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United Arab Emirates

Top Economic & Investment Themes for 2016

Classification of economic and investment themes for the UAE financial markets.

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Top Economic & Investment Themes for 2016

United Arab Emirates

Research Highlights:
Analysis of key economic and investment themes for United Arab Emirates in 2016

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Economic Themes & Impact on Investments

Key Themes	Rationale	Stock Market	Bonds	Real Estate	SME
Diversified and Competitive Economy	UAE should sustain the reform momentum and create new engines of economic growth				
Creation of a Local Debt Market in UAE	Creating a local debt market is of prime importance to diversify capital source and lessen stress on bank balance sheets				
Dubai Real Estate	Strengthening US dollar and lower oil prices could affect investor confidence and real estate activity, which is largely driven by foreign investments			na	
Subsidy Rationalization	UAE has capitalized on the opportunity offered by low oil prices to deregulate fuel prices				
Improving Business Environment	UAE could further improve its Doing Business rankings especially with regard to credit availability for SMEs				
Leader in SME Space in GCC	Renewed focus on SME space and appropriate reforms could spur SMEs to be a key growth engine				

Source: Marmore; Legend for color codes: Positive Impact | Neutral Impact | Negative Impact

In UAE, hydrocarbon sector is expected to contribute positively to real growth in 2016 as the phased increase in oil production happens. UAE had earlier set a target to raise its production capacity by 30% in 2020. Production is being increased to meet the growing domestic demand for hydrocarbons which is now currently being met with imported gasoline. Thus, the phased rise in production would materialize despite the persistence of lower oil prices.

Non-hydrocarbon growth is expected to be moderate in 2016, amid the lower oil price environment, as government expenditures are reined in. However, the buoyant service industry underpinned by transportation, logistics and hospitality sectors and implementation of various infrastructure projects associated with hosting Dubai Expo 2020 is expected to revive non-hydrocarbon activity.

UAE has been quick to recognize the need to implement reforms to sustain its competitiveness and consolidate its fiscal balance despite having sizeable reserves and buffers. The efforts of the government to deregulate fuel prices is laudable. Going forward, UAE must sustain the reform momentum and introduce various measures, including taxes, to increase the non-hydrocarbon revenues.

United Arab Emirates (UAE) has been the forerunner in implementing reforms to strengthen its business and economy among the GCC nations

UAE ranks much higher than its GCC peers in World Bank's Ease of Doing Business 2015 rankings

UAE needs to improve on its tertiary education levels and its capacity to innovate by upgrading its scientific research institutions.

Theme 1: Diversified & Competitive Economy

United Arab Emirates (UAE) has been the forerunner in implementing reforms to strengthen its business and economy among the GCC nations. Consequently, UAE has made significant progress in diversifying its economic structure. Share of hydrocarbon GDP to total GDP has fallen over the years. Dubai has established itself a key trading hub for the region. UAE ranks much higher than its GCC peers in World Bank's Ease of Doing Business 2015 rankings. UAE is ranked at 31 amongst 189 economies. In World Economic Forum (WEF) Global Competitiveness report UAE is ranked at 17 among 140 major global economies due to the presense of solid institutions, well developed infrastructure and its openness to trade and investments. UAE needs to improve on its tertiary education levels and its capacity to innovate by upgrading its scientific research institutions.

Competitive Ranking of UAE

	Ease of Doing Business	Global Competitiveness
UAE	31	17
Bahrain	65	39
Qatar	68	14
Oman	70	62
Saudi Arabia	82	25
Kuwait	101	34

Source: World Bank; World Economic Forum, Global Competitiveness ranking out of 140 countries in 2015/16

For UAE, being the least dependent nation on oil, IMF has estimated the revenue loss to be in the range of 5% to 20% compared to other GCC nations whose losses are estimated to be more than 20%. Notably, UAE is the only GCC nation to have diversified its exports to other sectors by more than 50% and therefore has lesser impact on its revenue[1].

Share of Hydrocarbon GDP/Nominal GDP

	Avg 2008-12	2013	2014	2015e	2016f
Bahrain	24.1%	26.1%	24.1%	16.5%	19.0%
UAE	35.1%	37.6%	34.6%	21.6%	21.0%
Saudi Arabia	48.2%	46.2%	42.5%	30.2%	32.5%
Qatar	53.5%	54.4%	49.2%	35.1%	37.1%
Oman	48.4%	50.6%	46.6%	34.0%	37.6%
Kuwait	58.5%	62.8%	59.1%	46.9%	49.7%

Source: IIF

Current economic environment where the oil prices are expected to be lower for longer raises the need to sustain the reform momentum to maintain economic growth.

Apart from tax reforms to raise revenues and deregulating fuel prices to curb subsides, reforms to diversify the economic structure should be accorded priority. Growth and development should focus on job creation for its nationals. Educational reforms to improve curricula which is more oriented towards industry needs and vocational related traning should be intensified. Emphasis on knowledge-based economy, further opening-up of foreign investments in key areas such as manufacturing and technology sectors should be encouraged. Development of Small Medium Enterprises (SMEs) by ensuring their access to credit, improving their business environment, creating appropriate incentives for job creation and establishing a culture of enterpreneurship would add greater value to the economy.

[1] The National

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	Positive
Bonds	Positive
Real Estate	Neutral
SME	Positive

Source: Marmore Analysis

Economic diversification policy of UAE has paid off in terms of better growth in corporate earnings compared to other GCC economies.

Stock Market: Economic diversification policy of UAE has paid off in terms of better growth in corporate earnings compared to other GCC economies. We believe the UAE economic structure which is dominated by service industries such as financial services, hopsitality, trade, transport and logistics that are not directly dependent on oil revenues bodes well for stock markets. Oil related revenues is expected to account for 58% of total government revenues in 2016 as against 82% for KSA and 79% for Oman[2]. Petrochemicals and related commodities account for mere 1% of overall corporate earnings in UAE stock markets. Thus UAE stock markets could better withstand the impact of lower oil prices (which is expected to continue in 2016 as well) than its GCC peers such as KSA & Kuwait.

Bond Market: Stable credit ratings and diversification into various sectors has helped in increasing the breadth of issues across sectors in its bond markets. UAE witnessed one of the highest corporate bond issues in 2015 amounting to USD 9.5 Bn. Out of the 26 bonds issued, 24 were from corporates with the majority of them from banks and real estate[3]. Compared to other GCC countries, the loan portfolio of UAE banks is also diversified across sectors and this has enabled the banks to easily issue bonds due to lower concentration risk and have a healthy outlook for issuance in 2016.

The current low oil price envoronment bodes well with the strategy of economic diversification of which SMEs are a key component

Real estate: Impact of the economic diversification on real estate sector remains minimal. Unlike stock and bond markets, real estate investments mainly depends on the current price trends and large scale investments. Since the sector is open to foreign investment unlike the other countries in the GCC, speculation plays a major part in determining the prices. Projects which are planned to be completed before the Expo 2020 are being executed as planned owing to which we expect the impact of diversification to be minimal on real estate sector.

SMEs: Economic diversification and the government's concerted efforts to build a strong SME sector in the country has been beneficial. Further impetus by the Government to accelerate their diversification agenda has resulted in establishmnet of SMEs in a variety of sectors such as Information Technology, education and services. The current low oil price envoronment bodes well with the strategy of economic diversification of which SMEs are a key component.

[2] IIF
[3] Zawya

Theme 2: Creation of a Local Debt Market in UAE

Budget deficit for UAE in 2015 is expected only to be modest and UAE government is expected to register budget surplus in 2017

UAE's sovereign debt commands an investment grade rating of Aa2 (Moody's), AA (Standard & Poor's) and AA (Fitch) with a stable outlook for the year 2016. Rating agencies cite the rating is underpinned by the presence of large scale fiscal buffers. Budget deficit for UAE in 2015 is expected only to be modest and UAE government is expected to register budget surplus in 2017[4]. The return to surplus situation is not on expectations of oil price recovering but an outcome of implementing reforms to curb subsidies by UAE government. In August 2015, fuel prices were deregulated in UAE.

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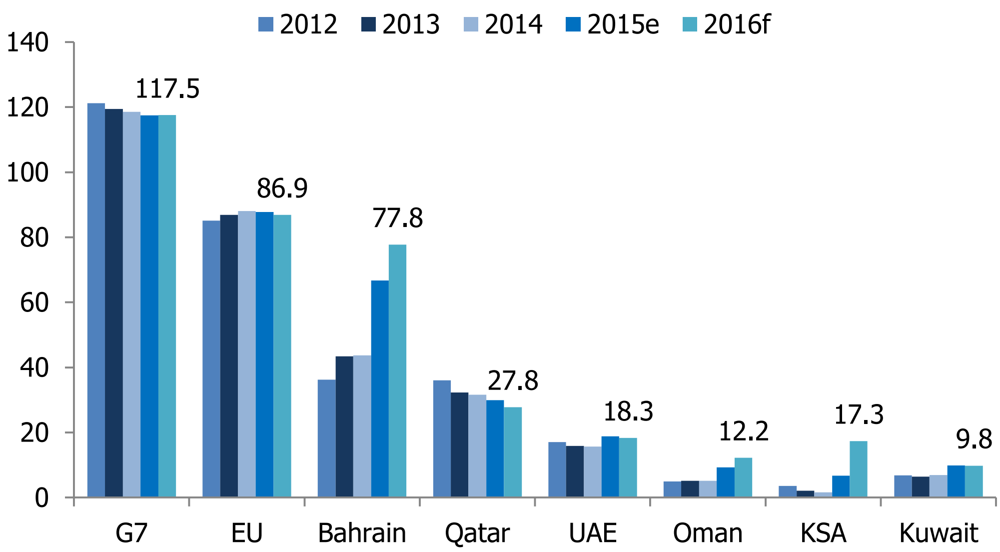
Government Gross Debt (as % of GDP)



Source: IMF; G7 Countries consists of Canada, France, Germany, Britain, Italy, Japan & U.S

Public debt law, which is required for issuance of federal sovereign bonds has been stuck in the government consultative process for the past five years

While UAE has so far not issued any debt instruments, it might do so in the coming year. Public debt law, which is required for issuance of federal sovereign bonds has been stuck in the government consultative process for the past five years[5]. The individual emirates (Dubai, Abu Dhabi), however, could issue debt[6]. So far, only Dubai government has raised debt in the past 5 year period. Though UAE had run balanced budgets and at times even registered surplus, the current environment of lower oil prices warrants relook at government finances. Additionally, the implementation of Basel III norms by 2018 would entail the banks to hold certain amount of sovereign bonds as part of their core capital.

In this regard, UAE could utilize the opportunity to raise debt in domestic market by placing bonds with the local banks, which have sufficient capital and liquidity buffers. Raising debt in the domestic market, if done in a measured way, could help in the establishment of an active and liquid debt market.

[4] Moody's, based on oil projections rising to USD 73/bbl by 2019 after a modest dip in 2016
[5] Reuters
[6] Gulf News

Bond Issuance in UAE (USD mn), 2011-2015

Issuers	2011	2012	2013	2014	2015	Total	as % of Total
Department of Finance - Government of Dubai	500		500			1,000	**1.7%**
Aabar Investments	1,367				2,187	3,554	**5.9%**
Abu Dhabi Commercial Bank			2,300	1,430	750	4,480	**7.5%**
Abu Dhabi National Energy Company	1,500	2,000		750		4,250	**7.1%**
Agricultural Bank of China Limited Dubai Branch				154		154	**0.3%**
Bank of Sharjah					500	500	**0.8%**
Commercial Bank of Dubai			500		400	900	**1.5%**
Dolphin Energy		1,300				1,300	**2.2%**
DP World				1,000	500	1,500	**2.5%**
Emirates Airline	1,000		750			1,750	**2.9%**
Emirates NBD	332	1,169	1,852	2,214	1,722	7,289	**12.1%**
Emirates Telecom				4,024		4,024	**6.7%**
First Gulf Bank	202	650	500	428	952	2,733	**4.6%**
Glencore Finance (Dubai)		2,460				2,460	**4.1%**
HSBC Bank Middle East				400		400	**0.7%**
ICICI Bank (Dubai Branch)	1,000	750	101			1,851	**3.1%**
Industrial and Commercial Bank of China (Middle East)					500	500	**0.8%**
International Petroleum Investment Company	7,300	1,804				9,105	**15.2%**
Investment Corporation of Dubai				300		300	**0.5%**
Majid Al Futtaim Holding		500				500	**0.8%**
Majid Al Futtaim Properties			500	500		1,000	**1.7%**
Mashreq Bank				68	30	98	**0.2%**
Mubadala Development Company	1,587			750		2,337	**3.9%**
Mubadala GE Capital				500		500	**0.8%**
National Bank of Abu Dhabi	128	1,648	896	552	1,700	4,925	**8.2%**
Ruwais Power Company			825			825	**1.4%**
The National Bank of Ras Al-Khaimah (P.S.C.)				800		800	**1.3%**
Topaz Energy & Marine			350			350	**0.6%**
Union National Bank	400	250				650	**1.1%**
Total	**15,318**	**12,532**	**9,074**	**13,872**	**9,241**	**60,036**	**100.0%**

Source: Zawya; Data as of December 24, 2015

The impact of low oil prices reflected in the bond markets as bond issuances in UAE for 2015 were down by 33% (YoY) to USD 9.2bn. In June, construction contractor Drake and Scull International tried and failed to issue a perpetual Islamic bond worth USD 150mn to USD 200mn[7]. Subsequently in September, Abu Dhabi Commercial Bank (ADCB) whose credit is rated (A/A+) by international rating agencies Standard & Poor's and Fitch Ratings cancelled the USD 500mn issue, which it started to market, due to lack of sufficient bidding at the quoted price[8]. The dollar denominated, six-year tenure bond was priced 155bps over mid-swaps. With liquidity tightening in the financial system, as deposit mobilization process (petrodollars are major source of deposit for domestic banks in GCC) has

[7] Reuters
[8] Financial Times

significantly slowed, investors demand higher spreads. Creation of local debt market would help in establishing the much needed yield curve, which could have helped in better pricing of risk for issues.

Central Bank of UAE in its regulations had introduced credit concentration limits on the amount that domestic banks can lend to government and government related entities (GREs)

Central Bank of UAE in its regulations had introduced credit concentration limits on the amount that domestic banks can lend to government and government related entities (GREs). In such a scenario, development of local debt markets could provide an additional source of avenue for capital on a long-term basis. Further, establishment of local debt markets, in addition to deepening the financial market, could help create financial hubs in the GCC region.

Currently, firms rely heavily on bank loans and retained earnings. Debt issuance in local currency remains meagre

Currently, firms rely heavily on bank loans and retained earnings. Debt issuance in local currency remains meagre while debt issuance in international markets, often done only by large corporates, has been minimal. Thus, debt market in the UAE has remained smaller and underdeveloped. Though the small size offers scope for growth, primary market issues that are meagre and skewed towards long-term maturities often promote buy and hold strategies – and has resulted in shallow secondary markets devoid of liquidity.

The market regulator Securities and Commodities Authority (SCA) to develop the local bond market devised a new set of rules and regulations.

1. The rules which do not apply for government or GREs has lowered the floor size of issuance from AED 50mn to AED 10mn to facilitate fund raising even by firms with smaller needs.
2. Time taken to review and approve the issuance applications has been shortened to five days, while private placement of bonds would not require SCA approval.
3. The companies that issue bonds can report only the annual financials instead of quarterly and credit rating for the issuance is no longer required.

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	Neutral
Bonds	Positive
Real Estate	Positive
SME	Positive

Source: Marmore Analysis

Local bond markets will improve the liquidity and trading of the debt securities thereby encouraging more investors to invest in these securities

Stock Market: Creation of local debt market will not have major impact on the stock markets, as equities are more attractive as an investment option for investors in UAE mainly due to the higher return it provides. Invesco asset management survey, 2014 shows that 34% of assets allocated in UAE are towards equities compared to just 3.5% towards fixed income. Though the creation of the bond market will be beneficial for the companies in terms of raising capital, the impact on the stock markets is expected to be negligible especially in markets such as UAE that are dominated by retail investors.

SMEs in UAE can benefit to higher extent from the bond markets, provided they improve their transparency as bond markets are generally dominated by institutional investors who expect higher levels of transparency and better corporate governance.

Bond Market: Local bond markets will improve the liquidity and trading of the debt securities thereby encouraging more investors to invest in these securities. Companies will have an alternate financing option, which will reduce their cost of capital. Companies can raise capital at relatively lower cost that would help them to fund their expansionary plans.

Real estate: With developments in the local bond markets, the real estate companies can raise additional capital in the debt markets to fund their projects especially in circumstances of lower liquidity in the banks. The performance of the real estate bonds issued in 2015 indicates the markets' positive sentiment[9]. Real estate sector can be expected to benefit from the development of the local bond market.

SMEs: In the aftermath of the low oil prices, banks have reduced their lending to the SMEs. SMEs in UAE can benefit from the debt market as it will be a viable funding option. SMEs can consider issuing debts compared to equity funding when bank loans are not available as the cost of capital will be considerably lesser. SMEs in UAE can benefit to higher extent from the bond markets, provided they improve their transparency as bond markets are generally dominated by institutional investors who expect higher levels of transparency and better corporate governance.

[9] Khaleej Times

Dubai government also increased the land registration fees to 4% from 2% back in 2013 in order to prevent unnecessary flipping of properties in hope of making short-term gains

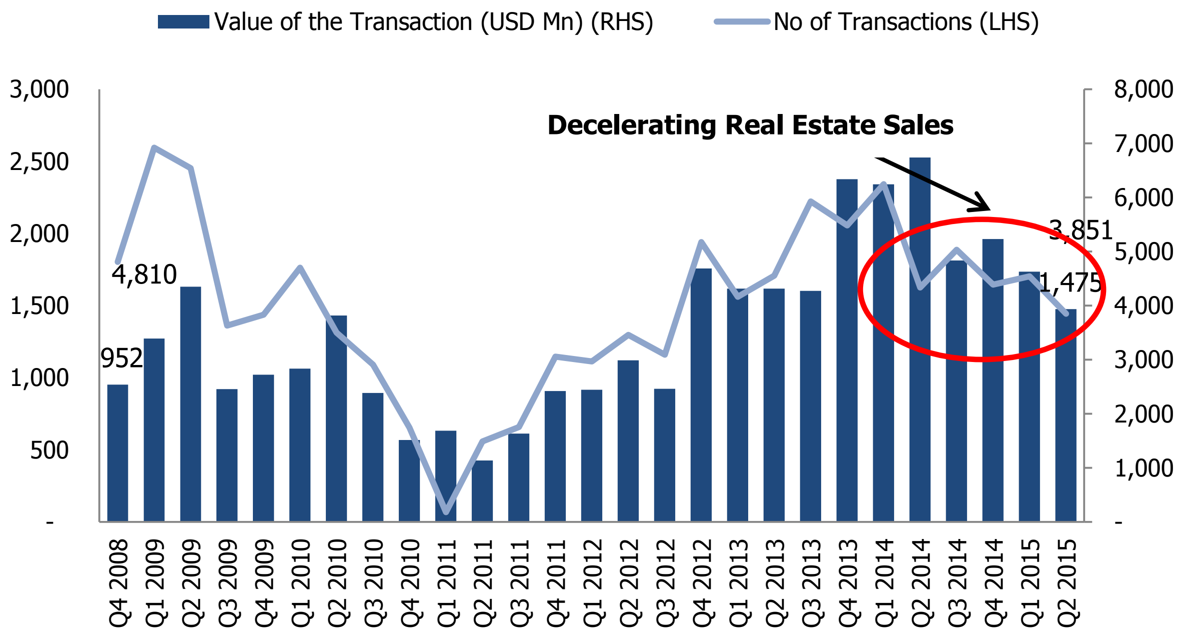
In the first half of the year, residential transactions dropped by 69% compared with the same period last year

Theme 3: Dubai Real Estate

Real estate sales were robust in the first half of 2014, supported by successful bid for Expo 2020, while the rentals in Dubai surged by more than three times during the 2013-14 period. With the rapidly increasing rental and sale value for the residential sector in UAE, it was anticipated that the sector was overheating, particularly in Dubai, raising concerns of another real estate bubble as witnessed earlier in the year 2010.

This led to the introduction of various measures to rein in speculative activity in real estate sector. The Government of Dubai followed the Singapore and Hong Kong model in containing the housing prices – by way of tightening the lending rules. Expatriates buying a property for under Dh 5mn were required to deposit a minimum of 25 per cent of the property value, rising to 35 per cent for properties above Dh 5mn. For second properties, the minimum deposit was set at 40 per cent. The minimum deposit requirement was slightly relaxed for nationals who needed to produce 20% and 30% deposits for properties less than Dh 5mn and greater than Dh 5mn respectively. The minimum deposit was set at 50% (expatriate and nationals) if the property they purchased was an off plan property. In addition to cap on mortgages, the Dubai government also increased the Dubai land registration fees to 4% from 2% back in 2013 in order to prevent unnecessary flipping of properties in hope of making short-term gains.

Number of transactions and value of transactions for Apartments in Dubai from 2009 to 2015



Source: dubailand.gov.ae

The measures have led residential real estate sales to moderate in the recent quarters amid a strong supply and subdued demand. Sales volume has visibly thinned while prices have fell by 16% for apartments and 14% for villas in dubai for the first 11 months of 2015, compared with the same period a year ago[10]. In the

[10] CBRE

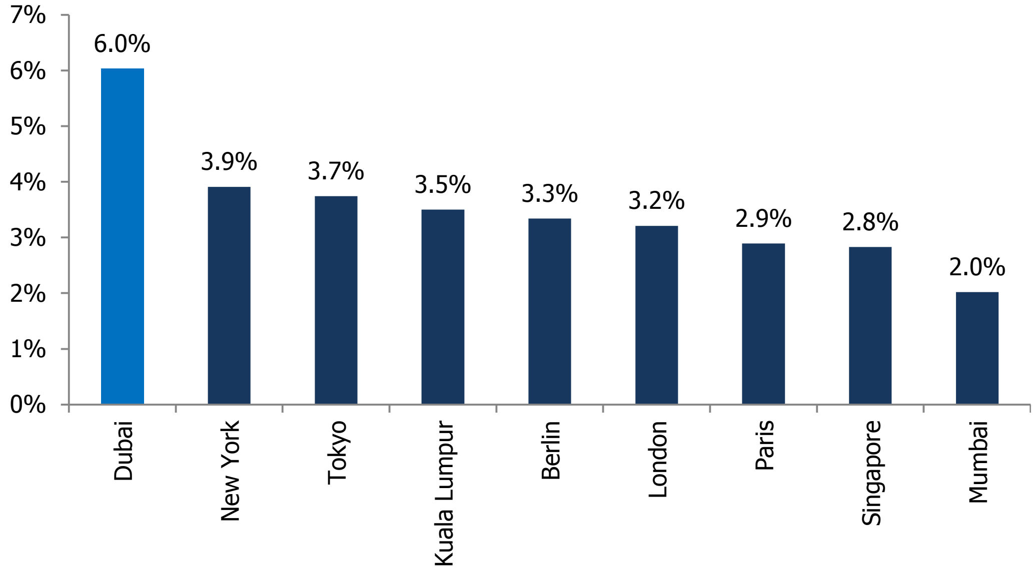
Higher rental yields and relatively underpriced properties places Dubai as an attractive real estate investment destination for foreign buyers

In the first half of 2015, foreigners accounted for as much as 78% of investments in Dubai real estate

With sales in the real estate sector dwindling and prices marginally declining, it is imperative other engines of growth are established

first half of the year, residential transactions dropped by 69% compared with the same period last year while unit prices fell by 8% in H1 2015 (YoY)[11].

Rental Yields



Source: Global Property Guide; Note: Data as of 2014

Higher rental yields and relatively underpriced properties at an average cost of USD 6,800 per sq m as against other destinations such as London, Hong Kong and New York places Dubai as an attractive real estate investment destination for foreign buyers. In the first half of 2015, foreigners accounted for as much as 78% of investments in Dubai real estate[12].

Real Estate Investment in Dubai by Nationality (AED bn)

	2012	As % of total	2014	As % of total	9m, 2015
UAE	12.8	25%	22.8	21%	n.a
GCC ex UAE	4.9	10%	9.2	8%	n.a
India	8.7	17%	18.1	16%	13
UK	5.1	10%	9.3	8%	7
Pakistan	3.9	8%	7.5	7%	5
Others	10.2	20%	31	28%	21
Total	50.5	100%	110	100%	

Source: IIF, Emirates 24/7

Howeever, the lower consumer confidence following lower oil prices and a stronger U.S dollar post the recent interest rate hike by the U.S Fed, could further affect foreign investments into UAE, especially in the real estate sector. With sales in the real estate sector dwindling and prices declining, it is imperative other engines of growth are established.

[11] JLL, The National
[12] Dubai Land Department

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	**Negative**
Bonds	**Negative**
Real Estate	not applicable
SME	**Negative**

Source: Marmore Analysis

Large-scale use of real estate as a collateral asset is bound to spread volatility in bond markets as real estate prices oscillate.

Stock Market: On the overall scheme of corporate earnings, real estate sector earnings accounted for c.15% in the past 3 years. Additionally, the current decline in volume of real estate trasactions and subsequent decline in prices, though marginal, is bound to affect investor confidence. The current state of real estate market could present downside risks and doesn't bode well for stock markets.

Real estate prices, so far, have declined by c.16% in Dubai in the first 11 months of 2015 compared with the same period a year back.

Bond Market: Large-scale use of real estate as a collateral asset is bound to spread volatility in bond markets as real estate prices oscillate. Real estate prices, so far, have declined by c.16% in Dubai in the first 11 months of 2015 compared with the same period a year back. The double digit fall in collateral value could lead to spike in yields, as investor confidence wears thin. Thus, we believe the effect of this factor is Negative.

Real Estate: Not applicable

SMEs: SMEs providing real estate and renting services accounted for 33% of the service firms in Dubai followed by constructions and contracting firms that accounted for 27% in 2015. Sluggish real estate sector will affect the SMEs sector as real estate and construction related firms account for almost 50% of the service firms. Real estate also serves as a critical input to many SMEs due to which we expect the SMEs in UAE to be affected with the falling real estate sales and prices.

UAE's government has introduced major fiscal reforms in order to cope with the low oil price

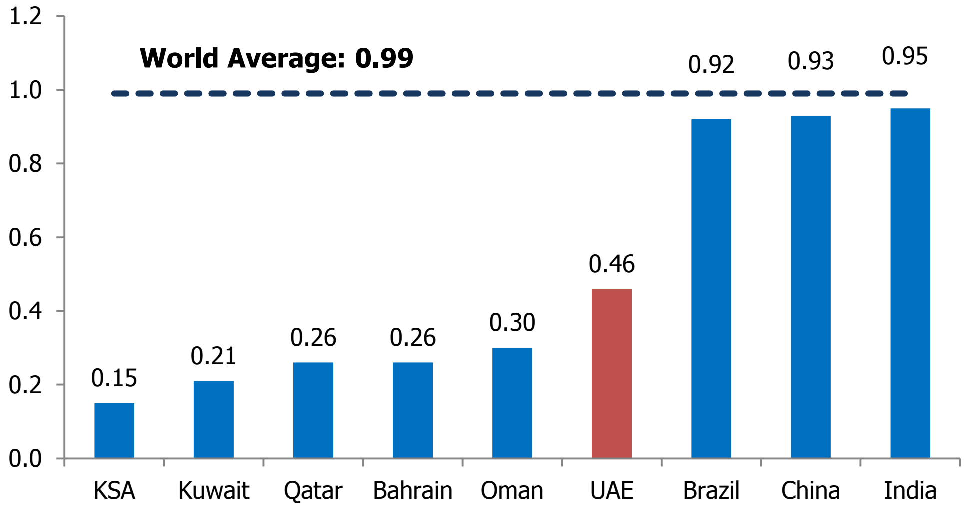
UAE's positive step in its subsidy reforms would go a long way in shaping the economy

Subsidy cut would comfort the pressure on the government budget, as pre-tax energy subsidy in UAE accounted for 1.1% of the government expenditure in 2014

Theme 4: Subsidy Rationalization

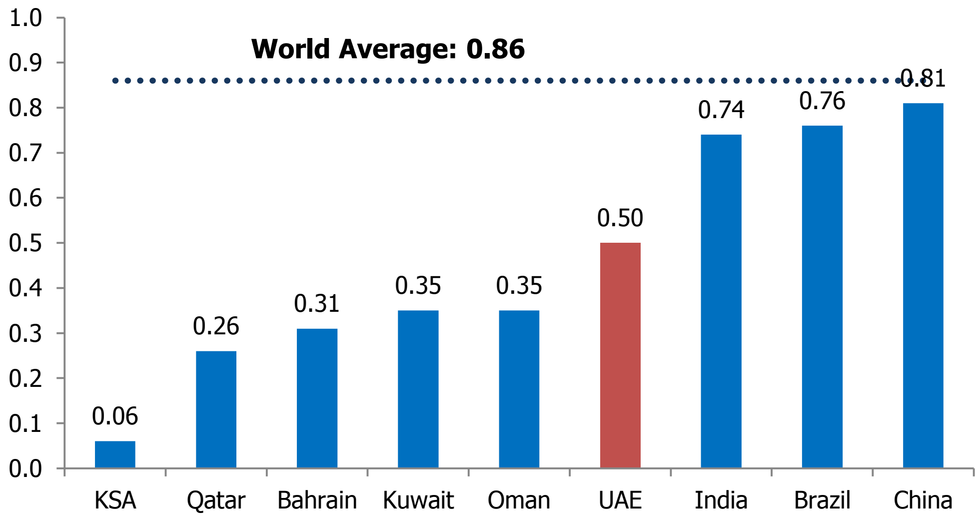
Assessing the impact of oil on revenues and GDP and comparing it with its peers, we can uphold that low oil prices will have lesser impact on UAE than other GCC nations. UAE's government has introduced major fiscal reforms in order to cope with the low oil price and strengthen their economy to be more resilient in the coming years. One of the much awaited and important step towards fiscal consolidation was the fuel subsidies reform introduced on 1st August 2015. UAE's positive step in its subsidy reforms would go a long way in shaping the economy as it has been a long standing recommendation from international agencies such as World Bank, IMF as a part of fiscal consolidation. Subsidy cut would comfort the pressure on the government budget, as pre-tax energy subsidy in UAE accounted for 1.1% of the government expenditure and 2.9% of the GDP in 2014.

Gasoline Prices, (USD/Liter)



Source: Globalpetroprices.com; Data as of December 21, 2015

Diesel Prices, (USD/Liter)



Source: Globalpetroprices.com; Data as of December 21, 2015

The petrol prices in UAE post the subsidy cut are closer to average world prices

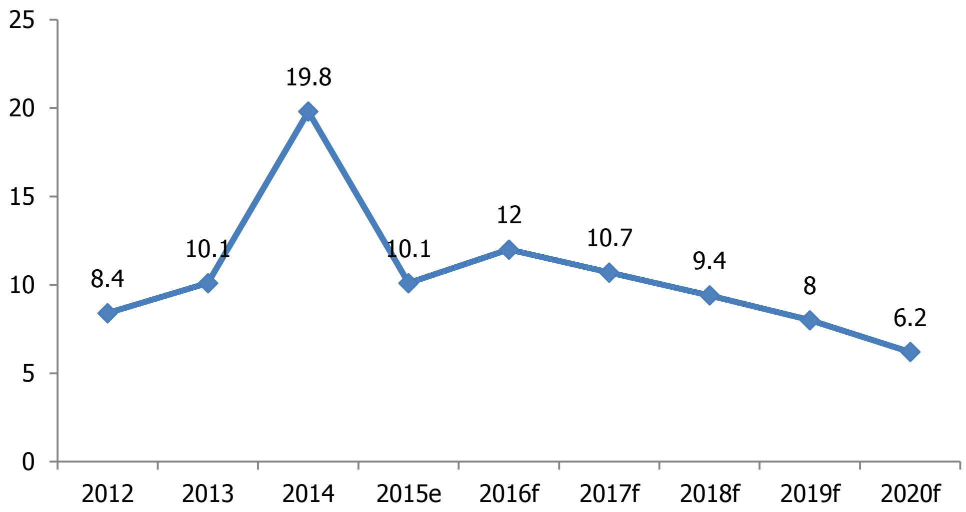
The petrol prices in UAE post the subsidy cut are closer to average world prices. UAE however retains the diesel prices low in order to aid its transport and logistics industry which is currently traversing difficult waters. Reforms towards prudent fiscal consolidation including reducing subsidies on water and electricity and expenditure on government employees pay cheques could help UAE reduce its expenditure by almost 9%. While countries in GCC region have one of the lowest tariffs in the world for electricity, Abu Dhabi charges the lowest per kiloWatt hour (kWh) at USD 0.01 (1 cent) for its residential customers. However, charges for expatriates are higher than national customers in Abu Dhabi as it follows a dual tariff structure for electricity. In December, Abu Dhabi Distribution Company (ADDC) raised water charges to AED 5.95/cu.m for expats compared to AED 1.7/cu.m for nationals. Reduction in water and power subsidies have been enforced for expatriates, which the Energy minister expects would rationalize their consumption and reduce the government's burden. In the forthcoming year, UAE aims to cut its energy and water subsidy by USD 950mn (Dh 3.5 billion)[13].

While countries in GCC region have one of the lowest tariffs in the world for electricity, Abu Dhabi charges the lowest per kiloWatt hour (kWh) at USD 0.01 (1 cent) for its residential customers

UAE has a multitude of agencies that are responsible for water supply among various Emirates. Abu Dhabi is unique in defining multiple slabs for per day residential usage, setting tariff on the basis of whether it is for a national or an expatriate, and whether the residential complex is a flat or a villa. Dubai has the 2nd highest tariff in the region mainly because of its status as a commercial center. Dubai does not distinguish between residential, commercial and industrial customers and offers the same slab and same tariffs for everyone. Increase in water and electricity tariffs combined with low oil prices in Abu Dhabi is expected to result in savings of 0.5% of the non-hydrocarbon GDP in 2015. Further implementation of subsidies reform and gradual increase in tariff in all emirates can save 0.6% of the non-hydrocarbon GDP in 2020[14]. The subsidies reform introduced and with those expected in the coming years is estimated to reduce the expenses on subsidies provided from AED 10.1mn in 2015 to AED 6.2mn in 2020.

Increase in water and electricity tariffs combined with low oil prices in Abu Dhabi is expected to result in savings of 0.5% of the non-hydrocarbon GDP in 2015.

Subsidy Expenses of UAE Central Government (AED mn), 2012-2020

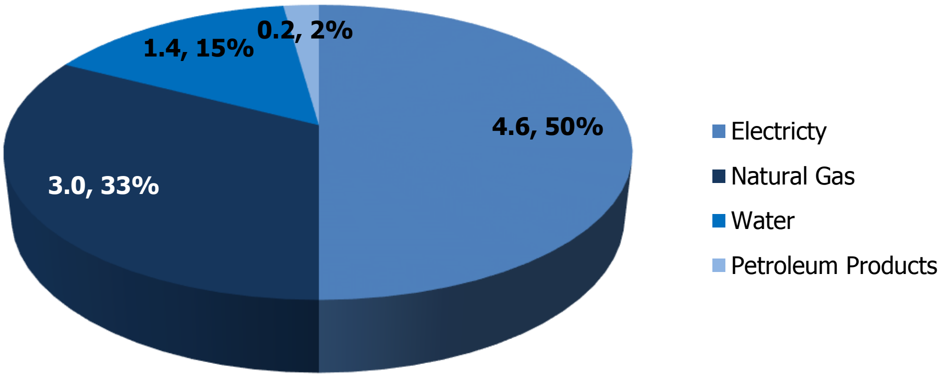


Source: IMF

[13] Emirates 24/7
[14] Special Issues, IMF

Increase in water and electricity tariffs combined with low oil prices in Abu Dhabi is expected to result in savings of 0.5% of the non-hydrocarbon GDP in 2015

Pre-Tax Subsidies (as percentage of GDP), 2015



Subsidy reforms can also lead more spending on education, health care and sectors such as renewable energy in the long run

Source: IMF; Note: Food subsidies in UAE (as % of GDP) accounts for a miniscule portion and hence it hasn't been illustarted in the above figure.

Removing subsidies is also expected to curtail the overconsumption of water and power which will thereby increase the exportable energy available and help to increase the trade balance. Subsidy reforms can also lead more spending on education, health care and sectors such as renewable energy in the long run. Higher inflation and constrained profits for the companies depending on subsidised energy can be the immediate impact of subsidies reform, though it will help to strengthen the fiscal buffers, rationalize consumption of water and energy and government spending.

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stock Market	Negative
Bond Market	Positive
Real Estate	Neutral
SME	Negative

Source: Marmore Analysis

Reducing the subsidies will increase their costs and weigh heavily on their global competitiveness leading to strained corporate earnings.

Stock Market: Subsidies act as one of the main cushions for businesses in UAE as it helps them to reduce the cost of production and operation thereby making their products more competitive in the international markets at lower price, mostly in the petrochemicals industry. Reducing the subsidies will increase their costs and weigh heavily on their global competitiveness leading to strained corporate earnings. Increasing household expenses could lead to reduced allocation for investments in stock markets thus leading to lower liquidity.

Bond Market: Apart from the removal of subsidies in fuel, water and electricity, UAE government has planned for the reduction in transfer of funds to Government related entities (GREs) which is especially higher in Abu Dhabi. Government entities will have to resort to the bond markets to raise capital in case of spending cuts by the government, which we expect will be a positive factor for the bond markets.

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Real Estate: Though operating costs for properties may increase due to reduction in water and electricity, the effect on real estate market would not be major in terms of sales volume and prices as the incremental operational cost rise would be minimal. Slower growth rate of income levels may affect the repayments towards housing loans, though its impact on the sector will be minimal.

SMEs: Higher operating costs will increase the operating expenses and shrink the profit margins for the SMEs. This would in turn become an entry barrier for new SMEs wishing to enter into the market space. We rate the impact of the subsidy rationalization to be negative on SMEs.

Theme 5: Improving Business Environment

In terms of Ease of Doing Business, UAE stands at 31st rank, the highest among the GCC countries. For starting a business in UAE, an entrepreneur has to deal with 6 procedures which take 8 days costing 6.2% of the income per capita. UAE stands 60th globally, indicating better position compared to its regional peers.

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High income economies have taken steps to ease the procedures related to starting business in the recent years. Creation of one-stop-shop for all approvals can be a breakthrough in reducing the number of procedures, costs and time associated. Better use of technology for providing permits, construction approval and for registering property would further help to improve the business environment in UAE, though few measures have been taken in the direction so far.

UAE's rank in getting credit parameter was 97, lower than KSA which ranks 79. Credit bureau information and credit scores dissemination to banks need to be improved in UAE.

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GCC Ease of Doing Business and components, 2015 Rankings

Economy	UAE	KSA	Qatar	Bahrain	Oman	Kuwait
Ease of Doing Business Rank	**31**	82	68	65	70	101
Starting a Business	**60**	130	109	140	149	148
Dealing with Construction Permits	**2**	17	8	9	46	133
Getting Electricity	**4**	24	111	77	60	128
Registering Property	**10**	31	28	25	33	68
Getting Credit	**97**	79	133	109	126	109
Protecting Minority Investors	**49**	99	122	111	134	66
Paying Taxes	**1**	3	1	8	10	11
Trading Across Borders	**101**	150	119	85	69	149
Enforcing Contracts	**18**	86	112	101	70	58
Resolving Insolvency	**91**	189	51	85	105	122

Source: World Bank Doing Business

World over companies are liberalising their international trade policies to improve the competitiveness of their companies both domestically and internationally.

Steps taken in UAE for improving credit availability and related issues

Year	Reform
2011	UAE enhanced access to credit by setting up a legal framework for the operation of the private credit bureau and requiring that financial institutions share credit information.
2012	UAE improved its credit information system through a new law allowing the establishment of a federal credit bureau under the supervision of the central bank.
2015	In UAE, the credit bureau improved access to credit information by starting to exchange credit information with a utility.

Source: World Bank Doing Business

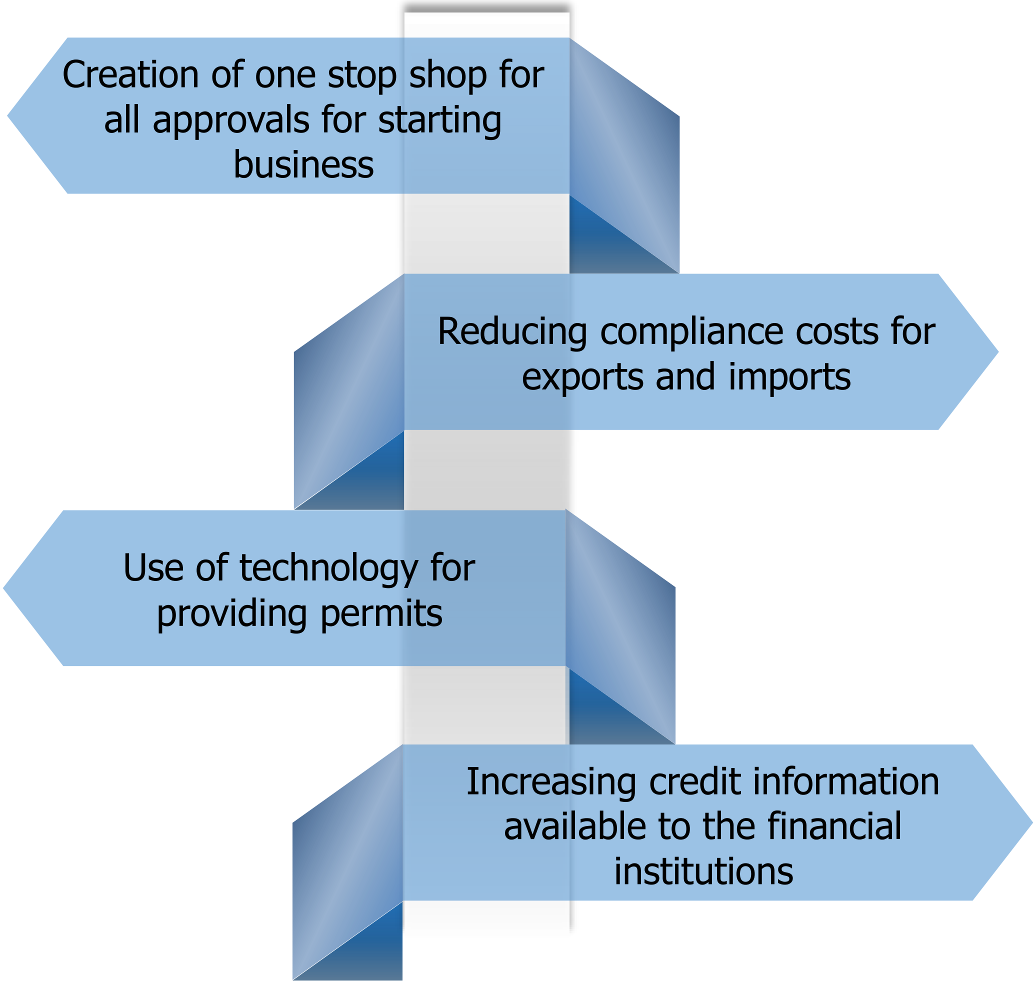
UAE has scope for improvement in trading across borders parameters as it ranks 91 lower than Qatar and Bahrain which rank 51 and 85 respectively. World over companies are liberalising their international trade policies to improve the competitiveness of their companies both domestically and internationally. Though the time taken for goods and services to enter and exit UAE borders is lesser than the MENA region's average, the cost of imports and exports still remain higher. Cost

Time taken for goods and services to enter and exit UAE borders is lesser than the MENA region's average

Steps towards reducing the cost of compliance need to be taken in order to make the UAE products more competitive for exports.

of exports (Border compliance) is USD 650 in UAE while MENA region average is USD 445. Similarly, the cost of imports (Border compliance) is USD 678 in UAE and USD 594 is the average cost in the MENA region. Steps towards reducing the cost of compliance need to be taken in order to make the UAE products more competitive for exports.

Steps that can be taken for creating better business environment



Source: World Bank Doing Business, Markaz Research

UAE fares much better than its GCC peers in terms of ease of doing business. This is refelected in the wide spread presence of companies in service sectors such as hospitality, trade, retail and logistics.

Numerous start-up companies dot the corporate landscape as it is easier to regiser business in UAE. The impact of this is already seen in commercial realty where quality office spaces are sought after.

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	**Positive**
Bonds	**Positive**
Real Estate	**Positive**
SME	**Positive**

Source: Marmore Analysis

Stock Market: UAE fares much better than its GCC peers in terms of ease of doing business. This is refelected in the wide spread presence of companies in service sectors such as hospitality, trade, retail and logistics. Dubai has also established itself as a trading hub aided by the ease of import and export procedures. The resultant competitiveness of the economy has helped it to secure the rights to host Expo 2020. All these augur well for growth in corporate earnings and we consider it as a positive for stock markets.

Bond Market: Improvements have been made over the years to facilitate easier access of credit in UAE. In 2012, UAE established a federal credit bureau under the supervision of the Central Bank to improve its credit information system and in 2015 it improved access to credit information by exchanging with utilities. Continuous progress in improving the credit information infrastructure and by utilizing it to assess creditworthiness would help in making a informed decision. This would help enterprises and investors to better perceive the risk and seek suitable returns. Improvement of legal laws involving bankruptcy, establishment and enforcement of creditor rights would further improve the confidence of investors in considering bonds as an asset class for investments.

Real Estate: Dubai is often perceived as a start-up hub in the wider MENA region. Numerous start-up companies dot the corporate landscape as it is easier to regiser business in UAE. The impact of this is already seen in commercial realty where quality office spaces are sought after. The quality of land administartion department is superior with most data pertaining to transactions, ability to check for encumberances, property boundaries, plans and accuracy of identity documents could be done online. Foreign investors feel at ease and often invest in UAE due to simple procedures. Additional improvements bodes well for real estate growth in UAE.

SME: UAE has recognized the need to nurture SME sector and has initiated several reforms in this regard. To ease access to credit, various funds such as Khalifah Fund, Mohammed Bin Rashid Fund, Ruwad Establishment and Al Tomooh Finance Schemes were implemented. To further improve availability of credit and lower their cost of capital, new credit registry and bankruptcy law is being initiated[15]. All these factors augur well for growth and development of SMEs in UAE.

[15] IMF

UAE has around 300,000 Small and Medium Enetrprises (SMEs), which represent 92 per cent of all companies and provide 86 per cent of jobs in the UAE market

Despite the push for SMEs by the authorities, there are still several structural problems that are likely to impede the uptake of SMEs in UAE

Recently, the UAE cabinent has decided to allocate 10 per cent of government spending to SME funding

Theme 6: Leader in SME Space in GCC

UAE has around 300,000 Small and Medium Enetrprises (SMEs), which represent 92 per cent of all companies and provide 86 per cent of jobs in the UAE market. Further, SMEs contribute to over 60 per cent of UAE's non-oil GDP. Considering the significant contribution to overall economic activity and their ability to generate jobs, development of SMEs have been accorded special focus in Vision 2021 agenda. UAE has plans as part of its Vision 2021 to increase SMEs contribution to non-oil GDP by 70 per cent[16].

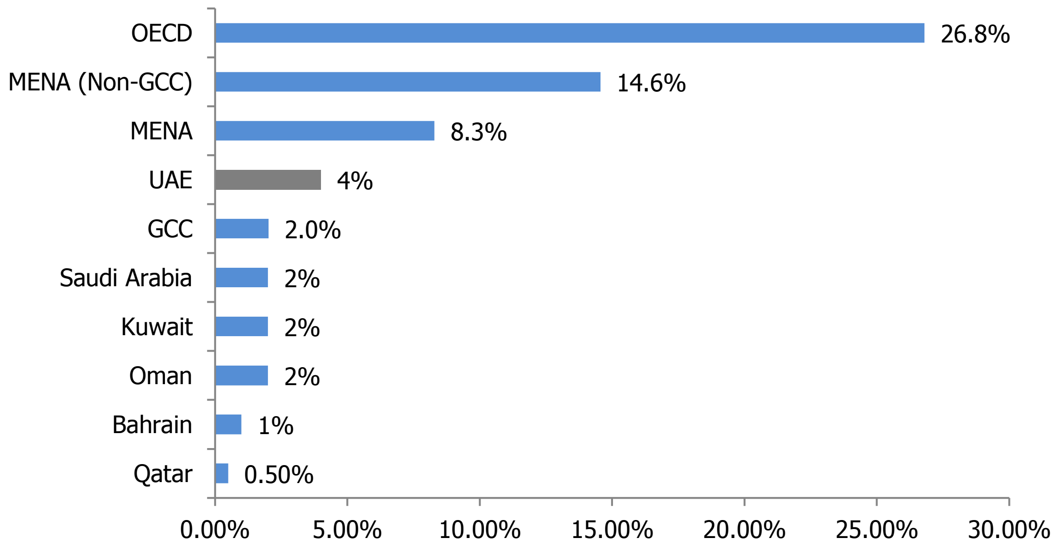
GCC SMEs Statistics

Country	Number of SMEs	% of SMEs to total companies
Bahrain	29,600*	99%
Kuwait	27,000*	90%
Oman	13,741**	90%
Saudi Arabia	670,000*	90%
Qatar	30,881**	75%
UAE	300,000*	92%

Source: Business Intelligence Middle East, 2013 (for UAE); SUSRIS, 2013 (for KSA); Tamkeen (for Bahrain), 2011; Open to Export C.I.C. (for Kuwait), 2013 & Gulf Investment Corporation (2013); Gulf Investment Corporation (For Qatar), 2013; Gulf Investment Corporation (For Oman), 2013

Despite the push for SMEs by the authorities, there are still several structural problems that are likely to impede the uptake of SMEs in UAE. For instance, in UAE, the percentage of total bank loans given to SMEs is a low 4%, only. This follows patterns in other GCC countries.

Low banking support for SMEs in the region



Source: Union of Arab Banks/World Bank Financial Flagship Report 2011; International Finance Corporation; Banks and the World Bank, 2010

UAE government has initaited a series of measures and targeted funding to boost the growth and development of SMEs. Recently, the UAE cabinent has decided to allocate 10 per cent of government spending to SME funding. The government of

[16] Ministry of Finance, UAE

Despite various efforts by the government to boost their SME sector, funding remains a hurdle for most SMEs.

Lack of taxation and reporting requirements has served as an disincentive for eneterprises to maintain financial records

UAE to encourage establishment of SMEs has also exempted registeration fees for local business for their first two years of establishment. Additionally, funding would be provided for purchases and tenders including publications, stationery, gifts and electronics for up to AED 200,000 per contract or transaction within the first two years of establishment.

Complementing the government initiatives, Khalifa fund - was launched in 2007 with a capital of AED 2billion, which provides holistic support including training, development, counselling and advisory services to nurture entrepreneurship. The fund until 2013 has provided AED 904mn of capital to over 600 projects[17].

'Dubai SME100' was launched in 2011, which aims to identify top performing SMEs in Dubai and governmental support would be extended to them to ensure their growth is sustainable.

Despite various efforts by the government to boost their SME sector, funding remains a hurdle for most SMEs. Loans to SMEs account for only 4% of total outstanding loans[18]. On one hand, lack of taxation and reporting requirements has served as an disincentive for eneterprises to maintain financial records. On the other, banks perceive SME as high risk lending and often resort to name based lending to large business groups. This deprivies SMEs of credit and they are most dependent on private financicers where the capital costs are high.Addressing the issues and ensuring availability of financing for SMEs could prove to be a game changer.

[17] The National
[18] The National

Investment Implications

Impact Indicator

Investment Arena	Relative Impact
Stocks	**Positive**
Bonds	**Positive**
Real Estate	**Positive**
SME	**Positive**

Source: Marmore Analysis

Robust presence of SMEs could spur development of industrial clusters.

Stock Market: Bouyant SME sector is a positive for stock market. As SMEs develop and grow into larger organizations, early stage investors such as venture capitalists, private equity players or founders would either try to exit their stake in full or monetize a part of stake through Intial Public Offering (IPO) process. Such activity would lead to continuous supply of new securities and keep the markets active. Presence of large number of SMEs could also lead to establishment of SME Index to help them raise equity capital.

Efforts to improves access to credit, incubation programs to nurture, train and support their development places SMEs in a favourable spot

Bond Market: SMEs often try to secure funding through multiple sources to reduce their reliance on single source of capital/founders equity. Debt, which is cheaper than equity, is an attractive proposition for SMEs in this regard. SMEs could lead to a spurt in debt issues and eventually in the development of bond markets.

Real Estate: Robust presence of SMEs could spur development of industrial clusters. Job creation by SMEs would create demand for residential realty, educational institutes, recreational centres and fuel community development. Thus, real estate would be positively affected by development of SMEs

SME: UAE being a leader in SME space in GCC region has taken further initiatives to bolster its position. Efforts to improves access to credit, incubation programs to nurture, train and support their development places SMEs in a favourable spot.

A Selection of Key Reforms in UAE: 2013-Q2 2015

Sector	Highlights
Telecom	The telecom authority waived off the need for its approval for operators to set prepaid packages and tariffs.
Real Estate	Dubai revoked the cap on rental increase, which previously stood at 5%, per annum.
	The Follow Up Committee of the Initiatives of the UAE President approved the completion and establishment of 196 low cost homes in various areas of the country.
Energy/Utilities	The Dubai Electricity and Water Authority introduced an electronic "one window, one step" application process.
	Announcements were made regarding a law being planned that targets curbing profligate and wasteful usage of energy and water.
	The Emirate of Abu Dhabi imposes water and electricity tariff hikes, starting January 2015.
Education	The need for unifying educational reform procedures across all emirates was called for due to the fact that dynamic progress on the part of some alone could risk leaving other emirates lagging behind.
Foreign Investment	UAE drafting law for 100% foreign ownership of firms

Source: Marmore GCC Regulatory Digest

Appendix

Key Economic Indicators	2012	2013	2014	2015e	2016f
Real GDP (AED Billion)	1,059	1,104	1,155	1,193	1,237
Real GDP Growth (%)	6.9	4.3	4.6	3.3	3.7
Hydrocarbon, Real GDP Growth (%)	7.2	3.1	4.0	3.6	3.5
Non-Hydrocarbon, Real GDP Growth (%)	6.8	4.9	4.8	3.2	3.7
Hydrocarbon exports (USD Billion)	126.3	131.0	111.6	61.4	62.2
Current Account Balance (% GDP)	21.2	18.6	13.6	3.0	3.3
Fiscal Balance (% GDP)	10.9	10.4	5.0	-4.2	-1.8
Hydrocarbon, GDP (% of Total)	40%	38%	35%	22%	21%
Total Foreign Assets (USD Billion)	608.4	670.1	721.6	740.8	761.5
Inflation (%)	0.7	1.1	2.3	4.4	2.9
Central government revenue (AED bn)	550	583	554	402	417
Hydrocarbon revenue (AED bn)	396	414	376	224	244
Hydrocarbon revenue (% of Total)	72.0	71.1	67.9	55.8	58.5
Central government expenditure (AED bn)	401	434	481	457	443
Current Expenditure (AED bn)	371	389	419	405	386
Current Expenditure (% of Total)	92.6	89.6	87.1	88.6	87.1
Capital Expenditure (AED bn)	30	45	62	52	57
Population (mn)	9.21	9.35	9.63	9.92	10.22
Per capita $ GDP	40,534	41,424	41,478	36,180	37,196
Crude oil production (barrels/day thousand; average)	2,734	2,857	2,943	3,046	3,137
Consumption of oil (b/d thousand; average)	1,186	1,228	1,330	1,384	1,432

Source: IIF

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