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ABU DHABI CHAMBER

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Exports and Manufacturing in Abu Dhabi

August 2019

In association with  IHS Markit



Dear reader



Manufacturing in Abu Dhabi has always had an important place in the Emirate's 2030 Vision and for the diversification of the economy away from oil. Manufacturing exports were meant to lead the way and turn Abu Dhabi into a powerhouse that supplies the world with innovative products, eventually making the Emirate much less dependent on its vast natural resource riches.

The Abu Dhabi Chamber has clearly recognized this and spearheaded several critical initiatives and ventures to promote exports abroad. Countless visits from foreign guests were hosted at the Chamber's premises and in other locations in Abu Dhabi, helping firms from other countries finding the best supplier or to connect with an Abu Dhabi-based company. Similarly, the Chamber's leadership went to other countries and conference venues to help grow new business for Abu Dhabi firms.

With this report, the Chamber would

like to contribute a review of Abu Dhabi's manufacturing exports and provide an outlook for the competitiveness on key export markets. Saudi Arabia, the ally and friend next door, comes to mind, as does India with its large expat community in Abu Dhabi. The report reviews the status of exporters on these markets and provides an assessment of future perspectives for exporting firms from Abu Dhabi.

The diversification of exports is already on the way. The report shows this by comparing the situation in 2016 with the latest available export data. Recently, export orders have even thrived further, despite the malign and protective climate that currently governs international relations. The report explains this performance of the Emirate's companies and why it matters for the near-to-longer-term outlook. Progress in economic diversification is evident—Abu Dhabi just needs to stay on this road.

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Abu Dhabi's manufacturing exports – recent trends

Currently, 2019 is on its way to become a record year for exports from Abu Dhabi, which is remarkable in a world that is suffering from a wave of protectionism and a maturing economic cycle. In fact, the outlook was clouded at the end of 2018, with a ray of hope being provided by the Abu Dhabi government's stimulus package. Yet the economy, and the export sector in particular, proved doomsayers wrong.

The index of New Export Orders—a component of the IHS Markit Purchasing Manager Index (PMI) for Abu Dhabi—has been rising for four months in a row until June and reached a record high of 69.7 points. The index runs on a scale from 0 to 100—with a value of 50 representing the threshold between contraction and growth—and is available monthly.

The PMI survey includes only private sector companies. This means that the recent export surge was firmly rooted in the private segment of the Abu Dhabi economy.

The export orders index is the most up-to-date metric for exports. The second quarter was particularly remarkable as the index climbed more than 15 index points, suggesting that exports recently morphed into a key driving force for the private sector's economy in Abu Dhabi. (see charts 1 and 2).

The relatively downbeat global economic sentiment, meanwhile, is displayed by Abu Dhabi's Export Climate Index, which is a weighted average of PMIs for Abu Dhabi's main trading partners. Although remaining in positive territory, the index trended mostly sideways during the last couple months, or even went down slightly. In the wake of that,

the strong growth rate of Abu Dhabi's export orders index is astounding.

However, actual exports—for which data are available for first quarter 2019—have not moved much, at least in terms of value. That is consistent with the rest of the data, though, since many companies indicated in the PMI survey that the strong increase of exports came on the back of an aggressive pricing strategy, and several respondents to the PMI survey suggested that lowering output prices enabled them to maintain or even expand their share in the market (see chart 3).

If prices for exports went down, export volumes must have gone up, if exports as published by SCAD, which measures deliveries in current prices, are correct and have not changed at all or not much. For second quarter 2019—for which trade results are not published yet—it will be interesting to see what course actual export data have taken.

There are some implications following from this insight—strong indications for volume increases amid stagnant export values. The first implication is that exporting companies in Abu Dhabi are competitive on price since they can expand their sales in volume terms simply by cutting back on prices. This gives hope that the price structure for supplies in Abu Dhabi—including labor costs, bureaucracy, and all else—is not too much of a burden for the companies operating here, which is good for Abu Dhabi's overall competitiveness and outlook.

The second implication is that, if global conditions worsen, the private sector in Abu Dhabi might still be insulated from the impact—at least for some time and to



69.7

Record high for Abu Dhabi's PMI export orders

Chart 1: Purchasing Manager Index export orders for Abu Dhabi

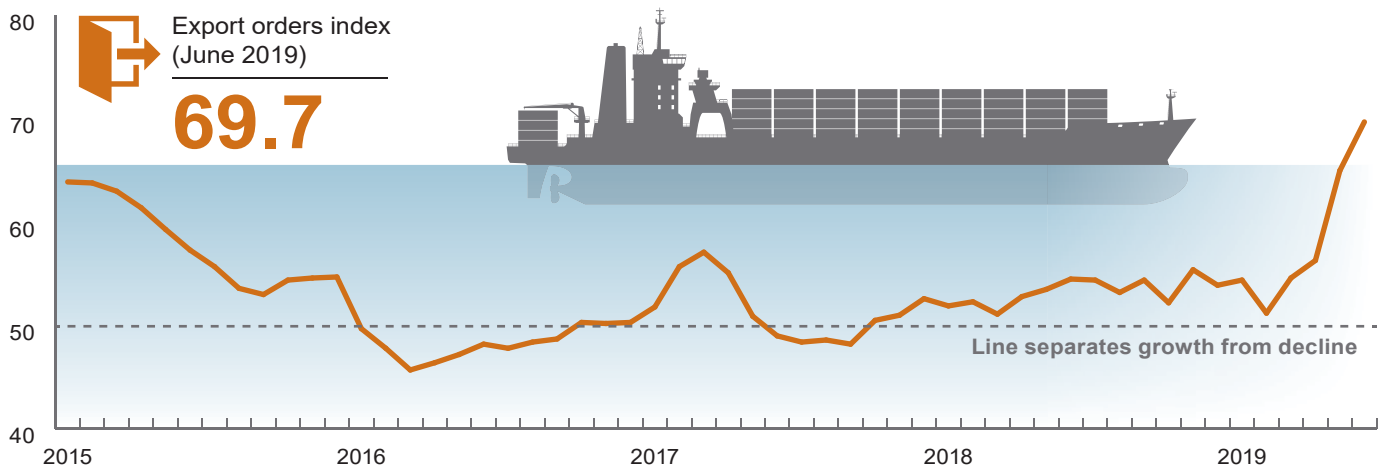
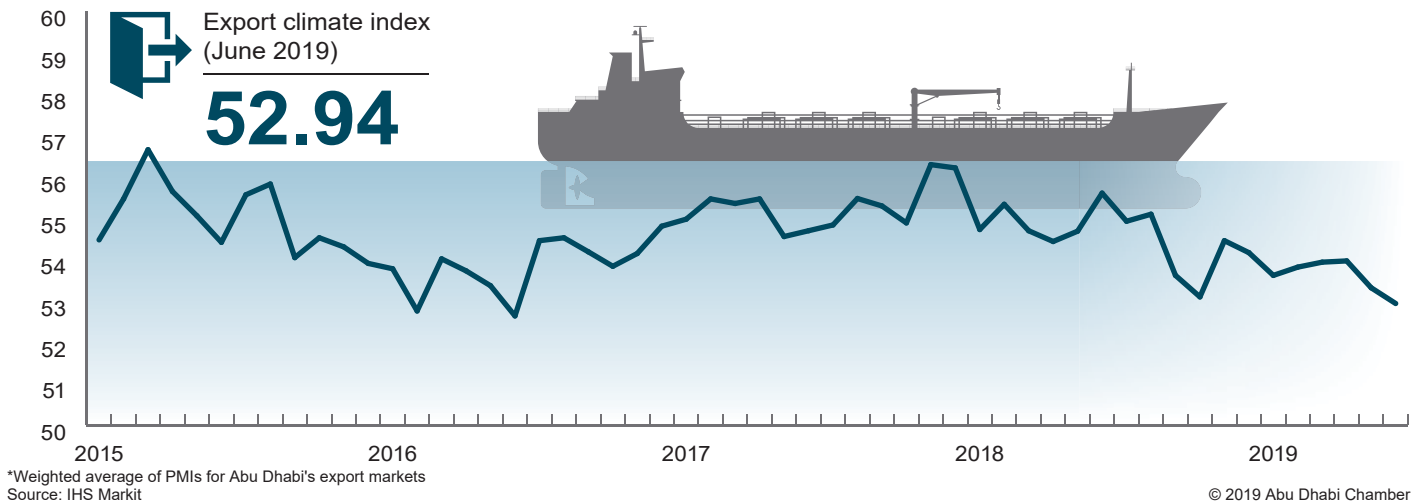




Chart 2: Purchasing Manager Index export climate for Abu Dhabi*



a certain extent. Although this implication might be tested soon if global conditions worsen further. In any case, Abu Dhabi can be regarded as an attractive investment location for corporate business.

Fostering Abu Dhabi's location for trade

The rebound in export orders comes as the facilities to deliver goods from Abu Dhabi to overseas have recently been built. Chinese shipping company COSCO opened a container terminal in December 2018 with a capacity of 1.5 million 20ft equivalent unit (TEU) per annum that will give trade between Abu Dhabi and China—which already has the largest value of all bilateral trade relations if all UAE trade is counted—a further boost.

The new facility is designed to manage the fast growth rate of Abu Dhabi's seaborne trade. A capacity expansion to 2.5 million TEU is already part of the plan. Altogether, the capacity of Khalifa port will reach 9.1 million TEU within the next five years, which will leap Khalifa port into the top league of the largest 25 ports worldwide.

The terminal, which is adjacent to Sheikh Khalifa Port, has been the first greenfield port investment for COSCO and will cement Abu Dhabi's position as a prime location on China's Belt and Road Initiative. The UAE is a signatory country with China for the initiative and a cornerstone on the maritime arm of the new silk road.

Regarding land-based trade, a key project is the new rail link that will span the countries of the Gulf Cooperation Council (GCC). A core component of the new railway network will be in Abu Dhabi and link production hubs and warehouses with logistics centers for

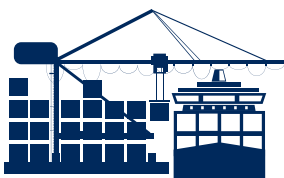
further distribution and reduction of costs. Moreover, the railway will also reduce CO2 emissions as opposed to transporting everything on the road.

While the new COSCO container port will facilitate Abu Dhabi's link beyond the region alongside its existing facilities at Khalifa port and logistics at the Abu Dhabi airport, the new railway will ensure more cost-effective transport within the Arab region, especially with Saudi Arabia, which continues to be Abu Dhabi's most important trade partner.

Another key country for Abu Dhabi's trade and investment outlook is India. In fact, India is the key investment destination for many UAE investments, which means trade is growing rapidly—especially in the current global environment. About 3.3 million Indian nationals are currently living in the UAE, and many of them have set up businesses that will grow and possibly export goods manufactured in the UAE back to India (see chart 4).

The UAE ranked as India's most important export destination in 2018, second only to the United States. This is hardly surprising given the strength of the Indian expat community in the UAE. The UAE, meanwhile, ranked fourth in terms of Indian imports in 2018, which still leaves a moderate trade deficit in UAE's trade with India (back in 2017, the UAE was in third place among Indian imports).

One commodity group from Abu Dhabi's exports is especially represented in trade with India—"natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof; imitation jewelry; and coins." That product group grew by nearly half during the last three years—between the first quarter of



1.5
million TEU p.a.
is the size of COSCO's new
container terminal at
Khalifa port

2016 and the same period of 2019. It is the second-most important commodity group for Abu Dhabi exports.

However, the trade relationship with India will undoubtedly intensify as Indian demand and demand from Abu Dhabi grow; the recently signed AED100-billion investment agreement between the UAE and India will ensure that the web of economic linkages between the two nations will become even more robust.

Commodity structure of Abu Dhabi's exports

A brief look at the commodity structure of Abu Dhabi's exports reveals that a diversification process is well underway, and it is broadly in line with the long-term Vision 2030 for Abu Dhabi and the associated industry strategy. Jewelry aside, which is mainly produced for the Indian market, the most important export commodity are base metals, and is followed by rubber and plastic products.

This ranking changed within the last three years. In first quarter 2016, rubber and plastics was by far the largest export commodity, accounting for nearly half of total exports from Abu Dhabi. Investment in metals production paid off, and base metals caught up in the export structure. At the

beginning of 2019, base metals are now the most important nonoil export commodity of Abu Dhabi (see chart 5).

Moreover, there are some commodities that have gained importance in the last couple of years for which no or nearly no exports had been registered just three years ago. Food products grew from a low base in first quarter 2016 to 6% of total exports in first quarter 2019.

Chemical products (fertilizers and such) are another example. The product group alone grew nearly tenfold during the last three years and accounted for almost 6% of all exports, rivaling food exports.

Another product group with export growth potential is machinery and equipment, which soared sixfold in the last three years and now accounts for 3% of exports. These product groups represent a genuinely new surge of export goods that were not there just a few years ago—the result of an investment campaign that is encouraging for the success of Abu Dhabi's industry strategy and long-term vision (see chart 6).



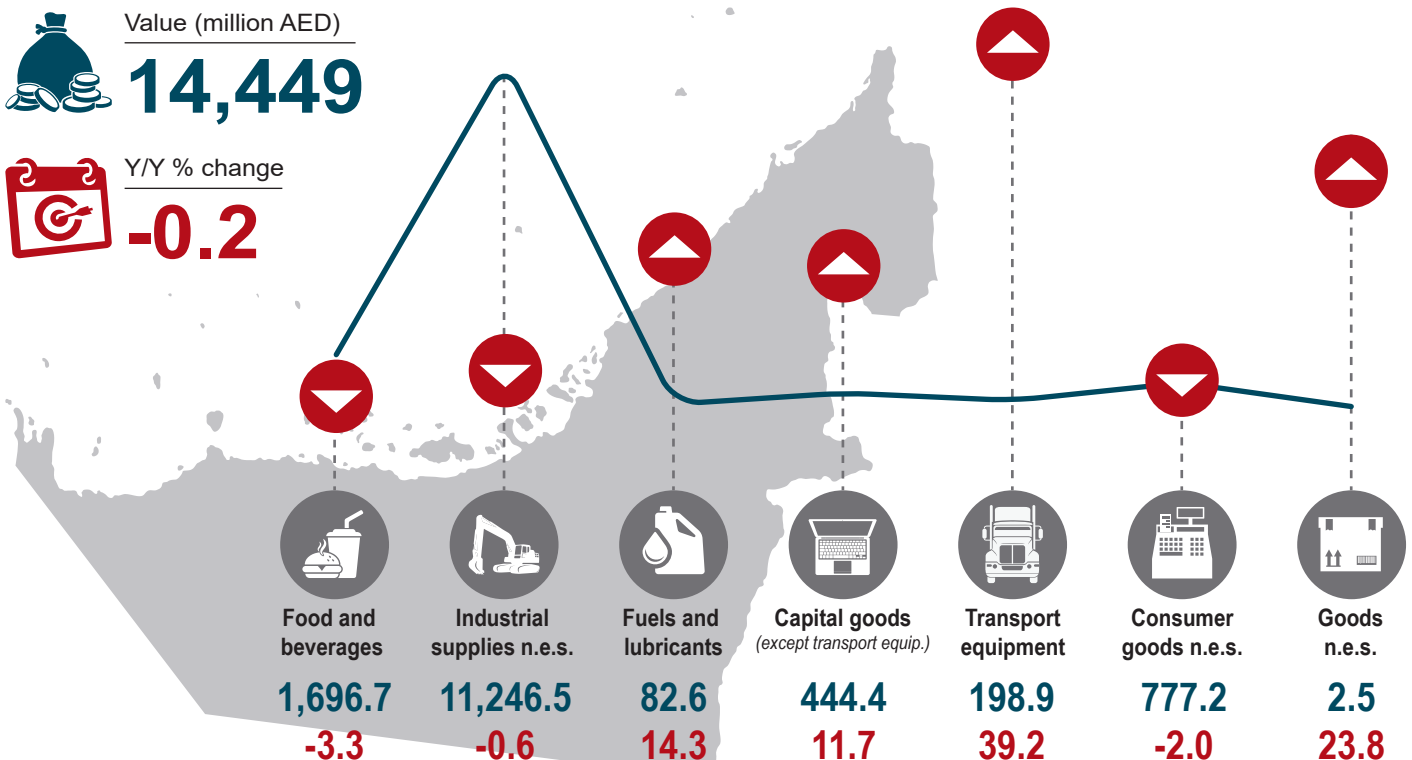
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UAE's rank among nations exporting to India

Abu Dhabi's key trading partners and export competitiveness

The outlook for Abu Dhabi's nonoil exports will determine the success of the long-term

Chart 3: Non-oil exports Abu Dhabi Q1 2019

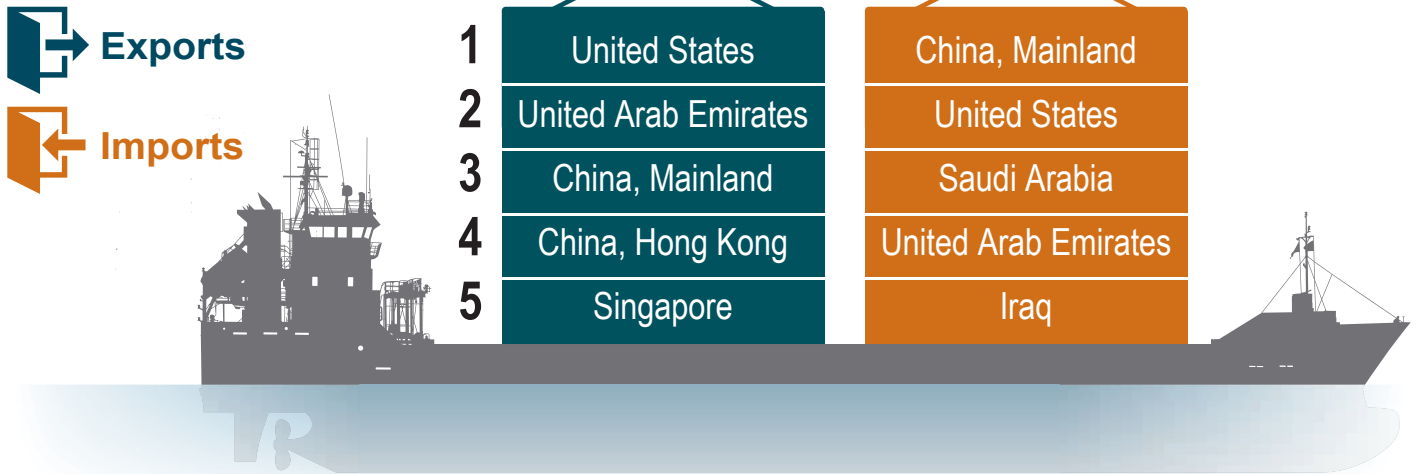


Source: SCAD

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Chart 4: India's top trade partners 2018



Source: IMF

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Base metals are Abu Dhabi most important export commodity

vision for the country to a large extent. Virtually all successful development country stories are built on success with exports in one way or another. It is important to reflect on the competitiveness of Abu Dhabi's exports to gauge the chances for exporters in foreign markets.

These chances are driven by fluctuations of the exchange rate against major nations importing goods from Abu Dhabi, as well as price and cost calculations of Abu Dhabi's exporting companies. However, imports of a host country are also determined by the ability of that country to buy and receive goods—in other words, how fast a country is growing.

A deeper dive on the outlook for Abu Dhabi's key export markets will help to assess chances for exporters. Abu Dhabi's three major export destinations are India, Saudi Arabia, and China. Of course, Abu Dhabi ships goods to other destinations, including Switzerland and the United States. Although India, Saudi Arabia, and China play the most critical role for Abu Dhabi in the long term.

Saudi Arabia is the key export market next door. India is the fastest growing market in the South Asian region, and the Indian expat community plays a catalyst role for economic linkages. While China is still the largest emerging market, which hardly anybody can ignore.

India – a market with vast upside export potential

Despite recent softening of Indian growth, private consumption will remain India's major growth driver. During the next five years,

Indian households will become the biggest spenders among the G20 countries. A steadily rising number of middle- and high-income households, rising urbanization, and improving access to credit will support India's consumer demand.

This will open fresh opportunities not only for local suppliers, but also for trading partners. Abu Dhabi, thanks to its strong expat community of native Indians, is well placed to exploit this opportunity. Companies from Abu Dhabi, which are looking for exports to increase their sales base, will be well-placed here.

Despite improved fundamentals and a more liberal investment regime, the Indian rupee remains vulnerable to excessive financial markets volatility and strong selling pressures owing to its large and chronic current-account and fiscal deficits. This trend is unlikely to change substantially, and the Indian rupee is expected to see gradual depreciation as the Reserve Bank of India's monetary policy remains more accommodative than that of the world's other leading central banks. That said, the economic fundamentals now appear to be much stronger than in 2012–13, and a repeat of the recent Indian currency crisis is not anticipated.

Saudi Arabia – an economy in transition

Saudi Arabia is Abu Dhabi's most important trading partner, key friend and ally, and the country next door. The country shares the same issues and similar advantages with Abu Dhabi. It will remain Abu Dhabi's prime



Rate with which machinery exports surged since 2016

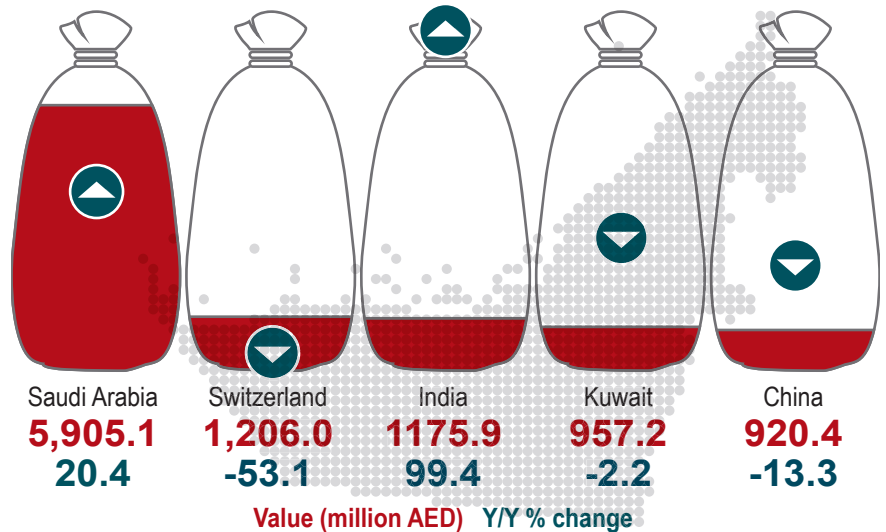
export destination, even though growth is relatively modest compared with India or China.

The lower-for-longer outlook for oil prices has prompted Saudi authorities to genuinely address the economy's dependence on oil and its reliance on the public sector for growth and employment through its Vision 2030 and National Transformation Program (NTP) 2020. The Vision 2030 program provides a broad framework to help transform Saudi Arabia during the next 12 years.

In terms of economic diversification, Vision 2030 calls on a combination of initiatives to develop a thriving private sector and promote greater investment opportunities while fostering greater activity in underdeveloped sectors of the economy such as mining, defense industries, retail services, and renewable energy. The government looks to reduce its footprint on the economy through privatization, public-private partnerships (PPPs), and increased foreign investment (see chart 7).

Progress with fiscal consolidation and reforms will be critical to the kingdom's medium-term outlook. Saudi Arabia has moved to curtail spending, primarily cutting nonessential capital spending while also moving to reduce costly subsidies, including those on energy. Key industrial and infrastructure projects, such as the kingdom's economic cities and expanding transport capacity as well as housing projects are expected to continue. Saudi GDP growth

Chart 6: Top 5 export destinations of Abu Dhabi Q1 2019



Source: SCAD

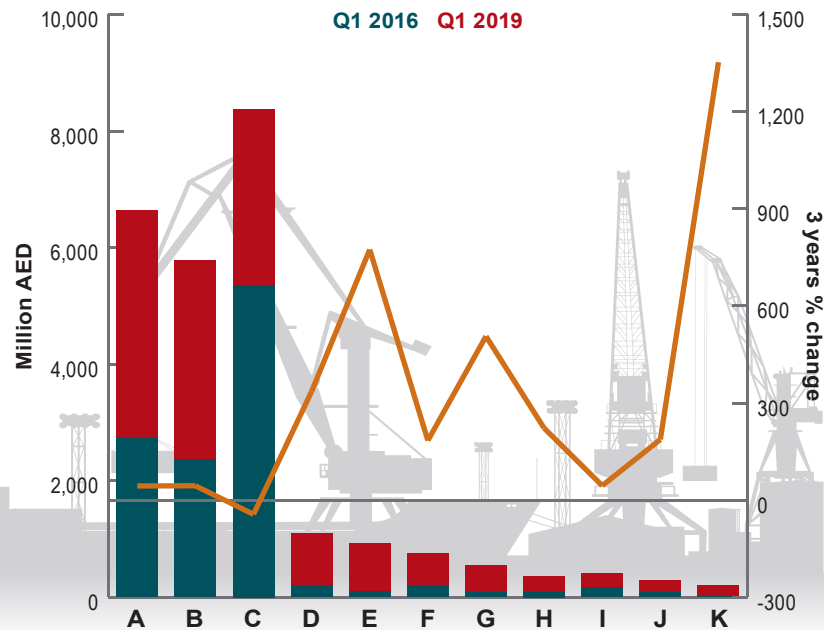
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should scale back up beyond 2020.

Consumer price inflation in Saudi Arabia should average about 2% in the longer term. With the exchange rate fixed to the US dollar for the foreseeable future—the same situation as for Abu Dhabi—local price trends and investment conditions will determine the location of greenfield investors and the competitiveness of exports. Abu Dhabi is in a good starting position as the strong rebound in the second-quarter export order index showed.

Chart 5: Abu Dhabi's nonoil exports breakdown Q1 2016–19

- A: Base metals and articles of base metal
- B: Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof; imitation jewellery; coin
- C: Plastics and articles thereof; rubber and articles thereof
- D: Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes
- E: Products of the chemical or allied industries
- F: Live animals; animal products
- G: Machinery and mechanical appliances; electrical equipment; parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles
- H: Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap) paper or paperboard; paper and paperboard and articles thereof
- I: Vehicles, aircraft, vessels and associated transport equipment
- J: Articles of stone, plaster, cement, asbestos, mica or similar materials; ceramic products; glass and glassware
- K: Vegetable products

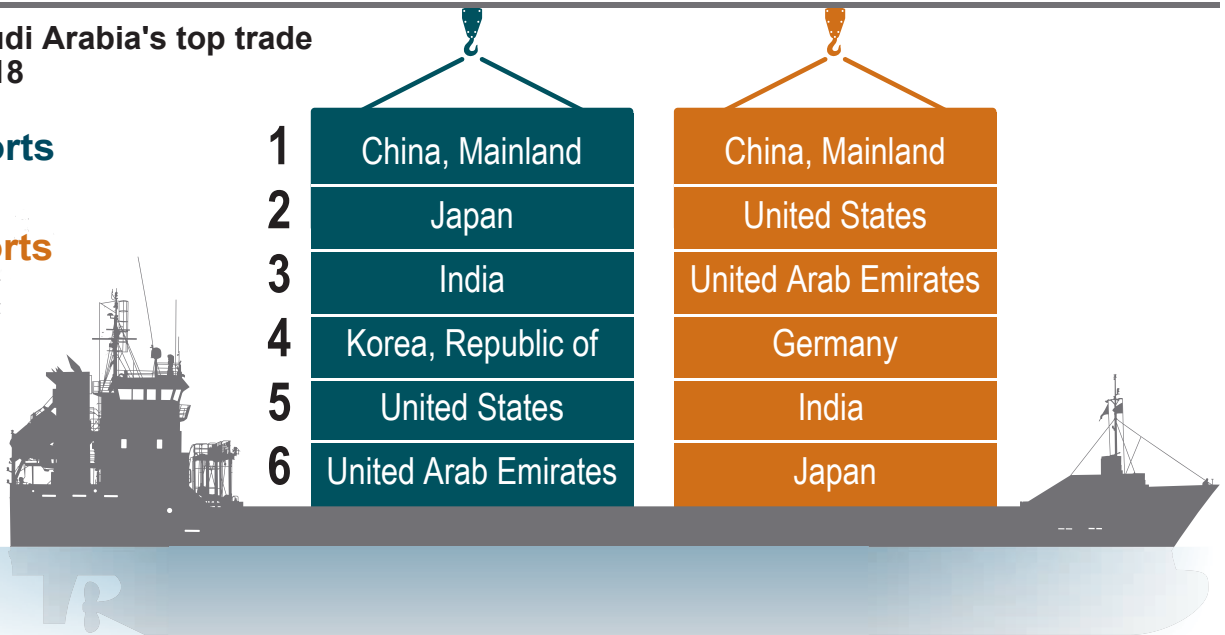


Source: SCAD

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Chart 7: Saudi Arabia's top trade partners 2018



Source: IMF

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No 1

Saudi Arabia is Abu Dhabi's key export destination

The Saudi economy is open, and imports quickly respond to any increase in demand. Some sectors will experience a relatively higher inflation rate, such as housing and transportation. Real estate is also viewed as an investment asset, so the real estate market will likely face stronger demand in the next five years as domestic and external conditions bounce back from the current slowdown. This bounce back offers another opportunity for manufacturers of construction materials—this will be primarily supplied locally, but there is also an opportunity for shipments from abroad, including from Abu Dhabi.

China – the emerging giant

China is fifth in Abu Dhabi's export country ranking. Exports to the country have slipped compared with first quarter 2018. However, given its size and dynamism, China will play a critical role for Abu Dhabi's exports in the next couple of years and beyond.

Chinese demand lost some traction recently, reflecting the weakness from the global slowdown and knock-on effects from the trade war with the United States. Another factor that would directly influence the competitiveness of Abu Dhabi's exporters is the exchange rate of the Chinese yuan. Recent bouts of yuan weakness tested the ability of Abu Dhabi's exporters to compete.

Beijing will likely maintain a stable renminbi policy to avoid further escalating the trade conflict with the United States. However, if trade negotiations with the United States

break down completely, Beijing may resort to a weak renminbi policy to support growth, posing a potential threat to Abu Dhabi's exporters since the dirham is fixed to the US dollar (see chart 8).

In the longer term, mainland Chinese economic prospects depend on the government's continued effort to liberalize its economy. So far in the economic reform era, China has been able to achieve phenomenal growth by lifting the most blatant anti-market institutions, such as communes in rural areas, price controls, and the antitrade self-sufficiency policy.

Given the Chinese government's resources and control of the financial system and the large state-owned enterprise sector, it should be able to achieve the 2019 6% growth target. China's economy is still not a fully market-based system, and further liberalization is needed.

With China in the fourth decade of market reform, many private firms are ready to climb the value-added chain, from labor-intensive production that requires low-level investment to the more capital-intensive activities that require much higher-level investment. As the private sector's investment demand soars, the lack of financing options naturally leads to excess saving in the sector.

These structural problems could endanger China's long-term economic growth potential and force a more difficult road ahead, especially if current trade wars persist. It will make foreign exporters' life in China by no means easier. However, the central forecast



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China's rank among Abu Dhabi's export destinations

still assumes continued, albeit slightly slowing, growth ahead.

Abu Dhabi's key advantages are cheap energy, abundant labor—albeit partly sourced through expat workers—and a friendly investment climate. The Abu Dhabi Chamber, meanwhile, will continue to promote exports as much as facilitate favorable commercial conditions. The brief survey of three major export markets showed that the diversification strategy is already bearing fruit, and considerable upside potential exists—notably in India, but also in Saudi Arabia and, assuming a more benign global environment, in China. Other, smaller markets will likely thrive as well. ■

Chart 8: UAE ranking as China's trade partner



Source: IMF

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