UAE ECONOMIC REPORT

ECONOMIC ACTIVITY TO BUILD MOMENTUM ON EXPO 2020 AND FISCAL STIMULUS

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- Sluggish economic activity in most of 2019 to turnaround in 2020

Following a relatively challenging period, UAE'S economic activity has been slightly recovering over the past few months and is likely to pick up more momentum next year, helped by Expo 2020 and existing fiscal stimulus. The latter is underway to facilitate non-oil growth recovery, though putting pressure on public finances. Expo 2020 should provide the much needed boost to domestic demand for goods and services in the UAE. Most of the year 2019 was however sluggish for economic activity. While the array of coincident and leading indicators for the UAE is relatively limited, Purchasing Managers Index readings collapsed to a six-year low in the third quarter of 2019.

- Continued strong external position despite a challenging global trade environment

UAE has continued its efforts over the year to introduce innovative policies and services that facilitate global trade, transforming itself into one of the world's foremost trading hubs despite a challenging global trade environment. UAE's ability to adapt to change, its responsiveness to the needs of businesses and investors, and the diversified profile of the Emirates' foreign sector have made it a model for the global trade map. Within this context, the trade balance surplus for the UAE is estimated to have increased by 4.1% to reach about US$ 84.8 billion (or AED 311.4 billion) in 2019.

- Public finances improving towards a zero-deficit budget in 2020

UAE's fiscal situation continued to improve over the first half of 2019 owing to the introduction of new taxes, most notably the value-added tax in 2018. In fact, the government continued to target non-oil sources of revenues, benefitting the most, across the GCC, from the introduction of the VAT, given its larger consumer base and significant retail activity, thus supporting non-hydrocarbon revenue growth and fiscal surplus. In parallel, the UAE Cabinet approved a zero-deficit federal budget of AED 61.4 billion for the year 2020, the largest budget allocated since the establishment of the UAE.

- Deflationary pressures along with interest rate cuts amid US Fed monetary easing

The year 2019 was marked by a decent growth in monetary aggregates in the UAE, deflationary pressures, expansions in the Central Bank's gross international reserves, and interest rate cuts in line with the US Federal Reserve monetary policy easing as the UAE dirham remained pegged to the US dollar. Consumer prices went into a deflationary mode in 2019, mainly weighed down by weak domestic demand, a prolonged slump in housing costs in an oversupplied residential market, lower oil prices amid rising global growth concerns triggered by lingering US-China trade tensions, and as the impact of a 5% VAT introduced at the beginning of the year 2018 dropped out of the annual data. Consumer prices in the UAE contracted by 1.9% year-on-year in October 2019.

- Continued banking activity growth in a sound financial sector

The UAE banking sector witnessed another healthy activity growth year in 2019, on the back of continued economic expansion in the country (albeit at a slightly weaker pace), Expo 2020-related momentum and large infrastructure programs favoring progression in banking aggregates. Measured by the total assets of banks operating in the UAE, banking activity grew by 6.0% in the first ten months of 2019 to reach US$ 827.9 billion at end-October 2019. It is yet worth noting that lower interest rates are likely to translate into some profitability pressures going forward, with re-pricing of loan books more than offsetting lower cost of funding.

- Upward price movements across UAE capital markets in 2019

The year 2019 was a favorable year for the UAE's capital markets. The equity markets posted decent price gains amid attractive market valuations, favorable financial results and bank merger deals. Also, the UAE fixed income markets saw upward price movements across the board, mainly tracking US Treasuries move following three rate cuts by the US Federal Reserve, and as the UAE maintained its safe haven image amid lingering regional geopolitical tensions.

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

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Following a relatively challenging period, UAE'S economic activity has been slightly recovering over the past few months and is likely to pick up more momentum next year, helped by Expo 2020 and existing fiscal stimulus. The latter is underway to facilitate non-oil growth recovery, though putting pressure on public finances. Expo 2020 should provide the much needed boost to domestic demand for goods and services in the UAE.

Most of the year 2019 was however sluggish for economic activity. While the array of coincident and leading indicators for the UAE is relatively limited, Purchasing Managers Index readings collapsed to a six-year low in the third quarter of 2019. Key sectors in the non-oil economy are indeed experiencing cyclical and structural headwinds. The real estate sector continues to suffer from oversupply and slow population growth. Rental and sale prices for residential property across the UAE continued to decline in 2019, with rental prices for apartments declining by 11% year-on-year and sales prices by 9%. Geopolitical developments are also primarily affecting the shipping sector. Within this context, real GDP growth is estimated at 1.6% in 2019, against 1.7% in 2018.

At the external sector level, the current account balance is set to have recorded in 2019 its previous year's level of 9% of GDP within the context of a continuing positive trade surplus. Gross international reserves grew to US$ 102 billion at end-October 2019, to cover 34.9% of domestic currency Money Supply. Broad Money supply growth reported 4.9% over the first ten months of 2019, while consumer prices are set to have reported a deflation of 1.5%.

At the public finance level, the Federal Budget is expected to be balanced, while Abu Dhabi runs a deficit. The introduction of VAT has supported revenues in Dubai to a greater extent because of the greater preponderance of non-hydrocarbon activity there. Abu Dhabi authorities have been funding these small deficits with external funding, preferring to limit drawdowns on the Abu Dhabi Investment Authority since the cost of funding is less than the potential return on ADIA investments.

At the banking sector level, activity reported positive growth in 2019. Measured by the aggregation of banks assets, banking activity grew by 6.0% over the first ten months of 2019 to reach US$ 828 billion at end-October. Likewise, deposits grew by 3.6% to reach US$ 496 billion, while loans to the private sector reported an insignificant growth of 1.0% over the period. Banks' NPLs however rose to 6.4% of bank loans, from 5.6% at end-2018 mainly attributed to the sluggishness in the property sector. As to other financial soundness indicators, the eligible liquid asset ratio remains satisfactory at 17.4%, while banks' capital adequacy ratio stands at 17.7%, portraying a sound coverage of credit risks, market risks and operational risks by banks shareholders' equity at large.

At the capital markets level, Dubai and Abu Dhabi markets performed more or less evenly portraying improved performance. Dubai's share price index reported a net increase of 5.9% over the first 11 months of 2019 and Abu Dhabi's share price index reported a rise of 2.4% over the period. But while Dubai reported a retreat in its turnover ratio from 17.3% to 14.8%, Abu Dhabi registered an increase in its turnover ratio from 6.6% to 8.0%. In parallel, both markets registered an improved market perception of credit sovereign risks. Abu Dhabi's 5-year CDS spreads contracted from 67 basis points at end-2018 to 41 basis points in November 2019, and Dubai's 5-year CDS spreads fell from 129 basis points to 110 basis points over the same period.

UAE ECONOMIC PERFORMANCE

Sources: IMF, Bank Audi's Group Research Department

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

Country's hydrocarbons sector remains backbone of its economic model

Despite consistent efforts to diversify the UAE economy, the country's hydrocarbons sector remains the backbone of its economic model. The country's hydrocarbon real GDP grew by 1.4% in 2018, and is estimated to grow by 1.7% in 2019. Crude and other liquids net exports slightly fell to US$ 69.1 billion in 2019, from an estimated US$ 76.1 billion in 2018.

It is worth noting that oil prices slightly declined on average this year, but remained supportive reinforced by a potential breakthrough in the Sino-US trade war and OPEC-led efforts to constrain supply. Brent crude oil prices contracted by 6.7% in 2019, against a notable rise of 22.8% in 2018. On the supply side, crude oil production is estimated to rise by 3.3% in 2019, with production expected to further rise by 0.6% in 2020. The UAE has the fourth highest petroleum production in OPEC behind Saudi Arabia, Iraq and Iran.

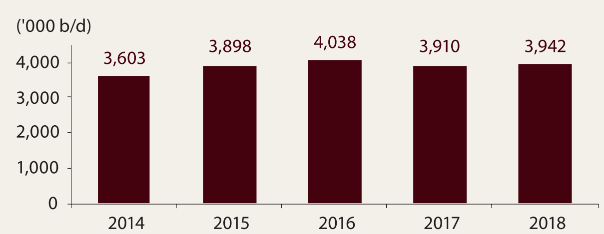
The country exports the bulk of its crude to consumers in Asia, with Japan, Singapore, South Korea and China among the major buyers. Fitch Solutions added that aggressive expansion of refining capacity in Asia Pacific is increasingly pushing crude demand growth east of the Suez, and this will see the UAE increasingly reliant on Asian buyers.

Moreover, the UAE's oil reserves stood at 96.6 billion barrels and 6.0 tcm of natural gas. The bulk of reserves are located in Abu Dhabi, at more than 90% of the total, followed by Dubai, Sharjah and Ras al Khaimah. The reserves are large on a global scale, with the UAE holding the seventh largest proved oil and gas reserves, according to data from the US Energy Information Administration.

The majority of the acreage, both onshore and offshore, is relatively well explored and recent drilling has yielded few significant discoveries. Instead, the continued increase in proved reserves has been largely driven by appraisal activities at existing fields and the deployment of enhanced oil recovery techniques.

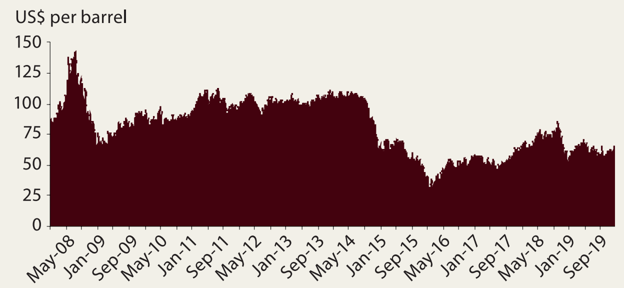
As for oil consumption, it is expected to remain strong in the UAE despite ongoing fuel price deregulation. This is due to sustained weakness in international fuels prices, increased vehicle sales and strong growth in the energy-intensive industrial sectors. For instance, the consumption of refined fuel products is set to rise by 3.1% year-on-year in 2019, in barrels of oil equivalent.

OIL & GAS PRODUCTION



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

CRUDE OIL & NATURAL GAS PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

Moving on to the country's gas sector, the UAE plans to boost domestic natural gas production over the next several years to help meet growing internal demand. In fact, gas consumption is expected to rise by 1.0% in 2019, against a growth rate of 2.0% in 2018. Currently, the power sector accounts for the majority of gas consumption in the UAE, representing more than 98% of total electricity generation.

With regards to gas reserves, the UAE holds 215 trillion cubic feet of gas of natural gas reserves, according to the US Energy Information Administration. Nonetheless, despite its large endowment, the UAE has been a net importer of natural gas since 2008 because of increased demand. Increasing gas consumption and limited domestic production growth will sharply raise the UAE's net imports of gas over the coming decade and turn the country into an LNG importer in the 2020s.

Finally yet importantly, the UAE's hydrocarbons sector continues playing a major role in its economic system. However, commitment to diversification is displayed via fiscal easing and structural reforms to facilitate non-oil growth recovery. The country has set a comprehensive strategy to encourage FDI outside free zones and energy sectors, and expand non-bank and capital market financing options for SMEs.

1.1.2. Non-Hydrocarbons Sector

Real Estate and Construction

Slowdown in UAE's real estate and construction sector continues

UAE's real estate sector remains one of the pillars of the country's diversification strategy. However, the supply glut continues to cause downward pressure across all its sub-sectors. As a result, the market is expected to remain tenant-favorable well into 2020. Moreover, the strong dollar and tensions with Qatar have put pressure on investment returns as property owners absorb higher costs amid soft market conditions. Falling rents are expected in the short-term, as the market is expected to witness a number of project completions in the run up to the World Expo 2020.

In Abu Dhabi, the real estate market reported sluggish performance in 2019. Slow commercial activity weighed on the performance of the office market as rental rates continued to decline despite no new office space being delivered to the market, as per Jones Lang Lasalle (JLL).

In a more detailed look, demand in the office market remains restricted to small and serviced office spaces. In turn, the residential market registered a negative performance as apartment sale prices and rents continued to decline by 10% year-on-year in the first three quarters of 2019. The performance of villas followed a similar path with a decline of 4% in sales prices and 6% in rents over the same period. In the retail market, average retail rents dropped by 10% to 20% yearly. However, market sentiment is softening with landlords continuing to offer flexible incentives.

In Dubai, the government has taken steps to also limit future supply, with the announcement of a new Real Estate Planning Committee in Q3 2019, after a number of initiatives announced over the past year to boost demand. Developers are also launching fewer new projects, with activity at this year's Cityscape Global focusing on the sale of existing inventories. Despite these trends, the market is still expected to see a high level of deliveries in the short term, with potential residential completions in 2019 (36,000 units) likely to be the highest in the last 10 years, as per JLL.

It is worth noting that the growth of flexible offices and e-commerce continue to disrupt the office and retail sectors, with the latter also creating opportunities for further logistics facilities in Dubai.

In details, the emirate's residential market is at the bottom of the cycle with yearly declines of 8% and 7% in apartment rents and sale prices in the first three quarters of this year. Villa rents and sales price also retreated by an annual 6% and 9% over the same period. Looking at the office market, vacancies in the Central Business District (CBD) remained stable over the quarter (at 13%). Average Grade A rents have declined by 6% in Q3 to AED 1,417, a 13% decline over the similar quarter of the past year. With more quality office supply expected to enter the market, further downward pressure on rents and occupancies is expected over the next 12 months. Hence, the market remains in favor of tenants and landlords continued to offer favorable renewal terms to retain existing tenants in the face of increased competition, as per JLL. As for the retail segment, retail rents remained stable over the quarter but softened across all mall categories compared to last year. Primary and secondary malls registered declines of around 9% and 19% respectively in the third quarter of this year, when compared to the same period last year. Market wide vacancies are estimated to have increased to 19% in Q3 2019 from 16% in Q3 2018.

In sum, the real estate and construction sector in the country continue to post a relatively weak performance this year. Oversupply and subdued demand continue to put negative pressure on prices and rents in both Abu Dhabi and Dubai, while the government is trying some initiatives to keep supply under control on the overall.

Transport

UAE's transport sector remains on expansionary path

The UAE's transport sector remained on an expansionary path, supported by a series of high-value rail and airport projects. The country continued affirming its position as a regional transport hub, as economic diversification remains a key objective of the government.

Dubai plans to build multiple urban transport projects in preparation for hosting the World Expo in 2020, while the federal government has long-term plans for expanding the UAE's rail network. Dubai and Abu Dhabi are also pursuing massive expansions to their respective airports, targeted at strengthening the UAE's position as a global aviation hub. The sheer scale of these plans means that the UAE has the second-largest transport projects pipeline in the Middle East, with 71 projects worth US$ 54.6 billion under construction or in planning, according to Fitch Solutions.

Investment and construction in the UAE's transport infrastructure sector would remain robust over the next ten years as the government pursues high-value projects aimed at bolstering the country's role as a logistics and tourism hub, as per the same source.

In the UAE's airport subsector, both Dubai and Abu Dhabi are pursuing airport expansion and redevelopment programs to bolster their roles as regional and international aviation hubs. In the near term, construction activity in the airports segment will be sustained by ongoing improvement and expansion works at the Dubai and Abu Dhabi airports, including the US$ 2.94 billion Abu Dhabi International Airport project. Over the longer-term horizon, significant growth potential is suggested by initiatives like the US$ 38 billion expansion of the Al Maktorum International Airport in Dubai.

Similarly, the UAE is investing in its ports infrastructure to bolster its role as a shipping and logistics hub. The country's two major ports at Khalifa and Jebel Ali have benefited enormously from the country's location along major shipping corridors between Europe and Asia, and proximity to energy producers in the Middle East. Growth in the ports infrastructure segment over the next ten years would come from expansion and upgrade plans aimed at increasing the capacity and improving the efficiency of the UAE's port facilities. The largest ongoing project is at the port of Khalifa, near Abu Dhabi, which is currently expanding its container terminal to handle an additional 2.4 million twenty-foot-equivalent units per year.

Lastly, the UAE's railway projects account for the second-largest component of the UAE's transport infrastructure project pipeline, with the governments of Abu Dhabi and Dubai pursuing urban transit initiatives aimed at improving mobility and reducing traffic congestion. Steady progress in both urban and regional railways are supporting the UAE's rail segment, with 22 ongoing or upcoming rail projects in the country as of May 2019, as per Fitch Solutions. For instance, the US$ 11 billion, 1,200-km Etihad Rail Project, would be the primary driver of growth in the rail sector. In the urban transit segment, ongoing and upcoming projects in the UAE's rail sector include expansions to the Dubai Metro and tram network and the construction of new metro and tram systems in Abu Dhabi.

Tourism

Tourism maintains a favorable performance

The UAE tourism industry posted sustained growth driven by a host of supportive underlying factors. One of the main drivers of growth include broad government support for tourism development as part of the greater economic diversification agenda and a robust, capital-intensive construction pipeline boasting new hotels, infrastructure, theme parks and retail spaces. The tourism momentum is favorable and is expected to continue in both the leisure holiday and commercial segments over the coming years.

Tourism and travel sector in the UAE accounted for 11.1% of the country's total economy in 2018, which is equivalent to more than AED 164.7 billion (US$ 44.8 billion), according to a report from the World Travel and Tourism Council. The council also mentioned that the sector accounted for 9.6% of the country's labor market in 2018, with expectations of a 23.2% increase this year or up to 753,300 jobs.

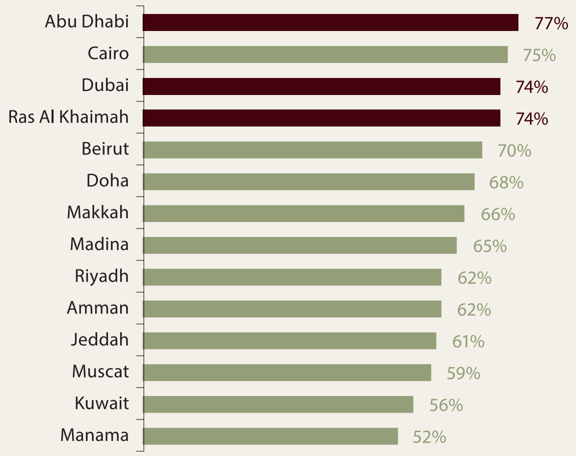
It is worth noting that the number of travelers is expected to stand at 27.9 million in 2019, up from 26.2 million in 2018. Moreover, tourism receipts are estimated at US$ 36.5 billion in 2019, up by a yearly 6.1%.

On another level, Dubai's hospitality market witnessed a decline in average daily room rate, occupancy and RevPar in the first ten months of 2019. Occupancy in Dubai's four and five stars hotels declined by 0.4% to 73.5% in the first ten months of 2019. Average daily room rates reported a decrease from US$ 254 to US$ 217 in the first ten months of 2019, as per EY. Accordingly, the RevPAR fell from US$ 188 to US$ 160 respectively, an annual decrease of 6.9%.

Abu Dhabi's hospitality market reported an improvement in occupancy, average daily room rate and RevPAR of its four and five star hotels. Occupancy rates ameliorated by 2.7% year-on-year from 74.7% in the first ten months of 2018 to 77.4% in the same period of 2018. Average daily room rate expanded from US$ 95 to US$ 98 over the same period. Accordingly, the RevPAR rose from US$ 71 to US$ 76 between the two periods, an annual increase of 6.9%.

It is worth noting that Abu Dhabi and Dubai, the two main tourist and business travel hubs of the country, are emphasizing investment in the development and diversification of their tourist markets in order to attract more visitors, as per Fitch Solutions. In addition to new theme parks, museums and exhibition centers to be built in the two Emirates, there will also be a wider variety of budget accommodations to attract more short-term travelers, many of whom use the cities as transit hubs for long-haul travel.

COMPARATIVE HOTEL OCCUPANCY RATES*



* First 10 Months 2019, four and five star hotels

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

In sum, the sector continued to report a positive performance over the past year, despite a slight set back in Dubai's four and five stars hotel performance. The government continues to support the sector in its diversification strategy at large.

1.2. EXTERNAL SECTOR

Continued strong external position despite a challenging global trade environment

UAE has continued its efforts over the year to introduce innovative policies and services that facilitate global trade, transforming itself into one of the world's foremost trading hubs despite a challenging global trade environment. UAE's ability to adapt to change, its responsiveness to the needs of businesses and investors, and the diversified profile of the Emirates' foreign sector have made it a model for the global trade map. Within this context, the trade balance surplus for the UAE is estimated to have increased by 4.1% to reach about US$ 84.8 billion (or AED 311.4 billion) in 2019 as per the Ministry of Economy.

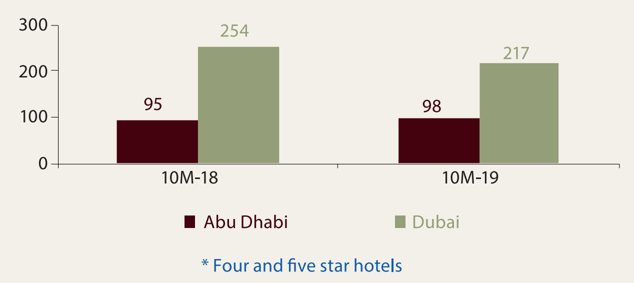
Going further into details, Abu Dhabi recorded a non-oil foreign trade volume of AED 154.4 billion (or US$ 42.0 billion) over the first nine months of 2019, a decrease of 8.8% year-on-year from AED 169.3 billion, according to Statistics Centre of Abu Dhabi (SCAD). The decrease was a result of a 12.7% decline in non-oil imports (to AED 75.4 billion), as well as a 14.8% decrease in non-oil exports (AED 41.4 billion), while re-exports grew by 9.0% over the same period. As such, Abu Dhabi's non-oil trade balance registered a shift from a deficit of AED 1.6 billion to a surplus of AED 5.3 billion between the two periods.

In parallel, the breakdown of non-oil imports of Abu Dhabi by commodity shows that the main imports over the first nine months of 2019 were industrial supplies (43.0% of total imports, mainly boilers, machinery and mechanical appliances, articles of iron and steel, copper and copper articles), followed by transport equipment, and parts (23.4%), capital goods (except transport equipment) (14.8%), consumer goods (11.9%), and foods and beverages (6.1%). The breakdown of non-oil exports and re-exports of Abu Dhabi by commodity shows that the main exports over the first nine months of the year were industrial supplies (41.6% of total exports), followed by transport equipment, and parts (21.3%), consumer goods (11.2%), capital goods (except transport equipment) (10.4%) and foods and beverages (7.9%).

On another hand, Dubai recorded a non-oil foreign trade volume of AED 676.3 billion (or US$ 184.1 billion) in the first half of 2019, an increase of 4.9% year-on-year, as per the Government of Dubai. The first-half figures, which represent a considerable growth of 87% from 2009, reflect the ability of the Dubai's trade sector to raise its strength and competitiveness. In fact, Dubai's exports registered a strong rise of 17.5% to reach AED 76.4 billion, while re-exports were up by 3.2% at AED 209.5 billion, and non-oil imports grew by 3.6% to reach AED 390.5 billion. As such, Dubai's non-oil trade deficit went down by 4.0% from AED 109.0 billion over the first half of 2018 to AED 104.6 billion over the first half of 2019.

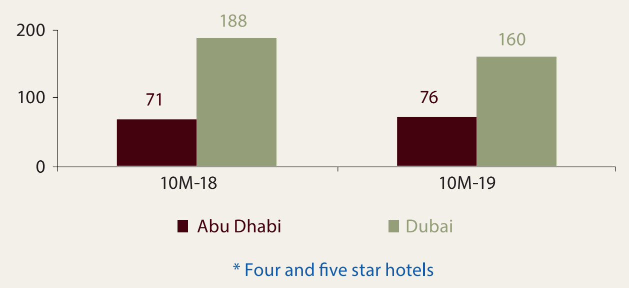
In parallel, the breakdown of non-oil direct imports of Dubai by commodity shows that the main imports over the first half of 2019 were pearls, precious stones and metals (35.2% of total non-oil direct imports), followed by machinery, sound recorders, TV and electrical equipment (16.9%), vehicles, aircraft and vessels (7.6%), mineral products (7.2%) and products of chemical and allied industries (5.9%). The breakdown of

AVERAGE HOTEL ROOM RATE IN US$*



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

HOTEL ROOM YIELD IN US$*



Sources: Ernst & Young, Bank Audi's Group Research Department non-oil direct exports and re-exports of Dubai by commodity shows that the main categories over the first half of 2019 were pearls, precious stones and metals (45.1% of total non-oil direct exports and re-exports), followed by machinery, sound recorders, TV and electrical equipment (11.9%), base metals and articles of base metals (10.7%), vehicles, aircraft and vessels (10.1%), and products of chemical and allied industries (3.7%).

Looking forward, the current account surplus is projected to average 7.1% of GDP in 2020 (from 9.0% of GDP in 2019), 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 mega-projects, yet mitigated by rising imports from higher consumption.

1.3. PUBLIC SECTOR

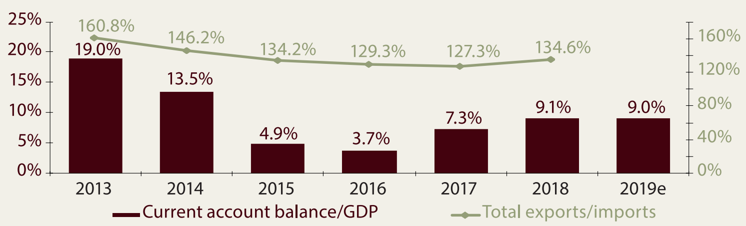
Public finances improving towards a fiscal surplus over the first half of 2019

UAE's fiscal situation continued to improve over the first half of 2019 owing to the introduction of new taxes, most notably the value-added tax in 2018. In fact, the government continued to target non-oil sources of revenues, benefitting the most, across the GCC, from the introduction of the VAT, given its larger consumer base and significant retail activity, thus supporting non-hydrocarbon revenue growth and fiscal surplus.

Going further into details, government revenues have registered an increase of 10.3% year-on-year, rising from AED 226.5 billion in the first half of 2018 to AED 249.9 billion (or US$ 68.0 billion) in the first half of 2019, as per the latest figures released by the Ministry of Finance, supported by the expansion of the list of excise taxable products and boost in Dubai's VAT from Expo 2020 spending. Within this context, tax revenues increased by 19.3% over the first half of 2019, registering AED 114.7 billion compared to AED 96.2 billion over the first half of 2018. As such, annualized general government revenues reached 33.5% of GDP over the period, up from 29.8% of GDP over the same period of the previous year.

On the spending front, public finances witnessed a modest room for further consolidation, since the country's consolidated fiscal position shows a diverging path between Abu Dhabi, where broad spending cuts were enacted, and Dubai, which has continued to increase spending (particularly capital spending) ahead of the World Expo 2020. Government expenditures registered a moderate increase of 5.5%, rising to AED 200.4 billion (or US$ 54.6 billion) over the first half of 2019, up from AED 190.0 billion over the same period of 2018. In details, compensation of employees increased by 33.8% in the first half of 2019 to reach AED 54.4 billion, while expenditures on social benefits went up by 15.5% to AED 37.8 billion in the first half of 2019. On another hand, government spending on non-financial assets, of which expenditures on fixed assets, inventories, valuables and non-produced assets, went down by 67.3% to reach AED 23.0 billion in the first half of 2019.

FOREIGN SECTOR INDICATORS



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

Accordingly, as government revenues are rising at a faster pace than government expenditures, the overall UAE government net lending/borrowing surplus registered a rise of 16.0% to AED 26.4 billion (US$ 7.2 billion) during the first half of 2019, up from a smaller surplus of AED 22.8 billion over the same period of 2018. However, while full-year 2019 revenue growth is expected to be modest with low oil prices over the second half of the year compounded by fee reductions, the loss may be mitigated by VAT revenue. Overall, the fiscal balance is estimated to return to a small deficit in 2019, as per the World Bank, but will gradually improve over the medium term.

In parallel, it is worth mentioning that the UAE Cabinet approved a zero-deficit federal budget of AED 61.4 billion for the year 2020, the largest budget allocated since the establishment of the UAE. The budget is distributed amongst various sectors related to Emirati citizens and their services as follows: 31% is allocated to social development, 14% is allocated to infrastructure and economic resources, 6.5% is allocated to social benefits, 33% is allocated to government affairs. The budget has been without deficit for the third consecutive year, thus reflecting the strength of the national economy and the country's abundant financial resources that can fund economic development projects.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Deflationary pressures along with interest rate cuts amid US Fed monetary easing

The year 2019 was marked by a decent growth in monetary aggregates in the UAE, deflationary pressures, expansions in the Central Bank's gross international reserves, and interest rate cuts in line with the US Federal Reserve monetary policy easing as the UAE dirham remained pegged to the US dollar.

Consumer prices went into a deflationary mode in 2019, mainly weighed down by weak domestic demand, a prolonged slump in housing costs in an oversupplied residential market, lower oil prices amid rising global growth concerns triggered by lingering US-China trade tensions, and as the impact of a 5% VAT introduced at the beginning of the year 2018 dropped out of the annual data. Consumer prices in the UAE contracted by 1.9% year-on-year in October 2019, with the Consumer Price Index dropping from 110.40 in October 2018 to 108.35, according to the UAE Federal Competitiveness and Statistics Authority.

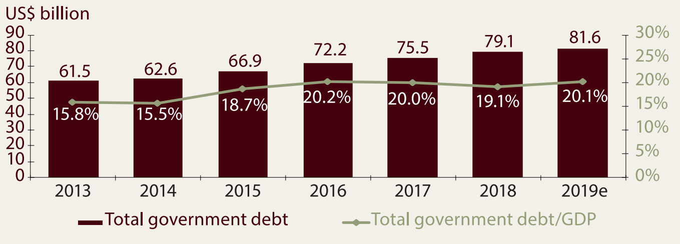
The division of the Consumer Price Index by sector shows that the textiles, clothing and footwear sector registered the largest yearly price contraction of 5.81%, followed by the transportation sector (-5.29%), the housing, water, electricity & gas sector (-4.28%), noting that it accounts for the largest weighting in the Consumer Price Index of 34.1%, the food and beverages sector (-1.78%), the restaurants and hotels sector (-0.59%), the furniture and household goods sector (-0.24%) and the communications sector (-0.19%). Contributions to inflation have been positive from the recreation and culture sector (+23.17%), the miscellaneous goods and services sector (+1.51%), the education sector (+0.69%), the tobacco sector (+0.60%) and the medical care sector (+0.02%). Within this context, it is worth mentioning that the IMF

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2017	2018	H1-18	H1-19	H1/H1
Public revenues	109.4	130.1	61.7	68.0	10.3%
Public revenues/GDP	29.0%	31.4%	29.8%	33.5%	3.8%
Public expenditures	97.9	105.7	51.7	54.6	5.5%
Public expenditures/GDP	25.9%	25.5%	25.0%	26.9%	1.9%
Fiscal balance	-0.8	16.1	6.2	7.2	16.0%
Fiscal balance/GDP	-0.2%	3.9%	3.0%	3.5%	0.6%

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

PUBLIC DEBT AND INDEBTEDNESS RATIO



Sources: IMF, Bank Audi's Group Research Department expects consumer prices to contract by 1.5% on average in 2019 after growing by 3.1% on average in 2018.

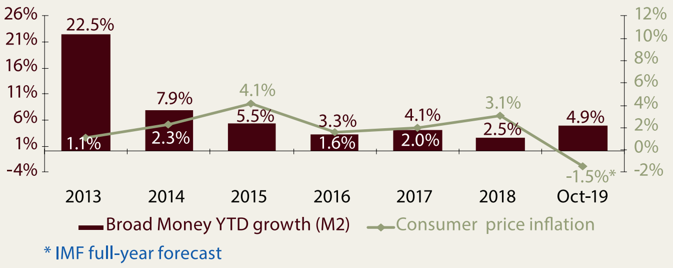
Monetary aggregates in the UAE saw decent expansions during the first ten months of 2019. The narrowest measure of money supply (M1), which consists of currency in circulation outside banks plus monetary deposits in local currency with banks, expanded by 4.1% during the first ten months of 2019, moving from US$ 132.3 billion at end-2018 to US$ 137.7 billion at end-October 2019. This compared to a contraction of 3.1% during the corresponding period of 2018. The broader money supply (M2), which consists of Money Supply (M1) plus quasi-monetary deposits, widened by 4.9%, moving up from US$ 356.3 billion at end-2018 to US$ 373.8 billion at end-October 2019, within the context of a 14.0% surge in net international reserves. This compared to a 0.8% contraction in (M2) over the first ten months of 2018. On the other hand, the money supply in its broadest sense (M3), which consists of Money Supply (M2) plus government deposits, expanded by 4.9% during the first ten months of 2019, moving from US$ 436.3 billion at end-2018 to US$ 457.7 billion at end-October 2019 given a 4.8% rise in government deposits to reach US$ 83.9 billion at end-October 2019. This followed a 5.3% expansion in (M3) during the same period of 2018.

EVOLUTION OF MONETARY CONDITIONS

Flows in US$ million	2017	2018	10M-19
Net international reserves	**18,916**	**24,456**	**15,967**
Central Bank (net)	**9,866**	**3,626**	**3,169**
Gross international reserves	9,980	4,130	2,320
Foreign Liabilities	114	504	-849
Banks (net)	**9,050**	**20,830**	**12,797**
Foreign Assets	8,740	27,409	29,496
Foreign Liabilities	-310	6,578	16,699
Net Domestic Assets	**-5,114**	**-15,663**	**1,532**
Claims on private sector	2,093	12,006	4,484
Net claims on public sector	-1,119	-19,683	5,942
Claims on financial institutions	435	184	-1,278
Capital & Reserves	-8,349	-5,176	-7,282
Other Items (net)	1,825	-2,993	-335
Broad Money (M2)	**13,802**	**8,793**	**17,499**
Money Supply (M1)	4,986	-1,815	5,448
Quasi-Money	8,816	10,608	12,051

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

EXCHANGE MARKET INDICATORS

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

Given the UAE dirham/US dollar peg at AED 3.6725, the Central Bank of the UAE tracked three interest rate cuts by the US Federal Reserve over the year 2019, slashing the interest rates applied to the issuance of its Certificates of Deposits and the repo rate for borrowing short-term liquidity from the UAE Central Bank against Certificates of Deposit three times since July 2019 by a cumulative 75 bps.

Last but not least, the Central Bank's gross international reserves grew by 2.3% over the first ten months of 2019, moving from US$ 99.5 billion at end-December 2018 to US$ 101.8 billion at end-October 2019, mainly driven by a 19.1% rise in "current account balances & deposits with banks abroad", with the latter moving from US$ 80.1 billion at end-2018 to US$ 95.3 billion at end-October 2019. Accordingly, the Central Bank's gross international reserves coverage ratio to money supply (M1) and Dirham deposits reached 34.9% at end-October 2019, down from 36.4% at end-December 2018.

Looking forward, key policy rates in the UAE are expected to remain stable in 2020, after the US Federal Reserve kept interest rates on hold in December 2019 and signaled no change in borrowing costs anytime soon, citing solid job gains, historically low unemployment rate and rising economic activity at a moderate rate in the US. In parallel, consumer prices variation is expected to turn positive in the UAE in 2020, partly due to the low base effect from the year 2019 and as the Expo 2020 would help stabilizing downward pressures on consumer prices by providing a one-off boost to demand.

1.4.2. Banking Activity

Continued activity growth in a sound financial sector

The UAE banking sector witnessed another healthy activity growth year in 2019, on the back of continued economic expansion in the country (albeit at a slightly weaker pace), Expo 2020-related momentum and large infrastructure programs favoring progression in banking aggregates. Measured by the total assets of banks operating in the UAE, banking activity grew by 6.0% in the first ten months of 2019 (5.5% increase in the same period of 2018) to reach US$ 827.9 billion at end-October 2019.

Banking sector deposits, a traditional driver of sector activity accounting for 60% of total balance sheets, rose by 4% in this year's first ten months to reach the equivalent of US$ 495.5 billion at end-October 2019. A look at details shows that the non-resident side saw a 3.6% contraction in deposits in the covered period of this year (mostly attributable to the corporate and government and non-commercial entities segments) while the entire growth in total deposits at banks in the UAE was accounted for by the resident sector.

The resident sector deposits progressed by 4.7% in the first ten months of 2019 and account for close to 89% of the total stock of deposits parked at UAE banks. All categories among the resident sector witnessed a rise in deposits. The most important of the latter in volume terms proved to be the private sector (mostly retail deposits), followed by the government-related entities (government ownership of more than 50%) and the government sector, leaving a small increase to the non-banking financial institutions over the covered period. From a currency angle, the deposit growth is attributed to the local currency side, as foreign currency deposits contracted this year according to the latest statistics excluding interbank deposits.

While UAE banks continue to exhibit healthy growth and are funded mostly by customer deposits and to a certain extent shareholders' equity as they have moderate reliance on confidence-sensitive market funding, deposits show a high depositor concentration (especially GREs and corporates) coupled with term structure challenges given the short tenure in general of deposits parked at UAE banks. At the same time, it is worth noting that the public sector, while conveying a concentration label to those deposits with a 29% share at end-October 2019, actually do also provide banks with a stable source of funding.

Part of banks' liquidity is channeled towards lending to the economy at large. As a matter of fact, gross credit continued to progress this year with a 3.2% increase in the first ten months of 2019 to reach the equivalent of US$ 465.2 billion at end-October. The increase in banks' lending volumes was attributed to the extent of 12% to foreign credit, leaving the bulk to domestic credit. Among the latter, the largest beneficiary was the government sector that accounted for 55% of total gross credit growth, followed by the private sector (22% of the total) and the GREs (17% of the total).

It appears that credit demand from the public sector (government and GREs) is at least partly tied to the government related infrastructure projects and investments in the oil and gas sectors. At the same time, new lending volumes earmarked to the private sector declined by 75% relative to the corresponding period of 2018, likely reflecting lower business volumes across the Emirates. The latest official statistics on the breakdown of credit to residents by sector up until end-September 2019 shows that the top three beneficiaries were the government sector, the real estate sector and the financial institutions sector.

It is worth noting that on the lending front as well, there seems to be some high single-name and sector concentration. S&P noted in its latest report on UAE banks that for most rated banks in the UAE, the top 20 corporate borrowers represent more than 25% of their corporate lending exposure.

Another chunk of banks' liquidity is invested in debt securities, equities, held to maturity securities (alongside other investments). Total investment by banks actually rose by 23.0% in the covered period of 2019 to reach the equivalent of US$ 111.4 billion as banks seem to have made stepped up such investments this year.

Within the context of deposit growth outpacing credit growth, the lending to stable resources ratio dropped from 82.3% at end-December 2018 to a new low of 80.5% at end-October 2019. This ratio actually represents the ratio of total advances (net lending + net financial guarantees and standby LC + interbank placements of more than three months) to the sum of net free capital funds and total other stable resources, thus shedding light on relatively improved liquidity of banks in the UAE.

Furthermore, the ELAR ratio (eligible liquid assets ratio), measured as the ratio of total banks' eligible liquid assets (consisting of cash at hand, liquid assets at the Central Bank and eligible bonds/Sukuks as prescribed by regulation 33/2015 & Basel Principles but excluding interbank positions) to total liabilities (balance sheet total assets minus sum of capital & reserves and all provisions and interest in suspense except staff benefit provisions and refinancing and subordinated borrowing/deposits) stood at a decent 17.4% at end-October 2019, almost unchanged when compared to end-2018.

Along the same lines, asset quality at UAE banks remains satisfactory on the overall, with a sector-wide NPL ratio of 6.4% at end-September 2019 as per the latest Central Bank disclosures. While this compares to a slightly lower 5.6% at end-December 2018, it remains slightly below emerging market and global averages in the 7% range. Moreover, NPLs are adequately provisioned for, with the NPLs net of provisions to capital ratio at 9.1%.

Should pressures on their capital base arise, UAE banks remain adequately buffered. Indeed, their capital adequacy ratio stood at 17.7% at end-September 2019 as per the latest official data, the bulk of which consists of common equity Tier 1 capital with a ratio of 14.7%. This reflects the banking sector's resilient internal capital generation.

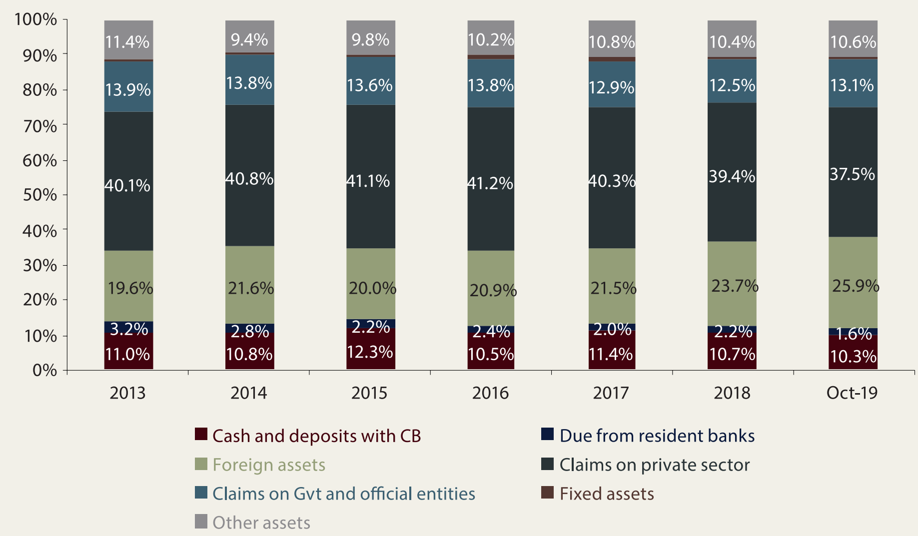
EVOLUTION OF BANKING AGGREGATES

US$ billion	2015	2016	2017	2018	Oct-19
Total assets	674.8	711.7	733.5	781.1	827.9
% YTD growth in assets	7.5%	5.5%	3.1%	6.5%	6.0%
Total deposits	400.7	425.6	443.1	478.1	495.5
% YTD growth in deposits	3.5%	6.2%	4.1%	7.9%	3.6%
Total bank loans to the private sector	277.3	292.9	295.8	307.7	310.9
% YTD growth in bank loans to the private sector	8.5%	5.6%	1.0%	4.0%	1.0%

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

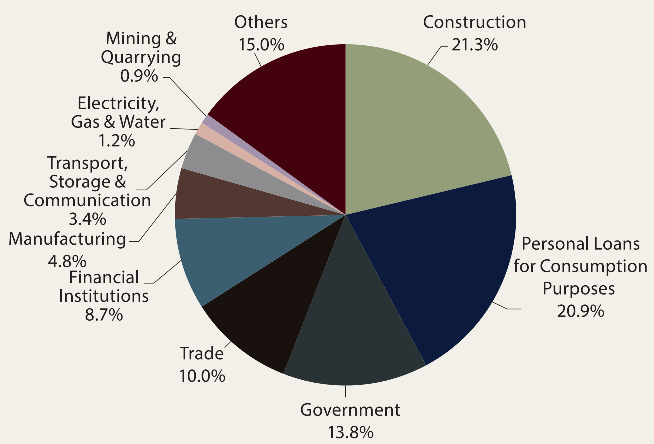
Finally, UAE banks report decent profitability metrics owing to low funding costs and high efficiency (cost-to-income ratio of 32.7% at end-Q3 2019), with a return on assets ratio of 1.7% and a return on equity ratio of 12.3% at end-Q3 2019. It is yet worth noting that lower interest rates are likely to translate into some profitability pressures going forward, with re-pricing of loan books more than offsetting lower cost of funding.

BANK ASSET COMPOSITION



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

BANK LOAN BREAKDOWN BY ECONOMIC ACTIVITY *



*September 2019 figures for bank credit to residents

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

1.4.3. Equity and Bond Markets

Upward price movements across UAE capital markets in 2019

The year 2019 was a favorable year for UAE's capital markets. The equity markets posted decent price gains amid attractive market valuations, favorable financial results and bank merger deals. Also, the UAE fixed income markets saw upward price movements across the board, mainly tracking US Treasuries move following three rate cuts by the US Federal Reserve, and as the UAE maintained its safe haven image amid lingering regional geopolitical tensions.

The UAE equity markets bounced back during the first eleven months of 2019, mainly supported by price gains in the banking sector. Banks in the UAE are undervalued relative to regional peers as they navigate a soft property market and challenging global economic conditions. Based on price-to-earnings ratios, UAE banks are valued at 9.5x their expected 2020 earnings, which is much lower than the 13.6x that Saudi banks are valued at and 15.3x valuations of Kuwaiti banks, according to EFG Hermes.

In details, the Dubai Financial Market saw a price rebound during the first eleven months of the year 2019 following sharp price falls in 2018, mainly supported by attractive market-pricing ratios and favorable corporate earnings. In fact, listed stocks on the Dubai Financial Market registered a 15% year-on-year growth in net profits during the first nine months of 2019. Within this context, the DFM General Index rose by 5.9% during the first eleven months of 2019, moving from 2,529.75 at end-2018 to 2,678.7 at end-November 2019, and pursued its downward trajectory during the month of December to reach 2,782.45 on December 23, 2019.

The breakdown of the DFM General Index by sector during the first eleven months of 2019 shows that the banking sector registered the highest index rise of 18.2% (noting that DFM banks have a weight of 47.5% in the DFM general index), followed by the insurance sector (+17.3%), the telecommunications sector (+9.3%), the industrial sector (+9.1%), the transportation sector (+5.4%), and the financial and investment services sector (+4.5%), while the services sector witnessed the highest index drop of 11.0%, followed by the consumer staples and discretionary sector (-10.5%) and the real estate sector (-8.4%).

The Dubai Financial Market was marked by a reduced activity over the first eleven months of 2019, as shown by a 10.5% yearly decline in the total turnover to reach US$ 13.5 billion. The total number of traded shares reached 37.4 billion shares over the first eleven months of 2019 against 40.2 billion shares during the same period of 2018, down by 7.1%, and the total number of trades was quoted at 615,808 during the first eleven months of 2019 versus 600,541 during the same period of 2018. On the back of price gains, the market capitalization in the Dubai Financial Market rose from US$ 93.4 billion at end-2018 to US$ 99.2 billion at end-November 2019, up by 6.3%. Within this context, the turnover ratio, measured by the annualized trading value to market capitalization, fell from 16.9% over the first eleven months of 2018 to 14.8% over the corresponding period of 2019.

Also, the Abu Dhabi Securities Exchange continued to trace an upward trajectory during the first eleven months of 2019, with the Abu Dhabi general index moving from 4,915.07 at end-2018 to 5,030.75 at end-November 2019, up by 2.4%, and extended its rise until December to reach 5,111.78 on December 23, 2019. Prices gains were mainly supported by favorable financial results and merger deals in the banking sector. The breakdown of the Abu Dhabi general index by sector during the first eleven months of 2019 shows that the highest increase was in the consumer staples sector (+85.2%), followed by the real estate sector with +30.1% and the banking sector with +4.8% (noting that ADX banks have a weight of 63.9% in the Abu Dhabi general index). In contrast, the investment and financial services sector posted the largest price drop with -50.9%, followed by the industrial sector (-21.5%), the insurance sector (-14.5%), the energy sector (-5.7%), the telecommunications sector (-4.0%), and the services sector (-1.6%).

The total trading value rose by 26.0% during the first eleven months of 2019 to reach US$ 10.8 billion. The total number of traded shares reached 10.7 billion shares over the first eleven months of 2019 against 11.6 billion shares during the same period of 2018 (down by 8.1%), and the total number of trades was quoted at 354,865 during the first eleven months of 2019 versus 240,089 during the same period of

2018. The number of listed companies declined from 71 companies at end-2018 to 70 companies at end-November 2019. The market capitalization rose from US$ 141.4 billion at end-2018 to US$ 146.2 billion at end-November 2019, up by 3.4%, mainly supported by price gains and additional listings. Within this context, the turnover ratio, measured by the annualized trading value to market capitalization, reached 8.0% during the first eleven months of 2019 as compared to 6.8% over the corresponding period of 2018.

In parallel, the UAE fixed income markets registered price gains across the board during the first eleven months of 2019, mainly tracking US Treasuries move following three rate cuts by the US Federal Reserve amid lingering US-China trade war and rising concerns over its impact on the global economic growth.

In the Dubai credit space, sovereigns maturing in 2023, 2029 and 2043 registered price gains of 4.05 pts, 10.15 pts and 14.43 pts respectively during the first eleven months of 2019. Prices of Emaar'26 increased by 8.70 pts. DP World'23 and '28 closed up by 4.97 pts and 11.09 pts respectively. Majid Al Futtaim'24 and Perpetual (offering a coupon of 5.50%) saw price improvements of 7.02 pts and 7.41 pts respectively. Amongst financials, Dubai Islamic Bank'23 was up by 4.94 pts. Prices of ENBD papers maturing in 2021 and 2022 advanced by 2.16 pts and 1.63 pt respectively. As to the cost of insuring debt, Dubai's five-year CDS spreads reached 110 bps at end-November 2019, down from 129 bps at end-2018.

In the Abu Dhabi credit space, sovereigns maturing in 2021, 2027 and 2047 posted price rises of 2.40 pts, 8.84 pts and 20.12 pts respectively over the first eleven months of 2019. Taqa'24, '26 and '30 were up by 6.35 pts, 8.94 pts and 13.10 pts respectively. Mubadala papers maturing in 2022, 2024, 2026, 2029 and 2041 registered price gains ranging between 1.68 pt and 19.55 pts. Prices of ADNOC'29 and '47 expanded by 11.62 pts and 16.78 pts respectively. Etisalat'24 and '26 closed up by 6.37 pts and 6.80 pts respectively. Dolphin'21 was up by 1.69 pt. Amongst financials, ADIB Perpetual (offering a coupon of 7.125%) closed up by 3.33 pts. Prices of Al Hilal Bank'23 rose by 5.45 pts. First Abu Dhabi bank Perpetual (offering a coupon of 5.25%) were up by 0.65 pt. ADCB'23 posted price gains of 5.72 pts. Noor Bank Perpetual (offering a coupon of 6.25%) saw price increases of 2.30 pts. As to the cost of insuring debt, Abu Dhabi's five-year CDS spreads contracted by 26 bps over the first eleven months of 2019 to reach 41 basis points at end-November, remaining one of the lowest in the MENA region.

The UAE fixed income markets saw several new bond issues over the year 2019 totalling circa US$ 26 billion, almost doubling when compared to the previous year, as borrowers sought to take advantage of a global monetary easing environment and low funding costs to finance their needs after the US Federal Reserve cut its benchmark interest rate three times during the second half of the year. As to sovereigns, Abu Dhabi launched in September 2019 a US$ 10 billion three-tranche bond, which is its first international offering in two years. The first tranche consists of US$ 3 billion notes maturing in 2024 and issued at 65 bps over US Treasuries. The second tranche consists of US$ 3 billion notes maturing in 2029 and issued at 85 bps over US Treasuries. The third tranche consists of US$ 4 billion notes maturing in 2049 issued at 110 bps over US Treasuries. Also, Mubadala issued in October 2019 a five-year US$ 1 billion bond at a coupon rate of 2.50%.

In the Dubai credit space, Majid Al Futtaim issued a 10-year US$ 600 million bond at a coupon of 4.638% in May 2019 and a 10-year US$ 600 million bond at a coupon of 3.933% in October 2019. DP World raised in July 2019 US$ 1 billion through the sale of a 10-year bond at a coupon rate of 3.875%. Also, DP World raised US$ 1 billion in September 2019 through the sale of a US$ 500 million bond maturing in 2030 at a coupon of 3.75% and a US$ 500 million senior unsecured bond maturing in 2049 at a coupon of 4.70%.

As to credit ratings, Fitch affirmed in October 2019 Abu Dhabi's long-term foreign currency Issuer Default Rating at "AA" with a "stable" outlook. The "AA" rating reflects, according to Fitch, Abu Dhabi's strong fiscal and external metrics and high GDP per capita, balanced by high dependence on hydrocarbons, an underdeveloped economic policy framework and weak governance indicators relative to "AA" peers.

Also, Moody's affirmed in March 2019 the long-term issuer and senior unsecured ratings of the Government of Abu Dhabi at "Aa2". The outlook remains "stable". Moody's has also affirmed the short-term issuer rating at "P-1", and the long-term and short-term MTN program ratings at "(P)Aa2" and "(P)P-1", respectively. The affirmation of Abu Dhabi's "Aa2" ratings is supported by Moody's expectations that the sovereign's fiscal strength would remain very high, with very low government debt and vast sovereign assets. The "stable" outlook indicates, according to Moody's, that the risks are broadly balanced, supported by current oil prices and upside potential from continuing diversification efforts, and constrained by lingering government-related entity contingent liabilities and geopolitical tensions.

Looking forward, the UAE debt markets may continue to benefit from investor demand for high quality debt amid lingering US-China trade tensions and global growth concerns. As to plans for issues, the UAE's Ministry of Finance announced plans to sell Federal bonds for the first time in 2020. The bonds would be for the achievement of certain goals for the UAE, and the proceeds would not be used to fund the budget except in certain capital projects, according to UAE officials. It is worth recalling that the UAE has enacted in October 2018 a law permitting the Federal Government to issue sovereign debt, which would enable individual Emirates to benefit from higher issuer ratings than they could achieve on their own.

ABU DHABI STOCK MARKET INDICATORS

	2015	2016	2017	2018	Nov-19
Market capitalization (in US$ billion)	119.0	129.6	132.2	141.4	146.2
Trading value (in US$ billion)	15.4	12.3	11.9	9.4	10.8
Turnover ratio	13.0%	9.5%	9.0%	6.6%	8.0%
Trading volume (in millions)	25,263	24,683	24,224	12,382	10,658
Number of transactions	436,363	362,141	332,905	266,298	354,865
General share price index	4,307	4,546	4,398	4,915	5,031
% Change in share price index	-4.9%	5.6%	-3.3%	11.7%	2.4%
5-Year CDS spreads (bps)	93	61	63	67	41

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

DUBAI STOCK MARKET INDICATORS

	2015	2016	2017	2018	Nov-19
Market capitalization (in US$ billion)	83.9	91.9	107.2	93.4	99.2
Trading value (in US$ billion)	41.2	36.3	31.1	16.2	13.5
Turnover ratio	49.1%	39.4%	29.0%	17.3%	14.8%
Trading volume (in millions)	98,231	106,387	80,581	44,842	37,389
Number of transactions	1,570,369	1,305,208	1,067,623	653,158	615,808
General share price index	3,151	3,531	3,370	2,530	2,679
% Change in share price index	-16.5%	12.1%	-4.6%	-24.9%	5.9%
5-Year CDS spreads (bps)	234	150	128	129	110

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

2. CONCLUDING REMARKS

Looking forward, economic policy at both federal and emirate level will continue to aim at reducing the UAE's dependence on the hydrocarbons sector, including attracting foreign and other private sector financing into the industry in order to release government funds for diversification efforts. However, the government's economic and fiscal policies will continue to be partly guided by global oil price movements, as Abu Dhabi, which funds a major portion of federal spending, is still heavily dependent on oil revenue.

The Emirates' economy is relatively diversified but still depends on regional oil trends, and volatility in oil prices will keep performance weak in some sectors, especially real estate. OPEC-mandated oil production cuts will curb oil sector activity and export growth in the first half of 2020. Real estate and construction have been facing headwinds in the past two years, which is expected to continue into 2020 as oil prices remain low, affecting investment flows into real estate from the region.

With respect to the real economy, the growth in private consumption would remain modest, as high-spending Western residents expatriates are increasingly leaving the UAE, mostly being replaced by lower-spending expatriates. However, Dubai's hosting of Expo 2020 would attract temporary visitors and boost services exports and overall economic growth. Sustained government expenditure growth would supplement this, boosting private consumption among the small national population. The government would increase investments (traditionally one of the major growth drivers) in an attempt to offset the effects of slowing private consumption and sluggish economic activities. Considering these factors, real GDP growth is expected to accelerate modestly to 2.5% in 2020 as per the IMF, against 1.6% in 2019.

At the monetary level, the modest deflation experienced in 2019 should reverse in 2020. As such, inflation should edge up to 1.2% in 2020. Private consumption, although still modest, would rise with the help of Expo 2020 and lower interest rates, driving inflation up relatively. In the years after, as private consumption picks up more relatively, owing to higher economic growth and oil prices, inflation will edge upwards to approach the 2% average over the next five years. With respect to the exchange rate, the UAE dirham peg to the US dollar is expected to remain in place looking ahead. Confidence in the durability of the peg is supported by the government's commitment to it and the sizeable pool of foreign assets available to protect it if required, despite volatility in global oil prices.

At the external level, goods exports revenue will move largely in tandem with global oil prices and export volumes and partly in line with re-exports from Dubai. Oil export revenue would grow only moderately in 2020, owing to lower global oil prices, despite increases in oil export volumes. Goods imports would increase over the next few years, in tandem with the rise in private and government consumption. The current account balance is likely to register a surplus of 7.1% of GDP in 2020 and an average of 5.5% over the next five years.

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 history of domestic political stability coupled with strong international relations, the UAE's high GDP per capita, the low unemployment rate and the full-backing from the government of Abu Dhabi and its strong balance sheet. Among challenges, we mention the reliance of consolidated revenues on hydrocarbons, the regional political tensions, the lack of data and policy transparency and the continued global slowdown.

In its just released Article IV Consultation Mission Report, the IMF commends that sustaining robust non-oil growth after Expo 2020 remains a key priority, made all the more pressing over the longer term by the likelihood that global oil demand will slow in the face of technological advances as well as policy responses to climate change. Fostering growth of the non-oil private sector, including SMEs, and developing transparent, rules-based fiscal frameworks would support long term sustainability at large.

DISCLAIMER

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