U.A.E.

AN UNEVEN ECONOMIC RECOVERY

The United Arab Emirates (UAE) was hit by a twin shock with the fall in oil prices in 2020 and the pandemic's impact on the services sector. The 2020 recession was severe, and the recovery this year is expected to be mild. Despite the positive prospects of the World Expo, Dubai's economic activity will continue to be restrained by structural difficulties in the real estate market and uncertainty in the tourism and logistics sectors, which are unlikely to return to normal before 2023. Against this backdrop, public finances and the external accounts remain very favourable thanks to the accumulation of years of surpluses, but credit risk is on the rise. Some government-related entities active in the real estate sector are experiencing difficulties, and government support will remain selective.

A GRADUAL ECONOMIC RECOVERY

Of the Gulf countries, the United Arab Emirates (UAE) was the economy hit hardest by the double shock of the fall in oil production and prices, and the impact of the Covid-19 pandemic on the services sector. Real GDP contracted 6.1% in 2020 due to a decline of roughly 6% in hydrocarbon GDP (about 30% of total GDP) and non-hydrocarbon GDP. As OPEC's third largest oil producer, the UAE accounts for 10% of the cartel's total oil production. Under the restrictive policy of OPEC+ producers, oil production was cut back by 7.5%. The Covid-19 pandemic had a massive impact on logistics (down 16%) and retailing (down 13%), which account for 6% and 13% of GDP, respectively. In construction and real estate, which together account for 14% of GDP, activity contracted 9%. Most of the country's non-hydrocarbon activity is concentrated in Dubai, which accounts for about 30% of UAE GDP. With the downturn in retailing (-12%), restaurant services (-33%) and logistics (-36%), Dubai's GDP contracted 11%.

In 2021, GDP growth in the UAE is expected to reach 2.0%. This sluggish recovery is due in part to the decline in hydrocarbon GDP (-2.8%) for the second consecutive year. Oil production has picked up since June, but only gradually, and current production levels (2.8m b/d in September 2021) are still far from that of April 2020 (3.7m b/d). As to non-hydrocarbon activity, leading indicators are still mixed for H1 2021, and the situation will not change fundamentally with the opening of the Dubai World Expo in October. Despite one of the world's most extensive vaccination campaigns, mobility indicators are still barely higher than pre-pandemic levels. In Q1 2021, Dubai's GDP contracted 3.7% due to an ongoing decline in logistics (-32% y/y), and despite a mild rebound in retailing (+2.8% y/y). At 30 June 2021, passenger arrivals at the Dubai airport were down 70% year-on-year. Over the same period, the number of building completions was down 41%. Tourism picked up over the summer months and the opening of the Dubai World Expo over the next six months should add to this momentum.

The economic recovery is not expected to consolidate before 2022. Hydrocarbon GDP growth is estimated at about 7% thanks to the ongoing increase in oil production, but also the upward revision of the UAE's production quota within OPEC. Although the UAE has major oil production capacity (4.2m b/d), it is worth being cautious about oil market trends since demand is uncertain, and non-Opec+ oil producers could increase their production. The expected increase in oil prices should benefit the non-hydrocarbon economy, notably the real estate sector. With the gradual decline in the pandemic's restrictive grip on travel, non-hydrocarbon GDP should increase by 3.2%. All in all, GDP growth in the UAE is likely to reach 4.4%. Yet there are still major downside risks. If the pandemic persists, it could have a negative impact on global oil demand and tourist traffic. The logistics sector activity is expected to be constrained for several more quarters due to the disruptions in world trade. As a result, business is not expected to return to normal before 2023.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	3.4	-6.1	2.0	4.4
Inflation (CPI, year average, %)	-1.9	-2.0	-0.1	0.9
Gen. Gov. balance / GDP (%)	0.6	-5.5	1.8	2.5
Gen. Gov. debt / GDP (%)	17	16	17	18
Current account balance / GDP (%)	8.9	5.8	6.8	7.6
External debt / GDP (%)	66	66	67	68
Forex reserves (USD bn)	107	103	109	123
Forex reserves, in months of imports	40	46	46	50

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

REAL GDP GROWTH (%)

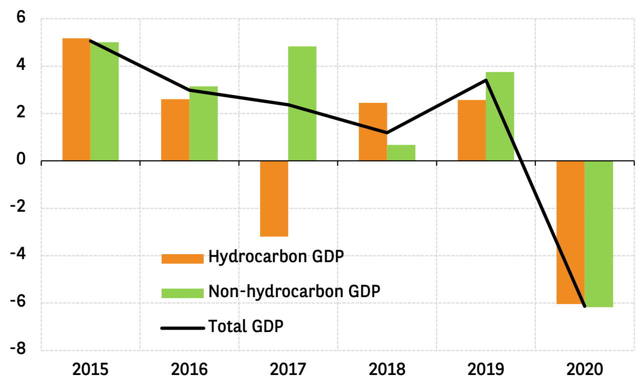

CHART 1

SOURCE: FEDERAL COMPETITIVENESS AND STATISTICS CENTRE, BNP PARIBAS

In the medium term, the hydrocarbon sector should benefit from the investment plan announced by the national oil company ADNOC, which plans to invest massively over the next five years (a total of USD 122 bn, the equivalent of 40% of hydrocarbon GDP each year) to increase its oil and gas production capacities and to boost petrochemical production.

In the non-hydrocarbon sector, prospects are not as clear. For several years, Dubai has been caught in a lasting crisis in the real estate sector. Due to a structural oversupply, transaction prices and rent have fallen constantly since 2015. Passenger traffic growth at the Dubai airport has also been constantly losing momentum since 2015 (+4.3% on average in 2015-19, vs. +11.2% in 2009-14), and it has slipped into negative territory since June 2019. Looking beyond the cyclical influence of the hydrocarbon sector, this downturn could signal Dubai's relative loss of attractiveness as a destination. Airport traffic trends at Dubai have fallen short of global passenger traffic growth since 2019. Generally speaking, since 2020, the authorities have engaged in a programme to improve the UAE's attractiveness for companies and residents alike at a time of growing regional competition.

SOLID MACROECONOMIC FUNDAMENTALS

Despite the sharp contraction in GDP growth, the fiscal and external accounts have not deteriorated much. In 2020, according to our estimates, the fiscal deficit amounted to about 5.5% of GDP. Accounting for about 45% of total revenue, hydrocarbon revenue fell by a third as oil production and prices plummeted. Total spending contracted by about 15% despite specific economic support measures, equivalent to about 2% of GDP. The UAE is expected to report a slight surplus in 2021 (1.8% of GDP) thanks to a significant increase in hydrocarbon revenue and a mild increase in spending. Yet this still falls far short of the pre-pandemic level of 2019.

Public solvency is bolstered by the moderate level of consolidated government debt (36% of GDP in 2020) and by very large sovereign wealth funds (more than twice GDP), the majority of which are held by the Emirate of Abu Dhabi. Each emirate is fiscally autonomous (excluding defence and security budgets, which are federal) and can issue debt in the international markets. Since 2020, a total of about USD 25 bn has been issued by the Emirates of Abu Dhabi (USD 20 bn, or about 10% of Abu Dhabi's GDP), Sharjah (USD 2.3 bn, or 7.4% of GDP) and Dubai (USD 2.9 bn, or about 2.8% of Dubai's GDP). Abu Dhabi's bond issues go beyond the financing of any fiscal deficits or the rollover of maturing debt. Thanks to regular bond issues, they serve as a benchmark for other issuers. As to Dubai, part of its financing is used to support certain ailing state-owned enterprises (notably in the transport sector). Moreover, for the first time, the federation issued an international bond in October 2021 for a total amount of USD 4 bn. The federation has been authorised to call on market funds only since 2019. It should finance infrastructure projects.

The external situation is very comfortable, with high and recurrent current account surpluses, even during downturns in the oil cycle. These surpluses have averaged 7% of GDP since 2016, and we are forecasting a surplus of 6.8% of GDP again this year. Foreign reserves are currently equivalent to about 4.5 months of imports of goods and services.

PERSISTENT CREDIT RISK

The exposure of banks to the sectors hit hardest by the economic slowdown has had a negative impact on the quality of loan portfolios. At the federation level, the non-performing loan ratio rose to 8.2% in June 2021 (according to the IMF), the highest among the Gulf countries, up from 6.5% at year-end 2019. In Dubai, a number of real estate developers are experiencing financial troubles and have begun to renegotiate their debt, which could lead to partial defaults. The construction and real estate sectors accounted for 20% of domestic loans outstanding in June 2021.

COMMERCIAL BANKS' BALANCE SHEET: MAIN ITEMS (YOY, %)

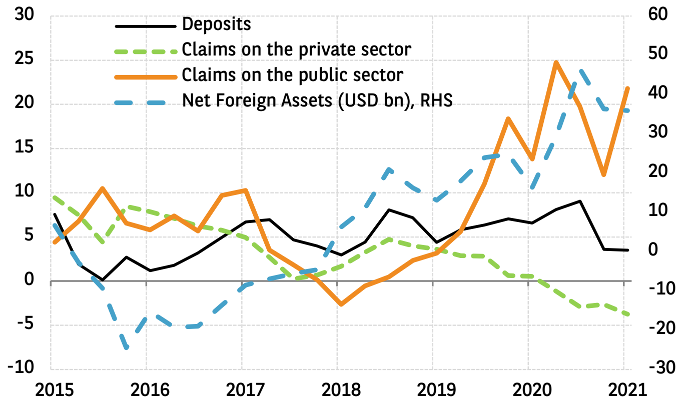

CHART 2

SOURCE: IMF, BNP PARIBAS

The increase in credit risk is not a systemic risk. Bank liquidity is still comfortable given the slow growth of domestic lending and the increase in deposits (+1.1% in June 2021). Lending to the private sector (70% of domestic lending) was down 2.1% y/y in June 2021 (-1.6% for domestic lending). With the slowdown in lending and the upturn in government deposits thanks to the improvement in the oil cycle, the net external position of the banking sector shows a significant surplus: USD 36 bn in March 2021, up from USD 16 bn in March 2020. The central bank has set up measures to support the banking sector: liquidity injections, the easing of certain prudential standards, and key rate cuts (by 125 bp in 2020). In general, although systemic banks can be assured of receiving federal support if needed, support is more selective for the government-related entities (notably in the real estate sector), which fall under the responsibility of the federated governments, which have more limited resources.

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Pascal DEVAUX
pascal.devaux@bnpparibas.com