STANDARD & POOR'S

CREDIT RESEARCH REPORT

Credit Ratings

A+/Stable/A-1

Primary Credit Analysts: Luc Marchand
London
(44) 20-7176-7111
luc_marchand@
standardandpoors.com

Secondary Credit Analyst:
Farouk Soussa
PhD.
London
(44) 20-7176-7104
farouk_soussa@
standardandpoors.com

Additional Contact: Sovereign Ratings
SovereignLondon@
standardandpoors.com

RatingsDirect
Publication Date

September. 30, 2005

Qatar (State of)

Rating history

Long-term foreign and local currency ratings raised to 'A+'......July 2003

Long- and short-term foreign currency ratings raised to 'A-' and 'A-1'; long- and short-term local currency ratings raised to 'A' and 'A-1'......May 2002

Long- and short-term foreign currency ratings raised to 'BBB+' and 'A-2'; long-term local currency rating raised to 'A-'......March 2001

Long-term local currency rating of 'BBB+' assigned; short-term foreign and local currency ratings of 'A-3' and 'A-2' assigned......January 1999

Long-term foreign currency rating of 'BBB' assigned; outlook stable......February 1996

Default history since 1975

None

Year

2005

Population

780,000

Per capita gdp

$45,678

Current government

Sheikh Hamad bin Khalifa al-Thani is the Emir and head of state.

Election schedule

Parliamentary elections......Expected in 2006 or 2007

Major Rating Factors

Strengths:

- Sustainable fiscal policy.
- Substantial external liquidity.
- Strong economic prospects and high per capita income.

Weaknesses:

- Relatively high public sector external debt.
- Developing political and economic institutions.

Rationale

The ratings on the State of Qatar primarily reflect the country's very strong economic prospects—driven largely by the gas industry—combined with continuous prudence in fiscal policy and the ongoing improvement in domestic political institutions.

Standard & Poor's expects Qatar's strong fiscal performance to continue. Assuming an average Brent crude price of about $52 per barrel, a fiscal surplus of about 17% of GDP is projected in 2005-2006. General government debt is expected to continue to decline to 26% of GDP at fiscal year-end 2005-2006 (March 31, 2006). Taking into account the government's deposits would reduce its debt burden to a projected 2.6% of GDP in 2005-2006.

The ratings on Qatar also benefit from a strong external liquidity position, with current account surpluses of about 36%-44% of GDP forecast for 2005-2008. These improvements have been driven mainly by increases in export receipts from liquefied natural gas (LNG), which should continue to grow over the next few years thanks both to strong foreign direct investment boosting capacity, and to higher oil prices.

Qatar's GDP per capita, estimated at $45,700 in 2005, places it among the world's highest-income nations. Economic growth is expected to maintain its impressive pace, at about 5.0% in 2006-2007 and 15.5% in 2008, compared with a projected 10.8% in 2005. Inflation jumped to 6.8% in 2004 and is expected to improve to a still-high 4.5% in 2005, mostly due to the weakness of the U.S. dollar (to which the national currency is pegged) and to capacity problems in the construction sector.

Project-related borrowing in the past few years led to a build-up of gross public sector external debt that peaked at 167% of current account receipts (CARs) in 1997, but declined to less than 53% by 2004. This ratio is expected to rise to 67% by 2007 due to plans for substantial increases in natural gas export capacity that will need significant financing. Based on the financing schemes used in the past few years, however, the potential contingent liabilities for the government should be limited.

Qatar's political system is evolving slowly from a traditionally tribal structure, with a history of succession problems, toward one with more modern attributes. A new constitution promulgated by the Emir, Sheikh Hamad bin Khalifa al-Thani, in June 2004, and came into force in June 2005, lays the foundation for limited popular participation in political processes, greater clarity in leadership succession, and more transparency and accountability in governmental operations. Implementation has been slow, however, with parliamentary elections, for example, possibly being postponed until 2006 or 2007, and there is still a shortfall in the institutions needed to improve the functioning of a market economy.

Outlook

The stable outlook on Qatar balances the government's considerable success in continuing to foster improved economic and fiscal performance against inflationary pressures and hurdles to political reforms. Although the 2004 constitution reduces the likelihood of political and economic shocks, institutions are not yet sufficiently developed to support a fully efficient market economy, and ensure sufficient popular representation and other checks and balances to executive power policies. Upward momentum on the ratings will depend on the government effectively strengthening the country's political system and institutions and addressing the capacity difficulties linked to rapid economic development.

Table 1

State of Qatar Selected Indicators

	2008f	2007f	2006f	2005f	2004	2003	2002	'A' Median 2005
GDP per capita (000 $)	50.0	43.9	44.1	45.7	38.3	33.8	29.2	11.8
Real GDP (% change)	15.5	5.4	5.0	10.8	8.6	8.4	7.5	4.5
Real GDP per capita (% change)	9.7	0.2	(0.2)	5.3	4.0	3.0	2.1	3.9
General government balance (% of GDP)	5.7	11.6	16.9	11.0	3.6	6.5	3.1	(1.7)
General government debt (% of GDP)	21.3	25.7	27.0	27.9	35.5	44.4	54.7	39.1
Net general government debt (% of GDP)	(105.7)	(117.5)	(107.6)	(86.3)	(70.2)	(75.9)	(97.0)	27.7
General government interest expenditures (% of revenues)	7.0	13.2	18.1	12.2	5.5	9.1	6.7	5.3
Domestic credit to private sector and NFPEs (% of GDP)	34.1	37.8	36.6	34.5	34.6	31.1	29.5	68.3
Consumer price index (average; % change)	2.0	2.0	3.0	4.5	6.8	2.3	0.2	3.0
Gross external financing needs (% of CARs and usable reserves)	65.5	65.6	58.6	53.0	65.5	69.2	72.8	97.3
Net public sector external debt (% of CARs)	22.6	22.3	17.1	18.3	21.0	30.5	26.8	(20.6)
Net banking sector external debt (% of CARs)	(28.5)	(29.1)	(25.1)	(21.7)	(24.6)	(26.6)	(25.8)	3.3
Net nonbank private sector external debt (% of CARs)	(32.0)	(34.9)	(33.9)	(29.8)	(27.8)	(27.1)	(16.6)	0.8

NFPE—Nonfinancial public enterprise. CARs—Current account receipts. f—Forecast.

Comparative Analysis

- Within its peer group, Qatar has the smallest and wealthiest population.
- The political system and institutions are less developed than peers, but policy-making processes are more streamlined.
- Compared with peers, Qatar's economy depends more heavily on a single economic activity (oil and gas), but because the public sector has a majority stake in this activity, public finances are very strong.
- Despite a rapid improvement, debt indicators are less favorable than those of peers.

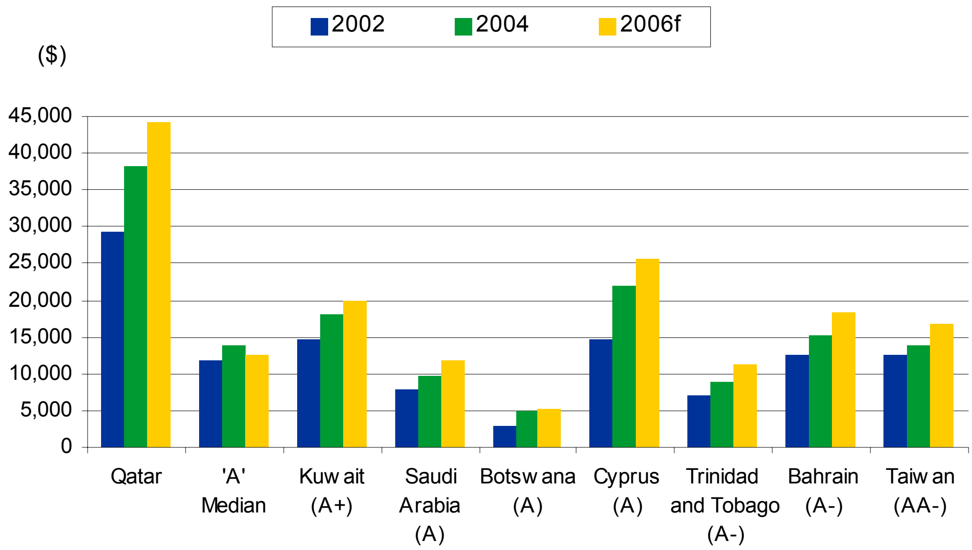
The population is small and wealthy compared with peers

With an estimated total population at about 780,000, the recent 2004 census revealed that the population in Qatar was growing at a higher rate than before, but remains much smaller than the sovereign's rated peers. There are no published official figures on the number of nationals, but independent estimates put this figure at 150,000-250,000. The rest are foreign workers—Arab and non-Arab—who are employed both by the government and by the private sector. There is no registered unemployment among Qataris. GDP per capita is expected to reach $45,678 in 2005, which makes the sovereign one of the wealthiest nations in the world (see chart 1). This measure suffers from the usual shortcoming of concealed income inequality. Moreover, in the case of Qatar and other Gulf states, it should be used with additional care because of the presence of a large foreign labor force that earns much less than the national labor force.

Chart 1

Qatar Peer Group Comparison

GDP per capita



f--Forecast.

The political system is still less developed than peers

Qatar is a member of the Gulf Cooperation Council (GCC), along with the Kingdom of Bahrain (foreign currency A-/Positive/A-2; all references to ratings hereafter are to foreign currency sovereign credit ratings), the State of Kuwait (A+/Stable/A-1+), the Sultanate of Oman (BBB+/Stable/A-2), the Kingdom of Saudi Arabia (A/Stable/A-1), and the United Arab Emirates (UAE; not rated). Like certain other GCC members, Qatar's political system has been evolving from a traditional tribal system to a modern democratic one. Qatar's political evolution, however, accelerated after the present Emir came to power in 1995. A new constitution was approved by a 97% majority vote in a referendum held in April 2003, and was ratified by the Emir in June 2004. The constitution came into force in June 2005. Problems surrounding the decision on a new electoral law, however, have prevented the process from continuing at the same pace. Parliamentary elections that were planned for 2005 are now expected in late 2006 or 2007.

Additionally, there is still a shortfall in the institutions needed to improve the functioning of a market economy, such those that exist in higher rated Republic of China (Taiwan; AA-/Negative/A-1+) and Hong Kong Special Administrative Region (AA-/Stable/A-1+). These institutions are, for example, an independent and efficient judiciary and legal system (including up-to-date commercial laws and efficient constitutional and civil courts), a fair and effective electoral commission, strong property rights, parliamentary commissions and audits to ensure good policy and public accounting transparency, and a strong and prudent central bank. All these institutions are still somewhat less developed in Qatar than in the 'AA' rated sovereigns. Also, in Hong Kong and Taiwan, the political and institutional set-up, such as the parliaments and judicial systems, has so far allowed greater policy continuity and predictability.

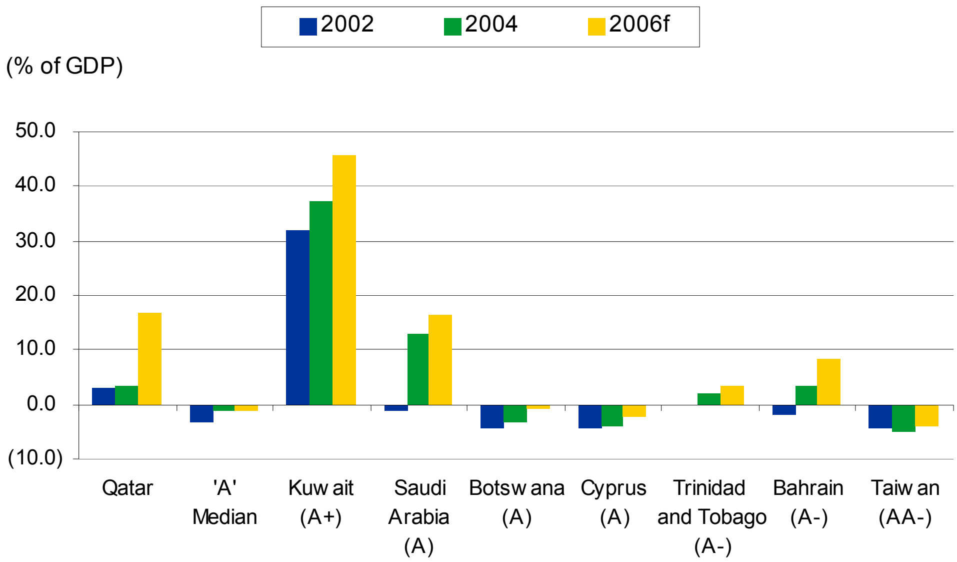
Costs and benefits of energy dependence

Qatar's economy is highly dependent on oil and gas exports and is therefore significantly vulnerable to oil price shocks. In this sense, the country's economy is narrowly based, and is comparable with Kuwait and Saudi Arabia. The public sector has a majority stake in this highly successful industry, however, and so prudent fiscal policy has mitigated the impact of price shocks and enabled the government to accumulate a comfortable cushion of reserves, which probably exceeds that of Oman, although it is not as large as that of Kuwait. As in Kuwait, and to a lesser extent Saudi Arabia, the current high oil prices and prudent price assumption in planning budget expenditures have led to comfortable surpluses since 2001 (see chart 2). Moreover, Qatar's industrial base is modern and competitive and does not face the type of restructuring challenges that confront its larger and more diversified peers such as the Republic of Korea (A/Stable/A-1) or the Czech Republic (A-/Stable/A-2). In addition, Qatar does not have an unemployment problem, which distinguishes it even from Bahrain, Oman, and Saudi Arabia. Unemployment is estimated at 2% of the total labor force, and the public administration could easily afford to absorb more Qataris by reducing the number of non-Qataris in its ranks.

Chart 2

Qatar Peer Group Comparison

General government balance



f--Forecast.

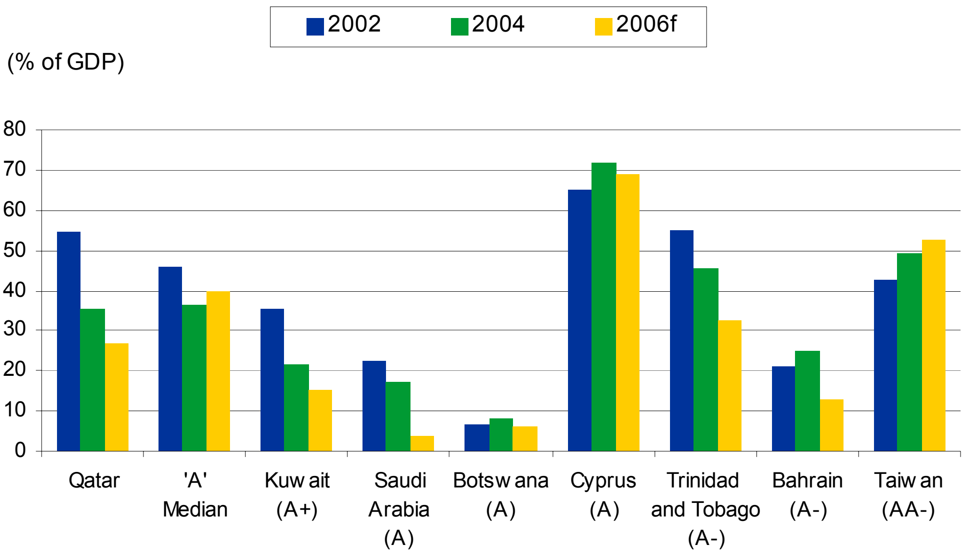
Debt indicators remain less favorable than those of peers

Qatar's government has been bold and decisive in developing the country's natural resources in partnership with major international companies. It borrowed heavily to build up its natural gas industry rather than financing budget deficits, and it is now reaping the rewards. Consequently, its external debt indicators, which are now less favorable than those of certain peers, have begun to improve since 2002 (see charts 3 and 4). At 72.4% of GDP in 2005, however, total public sector debt remains higher the 'A' median, which is 60% of GDP. Due to plans for substantial increases in natural gas export capacity that will need significant financing, this ratio is expected to rise to 91.6% by 2007 against an expect 61.2% of GDP for the 'A' median level.

Chart 3

Qatar Peer Group Comparison

General government debt

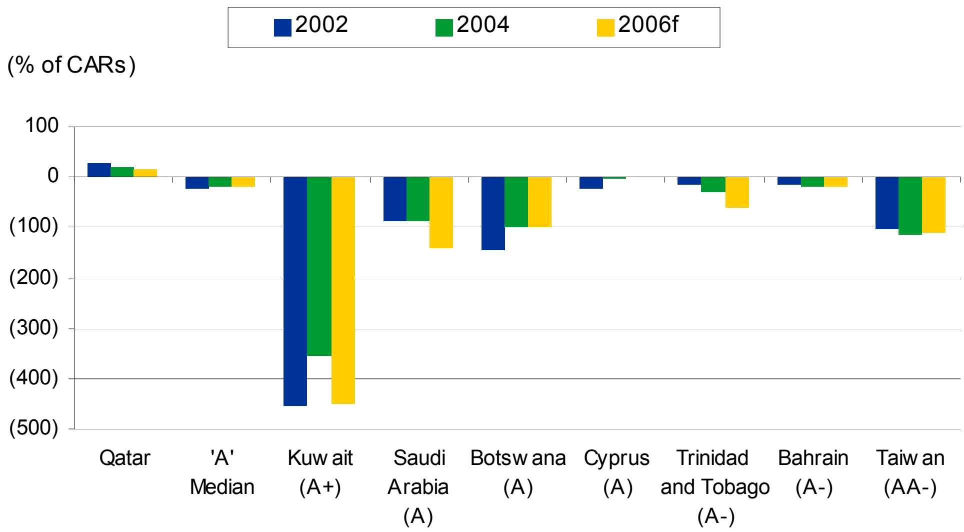


f--Forecast.

Chart 4

Qatar Peer Group Comparison

Net public sector external debt



CARs--Current account receipts. f--Forecast.

Political Environment

- A constitution providing for modern state institutions with separate powers came into force in June 2005.
- Parliamentary elections, however, are probably going to be postponed to 2006 or 2007.
- Reforms are slowing and the institutions for a better functioning market economy are lacking.
- Despite tensions with Saudi Arabia, external threats are minimized by good regional relations and cooperation with the U.S. and EU countries.

New constitution lays the foundations of a modern state

Executive power is concentrated in the hands of the Emir, Sheikh Hamad bin Khalifa al-Thani, who is aided by one of his brothers as prime minister in a cabinet comprised of members of his clan and other prominent clans. To ensure continued political stability and to modernize the institutions of the state, the Emir ratified a new constitution in June 2004. This established greater representation of the population in governing institutions—notably through a parliament—and set guarantees on civil rights and the freedom of individuals, and the basic principle of a market economy. Legislative power will be vested in a Shura Council made up of 45 members, two-thirds of whom will be elected and the rest appointed by the Emir (compared with 100% appointees until now). This new constitution, along with greater independence for the judicial system, will strengthen the quality of Qatar's governance and enhance its transparency, but the extent of change will depend crucially on the powers conferred on the parliament. The constitution will also enshrine the current system of succession and bolster the legitimacy of the new crown prince—Sheikh Tamim bin Hamad bin Khalifa al-Thani—who is in good health (unlike the previous heir) and is reportedly more in agreement with his father's reform-led policies.

Parliamentary elections, however, are likely to be postponed

Originally planned in 2005, Qatar will have its first parliament by 2006 or 2007. Officially, the constitution came into force on June 9, 2005, and is expected to lead to the election of part of the new advisory council, but the date of this election seems to have been postponed by another one or two years. The promise from the Emir was to pass an electoral law by the end of 2005, but the inability of the main political players to agree on this law has slowed down the political liberalization process. The other groups and clans outside the royal family seem to have prioritized ensuring that they will have sufficient representation in the new institutions.

Institutional shortfalls

Despite progress toward political liberalization, the process of strengthening institutions is slow, particularly with regard to the challenges that face the economy and the new constitution. In particular, Qatar still lacks a constitutional court, an electoral commission, and proper parliamentary infrastructure. One of the most important expectations from a parliamentary election is for the establishment of a commission headed by parliament to audit public finances, and in particular Qatar's foreign assets. A similar system already exists in Kuwait. Other institutions that still need to develop further in Qatar are the creation of an independent and efficient judiciary and legal system (including up-to-date commercial laws and efficient civil courts), firm property rights, and an independent, strong and prudent central bank.

Minimal external threats

Regionally, the relationship with Saudi Arabia has deteriorated slightly in the past year, partly due to the Qatar-based Al-Jazeera television station that is critical of a number of political regimes in the region including Saudi Arabia. The most important tension in the short term regards the expulsion from Qatar of 5,000 dual Saudi/Qatari nationals, members of the "Al-Murrah" family, after it was decided that they should not originally have been allowed to take up Qatari nationality. The Saudi authorities have also raised concerns over the construction of the pipeline linking Qatar to Kuwait, because it would transit via the coastal waters that Saudi Arabia claims as its own. External threats are minimized, however, by Qatar's good relations with other Gulf states and strategic alliance with the U.S.

Terrorist attack did not significantly increase security risks

To respond to the recent terrorist attack in a theater in Doha, the authorities have decided to reinforce security measures, notably by the creation in the West Bay area of Doha of a new diplomatic quarter for embassies and personnel from foreign companies. In Standard & Poor's view, the attacks do not threaten political stability and should not call into question the good business environment for foreign direct investment (FDI) in Qatar.

Economic Prospects

- Qatar has extremely large oil and gas reserves and is about to increase and diversify its energy exports substantially.
- Higher capital expenditure by the energy sector and the government will fuel private sector growth.
- The government will continue to encourage the growth of the private sector through privatization, the outsourcing of public services, and the development of industrial zones for small and midsize enterprises (SMEs).

Table 2

Economic and Financial Indicators

	2008f	2007f	2006f	2005f	2004	2003	2002
Nominal GDP (bil. QAR)	165.7	138.3	132.0	130.0	103.6	87.5	71.7
Nominal GDP (bil. $)	45.5	38.0	36.3	35.7	28.5	24.0	19.7
GDP per capita (000 $)	50.0	43.9	44.1	45.7	38.3	33.8	29.2
Real GDP (% change)	15.5	5.4	5.0	10.8	8.6	8.4	7.5
Real GDP per capita (% change)	9.7	0.2	(0.2)	5.3	4.0	3.0	2.1
Real domestic demand (% change)	15.8	18.3	12.0	13.2	(10.2)	23.9	14.5
Real investment (% change)	7.7	7.9	7.7	7.9	8.8	6.9	7.4
Gross domestic investment (% of GDP)	34.7	31.8	25.9	23.3	27.4	34.6	20.8
Gross domestic savings (% of GDP)	72.5	67.7	67.1	67.2	57.0	59.6	45.1
Unemployment rate (average claimant count; %)	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Consumer price index (% change)	2.0	2.0	3.0	4.5	6.8	2.3	0.2
Domestic credit to private sector and NFPEs (% change)	8.2	8.1	7.9	25.1	31.7	28.6	15.0
Domestic credit to private sector and NFPEs (% of GDP)	34.1	37.8	36.6	34.5	34.6	31.1	29.5

QAR—Qatari riyal. NFPE—Nonfinancial public enterprise. f—Forecast.

Economic structure

Qatar's economy is based on the exploitation of its vast reserves of oil and gas and is expected to remain so for the foreseeable future. At 27.0 billion barrels, oil reserves should last for at least 95 years. Gas reserves of 906 trillion cubic feet (tcf) place Qatar third in the world in terms of this resource, behind The Russian Federation (BBB-/Stable/A-3) with 1,694 tcf, and Iran with 971 tcf. At the current pace of gas production, Qatar's reserves could last for about 200 years. The share of the oil and gas sector in nominal GDP was almost 74% in 2004, up from an average of 40% in 1995-2001, as a result of the strength of oil and gas prices since 2001. Qatar's economy is still dominated by the public sector, which accounts for about 70% of GDP. Nevertheless, the state sector, itself dominated by Qatar Petroleum (QP; A+/Stable/—) and its subsidiaries, is efficient and profitable, and the economy is diversifying with rapid growth in construction, services, and petrochemicals and other downstream industries.

The country's high per capita income is underpinned by the well-maintained competitiveness of Qatar's economy, which is based on cheap energy supply, low labor costs, flexible labor supply from abroad, and prudent macroeconomic policies. These are also the main factors behind the substantial FDI in oil and gas, permitting both private and public sectors to benefit from enhanced and sustained investment in technology. Nevertheless, the economy is still dependent on oil and gas, and a significant number of institutions need to be developed further for creating a fully fledged market economy.

Economic growth

In 2004, production of crude oil averaged 752,000 barrels per day, increasing only marginally from 723,000 barrels per day in 2003, as a result of OPEC quota restrictions. Overall liquefied natural gas (LNG) production and export is expected to increase sharply in the next few years. Several Heads of Agreements have also been signed, and if these are transformed into Sales and Purchase Agreements, it is possible that planned exports may be raised easily to about 78 million tonnes per year (tpy) by 2012 from about 25 tpy in 2005. This level of production would make Qatar the largest LNG producer in the world, and would be easily absorbed by demand for natural gas that is expected to quadruple between now and 2020. Moreover, whereas oil quotas exist to prevent oversupply and a fall in price, there is no such limitation on the production of natural gas. Finally, the production cost of gas in Qatar is one of the lowest in the world and continues to decrease. Individual gas trains' capacities are constantly rising toward an expected 7.8-8.0 million tpy in 2009-2010, thereby increasing economies of scale. Condensates and petrochemicals, together with other associated industries such as construction, are also benefiting from the diversification program and will witness concurrent growth.

The economy will continue to diversify

Qatar is aiming to be a world leader in the export of ultrA-clean fuels such as diesel, naphtha, and liquefied petroleum gas, using new technology to transform gas to liquids. These products, which are sold as premium-refined products, will be marketed in Japan and Europe. Furthermore, the QP subsidiaries that produce petrochemicals have all significantly increased their production and exports. Overall, the growth rate in 2005 is estimated at about 10.8% and forecast at more than 5.0% per year until 2007 and 15.5% in 2008, reflecting the current boom in the gas sector, growth in the construction sector resulting from continued investment in oil and gas, and government infrastructure projects. The private sector will also benefit from plans to reduce the size of the public sector through privatization, and from initiatives to promote SMEs and FDI.

Fiscal Flexibility

- The government relies heavily on oil revenues, but prudent budgeting based on low price assumptions and expenditure restraint minimizes the downside risks.
- The official presentation of the fiscal accounts understates their true strength by excluding foreign investment income and surpluses retained by QP.
- The government's domestic and undisclosed foreign assets make it a net creditor.

Table 3

Fiscal Indicators

(% of GDP)	2008f	2007f	2006f	2005f	2004	2003	2002
Public sector gross debt	87.5	91.6	81.4	72.4	74.6	86.2	102.9
Of which general government debt	21.3	25.7	27.0	27.9	35.5	44.4	54.7
Of which central government debt	16.4	19.8	21.0	21.7	28.5	36.9	49.2
Public sector net debt	(97.5)	(117.9)	(119.4)	(105.9)	(107.8)	(74.5)	(89.7)
Of which general government net debt	(105.7)	(117.5)	(107.6)	(86.3)	(70.2)	(75.9)	(97.0)
Of which central government net debt	(110.6)	(123.4)	(113.7)	(92.5)	(77.2)	(83.4)	(102.6)
General government revenues	35.1	42.7	45.5	38.0	29.6	32.6	31.7
Of which central government	35.1	42.7	45.5	38.0	29.6	32.6	31.7
General government expenditures	29.4	31.1	28.6	27.1	26.0	26.1	28.6
Of which central government	29.4	31.1	28.6	27.1	26.0	26.1	28.6
General government balance	5.7	11.6	16.9	11.0	3.6	6.5	3.1
Of which central government	5.7	11.6	16.9	11.0	3.6	6.5	3.1
Of which local authorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government primary balance	7.0	13.2	18.1	12.2	5.5	9.1	6.7
Central government primary balance	7.0	13.2	18.1	12.2	5.5	9.1	6.7
General government balance (% of revenues)	16.3	27.1	37.2	28.9	12.0	20.0	9.9
General government interest payments (% of revenues)	3.5	4.0	2.6	3.2	6.4	7.8	11.2
Central government interest payments (% of revenues)	3.5	4.0	2.6	3.2	6.4	7.8	11.2

f—Forecast.

Revenue, expenditure, and balance performance

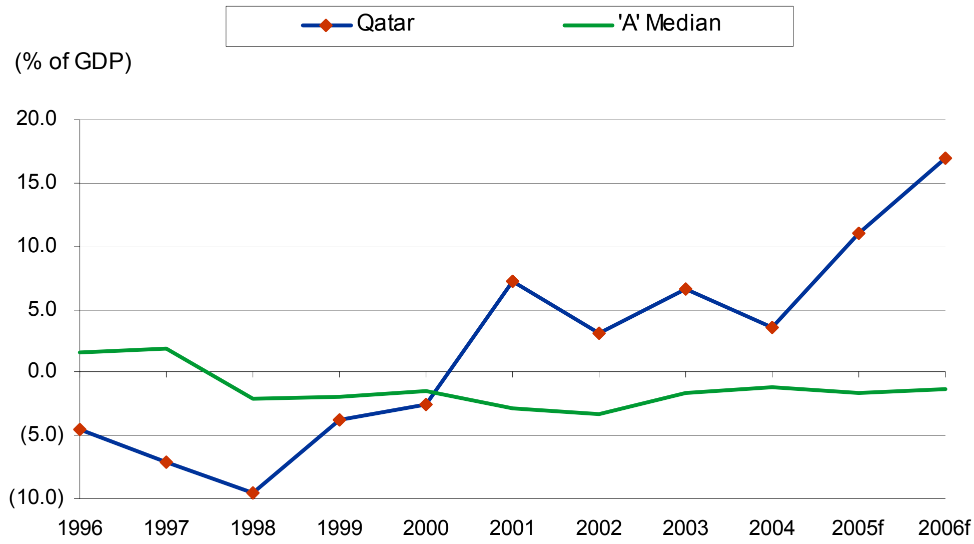
Standard & Poor's expects Qatar's sustainable fiscal policy to continue. The State has budgeted on the basis of conservative oil price assumptions and tight current expenditure allocations. Total expenditure may be relaxed in the course of each fiscal year for priority development programs, provided that oil prices turn out to be higher than budgeted.

The budget for fiscal year 2005-2006 (ending March 31, 2006) assumes an average oil export price of $27 per barrel, an increase in investment income from the LNG industry, and higher spending, mainly on infrastructure projects such as schools, roads, the sewerage system, the Medical City, and other facilities for the 2006 Asian Games. The budget targets a small surplus of about 0.1% of GDP, but based on a Brent crude price assumption of about $52 per barrel, Standard & Poor's projects a budget surplus of about 16.9% of GDP (see chart 5). Consolidating the balances of the government and QP, Standard & Poor's projects the public sector to record a surplus of 20.7% of GDP in 2005-2006, compared with 8.4% in 2003-2004.

Chart 5

State of Qatar

General government balance



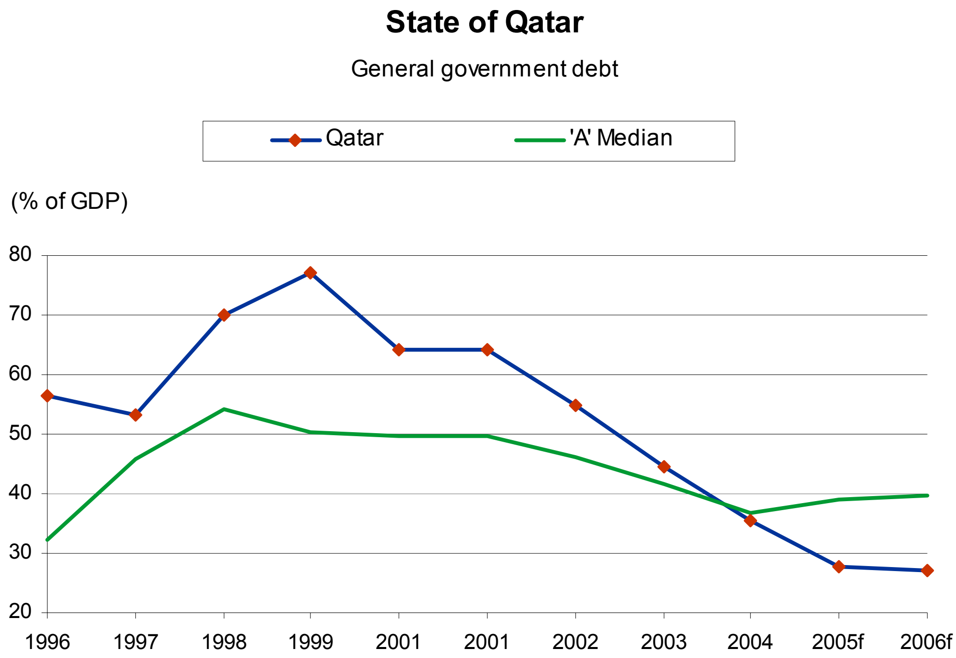
f--Forecast.

Government debt and interest burden

The government is in net general government asset position estimated at about 86% of GDP in 2005, or 61% of GDP in 2005 taking into account only the declared cash deposits and securities held both domestically and abroad.

The government is now making net repayments of its external debt. General government debt, including liabilities other than bonds due to domestic commercial banks, has declined very fast in recent years to 27.9% of GDP at the end of fiscal year 2004-2005 (March 31, 2005), and is expected to decrease further to about 21.3% of GDP at the end of fiscal year 2007-2008 (see chart 6). Qatar's direct debt, external and internal, totaled $7.5 billion, or about 20.9% of GDP, at March 31, 2005 (excluding liabilities other than bonds due to domestic commercial banks), of which almost 49.3% was domestic debt. Although Qatar has no need to borrow, the government strategy is to further develop domestic and external Islamic finance instruments, as well as other domestic instruments.

Chart 6



f--Forecast.

Interest payments on both domestic and external debt have declined to about 3.2% of revenues in 2004-2005 from their peak of 11.2% in 2001-2002. The interest burden should trend up marginally to about 4.3% of revenues in 2007-2008, in line with the increase in interest rates, and despite the declining debt burden.

Off-budget and contingent liabilities

Given the small size of the domestic banking sector, Standard & Poor's estimates that, in the event of financial system stress, gross problematic assets in the banking sector could amount to 15.0%-30.0% of domestic credit to the nongovernment sector (against 25-40% in 2003). The resulting contingent liability is only 5.2%-10.4% of GDP. The public sector debt outside the general government is essentially that of QP and its subsidiaries and is not a contingent liability for the sovereign.

The State now expects the country's gas, oil, and petrochemicals investment programs to cost about $110 billion (about 308% of 2005 GDP) over the seven-year period 2004-2010. Almost all of it will be financed via the private sector and QP, and mostly in the form of structured debt (see section headed "External Finances" below). Only $14-$15 billion (42% of GDP) will be spent by the State, mostly in cash (rather than borrowings). About $33 billion (92.4% of GDP) will be accessible to external investors, 80% in equity and 20% in debt, mostly in the oil sector. The breakdown by sector will be about $70 billion in the oil and gas sectors and, the remainder in the non-oil sectors. Given the expected private sector participation, QP's very strong financial profile, and the form of debt used (partly nonrecourse), the potential contingent liabilities for the government should be very limited.

Monetary Policy

- The exchange rate for the Qatari riyal is expected to remain pegged to the U.S. dollar.
- After a pick-up in 2004, inflation should slow to 4.5% in 2005, and to less than 2.0%-3.0% in 2005-2006.
- Qatar Central Bank (QCB), although passive regarding monetary policy because of the exchange rate peg, is developing market instruments aimed at enhancing its liquidity management.
- Financial intermediation is still modest.

A sustainable exchange rate policy

The exchange rate for the Qatari riyal is expected to remain pegged to the U.S. dollar at Qatari riyal (QAR) 3.64 per $. This nominal anchor has served the authorities well in keeping inflation low, at an average of 1.6% per year in the past five years. In the context of the pegged exchange rate and an open capital account, the Qatar Central Bank (QCB) is not in a position to pursue an active monetary policy apart from short-term liquidity management. Its role is confined to prudential regulation and supervision of the banking system, which includes several branches of foreign banks. Prudent macroeconomic policies, especially those maintaining fiscal discipline and a sound banking system in an environment of high capital mobility, ensure the sustainability of the longstanding peg to the dollar.

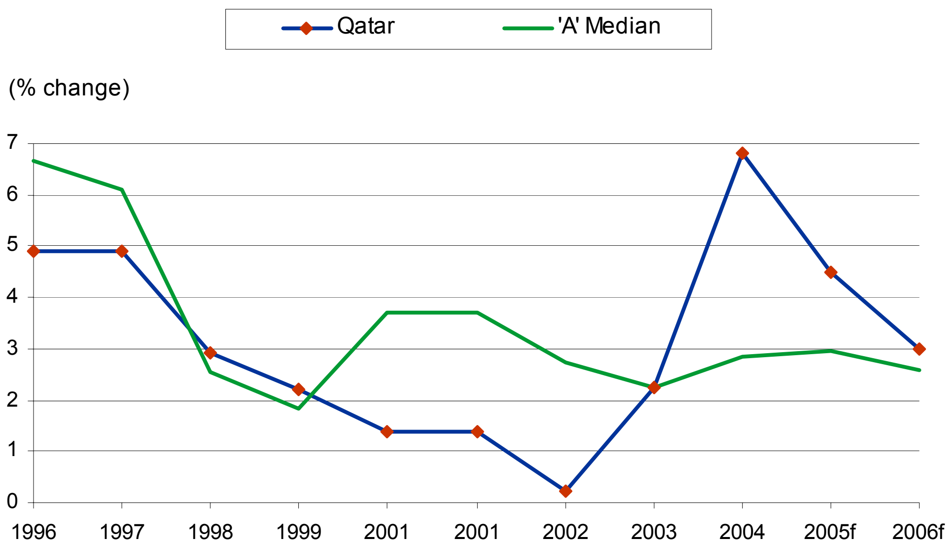
Inflationary pressures in the short-term

Overall consumer price inflation (CPI) increased to 6.8% in 2004 from 2.3% in 2003, mainly due to inflation of about 17% in the rent, construction materials, fuel, and energy components of the consumer price index. Most of the increase was due to the rent and construction elements, because energy prices are still subsidized. Price pressures in the construction sector began in late 2003, because of the temporary lack of housing supply, which led to high demand for construction materials and an increase in rents. More expensive imports from the EU (about one-third of total imports) due to the fall in the riyal against the euro and expansionary fiscal policy have also stoked inflationary pressures. As housing capacity rises and shortages of building materials decrease, however, the price pressures are expected to ease. The increase of interest rates in the line with the U.S. Federal Funds rate will also help a downward trend in 2005, and CPI is expected to reach 4.5% for the year, before returning to about 3.0% in 2006 and 2.0% in 2008 (see chart 7).

Chart 7

State of Qatar

Consumer price index



f--Forecast.

More active liquidity management

Despite its passive role in monetary policy, QCB has tried to improve its liquidity management. To diversify its market instruments, QCB introduced a Qatar Monetary Rate in 2001 that allows the banks to borrow or deposit overnight funds with the QCB at fixed interest rates set on a daily basis. In 2004, the government decided that QCB's profits would no longer be transferred to the budget because the government is accumulating sufficient assets through the current fiscal surpluses.

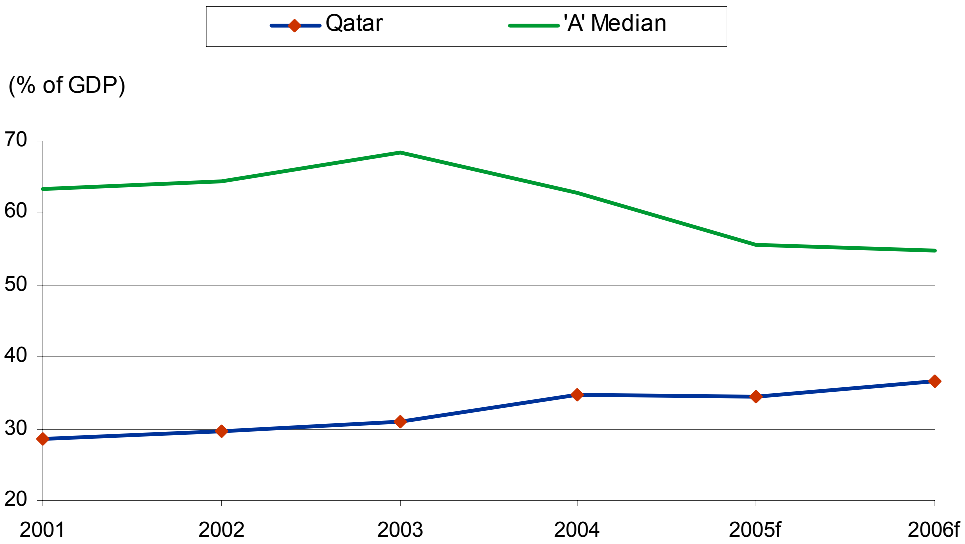
Stable but underdeveloped credit and capital markets

Financial intermediation is still mainly limited to credits to the government, with total credit to the private sector and nonfinancial public enterprises representing only 34.5% of GDP in 2005 (see chart 8). This, however, has grown rapidly from 28.5% of GDP in 2001. The Doha Stock Market (DSM), created in 1995, is still small in terms of listings, capitalization, and turnover, but has no history of crashes or bailouts and is developing fast. This trend is expected to continue with the overall investor appetite for equities in the region and the excess liquidity linked to the oil windfall. The increase will also be spurred by more stable and sustainable factors such as the privatization of high-value assets in the coming years. Equity and bond issuance by corporates is increasing and the market for government domestic paper benefits from bonds with five-year maturities.

Chart 8

State of Qatar

Domestic credit to private sector and NFPEs



NFPE--Nonfinancial public enterprise. f--Forecast.

External Finances

- LNG exports should pick up and the current account balance should record surpluses of about 36%-41% of GDP in 2005-2006.
- Net public sector external debt has declined in relation to current account receipts, but should increase moderately in the next few years with the current borrowing for infrastructure.
- In view of the growing share of nonrecourse debt, the debt service ratio should also remain reasonable despite an increase in nominal external debt.

Table 4

State of Qatar External Indicators

	2008f	2007f	2006f	2005f	2004	2003	2002
(% of GDP)							
Current account balance	37.8	35.9	41.3	44.0	29.6	25.0	24.4
Trade balance	48.1	48.5	54.7	58.1	49.1	39.1	39.2
Net foreign direct investment	3.8	4.1	4.0	3.8	4.2	4.2	4.6
(% of CARs)							
Current account balance	47.3	43.9	48.4	51.8	37.6	37.2	35.9
Net external liabilities	(192.1)	(184.5)	(156.3)	(121.4)	(116.3)	(121.5)	(152.1)
Total external debt	87.9	86.2	69.4	58.1	61.3	82.8	101.9
General government external debt	12.0	13.9	13.9	14.0	18.9	26.1	34.5
Net public sector external debt	22.6	22.3	17.1	18.3	21.0	30.5	26.8
Net banking sector external debt	(28.5)	(29.1)	(25.1)	(21.7)	(24.6)	(26.6)	(25.8)
Net nonbank private sector external debt	(32.0)	(34.9)	(33.9)	(29.8)	(27.8)	(27.1)	(16.6)
Net investment payments	2.1	3.1	3.8	4.8	9.5	3.4	2.4
Net interest payments	(2.2)	(2.5)	(2.8)	(3.0)	(4.0)	(4.1)	(5.5)

Table 4

State of Qatar External Indicators (cont.'d)

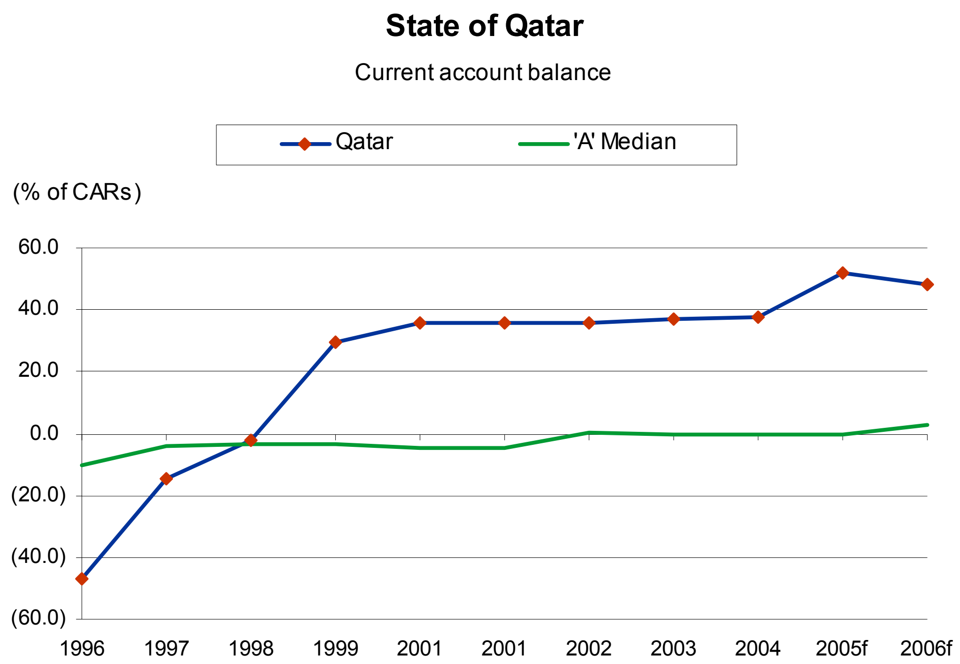
	2008f	2007f	2006f	2005f	2004	2003	2002
Reserves/imports (months)	2.2	2.5	2.7	2.8	2.5	1.9	1.8
Gross external financing needs (% of CARs and usable reserves)	65.5	65.6	58.6	53.0	65.5	69.2	72.8

CARs—Current account receipts. f—Forecast.

External liquidity

Exports of aluminum, steel, refined petroleum products, petrochemicals, and other energy-related commodities will increase, but Qatar's export receipts will continue to be highly sensitive to movements in the price of oil, and this will be an important source of continued volatility in the current account balance (see chart 9). Another source of volatility is the level of capital goods imports for energy projects. Standard & Poor's estimates the current account surplus to have been about 29.6% of GDP in 2004 and forecasts even higher surpluses in 2005-2007 of about 36.0%-44.0% of GDP. As a result, Qatar's international liquidity position will continue to strengthen (see table 4). The large projected current account surpluses will more than cover all projected loan principal repayments, and international reserves are expected to continue to grow. In addition, the government is expected to increase its own foreign assets, which already exceed its foreign debt.

Chart 9



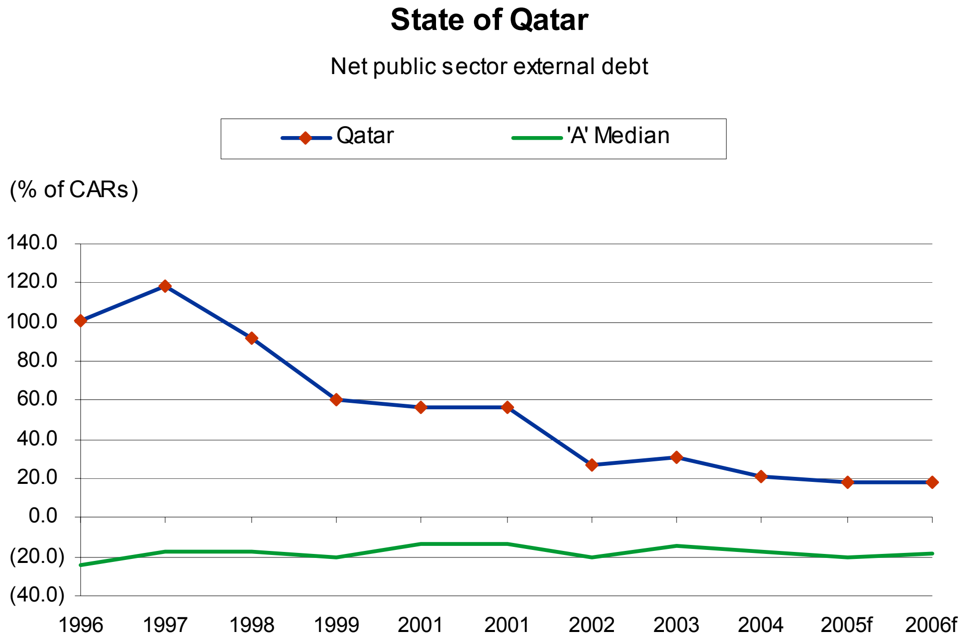
CARs--Current account receipts. f--Forecast.

Qatar's debt service ratio excluding short-term debt declined significantly to about 13.9% of current account receipts (CARs) in 2004 and is expected to reach 12.5% in 2005, before increasing again to 21.4% in 2008. Most of the debt that will be accumulated by Qatar Petroleum by 2010 will be nonrecourse, and the debt service (interest and amortization) will cease to be paid after the completion of the corresponding construction project. This means that the implicit debt service as a proportion of the total debt is decreasing, balancing the increase in nominal external debt. This factor will also permit the maintenance of high sovereign external liquidity.

Public sector external debt

Public sector external debt is increasing but is export-related. After having decreased to 51.5% of CARs in 1997 from 167.0% in 2004 and 47.9% in 2005, the public sector external debt is expected to rise fast again between to about 67.0% of CARs in 2007. Taking into account liquid external assets, however, the net public sector external debt-to-CARs ratio stood at 21.0% in 2004, is estimated at 18.3% in 2005, and is projected to increase to 22.3% by 2007 (see chart 10).

Chart 10



CARs--Current account receipts. f--Forecast.

About $6.7 billion—or 80.0% of the total public sector external debt not owed directly by the government in 2005—is connected to the oil and gas industry and related downstream projects and is not guaranteed by the state or by QP. This debt was in the form of structured transactions backed either by assets or by future receivables, thereby limiting creditors' recourse to shareholders. Of this proportion, about $4.7 billion (56.0% of total public external debt, against 51.0% in 2004), is nonrecourse debt owed by QP, which will cease to be paid after the completion of the projects and which carries no debt service obligation for the shareholders. Finally, another reason why this debt should not pose a significant contingent liability for the State is because most of these projects are joint ventures with highly competitive Western oil companies with a strong interest in keeping projects on schedule and ensuring product delivery.

Private sector external debt

Private sector external debt is limited to only a few sectors. Furthermore, at an estimated $1.6 billion in 2005, this is a negligible component of the estimated $17.6 billion total Qatari external debt in 2005. On a net basis, the private nonbank sector is in an asset position estimated at about 29.8% of CARs, and debt increases are mostly resulting from credit extended to Qatar Telecom, which is a highly profitable company. In 2005, private banks are also in a net external asset position estimated at 21.7% of CARs, and are likely to remain in a healthy net asset position for the foreseeable future.