United Arab Emirates

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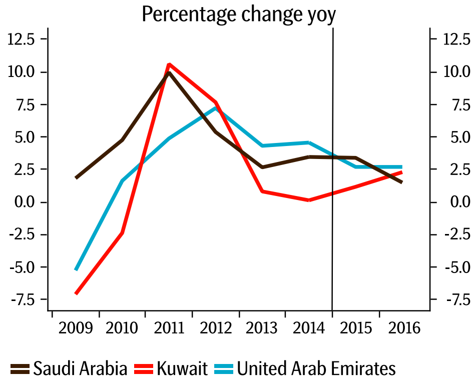
Lower oil revenues are hampering economic growth and are eroding fiscal and external balances thus making the economy more vulnerable. As a response, the authorities are undertaking a significant fiscal tightening which should bring the government finances in balance. Geopolitical instability in the region has risen but political risk in the UAE remains relatively low.

Country Risk Analysis

Economic growth slowing on oil prices: Despite being one of the most diversified economies in the Gulf region, tumbling oil prices are leaving a marked imprint in economic activity and have led to deteriorating fiscal and external balances in the past year. Forecasts for real GDP growth have gradually been revised downwards in tandem with the past years' falling oil prices having reduced exports. While the non-oil sector of the economy has been expanding at a relatively healthy pace, and oil production has remained close to maximum, lower prices are expected to have reduced overall GDP growth in 2015 to less than 3%, down from 4.6% in 2014.

Economy supported by solid investment activity. Government spending is expected to pick up in 2016, producing slightly higher growth. Over the medium term, activity should be increasingly supported by the non-oil sector. More specifically, government sponsored mega investments and private investments related to the World Expo in 2020 are expected to be key growth drivers. Such investments and other private investments, attracted by the UAE's favorable business climate, should in turn contribute to rising revenues from tourism.

Real GDP
Percentage change yoy

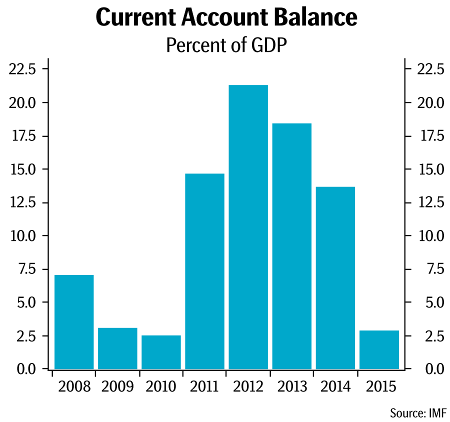


Source: Oxford Economics

Inflation is low but relatively volatile. With the long-time fixed exchange rate, the central bank has weak control over inflation. Consequently, while it remains low, it has a history of being volatile. At the end of 2015 it fell to about 3.5% reflecting a cooling of activity. A downturn in Dubai's residential property market, with prices falling for the first time in many years, may have further contributed.

More diversified economy: The UAE economy is more diversified than most regional peers. Growth of the non-oil sector stands for 60-70% of GDP. Similarly, the share of non-oil goods in exports has risen and is now the highest among all oil-exporters in the region. Still, even the non-oil sectors depend on demand from oil producing neighboring economies, for example through Dubai's focus on logistics, trade and transport. Consequently, and similarly to past oil price downturns, the economy remains vulnerable to a longer period of low oil prices.

External balances turning weaker from a very strong position: Lower oil prices have reduced the surplus on the current account quite sharply. While we assume it will remain comfortably above 5% of GDP in the next few years, the IMF (see chart) and most other observers are more pessimistic. Having averaged roughly 10% of GDP during the past decade, the current account surpluses have contributed to building extensive reserve buffers. Foreign direct investment has also remained steady. Official foreign exchange reserves have roughly doubled since 2012 to about USD 78 bn. at the end of 2015.



Budget swings into negative territory: The country's increasing diversification also means it is less reliant on oil revenues than other economies in the region. Oil flows now amount to less than half of total revenues according to the authorities. It also has a lower fiscal breakeven price than many other major oil producers. According to the IMF, only Kuwait and Qatar has lower fiscal breakeven prices than UAE's estimated USD 73 in 2015. Nevertheless, similar to the external balances, consolidated government finances have deteriorated in the past year, more than expected a year ago, shifting from a significant surplus in 2014 to an expected -3% of GDP in 2015, according to the IMF.

Consolidation efforts have been fairly extensive. As a response to falling oil prices, UAE was the first state in the region to start a significant fiscal consolidation. Measures in 2015 included a complete removal of transport fuel subsidies, increases in utility tariffs and cuts in transfers to government related entities. This is expected to shift the budget back to close to balance in 2016.

Uncertainty about data, including on public finances. We would note that differences in the strength of public finances are significant among the emirates. We look at public finances on a consolidated level and we also make the assumption that Abu Dhabi stands behind the federal system. We would also note that forecasts regarding the budget deficit come with a large standard deviation between analysts, depending partly on the lack of data transparency. We use IMF data and forecasts which are slightly more optimistic than current consensus numbers.

Huge external assets: Mitigating the risks stemming from continued low oil prices is the UAE's significant buffers in the form of sovereign wealth funds.

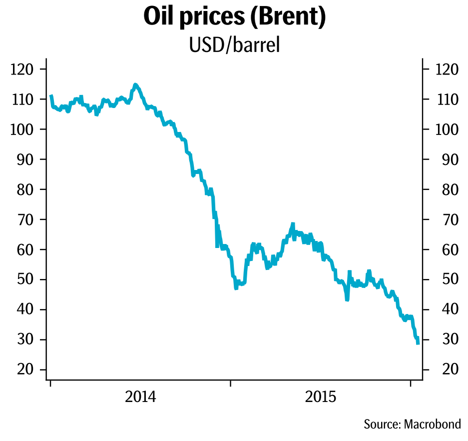
Data on the funds are not publicly available and estimates of their financial assets differ. Abu Dhabi Investment Authority (ADIA), chaired by the UAE's president, is by far the largest fund with estimates from Fitch putting its assets at USD 481 bn at end-2014. This is equivalent to more than five years' of government spending. Consequently, even with oil at current low levels the government would be able to finance fiscal deficits for several years.

Government debt is manageable and declining. The consolidated government gross debt remains manageable at about 15% of GDP. Most of it refers to the government of Dubai. Adding contingent fiscal liabilities from debt incurred by government related entities (GRE) worsens the picture. In the case of Dubai, where the debt debacle involving Dubai World led to an uptick in country risk in 2009-10, government debt has edged down in the past couple of years reaching about 30% of Dubai's GDP in 2015. Following early repayments by several GREs and an important debt rescheduling by Dubai World in early 2015 overall debt has also declined.

Bank sector posing little risk: The IMF gives the banking sector a clean sheet in its 2015 review, indicating that so far lower oil prices appears to have had limited effects on banks. However liquidity in the sector is declining (from high levels) and credit and deposit growth has slowed.

Political risk is low: Ever since its creation, the UAE has enjoyed a high degree of political stability. Political relations between the individual emirates are reported to be constructive although transparency in this area is very limited. The UAE maintains close relations to the major global powers and most of its neighbors in the region. Regional instability has risen since our last review. Some observers note that the UAE's increased involvement in the regional crises -most lately by participating in the Saudi-led campaign in Yemen - has increased the risk that it might be a target for terrorist attacks.

Outlook mainly threatened by low oil prices. The main risk to our base scenario comes from oil prices staying low longer than expected. Lower export revenues from oil sales would be the main spillover channel depressing economic growth and pressuring fiscal balances. A domestically related risk is that Dubai's mega projects, if mismanaged, could negatively affect the financials of the emirates' GREs, banks and ultimately the government, as noted by the IMF.



On the upside, there is the possibility that the lifting of the sanctions against Iran could boost the demand for UAE trade and financial services more than expected thereby lifting economic activity.

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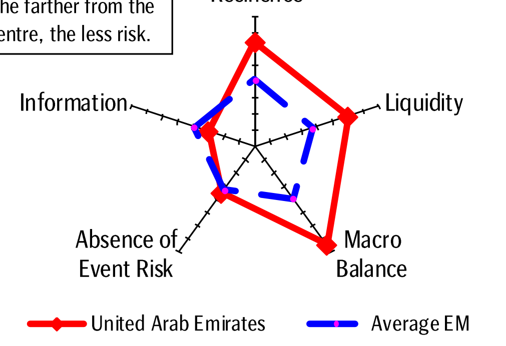
Key ratios	2016
Population (million)	9.4
GDP per capita (USD)	44 426
Real GDP growth (%)	2.7
CPI inflation (%)	2.5
Current account (% of GDP)	6.5
Reserves (months of imports)	11
Budget balance (% of GDP)	0.2
Government debt (% of GDP)	15

Chart Key:
The farther from the centre, the less risk.



External Ratings
Moody's: Aa2 / Stable
S&P
Abu Dhabi: AA / Stable
Ras Al Khaimah: A / Stable
Sharjah: A / Stable
Fitch
Abu Dhabi: AA / Stable
Ras Al Khaimah: A / Stable

Peers:
Botswana
China
Oman

Graph: UAE's risk profile is stronger than the emerging-market average except for event risk and information, due to Dubai's boom-bust cycle and lack of economic and political transparency. The liquidity score includes 50% of estimated foreign assets of Abu Dhabi's sovereign wealth fund.

United Arab Emirates: Economic Indicators

Macroeconomic	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
GDP real (chg)	5.2%	6.9%	4.3%	4.6%	2.7%	2.7%	3.1%	3.5%
GDP (USD bn)	348.5	373.4	387.2	399.5	417.5	440.3	461.9	484.9
GDP/capita (USD)	41 029	43 120	43 870	44 426	45 597	47 394	49 013	50 744
Investments/GDP	18%	19%	19%	19%	19%	19%	18%	18%
Trade/GDP	148%	154%	157%	163%	171%	171%	170%	173%
Oil production, bpd ('000)	2679	2804	2820	2820	2851	2891	2937	2984
Money & Prices								
CPI inflation	0.9%	0.7%	1.1%	2.3%	4.3%	2.5%	3.0%	4.0%
Money, M2 (chg)	0%	0%	0%	0%	0%	0%	0%	0%
Interest rates	1%	1%	1%	1%	1%	2%	3%	3%
Exchange Rate (USD)	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances								
Budget balance/GDP	-1.9%	10.9%	10.4%	5.0%	-2.9%	0.2%	1.5%	3.4%
Govt debt/GDP	18%	22%	16%	14%	16%	15%	14%	13%
Balance of Payments (USD bn)								
Current account	50.9	79.6	71.4	54.6	24.0	33.4	32.5	28.3
(% of GDP)	14.6	21.3	18.4	13.7	5.7	6.5	5.9	5.3
Exports of goods	271.9	318.0	332.2	359.4	384.4	406.4	425.0	453.1
Imports of goods	245.4	258.1	274.8	291.5	330.7	345.6	360.1	385.1
Other current acct flows	24.5	19.7	13.9	-13.3	-29.8	-27.4	-32.4	-39.7
Net FDI	5.5	1.4	1.7	3.9	4.6	4.9	5.2	5.4
Loan repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net other capital flows	-56.4	-81.0	-73.0	-58.5	-28.6	-38.3	-37.6	-33.7
Chg in intl reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External Debt & Liquidity (USD bn)								
Reserves	36.1	45.8	67.0	77.2	78.0	84.0	90.0	100.0
Gross external debt (% of GDP)	40%	38%	37%	38%	38%	37%	37%	36%
Gross External Debt	138.2	142.1	145.0	150.8	156.8	163.1	169.6	176.4
o/w short term debt	10.3	10.0	13.3	10.0	10.4	10.8	11.3	11.7

Type of government:

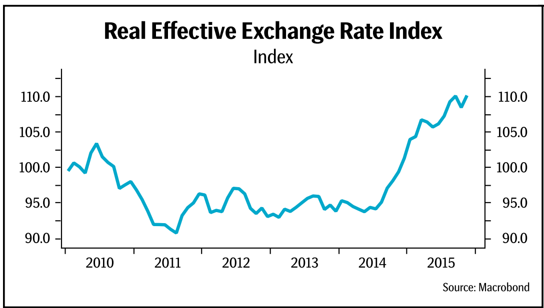
Next elections — Federation, no political parties

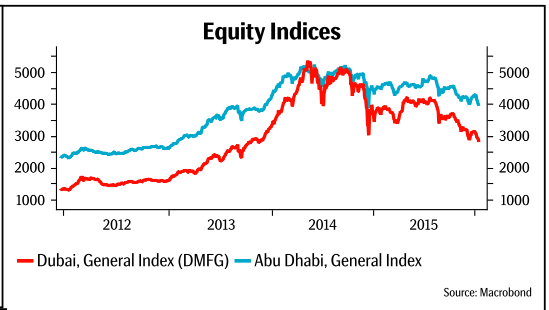
Other:

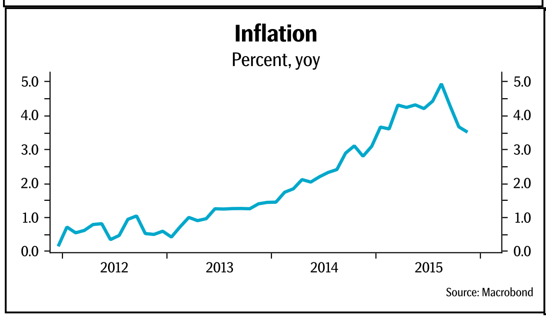
Latest PC deal — None

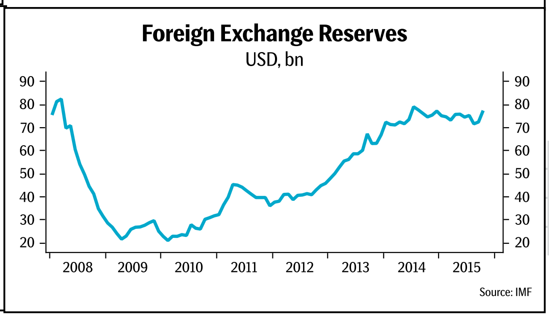
Recent IMF programs — None

Sources: Oxford Economics, IMF, Moody's and SEB estimates









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