KAMCO Research

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Economic Brief and Outlook 2011

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UAE Economic Outlook 2011

The economic recovery in the UAE is gaining strength, supported by a favorable global environment but subject to increased regional political uncertainty coupled with a slowdown in the real estate sector

Underpinned by its wealth in oil, the UAE's economy has recorded an overall steady level of growth over the years and the value of GDP has more than doubled from AED 387.8 billion (USD 105.6 billion) in 2004 to AED 934.3 billion (USD 254.4 billion) in 2008. Non-oil GDP in recent years, however, has been a main driver of growth, accounting for an average of 65% of GDP from 2004 to 2008. Major non-oil sectors in the economy in 2008 include: Trade (16%), Manufacturing (12%), Real Estate (8%), Construction (7%), and the Financial Sector (7%). Although Abu Dhabi and Dubai contribute the most to the country's GDP at 56% and 32% respectively in 2008, the latter has played a greater role in the growth witnessed among the majority of non-oil sectors. Additionally, in line with the effects the global financial crisis had on countries around the globe; the UAE wasn't able to entirely avoid the crisis in the latter part of 2008 and 2009 as evidenced by the 2% contraction witnessed in its 2009 GDP, which stood at AED 914.3 billion (USD 248.9 billion). Nonetheless, the UAE's situation remains better than other countries.

As a result, growth prospects in the UAE over the coming years will undoubtedly be shaped by the pace of the global economic recovery and the slowdown within the real estate sector - particularly in Dubai. Despite having short-term growth depend largely on how much economic activity expands, prospects for the long-term health and stability of the economy will depend on the progression of Abu Dhabi's Economic Vision of 2030 and Dubai's Strategic Plan of 2015. Growth trends differ across Emirates as higher oil production and increased infrastructure spending are the main drivers of growth in Abu Dhabi. On the other hand, Dubai is benefiting from its leading position as a regional trade hub, with growing links to Asia, and improved competitiveness.

Estimates for 2009 by the UAE National Bureau of Statistics reveal that the UAE's contraction in nominal GDP was led by the drop in the oil sector, which slumped 22% in 2009 to reach AED 267 billion (USD 72.7 billion) on the back of a drop in oil prices. However, non-oil GDP rose 10%, albeit at a slower pace than 2008, to reach AED 647.3 billion (USD 176.2 billion) in 2009. Thereby leading non-oil GDP to contribute a hefty 71% of the UAE's GDP - a considerable jump from the 63% contribution it registered in 2008.

Additionally, with average oil prices ending 2010 at USD 77 pb, 18% higher than 2009's average oil price of USD 60 pb, growth in the oil & gas sector is set to rebound, yet the recovery will be limited due to OPEC constraints on crude oil production. As a result, the expected increase in the oil & gas sector will help drive GDP growth in the short-term horizon, as well as the government's expansionary fiscal policies as they will ensure expansion in the non-oil sectors; thus enabling the UAE to deliver towards its diversification strategy goals. It is the government's redirection of hydrocarbon revenues towards the development of key industries over the long run that will enhance the Emirate's economy and enable it to compete with emerging markets.

According to the IMF, real economic growth in U.A.E. is expected to remain unchanged in 2011 at 3.25% and non-oil GDP growth is forecasted to grow from 2% in 2010 to 3.25% in 2011; reflective of strong tourism, logistics, and trade in Dubai and large public investment spending in Abu Dhabi. Also in spite of higher international food prices, inflation is expected to remain moderate in 2011 at 4.5% as rents continue to decline. However, risks to the recovery remain as spillovers of regional political events will lead to re-pricing of political and sovereign risks in the region making it difficult to finance, hence placing pressure on the private sector and the Government Related Enterprises (GREs.) The excess supply of property in Dubai and the uncertainty regarding its size will continue to weigh on growth.

The global financial crisis has put to test a decade of high economic growth. In 2009, nominal GDP is estimated to have contracted 2% to AED 914.3 bn (USD 249 bn)

The UAE had notable achievements over the past decade with its open and outward orientation, which allowed the diversification of the economy along with generating sustainable economic growth. However, the drop in oil prices, the sudden drying up of international credit markets and the correction in property prices in Dubai have put strains on the economy thus slowing down economic activity.

Nonetheless, authorities supported the banking system through liquidity injection, recapitalization of banks, and deposit guarantees. Abu Dhabi also provided financial support to Dubai. Yet, with the effect of extensive short-term borrowings, a price correction in the real estate market, and maturity mismatches Dubai World (DW) was forced to seek a debt standstill ultimately generating a round of ripple effects. Accordingly the UAE's real GDP as per the UAE National Bureau of Statistics is estimated to have contracted by 2% in 2009.

Real estate sector remains pressured, making the economic recovery fragile

A contraction in real estate growth is expected as a further drop in property prices is forecasted to prevail in the short-term horizon as new supply enters the market coupled with lower demand; thus widening the supply-demand gap. The excess supply of property in Dubai, which will increase in light of the expected completion of unfinished projects, will continue to weigh down on property prices and growth prospects. Abu Dhabi's strategy to boost its housing supply may also pose risks as it will put additional pressure on the property market. Lower funding levels as banks' liquidity levels remained pressured, high leverage, the mandatory 5% housing tax which is set to come into effect across all areas of Dubai starting January 2011 are all factors that will continue adding downward pressure on prices and dampening investor sentiment, thereby explaining the projected slowdown in the real estate market. However, massive government investment in infrastructure projects is expected to reignite demand for construction and contracting services while also boosting employment, consequently providing a more solid base for the economy to grow in the near future.

Domestic Credit Growth remains Sluggish

Bank lending is reviving but credit growth remains sluggish. 2010 data from the Central Bank of the UAE reveals that lending was up 1.4% in 2010 reaching AED 972.1 billion (USD 264.6 billion), indicative of a slow recovery and bank's general cautiousness in lending to the economy. In line with the government's continued expansionary policies, lending to the government maintained its upward trend reaching AED 100 billion (USD 27.2 billion) during the in 2010. Lending for construction, on the other hand, decreased 2.6% to AED 122.7 billion (USD 33.4 billion) in 2010 while credit extended for real estate mortgage loans has witnessed a sense of revival rising 15% in 2010 to reach AED 163.2 billion (USD 44.4 billion) as of Dec-10. Despite the modest loan growth, continued depositor confidence led deposits to surpass one trillion AED, leading the aggregate loan to deposits ratio to maintain its downward trend since the start of 2010, dropping to 92.6% as of Dec-10 compared to its peak of 101.3% at the end of 2008.

The Banking Sector is Well Capitalized

Further along, the capitalization of the UAE's banking system remains sound as the capital adequacy ratio (CAR) stands at 21% as of Dec-10. Fitch Ratings UAE Banks Review and Outlook report, which was published in June-10 indicated that despite rising impairments and difficult operating conditions; the UAE banking sector's sound capitalization should make the country's asset quality challenges and liquidity pressures manageable with support from the government to the sector less likely required. In addition, stress tests on aggregate banking data indicate resilience to shocks despite nonperforming loans (NPLs) doubling since the crisis, marking the second highest increase in the GCC.

In terms of the prospects for the emirate of Abu Dhabi, its past accumulated surpluses will enable it to move on as planned with its Abu Dhabi 2030 vision. Additionally, the emirate's young population and relatively young real estate market in comparison to its neighbor - Dubai, will continue serving as major elements of growth in the coming years. As for the emirate of Dubai, the continuous development of its sea port will enable foreign trade to continue thriving, hence positively reflecting on the UAE's trade balance. With average oil prices expected to end the year on a higher note compared to 2009, growth in the oil and gas sector is expected to rebound in spite of the marginal increase in crude oil production due to OPEC quota constraints. The rise within the oil sector will be positively reflected within Abu Dhabi's oil & gas contribution to GDP as the emirate sits on 94% of the UAE's 98 billion barrels of oil reserves.

Also, in line with the UAE's plans to increase oil production capacity from its current 2.7 million barrels per day (bpd) to 3.5 million bpd within its "underdeveloped" offshore reserves by 2018, which are estimated at 45%, will undoubtedly enable the country to sustain its expansionary fiscal policies to ensure expansion in the non-oil sectors. However, the effect of Dubai's debt problems and future repayments will likely slowdown growth in the real estate, construction, and financial services sectors - namely Dubai as they have the greatest exposure to troubled Dubai based government related entities.

Approval of Dubai World's Restructuring Partially Restored Investor Confidence

Moreover, approval of Dubai World's estimated USD 25 billion debt restructuring by its creditors in Mar-11 has once again restored investor confidence, thereby easing concerns on the soundness of the UAE's economic prospect. The agreement, as a matter of fact, will shed light once again on UAE banks as the restructuring approval will be a key element in defining and clarifying the picture of "problem" loans to investors as banks are expected to follow the guidance of provisions by the UAE Central Bank in terms of their exposure to Dubai World in the near future. Additionally, the restructuring approval marks a new start for debt-struck Dubai as it continues to look for fruitful investment opportunities within its tourism, transport, and trade sectors to ensure sustainable economic growth and development, which will simultaneously enable the emirate to regain its position as a regional trade and services hub. Meanwhile, Dubai will also likely focus on paying off its debts, which may include the possible sale of some of its assets. As a result, going forward, the government of Dubai is expected to refocus its expansion on international and regional trade, transport, and tourism under its long-term strategic plan as it reduces its focus on real estate and financial services, which served as the two main engines of growth up until the financial downturn.

Lower levels of spending and their effect on oil and non-oil GDP growth

Oil GDP growth in 2008 and 2009 was pressured by the drop in oil prices. More notably, Abu Dhabi's GDP in 2009 slumped on the back of a drop in oil prices ultimately weighing on the UAE's oil component of GDP as Abu Dhabi holds about 98% of the country's oil reserves. Nonetheless, an improvement in world's oil prices in 2010 as compared to 2009 will enable the UAE to witness growth among its oil GDP. The IMF's latest "Regional Economic Outlook - Middle East & Central Asia" revealed that oil GDP growth in 2010 and 2011 is expected to reach 3.0% and 3.4% respectively as oil production capacity is not expected to witness any major changes in the coming years. In terms of the IMF's forecasts on the UAE's future lower levels of spending in 2010 and 2011 after shoring up spending to counter the effects of the 2008 global crisis; such a move will not hamper non-oil GDP growth. Non-oil GDP growth in the short-term horizon will likely be focused among the manufacturing and trade sectors - particularly within the emirate of Dubai as it was hit the most within its real estate sector, which was once deemed as the emirate's main engine of growth. In fact, Dubai will likely shift its long-term strategy towards the development of its trade and logistics sectors to ensure sustainable growth and development in the future.

The banking sector remains resilient to shocks, backed by solid capital base-including money injected by the government, and strong earnings, although nonperforming loans have doubled since the crisis. The Central Bank of UAE has made important progress in strengthening its financial stability approach, revamping the regulatory framework, and developing macro-prudential policies. The Central Bank continues to ensure that banks provision adequately, particularly in light of increasing provisioning needs on Dubai GREs.

Central Bank of the UAE Mandates Banks to Book Provisions on a Quarterly Basis

In an effort to boost transparency among the banking sector and investment companies, the Central Bank of the UAE (CBUAE) has identified a new framework for lenders to classify their loans and levels of provisioning necessary for each of them- a framework that is in line with international best practices and one that has been adopted by the Basel Committee. According to the published statement by the CBUAE, lenders are required to book provisions (specific and general) on a quarterly basis rather than waiting until the end of the fiscal year "and deduct them from the profit and loss account" to provide a more realistic financial position of banks and other lenders. Banks, for example, are required to book general provisions for unclassified loans and advances "equal to 1.5% of the risk weighted assets as per Basel II." However companies or government entities with loans backed by local governments are exempt from such provisioning. Since the start of the global credit crisis banks in the UAE have faced a credit crunch, prompting the central bank to inject billions of UAE dirhams into local banks. Nonetheless, the credit crunch led banks to book extensive provisions due to their significant exposure to bad loans from the real estate slump and government related entities, ultimately leading provisioning to rise through 2010. As a result, the new guidelines are expected to bring the UAE's banking sector in line with international standards while also enabling banks to provide investors and the public with a more accurate valuation of their loan books.

In 2010, total provisions for UAE banks stood at AED 56.8 billion (USD 15.5 billion) up by 31% from AED 43.3 (USD 11.8 billion) in 2009. Following, in Dec-10 local UAE daily newspapers revealed, in accordance to a local bank circular, the Central Bank asked lenders to increase provisioning against their exposure to troubled Saudi conglomerates - SAAD and Al Gosaibi Group - to 80% by the end of 2010. The two companies are locked in a complex legal dispute involving an estimated USD 22 billion worth of debt. Therefore, the banking sector is expected to come under pressure following this announcement, with the impact of provisions likely to be seen in the upcoming years. As a result, banks will be challenged in reversing any weakening in their asset base quality since they are required to undertake specific provisioning for non-performing loans, which they already started doing over the past due to exposure to troubled Saudi conglomerates, retail and real estate loans.

The UAE economy is recovering gradually but risks remain elevated

After benefiting from higher oil prices, strong demand from trading partners, and despite a fiscal contraction in 2009, the economy as per IMF figures is estimated to have grown 3.2% in 2010. In fact, this momentum is carrying into 2011, according to IMF estimates, with non-oil GDP growth projected to accelerate from 2% in 2010 to 3.25%, reflective of strong tourism, logistics, and trade in Dubai as well as large public spending in Abu Dhabi. As a result, higher oil prices are expected to contribute to a marked improvement in the fiscal position and balance of payments. The successful restructuring of DW's debt has also improved confidence by allowing top-grade Dubai issuers to regain market access. But credit spreads continue to remain high - reflecting uncertainty about other GREs debt restructuring needs and more recently a higher regional risk premium. Additionally, the slowdown in the real estate market, as aforementioned, will remain a drag on the economy and the unrest in the MENA region poses downside risks.

Several factors that might undermine economic recovery

- **Massive property projects and uncertainty regarding their size:** The excess supply of property in Dubai, which will further increase as unfinished projects come to completion, will continue to weigh on property prices and growth prospects. Abu Dhabi's strategy to increase its housing supply may also pose risks by placing additional pressure on the property market.

- **GREs Debt Rescheduling:** According to the IMF, GREs have an estimated USD 31 billion of debt due in 2011-12, of which at least USD 5 billion in the real estate sector. Therefore, Dubai may continue to face significant rollover risks in the short-term, which may raise the cost of borrowing.

- **International sanctions on Iran:** Iran is one of the UAE's largest trading partners, as a result, sanctions on Iran could weaken the UAE's recovery.

- **The political unrest in the region poses downside risks to the outlook:** The re-pricing of risk in the region may result in more difficult market conditions as evidenced by the sharp drop in equity markets during Q1-11. On the positive side, there are indications that the UAE may benefit from increased tourism and investments. Higher oil prices are also benefiting the UAE as it exports oil and hydrocarbons.

Gross Domestic Product

Oil vs. Non-Oil Component of GDP

Between 2002 and up until the first half of 2008 the UAE's economy registered record levels of growth...

The UAE's economy has recorded promising levels of growth fueled by the rise in oil prices between 2002 up until the first half of 2008 coupled with the governments' massive investments in projects related to infrastructure and real estate, which fueled demand for construction and contracting services, ultimately leading the Emirate to register record levels of growth within its non-oil sectors. The Emirates' economy recorded a CAGR of 22.8% in its GDP from 2002 to 2008 to reach AED 934.3 billion (USD 254.4 billion). The oil and gas component of GDP registered a CAGR of 29.5% over the same period to stand at AED 344.1 billion (USD 93.7 billion) in 2008, representing 37% of the country's total GDP. The non-oil component of GDP, on the other hand, stood at AED 590.1 billion (USD 160.7 billion) in 2008 compared to AED 199.8 billion (USD 54.4 billion) in 2002, representing a CAGR of 19.8% from 2002 to 2008.

The plunge in world oil prices during 2009 weighed on the UAE's 2009 GDP.

However, with the start of the global economic and financial crisis throughout the second half of 2008, namely the last quarter of 2008 and 2009, the economy of the UAE was set to face a challenging period as over a third of the Emirates' revenues are generated from oil. Nominal GDP estimates for 2009 indicate that GDP contracted by 2% to reach AED 914.3 billion (USD 248.9 billion) in 2009, with the oil component of GDP slumping 22% to AED 267 billion (USD 72.7 billion) in 2009 as compared to the 36% growth it registered in 2008. Oil prices plunged from a record high of USD 140 per barrel in July 2008 to a low of USD 35 per barrel in January 2009.

Oil prices since the start of 2011 surpassed USD 110 pb mark.

Average oil prices, which stood at USD 60.25 pb in 2009, ended 2009 36% lower than the USD 94.26 pb average of 2008. The sharp drop in oil prices ultimately weighed on the country's macroeconomic indicators in 2009 as oil revenues constitute a significant amount of total income. However, oil prices during the latter part of 2009 and throughout 2010 bounced back, with average oil prices trading at an average of USD 77.34 pb in 2010, 28% higher than average prices in 2009. Likewise, in late 2010 and onto the start of 2011, oil prices surpassed the USD 110 pb mark, driven by the geopolitical instability in the Middle East. Accordingly, the rise in oil prices will mitigate the impact of the economic downturn in the UAE as better than expected oil prices and revenues will aid the government in supporting economic growth and enhancing investor confidence throughout the country's emirates.

Table 1: Evolution of UAE Gross Domestic Product (2002 - 2009)

(AED Billions)	2002	2003	2004	2005	2006	2007	2008	2009
Nominal GDP	**272.9**	**321.8**	**387.8**	**506.8**	**643.5**	**758.0**	**934.3**	**914.3**
y-o-y % change	*7%*	*18%*	*21%*	*31%*	*27%*	*18%*	*23%*	*(2%)*
Oil Component	**73.1**	**93.0**	**123.9**	**182.5**	**220.5**	**253.8**	**344.1**	**267.0**
y-o-y % change	*(3%)*	*27%*	*33%*	*47%*	*21%*	*15%*	*36%*	*(22%)*
% of GDP	*27%*	*29%*	*32%*	*36%*	*34%*	*33%*	*37%*	*29%*
Non-Oil Component	**199.8**	**228.7**	**263.9**	**324.3**	**423.0**	**504.3**	**590.1**	**647.3**
y-o-y % change	*11%*	*14%*	*15%*	*23%*	*30%*	*19%*	*17%*	*10%*
% of GDP	*73%*	*71%*	*68%*	*64%*	*66%*	*67%*	*63%*	*71%*

Source: KAMCO Research & UAE National Bureau of Statistics

The UAE remains dependent on oil revenues as the hydrocarbon sector accounts for over a third of its GDP.

Further along, economic indicators in 2008 and 2009 have revealed that despite the extensive growth and development the country has witnessed within the past several years, which led to a transformation that further emphasized the UAE's existence on the world map, the UAE's economy continues to remain dependent on the hydrocarbons sector, which accounts for over a third of the country's GDP (37% of GDP in 2008).

According to estimates, nominal GDP in the UAE contracted 2% to AED 914.3 bln in 2009 vs. AED 934.4 bln in 2008.

Although economic figures for 2009 have yet to be published by UAE authorities, estimates from the UAE National Bureau of Statistics reveal that nominal GDP in 2009 stood at AED 914.3 billion (USD 248.9 billion), representing a 2.1% contraction versus 2008. Evident of a worsening economic situation throughout the country that was manifested by project cancellations, layoffs, a deterioration in corporate earnings, the plunge in real estate prices in Dubai which led to a market correction, and most importantly the negative news flow surrounding Dubai World's (DW) debt troubles; thus weighing down extensively on investor sentiment and the UAE's economic standing. In fact, DW's debt restructuring efforts was among the main drivers in the UAE's market performance during the first half of 2010 as uncertainty concerning the outcome of the debt restructuring and its effect on capital markets and the economy remained high.

The UAE's economy contracted in 2009 on the back of a slowdown in activity among the hydrocarbon, real estate, and construction sectors particularly in the emirates' of Dubai and Abu Dhabi.

Dubai's economy unlike Abu Dhabi is not strengthened through natural resources - oil - and its associated fiscal surpluses, leaving it more vulnerable to the effects of the global slowdown in economic activity as Dubai's economy is more construction and services based. As a result, the reliance on debt to finance economic growth and diversification coupled with a real estate bubble burst, the shutdown of global credit markets, and soaring debt levels of government related entities resulted in the "perfect storm" for Dubai - pushing it into a marked slowdown. As a result, given that oil accounts for over a third of the UAE's GDP and the contraction within Dubai's main economic sectors have unquestionably led GDP and economic growth to slowdown in the short-term horizon.

GDP by Type of Expenditure

Consumption expenditure grew at a CAGR of 20% during 2004-08, indicating that consumer demand has been a main driver of economic growth in the UAE.

When taking a closer look at the UAE's GDP components by type of expenditure - consumption, private investment, gross fixed capital formation, and net exports - it becomes clear how consumption expenditure over the past several years has represented a significant portion of GDP. In fact, from 2004 to 2008, as seen in Table 2, consumption expenditure grew at a CAGR of 20% from AED 246.1 billion (USD 67 billion) in 2004 to AED 511.7 billion (USD 139.3 billion) in 2008, thereby reflecting the significance consumer demand has on the GDP of the UAE. While private expenditure represented 83% or AED 425.2 billion (USD 115.8 billion) of total expenditures in 2008, hence further demonstrating how consumer demand in the past four years has been a main driver of economic growth in the UAE; ultimately confirming that the UAE is gradually moving from an oil driven to a more consumer driven economy.

In addition, the rise in gross fixed capital formation, namely within the private sector, which has more than doubled from 2006 to 2008 to reach AED 217.3

The rise in gross fixed capital formation within the private sector from 2004-08 reflects the key role the private sector has played in the UAE's expansion.

billion (USD 59.2 billion), illustrates the massive investments that have been made by businesses and investors over the past several years in tandem with the economic growth the UAE was witnessing. Thereby, indicating that in such fruitful economic times, mainly 2007 and up until the last quarter of 2008, the value of fixed investments rose as it was perceived with the observed market expansion that was taking place that fixed investments would be profitable in the future. In fact, the rise in value of gross fixed capital formation within the private sector over 2004 to 2008 is strongly indicative of the private sector's expansion within the UAE. Also, the rise in government investments, which grew at a CAGR of 13% from AED 15.2 billion (USD 4.1 billion) in 2004 to AED 25.1 billion (USD 6.8 billion) in 2008, reveals the vital role the government of the UAE has been playing in the economy through its expansionary fiscal policies in an effort to boost the economy and sustain high levels of growth.

Table 2: UAE GDP by Type of Expenditure

Expenditure (AED millions)	2002	2003	2004	2005	2006	2007	2008
Final Consumption Expenditure:	**183,646**	**202,103**	**246,081**	**303,663**	**370,765**	**426,537**	**511,753**
Government	39,388	42,661	44,286	51,544	57,961	76,190	86,570
Private	144,258	159,442	201,795	252,119	312,804	350,347	425,183
Gross Fixed Capital Formation:	**62,404**	**73,105**	**81,255**	**93,798**	**120,999**	**248,562**	**300,427**
Government	14,016	16,129	15,207	14,042	16,748	21,197	25,072
Public Sector	22,003	24,520	28,395	32,509	37,942	42,992	58,001
Private Sector	26,385	32,456	37,653	47,247	66,309	184,373	217,354
Add: Change In Stocks	**2,870**	**2,950**	**3,392**	**5,724**	**6,663**	**7,435**	**15,235**
Add: Exports of Goods & Services	**199,647**	**255,380**	**345,100**	**448,305**	**559,813**	**685,620**	**913,748**
Less: Imports of Goods & Services	**175,711**	**211,786**	**288,027**	**344,710**	**414,737**	**610,128**	**806,901**
Nominal GDP	**272,856**	**321,752**	**387,801**	**506,780**	**643,503**	**758,026**	**934,262**

Source: KAMCO Research & UAE National Bureau of Statistics

GDP Components by Sector

The Manufacturing sector represented the highest contribution to the UAE's non-oil GDP in 2008, at 12% followed by the Construction and Real Estate sectors.

The UAE's expansionary fiscal and monetary policies, contributed to a rise in construction, manufacturing, financial and transportation services over the past few years, which led the non-oil sector to witness notable levels of growth. In tandem with the development strategies of Abu Dhabi and Dubai to diversify their respective economies away from hydrocarbons towards non-oil sectors such as: manufacturing, trade, logistics, and financial services; when further analyzing the non-oil components of GDP by economic activities, it becomes evident how the Manufacturing Sector registered the highest share contribution within the non-oil sector, after recording a share contribution of 12.1% in 2008 followed by the Construction Sector at 7.4%. The Real Estate & Business Services Sector, despite the considerable slowdown in activity it witnessed in 2008 and 2009, contributed a sizeable share of 8.4% of the UAE's GDP in 2008 compared to its peak in 2007 where it contributed 9.1% to the UAE's GDP.

Financial Services Sector Contribution to GDP

Financial Services sector contribution to UAE GDP fell to 6.7% in 2008.

Further along, the Financial Services Sector has also served as an important element of growth towards the diversification of the UAE's strategy as it contributed 7.1% of GDP in 2007, attributable mostly to Abu Dhabi and Dubai as their financial sectors represent the majority of the UAE's at 40.7% and 41.7% in 2007 respectively (Table 3). Yet due to the financial crisis, financial institutions became constrained as profitability levels and credit conditions shrunk considerably, as seen with the decline in contribution the sector posted in 2008 of 6.7% down from the 7.1% contribution registered in 2007; thus leading to a reduction in liquidity levels and a notable reduction in the ability and readiness of institutions to extend credit facilities. In fact, with the financial crisis witnessed in Dubai in 2008, which led its neighbor Abu Dhabi to intervene and provide financial aid; Dubai's financial services share dropped to 39.7%, while Abu Dhabi's rose to 41.4%. The contraction in lending activity, among the financial services sector along with the sudden shrink in foreign lending, was a chief factor in the slowdown in economic activity in 2008.

Table 3: Financial Services Sector Contribution to UAE GDP by Emirate

(AED millions)	2005	2006	2007	2008
Abu Dhabi	16,492	18,991	22,018	25,913
% of UAE Financial Services Sector	*38.7%*	*40.9%*	*40.7%*	*41.4%*
Dubai	20,234	20,743	22,571	24,879
% of UAE Financial Services Sector	*47.5%*	*44.7%*	*41.7%*	*39.7%*
Sharjah	3,678	4,178	5,940	7,432
% of UAE Financial Services Sector	*8.6%*	*9.0%*	*11.0%*	*11.9%*
Other Emirates	2,171	2,499	3,536	4,424
% of UAE Financial Services Sector	*5.1%*	*5.4%*	*6.5%*	*7.1%*

Source: KAMCO Research & UAE National Bureau of Statistics

The UAE's accumulated surpluses over the years on the back of oil exports serve as an essential source of funding for the country's projects.

Despite the growth in the non-oil sector over the years, it's important to point out that the UAE's export earnings and budget surpluses, which are attributable to a large extent to the country's oil exports and revenues, have served as an essential source of funding for the country's large scale public sector infrastructure and development projects that have transformed the UAE into a regional trade hub. As a result, the extent to which the UAE will grow in the coming years will likely be influenced by the performance of global oil prices and demand for oil.

GDP by Emirates

Abu Dhabi, Dubai, and Sharjah are the main contributors to the UAE's GDP.

In terms of GDP distribution by the seven emirates, Abu Dhabi is the primary contributor to the UAE's GDP followed by the emirates of Dubai and Sharjah respectively. Abu Dhabi has consistently represented half of the UAE's GDP (Table 4) with its share contribution ranging from 53% to 57% throughout the 2004 to 2008 period. In 2008 Abu Dhabi's GDP stood at AED 519.9 billion (USD 141.6 billion) followed by Dubai which recorded a GDP of AED 301.5 billion (USD 82.1 billion), representing 32.3% of UAE GDP. The emirate of Sharjah, on the other hand, trails behind Dubai with a single digit contribution of 7.7% or AED 72 billion (USD 19.6 billion) in 2008.

Table 4: UAE GDP Distribution by Emirate

(AED millions)	2004	2005	2006	2007	2008
Abu Dhabi	**216,179**	**290,323**	**341,286**	**400,047**	**519,921**
% of GDP	*55.7%*	*57.3%*	*53.0%*	*52.8%*	*55.7%*
Dubai	**118,428**	**147,895**	**224,344**	**264,174**	**301,485**
% of GDP	*30.5%*	*29.2%*	*34.9%*	*34.9%*	*32.3%*
Sharjah	**33,624**	**44,826**	**49,406**	**59,682**	**71,993**
% of GDP	*8.7%*	*8.8%*	*7.7%*	*7.9%*	*7.7%*
Ajman	**5,192**	**6,216**	**7,428**	**9,583**	**11,549**
% of GDP	*1.3%*	*1.2%*	*1.2%*	*1.3%*	*1.2%*
Um Al Quwain	**1,749**	**2,159**	**2,482**	**3,006**	**3,576**
% of GDP	*0.5%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*
Ras Al Khaimah	**7,835**	**9,315**	**11,435**	**13,400**	**15,895**
% of GDP	*2.0%*	*1.8%*	*1.8%*	*1.8%*	*1.7%*
Al Fujairah	**4,794**	**6,046**	**7,122**	**8,134**	**9,843**
% of GDP	*1.2%*	*1.2%*	*1.1%*	*1.1%*	*1.1%*
UAE Nominal GDP	**387,801**	**506,780**	**643,503**	**758,026**	**934,262**

Source: KAMCO Research & UAE National Bureau of Statistics

Oil GDP Contribution by Emirates

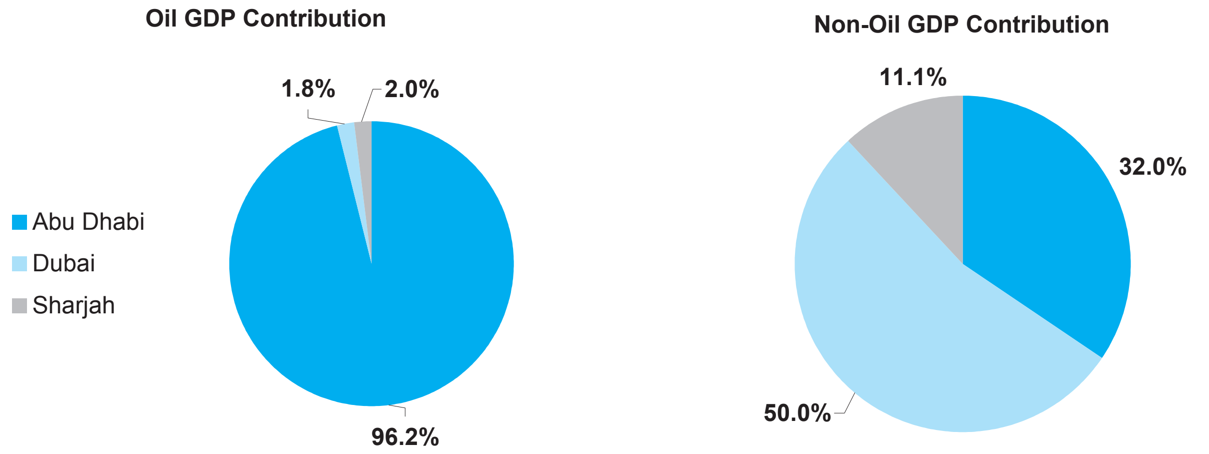
The emirate of Abu Dhabi represented 96% of the UAE's oil GDP in 2008.

Following along, when further analyzing GDP by emirate, Abu Dhabi's oil and gas sector represents the largest percentage contribution in terms of the UAE's oil component of GDP, with a contribution of 96.2% or AED 330.7 billion (USD 90 billion) in 2008. Dubai and Sharjah combined, on the other hand as seen in Chart 1 below, contributed a mere 3.8% or AED 12.6 billion (USD 3.4 billion), to the oil component of GDP in 2008 compared to the 4.7% contribution they registered in 2007.

In line with the drop in oil prices in 2009, Abu Dhabi's GDP contracted in 2009 as oil revenues make up over 60% of the emirate's GDP.

In line with the fall in oil prices which continued their downward trend in 2009, Abu Dhabi witnessed a notable drop in its GDP in 2009, as per the figures published in the Abu Dhabi Statistical Yearbook of 2010. The oil and gas sector, which represented 64% of the emirate's GDP in 2008, slumped 33.5% in 2009 hence explaining the 18% drop in GDP. As a result, Abu Dhabi's contribution to the UAE's GDP in 2009 is expected to decline as the emirate holds about 94% or 92.2 billion barrels of oil reserves of the UAE's 98 billion barrels of oil reserves. Nonetheless, with oil prices trading 28% higher in 2010, at an average of USD 77 pb compared to an average of USD 60 pb in 2009 and strong oil prices expected during 2011, Abu Dhabi's contribution to the UAE's GDP is expected to rebound back to previous levels.

Chart 1: UAE Oil & Non-Oil GDP Contribution by Top 3 Emirates in 2008



Source: KAMCO Research & UAE National Bureau of Statistics

Main Non-Oil Sector's Contribution to UAE GDP by Emirate

Dubai has played a major role in the UAE's non-oil GDP growth over the past several years.

Yet given that non-oil GDP has been an important factor behind the UAE's GDP growth over the past several years on the back of Dubai's Strategic Plan of 2015 and Abu Dhabi's Economic Vision of 2030, as a goal of diversifying the respective emirate's economies away from oil; it is worth identifying the non-oil sectors responsible for the growth the emirates have witnessed. The main non-oil sectors within the UAE's economy are Trade and Manufacturing representing 16% and 12% of GDP respectively in 2008. With regards to manufacturing, 2008 figures reveal that the chief producer is Abu Dhabi as it represents 44% of the UAE's Manufacturing Sector (as seen in Table 5) followed by Dubai with a share of 38%. Trade on the other hand is mostly carried out by Dubai. In 2008 Dubai's share of total trade in the UAE reached 78% followed by Abu Dhabi and Sharjah with a 12% and 6% share respectively. The robust share contribution of trade in Dubai has been stimulated by a rise in local demand and re-exports in Dubai as it operates a major sea port and free trade zone.

Trade and Manufacturing are the UAE's main non-oil sectors.

Table 5. Manufacturing and Trade Sector's Contribution to GDP by Emirate

Manufacturing (AED mlns)	2006	2007	2008	Trade (AED mlns)	2006	2007	2008
Abu Dhabi	34,539	41,529	49,761	Abu Dhabi	12,623	14,895	17,548
% of Sector	*40.8%*	*43.0%*	*43.9%*	*% of Sector*	*12.7%*	*11.9%*	*11.8%*
Dubai	34,855	38,400	42,582	Dubai	77,301	98,492	116,310
% of Sector	*41.2%*	*39.7%*	*37.6%*	*% of Sector*	*77.8%*	*78.8%*	*78.4%*
Sharjah	11,714	12,197	15,261	Sharjah	5,640	6,764	8,463
% of Sector	*13.8%*	*12.6%*	*13.5%*	*% of Sector*	*5.7%*	*5.4%*	*5.7%*
Other Emirates	3,502	4,508	5,641	Other Emirates	3,817	4,871	6,094
% of Sector	*4.1%*	*4.7%*	*5.0%*	*% of Sector*	*3.8%*	*3.9%*	*4.1%*

Source: KAMCO Research & UAE National Bureau of Statistics

Dubai's share contribution to the Construction and Real Estate sectors reached 42% and 57%, respectively in 2008.

Similarly, the Construction and Real Estate sectors, also make up a considerable portion of the UAE's GDP, representing 15.8% of GDP (combined) in 2008 (Table 6). Yet, the share contribution of these sectors is larger in Dubai than Abu Dhabi as the construction and real estate sectors in Dubai represent 42.1% (AED 29.1 billion, USD 7.9 billion) and 56.6% (AED 44.4 billion, USD 12.1 billion) of the UAE's construction and real estate sectors, respectively. This hefty share contribution came on the back of the construction and real estate boom the emirates witnessed prior to the fallout of the crisis during the second half of 2008. Abu Dhabi's share of the real estate and construction sectors of the UAE, on the other hand, stood at 38.7% and 24%, respectively while Sharjah trailed behind with a share of 11.7% and 13.1%, respectively.

Table. 6 Construction and Real Estate Sector's Contribution to GDP by Emirate

Construction (AED mlns)	2006	2007	2008	Real Estate (AED mlns)	2006	2007	2008
Abu Dhabi	15,984	20,070	26,793	Abu Dhabi	12,695	15,800	18,801
% of Sector	***36.7%***	***36.6%***	***38.7%***	***% of Sector***	***22.5%***	***23.0%***	***24.0%***
Dubai	19,118	24,186	29,130	Dubai	33,944	39,228	44,419
% of Sector	***43.9%***	***44.1%***	***42.1%***	***% of Sector***	***60.2%***	***57.1%***	***56.6%***
Sharjah	5,277	6,467	8,092	Sharjah	5,882	9,024	10,291
% of Sector	***12.1%***	***11.8%***	***11.7%***	***% of Sector***	***10.4%***	***13.1%***	***13.1%***
Other Emirates	3,146	4,159	5,203	Other Emirates	3,903	4,624	4,986
% of Sector	***7.2%***	***7.6%***	***7.5%***	***% of Sector***	***6.9%***	***6.7%***	***6.4%***

Source: KAMCO Research & UAE National Bureau of Statistics

The robust growth in the construction and real estate sectors witnessed in the UAE from 2006-08 was driven by Dubai and Abu Dhabi.

Overall the UAE's Real Estate Sector has more than doubled in value from 2005 to 2008 as it grew at a CAGR of 29% from AED 36.2 billion (USD 9.8 billion) in 2005 to AED 78.5 billion (USD 12.5 billion) in 2008 whilst the Construction Sector also recorded notable levels of growth since 2005, growing at a CAGR of 21% to AED 69.2 billion (USD 18.8 billion) in 2008 compared to AED 39 billion (USD 10.8) in 2005. The Construction and Real Estate Sector's extensive levels of growth have in large part been driven by the infrastructure and building boom witnessed within the emirates - namely Dubai and Abu Dhabi during the past few years.

Public Finance

Revenues, Expenditures & Surplus

Oil & gas revenues represent over 70% of the UAE's total revenues.

From 2001 to 2007 oil & gas revenues consistently represented over 70% of total revenues, with oil & gas revenues growing from AED 51.6 billion (USD 14.1 billion) in 2001 to AED 176.3 billion (USD 48 billion) in 2007. Thus, any major fluctuations in oil prices are directly reflected within the government's oil & gas revenue stream as was seen in 2001 and 2002, respectively, where the UAE ran a budget deficit on the back of a decline in oil revenues, which dropped from AED 51.6 billion (USD 14.1 billion) in 2001 to AED 40.9 billion (USD 11.1 billion) in 2002. The rise in oil revenues on the back of higher export earnings between 2003 to 2005 is in large part attributable to the OPEC increase in oil production due to a rise in global demand for oil, which ultimately further led to an increase in total revenues during the corresponding periods. As a result, the rise in world demand for oil during the 2003 to 2005 period led the UAE to record a budget surplus of AED 39.47 billion (USD 10.7 billion) in 2005. The UAE managed to further grow its budget surplus the following years as it almost doubled to AED 69 billion (USD 18.8 billion) in 2007; thereby indicating that the UAE's budgetary position is highly reliant on changes in oil prices.

Table 7. Public Finance -Total Revenues and Expenditures

(AED millions)	2001	2002	2003	2004	2005	2006	2007
Oil & Gas Revenues	**51,648**	**40,926**	**56,738**	**73,322**	**111,377**	**164,775**	**176,265**
Other Revenues	16,985	16,292	20,274	21,429	32,528	36,391	52,485
Total Revenues	**68,633**	**57,218**	**77,012**	**94,751**	**143,905**	**201,166**	**228,750**
Current Expenditures:							
Wages & Salaries	14,019	14,612	15,159	15,628	16,654	17,693	21,265
Goods & Services	21,553	22,187	23,801	25,032	24,383	26,177	35,420
Subsidies & Transfers	18,750	14,782	10,408	11,666	18,916	30,806	29,692
Other	22,683	21,021	24,885	28,658	24,302	29,231	34,937
Total Current Expenditures	**77,005**	**72,602**	**74,253**	**80,984**	**84,255**	**103,907**	**121,314**
Capital Expenditures	**13,283**	**12,470**	**16,028**	**15,207**	**14,042**	**15,225**	**17,271**
Loans & Equity	5,171	1,544	1,152	83	6,133	6,845	21,141
Total Expenditures	**95,459**	**86,616**	**91,433**	**96,274**	**104,430**	**125,977**	**159,726**
Surplus / (Deficit)	**(26,826)**	**(29,398)**	**(14,421)**	**(1,523)**	**39,475**	**75,189**	**69,024**

Source: KAMCO Research & UAE National Bureau of Statistics

Capital expenditures grew at a CAGR of 4% over the period 2001 - 2007.

In terms of expenditures on the other hand, current expenditures, which is further broken down into: wages & salaries, goods & services, subsidies & transfers, has on average represented 81% of total expenditures from 2001 up until 2007. Similarly, capital expenditures throughout the examined period also reveal an upward trend as they have grown at a CAGR of 4% from AED 13.3 billion (USD 3.6 billion) in 2001 to AED 17.3 billion (USD 4.7 billion) in 2007, indicating the continued role the UAE government has been playing in further developing the country's infrastructure over the past years.

Balance of Payments

In line with the effects of the global financial crisis, UAE exports slumped 20% in 2009 on the back of a drop in oil exports.

The total value of exports in the UAE reached AED 878.5 billion (USD 239.2 billion) in 2008 compared to AED 656 billion (USD 178.6) in 2007, an increase of 34% led by the rise in crude oil and gas exports. Crude oil exports rose 40% in 2008 to reach AED 313.7 billion (USD 85.4 billion) while gas exports increased by 37% to stand at AED 39.1 billion (USD 10.6 billion); thus leading total hydrocarbon exports to register a 38% growth in 2008 to reach AED 374.9 billion (USD 102.1 billion) versus AED 271.1 billion (USD 73.8 billion) in 2007. However in 2009, the total value of exports dropped 20% to AED 705.8 billion (USD 192.2 billion) on the back of declines witnessed in crude oil and gas exports, which slumped 37% and 22% to AED 198.77 billion (USD 54.1 billion) and AED 30.50 billion (USD 8.3 billion), respectively. The decline in exports comes in line with drop in oil prices compared to the highs registered during the first half of 2008 and lower world demand for oil. More importantly, it's worth noting that crude oil exports account for over 80% of the UAE's hydrocarbon exports; hence revealing the significant impact any fluctuations in the price of oil have on the country's economic indicators.

Table 8. UAE Trade Balance

(AED millions)	2007	2008	2009*
Hydrocarbon Exports:			
Crude Oil	224,647	313,735	198,773
Petroleum Products	17,981	22,100	20,000
Gas	28,500	39,080	30,500
Total Hydrocarbon	**271,128**	**374,915**	**249,273**
Non-Hydrocarbon Exports:			
Free Zone	83,700	97,455	96,200
Other	42,068	60,359	66,035
Total Non-Hydrocarbon	**125,768**	**157,814**	**162,235**
Re Exports	**259,124**	**345,779**	**294,320**
Total Exports & Re Exports	**656,020**	**878,508**	**705,828**
Less: Total Imports	**485,169**	**647,417**	**551,068**
Trade Balance (FOB)**	**170,851**	**231,091**	**154,760**

** 2009 Preliminary Estimates - Central Bank of the UAE*
*** Free on Board*
Source: KAMCO Research & UAE National Bureau of Statistics

Non-Hydrocarbon exports rose 3% in 2009 to AED 162 bln (USD 44 bln.)

In 2009 on the other hand, Non-Hydrocarbon exports according to preliminary estimates registered a modest increase of 3% to stand at AED 162.2 billion (USD 44.2 billion) compared to the 25% rise recorded in 2008 where non-hydrocarbon exports stood at AED 157.8 billion (USD 43 billion). In terms of the UAE's main non-oil exporting countries by value, in 2008, they include India, Qatar, and Bahrain accounting for 29.7%, 12.8%, and 6.0% of non-oil exports respectively. As for free zone exports on the other hand, they witnessed a decline of 1% to AED 96.2 billion (USD 26.2 billion) in 2009 versus the 16% increase posted in 2008; consequently revealing the negative implications the UAE is set to face as a result of the global financial crisis. Re-

Main re-exporting countries for the UAE include India and Iran, accounting for over a third of the UAE's re-exports.

exports also dropped in 2009 to AED 294.3 billion (USD 80.1 billion) versus AED 345.8 billion (USD 94.1 billion) in 2008, representing a 15% decline. Major re-exporting countries for the UAE include India and Iran, accounting for over a third of the UAE's re-exports. In 2008, India and Iran represented 37% of the UAE's total re-exports. Accordingly, in line with the fall in foreign trade, the value of total exports and re-exports slumped 20% in 2009 to AED 705.8 billion (USD 192.2 billion) compared to AED 878.5 billion (USD 239.2 billion) in 2008. As a result, the effects of the global financial crisis and slowdown in economic activity became highly notable among the UAE's trade figures in 2009 and may likely continue to do so in the coming years.

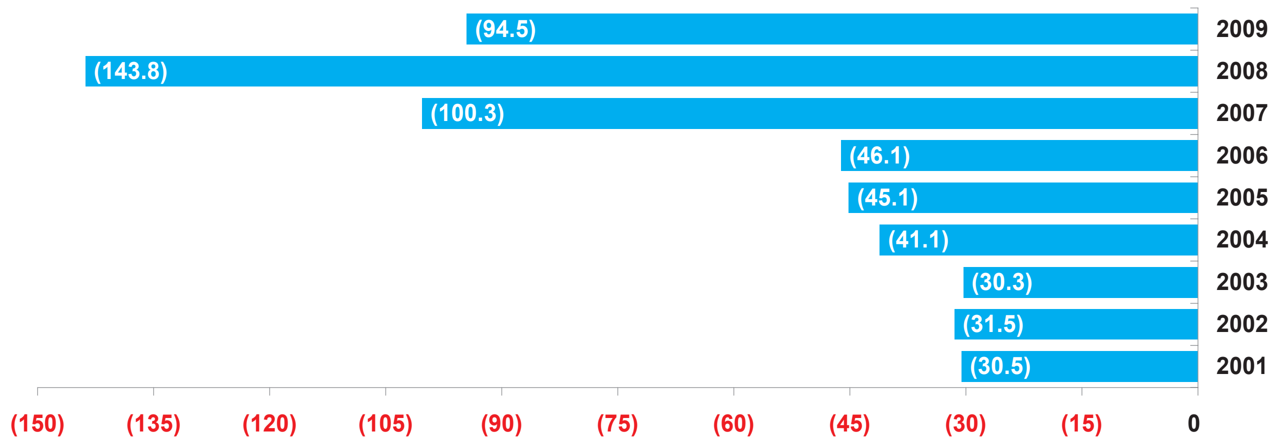
An increase in domestic demand led total imports to rise up until 2008. However in 2009, imports fell 15%.

Likewise, Imports (FOB) registered a decline in 2009 of 15% to AED 551.1 billion (USD 150 billion) compared to AED 647.4 billion (USD 176.3 billion) the previous year. However, prior to the start of the financial crisis, the total value of imports maintained an upward trend growing at a CAGR of 23% the past seven years from AED 120.5 billion (USD 32.8 billion) in 2001 to AED 647.4 billion (USD 176.3 billion) in 2008, indicating an increase in domestic demand, further emphasizing how the UAE's economy and GDP are gradually being driven by demand. In terms of the sources of imports, imports from China in 2008 constituted the largest portions of imports with an 11.3% share of total imports, followed by India, US, and Japan with an 11%, 7.9% and 7.5% share respectively.

Despite the drop in trading activity, the UAE trade balance remains at a surplus. But the UAE's non-oil trade balance has been at a deficit for the past 9 years.

Despite the declines witnessed in trading activities, which led the total trade balance of the UAE to slump 34% in 2009, its trade balance continues to remain at a hefty surplus of AED 154.8 billion (USD 42.1 billion) compared to AED 231.1 billion (USD 62.9 billion) in 2008. However, the trade balance excluding oil is in a trade deficit and has been so for the past 9 years (Chart 2). But in 2009, with the sharp drop in oil exports and rise in non-hydrocarbon exports, the trade deficit narrowed to AED 94.51 billion (USD 25.7 billion) compared to AED 143.82 billion (USD 39.2 billion) in 2008.

Chart 2. Evolution of UAE Non-Oil Trade Balance Deficit (AED Blns)



Source: KAMCO Research, UAE National Bureau of Statistics, & Central Bank of the UAE

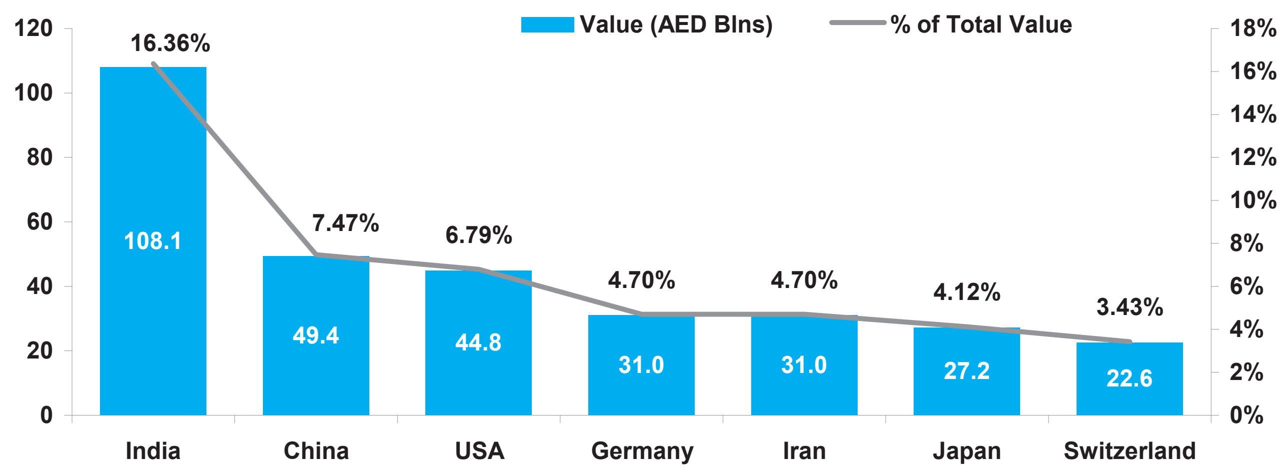
Foreign Trade

Major trading partners of the UAE include India, China, the US, Japan, and Germany.

All in all, as is evident, foreign trade plays an essential part in the UAE's economy, more importantly oil. India, China, the USA, Germany, and Iran play an essential role within the UAE's trade as they represent 40% the UAE's trade, as seen in Chart 3 below. As a result, it is likely that in the future the UAE will look to maintain and further strengthen its ties with major business and trading partners while also developing ties with new partners as a means of increasing its trading activity while enabling it to further diversify its economy away from oil, as stipulated through each respective emirate's long-term strategic plans. Reaching out to new countries to explore areas of economic cooperation with the goal of building strategic relations to benefit the UAE economy will enable the UAE to further strengthen its position on the world map as the UAE is a gateway to the Middle East and Asian markets as well. However, the world's economic situation caused growth in trade to slow in 2009 as the total value of the UAE's trade reached AED 660.4 billion (USD 179.8 billion) compared to AED 788.9 billion (USD 214.8 billion) in 2008, representing a 16% drop in foreign trade. Trade with major foreign partners slumped on the back of lower demand and economic activity - in line with the economic slowdown. As a result, the downward trend may continue in 2010 and 2011. Nonetheless the trading ties that the UAE has developed will enable the UAE to be in good standing especially as the Emirate diversifies its economy. As a matter of fact, the benefits of the implementation of the UAE's strategy to reduce its dependency on oil are now evident, especially during the past several years. Over the past 9 years, non-hydrocarbon exports and re-exports have experienced high levels of growth, growing at a CAGR of 23% to reach AED 456.56 billion (USD 124.3 billion) in 2009 compared to AED 89.99 billion (USD 24.5 billion) in 2001.

The value of foreign trade in the UAE fell 16% in 2009 to AED 660 bln compared to 2008.

Chart 3. Total Trade of the UAE by Value with Major Countries in 2009



Source: KAMCO Research & UAE Ministry of Economy

Monetary Developments

Inflation

Inflation rose sharply in 2008 to 12.3% on the back of rising costs, yet it eased in 2009 to 1.56%.

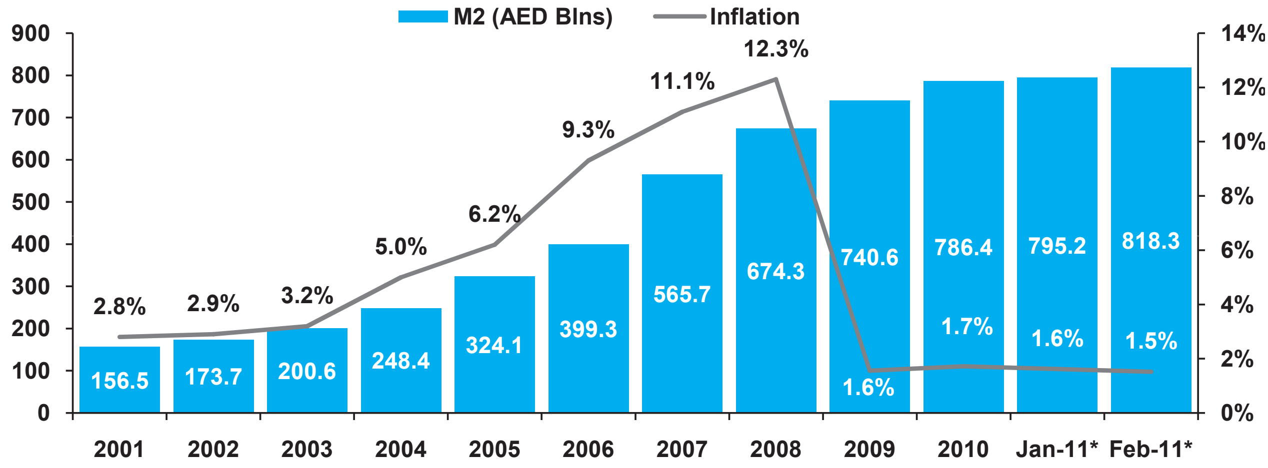
Inflation rates in the UAE have been increasing continuously since 2001, rising from 2.8% in 2001 to 12.3% in 2008. The sharp rise in inflation rates from 2007 to 2008 came in line with the rapid pace of economic growth and development that was taking place in the UAE. The surge in inflation rates more importantly throughout 2008 came on the back of rising housing, rental prices, and food costs due to higher commodity prices at a global level and a drastic increase in the emirate's import bill due to a weakening U.S. dollar against the Euro and other major currencies. Nonetheless, in line with the economic downturn, the correction the emirate of Dubai witnessed in its real estate market, falling commodity prices, and a strengthening in the US dollar led inflation rates to reverse their upward trend. As a result, inflation rates eased and dropped to its lowest at 1.56% in 2009 compared to the record levels registered in 2008, consequently illustrating how housing prices and rentals witnessed a correction after bottoming out in June 2009. Although inflation is expected to pick up in the coming periods, it is expected to remain within the single digits, as a result of the recovery in domestic demand on the back of improving lending conditions, improved investor sentiment, and the gained momentum in the pace of economic recovery.

Money Supply

Money supply (M2) grew at a CAGR of 20% from 2001-10 to reach AED 786.4 bln (USD 214.1 bln) in 2010.

Additionally, the peg of the UAE's currency with the US dollar leaves the Central Bank of the UAE with limited options to curb the rates of inflation and manage the money supply in the country. As a result, money supply growth is to a certain extent managed by aligning domestic interest rates with interest rate developments in the U.S. Accordingly, by following interest rate cuts in the U.S, interest rates in the UAE also witnessed numerous cuts. Thus, the cut in rates which led to a drastic rise in credit growth, coupled with the government's expansionary fiscal policies as seen in Chart 4, led to high inflationary pressures. In line with GDP growth, monetary indicators also exhibited positive growth. The growth in the broad measure of money supply as measured by M2 grew at a CAGR of 19.6% to AED 786.4 billion (USD 214.1 billion) in 2010 from AED 156.5 billion in 2001 (USD 183.6 billion.) After double digit increases in previous years monetary aggregates in the UAE slowed down in 2009 and 2010. M2 grew moderately by 6.2% in 2010 to AED 786.4 billion (USD 214.1 billion) over its level at the end of 2009. Likwise, during the first two months of 2011 M2 grew 4.1% to AED 818.3 billion (USD 222.8 billion) at the end of Feb-11 compared to its value at the end of 2010.

Chart 4. UAE Historical Inflation Rates vs. Growth in Money Supply (M2)



** Inflation figure is annual from Jan-11 vs Jan-10*
** Inflation figure is annual from Feb-11 vs Feb-10*
Source: KAMCO Research, Central Bank of the UAE and UAE National Bureau of Statistics

In 2010 inflation rates rose marginally, with inflation reaching 1.7% versus 1.6% in 2009.Whereas in Feb-11 inflation stood at 1.52% vs. Feb-10.

As for 2010, the rate of inflation stood at 1.7%, slightly higher than the previous year. Despite the modest rise, that came on the back of rises witnessed within the majority of the groups in the consumer price basket, the continued downward trajectory of housing and rents upholded the rate of inflation in the low digit range compared to previous years. In fact, during the first two months of 2011 inflation rates decreased on a month over month basis driven by the drop in housing prices. At the end of Feb-11 the Consumer Price Index (CPI) decreased by 0.27% compared to its value at the end of Jan-11 on the back of declines witnessed in the Housing, Communications, and Health Care groups. Yet it increased 1.52% compared to its value at the end of Feb-10. Accordingly, estimates within the IMF's latest report on the UAE indicate that inflation is forecast to increase to 3% in 2011. As a result, the rise in housing supply is expected to place downward pressure on housing prices and rentals, which account for a significant portion of the price basket, thereby maintaining the rate of inflation within the single digit range.

Real Estate Market in the UAE

The move by Dubai top open its real estate market to foreign ownership led the real estate sector to witness record levels of growth up until the first half of 2008.

The real estate sector in the UAE has experienced record levels of growth in the past several years driven by economic growth, rising incomes, abundant levels of liquidity, capital inflows by foreign investors and a growing expatriate population. Property prices, namely in Dubai, soared up until the first half of 2008 before witnessing a major correction as the effects of the global financial crisis rippled in to the emirate. The rise in prices is attributable to the high speculations on properties which inflated prices along with the increase in the expatriate population and change in foreign ownership laws, which enabled foreign investors to not only invest and own in real estate, but also access residency visas. The move by Dubai, which has been in the forefront in relaxing foreign ownership laws, was followed by the establishment of renowned state owned developers Emaar Properties and Al Nakheel

Properties, as they were the developers of the manmade island of Palm Jumeirah and Jebal Ali Industrial and Free Trade Zone, which are open to foreign investors. This as a result led to a change in the population dynamics, as more expatriates started to enter the country to take on more promising employment opportunities prompted by the economic boom.

The correction in the real estate market after the UAE felt the effects of the global crisis led to a large drop in demand for properties.

However, a sudden decline in demand for real estate was evident in the post crisis period triggered by the tight credit markets and the collapse in asset prices worldwide. Expatriate population growth also slowed down after employment opportunities became scarce. The demand among foreign investors for real estate as an investment also dropped due to a lack of funding as liquidity conditions tightened worldwide and investor confidence weakened; thus reflecting on the UAE economy and revealing that the UAE was not immune to the effects of the global economic downturn.

The Banking Sector

Banks' Credit Facilities Allocation by Sectors

Credit facilities grew 47.5% in 2008 with the real estate and construction sectors representing 13.6% and 13.1% of total credit facilities.

Credit growth spiked by 47.5% in the UAE in 2008 to reach AED 924.4 billion (USD 251.7 billion) (Table 9), with loans to the real estate, trade, and construction sectors accounting for 13.6%, 10.5%, and 13.1% respectively, of total credit facilities extended by local banks. As is evident, banks' credit portfolios in the UAE have extensive exposures to the aforementioned sectors which together constituted around 40% of banks' loan portfolios. In 2009, on the other hand, credit growth slowed down extensively to AED 958.6 billion (USD 261 billion), a 3.7% rise in comparison to the double digit growth recorded in 2008. Likewise in 2010 credit growth remained sluggish after growing marginally by 1.4% to AED 972.1 billion (USD 264.6 billion) compared to 2009.

Table 9. UAE Banks' Credit Facilities by Economic Activities (AED millions)

(AED millions)	2007	2008	2009	2010
Agriculture	1,605	2,391	642	712
% of Total	*0.3%*	*0.3%*	*0.1%*	*0.1%*
Mining & Quarrying	7,782	11,853	6,729	6,717
% of Total	*1.2%*	*1.3%*	*0.7%*	*0.7%*
Manufacturing	32,840	45,668	44,192	45,897
% of Total	*5.2%*	*4.9%*	*4.6%*	*4.7%*
Electricity, Gas, Water	12,094	20,250	24,886	23,742
% of Total	*1.9%*	*2.2%*	*2.6%*	*2.4%*
Construction	66,003	119,251	126,010	122,683
% of Total	*10.5%*	*12.9%*	*13.1%*	*12.6%*
Trade	102,444	124,243	100,489	97,087
% of Total	*16.3%*	*13.4%*	*10.5%*	*10%*
Transport, Storage, Communication	21,211	25,039	27,523	26,450
% of Total	*3.4%*	*2.7%*	*2.9%*	*2.7%*
Fin. Institutions	35,637	72,772	86,150	81,879
% of Total	*5.7%*	*7.9%*	*9.0%*	*8.4%*
Govt.	58,402	72,260	91,873	99,982
% of Total	*9.3%*	*7.8%*	*9.6%*	*10.3%*
Personal Loans (for business)	106,449	160,103	171,352	181,949
% of Total	*17.0%*	*17.3%*	*17.9%*	*18.7%*
Personal Loans (for consumption)	41,923	67,039	66,561	65,172
% of Total	*6.7%*	*7.3%*	*6.9%*	*6.7%*
All Others	140,304	203,516	212,181	219,837
% of Total	*22.4%*	*22.0%*	*22.1%*	*22.6%*
Total Credit Facilities	**626,694**	**924,383**	**958,588**	**972,107**
y-o-y % Change	*16.6%*	*47.5%*	*3.7%*	*1.4%*

Source: KAMCO Research & Central Bank of the UAE

Credit facilities extended to the private sector declined in 2009 and 2010 while credit facilities to the government rose 27% in 2009 & 9% in 2010, reflecting the government's expansionary fiscal policies.

Additionally, credit facilities extended to the private sector followed a downward trend in 2010 after dropping to AED 720.6 billion (USD 196.2 billion) compared to AED 723.9 billion (USD 197.1 billion) in 2009 (Table 10), representing a 0.4% decline. As a result, due to the prevalence of challenging market conditions within the private sector in 2009 and 2010, banks began lending to the government and public sector. In fact, credit facilities to the government increased by 27% to AED 91.9 billion (USD 25 billion) in 2009 versus AED 72.3 billion (USD 19.7 billion) in 2008 while growing further by 8.8% during 2010 to reach AED 99.98 billion (USD 27.2 billion) in 2010. Hence reflecting the UAE government's goals towards expanding its fiscal policies and directing its efforts towards the promotion of infrastructure projects to support the creation of jobs and economic activity.

Banks' Capitalization Remains Sound

The UAE's banking capitalization remains sound although local banks remain challenged with rising loan impairments.

Further along, the UAE banking sector's capitalization remains sound and is sufficient to absorb debt problems faced by Dubai Government Related Entities (GRE). The financial turmoil has put the banking sector in the UAE on a test as local banks are facing difficulties particularly with rising retail and corporate impairments, debt restructuring related to Dubai GREs, slump in the real estate market along with funding and liquidity pressures triggered by a reduced lending appetite and high loan-to-deposit ratio resulting in a stagnation in the sector. Also, the banking sector in the UAE is highly exposed to the construction sector (13% of total loans) and the highly speculative real estate sector. Personal loans for business purposes constitute around 18.7% of banks' loan portfolio; it is believed that a significant portion of those loans is directed to the real estate market. Trade and Manufacturing sectors also contribute to a significant portion of the banking loan portfolio with a percentage contribution of 10% and 4.7% respectively as of December 2010.

Table 10. Breakdown of Credit Facilities by Sector (AED millions)

Credit Facilities by Sector	Dec. 2007	Dec. 2008	Dec. 2009	Dec. 2010
Government	**58,402**	**72,260**	**91,873**	**99,982**
Official Entities	**39,823**	**47,368**	**68,700**	**73,993**
Other Financial Institutions	**36,941**	**74,930**	**74,149**	**77,515**
Private Sector	**491,528**	**729,825**	**723,866**	**720,617**
Commercial Bills	12,772	20,338	18,792	22,616
Real Estate Mortgage Loans	56,471	125,834	141,714	163,185
Loans, Advances, & Overdrafts	422,285	583,653	563,360	534,816
Total Credit Facilities	**626,694**	**924,383**	**958,588**	**972,107**

Source: KAMCO Research & Central Bank of the UAE

Real Estate Mortgage Loans

Real estate mortgage loan growth slowed down extensively in 2009 and 2010 on the back of lower demand and risk appetite among investors.

After increasing a staggering AED 69.3 billion (USD 18.9 billion) in 2008, mortgage loans rose by AED 15.9 billion (USD 4.3 billion) in 2009 to AED 141.7 billion (USD 38.6 billion.) Similarly, in 2010 real estate mortgage loans reached AED 163.2 billion (USD 44.4 billion), rising AED 21.5 billion (USD 5.8 billion.) As is evident, real estate mortgage loan growth slowed down in 2009 and 2010 following the fall in demand and lower risk appetite among investors on the back of tight credit markets and a more challenging economic environment. Although credit conditions remain tight today, they have shown a slight improvement, as credit facilities recorded a growth of 1.4% in 2010. Also, despite the slowdown in growth of mortgage lending activity, it has picked up as real estate lending reached AED 163.2 billion (USD 44.4 billion) at the end of 2010 - indicating a gradual recovery in the prperty market and improvement in investor sentiment.

Banks' Deposits Snapshot

UAE deposits with foreign banks have been growing while foreign deposits with local banks have been decreasing.

UAE banks have also managed to diversify their deposit base as deposits with foreign banks grew by 38% in 2010 to AED 76.4 billion (USD 20.8 billion) versus AED 55.5 billion (USD 15.1 billion) in 2009. Foreign banks' deposits in UAE banks, on the other hand, slumped 45% in 2010 to AED 51.5 billion (USD 14 billion) against AED 93.2 billion (USD 25.4 billion) the previous year, indicating the flight of foreign capital and the loss of confidence in the UAE's financial system by foreign banks, especially as a result of Dubai's debt troubles.

Loan-to-Deposit Ratio

Table 11. UAE Banks' Loan to Deposit Ratio

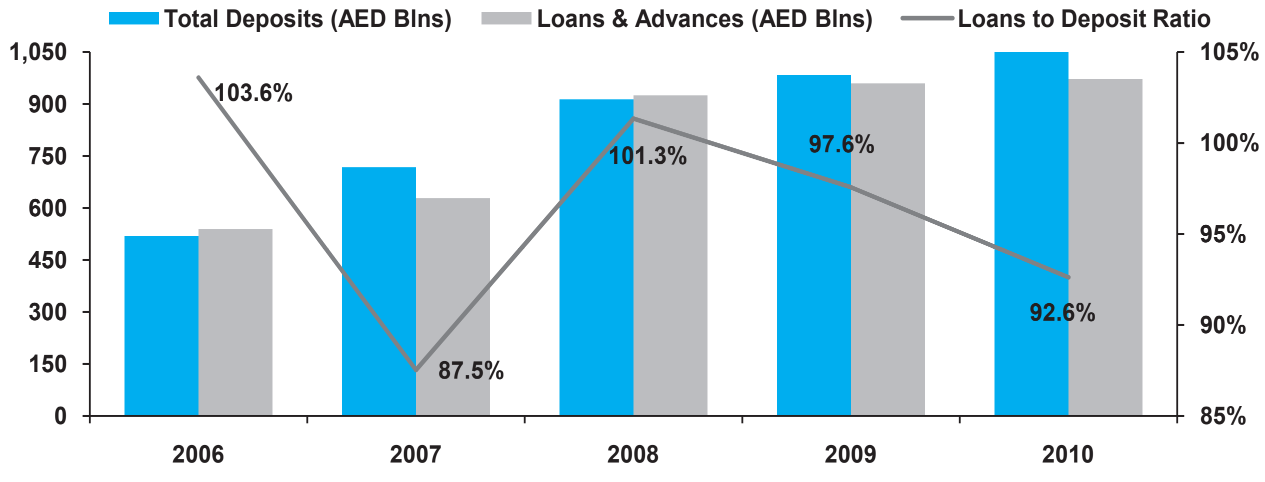
(AED millions)	2006	2007	2008	2009	2010
Loans & Advances	537,425	626,694	924,383	958,588	972,107
Total Deposits	518,806	716,021	912,170	982,579	1,049,628
Loan to Deposit Ratio	***103.6%***	***87.5%***	***101.3%***	***97.6%***	***92.6%***

Source: KAMCO Research & Central Bank of the UAE

UAE finances look healthier today with the loans to deposit ratio standing at 92.6% as of Dec-10, down from the peak of 101.3% in 2008.

On a whole, the UAE's banking sector finances look healthier today as deposits have registered considerable growth since 2008. Deposits grew almost every month throughout 2009, while also growing in 2010 to cross the one trillion mark at AED 1.05 trillion (USD 286.9 billion.) Loans and advances as of Dec-10, on the other hand, have remained tight with total credit increasing slightly by 1.4% to AED 972.1 billion (USD 264.6 billion) compared to AED 958.6 billion (USD 261 billion) as of Dec-09, illustrative of the cautiousness of banks in lending as economic conditions remain challenging. However, as a result of the increase in deposits, UAE banks' loan-to-deposit ratio has improved from 101.3% in 2008 to 92.6% as of Dec-10. As a result, banks have been successful in gradually reducing their loan to deposit ratio below the UAE Central Bank's ceiling of 100%.

Chart 5. UAE Banks' Loan-to-Deposit Ratio (2006-Oct. 2010)



Source: KAMCO Research & Central Bank of the UAE

UAE Banks' Loan Loss Provisions

Total provisions of UAE banks in 2010 surged to AED 56.8 bln vs. AED 43.8 bln in 2009.

Further along, in terms of provisions booked by UAE banks, the level of provisioning increased notably once the effects of the global financial crisis struck the UAE. As banks undertook provisioning on troubled retail and real estate loans along with their exposure to troubled Saudi conglomerates. Central Bank figures indicate that total provisions (specific provisions for nonperforming loans & general provisions) as of Dec-10 stood at AED 56.8 billion (USD 15.5 billion) up by 31% from Dec-09 where they stood at AED 43.3 billion (USD 11.8 billion.) The rise in provisioning by banks in 2010 in comparison to 2008 and 2009 comes in line with the new framework identified by the Central Bank of the UAE (CBUAE) in Nov-10, which requires lenders to book provisions on a quarterly basis rather than waiting until the end of the year, to provide a more realistic financial position of banks. As result, the impact of the Central Bank's new regulation will be evident within the 2010 fourth quarter financial statements of lenders and onwards. Also, in December 2010 the Central Bank, asked banks to increase provisioning on their exposure to SAAD and Al Gosaibi groups to 80% by the end of the 2010. This will lead specific provisions on non-performing loans to increase in the short-term horizon as the two Saudi conglomerates remain locked in a complex legal dispute involving USD 22 billion worth of debt. Therefore, the banking sector may come under increased pressure in the short-term horizon as banks continue to clean up their balance sheets whilst looking to reverse any weakening in the quality of their asset base.

UAE Creditworthiness

In spite of the debt troubles of Dubai World, the UAE managed to maintain its creditworthiness amongst other government related agencies.

In spite of the challenging financing environment that continues to prevail as a result of the financial crisis and the shadows that cast over the restructuring efforts of debt laden Dubai World, the UAE has managed to maintain its creditworthiness as evident by the credit ratings it has received for the UAE federal government, Abu Dhabi government and its government related entities such as Abu Dhabi based Mubadala. In April of 2009 the government of Abu Dhabi raised USD 3 billion under its USD 10 billion Global Medium Term Note Program, which pays 400 and 420 basis points above comparative U.S. treasuries for its 5-year and 10-year notes respectively. The funds were used to finance part of the government's massive infrastructure projects. Additionally, government related entities (GREs) such as Al Dar Properties and Mubadala were successful in raising USD 1.25 billion and USD 1.75 billion respectively in 2009. Dubai, as well, despite being plagued with restructuring issues surrounding Dubai World, was successful in issuing USD 10 billion of a USD 20 billion bond program in 2009, which was fully subscribed by the Central Bank of the UAE. Funds raised were primarily used to meet the financing needs of Dubai based GREs.

The inclusion of the UAE in FTSE's Global Equity Index Series as a secondary emerging market and the final restructuring of DW debt places the UAE in a stronger position today since it surrendered to the effects of the crisis.

Moreover, in 2010 Dubai was also successful in launching a USD 1.25 billion bond - its first foreign bond issue in 2010. The dual-tranche Eurobond, drew strong investor appetite as the order book exceeded USD 5 billion. The first tranche which is valued at USD 500 million matures in five years and carries a yield of 6.7% while the remaining USD 750 million ten year tranche yields 7.75% - an attractive yield given market performance today. As a result, taking cue of the emirate's bond issue Emaar Properties - Dubai's property builder - launched a USD 375 million convertible bond issue with an increase option of USD 125 million, which matures in 2015 and is set to be listed on the

Luxembourg Stock Exchange. Additionally, the recent categorization of the UAE as a secondary emerging market by the London Financial Times Stock Exchange (FTSE) Group, and the inclusion of the country within its Global Equity Index Series on the 17^{th} of September 2010 - ultimately leading an estimated 21 companies to be included within the index clearly place the UAE in a stronger position since it surrendered to the effects of the global financial crisis. Also, in March of 2011, DW signed its final agreement to restructure USD 14.7 billion of its debt with all of its creditors. According to the agreement, DW will divide its liabilites in two tranches - with USD 4.4 billion to be repaid in five years and the remaining USD 10.3 billion in eight years.

Standard & Poor's affirmed its 'AA' long-term and 'A-1+' short-term credit ratings on Abu Dhabi with a stable outlook.

Additionally, Standard & Poor's (S&P) in Nov-10 affirmed its 'AA' long-term and 'A-1+' short-term sovereign credit ratings on Abu Dhabi with a stable outlook. According to S&P's report ''Abu Dhabi's economy is weathering the global downturn well, despite increased contingent liabilities from the financial sector and Dubai,'' while the ratings on the emirate are ''supported by the government's very strong asset position'' which provides it with financial flexibility to face any additional unforeseen challenges.

Population

End of year estimates indicate the UAE population reached 8.26 million in 2010.

According to end of year estimates of the UAE National Bureau of Statistics, the UAE's population reached 8.26 million inhabitants compared to 5.01 million inhabitants in 2006, representing a growth of 65% in four years - as strong economic growth attracted workers from all over the world. The majority of the country's Emarati population is concentrated in the emirates of Abu Dhabi, Dubai and Sharjah respectively; with each emirate representing 43%, 18%, and 16% of the local population in 2010. In line with the strong economic growth witnessed in the years prior to the global financial crisis, the demand for labor increased as evident by the growth registered of Non-National inhabitants. At the end of 2008, the population of Non-National inhabitants recorded a growth of 30% to 7.17 million inhabitants.

Table 12. UAE Population by Nationality (End of Year Estimates)

Population by Nationality	2006	2007	2008	2009	2010
National	851,164	877,741	904,857	933,381	947,997
Non-National	4,161,220	5,341,265	7,168,769	7,266,615	7,316,073
Total	**5,012,384**	**6,219,006**	**8,073,626**	**8,199,996**	**8,264,070**

Source: KAMCO Research & UAE National Bureau of Statistics

Non-citizens make up the majority of the UAE population.

However, with the slowdown in economic activity, which led to a drop in demand for labor, the growth in the Non-National population slowed down considerably. In 2009 the growth rate of non-nationals stood at 2% reaching 7.27 million inhabitants. Nonetheless, non-nationals continue to outnumber nationals, representing an average of 87% of the total population from 2006 to 2010. The population of non-citizens stood at 7.32 million in 2010, hence reflecting that expatriates continued to migrate to the UAE in 2010, yet in lower numbers compared to previous years.

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