Economic Update

NBK Economic Research Department I 2 January 2019

UAE outlook

Growth rising as non-oil activity gains momentum

> Dana Al-Fakir
Economist
+965 2259 5373, danafakir@nbk.com

> Omar Al-Nakib
Senior Economist
+965 2259 5360, omarnakib@nbk.com

Highlights

- **Real GDP growth should continue to trend upwards, rising from an estimated 2.2% in 2018 to 2.7% in 2020, supported by the non-oil economy and especially by gains in the construction sector.**
- **We see inflation slowing from an estimated 3.5% in 2018 to 1.5% in 2020, amid continued downward pressures, particularly from the housing component, and as the initial impact of the tax/fuel hikes wears off.**
- **The fiscal position is expected to improve over the forecast period on a pick-up in non-oil revenues; the deficit should narrow to 0.7% of GDP in 2019 before the balance shifts to a surplus of 1.2% of GDP in 2020.**
- **Credit growth is expected to gradually recover as lending to the business sector continues to gain traction.**
- **Lower oil prices and rising borrowing costs represent the main risks to the outlook in 2019-2020, although announced economic reforms and elevated public investment, especially in Dubai ahead of Expo 2020, are growth-positive.**

Growth to rise as non-oil sector gathers momentum

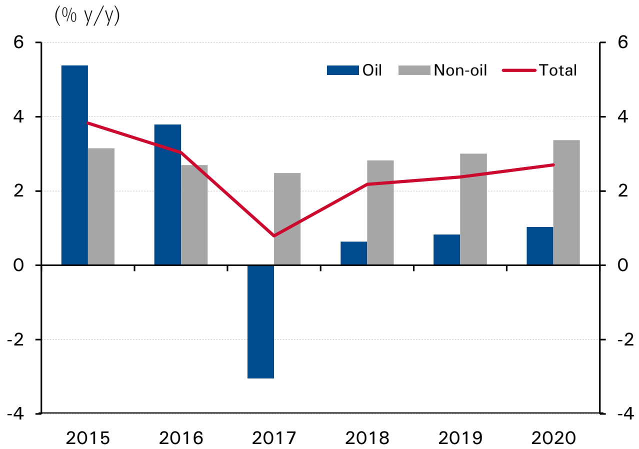
Real GDP growth in the UAE is projected to continue to trend upwards over the next two years, rising from an estimated 2.2% in 2018 to 2.4% and 2.7% in 2019 and 2020, respectively. (Chart 1.) While headline growth will see only a moderate contribution from the oil sector, on account of the UAE's participation in another round of OPEC+ production cuts in 2019 in order to balance oil supply (and thus support oil prices), it will, nevertheless, benefit from elevated construction activity and government spending ahead of the Expo 2020 on the non-oil side. The UAE cabinet, in October, approved a record federal budget of Dh60.3bn for the 2019 fiscal year. Credit growth will likely continue to recover as gains in business lending activity offset some of the monetary tightness stemming from higher interest rates. Further falls in oil prices represent the greatest risk to the outlook, in terms of lower government revenues, which could possibly force the government to scale back spending, and in terms of business confidence and banking sector liquidity.

Table 1: Key economic indicators

		2017	2018e	2019f	2020f
Nominal GDP	USD bn	387	396	405	416
Real GDP	% y/y	0.8	2.2	2.4	2.7
- Oil	% y/y	-3.0	0.6	0.8	1.0
- Non-oil	% y/y	2.5	2.8	3.0	3.4
Inflation	% y/y	2.1	3.5	2.0	1.5
Budget balance	% of GDP	-3.8	-1.2	-0.7	1.2

Source: Official sources, NBK estimates

Chart 1: Real GDP



Source: UAE Federal Competitiveness & Statistics Authority, NBK estimates

Only a marginal boost in oil GDP expected in 2019-20...

In 2019, according to the OPEC+ production agreement, the UAE is expected to pare back crude production by 2.5% (from October 2018's reference level) to 3.10 million barrels per day, starting January. Despite the cut, output in January will still be 8.2% higher y/y, and as such, we think real oil GDP growth is still likely to rise next year, from an estimated 0.6% in 2018 to 0.8% in 2019. It should accelerate further to 1.0% in 2020 as the UAE expands its oil production capacity in anticipation of higher demand.

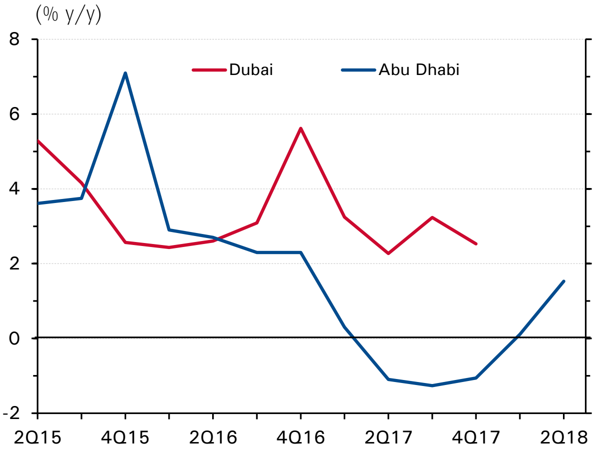
...but non-oil activity to benefit from 2018's economic reforms

Meanwhile, the non-oil sector is expected to remain supportive of overall growth, expanding by a healthy 3.0% and 3.4% in 2019 and 2020, respectively, mainly due to increasing construction activity ahead of Dubai's Expo 2020 event.

In an effort to prop up growth, the federal authorities and the governments of Dubai and Abu Dhabi announced a raft of pro-growth reforms throughout 2018. At the federal level, the authorities approved the issuance of residency visas of up to 10 years to investors and highly skilled expats, such as specialists in the scientific, technical, medical and research fields, and will allow expatriates to seek extended residency visas after retirement. The authorities also raised the share that foreigners are permitted to own of local businesses (based outside of designated "free zone" areas) from 49% to 100%.

Chart 2: Dubai & Abu Dhabi real GDP

(% y/y)



Source: Dubai Statistics Center, Statistics Centre - Abu Dhabi

Moreover, in further support of foreign direct investment (FDI), the UAE president issued a new law to establish a Foreign Direct Investment Unit in the Ministry of Economy. The unit will be responsible for promoting initiatives that help create a more attractive investment environment. The UAE is determined to boost inward investment and diversify its financing options away from public funding. According to the finance minister, FDI is expected to increase by almost 6% y/y in 2018 to reach $11-11.5bn, which is by far the largest in the region. The authorities are eyeing a further 15-20% increase by end-2020.

Meanwhile, Abu Dhabi recently revealed further details of its new three-year, Dh50 billion stimulus plan, which will be called 'Tomorrow 21' and directed at four main sectors: business and investment; society; knowledge and innovation; and lifestyle. Additionally, companies based in the capital's free zones will be allowed to operate on the mainland under a dual license. This should help reduce the cost of doing business, improve competitiveness and boost foreign investments.

The most recent figures showed real growth in Abu Dhabi rising from a mere 0.1% in 1Q18 to 1.5% y/y in 2Q18, thanks to increased crude output and non-oil activity. (Chart 2.)

Dubai also announced its own plans to improve the business climate and stimulate foreign investment, including waiving some fees on aviation, real estate and school and reducing those on businesses. Along with Abu Dhabi, it also agreed to exempt businesses from any administrative fines until the end of the 2018.

Dubai's economic growth registered 2.5% y/y in 4Q17, driven by the emirates' construction and hospitality sectors. The measures announced above are likely to give these sectors a further boost. Indeed, the Dubai Economy Tracker index leapt from 52.5 in October to a five-month high of 55.3 in November, as growth in the construction sector accelerated ahead of the Expo 2020.

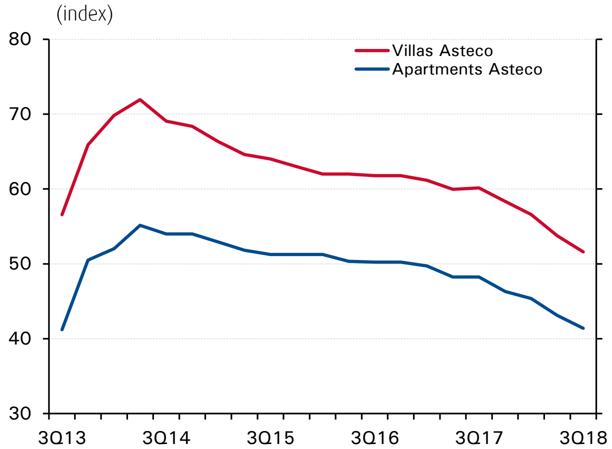
Tourism was also a major contributor, with the number of passengers passing through Dubai International Airport coming in at a record high of 24 million in 3Q18, above the average of 22 million recorded in 2017.

Dubai's residential property prices maintained their downward trend in 2018

The impact of more stringent loan-to-value regulations on Dubai's residential property market continues to be compounded by the effects of increased supply, higher interest rates and changing demand patterns—tenants are increasingly opting for more affordable housing units. According to Asteco, the average prices of apartments and villas fell at a faster rate (-13.6% y/y) in 3Q18 than in 2Q18 (-9.3% y/y). (Chart 3.)

Chart 3: Dubai residential property sales prices

(index)



Source: Asteco

Inflation higher in 2018 but should slow in 2019-2020

After rising in January following the introduction of a 5% VAT and the paring back of fuel subsidies, inflation trended downwards in 2018 as the initial impact of the tax/fuel hikes wore off, food price rises moderated and housing costs fell deeper into deflationary territory. Latest data showed inflation easing from 1.6% y/y in October to just over a one-year low of

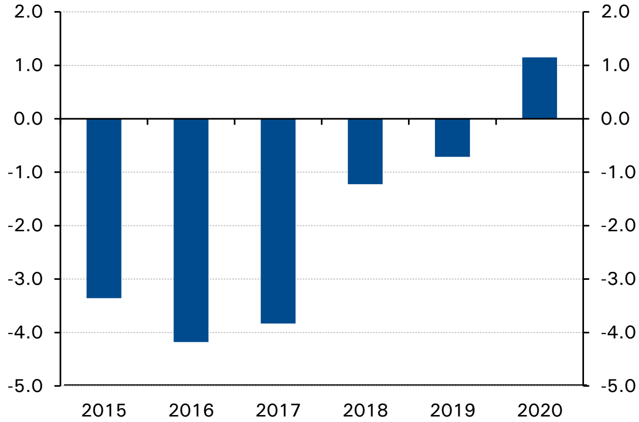
1.3% y/y in November. We see inflation (avg.) slowing from an estimated 3.5% in 2018 to 1.5% in 2020.

Fiscal balance to gradually improve over 2019 and 2020

The fiscal deficit is expected to gradually narrow to 0.7% of GDP in 2019 from an estimated 1.2% of GDP in 2018, on mainly higher non-oil revenues, in-line with an improvement in the business climate. (Chart 4.) A surplus of 1.2% of GDP should be on the cards for 2020. In October, the UAE cabinet approved a balanced budget of Dhs 60.3 billion ($16.4bn) for the 2019 fiscal year, 17.3% higher than 2018's expected outlay. This is the highest budgeted spending on record.

Chart 4: Budget balance

(% of GDP, revenues include ADNOC profits & investment income)



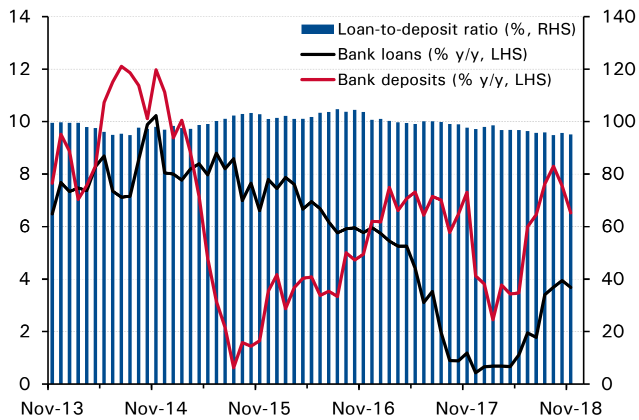
Source: Thomson Reuters Datastream

Lending activity but also cost of funding on the rise

Having bottomed out at the end of 2017, total credit growth has since trended upwards, reaching 3.7% y/y in November 2018 on increased corporate lending. (Chart 5.)

Chart 5: Bank loan and deposit growth

(% y/y)



Source: Thomson Reuters Datastream

Lending to the business and industrial sectors increased by a strong 6.5 y/y in November. With construction activity expected to continue apace ahead of Expo 2022, credit growth should continue to gain traction.

Despite slowing from 7.5% y/y in October to 6.5% y/y in November, deposit growth has also been on an upward trend in 2018. The recent slowdown was attributed to an easing in both government and private sector deposit growth. Broad money supply (M2) growth, however, continues to hover in the low single digits, near multi-year lows.

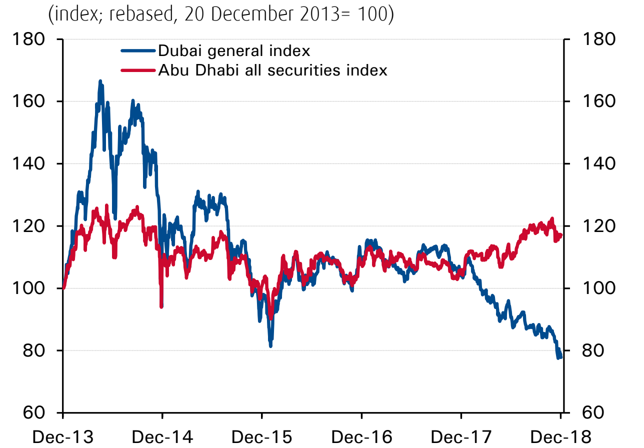
Meanwhile, in response to the tightening in monetary policy in the US, the cost of funding in the UAE has been on the rise. The most recent federal funds rate hike, of 25 bps in December—the fourth rate increase this year—was followed immediately by a 25 bps increase in the UAE's benchmark rate to 2.75%. At least one, possibly two more rate hikes are expected in 2019. Also, the 3-month interbank rate (EIBOR) was up 109 bps year-to-date (ytd) as of mid-December.

Real estate sector woes weigh on Dubai's stock market

Equities on the Abu Dhabi Exchange (ADX) and Dubai Financial Markets (DFM) were on opposite trajectories in 2018. While the ADX was up almost 10% ytd (as of mid-December), thanks to the improvement in oil prices, the DFM was down 26% on continued weakness in the property sector. (Chart 6.) Indeed, real estate stocks were down almost 40% ytd.

Chart 6: Main UAE stock indices

(index; rebased, 20 December 2013= 100)



Source: Thomson Reuters Datastream

Downside risks to the outlook center on oil prices

As ever, oil prices are central to the outlook. Government spending and hence non-oil activity is largely determined by it. Oil also has knock-on effects in terms of banking sector liquidity and broader consumer confidence. Moreover, with the US Fed expected to tighten interest rates further in 2019, borrowing costs are rising, potentially dampening business activity. However, Dubai's Expo 2020 expansive public investment program and the UAE's broader economic reforms should prove to be positive for economic growth.

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353