

United Arab Emirates: the essentials

- **Agreement on a restructuring of Dubai's debt stock is not a quick fix for the UAE, but after months of uncertainty, a deal should finally open the way for recovery**

The long road back

Dubai in late March released the terms on which it proposes to restructure over USD20bn of debt and payment arrears owed by one of its largest government-owned conglomerates, Dubai World. The proposal has not yet been accepted by creditors. However, it includes no explicit haircuts and has an undertaking to provide additional government funds in return for an extension of maturities – significantly more generous terms than creditors had been expecting early in the year. As well as offering terms to creditor banks and bond holders, the restructuring deal proposes a repayment package for corporates with arrears outstanding to Dubai world entities.

Approval of the deal would mark the beginning of the end of the crisis triggered in late November when Dubai World unexpectedly requested a payment standstill from some of its leading creditors. The proposal has already facilitated the return of UAE names to the international credit markets, tentatively reopening a key source of infrastructure funding. The promise of payment to local corporates also opens the way for an easing of the acute liquidity squeeze the private sector has faced for well over a year. Together with the commitment to service loans and bonds,

making payments to local corporates should also ease some of the pressure on bank balance sheets. With high oil prices also promoting strong growth in public spending at an aggregate UAE level and global recovery boosting demand for the UAE's service and non-oil goods exports, we look for the economy to return to growth this year and for the pace of expansion to strengthen in 2011.

Nevertheless, we expect recovery in the UAE to lag the rest of the region. In part this reflects the months lost by the debt crisis, the time it may yet take to execute the deal and the damage done by recent events to the UAE's reputation. We remain concerned at the scale of the debt stock of government-owned entities and the demanding maturity profile of those loans and bonds yet to be restructured. Local banks are also likely to struggle to extend new funding in the near term, particularly against the backdrop of a still-fragile real estate market.

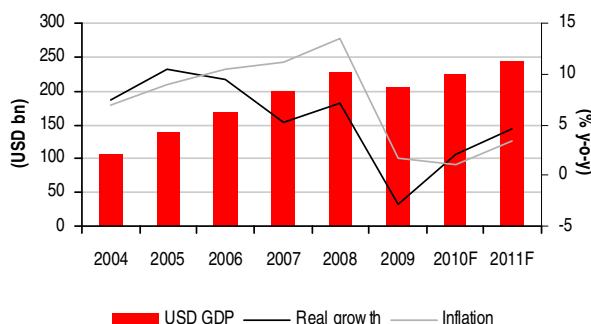
Within the UAE, Abu Dhabi looks well-placed to continue to outperform Dubai. The ability of the Abu Dhabi authorities to spend from their own resources and raise funds appears far stronger than that of its neighbour and its infrastructure development programme is at an earlier stage. With oil expected to average USD80/b over 2010-11, we also expect to see an acceleration in Abu Dhabi's purchase of overseas assets and look for an increased emphasis on both emerging market and hi-tech acquisitions.

	Q1 2009e	Q2 2009	Q3 2009	Q4 2009	Q1 2010e	Q2 2010e	Q3 2010e	Q4 2010e	Q1 2011e	Q2 2011e
International reserves (USD bn)	34.0	34.1	36.0	37.6	40.6	42.0	43.2	44.2	45.0	45.8
Policy rate, end quarter (%)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
1-yr yield, end quarter (%)	3.7	3.5	2.8	2.4	2.7	2.4	2.1	2.0	1.9	1.9
AED/USD, end quarter	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
AED/EUR, end quarter	5.33	5.15	5.33	5.25	4.96	4.96	5.14	5.33	5.33	5.33

UAE capital markets lag rally; no nerves over currency

Concerns over debt and contingent liabilities of the UAE authorities weighed heavily on capital market performance over 2009 and the first months of 2010. While the Dubai World restructuring announcement prompted a turnaround, the rally struggled to build momentum. UAE equity markets were up 10% y-o-y in late March, lagging the MSCI EM index by 60ppts and leaving local markets still down 20% on 2009 highs. CDS levels have tightened but concerns over the impact of still-elevated debt levels on economic performance have persisted. The only asset to have shrugged off the uncertainty has been the currency. Both spot and forward markets have remained firm, underscoring how strong market confidence in the central bank's ability to sustain the currency peg remains.

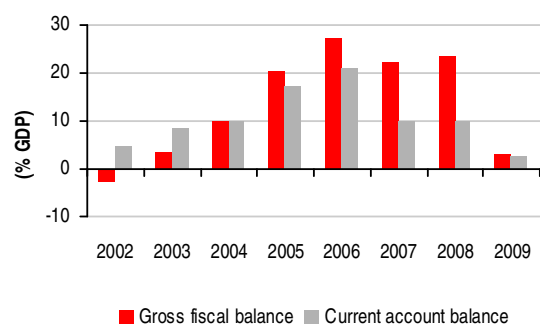
Activity & inflation



Interbank rates still elevated

At 2.3%, the 3m UAE interbank rate stood 200bps above its USD equivalent in late April, an exceptionally high spread given the stability of the AED's dollar peg. The spread has changed little over the past year, in contrast to neighbouring Saudi Arabia, where the spread on 3m interbank funds has narrowed to 40bps. The wide differential in the UAE reflects strains in the banks' balance sheets, which show a loan-to-deposit ratio still running well over 100%, despite near-zero credit growth. In Saudi Arabia, by contrast, the LDR dropped 20ppt during 2009 as the sector went through a period of rapid balance-sheet adjustment. High levels of capital and progress with Dubai World debt would boost confidence and liquidity during 2010. Spreads are likely to remain elevated, however, and credit growth slow until asset-quality concerns are addressed.

Policy stance



United Arab Emirates: macro framework

	2004	2005	2006	2007	2008	2009e	2010e	2011e
Production, demand and employment								
GDP growth (% y-o-y)	7.4	10.5	9.4	5.2	7.0	-2.9	2.0	4.5
Nominal GDP (USDbn)	105.2	139.7	170.1	198.7	226.5	203.3	223.6	243.9
GDP per capita (USD)	24,359	29,941	33,749	36,854	39,270	35,966	38,280	41,254
Private consumption (% y-o-y, nominal)	29.1	17.6	12.2	18.0	20.0	2.0	5.0	11.0
Govt consumption (% y-o-y, nominal)	3.8	16.4	12.4	21.0	16.0	7.0	7.5	8.0
Investment (% y-o-y, nominal)	11.1	15.5	29.0	25.0	26.0	-15.0	6.0	12.5
Industrial production (% y-o-y)	6.7	5.6	10.3	8.0	6.4	-4.0	2.7	4.8
Gross domestic saving (% GDP)	35.3	42.8	47.2	45.7	43.2	34.9	37.6	36.8
Prices & wages								
CPI, average (% y-o-y)	7.0	9.0	10.5	11.1	13.5	1.8	1.0	3.4
CPI, end-year (% y-o-y)	8.0	9.8	10.0	9.0	12.0	1.5	2.2	3.7
Money, FX & interest rates								
Broad money supply M3 (% y-o-y)	20.8	33.8	23.2	41.7	19.2	11.7	11.9	17.9
Real private sector credit growth (% y-o-y)	17.0	32.8	22.4	18.9	22.5	0.2	4.5	9.6
Policy rate, end-year (%)	3.0	4.7	5.2	4.3	1.8	1.0	1.0	1.0
1-yr yield, end-year (%)	3.2	5.0	5.4	4.4	4.3	2.4	2.0	2.2
AED/USD, end-year	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
AED/USD, average	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
AED/EUR, end-year	4.98	4.35	4.85	4.96	5.14	5.25	5.33	5.33
AED/EUR, average	4.57	4.55	4.62	4.77	5.51	5.18	5.11	5.33
External sector								
Merchandise exports (USDbn)	91.0	117.3	145.6	178.6	239.2	180.9	201.9	225.2
Merchandise imports (USDbn)	-63.4	-74.5	-88.0	-132.1	-176.3	-141.0	-150.9	-172.0
Trade balance (USDbn)	27.6	42.8	57.5	46.5	62.9	39.9	51.0	53.2
Current account balance (USDbn)	10.5	24.4	36.0	19.6	22.3	5.1	12.1	13.4
Current account balance (% GDP)	10.0	17.4	21.2	9.9	9.8	2.5	5.4	5.5
Net FDI (USDbn)	7.8	7.2	7.7	7.5	3.5	-0.2	2.2	6.0
Net FDI (% GDP)	7.4	5.2	4.5	3.8	1.5	-0.1	1.0	2.5
Current account balance plus FDI (% GDP)	17.4	22.6	25.7	13.7	11.4	2.4	6.4	7.9
Exports (% y-o-y)	35.5	28.9	24.1	22.7	33.9	-24.4	11.6	11.6
Imports (% y-o-y)	38.4	17.4	18.2	50.0	33.4	-20.0	7.0	14.0
International FX reserves (ex gold) (USDbn)	18.5	21.0	27.6	77.2	31.6	37.6	44.2	46.2
Import cover (months)	3.5	3.4	3.8	7.0	2.1	3.2	3.5	3.2
Public and external solvency indicators								
Commercial banks' FX assets (USDbn)	34.4	47.7	63.2	53.6	55.4	60.0	64.8	71.3
Gross external debt (USDbn)	27.8	41.0	82.7	133.2	180.5	176.1	193.3	208.3
Short term external debt (% of int'l reserves)	75.0	109.0	100.8	57.1	184.6	123.8	109.5	115.8
Central government balance (% GDP)	10.0	20.6	27.3	22.5	23.6	3.2	9.8	12.0
Gross public domestic debt (AED, bn)	48.5	66.8	88.2	101.4	116.6	126.2	122.7	119.6
Gross public domestic debt (% GDP)	12.5	13.0	14.1	13.9	14.0	16.9	14.9	13.3

Source: UAE Central Bank, IMF – IFS, HSBC

Disclosure appendix

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Issuer of report**HSBC Bank plc**

8 Canada Square, London

E14 5HQ, United Kingdom

Telephone: +44 20 7991 8888

Fax: +44 20 7992 4880

Website: www.research.hsbc.com

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Contributors

Philip Poole*
+44 20 7992 5641
philip.poole@hsbcib.com

Paras Patel*
+44 20 7991 5624
paras.patel@hsbcib.com

Amit Shrivastava*
Associate
Bangalore

Ramiro D Blazquez*
+54 11 4348 5759
ramiro.blazquez@hsbc.com

Artem Biryukov*
+7 495 721 515
artem.biryukov@hsbc.com

Janus Chan*
+852 2996 6975
januschan@hsbc.com.hk

Javier Finkman*
+51 11 4344 8144
javier.finkman@hsbc.com.ar

Qu Hongbin*
+852 2822 2025
hongbinqu@hsbc.com.hk

Song Yi Kim*
+852 2822 4870
songyikim@hsbc.com.hk

Andre Loes*
+55 11 3371 8184
andre.a.loes@hsbc.com.br

Sergio Martin*
+52 55 5721 2164
sergio.martinm@hsbc.com.mx

Jorge C Morgenstern*
+54 11 4130 9229
jorge.morgenstern@hsbc.com.ar

Alexander Morozov*
+7 495 783 8855
alexander.morozov@hsbc.com

Frederic Neumann*
+852 2822 4556
fredericneumann@hsbc.com.hk

Kubilay Ozturk*
+44 20 7991 6045
kubilay.ozturk@hsbcib.com

Robert Prior-Wandesforde*
+65 6239 0840
robert.prior-wandesforde@hsbc.com.sg

Murat Ulgen*
+90 212 376 4619
muratulgen@hsbc.com.tr

Simon Williams*
+971 04 423 6925
simon.williams@hsbc.com

Wellian Wiranto*
+65 6230 2879
wellianwiranto@hsbc.com.sg

Christopher WW Wong*
+852 2996 6917
christopherwong@hsbc.com.hk

Sun Junwei*
Associate

Jonathan Katz
Consultant

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