Euler Hermes Economic Research

Country Report

United Arab Emirates

Navigating headwinds from a position of strength

General Information

GDP	USD401.65bn (World ranking 30, World Bank 2014)
Population	9.45mn (World ranking 92, World Bank 2014)
Form of state	Federation
Head of government	HH Sheikh Khalifa bin Zayed bin Sultan Al Nahyan
Next elections	October 2019, legislative

Strengths

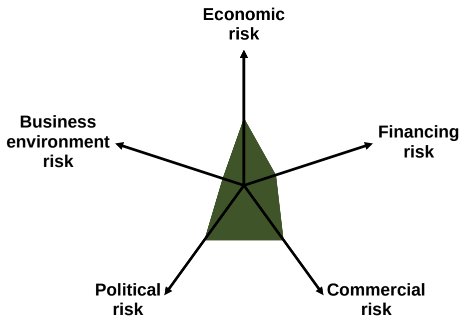
- Regional co-operation through the GCC.
- Stable society, with established method of succession.
- Abundance of natural resources (hydrocarbons).
- Large asset holdings and investments held overseas. Net creditor status.
- Actively diversifying economy.
- Relatively liberal business and trading environment.
- Fiscal and current accounts sound, despite some short-term effects from current weaker oil prices.
- Re-classified to emerging market status (formerly frontier market) within the MSCI.

Weaknesses

- Despite diversification (including further developments in the transport and travel sectors), the economy overall is affected by the vagaries of international oil and gas markets.
- High dependence on global and regional markets and events.
- Fixed exchange rate peg to the USD limits independence of monetary policy.
- Speculative flows (stock market, real estate etc.) provide some concern of asset bubbles.
- Regional uncertainties.
- Data provision is poor for a high income economy.

Country Rating

BB1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Japan	15%	1	16%	China
China, Taiwan Province of	13%	2	13%	India
India	11%	3	9%	United States
Iran (Islamic Republic of)	10%	4	6%	Germany
Korea, Republic of	6%	5	4%	Japan

By product (% of total)

Exports		Rank		Imports
Petroleum, petroleum products and	51%	1	8%	Miscellaneous manufactured articles,
Non metallic mineral manufactures, n.e.s.	7%	2	7%	Road vehicles
Gas, natural and manufactured	6%	3	7%	Non metallic mineral manufactures,
Gold, non-monetary (excluding gold	6%	4	6%	Telecommunication and sound
Road vehicles	3%	5	6%	Petroleum, petroleum products and

Source: UNCTAD

Economic Overview

The UAE possesses 5.8% of global oil reserves (the eighth highest) and, at current levels of extraction, these will last for over 72 years. In addition, the UAE possesses the seventh largest reserves of natural gas, which will last over 100 years. Partly as a result of its large hydrocarbon-based economy, but also reflecting trading, financial (particularly in Dubai) and investment activities, the country has over USD1,200bn in sovereign wealth funds. Such financial resources enable the UAE to withstand periods of global downturn and weaker oil and gas revenues. The economy of Dubai is more volatile than that of Abu Dhabi, given its higher debt profile, its diversified economy and its more direct links to global (including Iranian) trade.

Vibrant business environment

The UAE is one of the most liberal business environments in the Middle East and foreign investment is actively encouraged in many non-oil sectors. The Heritage Foundation's 2016 Index of Economic Freedom (IEF) ranks the UAE 25 out of 178 countries, below Japan and Finland but above Sweden and Austria. The IEF notes low barriers to trade, supportive open-market policies and a transparent business climate. However, the IEF also reports a relatively inefficient judicial system that is vulnerable to political influence.

GDP growth has slowed but the economy is not just about oil and gas

GDP growth in 2014 is estimated at +4.6%, with both the oil and non-oil sectors (particularly trade, tourism and transport) contributing positively. However, overall growth dipped to +3.4% in 2015 and EH expects only +2% growth in 2016, the weakest GDP performance since the financial crisis year of 2009 (-5.2%). Low oil and gas prices and lacklustre global demand, combined with countervailing policy adjustments, are the main reasons for relatively weaker growth. Regional tensions (including conflicts and uncertainties relating to Iran's re-emergence in the global economy) are also weighing against strong economic activity levels.

Oil prices are unlikely to recover to USD100/barrel but have staged a recovery from a low of USD27 in January 2016 to around USD50 in June 2016. Weakness in the oil sector is partly offset by growth in non-oil sectors. The UAE has developed rapidly as a transport hub and Dubai International Airport is now the busiest airport for international passenger traffic (almost 70mn passengers). It is also the busiest for Airbus A380 usage and the world's sixth busiest cargo airport.

Exchange rate system will continue

There is now an upward bias to price pressures, reflecting cutbacks in subsidy provision. However, EH expects consumer price inflation will end 2016 at around 3.5% and a still manageable 4% at end-2017.

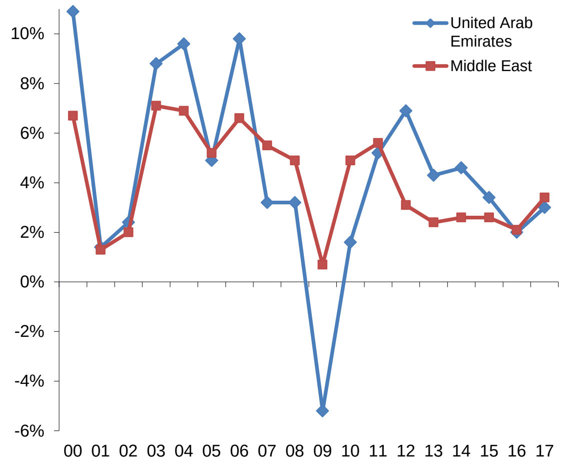
EH does not expect the exchange rate regime to change in the forecast period to end-2017, with the fixed peg of AED3.67 = USD1 throughout. Indeed, UAE authorities continue to re-iterate their commitment to the dirham's peg, despite renewed speculation (in markets and general commentaries) of a fundamental change to the system. EH does not envisage the introduction of an effective GCC single currency in this period. In May 2009, the UAE opted out of the monetary union but this policy may be revisited when the GCC moves forward with its planned integration.

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	4.6	3.4	2.0	3.0
Inflation (%, end-year)	3.1	3.6	3.5	4.0
Fiscal balance (% of GDP)	-5.4	-12.5	-12.5	-9.0
Public debt (% of GDP)	15.7	22.1	25.0	20.5
Current account (% of GDP)	14.7	5.7	3.5	7.5
External debt (% of GDP)	50.4	53.8	59.0	54.5

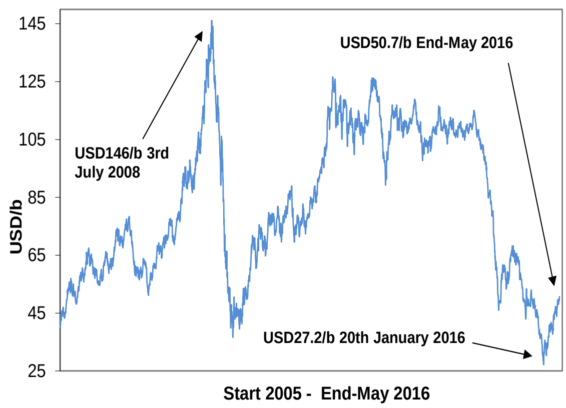
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Oil Prices (Brent benchmark, USD/barrel)



Sources: FT, Euler Hermes

External accounts are weakening but the current account remains in surplus

Although the UAE's economy is relatively diversified compared with other GCC states, the strength of the external accounts continues to depend on internationally-determined oil prices and the country's associated revenue generating capacity. Crude oil and related products account for almost 60% of the UAE's export receipts. Strong annual current account surpluses were recorded in 2011-2014 (average +17.5% of GDP), when oil prices were high (indicative average benchmark prices of over USD100/barrel, after USD80/b in 2010). Oil prices are unlikely to recover to USD100/barrel as global inventories are high and output from shale deposits in North America can be brought back on stream relatively easily when prices rise. EH estimates that the current account surplus in 2015 was +5.7% of GDP, with a further fall forecast in 2016, to +3.5% of GDP.

The UAE's oil policy is likely to remain aligned closely with that of neighbouring Saudi Arabia. As a result, unilateral action to cut output in an attempt to boost the oil price is unlikely. EH expects that the current account will remain in surplus over the forecast period.

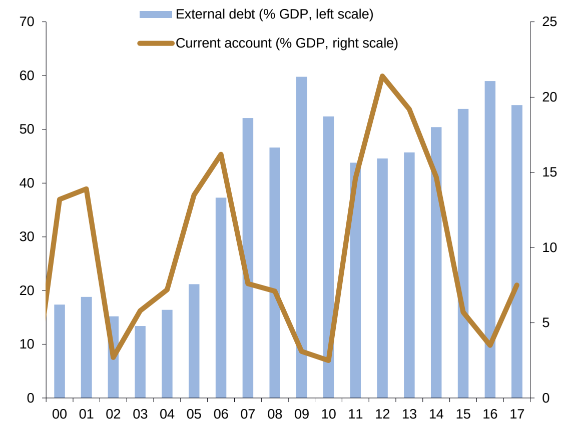
FX reserves and import cover are relatively low but external liquidity is boosted by SWFs and other funds

Hard currency foreign exchange reserves are around USD80bn but the UAE's policy is to keep FX low and store accumulated wealth in other areas, including several sovereign wealth funds (currently estimated at a combined value of around USD1,230bn, with USD790bn held by the Abu Dhabi Investment Authority) and in other assets. Accordingly, a strict interpretation of import cover (currently less than four months) is not an accurate measure of external liquidity. Using an alternative definition, EH calculates import cover is comfortably in double figures. Net external assets are equivalent to over 110% of GDP.

External debt levels and servicing of obligations are comfortable in the forecast period

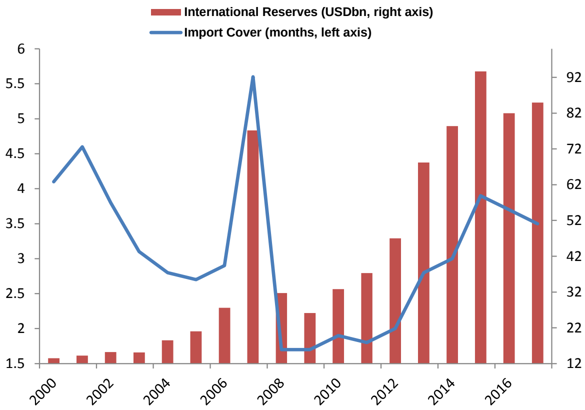
External debt ratios are relatively low, with total foreign debt stock at around 59% of GDP and 70% of export earnings and the debt service ratio on existing obligations is around 5% of total export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments) are unlikely to be problematic.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign Exchange Reserves (USDbn) & Import Cover (months)



Sources: National sources, IHS, Euler Hermes

Sovereign Wealth Funds:

- **USD1,230bn**
- **of which, Abu Dhabi Investment Authority (ADIA) USD790bn**

(Approximate asset size at end-May 2016)