

The uae monetary system



**ASSIGN
BUSTER**

In an open and emerging economy like the United Arab Emirates, a clear-cut monetary system is needed to be able to conduct a successful and efficient trade. A monetary system is defined as “ set of mechanisms by which a government provides money (cash) in a country’s economy.”

By virtue of the 1980 Union Law No. 10, the Central Bank of the UAE (CBU) controlled the monetary system of the United Arab Emirates. The CBU was to be the “ bank of banks” who enforces provisions of the law, sets regulations, and issues policies, circulars for the maintenance and sustenance of the UAE economy. The same law also put into circulation the Emirian dirham (AED) which replaced the Qatari/Dubai dinar and the riyal as currency of the UAE.

The 2003 IMF ROSC reveals that the CBU ranked among those banks with best banking practices . Despite this honor, the CBU has its weaknesses namely in the transparency in reporting the amount and the process involved in annual net profits. Though, CBU may lack in this area it already has the media to implement this: Statistical Bulletins, Annual Reports, and the CBU website itself, which is constantly updated.

The UAE dirham is linked to the US dollar and much of UAE goods and services are sold in dollars; thereby, causing less fluctuations in its monetary values. However, the UAE does not have control over its contractionary policy, thus, it cannot also control inflation rates. On the other hand, both the IMF and an independent analyst see this in a positive light in relation to UAEs persistent economy, at least for the medium-term.

Keywords: monetary system, monetary policy, Central Bank of UAE, currency

The Monetary System of the United Arab Emirates

The United Arab Emirates, as in the other states of the Gulf Cooperating Council (GCC), engage in an open and free economic system; thereby, encouraging businesses from all over the world to invest in its emirates, particularly in Abu Dhabi and Dubai. To successfully and efficiently conduct trade with their world partners, the UAE employs a monetary system, or a medium of exchange.

There are several definitions for what a monetary system is. Financial Times Lexicon defines a monetary system as “ the system of money in a particular country or the world as a whole, and the way that it is controlled by governments and central banks.” On the other hand, BusinessDictionary.com labels a monetary system as a “ set of mechanisms by which a government provides money (cash) in a country’s economy.” This set of mechanisms is not limited to a mint but also encompasses a central bank which in turn regulates local and foreign commercial banks.

The Central Bank of the UAE

The Central Bank of the UAE (CBU) operates most of the mechanisms and procedures of the UAE monetary system. CBU was created per Union Law No. 2 of 1973 on May 19, 1973, then known as the UAE Currency Board, and was tasked to replace with a national currency the dinar of Bahrain and the riyal of Qatar and Dubai, which were still in circulation after the Union of Emirates was established in 1971. Thereafter, the 260 million UAE dirhams replaced a total of 131 million riyals and 12. 9 million dinars. The rate for the exchange is one dirham for one riyal and 10 dirhams per 1 dinar.

Although, the function of the Currency Board is limited to issuing the dirham and making sure that it is fully covered in both gold and foreign currencies, it guaranteed both the organization of UAE banking and set up rules governing sound banking business with the aid of the International Monetary Fund (IMF).

In December 10, 1980, the Currency Board issued the Union Law No. 10 of 1980, which officially changed it to the Central Bank of the UAE. The said law drafts the functions of the Central Bank, its monetary system, and its organization of banking in order to support the country's fast growing economy.

The passage of 1980 Union Law No. 10, which authorized the CBU to systematize, supervise and implement its monetary, credit and banking policies, supported its financial and economic stability. The 2003 IMF ROSC cites these CBU authorizations:

Issuing the dirham currency according to the provisions of the law;

Ensuring for the support of the currency as well as its stability and free convertibility;

Assuring a credit policy which will aid in a balanced economic growth;

Organizing, developing, and monitoring the efficiency of UAE banking systems;

Serving as the government bank through: a) offering financial advices to the Government; b) sustaining government reserves in gold and in other

currencies; c) handling all state transactions with the IMF and WB as well as other institutions, and the Arab/International Monetary Funds; and

Stands in as the “ bank of the banks” operating in the country.

CBU Gov. Sultan Bin Nasser Al Suwaidi (2010) reaffirms the bank’s role in maintaining a fixed exchange rate of the dirham against the US dollar and ensuring that the dirham could be converted to other foreign currencies.

Since the passage of Union Law. No. 10 of 1980, the CBU Board has been implementing, issuing circulars, regulations and decisions, which greatly aided the economic growth of UAE and making its system one of the best in the world.

The emirates, through the Central Bank of the UAE have become globally competitive and its main cities, especially Abu Dhabi and Dubai, have become commercial hubs attracting foreign investors and huge multinational companies. (Central Bank of the UAE, [www. centralbank. ae/en](http://www.centralbank.ae/en)).

The UAE Currency

The UAE currency is the Arab Emirate Dirham (AED), or dirham. Some of its abbreviations are DH or Dhs. One dirham, which is minted in coins, consists of 100 fils. Fils are minted as coins and are available in denominations of 1, 5, 10, 25 and 50.

Dirham are also available in denominations of 5, 10, 20, 50, 100, 200, 500 and 1, 000. Each bank note denomination have its distinctive color-brown, green, blue, purple, pink, green/brown, navy blue, and greenish-blue, respectively. The value of the note is indicated in both Arabic and English.

<https://assignbuster.com/the-uae-monetary-system/>

Dirham value in gold is 0.186621 gram and has a flat rate of 3.67 AED to 1 USD, with a very narrow margin of -0.0027%, the exchange rate is much more stable compared with that of other currencies (<http://www.exchangerate.com>, 2010).

Dubai Online (2010) lists the following current exchange rates with other popular currencies:

Monetary Policies in the UAE

The UAE owes much of its success in banking to enforcing tight monetary policies while maintaining an open and free economic zone.

The Nations Encyclopedia (2010) states that the UAE dirham -US dollar linkage simply shows that crude oil is sold in US dollars and that domestic interest rates will also move in tune with the US interest rates.

As an open and free economic system, the government kept to a minimum its directives on how private sectors conduct their businesses. No direct taxes are imposed on profits earned by the corporation as well as on personal income. This rule, however, does not apply to foreign banks and oil companies. In addition to the fact that trade barriers and exchange controls does not exist, capital and profits earned by foreign business can also be moved from UAE to the home base without fees. Moreover, customs duties are not only low but also has a lot of exemptions and tolerant visa policies permits easy hiring of skilled migratory workers (www.dubai.ae).

Sultan Bin Nasser Al-Suwaidi, Governor of CBU, expressed his fears in his speech during the 18th World Conference of Banking Institutes (2009) that

the crisis of finance around the globe may slightly “ reduce the prospects for the UAE economic growth” but to help lessen its impacts, he offers the following steps to be taken:

The UAE monetary policy will continue its direction on maintaining low official interest rates;

A “ reasonable but low rate of credit expansion and restricted banking expansion will be enforced by the credit and banking policies of the UAE CBU;

Comprehensive assessment of UAE banking practices is generally conducted by the International Monetary Fund (IMF) missions using available data provided by the country itself and self-assessment documentations.

The IMF 2003 Report on the Observance of Standards and Codes (ROSC) as cited by eStandardsforum (2010) reveals that while CBU “ observes most good transparency practices regarding monetary policy,” it also has its weaknesses. For instance, there has never been a public disclosure of the process of determining the amount as well as amount of annual net profits. At present, this policy hasn’t been changed.

As a whole, the ROSC recommended for the CBU to reinforce their reporting methods, especially with regards to the banking decisions and operations.

Discussion

The UAE has been reported to be among the countries with some of the best banking practices in the world. This reputation is largely due to the monetary system employed by the United Arab Emirates. In a growing economy like

the UAE, monetary policies have the power to control its economy and have the government provide for the money that it needs.

However, the recent 2008 global crisis show a dwindling of this confidence and loopholes in the monetary policy of the country were noted (Albastaki, 2010). The blog further opined that total monetary policy control had never been previously an issue due to an incorrect assumption that the “ economy will always grow and the market will not fluctuate.” The UAE then realized that it should have had total monetary policy control, specifically in controlling the interest rates, to deflect some of the negative effects of the inflation. Among the reasons for which is the AED dirham-US dollar linkage.

Monetary policies are used to control economic factors as unemployment, inflation, international trade, productivity, and investments. Even if the UAE have some abilities in its expansion policies due to the country’s oil reserves, the UAE doesn’t have a contractionary monetary policy which uses an increase in interest and tax rates (Albastaki, 2009). Although, the country may well be able to control other factors, if and when the UAE economy will mature and it still does not have total control over its contractionary monetary policy, one of its predicted results will be that the circulation of money will get out of hand.

Albastaki (2009) concludes that monetary policies should give total authority on money supply, expansion, and contraction policies for the economy to become truly stable.

On the other hand, Dr. Tarek Coury (2009) believes that the UAE will not be affected too much by the “ deflationary trap” experienced by other

countries. Since the UAE pegs its dirham to the US dollar, it lacks a contractionary monetary policy; hence, the CBU cannot control inflation rates and inflation rates, in turn, tend to be erratic.

Among its effects would we that “ investment decisions on the aggregate level are made according to the real rate of interest” (Coury, 2009). When the dynamics in investments become unstable, this dirham-dollar linkage would have its advantages in the long run because it ensures minimal monetary disturbances. Coury (2009) further purports that this set-up is especially beneficial for an emerging economy like the UAE.