

**United Arab Emirates: 2007 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the United Arab Emirates**

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 2007 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 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 6, 2007, 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 August 21, 2007. 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 September 21, 2007 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 21, 2007 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for the United Arab Emirates.

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

Statistical Appendix

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INTERNATIONAL MONETARY FUND

UNITED ARAB EMIRATES

**Staff Report for the 2007 Article IV Consultation**

Prepared by Staff Representatives for the 2007 Consultation with  
the United Arab Emirates

Approved by Lorenzo Pérez and Scott Brown

August 21, 2007

- Discussions for the 2007 Article IV consultation were held in Abu Dhabi, Dubai, and Sharjah during April 22–May 6, 2007. The team comprised Messrs. Jbili (head), Jaber, Çakir, Singh, and Ms. Hakura (all MCD). Ms. Brenner (MCM) joined the mission to complete the Financial Sector Assessment Program (FSAP) Update discussions. Mr. Shaalan, Executive Director for the United Arab Emirates (U.A.E.), participated in the policy discussions.
- The mission met with the Minister of State for Finance and Industry, the Governor of the Central Bank, other senior officials of the federal and emirate governments, and representatives of the private sector, the commercial banks, the stock exchanges, the Dubai International Financial Center (DIFC), and large public entities.
- The previous consultation was concluded on May 24, 2006. The PIN of the Executive Board discussion is available at <http://www.imf.org/external/np/sec/pn/2006/pn0676.htm>. An assessment update under the FSAP was carried out during January 14–25, 2007.
- The U.A.E. has accepted the obligations of Article VIII and the Fourth Amendment of the Fund's Articles of Agreement. The U.A.E. dirham has been officially pegged to the U.S. dollar since 2002.

Contents	Page
Executive Summary .....	3
I. Background.....	4
II. Recent Developments.....	4
III. Policy Discussions .....	9
A. Near- and Medium-Term Outlook .....	9
B. Inflation .....	10
C. Fiscal Policy .....	11
D. The Financial Sector .....	13
E. Monetary and Exchange Rate Policies .....	14
F. Structural Reforms.....	16
G. Regional Cooperation .....	16
H. Statistics .....	17
IV. Staff Appraisal .....	17
 Figures	
1. Growth and Inflation, 2003–07.....	5
2. Fiscal Developments, 2003–07.....	6
3. External Sector Developments, 2003–07.....	6
4. Money and Credit Growth, and Interest Rates, 2000–07 .....	8
5. Stock Market Developments, 2003–07.....	9
 Boxes	
1. Developments in the Real Estate Markets .....	11
2. Investment Projects in the U.A.E.....	12
3. U.A.E.'s Real Effective Exchange Rate .....	15
 Tables	
1. Selected Macroeconomic Indicators, 2003–07 .....	20
2. Balance of Payments, 2003–07 .....	21
3. Consolidated Government Finances, 2003–07 .....	22
4. Monetary Survey, 2003–07.....	23
5. Medium-Term Baseline Scenario, 2006–12 .....	24
6. Selected Indicators of External Vulnerability, 2003–06.....	25
7. Financial Soundness Indicators, 2003–06 .....	26
 Attachments	
1. Draft Public Information Notice .....	27

## EXECUTIVE SUMMARY

### Background

- **The rapid economic expansion in the U.A.E. has continued** uninterrupted for the fourth consecutive year, with non-hydrocarbon GDP growth averaging in excess of 10 percent. This has been aided by an outward-oriented development strategy, a favorable business climate, and sustained high oil prices. The fiscal and external surpluses remain large, allowing for further accumulation of official foreign assets.
- **Capacity constraints, however, have intensified.** Strong demand growth and housing shortages have led to sharp increases in rents and contributed to upward pressure on other prices. As a result, consumer price inflation exceeded 9 percent in 2006.
- **The medium-term outlook is very positive** with real GDP growth projected to remain strong in 2007, and decelerating to about 7 percent on average during 2008–12. The fiscal and external positions are projected to remain in large surplus under current WEO oil price projections.

### Key policy issues and recommendations

- **Inflation is a source of concern.** If inflation fails to decline in 2007 as a result of the expected easing of housing shortages, further fiscal expenditure restraint, including by public and quasi-public entities, would be needed to slow down aggregate demand growth. To this end, staff underscored the importance of enhancing fiscal coordination between the federal and emirate governments and improving the phasing and monitoring of large investment projects that are carried out by government and quasi-public entities outside the budget.
- **The FSAP Update found the financial system to be sound, and identified areas for development.** These include the need to strengthen the prudential and regulatory oversight of the banking system and capital markets; open the banking sector to greater competition; and strengthen the legal framework for the financial sector.
- **The authorities reiterated their commitment to the U.S. dollar peg in the period leading up to the establishment of the monetary union among the Gulf Cooperation Council (GCC) members.** Moreover, they remain committed to achieving the monetary union by 2010. Staff calculations suggest that the real effective exchange rate of the U.A.E. dirham, which has appreciated by 6 percent over the past two years, is consistent with the fundamentals.
- **The efforts to upgrade the statistical system are welcome and should continue.** A National Bureau of Statistics is to be established by end-2007, a number of surveys are being carried out, and work is proceeding to establish a new national consumer price index (CPI).

## I. BACKGROUND

1. **The U.A.E. has continued to benefit from its oil wealth, prudent macroeconomic policies, and dynamic diversification strategy.** As a result, the country has emerged as an important hub for international trade, finance, and tourism, attracting large inflows of foreign direct investment (FDI) and expatriate workers, and is increasingly playing an important regional economic role.<sup>1</sup> The rapid economic expansion, which began in 2003, has continued uninterrupted, with non-oil sectors, such as tourism and construction, delivering double-digit growth rates. Per capita income has risen to about \$38,000 in 2006, and the U.A.E. is now the second largest economy in the Arab world after Saudi Arabia.

2. **The political situation remains stable.** The president of the U.A.E., Sheikh Khalifa bin Zayed Al-Nahayan, continues to enjoy the support of the rulers of the other emirates. In December 2006, the U.A.E. held elections for the Federal National Council, a consultative body which reviews legislation proposed by the Council of Ministers.

3. **The authorities have maintained a close dialogue with the Fund through Article IV consultations and, beginning in 2006, through mid-year staff visits.** In recent years, the Fund has encouraged the authorities to strengthen fiscal management and coordination between the federal and emirates governments, to upgrade the financial sector's legal framework and improve banking and capital markets' supervision, as well as strengthen economic data. Progress is being made in these areas, but further efforts are still needed.

## II. RECENT DEVELOPMENTS

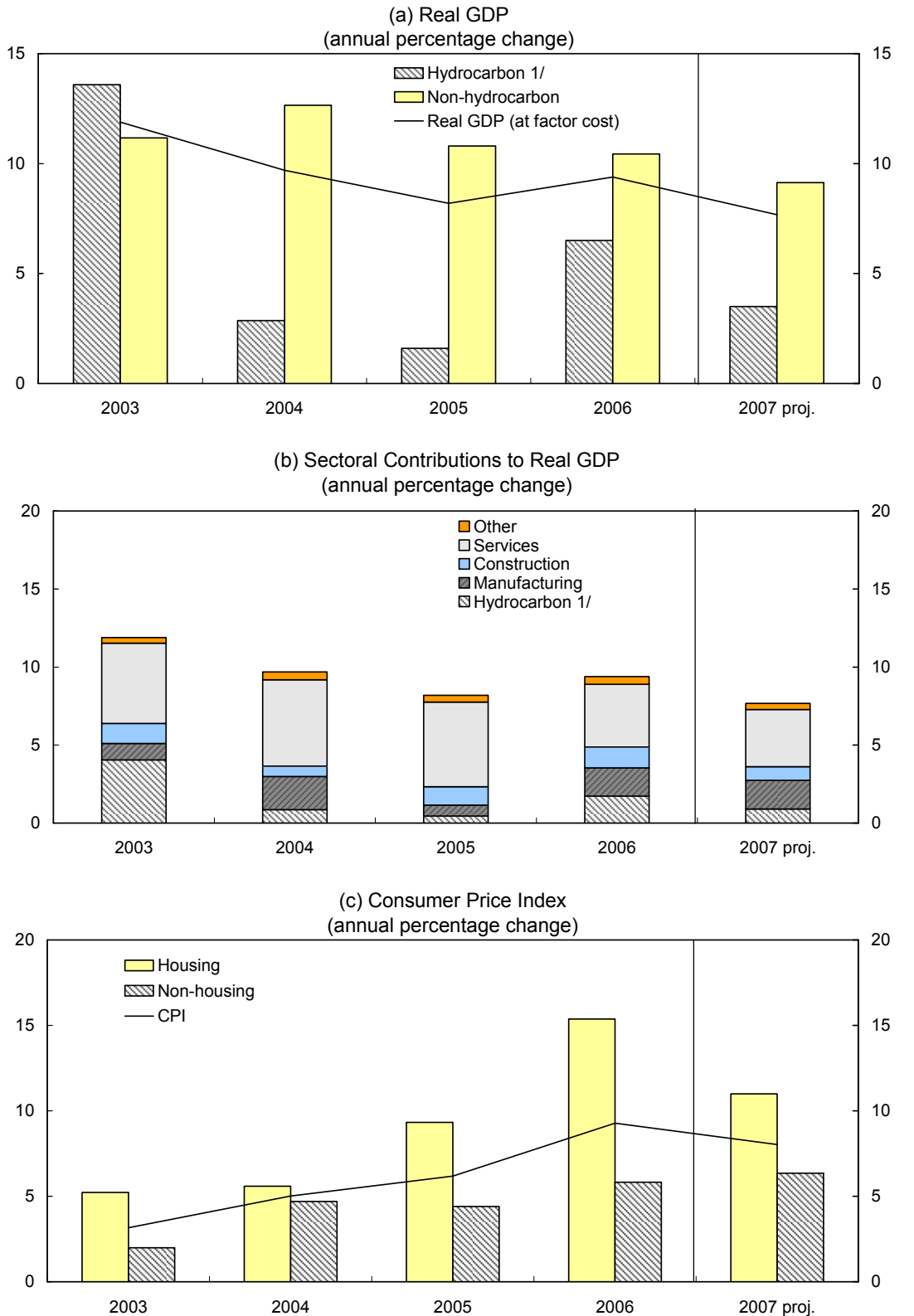
4. **The strong momentum of investment and growth continued in 2006, but supply bottlenecks have pushed up inflation.** Real GDP grew by 9.4 percent in 2006, with oil production rising by 8 percent, while construction, financial services, and trade services grew at double-digit rates. Domestic demand remained buoyant, reflecting the rapid population growth (about 6 percent per year on average) as well as large infrastructure investment projects in Abu Dhabi and Dubai. However, strong demand growth and shortages of housing, have led to sharp rises in rents and put upward pressure on other prices. As a result, inflation picked up from 6.2 percent in 2005 to 9.3 percent in 2006, but is expected to decelerate somewhat in 2007.<sup>2</sup>

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<sup>1</sup> The seven emirates are Abu Dhabi, Dubai, Sharjah, Ajman, Ras al-Khaimah, Umm al-Quaiwain, and Fujairah. Under the current confederation, each emirate enjoys considerable autonomy.

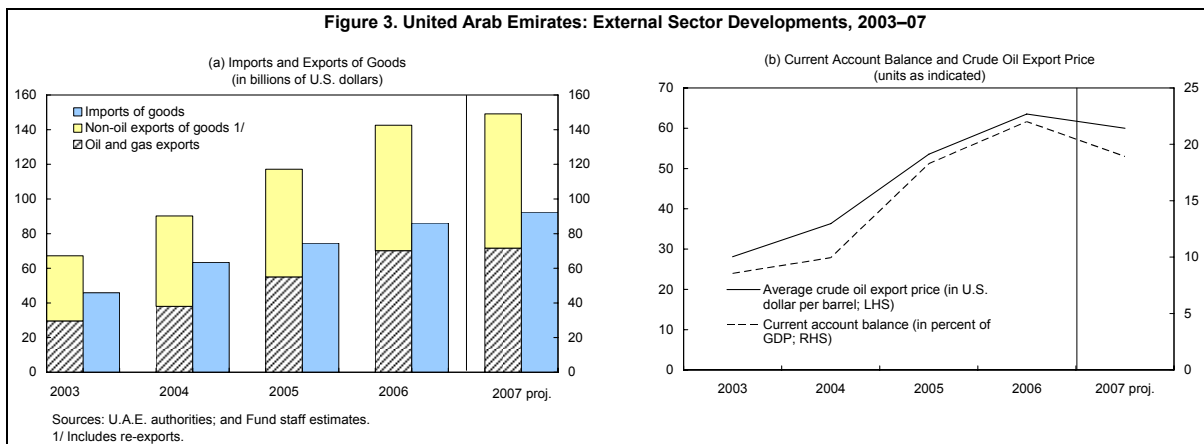
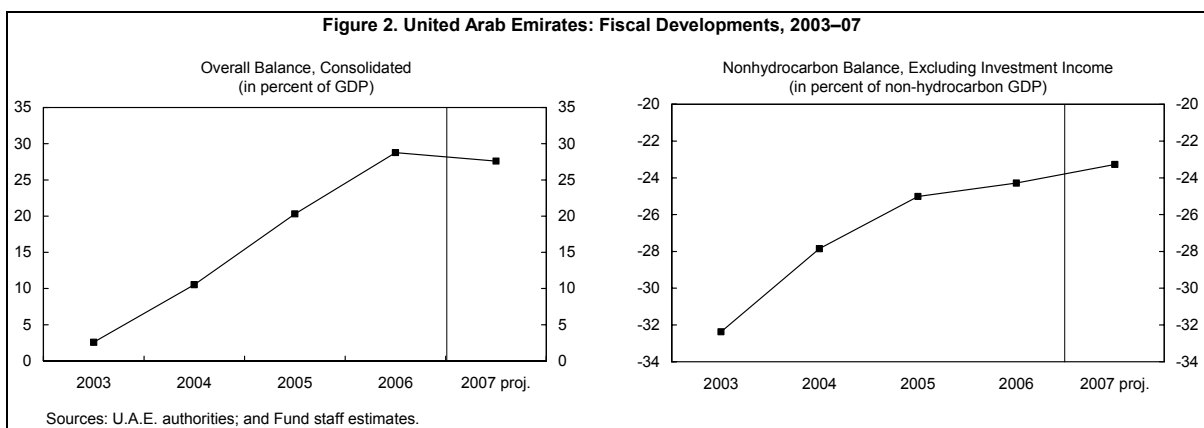
<sup>2</sup> There are, however, considerable weaknesses in the U.A.E.'s CPI data (see Informational Annex III), and unofficial sources estimate inflation above the official figure.

**Figure 1. United Arab Emirates: Growth and Inflation, 2003–07**



Sources: U.A.E. authorities; and Fund staff estimates.  
 1/ Includes refined products and gas.

5. **The fiscal and external positions remain in large surplus.** Reflecting record high oil prices, the overall fiscal surplus (federal and emirate governments, including investment income) increased by 8.5 percentage points to about 29 percent of GDP in 2006, allowing a further build up of official foreign assets. Also, the non-oil fiscal deficit (excluding investment income) narrowed slightly. With high oil prices and strong performance of non-oil exports, the external current account surplus increased to close to \$36 billion, or 22 percent of GDP. Capital account movements continued to mirror the large build up of official foreign assets by the Abu Dhabi Investment Authority (ADIA).<sup>3</sup> Gross official reserves at the central bank increased in 2006 to \$27.9 billion, or the equivalent of about 2.8 months of next year's imports of goods and services (or 4.7 months excluding imports for re-exports).



<sup>3</sup> In early 2007, Abu Dhabi Investment Council (ADIC), a sister institution to ADIA, was established for the purpose of investing government funds domestically and internationally. The management of official investment funds will be shared between ADIA and ADIC.



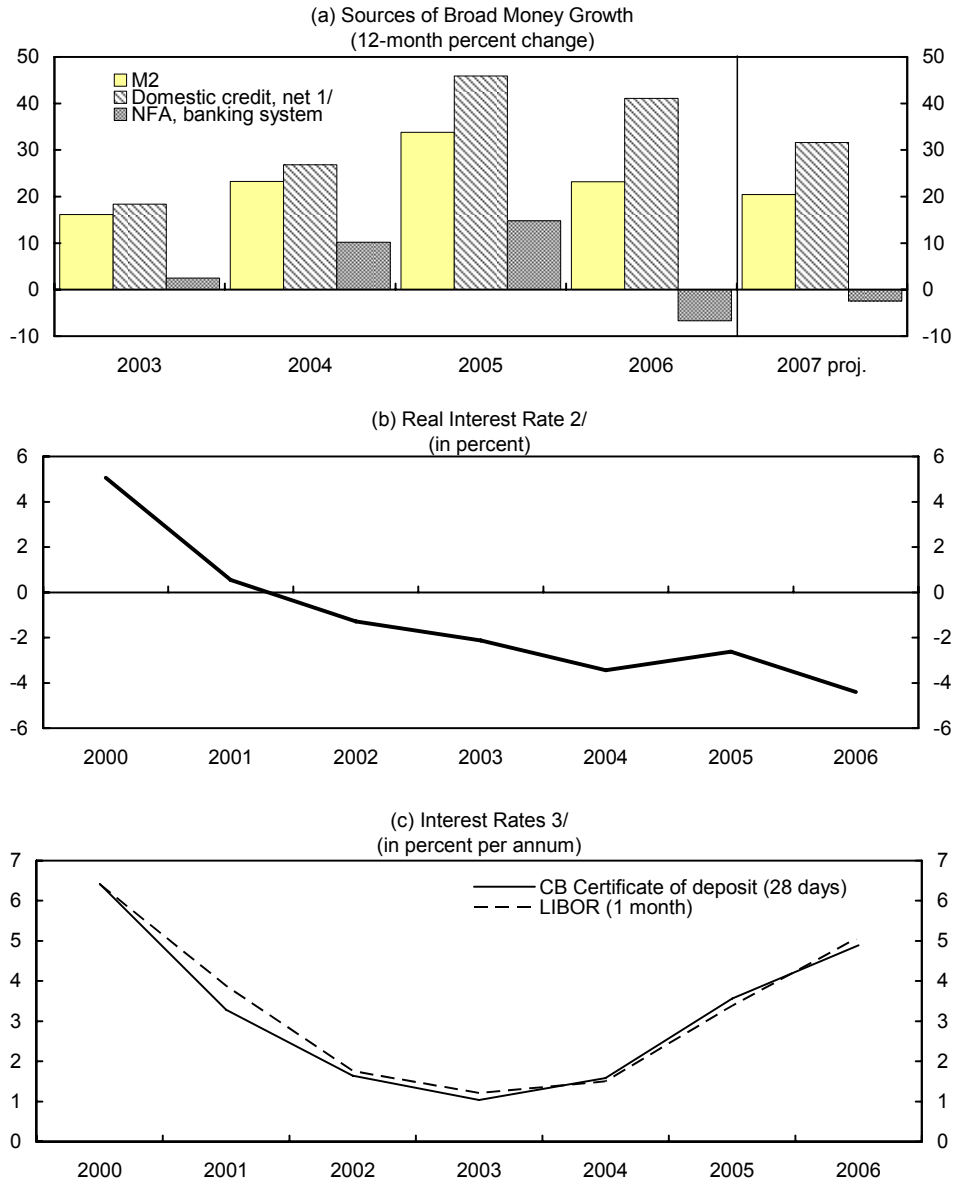
6. **Money and private sector credit continued to grow rapidly in 2006, albeit at a somewhat slower pace than in 2005.** The growth in credit was particularly high for services, personal business and real estate. Banks increasingly relied on foreign borrowing, at longer maturities and lower rates than available in the domestic market, to fund the strong growth of credit. With the U.S. dollar peg and complete capital mobility, nominal interest rates in the domestic market have tracked corresponding U.S. rates closely. But real interest rates have become increasingly negative.

7. **The banking sector continues to show comfortable levels of capitalization and profits.** Banks have benefited from the rapid economic expansion in recent years and the significant reduction in the ratio of nonperforming loans to total loans (Table 7). Bank assets and profits increased by about 35 percent and 11 percent, respectively, in 2006, despite the fallout of the 2005–06 stock market correction, and banks are rapidly gaining in sophistication and international exposure.<sup>4</sup> Five new banks and a number of new branches were authorized in 2006. The planned merger of two Dubai-based banks (National Bank of Dubai and Emirates Bank) would create the largest bank in the U.A.E. and one of the largest in the GCC.

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<sup>4</sup> International ratings of several U.A.E. banks were upgraded in 2006.

**Figure 4. United Arab Emirates: Money and Credit Growth, and Interest Rates, 2000-07**



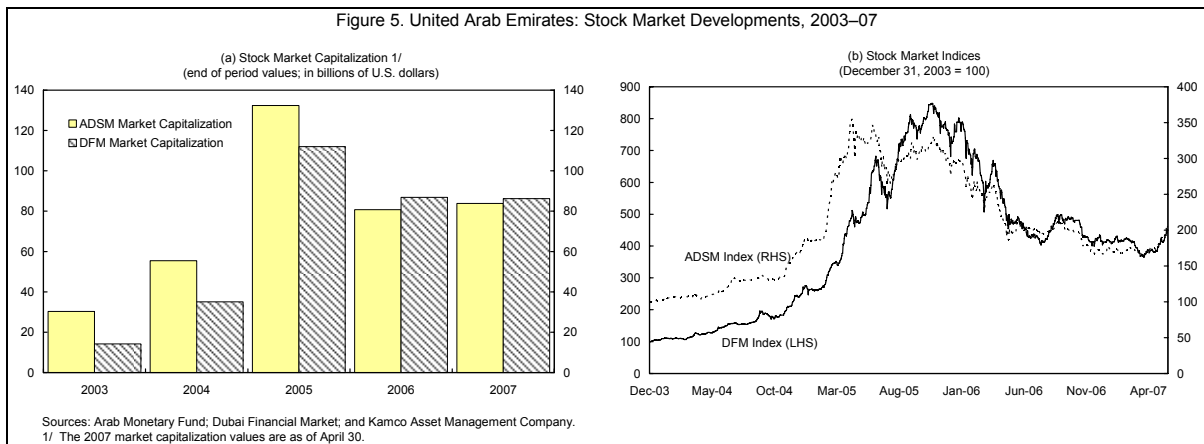
Sources: U.A.E. authorities; and Fund staff estimates.

1/ Includes claims on government (net), claims on public sector enterprises and claims on private sector.

2/ Average of quarterly nominal rates on 28-day CDs deflated by the annual change in the CPI.

3/ U.A.E. rates are unweighted averages of quarterly data.

8. **Following a spectacular performance in recent years, the U.A.E. capital markets experienced a sharp correction beginning in late 2005, along with other regional markets.** In 2006, the Abu Dhabi Securities Market and the Dubai Financial Market declined by 42 percent and 44 percent, respectively. The correction was due to a reversal in investors' sentiment following the sharp increases in the value of shares in the U.A.E. in the previous years, which pushed valuation indicators (P/E ratios and price/book values) well beyond their historical levels and those of other emerging markets. The overall economic impact of the market correction has, however, been very limited, and stock prices have started to recover during the second quarter of 2007.



### III. POLICY DISCUSSIONS

9. **Against the background of favorable medium-term prospects,** the policy discussions focused on: the need to reduce inflation; the role of fiscal policy in demand management given the constraints on monetary policy; financial sector issues; the U.A.E.'s monetary and exchange rate policies in the run-up to the GCC monetary union; structural reforms; regional cooperation; and the progress underway to strengthen the statistical system.

#### A. Near- and Medium-Term Outlook

10. **Growth is projected to remain high at about 8 percent in 2007, somewhat lower than in 2006.** Real domestic demand growth is expected to remain robust, reflecting the rapid population growth, sustained private consumption following wage increases in the public sector, as well as strong investment momentum. On the supply side, crude oil production is projected to increase by about 3.5 percent to 2.66 million barrels per day (mbd). While the growth of the non-oil sector is expected to decelerate moderately owing to existing supply bottlenecks, it is projected to remain relatively high (9 percent). Inflation is also projected to ease to 8 percent, on the expectation that upward pressure on rents will diminish gradually with the improvement in the supply of new housing units.

11. **The fiscal and the external current account positions will continue to be in sizable surplus.** The overall fiscal surplus is expected to remain at about 28 percent of GDP, with the non-oil fiscal deficit (excluding investment income) projected to narrow by one percentage point to about 23 percent of non-oil GDP, mostly reflecting lower budgeted spending by Abu Dhabi on behalf of the federal government. Under the assumption that oil export prices would average \$63 per barrel, the current account surplus is projected to remain very large (about \$38 billion).

12. **The medium-term prospects are also highly favorable.** Growth is projected to decelerate gradually from its current high level to about 7 percent on average during the period 2008–12. With further progress in economic diversification, growth will increasingly depend on non-oil activities, with tourism and other services continuing to expand at relatively high rates in response to sustained demand. The hydrocarbon sector is projected to grow by 3.5 percent annually in line with the authorities' medium-term expansion plans. The fiscal and external positions are projected to remain in large surplus, even if oil prices were to decline significantly from their current level.<sup>5</sup>

13. **The main risks to this outlook are balanced.** On the upside, the U.A.E.'s attractive business climate and its ambitious development strategy, supported by accelerated structural reforms, could further spur investment and growth in the next few years; moreover, with the completion of mega projects in infrastructure and tourism, the service industry will expand rapidly, including in Abu Dhabi and the northern emirates. This scenario assumes that the current bottlenecks in key infrastructure and housing will be resolved over the next few years. On the downside, the major risks relate to an acceleration of inflation, a sharp decline in oil prices, and heightened geopolitical tensions in the Gulf region.

## B. Inflation

14. **High inflation has become a major issue.** With the rapid growth in recent years, capacity constraints have intensified, putting upward pressure on asset and consumer prices. Shortages of housing—which are more severe in Dubai and Abu Dhabi than in the other emirates—have led to sharp rises in rents which are reflected in the increase in the CPI. The authorities agreed that inflation was a major source of concern. If allowed to persist at the current rate, inflation could become entrenched with the attendant risk of undermining competitiveness and long-term growth. Staff pointed out that upward pressures on wages have emerged, and production costs in some sectors, such as construction, have risen significantly. The authorities indicated that they have introduced temporary caps on rent increases on existing contracts in Dubai and Abu Dhabi, and were confident that upward pressure on rents would start to ease in late 2007, as new housing units come to the market (Box 1).

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<sup>5</sup> Based on the current medium-term scenario, the fiscal and the current account positions would be in balance at oil prices of \$20 and \$32 per barrel, respectively, on average during the period 2008–12.

### **Box 1. Developments in the Real Estate Markets**

**The real estate market in the U.A.E. has been buoyant in recent years.** The rapid population growth of about 6 percent per year on average, has been a major factor behind the strong demand for housing. Some 43,000 additional residential units will be needed annually to accommodate the growing demand in 2006–10.

**The supply-demand imbalance has increased pressure on rents.** Rent increases have been officially estimated at 9 percent in 2005 and 15 percent in 2006, although market estimates have been higher. The authorities introduced temporary caps of 7 percent on rent increases in Abu Dhabi and Dubai in late 2006 and early 2007, respectively.

**Rent increases are expected to ease in late 2007 as new housing units come to the market.** Around 120,000 residential units are expected to be completed over the next three years. Although capacity constraints have delayed some large real estate projects, especially in Dubai, there are indications that many of these projects will be completed shortly. However, pressures on rents and prices in the Abu Dhabi market are expected to continue during 2007, with less than 8,000 residential units to be completed over the course of the year. Given the continued strong demand in the medium term, a sharp price correction in the real estate market is not expected.

Sources: Dubai Chamber of Commerce and Industry; Colliers International; CB Richard Ellis; and Shuúa Capital.

### **C. Fiscal Policy**

15. **Fiscal policy at both the federal and emirate levels has remained prudent as evidenced by the decline in the non-oil fiscal deficit (excluding investment income).** The authorities indicated that current spending has been kept under control at all government levels. While wages were increased for government employees in Abu Dhabi and Dubai in 2006 and early 2007, no such increase was granted to federal government employees. More important, the overall number of civil servants in Abu Dhabi has been reduced significantly in connection with the outsourcing of certain activities. As a result, the consolidated wage bill grew moderately in 2006 and is expected to increase by only 9 percent in 2007. Capital expenditure at the federal and emirate levels remained broadly stable.

16. **Substantial progress has been made in implementing fiscal management reforms at the federal level.** A single treasury account has been established and the government intends to close all commercial bank accounts soon; the budget classification and the chart of account have been revised; and a government financial management information system has been developed. The authorities are also making efforts to prepare for the introduction of a value added tax in the U.A.E. ahead of the GCC countries' target of 2012.

17. **The authorities recognized the importance of enhancing the effectiveness of fiscal policy.** Fiscal coordination between the federal and the emirate governments needs to be improved, as well as monitoring and planning of the large investment projects that are carried out by government and quasi-public entities outside the budget to ensure that overall public investment is consistent with the economy's absorptive capacity (Box 2). Currently, the data needed to consolidate public sector spending, including by government and quasi-public entities, are not available and need to be compiled as a matter of priority. The authorities indicated that these objectives were part of their strategic reform plan, and expressed interest in receiving Fund technical assistance for the establishment of a macro-fiscal unit that would coordinate fiscal spending.

### Box 2. Investment Projects in the U.A.E.

**A large number of infrastructure and oil-related projects are currently being undertaken, or planned, by the government.** Others are being carried out by private and quasi-public entities mainly in real estate. Selected projects planned over the next ten years are estimated at \$227 billion.

#### Selected Investment-Projects Planned Over the Medium- to Long-term 1/

Project	Location	Estimated Investment (in billions of U.S. dollars)
<b>Hydrocarbons</b>		
Upstream oil production	Abu Dhabi	20
Gas production	Abu Dhabi	10
Downstream oil production	Abu Dhabi	5
<b>Manufacturing</b>		
Emirates Aluminum Smelter	Abu Dhabi	5
Khalifa Industrial City	Abu Dhabi	2
<b>Real Estate/Tourism</b>		
Yas Island	Abu Dhabi	40
Saadiyat Island	Abu Dhabi	27
Mina Zayed	Abu Dhabi	15
Raha Beach	Abu Dhabi	15
Palm Deira	Dubai	13
Ayn Project	Abu Dhabi	11
Dubai Land	Dubai	10
Emirates Pearl	Dubai	10
Palm Jebel Ali	Dubai	8
Al-Marjan Islands	Ras-Al-Khaimah	2
<b>Tourism</b>		
Louvre Abu Dhabi	Abu Dhabi	1
<b>Transportation</b>		
Jebel Ali Airport City	Dubai	20
Abu Dhabi Airport	Abu Dhabi	5
Abu Dhabi Seaport	Abu Dhabi	5
Dubai Light Rail	Dubai	3

Sources: ADNOC, Abu Dhabi Chamber of Commerce, and various sources.

1/ Investment estimates, which are based on public announcements, will be carried out over several years and may not be fully funded at present.

#### **D. The Financial Sector**

18. **Against the backdrop of continued strong performance of the financial system coupled with rapid growth of credit, efforts are being made to further strengthen the financial sector.** As discussed in the FSAP Update, these reforms are aimed at strengthening the prudential and regulatory oversight of the banking system and the capital markets; opening the banking sector to greater competition; and strengthening the legal framework for the financial sector.<sup>6</sup> The authorities agreed on the need to step up their efforts toward updating the banking law and the company law, which would address, among other issues, the removal of barriers to foreign participation in U.A.E. markets and the protection of shareholder rights. Moreover, the development of the DIFC continues to support the diversification and international standing of the U.A.E.'s financial sector.<sup>7</sup>

19. **Banking supervision faces new challenges.** Stress test results in the FSAP Update indicate that while banks would be resilient to various exogenous shocks, a few banks (accounting for one-fourth of bank assets) would be vulnerable to a severe correction in real estate markets. The authorities indicated that exposure to the real estate sector was difficult to monitor and agreed to review their loan classifications. Staff expressed reservation regarding a proposal that would allow banks to increase their exposure to the real estate sector through subsidiary companies. At the same time, as part of efforts to strengthen bank supervision, the authorities intend to establish a federal credit bureau. A basic AML/CFT framework is in place, but the legal framework for anti-money laundering needs strengthening as recommended by the March 2007 AML/CFT mission.

20. **The supervision of U.A.E. capital markets is being strengthened.** The responsibility for oversight of Initial Public Offerings in the stock market had been transferred from the Ministry of Economy to the Emirates Securities and Commodities Authority as of January 2007, and a corporate governance code has been issued. Staff underscored the need for the authorities to move ahead with the enactment of the draft securities law, which will improve securities market oversight and strengthen capital markets' supervision. In addition, eliminating restrictions on foreign ownership, encouraging the listing of large quasi-public enterprises, and increasing the role of institutional investors would help strengthen investor confidence, reduce market volatility, and deepen capital markets.

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<sup>6</sup> The Financial System Stability Assessment (FSSA) report will be discussed by the Board in conjunction with this staff report.

<sup>7</sup> See accompanying FSSA report for details on the DIFC's supervisory and regulatory framework.

21. **External borrowing by financial institutions and large corporations to finance investment and credit growth has picked up significantly and would need to be monitored.** While comprehensive information on the U.A.E.'s total external liabilities (including the nonfinancial private sector) is not available, data from the central bank and the Bank for International Settlements indicate that the U.A.E.'s foreign liabilities have almost tripled over the last two years to reach close to \$80 billion at end-2006. There are presently no signs of vulnerability associated with such borrowing given the U.A.E.'s large net creditor position. The authorities are monitoring these developments, and indicated that Dubai will be establishing a debt management unit.

### E. Monetary and Exchange Rate Policies

22. **Monetary policy is determined by the exchange rate peg to the U.S. dollar and a completely open capital market.** Interest rates closely track U.S. dollar rates and liquidity management operations through the issuance of central bank certificates of deposit have aimed only at smoothing changes in liquidity conditions. The authorities intend to develop additional instruments for liquidity management, including Shariah-compliant instruments that would help Islamic financial institutions manage their liquidity.

23. **The authorities reiterated their commitment to the U.S. dollar peg in the period leading up to the GCC monetary union in 2010.**<sup>8</sup> They indicated that moving the peg to a basket of currencies might entail sizable financial losses, not to mention the risk of loss of credibility if the market were to expect some instability in exchange rate policy during the transition to the monetary union. They also stressed that a nominal revaluation of the current exchange rate was neither needed, nor would it be beneficial for the U.A.E. economy, given that most U.A.E. exports and imports were denominated in U.S. dollars and a large share of the country's sizable official foreign assets was invested in U.S. dollar instruments. The authorities further indicated that much of the increase in inflation in recent years was due to factors unrelated to the euro/dollar exchange rate, especially housing shortages that have caused sharp increases in rents as highlighted above.

24. **Both traditional competitiveness indicators and an analysis of the U.A.E.'s real exchange rate based on Consultative Group for Exchange Rate Issues (CGER)-type methodology suggest that there is no misalignment of the dirham (Box 3).** While there is some evidence of modest undervaluation of the currency, it cannot be concluded that the exchange rate is misaligned, particularly given the uncertainties in estimating equilibrium exchange rates in oil producing countries. The authorities agreed with the staff's analysis and assessment of the level of the exchange rate.

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<sup>8</sup> At the time of the consultation discussions, Kuwait had not yet announced its decision to switch from a dollar peg to a peg to an undisclosed basket of currencies. Very soon after this announcement, the U.A.E. authorities (along with the other members of the GCC) reaffirmed their commitment to the dollar peg.



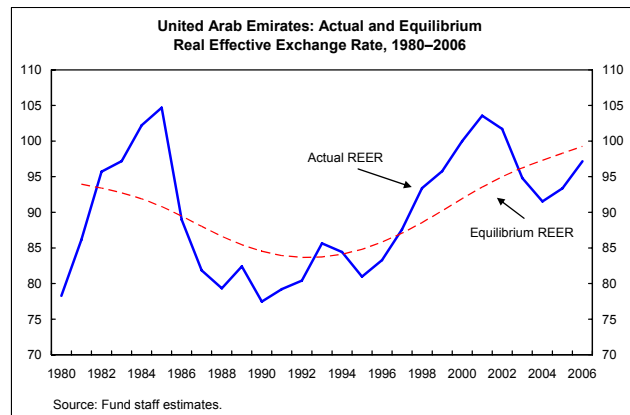
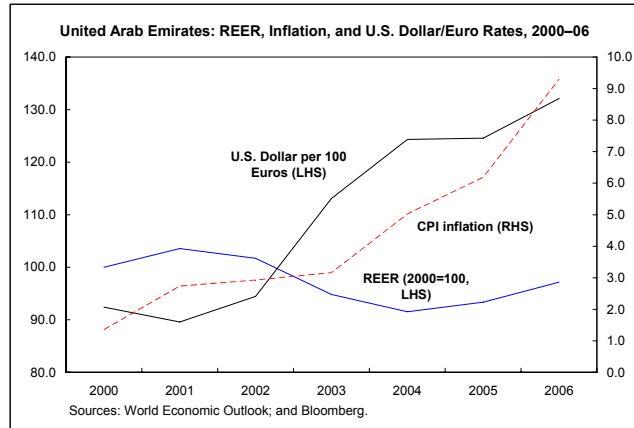
### Box 3. U.A.E.'s Real Effective Exchange Rate

1. **Following a short period of depreciation, the real effective exchange rate (REER) of the U.A.E. dirham has appreciated by about 6 percent in the past two years.** During the period 2000–04, the REER depreciated by about 8.5 percent in line with the depreciation of the U.S. dollar against the euro. However, since December 2004, the inflation differential with partner countries has become relatively high and more than offset the depreciation of the dollar, leading to a 6 percent appreciation of the REER. The question is whether this real appreciation was in line with the appreciation of the equilibrium real exchange rate that has resulted from the terms-of-trade (TOT) improvement due to the increase in oil prices.

2. **The equilibrium real exchange rate approach suggests that there is no misalignment of the U.A.E. dirham.** An estimation of the long-run equilibrium real exchange rate derived from key macroeconomic fundamentals, such as the overall fiscal balance and the TOT, shows that, in 2006, the U.A.E. dirham was undervalued by only about 2 percent with respect to its estimated equilibrium level, well within the margins of error in this type of analysis.

3. **The application of the macroeconomic balance approach also points to no misalignment of the dirham currently or in the medium term.** The equilibrium current account (or “norm”) for the U.A.E., as derived from projections of medium-term fundamentals that determine the U.A.E.’s saving and investment, is estimated at 21.1 percent of GDP in 2012, compared to a projected surplus of 15.0 percent of GDP.<sup>1</sup> Thus, under this approach, there is no evidence that the dirham is undervalued. Based on projected outcomes, the current account balance would also be expected to remain below the norm over the medium term, with both declining over time in response to strong domestic demand. It should be noted, however, that the estimates of the current account norms are subject to wide margins of errors, especially in oil producing countries, which calls for caution in interpreting the results. Moreover, the estimates are sensitive to prospective developments in oil prices and other variables, and the norm can change significantly over time as a result.

4. **Competitiveness of the non-oil sector does not seem to have been significantly affected by the real exchange rate appreciation, given the productivity gains from the improvement in the business climate, the modernization of large segments of the economy, and the supply of expatriate labor at competitive rates.** The U.A.E.’s non-oil exports of goods and services have been growing at about 26 percent over the past four years.



<sup>1</sup> The variables used in the estimation of the equilibrium current account include the fiscal balance, net foreign assets, net oil exports, real per capita GDP growth, and population growth.

## F. Structural Reforms

25. **The authorities have announced a major reform plan that sets the U.A.E. government's strategy for the next three years.** The strategic plan addresses key issues pertaining to social and economic development, public sector reforms, infrastructure and rural development, as well as justice and safety. Specific action plans for the federal and emirate governments are still under discussion. The authorities explained that emphasis will be placed on improving government efficiency and strengthening the cooperation between the federal and emirate governments.

26. **Efforts to improve the business environment have intensified.** The authorities noted that the U.A.E. ranks high in international business surveys, and pointed to several initiatives under way to update key laws and regulations, including the corporate law, the competition laws, and labor market legislation.<sup>9</sup> Several initiatives to improve labor markets regulations were introduced in 2006, including to allow greater flexibility for labor mobility across sectors, imposing mandatory health insurance schemes, and enforcing safety regulations.

## G. Regional Cooperation

27. **The U.A.E. authorities remain committed to achieving the GCC monetary union by 2010.** Although some countries may encounter difficulties in meeting the convergence criteria by the agreed deadline, the U.A.E. authorities were confident that these difficulties would be overcome. As such, the 2010 target date remains unchanged, and the relevant decisions in this regard will be made by the GCC finance ministers and governors of central banks at their meeting in October 2007. The U.A.E. authorities remain open to discussing all options for the common exchange rate regime under the monetary union.<sup>10</sup>

28. **The high economic growth in the U.A.E. has had significant regional spillover effects.** Government investment funds and public enterprises have become a major source of FDI in several countries in the Middle East region. For example, in Pakistan and Egypt, FDI inflows from the U.A.E. amounted to about 40 percent and 20 percent of total FDI inflows in 2006, respectively. U.A.E. companies are also undertaking major investment projects in other countries, including Jordan, Syria, Morocco, and Tunisia. Dubai is playing an increasingly important role as a regional financial center. Finally, transfers of remittances by foreign workers in the U.A.E., estimated to be in excess of \$8 billion in 2006 are benefiting several recipient countries in the Middle East and Asia.

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<sup>9</sup> The U.A.E. ranks 31 out of 125 countries surveyed by the World Economic Forum's 2006 Global Competitiveness Report.

<sup>10</sup> These issues are discussed in the forthcoming 2007 Article IV report on Saudi Arabia.

## H. Statistics

29. **Efforts to upgrade the statistical system have intensified.** The authorities underscored their determination to make major improvements in the U.A.E. statistical systems in the next few years as highlighted in their strategic plan. A National Bureau of Statistics will be established by end-2007, and a number of surveys are under preparation.<sup>11</sup> The authorities reaffirmed their commitment to follow up on the recent IMF technical assistance mission to improve the quality and timeliness of the consumer price data. The authorities have also requested further technical assistance in this area, including a multi-sector statistics mission to advise on further steps to upgrade the statistical system. Finally, the authorities confirmed their intention to expedite the process toward participating in the Fund's General Data Dissemination System (GDDS), including by appointing a national coordinator.

## IV. STAFF APPRAISAL

30. **The U.A.E. has firmly established itself as a dynamic, well-managed economy.** Strong growth, investment, and job-creation have been aided by an outward-oriented development strategy, a favorable business climate, and sustained high oil prices. The fiscal and external positions exhibit large surpluses, and the medium-term prospects look positive even if oil market conditions were to be significantly less favorable than projected. Staff expects investment and growth to ease moderately in the near term in light of the existing capacity constraints, but to expand at relatively strong rates, once the capacity constraints have been addressed.

31. **A key challenge is to contain inflation.** Alleviating capacity constraints, especially in the housing and transportation sectors, will be essential in avoiding overheating and reducing inflation. Ongoing projects in these sectors will help in this respect, but a coordinated phasing of some of the planned large-scale investment projects by public and quasi-public entities outside the budget is needed, with the priority given to those projects that help improve the economy's absorptive capacity. If inflation fails to decelerate significantly in 2007, further expenditure restraint, including by public and quasi-public entities, would be necessary to contain domestic demand growth. Caps on rent increases should be temporary and be eliminated as soon as housing supply improves.

32. **Fiscal policy would need to be geared to playing a more active role in containing demand growth** in view of the limitations of monetary policy under the current pegged exchange rate regime. The federal and emirate governments are proceeding on a range of fiscal reforms aimed at modernizing the fiscal system and improving government efficiency.

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<sup>11</sup> A national Household Expenditure Survey is underway in preparation for a new CPI, in addition to investment and economic surveys by the Statistics Center of Dubai and the Abu Dhabi Department of Planning.

Given the federal structure of the U.A.E. in which the federal government budget is relatively small, and the emirate governments enjoy a large degree of fiscal autonomy, there is an urgent need to strengthen fiscal coordination at all government levels. Staff welcomes the authorities' intention to give priority to this issue, including by establishing a macro-fiscal unit with Fund technical assistance.

33. **The authorities' policy choice of maintaining the current exchange rate regime during the run up to the GCC monetary union is appropriate.** The peg to the U.S. dollar has provided the U.A.E. economy a credible nominal anchor and there are no compelling reasons to change it during the transition to the GCC monetary union. The current peg to the U.S. dollar remains appropriate for the U.A.E. given its trade pattern and the large share of dollar-denominated financial assets. Staff supports the authorities' commitment to work closely with the other GCC member countries on the preparation of the monetary union, including reaching consensus among all parties on the appropriate common exchange rate regime to be adopted in this context.

34. **Real exchange rate developments do not suggest that the dirham is out of line with fundamentals.** Based on current policies, the real effective exchange rate is in line with its equilibrium level over the medium term. The real effective exchange rate has appreciated, through higher inflation. However, the normal indicators of competitiveness do not give reasons for concern at this stage, especially given improvements in the business climate and the U.A.E.'s access to expatriate labor at competitive wage rates. Going forward, priority should be to step up structural reforms to improve efficiency and competitiveness.

35. **The banking system is sound, but there are areas in need of development.** The authorities are encouraged to implement the recommendations of the FSAP Update aimed at further strengthening prudential regulations and supervision. In view of the rapid credit growth, including in real estate lending, there is a need to enhance central bank surveillance of bank and finance company risk management practices. Staff cautions against allowing banks to increase their exposure to the real estate sector through subsidiary companies, and underscores the need to coordinate and improve supervision of financial services groups comprising banks, insurance companies, and securities firms. It also welcomes the authorities' intention to establish a federal credit bureau to help improve the reporting and monitoring of credit data. The authorities are encouraged to enact a number of laws aimed at strengthening the regulations governing the equity markets and their supervision. Finally, staff calls for improved monitoring of external borrowing by financial institutions and large corporations and welcomes the planned establishment of a debt management unit by the Dubai government.

36. **Current efforts to improve the statistical system are encouraging.** While data provision to the Fund is adequate for surveillance purposes, improvements in the quality, availability, and timeliness of economic statistics would help policy analysis and formulation. The authorities are encouraged to follow through with the envisaged steps to improve consumer price and other economic statistics, including national accounts, balance of payments, and fiscal data as well as to expedite the process of subscribing to the GDDS. Consolidating data on public sector spending, including by government and quasi-public entities outside the budget would allow a better assessment of their contribution to demand pressures.

37. **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, 2003–07**

(Quota: SDR 611.7 million)  
 (Population-2006: 4.23 million )  
 (Per capita GDP-2006: \$38,600 )

	2003	2004	2005	2006	Proj. 2007
<b>Oil and gas sector</b>					
Total exports of oil and gas (in billions of U.S. dollars)	29.6	38.0	55.0	70.2	71.7
Average crude oil export price (in U.S. dollar per barrel)	28.1	36.3	53.6	63.5	63.0
Crude oil production (in millions of barrels per day)	2.26	2.33	2.38	2.57	2.66
(Annual percent change, unless otherwise indicated)					
<b>Output and prices</b>					
Nominal GDP (in billions of AED)	325.3	381.1	488.4	599.7	679.1
Nominal GDP (in billions of U.S. dollars)	88.6	103.8	133.0	163.3	184.9
Real GDP (at factor cost)	11.9	9.7	8.2	9.4	7.7
Real oil and gas GDP	13.6	2.9	1.6	6.5	3.5
Real non-oil GDP	11.2	12.6	10.8	10.4	9.1
Domestic demand	12.1	16.8	17.7	18.9	15.4
CPI inflation (average)	3.2	5.0	6.2	9.3	8.0
(In percent of GDP)					
<b>Investment and saving</b>					
Gross domestic investment	23.4	22.5	20.4	21.3	21.6
Gross national saving	31.9	32.5	38.7	43.3	42.1
Public	7.9	14.0	24.5	33.4	32.7
Private	24.1	18.4	14.2	9.9	9.4
(In percent of GDP)					
<b>Public finances</b>					
Revenue	30.7	35.4	41.7	50.5	49.5
Oil	23.2	26.1	31.3	38.4	35.8
Non-oil	7.5	9.3	10.4	12.1	13.7
Expenditure and net lending	28.2	24.9	21.4	21.7	21.9
Current	22.8	21.4	17.2	17.1	16.8
Capital	4.9	3.3	3.9	4.5	5.0
Budget balance	2.6	10.5	20.3	28.8	27.6
Nonhydrocarbon balance 1/	-29.3	-22.6	-17.1	-15.3	-12.6
Nonhydrocarbon balance (excluding investment income) 1/	-32.4	-27.9	-25.0	-24.3	-23.3
(Annual percent change, unless otherwise indicated)					
<b>Monetary sector</b>					
Net foreign assets	2.5	10.2	14.8	-6.7	-2.4
Net domestic assets	59.4	49.8	62.2	54.9	35.1
Credit to private sector	13.5	24.7	44.5	36.9	28.9
Broad money	16.1	23.2	33.8	23.2	20.4
(In billions of U.S. dollars, unless otherwise indicated)					
<b>External sector</b>					
Exports of goods	67.2	90.2	117.2	142.6	149.1
Oil and gas	29.6	38.0	55.0	70.2	71.7
Non-oil exports of goods	14.1	18.3	22.4	26.4	29.7
Imports of goods	-45.8	-63.4	-74.5	-86.1	-92.4
Current account balance	7.6	10.3	24.3	35.9	37.9
Current account balance (in percent of GDP)	8.6	10.0	18.3	22.0	20.5
Gross official reserves	15.1	18.7	21.3	27.9	33.6
In months of next year imports of goods and services	2.3	2.4	2.3	2.8	3.0
<b>Memorandum items:</b>					
Nominal effective exchange rate (1990=100)	120.5	115.4	115.1	114.6	...
Real effective exchange rate (1990=100)	122.4	118.1	120.5	125.4	...
Average exchange rate (AED per dollar)	3.6725	3.6725	3.6725	3.6725	3.6725

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

1/ In percent of non-hydrocarbon GDP.

**Table 2. United Arab Emirates: Balance of Payments, 2003–07**

(In billions of U.S. dollars)

	2003	2004	2005	2006	Proj. 2007
Current account balance	7.6	10.3	24.3	35.9	37.9
(In percent of GDP)	8.6	10.0	18.3	22.0	20.5
Trade balance	21.4	26.7	42.7	56.4	56.7
Exports	67.2	90.2	117.2	142.6	149.1
Oil and products	25.7	33.3	49.2	63.1	64.3
Crude oil and condensates	22.0	29.6	43.5	58.1	59.5
Petroleum products	3.8	3.7	5.8	4.9	4.9
Gas	3.9	4.7	5.8	7.1	7.3
Nonhydrocarbon	14.1	18.3	22.4	26.4	29.7
Exports by emirates	2.9	4.0	5.0	5.9	6.7
Free zone exports	11.3	14.3	17.4	20.5	23.1
Re-exports, of which: 1/	23.4	33.9	39.8	46.0	47.7
Nonmonetary gold	2.0	2.3	2.4	2.5	2.6
Imports (f.o.b.)	-45.8	-63.4	-74.5	-86.1	-92.4
Imports by emirates, of which:	-35.4	-46.7	-64.8	-65.3	-71.2
Nonmonetary gold	-2.3	-2.4	-2.5	-2.6	-2.7
Unrecorded government imports	-1.7	-1.8	-1.9	-2.0	-2.1
Free zones	-10.4	-16.7	-17.2	-20.8	-21.2
Income, net	0.0	0.7	2.9	5.7	7.1
Government	1.9	3.8	6.7	9.2	12.9
Services, net	-9.1	-12.1	-14.6	-17.8	-15.6
Transfers, net	-4.7	-5.1	-6.7	-8.4	-10.3
Private	-4.4	-4.6	-6.2	-7.9	-9.7
Official	-0.3	-0.4	-0.5	-0.5	-0.6
Financial account balance	-7.0	-5.3	-14.7	-16.1	-32.2
Private capital	3.9	12.5	15.0	23.8	17.5
Direct investment, net	3.3	7.8	7.2	1.9	3.2
Portfolio securities, net	0.0	2.0	6.1	1.2	3.0
Commercial banks	-1.1	-0.2	-3.4	9.7	6.7
Private nonbanks and other	1.8	2.9	5.1	11.1	4.6
Official capital 2/	-10.9	-17.8	-29.7	-39.9	-49.8
Errors and omissions	-0.8	-1.5	-7.2	-13.2	0.0
(As percent of GDP)	-0.9	-1.5	-5.4	-8.1	0.0
Overall balance	-0.2	3.5	2.5	6.6	5.7
Change in central bank net foreign assets (minus equals increase)	0.2	-3.5	-2.5	-6.6	-5.7
Memorandum items:					
Overall balance (as percent of GDP)	-0.2	3.4	1.8	4.1	3.1
Gross reserves of central bank	15.1	18.7	21.3	27.9	33.6
(In months of next year imports of goods and services)	2.3	2.4	2.3	2.8	3.0
(In months of imports of goods (excluding re-exports) and services)	4.1	4.1	4.0	4.7	5.0

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

1/ Not formally compiled; estimated at 40–70 percent of U.A.E. imports.

2/ Includes changes in government external assets.

**Table 3. United Arab Emirates: Consolidated Government Finances, 2003–07**

(In millions of U.A.E. dirhams)

	2003	2004	2005	2006	<u>Proj.</u> 2007
Total revenue	99,968	134,927	203,685	302,552	336,138
Hydrocarbon 1/	75,542	99,586	152,751	230,153	243,194
Nonhydrocarbon	24,426	35,341	50,933	72,399	92,944
Customs	2,449	3,040	3,852	4,693	4,701
Profit transfers	2,935	3,322	4,624	4,182	5,457
Income tax 2/	301	320	420	430	430
Fees and charges	6,479	7,046	8,791	13,566	15,754
Investment income 3/	7,156	13,912	24,613	33,736	47,243
Other	5,106	7,701	8,634	15,791	19,359
Total expenditure and grants	91,614	94,766	104,431	129,934	148,645
Current expenditure	74,306	81,423	84,256	102,367	114,129
Wages and salaries 4/	15,764	15,990	15,915	17,731	19,261
Goods and services	27,030	28,326	25,454	25,979	32,006
Abu Dhabi "federal services" 5/	19,251	23,760	22,784	25,349	27,035
Subsidies and transfers 6/	11,370	12,335	19,353	32,216	33,950
Other	892	1,012	751	1,092	1,877
Development expenditure	16,028	15,064	14,042	16,768	21,057
Loans and equity (net) 7/	16	-2,308	5,118	10,440	13,089
Foreign grants 8/	1,264	587	1,015	359	370
Abu Dhabi	1,136	587	1,015	359	370
Federal	128	0	0	0	0
Overall balance (consolidated) 9/ (In percent of GDP)	8,354 2.6	40,162 10.5	99,254 20.3	172,618 28.8	187,493 27.6
Non-hydrocarbon balance (In percent of non-hydrocarbon GDP)	-67,188 -29.3	-59,425 -22.6	-53,498 -17.1	-57,535 -15.3	-55,701 -12.6
Non-hydrocarbon balance (excluding investment income) (In percent of non-hydrocarbon GDP)	-74,344 -32.4	-73,336 -27.9	-78,111 -25.0	-91,271 -24.3	-102,944 -23.3
Financing	-8,354	-40,162	-99,254	-172,618	-187,493
Bank financing, net 10/	-2,269	-1,776	-16,039	-4,550	-4,726
Non-bank financing	-6,085	-38,386	-83,215	-168,068	-182,768
Memorandum items:					
Hydrocarbon share of revenue	75.6	73.8	75.0	76.1	72.3
Balance on pension fund operations 11/	3,593	3,511	3,558	780	...

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

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

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

3/ Fund staff estimates.

4/ Excludes military wages and salaries.

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

6/ Includes the government's contribution to the pension fund in 2005 (AED 6,207 million) and transfers made directly by the office of Abu Dhabi's ruler in 2006 (about AED 8 billion).

7/ 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.

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

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

10/ From the monetary statistics.

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



Table 4. United Arab Emirates: Monetary Survey, 2003–07

	2003	2004	2005	2006	Proj. 2007
(In billions of U.A.E. dirhams)					
Net foreign assets	131.8	145.3	166.8	155.7	151.9
Foreign assets	167.3	194.7	253.2	334.6	401.9
Central Bank	55.5	68.5	78.1	102.7	123.6
Commercial banks 1/	111.7	126.1	175.0	231.9	278.3
Foreign liabilities	35.4	49.3	86.4	179.0	250.0
Central bank	0.3	0.5	1.1	1.3	1.3
Commercial banks 1/	35.1	48.8	85.2	177.7	248.8
Net domestic assets	64.7	96.9	157.2	243.6	329.0
Claims on government (net)	-29.5	-31.3	-47.3	-51.9	-56.6
Claims	20.1	30.6	44.0	55.5	68.7
Deposits	49.6	61.9	91.3	107.3	125.3
Claims on public sector enterprises	13.0	13.9	24.8	33.0	42.9
Claims on private sector 2/	169.5	211.4	305.5	418.2	539.1
Capital and reserves (-)	-46.1	-54.0	-79.7	-105.6	-140.0
Other assets (net)	-42.2	-43.0	-46.1	-50.0	-56.4
Central Bank	-28.4	-39.0	-47.8	-64.7	-81.1
Commercial banks 1/	-13.8	-4.1	1.7	14.7	24.8
Of which: certificates of deposits	11.8	16.0	21.0	32.3	44.5
Domestic liquidity (M2)	196.6	242.2	324.1	399.3	480.9
Money	58.3	80.8	104.4	120.0	137.1
Currency outside banks	13.8	15.8	17.5	21.8	24.9
Dirham demand deposits	44.5	65.0	86.9	98.2	112.1
Quasi-money	138.3	161.4	219.6	279.3	343.8
Foreign currency deposits	48.0	62.5	73.8	96.3	118.6
Dirham time and savings deposits	90.3	98.9	145.8	183.0	225.3
(Changes in percent of initial M2 Stock)					
Memorandum items:					
Net foreign assets	1.9	6.9	8.9	-3.4	-1.0
Central bank	-0.5	6.5	3.7	7.5	5.2
Commercial banks	2.3	0.3	5.2	-11.0	-6.2
Net domestic credit	14.0	20.9	36.7	35.9	31.6
Claims on government (net)	-1.3	-0.9	-6.6	-1.4	-1.2
Claims on public sector enterprises	3.5	0.5	4.5	2.5	2.5
Claims on private sector	11.9	21.3	38.9	34.7	30.3
(Changes in percent; unless otherwise indicated)					
Claims on private sector	13.5	24.7	44.5	36.9	28.9
Domestic liquidity (M2)	16.1	23.2	33.8	23.2	20.4
Money	23.8	38.7	29.2	14.9	14.2
Quasi Money	13.2	16.7	36.0	27.2	23.1
Velocity (non-oil GDP/M2)	1.17	1.09	0.96	0.94	0.92

Sources: U.A.E. authorities; 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, 2006–12

	Est.	Proj.					
	2006	2007	2008	2009	2010	2011	2012
Crude oil production (millions of barrels per day) 1/	2.86	2.96	3.06	3.17	3.28	3.40	3.52
<i>Of which:</i> condensates	0.29	0.30	0.31	0.32	0.33	0.34	0.36
Crude oil exports (millions of barrels per day) 1/	2.50	2.58	2.67	2.76	2.86	2.95	3.05
WEO oil price (U.S. dollars per barrel) 2/	64.27	63.75	68.75	68.50	66.75	66.00	65.50
		(In billions of cubic meters per year)					
Natural gas production and exports							
Natural gas production	47.0	48.6	51.1	53.6	56.3	59.1	62.1
LNG exports	7.8	8.0	8.4	8.9	9.3	9.8	10.3
NGL exports	13.7	14.2	14.9	15.7	16.5	17.3	18.1
		(Percentage change, except as noted)					
Nominal GDP (in billions of U.S. dollars)	163.3	184.9	208.7	227.8	246.5	268.6	293.7
Real GDP (at factor cost)	9.4	7.7	6.6	6.7	6.9	7.3	7.7
Crude oil and natural gas 3/	6.5	3.5	3.5	3.5	3.5	3.5	3.5
Nonhydrocarbon 4/	10.4	9.1	7.6	7.7	8.0	8.4	8.9
Consumer prices	9.3	8.0	6.4	5.4	4.9	4.2	3.4
		(In percent of GDP)					
National saving	43.3	42.1	43.3	42.5	41.2	41.0	40.6
Government	33.4	32.7	32.8	31.0	29.0	27.3	25.6
Nongovernment	9.9	9.4	10.5	11.5	12.1	13.7	14.9
Gross domestic investment	21.3	21.6	21.7	22.7	23.2	24.6	25.6
Government	2.8	3.1	3.1	3.2	3.3	3.3	3.4
Nongovernment	18.5	18.5	18.6	19.5	19.9	21.3	22.2
		(In billions of U.A.E. dirhams)					
Consolidated fiscal accounts							
Revenue	302.6	336.1	381.4	405.8	426.2	452.0	480.3
Hydrocarbon	230.2	243.2	273.2	282.2	284.8	291.7	300.0
Nonhydrocarbon	72.4	92.9	108.2	123.6	141.5	160.3	180.3
<i>Of which:</i> Investment income	33.7	47.2	56.2	65.0	75.7	86.5	97.4
Expenditure, <i>of which:</i>	129.9	148.6	168.1	188.6	210.3	234.2	261.6
Current	102.4	114.1	130.2	146.2	163.4	182.5	204.2
Development	16.8	21.1	23.9	26.8	29.8	32.9	36.8
Overall balance	172.6	187.5	213.3	217.2	215.9	217.8	218.8
(In percent of GDP)	28.8	27.6	27.8	26.0	23.8	22.1	20.3
Overall balance (excluding investment income)	138.9	140.3	157.1	152.2	140.2	131.3	121.4
Excluding hydrocarbon revenue and investment income	-91.3	-102.9	-116.1	-130.0	-144.6	-160.4	-178.6
(In percent of GDP)	-15.2	-15.2	-15.1	-15.5	-16.0	-16.3	-16.6
(In percent of nonhydrocarbon GDP)	-24.3	-23.3	-23.1	-23.1	-23.0	-22.9	-22.8
Government debt 5/	60.5	73.7	86.8	99.9	113.2	126.4	143.8
(In percent of GDP)	10.1	10.9	11.3	11.9	12.5	12.8	13.3
		(In billions of U.S. dollars)					
External accounts							
Exports	142.6	149.1	164.5	175.7	185.9	198.4	212.6
<i>Of which:</i> Crude oil and products	63.1	64.3	71.6	73.6	74.0	75.4	77.2
Non-oil exports	26.4	29.7	32.2	34.6	37.4	40.4	43.7
Re-exports	46.0	47.7	52.5	58.8	65.7	73.3	82.0
Imports, f.o.b.	-86.1	-92.4	-103.3	-113.3	-124.1	-136.1	-149.5
Services (net)	-17.8	-15.6	-18.5	-21.1	-24.0	-27.2	-30.8
Investment income (net)	5.7	7.1	12.8	15.0	18.1	21.2	24.4
Transfers (net)	-8.4	-10.3	-10.6	-11.1	-11.7	-12.2	-12.7
Current account balance	35.9	37.9	45.0	45.1	44.2	44.1	43.9
(In percent of GDP)	22.0	20.5	21.6	19.8	17.9	16.4	15.0
Overall balance	6.6	5.7	6.8	6.8	6.6	6.6	6.6
Central bank reserves	27.9	33.6	40.4	47.1	53.8	60.4	67.0
In months of next year imports of goods and services	2.8	3.0	3.3	3.5	3.7	3.8	3.8
External debt (In percent of GDP) 6/	47.0	55.0	58.4	61.5	62.5	62.1	61.6

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 May 31, 2007 World Economic Outlook oil price projections.

3/ Crude oil output includes condensates.

4/ Includes refined oil products and gas liquification.

5/ Mainly commercial banks' claims on government.

6/ Mostly foreign liabilities of U.A.E. commercial banks and private institutions that are more than offset by the U.A.E.'s foreign assets.

**Table 6. United Arab Emirates: Selected Indicators of External Vulnerability, 2003–06**

	2003	2004	2005	2006
<b>External solvency indicators</b>				
REER (CPI-based, percent change, annual average)	-6.8	-3.5	2.0	4.1
Total external debt (in billions of U.S. dollars) 1/	16.5	24.9	41.0	76.7
Total external debt/GDP (in percent) 1/	18.7	24.0	30.8	47.0
<b>Public sector solvency indicators (in percent)</b>				
Overall fiscal balance/GDP	2.6	10.5	20.3	28.8
Government domestic debt/GDP	6.6	8.4	9.3	10.1
Oil revenue/total revenue	75.6	73.8	75.0	76.1
Investment income/total revenue	7.2	10.3	12.1	11.2
Non-oil revenue (excl. investment income)/non-oil GDP	7.5	8.1	8.4	10.3
Non-oil balance/GDP	-20.7	-15.6	-11.0	-9.6
<b>External Liquidity Indicators</b>				
Central Bank foreign assets (in billions of U.S. dollars)	15.1	18.7	21.3	27.9
In months of imports of goods and services	2.3	2.4	2.3	2.8
As percent of M1	95.3	84.8	74.8	85.4
As percent of commercial banks foreign liabilities	158.4	140.5	91.7	57.7
Commercial banks' NFA (in billions of U.S. dollars)	20.9	21.1	24.5	14.8
Foreign assets	30.4	34.3	47.7	63.2
Foreign liabilities	9.5	13.3	23.2	48.4
Crude oil exports/total exports (in percent)	32.7	32.8	37.1	40.8
<b>Financial sector indicators</b>				
Foreign currency deposits/total deposits (in percent)	26.3	27.6	24.1	25.5
Net domestic assets (annual change in percent)	59.4	49.8	62.2	54.9
Private sector credit (annual change in percent)	13.5	24.7	44.5	36.9
Private credit/total assets of banks (in percent)	48.2	48.9	50.2	50.7
Interest rate spread against U.S. dollar (in basis points) 2/	-0.2	0.1	0.2	-0.2
<b>Banking system indicators (in percent)</b>				
Commercial banks' capital to risk-weighted assets ratio	18.6	16.9	17.4	16.6
Gross non-performing loans to total loans	14.3	12.5	8.3	6.3
Return on assets	2.3	2.1	2.7	2.3
Return on equity	16.4	18.6	22.5	18.0
Spread between 3-month dirham time deposits and local currency business loans (in percentage points)	4.9	4.8	4.4	3.2

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

1/ Mostly foreign liabilities of U.A.E. commercial banks and private institutions that are more than offset by the U.A.E.'s foreign assets. During 2003–06, deposits of non-residents in U.A.E. banks constituted about 17 percent of total foreign liabilities.

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

**Table 7. United Arab Emirates: Financial Soundness Indicators, 2003–06**

(In percent, unless otherwise indicated)

	2003	2004	2005	2006
<b>Core indicators</b>				
Deposit-taking institutions				
Total regulatory capital to risk-weighted assets 1/	18.6	16.9	17.4	16.6
Regulatory Tier I capital to risk-weighted assets	18.2	16.3	16.9	15.0
Nonperforming loans net of provisions to capital	7.7	3.5	1.8	0.6
Nonperforming loans to total gross loans	14.3	12.5	8.3	6.3
Return on assets	2.3	2.1	2.7	2.3
Return on equity	16.4	18.6	22.5	18.0
Interest margin to gross income	59.5	64.6	49.3	29.3
Noninterest expenses to gross income	43.6	40.3	26.9	20.9
Liquid assets to total assets	22.7	23.2	26.9	16.4
<b>Encouraged indicators</b>				
Deposit-taking institutions				
Capital to assets	11.4	11.1	11.9	12.6
Personnel expenses to noninterest expenses	29.5	38.6	41.8	54.6
Customer deposits to total (non-interbank) loans	125.0	113.6	112.4	96.5
Households				
Household debt to GDP	6.6	6.1	6.9	5.2
Real estate loans to total loans	5.4	4.7	5.0	5.9
<b>Other indicators</b>				
Loan loss reserves/non-performing loans	88.5	94.6	95.7	98.2
Deposits as percent of M2	92.7	93.2	94.1	94.1
Commercial banks loans to private sector as percent of total deposits	69.9	69.5	69.1	66.6
Number of commercial banks (end-of-period)	46	46	46	46
Number of banks with C.A.R. above 10 percent	46	46	46	46
Foreign currency deposits as percent of M2	24.4	25.8	22.8	24.1
Foreign currency denominated lending/total lending	23.9	20.7	19.7	22.8
Earning per employee (in millions of AED)	0.40	0.50	0.70	0.71

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

**Staff Report for the 2007 Article IV Consultation  
Informational Annex**

Prepared by the Middle East and Central Asia Department

August 27, 2007

Contents	Page
I: Fund Relations.....	2
II. Relations with the World Bank.....	4
III. Statistical Issues.....	5

## ANNEX I: UNITED ARAB EMIRATES—FUND RELATIONS

(As of April 30, 2007)

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

<b>II. General Resources Account:</b>	SDR Million	Percent of Quota
Quota	611.70	100.00
Fund holdings of currency	566.77	92.65
Reserve position in Fund	45.53	7.44

<b>III. SDR Department:</b>	SDR Million	Percent of Allocation
Net cumulative allocation	38.74	100.00
Holdings	8.40	21.67

**IV. Outstanding Purchases and Loans:** None

**V. Financial Arrangements:** None

**VI. Projected Payments to Fund:**

(SDR million; based on present holdings of SDRs):

	2007	Forthcoming			
		2008	2009	2010	2011
Principal charges/ Interest	0.96	1.29	1.28	1.29	1.29
<b>Total</b>	<b>0.96</b>	<b>1.29</b>	<b>1.28</b>	<b>1.29</b>	<b>1.29</b>

**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, in practice, 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 officially 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 transfers for current international transactions, other than restrictions maintained for security reasons pursuant to UN Security Council resolutions, which restrictions should be notified to the Fund in accordance with Executive Board Dec. No. 144-(52/51).

## **XI. Article IV Consultation**

The U.A.E. is on the standard 12-month consultation cycle. The last Article IV consultation discussions were held during March 22—April 6, 2006, and the staff report (IMF Country Report No. 06/257) and the Statistical Appendix (IMF Country Report No. 06/256) were considered by the Executive Board on June 12, 2006.

## **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
MFD	AML/CFT	April 2005
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	UAE: Options for New Indirect Taxation and Intergovernmental Fiscal Relations	March 2006
LEG	AML/CFT	March 2007
STA	Compilation of a high-frequency CPI Index	March 2007

**XII. Resident Representative:** None.

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

As of June 7, 2007

**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 07.
- In response to a request from the federal Ministry of Finance and Industry, a Bank specialist will visit Abu Dhabi on June 24 to discuss the development of debt markets.

**International Finance Corporation (IFC)**

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



### ANNEX III: UNITED ARAB EMIRATES—STATISTICAL ISSUES

1. While data provision to the Fund is adequate for overall surveillance purposes, data shortcomings affect staff's analysis. Shortcomings in 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 some trade statistics. In addition, the frequency of official statistics is inadequate—most data are produced only on an annual basis.
2. The U.A.E. has received several STA technical assistance missions over the past decade. The 2003 STA multi-sector statistics mission concluded that, while the methodologies used to compile macroeconomic statistics are generally appropriate, serious deficiencies exist in most sectors.<sup>1</sup> These are attributable to the lack of sufficient and regular data sources in the real sector; inadequate coordination among data compiling agencies; and constraints from the distribution of personnel and financial resources between the federal government and the largest emirates. In response to the authorities' interest in participating in the General Data Dissemination System (GDSS), the 2003 mission worked with U.A.E. officials to prepare draft GDSS metadata. The U.A.E. hosted a GDSS workshop in Abu Dhabi during February 27–March 9, 2005.
3. The STA Country Coordinator for the U.A.E. visited Abu Dhabi during March 11–22, 2007 as part of a consumer price index (CPI) mission. The authorities expected that follow-up discussions involving the Ministry of Economy (MOE), the U.A.E. Central Bank, and the Ministry of Finance and Industry would result in the appointment of a GDSS coordinator.

#### Real sector

- Only an annual CPI is compiled.
- Staff resources at the Ministry of Economy (MOE)—which compiles and disseminates the annual CPI with a three month lag—and coordination among various federal and emirate data producing agencies need considerable strengthening.
- The proposal for the creation of an independent National Bureau of Statistics (NBS), submitted to the Council of Ministers in early 2007, was approved in April 2007 as part of the U.A.E. Government Strategy for the next three years. The NBS will have general oversight of the national statistical system and will undertake the current statistical functions and responsibilities of the MOE, including the compilation of price statistics. The conduct of the new 2007/08 Household Expenditures Survey,

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<sup>1</sup> United Arab Emirates: Report of the Multisector Statistics/GDSS mission, December 2003.

which was launched in April 2007, will greatly facilitate the adoption of a high-frequency CPI.

- The annual CPI has several shortcomings. The outdated weights do not adequately represent all regions; items, outlets and rental units surveyed for prices are not sufficiently representative; there are no replacement items or imputations for missing prices, and no quality adjustment procedures.
- The national accounts compilation system suffers from a number of deficiencies, including lack of a comprehensive data collection program. The statistical techniques used in compiling GDP by production and expenditure approaches are not sound. Basic data remain inadequate for manufacturing, construction, wholesale and retail trade, and most of the other service sectors. Despite their importance in total GDP, oil and gas sector data are received with a lag from the Abu Dhabi National Oil Company (ADNOC) and computation of the real value-added for petrochemicals is not based on the 1993 SNA methodology.
- Although labor statistics collected through census are broadly in line with ILO recommendations, there are divergences from ILO definitions, including inconsistency of some concepts and irregular and incomplete updating of the census data. Lack of regular household surveys prevents compilation of annual data on basic national labor force statistics such as wages, unemployment, labor force and employment.

### **Fiscal sector**

- Principal deficiencies can be attributed to both the lack of coordination among the emirates and federal government, and the low frequency in reporting of government financial operations. The Ministry of Finance and Industry (MOFI) compiles data for the federal government only. Separate fiscal data on the federal government and three emirates (Abu Dhabi, Dubai, and Sharjah), which are provided to the annual Article IV consultation missions, are used by Fund staff to provide a consolidated fiscal position for the U.A.E. An annual, “consolidated” fiscal statement is published in the central bank’s *Statistical Bulletin*, which is different from the Fund staff presentation, due to the omission of certain budget items, such as investment income. International standards of economic classification of expenditure and revenue are not fully followed.
- The last data reported to STA for publication in the *Government Finance Statistics Yearbook* were for 1999 and covered 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.<sup>2</sup>

### **Monetary sector**

- Monetary and financial sector statistics are reported with a considerable lag and do not include information on the activities of non-bank finance companies.
- As in the case of other GCC countries, the 2006 STA workshop on the harmonization of monetary and financial statistics found that the U.A.E.'s Standardized Report Forms (SRFs) suffer from a number of weaknesses.

### **External sector**

- Balance of payments (BOP) statistics suffer from a lack of primary data sources for most transactions. Staffing for BOP compilation is insufficient, and cooperation from other government agencies remains inadequate. Many entries are estimates based on incomplete information and some important transactions, such as foreign direct investment (FDI), are not covered at all and are estimated by Fund's staff. There are major gaps in official and private transfers, oil companies' service payments, private and official investment income, and financial transactions for all sectors except banks. The U.A.E. does not report BOP data for publication in the IMF's *IFS* (with the exception of trade statistics, which have been irregular), or the *Balance of Payments Statistics Yearbook (BOPSY)*.
- The authorities do not compile or publish the International Investment Position (IIP) statement, despite ready availability of certain potential sources, such as banking and government statistics.

### **Socio-demographic statistics**

- The U.A.E. follows the practice of many other countries, with the MOE taking the lead in conducting the population census and large surveys, while line ministries collect data through their administrative reporting systems. A population census was completed in 2005. At present, no data exist on measures of income distribution, poverty, and access to basic services.<sup>3</sup>

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<sup>2</sup>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).

<sup>3</sup> It should be noted that the Statistics Center of Dubai has made substantial progress regarding the provision of socio-demographic statistics for the emirate of Dubai.

## United Arab Emirates: Table of Common Indicators Required for Surveillance

As of June 15, 2007

	Date of Latest Observation	Date Received	Frequency of Data <sup>4</sup>	Frequency of Reporting <sup>4</sup>	Frequency of Publication <sup>4</sup>
Exchange Rates	05/07	06/07	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	06/8/2007	6/11/2007	W	W	W
Reserve/Base Money	12/06	04/07	M	Q	Q
Broad Money	12/06	04/07	M	Q	Q
Central Bank Balance Sheet	12/06	04/07	M	Q	Q
Consolidated Balance Sheet of the Banking System	12/06	04/07	M	Q	Q
Interest Rates <sup>2</sup>	02/06	03/06	M	Q	Q
Consumer Price Index	2005	3/06	A	A	A
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2005	3/06	A	A	A
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	2005	3/06	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	2005	3/06	A	A	A
External Current Account Balance	2005	3/06	A	A	A
Exports and Imports of Goods and Services	2005	3/06	M	A	A
GDP/GNP	2005	3/06	A	A	A
Gross External Debt	...	...	...	...	...

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

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

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by the IMF Staff Representative  
September 21, 2007**

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 August 21, 2007. This information does not change the staff appraisal.
2. In August , the WEO oil price projections for 2007 were revised upward by 3 percent on average compared to their June 2007 baseline. The impact of this revision on the projected current account and fiscal balances for 2007 is modest (about 0.6 percentage point of GDP each) and does not materially change the staff's medium-term scenario.
3. In July 2007, Moody's upgraded the government of Abu Dhabi's long-term foreign and local currency bond rating to Aa2. This was followed by a rating upgrade for several U.A.E.-based banks. The Emirate of Abu Dhabi announced plans to issue its first bond in the international capital markets, which would serve as a benchmark for the pricing of corporate debt instruments.
4. The merger of two of the largest banks in Dubai—Emirates Bank International and the National Bank of Dubai—is underway following the approval by the shareholders in September. The new consolidated bank, to be named Emirates NBD, will have an asset base of about \$45 billion, the largest in the U.A.E. The merger is expected to lead to further consolidation in the U.A.E. banking sector.
5. The U.A.E.'s capital markets seem to be slowly recovering from the sharp correction that started in 2005. As of September 13, 2007, the Abu Dhabi Securities Market (ADSM) and the Dubai Financial Market (DFM) had posted positive returns for the year, with gains of about 14 percent and 2 percent, respectively. A new exchange, the Dubai Mercantile Exchange, started operations on June 1, with the introduction of the first Oman crude oil futures contract. The recent turmoil in international financial markets has had a relatively minor effect on U.A.E. capital markets.
6. Collaboration between the authorities and the IMF Statistics Department for the development of a new consumer price index has continued. In addition, a multi-sector statistics mission is expected to take place in the next few months with the aim of helping the authorities upgrade their statistical system and subscribe to the GDDS.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 07/125  
October 9, 2007

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2007 Article IV Consultation with the United Arab Emirates**

On September 21, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United Arab Emirates.<sup>1</sup>

### **Background**

The U.A.E.'s economic performance remains very strong. Real GDP growth was in excess of 9 percent in 2006, with oil production rising by 8 percent and non-oil sectors growing at double-digit growth rates. The rapid expansion is supported by an outward-oriented development strategy, a favorable business climate, and sustained high oil prices. Strong domestic demand and housing shortages have led to sharp increases in rents and contributed to upward pressure on other prices. As a result, the consumer price index inflation exceeded 9 percent in 2006. Reflecting record high oil prices, the overall fiscal and external current account surpluses remained large in 2006, and have allowed further accumulation of official foreign assets.

The medium-term outlook is very positive with real GDP growth projected to remain strong in 2007, and slightly decelerating thereafter due to temporary capacity constraints. The fiscal and external accounts are projected to remain in large surplus.

Prudent government spending at the federal and emirate levels has led to a decline in the non-oil fiscal deficit (excluding investment income). At the same time, however, a number of large

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<sup>1</sup> 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.

investment projects are being undertaken by public and quasi-public entities outside the budget, including in the hydrocarbon sector, infrastructure, real estate, and tourism. External borrowing to finance these investment projects has also picked up significantly.

The financial system is sound and has not been affected by the correction of the U.A.E. stock markets in 2005-06. The growth of private sector credit remains high and banks' exposure to the real estate sector has increased recently. Reforms are underway to strengthen the prudential and regulatory oversight of the banking system and the capital markets; open the banking sector to greater competition; and strengthen the legal framework for the financial sector.

The authorities are committed to the U.S. dollar peg in the period leading up to the establishment of the monetary union among the members of the Gulf Cooperation Council (GCC). They also remain committed to achieving the monetary union by 2010. On the back of higher inflation in the U.A.E. than in partner countries, the exchange rate of the dirham has appreciated in real effective terms by about 6 percent since 2004.

The authorities announced a major reform plan that sets the U.A.E.'s strategy for the next three years. A key focus of the strategy will be to improve government efficiency and strengthen the cooperation between the federal and emirate governments. Progress is also being made to improve the business climate, through updates of key legislation, such as the labor, company, and competition laws.

Efforts to address the weaknesses of economic statistics at the national level have intensified. Work is underway to improve consumer price data, including with Fund technical assistance, and to establish a National Bureau of Statistics by end-2007.

### **Executive Board Assessment**

Executive Directors commended the U.A.E.'s impressive growth performance over the past few years, stemming from the authorities' successful outward-oriented development strategy, the use of oil resources to achieve economic diversification, and the pursuit of prudent macroeconomic policies. The medium-term prospects look bright, supported by a continued favorable outlook for energy prices given sustained global demand, a strong investment momentum, and an improved domestic business climate. Directors agreed that the key challenges will be to ensure sustained noninflationary growth and further diversification of the economy.

Directors observed that although the assessment of inflation is complicated by data weaknesses, the rate of price increases, driven mainly by strong demand for housing, is too high. They acknowledged, however, that the anticipated reduction of capacity constraints—especially in the housing market—is likely to reduce inflation pressures over the medium term. Directors considered that fiscal policy could play a greater role in regulating domestic demand. In particular, expenditure increases—including by public and quasi-public entities—should be consistent with the country's absorptive capacity. This, together with efforts to alleviate capacity

constraints, would help subdue inflation and support a continued economic expansion with macroeconomic stability.

Directors supported the authorities' prudent fiscal policy, with the non-oil deficit declining substantially as a proportion of non-oil GDP, and the overall fiscal position expected to remain in surplus over the medium term. They commended the authorities' fiscal reforms, which are aimed at modernizing the fiscal system and improving efficiency. They welcomed the preparations to introduce a Value Added Tax system at the federal level. Directors called for greater fiscal coordination between the emirates and the federal government. They therefore welcomed the authorities' intention to establish a macro-fiscal unit at the federal government level. The phasing and monitoring of large investment projects carried out by government and quasi-public entities outside the budget should also be intensified.

Directors agreed that the current peg of the dirham to the U.S. dollar has served the U.A.E. well. They considered that the exchange rate of the dirham is in line with fundamentals, and noted that further structural reforms would help to sustain the U.A.E.'s competitiveness. Directors noted the authorities' commitment to work closely with other GCC member countries to reach consensus on the appropriate future exchange rate regime to be adopted as part of the GCC currency union. Looking forward, a few Directors saw value in some flexibility.

Directors noted the strength and resiliency of the U.A.E. financial system, as evidenced by the high capitalization and profitability of financial institutions. They encouraged the authorities to further strengthen prudential regulations and bank supervision, especially in the context of the current rapid credit growth and buoyant real estate market. Directors welcomed the authorities' intention to establish a federal credit bureau to help improve the reporting and monitoring of credit data. At the same time, they called for a strengthening of the supervision of financial services groups comprising banks, insurance companies, and securities firms.

Directors welcomed steps to enhance the supervision of capital markets and efforts to update the banking law and the company law, consistent with the recent Financial Sector Assessment Program update proposals. These steps would, inter alia, remove barriers to foreign participation in U.A.E. markets and help protect shareholder rights. Directors called on the authorities to move ahead to enact the draft securities law, encourage the listing on the equity market of large quasi-public enterprises, and promote an increased role for institutional investors in the markets. Such measures would strengthen investor confidence, reduce market volatility, and deepen the U.A.E.'s capital markets.

Directors welcomed the important steps taken to improve the U.A.E.'s statistical systems in the next few years. They looked forward to the establishment of a National Bureau of Statistics, and the launching of several statistical surveys currently under preparation. They encouraged the authorities to follow up on the Fund's technical assistance recommendations to improve the quality and timeliness of consumer price data, and fiscal data at the federal and emirates levels. Directors welcomed the authorities' intention to expedite the U.A.E.'s participation in the Fund's General Data Dissemination Standard.



**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.

**United Arab Emirates: Selected Economic Indicators, 2003–06**

	2003	2004	2005	2006
		(Annual percent change)		
Real GDP (at factor cost)	11.9	9.7	8.2	9.4
Real oil and gas GDP	13.6	2.9	1.6	6.5
Real non-oil GDP	11.2	12.6	10.8	10.4
CPI inflation (average)	3.2	5.0	6.2	9.3
		(In percent of GDP, unless otherwise indicated)		
Public finances				
Revenue	30.7	35.4	41.7	50.5
Oil	23.2	26.1	31.3	38.4
Non-oil	7.5	9.3	10.4	12.1
Expenditure and net lending	28.2	24.9	21.4	21.7
Budget balance	2.6	10.5	20.3	28.8
Non-hydrocarbon balance (excluding investment income) 1/	-32.4	-27.9	-25.0	-24.3
		(Annual percent change)		
Monetary sector				
Broad money	16.1	23.2	33.8	23.2
Credit to private sector	13.5	24.7	44.5	36.9
		(In billions of U.S. dollars, unless otherwise indicated)		
External sector				
Exports of goods	67.2	90.2	117.2	142.6
Oil and gas	29.6	38.0	55.0	70.2
Imports of goods	-45.8	-63.4	-74.5	-86.1
Current account balance	7.6	10.3	24.3	35.9
Current account balance (in percent of GDP)	8.6	10.0	18.3	22.0
Gross official reserves	15.1	18.7	21.3	27.9
In months of next year imports of goods and services	2.3	2.4	2.3	2.8
Total external debt (in percent of GDP) 2/	18.7	24.0	30.8	47.0
REER (CPI-based, percent change, annual average) 3/	-6.8	-3.5	2.0	4.1

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

1/ In percent of non-hydrocarbon GDP.

2/ Mostly foreign liabilities of U.A.E. commercial banks and private institutions that are more than offset by the U.A.E.'s foreign assets. During 2003–06, deposits of non-residents in U.A.E. banks constituted about 17 percent of total foreign liabilities.

3/ An increase is a real appreciation.

**Statement by A. Shakour Shaalan, Executive Director for the United Arab Emirates  
September 21, 2007**

1. At the outset, I would like to convey the appreciation of the United Arab Emirates (U.A.E.) authorities to staff and management for the constructive engagement with the Fund. They are in broad agreement with the thrust of the staff appraisal and look forward to continued dialogue on the policy priorities in the period ahead.

**Recent Developments**

2. For the fourth consecutive year, the economic expansion in the U.A.E. continued at a brisk pace, against the background of buoyant oil prices, strengthened fundamentals, and an improved outward-oriented policy environment. At 9.4 percent in 2006, GDP growth was among the highest in the world, generating over 220 thousand jobs. The expansion was broad-based, driven by sustained momentum in non-oil activity at over 10 percent—particularly in the construction, trade, and tourism sectors—as well as an acceleration in hydrocarbon output. The fiscal and external accounts continued to post record surpluses. Moreover, the economy has weathered the fallout from the equity market correction in 2006 and the recent financial turbulence induced by the U.S. subprime mortgage sector. These positive developments reflect the authorities' steadfast commitment to the judicious use of hydrocarbon revenues to intensify the diversification drive and further reinforce the economy's fundamentals and resilience. Not surprisingly, however, with the sustained dynamism of the economy outpacing supply-side response, tightening capacity constraints have stoked inflationary pressures. The rise in inflation in 2006 was largely driven by the sharp increase in rental prices—particularly in Dubai and Abu Dhabi. Nonetheless, inflationary pressures are expected to abate in 2007 onwards, with the coming on market of several property and housing projects.

**Prospects and Policies**

3. The authorities share staff's assessment regarding the strength of the macroeconomic outlook. In the near-term, the authorities are cognizant that inflation is a major concern, given the risk of entrenching higher expectations if inflation is allowed to persist at its current rate. To mitigate this risk, a number of measures have already been initiated. These include the introduction of a temporary cap on rent increases in Dubai and Abu Dhabi, which will be lifted once housing pressures ease in response to the completion of large real estate projects.

4. Over the medium-term, the authorities' development strategy continues to deepen the diversification process along each emirate's competitive advantage, with the services industry likely to become a key driver of non-oil growth. A comprehensive reform plan setting out the government's agenda for the coming three years has been announced. The plan addresses economic development and social issues, with federal and emirate-specific proposals still under deliberation. Furthermore, an ambitious investment program is currently underway to expand capacity in the tourism, transportation, manufacturing, and hydrocarbon sectors. These investments are expected to set the stage for a structurally higher productivity growth and output potential. To safeguard price stability, execution of this strategy will take into account absorptive capacity and implementation considerations in the economy. Additionally, and while the economic transformation should temper any potential weaknesses stemming from the hydrocarbon sector, it is important to note that public finances remain resilient to slides in oil prices as low as US\$32 per barrel—a highly unlikely scenario given the structural shift in oil prices.

### **Fiscal Policy and Reforms**

5. In view of the volatility in oil prices and uncertainty about the permanence of the price increase, fiscal policy in the U.A.E. continues to aim at achieving a balance between saving the oil revenues and the need for increased spending to expand the economy's absorptive capacity. Against this backdrop, and notwithstanding a sharp increase in hydrocarbon-based revenues, a prudent expenditure policy has been maintained at all levels of government. Indeed, while the overall budget balance registered a record surplus of 29 percent of GDP in 2006, the non-oil deficit as a proportion of non-oil GDP further narrowed to about 15 percent—half its value just three years ago. Such a remarkable fiscal stance is attuned to efforts to contain inflation at the current juncture.

6. On the expenditure side, current expenditure in relation to GDP registered a modest decline, underpinned by a diminished share of the wage bill. This largely reflects ongoing efforts by Abu Dhabi to outsource non-core budget activities, with the significant retrenchment of the size of its government partly offsetting the effect of the wage increase on the budget. On the revenue side, non-oil revenues as a share of non-oil GDP continued on an upward trend, picking up by 3 percentage points in 2006 to 19.2 percent. The prospective introduction of a value added tax (VAT) in advance of the Gulf Cooperation Council (GCC) target date should further broaden the revenue base, and provide the federal government with more instruments to calibrate fiscal policy.

7. Complementing the disciplined fiscal stance has been the substantial progress on important structural reforms to enhance the budget structure and improve its effectiveness. At the federal level, key achievements include the establishment of a treasury single account, the revision of the budget classification and chart of accounts, and the development of a government financial management information system. At the same time, the authorities have devised a strategic reform plan aimed at enhancing fiscal coordination between the federal and emirate levels, including by better capturing of off-budget investment spending by government and quasi-public entities. To this end, the authorities are working toward setting up a macro-fiscal unit at the federal level.

## **Monetary and Exchange Rate Policies**

8. Given the full convertibility of the capital account, monetary policy in the U.A.E. is primarily geared toward maintaining credibility of the currency peg. Although growth in money aggregates was robust in 2006, it decelerated markedly compared to 2005. The Central Bank of the U.A.E. (CBU) has stepped up its issuance of certificates of deposits, which helped ease the growth in liquidity. The deceleration in money growth in large part reflects the decline in net foreign assets by commercial banks. Taking advantage of the favorable external environment and successive ratings upgrades, banks have increased their foreign borrowing to finance the strong growth in credit in support of investment. The authorities are aware of the importance of monitoring external borrowing by financial institutions and corporations. To this end, a debt management unit will be established in Dubai.

9. The authorities are reconfirming their commitment to the U.S. dollar peg in the transition to the GCC monetary union in 2010. The peg has served the economy well by enhancing the credibility of the policy framework. The authorities are also of the view that the current exchange level is appropriate, and agree with staff's assessment outlined in Box 3. While on the subject of the exchange rate, it is well to assert that there are inherent difficulties in the application of the 2007 Surveillance Decision to oil producing countries. Consistent with the broader GCC strategy, the authorities remain open to discussing all options for the common exchange rate regime under the monetary union.

## **Financial Sector Issues**

10. The Financial Sector Stability Update (FSSA) has confirmed the soundness and increased sophistication of the U.A.E. financial system. Benefiting from the rapid expansion in the economy, the banking sector is enjoying comfortable levels of profits and capitalization. The sector is being opened up to foreign competition, with the granting of licenses to three GCC banks and two Islamic banks in 2006. Islamic banks are becoming an increasingly important part of the banking system. To assist them in better managing their liquidity, the CBU is contemplating the issuance of Shariah-compliant instruments. Good progress has been made in strengthening banking sector supervision and regulation, notably the introduction by the CBU of a comprehensive risk assessment approach, the preparation for full implementation of Basel II principles by end-2007, and the approval of several key pieces of AML/CFT legislation.

11. Stress testing has also established the resilience of the banking system to a variety of shocks, including to deterioration in asset quality, as well as interest rate and foreign exchange risks. Although a few banks could be affected by a severe correction in the real estate market, the authorities are of the view that the related risks are relatively muted. Two important considerations bear on this view. First, banking sector exposure to the real estate sector (mortgage and construction) is relatively limited and concentrated within some institutions and geographic areas. This should help contain any spillover effect from a potential correction in the real estate sector. Second, staff's own assessment is for the strong demand in housing and property to continue over the medium term. If correct, this would substantially diminish the risk of a sharp price correction in the real estate sector.

Nevertheless, the CBU is reviewing its classification of bank exposure to the real estate sector, and is further contemplating more appropriate prudential oversight. The planned establishment of a federal credit bureau should also help strengthen banking supervision more generally.

12. The U.A.E. capital markets are further gaining in depth and sophistication, and their supervision is being strengthened. In connection with the latter, important measures include the transfer of responsibility for oversight of Initial Public Offerings (IPO) from the Ministry of Economy to the Emirates Securities and Commodities Authority (ESCA) in early 2007, with the pricing of IPOs undertaken in collaboration with the private sector. In addition, a new code of good governance has been issued, envisaging the enhancement of governance practices and disclosure of listed companies.

13. Building on Dubai's aggressive diversification drive, the Dubai International Financial Center (DIFC) is increasingly promoting the U.A.E. as a regional financial hub. Activities in the DIFC are supported by an impressive physical infrastructure and sound legal framework aligned with best international practices. While banking activities remain relatively limited, the stock exchange, DIFX, is competing successfully with other U.A.E. and GCC markets.

### **Structural Policies and Other Issues**

14. The authorities' outward oriented and private sector friendly strategy is reflected in highly open and flexible labor markets. Notwithstanding the favorable ranking in international business surveys, the authorities are intensifying their efforts to strengthen the business climate and safeguard private sector competitiveness. Key initiatives in this regard include the ongoing revision of the corporate and competition laws, as well as the updating of labor market legislation to allow greater labor mobility across sectors.

15. Significant steps have been taken to upgrade the statistical database. As part of the government's three-year strategy to overhaul federal government statistics, a National Bureau of Statistics (NBS) will be established by end-2007. In this connection, the 1974 Statistics Law is being revised to grant the NBS the professional independence and the authority to undertake its designated activities. Progress is also being made to improve the timeliness and quality of consumer price data, with the assistance of the Fund. In March 2007, a technical assistance mission prepared a report which included a work plan for the development of a monthly Consumer Price Index (CPI), compiled in accordance with international standards. The plan takes into account several requirements for the construction of the CPI, most notably the implementation of a new Household Expenditure Survey (HES) launched in April 2007. The authorities are also working on finalizing their participation in the IMF General Data Dissemination System.