UAE ECONOMIC REPORT

FOR THE EMIRATES, REGIONAL TURMOIL SEEMS TO HAVE A SILVER LINING

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- UAE somehow benefitted from last year's regional turmoil
  As the UAE does not share the political and economic characteristics of regional countries under turmoil, no contagious unrest scenario was reported towards the Emirati landscape. On the contrary, the Emirates are seemingly profiting from the indirect spillover effects of the redirection of business, trade and touristic flows from other countries in the Arab MENA region.

- Notwithstanding the corollary turmoil impact on oil prices
  The UAE, still significantly reliant on its hydrocarbons sector with the share of oil-related activity accounting for about 27% of total GDP and oil revenues representing about 82% of total fiscal revenues, has benefited from the 27% surge in average oil prices in 2011. This has helped bolster UAE fiscal and external positions and support real GDP growth that recorded a sound 3.3% in 2011, with nominal output regaining its pre-crisis level of US$ 360 billion.

- But the full recovery from recent crisis seems to be a protracted process
  In fact, the government has been recently cutting its spending on construction related projects, due to concerns about the significant oversupply in the property market, an increase in the country's financial commitments and the slowdown in the global economy. While key projects remain in the pipeline, some contracts have been delayed or possibly cancelled, with the ongoing prioritization of infrastructure projects amid atypical global market conditions.

- Monetary policy easing targets growth within contained inflation
  Monetary conditions in the United Arab Emirates were marked in 2011 by a sustained low level of inflation (below 1%), moderate expansion in Money Supply (6.2%) and a tangible rise in the Central Bank's foreign assets (circa 25%). Looking forward, the Central Bank of the UAE would remain focused on managing liquidity and would be turning its attention to controlling inflation only if inflationary pressures re-emerged in the event of fast output expansion.

- A relative improvement in banking conditions was reported this year
  Measured by total assets of operating banks, banking activity grew by a moderate 4.2% during the first 11 months of 2011, with lending activity posting a mild recovery from relatively stagnating volumes in the immediate post-Dubai crisis period. The US$ 11.8 billion progression in lending volumes is mostly tied to public sector related loans while private lending is still suffering from corporate deleveraging. Amidst a growing fiscal driven global distress creating pressures on bank operating conditions, UAE banks benefit from higher capitalization, more stable funding resources, more liquid assets, and less reliance on foreign funding than at the onset of the previous crisis episodes.

- UAE capital markets performance was rather erratic with mixed results
  While the UAE fixed income markets somehow benefited from a relative improvement in Dubai risk perception and Abu Dhabi's safe-haven status in 2011, the country's equity markets witnessed drops in prices year-on-year (17.0% for Dubai market and 11.7% for Abu Dhabi market) on the back of regional turmoil, concerns about the European debt crisis and the sluggish global economic outlook. Amid relatively low trading volume and weak market efficiency, the UAE missed two opportunities in 2011 to get upgraded by MSCI from frontier market to emerging market status.

- The Emirates are in a better position to gradually overcome threats at the horizon
  The indebted Emirate of Dubai is indeed likely to be able to manage the rollover of its 2012 debt maturities through a combination of internal cash generation, potential asset sales, market refinancing and Abu Dhabi government support. At the property sector level, the stabilization of the UAE real estate market conditions suggest the market has somehow bottomed out, with a potential pick-up in activity in the year to come. At the financial sector level, the UAE is in a better posture to weather adverse shocks and global headwinds on the background of new banking sector legislation and improving domestic conditions which should help UAE-based banks to gradually overcome asset quality and loan exposure issues.

The UAE Economic Report can be accessed via internet at the following web address: http://www.banqueaudi.com

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The UAE economy is recovering from previous headwinds, driven by a pick-up in trade, tourism and public spending, supported by higher oil prices. Real GDP recorded a sound 3.3% growth in 2011, with nominal output regaining its pre-crisis level of US$ 360 billion. The United Arab Emirates have benefited from increased investments looking for diversification within the region, along with the spillover effects of higher oil prices benefitting the economy as a hydrocarbon exporter on the background of abundant oil and gas reserves, the seventh largest in the world. The Arab Spring has indeed diverted tourists, businesses and financial capital into Dubai while a significant headway has been made on debt restructuring in the Emirate's troubled government related entities.

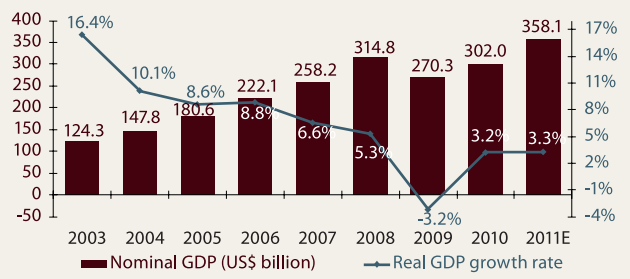
But the full recovery from recent crisis seems to be a protracted process, with the economy not booming yet. The government has been cutting its spending on construction related projects, due to concerns about the significant oversupply in the property market, an increase in the country's financial commitments and the slowdown in global economic conditions. While key projects remain in the pipeline, some contracts have been delayed or possibly cancelled within the ongoing prioritization of infrastructure projects.

The external sector was at the image of the macroeconomy and oil market developments. While the growth in imports is estimated at circa 15% in 2011 fueled by stronger domestic demand, merchandise export growth is estimated to have reached 19% in the same year, driven by higher oil output and prices on one hand and the revival of non-oil trade mainly in Dubai on the other hand. With a current account surplus of 7.2% of GDP and an exports to imports ratio of 136%, UAE rises among the few countries around the World with significantly strong external surpluses and healthy foreign positions.

At the monetary sector level, the low growth in money supply in 2011 (6.2% in the first eleven months) was coupled with a moderation of inflation that recorded below 1% for the second consecutive year. The rise in money supply by US$ 7.4 billion was almost fully tied to net domestic assets while net foreign assets almost maintained their last year's level. Still, the Central Bank was able to reinforce its reserves position, with its foreign assets moving from US$ 31.8 billion in 2010 to US$ 39.8 billion in November 2011, raising its coverage to the Domestic Money Supply from 17.8% to 21.6% respectively though still way below the 2007 coverage level.

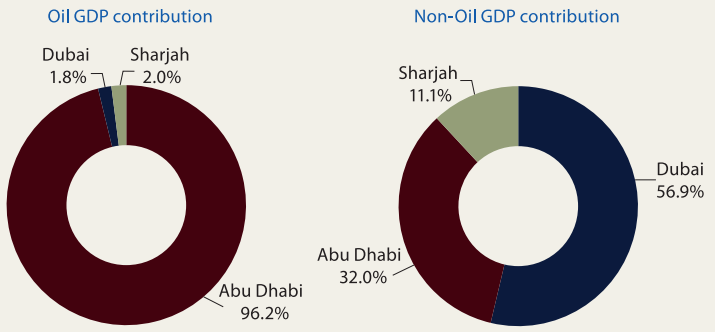
The banking sector performance was somehow erratic in 2011 amid atypical market conditions. While the first half of 2011 reported a rise in deposits triggered by significant inflows from elsewhere in the region in addition to the oil price surge, there was evidence of hot money leaving the system in the second half along with the withdrawal of government related deposits. The sector yet remained profitable benefiting from lower funding costs, despite relatively weaker asset quality (6.2% NPL ratio) and slow loan growth (4.2% over the first 11 months), reflecting a slow restoration of business activities and difficulties in finding high-quality borrowers with viable projects. Banks maintain a high level of capitalization, with an average sector adequacy ratio of 21.2% well above international benchmarks, allowing banks to adequately cover third party risks with shareholders' funds.

EVOLUTION OF ECONOMIC PERFORMANCE



Sources: IMF, Bank Audi's Group Research Department

OIL AND NON-OIL CONTRIBUTION TO GDP



Sources: Noozz, Bank Audi's Group Research Department

UAE capital markets performance was likewise erratic in 2011 but ended on the downside on the overall. Dubai and Abu Dhabi stock markets prices dropped by 17.0% and 11.7% respectively in a market lacking liquidity and efficiency. The annual stock market turnover to market capitalization actually stood at 11% in Abu Dhabi and 18% in Dubai in 2011, well below the emerging and global countries average (102% and 198% respectively). In parallel, Dubai's 5-year sovereign CDS spread, a refection of market perception of credit risks, reported a slight expansion of 30 bps in 2011 to 445 bps and Abu Dhabi's 5-year sovereign CDS spread recorded a similar increase of 34 bps over the same period. It looks like the UAE fixed income markets reported mixed performances in 2011, with nearly a quarter of bonds reporting price contraction and three quarters reporting upsurge in prices.

The developments in the different sectors in 2011 are analyzed in the sections that follow while the concluding remarks are left to the challenges looking ahead.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

Profiting from spillovers of regional unrest

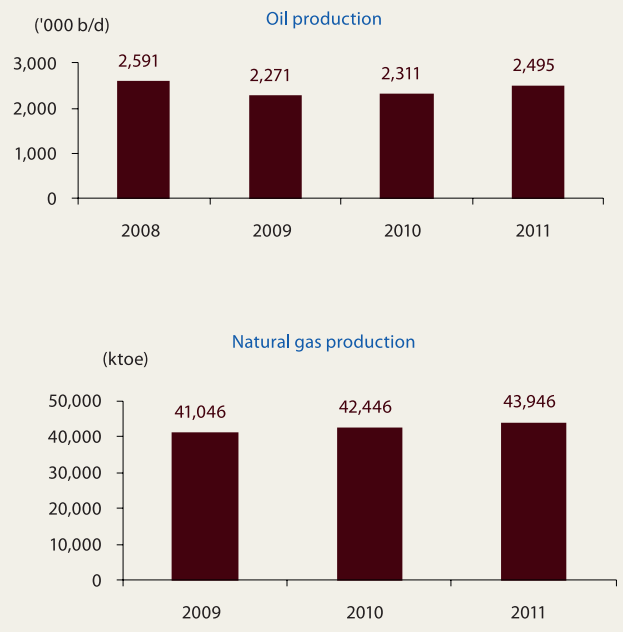
1.1.1. Hydrocarbons Sector

The UAE, still significantly reliant on its hydrocarbons sector with the share of oil-related activity accounting for about 27% of its total GDP and oil revenues representing about 82% of total fiscal revenues (according to the IMF), has benefited from higher oil prices in 2011. As a matter of fact, oil prices are estimated to have averaged around US$ 110 per barrel in 2011, up by 27% from around US$ 86 per barrel in 2010. However, the reliance on oil revenues has resulted in unpredictable fluctuations in real GDP growth over the years, creating economic planning problems for the government and prompting the move towards economic diversification.

The UAE has the seventh largest proven oil reserves in the world, estimated at 97.8 billion barrels, of which 92.2 billion barrels are located in Abu Dhabi. The country also has the sixth largest proven natural gas reserves in the world, estimated at 6.1 trillion cubic meters. In addition to their direct contributions to economic growth, the oil and gas industries indirectly account for a much larger share of the economy as the revenues accrue directly to the individual emirates and are then recycled back into the economy through expenditure programs.

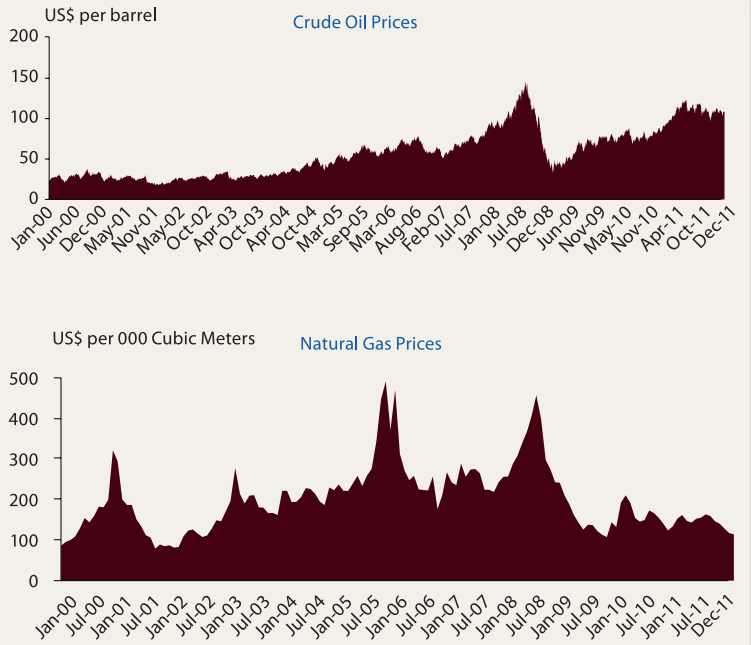
With a domestic oil consumption of around 525,000 barrels per day and production of around 2.57 million barrels a day, most of the country's crude oil is exported, largely to Asian countries. Abu Dhabi is planning to expand oil production, targeting a rise from 2.5 million barrels per day to 3.5 million barrels per day by 2017, with Abu Dhabi National Oil Company (ADNOC) increasing its own production to 1.8 million barrels per day at that horizon.

OIL & GAS PRODUCTION



Sources: EIU, Bank Audi's Group Research Department

CRUDE OIL & NATURAL GAS PRICES



Sources: Bloomberg, Thomson-Reuters, IMF, Bank Audi's Group Research Department

Within this context, ADNOC has begun the implementation of projects to boost Abu Dhabi's oil production. Projects underway include the Upper Zakum onshore field which is a partnership between ADNOC, Exxon Mobil and the Japan Oil Development Company. It is the largest oil field in the UAE and aims to increase oil producing capacity from 550,000 barrels per day to 750,000 barrels per day by 2015 and to 1.2 million barrels per day thereafter.

Another project undertaken to increase oil production capacity is the Abu Dhabi Crude Oil Pipeline which is under construction by China National Petroleum Corporation. The 404-kilometer pipeline connecting Abu Dhabi's Habshan oilfield to Fujairah port will act as a conduit for the transport of 60% of the UAE's oil exports to Fujairah port, avoiding shipping through the Strait of Hormuz. The deadline for the project was delayed from April 2011 to May 2012. The strategic importance of the pipeline has been greatly elevated since Iran threatened to block the Strait of Hormuz, through which about one-fifth of the global crude oil supply flows, or 17 millions barrels a day, in the event of tougher Western sanctions against Iran oil exports.

Although the UAE has more than sufficient oil production capacity to meet local demand, the same is not true for gas. Shortages of gas forced the UAE to begin importing gas via Qatar from the Dolphin pipeline in 2008 and hence the UAE became a net gas importer. The main focus is actually on increasing gas production and ADNOC awarded the lead contract to develop the sour gas reserves from the Shah field to Occidental Petroleum in January 2011 after ConocoPhillips pulled out in April 2010. The Shah field will produce 10 billion cubic meters per year. In addition, Abu Dhabi Gas Industries Company (Gasco) is working on an integrated gas development project which will produce 7.5 billion cubic meters per year by 2012 from the offshore Umm Shaif and Khuff fields.

1.1.2. Non-Hydrocarbons Sector

Thanks to the UAE's important diversification strategy through large-scale infrastructure investment in transport, trade and tourism, the contribution of the non-oil sector to the country's gross domestic product is at circa 70%. The IMF estimated that non-hydrocarbon GDP growth in the UAE reached 3.3% in 2011, up from 2.1% in 2010, which shows a pick-up in non-oil activity, led by strong tourism, logistics, and trade in Dubai in addition to large public investment spending in Abu Dhabi.

It is worth noting that according to the government's Plan Abu Dhabi 2030, Abu Dhabi will seek to foster non-oil GDP growth at a higher rate than that in the oil sector as part of efforts to diversify the economy. By focusing on non-oil economic growth, revenue sources will be more balanced, creating an economy that can withstand long-term economic trends. By the end of 2030, some 64% of real GDP in Abu Dhabi is planned to come from non-oil sources.

Construction and real estate

The UAE's real estate sector benefited from the economy's safe-haven status amid regional turmoil in 2011. Also, some internal positive factors left their impact on the property sector. First, the UAE federal government extended in June 2011 visas for real estate investors from six months to three years. Second, mortgage rates continued to fall and banks were more liquid. Third, oil prices remained buoyant, supporting the local economy. The overall effect of all these internal and external factors was that property prices in some areas stagnated and stopped falling. The high-end residential sector seemed to be benefiting from ongoing capital shifts in the region as a result of the regional turmoil.

The Dubai residential property market remained steady in 2011 in a clear sign that confidence is gradually returning to the emirate's real estate market. Rental rates for apartments relatively stabilized towards the end of the year after having dropped marginally in the first six months, according to Asteco. One exception for these apartments was the residential properties that are close to the emirate's metro network. In fact, properties near some of the 29 stations on the Red Line, one of the two lines of the Dubai Metro network, have increased in popularity and value at a healthier pace and their rents have risen by more than 10% since the route opened in September 2009. Villa rentals were relatively stable throughout the whole year 2011. Transactions in the rental market for both apartments and villas picked up as tenants took advantage of lower rates to move to better quality accommodation, while people also relocated to Dubai from other emirates. In fact, the Dubai Land Department recorded 35,297 transactions worth AED 143 billion in 2011, a 20% increase over 2010, and government officials predict that the market is set to bring in more foreign investment in 2012. Likewise, commercial rents stabilized in Dubai in the second quarter of 2011, according to statistics of Cushman & Wakefield.

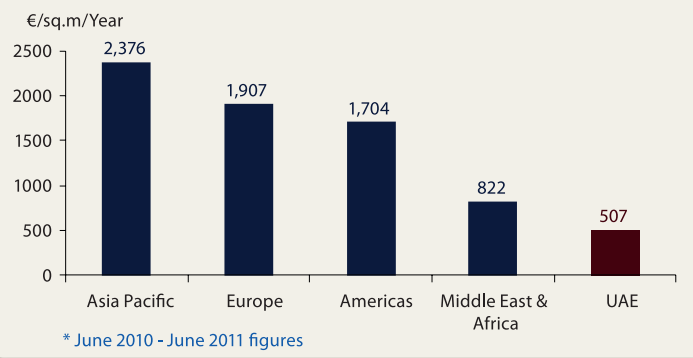
In Abu Dhabi, the office market saw a latent demand from existing occupiers upgrading from lower grade space and increasing their Abu Dhabi presence as rentals continued to decline during the year 2011 and higher quality space comes on line. Office vacancy rates were quoted at 11.5% at the end of the second quarter of 2011, according to Jones Lang LaSalle, with the delivery of new buildings in the first half of the year. It is worth mentioning that vacancy levels in older Grade B and C buildings rose as more tenants shifted to better quality, value-for-money buildings.

Leasing prices in Abu Dhabi's office market fell in 2011 with some 455,750 square meters of new supply entering the market. Leasing rates for offices are expected to further decline in 2012 with some 650,350 square meters of office space expected to enter the market, according to Asteco. The decrease in office rentals would have a positive impact on demand, creating opportunities for tenants to upgrade their space without increasing costs.

As to the residential market in Abu Dhabi, some 6,680 apartments and 3,600 villas were handed over in 2011, according to Asteco, far below forecasts due to the continued handover delays within the major projects. Sales prices for apartments and villas remained stagnant throughout 2011 due to limited supply ready for immediate occupation. Unaffordable prices have limited and discouraged demand from existing residents and potential buyers.

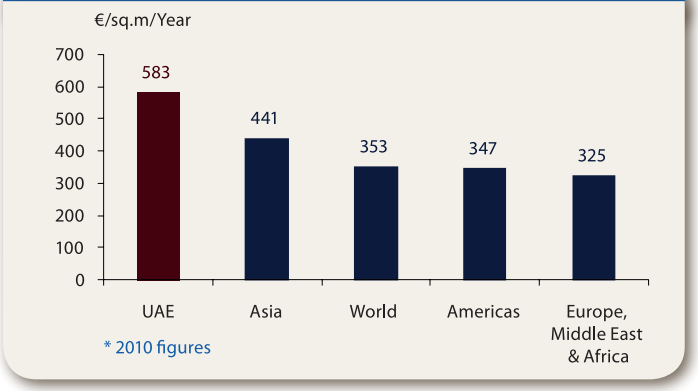
Since the market peaked in 2008, average sales prices for residential units declined by more than 45% in Abu Dhabi, falling from AED 21,000 per sq m to AED 11,800 per sqm. The introduction of rent-to-own schemes (currently available for Sorouh's Sun Tower on Reem Island) may boost overall demand. Apartment rents fell by 6% in the third quarter of 2011 after dropping by 8% and 9% in the previous two quarters, indicating a degree of relative stabilization in the third quarter. Villa rental rates during the third quarter of 2011 were relatively static for the second consecutive quarter although villas in off-island locations such as Mohamed Bin Zayed City and Khalifa City continued to slide by 5% on average. Looking forward, the delay in handover in Abu Dhabi in 2011 will only exacerbate the volume of new supply delivered in 2012, and consequently, rents could come again under further downward pressure.

RETAIL AVERAGE RENTS PER REGION*



Sources: Cushman & Wakefield, Bank Audi's Group Research Department

OFFICE AVERAGE RENTS PER REGION*



Sources: Cushman & Wakefield, Bank Audi's Group Research Department

Transport

The UAE continues to invest substantial amounts to develop its infrastructure, noting that it has one of the highest levels of per capita transport infrastructure spending globally, according to Jones Lang LaSalle. In the 2012 budget for the Government of Dubai, the infrastructure, transportation and economic development sectors make up 41% of total public expenditures estimated at US$ 8.8 billion. This includes a number of vital sectors including roads, transport, civil aviation, airports and tourism.

At the level of new infrastructure projects, the UAE is building the Gulf's first mainline railway network at a cost of almost US$ 11 billion. The project will link cities across the UAE in a 1,200 kilometer network, and connect the UAE to Saudi Arabia as part of a broader Gulf rail network. Abu Dhabi-based Etihad Rail, the government-owned company that is set to develop the rail network across the country, awarded in October 2011 a consortium comprising Italy's Saipem, Tecnimont, and UAE-based Dodsal Engineering and Construction an AED 3.3 billion (US$ 899.2 million) contract to start up the first phase of the railway network. The civil and track works contract includes the design, procurement and construction of a 266-kilometer rail line that will link the cities of Habshan and Ruwais in Abu Dhabi's western region by 2013, and then Shah and Habshan, also in the emirate, in 2014. Etihad Rail has invited as well prequalification bids for phase II of the UAE's US$ 11 billion rail plan in November 2011. The second phase of the project will connect Abu Dhabi to Jebel Ali in Dubai as well as link the borders of Saudi Arabia and Oman and will be carried out under four railway design and infrastructure contracts.

The Roads and Transport Authority is undertaking an AED 1 billion five-year plan (2012-2016) to pave internal roads in a number of residential areas in Dubai. With an estimated cost of AED 150 million, Phase I of the project will commence in five areas where water drainage system has been completed and urban development exceeds 50%. Phase II is scheduled to begin in 2013 with three residential areas. Phases III and IV will commence in 2014 and 2015 respectively, while phase V is scheduled to begin in 2016.

Also, Dubai Jebel Ali port announced in 2011 plans to invest a total of US$ 850 million to construct a new terminal that would be able to handle the world's largest container vessels planned for the future. The additional capacity would enhance the total capacity at the flagship port by 2014 to 19 million twenty foot equivalent container units. The expansion is required to enable the port to cope with anticipated demand growth, particularly as Jebel Ali continued to be the Gulf region's number one port in terms of tonnage handled.

In Abu Dhabi, the Department of Transport (DoT) awarded a comprehensive tunnel and road construction project in Abu Dhabi to Al Naboodah Contracting Company. The total cost of the project is estimated at AED 700 million (around US$ 190.6 million). The project is aimed at further improving the road infrastructure and accommodating the traffic growth in the Capital.

Air traffic movement in the UAE hit a new record high level of 683,389 movements in 2011, up by 7.6% relative to the previous year, according to the General Civil Aviation Authority (GCAA). The remarkable increase in air traffic movement in the UAE is attributed to the prosperity of business and tourism in the country. The government has adopted a policy to encourage the signing of air service agreements on the basis of open skies with countries across the region and the world, and to provide a competitive environment for airlines. This has translated in a greater number of registered companies and a hike in the number of air traffic movement, according to GCAA officials.

The number of Dubai passengers at Dubai International Airport grew by 7.8% during the first eleven months of 2011 to 46.28 million. The flight movements increased by 6% during the first eleven months of 2011 to reach 296,799, up from 279,888 during the corresponding period of 2010. The January-November 2011 freight movement reached 1,999,898 tonnes as compared to the 2,033,828 tonnes handled during the corresponding period of the previous year, down by 1.7%.

As to Dubai Metro that is expected to form the backbone of Dubai's public transport network, the number of passengers using the Red Line reached 94,330,908 passengers since it was launched in September 2009 and up to the end of October 2011, while the number of passengers using the Green Line reached 3,660,544 passengers over the period, according to the Roads & Transport Authority.

Tourism

The year 2011 was a year of remarkable resilience for the UAE's tourism industry, as the country benefited from its relatively stable and open market status amid regional political unrest, with both Dubai and Abu Dhabi reporting an increase in hotel occupancy rate, number of hotel guests, and revenues of hotels and hotel apartments.

Hotels in Dubai outperformed their regional peers in terms of overall hotel occupancy and growth in occupancy rate during the first eleven months of 2011. Indeed, hotels in Dubai recorded the highest occupancy rate in the region of 79% during the first eleven months of 2011, moving up by 4% relative to the corresponding period of 2010, according to Ernst and Young.

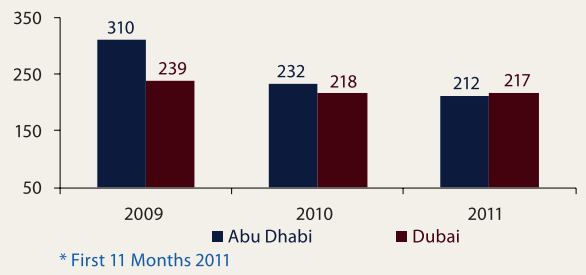
The number of hotel guests in Dubai reached 6.64 million during the first nine months of 2011, up by 11% relative to the corresponding period of 2010, according to latest figures provided by the Dubai Department of Tourism and Commerce Marketing (DTCM). The guest nights rose by 26% to reach 23.68 million, while the average length of stay increased by 14% during the same period. The gains made during the January-September 2011 period are mainly attributed to the aggressive promotional and marketing drive that the DTCM has been pursuing to enhance the number of tourists to the destination by tapping established and emerging markets across the world, according to DTCM officials. They also reflect the public-private sector partnership to tap the tourism potential of Dubai. In parallel, revenues of hotels and hotel apartments in Dubai increased by 19% to reach AED 10.96 billion, with the share of hotels rising by 20% and that of hotel apartments moving up by 13%. Last but not least, the number of hotel establishments increased by 1% to 573 while the number of hotel rooms and hotel apartments in Dubai increased by 7% to attain 73,522 during the first nine months of 2011.

In Abu Dhabi, occupancy rates of hotels rose by 2% during the first eleven months of 2011 to reach 76%, according to Ernst and Young, noting that Abu Dhabi ranked second in the region in terms of occupancy rate and third in terms of growth in occupancy rates.

Abu Dhabi hotel guests increased by 16% during the first eleven months of 2011 to reach 1,903,888, according to the Abu Dhabi Tourism Authority, i.e less than 97,000 guests away from achieving Abu Dhabi's 2011 target of two million hotel guests. Guest nights rose by 23% to reach 5,694,140 during the first eleven months of 2011 from 4,640,893 in the corresponding period of the previous year. The average length of stay in Abu Dhabi reached 2.99 nights during the first eleven months of 2011, up by 6% when compared to the corresponding period of the previous year. Revenues from Abu Dhabi's hotels and hotel apartments reached AED 3.96 billion, up by 4% year-on-year.

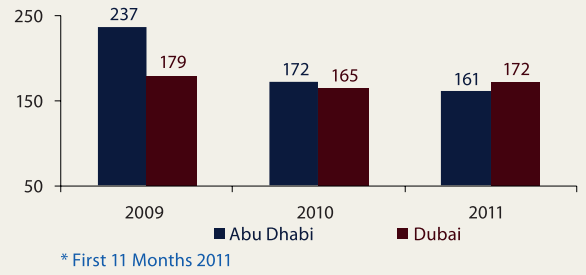
In sum, the UAE witnessed a rise in the flow of visitors in 2011 spurred by its safe environment amid regional political turmoil, advanced tourism and hospitality infrastructure, exhibitions, conferences and mega sports events like Formula one Grand Prix that helped to boost hotel guest numbers. The UAE tourism activity is set to contribute to a growing share of GDP in the coming years within the context of continuous massive efforts to diversify the country's oil-reliant economy.

AVERAGE ROOM RATE IN US$*



Sources: Ernst & Young, Bank Audi's Group Research Department

ROOMS YIELD IN US$*



Sources: Ernst & Young, Bank Audi's Group Research Department

1.2. EXTERNAL SECTOR

External accounts surpluses back to pre-crisis levels

The performance of the UAE external sector in 2011 sustained the upward trajectory seen in 2010 on the back of a double-digit growth in average oil prices coupled with the revival of the country's non-oil trade activity. According to the Economist Intelligence Unit (EIU) estimates, total imports and exports attained US$ 437.6 billion in 2011, up by 17.1% from a total of US$ 373.7 billion in 2010. The 2011 total foreign trade volume thus reached a new high, exceeding pre-crisis oil sector boom levels.

Total exports increased by 18.7% year-on-year to reach US$ 252.0 billion in 2011, versus a lower rise of 10.7% in 2010, as per the EIU. The rise in exports was driven to a large extent by revenues generated from the hydrocarbon sector.

Crude oil exports, which account for close to 30% of the total export volume, increased by 24% in 2011 versus a rise of 11% in 2010. Indeed, export revenues were positively affected by both a price and a quantity effect. In details, average oil prices edged up by a yearly 27% in 2011 while total oil output attained 2,495 thousand barrels per day, up by 8% from 2010, year during which it had risen by only 2%.

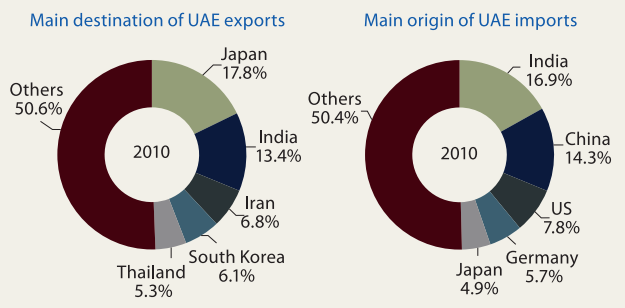
On the other hand, non-crude oil exports amounted to US$ 177.3 billion last year, up by a yearly 16.5%. This compares to an increase of 10.5% in 2010, bearing witness to the government's ongoing economy diversification efforts away from the oil sector.

In parallel, imports edged up by a yearly 15.0% in 2011 to reach US$ 185.6 billion, versus a lower increase of 7.8% in 2010, as per the EIU. The yearly progression of import volumes actually comes in line with the country's overall rising consumption and investment spending in a moderately growing real economy.

The growth of exports at a rate higher than that of imports led to a further widening of the trade surplus by 30.5% to attain a historical high of US$ 66.3 billion in 2011, from US$ 50.8 billion in 2010. The trade balance now accounts for 19% of GDP, versus a share of 17% in 2010. Overall, the UAE's comfortable merchandise trade surplus stands as a major buffer against leakages from the services and transfers account, thereby resulting in the country's predominant current account surplus.

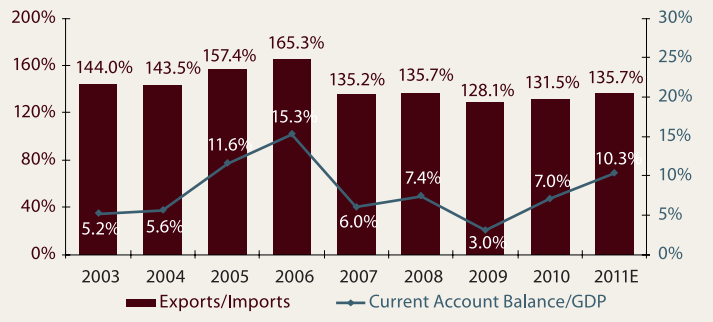
The services and income balances, which incorporate payments or receipts from transportation, business services, tourism, or licensing and salaries going in and out of the country continued to register a deficit of US$ 29.0 billion in 2011, up by a slight 2.1% year-on-year against a higher increase of 18% seen in 2010. Over the past few years, the UAE has been upgrading infrastructure of such services to enhance its performance in those areas, and thus payments naturally exceeded receipts. Yet, expenditures for 2011 were lower than previous levels as the government was only undergoing projects that were of high necessity to the country. This partly offset rising tourism related revenues (+4.1% as per WTTC) with the UAE perceived as a relatively safer haven at a time of widespread regional unrest.

EXPORTS & IMPORTS STRUCTURE



Sources: EIU, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



Sources: EIU, IMF, Bank Audi's Group Research Department

As to the current transfers balance, it posted a deficit of US$ 11.6 billion, up by a yearly 3.1%. This compares to a growth of 10.7% seen in 2010. The main component of transfer outflows is remittances sent by the important expatriate labor force which accounts for the bulk of total workers in the UAE. The growth in remittance outflows is estimated to have remained modest in 2011, after a growth of 6.2% during the previous year.

The strong rise in the UAE's trade surplus in 2011 along with a practical standstill in the services, income and current transfers balances resulted in a further widening of the current account surplus last year. The latter more than doubled to reach US$ 25.7 billion in 2011, equivalent to 7.2% of GDP, against an average of 5.4% of GDP in the past four years.

In short, the UAE's external sector is pursuing its recovery track in 2011, a fact deemed positive, especially within the context of regional politico-security turmoil spillovers and slowing down global economic momentum on the back of Euro zone debt issues affecting demand for exports goods and services. While the UAE authorities have achieved some progress in diversifying external receipts away from the still dominant hydrocarbon sector in the past few years, the country still relies to a notable extent on petrodollars to cover up services, income and current transfers outflows. The surge in the UAE's current account surplus, along with the sustained FDI volumes during the year 2011 (second largest recipient of FDI in the Arab World after Saudi Arabia over the past decade as per UNCTAD) and large stock of sovereign wealth fund assets would help comfort further the UAE's strong external creditor position at a time of renewed financial uncertainties and tough funding conditions at large.

1.3. PUBLIC SECTOR

Recovering 2011 fiscal position and low indebtedness ratios

The UAE has witnessed an improvement in fiscal performances during the year 2011, within the context of rising hydrocarbon related receipts in an overall improving real economy outpacing a rise in government expenditures. The general government fiscal balance is estimated to have returned to a surplus of 5.8% of GDP in 2011, as per the IMF, following a couple of years of adverse performances driven by lower government receipts and countercyclical fiscal policies aimed at weathering the spillovers of the global financial crisis on the UAE economy.

General government revenues are estimated to have surged by 37.8% last year, according to the latest IMF figures. Government receipts moved from 28.3% of GDP in 2010 to 32.9% of GDP in 2011, driven by growing oil receipts amid a double-digit rise in average global oil prices and enhanced domestic oil output. Within this context, the UAE government's hydrocarbon revenues, accounting for more than three quarters of total government receipts, are actually estimated to have almost increased by half their 2010 value. Also, non-hydrocarbon revenues are believed to have posted a lower double-digit growth rate during 2011 in an improving domestic environment to support further the UAE government's revenue base.

In parallel, general government expenditures are estimated to have continued on an upward path last year, progressing by 9.3% according to the IMF. Expenditures accounted for an estimated 27.1% of GDP in 2011, bearing witness to sustained high levels of government spending relative to pre-crisis levels, with government expenditures averaging about 20% of GDP in the 2000-2008 period. The UAE federal government, along with the larger Emirates (of which the UAE capital Abu Dhabi) whose accounts are all consolidated to form the general government position, have mostly been striving to diversify the economy away from the dominant hydrocarbon sector by boosting current but also capital spending in various sectors such as infrastructure, health and education, among others, though spending is likely to decelerate this year at both Emirate and federal levels.

As a result of government receipts growth outpacing that of spending, the UAE general government fiscal accounts have returned to a positive balance of 5.8% of 2011 GDP, following a net deficit of 1.1% of GDP in 2010 and 12.6% of GDP in 2009 amidst global and domestic economic slowdown.

Within the context of easing pressures on the fiscal accounts front, the general government gross debt is estimated to decline further as a percentage of GDP, with the indebtedness ratio moving from 21.0% in 2010 to 18.5% in 2011 according to IMF estimates, the lowest level since the global financial crisis outburst. While the debt levels of the UAE are far from being worrisome in both absolute and relative terms, government related issuers continue to have relatively high leverage, and, within the context of persisting realty sector weaknesses, are likely to continue posing potential contingent liabilities on UAE government balance sheets in the near-term horizon.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Sustained low level of price inflation

Monetary conditions in the United Arab Emirates were marked in 2011 by a sustained low level of inflation, small expansion in monetary aggregates and a tangible rise in the Central Bank's foreign assets.

The Central Bank of the UAE continued to focus on increasing liquidity in the financial sector during the year 2011. Within this context, the Central Bank launched in June 2011 a repurchase facility for Islamic Certificates of Deposits to provide a new liquidity tool for the country's banks. The new facility, which is based on a Murabaha concept, accepts the Central Bank's Islamic Certificates of Deposits as collateral against cash, enabling liquidity to be freed up. In addition, the temporary repo rate of just 1%, introduced in January 2009, remained in place in order to boost liquidity in the financial system. The introduction of a new system to calculate the Emirates Interbank Offered Rate has also eased pressures on banks. Finally, the Central Bank of the UAE maintained the ratios of mandatory reserves at 14% on demand deposits and 1% on term deposits, stating that there is no need to revise them.

Along with its plans to maintain liquidity in the financial sector, the Central Bank of the UAE reported a drop in its Certificates of Deposits portfolio from US$ 25.6 billion at end-2010 to US$ 23.6 billion at end-September 2011, down by 7.8%.

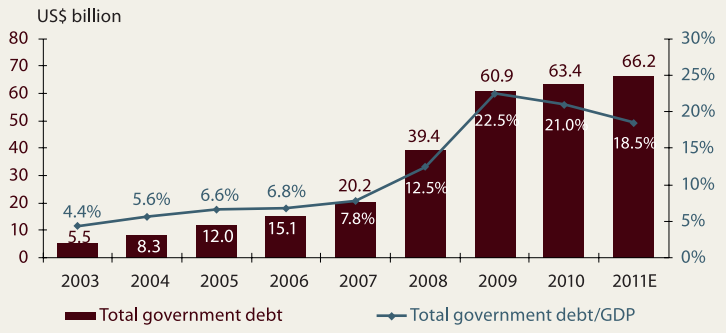
Monetary aggregates in the UAE showed a small expansion year-to-date. The narrow measure of money supply (M1) widened by 9.1% during the first nine months of 2011, moving up from US$ 63.4 billion at end-2010 to US$ 69.2 billion at end-September 2011. This compared to a much lower growth rate of 0.9% during the corresponding period of 2010. The broader money supply (M2) accelerated by 3.5%, moving up from US$ 214.1 billion at end-2010 to US$ 221.6 billion at end-September 2011, mainly due to a 4.0% rise in net domestic assets. This compared to a similar growth rate of 3.5% during the corresponding period of 2010. Overall money supply in its broadest sense (M3) witnessed a tiny increase of 1.9%, moving up from US$ 268.4 billion at end-2010 to US$ 273.5 billion at end-September 2011, due to a decrease in government deposits by 4.4% during the same period. This compared to a lower growth of 1.5% during the corresponding period of 2010.

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2007	2008	2009	2010	2011E
General government revenues	85.3	121.7	68.3	85.5	117.9
General government revenues/GDP	33.1%	38.6%	25.3%	28.3%	32.9%
General government expenditures	45.7	69.9	102.2	88.8	97.0
General government expenditures/GDP	17.7%	22.2%	37.8%	29.4%	27.1%
General government fiscal balance	39.6	51.9	-34.1	-3.3	20.9
General government fiscal balance/GDP	15.4%	16.5%	-12.6%	-1.1%	5.8%

Sources: IMF, Bank Audi's Group Research Department

PUBLIC DEBT AND INDEBTEDNESS RATIO



Sources: IMF, Bank Audi's Group Research Department

The overall Consumer Price Index for the UAE reached 116.65 in November 2011, according to the UAE National Bureau of Statistics, declining slightly by 0.09% relative to November 2010. The small change came within the context of a drop in prices in the housing sector (-4.70%) versus a rise in prices in the food & beverages sector (+5.48%), an increase in prices in the Alcoholic beverages & tobacco (+4.88%), a pick-up in prices in the furniture and other items sector (+4.57%), and a rise in prices in the education sector (+3.77%). The CPI increased by 0.94% during the first eleven months of 2011 as compared to the corresponding period of the previous year.

The Central Bank's foreign assets rose from US$ 31.8 billion at end-2010 to US$ 39.8 billion at end-September 2011, climbing by 25.2% on the back of rising oil prices and a growth in securities investment. Accordingly, the Central Bank's foreign assets coverage ratio to money supply (M1) and Dirham deposits rose in 2011, moving up from 17.8% at end-2010 to 21.6% at end-September 2011. The UAE Dirham peg to the US Dollar has provided stability for decades, and, having ridden out the problems that fixed currency brings for this long, the authorities seem keen not to change the system.

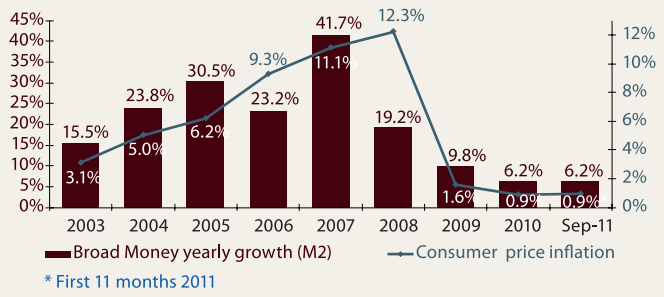
Looking forward, the Central Bank of the UAE is set to remain focused on managing liquidity and would be turning its attention to controlling inflation should inflationary pressures re-emerge in the event of fast output expansion.

EVOLUTION OF MONETARY CONDITIONS

US$ million	2003	2004	2005	2006	2007	2008	2009	2010	Sep-11
Net foreign assets	37,196	41,385	45,424	42,378	43,656	9,012	12,784	21,409	21,100
Foreign Assets	45,540	53,077	68,939	91,113	131,469	86,278	81,336	95,561	106,965
Foreign Liabilities	-8,344	-11,692	-23,514	-48,735	-87,813	-77,265	-68,552	-74,152	-85,865
Net Domestic Assets	17,427	26,254	42,817	66,347	104,721	167,718	188,882	192,720	200,476
Claims on private sector	44,988	55,764	79,048	105,048	138,871	204,744	214,174	215,677	221,938
Net claims on public sector	-4,695	-4,880	-6,136	-5,141	-4,355	-7,888	23,759	31,728	43,077
Claims on financial institutions	1,158	1,800	4,151	8,812	15,033	26,668	24,902	24,828	23,162
Capital & Reserves	-12,530	-14,710	-21,700	-28,768	-36,063	-45,083	-66,857	-74,755	-77,487
Other Items (net)	-11,494	-11,721	-12,546	-13,605	-8,764	-10,723	-7,097	-4,758	-10,216
Broad Money (M2)	54,622	67,639	88,241	108,726	154,037	183,611	201,666	214,129	221,575
Money Supply (M1)	15,864	22,006	28,441	32,680	49,466	56,675	60,853	63,434	69,176
Quasi-Money	38,758	45,633	59,800	76,046	104,571	126,936	140,813	150,695	152,400

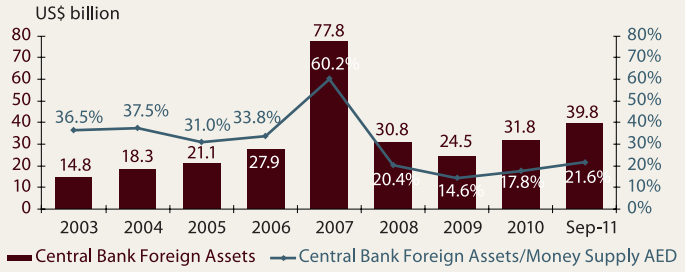
Sources: Central Bank of UAE, Bank Audi's Group Research Department

BROAD MONEY AND INFLATION



Sources: Central Bank of UAE, Bank Audi's Group Research Department

EXCHANGE MARKET INDICATORS



Sources: Central Bank of UAE, Bank Audi's Group Research Department

1.4.2. Banking Activity

Mild lending activity recovery year-to-date supported by high capital buffers

The UAE witnessed a moderate banking activity growth during the year 2011 amidst politico-security tensions across the broader region. Measured by total assets of banks operating in the UAE, banking activity grew by 4.2% during the first 11 months of 2011 to reach US$ 455.5 billion at end-November, against a higher 7.5% growth rate realized over the corresponding period of 2010.

Total UAE banking sector deposits, which have traditionally been an important driver of total sector activity and accounted for 63.0% of total banks' balance sheet as at end-November 2011, posted a mild 0.4% rise over the first 11 months of 2011 to reach US$ 286.9 billion at end-November 2011.

Bank deposits had been on a steadily upward path between December 2010 and April 2011 (+7.5%, with volume growth exceeding that of the whole year 2010), a period mostly dominated by politico-security turmoil across a number of neighboring Middle East and North Africa countries - and rising oil prices - and which might have prompted some depositors to seek safer haven markets such as the Emirates. Yet, they dropped in the following months until end-November (latest statistics available), registering a 6.6% decline over the latter half-yearly period.

The deceleration in bank deposit volumes over the past few months is mostly attributed to a decline in local currency time deposits. On the one hand, the deceleration in government deposit volumes throughout the past few months came within the context of lower oil prices from peaks attained during the height of the Arab Spring period. On the other hand, the drop in key domestic interest rates in the past few months somewhat affected local currency deposits' competitiveness for expatriates and foreigners. Furthermore, non-resident financial institutions have reported a deceleration in deposits in the UAE banking sector within the context of deleveraging across Europe in light of the accrued debt woes and their exposure to troubled Euro zone countries.

It is worth noting that while seeing some deposit outflows during the second half of 2011, UAE banks have been lengthening their deposit maturity profiles in recent years, which somewhat helps them limit vulnerability to adverse funding market conditions. Although deposits below the six-month horizon still account for the bulk of time deposits in the UAE, their share has declined over the past few years to the benefit of over-one-year funds which now account for 25% of time deposits (against a much lower 10% five years ago).

Banks' stable deposit bases and high capitalization levels helped lending activity progress at a moderate pace during the year 2011, and post a mild recovery from relatively stagnating volumes in the immediate post-Dubai crisis period during the year 2010. Banks' loans and advances rose by 4.2% in the first 11 months of 2011 to reach US$ 292.6 billion at end-November 2011. The US$ 11.8 billion progression in lending volumes actually proved 88% higher than that of the corresponding 2010 period.

The breakdown of lending activity by sector reveals that bank loans continued to target significantly the UAE public sector, with volumes up by 8.3% in the first nine months of 2011 (latest Central Bank

EVOLUTION OF BANKING AGGREGATES

US$ million	2003	2004	2005	2006	2007	2008	2009	2010	Nov-11
Total assets	99,907	122,538	173,845	234,057	327,375	396,515	413,642	437,195	455,521
% yearly growth in assets	10.7%	22.7%	41.9%	34.6%	39.9%	21.1%	4.3%	5.7%	2.5%
Total deposits	63,388	79,103	111,550	141,268	194,968	251,191	267,550	285,800	286,943
% yearly growth in deposits	11.0%	24.8%	41.0%	26.6%	38.0%	28.8%	6.5%	6.8%	0.4%
Total bank loans and advances	55,491	69,979	101,384	137,857	185,138	270,579	277,114	280,817	292,580
% yearly growth in bank loans and advances	18.4%	26.1%	44.9%	36.0%	34.3%	46.1%	2.4%	1.3%	3.2%

Sources: Central Bank of UAE, Bank Audi's Group Research Department

breakdown available). However, those to the domestic private sector rose by a mere 1.1% over the same period, reflecting continued corporate deleveraging and low appetite for bank lending, especially in the aftermath of the Dubai debt crisis, and banks' cautiousness with regards to borrower quality and the overall security tensions in some neighboring countries. Besides, the amended regulations on consumer lending as of May 2011 contributed to a slowdown in retail lending, with consumer credit limited to 20 times the monthly salary and spread over a maximum period of four years.

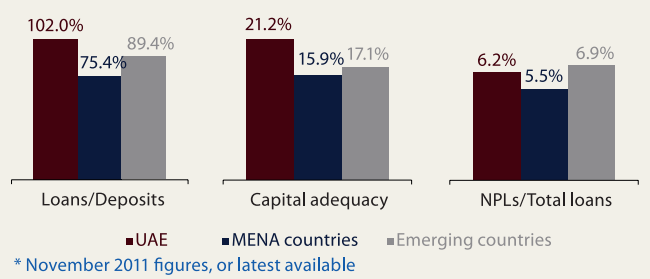
Within the context of a moderate growth in lending volumes and a practical standstill in the year-to-date deposit base, banks' liquidity conditions have somewhat tightened throughout the past few months. The loan-to-deposit ratio moved from 98.3% at end-December 2010 to 102.0% at end-November 2011, exceeding anew the 100% threshold as of the end of 2011's third quarter for the first time since the Dubai debt crisis episode. Still, banks' liquid assets levels improved during 2011, mainly driven by a rise in deposits at the Central Bank that could be attributed to banks' cautiousness in the current domestic and regional environment and to rather limited lending opportunities.

With the cost of funding on the decline relative to the previous year and lending volumes reporting a moderate progression year-to-date, banks' net interest income increased during the covered period of 2011 despite pressures on asset yields. Notwithstanding still high provisioning levels, this favored a growth in UAE banks' bottom lines. In the absence of consolidated sector statistics, we resorted to the aggregation of first three quarters' financials of the nine largest listed banks, which account for the bulk of sector activity. These results actually depict a 30% yearly rise in aggregated net profits during the first nine months of 2011 relative to the corresponding 2010 period.

In parallel, banks' capital buffers remain significant, with sector capital adequacy ratio reaching a high 21.2% at end-September 2011, against 20.8% at end-December 2010 and levels hovering around the 13% mark upon the outburst of the global financial crisis. In fact, the significant improvement in capital adequacy ratios of the UAE banking sector over the past couple of years comes along with lower cash dividend payments, slower lending activity, and Ministry of Finance deposits conversion into Tier 2 capital and direct government equity injections of Tier 1 capital. The current UAE banks' capital adequacy levels remain much higher than the minimum Central Bank requirement of 12% established as of June 2010. Tier 1 capital ratios averaged 16.7% at end-September 2011, more than twice higher than the minimum 8% requirement. Such elevated capitalization levels actually help banks bear additional loan loss provisioning charges and weather a potential further deterioration in asset quality metrics.

Asset quality actually remains a major near-term concern for UAE banks. The non-performing loans to total loans ratio reached 6.2% as at end-June 2011 as per the IMF, rising from 5.6% at year-end 2010 and a much lower 2.3% a couple of years earlier, within the context of the economy slowdown in the aftermath of the global crisis outburst and the Dubai debt crisis. While such asset quality ratios remain in line with emerging market and global averages, risks are tilted to the downside, especially in light of the ongoing Dubai government related issuers (GRIs) restructurings and the lingering Dubai debt woes and real estate sector weaknesses. Loan impairments actually took their toll on Dubai Bank, which was taken over by

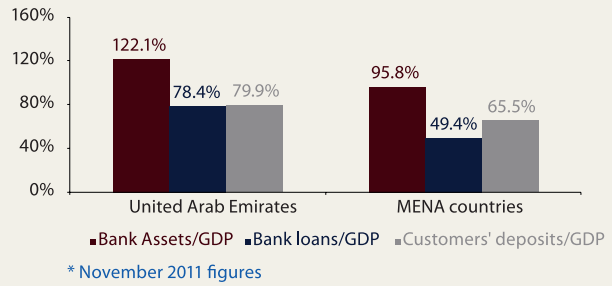
COMPARATIVE FINANCIAL SOUNDNESS INDICATORS *



* November 2011 figures, or latest available

Sources: IMF, Bankscope, Central Bank of UAE, Bank Audi's Group Research Department

COMPARATIVE BANKING SECTOR ECONOMIC DIMENSION *



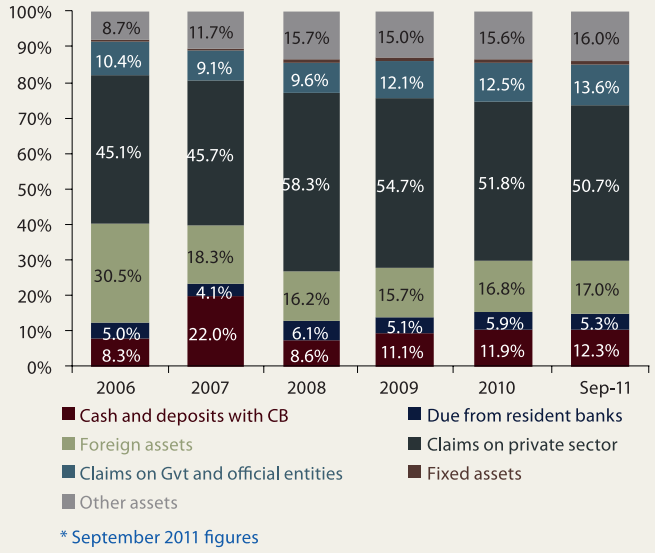
* November 2011 figures

Sources: Central Bank of UAE, Central Banks of MENA countries, IMF, Bank Audi's Group Research Department

Emirates NBD in October 2011 as part of a government initiative. Anyhow, UAE banks' NPLs coverage remains adequate in both absolute and relative terms, with the bank provisions to NPLs ratio standing at 86.1% at end-June, according to the IMF.

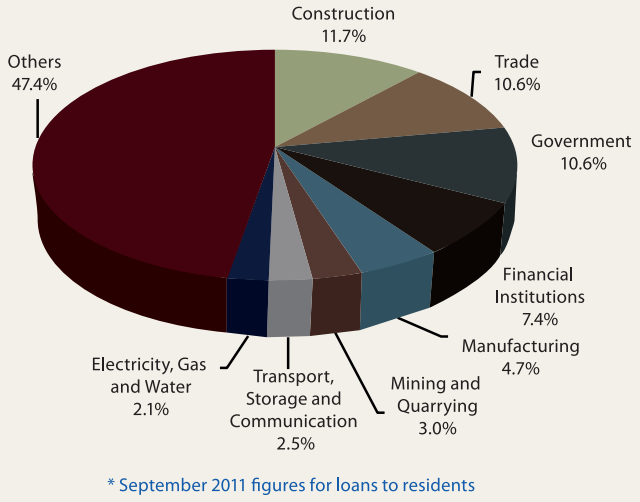
Notwithstanding lingering challenges at the level of asset quality and still difficult funding conditions, a relative improvement in domestic conditions has been reported, with private sector deleveraging advancing steadily and some progress achieved at the level of GRIs restructurings. In sum, the UAE banking sector today is in a better posture to weather adverse shocks and global headwinds, for instance spillovers of a European debt crisis driven global slowdown. Not only do UAE banks have very limited exposure to sovereign and corporate sector Euro zone borrowings, but they also benefit from higher capitalization, more stable funding resources, more liquid assets, and less reliance on foreign funding than at the onset of the previous crisis episodes.

ASSET COMPOSITION *



Sources: Central Bank of UAE, Bank Audi's Group Research Department

BANK LOAN BREAKDOWN BY ECONOMIC ACTIVITY *



Sources: Central Bank of UAE, Bank Audi's Group Research Department

1.4.3. Equity and Bond Markets

Drops in UAE equity markets prices, relatively mixed conditions in fixed income markets

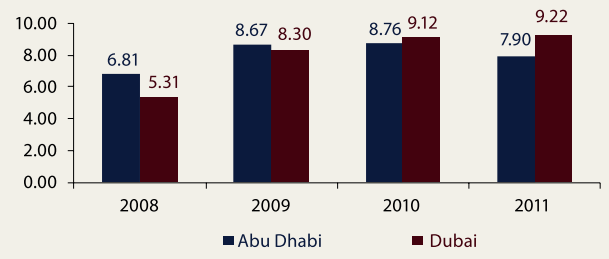
While the UAE fixed income markets benefited from a relative improvement in Dubai risk perception and Abu Dhabi's safe-haven status in 2011, the country's equity markets witnessed drops in prices year-on-year amid regional turmoil, concerns about the European debt crisis and the global economic outlook, with the UAE missing two opportunities in 2011 to get upgraded by MSCI from frontier market to emerging market status.

In details, the Dubai Financial Market index fell from 1,630.52 at end-2010 to 1,353.39 at end-2011, moving down by 17.0%. The breakdown of the DFM index by sector shows that the services sector witnessed the highest index drop with -70.3%, followed by the industrial sector with -40.9%, the financial and investment services sector with -35.4%, the transportation sector with -23.7%, the real estate & construction sector with -23.0%, the insurance sector with -15.6%, and the banking sector with -1.3%, while the telecommunication sector posted a rise of 1.1% and the consumer staples sector reported nil change in prices. The total trading value in the Dubai Financial Market amounted to US$ 8.7 billion in 2011, as compared to US$ 19.0 billion in 2010. The total number of traded shares was 25.0 billion shares in 2011 relative to 38.4 billion in 2010 and the total number of transactions was 442.5 thousand versus 794.3 thousand in the previous year. The market capitalization fell from US$ 54.2 billion in 2010 to US$ 49.0 billion in 2011.

The Abu Dhabi Securities Exchange reported a sharp drop in prices of 11.7% in 2011, as reflected by a fall in its index from 2,719.87 at end-2010 to 2,402.28 at end-2011. The breakdown of the Abu Dhabi general index by sector shows that the highest drop was in the industrial sector with -34.4%, followed by the consumer staples sector with -25.9%, the telecommunication sector with -15.5%, the services sector with -9.2%, and the insurance sector with -7.4%, while the banking sector remained stable year-on-year. The total trading value amounted to US$ 6.8 billion in 2011, as compared to US$ 9.4 billion in 2010. The number of shares traded was 15.9 billion in 2011, versus 17.6 billion shares in 2010, and the total number of trades was 283,368 in 2011 versus 363,471 in 2010. The market capitalization fell from US$ 69.7 billion at end-2010 to US$ 63.1 billion at end-2011.

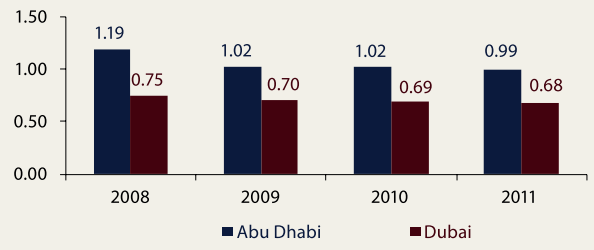
On the other hand, the UAE fixed income markets reported mixed conditions in 2011, with nearly a quarter of bonds reporting price contraction and three quarters reporting rise in prices over the year. Dubai benefited from amelioration in its risk perception after the announcement of the restructuring deal between the Dubai World and its creditors but its high beta names remained vulnerable. Abu Dhabi's fixed income papers were mostly viewed as a safe-haven investment amid major regional political and

PRICE/EARNINGS RATIO (x)



Sources: Abu Dhabi Stock Exchange, Dubai Financial Market, Bank Audi's Group Research Department

PRICE/BOOK VALUE RATIO (x)



Sources: Abu Dhabi Stock Exchange, Dubai Financial Market, Bank Audi's Group Research Department

security developments, concerns about European debt crisis and global pressures. Within this context, Abu Dhabi'19 closed up by 5.38 pts. Mubadala'19 ended 2.88 pts higher, while Taqa'17 dropped by 4.50 points and TDIC'14 contracted by 1.38 pts. Dubai names, though witnessing some kind of volatility in 2011, managed to end the year on a positive territory. For instance, Dubai'15 closed up by 4.25 pts and Dubai'20 closed up by 10.75 pts.

In parallel, the Sukuks were on the rise in 2011 as they proved to be somehow resilient to regional and global pressures. This is partly due to limited supply of Sukuk, and partly because Sukuk investors (of which cash-rich Islamic investors in the Gulf) tend to hold the bonds until maturity, which reduces the chance of big swings in secondary market prices that can be triggered by short-term speculators bailing out of positions. ADIB'15 closed up by 3.75 pts year-on-year. Dubai'14 closed up by 7.50 pts. As to the cost of insuring debt, Abu Dhabi and Dubai reported the lowest expansions in five-year CDS spreads in the region in 2011. Abu Dhabi's five-year CDS spread widened moderately by 34 bps, while Dubai's five-year CDS spread expanded by 30 bps year-on-year.

The UAE saw several bond issues in 2011. In fact, the government of Dubai launched in June 2011 a 10-year US$ 500 million bond with a put option after five years that allows investors to redeem their investment ahead of maturity at full value. The bond sale attracted orders of US$ 1.8 billion. Emirates Airlines launched a five-year US$ 1 billion bond in an upsized offering from an initial US$ 500 million on strong demand, with order books exceeding US$ 5 billion. In Abu Dhabi, Mubadala launched a dual-tranche US$ 1.5 billion bond. The book size exceeded US$ 7 billion. Aabar Investments raised € 1.25 billion from the sale of bonds exchangeable into the German automaker Daimler's stock. The bonds carry a coupon of 4.0%. IPIC issued in March 2011 a five-year € 1.25 billion bond, a 10-year € 1.25 billion bond, and a 15-year GBP 550 million bond. In addition, it issued in October 2011 US$ 1.5 billion notes due in March 2017, US$ 1.5 billion notes due in March 2022, and US$ 750 million notes due in November 2041.

ABU DHABI STOCK MARKET INDICATORS

	2006	2007	2008	2009	2010	2011
Market capitalization (in US$ billion)	70.1	110.7	60.7	71.7	69.7	63.1
Trading value (in US$ billion)	19.2	47.7	63.2	19.1	9.4	6.8
Turnover ratio	27.4%	43.1%	104.1%	26.7%	13.5%	10.7%
Trading volume (in millions)	11,296	52,066	49,984	37,616	17,595	15,857
Number of transactions	715,750	1,102,658	1,126,484	744,704	363,471	283,368
General share price index	3,000	4,552	2,390	2,744	2,720	2,402
% Change in share price index	-42.3%	51.7%	-47.5%	14.8%	-0.9%	-11.7%
Dividend yield	6.18%	5.26%	5.22%	4.53%	4.74%	4.58%

Sources: Dubai Financial Market, Zawya Investor, Bank Audi's Group Research Department

DUBAI STOCK MARKET INDICATORS

	2006	2007	2008	2009	2010	2011
Market capitalization (in US$ billion)	84.8	136.1	63.4	58.1	54.2	49.0
Trading value (in US$ billion)	94.6	103.2	83.1	47.2	19.0	8.7
Turnover ratio	111.6%	75.8%	131.1%	81.3%	35.0%	17.7%
Trading volume (in millions)	39,578	105,249	76,242	111,726	38,362	25,030
Number of transactions	2,415,392	2,251,467	2,125,485	1,998,142	794,254	442,456
General share price index	4,128	5,932	1,636	1,804	1,631	1,353
% Change in share price index	-	43.7%	-72.4%	10.2%	-9.6%	-17.0%
Dividend yield	4.27%	6.69%	6.47%	3.75%	4.39%	3.67%

Sources: Dubai Financial Market, Zawya Investor, Bank Audi's Group Research Department

CONCLUDING REMARKS

There is no doubt that the Arab Spring of 2011 brought an influx of business, trade and human flows to the Emirates and boosted aggregate demand but the global economic slowdown and the ongoing oversupply of property are believed to be persistently weighing on the near term economic outlook. It is within this context that international institutions have adopted moderate output and price assumptions for the year ahead. According to the IMF, real GDP is forecasted at 3.8% in 2012 while inflation is set at 2.5% for the year.

A number of questions and issues actually continue to arise on the Emirates property sector outlook, on Dubai's debt sustainability and on corollary asset quality of operating banks. Such questions that might lead to investment paradox for observers and analysts closely looking at UAE are exacerbated by an uncertain global economy, with the Emirates believed to be the most susceptible among MENA countries to fluctuations in global economic and market conditions. The outlook for 2012 and beyond thus requires a careful analysis of strengths and threats or a thorough study of positive and negative risk factors.

Positive risk factors are actually many. The history of domestic political stability rises among the most important, with open system of government, strong security system and a general satisfaction among Emiratis with their situation helping avoid the serious political unrest seen elsewhere around the region. The UAE population enjoys high standard of living, with US$ 66.6 thousand of income per capita and with a 4.2% unemployment rate. On the background of abundant hydrocarbon resources (97.8 billion barrels of oil reserves and 6.1 trillion cubic meters of gas reserves), Abu Dhabi government's very strong balance sheet provides a strong cushion against potential risks, with more than US$ 300 billion of assets under management in its Sovereign Wealth Fund as per IMF.

At the level of negative risk factors, we mention the following. At more than 100% of GDP, Dubai's sovereign and government related debt is still large, posing continued financial risks to the United Arab Emirates on the overall, with the federal structure of the UAE making close coordination between the various governments and improved transparency a growing requirement. The current re-pricing of risk could lead to more challenging market conditions within less liquid global markets, which may put pressure on the UAE entities that need to roll over external borrowing. The real estate sector is not out of the woods yet, with a near term market recovery highly unlikely, putting continuing pressure on asset quality of banks. Last but not least, the regional political tensions have recently risen as a worrying risk factor, with the cold war between GCC and Iran recently amplified by the Iranian threat for Hormuz Strait closure.

But the integration of positive and negative risks reinforce the conviction of an underlying capacity to overcome threats at the horizon. Dubai is likely to be able to manage the rollover of its 2012 debt maturities through a combination of internal cash generation, potential asset sales, market refinancing and Abu Dhabi government support. The Central Bank and Abu Dhabi government actually own 70% of the Dubai government debt, which supports the Emirate's credit profile and rollover pressures. At the property sector level, the relative stabilization of the real estate market conditions suggest the market has somehow bottomed, out with a potential pick-up in activity in the year to come. At the financial sector level, the recently launched new legislation aimed at strengthening the banking sector should benefit the operating banking environment, helping UAE-based banks to gradually overcome asset quality and loan exposure issues.

Finally, as the UAE does not share the political and economic characteristics of regional countries under turmoil, the possibility of a contagious unrest scenario towards the Emirati landscape is practically non-existent. In parallel, the Emirates are seemingly benefiting from the indirect spillover effects of the regional turmoil on the redirection of business and touristic flows from other countries in the region. Notwithstanding the corollary impact on oil prices which so far helped bolster UAE fiscal and external positions at large. For the Emirates, regional turmoil seems to have a silver lining.

DISCLAIMER

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