UAE outlook

Growth rising as non-oil activity gains momentum

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

<table>
<thead>
<tr>
<th>2017</th>
<th>2018a</th>
<th>2019f</th>
<th>2020f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP USD bn</td>
<td>387</td>
<td>396</td>
<td>405</td>
</tr>
<tr>
<td>Real GDP % y/y</td>
<td>0.8</td>
<td>2.2</td>
<td>2.4</td>
</tr>
<tr>
<td>- Oil % y/y</td>
<td>-3.0</td>
<td>0.6</td>
<td>0.8</td>
</tr>
<tr>
<td>- Non-oil % y/y</td>
<td>2.5</td>
<td>2.8</td>
<td>3.0</td>
</tr>
<tr>
<td>Inflation % y/y</td>
<td>2.1</td>
<td>3.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Budget balance % of GDP</td>
<td>-3.8</td>
<td>-1.2</td>
<td>-0.7</td>
</tr>
</tbody>
</table>

Source: Official sources, NBK estimates

Chart 1: Real GDP (% y/y)

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%.

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.)

**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**

 Câmara de contas do distrito de Braga (2015-2020)

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**

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**

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.
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