The spice of life

The GCC economies are growing strongly, but with changes afoot, Finbarr Bermingham asks what steps they are taking to diversify their exports and trade routes.

The powerhouse economies of the Middle East have entered 2013 in excellent health. The slump of 2009, which saw the price of crude drop below US$40 per barrel at the height of the financial crisis, feels like a distant memory. At the time of writing, prices have recovered to more than US$120 per barrel and are creeping towards the peak prices of pre-Lehman's collapse 2008. Even the Arab Spring, which severely unsettled much of the Mena region, appears to have left the Gulf Cooperation Council (GCC) member states relatively unscathed – due in no small part to the sanctions placed on Iranian oil exports.

Qatar National Bank (QNB) expects nominal regional GDP to grow by 7.4% in 2013, a huge uptick from the 0.9% contraction of its 2009 nadir. But the perils of keeping all your eggs in one basket are clear: failure to diversify leaves an economy open to fluctuations within its dominant industry. And when the market for your main product is as volatile as that of oil, the basket's base can be flimsier still.

For GCC nations, dependence on oil-related trade is likely to become even riskier in the years to come. In 2011, Venezuela announced that it had overtaken Saudi Arabia as having the world's largest proven oil reserves. Last year, the International Energy Agency (IEA) predicted that the US could become the world's largest producer of oil and gas by the close of the decade, as it attempts to move towards energy independence. And with untapped reserves of East African liquefied natural gas (LNG) to be extracted over the coming decades, the GCC's commanding position at the top table of energy exporters is becoming less secure. So what lessons have been learnt?

The road to diversity

Steps are being made towards economic plurality, however baby-sized they may be. Take Saudi Arabia: according to a report by Samba Financial Group, Saudi's non-oil sector will expand by 6% in 2013. From 2012 to 2016, the fastest growing Saudi industries will be nonwoven textiles, followed by forms of thermoplastics and hot-rolled iron and steel.

Arup Roy, head of transaction banking at Saudi British Bank (SABB), says there's a "conscious effort from the government to expand non-crude exports". He adds: "The percentage of non-oil exports has grown steadily. Based on last year's figures, 13% of total exports were non-oil, and that has risen steadily year-on-year. The government has set up a couple of financial institutions whose mandate is to grow non-oil exports. They're financing overseas buyers at a very competitive rate."

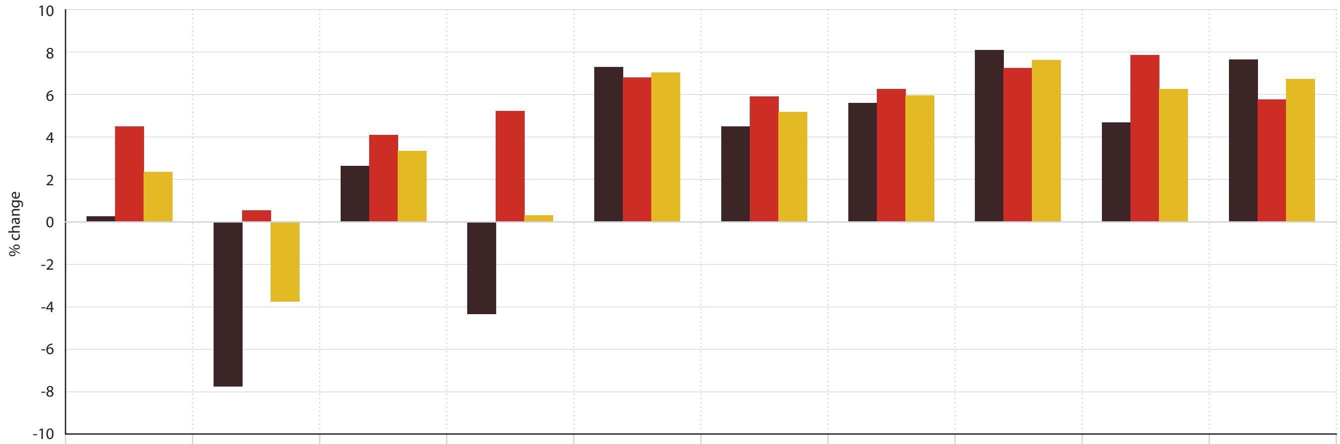
In a deal that reflects this push, in Q3 of last year, Saudi Arabian Mining Co (Ma'aden) signed financing agreements worth US$320mn with Saudi Industrial Development Fund (SIDF), a government lending body, to fund an aluminium smelting plant in the east of the country. The project is part of a huge Saudi initiative, which involves the construction of a new industrial city around the smelter and the mine from which the aluminium will be extracted.

The deal highlights the importance of nurturing diversification. First, it emphasises the industrial impact. The plant is expected to produce the world's cheapest aluminium and in December, Tata Motors announced plans to build a US$1.2bn Jaguar Land Rover assembly plant in the area – its third largest, globally. As part of its feasibility study, Tata said "opportunities had already been identified in the production of aluminium components".

Second, it will put Saudis to work. According to Nayani Bandara, project manager at economic forecasting company Delta Economics, the biggest problem with the competitiveness of Saudi non-

Top 10 MENA exports, compound annual growth rate 2012-16, 2017-21, 2012-21

Source: Delta Economics



	Petroleum gases	Petroleum oils (including crude)	Diamonds (not mounted)	Petroleum oils (excluding crude)	Gold (semi-manufactured)	Medicines	Insulated wire and cable	Jewellery and parts containing precious metal	Automobiles (except buses)	Fertiliser
2012-16	0.29	-7.71	2.61	-4.26	7.28	4.47	5.61	8.07	4.6956	7.6271
2017-21	4.42	0.58	4.03	5.2	6.75	5.85	6.24	7.22	7.8286	5.7327
2012-21	2.34	-3.65	3.32	0.36	7.02	5.16	5.92	7.64	6.2506	6.6757

oil exports is underemployment. She says: "So much labour in the region is unutilised. The oil industry is efficient enough that it doesn't need any more labour and increasing technology won't positively influence employment in the long run. Manufacturing could be huge, if the right investments are made."

The top three sectors to which SIDF lent last year were engineering (659 projects), consumer produce (624 projects) and chemicals (562 projects). But despite this, the oil sector will still be Saudi Arabia's biggest in 2016. Of the GCC countries, only Bahrain and the UAE can lay stake to having truly diverse economies. By 2021, petrochemicals won't feature in Bahrain's top three industry sectors and for the UAE, they won't be in the top 10. According to Kersi Patel, Barclays' head of trade and working capital in the Middle East, Dubai has a different attitude towards trade, which has allowed it to develop a diverse economy.

"Diversification requires a change in the way countries offer opportunities to various global industries to come and work with them. The countries in this region have become prosperous on the back of oil, but only for the past 50 years. They don't have a deep history of working with corporates, governments and enterprise. They require a huge amount of support from external sources to help them to do so and Dubai is an excellent example."

Patel points to the fact that under 5% of Dubai's GDP comes from hydrocarbon products. Citywide, there are 20 tax free zones, each catering to a different industry sector, in which 100% foreign ownership is permitted. Such zones have led to an influx in financial services, logistics, shipping and manufacturing in Dubai, meaning it's much less dependent on hydrocarbon (of course, it was the money generated from this sector that enabled it to make such dramatic progress), and a more likely destination for investment. Another trade finance professional adds: "That's a mindset that is very different from what has prevailed over recent years in other countries. The others don't have this kind of relationship with foreign corporates."

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But the UAE hasn't been relying on foreign direct investment (FDI) alone to spur on its economic diversity. In Q1 of 2012, Microsol, a solar cell manufacturer based in Fujairah, made the first Middle Eastern takeover of a high-profile Western solar manufacturer when it bought the troubled German manufacturer Solon, with a view to expanding into the Indian market.

The deal was conducted with input from alternative trade finance organisation Falcon Group, and the head of the UAE for Falcon, Nam Sahasra, tells **GTR** that there is great room for optimism when considering the UAE's manufacturing sector, given the free flow of capital, the tax free regime and the skilled workforce. Sahasra points to a trio of Indian manufacturers in the UAE: in Ras Al Khaimah, Ashok Leyland and JBF Industries make vehicles and polyester products respectively, while in Jebel Ali, EKC is one of the world's largest high-pressure glass cylinder manufacturers.

"That's where trade financiers come into play. Companies like these need access to funding in order to complete the finance chain of the transaction. They need the support of local banks and of financiers like us, who can arrange access to funding." In order to spread the UAE's diversity throughout the region, mindsets need to change and access to finance needs to be greater.

Gazing east

Since ancient times, the Middle East has been an important junction in regional and, latterly, global trade. In more recent years, though, the region has gone from being a stop-off point on the corridor linking east to west to an important hub in its own right. Now, things have developed again. For the GCC nations, in particular, there has been a marked shift in the destination of their exports and the source of their imports.

SABB's Roy has noticed a real transformation in Saudi Arabia's trading partners. "Clearly, there has been a shift from trading activity from west to east," he tells **GTR**. "During the early 2000s, about a fifth of the trade was done almost exclusively with North America. Of late, this regional concentration has been reduced to 14% as Saudi traders are increasingly looking to ensure that their supply chains are resilient in the face of financial crises and have explored successfully new export markets for oil and non-oil products. Trade with Asia accounts for a little more than half of the bilateral flows, according to Central Bank statistics."

"BASED ON LAST YEAR'S FIGURES, 13% OF TOTAL EXPORTS WERE NON-OIL, AND THAT HAS RISEN STEADILY YEAR-ON-YEAR."

Arup Roy, SABB

The shift has been driven largely by demand from the resource-hungry economies of South and East Asia, as well as changing trade relations with its neighbouring countries. Turkey, for instance, buys its oil from Saudi Arabia now instead of Iran. For the Middle East as a whole, trade with Asia currently represents 25% of its total trade flows – up from 15% in 2000. The trade corridor with Asia is the region's fastest-growing, expanding by 17% annually.

Before the Fukushima disaster of 2011, Japan got one third of its electricity power from nuclear generators. The decision to phase out such facilities by 2040 has led to a sharp increase in Japan's demand for LNG, of which Qatar is the world's largest exporter, providing 25% of global exports last year. By 2020, Qatar Petroleum will be producing almost twice as much LNG as its closest rivals, Algeria's Sonatrach. Post-Fukushima, Japan's predicament intensified the need for LNG across the world, with other countries, such as Germany, committing to reducing their nuclear facilities too. And while the likes of Australia, the US and China scramble to access their own supplies, demand for Qatar's LNG has risen further still.

Japan's demand for traditional Middle Eastern oil-products has risen too. Late last year, Abu Dhabi Oil Co (Adoc) received a loan of US$250mn from a syndicate of Japanese banks and export credit agencies, including the Japan Bank for International Co-operation (JBIC), Mizuho, the Bank of Tokyo-Mitsubishi UFJ and Sumitomo Mitsui Banking Corporation. The loan will see all of Adoc's crude oil output shipped to Japan.

Other eastern economies have also strengthened their hands with the GCC over the past year. In March 2012, Saudi Electric Company (SEC) signed its first Asian ECA-backed financing. Korea Eximbank (Kexim) and Korea Trade Insurance Corporation (K-sure) guaranteed a US$1.4bn loan, arranged by HSBC, for the development of the Rabigh VI thermal power plant on the Red Sea coast. Significantly, the transaction was the largest ECA-backed corporate financing the country has ever seen, with the work to be carried out by Korea's Doosan Heavy Industries and Construction.

Falcon's Sahasra sees the trend continuing. "On a global scale," he says, "the region is within four hours of about 50% of the world's population. It's a convenient meeting place for people, logistically and in terms of time frame. For supply chain purposes, it's ideal. For cargo, you're six or seven days from India and Sri Lanka – the trade route is growing all the time."

The ongoing investment in transport infrastructure in the UAE, Qatar and Saudi Arabia can only serve to boost the region's hub status. Late last year, for instance, the huge Khalifa port in Abu Dhabi opened and will act as a gateway for the Khalifa Industrial Zone Abu Dhabi (Kizad). In 20 years, the emirate hopes that the combined facility will account for 15% of non-oil GDP.

Sahasra thinks that these improved facilities, combined with increasing consumer and corporate demand within the Middle East, will increase ties with Asia, using Bangladesh as an example. "China initially supplied a lot of textiles and knitwear," he says. "Now there's been a structural change in the supply chain, with China moving up, and the textiles industry moving towards Bangladesh. Bangladesh supplies a whole lot of textile products that go into hotels, buildings, meeting rooms and homes, both to the Middle East and further afield.

"Bangladeshi companies need a place where they can store produce that has warehousing facilities, can provide staff and arrange shipment to different parts of the world. Also, the weather conditions in the Middle East are more stable all through the year, so a large influx of Bangladeshi companies are setting up offices, manufacturing lines and warehouse complexes. They're catering to existing regional customers and re-exporting to the US and Europe. This is a clear shift in the pattern, by which both economies benefit."

The model works for more than just textiles. The Middle East has become an important hub for re-exports of everything from white goods to automobiles, most of which come from Asia. It has led to plenty of Asian exporters setting up shop in the Middle East, in order to capitalise on local demand, taking advantage of the world class infrastructure in the process.

Louis Robinson, managing director Emea trade sales at RBS, explains: "We worked with a Japanese car manufacturer who wanted to boost sales in the Middle East. They arranged for cars to be shipped to the Middle East from Japan and then they were sold out to various distribution networks all over the region. We ended up funding both ends of the transaction over a 90-120 day period. We paid the company in Dubai on day one, which allowed them to settle back to head office in Japan immediately."

Extract the detail of the deal, and you've got a thumbnail sketch of some of the key areas of development in Middle Eastern trade: rising local demand, the region as a re-export hub, the diversity of imports, and the emergence of alternative trade corridors. It's certain that efforts to nurture all of these elements will become more concentrated in 2013. GTR