Bank Audi

UAE ECONOMIC REPORT

JANUARY 2022

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CONTACTS

Dr. Marwan Barakat
(961-1) 977409
marwan.barakat@bankaudi.com.lb

Salma Saad Baba
(961-1) 977346
salma.baba@bankaudi.com.lb

Farah Nahlawi
(961-1) 959747
farah.nahlawi@bankaudi.com.lb

Zeina Labban
(961-1) 952426
zeina.labban@bankaudi.com.lb

Michele Sakha
(961-1) 977102
michele.sakha@bankaudi.com.lb

RECOVERY UNDERPINNED BY STRONG HEALTH RESPONSE, SUPPORTIVE MACRO POLICIES AND EXPO 2020

2021 marking a recovering year for the Emirates

A gradual recovery took place in the UAE in 2021, supported by the UAE's early and strong health response, continued supportive macroeconomic policies, and rebound in tourism and domestic activity related to the delayed Expo 2020. The IMF forecasts overall GDP to expand by 2.2% in 2021 after a 6.1% contraction in 2020. Non-oil GDP growth is expected to exceed 3% in 2021, and to improve further in the medium-term, while oil GDP continues to grow with increased production. It is worth recalling that the year 2021 recorded the opening of Dubai's Expo 2020, delayed for a year because of COVID-19. Dubai's expo, which runs until April 2022, is actually a showcase for Dubai.

UAE shifts from deflation to price growth, international reserves bounce back in 2021

The year 2021 saw a return to annual inflation rates for the first time in the UAE since December 2018, along with a decent growth in monetary aggregates, and a rebound in the Central Bank of the UAE's gross international reserves amid a robust growth in its foreign securities' portfolio, while policy interest rates continued to be anchored to the US Federal Reserve's rates given the UAE Dirham peg to the US dollar. The UAE shifted from deflation to price growth starting August 2021, mainly outlining a recovery from the harsh pandemic year of 2020 with low base effects, and an increased business activity with the reopening of the economy, in addition to a rise in global commodity prices and a strong oil price rebound. Latest figures released by the UAE Federal Competitiveness and Statistics Authority showed that consumer prices in the UAE grew by 1.2% year-on-year in September 2021. The Central Bank's gross international reserves expanded by 12.7% over the first ten months of 2021 to reach US$ 120.2 billion at end-October.

Banking activity and financial soundness at the image of a recovering economy

The banking sector has been at the mirror image of a recovering economy over the past year. Measured by the aggregation of assets of operating banks, banking activity grew by 2.6% over the first ten months of 2021 to reach US$ 890.7 billion in October, the equivalent of 220% of the country's GDP. Financial soundness indicators remain in good shape on the overall. The Advances to Stable Resources ratio amounted to 77.7% at the end of June 2021, which indicates that the structural liquidity of the banking sector remained sound. Eligible liquid assets, as a percentage to total liabilities fell to 18.3% at end-June, however well above the 10% minimum regulatory requirement, constituting an adequate buffer for the banking sector. Non-performing loans to total gross loans ratio stood at 8.2% at end-June 2021. In parallel, the UAE banking system remains well capitalized, with an average Capital adequacy ratio at 17.5%, Tier 1 Capital Ratio at 16.3% and Common Tier 1 ratio at 14.5% as at the same date.

Price rebounds in UAE equity markets, while bond markets plunge in the red

The UAE equity markets registered strong price rebounds over the first eleven months of 2021, mainly tracking global equity strength amid a post-pandemic recovery and driven by a strong oil price rally. In contrast, the UAE fixed income markets came under downward price pressures over the covered period, mainly tracking US Treasuries move on prospects of a global monetary policy tightening next year and on rising concerns about elevated inflation in global economies. The DFM General Index expanded by 23.3% during the first eleven months of 2021, while the Abu Dhabi general index surged by 69.4% over the same period.

Real growth forecasted at slightly above 3% looking forward

The hydrocarbon sector is regaining strength with rising global oil prices, helping to restore the fiscal and external positions, and boosting confidence on the overall economy. This, coupled with a sustained recovery of global trade and travel, is allowing the non-hydrocarbon sector to rebound. But the pandemic could have a lingering impact on global travel, hampering a speedy recovery of the UAE's large tourism industry at large. Within this environment, UAE's real growth is forecasted at 3.0% in 2022 and at an average of 3.1% over the next five years, as per the World Economic Outlook issued by the IMF in mid-October. The long-run economic prospects continue to hinge on the authorities' efforts to create a favorable business environment to foster growth of the non-hydrocarbon sector and create jobs in the private sector at large.

Bank Audi sal - Group Research Department - Bank Audi Plaza - Bab Idriss - PO Box 11-2560 - Lebanon - Tel: 961 1 994 000 - email: research@bankaudi.com.lb

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A gradual recovery took place in the UAE in 2021, supported by the UAE's early and strong health response, continued supportive macroeconomic policies, and rebound in tourism and domestic activity related to the delayed Expo 2020. The IMF forecasts overall GDP to expand by 2.2% in 2021 after a 6.1% contraction in 2020. Non-oil GDP growth is expected to exceed 3% in 2021, and to improve further in the medium-term, while oil GDP continues to grow with increased production. In parallel, higher oil prices is lifting the fiscal and external balances. Long-term growth potential is supported by structural reforms, including opening some sectors to 100% foreign ownership and a relaxation of visa rules, which could also provide uplift to the real estate market, but the narrower fiscal space in the UAE and the wider GCC is likely to keep growth below historical norms after the rebound from the pandemic shock.

The year 2021 recorded the opening of Dubai's Expo 2020, delayed for a year because of COVID-19. Dubai's expo, which runs until April 2022, is actually a showcase for Dubai. The government spent US$ 6.8 billion on construction projects. It hopes for 25 million visitors from 190 confirmed countries and that may inspire some of them to set up businesses or buy homes in the emirate, boosting an economy slowed by the pandemic.

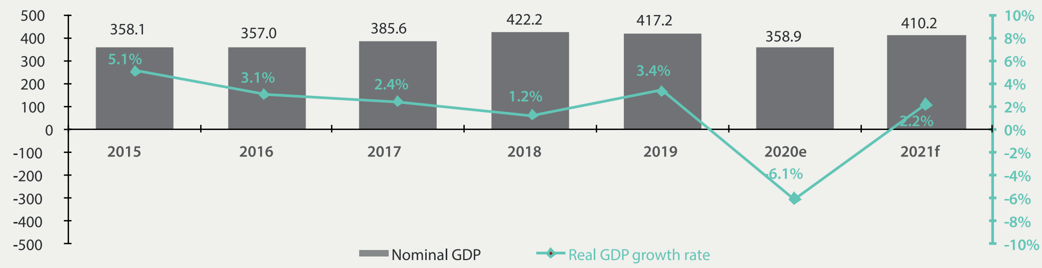
At the fiscal level, the United Arab Emirates is likely to have recorded a deficit to GDP ratio of 0.5% in 2021, against a deficit of 5.6% in 2020 as per IMF figures. The UAE federal government launched a global medium-term note programme and issued debt for the first time in early October. The issuance amounted to US$ 4 billion (just below 1% of estimated 2021 GDP), comprising three tranches of 10, 20 and 40 years with coupon rates of 2%, 2.875% and 3.25% respectively. The federal government intends to use the net proceeds from each issuance for general budgetary purposes in compliance with its public debt strategy, including the financing of infrastructure projects and investment by the Emirates Investment Authority.

At the external sector level, the UAE has seen its current account balance moving from a surplus of US$ 11.1 billion (the equivalent of 3.1% of GDP) in 2020 to US$ 39.6 billion (the equivalent of 9.7% of GDP) in 2021. In parallel, net international reserves rose from US$ 103.8 billion in December 2020 to US$ 115.8 billion in October 2021, the equivalent of 35.8% of domestic currency Money Supply. It is worth mentioning that Abu Dhabi's sovereign net foreign assets are among the highest of rated peer sovereigns.

At the banking sector level, the year 2021 was another year of resilience of banking sector activity. Measured by the aggregation of assets of operating banks, banking activity grew by 2.6% over the first ten months of 2021 to reach US$ 890.7 billion in October, the equivalent of 220% of the country's GDP. As to deposits, they reached US$ 535.7 billion, growing by 4.4% over the first ten months of the year 2021, after having slowed down the year before. Likewise, loan growth, that was contractionary in the year 2020, reported 0.8% over the 2021 ten-month period to reach a total lending portfolio to the private sector of US$ 304.1 billion at end-October.

With respect to capital markets, they have been throughout the year 2021 at the mirror image of an improving economy. Over the first 11 months of the year, the change in share index reported 69.4% in Abu Dhabi and 23.3% in Dubai, raising market capitalization to US$ 427 billion and USS$ 118 billion respectively.

EVOLUTION OF ECONOMIC PERFORMANCE



Sources: IMF, Bank Audi's Group Research Department

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However, CDS spreads moved in opposite direction. While Abu Dhabi's 5-year CDS spread rose from 38 basis points at end-2020 to 45 basis points at end-November 2021, Dubai's 5-year CDS spread dropped from 112 basis points at end-2020 to 94 basis points at end-November 2021.

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.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbons Sector

UAE hydrocarbons sector moving into post-pandemic recovery

The year 2021 saw the UAE hydrocarbons sector moving into a post-pandemic recovery, with the country embarking into monthly oil production increases under an OPEC+ deal reached in July 2021 to boost oil supply amid a global reopening and a pick-up in demand.

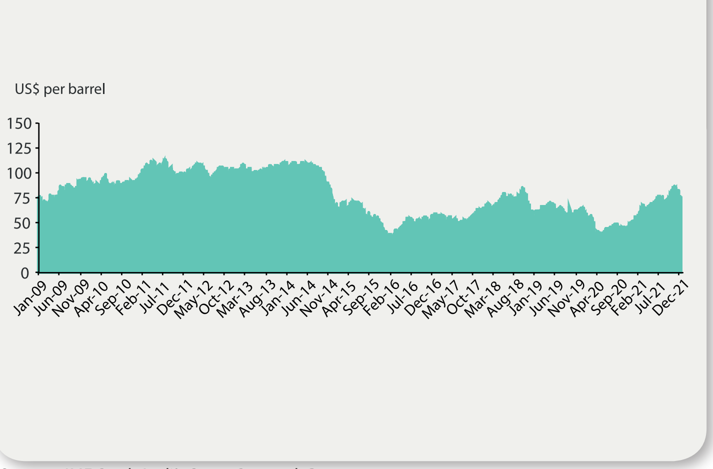
The recently released Central Bank of the UAE quarterly economic review for Q2 2021 revealed that real oil GDP growth has been revised to -2.0% in 2021, down from -1.0% previously, corresponding to an average oil production of 2.72 mbpd for the year as a whole. This diverges from the views of the IMF, which in its latest regional economic outlook report, projected a nil change in real oil GDP in 2021, following a 6.0% contraction in 2020, while expecting oil GDP to continue to grow with increased production.

Latest estimates released by Bloomberg for monthly crude oil production showed that the UAE's crude oil output averaged 2.72 mbpd during the first eleven months of 2021, down from an average of 2.85 mbpd in 2020 and 3.07 mbpd in 2019. This is mainly explained by OPEC+ April 2020 agreement to reduce oil output in the face of the Coronavirus pandemic.

However, with the partial rollback of the OPEC+ production cut deal in July 2021 since the cartel decided to boost oil supply by 400,000 bpd a month, the UAE's oil production increased by 3.9% quarter-on-quarter during the third quarter of 2021 to reach 2.77 mbpd on average, and continued rising during the October-November 2021 period to average 2.86 mbpd.

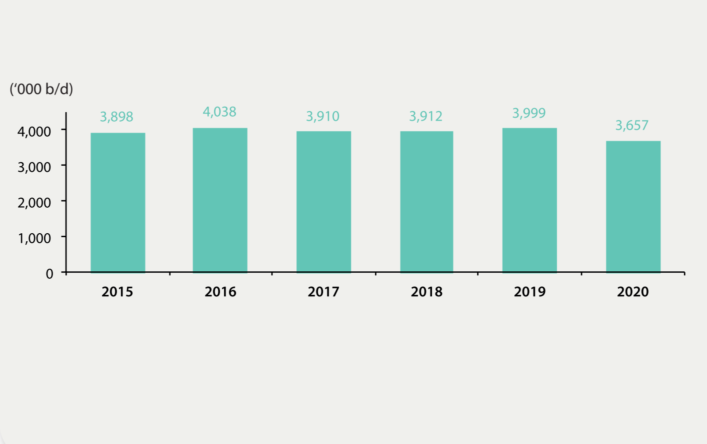
Under these conditions, the UAE's crude oil exports, the bulk of which are destined to the Asian markets, are projected by the IMF to contract by 1.6% in 2021, moving from 2.44 million barrels per day in 2020 to 2.40 million barrels per day. This followed a 1.2% contraction in 2020.

CRUDE OIL PRICES



Sources: IMF, Bank Audi's Group Research Department

OIL PRODUCTION



Sources: British Petroleum, Bank Audi's Group Research Department

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According to the BP Statistical Review of World Energy 2021, the UAE was among the top 10 oil producers globally in 2020 and held the eighth largest proved oil reserves in the world at 97.8 billion barrels at end-2020 (around 5.6% of the world's proved oil reserves). The Reserves-to-Production (R/P) ratio in the UAE shows that oil reserves in 2020 accounted for circa 73 years of current production and compared to a global R/P of 53.5 years.

Also, the UAE held the ninth largest proved reserves of natural gas in the world at 209.7 trillion cubic feet at end-2020, according to the BP Statistical Review of World Energy 2021. The Reserves-to-Production (R/P) ratio in the UAE shows that natural gas reserves in 2020 accounted for circa 107.1 years of current production and compared to a global R/P ratio of 48.8 years.

Natural gas has become a key strategic priority, and the UAE is planning a string of new investments to further develop its large sour and unconventional gas resources, to meet rising domestic consumption and ultimately boost exports, according to Fitch Solutions. The UAE government is putting increasing focus on developing the country's domestic gas resource. The bulk of the resources are sour, with major projects in the pipeline including the North West Area project, for which tendering is currently ongoing.

Looking forward, should the impact of the pandemic recede, the hydrocarbon sector would move further into a recovery. Fitch Solutions maintains its bullish outlook on both the upstream and downstream sectors in the country, which remains among the most attractive destinations for investment globally. A number of upgrade and expansion projects would boost oil production capacity in the early-to-mid 2020s, while renewed exploration efforts are a positive sign for greenfield projects and could unlock substantial further resources over the coming years.

1.1.2. Construction

UAE's construction sector encounters gradual recovery

The gradual recovery in UAE's economic activity mainly driven by the fast rollout of COVID-19 vaccines and the Dubai Expo supported an improvement in the construction and real estate sector in the country. Within this context, the government started implementing a series of policy reforms in order to support prices in the real estate market. These span initiatives like visas for expatriate retirees and the expansion of the ten-year golden visa scheme to attract foreign professionals to settle in the UAE. The country also amended its commercial companies law in order to boost foreign direct investment.

At the level of the residential market, Dubai's residential stock reported an increase by the end of Q3 2021 as 11,000 units were added over the third quarter of 2021. An additional 23,000 units were estimated to be delivered in the fourth quarter of 2021, as per Jones Lang Lasalle (JLL). In Abu Dhabi, the total stock improved to 270,000 units at the end of the third quarter of 2021 with around 2,000 units planned to enter the market in fourth quarter of 2021. On another level, villas and townhouses saw a strong demand which ensured driving the recovery in villa sales prices across both cities. Apartment prices have picked up in Dubai on the back of higher demand but remained flat in Abu Dhabi. At a city level, residential sale prices in both Dubai and Abu Dhabi were up, as per the same source. It is noteworthy that tenants remain in the driving position in the negotiations of leasing contracts, as some are aiming to upgrade to bigger units due to the relatively affordable rents. As the off-plan market starts to re-attract investors, developers started to launch projects with attractive payment plans in place to build on the uptick in activity.

In the office market, the total stock in Dubai stood at 9 million square meters at the end of the third quarter of 2021 and reported 3.8 million square meter in Abu Dhabi at the end of the same period, as per JLL. Vacancy rates were unchanged at 20% in Dubai and fell marginally to 27% in Abu Dhabi in the third quarter of 2021. Furthermore, office occupiers aiming to relocate or expand are anticipated to focus on good quality office space with attractive incentives in place.

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Looking at the retail market, retail rental rates in the UAE continued to retreat over 2021. Both Abu Dhabi and Dubai are seeing a strong supply that overgrows demand, resulting in falling rental rates. It is worth noting that retail rates have been on a downward trend for several years now, on the back of oversupply in the market, however, the COVID-19 pandemic exacerbated this trend and in 2020 rents fell steeply, as per Fitch Solutions. 2021 saw less steep declines, as the market recovers from the impact of the pandemic and the resumption of tourists is expected to provide much relief for landlords and retailers alike.

In conclusion, the UAE takes advantage of a highly developed and modern commercial real estate market. Over time, the services and tourism were the main demand boosters, as the country promoted itself as a regional financial and touristic hub, driving demand for modern retail and office space. The sector seems to encounter a gradual recovery following the vaccine roll-out, the return of tourism and the impact of the Dubai Expo.

1.1.3. Transport

Transport industry back to activity following slowdown due to the pandemic

The transport infrastructure sector reported an improvement in 2021 as projects resumed after the country relaxed its lockdown measures and lifted restrictions.

In details, railway projects take over a share of 30% of the UAE's transport infrastructure project pipeline, as per Fitch solutions. The emirates of Abu Dhabi and Dubai continue to follow a long list of urban transit initiatives that target improving mobility and reducing traffic congestion. The previously mentioned emirates take over the bigger share of metro line developments with substantial plans for expansion and upgrades of both systems, as per the same source. At the level of new projects, Dubai's Road and Transport Authority awarded a contract for the construction of three internal roads with a combined length of 34.4 kms in the emirate. The works are likely to be completed in the second half of 2022.

Furthermore, road development and infrastructure maintain their importance for the car-reliant country, especially in order to meet the needs for the Expo 2020. Roads and Bridges currently account for 40% of transport. Roads in and around Dubai and Abu Dhabi take over the lion's share of developments. This comes along with the rising urbanism and tourism in both Dubai and Abu Dhabi.

At the level of airport development, the latter is expected continue its growth though at a slower pace taking into consideration fears about the impact of COVID-19 on the long-term future of the aviation industry. The World Expo 2020 will also serve this growth. The country had previous large-scale investments in airports, hence a strong demand case for further high-value projects is not needed. However, the completion of expansion projects in airports, including Abu Dhabi International Airport, Ras Al Khaimah Airport and the Dubai International Airport is expected in the near future.

As for the development of ports in the country, the country's investment in port infrastructure is expected to continue to emphasize its role as a shipping and logistics hub. The UAE's two major ports at Khalifa and Jebel Ali built up on the country's location along major shipping corridors between Europe and Asia, as well as proximity to energy producers in the Middle East.

In sum, the long-term view for the country's transport infrastructure seems positive. The country has a geographically strategic position which allows it to remain an important link in the regional and global supply chains.

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1.1.4. Tourism

UAE's tourism sector growth poised to reverse 2020 contractionary trend

The tourism sector in the UAE has been an outperformer over the past period as sustained government efforts continue to support pent-up demand from both domestic and international visitors. Furthermore, the sector took advantage of the Dubai Expo 2021 event and the easing restrictions that followed the vaccine roll-out.

In details, total arrivals to the country are estimated at 13.2 million in 2021, up from around 8.1 million in 2020. International tourism receipts are estimated to report an annual growth of 69.2% to stand at US$ 16.8 billion in 2021, as per Fitch Solutions. In details, Abu Dhabi is increasing its touristic focus on meetings, incentives, conferences and events (MICE) and cultural tourism. In parallel, Dubai's focus is mainly on the development of family attractions and leisure facilities. It is worth noting that Dubai is among the busiest airports in the world with extensive regional and global travel connections, as per the same source.

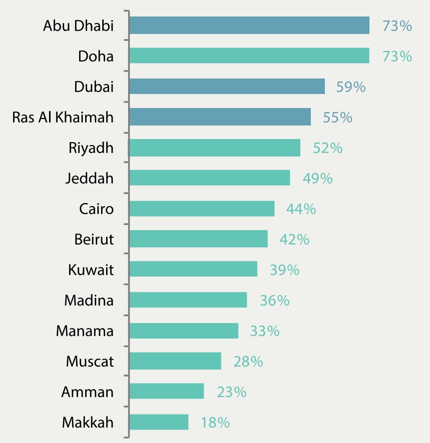
At the level of hotels, the country developed a competitive hotel sector as a tourist destination attracting millions of visitors every year, aiming to diversify its hotel sector in order to attract a wider range of tourists. The development of a bigger low-budget sector will continue in the coming years, catering to middle class tourists coming from Asia and Africa as well as more people seeking to remain in Dubai for shorter stays, perhaps to take advantage of the many theme parks and other attractions.

With a broad range of projects in the pipeline and in light of the stated commitments to hotel development by private and public investors, the number of hotels is now estimated to report an amelioration of 2.7% in 2021.

On a side note, four and five star hotels in Abu Dhabi observed an occupancy growth of 3.1 percentage points in the first seven months of 2021, while the average daily room rate (ADR) and RevPAR decline over the same period. Dubai saw an occupancy improvement of 17.7 percentage points and an ADR rise by 7.9% to stand at US$ 225 in the first seven months of 2021. This resulted in a RevPAR increase of 54.5% in the aforementioned period. RAK encountered an occupancy edge up of 7.7 percentage points and an ADR hike of 4.9% to US$ 171 in the first seven months of 2021, which resulted in a RevPAR increase of 22.1% to US$ 94 in the first seven months of 2021, as per Ernst & Young.

The sector fared well in 2021 due to a number of support factors, mainly the lifting of restrictions, government support and Dubai Expo. In a forward look, tourism will benefit from the government's long-term economic diversification agenda to move the economy away from hydrocarbons by developing new service sector verticals.

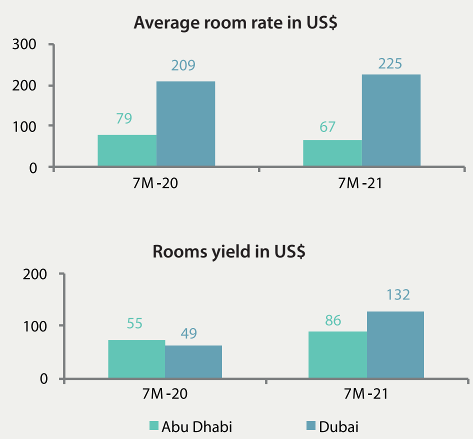
COMPARATIVE HOTEL OCCUPANCY RATES*



* 7 Months 2021

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

AVERAGE ROOM RATE IN US$



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

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1.2. EXTERNAL SECTOR

Continued strong external position despite a challenging global trade

UAE continues to outperform in its MENA region being a logistics hub facilitating global trade, beyond the trade recession erupted globally during the prolonged pandemic phase. The recent rise in hydrocarbon prices positively impacted UAE's inflows and its external position. Within this context, UAE's current account balance moved from a surplus of US$ 11.1 billion (the equivalent of 3.1% of GDP) in 2020 to a bigger surplus of US$ 39.6 billion (the equivalent of 9.7% of GDP) as per IMF.

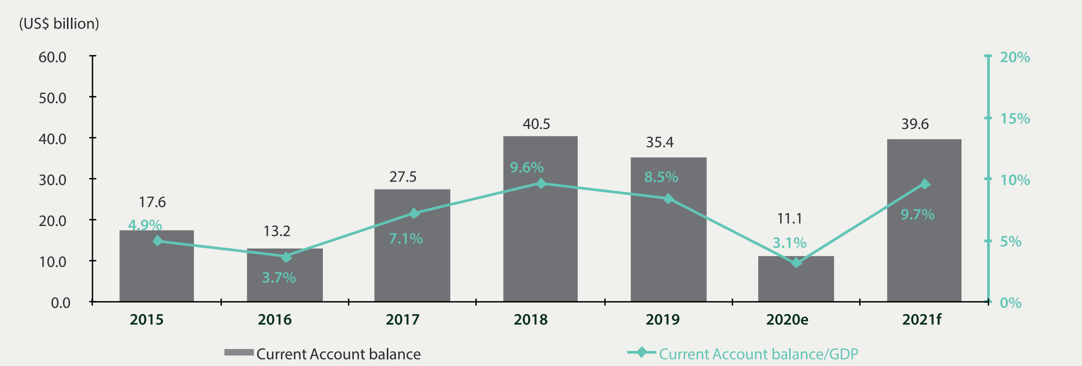
Going further into details, UAE recorded a non-oil foreign trade volume of nearly AED 900 billion (or US$ 244.9) in the first half of 2021, representing a growth of 27% when compared to first half of 2020, according to preliminary data released by the Ministry of Economy. The growth was a result of a 44% hike in non-oil exports (AED 170 billion), as well as 24% increase in imports (exceeding AED 482 billion), in addition to a jump of 22% in re-exports (which totaled AED 238 billion) over the same mentioned period. As such, UAE's non-oil trade balance witnessed a rapid recovery and significantly grew with the five fast growing economies: China, KSA, Iraq, Turkey and Italy.

In details, the breakdown of non-oil exports of UAE by commodity over the first half of 2021 shows that the main export article is gold constituting 41.2% of the totals exceeding AED 70 billion. The remaining non-oil exports reached AED 98 billion, recording a growth of 42% in H1 2021 when compared to H1 2020. It also revealed that 87% of the country's non-oil exports are locally made and that 13% came from free zones and customs warehouses as per Ministry of Economy. It is worth mentioning that the top five export destinations during H1 2021 were India, KSA, Hong Kong, Kuwait and China.

Having said that, Dubai in particular recorded a non-oil foreign trade volume of AED 722.3 billion (or US$ 196.5 billion) in the first half of 2021, an increase of 31% year-on-year, as per the Government of Dubai. The first-half figures, which represented a considerable growth were due to skyrocketing exports recording a rise of 45% year-on-year to reach AED 109.8 billion from AED 75.8 billion. Imports increased by 29.3% year-on-year to reach AED 414 billion from AED 320 billion, while re-exports grew by 28.3% year-on-year to reach AED 198.6 billion from AED 154.8 billion.

In parallel, the breakdown of non-oil direct imports of Dubai by commodity shows that the main imports over the first half of 2021 were pearls, precious stones and metals (47.6% of total non-oil direct imports), followed by machinery, sound recorders, TV and electrical equipment (13.8%), vehicles, aircraft and vessels (6.9%), products of chemical and allied industries (5.6%) and base metals and articles of base metals (4.0%).

CURRENT ACCOUNT BALANCE



Sources: IMF, Bank Audi's Group Research Department

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The breakdown of non-oil direct exports and re-exports of Dubai by commodity shows that the main categories over the first half of 2021 were pearls, precious stones and metals (52.7% of total non-oil direct exports and re-exports), followed by base metals and articles of base metals (11.7%), machinery, sound recorders, TV and electrical equipment (9.9%), vehicles, aircraft and vessels (6.4%), and products of chemical and allied industries (3.1%).

Looking forward, the Emirates current account surplus is set to average 9.7% of GDP in 2021 and 9.4% in 2022 (up from 3.1% of GDP in 2020), as per the IMF, supported by higher export volume from Abu Dhabi's oil capacity improvement, and projected growth in the services account from tourism related to Expo 2020, yet mitigated by rising imports from higher consumption after easing lockdown restrictions.

1.3. PUBLIC SECTOR

Fiscal balance swinging into a narrower deficit over the first half of 2021

Amid the successful vaccination race boosting domestic spending, rebound in tourism after relaxation of lockdowns, rising oil production and prices, coupled with the supportive monetary and fiscal measurements implemented by the authorities and significant economic boost from Expo 2020 that began in October, UAE's economy is revealing signs of fiscal recovery underlined by a deficit to GDP ratio of 0.5% in 2021, against a deficit to GDP of 5.6% in 2020 as per IMF figures.

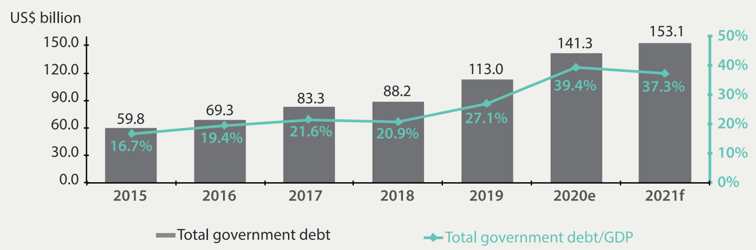
Going further into details, government revenues have registered a miscellaneous yearly increase of 1.3%, moving from AED 205.6 billion (or US$ 56.0 billion) in the first half of 2020 to AED 208.3 billion (or US$ 56.7 billion) in the first half of 2021, as per the latest figures released by the Ministry of Finance. This was mainly due to higher oil prices lifting revenues slightly up despite the continuous government's stimulus measures taken last year, which included temporary reductions to business fees, VAT, excise receipts, municipality fees and Tourism dirham fees. Within this context, tax revenues contracted by 1.5% over the first half of 2021, registering AED 84.5 billion, compared to AED 85.8 billion over the first half of 2020. As such, annualized general government revenues are set to reach 30.7% of GDP over 2021, up from 27.5% of GDP over the same period of the previous year, as per IMF.

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2020	H1-20	H1-21	H1/H1
Public revenues	100.2	56.0	56.7	1.3%
Public revenues/GDP	27.9%	27.3%	27.7%	0.3%
Public expenditures	96.1	44.0	46.2	5.0%
Public expenditures/GDP	26.8%	21.5%	22.5%	1.1%
Fiscal balance	-8.6	6.1	8.0	-

Sources: Ministry of Finance, Bank Audi's Group Research Department

PUBLIC DEBT



Sources: IMF, Bank Audi's Group Research Department

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On the spending front, government expenditures registered an increase of 5.0%, from AED 161.7 billion (or US$ 44.0 billion) over the first half of 2020 to AED 169.7 billion (or US$ 46.2 billion) over the same period of 2021. In details, on the back of the authorities announcement of hiring freeze and cuts to capital expenditure, compensation of employees almost maintained the same figure with only a 0.5% decline in the first half of 2021 to reach AED 56.7 billion, while expenditures on subsidies went down by 32.5% to AED 14.6 billion in the first half of 2021. On another hand, government spending on non-financial assets, of which expenditures on fixed assets, inventories, valuables and non-produced assets witnessed a slump of 57.9% to reach AED 9.1 billion (or US$ 2.5 billion) in the first half of 2021.

It is worth mentioning that the authorities announced combined fiscal measures of AED 32 billion (or US$ 8.7 billion) as at November 2020, which is approximately 2.8% of GDP. With a continuous support, the Dubai Government launched in January 2021 an economic stimulus package worth AED 315 million, raising the value of business incentives introduced by the emirate's government to AED 7.1 billion. It aims further support to businesses by reducing costs and simplifying procedures, targeting tourism, retail, trade and logistics. The new package extended the validity of some of the initiatives announced in the previous stimulus packages until June 2021.

Accordingly, as government revenues increase at a slower pace than government expenditures, the overall UAE government net lending/borrowing balance achieved a bigger surplus of AED 22.3 billion (or US$ 6.1 billion) during the first half of 2020 to AED 29.4 billion (or US$ 8.0 billion) over the first half of 2021, whereas total government debt is estimated to slightly increase to 37% of GDP in 2021, from 39% of GDP in 2020, as per the IMF.

In this context, with OPEC's new oil production quotas which ease oil revenues, this will enable the fiscal balance to recover to pre-pandemic levels by 2023, where Fitch projects modest surpluses of close to 0.5% of GDP in 2022 and 2023. Dubai in particular would witness gradual return to fiscal surpluses with recovering revenues, and lower equity injection requirements from GREs. While debt issuances are expected to be forthcoming over the next few years, in both foreign and local currencies, federal government debt is likely to remain very low as a share of GDP for some time, since the federal government will continue to target balanced budgets under its medium-term fiscal framework.

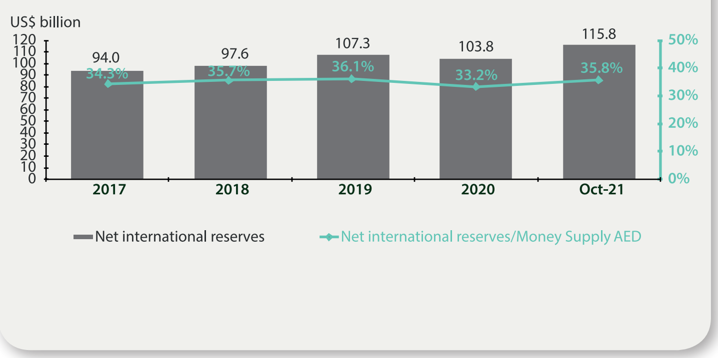
1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

UAE shifts from deflation to price growth, international reserves bounce back in 2021

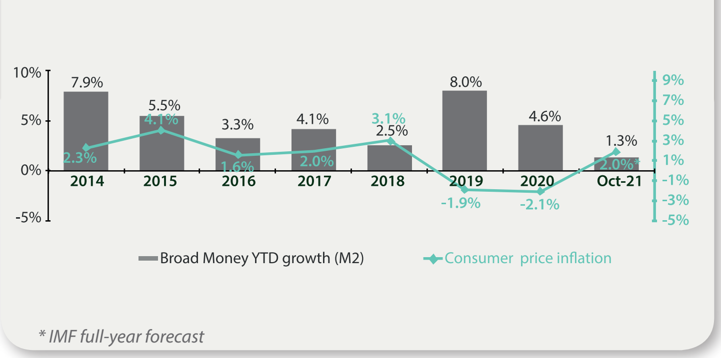
The year 2021 saw a return to annual inflation rates for the first time in the UAE since December 2018, along with a decent growth in monetary aggregates, and a rebound in the Central Bank of the UAE's gross international reserves amid a robust growth in its foreign securities' portfolio, while policy interest rates continued to be anchored to the US Federal Reserve's rates given the UAE Dirham peg to the US dollar.

EXCHANGE MARKET INDICATORS



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

BROAD MONEY AND INFLATION



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

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UAE MONETARY FLOWS

Flows in US$ million	2019	2020	10M-21
Net international reserves	**18,307**	**7,947**	**21,172**
Central Bank (net)	**9,741**	**-3,587**	**12,079**
Gross international reserves	8,856	-1,659	13,537
Foreign Liabilities	-886	1,928	1,458
Banks (net)	**8,565**	**11,534**	**9,094**
Foreign Assets	24,900	21,235	21,244
Foreign Liabilities	16,335	9,701	12,150
Net Domestic Assets	**10,212**	**9,872**	**-15,795**
Claims on private sector	1,977	-8,353	2,951
Net claims on public sector	19,101	20,102	9,590
Claims on financial institutions	-1,695	636	-582
Capital & Reserves	-10,737	-420	-459
Other Items (net)	1,565	-2,093	-27,296
Broad Money (M2)	**28,518**	**17,819**	**5,377**
Money Supply (M1)	7,995	23,145	19,491
Quasi-Money	20,523	-5,326	-14,114

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

The UAE actually shifted from deflation to price growth starting August 2021, mainly outlining a recovery from the harsh pandemic year of 2020 with low base effects, and an increased business activity with the reopening of the economy, in addition to a rise in global commodity prices and a strong oil price rebound. Latest figures released by the UAE Federal Competitiveness and Statistics Authority showed that consumer prices in the UAE grew by 1.2% year-on-year in September 2021, with the Consumer Price Index rising from 105.95 in September 2020 to 107.21.

The division of the Consumer Price Index by sector shows that the recreation and culture sector registered the largest yearly price expansion of 15.5% as the economy reopened, followed by the transportation sector (+12.7%) amid a strong oil price rebound, the furniture and household goods sector (+2.2%) noting that the latter are largely imported and are likely to be have been hit by global supply-chain issues, the education sector (+1.1%), the restaurants and hotels sector (+1.0%) as international travel somehow recovered from pandemic, and the food and beverages sector, the tobacco sector and the medical care sector with +0.3% each. In contrast, the housing, water, electricity & gas sector registered yearly price contraction of 3.7%, followed by the textiles, clothing and footwear sector (-1.7%), the miscellaneous goods and services sector (-0.7%) and the communications sector (-0.1%). Within this context, it is worth mentioning that the IMF expects consumer prices to rise by 2.0% on average in 2021 following two consecutive years of contractions in consumer prices.

Monetary aggregates in the UAE registered decent expansions over the first ten months of 2021. The narrowest measure of money supply (M1), which consists of currency in circulation outside banks plus monetary deposits in local currency with banks, expanded by 11.9% during the first ten months of 2021, moving from US$ 163.4 billion at end-2020 to US$ 182.9 billion at end-October 2021. This compared to an 11.6% expansion in M1 during the corresponding period of 2020. The broader money supply (M2), which consists of Money Supply (M1) plus quasi-monetary deposits, grew by 1.3%, moving up from US$ 402.6 billion at end-2020 to US$ 408.0 billion at end-October 2021, with net foreign assets at the Central Bank of the UAE rising by 11.6%, moving from US$ 103.8 billion at end-2020 to US$ 115.8 billion at end-October 2021, resulting into a 15.1% expansion in net international reserves. This compared to a 5.2% expansion in M2 over the first ten months of 2020.

Given the UAE dirham/US dollar peg at AED 3.6725, the Central Bank of the UAE raised the base rate applicable to overnight deposit facility, which is the prevailing official monetary policy rate of the CBUAE, by 5 bps on June 17, 2021 to reach 0.15%. This follows the US Federal Reserve's decision to increase interest it pays on excess reserves (IOER) to 0.15% from 0.10%. Concurrently, the Central Bank of the UAE raised its Collateralized Murabaha Facility rate and its Marginal Lending Facility rate by 5 bps to 0.65% each on June 17, 2021.

Last but not least, the Central Bank's gross international reserves expanded by 12.7% over the first ten months of 2021 or the equivalent of US$ 13.5 billion, moving from US$ 106.7 billion at end-December 2020 to US$ 120.2 billion at end-October 2021. This is mainly driven by a strong surge in "foreign securities" of US$ 36.6 billion over the first ten months of 2021, moving from US$ 1.1 billion at end-December 2020 to US$ 37.7 billion

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at end-October 2021 amid a pick-up in US Treasuries yields, while "current account balances & deposits with banks abroad" contracted by 31.0% or the equivalent of US$ 29.3 billion, moving from US$ 94.8 billion at end-December 2020 to US$ 65.5 billion at end-October 2021. Accordingly, the Central Bank's gross international reserves coverage ratio to money supply (M1) and Dirham deposits reached 37.1% at end-October 2021, up from 34.2% at end-December 2020.

Looking forward, the IMF expects consumer prices in the UAE to tick up in 2022, averaging 2.2% versus an average of 2.0% in 2021, while rising concerns over new potentially vaccine-resistant Coronavirus variants and renewed lockdowns remain the largest source of uncertainty to the domestic economy and business activity. Concurrently, key interest rates are set to follow the lead taken by the US Federal Reserve in tightening its monetary policy during the second half of 2022, given the UAE Dirham peg to the US dollar.

1.4.2. Banking Activity

Banking activity and financial soundness at the image of a recovering economy

The banking sector has been at the mirror image of a recovering economy over the past year. Measured by the aggregation of assets of operating banks, banking activity grew by 2.6% over the first ten months of 2021 to reach US$ 890.7 billion in October, the equivalent of 220% of the country's GDP. As to deposits, they reached US$ 535.7 billion, growing by 4.4% over the first ten months of this year, after having slowed down the year before. Likewise, loan growth, that was contractionary in the year 2020, reported 0.8% over the 2021 ten-month period to reach a total lending portfolio to the private sector of US$ 304.1 billion at end-October.

Financial soundness indicators remain in good shape on the overall. The Advances to Stable Resources ratio amounted to 77.7% at the end of June 2021, which indicates that the structural liquidity of the banking sector remained sound. Eligible liquid assets, as a percentage to total liabilities fell to 18.3% at end-June, however well above the 10% minimum regulatory requirement, constituting an adequate buffer for the banking sector. Non-performing loans to total gross loans ratio stood at 8.2% at end-June 2021. In parallel, the UAE banking system remains well capitalized, with an average Capital adequacy ratio at 17.5%, Tier 1 Capital Ratio at 16.3% and Common Tier 1 ratio at 14.5% as at the same date.

The year 2021 has actually highlighted a strong comeback of the UAE banking sector as profitability rebounds to pre-pandemic levels with robust growth in Net Interest Income (NII) and other income. While asset quality improves and risk costs decline, banks remain cautious on new loan originations. The impact of cost efficiency measures during pandemic comes through, as the sector records lowest levels in Cost-to-Income ratio since 2018. The result is a return on assets ratio in the vicinity of 1.0% and a return on equity ratio in the vicinity of 7.2%.

Improvements in asset quality are helping to drive the UAE banking sector turn around, while looking forward to this trend continuing. The UAE's Central Bank's credit sentiment survey notes a strong, ongoing domestic credit demand across all sectors of the economy indicating that a vibrant recovery is on track.

EVOLUTION OF BANKING AGGREGATES

US$ billion	2017	2018	2019	2020	Oct-21
Total assets	733.5	781.1	839.5	868.1	890.7
% YTD growth in assets	3.1%	6.5%	7.5%	3.4%	2.6%
Total deposits	443.1	478.1	509.2	513.2	535.7
% YTD growth in deposits	4.1%	7.9%	6.5%	0.8%	4.4%
Total bank loans to the private sector	295.8	307.7	308.9	301.8	304.1
% YTD growth in bank loans to the private sector	1.0%	4.0%	0.4%	-2.3%	0.8%

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

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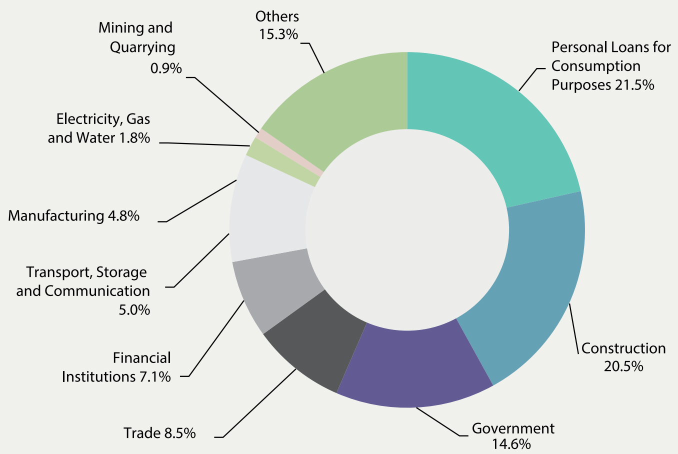
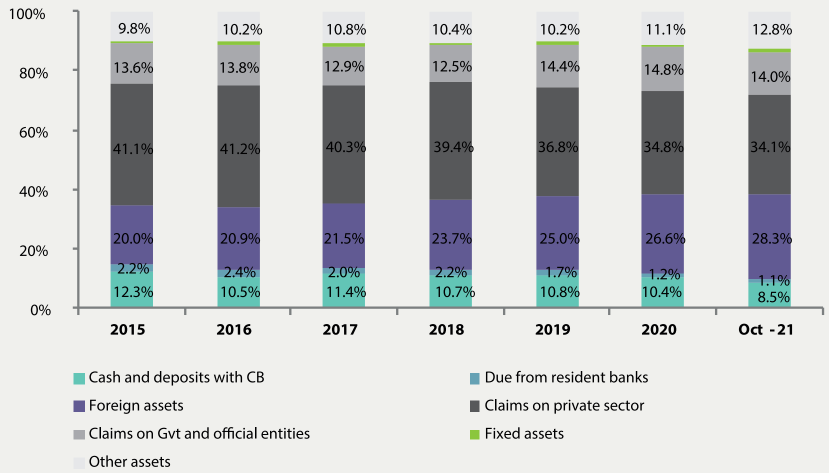
BANK CREDIT TO RESIDENTS BREAKDOWN BY ECONOMIC ACTIVITY*



* September 2021 figures

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

ASSET COMPOSITION (% OF TOTAL ASSETS)



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

Alvarez & Marsal believes focusing on significant efficiency improvements, continuing to adopt technology, either organic or in partnership with fintech's, and actively managing non-performing portfolios are critical to driving improvements forward.

Sound capital buffers, a stable funding profile, and expected government support should continue to uphold banks' creditworthiness. However, asset quality may deteriorate over the medium term as forbearance measures are gradually withdrawn. It is expected that the economic boost from Expo 2020, continued economic recovery and digital transformation will continue to drive the UAE banking sector growth. An interesting outcome of the current IPOs would be to see how they impact the earnings of the local banks; it is probable that this may highlight the need for some of the banks to build better capabilities that broaden their fee income capabilities and hence diversify their income streams as per Alvarez & Marsal.

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1.4.3. Equity and Bond Markets

Price rebounds in UAE equity markets, bond markets plunge in the red over the first eleven months of 2021

The UAE equity markets registered strong price rebounds over the first eleven months of 2021, mainly tracking global equity strength amid a post-pandemic recovery and driven by a strong oil price rally. In contrast, the UAE fixed income markets came under downward price pressures over the covered period, mainly tracking US Treasuries move on prospects of a global monetary policy tightening next year and on rising concerns about elevated inflation in global economies.

The UAE equity markets posted a strong price rally over the first eleven months of 2021, mainly driven by (1) a post-pandemic recovery (2) a robust oil price rebound, with Brent prices hitting seven-year highs and topping US$ 80 per barrel in November 2021; (3) increased business activity with the non-oil private sector expanding in October 2021 at its fastest pace since June 2019; (4) a strong recovery in the real estate market on the back of a pent-up demand noting that the total property sales in the first ten months of 2021 were the highest in six years; (5) upbeat corporate earnings; and (6) Dubai's recent measures aiming to expand the base of the Dubai Financial Market and ensure a slew of high-profile IPOs flowing in.

The UAE equity markets actually continued to follow an upward streak towards mid-December 2021 following the country's decision to shift its weekend to Saturday and Sunday from the start of next year, in a move aimed at ensuring smooth financial, trade and economic transactions with countries that follow a Saturday-Sunday weekend, and facilitating stronger international business links and opportunities for UAE-based and multinational firms.

In details, the Dubai Financial Market benefited from improved investor sentiment after the reopening of the economy, and as Dubai rolled out an incentive program to attract private sector IPOs, which includes financial support during IPOs and post-listing, and a three-year waiver on listing, AGM and dividend distribution fees, and following a merge between the Dubai Economic Department and the Department of Tourism and Commerce aimed to prod private and family-owned businesses to sell shares on the Dubai Financial Market. The DFM General Index expanded by 23.3% during the first eleven months of 2021, moving from 2,491.97 at end-2020 to 3,072.91 at end-November 2021.

The breakdown of the DFM General Index by sector during the first eleven months of 2021 shows that the financial and investment services sector registered the highest index drop of 56.8%, followed by the real estate sector with +32.5% (the DFM real estate index has a weight of 28.8% in the general index), the banking sector with +21.1% (noting that the DFM banks index has the largest weight in the DFM general index of 44.4%), the services sector (+12.3%), the insurance sector (+8.6%), and the telecommunications sector (+5.7%). In contrast, the consumer staples and discretionary sector registered the highest index drop of 14.0%, followed by the industrial sector with -1.8% and the transportation sector with -1.5%.

The Dubai Financial Market was marked by a flat activity over the first eleven months of 2021, as shown by a shy yearly increase in the total turnover of 0.3% to reach US$ 16.4 billion, noting that the real estate and construction sector accounted for circa 42% of the total. The total number of traded shares reached 42.1 billion shares over the first eleven months of 2021, against 60.1 billion shares during the same period of 2020, down by 29.9%, and the total number of trades was quoted at 724,099 during the first eleven months of 2021 versus 899,165 during the same period of 2020, down by 19.5%. On the back of strong price gains, the market capitalization in the Dubai Financial Market surged from US$ 91.8 billion at end-November 2020 to US$ 118.2 billion at end-November 2021, down by 28.7%. Within this context, the turnover ratio, measured by the annualized trading value to market capitalization, fell from 19.4% over the first eleven months of 2020 to 15.1% over the corresponding period of 2021.

Also, the Abu Dhabi Securities Exchange registered a strong price rally and a significant rise in activity over the first eleven months of 2021 amid an IPO boom and robust oil price gains. For instance, the Abu Dhabi Securities Exchange saw in 2021 the listing of Alpha Dhabi Holding's stock, which is the second heaviest stock by market capitalization.

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Within this context, the Abu Dhabi general index surged by 69.4% over the first eleven months of 2021, moving from 5,045.32 at end-2020 to 8,546.52 at end-November 2021. The breakdown of the Abu Dhabi general index by sector during the first eleven months of 2021 shows that the financial services and investment sector registered the highest price surge of 256.6%, followed by the industrial sector (+139.9%), the telecommunications sector (+87.2%) noting that Abu Dhabi telecommunication index has a weight of 20.2% in the Abu Dhabi general index, the banking sector (+42.4%) noting that Abu Dhabi banks index has a weight of 38.2% in the Abu Dhabi general index, the services sector (+41.2%), the consumer staples sector (+30.8%), the real estate sector (+29.0%) and the energy sector (+19.8%). In contrast, the insurance sector was the only sector registering price declines of 5.8%.

The total trading value rose more than five times during the first eleven months of 2021 when compared to the same period of 2020 to reach US$ 79.2 billion. The total number of traded shares reached 46.4 billion shares over the first eleven months of 2021 against 16.3 billion shares during the same period of 2020 (up by 184.5%), and the total number of trades was quoted at 1,096,872 during the first eleven months of 2021 versus 453,341 during the same period of 2020. The number of listed companies rose from 76 companies at end-2020 to 85 companies at end-November 2021. The market capitalization rose from US$ 197.0 billion at end-November 2020 to US$ 426.6 billion at end-November 2021, up by 116.6%, mainly supported by a strong price rally and additional listings. Within this context, the turnover ratio, measured by the annualized trading value to market capitalization, reached 20.2% during the first eleven months of 2021 as compared to 8.5% over the corresponding period of 2020.

In contrast, the UAE fixed income markets came under downward price pressures over the first eleven months of 2021, mainly tracking US Treasuries move, on rising bets over interest rate hikes during the first half of 2022 when the Central Bank finishes tapering its emergency bond buying program, and since the reappointment of the US Fed Chair for a second term and the elimination of the word "transitory" from inflation forecasts for the first time since April 2021 have reinforced speculation about a faster pace of policy tightening next year.

ABU DHABI STOCK MARKET INDICATORS

	2017	2018	2019	2020	Nov-21
Market capitalization (in US$ billion)	124.6	135.1	142.0	198.3	426.6
Trading value (in US$ billion)	11.9	9.4	11.7	17.5	79.2
Turnover ratio	9.6%	7.0%	8.3%	8.8%	20.2%
Trading volume (in millions)	24,224	12,382	11,603	18,395	46,438
Number of transactions	332,905	266,298	380,249	501,904	1,096,872
General share price index	4,398	4,915	5,076	5,045	8,547
% Change in share price index	-3.3%	11.7%	3.3%	-0.6%	69.4%
5-Year CDS spreads (bps)	63	67	36	38	45

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

DUBAI STOCK MARKET INDICATORS

	2017	2018	2019	2020	Nov-21
Market capitalization (in US$ billion)	107.2	94.2	102.6	93.0	118.2
Trading value (in US$ billion)	31.1	16.1	14.5	17.9	16.4
Turnover ratio	29.0%	17.1%	14.1%	19.2%	15.1%
Trading volume (in millions)	80,581	44,625	40,045	65,472	42,110
Number of transactions	1,067,623	660,261	656,674	977,526	724,099
General share price index	3,370	2,530	2,765	2,492	3,073
% Change in share price index	-4.6%	-24.9%	9.3%	-9.9%	23.3%
5-Year CDS spreads (bps)	128	129	91	112	94

Sources: Dubai Financial Market, Bank Audi's Group Research Department

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In the Abu Dhabi credit space, sovereigns maturing in 2026 and 2031 posted price contractions of 4.0 pts and 3.0 pts respectively over the first eleven months of 2021. Mubadala papers maturing in 2026 registered price falls of 3.06 pts. ADNOC'29 closed down by 5.41 pts. Etisalat'24 registered price drops of 3.05 pts. Taqa'26 were down by 4.10 pts. Amongst financials, ADIB Perpetual (offering a coupon of 7.125%) recorded price falls of 2.64 pts. Prices of Al Hilal Bank'23 declined by 2.95 pts. ADCB'23 posted price decreases of 3.13 pts. First Abu Dhabi Bank'24 saw price contractions of 2.01 pts. As to the cost of insuring debt, Abu Dhabi's five-year CDS spreads reached 45 bps at end-November 2021 as compared to 38 bps at end-2020, which is the lowest in the MENA region.

In the Dubai credit space, sovereigns maturing in 2029 registered price falls of 2.35 pts during the first eleven months of 2021. Majid Al Futtaim'29 saw price drops of 1.42 pt. DP World'30 closed down by 3.03 pts. In contrast, Emaar'26 traded up by 2.61 pts. Prices of Emirates Airline'28 improved by 1.17 pt. As to papers issued by financial institutions, Emirates NBD papers Perpetual (offering a coupon of 6.125%) registered price decreases of 2.12 pts. As to the cost of insuring debt, Dubai's five-year CDS spreads contracted by 18 bps during the first eleven months of 2021 to reach at 94 bps end-November 2021.

Regarding new bond issues, Abu Dhabi tapped the international debt markets twice in 2021, joining the rush of borrowers to lock in funds ahead of expected US Fed interest rate hikes next year. In fact, Abu Dhabi raised US$ 2 billion in June 2021 from the sale of seven-year bonds at a coupon of 1.625%, noting that the bond sale attracted around US$ 6 billion in orders. Also, Abu Dhabi raised US$ 3 billion in September 2021 from the sale of a US$ 1.75 billion 10-year tranche at 63 bps over US Treasuries versus an initial price guidance of 90 bps over UST, and a US$ 1.25 billion 30-year bond at a yield of 3% versus an initial price guidance of 130 bps over UST. The bond sale attracted about US$ 9.75 billion in bids.

Also, the Federal government of the UAE raised in October 2021 US$ 4 billion from the sale of its debut bond, consisting of three tranches: US$ 1 billion 10-year bonds issued at 70 bps over US Treasuries versus an initial price guidance of 105 bps over UST; US$ 1 billion 20-year bonds issued at 105 bps over UST versus an initial price guidance of 135 bps over UST; and US$ 2 billion 40-year notes issued at 3.25% versus an initial price guidance of 3.6%. Orders for the three-tranche bond topped US$ 22.5 billion.

As to credit ratings, Fitch Ratings affirmed in November 2021 the UAE's long-term foreign currency Issuer Default Rating at "AA-", which applies to the federal government of the UAE, with a "stable" outlook. In addition, Fitch Ratings affirmed in October 2021 Abu Dhabi's long-term foreign currency Issuer Default Rating at "AA" with a "stable" outlook. In parallel, Moody's affirmed in May 2021 the "Aa2" long-term issuer and senior unsecured ratings of the Government of Abu Dhabi, with a "stable" outlook.

Looking forward, new COVID-19 variants may dent the global risk appetite in the UAE equity markets and spur some profit-taking operations following 2021's strong price rally. At the level of debt markets, more bonds may be issued at the federal level in 2022, as the UAE aims to achieve the country's strategy to build the Treasury yield curve and start issuing Emirati dirham-denominated bonds in the future.

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CONCLUSION

The hydrocarbon sector is regaining strength with rising global oil prices, helping to restore the fiscal and external positions, and boosting confidence on the overall economy. This, coupled with a sustained recovery of global trade and travel, is allowing the non-hydrocarbon sector to rebound. But the pandemic could have a lingering impact on global travel, hampering a speedy recovery of the UAE's large tourism industry at large. Within this environment, UAE's real growth is forecasted at 3.0% in 2022 and at an average of 3.1% over the next five years, as per the World Economic Outlook issued by the IMF in mid-October.

The long-run economic prospects continue to hinge on the authorities' efforts to create a favorable business environment to foster growth of the non-hydrocarbon sector and create jobs in the private sector. The introduction of a new Commercial Companies Law in December 2020, which among other things permits foreign nationals 100 percent owner-ship in most industries, marks a further extension of the free zone investment environment to the "on-shore" economy. Combined with the measures on business costs and the earlier introduction of VAT, there has been a sizable gain in competitiveness, and thus significant upside risks to the outlook as viewed by the World Bank.

At the fiscal level, Fitch projects modest surpluses of close to 0.5% of GDP in 2022 and 2023 as increases in oil production in Abu Dhabi will largely offset a drop of oil prices to their long-term assumption of US$ 53/bbl by 2023. They expect Dubai to gradually return to fiscal surpluses with recovering revenues, lower equity injection requirements from GREs and the possible listing of GREs on the stock market. While debt issuances are expected to be forthcoming over the next few years, in both foreign and local currencies, federal government debt is likely to remain very low as a share of GDP for some time, since the federal government will continue to target balanced budgets under its medium-term fiscal framework.

At the banking level, Standard and Poor's views the trend in industry risk in the UAE as stable. The CBUAE's support package is timely and provides some relief to borrowers. UAE banking authorities' reporting requirements have reinforced oversight and transparency, and banks are expected to continue displaying transparency in the recognition and disclosure of problematic assets. No major changes are expected in system-wide dynamics or the competitive landscape. Banks should be able to maintain adequate sources of funding and liquidity on higher oil prices.

When assessing the outlook of the UAE economy, it is important to address the key strengths and major weaknesses facing the economy. At the level of strengths, we mention the high GDP per capita, the history of domestic political stability coupled with strong international relations, and the assumed full backing from the government of Abu Dhabi and its strong balance sheet. Among challenges, we mention the still significant exposure of the economy and government finances to hydrocarbons, the regional geopolitical tensions and the limited data disclosure and policy transparency. While challenges are material, we believe opportunities outpace threats at the horizon.

Finally, according to the IMF Article IV Consultation report, uncertainty around the recovery remains globally and in the UAE, and the overall balance of risks is tilted towards the downside, with a resurgence of the pandemic the key source of risk to the outlook. However, the UAE's strong reform momentum provides an upside risk to growth. For the recovery to be sustained, protecting public health through continued strong vaccination and testing efforts for all nationals and residents remains the top priority. The current macroeconomic policy mix remains appropriate. Going forward, however, support measures should be increasingly targeted to viable sectors and firms and supporting people most in need. New fiscal stimulus and structural reforms, such as those to attract highly skilled professionals, support private sector employment, increase trade and foreign investment, and harness the benefits of technology, should be prioritized and sequenced to ensure their efficiency and effectiveness, ensuring sustainable and inclusive growth outcomes at large.

Bank Audi sal - Group Research Department - Bank Audi Plaza - Bab Idriss - PO Box 11-2560 - Lebanon - Tel: 961 1 994 000 - email: research@bankaudi.com.lb