

**United Arab Emirates: 2011 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with United Arab Emirates, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 7, 2011, with the officials of United Arab Emirates on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 5, 2011. 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 supplement of April 5, 2011 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its April 21, 2011 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper and Statistical Appendix

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

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# UNITED ARAB EMIRATES

## STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

### KEY ISSUES

April 5, 2011

**Economic prospects.** Nonhydrocarbon GDP growth is projected to increase from 2.1 percent in 2010 to 3.3 percent in 2011, led by strong tourism, logistics, and trade in Dubai; and large public investment spending in Abu Dhabi. Nevertheless, the real estate overhang and short-term refinancing needs from overleveraged Government-Related Entities (GREs) weigh on the near-term outlook. Despite higher international food prices, the CPI inflation rate is expected to remain moderate at 4.5 percent, as rents continue to decline.

**Risks to the outlook.** The unfolding turmoil in the Middle East and North Africa poses downside risks. The re-pricing of risk in the region could result in more difficult financial market conditions. On the positive side, there are indications that the United Arab Emirates (U.A.E.) may benefit from increased tourism and investments looking for diversification within the region. Higher oil prices are also benefiting the U.A.E. as a hydrocarbon exporter, though if sustained, they may affect the recovery if demand from Asia falls.

**Supporting the recovery in the short term.** Given the still fragile economic recovery, macroeconomic policies in 2011 should support domestic demand and respond to potential economic spillovers from the unfolding events in the region. The government should adopt a neutral fiscal stance in 2011, and expand spending in case the regional unrest starts affecting the economy. The central bank should be prepared to provide liquidity if the re-pricing of risk in the region were to trigger a reversal of the recent bank deposit inflows.

**Mitigating the risks posed by quasi-sovereign entities.** GREs have contributed significantly to U.A.E.'s economic growth. Nevertheless, the recent bailouts, the size of Dubai's GRE debt, and the significant short- and medium-term roll-over needs call for containing the risks posed by these entities. This entails better governance, as well as assessing, monitoring, reporting, and disclosing GRE contingent liabilities in government accounts. Containing GRE borrowing is key for fiscal sustainability at the emirate level.

**Securing financial stability.** The banking sector remains resilient to shocks, thanks to high capital and strong earnings. Although nonperforming loans have doubled since the crisis, banks have increased provisioning. In light of the ongoing restructuring of Dubai GREs, the central bank should continue to ensure that banks provision adequately, monitor the performance of restructured loans, and encourage banks to retain more earnings to handle potential risks in the medium term.

**Managing the economy over the cycle.** The recent boom-bust underscores the need for strong demand management over the economic cycle. Under a pegged exchange rate regime, this requires mutually-supportive countercyclical fiscal and macroprudential policies; and the federal structure of the U.A.E. makes close coordination between the various governments imperative.

**Improving the statistical framework.** With data availability underpinning good policy-making, more progress is needed for timely compilation and dissemination of key statistics.

**Approved By**  
**Alfred Kammer and**  
**Thomas Dorsey**

Discussions took place in Abu Dhabi and Dubai from February 27–March 7, 2011. The staff team comprised Ms. Koranchelian (head), and Messrs. Sensenbrenner, Cevik, Sadikov, and Ribeiro da Silva (all MCD), and Guzzo (MCM). Mr. Kammer joined the team during March 6–7

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## BACKGROUND

### 1. The U.A.E. is a federation of seven emirates, with a net external creditor position.

The U.A.E. has the fifth-largest oil and gas reserves in the world. Abu Dhabi produces 95 percent of the country's oil and gas, and owns one of the largest sovereign wealth funds in the world, with more than \$300 billion assets under management. In contrast, Dubai, the second largest emirate, has a more diversified economy, driven by re-export trade, services, and real estate, and is highly leveraged, with a gross debt-to-GDP ratio above 100 percent. While the U.A.E. has a federal structure and some wealth is shared between emirates, each emirate manages its own budget independently. Expatriates constitute 80 percent of the U.A.E. population and are virtually fully employed. Unemployment among nationals is high (14 percent in 2009) and concentrated among the youth and in the northern emirates.

### 2. The global financial crisis brought an end to a decade of high growth.

The U.A.E. has had remarkable achievements over the last decade with its open and outward orientation, which led to a diversified and steadily growing economy. The decline in oil prices, the post-Lehman shut down of international capital markets, and the price correction in the property market in Dubai have put significant strains on the economy. The authorities supported the banking sector through liquidity injection, recapitalization, and deposit guarantees, and the Emirate of Abu Dhabi provided financial support to the Emirate of Dubai. Nevertheless, the combination of substantial short-term borrowing of the highly-leveraged GREs in Dubai, the price correction in the real estate market, and maturity mismatches forced Dubai World (DW), a major Dubai GRE, to seek a debt standstill. Real GDP is estimated to have contracted by 3¼ percent in 2009 (Figure 1).

## RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

### A. Signs of Economic Stabilization

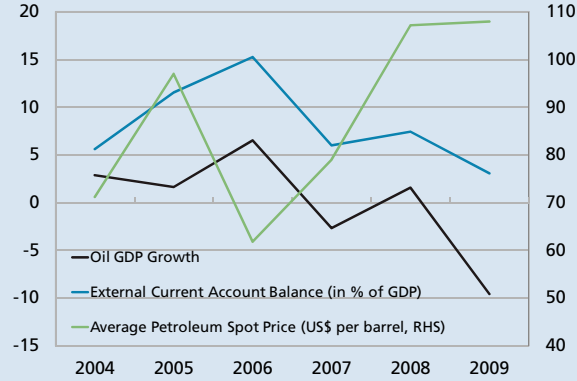
### 3. The economy started to recover in 2010, though more modestly than in neighboring GCC countries.

Benefiting from higher oil prices and strong demand from traditional trading partners in Asia, real GDP grew by an estimated 3.2 percent in 2010 (Figure 2). Nevertheless, because of the real

estate overhang and continued uncertainties about the solvency of GREs, growth remained below the regional average of 5 percent. The 12-month consumer price (CPI) inflation rate was subdued at 1.7 percent in December 2010, up from -0.3 percent at end-2009.

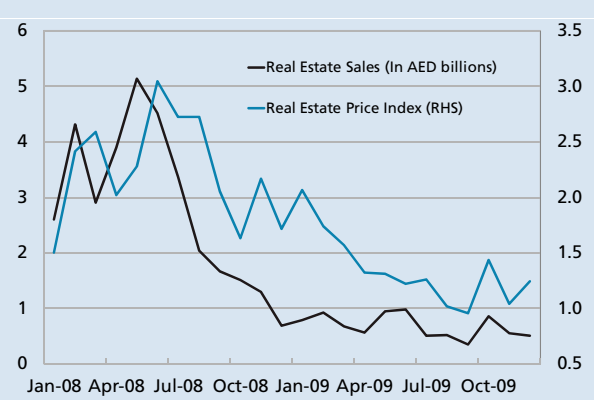
**Figure 1** United Arab Emirates: Impact of the Global Financial Crisis, 2004–09

*Hydrocarbon GDP growth and the external account moved in tandem with oil prices and production*



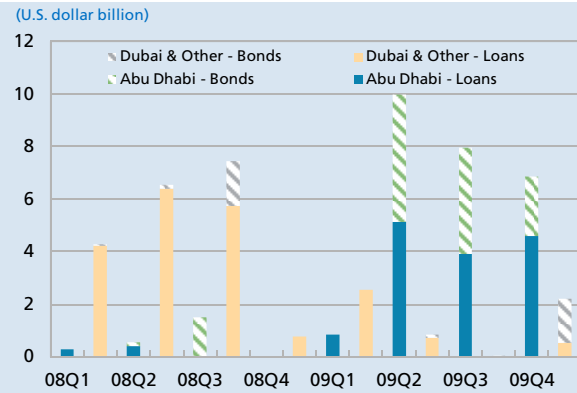
Sources: Country authorities, Fund staff estimates.

*Following Lehman's default the real estate bubble burst...*



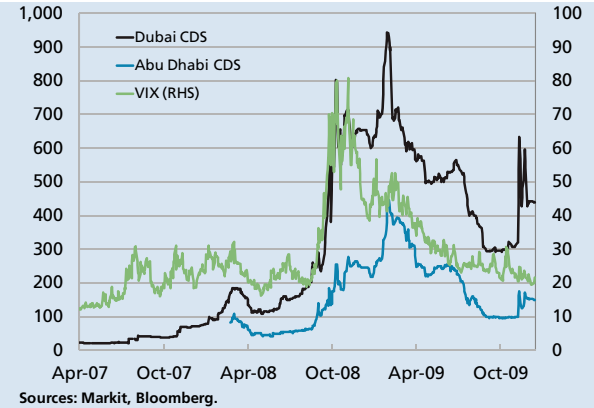
Sources: Dubai Land Department, and Fund staff estimates.

*...and the shutdown of international capital markets led to a sudden stop in financing for Dubai in the fourth quarter of 2009.*



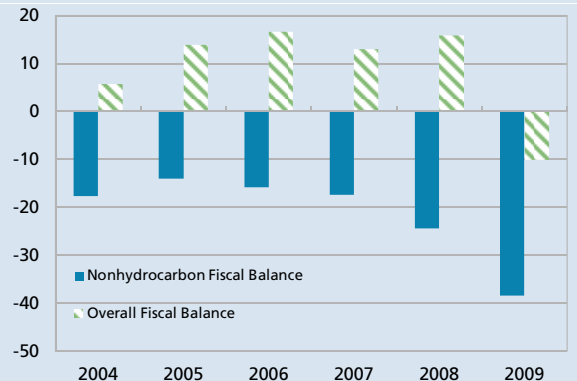
Source: Dealogic.

*The increase in global volatility made Dubai more risky...*



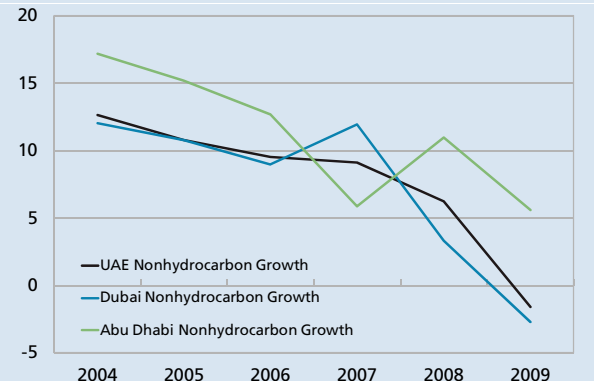
Sources: Markit, Bloomberg.

*... and despite the fiscal stimulus,*



Sources: Country authorities, Fund staff estimates.

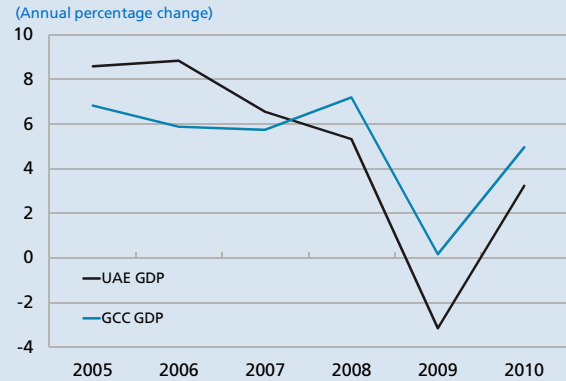
*...nonhydrocarbon GDP growth declined.*



Sources: Country authorities, Fund staff estimates.

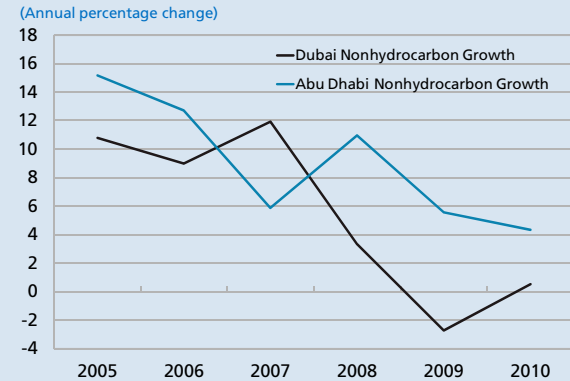
**Figure 2** United Arab Emirates: Different Pace of Recovery in the U.A.E. and the GCC, 2005–10

The recovery in the U.A.E. is lagging behind other GCC countries...



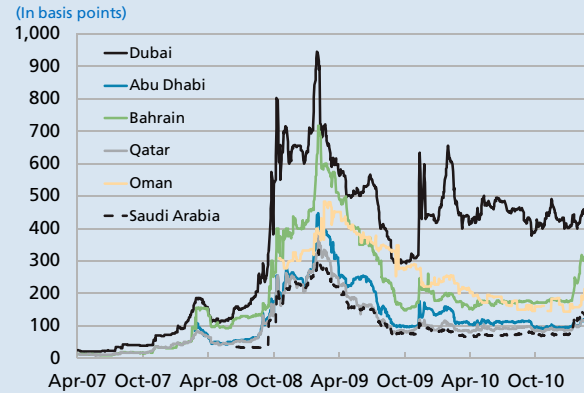
Sources: Country authorities, and Fund staff estimates.

... and this is mainly due to the still weak growth in Dubai, reflecting weaknesses in real estate and GREs.



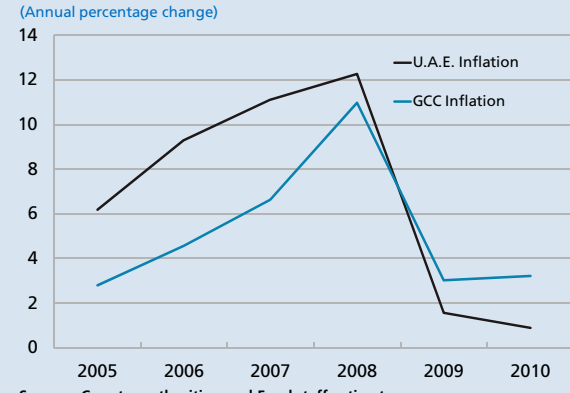
Sources: Country authorities, and Fund staff estimates.

These weaknesses are reflected in Dubai's relatively high CDS spreads compared to other GCC countries...



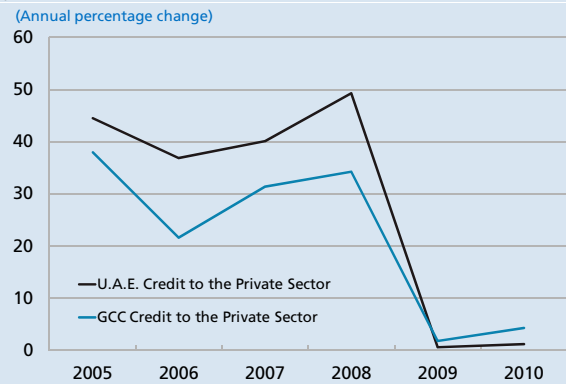
Sources: Markit.

and lower inflation reveals the weaker recovery and real estate overhang.



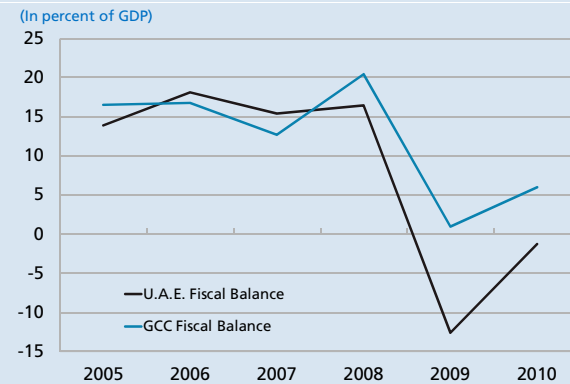
Sources: Country authorities, and Fund staff estimates.

Credit to the private sector started to pick up in the GCC, but not yet in the UAE...



Sources: Country authorities, and Fund staff estimates.

...and bailouts of GREs contaminated the sovereign balance sheet



Sources: Country authorities, and Fund staff estimates.

**4. The external current account balance improved, reflecting higher oil prices and production.** With exports increasing by 15 percent in 2010, and imports by 6 percent, the current account balance is estimated to have reached 7.7 percent of GDP in 2010. Deposit inflows in the second half of 2010 helped improve the financial account balance. As a result, the central bank foreign exchange reserves recovered from the losses sustained in 2009 (\$ 7 billion), reaching US\$32 billion by year-end (1.7 months of imports).<sup>1</sup>

**5. Fiscal policy was contractionary in 2010.** After widening sharply in 2009, the nonhydrocarbon primary fiscal deficit (excluding investment income) contracted sharply to 35.2 percent of nonhydrocarbon GDP in 2010, from 44 percent in 2009.<sup>2</sup> The decline was largely due to slower project implementation in Abu Dhabi, including through GREs, as well as to lower transfers to Dubai GREs. Moreover, because of higher hydrocarbon revenue, the consolidated fiscal deficit shrunk to about 1.3 percent of GDP in 2010 from 12.6 percent in 2009.

**6. The DW debt restructuring was completed, but other GREs entered into restructuring negotiations.** The successful restructuring of DW's debt improved market confidence, allowing top-grade Dubai issuers to

regain market access. However, Dubai spreads remain high reflecting the risks posed by further restructuring needs. Many Dubai GREs initiated DW-style restructuring talks, while Abu Dhabi stepped up support to some of its GREs (Box 1).

**7. Despite debt restructurings and weak economic activity, banks remained profitable in 2010.** With continued pressures in Dubai's real estate market, several GREs and other private companies restructured their bank loans. Dubai banks reduced lending to improve liquidity, while Abu Dhabi banks continued to expand in line with the emirate's fiscal expansion. Nevertheless, overall credit to the private sector remained sluggish, and nonperforming loans (NPLs) increased to 5.9 percent from 4.3 percent in 2009, reflecting mainly the deterioration of loan quality in Dubai banks (8.8 percent). Preliminary data show that banks delivered solid core earnings, though weaker than in 2009, allowing them to increase provisions the most in the GCC (Figure 3).

**2010 Profitability in GCC banks**  
(In percent, year-on-year change)

	Kuwait	Oman	Qatar	Saudi	UAE
Net interest income	-4	12	23	-5	8
Provisions	-8	-49	-21	34	42
Profits	11	0	15	-10	-10

Source: Bankscope, unaudited financial statements as of Q3-2010.

<sup>1</sup> Excluding the assets of Abu Dhabi Investment Authority, Abu Dhabi's sovereign wealth fund.

<sup>2</sup> The cyclically-adjusted data show a similar contraction in the fiscal impulse.



**Box 1 Dubai Debt Restructuring**

**Prior to Dubai World's (DW) standstill announcement on November 25, 2009, the government of Dubai had put in place a structure to support its GREs.** In July 2009, it established the Dubai Financial Support Fund (DFSF), to provide financial assistance to GREs of strategic importance. The DFSF is managing the US\$20 billion bond program subscribed 50 percent by the central bank and 50 percent by Abu Dhabi. Following the standstill announcement, the government of Dubai enacted a special insolvency regime for DW and its Nakheel subsidiary specialized in real estate development.

**The first debt restructuring of DW was completed in 7 months.** On March 25, 2010, DW submitted a restructuring plan to creditors. On September 9, 2010, most creditors had agreed on the terms, and on October 27, 2010, DW announced full support of its creditors. The restructuring plan covered US\$24.9 billion of debt, of which US\$14.4 billion was owed to some 90 domestic and foreign banks and the remaining US\$10.5 billion to the government of Dubai.

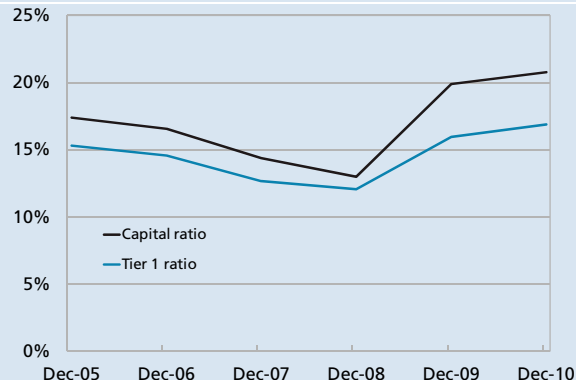
**Banks provided maturity extensions and interest reductions, and the government of Dubai converted its loans into equity.** The US\$14.4 billion debt was divided into two tranches: a US\$4.4 billion tranche with a 5 year maturity and 1 percent interest and a US\$10.0 billion tranche with an 8-year maturity and 1 percent interest paid each year. An additional payment of 1.5 to 2.5 percent will be made upon maturity and the Government of Dubai will offer a guarantee of between US\$1 billion and 4 billion. As for the government, acting through the DFSF, it would convert its US\$10.5 billion share of claims into equity through the DFSF. In addition, the DFSF committed to provide new funds up to US\$1.5 billion to DW for the company's working capital and interest payments.

**Separately, the government (again, through the DFSF) would provide US\$8 billion new equity to Nakheel and convert its existing US\$1.2 billion debt into equity.** Trade creditors and suppliers will be paid off with a combination of 40 percent cash and 60 percent publicly traded debt security with a 10 percent annual interest rate. The outstanding Nakheel bonds will be paid off in full and on time. The remaining bank creditors will receive principal and accrued interest through a maturity extension at commercial rates. The government would own Nakheel directly, instead of through DW, to protect DW's non-real estate assets.

**Following DW, Dubai Holding (DH) has also been in discussions with banks to restructure debt.** In July 2010, Dubai Holding Commercial Operations Group (DHCOG) secured a two-month extension on a US\$555 million loan, which was later rescheduled further through year-end. Lately, press reports have indicated that DHCOG reached an agreement with banks to convert the revolving debt into a 5-year loan. In November 2010, Dubai Group (DG) with participations in financial services firms in Dubai and abroad, missed two scheduled loan payments worth US\$1.8 billion and started restructuring its US\$6.2 billion liabilities. In December 2010, Dubai International Capital (DIC) agreed with bank creditors to restructure US\$2.5 billion worth of bank loans: US\$2 billion would be extended to 2016 at 2 percent; US\$500 million would be extended to 2014 at an unchanged interest rate.

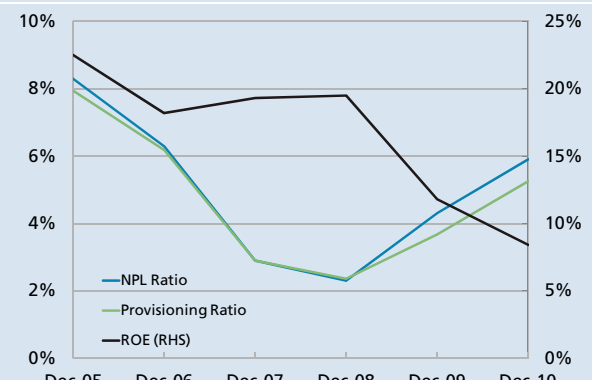
**Figure 3** United Arab Emirates: Recent Developments in Local Banks

*Local banks boosted capital pre-emptively, including through official support.*



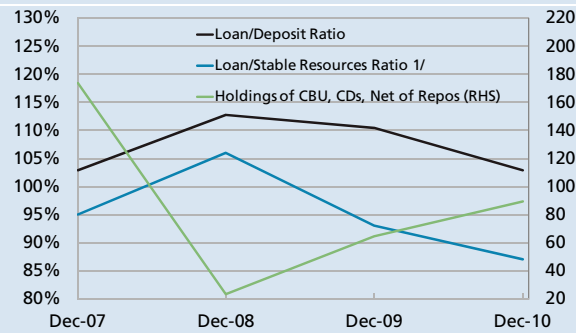
Sources: Central Bank of the U.A.E., and Fund staff estimates and calculations.

*They remained profitable in 2010, despite increasing NPLs and provisions.*



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

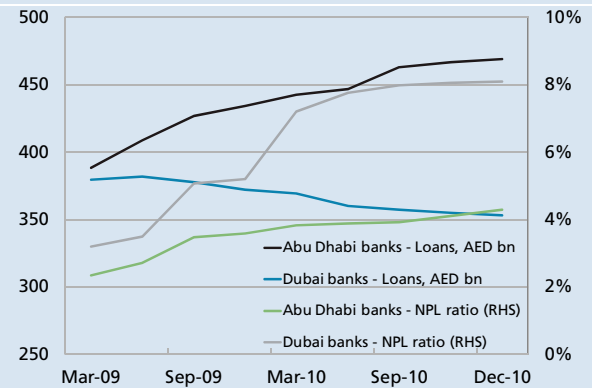
*With their cautious approach to lending and efforts to attract deposits, their liquidity profile improved.*



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

1/ Stable resources include capital, reserves, interbank funds of more than six month maturity, and 85 percent of customer deposits.

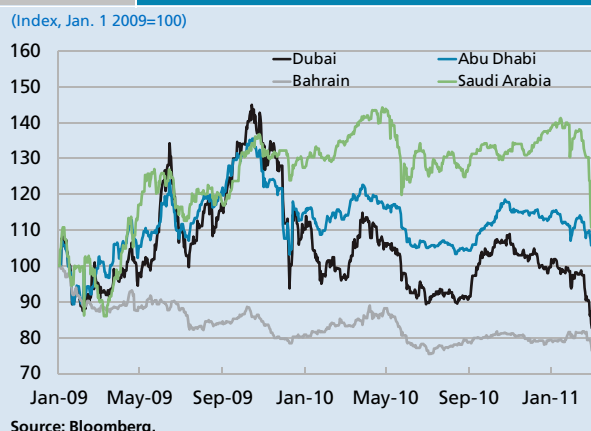
*Abu Dhabi banks continued to expand, Dubai banks shrunk, while dealing with rising NPLs.*



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

**8. Spillovers from the recent regional turmoil have been relatively muted.** Dubai stock prices reached record lows in 2009, given the weight of real estate and financials in the market index. The recent turmoil has erased the gains made since the September 2010 announcement of the DW debt restructuring, reflecting the impact on prices in the broader region. Nevertheless, since end-February 2011, there has been some reversal (Figure 4).

**Figure 4** Stock Market Indices



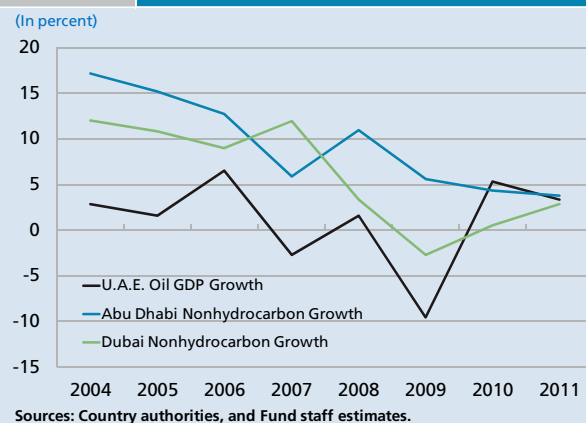
## B. Fragile Recovery Gaining Strength Under Uncertainty

**9. A fragile recovery is gaining strength, benefiting from a broadly favorable global environment.** High oil prices, stronger growth in Asia, and low global interest rates are contributing to the recovery. While real GDP is projected to continue to grow at 3.3 percent in 2011, nonhydrocarbon GDP growth is expected to increase from 2.1 percent in 2010 to 3.3 percent in 2011. Driven by higher food prices and in light of the limited food subsidies, the CPI inflation rate is expected to rise, but will remain moderate at 4.5 percent, as rents—which account for 40 percent of the CPI basket—continue to decline.

**10. Growth dynamics differ across the Emirates.** Higher oil production and increased infrastructure spending, including through GREs, are the main drivers of growth in Abu Dhabi, though its nonhydrocarbon growth will continue to

slow down partly due to last year's fiscal contraction. Dubai is benefiting from its leading position as a regional hub, with growing links to Asia, and improved competitiveness thanks to the ongoing price correction in the real estate market (Figure 5).

**Figure 5** Real GDP Growth, 2004–11



**11. Several factors make the economic recovery fragile.**

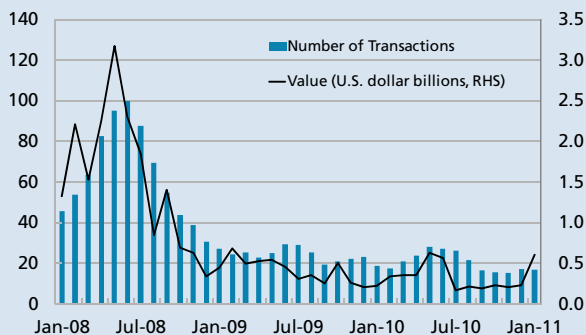
- **The large property overhang and uncertainty regarding its size.** The excess supply of property in Dubai—which will further increase as unfinished projects are completed—and the uncertainty regarding its

size will continue to weigh on property prices, investment, and growth. There is also a risk that Abu Dhabi’s strategy to ramp up its housing supply, unless carefully managed, may put further pressure on the property market (Box 2).

**Box 2 Real Estate Market Developments**

**Dubai’s real estate market has seen one of the largest price corrections in the world.** Following a dramatic run-up in prices, the Dubai real-estate market dropped sharply in the fall of 2008, both in activity and prices. By early 2009, the number of transactions was one fourth of the summer 2008 peak, while prices had fallen by some 50 percent.

**Dubai Real Estate Sales**  
(June 2008=100)



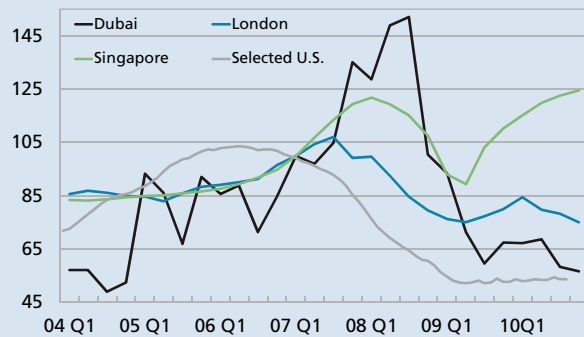
Sources: Dubai Land Department, and Fund staff calculations.

**Abu Dhabi’s real estate has also fallen, but fared better than Dubai’s.** This is largely due to the real estate boom in Abu Dhabi lagging behind Dubai’s, and investors’ confidence in Abu Dhabi’s long-term growth potential. While both commercial and residential segments suffered heavy losses in Dubai, the slowdown in Abu Dhabi is concentrated in the residential market, although flexible payment plans and more competitive finance rates offered by banks helped cushion the impact. Facing competitive pressures from the drop

in housing prices in Dubai, residential prices in Abu Dhabi have also fallen by almost 50 percent. However, commercial real estate is proving more resilient.

**The real estate market faces a prolonged road to recovery.** On the downside, recovery prospects are undermined by uncertainty about the economy, large existing and prospective oversupply, and tight mortgage lending conditions, particularly in Dubai. The surplus of residential properties reportedly exceeds 30 percent, and inventory is projected to stay high as more supply (15 percent of the current stock)—from projects initiated before the crisis—is expected in the next two years. Potential buyers continue to find it difficult to secure mortgages, as banks remain focused on repairing their balance sheets. Some upside may come from higher oil prices and turmoil elsewhere in the region.

**Urban Real Estate Prices, CPI Deflated**  
(Index, 2007 Q1=100)



Sources: Dubai Land Department, Haver, Case/Shiller, and Fund staff estimates.

- **Lack of clarity on GRE financing strategies.**

With an estimated US\$31 billion of debt due in 2011–12, of which at least \$5 billion in the real estate sector, Dubai continues to face significant roll-over risks in the short term. Despite better investor communication, the absence of a well-defined, coherent, and transparent strategy to address GRE financing translates into higher borrowing costs for Dubai (both for the sovereign and the GREs) in an already difficult market. In addition, the government of Dubai's strategy to use the earnings of the well-performing GREs to finance the underperforming entities may dampen investment and growth.

**U.A.E. Gross Public and Publicly Held Debt**  
(in billion of US\$)

Maturing in	2011	2012	Beyond	Total
Government of Abu Dhabi	0.4	1.3	9.9	11.6
Abu Dhabi GREs	16.6	9.3	66.4	92.4
<b>Total Abu Dhabi</b>	17.1	10.6	76.4	104.0
<i>In percent of Abu Dhabi 2010 GDP</i>	8.9	5.5		54.2
Government of Dubai 1/	5.6	1.6	28.9	36.0
Dubai GREs	10.4	13.6	52.9	76.9
<b>Total Dubai</b>	16.0	15.2	81.7	113.0
<i>In percent of Dubai and Northern Emirates' 2010 GDP</i>	14.5	13.8		102.6
Other Emirate Sovereign	0	0	2.8	2.8
Other Emirate GREs	0.9	0.3	1.2	2.4
<b>Total Other Emirates</b>	0.9	0.3	4.0	5.2
<b>Federal Government</b>				19.1
<i>In percent of U.A.E. 2010 GDP</i>				6.3
<b>Total U.A.E.</b>	33.1	25.8	158.1	236.0
<i>In percent of U.A.E. 2010 GDP</i>	11.0	8.5		78.2

Sources: Dealogic, Zawya, Bloomberg, U.A.E. authorities, and Fund staff estimates.

1/ Including GRE debt guaranteed by the Dubai government.

- **International sanctions on Iran.** The sanctions on Iran, one of the U.A.E.'s largest trading partners and a traditional source of demand for Dubai real estate, could undermine the recovery (Box 3).

**12. The unfolding turmoil in the region poses downside risks to the economic outlook.**

The re-pricing of risk in the region will likely result in more difficult market conditions. On the positive side, there are indications that the U.A.E. may benefit from increased tourism and the attractiveness of its business environment. Higher oil prices are also benefiting the U.A.E. as a hydrocarbon exporter, though if sustained, they may dampen global demand.

**13. Staff's baseline scenario shows a steady increase of nonhydrocarbon growth over the medium term.**

It assumes a gradual pick up in private activity replacing the government stimulus during the crisis. With oil prices remaining around \$105 per barrel over the medium term, the fiscal and external accounts will remain in surplus, and real nonhydrocarbon growth is projected to increase to 4.5 percent. The main medium-term risk would come from GREs, as debt roll-over needs will remain substantial in light of the restructurings. The trend growth rate would be lower than before the crisis because of a smaller real estate sector.

**14. Analysis of the real exchange rate suggests that the dirham is broadly in line with fundamentals.**

Although the three approaches—the equilibrium exchange rate, the macroeconomic balance approach, and the external sustainability approach—indicate slight to modest overvaluation, such overvaluation is well within the margin of error (Appendix I).

**Box 3 The Economic Impact of the International Sanctions on Iran**

**Existing international sanctions on Iran could adversely impact the U.A.E.'s economy.** Losses from disruptions in strong trade links between the U.A.E. and Iran could reach 0.2 to 0.7 percent of GDP annually. Losses could also accumulate in banks, which have reportedly cut financial services provided to Iran-based customers. By complicating the execution of payments and settlements, sanctions risk stifling demand for real estate from Iran,<sup>1</sup> undermining further prospects of recovery in the already weak housing market in Dubai.

**The reduction in availability of trade finance and payments schemes would be the main channel through which the sanctions could affect trade with Iran.** The sanctions do not target the types of goods that make up the bulk of the trade between the two countries. However, the financial restrictions imposed by these sanctions are making U.A.E. banks reluctant to take on transactions involving Iranian banks or companies. This complicates and increases costs of securing trade finance, executing payments, and obtaining insurance for trading companies, and thus hurts trade with Iran.

**Preliminary data suggests that the latest sanctions approved in June 2010 led to a reduction in trade.** Iran accounts for a little more than 6 percent of total and 12 percent of nonhydrocarbon exports of the U.A.E., and is the second largest destination of U.A.E. exports after India. A salient feature of this trade is that re-exports of goods account for more than 90 percent of exports to Iran. Dubai's total trade with Iran in the third quarter of 2010 declined by 15 percent compared to the same period of 2009, as Iran's share in re-exports from Dubai fell to 13 percent, from 18 percent in 2009. However, reflecting strong trade in the first half of 2010, the value of trade in the first nine months of 2010 remained broadly unchanged compared to the same period of 2009.

**Staff's calculations suggest that a 30-percent fall in exports to Iran would reduce the U.A.E. GDP by 0.2 percent.** Such a decline in exports would represent

almost 4 percent of U.A.E.'s nonhydrocarbon exports. However, the impact on net exports and the balance of payments would be substantially less, considering that re-exported goods dominate the trade with Iran.

**UAE: The Economic Impact of the Sanctions on Iran**  
(US\$ millions unless otherwise noted)

	Scenario 1 1/	Scenario 2 2/
<b>Exports affected by the sanctions</b>	2,277	7,582
percent of exports to Iran	30.0	100.0
percent of exports to world	1.9	6.2
percent of nonoil exports to world	3.7	12.2
percent of 2009 GDP	0.8	2.8
percent of 2009 nonoil GDP	1.2	3.9
<b>Impact on net exports 3/</b>	569	1,896
percent of 2009 GDP	0.2	0.7
<b>Memorandum items:</b>		
Exports to Iran, 2009	7,582	
of which re-exports	7,551	

Sources: COMTRADE, Fund staff estimates.

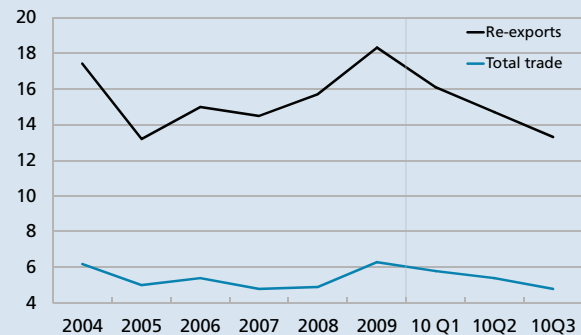
1/ Assumes a 30 percent reduction of exports to Iran.

2/ Assumes no exports to Iran.

3/ Assumes that re-exports to Iran have 25 percent local value-added content.

**Dubai - Iran Trade (Value)**

(In percent of aggregate Dubai trade)



Sources: DP World, DFSA.

1/ Iranian nationals have been the fourth largest buyers of Dubai real estate, after India, the U.K., and Pakistan.

## POLICY THEME #1

# SUPPORTING THE STILL FRAGILE RECOVERY

*Given the still fragile economic recovery, macroeconomic policies in 2011 should support domestic demand and be adjusted to the economic spillovers from the unfolding events in the region.*

**15. Fiscal policy should support economic recovery in 2011.** With the reduction in communication fees, the federal budget foresees a deficit in 2011. In contrast, with the completion of some investment projects, Dubai is entering a period of fiscal consolidation. Although Abu Dhabi's budget for 2011 is still not available, the government of Abu Dhabi intends to increase infrastructure spending, including through GREs. Staff concurred with these intentions and recommended maintaining a neutral fiscal stance in 2011 following the sharp contraction in 2010, as further contraction may hamper the recovery.

**16. The government should stand ready to expand spending on productive investment, in case the regional unrest starts affecting the economy.** In this context, staff advised the authorities to undertake cost-benefit analyses of projects in order to implement those with high economic return. The authorities emphasized that the U.A.E. economy has been able to withstand much larger geopolitical shocks in the 80s and 90s, continuing to grow steadily. The impact of the current turmoil on the U.A.E. appears also manageable.

**17. The authorities' plan to upgrade the infrastructure in the northern emirates is a step**

**towards more inclusive economic development and should be expanded.** The plan will help ease the electricity shortages in the northern emirates. In addition, replacing the current mostly implicit subsidies on water and electricity with explicit cash transfers to lower-income households would better target those in need, while reducing utility bottlenecks through more effective conservation.

**18. The central bank should monitor bank liquidity conditions and stand ready to relieve potential pressures.** The central bank's accommodative policy stance, in an environment of low global interest rates, will support the recovery in private sector credit. The re-pricing of risk in the region could however trigger a sudden reversal of the recent deposit inflows to the banking sector. Staff advised the Central Bank of the U.A.E. (CBU) to monitor individual bank liquidity conditions to ensure that banks have the needed liquid assets to respond to such a reversal.



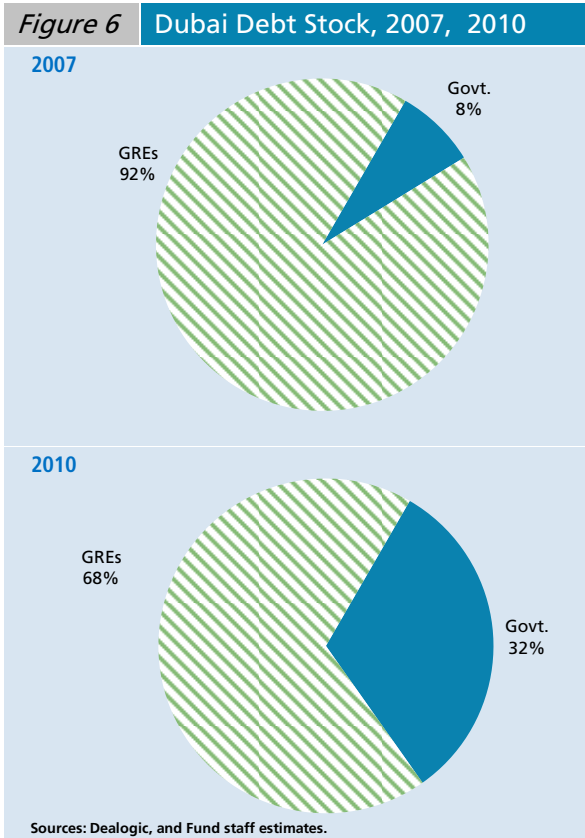
## POLICY THEME#2

# STRENGTHENING THE ECONOMY'S RESILIENCE

As the recovery firms up, policies should progressively shift focus towards strengthening the economy's resilience. Dubai's debt restructuring and its fiscal and financial implications, the sizeable GRE roll-over needs over the medium term, and growing GRE borrowings in other emirates call for close monitoring of the risks posed by these entities, and strengthening the resilience of the financial sector. The recent boom-bust experience of the U.A.E. underscores the need for strong macroeconomic management over the cycle. Under a pegged exchange rate regime, this requires mutually-supportive countercyclical fiscal and macroprudential policies and close coordination across the federal and emirate governments.

### A. Mitigating Risks Posed by GREs<sup>3</sup>

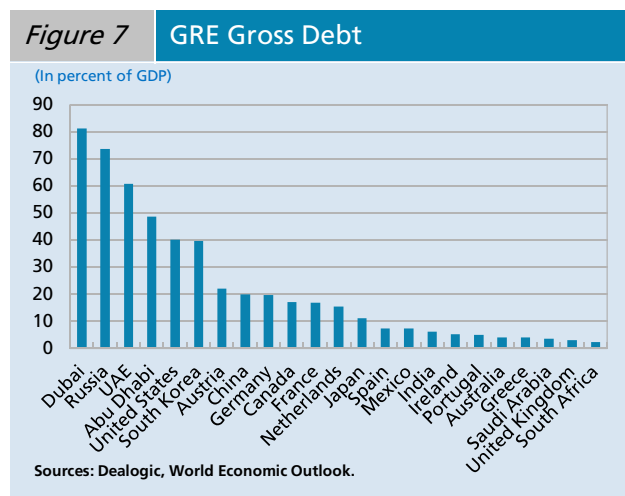
**19. GREs have contributed significantly to economic diversification, but the global financial crisis has highlighted the risks they pose.** The DW debt restructuring led to an increase in Dubai sovereign debt (Figure 6), with spillovers to the banking sector and financial markets. Other Dubai GREs are also in debt restructuring negotiations with banks, and there are signs that some Abu Dhabi GREs heavily investing in the real estate sector are experiencing financial difficulties.



<sup>3</sup> See Selected Issues Paper on "Risks Posed by Government Related Entities in the U.A.E." ([www.imf.org](http://www.imf.org)).



**20. Looking forward, GREs will likely continue to pose risks.** Although little information is available on the financial situation of most GREs, overall GRE debt is high by international comparisons (Figure 7). With an estimated US\$60 billion of debt due in 2011–12, the U.A.E. faces short-term roll-over risk that needs to be managed carefully. Moreover, with the restructuring of Dubai GREs, a significant amount of Dubai debt will mature in the medium term (2014–15). The overhang in the real estate sector means that these risks can affect the sovereign balance sheet as contingent liabilities may materialize, affect banks holding GRE debt, and have broader implications for capital markets through higher cost of borrowing and bailouts.



**21. The authorities have taken steps to monitor GRE debt.** In particular, they have prepared a new draft federal law on public debt, which sets the general principles regarding the issuance and management of public debt both at the federal and emirate levels, stipulates the establishment of debt management offices (DMO) at the federal and emirate levels and regulates the coordination between the various DMOs, and allows the federal DMO to monitor the debt of the federal GRES. They have also established DMOs in

the federal and in Abu Dhabi and Dubai governments. Moreover, the government of Abu Dhabi is also preparing a public debt policy framework to limit the borrowings of its GREs.

**22. In the short term, completing GRE debt restructuring and cleaning their balance sheets should be a priority.** The ongoing restructuring will likely result in better financing conditions. Throughout the process, due regard should be accorded to ensuring the viability of these entities through writing-off impaired assets and operational restructuring. Increased transparency regarding the government strategy on refinancing GRE liabilities would also help improve investor confidence. In this context, the government should clarify and communicate the stock, composition, and maturity profile of GRE liabilities and their financing strategy, including through government support. Disclosing information on the state and outlook of the real estate sector together with a communication of the government's strategy to address the overhang would also help.

**23. Mitigating the risks posed by GREs require the development of a proper risk management framework.** Such a framework entails effective identification, assessment, monitoring, and reporting of contingent liabilities arising from GREs, and disclosure of these liabilities in government accounts. The authorities should also consider including a statement of fiscal risks as part of the annual budget documents including discussion of past experiences with the materialization of risks, a presentation of policies to mitigate risks, and forward-looking risk estimates. The statement should focus on risks posed by GREs, and expand later to public-private partnerships (PPP) and other risks, as they

arise. The authorities have requested Fund technical assistance in this area.

**24. Containing GRE borrowing is key for fiscal sustainability at the emirate level and requires a strong institutional framework.** This could be achieved through limits on GRE borrowing, which could be defined by individual governments and communicated through the fiscal coordination committee. The various DMOs would monitor compliance with these limits; while the federal DMO could ensure information-sharing and disseminate data on public sector debt by emirate. To enable this mechanism, the current federal draft law on public debt should clarify the relations between the federal and emirate-level DMOs and expand its coverage to Emirati GREs. The draft law also needs to define better the federal DMO's scope and objectives; and specify coordination mechanisms between the DMOs,

## B. Securing Financial Stability<sup>4</sup>

**26. Strong core earnings and higher capital compared to pre-crisis levels have prepared the banking system to withstand shocks.** Although they remain low, NPLs have already doubled since the crisis, the second highest increase in the GCC after Kuwait. Nevertheless, the capital adequacy ratio is high (20.8 percent), thanks to government support.<sup>5</sup> System liquidity has also improved in light of slower

<sup>4</sup> See Selected Issues Paper on "Ensuring Financial Sector Stability in the U.A.E." ([www.imf.org](http://www.imf.org)).

<sup>5</sup> This includes about 5 percentage points of tier 2 capital notes subscribed by the federal government in 2009; the notes will start to amortize in 2012 at 20 percent per year.

and fiscal and monetary authorities within clearly defined roles and responsibilities.

**25. Improved corporate governance and transparency are also key for mitigating the risks posed by GREs.** An assessment of corporate governance against the OECD standard would be useful. In particular, it would be important to separate clearly the commercial from the noncommercial operations carried by GREs, clarify the government support strategy to the GREs, and standardize the accounting, auditing, and financial reporting practices of GREs. The government of Abu Dhabi has made important progress in this area by disclosing the list of GREs that it would support, and by including explicit transfers in the budget to cover the noncommercial operations of GREs. Better disclosure of GRE financial accounts would also help attract investors and translate into lower funding costs.

credit growth and high deposit rates attracting foreign flows. Stress tests on overall banking data indicate resilience to shocks, although aggregate data can mask risks in individual banks from concentrated exposures to particular borrowers or sectors.

**GCC: Selected Financial Soundness Indicators 1/**

(In percent)

	Nonperforming Loans		Capital Adequacy		Provisioning Rate		Return on Assets		Return on Equity	
	2007	Latest	2007	Latest	2007	Latest	2007	Latest	2007	Latest
Bahrain	2.3	3.9	21.0	19.6	74.0	60.3	1.2	1.2	18.4	10.6
Kuwait	3.2	9.7	19.4	18.0	48.2	38.5	3.6	0.8	29.4	6.9
Oman	3.2	3.5	15.8	15.5	111.8	104.0	2.1	1.4	14.3	10.0
Qatar	1.5	1.7	13.5	16.1	90.7	84.5	3.6	2.6	30.4	19.3
Saudi Arabia	2.1	3.3	20.6	16.5	142.9	89.8	2.8	2.0	28.5	25.8
U.A.E. 2/	2.9	5.8	13.0	21.3	100.0	80.7	2.0	1.4	19.3	11.2

Source: Country authorities.

1/ End-2009, unless otherwise indicated.

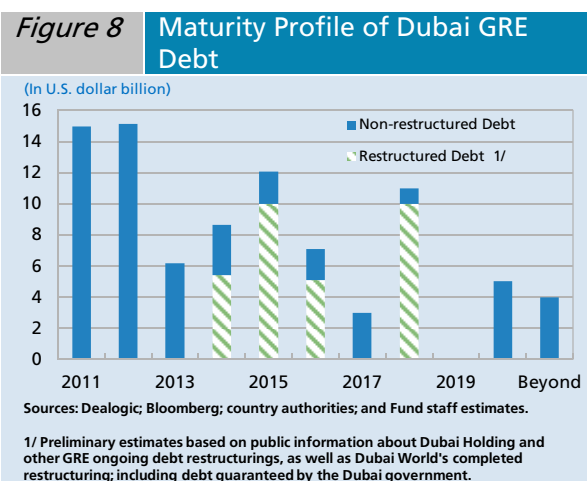
2/ Local banks, November 2010. Provisions are collective and specific under IFRS.

**27. The system's resilience in the aggregate conceals the greater pressure on Dubai-based banks,** which may pose a risk to financial stability. Dubai banks face greater pressures from their exposures to GREs and real estate in Dubai. They bear a greater burden of provisions on Dubai loan restructuring; their NPLs are twice as high as Abu Dhabi banks; and they continue to deleverage. As a result, the Dubai banks are losing market share. Islamic banks are also under some pressure because of their larger exposure to real estate.

**28. The central bank has strengthened risk monitoring and management.** The CBU has engaged in wide-ranging reforms to strengthen financial stability analysis, revamp the regulatory framework, and develop macroprudential policies.

- Staff advised the CBU to consider capital charges above 100 percent for unrated GREs that it deems risky. Higher charges would provide incentives to banks to better align their GRE exposure with their risk-bearing capacity. To this end, the CBU would have to develop an internal risk management and rating function, which will also help it manage the increased range of collateral eligible for central bank lending since the crisis. Sharing GRE financial information collected by DMOs with the CBU would help the latter monitor GRE risks. The authorities agreed that monitoring and limiting GRE risks was key to financial stability.
- Broadening the regulation on real estate exposure would also improve risk management. The CBU believed that real estate risk was manageable for local banks, partly because real estate activity has relied heavily on foreign financing.

**29. The debt restructuring in Dubai may imply postponing the realization of losses and a new bout of roll-over risk in a few years that requires monitoring.** Current restructuring plans assume that the borrowers' problem is one of liquidity rather than solvency. However, if asset prices do not recover, there is a risk that some borrowers may not be able to pay when the loans start to mature. Staff advised on the need to monitor the performance of restructured loans, and consider regulating their classification and provisioning, should they need further restructuring (Figure 8).



**30. The CBU should continue to contain banks' dividend distribution over the next few years to ensure that the banks can handle this risk without new government support.** Since 2009, the CBU has been limiting dividend distribution to strengthen banks' resilience. Staff recommended linking the CBU approval of dividend distribution to the results of stress tests with uniform parameters across the industry. The CBU could also consider more forward-looking provisioning (moving from incurred to expected loss) as envisaged by forthcoming changes to International Financial Reporting Standards.

**31. Government control of banks together with high exposure to GREs point to potential governance issues.** As in other countries, the crisis has increased government stakes in banks. At the same time, some banks have been heavily involved in lending to GREs and GRE debt restructurings. Good governance should be seen as part of the implementation of risk-based oversight. Staff recommended conducting a diagnostic for bank governance prior to the forthcoming Financial Sector Assessment Program (FSAP) update.<sup>6</sup>

**C. Managing the Economy over the Cycle<sup>7</sup>**

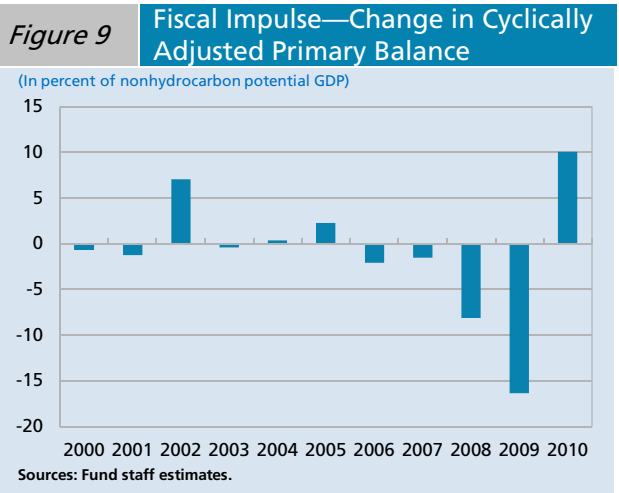
**33. Countercyclical fiscal policy could mitigate boom-bust cycles in the U.A.E. economy.** Except in 2009, the fiscal stance has always been procyclical (Figure 9). This has contributed to the overheating of the economy prior to the crisis, while in 2010, the contractionary fiscal stance has slowed the recovery. As a main tool for macroeconomic management under a pegged exchange rate regime, fiscal policy should aim at delinking government and GRE spending from the volatility of oil prices. Given that Abu Dhabi owns the bulk of hydrocarbon wealth in the U.A.E., its fiscal policy should ensure long-term sustainability and intergenerational equity. Other emirates need to ensure medium-term fiscal sustainability. In this

<sup>6</sup> The FSAP is a joint program of the Fund and the World Bank. The Bank would assess bank governance upon the authorities' request.

<sup>7</sup> See Selected Issues Paper on "Fiscal Policy and Fiscal Coordination in the U.A.E.: Drawing Lessons from the Crisis" ([www.imf.org](http://www.imf.org)).

**32. The authorities committed to conform their Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework to the Financial Action Task Force's (FATF) 40+9 Recommendations.** However, that framework in the U.A.E. needs further strengthening in a number of areas, in particular the criminalization of money laundering and the financing of terrorism, and the reinforcement of the AML/CFT supervisory system.

context, Dubai should undertake fiscal consolidation to achieve a prudent debt-to-GDP ratio (Box 4). The authorities are preparing to introduce a VAT in the context of the GCC, which could enhance revenue mobilization capabilities and facilitate such consolidation.



**34. Given the federal structure, effective intergovernmental coordination is key to promote both short-term demand management and medium-term sustainability.** Timely and reliable information-sharing structures, including on medium-term fiscal frameworks, annual

budgets and their execution, as well as consolidated fiscal accounts to inform policy making are prerequisites for such coordination. In this context, the Fiscal Coordination Council has made progress in sharing information. Moreover, the authorities indicated that coordination would be expanded to include the ministry of economy, the CBU, and departments of economic development at the emirates level.

### 35. In coordination with countercyclical fiscal policy, macroprudential tools could help avert a

**resurgence of imbalances.** In this respect, the CBU should tailor its early warning system to system-wide risks it has identified as being systemic (e.g., GRE borrowing, real estate, speculative flows); ensure that a matching range of prudential tools are in place to act on warning signs; and decide on trigger values that will ensure activation of the tools and communicate them effectively to stakeholders. The CBU intends to make swift progress on macroprudential policies by building on the recommendations of the IMF technical assistance on measuring and managing system-wide risks.

#### Box 4 Dubai's Debt Sustainability

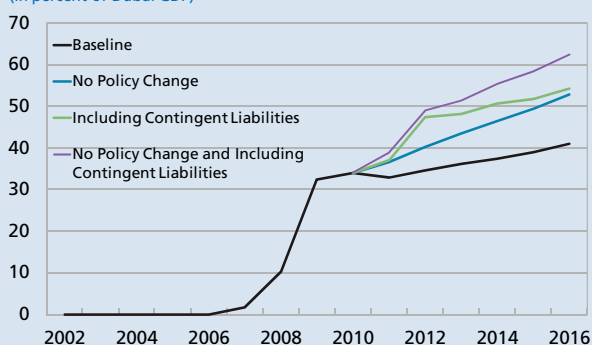
**The materialization of contingent liabilities from GREs has raised Dubai's fiscal vulnerability.** Dubai's gross government debt, including guarantees, increased from 1.6 percent of Dubai GDP in 2007 to 10.3 percent in 2008 and 34 percent as of end-2010. This was mainly due to the bailout of GREs.

**Government debt data underestimate Dubai's total public sector debt by omitting quasi-sovereign contingent liabilities.** While variable financial conditions suggest that not all GREs should pose a fiscal risk, most entities operating in the real estate sector are continuing to register weak performance, and thus may fall in this category. Assuming that the debt of these entities is a contingent liability for the government, at least US\$11 billion of contingent risk can be foreseen for the government of Dubai by end-2016, with more than 70 percent of these liabilities coming due in 2011–12. This would raise the total debt-to-GDP ratio to 47.4 percent in 2012, compared to 34.6 percent for the government alone.

**The debt sustainability analysis indicates that Dubai's debt may become unsustainable in the**

**absence of policy change.** Despite gradual fiscal consolidation projected in the baseline scenario, Dubai's government debt is estimated to increase to 41 percent of GDP by the end of 2016. In the absence of fiscal consolidation (i.e., without policy change compared to 2005–09), however, it is projected to reach 53 percent by 2016. Furthermore, including the potential contingent liabilities as estimated above and with the baseline profile for fiscal adjustment, the total debt-to-GDP ratio would increase to 54.3 percent by the end of 2016, and to 62.5 percent without fiscal consolidation.

#### Dubai - Public Sector Debt Sustainability Analysis (In percent of Dubai GDP)



Sources: Fund staff calculations.

#### Public Sector Debt Sustainability Framework, 2008-16 (In percent of GDP, unless otherwise indicated)

	Actual		Projections								Debt stabilizing primary balance
	2008	2009	2010	2011	2012	2013	2014	2015	2016		
Public sector debt /1	10.3	32.4	34.0	32.9	34.6	36.1	37.4	39.0	41.0	0.7	
Alternative scenarios											
A1. No policy change (constant primary balance in 2005-09)			34.0	36.7	40.3	43.5	46.4	49.5	52.9	0.8	
A2. Including contingent liabilities			34.0	37.0	47.4	48.2	50.7	51.7	54.3	0.8	
A3. No policy change including contingent liabilities			34.0	38.8	49.0	51.4	55.5	58.3	62.5	0.9	

Source: IMF staff estimates.

1/ Dubai government and government guaranteed debt.

## POLICY ITEM #3—STRUCTURAL ISSUES

### A. Statistical Capacity

**36. The establishment of the National Bureau of Statistics (NBS) is an important step in developing statistical capacity at the federal level.** The NBS has made some progress in establishing databases for key statistics. Thanks to sustained coordination efforts between the federal and emirate governments, the Ministry of Finance has developed consolidated fiscal accounts. Nevertheless, further efforts are needed for the timely compilation and dissemination of key statistics, including on

national accounts, balance of payments, and fiscal accounts, and this requires harmonization of methodologies across emirates. It also encourages the authorities to move towards timely dissemination of existing data; and to strengthen capacity to collect and disclose data on the International Investment Position (IIP). NBS has indicated its intention to request Fund technical assistance to develop further the national accounts.

### B. Domestic Capital Markets

**37. One of the vulnerabilities of the Dubai model was the heavy reliance on external borrowing.** To prevent the reoccurrence of such events in the future, the authorities are focusing on developing the domestic capital and debt markets, including by issuing federal securities to establish a yield curve. Developing a domestic debt market would also help banks improve their liquidity buffers and meet the Basel III liquidity requirement over time. In

this context, given the limited role of federal debt in the foreseeable future, the authorities could also explore funding from non-traditional sources, such as term deposits from government sources. While foreign term-funding is an essential element of bank asset-liability management, maturities should avoid coinciding with those of GRE debt in case of a market disruption.

### C. Labor Markets

**38. The government is working towards creating job opportunities for nationals.** The federal and the local governments have set up jobs programs to promote the recruitment of nationals in the private sector. Some local governments have also established SME funds and training programs. Staff welcomed the active labor market policies, and

encouraged the federal government to also consider locating some of its agencies/entities in the North. It also stressed that strengthening the skills mix will further facilitate job creation among nationals (Box 5).

## D. GCC Monetary Union

39. **The U.A.E. does not plan to join the GCC monetary Union at this stage.** The authorities believed that further efforts are needed to establish a framework that could lead to a currency union. These should focus on the

harmonization of the payment and settlement systems, the regulatory and supervisory frameworks, and the statistical systems, as well as on the removal of nontrade barriers.

### Box 5 Labor Market Issues

**Similar to other GCC countries, the U.A.E. labor market is segmented between national and foreign workers.** According to the latest official survey results, the average unemployment rate stood at 4.2 percent in 2009. Unemployment among U.A.E. nationals, however, was 14 percent, compared to 2.8 percent among expatriate workers, and has doubled since 2000. Nevertheless, there are no official data on the number of unemployed; estimates range between 10,000 and 40,000 persons

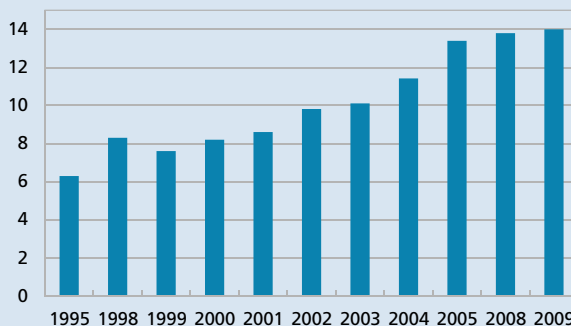
**Unemployment among U.A.E. nationals is higher among the youth and concentrated in the northern emirates.** The unemployment rate among nationals aged 20-24 is estimated at 23.9 percent in 2009; it is higher in rural areas compared to urban areas—18.6 percent versus 11.5 percent; and the northern emirates have, on average, higher unemployment rates, and account for about 80 percent of unemployment among nationals. At 28.1 percent, unemployment among women is also higher than for men (7.8 percent).

**The U.A.E. has a flexible labor market, but structural bottlenecks cause higher unemployment among nationals.** According to the Global Competitiveness Report, the U.A.E. ranks seventh among 139 countries for flexibility in wage determination and tenth in professional

code of ethics and productivity. Although this is an important point of attraction for private firms in creating new jobs, nationals do not appear to be in a position to take advantage. One structural factor is the skills gap. For example, foreign professionals have attained, on average, 4 more years of formal education than nationals.

**High reservation wages, reflecting better wages in the public sector and other sources of income, discourage nationals to seek employment in the private sector.** Consequently, around 90 percent of nationals are employed in the public sector; and the preference for public sector jobs has resulted in frictional unemployment among nationals.

**Unemployment Rate Among Nationals, 1995-2009**  
(In percent)



Sources: Ministry of Planning, National Bureau of Statistics.



## STAFF APPRAISAL

### **40. The U.A.E. economy is recovering in an increasingly uncertain regional environment.**

Benefiting from high oil prices and strong demand from traditional trading partners, nonhydrocarbon GDP growth is projected to accelerate from 2.1 percent in 2010 to 3.3 percent in 2011. The real estate overhang and short-term refinancing needs from overleveraged GREs continue to weigh on the near-term outlook. Downside risks to the recovery relate to possible economic spillovers of regional events, including the re-pricing of risk.

### **41. In light of the still fragile recovery, short-term policies should focus on supporting domestic demand, and adjust to the economic spillovers from the unfolding regional events.**

An overall neutral fiscal policy stance following last year's fiscal contraction would support the economic recovery, while Dubai should consolidate. To ensure efficiency of spending, the government should undertake cost-benefit analyses and implement the projects that have high economic return. While the central bank will maintain its accommodative monetary policy stance, it should also stand ready to provide liquidity to the market in case the re-pricing of risk in the region triggers a reversal of the recent deposit inflows to the banking sector.

### **42. The authorities' response to the unfolding events in the region is appropriate.**

Improved infrastructure in the northern emirates will help raise the standards of living in these areas. Staff also advises the authorities to consider replacing the subsidies on water and electricity with explicit cash

transfers to lower-income households. The authorities' active labor market policies will help create jobs for nationals, and should be complemented by strengthening the skills mix. Given the concentration of unemployment in the northern Emirates, the government could also consider locating some of its agencies/entities in the North to create further employment opportunities for nationals in these areas.

**43. The exchange rate is broadly aligned with fundamentals,** and the dollar peg continues to serve as an effective nominal anchor for the economy.

**44. Mitigating GRE risks should remain a policy priority.** In the short term, the authorities should complete the restructuring of GRE debt, ensure the viability of these entities through writing-off impaired assets, and communicate their strategy on GRE debt refinancing. Going forward, limiting overall GRE borrowing by emirate, developing a GRE risk management framework, and reporting contingent liabilities arising from GREs in the fiscal accounts will help reduce GRE risks. GRE governance also needs to be improved, including by clarifying ownership, government support strategy, and delineating commercial and noncommercial operations carried by the GREs. Finally, better information disclosure about GRE financial accounts would improve investor confidence and ultimately translate into lower funding costs.



**45. The CBU should continue to prepare the banking system for further possible deterioration in asset quality and future risks.**

The central bank has taken a number of steps that would help improve the resilience of the banking sector to future shocks. Given the likelihood of further increase in NPLs, the central bank should continue to ensure that banks provision adequately, while monitoring the performance of restructured loans. Higher capital charges on risky GREs, and continued retained earnings by banks would also limit the potential financial risks posed by the GREs.

**46. The recent boom-bust underscores the need for strong demand management over the cycle.**

Under a pegged exchange rate regime, this requires mutually-supportive countercyclical fiscal and macroprudential policies, and the federal structure of the U.A.E. makes a close coordination between various governments imperative. Staff is encouraged by the authorities' decision to deepen further the intergovernmental cooperation, including the CBU.

**47. Developing the domestic capital markets will reduce U.A.E.'s dependency on external markets.**

In this context, given the limited scope for federal securities in the short term, the authorities should explore stable funding from non-traditional sources, such as term deposits from government sources.

**48. The progress made by the NBS in establishing macroeconomic statistics and the ministry of finance in preparing consolidated fiscal accounts is an important step towards developing statistical capacity.** However, further efforts are needed for the timely compilation and

dissemination of key statistics, including on national accounts, balance of payments, and fiscal accounts. This will also require harmonization of methodologies across emirates. Staff encourages the authorities to move ahead with further developing the capacity to produce leading indicators and to collect and disseminate data on U.A.E.'s IIP.

**49.** It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

**Table 1 United Arab Emirates: Selected Macroeconomic Indicators, 2007–11**

<b>(Quota: SDR 611.7 million)</b>					
<b>(Population: 5 million, nationals: 1 million)</b>					
<b>(Per capita GDP-2009: \$53,477; poverty rate: n.a.; unemployment rate: 4.2% (2009))</b>					
	2007	2008	2009	Proj. 2010	Proj. 2011
<b>Hydrocarbon sector</b>					
Exports of oil, oil products, and gas (in billions of U.S. dollars)	73.8	103.0	68.1	77.5	107.6
Average crude oil export price (in U.S. dollar per barrel)	71.1	96.7	62.8	77.0	106.4
Crude oil production (in millions of barrels per day)	2.5	2.6	2.3	2.4	2.5
<b>(Annual percent change, unless otherwise indicated)</b>					
<b>Output and prices</b>					
Nominal GDP (in billions of AED)	948	1,156	993	1,109	1,336
Nominal GDP (in billions of U.S. dollars)	258	315	270	302	364
Real GDP	6.5	5.3	-3.2	3.2	3.3
Real hydrocarbon GDP	-2.7	1.6	-9.6	5.3	3.4
Real nonhydrocarbon GDP	9.1	6.3	0.6	2.1	3.3
Real GDP of Abu Dhabi	2.6	7.6	-3.6	5.0	3.6
Real GDP of Dubai and Northern Emirates	11.5	3.1	-2.4	0.5	2.8
CPI inflation (average)	11.1	12.3	1.6	0.9	4.5
<b>(Percent of GDP)</b>					
<b>Investment and saving</b>					
Gross domestic investment	23.8	22.5	23.9	18.7	19.1
Change in stocks	0.8	1.3	1.6	0.0	0.0
Total fixed capital formation	23.0	21.2	22.3	18.7	19.1
Public	6.8	7.4	9.1	7.0	6.9
Private	16.2	13.8	13.2	11.7	12.2
Gross national saving	29.7	29.6	26.8	26.4	29.4
Public	19.7	24.0	4.1	6.8	14.3
Private	10.1	5.7	22.7	19.5	15.2
<b>Public finances</b>					
Revenue	33.1	38.6	25.3	28.4	33.5
Hydrocarbon	24.6	31.3	17.5	21.6	27.4
Nonhydrocarbon	8.4	7.4	7.7	6.8	6.1
Expenditure and net lending	17.7	22.2	37.8	29.7	27.0
Current	13.4	14.7	21.2	21.6	19.2
Capital	4.0	7.2	16.3	8.0	7.7
Budget balance	15.4	16.5	-12.6	-1.3	6.5
Nonhydrocarbon balance (excl. investment income) 1/	-18.9	-26.7	-44.7	-36.5	-36.8
Nonhydrocarbon primary balance (excl. investment income) 1/	-18.8	-26.3	-43.9	-35.2	-35.2
<b>(Annual percent change, unless otherwise indicated)</b>					
<b>Monetary sector</b>					
Net foreign assets	3.1	-79.4	41.8	67.5	87.0
Net domestic assets	28.5	58.2	8.2	2.0	0.2
Credit to private sector	40.1	49.3	0.7	1.2	3.5
Broad money	41.7	19.2	9.8	6.2	9.6
<b>(Billions of U.S. dollars, unless otherwise indicated)</b>					
<b>External sector</b>					
Exports and re-exports of goods, of which:	178.6	240	192	222	265
Hydrocarbon	73.8	103	68	78	108
Nonhydrocarbon, excluding re-exports	34.2	43	44	54	59
Imports of goods	132	176	150	158	179
Current account balance	15.4	23.3	8.2	23.3	37.7
Current account balance (in percent of GDP)	6.0	7.4	3.0	7.7	10.4
External debt (in percent of GDP) 2/	50.4	43.1	48.1	46.2	39.9
Gross official reserves 3/	77.9	30.9	24.7	32.0	49.7
In months of next year's imports of goods & services	4.3	2.0	1.5	1.7	2.5
<b>Memorandum items:</b>					
Local currency per U.S. dollar (period average)	3.67	3.67	3.67	3.67	..
Nominal effective exchange rate (2000 = 100)	86.1	84.2	88.3	87.5	..
Real effective exchange rate (2000 = 100)	99.8	102.8	107.9	103.7	..

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

1/ Percent of nonhydrocarbon GDP.

2/ Foreign liabilities of banking system only due to incomplete coverage of debt raised by non-banks in international markets.

3/ Excludes the foreign assets of the sovereign wealth fund.

<b>Table 2 United Arab Emirates: Balance of Payments, 2007–11</b>					
<b>(In billions of U.S. dollars, unless otherwise indicated)</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Proj. 2011</b>
<b>Current account balance</b>	15.4	23.3	8.2	23.3	37.7
(In percent of GDP)	6.0	7.4	3.0	7.7	10.4
<b>Trade balance</b>	46.5	63.8	42.5	63.5	86.2
Exports	178.6	240.1	192.2	221.9	265.5
Hydrocarbon	65.7	91.4	59.6	66.8	95.0
Nonhydrocarbon	34.2	43.0	44.0	53.5	59.5
Re-exports 1/	70.6	94.2	80.1	90.8	98.3
Imports (f.o.b.)	-132.1	-176.3	-149.7	-158.3	-179.3
Imports by emirates	-89.7	-115.9	-101.4	-103.9	-118.3
Free zones	-42.4	-60.4	-48.3	-54.5	-61.0
<b>Income, net</b>	4.2	3.9	3.3	-0.8	-1.6
<b>Services, net</b>	-26.0	-33.8	-27.4	-28.1	-31.8
Credits	8.1	9.6	10.2	11.8	13.3
Debits	-34.0	-43.4	-37.6	-39.9	-45.1
<b>Transfers, net</b>	-9.3	-10.6	-10.2	-11.4	-15.0
<b>Financial account balance</b>	27.9	-19.9	9.3	2.0	-20.0
(in percent of GDP)	-94.5	-6.3	3.4	0.7	-5.5
Private capital	58.4	9.6	-4.4	6.2	5.7
Direct investment, net	-0.4	-2.1	1.3	2.0	2.6
Portfolio flows, net	1.4	2.2	2.5	1.0	1.5
Commercial banks	48.6	-12.2	-9.9	-1.3	-1.0
Private non-banks and other	8.8	21.7	1.8	4.6	2.5
<b>Official capital</b>	-30.5	-29.5	13.6	-4.3	-25.7
<b>Errors and omissions</b>	6.5	-50.2	-23.5	-17.9	0.0
(In percent of GDP)	2.5	-16.0	-8.7	-5.9	0.0
<b>Overall balance</b>	49.9	-46.8	-6.0	7.3	17.7
Change in central bank net foreign assets (minus equals increase)	-49.9	46.9	6.1	-7.3	-17.7
<b>Memorandum items:</b>					
Current account balance (percent of GDP)	6.0	7.4	3.0	7.7	10.4
Overall balance (percent of GDP)	19.3	-14.9	-2.2	2.4	4.9
Gross reserves of central bank	77.9	30.9	24.7	32.0	49.7
in months of next year's imports	4.3	2.0	1.5	1.7	2.5
Value of GNFS imports, percent change	47.1	32.3	-14.8	5.9	13.2
Volume of GNFS imports, percent change	32.2	13.6	-11.7	-1.5	4.7

Sources: U.A.E. authorities; and Fund staff estimates.  
1/ Not separately compiled; estimated at 40 to 70 percent of emirates imports.

Table 3 United Arab Emirates: Consolidated Government Finances, 2007–11<sup>1/</sup>

	2007	2008	2009	Proj. 2010	2011
	(Billions of U.A.E. dirhams)				
<b>Total revenue</b>	313.4	446.8	250.9	315.0	447.4
Hydrocarbon 2/	233.6	361.5	174.1	239.3	366.5
Nonhydrocarbon	79.8	85.3	76.8	75.8	81.0
<b>Total expenditure and grants</b>	167.3	256.6	375.6	329.0	360.6
Current expenditure	127.0	169.7	210.6	239.2	256.7
Development expenditure	17.3	31.5	45.1	38.7	46.0
Loans and equity (net) 3/	20.8	51.8	116.6	49.9	56.3
Foreign grants 4/	2.3	3.6	3.3	1.2	1.7
<b>Overall balance</b>	146.0	190.2	-124.7	-13.9	86.8
<b>Primary balance</b>	146.5	193.3	-118.8	-4.5	99.2
<b>Financing</b>	-146.0	-190.2	124.7	13.9	-86.8
Bank financing, net	-9.5	-23.7	95.1	19.3	-12.0
Non-bank financing	-136.5	-166.6	29.6	-5.4	-74.8
	(Percent of GDP)				
<b>Total revenue</b>	33.1	38.6	25.3	28.4	33.5
<i>of which hydrocarbon</i>	24.6	31.3	17.5	21.6	27.4
<b>Total expenditure and grants</b>	17.7	22.2	37.8	29.7	27.0
Current	13.4	14.7	21.2	21.6	19.2
Interest payments	0.0	0.0	0.0	0.9	0.9
Development	1.8	2.7	4.5	3.5	3.4
Loans and equity	2.2	4.5	11.7	4.5	4.2
<b>Overall balance</b>	15.4	16.5	-12.6	-1.3	6.5
<b>Primary balance</b>	15.4	16.7	-12.0	-0.4	7.4
<b>Nonhydrocarbon balance (excl. investment income)</b>	-12.5	-16.8	-31.8	-24.0	-21.9
<b>Nonhydrocarbon primary balance (excl. investment income)</b>	-12.4	-16.6	-31.2	-23.2	-21.0
<b>Nonhydrocarbon balance (excl. investment income and</b>	-12.5	-16.8	-26.8	-22.7	-21.9
	(Percent of non-hydrocarbon GDP)				
<b>Total revenue</b>	49.9	61.3	35.6	43.1	56.2
<i>of which nonhydrocarbon</i>	12.7	11.7	10.9	10.4	10.2
<b>Total expenditure and grants</b>	26.7	35.2	53.2	45.0	45.3
Current	20.2	23.3	29.8	32.7	32.2
Development	2.8	4.3	6.4	5.3	5.8
Loans and equity	3.3	7.1	16.5	6.8	7.1
<b>Overall balance</b>	23.3	26.1	-17.7	-1.9	10.9
<b>Primary balance</b>	23.3	26.5	-16.8	-0.6	12.5
<b>Nonhydrocarbon balance</b>	-14.0	-23.5	-42.3	-34.7	-35.1
<b>Nonhydrocarbon balance</b>	-14.0	-23.5	-42.3	-34.7	-35.1
<b>Nonhydrocarbon balance (excl. investment income)</b>	-18.9	-26.7	-44.7	-36.5	-36.8
<b>Nonhydrocarbon primary balance (excl. investment income)</b>	-18.8	-26.3	-43.9	-35.2	-35.2
<b>Nonhydrocarbon primary balance (excl. DFSF)</b>	-13.9	-23.1	-34.6	-31.4	-33.6
<b>Nonhydrocarbon balance (excl. investment income and DFSF)</b>	-18.9	-26.7	-37.8	-34.5	-36.8
<b>Financing</b>	-146.0	-190.2	124.7	13.9	-86.8
Bank financing, net	-9.5	-23.7	95.1	19.3	-12.0
Loans to government	13.7	70.6	78.8	9.3	-12.0
Government deposits	23.2	94.3	-16.2	-10.1	0.0
Non-bank financing	-136.5	-166.6	29.6	-5.4	-74.8
<b>Memorandum items:</b>					
Hydrocarbon share of revenue (in percent)	74.5	80.9	69.4	75.9	81.9
Nonhydrocarbon revenue, excl. investment income	49.0	62.1	60.2	62.7	68.0

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

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

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

3/ 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.

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

**Table 3a United Arab Emirates: Abu Dhabi Government Finances, 2007–11**

	2007	2008	2009	Proj.	
				2010	2011
	(Billions of U.A.E dirham)				
<b>Total revenue</b>	204.8	300.4	144.0	188.5	283.1
Hydrocarbon	168.3	269.6	121.8	169.1	263.3
Nonhydrocarbon	36.5	30.8	22.2	19.3	19.8
<b>Total expenditure and grants</b>	121.7	187.4	261.4	245.5	284.2
Current expenditures	81.6	105.4	139.0	165.4	178.5
Development expenditures	5.0	13.2	27.6	23.6	30.1
Loans and equity (net)	19.5	49.8	77.4	43.9	62.8
Grants	15.6	19.0	17.4	12.6	12.8
<b>Overall balance</b>	83.1	113.1	-117.5	-57.1	-1.0
	(Percent of Abu Dhabi GDP)				
<b>Total revenue</b>	37.6	42.6	24.1	26.8	31.7
Hydrocarbon	30.9	38.2	20.4	24.0	29.5
Nonhydrocarbon	6.7	4.4	3.7	2.7	2.2
<b>Total expenditure and grants</b>	22.3	26.6	43.8	34.9	31.9
Current expenditures	15.0	15.0	23.3	23.5	20.0
Development expenditures	0.9	1.9	4.6	3.4	3.4
Loans and equity (net)	3.6	7.1	13.0	6.2	7.0
Grants	2.9	2.7	2.9	1.8	1.4
<b>Overall balance</b>	15.2	16.0	-19.7	-8.1	-0.1
<b>Nonhydrocarbon balance (excl. invest. income) 1/</b>	-48.8	-61.5	-79.5	-70.0	-74.2
<b>Nonhydrocarbon primary balance (excl. invest. income) 1/</b>	-48.8	-61.4	-79.3	-69.8	-73.8

Sources: Abu Dhabi Department of Finance, and Fund staff estimates and projections.

1/ Percent of Abu Dhabi nonhydrocarbon GDP.

**Table 3b United Arab Emirates: Dubai Government Finances, 2007–11**

	2007	2008	2009	Proj.	
				2010	2011
	(Billions of U.A.E dirham)				
<b>Total revenue</b>	25.6	32.6	40.6	41.9	45.1
Non tax revenue	18.8	25.0	33.4	34.6	36.8
Tax revenue	6.8	7.6	7.1	7.3	8.3
<b>Total expenditure and grants</b>	26.9	40.8	95.6	61.9	51.5
Current expenditure	16.8	25.3	30.9	34.5	37.0
Development expenditure	8.9	14.3	13.5	11.0	11.5
Loans and equity (net)	0.0	0.0	49.9	15.8	1.2
<b>Overall balance</b>	-1.3	-8.2	-55.0	-20.0	-6.4
	(Percent of Dubai and Northern Emirates GDP)				
<b>Total revenue</b>	6.4	7.2	10.2	10.4	10.2
<b>Total expenditure and grants</b>	6.7	9.1	24.1	15.3	11.6
Current expenditure	4.2	5.6	7.8	8.5	8.3
Development expenditure	2.2	3.2	3.4	2.7	2.6
Loans and equity (net)	0.0	0.0	12.6	3.9	0.3
<b>Overall balance</b>	-0.3	-1.8	-13.9	-4.9	-1.4

Sources: Dubai Department of Finance, and Fund staff estimates and projections.

Table 4 United Arab Emirates: Monetary Survey, 2007–11

	2007	2008	Prel. 2009	Proj. 2010	2011
	(Billions of U.A.E. dirhams)				
<b>Net foreign assets</b>	160	33	47	79	147
Foreign assets	483	317	299	351	428
Central Bank	286	113	91	117	182
Commercial banks	197	203	208	234	245
Foreign liabilities	322	284	252	272	280
Central bank	1	1	1	1	1
Commercial banks	321	283	251	272	280
<b>Net domestic assets</b>	405	641	694	708	715
Claims on government (net)	-61	-85	10	29	23
Claims	69	140	219	228	221
Deposits	131	225	209	199	199
Claims on public sector enterprises	45	56	77	88	92
Claims on private sector	586	875	881	892	923
Real estate mortgage loans	59				
Other items (net)	-165	-205	-275	-301	-323
Capital and reserves (-)	-132	-167	-246	-275	-290
Other assets (net)	-32	-38	-29	-26	-32
Central Bank	-241	-108	-141	-167	-228
Commercial banks	209	70	112	141	195
<i>Of which: certificates of deposits</i>	174	47	71	94	145
<b>Broad money (M2)</b>	566	674	741	786	862
Money	182	208	223	233	260
Currency outside banks	26	37	37	39	43
Dirham demand deposits	156	171	186	194	217
Quasi-money	384	466	517	553	602
	(Changes in percent of initial M2 stock)				
<b>Net foreign assets</b>	1.2	-22.5	2.1	4.3	8.7
Central bank	45.9	-30.5	-3.3	3.6	8.3
Commercial banks	-44.7	7.9	5.4	0.6	0.4
<b>Net domestic credit</b>	42.8	48.8	18.1	5.5	3.6
Claims on government (net)	-2.4	-4.2	14.1	2.6	-0.8
Claims on public sector enterprises	3.1	1.9	3.1	1.4	0.5
Claims on private sector	42.0	51.1	0.9	1.5	3.9
	(Changes in percent, unless otherwise indicated)				
<b>Claims on private sector</b>	40.1	49.3	0.7	1.2	3.5
<b>Broad money (M2)</b>	41.7	19.2	9.8	6.2	9.6
Money	51.4	14.6	7.4	4.2	11.6
Quasi Money	37.5	21.4	10.9	7.0	8.7
<b>Velocity (non-oil GDP/M2)</b>	1.1	1.1	1.0	0.9	0.9
<b>Base money</b>	70.0	32.2	-6.5	-1.3	8.8
<b>Money multiplier (M2/base money)</b>	6.1	5.5	6.5	7.0	7.0

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

**Table 5** United Arab Emirates: Medium-Term Baseline Scenario, 2008–16

	2008	2009	2010	2011	2012	Proj.			
						2013	2014	2015	2016
Crude oil production (millions of barrels per day) 1/	2.84	2.61	2.75	2.84	2.95	3.05	3.16	3.28	3.39
Crude oil exports (millions of barrels per day) 1/	2.42	2.09	2.15	2.23	2.31	2.39	2.47	2.56	2.65
Average U.A.E. oil export price (in U.S. dollars/barrel)	96.7	62.8	77.0	106.4	107.3	104.8	103.8	104.3	105.3
	<b>(Percentage change, except as noted)</b>								
<b>Nominal GDP (in billions of U.S. dollars)</b>	315	270	302	364	384	403	426	454	482
Real GDP (at factor cost)	5.3	-3.2	3.2	3.3	3.8	4.0	4.3	4.4	4.2
Hydrocarbon	1.6	-9.6	5.3	3.4	3.6	3.6	3.6	3.6	3.6
Nonhydrocarbon	6.3	0.6	2.1	3.3	3.9	4.3	4.7	4.9	4.5
Consumer prices (annual average)	12.3	1.6	0.9	4.5	3.0	2.5	2.2	2.2	2.2
	<b>(Percent of GDP)</b>								
<b>National saving</b>	29.6	26.8	26.4	29.4	30.9	31.2	32.3	34.2	33.4
Government	24.0	4.1	6.8	14.3	14.7	14.2	14.6	15.3	15.7
Non-government	5.7	22.7	19.5	15.2	16.2	17.1	17.7	18.9	17.7
<b>Gross domestic investment</b>	22.5	23.9	18.7	19.1	20.4	21.8	22.1	22.7	22.2
Government	7.4	9.1	7.0	6.9	7.0	7.2	7.4	7.4	7.5
Nongovernment	15.1	14.8	11.7	12.2	13.4	14.5	14.8	15.3	14.7
<b>Consolidated fiscal accounts</b>									
Revenue	38.6	25.3	28.4	33.5	33.6	32.7	32.8	33.2	33.3
Hydrocarbon	31.3	17.5	21.6	27.4	27.2	26.1	25.4	24.9	24.5
Nonhydrocarbon	7.4	7.7	6.8	6.1	6.4	6.6	7.4	8.3	8.8
Expenditure and net lending	22.2	37.8	29.7	27.0	26.7	26.6	26.3	25.9	25.5
Current	14.7	21.2	21.6	19.2	18.8	18.6	18.2	17.9	17.6
Capital	7.2	16.3	8.0	7.7	7.7	7.9	7.9	7.9	7.8
Overall balance	16.5	-12.6	-1.3	6.5	6.9	6.2	6.5	7.3	7.8
Nonhydrocarbon primary balance (excl. invest. income) 2/	-26.3	-43.9	-35.2	-35.2	-34.4	-33.3	-32.2	-31.0	-30.0
Nonhydrocarbon balance (excl. invest. income) 2/	-26.7	-44.7	-36.5	-36.8	-35.9	-34.9	-33.7	-32.6	-31.8
<b>External accounts</b>									
Exports	76.3	71.1	73.5	73.0	74.1	73.7	74.3	74.4	73.5
Imports, f.o.b.	-56.0	-55.4	-52.4	-49.3	-50.5	-51.4	-51.7	-51.7	-52.0
Services (net)	-10.7	-10.1	-9.3	-8.8	-8.7	-8.7	-8.6	-8.4	-8.2
Investment income (net)	1.3	1.2	-0.3	-0.4	-0.2	0.0	0.3	1.3	2.0
Transfers (net)	-3.4	-3.8	-3.8	-4.1	-4.1	-4.1	-4.1	-4.1	-4.1
Current account balance (in billions of U.S. dollars)	23.3	8.2	23.3	37.7	40.5	38.2	43.4	51.9	54.1
Current account balance	7.4	3.0	7.7	10.4	10.5	9.5	10.2	11.4	11.2
Overall balance	-14.9	-2.2	2.4	4.9	5.0	4.0	4.2	4.7	4.0
Central bank reserves	9.8	9.1	10.6	13.6	17.9	21.0	24.1	27.3	29.7
In months of next year imports of goods and services	2.0	1.5	1.7	2.5	3.2	3.7	4.2	4.8	5.3
External debt 3/	43.1	48.1	46.2	39.9	39.1	38.6	37.7	36.7	35.7

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

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

2/ In percent of nonhydrocarbon GDP.

3/ Mostly foreign liabilities of banking system; incomplete coverage of debt raised by non-banks in the international markets.

**Table 6** United Arab Emirates: Social Indicators

	2000	2005	2006	2007	2008
Population density (people per sq. km)	38.7	48.9	50.6	52.2	53.6
Population in urban agglomerations of more than 1 million (% of total)	29.0	32.5	...	31.5	...
Literacy rate, adult total (% of people ages 15 and above)	...	90.0	...	...	...
Literacy rate, youth total (% of people ages 15-24)	...	95.0	...	...	...
Primary completion rate, total (% of relevant age group)	80.1	98.0	101.9	105.0	...
Ratio of female to male primary enrollment (%)	96.1	98.9	99.4	99.6	...
School enrollment, secondary (% net)	67.9	76.4	78.9	83.8	...
Employment to population ratio, ages 15-24, total (%)	44.9	47.5	46.7	46.6	45.6
Employment to population ratio, ages 15-24, male (%)	60.5	62.8	62.3	62.1	61.2
Employment to population ratio, ages 15-24, female (%)	22.3	24.6	24.0	25.0	24.9
Unemployment, total (% of total labor force)	2.3	3.1	...	...	4.0
Unemployment, male (% of male labor force)	2.2	2.5	...	...	2.4
Unemployment, female (% of female labor force)	2.6	7.1	...	...	10.8
Unemployment, youth total (% of total labor force ages 15-24)	...	8.0	...	...	...
Life expectancy at birth, total (years)	76.8	77.4	77.5	77.6	77.7

Source: World Banks' World Development Indicators.



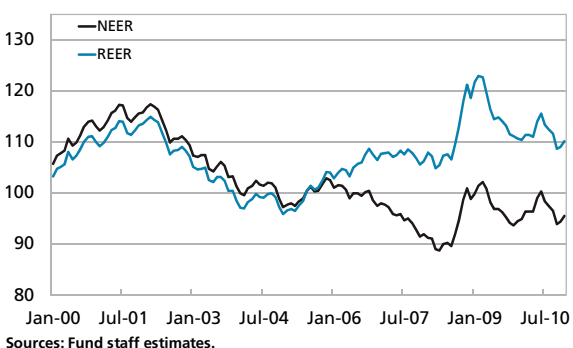
## Appendix I. Exchange Rate Assessment

Estimates from CGER-type methodologies for exchange rate assessment indicate that the U.A.E. dirham exchange rate is broadly in line with fundamentals.

### 1. The real exchange rate depreciated by 10.2 percent since the first quarter of 2009, moving broadly in line with fundamentals.

Following a period of strong appreciation between 2005 and 2008, the trade-weighted real effective exchange rate (REER) depreciated by 10.2 percent from the peak in March 2009 until end-2010. Estimation of the equilibrium exchange rate shows that at end-2010, the REER was overvalued by about 1 percent, well within the margin of error.

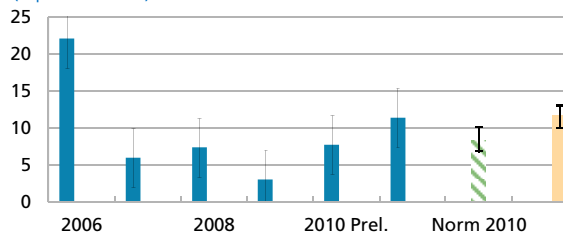
**Real and Nominal Effective Exchange Rates, 2000-10**  
(Index, 2005=100)



**2. The macroeconomic balance approach suggests a slight overvaluation of the dirham but well within the margin of error.<sup>1</sup>** The estimation yields a current account norm for the U.A.E. at a surplus of 8.3 percent of GDP in 2010 and 11.6 percent in 2015, compared to the projected current account position of 11.4 percent in 2015. Therefore, the projected current account lies within the confidence interval, indicating only slight evidence of exchange rate overvaluation. For 2010, the difference is marginally larger but still within the

confidence band—a norm of 8.3 percent of GDP compared to the actual surplus of 7.7 percent of GDP.

**Macroeconomic Balance Approach: Current Account Balances and Estimated Norms 1/**  
(In percent of GDP)



Sources: Fund staff estimates and projections.

1/ In computing the norms, medium-term values of the fundamentals (including the non-oil fiscal balance, oil trade balance, fund oil and gas reserves) are drawn from staff projections. Band is  $\pm 1$  standard error of the prediction.

2/ Based on Fund staff estimates. Medium-term is 2015.

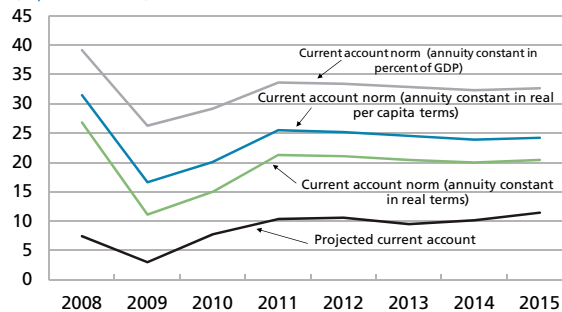
<sup>1</sup> The macroeconomic balance approach estimates an equilibrium current account norm from a set of fundamentals (nonhydrocarbon fiscal balance, hydrocarbon reserves, a proxy for an underreported international investment position, old-age dependency ratio, population growth rate, initial net foreign assets, hydrocarbon trade balance, growth rate of real per capita GDP, and relative income), using a generalized method of moments technique. See S. Beidas-Strom and P. Cashin, forthcoming, "Are Middle Eastern Current Account Imbalances Excessive?" IMF Working Paper.

**3. The external sustainability approach indicates a modest overvaluation of the dirham.**<sup>2</sup> Based on the U.A.E.'s estimated hydrocarbon wealth, import trajectories ("annuities or allocation rules") are calculated under three different policy scenarios: (a) a constant share of GDP annuity; (b) constant real per capita annuity; and (c) constant real annuity. All three annuities are used in the literature, and can be derived from the optimization of plausible government utility functions.<sup>3</sup> These calculations lead to the same result for the U.A.E.: the projected current account balance is too low. Albeit sensitive to parameter assumptions, this would imply a need to accumulate further savings (e.g. higher fiscal savings) of about 9 percentage points of GDP. Notwithstanding the estimated overvaluation, nonhydrocarbon exports have continued to grow rapidly.

<sup>2</sup> The underpinning of the external sustainability approach is that the sustainability of the current account trajectory requires that the net present value (NPV) of all future hydrocarbon and investment income be equal to the NPV of imports of goods and services net of nonhydrocarbon exports. Subject to this constraint, the government would choose a path for imports, and hence a current account norm, that would support intergenerational equity—and some precautionary savings in view of volatile oil prices—through an appropriate pace of accumulation of net foreign assets.

<sup>3</sup> See Bems, R., and I. de Carvalho Filho, 2009, "Exchange Rate Assessments: Methodologies for Oil Exporting Countries," IMF Working Paper, No. 09/281.

**Current Account Norms vs. Projected Current Account**  
(In percent of GDP)



Source: Fund staff calculations and projections.



INTERNATIONAL MONETARY FUND

# UNITED ARAB EMIRATES

STAFF REPORT FOR THE 2011 ARTICLE IV  
CONSULTATION—INFORMATIONAL ANNEX

April 5, 2011

Prepared By Middle East and Central Asia Department

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## ANNEX I. FUND RELATIONS

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

### General Resources Account

	SDR Million	Percent Quota
Quota	611.7	100.00
Fund holdings of currency	456.86	74.69
Reserve position in Fund	155.42	25.41

### SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	568.41	100.00
Holdings	541.34	95.24

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:** None

### Projected Payments to Fund

	Forthcoming				
	2011	2012	2013	2014	2015
Principal					
Charges/interest	0.09	0.12	0.12	0.12	0.12
<b>Total</b>	<b>0.09</b>	<b>0.12</b>	<b>0.12</b>	<b>0.12</b>	<b>0.12</b>

### Implementation of HIPC Initiative:

Not Applicable

### Implementation of Multilateral

**Debt Relief Initiative (MDRI):** Not Applicable

### Implementation of Post-Catastrophe Debt

**Relief (PCDR):** Not Applicable

### Exchange Arrangement

The U.A.E. dirham was officially pegged to the SDR at the rate of AED 4.76190=SDR1 from

November 1980 to February 2002—albeit de facto it was pegged to the dollar at a fixed parity. Since then, the U.A.E. dirham has been de jure pegged to the U.S. dollar, with the mid-point between the official buying and selling rates fixed at AED 3.6725 = US\$1.

The U.A.E. has accepted the obligation of Article VIII, Sections 2, 3, and 4. There are no restrictions on the making of payments and transfer for current international transactions, except for those restrictions for security reasons that have been notified to the Fund, by the authorities, in accordance with Executive Board Decision No. 144 (52/51).

### Article IV Consultation

The U.A.E. is on the annual consultation cycle. The previous consultation discussions were held during October 13–28, 2009 and January 3–11, 2010, and concluded on February 3, 2010. The staff report (SM/10/42) was discussed by the Executive Board on February 3, 2010, and is available at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=23628.0> (Country Report No. 10/42).

### FSAP Participation, ROSCs, and OFC Assessments

FSAP missions visited U.A.E. in 2003 and 2007.

XIV	Technical Assistance (since 2000)	
FAD	Public Expenditure Management	November 2000
FAD	Public Expenditure Management Follow up	May 2003
STA	Multi-sector	December 2003
MFD	Anti-Money Laundering/Combating Terrorist Financing	March 2004
STA	Coordinated Portfolio Investment Survey	April 2004
FAD	Revenue Diversification and VAT Feasibility	November 2005
FAD	Public Financial Management	November 2005
FAD	Gulf Cooperation Council: Options for Indirect and Taxation	March 2006
FAD	U.A.E.: Options for New Indirect Taxation and Intergovernmental Fiscal Relations	March 2006
STA	Compilation of a High-Frequency CPI Index	March 2007
STA	Multi-sector	April 2008
STA	Balance of Payments	March–April 2009
MCM	Macroprudential Tools and Liquidity Management	January 2011

**Resident Representative:** None.

## ANNEX II: RELATIONS WITH THE WORLD BANK GROUP

As of March 25, 2010

Technical cooperation between the United Arab Emirates (U.A.E.) and the Bank started in 1980 and continued on ad-hoc basis until 1993. In 1994, the framework agreement for technical cooperation programs was signed, to provide a basis for an ongoing cooperation. The first program featured two studies: a comprehensive national health assessment study and a government computer center restructuring study. Later, the government requested assistance in agriculture and water resource management, including environmental impact assessment.

At the federal level, the Bank provided assistance to the Ministry of Finance in the area of debt market development: a bond market development strategy was completed in May 2008, and the Bank assisted with certain aspects of its implementation. Currently, the Bank is providing assistance to the Ministry of Finance with capacity building in macrofiscal area.

A program of assistance to the federal Ministry of Labor has begun in FY11 in the area of labor market development, Emiratization policies, and labor market information systems.

Within the U.A.E., the Bank has been successful in cooperating with individual Emirates on an ad hoc basis. In Ras Al Khaimah (RAK), technical cooperation has included promoting a better investment climate and assisting in mobilizing private investment. An investors' conference (May 2005) attracted major strategic, financial and individual investors from around the world and had a significant impact on investment climate improvement. More recently, the Bank provided an expert advice to the Government of RAK on a multi-jurisdictional student loan program design.

In Abu Dhabi, the Bank provided assistance to Abu Dhabi Food Control Authority, on a food security program for the emirate of Abu Dhabi; currently, the Bank is assisting Abu Dhabi Judicial Department with a judicial reform process. Under discussion is a program of cooperation with the Executive Council of Abu Dhabi, including technical assistance to the Abu Dhabi Water Council and to the Executive Council itself.

In Dubai, the Bank is providing support with analysis of options in the area of retirement planning for expatriate workers.

## ANNEX III. STATISTICAL ISSUES

As of March 25, 2011

### I. Assessment of Data Adequacy for Surveillance

**General:** Data provision is broadly adequate for surveillance, but there are substantial shortcomings on the accounts of government-related corporations. In particular, data on GRE debt and contingent liabilities to the government are not available. The federal and individual emirates' agencies have improved the availability and quality of the statistics, but more progress is needed. The adoption of the Federal Statistics Law on May 18, 2009, and the establishment of an independent National Bureau of Statistics (NBS) are important steps in establishing a statistical system at the federal level. While the Law expressly requires all agencies and local statistical centers to provide data as required by the NBS, its success will depend on implementing arrangements, staffing, funding and training, as well as political commitment.

**National Accounts:** The methodology broadly conforms to the 1968 SNA. GDP is compiled annually with a lag of around 18 months and only current price expenditure estimates are available. Some progress has been made in improving the source data but further work is needed to improve updating procedures, and quarterly indicators are not available.

**Price statistics:** Following technical assistance from the IMF Statistics Department, the Ministry of Economy started publishing a monthly CPI since January 2008. However, price indexes and GDP deflators need further harmonization at the federal level.

**Government finance statistics:** In 2008, six of the seven emirates and the federal government have received technical support in the compilation of fiscal data on a consolidated basis, using the GFSM 2001 format and 2008 as a base year. The authorities, however, are yet to adopt the action plan to establish a fiscal reporting system for the production of the GFS in a regular and timely manner. Since reporting of data by the emirates is voluntary, an institutional arrangement will need to be established to ensure adequate data provision. This consolidation should complement initiatives to establish debt management units at both the emirate and federal levels.

**Monetary statistics:** The central bank has recently shifted the responsibility for compiling and disseminating monetary data to the Banking Supervision and Examination Department, in order to improve the timeliness of data to monthly frequency with less than a month lag. Although some monthly aggregates and FSIs are already published on a monthly basis the Banking Supervision and Examination Department has not been trained in MFSM 2000 and the published data do not follow the recommended methodology.

**Balance of Payments:** The information needed to compile the balance of payments is insufficient, especially for the financial account. Many components of the IIP also are missing or incomplete, as the data on government foreign assets and private holdings of foreign assets and liabilities are not published or lack appropriate surveys. The development of a comprehensive Balance of Payments and IIP is however within the reach of the U.A.E. if the central bank, the NBS, and the Ministry of Economy strengthen their capacity and receive appropriate support at the high level. The authorities have indicated their interest in IMF technical assistance.

### II. Data Standards and Quality

Participant in the GDDS since July 31, 2008. The metadata were last updated in 2008 (Monetary and BOP), 2008 (National Accounts and Prices), and 2008 (Government Finance).

No data ROSC is available.

**Table of Common Indicators Required for Surveillance  
(As of March 19, 2011)**

	Date of latest	Date received	Frequency of	Frequency of	Frequency of
			Data <sup>6</sup>	Reporting <sup>6</sup>	publication <sup>6</sup>
Exchange Rates	Real time	Real time	D	M	M
International reserve assets and reserve liabilities of the monetary Authorities <sup>1</sup>	12/10	1/11	M	M	M
Reserve/base money	12/10	2/11	M	M	M
Broad money	12/10	2/11	M	M	M
Central bank balance sheet	12/10	2/11	M	M	M
Consolidated balance sheet of the banking system	12/10	2/11	M	M	M
Interest rates <sup>2</sup>	Real time	Real time	D	D	D
Consumer price index	2/11	3/11	M	M	M
Revenue, expenditure, balance and Composition of financing <sup>3</sup> – Central government	2010	3/11	A	A	A
Stocks of central government and central government-guaranteed debt <sup>4</sup>	2010	3/11	A	A	A
External current account balance	2010	3/11	A	A	A
Exports and imports of goods and services	2010	3/11	A	A	A
GDP/GNP	2009	1/11	A	A	A
Gross external debt	...	...	NA	NA	NA
International investment position <sup>5</sup>	...	...	NA	NA	NA
<p><sup>1</sup> Any reserve assets that are pledge or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by means as well as the notional values of derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.</p> <p><sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.</p> <p><sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.</p> <p><sup>4</sup> Including currency and maturity composition.</p> <p><sup>5</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p><sup>6</sup> Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).</p>					





INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 11/57  
FOR IMMEDIATE RELEASE  
May 23, 2011

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

## **IMF Executive Board Concludes 2011 Article IV Consultation with United Arab Emirates**

On April 21, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United Arab Emirates (U.A.E.), and considered and endorsed the staff appraisal without a meeting.<sup>1</sup>

### **Background**

The economic recovery in the U.A.E. is gaining strength, supported by a favorable global environment but subject to increased regional uncertainty. Real nonhydrocarbon GDP growth is projected to accelerate to 3.3 percent in 2011 from 2.1 percent in 2010, reflecting stronger tourism, logistics, and trade in the emirate of Dubai; and large public investment spending in the emirate of Abu Dhabi, including through Government-Related Entities (GREs). Higher oil prices are also contributing to a marked improvement in the fiscal and external positions. Despite higher international food prices, the CPI inflation rate is expected to remain moderate at 4.5 percent, as property rents continue to decline. At 4.2 percent, the U.A.E.'s unemployment rate is low, though unemployment among nationals remains high (at 14 percent), and concentrated in the northern emirates.

The Dubai World (DW) debt restructuring was completed, but other GREs entered in restructuring negotiations. Nevertheless, the successful restructuring of DW's debt improved market confidence, allowing top-grade Dubai issuers to regain market access. However, Dubai spreads remain high reflecting the risks posed by further potential debt restructuring needs.

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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. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Many Dubai GREs initiated DW-style debt restructuring talks with banks, while Abu Dhabi stepped up its support to some GREs.

The banking sector has high capital buffers—including from the government—and remained profitable in 2010, but nonperforming loans have doubled since the crisis. The Central Bank of the U.A.E. (CBU) has made important progress in strengthening its financial stability analysis, revamping the regulatory framework, and developing macroprudential policies, with the view to improve bank risk management practices.

Risks to the recovery remain, including from possible economic spillovers of regional events. In particular, the current re-pricing of geopolitical risk in the region could lead to more challenging market conditions, which may put pressure on the entities that need to roll over external borrowing. The excess supply of property in Dubai, and the uncertainty regarding the scale of oversupply in the emirate, will continue to weigh on growth in the U.A.E. At more than 100 percent of GDP, Dubai's GRE debt is large and roll-over needs are expected to remain substantial for the medium term, posing continued fiscal and financial risks to the U.A.E. overall.

### **Executive Board Assessment**

In concluding the 2011 Article IV consultation with the United Arab Emirates, Executive Directors endorsed staff's appraisal, as follows:

The U.A.E. economy is recovering in an increasingly uncertain regional environment. Benefiting from high oil prices and strong demand from traditional trading partners, nonhydrocarbon GDP growth is projected to accelerate from 2.1 percent in 2010 to 3.3 percent in 2011. The real estate overhang and short-term refinancing needs from overleveraged GREs continue to weigh on the near-term outlook. Downside risks to the recovery relate to possible economic spillovers of regional events, including the re-pricing of risk.

In light of the still fragile recovery, short-term policies should focus on supporting domestic demand, and adjust to the economic spillovers from the unfolding regional events. An overall neutral fiscal policy stance following last year's fiscal contraction would support the economic recovery, while Dubai should consolidate. To ensure efficiency of spending, the government should undertake cost-benefit analyses and implement the projects that have high economic return. While the central bank will maintain its accommodative monetary policy stance, it should also stand ready to provide liquidity to the market in case the re-pricing of risk in the region triggers a reversal of the recent deposit inflows to the banking sector.

The authorities' response to the unfolding events in the region is appropriate. Improved infrastructure in the northern emirates will help raise the standards of living in these areas. Staff also advises the authorities to consider replacing the subsidies on water and electricity with explicit cash transfers to lower-income households. The authorities' active labor market policies

will help create jobs for nationals, and should be complemented by strengthening the skills mix. Given the concentration of unemployment in the northern Emirates, the government could also consider locating some of its agencies/entities in the North to create further employment opportunities for nationals in these areas.

The exchange rate is broadly aligned with fundamentals, and the dollar peg continues to serve as an effective nominal anchor for the economy.

Mitigating GRE risks should remain a policy priority. In the short term, the authorities should complete the restructuring of GRE debt, ensure the viability of these entities through writing-off impaired assets, and communicate their strategy on GRE debt refinancing. Going forward, limiting overall GRE borrowing by emirate, developing a GRE risk management framework, and reporting contingent liabilities arising from GREs in the fiscal accounts will help reduce GRE risks. GRE governance also needs to be improved, including by clarifying ownership, government support strategy, and delineating commercial and noncommercial operations carried by the GREs. Finally, better information disclosure about GRE financial accounts would improve investor confidence and ultimately translate into lower funding costs.

The CBU should continue to prepare the banking system for further possible deterioration in asset quality and future risks. The central bank has taken a number of steps that would help improve the resilience of the banking sector to future shocks. Given the likelihood of further increase in NPLs, the central bank should continue to ensure that banks provision adequately, while monitoring the performance of restructured loans. Higher capital charges on risky GREs, and continued retained earnings by banks would also limit the potential financial risks posed by the GREs.

The recent boom-bust underscores the need for strong demand management over the cycle. Under a pegged exchange rate regime, this requires mutually-supportive countercyclical fiscal and macroprudential policies, and the federal structure of the U.A.E. makes a close coordination between various governments imperative. Staff is encouraged by the authorities' decision to deepen further the intergovernmental cooperation, including the CBU.

Developing the domestic capital markets will reduce U.A.E.'s dependency on external markets. In this context, given the limited scope for federal securities in the short term, the authorities should explore stable funding from non-traditional sources, such as term deposits from government sources.

The progress made by the NBS in establishing macroeconomic statistics and the ministry of finance in preparing consolidated fiscal accounts is an important step towards developing statistical capacity. However, further efforts are needed for the timely compilation and dissemination of key statistics, including on national accounts, balance of payments, and fiscal accounts. This will also require harmonization of methodologies across emirates. Staff

encourages the authorities to move ahead with further developing the capacity to produce leading indicators and to collect and disseminate data on U.A.E.'s International Investment Position.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2011 Article IV Consultation with United Arab Emirates is also available.

## United Arab Emirates: Selected Macroeconomic Indicators, 2007–11

	2007	2008	2009	Est. 2010	Proj. 2011
	(Annual percent change, unless otherwise indicated)				
Output and prices					
Nominal GDP (in billions of AED)	948	1,156	993	1,109	1,336
Nominal GDP (in billions of U.S. dollars)	258	315	270	302	364
Real GDP	6.5	5.3	-3.2	3.2	3.3
Real hydrocarbon GDP	-2.7	1.6	-9.6	5.3	3.4
Real nonhydrocarbon GDP	9.1	6.3	0.6	2.1	3.3
CPI inflation (average)	11.1	12.3	1.6	0.9	4.5
Public finances					
Revenue	33.1	38.6	25.3	28.4	33.5
Hydrocarbon	24.6	31.3	17.5	21.6	27.4
Nonhydrocarbon	8.4	7.4	7.7	6.8	6.1
Expenditure and net lending	17.7	22.2	37.8	29.7	27.0
Budget balance	15.4	16.5	-12.6	-1.3	6.5
Non-hydrocarbon balance 1/	-14.0	-23.5	-42.3	-34.7	-35.1
	(Annual percent change, unless otherwise indicated)				
Monetary sector					
Credit to private sector	40.1	49.3	0.7	1.2	3.5
Broad money	41.7	19.2	9.8	6.2	9.6
	(In billions of U.S. dollars, unless otherwise indicated)				
External sector					
Exports of goods	178.6	240	192	222	265
Hydrocarbon	73.8	103	68	78	108
Imports of goods	132	176	150	158	179
Current account balance	15.4	23.3	8.2	23.3	37.7
Current account balance (in percent of GDP)	6.0	7.4	3.0	7.7	10.4
Gross official reserves 2/	77.9	30.9	24.7	32.0	49.7
In months of next year's imports of goods & services	4.3	2.0	1.5	1.7	2.5
Real effective exchange rate (2000 = 100)	99.8	102.8	107.9	103.7	..

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

1/ In percent of nonhydrocarbon GDP.

2/ Excludes foreign assets of sovereign wealth funds.