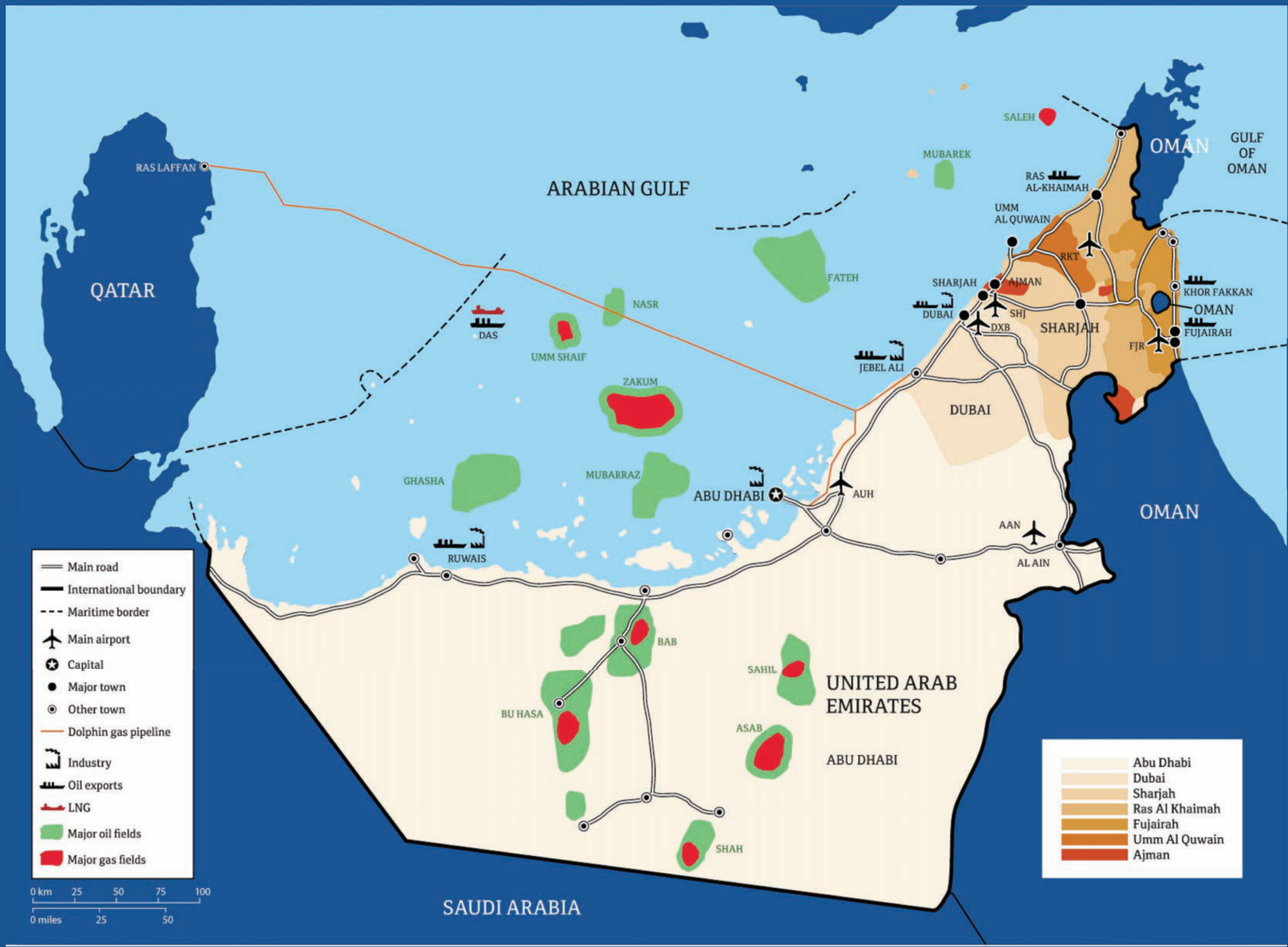
QNB

UAE Economic Insight
2013



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OMAN
FUJAIRAH
FJR
BAB
BU HASA
SAHIL
ASAB
SHAH
Main road
International boundary
Maritime border
Main airport
Capital
Major town
Other town
Dolphin gas pipeline
Industry
Oil exports
LNG
Major oil fields
Major gas fields
0 km 25 50 75 100
0 miles 25 50
Abu Dhabi
Dubai
Sharjah
Ras Al Khaimah
Fujairah
Umm Al Quwain
Ajman

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Editorial closing, 15th July 2013

Executive Summary

A. Recent Macroeconomic Developments (2012)

- **Real GDP** registered the strongest growth (4.4%) since 2006. This was driven by an expansion in oil and gas (6.3%) and a recovery in the non-oil sector (3.5%), particularly in real estate and business services (6.3%). On the demand side, there was particular strength in private consumption (9.4%) and investment (12.5%). **Inflation** was subdued at 0.7%, kept low by a third year of falling rents.
- The 2012 **fiscal outturn** is not yet available, but we estimate that a significant consolidation (3% of GDP) has taken place in capital expenditures. This, together with stronger oil exports, is estimated to have boosted the consolidated national surplus to 5.9% of GDP.
- The **current account surplus** rose to 17.3% of GDP, given higher oil and non-oil exports.
- The **banking sector** witnessed deposits growing at their strongest pace since 2008 (8.6%). However, lending growth was more muted (3.4%) and the non-performing loans ratio rose to 8.4% at end-2012, reflecting the lingering effects of the real estate crisis of 2009-10.

B. Macroeconomic Outlook (2013-14)

- We forecast **real GDP** growth will slow to 4.0% in 2013 and 3.8% in 2014 as further strengthening in the non-oil sector is offset by a slowdown in oil and gas.
- **Oil production growth** is expected to slow because of delays in issuing contracts and uncertainty over the 2014 expiration of the 35yr concession on Abu Dhabi's onshore oil fields. **The non-oil sector** will be buoyed by continued strong private sector consumption growth (averaging 6.6%) and large construction projects more than offsetting a slowdown in government expenditure. This will help raise non-oil growth to an average of 4.7% in 2013-14. **Downside risks** to this scenario include lower global economic activity and further declines in oil prices. **Inflation** is expected to remain moderate over the medium term.
- Lower oil revenues will also lead to a narrowing of the **national fiscal surplus** to 5.0% in 2013 and 3.5% of GDP in 2014.
- The **current account** surplus is expected to narrow slightly in 2013-14 (to an average 14.7% of GDP), owing to lower oil prices and import growth, linked to rising domestic demand.
- The **banking sector** is expected to see stronger lending growth than in recent years, particularly in the construction sector. Lending to the public sector will be impacted by a final decision by the central bank on new lending limits to Government-Owned Enterprises (GREs). On the deposit side, banks are likely to focus increasingly on higher net-worth depositors.

Background

Abu Dhabi is pre-eminent among the emirates because of its oil reserves and size

Uniquely amongst the Gulf Cooperation Council (GCC) states, the United Arab Emirates (UAE) is a **federation** of seven largely autonomous emirates who joined together in 1971 after independence. They vary significantly in size, population, economic structure and hydrocarbon resources. **Abu Dhabi** has a dominant role as it holds most of the UAE's oil and gas reserves, as well as 87% of the land area and 43% of nationals. Abu Dhabi's hydrocarbon revenue per national is US$232,000, the highest in the GCC. As a result, Abu Dhabi has a per capita GDP of US$82,000, more than double the UAE average.

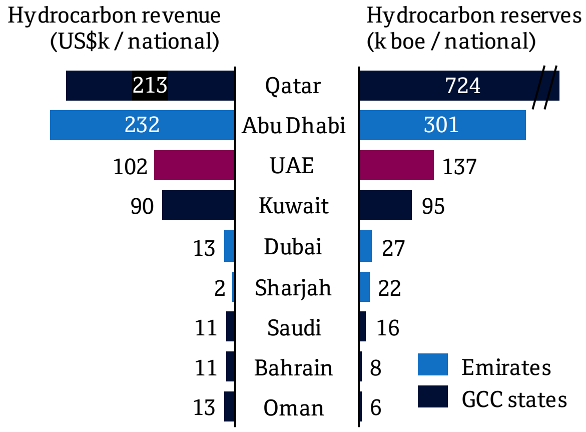
Dubai has become a regional trade, manufacturing and services hub

Dubai still has significant hydrocarbon reserves and revenue, relative to its population, but its production has declined since the late 1990s. In response to this decline, Dubai has invested heavily in infrastructure development to diversify its economy. It drew on a long tradition of international commerce to create an unrivalled regional hub for trade and manufacturing, now focused on the Jebel Ali port and free zone, as well as a broader services economy. As a result, it has achieved a similar level of development to Abu Dhabi and a per capita GDP more than twice as high as the five northern emirates. Although it was weakened by a debt and real estate crisis in 2009, its economy is now recovering.

Sharjah and Ajman serve as residences for workers in Dubai; other emirates rely on federal funding

Sharjah is the third largest emirate and has some oil and gas reserves, although production is down sharply from the peak. It is situated next to Dubai and, along with **Ajman**, the smallest but most densely populated emirate, forms part of a continuous coastal metropolis. Cheaper rents in these emirates mean that hundreds of thousands of workers commute from them into Dubai daily. The other three emirates have smaller expatriate populations. They are subsidized by revenue transfers from the federal government. **Umm al-Quain**, the smallest emirate, has recently begun producing gas from a small offshore field. **Ras al-Khaimah**, at the UAE's northern tip, is the fourth largest emirate, with a little offshore gas, although its Saleh field has been largely depleted. Finally, **Fujairah** is the only emirate situated on the east coast. It is rising in importance as the terminus of a strategic new pipeline bypassing the Straits of Hormuz, and associated downstream industries.

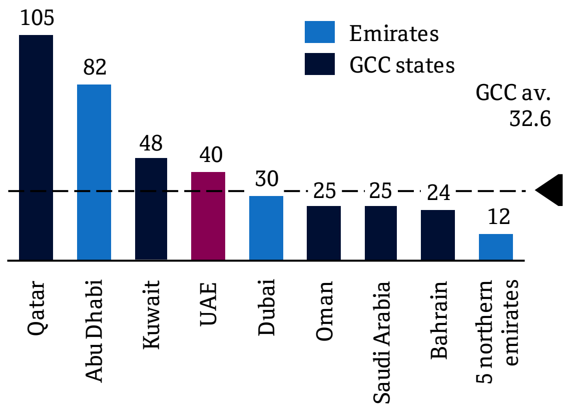
Oil and Gas Wealth Per National (2012)



Source: BP and QNB Group estimates; excludes emirates with little oil or gas

GDP Per Capita (2012)

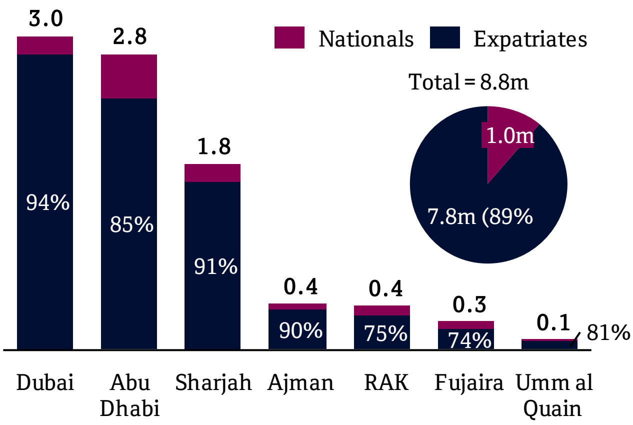
(US$k)



Source: National and emirate sources and QNB Group estimates

Population by Emirate and Nationality (2012)

(m, % share shown)



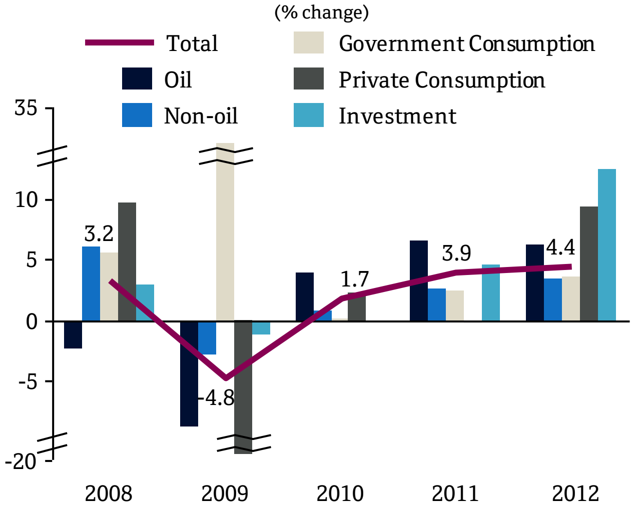
Source: QNB Group estimates based on National Bureau of Statistics (NBS) data

Recent Developments (2012)

The private sector took the lead in the recovery in 2012...

Real GDP registered the highest growth since 2006 (4.4%) as the oil sector saw a second year of strong expansion (6.3%) and the non-oil sector grew by 3.5%, the strongest rate since 2008. Oil production reached a new record of 3.4m barrels/day (including crude, condensates and NGLs), according to BP data, although this only represented a 1.8% rise compared with 2011. In addition, marketable gas production actually declined slightly. On the demand side, the private sector showed a marked uptick after a period of weak performance. On top of very strong private consumption growth (9.4%), the surge in investment (12.5%) was driven by the private sector, more than offsetting a contraction in government investment.

Real GDP Growth with Selected Components (2008-12)

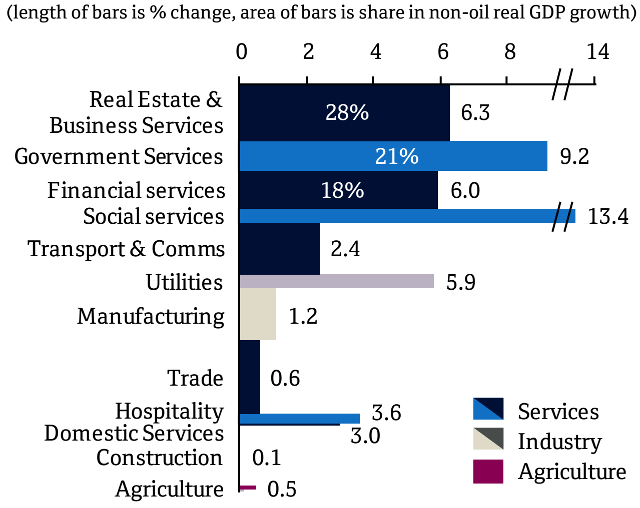


Source: NBS and QNB Group analysis

...boosted by a turnaround in the real estate sector

The real estate sector (combined with business services) grew at its strongest rate in five years (6.3%), providing the largest contribution (28%) to non-oil growth. This real estate recovery was most evident in Dubai which was ranked as the world's second hottest real estate market of 2012 in Knight Frank's global house price index, with average residential prices up 19% over the year. Price rises have fed into Dubai rents which bottomed out in late 2012, after four years of decline. Average UAE rental inflation was still -2.6% on average over 2012, keeping overall inflation at a muted 0.7%. Government and financial services also provided a significant contribution to growth in 2012. Less positively, domestic trade, the largest non-oil sector, grew by just 0.6%. The construction sector stabilized (0.1%) following two years of contraction.

Sector Contributions to Non-Oil Real Growth (2012)

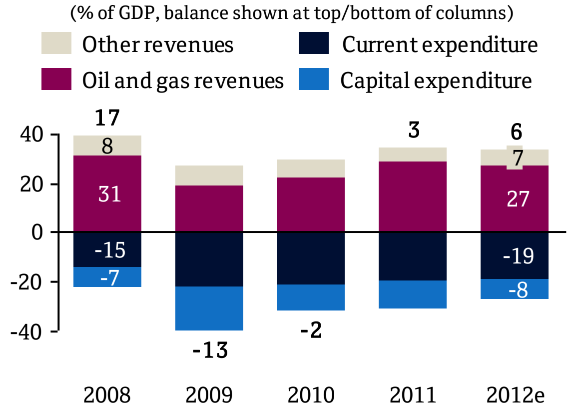


Source: NBS and QNB Group analysis

Expenditure consolidation boosts the fiscal surplus

The 2012 fiscal outturn is not yet available, but we estimate that expenditure consolidation (3% of GDP) led to a significant increase in the fiscal surplus. The expenditure consolidation was concentrated in capital expenditures, where project implementation and the start of new projects were delayed. Overall current expenditure is estimated to have grown in line with GDP, notwithstanding a significant hike in federal wages. Oil and other revenue remained broadly unchanged in percent of GDP. As a result, the overall fiscal surplus is estimated to have increased to 5.9% of GDP, the highest in the last four years.

Consolidated Fiscal Outturn (2008-12)



Source: IMF and QNB Group analysis

The economic recovery led to reduced CDS spreads

The economic recovery, together with a broader repricing of emerging market debt, helped reduce bond yields and credit default swap (CDS) spreads to historic lows in Abu Dhabi and by over a half in Dubai. Concerns remain about the debt of Government-Related Enterprises (GREs) and the Dubai government, but the market seems to expect that the sizable tranches of debt coming due in the next few years, including a key US$20bn bailout loan from Abu Dhabi and the central bank to Dubai, will be rolled over successfully.

Dubai CDS Spread (Jan 2012 – Jun 2013)

(basis points above US Treasuries for a 5yr bond)

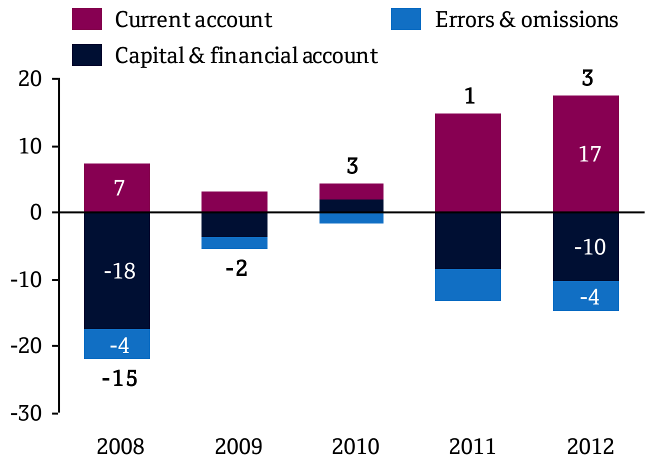
Source: Bloomberg and QNB Group analysis

A record trade surplus swelled the current account surplus

The current account surplus rose to the highest level (17.3% of GDP) since 2000. Higher oil and non-oil exports delivered a record trade surplus (33.4% of GDP), despite strong import growth (13.5%). The other components of the current account (services, income and transfers) remained stable in relative terms. In the capital and financial account, foreign direct investments picked up significantly. Portfolio investment data is only available in net terms and showed only a small increase (US$1bn) making it hard to identify the reported US$8bn of safe haven capital inflows that were received in 2012 in response to regional instability. The overall balance of payments surplus boosted reserves to US$45.8bn at end-2012, equivalent to 4.4 months of domestic import cover (the IMF recommends a minimum of three month cover for pegged exchange rate regimes like the UAE).

Balance of Payments (2008-12)

(% of GDP, overall balance shown at top/bottom of columns)



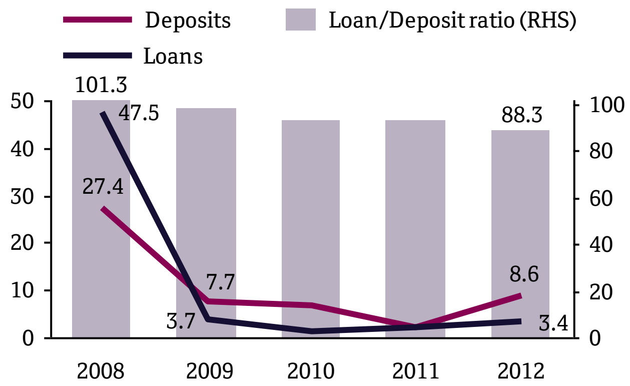
Source: Central Bank and QNB Group analysis

Bank deposits rose but lending remained muted

The banking sector witnessed deposits growing at their strongest rate (8.6%) since 2008, partly due to safe haven capital inflows from countries in the region with political instability. This provided a boost to liquidity and eased interbank lending rates (three month rates fell to 1.3% by end-2012). Lending grew more gradually (3.4%), and new lending was concentrated mainly in the government and construction sectors. The 2009 real estate and debt crisis has contributed to this moderation in lending and rising non-performing loans levels (8.4% at end-2012). New central bank rules, increasing liquid asset coverage requirements, may have reduced the pool of loanable funds. All but one of the local banks saw a rise in profits in 2012, and their aggregate profit growth was 17.4%, despite pressure on margins. Contributions to the uptick included lower growth in provisioning and greater fee income, including from trade financing.

Bank Loan and Deposit Growth (2009-2012)

(% change on LHS, loans as % of deposits on RHS)



Source: Central Bank and QNB Group analysis

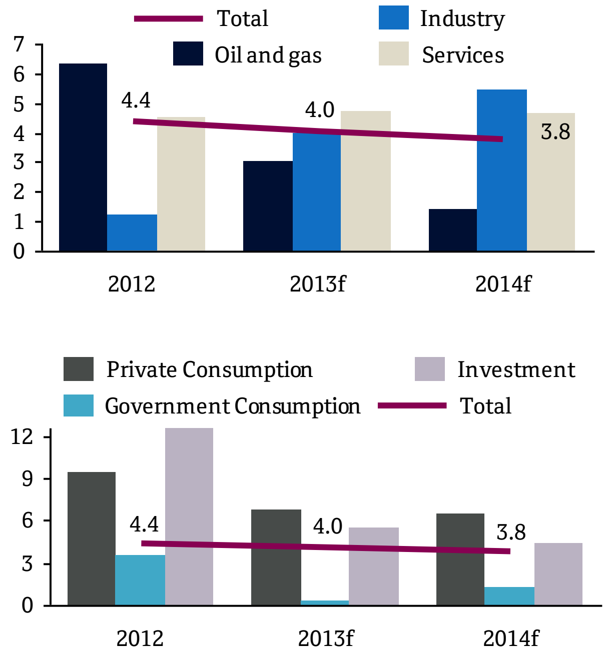
Macroeconomic Outlook (2013-14)

Growth momentum shifts from oil to non-oil

We forecast that the UAE will continue its recent trend of steady expansion, although the rate of growth will ease slightly in 2013 (4.0%) and 2014 (3.8%). This reflects a slowdown in the **oil & gas sector** owing to delays in issuing contracts and uncertainty over the expiration, in 2014, of the 35 year concession on Abu Dhabi's onshore oil fields. However, the **non-oil sector** will continue to gather momentum, buoyed by continued strong private sector consumption growth (averaging 6.6%), more than offsetting a slowdown in government consumption. **Private demand** will feed particularly into the hospitality, entertainment and financial sectors, which will lead the services sector's growth. Evidence of this growth is already visible in leading indicators such as hotel occupancy. **Construction** is expected to return to solid growth (averaging 5.5%). The sector will be supported by housing projects, including a state plan to build over 12,000 units in Abu Dhabi. There are also major infrastructure projects underway, such as railways and two nuclear plants, and new megaprojects planned including Mohammad Bin Rashid City in Dubai. If Dubai wins the bid to host World Expo 2020 (decision due in November 2013), this will provide a further boost. **Manufacturing** is also picking up. The Markit Manufacturing Purchasing Managers Index (PMI) averaged 54.9 in H1-2013, up from 53.4 in 2012.

Real GDP Growth by Sector and Demand (2012-14)

(% change, selected components)



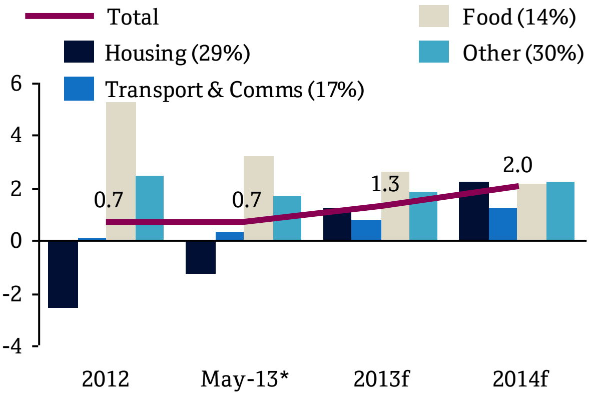
Source: NBS and QNB Group forecasts

Inflation will remain muted despite rising rents

The official consumer price index (CPI) rose on average by 0.7% in the 12 months to May 2013. The principal trend relates to housing rents, which have stabilized in Abu Dhabi and begun to increase in Dubai. We estimate that rental inflation has already turned positive nationwide and will average 1.2% over 2013, picking up to 2.2% in 2014. This shift will drive up inflation, but only moderately (2.0% in 2014), given an easing in other parts of the CPI, particularly food as a result of falling global commodity prices. Oil prices are expected to fall to US$97/barrel in 2014. As a result, nominal GDP growth will average just 2.9%, bringing total GDP to US$407bn in 2014.

Inflation (2012-14)

(% change, sector weights in consumer price index shown)



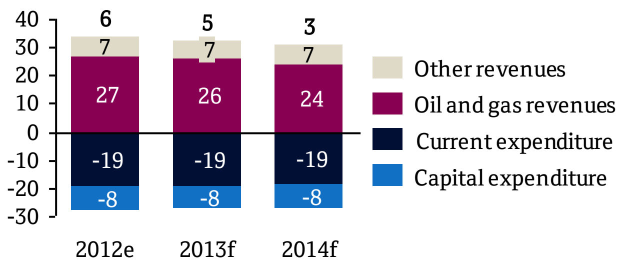
Source: NBS and QNB Group forecasts; *average of prior 12 months

The fiscal surplus will narrow

Lower oil revenues will also lead to a narrowing of the consolidated national fiscal surplus to around 3% of GDP in 2014. Non-oil revenue is expected to pick up slightly, mainly due to higher tax and fee receipts in Dubai as its economy gathers pace. Current and capital expenditure will both ease moderately relative to GDP, as continued fiscal prudence will result in only small nominal increases in government outlays.

Consolidated Fiscal Outturn (2012-14)

(% of GDP, balance shown at top of columns)



Source: QNB Group estimates and forecasts

Debt levels are expected to fall to sustainable levels

Public debt levels are expected to continue to fall to below 60 percent of GDP by 2014. The consolidated stock of public debt, including GRE borrowing, is expected to remain roughly constant in nominal terms in the coming years. Some of the maturing Dubai GRE debt will be paid off through asset disposals, and some stronger GREs will issue additional debt, but the balance of debt is unlikely to change significantly. This means that the level of debt will fall relative to GDP to about 57% of GDP by 2014. Yields have increased since the US Federal Reserve began discussing a tapering of quantitative easing in June, in particular the yields on benchmark Dubai bonds and sukuk are up over 100bps. This will increase the cost of refinancing. We expect that higher yields will remain manageable as they are at par with mid-2012 levels.

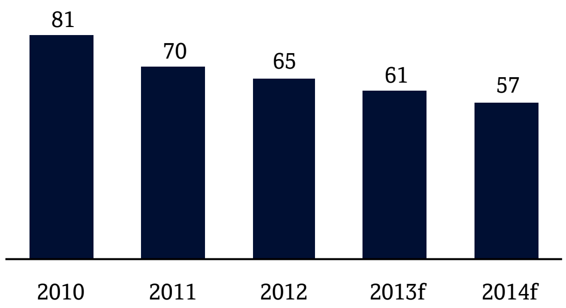
The balance of payments surplus will continue to register a significant surplus

A small narrowing in the current surplus is forecast to be offset by similar reductions in financial outflows over the next two years, maintaining a relatively steady balance of payments surplus (averaging 2.2% of GDP). This will boost international reserves to around US$64bn, equivalent to just over 5 months of domestic import cover (excluding imports destined for re-export). The narrowing of the current surplus (to an average of 14.7% of GDP) will mainly be driven by rising imports of both consumer and capital goods, drawn in by strong growth in private consumption and investment. Lower oil prices are expected to reduce hydrocarbon exports.

The banking sector will continue to expand in line with the growth in the deposit base

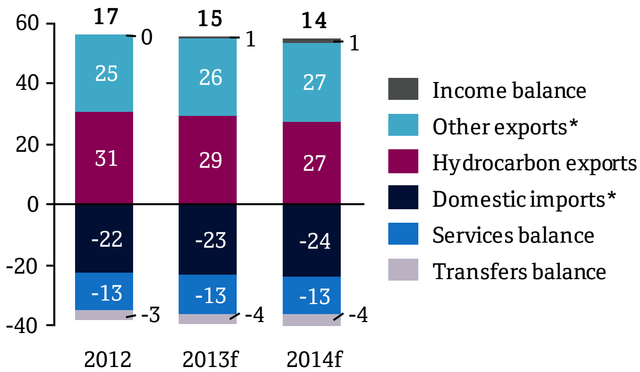
The growth in the banking sector will continue to be driven by its deposit base. Loan and advances growth has been picking up to 5.2% y-o-y in May 2013. It is expected to accelerate further during 2013-14. New central bank's restrictions on lending to GREs are on hold as further consultations are underway with the banking sector. Their final form will significantly affect lending trends to the public sector. Deposits are growing faster than loans (10.8% in May 2013). As a result, the loan/deposit rate has been declining steadily. This provides banks with room to increase their lending portfolios, such as in construction (up 9.1% in March 2013). Growth in this sector is likely to pick up further, given the increase in ongoing projects. Personal loans are also growing strongly on the back of rising private consumption. In terms of deposits, banks are likely to focus on higher net-worth depositors as they face some competition from shadow banking in lower income segments.

Public Debt (2010-14)
(% of GDP)



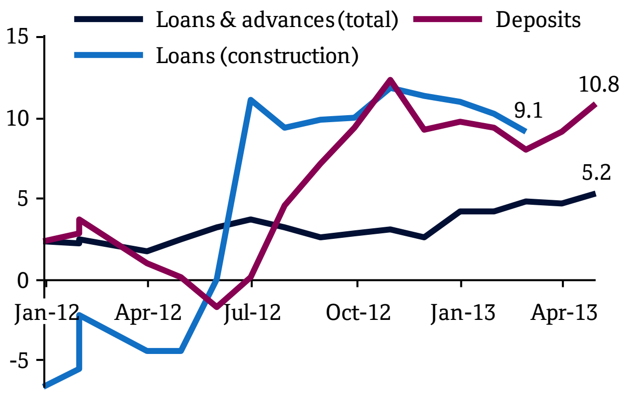
Source: IMF and QNB Group forecasts

Current Account Balance (2012-14)
(% of GDP, overall balance shown at top of columns)



Source: Central Bank and QNB Group forecasts; *re-export trade excluded

Bank Loan and Deposit Growth (Jan 12-May 13)
(% change YoY)



Source: Central Bank; Loan by sector data only available until Mar-13

Key Macroeconomic Indicators

	2008	2009	2010	2011	2012	2013f	2014f
Real sector indicators							
Real GDP growth (%)	3.2	-4.8	1.7	3.9	4.4	4.0	3.8
Oil & gas sector	-2.4	-8.9	3.8	6.6	6.3	3.0	1.4
Non-oil sector	6.0	-2.9	0.7	2.6	3.5	4.5	4.9
Government consumption	5.5	32.1	0.1	2.5	3.6	0.3	1.3
Private consumption	9.6	-19.5	2.3	-0.3	9.4	6.7	6.5
Fixed investment	3.0	-1.3	-0.1	4.6	12.5	5.5	4.4
Net exports	-56.7	202.0	4.8	25.5	-28.8	-14.2	-17.1
Nominal GDP (US$ bn)	315.5	254.8	287.4	348.6	383.8	395.9	406.6
Growth (%)	22.3	-19.2	12.8	21.3	10.1	3.2	2.7
Oil & gas sector (% of GDP)	36.9	26.9	31.4	39.3	40.2	38.2	35.3
Consumer price inflation (%)	12.3	1.6	0.9	0.9	0.7	1.3	2.0
Food	16.3	0.8	4.5	5.9	5.2	2.6	2.1
Housing	13.4	0.4	-0.3	-2.4	-2.6	1.2	2.2
Budget balance (% of GDP)	16.7	-13.1	-2.2	3.0	5.9	5.0	3.5
Revenue (oil)	31.1	18.6	22.2	28.3	26.7	25.6	23.6
Revenue (non-oil)	7.8	8.7	7.5	6.1	6.9	6.7	7.0
Expenditure	22.2	40.4	31.8	31.4	27.7	27.3	27.1
Public debt	45.9	87.7	81.0	69.8	65.1	60.6	56.6
External sector (% of GDP)							
Current account balance	7.1	3.1	2.5	14.6	17.3	15.4	14.2
Trade balance	19.9	16.5	17.0	30.6	33.4	31.5	29.5
Exports	75.8	75.3	74.3	86.6	91.2	91.5	91.7
Imports	-55.9	-58.8	-57.3	-56.1	-57.8	-60.0	-62.2
Services balance	-10.7	-10.7	-10.6	-12.5	-12.7	-13.2	-12.6
Income balance	1.2	1.3	0.0	0.0	0.1	0.7	1.0
Current transfers balance	-3.4	-4.0	-3.9	-3.5	-3.4	-3.5	-3.7
Capital account balance	-17.5	-3.8	1.7	-8.5	-10.3	-10.1	-9.0
International reserves	10.0	9.8	11.0	10.4	11.9	13.6	15.7
External debt	43.2	48.4	47.2	39.6	37.5	36.1	34.8
Monetary indicators							
Interbank interest (%, 3 months)	4.3	1.9	2.1	1.5	1.3	-	-
Exchange rate US$:AED (av)	3.673	3.673	3.673	3.673	3.673	3.673	3.673
Banking sector indicators (%)							
Average return on assets	1.4	1.4	1.3	1.5	1.5	-	-
Average non-performing loans ratio	2.3	4.3	5.6	7.0	8.4	-	-
Deposit growth	27.4	7.7	6.8	1.9	8.6	-	-
Credit growth	47.5	3.7	1.4	2.1	3.4	-	-
Memorandum items							
Population (m)	8.07	8.20	8.26	8.47	8.75	9.05	9.39
Growth (%)	29.8	1.6	0.8	2.5	3.3	3.4	3.8
Oil production ('000 bpd)	2,572	2,242	2,324	2,565	2,657	2,750	2,780
UAE crude price (US$/barrel)	93.7	70.6	78.3	106.6	105.4	103.0	97.0
Gas production (m cu ft/day)	4.9	4.7	5.0	5.1	5.0	5.1	5.2

Source: NBS, Central Bank, IMF and **QNB Group estimates and forecasts;** Data as at 15th July 2013

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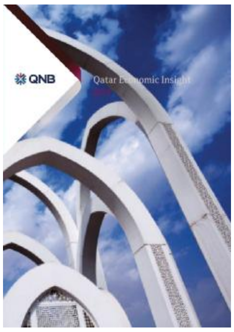
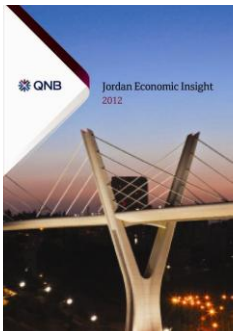


Qatar 2013

Oman 2013



Jordan 2012

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UAE: Commercial Bank International, +971 4227 5265, www.cbiuae.com