# UAE ECONOMIC REPORT

## THE CHALLENGE OF FURTHER ECONOMIC DIVERSIFICATION AMID THE PLUNGE IN OIL PRICES

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- Sound growth in UAE economy despite the oil price slump

  While it is true that the plunge in international oil prices have somehow eroded UAE's long standing fiscal and external surpluses, the Emirates continued to benefit from a perceived safe haven status and large fundamental buffers that have helped restrict the adverse spillovers from contracting oil prices, sluggish global growth and volatility in emerging market economies. Real GDP growth is estimated at a moderate 3% in 2015, against 4.6% in 2014. Non-oil sector is poised to be growing at a rate of circa 5%, driven by buoyant levels of activity in the tourism and construction sectors.

- First fiscal deficit since 2009 amidst dwindling government revenues

  The UAE fiscal position has deteriorated in 2015, with the government fiscal balance posting its first deficit since 2009 and the largest ever amidst dwindling oil prices and contracting revenues. This prompted some fiscal adjustments, including the rise of electricity and water tariffs and the deregulation of fuel prices, while the government is considering the possible implementation of a VAT in coordination with other GCC member countries in the aim of bolstering its non-hydrocarbon revenue side. General government revenues are estimated to have registered a significant contraction of US$ 44.6 billion in 2015, while general government expenditures moved down US$ 6.2 billion. Fiscal deficit is estimated to have reached 5.5% of GDP in 2015, as compared to a fiscal surplus of 5.0% of GDP in 2014.

- Slower growth in monetary aggregates along with increased inflationary pressures

  Monetary conditions in the United Arab Emirates were marked in 2015 by a slower growth in monetary aggregates amidst an oil price slump, a shy rise in the Central Bank's gross international reserves, increased inflationary pressures amidst cuts in fuel and utility subsidies, and a rise in interest rates in line with the US Federal Reserve interest rate hike. The overall Consumer Price Index for the UAE moved up by a yearly 3.5% in November 2015.

- Decent but slower banking activity growth in 2015

  The banking sector witnessed during 2015 a slowdown in activity growth. Measured by total assets of banks operating in the country, banking sector activity grew by a decent 6.1% in the first 11 months of 2015 to reach US$ 666.0 billion in November. The asset growth in volume yet proved 42% lower than that recorded during the 2014 corresponding period. Banks maintain good financial soundness indicators, with adequate capitalisation, acceptable asset quality and strong profit metrics.

- Price drops across UAE capital markets

  The UAE capital markets witnessed a trend reversal in 2015, with the UAE equity markets registering the largest price falls since 2008 and the fixed income market coming under downward price pressures amidst an oil price slump and lingering concerns about an oversupplied global oil market, in addition to bets over a US Federal Reserve interest rate hike that effectively took place in December 2015. The Dubai Financial Market index fell from 3,774.00 at end-2014 to 3,151.00 at end-2015, moving down by 16.5%, while the total trading value in the Dubai Financial Market was down by 63.7%. In parallel, the Abu Dhabi Securities Exchange reported price decreases of 4.9% in 2015 with the total trading value falling by 68.3%.

- A number of economic challenges rise at the horizon

  A hike in US interest rates could lead to a tightening of financial conditions, notwithstanding the impact of lower oil prices on fiscal and external surpluses. Export and revenue losses from lower oil prices will be the most significant transmission channel for the UAE economy at large. Growth in the UAE's oil sector is likely to weaken and, with Saudi Arabia ruling out any increase in production in the wake of the crude oil price falls, there will be little opportunity to increase output considerably over the coming years. While the current environment of low oil prices presents fiscal constraints, it should intensify policy initiatives promoting diversification as the UAE develops its role as a regional hub for trade, finance, transport and tourism.

The UAE Economic Report can be accessed via internet at the following web address: http://www.bankaudigroup.com



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While it is true that the plunge in international oil prices have somehow eroded UAE's long standing fiscal and external surpluses, the Emirates continued to benefit from a perceived safe haven status and large fundamental buffers that have helped restrict the adverse spillovers from contracting oil prices, sluggish global growth and volatility in emerging market economies. Real GDP growth is estimated at a moderate 3% in 2015, against 4.6% in 2014, with GDP contracting to circa US$ 340 billion. Non-oil sector is poised to be growing at a rate of circa 5% year-on-year, driven by buoyant levels of activity in the tourism and construction sectors.

At the external sector level, the current account surplus came under pressure in 2015 to reach one of its lowest levels in a number of years. With the ratio of exports to imports contracting from 154.6% in 2014 to 130.7% in 2015, the current account surplus subsequently declined from 13.7% of GDP in 2014 to 2.9% of GDP in 2015, its lowest level since the global financial turmoil. It is yet worth mentioning that downward pressures on the surplus from lower oil export earnings and higher imports are being partly offset by robust non-oil export revenues, especially from the tourism and real estate sectors, notwithstanding the fact that the stronger US dollar and therefore dirham has helped lower the cost of imports.

At the public finance level, fiscal vulnerability has increased amid the absence of UAE plans to cut back on spending and lower oil revenues at large. The fiscal break-even oil price is projected at US$ 72 a barrel in 2015, above the US$ 58 average Brent oil price for the year. The government fiscal balance turned accordingly into deficit to reach 5.5% of GDP in 2015, following continuous surpluses over the past half a decade. The public finance deficit is driven by a 30% reduction in government revenues in 2015, while government expenditures have barely contracted by 5% over the year. Government debt has extended its stability for a number of years, reporting US$ 63.9 billion by end-2015, the equivalent of 18.9% of GDP.

At the monetary level, inflation has reported a relative pick up in 2015. It is estimated at 3.7% for 2015, the highest over the past eight years. Though real estate prices have declined somewhat since mid-2014, rents are driving up inflation while a stronger US dollar and lower commodity prices helped limit any further significant gain in the headline inflation rate. The rise in inflation comes despite a low broad money supply growth of a yearly 3.7% as of November 2015, the lowest in almost a decade. The UAE's exchange rate appreciated in line with the US dollar appreciation. Following a gradual rise over the past half a decade, effective gross international reserves stabilized in 2015 to amount to US$ 78.7 billion at end-November 2015, the equivalent of 30.4% of Money Supply in AED, a sound level in line with peer averages.

At the banking sector level, activity growth remains sound, despite relative slowdown from previous years. Total assets grew by 6.1% in the year-to November period, against a growth of 9.7% in 2014 and 11.9% in 2013. Bank assets to GDP subsequently reached 188.8%, among the high levels in the region and in the emerging markets arena at large. Lending to the private sector in particular picked up to reach a significant 8.1% in November 2015, suggesting a higher pace than previous years despite the slowdown in deposit growth to a low of 2% over the period. The banking sector still enjoys strong financial soundness indicators as it is well capitalized, liquid, profitable and with low NPLs.

At the capital markets level, the sharp drop in oil prices has triggered a stock market correction and volatility. The stock market prices declined by 17.0% in 2015 after a growth of 4.4% in 2014 and a

**UAE ECONOMIC PERFORMANCE**


*Sources: IMF, Bank Audi's Group Research Department*

spectacular growth of 85.2% in 2013, as per the S&P UAE price index. In parallel, the Dubai CDS spreads expanded by 7 bps in 2015, while the Abu Dhabi spreads rose by 29 bps over the year, reflecting a slight retreat in the market perception of sovereign risks.

The in-depth developments in the real sector, external sector, public sector and financial sector of the economy are detailed in the forthcoming sections. The concluding remarks are left to the outlook of the UAE economy looking ahead on the back of fundamental challenges mainly tied to lower oil prices at large.

# 1. ECONOMIC CONDITIONS

## 1.1. REAL SECTOR

*Sound growth in major economic sectors*

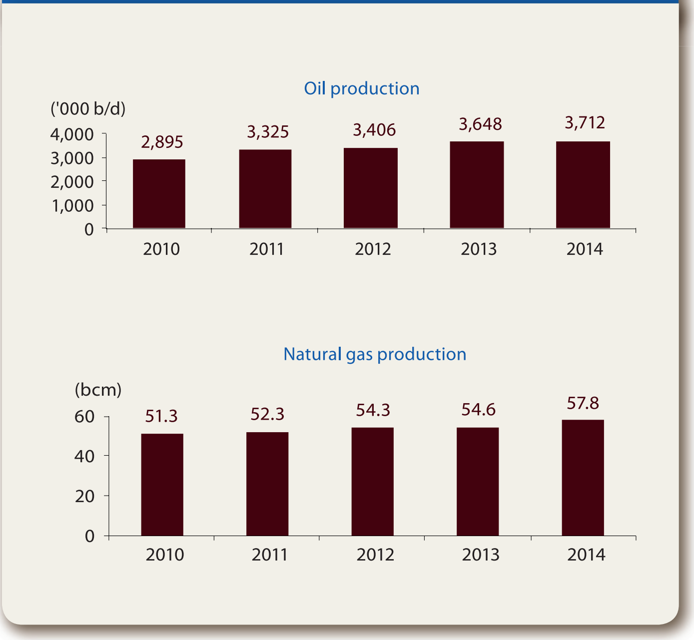
### 1.1.1. Hydrocarbons Sector

The UAE's hydrocarbons sector remains the backbone of the economy, directly contributing to 34.3% of nominal GDP in 2014. The sector's real output is expected to grow by 2.0% in 2015 compared to 4.0% last year, amidst a slump in global oil prices and higher production levels, as per the International Monetary Fund.

In spite of the UAE's relatively high exposure to hydrocarbons, the new oil price regime, which saw oil prices drop by 43.4% by end-December 2015 from end-2014 and by 61.2% from end-2013, is not expected to dramatically alter the economy's medium-term real growth trajectory. In fact, the hydrocarbons sector is currently projected to make positive contributions to real growth in 2015-2016 as the country ramps up oil production. Abu Dhabi National Oil Company, the country's flagship oil producer, recently committed to boosting its productive capacity from 3.0 million to 3.5 million barrels of crude oil per day by 2018. The decision to increase the capacity was made in response to growing domestic demand for processed hydrocarbons.

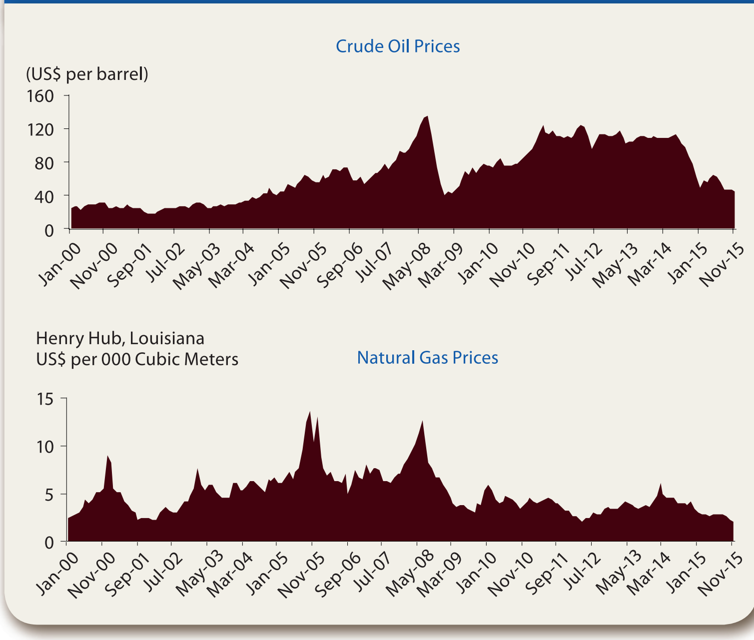
Within this context, it important to note that the UAE produced 2,871 million barrels per day of oil during the first three quarters of 2015 compared to 2,768 million barrels per day of oil in the corresponding 2014

**OIL & GAS PRODUCTION**




*Sources: IMF, Bank Audi's Group Research Department*

**CRUDE OIL & NATURAL GAS PRICES**




*Sources: IMF, Bank Audi's Group Research Department*

period, as per the Economist Intelligence Unit. It is estimated that the rising production volumes would add 0.8 to 0.9 percentage points to the 2015-2016 real GDP growth.

Moving to the consumption of hydrocarbons, total consumption, in barrels of oil equivalent, is expected to rise by 4.7% year-on-year in 2015 against 4.9% year-on-year in 2014, as per the US Energy Information Administration (EIA). However, reflecting the impact of lower oil prices, total hydrocarbons consumption in US dollar terms fell by 38.7% annually in 2015 against a decline of 2.9% in 2014.

Moreover, the UAE's oil reserves were estimated at 97.8 billion barrels in 2014, and the country's gas reserves were estimated at 6.1 trillions of cubic meters, as per the EIA. The country's oil reserves to production ratio was 73 years in 2014, meaning oil reserves would last for 73 years at the current rate of production. Similarly, the natural gas reserves-to-production ratio was 104.9 years in 2014.

Furthermore, hydrocarbon revenues represent the majority of revenues at the consolidated government level, accounting for about 64% of the total in 2014 although this proportion dropped to just over 50% in 2015. The latter makes the UAE government less dependent on hydrocarbons than Saudi Arabia, Qatar, Kuwait, Oman, or Bahrain.

The UAE plans to increase its crude and condensates production, as well as its natural gas liquids. Some of the major projects that would help the country attain its targets include the Zakum Development Company (ZADCO), a joint venture between the Abu Dhabi National Oil Company, ExxonMobil and the Japan Oil Development Company. ZADCO is pursuing higher output from Upper Zakum, adding around 150,000 b/d to production from 2017.

Moreover, Abu Dhabi Company for Onshore Operations is investing up to US$ 7 billion in the period 2015-2017 to increase production by around 180,000 b/d. In addition, the Abu Dhabi Marine Operating Company (ADMA-OPCO) plans to significantly raise production at the Lower Zakum field (+90,000 b/d), and to bring on stream new output at the Umm Lulu (105,000 b/d), Nasr (65,000 b/d) and SARB (100,000 b/d) fields over the next five years.

As for projects that would increase the UAE's gas production capacity, the non-associated Sour Gas Bab project, expected to come on stream in 2020, would produce 5 billion cubic meters of marketable gas. The project is being operated by Royal Dutch Shell, with a 40% stake and ADNOC holding the remaining 60%.

Last but not least, it is important to note that production growth in the UAE's oil and gas sectors would be relatively slow due to a lack of major new discoveries brought online. The country remains dependent on field expansions and expensive enhanced oil recovery to offset depletion rates, leaving it exposed to a slowdown in spending in a sustained lower oil price environment.

### 1.1.2. Non-Hydrocarbons Sector

#### Real Estate and Construction

The real estate sector plays an important role in the country's diversification strategy and supports its aim in building a strong non-hydrocarbon sector activity. Although a full rebound from previous setbacks has not yet been achieved, the country's efforts to boost the industry have been successful and recovery is being encountered in the country's two main Emirates, namely Dubai and Abu Dhabi. Growth is taking place at a slower and more cautious pace, with investments boosting retail, hospitality and commercial real estate developments.

In the case of Dubai, the market continued to encounter a slowdown in performance over the third quarter of 2015 that was expected to continue till the end of the year, according to Jones Lang LaSalle (JLL). Regarding the residential performance, the downward trend remained over the aforementioned period with sales prices falling by around 11% year-on-year in the case of apartments and a yearly 7% in the case of villas. Rentals registered marginal declines year-on-year. This comes along with tighter government regulations, higher inflation and a stronger US dollar which made property expensive, leading to a decline in the volume of transactions and hence a drop in prices. Moreover, one of the main challenges to the sector in Dubai is oversupply, and that was nourished by the global economic recession, declining demand levels and the regional political unrest. Residential supply registered 452 thousand units in the first nine months of 2015, up from 448 thousand units in 2014. In this context, prices are expected to hold on the softening trend into 2016, before Dubai encounters a new growth cycle in the years leading up to Expo 2020.

Regarding the office market, CBD vacancy rates declined marginally from 24% in the third quarter of 2014 to 22% in the third quarter of this year, whereas prime CBD rents rose by 1% year-on-year to stand at AED 1,880 per square meter (US$ 511.9) in the third quarter of this year. On the other hand, activity in Dubai's retail market remained slow over the third quarter of 2015 with vacancy rates remaining constant at 9% compared to the third quarter of 2014, as per JLL.

Regarding Abu Dhabi, real estate market indicators saw minor changes but with rising signs of caution, as per JLL. Supply in the emirate remained under the control with the new real estate regulations expecting to further slow down supply growth. In the residential sector, sales prices of both apartments and villas maintained their stability; however the weaker investor sentiment has put a downward pressure on transaction volumes.

In Abu Dhabi's office market, vacancy rates rose from 25% in the third quarter of 2014 to 27% in the third quarter of 2015. Grade A offices average rents rose by 13% year-on-year, while Grade B offices rents remained constant in the aforementioned period. Regarding the retail market, current supply registered 2.6 million square meters worth of gross leasable area in the first three quarters of 2015. Vacancy rates remained constant at 2% between the third quarter of 2014 and the same quarter of 2015. Average retail rents remained constant year-on-year and are expected to remain stable over the short term.

It is worth noting that other Emirates including Ajman, Ras Al Khaimah and Sharjah aim to catch up with Dubai and Abu Dhabi in their efforts of economic diversification and in attracting investments into the real estate sector despite their smaller population. However, the economical options within these areas are attracting buyers and renters due to the high prices of residential homes and rentals in Dubai and Abu Dhabi.

In sum, UAE real estate sector is heading towards healthy growth in the medium term despite the drop in oil prices and the continuous oversupply in the residential market. Furthermore, the Expo 2020 raising demand in all real estate sectors, the country's safety status, the investment climate, the relatively developed regulatory framework and the improved retail and hospitality projects are all serving the growth of the real estate sector in the country.

## Transport

The United Arab Emirates invested heavily in boosting its transport infrastructure in the last few years in order to deal with the rapid population growth in Abu Dhabi and Dubai, and positioned itself as a shipping, aviation and tourism hub. The latter also represents an important component in the UAE's economic diversification efforts.

Despite the consequences of a low oil-price environment, the country's investments in the transportation sector remain on an expansionary trend. In fact, the government plans to maintain spending during the next five years, with Dubai to increase spending on infrastructure by 20%.

The total value of transport projects in the planning or pre-construction phases in the UAE is US$ 60.8 billion. The airports subsector constitutes the lion's share of the latter with 61%, followed by the rail sector at 29%, the road segment at 8%, and the ports and waterways sector at 2%.

The airports segment has been at the forefront of the UAE's infrastructure sector, with one of the largest airports in the world under construction in Dubai. The emirate's current hub, Dubai International, serves more than 150 airlines, as it aims to position itself as a global trade hub. Within this context, expansion is underway at Dubai World Central, also known as Al Maktoum International Airport, where the construction of Emirates SkyCargo's new terminal is progressing as scheduled. Abu Dhabi International airport also launched a US$ 6.8 billion airport redevelopment project, which is aimed at increasing its capacity to 30 million passengers per year. In addition, the Sharjah Airport Authority is reportedly reviewing a master plan to expand the Sharjah International Airport, hiring Bechtel to provide services for the airport's phased expansion project.

The rail segment is one of the most upbeat amongst the UAE's transport infrastructure sector and would support growth over the long-term. For example, the UAE's national rail operator Etihad Rail is in the final phases of evaluating tenders to build the second stage that would link Abu Dhabi to Dubai, to Saudi Arabia and Oman. Also, Dubai is looking to significantly extend its current metro network. The first phase of the planned extension to the metro would involve the Green line, with 12 new stations. The second phase would see a further 58 stations added.

Moving to the road segment, although it is the most developed infrastructure in the UAE, the government continues to actively invest in it. For instance, the Dubai's Road and Transport Authority (RTA) is building a second tier to the Sheikh Zayed Road highway to reduce traffic congestion. A 35 km long second deck is being planned above the existing highway, which would connect Jebel Ali Port to Dubai Creek. Moreover, a consortium, led by Italy-based infrastructure company Salini Impregilo, secured a construction contract for the Lot B of the new Abu Dhabi-Dubai highway in the UAE. Abu Dhabi General Services awarded the AED 840 million (US$ 228.6 million) contract for the 28 km long highway, with the consortium scheduled to complete the project within 27 months.

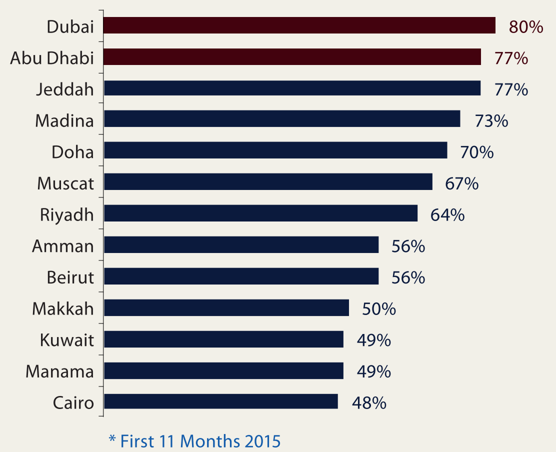
In terms of the port infrastructure in the UAE, which is central to the country's economic diversification plans, Abu Dhabi Ports plans investments in the Khalifa Industrial Zone and in Mina Zayed port to upgrade and build the cruise terminal. Actually, Abu Dhabi Ports contributed to more than AED 14 billion to the Abu Dhabi GDP in 2014, representing 2.9% of the total non-oil GDP. Also, in August 2015, the firm awarded US-based Parsons a US$ 680 million contract to manage the development of Delma Port in the UAE. The contract would include the development of a 300 meter concrete wharf designed for heavy loads, and new floating pontoons to create a marina setting for more than 280 boats.

In conclusion, the outlook for the transportation sector in the UAE is positive, driven by government investment programs like Vision 2021 and Abu Dhabi's "Surface Transport Master Plan (STMP)" which aims at improving the country's strategic infrastructure. There are more than US$ 20 billion transport project contracts scheduled to be awarded in the 2015-2017 period in the UAE. Investments in Abu Dhabi are in line with Abu Dhabi's STMP, while investments in the transportation sector in Dubai are mainly driven by the Expo 2020.

## Tourism

Given its stable political and economic environment, tourism in the United Arab Emirates is growing rapidly, as the country benefits from an expanding range of regional and global air travel connections and improving accessibility for foreign visitors. The UAE has no shortage of domestic and international

**COMPARATIVE HOTEL OCCUPANCY RATES**




*Sources: Ernst & Young, Bank Audi's Group Research Department* investor interest and the hotel sector continues to expand, supported by strong government investment in transport infrastructure and other tourism-related infrastructure. The travel and tourism's direct contribution to GDP was AED 61.6 billion, i.e. 4.1% of total GDP, in 2014 and this figure is estimated to rise by 4.9% annually in 2015, as per the World Travel & Tourism Council.

The UAE managed to establish itself as a safe tourist destination in the region, using its geographic proximity to attract European, Asia Pacific and Middle Eastern visitors. The UAE's tourism industry is estimated to have grown strongly in 2015, with growth of inbound tourism expected to come in at 7.6%, reaching 16.5 million inbound arrivals. This took place despite economic difficulties in source markets such as Russia and the growing political insecurity in nearby countries.

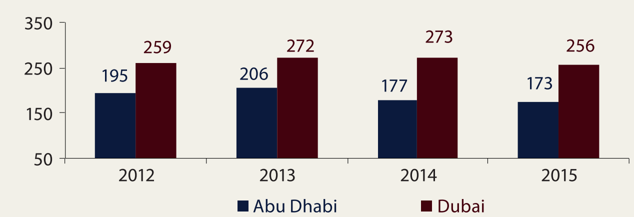
The country's tourism sector is supported by several factors including the government's financial incentives to build mid-range hotels, which strengthens previously under-represented areas of the market. Dubai and Abu Dhabi are the two most developed areas in terms of international tourism, but the government is also attempting to improve other Emirates in the country such as Sharjah. Both international and domestic hotel groups invested significantly in the country over the past few years, witnessing the entry of a number of major brands such as Hyatt and Carlson Rezidor into the market.

Companies were attracted by the economic stability in the country alongside incentives by the government. The latter included a decision by the UAE government to waive the 10% municipality fee for new three-star and four-star properties whose construction began between 2013 and 2017.  As a result, the cities of Dubai and Abu Dhabi occupied the top two positions amongst peers in hotel occupancy during the first 11 months of 2015, with 80% for Dubai and 77% for Abu Dhabi, according to Ernst & Young.

Moreover, the development of large-scale projects, such as a theme park called Dubai Adventure Studio and the Dubai Art Museum, would ensure that leisure tourism would continue to rise. Also, a US$ 680 million expansion of the Madinat Jumeirah tourism zone into the Burj al-Arab area would benefit the sector.

Last but not least, the Ruler of Dubai approved the development of five new theme parks at Jebel Ali in Dubai. The development involves total investments of AED 10 billion (US$ 2.72 billion). The previously mentioned aspects would further support the tourism sector and make it a key driver of the country's non-oil economy.

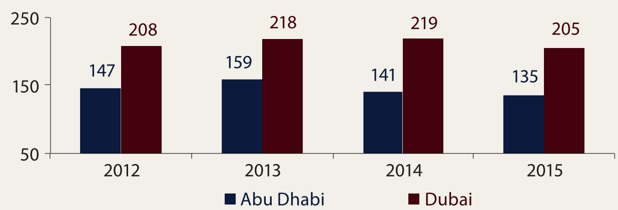
**AVERAGE HOTEL ROOM RATE IN US$***




* First 11 months of each year

*Sources: Ernst & Young, Bank Audi's Group Research Department*

**HOTEL ROOM YIELD IN US$***




* First 11 months of each year

*Sources: Ernst & Young, Bank Audi's Group Research Department*

## 1.2. EXTERNAL SECTOR

*Current account balance on a sliding path*

The UAE trade surplus mirrored lower oil prices registered in 2015, while the services and income balance saw its deficit widen, reflecting economic diversification efforts and higher levels of spending in the country.  Accordingly, the current account balance registered a significant drop over the year, according to EIU estimates.

In details, total exports of goods free on board dropped by an estimated 12.5% on a yearly basis, moving from US$ 370.6 billion in 2014 to US$ 324.4 billion in 2015. This compares to a very slight drop of 0.9% in the previous year. According to the IMF, this is explained by lower value of hydrocarbon exports in the context of decreased oil prices over the year. In fact, according to the same source, the share of oil and gas exports out of total exports has dropped from 30% in 2014 to 21% in 2015. As to non-oil exports, the IMF estimates them to have increased despite the appreciation of the dirham in line with the US dollar peg.

In parallel, imports progressed by an estimated 3.5% year-on-year, moving from US$ 239.8 billion in 2014 to US$ 248.2 billion in 2015 as per the EIU. This compares to a slightly higher 4.3% growth in the previous year, and comes in line with a similar drop in the economic growth level over the year.

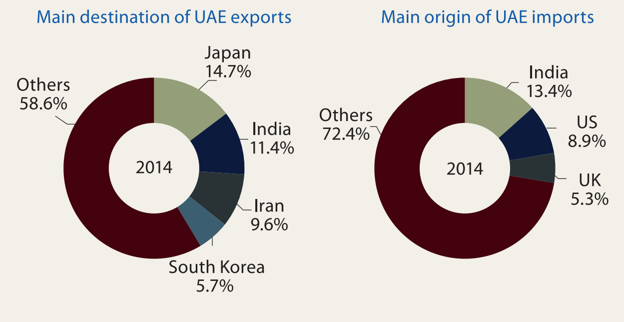
With the rise in imports coupled with a drop in exports, the UAE's trade balance shrank by an estimated 41.7% year-on-year, but remained well in surplus to attain US$ 76.2 billion. While the previously favourable trade account used to act as a major buffer against the leakages in the services and transfers account, following the drastic drop in its surplus, the trade balance of 2015 almost equates the deficit registered in the services and transfers accounts.

At the level of the services and income balance, an aggregate deficit of US$ 52.3 billion was reported as per EIU estimates, growing by 3.6% year-on-year (+2.9% in 2014). The services balance includes receipts and payments from transportation, business services, tourism and licensing. The deficit in the services account comes in line with the expenses related to the UAE diversification program and the underlying expansion in infrastructure projects, such as port and economic zones. Accordingly, it is natural for the imports in the services account to outweigh the services exports, with the latter category comprising tourism and financial receipts. As to the income balance, it is only in small surplus, and accounts mainly for returns on the government's foreign assets.

The current transfers balance, comprising the remittance and aid flows in and out of the country, witnessed a mild decrease in its deficit (-13.5% on a yearly basis) to an estimated US$ 22.2 billion. A major component of this balance remains workers' remittances, the outflows of which are notable given the large number of foreign workers in the UAE out of the total workforce.

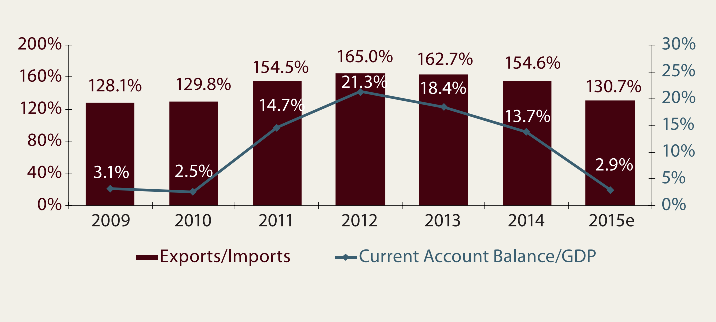
The significant trade balance surplus shrinking and the services deficit widening overweighed the slight improvement in the transfers account. Accordingly, the current account balance decreased drastically,

**EXPORTS & IMPORTS STRUCTURE**




*Sources: EIU, Bank Audi's Group Research Department*

**FOREIGN SECTOR INDICATORS**




*Sources: EIU, IMF, Bank Audi's Group Research Department* by 97% year-on-year, yet managed to register a small surplus of US$ 1.6 billion. The latest IMF estimates put the current account surplus to GDP ratio at 2.9% in 2015, following four-years of double-digit levels.

Overall, lower oil prices are eroding long-standing external surpluses, but the UAE continues to benefit from its perceived safe haven status and large external buffers, defined as Central Bank reserves and sovereign wealth fund assets. Combined with estimated assets in sovereign wealth funds, which are mandated to make resources available in case of need, foreign reserves are in well comfortable levels by international standards.

## 1.3. PUBLIC SECTOR

*First fiscal deficit since 2009 amidst dwindling oil prices*

The UAE fiscal position has deteriorated over the year 2015, with the government fiscal balance posting its first deficit since 2009 and the largest ever amidst dwindling oil prices and contracting revenues. This prompted some fiscal adjustments, including the rise of electricity and water tariffs and the deregulation of fuel prices, while the government is considering the possible implementation of a VAT in coordination with other GCC member countries in the aim of bolstering its non-hydrocarbon revenue side.

On the revenue front, general government revenues are estimated to have registered a significant contraction of US$ 44.6 billion over the year 2015, falling from US$ 150.8 billion in 2014 to US$ 106.2 billion in 2015, as per the latest IMF World Economic Outlook released in October 2015, following a smaller contraction of US$ 7.9 billion in 2014. The said decline, which is the highest since 2009, came within the context of an extended oil price slump in 2015, as Brent oil prices averaged US$ 58 in 2015 as compared to a much higher average of US$ 96 in 2014. Within this context, it is worth mentioning that hydrocarbon revenues represent the majority of the revenues at the consolidated government level, accounting for over 50% of the total in 2015. Accordingly, the ratio of general government revenues to GDP dropped from 37.8% in 2014 to 31.3% of GDP in 2015, as per IMF estimates.

On the spending front, the UAE authorities reversed the expansionary fiscal stance adopted over the year 2014, pursuing a gradual fiscal consolidation strategy in 2015 amidst persistently lower oil prices. Within this context and in a bid to strengthen finances, Abu Dhabi increased electricity and water tariffs for both expatriates and nationals in early-2015. Also, the UAE authorities abandoned in August 2015 a system of fixed gasoline prices in favor of one linked to global oil prices. This move makes the UAE the first oil exporting country in the region to remove fuel subsidies, allowing it to save US$ 7 billion in fuel subsidies per year, which was considered by Moody's as "credit positive". In addition, the UAE authorities scaled back a large number of non-priority projects in Abu Dhabi.

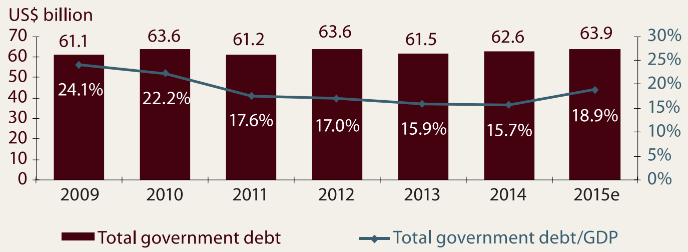
General government expenditures are estimated to have registered in 2015 their largest contraction of the past two decades, as per the IMF, moving from US$ 130.9 billion in 2014 to US$ 124.7 billion in 2015, down US$ 6.2 billion. Yet, The IMF estimates a 4.0% increase in general government expenditures to GDP to 36.8% of GDP (32.8% in 2014).

### SELECTED PUBLIC FINANCE INDICATORS

| US$ billion | 2011 | 2012 | 2013 | 2014 | 2015e |
|---|---|---|---|---|---|
| General government revenues | 131.3 | 149.8 | 158.7 | 150.8 | 106.2 |
| General government revenues/GDP | 37.8% | 40.1% | 41.0% | 37.8% | 31.3% |
| General government expenditures | 109.3 | 109.2 | 118.3 | 130.9 | 124.7 |
| General government expenditures/GDP | 31.5% | 29.2% | 30.6% | 32.8% | 36.8% |
| General government fiscal balance | 22.0 | 40.6 | 40.4 | 19.9 | -18.5 |
| General government fiscal balance/GDP | 6.3% | 10.9% | 10.4% | 5.0% | -5.5% |

*Sources: IMF, Bank Audi's Group Research Department*

### PUBLIC DEBT AND INDEBTEDNESS RATIO




*Sources: IMF, Bank Audi's Group Research Department*

With general government revenues dropping at a faster pace than general government expenditures, the overall UAE fiscal balance is estimated to have registered a deficit of US$ 18.5 billion, which is the first since 2009 and the largest ever. The fiscal deficit is estimated to have reached 5.5% of GDP in 2015 as compared to a fiscal surplus of 5.0% of GDP in 2014. That being said, the UAE's general government gross debt is estimated to have reached 18.9% of GDP in 2015, as per the IMF, up from 15.7% of GDP in 2014.

The UAE Cabinet approved in October 2015 a slightly smaller federal budget for 2016 after several straight years of rises, in a sign that the country is curbing expenditures because of the impact of low oil prices on State revenues. Next year's budget is set at AED 48.56 billion with a zero deficit, down from AED 49.1 billion budget plan for 2015. More than half of the budget has been allocated to education (21.2%), social development (15.5%), public services (11.1%) and health (7.9%). Other sums would be spent on defense, public safety, economic development, environment and culture.

In the period ahead, gradual fiscal consolidation remains important to strengthen long-term fiscal sustainability while cushioning negative effects on growth. It will require rationalization of spending and further mobilization of non-hydrocarbon revenues, as per the IMF. In fact, on the expenditure side, the Fund recommended controlling public wage bill growth (stabilizing the size per capita and limiting wage increases to correspond to productivity gains), continue reducing energy and water subsidies and other transfers while protecting those in need, lowering capital transfers to Abu Dhabi GREs and stabilizing other expenses in real terms. Also, the Fund recommends raising more non-hydrocarbon revenues through new tax measures such as VAT, in addition to broadening corporate income and excise taxes.

## 1.4. FINANCIAL SECTOR

### 1.4.1. Monetary Situation

*Slower growth in monetary aggregates along with increased inflationary pressures*

Monetary conditions in the United Arab Emirates were marked in 2015 by a slower growth in monetary aggregates amidst an oil price slump, a shy rise in the Central Bank's gross international reserves, increased inflationary pressures amidst cuts in fuel and utility subsidies, and a rise in interest rates in line with the US Federal Reserve interest rate hike.

The overall Consumer Price Index for the UAE reached 126.53 in November 2015, according to the UAE National Bureau of Statistics, moving up by 3.5% relative to 122.23 in November 2014, amidst property rental inflation, upward adjustments of electricity and water tariffs in Abu Dhabi, and as the UAE started on August 1st, 2015 linking gasoline and diesel prices to global oil markets, becoming the first country in the GCC to remove transport fuel subsidies amidst a slump in oil prices.

The division of the CPI by sector shows that the housing sector registered the largest price increase (+8.27%), followed by the education sector (+3.39%), the restaurants and hotels sector (+2.62%), the food and soft drinks sector (+1.18%), the miscellaneous goods and services sector (+1.00%), the furniture and household goods sector (+0.29%), the textiles, clothing and footwear sector (+0.27%), the beverages and tobacco sector (+0.12%) and the recreation and culture sector (+0.07%). Contributions to inflation have been negative from the transportation sector (-0.86%), the medical care sector (-0.13%) and the communications sector (-0.09%).

All in all, the CPI grew by 4.1% on average during the first eleven months of 2015 relative to the corresponding period of the previous year, according to the National Bureau of Statistics, and the IMF expects an average inflation of 3.7% for full-year 2015.

Growth in monetary aggregates in the UAE slowed during the first eleven months of 2015 as compared to the corresponding period of the previous year, as falling oil prices put pressures on liquidity. The narrow measure of money supply (M1) widened by 4.9%, moving up from US$ 118.8 billion at end-2014 to US$ 124.5 billion at end-November 2015. The broader money supply (M2) accelerated by 3.7%, moving up from US$ 310.7 billion at end-2014 to US$ 322.1 billion at end-November 2015, mainly supported by a 21.4% surge in net claims on public sector (the equivalent of US$ 12.6 billion) and an 8.2% increase in claims on the private sector (the equivalent of US$ 21.5 billion). Overall money supply in its broadest sense (M3) witnessed a shy increase of 1.5%, moving up from US$ 362.7 billion at end-2014 to US$ 368.1 billion at end-November 2015.

Within the context of tight liquidity, the Emirates Interbank Offered Rates pursued their upward trajectory in 2015, with the twelve-month category reporting the highest increase of 42 bps since the beginning of the year to reach 1.43% towards the end of 2015.

In parallel, the UAE dirham remained pegged at AED 3.6725 to the US dollar, as it provided stability for decades, though the fall in oil prices has put the sustainability of oil-exporter pegs in the spotlight. Within this context, the Central Bank of the UAE reiterated in September 2015 that the UAE has no intention to discontinue the policy of a fixed exchange to the US dollar, declining bets that the UAE may abandon the currency peg given the dominance of non-oil exports, mainly from Dubai and other Northern Emirates. In this context, the IMF said that the peg has anchored prices of tradables and thus inflation, and provided stability to income flows and financial wealth in periods of both high and low oil prices.

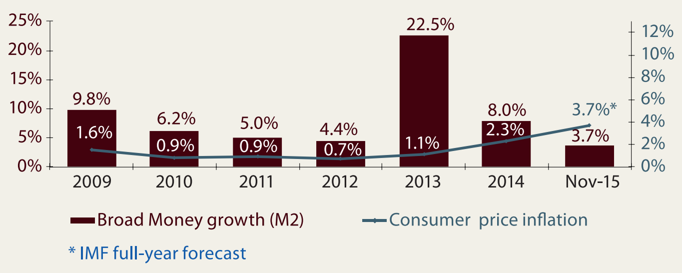
Given the dirham peg to the US dollar and the tight liquidity, the Central Bank of the UAE raised on December 17, 2015 interest rates applied to its Certificates of Deposits by 25 basis points, in line with the

## EVOLUTION OF MONETARY CONDITIONS

| Flows in US$ million | 2013 | 2014 | 11M-15 |
|---|---|---|---|
| **Net international reserves** | **23,208** | **10,861** | **-9,774** |
| **Central Bank (net)** | **21,140** | **9,053** | **296** |
| Gross international reserves | 21,133 | 10,349 | 152 |
| Foreign Liabilities | -6 | 1,296 | -144 |
| **Banks (net)** | **2,068** | **1,808** | **-10,070** |
| Foreign Assets | 28,710 | 23,247 | 7,550 |
| Foreign Liabilities | 26,642 | 21,439 | 17,620 |
| **Net Domestic Assets** | **29,725** | **12,106** | **21,174** |
| Claims on private sector | 7,843 | 26,872 | 21,524 |
| Net claims on public sector | 21,286 | -1,915 | 12,586 |
| Claims on financial institutions | 994 | -13,488 | 2,308 |
| Capital & Reserves | 4,746 | -5,403 | -5,465 |
| Other Items (net) | -5,144 | 6,041 | -9,778 |
| **Broad Money (M2)** | **52,933** | **22,968** | **11,400** |
| Money Supply (M1) | 21,886 | 15,407 | 5,778 |
| Quasi-Money | 31,047 | 7,561 | 5,622 |

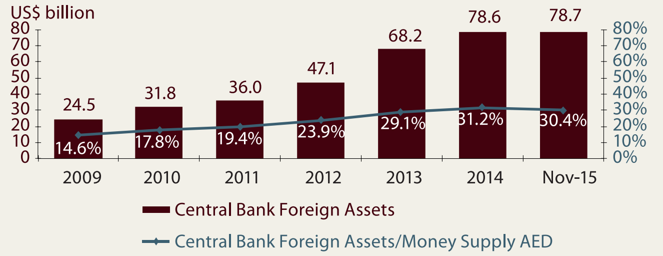
*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

## BROAD MONEY AND INFLATION




*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

## EXCHANGE MARKET INDICATORS




*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

US Federal Reserve's decision to raise its federal funds rate by 25 bps for the first time in almost a decade. Certificates of Deposits are the monetary policy instrument through which changes in interest rates are transmitted to the UAE banking system.

Last but not least, the Central Bank's gross international reserves grew by a mild 0.2% during the first eleven months of 2015 (the equivalent of US$ 152 million) to reach US$ 78.7 billion at end-November 2015, mainly driven by an increase in cash, bank balances and deposits with banks abroad. Accordingly, the Central Bank's gross international reserves coverage ratio to money supply (M1) and Dirham deposits went down from 31.2% at end-2014 to 30.4% at end-November 2015.

Looking forward, the UAE dirham is set to appreciate in effective terms given a stronger US dollar, leading to lower inflation. Meanwhile, the authorities' monetary policy framework, which aims to maintain the peg while strengthening liquidity management and deepening money markets, is considered appropriate, as per the IMF.

### 1.4.2. Banking Activity

*Decent but slower activity growth amid low oil prices*

The UAE banking sector witnessed during 2015 a slowdown in activity growth amidst low oil prices crippling the oil-rich countries of the region, and translating into weaker economic momentum and a drawdown on government deposits to counterbalance lower government revenues from hydrocarbons. Measured by total assets of banks operating in the country, banking sector activity grew by a decent 6.1% in the first 11 months of 2015 to reach US$ 666.0 billion at end-November 2015. The asset growth in volume yet proved 42% lower than that recorded during the corresponding period of 2014.

A quick glance at banks' aggregated balance sheets shows that on the asset utilization side, the major activity driver during 2015 turned out to be lending to the private sector. As a matter of fact, the growth in total credit facilities extended by banks operating in the UAE accounted for more than three quarters of total asset growth, noting that the bulk was attributed to higher private sector lending. Claims on the government and official entities continued to grow, albeit with lower volumes than private sector lending.

Gross credit extended by banks progressed by a healthy 8.1% in the first 11 months of 2015 to reach US$ 405.8 billion at end-November 2015, yet proved slightly lower (by 8%) than the volume of gross credit extended during the same period of 2014. The government and government related entities accounted for 19% of gross credit growth over the covered period (almost the same share as the previous year's similar period), foreign credit contributed to a mere 5% of the total, and private sector lending to the bulk (almost 70%). Among private sector credit, business and industrial sector credit contributed to 58% of total private sector lending growth, while the remainder was attributed to individual credit.

From an economic sector standpoint, the latest quarterly breakdown of domestic credit (i.e. credit to residents) covering the period up to September 2015 shows that apart from the government sector, the largest contributors to total domestic credit growth were the personal loans for business purposes category, followed by construction and real estate, trade (particularly the wholesale component) and

**EVOLUTION OF BANKING AGGREGATES**

| US$ million | 2012 | 2013 | 2014 | Nov-15 |
|---|---|---|---|---|
| Total assets | 511,096 | 571,899 | 627,611 | 666,031 |
| % YTD growth in assets | 8.3% | 11.9% | 9.7% | 6.1% |
| Total deposits | 317,985 | 348,237 | 387,012 | 394,690 |
| % YTD growth in deposits | 9.2% | 9.5% | 11.1% | 2.0% |
| Total bank loans and advances | 322,532 | 347,311 | 375,248 | 405,773 |
| % YTD growth in bank loans and advances | 3.7% | 7.7% | 8.0% | 8.1% |

*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

manufacturing.

On the liabilities or funding side, the traditional banking activity driver, i.e. bank deposits, slowed down during the year 2015. Bank deposits only grew by 2.0% in the first 11 months of 2015 to reach US$ 394.7 billion at end-November 2015. What is more noticeable is that the deposit growth witnessed throughout 2015 proved as much as 81% lower than during the 2014 corresponding period, in the wake of low oil price levels curbing government revenues and crippling economic momentum across the UAE.

Both resident and non-resident deposits slowed down in 2015, noting that the former contributed to 72% of total deposit growth. A closer look at the structure of bank deposits reveals that the growth in deposits of corporates and individuals (and even a mild rise in GREs' deposits) was counterbalanced by an 11% decline in government deposits. Same goes on the non-resident side, where the rise in private sector deposits was somewhat offset by a drop in deposits from government and non-commercial entities. It is worth noting that the UAE has kept its safe haven status in a wider MENA region in turmoil, and this has helped it sustain its private non-resident deposit base.

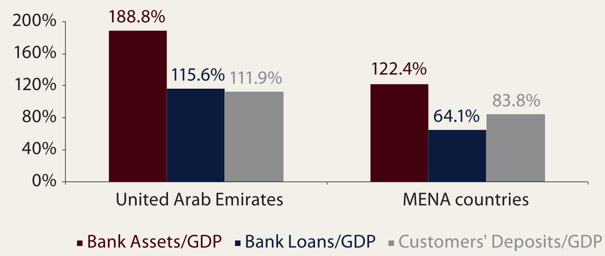
Going further into details, the currency structure of resident and non-resident deposits (excluding government deposits and commercial prepayments, and as published by the Central Bank of the UAE), shows that foreign currency deposits were responsible for 57% of deposit growth, leaving 43% to local currency funds and leading to an increase in the deposit dollarization ratio, which moved from 26.1% at end-December 2014 to 27.5% at end-November 2015. This comes within the context of arising questions over the sustainability of currency pegs across the GCC region at large, given the sustained oil price levels at lows and the ensuing tightening of government finances, though it is widely believed that the probability of de-pegging remains very low, at least for the time being.

It seems that UAE banks are focusing on other sources of funding such as EMTN and syndicated loans to counter some of the liquidity pressure that they have been facing, noting that market funding has been on the rise over the course of the year. Having said that, the UAE banking sector remains mostly funded by deposits, which are sticky by nature and account for practically 60% of total banks' balance sheets.

It is true that lower public sector deposits might constrain loan growth looking ahead and drive banks further towards perhaps costlier wholesale funding markets, but UAE authorities still have sufficient capacity to address funding shortages given the large sovereign wealth funds cash parked abroad.

Anyhow, banking sector liquidity started tightening, with the loan-to-deposit ratio (gross credit to deposits) rising to cross the 100% threshold as of June for the first time in more than a couple of years, as the government continues to withdraw funds from the sector to finance public spending. Another measure published by the Central Bank, the lending to stable resources ratio, measured as the ratio of total advances (net lending + net financial guarantees + stand-by LCs + inter bank placements of three months and more) to the sum of net free capital funds and total other stable resources reached 88.1% at end-November 2015, against 85% at end-2014 and end-2013.

**COMPARATIVE BANKING SECTOR ECONOMIC DIMENSION ***



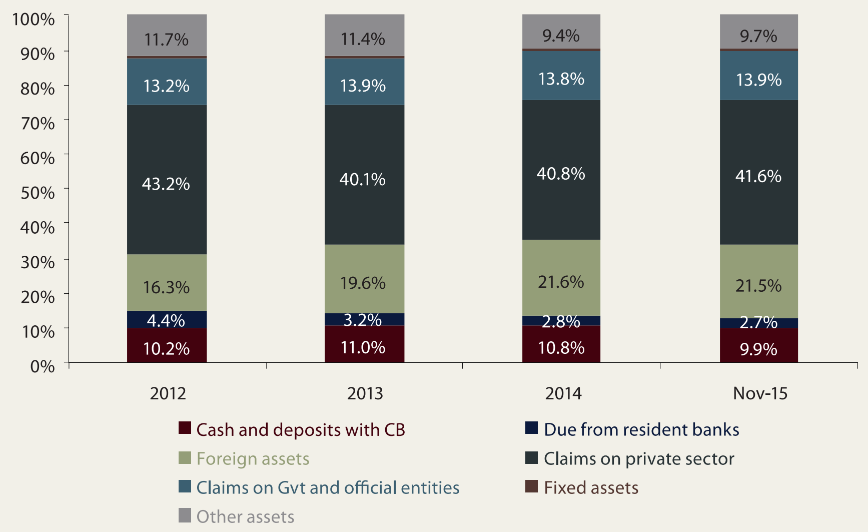

* October 2015 figures or latest available

*Sources: Central Bank of UAE, Central Banks of MENA countries, IMF, Bank Audi's Group Research Department*

Meanwhile, the Central Bank of the UAE-published liquid assets ratio, including reserve requirements, Certificates of Deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets, only slightly declined to 14.2% at end-September 2015 (15.7% at end-December 2014). As such, excess reserves banks hold at the Central Bank provided them with liquidity buffers to continue extending their loan books, as per the Central Bank.

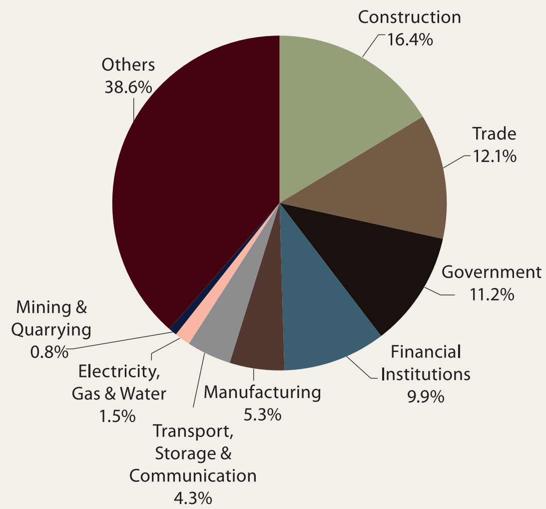
While deposit growth slowed and liquidity is being squeezed, banks in the UAE have so far witnessed an improvement in asset quality metrics, and remain well capitalized and profitable. On the asset quality front, the ratio of non-performing loans to total loans improved further in 2015, from 7.0% at end-2014 to 6.3% at end-Q3 2015, well below its peak of 8.6% in Q2 2014 and pretty much in line with the emerging

**BANK ASSET COMPOSITION**




*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

**BANK LOAN BREAKDOWN BY ECONOMIC ACTIVITY ***




*September 2015 figures for bank credit to residents

*Sources: Central Bank of UAE, Bank Audi's Group Research Department*

markets and global averages. Meanwhile, bank specific provisions for NPLs rose further in Q3 and ensure that NPLs remain fully provisioned. The Central Bank recently said that banks in the UAE are reluctant to write off NPLs even though they are fully provisioned, which can result in the NPL stock being slow to adjust to economic changes, and this can be attributed to the lengthy recovery process endured by many banks.

On the capital adequacy front, banks remain highly capitalized, with the capital adequacy ratio at 18.3% at end-Q3 2015, bearing in mind that the bulk of banks' capitalization consists of Tier 1 capital (ratio of 16.5%), well above minimum requirements (12% and 8% respectively). The Central Bank Governor lately said that the Central Bank has developed an implementation program for Basel III and would begin meetings with banks to implement a new capital regime.

On the profitability front, and in the absence of frequent consolidated sector statistics, we resorted to the aggregation of the results of the 19 listed banks domiciled in the UAE. Out of the total, 17 reported an improvement in their bottom line, suggesting a relative resilience of UAE banks to adverse liquidity conditions. On aggregate, the listed banks registered an 11.8% rise in net profits on a yearly basis in the first nine months of 2015 on the back of a 9.4% decline in provisions for loan losses over the same period.

### 1.4.3. Equity and Bond Markets

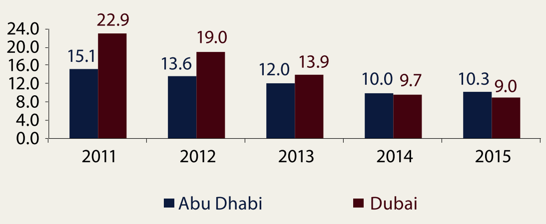
*Price drops across UAE capital markets amid the oil price slump and bets over a US interest rate hike*

The UAE capital markets witnessed a trend reversal in 2015, with the UAE equity markets registering the largest price falls since 2011 and the fixed income market coming under downward price pressures amidst an oil price slump and lingering concerns about an oversupplied global oil market, in addition to bets about a US Federal Reserve interest rate hike that effectively took place in December 2015.

The UAE equity markets reversed in 2015 the upward trend that was traced over the past three years, driven by an oil price slump and worries about its impact on the State budget, in addition to growing concerns over a prolonged global oil glut after OPEC set on December 4, 2015 a new output target of 31.5 million b/d for the first half of 2016, up from a previous 30 million b/d, reaffirming its policy of maintaining market share rather than cutting supply to support oil prices.

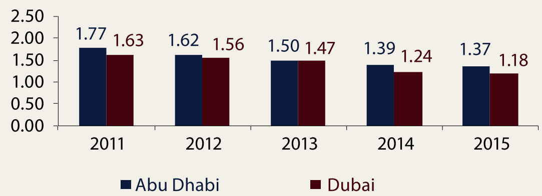
In details, the Dubai Financial Market index fell from 3,774.00 at end-2014 to 3,151.00 at end-2015, moving down by 16.5%, which is its largest drop since 2011. The breakdown of the DFM index by sector shows that the real estate sector witnessed the highest index drop of 25.4%, followed by the financial and investment services sector with (-19.1%), the banking sector (-14.5%), the insurance sector (-12.0%) and the transportation sector (-2.8%). In contrast, the consumer staples and discretionary sector registered a price increase of 39.8%, followed by the services sector (+6.3%) and the telecommunications sector (+1.2%).

**PRICE/EARNINGS RATIO (x)**




*Sources: Zawya Investor, Bank Audi's Group Research Department*

**PRICE/BOOK VALUE RATIO (x)**




*Sources: Zawya Investor, Bank Audi's Group Research Department*

The total trading value in the Dubai Financial Market amounted to US$ 36.9 billion in 2015, as compared to a much higher value of US$ 101.9 billion in 2014, down by 63.7%. The total number of traded shares reached 87.6 billion shares in 2015 against 155.8 billion shares in 2014, and the total number of trades was quoted at 1,404,588 in 2015 versus 2,359,275 in 2014. On the back of price declines, the market capitalization in the Dubai Financial Market dropped from US$ 85.6 billion at end-2014 to US$ 78.0 billion at end-2015, down by 8.9%.

Similarly, the Abu Dhabi Securities Exchange reported price decreases of 4.9% in 2015, as reflected by a fall in its index from 4,528.93 at end-2014 to 4,307.26 at end-2015. The breakdown of the Abu Dhabi general index by sector shows that the highest fall was in the investment and financial services sector with -23.0%, followed by the insurance sector (-22.3%), the services sector (-17.6%), the banking sector (-17.2%), the real estate sector (-15.4%), the energy sector (-11.0%) and the industrial sector (-2.7%). In contrast, the telecommunications sector posted the largest price increase of 61.8%, followed by the consumer staples sector (+22.0%). The total trading value fell by 68.3% to reach US$ 15.1 billion in 2015. The market capitalization went down from US$ 113.7 billion at end-2014 to US$ 111.9 billion at end-2015 (-1.6%).

All in all, the UAE equity markets went in line with regional stock markets, as reflected by a 17.0% fall in the S&P UAE price index against a 17.2% drop in the S&P Pan Arab Composite Index amidst a slump in oil prices and concerns over its impact on GCC State budgets.

In parallel, UAE fixed income markets witnessed downward price movements across the board over the year 2015 within the context of subdued investor sentiment due to falling Brent prices from US$ 96 on average in 2014 to US$ 58 on average in 2015, and amidst growing bets over an interest rate hike in the

## ABU DHABI STOCK MARKET INDICATORS

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Market capitalization (in US$ billion) | 63.1 | 69.4 | 109.5 | 113.7 | 111.9 |
| Trading value (in US$ billion) | 6.7 | 6.1 | 23.1 | 39.6 | 15.1 |
| Turnover ratio | 10.6% | 8.7% | 21.1% | 34.8% | 13.5% |
| Trading volume (in millions) | 15,677 | 16,394 | 51,519 | 55,742 | 23,226 |
| Number of transactions | 280,840 | 258,685 | 556,290 | 837,845 | 405,746 |
| General share price index | 2,402 | 2,631 | 4,290 | 4,529 | 4,307 |
| % Change in share price index | -11.7% | 9.5% | 63.1% | 5.6% | -4.9% |

*Sources: Abu Dhabi Securities Exchange, Bank Audi's Group Research Department*

## DUBAI STOCK MARKET INDICATORS*

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Market capitalization (in US$ billion) | 30.7 | 33.8 | 65.9 | 85.6 | 78.0 |
| Trading value (in US$ billion) | 8.7 | 13.2 | 43.1 | 101.9 | 36.9 |
| Turnover ratio | 28.5% | 39.0% | 65.4% | 118.9% | 47.3% |
| Trading volume (in millions) | 25,030 | 40,297 | 125,902 | 155,785 | 87,619 |
| Number of transactions | 442,456 | 619,168 | 1,325,416 | 2,359,275 | 1,404,588 |
| General share price index | 1,353 | 1,623 | 3,371 | 3,774 | 3,151 |
| % Change in share price index | -17.0% | 19.9% | 107.8% | 11.9% | -16.5% |

*Dubai Financial Market

*Sources: Zawya Investor, Bank Audi's Group Research Department*

US. In fact, the US Federal Reserve decided in its latest FOMC meeting held in December 2015 to raise its benchmark interest rate by 25 bps for the first time in almost a decade, prompting the Central Bank of the UAE to lift the interest rate on Certificates of Deposits by a similar rate. UAE bond sales totalled US$ 9.6 billion in 2015 as compared to US$ 17.5 billion in 2014. Also, the share of UAE bond issues reached 41.6% of total MENA bond issues in 2015 as compared to a share of 66.3% in 2014.

In the Abu Dhabi space, prices of sovereigns maturing in 2019 were down by 4.00 pts over the year. Mubadala'19, '21 and '22 posted price declines of 5.38 pts, 2.63 pts and 1.50 pt respectively. IPIC papers maturing between 2016 and 2041 saw price falls ranging between 0.25 pt and 5.38 pts. Also, Taqa papers maturing between 2016 and 2036 registered price declines of up to 6.13 pts. As to papers issued by financial institutions, ADIB'16 and ADIB Perpetual traded down by 2.38 pts and 1.75 pt respectively. FGB'17 (offering a coupon of 4.046%) closed down by 2.81 pts. Prices of ADCB'16 declined by 2.63 pts.

Regarding new bond issues in Abu Dhabi, NBAD issued in 2015 a US$ 750 million 2020 bond, at 85 bps over midswaps. Also, NBAD launched a US$ 750 million non-callable five-year perpetual Tier 1 bond at a final guidance of 5.25%. First Gulf Bank priced a US$ 750 million bond at midswaps +100 bps. ADCB sold a 5-year US$ 750 million bond at a coupon rate of 2.625%. Noor Bank issued five-year Sukuk worth US$ 500 million at MS +130 bps. As to the cost of insuring debt, Abu Dhabi's five-year CDS spreads expanded by 29 bps to 93 bps, mainly undermined by weaker investor sentiment amidst an oil price slump.

In the Dubai space, sovereigns maturing in 2017, 2022 and 2043 registered price decreases of 2.44 pts, 1.63 pt and 7.00 pts respectively on an annual basis. Amongst quasi-sovereigns, DEWA'16 traded down by 4.56 pts. DP World'17 posted a price fall of 3.75 pts. As to corporates, Emaar'16 closed down by 6.25 pts. Majid Al Futtaim'17 and '19 saw price decreases of 3.81 pts and 1.63 pt respectively. As to papers issued by financial institutions, EIB'17 and '18 were down by 2.75 pts and 1.56 pt. ENBD'17 and '23 traded down by 2.13 pts and 1.50 pt respectively.

Dubai saw several new bond issues in 2015. ENBD sold a seven-year Regulation S-compliant € 550 million bond at 135 bps over midswaps. It also sold US$ 350 million worth of five-year RegS bonds at MS+150 bps. DP World sold US$ 500 million worth of five-year notes at 169.9 bps over midswaps. Bank of Sharjah priced a US$ 500 million 5-year bond at MS +175 bps. DIB launched a US$ 1 billion perpetual capital-boosting Sukuk at 6.75%. It also issued a five-year benchmark Dollar-denominated Sukuk at 125 bps over midswaps. RAK Capital issued a 10-year US$ 1 billion bond at a coupon of 3.094%. Majid Al Futtaim issued a US$ 500 million ten-year Sukuk bond at 255 bps over midswaps. Commercial Bank of Dubai sold US$ 400 million five-year bonds with a semi-annual coupon of 4%. As to the cost of insuring debt, Dubai's five-year CDS spreads expanded slightly by 7 bps in 2015 to reach 234 bps at end-December 2015.

## 2. CONCLUDING REMARKS

Looking forward, a number of economic challenges rise at the horizon. In particular, a hike in US interest rates could lead to a tightening of financial conditions, notwithstanding the impact of lower oil prices on fiscal and external surpluses. Export and revenue losses from lower oil prices will be the most significant transmission channel for the UAE economy at large. Growth in the UAE's oil sector is likely to weaken and, with Saudi Arabia ruling out any increase in production in the wake of the crude oil price falls, there will be little opportunity to increase output considerably over the coming years.

While the current environment of low oil prices presents fiscal constraints, it should intensify policy initiatives promoting diversification as the UAE develops its role as a regional hub for trade, finance, transport and tourism. Private sector dynamics would remain fairly robust and capacity at free zones and ports is increasing. The implementation of mega projects and private investment in the run-up to Expo 2020 are expected to support economic activity over the medium term, especially given the related infrastructure spending. The removal of sanctions on Iran by the West could be a huge boost for UAE trade particularly in the non-oil sector, bearing in mind that the UAE is Iran's biggest non-oil trading partner and Iran's biggest source of imported goods.

When assessing the outlook of the UAE economy, it is important to address the key strengths and major weaknesses facing the economy. Among strengths, we mention the strong government that has ensured that the country was not touched by the Arab turmoil of the past few years, the economic diversification that has so far protected the UAE against the impact of the fall in crude prices, the country's large foreign asset reserves that will protect it from falls in export revenues, the favorable business environment with the UAE seen as a safe place to invest and do business and the low consolidated government debt with the largest part being Dubai's.

Among weaknesses, we mention a sustained decline in oil prices which represents the primary external risk to public finances, the expected tightening of monetary policy in the United States which could cause grater volatility for emerging markets that could in turn increase their borrowing costs, the Dubai real estate market cool-off that poses medium term risks, the lack of transparency especially that related to GRIs along with the substantial contingent liabilities from State-owned enterprises and the geopolitical tensions that pose the greatest event-driven risk.

Within this environment, while strengths exceed weaknesses and opportunities outpace threats at the horizon, UAE's macroeconomic policy mix should focus on gradual fiscal consolidation and on maintaining the peg and easing liquidity management whenever needed. The IMF considers that the authorities' fiscal plan would reduce fiscal vulnerability, ensure intergenerational equity and bring the external position closer to the level consistent with medium term fundamentals, though its pace should take into consideration the available fiscal buffers and the impact on the broad economy while government deficit financing should avoid a tightening in the banking system.

Finally, there is a growing need within the current fundamental challenges to implement structural reforms in the aim of enhancing competitiveness and strengthening inclusive growth through adequate job creation within the context of a strong macro-fiscal framework that builds on past progress and existing strengths. What is needed is further economic diversification through increasingly opening up foreign direct investment, further upgrading the business environment and easing access to finance for startups and SMEs in the UAE economy at large.

## DISCLAIMER

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