UNITED ARAB EMIRATES

As low oil prices have persisted, the economy has slowed further, with growth projected at 2.3 percent in 2016 (down from 4.7 percent in 2013). Despite significant reforms, the fiscal deficit has widened and external balances deteriorated. However as projected oil prices trend upwards and production rises, growth is expected to pick up in the medium term. Tight fiscal policy will hold back government expenditure growth while simultaneously developing new revenue sources, thereby reversing the fiscal deficit.

Recent developments

The UAE's economy continues to slow down as a result of low oil prices and fiscal consolidation weighing on non-oil growth. Overall real GDP growth is estimated at 2.3 percent in 2016, a significant drop from the pre-2014 oil shock average of 5 percent (2010-14). Austerity measures weakened business and consumer confidence and slower growth in credit to the private sector. This is expected to result in lower non-oil growth estimated at 2.4 percent in 2016. Hydrocarbon GDP growth is also expected to slow down to 2 percent in 2016 from an estimated 4.6 percent in 2015. The average rate of inflation is estimated to ease to 3.3 percent in 2016 from 4.1 percent in 2015.

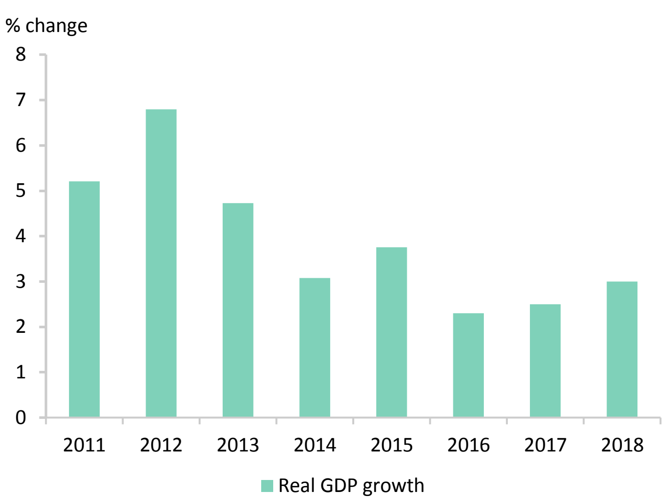
Sustained low oil prices have led fiscal and external balances to deteriorate, despite significant fiscal consolidation efforts. Authorities have managed some fiscal consolidation by raising electricity and water tariffs, removing fuel subsidies and scaling back capital transfers to Government Related Entities (GREs). Abu Dhabi reduced reliance on government deposits and issued a US$5 billion Eurobond in April. Despite these measures, the drop in hydrocarbon revenues has pushed the fiscal balance down from a comfortable surplus of 10.4 percent of GDP in 2013 to an estimated deficit of 2.1 percent in 2015 and 3.5 percent in 2016. The Abu Dhabi and Dubai sovereign wealth funds have recorded lower returns (3 percent y-o-y fall in 2015 net profits) resulting from global volatility. The current account surplus also fell from 19.1 percent of GDP in 2013 to 3.3 percent in 2015 and an estimated 1.3 percent of GDP in 2016.

Monetary policy is tightening, as is liquidity in the banking system. The central bank raised its policy rate by 25 basis points in December in response to the US Federal Reserve rate increase and is expected to continue mirroring the Fed's rate movements. Reduced government deposits are resulting in lower liquidity in the banking sector with deposit growth decelerating to 1.8 percent y-o-y at end-March 2016. A recent Credit Sentiment Survey revealed that banks are increasingly unwilling to lend, especially to SME's.

Dubai's property market continues to soften but does not pose a systemic risk. Average real estate residential prices fell by 11 percent in 2015. Increased supply and weakening demand amidst financial tightening resulting from low oil prices have led to office rents falling by up to 10 percent in Q1 2016. Nevertheless, continued demand in established free-zone developments is sustaining non-oil growth and the real estate loan portfolio remains resilient.

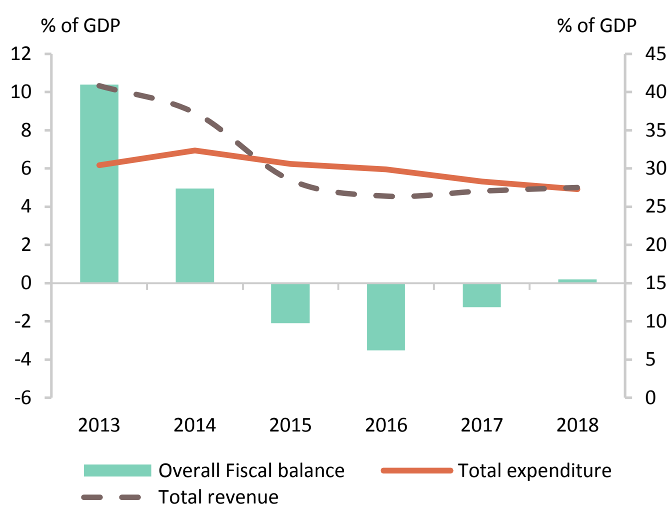
The UAE is yet to fully develop its capacity for a comprehensive measurement and analysis of household welfare across its seven Emirates. Each Emirate has an independent statistics agency, and while the federal-level statistical bureau was established in 2009, the harmonization of methods and statistical agendas for a country-level welfare measurement is yet to be accomplished.

FIGURE 1 United Arab Emirates / GDP growth rate (percent per annum)



Sources: UAE authorities and World Bank Staff estimates.

FIGURE 2 United Arab Emirates / Government operations (as share of GDP)



Sources: UAE authorities and World Bank staff estimates.

Outlook

Growth is expected to slowly recover, reaching 3 percent in 2018. Oil production is expected to rise due to investments in oilfield development. Non-oil growth is also projected to rebound (i) as the expected improvement in oil prices and its positive effects on confidence and financial conditions dampen the effects of fiscal consolidation; (ii) as megaproject implementation ramps up ahead of Dubai's hosting of Expo 2020; and (iii) as the lifting of sanctions on Iran translates into increased trade. Fiscal and external balances are expected to improve over the medium term; with a reversal of the fiscal deficit expected and a rebound in the current account surplus to 3.2 percent of GDP by 2018.

Progress in economic diversification, large buffers and safe-haven status have strengthened the resilience of the economy. The UAE is expected to implement a GCC-wide value added tax (VAT) by 2018, and is considering increasing excise taxes and introducing corporate tax. Despite pressures key investment areas will be maintained, as evident by the recently announced nuclear energy project. Abu Dhabi's aerospace manufacturing has secured contracts with Airbus and Boeing, underscoring its commitment to diversification. New bankruptcy and investment laws are also being prepared with a potential positive impact on investment. In addition, as anxiety looms over the impact of UK's decision to leave the EU, according to a survey of financial investment professionals Dubai's competitiveness as a financial hub is not expected to be affected.

Risks and challenges

However, macro-financial risks are increasing; the financial management of GRE's megaprojects on the domestic side, and further sustained drop in oil prices on the external side. In an environment of low oil prices, macro-financial risks could be exacerbated by declining liquidity in the banking system, increased volatility in the stock markets, and disruptive declines in the real estate sector. Further, imprudent management of Dubai's megaprojects could be a source of macro-financial risks for its GREs, its banks, and ultimately the government. In this context, the recent hike in interest rates in the US could lead to a tightening of financial markets and increase the costs of financing.

Structural reforms are needed to support the move towards a knowledge based economy as envisaged by Vision 2021. Easing SME access to finance and innovation financing should be a priority. Reforming labor admissions policies is key for private sector job creation since under the current sponsorship system expatriate labor mobility is limited leading to large-scale importation of expatriate workers, wages below marginal productivity and lower incentives to upgrade skills. This in turn negatively affects productivity, technology choice, and contributes to making nationals uncompetitive in the private sector.

TABLE 1 United Arab Emirates / Macro outlook indicators (annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	4.7	3.1	3.8	2.3	2.5	3.0
Private Consumption	-1.6	25.3	-12.0	2.1	2.4	3.2
Government Consumption	23.2	5.8	16.6	-0.9	-0.5	2.5
Gross Fixed Capital Investment	11.5	8.3	10.6	3.0	4.5	9.5
Exports, Goods and Services	5.1	0.2	3.4	1.3	2.5	4.0
Imports, Goods and Services	6.5	12.3	-1.2	1.7	3.0	3.2
Real GDP growth, at constant factor prices	4.7	3.1	3.8	2.2	2.1	3.8
Agriculture	-0.5	1.9	3.1	0.5	0.1	0.2
Industry	1.1	1.6	4.6	1.1	1.8	3.1
Services	7.4	4.1	3.2	2.9	2.3	4.3
Inflation (Consumer Price Index)	1.1	2.3	4.1	3.3	2.8	3.1
Current Account Balance (% of GDP)	19.1	10.1	3.3	1.3	3.0	3.2
Fiscal Balance (% of GDP)	10.4	5.0	-2.1	-3.5	-1.3	0.2

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: f = forecast.