UAE Trade Finance Conference: UAE Banks - Resilience in the Face of Tightening Liquidity

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APRIL 25, 2016

Agenda

1. **Recent Rating Update**
2. **UAE Banking System Outlook**
   - » Operating Environment
   - » Asset Quality & Capital
   - » Profitability
   - » Funding & Liquidity
   - » Government Support
3. **Q&A**

Key Messages

1 Operating environment is softening but growth remains resilient

2 Liquidity is tightening, however solvency remains robust

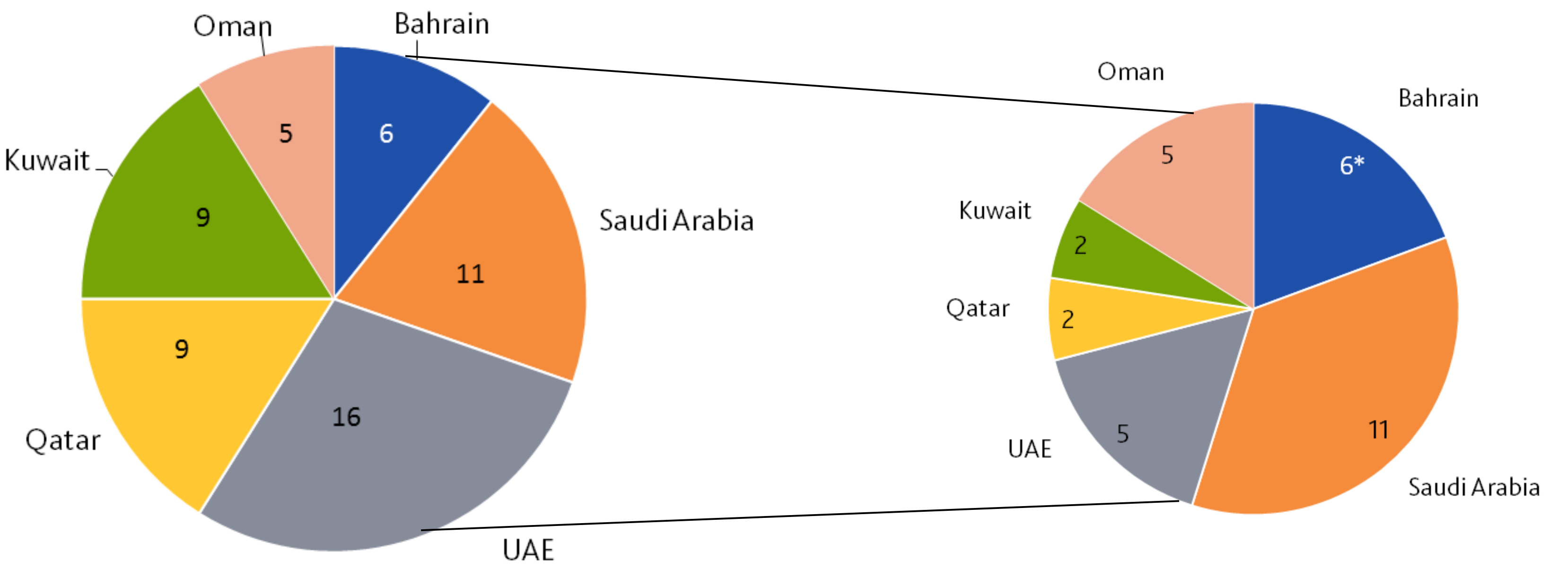
3 Support for Abu Dhabi banks more sensitive to sovereign credit profile

1 Recent Rating Update

Moody's took actions on 31 banks domiciled in oil-exporting countries

56 Rated Banks in Affected Oil-Exporting Countries

31 Rated Banks Placed on Review for Downgrade



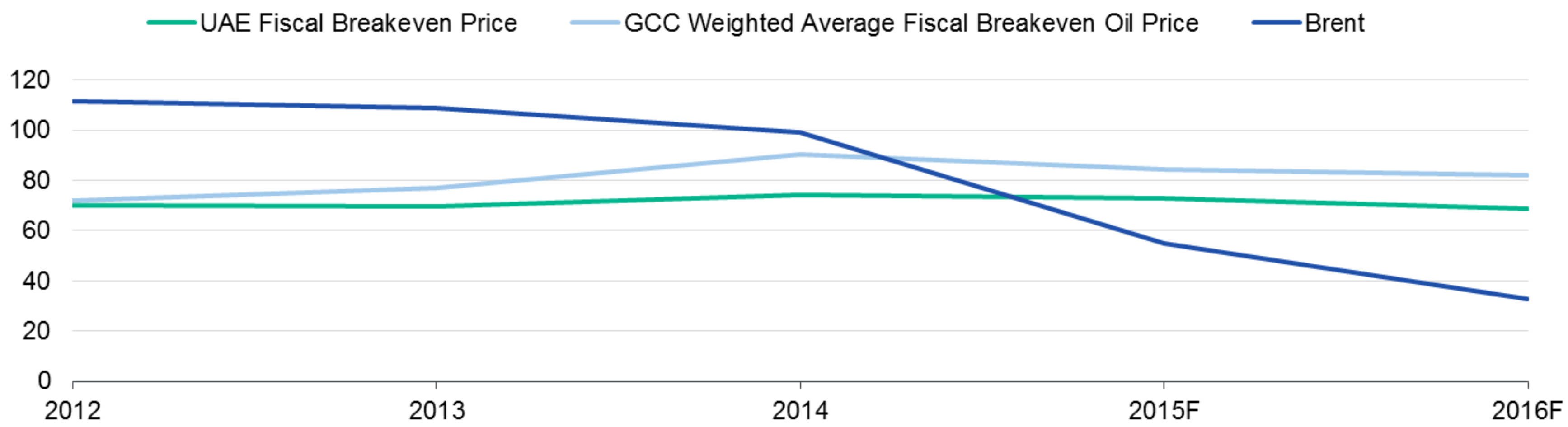
* Four banks are placed on Review for Downgrade, one bank is assigned a Negative outlook, one bank is assigned a Stable outlook

2 UAE Banking System Outlook

2a Operating Environment Overview

UAE operating environment is softening with low oil…

» **Brent crude to average $33/barrel** for 2016 (from $100+ in 2012-14). Although supply is expected to drop - supporting prices, Iranian exports could change the picture



Sources: IMF, Moody's Sovereign Group

» **Economic diversification and strong sovereign wealth buffers** will help moderate the impact of low oil prices and the slowdown. Oil contributes to around 34% of GDP, making the UAE the least commodity dependent in the GCC

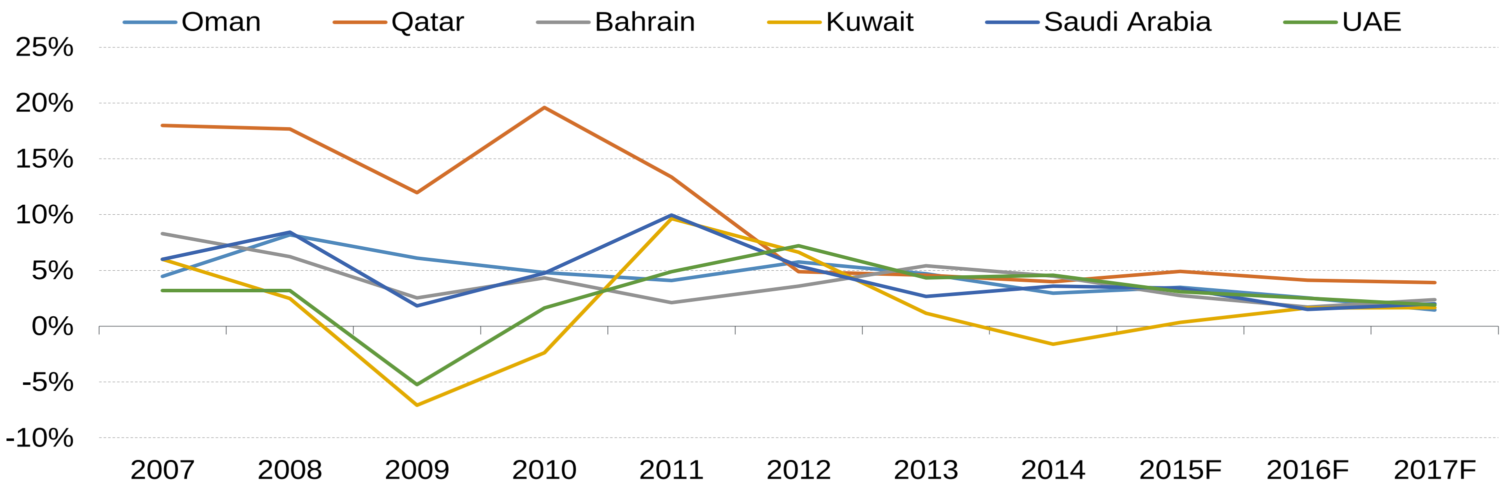
- **Public-sector** spending by the Emirate of Abu Dhabi complements the continued growth in Dubai's significantly more diversified **private sector** (particularly the trade, tourism and transport sectors)
- **Real Estate** sector is a key GDP contributor that has observed a relatively 'soft' landing compared to the prior cycle
- **Countercyclical spending** will remain robust, especially given large projects expected (**Expo 2020** is non-discretionary anchor)

…but GDP growth will remain resilient

» **Oil production has increased** - we expect rising production volumes to add 0.80 to 0.90 percentage points to 2015-2016 real GDP growth

» **Real GDP growth** expected to remain positive at around 3.1% in 2015 and 2.5% in 2016 (vs.7.2% in 2012) as core, private sectors of trade, tourism and transport - while impacted - remain resilient

GCC Real GDP Growth (% change)



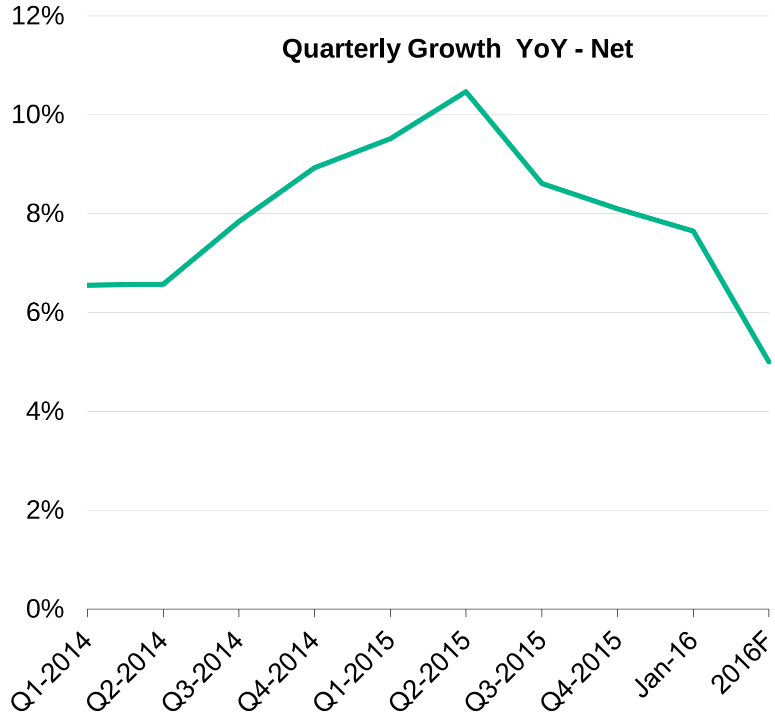
Sources: IMF, National Authorities, Moody's Sovereign Group

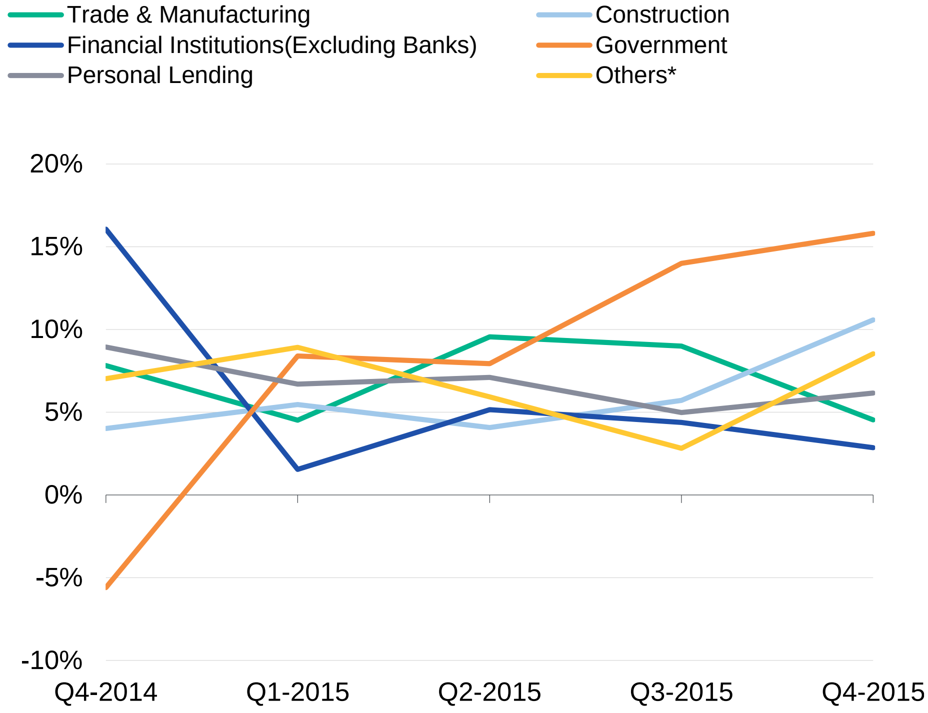
» **Tail risks** to our current baseline scenario have also risen slightly, driven by intensification of **geopolitical tensions** in the region and the prospect of a more **protracted period of low oil** prices, which would further dampen confidence, future spending and economic growth

Credit growth will slow except for Government lending

» Moderation in real GDP growth (+3.2% in 2016 vs. +7.2% in 2012) will nonetheless impact private sector business activity and economic confidence

» **Domestic loan growth is expected to reduce to around 3%-5%** for the period, down from 9% during 2014. Government borrowing is supportive but may crowd out private sector





Sources: The Central Bank of the UAE

2b Asset Quality & Capital

Asset Quality to Remain Stable over 2016

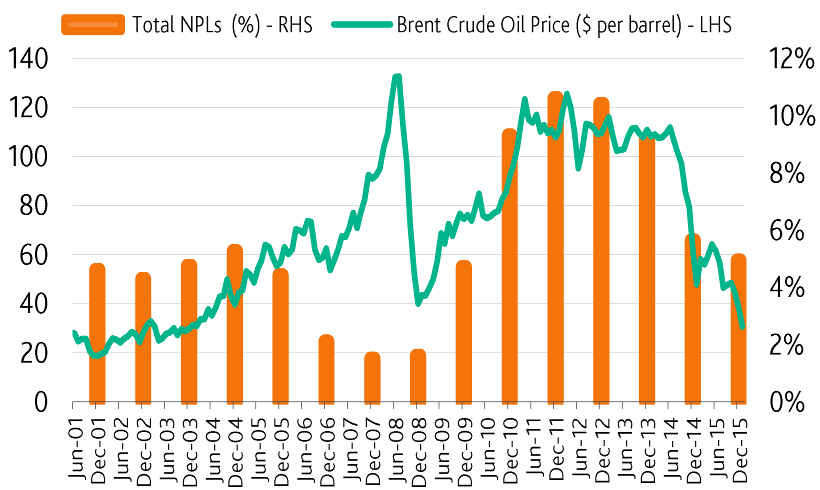
» **Decline in oil prices** and **slowdown in government spending** will impact business activity and corporate profits and have a lagging effect on the banks' asset quality

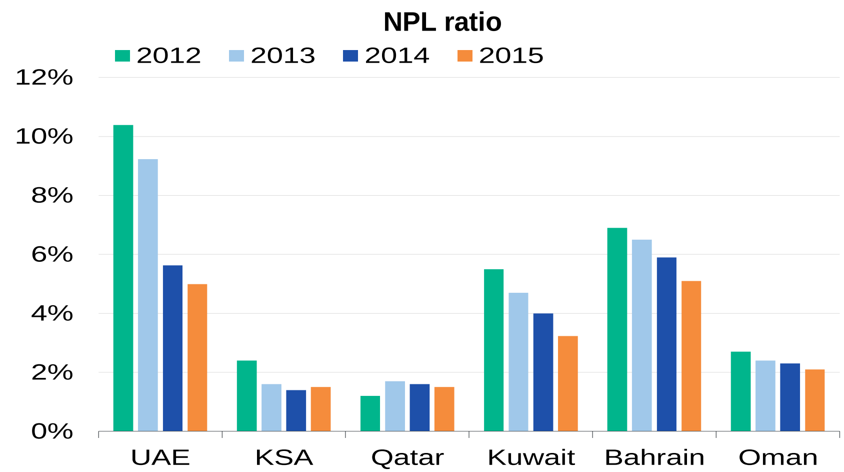
» **UAE NPLs to remain around 5**% into 2016 due to a combination of factors:

– Increases driven by economic slowdown and commodity weakness, particularly in the overleveraged SME segment

– Decreases from the continued resolution of legacy impairments

» Recent **macro-prudential regulations** and **tighter underwriting** will support future performance





Sources: UAE rated banks financial statements and US Energy Information Administration

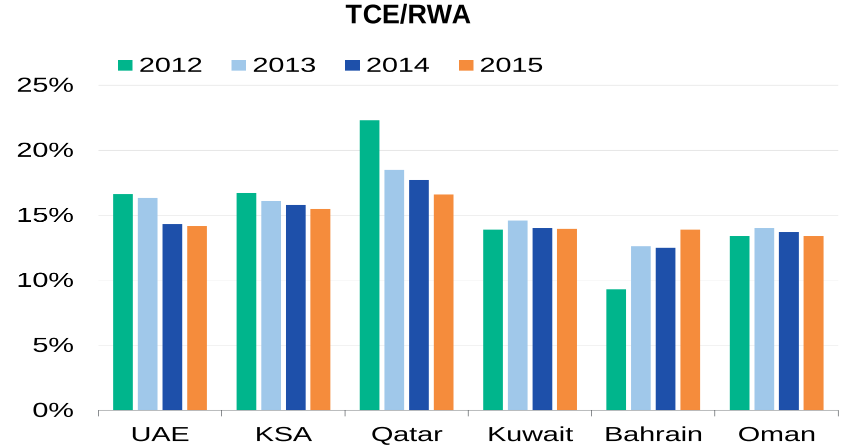
» **Asset quality pressures would increase** with more severe public spending cuts (Abu Dhabi) and weakened global growth (Dubai) both contributing to a decline in economic activity and business confidence but this is not our central scenario

Capitalisation to Remain Robust Over 2016…

» UAE banks' capital ratios are **solid and above most global peers**, which provides a significant mitigant against moderate asset quality deterioration

» **Capital** as of 2015E:

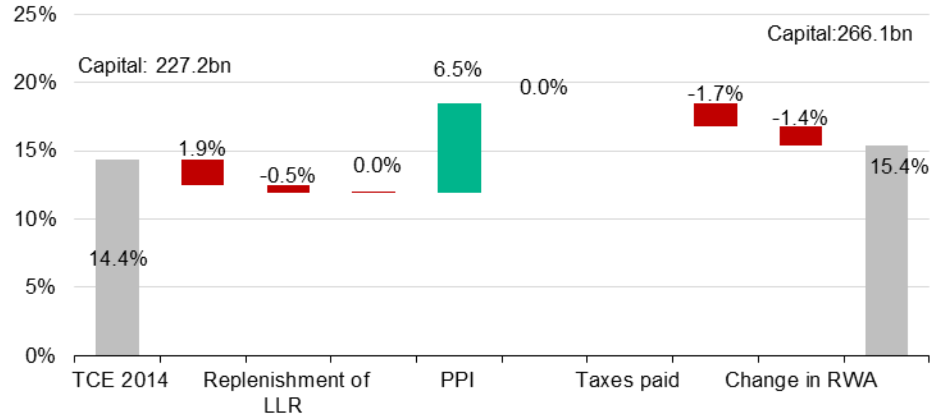
i. Average T1 and TCE ratio were around 16% and 14%, respectively



» **UAE TCE ratio to increase** around 100bps to around 15% under our baseline scenario owing to:

i. Slower credit growth

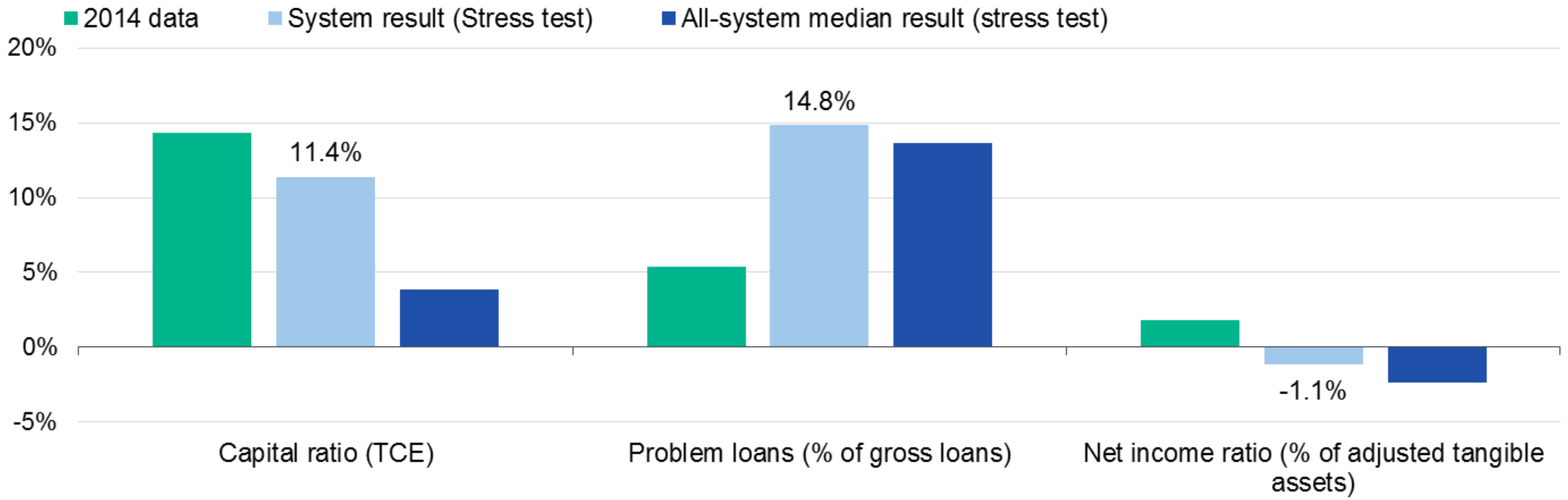
ii. Solid internal capital generation though resilient profitability



Sources: Moody's

…and Moderately Impacted Under Our Stress Scenario

Under our **stress scenario**, UAE banks would maintain a TCE ratio of around 11%, which is much higher than the global median of 4% result for all banking systems subjected to the same stress test



Source: Moody's

» Our projections are based on a set of severe assumptions, amongst which:

i. An increase in NPLs to around 15% of gross loans (similar to year 2000 levels)

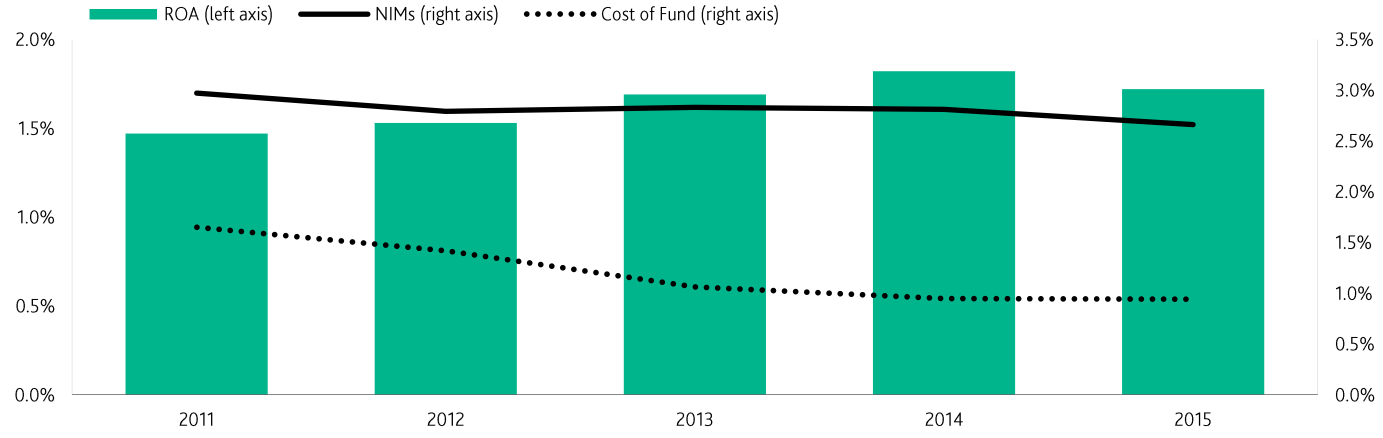
ii. Credit costs to reach 3.5% of gross loans from around 80bps estimated for 2015

2c Profitability

Profitability to be Resilient in 2016 Despite Challenging Business Conditions…

Overall expect UAE banks' profitability to remain stable with return on assets of around 2% over into 2016

- **Provisioning costs** were declining but from 2015 should stabilise at around 20% of Pre-Provision Income, with charges from new formation balanced by releases from resolution of legacy exposures
- **Negative impact** from reduced credit growth and increase in funding costs on profitability for 2016
- **Positive impact** on yields expected **from U.S. interest rate hike** (due to USD currency peg). Assets will re-price upwards after a long period of compression and help support margins



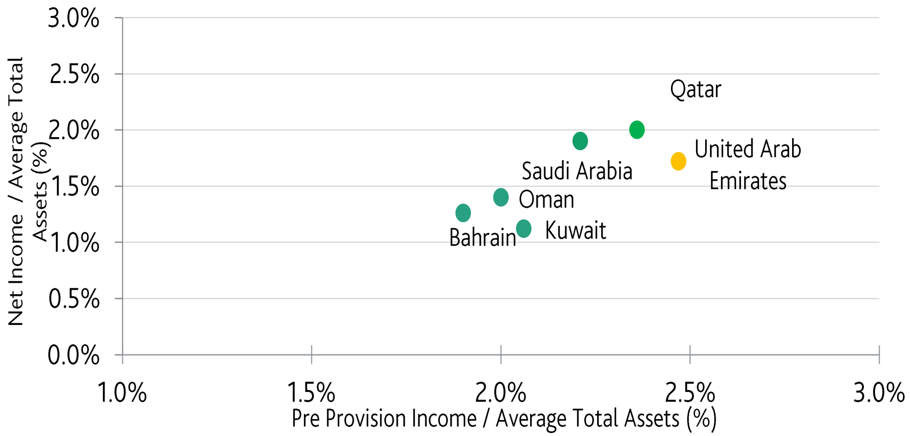
Source: UAE rated banks' financials, Moody's

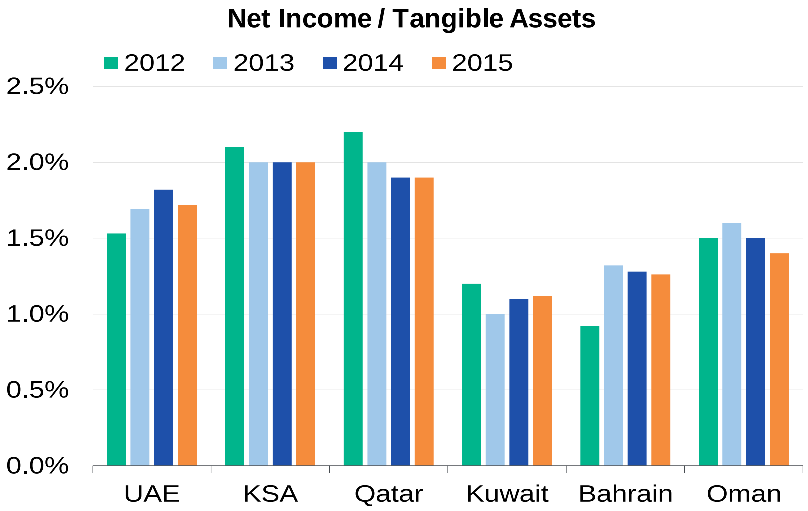
...and Compares Well With Other GCC Banking Systems

» UAE banks' **stable** profitability is further supported by:

i. **Substantive low-cost CASA deposits** (around 55% of deposits as of January 2016), which help moderate the cost impact of increased market funding

ii. **Stable operating costs**. UAE banks' efficiency metrics expected to remain at the current low levels (cost-to-income ratio at around 37%)





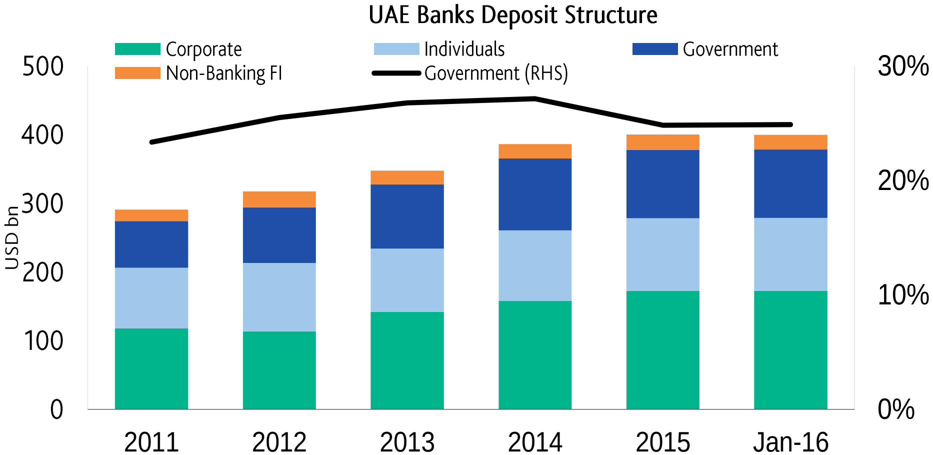
Source: UAE rated banks' financials, Moody's

» UAE banks remain amongst the **most profitable** in the GCC, with an **average net income-to-tangible assets ratio of 2.0%** expected for 2016

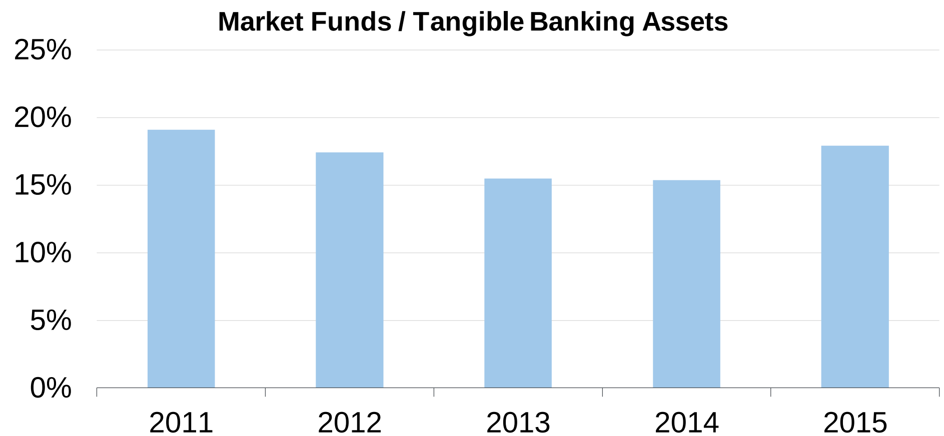
2d Funding & Liquidity

UAE Banks' Reliance on Market Funding is Increasing

- » **Deposit growth will slow** to around 3% for 2016 from 11% during 2014
  - – Decline in direct **government** deposit balances (-16% in 2015 vs. +17% in 2014)
  - – Slowdown in **GRE** deposit balances (+5% in 2015 vs. +9% in 2014)
  - – Slowdown in **corporate** and **retail** deposit inflows (+7% in 2015 vs. +11% in 2014)
- » Market funding to increase to around 20% of total assets in 2016 from 15% at YE2014



Sources: Central Bank of UAE, UAE rated banks' financials, Moody's



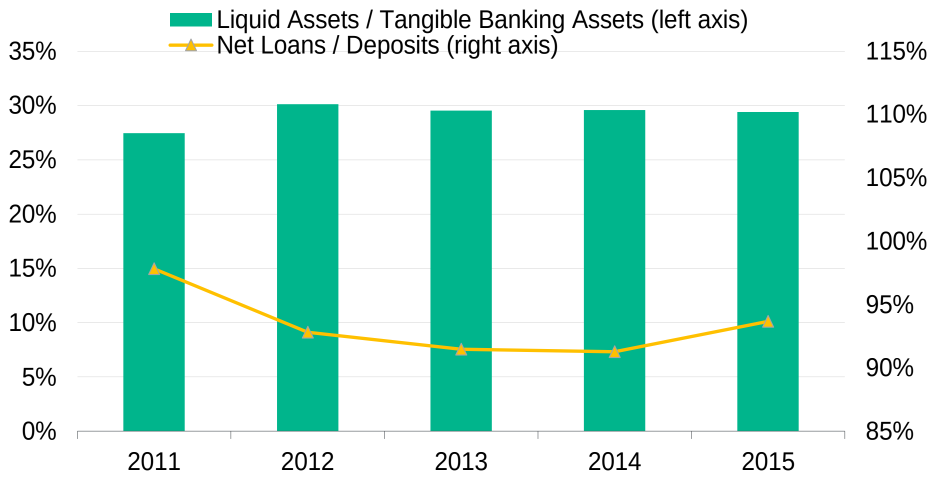
- » However UAE banks' funding structures will continue to benefit from:
  - i. **Stable albeit slow growing deposit base** (around 71% of non-equity funding)
  - ii. Large proportion of stable, low-cost, **CASA** (around 55% of customers deposits)
  - iii. Limited exposure to more volatile foreign liabilities given currency peg

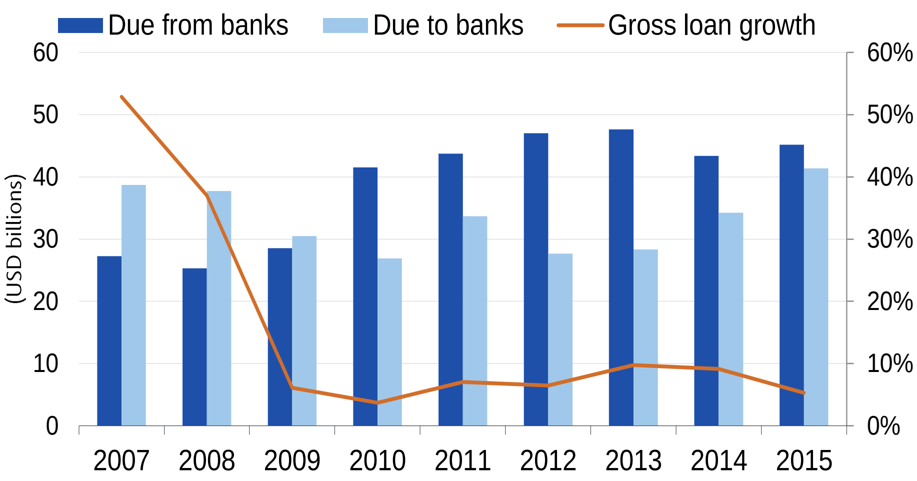
Liquidity Buffers Will Decline but Remain Solid in 2016

» **Loan-to-Deposit** ratio for the system is expected to climb past 100% by YE2016

» **Liquid Assets** are expected to fall to around 25% of Total Assets in 2016 from 30% at YE2014

» **Basel III Liquidity Coverage Ratio -** most banks are 'expected' to be compliant but timing is uncertain





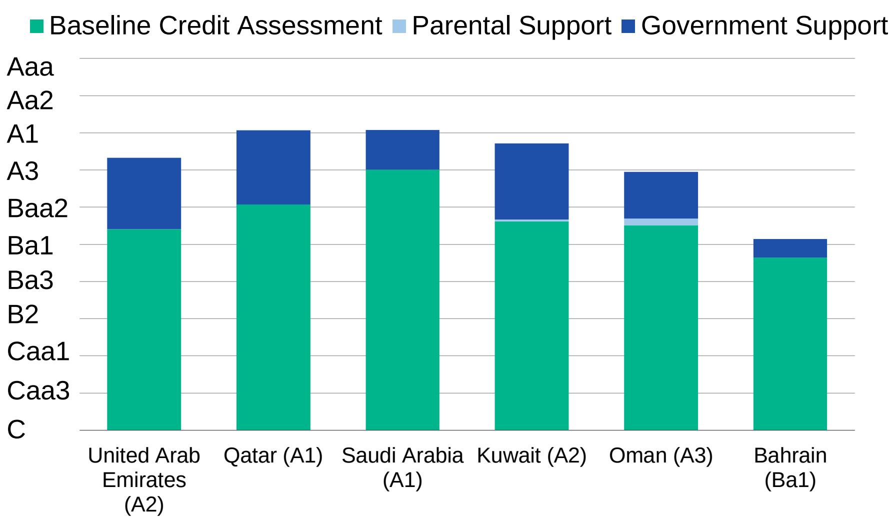
Sources: UAE rated banks' financials, Moody's

2d Government Support

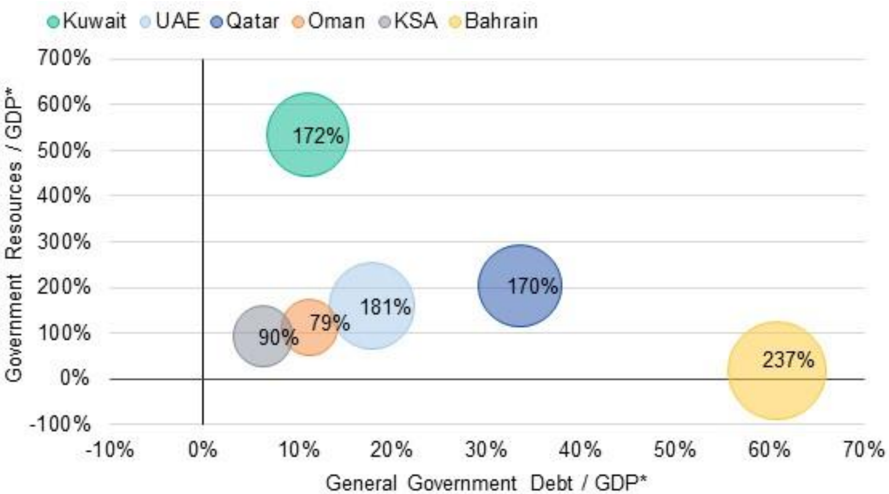
Support Capacity and Willingness to Remain High

- We view UAE as a **high-support country**, based on the historical record of actions to resolve bank distresses, as no depositors/creditors have suffered any losses
- The UAE government has **strong fiscal capacity** to provide support if needed, but some UAE banks have supported ratings close to the Sovereign rating - creating linkages

GCC Bank Ratings Comparison



GCC Government Support Capacity



*Government resources are government's reserves (including the sovereign wealth funds). Circle size and associated metric corresponds to the size of banking sector relative to Nominal GDP

- While countercyclical spending continues to support banks' financial performance, it may ultimately **pressure sovereign creditworthiness** and consequently the supported ratings.

Moody's rates 16 Banks in UAE that together account for 88% of total banking assets

Name	Total Assets (in US$ mms, as of Sept 2015)	Domestic market share - loans (in US$ mms, as of Sept 2015)	Domestic market share - Deposits (in US$ mms, as of Sept 2015)	Long-term Bank Deposit Rating (local currency) and Outlook	Standalone Credit Strength	Notches of uplift for external support
Nat'l Bank of Abu Dhabi (NBAD)	110,177	15.4%	16.3%	Aa3/RUR	a3	3
Abu Dhabi Comm'l Bank (ADCB)	58,627	10.9%	9.0%	A1/RUR	baa3	5
Union Nat'l Bank (UNB)	27,729	5.0%	5.1%	A1/RUR	baa3	5
Al Hilal Bank (AHB)	11,725	2.4%	2.2%	A1/RUR	ba2	7
Abu Dhabi Islamic Bank (ADIB)	31,833	5.6%	6.2%	A2/RUR	ba2	6
First Gulf Bank (FGB)	62,222	11.2%	9.8%	A2/STA	baa2	3
HSBC Middle East Limited (HBME)	34,892	5.3%	5.1%	A2/NEG	baa2*	0
Sharjah Islamic Bank (SIB)	7,673	1.2%	1.1%	A3/STA	baa3	3
Dubai Islamic Bank (DIB)	40,152	6.7%	7.6%	Baa1/STA	ba3	5
Emirates NBD (ENBD)	106,303	18.9%	18.7%	Baa1/POS	ba2	4
National Bank of Fujairah (NBF)	7,796	1.4%	1.4%	Baa1/STA	ba1	3
Nat'l Bank of Ras-Al-Khaimah (RakBank)	10,610	2.0%	1.9%	Baa1/STA	baa3	2
Commercial Bank of Dubai (CBD)	14,516	2.8%	2.6%	Baa1/STA	ba1	3
Mashreqbank (Mashreq)	30,325	4.2%	5.1%	Baa2/STA	ba1	2
United Arab Bank (UAB)	7,033	1.3%	1.3%	Baa2/RUR	ba1*	1
Invest Bank	4,070	0.8%	0.8%	Baa3/STA	ba2	2
Average (asset-weighted)				A2	baa3	

Source: Central Bank of UAE, Moody's

*UAB and HBME benefit from 1 and 3 notches of parental support, respectively

On March 7, Moody's placed the ratings of 5 UAE banks on review for possible downgrade

Key Messages

1 Operating environment is softening but growth remains resilient

2 Liquidity is tightening, however solvency remains robust

3 Support for Abu Dhabi banks more sensitive to sovereign credit profile

3 Q & A

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