THE COFACE ECONOMIC PUBLICATIONS

panorama

September 2014

coface

Panorama United Arab Emirates

By Seltem Iyigün,
Economist, Coface

CONTENTS

How wealthy is the UAE economy after the debt crisis? Figures indicate that after contracting around 5 percent in 2009, the UAE economy recorded gradually solid growth rates. The economy is expected to grow by 5 percent in 2014, after expanding around 5.2 percent in 2013.

However the growth in the Emirates remains dependent on hydrocarbon revenues, mainly those of Abu Dhabi, despite an active policy of economic diversification. This leaves the country vulnerable to the changes in global economic trend as the latter has an impact on the production and prices of hydrocarbon products.

The reason of Dubai World's default in 2009 was mainly the burst of a property bubble resulting from an over - development of high-end luxury projects relying too much on foreign capital. Since then the country has completed an important part of the debt restructuring. In February and March 2014, Dubai managed to refinance favorably its debt maturing this year (around 20 billion USD) with Abu Dhabi and the UAE central bank.

Today's question is whether the country will see a renewed property price bubble amid the increasing number of new real estate launches in Dubai and the rising housing prices in some areas back to near pre-crisis level.

The lack of transparency and poor legislative controls also contributed to the collapse of the property market. Therefore the introduction of regulatory measures by the authorities aiming at avoiding another bubble is promising for the country's economy.The introduction of the new Companies Law which brings gradual reforms to the corporate governance is also seen as a major progress. Coface upgraded its business climate assessment about the country based on this law.

Coface evaluates the UAE's country assessment which measures corporate risk, as A3. The business climate which considers factors such as the availability of company reports, their reliability and the effectiveness of legal system stands at A3. Coface uses a seven-level ranking. In ascending order of risk, these are: A1, A2, A3, A4, B, C and D

The UAE stands away from the protest movements in the Arab countries. The country is a federation of seven emirates, Dubai and Abu Dhabi are the largest ones. Situated in a key geostrategic area, the country aims to maintain a diplomatic balance between its membership of the Arab world and its alliance with western countries, particularly the United States. The business environment is considered as one of the most favorable in the region (infrastructure quality, government effectiveness, etc.) , even if the Dubai World crisis has highlighted a lack of transparency on the public accounts, the status of public entities, the banks and businesses at that time.

In this panorama, we will focus on hydrocarbons, agro food and retail sectors as these are the key elements of the real sector in the country. The UAE is a major crude oil producer in the world. Around 94 percent of the country's oil resources are in Abu Dhabi. In 2013, the hydrocarbon sector accounted for one third of the GDP and hydrocarbon exports were about one third of total exports. Public finances of the UAE remain highly dependent on hydrocarbon revenues, despite the ongoing diversification of the economy. The oil accounted for almost 80 percent of the budget revenues in 2013. This ratio is expected to decrease slightly to 76.5 percent in 2014. The main risks in this sector would be the corporate profitability depending on the government supports and the balancing of the hydrocarbon supply and demand in the country. The regional conflicts can also represent a source of risk. The agro food sector is becoming increasingly important for the UAE in line with the growing population and per capita income. However the arable lands is very limited and the climate is not very favorable for the agricultural activities. The government supports the agriculture sector and food processing industry. Heavy dependence on food imports creates a risk for the country in case of a shortage in food supply. The government's control over the food prices may also weigh negatively on the corporate profit margins. The retail sector is one of the fastest growing industries in the UAE on the back of increasing wealth, economic sustainability and strong domestic consumption. The retail sales volume which is estimated at 114 billion AED in 2011 (31 billion USD) is expected to rise to 151 billion AED (41 billion USD) in 2015. The intense competition and the rise in real estate prices represent main risks for this sector but these risks remain mitigated. Source:

UAE Sector Barometer	
Sectors	Risk Level
Petrochemicals	●
Agrofood	●
Retail	●
Construction	●
Logistics	●

Source: Datastream, Coface

● Moderate risk ● Medium risk ● High risk ● Very high risk

Macro-economic analysis

Is the UAE getting its mojo back?

By Seltem IYIGUN, Economist, Coface

1/ A remarkable recovery after the debt crisis but financing need still high

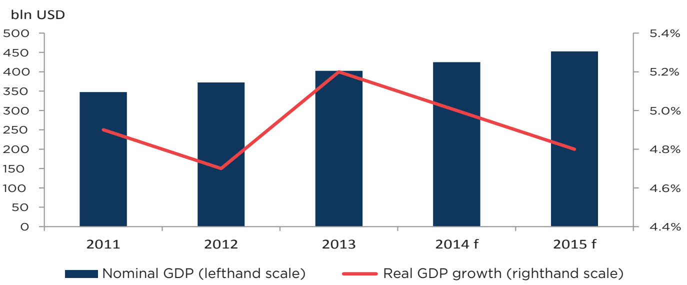
Solid growth, effective diversification policy

The UAE economy grew by 5.2 percent in 2013 and the national income rose approximately to 403 billion USD based on Emirates NBD estimates. Per capita income is rising. It stood around 43,000 USD in 2013. The relatively strong economic growth is driven by an active policy of diversification. Abu Dhabi has still a major role in the economy. The growth is expected to be slightly lower in 2014, supported by the increase in private consumption and investment as well as by the government spending.

The growth remains highly dependent on oil revenues, mainly of Abu Dhabi, holding around 94 percent of the country's reserves. This situation provides a kind of guarantee for the country's economic future, given the principle of implicit solidarity between the emirates. The long-term projections suggest that the world will remain largely dependent on oil from the Middle East and the UAE is well placed to meet this demand. The country produces 3.5 percent of the global crude oil, representing 7 percent of the proven reserves, and ranked 7th in the world (4th largest in OPEC). In addition, production costs in the UAE are among the lowest in the world.

CHART 1

Economic growth performance



Source: Emirates NBD Research

The UAE also has the 7th proved natural gas reserves of the world and develop projects of units of liquefied natural gas, the most recent to be installed in the emirate of Fujairah. These large proven reserves of oil and gas represent respectively 90 and 110 years of production.

Therefore, the economy is very dependent on hydrocarbons in terms of budget revenues (nearly 80% in 2013). In terms of export revenues, the dependence on hydrocarbons remains lower as they accounted for about a third of exports in 2013.

Saving systematically the hydrocarbon revenues has allowed the country to build important financial assets, mainly held by the sovereign wealth fund of Abu Dhabi, ADIA (Abu Dhabi Investment Authority). The amount of the sovereign wealth funds of the UAE is estimated at 430 billion USD in 2013 and the total assets are estimated at 600 billion USD. The funds could reach 480 billion USD in 2014. This financial accumulation is a guarantee of financial stability for the whole of the UAE as it would dampen potential shocks.

The growth accelerated in 2013 led by the expansion in hydrocarbon sector but also in trade, transport, real estate and tourism activities. The oil sector was the main contributor to the economy as it grew by 4.8 percent during last year, according to Emirates NBD while the non-hydrocarbon sector expanded 5.4 percent.

The activity excluding hydrocarbons is expected to be dynamic in 2014 as well. Despite the importance of hydrocarbon production, the share of non-oil sectors in real GDP increases gradually on the back of active diversification policy by the emirates. The share of non-hydrocarbon sectors is estimated at about two thirds of GDP in 2013.

The federation seeks to promote its role as a financial hub and as a regional platform for the aviation and maritime transport. It also supports the development of the tourism sector and the alternative energy sources such as nuclear and solar.

Dubai, which has seen its oil reserves falling, plays a very active role in this diversification policy. The emirate has created zones to develop different sectors (manufacturing, media, information technology, healthcare, financial services and ports). Following the real estate crisis of 2008-2009, several projects were either postponed or canceled. But since 2012 a recovery is underway, however, there is still a risk of recurrence of a new bubble.

The authorities have implemented a mega project (Mohammed bin Rashid City) with the largest mall in the world and 100 hotels. The first phase should be completed in 2014-2015. There are also other real estate projects totaling 110 billion USD.

Abu Dhabi has a more prudent policy of diversification. Like Dubai, Abu Dhabi has also created zones to develop industrial activities, such as industrial zone of Khalifa. This emirate also plans to develop energy and capital consumer industries as well as advanced technologies, like Masdar City project. The emirate also has the luxury and culture tourism to diversify its economy.

The UAE is marked by a high degree of heterogeneity among the seven emirates forming the federation. The process of diversification has begun to expand outside of the emirates of Dubai and Abu Dhabi.

Sharjah, specialized mostly in the manufacturing and shipbuilding industry is also diversifying into tourism, commercial distribution and education.

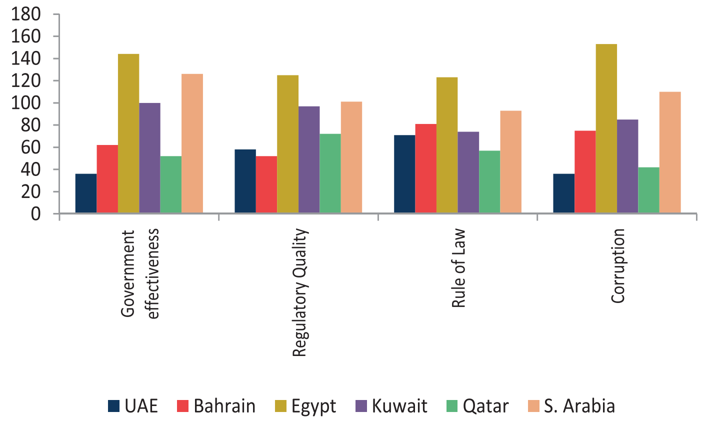
Business climate favorable but opacity persists

The UAE has modern infrastructures. The financial system is developed. Governance indicators of the World Bank put the UAE at a relatively satisfactory level, which is a supportive factor of the country's economic growth. However, the lack of transparency complicates the assessment of risk. With the exception of international large groups, the financial accounts are rarely available.

However, since 2008, the UAE participates in the General Data Dissemination System of the IMF which requires that the Federation provides data consistent with the international practices.

In the fight against corruption, the UAE is ranked among the best in the region (36^{th}) by the World Bank. Transparency International ranked the country 26^{th} out of 177 countries in its corruption perception index of 2013. The number of countries classified by the World Bank concerning the indicators of government effectiveness, regulatory quality and corruption is 210. Concerning the indicator of the rule of law, the number of countries classified is 212. The ranking is decreasing with the first ranked country being the best.

CHART 2:
World Bank 2013 indicators



Source: World Bank

On the other hand, a new Companies Act (Companies Law), closer to the international standards, was adopted in mid-2013 to replace the old one from 1984. This law provides improvements in corporate governance and changes in entrepreneurship, accounting, IPOs etc. Coface upgraded its business climate assessment about the UAE based on this law.

Although the new law seems to maintain the fundamentals of the old one, it brings some clarifications on certain aspects. The law aims to support the improvement of the business environment in the country by making the corporate management compatible with the global business management criteria, especially in terms of governance rules and the protection of shareholders. This would also help to make the country more attractive for the global investors.

The law supports the transparency as it imposes fines on individuals who try to manipulate the accounting figures of their companies. Companies that fail to keep accounting records about the company's transactions would be subject to a fine. The law also strengthens regulation on limited liability companies and make their management simpler with dozen of articles. It also requires companies for documentation to be made publicly open, an important step towards more transparency and a better corporate governance environment.

However the law doesn't liberalize foreign ownership, a decision aiming at protecting local businesses. Currently, foreigners can hold up to 49 percent of the stakes of a company situated outside free zones.

Another law on the small and medium enterprises (SMEs) has been approved in April 2014. The law creates a dedicated council to SMEs and determines incentives to be offered to these businesses. The SMEs would receive tax incentives. They would be exempt from customs taxes for equipment, raw materials and goods necessary for their production activities. Under the legislation, 10 percent of the future federal government contracts would be required to award SMEs, a step seeking to encourage government agencies to support these businesses. The legislation also provides some benefits to companies investing in research and development area. The law is an important progress to support the small size enterprises which are estimated to represent around 90 percent of the total number of companies in the economy. This would help the country to reduce the unemployment among the UAE citizens and to encourage the entrepreneurship. Consequently, it would contribute to the diversifying process of the economy as the legislation is expected to increase the contribution of SMEs to gross domestic product to 70 percent by 2020 from 60 percent currently.

Another positive development about the business environment in the country has been the publication of a new law allowing companies to use existing shares while offering shares to the public on local exchange. Before this new law, the legislation was more restrictive about initial public offerings (IPO) as it would require to list a minimum of 55 percent of the shares and was allowing only the sale of new shares. This legislation is expected to boost the interest of private equity companies for the country as it makes the exit from existing investments easier.

The remarkable economic growth of the country since early 2000s has led to an influx of foreign countries. The economic diversification also increased the need for labor. According to the United Nations migration report of 2013, the UAE recorded the second largest number of international migrants between 1990-2013 of 7 million. In this context, the UAE nationals represent only about one fifth of the total population

The rise of popular protests in North Africa and the Middle East since 2011 has increased the emphasis on the "Emiratisation" of the jobs. This program aims to reduce the dependence of the country on expatriate workers. But it could hamper the improvement of the business environment, as it would encourage recruitment and promotion based on nationality rather than on skills.

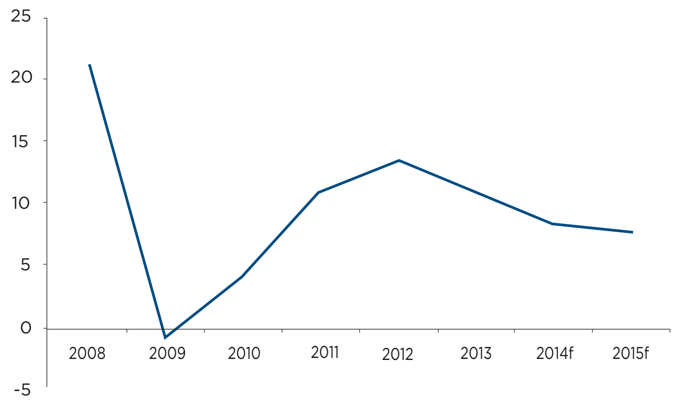
Debt profile improves

In the UAE, the consolidated budget reflects the accounts of the federal government and the emirates of Abu Dhabi, Dubai and Sharjah. Each emirate has its own budget and the richest emirates (Abu Dhabi in particular, with its oil revenues) support financially the poorer ones. According to the IIF figures, the consolidated fiscal balance is estimated to have recorded a surplus of 10.6 percent of GDP in 2013 if net loans and equity are excluded from expenditures.

Public finances of the UAE remain highly dependent on hydrocarbon revenues, despite the ongoing diversification of the economy. The oil accounted for almost 80 percent of the budget revenues in 2013. This ratio is expected to decrease slightly to 76.5 percent in 2014.

However, the price of oil that would balance the budget (fiscal breakeven oil price) tends to increase in recent years. It would be around 65 USD in 2013, according to the IIF compared with 45 USD in 2008. Therefore, the country's public accounts are susceptible to a sharp decline in oil prices, which however is not the expected trend.

CHART 3:
Consolidated government balance (% of GDP)



Source: IIF

The special case of Dubai, after GREs' debt restructuring

The country was negatively affected by the global financial crisis as Dubai World Holding, a government related entity (GRE) that invests in a wide range of projects from different industries, asked to delay the repayment of its debt in 2009. Although these entities are government-related companies, they are not backed by a sovereign guarantee. Therefore Dubai World debt was not guaranteed by the government. Abu Dhabi stepped in to help the holding.

Approximately 25 billion USD of the debts belonging to Dubai World and its main property subsidiary Nakheel and Limitless were restructured in 2010. In addition, the subsidiaries of Dubai Holding finalized with creditor banks the agreements about the restructuring of their debts late in 2010. In November 2010, Dubai Group restructured 6.2 billion USD of debt over 5 years with an interest rate of 2 percent. In December 2010, Dubai International Capital also restructured 2 billion USD of debt over 5 years with an interest rate of 2 percent. In July 2011, under the restructuring process, Dubai World has signed agreements about transferring its Nakheel and Limitless units to the government of Dubai.

After this debt restructuring process, Dubai has taken an action composed of asset sales, additional help from Abu Dhabi and significant improvement in the cash flow of the GRE in order to improve its debt profile. In February and March 2014, Dubai managed to refinance favorably its debt maturing this year (around 20 billion USD) with Abu Dhabi and the UAE central bank.

Around 30.5 billion USD of Dubai's public sector debt would mature this year. The refinancing of two-thirds of this amount would seriously contribute to the improvement of this emirate's debt profile. This would allow the emirate to continue spending on infrastructure and tourism projects. However the debt burden of the entire public sector in Dubai remains still heavy with significant amounts coming due in the next few years, around 40 billion USD between 2015 and 2017 based on the IMF estimates. Dubai's total government and GRE debt is estimated at 142 billion USD (around 140 percent of its GDP) according to the IMF. These high debt levels of Dubai are still a source of risk, given the importance of housing in the economy and price volatility in this sector.

On the other hand, the ability of Dubai's GREs to repay or refinance their debts depends mainly on the performance of the real estate sector, as most of their investments are concentrated in this area. However, after experiencing one of the most severe real estate crash in the world, with prices having dropped 60 percent from the peak in mid-2008, the real estate market in Dubai has sharply increased since 2012, some observers even talking about a possibility of a new bubble. The question is about the existence of overcapacity in the property market.

CHART 4:
Dubai: Maturing bonds and syndicated loans
Abu Dhabi: Maturing bonds, syndicated and bilateral loans
As of end-April 2014, total debt*, million USD

	2014	2015	2016	2017	2018	2019
Government of Dubai	2,020	651	1,289	1,723	20,024	0
Investment Corporation of Dubai and subsidiaries	2,074	1,234	4,193	2,690	5,149	0
Dubai World and susidiaries	789	4,658	1,517	4,198	12,973	650
Nakheel	0	1,212	1,345	0	150	0
Dubai Holding and subsidiaries	0	31	6,300	3,134	0	1,400
Government of Abu Dhabi	2,057	557	541	527	526	2,026
International Petroleum Investment Company	4,877	3,363	6,465	2,279	3,263	731

**Total debt indicates total of bonds, loans and guarantees for the Government of Abu Dhabi, total of bonds and loans for the rest*
Source: IMF, Staff report for the 2014 Article IV Consultation, Page: 34-35

Indebted GREs of Abu Dhabi, recovery on track

The government related entities of Abu Dhabi are also indebted for an amount of 105 billion USD according to the IMF estimates. A significant portion of the debt is related to the real estate market, which has suffered from losses, especially in the residential segment.

The recovery is on track. The authorities have taken steps to have a better control over the debt of the GREs and improve their governance. However risks remain as these entities have still important financing needs. Thus, Aabar, an entity owned by the public firm Abu Dhabi International Petroleum Investment Company, was awarded the refinancing of a 2 billion USD loan maturing in May 2013.

On the other hand, Al Jaber Group, one of the largest private groups of Abu Dhabi, concluded in March 2013 a restructuring agreement over 5 years of a debt of 4.1 billion USD, one of the main creditors being HSBC. Al Jaber operates in construction, engineering and shipping sectors.

It should be noted that the Abu Dhabi authorities have warned their paragovernmental entities in 2013 saying they should not automatically count on an implicit sovereign guarantee.

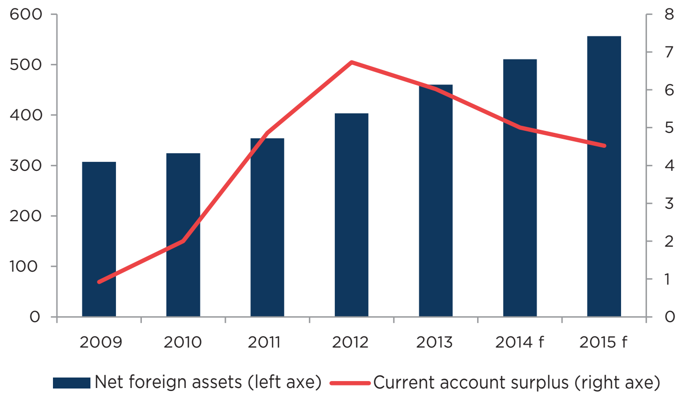
The global financial environment is also a key risk. A deterioration of international funding could slow the process of deleveraging of the public entities and also private firms. This would increase the cost of borrowing on international markets. However, despite the problems faced by GREs, sovereign risk is limited as the UAE is net creditor through the assets of sovereign wealth funds and investments, mainly of Abu Dhabi.

The improvement is expected to continue on the back of strong economic growth and higher real estate prices. Major international institutions expect the public debt to GDP ratio to gradually decrease within the upcoming period (chart 7). By contrast, the volatility in the global financial markets and a rise of interest rates following the exit strategy of the U.S. Federal Reserve could increase borrowing costs for the GREs. Further strengthening of GREs' governance and rectifying of heated demand in real estate market would be important to manage the risks over these entities.

External position robust, partially dependent on hydrocarbons

The current account surplus of the UAE is estimated to decline to 11.7 percent of its GDP in 2014 from 14.7 percent in 2013 according to the IIF. The contraction in the current account surplus is mainly due to the higher pace of growth of merchandise imports than the merchandise exports. This trend resulted in a contraction of trade surplus by around 5 percent in 2013 from a year ago. In 2014 the trade surplus is expected to slow by 6.4 percent compared with 2013. The wider deficit on services and transfers in 2013 compared with the previous year also contributed to the contraction of the current account surplus.

CHART 5:
UAE Net foreign assets and current account balance (Bln USD)



Source: IIF

In 2013, oil accounted for about one third of total exports. The same trend is expected for 2014. The trade and current account balances, as well as external financing capacity, are relatively sensitive to changes in oil prices and gas. This dependence can be considered as a source of vulnerability to a sharp decline in oil and gas prices, which is not the current trend.

In order to reduce this dependence on oil, an active policy of sectoral and geographical diversification is conducted for several years by the UAE.

The external debt of the UAE has risen sharply since 2007, this increase expected to continue in 2014 at a more moderate pace of around 5 percent. The external debt is expected to decline gradually as a percentage of GDP. The part of Dubai represents about two-thirds of the total foreign debt. The debt of banks represents 45 percent of the total. The majority of non-bank debt, estimated at 45 percent of the total, comes from the borrowings of the public or paragovernmental entities of Dubai. The external debt purely sovereign is only 10 percent of the total.

The risk on the external debt of the UAE is very limited because the country is a net creditor. Its financial assets in foreign currencies are valued at 585 billion USD in late 2013, equivalent of 3.7 times the estimated amount of the external debt. These amounts which are confidential include mainly the assets of the sovereign fund of Abu Dhabi, ADIA, official foreign exchange reserves and bank reserves. The net external position of the UAE is expected to improve due to the financial assets in foreign currency which are expected to reach nearly 650 billion USD in 2014 (4 times the amount of external debt), given the expected fiscal and current account surpluses.

Nevertheless, the high level of Dubai debt remains a source of risk as there are still uncertainties about the global economic growth, the real estate market is volatile and borrowing costs can go up because of a possible renewed regional tensions.

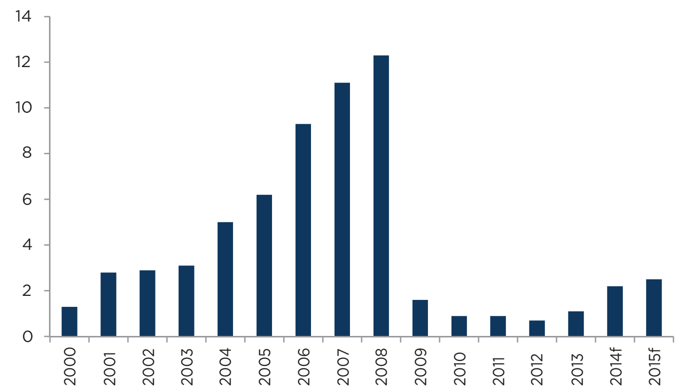
Inflation low, monetary policy less accommodative

The annual average inflation rate plunged to 0.7 percent in 2012, pulled down mainly by the widespread decline in property prices. The current real estate rebound and the increase in public service prices would push the inflation higher. The IMF sees the average annual inflation to stand at 2.2 percent in 2014, far below its pre-crisis level of around 12 percent in 2008.

Dubai's inflation climbed to 3 percent in April on the back of rising housing prices. In fact, housing index is the biggest component of the consumer price index as it accounts for around 44 percent of the total index. The yearly increase in housing prices which includes housing, water, electricity, gas and other fuel prices, jumped to 5 percent in April 2014. The Reidin residential property sale price index for Dubai rose by 37.5 percent in April year-on-year.

One should note that the official basket used by the UAE is representative of prices applicable to the indigenous population, which profit from large incentives, rather than expatriates, who represent more than 85 percent of the workforce. A change in the composition of the basket price is under consideration but has not yet been completed.

CHART 6:
UAE annual average inflation rate (%)



Source: IMF

Moreover, the country's exchange rate is fixed against the dollar (3.6725 dirhams for 1 dollar). This anchor has provided stability for years and the authorities seem anxious not to change this system. Therefore, the anchor of the dirham against the dollar should not be questioned. However, questions about its effectiveness can re-emerge. Critics of the currency peg to the dollar argue that it restricts monetary policy by linking domestic interest rates to the U.S. rates.

The UAE's central bank pursues a relatively accommodative monetary policy in a context of low inflation and low interest rates around the globe. In any case, monetary policy is linked to the Federal Reserve and the U.S. rates, due to the anchoring of the UAE dirham to the U.S. dollar. As the Fed in the United States is in exit process and expected to start increasing its rates next year, the monetary policy in the UAE could be a little less accommodating from 2015 on.

Political stability

Despite the boiling Arab world, the political situation seems relatively stable in the UAE. The UAE is chaired by Sheikh Khalifa Bin Zayed Al Nahyan, ruler of Abu Dhabi emirate whose economic weight is the most important. Each of the seven emirates is an absolute monarchy, headed by an emir, whose authority does not seem threatened. The emir of Abu Dhabi is regularly re-elected president of the Federation by his peers of the ruling families of the six other emirates. The Ruler of Dubai - the second largest economy of the Federation - Sheikh Mohammed Bin Rashid Al Maktoum, is also the Vice President of the UAE.

The UAE is managed by the Supreme Council. It includes leaders of the seven emirates, with a consultative body, the Federal National Council. The council is composed of 40 members, nationals of the UAE and has the role of monitoring and review federal legislative proposals. There are talks to introduce universal suffrage for elections to the Federal National Council, the advisory body to the Supreme Council, until 2019, after the next elections in 2015.

CHART 7:
Macroeconomic data and forecasts

	2011	2012	2013(e)	2014(f)	2015(f)
GDP growth (%)	4.9	4.7	5.2	5	4.8
Inflation (yearly average) (%)	0.9	0.7	1.1	2.2	2.5
Budget balance (% GDP)	11	13.3	10.6	8.5	7.6
Current account balance (% GDP)	13.9	17.5	14.7	11.7	10
Public debt (% GDP)	31,4	33,2	32, 1	31,3	30

Source: Coface, Emirates NBD Research, IMF, IIF

The UAE remained immune from the protest movements experienced by many other Arab countries since the beginning of 2011. The federation seems unlikely to be affected by popular events, particularly because of the special structure of its population.

In fact, at least 80 percent of the population is estimated to be foreigners, while the Emirati population, relatively privileged (benefiting from generous social assistance and employment), does not seem inclined to express political and social demands.

However, in order to prevent the risk, the UAE has increased public spending. The emirate of Abu Dhabi has also funded infrastructure for poorer emirates situated in the north.

Yet, the importance of the foreign workforce is a serious social and political challenge. Large number of expatriates (mainly from the Indian subcontinent), hard working conditions especially of a part of the foreign labor force and income disparity may generate social tensions. In addition, a part of the expatriate population tends to want to make the UAE their permanent home and therefore it is possible they claim their participation in political decisions.

The recent turmoil in Iraq may represent another source of risk for the UAE's companies. Iraq has become an important trade partner for the country in recent years. The volume of bilateral trade between Iraq and the UAE exceeds 13 billion USD out of which 4 billion USD is invested in Iraq's Kurdistan region, with the majority (3 billion USD) is dedicated to Erbil. There are more than 120 Emirati companies in this region operating in a wide range of sectors from construction to oil and gas. Most of the trade between the two countries are channeled through this region. After Mosul, Iraq's second city, has been seized by ISIS militants in June, foreign employees working in the region was evacuated. Some of them were working for Emirati companies. Militants also seized the control of the biggest oil refinery of Iraq, Baiji. The UAE recalled its ambassador from Baghdad in mid-June for consultations.

However so far the country stood insulated from political turmoil in the region as the government, like in other Gulf countries, has strong financial resources built up on rising global oil prices which enable it to address the economic or political turmoil. The country accumulated solid reserves that jumped around 120 percent between 2010-2013 and reached approximately 68 billion USD and it would use this strong financial power to support the social peace in case of a geopolitical threat.

2/ What sector risks?

Although the UAE'S economy depends mainly on the hydrocarbons revenues, there is a strong policy of diversification implemented successfully by the government. This policy has allowed other industries from the real sector to record a solid expansion such as agro food and retail sectors. Therefore we will focus on these three sectors in the panorama.

Hydrocarbon sector: key component of the economy

The UAE produces 3.5 percent of the global crude oil, representing 7 percent of the proven reserves, ranked 7th in the world and 4th within the OPEC countries. The country's production capacity is around 2.8 million barrels per day but the authorities recently said they were planning to raise it to 3.5 million barrels per day by 2017 aiming to meet the rising demand.

The share of hydrocarbons sector is estimated at about one third of the country's GDP. In 2013, hydrocarbon export revenues were estimated at 118.5 billion USD compared with 81.2 billion USD in 2010 according to IIF. Around 90 percent of the hydrocarbon exports consisted of oil exports. Although budget revenues depend mainly on hydrocarbons, only one third of the export revenues come from these products. The growth of hydrocarbon sector is expected to stand at 2.3 percent in 2014 compared with 4.4 percent in 2013, according to IIF.

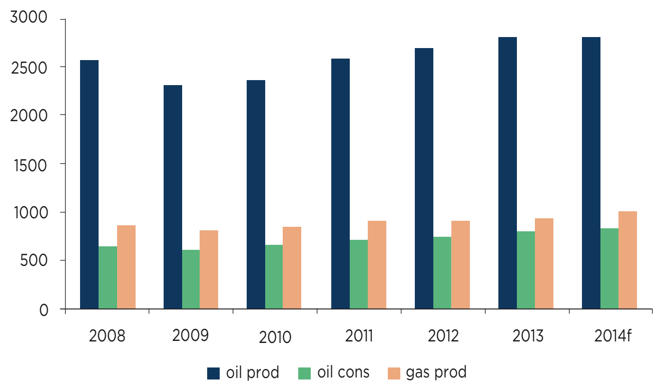
Around 94 percent of the country's oil resources (about 92 billion barrels) are in Abu Dhabi. Dubai has around an estimated 4 billion barrels while Sharjah and Ras al-Khaimah have 1.5 billion and 500 million barrels, respectively, according to the UAE embassy data. The UAE's main export destination for oil and gas is Japan.

According to the 2013 BP Statistical Review of World Energy, United Arab Emirates had a refinery capacity of 710 thousand barrels a day in 2012, equivalent of 0.8 percent of the world total. The country has five oil refineries. Two are in Abu Dhabi and the others in Dubai, Sharjah and Fujairah. Abu Dhabi has intensified efforts for the discovery of new reserves especially in the sea and for the development of the current reserves.

The Ruwais refinery in Abu Dhabi, biggest refinery of the country, has a refining capacity of 400,000 barrels per *day. The refinery is owned by Abu Dhabi Oil Refining Company (Takreer), a public joint-stock company, undertaking* refining operations previously executed by Abu Dhabi National Oil Company (ADNOC).

The expansion of Ruwais refinery is expected to be completed by end-2014, adding another capacity of 417,000 barrels per day. The total budget of the expansion project is estimated at 10 billion USD. The Jebel Ali refinery of Dubai has a refining capacity of 120,000 barrels per day.

CHART 8:
Oil production and consumption, gas production (b/d thousand)



Source: IIF

The country also has the 7th proved natural gas reserves of the world at around 6.1 trillion cubic meters according to OPEC. Approximately 90 percent of the natural gas sources are in Abu Dhabi. The country is expected to produce 8.6 percent of the total natural gas production of the Middle East countries. The UAE develops projects of units of liquefied natural gas, the most recent to be installed in the emirate of Fujairah.

The petrochemicals and chemicals sector has also a relatively important place in the country's GDP. The contribution of this sector to the economy is estimated at 6.7 billion USD in 2012, according to the Gulf Petrochemicals and Chemicals Association (GPCA). In 2011, the UAE revenue from the petrochemicals sales jumped 107 percent from a year ago and reached 2.6 billion USD. However, the country accounted only for 3 percent of the total GCC (Gulf Cooperation Council) petrochemical sale revenues in 2011. The country produces fertilizers through Ruwais Fertilizer Industries and Abu Dhabi Polymers Company.

A strong player

The UAE's hydrocarbon sector has some strengths such as good geographic location, low production costs, supportive government policy, good infrastructure and presence of strong joint ventures.

The country is located in a key geostrategic area, south of the Strait of Hormuz, through which passes nearly 20% of the world oil production. It remains like a bridge between the Far East and Europe, close to Africa.

The cost for producing crude oil and natural gas is lower in the Middle East region compared with all the other producer regions. During 2007-2009 period, the total upstream costs of oil and natural gas production was 16.88 dollars per barrel of oil equivalent in the Middle East compared with 24.76 dollars in Canada, 45.32 dollars in Africa, 26.64 dollars in Central and South America and 33.76 dollars on average in the United States, according to the US Energy Information Administration (EIA) figures.

The completion of infrastructure projects at existing oilfields will also help the country to increase its production capacity. The country also undertakes ambitious infrastructure projects with an estimated budget of around 20 billion USD during 2014, according to some media reports. Besides, the Gulf governments are working on the development of oil pipelines to enhance the security of oil supply.

There is a strong presence of joint ventures between the country's oil and gas companies and the large European and U.S. companies. The operating units of ADNOC such as Adma-Opco, are structured as joint ventures with foreign oil companies. Adma-Opco is a joint venture between ADNOC, Japan Oil Development Company, BP and Total. Al Hosn Gas is also a joint venture between ADNOC (60%) and Oxy (40%) undertaking gas exploration of Shah and drilling operations. ADNOC also selected Shell as its partner in a 30-year joint venture to develop Bab sour gas reservoirs.

These joint ventures are a result of good relationship with the Western countries and the favorable business environment of the country. Coface evaluates the country's business climate assessment as A3 on a scale of seven-level ranking. In ascending order of risk, these are: A1, A2, A3, A4, B, C and D.

But some risks in this key sector

Despite the economic diversification, hydrocarbon sector remains the main industry in the country. The sustainable economic growth and the investments aiming to increase the productivity would support the expansion of the hydrocarbon sector in the UAE in the upcoming period. The global economic trend will continue to have an impact on the production and prices of hydrocarbon products. According to estimates by the IIF, the price of oil to achieve a balanced budget (fiscal breakeven oil price) for the UAE was 65 dollars per barrel in 2013. This price is steadily increasing since 2008 both in the UAE and in other major oil producing countries, but far behind compared to the predictable course.

The political risks and delays of some projects may weigh on the financial performance of the companies and create worries on the supply side. Earlier in 2014, Occidental Petroleum Corp. faced some delays due to some political complications while selling its stakes in its Middle East business as a part of a restructuring program. Significant state ownership in these companies may also create a risk of nonpayment. Corporate profitability in these projects would also depend partly on the government support to provide feedstock at subsidized rates.

Balancing the supply and demand on the hydrocarbon sector would be also another challenge. The economic growth is estimated to remain firm in 2014 which would increase further domestic demand for energy. The UAE's natural gas consumption increased on average by more than 5 percent per year between 2003 and 2012, according to the EIA. The country became a net importer of natural gas in 2008 as it re-injected around one third of its gross natural gas production from 2003 to 2012 into the oil fields to increase the productivity. Currently, the country meets majority of its natural gas needs by the imports from Qatar through the Dolphin Gas Project. The risk here would be about price disputes and political disagreements between Qatar and the UAE.

As the gas-consuming industries such as aluminum and petrochemicals are growing, the UAE's need of natural gas for domestic purposes would continue to rise in the short and medium term. This encourages the country to work on diversifying its energy resources. The authorities stated late 2013 that they would like the nuclear power accounts for 25 percent of the country's energy sources, natural gas for around 70 percent and renewable energy for around 5 percent. The UAE invested 10 billion USD in the Shah gas project and considers investing in shale gas projects in the US and Canada. On the other hand, the country develops other projects such as Emirates LNG, a joint venture between Mubadala Petroleum and International Petroleum Investment Company aiming to secure additional gas supplies.

The security of the oil shipment is also another important issue. After Iranian threats in the past to block the Strait of Hormuz, which is a strategic chokepoint for global oil shipment, the UAE inaugurated Abu Dhabi Crude Oil Pipeline (ADCOP) in 2012, a 380-kilometers pipeline carrying oil from the Habshan oil fields of Abu Dhabi to Fujairah oil storage hub, bypassing the Strait of Hormuz. ADCOP is estimated to carry 1.8 million barrels per day, accounting for nearly three-quarters of the UAE's daily crude exports and 10 percent of oil that currently passes through the Strait of Hormuz, according to information provided by the UAE embassy in Washington DC. The pipeline has been built by an investment of 3.3 billion USD and owned by the International Petroleum Investment company. This pipeline has eased fears of a supply interruption and allowed the UAE to protect its most strategic asset from the potential regional threats. The pipeline is also said to help reduce insurance costs.

There are also some risks concerning the country's hydrocarbon investments undertaken in regions with political tensions like Iraq mainly due to the dispute over the sharing of oil revenues. Many Emirati oil and gas companies have investments in this country. Abu Dhabi National Energy Company said early 2014 it was planning to invest about 1.2 billion USD in the Kurdistan oil field. Iraqi central government considers it has the unique right to export the country's resources while the Kurdistan Regional Government (KRG) believes it has the right to exploit and exports the resources within its area. The failure to reach an agreement causes some problems about getting the payments for the companies operating in the region. Dana Gas, a Sharjah based fuel producer, had a dispute with the Kurdish region over non-payment from the regional government. Dubai-based developer Damac Properties' 15 billion USD project was also canceled in 2010.

Agro food sector: Heavy dependence on imports

The agro food sector is becoming increasingly important in the UAE in line with the growing population and per capita income. The total area of the country is 83,600 square kilometer. Between 2009-2013, arable lands were 0.6 percent of the total land area while agricultural land was 4.8 percent according to the World Bank figures. The most productive lands are in Ra's al-Khaimah, especially in Diqdaqah village. The share of agricultural value added stands around 1 percent of the GDP.

The main agricultural products are dates, poultry meat, eggs and some vegetables like citrus, mangos, tomatoes etc. The labor force in agriculture was around 2.7 percent of the total labor force in 2013, according to the Food and Agricultural Organization of the United Nations (FAO). The total number of farms in the country was around 38,500 in the country in 2003. Around 60 percent of the farms were in Abu Dhabi, 16 percent in the Central and Eastern zones and the remainder in the Northern zone.

The local and federal governments support the agriculture sector. The Ministry of Agriculture and Fisheries (MOEW) is responsible of the agricultural policy of the country. The governmental supports are usually in the form of purchasing of some crops at a certain price, providing technical services to the farmers, subsidies on cultivation or loans for machinery etc.

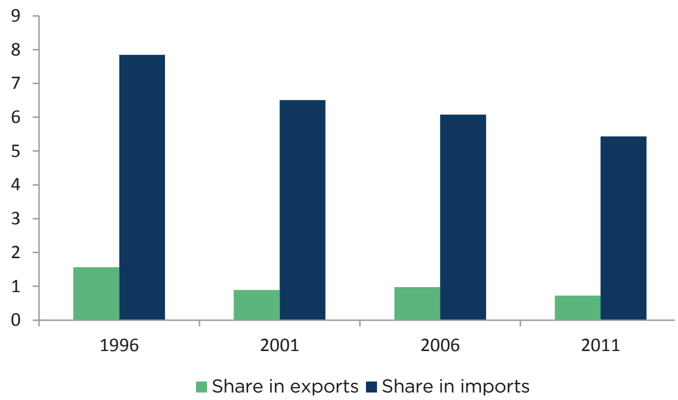
The government of Abu Dhabi provides lands and services to the local farmers. Free land is a very important advantage for the farmers which then hire labor to start cultivation. The government also provides water, fertilizers and seeds to support the agricultural activities. It also provides advising services. As nearly 72 percent of the total water in the emirate is consumed by the agricultural and related activities, Abu Dhabi has decided to install a new irrigation system in order to save water. The UAE has also acquired more than 1.4 million hectares of arable lands in Sudan, Pakistan and Morocco to ensure food security.

The rising population and per capita income, urbanization, changing food consumption patterns towards a more protein-rich nutrition trigger a higher demand for products like meat and fruits. The country accounts for 20 percent of the total food consumption of the GCC countries, according to Alpen Capital GCC Food Industry report of May 2013, the country being second largest consumer after the Saudi Arabia which consumes 62 percent of the total food in the region. The food consumption in the UAE has been increasing by 12 percent annually, according to the ministry of economy.

The country is the second largest food producer in the GCC region, after the Saudi Arabia. Total food production was 1.4 million MT in 2010, according to Alpen Capital. The production capacity is not enough to meet the demand as the cultivable lands and water resources are limited. Per capita agricultural product stood at 339.75 USD in the UAE in 2011, according to the Arab Agricultural Statistics Yearbook. The only GCC country having a better per capita production was Saudi Arabia with 452.61 USD in the same period.

Therefore the UAE imports around 90 percent of its foods. In 2011 the food imports (excluding fish) stood at 11 billion USD, according to the FAO data. The most imported food products are refined sugar, forage products, chicken meat and wheat. The UAE's main food suppliers are Brazil, India, Pakistan, Thailand and Iran.

CHART 9:
Share of food (excl. fish) in UAE merchandise imports and exports (%)



As the production capacity is limited, the country invests in food processing industry. The UAE is the main country of food processing and re-export among the GCC countries. The government of Dubai said the emirate is the third largest re-export hub in the world and the total exports and re-exports reached 117 billion USD in 2011, 21 percent up from a year ago.

The country invested 1.4 billion USD in the food processing industry since 1994 aiming to produce food with high value added for local clients as well as for re-exporting. There are an estimated of 300 food processing companies in the country.

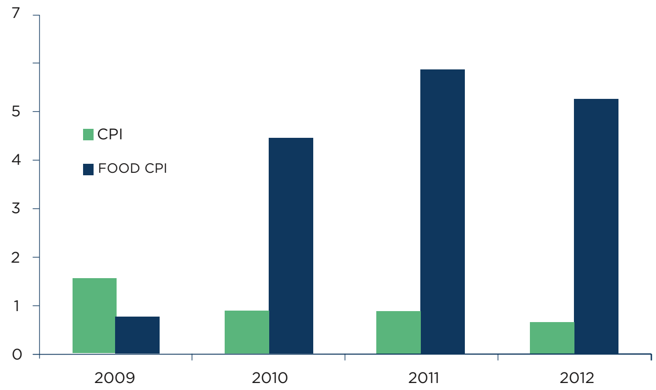
The UAE is a re-export hub. It re-exports around 50 percent of the imported products to other GCC countries, East Africa, Russia, Iran and India, according to the FAO. Some of the most exported products were refined sugar, rapeseed oil, palm oil and dates in 2011. The country's food exports (excluding fish) stood at 2.2 billion USD in 2011 according to the FAO statistics.

Despite the governmental support, some structural challenges remain

Although the country has an effective strategy to ensure its food security, the heavy dependence on food imports remains a concern as it makes the country vulnerable to an increase in food prices or shortage in food supply. The volatility in food prices is increasing due to the changes of the global climate causing droughts, frosts, floods etc. Yet the country's import dependence is expected to continue due to rising population, increasing per capita income, tourism and demand for diversified nutrition. Besides, the limited availability of agricultural resources and water supply make the food imports inevitable.

This dependence on food imports creates also an upward pressure on the consumer prices. In recent years, the inflation in food prices remained above the UAE's annual headline inflation rate. However, this pressure is partly offset by the government's interventions to balance the food prices in the country. For instance, the government issued a low in 2012 to fix the prices of some food items to ensure that retailers wouldn't be able to overcharge consumers. Although this kind of practice can be successful in the short term to counter excessive price hikes, it may result in narrower profit margins for companies. Majority of the businesses operating in the UAE's food sector are SMEs and some retailers may face financial difficulties. This kind of practices would increase the risk of the food shortages in the market and reduces the competition.

CHART 10:
Annual average headline and food inflation in UAE (%)



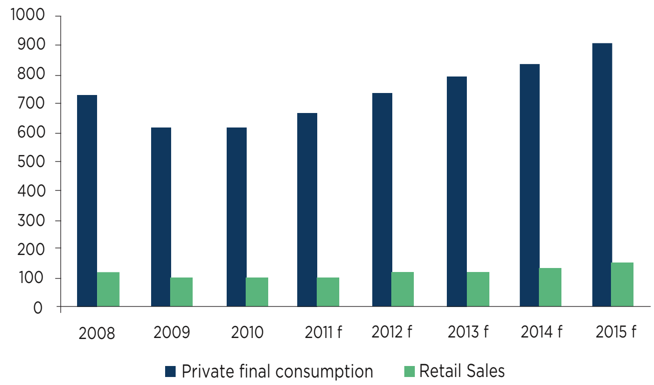
Source: UAE Bureau of National Statistics

Retail sector: Favorable environment for expansion

The UAE's retail sector has been one of the fastest growing industries in the country in recent years on the back of increasing wealth, economic sustainability and increasing domestic consumption.

The retail sales volume which is estimated at 114 billion AED in 2011 (31 billion USD) is expected to rise to 151 billion AED (41 billion USD) in 2015, according to the Business Monitor International. The fact that the UAE was not affected by the political turmoil in the Arab World made the country a more popular tourism destination which also contributed to the expansion of the retail sector. In addition, the recovery in consumer confidence after the debt crisis in 2009 affected positively the retail sales. The UAE consumer confidence reached 114 in the first quarter of 2014, its highest level since the third quarter of 2012, according to Nielsen.

CHART 11:
UAE retail sales and private final consumption (bln AED)



Source: UAE Ministry of Economy, BMI estimates, Dubai FDI

The retail sector in the UAE has many subsectors such as hypermarkets, electronics, luxury, health and beauty specialist retailers, home shopping, grocery retailers etc. In this panorama, the focus will be on the food retailers and partly the luxury retail. In fact, the country's food and drink market is the largest within the GCC countries. The food sales are expected to reach 38.5 billion AED by 2015, an increase of 36 percent compared with 2011, according to Dubai FDI. On the other hand, the mass grocery retail sector value is estimated to reach 27.7 billion AED by 2015, accounting for 74 percent of the total food and drink market.

The population living in Dubai, Abu Dhabi and Sharjah, accounting for around 60 percent of the country's total population, has tendency to do shopping from the global chain stores while people living in other emirates usually do their shopping in grocery stores. Both international and domestic hypermarkets such as Carrefour, Spinneys, Lulu Emke, Al Maya, Geant and LIFCO are present in the country. Carrefour has 109 outlets while Lulu Emke has 110 in the Middle East region.

The share of the hypermarkets, chain stores and supermarkets in the food retail sector stands around 50 percent. The competitive prices, large variety of goods, possibility of buying everything under one roof and the influence of western life (around 80 percent of the population is formed of expatriates) are the main contributors to the success of the hypermarkets in the UAE. The demand for healthy convenience and fresh food also make these stores attractive for the consumers. As the country imports 90 percent of its food needs, there is an intense competition among the suppliers in order to offer the lowest price to their customers. Some retailers also follow the strategy of importing directly without passing though the suppliers, in order to reduce their costs and the sale prices.

The rise in real estate prices constitutes a major cost for the retailers. Average rents in retail centers on Abu Dhabi island increased 4 percent in the first quarter of 2014 while the rents outside the island decreased 4 percent, according to Jones Lang LaSalle. In Dubai, average retail rents increased significantly for the primary malls while it recently started to rise for the secondary locations. As a result, some retailers moved to secondary locations in order to benefit from lower rents.

Another type of hypermarkets chain is the Union Co-operative Society, which is established as an affiliate of the government and developed through the participation of UAE nationals as shareholders. The aim is to maintain the price stability and provide competitive prices. The kind of cooperative is spread all over the country. In Dubai, it has 10 outlet stores.

The country has also an important luxury retail sector. Dubai is the top luxury center of the region for locals and international visitors. According to the Luxury Goods Worldwide Market Study conducted by Altagamma and Bain & Company in 2013, the personal luxury goods market in the Middle East grew 4 percent in 2012 compared with the previous year and reached 6.3 billion Euros. In 2013, the market is estimated to increase by 7 percent to 6.6 billion Euros.

Abu Dhabi and Dubai also host upper-scale hotels such as Jumeirah and Armani Hotel, a joint venture with Emaar Properties. Dubai is also famous with man-made palm-shaped islands. Within the first nine months of 2013, Dubai received 7.9 million tourists, an increase of around 10 percent from a year ago, according to the Department of Tourism and Commerce Marketing of Dubai. The hotel room occupancy average stood at 78.6 percent at that time, 3.1 percent up compared with the same period of 2012.

The rising per capita income and tourism allow the country to keep its luxury retail sector strong. The organization of events like shopping festivals and Dubai summer surprises also help the country to attract more tourists. MasterCard's Top 20 Global Destination Cities ranked Dubai 7th most attractive city in the second quarter of 2013, ahead of cities like Hong Kong, Barcelona, Milan, Amsterdam, Tokyo and Los Angeles.

There are risks, but they seem mitigated

As the wealthy consumer base, economic growth and higher income support the retail sector expansion, the risks on the retail sector seem quite mitigated.

Especially in the retail food industry, the intense competition concerning all segment of retailers –large, medium and small, may result in lower profit margins. The vertical integration of some retail companies by eliminating suppliers can also be threatening, specifically for small size food suppliers. Another factor triggering competition among retailers is the construction of new retail outlets which put pressure on retailers to differentiate their services and products in order to attract more clients to these new locations. The competition among the large international retailers and family-run businesses also work against the latter due to the lack of effective institutional and operational structure. This results in poor business decisions.

Inflation would be another factor weighing negatively on margins for retailers. The increase in accommodation, food, transports and education prices may be a restrictive factor especially for middle-income consumers, reducing the demand of products targeting this type of customer base. The increase in rents represents major costs for retailers, encouraging some of them to move into the secondary malls. Rising wages can also be considered as an important cost however as there is a lack of qualified professionals in some positions, it happens that companies would fight to attract and maintain the skilled workers.

The country is dependent on food imports to meet the domestic food demand. In case of an increase in global food prices, this would require from the companies to raise their selling prices. However, the governmental control over the prices can be a restrictive factor on the price hikes, creating a pressure on profit margins.

UAE Sector Barometer	
Sectors	**Risk level**
Petrochemicals	Moderate risk
Agrofood	Moderate risk
Retail	Moderate risk
Construction	Medium risk
Logistics	Moderate risk

Source: Datastream, Coface
**Except iron and steel*
Moderate risk · Medium risk · High risk · Very high risk

a) Construction: Another bubble?

The construction sector in the UAE represents medium risk level. However, in Dubai this sector represents higher risks compared with the rest of the country, especially in the residential segment.

The construction sector is developed especially in Dubai and Abu Dhabi. After almost defaulting in 2009 due to a bubble in the property market, the residential market gained a strong momentum on the back of solid economic growth. In Dubai, residential average prices rose 33 percent year-on-year in the first quarter of 2014 while average rents increased 23 percent at that time, according to Jones Lang LaSalle (JLL). In Abu Dhabi, sales prices for residential units rose 27 percent annually in the first quarter of 2014 while rents were more subdued.

The Dubai Land Department (DLD) announced in May that the investments in Dubai's real estate sector totaled 35 billion AED during the first quarter of 2014, an increase of 57 percent compared with the same period of last year. DLD said 133 nationalities made real estate investment in Dubai at that time.

The construction activities are expected to remain strong in the country due to the healthy economic growth and growing tourism sector. The fact that Dubai won the rights to organize World Expo 2020, strengthens the positivism about the sector as it would boost the demand for especially office segment.

The increasing number of real estate projects launched in Dubai and signs of speculative activities in the residential segment trigger fears about another property bubble. Recently the UAE central bank warned about the possibility of an overheating in the real estate market, citing the current average rental yields in Dubai and Abu Dhabi were around 70 and 130 basis points below historical averages, which would indicate growing imbalances and overheating in the real estate market. Last year, the bank introduced new regulations to restrict home loans in an attempt to counter rising property prices.

However other segments of the real estate market have a pace of recovery slower than the residential market. According to figures from JLL, in the office segment rents increased in the prime locations in Dubai in the first quarter of 2014 while the rents were stable for the secondary locations. In the hotel segment, the average daily rates rose 7.7 percent in the first quarter of 2014 from 2013 in line with an increasing number of tourists coming to the city. Dubai expects to attract 20 million annual visitors by 2020. In 2013 it attracted 11 million hotel guests, a 10.6 percent increase year-on-year.

In Abu Dhabi, in the office segment rents remained stable in the first quarter of 2014 while in the hotel segment the average rates declined despite a continued increase in occupancy.

Although these indicators suggest the overheating risk is currently limited with the residential segment of Dubai, there are still some vulnerabilities in the real estate market. The debt burden of the entire public sector in Dubai is still heavy with significant amounts coming due in the next few years, around 40 billion USD between 2015 and 2017 based on IMF estimates (ref. Part I).

Although the rebound in the real estate market is positive for the economic growth and GREs investments, an overheated demand could result in speculative transactions and destabilize the prices in the market in case of a global downturn. This would cause a sharp correction and harm financial health of these entities like in 2008-2009 period and harm sustainability of the economic growth.

Therefore, the authorities introduced some macro prudential measures in order to address the heated demand in the market. DLD doubled the property registration fees to 4 percent of the total value of the property in September 2013 to avoid quick transactions that heat up the market and prices. Additionally, the central bank issued the mortgage cap law in October 2013 which states that mortgage amount is limited to 80 percent of the total property price for Emiratis and 75 percent for expatriates. The law forces investors to have at least 20 percent to 25 percent of the property price as deposit. This helps to address the speculative demand in the market.

In November 2013, EMAAR properties, one of the largest developers in the UAE and Dubai banned off-plan property selling. The decision means that investors can only re-sell their units after hand over. This also reduces the number of transactions or possible heating of the property prices.

In Dec 2013, the authorities issued decree 43 of 2013. The decree aims to specify the maximum percentage of rent increase that are allowed upon rental of tenancy contracts in Dubai.

DLD introduced TANWEER late in 2013, the real estate investor protection law which aims to protect investors and reduce the property disputes by assuring investors of their rights. The measure of protection includes giving the investors the right to cancel, replace or demand a refund on the property if the contractor did not comply to the agreed terms or delivery dates and makes it possible for investors/contractors to link payment plan with construction milestone.

Tanweer is expected to increase transparency and precision in the real estate market and therefore boost the investors' confidence, especially for the foreign investors.

These measures are positive for having a wider control over the real estate prices and avoid potential bubbles. In case of further increase in prices, the authorities could opt to introduce more measures to tighten the conditions in the market and ensure the price sustainability.

b)Transportation: Strong infrastructure, high competition

The transportation sector in the UAE represents moderate risk level.

The transportation sector is an important component of the UAE's economic diversification. The country enjoys the advantage of its strategic location at the cross roads of Africa, Europe and Asia. The country is ranked 16th in the World Economic Forum's Enabling Trade Index 2014 and ranked 1st in terms of availability and quality of transport infrastructure.

Both Dubai and Abu Dhabi make aggressive investments in the transportation sector. Dubai has one of the world's best logistic facilities like the Port of Jebel Ali. This port is the world's 7th largest container port and Jebel Ali International Airport is one of the world's largest cargo airports. The government continues to invest in infrastructure. Expo 2020 would boost these investments. According to official estimates, Expo 2020 is expected to create more than 275,000 jobs in the sectors like construction, retail, transportation, aviation etc. across the region. Some media reports indicated that the emirate would spend over 8 billion USD in new infrastructure until Expo 2020. The Dubai Multi Commodities Center (DMCC) has been awarded best MENA and UAE free zone for SMEs. DMCC reported that they have 8,700 member companies, 95 percent of which are new to Dubai and 70 percent of which are SMEs. These enterprises would contribute to the expansion of the transportation sector in the emirate.

Dubai International Airport is also an important hub in the Middle East. Annual passenger traffic reached 66.4 million passengers in 2013, 15.2 percent up from a year ago. At that time cargo volumes rose 6.8 percent to 2,435,567 tons of air freight.

Within the Dubai World Central economic zone, the emirate opened in 2010 another airport, Al Maktoum International Airport with a planned annual capacity of 160 million passengers and 12 million tons of cargo.

Abu Dhabi government is also investing in the transportation sector. Abu Dhabi Port Company develops ports and industrial zones in the emirate. One of the major achievements is Khalifa Port inaugurated in 2012. When all the phases are completed, the port would have a capacity of 15 million TEUs of container volumes and 35 million.

The number of passengers passing through the Abu Dhabi International Airport rose to 16.5 million in 2013, 12.4 percent up on 2012. With the completion of the Midfield Terminal Project, which is set to open in 2017, the airport's capacity is expected to increase to 30 million passengers per year.

The supports from the local governments, huge infrastructure investments, the advantage of strategic location and resilient economic growth are expected to reinforce the development of logistics sector in the UAE. The increasing trade volume in the region and across the world would also add to this development.

However, there are some challenges for the transportation sector. The appeal of the factors mentioned above has attracted numerous players into the sector, intensifying the competition. Under these circumstances, the differentiation becomes crucial for the companies. This would require more investment in technology and hiring of skilled staff, which would increase costs for the logistics companies. Besides, the number of professionals having necessary qualification and specialization is limited in the country.

The aggressive competition would also avoid the companies to reflect fully the impact on costumers in case of a rise in fuel prices, creating downward pressures on the profit margins.

The lack of different type of transportation constitutes also another challenge for the logistics sector. Therefore the development of railways will be very important for the country and the region. The UAE took steps in order to construct a national freight and passenger railway network through the establishment of Etihad Rail in 2009. Etihad Rail's 1,200 km-network would connect the country, from the Saudi Arabia border to the Oman border.

The recent developments in the Middle East showed again that the geographic environment in the region may be difficult for the logistic companies during the turmoil period as it could create damages during the transportation.

INTERVIEW

KHATIJA HAQUE

Head of MENA Research Emirates NBD

“Growth in the UAE is getting stronger. Oil price movements should help UEA’s

The UAE’s economy recorded remarkable growth since the economic turmoil of 2009. What are your growth prospects for 2014?

Real growth in the UAE was stronger than forecast last year, and the IMF has upgraded its estimates for 2014 as well. The IMF has revised up its 2014 growth forecast for the UAE to 4.75% from 4.4% previously, and now expects 2015 growth at 4.5% from 4.2% previously… Overall, the IMF's assessment of the UAE's economy is positive, with growth expected to come from the non-oil sectors, supported by an improving global backdrop and stronger domestic confidence. The Fund highlighted both external and domestic risks to this outlook, and highlighted the need for prudent macroeconomic policy to manage these risks. On the domestic side, the IMF supports further fiscal consolidation, and suggests additional options to discourage speculation in the real estate sector including higher transaction fees and lower LTV ratios if prices continue to rise strongly. The Fund also stressed the importance of coordinating and prioritizing mega-projects in the run-up to Expo 2020, as well as managing upcoming debt maturities of GREs.

How do you evaluate the contribution of the hydrocarbon to the economic growth in 2014? How would the escalating violence in Iraq affect the oil industry and the economic growth in the UEA?

Recent events in Iraq, combined with lower than expected oil production in Libya and Iran suggest that risks to the oil sector in the GCC are on the upside rather than the downside in the short term. Saudi Arabia would be the main beneficiary of higher oil prices as it remains the ‘swing’ producer in OPEC and has already increased output in May. Other GCC states would also benefit from higher oil revenues and boosts to GDP growth from increased oil production in 2H 2014.

Do oil prices pose an upside rather than a downside risk?

External risks highlighted in the IMF’s assessment revolved around the impact of a sustained decline in oil prices, and the potential consequences for the budget and external balances. At the start of this year, most analysts had anticipated increased oil production from Libya, Iran and Iraq and the consensus forecast for oil prices1 was around USD 100/bbl, around 5% lower than the average 2013 oil price. As of end-May 2013, oil production in Iran, Iraq and Libya stood at 6.2mn bpd according to Bloomberg estimates, unchanged from January 2014 and well below the 7.0mn bpd produced in May 2013.

Recent events in Iraq suggest that increasing oil production from current levels is unlikely in 2H 2014. Similarly, the situation in Libya shows little sign of improvement, and negotiations between the West and Iran on a more permanent accord appear to have a long way to go (the temporary accord agreed in November 2013 and signed in January 2014 expires at the end of this week but may be extended for another six months).

Consequently, oil prices have risen to their highest level since December 2013, with the recent spike (to USD 110/bbl) on the back of the recent violence in Iraq. However, oil prices are still lower than they were in Q1 2012, at the start of the Syrian crisis, when the OPEC reference price reached nearly USD 125/bbl, and consensus forecasts for 2014 have risen to just USD 105/bbl.

Nevertheless, at this stage it appears that the external risks posed by oil prices, at least in the short term, are on the upside rather than the downside for the GCC.

How would higher oil prices and output affect growth, budgets and external balances?

If oil prices continue to rise, GCC oil exporters are likely to see direct and indirect benefits. Oil production in Saudi Arabia is likely to be increased to compensate for any potential decline in supply from Iraq (although at this stage we believe the risk of supply disruptions is small), which would have a direct positive impact on headline GDP growth. Oil production in Saudi Arabia in the first five months of this year was 1.3% higher than average 2013 output, while our GDP forecast of 4.2% assumes no growth in the oil sector this year. The UAE and Kuwait could also boost oil production in 2H 2014 if required, offsetting marginal declines in Jan-May.
Our budget and current account forecasts for the GCC are based on an average oil price of USD 100/bbl in 2014. In the year-to-May, oil prices averaged just under USD 105/bbl, and if prices continue to rise on geopolitical tensions, then budget and current account surpluses are likely to be higher than currently forecast. Increased budget revenues could also reduce GCC government’s commitments to constrain spending this year, further supporting non-oil growth.

“Recent events in Iraq, combined with lower than expected oil production in Libya and Iran suggest that risks to the oil sector in the GCC are on the upside rather than the downside in the short term”

INTERVIEW

HAITHAM ALKHAZALEH

Coface Information and Claims Manager

"Both Dubai and Abu Dhabi should implement the right evaluation and measurement standards to make sure the property market remains attractive to investors"

The retail sector is increasingly important in the UAE and there are numerous hypermarkets and supermarkets in the market. How a hypermarket/supermarket can differentiate itself to be more attractive for potential clients?

Many large retail shops opened smaller stores in different locations in the UAE to allow access to more people and provide convenience to their customers. Others developed a niche market for certain products that you can only find at these stores while others developed a loyalty program shopping with cards allowing customers to get better prices and offers the more they use these card.

What are the main challenges and risks for retailers in the upcoming period?

With the fast pace of growth the retail sector is witnessing, providing skilled operational and mall management staff would be a major challenge to the sector.

As the sector continues to perform very well in the UAE, the rental costs are expected to increase which means more pressure on the margins for retailers. The real challenge is for the major retailers are to balance their growth and performance and at the same time to still make profit.

What are the advantages and disadvantages of the UAE's retail market compared with the other GCC countries?

The UAE adopts an advanced marketing and promotional initiatives that attract shoppers from all over the region and the world supported by tourism influx. The UAE retail market is expected to increase by 32% by 2015 and it holds one of the largest retail shops worldwide which gives it an advantage over other GCC markets. , the DDF for example is the largest single-airport retailer in the world; the UAE has presence of more than 50% of the 323 major international fashion retailers.

What business opportunities does the UAE market offer to investors in the retail market?

The absence of a personal spending tax, growing population that follows a progressive lifestyle, being the leading tourist destination regionally and at global level and the political stability are all opportunities for investors in the retail market to expand their businesses and generate profit.

Let's move to the construction sector. Which are the segments (residential, commercial, hotels etc.) which look more promising?

Hotels and leisure sector is expected to witness the highest investment levels.

What kind of risk could create the increase of property prices in Dubai for the country's economy? What kind of measures does the government plan to implement?

The increasing property prices could affect the overall economy of the country and the profit margins of many businesses.

The regulations have improved as many laws across the UAE have been implemented.

Developments should now be more focused in line with demand and less reliance on pre-sale policies for financing.
Both Dubai and Abu Dhabi should implement the right evaluation and measurement standards to make sure the property market remains attractive to investors.

"The real challenge is for the major retailers are to balance their growth and performance and at the same time to still make profit"

4/ Conclusion

After contracting around 5 percent in 2009, the United Arab Emirates (UAE) economy gradually recovered and recorded solid growth rates. The growth stood at 5.2 percent in 2013 and is expected to stand around 5 percent in 2014.

Despite active diversification policies, the economy is still dependent on hydrocarbon sector especially in terms of budget revenues (nearly 80% in 2013). The economic diversification continues primarily based on the construction and real estate sector and on new projects and large-scale investments, mainly in transport, trade and tourism.

One of the main challenges for the UAE economy would be the improvement of transparency. This would enable investors to assess financial health of the government related entities. The country took positive steps to address this issue by introducing a new companies law and by adhering to the international data dissemination program of the IMF. Based on these progress, Coface upgraded the business climate of the UAE to A3. Further improvement on the communication and governance side would contribute to the strengthening of market confidence.

Another challenge is about addressing the heated demand in the real estate market. Since the 2008-2009 crisis, the real estate market has recorded a solid recovery, especially in the residential segment. In some locations, the rental yields approached their peak levels of 2008. Therefore, there could be an overheating risk in the residential segment of the real estate market especially in Dubai. In case of a global risk aversion, this heated demand could create a volatility over the prices and result in a sharp correction. At this point, the introduction of new actions to protect investors and avoid potential bubbles are considered positive steps to assure he economic health and sustainability of growth.

The key sector for the country is the hydrocarbon sector. The UAE produces 3.5 percent of the global crude oil, representing 7 percent of the proven reserves, ranked 7th in the world and 4th among the OPEC countries. The completion of infrastructure projects at existing oil fields will help the country to increase its production capacity. However political and regional developments, rising domestic demand for energy and enhancing the security of oil shipments will continue to be the major issues in this sector.

The retail sector is also one of the fastest growing industries in the country on the back of increasing wealth, economic sustainability and higher domestic consumption. The supportive policies of the government and the private sector's implication created a favorable environment for the development of this sector. The aggressive competition and the rise in real estate prices can be considered as the main risks for the companies operating in this industry. However these risks seem quite mitigated.

The agro food sector is becoming increasingly important in the UAE in line with the growing population and per capita income. The country is the second largest food producer in the GCC region, after the Saudi Arabia. Yet its production capacity is short to meet the demand as the cultivable lands and water resources are limited. Therefore the UAE import around 90 percent of its foods. This heavy dependence on food imports is a concern as it makes the country vulnerable to the volatility in food prices or shortage in food supply. The government intervenes to balance the food prices. However, even if this kind of practice could be successful in the short term to counter excessive price hikes, it may result in narrower profit margins for corporates.