An economic profile of the UAE

Introduction

This is a brief on the major current and projected economic trends in the UAE as an introductory overview for this UN statistical meeting.

Growth, diversification and macroeconomic policies

First, the International Monetary Fund (IMF) has warned of inflationary pressures with the UAE is in the midst of an asset boom. While underpinned by sound macroeconomic fundamentals and high oil prices, the Ministry of Economy and Planning has set up various committees to monitor and take action to control prices and inflation which has been felt for a while. Similarly, the government acknowledges that high oil prices and revenues are no guarantee that the stock and real estate markets would not crash; witness bear market in Shanghai and other Asian cities.

On the whole, the IMF Article IV consultation report commended the UAE’s outward-oriented development strategy and prudent macroeconomic policies which have led to impressive economic growth, rapid development of the non-oil economy and a sizable accumulation of foreign assets. The UAE Central Bank posted a nominal gross domestic product (GDP) growth of 7.4 per cent, from Dh301.3 billion in 2003 to Dh323.6 billion in 2004 (US$1 = 3.67 dirham). With inflation around 4 percent, real growth would be 3.4 percent. The UK-based Business Monitor International (BMI) has projected real GDP to grow by 4.5 per cent in 2005 against 4.8 per cent last year. However, for next two years the country's GDP is projected to grow more around 4 per cent.

The IMF commended the continued progress in economic diversification and structural reforms which have enhanced the economy's resilience to external shocks. The IMF team agreed that the medium-term outlook remains favorable and that the UAE is in a good position to consolidate the recent gains from the high oil prices. In 2004, UAE crude production averaged around 2.5 million barrel per day (b/d), averaging $33.50 a barrel. Estimated oil export earning of more than $30 billion in 2004 as nearly double the level two years earlier, has allowed liquidity to spread throughout the economy and drive the real estate expansion. Planned new capacity addition will substantially increase the 2.6 million b/d oil production capability, realizing Abu Dhabi's ambition of reaching a sustainable output level of 3 million b/d. Around 200,000 b/d of new production will come through development of the offshore upper Zakum field, currently producing 550,000 b/d.

The economic diversification is supported by an increasing role of the private sector, which has laid the foundation for further economic and social progress in the period ahead. Growth was broad based with most sub-sectors growing at historically high rates, with manufacturing leading the way, followed by services and construction. Sharp rise in oil prices and increased oil production, strong investor confidence, and a significant increase in foreign direct investment (FDI) drove the significant restructuring in the UAE's manufacturing sector, also to meet the challenges it will face when new WTO regulations come into effect in 2005. The main thrust is in establishing projects with production privileges that will enable them to penetrate new markets and increase exports. Preliminary data for 2004 indicate that the real non-hydrocarbon GDP grew at 10 per cent, while hydrocarbon production rose 3 percent.

The sustainability of growth prospects hinges on maintaining financial stability too. While not in need of financing and foreign exchange *per se*, the UAE is attractiveness to FDI with its social and political stability, infrastructure and many investment-friendly policies including some 13 free zones mainly in Dubai, and forthcoming amendments on its investment laws, commercial and company laws governing ownership. To target zones and industries, even the largest Emirate of Abu Dhabi is considering lifting the 51:49 ruling for majority ownership by nationals. The IMF has further recommended that the UAE lift other remaining impediments to foreign investment outside the free zones and enhance the long-run employability of the national labor force through training and education.

Fiscal policy

The UAE’s prudent fiscal stance is reflected in the narrowing of the non-hydrocarbon fiscal deficit and projected improvement in the overall fiscal balance. However, the IMF pointed to the need for greater fiscal policy coordination between the individual Emirates and the Federal government, standardized accounting systems, and an improved flow of data between the levels of government. The structure of the budget could be further strengthened by containing government employment and basing the civil service rewards system on productivity.

The IMF has consistently urged the UAE government to phase out subsidies on water and electricity for nationals, and replace them by targeted payments to nationals below a certain income level. The continued reduction in agricultural subsidies in the Emirate of Abu Dhabi is commended.

For fiscal prudence and discipline, the IMF continued its call that the revenue base be broadened to reduce reliance on oil and gas revenues, including by introducing a local property tax and a value-added tax (VAT), the latter in coordination with other members of the Gulf Cooperation Council (GCC). The IMF supported the authorities' request for technical assistance from the IMF for the introduction of a VAT as efforts should also be made to strengthen the institutional capacity of tax administration.

Exchange rate policy

The pegged exchange rate arrangement continues to be supported by strong economic fundamentals and sound financial policies and provides an anchor for price stability and market confidence. The UAE government is open-mindedness about the choice of exchange rate regime under the planned GCC monetary union, but the IMF cautioned that more flexible exchange rate regimes require greater institutional development of the foreign exchange markets and well-defined risk management and intervention policies. It therefore recommended that the authorities formulate strategies in these areas at an early stage.

The depreciation of dirham in real effective terms and strong economic growth in the export markets helped drive faster growth in manufactured exports. Both the external current account and consolidated fiscal balances are estimated to have recorded large surpluses in 2004 of 12 percent and 18.3 per cent of GDP, respectively. The non-hydrocarbon deficit (excluding investment income) narrowed by about 5 percentage points of non-hydrocarbon GDP, to about 27.5 per cent.

Monetary policy

Monetary policy remains appropriately geared to contain inflation. While recent increases in asset prices are attributable in part to strong economic fundamentals, the authorities were nevertheless urged to closely monitor equity and real estate markets and to tighten financial conditions if warranted. The authorities could consider higher provisioning rates for credits carrying greater-than-average risks, increasing the minimum amount of equity needed for approval of real estate and margin trading loans and tightening collateral requirements.

Financial sector

Asset prices in the real estate and the stock markets have soared, aided by stronger economic fundamentals and investor optimism. The composite equity market index rose by 88 percent in 2004. Net FDI is estimated to have reached $9 billion. The broad money stock rose by 23 percent, mainly on account of an increase in private sector credit.

The banking sector in the UAE remains strong, bolstered by effective supervision. Overall, the capital-assets ratio (CAR) declined slightly to just below 17 per cent, as banks increased their lending activities, but remains well above prudential norms for all banks. At end-2004, while the official ratio of non-performing loans (NPL) to total loans remained somewhat high at 12.5 per cent, provisions were considerable, bringing the net NPL ratio below 4 per cent. Banks' exposure to the booming real estate sector has so far been limited. Information on the non-bank financial sector exposure to the real estate sector is not available.

The UAE authorities, including the Emirate and Securities and Commodities Authority (ESCA) have undertaken steps to continue to strengthen supervision of securities and non-bank financial institutions. Major steps have been taken to put in place a strong legal framework to prevent money laundering and financing of terrorist activities. Two laws were passed in 2004, one on dealing with financing of terrorism and the other addressing the same issues in the financial free zones.

The Dubai International Financial Centre (DIFC) began operations in September 2004. Considerable progress has been made in the regulatory framework governing the DIFC with an extensive set of laws established based on best international practices. The IMF is sought to assess the DFIC's structure and operations by year-end. As also for the rest of the country, the DIFC works hard on a legal framework to prevent money laundering and the financing of terrorism. The IMF has encouraged the UAE to broaden the scope of the investment regime outside the free zones and enhance its transparency. Efforts in a new FDI legislation and other amendments to the commercial company law would increase transparency and unambiguous legal framework for the private sector.

Liberalization policy

The pace of liberalization gained momentum, in particular in Dubai. Dubai's policy of extending foreign ownership of land and properties for real estate developments have resulted in a construction boom and a significant increase in FDI in this sector. Sharjah has also established a number of industrial free zones while the privatization of Abu Dhabi's utilities sector is proceeding as planned with one power plant being sold to private investors. Consideration is being given in Abu Dhabi to follow Dubai's example of relaxing government control over the real estate market.

Labor policy

The UAE has an open-border foreign labor policy which has enabled the private sector to recruit expatriate workers at internationally competitive wages and contributed to economic growth. Measures to increase employment of nationals in the private sector are noted which should continue to rely on raising the skills of nationals through better education and training programs, rather than on mandatory measures such as quotas. Labor market reforms should aim at increasing flexibility in hiring and firing, and equalizing benefits for nationals in the private and public sectors.

Statistical system

A system for collecting information on non-bank financial sector exposure to the real state market is needed while the financial sector in the UAE remains sound and its role as a regional hub continues to evolve. The UAE authorities have made progress in improving financial sector supervision, but the need for rationalization and consolidation of regulatory oversight of the capital markets and non-bank financial intermediaries is highlighted. Effective coordination between the central bank and the Emirate Security and Commodity Authority (ESCA) is needed to ensure that a comprehensive supervisory framework is in place for the entire financial sector.

This weakest link is in the statistical system. The Ministry of Economy and Planning is working with the United Nations Statistics Division and some partner countries to improve the institutional statistics framework, including the efforts of the Inter-ministerial Statistical Committee and the authorities' intention to participate in the General Data Dissemination System. The UAE is in the process of strengthening its national statistical system, database and procedures, both technically and professionally to enable effective monitoring and planning. The compilation of statistics on consolidated government activities needs to be improved with structural weaknesses on data quality; coverage, periodicity, timeliness, and inter-sectoral consistency. Better coordination between the Federal and Emirates authorities, the commitment of adequate resources, and further staff training will be needed to make progress in this area.

UAE Central Bank

The Central Bank estimated the UAE's nominal GDP grew by 7.4 per cent to Dh323.6 billion in 2004, against Dh301.3 billion the previous year. The non-oil sector accounted for 71.7 per cent of the GDP, signifying that diversification of the economy is on the right track. The country also benefited from the current high crude prices. The oil sector's contribution increased from Dh91.03 billion in 2003 to Dh93.63 billion, a rise of 2.9 per cent. The per capita income increased from Dh74,600 in 2003 to Dh74,900 in 2004. The UAE's population has increased substantially, reaching 4.32 million. The UAE 2005 census is underway in planning, to start by year-end.

The country's trade balance witnessed a 34 per cent increase while its current account surplus grew by 71.3 per cent. The total trade balance recorded a net surplus of Dh12.8 billion in 2004. The balance of payments in 2004 recorded a surplus of Dh12.8 billion, against a surplus of Dh4.7 billion the previous year. The value of net foreign assets, according to the Central Bank report, was Dh15.39 billion (11.3 per cent), while net local credit stood at Dh41.26 billion (27.1 per cent).Capital reserves and other items increased by Dh8.84 billion (10.02 per cent).

The UAE's financial markets witnessed remarkable surges in 2004. The value of stocks traded on the Abu Dhabi Securities Market (ADSM) increased by 343 per cent and on the Dubai Financial Market (DFM) by 1,238 per cent, as a result of improved performances reported by companies listed on both bourses.

The processing industry saw growth of 15 per cent, the highest among all other sectors. The value of the sector increased from Dh39.2 billion in 2003 to Dh45 billion in 2004. Its contribution to GDP increased from 13 per cent to 13.9 per cent. The value of the real estate sector also increased from Dh23.3 billion in 2003 to Dh26.6 billion, representing 8.2 per cent of the GDP.

The hotels and restaurants industry grew by 12.2 per cent to stand at Dh6.4 billion. The contribution of the transport, warehousing and communications sector rose by 10.1 per cent to reach Dh23.3 billion in 2004. The wholesale and retailer sector output was valued at Dh33.9 billion, compared to Dh32.3 billion in 2003.

The value of government services sector production increased from Dh28.2 billion in 2003 to Dh 29.3 billion. The value of commodity exports at the free zones and beyond was Dh60.9 billion in 2004.

The UAE Central Bank's assets and liabilities stood at Dh67.64 billion as of December 2004 compared to Dh54.50 billion in December 2003. Its foreign currency assets and those of other banks in the UAE rose to Dh1.47 billion at the end of 2004. At the same time, deposits dropped by Dh6.47 billion, or 15.3 per cent, to Dh35.86 billion. Other assets rose by 161.1 per cent to Dh637 million, and fixed assets surged by 82.6 per cent to Dh104 million.

Current accounts and deposits increased by Dh6.12 billion or 39.8 per cent, to Dh21.50 billion. Certificates of deposit rose by 35.8 per cent to Dh15.98 billion. Permanent deposits by the federal government rose to Dh9.97 billion, up by 2.5 per cent, while other liabilities rose from Dh105 million at the end of 2003 to Dh146 million as of December 31, 2004.

Prospects for GDP

Prospects of high oil prices and large number of infrastructure projects under way in the UAE is expected to keep up the tempo of economic boom throughout the second half of 2005, while the country is expected to move on a high growth trajectory for the next two years. This is the forecast by Business Monitor International (BMI) which has real GDP to grow by 4.5 per cent in 2005 against 4.8 per cent in 2003 and more than 4 per cent for next two years.

The BMI has revised the oil prices forecasts upwards for OPEC basket in 2005. Despite the change, there remains significant upside risk. As the changes are primarily due to unexpectedly strong demand growth (principally from China, India and the US), rather than supply disruptions, the prospect is especially positive for the UAE. While the oil prices are projected to remain high, the multiplier effects of oil revenue are expected to filter through the UAE economy in general. Higher revenue for oil companies is likely to result in higher investment in the sector and most likely, increased wage bills as companies expand production and reward workers.

Essentially, private sector investment and consumption are likely to grow. More directly, higher oil revenues will lead to higher fiscal revenue for the government. The UAE has a better reputation than many of its Gulf neighbors for fiscal prudence and government spending, most likely on infrastructure projects will grow. Higher oil revenues across the region are expected to result in increased capital inflows from other Gulf states, as investors seek new opportunities. The most likely result will be continued growth of equity values which may have a “wealth” effect on domestic consumption as local investors raise spending based on paper profits and the construction sector, both of which have benefited from increased spending over recent years.

For the medium term the outlook is encouraging. In the long term, concern is raised about the danger of an investment bubble forming in both equities and construction, as company valuations rise faster than profits and capital gets directed to projects where returns are less secure. While a crash is not anticipated any time soon, the key challenge for the government over the medium term will be to manage this success through effective regulation of financial market to save it from over leveraging and speculation.

Dubai and Abu Dhabi as best business cities in Gulf

Two pillars in the UAE are Dubai and Abu Dhabi, the capital city. Dubai has been ranked as the number one business city and Abu Dhabi achieved the fourth position among the top ten business cities in the GCC region, according to the Economist Intelligence Unit (EIU). Both the cities were selected on the basis of trade, investment, projects and various other industrial developments in the new millennium compared to other Gulf cities like Doha, Kuwait City, Manama, Muscat, Jeddah among others.

The EIU survey also revealed that although a daily business trip to Dubai costs around $100 which is expensive compared to other cities in the Gulf. Dubai offers the best as in all facilities and infrastructure to set up business along with the help of government departments which include the Dubai Chamber of Commerce and the Department of Economic Development.

The UAE government has provided modern technology in administration and business development by taking lead in certain aspects of on-line marketing. The e-commerce business-to-business (B2B) web marketing of Tejari.com is a success story as it focuses on government and private sector contracts and tendering procedures, enabling both national and international companies easier access to participate in development projects and make business more easy and efficient.

The World Bank has also identified the UAE as one of the least cumbersome countries to set up new business as it takes only 29 days to start a business in the UAE whereas the average period for the Middle East North Africa (MENA) region is 60-day and the cost of establishing business in the UAE is 24.4 per cent (as a percentage of gross national income) which is relatively lower compared to the average of 76.1 per cent in the MENA region.

Various factors which helped Dubai and Abu Dhabi achieve their status in the Gulf include the construction sector, manufacturing sector, trade as well as government policies like no taxation and easy bank loans. Dubai attained its eminence as it also has several free zones offering 100 per cent ownership to non-nationals, including Jebel Ali Free Zone as a major base for warehousing, regional distribution center for multinational companies and service companies including many global leaders. Dubai Airport Free Zone also offers business opportunities in information technology (IT) products, jewelry, luxury items, aviation industry related business.

The financial markets in Abu Dhabi and Dubai recorded growth in the last years and trading volume increased which is also a major factor for business to prosper and make both the emirates a safe haven for investment and trading. Abu Dhabi and Dubai offer excellent seaports and airports which boost trade, import and export business. The UAE is strategically located in the Gulf with a lot of transit from this sector which is very helpful for multinational companies and big companies willing to set up business in Dubai and Abu Dhabi.

Dubai

The push for industrial diversification in mega infrastructural and private sector projects has created another booming sector in construction and real estate. The construction sector in the UAE is worth Dh 31.8 billion with projects like Dubailand, Jebel Ali Airport City, The World and Business Bay project contributing to the GDP of the economy and providing ample opportunities for setting up various industries and business units in Dubai. The real sector is expected to see the total value of development rise to more than $50 billion by the year 2010. Some of the biggest operators are Addar in Abu Dhabi and Nakheel and Emmar based in Dubai have opened the scope for building products, furniture, cement, glass, iron and steel among others.

The local manufacturing sector in Dubai recorded seven per cent growth as the emirate is not a major manufacturer. The growth in the manufacturing sector has been steady due to rise in population and demand for consumer goods, growth of the free zones and FDI in the country. Its largest industrial manufacturing venture is Dubai Aluminum Company (Dubal), which has been going through an almost continuous expansion program over the past few years. Dubai Dry Docks is the emirate's largest service company with four large dry docks, one of which is the largest of its kind worldwide. The Dubai Emirate's global non-oil trade, which recorded a 41 per cent surge in 2004 to Dh215.72 billion, from Dh153.064 billion in 2003, received a major boost in the first half with export, re-exports and imports showing major increase in the backdrop a buoyant economy.

In 2004, Dubai witnessed by a noticeable activity in the re-exports field which contributed to 26.4 per cent to the emirate's total (excepting free zones), a fact that strengthened Dubai's position as a trade hub in the region. These numbers have risen 51.1 per cent compared to 2003 to reach Dh 57.037 billion in 2004 compared to Dh 37.748 billion in 2003, while exports, which were 4.5 per cent, saw a remarkable growth of 45.5 per cent to reach 9.643 billion in 2004 compared to Dh 6.5 billion in 2003.

On the other hand, imports which consisted 69.1 per cent, increased by 37.1 per cent to reach Dh 179.046 billion in 2004 compared to Dh 108.723 billion in 2003. This is due, mainly, to the leap within the construction sector and the increased needs for building materials in order to comply with the requirements of the gigantic projects and developments in Dubai.

According to the statistics provided by the Dubai Customs, Dubai, which handles some 80 per cent share of the total international non-oil trade of the UAE, is geared to register such growth rate if the buoyancy in trade continues at the same level for the rest of 2005.

Dubai has made the best use of Gulf financing to develop its property and tourism sectors and finally begun to attract American capital and showing its competitive edge. It is the most aggressive of all the emirates in liberalization and enhancing its competitive competitiveness with its smaller and more limited oil and gas reserves. Beside the Jebel Ali Free Zone Authority (JAFZA), other free zones like Dubai Technology & Media Free Zone and Dubai Internet City are the best place for Internet related business and part of Dubai Technology and Media Free Zone(TECOM). The number of registered companies in JAFZA has jumped to 5,000 in the first half of 2005.

Abu Dhabi

The Emirate of Abu Dhabi has plans to establish five industrial zones and the world's largest complex for service companies in the onshore and offshore oil and gas business are underway with the creation in 2004 of the Higher Corporation for Specialized Economic Zones (HCSEZ). This is the latest step in a series of major measures to promote diversification in the Abu Dhabi Emirate. The HCSEZ aims to provide an integrated infrastructure, a suitable business environment and professional services through establishing and managing special zones in Abu Dhabi. The objective is to make the emirate an attractive place for local and international investment and includes the promotion of local industries and the creation of appropriate opportunities to attract and train UAE nationals so that they may play an active role in business development.

The Abu Dhabi government has also announced plans to privatize a number of state-owned companies. This is being handled through a newly established public joint stock company, General Holding Company (GHC), which has taken over the industrial holdings of the General Industries Corporation. The companies to be privatized include fodder, cement, steel and pipe plants and flour mills.

In 2004, investment in the Industrial City of Abu Dhabi, at Mussafah had reached Dh 5.5 billion with over 50,000 workers employed there by 555 companies. Of these, 56 are in the petrochemicals sector, 28 in foodstuff, I5 in garment and textile, 58 in fiberglass, 75 in construction material, 81 in metal industries and 25 in computer and equipment assembling.

Abu Dhabi International Airport operates 50 airlines and is expanding rapidly as Etihad Airways is growing to catch up with Dubai International Airport, one of the busiest in the region with more than 105 airlines servicing 145 destinations. As the capital city and tremendous scope for business and investment in partnership with private capital and foreign direct investment (FDI), Abu Dhabi is an emirate of opportunity as its business environment and legal framework become more transparent to sustain its position in the future.

Conclusion and prospects

The UAE economy is based on strong macroeconomic fundamentals and sound policies stressing in infrastructure and competitive advantage. Its successful diversification from hydrocarbon into higher value-added, export-oriented manufacturing and services makes it an attractive strategic partner for other developing countries beside its natural attractiveness in hydrocarbons.

In pursuing a globalized, open and technology-driven economy like other developing economies, the UAE is seeking free trade agreements bilaterally and in the GCC context as with the European Union (EU) and China. Its open-door, outward orientation is a conscientious policy to support its industrial restructuring and augment its small population base of some 4 million of which only one-fifth are nationals. The UAE is unique in this respect and requires global talents. Despite its geographical location, the UAE is a political and socially stable environment, making it a good place to live, work and invest in. The UAE is a window to the GCC region with a population of over 300 million. There is more than hydrocarbons to make the UAE a strategic partner to the rest of the world.

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