DECEMBER 2021

MEDIA BRIEFING

Planning is the only way to prepare for inflation

Middle market companies in the UAE must prepare for a higher interest rate environment in 2022 and 2023

Companies in the UAE must start planning for rising costs in 2022 and 2023, says a senior corporate banking executive from Mashreq Bank.

"Inflation is a natural follow-up to any contraction or recession," says Hind Eisa Salim, executive vice-president and head of services and manufacturing at Mashreq Bank.

AT A GLANCE

- Businesses in the UAE must prepare for inflation – this can be done through agile budgeting, alternate routes of sourcing finance and diversification of suppliers
- Central banks across the world are preparing to gradually raise interest rates, which will help reduce the impact of inflation as people borrow and spend less, and save more
- Multiple factors including rising energy prices, high demand for products and services, and the supply chain crisis are contributing to the rise in inflation

"But through better planning and precautionary measures built into their strategies for 2022, companies will be able to ride this wave out."

Hind Eisa emphasises this approach for middle market companies and small and medium-sized enterprises (SMEs), who form the backbone of the UAE economy.

With economic recovery underway, stimulus measures and lower interest rates introduced by regulatory authorities at the height of the pandemic are now being pulled back.

"The slashing of interest rates, a move that happened across the world, was introduced to save the global economy from a deep depression," says Hind Eisa. "It was not the only measure, but certainly one of the most critical ones.

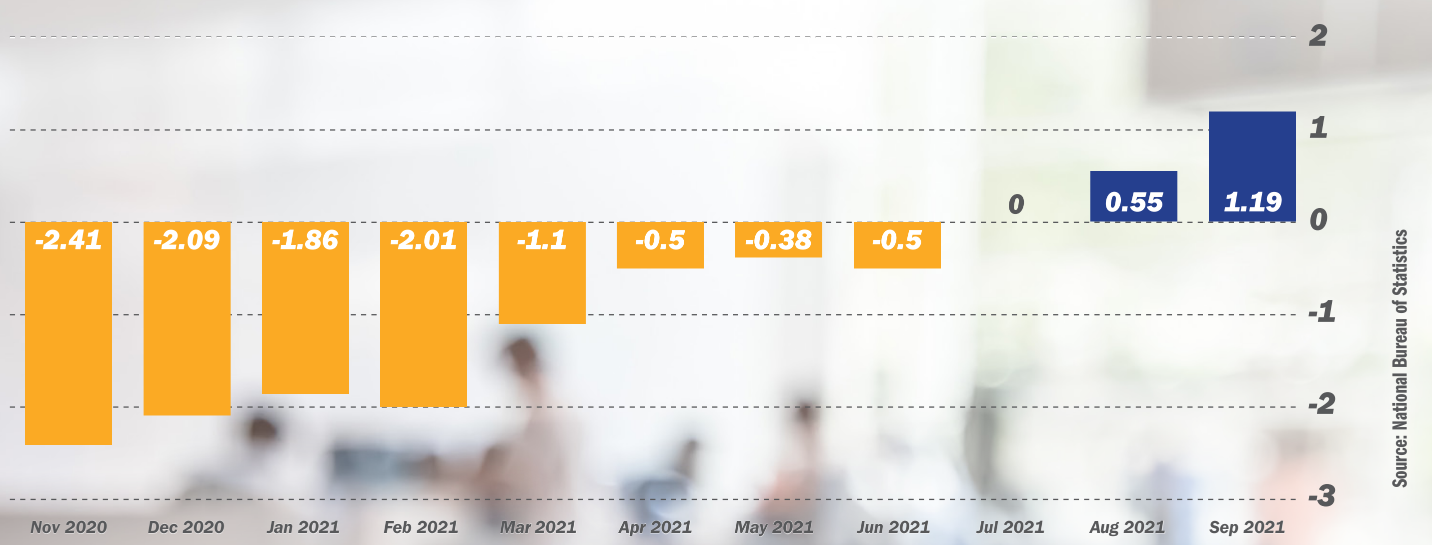
"So far, the UAE Central Bank (CBUAE) has kept interest rates low to support businesses. But this is not a sustainable model and was bound to revert to its pre-pandemic stage eventually," says Hind Eisa.

"This increase in rates will affect especially middle market companies and SMEs, who will have to borrow at higher rates."

But the rise in interest rates is not the only factor likely to be driving inflation in the coming two years.

A surge in demand for goods and services, rising energy prices and disruptions to supply chains are adding to inflation worries. These pressures could drive future increases in interest rates, which could affect businesses,

Annual inflation rate in the UAE (%)



Annual inflation rate in the UAE increased to 1.19 per cent in September of 2021 from 0.55 per cent in the previous month.

Drivers of inflation:

1. Pickup in economic activity or closing output gaps supported by accommodative fiscal and monetary policies, along with the release of pent-up demand and savings
2. Rapidly rising commodity prices
3. Input shortages and supply chain disruptions

Source: World Economic Outlook, IMF October 2021

especially middle market companies who are more vulnerable to disruptive market conditions than large corporates or even SMEs.

Middle-market companies tend to have limited sources of finance when compared to large corporates. The latter's shareholder structures gives them access to more sophisticated sources of financing, including debt capital markets and mezzanine financing.

Furthermore, middle-market companies may often lack the bargaining power necessary to pressure their suppliers to extend credit terms, unlike larger corporates.

On one hand, larger firms can channel their financial might to keep funding costs in check. On the other, SMEs in the region benefit from financial relief and buffers offered by governments and banks. Middle-market companies fall in neither category an are therefore not privy any of these privileges.

"There is pressure on the central banks to contain rising inflation, requiring them to take a number of corrective measures.

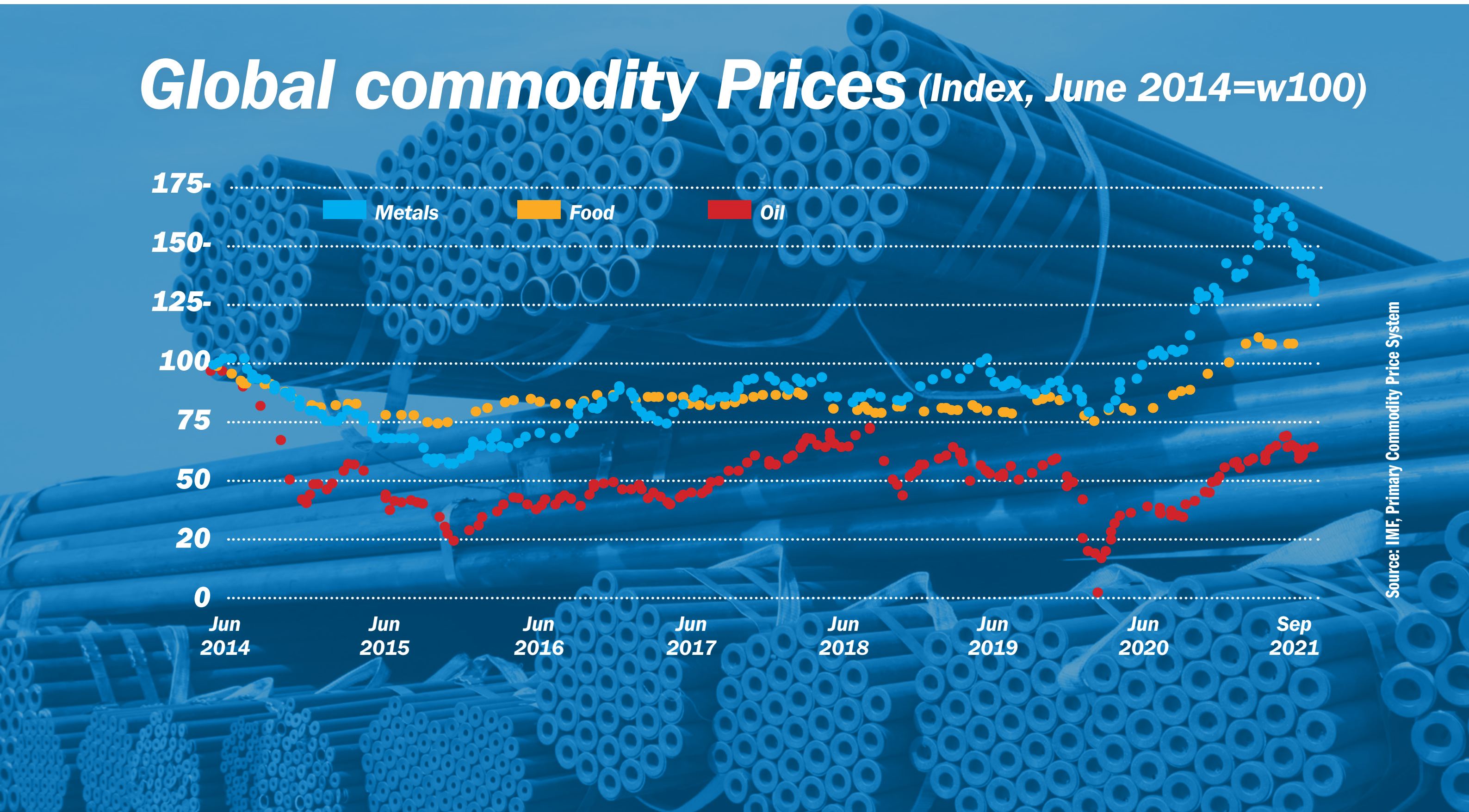
"The most important of these would be raising interest rates, which is expected to hit the brakes on the inflation risk," says Hind Eisa.

She adds that interest rates are unlikely to rise suddenly but over a gradual period.

The dirham's currency peg to the US dollar means that the UAE's base rate for overnight deposit — Emirates Interbank Offered Rate (Eibor) — is anchored to the Fed's Interest on Excess Reserves (IOER).

Planning better

Hind Eisa advises that companies need to budget



better for 2022 and 2023, accounting for factors such as projected rise in interest rates, energy prices and an extended supply chain crisis.

Middle-market companies will have to prepare their budgets with more scrutiny, factoring in the rising cost of both inputs and funding.

"It is critical to remain agile and keep evaluating market rtends," says Hind Eisa.

Firms that employ more efficient and innovative finance teams will be able to better navigate a rising interest rate environment.

These companies further need to seek advice from their banks, to find ways to diversify both their sources of funds as well as their suppliers to keep costs under control.

"All of this can only happen with planning," says Hind Eisa. "Companies in the UAE need to be aware of it and plan for it, so they can reduce the severity of the impact on business.

"We are coming out an extraordinary set of circumstances with regards to the pandemic, coupled with the supply chain crisis," she says.

"But in the end, experienced management teams can play an instrumental role in navigating their companies through the transition to the post-pandemic business environment."

Real GDP growth (annual change %)

This briefing is brought to you by the MEED-Mashreq Services & Manufacturing Partnership

Find more insights: www.meedmashreqindustryinsight.com
Write to us on: MEEDMashreqPartnership@meed.com