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Dubai Property – Why Things Look Different Now, and Why There's Little Room for Complacency

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With thanks to
Adrian Thomas

- 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, this month we turn to the key question of whether this is leading to the kind of economic and financial volatility that Dubai experienced in 2008/2009.

- We believe that Dubai is experiencing a sound and balanced cyclical economic upswing. But as a small open economy, Dubai remains exposed to exogenous shocks, such as the impact of EM tapering or a potential hard landing in China, and that these could have a significant impact on domestic assets prices. Today, we consider that Dubai is much more resilient to such shocks than it was at the height of the previous cycle in mid-2008, for three main reasons.

- The first of these is a more sound and liquid banking system. In contrast to mid-2008, bank liquidity is less vulnerable to exogenous shocks and is likely to remain supportive of local asset markets.

- The second is the progress Dubai has made 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.

- Despite the differences, we also recognize that Dubai's 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.

- We believe the authorities are aware of these risks and have responded with a number of measures to curb speculative demand and to strengthen the prudential regulation of the real estate and banking sectors. Whether these measures are sufficient to prevent a repeat of the property-led volatility of 2008/2009 remains to be seen, however, and as a result we argue that there is little room on the part of investors for complacency.

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We believe that Dubai today is experiencing a real economic upswing and that its resilience to exogenous shocks is much greater than was the case in the lead up to the global financial crisis and economic downturn of 2008/2009. We do have concerns regarding the sustainability of asset price inflation in the emirate, particularly in the property market, but see the risks of such inflation as being contained for the time being.

However, if signs 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, vulnerability to exogenous shocks is likely to creep back into Dubai's economy.

We believe the authorities are aware of these risks and have responded with a number of measures to curb speculative demand and to strengthen the prudential regulation of the real estate and banking sectors. Whether these measures are sufficient to prevent a repeat of the property-led volatility of 2008/2009 remains to be seen, however, and as a result we argue that there is little room on the part of investors for complacency.

Booming Dubai

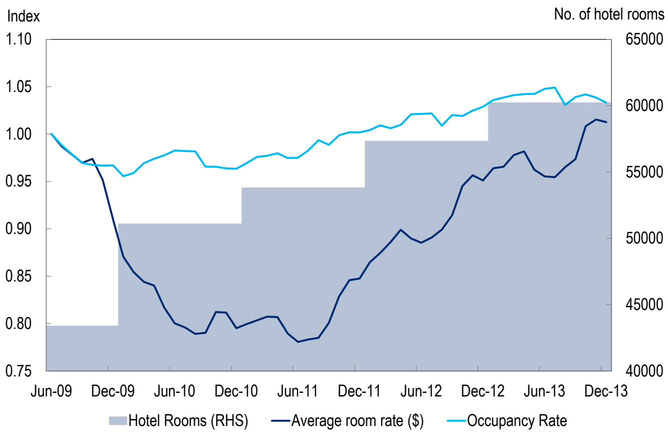
Dubai is booming. GDP growth in 2013 reached 4.7%, according to official statistics, and is on a rising trend. Indicators of economic activity, from hotel occupancy to international passenger and freight traffic through Dubai International Airport (DXB), all point to a high and rising level of economic activity in this dynamic emirate that in 2008/2009 had suffered a major economic downturn when its property market collapsed and a global liquidity squeeze impaired its ability to refinance its burgeoning debt burden.

Even in the immediate aftermath of the crisis back in 2010 we argued that Dubai's fundamentals were sound and that growth prospects looked strong (see Dubai Macro View - Short-Term Pain, Long-Term Gain, 8 June 2010). Dubai's economic recovery, which has been gaining momentum for some time, therefore comes as little surprise.

But what we hadn't expected back in 2010 was a strong recovery in the property sector so soon. According to Cluttons data, average property prices have risen by around 40% in the past 12 months, with growth in villa prices having peaked at over 50% in mid-2013 (Figure 3). According to Jones Lang Lasalle, property prices are less than 10% off their peak of August 2008[1], and will almost certainly surpass these peaks in the course of this year. We have been highlighting our concerns regarding this unanticipated development for some time (see Dubai Macro View - Dubai's property boom: friend or foe? 1 November 2012), and all the while the rise in housing prices has marched on.

[1] Jones Lang Lasalle, Dubai Reals Estate Market Overview, Q4 2013. http://www.joneslanglasalle-mena.com/ResearchLevel1/JLL_DXBQ4%202013.pdf

Figure 1. Hotel occupancy and room rates are rising steadily against a backdrop of increased capacity



Source: Ernst & Young, Citi Research

Figure 2. International passenger and freight traffic through DXB are among the world's highest… and rising quickly

International passenger traffic

Ranking	*Airport*	*Passengers*	*% YoY*
1	London (Heathrow)	5,765,172	2.9
2	Dubai	5,619,163	15.1
3	Hong Kong	4,978,000	7.2
4	Paris (CDG)	4,937,698	3.4
5	Frankfurt	4,759,031	3.6

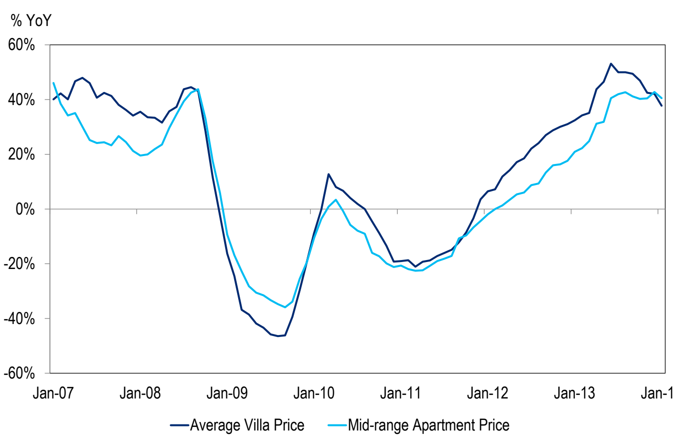
International freight traffic

Ranking	*Airport*	*Metric Tonnes*	*% YoY*
1	Hong Kong	367,000	6.1
2	South Korea (Incheon)	214,191	2.5
3	Dubai	208,695	3
4	Shanghai	187,185	8.5
5	Tokyo	175,652	5.5

Source: Airports Council International, Citi Research

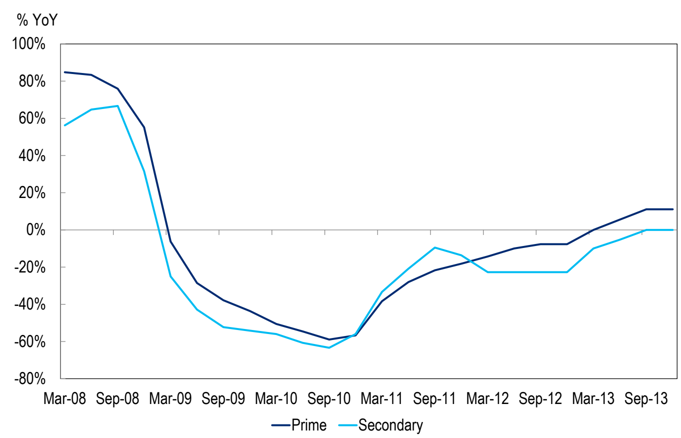
And it's not just house prices – Dubai assets across the board have been rallying on the back of improved sentiment, which was given a further boost when Dubai was awarded the right to host EXPO 2020, which is expected to draw millions of visitors to the emirate and lead to a construction-led stimulus to the economy over the coming years. The Dubai Financial Market General Index rallied 108% in 2013, given an additional spur by the UAE's impending reclassification from 'frontier market' to 'emerging market' in the MSCI index this summer, while spreads on Dubai debt (both sovereign and quasi sovereign) have compressed sharply.

Figure 3. Residential prices are rising sharply…



Source: Cluttons, Citi Research

Figure 4. …although this is not true of commercial lease rates



Source: Cluttons, Citi Research

This all paints a picture of a fundamentally strong economic story that is in danger of once again being overshadowed by exuberance in asset markets, and an uneasy sense of déjà vu is setting in. But is this creating the sort of vulnerability that Dubai suffered from in 2008/2009?

Why we think things are different today

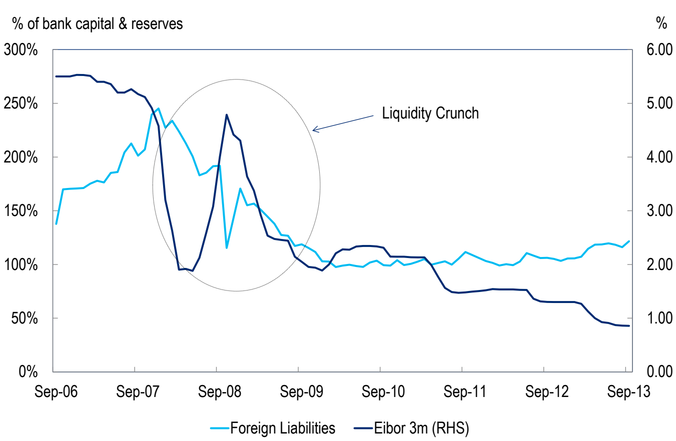
We will not speculate as to what triggers might result in an asset price correction in Dubai. The candidates are many and varied, including the impact of Fed tapering, an unanticipated fall in oil prices, a hard landing in China and regional geo-political risks, to name but a few. Triggers, by their very nature, are often impossible to predict. Rather, the purpose of this note is to examine Dubai's current vulnerability to an asset price correction relative to mid-2008, independently of what may trigger such a correction. In considering this, we see several reasons why Dubai's resilience today is significantly stronger.

Financial sector soundness

The liquidity situation in Dubai today is much stronger than it was in 2008/2009 and is likely to provide support to asset valuations in the event of an exogenous shock. In the banking sector, two factors increased Dubai's vulnerability to the global financial crisis six years ago. The first was the rapid rise in foreign liabilities of domestic banks, spurred by international speculation regarding the sustainability of the Dirham peg against the US dollar. These inflows were speculative in nature, and short-term.

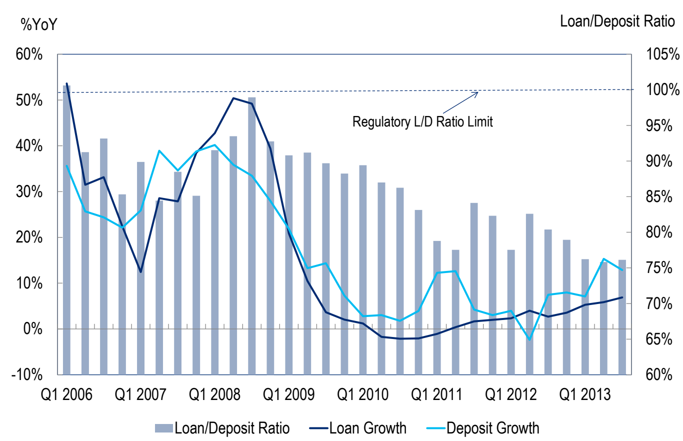
The second was the unsustainable rate of credit expansion, which topped 50%YoY. This meant that the build-up of short-term and speculative liabilities in bank balance sheets was matched with long-term assets in the form of lending commitments. In the summer of 2008, the sudden reversal of foreign flows from the banking sector led to a sharp increase in the loan to deposit ratio (over the 100% regulatory limit in some instances) and a sudden drying up of bank aggregate credit capacity (Figure 5).

Figure 5. The build-up of foreign liabilities prior to mid-2008 increased Dubai's vulnerability to capital outflows



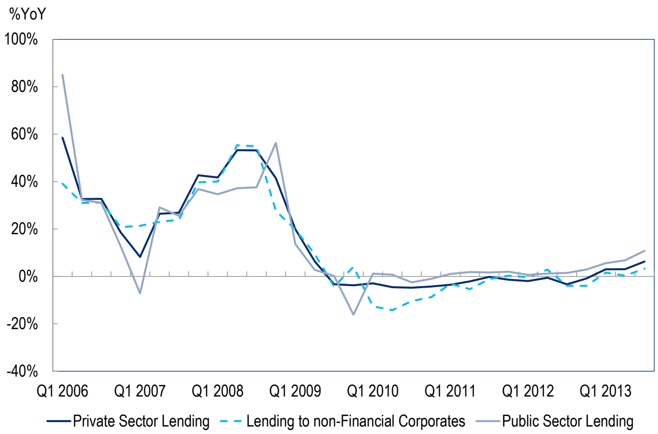
Source: Haver Analytics, Bloomberg Citi Research

Figure 6. The ensuing collapse in credit extension combined with a recovery in domestic deposit growth has greatly improved liquidity



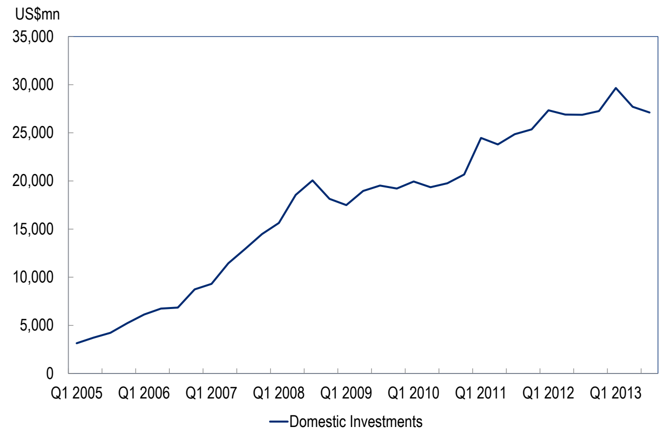
Source: Haver Analytics, Bloomberg, Citi Research

Figure 7. Credit extension remains sluggish, especially to the private sector



Source: Haver Analytics, Citi Research

Figure 8. Domestic banks are increasingly turning to domestic investments as a result



Source: Haver Analytics, Citi Research

Consequently, interbank (EIBOR) rates shot up and domestic credit extension ground to a halt. Combined with a considerable rise in impaired assets due to the subsequent economic downturn in Dubai, local banks effectively ceased to be an engine of economic growth, further exacerbating the asset price collapse and economic downturn of 2008/2009.

Today, the situation is much changed. The local deposit base has been expanding at a far greater pace than domestic credit, pushing down the loan to deposit ratio to just 75% in the third quarter of 2013 (latest available data), its lowest level since data has been collected (Figure 6). EIBOR rates are at their lowest absolute level ever, and the spread over LIBOR is at its lowest level since the crisis 2008 crisis. Moreover, there has not been growth in banking sector foreign liabilities akin to that of pre-2008; foreign liabilities have stabilized at around 110% of bank capital since late 2009 (compared with 250% of bank capital at the beginning of 2008).

This has not, however, restored bank appetite for credit extension, particularly to the private sector (Figure 7). Indeed, credit growth remains sluggish and has only recently re-entered positive territory. Credit to local corporates grew by only 3%YoY in Q3 2013, compared with 55% in Q2 2008. At 11%YoY, growth has resumed to the public sector, with banks keen to utilize their liquidity, some of which has been going into domestic investments (Figure 8). All this paints a picture of comfortable domestic liquidity situation that is far less vulnerable to foreign capital outflows and which is likely to be a great support to domestic asset prices, greatly increasing Dubai's resilience to exogenous shocks relative to six years ago.

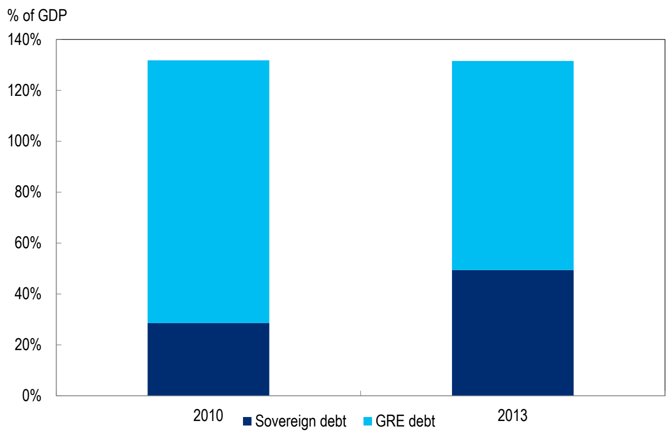
Reduced refinancing risk

In absolute aggregate terms, we do not believe that Dubai's outstanding debt has changed significantly since the financial crisis. In effect, though, there are three factors that have reduced financing risks significantly.

First is the restructuring of a large part of Dubai's bank debt. The vast majority of Dubai World's 2009 US$25bn debt standstill related to non-market obligations owed to banks, most of which was in turn restructured, with maturities pushed out by 5 or 10 years. The same is true of the bank debt of a number of Dubai GREs, including other Dubai World entities. Indeed, the majority of Dubai GRE debt has always been non-traded bank debt, and the restructuring of this bank debt has pushed maturities out to a more manageable schedule, allowing time for revenue and asset valuation recovery to help fund repayments.

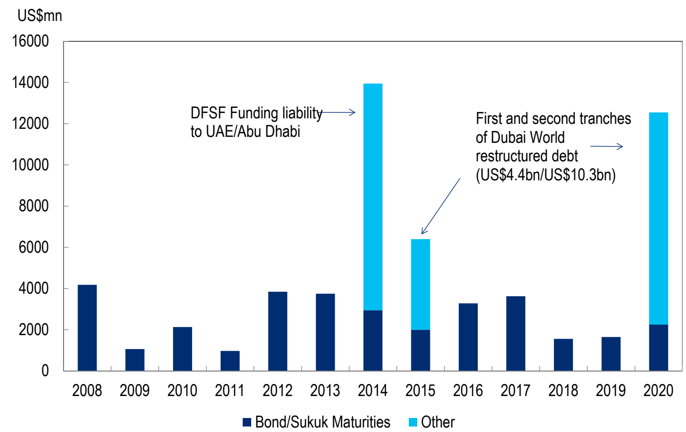
Second, a consequence of the bank debt restructuring is that the net present value (NPV) of the outstanding debt has diminished. This is because the restructurings have by and large been carried out on favourable terms to the GREs, with low interest rates that imply a significant NPV haircut to bank lenders. This reduces the *effective* debt burden.

Figure 9. IMF figures show the shifting composition of Dubai's debt



Source: IMF article IV (2010, 2013), Citi Research

Figure 10. Dubai's upcoming debt maturities appear manageable

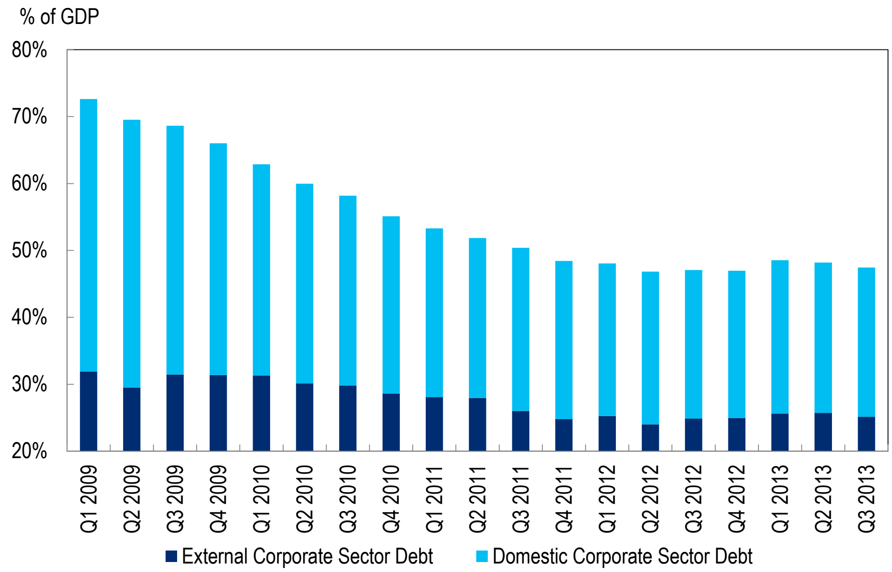


Source: Zawya, Citi Research

Third, through the establishment of the Dubai Financial Support Fund (DFSF) in 2009, a significant amount of debt has transferred from corporate balance sheets to the sovereign balance sheet. The DFSF was established to provide financial support to Dubai's GREs, and effectively injected funds in many instances in order to allow these GREs to repay commercial debt. The fund's US$20bn therefore effectively represents a transfer of corporate liabilities to the government. In addition, since 2010 a greater amount of Dubai's borrowing needs have been met by the government directly, rather than through its GREs, leading to a further shift in the composition of indebtedness (Figure 9).

Together with a recovery in GDP (and assets) and a slow-down in new debt accumulation, the above factors have helped the deleveraging process that has been taking place in the corporate sector since the crisis. Figures for Dubai are not available, but UAE data show that corporate leverage, including external leverage, is on the decline, having fallen from around 75% of GDP at the start of 2009, to around 50% currently (Figure 11). This, in our view, reduces the corporate sector's vulnerability to tightening liquidity, including a further tightening in external financing conditions.

Figure 11. UAE corporate leverage, including external borrowing, is on the decline



Source: Haver Analytics, Citi Research

Looking ahead, Dubai's corporate and government sector traded debt maturity profile looks manageable to us at the aggregate level (Figure 10). We note two potential exceptions, however (highlighted in light blue). In 2014, US$20bn of privately placed notes held by the UAE central bank and Abu Dhabi are coming due. The first tranche (US$10bn to the central bank) is due in the coming days and Dubai has already announced an agreement to roll these over in full. We expect a similar agreement to be made with Abu Dhabi when the remaining US$10bn comes due at the end of the year.

The second exception relates to the restructured Dubai World debt, which is falling due in two tranches. The first, in 2015, is worth US$4.4bn, while the second, in 2020, is worth US$10.3bn. While not technically traded debt, these repayments are still the lumpiest on the horizon and warrant highlighting, in our view, given their implications for overall financial conditions in Dubai.

Greater balance in economic growth

At the height of the property bubble in mid-2008, the Dubai economy was being increasingly driven by construction activity. A quick recap on how this came about is useful in comparing and contrasting the current state of the construction and real estate sectors.

Then…

Dubai's economic growth in the early 2000s in essence was fuelled by a rising oil prices and a healthy regional project pipeline which attracted a multitude of foreign companies to the region. Dubai was a natural destination for much of this inflow of capital and labour, having been investing in its non-oil infrastructure for decades. In addition, Dubai made a conscious effort to attract a greater share of these inflows, establishing a series of free trade zones (FTZs) that provided strong incentives for businesses to locate in the emirate.

In the initial stages, Dubai's real estate market was arguably lacking in capacity to accommodate the rapid expansion. Limited housing and office space saw prices surge in the face of strong demand. Soon, a swathe of new ambitious developments were under way, both in the residential and commercial sectors. These developments were financed largely by 'off plan' models, where a buyer makes a small down payment at the launch of a project to secure a property, and then makes further stage payments throughout the build phase. This was in theory a 'win-win' situation, allowing a portion of the developer's build costs to be met by buyer cash flows while at the same time 'guaranteeing' a market for whatever was built.

In reality, however, these developments laid the foundations of the property bubble that was to collapse in 2008/2009 for several reasons:

- Leverage – while a portion of the build cost was indeed covered by buyer down and stage payments, a larger portion associated with the wider infrastructure requirements that remained the responsibility of the master developer, was not. Near-term financing was therefore sought by developers, with repayments envisaged upon project completion. This led to a sharp rise in GRE indebtedness, which was short-term, lumpy and highly dependent on the continued commitment of buyers to honour their stage payments.

- Contagion – not only did dedicated developers enter the property fray, many GREs in Dubai whose primary business was far removed from the real estate market did as well. This is because these GREs were keen to monetize land banks that they had been granted, in order to expand their core operations. The blurring of lines between the property market and the real economy intensified.

- Flippers and oversupply – as the developers' order books swelled, buyers were mistaken for genuine end-users or long-term investors. In reality, 'flipping', the speculative practice of making a modest down payment on an off plan property with the intention of on-selling it, sometimes within hours, for a large profit, became rampant. At the height of the bubble, some 'buyers' had portfolios containing dozens of off plan properties. This was not real demand, but the inability of developers to distinguish between 'flippers' and end-users led to them launching ever more ambitious projects, aggravating a rapidly swelling over-supply problem. It also reinforced financial interlinkages, as many flippers used retail borrowing from banks to finance their speculative portfolios.

- Lack of co-ordination/oversight – at the heart of the problem was arguably a lack of co-ordination among, or perhaps oversight of, the real estate market. In an environment where double-digit profits were possible in a matter of weeks or days, it was only natural that speculators would enter the game. At the same time, developers could not sell property fast enough to meet the swelling demand, so it was natural that new projects were conjured and implemented in an accelerated time frame, particularly as each was working in a relative vacuum. The end result was that the aggregate pipeline of residential and commercial real-estate far exceeded even the most ambitious of population growth scenarios – consider, for example, that just three projects cancelled by one developer when the bubble burst (Dubai Waterfront, Palm Jebel Ali and Palm Deira) were intended to house well over 2m people, three times the existing white-collar population of the emirate, according to our calculations. To prevent this, an overarching development plan linking expected demand with supply would have been desirable, as well as stricter controls on flipping and other speculative practices. Such co-ordination and oversight at the time was, in our view, insufficient.

The net result was that by mid-2008, the pipeline of projects that were in execution phase far exceeded fundamental demand, and, when liquidity dried up and the economic environment turned, draining speculators of their enthusiasm for property, flippers became unable to on-sell and were left with large portfolios of speculative property that they had not intended (or budgeted) to fully finance. Such speculators began defaulting on stage payments and the forecast cash flow of developers dried up, leading to a chain reaction as sub-developers, contractors and ultimately their lenders all began to feel the cash flow strain. Projects were mothballed or cancelled, construction ground to a halt, real-estate professionals left the emirate in droves, loan delinquency soared, and the real economy suffered.

Now…

The good news is that we are probably quite far from that stage now, in our view. The drop in construction activity in the past few years has given Dubai's economic revival time to reduce significantly the residential supply overhang problem (although this cannot be said of commercial real estate yet), in our view. According to our calculations, vacancy rates in the residential markets peaked in 2010 and have been coming down steadily ever since. What's more, we believe there is scope for the market to absorb further development given the current rate of population growth (estimated at around 7%), with the market capable of absorbing on average around 25,000 units a year in future to maintain current vacancy rates.

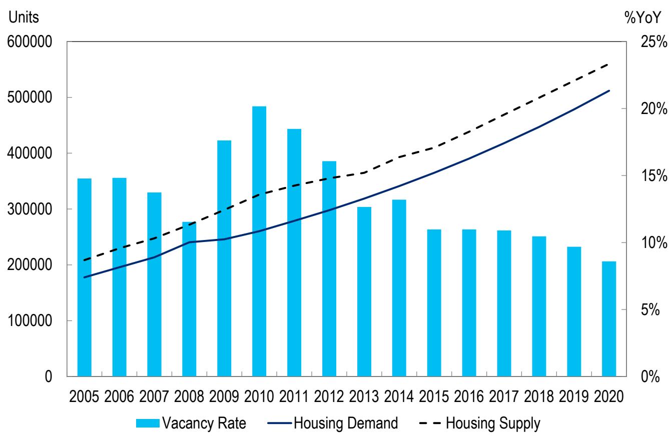
Current levels of construction activity, in other words, are not out of line with market fundamentals, in our view. Equally importantly, they are not currently creating the kind of distortions to overall economic growth that occurred in the lead up to 2008. Indeed, we highlight a few differences:

- Growth in construction lower – the construction industry experienced a sharp contraction between 2009 and 2012, and has only re-emerged into positive growth territory in 2013 (Figure 14). Despite the announcement of ever-grander projects in recent months, the reality is that construction remains relatively subdued.

- Contribution to GDP lower – the subdued activity is also reflected in the lower share that construction represents in overall GDP. Today, this stands at under 8% of economic activity, while at the peak of the bubble construction represented some 14% of GDP. The contribution to GDP growth has also fallen, from between 2-3 percentage points to close to zero in 2013.

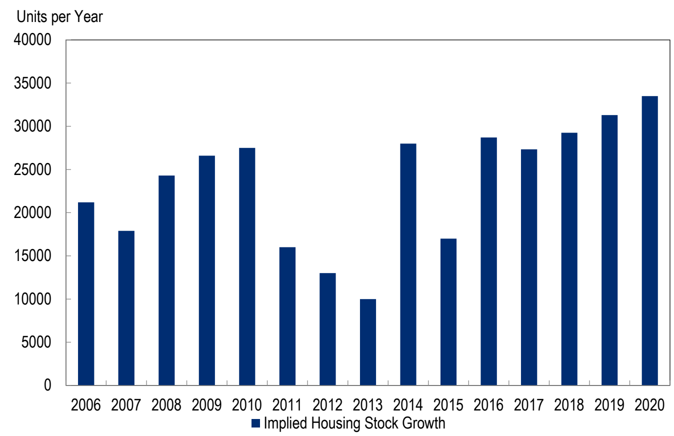
- Reduced leverage – related to the earlier discussion of leverage, the real estate and construction sectors are much less highly geared than they were in 2008, reducing the sector's vulnerability to exogenous shocks. This reduces the likelihood of a sudden stop in construction activity and its negative impact on the wider economy.

Figure 12. Residential oversupply issues have receded somewhat…



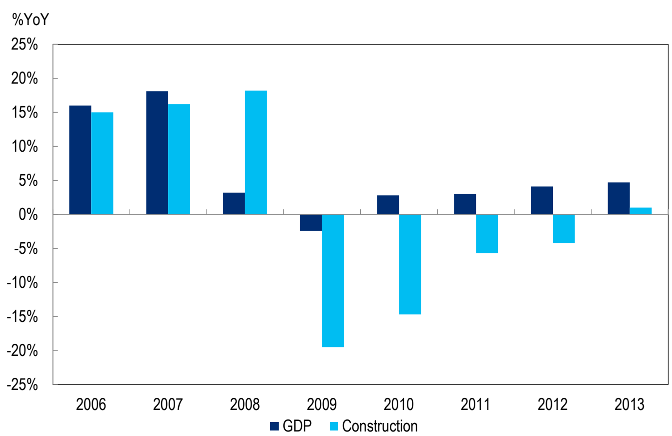
Source: Dubai Statistics, Jones Lang Lasalle, Citi Research

Figure 13. …And there is room for moderate new construction



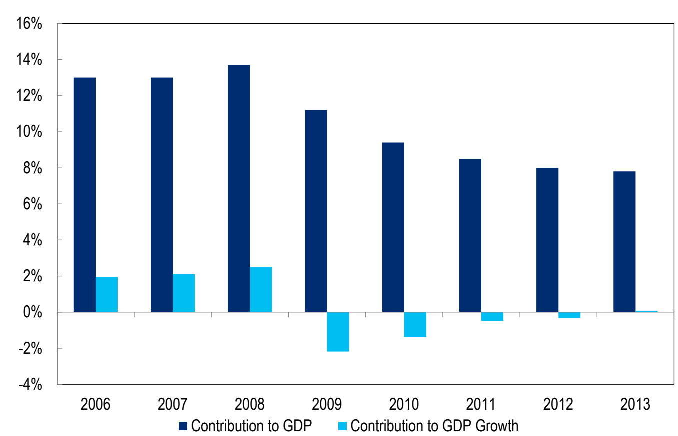
Source: Dubai Statistics, Jones Lang Lasalle, Citi Research

Figure 14. Construction activity remains relatively subdued



Source: Dubai Statistics, Citi Research

Figure 15. Construction not a growth driver at present



Source: Dubai Statistics, Citi Research

And why there's little room for complacency

The fact that we think things are different now does not mean that things cannot go back to the way they were. Indeed, Dubai's dynamic economic and financial landscape are fast-moving and the circumstances of the real estate market and the wider economy could change in short order. There are some key areas that we believe will require close monitoring, including:

The return of flippers

It is impossible to say with confidence to what extent the recent surge in property prices is attributable to speculative activity, particularly to so-called flippers. The magnitude of price rises, as well as anecdotal evidence, would, however, suggest that some level of speculative demand is probably back in property markets. The risk here is that aggregate demand for property could once again far exceed the real underlying end-user demand. The authorities have responded to this risk by raising the property sales tax from 2% to 4%, and developers have put their own restrictions on 'flipping'. Whether this is effective in substantially reducing the practice remains to be seen.

There are two outcomes to rising speculation, one relatively benign, the other more problematic. The first is that real estate prices rise beyond what is justified by fundamentals, resulting in a correction further down the line. In isolation, such a price effect is likely to have a limited impact on the wider economy, given the limited leverage in the market. The second outcome is that supply once again responds to the inflated demand, resulting in a renewed construction drive that increases the price interlinkages with the real economy.

A new construction drive

In the past 18 months there has been a spate of announcements regarding new projects, many of which have been revived after they were put on hold in 2009. As we have argued, current growth rates would justify, in our view, new supply in the residential market equivalent to around 25,000 units a year, on average. Indications in the retail and hospitality markets also are supportive of moderate construction growth in these sectors. However, the risk is that the surge in demand and prices could once again lead to exuberance in supply, which could have two detrimental effects on Dubai’s economic outlook.

The first is the risk that construction activity will once again take a prominent role in economic growth. In the event that the construction sector were to suffer another shock (e.g. large-scale off plan buyer defaults, as happened in 2008/2009), another sudden stop in activity could once again lead to the chain reaction described earlier and impact real economic activity.

The second risk is that the financing of new projects becomes increasingly dependent on debt.

Leverage

To begin with, it is worth re-iterating that overall leverage in Dubai has not decreased substantially, according to available data. The composition of the leverage and the smoothing of maturities have substantially reduced refinancing risk relative to 2008/2009, as we have argued above, but have not altogether eliminated it.

Going forward, there is a clear risk that any renewed construction drive could be accompanied by heavier borrowing and increased leverage on the part of developers. The domestic liquidity situation is supportive of such borrowing, in our view. We believe that a reversal of the trend in corporate deleverage in Dubai could result in a re-emergence of vulnerability of Dubai’s economy to global and domestic financing conditions and would spell rising risks to Dubai’s real economy.

The Global Backdrop[2]

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This year's pick up in global growth is likely to be less solid than we previously expected, with a 0.2% downgrade to our 2014 forecast

We argued last month that global growth is likely to accelerate this year. While it remains our view, recent events have taken a bite out of that prospective pickup. We now expect global growth to accelerate from 2.5% in 2013 (at current exchange rates) to about 3.1% this year and 3.4% in 2015, with a 0.2% downgrade for this year. We are again trimming growth forecasts for a range of EMs, with downgrades to the 2014 outlook this month for Turkey, S Africa, Argentina and Brazil, and notable downgrades to the medium-term outlook for India (cutting 0.5-0.6% off average YoY GDP growth in 2015-18). This is the 3rd consecutive downgrade to our 2014 EM growth forecast with a 1½% downgrade to EM growth forecast since mid-2011. In contrast to the general recent pattern of upgrades among AEs, this month we mark down our 2014 growth forecasts by about ½% for both the US and Japan.

Many EMs face a crunch between domestic imbalances, limited prospects for export improvement and worries over the sustainability of China's credit-led growth model

Details of the worsening EM outlook differ from country to country, but common themes are the deterioration in EM balance sheets and current accounts over recent years, the relatively low spillover from higher AE growth to a recovery in world trade, sticky inflation, and worries over the sustainability of China's credit-driven growth model. The prospect of continued Fed tapering and an eventual turn in the AE rate cycle may be a contributing factor to EM strains, but the Fed is still expanding its balance sheet, while the ECB and BoJ are both likely to loosen further. The recovery in AE growth is still not generating the widely-hoped-for return to export-led growth in EMs. While output growth has returned close to pre-crisis trends, world trade (goods only) is well below the pre-crisis trend. With less-import intensive AE growth, the boost to export-oriented EM countries probably will continue to be relatively disappointing.

Despite the recovery in AE growth, world trade growth remained sluggish on average in 2013

China's growth continues to be credit-led, with downside risks to growth if the authorities eventually seek to seriously rein in the credit boom

China's authorities continue to gradually tighten credit availability, and stress that monetary policy "*should focus on supporting the structural adjustment and promoting reform and transformation of the growth pattern*"[3]. While the one-year repo rate is a little above 6% now, versus 4% a year ago, credit growth remains very strong and China is still following the credit-led growth model of recent years. In the near-term, such rapid credit growth probably will help keep China's real GDP growth at 7-7½% this year, but if (as seems likely eventually) worries over worsening credit quality and inefficient use of resources prompt the authorities to genuinely rein in the credit boom, then the economy probably will slow markedly further unless (surprisingly) the reform agenda opens up major new growth drivers.

We doubt that EM FX rates have yet weakened enough to produce a significant export boost, and rising EM interest rates will further cap GDP growth

These factors imply many export-oriented EM countries are unlikely to be able to improve their current account balances via faster export growth. And, with capital flows moving back to AEs, we expect further EM FX weakness. Eventually, sustained FX depreciation among EMs probably will revive their exports, but we question whether FX rates have yet adjusted sufficiently to achieve this. The unweighted average real exchange rate across 24 major EM countries is 5% above the 1999-07 average, with substantially greater overvaluation in some cases (e.g. Hungary, Czech Republic, China, Russia, Venezuela). Moreover, in the near-term, EM rate hikes probably will further cap EM growth. Thus, we suspect EM growth risks overall remain firmly to the downside even relative to our falling forecasts.

In theory, EM links could hit AE growth through various trade, banking and FDI channels

In theory, disappointing EM growth could hit advanced economies through several channels. AEs have exposure via direct trade as well as indirect trade via third countries. Moreover, banking sector exposure to EMs is significant. In addition, some countries have large FDI links with emerging markets. Against these potential headwinds, the EM slowdown is helping to cap AE inflation and this could boost consumers' real incomes.

[2] This is a summary of the Overview from Global Economic Outlook and Strategy - February 2014. 26 February 2014.
[3] Source Monetary Policy Report, November 2013, PBOC.

Disappointing EM growth adds to the likelihood that Japan's growth will undershoot official forecasts, prompting further BoJ easing around midyear

These EM-related headwinds are likely to contribute to Japan's underperformance, along with heavy fiscal drag. We are cutting our 2014 growth forecasts to 1.2% from 1.6% last month. The government's current plans imply the structural fiscal stance will tighten in FY 2014 and FY 2015. Last year's monetary easing has yielded only modest underlying momentum in the economy so far. In particular, the boost to exports from yen depreciation has been partly offset by weak demand in Asia. We look for the BoJ to ease further in coming months. However, we expect further BoJ action will only occur around midyear, once evidence of 2014 wage trends and the consumption tax hike impact come through[4].

The downgrade to our 2014 US growth forecast chiefly reflects weather-related effects — probably temporary — in Q1…

By contrast, this month's downgrade to our US forecast reflects domestic factors rather than EM effects. We have cut our US Q1 growth forecast to only about 1%QoQ SAAR from 2.4% last month, reflecting weather-related delays and disruptions plus the reversal of prior stockbuilding[5]. We think this weakness is temporary and look for GDP growth to rebound to about 3½%QoQ SAAR in Q2 (unchanged from last month). Financial conditions are very supportive, fiscal policy is roughly neutral this year, private sector balance sheets have improved markedly and trends in job growth remain fairly solid. With the lower Q1 figure, we have marked down our 2014 US growth forecast to 2.6% from 3.1% last month. But, given the unusual (and probably temporary) Q1 dip, we continue to look for further Fed tapering this year with an extended Fed tightening cycle starting in 2015.

…but so far growth is holding up in the most EM-oriented AEs, notably Germany and Switzerland

The euro area remains on the edge of deflation…

…and such low inflation rates will make it harder for the periphery to return to fiscal sustainability

European economies have relatively high trade and banking sector exposure to EM, and EM disappointment reinforces the likelihood euro area growth will remain modest. So far, business surveys are holding up. Financial market contagion from EMs to AEs also seems limited. Even so, the euro area continues to skirt the edge of deflation risk. We cut our euro area inflation forecasts to 0.7%YoY for both 2014 and 2015, far below the midpoint of the ECB's Dec-13 forecasts (1.1% and 1.3% respectively). Our base case does not envisage a sustained period of outright deflation, but the euro area potentially is just one major adverse shock away from deflation in coming years[6]. While very low (or negative) inflation may help support the real spending power of people on fixed incomes or facing wage freezes, if it is combined with relatively high bank lending rates, it means real interest rates in periphery countries are extraordinarily high. Moreover, low or negative inflation is likely to be reflected in weak nominal GDP growth, capping tax revenues and boosting public debt/GDP ratios. We expect general government gross debt/GDP ratios will rise further during 2014-16 in Italy, Spain and Portugal.

We expect the ECB to cut the refi rate further at the March meeting

We expect the ECB will cut the refi rate by 15bp at the March meeting (from 0.25% to just 0.1%), citing its updated (and probably lower) inflation forecasts out to 2016. We still look for a modest cut in the deposit rate to -0.1% around midyear. However, such action probably will have only a modest effect on overall financial conditions. We do not expect the ECB will implement major QE unless it concludes inflation will stay very low (probably below 1%) and slack will remain ample even 2-3 years ahead.

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[4] See "*Rush demand and the ensuing drop look likely to be larger than expected*", Naoki Iizuka and Kiichi Murashima, 25 February 2014, Citi.

[5] See "*Room to Grow*", US Economics Weekly, Robert DiClemente, Citi, 21 February 2014.

[6] See "*The Euro Area Now and Japan Then: Separated by One Large Shock*", Ebrahim Rahbari, Euro Economics Weekly. 31 January 2014, Citi.

Developed Market Economic Forecasts

Figure 16. 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**	**3.4**	**3.6**	**3.0**	**3.1**	**3.4**	**0.8**	**0.6**	**0.3**	**-3.0**	**-2.5**	**-2.4**
Based on PPP weights	*3.5*	*3.8*	*4.0*	*3.4*	*3.6*	*3.9*	*0.5*	*0.3*	*0.1*	*-3.1*	*-2.7*	*-2.5*
Industrial Countries	**2.0**	**2.3**	**2.4**	**1.6**	**1.6**	**1.5**	**0.0**	**0.2**	**0.2**	**-3.5**	**-2.7**	**-2.6**
United States	**2.6**	**3.1**	**3.2**	**1.5**	**1.7**	**2.2**	**-2.0**	**-1.5**	**-1.8**	**-3.9**	**-3.0**	**-3.4**
Japan	**1.2**	**1.0**	**1.2**	**2.8**	**1.6**	**1.6**	**0.2**	**0.1**	**0.8**	**-8.0**	**-6.2**	**-5.8**
Euro Area	**1.1**	**1.3**	**1.5**	**0.7**	**0.7**	**1.0**	**2.5**	**2.6**	**2.6**	**-2.4**	**-2.1**	**-1.7**
Canada	2.3	2.7	2.7	1.7	1.8	2.0	-2.5	-2.4	-2.0	-0.1	0.3	0.4
Australia	2.9	2.8	2.9	3.2	2.1	2.5	-3.0	-3.1	-3.3	-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	2.0	2.1	2.0	1.5	1.9	1.9	6.3	5.5	5.1	0.0	0.0	-0.1
France	0.9	1.1	1.5	1.0	1.2	1.4	-0.8	-0.1	0.4	-3.6	-3.1	-2.8
Italy	0.3	0.3	0.6	0.3	-0.3	0.4	1.3	1.6	1.9	-2.8	-2.4	-2.0
Spain	0.9	1.1	1.5	-0.1	0.0	0.1	0.7	0.7	0.5	-5.8	-4.6	-3.5
Greece	-1.0	0.4	0.9	-2.3	-2.1	-1.3	1.9	2.4	2.8	-3.7	-2.7	-2.5
Ireland	2.2	2.3	2.6	0.8	1.0	1.1	8.7	7.8	6.9	-5.0	-2.9	-2.2
Portugal	1.5	1.2	1.1	-0.6	-0.9	-0.1	2.2	2.5	2.6	-4.5	-3.4	-2.5
Netherlands	1.0	0.9	1.2	0.8	1.3	1.4	9.9	8.9	8.4	-3.4	-2.8	-2.2
Belgium	1.2	1.3	1.4	0.9	1.0	1.1	-0.1	0.6	0.8	-2.7	-1.6	-1.0
Denmark	1.2	1.5	1.8	1.5	1.7	1.8	6.7	5.7	5.4	-1.5	-2.4	-1.0
Norway	2.2	2.4	2.7	2.0	2.1	2.1	12.2	12.5	12.8	11.8	11.0	10.0
Sweden	2.3	2.7	2.8	0.5	1.8	2.4	5.9	5.6	5.6	-1.6	-1.0	-0.3
Switzerland	2.0	2.0	2.2	-0.2	0.9	1.1	12.9	12.7	13.7	0.6	0.8	1.2
United Kingdom	3.3	3.2	2.7	1.6	1.9	2.1	-3.2	-3.4	-3.4	-5.5	-4.2	-2.6

Source: National sources and Citi Research

Figure 17. G3 Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 26 February 2014

	26-Feb-14	1Q 14F	2Q 14F	3Q 14F	4Q 14F	1Q 15F	2Q 15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	2.84	2.70	2.80	2.95	3.10	3.30	3.40
Euro Area: US$/€	1.36	1.37	1.38	1.39	1.40	1.40	1.40
Euro Repo Rate	0.25	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. Bunds (Period Average)	1.75	1.70	1.65	1.70	1.80	1.90	1.90
Japan: Yen/US$	104	105	106	107	108	109	111
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Average)	0.67	0.63	0.55	0.70	0.85	0.95	1.05

Industrialised Countries 10-Year Yield Spreads (Period Average)

	Spread vs. US$						Spread vs. Germany					
	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15
United States	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**109**	**102**	**117**	**127**	**132**	**143**
Japan	**-213**	**-217**	**-212**	**-212**	**-217**	**-228**	**-104**	**-115**	**-95**	**-85**	**-85**	**-85**
Euro Area	**-109**	**-102**	**-117**	**-127**	**-132**	**-143**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	-26	-20	-20	-20	-20	-10	83	82	97	107	112	133
Australia	144	163	163	158	153	143	253	265	280	285	285	286
New Zealand	182	209	214	219	235	225	291	311	331	347	367	368
France	-50	-37	-52	-62	-67	-78	57	65	65	65	65	65
Italy	85	98	63	43	28	17	192	200	180	170	160	160
Spain	81	88	58	33	8	-3	188	190	175	160	140	140
Netherlands	-85	-67	-87	-97	-102	-113	22	35	30	30	30	30
Belgium	-34	-32	-47	-62	-67	-78	73	70	70	65	65	65
Austria	-80	-67	-82	-97	-102	-113	27	35	35	30	30	30
Finland	-78	-82	-97	-107	-112	-123	29	20	20	20	20	20
Ireland	41	48	13	-7	-22	-43	148	150	130	120	110	100
Denmark	-109	-92	-107	-117	-122	-133	-2	7	10	10	10	10
Switzerland	6	10	-7	-17	-42	-58	113	112	112	110	110	90
United Kingdom	-53	-32	-42	-52	-57	-68	54	62	70	75	75	75

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

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Commodities Market Outlook[7]

There has been a surge of investor interest in commodities this month, particularly natural gas, the oil complex, ags and gold, accompanying an increase in prices for most commodities and, as a result, we have shifted more neutral and less bearish toward the complex than was the case at the start of the year. Weather-related tail risk events have been at the heart of the energy and agricultural price increases, but in the case of oil and natural gas, these should dissipate over time as inventories are replenished. Weather conditions, particularly drought, should affect specialty crops but so far the main grains should see prices becoming more moderate later this year should the US harvest remain resilient. Macro events, including US Fed tapering, are weighing on the dollar and investors' renewed interest in gold is also being bolstered by emerging political instability in Ukraine and Venezuela and by EM currency and growth concerns.

Oil prices have been range-bound with the global waterborne benchmark Brent trapped in a $105-111/bbl band since the start of this year. Global oil fundamentals have firmed with OECD demand surprising to the upside, helped by the extreme US winter, and there is growing pessimism over returning Iraqi and Libyan supply. Delays at the supergiant Kashagan field mean commercial production is unlikely in 2014 despite previous forecasts of ~200-k b/d y/y growth. The Brent benchmark, which is used to price around 70% of global crude, is also finding support from the North Sea physical market as structurally declining output, lower Urals flows to Europe and an increasing bid from Asia are helping to keep the Brent structure firmly backwardated. Supply disruptions have shown little sign of abating in 2014 as Libya, Iran, Iraq, South Sudan, Nigeria, Syria and Yemen continue to face heavy supply disruptions. Saudi production was ~9.7-m b/d in January, which will likely have to drop if non-OPEC supply grows at an expected 1.7-m b/d level; yet there are big uncertainties over this and with prices well over $100/bbl, voluntary pullbacks from the Saudis seem unlikely. OECD oil stocks have seen heavy draws, with the 1.5-m b/d 4Q'13 draw, the steepest quarterly decline since 4Q'99 (and the need to replenish them should provide a bid for oil). Sentiment remains unlikely to remain bullish throughout the entire year. However, with managed money net length as a percentage of total open interest around the all-time highs. Citi remains bearish on oil prices in 2014 despite the recent upward revision, forecasting a cal-14 price of cUS$103/bbl compared to the realised 2013 price of US$109/bbl.

On the other hand for base metals, the early 2014 exuberance for copper, driven by expansive China Grid Corporation spending plans, has increasingly given way to pessimism, as successive China data releases have pointed towards slowing manufacturing activity. Indeed, the flash February PMI conducted by HSBC/Markit came in at 48.3, well below expectations, while moves by Chinese banks to limit property-related lending have prompted concerns over construction activity outlook through this year. Despite economic concerns, China continues to absorb significant tonnages of metal. We believe much of this import demand continues to be driven by the shadow banking sector and the use of metals, most notably copper, but also zinc and nickel, as collateralised tools to raise funds. To be sure, the moves to restrict official forms of credit have prompted stronger demand for metals to collateralise loans despite the Chinese Government's clearly stated intention of clamping down on shadow banking activities. On an aggregate level, most metals markets continue to struggle with an over-abundance of supply, most notably with aluminum, but also with nickel and increasingly copper. Indeed, we expect refined copper supply to pick up strongly through 2014 as over 1 million tonnes of new Chinese copper smelting and refining capacity is brought on stream, while existing plants up capacity utilisation rates in response to more positive

[7] This summarises Commodity Market Outlook from Global Economic Outlook and Strategy - February 2014. 26 February 2014.

treatment and refining charges (TC/RCs). Although Nickel remains oversupplied, we expect the complexion of this market to change significantly as 2014 progresses driven largely by the impact of the Indonesian ore export ban, introduced on January 12th, becoming an increasingly supportive factor. Indonesia accounted for over 65% of China's nickel ore supplies in 2013, accounting for between 400-450 kt of Chinese Nickel Pig Iron production last year. We believe China has around 10-12 months of ore supply collectively, but also expect some NPI producers to begin to run out of ore as soon as April. As a result, we expect nickel prices to grind upwards through the year, a significant contrast to the base metals sector as a whole.

For thermal coal, we are marking to market our 1Q 14 price forecast and rolling over our 0-3M price target, with the latter moving to US$75 for Newcastle swaps. The Pacific Basin remains awash with supply, as Australian producers hamstrung by take-or-pay rail contracts seek to increase production to reduce average costs per tonne. The Indonesian government is seeking to rein in production, but historical difficulties in enforcing local regulation in the region suggest that this may be challenging. Chinese demand is likely to weaken, while Japanese demand is strengthening, with India representing the key swing factor. In the Atlantic, while US exports are likely to decline due to stronger domestic demand, Columbian exports should rebound by 25 Mt/y as Drummond completes direct loading facilities. For metallurgical coal, we are revising down our price forecasts for 2014 and 2015 and setting a 0-3M price target of US$125 and 6-12M target of US$130. While a rebound in Chinese steel production should provide short-term relief to met-coal prices, strong supply out of Australia and China, rebounding exports from Mongolia, and weaker end-use demand from China are expected to drive prices lower over the coming months.

Figure 18. Citi Commodities Price Forecast*

		Point Prices																			
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014E	Q2 2014E	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014	2015E	2016E	2017E	2018E
Energy				**5Y Cyclical**																	
NYMEX WTI	USD/bbl	88.0	96.0	81.0	108.0	97.6	97.0	88.0	102.0	90.0	93.0	86.0	92.0	84.0	94.1	98.0	94.3	88.8	83.0	78.0	80.0
ICE Brent	USD/bbl	100.0	102.5	85.0	112.0	109.3	107.0	100.0	106.0	99.0	97.0	93.0	97.0	93.0	111.7	108.7	103.0	95.0	90.0	85.0	85.0
Henry Hub Natural Gas	USD/MMBtu	4.70	4.65	N/A	3.55	3.85	5.40	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	USD/MT	1,750	1,820	2,200	1,827	1,815	1,750	1,770	1,790	1,810	1,830	1,860	1,890	1,900	2,049	1,808	1,780	1,870	1,950	2,100	2,200
LME Copper	USD/MT	7,300	6,600	6,200	7,096	7,161	7,200	7,250	6,800	6,650	6,800	7,000	7,200	7,500	7,945	7,169	6,975	7,125	7,700	8,000	8,200
LME Lead	USD/MT	2,070	2,300	2,200	2,116	2,134	2,150	2,050	2,150	2,250	2,350	2,100	2,200	2,370	2,072	2,135	2,150	2,255	2,350	2,400	2,360
LME Nickel	USD/MT	16,000	18,000	20,000	13,996	13,980	15,500	16,500	17,000	17,500	18,000	18,500	19,000	20,500	17,592	13,968	16,625	19,000	23,000	24,000	24,000
LME Tin	USD/MT	22,500	24,500	20,000	21,284	22,951	22,200	22,000	22,500	24,000	25,000	24,000	23,000	24,000	21,108	22,917	22,675	24,000	25,000	24,000	23,000
LME Zinc	USD/MT	2,050	2,150	2,100	1,896	1,932	2,030	2,050	2,080	2,100	2,150	2,200	2,250	2,300	1,963	1,929	2,065	2,225	2,300	2,350	2,320
Precious Metals				**LT Price**																	
COMEX Gold	USD/T. oz	1,320	1,350	1,050	1,330	1,274	1,280	1,300	1,310	1,320	1,330	1,340	1,360	1,400	1,669	1,274	1,305	1,360	1,380	1,400	1,420
Silver	USD/T. oz	20.4	21.2	16.5	21.5	20.8	20.2	20.3	20.4	20.7	21.2	21.9	22.4	23.2	31.2	20.8	20.4	22.2	22.5	23.0	23.1
Platinum	USD/T. oz	1,460	1,525	1,763	1,456	1,397	1,450	1,475	1,475	1,500	1,525	1,565	1,640	1,675	1,552	1,398	1,475	1,600	1,710	1,800	1,960
Palladium	USD/T. oz	770	860	780	729	725	735	790	830	850	875	900	900	925	645	725	800	900	935	980	980
Bulk Commodities				**5Y Cyclical**																	
Hard Coking Coal (benchmark Asia)	USD/MT	125	130	200	145	152	127	120	130	135	145	150	160	170	211	159	128	156	180	190	200
Thermal Coal Asia (NEWC)	USD/MT	75	80	90	77	82	79	77	75	80	88	84	82	85	94	84	78	85	85	90	100
Iron Ore Spot (TSI)	USD/MT	135	115	81	133	135	130	120	115	115	115	100	95	90	128	135	120	100	90	90	90
Agriculture																					
CBOT Corn	USd/bu	420	390	N/A	512	430	440	450	430	380	420	450	505	505	695	578	425	470	515	N/A	N/A
CBOT Wheat	USd/bu	610	655	N/A	650	655	615	635	655	655	650	640	635	635	750	684	640	640	615	N/A	N/A
CBOT Soybeans	USd/bu	1,265	1,000	N/A	1,405	1,304	1,260	1,250	1,135	1,075	1,050	1,050	1,000	1,100	1,465	1,406	1,180	1,050	1,075	N/A	N/A
CBOT Rice	USD/cwt	15.5	15.3	N/A	15.6	15.5	15.4	15.3	15.4	15.0	14.4	14.2	14.1	14.1	14.9	15.5	15.3	14.2	N/A	N/A	N/A
NYB-ICE Cotton	USd/lb	79.0	77.8	N/A	85.6	80.3	79.0	78.0	80.5	75.0	75.0	75.0	75.0	75.0	80.0	83.3	78.0	75.0	N/A	N/A	N/A
Sugar#11	USd/lb	18.0	18.0	N/A	16.7	17.7	18.0	18.0	18.0	18.0	18.5	18.5	18.5	18.5	21.6	17.5	18.0	18.5	N/A	N/A	N/A
ICE Coffee	USd/lb	120	130	N/A	118	110	120	125	130	133	130	130	130	130	175	126	128	130	N/A	N/A	N/A
ICE Cocoa	USD/MT	2,600	2,700	N/A	2,420	2,706	2,550	2,550	2,700	2,600	2,600	2,600	2,600	2,600	2,348	2,405	2,600	2,600	N/A	N/A	N/A

Source: Citi Research, *subject to revision

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Country Section

Bahrain

- **Key developments on the month**
  - Government hits the 'reset button' on National dialogue
  - Economic indicators recovering, as opposition activity pushed outside the capital;
  - We raise our growth forecast for 2013 to 4.3%YoY from 3.8% previously.
- **Key macro drivers**
  - Economic growth drivers look weak, and public finances appear stretched;
  - Political uncertainty set to act as drag on prospects for the foreseeable future;
  - Actual and potential support from Saudi Arabia crucial to an otherwise negative outlook.

Summary Analysis

Hopes for National Dialogue revived after Crown Prince intervenes

In early January, the government announced a formal suspension of the National dialogue, which the 5 opposition groups had been boycotting since last September over the arrest of opposition leaders and the alleged heavy-handed suppression of the ongoing anti-government protest movement. Shortly afterwards, however, Crown Prince Salman bin Hamad al-Khalifa, upon the instructions of King Hamad, met with opposition leaders to agree the resumption of talks under a new guise, thereby raising the hopes of a negotiated solution to Bahrain's current political impasse.

Three reasons to be optimistic

There are three reasons to be relatively optimistic about the new phase of the national dialogue. Firstly, the role played by Crown Prince Salman in reviving the talks suggests that the more moderate and reformist elements within the ruling family are now playing a greater role in influencing government policy on the political crisis that has gripped the Kingdom for the past three years. Second, the government has agreed to be directly involved in negotiations with the opposition, a key sticking point under the first round of talks. And finally, five discussion points have already been agreed, including i. parliamentary approval of governments, ii. the powers and composition of the upper house of parliament, iii. the electoral map, iv. the independence of the judiciary and police and v. security issues (Reuters 22 Jan). The previous national dialogue had failed to even agree a broad agenda after one year.

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

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

2013 GDP data points to increased momentum

The economy expanded 4.6%YoY in 3Q 2013 with support coming almost equally from both the oil and nonoil sectors, bringing growth for the year to date to 4.7%. This puts 2013 GDP on course to beat 2012 (3.4%), and we have revised up our GDP growth estimate for 2013 to 4.3% (from 3.8% previously) on higher-than-expected output in the oil sector. Part of the pick-up in economic numbers is also down to a base effect, as economic activity in the wake of the 2011 protests stumbled. While the Bahrain Economic Development Board (EDB) latest economic quarterly is also looking for growth to be driven by hydrocarbons, they are more optimistic than we are, looking for headline growth of 4.8% in 2013.

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

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

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

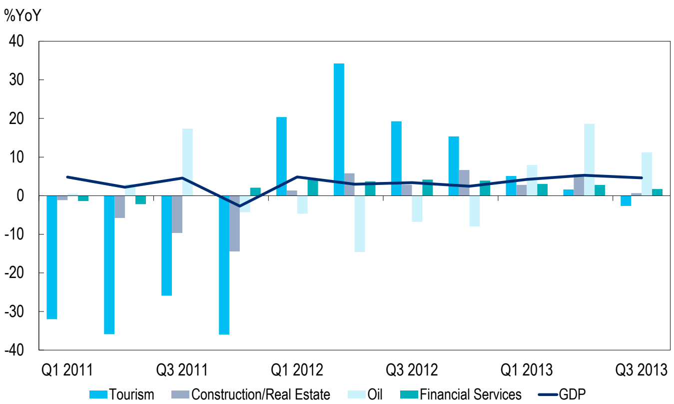
Inflation likely to fall further in 2014

Headline inflation has begun to pick up in the last few months of 2013 on the back of stronger food and transport costs. While easing back, price growth in November at 3.6%YoY (3.8% in October) has remained close to highs for the year. On the month, inflation declined 0.1%MoM, with significant deflationary impulses from Transport and Miscellaneous Goods & Services. With only one month of 2013 data remaining, we continue to believe inflation will reach 3.3%YoY for the whole year, up from 2.8% in 2012. Our expectation is above the latest Bahrain Economic Development Board Q4 Economic Quarterly of 3.0%. For this year we look for inflation to fall back to 2.4% partly on a weaker outlook for food prices from the Citi Commodities team, but also on base effects from the rental subcomponent, which was elevated throughout this year. In our view, the recovery in the real estate market is driven by a regional real estate recovery, led by Dubai, and does not necessarily reflect a change in Bahrain's underlying real-estate fundamentals.

Tourism continues to struggle

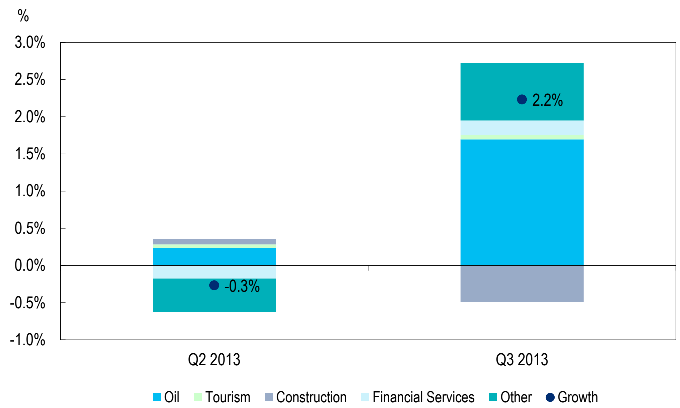
Tourism continues to be affected by the unrest. At only 37%, according to data from Ernst and Young, occupancy in December remained weak. Occupancy has only breached 50% three times in the past two years. Most other countries in the region have seen occupancy rates closer to 70-80%. While there is some stability in room rates they, along with occupancy data are still significantly below the levels recorded prior to 2011. After two months over the summer and Ramadan, when hotel occupancy levels fell to near record lows (28% in July), they jumped back up to 42% in September – staying at 46% for October and November. Political developments in the coming year will likely determine how sustainable the tourism recovery will be.

Figure 19. Economic growth has been adversely impacted by the unrest



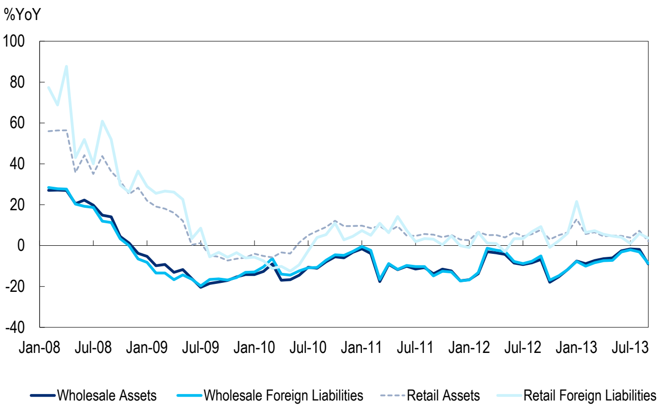
Source: Haver Analytics, Citi Research

Figure 20. Though the economy has shown some signs of recovery



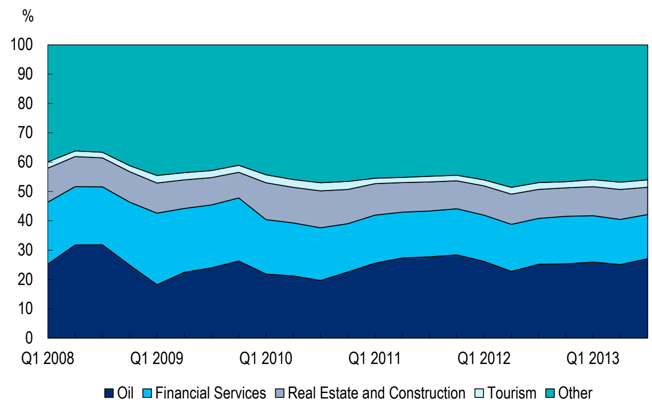
Source: Haver Analytics, Citi Research

Figure 21. The offshore banking system remains hard hit



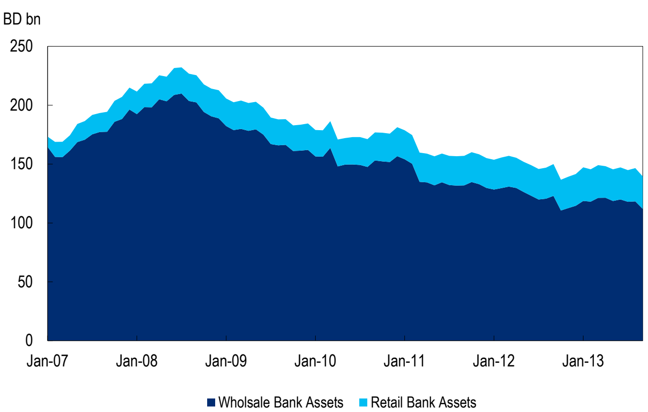
Source: Haver Analytics, Citi Research

Figure 22. The financial sector is a major pillar of the economy



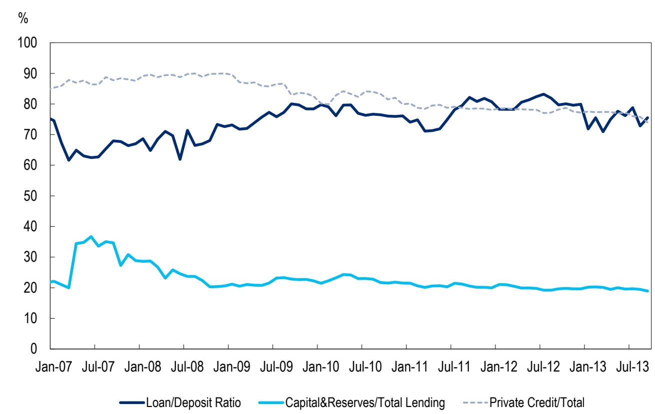
Source: Haver Analytics, Citi Research

Figure 23. Offshore banks are around 90% of the banking assets



Source: Haver Analytics, Citi Research

Figure 24. Retail bank indicators still appear robust



Source: Haver Analytics, Citi Research

Figure 25. 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	29.0	30.3	34.9	37.6	40.3
Nominal GDP, local currency bn	8.2	9.7	8.6	9.7	10.9	11.4	13.2	14.2	15.2
GDP per capita, US$	21,072	22,983	19,192	20,482	22,401	22,973	25,486	26,370	27,202
Share of oil in GDP (real)	24.0	22.7	22.0	21.1	21.4	19.0	19.2	18.4	17.7
Average oil production (mbpd)	0.18	0.18	0.18	0.18	0.18	0.17	0.18	0.18	0.18
Population, mn	1.0	1.1	1.2	1.3	1.3	1.3	1.4	1.4	1.5
Economic Activity									
Real GDP, % yoy	8.3	6.2	2.5	4.3	2.1	3.4	4.3	4.0	4.1
Real per capita GDP, % yoy	-0.2	-1.8	-4.0	-0.7	-1.1	1.4	0.3	0.0	0.1
Real non-oil GDP, % yoy	10.9	8.2	3.4	5.5	1.7	6.6	4.0	5.0	5.0
Prices, Money & Credit									
CPI, % yoy	-	5.1	1.6	1.0	0.2	2.6	4.0	1.8	2.2
CPI, % avg	3.3	3.5	2.8	1.9	-0.4	2.8	3.3	2.4	2.0
Policy interest rate, %, eop	4.00	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Credit extension to private sector, % yoy	38.5	43.6	-0.7	6.2	15.0	6.2	10.0	10.0	10.0
Credit to private sector, % total deposits	58.7	65.3	64.7	60.8	63.0	61.7	61.7	61.7	61.7
Private sector deposits, % yoy	42.8	18.5	6.6	10.2	2.6	4.6	10.0	10.0	10.0
Bank capital & reserves, % total loans	28.9	20.6	22.2	21.5	20.0	19.6	18.9	18.0	17.1
3 month inter-bank rate, %, eop	4.90	2.40	0.40	0.30	0.30	0.30	0.30	0.30	0.30
BHD/US$, eop	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38
BHD/US$, avg	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38
Balance of Payments, USD bn									
Current account	2.8	2.1	0.4	0.6	3.0	2.0	1.8	0.9	-0.6
% of GDP	12.7	8.1	1.7	2.3	10.3	6.4	5.3	2.4	-1.5
Trade balance	2.7	3.1	2.3	2.5	7.5	6.5	5.8	4.9	3.5
Exports	13.6	17.3	11.8	13.6	19.6	19.7	20.3	20.3	19.8
o/w oil, % total exports	79.2	79.6	75.1	74.6	78.8	76.9	76.4	75.2	73.3
Imports	10.9	14.2	9.6	11.2	12.1	13.2	14.5	15.4	16.3
Service balance	1.8	1.7	1.9	2.1	1.3	1.3	1.7	1.7	1.6
Income balance	-0.3	-0.9	-2.4	-2.4	-3.8	-3.8	-3.8	-3.8	-3.8
o/w outward remittances, % GDP	6.8	6.9	6.1	6.4	7.1	6.8	6.2	6.1	5.9
FDI, net	0.1	0.2	2.0	-0.2	-0.1	0.0	0.3	0.3	0.3
Public Finances, % of GDP									
Government revenues	24.9	27.7	19.8	22.5	25.8	26.6	23.8	22.1	20.1
o/w oil revenues	20.0	23.6	16.4	19.2	22.7	23.2	20.6	18.8	16.7
Government expenditure	22.3	21.3	24.1	27.3	26.1	28.6	26.0	25.4	25.5
o/w capital expenditures	6.0	5.3	4.5	7.9	4.0	6.5	5.9	5.7	5.6
Government balance	2.7	6.4	-4.3	-4.8	-0.3	-2.0	-2.2	-3.3	-5.5
non-oil balance, % of non-oil GDP	-21.9	-22.8	-25.7	-30.3	-31.5	-33.4	-29.1	-27.5	-26.9
Breakeven oil price (fiscal), US$/barrel	62.60	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	32.6	41.0	35.6	33.0	30.8
Cumulative government balance since 2000	25.5	31.9	27.5	22.8	22.5	20.5	18.3	15.1	9.6
Net debt (public debt net cumulative balance)	-9.2	-19.3	-6.1	7.0	10.1	20.5	17.2	18.0	21.2
Foreign Assets & Liabilities, USD bn									
External debt	29.8	36.3	35.0	37.5	36.5	39.3	40.9	42.2	42.6
External debt / GDP	137.1	141.6	152.8	146.2	125.9	129.9	117.0	112.1	105.6
External debt / XGS	-	-	225.8	212.4	161.1	174.6	201.4	208.0	215.0
External Assets	8.3	10.5	11.1	11.8	12.4	15.4	17.4	19.2	20.1

Source: National Sources, Citi Research Estimates

Egypt

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- **Key developments on the month**
  - Following the holding of the constitutional referendum, the military's political roadmap to a new political dispensation will continue to unfold in 1H 2014.
  - And even with periodic upsurges in violence, we still expect the political transition to be completed by year end.
- **Key macro drivers**
  - Gulf support has helped stabilize 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. With a reasonable turnout and a strong "yes" vote, the outcome of the referendum seems to have persuaded Field Marshall Abdelfattah el Sisi to stand in presidential elections, which are now likely to be held in April.

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

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

The need to keep the Islamist political community on side

It is also possible that the current level of bombings and violent incidents subsides given the major clampdown on the Muslim Brotherhood (MB) that is under way. But pushing the MB underground raises the risk of returning to the low level insurgency of the 1990s. Attempts by the MB to 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 divisions remain polarized in Egypt.

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

The re-emergence of a fragile economic stability…

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

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

…but 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.

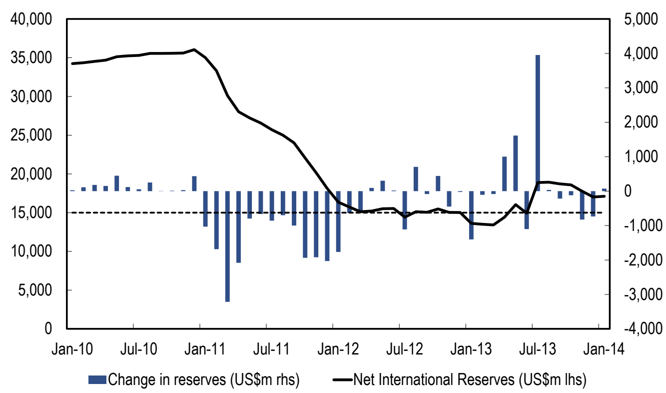
On a more positive note, with only modest EGP depreciation expected in 2014 and a still weak growth environment we think that inflation is unlikely to rise sharply. While, it could be argued that the CBE's cuts in the Overnight Deposit Rate (ODR) in 2013 were premature given the rise in inflation in 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, 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 current political agenda.

A homegrown reform programme

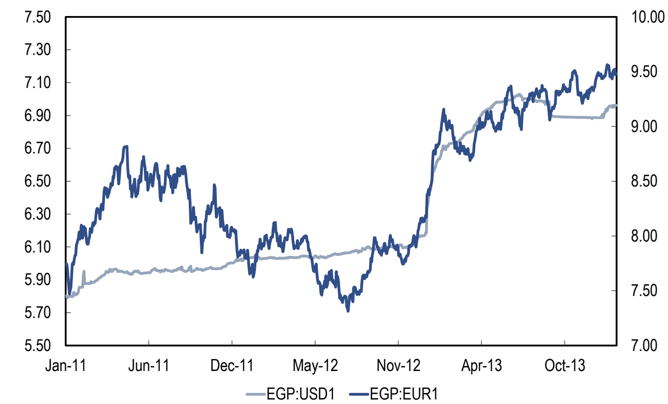
Having said that, the provision of Gulf support means that such difficult choices can be put off and the government can continue to operate in "muddle through" fiscal mode, probably well into 1H 2015. But at some point, the government will have to think about a more comprehensive reform programme. While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

Figure 26. Reserves have stabilised since late 2013, but remain low



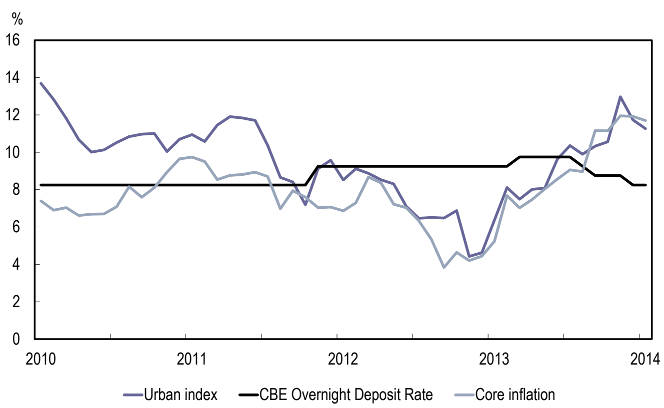
Source: Central Bank of Egypt, Haver Analytics

Figure 27. The EGP also starts to stabilise against USD since mid-2013



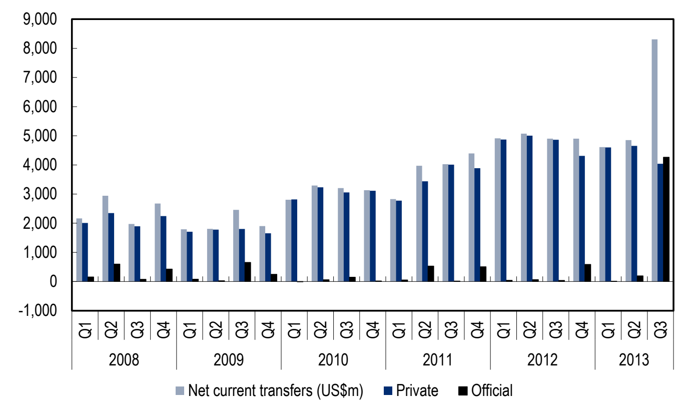
Source: Reuters

Figure 28. The CBE has cut rates, despite the rise in inflation in 2H 2013



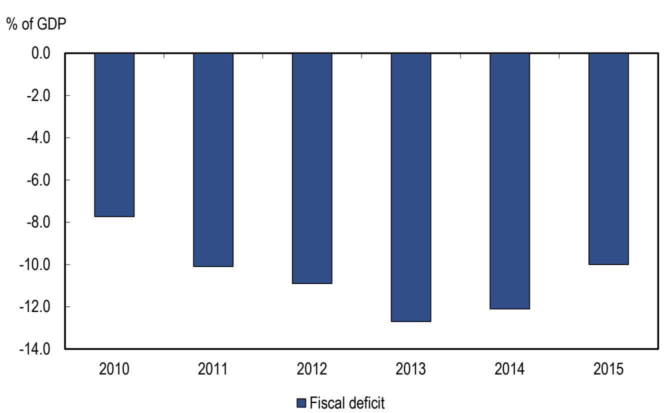
Source: Central Bank of Egypt, Haver Analytics and Citi forecasts for 2H13-2014

Figure 29. Robust transfers have limited the deterioration in the current account and helped support consumption



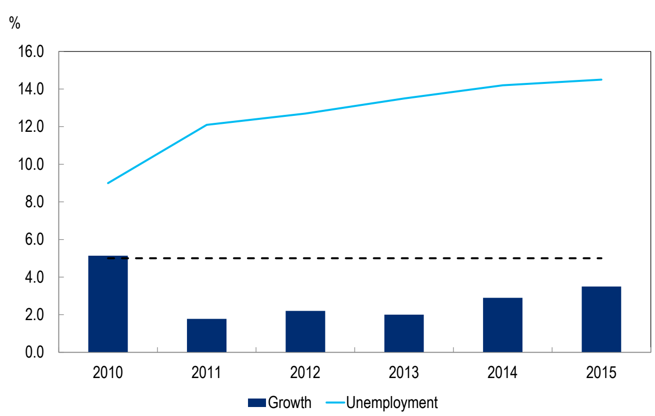
Source: Central Bank of Egypt, Haver Analytics

Figure 30. The fiscal deficit remains large and is a problem



Source: Haver Analytics and Citi forecasts for 2013

Figure 31. A weak recovery may now be possible in 2014-15



Source: Haver Analytics and Citi forecasts for 2013-14

Figure 32. 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	254.4	248.6	267.9	281.0
Nominal GDP, local currency bn	744.8	895.5	1,042.2	1,206.6	1,371.0	1,542.3	1,719.2	1,918.2	2,119.4
GDP per capita, US$	1,783	2,187	2,454	2,755	2,919	3,164	3,042	3,226	3,329
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	7.1	7.2	4.7	5.1	1.8	2.2	2.0	2.9	3.4
Real per capita GDP, % yoy	5.4	5.4	3.0	3.4	0.1	0.6	0.4	1.2	1.8
Prices, Money & Credit									
CPI, % yoy	6.9	18.4	13.2	10.6	9.5	4.7	11.7	8.6	7.2
CPI, % avg	9.5	18.3	11.8	11.1	10.1	7.1	9.5	8.7	7.0
Policy interest rate, %, eop	8.75	11.50	8.25	8.25	9.25	9.25	8.25	7.50	7.00
Credit extension to private sector, % yoy	10.0	12.0	3.0	6.7	6.1	7.6	3.0	4.5	5.8
Credit to private sector, % total deposits	48.9	50.1	44.5	42.8	43.7	42.7	-	-	-
Private sector deposits, % yoy	11.8	12.1	-1.6	6.7	6.1	7.6	-	-	-
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	7.16	7.54
Balance of Payments, USD bn									
Current account	0.2	-1.3	-3.2	-5.6	-7.6	-7.6	-4.2	-3.5	-6.2
% of GDP	0.2	-0.8	-1.7	-2.6	-3.3	-3.0	-1.7	-1.3	-2.2
Trade balance	-20.8	-26.8	-22.5	-27.7	-28.2	-33.8	-31.6	-31.2	-31.2
Exports	24.5	29.8	23.1	25.0	27.9	25.9	24.9	26.3	27.6
Imports	45.3	56.6	45.6	52.7	56.1	59.7	56.5	57.4	58.8
Service balance	12.7	15.7	11.3	9.6	5.4	6.4	2.9	2.1	3.1
Income balance	-	-	-	-	-	-	-	-	-
FDI, net	10.9	7.6	6.1	5.2	-1.1	3.5	5.7	2.0	5.0
Public Finances, % of GDP									
Government revenues	27.6	27.8	27.7	25.1	22.0	22.6	20.7	21.1	22.4
Government expenditure	32.8	34.1	34.2	32.9	32.1	33.5	33.4	33.1	32.3
o/w capital expenditures	3.4	3.8	4.2	4.0	2.9	2.3	-	-	-
Government balance	-5.2	-6.4	-6.6	-7.7	-10.1	-10.9	-12.7	-12.0	-9.9
Public debt	64.2	53.5	54.0	59.8	69.0	79.4	79.9	79.5	79.0
Government's deposits with banks	11.4	10.5	11.0	9.6	8.8	7.9	-	-	-
Net debt (public debt net cumulative balance)	52.8	43.0	43.0	50.2	60.2	71.5	-	-	-
Foreign Assets & Liabilities, USD bn									
External debt	32.8	32.1	33.3	35.0	33.7	38.8	40.0	40.5	40.7
External debt / GDP	24.8	19.5	17.7	16.3	14.6	15.3	16.1	15.1	14.5
External debt / XGS	68.8	55.6	73.0	70.9	71.1	81.1	91.8	91.5	86.4
External Assets	-	-	-	-	-	-	-	-	-

Source: National Sources, Citi Research Estimates

Iraq

- **Key developments on the month**
  - KRG still unable to sell oil independently;
  - Sadr's withdrawal from politics may signal return of Maliki after elections;
  - Fallujah crisis highlights rise in sectarian violence, but civil war still unlikely.
- **Key macro drivers**
  - Oil production ramp-up to lead strong growth;
  - Very large infrastructure requirements present non-oil sector opportunity;
  - Politics and security present significant downside risks to outlook.

Summary Analysis

KRG not yet able to sell oil independently

Around 420,000 barrels of Kurdish oil are sitting in storage tanks in the Turkish port of Ceyhan, having been pumped directly from the Kurdish autonomous region of Iraq through the new pipeline during the month of January. Pumping has now stopped, although it is not clear whether this is to allow time for an agreement to be reached between Baghdad and Erbil over the export of Kurdish crude, or whether it is due to technical issues on the pipeline. What is clearer is that the Turkish authorities are reluctant to sell the oil in the absence of an agreement for the time being, but have indicated that they may do so in future. As ever, prospects for independent Kurdish oil exports rest with the political calculations of Ankara, and the signals coming from the Turkish government remain mixed.

Negotiations with Baghdad continue

In the meantime, negotiations between the KRG and Baghdad continue, and reports suggest a deal is imminent. In January, Baghdad proposed a resolution that would see the sale of Kurdish crude marketed by the State Oil Marketing Organisation (SOMO), with proceeds transferred to the Development Fund for Iraq account in New York, as would normally be the case. At that point, an automatic payment mechanism would transfer the proceeds of sale to the KRG, up to an amount equivalent to the KRG's constitutional entitlement of 17% of the total Iraqi federal budget. While the details of the proposal have not been disclosed, the framework appears to leave Baghdad with significant control over Kurdish oil sales and revenues. This has in the past been an obstacle to lasting agreements.

Sadr's withdrawal from politics may signal higher chance of Maliki return to office after elections

The chances of another Maliki government after April elections were given a boost with the announced withdrawal from politics of Shia rival Moqtada al Sadr. The influential cleric and leader of the eponymous political movement has made similar announcements in the past only to reverse his decision. However, the resignation of many of his Ahrar MPs and his repeated public pledges to distance himself from day-to-day politics give his decision added credibility this time. Sadr, the former commander of the Mehdi army Shia militia which played a large role in Iraq's civil war, had recently taken a much more conciliatory tone in his political rhetoric and appeared, in our view, to be challenging incumbent PM Nouri al Maliki as the consensus candidate for the highest office. His decision to step down less than three months before the general election would suggest that he has abandoned his challenge, leaving, we believe, a greater chance that Mr Al Maliki will be returned to office.

Fallujah crisis continues

The rise in sectarian violence continues amid the ongoing crisis in the Anbar city of Fallujah, which remains besieged by Iraqi security forces after Sunni militants overran it in January. Fallujah has traditionally been a Sunni Islamist stronghold, and was the scene of bloody fighting between US occupational forces and militants in 2004. Back then, the violence led to significant internal displacement and a massive backlash by the Sunni community against US and State forces that contributed to the country's descent into civil war. For this reason, PM Maliki appears to be biding his time, reluctant to engage in an all-out conflict. That said, despite a recent 72-hour truce, targeted military operations are ongoing, with reports of civilian casualties, and the UN estimates that almost 400,000 people have been displaced.

Violence sustained at levels not seen since 2005

More generally, violence in Iraq has reached levels comparable to 2006 when the country's slide into civil war accelerated. According to Iraq Body Count, civilian deaths have occurred at an average rate of over 1,000 per month since July 2013, a three-fold increase since US troops withdrew at the end of 2011. There are a number of contributing factors to this, including US troop withdrawal and inadequate Iraqi security forces, heightened sectarian tactics employed by the political elite and the civil war in neighbouring Syria, which is stoking sectarian tensions across the region.

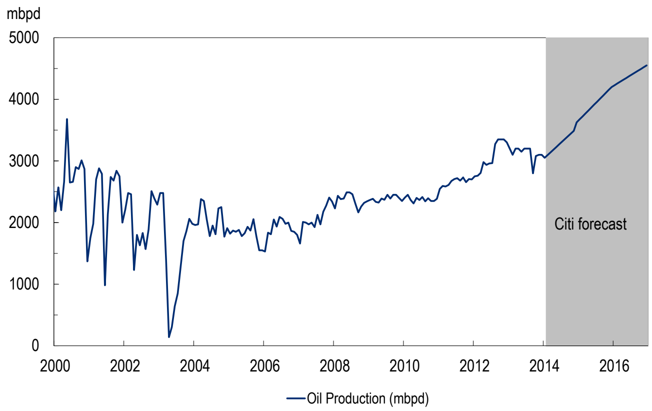
Likelihood of full-blown civil war remains limited, in our view

That said, we maintain our view that the likelihood of a descent into full-blown civil war is unlikely for a number of reasons. To begin with, despite having initially provoked the crisis through alienation of the Sunni leadership, PM Maliki's government is showing signs of trying to revive the 'Sunni awakening', an alliance between Sunni tribal leaders and militia against extremist insurgents in the Anbar province. This alliance was key to the quelling of the insurgency in 2007/2008 and was successful in clearing Ramadi of insurgents in January. Moreover, there are fundamental differences between the dynamic of violence today and that which existed during the height of the civil war, mainly that US troop withdrawal has removed at least one casus belli for insurgents, Shia militias, such as the Badr Brigades and Mehdi army, remain disbanded, and the Iraqi security forces are stronger than they used to be. In short, sustained violence is likely, but we think this will remain concentrated in Sunni strongholds and is unlikely to spread to the Shia-dominated south, where the majority of Iraq's oil infrastructure resides.

Oil production set to increase this year

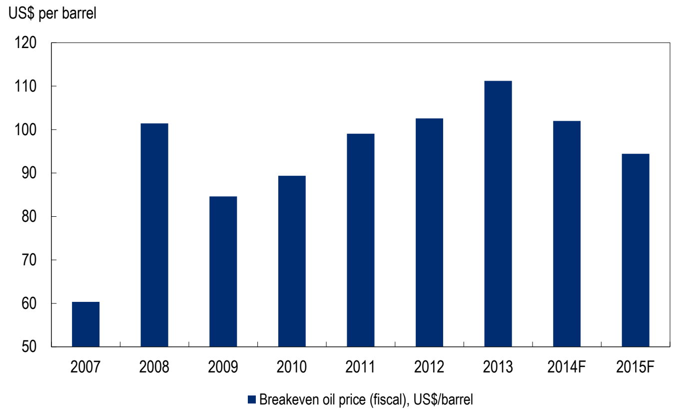
Oil production and exports in 2013 were largely unchanged from the previous year, at around 2.4mbpd, with expected increases hampered by a loss of Kurdish output, sabotage of the ITP, poor weather in the south, and infrastructure bottlenecks. However, we expect 2014 to see a jump in Iraqi oil exports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

Figure 33. Oil production on track to ramp up in near term



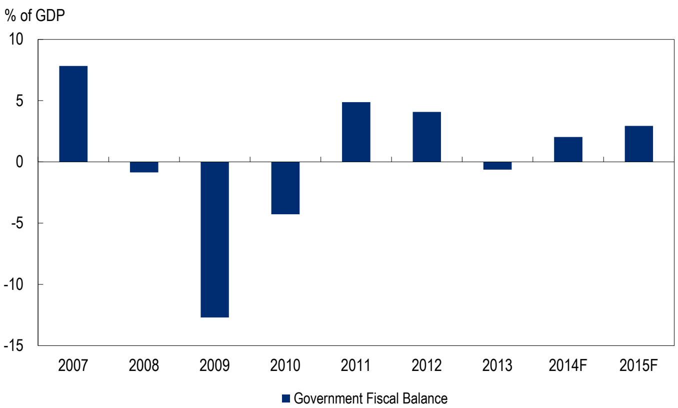
Source: Bloomberg, Citi Research

Figure 34. The fiscal breakeven oil price remains elevated



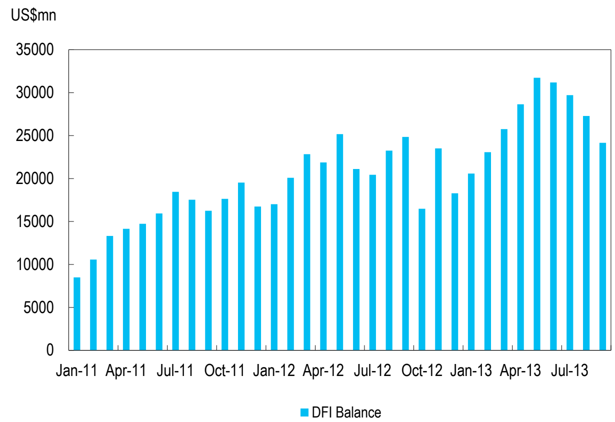
Source: Haver Analytics, Citi Research estimates

Figure 35. Fiscal performance should remain solid



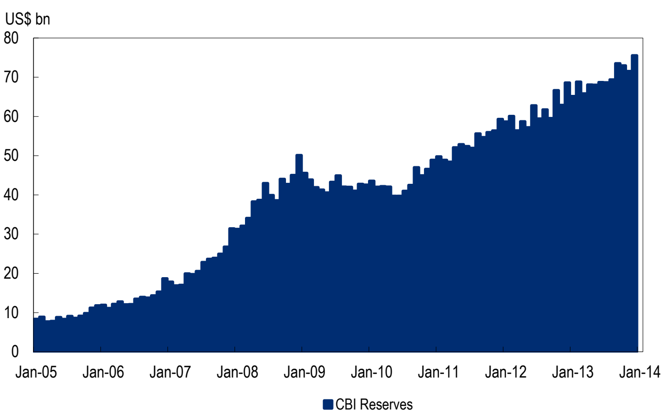
Source: Haver Analytics, Citi Research estimates

Figure 36. Balances at DFI account remain strong



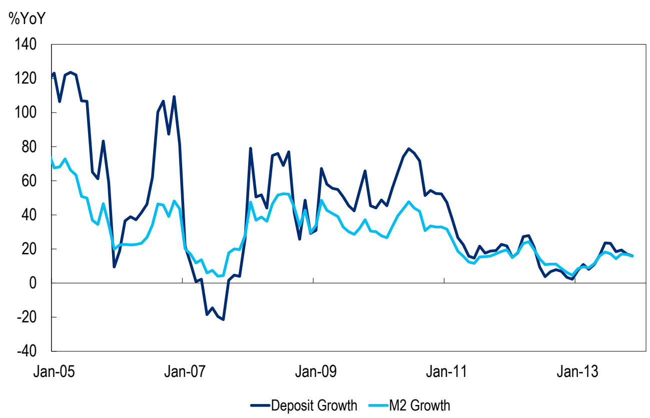
Source: IAMB, Committee of Financial Experts

Figure 37. Central bank reserves have settled around US$70bn



Source: Haver Analytics, Citi Research

Figure 38. Monetary growth has eased recently



Source: Haver Analytics, Citi Research

Figure 39. Iraq Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US$ bn	91.7	135.6	113.6	135.9	181.2	213.0	230.8	267.6	313.7
Nominal GDP, local currency bn	111,455.8	157,026.1	130,642.2	158,521.5	211,310.0	247,775.7	268,242.8	311,014.8	364,574.5
GDP per capita, US$	3,190	4,607	3,766	4,389	5,708	6,545	6,914	7,818	8,936
Share of oil in GDP (real)	43.0	45.4	43.5	40.9	42.1	44.7	44.3	46.5	48.2
Average oil production (mbpd)	2.07	2.36	2.39	2.38	2.66	3.06	3.13	3.63	4.20
Population, mn	28.7	29.4	30.2	31.0	31.7	32.5	33.4	34.2	35.1
Economic Activity									
Real GDP, % yoy	1.4	6.6	5.8	5.9	8.6	8.4	3.1	10.4	11.6
Real per capita GDP, % yoy	-1.0	4.1	3.2	3.1	5.9	5.7	0.5	7.7	8.9
Real non-oil GDP, % yoy	-2.8	2.2	9.5	10.8	8.0	8.0	10.0	10.0	15.0
Prices, Money & Credit									
CPI, % yoy	4.7	6.8	-4.4	3.3	6.0	3.6	3.1	4.7	6.0
CPI, % avg	32.6	2.8	-2.8	2.4	5.6	6.1	1.9	4.5	6.0
Policy interest rate, %, eop	20.00	15.00	7.00	6.00	6.00	6.00	6.00	6.00	6.00
Credit extension to private sector, % yoy	27.5	52.8	17.3	77.1	34.0	28.2	25.0	25.0	25.0
Credit to private sector, % total deposits	-	-	-	-	-	-	-	-	-
Private sector deposits, % yoy	-	-	-	-	-	-	-	-	-
Bank capital & reserves, % total loans	-	-	-	-	-	-	-	-	-
3 month inter-bank rate, %, eop	-	-	-	-	-	-	-	-	-
IQD/US$, eop	1,213	1,168	1,153	1,170	1,167	1,164	1,165	1,162	1,162
IQD/US$, avg	1,253	1,189	1,156	1,167	1,171	1,164	1,162	1,162	1,162
Balance of Payments, USD bn									
Current account	20.0	28.4	-1.3	6.3	26.2	38.0	31.1	36.9	40.2
% of GDP	21.9	20.9	-1.1	4.7	14.5	17.8	13.5	13.8	12.8
Trade balance	23.0	34.0	4.1	14.4	39.0	44.8	38.3	44.5	48.3
Exports	39.6	63.7	39.4	51.8	79.7	90.3	89.2	101.6	112.2
o/w oil, % total exports	94.9	96.9	92.4	94.2	96.2	96.7	96.6	97.0	97.3
Imports	16.6	29.8	35.3	37.3	40.6	45.5	51.0	57.1	63.9
Service balance	-4.0	-6.1	-6.4	-7.0	-8.1	-4.1	-4.5	-5.0	-5.5
Income balance	1.5	3.5	3.1	1.6	-0.2	0.1	0.1	0.1	0.1
FDI, net	1.0	1.8	1.5	1.3	1.7	2.6	3.1	3.4	3.8
Public Finances, % of GDP									
Government revenues	54.0	56.4	46.2	46.4	49.5	48.2	43.7	43.5	41.3
o/w oil revenues	47.4	47.8	35.9	37.8	45.7	44.1	40.3	39.6	37.3
Government expenditure	46.1	57.3	58.9	50.7	44.6	44.1	44.3	41.4	38.3
o/w capital expenditures	9.9	17.4	12.8	15.2	13.0	15.3	14.2	12.8	11.5
Government balance	7.8	-0.9	-12.7	-4.3	4.9	4.1	-0.6	2.0	2.9
non-oil balance, % of non-oil GDP	-85.2	-117.4	-92.9	-85.3	-84.2	-81.7	-75.1	-69.1	-60.3
Breakeven oil price (fiscal), US$/barrel	60.3	101.4	84.6	89.4	99.1	102.6	111.2	102.0	94.4
Public debt	116.1	72.6	84.0	52.2	40.2	34.1	32.1	25.7	19.0
Cumulative government balance since 2000	7.8	7.0	-5.7	-10.0	-5.1	-1.0	-1.7	0.4	3.3
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	32.4	26.9	23.5	22.1	17.1	13.9
External debt / XGS	255.0	146.5	223.9	80.8	59.1	54.7	57.1	45.1	38.8
External Assets	23.3	51.7	50.6	57.0	83.3	121.3	152.4	189.3	229.4

Source: National Sources, Citi Research Estimates

Jordan

- **Key developments on the month**
  - 2014 budget narrowly approved with 13% rise in expenditures, fiscal position remains vulnerable;
  - Rumblings of discontent with further anticipated electricity tariff hikes;
  - FX reserve position improves significantly, but on the back of transient factors.
- **Key macro drivers**
  - Weak public finances with limited revenue capacity;
  - Growth expected to stay fairly depressed in medium term;
  - Political risk to remain relatively high as reform process continues.

Summary Analysis

2014 budget passed by parliament with 12% rise in expenditures

The Jordanian budget was narrowly passed by the lower house of parliament amid protest from several MPs, some of which called for the resignation of the government. The budget has stirred controversy primarily because it envisages a cut to subsidies (particularly energy subsidies) while at the same time expanding overall expenditure. Total expenditures are expected to rise to JD8.1bn, a 12% increase on 2013, leading to a deficit of JD1.1bn, or 4.5% of GDP. This is based on what we consider an optimistic assumption that revenues will rise in line with expenditures. On our more cautious view that revenues will rise in line with historical experience (as a rate of around 6%), we are forecasting a budget deficit more than double the official target, at JD2.5bn, or over 10% of GDP.

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

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

Fiscal vulnerability remains, but FX position has recovered strongly

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

Jordan's FX reserve improvement reflects transient factors

Jordan's FX reserve position has improved significantly over the past year, despite ongoing external imbalances. Total FX reserves rose sharply to US$13.1bn in November last year, from US$7.9bn at the end of 2012.This is despite a continued widening in the current account deficit, to over 11% of GDP in Q3, and sluggishness in capital inflows. Indeed, the balance of payments has remained in a net negative position, and the build-up of FX reserves reflects mainly two exceptional factors. First, there has been a significant de-dollarisation in the economy, with the ratio of FX to Dinar deposits falling from 32% to 27% in the first 11 months of the year. Second, the FX reserves reflect the IMF disbursements under the programme.

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

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

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

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

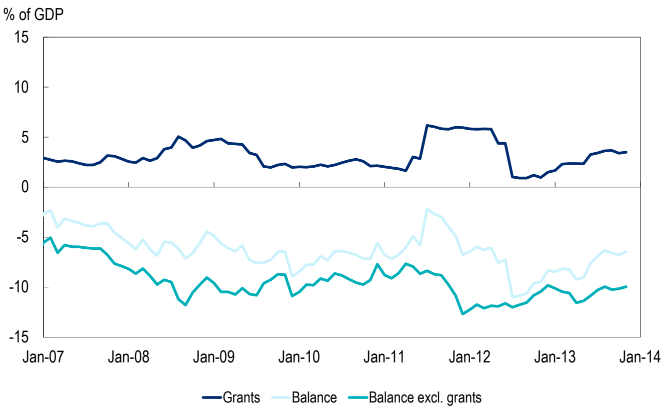
Refugee crisis has an ambiguous impact on the macro-economy

Jordan's economy has been affected by a wave of around 500,000 refugees from Syria, although the net impact is unclear. On the one hand, the refugees, most of whom live in Jordanian urban centres, put further strain on Jordan's limited resources. On the other, their presence, along with that of the NGO community which has swelled as a result of the conflict, is supporting domestic demand and motivating an increase in aid flows to the Kingdom.

Expect continued sluggish growth

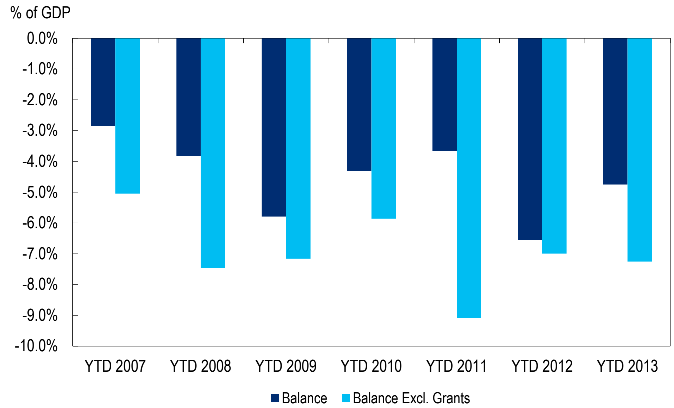
Continued weak external demand, low levels of foreign and domestic investment, falling remittances and a sharp rise in refugee inflows from Syria are all adding to a gloomy economic picture. The fiscal and external balances remain wholly unsupportive of domestic growth in our view. While the recovery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

Figure 40. The fiscal bottom line has remained problematic…



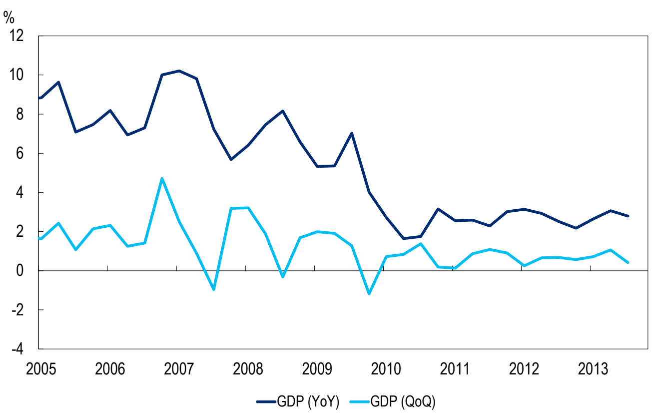
Source: Haver Analytics, Citi Research

Figure 41. …and would be weaker still if grants were excluded



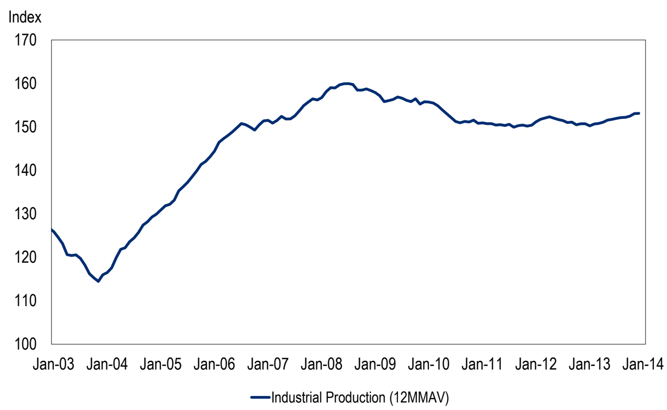
Source: Haver Analytics, Citi Research

Figure 42. Growth has begun to slow …



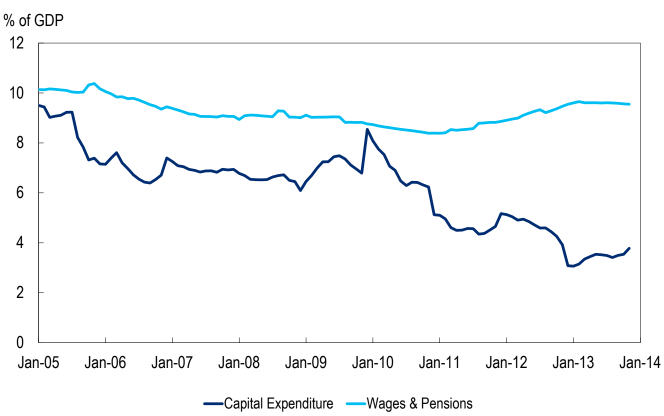
Source: Haver Analytics, Citi Research

Figure 43. … and industrial production has been stalled since 2008



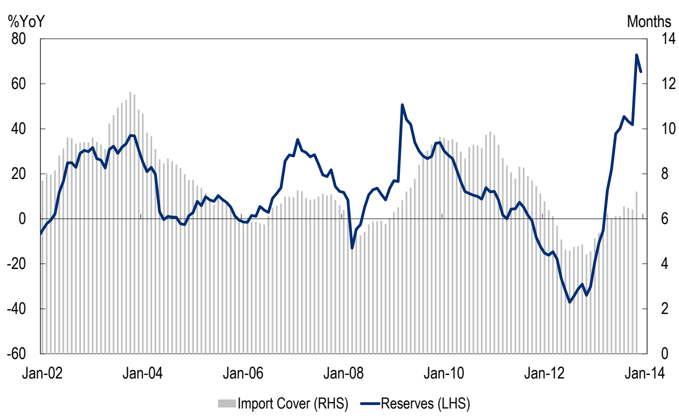
Source: Haver Analytics, Citi Research

Figure 44. Capital expenditures have stabilised …



Source: Haver Analytics, Citi Research

Figure 45. … while reserves are beginning to grow again



Source: Haver Analytics, Citi Research

Figure 46. 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	32.8	35.0	37.6
Nominal GDP, local currency bn	12.1	15.6	16.9	18.8	20.4	21.9	23.2	24.8	26.7
GDP per capita, US$	3,026	3,722	3,866	4,104	4,284	4,404	4,490	4,594	4,739
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	3.0	4.0	4.5
Real per capita GDP, % yoy	3.8	2.6	0.9	-2.0	-1.6	-1.4	-1.2	-0.2	0.3
Prices, Money & Credit									
CPI, % yoy	5.1	9.1	2.7	6.1	3.3	7.2	2.7	5.2	5.0
CPI, % avg	4.7	13.9	-0.7	5.0	4.4	4.8	5.5	3.7	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	-5.0	-5.0	-4.5
% of GDP	-16.8	-9.3	-5.2	-7.1	-12.0	-17.4	-15.2	-14.2	-11.9
Trade balance	-6.5	-7.2	-6.3	-6.8	-8.8	-10.5	-11.1	-11.6	-11.8
Exports	5.7	7.9	6.4	7.0	8.0	7.9	8.3	8.7	9.6
Imports	12.2	15.1	12.7	13.9	16.8	18.4	19.4	20.3	21.3
Service balance	0.0	0.4	0.7	1.2	0.7	1.1	1.2	1.3	1.3
Income balance	0.7	0.7	0.5	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4
FDI, net	2.6	2.8	2.3	1.6	1.4	1.5	1.5	1.6	1.7
Public Finances, % of GDP									
Government revenues	32.7	30.4	26.7	24.9	26.5	23.1	22.9	22.4	21.9
Government expenditure	37.8	34.8	35.7	30.4	33.2	31.4	31.1	32.6	31.8
o/w capital expenditures	6.9	6.1	8.5	5.1	5.2	3.1	4.0	5.0	5.0
Government balance	-5.1	-4.4	-8.9	-5.6	-6.8	-8.3	-8.2	-10.1	-9.9
Public debt	70.9	58.2	62.2	63.4	68.9	76.8	80.5	85.6	89.5
Government's deposits with banks	17.6	15.7	14.8	15.7	13.3	15.3	20.6	20.2	19.7
Net debt (public debt net cumulative balance)	53.3	42.5	47.5	47.7	55.6	61.5	59.9	65.4	69.8
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	60.5	59.6	58.2
External debt / XGS	161.0	111.4	130.2	128.5	131.8	139.3	141.6	143.8	141.9
External Assets	-5.5	-7.5	-8.3	-9.7	-13.2	-18.5	-23.5	-28.5	-33.0

Source: National Sources, Citi Research Estimates

Kuwait

- **Key developments on the month**
  - Government spending rose 23% in 2013, highlighting need to address subsidies;
  - 2014/2015 budget approved by cabinet, modest growth, requires NA ratification;
  - Tentative signs of progress on development plan, question marks remain.
- **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 (September 23). The new Finance Minister, Al-Saleh, has, however, re-affirmed the ministry's commitment to push ahead with the review, which we believe will help maintain confidence in Kuwait's public finances. Kuwait remains in a relatively comfortable fiscal position, even compared with its oil-rich GCC peers, but plateauing oil revenues and rising expenditures do pose a threat to the fiscal outlook in the medium to long term. This is true of most Gulf oil exporters, as we have recently argued (Middle East Macro Monthly - Why the GCC's Structural Challenges Matter, September 30).

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 have 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 $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 2 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 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 the economic prospects of the country. Hopes that a relatively pro-government parliament elected last summer (following an opposition boycott) would lead to a better working relationship and, importantly, progress on the implementation of the US$104bn development plan, were dashed when parliamentarians soon began targeting cabinet ministers for 'grillings'. We do not believe that the current cabinet is likely to resolve the underlying problems that plague the relationship between the government and law-makers, and expect further political stasis and instability going forward, with continued negative impact on economic policy-making.

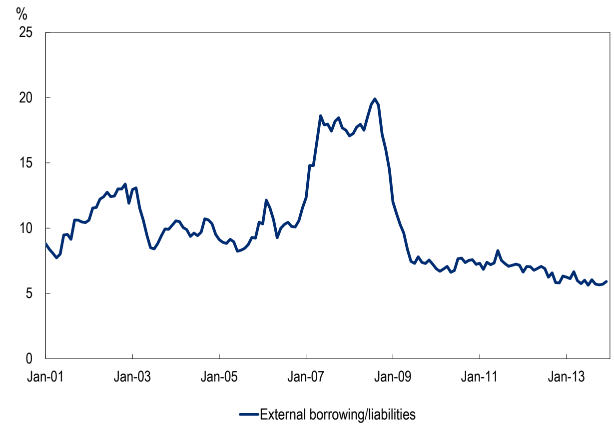
Weak credit growth likely to continue in 2014

Lending growth continued to be sluggish in 2013. Total credit extended in December rose to 6.3%YoY – the highest level for just over 4 years. For the full year, credit growth was a measly 3.3%, way off the highs prior to the 2008 financial crisis when credit extension reached close to 40%. Lending to the public sector continues to improve, but remains in double digit contractionary territory. However, lending is likely to remain weak until there is a significant recovery in private sector credit, which makes up more than 90% of total bank lending; in the near term this seems unlikely with private credit growth stuck at around 5%. On the flip side, the weak loan growth has allowed the loan deposit ratio to stabilise below 80%.

Figure 47. Lending to the government continues to be anaemic

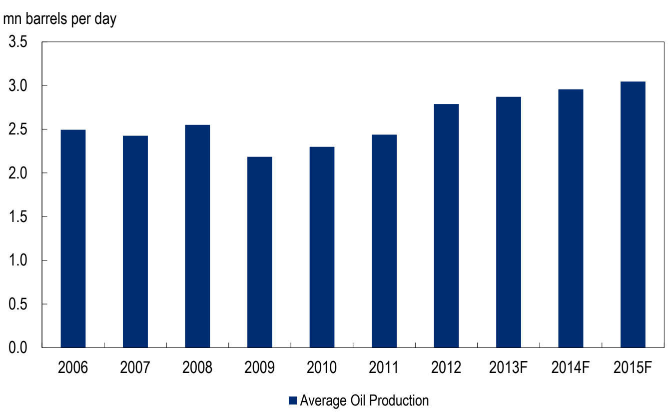
Source: Haver Analytics, Citi Research

Figure 48. Foreign liabilities remain moderate



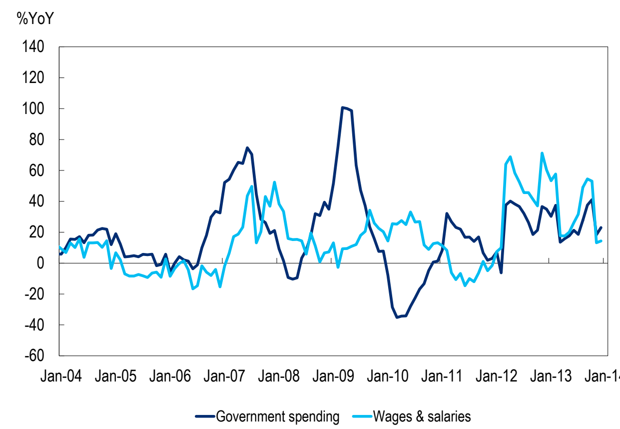
Source: Haver Analytics, Citi Research

Figure 49. Oil production remains relatively stagnant



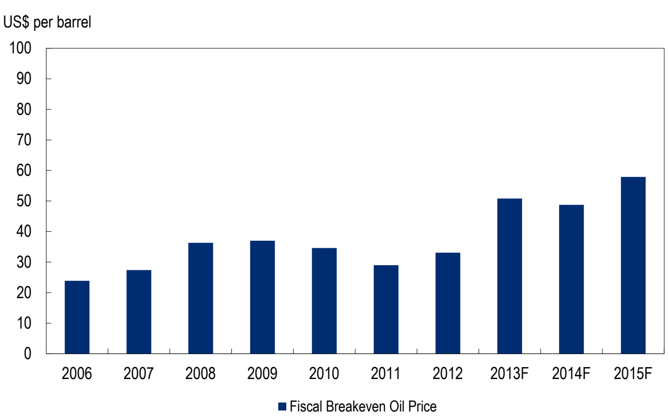
Source: Haver Analytics, Citi Research estimates

Figure 50. Government spending has picked up



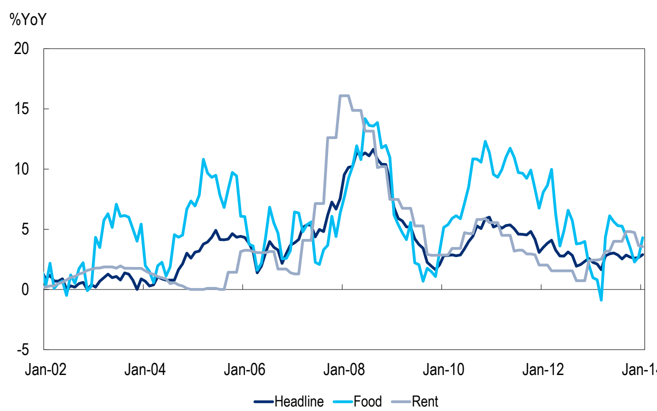
Source: Haver Analytics, Citi Research

Figure 51. Fiscal breakeven rising but still relatively prudent



Source: Haver Analytics, Citi Research estimates

Figure 52. Food prices have begun to pick up



Source: Haver Analytics, Citi Research

Figure 53. 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)	-	-	-	53.6	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	-	-	-	-	10.2	8.3	4.3	3.9	3.9
Real per capita GDP, % yoy	-	-	-	-	5.5	5.2	1.2	0.8	0.8
Real non-oil GDP, % yoy	-	-	-	-	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	3.8	5.0
CPI, % avg	5.5	10.6	4.0	4.0	4.7	2.9	2.6	3.1	5.0
Policy interest rate, %, eop	6.25	3.75	3.00	2.50	2.50	2.00	2.00	2.00	2.00
Credit extension to private sector, % yoy	35.1	16.6	6.2	1.9	2.6	2.8	7.3	2.0	2.0
Credit to private sector, % total deposits	107.4	102.7	96.1	96.2	91.8	86.6	85.7	83.3	80.9
Private sector deposits, % yoy	20.0	16.0	13.5	2.8	7.8	6.8	9.5	5.0	5.0
Bank capital & reserves, % total loans	20.2	17.9	18.0	21.0	21.8	22.4	22.4	24.1	25.9
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	79.2	103.1	102.7	99.7
% of GDP	37.3	42.3	27.6	31.9	43.3	44.8	51.0	49.5	47.8
Trade balance	43.2	61.5	36.9	48.9	79.7	96.8	118.2	119.8	118.1
Exports	63.5	83.5	55.9	68.7	101.5	119.2	142.9	147.0	148.0
o/w oil, % total exports	94.4	95.0	89.9	92.1	93.9	94.7	94.2	92.7	90.6
Imports	20.3	22.0	19.0	19.8	21.8	22.5	24.7	27.2	29.9
Service balance	-3.2	-3.7	-2.3	-6.9	-7.9	-9.6	-10.5	-11.6	-12.7
Income balance	12.6	10.3	7.9	8.7	8.9	9.2	9.0	8.7	8.9
o/w outward remittances, % GDP	-8.5	-7.0	-11.0	-10.0	-8.3	-8.6	-7.7	-7.6	-7.7
FDI, net	-9.5	-8.4	-7.4	-1.1	-7.7	-5.5	-6.0	-5.5	-5.2
Public Finances, % of GDP									
Government revenues	55.3	64.5	58.3	66.2	68.4	72.3	62.3	63.4	59.1
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	10.0	10.0	3.3
Government balance	30.0	36.4	19.0	30.8	40.1	39.4	26.8	27.0	21.0
non-oil balance, % of non-oil GDP	-38.4	-51.3	-56.0	-51.3	-44.9	-57.0	-67.0	-63.1	-73.5
Breakeven oil price (fiscal), US$/barrel	27.41	36.32	36.99	34.61	29.01	33.07	50.83	48.74	57.88
Public debt	12.4	10.2	11.1	11.2	8.4	6.2	5.6	5.9	6.5
Cumulative government balance since 2000	153.8	190.2	209.2	240.0	280.1	319.5	346.3	373.3	394.3
Net debt (public debt net cumulative balance)	-141.4	-180.0	-198.0	-228.8	-271.7	-313.3	-340.7	-367.4	-387.8
Foreign Assets & Liabilities, USD bn									
External debt	57.6	52.9	45.7	41.1	35.0	28.6	31.5	34.6	38.1
External debt / GDP	51.2	38.7	43.5	34.7	22.9	16.2	15.6	16.7	18.2
External debt / XGS	90.7	63.4	81.7	59.8	34.5	24.0	22.0	23.5	25.7
External Assets	219.1	261.3	321.5	349.8	387.6	453.8	533.0	636.1	738.7

Source: National Sources, Citi Research Estimates

Lebanon

- **Key developments on the month**
  - Cabinet formed after 10 month delay;
  - We do not expect policy progress as cabinet faces twin challenge of security and upcoming elections;
  - Retail trade and wider economy continues to suffer.
- **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

Government finally formed after 10 months of wrangling

After 10 months of deliberations, Prime Minister Tammam Salam has finally formed what is being termed a government of 'national interest'. The government is formed of 8 March 14 ministers, 8 March 8 ministers, and 8 neutral ministers aligned with the PM Salam and President Sleiman. Its formation was made possible after Salam reached a compromise deal with Michel Aoun's Free Patriotic Movement on the thorny issue of cabinet rotations. Former Energy Minister Gibran Bassil will move to the foreign ministry, while retaining some responsibilities within the energy ministry. The latter will also go to a minister from within the change and reform bloc (Arthur Nazarian), headed by Aoun. This could indicate greater continuity at the energy ministry, which is in charge of dealing with the pending oil and gas auctions, but we remain cautious on the prospects of this, and other economic policy progress in the current political environment.

Government is an interim government in all but name

In our view, the current government is an interim government in all but name. While a policy statement is pending final agreement on wording (a process that is unsurprisingly difficult given the deep divisions within the government) we consider its real task to be twofold.

Government's main priority is to diffuse sectarian conflict

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. Violence continued across the country in February, and included another twin suicide bombing targeting Iranian interests in South Beirut in which 8 people were killed. We believe the cabinet will have limited success in this, given that it is unlikely to display strong leadership and is also unlikely to act as an effective forum for inter-sectarian dialogue.

Second task is to pave the way for presidential succession and general elections

Its second task is to manage the looming presidential succession (May) and parliamentary elections (November), after which point it will be disbanded and replaced with a new government (reflecting the results of the latter). Debate over candidates for the presidency has begun, and there is great concern 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 6 months until Michel Sleiman assumed office, and in the interim the country went to the verge of civil war, with fighting in the streets between Hizbollah and the Sunni Future Movement.

Prospects for a deal on electoral law look slim at present

As for the parliamentary elections, disagreement between the various political groupings over the electoral 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 on 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.

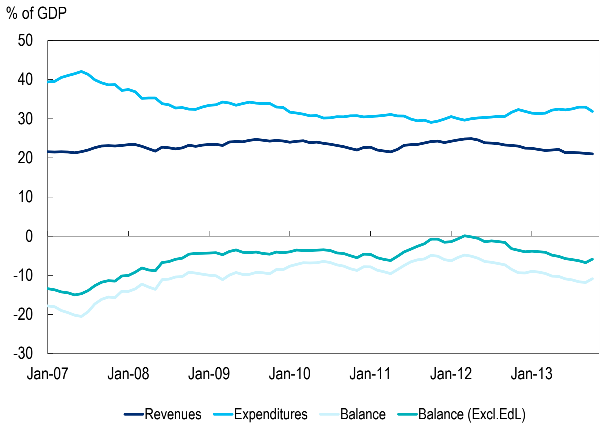
Lebanon's oil and gas development will likely remain slow

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.

Retail activity down 35% in two years

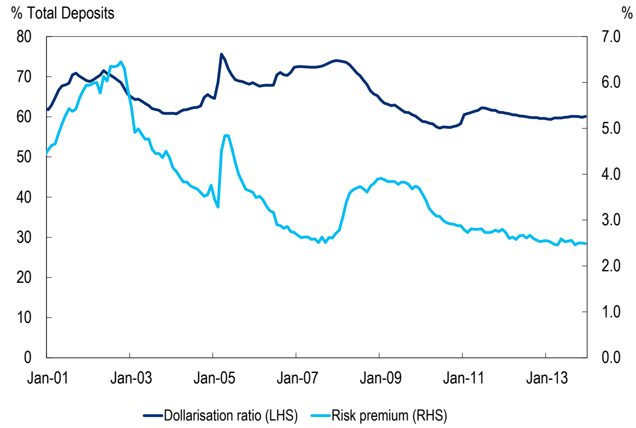
The political climate, including Lebanon's ongoing security challenges, is taking its toll on the Lebanese economy. A recent study published by the Beirut Traders Association and Fransabank showed that Lebanon's retail trade has fallen by a cumulative 35% over the past two years, a clear consequence of the political instability the country has faced during this time. We continue to forecast sluggish economic growth in the 1.5%-2.5% range, driven mainly by the banking sector. Despite this, we maintain our view that sovereign risk in Lebanon remains relatively stable, as government finances are propped up by a sound and liquid banking sector.

Figure 54. Fall in expenditures, rise in revenues, narrowing the deficit



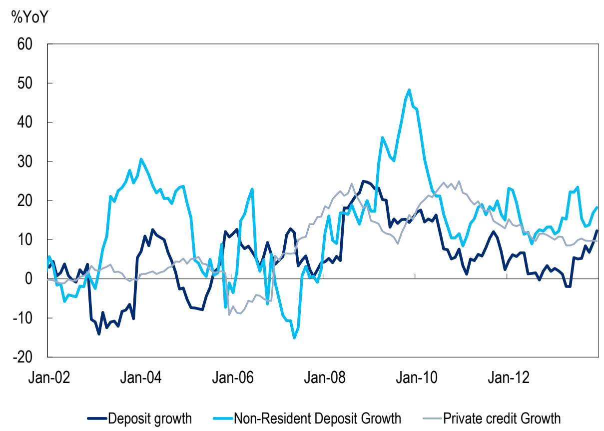
Source: Haver Analytics, Citi Research

Figure 55. Rise in dollarisation, LBP deposit premium over USD stable



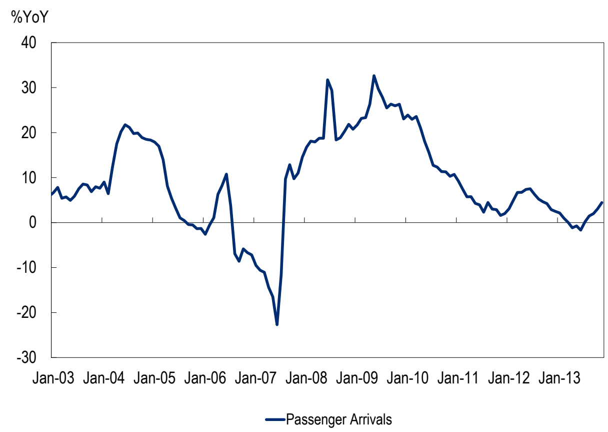
Source: Haver Analytics, Citi Research

Figure 56. Banking growth indicators have eased in recent months



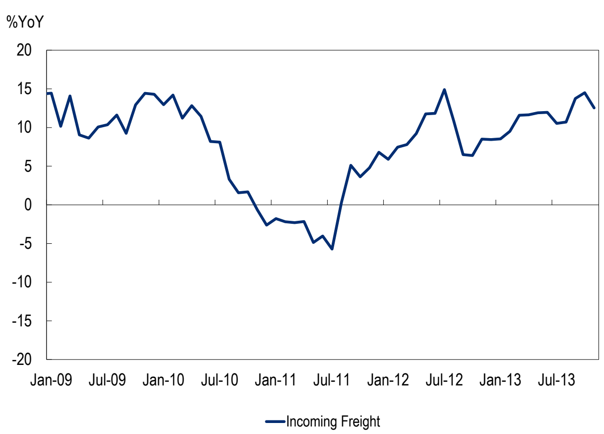
Source: Haver Analytics, Citi Research

Figure 57. Passenger arrivals continue to disappoint



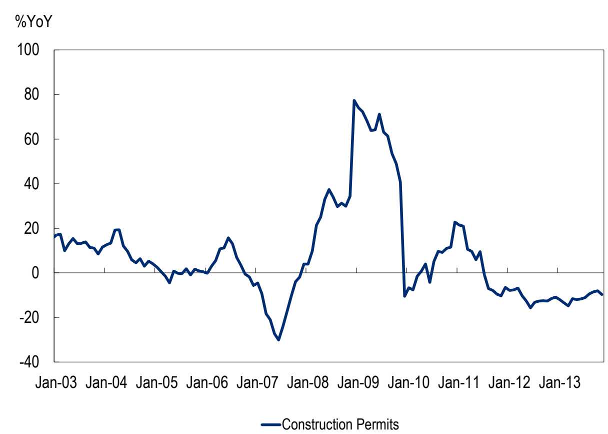
Source: Haver Analytics, Citi Research

Figure 58. Incoming freight volumes have picked up recently



Source: Haver Analytics, Citi Research

Figure 59. Construction permits (sq. metre) remain weak



Source: Haver Analytics, Citi Research

Figure 60. 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	3.4	4.6	3.1	10.1	1.1	5.7	5.0
CPI, % avg	4.1	10.8	1.2	4.0	5.1	6.4	2.1	3.7	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	-4.9	-1.7	-2.1	-2.5	-3.1
% of GDP	-5.6	-14.4	-19.2	-20.0	-12.1	-3.9	-4.5	-5.3	-6.0
Trade balance	-7.9	-11.0	-11.2	-12.3	-13.9	-14.6	-15.3	-17.2	-19.2
Exports	4.0	5.3	4.7	5.5	6.0	6.2	6.5	6.9	7.2
Imports	11.9	16.3	15.9	17.7	19.9	20.8	21.9	24.1	26.5
Service balance	3.0	4.1	2.8	2.6	6.7	9.9	10.9	11.9	13.1
Income balance	0.7	0.4	-0.2	-0.5	-0.2	0.4	-0.5	-0.5	-0.5
FDI, net	1.9	3.3	3.7	3.8	2.7	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	20.4
Government expenditure	34.0	34.4	32.4	29.8	29.1	31.0	30.9	30.0	29.0
o/w capital expenditures	1.5	1.2	1.0	1.2	1.1	1.1	1.1	1.1	1.1
Government balance	-10.4	-10.1	-8.4	-7.6	-5.8	-9.1	-10.0	-9.3	-8.7
Public debt	158.8	144.1	125.7	118.5	115.7	114.3	118.4	121.0	122.4
Government's deposits with banks	42.2	43.0	50.2	52.3	58.0	62.2	69.4	72.0	74.4
Net debt (public debt net cumulative balance)	116.7	101.1	75.5	66.2	57.7	52.0	49.0	49.0	48.0
Foreign Assets & Liabilities, USD bn									
External debt	28.8	30.2	35.6	37.3	40.6	44.6	46.8	49.2	51.6
External debt / GDP	117.1	104.7	101.3	98.0	101.2	103.8	103.3	102.3	101.0
External debt / XGS	169.0	132.3	164.8	173.4	158.3	157.2	151.6	146.1	140.8
External Assets	-47.1	-48.2	-50.5	-53.7	-58.5	-60.2	-62.2	-64.8	-67.9

Source: National Sources, Citi Research Estimates

Oman

- **Key developments on the month**
  - 2013 fiscal performance slightly beats expectations, lowering 2014 deficit forecast;
  - Fiscal trajectory remains a concern, we expect debt issuance in coming months;
  - Tourism sector picking up.
- **Key macro drivers**
  - Demographic imbalance fuelling political uncertainty;
  - Public finances weaker than most GCC peers;
  - Potential economic growth constrained by energy supply shortage.

Summary Analysis

Significant erosion in public finances going forward

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 previous anticipated a small deficit of 0.2%) was down mainly to lower government expenditure than expected. As a result, we have reduced 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 are expecting financing conditions for emerging markets to tighten next year as Fed tapering kicks in. Ultimately, we think Oman has little option but to carry out reforms of its public finances. On the expenditure side, this would mean rationalisation of the burgeoning wage and subsidy bills. On the revenue side, this would mean diversifying into non-oil sources of income, notably taxes. The net impact of these measures is likely to be negative for the public, with a higher tax burden and slowing economy, and could well spark some measure of social unrest, although the popularity of Sultan Qaboos remains strong.

Signs that such action is imminent

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

High likelihood of debt issuance in coming months

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

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

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

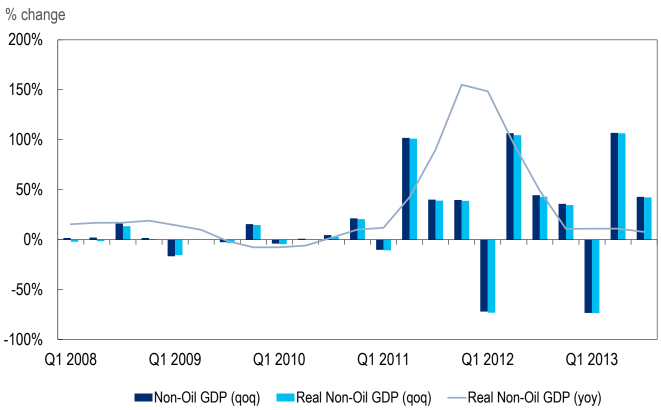
Meanwhile, the tourism industry remains largely unaffected by the unrest

After the typical lull in hotel activity in July and August, 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. In December while occupancy rates eased slightly to 77% (from 83% in November), data from Ernst and Young showed room rates actually moved up to US$218 (from US$208 in November). Tourism remains one of Oman's key diversification sectors, given that it is relatively labour-intensive and thus provides for greater job opportunities than more capital-intensive sectors.

Credit expansion to build momentum gradually in 2014

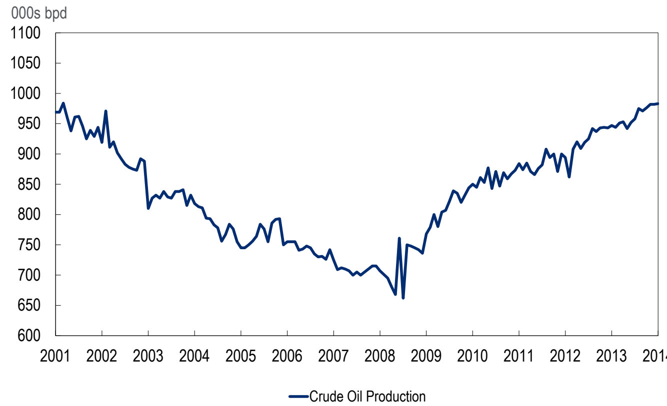
Credit growth continues to be stuck in the single digits/low teens with no immediate signs of a return to the 50%YoY rates experienced in 2008. We remain concerned that credit extension continued to slow in December, though private sector credit now appears to be bouncing along the bottom. If, as we expect, total lending is to gradually pick up in 2014, we believe that in particular, private sector credit will be critical given it dominates bank lending with almost 90% of bank credit.

Figure 61. Quarterly data shows drop in non-oil GDP



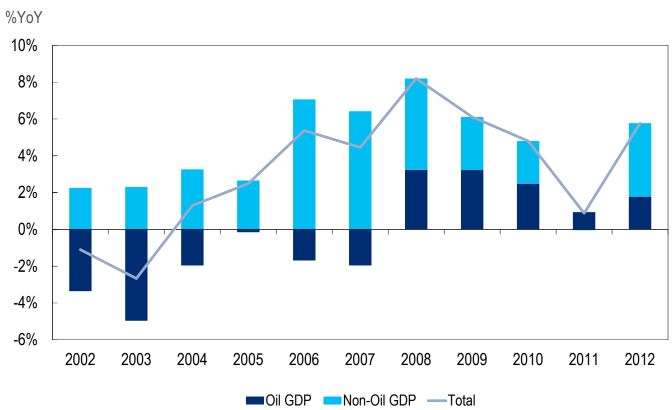
Source: Haver Analytics, Citi Research

Figure 62. Oil production continues to pick up



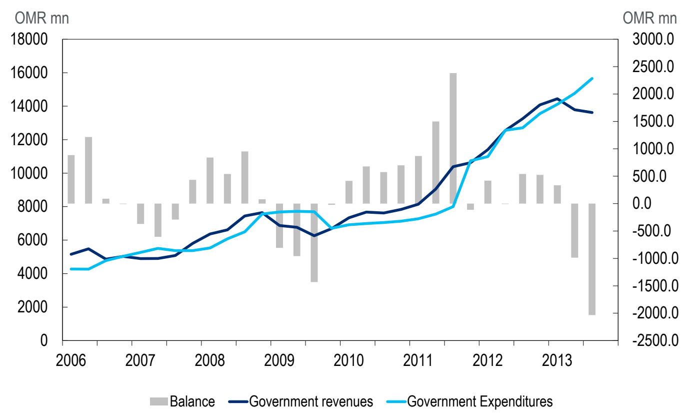
Source: Bloomberg

Figure 63. Non-oil GDP remains the engine for growth in Oman



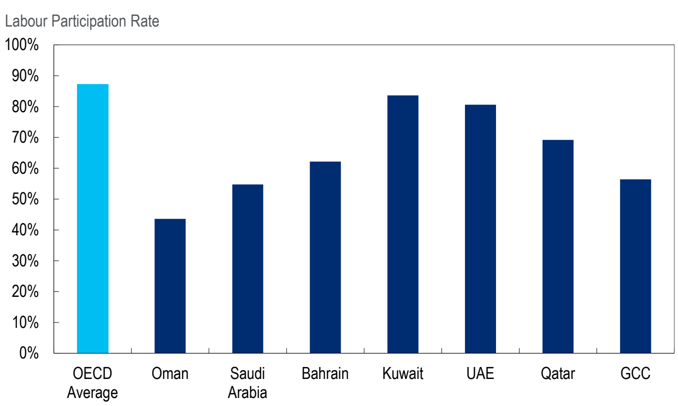
Source: Haver Analytics, Citi Research

Figure 64. Sharp rise in expenditures hurts government balance



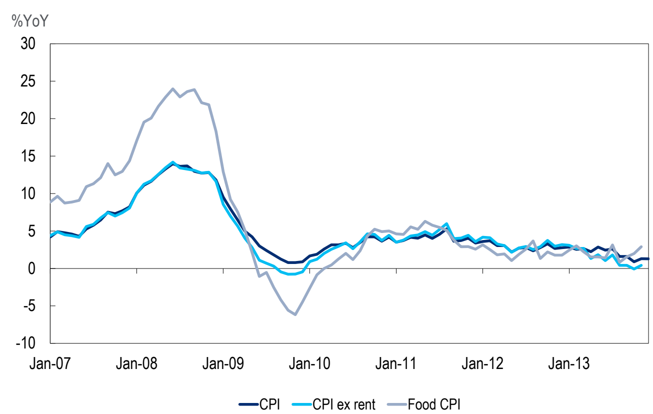
Source: Haver Analytics, Citi Research

Figure 65. Job participation lowest in GCC



Source: OECD, national statistics bureaus, Citi Research

Figure 66. Inflationary pressures remain subdued



Source: Haver Analytics, Citi Research

Figure 67. 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	87.0	93.8	100.3
Nominal GDP, local currency bn	16.2	23.4	18.6	22.5	26.7	29.8	33.5	36.1	38.6
GDP per capita, US$	15,326	20,887	18,015	17,438	16,881	16,180	25,157	25,968	26,565
Share of oil in GDP (real)	45.8	45.4	45.8	46.1	46.6	45.7	42.3	41.1	40.0
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	11.5	5.9	5.9
Real per capita GDP, % yoy	-2.7	3.4	2.7	1.4	-2.3	1.4	6.3	1.4	1.4
Real non-oil GDP, % yoy	11.0	10.8	5.6	4.7	6.1	6.9	8.0	8.0	8.0
Prices, Money & Credit									
CPI, % yoy	8.2	11.8	0.9	4.2	3.4	2.8	1.3	2.9	3.0
CPI, % avg	5.9	12.5	3.6	3.2	4.0	2.9	2.1	2.1	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	10.4	8.2	6.3
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	9.5	9.0	8.5
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	36.6	32.6	36.3	35.1	39.7	45.2	42.0	38.2	35.5
o/w oil revenues	28.3	26.0	28.2	28.6	33.8	38.4	34.1	32.0	29.4
Government expenditure	36.3	32.3	39.9	35.3	40.2	45.5	40.8	39.8	39.1
o/w capital expenditures	10.5	9.7	14.5	11.5	11.1	9.7	8.4	8.6	8.8
Government balance	0.2	0.3	-3.7	-0.2	-0.4	-0.3	1.2	-1.5	-3.5
non-oil balance, % of non-oil GDP	-48.8	-50.9	-51.0	-51.5	-63.7	-72.0	-63.6	-58.9	-54.5
Breakeven oil price (fiscal), US$/barrel	71.66	98.35	70.60	80.90	112.30	113.80	105.66	112.70	114.72
Public debt	6.9	4.8	6.0	6.1	7.2	8.8	6.5	7.0	6.5
Cumulative government balance since 2000	7.8	8.1	4.5	4.3	3.8	3.6	4.8	3.2	-0.3
Net debt (public debt net cumulative balance)	-0.9	-3.4	1.5	1.8	3.3	5.2	1.7	3.8	6.8
Foreign Assets & Liabilities, USD bn									
External debt	10.1	13.3	12.7	11.5	13.7	15.3	15.6	16.0	16.0
External debt / GDP	24.0	22.1	23.7	21.6	25.6	28.6	18.0	17.1	16.0
External debt / XGS	38.3	33.6	43.4	29.9	27.7	27.8	29.5	28.3	26.3
External Assets	17.0	22.0	21.4	27.2	36.2	44.3	53.4	61.0	67.3

Source: National Sources, Citi Research Estimates

Qatar

- **Key developments on the month**
  - Credit growth decelerates, but banking trends remain unfavourable;
  - Inflation remains subdued, but pressures from housing on the rise.
- **Key macro drivers**
  - Strong government expenditure to drive growth in the medium term;
  - Risk of misallocation of capital in aggressive project pipeline;
  - Proactive and wealthy government mitigates risks.

Summary Analysis

Credit growth has decelerated sharply

Credit growth in Qatar 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 5 months.

Slow-down 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. Headline inflation remained low, at 2.3% in January driven particularly by easing food and Entertainment, Recreation & Culture costs. However, the resurgence of inflation in the housing sector does indicate a potential acceleration in overall price levels going forward. Since the beginning of 2009, property prices and rents had been on a steady decline, keeping overall inflation subdued, and sometimes even negative. In the past 15 months, however, rent inflation has registered in positive territory on a YoY basis, although it has been steady in the 5% range. While we continue to see fundamental weakness in the real estate market emanating from a large supply overhang which will be exacerbated with the completion of further ambitious projects, prices have recovered in the past year, owing mainly to the surge in the Dubai property market, in our view, which acts as a weathervane for property investor sentiment in the region. We expect prices to continue to rise over a one- to two-year horizon, putting further upward pressure on CPI inflation going forward.

Too early to judge policy shifts from change in Emir

It has been over six months since the abdication of the former Emir, Sheikh Hamad bin Khalifa al Thani, in favour of his 33-year old son Sheikh Tamim. There has been little change in government policy since Sheikh Tamim's ascension (except with respect to Egypt, where policy was reversed by the change in government there). Indeed, as far as foreign policy is concerned, we perceive little change in the approach adopted by Sheikh Tamim.

One potential area of change is in domestic political reform

We believe that Sheikh Tamimwill faces significant pressure going forward to implement the 2003 constitution, and that this may increase execution risk on Qatar's project pipeline. In 2003, Qatar adopted a new constitution that called for a partially elected consultative council, but the vote has yet to be held. After several delays, the elections, which will see 30 of the 45 available seats publicly contended by universal suffrage, were due in the second half of 2013, but were further delayed in one of Sheikh Hamad's last acts as Emir. Constitutionally, the council's role is similar to Kuwait's national assembly, notably in its ability to monitor government through no-confidence votes. Kuwait's experience in recent years highlights the risk of political gridlock inherent in such a system, presenting a potential challenge for Sheikh Tamim and government policy in the medium term.

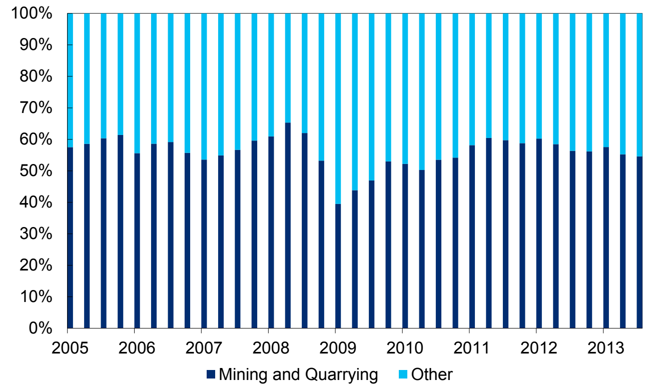
Housing sector should get support from World Cup, regional developments, but will remain plagued by oversupply, in our view

We believe the housing sector will get a boost from the substantial infrastructure spend that is under way in Qatar ahead of the 2022 World Cup. Moreover, insofar as property prices are correlated in the region, particularly in the Emirate states of the eastern peninsula (UAE, Qatar and Bahrain), we expect to see some support from developments in the Dubai property sector. That said, we believe overall pricing should remain soft due to the substantial supply overhang and risk of further large-scale development completions (see below). This should help contain inflationary pressures for the foreseeable future.

Construction leads growth as the gas sector levels off

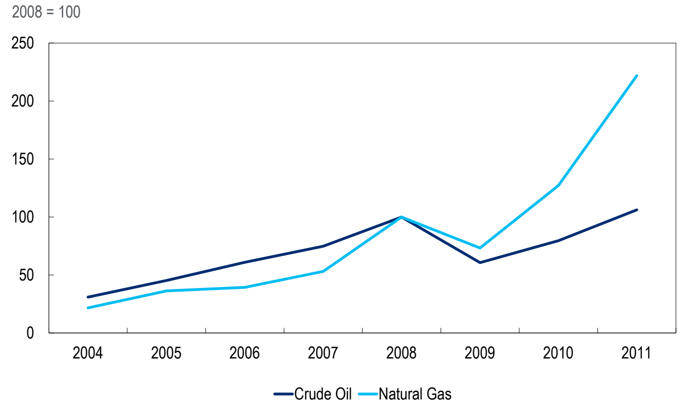
Available data suggest that construction and infrastructure development will be the key drivers of growth in the wider economy in the coming decade, as the oil sector levels off. Economic growth slowed sharply in the second quarter of 2012 to just 4.9%YoY, compared with 21% for the same period last year.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

Figure 68. Natural resources still a major part of activity



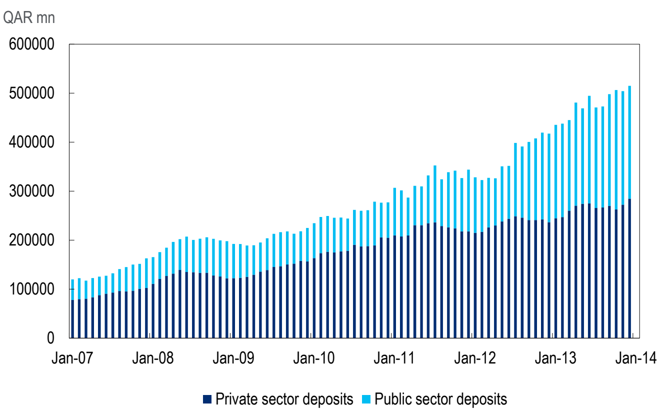
Source: Haver Analytics, Citi Research

Figure 69. But LNG IP surging relative to crude



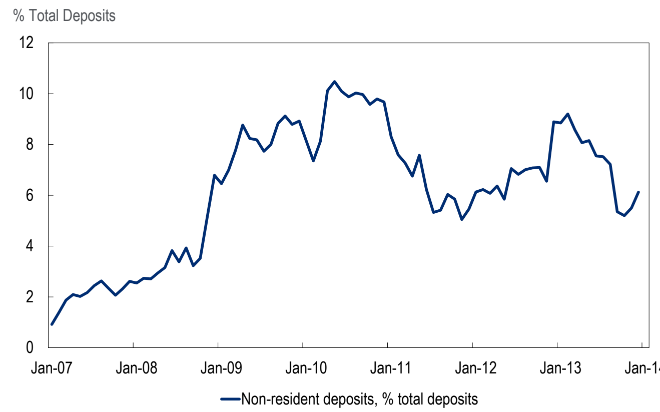
Source: Haver Analytics, Citi Research

Figure 70. Public sector deposits a major source of bank funding



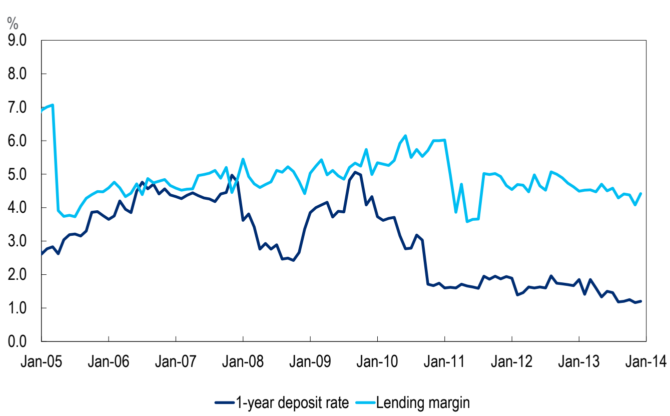
Source: Haver Analytics, Citi Research

Figure 71. Non-resident deposit growth has begun to ease



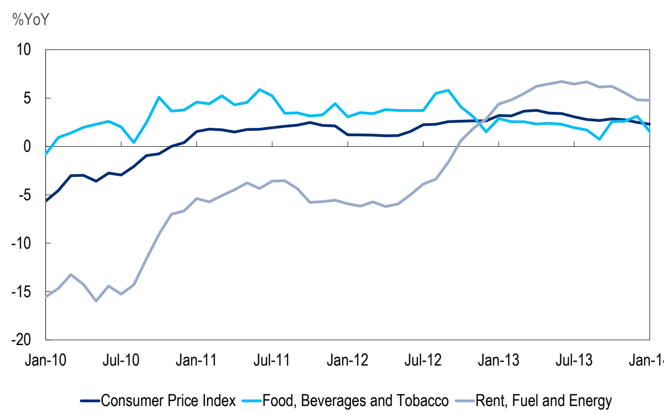
Source: Haver Analytics, Citi Research

Figure 72. Lending margins have stabilised



Source: Haver Analytics, Citi Research

Figure 73. Rising rent continues to put pressure on CPI



Source: Haver Analytics, Citi Research

Figure 74. 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	204.8	218.8	234.0
Nominal GDP, local currency bn	290.2	419.6	356.0	455.4	624.2	700.3	745.6	796.3	851.8
GDP per capita, US$	85,712	104,982	80,294	92,546	114,241	118,688	116,999	115,693	114,590
Share of oil in GDP (real)	44.7	43.0	40.2	44.4	45.5	43.5	41.2	38.9	36.7
Average oil production (mbpd)	-	-	-	-	-	-	-	-	-
Population, mn	0.9	1.1	1.2	1.4	1.5	1.6	1.8	1.9	2.0
Economic Activity									
Real GDP, % yoy	18.0	17.7	12.0	16.7	13.0	6.2	5.6	5.9	6.1
Real per capita GDP, % yoy	6.3	-0.3	0.9	5.2	1.7	-1.7	-2.2	-2.0	-1.8
Real non-oil GDP, % yoy	21.6	21.3	17.6	8.6	10.8	9.9	10.0	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	29.7	25.5	20.7
Trade balance	23.3	42.2	25.6	53.9	87.4	102.2	98.9	96.9	93.0
Exports	44.5	67.3	48.0	74.8	114.3	133.0	137.4	145.0	153.1
o/w oil, % total exports	86.4	88.2	85.7	82.6	85.3	82.2	77.6	72.4	66.1
Imports	21.1	25.1	22.5	20.9	26.9	30.8	38.5	48.1	60.1
Service balance	-3.9	-3.8	-3.9	-5.8	-9.5	-14.0	-15.4	-16.9	-18.6
Income balance	-4.2	-6.8	-9.4	-12.9	-13.3	-12.1	-12.7	-13.4	-14.0
o/w outward remittances, % GDP	5.6	4.7	7.3	6.5	6.0	5.6	6.0	6.5	7.0
FDI, net	-	-	-	-	-5.9	-2.2	-2.4	-2.6	-2.9
Public Finances, % of GDP									
Government revenues	40.6	33.6	47.5	34.3	35.7	40.0	39.1	38.6	37.8
o/w oil revenues	24.4	19.1	23.3	21.3	24.9	24.8	22.7	20.9	18.8
Government expenditure	29.7	23.8	34.2	31.6	27.9	28.2	31.0	34.4	36.6
o/w capital expenditures	11.7	8.0	11.0	9.7	8.1	7.3	7.2	7.4	7.6
Government balance	10.9	9.8	13.4	2.7	7.7	11.8	8.1	4.2	1.2
non-oil balance, % of non-oil GDP	-27.9	-20.6	-17.9	-39.3	-42.2	-30.8	-32.0	-33.5	-32.1
Public debt	8.2	9.2	34.9	42.9	37.9	36.3	38.2	37.4	36.7
Cumulative government balance since 2000	68.2	78.0	91.4	94.1	101.8	113.6	121.7	125.9	127.1
Net debt (public debt net cumulative balance)	-60.0	-68.9	-56.5	-51.1	-63.9	-77.3	-83.5	-88.4	-90.3
Foreign Assets & Liabilities, USD bn									
External debt	42.5	58.0	80.5	109.0	131.8	157.3	166.0	188.0	188.0
External debt / GDP	53.4	50.3	82.3	87.1	76.9	81.8	81.0	85.9	80.3
External debt / XGS	88.5	81.9	161.0	140.1	108.3	110.1	120.9	129.6	122.8
External Assets	45.2	71.8	78.2	102.0	153.9	216.3	277.2	332.9	381.4

Source: National Sources, Citi Research Estimates

Saudi Arabia

- **Key developments on the month**
  - Potential rise in oil production in Iraq and Iran spell downside risks to Kingdom;
  - Public finances to remain robust, but longer-term concerns emerge;
  - Enforcement of Nitiqat in full swing.
- **Key macro drivers**
  - Government expenditure remains key economic driver;
  - Demographic imbalance necessitates push on labour reform;
  - Mortgage law expected to unleash pent-up demand in housing and beyond.

Summary Analysis

Risks to oil production and forecasts from regional developments

Oil production declined in the final months of 2013, bringing the yearly average production to 9.5mbpd, in line with our forecasts. We expect production to decline slightly in 2014, and we are forecasting an average for 2014 of 9.2mbpd. The drop in production will reflect the slight softening in oil prices that we are forecasting going forward, along with increased production elsewhere in the region, most notably Iraq, where we anticipate an increase of around 500kbpd in exports next year. The ongoing talks between the P5+1 and Iran may, in our opinion, result in an easing of some sanctions on oil exports. If this were to happen, it would represent an additional down-side risk to Saudi production and our economic forecasts.

Public finances will remain strong in near term

That said, public finances and external balances are expected to remain robust in the near term: we forecast the current account surplus to remain in double digits in 2014, while we expect the fiscal surplus to narrow from around 7.4% this year to a still healthy 5% in 2014. That said, we think rising expenditures and an expected leveling off in oil revenues present a challenge in the medium- to long-term. We expect the fiscal breakeven oil price to rise to over US$90 per barrel in 2014 and to continue to rise, resulting in forecast deficits as early as 2016. Although Saudi has ample resources to finance expected deficits from current cash reserves, the outlook does underscore the need for structural reform to set public finances on a long-term sustainable footing.

Consumer spending still growing strongly

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

Nitiqat programme one factor behind surge in consumer growth

The rise in consumer spending does also reflect the government's drive to raise domestic standard of living. Shortly after the outbreak of regional unrest, King Abdullah announced a slew of social spending and reforms aimed at increasing Saudi employment and income. These range from wage rises in the public sector to unemployment benefits under the Hafiz programme, all of which are fuelling a rise in consumer spending. Perhaps the most profound reform taking place, however, is that of the Saudi labour market, which, under the guise of the Nitiqat programme, has begun an aggressive programme of Saudization in the past year.

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

Since the Nitiqat programme was introduced, two things have happened. First, the drive to register all foreign labour has resulted in the forced exit of over a million illegal immigrants from the Kingdom, according to the minister of labour. This process stepped up a gear after the grace period ended in November, and security forces have begun a widely reported campaign of rounding up suspected illegal immigrants, in some cases leading to violent confrontations. These first aftershocks have led to more undocumented migrants handing themselves in to the authorities for deportation. There are currently many 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.

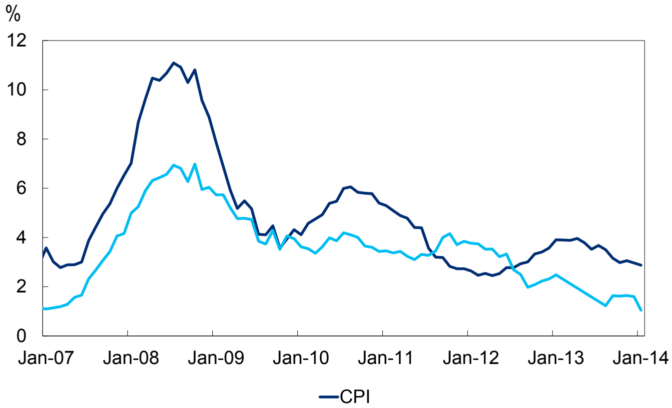
Nitiqat policy necessary, if controversial

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

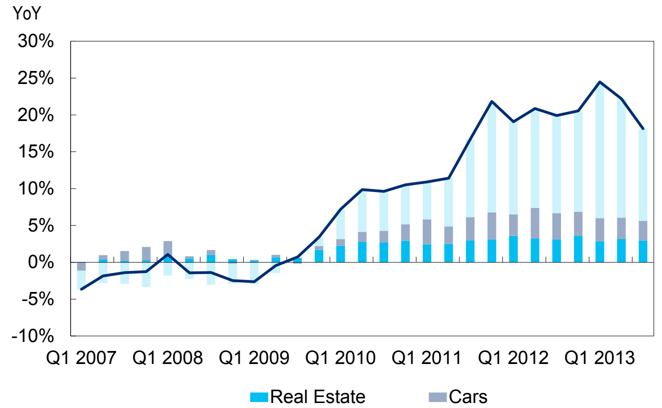
Inflation continued to decline in January to 2.9%YoY from the recent high of 4% in Q2 2013 driven primarily by easing food price costs. We are expecting inflation for full year 2014 to come in at 3.4%; roughly unchanged from the 2013 rate of 3.5%, with price growth picking up close to 4% in 2015.

Figure 75. Inflation remains subdued



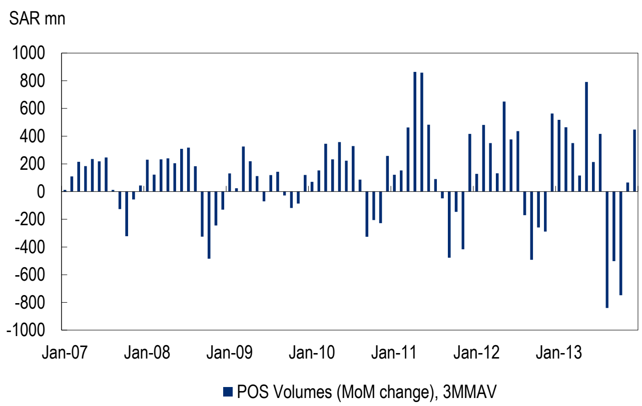
Source: Haver Analytics, Citi Research

Figure 76. Consumer lending has eased recently



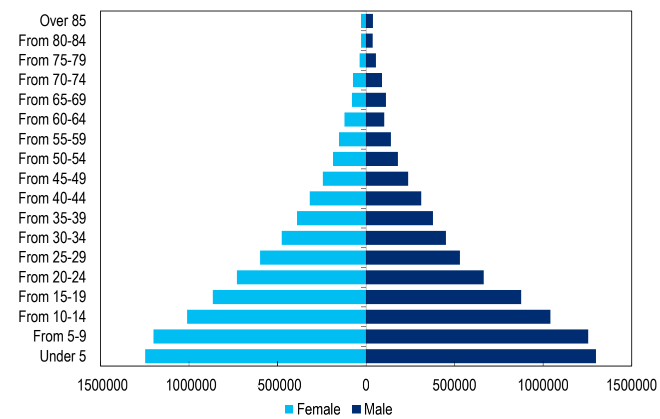
Source: Haver Analytics, Citi Research

Figure 77. Point of sales transactions remain robust



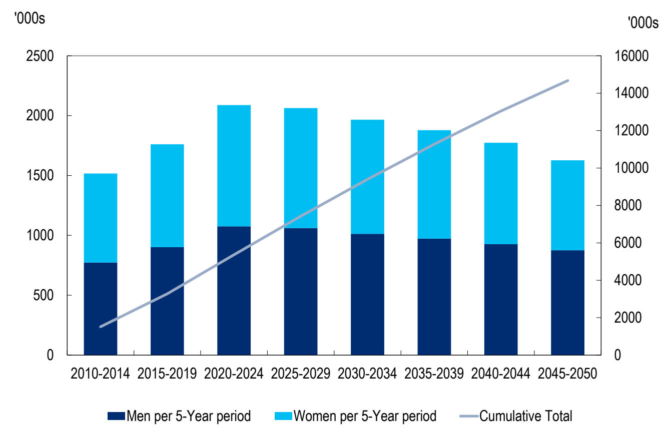
Source: Haver Analytics, Citi Research (3MMA)

Figure 78. Demographic imbalance is acute



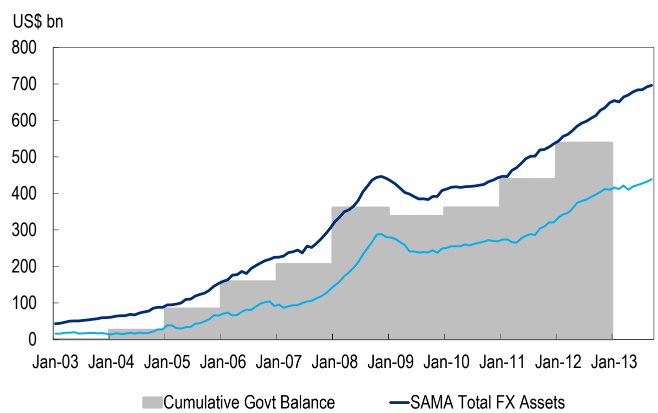
Source: SAMIRAD, Citi Research

Figure 79. Almost 2 million people coming to job market every 5 years



Source: SAMIRAD

Figure 80. Government assets stand at around US$500bn



Source: Haver Analytics, Citi Research

Figure 81. 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	739.3	773.5	818.8
Nominal GDP, local currency bn	1,558.8	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,772.8	2,901.3	3,071.1
GDP per capita, US$	17,111	20,861	16,811	20,178	25,645	27,559	27,220	27,921	28,976
Share of oil in GDP (real)	25.4	24.4	22.0	20.7	21.2	21.3	20.0	18.6	17.1
Average oil production (mbpd)	8.69	9.21	8.05	8.25	9.24	9.77	9.50	9.20	9.00
Population, mn	24.3	24.9	25.5	26.1	26.1	26.6	27.2	27.7	28.3
Economic Activity									
Real GDP, % yoy	6.0	8.4	1.8	6.4	8.6	5.1	3.7	4.2	6.1
Real per capita GDP, % yoy	3.4	5.8	-0.6	4.0	8.6	3.1	1.7	2.1	4.0
Real non-oil GDP, % yoy	10.0	9.8	5.3	9.6	8.0	4.9	5.5	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	-	-	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	134.5	106.4	75.8
% of GDP	22.7	25.6	5.0	12.8	23.8	22.6	18.2	13.7	9.3
Trade balance	151.6	212.7	105.8	154.3	245.5	247.5	221.7	201.3	178.5
Exports	233.1	313.4	192.2	251.0	364.5	388.2	383.5	387.4	392.4
o/w oil, % total exports	88.1	89.7	84.8	85.8	87.1	87.0	82.9	77.9	71.7
Imports	81.5	100.6	86.4	96.7	119.0	140.7	161.8	186.0	213.9
Service balance	-46.7	-65.9	-65.2	-66.1	-66.5	-62.4	-68.6	-75.5	-83.0
Income balance	6.4	9.2	8.6	7.0	9.7	11.0	9.1	9.1	9.2
o/w outward remittances, % GDP	-3.8	-4.0	-6.0	-5.0	-4.1	-3.9	-3.5	-3.5	-3.3
FDI, net	24.2	43.0	38.6	33.1	19.7	16.6	18.2	20.1	22.1
Public Finances, % of GDP									
Government revenues	42.2	57.5	34.0	39.4	46.1	47.1	40.8	41.9	37.9
o/w oil revenues	36.1	50.4	27.0	33.9	41.2	41.6	38.9	35.3	31.1
Government expenditure	29.9	26.7	37.1	33.1	32.9	31.7	33.4	36.8	37.5
o/w capital expenditures	7.6	6.7	11.2	10.1	11.0	9.5	10.6	11.3	11.8
Government balance	12.2	30.8	-3.0	6.3	13.2	15.4	7.4	5.1	0.4
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	91.88	101.30
Public debt	11.7	12.4	11.3	10.9	8.3	8.0	7.2	6.2	5.2
Cumulative government balance since 2000	62.1	92.9	89.9	96.2	109.4	124.8	132.2	137.4	137.7
Net debt (public debt net cumulative balance)	-50.4	-80.5	-78.6	-85.4	-101.1	-116.8	-125.1	-131.2	-132.5
Foreign Assets & Liabilities, USD bn									
External debt	75.8	83.2	89.4	93.7	90.1	87.8	90.4	90.5	95.0
External debt / GDP	18.2	16.0	20.8	17.8	13.5	12.0	12.2	11.7	11.6
External debt / XGS	30.4	25.8	44.3	35.8	24.0	22.0	23.6	23.4	24.2
External Assets	308.7	441.0	462.0	528.7	688.1	853.7	988.3	1,094.7	1,170.5

Source: National Sources, Citi Research Estimates

United Arab Emirates

- **Key developments on the month**
  - Expo 2020 could fuel real estate volatility;
  - Dubai Group concludes restructuring, risks linger in Dubai public debt;
  - Sharjah gets an Investment Grade rating.
- **Key macro drivers**
  - Abu Dhabi fiscal strength supportive of long-term growth;
  - Dubai's hub position to drive long-term growth;
  - Dubai exposed to turn in global conditions.

Summary Analysis

Expo could fuel real estate volatility in Dubai

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

We believe hosting the event will provide stimulus to the economy

We believe hosting the event will provide stimulus to the economy in the construction phase (2015-2020) and during the event itself, and could also enhance Dubai's global brand, further reinforcing its strong position as regional hub.

That said, we caution against overstating the economic benefits of hosting the Expo.

That said, we caution against overstating the economic benefits of hosting the Expo. We expect direct expenditure on the event to amount to around a relatively modest 1% of GDP per year between now and 2020. However, the effectiveness of the impact of this expenditure on the local economy is likely to be limited and short-lived, as the majority of contractors and workers preparing and managing the event will be foreign. Moreover, we think the government expenditure directed towards the expo will need to be diverted, at least in part, from other areas of spending to avoid an excessive build-up of debt. Finally, the legacy economic value of the event is highly uncertain, as the unutilised buildings from the Shanghai World Expo 2010 attest.

Tourism impact will be pronounced

The event will be held during the peak tourism season between October 2020 and April 2021, and the authorities are expecting around 18m foreign visitors. At the current rate of growth, Dubai's existing tourism infrastructure (including hotels and transportation) will be capable of accommodating this level of visitors, particularly as Abu Dhabi will provide additional capacity. In our view, the visitor numbers will not be a net increase in tourism – much non-Expo related tourism is likely to be squeezed out by the event. Effectively, Expo should mean a bumper tourism season of close to 100% occupancy, but Dubai runs at remarkably high occupancy levels during the peak season anyway, so the overall impact should be somewhat less than the visitor numbers imply. According to data from Ernst &

Young, occupancy barely dips below 80% on average throughout the year. There are significant declines to 50-60% occupancy during the hot summer months of July and August, but these are almost immediately followed by strong rebounds back to the 80% territory for the rest of the year. More remarkable is that the average price per room has not only recovered to levels prior to the Arab Spring but is now at an almost five-year high.

Dubai Group concludes debt restructuring

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

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

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

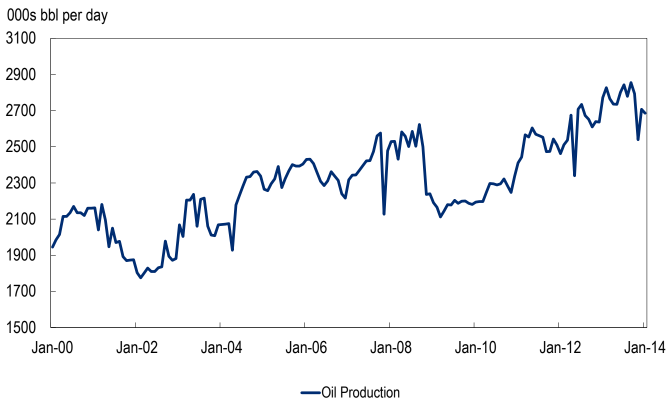
Sharjah gets a rating

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

IG ratings flatter debt bearing capacity of Sharjah

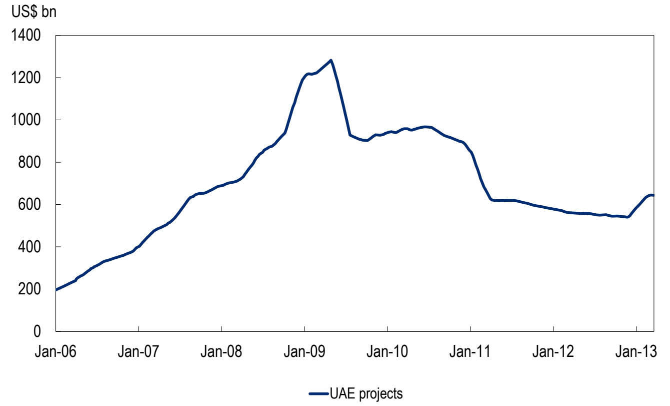
That said, we believe that the solid investment-grade rating for Sharjah flatters its debt-servicing capacity. Sharjah's economy is one-fifth that of Dubai's, its government revenues are one-tenth those of Dubai's and its ability to raise revenues is greatly restricted by the federal structure and the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

Figure 82. Abu Dhabi oil output has increased through 2013



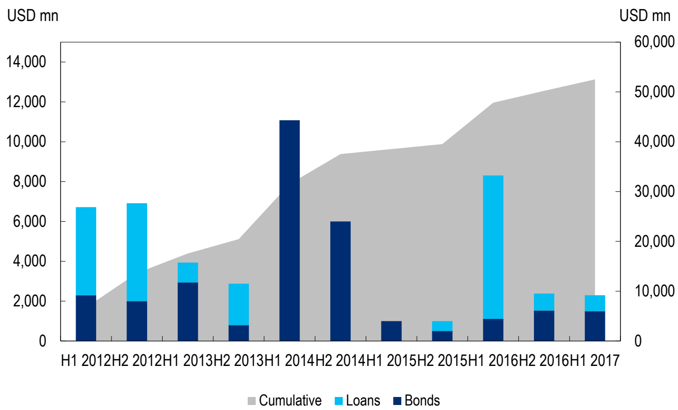
Source: Bloomberg

Figure 83. Value of projects under way has begun to pick up in the UAE



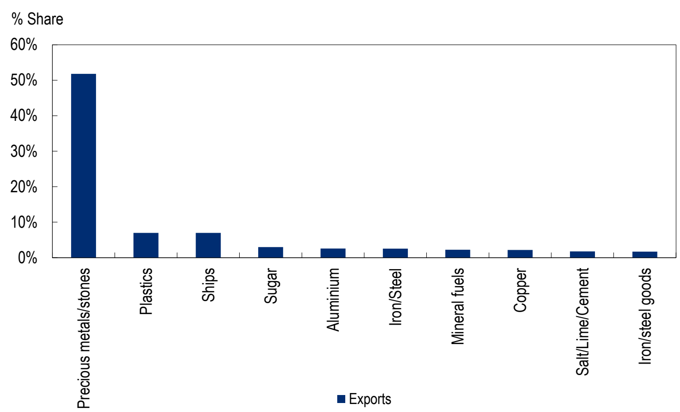
Source: MEED, Citi Research (12-wk moving average)

Figure 84. Dubai's debt refinancing requirements are lumpy



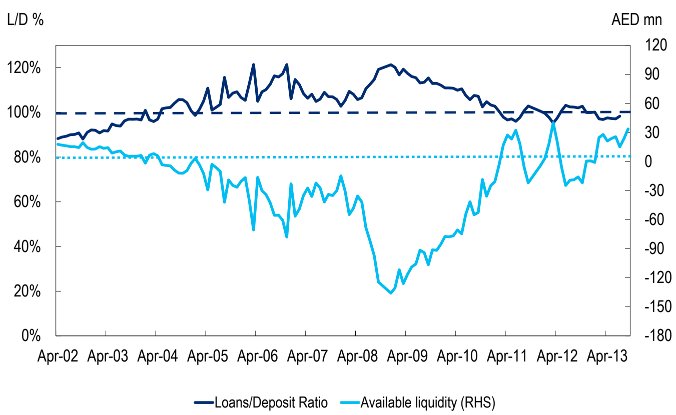
Source: Bloomberg, Dealogic, Citi Research

Figure 85. Gold dominates UAE non-oil exports



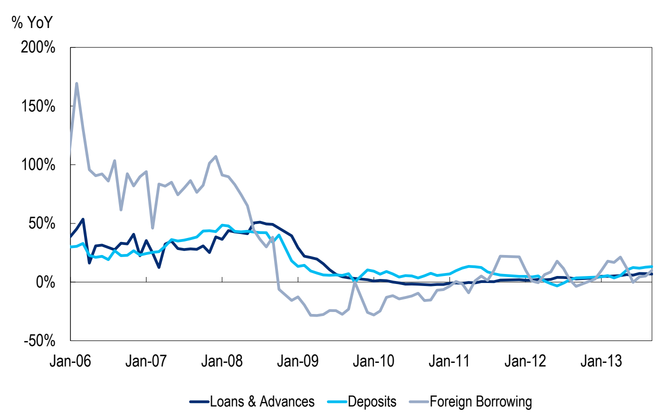
Source: National Bureau of Statistics (2010)

Figure 86. Bank liquidity is much improved, despite a recent fall



Source: Haver Analytics, Citi Research

Figure 87. External leverage has been in decline since 2008



Source: Haver Analytics, Citi Research

Figure 88. 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	-	192.0	145.8	-	230.5	-	-	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$	-	105,107.0	74,077.5	-	106,266.5	-	-	104,986.6	102,098.8
Share of oil in GDP (real)	56.4	57.0	51.6	51.8	52.9	52.0	50.9	49.6	48.4
Average oil production (mbpd)	2.4	2.5	2.2	2.3	2.5	2.6	2.6	2.6	2.6
Population, mn	1.7	1.8	2.0	2.1	2.2	2.3	2.4	2.5	2.6
Real GDP, % yoy	5.4	6.4	-4.9	6.5	9.3	5.6	4.2	3.7	2.5
Real per capita GDP, % yoy	-2.1	-1.2	-11.7	1.4	4.1	0.6	-0.8	-1.2	-2.4
Real non-oil GDP, % yoy	8.9	4.9	6.9	6.1	6.7	7.7	6.5	6.5	5.0
Government revenues	41.4	47.4	36.4	37.9	40.2	39.4	38.6	37.5	36.2
o/w oil revenues	22.3	17.6	29.2	27.0	23.8	23.4	23.4	23.3	23.5
Government expenditure	22.3	17.6	29.2	27.0	23.8	23.4	23.4	23.3	23.5
o/w capital expenditures	0.9	1.9	5.2	4.2	3.2	3.2	3.2	3.3	3.3
Government balance	19.1	29.8	7.2	10.9	16.4	16.0	15.2	14.2	12.7
non-oil balance, % of non-oil GDP	-26.9	-20.4	-28.1	-30.8	-33.9	-32.2	-29.3	-26.6	-24.3
Breakeven oil price (fiscal), US$/barrel	27.5	22.0	42.7	47.3	52.0	52.1	51.5	51.4	51.2
DUBAI									
Nominal GDP, US$ 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	1.1	2.0	1.3	1.6
CPI, % avg	11.1	12.3	1.6	0.9	0.9	0.7	1.5	1.3	1.6
Policy interest rate, %, eop	-	1.50	1.00	1.00	1.00	1.00	1.00	1.00	1.25
Credit extension to private sector, % yoy	43.3	48.5	-0.8	-0.4	1.4	-0.3	5.0	7.0	7.0
Credit to private sector, % total deposits	68.6	80.0	73.7	68.7	68.3	62.4	59.6	58.0	56.4
Private sector deposits, % yoy	48.2	25.2	4.9	7.1	3.6	-1.2	10.0	10.0	10.0
Bank capital & reserves, % total loans	20.9	17.9	25.5	28.1	28.3	29.1	30.1	30.7	31.3
3 month inter-bank rate, %, eop	-	-	1.89	2.14	1.52	1.30	0.81	1.60	1.75
AED/US$, eop	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
AED/US$, avg	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
Balance of Payments, USD bn									
Current account	15.5	22.7	7.9	7.4	74.3	108.6	107.3	93.8	80.0
% of GDP	6.0	7.2	3.1	2.6	21.3	28.3	26.2	21.4	17.0
Trade balance	46.5	62.9	42.1	49.0	129.2	168.7	171.4	164.9	158.9
Exports	178.6	239.2	191.8	213.5	302.0	350.1	371.0	394.4	422.8
o/w oil, % total exports	41.3	42.7	35.4	35.0	37.0	33.7	31.2	28.8	25.6
Imports	132.1	176.3	149.7	164.6	172.8	181.4	199.6	229.5	263.9
Service balance	-26.0	-33.8	-27.3	-30.4	-43.7	-48.9	-53.7	-59.1	-65.0
Income balance	4.2	4.2	3.3	0.1	0.1	0.1	2.0	1.6	1.2
o/w outward remittances, % GDP	3.4	3.2	3.7	3.7	3.2	3.2	3.2	3.2	3.2
FDI, net	-0.4	-2.1	1.3	3.5	5.5	6.7	3.0	3.0	3.0

Source: National Sources, Citi Research Estimates

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Figure 89. 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	3.1	3.2	2.7	2.2	1.1	1.5	1.7	2.2	2.3	2.2	-2.2	-2.0	-1.5	-1.8	-1.7	-1.4	-5.7	-3.9	-3.0	-3.4	-3.4	-3.8	NA	NA	NA	NA	NA	NA
Japan	1.6	1.2	1.0	1.2	1.2	1.0	0.4	2.8	1.6	1.6	0.7	1.0	0.6	0.2	0.1	0.8	1.0	1.0	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	98	106	112	115	115	115
Euro Area	-0.4	1.1	1.3	1.5	1.6	1.6	1.4	0.7	0.7	1.0	1.2	1.5	2.2	2.5	2.6	2.6	2.5	2.3	-2.9	-2.4	-2.1	-1.7	-1.5	-1.1	0.75	0.72	0.71	0.71	0.71	0.71
Canada	1.8	2.3	2.7	2.7	2.6	2.4	0.9	1.7	1.8	2.0	2.0	2.0	-3.3	-2.5	-2.4	-2.0	-1.8	-1.9	-0.9	-0.1	0.3	0.4	0.4	0.4	1.03	1.14	1.15	1.14	1.13	1.11
Australia	2.4	2.9	2.8	2.9	3.0	3.2	2.4	3.2	2.1	2.5	2.4	2.4	-3.0	-3.0	-3.1	-3.3	-3.7	-3.6	-1.2	-3.0	-2.1	-1.4	-1.0	-1.5	1.03	1.14	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	-3.3	-4.2	-5.4	-5.0	-5.4	-6.6	-2.9	-1.6	-0.4	0.5	1.2	2.2	1.22	1.19	1.18	1.20	1.25	1.30
Germany	0.5	2.0	2.1	2.0	1.8	1.6	1.5	1.5	1.9	1.9	1.8	1.9	7.3	6.3	5.5	5.1	4.7	4.4	0.0	0.0	0.0	-0.1	-0.4	-0.5						
France	0.3	0.9	1.1	1.5	1.7	1.8	1.0	1.0	1.2	1.4	1.3	1.5	-1.5	-0.8	-0.1	0.4	0.1	-0.2	-4.1	-3.6	-3.1	-2.8	-2.3	-1.8						
Italy	-1.9	0.3	0.3	0.6	0.6	0.7	1.3	0.3	-0.3	0.4	1.1	1.4	0.9	1.3	1.6	1.9	2.2	2.4	-3.1	-2.8	-2.4	-2.0	-1.8	-1.4						
Spain	-1.2	0.9	1.1	1.5	1.4	1.5	1.5	-0.1	0.0	0.1	0.5	0.9	0.6	0.7	0.7	0.5	0.5	0.6	-6.9	-5.8	-4.6	-3.5	-2.9	-2.4						
Greece	-3.7	-1.0	0.4	0.9	1.4	1.4	-0.9	-2.3	-2.1	-1.3	-0.3	0.9	0.7	1.9	2.4	2.8	3.2	3.1	-3.7	-3.7	-2.7	-2.5	-2.1	-1.9						
Ireland	0.1	2.2	2.3	2.6	2.7	2.9	0.7	0.8	1.0	1.1	1.6	1.7	8.4	8.7	7.8	6.9	6.1	5.4	-7.1	-5.0	-2.9	-2.2	-1.6	-0.9						
Portugal	-1.4	1.5	1.2	1.1	1.2	1.3	0.4	-0.6	-0.9	-0.1	0.7	1.0	0.4	2.2	2.5	2.6	2.7	2.7	-5.5	-4.5	-3.4	-2.5	-1.9	-1.7						
Netherlands	-0.8	1.0	0.9	1.2	1.6	1.9	2.6	0.8	1.3	1.4	1.5	1.8	10.2	9.9	8.9	8.4	7.9	7.5	-3.8	-3.4	-2.8	-2.2	-1.2	0.0						
Belgium	0.2	1.2	1.3	1.4	1.9	2.1	1.1	0.9	1.0	1.1	1.6	2.0	-1.7	-0.1	0.6	0.8	0.6	0.4	-3.1	-2.7	-1.6	-1.0	-0.5	0.1						
Switzerland	2.0	2.0	2.0	2.2	2.0	2.0	-0.2	-0.2	0.9	1.1	1.2	1.2	12.2	12.9	12.7	13.7	14.0	14.0	0.2	0.6	0.8	1.2	1.2	0.9	0.93	0.90	0.91	0.91	0.91	0.91
China	7.7	7.3	7.0	7.5	7.3	7.0	2.6	3.2	3.7	3.8	4.0	3.8	2.2	2.0	1.5	0.8	0.5	0.5	-2.0	-2.0	-1.5	-1.5	-1.5	-1.5	6.15	6.02	6.00	6.01	6.03	6.05
India	4.9	5.6	6.2	6.6	6.9	7.0	6.0	5.5	5.0	4.5	4.5	4.5	-2.0	-2.3	-2.2	-2.2	-2.3	-2.3	-6.9	-6.7	-6.5	-6.2	-5.9	-5.5	58.6	63.0	63.5	61.5	58.5	55.4
Indonesia	5.8	5.3	5.5	5.7	5.9	5.7	6.4	6.5	5.7	5.4	5.3	5.5	-3.3	-2.5	-2.1	-1.7	-1.5	-1.6	-2.2	-2.2	-1.7	-1.9	-2.0	-2.0	10449	12108	12083	11598	10765	9933
South Korea	2.8	3.7	3.9	4.0	3.6	3.8	1.3	2.1	3.1	3.1	3.0	2.9	5.9	4.1	3.3	2.5	1.7	0.7	0.9	1.0	1.6	1.9	2.1	1.8	1095	1071	1062	1040	1019	998.7
Poland	1.6	3.4	3.6	3.6	3.5	3.2	2.6	1.5	2.8	2.7	2.5	2.5	-1.5	-2.5	-3.6	-4.4	-4.6	-4.3	-4.2	5.7	-2.3	-2.2	-2.2	-2.2	4.20	4.23	4.20	4.07	4.00	3.93
Russia	1.3	2.6	2.7	2.9	3.0	3.0	6.8	5.7	4.9	4.7	4.5	4.2	1.6	1.2	0.9	-0.4	-1.4	-2.5	-2.0	-4.3	-4.9	-1.4	-1.4	-1.4	31.9	37.4	38.1	38.0	38.0	38.0
Turkey	4.0	2.3	3.5	3.9	4.1	4.1	7.5	7.7	7.4	6.8	6.5	6.1	-7.8	-5.2	-5.3	-5.5	-5.4	-5.3	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	1.91	2.36	2.46	2.42	2.25	2.09
South Africa	1.9	2.4	2.9	3.2	3.4	3.2	5.8	6.1	5.7	5.9	6.2	5.5	-5.8	-4.7	-4.2	-3.7	-3.1	-2.9	-4.2	-4.2	-4.3	-3.8	-3.0	-2.1	9.65	11.48	11.58	11.23	10.66	10.09
Argentina	4.9	1.0	1.5	-2.0	3.5	3.0	10.6	25.6	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	31.0
Brazil	2.1	1.3	1.8	2.5	3.0	3.0	6.2	6.0	6.0	5.6	5.5	5.5	-3.7	-3.9	-3.8	-3.8	-3.7	-3.7	-3.3	-3.7	-2.8	-3.1	-3.1	-3.1	2.16	2.59	2.79	2.75	2.54	2.33
Mexico	1.1	3.8	4.0	4.4	4.5	4.6	3.8	4.3	3.7	3.6	3.6	3.6	-1.7	-2.0	-1.7	-1.4	-1.5	-1.5	-2.4	-3.5	-2.5	-2.0	-2.0	-2.0	12.8	13.2	12.9	12.6	12.5	12.4
Venezuela	1.5	-1.0	1.9	1.9	1.9	1.9	38.5	63.2	81.4	60.0	60.0	60.0	3.3	4.0	5.1	3.0	3.0	3.0	-11.9	-11.1	-10.3	-12.0	-12.1	-11.5	5.99	10.58	19.80	31.28	49.43	78.10
Bahrain	4.3	4.0	4.1	4.1	4.1	4.2	3.3	2.4	2.0	2.0	2.0	2.0	5.3	2.4	-1.5	-5.9	-8.7	-9.6	-2.2	-3.3	-5.5	-7.9	-9.9	-10.9	0.38	0.38	0.38	0.38	0.38	0.38
Egypt	2.0	2.9	3.4	4.1	4.5	4.0	9.5	8.7	7.0	9.0	11.2	10.5	-1.7	-1.3	-2.2	-3.4	-3.5	-3.1	-12.7	-12.0	-9.9	-8.2	-7.1	-6.8	6.87	7.16	7.54	7.76	8.16	8.59
Iraq	3.1	10.4	11.6	8.2	7.9	7.6	1.9	4.5	6.0	6.0	6.0	6.0	13.5	13.8	12.8	9.1	6.3	5.1	-0.6	2.0	2.9	0.9	-0.2	0.4	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	1.2	1.9	1.7	2.8	3.9	4.1	-2.7	-3.0	-2.5	-2.5	-2.5	-2.5	3.61	3.56	3.75	3.78	3.63	3.48
Jordan	3.0	4.0	4.5	4.3	4.1	4.0	5.5	3.7	5.0	5.0	5.0	5.0	-15.2	-14.2	-11.9	-9.7	-7.5	-5.3	-8.2	-10.1	-9.9	-9.7	-9.5	-9.3	0.71	0.71	0.71	0.71	0.71	0.71
Kuwait	4.3	3.9	3.9	2.8	2.8	2.8	2.6	3.1	5.0	5.0	5.0	5.0	51.0	49.5	47.8	43.4	40.0	38.8	26.8	27.0	21.0	16.9	13.2	11.2	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	3.7	5.0	5.0	5.0	5.0	-4.5	-5.3	-6.0	-6.8	-5.2	-3.8	-10.0	-9.3	-8.7	-8.0	-6.9	-5.8	1507	1508	1508	1508	1508	1508
Oman	11.5	5.9	5.9	6.0	5.4	4.2	2.1	2.1	3.0	3.0	3.0	3.0	10.4	8.2	6.3	4.2	3.6	5.0	1.2	-1.5	-3.5	-6.0	-7.7	-8.0	0.38	0.39	0.39	0.39	0.39	0.39
Qatar	5.6	5.9	6.1	6.3	6.6	6.8	3.1	2.5	3.5	4.5	5.0	5.0	29.7	25.5	20.7	15.4	9.7	5.2	8.1	4.2	1.2	-2.4	-5.3	-5.9	3.64	3.64	3.64	3.64	3.64	3.64
Saudi Arabia	3.7	4.2	6.1	6.6	6.7	6.8	3.5	3.5	4.1	4.3	4.6	5.0	18.2	13.7	9.3	5.5	3.4	3.4	7.4	5.1	0.4	-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	1.5	1.3	1.6	1.9	2.2	2.7	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 Forecasts. Note: We use PCE Deflator for the US

Notes

Notes

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Appendix A-1

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