Emirate of Sharjah Debt Update

The Emirate of Sharjah is the third largest of the seven emirates that comprise the UAE. It is relatively a small emirate with population of 1.4 million, land area of 2590 sqkm (3.3% of the UAE total area) and GDP of $24 billion in 2016 (7% of UAE total). GDP per capita is around $18k which is high in global terms but substantially lower than Abu Dhabi at $114k and Dubai at $81k. **Sharjah is rated A3/stable by Moody's and BBB+/stable by S&P.**

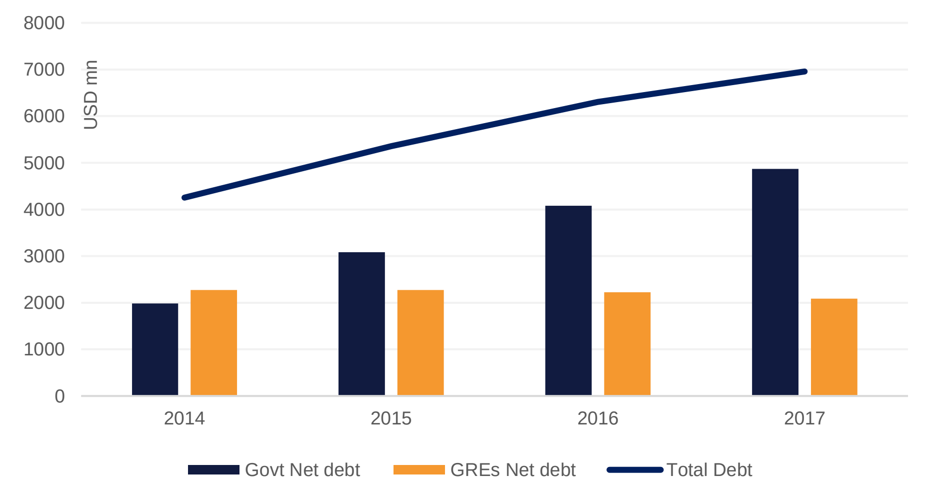
Sharjah Debt

Sharjah's debt as at end 2017 was circa $4.9 billion and debt to GDP was close to 20%. Its debt is well diversified across bonds, loans and sukuk and has weighted average maturity of over 4 years. In end 2017, 55% of the debt was denominated in AED and 45% in USD. Bond documents have no stringent covenants of note.

The weighted average cost of borrowing was 3.2% as of the end of 2016, which is likely to have increased now in view of the ongoing interest rate hikes in the US. Sharjah debt management office actively manages interest rate risk and hedging is likely to have kept any rate increase contained.

Sharjah has 19 GREs (Government Related Entities) including Sharjah Electricity and Water Authority (SEWA), Sharjah International Airport, SIAF and Hamriya Free Zones, Sharjah's seaports, two universities, Sharjah Public Transport Corporation, Sharjah Asset Management and Sharjah Waste Management Co. In addition to the government debt, there was $2.09 billion worth of net debt taken by the GREs. Government of Sharjah does not generally guarantee GRE debt, however exceptions are made based on specific requirements. Currently it guarantees USD 775 million of debt taken by the SEWA which matures in end 2019. Sharjah DMO (Debt Management Office) co-ordinates all borrowings by the Sharjah central government and de-centralised departments as well as government owned independent authorities.

Sharjah Debt



Source: Sharjah Finance Department, Emirates NBD Research

Sharjah has improved its access to international capital markets via issuance of sukuk in 2014, then in 2016 and now again in 2018. Last week it raised $1 billion via a 10 yr sukuk issued at MS+135bps i.e. circa 4.25%. The order book was over $2.4 billion indicating strong investor support. It also expanded its investor base via tapping into the abundant liquidity available in Asia. Last month, it raised CNY 2 billion via Panda bond issued in the Chinese domestic market.

We consider Sharjah's access to funding as adequate. Furthermore, the vast resources of the UAE's sovereign wealth fund is expected to provide a backstop to any liquidity concerns.

بنك الإمارات دبي الوطني
Emirates NBD

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Sharjah bonds and sukuk

	Ticker	Cpn	Maturity	Amount $mm	YTW %
Bonds					
	SHRJAH	5.8	02/02/2021	CNY 2,000M	
Sukuk					
	SHARSK	3.839	1/27/21	500	3.23
	SHARSK	3.764	9/17/24	750	3.63
	SHARSK	4.226	03/14/2028	1000	4.28

Source: Bloomberg, Emirates NBD Research

Sharjah sukuk have traded largely in tandem with the macro events, albeit with lesser volatility. Liquidity is better in 2024 sukuk given its larger issue size compared with the one maturing in 2021.

Investor base is dominated by local GCC investors. Given the lower risk weighting required for capital treatment of sovereign bonds, Sharjah sukuk are attractive to the bank ALM books.

GCC Credit Index YTW vs SHARSK 24s YTW

Source: Bloomberg, Emirates NBD Research

Given the expectation of support from the UAE government, the spread between the Sharjah government sukuk and the Abu Dhabi government bonds can be seen as a good premium to pick up.

SHARSK 21s vs ADGB 21s Z-spread (bps)

Source: Bloomberg, Emirates NBD Research

Key Credit Considerations

Stable political landscape

Sharjah is ruled by H.H Sheikh Dr Sultan Bin Mohammed Al Qasimi since 1972. The deputy ruler of Sharjah who is also the crown prince since 1999 is H.H Sheikh Sultan bin Mohammed Bin Sultan Al Qasimi. Political stability is high in the emirate and citizenry is ethnically and religiously cohesive.

Well diversified economy

Sharjah's economy is well diversified with no single sector accounting for more than 20% of the total. Reliance on hydrocarbons is low. Although Sharjah produces gas and LPG, it is a net importer of energy. Four largest sectors in its economy are real estate (12%), manufacturing (17%), mining & energy (10%) and wholesale/retail trade (13%).

Despite the minimal direct contribution to GDP from the hydrocarbon sector, GDP growth in Sharjah remains co-related with oil price dynamics given its correlation with its oil price impacted neighboring emirates as many of its residents travel for work to Dubai and Abu Dhabi. Economic growth was around 3% pa in 2016-18 and is expected to range between 2.5% to 4% over the next two years. Sharjah's economy will benefit from increased demand from Dubai stemming from the World Expo 2020 related activity. Sharjah's housing market somewhat correlated with that of Dubai given the high level of daily migration between the two emirates.

India, Iran and Iraq are Sharjah's three largest trade partners, representing around half of Sharjah's combined imports, exports and re-exports. Trade with Iran increased substantially during the era of sanctions as a result of Sharjah being a good re-export hub.

A 5% VAT has been implemented in the UAE since January 2018 which will be collected by the Federal Tax Authority. Sharjah with a considerably higher share of non-oil GDP than Abu Dhabi is likely to contribute a material amount of VAT. Distribution of the VAT revenue from the federal level to individual emirates is yet to be finalized. Revenue sharing based on population will give Sharjah 15% of total VAT collection, while that based on GDP or a measure based on non-oil GDP will only give around 7% to 8% of the total.

Focus on attracting foreign capital

Sharjah Investment and Development Authority, Shurooq, was created in 2009 to attract foreign direct investment (FDI) into the emirate. It attracted USD 803 million in FDI from outside UAE in the period between Jan 2016 – Apr 2017. Shurooq is currently focusing on attracting FDI into transport and logistics, education, healthcare and environmental technologies.

In line with the Sharjah Tourism Vision 2021, Sharjah aims to attract 10 million tourists by 2021 from less than 2 million in 2015. It is focusing on family tourism, introducing ecotourism, heritage and cultural projects and aims in particular to attract tourists from China.

Relationship with the UAE Federal Government

Sharjah's credit profile gains support from its membership of the UAE. While there are no fiscal flows between the Government of Sharjah and the UAE Federal Government, Sharjah benefits significantly from public services such as basic healthcare & education, defense and postal services that are provided by the Federal Government. Federal Government also maintains some major inter-emirate roads and runs a UAE-wide public housing scheme.

Late last year, the UAE cabinet approved its second five-year federal budget of AED 201 billion for 2018-2022 of which AED 51.4 billion is earmarked for 2018. Over 43% of the budget is allocated to social development programs, with 17.1% earmarked for general education and higher education, and 7.4% allocated to the health sector.

Expectation of extraordinary support from the UAE federation (Aa2/stable) in times of need is extremely high.

Impact of dispute with Qatar

Sharjah Electricity and Water Authority (SEWA) signed a 10yr agreement with Qatar Petroleum and Dolphin Energy in October 2016 for receiving gas at competitive pricing. SEWA's financial profile will likely get materially impacted if an escalation in the current diplomatic dispute with Qatar were to result in halting of gas exports to the UAE. However, the probability of this happening appears low at present as reduced gas exports would lower foreign exchange earnings for Qatar at a time when they are urgently needed.

Banking System

Sharjah banking system includes four Sharjah registered banks (Bank of Sharjah, Sharjah Islamic Bank, United Arab Bank and InvestBank) and several non-sharjah based national and international bank branches. All banks operate under the supervision of UAE central bank. The financial sector accounts for just 8% of Sharjah's GDP but has been growing fast, at an average rate of 12.7% per year over the past five years. As a member of the UAE-wide monetary union, Sharjah has limited policy flexibility relative to sovereigns with their own central banks.

Limited availability of consistent data

Consistent and timely data about public finances is difficult to get. There are also no official time series for national accounts at constant prices, and no balance-of-payments statistics at the emirate level. Currently, the Federal Competitiveness and Statistics Authority compiles the GDP for Sharjah by extrapolating data from surveys conducted in Abu Dhabi and Dubai. However, the Sharjah Department of Statistics and Community Development plans to conduct its own economic surveys to compile both quarterly and annual national accounts data from 2018 onwards.

Sharjah Economic Data				
	2014	2015	2016	2017e
GDP USD mn	22.4	23.2	24.1	24.5
GDP growth	4.2	3.6	3.9	2.0
Net Govt Debt (USD mn)	1.98	3.09	4.08	4.87
Net Govt Debt / GDP	9%	13%	17%	20%

Source: Sharjah Finance Department, Emirates NBD

Budget and Finances

Sharjah Finance Department directly manages the financial affairs of Centralised Departments and the Ruler's Office.

Sharjah's budget is generally small (circa 10% of GDP) as bulk of required services are covered by the federal UAE budget. 2017 budget data is not yet available. In 2016, government revenue of $2.02 billion came mainly from fees such as customs, company registration fee, police/fines etc. collected by the government departments (69%), contribution from oil & gas (2%), land sales (6%) and Shares / dividends received (9%). The contribution of hydrocarbons has fallen considerably since 2015, making up less than 5% of total revenues.

Government expenditure of $2.7 billion comprised largely of wages and maintenance of government departments (61%), interest payments (4%) and major capital expenditure (22%). Circa 13% of budget is estimated to be for flexible discretionary items. Capital spending is focused on infrastructure, public housing, social development and welfare benefits. Public expenditure has remained high as government has been reluctant to cut expenditure in times of slowing economic activity in the region.

Budget deficit in 2016 was $679 million compared with $600 million in 2014 and $974 million in 2015. The 2015 deficit was higher than planned, primarily due to delays in planned land sales and revenue enhancement measures. For 2018, the government forecasts a deficit of AED2.5 billion-AED3.0 billion i.e. circa 2.6%-3.1% of GDP. Budget deficits are likely to reduce over the coming years as discretionary spending gets curtailed. In addition, government finances will benefit from VAT receipts once the distribution method is finalized.

Gross borrowing requirement in 2018 is likely to be around AED3.5 billion including refinancing and budget deficit funding. This has already been completed by issuance of sukuk and CNY bonds.

Sharjah's debt to GDP has almost doubled over the last four years from 9% in 2014 to circa 20% now. That said, its public sector is relatively low leveraged and GRE debt has remained stable, at around 9% of GDP. SEWA is by far the largest single entity among Sharjah GREs, having net debt of $1.7 billion. It has history of needing government support in the past, however, has become profitable since 2015 and is now a net contributor to the government budget.

Sharjah Budget Highlights

USD mn	2014	2015	2016
Revenue			
Govt Departments	782	862	1,396
Oil & Gas	235	69	40
Land Sales	109	34	121
Bank Tax	16	23	20
Shares / Dividends	47	46	182
Transfer from GREs	375	115	263
Total	**1,564**	**1,149**	**2,023**
Expenditure			
Govt. Departments	974	1,083	1,648
Major Capex	411	552	594
Interest	87	85	108
Grants & Subsidiaries	692	403	351
Total	**2,164**	**2,123**	**2,702**
Surplus / (Deficit)	**(600)**	**(974)**	**(679)**

Source: Sharjah Finance Department, Emirates NBD

Sharjah government balance sheet is strong. It has ownership in a number of private-sector businesses such as Bank of Sharjah (17.16%), SIB (37.55%), Air Arabia (18.02%), Dana Gas (3.48%) and Sharjah Cement (23.87%). Estimated value of these assets is circa AED 5.079 bn of which Sharjah's equity stake is worth circa AED 908 million. No comprehensive valuation is available for the government owned all unallocated land in the emirate and large number of buildings used for government activities.

Credit Ratings

Emirate of Sharjah is rated BBB+/stable by S&P and A3/stable by Moody's. The ratings reflect positives of low government debt and implied support from higher rated UAE Federation (Aa2/Stable) and negatives of centralised policy-making, underdeveloped political institutions and unavailability of reliable economic and demographic data.

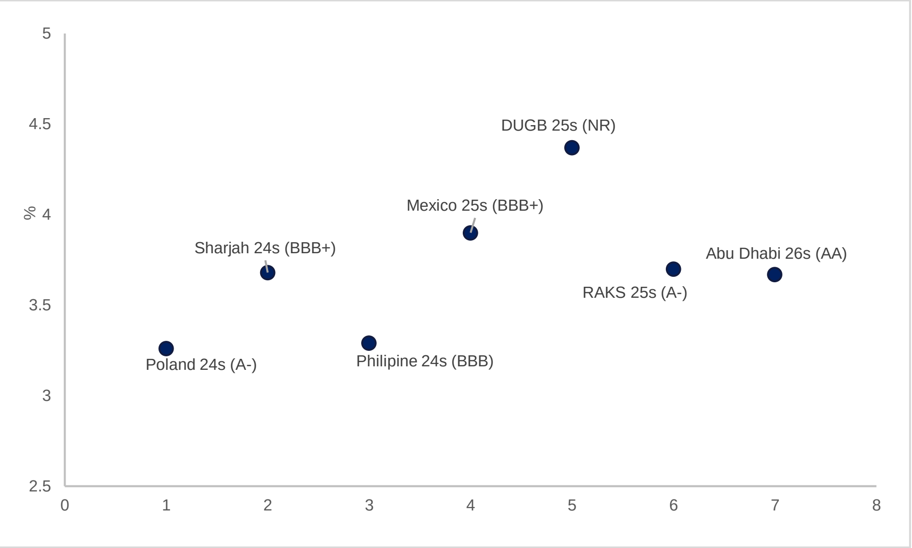
Moody's rating accounts for Sharjah's small revenue and expenditure relative to GDP base and high share of non-tax revenue. As per Moody's, the government has a high reliance on revenues sources such as business licensing and land sales which has proven to be volatile in the past, leading to unpredictable revenue outcomes Risks to the government's balance sheet from contingent liabilities, previously a significant ratings constraint, have declined following the restructuring of SEWA, which is now profitable and a net contributor to the government budget.

S&P's sees Sharjah's debt burden as moderate with interest payments accounting for an average 7% of revenue and expects an acceleration in GDP growth in 2018. It expects Sharjah's budget deficit to range between 1% to 2% until 2021 mainly as a result of high capital expenditure.

Relative Value

Sharjah sukuk are well supported by investors given its membership of the Federation of the UAE (Aa2/stable) which is rated multi notches higher than Sharjah itself.

Yield on sovereign USD bonds (%)



Source: Bloomberg, Emirates NBD Research

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