UAE: Recovery requires reinvention

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- **The UAE has seen its 2020 economic outlook soured by the double blow of low oil prices and the COVID-19 pandemic, but private sector activity and foreign investor interest are showing signs of recovery.**
- **The UAE is expecting an economic fillip from Dubai Expo 2021, from the growth-friendly modernisation reforms it has passed, and from acceleration programmes it has launched, especially in Abu Dhabi.**
- **The pace of recovery remains uncertain as it largely depends on the ability of the hospitality industry to rebound. All seven emirates have reopened for international tourism.**

GDP contraction worse than feared

The IMF has nearly doubled its forecast for the UAE's GDP contraction this year to -6.6%. Coming after five lacklustre years, this will further widen the fiscal gap and strain the UAE's external position. Stimulus packages, acceleration programmes such as Ghadan 21 in Abu Dhabi, along with continued reform efforts focused on improving the investment climate are expected to alleviate some pressures.

- The IMF had projected a contraction of 3.5% for 2020 in its April outlook, but despite the early success in containing the first wave of the virus, and opening up the economy in H2, economic activity will take a heavier hit overall. It should rebound into modest positive territory next year -- now forecast at 1.3% growth.
  - The Central bank of the UAE (CBU) estimates differ from those of the IMF, forecasting a GDP contraction of 5.2% this year.
  - Our view is in line with the IMF's, as we believe the COVID-19 impact will be more severe than after the financial crisis in 2008, when the economy contracted by 5.2%. In 2008 oil averaged USD 61 pb, versus USD 40.5 pb YTD in 2020.
    - Oil was also key to the recovery; in 2011 GDP rose by 4.9% as oil prices averaged USD 111 pb.
  - With oil prices not expected to rise much next year, remaining range-bound between USD 40 pb and USD 50 pb, a strong GDP rebound is unlikely.
    - This is also far short of the USD 76 pb the IMF estimates is needed to balance the UAE's federal budget in 2020.
- Although the federal government's recently approved budget for next year includes cutting spending by 5.3% YoY to around USD 16B, the UAE's fiscal position is still expected to worsen on the back of expansionary federal and local government budgets.
  - With the loss of over 35% of total revenue (around 26% of GDP), the deficit is expected to reach 9.9% of GDP, from 0.8% last year.

Table 1 - UAE Macroeconomic Indicators[1]

	2016	2017	2018	2019	2020f
Real GDP Growth (%)	3.0	0.5	1.7	1.3	-6.6
Crude Oil Production (M Bpd)	3.0	2.9	3.0	3.1	2.8
Oil GDP Growth (%)	2.6	-2.8	2.8	2.0	-6.3
Non-oil GDP Growth (%)	3.2	1.9	1.3	1.0	-6.7
CPI Inflation (%)	1.6	2.0	3.1	-1.9	-1.5
Fiscal Balance (% of GDP)	-2.0	-2.0	2.0	-0.8	-9.9
C/A Balance (% of GDP)	3.7	7.3	10.0	7.4	3.6
Total Gov't. Gross Debt (% of GDP)	20.2	22.1	21.8	26.6	36.9
Total Gross Extrn'l Debt (% of GDP)	69.6	73.5	69.7	77.7	97.5
Gross Official Reserves (Mos. of Imports)	3.3	3.7	3.8	4.7	4.1
Nominal GDP (USD B)	357.0	377.7	414.2	402.5	353.9
Population (Millions)	9.2	9.4	9.5	9.7	9.8

    - Total spending is expected to edge up by 2.3% this year because the rise in current spending has outweighed capital spending cuts.
    - While the federal budget is separate from expenditure budgets of each emirate across the UAE, adjusting for major current spending cuts next year will be challenging.
  - Similarly, the current account will weaken in 2020 on the back of lower energy prices, reaching 3.6% of GDP, from 8.4% of GDP last year. The balance is forecast to improve in the coming years and bounce back to 7.5% of GDP next year as the UAE's economic wheels start to turn again.
- While the UAE is more diversified than its GCC peers, the possible extension of production cuts by OPEC+ until March 2021 could weigh heavy on the recovery, particularly as the debt of government-related entities (GREs) continues to increase.
  - Taking this into account, we would not be surprised to see the overall debt burden reach nearly 150% of GDP going into 2021.
  - Plans are underway for further federal bond issuance to add to Abu Dhabi's and Dubai's recent return to the debt market.
- Fiscal and monetary stimulus packages, which stand at 17.5% of GDP to date, have provided a buffer, but more will be needed.
  - Support packages rolled out by the CBU since March as part of the Targeted Economic Support Scheme, include USD 69B in stimulus and USD 13B in zero-cost funding. This has provided relief measures and loan restructuring to allow for more lending to over 300K individuals, 10K SMEs, and 1,500 private firms so far.
    - The recent temporary relaxation of the two prudential ratios by 10 percentage points, providing banks with more flexibility, are also expected to support the implementation of these packages, and in turn aid in a faster economic recovery.[2]
  - In addition, multiple federal and local initiatives reduced or waived several administrative fees while allocating 15% of government procurements and contracts to SMEs to stimulate growth for small businesses.
    - Latest available data shows that SMEs have benefited with over USD 1B in loans, by the end of July -- accounting for over 9% of the total amount disbursed.

[1] Arabia Monitor; IMF.

[2] The net stable funding ratio (NSFR) and the advances to stable resources ratio (ASRR) have been relaxed until the end of the year.

Reinventing the UAE

While the pandemic-induced shocks have inevitably weakened domestic activity and growth in key sectors, there has been an acceleration in government efforts to expand its knowledge-based economy and boost investment, following the passing of the landmark FDI ownership law in 2018.

- On 28 October, the Abu Dhabi Department of Economic Development issued the emirates' first FDI licence to allow foreign companies 100% business ownership.
  - The licence covers over 120 different activities and sectors, with total capital spending required to be at least USD 500K annually.
  - This move comes after Abu Dhabi formalised its public-private partnership (PPP) procurement framework, launched under the umbrella of the multi-phase “Ghadan 21” accelerator plan.
    - Ratifying the framework is important, particularly now, to Abu Dhabi's investment climate and private sector as the emirate works to procure over USD 2B worth of infrastructure projects.
    - We will be following projects in this pipeline, which the Abu Dhabi Investment Office recently stated will be announced by early 2021 at the latest.
  - The establishment of a regulated framework is expected to encourage long-term private sector investments, accelerate the emirate's transition to a knowledge-based economy, and strengthen its position as a global innovation hub.
- The recent announcement of an investment by Abu Dhabi’s sovereign investment firm Mubadala in Group 42, a UAE-based AI and cloud computing company, is among the latest in the government’s efforts to grow its technology portfolio.
  - In September, Group 42 became the first UAE-based company to establish an office in Israel, following the signing of the Abraham Accords.
  - Following the government's launch of its AI strategy in October 2017, we expect to see more government entities partnering with major technology firms, leading to further relaxation of state policies.
  - This is also expected to aid the country’s economic recovery, as the UAE, followed by Saudi Arabia, is expected by 2030 to see the largest impact in MENA from AI revenue contributions.
    - AI is expected to account for 13.6% of UAE’s GDP. This would be just shy of the global average of 14%.
- We have recently discussed how the UAE-Israel normalisation deal could bring renewed opportunities for rapid post-pandemic business growth, particularly in the fields of technology, cybersecurity and finance.

Figure 1 – Dubai GRE Debt, by Sector (%)[3]

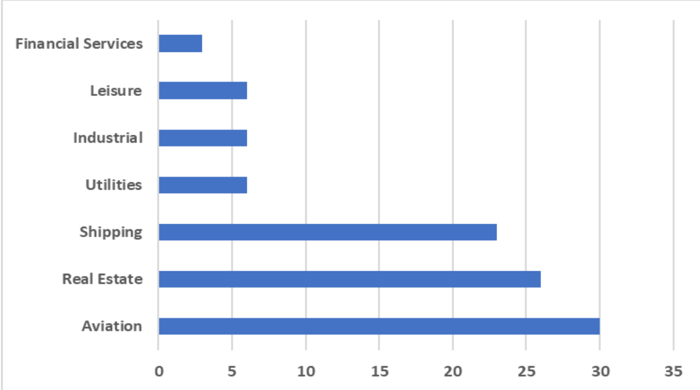
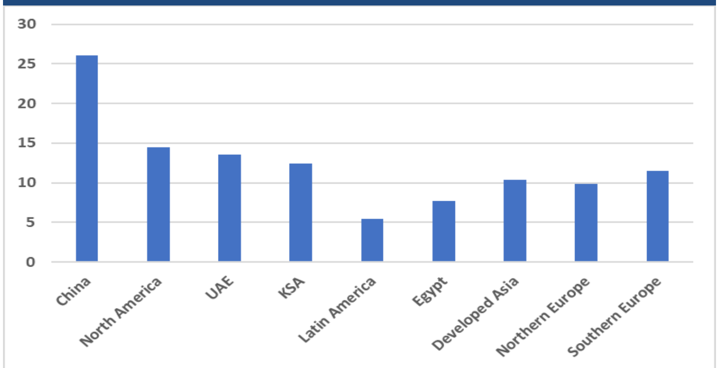


Figure 2 – AI Contribution to GDP by 2030, by region[4]



  - In just over a month, several bilateral business deals have been signed between the two nations. We expect this to continue on an upward trend,
    - Commercial excitement over the accords remains strong, and;
    - The Biden administration looks set to support bilateral accords, while taking a different tack on Palestinian matters.
- In the meantime, we see a trajectory for the UAE’s recovery; recent government policies include a shift to a more effective and modernised economy.
  - Earlier this week, the UAE unveiled secular-leaning legal reforms focused on decriminalising alcohol, criminalising so-called honour crimes and allowing the cohabitation of unmarried couples.
    - Such moves are part and parcel of the UAE strategy to offer an environment that is more supportive of expatriates, including foreign investors.
  - In the coming quarters, broadening such efforts will prove imperative for a speedy recovery, particularly as the country gears up for the Dubai Expo in October 2021 and looks to attract international visitors once again.
  - Like Singapore has done multiple times, the UAE has embarked on the challenge of reinventing itself to remain competitive.

[3] Arabia Monitor; Bloomberg.

[4] Arabia Monitor; PwC.

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