

UAE ECONOMIC REPORT

NOTABLE PICK UP IN CONSUMER CONFIDENCE ALONG WITH STRENGTHENING INVESTMENT GROWTH PACE

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- Economic recovery on a sustained track**
UAE's recovery has gathered momentum in the past couple of years, driven by strong growth in tourism, trade, transport and manufacturing while the real estate and construction sectors have also staged a comeback. On the back of a notable pick up in consumer confidence, real GDP growth has reported 4.0% in 2013, following 4.4% in 2012, according to estimates provided by the IMF. While growth in the non-oil sector has accelerated, oil sector growth has relatively weakened over the past year, estimated at less than 3% in the context of an amply supplied global oil market.
- Large yet contracting external accounts surpluses**
The UAE's external sector was underpinned by a contracting trade surplus in 2013 on account of a slower growth in exports than imports. The country managed to maintain a high though slowing current account surplus on the back of sustained high oil prices and growing non-hydrocarbon exports and re-exports. The contraction in the UAE's trade surplus in 2013, coupled with wider deficits at the level of services, income and current transfers balances, resulted in a contraction of the current account surplus as a percentage of GDP from 17.3% in 2012 to 15.2% in 2013, as per the IMF.
- Comfortable fiscal stance further supported by healthy economic activity**
Fiscal accounts continued to show comfortable surpluses, with the improving economic activity supporting further withdrawal of the large fiscal stimulus introduced post economic and realty downturn. The maintained revenue levels coupled with moderate expenditure increases are estimated to be leading to a comfortable albeit slightly lower fiscal surplus of 11.1% of GDP in 2013, according to the IMF. With comfortable fiscal surpluses accumulated over the years, the UAE's general government gross debt remains more than adequate absolute and relative terms, at less than 20% of GDP. Having said that, the aggregate debt of Dubai government and government related entities (GREs) remains sizeable, which raises some challenges given the significant debt redemption maturities.
- Significant growth in money supply and Central Bank's foreign assets**
Monetary conditions benefited from a sustained economy recovery and a robust flow of capital during the year 2013, which triggered a significant expansion in net foreign assets, a tangible growth in the Central Bank's reserves holdings, and an important expansion in money supply, while inflation remained relatively low despite rising housing costs. The overall Consumer Price Index for the UAE reached 118.89 in November 2013, according to the UAE National Bureau of Statistics, rising by 1.4% relative to November 2012. Overall money supply in its broadest sense (M3) witnessed an increase of 10.5% in the first eight months of 2013. In parallel, the Central Bank's foreign assets holdings grew significantly by 31.5% during the same period to reach US\$ 60.3 billion at end-August 2013.
- Favorable banking activity on the back of sound growth and increasing profitability**
The UAE banking sector witnessed a healthy growth during the year 2013. Measured by the aggregate assets of banks operating in the Emirates, total sector activity progressed by 6.5% in the first nine months of 2013 to reach US\$ 519.5 billion at end-September 2013. A sound loan growth during 2013 and improving macroeconomic fundamentals favored an amelioration at the level of asset quality metrics with a reduction in the non-performing loans to total loans ratio of UAE local banks. Along the same lines, UAE banks have witnessed during 2013 an improvement in profitability, providing them with the internal capital generation capacity needed to foster balance sheet growth ahead while continuing to boast solid capitalization levels.
- Positive prospects for the Emirates over the year to come**
Looking ahead, growth prospects are positive for the UAE, with real GDP growth forecasted at circa 4% by the IMF for 2014 on the back of a renewed investment drive, an accelerated population growth, a dynamic demand from GCC neighbors and a stable domestic political environment. The UAE's non-oil sectors, particularly trade, logistics, hospitality and manufacturing will remain the main drivers of growth in 2014. The UAE's status as a hub for trade, transport and tourism is vital both to its growth prospects and to further economic diversification away from hydrocarbons to galvanize the private sector and job creation for nationals.

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

UAE's recovery has gathered momentum in the past couple of years, driven by strong growth in tourism, trade and transport as well as manufacturing. Notably, the real estate and construction sectors have also staged a comeback, with those sectors that had been impaired since the 2009 crisis stabilizing in Abu Dhabi and starting to recover in Dubai. On the back of a notable pick up in consumer confidence, real GDP growth has reported 4.0% in 2013, following 4.4% in 2012, according to estimates provided by the IMF in their World Economic Outlook published last October. The UAE has benefited from its perceived safe-haven status in the region amid the political and social unrest that has been sweeping through the Middle East and North Africa region at large.

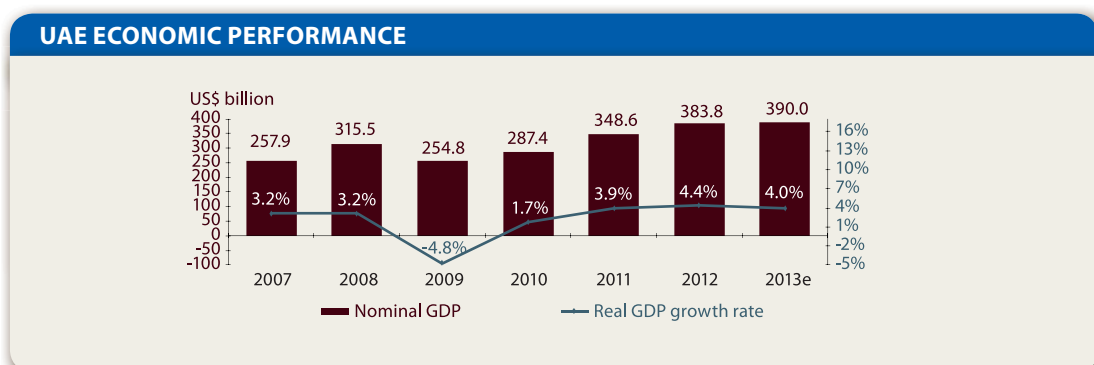
While growth in the non-oil sector has accelerated, oil sector growth has relatively weakened over the past year, estimated at less than 3% in the context of an amply supplied global oil market. It is worth noting that the UAE economy continues to be considerably dependent on the hydrocarbon sector which accounts for 40% of GDP and continues to make sizeable contributions to growth on the back of strong reserves. The UAE's hydrocarbon reserves are indeed very large, both in absolute and per capita terms. According to the 2013 BP Statistical Review of World Energy, the UAE's proven oil and gas reserves approximated 138 billion barrels of oil equivalent, which would last about 88 years at the current rate of production.

In parallel, UAE's non-oil sector has developed rapidly and has overtaken the oil sector as the main contributor to real GDP growth in most years in the past decade. The UAE's openness and ease of doing business has helped this development. The UAE ranks 19th out of 148 countries in the World Economic Forum's Competitiveness Index, making it the second most competitive country in the Middle East region. The UAE's openness and resulting rapid population growth are major sources of growth, with expatriate workers making up the majority of the local workforce within the context of a population growth exceeding 3% per annum.

The UAE's policy framework is sound and the economy has demonstrated its resilience to downturns in global economic cycles. Inflation has picked up slightly in 2013 (1.5% relative to 0.7% in 2012), as the housing market continues its recovery. The external current account surplus has been projected to remain high at 15.2% in 2013, supported by strong oil prices and large nonhydrocarbon exports and re-exports. UAE's large external net asset position gives it a considerable buffer to support its economy and mitigate the risks from external vulnerabilities.

The UAE has opted for continued fiscal consolidation last year at an appropriate pace, helping to further unwind the fiscal stimulus of recent years without undermining the economic recovery. A fiscal surplus of 11.1% of GDP is expected in 2013, close to its 2012 level, as transfers to government owned entities receded, and unlike in other GCC countries, its fiscal breakeven oil price fell. The fiscal consolidation is achieved by a rationalization of capital spending and subsidies and transfers, while spending on goods and services, defense and security and the wage bill have reported net increases. In addition, there was a notable progress made in fiscal coordination among the federal and emirate government, as acknowledged by the IMF.

The UAE banking system maintains significant capital and liquidity buffers. The banking system's capital adequacy ratio stood at a sound 19% in September 2013. With significant financial buffers, banks show



Sources: IMF, Bank Audi's Group Research Department

substantial resilience to shocks. But non-performing loans remain relatively high and while NPLs have begun declining from their high of December 2012, there is still some divergence among banks in the recognition of NPLs on restructured loans and provisioning practices. Still, Moody's changed its outlook for the UAE banking system from negative to stable in November 2013 to reflect continued improvements in the operating environment at large.

The in-depth developments in the real sector, external sector, public sector and financial sector of the economy are detailed in the forthcoming sections. The concluding remarks are left to the yearly outlook of the UAE economy on the back of positive and negative risk drivers looking ahead.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

Economic recovery on a sustained track

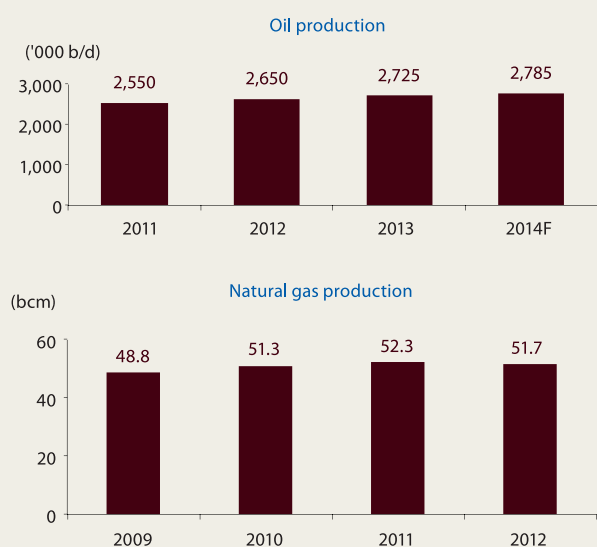
1.1.1. Hydrocarbons Sector

While UAE hydrocarbons sector is estimated to have grown at less than 3% in 2013, relatively lower than the growth rate in 2012, the sector still benefited from somehow elevated oil prices and production. In fact, average oil prices went up by 0.9% in December 2013 compared to the same period of the previous year while output remained almost unchanged in 2013.

The UAE is the fourth largest oil producer in OPEC with output reaching between 2.7-2.8 million barrels per day as of September 2013. Although the government has undertaken intensive efforts to bolster development in other economic sectors in order to strengthen economic diversity and stability, the hydrocarbon sector remains fundamental to the Emirate's economy, accounting for an estimated 40% of the country's GDP.

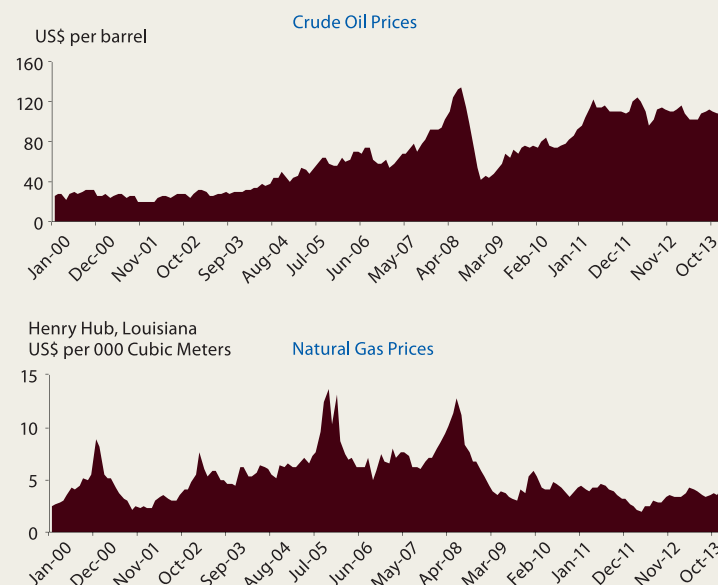
Abu Dhabi has increased spending on major developments at its offshore oil and gas fields, giving out high-profile awards in its hydrocarbon sector in 2013. The Emirate awarded four major contracts in 2013, with construction works on the awards on track following the Emirate's plan to expand production at the

OIL & GAS PRODUCTION



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

CRUDE OIL & NATURAL GAS PRICES



Sources: IMF, Bank Audi's Group Research Department

Upper Zakum, Satah al-Razboot (Sarab) and Umm al-Lulu fields, with further awards expected on the Nasr field in 2014.

In the first half of 2013, the UAE witnessed three major awards. Petrofac and Hyundai Engineering & Construction Company were awarded a US\$ 2.4 billion contract by Abu Dhabi Marine Operating Company to develop a 100,000 barrel-a-day Satah al- Razboot field. The project is a part of a plan to increase crude output by 300,000 barrels daily from new offshore fields. A second contract was given to South Korea's Daewoo. The deal was valued at US\$ 796 million and consists of building oil production facilities in the Upper Zakum oil fields for the Zakum Development Company, a subsidiary of Abu Dhabi National Oil Company. The third contract in the first half of 2013 was awarded to Abu Dhabi-based National Petroleum Construction Company. The deal consisted of developing an offshore field valued at US\$ 2.8 billion.

During the second half of 2013, French oil industry engineering company Technip was awarded, as part of a consortium led by the Emirati National Petroleum Construction Company, an oil field deal in the UAE worth US\$ 1.7 billion by the Abu Dhabi Marine Operating Company. The contract concerned the engineering, procurement and construction work of Umm al-Lulu full field development project in the UAE.

In parallel, Abu Dhabi's Executive Council approved the Emirates LNG project. The project, a joint venture between International Petroleum Investment Company and Mubadala Petroleum, plans to build and operate a land-based liquefied natural gas (LNG) re-gasification facility at Fujairah. The Emirates LNG's re-gasification terminal would have an average throughput capacity of 1.2 billion standard cubic feet of natural gas per day. The terminal would be a key infrastructure to support the UAE energy diversification strategy by enhancing energy security and providing flexibility to meet future gas demands. This state terminal would be able to accommodate the largest LNG carriers with the ability to access competitively priced LNG from any source around the world. The strategic and vital terminal location at Fujairah has access points into the UAE gas network and is in close proximity to key power stations and desalination plants.

It is important to note that Abu Dhabi National Oil Company has taken full control of the ADCO oil concession after decades-old partnerships expired with top European and American Oil companies. Under the concession arrangement, Adnoc held a 60% controlling stake in the Abu Dhabi Company for Onshore Oil Operations oilfields, while ExxonMobil, Royal Dutch Shell, Total and BP, each held 9.5% stakes. The western oil majors are among bidders for the right to help ADNOC run the fields for future decades, but they face stiff competition from Asian companies at large.

1.1.2. Non-Hydrocarbons Sector

Real Estate and Construction

The real estate sector in the UAE continues to be characterized by distinct patterns in its two main cities. While the market of Abu Dhabi remains subdued, that of Dubai has been characterized by increasing prices, renewed development activity and rising concerns of a bubble comeback.

Indeed, the recovery has been boosting prices in Dubai, with indicators like the Knight Frank Prime Global Cities Index expecting the emirate among the world's strongest performing real estate markets in 2013. The expectation was kind-of true, with average residential rates in Dubai rising by nearly one-third over the last 12 months to August. Most importantly, property prices are estimated to have increased between 22% and 30% in 2013 from their 2012 levels.

However, and in order to prevent the formation of another real estate bubble, the UAE Central Bank imposed restrictions on the value of mortgages available to foreign buyers. This has raised complaints by banks and is expected to slow down the market recovery as 35% to 40% of all property sales in Dubai are mortgage-based. In addition, Dubai's Land Department has doubled the transfer fee on property sales to 4% of property value. This rise aims to deter "flipping", which is defined as the practice of buying speculatively for quick-resale and was previously witnessed in the period surrounding the realty crush. The higher fee is expected to deter some speculators but is unlikely to affect the rate of home prices' increase.

Signs of recovery have also been channeled to Dubai's corporations which have benefited from the rebounding property sector. In fact, Nakheel, which was taken over by the government as part of a US\$ 16 billion rescue package completed in 2011, has recently announced plans to repay in 2014 US\$ 1.1 billion of its bank debt originally due in 2015. The developer will no longer require government support and is currently targeting annual profit growth of 15%.

The optimism related to Dubai winning the Expo 2020 bid is also expected to push property prices further up. However, as it has been the case since the start of the market rebound, the news of the successful bid has raised fears over the impact of the foreseen high-budget projects on over-inflating Dubai's already bouncing property market. In addition, the Expo 2020 presents also risks related to further indebtedness needed for financing sake. It is worth mentioning in this regard that the government has earmarked US\$ 6.8 billion for infrastructure related to the event.

The launching of huge new real estate schemes in 2013 is adding to the optimism. For instance, the sale of 188 townhouses by Emaar Properties and the selling out of serviced residences in Downtown Dubai on the first day of its public launch, provoked a positive agitation in the market, similar to the one witnessed at the peak of the emirate's property boom.

However, Dubai's property market remains vulnerable to potential additional volatility in the global financial markets. The emirate's government-related-entities (GREs), many of which are linked to the latest cluster of real estate projects, continue to be substantially indebted from the last crisis. The IMF estimates the total debt of the Dubai government and its GREs at US\$ 142 billion, or 102% of the nominal GDP of emirate.

Meanwhile, the market in Abu Dhabi has not recorded any significant change in pattern with rents and prices flat and overall supply plentiful. According to Jones Lang LaSalle, Abu Dhabi has a large amount of supply under construction. At the same time, demand from private sector occupiers and investors is weak, implying that rents and prices are not likely to rise this year.

The government has been intervening in an attempt to revive the market momentum. In fact, it has made it compelling to all people employed in Abu Dhabi to relocate to the capital (from Dubai) specifying the beginning of September as the deadline for the edict enforcement. The capital's attempt to legislate demand would help in boosting the market by attracting fresh inward investment and encouraging a slow recovery in residential rents.

At the level of Abu Dhabi's large real estate corporations, the merger of Sorouh and Aldar became effective in June. Sorouh has been dissolved and its assets and liabilities have been transferred to Aldar. As a consequence of the acquisition, the value of Aldar has risen to US\$ 13 billion in assets. The transaction was government-backed, as the two developers are part of the State's drive to diversify its hydrocarbon economy through office and leisure projects. It is worth mentioning that Aldar received more than US\$ 9.8 billion in bailouts from the government in 2011.

Transport

The UAE has continued to claim its status as a hub for transport and trade as one measure of boosting growth and economic diversification. The country's development of transport links with the region and with farther trade partners, have helped the UAE in taking advantage of trade opportunities.

While trade is of crucial importance specifically to Dubai as it does not have the hydrocarbon fortunes of Abu Dhabi, both emirates are set to move on with aggressive investments to boost their trade and transport infrastructure. While parallel expansion plans are not guaranteed to create synergy, the emirates' ambitions are taking a clashing pattern amidst fears of overcapacity.

For instance, Khalifa Port in Abu Dhabi whose commercial operations kicked off late in 2012 has plans to become one of the biggest in the world once fully operational. At the same time, and at a distance of barely 60 kilometers, exists the world's sixth largest seaport in Jebel Ali of Dubai. Moreover, Abu Dhabi International Airport is currently undergoing a massive expansion program aimed at increasing the market share of the emirate's flagship carrier, Etihad Airways. While Abu Dhabi's carrier is working on

its own expansion, Dubai's Emirates Airline continue to reap the benefit of its reputation as one of the leading airlines globally and is pulling in record passenger numbers. 80 kilometers away, Dubai World Central airport is expected to be fully operational in 2015, with capacity to make it the largest airport in the world.

Dubai International Airport registered in 2013 a 16% year-on-year increase in passenger numbers to 49 million in the first nine months of 2013. The airport is currently undergoing expansion plans to raise its capacity to 100 million passengers by 2020. The emirate's expansion projects for 2013 included the opening of phase one of its new airport, Al Maktoum International Airport, adding capacity for further 7 million passengers. The airport is planned to be able to accommodate for 160 million passengers by 2030. November has witnessed a main five-day aircraft event, namely the Dubai Airshow, which displayed passenger jets of around US\$ 140 billion in value. In addition, Dubai is expected to foresee an extension of the existing metro line in order to service the site of the Expo 2020, in Jebel Ali near Dubai World Central. Moreover, the building of the first foot bridge across Dubai Creek has been recently approved.

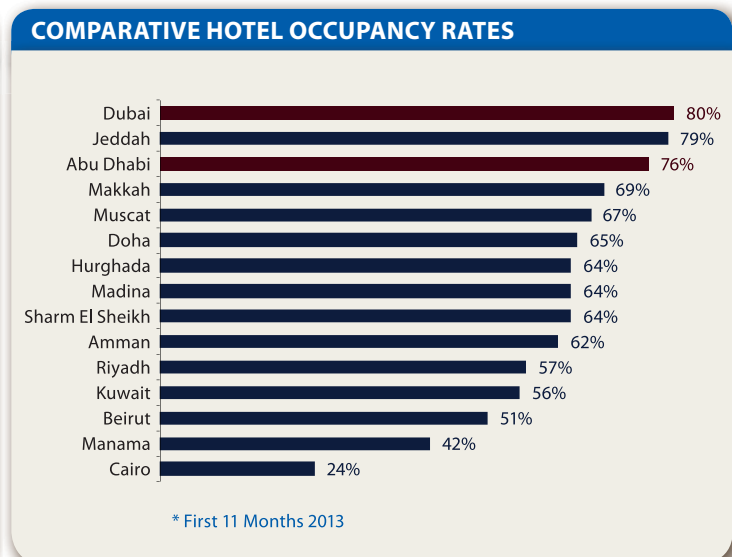
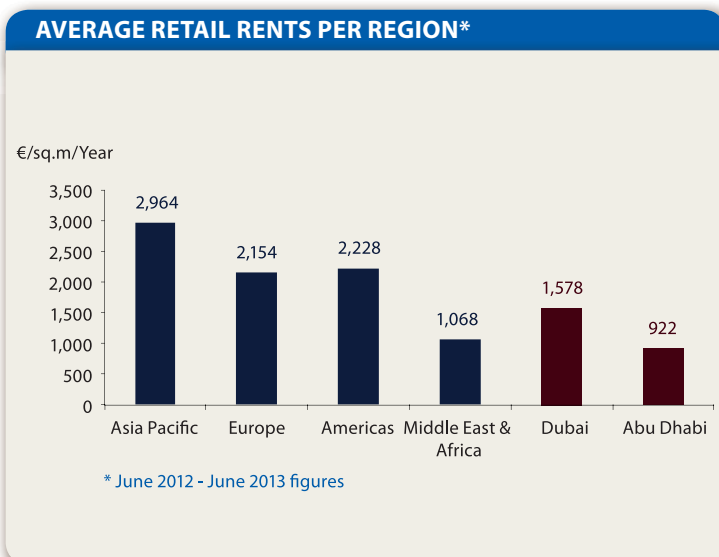
As to Abu Dhabi International Airport, it received 12.2 million passengers, up by 12% year-on-year in the first nine months of 2013. In regard to land transport, the funding for work on a new motorway has been approved along with a bus depot. In details, US\$ 73 million will be spent on an 80 km double-lane motorway linking Madinat Zayed with Ghayathi. As to the emirate's main bus depot at Khalifa City, in Abu Dhabi city, it will be renovated to increase capacity to around 480 vehicles. A fuel station, car washing facilities, and maintenance workshop with space for 550 buses will also be established.

In parallel, attention is being put on the development of the UAE's first national railway network. Financing of US\$ 1.3 billion for the first link of the project has been secured. The project should boost economic growth as its aim is to push ahead the efficiency of trade, mainly regarding non-oil exports.

At the same time, the stretch of track, which runs from south-western side of Abu Dhabi, to the west of the emirate, should make the transport of onshore oil and gas resources and petrochemicals to ports on the Gulf coast easier. The network will eventually span about 1,200 km across the UAE. At an estimated total cost of US\$ 10.8 billion, the rail network will link the UAE's seven emirates to other GCC countries.

Tourism

The UAE continues to benefit from its perceived safe haven status amidst the shaken Middle East region, registering increases in airport traffic and hotel occupancy. Both Dubai and Abu Dhabi are investing in high profile leisure and retail projects as well as in growing air links of their national carriers. At the same time, overoptimistic development plans are raising fears of a saturated supply.



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

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

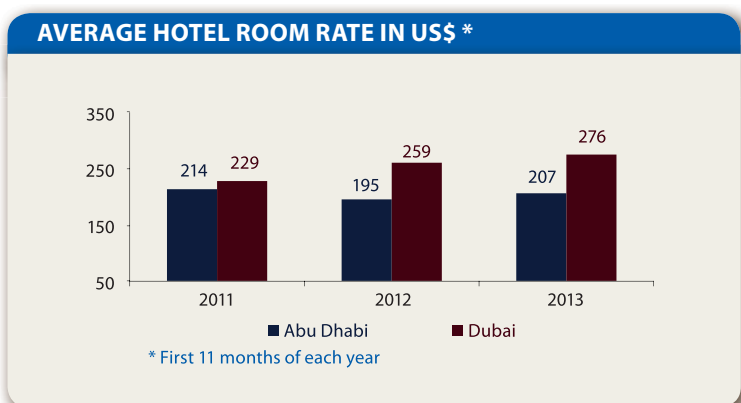
In details, Dubai attracted 11.1% more tourist incomers year-on-year to reach 5.5 million in the first half of 2013, pushing hotel occupancy to a significant 84.6%. The numbers in Abu Dhabi are also encouraging. In fact, the emirate reported more than 1.3 million visitors in the above mentioned period, up by 12% from the equivalent period of 2012.

It is worth noting that the UAE picked top ranks in terms of occupancy of four and five star hotels in the first ten months of the year. Indeed, Dubai registered the highest occupancy level at 80%, while Abu Dhabi's occupancy level was the third highest in the region, at 76%. The average room rate in Dubai rose by 7% year-on-year in the above mentioned period, while that of Abu Dhabi rose by 6%.

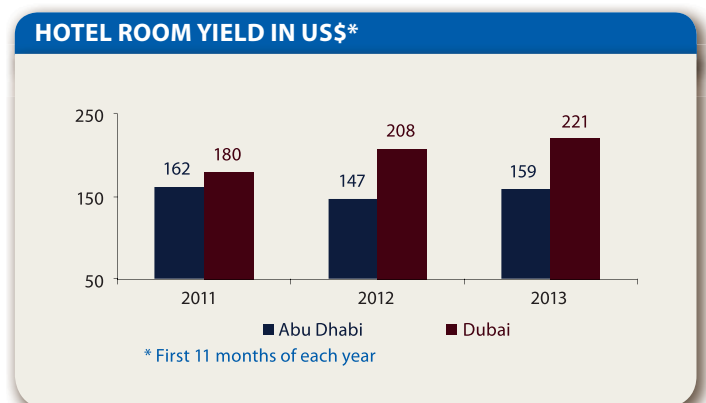
The above numbers reflect the fact that the UAE was a beneficiary of the uprisings elsewhere in the region after visitors stayed away from other tourist destinations like Egypt, Tunisia, and Bahrain. In addition, both emirates, aware of tourism's potential contribution in strengthening the private sector and creating jobs for nationals, are spending billions of dollars in order to sustain the sector's growth rates.

In fact, Dubai property developers, many of them State-backed, have announced a cluster of huge projects over the last year. On top of the list comes Dubai's Mohammed bin Rashid City, an extensive tourism and retail district set to include homes, 100 hotels, artificial beaches, and gardens 30% bigger than London's Hyde Park. Others include a replica Taj Mahal and the world's biggest Ferris wheel. In Abu Dhabi, the US\$ 27 billion Saadiyat Island project will include outposts of the Louvre and Guggenheim museums as well as resorts and cultural attractions. Benefiting from the UAE's position at the heart of the flight paths, the growing air links of both Etihad and Emirates airways will be critical in supporting hotel occupancy rates as supply increases.

Dubai, which has stated previously that it aims to attract 20 million visitors by 2020, is now expecting 25 million after its bid for hosting the Expo 2020 event has proved successful. The actual event itself, whose 75% of visitors will come from overseas, is expected to boost the tourism, retail, and hotel sectors. The Expo committee, concerned about the potential overcapacity, wants to ensure that any development triggered by hosting the Expo is sustainable in the long term.



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



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

1.2. EXTERNAL SECTOR

Large yet contracting external accounts surpluses

The UAE's external sector was underpinned by a contracting trade surplus in 2013 on account of a slower growth in exports than imports. The country managed to maintain a high, though slowing current account surplus on the back of sustained high oil prices and growing non-hydrocarbon exports and re-exports. The Economist Intelligence Unit (EIU) estimated total imported and exported free on board (FOB) goods at US\$ 618.8 billion in 2013, up by 8.2% relative to their value in 2012.

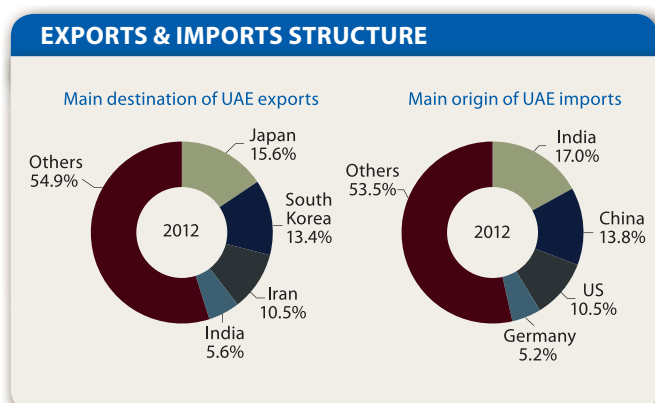
The growth in overall trade activity is the result of a rise in both imports and exports, although the former grew at a faster pace. Indeed, the EIU estimated that the rise in exports reached 5.5% in 2013 as compared to a double-digit growth of 15.9% reported during the previous year, whereas imports are estimated to have grown by 12.5% in 2013, versus a higher increase of 13.5% registered a year earlier.

Total exports indeed increased by 5.5% year-on-year to reach US\$ 369.2 billion in 2013. The rise in exports was still driven by revenues generated from the oil sector. As a matter of fact, crude oil exports went up by 11.1% in 2013 following a staggering increase of 49.7% in 2012. They now account for circa 41% of the overall export revenues compared with 39% a year earlier. As to non-oil exports, accounting for nearly 59% of the total, they amounted to US\$ 219 billion in 2013, up by a yearly 1.9%. This compares to an increase of 1.4% in 2012. The growth in non-oil exports is mainly supported by the progress with major infrastructure projects. In parallel, imports grew by a yearly 12.5% in 2013 to reach US\$ 249.6 billion, as per the EIU. The ongoing yearly progression of import volumes actually comes in line with the country's overall rising consumption and investment spending in a growing real economy.

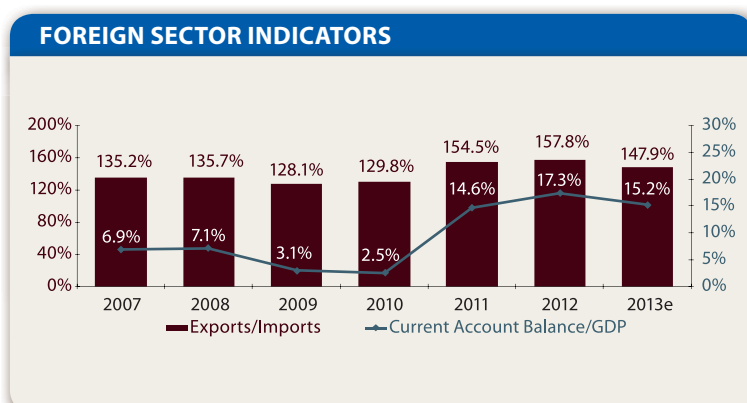
The growth of exports at a rate lower than that of imports led to a yearly contraction in the trade surplus of 6.7% to reach US\$ 119.6 billion in 2013, following an increase of 20.3% in 2012. The trade balance now accounts for 31% of GDP, versus 33% in 2012. Overall, the UAE's comfortable merchandise 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\$ 52.6 billion in 2013, up by 8.4% year-on-year against a higher increase of 11.3% seen in 2012. 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.

As to the current transfers balance, it posted a deficit of US\$ 13.9 billion, up by a yearly 6.0%. This compares to a growth of 9.1% seen in 2012. The main component of transfer outflows is remittances sent by the important expatriate labor force which accounts for the bulk of workers in the UAE. Remittance outflows are estimated to have grown in 2013 in line with the economic growth.



Sources: EIU, Bank Audi's Group Research Department



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

The contraction in the UAE's trade surplus in 2013, coupled with wider deficits at the level of services, income and current transfers balances resulted into a contraction of the current account surplus as a percentage of GDP from 17.3% in 2012 to 15.2% in 2013, as per the IMF.

All in all, the UAE enjoys large current account surpluses that have averaged 9.7% of GDP over the past decade, reinforcing its reserve buffers. The hydrocarbon sector contributes to circa 25% of current account receipts, while the UAE's external breakeven oil price stands at US\$ 48.9 per barrel, according to the IMF, which spots light on the country's strong external position.

1.3. PUBLIC SECTOR

Comfortable fiscal stance further supported by healthy economic activity

The UAE's fiscal accounts continued to show comfortable surpluses during the year 2013, with the improving economic activity and healthy fundamentals supporting further withdrawal of the large fiscal stimulus introduced post economic and realty downturn. The UAE's maintained revenue levels coupled with moderate expenditure increases are estimated to be leading to a comfortable albeit slightly lower fiscal surplus of 11.1% of GDP in 2013 (13.3% in 2012), according to the IMF.

On the revenue front, strong oil prices well above fiscal breakeven levels are feeding into the government revenue base, with hydrocarbon earnings accounting for an estimated 80% of total revenues. Healthy economic performances are favoring non-hydrocarbon revenues which are already supported by ongoing economic diversification efforts, and this is also having positive spillovers on the Emirates' fiscal revenues. General government revenues are hovering around their last year's highs and accounting for 34.3% of 2013 GDP, as per the latest IMF estimates. The recent increase in real estate transaction fees (which doubled from 2% to 4% as of October 2013) is likely to add to government revenues.

On the spending front, UAE authorities are continuing their fiscal consolidation strategy, as per the same source, expected to be achieved by a rationalization of capital spending and subsidies and transfers, while expenditures on goods and services, defense and security, and wages are estimated to be on the rise. The actual estimates of UAE government expenditures seem to be relatively in line with the budget plans. The IMF estimates a moderate 8.7% increase in general government expenditures to 23.3% of GDP in 2013 (21.8% in 2012), noting that the increase in spending is mostly earmarked for the financing of some large scale development projects. With general government revenues maintained at high levels and expenditures increasing moderately, the overall UAE fiscal balance is estimated to have registered a healthy though slightly lower surplus that the IMF placed at 11.1% of GDP for 2013, against 13.3% of GDP in the year before.

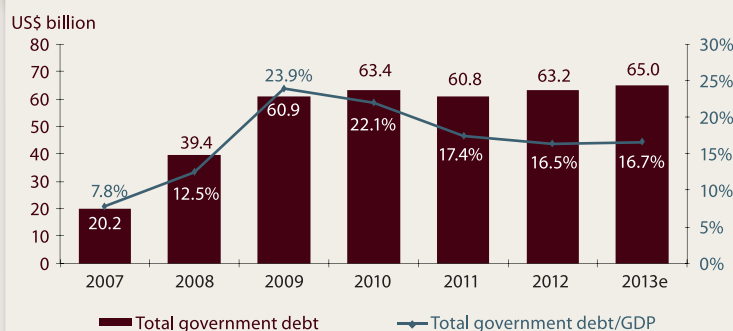
With such comfortable fiscal surpluses accumulated over the years, the UAE's general government gross debt remains more than adequate in both absolute and relative terms, at less than 20% of GDP. Having said

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	2008	2009	2010	2011	2012	2013e
General government revenues	122.9	69.0	85.2	119.7	134.7	134.0
General government revenues/GDP	39.0%	27.1%	29.6%	34.3%	35.1%	34.3%
General government expenditures	55.3	70.2	71.8	81.2	83.5	90.8
General government expenditures/GDP	17.5%	27.6%	25.0%	23.3%	21.8%	23.3%
General government fiscal balance	67.6	-1.2	13.4	38.5	51.2	43.1
General government fiscal balance/GDP	21.4%	-0.5%	4.7%	11.0%	13.3%	11.1%

Sources: IMF, Bank Audi's Group Research Department

PUBLIC DEBT AND INDEBTEDNESS RATIO



Sources: IMF, Bank Audi's Group Research Department

that, the aggregate debt of Dubai government and government related entities (GREs) remains sizeable, which raises some challenges given the significant debt redemption maturities during 2014 and in the next few years. While GRE debt restructurings linked to the recent crisis are nearing completion, several major maturities are now drawing closer, notably US\$ 20 billion Dubai government debt owned to Abu Dhabi and the Central Bank of the UAE in 2014. In this respect, a top Dubai official recently said that the emirate is witnessing growth, profitability and that it is going to be able to meet debt repayments. Those could be rolled over or repaid, perhaps through assets sales, which would contribute to alleviating the debt burden and further send positive signals to the investor community as to the gradual recovery of the Emirates in general, and Dubai in particular, from a quite severe debt crisis a mere few years ago.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Significant growth in money supply and Central Bank's foreign assets

Monetary conditions in the UAE benefited from a sustained economy recovery and a robust flow of capital during the year 2013, which triggered a significant expansion in net foreign assets, a tangible growth in the Central Bank's reserves holdings, and an important expansion in money supply, while inflation remained relatively low despite rising housing costs.

The overall Consumer Price Index for the UAE reached 118.89 in November 2013, according to the UAE National Bureau of Statistics, rising by 1.4% relative to November 2012. The rise came within the context of an increase in the education sector of 4.39%, the food and soft drinks sector (+2.96%), the furniture and household goods sector (+1.95%), the restaurants and hotels sector (+1.54%), the beverages and tobacco sector (+1.29%), the housing sector (+1.17%), the transportation sector (+1.06%), the textiles sector, clothing and footwear sector (+0.44%), and the recreation and culture sector (+0.24%), versus a fall in prices in the medical care sector (-0.41%), the miscellaneous goods and services sector (-0.48%), and the communications sector (-0.08%). It is worth noting that housing prices in the UAE have picked up in 2013 following three consecutive years of contractions, with residential prices and rentals in Dubai registering significant increases driven by fundamentals, which prompted the Dubai Land Department to double the property tax fee in an attempt to curb speculative actions. In addition, Abu Dhabi rental prices rose in 2013, partly due to the new regulation that requires government employees to reside in the capital to maintain their housing allowance. All in all, the CPI grew by 1.1% on average during the first eleven months of 2013 as compared to the corresponding period of the previous year, according to the National Bureau of Statistics, while the IMF expects an average inflation of 1.5% for full-year 2013 in tandem with a recovery in the housing sector.

Given relatively low inflation, sluggish global growth and low US interest rates, the Central Bank of the UAE retained its loose monetary policy under the fixed exchange rate regime. The Emirates Interbank Offered Rates saw declines across all tenors in 2013, with the three-month category reporting the highest fall of 49 bps since the beginning of the year to reach 0.81% at end-2013, indicating high liquidity in the market.

Amidst acceleration in credit growth, the Central Bank of the UAE's Certificates of Deposits portfolio contracted by 4.2% during the first eight months of 2013, moving down from US\$ 26.0 billion at end-2012 to US\$ 24.9 billion at end-August 2013.

Monetary aggregates in the UAE expanded significantly during the first eight months of 2013, mainly supported by capital flows into the country. The narrow measure of money supply (M1) widened by 16.3%, moving up from US\$ 81.5 billion at end-2012 to US\$ 94.8 billion at end-August 2013. This compared to a lower growth rate of 7.9% during the corresponding period of 2012. The broader money supply (M2) accelerated by 8.9%, moving up from US\$ 234.8 billion at end-2012 to US\$ 255.8 billion at end-August 2013, mainly supported by a 54.2% surge in net foreign assets (the equivalent of US\$ 23.7 billion). This compared to a much smaller growth rate of 1.1% during the corresponding period of 2012 (the equivalent of US\$ 2.5 billion). Overall money supply in its broadest sense (M3) witnessed an increase of 10.5%, moving up from US\$ 295.1 billion at end-2012 to US\$ 326.2 billion at end-August 2013. This compared to a lower growth of 4.7% during the corresponding period of 2012.

In parallel, the Central Bank's foreign assets holdings grew significantly by 31.5% during the first eight months of 2013 (the equivalent of US\$ 14.4 billion) to reach US\$ 60.3 billion at end-August 2013, its highest level since year-end 2007. The staggering growth in the Central Bank's foreign assets is mainly driven by a significant expansion in held-to-maturity foreign securities of US\$ 8.1 billion, with the latter hitting a record high level of US\$ 34.0 billion at end-August 2013. Accordingly, the Central Bank's foreign assets coverage ratio to money supply (M1) and Dirham deposits went up from 23.3% at end-2012 to 28.8% at end-August 2013. The UAE Dirham remained pegged to the US Dollar. The peg has provided stability for decades and, having ridden out the problems that fixed currency brings for this long, the authorities seem keen to maintain the system.

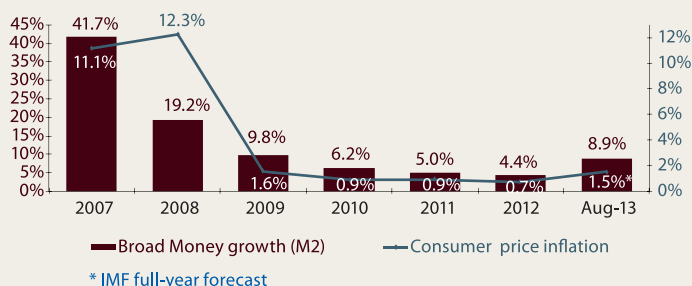
Looking forward, the Central Bank of the UAE is expected to maintain an accommodative monetary policy under the US Dollar peg, according to the IMF, and there are few near-term inflationary risks despite an expected pick-up in the housing component of inflation.

EVOLUTION OF MONETARY CONDITIONS

Flows in US\$ million	2010	2011	2012	8M-13
Net foreign assets	8,625	3,778	18,615	23,730
Foreign Assets	14,225	8,576	25,587	26,374
Foreign Liabilities	-5,600	-4,798	-6,972	-2,643
Net Domestic Assets	3,838	6,942	-8,645	-2,737
Claims on private sector	1,504	7,374	3,654	9,762
Net claims on public sector	7,968	13,100	-5,482	-15,250
Claims on financial institutions	-75	-2,381	1,580	2,389
Capital & Reserves	-7,898	-6,373	-5,159	4,814
Other Items (net)	2,339	-4,778	-3,237	-4,451
Broad Money (M2)	12,463	10,720	9,970	20,994
Money Supply (M1)	2,581	8,478	9,551	13,307
Quasi-Money	9,882	2,242	419	7,687

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

Lending activity picks up and profitability improves

The UAE banking sector witnessed a healthy growth during the year 2013 against the backdrop of improving macroeconomic performances, a recovering realty market, growing investor optimism about the MSCI country upgrade and the recent Expo 2020 win for Dubai. Measured by the aggregate assets of banks operating in the Emirates, total sector activity progressed by 6.5% in the first nine months of 2013 to reach US\$ 519.5 billion at end-September 2013, as per the latest Central Bank statistics.

Bank deposits continued to account for the larger part of funding in the sector during 2013, at two thirds of total balance sheets on aggregate. Deposits grew by 8.8% in the first nine months of 2013, moving from US\$ 318.0 billion at end-December 2012 to US\$ 345.8 billion at end-September 2013. The 2013 year-to-date deposit increase in volume, amounting to US\$ 27.8 billion, proved 38% higher than during the similar period of 2012, within the context of accrued economic activity and relatively healthier fundamentals.

A more detailed look at bank deposits shows that the year-to-date 2013 growth is owed to resident deposits, which grew by 10.9% over the covered period. Non-resident deposits, representing circa 10% of the total deposit base at banks in the UAE, slightly contracted during the covered 2013 period after having increased in the year 2012. The slight retreat in non-resident deposits during 2013 is mostly due to lower deposits from financial institutions and to a lesser extent from foreign public sector entities, while rising funds from the resident sector in the UAE could be attributed to growing deposits from the public sector and the private sector in both its corporate and retail components, as per the latest available detailed UAE Central Bank figures.

In particular, private sector deposit increases during 2013 are owed to both the local currency and the foreign currencies, and to higher demand and savings deposits. This reflects an alteration of banks' deposit mixes, shifting more the balance towards demand and savings deposits rather than the more expensive time deposits. Demand and savings deposits now account for about half of private sector deposits, against a share of 37% before the global financial crisis outburst, which increases the risk of duration mismatch as banks become reliant on shorter-term funds to finance lending. Furthermore, the share of time deposits exceeding 12 months, as per the latest detailed official figures covering the first eight months of 2013, reached 21% of total time deposits at end-August 2013, against 25% at end-December 2012. Anyhow, the cash-rich public sector continues to be a main and stable source of funding for UAE banks with 27% of total deposits at end-August 2013, limiting the reliance on confidence-sensitive wholesale funding and somehow offsetting the contractual maturity mismatch.

With additional liquidity at hand, an improving economic activity and lower risk aversion in the corporate segment, the UAE banking sector has seen an acceleration in lending activity during the covered period of 2013. Loans and advances rose by 7.2% in the first nine months of 2013 to reach US\$ 320.8 billion at end-September 2013. This marks a pick-up in lending activity after mild to stagnant lending growth in the post-crisis period, with the volume of new loans and advances 2.5x higher than that during the similar period of 2012.

EVOLUTION OF BANKING AGGREGATES

US\$ million	2007	2008	2009	2010	2011	2012	Sep-13
Total assets	327,375	396,515	413,642	437,195	452,580	487,842	519,455
% YTD growth in assets	39.9%	21.1%	4.3%	5.7%	3.5%	7.8%	6.5%
Total deposits	194,968	251,191	267,550	285,800	291,273	317,985	345,813
% YTD growth in deposits	38.0%	28.8%	6.5%	6.8%	1.9%	9.2%	8.8%
Total bank loans and advances	185,138	270,579	277,114	280,817	291,627	299,278	320,844
% YTD growth in bank loans and advances	34.3%	46.1%	2.4%	1.3%	3.8%	2.6%	7.2%

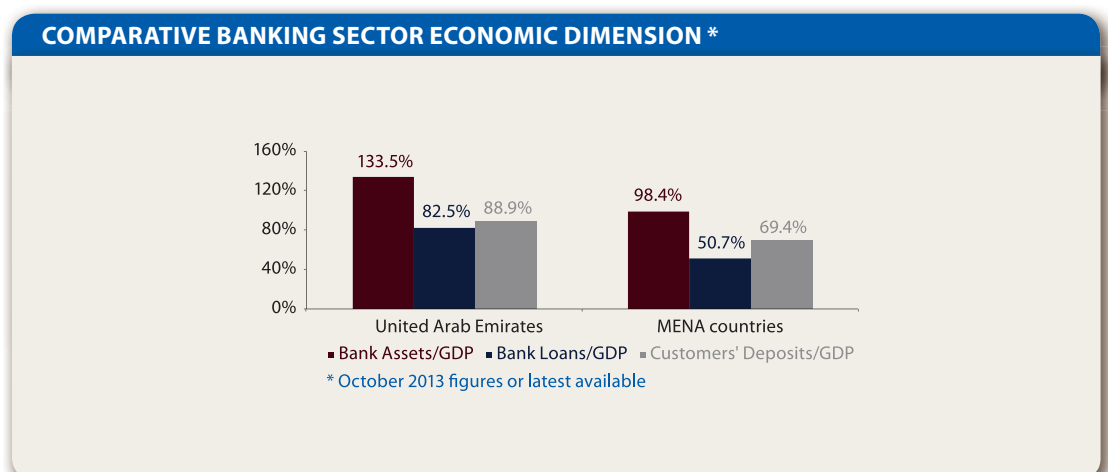
Sources: Central Bank of UAE, Bank Audi's Group Research Department

This comes at a time when the authorities are studying macro-prudential policies to regulate credit growth. The Central Bank is imposing borrowing curbs and tightening rules on loan-to-value ratios for mortgages to prevent another credit bubble similar to that seen a scant few years ago. Foreigners can now borrow 75% of the value of a first residence priced at AED 5 million or less and UAE nationals can get 80%, with the limits at 65% and 70% respectively for homes worth more than AED 5 million. The authorities capped mortgages for second homes and investment properties at 60% of their value for expatriates and 65% for nationals regardless of the value. The Central Bank actually initiated during 2013 a number of initiatives to protect the asset quality and balance sheet strength of banks. Among those measures, it granted a five-year period to UAE banks to reduce their excess balance sheet exposure to government related entities by 20% each year until the ceiling set is reached. This gives time for banks to realign their balance sheets and for those entities to seek alternative funding. It is yet worth noting that a profitable GRE without any need for implicit or explicit government support and with a credit rating of at least BBB can be treated as an entity separate from the government, as per the Central Bank of the UAE.

Having said that, the loan growth during 2013 and improving macroeconomic fundamentals favored an amelioration at the level of asset quality metrics with a reduction in the non-performing loans to total loans ratio of UAE local banks. The latter reached 8.3% at end-March 2013 (latest IMF statistics), down from a high of 8.7% at end-December 2012 for the sector attained after consecutive asset quality deterioration following the global crisis outburst. While the ongoing realty market recovery and higher lending volumes coupled with the cautious stance towards underwriting during the difficult post-crisis period augur well for asset quality ratios of UAE banks, a potential further restructuring of GRE debt could weigh on the stock of NPLs.

In parallel, banks' liquidity position improved further during 2013. The loan-to-deposit ratio stood at 92.8% at end-September 2013, against 94.1% at end-December 2012 and levels slightly above the 100% threshold in 2011. Moreover, UAE banks continued to hold more liquid assets (cash and deposits and quasi-deposits at the Central Bank and at banks domestically and abroad) than the pre-crisis period, and during 2013 their dues from other banks abroad and higher deposits at the Central Bank contributed to maintaining an adequate liquid asset level at 35.5% of total deposits at end-August 2013 (latest available figures). This level is deemed to be adequate in absolute terms and compares favorably to regional and international benchmarks.

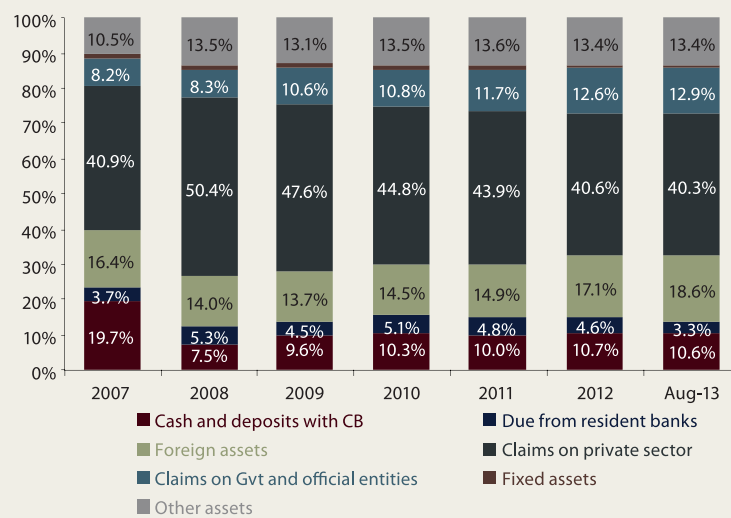
Along the same lines, UAE banks have witnessed during 2013 an improvement in profitability. In the absence of consolidated sector statistics for the year covered, we resorted to the aggregation of bottom lines of the 20 listed UAE banks which account for the bulk of sector activity. Aggregated net profits of those banks posted a 16.7% yearly rise over the first nine months of 2013 within the context of higher core revenues despite margin pressures amidst a relatively low interest rate environment.



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

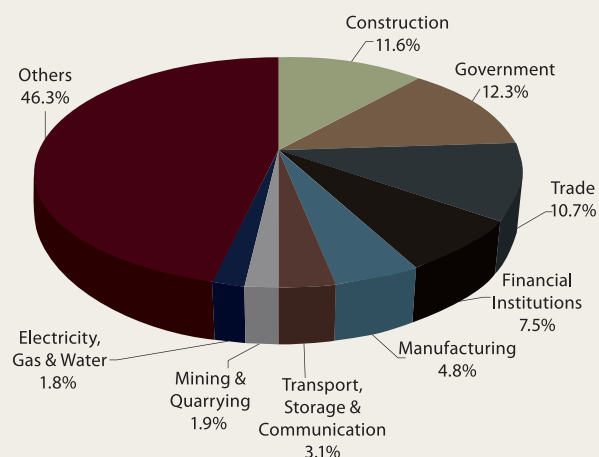
Banks' rising bottom lines is likely to provide them with the internal capital generation capacity needed to foster balance sheet growth ahead while continuing to boast solid capitalization levels. The sector's capital adequacy ratio reached 19.0% at end-September 2013, the bulk of which consists of Tier 1 capital (17.4% ratio at end-September), slightly declining from 21.0% at year-end 2012 as banks started paying down Tier 2 capital held by the government. Nonetheless, UAE banks' capital adequacy ratios remain well above regulatory requirements (12% for the capital adequacy ratio and 8% for the Tier 1 ratio), thus helping them bear potential further provisioning expenses and maintain adequate capital buffers.

BANK ASSET COMPOSITION



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

BANK LOAN BREAKDOWN BY ECONOMIC ACTIVITY *



* August 2013 figures for bank credit to residents

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

1.4.3. Equity and Bond Markets

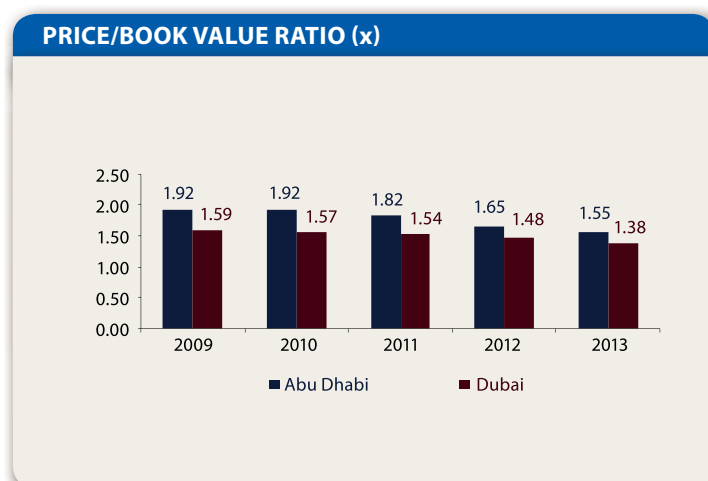
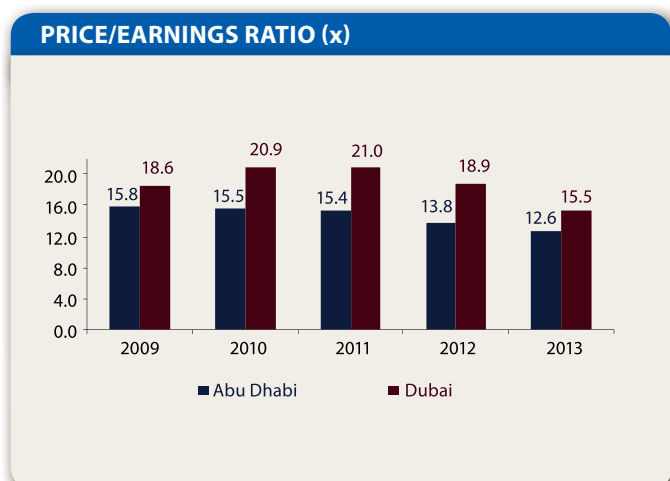
Strong rally in equity prices coupled with price contraction in bond markets

The UAE equity markets witnessed a buoyant activity and a strong rally in prices during the year 2013 amidst sustained economic recovery, while the country's fixed income markets saw price falls, tracking rises in US Treasuries yields, on speculation the US Federal Reserve would taper its bond-buying program.

In details, the UAE equity markets registered staggering price increases in 2013, mainly supported by an MSCI upgrade from "frontier market" to "emerging market", an economic recovery that gained momentum during the year, the launching of several realty projects, buoyant company results, and an improved investor sentiment after Dubai won in November the right to host World Expo 2020 Exhibition, a move that is expected, according to Fitch, to generate activity and boost confidence across the Emirate's infrastructure, real estate and hospitality sectors over the next few years.

In details, the Dubai Financial Market index rose from 1,622.53 at end-2012 to 3,371.43 at end-2013, moving up by a staggering 107.8%. The breakdown of the DFM index by sector shows that the financial and investment services sector witnessed the highest index rise of 169.2%, followed by the banking sector with 120.6% as banks have benefited from increased confidence in the growth outlook that has spurred demand for credit, the real estate sector (+108.4%) within the context of a robust growth in sales and rental prices in Dubai and the launching of several mega projects, the services sector (+98.3%), the telecoms sector (+90.8%), the transportation sector (+68.2%), the industrial sector (+31.2%), while the consumer staples sector and the insurance sector posted price declines of 9.9% and 7.2% respectively. The total trading value in the Dubai Financial Market amounted to US\$ 43.5 billion in 2013, as compared to US\$ 13.3 billion in 2012. The total number of traded shares was 127.2 billion shares in 2013 against 40.5 billion in 2012, and the total number of trades was 1,337,858 in 2013 versus 621,434 in the previous year. As to market capitalization, it rose significantly by 41.3% in 2013, moving up from US\$ 50.1 billion at end-December 2012 to US\$ 70.7 billion at end-December 2013.

Similarly, the Abu Dhabi Securities Exchange reported a significant rise in prices of 63.1% in 2013, as reflected by an increase in its index from 2,630.86 at end-2012 to 4,290.30 at end-2013. The breakdown of the Abu Dhabi general index by sector shows that the highest rise was in the investment and financial services sector with 300.0%, followed by the real estate sector with 146.1%, the industrial sector with 70.2%, the banking sector with 68.0%, the consumer staples sector with 65.5%, the energy sector with 55.0%, the services sector with 31.4%, the telecommunications sector with 29.0%, and the insurance sector with 16.8%. Trading value almost quadrupled in 2013 relative to the previous year to reach US\$ 23.1 billion, which is its highest level in five years. The market capitalization surged from US\$ 69.5 billion at end-2012 to US\$ 106.6 billion at end-2013.



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

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

All in all, the UAE equity markets rallied strongly in 2013, outperforming regional and emerging stock markets, as reflected by an 85% surge in the S&P UAE price index as compared to a 22% rise in the S&P Pan Arab Composite Index and a 2.0% decrease in the S&P emerging frontier super composite index. Under these favorable conditions, EFG-Hermes upgraded the UAE from "Neutral" to "Overweight", citing strong cyclical upswing and potential for earnings beats.

In parallel, UAE fixed income markets saw price falls in 2013, tracking rises in US Treasuries yields, on speculation the US Federal Reserve would taper its bond-buying program, which was effectively announced on December 18, given the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions in the US.

In Abu Dhabi, sovereigns maturing in 2014 and 2019 closed down by 5.00 pts and 6.25 pts respectively. Amongst quasi-sovereigns, prices of Mubadala papers maturing between 2014 and 2021 fell by up to 8.00 pts. IPIC'41 traded down by 18.50 pts. Dolphin'19 and '21 were down by 3.75 pts and 8.00 pts respectively. Taqa papers saw price falls across the curve, with papers maturing between 2014 and 2036 closing down by 0.88 pt to 17.25 pts. As to papers issued by financial institutions, they were mostly on the decline. Prices of NBAD'19 and ADIB Perpetual decreased by 2.13 pts and 6.00 pts respectively. ADCB'14 and '16 closed down by 2.38 pts and 1.00 pt respectively. Regarding new bond issues, ADCB, Al Hilal Bank and FGB launched new issues during the first half of 2013 and during the fourth quarter of the year. As to the cost of insuring debt, Abu Dhabi's five-year CDS spread contracted by 29 bps in 2013 to 55 bps.

ABU DHABI STOCK MARKET INDICATORS

	2007	2008	2009	2010	2011	2012	2013
Market capitalization (in US\$ billion)	110.7	60.7	71.7	69.7	63.1	69.5	106.6
Trading value (in US\$ billion)	47.7	63.2	19.1	9.4	6.7	6.1	23.1
Turnover ratio	43.1%	104.1%	26.7%	13.5%	10.6%	8.7%	21.7%
Trading volume (in millions)	52,066	49,984	37,616	17,595	15,677	16,394	51,519
Number of transactions	1,102,658	1,126,484	744,704	363,471	280,840	258,685	556,290
General share price index	4,552	2,390	2,744	2,720	2,402	2,631	4,290
% Change in share price index	51.7%	-47.5%	14.8%	-0.9%	-11.7%	9.5%	63.1%
Dividend yield (%)	2.82	2.77	2.40	2.58	3.13	3.82	-

Sources: Abu Dhabi Stock Exchange, Zawya investor, Bank Audi's Group Research Department

DUBAI STOCK MARKET INDICATORS

	2007	2008	2009	2010	2011	2012	2013
Market capitalization (in US\$ billion)	138.2	64.8	58.8	54.7	49.6	50.1	70.7
Trading value (in US\$ billion)	103.2	83.1	47.2	19.0	8.7	13.3	43.5
Turnover ratio	74.7%	128.2%	80.3%	34.7%	17.6%	26.5%	61.6%
Trading volume (in millions)	105,249	76,242	111,726	38,362	25,164	40,463	127,180
Number of transactions	2,251,467	2,125,485	1,998,142	794,254	444,814	621,434	1,337,858
General share price index	5,932	1,636	1,804	1,631	1,353	1,623	3,371
% Change in share price index	43.7%	-72.4%	10.2%	-9.6%	-17.0%	19.9%	107.8%
Dividend yield (%)	2.98	2.86	1.65	1.95	1.98	2.68	-

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

In the Dubai space, sovereigns and quasi-sovereigns ended the year 2013 on a negative note despite some price rises observed towards the end of the year following the Expo 2020 win. In fact, sovereigns maturing between 2014 and 2022 saw their bond prices drop by 0.75 pt to 7.00 pts. As to new issues, the government of Dubai sold in January 2013 a ten-year US\$ 750 million Sukuk and a 30-year US\$ 500 million Sukuk, to take advantage of tumbling borrowing costs at that time (before the May announcement by the US Fed). Amongst quasi-sovereigns, DEWA'20 traded down by 6.38 pts. Prices of DP World'17 and'37 fell by 2.25 pts and 18.13 pts respectively. As to corporates, some papers issued by realty firms saw price increases in 2013, supported by a recovery in the property market and an improved investor sentiment following the Expo 2020 win. Emaar'19 was up by 1.00 pt. Nakheel'16 closed up by 6.63 pts. Nakheel said in December 2013 that it has made a Sukuk profit payment of AED 218 million to its trade creditors.

As to papers issued by financial institutions, ENBD'17 and DIB'17 closed down by 0.38 pt each. It is worth noting that some banks in Dubai launched new issues before the May announcement by the US Fed, as Dubai recovers from a property crash and lenders wanted to benefit from low yields. For instance, CBD sold a five-year US\$ 500 million bond. ENBD raised US\$ 1 billion from the sale of perpetual bonds. As to the cost of insuring debt, Dubai's five-year CDS spreads contracted by 5 bps in 2013 to 220 bps at year-end.

Looking forward, UAE equity markets are expected to benefit from strong cyclical upswing favorable for earnings upgrades, while fixed income markets would continue to track US Treasuries moves, noting that Dubai faces aggregate debt repayments of US\$ 30.5 billion in 2014, as per the IMF, two-thirds of which borrowed from Abu Dhabi and the Federal Government of the UAE when the financial crisis hit across the globe about five years ago. These are yet expected to be either repaid or rolled over, which could help push Dubai CDS spreads further down.

2. CONCLUDING REMARKS

Looking ahead, growth prospects are positive for the UAE, with real GDP growth forecasted at circa 4% by the IMF for 2014 on the back of a renewed investment drive, an accelerated population growth, a dynamic demand from GCC neighbors and a stable domestic political environment. The UAE's non-oil sectors, particularly trade, logistics, hospitality and manufacturing will remain the main drivers of growth in 2014. The UAE's status as a hub for trade, transport and tourism is vital both to its growth prospects and to further economic diversification away from hydrocarbons to galvanise the private sector and job creation for nationals.

The economic diversification drive is set to gather further steam. Dubai aims to build on its early achievements in becoming a hub for retail and wholesale trade, as well as a major tourism and real estate investment destination for the wider region. Dubai has won the race to host the World Expo 2020, an event that will draw in a large pool of visitors that the government forecasts at 19 million foreign visitors boosting the tourism and retail sectors and adding to Dubai's confidence and fast track implementation. This will undeniably add gradual impetus to the economy, as the emirate plans to spend US\$ 6.8 billion on infrastructure, but also presents risks related to overcapacity, property prices and debt. Dubai has made significant progress in restructuring and financing debts, but the emirate's total debt stock remains large at US\$ 142 billion.

Government spending on new projects in Abu Dhabi and Dubai will help to sustain non-oil growth in the year to come, including through support for the construction and manufacturing sectors. Services growth will also be buoyant, helped by trends in private consumption and strong dynamics in the trade, transport and tourism sectors. The federal budget for 2014 includes a 4.5% increase in total spending. The budget prioritises social spending, on the back of authorities' efforts to minimize contagion risks from the regional unrest. Spending on social welfare and development will account for half of total expenditures.

The still uncertain global economic and financial environment could pose external risks to this favorable outlook, although the UAE's sizeable foreign assets and strong fiscal position provide significant buffers. According to Moody's Investors Service, it is likely that the country's overall international investment position remains strongly positive, despite the previous rapid increase in debt by the government, the GRIs and the government owned banks.

At the external level, UAE's large current account surplus might somehow moderate in 2014, as oil prices fall on average, constraining growth in export earnings, and as goods import costs rise, along with a widening of the services deficit. Strong import growth and a widening of the non-merchandise deficit would continue. However, progress with major infrastructure projects would support non-oil export earnings, underpinning the large trade surplus.

At the monetary level, on the back of low inflation, sluggish global growth and low US interest rates, the Central Bank will retain a loose monetary policy for now. The Central Bank remains committed to the existing peg of the Dirham to the Dollar, which is not expected to come under threat in the foreseeable future. But the Central Bank might aim to tighten banking regulations further. Bank lending has accelerated during 2013, with net loans and advances up by 7.2% year-on-year in September and with credit growth expected to strengthen further in 2014, as large shares of the wider projects are expected to be carried out by the private sector and loan growth is expected to be broad based over the year to come.

In this environment, the IMF believes that economic and financial policies should focus on measures that will help prevent a renewed cycle of exuberant risk taking and strengthen the fiscal position, while completing the agenda of dealing with the legacy of the 2009 crisis by continuing the deleveraging and restructuring of government-related entities. Building on progress in restructuring the debt of GREs, a further strengthening of the GRE sector requires proactive management of upcoming debt maturities and improving the GREs' transparency and governance, while the new mega projects should be executed at a measured pace, and new risk taking by GREs should be avoided at large.

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