Emirates NBD
بنك الإمارات دبي الوطني

Economics

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Economic implications for UAE and Dubai of Qatar border closure

Most of the focus since the announcement of the breaking of diplomatic ties with Qatar and the imposition of air traffic and border controls has been on the potential impact on the Qatar economy, given its size and vulnerability to its exclusion from the rest of the region. In particular its dependence on external sources for food (KSA) and for building supplies, steel, iron, electronic equipment, machinery etc. (UAE) have been well commented on.

However, there are also implications for the UAE economy particularly the longer the crisis persists.

Assuming that the standoff continues for some time we have looked at the potential impact on the UAE and on Dubai economies, focusing on a number of key channels namely, foreign trade, air services and airlines, tourism and retail spending, real estate, financial/banking, energy, and financial markets.

Many of these risks would increase if the integrity of the GCC was brought into question by a more drawn out crisis, as this would impact foreign investor confidence in the GCC which has traditionally been seen as a unified political bloc.

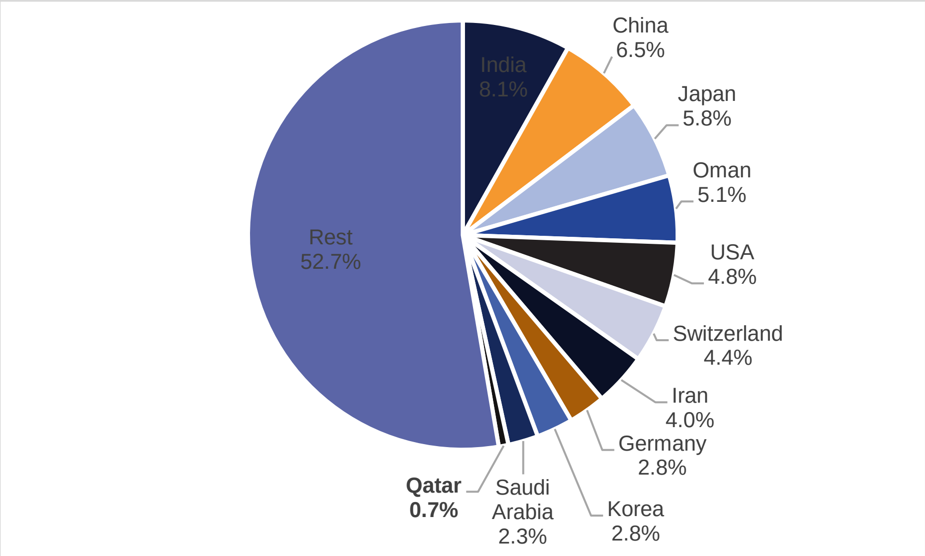
Foreign Trade

Qatar does not account for a major portion of the UAE's or Dubai's international trade:

- Qatar ranked 25th in terms of total value of foreign trade for the UAE, accounting for just 0.7% of the UAE's total trade (including oil and gas) in 2016. The value of total trade with Qatar last year was USD 3.4bn out of total trade worth USD469.3bn.
- Dubai's trade with Qatar totalled USD 4bn in 2016 or 1.2% of Dubai's total foreign trade with the world.

However, there are a number of sectors where the relationships and ties are more developed and significant.

UAE's top 10 trading partners and Qatar



Source: Bloomberg, Emirates NBD Research.

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Air services and airlines

Air travel links between the UAE and Doha in general (and Dubai in particular) are in important and significant link between both countries.

- Dubai Airports: Doha (290,524 passengers in April; 3.0mn in 2016) was the second most popular city destination after London (350,015 passengers).
- Abu Dhabi International Airport: Qatar ranks 3rd in terms of passenger traffic (38,659) or 2% of total traffic as of data for February 2017.

In terms of actual flights:

- Qatar Airways has almost 23 flights to the UAE. With 19 daily scheduled flights to Dubai, Qatar Airways would be one of the most frequent international carriers to land at Dubai International Airport. In addition, there are 3 daily flights to Abu Dhabi, and 1 daily flight to Sharjah International Airport.
- Air Arabia operates 3 daily flights between Sharjah and Doha.
- FlyDubai operates 4 daily flights between Dubai and Doha.
- Emirates Airlines operates 3 daily flights between Dubai and Doha.
- Etihad operates 3 daily flights between Abu Dhabi and Doha.

The intensity of air travel links between the UAE and Qatar are driven by a number of factors; tourism, mostly inbound to the UAE and especially Dubai; business travel with many businesses having regional offices in Dubai; transit airport travel with passengers from both countries benefiting from the opportunity cost of lower transit fares.

One metric for estimating the impact on the airports is to look at what Dubai International Airport charges per passenger at AED 75 for Passenger Service Charges and AED 5 for security charges. The potential loss of fee income impact based on the April monthly statistics would be about AED 23.2 million per month. Additionally there is the AED 35 departure tax applied at Dubai, landing charges/aircraft parking charges and others such aerobridge/security/fire charges per aircraft.

However, some of the losses related to these charges may be mitigated by a re-routing of flights. In the same vein Emirates and Etihad may actually benefit as passengers who would have travelled via Doha on Qatar Airways re-book on national carriers.

Tourism and retail spending

The number of Qatari tourists coming to Dubai and staying in hotels including holiday rentals and onboard cruise ships for at least one night reached 58,000 in Q1 2017, or just 1.3% of total visitors to Dubai. Although GCC visitors account for nearly 20% of all visitors to Dubai, Saudi Arabia is the largest source market in the region with 440,000 tourists.

Spending on Qatari-issued cards accounted for 4.6% of all foreign spending in the UAE in Jan-Apr 2017 amounting to USD102mn, and was up 17.1% y/y making Qataris the sixth biggest foreign spenders in the UAE, according to data compiled by Network International.

Data from Mastercard shows that Doha is one of the most important feeder cities for Dubai accounting for 1.1mn visitors in 2016, who spent USD1.1bn there during that year.

Real estate

Qatari nationals accounted for just 2.2% (USD 500mn) of the total value of real estate investment transactions (excluding land sales and mortgage transactions) in Dubai in 2016.

Financial/ banking

Qatari banks have become increasingly reliant on external liquidity as domestic deposits have declined (-3.5% in 2016). The external liquidity has been primarily interbank deposits (47% of total external funding in 2016) although deposits of non-residents (42%) have risen as well. According to a recent report by Standard & Poor's, most of this liquidity has come from other geographies (Europe and Asia). However, there is likely a portion that has come from the rest of the GCC.

While there are no restrictions on financial flows yet, there is a risk that Saudi/ UAE banks refuse to roll over money market loans or reduce exposure to Qatari banks which could put some strain on the banking system. SAMA has already instructed Saudi banks not to buy Qatari Riyals. Qatar Central Bank data shows that the gross foreign liabilities of Qatari commercial banks stood at USD 124.5bn at the end of April, and net foreign liabilities stood at USD 50bn.

Energy links

Qatar as a source of UAE and Dubai natural gas supply

The main energy link between the UAE and Qatar is the Dolphin Energy natural gas pipeline. The 3.2bn cu ft/day capacity pipeline brings Qatari natural gas into the UAE distribution system, feeding ADWEC, DUSUP and also extends into Oman. The pipeline provides around a third of the UAE's total natural gas supply as domestic production contains high levels of sulfur and is costly to process for use in power stations. Volumes of natural gas since the pipeline opened have been closer to 2bn cu ft/day but Qatar Petroleum agreed a long-term sale and purchase agreement with Dolphin Energy in October to provide additional volumes to the Sharjah and Ras al Khaimah gas infrastructure.

DUSUP secures its natural gas supply from ADNOC and Dolphin Energy and supplies gas to DEWA, the EGA smelter at Jebel Ali, ENOC and other industrial users in the Emirate. Dubai has taken steps to diversify its natural gas supplies and has operated a floating storage and regasification unit (FSRU) at Jebel Ali since 2010 to import LNG which it has sourced from origins as diverse as Australia and Trinidad and Tobago.

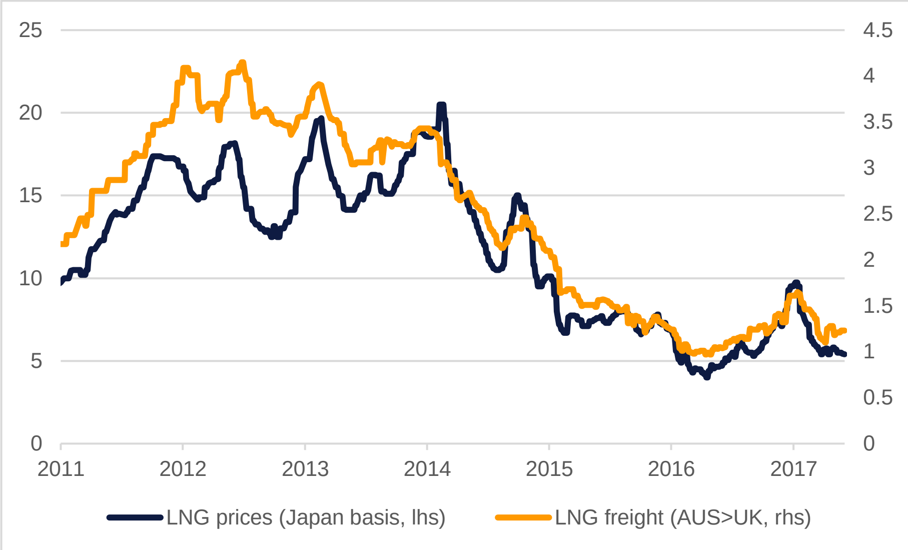
Abu Dhabi also installed an FSRU in mid-2016 and Sharjah National Oil Company has signed a MoU to set up an FSRU at the Hamriyah port by spring 2018 to secure LNG supplies.

Abu Dhabi ownership limits, but doesn't eliminate, risks

Dolphin Energy is owned 51% by Mubadala with the remaining stakes held by Total (France) and Occidental Petroleum (US). Abu Dhabi government ownership of the company and facilities moderates the risk of supply disruptions in our view. In a scenario where Qatar restricted access to the facilities or the supply of electricity to the gas processing plant, supplies of natural gas would be affected which would send domestic gas prices higher and affect industrial facilities in the UAE and Dubai (EGA's smelters, for example, are intensive users of gas-fired power).

The LNG market is lingering from the impact of large new supply additions in recent years from Australia and benchmark prices for cargoes imported into Japan were trading recently at USD 5.40/mBtu. This compares with over USD 20/mBtu as recently as 2014. LNG prices are largely indexed to oil prices so the current environment of soft oil prices and an oversupplied LNG market means that an upward price spike in LNG if the UAE needs to secure large near-term volumes may not be long-lasting. Freight costs for LNG have also been depressed in recent years with costs for shipping cargoes between Australia and the UK at multi-year lows (see chart below).

Soft LNG market could offset gas supply disruption

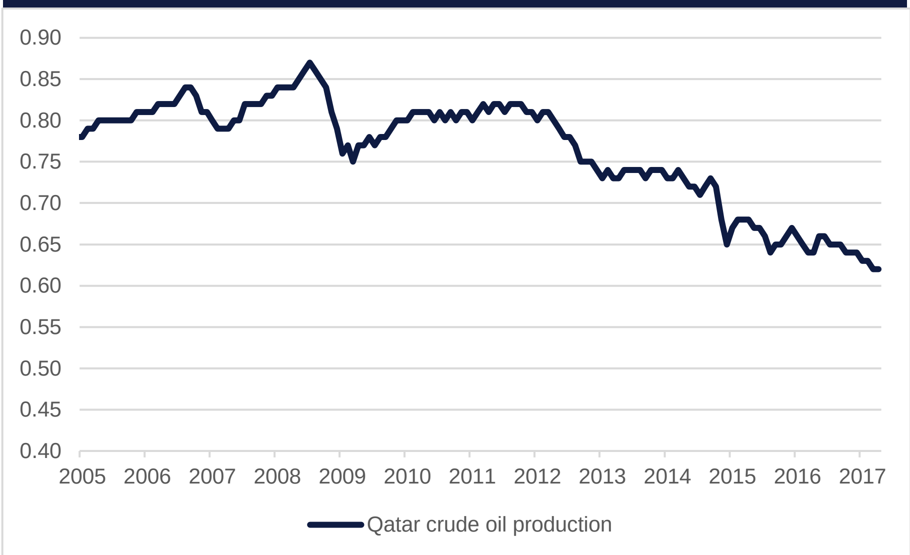


Source: EIKON, Emirates NBD Research.

Qatar as a disruptor to OPEC and crude oil markets

Qatar is a member of OPEC and is bound by the production cut agreement signed in November 2016 and renewed at the end of May 2017. However, its volumes of crude production are low, at less than 700 kb/d (compared with around 3m b/d from the UAE before the cut agreement came into force) and output has been in long-term decline since around 2008. In June 2016 Total (France) won a 30% stake in the Al Shaheen oil field concession which it will operate with Qatar Petroleum for 25 years. However, Total's investment in Al Shaheen is meant to keep production from the field steady rather than try to increase production. We therefore see little risk of Qatar being able to suddenly raise output and negatively affecting prices in a diplomatic retaliatory act.

Qatar a small crude producer



Source: EIKON, Emirates NBD Research. Note: spreads between first and 12 and 24 month futures.

Diplomacy may distract policymakers from oil market rebalancing

In a scenario where another OPEC member supported Qatar diplomatically (for example Iran or Iraq) then compliance with production cut agreement could be threatened. OPEC has been able to smooth over political disputes for the purposes of trying to manage markets—Iran and Saudi Arabia rapprochement at recent OPEC meetings is a case in point. However, if diplomatic conditions deteriorated further and proved to be a distraction to Saudi Arabia or the UAE then other producers may seek to raise output quietly. News that OPEC output was increasing would heap more downward pressure on oil prices and would upend efforts at rebalancing markets.

Impact on Financial Markets

Equities

Following the decision of several countries in the GCC including Saudi Arabia and the UAE along with Egypt to severe all diplomatic ties with Qatar, the immediate impact was felt mainly on Qatari equities. Most other regional markets were unaffected. The Qatar Exchange dropped -7.7%. In terms of flow, GCC investors were net sellers to the tune of USD 55mn while foreign investors were net buyers to the tune of USD 16mn.

In terms of broad equity market flows, GCC investors account for around 25% of total volumes on the DFM index.

Significant investments in the UAE banks by Qatari banks

United Arab Bank – 40% owned by Commercial Bank of Qatar
Commercial Bank International – 40% owned by Qatar National Bank

Credit

The immediate reaction was a sell-off in Qatari bonds with QATAR 21s losing 1.0% and QATAR 26s dropping -1.7%. However, the impact is likely to remain contained given material regional holdings and possible demand from Qatari and Kuwaiti banks. The sell-off in Qatari bonds has made them more attractive relative to their ratings which could draw interest from yield chasing foreign investors

FX

QAR 12-month forwards have spiked to the levels they were last at in January 2016 when oil prices were sub-USD30pb. Other regional forward prices have reacted only marginally. This suggests concerns about a QAR peg devaluation.

Ratings

Initial comments from rating agencies indicate that they are actively monitoring the developments. It must be noted that Moody's downgraded Qatar's rating by one notch to Aa3 recently with the outlook put at stable. It is possible that should the crisis continue for long, there are risks of at least another notch downgrade by rating agencies. Having said that, the last week's move by Moody's had no impact on bond prices.

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