

THE QATARI QUESTION

By Phil Torres, Director of Sovereign and Emerging Markets Research

On June 5, 2017, diplomatic, land, sea, and air relations were severed between Qatar and its Gulf Cooperation Council (GCC) neighbors. Qatar is exceptionally wealthy with a per capita GDP of \$66,500. Additionally exports and imports with the GCC are each less than 10% of trade. As of yet, there is no naval blockade (we don't expect one either), hence commerce should continue.

Political Analysis

The GCC actions against Qatar were led by Saudi Arabia in an attempt to force Qatar to re-align itself with Saudi Arabia's foreign policy interests.

Tensions between Saudi Arabia and Qatar have existed since the mid-1990s, when Qatar pursued a foreign policy independent of Saudi Arabia's—specifically one that supported the Muslim Brotherhood, a sworn enemy of Saudi Arabia, Egypt and other Emirates. More recently, tensions have grown due to Qatar's commercial and political interactions with Iran, Saudi Arabia's regional rival.

Under President Obama's tenure, the United States implored regional actors to cooperate for the sake of general stability as he sought a nuclear treaty with Iran. President Trump has abandoned this strategy, pivoting to a uniformly pro-Saudi Arabia stance. Combined with a new and more direct King in Saudi Arabia, this appears to have emboldened Saudi Arabia to have taken a harsher "with us or against us" position with Qatar.

Adding to strains in the relationship is the Qatari state-owned television network, *Al Jazeera*. The station broadcasts globally, and as an agent of the Qatari government, takes positions contrary to other regional actors, which can disrupt the Saudis ability to control the narrative.

At the moment, we assume that Qatar does not face and existential threat to its sovereignty. Our worst case scenario is that Saudi Arabia would foment a regime change in Qatar.

Economic Analysis

With Qatar's vast wealth, there is little near-term credit risk. Qatar holds savings in its sovereign wealth fund and foreign currency reserves of more than 225% of annual GDP and roughly 12 times annual imports. However, the energy price rout of 2014 did not spare Qatar. Like its GCC neighbors, growth has slowed to mid-single digit levels and it runs modest current account and budget deficits.

The government has official external debt of 50% of GDP. Net debt, after accounting for potential contingent liabilities of various quasi-sovereign and banking firms, is probably closer to 0%, though this estimate is difficult to confirm.

Qatar's hydrocarbon industry generates 74% of its fiscal receipts and 91% of its export earnings through sales of, primarily, liquefied natural gas (LNG). Over 90% of the LNG is shipped to Asia and Europe. Imports from the GCC are less than 7% of total trade.

The Qatari banking system appears to be the most exposed to GCC sanctions. Roughly 1/3 of liabilities in the domestic banking system are from overseas (S&P recently stated the GCC contributes about 8% of Qatar Banks' external funding). To help press their point on this exposure, the Saudi Monetary Authority has stated they will cease buying Qatari rials.

Credit Portfolio Implications

Credit spreads of sovereign, quasi, and corporate Qatari issuers have widened. Currency forward points have moved weaker as well. Both moves suggest fears of capital insufficiency, which we do not expect to occur in the medium term.

We have no special insight to Qatar's political situation, but based on an economics and policy evaluation, we think spreads are too wide. Our outlook supports the gradual accumulation of spread exposure. However, there are certainly scenarios which could lead us to change our view. For example, if external pressure on Qatar remains in place for a protracted amount of time (longer than a few years), if the pressure increases and Qatar's economic position deteriorates, or if rising tensions lead to military confrontation or regime change.

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