Growth to accelerate in 2018 as non-oil activity recovers and oil output increases

Highlights

- We see headline growth edging up from 0.8% in 2017 to around 2.5% in 2018, as preparations for the Dubai Expo 2020 event remain supportive of non-oil growth and as oil production increases.
- Consumer price inflation is expected to rise to 3.5% this year on average from 2.1% in 2017, mainly on the back of the introduction of VAT in January.
- The fiscal position should recover in 2018, registering a small surplus of 0.4% of GDP thanks to higher oil revenues and despite an easing in the pace of fiscal consolidation.
- Credit growth is expected to remain subdued over 2018-19 due to tighter lending standards, higher interest rates and weakness in the real estate market; infrastructure financing should provide some opportunities though.

Growth to pick up on gains in the non-oil sector and as oil growth recovers

After moderating for two straight years, real GDP growth in the UAE is set to accelerate over the forecast period, edging up from 0.8% in 2017 to around 2.5% in 2018 and 3.3% in 2019. (Chart 1.) Growth will be driven by ongoing infrastructure investment in the non-oil economy and increasing output in the oil sector, as the OPEC production cut agreement is wound down.

With oil production expected to increase from mid-2018, we think real oil GDP growth will recover from 2017’s decline of 3.0% and rise to 0.6% and 1.5% in 2018 and 2019, respectively. According to the latest official data, UAE crude production averaged 2.87 million barrels per day (mb/d) in May, having experienced its first increase in March (+1.6% m/m) in more than a year.

The UAE continues to invest in expanding its oil production capacity in anticipation of higher demand. ADNOC, the state-owned oil firm, recently announced plans to double its refining capacity and triple its petrochemical output by 2025. To support its plan of attracting strategic investors, it intends to privatize parts of its businesses and offer six competitive oil and gas concessions for the first time. Bids are due by October, with the winner granted exploration and development rights.

The non-oil economy, meanwhile, is forecast to maintain its healthy growth momentum and expand by 3.3% this year from 2.5% in 2017, supported by further gains in the tourism and construction sectors, especially with the Expo 2020 event in Dubai drawing nearer. 2019 should see the non-oil economy grow by a further 4.0%.

Growth in Dubai and Abu Dhabi to benefit from a new package of economic reforms

Moreover, in a further effort to support the non-oil economy, the federal authorities and the governments of Dubai and Abu Dhabi have unveiled a series of growth-enhancing measures in...
recent months. At the federal level, the UAE has raised the share of local businesses outside of designated “free zone” areas that foreigners are permitted to own from 49% to 100%.

The move is part of a wider plan that includes residency visas of up to 10 years to investors and highly skilled expats, such as specialists in the scientific, technical, medical and research fields. The new ownership and residency rules are expected to stimulate FDI inflows and help boost the domestic real estate market.

Abu Dhabi, meanwhile, recently approved a three-year Dh50 billion ($13.6 billion) economic stimulus program. The authorities intend to make it easier to do business in the emirate, spur employment growth and increase tourism activity. Government spending has been key to the emirate notching up a third consecutive quarter of accelerating non-oil growth—3.0% in 4Q17. Headline growth, however, managed only 1.1% y/y in the same quarter, given the dominance of the oil sector (which is subject to oil production cuts) in Abu Dhabi’s economy. (Chart 2.)

Dubai has also announced its own plans to improve the business climate and stimulate foreign investment. As a start, the authorities plan to waive some fees on aviation, real estate and school and reduce those on business. Furthermore, Dubai’s Department of Economic Development (DED) launched a package that will help businesses clear fines and renew licenses in monthly instalments. Businesses will also be able to freeze their trade licenses for a year and also seek favorable settlements with the DED for any commercial violations. In May, both Dubai and Abu Dhabi agreed to exempt businesses from any administrative fines until the end of the year, all in a bid to bolster foreign investment and business activity.

Meanwhile, economic growth in Dubai continues to fare better, thanks to its more diversified economy. Output expanded by 2.5% y/y in 4Q17. (See Chart 2.) Dubai’s important hospitality and construction sectors continue to perform well, and the measures unveiled above will undoubtedly act as a further boost to these respective sectors.

The number of passengers passing through Dubai International Airport came in at a record high of 23 million in 1Q18, just above the average 22 million recorded in 2017. (Chart 3.) Construction activity continues to be supported by preparations for the Expo 2020 event. Over $8 billion has been allocated to Expo-related projects, including for buildings, metro expansions, roads and bridges; Dubai has reportedly already invested up to half of that total amount so far.

A number of downside risks persist, however. If downward pressures on oil prices re-emerge, this could lead the government to adopt stricter fiscal consolidative measures again, quelling economic growth. Also, with interest rates likely to rise further, this could eventually lead to tighter liquidity and a slowdown in investment spending. A potential escalation of the Qatar crisis may also affect growth. While Qatar is not a major contributor to the UAE’s trade and tourism sectors, regional tensions typically affect investor sentiment.

Dubai’s residential property prices continued to ease in 1Q18

The impact of more stringent loan-to-value regulations (introduced back in 2013) on Dubai’s residential property market continues to be compounded by the effects of increased supply and higher interest rates. According to Asteco, the prices of both apartments and villas fell at a faster rate (−9% y/y) in 1Q18 than in the previous quarter; prices are expected to continue to fall this year due to still higher supply and further shifts in the composition of demand, away from luxury housing to more affordable housing units. (Chart 4.)
Inflation set to come in higher in 2018

After trending downwards for most of 2017, consumer prices increased in January following the introduction of a 5% VAT and the paring of fuel subsidies. Inflation leapt to 4.8% y/y in January from 2.7% y/y in December. However, the inflationary trend for the remainder of the year is expected to be downward—it fell to 3.5% y/y in April—as the initial impact of the tax/fuel hike wears off and as housing costs, which have been experiencing deflation, continue to move lower.

Loan growth remains subdued; deposit growth slows on government drawdowns

Loan growth continued to hit multi-year lows in 1H18, against the backdrop of a weak real estate market, higher interest rates and tighter lending rules. In April, lending growth stood at a mere 1.5% y/y, with private sector credit growth especially weak and lending to government-related entities in continued decline. (Chart 7.) However, while the central bank’s latest credit sentiment survey (1Q18) showed that lending standards continued to tighten moderately, especially for small to medium enterprises, it pointed to an improvement in credit growth in the near-to-medium term, particularly among businesses. Indeed, credit growth is likely to be supported by a rise in lending activity in the construction sector, as infrastructure spending is ramped up in preparation for the Expo 2020 event in Dubai.

Deposit growth also eased in 1H18. This is largely a reflection of a drawdown in government deposits. Latest figures showed deposit growth easing from 3.8% y/y in March to 3.4% y/y in April. Consequently, broad money (M2) growth also eased and, at 3.1% y/y in April, stood near multi-year lows. (Chart 8.)

Given the recent trends in credit and deposit growth, the loan-to-deposit ratio fell to 89.4% in April, compared to 91.0% at the start of the year.
Meanwhile, reflecting the slowdown in deposit growth, the cost of funding in the UAE has been rising; interbank rates were also lifted by the introduction of a new EIBOR system in April and in response to the general tightening in monetary policy that has been occurring since the US Federal Reserve began raising rates in late 2015. The most recent federal funds rate hike, of 25 bps on 14 June—the second rate increase this year—was followed immediately by a 25 bps increase in the UAE’s benchmark rate to 2.25%. (Chart 9.) At least one, possibly two more rate hikes are expected before year-end, but the increase in borrowing costs comes amid slowing deposit and credit growth, so will need to be monitored.

Dubai’s main stock market remains weighed down by the weakness in the property sector

Equities on the Abu Dhabi Exchange (ADX) and Dubai Financial Markets (DFM) have been on opposite trajectories in 2018. While the ADX is up 8% year-to-date (as of mid-June), thanks to the improvement in oil prices, the DFM is down 8%, as the ongoing weakness in the property sector continues to sour the mood. The planned liquidation of Abraaj, the region’s largest private equity firm, has also weighed on investor sentiment. The Dubai-based firm has been under international investor scrutiny over how it used money in a $1 billion healthcare fund. (Chart 10.) Nonetheless, the recently announced economic reforms are expected to help lift sentiment and ultimately improve market performance going forward.
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