UNITED ARAB EMIRATES

THE CHALLENGE OF THE LOW-CARBON TRANSITION

The economy of the United Arab Emirates (UAE) is still one of the most dynamic in the region. The strong performances are due to the UAE's sectoral diversification and the attractiveness of Dubai to tourists and investors. Despite the tense geopolitical environment, the short-term outlook is bright, as hydrocarbon production is expected to increase and the steady growth in services and real estate is expected to continue. However, geopolitical risk, oil market uncertainties and US monetary policy are all factors that could threaten this outlook. Uncertainty about the pace and scope of the low-carbon transition is making the longer-term outlook much more uncertain. The UAE's strategy is to continue to increase its hydrocarbon production capacity in order to take advantage of favourable production conditions and to diversify exports.

DYNAMIC NON-HYDROCARBON SECTORS

In 2023, economic growth in the UAE (which stood at +3.1%, according to central bank estimates) was among the strongest in the region, thanks to its dynamic non-oil sectors (+5.9%) and the relatively small drop in hydrocarbon GDP (-3%). Activity was up 3.1% in Abu Dhabi (around 60% of the UAE's economy), boosted mainly by the construction sector and financial services. The hydrocarbon sector (around 47% of GDP) contracted by 2.9% as a result of OPEC's decision to limit production in order to bolster prices.

In Dubai (around 22% of the UAE's GDP), the dynamic services sector is expected to drive growth to around 3.5% of GDP. The logistics and transport sectors and, to a lesser extent, retail were the primary growth drivers in 2023.

In the short term, the outlook for the non-hydrocarbon sectors is positive. Residential real estate is expected to continue growing, despite an expected slowdown in Dubai, given the rapid construction rate seen since 2020. More broadly, the UAE's attractiveness to tourists and foreign investors is supporting the real estate sector. For example, the visa system has recently been relaxed and foreign investors are now allowed to hold up to 100% of the capital of a company registered in the United Arab Emirates. Tourist numbers are expected to continue growing, albeit at a slower pace than in 2023. This is because the spike in the number of visitors in 2023 (+19% in Dubai) was partially as a result of COP28 being held in the country.

The short-term outlook for the oil sector is more mixed. Although there are some signs of global oil demand recovering, OPEC+ countries will be cautious before easing the restrictive quota policy. We expect oil production in the UAE to increase by around 1.7% in 2024.

Overall, growth is expected to hit 3.9% in 2024 and accelerate to 5.4% in 2025, thanks to the expected increase in oil production in particular.

POTENTIAL RISKS TO GROWTH

Oil market developments still have a major impact on activity, despite the country having a diversified economy compared to the rest of the region. In recent years, the increase in oil production capacity across North and South America has restricted the cartel's influence on the oil market, which may limit the increase in production quotas for OPEC countries.

Interest rates being kept high in the United States is another constraint, as the Central Bank of the UAE has to follow the Fed's monetary policy due to the Emirati dirham being pegged to the US dollar. Although the Fed is expected to start cutting rates this year, this will likely be done at a moderate pace, given the buoyant economic activity in the United States.

The geopolitical environment may have serious adverse repercussions for the United Arab Emirates, given the size of the services sector, which is traditionally more sensitive to political risk than industry, and the UAE's dependence on maritime trade routes. If the Strait of Hormuz were to be blockaded, this would severely limit oil export

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth (%)	4.4	7.9	3.1	3.9	5.4
Inflation, CPI, year average, %	-0.1	4.8	1.6	2.1	2.0
Gen. Gov. balance / GDP (%)	4.0	9.9	6.5	5.7	4.5
Gen. Gov. debt / GDP (%)	36	31	31	26	22
Current account balance / GDP (%)	11.5	11.6	9.3	7.8	6.9
External debt / GDP (%)	97	85	87	87	85
Forex reserves (USD bn)	128	134	184	192	202
Forex reserves, in months of imports	4.8	4.6	5.9	5.9	5.9

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

UAE: REAL GDP GROWTH

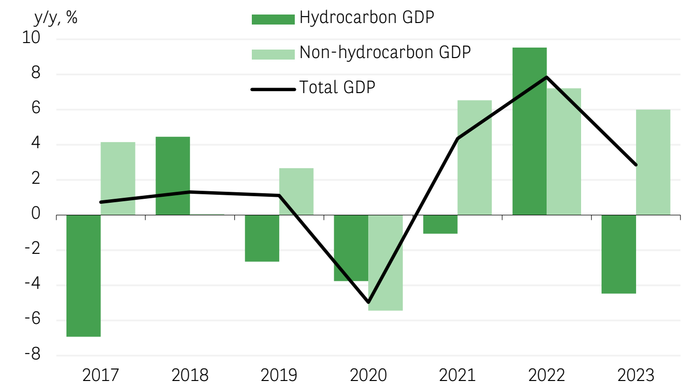

CHART 1

SOURCE: IMF, BNP PARIBAS

capacity. Indeed, the pipeline connecting Abu Dhabi's oil fields to the Port of Fujairah has a capacity of 1.5 mb/d, while exports average 2.6 mb/d. However, disruption to shipping traffic in the Red Sea has hardly affected oil exports, as Asia is by far the largest export market. Therefore, paradoxically, the increased geopolitical risk may positively impact activity in the UAE, and Dubai in particular, which is home to nationals from countries that have come under geopolitical tensions in recent years.

ROBUST PUBLIC AND EXTERNAL FINANCES

Public and external liquidity and solvency indicators are robust at the consolidated level. Non-hydrocarbon budget revenue accounts for approximately 45% of total government revenue. It comes from taxes and dividends from government-owned companies. On the other hand, government spending is growing at a moderate pace. Against this backdrop, the fiscal breakeven oil price per barrel is below USD 60/b, generating a surplus in the public accounts. Government debt is low (27% of GDP in 2023) and is decreasing. The government net asset position is confortable, given that the assets held by sovereign funds are worth at least twice the GDP.

The contingent debt of the seven Emirates (defined as the contingent debt of non-banking government-related entities in which the government holds a majority stake) is high (29% of Abu Dhabi's GDP and 38% of Dubai's GDP), but it does not pose a systemic risk.

THE UAE IN THE LOW-CARBON TRANSITION

Reliance on hydrocarbons (revenue from hydrocarbons accounts for about 40% of export revenue (excluding re-exports) and 55% of government revenue) is exacerbating the uncertainties around the low-carbon transition. There is a two-fold risk at play. On the one hand, hydrocarbon assets could lose their value (and become stranded assets) and therefore stop generating enough revenue for the economies in question, while on the other hand, the economic diversification may remain unsufficient. While many countries have a low-carbon transition as a goal, its pace and economic implications are currently very uncertain. Nevertheless, for oil producers, the risk of facing serious economic difficulties in a relatively short period of time (two decades) is not negligible, according to the IMF[1].

Against this backdrop, the UAE is developing a two-pronged strategy: continuing to make optimum use of its hydrocarbon resources, by increasing its production capacity, and preparing for the post-hydrocarbon era by accelerating the diversification of its economy. Unlike other producers in the region, the UAE is aiming to increase its oil production capacity in the medium term. It is currently estimated to stand at just over 4 mb/d, and the country is targeting 5 mb/d by 2027. At the same time, gas extraction is expected to increase so that the country becomes a net gas exporter by 2030. Currently, part of the UAE's domestic consumption is covered by imports from Qatar. At the same time, the targets for decarbonising the energy mix are ambitious. On the one hand, they involve electrifying more than 50% of the energy mix by 2050 (20% currently) and, on the other hand, decarbonising electricity generation. In 2022, around 18% of the electricity mix was decarbonised, if nuclear energy is included (13% of the electricity mix). The country has major renewable energy ambitions (which only involves solar energy, given the features of its climate), aiming to triple its production capacity between 2022 and 2030.

UAE: CRUDE OIL PRODUCTION

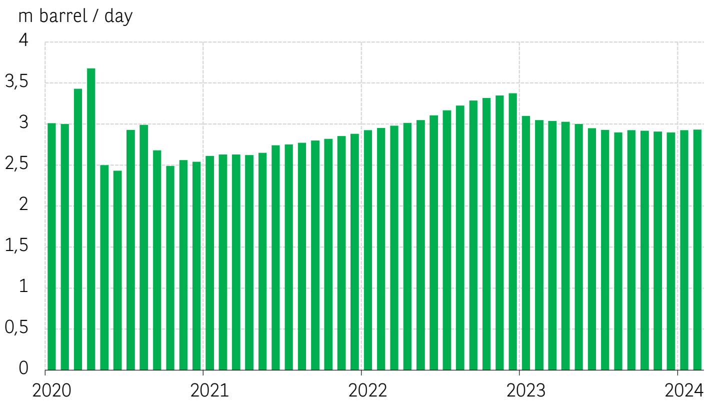

CHART 2

SOURCE: OPEC, BNP PARIBAS

THE CHALLENGE OF DIVERSIFYING EXPORTS

The energy transition adds a new dimension to the process of economic diversification. For more than twenty years, diversifying Gulf economies has mainly been about creating jobs by developing the private sector. As highlighted in the IMF report, the energy transition involves another diversification, as these economies will now have to diversify their exports, given falling income from hydrocarbons. Up until now, diversification has mainly been concentrated in sectors with limited productivity (tourism) or in non-exportable goods sectors (real estate), and has not been seen in many sectors involving exportable high value-added goods or services (with the exception of logistics and energy-intensive industrial sectors, such as petrochemicals and aluminium).

The UAE has a number of key assets that it can leverage in order to implement this new diversification. Substantial financial resources will enable the Federation to invest internationally in renewable energies (Masdar) or to hold stakes in innovative companies. In addition, its research and development expenditure are somewhat higher than the rest of the region (standing at around 1% of GDP on average between 2000 and 2018, compared to less than 0.5% for the other Gulf countries). Nevertheless, the UAE is facing stiff international competition in its willingness to develop new export sectors, particularly around trying to attract innovative companies and skilled labour. For exemple, in the artificial intelligence (AI) sector, considerable resources are being deployed to increase the capacities of data centres, which are essential for developing the AI sector. Growth in this sector is currently still too small to have a real economic impact. Overall, even though the UAE seems best placed within the region to implement the second wave of diversification, and while it is too soon to measure its effects, there are still major uncertainties around whether it can keep up its current level of economic development within the low-carbon transition.

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1 R. Cherif, F. Hasanov and M. Sarsenbayev, *Call of Duty. Industrial Policy for the Post-Oil Era*, IMF, WP/24/74.