Macroeconomic outlook

UAE: Real GDP growth sees signs of moderation in 2016

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Overview and outlook

- **Real GDP growth is expected to come in moderately lower in 2016 before seeing a pickup in 2017.**
- **Non-oil growth softened in 2016 but remains moderate thanks to pockets of strength in the transport, tourism and construction sectors.**
- **Inflation maintained its downward trend in 2016, as the initial impact of the sizeable 2015 subsidy cuts continued to subside.**
- **A wider but manageable fiscal deficit is projected for 2016, before returning to a surplus in 2017.**
- **Bank liquidity remained tight in 2016, as credit growth outpaced deposit growth; the latter has been pressured by lower oil revenues.**

Real GDP growth softening in 2016

Real GDP growth in the UAE is forecast to soften from an estimated 3.8% in 2015 to around 2.1% in 2016, on the back of a slowdown in the oil sector and a moderation in non-oil sector activity (Chart 1). Depressed global energy prices have capped gains in the oil sector. Growth in the non-oil sector has been softening, albeit moderately, as the hospitality and construction sectors continue to churn out decent gains.

Growth in the oil economy is expected to remain muted in the near-to-medium term, as low oil prices keep any significant increases in production at bay. We expect real growth in the oil sector to slow from 5.0% in 2015 to 1.0% in 2016, before recovering slightly in 2017, provided that production levels increase as planned.

Non-oil sector activity continued to lose momentum in 2016, though it maintained a healthy pace. The UAE's Markit Purchasing Managers' Index (PMI), a leading indicator of non-oil sector growth, appeared to stabilize in 2016 after a period of retreat. Some weakness in external demand appeared to be partly offset by strength in the domestic market. The tourism, transport and construction sectors, some of the biggest contributors to non-oil GDP growth, continue to see decent gains. Furthermore, after slowing for the bulk of 2015, activity in the residential real estate sector is seeing signs of stabilization.

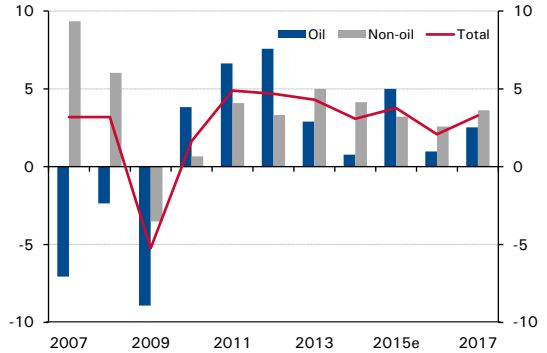
Table 1: Key economic indicators

		2014	2015	2016f	2017f
Nominal GDP	USD bn	401.9	370.3	360.8	395.8
Real GDP	% y/y	3.1	3.8	2.1	3.2
- Oil	% y/y	0.8	5.0	1.0	2.5
- Non-oil	% y/y	4.1	3.2	2.6	3.6
Inflation	% y/y	2.0	4.1	2.5	3.0
Budget balance	% of GDP	4.2	-1.1	-2.8	1.8

Source: Official sources, NBK estimates

Chart 1: UAE real GDP

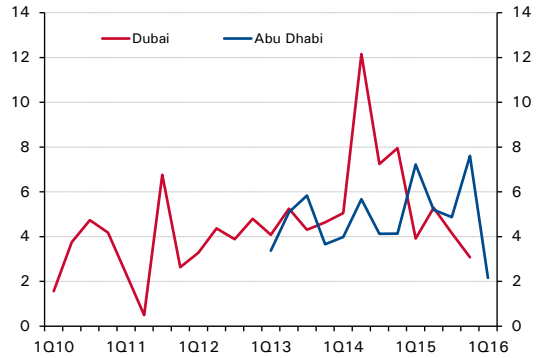
(% y/y)



Source: UAE National Bureau of Statistics, NBK estimates

Chart 2: Dubai & Abu Dhabi real GDP

(% y/y)



Source: Dubai Statistics Center, Statistics Centre - Abu Dhabi

Chart 3: Purchasing Managers' index

(index)

Source: Markit

Much of the resilience of the non-oil sector comes from Dubai's tourism and hospitality sectors. The number of passengers passing through Dubai's International Airport continues to hit new records. In August it reached 7.7 million passengers, up from the previous record of 7.6 million passengers just in July. Despite the drop in average daily room rates at hotels in Dubai over the past year, the demand for hotel rooms remains fairly strong as reflected in the occupancy rates. According to STR, Dubai's occupancy rate stood at a solid 76.1% in August.

Dubai's construction sector has also been a key driver of non-oil growth. Construction activity is poised to hold especially as Dubai prepares for Expo 2020. Projects include the construction of buildings, metro expansions, roads and bridges. In its 2016 budget, Dubai announced that it would allocate Dh 17 billion ($5 billion) to infrastructure projects; this is around Dh 2 billion higher than in 2015. The number is set to rise further in the lead up to Expo 2020 and as plans to foster the UAE's long-term vision of a post-oil "knowledge economy" get underway.

The vision is outlined in the recently launched "UAE Strategy for the Future", a comprehensive long-term blue print that aims to strengthen the nation's non-oil economy and further its economic diversification. The Dubai Industrial Strategy, which is expected to inject around $44 billion into Dubai's economy by 2030, was also launched recently and aims to harness and propel the emirate's non-oil economy.

Dubai's non-oil GDP loses some momentum but continues to hold

The latest data showed Dubai's overall economy slowing from 4.2% year-on-year (y/y) in 3Q15 to 3.1% y/y in 4Q15 (Chart 2). For the year 2015 as a whole, Dubai's headline GDP logged in a still decent growth rate of 4.1% y/y, thanks to pockets of strength in the non-oil economy.

We expect to see a slight improvement in GDP growth in 1H16, as reflected in the Emirates NBD Dubai Economy Tracker Index (DET), which has remained decent. The DET is a forward-looking survey that tracks economic activity in Dubai's non-oil private sector. It appears to have plateaued of late, steading at 55.1 in September (Chart 4).

Abu Dhabi's economy aided by decent levels of state spending

Following a strong acceleration of 7.7% y/y in 4Q15, growth in Abu Dhabi's real GDP slowed to 2.2% y/y in 1Q16 (Chart 2). The slowdown was led by a loss of momentum in both real oil GDP and non-oil GDP. While the slowdown can be attributed to lower oil revenues and a cutback in government spending, it can also be explained by some base effects; (overall growth was up 7.2% y/y around the same period last year). We should see some upward correction in 2Q16 as the economy remains supported by decent levels of state spending and the re-launching of delayed projects.

PMI appears to have steadied in 2016

After moderating throughout 2015, the UAE's PMI appears to have steadied between 53 and 55 in 2016 (Chart 3). In September, the headline PMI eased slightly to 54.1 on the back of a slowdown in new orders and new export orders. (A reading above 50 indicates an expansion in activity; a reading below 50 indicates a contraction.) However, output remains robust, above the 60 mark; the employment index ticked up slightly to 51.6, helping alleviate concerns of weaker business and employment conditions.

Residential property price growth in Dubai largely stabilized in 2016

Following almost two years of slowing growth amid tighter regulations,

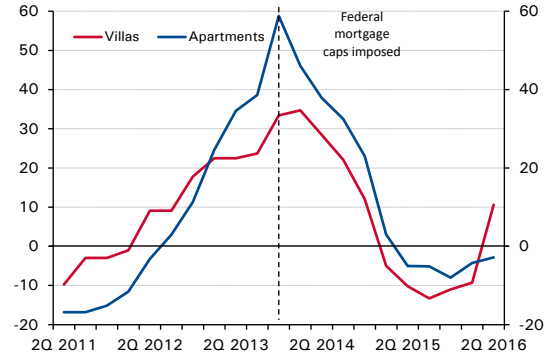
Chart 4: Dubai Economy Tracker

(index)

Source: Emirates NBD

Chart 5: Residential property sales prices

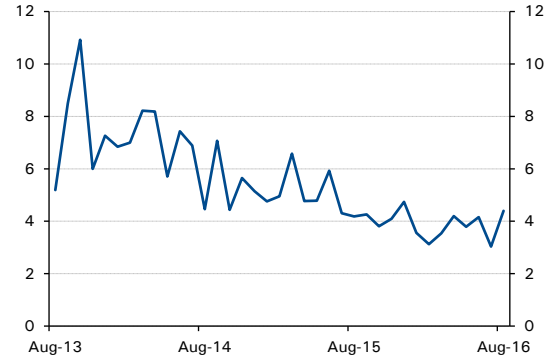
(% y/y)



Source: Asteco, JLL

Chart 6: Value of real estate transactions

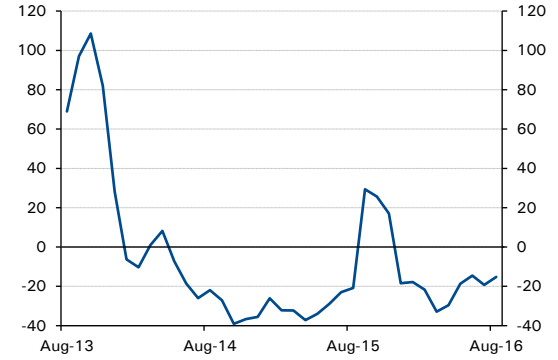
(AED billion)



Source: Dubai Land Department

Chart 7: Number of real estate transactions

(% y/y, 3-month average)



Source: Dubai Land Department

higher housing supply and risk aversion, residential property price growth in Dubai appears to have stabilized in 2016. According to data published by Asteco, prices of apartments fell by approximately 2.8% y/y in 2Q16 versus a decline of 4.3% y/y in 1Q16. On the other hand, prices of villas rose for the first time in just over a year, by 10.6% y/y. While the rebound in villa price growth indicates a recovery, it is also in part due to base effects (Chart 5).

While the value of real estate sales continues to trend lower, growth in the number of transactions has been recovering, albeit gradually. One reason for this has been increased activity in the "more affordable" housing segment (Charts 6 and 7).

Consumer price inflation down sharply in August on lower fuel prices

Headline inflation has been trending lower since mid-2015, mainly due to a slowdown in housing inflation (which weighs heavily in the index) and lower fuel prices. Inflation in the consumer price index (CPI) dropped from 1.8% y/y in July to 0.6% y/y in August (Chart 8). Among the drivers have been easing housing inflation and soft local food prices. Declining fuel prices were also a factor, causing prices in transportation & communication to decline by 12.1% y/y in August.

Following a recovery in global oil markets in both September and early October, we may see some upward inflationary pressures from the transport & communications segment in the near-to-medium term. However, the ongoing softness in both housing and food inflation should help offset some of that upward inflationary pressure. As a result, we forecast inflation to slow from an annual average of 4.1% in 2015 to 2.5% in 2016.

Wider but manageable fiscal deficit expected for 2016

The UAE's fiscal balance is expected to log in a deficit of 3.0% of GDP in 2016, on solid spending levels and lower oil earnings (Chart 9). The fiscal balance is expected to return to a surplus in 2017 provided that oil prices recover and the UAE increases its oil production levels as planned.

The UAE government is unlikely to engage in significant fiscal consolidation in the medium-term, thanks to its abundant financial reserves (200% of GDP). Both Dubai and Abu Dhabi are projected to maintain high levels of public spending on infrastructure projects. In Dubai, infrastructure spending is expected to accelerate in the run-up to Expo 2020.

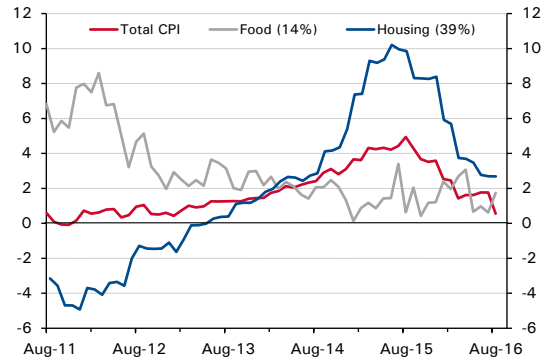
Nonetheless, the major emirates have embarked on some fiscal adjustment and reform, including subsidy cuts and the introduction of fees on certain services. According to official reports, Abu Dhabi has cut back or delayed spending on a number of projects designated as low-priority. Efforts have also been made to rely more heavily on the private sector for implementation of some projects.

Furthermore, it increasingly looks like the UAE will be one of the first GCC nations to implement a value added tax (VAT). According to recent reports, draft VAT legislation is expected in early 4Q16. So far, the first phase of implementation is scheduled for 2018 and will require UAE companies with annual revenues greater than $1 million (Dh 3.75 million) to collect and pay VAT. At 5%, the VAT is expected to generate around $3.3 billion (Dh 12 billion) in tax revenues or around 1% of GDP.

In an attempt to preserve foreign assets, the UAE has also tapped into international debt markets to plug its budget gap. In April, Abu Dhabi sold $5 billion in sovereign bonds, the first issuance since 2009. With public

Chart 8: Consumer price inflation by sector

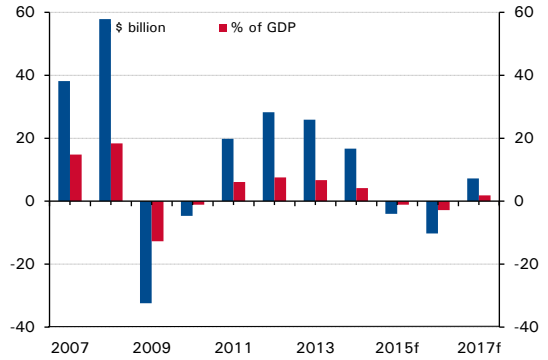
(% y/y, weights in brackets)



Source: Thomson Reuters Datastream

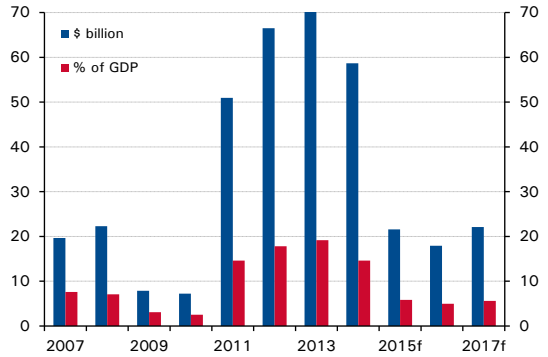
Chart 9: Budget balance

(revenues include ADNOC profits & investment income)



Source: UAE National Bureau of Statistics, NBK estimates

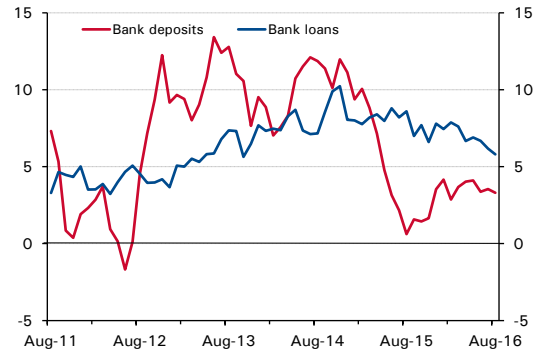
Chart 10: Current account balance



Source: UAE National Bureau of Statistics, NBK estimates

Chart 11: Bank loan and deposit growth

(% y/y)



Source: Central Bank of the UAE

debt estimated at around 50% of GDP, the UAE still has room to raise debt.

Thus far, sovereign issuance has been at the level of individual emirates rather than at the federal level. This is about to change, with the UAE in the process of finalizing a federal debt law by early 2017 allowing the federal government to issue bonds. With investors globally in search for yield amid a low global rate environment, higher yielding UAE bonds are expected to be in high demand once the federal government begins to issue them.

Current account surplus to narrow on lower oil export receipts

The surplus in the current account is set to continue to narrow in 2016, as oil export earnings remain in decline and non-oil export growth sees some moderation. Non-oil export revenues are expected to face downward pressure, but are nevertheless expected to hold thanks to modest gains in the trade and tourism sectors (Chart 10). As a result, we project the current account balance to narrow slightly from 6% of GDP in 2015 to 5% in 2016, before edging higher in 2017 on the back of a recovery in oil prices and as non-oil export growth gathers momentum.

The UAE's non-oil exports will be under some pressure due to the stronger dirham. Although it has come off the highs seen earlier this year, the stronger dollar has led to an appreciation in the dirham's trade-weighted index, increasing the cost of its exports and making it a more expensive place to visit and invest in (Chart 16). Trade with the UAE's Asian markets has been most affected by the stronger dirham. Tourism has been less affected given that a majority of tourists are from the GCC. Meanwhile, investment in real estate, which depends far more on UAE nationals, has not been much affected. Overall, the impact on the non-oil economy has been relatively limited and we forecast a continued decent performance.

Banking liquidity remains tight amid lower oil revenues

Credit growth has continued to moderate this year, albeit gradually, on the back of softer real estate activity and some cutbacks in the construction sector. Latest data showed loan growth easing from 6.2% y/y in July to a still decent 5.8% y/y in August. With capital spending projected to accelerate in the run-up to Expo 2020 in Dubai, we should see lending growth gather some momentum in the medium-term (Chart 11).

Bank deposit growth eased further, from 3.5% y/y in July to 3.3% y/y in August amid weaker government deposit growth, which continued to be weighed down by lower oil receipts (Chart 11). Against a backdrop of relatively decent rates of credit growth, the slowdown in deposit growth pushed the loan-to-deposit ratio up from 103.6% in July to 104.7% in August, its highest level in just over four years.

Growth in the broad money supply (M2) remains soft pointing to tighter liquidity conditions. In August, it stood at 2.3% y/y as growth in quasi-money (foreign exchange and longer-term dirham deposits) decelerated from 2.0% y/y in July to 1.5% y/y in August (Chart 12).

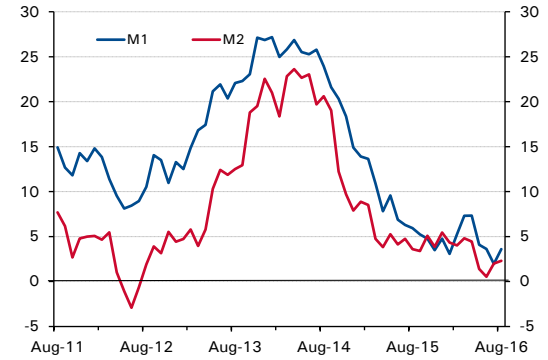
Both the UAE's three-month and one-month interbank rates have been gradually edging upwards, and are currently hovering at near four-year highs (Chart 13). These rates are forecast to edge even higher, especially if the US Fed hikes its federal funds rate again this year.

SME market reform should boost lending and growth

Small and medium-sized enterprises (SME) account for over 95% of companies in Dubai and are a major driving force behind the emirate's economy. Yet, SMEs have been hobbled by the absence of a robust and

Chart 12: Money supply

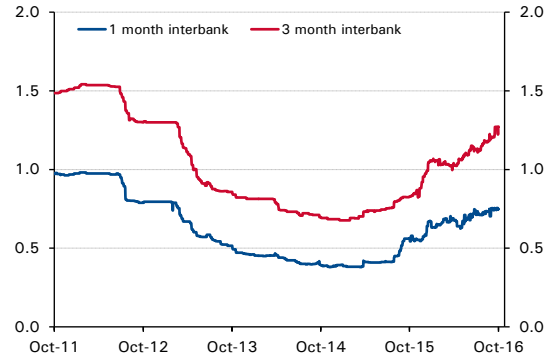
(% y/y)



Source: Thomson Reuters Datastream

Chart 13: Interbank rates

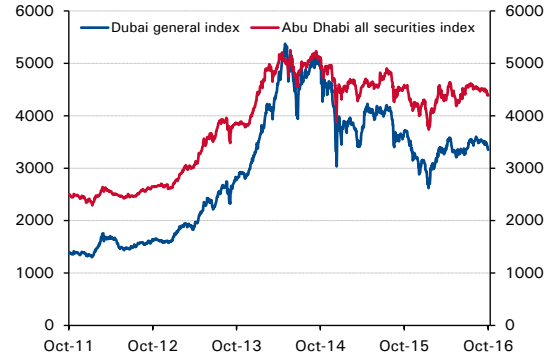
(%)



Source: Thomson Reuters Datastream

Chart 14: Stock market indices

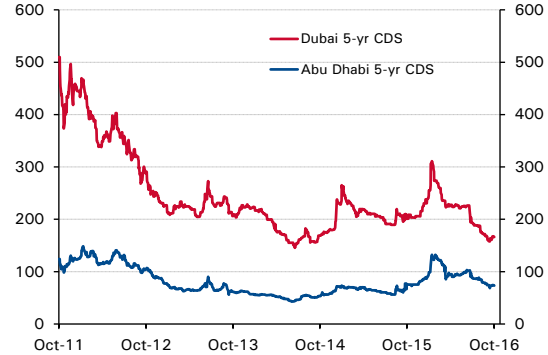
(index)



Source: Thomson Reuters Datastream

Chart 15: Credit default swaps

(basis points)



Source: Thomson Reuters Datastream

fair bankruptcy law, with knock-on effects on the banking sector. This is expected to change with a long-awaited bankruptcy law set to be finalized before the end of 2016.

Under the existing regulatory umbrella, any unpaid debt or a bounced check would land the owner in prison. Given the weaker external environment and a vulnerable trading sector that accounts for the bulk of SMEs in Dubai, this led to a jump in the incidences of default. Under the new insolvency law, banks and company owners will be able to negotiate ways to restructure any bad debts. This should help improve banks' credit quality and instill confidence in SMEs, and subsequently boost lending to the sector.

Markets and interest rates

The main Abu Dhabi and Dubai markets continue to lack major catalysts in -line with regional and international markets, on the back of global growth concerns, the low oil price environment and uncertainties ahead of the US presidential elections in November.

The main credit default swaps (CDS), which serve as good gauges of the level of risk within an economy, have come down further recently and have been hovering at multi-year lows (Chart 15). At the start of October, the CDS on five-year Dubai and Abu Dhabi government debt stood at 166 and 73 basis points, respectively.

Chart 16: UAE trade-weighted exchange rate

(index, Jan 2000 = 100)

Source: Thomson Reuters Datastream, NBK estimates

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