TRIP NOTE: QATAR

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GlobalEvolution

GLOBAL EVOLUTION TRIP NOTE

We visited Qatar as part of a longer GCC trip, which also included visits to Bahrain and Oman. The day in Doha included meetings with the Ministry of Finance, local banks and members of the US embassy. The relevance of the trip to Doha came after the blockade from its neighbors and the recent political tensions in the region.

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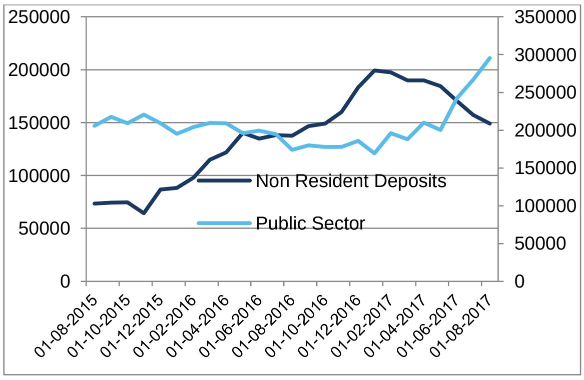
Blockade

The Blockade has had limited impact while forcing workarounds and a push towards self-suficiency

On the 5th of July, 2017 political tensions erupted between Qatar and some other GCC countries, namely Saudi Arabia, Bahrain and the UAE. Consequently, transfers of goods, capital and people were blocked. Oman and Kuwait remain neutral in the dispute. The immediate impact for Qatar was a rerouting of flights out of Doha but also a rerouting of land and sea trade. Consequently, flight routes over UAE and Saudi were rerouted through Iranian airspace and Iran reportedly has charged an abnormal large fee of USD 2000 per flight. The blockade has also lead to import substitution away from other GCC countries and towards Iran, Turkey and certain European countries. This establishment of new trade routes and import substitution has had limited fiscal impact. The fiscal deficit for 2017 will likely be around 5% of GDP as the expected peak in capex spending will be 2017/2018 (projects in gas, infrastructure and preparations for the FIFA World Cup). Nevertheless, the estimated breakeven oil price in 2018 is USD 45-50/bbl, which is the lowest in the region.

A larger impact of the blockade was seen in the banking sector. The sector saw a USD 30bn outflow from non-residential deposits between June and September. The government reacted by covering the deposits via the QIA (Qatar Investment Authority) thereby leaving net-liquidity in the banking sector unchanged (see chart 1).

Chart 1: The blockade's effect on deposits in Qatar. Numbers in millions of Qatari Riyal



Source: Bloomberg

Exports, especially gas to the UAE through the Dolphin pipeline has remained unchanged as the UAE has no interest in cancelling this trade agreement. In fact, more than 30% of UAE's electricity production is based on gas coming from Dolphin/Qatar.

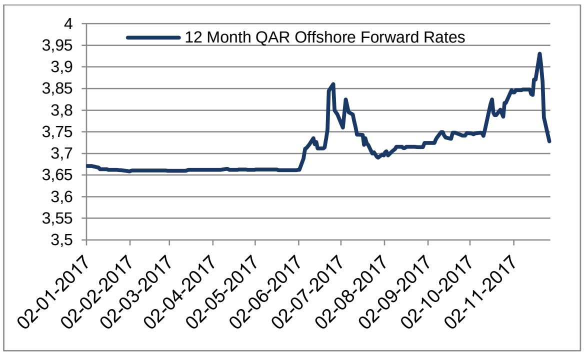
The overall feeling from visiting Qatar is that the blockade has had limited impact on the economy and the fiscal position. The blockade seems to have generated an increased national pride and people are clearly standing behind the Emir of Qatar.

Currency:

Pressure has been building on the Qatari Riyal but it now seems to be easing

Qatar, like the rest of GCC, has pegged their currency to the USD. The peg has received some attention after non-residents pulled liquidity from the banking sector (see chart 2).

Chart 2: Blockade effect on the offshore QAR market



Source: Bloomberg

The QAR came under immediate pressure as the blockade was announced and pressure has continued due to low possibility of a quick resolution. The local banks told us that the Central Bank has withdrawn from the offshore market in order not to provide dollars to what it considers speculators or manipulators. We were told that the liquidity of the offshore market was very limited. Onshore dollar liquidity is good, though, and domestic dollar demand is being honored as long as it is deemed legitimate (not allowing domestic speculation and currency manipulation). Legitimate private and corporate sector dollar demand is fixed at the official onshore rate. A recent decrease in the onshore forward rate towards the peg-level is supporting the notion that dollar liquidity is ample and available for what is deemed legitimate purposes.

Future Projects:

Massive expansion of gas production will be a medium term benefit

We met with Qatar Petroleum (QP) who explained their plan for future gas production in the country. QP is already the largest producer of LNG in the world but plan to expand output capacity by 30% over the coming 6 to 7 years. Such a large capex program and thus production increase in the gas sector will most likely deter competitors from large investments in the sector and leave Qatar's position unabated. Elsewhere, recent new LNG projects in Australia and the US are coming on line at the moment but due to the decline in energy prices since 2014, a lot of future projects have been cancelled which will allow Qatar to position itself for the future.

Qatar has pushed for more diversified and self-sufficient economy, especially after the blockade. New port and bunkering facilities are coming due to ensure that the maritime reliance on GCC countries will be limited in the future. The Qataris have also pushed for more self-sufficiency by importing cows and chickens to farm domestically. Currently 4000 cows have been imported and 10,000 more are planned next year allowing Qatar to become self-sufficient in dairy production. Previously dairy was imported from Saudi Arabia.

Conclusion:

The economy has rebounded after the initial shock following the blockade and a pipeline of future gas production will ensure a growing economy

Overall Qatar has handled the blockade well and the economy has recovered following the initial shock. We see no major impact of the blockade on the fiscal position. Only area of concern has been the currency market, as the authorities are trying to limit the supply of dollars to avoid speculation and currency manipulation. Based on our findings it seems that dollar liquidity is provided if the underlying purpose is deemed legitimate. That being said, every stakeholder we met on the trip agreed that the conflict will last for months, maybe years. The Qataris are planning for this and are apparently not considering reconciliation with its neighbors. Considering the new domestic projects and reserves of around 250% of GDP we feel the Qataris are well positioned to handle the future even under a blockade.

We entered the trip being neutral. The visit showed us that concerns over the blockade should be limited, and that there is medium-term growth potential in the country. We feel that further sanctions are very unlikely as Qatar have shown resilience but also since Qatar has a legal and legitimate right to stop the dolphin pipeline flow should the UAE escalate sanctions. Hence, we came back a bit more constructive on Qatar due to its ability to handle the blockade and the prospect of future projects.

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