Macroeconomic outlook - MECA Conference

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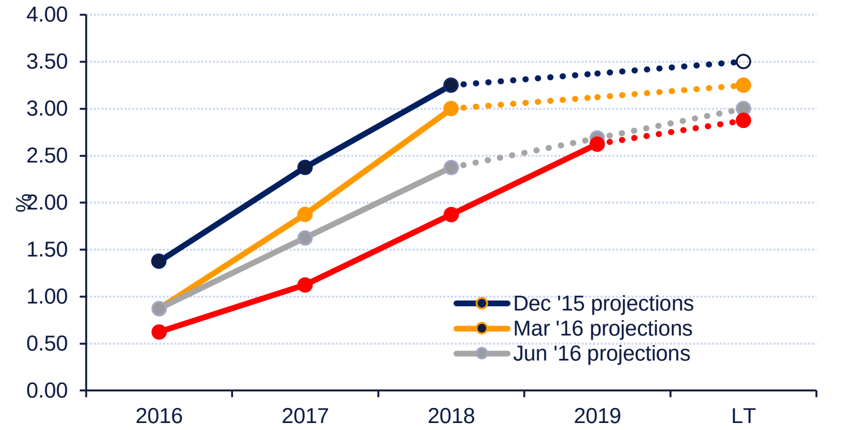
Outline

- Global macro themes
- Oil price outlook
- Implications for GCC
  - Growth and fiscal policy
  - Investment outlook
  - Financing deficits
- Dubai focus

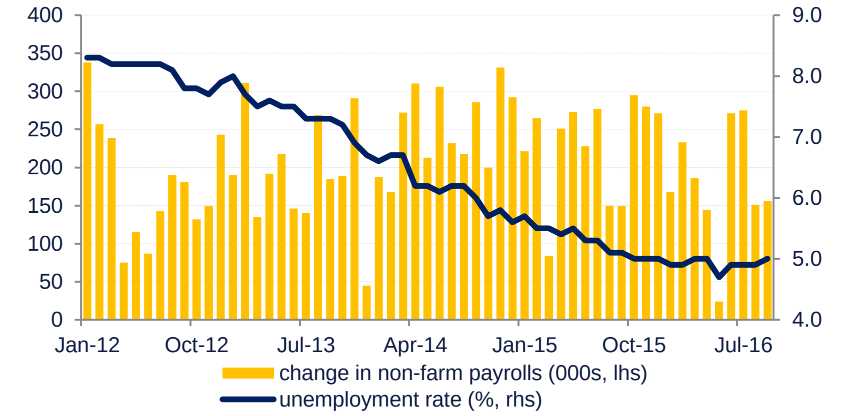
Global macro: The limits of monetary policy

- Global growth remains lackluster; IMF downgrades forecasts for advanced economies in October, particularly the US (1.6% in 2016 from 2.2% previously).
- Fed has become much more benign on its interest rate projections since the start of this year, suggesting a more gradual upward trajectory and a lower long-term interest rate. Trump's fiscal expansion plan may change this.
- ECB QE program comes to an end in March 2017 but can be (most likely will be extended).
  - Inflation well away from target; Growth prospects weak; Unemployment high (over 10%)
- Japan targets yield curve (10y rate at 0%)
  - To shield banks from negative rates
- Weak confidence – is QE/ low rates feeding a negative cycle
  - Fiscal policy needs to do more, but difficult due to political process.

Fed dots plot adjusted lower



Jobs data remain supportive

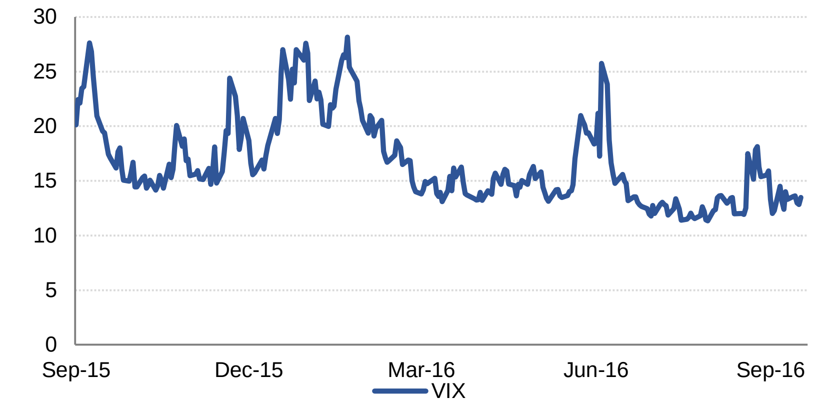


Source: Emirates NBD Research, Bloomberg.

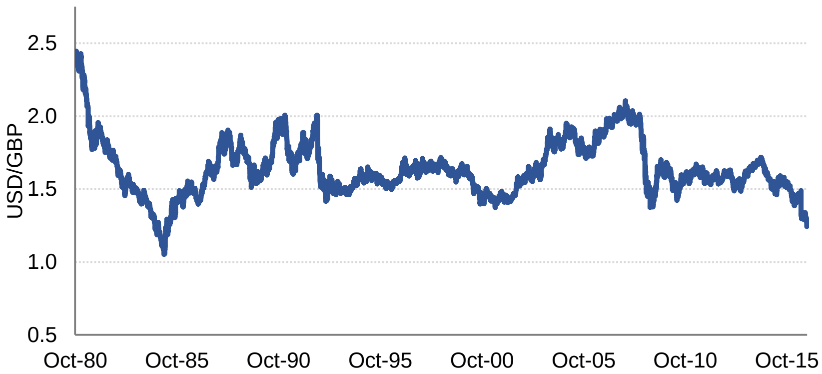
Global macro: 2017 risks abound

- 2017 a highly political year
  - Italy faces a Constitutional Referendum in December 2016
  - US President takes office January 2017
  - France's Presidential election May 2017
  - Germany Chancellor election October 2017
- Brexit negotiations to be triggered by end-Q1 17
  - Possibility of a snap UK general election
  - Implications for UK growth if there is a 'hard' Brexit
  - FX downside risks remain
  - BoE has one more rate cut, unlikely to use it now
  - Low rates and shortage of supply to support housing market, but uncertainty about impact of Brexit, immigration policy and FX suggests investors likely to remain cautious.
- China risk remains
  - RE sector accounts for 15% of GDP, overstock remains even as sales have picked up.
  - Highly leveraged, risks for financial sector
  - Authorities engineering a 'soft landing'

Volatility surprisingly low right now



GBP downside risks



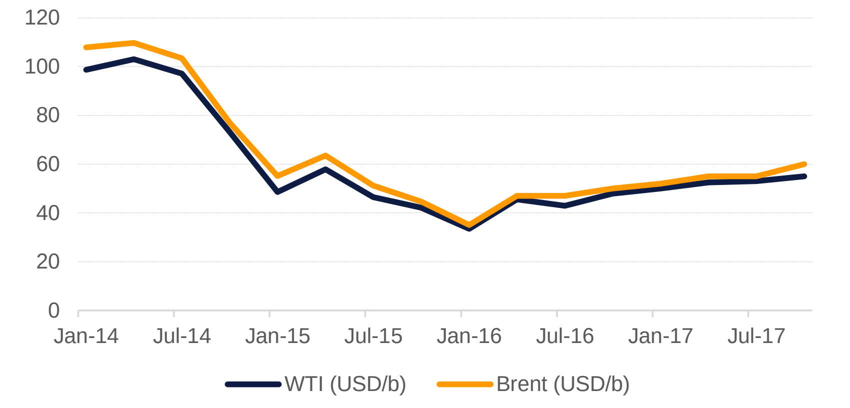
Source: Emirates NBD Research, Bloomberg.

Oil prices to show only muted recovery into 2017

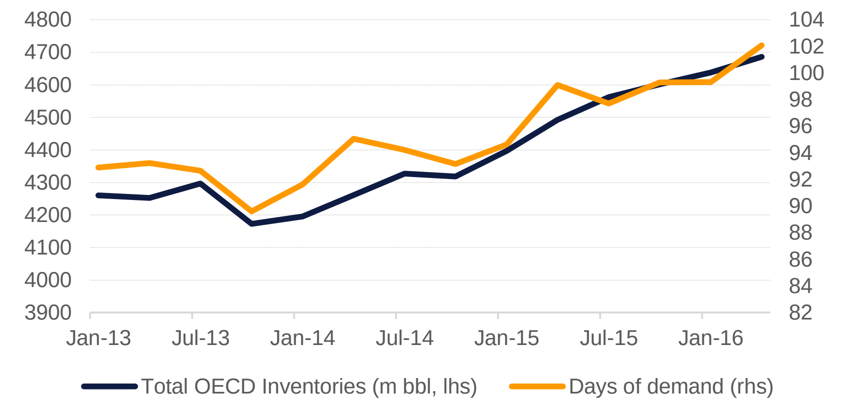
Topside for oil prices remains limited

- **Topside for oil prices remains limited thanks to heavy supply volumes, bloated inventories and uncertain demand prospects**.
- **Brent futures will average USD 45/b in 2016 before moving up to USD 55.5/b in 2017**
- **US oil industry showing signs of stabilization—**rising rig count, flat production and active hedging—means that potential for volumes to return to market in 2017
- **OPEC keeps trying to talk up prices but market must prepare itself for return of large volumes** from Iran, Iraq, Nigeria and potentially Libya. **The impact of the OPEC agreement to cut production may be less than markets are hoping for,** given the uncertainty over who will cut output.
- **Demand outlook is starting to get hazy with IEA and OPEC** cutting projections for 2017. India likely to be an outperformer but volumes not substantial enough to soak up substantial volumes of supply.
- The degree of **slack in the oil market outside the US is very low** and any disruption to supplies could lead to momentary upward spikes. However, these are likely to be transient factors.
- **Inventories globally are at highly elevated levels**; a surge in demand can be easily accommodated in current market conditions

Emirates NBD Research oil price forecasts



Inventories at exceptionally elevated levels

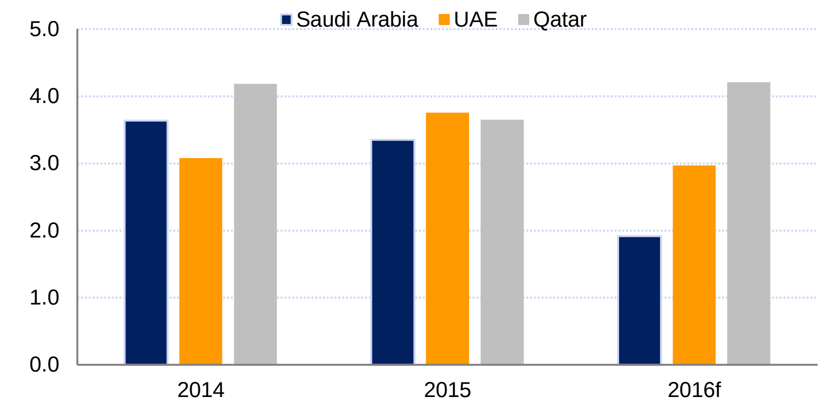


Source: Emirates NBD Research, Bloomberg.

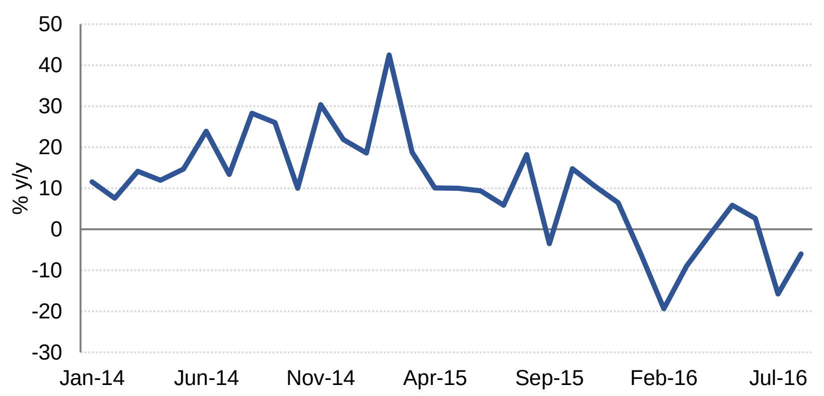
GCC growth has slowed as fiscal policy tightened

- **Oil prices have halved since mid-2014, putting strain on oil exporters' budgets.** Revenues have remained overly reliant on oil income even as economies have diversified. Oil revenue accounts for over 70% of total budget revenue in KSA, and around 90% in Kuwait. UAE is the most diversified, with around 50% of budget revenue coming from oil in 2015.
- **Budget deficits have given rise to reforms**, including measures to boost non-oil revenue and cut spending:
  – Public sector wage cuts
  – Reduced subsidies for fuel and utilities
  – Cuts to infrastructure spend over the medium term
  – VAT and higher corporate taxes
  – Increased visa/ tourism fees; new land taxes
- **Household income has been affected** by higher fuel costs and slower wage growth (or in some cases wage cuts). Employment growth has also been very weak this year. The impact can be seen on retail spending in Saudi Arabia with POS values down around 6% y/y Jan—Aug.
- **Corporates** affected by delayed payments, higher interest rates and substantial cuts in subsidies for energy (particularly in Saudi Arabia)

GDP growth has slowed in UAE and KSA



Saudi Arabia: Point of sale transactions fall

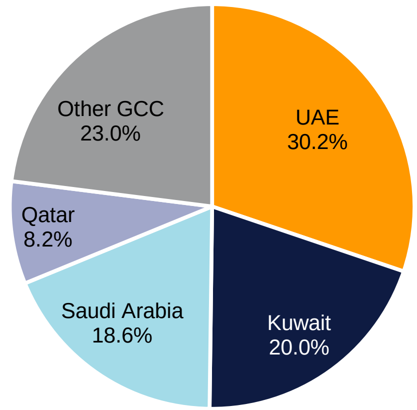


Source: Emirates NBD Research, Haver Analytics.

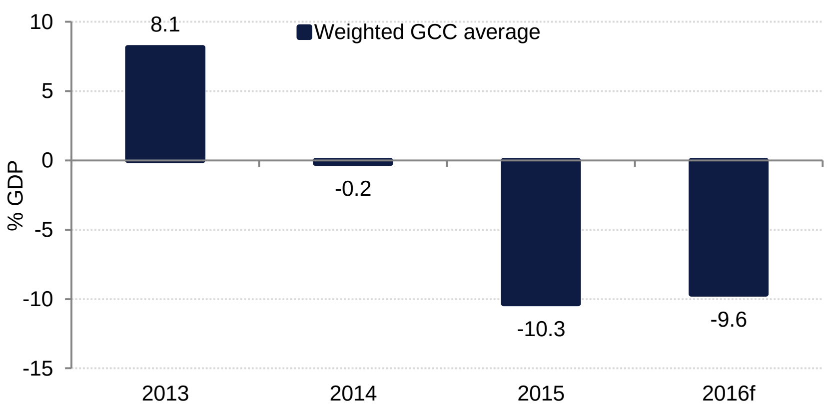
GCC infrastructure outlook

- **Saudi Arabia considers USD 20bn in cuts to projects**
  - Medium term impact, not in a single year
  - Increases pressure on construction sector
- **Oil related infrastructure investment set to continue**
  - Aramco says its increasing investment even as oil prices have declined
  - UAE targets 3.5mn bpd by 2020 (current output 3.0mn bpd)
  - Kuwait targets 4.0mn bpd capacity by 2020 (current output 2.9mn bpd)
- **Kuwait increases infrastructure spending in 2015/ 2016 fiscal year**
  - Budget fully executed, deficit of -13.1% GDP last year from +7.4% surplus previously.
  - Deficit set to widen to -17.2% GDP in 2016/17
  - Roads, refineries (clean fuel project), LNG terminal, university campus, utilities. Ports, airports investment on the cards.
- **Qatar FIFA 2022 – USD 22bn**
- **UAE Expo 2020 – USD 7bn**

Share of projects awarded ytd 2016



Budget deficits have widened sharply

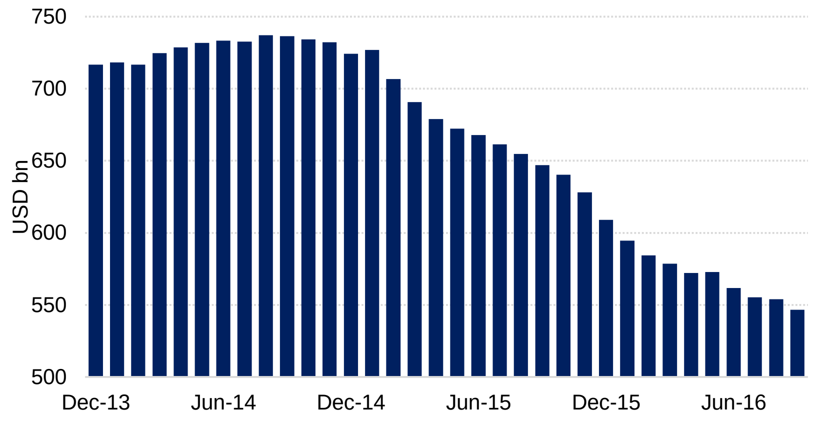


Source: Emirates NBD Research, Haver Analytics, MEED.

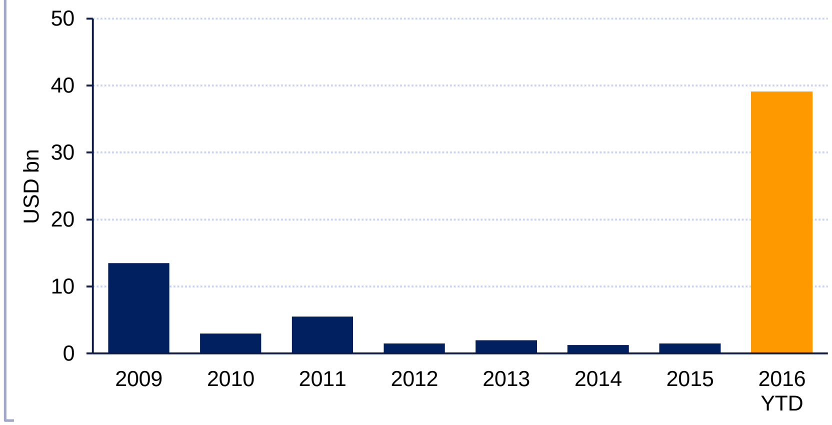
Financing GCC budget deficits

- **Run-down accumulated savings**
  - Bulk of deficits have been financed this way so far
  - SAMA's net foreign assets have declined –USD55bn ytd but remain high at USD 554bn
  - Substantial fiscal cushions in UAE, Qatar, Kuwait
  - Bahrain and Oman are most vulnerable with relatively low levels of reserves.
- **Privatisation/ asset sales**
  - SWFs were reportedly net sellers of equities and other financial assets in Q4 2015 and through Q1 2016 as oil prices fell below USD30 /b.
  - Privatisation is a key component of Saudi Arabia's National Transformation Program, with Saudi Aramco included in the list of potential assets for sale
  - KSA preparing by lifting restrictions on direct foreign investment into domestic capital markets and restructuring SOEs.
- **Debt issuance**
  - Domestic debt issuance of SAR 120bn (USD 32bn) in KSA. These bonds are not traded.
  - International bonds (tradable) issued by Abu Dhabi, Qatar, Oman, Saudi Arabia.
  - Syndicated loans at more attractive rates from Asian/ European investors looking for yield.

Saudi foreign assets have declined to 4y low



GCC debt issuance at multi-year high



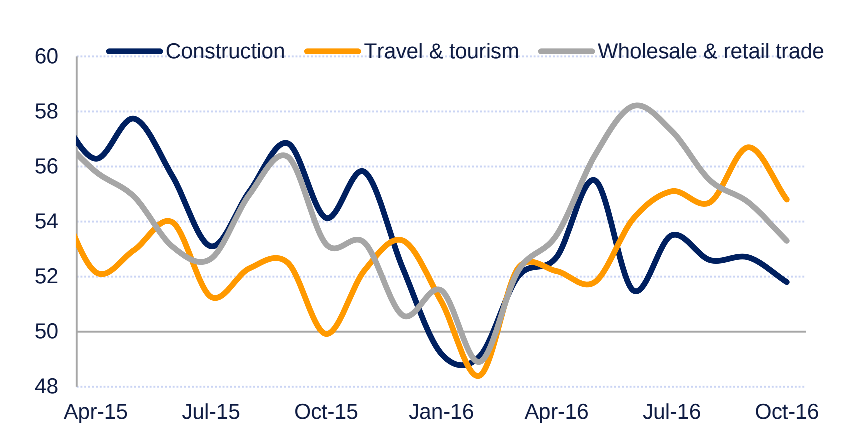
Source: Emirates NBD Research, Bloomberg.

Dubai: Growing at a slower rate than 2015

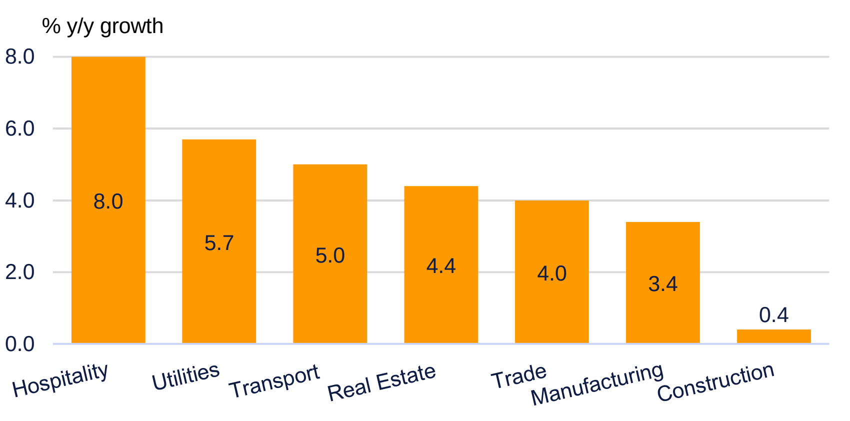
Highlights

- Dubai's growth in 2015 growth accelerated to 4.1% from 3.5% in 2014 according to official data. Hospitality, utilities and transport, storage & communication were the fastest growing sectors last year.
- Dubai Economy Tracker index increased in Q3 but the average for 2016 still points to slower growth compared to 2015. We retain our full year growth forecast at 3.5%.
- New orders and output growth are strong, there is weakness in external demand and employment growth has been soft so far this year. Margins continue to be squeezed as firms cut prices to secure this new work.
- Construction sector output is likely to be underpinned by Expo 2020 projects and associated infrastructure spending, which should gain momentum in 2017-2018. Wholesale & retail trade and hospitality continue to face headwinds of softer household consumption in Saudi Arabia and a relatively strong USD.

ENBD Dubai Economy Tracker Sector Indices



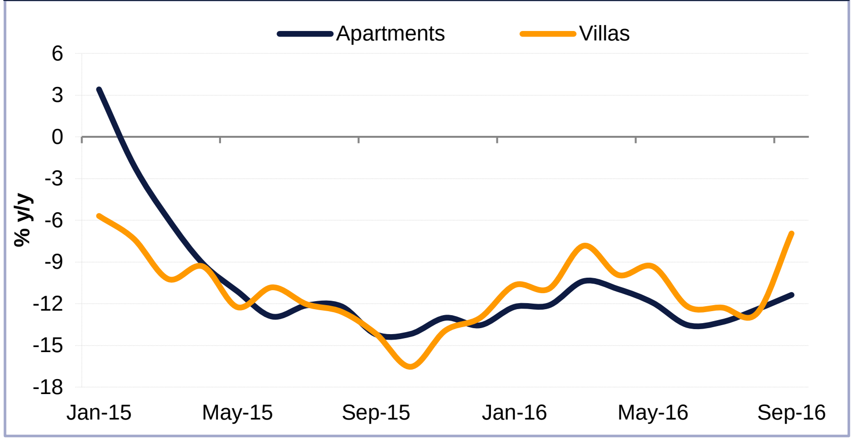
Dubai 2015 GDP growth by sector



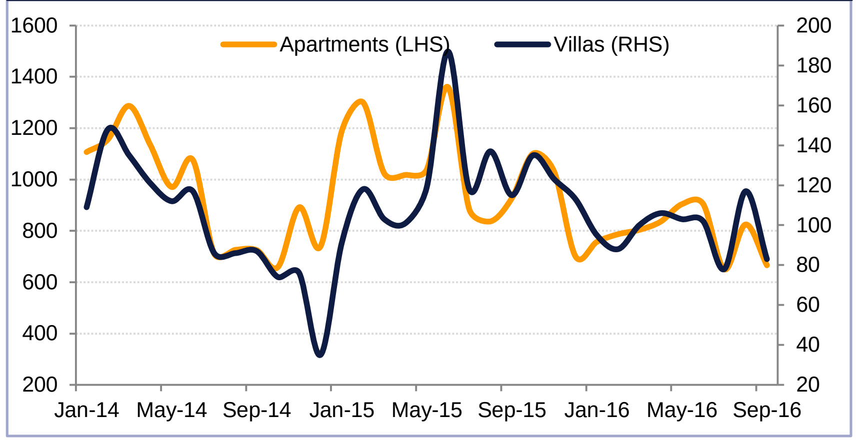
Sources: Markit, Emirates NBD Research

Dubai: Softness in residential real estate prices in September 2016

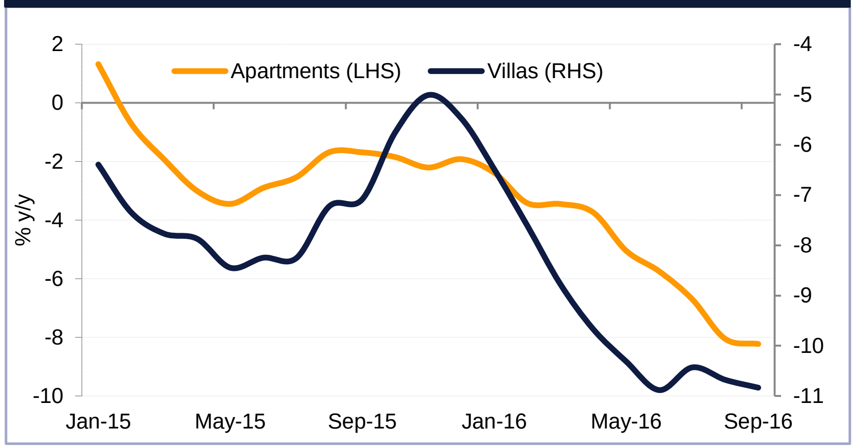
Phidar 9/5 House Price index easing at a slower pace



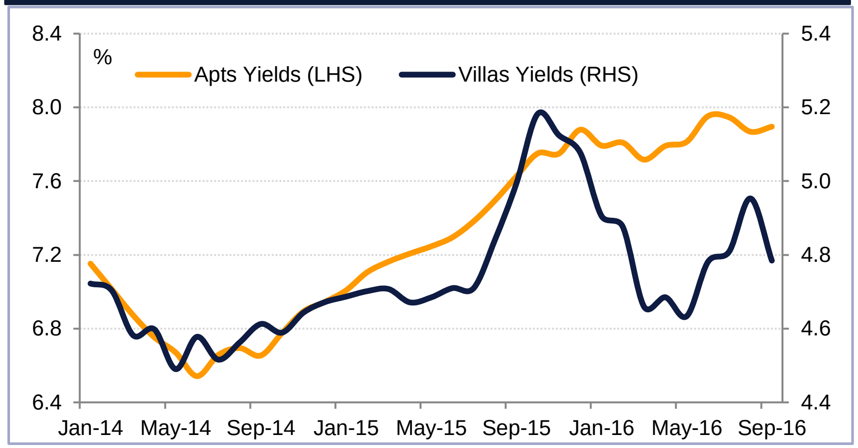
Transaction volumes fall in September (whole of Dubai)



Rents declined further



While yields are still high



Source: Phidar Advisory, Emirates NBD Research

Key points

- Global macro outlook remains challenging; monetary policy hitting limits
- Risks about in 2017: Elections, Brexit, China,
- Outlook for oil prices suggests very little upside from current levels. GCC budget revenues likely to remain subdued as a result
- …forcing governments to implement difficult fiscal reforms to re-balance budgets
  - Households and corporates are being squeezed by higher energy and utilities costs, cuts in wages, delayed payments and higher interest rates.
  - Infrastructure spending may be cut in Saudi Arabia, but the rest of the GCC expected to push ahead with ambitious investment programs.
  - Residential real estate sector likely to face headwinds still: strong USD, rising interest rates, low oil prices, uncertainty/ lack of confidence.
- Over the medium term, GCC reforms should support a more sustainable growth path, with privatization leading to increased capital inflows, technology transfer and a more dynamic economy that creates jobs.

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