MARKETS

# VAT to be productive for markets

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# be productive for markets

Every giant leap leaves behind an impression, the consequences of such a leap can be determined only after taking the leap. Similarly, the UAE is going to take a big leap by implementing the Value Added Tax, starting January 2018. VAT is generally viewed as the most stable revenue source, which has the least detrimental effects on investments. The 5 per cent VAT rate as in the UAE is the lowest rate by global standards, where in the global average stood at about 15 per cent.

**Impact on markets**: Net-net, although there could be a short-term hiccups in the economy in terms of higher inflation, slowing consumption growth, small knockout impact on the GDP, however in the medium- long run, we anticipate these revenues to find its way back to the economy, via deployment of new projects/job creation. Despite the ongoing economic adjustment, we believe that the UAE stock market offers a better value proposition both from the valuation and dividend yield perspective compared to the regional peers. Catalyst for the markets for next year could come from potential IPO pipeline in the UAE that should boost investors' confidence and increased contribution of government/private sector spending linked to Expo 2020 translating to stronger economic recovery, in our view. Most importantly, given the uncertain era of geopolitical risks, we believe that the investors will be willing to pay a premium to UAE valuations, given the country's strong international relations and solid track record of domestic politics, which has stood the test of time, without any tiny blemishes.

**Impact on companies**: The companies could face a tough time for first few quarters in understanding the new regime and will take time to implement and integrate with their existing systems. While the cost of implementation is likely to be limited, the new tax rates will ultimately be passed on to the consumers (although this will be challenging in the current environment), the demand for such goods is likely to see a decline due to such immediate increase in prices and hence, the revenue collections for the companies is likely to fall. We suspect the bigger business are unlikely to be affected much, while the smaller (and less organised) business entities could face a tough time moving forward. The cost of compliance will also add up and cause further mayhem. The near term impact of VAT would come from higher inflation (borne by the consumer), however it will be a one-time effect. We expect this one-off inflation to the tune of incremental 250-300 bps from VAT implementation in 2018 to be negative for consumption, thus leading to a contraction in retail spending in the first year of the VAT implementation.

**Market Watch**

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*Special to Gulf News*

The banking sector could see further pressure on retail lending growth (YTD -5.6 per cent), as the sentiments and growth in disposable income is likely to be negative. On that note, banks focusing recently on the retail sector such as the market share gainers this year UNB (+17.5 per cent), RAKBank (+4.4 per cent) could see a slowdown in their lending book, unless the growth is offset by private/public sector growth. While this could have an impact non-oil GDP growth, however we expect government spending to increase 2018-2020 pushing up the non-oil growth of the UAE, broadly offsetting any decline in the retail consumption rate.

In Dubai, megaprojects will continue to support non-residential construction activity in the next few years, while we expect Abu Dhabi to boost spending in 2018, slowly easing its fiscal tightening stance. We note that the key areas of public sector spending will not see an increase in VAT associated price, as they are usually exempted. On the other hand, we are optimistic about the performance of UAE sovereign bond market post the implementation of VAT.

Our confidence stems from the increasing budgetary discipline, and pace of reforms in the UAE, outshining the likes of Qatar, Kuwait, Oman and Bahrain. Accordingly, we expect these events to be credit positive, as it will mark a rapid increase in public finances in the first year. We note that post implementation the economy will witness a new direction to move forward, as VAT will boost the reputation of the country (UAE being the second country after Saudi Arabia to implement VAT in the GCC) marching towards a lower reliance on the oil economy.

We estimate, VAT being a highly effective mechanism of mobilising tax revenue, will increase the UAE's tax share (as a percentage of GDP) from the current levels (just above 1.8 per cent) to 3.5 per cent of GDP in next two years. Additionally, UAE dominates the regional peers in terms of consumer spending; note that the UAE's private consumption rate is close to 59 per cent of GDP versus 43 per cent for Saudi Arabia, 45 per cent of Kuwait, and 25 per cent for Qatar's GDP. This further denotes that the UAE will likely benefit the most on incremental VAT revenues compared to the regional peers.

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