April 14, 2020
Approval: 4/21/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/99-1

10:00 a.m., November 26, 2018

1. United Arab Emirates—2018 Article IV Consultation

Documents: SM/18/268 and SM/18/269; and Correction 1 ; and Supplement 1; and Supplement 1, Correction 1

Staff: Tabatchnaia-Tamirisa, MCD

Length: 41 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	**Alternate Executive Directors**
	W. Nakunyada (AE), Temporary
M. Raghani (AF)	
	E. Rojas Ulo (AG), Temporary
	G. Kim (AP), Temporary
	A. Souza (BR), Temporary
	K. Lok (CC), Temporary
	J. Rojas (CE), Temporary
	N. Feerick (CO), Temporary
R. Kaya (EC)	
	A. Castets (FF)
	K. Merk (GR)
S. Gokarn (IN)	
	L. Cerami (IT), Temporary
	H. Mori (JA), Temporary
	M. Daïri (MD)
H. Beblawi (MI)	
	H. Etkes (NE), Temporary
T. Ostros (NO)	
	S. Potapov (RU), Temporary
	R. Alkhareif (SA)
J. Agung (ST)	
	P. Trabinski (SZ)
	R. Masood (UK), Temporary
	A. Grohovsky (US), Temporary

G. Bauche, Acting Secretary
H. Malothra, Summing Up Officer
E. Mannefred, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: A. Aly. Middle East and Central Asia Department: A. Bibolov, T. Callen, A. Husain, T. Mirzoev, A. Panagiotakopoulou, E. Roos, A. Sadikov, N. Tabatchnaia-Tamirisa, L. Zhu. Strategy, Policy, and Review Department: K. Fletcher. Statistics Department: J. Hur.

Alternate Executive Director: S. Geadah (MI), P. Rozan (FF), F. Sylla (AF), K.Tan (ST). Senior Advisors to Executive Directors: M. Choueiri (MI), W. Kuhles (GR). Advisors to Executive Directors: F. Al-Kohlany (MI), P. Al-Riffai (MI), K. Badsi (MD), P. Dhillon (IN), D. Fadhel (MI), M. Merhi (MI), A. Olhaye (AF), F. Rawah (SA), A. Zaborovskiy (EC).

1. UNITED ARAB EMIRATES—2018 ARTICLE IV CONSULTATION

Mr. Beblawi and Ms. Merhi submitted the following statement:

The United Arab Emirates (UAE) authorities thank staff for the constructive policy discussions in Abu Dhabi and Dubai during the Article IV mission. They look forward to continuing the close engagement and candid policy dialogue with the Fund.

Economic Outlook and Challenges

The UAE economy has been resilient to the oil price shock reflecting its reduced dependence on the hydrocarbon sector. Non-oil growth has averaged 3.5 percent during 2015-17 and is expected to remain robust in 2018 and to further strengthen in 2019 to around 3.9 percent, benefitting from fiscal stimulus and a step-up in preparations for the 2020 World Expo. The authorities remain committed to reducing the share of oil in GDP to less than 20 percent by 2021, as per the National Vision 2021. Implementation of this vision will help to sustain growth and to protect the economy from the volatility in international oil prices. There is a continued momentum to push forward with additional reforms to boost growth and to improve the competitiveness of the economy.

As pointed out by staff, the outlook is subject to downward external risks, mainly related to policy uncertainties that could increase trade disruptions and further tighten financial conditions globally. The UAE's substantial foreign assets and low level of debt provide ample financial buffers and policy space to mitigate any of the potential risks highlighted by staff. While the authorities broadly agree with staff's outlook, they are more optimistic about non-oil growth in the medium term, due to the announced fiscal stimulus as well as favorable liquidity conditions that could lead to a further acceleration of lending to the private sector. Moreover, the authorities have not seen evidence of tightening financial conditions in the UAE, as evidenced by a pick-up in private credit growth of around 4.8 percent in September 2018 (year on year), including 6.5 percent growth to the business and industrial sector.

Fiscal Policy

Following a significant fiscal adjustment in 2015-16, due to the decline in oil prices, fiscal policy became more supportive of growth. After narrowing by nearly 16 percentage points of GDP between 2014 and 2016, the adjusted non-oil primary deficit is projected to widen by 8 percentage points in GDP from 2016 to 2018. The authorities introduced in 2018 a value-added tax in the context of a GCC-wide initiative at a rate of 5 percent to diversify non-oil revenues and to reduce the dependence of fiscal revenues on the hydrocarbon sector. VAT revenues are projected to reach 2 percent of GDP over the coming years. In addition, the authorities froze fee increases for 3 years and have initiated a holistic review of federal and local government fees with a view of rationalizing them to promote economic efficiency and support economic activity. On the spending side, the authorities plan to continue to stabilize the wage bill and other current expenses as a share of non-oil GDP.

Fiscal policy will be expansionary in 2019. The overall fiscal balance will swing by 3.5 percent of GDP and turn positive in 019, mainly on account of higher projected oil revenues and mobilizing non-energy revenues in additions to continued subsidy reforms. The government of Abu Dhabi approved in June 2018 an economic stimulus package of 50 billion AED (3.5 percent of GDP), aimed at increasing the non-oil economic growth over the next three years, as well as 10 economic initiatives to ease the cost of doing business, and the government of Dubai will step up its infrastructure investments for the Expo 2020[1].

The authorities have made substantial progress in fiscal coordination and reporting and have introduced a five-year fiscal framework at the federal level along the lines of the Fund advice, as highlighted in the staff's Selected Issues Report. The Fiscal Policy Coordination Council has been effective in coordinating government spending plans across the Emirates. The authorities plan to continue strengthening fiscal coordination between the Emirates and federal fiscal authorities, and between fiscal and monetary authorities. Progress has been made in strengthening the fiscal framework, including through transitioning to GFSM reporting and medium-term budgeting by the federal government and by some Emirates.

The overall general government debt is expected to remain stable at around 20 percent of GDP. The authorities would like to emphasize that Dubai's government debt, including guarantees, remains relatively low at 28 percent of GDP (below its operational target of 30 percent). While the report notes that the gross public debt of Dubai, including GREs, exceeds 100 percent of Dubai's GDP, the authorities have made it clear that GRE debt is

[1] The extent of fiscal decentralization in the UAE is the highest in the world. As such, the Emirates government spending accounts for 88.5 percent of total government spending.

not guaranteed by the Dubai government, unlike the situation preceding the 2009 crisis when it was not clear.

Monetary and Financial Sectors Developments

The Central Bank of the UAE (CBUAE) remains committed to preserving the soundness and stability of the financial system. The financial sector continues to perform strongly, and the banking sector remains highly capitalized and profitable, with a capital adequacy ratio at around 18.2 percent, well above the minimum requirement. The CBUAE will continue its close monitoring of the liquidity situation in the banking system, which has been robust. The authorities have seen no evidence of tightening financial conditions in the UAE, as evidenced by the credit growth to the private sector, which increased by 3.2 percent in the first nine months of the year, including 4.5 percent increase for the Business and Industrial sector.

The CBUAE has made a remarkable progress in modernizing its regulatory framework. The authorities have issued the new central bank and banking law in October 2018, which aims at enhancing the Central Bank independence and governance, setting up a sound institutional framework for financial stability oversight, and strengthening the ability of supervisors to take action, if necessary. A new risk management regulation for banks was also issued. The CBUAE is reviewing and updating existing regulations to strengthen the prudential framework in line with the requirements of Basel III. These revisions are expected to be published by the end of the year. In addition, the CBUAE is preparing to develop a new bank resolution regime, as well as regulations related to payments and Fintech in the near future. The Sharia board was established to act as a critical enabler for competitive Islamic and sound Islamic finance environment in the UAE.

The newly approved Public Debt Law will enable the federal government to issue sovereign bonds and support the Central Bank’s role in liquidity management. The authorities recognize that developing deep and liquid domestic debt markets can bring important benefits by benchmarking the yield curve in for dirham denominated debt, providing local governments and corporates, with new funding sources, deepening the financial sector, enhancing the monetary interest rate policy transmission mechanism, to the market and facilitating liquidity management.

The UAE authorities have continued to strengthen the AML/CFT framework and to address de-risking issues. The authorities have introduced amendments to the AML/CFT law and are aiming to finalize a national risk assessment by 2019. The Anti-Money Laundering and Suspicious Cases Unit at the Central Bank will continue to strengthen the effectiveness of the AML/CFT framework through capacity building and bolstering regional and international cooperation.

Structural and Regulatory Reforms to Boost Inclusive Growth

In line with Vision 2021, the UAE authorities have ambitious economic diversification goals. A wide range of policy measures to stimulate economic growth and to improve the business environment have been taken this year in this regard. The Abu Dhabi stimulus package covers economic initiatives related to infrastructure and legislative projects, as well as SMEs, and industrial and social projects. These include the Abu Dhabi Accelerated Development Program ("Ghadan 21" or 'Tomorrow' 21) to attract and to support value-added investments and technologies that will help increase the competitiveness of the economy[2]. Dubai government reduced municipalities fees by half and cancelled 19 fees related to the aviation industry, as part of initiatives aimed at lowering corporate and government charges to boost economic growth, creating jobs, and making it easier to do business. The federal government has also announced new measures of relaxing foreign ownership requirements and the introduction of ten-year visas[3] to stimulate the private sector and promote tourism.

Recognizing the significant role small and medium enterprises (SMEs) have played and is likely to continue to play, as a key growth driver towards further economic diversification, the authorities will continue to support SMEs, which employ most of the labor force in the UAE. The SME Council developed a federal procurement program, which requires awarding 10 percent of federal government contracts to SMEs (owned by nationals). A high-level committee was also recently created to boost SME financing. The authorities will continue to enhance the ecosystem in support of the sector and remove obstacles so that SMEs and start-ups get the support and financing needed to play their vital role in the economy. To that end, the CBUAE has developed draft regulations to encourage financial institutions to play their

[2] As part of the plan, the government plans to increase employment by creating 10,000 jobs for Emiratis in the private and public sectors over the next five years.

[3] The new visa system, which benefits all foreigners in the UAE, offers up to a 10- year visa for experts in medical, research, and technical fields. Foreign students will have the option to obtain a 10-year visa and up to 2 years training following the completion of their studies. Job seekers are also included in the new regulation and will be able to obtain 6-month visas.

role in the development of this sector. The authorities appreciate staff's Selected Issues paper on the subject and will consider its proposals.

Over the past few years, the UAE has taken the lead in adopting digital solutions. A strategy for Artificial Intelligence has been launched to boost government performance at all levels and to achieve the objectives of the UAE Centennial 2071, and a minister of state for Artificial Intelligence has been appointed to accelerate progress on this level. The UAE is emerging as the start-up hub for the regional financial sector, as Dubai and Abu Dhabi are the most favored destinations for Fintech firms owing to the availability of an advanced technological infrastructure[4]. The Securities and Commodities Authority (SCA), the Insurance Authority, along with the Central Bank, are the three on-shore regulators for all banking and financial activities and work in tandem with financial free zones to provide oversight for the financial industry. The goal of financial regulators is to develop new regulations for Fintech entities, as well as to provide a platform for start-ups to develop their ideas and to obtain support that enables their growth and increases their contributions to non-energy growth and employment in line with the country's vision.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for they insightful staff report, including the selected issues paper, and Mr. Beblawi and Ms. Merhi for their useful buff statement. The staff report sheds light on the good performance of the United Arab Emirates economy, which has successfully weathered off the prolonged decline in oil prices since 2014, has managed to make progress towards a diversification of its economy, and is implementing a thorough reform program, in line with the last article IV staff report recommendations. Consistency in reform implementation will be key to deliver, in particular to boost private sector development. We concur with the main messages conveyed by staff and wish to offer the following comments.

Outlook and Risks

The UAE's growth is expected to pick up in the next few year, thanks to higher oil production and investment, a dynamic private sector growth, and large public, non-oil investment programs. The quality of public spending will be key to raise long term, non-oil growth. Thorough and ambitious

[4] The Dubai International Financial Center (DIFC) and the Abu Dhabi Global Market (ADGM), along with the International Financial Centre in Abu Dhabi, have launched their accelerator programs.

implementation of structural reforms, in particular on the opening up of the economy is essential to unlock growth potential.

We concur with the staff assessment regarding downside risks, in terms of global financial conditions, trade disruptions and geopolitical tensions. In this regard, is staff concerned regarding possible spillover effects of US sanctions on Iran? In addition, private demand seems to be slowing in Dubai – we would welcome the staff assessment on this, including the impact on the retail sector.

Fiscal Policy

Easing of the fiscal policy is warranted in the short term, as rightly recommended by staff. This fiscal stimulus should help accelerate recovery and raise medium term growth prospects. As noted by staff, the UAE have strong policy buffers that will allow it to resume fiscal consolidation in a gradual manner. We welcome the focus on intergenerational equity; indeed, it will be important to ensure that the pick in public spending is sustainable. Going forward, we encourage the authorities to continue to transform the fiscal revenue system, to reduce the link with the oil sector, in keeping with the successful implementation of the VAT in 2018. Finally, and in line with the federal nature of the UAE, we thank staff for the very useful selected issues paper on fiscal policy framework, in order to avoid procyclicality, develop a consolidated fiscal framework across the Emirates, and improve policy coordination to avoid inconsistency. We thank the authorities for clarifying in their buff statement the ongoing work to strengthen this framework.

External Sector and Financial Stability

The external sector appears to be moderately weaker than the level that would be consistent with sufficient saving of non-renewable resource revenues, as noted by staff, though there are strong policy buffers (in particular SWFs). We also note that the current account surplus is projected to gradually decline over the medium term, with the expected decrease in oil price. We encourage the authorities to take this aspect into account for future policy developments. In addition, we note that the exchange rate peg appears to continue to serve the economy well.

The financial regulatory and supervisory regime has been gradually modernized. We share staff assessment that vigilance is needed on specific risks, notably stemming from the government-related enterprises and from the real estate market. We notably encourage the authorities to undertake adequate stress-testing in this regard. The recent bankruptcy of an investment fund (Abraaj) recall the importance of adequate supervision of offshore entities. Does staff identify any shortcomings in this regard?

While we note the recent upgrade made to the anti-money laundering and combatting of terrorism financing regimes, we encourage the authorities to further enhance the effectiveness of the regulatory framework. The swift finalization of the national risk assessment, and implementation of the new framework will be key to mitigate risks going forward, for instance on the transparency of beneficial ownership.

Structural Reforms

We encourage the authorities to continue deepening their structural reforms agenda, to realize their ambitious Vision 2021, which is key to ensure long term growth and employment opportunities. Among useful measures, we encourage the authorities to enhance efficiency among GREs, and to further liberalize foreign investment to trigger innovation. The authorities should follow through with the commitment to allow foreign investors to hold up to 100 percent of an Emirati firms' capital. We welcome the emphasis that the Authorities have placed on the development of SMEs, as well as talent promotion and inclusiveness. In this regard, we encourage the authorities to further their efforts to increase female labor force participation.

Mr. Kim and Mr. Amor submitted the following statement:

We thank staff for their report and Mr. Beblawi and Ms. Merhi for their informative buff statement. The authorities' policy responses to the oil price shocks have been instrumental, and strong reforms continue to support economic recovery. While risks remain, we believe that substantial foreign assets and low debt levels provide sufficient buffers and policy space to mitigate the risks. We agree that the policy focus may be geared toward supporting the recovery in the short-term. However, strengthening the policy framework and advancing the structural reforms are required to achieve sustainable growth, especially in the non-oil sector.

We support staff's view that the more accommodative short-term fiscal stance is warranted. Expansionary fiscal policy such as Abu Dhabi's investment package of AED 50 billion over three years ($13 billion) and Dubai's infrastructure investments for the Expo 2020 will mitigate down-side risks in the short-term. At the same time, we stress the needs for sustainable non-oil economic growth, further easing the business environment, and advancing the inclusive growth agenda, and encourage spending toward these goals. We welcome the introduction of VAT and the plans to review and streamline government fees. We anticipate scope for more attention toward government-related enterprises (GREs) to improve corporate governance, risk management and transparency practices, and help contain GREs' borrowing to mitigate the risks to fiscal sustainability and financial stability. While understanding the authorities' explanation that GRE debt is not guaranteed by the Dubai government, we would like to ask staff's assessment on operational efficiencies and financial situations of Dubai's GREs and the possibility of their spill-over to the government debt and financial markets.

We welcome that the banking sector remains resilient, well capitalized and profitable. While there are rooms for improvement for risk-based supervision, ongoing initiatives to improve the regulatory environment, including the newly issued central bank and banking law aimed at enhancing central bank independence and governance will make the banking sector more robust. Given UAE's geographic location, its openness and rising nonresident deposits, strengthening the effectiveness of the AML/CFT framework should continue to be prioritized.

The authorities have set ambitious goals to further diversify the country and to transition to a knowledge-based economy. We recognize Vision 2021 initiatives that the authorities are undertaking to attract value added investments and technologies to boost competitiveness. We also support initiatives aimed at improving the business environment. Controlling the size of the public sector and promoting a culture of entrepreneurship will enhance attractiveness of private sector employment. Deregulation measures to attract foreign talent are right steps forward and should be in tandem with strengthening education and training for locals. We encourage the authorities to continue their strong efforts in supporting SMEs. Efforts to further advance female labor force participation should continue. In this regard, we welcome the adoption of the Equal Pay and Gender Equality Law in 2018. Flexible work arrangements and provision of childcare services could help expand women's participation in the labor market. We also see merits in introducing gender budgeting to further advance the inclusion agenda in future years.

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the informative papers and Mr. Beblawi and Ms. Merhi for their helpful buff statement. The upswing in oil prices eased the financial pressures on the UAE economy and underpinned the authorities' reform agenda. Nevertheless, advancing economic diversification will require continued efforts and a strengthened coordination between fiscal, monetary, and structural policies. We concur with the thrust of staff’s analysis and policy recommendations and would like to provide the following comments for emphasis.

Well-calibrated structural fiscal reforms could help avoid pro-cyclicality and ensure intergenerational equity of fiscal policy. We note the deterioration in the adjusted non-oil primary fiscal deficit to 30 percent of non-oil GDP in 2018 on the backdrop of a growing gap between the actual and the desirable non-oil primary deficit that is needed to ensure sufficient savings for future generations. According to staff’s estimates this gap is expected to peak at 11.5 percent of non-oil GDP in 2019. However, staff broadly support the accommodative fiscal stance in the short run. In this regard, we would have preferred a more nuanced discussion in the report about the desirable fiscal stance vis-a-vis the business cycle, including the analysis of structural fiscal indicators. Considering the high uncertainty around the oil price and non-oil GDP dynamics, the recommended fiscal consolidation over the medium term may not be achievable and turn out to be pro-cyclical. Staff’s comments are welcome. To boost non-oil GDP growth the fiscal stimulus package should be appropriately targeted and implemented, including by strengthening public investment management. Could staff comment on the recent progress in this area? Staff appropriately recommends advancing the fiscal risks management to mitigate risks stemming from the contingent fiscal and quasi-fiscal liabilities, such as operations of government related enterprises, state guarantees, PPP contracts, and payroll and pension liabilities. The announced stimulus, including energy tariffs cuts, should be implemented in a fiscally responsible way to ensure debt sustainability. In this context, can staff further explain the relatively sizable contribution of the residual to changes in the public debt dynamics, especially taken into account the existing exchange rate peg (page 35, public DSA). Overall, a more comprehensive and transparent fiscal policy framework (including firmer fiscal anchors, a consolidated budget framework, risk management, and policy coordination) is warranted to facilitate decision-making and foster the credibility of fiscal policy.

The monetary policy framework could be advanced by developing liquidity management operations in coordination with fiscal policy. The UAE’s fixed exchange rate regime limits the independence of monetary policy. The real effective exchange rate appreciation in line with the US dollar also affects the export competitiveness of the non-oil sector. While we broadly agree with staff that the current exchange rate regime and monetary policy framework serve the UAE well, further enhancement is warranted. Coordinating financing plans and the issuance of debt between fiscal units and the Central Bank will help avoid simultaneous tapping of capital markets and crowding out of necessary liquidity to support private investment. We encourage the authorities to aim at better coordination, including by strengthening information-sharing, improving technical cooperation in conducting macro-fiscal analysis across emirates, and putting in place a high-level forum to facilitate coordinated decision-making.

Ensuring financial stability requires heightened supervisory vigilance. We note staff's conclusion that UAE's banks profitability, liquidity, and capital buffers remain strong. However, an uptick in non-performing loans (NPLs) warrants further monitoring and remedial actions, especially taking into account risks of a further deepening in the real estate downturn and weakening asset quality. We welcome the authorities' recent measures aimed at enforcing prudential norms as well as the Central Bank's plans to move to risk-based supervision in 2019. We would appreciate staff's further comments on the main drivers for the increased level of NPLs. The authorities have made commendable progress in strengthening the anti-money laundering and combatting of terrorism financing regime. They should continue identifying potential ML/TF risks including those related to nonresident financial flows, and communicate the results of the national risk assessment to the relevant public and private stakeholders.

Structural reforms aimed at raising productivity, improving competitiveness, trade openness and further diversifying the economy should be pursued. Economic diversification into tourism, financial services and high-tech industries offers some protection against volatile oil prices and helps prepare the economy to the "lower-for-longer" oil price environment. We encourage the authorities to use the current momentum to accelerate implementation of the Vision-2021 reform agenda in a fiscally responsible manner. The helpful Selected Issues Paper on SMEs points out the scope for further improvements in the business environment and the huge potential of private sector-led growth. We also strongly support staff's call on the authorities to further advance the UAE economic statistics.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for a set of informative papers and Mr. Beblawi and Ms. Merhi for their insightful buff statement. The UAE's economy has shown resilience to lower hydrocarbon prices. In their response to the large external shock, the authorities relied on prudent fiscal policy and sizable financial buffers. Higher oil prices over the past year have also contributed to improvements in the fiscal and external positions. Staff believe that reform momentum remains strong under the Vision 2021 program, although downside risks to the outlook have increased. We broadly agree with staff's recommendations in the report and limit our comments to the following points.

Following last year's slowdown, GDP growth is expected to pick up in 2018, supported by the fiscal stimulus and higher oil output and prices. At the same time, non-oil growth and exports continue to remain subdued, in part owing to a slowdown in external demand from several key trading partner countries. According to staff, successful implementation of structural reforms could boost non-oil growth by around 1 percent over the projection period, while the authorities are even more optimistic about non-oil growth prospects. We invite staff to elaborate on sectoral growth prospects in the UAE. Could staff also elaborate on the divergence between staff's and the authorities' assessments of financial conditions in the UAE?

In line with the recommendations made at the time of 2016-2017 Article IV consultations, the authorities have recalibrated the pace of fiscal consolidation, embarking on a short-term fiscal easing. This policy change was intended to support economic activity, while the cyclical position of the economy remains weak and growth-enhancing structural reforms require time to take hold.

We agree with staff that the accommodative fiscal stance should be accompanied by the approval of a medium-term fiscal framework aimed at supporting intergenerational equity and aligning budget financing with the strategic priorities. It is also paramount to monitor risks related to volatility of oil prices that can have adverse implications for macroeconomic stability. We highlight the importance of resuming gradual fiscal consolidation once the economic recovery takes hold. The VAT introduction in the beginning of this year was a remarkable achievement in strengthening the tax administration and raising non-oil revenues. Over the medium term, considerations could be given to gradual broadening of the VAT base. We also welcome staff's recommendations to analyze alternative revenue models, including the introduction of corporate income taxation, and would appreciate additional comments on the authorities' views on this proposal.

On the expenditure side, we welcome the authorities' plans to contain the public wage bill as a share of non-oil GDP and to strengthen financial positions of the government-related entities (GREs). These entities in both Dubai and Abu Dhabi may have some difficulties servicing their debts, which can have adverse effects on the financial sector. The recent downgrade by Standard and Poor's of two Dubai GREs was symptomatic of these risks. We encourage the authorities to improve data on contingent government liabilities and construct a comprehensive public-sector balance sheet, with technical assistance from the IMF.

According to staff, the exchange rate peg to the U.S. dollar has served the UAE well and has contributed to financial stability and economic development. At the same time, we find it useful to review the exchange rate policy periodically with the aim to support economic diversification and mitigate possible adverse implications of the continued real exchange rate appreciation. We also support staff's recommendations aimed at strengthening the framework for liquidity management and forecasting, as well as further developing domestic debt market.

According to the figure on page 5 of the report, since 2014 the residential real estate prices have significantly declined in both Dubai and Abu Dhabi. Can staff elaborate on any estimates of possible house price misalignments in the UAE? Do staff see oversupply risks in the housing market? What kind of impact can falling real estate prices have on the banking and real sectors? As a related matter, given the heightened risks from GREs and real estate prices, do staff see the need for an FSAP update to analyze financial stability risks deeper?

The main economic and structural challenges facing the UAE are associated with the country's ability to adapt its relatively successful diversification model to increasing international competition among economic hubs. In this context, we welcome the recently announced structural policy measures to boost economic activity and competitiveness. The timely implementation of the Vision 2021 would also be instrumental in promoting development, innovation, research, and Artificial Intelligence. The development of the SMEs sector would play an important role in supporting private sector-led job creation and advancing entrepreneurship. The SIP chapter "How to Enable Small and Medium-Sized Enterprises to Play a Larger Role in the UAE Economy" provides a very useful set of recommendations on how to broaden the SME's role in the UAE's economy. Further efforts are required to improve FDI regulations and deepen labor market and education reforms to generate productivity gains, especially for the nationals.

Mr. Villar and Mr. Rojas Ramirez submitted the following statement:

We thank Staff for the comprehensive report on the United Arab Emirates (UAE), and Mr. Beblawi and Ms. Merhi for their informative buff statement.

Fiscal stance is underpinning sustainable growth and aimed to ensure intergenerational equity. Policy in the short term is focused on implementing a stimulus plan boosting the economy. Additionally, authorities are investing in high growth multiplier areas ensuring efficiency in spending. In the medium term, fiscal policy aims at fiscal consolidation building gradual buffers to achieve a primary balance with a view to attain non-oil sustainable growth, debt sustainability and intergenerational equity. We commend the authorities for strengthening the federal fiscal coordination framework by creating the Policy Coordination Council and for the fiscal risk management actions for mitigating the impacts of adverse shocks on the economy.

The external position is strong. UAE has improved its international reserves and continues building buffers in sovereign wealth funds. Accordingly, the exchange rate policy seems appropriate with a stable real effective exchange rate underpinned by labor market flexibility.

The financial system is sound having good levels of liquidity, capital and NPL indicators. The stock market has strengthened pushed by oil price increase. The central bank has made progress on modernizing regulatory framework. We agree with staff that further efforts must be done in enhancing supervision and enforcing prudential norm. We encourage authorities to develop a new resolution regime and completing Basel III capital standards. It is crucial for the UAE's financial system to strengthen the AML/CFT framework and to maintain close vigilance on mitigating associated risks.

UAE authorities are committed to economic diversification and promoting a non-oil sustainable high productive economy. Vision 2021 is oriented to private sector development promoting knowledge and innovation. We agree with the staff's recommendation on guiding reforms to promote talent and inclusiveness, fostering human resources and labor markets, equal pay and gender equality laws. Authorities have taken important steps towards structural reforms by enhancing competitiveness, liberalization of foreign business ownership and creating a long-term high productivity economy and business promotion.

Mr. Ostros and Ms. Sand submitted the following statement:

We thank staff for the reports and Mr. Beblawi and Ms. Merhi for their informative buff statement. We broadly support staff's assessment and policy recommendations and would like to add the following comments for emphasis.

The report highlights that the economy of the UAE has adopted well to lower oil prices as non-oil GDP growth has fallen since 2014. Going forward, growth momentum is expected to strengthen on the back of fiscal stimulus and increased investment, and we welcome the authorities' commitment to reduce the share of oil to less than 20 percent of GDP by 2021 as set out in the National Vision 2021. We agree that successful implementation of Vision 2021 and structural reforms to diversify the economy away from the hydrocarbon sector will ensure the UAE becomes more resilient and will protect the economy for fluctuations in the oil price.

Fiscal consolidation is key to strengthen fiscal sustainability and ensure intergenerational equity. We support the more accommodative short-term fiscal stance accompanied by putting in place firmer fiscal anchors and strengthening policy frameworks going forward. Resuming fiscal consolidation once the economic recovery gains momentum is essential to ensure intergenerational equity and debt sustainability. However, we note that even with the planned gradual fiscal consolidation over the medium-term the government may not be saving enough of the oil revenues to ensure intergenerational equity as implied by staff's permanent income hypothesis. We support staff's recommendations regarding the necessity to implement a fiscal revenue system that strengthens the link between non-oil growth and fiscal revenues over time. In this regard we welcome the introduction of the VAT this year and agree the VAT base should be gradually broadened going forward.

We support the authorities' agenda of further diversifying the oil-dependent economy towards a knowledge-driven economy and welcome the ambitious plans to implement the Vision 2021 which promotes innovation, research, and development. However, as staff point out in the Selected Issues paper a robust policy framework and effective coordination among fiscal and monetary authorities is critical for the UAE's success in achieving the goals of diversified, inclusive, and more sustainable growth. We also highlight the importance of focus on an inclusive workforce and hence reforms to encourage female labor force participation.

Mr. Agung and Mr. De Lannoy submitted the following joint statement:

We thank staff for their concise report, and Mr. Beblawi and Ms. Merhi for their helpful buff statement. We commend the authorities for their strong policy response to the recent commodity price shock. Firmer oil prices are now supporting the recovery, but should not distract from the longer-term goal of building a diversified and resilient economy. We are also encouraged by the authorities' efforts to continue advancing their statistical and AML/CFT standards. We broadly concur with the staff appraisal and offer the following comments for consideration.

The fiscal strategy should aim to strengthen resilience and inter-generational equity. Medium-term structural consolidation will help to strengthen fiscal sustainability and reduce vulnerability to oil price fluctuations. Priority should be given to broadening the non-oil revenue base, containing current expenses and ensuring sound public financial management. We strongly commend the introduction of the VAT and welcome the authorities' intention to continue strengthening the fiscal framework. In the near-term, we note that the authorities plan to increase public investment to support the non-oil growth recovery, including planned infrastructure spending in the leadup to Expo 2020. As the UAE's infrastructure ranks highly on business environment indicators while human capital remains a challenge, we invite staff to comment on how the authorities should balance their spending between physical and human capital investments. We also note that the 2017 staff report emphasized the need for continued fiscal consolidation, while this year staff endorse a short-term fiscal easing despite higher oil prices and stronger real GDP growth. Could staff elaborate?

Staff considers that the longstanding peg to the USD has served the UAE well, noting that the peg is supported by UAE's strong external buffers as well as open and flexible labor markets. Can staff explain the method used for evaluating the level of labor market flexibility required to support the peg? Is the labor market for nationals also considered sufficiently flexible? The currency peg suggests that the Fed's monetary tightening will directly affect UAE's financial conditions regardless of the phase of its business cycle. This calls for close supervisory vigilance as debt servicing costs rise. More broadly, we also welcome CBU's continued efforts to enhance its monetary policy and financial regulatory frameworks. As an aside, we are somewhat surprised that a 30 percent real depreciation shock is examined in the external debt sustainability test (p. 41), given that the Emirati dirham's exchange rate vs. the USD has been fixed for two decades. We would appreciate staff's elaboration on the basis for the parameter set as it would be more meaningful if stress tests are tailored to the examined economy.

We look forward to continued progress toward the Vision 2021 goals. We note positively the authorities' plans to reduce red tape and liberalize foreign investment, which should help foster entrepreneurship. Streamlining the footprint of GREs, as suggested by staff, could also create space for further private sector development while helping to manage fiscal risks. Further to staff's interesting discussion of measures to boost SMEs' access to credit, we would add that a more pressing upstream issue would perhaps be their inability to open a bank account (para 7 of the SIP), which staff have linked to banks' AML/CFT compliance costs. Could staff comment on possible solutions to this problem? We encourage further efforts to boost female labor force participation.

Finally, we welcome the authorities' steps to improve data collection with support from Fund technical assistance. We wish the authorities continued success in their reform endeavors.

Mr. Trabinski and Mr. Tola submitted the following statement:

We thank staff for a well written and comprehensive set of reports, and Mr. Beblawi and Ms. Merhi for their buff statement. We broadly share the staff's appraisal and would like to provide the following comments for emphasis.

We commend the authorities for their successful policy response to a challenging environment. Large financial buffers have enabled the authorities to maintain a growth-friendly fiscal stance, while striving to diversify the economy and implementing structural reforms. To consolidate these achievements, the authorities should continue to improve the policy framework, increase the effectiveness of policy coordination, strengthen financial sector supervision, and accelerate the implementation of structural reforms.

Fiscal consolidation will be needed over the medium term to ensure debt sustainability and intergenerational equity. As fiscal policy remains the main tool for achieving economic policy goals, we support staff's call for the strengthening of the fiscal framework and the priority areas laid out in paragraph 18 of the report, specifically on further fiscal policy coordination. We see merit in staff's view regarding the need for continued fiscal easing to support the recovery in the short term. Once the recovery is on a steady path, however, the authorities should resume fiscal consolidation to ensure that the long-term goals of intergenerational equity and debt sustainability are reached. This will require, among other measures, strengthening the link between non-oil growth and fiscal revenues.

We welcome the recently announced structural policy measures. Successful implementation of structural reforms will be critical to underpin medium-term growth. In particular, opening up the capital account will facilitate technology transfer, which in turn will help foster competitiveness and lead to a more diversified economy. We join staff's call for more clarity on how and when these measures will be implemented, and which sectors are concerned.

Further efforts are needed to strengthen the statistical system. We are encouraged by the recent improvements in statistics, underlined by the successful implementation of the Enhanced General Data Dissemination Systems. At the same time, important gaps persist in recording and reporting of data for some key macroeconomic and financial variables. We note differences between staff and the authorities regarding contingent liabilities associated with government-related enterprises, which are flagged in the report as an important source of vulnerability. We agree with the measures proposed by staff to address this problem and would be interested to hear more details from staff about the concrete actions the authorities are planning to implement.

We support ongoing efforts to strengthen the AML/CFT framework. We welcome the recent improvements of the legislative and regulatory framework and encourage the authorities to finalize the National Risk Assessment. Further enhancements of the AML/CFT framework, in particular regarding the identification of beneficial ownership and the supervision of the remittances sector, will be necessary to increase its effectiveness in mitigating risks.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the excellent reports and Mr. Beblawi and Ms. Merhi for their informative buff statement. We broadly agree with the staff report and would like to offer the following points for emphasis.

The UAE economy is well calibrating its growth model and has maintained its resilience amid oil price variations. UAE's current account surplus, substantial foreign assets, low level of debt and well capitalized liquid banks provide a solid footing. Non-oil growth is projected to rise to 3.9 percent in 2019, with overall real GDP growth projected at around 3.7 percent for 2019–20. Increased investment, private sector development and prospects in trade, are expected to fuel growth. However, downside risks endure, underpinned by volatility in emerging markets, geopolitical tensions, and protectionism. The main economic challenge confronting the UAE relates to effective diversification and we welcome the authorities' multifaceted reform agenda to this end. We note the authorities being more optimistic about non-oil growth as compared to staff, backed by the planned fiscal stimulus and pick-up in private credit. Staff comments are invited on this divergence.

A fiscal stimulus in the short term, followed by fiscal consolidation in the medium term appears well strategized. Achieving the Vision 2021 for a diversified, robust, knowledge-based economy warrants this approach. We positively note the commendable initiatives of the authorities for developing non-oil revenues and rationalizing spending, including the introduction of VAT, review of federal and local government fees and stabilizing the wage bill. Progress in strengthening the fiscal framework and fiscal policy coordination is also commendable. Staff has placed much emphasis on the improving policy coordination among the authorities and developing a consolidated fiscal framework for UAE. In this context a High-Level Financial Policy Coordination Council supported by a technical Secretariat has been underscored. Could staff offer more details on the specific stakeholder feedback and the traction with the authorities?

The authorities must continue to reinforce an already sound and stable financial system. The Central Banks' assurance to continue monitoring of the liquidity situation in the banking system is encouraging. Beyond this, the staff recommendation of stress tests may be kept on the agenda for heightened vigilance. We agree that the exchange rate peg has served UAE well and the Central Bank has made notable progress in modernizing its regulatory framework. The newly approved Public Debt Law offers immense potential for boosting the financial markets and developing supplementary financing streams. We appreciate the efforts of the UAE authorities for the strengthening of the AML/CFT framework. Like staff, we urge the authorities to further enhance the effectiveness, including through identification of the beneficial owners of banks' customer accounts and robust monitoring.

On the structural side, the path to a diversified economy will hinge on advancement of core ingredients of human and private capital. In Vision 2021, the UAE authorities have articulated ambitious economic diversification goals. Early gains targeting the business environment, foreign ownership requirements, visa norms to stimulate the private sector and promote tourism, Equal Pay and Gender Equality Law, are admirable. Remarkable efforts have also been made in the digital domain, especially to provide oversight for the financial industry. In the selected issues paper, staff has stressed on sustained efforts to create an ecosystem conducive to SME development. Going forward, the authorities could move in this direction along with advancing talent pools, for achieving a diversified job rich inclusive growth.

Finally, we urge the authorities to make all efforts to improve the statistics and harmonization of the plans across the country. We note Fund's ongoing TA to this end.

With these comments, we wish the authorities the best in their endeavors.

Mr. Raghani, Mr. Sylla and Mr. Olhaye submitted the following statement:

We thank staff for the set of papers on United Arab Emirates (UAE) and we also thank Mr. Beblawi and Ms. Merhi for the informative buff statement.

We commend the authorities for maintaining macroeconomic stability in a difficult external environment marked notably by the 2014 oil price shock, geopolitical tensions, and tightened global financial conditions. We welcome the measures taken by the authorities to reform energy subsidies and introduce the VAT and excises in 2017-18, and the progress made in boosting structural reforms in the framework of the Vision 2021. Moreover, an accommodative fiscal stance, strong capital buffers and strengthening external position, have placed UAE on a sound footing. Recent recovery in oil prices, increased investments, and favorable prospects in tourism linked to the Expo 2020 should also contribute to improving growth over the medium term. However, downside risks remain, notably UAE's susceptibility to global market volatility and increasing trade tensions. We encourage the authorities to remain vigilant of these and other risks and to implement the appropriate policy responses.

We broadly concur with staff's assessment and therefore will confine our comments to a few points below, for emphasis.

On the fiscal front, we note that the significant fiscal adjustment in 2015-16 has helped the economy to adapt well to the prolonged decline in oil prices. We also agree that the priority of the fiscal policy in the near term would be to support the recovery. In this regard, the fiscal easing introduced in 2017 needs to be sustained, given spare capacity and large buffers. We encourage the authorities to resume fiscal consolidation in the medium term once economic recovery has strengthened to ensure debt sustainability and savings for future generations. Moreover, we encourage the authorities to further strengthen the fiscal policy framework and coordination in implementing the stimulus to mitigate any potential risk. In this regard, we welcome their plan to launch under the Fund technical assistance a project to analyze fiscal risks and construct a UAE public-sector-balance sheet. We commend the authorities for the successful introduction of the VAT and urge them to gradually broaden the VAT base and develop more efficient revenue systems. This will help develop a more diversified and robust economy and attain the objectives set out in the authorities' Vision 2021.

On the external sector, we welcome the sizeable improvement in the current account surplus in 2017 but note that external surpluses are projected to decline steadily over the medium-term. We also note from the External Sector Assessment in Annex IV that the current account is slightly below the desired level to achieve savings to build intergenerational equity. We therefore urge the authorities to make the necessary long-term fiscal adjustments needed to maintain the intergenerational equity.

On the financial sector, we welcome the authorities' efforts to strengthen financial supervision and modernize the regulatory framework, including in the areas of prudential norms and Basel III capital standards. We take positive note of the newly approved Public Debt Law which, as indicated in the buff statement by Mr. Beblawi and Ms. Merhi, "will support the Central Bank's role in liquidity management" and strengthen its liquidity management framework. The authorities should be commended for the progress made in strengthening the AML/CFT regime. We also encourage them to further enhance the effectiveness of the regime including by improving the understanding of the risks related to nonresident financial flows. Furthermore, the Central Bank close supervision of the remittance sector in collaboration with key stakeholders is important and we would be interested to know whether there are any lessons learned or best practices that can be drawn?

On structural reforms, we recognize progress has been made in the context of Vision 2021 to boost structural reforms and we encourage the authorities to continue to step-up reforms to boost diversified nonoil growth and to pay particular attention to unleashing local entrepreneurship. In this context we welcome, the federal SME program and the high-level committee on SME financing that was launched this year.

With these remarks, we wish the authorities every success in their future endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. Rawah submitted the following statement:

We thank staff for the well-written set of reports and Mr. Beblawi and Ms. Merhi for their helpful buff statement. We broadly share staff conclusions and policy recommendations and would like to make the following points for emphasis.

Thanks to the authorities' prudent policies, which have spurred the build-up of high financial buffers, and created a sound financial sector and a diversified economy, the UAE was able to successfully withstand recent economic shocks and is well-positioned to face external challenges. We also welcome the authorities' concerted structural reform efforts towards enhancing the medium-term prospects in line with their multifaceted reform agenda under Vision 2021. Notwithstanding the UAE's already high rankings on business environment indicators, the announcement of structural reform series in September 2018 is a step in the right direction to further boost growth and competitiveness and we look forward to their successful implementation.

We join staff in supporting the authorities' accommodative short-term stance to accelerate the recovery and raise the medium-term growth prospects. In this respect, we welcome the authorities' upcoming three-year stimulus package, which rightly focuses on key priorities including improving competitiveness and social development. Here, we would like to underscore the importance of close coordination between the fiscal and monetary authorities during the implementation period with a view to mitigate any potential risks to financial stability and growth. In this context, we take positive note of the authorities' recent efforts, as noted in the buff statement. We also see merit in resuming the gradual and growth-friendly fiscal consolidation efforts once the recovery gains momentum to safeguard fiscal sustainability.

We welcome the authorities' revenue mobilization and spending rationalization efforts including the important milestone achieved by the introduction of the VAT. The initiated comprehensive review of federal and local government fees with a view to promote economic efficiency and support economic activity is also welcome. We also welcome the authorities' plan to continue to stabilize the wage bill and other current expenditures as a share of non-oil GDP. Continued spending reviews and priority budgeting would help in achieving economic-boosting objectives in a cost-effective manner as rightly noted by staff.

Finally, the Central Bank of the UAE has rightly continued to strengthen regulation and supervision to reinforce financial stability. In our view, the exchange rate regime remains appropriate and continues to serve the UAE's economy well. We also take note of staff's views on strengthening the liquidity management framework in addition to developing a deep and liquid domestic debt market. Indeed, we are reassured to note that banks are well-capitalized, profitable and NPLs are fully provisioned.

With these remarks, we wish the authorities further success.

Mr. Merk and Ms. Kuhles submitted the following statement:

We thank staff for the well-written set of documents and Mr. Beblawi and Ms. Merhi for their informative buff statement. We welcome that the UAE economy has successfully adapted to recent external shocks. While the growth momentum is expected to strengthen, downside risks to the outlook have increased, in particular rising trade and geopolitical tensions. Against this background, we encourage the authorities to further enhance their policy framework, implement structural reforms to diversify the economy as well as strengthen financial sector supervision and the AML/CFT framework. We broadly share staff's appraisal and would like to highlight the following points for emphasis.

Resuming fiscal consolidation once the recovery gains momentum is essential to ensure intergenerational equity and debt sustainability. In this context, we support staff's recommendations to strengthen fiscal revenues and fiscal anchors, develop a consolidated fiscal framework, enhance fiscal coordination across different entities and improve fiscal risk management, in particular with regard to government-related enterprises (GREs) as a source of potential contingent fiscal risks. Moreover, we agree with staff that the link between non-oil growth and fiscal revenues should be strengthened.

We agree with staff on the need for continued structural reforms to further diversify the economy away from oil, improve competitiveness and achieve a more private sector-led growth. In this regard, we welcome the authorities' ambitious economic diversification goals and the policy measures that they have already taken or are planning to take, as outlined in the buff statement. Recognizing the important role of small and medium-sized enterprises (SMEs) as drivers for diversification, job creation and innovation, we particularly encourage the authorities to foster SME development along the policy recommendations in staff's very informative Selected Issues Paper, while being mindful of potential financial stability risks that an easing of access to financing might entail. As staff points out, broadening financing options by developing domestic capital markets might help mitigating financial risks. Moreover, we share staff's view that further reducing fragmentation between national and expat labor markets as well as fostering education and training in areas important for private sector development and a knowledge-based economy would support the authorities' Vision 2021.

Ms. Levonian, Ms. McKiernan and Mr. Feerick submitted the following statement:

We would like to thank staff for their reports, including excellent selected issues papers, and Mr. Beblawi and Ms. Merhi for their helpful buff statement. Across a number of fronts, the United Arab Emirates (UAE) have demonstrated robust policy responses to the external shocks over recent years. Looking to the future, it will be important that this commitment to appropriate policy choices is sustained. We broadly agree with the thrust of staff's conclusions and recommendations.

The UAE have implemented notable fiscal reforms over recent years which, coupled with rising oil prices, have improved the medium-term outlook. Most notable amongst these were the introduction, in conjunction with other GCC states, of a VAT and excise taxes to diversify the revenue base. However, in order to ensure sustainability and intergenerational equity, a return to consolidation is warranted over the longer term, with staff assessing that a primary deficit of 7 percent of non-oil GDP is necessary. Fortunately, large financial buffers will allow a gradual phasing in of consolidation measures. As regards the shorter-term outlook, we note that growth is expected to gain momentum over the coming years with a pick-up in infrastructure investment expected to support the continued recovery. Could we ask staff the import intensity of the planned infrastructure investment and the multipliers they are assuming?

A persistent issue remains the prevalence of Government-Related Entities (GREs), which are identified as a main source of vulnerability under the DSA. We agree that privatizing nonstrategic GREs could boost productivity and that strengthening synergies between the GREs in different emirates would improve efficiency through realizing economies of scale. When looking through Article IV reports over the last number of years, there have been calls from staff and Directors to reduce their role in the economy, as a means of both boosting the private sector and managing contingent liabilities. Can staff give an indication of progress in this regard?

The banking sector appears robust but continued vigilance is warranted. We welcome the plans by the CBU to move towards risk-based supervision next year and the broad array of reforms undertaken to date, as outlined in Annex VI. We support the view that commencing issuance of domestic debt securities will help facilitate the development of domestic capital markets. Steps have been taken to enhance the AML/CFT framework, but it is clear that further strengthening will be needed to ensure continuation of important correspondent banking relationships.

On structural reforms, the authorities have a rightfully ambitious agenda, as laid out in Vision 2021, and we welcome the intent to further diversify the economy. However, specifics of timelines and scope are yet to be fully announced, and we look forward to monitoring progress in future reports. The UAE have been successful in narrowing the gender gap compared to peers, and we encourage further efforts in this regard, which could underpin an increase in potential growth rates. Finally and relatedly, we welcome the adoption of the Equal Pay and Gender Equality Law earlier this year.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well-written set of papers and Mr. Beblawi and Ms. Merhi for their informative buff statement.

We commend the authorities for their success over the past several years in withstanding external shocks, including the protracted decline in oil prices. This owes much to their increasingly diversified economy, large reserves buffers, and sound policy implementation. The economy is recovering and is projected to strengthen gradually in both oil and non-oil sectors, while inflation is expected to resume its downward slope after its brief increase in 2018 following VAT introduction. The large current account surplus is projected to peak in 2019, including from the recent strengthening in oil and gas prices, but to decline somewhat over the medium term, mainly reflecting higher remittance outflows. Risks to the short and medium-term outlook are skewed to the downside, mainly driven by rising protectionism and retreat from multilateralism, geopolitical uncertainties, and a sharp tightening of global financial conditions. We concur with the thrust of the staff appraisal.

The planned fiscal stimulus package to revitalize growth is warranted by the existing financial buffers and policy space, including the substantial foreign assets and low level of debt, which would mitigate potential risks, as underscored by Mr. Beblawi and Ms. Merhi. We welcome the recent implementation of fiscal measures aimed at diversifying fiscal revenues, including the introduction of excises and VAT. We agree with staff on the need for resuming fiscal consolidation once growth is placed on a firm footing, and welcome authorities and staff' common view on the importance of prioritization of government spending towards realizing the authorities' Vision 2021. Progress achieved in strengthening the fiscal framework is commendable, while stepped-up efforts are needed to refine fiscal anchors, develop a consolidated fiscal framework, strengthen fiscal risk management, and improve policy coordination among fiscal authorities. Close coordination between monetary and fiscal policies is crucial to contain inflation.

The banking sector is well capitalized, with adequate profitability and liquidity. Progress made in strengthening the regulatory framework and banking supervision, including by enforcing prudential norms to improve compliance and through closer collaboration between bank supervisors and the Financial Stability Department, is commendable. We welcome the recent approval of the central bank and banking law and look forward to the implementation of the remaining Basel III capital standards. We encourage the authorities to push ahead with the issuance of domestic government securities and to upgrade the CBU's liquidity management framework. We call on the authorities to strengthen the effectiveness of AML/CFT regime and to maintain vigilance against potential CBR pressures.

We commend the authorities for their ambitious vision 2021 which aims at increasing the SMEs' contribution to UAE nonoil GDP to 70 percent to support a diversified, knowledge-based economy. We are, however, surprised to note that non-oil exports are expected to increase only marginally from 2018 onward, notwithstanding the authorities' efforts at diversification. Staff may wish to comment.

With these remarks, we wish the authorities further success in their endeavors.

Mr. Fanizza and Ms. Cerami submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Beblawi and Ms. Merhi for their informative buff statement. We share the thrust of the staff appraisal and provide the following comments for emphasis and clarification.

The outlook remains positive although vulnerable to increasing downside risks, such as increased trade tensions and financial market volatility. In this context, we were surprised by the limited consideration devoted to trade sanctions. Although the report specifies that most of the sizable trade with Iran is accounted by re-exports, which have a limited impact on the current account and growth, we are concerned that sanctions might have a much larger impact via reduced banking relationships, which have reportedly already deteriorated. Could staff elaborate on the indirect effects of trade sanctions through the banking channel?

The Selected Issue Paper (SIP) on coordination of macroeconomic policies builds a clear and convincing case for developing an institutional framework that would enable closer coordination of policies among fiscal and financial sector authorities at the Emirates' and federal levels. We share staff's analysis and welcome authorities' first steps to follow up on staff's recommendations, namely the introduction of a five-year federal fiscal plan and the creation of the Fiscal Policy Coordination Council. We take positive note of the authorities' plan to continue strengthening coordination, as stated in the buff. The SIP focuses on fiscal policy, but we see merit in expanding the scope of the analysis to explore the benefits of strengthening coordination of structural policies, which are deservedly receiving great attention in the Emirates and might benefit from the consideration of cross synergies and complementarities.

We agree that an expansionary fiscal policy to support the ongoing recovery is appropriate in the near term, while a gradual fiscal consolidation should resume to ensure intergenerational equity and debt to sustainability in the medium term. To this end, we encourage the authorities to leverage on the successful introduction of the excise and value added taxes as well as on the reform of energy subsidies to consider further measures of revenue diversification, expenditure rationalization, and public-sector wage restraint. We also call on the authorities to consider staff's recommendation to collect and disclose the financial statements of all government-related enterprises (GREs), which although not explicitly guaranteed by the government, as emphasized in the report and in the buff statement, could pose fiscal risks and hinder policies coordination. Furthermore, enhancing data quality and availability on public-private partnerships would be key to improving fiscal risks management.

Significant progress has been achieved towards a more developed and stable financial sector through multiple reforms to enhance central bank independence and strengthen the regulatory, prudential, and AML/CFT frameworks. We join staff in their call for continuing to strengthen regulation and supervision and to step up efforts to improve SMEs' access to finance. We appreciated the detailed SIP on the potential contribution of SMEs to the UAE economy, which identifies several measures to promote bank and nonbank financing of SMEs, other than regulatory forbearance, thereby fostering financial development while safeguarding financial stability. In this respect, we call on the authorities to be particularly vigilant and mindful of potential risks to financial integrity, as well as financial stability and investor and consumer protection, arising from the diffusion of new technologies and nonbank credit providers.

Mr. Jin and Ms. Lok submitted the following statement:

We thank staff for the useful set of papers and Mr. Beblawi and Ms. Merhi for their helpful buff statement. We are pleased to note that the UAE economy has been able to weather through the oil price shock and non-oil growth is expected to remain robust. Looking ahead, an uncertain external environment calls for a comprehensive policy agenda and continued reform momentum to enhance resilience and sustain growth. We agree with the thrust of staff's appraisal and would like to limit our comments as follows.

Given the decentralized nature of the UAE, implementing coordinated and mutually reinforcing policies would help achieve the federation's different short- and long-term objectives in an effective and efficient manner. We welcome the authorities' efforts to improve coordination, including the introduction of a five-year fiscal framework at the federal level, and coordination of government spending plans across the Emirates by the Fiscal Policy Coordination Council. Improving data quality would also facilitate better policy formulation across the board. To this end, we take positive note that the authorities are making active efforts in addressing data gaps with the support of the Fund's technical assistance.

On the fiscal side, we share staff's view that an accommodative fiscal stance in the short term is appropriate, while fiscal consolidation should resume once recovery takes hold. We welcome the introduction of the VAT and are glad to note that compliance is reported to be high. A strengthened fiscal framework with firmer anchoring would help balance the short-term aim of stabilization and long-term objectives of achieving intergenerational equity and preserving debt sustainability.

We concur with staff that the long-standing exchange rate peg continues to serve the UAE well. The Central Bank of United Arab Emirates (CBUAE) has made positive efforts in modernizing the regulatory framework. The strengthened collaboration between bank supervisors and the Financial Stability Department to enhance stress testing and better identify vulnerabilities and emerging risks is a welcome development. With increasingly uncertain global financial conditions, vigilance is warranted, and we look forward to further progress by the authorities in safeguarding external and financial stability.

Diversification of the economy to the non-oil sectors remains a priority for the UAE, and small- and medium-sized enterprises (SMEs) play a key role in this regard. The authorities have made notable efforts in supporting the SMEs. Further efforts can be considered on several fronts, such as developing domestic capital markets, increasing the coverage of SMEs by the credit bureau, and expanding support to all SMEs. Meanwhile, it is important to strike a right balance between facilitating SME development and ensuring appropriate risk management. The use of Fintech to enhance SME access to finance, for instance, requires an adaptive and coordinated supervisory and regulatory approach to address the risks that may arise in the rapidly changing landscape. Could staff elaborate on what draft regulations are being developed by the CBUAE to encourage financial institutions to support the development of the SME sector?

We encourage further efforts to improve inclusiveness and welcome the adoption of the Equal Pay and Gender Equality Law. What are the authorities' views on staff's suggestion of considering the introduction of gender budgeting in the coming years?

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Lopetegui and Mr. Rojas Ulo submitted the following statement:

We thank staff for the reports and by Mr. Beblawi and Ms. Merhi for their helpful buff statement.

The economy of United Arab Emirates (UAE) is showing signs of recovery and, looking forward, addressing key issues will be important for continued success. In recent years the UAE´s economy was affected by the decline in oil prices, geopolitical tensions, and tightening global financial conditions. The authorities implemented adequate fiscal and financial policies and stepped up structural reforms to boost medium-term prospects and competitiveness. Looking forward, economic growth is projected to strengthen due to the fact that the real non-oil GDP growth is expected to increase from 2.9 percent in 2018 to 3.9 percent in 2019 and stabilize at 3.5 percent over the medium term, led by increased investment, foreign trade, and tourism. We support the authorities' efforts in the implementation of and deepening structural reforms, which raise productivity and lay the foundations for sustainable growth.

The fiscal policy to prioritize economic recovery in the present conjuncture and support sustainable growth is appropriate. The non-oil primary deficit is estimated to increase to 30 percent of non-oil GDP in 2018 to support the recovery, an easing allowed by large buffers. Thereafter, a gradual and continued consolidation is needed over the medium term, to ensure sufficient savings of exhaustible oil wealth for future generations. We encourage the authorities to implement policies to raise spending efficiency, transform fiscal revenues systems, and strengthen the medium-term fiscal framework, with the objective of avoiding policy procyclicality and improving fiscal risk management.

The financial system's soundness indicators have improved, supporting the performance of the economy, but further efforts are necessary to strengthen supervision. The staff report shows that financial stability indicators on profitability, liquidity, and capital buffers remain favorable. The nonperforming loans (NPLs) rose slightly, mainly driven by GREs and other large corporates; nevertheless, they remain fully provisioned. With non-oil sectors recovering, credit to the private sector has started to improve, especially in construction, trade, and manufacturing. The supervisory authorities should continue monitoring bank credit and maintain the resilience of the financial system. We concur with the initiatives to upgrade the regulatory framework and the implementation of policies to promote financial market development.

Continued modernization of the legal and institutional framework in the Financial System is necessary to mitigate the anti-money laundering and combatting the financing of terrorism (AML/CFT) risk. Given some characteristics of the economy such as openness and an increase of nonresident deposits, it is susceptible to AML/CTF risk. We commend the authorities for their efforts and initiatives to upgrade the legislative and regulatory AML/CFT framework to enhance supervision of banks, remittances, foreign exchange offices, and to assess suspicious transactions and respond to foreign requests for information. We encourage the authorities to make continued efforts to strengthen the AML/CTF framework to promote financial market stability.

We support the implementation of structural reforms to foster productivity and inclusive growth. Key challenges going forward are centered on raising potential growth through diversified and knowledge-based economic factors which require private sector-led growth over the long term. The authorities have formulated an initiative called National Vision 2021 which requires a continued deepening and broadening of reforms to boost the role of the private sector and improve competitiveness. We concur that creating an ecosystem conducive to SME development would improve economic diversification and foster innovation. We support the promotion of talent and inclusiveness through strengthening education and increasing the female labor force.

With these comments, we wish the UAE authorities and people success in their future endeavors.

The Acting Chair (Mr. Zhang) noted that the United Arab Emirates' (UAE) economy had performed solidly, thanks to strong policies, particularly in the current environment of external shocks, including oil price shocks.

Mr. Beblawi made the following statement:

On behalf of the authorities, I thank the mission chief, Ms. Tamirisa, and her team, for their hard work and constructive policy discussions with the authorities. I also thank Directors for their interest in the UAE and for their valuable advice, which I will convey to my authorities.

Most Directors praised the authorities for their prudent policies, which spurred the build-up of substantial financial buffers and enabled the economy to be well-positioned to face external challenges. The authorities are committed to pursuing their sound macroeconomic policies, and they have introduced structural reforms to further boost growth and competitiveness.

I would like to comment on a few issues that were raised in many gray statements.

On government-related entities (GREs), GRE financial positions have strengthened considerably since the 2009 crisis. In addition, the central bank has introduced regulations to limit banks' exposure to GREs, and the central bank conducts rigorous stress tests to ensure that banks are well capitalized under extreme assumptions. For instance, a recent GRE-themed stress test showed that the banking sector is capitalized enough to withstand severe shocks to the GRE sector. Other policy changes are being implemented to strengthen the oversight of GREs, such as the creation of a debt management office and requiring GREs to get approval for any new borrowing from the executive council.

There was one question on one of the investment funds that went bankrupt early this year. I want to clarify that this fund is offshore. Nonetheless, the central bank is currently working on the law for financial stability, which is expected to lay the foundations for the Financial Stability Council, enhancing coordination across onshore regulators and with offshore regulators in the free zone.

On financial coordination, the Fiscal Policy Coordination Council has been coordinating government spending plans across emirates. Considerable progress has been made to strengthen the fiscal framework, and the authorities will continue to strengthen fiscal coordination between all the stakeholders involved. The coordination between the fiscal and monetary authorities will aim at instituting a policy framework, where the central bank will be in charge of mid-term liquidity forecasting. On the High-Level Financial Policy Coordination Council, the authorities are discussing options for moving forward in this area.

Some Directors asked about the authorities' plan to improve statistics. The Federal Competitive and Statistical Authority has developed a new national strategy to standardize statistical systems for all seven emirates in line with best international practices. The national enhanced general data dissemination system (e-GDDS) page was launched in June 2018, with technical assistance from the Fund, and national and emirate-level GDP data have been reconciled. As recognized by the staff, these are two recent important achievements. There is also ongoing work to improve balance of payments statistics, and the authorities are working towards joining the special data dissemination standard (SDDS) in the next few years. The authorities agree that cooperation and information sharing between federal and emirate statistical agencies are important in this regard.

On gender budgeting, the authorities have initiated work on how to introduce gender budgeting and have asked Fund staff for technical assistance in this area.

Mr. Alkhareif made the following statement:

We thank the staff for a well-written set of reports and Mr. Beblawi for his informative introductory remarks.

We issued a detailed gray statement, but I would like to take this opportunity to commend the authorities for their reform efforts to diversify the economy, underpinned by Vision 2021. We particularly welcome the ongoing reforms to increase the size of the small- and medium-sized enterprise (SME) sector. In this context, we appreciate staff's work in the selected issues paper on the SME sector. We find the fintech analysis in the selected issues paper to be useful, particularly in Box 4.

The paper, however, mentioned some competition issues in the banking sector when it comes to banks. It states that high interest rate margins could lead to a concentration in powerful banks. The analysis is based on the Lerner index, which compares the Gulf Cooperation Council (GCC) countries with others. Given the country-specific circumstances in the GCC countries, deposits have almost zero interest, given the preference for Shari'a compliance. In this context, comparing the GCC countries with other countries, where they do not have zero deposit predominant in the banking sector, could lead to a distortive picture of competition in the GCC banking sector.

On fiscal policy, we welcome the authorities' active fiscal policies, particularly to stimulate the non-oil sector. We also agree that a gradual and growth-friendly fiscal consolidation is appropriate, given the large buffers and low debt, relative to other countries.

We are encouraged by the efforts to improve spending efficiency and diversify the revenue base. In this context, we welcome the VAT introduction early this year.

Finally, we agree that the exchange rate peg serves the economy well.

With these remarks, we wish the authorities and the UAE people all the success.

Mr. Grohovsky made the following statement:

We did not issue a gray statement, as we concur with the staff's general assessment that the UAE has achieved significant progress on reform implementation, but further policy adjustments are needed to bolster private sector growth and move away from a government-directed economy. We just want to make a few points on specific issues.

First, we welcome the staff's discussion on fintech advancement and streamlined loan processes, expanding credit opportunities for smaller enterprises. However, the current dearth of credit flowing to SMEs is at least partially attributable to GREs crowding out small enterprises with longstanding relationships in the banking sector, keeping most funds flowing to GREs. We wanted to see whether the staff has a suggested policy to address this issue, or perhaps they could expand on the discussion on the lack of competition in the financial sector.

Second, we look forward to continued improvements to the business environment, including the strengthening of the insolvency legislation, and we support the removal of criminality in the case of personal loan defaults. We feel that this will add significant support to SME creation.

We also wanted to echo the comments that were made by Mr. Jin, Mr. Trabinski, and others, to note the authorities' progress in strengthening data collection, which is commendable. We strongly support further improvements to national statistics and the compilation of quarterly GDP. We welcome the comments from Mr. Beblawi on the authorities' efforts to improve data collection and the commitment to joining SDDS.

Finally, we agree with the staff that developing a domestic debt market will have numerous benefits, including the creation of a domestic revenue mobilization yield curve that will allow for greater financial market development. However, we do not necessarily see the direct connection to increasing credit flows to SMEs, considering that it is generally large businesses that issue debt on capital markets. We wonder whether the staff could flesh out their thinking on this issue.

Mr. Feerick noted that going back to 2015-2016, the staff had consistently called for the authorities to divest the state from the GREs. He asked if there was a number for stock of GREs five years ago compared to now.

Mr. Castets made the following statement:

I thank Mr. Beblawi and Ms. Merhi for their informative buff statement and the staff for the well-written reports and their answers to our written questions.

We commend the authorities for the progress made over the recent years, notably on reducing their reliance on energy-linked resources but also in diversifying the economy more broadly. The introduction of the VAT, as also underlined by Mr. Alkhareif, is a major step, and we would like to highlight that again.

One important risk for the UAE is the evolution of energy prices. Over the recent months, there has been a lot of variation in that field. It highlights even more the need for a medium-term fiscal framework, and we thank Mr. Beblawi for his informative remarks on this issue. We would appreciate if the staff could elaborate on whether they intend to review their growth projections for 2019, given the current context.

Mr. Daïri made the following statement:

We thank the staff for their excellent papers and Mr. Beblawi and Ms. Mehri for their informative buff statement.

We commend the authorities for their success over the past several years in withstanding external shocks, including the protracted decline in oil prices. We are particularly impressed by their efforts at diversification. If we look at the balance of payments, oil and gas products now account for maybe 35 to 40 percent of total exports, even if we exclude re-exports. This is quite a strong performance.

We raised a question in our statement about the modest projections for non-oil exports in the coming years. The staff has mentioned that there were some problems in terms of diversification and that diversification takes time to bear fruit. I am somewhat surprised by this response because the results are here already. Is there anything that they are not doing? Have the authorities paused in their diversification efforts? Even for the past three or four years, there is not much of an increase in non-oil exports. Maybe the international environment was not favorable for that. But the world economy has strengthened somewhat, so I am surprised to see this modest increase. I would appreciate the staff's indication of whether they see any pause in the authorities' diversification efforts because, if not, we would expect a much stronger increase in non-oil exports.

I would also refer to the significant increase in remittance outflows. It reflects a dynamic economy, employing workers from the the south Asian area, which is good. But the authorities have to take this into account in their projections for the future, because if exports do not grow much stronger than they are now, these remittance outflows may put pressures on the balance of payments. It is preferable to avoid this because there is so much at stake, not only for the UAE but also for its partners.

The staff representative from the Middle East and Central Asia Department (Ms. Tamirisa), in response to questions and comments from Executive Directors, made the following statement:[5]

I thank Mr. Beblawi and Ms. Mehri and the staff in their offices for their support and cooperation during this consultation. I also would like to thank my team for their hard work, and the staff from other departments of the Fund and the UAE authorities, who worked very closely with us as we prepared our reports.

The UAE's strong policies, diversified economy, and large financial buffers have helped it deal with the recent shocks. Their economy is starting to recover now, but there are downside risks, mainly from protectionism, financial market volatility, and geopolitics. The authorities are prioritizing the recovery now. They are also taking steps to further improve the resilience of the economy and raise medium-term growth prospects. When the recovery takes hold and private sector activity strengthens, the authorities intend to return to the path of fiscal consolidation to ensure intergenerational equity. We support this strategy.

The questions posed by Directors covered a broad range of topics. We have provided written answers to most of the questions. I would like to cover the remaining few questions now, focusing on topics of general interest: fiscal policy, borrowing by GREs, and the real estate sector. After that, I will address the additional questions that were raised by Directors.

Mr. Agung and Mr. De Lannoy asked about our fiscal policy advice, particularly the reasons for recommending an easier fiscal policy this year compared to last year's Article IV consultation. The change in our fiscal policy advice reflects the less favorable developments in non-oil growth. Despite higher oil prices, non-oil growth outcomes in 2017 were significantly below expectations: 2.5 percent compared to 3.3 percent at the time of the 2017 Article IV. The forecast for 2018 is a half percentage point lower. Given the slower pace of recovery and negative non-oil output gap and headwinds from rising global interest rates, we see merit in a temporary easing of fiscal

[5] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

policy. Large financial buffers, which the authorities accumulated in good times, and low sovereign debt allow the authorities to do so without jeopardizing fiscal sustainability.

Mr. Kaya and Mr. Zaborovskiy asked the staff to clarify the desirable fiscal stance, given high uncertainty about oil prices and non-oil GDP dynamics. Our fiscal policy recommendation of easing in the short run to support the recovery and, once the recovery takes hold, returning to the path of fiscal consolidation, is predicated on the current baseline forecast. If non-oil growth were to turn out to be significantly weaker than projected, we see the case for easing the fiscal stance further; for example, by bringing forward the fiscal stimulus that the authorities announced recently. The start of the fiscal consolidation may need to be delayed. For oil prices, we support not changing the fiscal stance in response to changes, saving the windfall and not tightening if prices fall further, in order to avoid amplifying the shocks.

Mr. Kim and Mr. Amor asked about the financial situation of Dubai's GREs and the risk of spillovers to sovereign and other financial markets. Mr. Beblawi responded to this question. I will add a few more points.

Data limitations hinder a comprehensive assessment of GREs' balance sheets and performance. We use partial data provided by the authorities and collected from public sources. This available data suggests that, following the Dubai crisis and the decline in oil prices in mid-2014, GREs have been deleveraging and restructuring, and their efficiency has likely improved.

Domestic borrowing by GREs has declined in recent years, although this decline might have been partly compensated by the increase in external borrowing. Given the still high GRE debt, rising global interest rates may present refinancing risks for some GREs. But so far, they have not experienced any difficulties. Most GRE debt is not explicitly guaranteed by the government. Large financial buffers should limit their impact on fiscal sustainability and sovereign bond yields if the government needs to step in to support any systemic GREs. Moreover, the authorities have strengthened GRE monitoring in the recent years; for example, by requiring government approval of GRE borrowing, as Mr. Beblawi mentioned. The staff welcomes these efforts. We recommend continued improvement in the monitoring and analysis of risks from contingent liabilities from GRE borrowing.

Mr. Palei and Mr. Potapov asked about risks from declining real estate prices. The real estate market has been softening for several years now. The supply of real estate is rising, especially in Dubai, in preparation for Expo

2020; while demand, both from domestic and external sources, has weakened. This is in part because of a broader adjustment to a prolonged decline in oil prices. Banks' exposure to real estate and construction loans is around one-fifth of their total deposits. This is the legal limit that helps contain potential adverse spillovers to the banking sector and to the economy. There are also other macroprudential measures in place, including loan-to-value ratios and debt-to-income limits. Requirements on minimum financing from developers, which were introduced after the Dubai crisis, also help contain the risks. This being said, the staff recommends continued vigilance in monitoring real estate exposures and avoiding a relaxation of prudential measures.

Let me turn to answering the questions that were raised in the Board.

Mr. Alkhareif suggested looking more carefully into the measures of competition in the banking sector. We appreciate this point. We will see how we could refine these measures, taking into account the Islamic financing component in the banking system.

Mr. Grahovsky raised a question about potential GRE crowding out and also the lack of competition and what implications it has for SME lending. There is evidence of declining borrowing by GREs from the domestic banking system, so this should create additional space for SME lending. But as we discuss in our selected issues paper, there are a number of obstacles that hinder the access of SMEs to finance. We hope that the recent steps that the authorities have taken through the SME Council and the High-Level Commission on SME lending, the measures that these new councils would propose would help address some of the specific impediments.

On the domestic debt market, we agree that perhaps there will be fewer benefits to microenterprises and small enterprises. However, medium-sized enterprises potentially could benefit from financial market development and additional instruments of non-bank financing that could emerge if there is a curve for sovereign yields.

Mr. Feerick asked about progress in reducing the role of the public sector. Overall, the number of GREs has not changed in recent years. It is about 200 companies, according to the information we have from the authorities. But we do see evidence of increased private participation and an increased contribution to GDP. But as we emphasized in the report, precise data on GREs are difficult to come by, so that is the area where we continue to work with the authorities on improving data.

> Mr. Castets asked about the possibility of changing our 2019 projections in light of the recent oil price developments. We regularly review our forecasts. The next point for us would be the World Economic Outlook (WEO) forecasting round in preparation for the January WEO update. At that point, we will reconsider our forecasts, especially as the oil price baseline may change.
>
> Mr. Daïri raised a number of questions about balance of payments. Non-oil export forecasts are subject to uncertainty. We prefer to be a bit more conservative in estimating the likely impact from diversification efforts. But certainly, there are positive trends, both in goods but also in services exports. The authorities, under their Vision 2021 program, are emphasizing knowledge-based services and a knowledge-based economy. That is the area where further progress can be expected.
>
> On remittances, the remittances outflows reflect the nature of the UAE economy, which highly relies on expatriate labor, especially in the private sector. The authorities are making efforts to improve education, to invest in human development, and also is encouraging nationals to take jobs in the private sector. As these efforts bear fruit in the coming years, this will have implications for remittance flows.

Mr. Daïri remarked that he had not questioned the rising remittances, but had been making the point that since remittances were projected to increase, it was even more important to diversify exports.

Mr. Etkes remarked that the forecast was based on the WEO published in October, and asked whether it was the case that the staff had used oil prices from September or October.

The staff representative from the Middle East and Central Asia Department (Ms. Tamirisa) responded in the affirmative.

Mr. Beblawi made the following concluding statement:

> I would like to come back to the question on remittances. Over and above what has been said about the need of the country to attract the best workers in the region, we should not underestimate the importance of some regional public goods. Without the remittances in the Middle East, political stability would have been greatly disturbed. In a way, what is happening in the Middle East with the remittances between oil-producing and non-producing countries greatly reflects what happened after the Second World War, when

people from outside Europe helped bring back [gold?]. Otherwise, the region would be exposed to great political uncertainty and instability. In a way, it is a regional public good that helps the whole region overall.

The Acting Chair (Mr. Zhang) noted that the United Arab Emirates is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their strong policies which, together with large financial buffers, have helped the U.A.E. tackle the challenges that the economy has been facing, particularly from the decline in oil prices. Directors welcomed the improved economic prospects but noted that downside risks to the outlook have risen. They welcomed the authorities' commitment to push forward additional fiscal and structural reforms aimed at further raising productivity, improving competitiveness, and boosting diversified, private-sector-led growth.

Directors agreed that the main fiscal policy priority is to support economic growth in the short term and resume fiscal consolidation once the recovery takes hold, to ensure sufficient savings of exhaustible oil revenue for future generations and debt sustainability. They welcomed the efforts to strengthen the fiscal policy frameworks and coordination, noting the importance of continuing progress in this area to realize the authorities' socio-economic Vision 2021 agenda, avoid policy procyclicality, and improve risk management. Directors also highlighted the need to gradually broaden the VAT base and prioritize expenditure, including containing the wage bill. In addition, they emphasized the importance of increasing supervisory vigilance and strengthening management of contingent liabilities from borrowing by government-related enterprises, government guarantees, and public-private partnerships.

Directors welcomed the progress made by the central bank to modernize the regulatory framework. They noted that the exchange rate peg continues to serve the economy well. Directors recognized that the financial sector remains highly capitalized and continues to perform strongly. However, the rising non-performing loans warrant vigilance. They welcomed the measures being taken to update the existing regulations to strengthen the prudential framework. Directors also welcomed the enhancements to the AML/CFT framework and looked forward to continued efforts in this regard.

Directors agreed that a wide-range of reforms are important to stimulate growth, improve the business climate, increase the role of the private sector, and diversify the economy. They welcomed the recently announced reforms, including the liberalization of foreign investment, and encouraged the authorities to swiftly implement them, while broadening and deepening policy initiatives to enhance productivity and competitiveness. Continued efforts to foster small and medium-sized enterprises will also be important.

Directors commended the implementation of the Enhanced General Data Dissemination System and other steps to improve economic statistics. They encouraged further progress, including on improving labor, fiscal, national accounts, and international investment position statistics, to facilitate decision-making and enhance transparency.

It is expected that the next Article IV consultation with the United Arab Emirates will take place on the standard 12-month cycle.

APPROVAL: April 21, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Could staff elaborate on the divergence between staff's and the authorities' assessments of financial conditions in the UAE?***

- Staff agrees with the authorities that structural liquidity conditions in the banking sector are comfortable, and credit growth has strengthened. Staff also uses a broader metric of financial conditions, which picks up effects of additional factors, such as rising interest rates, tightening spreads, appreciating exchange rate, and declining real estate and stock prices.

2. ***Is staff concerned regarding possible spillover effects of US sanctions on Iran? Could staff elaborate on the indirect effects of trade sanctions through the banking channel?***

- The re-imposition of the sanctions is not expected to have a large impact on the UAE economy and financial sector. Tourist arrivals from Iran declined this year, and so did real estate investment and trade. However, Iran's share in the UAE's overall trade is less than 10 percent and is mostly comprised of re-exports. Moreover, UAE firms apparently have not expanded their exposure to Iran after the removal of the sanctions in 2016, which should limit the impact of the sanctions' snap-back. Banks could be exposed to be pressures on their correspondent banking relationships if they fail to implement the necessary AML/CFT control measures to mitigate heightened money laundering/terrorist financing/proliferation financing risks. To detect any such potential pressure on correspondent banking relationships, staff recommends that the UAE should continue to closely monitor banks' CBRs.

3. ***Private demand seems to be slowing in Dubai – we would welcome the staff assessment on this, including the impact on the retail sector.***

- There are indeed signs of softening in private demand in Dubai, including slowdown in tourist arrivals, declines in cargo traffic, and in real estate and stock prices, and weakness in employment. However, profit margins in the retail and hospitality sectors apparently have provided some cushion for local businesses to absorb declines in demand through price discounting. Stepped-up preparations for Expo 2020 are expected to support private sector demand going forward.

4. ***Could we ask staff the import intensity of the planned infrastructure investment and the multipliers they are assuming?***

- While there is considerable uncertainty about growth multipliers of infrastructure investment, staff uses short-term multipliers of 0.3-0.5 and long-term multipliers of 0.5-0.7, in line with regional estimates. Import intensity of infrastructure investment in the UAE is generally high, although the authorities' focus on diversification and increasing local participation may augment on the impact on growth in the future.

5. ***We invite staff to elaborate on sectoral growth prospects in the UAE.***

- In the next few years, growth will likely be driven by the oil sector. Increased public investment in the run-up to Expo 2020 and the implementation of Abu Dhabi's stimulus package are likely to strengthen growth in a variety of sectors, including construction, logistics and transportation. Expo 2020 is likely to boost tourist arrivals and activity in the transportation, hospitality and retail trade sectors. The financial sector will continue to benefit from rising interest rates. Over time, contribution of the private sector to growth is expected to rise, helped by the authorities recently announced structural reforms, particularly liberalization of foreign investment and resident visas.

6. ***We are, however, surprised to note that non-oil exports are expected to increase only marginally from 2018 onward, notwithstanding the authorities' efforts at diversification. Staff may wish to comment.***

- Slower growth in non-oil exports reflects the expected softening in partner-country growth. In addition, regional geopolitical tensions are expected to weigh on non-oil growth prospects. Realizing the export growth dividend from the diversification agenda will take time.

7. ***We note the authorities being more optimistic about non-oil growth as compared to staff, backed by the planned fiscal stimulus and pick-up in private credit. Staff comments are invited on this divergence.***

- The authorities and staff agree that the recently announced reforms and the stimulus plans will have a positive economic impact. In staff's view, however, this impact will materialize more gradually because of the time needed to identify and implement specific stimulus measures and for these measures to have an impact on growth. The authorities' recent announcements that the implementation of Abu Dhabi stimulus plan will begin only next year appear consistent with staff's view.

Fiscal Policy and Debt Management

8. ***We note that the 2017 staff report emphasized the need for continued fiscal consolidation, while this year staff endorse a short-term fiscal easing despite higher oil prices and stronger real GDP growth. Could staff elaborate?***

- Staff will respond to this question during the Board meeting.

9. ***We would have preferred a more nuanced discussion in the report about the desirable fiscal stance vis-a-vis the business cycle, including the analysis of structural fiscal indicators. Considering the high uncertainty around the oil price and non-oil GDP dynamics, the recommended fiscal consolidation over the medium term may not be achievable and turn out to be pro-cyclical. Staff's comments are welcome.***

- Staff will respond to this question during the Board meeting.

10. ***To boost non-oil GDP growth the fiscal stimulus package should be appropriately targeted and implemented, including by strengthening public investment management. Could staff comment on the recent progress in this area?***

- The authorities have announced strategic areas for the fiscal stimulus and are working to identify specific stimulus measures. Advisory councils have been created to ensure appropriate project selection. Public investment programs across emirates are increasingly being coordinated, creating synergies and efficiency gains. The authorities are also increasing access of domestic SMEs to public contracts, which should help improve competition and efficiency. The Abu Dhabi authorities have announced plans to adopt a new law on public-private partnerships to better leverage public investment and increase private sector participation. (Dubai has already adopted such a law.)

11. ***Staff has placed much emphasis on the improving policy coordination among the authorities and developing a consolidated fiscal framework for UAE. In this context a High-Level Financial Policy Coordination Council supported by a technical Secretariat has been underscored. Could staff offer more details on the specific stakeholder feedback and the traction with the authorities?***

- The study was produced on the authorities' request and benefitted from their extensive feedback at various stages of the project. The authorities indicated their intention to discuss options for moving forward in this area at their upcoming Annual Government Meetings. Staff stands ready to continue to support the authorities in their efforts to improve policy coordination, both through policy advice in the context of bilateral surveillance and technical assistance.

12. ***As the UAE's infrastructure ranks highly on business environment indicators while human capital remains a challenge, we invite staff to comment on how the authorities should balance their spending between physical and human capital investments.***

- Staff agrees with the need for diversifying public investment to increase its productivity. The authorities' Vision 2021 envisages more emphasis on education and human capital development, to support transition to a knowledge-based economy. The government has been increasingly focused such as artificial intelligence, alternative energy sources, and high-tech areas, including space exploration.

13. ***We also welcome staff's recommendations to analyze alternative revenue models, including the introduction of corporate income taxation, and would appreciate additional comments on the authorities' views on this proposal.***

- Staff recommended a comprehensive assessment of the existing fee-based revenue system. A gradual move to a revenue system based on VAT and corporate income taxation, which is likely to be less regressive and more conducive to private investment and SME development, would be beneficial in the longer term. The authorities agreed with the need to examine these issues but preferred to await the results of their own diagnostic studies—being conducted in both Dubai and Abu Dhabi—which are aimed at a review and rationalization of the existing fees. The authorities also would like to gain more experience with the newly introduced VAT before making further changes to their revenue model.

14. ***While understanding the authorities' explanation that GRE debt is not guaranteed by the Dubai government, we would like to ask staff's assessment on operational efficiencies and financial situations of Dubai's GREs and the possibility of their spill-over to the government debt and financial markets.***

- Staff will respond to this question during the Board meeting.

15. ***We note differences between staff and the authorities regarding contingent liabilities associated with government-related enterprises, which are flagged in the report as an important source of vulnerability. We agree with the measures proposed by staff to address this problem and would be interested to hear more details from staff about the concrete actions the authorities are planning to implement.***

- The authorities have already strengthened some aspects of fiscal risk management, for example by requiring government approvals for new borrowing by GREs. Improvements have also been made in GRE reporting, such as stricter requirements to submit and, in some cases, seek advance government approvals of business and investment plans. The authorities are also considering initiating the work on constructing the UAE's public sector balance sheet.

16. ***Can staff further explain the relatively sizable contribution of the residual to changes in the public debt dynamics, especially taken into account the existing exchange rate peg (page 35, public DSA)?***

- The large residual in public debt dynamics mainly reflects savings of oil revenue stemming from primary surpluses projected from 2019 onwards. When a primary surplus is not used to reduce public debt, it is reflected in the residual. In addition, the residual also reflects the country-specific features of the UAE: the link between primary fiscal balances and overall general government debt is weaker in the UAE because most of public debt is owed by Dubai while fiscal surpluses and savings take place in Abu Dhabi.

17. ***A persistent issue remains the prevalence of Government-Related Entities (GREs), which are identified as a main source of vulnerability under the DSA. We agree that privatizing nonstrategic GREs could boost productivity and that strengthening synergies between the GREs in different emirates would improve efficiency through realizing economies of scale. When looking through Article IV reports over the last number of years, there have been calls from staff and Directors to reduce their role in the economy, as a means of both boosting the private sector and managing contingent liabilities. Can staff give an indication of progress in this regard?***

- The authorities are increasing private sector participation in public enterprises, e.g. through IPOs, and have indicated their intention to continue to do so. In 2017, the Abu Dhabi National Oil Company (ADNOC) sold 10 percent of its distribution unit through an IPO. ADNOC's medium-term strategic plan also envisages increased private sector participation through joint ventures. The UAE's sovereign wealth funds have also been divesting shareholding in companies under their ownership. Many GREs have been restructuring their operations and deleveraging. Alongside, management of contingent liabilities has been improving, for example, with explicit requirements for government-related enterprises to seek government approvals for new borrowing and putting in place frameworks for PPPs.

External Sector and Exchange Rate Policies

18. ***Can staff explain the method used for evaluating the level of labor market flexibility required to support the peg? Is the labor market for nationals also considered sufficiently flexible?***

- Labor market flexibility in the UAE context reflects the ease in hiring/firing expat personnel, which accounts for a significant share of employment in the UAE, especially outside government agencies. The labor market for nationals is not flexible—but it is also small as a share of total employment and the size of the economy and is concentrated in government.

19. ***We are somewhat surprised that a 30 percent real depreciation shock is examined in the external debt sustainability test (p. 41), given that the Emirati dirham's exchange rate vs. the USD has been fixed for two decades. We would appreciate staff's elaboration on the basis for the parameter set as it would be more meaningful if stress tests are tailored to the examined economy.***

- The risk of real depreciation is pertinent for the UAE economy because of its openness and reliance on trade and tourism. In addition, the real exchange rate also affects external demand for real estate in the UAE, which is significant. The magnitude of the shock, while being large from the historical, UAE-specific perspective, is comparable to shocks experienced in other countries. It helps ensure that staff's debt sustainability assessment is sufficiently rigorous, especially given data limitations on the coverage of external debt. Even with such a large shock, the UAE's external debt is sustainable.

Financial Sector

20. ***The recent bankruptcy of an investment fund (Abraaj) recall the importance of adequate supervision of offshore entities. Does staff identify any shortcomings in this regard?***

- Staff agrees with the need to continue to strengthen supervision of off-shore entities and improve corporate governance and transparency. The Abraaj case underscores the need for continued vigilance in these areas. Based on our discussions with the authorities, the Dubai Financial Services Authority has been stepping up efforts in all these areas. The Central Bank of the UAE also has a broad-ranging agenda for upgrading regulation and supervision, including in corporate governance, AML/CFT areas, etc.

21. ***We would appreciate staff's further comments on the main drivers for the increased level of NPLs.***

- Whereas the increase in NPLs in 2016 was mostly driven by SMEs, the increase in 2017 appears to reflect weaknesses in the corporate sector, including GREs. Overall NPL ratio currently stands at 7 percent. Sectoral composition points to trade, construction, real estate, and personal loans as sectors where loan delinquencies are above average.

22. ***Can staff elaborate on any estimates of possible house price misalignments in the UAE? Do staff see oversupply risks in the housing market?***

- It is difficult to quantify the extent of misalignment in real estate prices because of data limitations, as well as structural shifts due to the Dubai crisis. After recovering from the post-crisis lows, real estate prices have declined in recent years, in part owing to rising supply in Dubai in preparation for Expo 2020 and lower demand amid an economic slowdown caused by a prolonged decline in oil prices since 2014. Nonetheless, real estate prices still remain somewhat above their end-2013 levels (prior to the oil price shock) and the long-term historical average of 2003-17. Moreover, declining average real estate prices are partially symptomatic of the shift toward budget-friendly housing. Nonetheless, real estate prices remain above the troughs experienced during the Dubai crisis. The recent decline in real estate prices also has been observed in other countries in the GCC region.

23. ***What kind of impact can falling real estate prices have on the banking and real sectors?***

- Staff will respond to this question during the Board meeting.

24. ***The authorities should be commended for the progress made in strengthening the AML/CFT regime. We also encourage them to further enhance the effectiveness of the regime including by improving the understanding of the risks related to nonresident financial flows. Furthermore, the Central Bank close supervision of the remittance sector in collaboration with key stakeholders is important and we would be interested to know whether there are any lessons learned or best practices that can be drawn?***

- The Central Bank has recently increased its AML/CFT supervision of licensed money remitters (MVTS). It is also taking steps to reduce the size of the informal remittance operators (hawaladars) by attempting to bring them into the formal economy. These efforts include requiring halawadars to register voluntarily and apply minimum AML/CFT requirements, combined with efforts by law enforcement agencies to close non-registered operators. Although the voluntary registration has been an important first step, this system needs to be formalized, including by bringing hawaladars under the UAE's AML/CFT regime and vesting the Central Bank with sufficient powers to inspect and sanction halawadars for non-compliance with AML/CFT requirements. Staff encourages the UAE to continue those efforts.

25. ***Given the heightened risks from GREs and real estate prices, do staff see the need for an FSAP update to analyze financial stability risks deeper?***

- Staff agrees that an FSAP update would be timely. The authorities prefer to complete their agenda of regulatory upgrading first.

Structural Reforms

26. ***Further to staff's interesting discussion of measures to boost SMEs' access to credit, we would add that a more pressing upstream issue would perhaps be their inability to open a bank account (para 7 of the SIP), which staff have linked to banks' AML/CFT compliance costs. Could staff comment on possible solutions to this problem?***

- Staff recognizes that applying an overly cautious, non-risk-based approach to AML/CFT safeguards can have the unintended consequence of excluding legitimate businesses and consumers, including SMEs from the formal financial system. This can result from a poor understanding of ML/TF risks by both regulators and financial institutions. To address this concern, staff urges the authorities to continue improving their understanding of ML/TF risks and to provide guidance to banks on the appropriate application of a risk-based approach. The development and application of risk-sensitive and proportionate AML/CFT frameworks are a key step that seeks to build a more inclusive regulated financial system, enable SMEs to access appropriate financial services, and can reduce the scope of transactions conducted through the informal financial system without compromising the effectiveness in combating financial crimes.

27. ***Could staff elaborate on what draft regulations are being developed by the CBUAE to encourage financial institutions to support the development of the SME sector?***

- Staff's understanding is that the new regulations will strive to focus on encouraging market-based mechanisms of SME support without compromising financial stability or requiring regulatory forbearance, although staff does not have specific information on the draft regulations.

28. ***What are the authorities' views on staff's suggestion of considering the introduction of gender budgeting in the coming years?***

- The authorities indicated their intention to move ahead in this area with support of the Gender Balance Council. They have requested technical assistance from the Fund to help guide the process. FAD is exploring ways to provide the necessary support to the authorities.