# I. ECONOMIC ENVIRONMENT

## (1) OVERVIEW

1. The economy of the UAE has developed a strong services sector due to the strategy of diversification implemented during the last decade, but the oil industry continues to be of prime importance. Abu Dhabi produces 95% of the country's oil and gas, and owns one of the largest sovereign wealth funds in the world. Dubai, the second largest emirate, has a more diversified economy, driven by re-export trade, services, and real estate.

2. After a period of fast growth, boosted by investment and construction, the economy of the UAE was strongly affected by the global financial crisis, which led to a sharp contraction of GDP in 2009. The crisis also led to an increase in debt, particularly of Dubai's government-related enterprises (GREs).

3. The Federal Government reacted to the crisis by applying strong countercyclical monetary and fiscal policies and by adopting rescue packages for GREs, including an important debt restructuring. All in all, there was a strong transfer of resources from the oil-producing emirate of Abu Dhabi, to the more service-oriented emirate of Dubai, which was the hardest affected by the crisis. Departing from a situation of traditional surplus, as a result of the crisis, the federal Government ran fiscal deficits in 2009 and 2010; however, due to acceleration in oil revenues, the fiscal accounts are expected to have shown a surplus again in 2011.

4. As a result of the measures applied and to an increase in oil prices, the UAE economy started to emerge from the crisis in 2010, with real GDP growing by 1.4%. The global crisis had the effect of cooling off the economy, stopping the acceleration in price increases observed in the 2005-08 period. However, as growth resumes, inflation is forecast to accelerate somewhat, although to below the pre-crisis levels.

5. Exports of goods increased rapidly throughout 2006-08, but declined by some 17% in 2009, reflecting lower oil prices and the global economic crisis. Imports followed a similar pattern, but both exports and imports started to recover in 2010 as growth picked up. The UAE runs a structural trade balance surplus, which peaked at US$62.9 billion in 2008, declined in 2009 as a consequence of a considerable drop in oil exports and despite a reduction in imports, and increased again in 2010 in 2011, mainly due to higher non-hydrocarbon exports and re-exports.

## (2) STRUCTURE OF THE ECONOMY

6. The United Arab Emirates (UAE) is a federation of seven emirates: Abu Dhabi, Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah, and Umm al-Quwain; Abu Dhabi City is the federal capital. The UAE has 85% of world oil reserves and the fifth largest gas reserves (Chapter IV(4)). The authorities estimate that these reserves will last more than 100 years at current production rates. The UAE has a federal structure and there are many common policies at the federal level, including monetary policy, but each emirate manages its own budget independently.

7. The three major emirates, in terms of participation in GDP, are Abu Dhabi, Dubai, and Sharjah. Abu Dhabi accounts for over 50% of the UAE's total GDP, some 40% of the population, and 95% of crude oil and gas production. Mainly resulting from the proceeds of its oil and gas industries, Abu Dhabi owns one of world's largest sovereign wealth funds, and is estimated to have more than US$300 billion assets under management.[1] Dubai, the second largest emirate in terms of economic

[1] IMF (2011a).

size, accounts for about a third of the UAE's total GDP. Dubai has a more diversified economy, with a large financial sector, as well as a developed air transport industry and tourism sector (Chapter IV). Dubai also plays the role of regional commercial hub and is an important transhipment and re-export centre.

8. In 2010, total GDP reached US$297.65 billion (Table I.1); with a population of some 8.26 million, GDP per capita was some US$36,017. In 2010, the UAE ranked 32[nd] out of 179 countries in terms of the UNDP Human Development Indicators.

**Table I.1**
**Economic indicators, 2005-10**

| | 2005 | 2006 | 2007 | 2008 | 2009[a] | 2010 |
|---|---|---|---|---|---|---|
| **National accounts[b]** | | | | | | |
| GDP (AED billion) | 663.3 | 815.7 | 948.1 | 1,156.3 | 992.8 | 1,093.1 |
| GDP (US$ billion) | 180.6 | 222.1 | 258.2 | 314.8 | 270.3 | 297.6 |
| Real GDP, annual percentage change | 4.8 | 9.9 | 3.2 | 3.3 | -1.6 | 1.4 |
| Real hydrocarbon GDP | 2.3 | 11.2 | -7.1 | -2.3 | 3.9 | -5.6 |
| Real non-hydrocarbon GDP | 6.4 | 9.1 | 9.4 | 6.2 | -4.2 | 5.0 |
| **GDP by economic activity (share of GDP (%))[b]** | | | | | | |
| Agriculture, livestock and fishing | 1.4 | 1.1 | 1.0 | 0.8 | 1.0 | 0.9 |
| Mining and quarrying | 34.4 | 37.5 | 33.9 | 37.1 | 29.1 | 31.6 |
| Crude oil and natural gas | 34.3 | 37.4 | 33.8 | 37.0 | 28.9 | 31.5 |
| Quarrying | 0.1 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| Manufacturing industries | 10.6 | 9.7 | 9.0 | 8.6 | 10.1 | 9.7 |
| Electricity, gas and water | 1.9 | 1.9 | 1.8 | 1.8 | 2.4 | 2.6 |
| Construction | 8.7 | 8.9 | 10.0 | 10.6 | 11.8 | 11.6 |
| Services | 46.3 | 44.0 | 47.9 | 45.0 | 50.4 | 48.0 |
| Wholesale retail trade and repairing services | 13.6 | 13.1 | 13.9 | 12.8 | 13.5 | 12.8 |
| Restaurants and hotels | 2.0 | 1.9 | 1.9 | 1.8 | 2.1 | 2.1 |
| Transports, storage and communication | 7.9 | 7.6 | 8.0 | 7.7 | 9.3 | 9.1 |
| Real estate and business services | 10.7 | 10.0 | 11.7 | 10.9 | 10.7 | 9.9 |
| Financial sector | 6.4 | 6.3 | 7.2 | 6.3 | 7.2 | 6.8 |
| Government | 3.5 | 3.0 | 3.0 | 3.3 | 4.8 | 4.6 |
| Other services | 2.2 | 2.1 | 2.1 | 2.2 | 2.7 | 2.8 |
| Social and personal services | 1.8 | 1.7 | 1.8 | 1.8 | 2.3 | 2.4 |
| Domestic services of households | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| (Less: imputed bank services) | 3.3 | 3.0 | 3.6 | 3.9 | 4.7 | 4.4 |
| | | | **(% of GDP)** | | | |
| Final consumption expenditure | 65.1 | 64.0 | 68.3 | 68.3 | 70.6 | 67.7 |
| Government expenditure | 6.9 | 6.2 | 5.9 | 5.8 | 9.0 | 8.2 |
| Private expenditure | 58.3 | 57.8 | 62.3 | 62.5 | 61.7 | 59.4 |
| Gross fixed capital formation | 18.4 | 17.4 | 23.0 | 21.2 | 22.3 | 23.8 |
| Change in stocks | 0.9 | 0.8 | 0.8 | 1.3 | 1.6 | 1.5 |
| XGS / GDP (%) | 67.6 | 68.6 | 72.3 | 79.0 | 74.7 | 75.3 |
| MGS/ GDP (%) | 52.0 | 50.8 | 64.4 | 69.8 | 69.2 | 68.2 |

**Table I.1 (cont'd)**

| | 2005 | 2006 | 2007 | 2008 | 2009[a] | 2010 |
|---|---|---|---|---|---|---|
| **Consolidated government finances** | **(US$ billion, unless otherwise indicated)** | | | | | |
| Total revenue | 53.6 | 74.9 | 85.3 | 121.7 | 68.3 | 85.8 |
| Hydrocarbon[c] | 41.0 | 59.0 | 63.6 | 98.4 | 47.4 | 65.1 |
| Non-hydrocarbon | 12.5 | 15.9 | 21.7 | 23.2 | 20.9 | 20.6 |
| Customs | 1.0 | 1.3 | 2.2 | 2.4 | 2.2 | 2.3 |
| Profit transfers | 1.3 | 1.5 | 3.5 | 1.4 | 1.1 | 1.1 |
| Income tax[d] | 0.1 | 0.3 | 0.2 | 0.3 | 0.4 | 0.4 |
| Fees and charges | 4.1 | 3.7 | 2.6 | 6.5 | 6.6 | 6.9 |
| Investment income[e] | 3.7 | 6.3 | 8.4 | 6.3 | 4.5 | 3.6 |
| Other | 2.4 | 2.8 | 4.8 | 6.3 | 6.1 | 6.4 |
| Total expenditure and grants | 28.4 | 34.7 | 45.7 | 70.7 | 103.9 | 92.1 |
| Current expenditure | 22.9 | 29.0 | 34.7 | 47.0 | 58.9 | 67.7 |
| Wages and salaries[f] | 4.3 | 4.9 | 5.7 | 7.9 | 8.9 | 9.1 |
| Goods and services | 6.9 | 6.9 | 9.9 | 13.4 | 18.4 | 23.1 |
| Abu Dhabi "federal services"[g] | 6.2 | 6.9 | 8.5 | 12.4 | 15.2 | 19.7 |
| Subsidies and transfers[h] | 5.3 | 10.1 | 9.9 | 11.2 | 12.4 | 10.3 |
| Interest payments | 0.0 | 0.0 | 0.1 | 0.8 | 1.6 | 2.6 |
| Other | 0.2 | 0.2 | 0.5 | 1.3 | 2.4 | 2.9 |
| Development expenditure | 3.8 | 3.2 | 4.7 | 8.6 | 12.3 | 10.5 |
| Loans and equity (net)[i] | 1.4 | 2.4 | 5.7 | 14.1 | 31.8 | 13.6 |
| Foreign grants[j] | 0.3 | 0.1 | 0.6 | 1.0 | 0.9 | 0.3 |
| Overall balance (consolidated)[k] | 25.1 | 40.2 | 39.8 | 51.8 | -33.9 | -3.8 |
| Overall balance (consolidated), % of GDP | 13.9 | 18.1 | 15.4 | 16.5 | -12.6 | -1.3 |
| Non-hydrocarbon balance (excl. investment income) | -16.5 | -13.7 | -18.9 | -26.7 | -44.7 | -36.5 |
| Non-hydrocarbon primary balance (excl. investment income) | .. | .. | -18.8 | -26.3 | -43.9 | -35.2 |
| Abu Dhabi Overall balance (% of Abu Dhabi's GDP) | .. | .. | 15.2 | 16.0 | -19.7 | -8.1 |
| Abu Dhabi Non-hydrocarbon balance (excl. investment income) | .. | .. | -48.8 | -61.4 | -79.3 | -69.8 |
| Abu Dhabi Non-hydrocarbon primary balance (excl. investment income) | .. | .. | -48.8 | -61.5 | -79.5 | -70.0 |
| Dubai's Overall balance (% of Dubai's and northern emirates GDP) | .. | .. | -0.3 | -1.8 | -13.9 | -4.9 |
| **External sector** | **(US$ billion, unless otherwise indicated)** | | | | | |
| Trade balance (goods) | 42.8 | 57.5 | 46.5 | 63.8 | 42.5 | 63.5 |
| Exports | 117.3 | 145.6 | 178.6 | 240.1 | 192.2 | 221.9 |
| Exports of oil and products | 49.3 | 62.9 | 65.7 | 91.4 | 59.6 | 66.8 |
| Imports | -74.5 | -88.1 | -132.1 | -176.3 | -149.7 | -158.3 |
| Services, net | -14.6 | -18 | -26 | -33.8 | -27.4 | -28.1 |
| **Current account balance** | 20.9 | 33.9 | 15.4 | 23.3 | 8.2 | 23.3 |
| Current account balance (% GDP) | 11.6 | 15.3 | 6 | 7.4 | 3 | 7.7 |
| Capital and financial account | 0.1 | 0.7 | 27.9 | -19.9 | 9.3 | 2 |
| Overall balance | 2.5 | 6.6 | 49.9 | -46.8 | -6 | 7.3 |
| Gross reserves of Central Bank | 21.3 | 28 | 77.9 | 30.9 | 24.7 | 32 |
| Local currency per U.S. dollar (period average) | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 |
| 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 |
| **Monetary sector** | | | | | | |
| Money and quasi money (M2) (AED billion) | 324,064 | 399,293 | 565,702 | 674,310 | 740,618 | 786,388 |
| Money and quasi money (M2) (annual % change) | 33.8 | 23.2 | 41.7 | 19.2 | 9.8 | 6.2 |
| Money and quasi money (M2) as % of GDP | 48.9 | 49.0 | 59.7 | 58.3 | 74.6 | 71.9 |

**Table I.1 (cont'd)**

| | 2005 | 2006 | 2007 | 2008 | 2009[a] | 2010 |
|---|---|---|---|---|---|---|
| **Memorandum** | | | | | | |
| Inward FDI stock (% of GDP) | 15.2 | 18.2 | 21.1 | 21.7 | 26.7 | 25.6 |
| Outward FDI stock (% of GDP) | 5.3 | 9.2 | 13.6 | 16.1 | 19.8 | 18.7 |
| CPI inflation (%) | 6.2 | 9.3 | 11.1 | 12.3 | 1.6 | 1.7 |
| External debt (US$ billion) | 41.0 | 80.6 | 130.1 | 135.8 | 132 | 138 |
| External debt as a % of GDP | 30.6 | 49.2 | 50.4 | 43.1 | 48.1 | 46.2 |

.. Not available.

a Preliminary.
b Statistical information in 2010 is from IMF (2011b), Country Report No. 11/112, May.
c Includes IMF estimates of revenues from other government entities operating in the oil and gas sector.
d Taxes on profit of foreign banks. Income taxes on gas companies are included under hydrocarbon revenues.
e IMF staff estimates.
f Excludes military wages and salaries.
g Largely military and internal security expenditures paid by Abu Dhabi but not in the federal accounts.
h Includes Government's contribution to the pension fund in 2005 of AED 6,207 million.
i Includes Government's share in the 2005 privatization of the telecom company, Etisalat
j Intra-governmental grants are netted out in the consolidated fiscal accounts.
k Consolidated accounts of the Federal Government, Abu Dhabi, Dubai and Sharjah.

*Source:* UAE National Bureau of Statistics; UAE Central Bank; and IMF (2011b), Country Report No. 11/112, May.

9. Despite the diversification strategy implemented during the last decade, the UAE economy is still dominated to a considerable extent by the oil sector. The production of crude oil and natural gas accounted for some 31.6% of GDP in 2010; this share increases to over one third of GDP if oil-related manufactured production is included. Manufacturing represented some 9.7% of GDP in 2010. Of this share, some 50% is accounted for by metal products, machinery and equipment, and mining non-metal products; the rest is evenly distributed among chemical products, foodstuffs and beverages, textiles and garments, and wood and furniture. There are smaller contributions from the paper and basic metal industries. Despite being affected by the global crisis, construction continued to account for 11.6% of GDP in 2010. The agriculture sector (including livestock and fishing, but not processed food production) is of small economic importance in the UAE, accounting for less than 1% of total GDP.

10. Services as a whole accounted for 48% of GDP in 2010; the most important subsectors were: wholesale retail trade and repairing services (concentrated mainly in Dubai), which accounted for 12.8% of GDP in 2010; real estate and business services (9.9%); transport, storage and communication (9.1%); financial services (6.8%); and Government (4.6%) (Table I.1).

11. Although the economic regime is in general open and business-friendly, important competition and investment restrictions remain in place, with the exception of business conducted in free zones (Chapter II(6) and Chapter III(3)(iv)). Some of these restrictions include exclusive dealership arrangements, the general prohibition on foreign majority ownership of local companies and substantial state involvement in selected activities. Also, state involvement in the economy is large; a considerable number of UAE companies, in all sectors, are totally or partly government-owned (GREs).

12. GREs account for an important part of the UAE's economy and have historically been a source of growth. GREs are mainly commercial corporations, financial institutions, and investment bodies owned directly by the Governments of Abu Dhabi and Dubai, or by the emirates' rulers. They are organized under the umbrella of major holding companies with activities in various sectors and have the implicit guarantee of the government that owns them. GREs receive government transfers and had easy access to capital markets due to the implicit government guarantee. The development of

GREs has been particularly strong in Dubai, and more recently, in Abu Dhabi.[2] GREs in both emirates engage extensively in real estate and infrastructure projects and were considerably affected by the global financial crisis and the price correction in the local property market, which, despite government support, forced some Dubai GREs to reschedule their debts (Chapter IV(5)(i)).

13. An important development during the period under review, which resulted in an improvement in the information provided by the UAE, was the establishment in 2009 of the National Bureau of Statistics (NBS) of the United Arab Emirates, by Federal Law No. 9 of 2009, to satisfy the needs of the national development of the country and to organize the work of the national statistical system. The NBS has an independent budget and reports directly to the Cabinet. The NBS is now the sole official statistical source for the State.[3]

### (3) OUTPUT, PRICES, AND EMPLOYMENT

14. The UAE's economic performance was very strong over the period 2005-08, achieving an annual average growth rate of 5.5%. Growth was based to a large extent on a successful strategy of diversification, into services, real estate, and manufacture. Growth of non-hydrocarbon GDP, at an annual average rate of 8.2% during the period, was considerably faster than that of hydrocarbon GDP (annual average rate of 0.6%). The high non-hydrocarbon GDP growth was made possible by a policy of strong investment, which resulted in massive capital formation and by the large inflow of foreign labour, which allowed the policy of diversification to succeed.[4] This influx was partly behind the rapid development of the non-oil sector, both in manufacturing production and in services, including real estate.

15. The global financial crisis combined with lower oil prices and the price correction in the Dubai real estate market brought an end to this period of high growth, and the economy of the UAE contracted by 1.6% in 2009. In the wake of the financial crisis, the authorities adopted countercyclical measures to boost output and prop-up the banking industry (see below). In particular, the authorities supported the banking sector through liquidity injection, the recapitalization of institutions, and deposit guarantees. The money supply expanded rapidly, as did government expenditure, with the fiscal deficit rising quickly (see below).

16. The position of many highly-leveraged government-related entities (GREs) deteriorated rapidly (see Chapter IV(5)(i)) as they found themselves with substantial short-term obligations amidst lower revenues and declining prices of the assets they held, particularly real estate. This forced Dubai World (DW), a major Dubai GRE, to seek a debt standstill in November 2009 (Box IV.2). The Government of the Emirate of Abu Dhabi provided financial support to the Emirate of Dubai, through its participation in the Dubai Financial Support Fund (DFSF), established in July 2009 to provide financial assistance to GREs of strategic importance and by injecting AED 16 billion of capital into five large banks based in Abu Dhabi. The restructuring of some US$24.9 billion of DW debt was agreed by all creditors in late October 2010. Other Dubai GREs (Dubai Holding Commercial Operations Group (DHCOG), Dubai Group (DG) and Dubai International Capital (DIC)), also engaged in debt restructuring negotiations with banks.

[2] For an extensive discussion on GREs, see IMF (2011b), Chapter I.

[3] NBS online information. Viewed at: www.uaestatistics.gov.ae.

[4] In its May 2011 Article IV Consultation Staff Report, the IMF states that the growth of labour and capital, rather than total factor productivity, accounts for most non-oil output expansion over the 1981-2000 period. It also noted that, in turn, this expansion was possible because of the UAE's open foreign labour policy, which enabled the private sector to recruit expatriate workers at competitive wages. See IMF (2011a).

17. The UAE economy started to emerge from the crisis in 2010, when GDP is estimated to have grown by 1.4%, triggered in particular by a recovery of the non-hydrocarbon sector, which expanded by 5%. The IMF estimates that non-hydrocarbon GDP will grow by some 3.3% in 2011, led by strong tourism, logistics, and trade in Dubai; and by large public investment spending in Abu Dhabi. GDP as a whole is projected to expand at the same rate. However, there are downside risks for future growth particularly due to the still-ailing real estate sector and the short-term refinancing needs of GREs.

18. At the beginning of the period under review (2006-08), inflationary pressures continued to mount, reflecting strong domestic demand. Annual average Consumer Price Index (CPI) inflation reached a peak of 12.3% in 2008, before declining sharply in 2009 to 1.6% and 1.7% in 2010, reflecting falling domestic demand. However, due to stronger domestic demand, inflation picked up some in 2011, and is estimated by the IMF to have averaged 2.5%.

19. The employment situation in the UAE is particular to the country, with low unemployment among the foreign population and higher rates among nationals. Over the past two decades, the UAE applied a policy of attaining growth through a massive utilization of labour and capital factors. As a result, immigration was encouraged and the population grew rapidly, to some 8.26 million in 2009, of whom only about one million are UAE nationals. The workforce totalled 5.28 million in 2009; the private sector employed 58.4% of the workforce and the rest was employed mostly by Government at the federal or emirate level, or by GREs.[5] While unemployment is low among the foreign community, at some 3%, unemployment among nationals reached 14% in 2009, with a general unemployment rate of 4.2%. To boost employment, especially among nationals, the UAE Government has been conducting an "emiratization" policy to increase the number of nationals employed in private sector activities, particularly banking, insurance, and trading.

### (4) MONETARY POLICY AND EXCHANGE RATE REGIME

20. Monetary policy is formulated and conducted by the Central Bank of the UAE (CBUAE). The Central Bank is also responsible for the formulation and implementation of banking and credit policies, so as to ensure the stability of the currency and the growth of the national economy of the UAE in a balanced manner.[6] The CBUAE has authority over the banking and financial sectors, except for the financial institutions operating in the Dubai International Financial Centre (DIFC). The UAE adopts a fixed exchange rate of the dirham against the U.S. dollar policy, and by law the CBUAE must ensure the free convertibility of the national currency into foreign currencies. Hence, the CBUAE has to keep enough reserves to maintain the currency's peg to the dollar. As a result, there is no autonomous monetary policy. The CBUAE also acts as banker of last resort to the Government and the financial sector, and as the Government's financial advisor.

21. Under Law No. (10) of 1980, the CBUAE may use a number of instruments to attain its monetary objectives. The fixed peg of the dirham to the U.S. dollar, however, means that local interest rates must be aligned to those of the dollar across the maturity curve. As a result, and as mentioned above, the effectiveness of monetary policy instruments at the Central Bank's disposal has been reduced. The main instruments used by the CBUAE to regulate domestic liquidity are: (1) the

[5] Almost 85% of UAE nationals worked for the federal or emirate governments in 2009. During the financial crisis, jobs were created at the government level to help nationals face the crisis, raising the percentage of nationals working for the Government from 80.3% to 84.9%. Ministry of Economy (2010).

[6] CBU online information. Viewed at: http://www.centralbank.ae/en/index.php?option=com_content&view=article&id=68&Itemid=107.

minimum reserve requirement; (2) US$/AED swaps for dirham liquidity[7]; (3) advances and overdraft facility for banks[8]; (4) prudential regulation; (5) issuance by the CBUAE of certificates of deposit and repo facilities on certificates of deposit (CDs); and (6) liquidity support facilities made available to commercial banks since the advent of the international crisis.

22. In October 2011, the minimum reserve requirement was 14% on current, savings, and call accounts, and 1% only on time deposits. These ratios apply to both deposits in dirhams and in foreign currencies. In addition, banks are required to keep at the Central Bank 30% of their dirham deposits abroad with non-resident banks (including their Head Office and branches in the case of foreign banks). The US$/AED swap facility is available to all banks operating in the UAE under the jurisdiction of the CBUAE. Certificates of deposit (CDs) are issued by the Central Bank, as a tool for liquidity management; issuance is mainly demand-driven as banks with excess liquidity can invest their surplus funds in CDs of varying maturities. The CDs programme, launched in 1985, was amended in 1994 and in 2007: the New Expanded Central Bank CDs Issuance System became effective 28 November 2007.[9] A liquidity support facility was set up in September 2008, when banks were facing a shortfall in liquidity due to the global financial crisis.[10]

23. The CBUAE places a number of prudential requirements on banks. Its capital adequacy ratio requirement is 12% compared with an 8% Basel requirement. Banks are also required to maintain a ratio of loans and advances to stable resources equal to one.[11]

24. Reflecting high nominal GDP growth in 2006-08, the money supply expanded considerably during the period. This was due to the increase in bank credit to the private sector and to state-owned enterprises. The trend continued in 2009 due to the liquidity injected into the system by the CBUAE and the recapitalizing of banks in the middle of the global financial crisis, although at a lower rate than before (less than 10% in 2009 down from 19% in 2008). This slowdown in broad money growth amid increased liquidity available was due to weak demand for credit by firms and households in addition to the cautious attitude of banks towards lending. Any excess liquidity by the banks was invested in certificates of deposit with the Central Bank. The three-month inter-bank rate for the AED (EIBOR) declined from a peak of 4.7% in October 2008 to 2.1% in January 2011 and to 1.5% in mid-October 2011.

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[7] US$/AED swaps are a way of injecting dirham liquidity. Swap arrangements involve a simultaneous sale and forward purchase of U.S. dollars against the purchase/forward sale of equivalent dirham amounts for a fixed term at specified forward rates. Swap terms may be of one week, one month, 3 months, 6 months, 9 months, or 12 months.

[8] Under this mechanism, the Central Bank can provide banks with loans and advances for up to 7 days without collateral, and for up to 6 months against collateral. The CBU provides an overdraft facility to commercial banks that allows them to utilize their required reserves free of charge for up to seven days.

[9] The system is an auction-based issuance for CDs denominated in UAE dirhams, U.S. dollars, and euros. CDs of maturities ranging from 1 week to 12 months are issued daily, while CDs of maturities ranging between 2 and 5 years are issued monthly. Under the new issuance system, banks may repurchase (repo) their CDs from the CBUAE or from other banks to access liquidity. The repo term offered by the Central Bank is of up to 3 months as long as the balance life of the CD used as collateral goes beyond the repo term. Banks may also seek U.S. dollar funding by using their holdings of CDs as collateral. Banks may redeem CDs with the CBUAE at any point during the life of the CD as long as the CD is free from any encumbrance.

[10] Under this facility, a bank may submit its portfolio of securities to the CBUAE for evaluation. The CBUAE will accept as eligible the securities that comply with its guidelines, and assign a credit line to the bank based on the adjusted value of the eligible securities. The bank may then access CBUAE funds on a weekly rollover basis for as long as it needs the facility.

[11] The numerator of this ratio comprises loans and advances (including interbank placements with a remaining maturity of more than three months), while the denominator comprises free capital and reserves, interbank deposits received with a remaining maturity of more than six months, and 85% of customer deposits.

25. The UAE has a fixed exchange rate regime, whereby the domestic currency, the UAE dirham (AED) is pegged (since November 1997) to the U.S. dollar at an exchange rate of AED 3.6725/US$1. The UAE's exchange system is free of restrictions on payments and transfers for international transactions, except for certain restrictions under terrorist financing provisions, taken in accordance with UN resolutions. The UAE accepted the obligations under Article VIII of the IMF Statutes on 13 February 1974.

26. According to IMF estimates, the AED exchange rate is broadly in line with fundamentals, being overvalued by just 1% at the end of 2010. Also according to IMF calculations, following a period of strong real appreciation between 2005 and 2008, the trade-weighted real effective exchange rate (REER) depreciated by 10.2% from its peak in March 2009 until end 2010.[12] The UAE withdrew in May 2009 from plans to create a monetary union at Gulf Cooperation Council (GCC) level.

### (5) FISCAL POLICY

27. Despite large revenues from the oil industry, fiscal accounts in the UAE have deteriorated in the aftermath of the global financial crisis. From a surplus equivalent to 16.5% of GDP in 2008, the fiscal accounts deteriorated to post a deficit equivalent to 12.6% of GDP in 2009, with the non-hydrocarbon deficit reaching 44.7% of GDP. The deficit shrank to 1.3% of GDP in 2010 as a consequence of higher hydrocarbon revenues and a return to a more pro-cyclical policy stance. The non-hydrocarbon primary fiscal deficit (excluding investment income) contracted sharply, largely due to slower project implementation in Abu Dhabi, and to lower transfers to Dubai GREs.

28. The UAE posts a structural non-hydrocarbon fiscal deficit varies between a fifth and a third of GDP (Table I.1). The deficit is particularly large in the case of Abu Dhabi, where it reached almost 80% of GDP in 2009. The authorities indicated that steps have been taken to reduce this deficit by containing the growth of spending, and reducing producer subsidies and transfers. However, stronger efforts might be needed to achieve fiscal consolidation (see below).

29. In the context of this Review, the authorities highlighted that volatile oil prices make it difficult for the UAE to maintain stable fiscal indicators. They also indicated that the general policy to achieve fiscal consolidation is to reduce general expenditure and improve tax collection, while promoting economic growth. Among the elements being considered is the introduction of a value-added tax and income tax on companies, as well as the reduction/cancellation of some duty exemptions granted to companies and government agencies.

30. As the IMF notes, the active use of countercyclical fiscal policy could mitigate boom-bust cycles in the UAE economy, but the authorities have resorted to this type of policy stance only in extreme cases, like the strong 2009 recession. The IMF's assessment is that this contributed to the overheating of the economy prior to the crisis, while in 2010, the contractionary fiscal stance slowed the recovery.[13] The IMF recommends delinking government and GRE spending from the volatility of oil prices and aiming fiscal policy, particularly Abu Dhabi's where most hydrocarbon production takes place, at ensuring long-term sustainability and intergenerational equity.[14] It also recommends that Dubai undertake fiscal consolidation to lower its debt-to-GDP ratio.

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[12] See IMF (2011a).

[13] In a fixed exchange rate regime like the UAE's, fiscal policy is the main effective macroeconomic policy since monetary policy, as discussed above, is not effective in affecting output.

[14] IMF (2011b), Chapter III.

31. The IMF also considers that, given the federal structure, closer fiscal coordination among the emirates is key to promoting both short-term demand management and medium-term sustainability. This coordination should seek to avoid procyclicality and reduce fiscal risks. A Fiscal Coordination Council was created to this end.

32. The authorities are aware of the importance of achieving fiscal consolidation and are preparing to introduce a VAT in the context of the GCC, which is expected to enhance revenue and facilitate such consolidation.

33. The UAE's total debt increased substantially during the financial crisis, mainly due to a substantially higher fiscal deficit and to the refinancing needs of Dubai World and other GREs. Total UAE gross public debt is estimated to have reached US$236 billion, or 78% of GDP at end 2010. Of this total, Abu Dhabi's debt is US$104 billion (54.2% of Abu Dhabi's GDP), Dubai's US$113 billion (102.6% of Dubai's and the Northern Emirates GDP), US$5.2 is debt of other emirates, and US$19.1 billion is federal government debt (6.3% of GDP). In December 2010, the debt of Dubai's GREs was US$76 billion, while that of Abu Dhabi was US$92.4 billion. Debt accounting for almost 20% of GDP matures in 2011 and 2012 and is likely to be refinanced, pushing the concentration of maturities to the 2014-15 period.

## (6) BALANCE OF PAYMENTS

34. The UAE runs a structural trade balance surplus, which peaked in 2008, at US$62.9 billion, declined in 2009 as a consequence of a considerable drop in oil exports, despite a reduction in imports, and increased again in 2010, to US$50.9 billion, mainly due to an increase in non-hydrocarbon exports and in re-exports (Table I.2). The services balance showed a deficit throughout the period under review; posting a deficit of US$29.9 billion in 2010. The transfers balance was negative by US$11.3 billion. However, due to the strong trade surplus, the current account balance has traditionally showed a surplus in recent years. This surplus peaked at US$35.2 billion or 15.3% of GDP in 2006, before starting to decline, to reach a low of US$7.8 billion (2.9% of GDP) in 2009, in the middle of the financial crisis. The surplus grew again in 2010, to reach US$11.2 billion, (3.8% of GDP).

**Table I.2**
**Balance of payments, 2005-10**
(US$ billion)

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Current account balance | 24.4 | 35.2 | 31.6 | 21.6 | 7.8 | 11.2 |
| (% of GDP) | 13.5 | 15.8 | 12.2 | 6.9 | 2.9 | 3.8 |
| Trade balance (f.o.b.) | 42.8 | 56.4 | 58.9 | 62.9 | 42.1 | 50.9 |
| Trade balance (c.i.f.) | 32.6 | 44.6 | 43.0 | 38.9 | 21.7 | 28.9 |
| Exports and re-exports | 117.3 | 142.5 | 175.5 | 239.2 | 191.8 | 212.3 |
| Total exports of hydrocarbons | 55.1 | 70.1 | 24.5 | 102.1 | 67.9 | 75.1 |
| Crude oil exports | 43.5 | 58.1 | 4.9 | 85.4 | 54.1 | 60.1 |
| Petroleum products exports | 5.8 | 4.9 | 8.1 | 6.0 | 5.4 | 6.1 |
| Gas exports | 5.8 | 7.1 | 11.5 | 10.6 | 8.3 | 8.8 |
| Non-hydrocarbon exports | 22.4 | 26.4 | 88.8 | 43.0 | 44.0 | 51.0 |
| Free zone exports | 17.4 | 20.5 | 62.3 | 26.5 | 26.2 | 26.8 |
| Exports from Customs territory | 5.0 | 5.9 | 26.5 | 16.4 | 17.8 | 24.2 |
| Re-exports[a] | 39.8 | 46.0 | 62.3 | 94.2 | 80.0 | 86.2 |
| Imports | -74.5 | -86.1 | -116.6 | -176.3 | -149.7 | -161.4 |
| Imports to customs territory | -67.4 | -77.1 | -107.8 | -140.0 | -121.8 | -129.4 |
| Imports to free zones | -17.2 | -20.8 | -24.7 | -60.4 | -48.3 | -54.0 |

**Table I.2 (cont'd)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Investment income, net | 2.9 | 4.7 | 5.9 | 3.1 | 3.2 | 1.6 |
| Services, net | -14.6 | -17.8 | -23.9 | -33.8 | -27.3 | -29.9 |
| Credits | 4.8 | 6.8 | 8.0 | 9.6 | 10.2 | 11.7 |
| Debits | -19.4 | -24.9 | -34.0 | -43.4 | -37.6 | -39.9 |
| Transfers, net | -6.7 | -8.2 | -9.3 | -10.6 | -10.2 | -11.3 |
| Private | -6.2 | -7.6 | -8.7 | -10.0 | -9.5 | -10.6 |
| Official[b] | -0.5 | -0.6 | -0.6 | -0.6 | -0.7 | -0.7 |
| Financial account balance | -14.7 | -16.1 | 11.3 | -55.3 | -9.7 | 2.0 |
| Private capital | 15.0 | 23.9 | 59.2 | -25.8 | -4.2 | 6.3 |
| Direct investment, net | 7.1 | 1.9 | -0.4 | -2.1 | 1.3 | 1.9 |
| Portfolio securities, net | 6.1 | 1.2 | 1.4 | 2.2 | 2.5 | 1.0 |
| Commercial banks | -3.4 | 9.7 | 48.6 | -12.2 | -9.9 | -1.3 |
| Private non-banks and other | 5.1 | 11.1 | 9.6 | -13.7 | 1.9 | 4.6 |
| Official capital | -29.7 | -39.9 | -47.9 | -29.5 | -5.4 | -4.2 |
| Errors and omissions | -7.1 | -12.6 | 7.0 | -13.1 | -4.3 | -5.9 |
| Overall balance | 2.6 | 6.5 | 49.9 | -46.8 | -6.1 | 7.3 |
| Change in Central Bank net foreign assets[c] | -2.6 | -6.5 | -49.9 | 46.9 | 6.1 | -7.3 |
| Memorandum items: | | | | | | |
| Overall balance (% of GDP) | 1.4 | 3.0 | 19.3 | -14.9 | -2.2 | 2.4 |
| Central Bank gross reserves (IMF information) | 21.3 | 28.0 | 77.9 | 30.9 | 24.7 | 32.0 |

a Not formally compiled; estimated at 40% to 70% of UAE emirates imports.
b Includes changes in government external assets.
c A minus sign equals increase.

*Source:* Central Bank of the United Arab Emirates.

35. Flows of private capital, which had been increasing rapidly until 2007, declined considerably in 2008 and were negative in 2009, reflecting the extent of the global financial crisis and its effects on the UAE market. There was a sizeable reduction of foreign exchange reserves between 2007 and 2009, from US$77.9 billion to US$24.7 billion, before recovering in 2010 (to US$32 billion), when there was a net inflow of private capital again. The level of reserves continued to rise in 2011, due to the improvement in the current account of the balance of payments.

36. The UAE's external debt increased sharply during the period under review, partly as a consequence of the increased leverage of GREs; the situation was exacerbated by the effects of the financial crisis. The external debt increased from US$41 billion (30.6% of GDP) in 2005 to an estimated US$138 billion (46.2% of GDP) in 2010.

### (7) DEVELOPMENTS IN TRADE[15]

37. The UAE is an open economy, as witnessed by its high ratio of imports plus exports of goods and services to GDP, which was almost 143% in 2010.

#### (i) Composition of trade in goods

38. Exports of goods increased rapidly between 2006 and 2008, when they peaked at US$210 billion, according to COMTRADE data; in 2009, exports declined by some 17% reflecting lower oil prices and the global economic crisis (Table AI.1). Imports also peaked in 2008 (US$175.5 billion) and declined in 2009; however they started to recover in 2010 as growth picked up.

[15] The information in this section is based on the United Nations' COMTRADE database, and may differ from the figures provided in the balance-of-payments section.

39. The main export product continues to be crude oil, which accounted for about a third of total exports and re-exports in 2010, while fuels as a whole accounted for over 37% of the total. If re-exports are excluded, fuels accounted for half of total exports, while crude oil represented 44.3% of the total. Including re-exports, exports of manufactured goods represented some 26.6% of the total, the main products being machinery and equipment, diamonds, automotive products, and jewellery. However, if re-exports are excluded, manufactured products accounted for just 4.7% of total UAE exports in 2010.[16]

40. It is estimated that nearly two thirds of non-hydrocarbon exports originate in free zones, mainly the Dubai Jebel Ali Free Zone Authority (Jafza); the main products exported from free zones consist of machinery and appliances, including computers and other consumer electronics. Non-hydrocarbon exports from outside the free zones include clothing, tobacco products, and aluminium. Re-exports are an important source of revenue, representing around one third of total merchandise exports (Table AI.1). This reflects the importance of the UAE as a centre for re-exports, mainly to India, Iran, and Iraq.

41. Imports of manufactures account for over half of total imports; the main single item is machinery and equipment, with imports representing almost a third of the total (Table AI.2). Imports of gold, automotive products, diamonds and clothing are next in importance.[17]

### (ii) Direction of trade

42. Data presented by COMTRADE do not allow easy identification of the main trading partners, as the category "other" is very large, accounting for about one third of the total. According to the Ministry of Foreign Trade, the ten top major non-oil export destinations in 2010 were: India (33.7% of the total); Switzerland (16.2%); Saudi Arabia (4.5%); Brazil (3.5%); Iran (3.3%); Norway (3.2%); Pakistan (2.5%); Oman (2.2%); Qatar (2.2%); and Kuwait (2.0%). Including re-exports, the main destinations were: India; Iran; Iraq; Switzerland; Saudi Arabia; Afghanistan; Bahrain; Kuwait; Qatar; Hong Kong, China; and Belgium.

43. The main import sources in 2010 according to the UAE Ministry of Foreign Trade statistics (includes only non-oil imports) were: India (17.1%); China (10.3%); the United States (8.5%); Germany (6.1%); Japan (5.9%); the United Kingdom (3.6%); Italy (3.1%); France (2.6%); South Korea (2.5%); and Saudi Arabia (2.5%).

### (iii) Trade in services

44. The services trade deficit doubled between 2005 and 2010, when it reached US$29.9 billion. The UAE is an important exporter of tourism, and air and maritime transport services. It is a net importer of financial (including insurance), construction, and professional services.

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[16] According to information provided by the UAE authorities, the ten main export categories by HS Code in 2010 were: gold (HS 71.08); light vessels (HS 89.05); waste and scrap of precious metals (HS 71.12); cane or beet sugar in solid form (HS 17.01); polymers of ethylene (HS 39.01); petroleum oils an oils obtained from other bituminous metals (HS 27.10); other plates, film, sheets, foil and strip of plastics (HS 72.04); polyacetals (HS 39.07); and articles of jewellery (HS 71.13).

[17] According to information provided by the UAE authorities, the ten main import categories by HS code in 2010 were: gold (HS 71.08); diamonds (HS 71.02); motor cars (HS 87.03); articles of jewellery (HS 71.13); telephone sets (HS 85.17); parts of aircraft (HS 88.03); aircraft (HS 88.02); turbo jets and gas turbines (HS 84.11); parts and accessories of tractors (HS 87.08); and petroleum oils and oils obtained from bituminous metals (HS 27.10).

## (8) DEVELOPMENTS IN FOREIGN INVESTMENT

45. Foreign direct investment (FDI) inflows increased rapidly during the period under review; the stock of FDI more than tripled between 2005 and 2009, when it reached US$52.9 billion, representing some 21% of GDP (Table I.3). FDI inflows slowed down somewhat due to the global crisis, particularly in 2008, but accelerated again in 2009.

46. The Government has launched efforts to improve the collection of statistics on FDI, particularly by source. The leading sectors attracting FDI are financial services, construction and building, real estate, and wholesale and retail trade.

**Table I.3**
**Foreign direct investment stock by economic sector, 2005-09**
(AED billion and %)

| | 2005 | 2006 | 2007 | 2008 | 2009 | % of total 2009 |
|---|---|---|---|---|---|---|
| **Total (AED billion)** | **61.9** | **74.6** | **128.1** | **154.6** | **195.7** | **100.0** |
| **Total (US$ million)** | **16.7** | **20.2** | **34.6** | **41.8** | **52.9** | |
| Agriculture and fisheries | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 0.2 |
| Extraction industries | 1.6 | 1.9 | 4.0 | 4.8 | 5.1 | 2.6 |
| Manufacturing industries | 6.2 | 7.2 | 10.5 | 12.7 | 18.9 | 9.7 |
| Electricity and water | 1.3 | 1.6 | 6.2 | 7.4 | 4.1 | 2.1 |
| Construction and building | 15.0 | 16.4 | 24.7 | 29.8 | 42.9 | 21.9 |
| Wholesale and retail trade | 8.9 | 10.3 | 13.2 | 16.0 | 26.9 | 13.7 |
| Hotels and restaurants | 1.3 | 1.3 | 1.3 | 1.6 | 3.5 | 1.8 |
| Transportation and communications | 2.8 | 5.4 | 5.3 | 6.4 | 14.3 | 7.3 |
| Financial institutions | 16.0 | 17.1 | 26.5 | 32.0 | 44.9 | 22.9 |
| Real estate | 8.2 | 12.8 | 35.7 | 43.1 | 33.6 | 17.2 |
| Other | 0.4 | 0.5 | 0.4 | 0.5 | 1.3 | 0.7 |

*Source:* Ministry of Economy (2010), *Annual Economic and Social Report 2009.*

47. The UAE is also an important investor abroad, mainly the emirate of Abu Dhabi through the Abu Dhabi Investment Authority (ADIA), one of the world's largest government financial investment vehicles. ADIA is responsible for investing all of the Abu Dhabi Government's oil revenues and assets worldwide. The total amount of its investments is undisclosed. Since 2005, ADIA has been investing in equities, and investment-grade credit within fixed income. In 2007, ADIA started investing in infrastructure

## (9) OUTLOOK

48. In 2011, the UAE economy was continuing to recover from the effects of the global financial crisis. The IMF is forecasting GDP growth of 3.3% in 2011, with similar rates for both the hydrocarbon and non-hydrocarbon sectors. Inflation is expected to accelerate to 4.5% as domestic demand recovers. The increase in hydrocarbons revenue and expenditure moderation are expected to result in an improvement in the fiscal accounts, leading to an overall surplus of 6.5%, more in line with what was common before the global crisis. Both exports and imports of goods are expected to increase, and the surplus in the current account of the balance of payments is estimated to be in the 10% range.

49. The outlook for the UAE economy hinges strongly on the evolution of hydrocarbons markets and on the capacity to refinance GRE's debt. Also, it will be important for the Government to continue diversifying the economy away from oil, and to apply countercyclical policies when required. The real estate overhang is expected to continue to be a factor depressing growth perspectives.