PANORAMA

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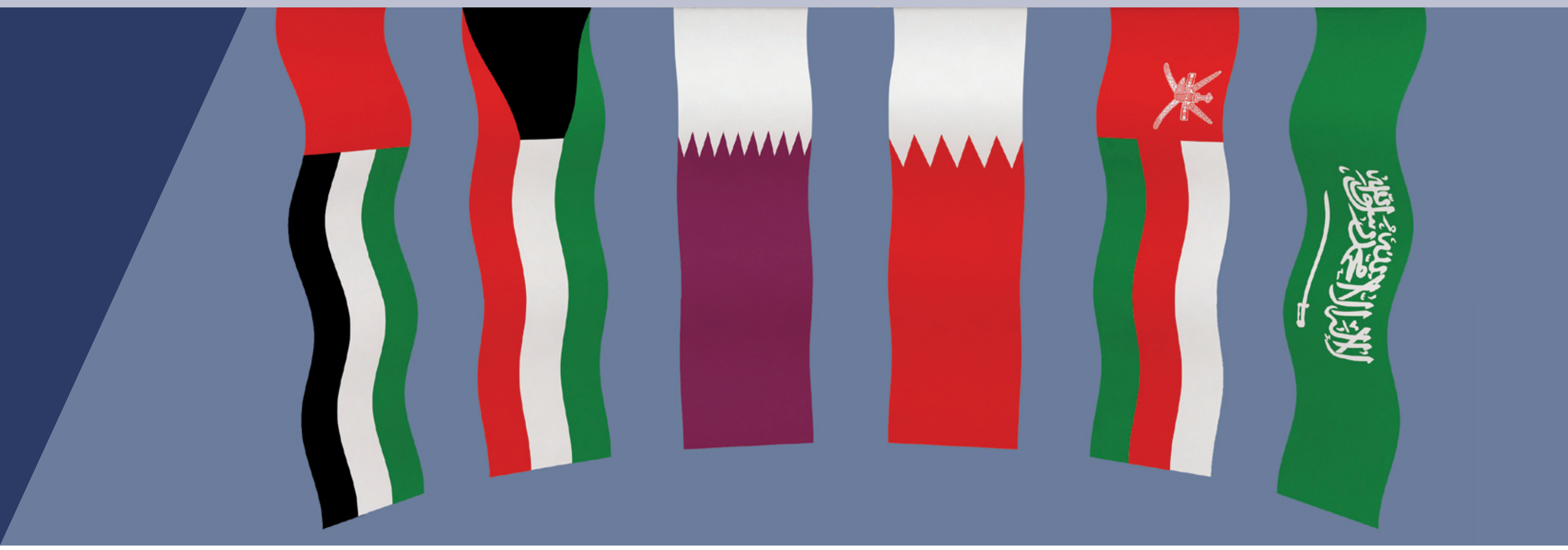
GULF COUNTRIES: VARIOUS REACTIONS TO THE SAME SHOCK

COFACE ECONOMIC PUBLICATIONS

By the Group MENA economist



Gulf Cooperation Council Countries -i.e. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates control around 30% of global oil reserves. According to the British Petroleum (BP) Statistical Review of World Energy 2015, the Middle East holds 47.7% of the world's proven oil reserves, with Saudi Arabia in the lead (15.7%), followed by Iran (9.3%), Iraq (8.8%), Kuwait (6%) and the United Arab Emirates (5.8%). Together they produced 28.6 million barrels per day in 2014, equivalent to 32.3% of total global production.

Lower oil prices therefore affect all GCC countries, but the magnitude of the shock varies from one country to another and indeed GCC countries have different break even prices for oil. Oman and Bahrain appear to have the economies the most exposed to the impact of the decline in oil prices, while the Kingdom of Saudi Arabia, the United Arab Emirates (UAE), Kuwait and Qatar are comparatively less impacted.

These more resilient economies benefit from strong macro economic fundamentals, such as more diversification, solid financial buffers and greater integration with world trade. They have also developed manufacturing and service industries, allowing them to mitigate their dependence on oil revenues.

The first part of this panorama seeks to explain the impact of lower oil prices on the economic outlook, with a focus on Saudi Arabia, the UAE and Bahrain. The second chapter of this report examines diversification strategies and the region's integration with international trade and the last chapter focuses on the food and beverage sector in the UAE and the automotive sector in Saudi Arabia.

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QUOTE BY ECONOMIST

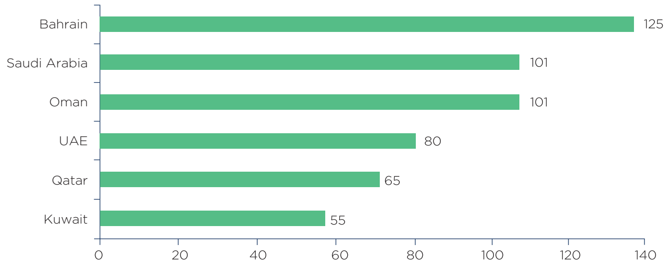
OIL DOMINANCE ON ECONOMIC PERFORMANCE

“Rising government spending, coupled with falling oil prices, may transform the region’s budget surplus of around 10% in 2013 into a significant deficit in 2015”

SELTEM İYİGÜN
MENA REGION ECONOMIST

Coface estimates that GCC countries will grow by 3.4% in 2015 and by 3.7% in 2016. Although these rates can still be considered as high compared with many emerging and advanced economies, they remain below the region’s average growth rate of 5.8% between 2000 and 2011. The main reason for this slowdown is the decline in oil prices.

Chart 1: GCC fiscal breakeven prices, USD



Source: Ashmore

Oil prices have fallen from around 110 USD per barrel in mid-2014, to around 50 USD in mid-2015. The IMF forecasts that annual average oil prices will stand at 59 USD in 2015, before slightly rising to 64 USD in 2016. The hydrocarbon sector provides nearly 43% of the region’s total output, 65% of exports and 78% of budget revenues. In the past these countries posted budget surpluses on the back of high oil prices. Lower oil prices have reversed this situation. Rising government spending, coupled with falling oil prices, may transform the region’s budget surplus of around 10% in 2013 into a significant deficit in 2015. The same situation applies to current account balances. It is estimated that the current account surplus will dip from around 20% of the region’s GDP in 2013, to close to 2% in 2015.

Nevertheless, not all the Gulf countries are alike. Despite their similarities in terms of economic structure, they differ in terms of economic size, population, key sectors of economic diversification, fiscal break even prices and other factors.The fiscal breakeven oil price is the average oil price needed for an oil exporting country to balance its budget for a particular year. This is an important indicator of fiscal vulnerability. Here our focus will be on the UAE, Saudi Arabia and Bahrain.As Saudi Arabia and the UAE accumulated solid foreign exchange reserves when oil prices were higher,they may be able to post budget deficits in order to support economic activity. However, this does not seem to be the case for Bahrain.

1 SAUDI ARABIA: SPEEDING UP THE DIVERSIFICATION PROCESS

The main driver of economic growth will be strong government spending to fuel private consumption and the construction sector

The biggest economy of the Gulf countries is forecast to see a moderation in its growth performance in 2015, in line with lower oil prices. Indeed, 80% of the Kingdom’s export revenues and nearly 85% of its budget revenues come from the oil sector. Coface estimates that the growth rate will slow to 2.5% in 2015, from the official growth of 3.5% announced in 2014.

The main driver of economic growth will be strong government spending to fuel private consumption and the construction sector. According to BMI figures, in real terms the construction sector posted a growth of 6.7% in 2014.The chances are that it will post a similar expansion in 2015, in line with the government’s investment plans for projects such as transportation infrastructure, energy, utilities and housing. The country has decided to invest 525 billion SAR (around 140 billion USD, equating to approximately 20% of current GDP) within the next 10 years, to expand its transportation infrastructure by building railway networks, ports and airports. In early 2015, the Saudi Arabian General Investment Plan (UIP).

The plan consists of four sector specific approaches, in order to boost investment. These include the integration of the energy sector with downstream chemicals, raising productivity in the construction, tourism, real estate and retail sectors, boosting mining and transport development and further investment in education to improve the Kingdom's competitiveness. The authorities have pointed out that there are more than 40 promising investment opportunities in the healthcare sector worth 71 billion USD (around 10% of GDP), including the manufacturing of medical hardware and equipment, medicines and vaccines, as well as the establishment and management of hospitals. In the transport sector, there are as many as 36 promising investment opportunities totaling around 25 billion USD. These include the manufacturing of buses, train carriages and spare parts, as well as providing technical and technological support services for the creation and development of infrastructure. The investment plan aims to establish investment entities to achieve sustainment development.

The government also seeks to support consumer spending. Saudi King Salman has ordered a massive 29.3 billion USD spending package, including two months' bonus salary for state employees and a series of subsidies worth 5.3 billion USD for electricity, water and housing. This generous spending reduced the central bank's net foreign assets by around USD 36 billion (around 5% of the total assets) in February and March in 2015, for the first time since 2009. Rather than curbing spending, the government is drawing down foreign currency reserves. This stimulus will boost consumption, especially retail sales,and partly compensate for the negative impact of lower oil prices on incomes.

Nevertheless,Markit HSBC Purchasing Managers' Index (PMI) fell to 57 in May, the lowest level since May 2014. This reading suggests that growth in the non-oil sector has been losing momentum, as economic activity is receiving less support from oil revenues. In the first five months of 2015, the pace of growth was lower than the second quarter of 2014, confirming the slowdown in the economy.

The main driver of economic growth will be strong government spending to fuel private consumption and the construction sector. According to BMI figures, in real terms the construction sector posted a growth of 6.7% in 2014.The chances are that it will post a similar expansion in 2015, in line with the government's investment plans for projects such as transportation infrastructure, energy, utilities and housing. The country has decided to invest 525 billion SAR (around 140 billion USD, equating to approximately 20% of current GDP) within the next 10 years, to expand its transportation infrastructure by building railway networks, ports and airports. In early 2015, the Saudi Arabian General Investment exporting 2.5 million barrels of oil a day before the sanctions were implemented. However, the lifting of the sanctions will be progressive and take time.

United Arab Emirates: resilient to lower oil prices

The UAE's economy is one of the most diversified among the GCC countries. Hydrocarbon revenues account only for 25% of GDP and 20% of total export revenues. Yet in fiscal terms, more than 60% of the country's budget revenues still depend on the hydrocarbon sector. The economic activity is expected to edge up on the back of non-oil sector development and the federation is seen to post a strong growth of 4% in 2015. Headline PMI data pointed to a robust pace of growth for the non-oil private sector in May, with the index standing at 56.4. Output and new orders posted very solid expansion, on the back of export demand.

Domestic demand and tourism are also supporting non-oil growth, especially in the Dubai emirate. According to Dubai Airports, in the first quarter of 2015, passenger traffic at Dubai International Airport (DXB) jumped by 7% YoY to 19.6 million.Dubai Airports expects passenger traffic to exceed 79 million at DXB by the end of 2015 and 103.5 million by 2020. Domestic demand is powered by strong retail sales and rising confidence. A report from the Emirate NBD showed that UAE consumer confidence improved in the first quarter of 2015, with a record high reading of 115 according to Nielsen's Confidence Survey. Dubai's retail sales, which rose by 7.3% YoY in 2014,are estimated to rise further during the upcoming period, on the back of solid tourism flux and Dubai Expo 2020. Following the property crisis in 2009, the federal government prioritised fiscal consolidation, which has created a sort of buffer to withstand weaker oil prices. The latter will impact the federation's budget performance. Coface estimates that the budget surplus will turn into a deficit in 2015, to stand at 2% of GDP. However,the country possesses ample foreign assets to mitigate the adverse impact of lower oil prices.The IIF estimates the UAE's net foreign assets at 509.4 billion USD in 2014, equivalent to 124% of GDP. The fall in oil prices will mostly affect Abu Dhabi's fiscal's revenues, as the emirate accounts for around 94% of the federation's oil resources (about 92 billion barrels). The federation kept its budget projection expansionary for 2015, with an annual rise of 6.3% in spending.

However it's ample foreign assets will allow the federation to run a budget deficit without a contraction in the economy.
The tightening of US monetary policy may impact the UAE, through the real estate market. Sales prices and rents may become less affordable, especially for foreign investors. Dubai's real estate market has been uplifted by foreign investors, as well as by wealth coming from the neighbouring Abu Dhabi emirate. With the appreciation of the US dollar and further deterioration in Abu Dhabi's revenues, if the drop in oil prices continues, the attractiveness of Dubai real estate market may drop off and non-oil sector growth may decline.

Saudi Arabia macro indicators

	2014	2015f	2016f
GDP (%)	3.5%	2.5%	3.0%
Current acc. bal. (1)	14.1%	-1.0%	3.7%
Budget balance	-2.3%	-15.0%	-9.0%
Government debt (1)	1.6%	1.8%	1.7%

(1) % of GDP
Source: Official statistics, IMF, BMI, Coface

UAE macro indicators

	2014	2015f	2016f
GDP (%)	4.6%	4.0%	3.8%
Current acc. bal. (1)	12.1%	5.3%	7.2%
Budget balance	4.4%	-2.0%	-1.9%
Government debt (1)	12.1%	14.7%	15.1%

(1) % of GDP
Source: Official statistics, IMF, BMI, Coface

Bahrain: Much less fiscal space than its neighbours

The drop in oil prices represents a challenge for Bahrain's economy. Weaker prices have put pressure on public finances which used to support the expansion of the non-oil sector. Coface forecasts that growth will moderate to 2.6% in 2015, down from close to 5% in 2014. In June 2015, Bahrain's country risk assessment (A4) was placed under negative watch. More over, at 125 USD fiscal break-even point, Bahrain remains the most vulnerableof the GCC countries to the drop in oil prices even though its economy is one of the most diversified. This is a because of the heavy dependence of government revenues on the hydrocarbon sector.

It is expected that the construction activity will benefit from financial support from other GCC countries. This sector expanded by 12.5% YoY according to the BMI, underscoring infrastructure investments funded by the Gulf countries.

Moreover, the public debt that already represents more than 43% of the GDP is forecast to increase to 54% of GDP in 2015. The budget deficit, a structural weakness for Bahrain, will peak in 2015 on the back of lower oil prices and the lack of new restrictive measures on expenditure. The absence of personal and corporate taxation and the high level of economic diversification have failed to provide the necessary resources for the country's budget.

Bahrain macro indicators

	2014	2015f	2016f
GDP (%)	4.8%	2.6%	2.4%
Current acc. bal. (1)	5.3%	-2.1%	-0.7%
Budget balance	-7.4%	-10.5%	-7.0%
Government debt (1)	43.8%	54.0%	56.7%

(1) % of GDP Source: Official statistics, IMF, BMI, Coface

As fiscal aggregates represent a weakness for Bahrain, the country has only limited foreign reserves. This situation could push Bahrain to turn to the financial markets to find the necessary funding to finance its deficit. In addition, the current account surplus is expected to become a deficit equivalent to 2.1% of GDP, while the external debt burdenis likely to rise significantly. The budget deficit limits the government's ability to support economic growth by increasing government spending to extend economic diversification into the wider services sector. On the other hand, the impact of the oil price slump may be cushioned by macroeconomic and financial assistance from other Gulf countries. In 2011, the GCC promised Bahrain a total of 10 billion USD (around 33% of GDP) of aid to improve its infrastructure.

2 DIVERSIFICATION AND GLOBAL INTEGRATION

Relatively successful diversification...

The GCC economies are still heavily dependenton the hydrocarbon sector as its main export and source of fiscal revenues. However, over the past decade, local authorities have decided to replace this growth model by economic diversification policies aimed at reducing their dependence on oil, especially as hydrocarbon prices are volatile and can be a source of macroeconomic imbalances.

Revenues from the hydrocarbon sector have been used for the development of non hydrocarbon industries in the form of subsidies and government spending. Saudi Arabia, the UAE and Qatar have been relatively more successful in terms of diversifying their economies,although there is still need for more. Many GCC countries have implemented long term economic and social development policies aimed at promoting sustainable development, increasing employment in the private sector and reducing oil reliance.
In this regard, Saudi Arabia has implemented its long-term strategy 2025, Oman has introduced Vision 2020, the UAE Vision 2021, Bahrain Vision 2030 and Qatar National Vision 2030. As a consequence, according to the IMF, between 2000 - 2013, growth in non oil output averaged 6.8% and the share of the non oil sector in total real GDP rose by 12 percentage points to 70% in the GCC countries.

Dubai has become an important hub for logistics and tourism. The emirate has created free trade zones to develop different sectors such as manufacturing, media, information technologies, healthcare, financial services and ports. Construction constitutes another important pillar of its economic diversification. Abu Dhabi has also created industrial zones to develop energy and capital consumer industries.
Saudi Arabia has identified the automotive, plastics, mineral and metal processing, solar energy and home appliances sectors as the main pillars of its diversification policy.It recently opened its stock exchange market to foreign investors.
In Qatar, non hydrocarbon activitiessuch as financial services, construction, trade and government services are leading the economic growth.
Bahrain is targeting the development of communication and transport facilities. Kuwait, which is one of the most dependent GCC countries on oil revenues, is trying to support the development of small and medium enterprises.
Yet some challenges remain, especially in terms of export diversification and export quality. Although from 2000 to 2013 non-oil exports (goods and services) rose from 13% to 30% of non-oil GDP, according to the IMF, export quality did not improve accordingly. Apart from Bahrain and the UAE, exports are still mainly composed of chemicals, which are oil related products. The development of non-hydrocarbon sectors in GDP is closely correlated with trends in oil prices. The decline in oil prices may therefore weigh on non-oil sector growth performance.

*NBK, « GCC : FDI down for fifth year in a row ; Kuwait the top Arab investor », 2014

Nearly 80% of the GCC's budget revenues still come from the oil sector, indicating that diversification from a fiscal point of view has been less evident.

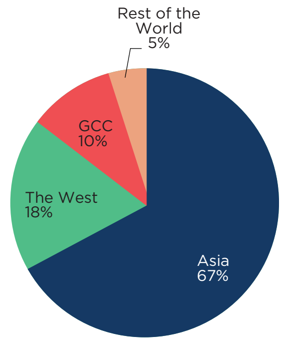
Productivity remains low across the region, as economic diversification is quite concentrated on activities with low productivity, such as tourism, construction, retail trade and transportation, rather than more added value and technology intensive industries.

These diversification policies are paired with more external openness. GCC countries have introduced measures to promote trade and attract more foreign direct investments (FDI). These measures have included the creation of free trade zones, the establishment of the GCC Free Trade Area, efforts for free trade agreements with European countries and the easing of bureaucracy. However, these efforts do not seem to be enough to attract further foreign investments, despite the improvements they bring. According to Coface business climate assessment (BC) which rates on a scale of seven levels (A1, A2, A3, A4, B, C, D in descending order of quality of the business environment), Qatar and the UAE stand at A3, Bahrain (which is on the negative watch list), Kuwait and Oman all stand at A4, while Saudi Arabia stands at B. The BC can be considered as a business confidence indicator. It measures the quality of the country for doing business, based on the availability and reliability of company accounts, as well as the fairness and efficiency of the judicial system concerning creditor protection. It also takes into account whether the country's institutions constitute a favourable framework for transactions. The assessment of the business environment is based on international organisation data. It also includes the experience of Coface entities worldwide.
Generally in GCC countries, company accounts tend to be opaque and the legal system does not provide all the necessary guarantees for enforcing debts, which makes risk assessment difficult. Additionally, some local policies may be discouraging for international investors, such as the "Saudisation" programme in Saudi Arabia. This programme, which consists of replacing foreign workers with Saudi nationals in the private sector, may limit foreign investment from companies who prefer to choose employees according to their qualifications and not their nationalities.
FDI flows into the GCC continued to fall for the fifth consecutive year in 2013, according to the United Nations Conference on Trade and Development (UNCTAD) World Investment 2014 report compiled by National Bank of Kuwait*. Indeed, FDI flows to the GCC fell from 28 billion USD in 2012, to 24 billion USD in 2013, despite a global improvement in FDI flows. As a consequence, the GCC's share in world FDI fell to 1.6% in 2013, from 4.2% in 2009.

...in line with more global integration

All GCC countries are open economies with close commercial relations with the rest of the world. According to the IIF, the region's total exports amounted to over 60% of its GDP in 2014.This panorama considers some of the main export partners of the region: Asia, the West and the zone composed of the Middle East, North Africa and Turkey (MENAT).

Chart 2: GCC exports, share by region, 2013



Source: EIU

Asia

Until recently, the dynamism of Asian economies gave some impetus to the global integration of the GCC countries. Over half of the GCC members export to Asia, which attracted 67% of the total GCC exports in 2013, according to the Economist Intelligence Unit (EIU)*. China and India are two major countries in terms of the size of their economies, their energy dependence and capacity to boost GCC exports. GCC exports to China jumped at a rate of 30% between 2010 and 2013, in line with China's strong growth performance. In order to secure their energy supplies, a rising number of Chinese companies have invested in the Middle East. In additionally, many Chinese construction companies have also invested in the GCC region. The amount of contracts between 2005 and 2014 are estimated at 30 billion USD, 8% of China's global contract wins, according to data from the Heritage Foundation.

More than half of the GCC members export to Asia,which attracted 67% of the total GCC exports in 2013

Asian countries are among the biggest trade partners of the GCC, not only in terms of hydrocarbon exports but also in imports such as manufactured goods, machinery and food.Nevertheless, the GCC's exports to non Japan Asia remained dominated by oil and gas, as well as petrochemical derived products. These products accounted for over 80% of total GCC exports in 2012**.
These developing trade ties allow the Gulf countries easier access to wide Asian markets in the energy, telecommunications and finance sectors, which is beneficial to their economic diversification strategies.

Over the last decade, GCC exports to India jumped at an annual rate of 43%. According to the EIU, they now account for 11% of total GCC exports. It is estimated that approximately 7 million Indian workers are employed in the Gulf region. The UAE and KSA accounted for more than two-thirds of total bilateral trade, by value, with India. Data from Alpen Capital shows that bilateral trade between the UAE and India reached 59.5 billion UAD (16.2 billion USD). GCC exports to India mainly consist of oil, mineral fuels and distillation products. Indian FDI in the GCC region stood at 2.1 billion USD in 2014.
Indian companies mostly invested in real estate, construction, finance, ICT, agriculture and manufacturing. The total GCC FDI between 2008 and 2014 stood at 2.9 billion USD.
Eastern Asia countries such as Japan, Taiwan and South Korea,

*NBK, « GCC : FDI down for fifth year in a row ; Kuwait the top Arab investor », 2014 have also developed strong trade ties with the Gulf countries. carbon sector, South Korean engineering and construction While Japanese oil companies have investments in the hydro firms have won contracts from the GCC members. The GCC provides oil and gas for Korean and Japanese manufacturing, transport and electricity activities, while they, in turn, offer business opportunities in the infrastructure and construction sectors. In March 2015, South Korea and Qatar signed Memoranda of Understanding (MOUs) to enhance bilateral cooperation focusing on business opportunities in various areas. Qatar, which will host the 2022 FIFA World Cup, plans to spend about 100 billion USD on construction projects including railroads, expressways and stadiums. Korean officials have said that Korean companies will participate in infrastructure projects worth 29 billion USD, including the construction of the main stadium, railway, roads and bridges

Qatari authorities are also seeking to benefit from Korea's technology and experience to support the development of industrial sectors.

The slow down in China's economy represents the biggest risk for the GCC economies, especially during this period when oil prices remain low. China is the world's biggest oil importer and its economic deceleration is reducing its demand for oil, petrochemicals and other materials from the GCC. According to research conducted by the IMF in 2012***, Saudi Arabia's economy is more sensitive to developments in China than to shocks in the Euro Area or the United States, due to China's growing impact on the global oil market. The research suggested that four quarters of shrinking growth in China would result in a 0.5% decline in Saudi Arabia's real GDP. In contrast, the same performance in the euro zone or the US economies over the same period would only reduce the kingdom's real GDP by 0.1%. The fact that China's slowdown is moderate and does not occur in the form of hard lending, can be considered as a mitigating factor.

The West holding the absolute share in GCC exports Western countries (Europe, North America, Australia and New Zealand) accounted for 18% of GCC exports and 54% of its imports, according to data from the EIU. Europe leads the trade flows, with an amount of 249 billion USD in 2013, out of a total of 393 billion USD between the GCC and the West. GCC exports consist mainly of hydrocarbons and petrochemical products, while western exports are composed primarily of industrial products, machinery and metals. During the troubled period of the Arab Spring, the GCC countries had the position of a safe haven, which allowed them to attract the majority of investments and capital inflows into the region. The real estate and property sectors have been principal sectors in the loop of investors. The adoption of similar structures to Western countries facilitated the investment of Western companies in the region. Dubai, for example, offers a tax free and 100% foreign ownership possibility in the freezone such as Dubai Multi Commodities Centre, JAFZA, DAFZA as well as financial zone such as Dubai International Financial Center (DIFC), where the international legal system is applied based on the Common Law of England & Wales. Usually the Western businesses that are active in the GCC region are very large in terms of turnover and staff count. Western companies such as Atkins, Bechtel, Technip, GDP-Suez, Bouygues, Vinci, Carrefour and Air Liquide have investments in GCC. Most of the Western companies are involved in the hydrocarbon sector, pipeline projects, the retail sector, or construction activities.

GCC countries invest in Western markets as well. Gulf carriers such as Emirates, Etihad and Qatar Airways are expanding to Western markets. These airline companies have, in particular, became the first choice forAsian travellers flying to Europe and beyond. Lower taxes, free infrastructure and a non-unionised environment, give these carriers an important price advantage over their Western competitors. Qatar Airways plans to serve new destinations in the United States such as Atlanta, Boston and Los Angeles, on top of already existing Emirates and Etihad services which include New York, Chicago, Houston and Seattle.

The huge amounts of cash accumulated in the GCC Sovereign Wealth Funds (SWFs) provided much needed liquidity to European countries during the global financial crisis of 2008 and the European debt crisis of 2010. Four out of ten of the world's largest SWFs are located in the GCC countries. Although official figures are not publically disclosed, their estimated value stands at more than 2 trillion USD. The share of these assets managed in the European Union is estimated at around 73 billion euros, as at the end of 2014, according to data from Eurostat compiled by the Aspen Institute. The Gulf countries have greatly invested in the energy and real estate sectors in Western markets. Taqa, a UAE based energy company, runs businesses in developing and operating gas storage facilities in the Netherlands, and operates oil and gas production platforms in the UK's North Sea. It also has operations in North America, focused on conventional oil and gas exploration and production. Other GCC energy giants such as Saudi Aramco, Qatar Petroleum International and Kuwait Petroleum Corporation have partnerships with Shell, Exxon Mobile and BP.

MENA and Turkey - growing trade prospects

The trade volume between the GCC region and the Middle East, North Africa and Turkey remains limited compared with other regions. It accounted for only 6.6% of GCC exports and 3.1% of imports in 2013, according to the EIU. This low level of trade between the two regions is partly a result of the turmoil that negatively affected most of the North African countries during the Arab Spring period in 2010. Most of the exports consist of hydrocarbon products.

Since the sharp impact of the Arab Spring turmoil, growth has slightly recovered in North African countries. In 2015, Coface expects growth to accelerate to 4% in Egypt (from 2.2 in 2014), to 4.5% in Morocco (from 2.9% in 2014) and to 3% in Tunisia (from 2.3% in 2014). The Egyptian government's efforts to improve the business environment, and the possible easing of Western sanctions on Iran, are expected to put these two economies on a more positive footing. Following the mass

*EIU, « GCC Trade and Investment Flows », 2014 **DB research, « The GCC going East », 2014 ***IMF, « Saudi Arabia : Selected Issues », 2012 protests, Saudi Arabia, Kuwait and the UAE have kept the Egyptian economy afloat with 23 billion USD in oil shipments, cash grants and central bank deposits. In March 2015, Gulf countries pledged a further 12 billion USD of investments for Egypt. In April 2014, Morocco's royal cabinet announced that the Gulf countries will invest 737 million USD in tourism infrastructures in the port of Casablanca. Tourism accounts for around 8 to 9% of Morocco's gross domestic product. According to research conducted by the Saudi based Arab.

Petroleum Investment Corp., Gulf hydrocarbon producers will pump around 121 billion USD into power projects in the MENA countries. The sum includes investments worth 75.9 billion USD in power generation, 15.5 billion USD in transmission and 29.6 billion USD in distribution.
Tourism and worker remittances also constitute revenue sources,especially for the oil importing Arab countries. These important financial resources and growing infrastructure projects suggest that the demand for migrant workers from the GCC countries will continue in the upcoming period.

Turkey has progressively become an important trade partner for the Gulf countries. Turkey's total exports to the Gulf countries peaked at 12.9 billion USD in 2012, according to data from the Turkish Statistics Institute. However, due to the region's geopolitical turmoil Turkish exports lost momentum and declined to 9.1 billion USD in 2014. GCC exports to Turkey rose to 6.6 billion USD in 2014, from 1.9 billion USD in 2008. The Gulf countries mostly buy from Turkey industrial products such as food, metals, textiles and furniture, while they princi pally sell chemicals and metal products. Gulf countries show great interest in Turkey's property sector. The Qatari Diar Real pally sell chemicals and metal products. Gulf countries show great interest in Turkey's property sector. The Qatari Diar Real Estate Investment Company has launched a residential project, Sea Pearl,in Istanbul's seaside neighbourhood of Atakoy. The project will comprise 1,474 luxury apartment units and a deluxe five star hotel with high end boutiques featuring global brands and lavish restaurants.In April 2015, the Saudi based AlBassam Group announced it will launch a new fund of 2 billion lira (750 million USD) in Saudi Arabia, in order to invest in Turkish real estate with Sumou Holding.Qatari investment fund, Mayhoola for Investments,has announced it will buy a 30.7 percent stake in Turkish retailer Boyner Perakende, for 885 million lira (332 million USD).

In summary, the efforts made in economic diversification have helped GCC countries to increase their integration with the rest of the world. China and India are especially important clients for the GCC's hydrocarbon products. The slowdown in China will be the main challenge over the upcoming period. Nevertheless, the infrastructure and energy sectors in India and the recovery in Europe will continue to represent important business opportunities for the Gulf states.The aviation and hydrocarbon sectors seem to be the principal areas attracting GCC investments, while many Western companies are investing in retail, manufacturing, infrastructure and pipeline projects in the Gulf. The growing needs of Middle Eastern and North African countries for infrastructure and energy are also attracting Gulf funds to the region.

3 SECTOR OUTLOOK: ECONOMIC RESILIANCE IN THE UAE AND SAUDI ARABIA VISIBLE IN SPECIFIC SECTORS

This section focuses on the food and beverage sector in the UAE and the automotive sector in Saudi Arabia. The first benefits from strong domestic demand and the country's higher per capita food consumption. The second represents important investment opportunities for car makers, on the back of the Kingdom's strategy to launch significant commercial vehicle assembly over the upcoming period.

Coface assesses the risks related to sectors based on indicators such as production, demand, corporate profits, exports, growth potential and the payment experience of Coface entities. The sector risk assessment is divided into four risk categories: moderate, medium, high and very high.

Chart 3: Coface GCC sector risk assessment

GCC Sector Risk Assessment							
	Tourism	Oil & gas	Construction	Transportation	Automotive	Retail	Agrofood
Saudi Arabia	● green	● green	● yellow	● green	● green	● green	● green
UAE	● green	● green	● yellow	● green	● green	● green	● yellow
Qatar	● green	● green	● green	● green	● green	● green	● green
Kuwait	● yellow	● green	● yellow	● green	● green	● green	● green
Bahrain	● red	● yellow	● yellow	● yellow	● green	● green	● green
Oman	● green	● green	● yellow	● green	● yellow	● green	● green

This panorama will evaluate the food and beverage sector in the UAE and the automotive sector in Saudi Arabia, as they represent key sectors in their respective countries.

Food and drink sector in the UAE: solid fundamentals, mitigated risks

Highlights

The UAE food and beverage sector benefits from factors including a high income domestic market, solid private consumption, a large population of expatriates with increasing demands, strong economic growth and the country's position as a safe haven. The facts that the soft beverage segment is unsaturated, and that there is an important potential in the halal food sector, make the country attractive for investors.
The main risks concern the country's high dependence on food imports and increased competition. These result in extended payment terms across the sector,as they put pressure on profit margins. Any slowdown in the economy, particularly resulting from a sudden and long lasting drop in oil prices, would affect negatively consumer spending yet this risk seems to be mitigated.

Supply

According to the World Bank figures for the period 2009-2013, the UAE' sarable lands account for only 0.6% of the total land area, while agricultural land is just 4.8%.The main agricultural

*CAGR provides a constant rate of return over multiple time periods by dampening the volatility effect products are dates, poultry meat, eggs and some fruit and vegetables such as citrus fruit, mangos and tomatoes.Climate conditions hamper the country's agricultural development.

As the production capacity is limited, the UAE has been investing in the food processing industry.Since 1994, the country has invested 1.4 billion USD in the food processing industry, with the aim of producing high added value food for local clients, as well as for re-exporting. Foreign investments and the government's willingness to increase its food production (and thus its self sufficiency) have resulted in the arrival of a growing number of companies in the food processing sector.There are currently an estimated 300 food processing companies in the UAE. The dairy industry, in particular, has recorded significant expansion. As the per capita consumption of dairy products remains high, hovering at around 80-85 kg annually,(compared with around 60 kg in Saudi Arabia, despite its population being almost four times that of the UAE), manufacturers have been attracted into the sector.

On the back of the government's strategy and supports to reduce import dependence, BMI figures indicate that the UAE has become more than 80% self sufficient for milk and 40% self sufficient for eggs.
The halal food segment is also continuing its strong expansion. According to a research report from the Dubai Chamber of Commerce, the halal food and beverage market reached a value of 1.1 trillion USD in 2013. The research estimated that the halal market will increase at a CAGR of 6.9%, to 1.6 trillion USD by 2018, boosted by strong consumer demand for varied natural food choices.
As regards the soft drinks industry, the UAE remains a competitive market offering a large variety of products across all segments. The country is also one of the world's highest per capita consumers of fruit juice. The strategy of companies, based on innovation and 'premiumisation', are expected to sustain the development of the soft drinks industry in the UAE.

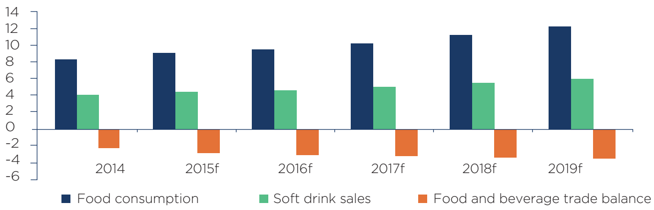
Although the government's policies have reduced import dependence for some products, the harsh desert climate means that the country still depends on imports of food and beverage to meet domestic needs. The gap between consumption and production is filled by imports. The UAE is the GCC's second largest food importer, behind Saudi Arabia. With a rising population, higher per capita income and changing nutrition choices, food and beverage imports are estimated to increase by 36% between 2014 and 2019, with exports to grow by 30%. The country is also a major regional hub for food re-exports. According to Dubai Exports, food re-exports increased by 10% in 2014, from 10.6 billion dirhams (nearly 1.1 billion USD) in 2013.China is the top destination for UAE food exports. Other GCC countries, Russia, Africa and CIS countries also create demand for the UAE exports, thanks to their large populations, rising middle classes and increasing disposable incomes. The most exported products include refined sugar, rapeseed oil, palm oil and dates.

Demand

In the UAE, food consumption stood at 8.4 billion USD and total soft drink sales reached 4.1 billion USD in 2014. Between 2014 and 2019, the compound annual growth rate (CAGR)* in local currency terms is estimated at 7.7% for food consumption and 7.6% for total soft drink sales.
This robust increase is driven by rising per capita income, the strong performance of the UAE economy, population growth and the 'premiumisation' strategies of food and beverage companies. Premiumisation enables companies to differentiate their products from the cost cutting market place, through strategies such as offering higher added value products at unique points of sale.

Strong private expenditure, which grew by 8.4% YoY in 2014, is leading the development of the food and beverage sector. Demand from expatriates (who are estimated to account for 85% of the UAE's total population) and from the Emiratis with the greatest purchasing power, are two main pillars of demand. In addition, during the Arab Spring, the UAE (as did some other GCC countries) became a safe haven for investors and tourists. The country's total tourism receipts will grow by 9.3% YoY in 2015, passing 20 billion USD. This tourism is also a growth driver for the food and drink sector. The country will continue to benefit from instability in countries like Bahrain.
Changing consumer tastes, adopting more healthy nutritional choices,are also sustaining the demand for food and beverage. This is a particularly important factor in Dubai, where consumers tend to calibrate towards higher value segments.

Chart 4: UAE food & beverage sector, billions USD



Source: BMI

Highlights

Besides its traditional wealth of vast oil and gas reserves, Saudi Arabia has become a major automotive hub in the Middle East. Wide government support for private consumption, good infrastructure, a positive business environment and plentiful natural resources have all contributed to the positive outlook for the Kingdom's automotive sector. The principal risks would be related to a substantial fall in oil prices, which would negatively impact the automotive sector and the dependence of the sector on international car makers, in terms of profitability. Yet these risks do not seem to be weighing on the sector's performance in the near future.

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*CAGR provides a constant rate of return over multiple time periods by dampening the volatility effect

Supply

Within the government's industrialisation strategy, several original equipment manufacturers have established local entities in the country. In 2012, Isuzu Motor began production at its plant in Dammam's Second Industrial City. German commercial vehicle manufacturer MAN's Saudi Automotive Manufacturing Company also has some production in Saudi Arabia. In 2014, Tata Motors owned Jaguar Land Rover (JLR) said it was planning to invest 100 million pounds into a new factory in Saudi Arabia and was close to signing a deal with the government. JLR is targeting an output of 100,000 units a year, to meet the booming demand in the Middle East region.In May 2015, South Korea's Daewoo International said it was working closely with The Saudi National Automobile Manufacturing Company (SNAM) and the Saudi Arabian Public Investment Fund (PIF), to establish an automobile manufacturing plant worth 1 billion USD with a production capacity of 150,000 cars a year by 2018, according to some media.

The government also plans to build the first Saudi Arabian car, Meeya, by 2017, following a deal between Saudi and Malaysian businesses. According to local media reports, the chairman of the Saudi Malaysian Industrial Development Holding Company has said that 300,000 Meeya units a year will be produced when the plant reaches maximum output. The Ministry of Commerce and Industry has reportedly given the companies permission to prepare a feasibility study on the venture. Ghazal project, a locally produced sports utility vehicle (SUV) is also currently under development. The 500 million USD project is being funded by an alliance of the King Saud University and the South Korean company Digm Automotive Technology.
In 2014, the top five light vehicle brands operating in Saudi Arabia were Toyota with 300,155 sales (36% of market share), Hyundai with 144,605 sales (17.7%), Kia with 58,126 units (7%), Nissan with 57,742 units (6.9%) and Isuzu with 52,963 units (6.4%)*.

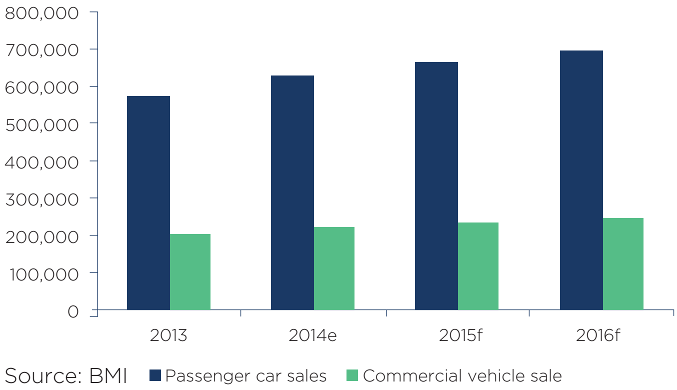
Thanks to the positive economic outlook in the Kingdom, the Saudi commercial vehicle sector outlook remains bullish and is expected to record an increase of 3.6%,YoY, in 2015. The government's plans to develop the country's transportation infrastructure and industries sustain this growth prospect.
In line with manufacturers, the parts and components distribution sector is also expanding. According to GfK research, 3.86 million tyres were bought in Saudi Arabia in the first half of 2014, compared with 1.32 million in the UAE and 0.52 million in Egypt. Growing automobile fleets and sales, encouraging government policies and increasing foreign investments are supporting the tyre market in Saudi Arabia. Important tyre producers, such as Bridgestone, Michelin, Continental and Goodyear, have a strong presence in the Kingdom.
Saudi Arabia is the largest importer of cars and automotive parts in the Middle East. The country imported 982,000 vehicles in 2012. The main car exporters to Saudi Arabia were the United States (215,000 units) and South Korea (207,000 units).
The main challenge for the Saudi automotive sector remains the fall in oil prices and the domestic market's heavy dependence on global car makers in terms of profitability. A substantial and continued fall in oil prices may lead to a cautious approach from consumers, pulling down automotive sales. However, with the vast financial assets of the Kingdom, the government will be able to sustain economic growth. This mitigates the possible impact of such a drop in energy prices.

*BMI, "Saudi Arabia Auto Report", Q2 2015

Demand

The country saw a solid growth in new vehicle sales in 2014. King Salman's announcement to increase spending (including two months bonus salary for state employees and a series of subsidies) is expected to boost automotive sales. In 2015, total vehicle sales are estimated to increase by 5.2% YoY and the vehicle fleet by 2.6% YoY. There is also a strong demand for luxury cars. High per capita income and households' willingness to spend, feeds the demand for luxury cars. Maserati's annual sales rose by 152% over the first half of 2014, with Saudi Arabia recording a growth rate of 231%. BMW Group Middle East announced, late in 2014, that it's annual sales soared by over 12% between January and September. According to the company, during that period, 22,786 BMW and MINI cars were sold across 12 Middle Eastern markets.
In addition, the rise in fixed investments is supporting the demand for commercial vehicles. Other structural factors, such as rising disposable incomes, favorable demographics and higher urbanisation rates are also helping the automotive sector's expansion. Nevertheless, the ban on women from driving and the fall in oil prices represent two restrictive factors on sales. Strong levels of private consumption should therefore support the demand for new cars. Auto financing should also remain fairly affordable, with monetary policy conditions set to remain supportive.

Chart 5: Car sales in Saudi Arabia, units



Source: BMI

4 CONCLUSION

The sharp decline in oil prices since mid 2014 revealed the importance of economic diversification and foreign assets for the GCC countries. Countries deprived of solid financial buffers, such as Bahrain, have started to witness problems related to poor growth performance as they cannot support their economy through fiscal instruments. The situation is totally the opposite for Saudi Arabia and the UAE, which can tolerate fiscal deficits as they possess huge financial assets.

Economic diversification is also a buffer for these countries, as it supports their increased integration with the world's economy. GCC countries have built solid trade ties with Western and Asian countries in particular. The biggest risk remains China's slowdown, as it could trigger a decline in the economic performance of GCC countries.

On the sectoral side, the pace of growth of private consumption expenditure and governments' efforts to support sustainable economic growth are helping to keep the outlook positive

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