MACROECONOMIC PERSPECTIVE

Summary of

IMF Executive Board Article IV Consultation with United Arab Emirates

August 4, 2015

KEY OBSERVATIONS OF REPORT

- The United Arab Emirates (UAE) has continued to benefit from its perceived safe haven status and large fiscal and external buffers that have helped limit negative spillovers from lower oil prices, sluggish global growth, and volatility in emerging market economies.
- Economic outlook is expected to moderate amid lower oil prices, with non-oil growth projected to slow from 4.8% last year to 3.4% in 2015, before increasing to 4.6% by 2020, supported by the implementation of megaprojects and private investment in the run-up to Expo 2020.
- The overall fiscal balance is expected to turn negative for the first time since 2009 to record a deficit of 2.9% of GDP in 2015, but is expected to return to a surplus balance by next year.
- The current account surplus is projected to decline substantially to 5% of GDP but will improve gradually as oil prices recover.
- Real estate prices have edged down since mid-2014, with past increases in rents only feeding gradually into consumer prices.
- Inflation increased 4.3% year-on-year in May 2015, partly reflecting upward adjustments of electricity and water tariffs in Abu Dhabi.
- GREs have continued to strengthen their finances.

IMF EXECUTIVE BOARD ASSESSMENT

- Prudent economic policies, progress in economic diversification, and the safe-haven status of the UAE have helped build large fiscal and external buffers and strengthen the resilience of the economy.
- Implementation of megaprojects and private investment in the run-up to Expo 2020 are expected to support activity over the medium term. However, lower oil prices are eroding fiscal and external surpluses, and a hike in US interest rates could lead to tightening of financial conditions. These risks can be exacerbated by high volatility in stock markets, high non-performing loans and low banking system liquidity if government and GREs withdraw deposits.
- The macroeconomic policy mix should focus on gradual fiscal consolidation, while maintaining the currency peg and easing liquidity management if needed
- Fiscal consolidation requires rationalization of spending but any spending cuts should avoid damaging the country's economic competitiveness and long-term growth prospects. Government investments should be preserved relative to non-hydrocarbon growth to support infrastructure, while the implementation of GRE megaprojects should be gradual and in line with external demand.
- Public sector wage bill growth should be controlled while energy subsidies and capital and other transfers should be reduced. Raising non hydrocarbon revenues through tax measures can be considered.
- Fiscal policy implementation requires further strengthening annual budget processes, including strong Public Finance Management Systems, and integrating and operationalizing medium-term budget frameworks.
- Although the banking sector is resilient and has enough capital and liquidity buffers to withstand an adverse shock, plans to strengthen the banking regulatory and supervisory framework; phase in Basel III capital and liquidity standards over 2015-19; and strengthen risk-based supervision are welcome and should be timely implemented.
- Developing domestic debt markets would reduce the reliance on external funding and bank lending, helping banks comply with loan concentration limits.
- Structural reforms should aim to further diversify the economy and accelerate private sector led job creation for nationals including further opening up foreign direct investment; improving selected areas of the business environment; transitioning toward a knowledge based economy; easing access to finance for start-ups and SMEs; and creating incentives for entrepreneurship and job creation.
- Progress in implementing an inter-agency project to compile the International Investment Position, which will close an important statistical gap, including for the reporting of foreign assets. It will be essential to develop more comprehensive demographic and labor market statistics, while disseminating complete data on Dubai GRE debt.

Source: International Monetary Fund (IMF), "Press Release: IMF Executive Board Concludes 2015 Article IV Consultation with United Arab Emirates", August 4, 2015.