

UNDERSTANDING THE UAE'S ECONOMIC ADVANTAGE AMID A POSSIBLE GLOBAL RECESSION



OCT 2022

OVERVIEW

After a tentative recovery in 2021 following the COVID-19 induced 2020 slowdown, global economies in 2022 have appeared gloomier amid both a slowdown in growth and sustained levels of high inflation. **In October 2022, the IMF revised down their forecasts for global growth by year end to 3.2%.** The actual growth could be even lower as global real GDP is estimated to have shrunk 0.6% in the second quarter.

General economic sentiment has been deterred by higher-than-expected inflation, tightening global financial conditions, a war on the European continent constraining energy supplies and a slowdown as a result of lockdowns and the deepening real estate crisis in China.

The tail end of 2022 is expected to have significantly less momentum, reflecting the **erosion of household purchasing power and the economic costs of steeper tightening in monetary policy.**

On the contrary, although not immune to the pressures of the global downturn, **the UAE has remained comparatively insulated in most measures, and this year the country is expected to register the highest growth rate in over a decade. It is forecasted to maintain above average growth in 2023.**

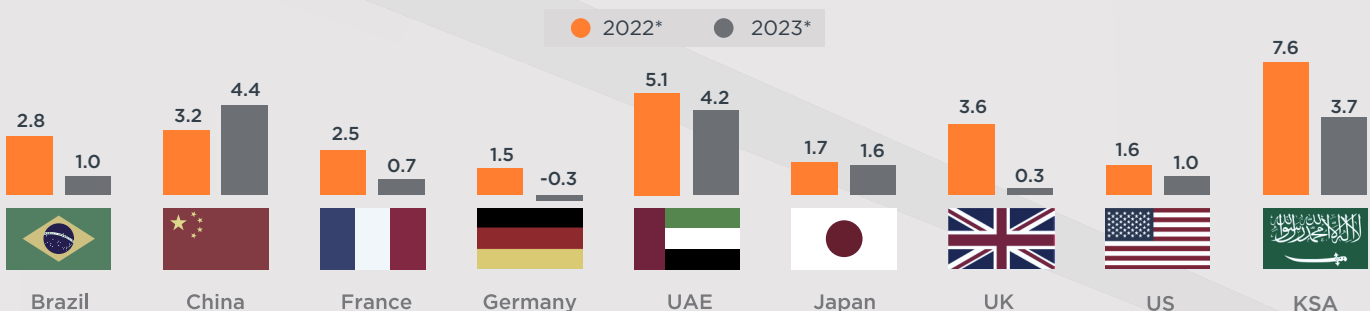
The IMF forecasts real GDP growth at 5.1% in 2022 (some entities are expecting over 6% growth rate), **inflation has remained relatively restrained and capital markets have remained strong on the back of higher oil prices, non-oil growth, prudent fiscal policies and sizable financial buffers that have continued to support the economy.**

This report explains the key drivers of the divergence:

2022 INDICATORS	UAE	GLOBAL
GDP growth (IMF)	5.1%	3.2%
Inflation (IMF)	5.2%	8.8%
Capital Market Performance (YTD 24/10/22)	ADX: 18.65% DFM: 6.37%	S&P 500: -21.76% MSCI ACWI: -24.7% MSCI EM: -29.78%
Fiscal Balance % of GDP (IMF)	18.5%	-8.2%
Trade Growth H1 YoY (IMF)	27% (non-oil)	22%
Currency performance	DXY: 15%	EMFX: -8.25
PMI (Sep 2022)	56.1	49.8

Source: IMF Data

Real GDP Growth - UAE vs Major Economies (%)

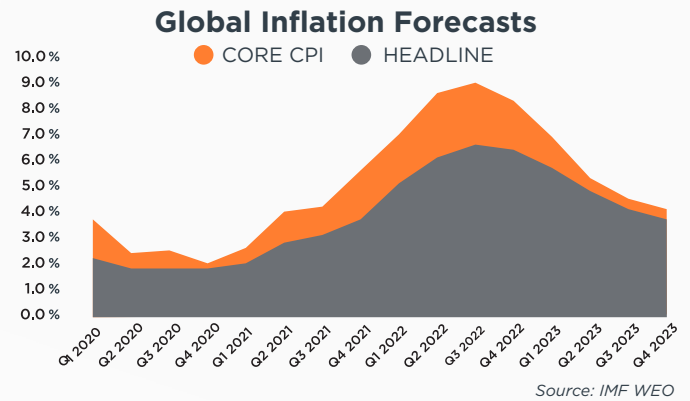


Source: IMF WEO

INFLATION

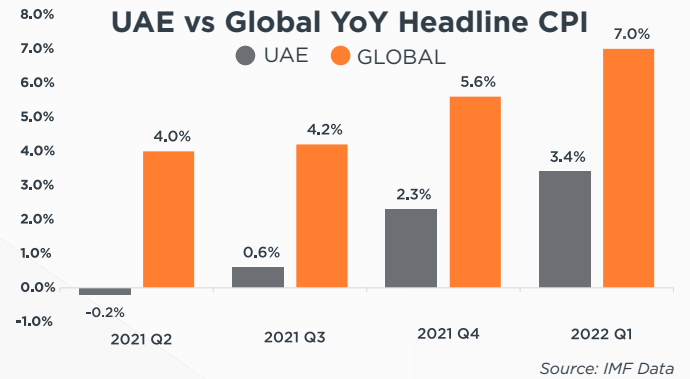
Inflation has proven less “transitory” than some central banks claimed in 2021. Delayed responses in many economies have prompted **rapid monetary policy tightening, including multiple 75bp hikes by the US Fed amid persistent price increases.**

Having reached four-decade highs in June 2022, the annual inflation rate in the US remained woefully high at 8.3% in August. The Euro area annual inflation rate increased to 9.1% and the UK reached 8.6% by August. **The IMF expects the global inflation to reach 8.8% in 2022 and marginally subside to 6.5 percent in 2023.**



Headline inflation in most economies has been driven up by higher food and energy prices, supply constraints, and a rebalancing of demand towards services. However, underlying core inflation has also increased, reflecting passed on cost pressures from supply chains and tighter labor markets particularly in advanced economies.

In general, policymakers have acknowledged that taming inflation is their first priority, despite the inevitable real economic costs of tighter financial conditions.



UAE inflation has yet to show up as widely in consumer barometers but has been felt more in the producer input side from imports.

Headline CPI inflation was estimated by the Central Bank to be 5.6% by year end. However, a more recent estimate by the IMF in July has revised this down to a more manageable 5.2% amid easing input costs. **Inflation in the UAE is forecasted at 3.6% in 2023 (IMF), with the GCC region in general set to enjoy one of the lowest levels of inflation worldwide.**

Reasons for comparatively lower inflation in the UAE:

- Trade efficiency.
- Moderate money printing and stimulus compared to the west during peak COVID.
- Dollar pegged currency strength may account for absorbing some of this.
- Delayed price hikes by distributors and retailers.
- Food and other essential items in the UAE are still partially subsidized.



CAPITAL MARKETS PERFORMANCE

Below trend growth, sustained elevated levels of inflation and stern monetary policy outlook has translated into lower corporate profits and reduced investor risk appetite as seen by developments in the capital markets. Technology and other high-growth stocks have fared worst in this environment.

There have been losses in most regions and industries, although emerging markets have fared better. Despite lower prices, investors remain somewhat cautious, with expectations of potentially average or below-average returns from markets.

Global Market Performance Comparison (2022 YTD)



Source: Bloomberg

On the contrary, the UAE is witnessing a remarkable bull market. Notably, following a 68% rally in 2021 amid an IPO boom, ADX performance has continued to be strong in 2022, having gained over 18% YTD outpacing both global and regional bourses such as Saudi's Tadawul and Dubai's DFM.

In 2021:

- ▶ **ADX was best in the region in terms of foreign investor engagement**, with over \$60 worth of buy and sell transactions by foreign investors.
- ▶ **The number of new investors who registered on the exchange grew eightfold** to 18,938, from 2,362 in 2020. New institutional investors increased by 77% to 708.
- ▶ **Net foreign investment on the exchange reached AED 15 billion**, the highest level recorded by the ADX so far.

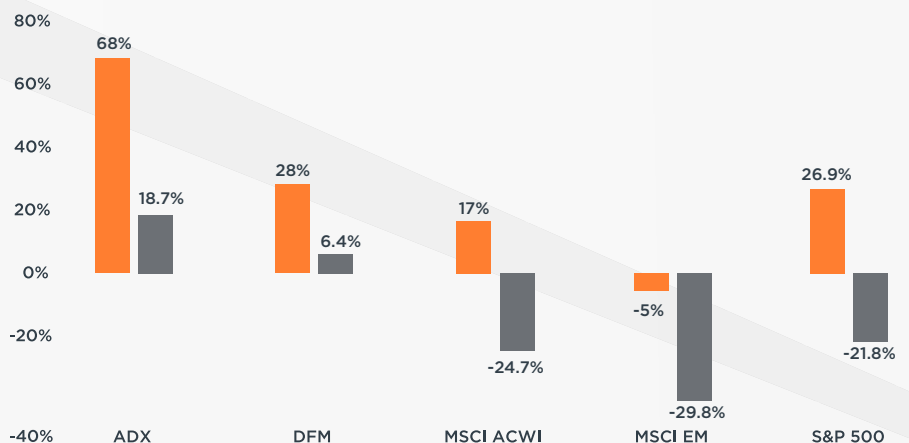
This strong performance has been driven by robust economic growth on the back of high oil prices and strong corporate profitability. Earlier, the resilience demonstrated to tackle the pandemic and major reforms such as allowing foreign investors to own 100% of business also proved to be a major boost.

Specifically, ADX adopted several policy changes boosting the markets international appeal, new listings, efficiency and liquidity. These include:

- ▶ The ADX One strategy which comprised 22 initiatives to bolster the bourse.
- ▶ ADX also introduced a derivatives market, paving the way for an agreement with FTSE Russell to develop co-branded indices.

Global Financial Market Yearly Returns

● 2021 ● 2022 YTD

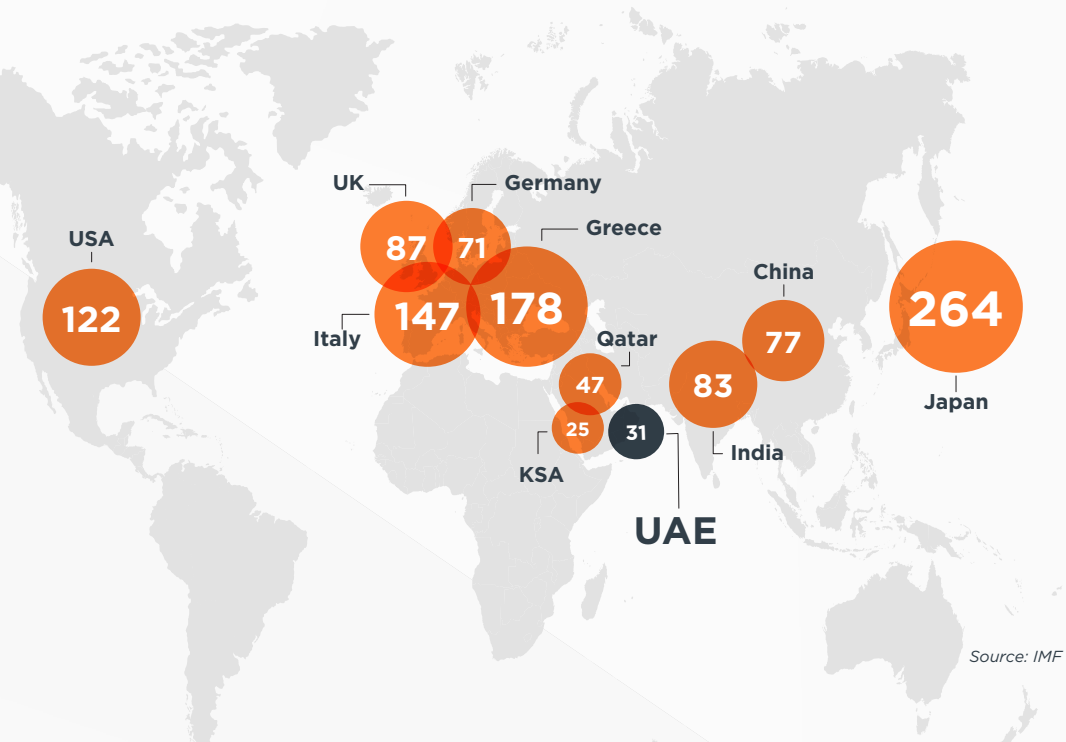


Source: Bloomberg

FISCAL STRENGTH

Global borrowing by governments, businesses and people, is at dangerously high levels. In 2021, global debt reached a record \$303 trillion, exacerbated by COVID induced spending. Heavy indebtedness is evident in both developed and emerging markets. High indebtedness and large fiscal deficits are expected to constrain the growth across these economies amid rising interest rates. Notably, the burden of external debt on emerging economies will be heavier due to strengthening of dollar.

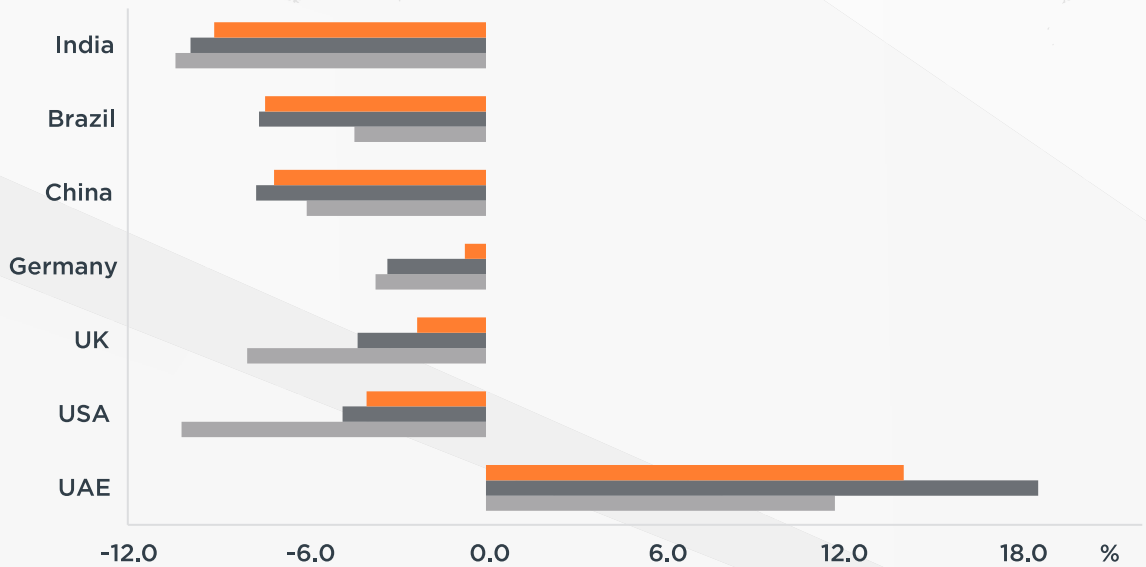
General government gross debt (% of GDP, 2022)



Source: IMF

Fiscal Balances (% of GDP)

- 2021
- 2022
- 2023



Source: IMF Data

The UAE, and Abu Dhabi in particular, has benefited massively from high energy prices over the year, resulting in a significant surplus. The government's coffers have been ample, providing strong financial buffers to external shocks and oil price volatility, with the UAE accumulating a net asset position of more than 250% of GDP.

TRADE

The value of global trade increased during Q1 2022, although its growth continued to decelerate, and is expected to slowdown further due to increased prices, tightening monetary policy supply chain disruptions and geopolitical frictions.

The UAE's foreign trade excluding oil rose an annual 17% to nearly 1.6 trillion dirhams (\$435.6 billion) in just the first half of the year for the first time. This represents an increase of 25% and 35% compared to the same period in the years of 2020 and 2019 respectively.



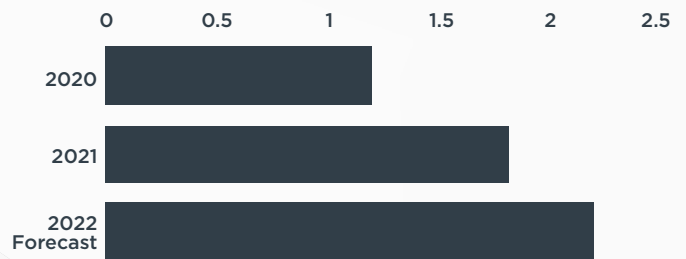
Drivers of UAE trade growth

High energy prices

Growth in trade from metals and minerals, gold, and machinery and electricals.

Policy of expanding trade relations (such as deals struck with Israel, Turkey and Indonesia)

UAE Non-Oil Trade Value (Trillion Dhs)



Source: UAE Central Bank

FDI AND OTHER CAPITAL FLOWS

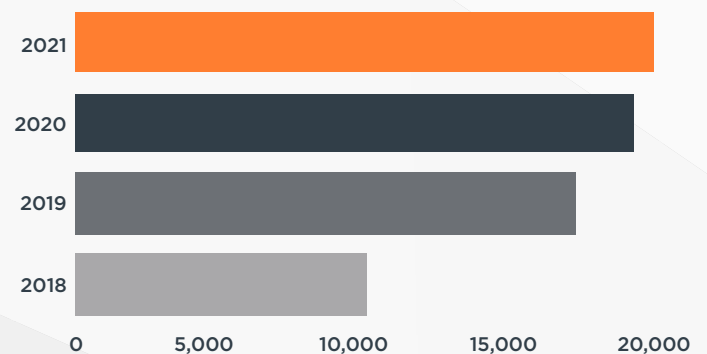
Global levels of foreign direct investment (FDI) generally saw a strong rebound in 2021, as the market started to recover from the pandemic-driven downturn the prior year.

With the exception of resource-rich countries, FDI in emerging markets has been scarce. The only two emerging economies that placed in the top ten for receiving inbound FDI are India and China. The expectation is FDI to lose some momentum entering the new year.

The UAE, however, experienced the largest global increase in inward FDI projects (77%) when compared with 2020 according to Investment Monitors 2021 report.

The total inflows of foreign investment in 2021 amounted to \$20.7 billion (AED 76 billion), compared to 73.04 billion dirhams (\$19.884) in 2020, growing by 4%. The UAE 19th globally in attracting FDI and 1st in West Asia for the year, accounting for 37% of the region's inflows.

UAE FDI (Millions USD)



Source: UAE Central Bank

The UAE is also spearheading the region in other capital flows. The country was ranked 1st in the Arab region with over \$60 billion worth of buy and sell transactions by foreign investors in 2021, as per the Arab Monetary Fund.

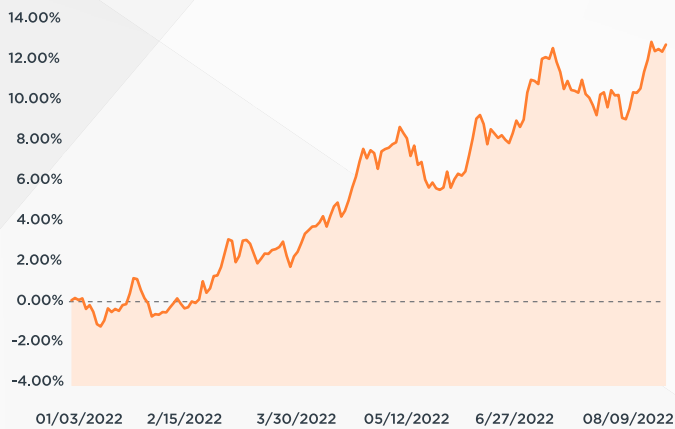
Notably, ADX received 88% of AED 15.5 billion net foreign investments to the UAE from Jan-Aug 2022.

CURRENCY

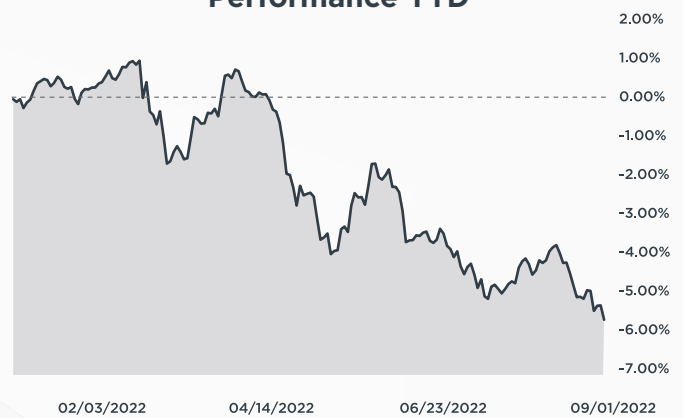
2022 has seen the Dollar gain significant strength over nearly all global currencies in both advanced and emerging markets. A key driver for this has been the Fed's early and swift rate hikes compared to other major economies.

The GBP hit near parity with the Dollar in September, with the Euro having already succumbed as the ECB lagged in matching the US risk free rates. Notably, across emerging markets, currencies have been battered amid rising interest rates in the US and a flight towards dollar safety.

DXY Performance YTD



MSCI EM Currency Index Performance YTD



Source: UAE Central Bank

By virtue of the Dirham peg to the US Dollar, the UAE has seen monetary policy near shadow the Fed and Dirham strengthen in line with their US counterpart.

The UAE's Real Effective Exchange Rate reached 123.311 in July 2022, up from 104.55 at the start of the year. Strong currency is allowing the UAE's to maintain a moderate price level with less imported inflation. In addition, it is offering UAE based investors a significant exchange rate premium as they hunt discount opportunities across the world.



2023 EXPECTATIONS

UAE

- ▶ Sustained high energy prices with potential for further supply constraints, a Chinese demand rebound as well as ample financial buffers could be drivers for 2023.
- ▶ The UAE has been strongly positioned and managed to protect itself from significant shocks in 2022, providing it with a comparative appeal in the global context.
- ▶ Prudent fiscal spending, as the federal government aims to increase spending 4% in the revised 2023-2026 budget, to provide stimulus.
- ▶ Currency strengthening of the Dirham, on the back of the USD currency peg, has meant cheaper imports from Europe and Asia. However, with the extension of Dollar dominance there is a risk of exports becoming less competitive.

GLOBAL

- ▶ The global economy faces economic scenarios that range from a 'soft landing' to 'stagflation' and perhaps outright 'recession' - outcomes that have promoted heightened caution across all asset classes.
- ▶ The tail end of 2022 and start of 2023 are set to be tough on most global economies with markets expecting similarly weakened markets..
- ▶ Weaker economic growth tends to translate into lower corporate profits and reduced investor risk appetite as seen by developments in the capital markets.
- ▶ Economic outperformance in some economies will offer a more attractive landscape for investing particularly amid transformational change and the development of opportunities in growing sectors (education, healthcare, fintech, renewables).



