United Arab Emirates

SEB GROUP – COUNTRY RISK ANALYSIS January 14, 2022

Analyst: Martin Carlens. Tel: +46 8 763 96 05. E-mail: martin.carlens@seb.se

A modest economic recovery last year was led by the non-hydrocarbon sector. External balances strengthened on the back of higher than expected oil prices. While an expansion of the oil sector should help medium-term growth, the outlook for the non-hydrocarbon industries is less certain despite a strong commitment to diversify the economy. Abu Dhabi's financial strength and assumed support for the federation provides the main country credit support

Country Risk Analysis

Recent economic developments

A modest recovery. Following the historically deep economic contraction in 2020, a modest recovery was seen in the second half of 2021. Increased tourism and activities related to the delayed World Expo 2020 have been important growth drivers. As an illustration, international arrivals in Dubai rose to nearly 80% of 2019 levels in late 2021. In addition, a gradual rebound in oil production following the phasing out of OPEC production limits means that the sector became less of a drag on overall GDP growth. Still, production caps are likely to have limited GDP growth to 1.8% last year. The recovery is progressing against the background of one of the highest corona vaccination rates in the world.

Inflation on the rise but barely positive. As in the rest of the world, inflation in the UAE is on the rise. However, after being in negative territory in the first half of 2021, it is likely to have averaged 0% for the year. Price increases are driven by non-tradables, in particular housing prices. House price have been declining for many years in Abu Dhabi and Dubai but started to rise in 2021 in tandem with the economic recovery.

External accounts strengthening. Despite the low oil price regime starting in 2015, the UAE, contrary to all other major oil producing economies continued to run current account surpluses. The surplus most likely doubled last year, to more than 11% of GDP, on the back of higher oil prices. Foreign direct investments (FDI) rose in 2020, contrary to most economies, and remained the highest in the region. Inward foreign direct investment have normally been overshadowed by the sovereign wealth funds' investments abroad. However, in 2020, net flows were positive, likely helped by reforms to improve the domestic investment and business environment. Net FDI inflows probably edged higher in 2021 but remain modest in relation to GDP.

Official reserves edging up from high levels. The improvements in the current account have contributed to an increase in international reserves over the past year. The official foreign exchange reserves amounted to about USD 123 bn in November. Given also the significant size of Abu Dhabi's sovereign wealth fund (see further below), the UAE has a solid reserves cushion.

Bank sector stable despite worsened asset quality. The sector comprises mainly of domestic entities and is large, with assets equivalent to about 200% of expected 2021 GDP according to FitchRatings. This and a proven will to support banks, including during the pandemic, means that contingent liabilities for the federal government are significant. Banks are generally profitable and average asset quality is high. This being said, the share of non-performing loans rose during 2020 and, despite levelling-out in 2021, was the highest in the region at 8.1% in September. The sector is considered well-regulated and supervised at the federal level. The IMF recently noted that, over the past year, efforts have been undertaken to further enhance the AML/CFT regime.

Economic policies

Fiscal policy less expansionary in 2021. The federal government's budget is relatively small and they are legally obliged to balance the budget. The track record in doing so was strong prior to the pandemic. The IMF expects the general government deficit to have narrowed to 0.5% of GDP in 2021 from about 5% of GDP. Higher than expected oil prices provided a boost to government revenues. We would note that reports and forecasts regarding the consolidated budget balance vary widely among analysts, partly due to the lack of data. We rely on IMF estimates. We would also note that the government's fiscal break-even price of about USD 70 per barrel in 2021 is lower than Saudi Arabia but higher than for example Qatar.

Government debt is lower than average among peers. The downturn has caused the individual emirates to issue new debt, and recently the UAE federal government issued debt (USD 4 bn) for the first time after assuming the right to do so in 2018. The proceeds are expected to be used for infrastructure investment but equally important the issuance, and future ones, was made to develop the UAE's domestic capital markets. The consolidated government debt across the emirates (mostly attributable to Dubai) which rose significantly in 2020 is expected to have edged down to 37% of GDP in 2021. This is low compared to peers. The majority of the debt is held by domestic investors.

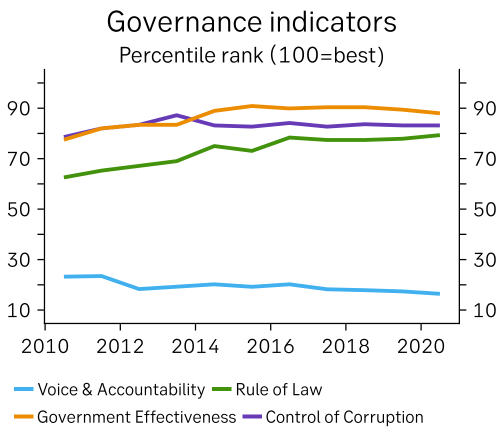
Leverage in the economy is substantial but risks are moderate. While direct debt is limited, the overall leverage in the UEA economy should be regarded as relatively substantial. Although indebtedness of government related entities (GRE) has declined in the past few years, FitchRatings estimate their total debt at 87% of 2020 GDP. Among the emirates, Dubai is the most exposed to risks, with significant holdings in real estate and tourism. In principle it would be prudent to assume that all GRE debt could ultimately end up on the consolidated government balance sheet. However, the risk that this materializes should have declined in the past few years.

Significant foreign assets provide buffer. Our assessment of the UAE's debt affordability and of country risk builds on the assumption that Abu Dhabi with its superior financial strength and oil wealth would stand behind the other emirates. There is no legal requirement for them to do so but there is a track record of support. There are several sovereign wealth funds (SWF) across the emirates supporting financial strength, although some are geared towards the domestic economy and not all are liquid. Among the large liquid funds, the Abu Dhabi Investment Authority, ADIA, is by far the largest. Data is not published but Global SWF, a data tracking platform, estimates that it has assets under management of USD 829 bn, despite some drawdowns in 2020. The Institute for International Finance (IIF) estimates that adding other SWF and official reserves, the UAE's public foreign assets were equivalent to 215% of GDP in 2021.

Limited data availability and timeliness raise country risk. Some improvements have been made in recent years but the availability of data is limited, and reporting delays are longer compared to countries in the same risk class outside the region. This weighs on country risk.

Structural and political developments

Most governance indicators and per capita incomes are superior to peers. Although transparency is limited, institutions in the UAE are generally considered of higher quality than those of other countries in the region. Most of the World Bank's governance indicators and business climate indicators are stronger than regional and country risk peers such as Poland. An exception is the voice and accountability indicator. Meanwhile, GDP per capita is one of the highest in the world.



Source: World Bank, Macrobond

Reforms to attract foreign investment and labour. Reforms aimed at improving the supply side of the economy by attracting private sector investment and foreign labour has continued. The latest reforms include a new FDI law in Abu Dhabi permitting foreign investors to have 100% ownership of businesses in various sectors, and revamped federal visa requirements to facilitate the recruitment of foreign experts. Another measure is that the public sector will shift to a Monday-Friday working week starting in January 2022. If the private sector follows suit, as appears likely, it should increase the UAE's attractiveness to expatriates, an important pillar of its growth and diversification plans.

Other reforms to raise long-term growth. Under the umbrella of a new long-term growth strategy ("Project of the 50"), the government has also recently announced new initiatives relating to the digitisation of the economy. The UAE already scores high in various surveys relating to ICT adoption (number 2 globally according to the World Economic Forum's competitiveness index).

Centralized, opaque but stable domestic political environment. A high degree of political stability has long served to limit country risk. On the other hand, political decision making is largely made by the ruling families of the individual emirates rather than by elected bodies. This limits policy transparency and thus weighs on institutional quality and country risk. The main political risks, however, are related to regional tensions, mainly the UAE's and other Gulf states' strained relations with Iran. Although it has scaled back its military presence, the UAE also remains involved in the Yemen war. This exposes it to geopolitical and event risk.

Sovereign rating agencies leaving credit ratings unchanged. The two major sovereign credit rating agencies that cover the UAE have left their ratings unchanged in the past year.

Outlook

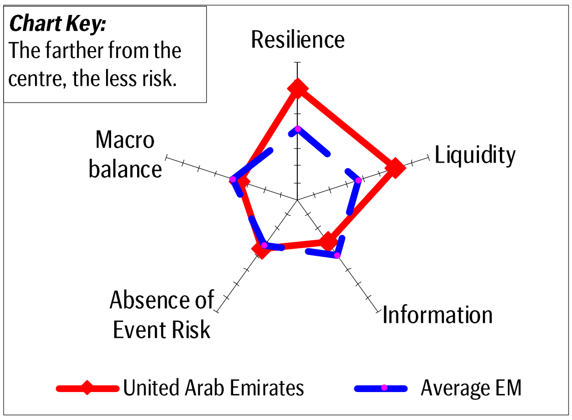
Near-term growth to speed-up. Our house forecasters Oxford Economics expect GDP growth to accelerate to more than 6% this year. This is high compared to the consensus forecast. While the near-term outlook indeed is brighter, uncertainty remains high. The development of the pandemic remains the largest source of uncertainty as intensified outbreaks could affect oil demand and tourism traffic. Our forecasts are based on the average oil price rising slightly in 2022 before retreating in 2023.

Medium-term developments. The hydrocarbon industry remains the single most important sector for the economy standing for roughly one fifth of GDP. It is also key for government finances. This being said, the economy is more diversified than others in the region. Since 2015, tourism, transport and trade have become increasingly important growth drivers. Following the contraction in the hydrocarbon sector over the past two years, the sector is expected to make an increasing contribution to GDP growth over the medium term. Abu Dhabi plans to invest massively (USD 122 bn) over the next five years to increase its oil and gas production capacities and to boost petrochemical production. The outlook for the non-oil sector largely depends on the continued competitiveness of Dubai as a regional hub for transport, finance and tourism. Competition with Saudi Arabia in this area has intensified.

Risks from oil prices and from geopolitical developments. Risks to our main scenario are mainly external. Oil exports are vulnerable to military conflicts in the region, including a possible blockade of the Strait of Hormuz. Although a pipeline enables continued exports in such a case, economic activity, such as tourism, trade and FDI are all vulnerable to the mere perception of rising conflict risk. Another key risk to our main scenario relates to lower than expected oil prices which could lead to higher than expected fiscal deficits and to a gradual rise in government debt.

United Arab Emirates

Key ratios	**2022**
Population (million)	9,3
GDP per capita (USD)	46 917
Real GDP growth (%)	6,3
CPI inflation (%)	1,8
Current account (% of GDP)	11,2
Reserves (months of imports)	22
Budget balance (% of GDP)	-0,2
Government debt (% of GDP)	39



External Ratings
Moody's: Aa2 / Stable
Fitch: AA- / Stable
S&P:
Abu Dhabi: AA / Stable

Peers:
Poland
Kuwait
Qatar

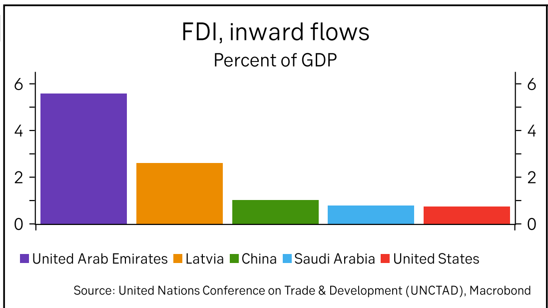
Graph: UAE's risk profile is significantly stronger than the emerging-market average on resilience and slightly worse on information, due the lack of economic and political transparency. The liquidity score includes 50% of estimated foreign assets of sovereign wealth funds.

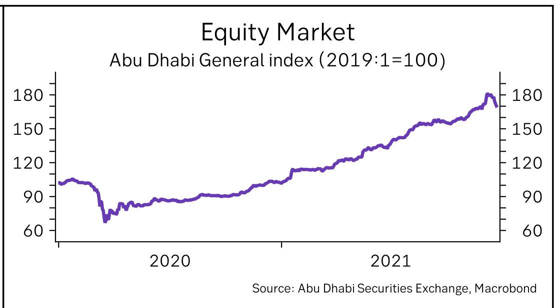
United Arab Emirates: Economic Indicators

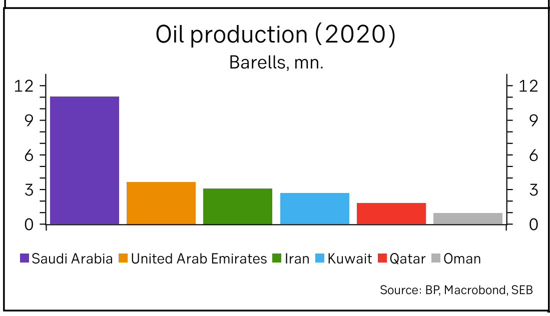
Macroeconomic	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
GDP real (% change)	1,2	3,4	-6,1	1,8	6,3	6,6	3,4	1,8
GDP (USD bn)	422,1	417,1	358,8	421,2	454,6	471,6	486,8	505,7
GDP/capita (USD)	43 793	42 718	39 182	45 380	46 917	47 136	47 745	49 045
Investments/GDP	17%	18%	20%	18%	17%	18%	18%	18%
Trade/GDP	170%	167%	181%	165%	162%	167%	169%	167%
Oil production, bpd ('000)	2 997,9	3 177,0	2 862,7	2 763,8	3 106,2	3 632,2	3 831,0	3 845,0
Money & Prices								
CPI inflation	3,1%	-1,9%	-2,1%	0,0%	1,8%	1,8%	1,9%	2,0%
Money, M2 (% change)	2,5	7,4	4,4	8,9	6,0	5,9	5,7	5,9
Interest rates	2,43%	2,57%	0,96%	0,52%	0,67%	1,24%	1,83%	2,25%
Exchange Rate (USD)	3,67	3,67	3,67	3,67	3,67	3,67	3,67	3,67
Oil price (USD, Brent)	71	64	42	71	72	60	60	61
Government Finances								
Budget balance/GDP	1,9%	0,6%	-5,6%	-0,5%	-0,2%	-0,1%	0,1%	0,3%
Consolidated govt debt/GDP	20%	27%	39%	37%	39%	39%	39%	38%
Balance of Payments (USD bn)								
Current account	40,5	37,3	21,0	48,3	50,8	62,1	67,7	68,3
% of GDP	9,6	8,9	5,9	11,5	11,2	13,2	13,9	13,5
Exports of goods	406,0	400,5	372,4	392,4	419,1	452,9	473,5	485,3
Imports of goods	312,1	295,0	276,0	304,1	317,9	333,5	346,8	361,1
Other current acct flows	-53,3	-68,2	-75,4	-40,0	-50,4	-57,4	-58,9	-55,9
Net FDI	-4,7	-3,3	0,9	0,8	0,8	0,7	0,6	0,5
% of GDP	-1,1	-0,8	0,3	0,2	0,2	0,1	0,1	0,1
Net other capital flows	21,8	5,4	-20,4	-35,3	-39,7	-59,2	-63,8	-56,4
External Debt & Liquidity (USD bn)								
Reserves (average)	98,4	106,4	102,2	105,9	114,7	120,8	126,9	133,0
months of imports	5,0	5,5	5,8	5,3	5,4	5,4	5,4	5,3
Gross external debt	250,4	264,8	318,5	332,2	371,7	401,8	375,2	387,1
o/w short term debt	91,7	86,1	101,2	103,6	124,7	123,4	125,9	125,9
% of GDP	59%	63%	89%	79%	82%	85%	77%	77%

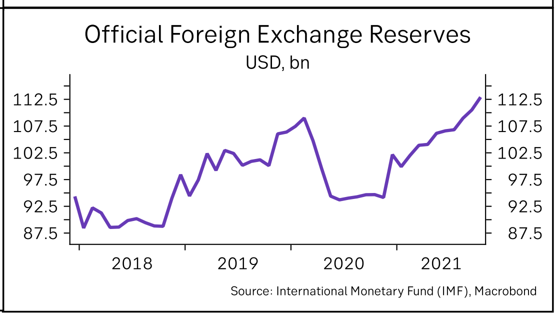
Sources: Oxford Economics, IMF, IIF, Moody's and SEB estimates

Type of government:	Federation, no political parties
Next elections	-
Other:	
Latest PC deal	None
Recent IMF programs	None









Disclaimer

Confidentiality Notice

The information in this document has been compiled by Skandinaviska Enskilda Banken AB (publ) (“SEB”).

Opinions contained in this report represent the bank’s present opinion only and are subject to change without notice. All information contained in this report has been compiled in good faith from sources believed to be reliable. However, no representation or warranty, expressed or implied, is made with respect to the completeness or accuracy of its contents and the information is not to be relied upon as authoritative. Anyone considering taking actions based upon the content of this document is urged to base his or her investment decisions upon such investigations as he or she deems necessary. This document is being provided as information only, and no specific actions are being solicited as a result of it; to the extent permitted by law, no liability whatsoever is accepted for any direct or consequential loss arising from use of this document or its contents.

SEB is a public company incorporated in Stockholm, Sweden, with limited liability. It is a participant at major Nordic and other European Regulated Markets and Multilateral Trading Facilities (as well as some non-European equivalent markets) for trading in financial instruments, such as markets operated by NASDAQ OMX, NYSE Euronext, London Stock Exchange, Deutsche Börse, Swiss Exchanges, Turquoise and Chi-X. SEB is authorized and regulated by Finansinspektionen in Sweden; it is authorized and subject to limited regulation by the Financial Services Authority for the conduct of designated investment business in the UK, and is subject to the provisions of relevant regulators in all other jurisdictions where SEB conducts operations.