Euler Hermes Economic Research

Country Report

# United Arab Emirates

## Financial strength and diversification soften the impact from weaker oil prices

### General Information

| | |
|---|---|
| **GDP** | USD402.34 bn (World ranking 29, World Bank 2013) |
| **Population** | 9.35 mn (World ranking 92, World Bank 2013) |
| **Form of state** | Federation |
| **Head of government** | HH Sheikh Khalifa bin Zayed bin Sultan Al Nahyan |
| **Next elections** | 2015, legislative |


### Strengths

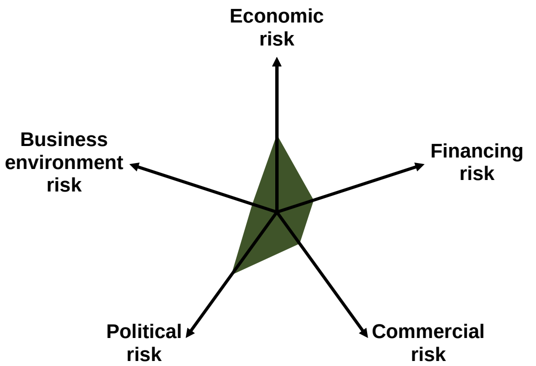
- Stable society, with established method of succession.
- Abundance of natural resources (hydrocarbons).
- Large asset holdings and investments held overseas. Net creditor status.
- Actively diversifying economy.
- Relatively liberal business and trading environment.
- Fiscal and current accounts sound,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

### 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 | 17% | India |
| India | 14% | 2 | 14% | China |
| Taiwan | 12% | 3 | 10% | United States |
| Iran | 9% | 4 | 5% | Germany |
| Thailand | 5% | 5 | 4% | Japan |

By product (% of total)

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Petroleum Products | 53% | 1 | 11% | Miscellaneous manuf. |
| Gold | 7% | 2 | 7% | Non-metallic mineral |
| Non-metallic mineral | 6% | 3 | 6% | Road Vehicles |
| Gas | 5% | 4 | 6% | Gold |
| Miscellaneous manuf. | 3% | 5 | 6% | Petroleum Products |

Source: UNCTAD (2012)

# Economic Overview

## Policy stance

As elsewhere in the region, there is concern relating to unemployment and under-employment, particularly among the young. Accordingly, the government adopted a policy of "Emiratisation", whereby the job market will favour nationals rather than expatriate workers. To date, however, the labour market remains highly skewed towards foreign nationals.

## Relatively strong growth is not only an oil and gas story

GDP growth in 2014 is estimated at +4.2% (+5.2% in 2013) and both the oil and non-oil sectors (particularly trade, tourism and transport) contributed positively. However, overall growth was below potential because of regional tensions (despite some positive substitution effect as the UAE is perceived as a safe haven within the wider region) and weakness in some key markets (including the Eurozone). Government spending (including social support packages and increased subsidy provision) and investment were also strong and somewhat compensated for weaker external demand.

## The growth outlook remains favourable, despite currently lower oil prices

The outlook for 2015 is for an easing in growth to reflect relative weakness in the oil sector and, in particular, reduced revenues through lower prices; indicative crude Brent oil prices at mid-June 2015 were down -40% y/y. Weakness in the oil sector is partly offset by growth in non-oil sectors. The UAE has developed rapidly as a transport hub and, last year, Dubai International Airport overtook London Heathrow as the busiest airport for international passenger traffic (almost 70 mn passengers). It is also the busiest for Airbus A380 usage and the world's sixth busiest cargo airport.

Oil prices are expected to consolidate around USD60-70/barrel, although uncertainties relating to the potential increase in Iranian crude supplies to world markets and to further production of energy supplies from North American shale reserves provide downside and upside risks. The global outlook for 2015 is for a gradual and probably subdued recovery, with the UAE benefiting from increased world trade and further boosted by preparations ahead of hosting the World Expo 2020. EH expects GDP growth of +3.5% in 2015 and +4.5% in 2016.

## Exchange rate system will continue

Price pressures remain low, although an improving housing (and general construction) market suggests that upward movement can be expected. EH expects consumer price inflation will end 2015 at around 3.3% and be around 3% at end-2016.

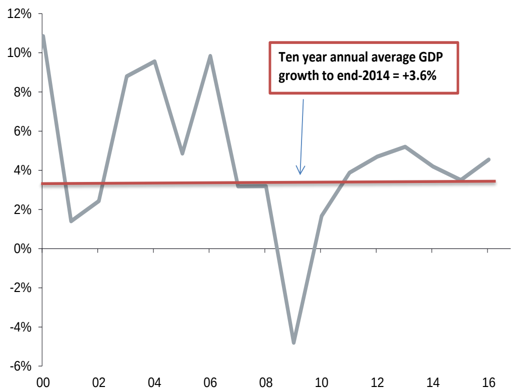
EH does not expect the exchange rate regime to change in the forecast period to end-2016, with the fixed peg of AED3.67 = USD1 throughout. Indeed, UAE authorities continue to re-iterate their commitment to the dirham's peg, despite ongoing speculation (in markets and general commentaries) of a fundamental 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

| | 2013 | 2014 | 2015f | 2016f |
|---|---|---|---|---|
| GDP growth (% change) | 5.2 | 4.2 | 3.5 | 4.5 |
| Inflation (%, end-year) | 1.5 | 3.1 | 3.3 | 3.0 |
| | | | | |
| Fiscal balance (% of GDP) | 5.3 | 5.0 | -2.5 | 2.0 |
| Public debt (% of GDP) | 11.7 | 11.4 | 17.6 | 14.8 |
| | | | | |
| Current account (% of GDP) | 16.1 | 9.0 | 4.5 | 5.0 |
| External debt (% of GDP) | 43.8 | 42.0 | 43.8 | 41.8 |

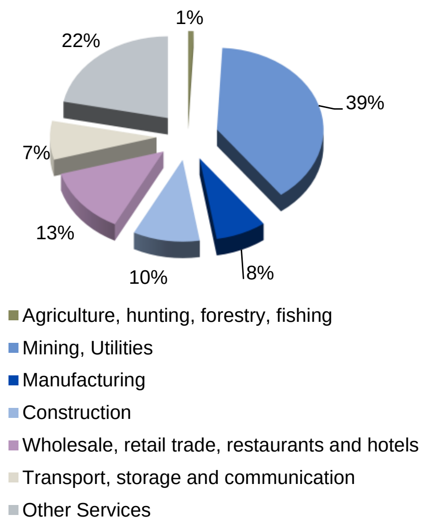
Sources: IHS, national sources, Euler Hermes

### GDP growth profile (%)




Sources: IHS, Euler Hermes

### GDP breakdown (%)




Sources: UNCTAD

## External accounts will weaken but remain strong

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 over 50% of the UAE's export receipts. Strong current account surpluses were recorded in 2011-13, when oil prices were high (indicative average benchmark prices of over USD100/barrel, after USD80/b in 2010). EH forecasts the current account surplus at +9% of GDP in 2014. Global oil prices fell below USD100/b in September 2014 and bottomed at USD46/b in January 2015 before staging a recovery to USD65/b in mid-June.

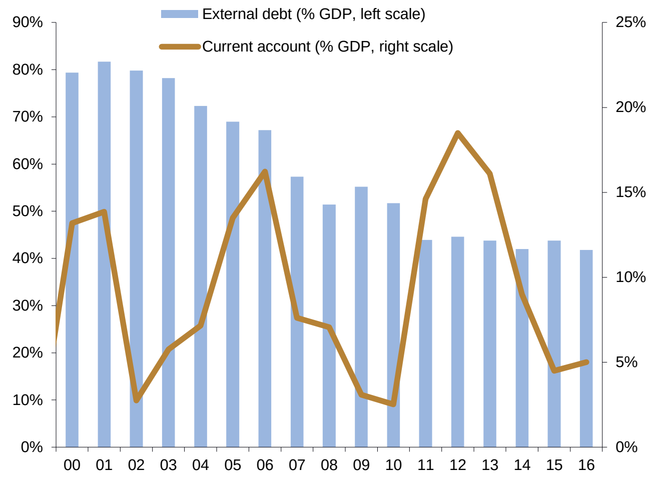
Oil prices are not expected to climb back to USD100/b in the forecast period. As a result, the UAE's external accounts are likely to deteriorate. However, the country is one of only a few that has the ability to alter its oil output in an attempt to support oil revenues and the UAE's policy is likely to be aligned closely with that of neighbouring Saudi Arabia. Whatever policy is adopted in relation to oil output, the current account will remain in surplus over the forecast period.

Hard currency foreign exchange reserves are over USD70 bn 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 USD1,188 bn, with USD773 bn held by the Abu Dhabi Investment Authority) and in other assets. Accordingly, a strict interpretation of import cover (currently just less than three 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

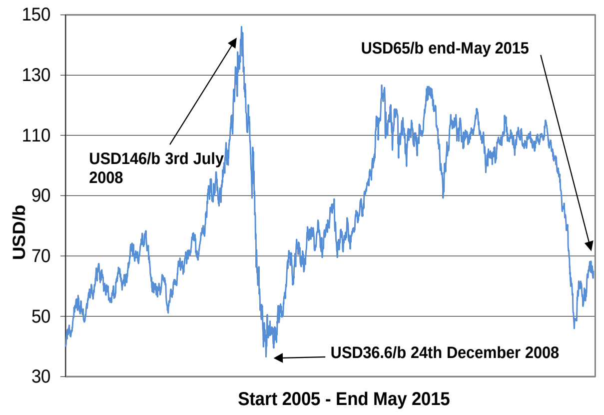
External debt ratios are relatively low, with total foreign debt stock at around 44% of GDP and 48% of export earnings and the debt service ratio on existing obligations is under 4.5% of total export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments) will not be problematic.

**External debt and current account balance (% of GDP)**




Sources: IHS, Euler Hermes

**Oil prices (Brent crude USD/barrel)**




Source: Euler Hermes





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