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Economics - CEEMEA

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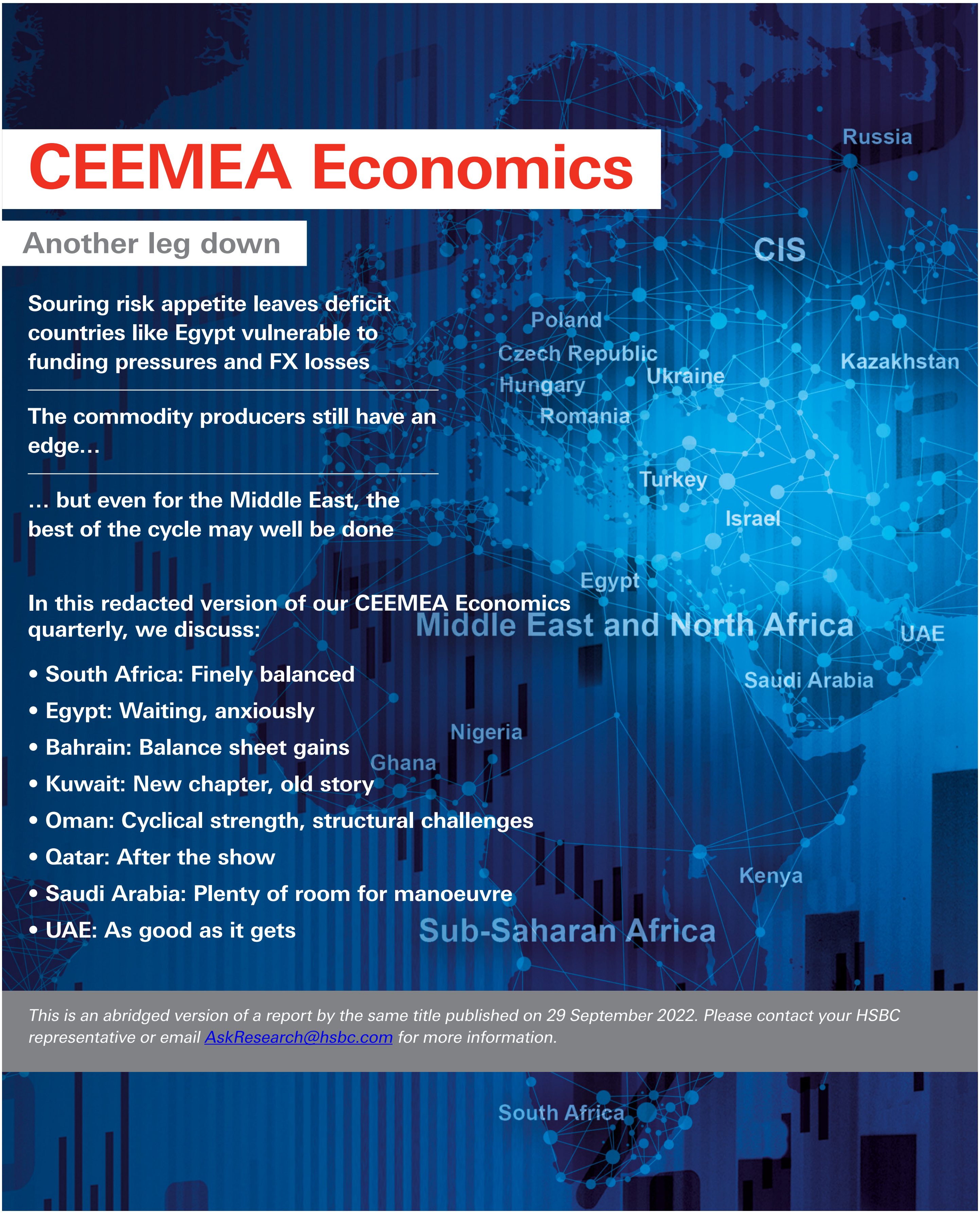

CEEMEA Economics

Another leg down

Souring risk appetite leaves deficit countries like Egypt vulnerable to funding pressures and FX losses

The commodity producers still have an edge…

… but even for the Middle East, the best of the cycle may well be done

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

- **South Africa: Finely balanced**
- **Egypt: Waiting, anxiously**
- **Bahrain: Balance sheet gains**
- **Kuwait: New chapter, old story**
- **Oman: Cyclical strength, structural challenges**
- **Qatar: After the show**
- **Saudi Arabia: Plenty of room for manoeuvre**
- **UAE: As good as it gets**

This is an abridged version of a report by the same title published on 29 September 2022. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Key events in Q4

October

3 **Israel:** Interest rate decision
5 **Poland:** Interest rate decision
5 **Romania:** Interest rate decision
7 **Romania:** Fitch rating review
7 **Ghana:** Interest rate decision
14 **Romania:** S&P Global rating review
14 **Romania:** Moody's rating review
14 **Czech Rep:** S&P Global rating review
20 **Turkey:** Interest rate decision
21 **Czech Rep:** Fitch rating review
21 **Egypt:** S&P Global rating review
25 **Hungary:** Interest rate decision
26 **South Africa:** Budget statement
28 **Poland:** Moody's rating review
28 **Russia:** Interest rate decision

November

1 **Israel:** Legislative election
2 **US:** Interest rate decision
3 **Egypt:** Interest rate decision
3 **Czech Rep:** Interest rate decision
4 **Qatar:** S&P Global rating review
8 **Romania:** Interest rate decision
9 **Poland:** Interest rate decision
11 **Israel:** S&P Global rating review
12 **Bahrain:** Legislative election
18 **Russia:** Fitch rating review
18 **Turkey:** Fitch rating review
18 **South Africa:** S&P Global rating review
21 **Israel:** Interest rate decision
22 **Nigeria:** Interest rate decision
22 **Hungary:** Interest rate decision
23 **Zambia:** Interest rate decision
24 **South Africa:** Interest rate decision
24 **Turkey:** Interest rate decision
28 **Ghana:** Interest rate decision

December

7 **Poland:** Interest rate decision
9 **Nigeria:** Moody's rating review
9 **Kuwait:** S&P Global rating review
9 **Saudi Arabia:** Moody's rating review
14 **US:** Interest rate decision
16 **Russia:** Interest rate decision
20 **Hungary:** Interest rate decision
21 **Czech Rep:** Interest rate decision
22 **Egypt:** Interest rate decision
22 **Turkey:** Interest rate decision

Next year

January

Czech Rep: Presidential election
Israel: Interest rate decision
Romania: Interest rate decision

February

US: Interest rate decision
Nigeria: Presidential and legislative elections
Russia: Interest rate decision
Israel: Interest rate decision
Romania: Interest rate decision

March

US: Interest rate decision
Russia: Interest rate decision

Q2 2023

US: Interest rate decision
Turkey: Presidential and legislative elections
Russia: Interest rate decision
Israel: Interest rate decision

Q3 2023

US: Interest rate decision
Russia: Interest rate decision
Israel: Interest rate decision

Q4 2023

US: Interest rate decision
Poland: Legislative election *
Russia: Interest rate decision
Israel: Interest rate decision

* Autumn 2023

Sub-Saharan Africa

South Africa

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Finely balanced

South Africa's economy contracted by 0.7% q-o-q during Q2 2022 as net exports weighed heavily on growth. Government consumption also contracted, but household consumption was positive on stronger services spending and investment gains underpinned by rising private sector fixed capital formation. As a result, the Q2 contraction was less severe than we had anticipated, prompting us to lift our full-year growth forecast to 2.0% y-o-y. But the outlook faces a myriad of challenges including a deteriorating global growth backdrop, worsening domestic energy shortages, and headwinds to consumer spending from elevated inflation, rising interest rates, low confidence, and a weak jobs recovery.

Policy initiatives to open up the power generation market should encourage a ramp-up in private sector investment in new renewable energy projects, but it will take time to unwind the supply shortfall leaving the economy vulnerable to persistent power cuts during H2 2022 and through 2023 that saps sentiment and growth momentum. There is scope for faster growth as South Africa's power constraint starts to ease and we forecast GDP growth of 1.5% y-o-y in 2024.

Inflation accelerated to a 13-year high in Q3 driven by fuel and food prices, while core pressures have gradually risen over time. We forecast inflation to average almost 7% in 2022, but to slow to 5.0% in 2024, still above the 4.5% mid-point of the SARB target range with upside risks from high producer price inflation, a weaker ZAR, elevated energy costs and rising expectations. The SARB hiked by another 75bp at its September MPC meeting, responding to upside inflation risks, a weaker ZAR and a further deterioration in inflation expectations. We think a bigger and more protracted breach of the inflation target, further increases in price expectations, and the faster pace of global policy tightening will prompt the SARB into another 75bp hike in November, and a 50bp rate rise in January 2023, taking the policy rate to 7.5% in Q1 2023 (7.0% previously).

Elevated prices for a range of commodity exports continue to buoy South Africa's macro balances, although the current account posted a surprise deficit in Q2 2022 suggesting that support for the external position may be unwinding more quickly than we previously thought. A decline in the terms of trade, infrastructure constraints that weigh on exports and rising import volumes in response to stronger investment are set to narrow the trade surplus further and push the current account back into deficit from 2023.

Strong corporate receipts and broader tax gains meanwhile support our estimate that revenue will beat the government's budget target by cZAR90bn (1.3% of GDP) in FY22/23, pointing to a much smaller deficit and a borrowing requirement when compared with the government's estimate of 6% of GDP shortfall. As a result, we have few immediate concerns over the budget even though the long-term fiscal outlook remains vulnerable to the risks posed by a range of structural spending pressures and any decline in commodity prices. Basic income support is a key policy issue for the upcoming ANC elections, with potentially significant fiscal implications.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
GDP growth (% y-o-y)	2.7	0.2	2.5	2.3	0.3	1.2	1.0	0.7
CPI, eop (% y-o-y)	5.9	7.4	7.6	7.3	6.9	5.7	5.5	5.4
Policy rate, eop (%)	4.25	4.75	6.25	7.00	7.50	7.50	7.50	7.50
USD/ZAR (eop)	14.6	16.4	18.0	16.5	16.0	16.0	15.5	15.5

Source: Refinitiv Datastream, Bloomberg, HSBC forecasts

Middle East and North Africa

Egypt

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Waiting, anxiously

Some six months after talks began, Egypt's economic outlook continues to be overshadowed by negotiations with the IMF. Our working assumption remains that talks over a programme will be successful and will provide USD3-5bn in new funding as well as some relief on the USD13bn of repayments on existing facilities due over the coming three years. We expect the agreement to be concluded in the coming weeks, with the key immediate policy conditions for the release of the funds likely to include a significant liberalisation of the FX regime that will see the nominal value of EGP drop. How far the currency will depreciate is difficult to gauge, but our forecasts assume EGP weakens from EGP19.5 against the dollar at present (the end of Q3) to around EGP22 by year-end. With the currency having also fallen in Q1, our forecast would take the depreciation for 2022 as a whole to some 30%.

Inflation has risen throughout 2022, hitting a four-year high of 14.6% in August, more than 5ppt above the top-end of the central bank's target range. If the currency weakens by the amount we anticipate, inflation would likely push as high as 20% early next year and remain at double-digit rates until well into 2024. Despite keeping rates flat over Q3, we would expect the bank to respond to the inflation spike by tightening policy by as much as 400bps both to anchor price expectations and help stabilise the new FX regime. With the currency likely to trend lower as the forecast period progresses, we expect rates to remain high, which together with tighter fiscal policy and the impact of high inflation on real incomes, will see domestic demand slow and headline growth drop. However, we see this slowdown accelerating the rebalancing of the current account and opening the way for a rebound in activity through the second half of 2023 and into 2024, with prospects bolstered by gains in GCC-funded FDI as well as higher inflows from expatriate workers and a further pick-up in goods and services exports.

But while this base case is captured in our forecasts, we are acutely aware of the uncertainties that surround it. Although there has been some guidance on the scope of the IMF talks, for example, we have no clarity on the scale or conditionality that will inform it, or when negotiations might be concluded. We recognise that this could see more generous terms being offered than we project, which could trigger more rapid rebalancing and a faster recovery than we expect, especially if an IMF agreement is coupled with further financial support from allies or speedy access to market funding. But we would argue that the more significant risks are weighted to the downside, with the time negotiations have already taken underscoring their sensitivity and complexity, and the difficulty of reaching an accord. Should these challenges see the deal stall, the near-term outlook would likely deteriorate sharply with deepening FX shortages disrupting production and investment, and goods shortages boosting inflation. Protracted delays could also result in an even sharper fall in the value of the currency when restrictions are lifted to allow balance of payments strains to be relieved.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	10.5	13.1	13.8	19.8	17.3	15.4	15.1	11.3
Policy rate, eop (%)	8.25	11.25	11.25	11.25	15.25	15.25	15.25	15.25
USD/EGP (eop)	18.5	18.8	19.5	22.0	23.0	23.5	24.0	24.0

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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Balance sheet gains

With firm oil prices set to keep budget revenues and export receipts high, we expect Bahrain's balance sheet to continue to strengthen, reversing the losses of the pandemic period and enhancing the Kingdom's resilience to cyclical shocks.

The most striking gains are for the external account, with Bahrain recording a fifth consecutive quarterly current account surplus in Q2 2022, a run that followed more than four years of large rising shortfalls that had left reserves all but depleted in early 2020 and the BHD's dollar peg under strain. In contrast, reserves stood at some 7% of GDP in early Q3, with the cushion allowing Bahrain to comfortably repay a maturing Eurobond at a time when market conditions could have made re-financing costly. Significantly, the current account data show double-digit gains in services credits as the recovery in the tourism supplemented higher hydrocarbon earnings. There has also been no run-up in expatriate remittances that have previously been a disproportionate draw on the Kingdom's resources, suggesting the overhaul of labour market regulations may be delivering lasting returns. All told, we now see the current account surplus at 14% of GDP this year, the highest on record, and remaining high over 2023-24 even as oil prices soften.

Projections for public finances – the other source of balance sheet strain over the past decade – are more difficult to make, with data available late and lacking in detail. However, headline figures for the first half of the year point to sub-inflation spending growth and strong revenue gains leaving Bahrain with a surplus of around USD100m. This is lower than we anticipated but still puts the government ahead of its target to balance the budget in 2024, and allowing for a strong H2, should see the 2022 full-year surplus exceed 2% of GDP. This will be the first surplus since 2008, an outturn which should see the heavy debt stock trend toward 90% of GDP in 2024, from a peak of more than 120% of GDP in 2020.

Even with the much improved performance, however, we expect policy to remain focused on consolidation, and see limited scope for fiscal stimulus. Elections are due before year-end but will be completed before the budget is rolled out, suggesting pressure for a more accommodative stance will be contained. Monetary policy, too, will remain tight as Bahrain raises rates in line with the Fed. Labour market stability and sentiment gains should support consumption, however, a view supported by strong point of sales numbers. Gulf-funded capital projects are pushing ahead and are unlikely to be impacted by changes in global monetary conditions. With the outlook for the rest of the Gulf robust, external services demand should also remain firm. All told, we see this likely delivering growth of around 2.5-3% over 2023-24, down on an estimated 4% this year, but with the risks likely to the upside if oil prices hold. Inflation is likely to continue to trend higher into year-end, peaking at a little under 6%. From here though, we expect price growth to fall back towards 3% through next year and into 2024.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	3.8	3.0	4.4	5.7	3.7	4.9	4.0	3.7
Policy rate, eop (%)	1.25	2.50	4.00	5.25	5.50	5.50	5.50	5.50
USD/BHD (eop)	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38

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

Middle East and North Africa

Kuwait

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New chapter, old story

For all of the questions that hang over the longer term outlook, we make fresh upward revisions to our near-term forecasts for what looks set to be Kuwait's strongest economic performance in a decade. We now expect growth to run at over 7% this year (5.9% previously), some 6ppt stronger than 2021 and one of the highest rates of expansion in the Gulf. The upward revision largely reflects quicker than anticipated gains in oil output following the relaxation of OPEC production cuts from the start of the year. However, proxy indicators suggest that non-oil growth has also gained more strongly than we expected, with point of sales values rising and private sector credit growth picking up pace despite interest rate hikes. Sentiment also appears firm, and with employment strengthening for both locals and expatriates, we expect consumption to maintain momentum well into next year, boosted by an increasingly expansionary fiscal stance.

Although MEED data suggest that the pick-up in planned projects has been more muted than elsewhere, we look for strong public finances to offer capital spending some support. Here, prospects are strong with our forecasts suggesting the budget will record a surplus of some 7% of GDP over 2022-23 and remain in surplus the following year. If realised, this would be the strongest two-year outturn since 2013-15, and should allow the government to replenish the General Reserve Fund, which was heavily depleted during the 2020 slump when the budget shortfall exceeded 30% of GDP. In addition to strong public finances, we also look for robust external account gains, with surging oil receipts likely to leave Kuwait with a current account surplus above 30% of GDP despite rising import costs and gains in remittance outflows.

But despite high levels of wealth and the strong cyclical performance, longer term prospects continue to be capped by the poor policy environment. A new government was formed in August ahead of a general election scheduled for the end of September, but we see little to suggest that this change in political leadership will break the stand-off between parliament and the executive that has held policy-making back for so long. This includes progress on structural reform plans that remain stalled even as they pick up pace elsewhere in the Middle East, but also on more immediate measures including this year's budget and approval of the new debt law. Instead, policy discussion ahead of the election has focused on how recent oil revenue gains could be utilised to boost current spending – a trend that is unlikely to lead to near-term fiscal strain given high oil prices and low debt, but will see vulnerabilities to any downturn in energy prices build. The policy stasis will also keep potential non-oil growth low, and we see growth falling back to around 2.5% over 2023-24, even if oil prices hold at current highs. The slowdown would be sharper still if energy revenues were to decline.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	4.4	4.4	3.3	2.9	3.3	3.5	3.7	3.7
Policy rate, eop (%)	1.75	2.25	3.25	4.00	4.25	4.25	4.25	4.25
USD/KWD (eop)	0.30	0.31	0.31	0.31	0.31	0.31	0.31	0.31

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

Middle East and North Africa

Oman

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Cyclical strength, structural challenges

Extending our forecast horizon and lowering our oil price assumption put Oman's longer-term policy challenges back into focus, but the near-term outlook remains comfortable, with the funding strains that have dominated the economy over the last decade in abeyance. Most notably, the budget generated a surplus of OMR1bn over the first seven months of the year compared to a OMR1.2bn deficit over the same period of 2021 – a 10% of GDP shift that puts Oman on track to deliver its first fiscal surplus since 2008. The external account position has also firmed and while no regular current account figures are released, the trade balance was at its strongest in seven years going into Q2, a performance we see as consistent with a current account surplus of some 4% of GDP. FX reserves fell in Q2, but the drop likely reflects the authorities' decision to smooth their foreign liabilities by buying back high yielding foreign debt, rather than marking external account weakness.

Though welcome, we view this current strength as a first step in the consolidation process rather than a marker that the vulnerabilities of the past have been resolved, with the underlying data suggesting there is work still to be done. In particular, we note that the fiscal and trade gains continue to be driven overwhelmingly by shifts in oil receipts, with the non-oil deficit yet to close materially. There are also some signs of slippage, with public spending rising well ahead of the pace of inflation, at the same time as import spending is pushing higher and expatriate employment is gaining fast. For now, the shift is covered by rising oil receipts, but our forecasts indicate Oman will likely be back to twin deficits by 2024, even if oil holds at around USD90/b. This suggests that ongoing adjustment is critical to guard against more substantial shortfalls an oil price drop would bring, particularly with debt still high at some 60% of GDP. Our forecasts assume the authorities will press ahead with reform, but the 2023 budget – and in particular progress with plans to introduce income tax and the stance on public wages and subsidies – will be a test of the government's intent.

We have pushed our 2022 growth estimate to 4.5% (3.8% previously), largely to reflect Q1 GDP data that showed stronger energy sector gains than we had initially anticipated. Although non-oil GDP growth was more muted, high frequency data suggests that domestic demand is firming, buoyed by strong job creation and demographic growth. The recovery in the tourism sector is also ongoing. But if fiscal policy remains conservative as we expect and rising interest rates continue to keep credit growth subdued, then as the lift from higher oil and gas output fades we see the overall pace of expansion slowing to 3% or less over 2023-24, below the GCC average. We expect price growth to remain broadly stable, with inflation averaging around 3.5% over the coming two years on a downward path.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	3.6	2.9	3.4	3.7	4.5	4.4	3.9	3.5
Policy rate, eop (%)	0.50	1.75	3.25	4.50	4.75	4.75	4.75	4.75
USD/OMR (eop)	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39

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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After the show

Qatar's immediate economic outlook remains dominated by the FIFA World Cup, the largest sporting event ever to take place in the Middle East. The tournament, due to begin in mid-November, is expected to attract up to two million visitors during the month over which it is held – as many arrivals as Qatar normally receives in a year. As such, the event will deliver an unprecedented boost to every aspect of the service sector, led by the travel, tourism and hospitality industry, which has been building additional (temporary) capacity in preparation for the tournament.

There will likely be longer-term benefits from hosting the event stemming from both the infrastructure and sector expertise developed for the tournament, and the profile the World Cup is set to bring. Some of the structural reforms brought into effect ahead of the event, including the liberalisation of the labour market, are also likely to deliver ongoing gains. When the tournament is over, attention will also shift fully to Qatar's well advanced plans the expansion of its gas sector, with investment in the North Field set to see LNG output rise by 50% within five years. That the expansion coincides with pronounced European concerns over the security of gas supplies further strengthens the already robust case for the capital outlays.

Even before the new capacity is complete, strong hydrocarbon revenues are set to deliver external account and budget surpluses. Data for the first seven months of 2022 shows export receipts up 70% y-o-y, with revenues in July more than three times higher than at the same point in 2020. The windfall is even more marked than in other parts of the Gulf, a reflection of the premium for the gas that dominates Qatar's exports. We see this leaving Qatar with a trade-driven current account surplus of more than 15% of GDP over 2022-24, with savings adding to the state's already large stock of sovereign wealth. We also look for the budget to remain in surplus, with the impact of earnings likely to be boosted by lower spending as capital outlays continue to trend lower once the World Cup is over.

But while this positive picture holds, we sense this year marks the end of a cycle and that as the World Cup effect (both the immediate gains from higher demand during the tournament and the longer-term anchor for infrastructure spend the event has represented) fades, the trend pace of non-oil growth is likely to slow. This shift may be particularly pronounced next year if population growth turns negative as the transitory demand of the tournament fades. It is also not clear to us that the expansion of the gas sector will have a significant feed through into the domestic economy, with the development likely to be capital intensive and import reliant. We also see less evidence of movement on structural reform in Qatar than in the UAE and Saudi Arabia, suggesting the non-oil sector will face tough competition from regional peers. One consequence of the shift in tempo, however, will likely be a moderation in inflation, which we see peaking at around 6% in Q4 before easing to around 3% in 2023.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	4.4	5.4	5.4	6.1	4.2	2.8	2.8	0.2
Policy rate, eop (%)	1.25	2.50	4.50	5.25	5.50	5.50	5.50	5.50
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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Plenty of room for manoeuvre

From an already strong starting point, we have revised our forecasts higher and now estimate growth will reach at least 7.5% this year – 0.5ppt above our projection three months ago, and likely the fastest pace of growth in the G20. Although this would run 5ppt above the ten-year trend, output expanded by more than 2% q-o-q in Q2 and 11% y-o-y in H1 as a whole, suggesting that the risks are still to the upside, particularly given strong high frequency data for Q3. Nominal GDP looks set to exceed USD1trn for the first time.

From here we expect headline growth to slow to around 4% as oil production plateaus, but we look for the non-oil economy to retain much of its momentum. Consumption is likely to remain the key driver, with prospects anchored by firm employment and wages, ongoing demographic growth and strong sentiment. We also expect capital formation to be robust, led by investment in state-backed projects. There should also be gains in exports of non-oil goods and services, boosted by capacity expansion and post-COVID-19 normalisation of religious tourism. We expect unemployment to fall despite gains in the female labour force participation rate and fresh inflows of expatriates.

Despite growth running well ahead of trend, there are few signs of imbalances. We expect inflation to peak before year-end at around 4% and then subside, and while we have nudged our fiscal forecasts lower to reflect slightly softer oil prices, we expect surpluses throughout 2022-24. We also forecast large trade-driven current account surpluses, with the large savings set to drive the Kingdom's asset stock that reached USD1.3trn at the end of Q1 2022 higher still. With the Kingdom focused on a multi-year budget programme that ties spending commitments to non-oil revenue trends, we expect the fiscal stance to remain conservative, despite strong oil receipts. However, spending rose more quickly than we had anticipated in Q2, and with revenues high, the pressure to ease the fiscal stance will likely gain, particularly if growth slows more markedly than we expect or inflation takes a bigger toll on real incomes.

As such, the 2023 budget will be a key test of government intent, and we would view any increases in public salaries or a cut to VAT as an unwelcome return to the pro-cyclical bias of the past. Even if there is no shift in on budget spending, we will look to see if the growing strength of overall public finances feeds through into more rapid gains in off-budget spending through the PIF or other agencies. There is clear scope for the recycling of oil surpluses into onshore projects rather than offshore assets, and we look for strong gains in capital spending that will deliver steady productivity gains. However, careful management of the pace at which spending rises and the framework with which spending decisions are made will both be critical if capital is to be allocated effectively. Managing the role of capital-rich state entities in the economy will also be key if they are to act as facilitators for the private sector as Vision 2030 intends, rather than emerge as dominant actors.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	2.0	2.3	3.2	3.8	3.7	3.7	3.3	3.1
Policy rate, eop (%)	0.75	1.75	3.25	4.50	4.75	4.75	4.75	4.75
USD/SAR (eop)	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75

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

Middle East and North Africa

UAE

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As good as it gets

The paucity of data makes it difficult to gauge the strength of the cycle, but we are nonetheless constructive on prospects for the UAE, which we continue to regard as one of the strongest economic stories in CEEMEA. The upbeat view in good part represents the outlook for growth, with our revised estimate suggesting the economy will expand by close to 6% (5.1% previously) in 2022. This would be the fastest pace of growth in over a decade, and although the expansion will in part reflect increases in oil output, high frequency data suggest the non-oil economy continued to build momentum into the second half of the year. This includes the PMIs for both the UAE as a whole and Dubai, which both hit post-pandemic highs in August.

We expect the overall pace of expansion to slow as energy output normalises, but we are optimistic that the broader economy will perform well. Private consumption will be key, with the outlook boosted by strong labour demand that appears to be already bringing new inflows of expatriate workers. We also look for investment to gain in both Dubai and Abu Dhabi, and expect the 2023 budgets to include plans for higher capital outlays. Non-oil exports are also trending higher, with prospects for travel and tourism boosted in the near term by demand linked to the FIFA World Cup in Qatar in Q4 and over the longer term by gains in capacity. Structural reform, including the overhaul of the labour market, changes in foreign ownership rules, new free trade agreements and the ongoing privatisation drive may also boost potential growth rates as well as the cyclical pace of expansion. Supporting this robust outlook, public finances appear strong, with our forecasts pointing to two more years of fiscal surpluses even as spending gains and oil prices soften. We also look for a trade-driven cumulative current account surplus worth some USD125bn over 2022-24, allowing the UAE to add to its already large stock of sovereign assets.

Against this broadly positive outlook, however, we sense that the headwinds are set to build, and that downside risks are coming back into focus. As the most open economy in the Middle East, for example, the UAE is more exposed than its peers to the weakening global backdrop. The poor outlook for Europe and the UK is a concern given their importance to the tourism sector, particularly given the dollar-driven strength of the AED. At the same time, Fed-driven rate hikes are set to push funding costs to their highest in 15 years, weighing on a credit impulse that only started to build early this year after some seven years of stagnation. We also see some signs of excess building in parts of the economy, particularly in the real estate sector, where prices gained very quickly over the past year and now appear to be falling. Consumer price inflation, though still muted compared to much of the world, has also risen further than we expected. Rate hikes may see these price pressures fade and there are signs that the gains may have already peaked. But we are conscious that inflation expectations have been tough to reset in the past, and aware that any shift toward fiscal stimulus in 2023 could give the price cycle a fresh push higher.

Quarterly data

	Q1 22	Q2 22	Q3 22e	Q4 22f	Q1 23f	Q2 23f	Q3 23f	Q4 23f
CPI, eop (% y-o-y)	5.0	5.8	6.6	6.1	4.6	3.8	3.5	3.6
Policy rate, eop (%)	1.75	3.00	4.50	5.75	6.00	6.00	6.00	6.00
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

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