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CEEMEA Economics

Shifting up a gear

With the COVID shock fading and commodities gaining we take our growth forecasts sharply higher but with imbalances largely in check, policy normalisation can be slow and measured

In this redacted version of our CEEMEA Economics quarterly, we discuss:

- South Africa: All that glitters
- Egypt: Still outperforming
- Bahrain: Weighed down
- Kuwait: Nominal growth, real stall
- Oman: Work in progress
- Qatar: Back to black
- Saudi Arabia: Rapid rebalancing, strengthening growth
- UAE: Waiting for the wheels to turn

This is an abridged version of a report by the same title published on 6-Jul-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Key events in Q3

July

Poland: Inflation report
05 **Israel:** rate decision
08 **Poland:** rate decision
09 **Russia:** Fitch rating review
14 **Turkey:** rate decision
16 **Russia:** S&P rating review
16 **Kuwait:** S&P rating review
22 **South Africa:** rate decision
23 **Russia:** rate decision
23 **Ghana:** rate decision
24 **Kenya:** rate decision
27 **Hungary:** rate decision
27 **Nigeria:** rate decision
28 **US:** rate decision
29 **Turkey:** Inflation report
29 **Angola:** rate decision
30 **Hungary:** Fitch rating review

August

Czech Rep.: Inflation report
Romania: Inflation report
05 **Egypt:** rate decision
05 **Czech Rep.:** rate decision
06 **Czech Rep.:** Moody's rating review
06 **Angola:** S&P rating review
12 **Turkey:** rate decision
13 **Hungary:** S&P rating review
13 **Turkey:** Fitch rating review
13 **Nigeria:** S&P rating review
23 **Israel:** rate decision
24 **Hungary:** rate decision
24 **Poland:** rate decision
27 **Poland:** Fitch rating review

September

Russia: State Duma election
03 **Kenya:** S&P rating review
08 **Poland:** rate decision
10 **Ghana:** S&P rating review
10 **Russia:** rate decision
16 **Egypt:** rate decision
21 **Hungary:** rate decision
21 **Nigeria:** rate decision
22 **US:** rate decision
23 **Hungary:** Inflation report
23 **Turkey:** rate decision
23 **South Africa:** rate decision
24 **Hungary:** Moody's rating review
24 **Saudi Arabia:** S&P rating review
24 **Kenya:** rate decision
24 **Ghana:** rate decision
27 **Angola:** rate decision
30 **Czech Rep.:** rate decision

Rest of the year

October

South Africa: MTBPS
Poland: S&P rating review
Turkey: S&P rating review
Poland: Moody's rating review
Turkey: inflation report
Czech Rep.: Chamber of deputies election
South Africa: Local government elections

November

Saudi Arabia: Moody's rating review
South Africa: Moody's rating review
South Africa: S&P rating review
US: rate decision
Poland: inflation report

December

Russia: Fitch rating review
US: rate decision

Sub-Saharan Africa

South Africa

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All that glitters

Robust household spending and significant restocking underpinned GDP growth during the first quarter of 2021. While household consumption is nearing pre-pandemic levels, investment spending continues to lag – contracting during the first quarter as private fixed capital formation slumped – and is still 24% below its 2015 peak. With signs that momentum continued into Q2, we now see 2021 GDP growth of 4.9% y-o-y, even as the country faces its third wave of COVID-19 cases and fresh curbs on activity. A slow vaccine rollout means that COVID-19 continues to represent a key cyclical headwind to the recovery, while recurring energy shortages suggest there are limits to how fast the economy can rebound from last year's losses.

For a more meaningful acceleration in economic growth, there needs to be improved energy security and a stronger recovery in investment. This received a boost in June as the president took steps to reform and liberalise energy generation, allowing private power producers to generate up to 100MW of electricity without needing a license. The previous limit was just 1MW. We have increased our 2022 growth forecast slightly to 2.0% y-o-y (1.7% previously), and see potential for stronger investment and growth beyond our current forecast horizon as the energy constraint begins to ease more meaningfully.

The terms of trade have risen by almost 12% over the past year supported by rapidly rising precious metal and iron ore prices, boosting export earnings and the current account, delivering a positive income shock for the economy, and supporting a sustained rally in the currency. We think these gains may prove transitory, and expect a gradual recovery in import volumes in response to firmer domestic demand, inventory restocking and higher income payments to push the current account back into deficit next year.

Mining sector tax receipts, and the stronger rebound in activity and nominal GDP growth have also provided some respite for South Africa's public finances and eased the government's funding pressures. We expect tax collections to beat the government's estimate by ZAR65bn (c1.2% of GDP) in FY21/22 (ending March) and narrow the fiscal shortfall to below 8% of GDP. The government has demonstrated resolve in sticking to its spending targets but risks remain and we have some concerns that the relief from the commodity windfall could weaken the path towards fiscal consolidation. Long-term debt sustainability demands structural reforms to boost growth.

Our CPI projections continue to move higher, and the SARB's policymakers were more focused on upside price pressures and risks at the May MPC meeting, including power and other administered prices, increasing domestic and global producer price inflation, higher domestic import tariffs and rising wage demands. Faster GDP growth, particularly as investment remains moribund, suggests the output gap will close more quickly, and we remain comfortable with our view that the SARB will begin its policy normalisation sooner rather than later, forecasting a 25bp rate hike in September.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
GDP growth (% y-o-y)	-6.2	-4.2	-3.2	18.0	4.0	2.8	1.9	1.7
CPI, eop (% y-o-y)	3.0	3.1	3.2	5.0	4.8	4.9	4.7	4.5
Policy rate, eop (%)	3.50	3.50	3.50	3.50	3.75	3.75	4.00	4.25
USD/ZAR (eop)	16.68	14.69	14.77	14.28	14.20	14.50	14.80	15.00

Source: Refinitiv Datastream, Bloomberg, HSBC forecasts

Middle East and North Africa

Egypt

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Still outperforming

We remain upbeat on Egypt's economic prospects, and continue to look for it to deliver both strong growth and policy-driven rebalancing. Only headline GDP has been released for Q1, but the provisional data bear out our optimism with the economy expanding by 2.9% y-o-y. The performance means that, after just one quarter of pandemic-driven contraction, the economy has built momentum for three consecutive quarters despite ongoing disruption to tourism and periodic spikes in infection rates. We are hopeful that this trend will persist, and see growth back above 5% next year from an average of around 3% in fiscal 2020/21, with risks weighted to the upside if global travel recovers more quickly than we currently expect.

Despite the rapid recovery in growth, domestic prices remain broadly stable. Headline annual inflation hit 4.8% in May, the fastest increase of the year but still below the lower bound of the central bank's 7% (+/- 2ppt) range, with core lower still at just 3.4%. We see further price gains in Q3 but do not expect the rise to push inflation above the mid-point of the target, in part because subsidies and currency strength will dampen the impact of rising commodity prices. We also expect monetary policy to remain tight, and retain our view that the policy rate will remain on hold over the remainder of our forecast period. As inflation picks up, the real rate will fall but, at more than 250bps at year-end, will remain one of the highest rates in EM – a buffer that should shield Egypt from any pick-up in market volatility as the global focus shifts toward US tapering. In addition to price stability, the authorities continue to make good progress on fiscal adjustment, with data to March (Q3 of the fiscal year) showing revenues rising more rapidly than spending despite the impact of COVID-19. The outturn has been stronger than we anticipated and we now see the budget deficit for this year at 8% (8.5% previously), falling to 6.8% in 2021/22 – a high sum, but the lowest since 2009 and a level that should see public debt trend lower.

Against this positive backdrop, our most pronounced concerns centre on Egypt's external position where a rising import bill and weak tourism receipts are pushing the current account deficit wider. We already forecast a shortfall of around 4% of GDP, but see the possibility of lower worker remittances weighting the risks toward a bigger deficit. In addition, Egypt faces significant repayment obligations, including from 2023 on the USD20bn drawn down from the IMF to anchor the reform programme and offset the COVID-19 shock. Record foreign holdings of local currency assets would add to the potential funding challenge should risk appetite sour. In addition to external funding, we also have concerns over the shape of the recovery which, though strong, has been import intensive and dominated by rapid gains in consumption. We are hopeful that this will broaden, but with policy tight, external demand uncertain, FDI weak, and structural reform slowed by the COVID shock, the risk is that growth remains uneven, adding to near-term imbalances and weighing on longer-term growth potential.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
CPI, eop (% y-o-y)	3.7	5.4	4.5	5.2	6.3	6.1	6.6	5.4
Policy rate, eop (%)	8.75	8.25	8.25	8.25	8.25	8.25	8.25	8.25
USD/EGP (eop)	15.8	15.7	15.7	15.7	15.8	16.0	16.1	16.3

Note: quarters are based on calendar year and not fiscal year
Source: Central Bank of Egypt, Ministry of Finance, CAPMAS, CEIC, HSBC forecasts

Middle East and North Africa

Bahrain

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Weighed down

A fresh surge in COVID-19 infections – the most marked in the Middle East despite the relatively rapid pace of the Kingdom's vaccine roll-out programme – required Bahrain to tighten domestic lockdown restrictions in Q2, creating fresh headwinds to the normalisation of domestic demand and recovery in the vital travel and broader services sector. No GDP data has yet been released for 2021, but the recent publication of last year's outturn showed the economy contracted by close to 6% – a full percentage point more than we had expected and the steepest downturn in our thirty-year data set, underscoring the low point from which recovery must come. The quarterly growth profile shows only a sluggish turnaround, with non-oil GDP at the end of 2020 down 5ppt on its pre-pandemic levels. In contrast, non-oil demand in neighbouring Saudi Arabia had fully recovered by the same stage.

We take some encouragement from high frequency data pointing to gains in consumption, with point of sales (PoS) transactions up more than 60% y-o-y in April (the most recent point for which data is available). Much of the gains come from the base effect, however, and in sequential terms the increases were fading even before activity restrictions were re-imposed, as pent-up demand was satisfied. A breakdown of the PoS data also shows that spending on non-resident cards, which typically account for a quarter of total outlays, was down more than 50% on its pre-pandemic levels, marking the impact of ongoing travel restrictions, particularly those on the causeway to Saudi Arabia. Private sector credit growth also continued to decelerate through the first months of this year and, while GCC-funding has continued to give infrastructure spending some support, MEED data shows the value of projects planned and underway down 13% y-o-y in June. All told, we see the economy growing by around 3% this year and next – a little lower than the Ministry of Economy forecasts but close to consensus, and a performance that will leave real output below 2019 levels at the end of 2022.

In addition to subdued growth, the authorities must also manage still-pronounced balance sheet strains. Higher oil prices offer significant support, and Q1 current account data shows the deficit halved q-o-q as oil earning rose and the exit of expatriate workers saw remittances fall to their lowest level since the quarterly series began in 2018. We expect this consolidation to continue and see a deficit of around 3.5% of GDP over our forecast period, compared to 9.4% in 2020. We also see the budget deficit narrowing, but the drop to around 6% of GDP reflects oil revenue gains rather than underlying fiscal adjustment as pandemic-related spending continues to rise. With debt levels well over 100% of GDP and savings low, access to deficit finance may require fresh funding from neighbouring states. We think this will likely come if required, but uncertainty over funding coupled with large refinancing needs prompted Moody's and S&P to both put Bahrain's sub-investment grade credit rating on negative outlook in April and May, respectively.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
GDP growth (% y-o-y)	-6.9	-5.5	-	-	-	-	-	-
CPI, eop (% y-o-y)	-1.53	-1.65	-2.04	0.27	-1.07	0.04	1.76	1.87
Policy rate, eop (%)	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
USD/BHD (eop)	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376

Source: Bahrain Central Bank, Ministry of Finance, Bahrain Central Informatics Organisation, CEIC, HSBC forecasts

Middle East and North Africa

Kuwait

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Nominal growth, real stall

As the most oil intensive economy in CEEMEA, fresh upgrades to our oil price and production assumptions have had an especially marked impact on the outlook for Kuwait's nominal balances. We now see the current account generating a surplus of more than 15% of GDP this year and next (the highest in the region) as surging exports comfortably outpace a recovery in import spending. Remittances, which have in the past generated outflows of more than 10% of GDP, also look likely to drop as weaker labour demand and tightening regulation sees the number of expatriates fall. Indeed, full year data shows that more than 130,000 foreign workers left Kuwait in 2020 – the sharpest decline since the 1990 war, and sufficient to drive a fall of more than 2% in the total population. There will be marked gains in public finances too, which could see the budget deficit fall by more than 10ppt of GDP y-o-y in fiscal 2021-22. Though the shortfall will remain large at over 10% of GDP, we see the deficit narrowing further still in 2022-23 with discussion of subsidy cuts and tax reforms suggesting rebalancing could proceed more quickly still.

But though the oil revenue surge offers some relief, the broader outlook remains challenging. Most immediately, there has been no sign of an improvement in the policymaking backdrop, with tensions between parliament and the executive continuing to impede progress on key legislation, including the new public debt law. There have been fresh proposals for a debt law structure including a ceiling on borrowing and a limit on long duration liabilities, but no agreement has been reached, forcing the government to draw down savings to cover its still large financing needs. Parliament has also shown no enthusiasm for key elements of the broader consolidation plan, including the introduction of VAT. The structural reform programme laid out in the Vision 2035 New Kuwait programme also appears stalled and still-weak data for planned project spending suggests higher oil prices have not yet revitalised appetite for additional infrastructure development.

The policy inertia also contributes to the difficult outlook for growth. The belated release of full-year GDP data shows the economy contracted by 9% last year – the deepest downturn in the Middle East. We see growth turning positive this year, led initially by increases in consumption, which rose very strongly in Q2 as lockdown restrictions were removed. We look for investment to trend higher as confidence recovers and for exports to drive growth higher in 2022 as oil output gains. But with the budget still under pressure, there is unlikely to be meaningful fiscal stimulus, while the outflow of workers will weigh on consumption and last year's slump will keep private investment subdued. All told, we see growth at around 2.5% this year and 4.3% in 2022 – an outturn that will leave the economy still 2.5% smaller than it was before the pandemic hit, with output at roughly its 2016 level.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
GDP growth (% y-o-y)	-11.4	-10.2	-	-	-	-	-	-
CPI, eop (% y-o-y)	2.0	3.0	3.2	2.6	2.2	1.7	1.5	1.9
Policy rate, eop (%)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
USD/KWD (eop)	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30

Source: Kuwait Central Bank, Ministry of Finance Kuwait Central Statistics Office, CEIC, HSBC forecasts

Middle East and North Africa

Oman

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Work in progress

With oil prices strong and the budget reform (Tawazun) programme set to gain increasing traction, we remain optimistic that the Omani economy will rebalance quickly as our forecast period proceeds. As promised in the 2021 budget, VAT was implemented in April and we look for tax revenues to gain as growth recovers from the COVID-19 shock and the tax net is steadily tightened. Fiscal energy earnings should also rally as reported revenues capture the gain in prices (Oman's cash budget receives oil revenues with a three-month price lag) and production trends higher. In addition to rising revenues, we expect underlying spending controls to remain tight and look for overall outlays to drop as oil and gas spending is moved off budget to the state-owned Energy Development Oman (EDO).

All told, we see this leaving Oman with a budget shortfall of around 5.5% of GDP – the lowest deficit recorded since 2014 and a 12ppt improvement on the 2020 estimated outturn. The dynamic should also be sufficient to stabilise public debt and potentially begin its downward path. Alongside the marked improvement in public finances, we expect the current account deficit to narrow to around 4% of GDP from an estimated 13% in 2020, with rebalancing again driven in good part by rising hydrocarbon receipts. In addition, we expect Oman's large remittances outflows to drop as the expatriate population continues to contract, and look for tourism receipts to recover. As well as the comfort from a reduced funding requirement, access to finance has proved strong, with the Omani government able to raise almost 10% of GDP on the international bond and loan market over the first half of the year in heavily oversubscribed issues. State-owned enterprises have also come to the debt market, while planned asset sales provide an additional financing stream.

But given the magnitude of the deterioration Oman experienced over the last cycle (debt rose by some 70ppt of GDP between 2015 and 2020), the adjustment is inevitably a work in progress, not a completed task – a view shared by rating agencies which have held Oman at sub-investment grade, and in Fitch's case, kept a negative outlook. Indeed, while we look for consolidation, we have raised our fiscal deficit forecasts by more than 1ppt of GDP since last quarter in light of data that showed a larger shortfall than we had expected over the first four months of the year. With energy earnings still central to public finances and the sovereign needing to refinance loans and bonds worth 8% of GDP next year, Oman will also remain vulnerable to both oil price volatility and global market risk appetite. In that context, it will be imperative that the government press ahead with reform to consolidate credibility with funders and push funding needs lower. We are optimistic, but maintaining discipline will be testing if growth remains weak and high oil prices see pressure building for fiscal loosening to boost recovery

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
CPI, eop (% y-o-y)	-1.2	-1.4	-0.4	1.5	2.4	3.1	3.3	1.8
Policy rate, eop (%)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
USD/OMR (eop)	0.385	0.385	0.385	0.385	0.385	0.385	0.385	0.385

Source: Oman Central Bank, Ministry of Finance, National Centre for Statistics and Information, CEIC, IIF, HSBC forecasts

Middle East and North Africa

Qatar

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Back to black

Although the economy has yet to fully normalise, Qatar is emerging quickly from the COVID-19-driven downturn and we remain optimistic on its prospects over the remainder of our forecast period.

Most immediately, new data shows that the budget returned to surplus in Q1, making Qatar the first economy in the Middle East to move out of deficit, having also generated the smallest shortfall in the region last year. We expect the surplus to widen to around 3% of GDP this year and next, bolstered in part by strong hydrocarbon receipts but also soft spending growth following the completion of much of the large scale infrastructure work ahead of next year's FIFA World Cup. Against this comfortable backdrop, we do not expect Qatar to join other Gulf states in either introducing VAT or coming to the market for funding, a trend which should see public debt trend down toward 55% of GDP.

Qatar's external position recovered even more quickly than public finances, with surging energy earnings returning the current account to balance in Q4 20 following a deficit equivalent to more than 25% of GDP on an annualised basis in Q3. Very strong trade data to April makes clear that the gains have continued into this year, and we see a surplus of close to 5% over 2021-22, allowing the central bank to rebuild reserves and the QIA to add to its already-large asset base.

Economic activity is also recovering, though the gains have come through more slowly. The non-oil sector led the 2020 recession, and remained down 4% y-o-y in Q4 2020, with sequential data showing only a gradual return toward pre-pandemic levels over the year. PMIs have printed above 50 since the start of the year and strengthening numbers for building activity and new vehicle sales suggest pent-up demand is being released. However, mobility data remained below pre-COVID-19 levels into Q2 21, private sector credit growth has slowed, and the population continues to contract as expatriates leave. Visitor arrival numbers are also still very low as travel restrictions continue to disrupt demand and, all told, we see growth running below 3.5% for the year. From here, however, we expect growth to push above 4% and gain pace as COVID restrictions fade, sentiment gains and the World Cup tournament in Q4 22 brings a surge in tourism and other services exports.

The high profile arrest in May of Finance Minister Ali Sharif Al-Emadi in May on corruption charges has had no impact on our view of the policy outlook, and Fitch retained its AA- rating of the country the following month with a stable outlook. In a sign that geopolitical tensions continue to fade, Saudi Arabia re-established its ambassador in Doha for the first time since the breakdown of Qatar's ties with its GCC neighbours in 2017, and six months after the regional economic blockade was lifted.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
GDP growth (% y-o-y)	-4.6	-3.9	-	-	-	-	-	-
CPI, eop (% y-o-y)	-3.0	-3.4	-0.3	2.5	2.5	3.4	2.7	2.1
Policy rate, eop (%)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
USD/QAR (eop)	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64

Source: Qatar Central Bank, Ministry of Finance, Qatar Statistical Authority, CEIC, HSBC forecasts

Middle East and North Africa

Saudi Arabia

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Rapid rebalancing, strengthening growth

We remain upbeat on Saudi Arabia's economic prospects and look for the Kingdom to deliver accelerating economic growth over our forecast period against a backdrop of strengthening domestic and external balances.

To an extent, this optimism reflects the outlook for oil prices which have risen more quickly than we expected a quarter ago. At USD70/b Saudi Arabia's energy production will be worth 50% more than it was last year, with the impact of higher prices set to be boosted by gains in oil output over the rest of this year and more markedly in 2022 as OPEC production constraints ease. Even allowing for a recovery in demand for imported goods and services, the surge in export earnings should see last year's 2.8% of GDP current account deficit become a surplus of more than 4% of GDP over 2021-22. We expect the external account position to be bolstered further by a pick-up in FDI inflows, which hit a five-year high in 2020, and by a further drop in worker remittances.

The improvement in public finances will be more marked still, with the budget deficit likely to average under 3% of GDP over 2021-22 – the lowest two-year funding requirement since 2012-13, and an 8ppt of GDP gain on last year's outturn. In addition to the lift from higher oil prices, the improvement marks the impact of tax hikes and spending controls introduced last year that saw the deficit drop 80% y-o-y in Q1. The outturn should see public debt stabilise at a little over 30% of GDP – up 10ppt on its pre-COVID-19 level, but still modest by international standards. Inflation should also stabilise over the remainder of this year and through 2022 as the impact of last year's VAT hike fades and strong housing supply growth caps growth in rents.

Alongside this broad rebalancing, we expect activity to trend higher. The gains will be led by consumption, which has rallied strongly since H220 and lifted non-oil GDP back above its pre-COVID-19 levels in Q121. We also expect investment to gain pace over the remainder of this year and into 2022, with the Public Investment Fund (PIF – Saudi Arabia's sovereign wealth fund) set to become an ever more powerful domestic actor. The oil sector will be a brake on growth over 2021 as a whole as OPEC restraint weighs, but output gains should lift headline growth to around 4% in 2022 from 2% this year. We also expect to see non-oil exports rise next year, especially if an easing of restrictions allows religious tourism to resume in full.

We are also optimistic that Vision 2030 will frame continued policy gains, building on recent successes such as those focused on the labour market, housing market, SMEs, and fiscal reform. Maintaining policy momentum at a time of rising oil prices will be a test of commitment, however, particularly if unemployment trends higher. Ensuring the powerful public sector does not dominate investment choices to the detriment of the private sector may also prove challenging given the urgency with which change must be pursued.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
GDP growth (% y-o-y)	-1.5	5.2	4.3	-	-	-	-	-
CPI, eop (% y-o-y)	5.7	5.3	4.9	6.2	0.9	1.4	2.2	2.1
Policy rate, eop (%)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
USD/SAR (eop)	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75

Source: Saudi Arabia Central Bank, Central Department of Statistics and Information (CDSI), CEIC, HSBC forecasts

Middle East and North Africa

UAE

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Waiting for the wheels to turn

Full year GDP has yet to be released for 2020 and there is no consolidated data for 2021, making it is difficult to gauge the UAE's recovery with confidence. However, high frequency indicators continue to point to a cycle that has turned, but is still only building momentum slowly. The PMI, for example, has remained above 50 since the start of the year but lost speed through Q2 for the UAE as a whole and Dubai in particular. Significantly, employment has continued to contract and firms show no sign of rebuilding inventories in anticipation of gains in demand. The most recent monetary data show lending to the private sector contracting y-o-y to April and stagnating over the first four months of 2021 despite strong support from the UAE central bank – a marked contrast with Saudi Arabia where a 20% y-o-y increase in lending to the private sector has given the recovery support. Deflation has also persisted, with prices in the UAE dropping for a ninth consecutive quarter in Q1 as average rents fell. Real estate prices are up in some parts of the UAE for the first time in five years, but have lagged the far larger gains in other emerging and developed markets.

To an extent, the muted gains reflect the legacy of last year's slump. On the central bank's own estimates, the COVID-19 downturn will have cost the UAE 9ppt of GDP by the end of 2022, with the economy 2.5% smaller this year than it was in 2019. The spare capacity such an outturn represents creates few incentives for additional capital spending and MEED data shows project work in the UAE has continued to decline. There has also been a shock to the labour market with new demographic data showing the population contracted 2.4% in 2020 as expatriates left – the first drop in a decade and a lasting loss to economic potential and domestic demand. The openness of the UAE economy creates additional vulnerabilities, with the vital tourism and travel sectors exposed to the disruption COVID-19 restrictions continue to bring – Q1 visitor numbers are off their lows, but still down more than 70% on Q119. Saudi Arabia's decision in July to impose restrictions on travel to the UAE is just the latest external headwind to recovery.

While the recovery is nascent, however, we are hopeful that it is underway and optimistic that it will gain pace significantly over the remainder of our forecast period. In part this reflects the remarkable success of the vaccination programme, with 75% of the population now fully inoculated. This minimises the risks of any further lockdown restrictions, boosting sentiment. It also leaves the UAE exceptionally well placed to catch the first tailwinds of any normalisation in international travel, with the start of World Expo in Dubai in Q421 a potential accelerant for gains in demand. Fiscal policy is also likely to loosen as the forecast period wears on, with oil at USD70/b all but closing the budget shortfall. Alongside this cyclical support we are also hopeful that the structural reform programme will persist, building on the gains of the past year and encouraged by intensifying competition for capital from Saudi Arabia. All told, we see this taking growth to around 3% this year and over 4% in 2022, with the risks weighted to the upside for next year if oil prices continue to gain and UAE output rises.

Quarterly data

	Q3 20	Q4 20	Q1 21e	Q2 21f	Q3 21f	Q4 21f	Q1 22f	Q2 22f
CPI, eop (% y-o-y)	-2.4	-2.1	-1.0	-1.0	0.7	1.2	2.1	2.2
Policy rate, eop (%)	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
USD/AED (eop)	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67

Source: UAE Central Bank, Ministry of Finance, National Bureau of statistics, HSBC forecasts

Disclosure appendix

Analyst Certification

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