United Arab Emirates

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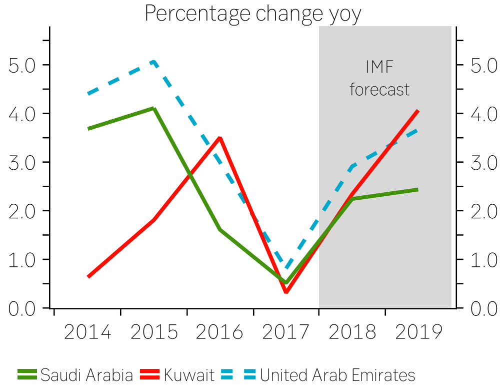
Macroeconomic developments in the past year have been positive. The authorities have continued to adapt the economy well to the lower oil price environment. This has contributed to improving the outlook for public finances and the current account. Regional geopolitical tensions remain high. Despite gradual improvements, the lack of data and the lack of policy transparency continue to weigh on country risk.

Country Risk Analysis

Recent economic developments

Economic growth recovering. Following a significant slowdown in 2017, largely due to the country's cuts in oil production under the OPEC agreement, economic growth recovered in 2018. Accelerating growth in both the oil and the non-oil sectors of the economy (including trade and tourism) is expected to have lifted real GDP growth to 2.3%. The share of GDP coming from the hydrocarbon sector has declined to less than one fifth following the lower oil prices since 2015. At the same time, the share of the service sector has steadily grown. GDP per capita is one of the highest in the world.



Source: International Monetary Fund (IMF)

Inflation picked up, partly on the back of the introduction of a VAT. House prices that started to fall in 2014 continue to fall in both Abu Dhabi and Dubai as supply is expanding and employment is growing slowly.

Solid external balances. The emirates have traditionally had smaller surpluses on the current account than its regional peers. Nevertheless, in 2018, the current account is estimated to have edged up to 7.4% of GDP helped by the recovery in oil prices (hydrocarbons stand for roughly 20% of exports). The surplus should edge down in 2019.

Reserves broadly stable at high levels. The healthy current account surplus has contributed to keeping FX reserve buffers at high levels. UAE's official foreign exchange reserves that increased in 2017 remained broadly stable in 2018 at about USD 90 bn. Add to this Abu Dhabi's sovereign wealth fund (ADIA, see further below) yields a solid reserves cushion, equivalent to roughly three times the emirate's external debt. Assuming that half of ADIA's funds are liquid, foreign reserve buffers are equivalent to more than 1.5 years of imports.

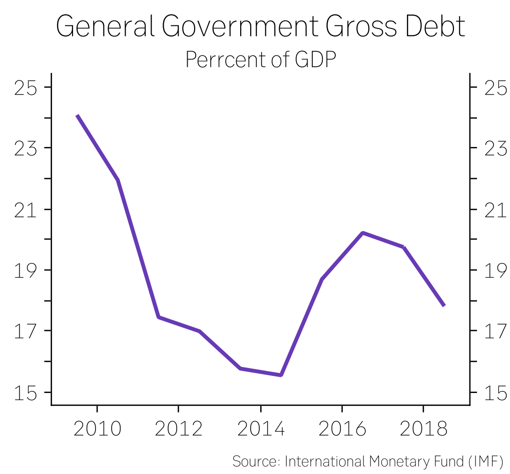
Oil stands for shrinking share of government revenues. Although external and fiscal balances (see below) still swing with shifts in the oil price, the country's increasing economic diversification means its external and public balances are less reliant on oil than other economies in the region. 40- 50% of the consolidated government revenues stem from the hydrocarbon sector. Consequently, the UAE also has a lower fiscal breakeven price for oil than most other major producers. According to the IMF, only Kuwait and Qatar has lower fiscal breakeven prices than UAE's estimated USD 65 per barrel in 2019. As reference, we forecast an average price of USD 65 per barrel in 2019, down from about USD 72 in 2018.

Economic policies

Fiscal policy adapted to lower oil prices. The lower oil price regime has triggered improvements to economic policy making and planning. One example is the introduction of multi-year fiscal plans which are considered to have improved the transparency and predictability in the relatively small federal budget. Lower oil prices have also triggered a wide range of policy steps to milden the impact on the budget. For example, gasoline subsidies have been eliminated and prices on electricity and water have been raised. In late 2017 an excise tax was introduced and in early 2018 the authorities introduced a 5% VAT. The latter was hailed as a milestone by many observers. The tax will indeed help to boost and diversify government revenues in the coming years.

Fiscal position strengthened on rising revenues. Together with higher oil revenues, VAT income is likely to have shifted the emirates' consolidated government finances to a small surplus in 2018 from a 1.6% of GDP deficit in 2017. We would note that reports and forecasts regarding the consolidated budget balance vary widely among analysts, partly due to the lack of data. We rely on IMF data and estimates.

Government debt is manageable. The consolidated general government debt, mostly attributable to Dubai, is expected to have edged down in 2018. At about 18% of GDP it remains manageable and low compared to peers. The majority of the debt is held by domestic investors. Debt management offices in Abu Dhabi and Dubai have been strengthened in the past couple of years. In addition, the authorities recently approved a long-awaited law allowing the federal government to issue sovereign bonds. Although issuance may be limited, the measure could, in the longer term, contribute to deepening local financial markets.

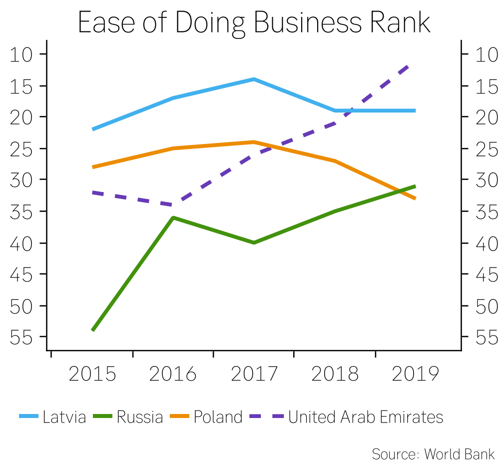


Buffers remain very significant. Our assessment of the UAE's debt affordability and of its country risk builds on the assumption that Abu Dhabi with its superior financial strength and oil wealth would stand behind the other emirates. Although there are several sovereign wealth funds across the emirates that provide financial buffers, Abu Dhabi Investment Authority, ADIA, is by far the largest fund. Data on its total assets is not published but estimates vary between USD 550-700 bn. The value is assumed to have stayed largely constant in the past year despite withdrawals as investment income has been strong. Estimates differ but total assets under management by the UAE's sovereign wealth funds are usually assumed to amount around 200% of GDP.

Risks posed by government related entities are gradually declining. The low level of debt does not include debt incurred by government related entities (GRE). While the government of Abu Dhabi has publically declared its commitment to support some of its major GDEs, Dubai has not done so. During the crisis related to Dubai's GREs in 2009-2011, Abu Dhabi did contribute with significant funds although investors also had to take large haircuts in the restructuring process. Hence, we believe it is prudent to assume that all GRE debt could ultimately end up on the consolidated government balance sheet. Adding the domestic debt of the GRE's in Abu Dhabi and Dubai, increases the consolidated government debt to roughly 50% of GDP according to most estimates. Reports of improved debt structures and a track record of successful restructurings of GREs partly mitigate the risks to the government. In addition, supervision of the GREs is reportedly being strengthened and disclosure is gradually improving.

Limited data availability. Although improvements have been made, the availability of economic data is limited compared to other countries at a similar level of country risk. For example, the IMF sees shortcomings in data relating to the accounts of the government related entities. Moreover, disclosures relating to the government's external assets are very limited and consolidated fiscal accounts for the UAE are published with a significant lag. This weighs on country risk.

Stronger governance indicators than regional peers. Institutions in the UAE are generally stronger than other countries in the region. Most World Bank's governance indicators are also better than peers in a similar risk class, barring voice and accountability. UAE's ranking in those indicators has been broadly stable recently. At the same time, judging from the World Bank's ease of doing business ranking, the business climate has been improving in the past few years.



Source: World Bank

Bank sector posing little risk. Banks are considered well-regulated and supervised at the federal level. Capitalization ratios have remained strong in the past year while the share of non-performing loans (NPL) edged up in late 2018.

Moderate political risk. The UAE is a loose federation of seven emirates which, since its creation, has enjoyed a high degree of political stability. The country does not have formally elected bodies. Instead, political decision making is largely made by the ruling families of the individual emirates, limiting transparency. The trade blockade against Qatar and re-imposed US sanctions on

Iran, a major trading partner for the UAE, has increased uncertainty and raised regional geopolitical risk. We do not envisage any noticeable impact on the economy however. The UAE's military engagement in Yemen is another exposure point to event risk.

Outlook

Growth to accelerate, peg to USD to hold. While the slowdown in the past years was deeper than we had expected, the macroeconomic outlook has become brighter than we have previously expected. Economic growth in 2019 is expected to pick up to 2.9%, helped by increased fiscal spending. The IMF's forecasts are significantly more optimistic. On the other hand, while our house forecasters Oxford Economics believe in a continued acceleration in growth beyond 2019, several other forecasters pencil in a slowdown.

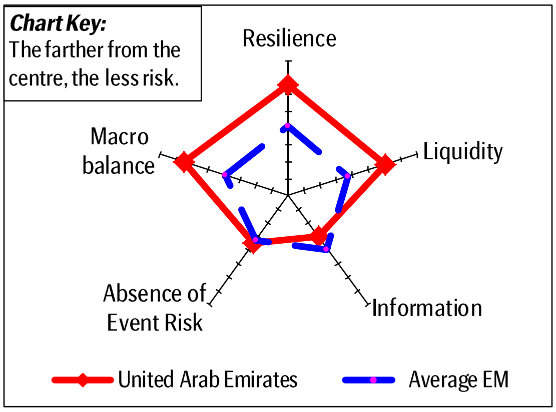
In the medium term, overall economic activity should mainly be supported by the non-oil sector. Moreover, public sector investment activity should be strong in Dubai as the government prepares for hosting the World Expo in 2020. We assume a continued diversification of the economy as the authorities are targeting a reduction in oil generated GDP to 20% of the total by 2021. We also assume that the exchange rate peg to the US dollar will be maintained.

Risks mainly from lower oil prices and geopolitical tensions. Risks to our main scenario are mainly external. The most evident risk relates to lower than expected oil prices which could lead to higher than expected fiscal deficits and to a gradual rise in government debt. Another risk relates to higher than expected interest rates originating from more rapid rate hikes in the US, for example. This would raise overall financing costs and rollover risks for GREs. A third risk involves escalating geopolitical tensions which could sour investor sentiment and possibly dampen growth. A domestically related risk is that Dubai's huge investment projects in the run-up to Expo 2020, if mismanaged, could hit the financials of the emirates' GRE:s, banks and ultimately the government.

United Arab Emirates

Key ratios	2019
Population (million)	9.5
GDP per capita (USD)	44 930
Real GDP growth (%)	2.9
CPI inflation (%)	2.0
Current account (% of GDP)	5.7
Reserves (months of imports)	20
Budget balance (% of GDP)	1.3
Government debt (% of GDP)	18

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
Fitch:
Abu Dhabi: AA / Stable

Peers:
Poland
Kuwait
Qatar

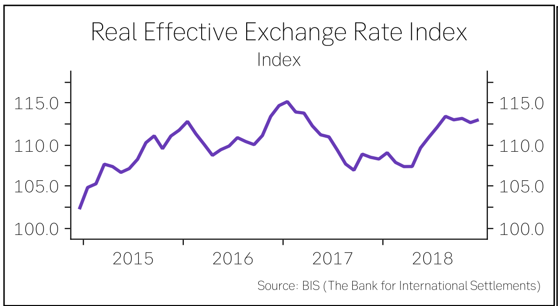
Graph: UAE's risk profile is significantly stronger than the emerging-market average on resilience and slightly worse on event risk and information, due the lack of economic and political transparency. The liquidity score includes 50% of estimated foreign assets of Abu Dhabi's sovereign wealth fund.

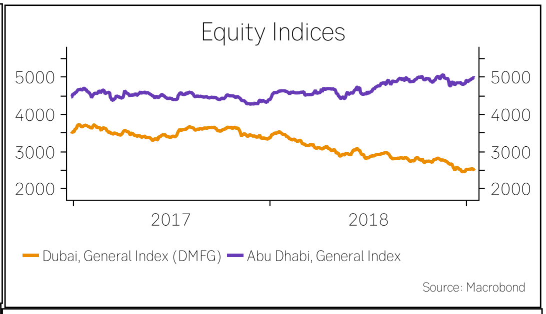
United Arab Emirates: Economic Indicators

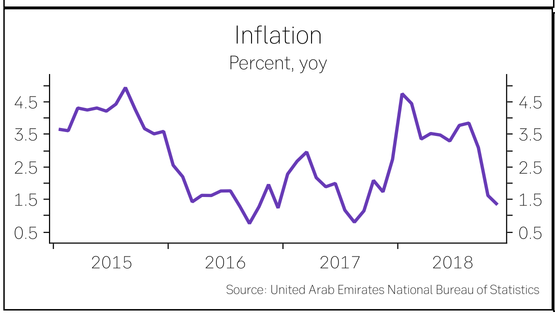
Macroeconomic	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GDP real (chg)	4.4%	5.1%	3.0%	0.8%	2.3%	2.9%	3.9%	3.4%
GDP (USD bn)	403.1	358.1	357.0	382.5	402.9	435.0	468.1	502.6
GDP/capita (USD)	44 905	39 117	38 444	40 617	42 189	44 930	47 703	50 575
Investments/GDP	19%	22%	24%	23%	22%	21%	20%	20%
Trade/GDP	155%	175%	181%	169%	167%	163%	161%	158%
Oil production, bpd ('000)	2773	2946	3050	2921	3038	3235	3271	3307
Money & Prices								
CPI inflation	-14.4%	4.1%	1.6%	2.0%	3.7%	2.0%	2.0%	2.0%
Interest rates	1.0%	1.3%	1.5%	2.3%	3.3%	4.0%	4.5%	4.5%
Exchange Rate (USD)	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Oil price (Brent)	$99	$52	$44	$54	$72	$65	$75	$75
Government Finances								
Budget balance/GDP	10.4%	-3.4%	-4.3%	-1.6%	0.6%	1.3%	1.2%	1.4%
Consolidated govt debt/GDP	16%	19%	21%	20%	18%	18%	18%	17%
Balance of Payments (USD bn)								
Current account	54.5	17.6	13.2	26.4	30.0	25.0	21.5	21.5
(% of GDP)	13.5	4.9	3.7	6.9	7.4	5.7	4.6	4.3
Exports of goods	350.9	369.1	381.7	383.4	400.5	423.8	449.1	474.2
Imports of goods	273.9	258.2	265.1	262.5	271.7	286.6	303.8	322.1
Other current acct flows	-22.6	-93.4	-103.4	-94.5	-98.8	-112.2	-123.8	-130.6
Net FDI	-16.6	-18.9	-13.70	-14.2	-14.5	-15.2	-15.9	-15.0
Net other capital flows	23.7	70.5	32.5	17.8	28.0	13.7	35.1	35.8
External Debt & Liquidity (USD bn)								
Reserves	77.2	92.6	84.4	94.4	97.1	103.0	107.5	114.8
Gross external debt (% of GDP)	44%	62%	63%	67%	69%	68%	65%	61%
Gross External Debt	176.5	222.9	225.6	256.7	279.4	295.1	302.1	305.0
o/w short term debt	66.6	91.7	85.2	91.2	97.6	104.4	111.7	110.0

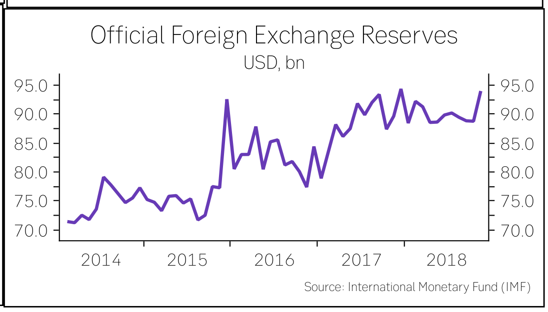
Type of government:	Federation, no political parties
Next elections	-
Other:	
Latest PC deal	None
Recent IMF programs	None

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









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