Euler Hermes Economic Research

Country Report

United Arab Emirates

Large fiscal and external surpluses

General Information

GDP	USD360.245bn (World ranking 32, World Bank 2012)
Population	9.21 million (World ranking 92, World Bank 2012)
Form of state	Federation
Head of government	HH Sheikh Khalifa bin Zayed bin Sultan Al Nahyan
Next elections	2015, legislative

Strengths

- Stable society, with established method of succession.
- Abundance of natural resources (hydrocarbons).
- Large asset holdings and investments held overseas. Net creditor status.
- Actively diversifying economy.
- Relatively liberal business and trading environment.
- Healthy fiscal and current accounts.
- Re-classified to emerging market status (formerly frontier market) within the MSCI.
- Regional co-operation through the GCC.

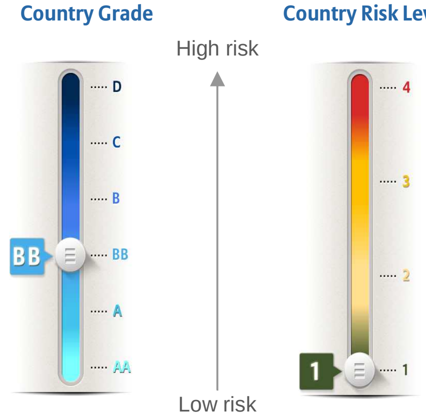
Weaknesses

- High dependence on global and regional markets and events.
- Despite diversification (including further developments in the transport and travel sectors), the economy overall is affected by the vagaries of international oil and gas markets.
- Fixed exchange rate peg to the USD limits independence of monetary policy.
- Speculative flows (stock market, real estate etc.) provide some concern of asset bubbles.
- Regional uncertainties.
- Data provision is poor for a high income economy.

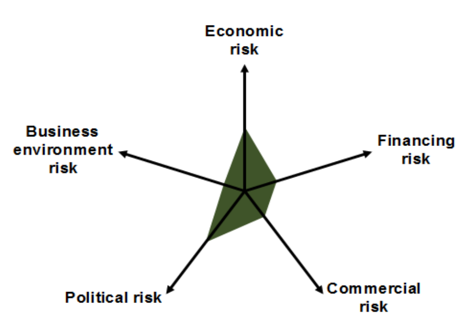
Country Rating

BB1

Country Grade | **Country Risk Level**



Risk Dimensions



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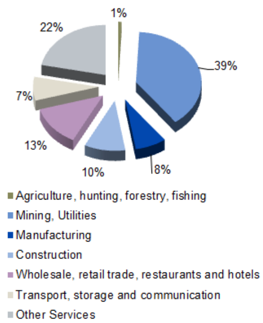
Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
Japan	17%	1	19%	India
India	15%	2	13%	China
Iran (Islamic Republic of)	11%	3	8%	United States
China, Taiw an Province of	8%	4	5%	Germany
Korea, Republic of	6%	5	4%	United Kingdom

By product

Exports		Rank		Imports
Petroleum, petroleum products and related	53%	1	9%	Non metallic mineral manufactures, n.e.s.
Non metallic mineral manufactures, n.e.s.	7%	2	8%	Gold, non-monetary (excluding gold ores and
Gold, non-monetary (excluding gold ores and	7%	3	8%	Miscellaneous manufactured articles, n.e.s.
Gas, natural and manufactured	4%	4	6%	Road vehicles
Non-ferrous metals	3%	5	5%	Iron and steel

Economic Forecast

	2010	2011	2012	2013	2014f	2015f
GDP growth (% change)	1.7	3.9	4.4	4.2	4.0	4.5
Inflation (%, end-year)	0.9	0.8	0.9	1.5	2.7	2.5
Fiscal balance (% of GDP)	4.6	11.1	13.2	5.3	4.5	3.1
Public debt (% of GDP)	22.1	17.5	16.6	18.3	19.7	21.1
Current account (% of GDP)	2.5	14.6	17.3	13.8	8.1	7.0
External debt (% of GDP)	51.8	43.9	43.9	41.9	40.5	38.4

Sources: IHS Global Insight, national sources, Euler Hermes

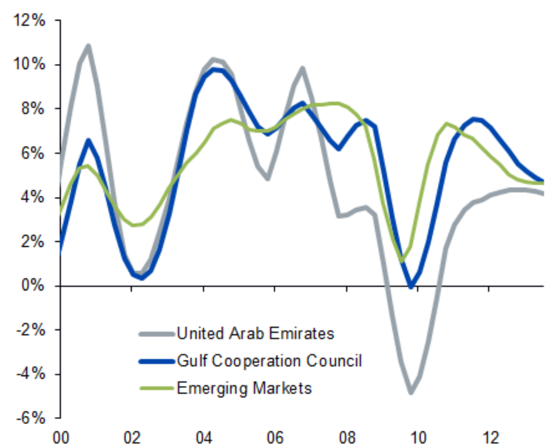
Economic Growth

Relatively strong non-hydrocarbon growth

GDP growth in 2013 is estimated at +4.2% (+4.4% in 2012), with both the oil and non-oil sectors (particularly trade, tourism and transport) contributing positively. However, overall growth was below potential because of regional tensions (despite some positive substitution effect as the UAE is perceived as a safe haven within the wider region) and weakness in some key markets (including the eurozone). Government spending (including social support packages and increased subsidy provision) and investment were also strong and somewhat compensated for weaker external demand.

The outlook for growth in 2014 is for relative stability compared with 2013, with potential for weakness in the oil sector, reflecting reduced output and declining revenues through (moderately) lower prices, offset by growth in non-oil sectors. The latter will be spurred by continuing high state expenditures. Oil prices are expected to weaken, but not collapse, reflecting weak demand in some areas and further production of energy supplies from North American shale reserves. The global outlook for 2015 is for a gradual and probably subdued recovery, with the UAE benefiting from increased world trade and further boosted by preparations ahead of hosting the World Expo 2020. EH expects GDP growth of +4% in 2014 and +4.5% in 2015.

GDP growth (y/y, 4 qtrs cumulated %)



Sources: IHS Global Insight, Euler Hermes

Economic Policies

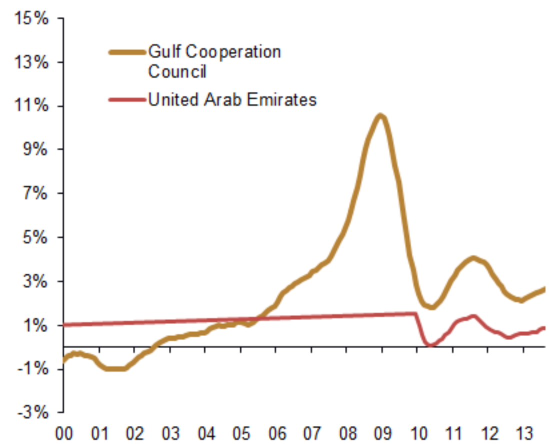
As elsewhere in the region, there is concern relating to unemployment and under-employment, particularly among the young. Accordingly, the government adopted a policy of "Emiratisation", whereby the job market will favour nationals rather than expatriate workers.

Inflationary pressures are building, but from a low base

The rate of inflation is below that for the GCC as a whole (see chart) and price pressures remain low, although an improving housing (and general construction) market suggests that upward movement can be expected. Food price inflation is also likely to increase in the forecast period but, overall, EH expects consumer price inflation will end 2014 at around 2.6% and amount to around 2.5% at end-2015.

EH does not expect the exchange rate regime to change in the forecast period to end-2015, with the fixed peg of AED3.67 = USD1 throughout. Indeed, UAE authorities continue to re-iterate their commitment to the dirham’s peg, despite ongoing speculation (in markets and general commentaries) of a fundamental change to the system. Progress towards a full Gulf monetary union has been limited and EH does not envisage the introduction of an effective GCC single currency in this period. In May 2009, the UAE opted out of the monetary union but this policy may be revisited when the GCC moves forward with its planned integration.

Inflation rate (%)



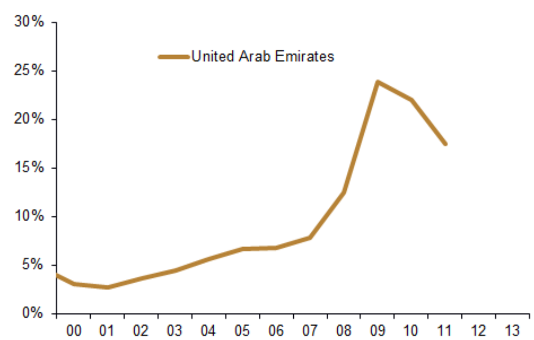
Sources: IHS Global Insight, Euler Hermes

Budget accounting is based on conservative oil prices and surpluses will continue to be recorded in the fiscal accounts

Recording and reporting of fiscal accounts is generally weak for a high income country and is complicated by the existence of individual emirate accounts in addition to the federal budget. The smaller emirates usually depend on transfer payments from the federal budget, which is underpinned by Abu Dhabi and Dubai. Moreover, budgets are typically based on conservative projections of oil prices and associated revenues and budgetary outcomes are usually stronger than initial targets.

Annual federal fiscal surpluses averaged over +10% of GDP in 2000-08 but some variance was recorded as revenue inflows depend substantially on international oil prices. With relatively high oil prices in 2011-13, fiscal surpluses of +6.4%, +5.7% and +5.3% of GDP were recorded in 2011, 2012 and 2013, respectively. EH expects smaller surpluses in 2014 (+4.5%) and in 2015 (+3.1%) reflecting weaker revenue generation at a time of buoyant state spending, partly to appease potential social discontent through extension of support measures and incremental public sector employment benefits. In recent federal budgets, more than half of overall spending is projected for social services, particularly education, health care and social assistance. In addition, state spending is targeting infrastructure, with large budgetary outlays earmarked for improvements to water and electricity supply in the northern emirates.

General government gross debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

External accounts will remain strong

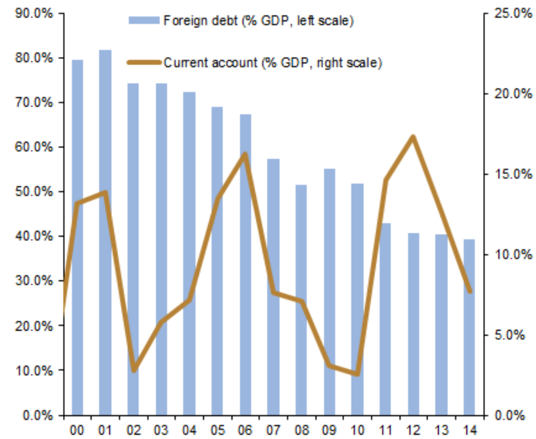
Although the UAE's economy is relatively diversified compared with other GCC states, the strength of the external accounts continues to depend on internationally-determined oil prices and the country's associated revenue generating capacity. Crude oil and related products account for over 50% of the UAE's export receipts. Strong current account surpluses were recorded in 2011-13, when oil prices were high (indicative average benchmark prices of over USD100/barrel, after USD80/b in 2010). EH forecasts the current account surpluses at +8% of GDP in 2014 and +7% in 2015. Global oil prices are forecast to weaken in 2014-15, although they currently remain above USD100/b, and the UAE's external accounts are likely to deteriorate moderately. However, the country is one of only a few that has the ability to alter its oil output in an attempt to support international oil prices and the UAE's policy is likely to be aligned closely with that of neighbouring Saudi Arabia. Whatever policy is adopted in relation to oil output, the current account will remain in surplus over the forecast period.

Hard currency foreign exchange reserves are over USD65 billion but the UAE's policy is to keep FX low and store accumulated wealth in other areas, including several sovereign wealth funds (currently estimated at over USD975 billion) and in other assets. Accordingly, a strict interpretation of import cover (currently around two months) is not an accurate measure of external liquidity. Using an alternative definition, EH calculates import cover is comfortably in double figures. Net external assets are equivalent to over 112% of GDP.

External debt levels and servicing of obligations are comfortable in the forecast period

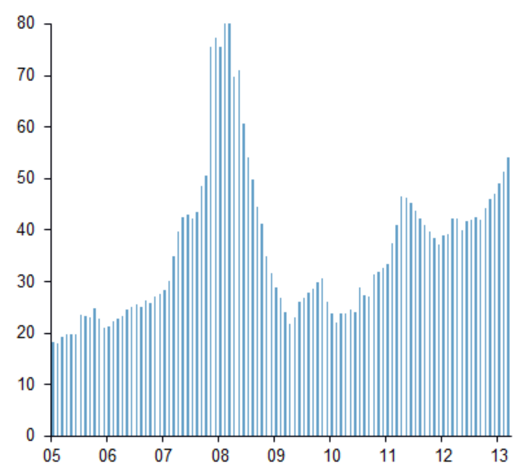
External debt ratios are relatively low, with total foreign debt stock at around 40% of GDP and 37% of export earnings and the debt service ratio on existing obligations is under 4% of total export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments) will not be problematic.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

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