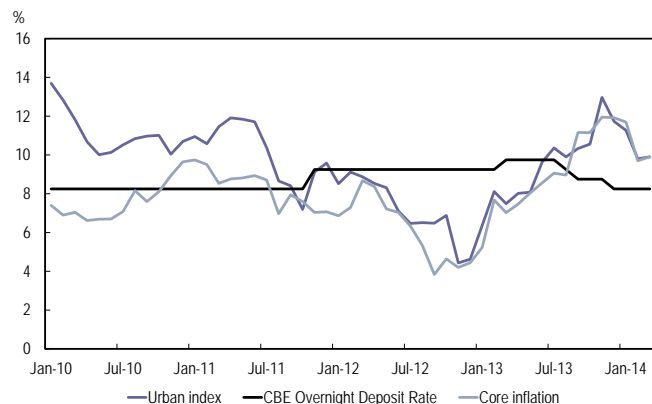
Source: Central Bank of Egypt, Haver Analytics

Figure 12. The EGP also starts to stabilise against USD since mid-2013



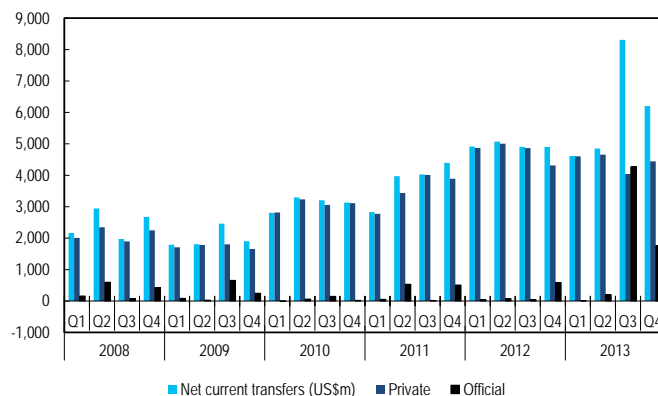
Source: Reuters

Figure 13. The CBE has cut rates, despite the rise in inflation in 2H 2013



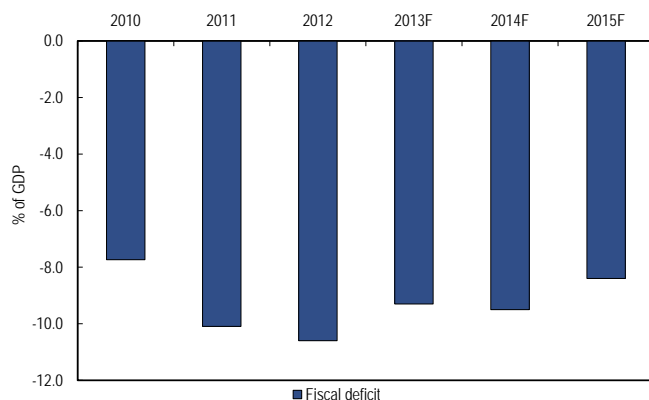
Source: Central Bank of Egypt, Haver Analytics and Citi forecasts for 2H 2013

Figure 14. Robust transfers have limited the deterioration in the current account and helped support consumption



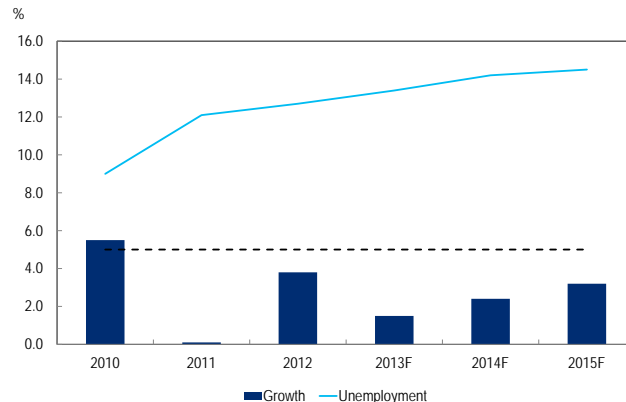
Source: Central Bank of Egypt, Haver Analytics

Figure 15. The fiscal deficit remains large and is a problem



Source: Haver Analytics and Citi forecasts for 2013-2015

Figure 16. A weak recovery may now be possible in 2014-15



Source: Haver Analytics and Citi forecasts for 2013-15

Figure 17. Egypt Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|-------|-------|---------|---------|---------|---------|---------|---------|---------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 132.2 | 164.8 | 188.0 | 214.4 | 231.0 | 259.9 | 254.5 | 274.5 | 285.3 |
| Nominal GDP, local currency bn | 744.8 | 895.5 | 1,042.2 | 1,206.6 | 1,371.1 | 1,575.5 | 1,753.3 | 1,950.2 | 2,151.5 |
| GDP per capita, US\$ | 1,783 | 2,187 | 2,454 | 2,755 | 2,920 | 3,233 | 3,114 | 3,305 | 3,379 |
| Population, mn | 74.1 | 75.4 | 76.6 | 77.8 | 79.1 | 80.4 | 81.7 | 83.1 | 84.4 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | - | 6.0 | 4.6 | 5.5 | 0.1 | 3.8 | 1.5 | 2.4 | 3.2 |
| Real per capita GDP, % yoy | - | 4.3 | 3.0 | 3.8 | -1.6 | 2.1 | -0.1 | 0.8 | 1.5 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 6.9 | 18.4 | 13.2 | 10.6 | 9.5 | 4.7 | 11.7 | 9.1 | 7.2 |
| CPI, % avg | 9.5 | 18.3 | 11.8 | 11.1 | 10.1 | 7.1 | 9.5 | 9.1 | 7.1 |
| Policy interest rate, %, eop | 8.75 | 11.50 | 8.25 | 8.25 | 9.25 | 9.25 | 8.25 | 8.00 | 7.50 |
| Credit extension to private sector, % yoy | 10.0 | 12.0 | 3.0 | 6.7 | 6.1 | 7.6 | 6.4 | 6.3 | 7.6 |
| Credit to private sector, % total deposits | 48.9 | 50.1 | 44.5 | 42.8 | 43.7 | 42.7 | 37.7 | - | - |
| Private sector deposits, % yoy | 11.8 | 12.1 | -1.6 | 6.7 | 6.1 | 7.6 | 6.4 | - | - |
| EGP/US\$, eop | 5.53 | 5.50 | 5.48 | 5.81 | 6.03 | 6.36 | 6.95 | 7.35 | 7.65 |
| EGP/US\$, avg | 5.64 | 5.44 | 5.55 | 5.63 | 5.94 | 6.07 | 6.87 | 7.10 | 7.54 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 0.2 | -1.3 | -3.2 | -5.6 | -7.9 | -10.7 | -3.6 | -2.9 | -5.5 |
| % of GDP | 0.2 | -0.8 | -1.7 | -2.6 | -3.4 | -4.1 | -1.4 | -1.1 | -1.9 |
| Trade balance | -20.8 | -26.8 | -22.5 | -27.7 | -28.5 | -36.8 | -30.2 | -30.1 | -30.1 |
| Exports | 24.5 | 29.8 | 23.1 | 25.0 | 27.9 | 23.2 | 25.1 | 26.1 | 27.3 |
| Imports | 45.3 | 56.6 | 45.6 | 52.7 | 56.5 | 59.9 | 55.3 | 56.2 | 57.4 |
| Service balance | 12.7 | 15.7 | 11.3 | 9.6 | 5.4 | 6.3 | 2.6 | 1.7 | 2.7 |
| Income balance | - | - | - | - | - | - | - | - | - |
| FDI, net | 10.9 | 7.6 | 6.1 | 5.2 | -1.1 | 6.7 | 5.6 | -0.1 | 3.0 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 27.6 | 27.8 | 27.7 | 25.1 | 22.0 | 22.1 | 21.8 | 21.5 | 22.1 |
| Government expenditure | 32.8 | 34.1 | 34.2 | 32.9 | 32.1 | 32.8 | 31.2 | 31.0 | 30.4 |
| o/w capital expenditures | 3.4 | 3.8 | 4.2 | 4.0 | 2.9 | 2.3 | 2.3 | - | - |
| Government balance | -5.2 | -6.4 | -6.6 | -7.7 | -10.1 | -10.6 | -9.3 | -9.5 | -8.4 |
| Public debt | 64.2 | 53.5 | 54.0 | 59.8 | 69.0 | 77.7 | 78.6 | 78.2 | 77.8 |
| Government's deposits with banks | 11.4 | 10.5 | 11.0 | 9.6 | 8.8 | 7.7 | 9.8 | - | - |
| Net debt (public debt net cumulative balance) | 52.8 | 43.0 | 43.0 | 50.2 | 60.2 | 70.0 | 68.8 | - | - |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 32.8 | 32.1 | 33.3 | 35.0 | 33.7 | 38.8 | 34.1 | 30.6 | 26.9 |
| External debt / GDP | 24.8 | 19.5 | 17.7 | 16.3 | 14.6 | 14.9 | 13.4 | 11.2 | 9.4 |
| External debt / XGS | 68.8 | 55.6 | 73.0 | 70.9 | 71.1 | 85.9 | 78.2 | 69.9 | 57.7 |
| External Assets | - | - | - | - | - | - | - | - | - |

Source: Citi Research

Iraq

■ Key developments on the month

- Parliamentary elections underway against backdrop of violence;
- We expect prolonged period of horse-trading post elections, chances of KRG deal are heightened;
- Latest data show fiscal weakening, though trend is likely to be positive.

■ Key macro drivers

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

Summary Analysis

Parliamentary elections underway against backdrop of violence

Campaigning kicked off this month for the parliamentary elections, which take place on 30 April. The elections take place against a backdrop of increased sectarian violence and a highly divisive and fractured political scene. Following the disintegration of political alliances that formed in the 2010 elections, the number of candidates and political groupings has proliferated, and it appears unlikely that any single party will emerge with the ability to form a majority government.

Prolonged period of horse-trading likely ahead of new government formation: outcome highly uncertain

The formation of the next government is therefore likely to be, yet again, the result of a prolonged period of horse-trading among the competing groupings, a process that took almost 10 months after the 2010 elections. On that occasion, Nouri al-Maliki emerged as the leader of a 'national unity' government, comprising Maliki's Shia rivals, the Iraqqiya bloc (representing Sunni interests) and the main Kurdish parties. The coalition was made possible after all parties agreed to a number of pre-conditions, collectively known as the Erbil Agreement. These included agreements on the distribution of ministerial portfolios among the political groupings, the establishment of an executive co-ordinating committee under Ayad Alawi (who had won the popular vote) to counter balance the executive powers of the Prime minister, and commitments to arrive at a final agreement on Kurdish oil production and exports as well as the status of the disputed territories.

Any deals ahead of new government likely to be more robust than previous one (Erbil Agreement)

In reality, the pre-conditions listed in the Erbil Agreement were never fulfilled, aggravating divisions among the country's political forces. Going into the next round of negotiations, therefore, the outcome is highly uncertain and the deals made between parties to facilitate their political co-operation are likely to be more binding in nature than the Erbil Agreement (which was never even published).

The weaker the position of dominant parties after the election, the greater the scope for deals

In our view, the weaker the position of the dominant political parties after the votes are counted, and thus the greater the need to piece together another wide-reaching coalition, the higher the chance of conciliatory deals being reached. Of these, one of the most important from an investment perspective would be any potential deal that would allow the Kurdish parties to support a new government. It is conceivable that this could act as a catalyst for a relatively robust agreement between Baghdad and Erbil on Kurdish oil exports.

KRG-Baghdad dispute continues, but signs of co-operation emerge

For the time being, however, the dispute between the KRG and Baghdad continues, precluding the passing of the 2014 budget. The announcement last month by the KRG that it would resume pumping 100,000 bpd of oil through the Iraq-Turkey Pipeline (ITP) never came into fruition, but talks between the parties have continued. In a recent sign of potential co-operation (and perhaps a

foreshadow of a future oil deal in post-electoral horse-trading), officials from both sides have agreed in principle to allow the Baghdad-controlled Northern Oil Company (NOC) to export crude to Ceyhan through the newly-completed Kurdish export pipeline (Iraq Oil Report, 25 April). Baghdad is seeking ways to bypass the existing Iraq-Turkey Pipeline (ITP), which has been out of action in March due to continued sabotage and terrorist activity.

Sectarian violence likely to remain contained, oil production rises expected in the South

We remain sanguine about the likelihood of the sectarian violence that has engulfed Anbar province and parts of the north will remain geographically contained, and thus remain optimistic regarding the trajectory of Iraq's oil production and exports. After rebounding sharply in February, Iraq's oil exports fell by around 400 kbpd in March, mainly due to the shut in in northern oil exports due to sabotage on the ITP. Exports from the South continued to perform well, however, and newly added production mean that Iraq is well on its way to achieving our forecast of an increase in average exports of 500,000bpd in 2014, in our view. We believe the rise will be sustained by added production in a number of oil fields in the South, including the coming on line of West Qurna 2 which plans to produce an additional 300,000 barrels of crude this year (Iraq Oil Report, 4 March). We expect some volatility to persist in export numbers, driven by the continued high risk of sabotage on the ITP and the continued vulnerability of exports and production to weather conditions. However, the trend remains positive and underpins Iraq's sovereign creditworthiness, in our view.

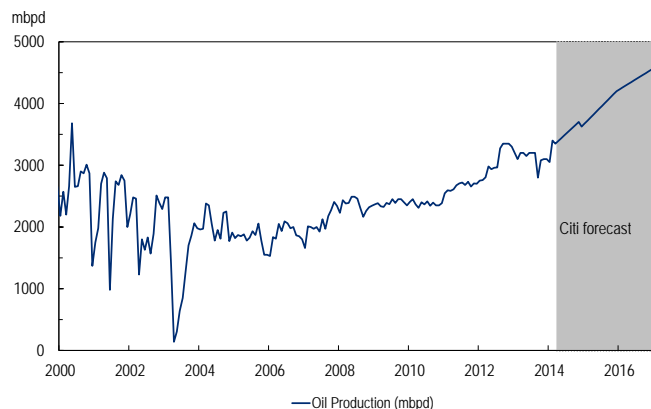
Mindful of risk of greater call for autonomy in the south, and potential implications for stability and production

That said, we continue to highlight the risk to production from any potential instability in the south: violence targeted against foreign oil workers last November is perceived to be a reflection of growing frustration of the local community in the south with a stagnant standard of living. This frustration is the driving force behind calls for greater regional autonomy in the south, something which may gather momentum following national elections. This is a potential threat to the relative political stability and security the south has enjoyed in recent years, and could have consequences for oil exports. While this risk remains relatively remote for the time being, we believe it is one worth watching.

Latest data show fiscal weakening, though trend is likely to be positive

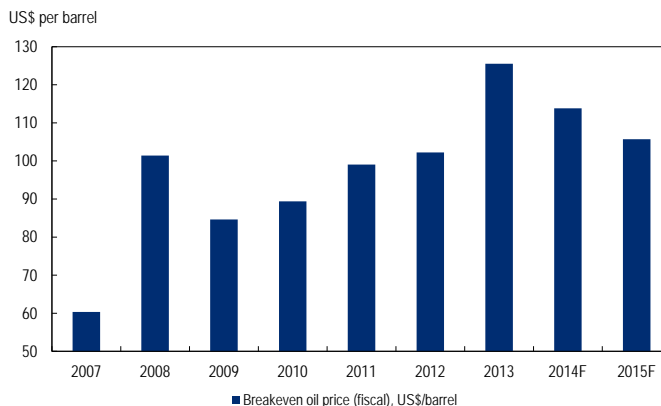
Recent data show a significant weakening in Iraq's fiscal position, although we expect a rebound on the back of higher crude oil exports this year. Crude exports (which account for over 90% of government revenues) declined by around 4% in 2013 vis-à-vis the previous year, as volumes stagnated at the 2.4mbpd mark and prices softened. At the same time, expenditures rose by around 5% of GDP, resulting in a deficit which we estimate at 5.8% of GDP, as opposed to a surplus of 4.1% last year. This deficit is likely to narrow substantially, in our view, given the expected progress in the country's crude sector in the coming years.

Figure 18. Oil production on track to ramp up in near term



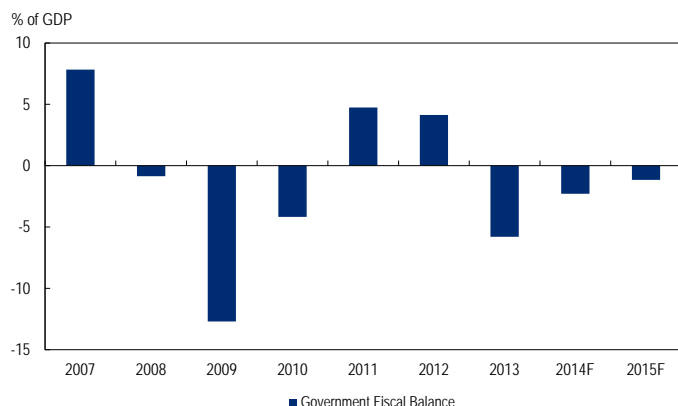
Source: Bloomberg, Citi Research

Figure 19. The fiscal breakeven oil price remains elevated



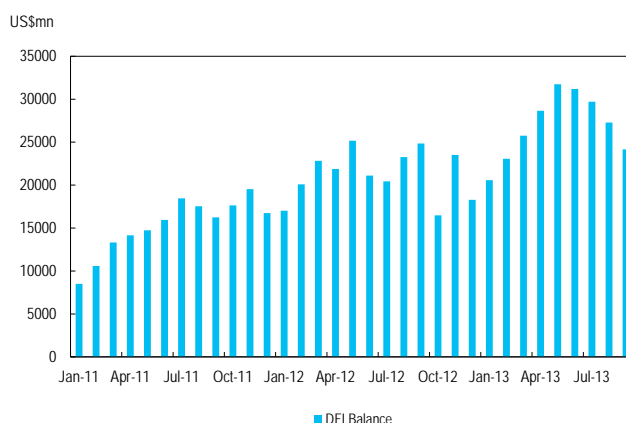
Source: Haver Analytics, Citi Research estimates

Figure 20. Fiscal performance should improve going forward



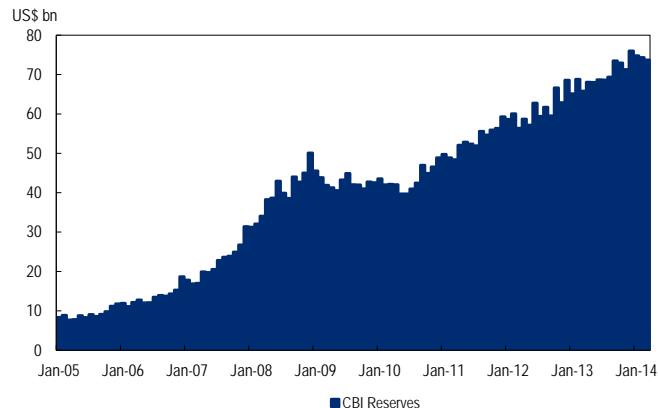
Source: Haver Analytics, Citi Research estimates

Figure 21. Balances at DFI account remain strong



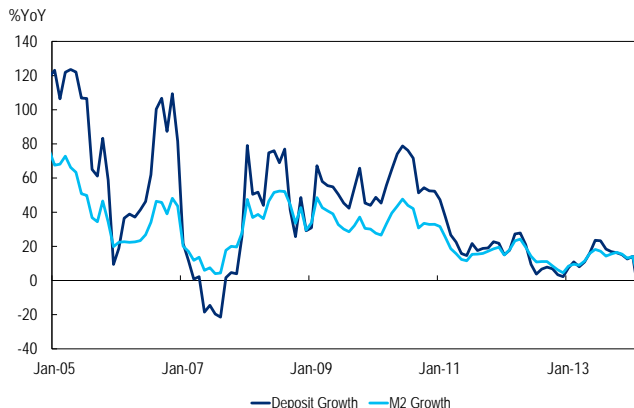
Source: IAMB, Committee of Financial Experts

Figure 22. Central bank reserves have settled around US\$75bn



Source: Haver Analytics, Citi Research

Figure 23. Monetary growth has weakened significantly



Source: Haver Analytics, Citi Research

Figure 24. Iraq Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 91.7 | 135.6 | 113.6 | 138.9 | 186.3 | 216.6 | 234.8 | 271.9 | 318.4 |
| Nominal GDP, local currency bn | 111,455.8 | 157,026.1 | 130,642.2 | 162,064.6 | 217,327.1 | 251,907.7 | 272,835.0 | 315,969.0 | 369,984.8 |
| GDP per capita, US\$ | 3,190 | 4,607 | 3,766 | 4,487 | 5,871 | 6,655 | 7,032 | 7,942 | 9,068 |
| Share of oil in GDP (real) | 43.0 | 45.4 | 43.5 | 41.0 | 41.6 | 43.5 | 43.0 | 45.2 | 47.0 |
| Average oil production (mbpd) | 2.07 | 2.36 | 2.39 | 2.38 | 2.66 | 3.06 | 3.13 | 3.63 | 4.20 |
| Population, mn | 28.7 | 29.4 | 30.2 | 31.0 | 31.7 | 32.5 | 33.4 | 34.2 | 35.1 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 1.4 | 6.6 | 5.8 | 5.5 | 10.2 | 10.3 | 3.2 | 10.3 | 11.5 |
| Real per capita GDP, % yoy | -1.0 | 4.1 | 3.2 | 2.8 | 7.5 | 7.5 | 0.6 | 7.6 | 8.7 |
| Real non-oil GDP, % yoy | -2.8 | 2.2 | 9.5 | 10.1 | 9.1 | 6.7 | 4.0 | 6.0 | 8.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 4.7 | 6.8 | -4.4 | 3.3 | 6.0 | 3.6 | 3.1 | 3.0 | 5.5 |
| CPI, % avg | 32.6 | 2.8 | -2.8 | 2.4 | 5.6 | 6.1 | 1.9 | 3.0 | 5.5 |
| 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 | 1,162 | 1,162 |
| IOD/US\$, avg | 1,253 | 1,189 | 1,156 | 1,167 | 1,171 | 1,164 | 1,162 | 1,162 | 1,162 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 20.0 | 28.4 | -1.3 | 6.3 | 26.2 | 38.0 | 31.1 | 36.9 | 40.2 |
| % of GDP | 21.9 | 20.9 | -1.1 | 4.6 | 14.1 | 17.5 | 13.2 | 13.6 | 12.6 |
| Trade balance | 23.0 | 34.0 | 4.1 | 14.4 | 39.0 | 44.8 | 38.3 | 44.6 | 48.3 |
| Exports | 39.6 | 63.7 | 39.4 | 51.8 | 79.7 | 90.3 | 89.3 | 101.7 | 112.2 |
| o/w oil, % total exports | 94.9 | 96.9 | 92.4 | 94.2 | 96.2 | 96.7 | 96.6 | 97.0 | 97.3 |
| Imports | 16.6 | 29.8 | 35.3 | 37.3 | 40.6 | 45.5 | 51.0 | 57.1 | 63.9 |
| Service balance | -4.0 | -6.1 | -6.4 | -7.0 | -8.1 | -4.1 | -4.5 | -5.0 | -5.5 |
| Income balance | 1.5 | 3.5 | 3.1 | 1.6 | -0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| FDI, net | 1.0 | 1.8 | 1.5 | 1.3 | 1.7 | 2.6 | 3.1 | 3.4 | 3.8 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 54.0 | 56.4 | 46.2 | 45.4 | 48.1 | 47.4 | 42.3 | 42.8 | 40.7 |
| o/w oil revenues | 47.4 | 47.8 | 35.9 | 37.0 | 44.4 | 43.4 | 39.6 | 39.0 | 36.7 |
| Government expenditure | 46.1 | 57.3 | 58.9 | 49.6 | 43.4 | 43.3 | 48.1 | 45.1 | 41.8 |
| o/w capital expenditures | 9.9 | 17.4 | 12.8 | 14.9 | 12.6 | 15.1 | 13.9 | 12.6 | 11.3 |
| Government balance | 7.8 | -0.9 | -12.7 | -4.2 | 4.7 | 4.1 | -5.8 | -2.3 | -1.2 |
| non-oil balance, % of non-oil GDP | -85.2 | -117.4 | -92.9 | -81.9 | -79.6 | -78.8 | -81.2 | -75.0 | -65.8 |
| Breakeven oil price (fiscal), US\$/barrel | 60.3 | 101.4 | 84.6 | 89.4 | 99.1 | 102.2 | 125.5 | 113.8 | 105.7 |
| Public debt | 116.1 | 72.6 | 84.0 | 51.0 | 39.1 | 33.5 | 36.7 | 34.0 | 30.2 |
| Cumulative government balance since 2000 | 7.8 | 7.0 | -5.7 | -9.9 | -5.2 | -1.0 | -6.8 | -9.1 | -10.3 |
| Net debt (public debt net cumulative balance) | - | - | - | - | - | - | - | - | - |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 103.2 | 95.5 | 93.2 | 44.1 | 48.8 | 50.0 | 51.0 | 45.8 | 43.6 |
| External debt / GDP | 112.5 | 70.5 | 82.0 | 31.7 | 26.2 | 23.1 | 21.7 | 16.9 | 13.7 |
| External debt / XGS | 255.0 | 146.5 | 223.9 | 80.8 | 59.1 | 54.7 | 57.1 | 45.1 | 38.8 |
| External Assets | 23.3 | 51.7 | 50.6 | 57.0 | 83.3 | 121.3 | 152.4 | 189.4 | 229.5 |

Source: Citi Research

Jordan

■ Key developments on the month

- 2013 budgetary outturns improve on back of grants, expenditure cuts;
- 2014 budget calls for sharp growth in spending;
- FX reserve position improves significantly, but on the back of transient factors.

■ Key macro drivers

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

Summary Analysis

2013 budgetary outturns improve on back of grants, expenditure cuts

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

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

Jordan's FX reserve improvement reflects transient factors

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

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

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

Jordan's FX reserve position has improved significantly over the past year, despite ongoing external imbalances. Total FX reserves rose sharply to US\$13.4bn in January, from US\$8.8bn a year earlier. This is despite a continued widening in the current account deficit, to over 11% of GDP in Q3, and sluggishness in capital inflows. Indeed, the balance of payments has remained in a net negative position, and the build-up of FX reserves reflects mainly two exceptional factors.

First, there has been a significant de-dollarisation in the economy, with the ratio of FX to dinar deposits falling from 32% to 27% in the first 11 months of the year. Second, the FX reserves reflect the IMF disbursements under the programme.

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

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

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

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

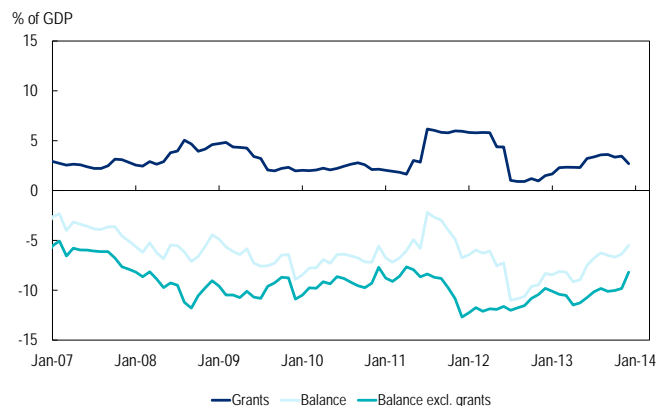
Refugee crisis has an ambiguous impact on the macro-economy

Jordan's economy has been affected by a wave of almost 600,000 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. Recently released data shows that the economy grew just 2.8%YoY in 2013, reflecting ongoing regional and domestic instability, weak external demand, and elevated energy costs.

Inflation continues to ease

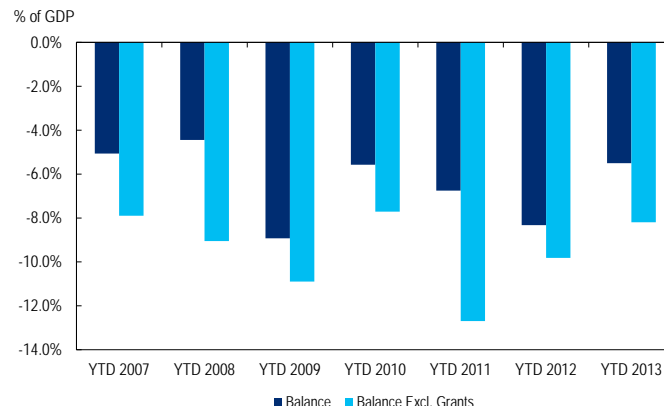
At 3.1%YoY March inflation was unchanged compared to February. There were declines in Food and Housing costs, while the prices of Clothing & Footwear and Other Goods & Services moved in the opposite direction. We are expecting inflation to pick up gradually for the rest of the year, averaging 4% for 2014.

Figure 25. The fiscal bottom line has remained problematic...



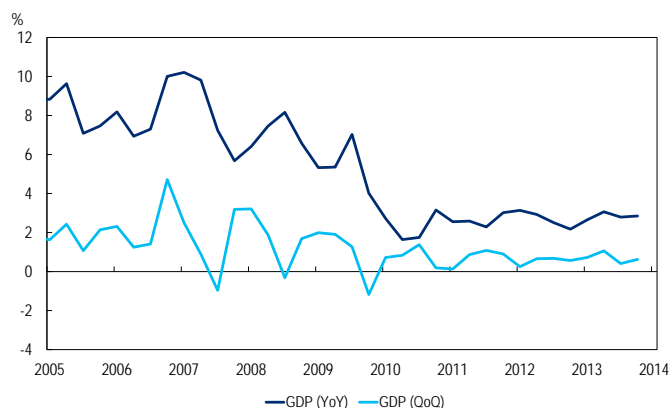
Source: Haver Analytics, Citi Research

Figure 26. ...and would be weaker still if grants were excluded



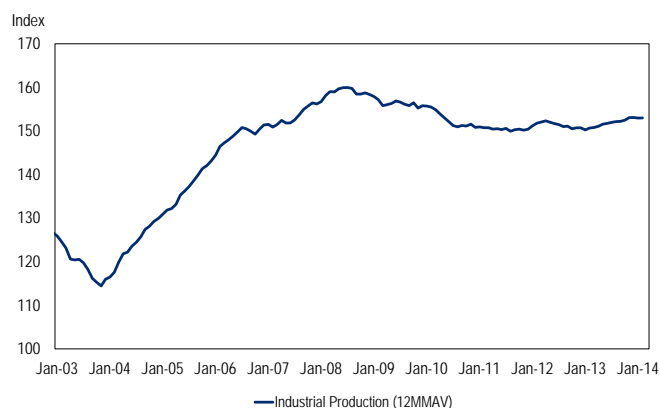
Source: Haver Analytics, Citi Research

Figure 27. Growth has begun to slow ...



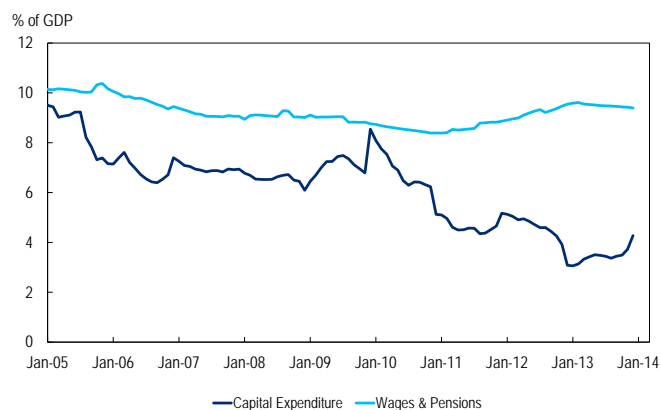
Source: Haver Analytics, Citi Research

Figure 28. ... and industrial production has been stalled since 2008



Source: Haver Analytics, Citi Research

Figure 29. Capital expenditures have stabilised ...



Source: Haver Analytics, Citi Research

Figure 30. ... while reserves are continuing to grow



Source: Haver Analytics, Citi Research

Figure 31. Jordan Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 17.1 | 22.0 | 23.9 | 26.5 | 28.8 | 30.9 | 33.6 | 35.8 | 38.5 |
| Nominal GDP, local currency bn | 12.1 | 15.6 | 16.9 | 18.8 | 20.4 | 21.9 | 23.8 | 25.4 | 27.3 |
| GDP per capita, US\$ | 3,026 | 3,722 | 3,866 | 4,104 | 4,284 | 4,404 | 4,593 | 4,699 | 4,848 |
| Population, mn | 5.7 | 5.9 | 6.2 | 6.5 | 6.7 | 7.0 | 7.3 | 7.6 | 7.9 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 8.2 | 7.2 | 5.5 | 2.3 | 2.6 | 2.7 | 2.8 | 4.0 | 4.5 |
| Real per capita GDP, % yoy | 3.8 | 2.6 | 0.9 | -2.0 | -1.6 | -1.4 | -1.4 | -0.2 | 0.3 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 5.1 | 9.1 | 2.7 | 6.1 | 3.3 | 7.2 | 2.7 | 5.5 | 5.0 |
| CPI, % avg | 4.7 | 13.9 | -0.7 | 5.0 | 4.4 | 4.8 | 5.5 | 4.0 | 5.0 |
| Policy interest rate, % eop | 7.00 | 6.25 | 4.75 | 4.25 | 4.50 | 5.00 | 4.50 | 4.25 | 4.50 |
| Credit extension to private sector, % yoy | 14.5 | 14.7 | 7.2 | 7.1 | 7.2 | 4.7 | 7.1 | 10.0 | 10.0 |
| Credit to private sector, % total deposits | - | - | - | - | - | - | - | - | - |
| Private sector deposits, % yoy | 9.5 | 12.5 | 12.9 | 12.0 | 8.7 | 1.9 | 10.0 | 10.0 | 10.0 |
| JOD/US\$, eop | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 |
| JOD/US\$, avg | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | -2.9 | -2.1 | -1.2 | -1.9 | -3.5 | -5.4 | -3.8 | -3.6 | -3.0 |
| % of GDP | -16.8 | -9.3 | -5.2 | -7.1 | -12.0 | -17.4 | -11.3 | -10.2 | -7.9 |
| Trade balance | -6.5 | -7.2 | -6.3 | -6.8 | -8.8 | -10.5 | -11.5 | -12.1 | -12.3 |
| Exports | 5.7 | 7.9 | 6.4 | 7.0 | 8.0 | 7.9 | 7.9 | 8.3 | 9.2 |
| Imports | 12.2 | 15.1 | 12.7 | 13.9 | 16.8 | 18.4 | 19.4 | 20.4 | 21.4 |
| Service balance | 0.0 | 0.4 | 0.7 | 1.2 | 0.7 | 1.1 | 1.3 | 1.3 | 1.4 |
| Income balance | 0.7 | 0.7 | 0.5 | -0.1 | -0.2 | -0.3 | -0.2 | -0.3 | -0.3 |
| FDI, net | 2.6 | 2.8 | 2.3 | 1.6 | 1.4 | 1.5 | 1.8 | 1.9 | 2.0 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 32.7 | 30.4 | 26.7 | 24.9 | 26.5 | 23.1 | 24.2 | 21.5 | 21.0 |
| Government expenditure | 37.8 | 34.8 | 35.7 | 30.4 | 33.2 | 31.4 | 29.7 | 31.1 | 30.4 |
| <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 | -5.5 | -9.6 | -9.4 |
| Public debt | 70.9 | 58.2 | 62.2 | 63.4 | 68.9 | 76.8 | 76.1 | 81.0 | 84.7 |
| Government's deposits with banks | 17.6 | 15.7 | 14.8 | 15.7 | 13.3 | 15.3 | 20.1 | 19.7 | 19.3 |
| <i>Net debt (public debt net cumulative balance)</i> | 53.3 | 42.5 | 47.5 | 47.7 | 55.6 | 61.5 | 56.0 | 61.2 | 65.4 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 14.9 | 13.8 | 14.3 | 16.3 | 17.3 | 18.9 | 19.9 | 20.8 | 21.9 |
| External debt / GDP | 87.3 | 62.9 | 59.7 | 61.4 | 60.2 | 61.3 | 59.2 | 58.2 | 56.9 |
| External debt / XGS | 161.0 | 111.4 | 130.2 | 128.5 | 131.8 | 139.3 | 145.1 | 147.5 | 145.7 |
| External Assets | -5.5 | -7.5 | -8.3 | -9.7 | -13.2 | -18.5 | -22.3 | -26.0 | -29.0 |

Source: National Sources, Citi Research Estimates

Kuwait

■ Key developments on the month

- Government spending rose 23% in 2013, highlighting need to address subsidies;
- 2014/2015 budget approved by cabinet, modest growth, requires National Assembly ratification;
- Parliamentarians move to 'grill' PM in potential sign of escalating political tensions.

■ Key macro drivers

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

Summary Analysis

Government spending rose 23% in 2013

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

Rising expenditures highlight need to address subsidy reform

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

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

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

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

Tentative progress on development plan, but question marks remain

Some tentative steps forward on development spending have been made, but question marks remain. This month, the government approved a US\$12bn bid for the Clean Fuels Project (CFP) which involves an overhaul of Kuwait's existing refineries. The project forms part of the US\$6bn slated towards infrastructure

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

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

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

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

Indeed, in a potential signal of rising tensions, three parliamentarians have moved to question Prime Minister Sheikh Jaber al-Sabah over the state of the housing market in Kuwait (Reuters, 24 April). The move reflects popular discontent over rising prices and rents, and long waiting lists for social housing. More importantly, in our view, the move reflects the populist instinct of some of Kuwait's parliamentarians, and the obstacles facing a normalisation of relations between the National Assembly and the government.

Weak credit growth likely to continue in 2014

Lending growth continues to be sluggish at the start of 2014. Total credit extended in February rose a disappointing 5.9%YoY. There had been some signs in the last few months of momentum building, but the February data shows how fragile the recovery in lending is. Although credit to the public sector remained weak at -8.2%YoY, the picture continues to improve with this being the highest level of growth (or least negative) since the -28.7%YoY trough reported in June 2013. The real weakness comes from the private side, which makes up more than 90% of total bank lending. While it grew 6.7%YoY in February, this was actually weaker than the last few months, setting back the overall lending picture. Although there were some signs of a small pick-up in H2 2013, it appears that this may have been premature with private credit growth stuck at around 7% over the past few months. On the flip side, the weak loan growth has allowed the loan deposit ratio to stabilise at around 80%.

Inflation remains contained

Inflation has remained well contained since the statistical office rebased the index last year. In March, inflation reached 3%YoY, which matches the 12 month high of 3% reported in May and June last year. Then, inflation was driven primarily by the price of food. More recently, it has been housing goods/maintenance that has supported the headline inflation rate. We think that inflation will remain stable for the rest of the year, averaging about 3% for 2014.

Figure 32. Lending to the government continues to be anaemic



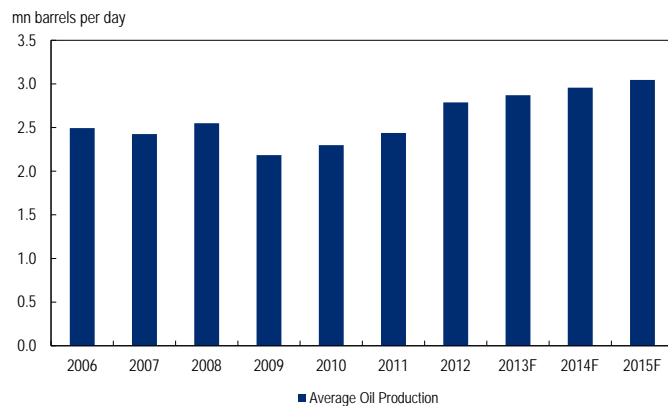
Source: Haver Analytics, Citi Research

Figure 33. Foreign liabilities remain moderate



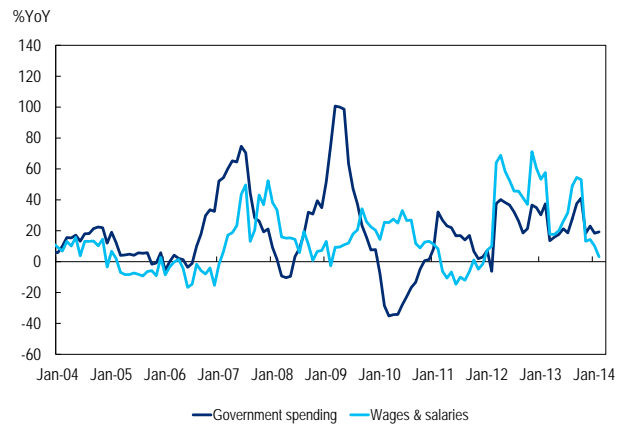
Source: Haver Analytics, Citi Research

Figure 34. Oil production remains relatively stagnant



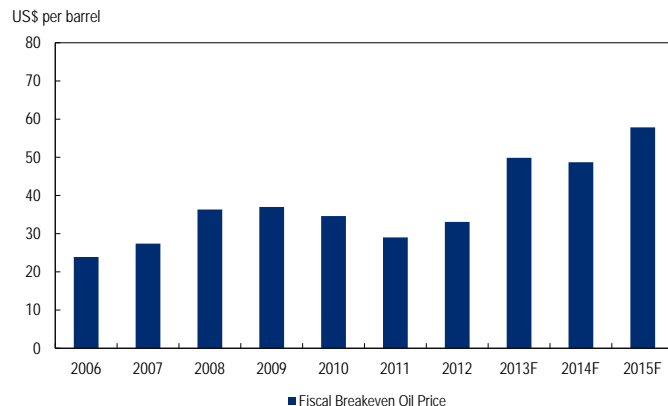
Source: Haver Analytics, Citi Research estimates

Figure 35. Government spending has stabilised



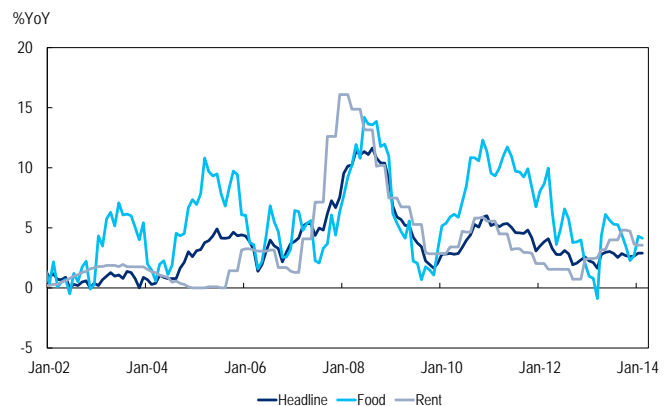
Source: Haver Analytics, Citi Research

Figure 36. Fiscal breakeven rising but still relatively prudent



Source: Haver Analytics, Citi Research estimates

Figure 37. Food price inflation remains elevated



Source: Haver Analytics, Citi Research

Figure 38. Kuwait Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 112.3 | 136.6 | 105.2 | 118.5 | 152.8 | 176.9 | 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) | 53.9 | 55.4 | 51.9 | 53.6 | 56.1 | 57.7 | 57.0 | 56.6 | 56.1 |
| 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 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 6.0 | 2.5 | -7.1 | -2.4 | 10.2 | 8.3 | 4.3 | 3.9 | 3.9 |
| Real per capita GDP, % yoy | 0.3 | -3.1 | -11.9 | -7.0 | 5.5 | 5.2 | 1.2 | 0.8 | 0.8 |
| Real non-oil GDP, % yoy | 15.3 | 2.7 | -4.8 | 15.7 | 4.3 | 4.1 | 6.0 | 5.0 | 5.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 7.5 | 9.0 | 2.1 | 6.0 | 3.1 | 2.6 | 2.7 | 3.5 | 4.5 |
| CPI, % avg | 5.5 | 10.6 | 4.0 | 4.0 | 4.7 | 2.9 | 2.6 | 3.0 | 4.5 |
| Policy interest rate, %, eop | 6.25 | 3.75 | 3.00 | 2.50 | 2.50 | 2.00 | 2.00 | 2.00 | 2.00 |
| Credit extension to private sector, % yoy | 35.1 | 16.6 | 6.2 | 1.9 | 2.6 | 2.8 | 7.3 | 2.0 | 2.0 |
| Credit to private sector, % total deposits | 107.4 | 102.7 | 96.1 | 96.2 | 91.8 | 86.6 | 85.4 | 83.0 | 80.6 |
| Private sector deposits, % yoy | 20.0 | 16.0 | 13.5 | 2.8 | 7.8 | 6.8 | 9.9 | 5.0 | 5.0 |
| Bank capital & reserves, % total loans | 20.2 | 17.9 | 18.0 | 21.0 | 21.8 | 22.4 | 22.5 | 24.2 | 26.1 |
| 3 month inter-bank rate, %, eop | 3.62 | 3.15 | 1.14 | 0.98 | 0.90 | 0.66 | 0.70 | 0.70 | 0.70 |
| KWD/US\$, eop | 0.27 | 0.28 | 0.29 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 |
| KWD/US\$, avg | 0.28 | 0.27 | 0.29 | 0.29 | 0.28 | 0.28 | 0.28 | 0.29 | 0.29 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 41.9 | 57.8 | 29.1 | 37.8 | 66.2 | 78.8 | 102.1 | 101.4 | 98.1 |
| % of GDP | 37.3 | 42.3 | 27.6 | 31.9 | 43.3 | 44.6 | 50.5 | 48.9 | 47.0 |
| Trade balance | 43.2 | 61.5 | 36.9 | 48.9 | 79.7 | 95.6 | 116.9 | 118.2 | 116.1 |
| Exports | 63.5 | 83.5 | 55.9 | 68.7 | 101.5 | 119.6 | 143.3 | 147.3 | 148.0 |
| o/w oil, % total exports | 94.4 | 95.0 | 89.9 | 92.1 | 93.9 | 95.0 | 94.6 | 93.1 | 91.1 |
| Imports | 20.3 | 22.0 | 19.0 | 19.8 | 21.8 | 24.0 | 26.4 | 29.1 | 32.0 |
| Service balance | -3.2 | -3.7 | -2.3 | -6.9 | -7.9 | -9.4 | -10.3 | -11.3 | -12.5 |
| Income balance | 12.6 | 10.3 | 7.9 | 8.7 | 8.9 | 9.7 | 9.1 | 8.9 | 9.0 |
| 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 | -5.0 | -5.9 | -5.4 | -5.0 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 55.3 | 64.5 | 58.3 | 66.2 | 68.4 | 72.3 | 62.7 | 63.5 | 59.2 |
| o/w oil revenues | 48.3 | 57.2 | 47.5 | 54.7 | 57.8 | 60.7 | 50.0 | 49.4 | 48.2 |
| Government expenditure | 25.3 | 28.1 | 39.3 | 35.4 | 28.3 | 33.0 | 35.5 | 36.5 | 38.2 |
| o/w capital expenditures | 1.8 | 2.3 | 3.2 | 3.6 | 2.8 | 2.9 | 2.8 | 10.0 | 3.3 |
| Government balance | 30.0 | 36.4 | 19.0 | 30.8 | 40.1 | 39.4 | 27.2 | 27.0 | 21.0 |
| non-oil balance, % of non-oil GDP | -40.8 | -54.1 | -59.1 | -51.3 | -44.9 | -57.0 | -65.7 | -63.0 | -73.5 |
| Breakeven oil price (fiscal), US\$/barrel | 27.41 | 36.32 | 36.99 | 34.61 | 29.01 | 33.07 | 49.88 | 48.70 | 57.83 |
| Public debt | 12.4 | 10.2 | 11.1 | 11.2 | 8.4 | 6.8 | 5.8 | 5.5 | 6.0 |
| Cumulative government balance since 2000 | 153.8 | 190.2 | 209.2 | 240.0 | 280.1 | 319.5 | 346.7 | 373.7 | 394.7 |
| Net debt (public debt net cumulative balance) | -141.4 | -180.0 | -198.0 | -228.8 | -271.7 | -312.7 | -340.9 | -368.3 | -388.8 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 57.6 | 52.9 | 45.7 | 41.1 | 35.0 | 33.7 | 37.1 | 40.8 | 44.9 |
| External debt / GDP | 51.2 | 38.7 | 43.5 | 34.7 | 22.9 | 19.1 | 18.3 | 19.7 | 21.5 |
| External debt / XGS | 90.7 | 63.4 | 81.7 | 59.8 | 34.5 | 28.2 | 25.9 | 27.7 | 30.3 |
| External Assets | 219.1 | 261.3 | 321.5 | 349.8 | 387.6 | 453.8 | 532.6 | 634.7 | 736.1 |

Source: National Sources, Citi Research Estimates

Lebanon

■ Key developments on the month

- S&P revises Lebanon's outlook to stable, but public finances and economy remain weak;
- Presidential elections underway, so far no consensus around any candidates threatens presidential vacuum;
- We do not expect policy progress as cabinet faces twin challenge of security and upcoming elections.

■ 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

S&P revises Lebanon's ratings outlook to Stable, from negative

In its scheduled annual review of Lebanon, rating agency Standard & Poor's revised its outlook on the country's long-term foreign currency ratings from negative to stable, holding them at B-. S&P's report echoed our own view that the stability of the sovereign risk profile rests on the robustness of the Lebanese banking sector and its ability to continue funding the government. This is at odds with the overall macroeconomic picture, which continues to remain somewhat bleak as political instability and violence, largely as a result of the civil war raging in neighbouring Syria, are negatively impacting Lebanese investment and commerce (particularly in the tourism sector). We estimate that the Lebanese economy grew by an average of 2% per year in real terms over the past three years, compared with an average annual growth of over 9% between 2008 and 2010.

Economic and fiscal outlook remains weak

The sharp slowdown in growth has also had a detrimental impact on the fiscal dynamics, with the latest data showing that the budget deficit widened to 9.3% in 2013, compared with 9.1% a year earlier. This is the largest deficit seen since 2008, and the trend reduction in the government debt burden reversed in 2013, with the first increase in the government debt to GDP ratio since 2006.

Banking sector, however, remains robust

At the same time, banking sector indicators remain robust. Overall deposit growth was 7% yoy in February, with non-resident deposit growth remaining in the double digits (11%). The dollarisation ratio remained stable at under 60%, and the risk premium on Lebanese Lira deposits has likewise hardly moved in recent months. In our view, the banking sector remains sound and liquid and retains significant capacity to continue financing the Lebanese sovereign through the purchase of government securities. This keeps sovereign risk in check, despite an evidently deteriorating country risk profile (see [Lebanon Macro View - The gap widens between country and sovereign risk](#)).

New government unlikely to affect outlook significantly

The formation of Prime Minister Tammam Salam's new government of 'national interest' will have limited influence on Lebanon's economic and political outlook, in our view. Given the general elections in November, the current government's term should be short-lived and will focus on two key tasks. First, it is to prevent the country from sliding further into sectarian strife by filling the leadership vacuum and providing a forum for inter-sectarian dialogue. We believe the cabinet will have limited success in quelling wider sectarian tensions as it is itself a forum in which such tensions often come to the fore. Co-operation among cabinet members from different political factions is very poor, and is unlikely to resolve broader communal differences.

**Presidential elections underway, no
consensus candidate emerges yet**

Its second task is to manage the upcoming election schedule. Presidential elections have begun, with the first round of voting by parliamentarians having taken place on 23 April. As expected, no clear consensus candidate emerged in this first round, with a large number of deputies submitting blank votes to oppose the attempt by Lebanese Forces (and March 14) candidate Samir Geagea from garnering the requisite two-thirds majority. Widespread concern persists regarding the possibility of a presidential vacuum. This happened in the last presidential succession, after Emile Lahood stepped down at the end of 2007 with no successor appointed. It was another six months until Michel Sleiman assumed office, and in the interim the country teetered on the brink of civil war, with fighting in the streets between Hizbollah and the Sunni Future Movement.

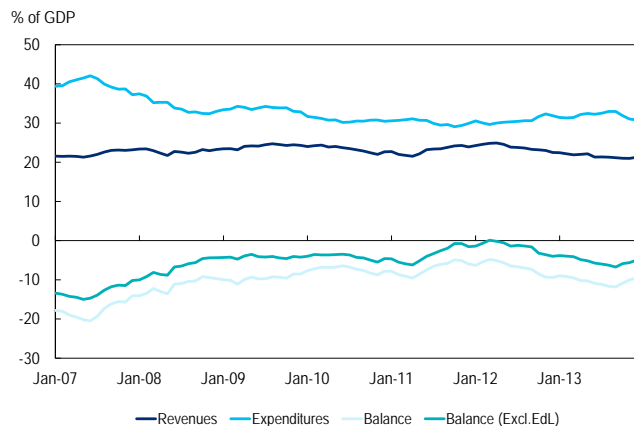
**Agreement over electoral law still
unlikely**

Parliamentary elections are also due in November. Disagreement between the various political groupings over the law that will govern the elections was one of the factors behind the collapse of the previous government of Najib Mikati. As far as we can see, there has been no progress in closing the gap between the different parties, and the 10-month delay in appointing a new government has eaten into the time available to strike a deal. The prospects of a deal are not encouraging, and we believe Lebanon is in for continued political instability for the foreseeable future.

**Lebanon's oil and gas development will
likely remain slow**

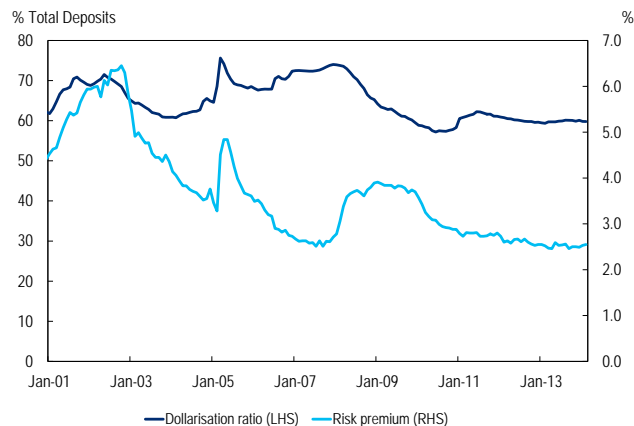
Despite the formation of a government, we believe the prospects for the implementation of an oil and gas strategy remain low. Last February saw the launch of the much-anticipated tendering process of Lebanon's first offshore exploration blocks. We believe that exploitation of Lebanon's oil and gas potential 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 39. Fall in expenditures, rise in revenues, narrowing the deficit



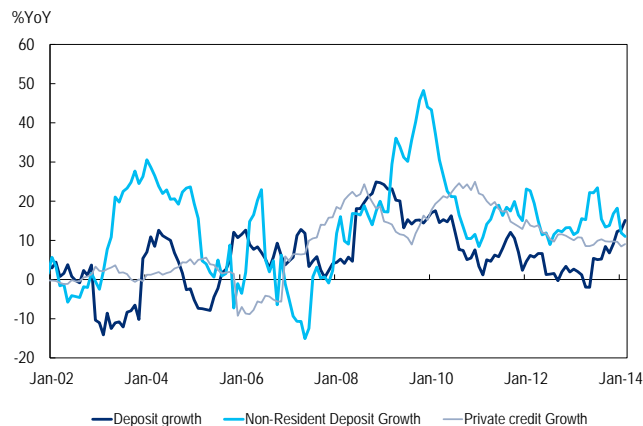
Source: Haver Analytics, Citi Research

Figure 40. Rise in dollarisation, LBP deposit premium over USD stable



Source: Haver Analytics, Citi Research

Figure 41. Banking growth indicators have eased in recent months



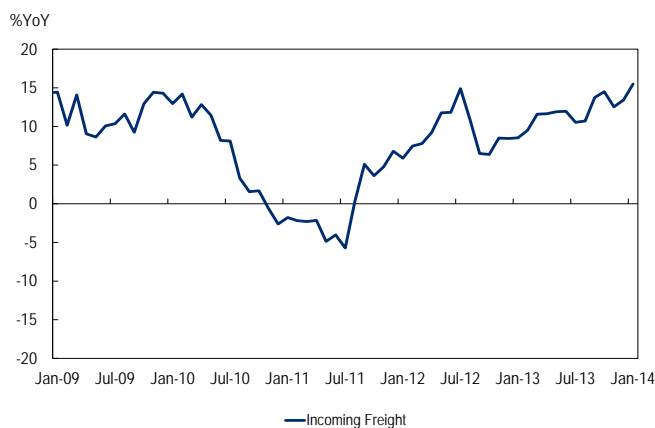
Source: Haver Analytics, Citi Research

Figure 42. Passenger arrivals continue to disappoint



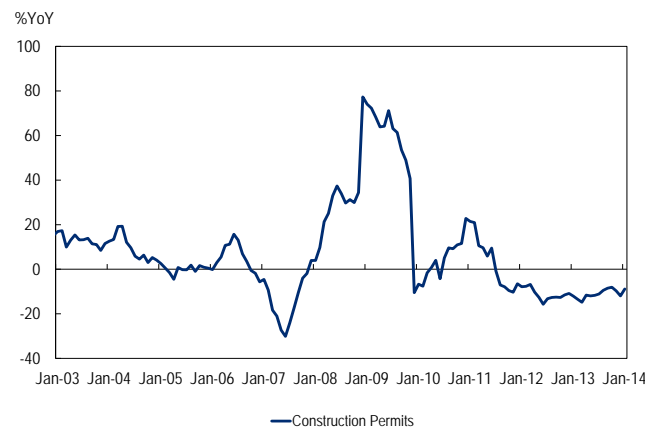
Source: Haver Analytics, Citi Research

Figure 43. Incoming freight volumes continue to pick up



Source: Haver Analytics, Citi Research

Figure 44. Construction permits (sq. metre) remain weak



Source: Haver Analytics, Citi Research

Figure 45. Lebanon Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 24.6 | 28.8 | 35.1 | 38.0 | 40.1 | 43.0 | 45.3 | 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 |
| Economic Activity | | | | | | | | | |
| 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 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 6.0 | 5.5 | 3.3 | 4.7 | 3.0 | 10.1 | 1.1 | 5.7 | 5.0 |
| CPI, % avg | 4.1 | 10.8 | 1.2 | 4.0 | 5.0 | 6.6 | 2.1 | 3.0 | 5.0 |
| Policy interest rate, %, eop | 12.00 | 12.00 | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 |
| Credit extension to private sector, % yoy | 15.9 | 18.6 | 15.2 | 25.0 | 12.9 | 10.6 | 9.7 | 20.0 | 20.0 |
| Credit to private sector, % total deposits | 26.1 | 26.8 | 25.1 | 27.9 | 29.1 | 29.6 | 29.8 | 29.8 | 29.8 |
| Private sector deposits, % yoy | 12.4 | 14.9 | 19.5 | 12.0 | 6.5 | 6.8 | 6.8 | 20.0 | 20.0 |
| Bank capital & reserves, % total loans | 15.9 | 15.3 | 14.9 | 15.5 | 16.9 | 18.3 | 17.9 | 19.1 | 20.2 |
| 3 month inter-bank rate, %, eop | - | - | - | - | - | - | - | - | - |
| LBP/US\$, eop | 1,512 | 1,508 | 1,503 | 1,501 | 1,506 | 1,504 | 1,503 | 1,508 | 1,508 |
| LBP/US\$, avg | 1,512 | 1,507 | 1,504 | 1,502 | 1,506 | 1,504 | 1,507 | 1,508 | 1,508 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | -1.4 | -4.1 | -6.7 | -7.6 | -4.4 | -3.5 | -4.1 | -4.7 | -5.5 |
| % of GDP | -5.6 | -14.4 | -19.2 | -20.0 | -10.9 | -8.2 | -9.0 | -9.8 | -10.7 |
| Trade balance | -7.9 | -11.0 | -11.2 | -12.3 | -13.9 | -14.7 | -15.4 | -17.3 | -19.3 |
| Exports | 4.0 | 5.3 | 4.7 | 5.5 | 5.4 | 5.6 | 5.9 | 6.2 | 6.5 |
| Imports | 11.9 | 16.3 | 15.9 | 17.7 | 19.4 | 20.3 | 21.4 | 23.5 | 25.8 |
| Service balance | 3.0 | 4.1 | 2.8 | 2.6 | 7.2 | 8.3 | 9.2 | 10.1 | 11.1 |
| 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 | 3.1 | 2.8 | 2.5 | 2.3 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 23.6 | 24.3 | 24.0 | 22.1 | 23.3 | 21.9 | 20.8 | 20.6 | 20.3 |
| Government expenditure | 34.0 | 34.4 | 32.4 | 29.8 | 29.1 | 31.0 | 30.1 | 29.2 | 28.3 |
| <i>o/w capital expenditures</i> | 1.5 | 1.2 | 1.0 | 1.2 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| Government balance | -10.4 | -10.1 | -8.4 | -7.6 | -5.8 | -9.1 | -9.3 | -8.7 | -8.0 |
| Public debt | 158.8 | 144.1 | 125.7 | 118.5 | 115.7 | 114.3 | 117.4 | 119.4 | 120.2 |
| Government's deposits with banks | 42.2 | 43.0 | 50.2 | 52.3 | 58.0 | 62.2 | 69.4 | 72.0 | 74.4 |
| <i>Net debt (public debt net cumulative balance)</i> | 116.7 | 101.1 | 75.5 | 66.2 | 57.7 | 52.0 | 48.0 | 47.4 | 45.8 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 28.8 | 30.2 | 35.6 | 37.3 | 40.6 | 45.3 | 47.6 | 50.0 | 52.5 |
| External debt / GDP | 117.1 | 104.7 | 101.3 | 98.0 | 101.2 | 105.5 | 105.0 | 104.0 | 102.6 |
| External debt / XGS | 169.0 | 132.3 | 164.8 | 173.4 | 165.2 | 177.6 | 171.2 | 165.0 | 159.0 |
| External Assets | -48.4 | -50.2 | -53.4 | -57.8 | -62.2 | -65.7 | -69.8 | -74.5 | -80.0 |

Source: National Sources, Citi Research Estimates

Oman

■ Key developments on the month

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

■ Key macro drivers

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

Summary Analysis

Oman-Iran ink preliminary gas deal

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

Significant erosion in public finances is likely

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

Limited financing options may force action on public finances

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

Signs that such action is imminent

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

High likelihood of debt issuance
in coming months

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

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

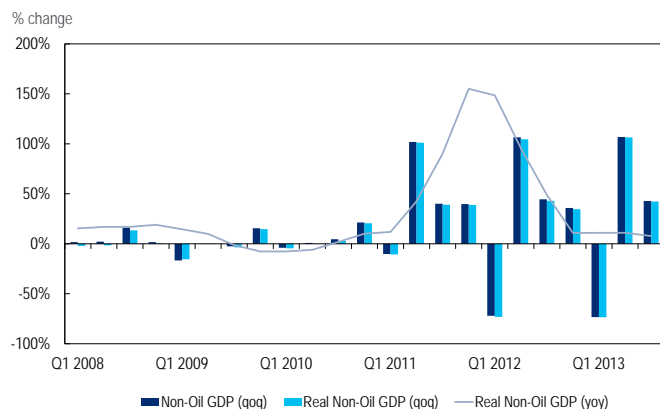
Credit expansion gradually building
momentum

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

Inflation remains well contained

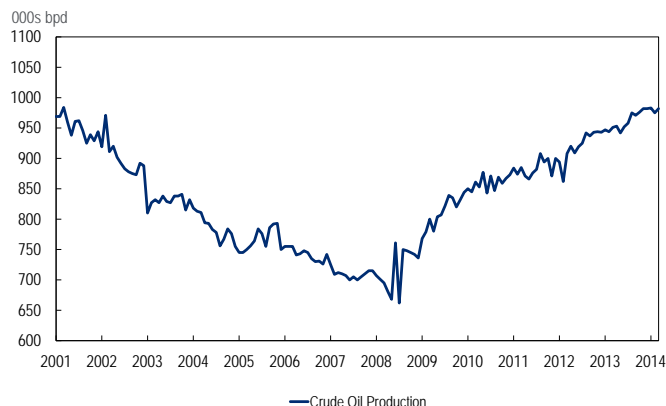
The inflation rate halved in February from January, reaching 0.6%YoY – the lowest level recorded since 2005. Some of this might have to do with the recent rebasing of the inflation basket and it remains difficult to draw immediate conclusions. However, what is clear is that price growth has remained contained over the recent past. In particular, food prices have been subdued with much of the easing in the headline rate over the last month down the prices of food and non-alcoholic beverages. And after the price-driven unrest in 2011, it may be some relief inflation has not shown the dynamism of previous years. At the same time while food prices have not moved out of a relatively tight range since 2011, policy makers are likely to keep a close eye on developments in this space. Recent price weakness has led us to revise down our 2014 inflation forecast to 1.2% from 1.9% last month.

Figure 46. Quarterly data shows drop in non-oil GDP



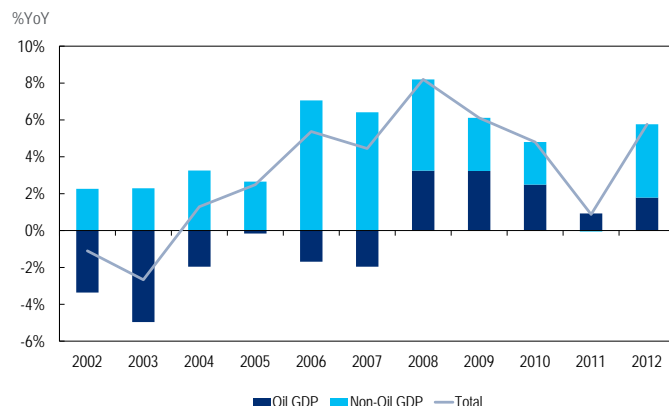
Source: Haver Analytics, Citi Research

Figure 47. Oil production continues to pick up



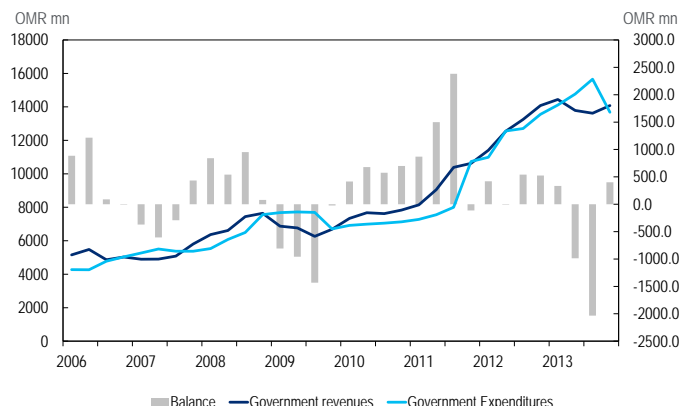
Source: Bloomberg

Figure 48. Non-oil GDP remains the engine for growth in Oman



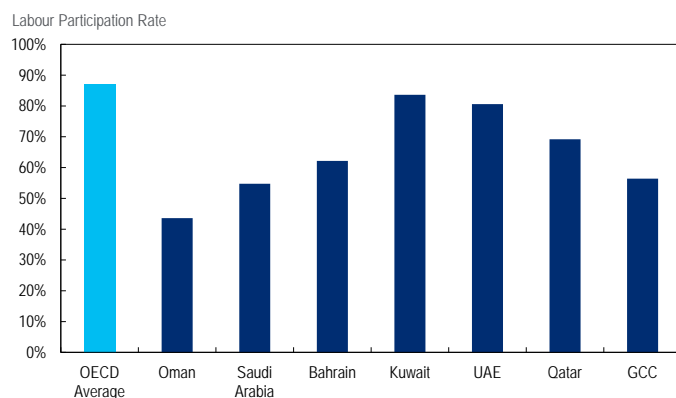
Source: Haver Analytics, Citi Research

Figure 49. Sharp rise in expenditures hurts government balance



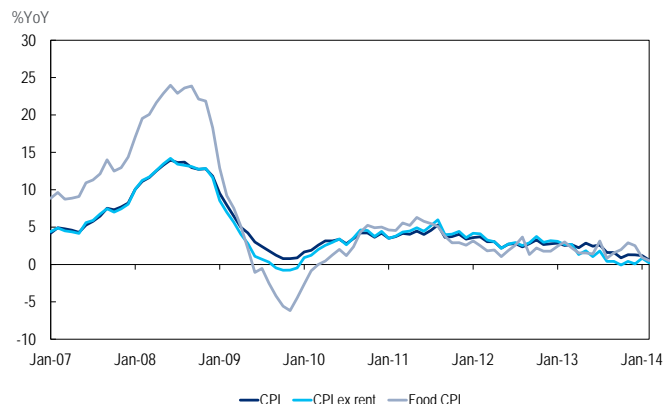
Source: Haver Analytics, Citi Research

Figure 50. Job participation lowest in GCC



Source: OECD, national statistics bureaus, Citi Research

Figure 51. Inflationary pressures remain subdued



Source: Haver Analytics, Citi Research

Figure 52. Oman Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 42.0 | 59.9 | 53.4 | 53.4 | 53.4 | 53.4 | 85.9 | 91.6 | 96.7 |
| Nominal GDP, local currency bn | 16.2 | 23.4 | 18.6 | 22.5 | 26.7 | 29.8 | 33.1 | 35.3 | 37.2 |
| GDP per capita, US\$ | 15,326 | 20,887 | 18,015 | 17,438 | 16,881 | 16,180 | 24,841 | 25,358 | 25,617 |
| Share of oil in GDP (real) | 45.8 | 45.4 | 45.8 | 46.1 | 46.6 | 45.7 | 44.7 | 44.0 | 43.2 |
| Average oil production (mbpd) | 0.71 | 0.72 | 0.81 | 0.86 | 0.88 | 0.92 | 0.95 | 0.98 | 1.01 |
| Population, mn | 2.7 | 2.9 | 3.0 | 3.1 | 3.2 | 3.3 | 3.5 | 3.6 | 3.8 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 4.5 | 8.2 | 6.1 | 4.8 | 0.9 | 5.8 | 3.4 | 4.7 | 4.7 |
| Real per capita GDP, % yoy | -2.7 | 3.4 | 2.7 | 1.4 | -2.3 | 1.4 | -1.3 | 0.2 | 0.1 |
| Real non-oil GDP, % yoy | 9.2 | 9.1 | 5.3 | 4.3 | -0.1 | 7.4 | 5.5 | 6.0 | 6.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 8.2 | 11.8 | 0.9 | 4.2 | 3.4 | 2.8 | 1.3 | 1.7 | 3.0 |
| CPI, % avg | 5.9 | 12.5 | 3.6 | 3.2 | 4.0 | 2.9 | 2.1 | 1.2 | 3.0 |
| Policy interest rate, %, eop | 6.02 | 1.97 | 2.00 | 2.00 | 2.00 | 1.00 | 1.00 | 2.00 | 2.25 |
| Credit extension to private sector, % yoy | 38.8 | 40.5 | 5.0 | 6.2 | 13.0 | 14.9 | 6.8 | 10.0 | 10.0 |
| Credit to private sector, % total deposits | 94.0 | 98.8 | 98.0 | 90.9 | 85.9 | 87.6 | 85.1 | 81.4 | 77.9 |
| Private sector deposits, % yoy | 37.4 | 20.1 | 2.6 | 10.6 | 11.0 | 12.3 | 9.3 | 15.0 | 15.0 |
| Bank capital & reserves, % total loans | 22.4 | 19.5 | 19.4 | 19.7 | 18.4 | 18.9 | 19.9 | 20.0 | 20.0 |
| 3 month inter-bank rate, %, eop | - | - | - | - | - | - | - | - | - |
| OMR/US\$, eop | 0.38 | 0.39 | 0.38 | 0.39 | 0.39 | 0.39 | 0.39 | 0.39 | 0.39 |
| OMR/US\$, avg | 0.38 | 0.38 | 0.38 | 0.38 | 0.39 | 0.39 | 0.38 | 0.39 | 0.39 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 2.5 | 5.0 | -0.5 | 5.0 | 9.0 | 8.1 | 9.1 | 7.7 | 6.3 |
| % of GDP | 5.8 | 8.4 | -0.9 | 9.4 | 16.8 | 15.2 | 10.5 | 8.4 | 6.5 |
| Trade balance | 10.3 | 17.0 | 11.6 | 18.7 | 25.6 | 26.5 | 23.6 | 22.7 | 21.9 |
| Exports | 24.7 | 37.7 | 27.6 | 36.6 | 47.0 | 52.1 | 53.0 | 56.6 | 60.8 |
| o/w oil, % total exports | 63.4 | 65.0 | 56.2 | 60.6 | 62.7 | 61.6 | 60.4 | 57.3 | 52.4 |
| Imports | 14.3 | 20.7 | 16.0 | 17.9 | 21.5 | 25.6 | 29.4 | 33.8 | 38.9 |
| Service balance | -3.4 | -4.0 | -3.9 | -4.4 | -5.3 | -5.8 | -4.7 | -4.8 | -5.0 |
| Income balance | -0.8 | -2.8 | -2.9 | -3.6 | -4.1 | -4.5 | -3.6 | -3.7 | -3.9 |
| o/w outward remittances, % GDP | 8.7 | 8.6 | 9.9 | 10.7 | 13.5 | 15.1 | 9.6 | 9.2 | 8.9 |
| FDI, net | 3.4 | 2.4 | 1.4 | -0.3 | -0.5 | 0.1 | 0.6 | 0.3 | 0.1 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 35.9 | 32.6 | 35.9 | 34.7 | 39.7 | 45.2 | 42.6 | 40.6 | 38.2 |
| o/w oil revenues | 27.4 | 25.6 | 28.0 | 28.4 | 33.6 | 38.3 | 37.0 | 35.1 | 32.7 |
| Government expenditure | 33.2 | 32.3 | 36.1 | 31.6 | 40.2 | 45.5 | 32.9 | 32.4 | 32.2 |
| o/w capital expenditures | 9.5 | 9.7 | 12.7 | 10.8 | 11.1 | 9.7 | 8.5 | 8.8 | 9.2 |
| Government balance | 2.7 | 0.3 | -0.1 | 3.1 | -0.4 | -0.3 | 9.7 | 8.2 | 5.9 |
| non-oil balance, % of non-oil GDP | -43.1 | -50.2 | -45.0 | -45.1 | -63.4 | -71.8 | -50.9 | -48.0 | -45.3 |
| Breakeven oil price (fiscal), US\$/barrel | 65.22 | 98.33 | 62.77 | 71.52 | 112.30 | 113.80 | 80.87 | 82.40 | 83.88 |
| Public debt | 6.9 | 4.8 | 6.0 | 6.1 | 7.2 | 8.8 | 6.1 | 6.2 | 5.9 |
| Cumulative government balance since 2000 | 12.8 | 13.2 | 13.0 | 16.1 | 15.7 | 15.5 | 25.1 | 33.3 | 39.2 |
| Net debt (public debt net cumulative balance) | -5.9 | -8.4 | -7.0 | -10.1 | -8.6 | -6.7 | -19.1 | -27.1 | -33.3 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 10.1 | 13.3 | 12.7 | 11.5 | 13.7 | 15.3 | 15.9 | 16.6 | 16.6 |
| External debt / GDP | 24.0 | 22.1 | 23.7 | 21.6 | 25.7 | 28.6 | 18.5 | 18.1 | 17.2 |
| External debt / XGS | 38.3 | 33.6 | 43.4 | 29.9 | 27.7 | 27.8 | 29.9 | 29.3 | 27.3 |
| 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

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

■ Key macro drivers

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

Summary Analysis

Economy remains resilient on the back of public spending, construction

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

Diplomatic rift with GCC states resolved, details unknown

The diplomatic spat which erupted between Qatar and three of its GCC neighbours in March has been resolved. Last month, Saudi Arabia, the UAE and Bahrain announced a unilateral withdrawal of their ambassadors from Qatar to protest at the latter's alleged non-compliance with the terms of a recent GCC security agreement. Further details on how Qatar was allegedly non-compliant were not given, although reference was made to Qatar's alleged failure to stop 'support for anyone who threatens the security and stability of GCC countries' (Bloomberg, 5 March).

Qatar's foreign policy has been a source of regional tension in the past

Since the late 1990s under the leadership of former Emir Hamad bin Khalifa al Thani, Qatar has pursued an active regional foreign policy that has often led to friction with its Gulf partners. The recent support offered to the Muslim Brotherhood-dominated government of former President Mohamed Morsi in Egypt is a case in point. Moreover, its hosting of the Al Jazeera news network, which is perceived by GCC neighbours as airing views that are critical of them, including those of Islamist preacher Yusuf al-Qaradawi, has also on several occasions led to accusations that Qatar is meddling in the internal affairs of its neighbours.

Tensions have risen this year due to controversial sermons by an Islamist cleric in Qatar

In the weeks prior to the withdrawal of ambassadors, such tensions escalated significantly. A sermon delivered by al-Qaradawi in January led to a very public dispute between the UAE and Qatar, in which the Chairman of the GCC, Dr Adulatif al Zayani publicly condemned comments made by the cleric; legal proceedings against Al Qaradawi were instigated within the UAE, and the Qatari ambassador to Abu Dhabi was summoned to hear an official protest (The National, 4 February). Another sermon in February drew the ire of Saudi Arabia, which went so far as to threaten to close its borders and airspace to Qatar (Middle East Monitor, 20 February).

Few regional economic implications from the spat

The details of the agreement between the GCC states to put an end to the dispute are not known. We do not expect a further escalation in the dispute.

Moreover, the region's economies operate largely independently of one another: we estimate non-hydrocarbons trade between Qatar and its GCC partners to be around 1% of Qatar's total trade by value. We therefore see few economic implications.

Credit growth still slowing

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

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

Despite the slowdown in lending growth and continued buoyant deposit growth, the loan to deposit ratio remains stubbornly in excess of 100%.

Moreover, question marks persist over the quality of the loan growth in the past two years and possible implications for future asset performance. The growth has been fuelled by high levels of government deposits and has been directed mainly at the public sector, making the banking sector a conduit for credit to government institutions. While we have few concerns over the creditworthiness of the government itself, the extent of leverage in the public sector has consequently risen, and the commercial rationale for many of the infrastructure projects and other investments that the bank funds could potentially be financing has, in many cases, yet to be demonstrated, in our view. Moreover, the rising share of consumer and real estate lending, with stagnant corporate lending, is also a cause for concern. First, it highlights the limited role the private sector plays in the economy. Second, the rise in personal and real estate borrowing also speaks to a relatively high credit risk profile in private sector lending, and is potentially fuelling some of the imbalances in the Qatari economy.

Inflationary pressures from housing market are rising

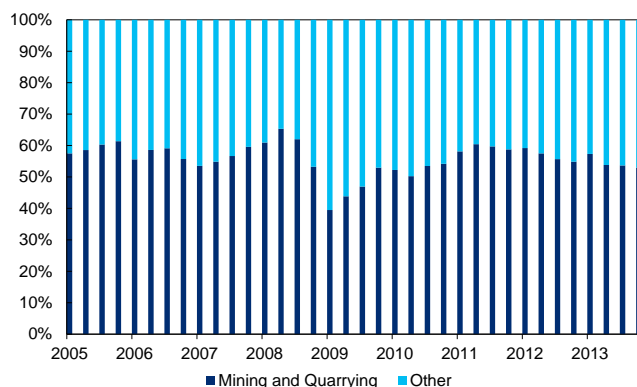
Inflation remains subdued, but we see pressures building, particularly from the real estate market. While headline inflation remained low in March (at 2.6%YoY), there were inflationary impulses from Garments & Footwear and Miscellaneous Goods & Services. Rent, Fuel and Energy costs continue to contribute the most to the headline rate, and the resurgence of inflation in the housing sector does indicate a potential acceleration in overall price levels. Since the beginning of 2009, property prices and rents had been on a steady decline, keeping overall inflation subdued, and sometimes even negative. For almost two years, however, rent inflation has registered in positive territory on a YoY basis, 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 likely be exacerbated with the completion of further ambitious projects, prices have recovered in the past year, owing mainly to the surge in the Dubai property market, in our view, which acts as a weathervane for property investor sentiment in the region. We expect prices to continue to rise over a one- to two-year horizon, putting further upward pressure on CPI inflation going forward.

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

We believe the housing sector will get a boost from the substantial infrastructure spend that is underway in Qatar ahead of the 2022 World Cup.

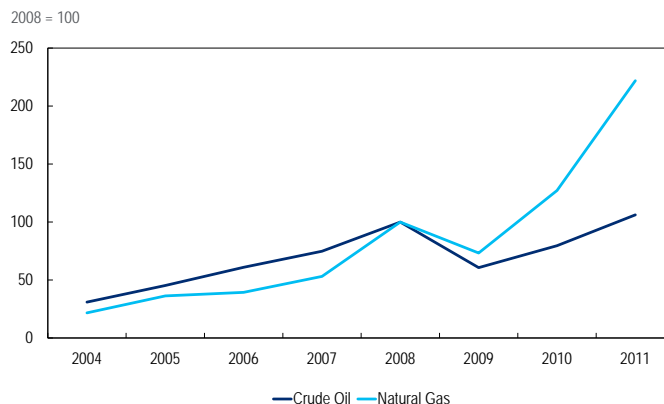
Recently-announced plans to reduce the number of World Cup stadia being built from 12 to eight will not impact overall investments significantly, in our view, which include a wide array of infrastructure projects. Moreover, insofar as property prices are correlated in the region, particularly in the Emirate states of the eastern peninsula (UAE, Qatar and Bahrain), we expect to see some support from developments in the Dubai property sector. That said, we believe overall pricing should remain soft due to the substantial supply overhang and risk of further large-scale development completions. This should help contain inflationary pressures for the foreseeable future.

Figure 53. Natural resources still a major part of activity



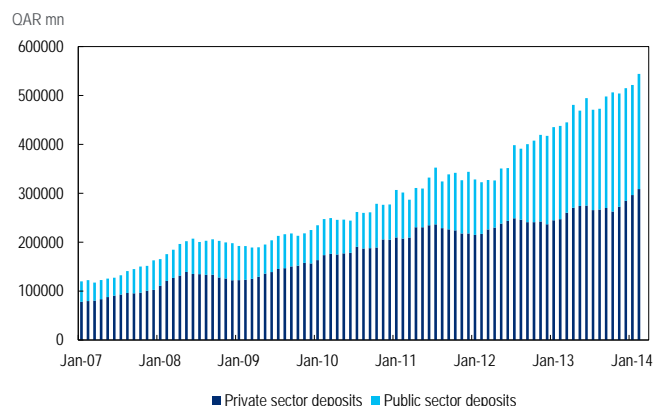
Source: Haver Analytics, Citi Research

Figure 54. But LNG IP surging relative to crude



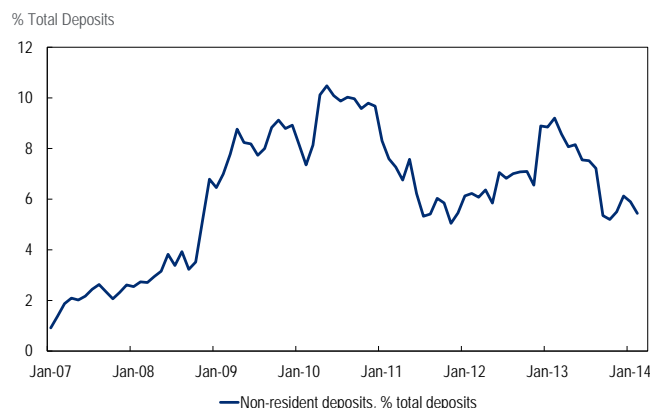
Source: Haver Analytics, Citi Research

Figure 55. Public sector deposits a major source of bank funding



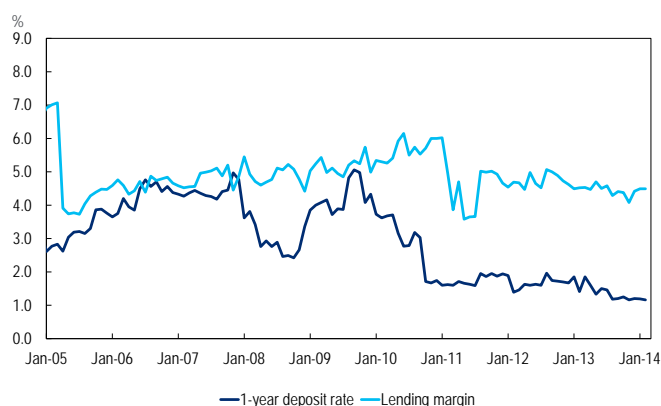
Source: Haver Analytics, Citi Research

Figure 56. Non-resident deposit growth has begun to ease



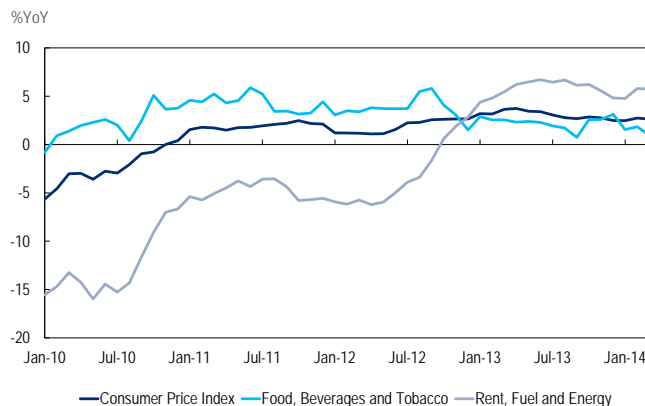
Source: Haver Analytics, Citi Research

Figure 57. Lending margins have stabilised



Source: Haver Analytics, Citi Research

Figure 58. Rising rent continues to put pressure on CPI



Source: Haver Analytics, Citi Research

Figure 59. Qatar Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|--------|---------|--------|--------|---------|---------|---------|---------|---------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 79.7 | 115.3 | 97.8 | 125.1 | 171.5 | 192.4 | 196.3 | 209.2 | 223.4 |
| Nominal GDP, local currency bn | 290.2 | 419.6 | 356.0 | 455.4 | 624.2 | 691.4 | 714.4 | 761.7 | 813.2 |
| GDP per capita, US\$ | 85,712 | 104,982 | 80,294 | 92,546 | 114,241 | 118,688 | 112,097 | 110,665 | 109,396 |
| Share of oil in GDP (real) | 44.7 | 43.0 | 40.2 | 44.4 | 45.5 | 43.3 | 40.7 | 38.4 | 36.2 |
| Average oil production (mbpd) | - | - | - | - | - | - | - | - | - |
| Population, mn | 0.9 | 1.1 | 1.2 | 1.4 | 1.5 | 1.6 | 1.8 | 1.9 | 2.0 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 18.0 | 17.7 | 12.0 | 16.7 | 13.0 | 6.2 | 6.5 | 5.9 | 6.2 |
| Real per capita GDP, % yoy | 6.3 | -0.3 | 0.9 | 5.2 | 1.7 | -1.7 | -1.4 | -1.9 | -1.7 |
| Real non-oil GDP, % yoy | 21.6 | 21.3 | 17.6 | 8.6 | 10.8 | 10.3 | 11.4 | 10.0 | 10.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 13.7 | 13.2 | -10.0 | -0.1 | 2.2 | 2.6 | 2.8 | 2.5 | 4.0 |
| CPI, % avg | 13.6 | 15.2 | -4.9 | -2.4 | 1.9 | 1.9 | 3.1 | 2.5 | 3.5 |
| Policy interest rate, %, eop | 5.55 | 5.55 | 5.55 | 5.55 | 4.50 | 4.50 | 4.50 | 4.50 | 4.75 |
| Credit extension to private sector, % yoy | - | 45.1 | 10.8 | 7.6 | 19.2 | 13.5 | 13.5 | 15.0 | 15.0 |
| Credit to private sector, % total deposits | 66.0 | 75.4 | 71.9 | 62.2 | 62.6 | 56.4 | 53.5 | 49.2 | 45.3 |
| Private sector deposits, % yoy | - | 19.1 | 28.2 | 30.9 | 6.3 | 8.6 | 20.3 | 25.0 | 25.0 |
| Bank capital & reserves, % total loans | - | 96.2 | 98.0 | 104.4 | 96.5 | 96.1 | 102.9 | 105.6 | 112.5 |
| 3 month inter-bank rate, %, eop | 5.75 | 2.83 | 2.25 | 1.56 | 1.50 | 1.05 | 1.05 | 1.05 | 1.05 |
| QAR/US\$, eop | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 |
| QAR/US\$, avg | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 11.5 | 26.6 | 6.4 | 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 | 31.0 | 26.7 | 21.7 |
| 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 | 6.3 | 6.8 | 7.3 |
| FDI, net | - | - | - | - | -5.9 | -2.2 | -2.4 | -2.6 | -2.9 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 40.6 | 33.6 | 47.5 | 34.3 | 35.7 | 40.5 | 40.8 | 40.4 | 39.6 |
| o/w oil revenues | 24.4 | 19.1 | 23.3 | 21.3 | 24.9 | 25.1 | 23.7 | 21.9 | 19.7 |
| Government expenditure | 29.7 | 23.8 | 34.2 | 31.6 | 27.9 | 28.5 | 32.4 | 36.0 | 38.4 |
| o/w capital expenditures | 11.7 | 8.0 | 11.0 | 9.7 | 8.1 | 7.4 | 7.5 | 7.7 | 7.9 |
| Government balance | 10.9 | 9.8 | 13.4 | 2.7 | 7.7 | 11.9 | 8.4 | 4.4 | 1.2 |
| non-oil balance, % of non-oil GDP | -27.9 | -20.6 | -17.9 | -39.3 | -42.2 | -31.7 | -34.1 | -35.8 | -34.3 |
| Public debt | 8.2 | 9.2 | 34.9 | 42.9 | 38.2 | 36.2 | 38.6 | 37.9 | 37.2 |
| Cumulative government balance since 2000 | 68.2 | 78.0 | 91.4 | 94.1 | 101.8 | 113.7 | 122.2 | 126.5 | 127.7 |
| Net debt (public debt net cumulative balance) | -60.0 | -68.9 | -56.5 | -51.1 | -63.6 | -77.6 | -83.6 | -88.7 | -90.5 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 42.5 | 58.0 | 80.5 | 109.0 | 131.8 | 150.8 | 178.2 | 181.3 | 181.3 |
| External debt / GDP | 53.4 | 50.3 | 82.3 | 87.1 | 76.9 | 78.4 | 90.8 | 86.6 | 81.1 |
| External debt / XGS | 88.5 | 81.9 | 161.0 | 140.1 | 108.3 | 105.5 | 129.8 | 125.0 | 118.4 |
| External Assets | 44.2 | 70.8 | 77.2 | 101.0 | 153.0 | 215.3 | 276.2 | 331.9 | 380.4 |

Source: National Sources, Citi Research Estimates

Saudi Arabia

■ Key developments on the month

- Saudi Crude boosted by exports to the US, despite surging US domestic production;
- Upgrading our 2014 forecasts, 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

Saudi Crude boosted by exports to the US, despite surging US domestic production

Saudi crude oil production continued at an elevated level in excess of 9.7mbpd in March. Production has been in the 9.6mbpd-10mbpd range since mid-2013, while prices have held up in the \$106/bbl to \$110bbl. Interestingly, a large proportion of this increase has been directed towards exports to the United States, which, according to the US EIA, has increased imports from Saudi Arabia by over 500kbpd since early 2013. Some of this increase reflects an offset to declining Venezuelan imports by the US, and some is being directed towards Saudi Arabia's expanded refining capacity in the United States. Either way, these suggest a firm underpinning to the rise in Saudi production, in our view, which we believe will likely to be sustained in the near term. We thus raise our expected average production for Saudi Arabia from 9.2mbpd to 9.5mbpd (on a par with 2013).

Upgrading our 2014 forecasts, but longer-term concerns emerge

As a result, we expect the public finances and external balances to remain robust in the near term. We raise our current account surplus forecast for 2014 to 14.8% (from 13.7% previously), real GDP growth to 4.8% (from 4.2%) and the fiscal surplus to 6.2% (from 5.1%). That said, we think rising expenditures and an expected levelling off in oil revenues and production present a challenge in the medium- to long-term. We forecast the fiscal breakeven oil price will rise to close to US\$100 per barrel in 2015 and will continue to rise, resulting in forecast deficits as early as 2016. Although Saudi Arabia 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 in our view.

Risks to oil production and forecasts from regional developments

That said, we do see downward bias in Saudi production. In our view, this bias will reflect the slight softening in oil prices that we are forecasting, along with increased production elsewhere in the region, most notably Iraq, where we anticipate an increase of around 500kbpd in exports this year. The ongoing talks between the P5+1 and Iran may 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.

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 Saudisation 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 from the kingdom, according to the Labour Minister. 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 thousands of immigrants from various countries, including Arab countries such as Egypt and Jordan, awaiting deportation from the kingdom.

...and forcing the hiring of Saudis

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

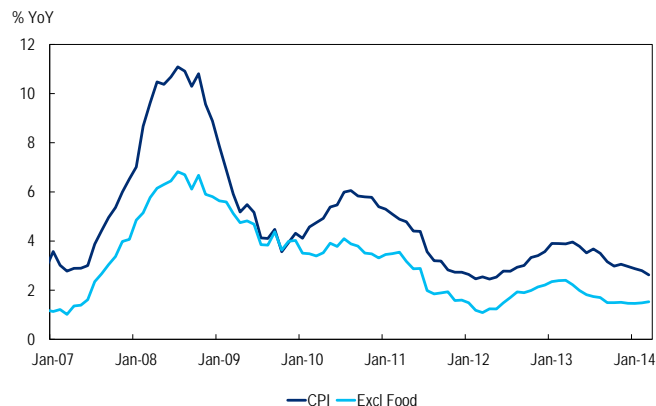
Nitiqat policy necessary, if controversial

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.

Inflation continued decline driven primarily by easing food costs

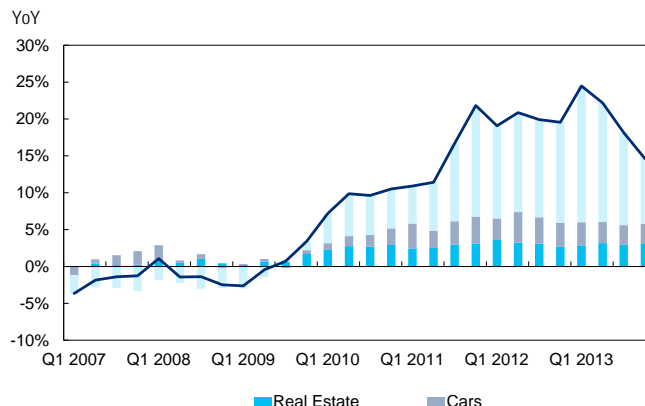
Inflation continued to decline in March, easing to 2.6%YoY from the recent high of 4% in Q2 2013, from 2.8% in February. The decline, as was the case in January, was driven primarily by easing food costs. We are expecting inflation for full year 2014 to come in at 3.4%; roughly unchanged from the 2013 rate of 3.5%, with price growth picking up close to 4% in 2015.

Figure 60. Inflation remains subdued



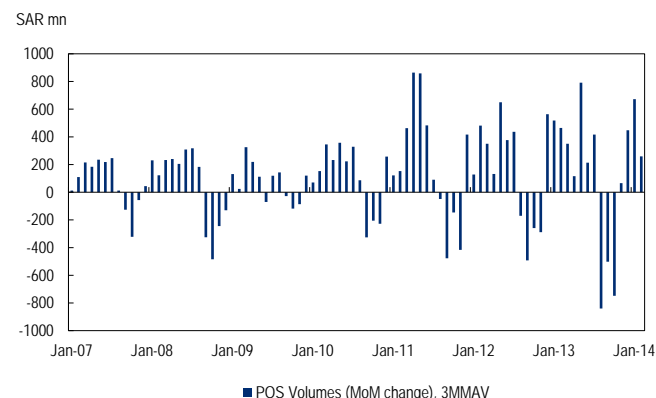
Source: Haver Analytics, Citi Research

Figure 61. Consumer lending continues to ease



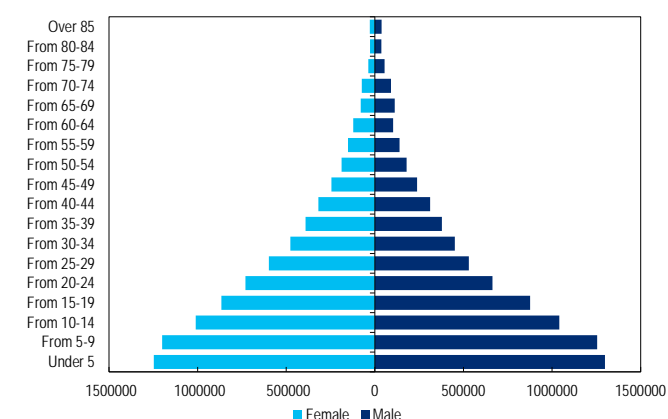
Source: Haver Analytics, Citi Research

Figure 62. Point of sales transactions remain robust



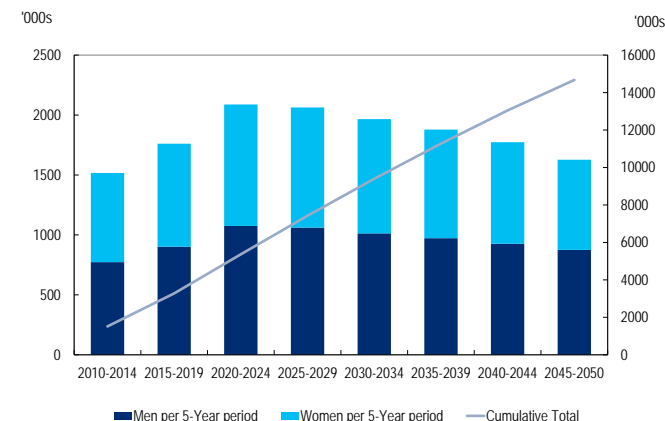
Source: Haver Analytics, Citi Research (3MMA)

Figure 63. Demographic imbalance is acute



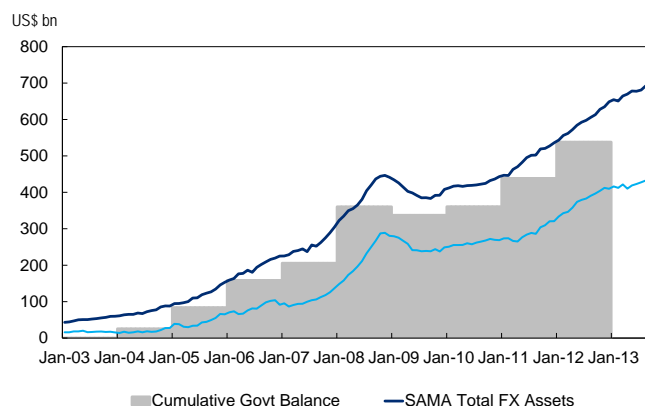
Source: SAMIRAD, Citi Research

Figure 64. Almost 2 million people coming to job market every 5 years



Source: SAMIRAD

Figure 65. Government assets stand at around US\$500bn



Source: Haver Analytics, Citi Research

Figure 66. Saudi Arabia Economic Indicators

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Summary Data | | | | | | | | | |
| Nominal GDP, US\$ bn | 415.6 | 519.4 | 429.0 | 526.8 | 669.5 | 733.8 | 745.2 | 784.7 | 827.6 |
| Nominal GDP, local currency bn | 1,558.8 | 1,949.2 | 1,609.1 | 1,975.5 | 2,510.7 | 2,752.3 | 2,794.8 | 2,943.1 | 3,104.1 |
| GDP per capita, US\$ | 17,111 | 20,861 | 16,811 | 20,178 | 25,645 | 27,559 | 27,436 | 28,323 | 29,287 |
| Share of oil in GDP (real) | 25.8 | 24.8 | 22.4 | 21.1 | 21.6 | 21.6 | 20.7 | 19.7 | 18.1 |
| Average oil production (mbpd) | 8.69 | 9.21 | 8.05 | 8.25 | 9.24 | 9.77 | 9.50 | 9.50 | 9.25 |
| Population, mn | 24.3 | 24.9 | 25.5 | 26.1 | 26.1 | 26.6 | 27.2 | 27.7 | 28.3 |
| Economic Activity | | | | | | | | | |
| Real GDP, % yoy | 6.0 | 8.4 | 1.8 | 6.4 | 8.6 | 5.8 | 3.8 | 4.8 | 5.9 |
| Real per capita GDP, % yoy | 3.4 | 5.8 | -0.6 | 4.0 | 8.6 | 3.7 | 1.8 | 2.7 | 3.8 |
| Real non-oil GDP, % yoy | 10.0 | 9.8 | 5.3 | 9.6 | 8.0 | 5.8 | 5.0 | 6.0 | 8.0 |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 6.5 | 8.9 | 4.3 | 5.4 | 2.7 | 3.6 | 3.0 | 4.0 | 4.3 |
| CPI, % avg | 4.1 | 9.9 | 5.1 | 5.3 | 3.9 | 2.9 | 3.5 | 3.5 | 4.1 |
| Policy interest rate, %, eop | 5.50 | 2.50 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.50 | 2.50 |
| Credit extension to private sector, % yoy | 20.6 | 27.9 | -0.6 | 4.8 | 11.0 | 16.4 | 12.1 | 15.0 | 15.0 |
| Credit to private sector, % total deposits | 77.7 | 84.2 | 75.4 | 75.4 | 74.7 | 76.2 | 76.8 | 73.6 | 70.5 |
| Private sector deposits, % yoy | 20.9 | 16.7 | 8.4 | 7.0 | 16.5 | 12.2 | 10.1 | 20.0 | 20.0 |
| Bank capital & reserves, % total loans | 22.9 | 21.7 | 25.8 | 26.3 | 25.8 | 24.3 | 23.3 | 23.3 | 23.3 |
| 3 month inter-bank rate, %, eop | 4.04 | 2.51 | 0.77 | 0.75 | 0.78 | 1.00 | 0.96 | 0.96 | 0.96 |
| SAR/US\$, eop | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| SAR/US\$, avg | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 94.3 | 133.0 | 21.5 | 67.4 | 159.3 | 165.7 | 135.3 | 116.0 | 73.5 |
| % of GDP | 22.7 | 25.6 | 5.0 | 12.8 | 23.8 | 22.6 | 18.2 | 14.8 | 8.9 |
| Trade balance | 151.6 | 212.7 | 105.8 | 154.3 | 245.5 | 247.5 | 225.3 | 208.2 | 173.2 |
| Exports | 233.1 | 313.4 | 192.2 | 251.0 | 364.5 | 388.2 | 376.8 | 382.4 | 373.6 |
| o/w oil, % total exports | 80.8 | 65.6 | 146.4 | 65.1 | 59.1 | 81.9 | 89.6 | 86.7 | 82.3 |
| Imports | 81.5 | 100.6 | 86.4 | 96.7 | 119.0 | 140.7 | 151.5 | 174.2 | 200.3 |
| Service balance | -46.7 | -65.9 | -65.2 | -66.1 | -66.5 | -62.4 | -64.9 | -71.4 | -78.5 |
| Income balance | 6.4 | 9.2 | 8.6 | 7.0 | 9.7 | 11.0 | 10.8 | 9.4 | 9.6 |
| o/w outward remittances, % GDP | -3.8 | -4.0 | -6.0 | -5.0 | -4.1 | -3.9 | -4.6 | -3.6 | -3.5 |
| FDI, net | 24.2 | 43.0 | 38.6 | 33.1 | 19.7 | 16.6 | 14.2 | 15.7 | 17.2 |
| Public Finances, % of GDP | | | | | | | | | |
| Government revenues | 42.2 | 57.5 | 34.0 | 39.4 | 46.1 | 47.1 | 40.5 | 42.5 | 38.4 |
| o/w oil revenues | 36.1 | 50.4 | 27.0 | 33.9 | 41.2 | 41.6 | 38.6 | 35.9 | 31.6 |
| Government expenditure | 29.9 | 26.7 | 37.1 | 33.1 | 32.9 | 31.7 | 33.1 | 36.3 | 37.1 |
| o/w capital expenditures | 7.6 | 6.7 | 11.2 | 10.1 | 11.0 | 9.5 | 10.5 | 11.2 | 11.6 |
| Government balance | 12.2 | 30.8 | -3.0 | 6.3 | 13.2 | 15.4 | 7.4 | 6.2 | 1.3 |
| non-oil balance, % of non-oil GDP | -48.4 | -44.3 | -51.2 | -50.6 | -57.8 | -53.2 | -51.7 | -53.2 | -49.6 |
| Breakeven oil price (fiscal), US\$/barrel | 47.95 | 38.28 | 69.50 | 65.41 | 75.38 | 71.12 | 88.57 | 88.93 | 98.42 |
| Public debt | 17.1 | 12.1 | 14.0 | 8.5 | 5.4 | 3.6 | 3.2 | 2.7 | 2.3 |
| Cumulative government balance since 2000 | 62.1 | 92.9 | 89.9 | 96.2 | 109.4 | 124.8 | 132.2 | 138.4 | 139.7 |
| Net debt (public debt net cumulative balance) | -45.0 | -80.9 | -75.9 | -87.7 | -104.0 | -121.2 | -129.0 | -135.7 | -137.3 |
| Foreign Assets & Liabilities, USD bn | | | | | | | | | |
| External debt | 75.8 | 83.2 | 89.4 | 93.7 | 90.1 | 87.8 | 92.5 | 97.0 | 101.9 |
| External debt / GDP | 18.2 | 16.0 | 20.8 | 17.8 | 13.5 | 12.0 | 12.4 | 12.4 | 12.3 |
| External debt / XGS | 30.4 | 25.8 | 44.3 | 35.8 | 24.0 | 22.0 | 23.8 | 25.4 | 27.3 |
| External Assets | 308.7 | 441.0 | 462.0 | 528.7 | 688.1 | 853.7 | 989.1 | 1,105.1 | 1,178.6 |

Source: National Sources, Citi Research Estimates

United Arab Emirates

■ Key developments on the month

- Property market surge draws parallels with previous cycle, but significant differences apparent;
- Little room for complacency, however, and preliminary evidence of levelling off in prices is inconclusive at this stage;
- Corporate leverage down, but risks linger;

■ Key macro drivers

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

Summary Analysis

Property market surge draws parallels with previous cycle

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

We see three differences this time round

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

But risks still exist

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

Early and as yet inconclusive indications that property prices may be leveling off

We believe early indications of a cooling in the property sector are inconclusive at present. Specifically, there has been hardly any growth in property prices in the first three months of the year, according to data from Cluttons. Moreover, real estate sales have come down since their peak last May. We believe it is still too early to judge whether this is a lasting cooling in the property market, or a temporary lull. Indeed, while real estate transactions are down from their peak, they have been rising steadily in the past three months, suggesting a potential pass-through to future prices, in our view.

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

We believe hosting Expo 2020 will provide stimulus to the economy in the construction phase (2015-2020) 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. We expect direct expenditure (US\$7bn) on the event to amount to around a relatively modest 1% of GDP per year between now and 2020. This is not very large, and in the context of the US\$670bn of projects currently underway in the UAE, is not a very significant stimulus in our view. Moreover, the effectiveness of the impact of this expenditure on the local economy is likely to be limited and short-lived, as the

majority of contractors and workers preparing and managing the event will be foreign. Moreover, we think the government expenditure directed towards the Expo will need to be diverted, at least in part, from other areas of spending to avoid an excessive build-up of debt. Finally, the legacy economic value of the event is highly uncertain, as the unutilised buildings from the Shanghai World Expo 2010 attest.

Tourism impact will be pronounced

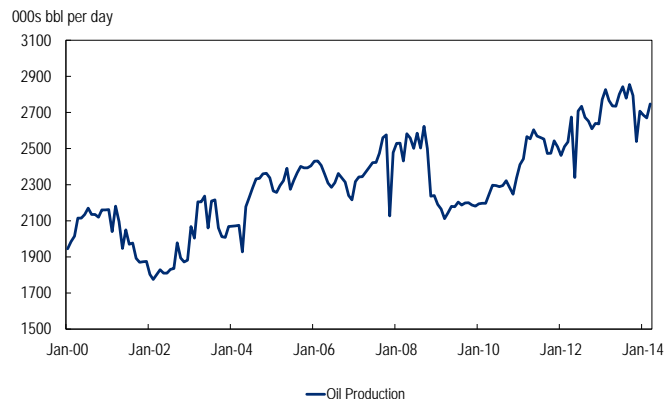
The event will be held during the peak tourism season between October 2020 and April 2021, and the authorities are expecting around 18m foreign visitors.

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

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

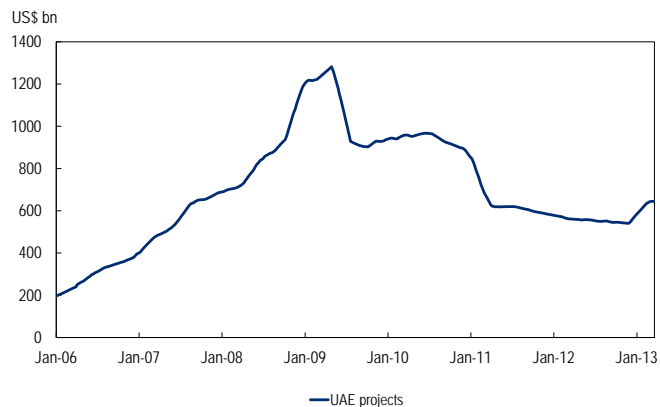
Public sector leverage in the emirate remains high, at over 100% of GDP according to the IMF, but the successful debt restructurings of the past few years have smoothed out the repayment schedules for this debt, which had previously been highly concentrated and short term. While making the debt burden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

Figure 67. Abu Dhabi oil output has increased through 2013



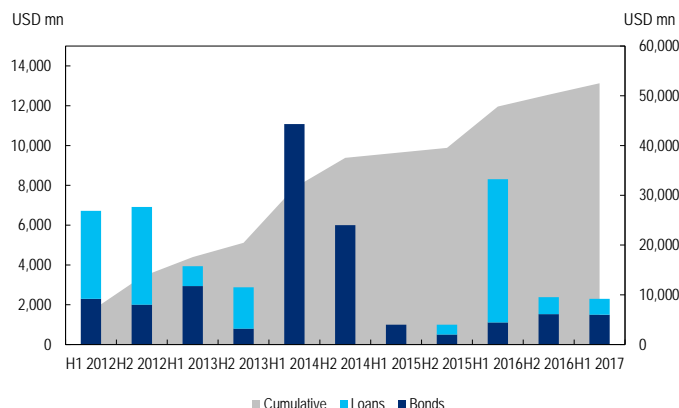
Source: Bloomberg

Figure 68. Value of projects under way has begun to pick up in the UAE



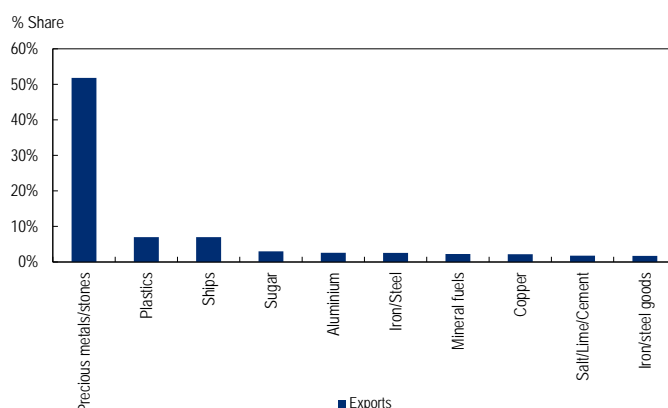
Source: MEED, Citi Research (12-wk moving average)

Figure 69. Dubai's debt refinancing requirements are lumpy



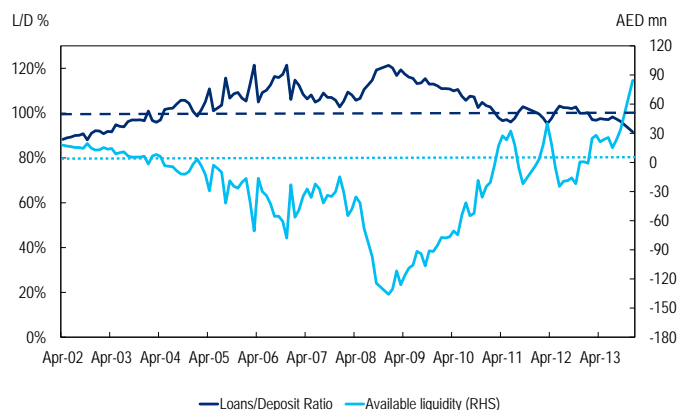
Source: Bloomberg, Dealogic, Citi Research

Figure 70. Gold dominates UAE non-oil exports



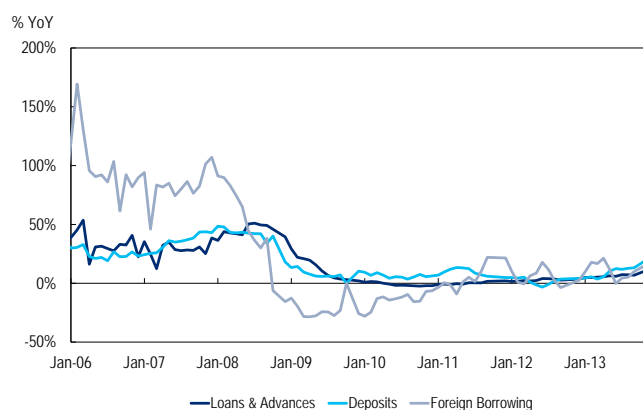
Source: National Bureau of Statistics (2010)

Figure 71. Bank liquidity is much improved, despite a recent fall



Source: Haver Analytics, Citi Research

Figure 72. External leverage has been in decline since 2008



Source: Haver Analytics, Citi Research

Figure 73. United Arab Emirates Economic Indicators (with Abu Dhabi and Dubai)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013F | 2014F | 2015F |
|--|----------|-----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| Summary Data | | | | | | | | | |
| ABU DHABI | | | | | | | | | |
| Nominal GDP, US\$ bn | 148.5 | 192.0 | 145.8 | 174.3 | 230.5 | 248.2 | 254.7 | 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 | 106,512.0 | 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 | 30.9 | 38.2 | 22.7 | 26.4 | 30.9 | 30.0 | 28.7 | 27.2 | 25.4 |
| 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 |
| DUBAI | | | | | | | | | |
| Nominal GDP, US\$ bn | 84.4 | 93.4 | 80.4 | 82.9 | 85.9 | 91.4 | 98.6 | 108.9 | 115.8 |
| Nominal GDP, local currency bn | 310.1 | 342.9 | 295.4 | 304.6 | 315.4 | 335.8 | 362.3 | 399.8 | 425.4 |
| GDP per capita, US\$ | 55,169 | 56,728 | 47,918 | 47,049 | 46,389 | 45,910 | 46,034 | 47,227 | 46,712 |
| Share of oil in GDP (real) | 1.9 | 1.9 | 1.9 | 1.7 | 1.5 | 1.5 | 1.4 | 1.3 | 1.3 |
| Average oil production (mbpd) | 0.3 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Population, mn | 1.5 | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 2.1 | 2.3 | 2.5 |
| Real GDP, % yoy | 17.5 | 3.5 | -2.7 | 2.8 | 3.0 | 4.1 | 4.7 | 6.1 | 6.4 |
| Real per capita GDP, % yoy | 9.2 | -3.8 | -4.6 | -1.4 | -1.6 | -3.0 | -2.7 | -1.4 | -1.1 |
| Real non-oil GDP, % yoy | 3.6 | -2.7 | 3.7 | 3.5 | 4.4 | 4.8 | 6.2 | 6.5 | 6.5 |
| Government revenues | 8.3 | 9.5 | 9.6 | 9.8 | 10.4 | 9.1 | 9.0 | 8.8 | 9.0 |
| 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 | 8.9 | 8.5 | 8.6 |
| o/w capital expenditures | 2.9 | 4.2 | 4.6 | 2.9 | 2.3 | 1.8 | 1.6 | 1.5 | 1.5 |
| 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 |
| UNITED ARAB EMIRATES | | | | | | | | | |
| Prices, Money & Credit | | | | | | | | | |
| CPI, % yoy | 11.7 | 6.6 | 1.2 | 0.9 | 0.8 | 0.9 | 1.7 | 1.8 | 2.1 |
| CPI, % avg | 11.1 | 12.3 | 1.6 | 0.9 | 0.9 | 0.7 | 1.1 | 1.8 | 2.1 |
| Policy interest rate, %, eop | - | 1.50 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| Credit extension to private sector, % yoy | 43.3 | 48.5 | -0.8 | -0.4 | 1.4 | -0.3 | 5.0 | 7.0 | 7.0 |
| Credit to private sector, % total deposits | 68.6 | 80.0 | 73.7 | 68.7 | 68.3 | 62.4 | 59.6 | 58.0 | 56.4 |
| Private sector deposits, % yoy | 48.2 | 25.2 | 4.9 | 7.1 | 3.6 | -1.2 | 10.0 | 10.0 | 10.0 |
| Bank capital & reserves, % total loans | 20.9 | 17.9 | 25.5 | 28.1 | 28.3 | 29.1 | 30.1 | 30.7 | 31.3 |
| 3 month inter-bank rate, %, eop | - | - | 1.89 | 2.14 | 1.52 | 1.30 | 0.81 | 1.60 | 1.75 |
| AED/US\$, eop | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 |
| AED/US\$, avg | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 |
| Balance of Payments, USD bn | | | | | | | | | |
| Current account | 15.5 | 22.7 | 7.9 | 7.4 | 74.3 | 108.6 | 107.3 | 93.8 | 80.0 |
| % of GDP | 6.0 | 7.2 | 3.1 | 2.6 | 21.3 | 28.3 | 26.2 | 21.4 | 17.0 |
| Trade balance | 46.5 | 62.9 | 42.1 | 49.0 | 129.2 | 168.7 | 171.4 | 164.9 | 158.9 |
| Exports | 178.6 | 239.2 | 191.8 | 213.5 | 302.0 | 350.1 | 371.0 | 394.4 | 422.8 |
| o/w oil, % total exports | 41.3 | 42.7 | 35.4 | 35.0 | 37.0 | 33.7 | 31.2 | 28.8 | 25.6 |
| Imports | 132.1 | 176.3 | 149.7 | 164.6 | 172.8 | 181.4 | 199.6 | 229.5 | 263.9 |
| Service balance | -26.0 | -33.8 | -27.3 | -30.4 | -43.7 | -48.9 | -53.7 | -59.1 | -65.0 |
| Income balance | 4.2 | 4.2 | 3.3 | 0.1 | 0.1 | 0.1 | 2.0 | 1.6 | 1.2 |
| o/w outward remittances, % GDP | 3.4 | 3.2 | 3.7 | 3.7 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 |
| FDI, net | -0.4 | -2.1 | 1.3 | 3.5 | 5.5 | 6.7 | 3.0 | 3.0 | 3.0 |

Source: National Sources, Citi Research Estimates

Recent Publications

| | | |
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Figure 74. Long-Term Economic Forecasts

| | GDP growth | | | | | | CPI Inflation | | | | | | Current Account % GDP | | | | | | Fiscal Balance % GDP | | | | | | Exchange Rate vs. U.S. Dollar | | | | | |
|---------------|------------|------|------|------|------|------|---------------|------|------|------|------|------|-----------------------|-------|-------|-------|-------|------|----------------------|-------|-------|-------|-------|-------|-------------------------------|-------|-------|-------|-------|-------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| United States | 1.9 | 2.6 | 3.2 | 3.2 | 2.7 | 2.2 | 1.1 | 1.4 | 1.8 | 2.2 | 2.3 | 2.2 | -2.3 | -2.0 | -1.5 | -1.8 | -1.7 | -1.4 | -7.3 | -6.4 | -5.6 | -5.6 | -5.4 | -5.4 | NA | NA | NA | NA | NA | NA |
| Japan | 1.5 | 0.9 | 1.0 | 1.2 | 1.2 | 1.0 | 0.4 | 3.0 | 1.6 | 1.6 | 0.7 | 1.0 | 0.7 | -0.2 | -0.3 | 0.0 | 0.2 | 0.2 | -9.8 | -8.0 | -6.2 | -5.8 | -5.4 | -5.0 | 98 | 105 | 111 | 115 | 115 | 115 |
| Euro Area | -0.4 | 1.3 | 1.8 | 1.9 | 1.9 | 1.8 | 1.4 | 0.6 | 0.9 | 1.2 | 1.3 | 1.8 | 2.4 | 2.5 | 2.3 | 2.2 | 1.9 | 1.8 | -3.1 | -2.6 | -2.1 | -1.6 | -1.2 | -0.9 | 0.75 | 0.73 | 0.73 | 0.71 | 0.71 | 0.71 |
| Canada | 2.0 | 2.3 | 2.7 | 2.7 | 2.6 | 2.4 | 0.9 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | -3.2 | -3.2 | -2.8 | -2.6 | -2.6 | -2.7 | -0.9 | -0.1 | 0.3 | 0.4 | 0.4 | 0.4 | 1.03 | 1.13 | 1.15 | 1.14 | 1.13 | 1.11 |
| Australia | 2.4 | 2.9 | 2.9 | 3.1 | 3.4 | 3.3 | 2.4 | 2.7 | 2.5 | 2.4 | 2.4 | 2.4 | -2.9 | -2.5 | -2.4 | -2.4 | -2.4 | -2.1 | -1.2 | -3.0 | -2.1 | -1.4 | -1.0 | 0.0 | 1.03 | 1.13 | 1.15 | 1.14 | 1.13 | 1.11 |
| New Zealand | 2.7 | 3.2 | 2.7 | 2.4 | 2.6 | 2.7 | 1.1 | 2.1 | 2.2 | 2.2 | 2.2 | 2.4 | -3.4 | -4.2 | -5.4 | -5.0 | -5.4 | -6.6 | -2.9 | -1.6 | -0.4 | 0.5 | 1.2 | 2.2 | 1.22 | 1.16 | 1.17 | 1.19 | 1.24 | 1.29 |
| Germany | 0.5 | 2.2 | 2.4 | 2.4 | 2.1 | 2.0 | 1.5 | 1.3 | 1.8 | 2.1 | 2.3 | 2.4 | 7.4 | 6.7 | 5.5 | 4.4 | 3.9 | 3.8 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | | | | | |
| France | 0.3 | 1.0 | 1.5 | 1.8 | 2.0 | 1.9 | 1.0 | 0.8 | 1.3 | 1.4 | 1.4 | 1.5 | -1.4 | -0.6 | 0.1 | 0.5 | 0.3 | 0.0 | -4.2 | -3.9 | -3.2 | -2.5 | -1.5 | -0.9 | | | | | | |
| Italy | -1.8 | 0.6 | 1.1 | 1.0 | 1.1 | 0.8 | 1.3 | 0.3 | -0.2 | 0.2 | 0.7 | 1.1 | 1.0 | 1.3 | 1.2 | 1.6 | 1.8 | 2.0 | -3.0 | -2.9 | -2.7 | -2.0 | -1.4 | -1.0 | | | | | | |
| Spain | -1.2 | 1.0 | 1.6 | 2.0 | 1.9 | 1.7 | 1.5 | 0.0 | 0.2 | 0.4 | 0.5 | 0.9 | 0.8 | 0.8 | 0.7 | 0.6 | 0.5 | 0.6 | -7.1 | -5.8 | -4.5 | -3.5 | -2.9 | -2.7 | | | | | | |
| Greece | -3.9 | -0.8 | 1.2 | 1.6 | 1.5 | 1.6 | -0.9 | -1.6 | -1.7 | -1.0 | -0.2 | 0.9 | 0.8 | 1.9 | 2.4 | 2.4 | 2.3 | 2.3 | -12.7 | -2.6 | -2.6 | -2.1 | -1.7 | -1.4 | | | | | | |
| Ireland | -0.3 | 1.8 | 3.1 | 2.8 | 2.9 | 2.9 | 0.4 | 0.8 | 1.0 | 1.1 | 1.6 | 1.7 | 6.6 | 8.7 | 9.0 | 8.3 | 7.6 | 6.8 | -7.2 | -5.5 | -3.0 | -2.3 | -1.6 | -0.9 | | | | | | |
| Portugal | -1.4 | 1.5 | 2.0 | 1.7 | 1.7 | 1.8 | 0.4 | -0.5 | -0.7 | 0.0 | 0.3 | 1.0 | 0.4 | 2.2 | 2.5 | 2.6 | 2.7 | 2.7 | -4.9 | -3.8 | -2.8 | -2.3 | -1.9 | -1.5 | | | | | | |
| Netherlands | -0.8 | 1.3 | 1.4 | 1.8 | 2.1 | 2.1 | 2.6 | 0.5 | 1.3 | 1.5 | 1.6 | 1.8 | 10.3 | 10.1 | 9.9 | 9.5 | 9.0 | 8.6 | -2.5 | -3.0 | -1.7 | -0.9 | 0.4 | 1.7 | | | | | | |
| Belgium | 0.2 | 1.3 | 1.5 | 1.6 | 2.0 | 2.1 | 1.2 | 0.4 | 1.0 | 1.8 | 1.6 | 1.9 | -1.6 | 1.1 | 1.7 | 1.9 | 1.7 | 1.3 | -2.6 | -2.3 | -1.9 | -0.9 | 0.2 | 1.3 | | | | | | |
| Switzerland | 2.0 | 2.2 | 2.0 | 2.2 | 2.0 | 2.0 | -0.2 | 0.1 | 1.0 | 1.1 | 1.2 | 1.2 | 12.0 | 12.2 | 11.3 | 11.8 | 10.5 | 10.5 | 0.2 | 0.7 | 0.9 | 1.3 | 1.3 | 0.9 | 0.93 | 0.90 | 0.92 | 0.92 | 0.91 | 0.91 |
| China | 7.7 | 7.3 | 7.0 | 7.5 | 7.3 | 7.0 | 2.6 | 2.6 | 3.2 | 3.8 | 4.0 | 3.8 | 2.0 | 2.0 | 1.5 | 0.8 | 0.5 | 0.5 | -1.9 | -2.1 | -2.0 | -2.0 | -2.0 | -2.0 | 6.15 | 6.19 | 6.04 | 6.01 | 6.03 | 6.05 |
| India | 4.9 | 5.6 | 6.2 | 6.6 | 6.9 | 7.0 | 5.9 | 5.5 | 5.0 | 4.5 | 4.5 | 4.5 | -2.0 | -2.3 | -2.5 | -2.2 | -2.3 | -2.3 | -6.9 | -6.7 | -6.5 | -6.2 | -5.9 | -5.5 | 58.6 | 61.5 | 63.6 | 62.0 | 59.0 | 55.9 |
| Indonesia | 5.8 | 5.3 | 5.5 | 5.7 | 5.9 | 5.7 | 6.4 | 6.4 | 7.2 | 5.4 | 5.3 | 5.5 | -3.3 | -2.4 | -2.1 | -1.7 | -1.5 | -1.6 | -2.2 | -2.3 | -1.7 | -1.9 | -2.0 | -2.0 | 10449 | 11700 | 11967 | 11555 | 10798 | 10031 |
| South Korea | 3.0 | 3.9 | 4.0 | 4.0 | 3.6 | 3.8 | 1.3 | 2.1 | 3.0 | 3.1 | 3.0 | 2.9 | 6.1 | 3.8 | 3.0 | 2.3 | 1.6 | 0.7 | 1.0 | 0.9 | 1.5 | 1.7 | 1.9 | 1.7 | 1095 | 1054 | 1056 | 1043 | 1022 | 1000 |
| Poland | 1.6 | 3.4 | 3.6 | 3.6 | 3.5 | 3.2 | 0.9 | 1.1 | 2.7 | 2.7 | 2.5 | 2.5 | -1.3 | -2.5 | -3.7 | -4.5 | -4.6 | -4.3 | -4.3 | 5.2 | -2.7 | -2.6 | -2.6 | -2.6 | 4.20 | 4.23 | 4.17 | 3.99 | 3.96 | 3.92 |
| Russia | 1.3 | 1.0 | 2.3 | 2.5 | 2.5 | 2.6 | 6.8 | 6.4 | 5.5 | 5.3 | 5.1 | 4.8 | 1.5 | 2.1 | 1.6 | 0.3 | -0.7 | -1.7 | -2.1 | -4.4 | -4.9 | -1.0 | -1.0 | -1.0 | 31.9 | 37.4 | 39.0 | 38.0 | 38.0 | 38.0 |
| Turkey | 4.0 | 2.2 | 3.5 | 3.8 | 4.0 | 4.0 | 7.5 | 8.1 | 7.4 | 6.8 | 6.5 | 6.1 | -7.9 | -5.2 | -5.3 | -5.0 | -4.9 | -4.4 | -1.2 | -2.8 | -3.2 | -3.3 | -3.3 | -3.3 | 1.91 | 2.22 | 2.39 | 2.48 | 2.43 | 2.38 |
| South Africa | 1.9 | 2.3 | 2.9 | 3.3 | 4.0 | 4.1 | 5.8 | 6.5 | 5.8 | 5.5 | 5.9 | 5.9 | -5.8 | -4.9 | -4.2 | -3.4 | -3.1 | -2.7 | -4.3 | -4.2 | -4.2 | -3.7 | -3.0 | -2.0 | 9.65 | 10.89 | 11.02 | 10.77 | 10.67 | 10.57 |
| Argentina | 4.9 | 1.0 | 1.5 | -2.0 | 3.5 | 3.0 | 10.6 | NA | 30.5 | 50.0 | 30.0 | 20.0 | -0.6 | -0.5 | -0.4 | 3.0 | 1.0 | 1.0 | -2.4 | -3.1 | -2.3 | 0.0 | -0.5 | -1.0 | 5.4 | 8.9 | 11.8 | 18.6 | 26.1 | 30.2 |
| Brazil | 2.3 | 1.3 | 1.8 | 2.5 | 3.0 | 3.0 | 6.2 | 6.5 | 6.3 | 5.9 | 5.5 | 5.5 | -3.7 | -4.1 | -4.1 | -4.1 | -4.1 | -4.1 | -3.3 | -3.9 | -3.4 | -3.3 | -3.2 | -3.2 | 2.16 | 2.35 | 2.57 | 2.69 | 2.80 | 2.92 |
| Mexico | 1.1 | 3.3 | 4.0 | 4.4 | 4.5 | 4.6 | 3.8 | 4.1 | 3.7 | 3.6 | 3.6 | 3.6 | -1.8 | -2.1 | -1.8 | -1.4 | -1.5 | -1.5 | -2.4 | -3.5 | -2.5 | -2.0 | -2.0 | -2.0 | 12.8 | 13.1 | 12.9 | 12.7 | 12.5 | 12.4 |
| Venezuela | 1.3 | -1.0 | 1.9 | 1.9 | 1.9 | 1.9 | 38.5 | 62.5 | 82.1 | 60.0 | 60.0 | 60.0 | 3.3 | 4.1 | 5.1 | 3.0 | 3.0 | 3.0 | -11.9 | -11.2 | -10.3 | -12.0 | -12.1 | -11.5 | 5.99 | 10.58 | 19.80 | 31.28 | 49.43 | 78.10 |
| Bahrain | 5.3 | 4.0 | 4.0 | 4.0 | 4.1 | 4.1 | 3.3 | 2.5 | 2.0 | 2.0 | 2.0 | 2.0 | 6.8 | 5.5 | 1.3 | -3.4 | -6.4 | -7.5 | -2.3 | -3.5 | -5.9 | -8.6 | -10.8 | -11.9 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 | 0.38 |
| Egypt | 1.5 | 2.4 | 3.2 | 5.2 | 4.1 | 3.6 | 9.5 | 9.1 | 7.1 | 9.0 | 11.2 | 10.5 | -1.4 | -1.1 | -1.9 | -2.1 | -2.1 | -2.3 | -9.3 | -9.5 | -8.4 | -8.0 | -7.0 | -6.7 | 6.87 | 7.10 | 7.54 | 7.76 | 8.16 | 8.59 |
| Iraq | 3.2 | 10.3 | 11.5 | 8.2 | 7.9 | 7.6 | 1.9 | 3.0 | 5.5 | 5.5 | 5.5 | 5.5 | 13.2 | 13.6 | 12.6 | 9.0 | 6.2 | 5.1 | -5.8 | -2.3 | -1.2 | -3.0 | -4.0 | -3.3 | 1162 | 1162 | 1162 | 1162 | 1162 | 1162 |
| Israel | 3.2 | 3.4 | 3.5 | 4.5 | 4.5 | 4.0 | 1.5 | 1.2 | 3.0 | 3.0 | 3.0 | 3.0 | 2.5 | 1.9 | 1.7 | 2.9 | 4.0 | 4.1 | -2.7 | -3.0 | -2.5 | -2.5 | -2.5 | -2.5 | 3.61 | 3.50 | 3.71 | 3.80 | 3.65 | 3.50 |
| Jordan | 2.8 | 4.0 | 4.5 | 4.3 | 4.1 | 4.0 | 5.5 | 4.0 | 5.0 | 5.0 | 5.0 | 5.0 | -11.3 | -10.2 | -7.9 | -5.7 | -3.4 | -1.1 | -5.5 | -9.6 | -9.4 | -9.2 | -9.0 | -8.8 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 |
| Kuwait | 4.3 | 3.9 | 3.9 | 2.8 | 2.8 | 2.8 | 2.6 | 3.0 | 4.5 | 5.0 | 5.0 | 5.0 | 50.5 | 48.9 | 47.0 | 42.5 | 38.8 | 37.4 | 27.2 | 27.0 | 21.0 | 16.9 | 13.3 | 11.3 | 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 | 2.1 | 3.0 | 5.0 | 5.0 | 5.0 | 5.0 | -9.0 | -9.8 | -10.7 | -11.6 | -10.0 | -8.8 | -9.3 | -8.7 | -8.0 | -7.4 | -6.3 | -5.2 | 1507 | 1508 | 1508 | 1508 | 1508 | 1508 |
| Oman | 3.4 | 4.7 | 4.7 | 5.8 | 5.3 | 4.2 | 2.1 | 1.2 | 3.0 | 3.0 | 3.0 | 3.0 | 10.5 | 8.4 | 6.5 | 4.4 | 3.8 | 5.2 | 9.7 | 8.2 | 5.9 | 3.0 | 0.9 | 0.4 | 0.38 | 0.39 | 0.39 | 0.39 | 0.39 | 0.39 |
| Qatar | 6.5 | 5.9 | 6.2 | 6.4 | 6.6 | 6.8 | 3.1 | 2.5 | 3.5 | 4.5 | 5.0 | 5.0 | 31.0 | 26.7 | 21.7 | 16.1 | 10.2 | 5.5 | 8.4 | 4.4 | 1.2 | -2.5 | -5.7 | -6.2 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 | 3.64 |
| Saudi Arabia | 3.8 | 4.8 | 5.9 | 6.1 | 6.7 | 6.8 | 3.5 | 3.5 | 4.1 | 4.3 | 4.6 | 5.0 | 18.2 | 14.8 | 8.9 | 2.8 | -0.8 | -2.2 | 7.4 | 6.2 | 1.3 | -3.6 | -6.5 | -7.7 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| UAE | 3.7 | 4.0 | 4.0 | 4.4 | 4.4 | 4.4 | 1.1 | 1.8 | 2.1 | 2.6 | 3.1 | 3.7 | 26.2 | 21.4 | 17.0 | 12.2 | 8.2 | 5.1 | NA | NA | NA | NA | NA | NA | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 | 3.67 |

Source: Citi Research Estimates

Notes

Notes

Notes

Appendix A-1

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