Macroeconomic outlook

UAE: Growth set to moderate slightly in 2017 amid crude oil cuts

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Overview and outlook

- **Growth is expected to moderate in 2017 on the back of oil sector cuts.**
- **Non-oil GDP growth is forecasted to remain resilient on stronger gains in tourism and construction.**
- **Inflation to see renewed pressure from new taxes and subsidy cuts.**
- **The fiscal deficit is set to narrow in 2017 and return to a surplus in 2018, on prudent reforms and higher public revenues.**
- **Bank liquidity is expected to continue to see improvements in 2017 and 2018 as higher oil revenues prop up deposit growth.**

Real GDP growth to moderate in 2017 on lower crude production

Real GDP in the UAE is expected to moderate in 2017 as crude production is lowered, in compliance with the agreement among OPEC members to cut crude supply. Whilst the oil sector is projected to act as a laggard on overall growth, the non-oil sector is set to continue to propel forward and offset a contracting oil sector. Subsequently, we foresee real GDP moderating from an estimated 2.4% in 2016 to 2.2% in 2017 (Chart 1).

Growth in the oil economy is expected to be limited in the medium-to-long term on the back of planned production cuts. In May, OPEC and a group of non-OPEC nations agreed to extend a six-month output cut that was scheduled to end in June, to at least the end of the first quarter of 2018, in a bid to prop up oil prices. As a result, real oil GDP is expected to decline by around 1% in 2017, before rising by 2.6% in 2018 as production is gradually restored to its pre-production cut levels.

The non-oil economy is forecast to gain some ground in 2017 and maintain that strong momentum in 2018, as the construction and tourism sectors (some of the biggest contributors to non-oil GDP growth) remain buoyant. The construction sector will be supported by easing fiscal consolidation as well as higher Dubai Expo 2020 related infrastructure investments. The non-oil economy is also set to be supported by the residential real estate sector, which after witnessing almost two years of slowing growth is showings signs of stabilization. We anticipate a jump in real non-oil growth from around 2.6% in 2016 to 3.6% and 4.5% in 2017 and 2018, respectively.

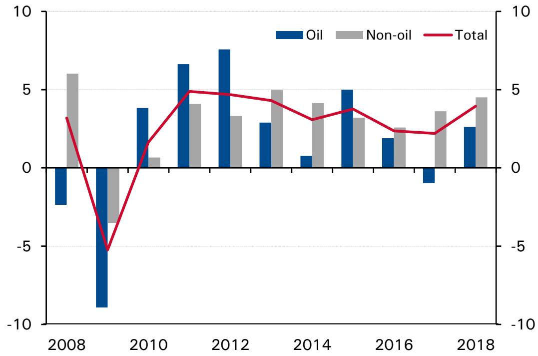
The latest data on the UAE's Markit Purchasing Managers' Index (PMI), a

Table 1: Key economic indicators

		2015	2016e	2017f	2018f
Nominal GDP	USD bn	370	360	391	425
Real GDP	% y/y	3.8	2.4	2.2	3.9
- Oil	% y/y	5.0	1.9	-1.0	2.6
- Non-oil	% y/y	3.2	2.6	3.6	4.5
Inflation	% y/y	4.1	1.6	2.5	3.0
Budget balance	% of GDP	-2.3	-3.6	-1.8	0.6

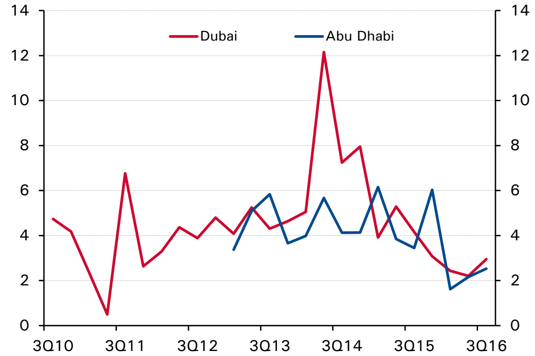
Source: Official sources, NBK estimates

Chart 1: UAE real GDP
(% y/y)



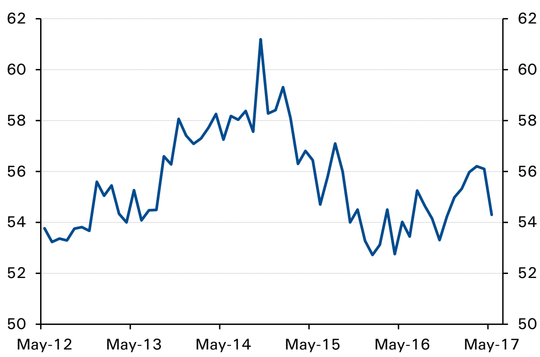
Source: UAE National Bureau of Statistics, NBK estimates

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

good gauge of non-oil sector growth, also show that non-oil sector activity is set to remain solid in the near-to-medium term (Chart 3). The headline PMI slipped in May, but still remained fairly solid at 54.3, as stable local economic conditions helped offset some of the softness in global demand.

Overall non-oil economy propped up by Dubai's resilience

Much of the non-oil economy's momentum continued to be fuelled by Dubai's hospitality and construction sectors. The number of passengers passing through Dubai International Airport remains near record highs. In April, this number stood at 7.6 million passengers, up a healthy 9.2% year-on-year (y/y). Despite an ongoing decline in average daily room rates at hotels in Dubai over the past year, demand for hotel rooms remains solid as reflected in the average occupancy rate. According to Ernst & Young's latest MENA Hotel Benchmark Survey, occupancy rates among hotels in Dubai averaged 88% in April (the highest in the MENA region).

Dubai's construction sector is also a major contributor to non-oil growth. Construction activity is expected to hold strong, especially as Dubai prepares for the Expo 2020 event. Projects include the construction of buildings, metro expansions, roads and bridges. The construction sector is also set to benefit from plans to foster the UAE's Vision 2021 and long-term strategy to establish a post-oil "knowledge economy" via the "UAE Strategy for the Future" blueprint. The strategy aims to bolster the nation's non-oil economy and enhance its economic diversification.

The resilience in Dubai's non-oil economy is reflected in the Emirates NBD Dubai Economy Tracker Index (DET) (Chart 4). The DET is a forward-looking index similar to the PMI which tracks non-oil activity in Dubai. It has gradually been regaining its momentum amid improvements in the travel & tourism and wholesale & retail trade segments.

Dubai residential property price growth stabilizing

Dubai's residential property prices continued to stabilize, following almost two years of decline amid tighter regulations, higher housing supply and risk aversion. According to Asteco's quarterly indexes, prices of apartments and villas in 1Q17 appeared steady, though they are down by 3.0% y/y and 1.3% y/y, respectively. (Chart 5.) We expect the stabilization period to continue at least until the end of 2017, after which we may see residential price growth pick up on the back of stronger demand.

The value of real estate transactions continues to trend lower (Chart 6), while growth in the number of transactions accelerated somewhat recently, which may be indicative of signs of strength in the "more affordable" housing segment.

Inflation to face some upward pressure

Inflation in the consumer price index (CPI) softened recently, after retreating from 3.0% y/y in March to 2.2% y/y in April, as housing inflation (which weighs more heavily in the index) continued to trend lower and as food costs declined. (Chart 7.)

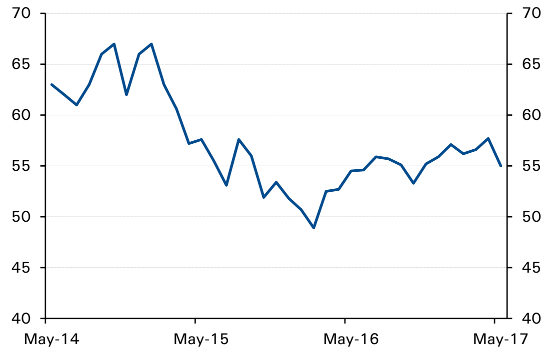
We expect CPI inflation to gradually edge higher in the second half of 2017 and average around 2.5% for the year, as a recovery in oil prices pushes inflation in the transport segment up, as housing inflation gathers pace and amid tax hikes planned for selected consumer goods in 4Q17.

Fiscal deficit forecast to narrow in 2017 and return to a surplus in 2018

We expect the fiscal deficit to narrow in 2017 thanks to more prudent public spending and higher revenues. We estimate the fiscal deficit

Chart 4: Dubai economy tracker

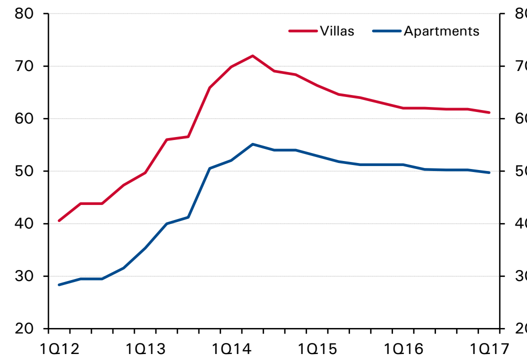
(index)



Source: Emirates NBD

Chart 5: Dubai residential property sales prices

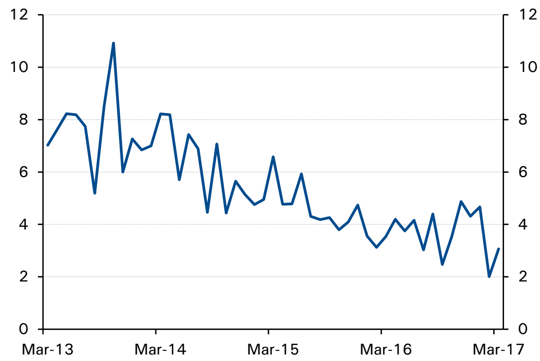
(index)



Source: Asteco

Chart 6: Value of real estate transactions

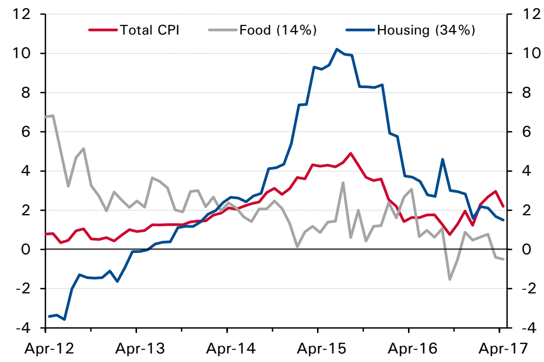
(AED billion)



Source: Dubai Land Department

Chart 7: Consumer price inflation by sector

(% y/y, weights in brackets)



Source: Thomson Reuters Datastream

widened to 3.6% of GDP in 2016 after having slipped into a deficit for the first time in six years in 2015 on the drop in oil prices. But with global oil markets recovering and a more prudent fiscal policy in place, the deficit is seen narrowing to 1.8% in 2017 and returning to a slight surplus of 0.6% in 2018. (Chart 8.)

Thanks to the UAE government's abundant financial reserves that hover above 200% of GDP, fiscal deficits have been manageable. In effect, this has helped both Dubai and Abu Dhabi maintain high levels of public spending, particularly on infrastructure projects. In Dubai, infrastructure spending is set to accelerate in the run-up to the Expo 2020 event.

Nonetheless, the major emirates have embarked on some fiscal adjustment and reform, including the establishment of the Federal Tax Authority (FTA), subsidy cuts and the introduction of fees and taxes on selected goods and 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.

The newly established FTA recently announced that it would impose a 100% tax on tobacco and energy drinks and a 50% levy on carbonated drinks from 4Q17. Furthermore, it increasingly looks like the UAE will be one of the first GCC nations to implement a value-added tax (VAT). The first phase of implementation, scheduled for the beginning of 2018, will include UAE companies with annual revenues greater than $1 million (Dh 3.75 million). 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 2016, Abu Dhabi issued $5 billion in sovereign bonds, the first issuance since 2009.

Moody's recently affirmed the UAE's Aa2 credit rating and upgraded its outlook from negative to stable, citing an effective public policy response to the lower oil price environment and improved economic growth prospects.

The main credit default swaps (CDS), which are deemed to be good bellwethers of a sovereign's level of risk, fell to new lows following Moody's announcement. As of mid-June, the CDS on five-year Dubai and Abu Dhabi government debt stood at 130 and 52 basis points, respectively (Chart 14).

With investors globally in search for yield amid a low global rate environment, the recent credit affirmation and outlook upgrade should be a further boon to the UAE bond market.

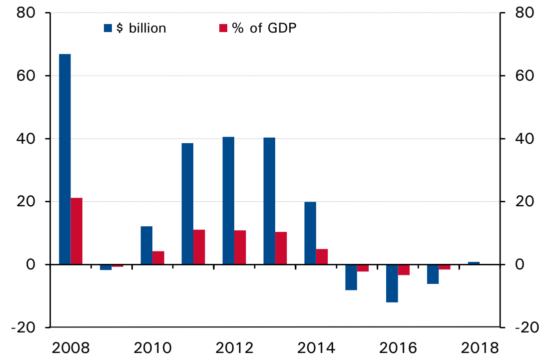
Current account surplus to expand in 2017 and 2018

The surplus in the current account balance is projected to expand for the first time in four years in 2017, as oil export earnings recover and non-oil export growth gathers pace. We foresee the current account surplus rising from a six-year low of around 4.8% of GDP in 2016 to a projected 5.1% in 2017 (Chart 9).

Non-oil export growth may continue to be affected by a stronger dirham. The stronger dollar has led to an appreciation in the dirham's trade-weighted index, increasing the cost of exports and making it a more expensive place to visit and invest in (Chart 15). Trade with Asian markets has been most affected by the stronger dirham, as their currencies weakened against a stronger US dollar. Tourism, however, has been less affected, given that a majority of tourists are from the GCC, and so has investment in real estate, which depends far more on UAE nationals. As a

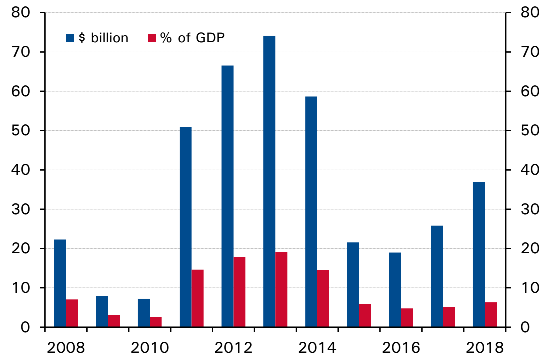
Chart 8: Budget balance

(revenues include ADNOC profits & investment income)



Source: UAE National Bureau of Statistics, NBK estimates

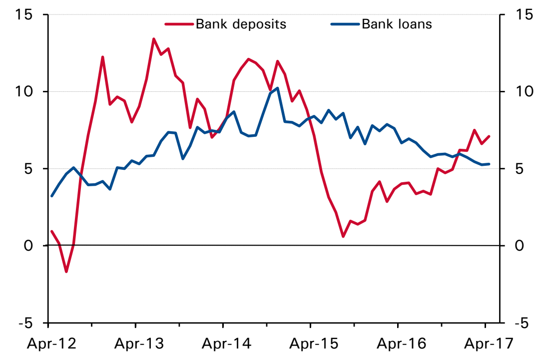
Chart 9: Current account balance



Source: UAE National Bureau of Statistics, NBK estimates

Chart 10: Bank loan and deposit growth

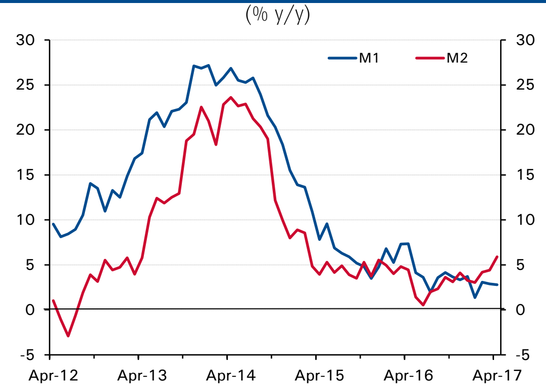
(% y/y)



Source: Central Bank of the UAE

Chart 11: Money supply

(% y/y)



Source: Thomson Reuters Datastream

result, the gains in the tourism and real estate sectors are expected to more than offset the costs of a stronger dollar. This should help keep non-oil export growth ebullient.

Banking liquidity recovers on stronger oil revenues

Following almost two years of moderation, lending activity appears to have plateaued in early 2Q17 on the back of improvements in the real estate and construction sectors. In April, lending growth came in at a modest 5.3% y/y (Chart 10).

Growth in bank deposits continues to trend upward. At the end of 2016, it surpassed lending growth for the first time in almost two years, thanks to higher oil export receipts, which have helped replenish government deposits. After deposit growth logged in a healthy pace of 7.1% y/y in April, the loan-to-deposit ratio subsequently eased further to 99.4% during the same period.

Growth in the broad money supply (M2) is gradually edging higher, mainly in tandem with stronger deposit growth. Latest data showed growth in this segment jumping from 4.4% y/y in March to an over-two-year high of 5.9% y/y in April (Chart 11).

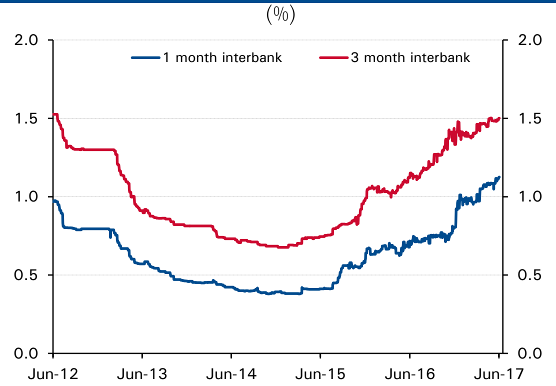
The three-month and one-month interbank rates have continued to rise amid key policy rate hikes. (Chart 12.) In June, the UAE Central Bank hiked its key policy rate, the repo rate, by 25 bps for the second time this year to 1.50%, in tandem with a 25 bps hike in the US Fed rate.

Equities have been mostly steady in 2017

The key equity markets in Abu Dhabi and Dubai have been trending sideways for the most part of 2017. Lacking any major catalysts of their own, the markets will continue to be led by international markets and oil prices. (Chart 13.)

Chart 12: Interbank rates

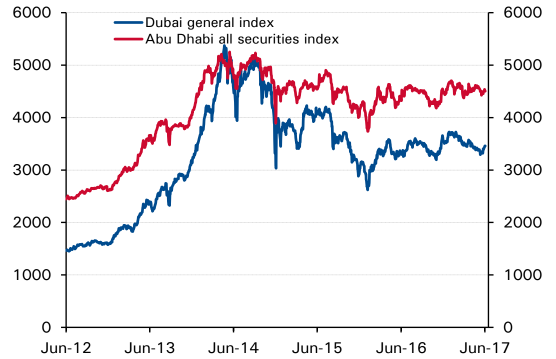
(%)



Source: Thomson Reuters Datastream

Chart 13: Stock market indices

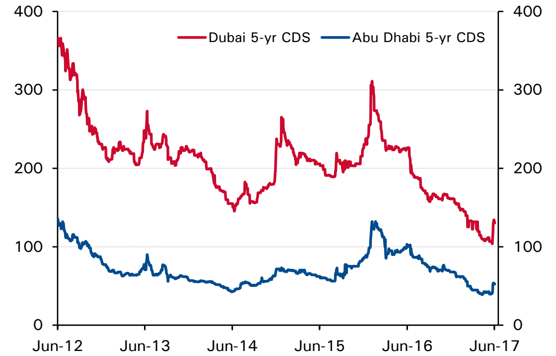
(index)



Source: Thomson Reuters Datastream

Chart 14: Credit default swaps

(basis points)



Source: Thomson Reuters Datastream

Chart 15: UAE trade-weighted exchange rate

(index, Jan 2000 = 100)

Source: Thomson Reuters Datastream, NBK estimates

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