Investment Strategy Update

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

First Abu Dhabi Bank

25 January, 2021

The UAE's dirham bonds can help the economy grow faster

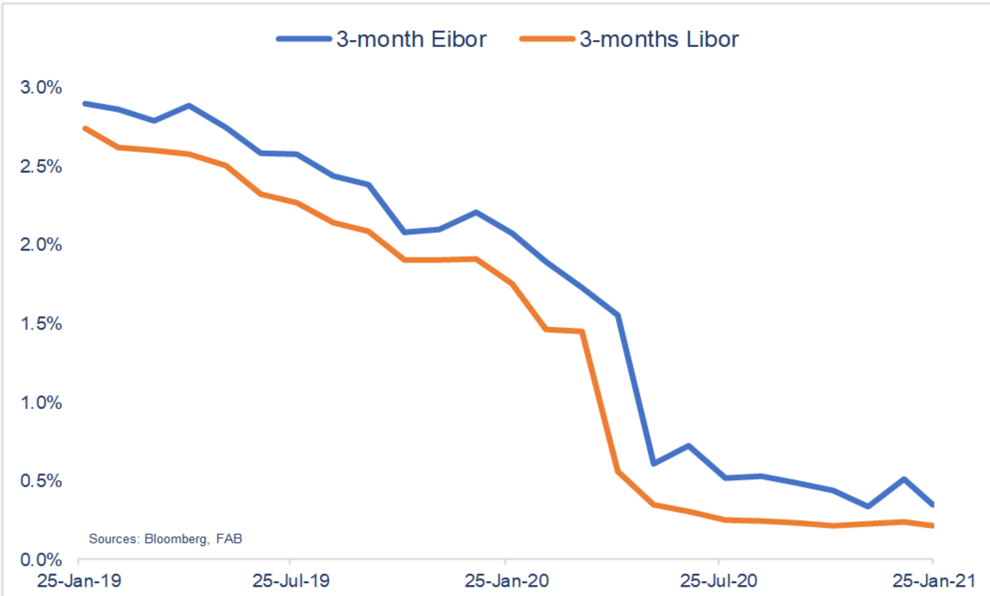
♦ **The UAE Cabinet today approved a plan to issue federal bonds in dirhams.**

♦ **The process had been started in 2018, with a federal law that created the groundwork for the new bonds.**

♦ **A dirham-denominated federal government bond curve would allow banks to manage liquidity and currency risks better and lend more.**

♦ **It can also allow local businesses to borrow in local currency from the country's investors.**

♦ **The FAB AAC has an overweight position in equities, IG and EM bonds, and gold, and underweight alternatives.**



The UAE today took an important step to boost future growth as the nation's Cabinet approved a federal public debt strategy, putting in action the legal framework created in 2018, which allowed for the issuance of federal bonds.

If the federal government moves ahead with the decision to issue dirham-denominated debt, its bonds are likely to enjoy strong demand among global investors, attracted by the high credit ratings of the country.

More importantly, however, federal bonds in dirhams allow banks to manage their liquidity risk better and to, perhaps, lend more. Banks are required to hold very liquid, high quality securities to ensure that there is enough cash readily available if people start running to take their deposits out. While this scenario is nearly impossible here, the requirements exist. They usually translate into banks buying government bonds in large amounts.

In the UAE, there is not enough dirham-denominated government debt to meet these liquidity requirements. As a result, local banks are often forced to hold dollar-denominated securities for liquidity purposes. That then creates a currency mismatch, as most of the local banks lend in dirhams but have large parts of their liquidity buffers in dollars.

The dirham is pegged to the US dollar, but, from a bank risk-management perspective, having a currency mismatch still requires taking positions in derivatives to compensate for any unexpected moves. All these gymnastics can increase the cost of lending for banks and their profitability.

A clear-cut, liquid government bond curve in dirhams, therefore, could make it easier and cheaper for local banks to lend money. In fact, one of the reasons why the Emirates Interbank Offer rate has historically been higher than LIBOR may be because of the gymnastics banks have to go through to lend in dirhams.

Eibor, a measure of interbank liquidity, has normally offered a premium to dollar Libor

This, therefore, could trickle down to everyday people in the UAE. A stable and low EIBOR means lower costs of borrowing on mortgages and loans.

Finally, big corporations which derive most of their revenues in dirhams will now be able to borrow in their home currency. Usually, investors like to have a government bond curve to benchmark against when they are evaluating how much a company should pay for its bonds.

In other words, the federal government dirham bond issuance could easily be followed by more bond issuance in dirhams from local corporations. Easier access to credit in the local currency usually translates into faster growth. Just another reason to be bullish of the UAE.

Investment Strategy Update

First Abu Dhabi Bank