UAE: Diversifying trade will yield economic benefits

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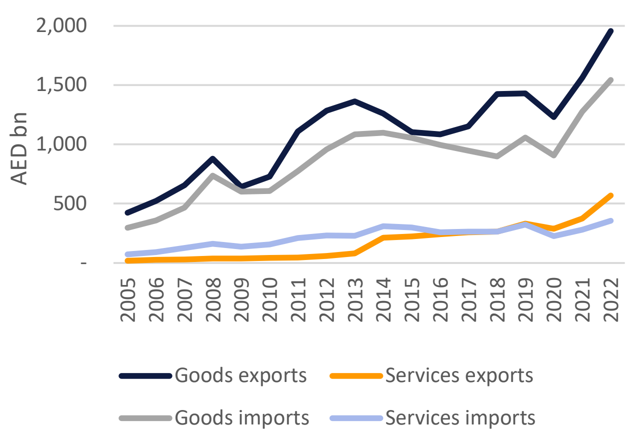
Trade plays a vital role in the UAE economy

Trade in goods and services is often credited with being an engine of global growth, with most cross-country studies identifying a statistically significant positive link between the two. The World Bank suggests that trade has increased global incomes by 24% since the 1990s.

Trade drives growth by increasing the size of markets available to domestic firms to sell into, as well as exposing these firms to increased international competition. Heightened levels of competition should in turn increase innovation, productivity and domestic firms' exposure to new technologies. High levels of trade can furthermore encourage inflows of FDI, as sufficient demand may make it efficient to set up additional production facilities in the importing country.

Value of UAE trade



Source: UNCTAD, ENBD Research

Trade has undoubtedly played an increasingly important role in the UAE economy over the course of the past two decades. In absolute terms the UAE has experienced a sharp rise in the value of both merchandise and services trade. UNCTAD data suggests that after moving broadly sideways between 2010 and 2019, the post-pandemic period saw a particularly sharp rise in the value of trade[1].

The value of goods exported from the UAE (inclusive of hydrocarbons and re-exports) rose 37% between 2019 and 2022, while the value of imported goods rose 46% over the same period. Although the nominal value of services trade remains significantly smaller than goods, it too has seen a robust increase. UAE exports of services rose by 71% between 2019 and 2022. Services imports to the UAE have also risen, but at a slower pace than exports, meaning that the UAE is now a net exporter of services.

And trade has risen not only in value terms but also relative to GDP. Trade openness, measured as the sum of the value of goods and services trade (imports and exports) as a share of GDP, has increased from 139% in 2010 to over 237% in 2022. This share becomes even larger when oil exports are stripped out[2] of both the trade and GDP components, with a wedge opening up between the two measures after 2020.

[1] Charts and figures make use of bilateral SICT category data from the UNCTAD trade database.

[2] For the purposes of this note non-oil exports exclude mineral fuels, lubricants, and related materials, as well as organic chemicals.

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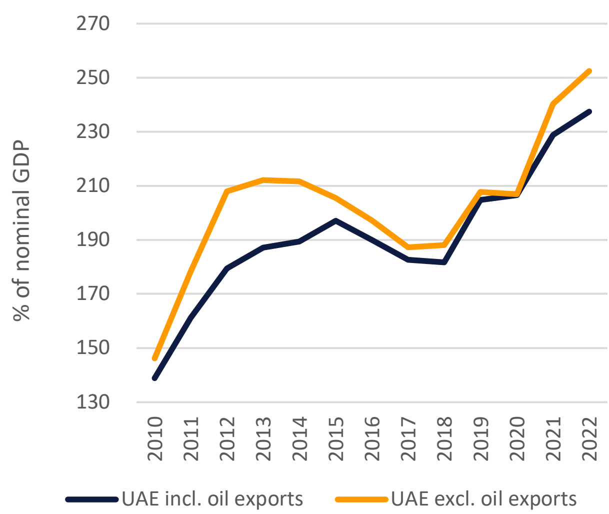
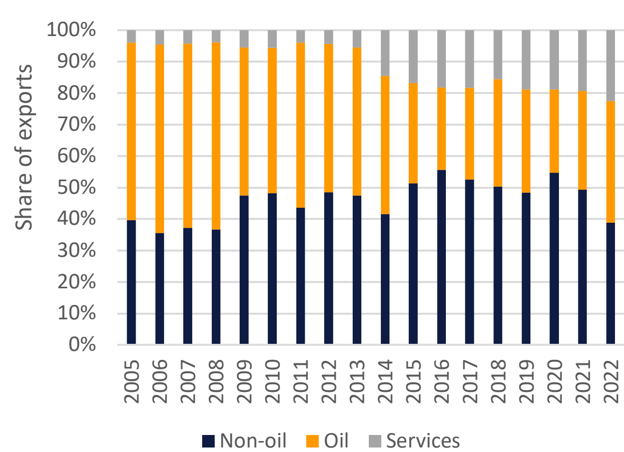
Trade openness



Source: UNCTAD, ENBD Research

There have been two notable developments in the UAE's trade patterns in recent years. The first is that there has been a sharp reduction in the share of oil exports in total exports since 2010, highlighting the increasing diversification of the UAE economy away from hydrocarbons. Oil as a share of total exports declined to just below 39% in 2022 from 56% in 2005. And secondly, the share of services exports has risen from just 4% of total exports in 2005 to almost 23% in 2022.

Share of UAE exports



Source: UNCTAD, ENBD Research

Where are goods coming from, and going to?

As of 2022, the top two markets for UAE goods exports (including hydrocarbons) were India and China, with the former having been a key export destination since the mid-2000s. The rise of China in the ranking table has been more recent, with a sharp rise in share since 2019. While Japan remains a vital export market, with a share just below 11%, its importance has been in long term decline, dropping from a share of 45% of UAE exports in 1995.

UAE exports to India, China and Japan continue to be dominated by oil and oil products, with exports in these categories accounting for almost 50%, 78% and 95% of total UAE exports to these countries, respectively. Outside of the top three, the UAE's exports predominantly go to other countries in Asia, as well as other GCC nations.

In contrast, the UAE's imports stem from a mix of markets, including Asia, the USA and Europe. China does however play an outsized role, accounting for 18.5% of the UAE's imports in 2022.

Top trade partners

Rank	Share of exports to		Share of imports from	
1	India	14.0%	China	18.5%
2	China	10.8%	India	8.7%
3	Japan	10.6%	USA	6.7%
4	Iraq	7.9%	KSA	4.1%
5	KSA	4.2%	Japan	3.3%
6	Thailand	3.9%	UK	2.9%
7	Singapore	3.9%	Turkey	2.8%
8	South Korea	3.5%	Italy	2.6%
9	Oman	3.4%	Germany	2.6%
10	Switzerland	3.0%	Vietnam	2.3%

Source: UNCTAD, ENBD Research

The UAE is increasingly seeking new trade partners

Reducing the UAE's reliance on hydrocarbons is a key approach to building a more stable and resilient economy. But an additional prong in making the UAE economy more resilient to macro-economic shocks is also to reduce reliance on individual countries as key trading partners.

At its peak in 2015, exports to other GCC countries accounted for over 14% of total UAE exports, with Oman and Saudi Arabia accounting for roughly 5% each. These shares have declined steadily since then, accounting for 3.4% and 4.2%, respectively in 2022. The decline in the share of exports flowing to Saudi may in part reflect changes to tariffs, made by the Kingdom in mid-2021. Under the new Saudi tariff rules UAE exports from freezones, as well as exports made by companies with less than 25% local staff or products with less than 40% local value added, are excluded from the GCC tariff agreement.

CEPA agreements

	CEPA in force	CEPA under negotiation or awaiting ratification	Share of UAE exports (2022)	Share of UAE imports (2022)
Australia		X	0.4%	0.8%
Cambodia	X		0.0%	0.1%
Chile		X	0.0%	0.1%
Colombia		X	0.0%	0.1%
Congo-Brazzaville		X	0.2%	0.6%
Costa Rica		X	0.0%	0.0%
Georgia		X	0.1%	0.0%
India	X		14.0%	8.7%
Indonesia	X		0.8%	0.8%
Israel	X		0.4%	0.2%
Kenya		X	0.5%	0.1%
South Korea		X	3.5%	1.3%
Malaysia		X	1.3%	1.1%
Pakistan		X	2.2%	0.5%
Philippines		X	0.4%	0.1%
Serbia		X	0.0%	0.0%
Thailand		X	3.9%	1.3%
Turkey	X		1.3%	2.8%
Ukraine		X	0.0%	0.2%
Uzbekistan		X	0.1%	0.0%
Vietnam		X	0.2%	2.3%
Total			29.5%	21.1%

Source: Various media reports, UAE Ministry of Economy, ENBD Research

These kinds of policy decisions, together with exogenous shocks like Covid-19, highlight the importance of diverse export and import markets, thereby reducing reliance on single trade partners, even those within the GCC. Consistent with this, the UAE has made strides in negotiating a host of Comprehensive Economic Partnership Agreements (CEPAs). Five of these CEPAs are currently in force, including agreements with India, Israel, Indonesia, Turkey and Cambodia. Negotiations are ongoing with at least another 16 nations, possibly more. These CEPA countries account for roughly 30% of the UAE's exports and 21% of the UAE's imports.

It is noteworthy that a significant share of the UAE's CEPAs are with Asian countries. Given the possible increase in geo-political tensions between China and much of the West, a strengthening of the UAE's access to broader Asian trade markets should contribute to more resilient supply chains. The remainder of the CEPAs are split across geographies, further diversifying potential trade routes.

More broadly the GCC has recently signed FTAs with both Pakistan and South Korea. The bloc has also intensified efforts to complete negotiations on a variety of other FTAs, including with the UK and Japan.

What are the benefits of signing trade agreements?

While the exact terms of each Free Trade Agreement (FTA) or CEPA differ, all ensure the elimination or gradual reduction of tariffs across a variety of goods. CEPAs tend to differ from FTAs in so far as they are usually more ambitious in their coverage, including not just goods but also services, investment, regulatory issues, freedom of movement for workers and visitors, and dispute resolution.

There are benefits to a domestic economy from the reduction of tariffs on both its exports and imports. Lower tariffs on exports make the UAE's goods and services more competitive abroad. The reduction of tariffs on UAE imports similarly reduces the cost for both final consumers as well businesses importing inputs to be used in domestic manufacturing. It should also increase productivity domestically, as local businesses face greater competition from international firms.

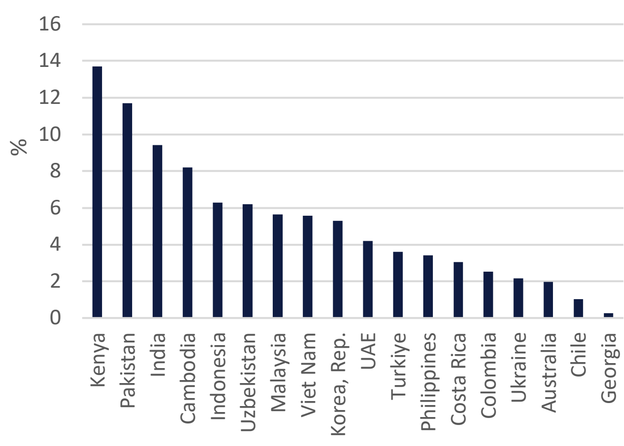
CEPA terms

	Share of products covered	Share of current trade covered	Tariff rate, mean across all products in 2020
Cambodia	92%	-	8.20%
India	80%	-	9.42%
Indonesia	90%	94%	6.29%
Israel	96%	99%	-
Turkey	83%	93%	3.61%

Source: UAE Ministry of Economy, World Bank, ENBD Research

The India-UAE CEPA agreement eliminates or reduces tariffs on around 80% of goods, while the Israel-UAE CEPA cuts or eliminated tariffs on 96% of all items. Comparing average tariffs across current or planned CEPA agreement countries prior to the implementation of these CEPAs, the UAE was broadly in the middle of the pack. The unweighted mean tariff on UAE imports from other countries was around 4.2% in 2020. In contrast the UAE's main export market, India, had an average pre-CEPA tariff rate of almost 9.5% on India's imports from other countries.

Simple mean tariff rate (%) in 2020



Source: World Bank, ENBD Research

In addition, the current CEPAs also cover several non-tariff issues, including ensuring that technical standards are not used as a mechanism to limit market access. CEPAs may also seek to boost opportunities for foreign firms in the domestic economy, thereby strengthening the relationship between countries. An example in the current CEPAs with India and Indonesia, is a provision that UAE businesses will be given a 10% price preference in government procurement tenders.

How would we expect these agreements to affect trade?

It is arguably too early to assess the economic impact of these trade agreements, with many coming into force less than 12 months ago and with full bilateral trade data for 2023 yet to be published by either UNCTAD or the FCSA. Nonetheless, some evidence can be found in a recent announcement by His Highness Sheikh Mohammed bin Rashid Al Maktoum on UAE trade in 2023. He noted that non-oil UAE trade rose to a value of AED 3.5 trillion in 2023, and also highlighted that non-oil trade with the country's top 10 partners had risen 26% y/y. Specifically non-oil trade with Turkey rose by 103% on an annual basis. Dr. Al Zeyoudi, Minister of State for Foreign Trade, further highlighted the importance of the recent CEPA agreements, noting that non-oil foreign trade with countries with whom CEPAs have either been implemented or are nearing implementation rose 24.5% y/y to a value of AED390.5 billion.

More broadly, we can also look to a selection of studies to provide an indication of the likely scale of the impact. Work by the IMF suggests that the reduction of tariffs on intermediate inputs, as part of 11 CEPA agreements considered by the authors, could increase competition, quality of inputs and the transfer of technology, and thereby raise the level of real GDP by up to 2% over the medium-term. UK government estimates suggest that an FTA with the UAE could increase the volume trade by at least 16%.

Trade agreements are also likely to dovetail into other strategies, making the UAE an attractive proposition for firms looking to set up in other markets. These strategies include Operation 300bn, which seeks to expand the manufacturing sector in the UAE, and reforms allowing

100% foreign ownership and longer-term visas for workers.

Furthermore, ongoing investment into infrastructure will allow companies to capitalize on the UAE's enviable location at the meeting point of three continents. The UAE is the 14th best connected country in the world at present, according to the UNCTAD shipping liner Connectivity Index, and its infrastructure scores highly on the WEF's Global Competitiveness Index. The recent announcement at the G20 summit of a rail and shipping corridor linking the UAE with India and the EU also speaks to the country's ambitions in this regard and will further underpin the country's position as a global trade hub. The signing and implementation of this volume of trade agreements is therefore likely to support UAE trade activity, FDI and ultimately GDP growth.

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