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Economics - CEEMEA

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CEEMEA Economics

The long road back

Cyclical headwinds, policy limits and the legacy of the 2020 slump will weigh on much of the region but a post-COVID world is coming into sight

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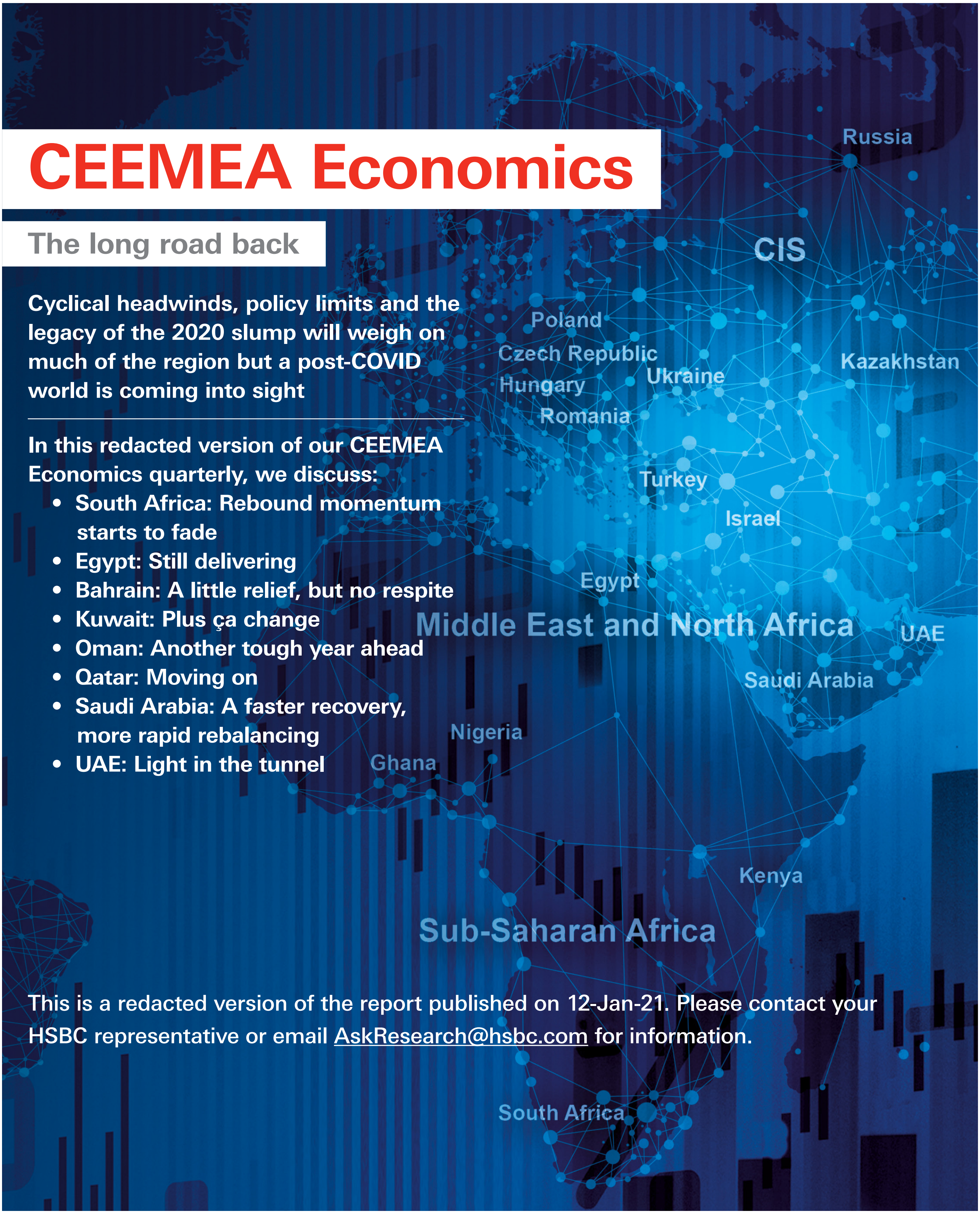
In this redacted version of our CEEMEA Economics quarterly, we discuss:

- South Africa: Rebound momentum starts to fade
- Egypt: Still delivering
- Bahrain: A little relief, but no respite
- Kuwait: Plus ça change
- Oman: Another tough year ahead
- Qatar: Moving on
- Saudi Arabia: A faster recovery, more rapid rebalancing
- UAE: Light in the tunnel



This is a redacted version of the report published on 12-Jan-21. Please contact your HSBC representative or email AskResearch@hsbc.com for information.

Key events in Q1

January

	Ghana: rate decision
04	**OPEC:** meeting
04	**Israel:** rate decision
08	**Romania:** rate decision
13	**Poland:** rate decision
15	**Kuwait:** S&P rating review
15	**Russia:** S&P rating review
21	**Turkey:** rate decision
21	**South Africa:** rate decision
22	**Turkey:** S&P rating review
22	**Czech Republic:** Fitch rating review
26	**Hungary:** rate decision
27	**US:** rate decision
27	**Kenya:** rate decision
28	**Turkey:** inflation report

February

	South Africa: national budget
	Czech Republic: inflation report
	Romania: inflation report
	South Africa: state of the nation address
03	**Poland:** rate decision
04	**Czech Republic:** rate decision
04	**Egypt:** rate decision
05	**Czech Republic:** Moody's rating review
05	**Russia:** Fitch rating review
09	**Romania:** rate decision
12	**Russia:** rate decision
12	**Hungary:** S&P rating review
12	**Hungary:** Fitch rating review
18	**Turkey:** rate decision
19	**Turkey:** Fitch rating review
22	**Israel:** rate decision
23	**Hungary:** rate decision

March

	Ghana: rate decision
	Poland: inflation report
	Hungary: inflation report
03	**Poland:** rate decision
05	**Kenya:** S&P rating review
12	**Ghana:** S&P rating review
17	**US:** rate decision
18	**Turkey:** rate decision
18	**Egypt:** rate decision
19	**Russia:** rate decision
19	**Poland:** Fitch rating review
23	**Hungary:** rate decision
24	**Czech Republic:** rate decision
25	**South Africa:** rate decision
26	**Hungary:** Moody's rating review
26	**Saudi Arabia:** S&P rating review
29	**Kenya:** rate decision

Rest of the year

April

Turkey: inflation report
US: rate decision
Poland: S&P rating review
Poland: Moody's rating review

May

South Africa: Moody's rating review
South Africa: S&P rating review
Turkey: S&P rating review

June

US: rate decision
OPEC meeting
Kenya: national budget
Saudi Arabia: Moody's rating review

July

Turkey: inflation report
US: rate decision
Poland: inflation report
Ghana: mid-year budget statement
Russia: Fitch rating review
Russia: S&P rating review

August

Turkey: Fitch rating review
Poland: Fitch rating review

September

Russia: State Duma election
US: rate decision
Saudi Arabia: S&P rating review

October

South Africa: MTBPS
Turkey: inflation report
Czech Republic: Chamber of deputies election
Qatar: Shura Council appointment
Poland: S&P rating review
Turkey: S&P rating review
Poland: Moody's rating review

November

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

December

US: rate decision
Russia: Fitch rating review

Sub-Saharan Africa

South Africa

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Rebound momentum starts to fade

South Africa's economy rebounded strongly in Q3 2020, growing by 13.5% q-o-q as the strict lockdown eased. The bounce in activity was driven by consumer spending and net exports, while investment lagged. Production data showed the strongest gains for mining, manufacturing and the trade sector. While this was a welcome bounce from the lockdown lows, the economy is 6% smaller than a year ago. More troublingly, there are signs that momentum is starting to flag.

Mobility data points to a laboured normalisation – our activity tracker grew by just 0.3% m-o-m in October – while the economy now faces headwinds from renewed lockdown restrictions implemented at the end of December in response to rising COVID-19 cases. Unemployment is back above 30% and is likely to worsen as more people re-enter the labour market, and gross fixed capital formation is currently at levels last seen in the mid-2000s, weighing heavily on long-term growth potential. The precarious energy supply situation remains a critical brake on growth and, alongside sluggish labour market gains and the macro overhang from the large fiscal imbalance, places a low ceiling for the recovery. Upcoming local polls and next year's ANC elections introduce an element of political risk to the macro outlook and South Africa's long-standing structural constraints to growth.

Weak investment is softening import demand and, alongside buoyant precious metals prices and the economy's robust terms of trade, should continue to support a healthy trade surplus that keeps the current account positive until the second half of the year. External gains have contributed to a stronger ZAR and, alongside disinflation for rentals and medical insurance, will help to anchor core inflation at a low rate. As a result, inflation is set to remain benign, even with some upside pressures from food prices, and administered prices such as electricity tariffs.

In the near term, the strong rebound in economic activity has supported government revenues and results in a slightly smaller budget deficit estimate for both FY20/21 (ending March) and over our forecast horizon. Nevertheless, the shortfalls are large and our concerns hardened after the government reduced its spending cut target in the 2020 MTBPS. In addition, there are notable execution risks that raise ongoing questions over fiscal sustainability. In particular, we think tax buoyancy assumptions may prove optimistic, while broader credibility rests on achieving a multi-year freeze in public sector wages – a contentious issue that will require political will for effective delivery. Reversal of risk appetite, meanwhile, could expose these increasingly acute vulnerabilities and financing risks.

Elevated fiscal risks continue to influence monetary policy, with SARB leaving the policy rate unchanged at 3.50% in November in another close decision. With the output gap narrowing and food prices keeping real rates close to zero, we expect no change in the policy rate until next year, when we think SARB will embark on a path of gradual policy normalisation.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
GDP growth (% y-o-y)	0.1	-17.5	-6.0	-4.5	-4.1	16.0	2.7	1.6
CPI, eop (% y-o-y)	4.1	2.2	3.0	3.2	3.0	4.0	3.8	4.0
Policy rate, eop (%)	5.25	3.75	3.50	3.50	3.50	3.50	3.50	3.50

Source: Refinitiv Datastream, Bloomberg, HSBC forecasts

Middle East and North Africa

Egypt

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Still delivering

Though headwinds will persist, we remain optimistic on Egypt's economic prospects, and continue to look for it to be one of the strongest and most stable recovery stories in CEEMEA. To a large extent this resilient outlook reflects orthodox policy choices Egypt has taken since it began its reform programme in late 2016 and which we expect will frame its policy approach in the years ahead. Fiscal policy has remained defensive and, though the headline budget deficit will widen over 2020/21, the deterioration should be modest and we expect the government to deliver a fourth successive primary surplus despite the pressures of COVID-19 on revenue and spending. Monetary policy has also been cautious and, while CBE delivered 400bps in rate cuts last year, the easing cycle was largely matched by falling inflation, leaving real rates very high. We see inflation remaining at or below the lower end of the authorities' 6-12% target range over the coming year, which will leave CBE with an easing bias. But for now we have pencilled no further cuts into our forecasts, leaving a large real rate buffer that should further anchor inflation expectations and facilitate continued access to external funding for the budget shortfall.

The policy approach also creates a strong backdrop to secure continued support from multilateral agencies led by the IMF, which pledged USD8bn in fresh funding support last year to mitigate the economic impact of COVID-19. The backing, which follows USD12bn in IMF support extended in 2016 to anchor the reform programme, sits with long-term concessional funding provided by the World Bank, the GCC and others, and has helped build large FX buffers at the central bank that guard against external shock. The stable macro backdrop is also central to our expectations for a recovery in growth, led initially by a normalisation of consumption, and then by a rebound in investment and service exports, led by the tourism sector. The pick-up will take time to come through, with growth at around 2.5% this year, down from a better than expected 3.6% in fiscal 2019/20. But we see activity gaining pace, and returning to its previous trend rate of close to 6% in 2022.

Nevertheless, downside risks and unresolved vulnerabilities remain. Growth momentum was weak into the year-end and COVID-19 infections had started to rise, potentially delaying the hoped for rebound in consumption, especially if the vaccine rollout proves slow. Fiscal consolidation will continue to be onerous, with high debt servicing and weaker costs limiting policy room for manoeuvre. External account pressures may also build over the coming year if, as we expect, weak growth in the Gulf pushes remittances lower, import spending gains on recovering domestic demand and tourism revenues take another year to normalise. FDI is likely to be subdued and, with foreign bond ownership ending 2020 close to record highs, portfolio inflows may be modest. We see this pushing the currency weaker, though the depreciation will be slow and from a stronger starting point than we had previously assumed.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
CPI, eop (% y-o-y)	5.1	5.6	3.7	6.1	5.4	4.6	4.7	4.2
Policy rate, eop (%)	9.25	9.25	8.75	8.25	8.25	8.25	8.25	8.25

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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A little relief, but no respite

Though we see Bahrain remaining under significant economic pressure throughout our forecast period, there has been some improvement in the Kingdom's prospects. To an extent, the gains are cyclical, with high frequency data pointing to a steady recovery in domestic demand through the second half of 2020, with Q3 GDP up 2% q-o-q following a record 9% contraction in Q2. Point of sales data suggests that local consumption trended higher into Q4, with spending up 45% on its April lows. We are hopeful that the trend will continue over the first months of this year, buoyed by Bahrain's success in avoiding a second wave of COVID-19 infections and the ongoing easing of border controls that should bring overseas consumers back to the market. There are also some signs that investment has found a floor, with MEED data pointing to a pick-up in new project work after a spate of cancellations, and the tender board announcing it had agreed USD2.7bn in new contracts over the first nine months of 2020.

In addition to some shift in growth momentum, there are also some signs of rebalancing. The current account deficit narrowed sequentially in Q3 as the trade account returned to surplus and services exports came off their lows. Central bank FX reserves also rose in Q3 and into Q4, boosted by fresh capital flows as the authorities retained access to global financial markets and received additional support from wealthier neighbours. We expect this adjustment to persist over our forecast period, bolstered by gains in oil prices and a gradual pick-up in non-energy exports. No new fiscal data has been released, but the two-year budget points to a marked fall in spending on last year's revised plan, though the finance ministry claimed there was still space to extend some of COVID-19 relief programme into 2021. The budget also runs off an assumed oil price of USD45/b, suggesting revenues could run ahead of plan.

But while this should see the budget deficit narrow from last year's double-digit high, the shortfall will remain substantial at around 8.5% of GDP, and public debt the highest in CEEMEA at 120% of GDP. The current account shortfall will also remain substantial and, though reserves have increased, they remain low at just two months of import cover, with FX funding needs boosted by pending debt repayments. At worst, this means Bahrain will remain vulnerable to fresh external shocks, and at best means policy options will remain highly constrained. We see this capping growth at under 4% in 2021, which will not reverse last year's losses, and though we have nudged our 2022 forecasts upward, we continue to expect activity to lose momentum. This represents a highly challenging outlook for Crown Prince Salman who assumed the role of Prime Minister in November following the death of Sheikh Khalifa (who had held the post since 1970), and must now lay out a policy programme that not only remedies the economy's immediate imbalances, but also delivers structural reforms that might begin to take medium-term potential growth higher.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
GDP growth (% y-o-y)	-	-	-	-	-	-	-	-
CPI, eop (% y-o-y)	-1.8	-3.4	-2.7	-1.5	-0.1	1.8	0.8	0.6
Policy rate, eop (%)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

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

Middle East and North Africa

Kuwait

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Plus ça change

The December general election means Kuwait begins the new year with a new government and a new parliament, just months after the accession of Sheikh Nawaf gave it a new emir. We are not persuaded, however, that this change in leadership will break the longstanding policy logjam that intensified last year as the economy deteriorated. To an extent, these concerns reflect the composition of the new parliament, which looks to be led by opposition MPs. We are also aware that there have been many new beginnings in recent years, with the current government the 17th to have been appointed since 2006, and the new finance minister the fifth in just seven years.

A key first test of the new policy dynamic will be the passage of legislation that would allow the government to issue new debt. If approved, the law could bring to an end a three-year standoff that has forced the authorities to drain reserves to fund the fiscal shortfall and could be tied to a broader reform of public finances. However, despite facing the largest budget shortfall since the 1990 Iraqi invasion, the need to put public finances on a sustainable footing was not part of last year's election campaigns, which focused instead on the need to protect public benefits – a marked contrast with other Gulf countries that set radical adjustment programmes in train last year as fiscal pressures mounted. Without a consensus, policy may continue to drift and, though higher oil prices will offer the budget some support and Kuwait's wealth should ensure a funding crisis is avoided, the shortfall will be in double digits for a second year in 2021/22 and for the fifth year in seven.

The policy standoff contributed to the very limited economic support the authorities offered last year in response to the COVID-19 downturn and will weigh heavily on recovery. There was some evidence in the high frequency data that consumption had bounced off its Q2 lows in Q3 as lockdown restrictions eased and Kuwait's success in guarding against a second wave of the pandemic should see activity continue to normalise. However, data also show momentum appearing to fade and employment pressures beginning to rise, with expatriates starting to exit the country in Q4 and job creation for nationals in reverse. Investment spending also looks soft, with MEED data showing a 15% y-o-y drop in the value of projects underway in December and a pick-up in project cancellations.

The low base should still see growth turn positive this year, bolstered by a likely pick-up in oil production and export volumes as OPEC restrictions ease. At less than 3%, however, the 2021 recovery will reverse less than half of last year's losses, with the rebound in domestic demand likely to be more muted still. Policy progress could create a more positive outlook for 2022, but for now our expectations are downbeat, and we see growth slowing toward 2%.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
GDP growth (% y-o-y)	-0.7	-	-	-	-	-	-	-
CPI, eop (% y-o-y)	1.9	1.8	1.9	2.1	2.0	1.7	1.4	1.7
Policy rate, eop (%)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50

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

Middle East and North Africa

Oman

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Another tough year ahead

Oman's large twin deficits, rapid increases in public debt and onerous repayment schedule will continue to dominate the economic outlook. Encouragingly, the adjustment and rebalancing process is already underway, with the new Sultan implementing a raft of measures in 2020 that suggest he both understands the magnitude of the challenges Oman faces and the necessity of urgent action. Framed by the overhaul and consolidation of the government itself, for example, Oman has already delivered significant spending cuts that took spending 12% lower over the first 8 months of last year. The Sultan has also laid out a medium-term programme that commits the state to delivering some 10ppt of GDP in fiscal adjustment over the coming four years. This year, we expect the measures to include the introduction of VAT, tight controls on wages, and cuts to subsidies, with the proposed introduction of income tax (a first for the Gulf) likely to be a focus for policy discussion in 2022. In addition to these measures, the improved outlook for global energy prices has also bolstered the outlook, pushing our forecasts higher for the oil and gas revenues that continue to dominate public finances.

Nevertheless, the process has only begun and it will take time to resolve deep-seated imbalances that have seen public debt rise from around 5% of GDP at the start of 2015 to some 80% of GDP at beginning of 2021. Despite higher revenues and spending cuts, we see the deficit running at around 9% of GDP this year, down more than 5% on last year's estimated outturn but still high, with the overall funding requirement boosted by the need to refinance a further 6% of GDP in external loans and bonds. Repayments will rise to around 8% of GDP in 2022, undoing much of the ongoing above-the-line consolidation we expect the authorities to deliver, while further gains in interest payments will partly offset the positive impact of primary spending cuts.

Oman was able to raise funds in the market twice in Q4 2020 and has laid out plans to diversify its funding mix through the divestment and levering of assets. Oman also confirmed it received funds from Qatar last year and has held preliminary discussions on a broader Gulf support programme. However, its stretched finances will leave it vulnerable to shocks that compromise access to external financing, while ongoing austerity will keep growth weak. Indeed, while we are hopeful that domestic demand will rise this year and service exports should gain as COVID-19 restrictions ease, we see growth at just 2.3% as investment stalls and consumption is held back by tax hikes and the outflow of large numbers of expatriate workers. The commissioning of the next phase of the Duqm industrial projects in 2022 should give exports further support, but domestic demand will remain sluggish. As a result, we see GDP struggling to return to its 2019 level even by the end of next year as the adjustment process continues to take its toll.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
CPI, eop (% y-o-y)	-0.3	-0.8	-1.2	-0.9	0.0	3.2	4.2	4.4
Policy rate, eop (%)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

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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Moving on

Recent developments have reinforced our longstanding optimism over Qatar's economic prospects, and we continue to see the emirate as the most robust of the Middle East oil states. Our strengthened optimism in part reflects the improved outlook for energy prices, which has boosted the outlook for the oil and gas receipts that are the mainstay of export earnings and the budget. From around 7% of GDP last year, we see the fiscal deficit falling to as little as 3% this year – the smallest shortfall in the Gulf and roughly half the level laid out in the 2021 budget. We also see the current account back in surplus this year after the 2020 shortfall, pushing foreign assets managed by the QIA and central bank higher and net borrowing lower after last year's gains.

In addition to the improving outlook for energy earnings, we are also encouraged by the re-establishment of ties between Qatar and key regional neighbours (Saudi Arabia, the UAE, Bahrain and Egypt) that imposed sanctions on Qatar in 2017. Although the Qatari economy has fully adjusted to the embargo, the resumption of ties holds out the prospect of a normalisation of capital and trade flows and a pick-up in regional travel and tourism (the Gulf accounted for 12% of imports and 33% of arrivals pre-embargo, compared to 4.5% and 15%, respectively, in 2019). The rapprochement will be particularly impactful when COVID travel rules are relaxed, and will support plans for the FIFA World Cup that takes place in Qatar in 2022.

These developments also create some upside risk to our growth forecasts and could accelerate the recovery, which looked to be struggling for momentum into year end. The whole economy PMI remained positive but lost pace in Q4 2020, despite low COVID-19 infection rates and Google mobility data showing activity levels have normalised. Population growth also turned negative into the year end, suggesting last year's sharp slowdown generated job losses among the large expatriate population that will weigh on consumption. While we expect the fiscal deficit to undershoot target, the 2021 budget included a 7% cut in spending, which will likely keep government consumption weak, at least over the first half of the year. MEED data also shows planned capital spending fell y-o-y over much of 2020 – a reflection in large part of much of the big ticket infrastructure development approaching completion, but also a marker of the more cautious public spending stance triggered by the pandemic.

All told, we see growth running at around 3.5% this year following last year's contraction of some 4%. Critically, we also see growth building momentum in 2022 to reach close to 4%, buoyed by final preparation for the World Cup and then an unprecedented surge in visitors when the tournament itself takes place.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
GDP growth (% y-o-y)	0.9	-6.1	-	-	-	-	-	-
CPI, eop (% y-o-y)	-1.3	-3.5	-3.6	-3.2	-1.3	0.7	1.3	1.4
Policy rate, eop (%)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

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

Middle East and North Africa

Saudi Arabia

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A faster recovery, more rapid rebalancing

We have made significant positive revisions to our forecasts for the Kingdom, and now look for lower deficits and a faster recovery over the coming two years.

To an extent, the stronger outlook reflects better prospects for oil earnings, with a more accelerated pick up in global energy demand and Saudi-led OPEC discipline opening the way for higher revenues. However, we also see signs that activity re-gained pace more quickly than we had expected, with high frequency data suggesting momentum built in Q4 2020 after turning positive in Q3. We are hopeful that this will continue into Q1 2021, with prospects for a normalisation of consumption bolstered by Saudi Arabia's success in guarding against a second wave of COVID-19 infections. In addition, we expect SAMA to keep the broad monetary environment accommodative, boosted by a steady drop in the government's own funding requirement and building on a year that saw it prove much more effective in transmitting policy easing to the private sector than its regional peers. Strong signaling that the Public Investment Fund (PIF – the Kingdom's main sovereign wealth fund) will lift domestic capital spending should also support stronger investment outlays, as will the next phase of the home building programme.

Against this, we expect central government spending to remain cautious and job creation to be slow, especially in 2021 when the withdrawal of relief programmes introduced to offset the first wave of the pandemic may expose losses within the corporate sector. The outflow of low cost expatriates will also take a toll on the private sector and, though we look for some recovery in non-oil services exports, it may be 2022 before health concerns have dissipated sufficiently for religious tourism to return fully to its pre-pandemic levels. All told, we see this resulting in growth of around 3.5-4% in 2021 and, while that will not fully reverse the losses of 2020, GDP will be down just 0.5% on its 2019 level compared to the 1.8ppt drop we expected previously. We have also pushed our 2022 forecast up to 3.5% (2.5% previously) as employment gains speed up and the recovery in investment builds momentum.

Alongside a recovery in growth, we expect the budget deficit to narrow from around 11% of GDP in 2020 to 7% and 4% of GDP in 2021 and 2022. The trend, which should stabilise public debt at around 35% of GDP, will be supported by rising oil receipts but will also reflect rapid progress on non-oil revenues and further gains in spending control. We look for progress on structural reform, too, as spending limits prompt the state to step back from areas of the economy it has previously dominated. This should build on a raft of other measures already underway as part of the *Vision 2030* programme that have seen far reaching changes to the social code and labour market, the overhaul of capital markets and the initiation of the privatisation drive, reshaping the economy and, with time, taking potential growth rates higher.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
GDP growth (% y-o-y)	-1.0	-7.0	-4.2	-	-	-	-	-
CPI, eop (% y-o-y)	1.5	0.5	5.7	5.9	5.5	6.8	1.4	1.4
Policy rate, eop (%)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

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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Light in the tunnel

After a painful 2020, developments in recent months have brought some grounds for cheer. Most immediately, the UAE looks set to benefit more than any other Gulf state from the development of COVID-19 vaccines, which should open the way for the recovery of the trade, transport and tourism sectors that are key drivers of the non-oil economy. Dubai was hit especially hard by last year's shutdown, but data for Q4 point to sequential gains in throughput at the airport as global demand rose and with the start of a recovery in visitor inflows. The arrival numbers were bolstered by the first visitors from Israel, while the rollout of the vaccine should boost prospects for the World Expo, delayed from 2020 to the last months of 2021.

In addition to better prospects for services exports, the outlook for the energy sector has also improved as OPEC discipline has held, and the recovery in global oil demand has gained traction, allowing us to lift our projection for oil prices and production and cut our forecast for the budget shortfall. The UAE's announcement of long-term plans to invest more than USD100bn in new oil and gas capacity also points to gains in capital spending. Of greater long-term significance, however, has been evidence that the shock of the 2020 downturn has served to sharpen appetite for economic reform. In recent months, this has seen the UAE deliver a long proposed overhaul of the commercial code to permit full foreign ownership for firms onshore (previously this was permitted only in exporting free zones) and the effective secularisation of the social code governing non-nationals in the country. Both measures address significant obstacles to drawing in FDI and follow liberalisation of the labour market and residency regulations delivered earlier in the year.

But though welcome, the recovery comes from a low base and a standing start, with the UAE's whole economy PMI flat into year-end and sentiment deteriorating. Though the progress with the vaccine should see the service sector come off its lows, it will likely be late 2022 before demand returns to its pre-pandemic levels. This will keep earnings soft and offer no incentive for a recovery in capital spending. We expect public policy to be cautious too, and notwithstanding the recovery in oil earnings, we see government spending flat or negative over the coming year – a view given credence by the cuts already announced to the Federal budget. In this environment we expect consumption to recover from last year's lockdown lows, but to remain subdued. In part, this is a result of the outflow of significant numbers of expatriate workers, dealing a permanent loss to demand. However, we also expect the private corporate sector to face another year of balance sheet strain as a result of last year's losses, which will only become fully apparent when central bank support measures roll off this year. All told, we see these trends capping growth this year at around 3%, reversing less than half of last year's losses, with output not retuning to 2019 levels until 2022.

Quarterly data

	Q1 20	Q2 20	Q3 20	Q4 20e	Q1 21f	Q2 21f	Q3 21f	Q4 21f
CPI, eop (% y-o-y)	-1.6	-2.4	-2.4	-1.9	-0.4	-0.4	1.3	1.6
Policy rate, eop (%)	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25

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

Disclosure appendix

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