MARMORE
MENA INTELLIGENCE
A MARKAZ Subsidiary

Marmore First Take

The GCC Diplomatic Crisis over Qatar

June, 2017

www.emarmore.com

Highlights

What is the history of this issue?

On June 05, 2017, Saudi Arabia, Egypt, the United Arab Emirates (UAE) and Bahrain severed ties with Doha, accusing the Qatari government of promoting instability in the region. At the core of the latest diplomatic crisis are incendiary comments purportedly made by Qatar's Emir HH Sheikh Tamim Bin Hamad Al-Thani at a Qatari military graduation ceremony on May 23, 2017[1].

A news report published on the Qatar News Agency (QNA) website, later on May 23, 2017, alleged that the Emir stated that Qatar shared a tense relationship with the U.S. President Donald Trump's administration, while favoring a role for Iran in the region. Though on May 24, 2017, the QNA made the announcement that its website had been hacked and false statements posted on it, the diplomatic and media damage had been done in the rest of the GCC.

The lead up to the crisis began earlier, according to many analysts and experts. According to some experts, Doha had in recent years nurtured an abiding ambition of following an independent foreign policy, unlike the consensual approach of the majority of the GCC, dominated by the Saudi perspective. The fault-lines appeared when Qatar welcomed the growing influence of the Muslim Brotherhood in Egypt after the fall of the Mubarak regime in 2011. However, KSA and its allies reportedly view the Brotherhood as a revolutionary movement that threatens regional stability.

As a consequence of the political differences, when the Brotherhood government of Mohamed Morsi in Egypt fell in 2013 and Abdel Fatteh al-Sisi came to power, Riyadh welcome the development; whereas Qatar appeared resistant to it. As a result, a diplomatic crisis opened in 2014 when KSA, the UAE and Bahrain temporarily suspended diplomatic relations with Qatar. Another contention is Qatar's relations with Iran.

Why now?

Unlike KSA, Qatar did not favor an approach of completely undermining relations with Iran. For instance, when KSA and some of its allies severed diplomatic ties with Iran following the crisis that erupted after the Kingdom executed cleric Sheikh Nimr al-Nimr in January 2016, Qatar only recalled its ambassador, a step short of cutting full ties. With that backdrop of simmering tensions, the immediate trigger appears to be a constellation of developments that occurred after U.S. President Donald Trump's visit to Riyadh (KSA) in May 2017. Trump called for a joint front against Iran.

Three days after the Trump visit was concluded, the Qatar News Agency carried purported comments by Qatar's Emir HH Sheikh Tamim Bin Hamad Al-Thani, questioning the growing anti-Iran sentiment. However, Qatari officials quickly deleted the comments and said their news agency was hacked. The crisis got worse when HH Sheikh Tamim held a telephone call with the re-elected Iranian President, Hassan Rouhani, a few days after the news agency controversy. Reportedly, Riyadh saw this as an act of defiance that went against the interests of the GCC. The rift is already being dubbed in some quarters as the biggest diplomatic crisis in the GCC region since the Gulf War of 1991[2].

What is the economic and financial market impact for Qatar and the GCC?

The four Arab countries announced that they would close air and sea transport connections with Qatar, which is the world's top exporter of liquefied natural gas (LNG)[3]. Also, the three GCC countries—KSA, UAE and Bahrain—have blocked their nationals from travelling to Qatar; while giving Qataris two weeks to leave their nations. Also, they indicated that they would pursue legal routes in an attempt to persuade friendly countries and companies to downgrade their ties to Qatar. Additionally, the closure of Qatar's only land border (with Saudi Arabia) threatens food supplies[4].

Abu Dhabi-based Etihad Airways and Dubai-based Emirates Airlines announced suspension of all flights to Qatar from June 06, 2017 (until further notice). Qatar Airways, a rapidly growing international carrier, is now threatened with disruption to its operational network if flights cannot access the national airspace of Qatar's three closest neighbors[5].

Figure: Qatar's vulnerable geographical location

Image Source: Searchbonus

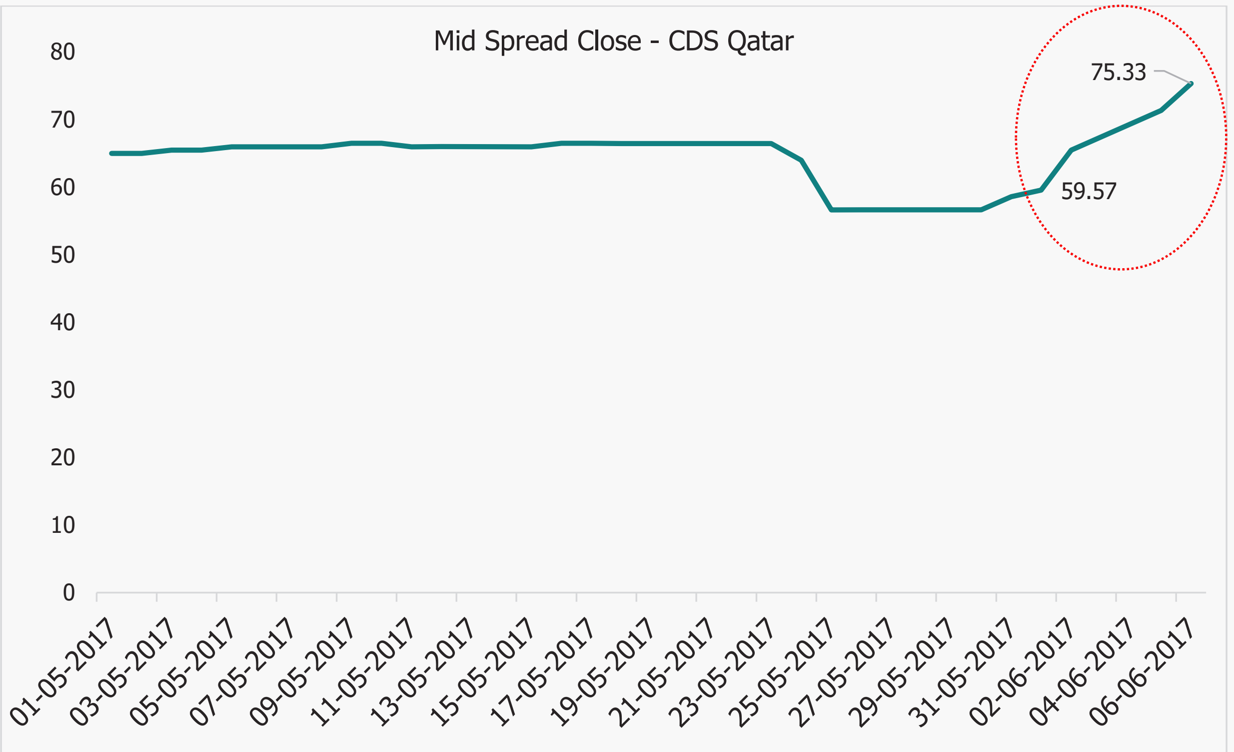
[1] *The Washington Post*
[2] *Vox Media*
[3] *Financial Times*
[4, 5] *ibid*
[6] *Mubasher Info*

Qatar has deep trading links with the rest of the GCC and the wider world. By the close of 2016, the trading value between Qatar and the GCC nations posted QAR 38 billion (USD 10.4 billion), according to Qatari official statistics, of which 82% or USD 8.55 billion were contributed by KSA and the UAE . In 2016, Qatar's imports from the rest of the GCC totaled QAR 18.79 billion (USD 5 billion), of which the UAE took a share of 56% and KSA of 27% at an aggregate value of USD 4.55 billion. Moreover, Qatar's imports from Bahrain is 6% of its imports from the GCC nations.

Given the close trade and deep geographical links with the rest of the GCC, especially the KSA and the UAE, the decision to sever ties by the group of Arab countries is likely to have a deep financial impact on Qatar's stock markets if the face-off continues for long. Moreover, Qatar's ability to transport its exports through sea and air may become extremely difficult. Even if options are worked out through Iran, the additional cost of transportation and the risk premiums will reflect on Qatari export prices. Otherwise, Qatar will have to write off the additional costs accrued as discounts if retaining market share is considered more important.

The devastation that can be wreaked on stock and bond markets is worth stressing upon. The Qatari stock index fell 7.6% in the first hour of trade on June 05, 2017, the day on which the diplomatic severance was announced[7]. Some of the top blue chips were hit most, with Vodafone Qatar, the most heavily traded stock, falling below its 10 per cent daily limit. Moreover, the KSA and other GCC nations traditionally account for about 5-10% of daily trading on the Qatari stock market. Notably, the other concerned countries' stock markets also fell (albeit slightly) during the period, with Dubai losing 0.8% and KSA by 0.2%.

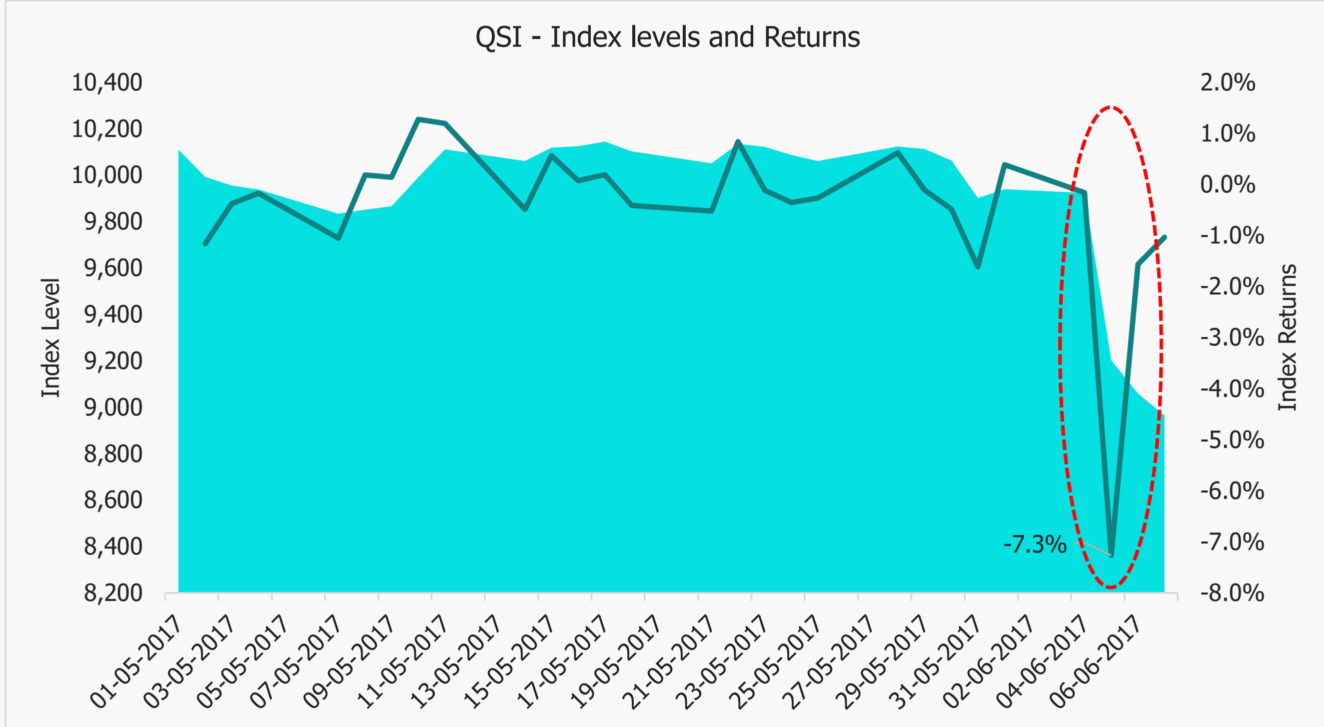
Figure: Qatar bond market reaction- Credit Default Swap (CDS) of Qatar rose sharply



Source: Reuters; Marmore Research

On the day that followed the announcement, Qatari stocks were little changed. However, the rout pulled down the Qatari index's price-to-earnings ratio from the highest level that it enjoyed since 2014[8]. U.S. Dollar bonds belonging to Qatar dropped by the most since November 2016, raising the yield on debt that is due in June 2026 by 22 basis points to 3.4%. The yield rose a further seven basis points on the day following the announcement, taking it 49 basis points higher than Abu Dhabi's (UAE) similar maturity dollar debt.

Figure: Qatar stock market reaction- QSE index declined sharply



Source: Reuters; Marmore Research

Though it is difficult to predict how the current crisis will end, the trade and financial impact will be significant on Qatar if it is not resolved quickly. Qatar also exports its gas to both the UAE and Egypt via LNG shipments. The two importers may start scouting for other sellers. The Dolphin Energy pipeline, which Qatar uses to supply the UAE, transports about 2 billion cubic feet a day of gas[9]. This is around 30% of the UAE's average gas consumption daily. Though Qatar has not announced any retaliatory measures as of the time of writing this note, there is little doubt that it is Doha that will stand to lose economically the most against a larger unified front of Arab countries.

[7] *EconomicTimes*

[8] *BloombergMarkets*

[9] *MEED*

What are the potential scenarios?

Qatar said it would refrain from retaliating against the measures imposed on Doha, which include the suspension of all land, sea, and air connectivity; the ejection of Qatari diplomats in the concerned GCC nations; and the order for all citizens of Qatar living in those nations to depart within 14 days.
A key component in the latest diplomatic rift is likely to revolve around Qatar's continued presence in the GCC bloc[10]. The likely scenarios are that either Doha apologizes, or they could eventually be eased out of the GCC. Qatar's stock exchange is reverberating with an 8% drop as a fallout, indicating the level of economic pain that the crisis can extract.

Also, if the current blockage and bad relations continue on a long-term basis, Qatar's many megaprojects will come under a cloud, including the 2022 FIFA World Cup[11]. Skyrocketing of food prices, an erosion of Qatari fiscal balances, and a rapid rise in borrowing costs are some of the real risks that Qatar will continue to face if the situation does not ease.

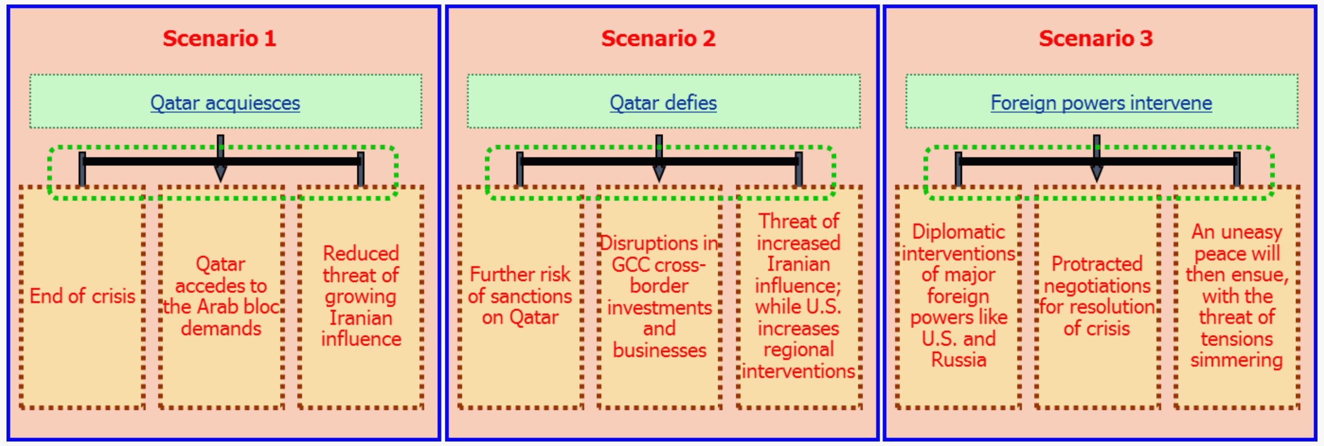
The US president's public support for the isolation of Qatar, advertised via Twitter, is additional pressure on Doha, despite Qatar hosting a US military base for American military operations in the Middle East region[12]. However, if media reports are to be believed, U.S. intelligence officials from the Federal Bureau of Investigation (FBI) are said to have hinted at Russian hackers being responsible for planting a false news story in QNA, which served as the backdrop to the current crisis[13].

The current crisis appears increasingly muddled with numerous known and unknown players involved. Thus, the outcomes are difficult to predict or ascertain. However, if Qatar does not quickly accede and the crisis grows in unpredictable ways, it can have deleterious impact on the rest of the GCC as well. For e.g., though Qatar is a relatively small player in oil, a prolonged crisis and hardening of stances can cause Qatar to provoke disturbances within Organization of the Petroleum Exporting Countries (OPEC), causing the output deal reached by OPEC members to unravel[14].

Several major players too may take an active interest in the conflict, if it proceeds, in order to prevent their interests from being harmed. For e.g., if Qatari gas finds it increasingly difficult to reach world markets, especially countries in Europe, then the European Union (EU) may feel threatened by the prospect of having to depend on more Russian gas imports, a decision that is highly fraught politically in many EU capitals.

The diplomatic face-off will start to inflict deep havoc on world supply chains, which might end up costing more in terms of transportation for even the rest of the GCC, especially those countries that have to traverse the strait of Hormuz (such as the UAE). Egypt, one of the original participants in the Arab bloc that severed ties, will especially face impact in terms of having to find alternative sources of gas in case Qatar decides to stop supplying to Egypt[15].

Figure: Graphical representation of how different scenarios can pan out



Source: Marmore Research

In conclusion, it can be said that if this diplomatic conflict intensifies, it can throw into question the GCC as a unified bloc. Diplomatic efforts are already afoot to broker a solution to the crisis. For e.g., Kuwait has already been instrumental in key diplomatic moves within the GCC bloc in terms of finding a solution to the crisis, which is principally between KSA-UAE and Qatar. At a time when the GCC is facing multiple challenges in the form of volatile oil prices and the need to diversify in order to generate jobs, the current diplomatic crisis threatens to divert critical energies into containing tensions or preventing open conflicts.

[10] *CNN*
[11] *Arab News*
[12] *The Financial Times*
[13] *Guardian News and Media Limited*
[14] *Telegraph Media Group Limited*
[15] *CNBC*