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WHAT YOU SHOULD KNOW

Substantial government stimulus measures will help the UAE's banking sector navigate the impact of the coronavirus crisis, but doubts remain over whether they will effectively translate into swift economic recovery once restrictions are lifted. Lenders certainly have the ability to lend – but whether they have the willingness to lend is the key consideration.

UAE banks are also grappling with exposure to medical services provider NMC Health, which has been put into administration by a UK court after admitting it would be unable to repay $6.6bn in debt. NMC Health is not an isolated case, paving the way for more such revelations ahead.

Corporate borrowing needs are expected to increase substantially as companies of all sizes, and in all sectors, struggle to stay afloat, maintain cash flow and pay salaries. Sectors considered strategically important, such as oil and gas, tourism and hospitality, real estate and construction, health care and state-owned entities, will be the main beneficiaries of new bank lending or renegotiated terms on existing debt, including deferrals or reductions in fees.

Despite pressure from the central bank (CB) to direct funding towards smaller businesses, individual lending is likely to be extremely discretionary. This will have a knock-on effect on cash flow for businesses in the private sector, with closures, unpaid salaries and stifled consumer demand all prolonging the downturn. Already, lending to private sector SMEs across the GCC is less than 10% of bank lending, according to some estimates.

WHY THIS MATTERS

CB measures announced in the last month are impressive for their headline numbers but unlikely to have the desired impact. The aggregate sum of all liquidity and capital measures is AED256bn ($69.2bn) under the Targeted Economic Support Scheme. The banking regulator has "urged" banks to act in the interest of SMEs, private sector corporates and individuals – but has stopped short of imposing any conditions. Plus, in the month since a AED50bn

($13.5bn) facility was made available for banks to borrow from the CB at zero interest rate, only 10bn had been disbursed as of the beginning of this week.

The UAE currency is pegged to the US dollar, meaning that the CB follows the monetary policy of the US federal reserve, especially with regards to interest rates. Historically low rates are further dampening banks' appetite to lend; the CB is quite constrained in its ability to act independently on this.

Mubarak Rashed Al Mansoori, the UAE's CB governor since 2014, was replaced on April 2 by Abdulhamid Saeed. Saeed is seen as a hands-on banker, having previously been CEO of First Abu Dhabi Bank (Bank FAB) – where he is still a board member – and trusted by the UAE leadership. He is expected to play a role in any future restructuring of the banking sector, including further consolidation, which has been a key policy in efforts to streamline several sectors and improve profitability. Bank FAB, the result of a merger between National Bank of Abu Dhabi and First Gulf Bank, was formed in 2017.

Amid the economic slowdown and health care crisis, banks face balance sheet pressures from exposure to NMC Health, one of the largest medical services providers in the country, which last week was placed into administration by a UK court. The company was listed on London Stock Exchange. A messy departure of top leadership, lack of corporate governance standards, and revelations that the company is unable to repay outstanding debts of $6.6bn ultimately led banks to call for administration and restructuring. Chief among these is Abu Dhabi Commercial Bank, which has a combined exposure to the Group of almost $1bn. Looking ahead, it is likely more cases of financial mismanagement and over-leveraged entities will come to light, leading to calls for greater oversight and corporate governance standards.

WHAT'S NEXT

The UAE is considered especially vulnerable to the twin shocks of a low oil prices and the coronavirus. Last week, Abu Dhabi, the largest and wealthiest of the seven emirates, and home to the country's vast oil reserves, took advantage of market conditions to issue $7bn in international bonds. Sovereign and sovereign-linked entities are likely to tap debt markets to meet rising borrowing needs, in an attempt to plug higher budget deficits and refinance existing debts. HSBC in its most recent report estimates the UAE budget deficit could hit at least 10% of GDP in 2020 on the back of oil production cuts and resulting loss in revenues.

Given the extent of the UAE’s cuts under the new OPEC+ deal, at current oil prices, the macroeconomic outlook is likely to deteriorate further.

Dubai’s economy is particularly exposed. It is dependent on revenues largely from non-oil sectors such as tourism and hospitality, construction and retail. All of these were under strain before the oil price war began and the full extent of the global impact of coronavirus was felt. A further setback will be the expected delay to Expo 2020, due to have kicked off in October. It is not surprising that Dubai has imposed the most stringent measures in the country so far to contain and control the spread of the virus, including widespread testing and an ongoing 24-hour lockdown for all residents. The federal government, and Abu Dhabi, is expected to step in with further measures to support economic recovery in Dubai and the other emirates.

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