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The UAE Country Risk Analysis

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Abstract

This research Studies the Risk Analysis of the United Arab Emirates (UAE). At first, an overview of the UAE is discussed, its emirates, government, constitution, population, rank in the world, etc. Then, a view on its economy is undertaken, showing its major sectors & development. An extensive discussion is then undertaken for the UAE's major economic sector, which is Oil & Gas. After having a good understanding of the UAE's economy, the UAE's financial position & the economical crisis impact on it is then discussed.

Finally, types of risk of which the UAE is exposed to are demonstrated. And at the end, a conclusion from the whole research issues was derived along with suggested recommendations for future improvements.

Keywords: UAE Risk, Oil and Gas, Abu Dhabi, Dubai, Financial Position, 2008 Economic Crisis.

1. Introduction

Country risk is that risk that is associated with investing in a foreign country. These risks are major in affecting the profitability & the value of assets of the investment. Hence, the thorough analysis & study of these risks is essential prior to any investment. Country risk is complicated because of the numerous factors affecting it, which range from business environment, financial, political, economical factors. This leads that in order to analyze country risk, an associated analysis & study should be undertaken for these affecting factors, where economical sectors should be studied, financial positions must be analyzed, political issues is a major field of concentration in the analysis. In this research, the United Arab Emirates (UAE) was selected to be analyzed, where all the above factors were studied, then & an assessment of the risks is demonstrated, & ending with conclusions & recommendations derived from the whole research

2. The United Arab Emirates: An Overview

The UAE is consisted of a federation of seven emirates: Abu Dhabi, Ajman, Dubai, Fujairah, Ras Al-Khaimah, Sharjah, and Umm al-Quwain. Abu Dhabi is the capital, & each emirate is governed by a separate 'Amir', & the whole federation is ruled by one president. The constitution of UAE is only concerned with the interrelations among the emirates, while governmental system is separate for each emirate, where each emirate has its own system.

The UAE is ranked as the most developed country is west Asia, & it is among the wealthiest nations in the world. It has the sixth largest oil reserve in the world, & in exchange rate market, it has the 35th rank in the world, & it is ranked by IMF as a high-income developing country. Abu Dhabi is the largest emirate with 87% of the total area of UAE, while Ajman is the smallest emirate. The coast of UAE is more than 650 kilometers, & the largest harbor is at Dubai, along with other ports in Abu Dhabi & other emirates.

2.1 UAE Basic Indicators:

Population (2010): 7,512,000

GDP (million current US$, 2009): 230,252

GDP (million current PPP US$, 2009): 264,294

Current account balance (million US$, 2008): 22,278

Trade per capita (US$, 2008-2010): 61,995

Trade to GDP ratio (2007-2009): 172.6

3. UAE Economic Sectors

UAE is a mixed free-market economy based on oil and natural gas production, and these industries combined take up more than a quarter of UAE gross domestic product (GDP). Over the past 2 decades, the UAE's economic diversification program has led to the rise of several non-oil sectors that now make up a significant percentage of the UAE's GDP as follows:

Oil & Gas More than 30%

Manufacturing 12.6%

Commerce and hotels 11.4%

Real estate 9.1%

Construction 8.6%

Transportation 7.3%

Finance and insurance 6.4%

Government services 11%

Free zones were created to assist Industrial growth, such as Jebel Ali Free Zone in Dubai. Also, in Technology sector, the Dubai Internet City was established & attracted high-profile firms such as Microsoft, IBM, HP, & others. However, the over whole economy of UAE keeps on fluctuating due to its main dependence on oil & gas that have fluctuating prices , since 70% to 80% of government revenues come from oil. Nevertheless, these revenues are spent in enhancing other sectors which had grown rapidly in recent years, such as trade, tourism, construction, & others.

4. Oil & GAS

In the Middle East, UAE is the fourth exporter of crude oil after Saudi Arabia, Iran & Iraq. Worldwide, it is the ninth oil producer, the sixth largest reserves of crude oil, & the seventh reserve of natural gas. The UAE have oil reserves of 97.8 billion barrels & gas reserves of 227.1 trillion cubic feet, which is enough to last for more than a century.

In 2008 & 2009, oil consumption decreased due to the recession, hence, the Organization of the Petroleum Exporting Countries (OPEC) set record production cuts to stabilize the oil market, & in compliance with these records, the UAE production fell from 2.9 million barrel per day (bpd) to 2.3 million.

As the crisis passed, oil demand is predicted to rise, where the International Energy Agency estimates that this rise will reach 24%, from 85 million bpd in 2008, up to 105 million bpd in 2030. In addition to the forecasted high demand, other oil producing areas, such as the North Sea, are declining in their production.

These estimations are all in the advantage of the UAE that is now required to raise its production capacity by 30%. The major authority for oil & gas in the UAE is the emirate's Supreme Petroleum Council (SPC), & it is chaired by the UAE's president, where all major projects require its approval.

4.1 ABU DHABI oil & gas

Abu Dhabi has the largest oil & gas reserves in the UAE, where it occupies 94% from the total UAE's oil, & 94% from the total gas. The major oil & gas corporation in Abu Dhabi is Abu Dhabi National Oil Company (ADNOC), where its board of directors is from the SPC, & it functions as joint venture with other foreign oil companies.

The most significant projects for oil & gas in Abu Dhabi are:

1. ADNOC joint venture with ConocoPhillips (US oil company) in 2009, for developing an oil field in the south west of Abu Dhabi called the Shah gas field. This project is estimated to cost \$10 billion (Dh37 billion), & it will provide 500 million standard cubic feet per day (scfd) of gas sales.
2. A program including four projects for gas production in 2009, where the first project has a cost of \$10.9 billion (Dh40 billion), & it will provide additional 1 billion scfd of gas from offshore and onshore oil fields. These four projects were awarded to Abu Dhabi Gas Industries (Gasco), an ADNOC subsidiary.
3. Two more projects handled by a partnership between ADNOC and Royal Dutch Shell to search for gas below the sea.
4. The Sahil, Asab and Shah oil fields development project, handled by the Abu Dhabi Company for Onshore Operations (Adco) with a cost of \$3.5 billion (Dh12.9 billion) in 2009. This project will increase oil production from 60,000 bpd to 455,000 bpd within 7 years.

5. The Bab oil field, the first onshore oil deposit in emirates, also awarded to Adco in 2009 with a cost of $805 million (Dh3billion) & a production increase of 400,000 bpd to 1.8 million bpd within 8 years.
6. The Umm Shaif and Lower Zakum oil fields, awarded to Abu Dhabi Marine Operations Company (Adma-Opco) in 2009. It is a ten-year project to increase output from 600,000 bpd to 1 million bpd.
7. The Upper Zakum field, awarded to The Zakum Development Company (Zadco), another ADNOC subsidiary. The project will increase this field production by 50% up to 750,000 bpd. ADNOC's main partner in most of its projects the US oil major ExxonMobil.

4.2 DUBAI oil & gas

Dubai's oil production was very much affected by the recession, where it dropped from 410,000 bpd to 80,00 bpd. In addition to Dubai's role in oil production, it also serves a major role in oil trading & energy services.

Dubai has developed the port of Jebel Ali, at its southern west shore, where in this port the largest portion of trading oil in the UAE is handled, where the port capacity reaches up to 80,000 tones.

And in order to enhance Dubai's role as a hub for oil trade, the Dubai Multi Commodities Centre (DMCC) signed in 2008 a project agreement for building oil storage at Jebel Ali port with a cost of $200 million.

Also, at Jebel Ali, two refineries were established with a capacity of 48,000bpd. These refineries are owned by Emirates National Oil Company (ENOC), which is owned by Dubai government. Another entity was established in 2006, The Dubai Mercantile Exchange (DME), which offered future contracts for crude oil, as well as the DMCC.

Major international oil companies had established main offices in Dubai, such as the American company Halliburton. Also, a joint venture between Abu Dhabi government-owned company, Mubadala Development, with the British firm Petrofac, had established a head quarter in Dubai. In 2009, new bodies were established in Dubai to handle long-term policies for oil & gas.These entities are the Department of Petroleum Affairs & the Energy Higher Council, where the first handles supply issues, & the second is concerned with demand issues.

5. The Crisis of 2008 and the UAE GDP

In 2008, oil prices had a very sharp decline in prices from $147 to a barrel, & that was a major factor to expose the UAE to the financial crisis at that year. UAE economy suffered from debt and high unemployment, which caused it to be put in slow development motion. The largest debt was Dubai World's with value of $13 Billion (91.5 Dhs). Another factor participating in exposure to crisis is the withdrawal of foreign investment.

Also, state-owned investment fund (sovereign wealth fund) had a decrease in the value of its global assets.

Government rushed into action to help stabilize the economy after the crisis, where it had a raise of 14% for its public expenditure from $71.5 billion (Dh 254 billion) in 2008 up to $81.5 billion (Dh 289 billion).

Also, Abu Dhabi helped Dubai with a $10 billion (Dh36.7 billion) support its economy.

At the start of the crisis in 2008, IMF anticipated that its impact on the UAE economy will shrink with a 1%, but later in 2009, it changed its forecast to 2.5%, where the crisis had a worse impact than expected. Also, the Institute of International Finance (IIF) had an estimate of 2% for UAE economy shrinkage in 2009.

5.1 Crisis Recovery

Nevertheless, the UAE's economy was set to recovery mode in 2010 due to high oil prices that helped solve debt issue, where a restructuring deal controlled by the state was achieved only in ten months for that debt, which restored UAE's reputation in its capability of quick recovery & restored investors' confidence, where at the end of that year, government bond sales had a significant increase.

The restructuring plan success had a great impact on the UAE's economy growth, where IMF had changed its forecast for UAE's growth from 1.3% to 2.4%. Also, the UAE Ministry of Economy had a forecast between 2% & 3.2% for economic growth, & for GDP an estimate of $282 billion (1 trillion Dhs).

Other estimates for economic growth are as follow:

The Economist Intelligence Unit (EIU): 2.6%

Agency Fitch: 2.4%

Standard Chartered: 3%

The main factor contributing for this recovery is the oil sector with 15% the rise in its prices reaching more than $90 a barrel, where oil accounts for more than 30% of GDP. As for trade, a noticeable recovery was rising where a higher demand emerged for goods & services, especially in Dubai. And for private sector recovery, a measure performed by HSBC named the Purchasing Managers' Index (PMI) revealed that the private sector is positively expanding, where this index reached 53 points, which is considered a very good score.

6. UAE Financial position

The UAE's ministry of State for Financial Affairs declared that the financial situation & economic indicators are positive, & that the (GDP) is steadily growing. The ministry also stated that it had collected from 39 agreements with other countries the amount of interests up to $454 million, & another amount from late rents & debts of $64 million out of &142 million. New recommendations were set from the ministry that enhanced internal auditing, & new strategies for embracing a zero-based budgeting.

Also, Emiratisation issue had more focus than before, where it had reached now 35% in technical jobs, & 56% in total. The Central Bank of UAE announced that growth rate in the economy is expected to be 4%, where new projects will continue to emerge, such as the nuclear power generation, the Emirates railway, & the marine transportation network.

6.1 Dubai Financial Position

In the last decade, Dubai had a great unique construction projects, including Burj Dubai, the tallest building in the world, & the Palm Jumeirah Islands, the largest man-made island in the world. When the crisis of 2008 struck, Dubai started suffering for funding these projects, & speculations were that Dubai is at the edge of collapse because of large amounts of debts that will force it to sell its assets or ask for a bail out from Abu Dhabi. Dubai's stock market was down 60%, & its property prices decreased 40%c in two months. At first, Dubai's officials did not reveal any figures & insisted that everything was fine. Later on, they had to reveal the real figures, which are as follows:

Sovereign debt $10 billion

State-affiliated debt $70 billion

Sovereign assets: $90 billion

State-affiliated companies assets $260 billion

Total debt: $80 billion

Total assets: $1.3 trillion

Dubai GDP: $28 billion

Debt per capita: $40,000

And comparing UAE's Ratio of debt: GDP with other countries, results in the following:

UAE 148%

USA 57%

Britain 40%

Japan 99%

Some economists argue that Dubai's assets worth more than $600m, & that debts amounts are higher than declared.

7. The UAE Country Risk

Country risk represents all kind of risks related to investment in a foreign country. These types of risks vary from financial, economical, political, & sovereign risks. High country risk will discourage foreign investments, which is completely not recommended. Investors always take into account country risk since it reduces their expected return, so they use effective hedging tools, if allowed in the country of investment.

Long term & direct investments would have higher country risk than exchange market investments.

For the UAE, we will discuss the following types of risk:

1. Sovereign risk
2. Currency risk
3. Financial Risk
4. Banking sector risk
5. Political risk
6. Economic structure risk

7.1 Sovereign risk

Sovereign risk is that risk when the foreign country of investment changes its foreign exchange regulations.

This could lead to reduce the value of foreign investment contracts or even nulling them. In the UAE, sovereign risk is rated as "Stable". It was previously rated as "Positive", but the rating was decreased because of the impact of the Dubai World crisis. Nevertheless, the UAE as a whole is trusted to meet its debts & obligations, thanks to its high oil reserves in Abu Dhabi.

7.2 Currency risk

Currency risk arises from changing the price of one currency against another currency. Currency risk is usually not compensated with higher rate of return. In the UAE, currency risk is rated as "Stable". This rating was based on the authority's commitment to maintain the UAE's currency price & stability, even though they will not participate in the GCC's proposed single currency.

7.3 Financial risk

Financial risk happens when a corporation or government defaults on its bonds, causing its bondholders to lose money. It also means when a company does not have sufficient cash flow to cover its debts, which could lead for the shareholders to lose their money.

Many kinds of risk ratios are used to assess the financial risk on an investment, such as:

The debt-to-capital ratio: the higher its value, the more risk is involved.

The capital expenditure ratio: it demonstrates how much cash left for running the business after paying its debts.

For the UAE, the financial risk is rated as "Moderate". This rating was based on the fact that DUBAI (which now has more risk than other emirates) has the Dubai International Financial Center (DIFC), which is a free trade financial zone, & this center is regulated by the Dubai Financial Services Authority, a recognized entity by the federal UAE government. So, government regulations keep risk level moderate.

7.4 Banking sector risk

The Dubai World debt caused banks to be hesitant to lend until they will fully recover from this, where UAE banks still need to book these non-performing loans. New regulations from the Central Bank led to increase lending by 35.5% in 2011. In general, the banking sector risk in UAE is rated as "Stable".

7.5 Political risk

Each emirate is ruled by its own emir (sheikh), & all UAE emirates are known for its political stability.

So it is obvious to rate the political risk in the UAE as "Stable".

7.6 Economic risk

Oil sector is the dominant one in the UAE, especially in Abu Dhabi that accounts for 90% of the total UAE's oil reserve. So high oil prices is a very huge supporter for UAE's economy. Non oil sector, such as trade, finance & real estate, especially in Dubai that accounts for 70% of the total UAE's percentage, is showing a start for stability. Still, the construction sector is depressed. Overall, the Economic risk of the UAE is rated as "low to moderate".

Conclusion

As demonstrated & discussed throughout this research, it is very much obvious that the UAE's main pillar is the oil sector. Avery good strategy was to diversify their economy with other sectors, but still these sectors are not comparable with the huge oil sector.

The independence on one major resource is the higher leading driver to higher exposure to risk. That was manifested in the effect of the economic crisis on the UAE, especially on Dubai. In addition to the one resource independence, another mistake was committed, which is the overconfidence on the strength of that resource, where extra huge projects were undertaken without considering any tiny possibility of recession risk, where these projects should be been planned in a slower pace with longer term financing instead of the high short term financing.

So, in order to avoid similar depressions, or at least to decrease its impact, diversification in other sectors & improving them in a significant way is highly recommended. Moreover, regardless of how much powerful a sector is, threats should always be taken into considerations, regardless of how much strength & confidence the market is.

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