SPOTLIGHT ON THE UAE

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- The Emirates has increasingly focussed on legislation to improve its governance across the gold market.
- The 2021 introduction of the UAEGD, albeit a voluntary code, has been augmented in July 2022 with an announcement concerning mandatory due diligence regulations.
- The increasing focus on CEPAs, which require adherence to various precious metal legislation, should see the UAE increasingly attract bullion imports, to help take advantage of these new agreements.

Introduction

The United Arab Emirates (UAE) is a major international gold trading hub largely thanks to Dubai, one of the country's seven Emirates. This has been the focal point for much of the UAE's development in the gold market, especially over the past 10-15 years, which has resulted in a marked growth in physical gold trading. In this regard, two headline figures stand out, official gold jewellery exports, which in 2020 exceeded $6bn, and bullion imports which reached $29bn. It was arguably the creation of the Dubai Multi Commodities Centre (DMCC) in 2002, which helped to strengthen Dubai's role as a key entrepôt in the Middle East. In 2020, the UAE accounted for around 10% of both total world gold bullion and the gold jewellery exports, making it the third largest in the world behind mainland China/Hong Kong and Switzerland.

The Emirates has long been home to a sizeable gold refining industry, but more recently the government has sought to strengthen its role in this market, with the launch of a Good Delivery system, known as the UAEGD. This appears to be quickly gaining prominence, not least in the context of two of the three Comprehensive Economic Partnership Agreements (CEPAs) that have been signed with India and Indonesia (the third being with Israel). Although details of the Indonesian CEPA are yet to be released, an important element of the UAE-India agreement is that the gold India imports, as part of the CEPA from the UAE, must be accredited under the UAEGD. As it stands, only two UAE gold refineries are UAEGD-certified (this being a voluntary standard), but as the government expands the CEPA programme this will most likely see the accreditation system grow, both for gold and silver.

While adherence to the UAEGD is voluntary, the government's late July announcement looks to build on the Good Delivery system and may well reflect the increasingly high-profile nature of its gold industry as more CEPAs are signed. This new legislation, the Due Diligence Regulations for Responsible Sourcing of Gold, will be effective from January 2023. One important difference with the UAEGD is that the responsible sourcing will be mandatory. To this end, it will be interesting to see in the coming years what impact this has on the UAE's gold imports.

Chapter 2 - Regulatory Landscape

The DMCC's Role in the UAE Gold Market

Until the establishment of the DMCC, Dubai's gold market had been largely associated with its Gold Souk in the Deira district, much like the Kapalıçarşı (Grand Bazaar) in Istanbul. Following the Emirate's decision to take a more prominent role in the world gold trade and promote Dubai as the "City of Gold", the DMCC was established to develop the Emirate's gold value chain, focusing on trading, refining and investment. To achieve these goals one of the first steps was to introduce DMCC Tradeflow in 2004, a trade finance product, which offers a customised online platform to register possession and ownership of commodities stored in UAE-based facilities. In 2005, the Dubai Gold and Commodities Exchange (DGCX) was established, this being an electronic financial and commodity derivatives exchange offering futures on gold, silver, copper, zinc, currencies, crude oil, equity indices and single stock futures on a number of global stocks. The same year the Dubai Good Delivery Standard (DGD) was introduced, the standard for 1kg gold bars of 995 purity.

Current Regulatory Environment: Responsible Gold and Other Initiatives

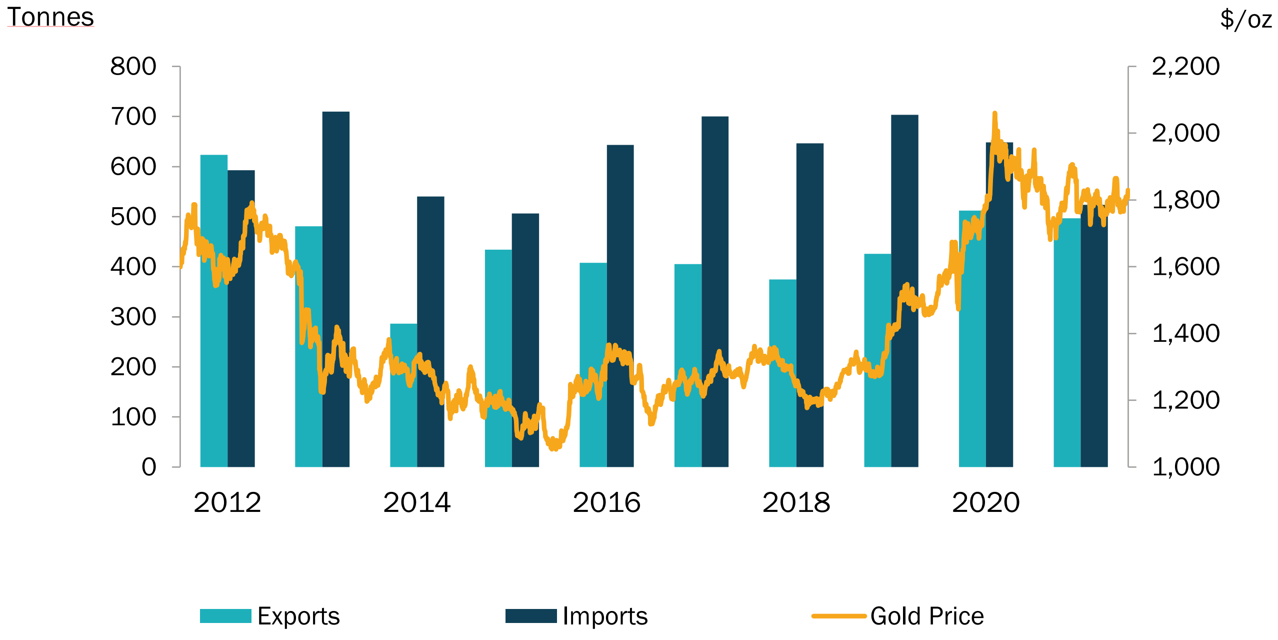
In October 2019, the UAE Cabinet approved a policy to enhance the country's position as a global hub for the gold and jewellery trade. The central aim of this legislation has been to enhance the competitiveness of the UAE gold market, around three main pillars: governance, sustainability and innovation. The main strategic programs include the governance of the gold sector at the federal and local level, the establishment of a federal platform for gold trading and traceability, international marketing of the gold sector, greater use of technology in the gold market (such as tokenisation), the establishment of the UAE's Good Delivery system and, finally, the promotion of UAE-based conventions related to this sector, such as the annual Dubai Precious Metals Conference (DPMC). In essence, integrating the regulatory environment across the Emirates should standardise rules governing the gold sector, eliminating loopholes and so potentially improving enforcement.

Following on from this, at the November 2021 DPMC, a UAE Good Delivery Standard (UAEGD) was announced. This will replace the DGD while keeping most of its features and adopting it nationwide. While the DGD was solely a Dubai initiative, by expanding it to cover the whole country the UAEGD will bring the gold market of the entire Emirates under one umbrella. In effect, the UAEGD is meant to align the UAE gold sector, principally by targeting refiners and smelters, under the auspices of the OECD responsible gold and due diligence guidance, which is already covered in the DGD. Although the specifics of the UAEGD have not yet been announced, it is widely expected to be a standard that provides a national framework for the gold sector, in line with international best practices.

Building on the above developments, on 21st July 2022 the UAE's Ministry of Economy (MoE) announced the Due Diligence Regulations for Responsible Sourcing of Gold. These build on recommendations from the Emirates' Financial Action Task Force, which looked at responsible sourcing mechanisms that were already in place in other jurisdictions and how these could be incorporated in the UAE. The Due Diligence Regulations for Responsible Sourcing of Gold specifies "the facilities under its control", which include companies working in gold refining and the recycling of gold products inside and outside the country, falling under the precious metals and gemstones trade sectors, and categorized as designated non-financial business or professions (DNFBP).

What makes this initiative stand out for the UAE is that, unlike past practices, the adherence to these guidelines is mandatory for all gold refineries operating in the country, starting from next January. The MoE further stipulated that the new guidelines support the legislation to counter money laundering and combat terrorism financing, in line with OECD directives.

UAE Gold Bullion Trade



Source: Metals Focus, Bloomberg

Comprehensive Economic Partnership Agreements

The CEPAs are bilateral trade agreements and so are not limited to the UAE's precious metals market. However, as the UAE-India CEPA makes clear, gold and, to a lesser extent, silver, have benefited considerably. Furthermore, the fact that this CEPA was finalised in just 80 days, and with the Indonesian and Israeli CEPAs being agreed in quick succession, demonstrates the importance of these mechanisms to the authorities. As touched on elsewhere in this Spotlight, this may explain why the new responsible guidelines when implemented will be mandatory. In that regard, as more CEPAs come into play these could prove to be one of the most important developments for the UAE precious metals sector.

Chapter 3 – Refineries and Bullion Dealers

There are 10 active Dubai Good Delivery Gold Members, although at present with only three refineries based in the UAE, Al Etihad Gold Refinery DMCC, Emirates Gold DMCC and Sam Precious Metals FZ-LLC. Looking at silver, the current list features six refineries with three located in the UAE, these being the same three operations as mentioned above.

Considering there are around 10 active gold refineries in the UAE, the fact that the more operations are not UAEGD accredited may simply be a timing issue as the accreditation process runs its course, as well as the fact that the DGD code is voluntary, which is in keeping with the setup in some other locations. However, with the signing of the India-UAE CEPA, where the Indian duty on gold bullion is 1% lower at 14% for imports of up to 150t annually, this may encourage more UAE refineries to join the DMCC as CEPA allows only UAEGD bars to be delivered into the country. The same is true for the silver at 9.5% (1.25% lower), which is set to be zero-rated in 10 years' time.

The attractiveness of CEPAs to the Dubai trade may encourage UAE-accredited refineries to bring in more gold for processing. However, as global refining capacity already exceeds combined world gold mine production and recycling, it will be interesting to see how this new dynamic plays out.

Other than the local refineries, the UAE (and particularly Dubai) hosts several local and international gold bullion dealers, many of which are based in the DMCC, in the traditional and newly constructed Gold Souks in Deira district. The Gold Souk, which traces its roots to the early 1900s, covered an area of just around 400 square meters, with only a handful of jewellers. During the 1940s, with the introduction of more liberal business and trade policies, the city started to attract Iranian and Indian investors. Another milestone was the discovery of oil in the region in the 1970s and the foundation of the UAE in 1971. As gold demand in the Gulf region has increased over the years, and especially in the wake of the momentum it gained from the 1990s onwards, more businesses from India arrived. Although today there are other areas in Dubai where jewellery fabrication and trading occur, the Gold Souk remains the most popular destination in the UAE for gold, which has over the years from its humble beginning, expanded to house 400 shops a decade ago, to now comprising almost double that figure.

Chapter 4 - Investment and Finance

Gold Banking Products

Over the past decade, bullion banking in the Emirates has gained some traction. Although only offered by a handful of banks to private, institutional investors and the trade, this will cover both Shari'ah compliant and more traditional vehicles. Specifically, for those investors in the UAE looking to store gold locally (perhaps as part of a multi-location strategy), one option, through the UAE banking system, is to utilise warehousing facilities in the free trade zones. In addition, and specifically from a B2B standpoint, one of the most widely used gold banking products are gold loans utilised by local gold market participants for trade finance.

UAE-based institutional and high-net-worth investors also work directly with overseas banks and trading houses, for example, for precious metals settlement, arbitrage, trading futures or buying precious metal ETPs.

DGCX

Three types of gold contracts can be traded on the DGCX: gold futures, "daily gold" futures and Shari'ah gold. Taking each in turn, there is one gold futures contract, which is traded in 32oz lot sizes and settled in dollars. There is also one "daily gold" futures contract, the 400oz (Dubai Good Delivery) contract, which is a hybrid contract, because it must be settled on a physical delivery basis. Finally, there is the 32oz Shari'ah gold contract, which must also be physically settled. However, trading in all three is extremely modest, although kilobar trading is a little more prevalent. Turning to silver, the exchange also features a 1,000oz dollar settled silver contract. Overall, annual turnover on the DGCX, which averaged 300t annually for the past five years for both metals, fell by 74% y/y in 2021 to 99t.

The low volume on the exchange reflects the preference for gold market participants to trade in the OTC and also because it is not compulsory to register gold bullion imports at the DGCX. This contrasts, for example, with Turkey's Borsa Istanbul's (BIST) Precious Metals Market, for which it is mandatory to register bullion imports, in addition, Turkish banks are only allowed to trade precious metals at the BIST and cannot otherwise trade with other bullion dealers or refineries in the OTC market.

Physical Investment

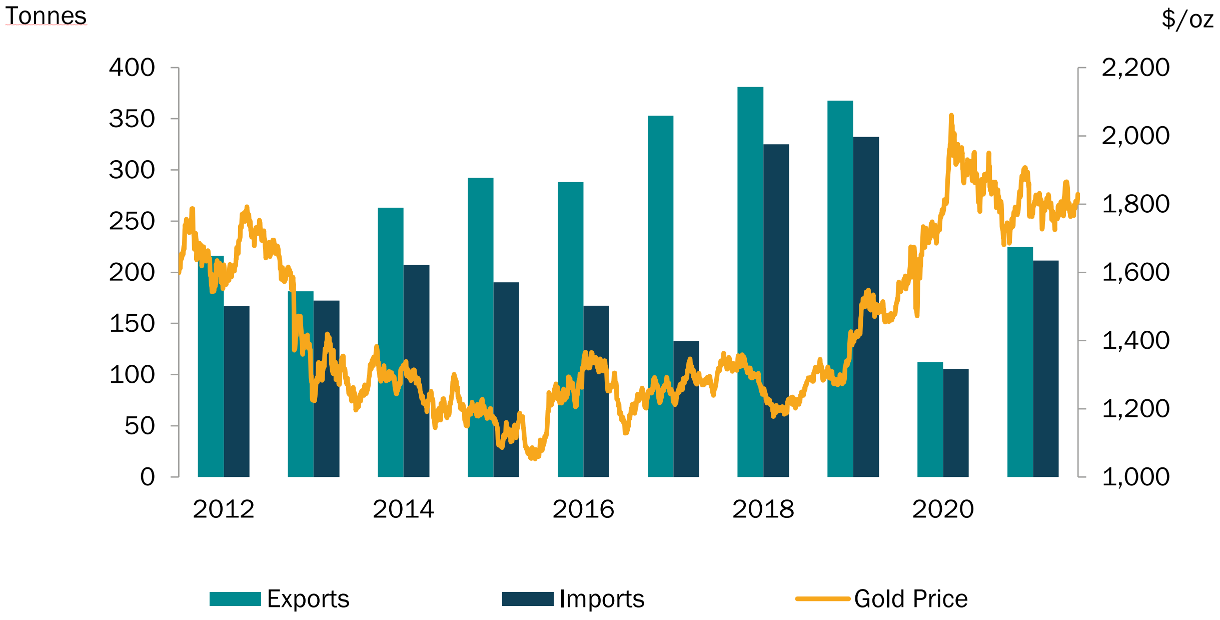
The gold bar and coin market in Dubai is important on two counts, in part reflecting a key characteristic that all of these products are Shari'ah compliant. In its role as a gateway for the region, Dubai acts as a distribution hub for bars and coins for the wider region. There is also a market for these products in the UAE in part due to the prominence of expatriates, most of whom originate from South Asia. Although annual UAE demand has averaged less than 6t over the past five years, against 10t at the start of the last decade, after emerging from COVID and taking advantage of the pullback in gold prices from their 2020 peak, physical investment jumped by 48% y/y to 7.7t in 2021. This year, the market has continued to strengthen, helped also by recent price weakness and as the economy continues to recover from the pandemic. As a result, Metals Focus forecasts a 10% gain for 2022, generating an eight-year high of 8.5t.

Unlike Turkey and Iran, the UAE does not issue legal tender coins (these being the only two countries in the Middle East to do so). As a result, the retail investment market is dominated by small minted and cast bars. Bar sizes vary between 1g to 10 tola (approximately 117g). Over the past decade or so, locally produced bars have been gradually taking market share from imported pieces due to improved quality and availability and low labour charges. However, bars produced by Swiss refineries still dominate physical investment in the Emirates.

Chapter 5 - Jewellery Market

Dubai's position as an entrepôt for the Middle East jewellery market reflects three broad themes. First, and perhaps most important has been its reputation for the jewellery it manufactures. This means there has been less concern with the purity of the gold, compared with (historically) India. Before compulsory hallmarking was introduced in India, under caratage was quite prevalent and this sharp contrast with the UAE was an important catalyst in helping tourism between South Asia and the Emirates to develop.

UAE Gold Jewellery Trade



Source: Metals Focus, Bloomberg

The second issue was the duty-free nature of the UAE gold market, which only changed in 2017. Without this tax-free regime, it is questionable how much the India-UAE trade would have developed, which is now so integral to the Emirates. In terms of the new tax structure, a 5% import duty on jewellery brought into the UAE, was introduced, effective from 1st January 2017, followed by a value added tax (VAT) of 5% from 1st January 2018.

This initially caused a stir, resulting in falling retail sales and a decline in jewellery inflows, with some of the wholesaling activity moving to other hubs, such as Istanbul. However, the authorities subsequently looked to address these issues by allowing tourists to reclaim some of the 5% (after processing fees are netted off) when they left the country, exempting B2B trades from VAT, streamlining the import duty mechanism (to avoid imposing 5% import duty for jewellery to be re-exported) and, more recently, removing the 5% import duty for Indian jewellery imports with the above-mentioned India-UAE trade agreement.

The third reason for Dubai's success as a global jewellery hub is inextricably linked to the above two themes, and reflects the depth of its wholesale jewellery sector, which has been established over the past 15-20 years. Despite the lack of comprehensive UAE trade data for 2021 statistics are available for India, the Emirates' largest trading partner for gold jewellery. This shows that last year around $2.7bn of product was delivered to the UAE, up some 18% on a COVID-affected 2020.

Overall though, the past 5-6 years have been challenging for the sector, which has had to contend with a new fiscal apparatus, at times record high gold prices, and the COVID pandemic. However, there now appears to be some momentum and a sense of renewed optimism, in part as the UAE (and the wider region) recovers from the pandemic, with a fresh injection now emerging from the CEPAs and with high energy prices benefiting oil and gas exporting countries in the Gulf.