January 2023

MEDIA BRIEFING

Growth outlook subject to economic uncertainties

Despite improved domestic demand, the UAE's mid-market firms are not invulnerable to external market challenges

Mid-market players in the UAE's services and manufacturing industries remain shielded from the debilitating effects of global economic downturn and surging cost pressures, at least for the time being.

Higher hydrocarbons revenues and the government's agile leadership and response to economic severities have allowed businesses in the country to withstand financial shocks, outperforming many of their global peers.

AT A GLANCE

- Mid-market firms in the UAE must gear up to face potentially choppy business conditions
- Macroeconomic challenges including inflation, rising interest rates and supply chain delays are impacting already thin profit margins
- The GCC's economies are projected to grow 6.9 per cent in 2022 before moderating to 3.7 per cent and 2.4 per cent in 2023 and 2024, according to the World Bank
- The growth forecast is however, caveated by geopolitical risks such as the Russia-Ukraine war and China's zero-Covid policy

But experts are concerned that if the market does not improve, the outlook could darken over the coming months.

"The fact of the matter is that there are headwinds. We cannot deny or ignore this," says Hind Eisa Salim, executive vice-president and head of services and manufacturing at Mashreq Bank.

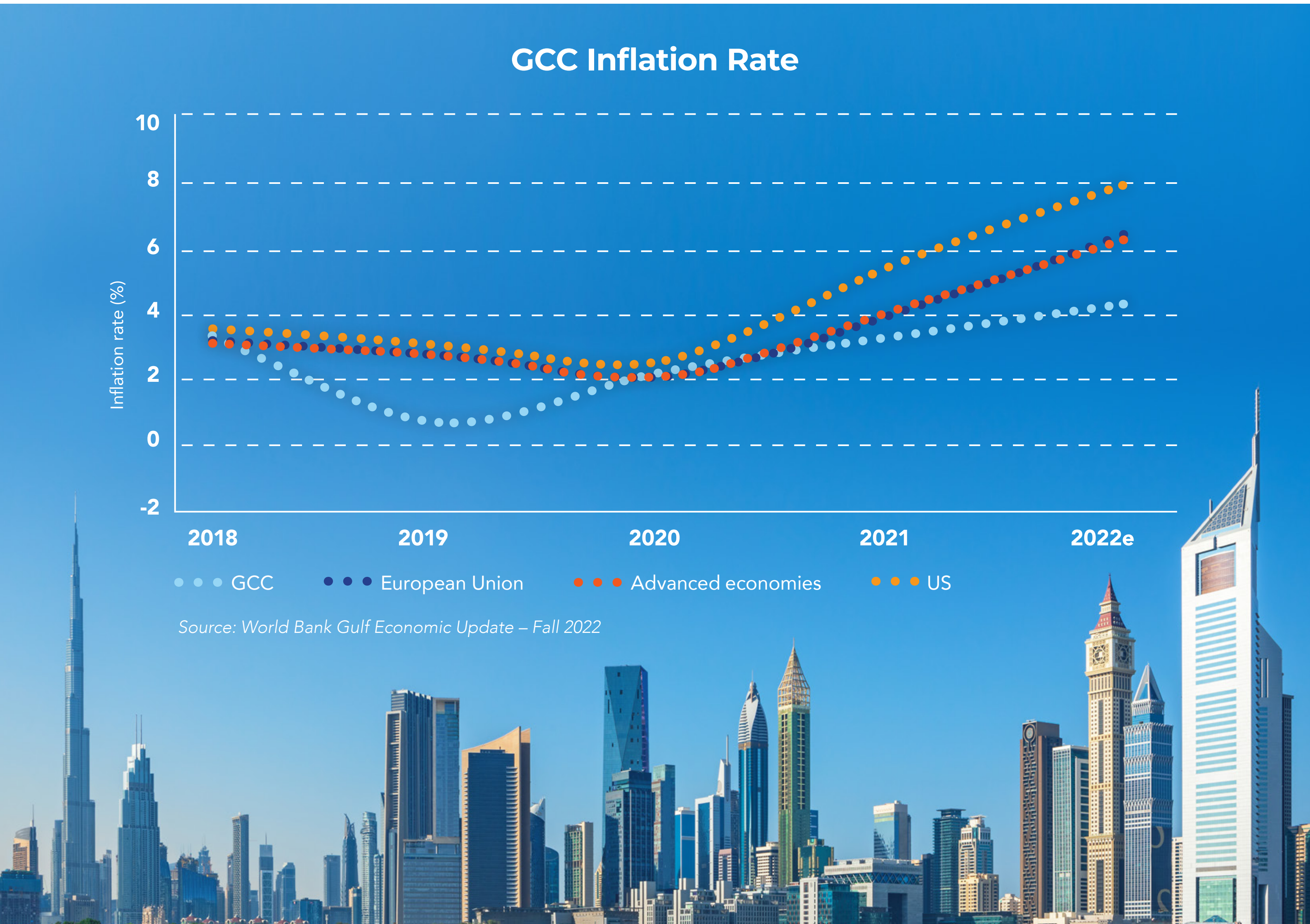
"Businesses in the UAE are blessed by the swift measures taken by the authorities since the Covid-19 pandemic. But the UAE's economy and its source markets are global, and external issues will ultimately affect businesses."

Industries around the world continue to be buffeted by volatile conditions. Pandemic-induced supply chain issues persist, while rising interest rates, container and fuel costs, and high commodity prices on the back of the Russia-Ukraine war are exerting downward pressure.

Nevertheless, the overall economic outlook for the GCC remains positive. The World Bank projects the region's economies to grow 6.9 per cent in 2022 before moderating to 3.7 per cent and 2.4 per cent in 2023 and 2024.

For the UAE, the International Monetary Fund (IMF) forecasts GDP growth to reach 5.1 per cent in 2022. This compares favourably with a projected global growth average rate of 3.2 per cent.

While much of the nation's strong economic performance is a result of the higher crude price, it has also been partly driven by growth in non-hydrocarbon sectors such as manufacturing.



Source: World Bank Gulf Economic Update – Fall 2022

FISCAL GROWTH

5.3% GDP

COLLECTIVE BUDGET SURPLUS FOR GCC REGION IN 2022

Source: World Bank Gulf Economic Update – Fall 2022

"When the oil prices are high, the GCC region as a whole benefits," says Hind Eisa. "Effects of these then spillover to the UAE – spending power rises among GCC inhabitants, boosting various sectors."

The residual knock-on effect of megaevents such as Expo 2020 in Dubai and the 2022 Fifa World Cup in Qatar also vitalises the GCC's economies.

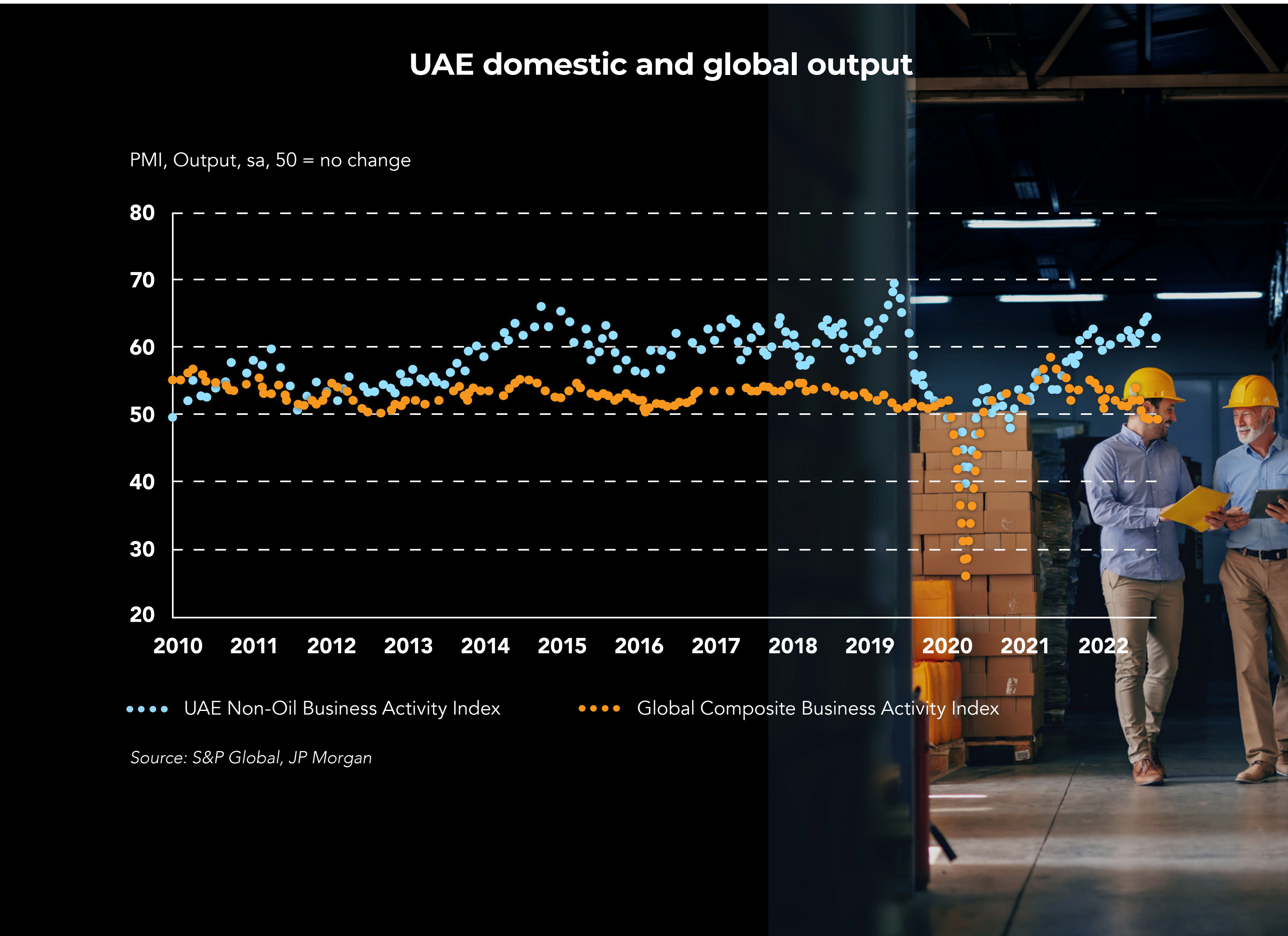
"The UAE has proven its status as a stable country from all perspectives – economically, politically and socially. This continues to attract investors and residents," says Hind Eisa.

An agile response to the Covid-19 pandemic and strong vaccination rates helped the UAE and the region's economies recover from the deep fiscal plunges experienced in 2020, when the collective budget deficit for the GCC hit 10.8 per cent of GDP.

The World Bank projects that this figure is expected to flip back to a 5.3 per cent surplus of GDP in 2022 before moderating to surpluses of 4.2 and 2 per cent of GDP in 2023 and 2024, respectively, on the back of higher oil revenues.

The worrying spectre of inflation has loomed throughout 2022 and was exacerbated by the Russia-Ukraine war, causing supply chain bottlenecks and other price surges.

Although inflation has been rising in the GCC, it remains far below other high-income countries. The IMF forecasts



Source: S&P Global, JP Morgan

GROWTH RATES IN 2022

5.1%

UAE PROJECTED GROWTH RATE

3.2%

GLOBAL GROWTH AVERAGE RATE

Source: International Monetary Fund (IMF)

an average inflation rate of 2.4 per cent across the region in 2022, when compared to 8.3 per cent globally.

Given their US dollar peg, the Gulf's central banks have to hike interest rates, which in turn will have a negative impact on local businesses.

Hind Eisa notes that with the expected hike in interest rates, many customers are questioning the feasibility of borrowing from banks.

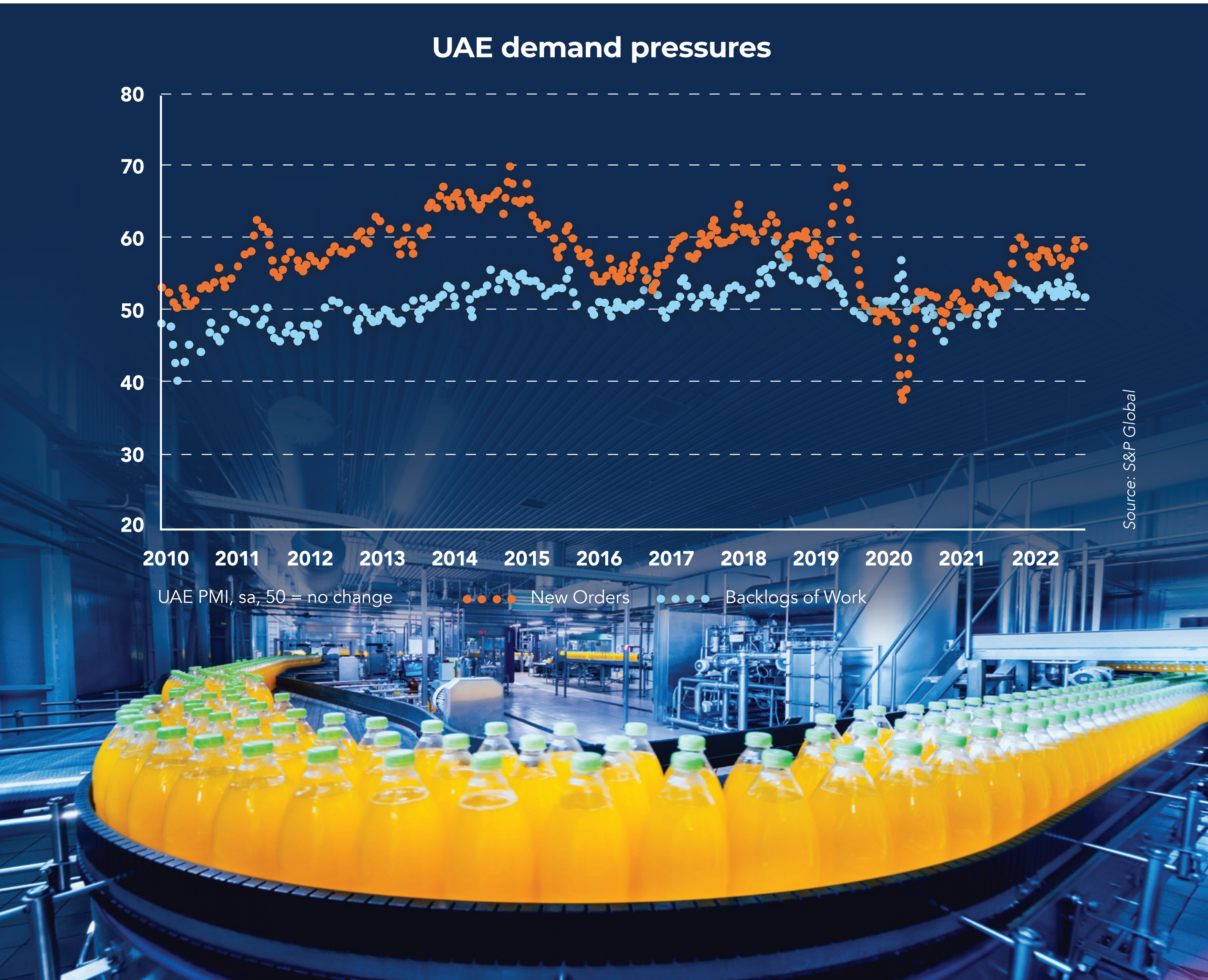
Many are holding back on any expansionary or renovation business plans that involve long-term financing, opting to save up "for a rainy day" instead.

"Despite global conditions, the UAE remains one of the least impacted countries due to the stable oil prices," says Hind Eisa.

Outperformed expectations

The combination of sustained oil prices and non-oil sector growth have ensured that the UAE continues its post-Covid recovery momentum, despite the worsening global economic climate.

If more evidence of this was required, the seasonally adjusted S&P Global UAE Purchasing Managers' Index



(PMI) shows that the rate of expansion reached its strongest in over three years during August 2022.

Even where growth slightly faltered in September 2022, surveys conducted for the PMI note that businesses largely reported improved demand for goods and services.

Activity bounced back in October, on the back of new orders growth and as the softening of fuel prices in September provided momentary respite.

S&P Global, however, reports that businesses are beginning to feel the strain on their capacity due to strong client demand and project backlogs. Moreover, uncertainty continues to surround the sourcing of raw materials from China. The nation's zero-Covid policy and resulting lockdowns have stifled economy activity, with effects reverberating across global supply chains.

"It's hard to predict how the Chinese market will shape up in the coming year – will they take more aggressive action and limit their exports? We cannot say for sure," says Hind Eisa.

Mid-market firms are also beginning to feel the pinch of cost pressures, with rising overheads on materials, freight charges and manpower further straining budgets.

Meanwhile, price fluctuations and the scarcer availability of raw materials have made it difficult to accurately forecast profitability and demand, in addition to the uncertainty regarding capital expenditure.

The issue is compounded due to the thin margins mid-market firms operate on and the fact that they cannot easily pass on the additional costs to their customers, explains Hind Eisa.

"These players lack the capital resources of larger firms, or the economic support offered to smaller businesses, because they sit somewhere in the middle of the spectrum," she says.

"Their margins are already tight – and now with the rising costs, they are struggling."

Faced with these challenges, Hind Eisa emphasises that financial institutions including Mashreq are keen to support customers.

"We realise that the costs of borrowing have almost doubled in the past year – an aggressive rise for any business anywhere in the world," she says. "We're actively holding conversations with our clients and trying to find out ways to help them. We want our customers to know that we're on their side. We understand the challenges facing them and want to back them as partners."

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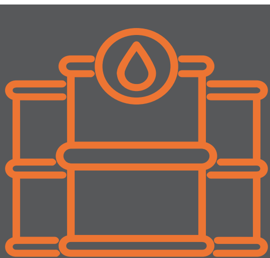

UAE REMAINS ONE OF THE LEAST IMPACTED COUNTRIES due to the stable oil prices and agile leadership response.

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