

United Arab Emirates: 2008 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with the United Arab Emirates, the following documents have been released and are included in this package:

- The staff report for the Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 2, 2008, with the officials of the United Arab Emirates on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 2, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of January 9, 2009, updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 9, 2008 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UNITED ARAB EMIRATES

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation with
the United Arab Emirates

Approved by Adam Bennett and David Marston

December 2, 2008

- **Mission dates:** October 20–November 2, 2008.
- **Team:** Mr. Enders (Head), Ms. Hakura, Mr. Erbas, Mr. Hasan, Ms. Zermeño (all MCD), and Mr. Chailloux (MCM). Mr. Shaalan (OED) participated in the policy discussions.
- **Meetings:** The mission met with the Minister of Finance, the Governor of the Central Bank, other senior officials of the federal and emirate governments, and representatives of the private sector.
- **Exchange arrangement:** The U.A.E. has accepted the obligations of Article VIII, Sections 2, 3, and 4. The exchange system is free of restrictions on payments and transfers for current international transactions. Since 2002, the dirham has been officially pegged to the U.S. dollar.
- **Data:** Generally adequate for surveillance, but substantial shortcomings constrain economic monitoring and policy formulation.
- **Past surveillance:** The authorities and the Fund have generally agreed on broad policy priorities. In the 2007 Article IV consultation (concluded on September 21, 2007; PIN available at <http://www.imf.org/external/np/sec/pn/2007/pn07125.htm>).

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EXECUTIVE SUMMARY

Discussions focused on the policy mix needed to contain the impact of global turmoil, especially on the financial sector, and keep the U.A.E. economy on a path of sustainable growth with single-digit inflation.

The authorities

- Explained their approach is to preserve financial stability through various emergency liquidity facilities, guarantee of deposits, and a strengthening of banking supervision.
- Expect public spending to remain a key driver for growth in 2008–09, including through higher transfers to quasi-public entities to replace foreign and domestic bank lending.
- Agreed that the dirham might be moderately undervalued.
- Consider that the current pegged regime remains appropriate at this juncture, providing a strong anchor in the current turmoil.

Staff recommendations

- Slow credit growth while avoiding too abrupt a slowdown to avoid damage to corporates and the financial system. In the event of a worse-than-expected downturn, target contingency measures to safeguard systemically important institutions.
- The peg to the U.S. dollar remains appropriate unless inflation were unexpectedly to persist.
- Minimize fiscal costs of the government guarantees; ensure adequate incentives to prevent banks from using the new liquidity facilities to acquire more risky assets.
- Rationalize subsidies and prioritize investment projects with a view to alleviate supply bottlenecks and inflation pressures; be ready to pursue a more active counter-cyclical fiscal policy if needed.
- Complete ongoing work to disseminate monthly CPI data, establish a National Bureau of Statistics, and improve national accounts and public sector statistics, including preparation and publication of the IIP.

I. RECENT ECONOMIC DEVELOPMENTS AND SHORT-TERM PROSPECTS¹

1. **The United Arab Emirates' (U.A.E.) economy continued to perform strongly in 2007 and the first nine months of 2008.** The government's outward-oriented development strategy and high international oil and gas prices boosted domestic and foreign investment, and led to strong growth in the construction and services sectors. However, as a worsening global environment started to take a toll in the second half of 2008, non-oil growth is projected to ease to 8.6 percent in 2008. Budget and external current account surpluses remained large in 2007 (25 and 16 percent of GDP, respectively) and are projected to remain at similar levels in 2008, with higher oil exports offset by increases in government imports.
2. **Inflationary pressures are likely to ease in coming months, and managing the vulnerabilities arising from the global downturn has become the key policy challenge.**
 - **Inflation has steadily accelerated since 2004 and is projected to reach 12.7 percent in 2008,** reflecting housing shortages, imported inflation, U.S. dollar depreciation, and strong domestic demand fuelled also by the expansionary monetary policy imported from the United States through the dollar peg. However, in the second half of 2008, the sharp appreciation of the U.S. dollar and declining global food and commodity prices have put downward pressures on tradables prices and should help ease inflation going forward. Reflecting relatively high inflation, the real effective exchange rate has been appreciating steadily since end-2004.
 - **The U.A.E. has been adversely affected by the turmoil in global financial markets,** as evident in a widening of sovereign risk spreads and a sharp downturn in stock markets—most pronounced for real estate companies. Capital inflows driven by expectations of a revaluation of the dirham vis-à-vis the U.S. dollar largely reversed over the summer of 2008; currency futures indicate that markets no longer doubt the peg. Anecdotal evidence suggests that foreign financing for corporates has tightened, and a slowdown in real estate and construction seems underway.
3. **The U.A.E. banking system appears adequately capitalized and highly profitable, but risks of a future deterioration of asset quality have risen.** Banks' assets and profits increased sharply in 2007 and the capital adequacy ratio stood at 13.3 percent by mid-2008, above the regulatory minimum of 10 percent, though somewhat below the level of 2007. However, the fast pace of growth of consumer and real estate loans along with the uncertain outlook for asset prices has raised the risk of a future increase in nonperforming loans (NPLs). Recent capital outflows, and growing concerns about counterparty risk have in recent months affected the functioning of the interbank market (see below).

¹ See charts, and tables 1–7.

4. **Money and private sector credit growth accelerated further in the first nine months of 2008, and liquidity problems emerged in late summer.** Credit to the private sector rose by 51 percent (y-o-y) in September 2008, up from 40 percent in December 2007, driven by the economic boom and highly negative real interest rates. Credit was financed by strong deposit growth, but in 2007 also by large foreign borrowing. Since March 2008, the central bank has taken several steps to address a drying-up of liquidity following an outflow of foreign deposits.² To preempt spillovers from the global turmoil and address continued liquidity pressures in the banking system, the government declared in October 2008 a blanket guarantee of deposits and inter-bank lending for three years, and put in place an additional \$19.1 billion emergency liquidity support fund (in the form of interest-yielding government deposits) to provide banks with long-term funding relief. The Abu Dhabi government is also providing some of its banks and corporates with deposits and direct budgetary loans, respectively. One-month interbank rates remained, however, above 4 percent in mid-November, compared with 2 percent in mid-June.

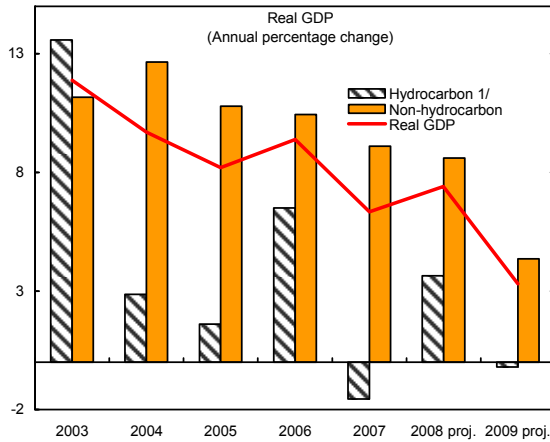
Flows in the Monetary Survey				
(In billions of U.S. Dollars)				
	2007		2008	
	H1	H2	H1	June–Aug.
Change in NFA of the central bank	15	34	-25	-9
Change in NFA of commercial banks	-9	-39	16	-14
Change in banks' gross assets	2	-11	9	-5
Change in banks' gross liabilities	11	28	-7	9
Change in NDA	15	29	38	27
Change in private sector credit	16	30	45	17
Change in capital and reserves 1/	-4	-4	-8	-3
Change in other assets	5	0	-2	9
Change in M2	21	25	30	4
Change in money	8	9	17	-2
Change in quasi-money	13	16	13	6

Source: Central Bank of the U.A.E.
1/ A minus represents an increase.

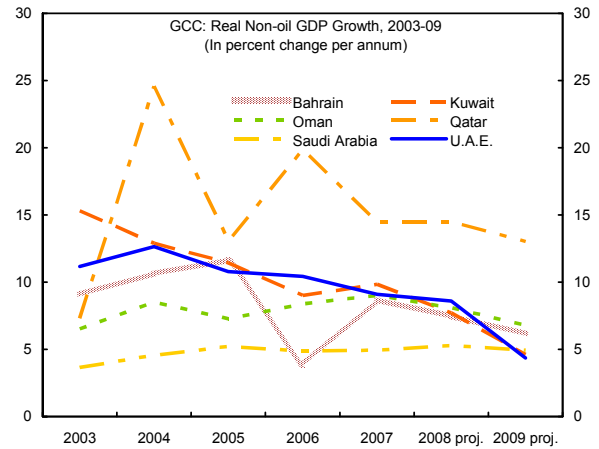
² In March 2008, a facility allowing banks to borrow against their holdings of central bank certificates of deposit (CDs) replaced foreign borrowing as a key source of funding. In September, the central bank established an additional \$13.6 billion facility to offset shortfalls in other bank funding sources, allowing banks to tap their reserve requirements at a penalty rate of 1.5 percent above the repo rate.

United Arab Emirates: Recent Economic Developments, 2003–09 1/

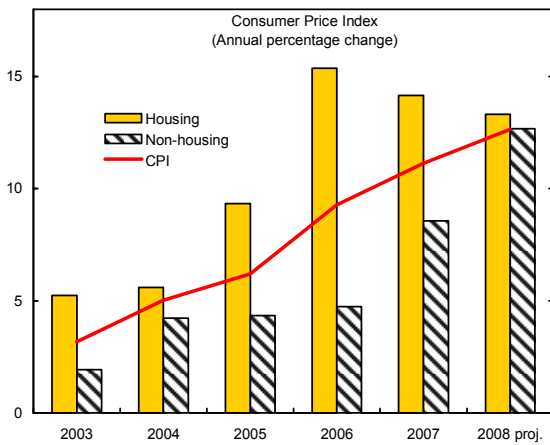
Real GDP growth has been driven by the non-oil sector



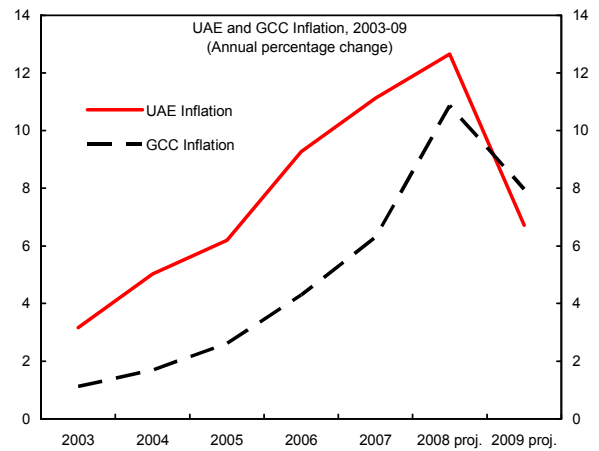
on par with other GCC countries



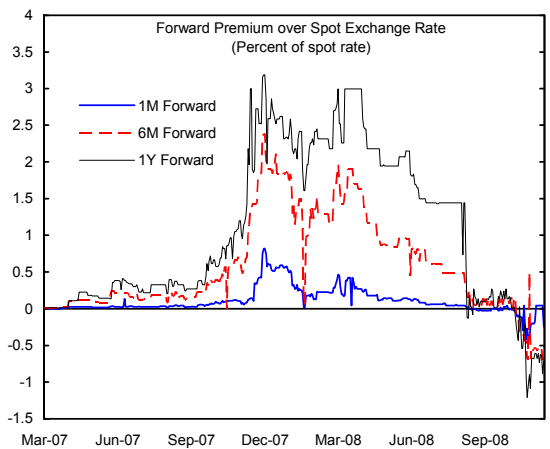
Inflation has been steadily rising due to increases in housing costs and other prices



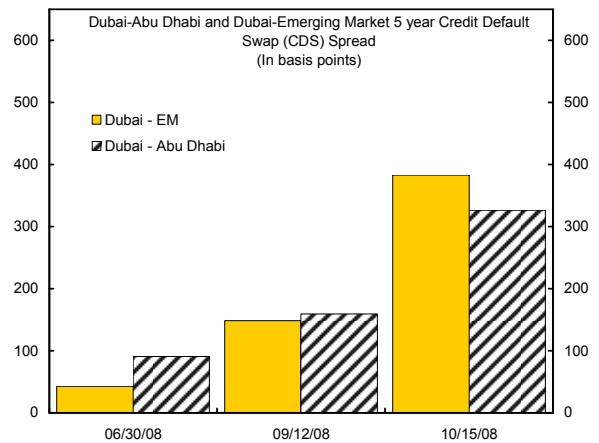
... and is above levels in other GCC countries



Speculation on a revaluation of the dirham has recently abated



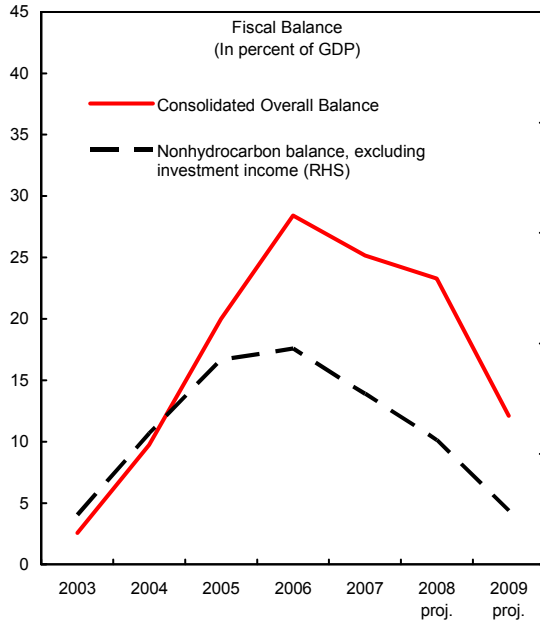
but the Dubai-Abu Dhabi CDS spread has widened amid concerns of an abrupt slowdown in the Dubai real estate sector



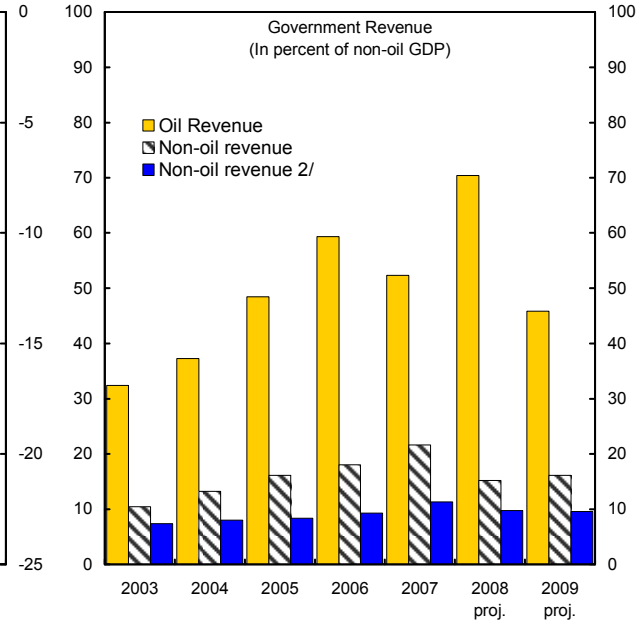
1/ Sources: Datastream; country authorities; and Fund staff estimates.

United Arab Emirates: Recent Economic Developments, 2003–09 (continued)

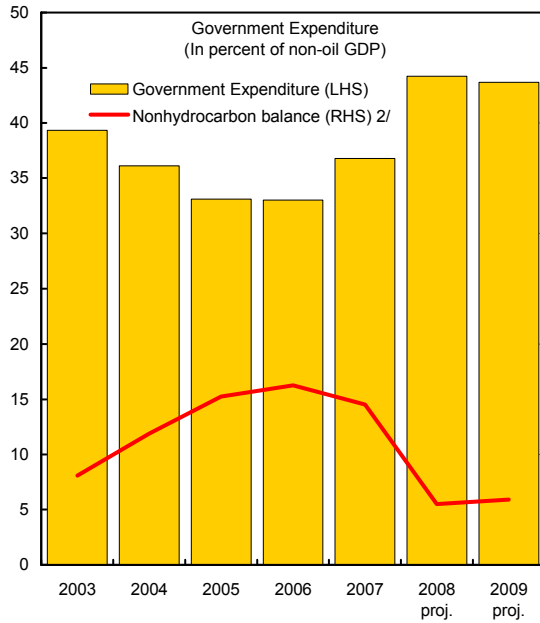
The fiscal surplus remained large in 2007–08



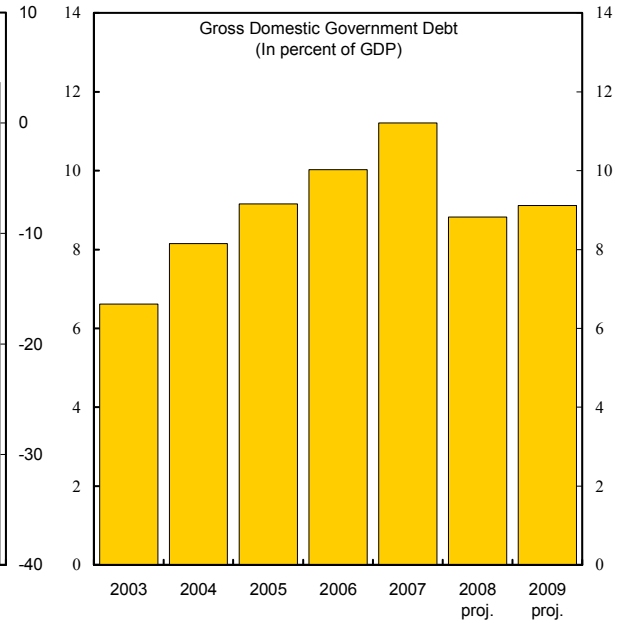
... mainly reflecting high oil revenues



But increases in current and development spending resulted in a worsening of the non-oil deficit



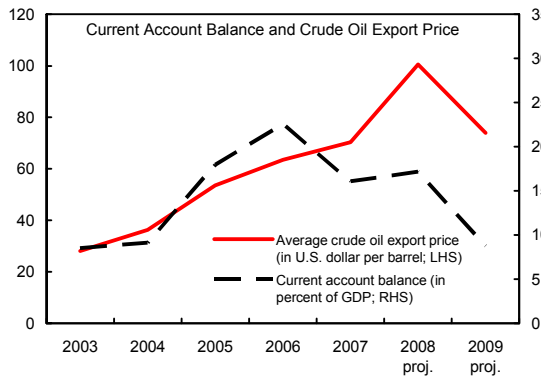
Government debt has been rising



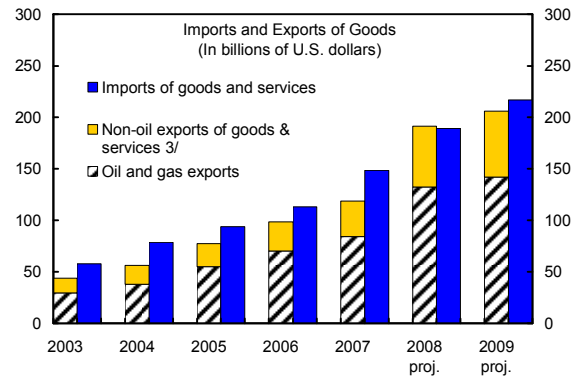
2/ Excluding investment income.

United Arab Emirates: Recent Economic Developments, 2003–09 (continued)

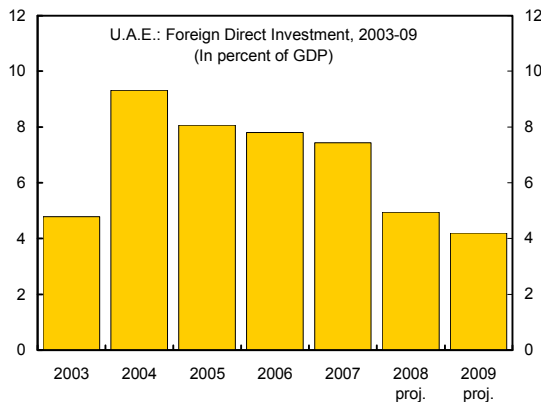
The current account as a share of GDP has been trending down since 2006



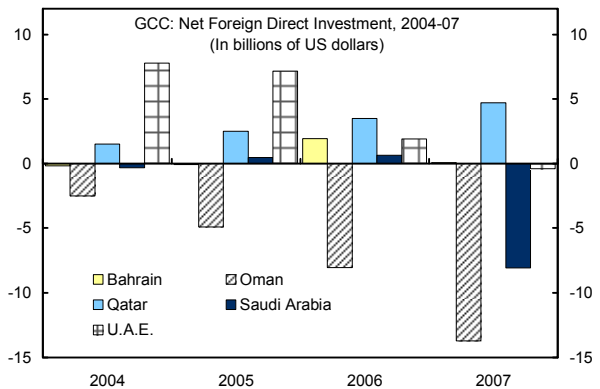
as increased oil export earnings were more than offset by higher imports and slower growth of non-oil exports



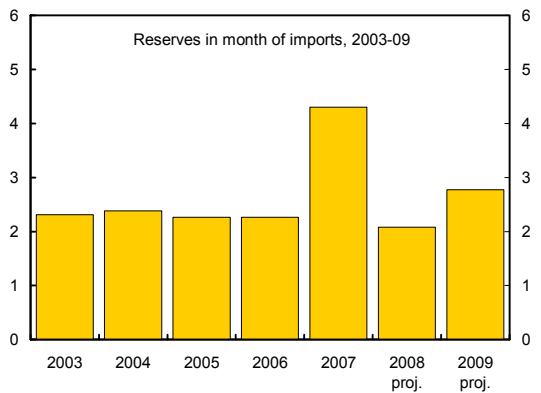
FDI inflows remained high in 2007



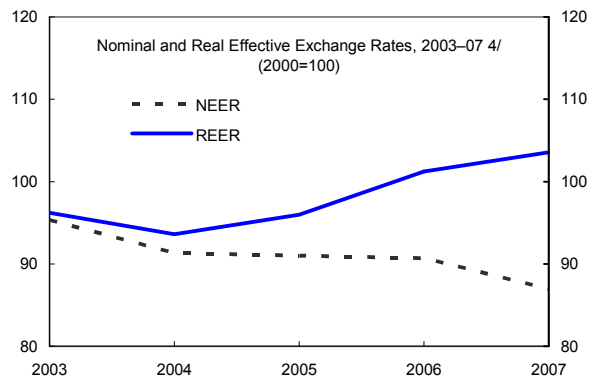
but FDI outflows exceeded inflows in 2007



Reserves increased sharply in 2007, reflecting large bank foreign borrowing and other private inflows



The REER continued to appreciate in 2007 as a result of high inflation

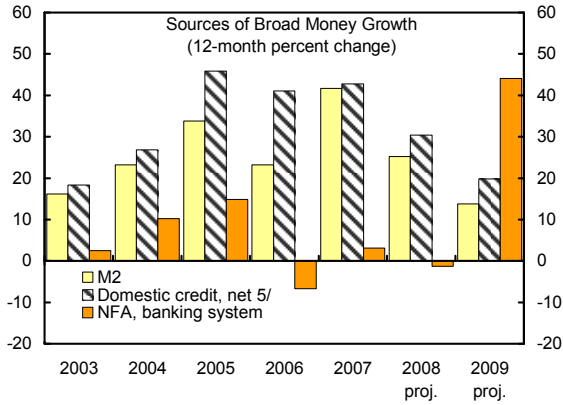


3/ Includes re-exports.

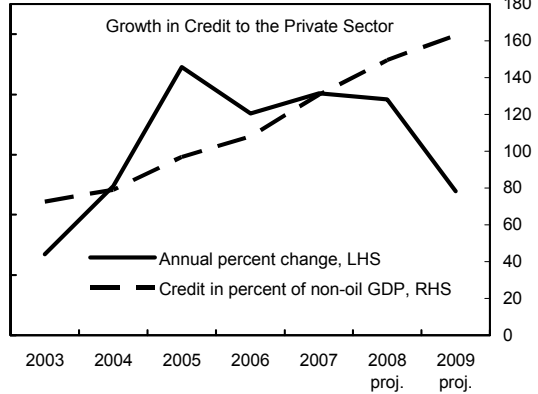
4/ An increase indicates appreciation.

United Arab Emirates: Recent Economic Developments, 2003–09 (concluded)

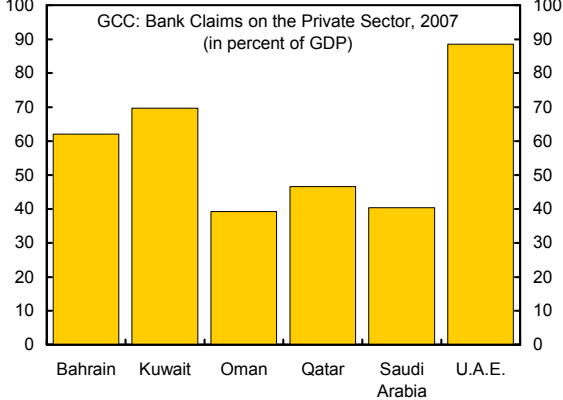
Strong growth in broad money and domestic credit in 2007



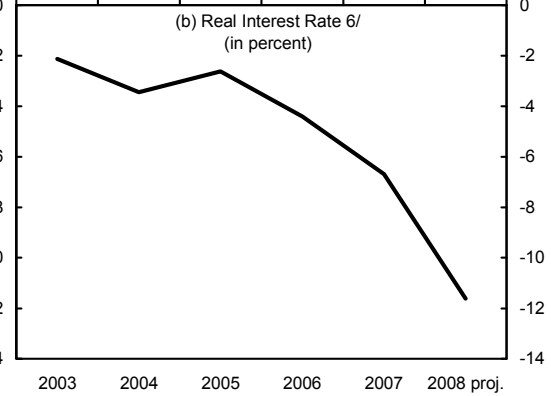
... was driven by high private sector credit growth financed in part by speculative inflows



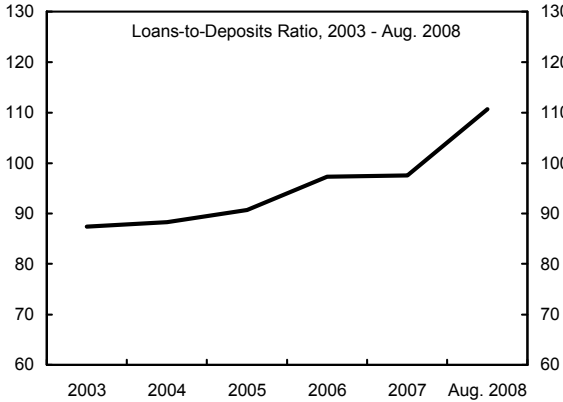
Ratio of private credit to GDP is highest in the GCC region.



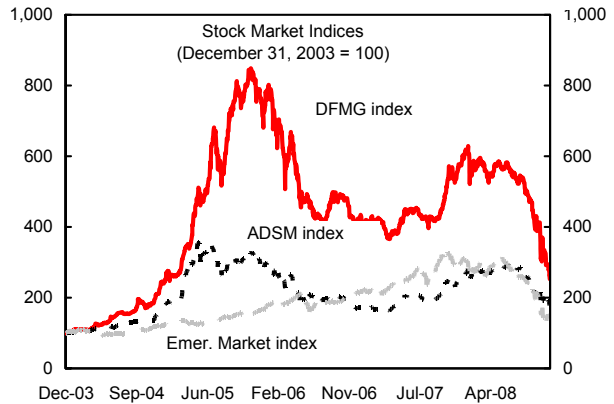
Credit was also fueled by increasingly negative real interest rates



and the loans to deposits ratio now exceeds 100 percent



Stock markets rebounded in 2007, but fell in 2008 along with other markets.



5/ Includes claims on government (net), claims on public sector enterprises and claims on private sector.
 6/ Average of quarterly nominal rates on 28-day CDs deflated by the annual change in the CPI.

II. MEDIUM-TERM ECONOMIC OUTLOOK

5. **Discussions were based on a staff scenario projecting growth to slow to about 3 percent in 2009 on the back of the worsened global outlook, before gradually recovering to around 5 percent during 2010–13.** This reflects a slower expansion in the non-oil sector, particularly in tourism and construction, as domestic and foreign demand growth is expected to weaken in the near future. Migration into the U.A.E. is also expected to ease with slower growth. Oil production is expected to expand gradually to about 3.39 million barrels per day by 2013, with oil prices gradually recovering to around \$86 per barrel. Inflation is expected to decelerate to about 3 percent by 2013 as demand pressures and international commodity price inflation ease.

6. **Fiscal and external balances are projected to remain in surplus over the medium-term, despite lower oil prices.** The non-oil fiscal deficit is expected to narrow to 29 percent of non-oil GDP over the medium-term, while the current account surplus would reach 15 percent of GDP by 2013. It would take a fall in oil prices to below \$53 per barrel before the current account would show a deficit in 2009.

7. **The short and medium-term outlook is subject to a number of downside risks arising from the difficult global environment as well as domestic financial vulnerabilities in the wake of the recent real estate and credit boom (especially in Dubai):**

- a more severe global weakening could further reduce non-oil growth through much lower oil prices, and through lower global demand for construction, tourism and financial and trade-related services.
- foreign financing for ongoing and planned investment projects may be scaled back further, and the refinancing of corporates' foreign debt could become more complicated.
- corporates (as well as households) will likely scale down investment plans for the next few years but demand for domestic financing will increase—if only to complete ongoing projects—at a time when domestic banks are already under stress.
- these developments could trigger a correction in the real estate market (Box 1), and thereby a deterioration of asset quality in the financial system.
- while the fiscal position (especially of Abu Dhabi) remains strong, and the willingness of the authorities to provide coordinated federal support for corporates and the banking system has been underscored by the latest liquidity-initiative, the scope for fiscal support could become more constrained if oil prices decline further or if the Abu Dhabi Investment Authority (ADIA) and other institutions experience further sharp declines in the value of their external assets.
- inflationary pressures could recur if there were, for example, a renewed sharp depreciation of the U.S. dollar, or an acceleration of global food price inflation.

III. REPORT ON THE DISCUSSIONS

8. **The turmoil in global financial markets poses significant challenges to the U.A.E. economy, although some officials expect a more limited impact on growth.** The policy discussions focused on the modalities of the authorities' recent intervention in financial markets, and the fiscal, monetary and financial policy mix needed to contain the impact of global turmoil and keep the U.A.E. economy on a path of sustainable growth with single-digit inflation.

A. Monetary and Financial Sector Issues

9. **The authorities introduced the blanket guarantee and emergency liquidity facilities to prevent any destabilization of the U.A.E.'s financial system.** Access to the first tranche of the \$19.1 billion liquidity facility was conditional on bank recipients limiting the growth of private sector credit to key areas, avoiding lending for new real estate projects and speculative activities or financing activities outside the U.A.E. The authorities aim to slow annual private sector credit growth to about 10–15 percent.

10. **An abrupt slowdown in the domestic real estate market poses the main risk to the banking system.** Direct exposure to U.S. mortgage-related securities is reportedly small, and official data indicate limited exposure to the domestic real estate market. Staff pointed however to FSAP concerns about the accuracy of the sectoral classification, and wondered about possible indirect exposure, especially with respect to some off-balance sheet commitments that may materialize rapidly in case of a real estate market downturn. The authorities consider that the U.A.E.'s banks have enough buffers (capital, reserves and earnings) to absorb losses that could result from a local real estate correction, which many market participants expect to be in the order of 20–30 percent. If needed, the authorities would consider targeted capital injections for weaker banks.

11. **The central bank of the U.A.E. (CBU) is taking steps to strengthen banking supervision to contain the fiscal risks related to the emergency liquidity facilities.** This involves evaluating banks' asset portfolios with a focus on real estate loans, and review of the loan classification and provision regulations to obtain sharper measures of exposures and risks. The CBU has also started to (a) increase the frequency of regular reporting by banks of liquidity indicators; (b) perform unscheduled visits to banks; and (c) strengthen the financial stability unit. In line with the 2007 FSAP recommendations, amendments to the banking law are planned that would strengthen the central bank's power to take prompt corrective measures, stiffening penalties for violation of laws and regulations or unsafe or unsound practices, and providing better legal protection for supervisors.

12. **The development of money market instruments, notably through the issuance of short-term government paper, would help support liquidity management.** The authorities recognized that supply of the current liquidity management instrument, CBU issued CDs, was inherently procyclical as it diminishes commercial banks' liquid asset holdings at the same time as liquidity gets harder to obtain on the interbank market. Regular issuance of government bills could also reduce

(federal and emirate) government reliance on funding from the various sovereign wealth funds (SWFs) in an economic downturn and in times of low oil prices. The recent issuance of a 5-year Treasury note to back the \$19.1 billion facility could be a first step in this direction. The authorities are also aiming to develop Sharia-compliant instruments (sovereign sukuks) that would help Islamic financial institutions manage their liquidity.

B. Inflation

13. **The authorities concurred with staff that inflation is set to recede**, due to the appreciation of the U.S. dollar and declines in global commodity and food prices. Pressures on rents and real estate prices in Abu Dhabi and Dubai are expected to ease as new housing units come to the market, while the expected slowdown in the non-oil sector would slow the growth of the expatriate population, and hence demand for housing.

Box 1. Real Estate in the U.A.E.

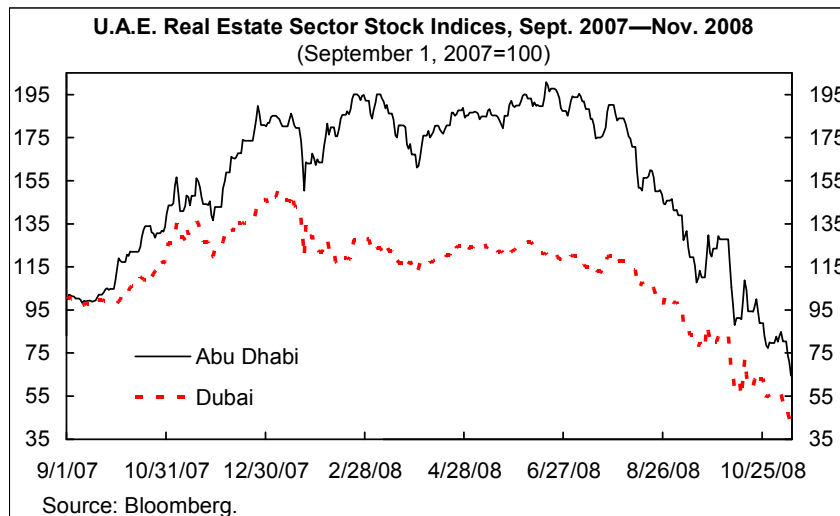
Development of basic infrastructure, including housing, has been key to the U.A.E.'s success in becoming an important regional trading and service center. Housing and office space supply has grown rapidly, and double-digit growth in prices and rents (at least through September 2008) points to continued strong demand, with continued housing shortages especially for expatriates.

Demand has been mainly driven by strong population growth (about 6 percent a year), with about 300,000 new immigration visas with work permits issued each year. The opening of the real estate market to non-residents has fostered a luxury segment where investors were often seeking to make capital gains or to take advantage of increasing rents. Negative real interest rates and loan-to-value rates of up to 95 percent also fuelled the boom.

To slow speculation and rent increases, both Dubai and Abu Dhabi made regulatory changes. Dubai introduced caps on rent increases in late 2005 and Abu Dhabi in late 2006. A new mortgage law requires all mortgage contracts to be registered with the land department and to be insured and sold by registered financial institutions. In addition, major developers now require off-plan buyers to own 30 percent of their properties before selling them, and financial institutions now demand larger down payments.

Looking forward, demand growth can be expected to slow along with non-oil growth, with demand for lower-price housing expected to remain relatively more robust.

A sharp drop in the value of listed real-estate companies (by end-November more than 60 percent from 2008 peaks) indicates that markets expect a substantial correction in real estate activity and valuations.



C. Fiscal Policy

14. **Fiscal policy has become more expansionary in 2008 and is set to remain so in 2009, with spending rising sharply as a share of non-oil GDP.** Including salary increases that took effect in 2008 at the federal and emirate levels, current and development spending will rise by 2–2½ percent of non-oil GDP during 2008-09, compared to 2007. The Abu Dhabi government is furthermore allocating large resources to quasi-public enterprises (e.g. Mubadala) to replace foreign and domestic bank lending. A 5-percent VAT is planned to be introduced within the next 2–3 years in coordination with other GCC countries.

15. **The authorities took note of the staff’s recommendations to strengthen coordination of fiscal policy between the emirates and the federal level, so as to be ready (if needed) to pursue an even more active countercyclical fiscal policy.** The federal authorities indicated that they did not expect the U.A.E’s growth outlook to deteriorate significantly in view of continued strong growth in Asia and because they do not see a significant risk of a further sharp decline in oil prices. Pointing at the quick and coordinated action taken by the federal government and the central bank to provide liquidity to commercial banks, the authorities indicated that they were ready to step in with all available tools should the need arise.

16. **The authorities were confident that the financial turmoil should not unduly affect emirate governments’ ability to meet financing needs.** In 2007, Dubai established the Supreme Fiscal Council to coordinate government entities’ borrowing. All government entities now need to obtain approval from the Council prior to any debt raising. In April 2008, the Dubai government completed the issuance of a first tranche of its AED15 billion Medium Term Note program aimed at financing large infrastructure projects. Given the projected deficits in 2009–10, the financing needs of Dubai government could reach \$8.6 billion by 2010.

17. **Vulnerabilities have emerged also in the non-bank corporate sector,** particularly for the various semi-public corporates of “Dubai Inc.” that depend heavily on foreign financing. The drying up of foreign financing for corporates is expected to complicate refinancing of existing debt (about \$20 billion is expected to come due through end-2009). Ongoing projects may have to be slowed down, and new projects, particularly in the real estate sector, be put on hold. The authorities are working on coordinated support for these corporates, to ensure an orderly “soft landing” and prevent spillovers to the banking sector.

Dubai Government and Quasi-public Entities (Dubai Inc.) Debt (billion USD) 1/	
Dubai Inc. Rated Debt	11.8
Dubai Inc. Unrated Publicly Reported Debt	35.8
Total	47.6
Memorandum items:	
Dubai total debt / Dubai GDP (in percent)	90
(Dubai central government debt and projected 2009 deficit)/Dubai projected budget revenues (2009) (in percent)	84
Dubai total debt / UAE current account surplus (in percent)	203
Investment Corporation of Dubai (ICD) assets 2/	68.7
Listed companies' values (as of 30 December 2007)	44.4
Unlisted companies (internal valuation of ICD based on 2006 financials)	24.3
Source: Dubai Department of Finance, Zawya, Moody's and Fund staff estimates and projections.	
1/ Central government and various entities held through the government's investment arm (ICD), such as Dubai-holding, DP World, Dubai Electricity and Water, Emaar, Nakheel etc. Does not include unreported debt for non-listed entities.	
2/ ICD is the investment arm of the government of Dubai. ICD's portfolio is comprised of wholly or partly owned government businesses, such as those mentioned in footnote 1. The numbers show ICD's ownership value.	

D. Exchange Rate Policy and Exchange Rate Assessment

18. **The authorities agreed that the dirham appears moderately undervalued (Boxes 2 and 3).** However, the U.A.E. needs large surpluses to build up investments to reduce dependency on volatile and finite oil income. Rising domestic absorption and lower oil prices would reduce current account surpluses from the current levels. Dollar-appreciation and relatively higher inflation would meanwhile bring the real exchange rate in line with its equilibrium level in the course of 2009; indeed there was concern about a possible erosion of competitiveness of the non-oil sector.

19. **The authorities remain committed to the dollar-peg as providing a stable anchor for inflationary expectations and financial stability.** Given recent developments, the authorities felt vindicated in staying with the dollar-peg. Currency futures indicated that speculation for a revaluation of the dirham has disappeared. Moreover, the flexibility of labor, prices, and wages—due to a flexible expatriate workforce—would ensure that any misalignment would be corrected quickly through price or labor force adjustments.

E. Regional Cooperation

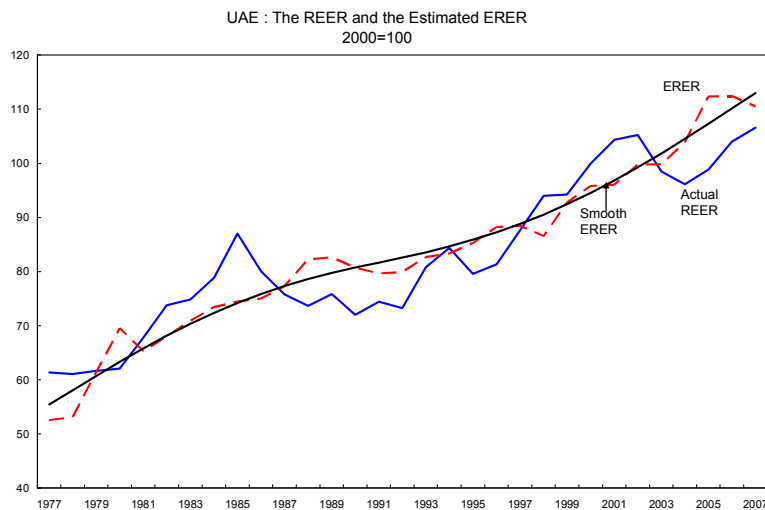
20. **The approval of draft statutes for a Monetary Council (forerunner of a Gulf Central Bank)** by GCC finance ministers and central bank governors in mid-September 2008 has given fresh impetus to monetary integration among GCC countries. The draft awaits final approval by the heads of states in December. While a common currency for the GCC is unlikely to be in place by 2010, the authorities considered that the economic benefits from the steps leading toward the monetary union (including facilitating capital flows, establishing a common market, and harmonizing regulation) were important by themselves.

21. **A worsened economic outlook for the U.A.E. could have significant regional spillover effects by lowering outflows to neighboring countries.** The U.A.E.'s weaker growth prospects and lower oil prices are expected to reduce outflows of remittances and FDI to neighboring countries that

have grown in importance in recent years. U.A.E. companies have undertaken major investment projects in the Middle East and North Africa region and remittances of expatriate workers (nearly \$9 billion in 2007) have been benefiting many economies in the region.

Box 2. Exchange Rate Assessment for U.A.E.

Staff estimates using the equilibrium real exchange rate (ERER) approach suggest that the U.A.E. dirham was moderately undervalued at end- 2007. Staff found evidence of a long-run cointegration relationship between the dirham REER and key fundamentals (notably the terms of trade (TOT), government consumption, and real per capita income relative to trading partners). Since 2003, when the actual REER was broadly in line with the estimated equilibrium rate, the ERER has been on a rising trend driven mainly by a significant improvement in the TOT. The actual REER has been appreciating by 11 percent between 2004 and 2007, driven by rising inflation. A remaining gap to the ERER of 6 percent is projected to vanish over 2009.



The macroeconomic balance (MB) approach indicates that the medium-term current account (CA) “norm” is 18.5 percent of GDP, somewhat above the current account balances projected for 2008–13. The norm is based on panel data estimates for the GCC countries; the variables used in the estimation of the current account norm include the fiscal balance, net foreign assets, and the oil balance. The results are robust to enlarging the panel to MCD oil exporters or all MCD countries, using different estimators, and changing the specification. In any case, driven mainly by lower import growth, the current account is projected to move closer into line with fundamentals over the medium term.

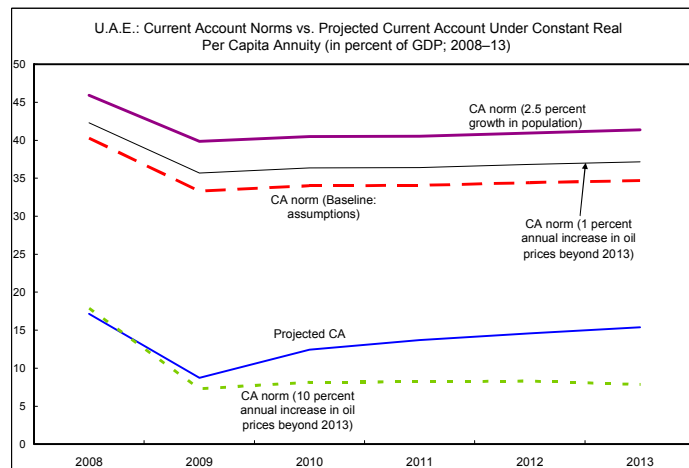
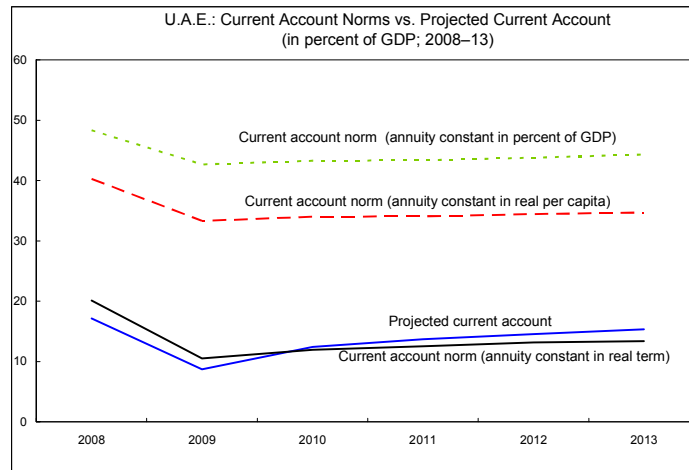
Box 3. Exchange Rate Assessment Under the External Sustainability Approach

Sustainability of U.A.E.’s current account trajectory requires that today’s net foreign assets plus the (expected) net present value (NPV) of all future oil income (“wealth”) equal the NPV of imports of goods and services, net of non-oil exports. Subject to this constraint, policy makers could seek to choose a path for imports, and hence current account “norm”, that would support intergenerational equity (and provide a safety cushion if uncertainty over future oil prices and production is factored in) through an appropriate pace of accumulation of net foreign assets to build a non-oil source of income for the future. Estimating the U.A.E.’s oil wealth at \$2.56 trillion,¹ import trajectories (“annuities”) are calculated under three different policy objectives: (a) constant share-of-GDP annuity; (b) constant real per capita annuity; and (c) constant real annuity.

Under the first two types of annuity the current account surplus projected for the coming years will remain below the “norm”, implying overvaluation of the U.A.E. dirham.

Only in the third scenario, which leaves future generations with rapidly declining benefits from current oil wealth, is the projected current account balance broadly in line with the “norm”.

The results are sensitive to the assumptions used in the norm calculations. For example, if oil prices were to rise faster (slower) than the GDP deflator, wealth and hence sustainable imports under all approaches would be higher (lower) and required current account surpluses lower (higher) in the coming years.



¹ Assuming 99 billion barrel of reserves, a 68 percent recovery rate, oil production to peak at 4.3 million barrel in 2025 before declining by 2¼ percent per annum, with reserves depleted by 2070. To take into account production costs and domestic consumption, it is assumed that 97 percent of oil revenues could be used in the calculation of the oil wealth. After 2013, oil prices and the GDP deflator increase annually by 3.5 percent, real GDP by 2.8 percent, and population by 2 percent. Future oil revenues are discounted at (nominal) 6.5 percent, the assumed rate of return on external assets. Initial financial wealth is estimated at \$0.4 trillion.

F. Statistics and Other Issues

22. **Efforts to improve statistics have intensified.** The U.A.E. officially began participating in the GDDS on July 31, 2008 and has recently approved a new federal statistics law that would allow establishment of a National Bureau of Statistics. Plans to disseminate CPI data on a monthly basis starting in 2009 are on track. The authorities have requested technical assistance from the Fund on balance of payments data. On the U.A.E.'s international investment position (IIP), the federal authorities indicated that the individual emirates' SWFs do not disclose information on their assets, partly in order to shield long-term investment strategy from politics-driven short-termism. Staff estimates based on balance of payments flow data suggest the U.A.E.'s aggregate net IIP was on the order of \$600 billion in 2007; the authorities were broadly comfortable with these orders of magnitude.

IV. STAFF APPRAISAL

23. **The U.A.E. economy continued to perform strongly in 2007–08, but tough policy challenges have emerged with the global turmoil.** Strong growth, investment, and job-creation have been aided by the government's outward-oriented development strategy and high international oil and gas prices. Budget and external current account surpluses remain large. However, the worsened global outlook will adversely affect the U.A.E.'s growth momentum through lower oil prices, tighter access to international finance, and weaker prospects for tourism, trade, and real estate related activities. The latter sector may be particularly vulnerable in the wake of an unprecedented credit and asset price boom. With inflationary pressures likely to ease in coming months, managing the vulnerabilities arising from the global downturn has become the key policy challenge.

24. **The foremost task is to safeguard the soundness and functioning of the financial sector.** While credit growth has to slow from the dangerously high pace in recent years, too abrupt a slowdown will have to be avoided to contain damage to corporates and the financial system. In the event of a worse-than-expected downturn, appropriate contingency plans will have to be activated focusing on safeguarding systemically important institutions. Staff encourages close coordination of the policy response to the fallout of the global financial turmoil with other GCC countries, inter alia to prevent regulatory arbitrage.

25. **The government's blanket guarantee of deposits and inter-bank lending for three years and various liquidity facilities demonstrate the willingness and capacity of the government to coordinate action at the federal level.** Going forward, the authorities need to minimize the fiscal costs of the government guarantee, and ensure that safeguards attached to the new facilities are creating adequate incentives for banks to prevent using the liquidity for a further buildup of risky assets, while improving disclosure of and provisioning for any emerging nonperforming loans. Staff welcomes plans to amend the banking law to strengthen the CBU's supervisory and regulatory power, and—under the emergency support facility—to monitor and limit the growth of private credit, particularly for real estate, and to strengthen supervision. Staff also welcomes CBU plans to conduct

in the near future a thorough assessment of banks' balance sheets, as well as off-balance sheet items, and large exposures. This would delineate, among other things, how and when the government would intervene if needed, and help quantify the measures that would be taken to ensure that banks are adequately capitalized. The authorities need to improve the sectoral classification of loans to better capture risky exposures, notably to real estate, in order to allow more accurate sensitivity analysis of bank risks and solvency.

26. **Follow-up measures are needed to manage the risks to the banking system**, such as ensuring (through more frequent on-site visits) compliance with prudential regulations, and enhancing surveillance (off-site) of bank and finance company risk management practices. A more comprehensive set of high frequency liquidity risk management indicators and contingency funding plans should be submitted by banks to the central bank's supervisory units. In addition, there is a need to conduct regular and comprehensive stress-testing to the system. Staff also encourages the authorities to prepare the regular issuance of short-term government paper, which would help banks to hold adequate buffers of highly liquid assets, even when the overall liquidity situation lead to a decreasing supply of central bank CDs.

27. **Inflation has become less of a priority but remains a concern.** While the absence of monthly price data complicates assessment of inflationary trends and the formulation of appropriate policies, anecdotal evidence and global developments indicate that inflationary pressures are receding. Measures such as caps on food price and rent increases involve costly distortions and are unlikely to provide more than temporary support in stemming inflation. Policies to address capacity constraints and improve the economy's absorptive capacity, especially in the housing, construction, and transportation sectors, are likely to be more effective in curbing inflation, even if implementation takes time.

28. **As the main tool of macroeconomic stabilization in the context of the exchange rate peg, fiscal policy needs to balance the objectives of containing inflation with the need to help stabilize growth and employment.** With inflation still high, staff sees a continued need to contain and rationalize current expenditures, notably wages and implicit energy subsidies, and focus investment on infrastructure. Support for public and semi-public corporates should aim to cushion the fallout from the drying up of foreign financing and encourage adjustment to a less-buoyant outlook. Staff welcomes the authorities' intention to refrain from direct interventions to support the housing and stock market; such interventions are distortionary, carry a potentially high fiscal cost, and risk encouraging moral hazard.

29. **Should the economic environment deteriorate much more than expected, a more counter-cyclical fiscal stance may be needed to support growth and employment.** Public investment may have to play a critical role in supporting activity should foreign and private demand weaken more sharply than expected. This would strengthen the case for the coordination of fiscal policies across emirates and the federal level to ensure that the overall fiscal stance will remain supportive of macro-economic stability. Improving the monitoring and planning of the large

investment projects that are carried out by the government and by quasi-public entities outside the budget—along the welcome steps recently taken by Dubai—will also be needed to ensure that overall public investment is consistent with the economy’s absorptive capacity and to better manage currency, interest and maturity risks associated with project financing.

30. **Staff welcomes the authorities’ intention to move ahead with preparations for the introduction of the VAT**, in coordination with other GCC countries. While a 5 percent VAT would cause a modest one-off increase in the price level, it would not have a lasting effect on inflation, but would make the budget less vulnerable to oil price fluctuations.

31. **Establishing reliable and regular statistics of public sector activities is key to assess the fiscal stance and to monitor contingent liabilities.** The Dubai government’s establishment of a Supreme Fiscal Council in 2007 to coordinate government entities’ borrowing is an important step and should be complemented by other initiatives to improve the oversight over public entities’ finances. Greater transparency on public assets and liabilities, notably preparation and publication of the U.A.E.’s IIP, including the assets held by various SWFs, could help shore up investor confidence by clearly signaling that the U.A.E. has the means to help the economy ride out the global storm.

32. **The peg of the dirham to the U.S. dollar remains appropriate provided inflation starts slowing soon, as expected.** The recent strengthening of the U.S. dollar, the easing of energy and commodity prices, and the moderation of speculative pressures have removed some of the factors behind the recent run-up in inflation, although the continued decline in the U.S. policy rate is likely to keep real policy interest rates negative for some time. The peg will provide the benefits of a strong and proven anchor in the stormy weather ahead, outweighing the costs of importing a monetary policy that is not necessarily in line with U.A.E. policy needs.

33. **The U.A.E. dirham remains likely undervalued, given the limited real appreciation that has taken place since 2004, despite large terms of trade gains.** High inflation driven by non-tradable prices also supports this assessment, although the recent strengthening of the U.S. dollar, the partial reversal of terms-of-trade gains, and continued relatively high non-tradables inflation—if sustained—may soon eliminate any undervaluation. Estimates using standard approaches to quantify misalignment are inconclusive, as for other oil exporters, but highlight that sizeable budget and current account surpluses in the coming years are consistent with intertemporal equilibrium, reflecting the need to replace oil wealth at least partly with financial wealth in order to ensure income for future generations.

34. **Efforts to address substantial weaknesses in macroeconomic statistics need to accelerate.** The current international environment, with a reduced appetite for risk, puts a premium on addressing data deficiencies as a matter of priority. The absence of monthly inflation data makes it difficult to formulate meaningful anti-inflationary policies and hampers severely the estimation of reliable real GDP aggregates. Staff encourages the authorities to move ahead with plans to establish a National Bureau of Statistics by mid-2009, to collect and disseminate CPI data on a monthly basis starting in

2009, and to prepare an action plan aimed at developing the legal and technical capacity to collect and publish IIP estimates.

35. **Staff welcomes the U.A.E.'s active participation in the International Working Group of Sovereign Wealth Funds (IWG)** and the U.A.E.'s endorsement of the voluntary principles elaborated by the IWG, that would help support an open and stable international investment climate. It urges the authorities to fully deliver debt relief assistance under the enhanced HIPC initiative.

36. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. United Arab Emirates: Selected Macroeconomic Indicators, 2004–09

(Quota: SDR 611.7 million)
 (Population-2007: 4.49 million)
 (Per capita GDP-2007: \$40,147)

	2004	2005	2006	2007	Proj. 2008	Proj. 2009
Oil and gas sector						
Total exports of oil and gas (in billions of U.S. dollars)	38.0	55.0	70.2	73.8	109.2	80.8
Average crude oil export price (in U.S. dollar per barrel)	36.3	53.6	63.5	70.4	100.5	74.0
Crude oil production (in millions of barrels per day)	2.66	2.68	2.86	2.76	2.91	2.96
(Annual percent change, unless otherwise indicated)						
Output and prices						
Nominal GDP (in billions of AED)	394.1	496.5	602.9	661.7	970.9	937.0
Nominal GDP (in billions of U.S. dollars)	107.3	135.2	164.2	180.2	264.4	255.1
Real GDP (at factor cost)	9.7	8.2	9.4	6.3	7.4	3.3
Real oil and gas GDP	2.9	1.6	6.5	-1.6	3.6	-0.2
Real non-oil GDP	12.6	10.8	10.4	9.1	8.6	4.4
CPI inflation (average)	5.0	6.2	9.3	11.1	12.7	6.7
(In percent of GDP)						
Investment and saving						
Gross domestic investment	21.8	20.0	21.2	23.6	20.5	21.8
Gross national saving	30.9	38.0	43.8	39.6	37.7	30.5
Public	22.6	31.8	40.5	40.7	38.5	29.8
Private	8.3	6.3	3.2	-1.0	-0.9	0.7
(In percent of GDP)						
Public finances						
Revenue	34.2	41.0	49.6	50.4	48.1	41.1
Oil	25.3	30.8	38.1	35.4	39.5	30.3
Non-oil	9.0	10.3	11.5	14.9	8.6	10.8
Expenditure and net lending	24.5	21.0	21.2	25.2	24.9	29.0
Current	20.7	17.0	17.1	19.1	16.4	19.4
Capital	3.7	3.9	4.0	5.8	8.2	9.3
Budget balance	9.7	20.0	28.4	25.2	23.2	12.1
Non-hydrocarbon balance 1/	-22.9	-17.0	-15.0	-15.2	-29.0	-27.4
Non-hydrocarbon balance (excluding investment income, loans, equities and foreign grants) 1/	-28.1	-22.8	-21.3	-20.4	-24.7	-24.7
(Annual percent change, unless otherwise indicated)						
Monetary sector						
Net foreign assets	10.2	14.8	-6.7	3.1	-1.3	43.9
Net domestic assets	49.8	62.2	54.9	66.3	35.7	5.0
Credit to private sector	24.7	44.5	36.9	40.1	39.2	23.9
Broad money	23.2	33.8	23.2	41.7	25.2	13.7
(In billions of U.S. dollars, unless otherwise indicated)						
External sector						
Exports of goods	90.2	117.2	145.7	170.3	259.9	234.0
Oil and gas	38.0	55.0	70.2	73.8	109.2	80.8
Non-oil exports of goods	18.3	22.4	28.5	34.2	59.2	63.8
Imports of goods	-63.3	-74.5	-88.1	-116.6	-176.8	-179.1
Current account balance	9.8	24.3	37.1	29.0	45.4	22.3
Current account balance (in percent of GDP)	9.1	18.0	22.6	16.1	17.2	8.7
Gross official reserves	18.7	21.3	28.0	77.9	38.1	53.5
In months of next year imports of goods and services	2.4	2.3	2.3	4.3	2.1	2.8
Memorandum items:						
Nominal effective exchange rate (2000=100)	91.3	91.0	90.7	87.0	87.0	87.0
Real effective exchange rate (2000=100)	93.6	96.0	101.2	103.6	109.9	111.9
Average exchange rate (AED per dollar)	3.7	3.7	3.7	3.7	3.7	3.7

Sources: U.A.E. authorities; and Fund staff estimates.

1/ In percent of non-hydrocarbon GDP.

Table 2. United Arab Emirates: Balance of Payments, 2004–09

(In billions of U.S. dollars)

	2004	2005	2006	2007	Proj. 2008	Proj. 2009
Current account balance	9.8	24.3	37.1	29.0	45.4	22.3
(In percent of GDP)	9.1	18.0	22.6	16.1	17.2	8.7
Trade balance	26.8	42.7	57.6	53.7	83.2	54.9
Exports	90.2	117.2	145.7	170.3	259.9	234.0
Oil and products	33.3	49.2	63.1	66.1	96.9	71.3
Crude oil & condensates	29.6	43.5	58.1	61.2	89.9	66.2
Petroleum products	3.7	5.8	4.9	4.9	7.0	5.1
Gas	4.7	5.8	7.1	7.8	12.3	9.5
Non-hydrocarbon	18.3	22.4	28.5	34.2	59.2	63.8
Exports by emirates	4.0	5.0	8.0	11.5	19.1	20.6
Free zone exports	14.3	17.4	20.5	22.8	40.1	43.2
Re-exports, of which: 1/	33.9	39.8	47.0	62.3	91.5	89.3
Non-monetary gold	2.3	2.4	2.5	2.6	4.0	4.2
Imports (f.o.b.)	-63.3	-74.5	-88.1	-116.6	-176.8	-179.1
Imports by emirates, of which:	-46.6	-57.3	-67.2	-91.9	-133.2	-133.3
Non-monetary gold	-2.4	-2.5	-2.6	-2.7	-4.2	-4.4
Unrecorded govt. imports	-1.8	-1.9	-2.0	-2.1	-3.1	-3.3
Free zones	-16.7	-17.2	-20.8	-24.7	-43.6	-45.7
Income, net	0.7	2.9	5.7	8.4	3.8	9.1
Government 2/	3.8	6.7	9.2	12.6	8.2	11.0
Services, net	-12.1	-14.6	-18.0	-23.9	-31.0	-30.6
Transfers, net	-5.7	-6.7	-8.2	-9.3	-10.6	-11.1
Private	-5.3	-6.2	-7.6	-8.7	-10.0	-10.5
Official	-0.4	-0.5	-0.6	-0.6	-0.6	-0.6
Financial account balance	-5.3	-14.7	-16.0	29.0	-85.1	-6.9
(in percent of GDP)	-5.0	-10.9	-9.8	16.1	-32.2	-2.7
Private capital	12.5	15.0	23.9	59.0	-55.8	3.4
Direct investment, net	7.8	7.2	1.9	-0.4	-2.1	1.6
Outward	-2.2	-3.8	-10.9	-14.6	-15.8	-4.7
Inward	10.0	10.9	12.8	14.2	13.7	6.4
Portfolio securities, net	2.0	6.1	1.2	1.4	1.9	2.4
Commercial banks	-0.2	-3.4	9.7	48.6	-39.2	-3.6
Private nonbanks and other	2.9	5.1	11.1	9.3	-16.5	2.9
Official capital	-17.8	-29.7	-39.9	-29.9	-29.3	-10.3
Errors and omissions	-1.0	-7.1	-14.4	-8.2	0.0	0.0
(As percent of GDP)	-0.9	-5.3	-8.8	-4.5	0.0	0.0
Overall balance	3.5	2.5	6.6	49.9	-39.7	15.4
Memorandum items:						
Overall balance (as percent of GDP)	3.3	1.8	4.0	27.7	-15.0	6.0
Gross reserves of Central Bank	18.7	21.3	28.0	77.9	38.1	53.5
(In months of imports) 3/	2.4	2.3	2.3	4.3	2.1	2.8
(In months of imports excluding re-exports) 3/	4.1	3.9	3.9	7.4	3.5	4.7

Sources: U.A.E. authorities; and Fund staff estimates.

1/ Not formally compiled; estimated at 50 percent of imports.

2/ Staff projections based on conservative estimates of transfers of earnings of sovereign wealth funds.

3/ Imports of goods and services in the next 12 months.

Table 3. United Arab Emirates: Consolidated Government Finances, 2004–09 1/

	2004	2005	2006	2007	Proj. 2008	Proj. 2009
(In billions of U.A.E. dirhams)						
Total revenue	134.9	203.7	299.0	333.4	467.1	385.4
Hydrocarbon 2/	99.6	152.8	229.4	234.5	383.3	283.8
Non-hydrocarbon	35.3	50.9	69.6	98.9	83.8	101.6
Customs	3.0	3.9	4.6	8.0	6.2	6.3
Profit transfers	3.3	4.6	8.0	7.2	8.9	10.1
Income tax 3/	0.3	0.4	0.6	0.8	1.2	1.0
Fees and charges	7.0	8.8	13.6	15.6	19.0	22.0
Investment income 4/	13.9	24.6	33.7	46.3	30.0	40.5
Other	7.7	8.6	9.2	21.0	18.5	21.6
Total expenditure and grants	96.6	104.4	127.7	166.9	242.0	271.6
Current expenditure	81.4	84.3	103.1	126.6	159.7	181.7
Wages and salaries 5/	16.0	15.9	17.7	21.3	27.5	31.3
Goods and services	28.3	25.5	26.4	36.9	50.2	56.9
Abu Dhabi "federal services" 6/	23.8	22.8	25.3	31.3	40.4	46.8
Subsidies and transfers 7/	12.3	19.4	32.7	35.7	39.7	44.6
Other	1.0	0.8	1.0	1.4	1.9	2.1
Development expenditure	15.1	14.0	15.2	17.3	28.8	32.7
Loans and equity (net) 8/	-0.5	5.1	9.0	20.8	50.8	54.0
Foreign grants 9/	0.6	1.0	0.4	2.3	2.8	3.2
Abu Dhabi	0.6	1.0	0.4	2.1	2.6	3.0
Federal	0.0	0.0	0.0	0.1	0.1	0.2
Overall balance (consolidated)	38.4	99.3	171.3	166.4	225.1	113.7
Financing	-38.4	-99.3	-171.3	-166.4	-225.1	-113.7
Bank financing, net	-1.8	-16.0	-4.6	-9.5	-71.5	-59.6
Non-bank financing	-36.6	-83.2	-166.8	-156.9	-153.6	-54.2
(In percent of GDP)						
Total revenue	34.2	41.0	49.6	50.4	48.1	41.1
of which hydrocarbon	25.3	30.8	38.1	35.4	39.5	30.3
Total expenditure and grants	24.5	21.0	21.2	25.2	24.9	29.0
Current	20.7	17.0	17.1	19.1	16.4	19.4
Development	3.8	2.8	2.5	2.6	3.0	3.5
Overall balance (consolidated)	9.7	20.0	28.4	25.2	23.2	12.1
Non-hydrocarbon balance	-15.5	-10.8	-9.6	-10.3	-16.3	-18.2
Non-hydrocarbon balance (excluding investment income)	-19.1	-15.7	-15.2	-17.3	-19.4	-22.5
(In percent of non- hydrocarbon GDP)						
Total revenue	50.5	64.6	77.3	74.3	85.7	62.1
of which hydrocarbon	37.3	48.4	59.3	52.3	70.3	45.7
Total expenditure and grants	36.1	33.1	33.0	37.2	44.4	43.8
Current	30.5	26.7	26.7	28.2	29.3	29.3
Development	5.6	4.5	3.9	3.9	5.3	5.3
Overall balance (consolidated)	14.4	31.5	44.3	37.1	41.3	18.3
Non-hydrocarbon balance	-22.9	-17.0	-15.0	-15.2	-29.0	-27.4
Non-hydrocarbon balance (excluding investment income, loans, equities and foreign grants)	-28.1	-22.8	-21.3	-20.4	-24.7	-24.7
Memorandum items:						
Hydrocarbon share of revenue (in percent)	73.8	75.0	76.7	70.3	82.1	73.6
Balance on pension fund operations (billion dirham) 10/	3.5	3.6	0.8	...	...	...

Sources: Federal government; Emirate finance departments; and Fund staff estimates.

1/ Consolidated accounts of the federal government, Abu Dhabi, Dubai and Sharjah.

2/ Includes staff estimates of revenues from other government entities operating in the oil and gas sector.

3/ Taxes on profit of foreign banks. Income taxes on gas companies are included under hydrocarbon revenues.

4/ Staff estimates. Projections are based on conservative estimates of transfers of earnings of sovereign wealth funds.

5/ Excludes military wages and salaries.

6/ Largely military and internal security expenditures paid by Abu Dhabi but not in the federal accounts.

7/ Includes government's contribution to the pension fund in 2005 of AED 6.2 billion, and transfers made directly by the office of the Abu Dhabi's ruler in 2006 of about AED 8 billion.

8/ Includes 2006 purchase of telecom company (Etisalat) shares (AED 2 billion); part of which were divested following the IPO.

The 2006 and 2007 figures also include the Abu Dhabi government's equity contributions to state-owned enterprises before converting them to joint-stock companies.

9/ Intragovernmental grants are netted out in the consolidated fiscal accounts.

10/ Operations of the General Pension and Social Security Authority, which was established in 2000.

Table 4. United Arab Emirates: Monetary Survey, 2004–09 1/

	2004	2005	2006	2007	Proj. 2008	Proj. 2009
	(In billions of U.A.E. dirhams)					
Net foreign assets	145	167	156	160	158	228
Foreign assets	195	253	335	483	360	429
Central Bank	69	78	103	286	140	196
Commercial banks 1/	126	175	232	197	220	233
Foreign liabilities	49	86	179	322	201	201
Central bank	1	1	1	1	1	1
Commercial banks 1/	49	85	178	321	200	200
Net domestic assets	97	157	244	405	550	578
Claims on government (net)	-31	-47	-52	-61	-130	-189
Claims	31	44	55	69	81	80
Deposits	62	91	107	131	211	270
Claims on public sector enterprises	14	25	33	45	58	70
Claims on private sector 2/	211	306	418	586	816	1,010
Capital and reserves (-)	-54	-80	-106	-132	-176	-233
Other assets (net)	-43	-46	-50	-32	-18	-80
Central Bank	-39	-48	-65	-241	-60	-108
Commercial banks 1/ of which, certificates of deposits	-4 16	2 21	15 32	209 174	42 62	28 64
Broad Money (M2)	242	324	399	566	708	806
Money	81	104	120	182	202	226
Currency outside banks	16	18	22	26	29	32
Dirham demand deposits	65	87	98	156	173	193
Quasi-money	161	220	279	384	506	580
	(Changes in percent of Initial M2 Stock)					
Memorandum items:						
Net foreign assets	6.9	8.9	-3.4	1.2	-0.4	9.8
NFA, central bank	6.5	3.7	7.5	45.9	-25.8	8.0
NFA, commercial banks	0.3	5.2	-11.0	-44.7	25.4	1.9
Net domestic credit	20.9	36.7	35.9	42.8	30.6	20.8
Claims on government (net)	-0.9	-6.6	-1.4	-2.4	-12.1	-8.4
Claims on public sector enterprises	0.5	4.5	2.5	3.1	2.2	1.7
Claims on private sector 2/	21.3	38.9	34.7	42.0	40.6	27.5
	(Changes in percent; unless otherwise indicated)					
Claims on private sector 2/	24.7	44.5	36.9	40.1	39.2	23.9
Broad Money (M2)	23.2	33.8	23.2	41.7	25.2	13.7
Money	38.7	29.2	14.9	51.4	11.1	11.8
Quasi Money	16.7	36.0	27.2	37.5	31.9	14.5
Velocity (non-oil GDP/M2)	1.10	0.97	0.97	0.79	0.77	0.77
Base money	27.0	14.2	22.3	70.0	33.2	29.2
Money multiplier (M2/base money)	6.2	7.3	7.4	6.1	5.8	5.1

Sources: Central Bank of the U.A.E., and Fund staff estimates.

1/ Including the restricted license bank.

2/ Includes non-bank financial institutions.

Table 5. United Arab Emirates: Medium-Term Baseline Scenario, 2006–13

	2006	2007	Projections					
			2008	2009	2010	2011	2012	2013
Crude oil production (millions of barrels per day) 1/	2.86	2.76	2.91	2.96	3.02	3.11	3.26	3.39
<i>Of which:</i> Condensates	0.29	0.23	0.29	0.34	0.33	0.32	0.34	0.34
Crude oil exports (millions of barrels per day) 1/	2.50	2.36	2.45	2.45	2.51	2.60	2.72	2.85
Average U.A.E. oil export price (in U.S. dollars per barrel) 2/	64	70	101	74	80	83	85	85
			(Percentage change, except as noted)					
Nominal GDP (in billions of U.S. dollars)	164.2	180.2	264.4	255.1	286.9	319.8	351.9	379.8
Real GDP (at factor cost)	9.4	6.3	7.4	3.3	4.2	5.1	5.4	5.4
Crude oil and natural gas 3/	6.5	-1.6	3.6	-0.2	2.7	3.7	4.7	4.7
Non-hydrocarbon 4/	10.4	9.1	8.6	4.4	4.6	5.5	5.6	5.6
Consumer prices (annual average)	9.3	11.1	12.7	6.7	6.2	5.7	4.6	2.9
			(In percent of GDP)					
National saving	43.8	39.6	37.7	30.5	34.2	35.7	36.7	37.6
Government	40.5	40.7	38.5	29.8	30.7	29.7	29.0	28.2
Non-government	3.2	-1.0	-0.9	0.7	3.5	6.0	7.7	9.4
Gross domestic investment	21.2	23.6	20.5	21.8	21.8	22.0	22.1	22.2
Government	9.1	9.7	9.6	11.3	11.2	11.2	11.2	11.2
Non-government	12.1	13.9	10.9	10.5	10.6	10.8	10.9	11.0
			(In percent of GDP)					
Consolidated fiscal accounts								
Revenue	49.6	50.4	48.1	41.1	41.9	40.9	40.2	39.4
Hydrocarbon	38.1	35.4	39.5	30.3	29.9	28.9	28.1	27.2
Non-hydrocarbon	11.5	14.9	8.6	10.8	12.0	12.0	12.1	12.1
<i>Of which:</i> Investment income	5.6	7.0	3.1	4.3	5.5	5.4	5.3	5.3
Expenditure, <i>of which:</i>	21.2	25.2	24.9	29.0	25.9	26.2	26.5	26.8
Current	17.1	19.1	16.4	19.4	19.5	19.8	20.1	20.4
Development	2.5	2.6	3.0	3.5	3.5	3.5	3.5	3.5
Overall balance	28.4	25.2	23.2	12.1	16.0	14.7	13.7	12.6
Non-hydrocarbon balance 5/	-21.3	-20.4	-24.7	-24.7	-24.7	-24.6	-24.6	-24.5
			(In percent of GDP)					
External accounts								
Exports	88.7	94.5	98.3	91.7	88.2	85.1	82.8	81.7
Imports, f.o.b.	-53.6	-64.7	-66.9	-70.2	-65.6	-62.5	-60.3	-59.3
In percent of domestic absorption	-70.7	-77.6	-83.3	-77.6	-74.2	-71.2	-69.0	-68.1
In percent of non-oil GDP	-83.6	-95.5	-119.0	-106.0	-98.5	-92.4	-87.9	-85.6
Services (net)	-11.0	-13.2	-11.7	-12.0	-11.0	-10.4	-9.9	-9.6
Investment income (net)	3.4	4.7	1.4	3.6	5.1	5.2	5.5	5.9
Transfers (net)	-5.0	-5.2	-4.0	-4.4	-4.2	-3.8	-3.6	-3.4
Current account balance	22.6	16.1	17.2	8.7	12.4	13.7	14.6	15.4
Overall balance	4.0	27.7	-15.0	6.0	1.5	9.0	1.5	0.0
Central bank reserves	17.0	43.2	14.4	21.0	20.2	27.1	26.2	24.2
In months of next year imports of goods and services	2.3	4.3	2.1	2.8	2.8	4.0	4.0	4.0
External debt	50.2	74.0	32.8	35.2	34.4	34.0	34.0	34.6
Real Effective Exchange Rate (2000=100)	101.2	103.6	109.9	111.9	114.4	116.9	118.2	117.6
Nominal Effective Exchange Rate (2000=100)	90.7	87.0	87.0	87.0	87.0	87.0	87.0	87.0

Sources: U.A.E. authorities; and Fund staff estimates and projections

1/ Includes condensates, which are not subject to the OPEC quota.

2/ Based on September, 2008 World Economic Outlook oil price projections.

3/ Crude oil output includes condensates.

4/ Includes refined oil products and gas liquification.

5/ Excludes investment income, loans, equities and foreign grants. In percent of non-hydrocarbon GDP.

Table 6. United Arab Emirates: Selected Indicators of External Vulnerability, 2004–07

	2004	2005	2006	2007
External solvency indicators				
REER (CPI-based, percent change, annual average)	-2.7	2.5	5.4	2.4
Total external debt (in billions of U.S. dollars)	24.9	41.0	82.3	133.3
Total external debt / GDP (percent)	23.2	30.3	50.2	74.0
Public sector solvency indicators (in percent)				
Overall fiscal balance/GDP	9.7	20.0	28.4	25.2
Government domestic debt/GDP	8.2	9.2	10.0	11.2
Oil revenue/total revenue	73.8	75.0	76.7	70.3
Investment income/total revenue	10.3	12.1	11.3	13.9
Non-oil revenue (excl. investment income)/non-oil GDP	8.0	8.3	9.3	11.7
Non-oil balance/GDP	-15.5	-10.8	-9.6	-10.3
External Liquidity Indicators				
Central Bank foreign assets (in billions of U.S. dollars)	18.7	21.3	28.0	77.9
In months of imports of goods and services	2.4	2.3	2.3	4.3
As percent of M1	84.8	74.8	85.5	157.4
As percent of commercial banks foreign liabilities	140.5	91.7	57.8	89.1
Commercial banks' NFA (in billions of U.S. dollars)	21.1	24.5	14.8	-33.8
Foreign assets	34.3	47.7	63.2	53.6
Foreign liabilities	13.3	23.2	48.4	87.4
Crude oil exports/total exports (in percent)	32.8	37.1	39.9	35.9
Financial sector indicators				
Foreign currency deposits/total deposits (in percent)	27.6	24.1	25.5	16.9
Net domestic assets (annual change in percent)	49.8	62.2	54.9	66.3
Private sector credit (annual change in percent)	24.7	44.5	36.9	40.1
Private credit/total assets of banks (in percent)	48.9	50.2	50.7	49.8
Interest rate spread against U.S. dollar (in basis points) 1/	0.1	0.2	-0.2	-0.8
Banking system indicators (in percent)				
Commercial banks' capital to risk-weighted assets ratio	16.9	17.4	16.6	14.0
Gross non-performing loans to total loans	12.5	8.3	6.3	2.9
Return on assets	2.1	2.7	2.3	2.0
Return on equity	18.6	22.5	18.0	19.3

Sources: U.A.E. authorities; and Fund staff estimates.

1/ Spread between 28 days certificate of deposits and 1-month U.S. dollar LIBOR.

Table 7. United Arab Emirates: Financial Sector Indicators, 2003–08

(In percent, unless otherwise indicated)

	2003	2004	2005	2006	2007	<u>June</u> <u>2008</u>
<i>Core indicators</i>						
Deposit-taking institutions						
Total regulatory capital to risk-weighted assets 1/	18.6	16.9	17.4	16.6	14.0	13.3
Regulatory Tier I capital to risk-weighted assets	18.2	16.3	16.9	15.0	12.4	11.9
Nonperforming loans net of provisions to capital	7.7	3.5	1.8	0.6	0.0	0.0
Nonperforming loans to total gross loans	14.3	12.5	8.3	6.3	2.9	2.5
Return on assets	2.3	2.1	2.7	2.3	2.0	2.3
Return on equity	16.4	18.6	22.5	18.0	19.3	10.3
Interest margin to gross income	59.5	64.6	49.3	29.3	32.4	37.7
Noninterest expenses to gross income	43.6	40.3	26.9	20.9	21.4	24.4
Liquid assets to total assets	22.7	23.2	26.9	16.4	13.2	8.6
<i>Encouraged indicators</i>						
Deposit-taking institutions						
Capital to assets	11.4	11.1	11.9	12.6	15.5	11.0
Personnel expenses to noninterest expenses	29.5	38.6	41.8	54.6	55.1	57.9
Customer deposits to total (non-interbank) loans	125.0	113.6	112.4	96.5	99.7	93.7
Households						
Household debt to GDP	6.6	6.1	6.9	5.2	6.0	...
Real estate loans to total loans	5.4	4.7	5.0	5.9	8.3	10.0
<i>Other indicators</i>						
Loan loss reserves/non-performing loans	88.5	94.6	95.7	98.2	100.0	101.5
Deposits as percent of M2	118.4	119.9	126.4	130.0	127.3	123.8
Commercial banks loans to private sector as percent of total deposits	70.9	70.5	70.8	60.4	61.5	67.3
Number of commercial banks (end-of-period)	46	46	46	46	48	50
Number of banks with C.A.R. above 10 percent	46	46	46	46	48	50
Foreign currency deposits as percent of M2	40.3	39.6	44.5	47.0	34.3	31.4
Foreign currency denominated lending/total lending	23.9	20.7	19.7	22.8	20.8	18.9
Earning per employee (in millions of AED)	0.40	0.50	0.70	0.7	0.8	0.9

Source: Central Bank of the United Arab Emirates.

1/ BIS Tier I plus Tier II Capital (net of deductions).

INTERNATIONAL MONETARY FUND

UNITED ARAB EMIRATES

2008 Article IV Consultation

Informational Annex

Prepared by the Middle East and Central Asia Department

December 2, 2008

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APPENDIX I: UNITED ARAB EMIRATES—FUND RELATIONS

(As of October 31, 2008)

I. Membership Status: Joined 9/22/72; accepted Article VIII status in February 1974.

II. General Resources Account:	SDR Million	Percent of Quota
Quota	611.70	100.00
Fund holdings of currency	568.86	93.00
Reserve position in Fund	43.42	7.10

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	38.74	100.00
Holdings	11.01	28.42

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Payments to Fund:

(SDR million; based on existing use of resources and present holdings of SDRs):

	2008	Forthcoming			
		2009	2010	2011	2012
Principal charges/ Interest	0.18	0.53	0.53	0.53	0.53
Total	0.18	0.53	0.53	0.53	0.53

VII. Implementation of HIPC Initiative: Not Applicable

VII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Exchange Rate Arrangement:

The U.A.E. dirham was officially pegged to the SDR at the rate of AED 4.76190 = SDR 1 from November 1980 to February 2002—albeit de facto it was pegged to the dollar at a fixed parity. Since then, in line with commitments agreed on with other GCC countries toward the adoption of a common currency in 2010, the U.A.E. dirham has become also de jure pegged to the U.S. dollar. The mid-point between the official buying and selling rates for the dirham has been AED 3.6725 = \$1 since November 1997.

X. Exchange System

The U.A.E.'s exchange system is free of restrictions on the making of payments and transfer for current international transactions, except for those restrictions that are yet to be notified to the Fund, by the authorities, in accordance with Executive Board Decision No. 144 (52/51).

XI. Article IV Consultation

The last Article IV consultation, Statistical Appendix, and Financial System Stability Assessment reports (IMF Country Reports No. 07/347, 07/348, and 07/357) were discussed by the Executive Board on September 21, 2007.

XI. Technical Assistance:

STA	Multi-sector	June 1993
FAD	Government financial management	June 1994
STA	Data collection and balance of payments	December 1995
STA	Terms of reference and arrangements for resident advisor in balance of payments	April 1997
STA	International reserves	May 1998
FAD	Public Expenditure Management	November 2000
FAD	Public Expenditure Management follow up	May 2003
STA	Multi-sector	December 2003
MFD	Anti-Money Laundering/Combating terrorist financing	March 2004
STA	Coordinated Portfolio Investment Survey	April 2004
FAD	Revenue Diversification and VAT Feasibility	November 2005
FAD	Public Financial Management	November 2005
FAD	Gulf Cooperation Council: Options for Indirect Taxation	March 2006
FAD	U.A.E.: Options for New Indirect Taxation and Intergovernmental Fiscal Relations	March 2006
STA	Compilation of a high-frequency CPI Index	March 2007
STA	Multi-sector	April 2008

XII. Resident Representative: None.

APPENDIX II: UNITED ARAB EMIRATES—RELATIONS WITH THE WORLD BANK GROUP

As of November 19, 2008

The World Bank

- **Investment Climate.** In response to a request from the advisor to the Crown Prince of Ras Al Khaimah (RAK) for assistance in the area of Foreign Investment and Economic Development, a World Bank mission visited the emirate in late February 2004. Following discussion in RAK, the Bank team prepared TORs for the first of a four-phase program, and an agreement was signed in late March. The second phase, consisting in an assessment of the investment climate in RAK, was followed by an Investors' Promotion Conference in May 27–28, 2005 to increase awareness that this emirate could quickly develop as a serious contender for investment destination.
- The World Bank jointly with the IMF, conducted an update of the FSAP in January 2007.
- An implementation program program is currently under development. It is expected to include drafting of a federal public debt law, designing a debt management unit setup, and conducting a debt market infrastructure assessment.

International Finance Corporation (IFC)

IFC continues to provide ad hoc support to the U.A.E. at the federal and local levels through its regional office in Dubai.

APPENDIX III: UNITED ARAB EMIRATES—STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance. Shortcomings in the economic and financial data reflect inadequate compilation techniques, infrequent data reporting, shortage of trained staff, insufficient resources assigned to data gathering, and poor information flow between federal and emirate governments and public sector entities. As a result, provision of data to the Fund between missions remains poor, except for monetary and fragmentary trade statistics. The frequency of official statistics is inadequate—most data are produced only on an annual basis. Despite recent institutional improvements further efforts are needed to build a strong, comprehensive, and consistent statistical system.
2. On July 1, 2007, the Cabinet approved the creation of the National Bureau of Statistics (NBS), which will undertake the current statistical functions and responsibilities of the Ministry of Economy (MOE). The 1974 Statistical Law was revised and the draft of a new federal statistics law, which explicitly refers to the NBS, was approved in October 2008.
3. An April 2008 multisector/GDDS mission addressed institutional issues regarding the development of the federal statistical system, provided technical assistance on macroeconomic statistics, and promoted the adoption of the GDDS. On July 31, 2008, the country began participation in the GDDS.

Real sector statistics

4. The analytical framework underlying the national accounts broadly conforms to the *1968 SNA*. GDP is estimated by the production approach for both constant and current prices. Only current price expenditure estimates of GDP are available. GDP is compiled annually with a lag of around 18 months. Most of the estimates are based on indicator series that are applied to historical benchmarks. The year of the benchmarks is not known—year on year growth in the indicator series are applied to the previous year's value. Since the 2003 multisector mission, the MOE has updated the base year for the constant price estimates from 1995 to 2000. Currently, the authorities are working on compiling volume measures of GDP at 2007 prices. Some progress has been made in improving the source data. Annual establishment surveys are being implemented for Abu Dhabi and Dubai. The results of the 2007/08 Household Income and Expenditure Survey (HIES) have yet to be incorporated into the national accounts. A business register covering the whole country has been set up, but further work is needed to establish appropriate updating procedures. No progress has been made in the development of quarterly indicators.
5. The current market basket CPI weights are derived from the 1996/97 HIES for Abu Dhabi. The reference base for the index is year 2000. Prior to year 2000 the index was compiled using market basket weights derived from HIES data from Kuwait and Qatar. In general, the concepts and definitions used for compiling the CPI are consistent with

internationally recommended standards, using the Laspeyres index. The CPI employs a national classification system with a level of detail consistent with the five digit level of the Classification of Individual Consumption by Purpose for Household Budget Surveys. The index is compiled for 620 market basket goods and services, 144 subgroups, 55 groups, and 8 major groups. The annual CPI for the previous calendar year is disseminated in March or April of each year. For the period 2000 to the present, annual indices for eight major groups and 55 groups are published for Abu Dhabi, Dubai, Sharjah, Ras Khaima and the whole country.

6. In response to a request from the authorities, STA conducted a CPI mission in March 2007 and agreed on a two-year work plan to develop a monthly CPI in accordance with international standards. From January 2007, the current CPI is compiled on a monthly basis, but only the annual index is disseminated. Monthly indices for 2007 are recompiled using the 2007/08 HIES market basket weights. It is planned that these indices along with monthly indices for 2008 will be disseminated when the new CPI is published in January 2009. This would avoid having two sets of monthly indices published for 2007 and 2008.

7. Although labor statistics collected in the census are broadly in line with ILO recommendations, certain divergences remain. Lack of regular household surveys prevents compilation of labor force statistics such as wages, unemployment, labor force and employment. Wage statistics are available for a small proportion of government employees. An employment/wages survey was launched recently, but data are not yet available for dissemination.

Government Finance Statistics (GFS)

8. The Ministry of Finance compiles data for the federal government only, which is fairly small in comparison with the emirate governments. In addition, these data exclude a large number of federal autonomous bodies and transactions undertaken by Abu Dhabi on behalf of federal government. Separate fiscal data on the federal government and three emirates (Abu Dhabi, Dubai, and Sharjah), which are provided to the Article IV consultation mission, are used by Fund staff to provide a consolidated fiscal account for the U.A.E. The MOE compiles annual general government fiscal data using aggregate information received from the MOF and the seven emirates. An annual, "consolidated" fiscal statement is published in the central bank's *Statistical Bulletin*, which is different from the Fund staff presentation. Most notably, investment income from government assets is not included in the fiscal statement. In addition, key information, such as investment income, and expenditure under the control of the respective Rulers' Offices and municipalities, remains off-budget in some emirates, hindering comparison of fiscal developments across the emirates and the federal government. International standards of economic classification of expenditure and revenue are not fully followed.

9. To address some of these issues, the 2008 multisector mission recommended that the compilation of consolidated general government GFS be made a high priority. The new budget economic classification of the federal government is broadly consistent with the

GFSM 2001, although there are some exceptions, notably regarding the recording of transactions in assets and liabilities. To this end, the 2008 mission recommended that the federal government introduce a more comprehensive framework that would allow the derivation of more analytic balances. It also recommended that the compilation and dissemination of public and publicly guaranteed debt should be considered in the near future.

10. The last data reported to STA for publication in the *Government Finance Statistics Yearbook* refer to 1999 and cover only the federal government. No financing information is provided by either the federal authorities or any of the emirates. No sub-annual data are reported for publication to the IMF's *International Financial Statistics (IFS)*. Information on pension fund activities administered by the authorities through the federal-level General Pension and Social Security Authority (GPSSA) has been available since the 2002 consultation mission.¹

Monetary and Financial Statistics

11. The analytical framework underlying the compilation of monetary statistics is generally sound and conforms broadly with the methodology in the *Monetary and Financial Statistics Manual (MFSM)*. Monetary data are compiled monthly but disseminated quarterly in the Central Bank of the United Arab Emirates (CBU) *Quarterly Statistical Bulletin* and website, with a timeliness of about three or four months after the end of the reference month. No information on nonbank finance companies are provided to the Fund.

12. The country participated in the 2006 workshop on the harmonization of monetary and financial statistics in the Gulf Cooperation Council region. As a result, test data based on the Standardized Report Forms (SRFs) for the central bank (Form 1SR) and other depository corporations (Form 2SR) were compiled for December 2005. The 2008 multisector mission recommended that the CBU adopt the *MFSM/SRF* methodological framework for regularly compiling and reporting monetary data to the IMF. The mission also recommended further improvements concerning the statistical treatment of IMF accounts, sectorization of the domestic economy, valuation procedures, and timeliness of the monetary statistics.

External sector statistics

13. Staffing for compilation of balance of payments statistics is insufficient and cooperation between the U.A.E. Central Bank and other government agencies remains inadequate. The coverage of transactions of the nonfinancial private sector (other than merchandise trade) is particularly sparse, and full reporting of public sector transactions is not ensured. Although the economic environment has changed significantly, many estimates are still based on outdated assumptions.

¹ The GPSSA was established in January 1999 to provide pension and social security insurance benefits to all nationals working in the government and the private sectors (except Abu Dhabi government employees which have their own separate pension fund).

14. The country does not report balance of payments (BOP) data for publication in *IFS* or *BOPSY*. Trade statistics have been reported irregularly.

15. The 2008 multisector mission found that a lack of reliable source data seriously impedes the accuracy of the balance of payments statistics compiled by the CBU. A foreign direct investment (FDI) survey conducted by the MOE is the main improvement in terms of source data. The 2008 mission concluded that it was both necessary and feasible that the CBU start disseminating monthly data on international reserves on their website. It should be noted that the authorities report monthly data on international liquidity for publication in *IFS*; international reserves are included in these data. Furthermore, the authorities should begin developing and publishing estimates of the international investment position and external debt statistics based on the FDI survey, a proposed new external debt survey among large companies, and other information available. At the authorities request, in early 2009 STA will field a BOP TA mission.

Socio-demographic statistics

16. The MOE leads in conducting the population census and large surveys, while line ministries collect data through their administrative reporting systems. A population and housing census is conducted every 10 years. A population census was completed in 2005. At present, no data exist on measures of income distribution, poverty and access to basic services. A Household Budget Survey was initiated in April 2007.

United Arab Emirates: Table of Common Indicators Required for Surveillance

As of November 19, 2008

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	08/08	09/08	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	08/08	011/08	M	Q	Q
Reserve/Base Money	08/08	11/08	M	Q	Q
Broad Money	08/08	11/08	M	Q	Q
Central Bank Balance Sheet	08/08	11/08	M	Q	Q
Consolidated Balance Sheet of the Banking System	08/08	11/08	M	Q	Q
Interest Rates ²	11/08	11/08	D	D	D
Consumer Price Index	2007	10/08	A	A	A
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2007	10/08	A	A	A
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	2007	10/08	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	2007	10/08	A	A	A
External Current Account Balance	2007	10/08	A	A	A
Exports and Imports of Goods and Services	2007	10/08	M	A	A
GDP/GNP	2007	10/08	A	A	A
Gross External Debt	...	...	NA	NA	NA
International Investment Position ⁶	...	...	NA	NA	NA

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 09/47
FOR IMMEDIATE RELEASE
April 13, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with the United Arab Emirates

On January 9, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United Arab Emirates.¹

Background

The United Arab Emirates (U.A.E.) macroeconomic performance during 2007–08 was strong, with growth especially in the construction and services sectors and despite some slowdown in the last quarter of 2008, due to the global crisis. Annual average inflation accelerated, driven by domestic demand pressures (especially rents) and higher import prices (such as prices of food, building materials and skilled and unskilled workers). Higher oil prices contributed to large external current account and fiscal surpluses in both 2007 and 2008.

However, the outlook for 2009 and beyond has become more clouded, as the U.A.E. has been adversely affected by the turmoil in global financial markets. This is evident in a widening of sovereign risk spreads and a sharp downturn in stock markets—most pronounced for real estate companies. Large private capital inflows, driven by expectations of an appreciation of the dirham vis-à-vis the U.S. dollar, largely reversed over the summer of 2008; currency futures indicate that markets no longer doubt the peg. Foreign financing for many corporates has tightened, and a slowdown in real estate and construction seems underway. The global weakening will reduce demand for tourism, trade, and financial services, while lower oil prices may affect public spending. Growth in the non-oil economy is expected to slow down considerably, while inflationary pressures should recede.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The U.A.E. banking system appears adequately capitalized and highly profitable, but risks have risen. Banks' assets and profits increased sharply in 2007 and the capital adequacy ratio stood at 13.3 percent by mid-2008, above the regulatory minimum of 10 percent, though somewhat below the level of 2007. However, the fast pace of growth of consumer and real estate loans along with the uncertain outlook for asset prices has raised the risk of a future increase in nonperforming loans (NPLs). Capital outflows, and growing concerns about counterparty risk, have in recent months affected the functioning of the interbank market.

Money and private sector credit growth accelerated further in the first nine months of 2008, and liquidity became tight in late summer. Credit to the private sector rose by 51 percent (year-on-year) in September 2008, up from 40 percent in December 2007, with demand driven by the economic boom and highly negative real interest rates. In mid-2008, the central bank took several steps to address a drying-up of liquidity following the outflow of foreign deposits. Subsequently, to preempt spillovers from the global turmoil, the government issued a blanket guarantee for deposits and inter-bank lending for three years, and put in place a \$19 billion emergency liquidity support fund to provide banks with long-term funding.

The short and medium-term outlook is subject to a number of downside risks arising from the difficult global environment as well as domestic financial vulnerabilities in the wake of the recent real estate and credit boom (especially in Dubai). The main risks to the outlook stem from (i) a more severe global weakening; (ii) further tightening of foreign financing for investment projects; (iii) an increase in the demand for domestic financing adding to banks' stress; (iv) a correction in the real estate market leading to a deterioration of asset quality in financial institutions; (v) a drop in oil prices that constrains the scope for fiscal policy to support growth; and (vi) an unexpected re-emergence of inflationary pressures.

Executive Board Assessment

Executive Directors commended the authorities of the U.A.E. for their outward-oriented development strategy and the impressive performance of the economy in recent years. The U.A.E.'s open economy and established linkages with international financial markets have played a key role in economic diversification and strong growth, but also make the U.A.E. vulnerable to the current global financial turbulence. They referred in this context in particular to the potential impact on external balances and growth through lower oil prices, more constrained access to international financial markets, and weaker prospects for tourism, trade, and real estate. Against that background, and taking into account the likelihood of an easing of inflationary pressures in coming months, Directors agreed that managing the impact of the global downturn and safeguarding financial stability have become the authorities' key policy challenges. Noting that it may be useful to coordinate the U.A.E.'s response to the economic crisis with that of other Gulf Cooperation Council (GCC) members, Directors welcomed the progress made toward coordinating monetary policies indicated by the recent establishment of the GCC Monetary Council.

Directors emphasized the importance of safeguarding the soundness and functioning of the financial sector, while facilitating a smooth and orderly deceleration in credit growth from an

unsustainable pace. They welcomed the actions taken to guarantee deposits and inter-bank lending for three years, and to establish liquidity facilities. They cautioned, however, that contingency plans for a worse-than-expected downturn should focus on safeguarding only systemically important institutions. Going forward, the fiscal costs of assistance to the financial sector will need to be minimized, and incentives provided to prevent a buildup of risky assets.

Directors welcomed the plans to amend the banking law to strengthen the central bank's supervisory and regulatory power and to launch a thorough review of banks' balance sheets, off-balance sheet items, and large exposures. They urged the authorities to improve the classification of loans in order better to assess risks, and to strengthen surveillance over bank and finance company risk management practices.

Directors concurred with the authorities on the need to maintain essential ongoing infrastructure investments to boost productive potential, while reining-in commitments for new projects and rationalizing subsidies. They emphasized that any financial support for corporates should aim to cushion the fallout from the drying up of foreign financing and promote adjustment to a less-buoyant outlook. Directors agreed that if the economic environment deteriorates more than expected, a more active countercyclical fiscal stance would be called for to support growth and employment. Directors welcomed the establishment of the Federal Council to Coordinate Fiscal Policy, aimed at coordinating budgets and expenditures between the emirates and at the federal level and ensuring that the U.A.E.'s overall fiscal stance safeguards macroeconomic stability. They supported plans to introduce a VAT over the next 2–3 years, which would make the budget less vulnerable to oil price fluctuations.

Directors agreed that the exchange rate peg of the dirham to the U.S. dollar remains appropriate, providing a strong and proven anchor in the stormy economic conditions that may lie ahead. They took note of the staff assessment that the real appreciation of the dirham in 2008 and the ongoing reversal of terms-of-trade gains with the recent drop in oil prices may have eliminated any dirham undervaluation.

Directors welcomed the U.A.E.'s participation in the General Data Dissemination System. They looked forward to the establishment of a National Bureau of Statistics, as planned, and the dissemination of monthly CPI data in 2009. They encouraged the authorities to continue to strengthen national accounts and public sector statistics. Directors emphasized that greater transparency on public financial assets and liabilities could help shore up investor confidence.

Directors welcomed the U.A.E.'s active participation in the International Working Group on Sovereign Wealth Funds (IWG) and its endorsement of the IWG's voluntary principles to promote an open and conducive climate for international investment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2008 Article IV Consultation with the United Arab Emirates is also available.

United Arab Emirates: Selected Macroeconomic Indicators, 2005–09 1/

	2005	2006	Est. 2007	Proj. 2008	Proj. 2009
Output and prices	(Annual percent change, unless otherwise indicated)				
Nominal GDP (in billions of AED)	496.5	602.9	661.7	970.9	936.6
Nominal GDP (in billions of U.S. dollars)	135.2	164.2	180.2	264.4	255.0
Real GDP (at factor cost)	8.2	9.4	6.3	7.4	3.3
Real oil and gas GDP	1.6	6.5	-1.6	3.6	-0.2
Real non-oil GDP	10.8	10.4	9.1	8.6	4.4
CPI inflation (average)	6.2	9.3	11.1	12.7	6.7
Public finances	(In percent of GDP, unless otherwise indicated)				
Revenue	41.0	49.6	50.4	48.1	41.1
Oil	30.8	38.1	35.4	39.5	30.3
Non-oil	10.3	11.5	14.9	8.6	10.8
Expenditure and net lending	21.0	21.2	25.2	24.9	29.0
Budget Balance	20.0	28.4	25.2	23.2	12.1
Non-hydrocarbon balance (excluding investment income) 2/	-24.8	-23.7	-25.5	-34.5	-33.9
Monetary sector	(Annual percentage change)				
Credit to private sector	44.5	36.9	40.1	39.2	23.9
Broad money	33.8	23.2	41.7	25.2	13.7
External sector	(In billions of U.S. dollars, unless otherwise indicated)				
Exports of goods	117.2	145.7	170.3	259.9	234.0
Oil and gas	55.0	70.2	73.8	109.2	80.8
Imports of goods	-74.5	-88.1	-116.6	-176.8	-179.1
Current account balance	24.3	37.1	29.0	45.4	22.3
Current account balance (in percent of GDP)	18.0	22.6	16.1	17.2	8.7
Gross official reserves	21.3	28.0	77.9	38.1	53.5
In months of next year imports of goods and services	2.3	2.3	4.3	2.1	2.8
Real effective exchange rate (2000=100)	96.0	101.2	103.6	109.9	111.9

Sources: U.A.E. authorities; and IMF staff estimates.

1/ Projections are based on information received through November 2008.

2/ In percent of non-hydrocarbon GDP.

**Statement by the IMF Staff Representative on the United Arab Emirates
January 9, 2009**

1. This statement provides information on recent developments in the United Arab Emirates that has become available since the staff report was circulated to the Executive Board on December 3, 2008. This information does not change the thrust of the staff appraisal.
2. The oil price baseline assumption for the *World Economic Outlook* (WEO) was revised downward (most recently in January 2009) and the U.A.E. announced that it will cut oil production starting in January 2009 in line with OPEC's decision. These developments affect staff projections of oil exports, fiscal revenues and growth. The new assumptions imply substantially lower U.A.E oil export prices of \$49 per barrel for 2009 and \$59 per barrel for 2010 and an estimated decline in oil production by 5 percent in 2009. Assuming unchanged expenditure policies, the fiscal surplus in 2009 would reach only 0.4 percent of GDP compared to 12.1 percent in the staff report, and the current account would register a small deficit of 3.7 percent of GDP in 2009 compared to a surplus of 8.7 percent in the staff report. Real GDP growth would reach only 2.1 percent compare to 3.3 percent, on account of lower oil production. From 2010 onward, both the fiscal and the current account balances would record modest rising surpluses.
3. As envisaged in the staff report, under this scenario maintaining the increased public expenditure levels through 2009 remains appropriate and feasible, and additional fiscal stimulus would be needed should the non-oil growth and employment situation deteriorate more than expected. The likelihood of the latter has risen in view of the expected downward revision of WEO projections for partner country and global trade growth. Furthermore, the revised oil prices imply a substantial reversal of recent terms of trade gains and hence a depreciation of the equilibrium real exchange rate. While the absence of recent price data does not allow a quantitative update, it is likely that the dirham's moderate undervaluation assessed in the staff report is by now eliminated, even earlier than foreshadowed in the staff appraisal. Indeed the dirham may by now be moderately overvalued.
4. The Dubai government in late 2008 formed a high-level committee to manage the fallout from the global crisis on Dubai's real estate market. In January 2009 a federal decree established a Federal Council to Coordinate Fiscal Policy with responsibilities to coordinate budget and expenditure across emirates and at the federal level to ensure that the overall fiscal stance remains supportive of macro-economic stability. The federal government is merging two Dubai-based mortgage companies that have been facing difficulties raising financing in the wake of the liquidity crunch (Amlak Finance and Tamweel, which together account for and estimated 2/3 of Dubai's housing lending market) with an amalgamation of the Abu Dhabi's Real Estate Bank and Emirates Industrial Bank. The government would hold a majority stake in the new entity (Emirates Development Bank) which will have access

to the government emergency liquidity support facilities. This might help revive access to financing for buyers in the real estate market and mitigate the risk of other institutions exposed to Amlak and Tamweel through lending or ownership. Several public real estate developers in Dubai have announced substantial lay-offs, as well as a slow-down in the launching of new and implementation of ongoing projects. Several banks have further tightened mortgage lending, while major developers have eased restrictions on resale of unfinished properties (that had been earlier introduced to discourage speculation).

5. As of December 31, 2008 stock markets remained sharply down for the year, more so in Dubai (-73 percent) than in Abu Dhabi (-48 percent). However, both markets have shown some recovery in early 2009. The U.A.E. central bank decided not to match the U.S. interest rate cuts in late October and December, the first time of not following the Fed moves. Interbank rates in the U.A.E. did not follow recent LIBOR declines and remained stable and around 4 percent, pointing to continued liquidity tightness. Credit default spreads came somewhat down from recent peaks, but remain elevated at around 650 bp for Dubai and 250 bp for Abu Dhabi. One-year dirham/U.S. dollar currency forwards now discount the dirham by around 1 percent. Anecdotal evidence continues to point to declining property prices and a rise in distressed sales in at least some segments of the U.A.E. market since October 2008.

6. Heads of State of the Gulf Cooperation Council (GCC) in late December approved the draft of a monetary council in 2009, forerunner of a common central bank. The agreement is to be ratified by all member states before end-2009. The deadline of 2010 for establishing a common currency was not changed, but the monetary council may adapt the schedule in view of the needed preparatory work.