مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

Quarterly Economic Review

2016 Q1

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Executive Summary

At the international level, the first quarter of 2016 was dominated by the continued downward revision of global growth, while low oil prices persisted despite some limited rebound which adds to the challenges faced by oil-dependent Emerging Economies as the benefits for oil importers seem to be less than previously thought. Further, the hesitant Fed's approach to future interest rate increase put an end to the strengthening of the dollar, which took some pressure off the economies that are highly indebted in the U.S. currency.

At the domestic level, the Central Bank of the UAE continues to develop its forecasting capabilities with: (1) the construction of the 'Economic Composite Indicator' (ECI) for the UAE which combines advanced econometric techniques with available economic variables such as CPI (consumer price indicator), PMI (purchasing manager index) and oil prices, and (2) the set-up of an econometric model to project economic growth for both oil and non-oil activities over a period of two years.

The Central Bank's estimates for the UAE show a resilient growth, driven by the non-oil activities which are expected to grow by 3.5% in 2016, while oil-GDP is expected to grow by 1.2%. Also, CPI inflation (Y-on-Y) slowed down to 2.1% in first quarter of 2016, due mainly to a slowdown in Housing and lower imported inflation, on account of dirham appreciation.

As regards banking activity, customer deposits grew by 2.1 percent comparted to the end of 2015, with the growth of non-resident deposits by 3.5 percent reinforcing growth in resident deposits of 1.9 percent, while government deposits declined by 1.2 percent compared to the previous quarter. Domestic credit continued to grow nonetheless by 1.1 percent in 2016 Q1 and 8.1% y-o-y, reflecting the adequate liquidity situation at banks and the resiliency of non-oil activities.

Chapter1. International Economic Developments

In the US, the economic environment was sluggish in the first quarter of 2016, with doubtful results in several areas of the economy. However, the employment situation remains an important bright spot, as are vehicle sales and retail sales. The domestic economy continued to face the fallout from ongoing issues in international developed and emerging markets economies, which resulted in economic uncertainty and financial markets volatility. Elsewhere, economic growth continued to lag as a result of several factors. In Europe, the health of banks remains a major concern, and the region is suffering from low demand despite the European Central Bank's (ECB) aggressive asset purchase program. China's policymakers are attempting to engineer a soft economic shift oriented to domestic demand while also navigating stock, bond, and currency markets.

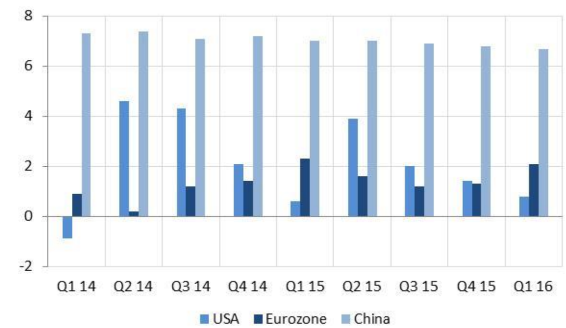
For the first quarter of 2016, the GDP figures releases for the US and China were disappointing in terms of growth expectations, while the Eurozone performed well.

In the US, the first quarter of 2016 was marked with the slowest growth since the first quarter of 2014. The growth for the first three months of the year was 0.8% Y-o-Y. The increase in real GDP in the first quarter reflected positive contributions from personal consumption expenditures (PCE), residential fixed investment, and state and local government spending that were partly offset by negative contributions from nonresidential fixed investment, private inventory investment, exports, and federal government spending. Countering the increase in domestic demand, imports increased.

The real GDP in the Eurozone rose by 0.5% on a sequential basis in Q1 (2.1% on an annualized basis). It matched the strongest sequential pace of growth in the current Euro area expansion. That said, the Y-o-Y pace of growth has held steady at 1.5% for the past four quarters, suggesting the expansion in activity remains fairly good.

On an annual basis, China's GDP grew by 6.7% according to official figures. This marks one of the lowest growth rates in years, lower than the 6.8% in quarter four 2015. The total value added of the industrial enterprises, above a designated size, in the first quarter was up by 5.8% at comparable prices, 0.3 percentage point lower than that in the previous year, or 0.4 percentage point higher than that in the first two months of this year. An analysis by types of ownership showed that the value added of state holding enterprises went down by 0.1%; collective enterprises grew by 2.4%; share-holding enterprises up by 7.2%; and a 3.3% growth for enterprises funded by foreign investors.

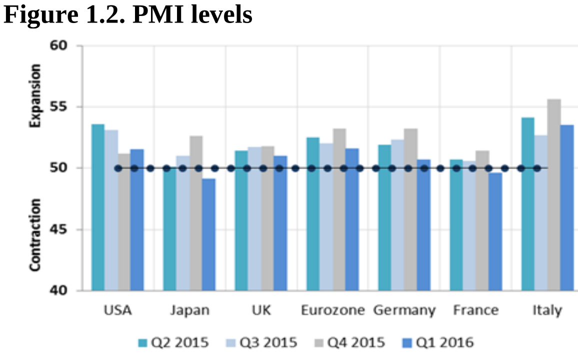
Figure 1.1. GDP growth for selected countries



Source: Bloomberg

Economic activity in the developed world as measured by the Purchasing Management Index (PMI) shows that in the US it has seen a slight improvement, while in the other countries shown in Figure 1.2 it has experienced a deterioration compared to quarter four 2015.

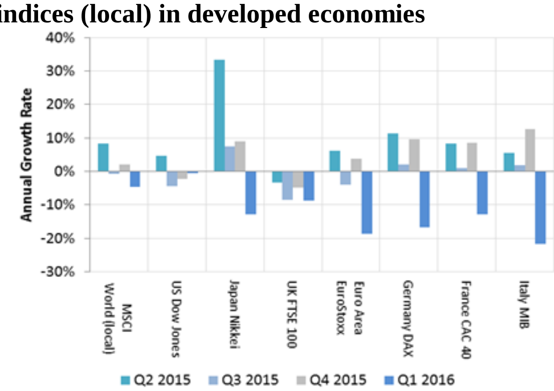
Figure 1.2. PMI levels



Source: Bloomberg

The US saw a marginal improvement in their PMI levels from almost 51.2 to 51.5, while the UK PMI declined from 51.8 to 51. In contrast, Japan's PMI level was at 52.6 at the end of 2015 and ended the first quarter of 2016 at 49.1, which is below the 50 mark and is a sign of contraction. Also, the Eurozone notched down from 53.2 at end of the fourth quarter of 2015 to 51.6 at the end of quarter one 2016. A PMI reading above 50 indicates expansion.

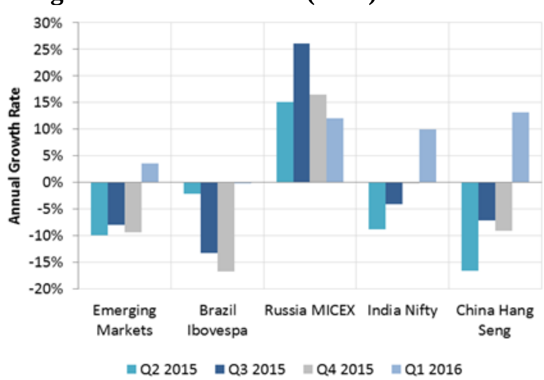
Figure 1.3. Annual percentage change of equity indices (local) in developed economies



Source: Bloomberg

All developed equity markets in the analysis, experienced negative annual returns during the first quarter of 2016.

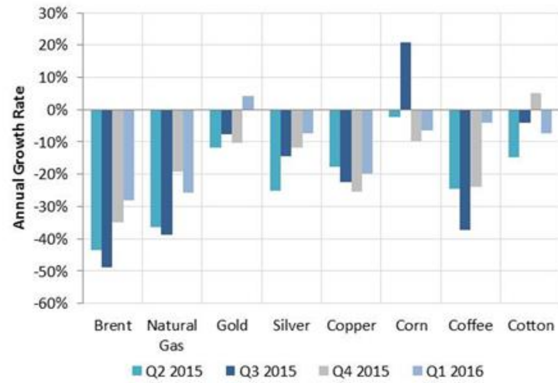
Figure 1.4. Annual stock market index percent changes in BRIC countries (local)



Source: Bloomberg

In contrast, equity markets have had a positive return on an annual basis for the BRIC, except for Brazil, in the first quarter of 2016. One of the major themes for the first quarter was the weakening of the Chinese economy which has also adversely impacted the commodity space.

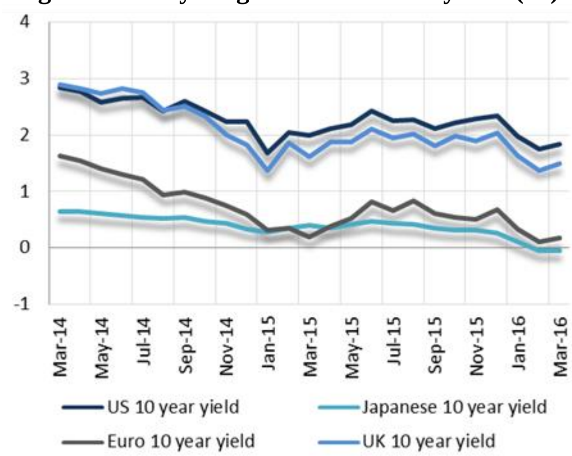
Figure 1.5. Selected commodity price levels annual changes (front-end futures)



Source: Bloomberg

The first quarter of 2016 saw a continuation of the general decline in commodity prices. On an annual basis, oil (Brent) for instance lost 28%. Only the gold contract could manage to post a small improvement in the first quarter of 4%.

Figure 1.6. 10-year government bond yields (%)

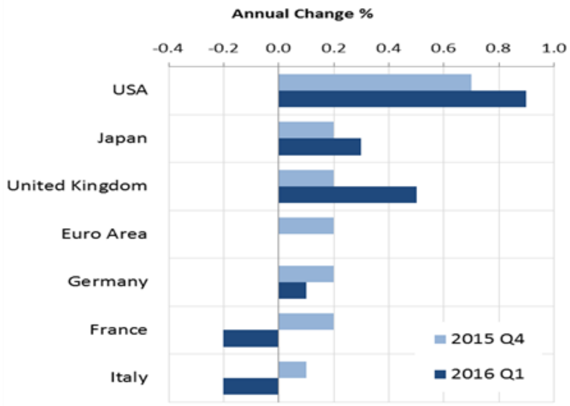


Source: Bloomberg

All of the 10-year yields in the four main developed government bond markets fell down in the first quarter of 2016, mainly driven by the decision of the Fed to target two times increase, instead of the already announced four times, of the Federal Fund rate in 2016. For Europe, the continuing quantitative easing was the main reason for the 10-year government yield to decrease from 0.67% in Q4 2015 to 0.16% in Q1 2016.

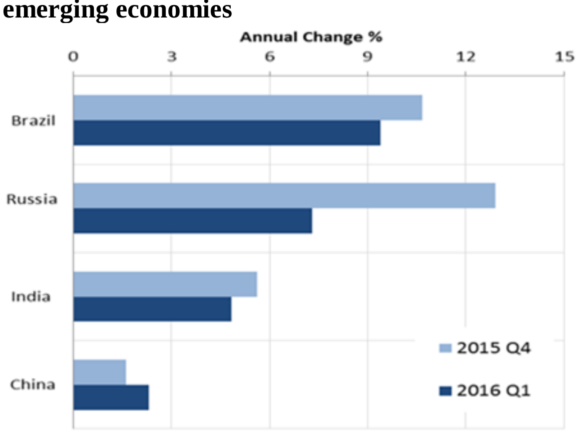
The charts below on consumer prices continue to show the marked difference between the developed and the developing world. Whereas the developed world is struggling with near zero inflation rates, the developing world experienced higher inflation rates with the exception of China. In Brazil, the devaluation of its currency in the first quarter of 2016 was the driving force of high inflation.

Figure 1.7. Year-on-Year consumer price change in the developed economies



Source: Bloomberg

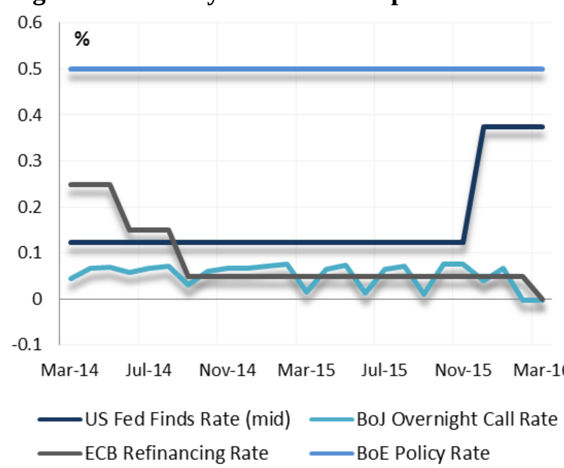
Figure 1.9 Year-on-Year consumer price change in emerging economies



Source: Bloomberg

In terms of monetary policy, the first quarter of 2016 will be remembered when the US Federal Reserve announced that the number of rate hikes for the year would be potentially two and not four, as initially announced. The period was also marked by the ECB's decision to continue its quantitative easing, increasing also the amount of assets to purchase. In this first quarter, further monetary easing was evident as the ECB has reduced the refinancing rate from 0.05% in December 2015 to 0% in March 2016 and the Bank of Japan has decreased their overnight call rate from 0.04% at the end of 2015 to -0.002%.

Figure 1.10. Policy rates of developed countries



Source: Bloomberg

The short-term outlook for the Middle East and North Africa (MENA) region remains mainly driven by geopolitical and oil price developments. Overall, according to the IMF revised projections as of April 2016, the MENA growth this year will continue to be 2.9% in 2016 and 3.3% in 2017.

Chapter 2: Domestic Economic Developments

Dipping oil prices led to the continuation of fiscal consolidation, which in tandem with global slowdown, led to softening economic sentiment in the first quarter of 2016 and moderate economic growth, mitigated by the jump in oil production and some resiliency in non-oil activities.

2.1 Economic Activity and Growth

The decreasing trend of oil prices continued during the first quarter of 2016. In fact, Brent prices fell during the first quarter of 2016 by more than 36% on a y-o-y basis and by 21% compared to the last quarter of 2015. (see figure 2.1.a). In this context, Real Oil GDP growth was revised downward by FCSA to 0.8% in 2014, with a rebound in 2015 displaying a growth rate of 4.6% on account of a jump in oil production.

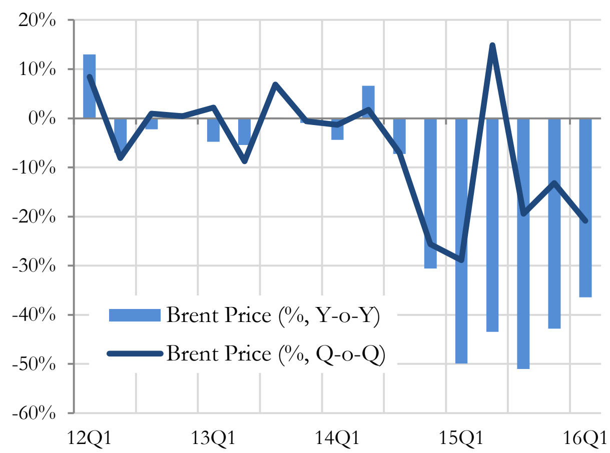
Real GDP grew by 4% in 2015 following a growth rate of 3.1% in 2014 and 4.7% in 2013 (see table 2.1).

Table 2.1 Economic Growth in the UAE (%)

	2013	2014	2015	2016 (P)	2017 (P)
Real GDP	4.7	3.1	4.0	2.8	3.0
Real Oil GDP	2.9	0.8	4.6	1.2	1.5
Real Non-Oil GDP	5.6	4.1	3.7	3.5	3.6

Source: Federal Competitiveness and Statistics Authority (FCSA) for 2013, 2014 and 2015, and Central Bank projections for 2016-2017.
Note: For more details concerning the Central Bank projections, see "Box: GDP forecasting model of the Central Bank of the UAE" in the Quarterly Economic Report for Q4 2015 in the CBUAE website.

Figure 2.1.a Oil Prices Development, Brent Price

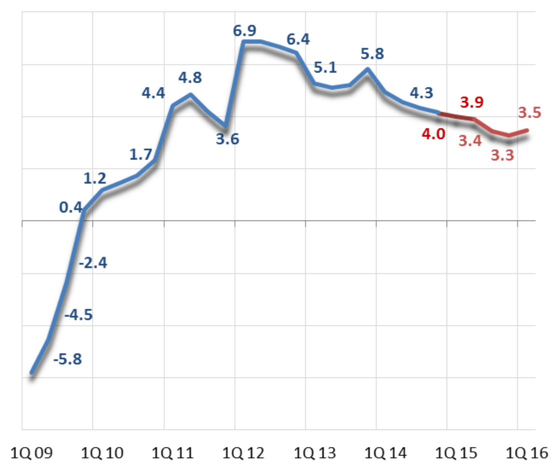


Source: IMF

On the other hand, official data indicate that real non-oil GDP increased by 3.7% in 2015 compared to a revised official figure of 4.1% in 2014 (see Table 2.1). This slowdown is due to negative spillovers of the adverse oil-price shock. The cut in capital spending, subsidies and transfers to GREs by the Government dampened domestic aggregate demand. However, thanks to the diversification of the economy in the UAE, this adverse impact is partially overcome by a growing non-oil sector. According to the economic composite indicator[1] (ECI) constructed by the Central Bank, the non-oil sector is estimated to have grown by 3.5% in the first quarter of 2016 against 3.3% in the fourth quarter of 2015 (see figure 2.1.b), leading to a growth of the total economy by 3% during the same period (see figure 2.1.c).

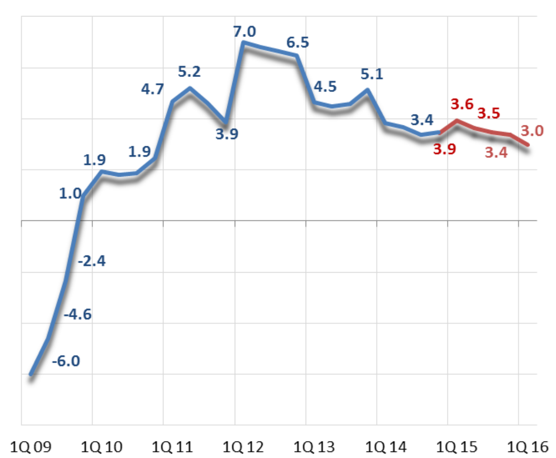
[1] For more details concerning the Economic Composite Indicator, see "Box 2: Economic Composite Indicator (ECI) for the UAE" in the Quarterly Report for Q3 2015 in the CBUAE website.

Figure 2.1.b Quarterly non-oil ECI in the UAE (%)



Source: Research and Statistics Department – CBUAE

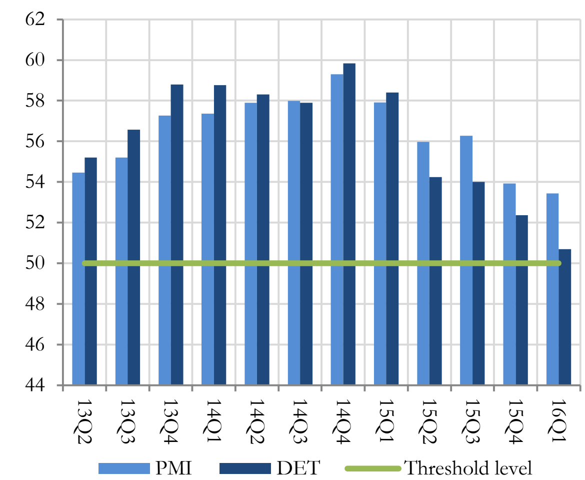
Figure 2.1.c Quarterly Overall ECI in the UAE (%)



Source: Research and Statistics Department – CBUAE

Concerning the recent developments of the Purchasing Mangers' Index (PMI) and the Dubai Economic Tracker (DET) (see Figure 2.1.d), although both indices remain in the expansion area during the first quarter of 2016 (more than the 50-threshold), their decreasing trend indicates that the growth momentum has slowed down. The average quarterly PMI for the first quarter of 2016 has decreased by 1% compared to the fourth quarter of 2015 and by 8% compared to the first quarter of 2015. Similarly, the average quarterly DET has decreased by 3.2% compared to the previous quarter and by 13% compared to the first quarter of 2015. These developments are driven mainly by a decrease of new orders and output. It is also noteworthy that the main improvements of both indices occurred during the last month of the quarter, where they have shown an upturn reflecting a positive sentiment due to a relative recovery of oil-prices. The increase was generated by an enhancement of domestic demand as reflected by an increase in output and new orders.

Figure 2.1.d Purchasing Managers' Index (PMI) and Dubai Economic Tracker (DET)



Source: Markit & Emirates NBD

2.2 Consumer Price Index and Inflation

The quarterly inflation rate started in the first quarter of 2016 a new decreasing trend (see Table 2.2). After rising to 4.6%[2] in the third quarter of 2015, the consumer Price Index (CPI) increased to 3.6% in the fourth quarter of 2015. The downward trend resulted in a more modest increase of 2.1% in the first quarter of 2016. The developments of non-tradables' prices remain the dominant driver of total inflation's trend (see Figure 2.2.a). Non-tradables constitute more than 66% of the total consumption basket, of which housing and utilities[3] prices represent around 60% of non-tradables and 39% of the total standard consumption basket in the UAE, while the total tradables constitute only 34% of the total basket.

The average consumer prices index of non-tradables increased by 2.9% in the first quarter of 2016, contributing by 2% to total CPI inflation. The quarterly non-tradables' inflation was around 5.2% in the fourth quarter of 2015 and 6.3% in the third quarter of 2015,

[2] All changes in prices are computed on a year-on-year basis, unless otherwise indicated.
[3] Utilities costs cover water, electricity and gas prices.

with a contribution to total inflation by 3.5% and 4.2%, respectively. This decreasing trend is due mainly to the softening in housing prices. The price index of rent and utilities prices increased by 5.1% in the first quarter of 2016, while they moved up by more than 8% in the previous quarter and by more than 9% in the third quarter of 2015. The average housing rent is likely to have fallen in the first quarter of 2016 in response to an adjustment from the demand side in particular. In fact, the slump in oil prices generated a series of infrastructure projects freeze, constraining the availability of jobs, especially in the highly paid oil and gas, infrastructure, construction and services sectors. In addition, the inflationary pressure induced by the subsidy cut for electricity and water implemented earlier in 2015 seems to be dissipating over time.

Table 2.2 UAE CPI Inflation (%)

	Weight %	2014	2015				2016
		Q4	Q1	Q2	Q3	Q4	Q1
Total CPI Inflation	100	3.3	3.7	4.3	4.6	3.6	2.1
Total CPI Inflation (end-of-period)	100	3.9	4.3	4.2	4.3	3.6	1.4
CPI Inflation of Tradable	34	2.5	1.1	0.8	1.4	0.6	0.4
CPI Inflation of Non-tradable	66	3.7	5.1	6.2	6.3	5.2	2.9
Housing CPI inflation	39	4.9	7.7	9.6	9.4	8.3	5.1
Transportation CPI inflation	10	1.8	1.5	1.0	5.6	-0.2	-6.7

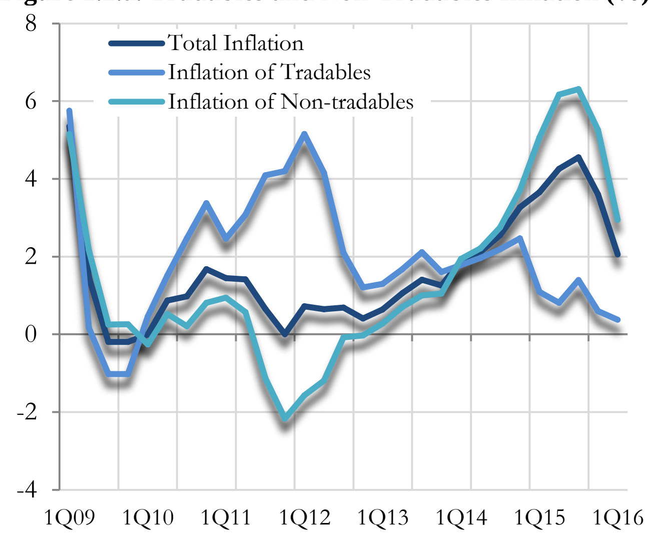
Source: Federal Competitiveness and Statistics Authority (FCSA).
Note: All the changes are computed on a Y-o-Y basis and based on the quarterly average CPI, unless otherwise indicated.

Besides housing costs, the sharp decline of transportation costs constitutes another reason for the reduction in the inflation rate in the first quarter of 2016 (see Figure 2.2.b). Transport costs, which account for around 10% of the consumer price index basket, fell by 6.7% during the quarter. After a significant increase in the third quarter of 2015 (5.6%) due to the fuel price subsidy cut, transportation costs plunged in the first quarter of 2016. The energy subsidy reform was intended to align domestic gasoline prices to international market prices. Thus, in line with falling global oil prices, gasoline prices fell in the UAE, inducing a cut in transportation costs.

While they decreased by 0.2% in the fourth quarter of 2015, medical care costs continued their decreasing trend; falling again by 0.1% in the first quarter of 2016. Moreover, education costs increased following a stable pace. The average CPI inflation of education is around 3.4% in the first quarter of 2016; the same rate recorded in the fourth quarter of 2015 and slightly lower than the rate of the third quarter of 2015 (3.7%).

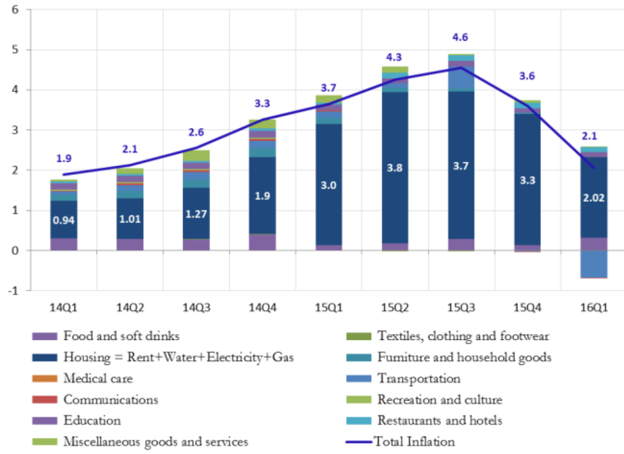
On the other hand, the average consumer price index of tradables has increased only by 0.4% in the first quarter of 2016, with a contribution of 0.1% to total inflation against a contribution of 0.2% and 0.5% in the fourth and third quarters of 2015, respectively. The inflation of tradables is driven by food price developments. The food and soft drinks component constitutes more than 40% of tradables in the consumption basket. Their prices increased by 2.2% in the first quarter of 2016 against a more modest increase of 0.9% in the previous quarter.

Figure 2.2.a. Tradables and Non-Tradables Inflation (%)



Source: Federal Competitiveness and Statistics Authority (FCSA).

Figure 2.2.b Contribution of different sub-components to the Total CPI Inflation (%)



Source: Federal Competitiveness and Statistics Authority (FCSA).

2.3 Exchange Rate and Foreign Trade Balance

The Dirham continued its appreciation in the first quarter of 2016 against its major trading partners, but at a slower pace. The weighted Dirham's appreciation[4] against the top 9 non-dollarized import partners, which account altogether for 48.1% of the total imports, has increased in the first quarter of 2016 by 0.48% compared to the fourth quarter of 2015 (see Table 2.3.a). On a year-on-year basis, the Dirham appreciated by 2.06% against its main import partners. These developments are owing to a sharp appreciation of the Dirham against the Chinese Yuan, the Indian Rupee, the UK Pound and the South Korean Won compared to the first quarter of 2015. They lost around 4.9%, 8.4%, 5.7% and 9% of their value against the Dirham, respectively. These countries account for around 29% of total imports.

[4] The weights of trading partners used for the computation are the ones of the first 9 months of 2015. The weights for 2015 are not available.

Table 2.3.a Dirham appreciation against currencies of top non-dollarized import partners

Currency	Share of UAE imports (%) 2015	% Change of Currencies per Dirham (Q3-Q2) 2015	% Change of Currencies per Dirham (Q4-Q3) 2015	% Change of Currencies per Dirham 2016Q1-2015Q4	% Change of Currencies per Dirham 2016Q1-2015Q1
Chinese Yuan	12.34	1.63	1.42	2.30	4.87
Indian Rupee	9.94	2.42	1.42	2.38	8.44
Germany (EUR)	6.17	-0.53	1.61	-0.79	1.94
Japanese Yen	5.36	0.66	-0.59	-5.12	-3.31
UK Pound	3.44	-1.06	2.13	5.85	5.69
South Korean Won	3.10	6.60	-1.07	3.65	8.97
Italy (EUR)	2.92	-0.53	1.61	-0.79	1.94
France (EUR)	2.47	-0.53	1.61	-0.79	1.94
Swiss Franc	2.36	2.51	2.72	0.27	4.30
Total	**48.10**				
Weighted Appreciation		**0.64**	**0.58**	**0.48**	**2.06**

Source: Data on Imports and Exports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for the first 9 months of 2015.Data for the exchange rate are the quarterly end-of-period observations, recorded and displayed by Bloomberg.
Note: These weights are based on the first 9 months of 2015

Table.2.3.b Dirham appreciation against currencies of top non-dollarized partners for non-oil export

Currency	Share of UAE Exports (%) 2015	% Change of Currencies per Dirham (Q3-Q2) 2015	% Change of Currencies per Dirham (Q4-Q3) 2015	% Change of Currencies per Dirham 2016Q1-2015Q4	% Change of Currencies per Dirham 2016Q1-2015Q1
Chinese Yuan	12.93	2.42	1.42	2.38	8.44
Indian Rupee	6.52	2.51	2.72	0.27	4.30
Germany (EUR)	6.01	-0.27	-0.66	-0.49	0.57
Japanese Yen	5.05	7.14	1.84	1.12	19.37
UK Pound	3.96	0.21	0.25	-0.51	1.81
South Korean Won	3.91	3.59	1.17	-0.40	3.34
Italy (EUR)	2.09	1.63	1.42	2.30	4.87
France (EUR)	1.78	-0.53	1.61	-0.79	1.94
Swiss Franc	1.55	2.55	0.77	2.22	7.36
Total	**43.80**				
Weighted Appreciation		**1.03**	**0.54**	**0.39**	**2.84**

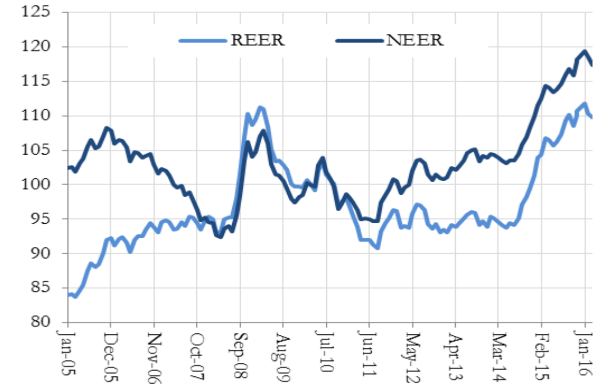
Source: Data on Imports and Exports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for the first 9 months of 2015. Data for the exchange rate are the quarterly end-of-period observations, recorded and displayed by Bloomberg.
Note: These weights are based on the first 9 months of 2015

On the other hand, the Dirham appreciated also against the main non-oil export partners. Its weighted appreciation against the top 9 non-dollarized non-oil export partners, which account for around 44% of the total non-oil exports, is around 0.39% in the first quarter of 2016 compared to the previous quarter (see Table 2.3.b). On a year-on-year basis, the Dirham's appreciation was more significant; it reached 2.8% compared to the first quarter of 2015. In particular, the Dirham realized significant gains against the Indian Rupee, the Turkish Lira, the Chinese Yuan and the Egyptian Pound, which account for around 22% of the total non-oil exports. They lost on a year-on-year basis around 8.4%, 19.4%, 4.9% and 7.4%, respectively.

The Real Effective Exchange Rate (REER) of the UAE Dirham has shown the same tendency. It has appreciated by about 0.8% on average during the first quarter of 2016, corresponding to an appreciation of Nominal Effective Exchange Rate (NEER) by about 1% (see Figure 2.3.a). On a year-on-year basis, the REER appreciated by more than 5%, reflecting nominal appreciation and relatively higher, albeit declining, inflation in the UAE, compared to major trading partners.

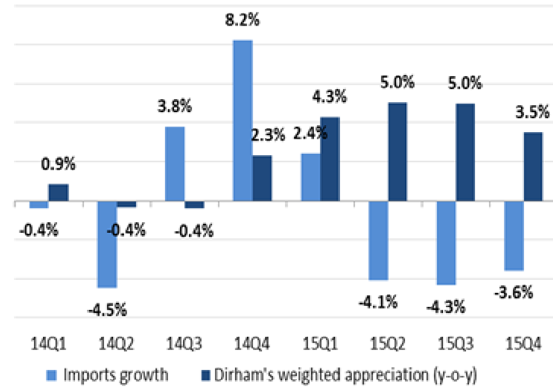
The Dirham's appreciation raises questions about its impact on foreign trade and the competitiveness of the non-oil sector since the UAE is the most open country in the GCC region with an openness index of 177, followed by Bahrain with an openness index of 117. Cheaper price of imports dominates the volume effect on nominal imports[5]. As shown in Figure 2.3.b, nominal imports displayed a series of negative growth during the last nine months of 2015. They declined successively by 4.1%, 4.3% and 3.6% during the second, third and fourth quarters of 2015, respectively. The adverse impact of the oil price slump and the decline in domestic demand has countered the potential positive impact of the Dirham's appreciation and cheaper imports on demand. On the other hand, this appreciation did not seem to have had a significant adverse impact on the competitiveness of the non-oil sector. Nominal non-oil exports increased successively by 35%, 21%, 20% and 21% during the four quarters of 2015, respectively (see Figure 2.3.b). The increase in nominal non-oil exports reflects higher receipts in dirham denomination[6], despite its appreciation, reflecting a significant increase in volume.

Figure 2.3.a Nominal and Real Effective Exchange rates Developments



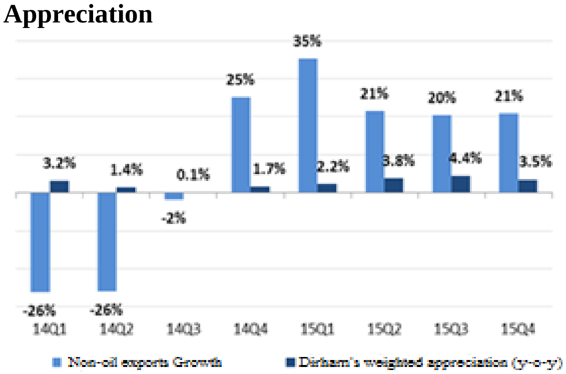
Source: Bank of International Settlement (BIS)

Figure 2.3.b Foreign Trade and Dirham's Appreciation



Source: FCSA and Bloomberg.

Figure 2.3.c Foreign Trade and Dirham's Appreciation



Source: Federal Competitiveness and Statistics Authority (FCSA) and Bloomberg.

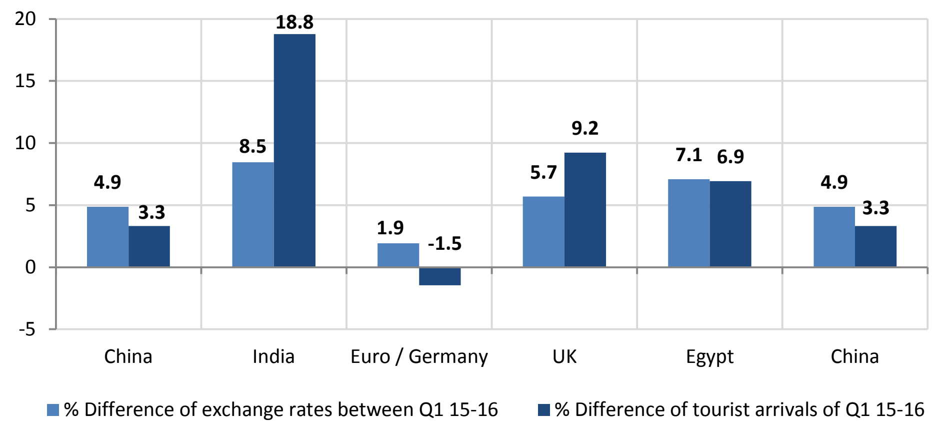
[5] Only nominal imports are considered since data on real imports for the whole year of 2015 are unavailable.

[6] Only nominal exports are considered since data on real exports for the whole year of 2015 are unavailable.

Box: Exchange Rate Appreciation and External Competitiveness

The graph below tracks the effect of the bilateral exchange rate movements on tourism between Q1 2016, compared to Q1 2015. To start off, the appreciation of AED is depicted with respect to the currencies of major countries. In parallel, for all countries below, except for Germany in the Euro area, there has been a surge in the number of tourists, despite the appreciation of the dirham.

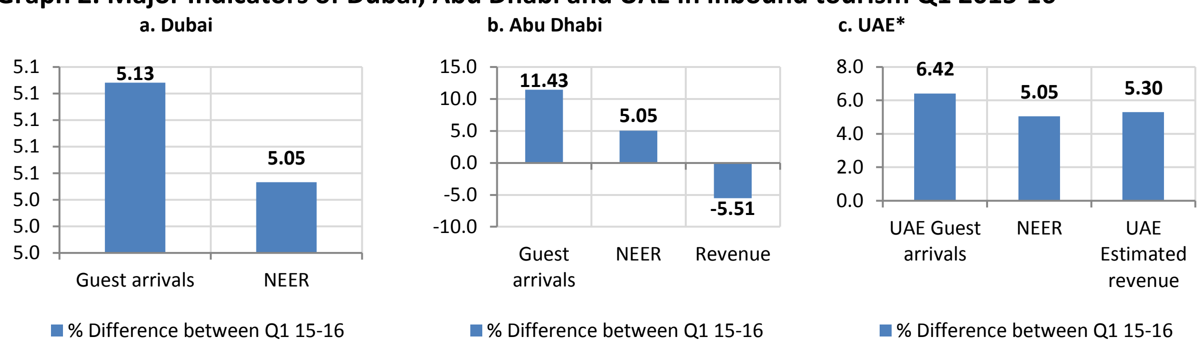
Graph 1. Guest arrivals and exchange rate on selected countries Q1 2015-2016



Source: Dubai Tourism Authority, Abu Dhabi Tourism and Culture Authority, Bloomberg and CBUAE calculations

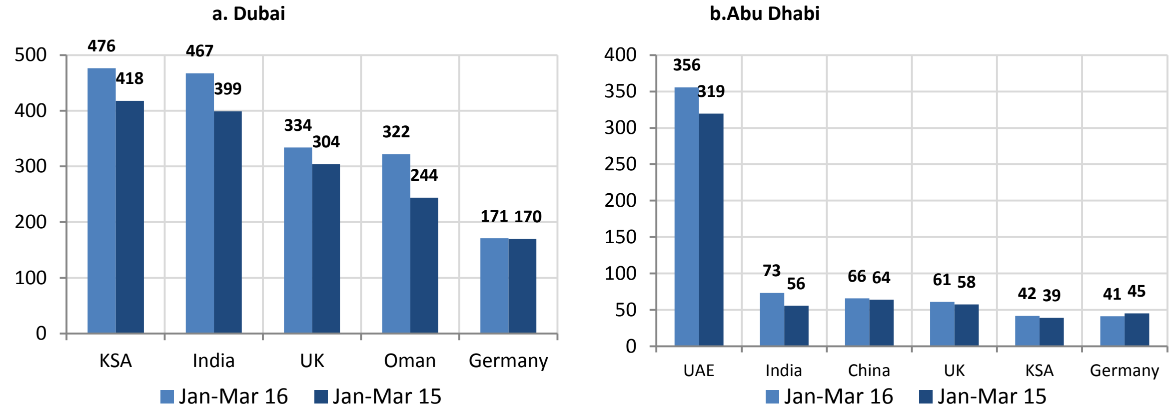
More specifically, the appreciation of the dirham is correlated with increasing trend of guest arrivals both in Dubai and Abu Dhabi. All major countries that are the markets of inbound tourism to Dubai and Abu Dhabi show an increase in the arrivals of tourists, except from Germany (graphs 2, 3). Nonetheless, the data for Abu Dhabi and Dubai demonstrate decreased average length of tourists' stay. Accordingly, the travel receipts for the Abu Dhabi emirate depict an annual decrease of 5.5% for the first quarter, reflecting a possible strategy to retain tourists by providing more discounts. At the aggregate level, it is recorded that tourists increased by 6.4%. Estimated revenues, factoring in spending per tourist, suggest a total annual increase in revenues by 5.3% (18 bil. AED for the first quarter of 2016).

Graph 2. Major Indicators of Dubai, Abu Dhabi and UAE in inbound tourism Q1 2015-16



Source: Dubai Tourism Authority, Abu Dhabi Tourism and Culture Authority, BIS and CBUAE calculations
**Estimates, multiplying number of arrivals by an average tourist spending based on credit card publications*

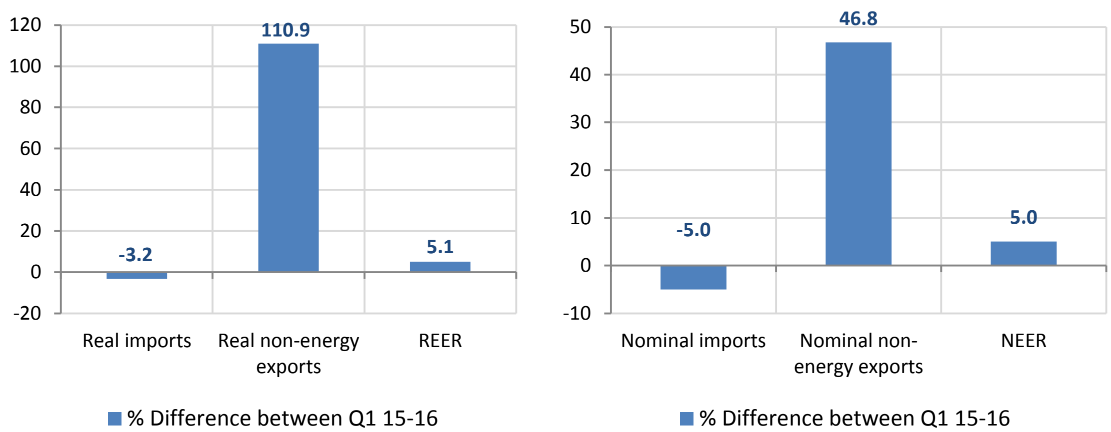
Graph 3. Major markets of inbound tourism in Dubai and Abu Dhabi *(In thousands)*



Source: Dubai Tourism Authority and Abu Dhabi Tourism and Culture Authority

Finally, the first estimates regarding trade activity were calculated by the Abu Dhabi Customs Department and show that trade activity in the Abu Dhabi emirate for the first quarter of 2016 depicts decreased imports by 3.2% in volume (5% decrease in value) compared with the first quarter of 2015. Simultaneously significant increase in volume is recorded in non-energy exports by 110.9% (46.8% in value), despite the 5% appreciation of AED according to the nominal and real effective exchange rates (graph 4). The evidence attests to the growth of non-energy exports and rules out loss of competitiveness on account of exchange rate appreciation.

Graph 4. Trading activity in Abu Dhabi and average NEER-REER for Q1 2015-2016 *(in volume and in value)*



Source: Abu Dhabi customs and BIS.

2.4 Fiscal Stance

The important decline of oil prices has triggered the drive for fiscal consolidation by the government in 2015. The acceleration is quite clear from the observed fiscal data (see Table 2.4). The UAE is pressing ahead with necessary fiscal adjustment to hedge the fiscal balance against oil price volatility and contain the prospective widening fiscal deficit. Consolidated public finance figures reflect efforts to decrease spending using a set of measures that include energy price-subsidy cut, the freeze of capital spending and reduction of current spending particularly transfers to GREs.

Total expenditures have decreased by more than 16% in the fourth quarter of 2015 compared to the last quarter of 2014. Subsidies and transfers to GREs declined by more than 95%, while other subsidy cuts are envisaged in 2016 which will help contain the fiscal deficit. Social benefits and the net acquisition of non-financial assets fell by more than 38% and 47% y-o-y, respectively.

The total annual expenditure declined by 14.5% in 2015, where the annual subsidies and annual social benefits fell by more than 84% and 13%, respectively.

On the revenues side, the reduction in total revenues is even more pronounced. They declined by around 38% y-o-y during the fourth quarter of 2015, on account of significant decline of the oil price and taxes (royalties based on sharing agreements) on the oil companies by 59%. Social contributions have decreased also by more than 46% in the fourth quarter. Consequently, the total annual revenues declined by 25%, where the annual taxes and annual social contributions fell by more than 37% and 14%, respectively.

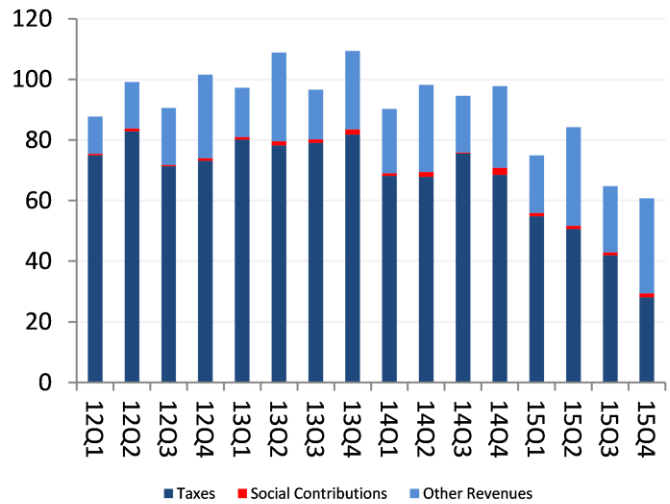
Table.2.4 Consolidated Government Finances

	2014					2015					Change (%, Y-o-Y) - 2015				Change 2015-2014
	Q1	Q2	Q3	Q4	2014	Q1	Q2	Q3	Q4	2015	Q1	Q2	Q3	Q4	
Revenues (a)	**90.2**	**98.1**	**94.5**	**97.8**	**380.7**	**74.9**	**84.2**	**64.8**	**60.7**	**286.9**	**-17.0**	**-14.2**	**-31.5**	**-37.9**	**-25.2**
Taxes	68.1	67.8	75.5	68.4	279.9	54.9	50.6	41.9	28.1	188.4	-19.4	-25.4	-44.5	-59.0	-37.3
Social contributions	0.9	1.6	0.4	2.4	5.3	1.1	1.1	1.0	1.3	5.5	14.0	-27.8	172.1	-46.5	-14.6
Other Revenues	21.2	28.7	18.6	26.9	95.5	19.0	32.5	21.8	31.4	104.7	-10.4	13.2	17.1	16.6	9.7
Expenditure (b)	**104.0**	**103.7**	**98.9**	**107.9**	**414.6**	**87.0**	**93.1**	**83.9**	**90.3**	**411.1**	**-16.4**	**-10.2**	**-15.2**	**-16.3**	**-14.5**
Compensation of employees	10.6	11.4	11.4	14.1	47.5	14.4	15.8	14.5	**14.4**	48.6	36.4	38.0	27.3	2.1	24.4
Use of goods and services	8.9	12.1	13.8	14.7	49.5	10.5	13.5	10.8	16.3	55.3	18.3	11.5	-22.0	10.4	3.0
Consumption of fixed capital	0.9	0.7	1.0	1.1	3.8	0.9	1.1	0.9	1.5	3.8	0.3	48.1	-14.8	37.7	16.7
Interest	1.0	1.0	0.9	1.2	4.1	0.5	0.5	0.6	1.3	3.1	-52.4	-49.1	-38.3	13.8	-29.5
Subsidies	2.5	3.6	3.4	2.6	12.1	0.2	0.2	1.4	0.1	13.0	-93.1	-95.6	-58.1	-95.5	-84.4
Grants	9.8	6.2	5.5	0.4	21.9	3.1	2.8	2.5	2.1	11.3	-67.9	-54.9	-55.1	507.3	-51.8
Social benefits	12.6	13.8	16.1	18.8	61.4	12.9	15.2	13.5	11.6	56.7	2.2	9.5	-16.1	-38.4	-13.4
Other expense	52.3	41.0	37.2	43.9	174.4	39.9	35.4	33.4	37.0	184.5	-23.8	-13.6	-10.2	-15.7	-16.4
Net Acquisition of Nonfinancial Assets	5.5	13.7	9.5	11.2	39.9	4.7	8.7	6.4	5.9	34.8	-15	-36.7	-33.3	-47.2	-35.8

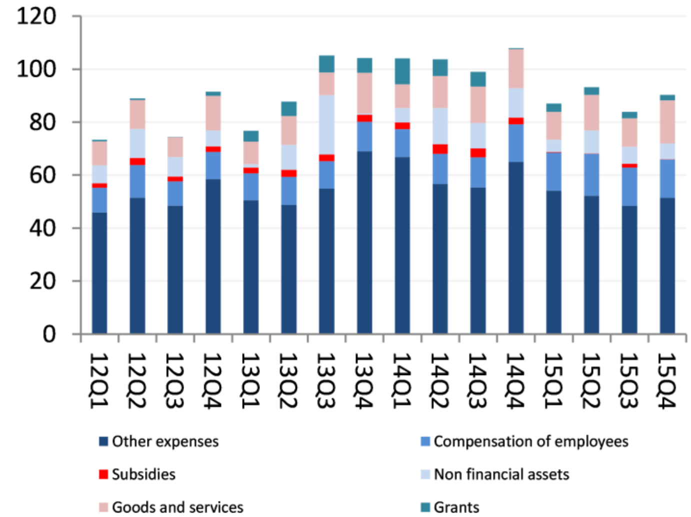
Source: UAE Ministry of Finance, revenues do not include ADNOC transfers and government investment income.
Note: All values are expressed in Billions of Dirhams.

Government Finance

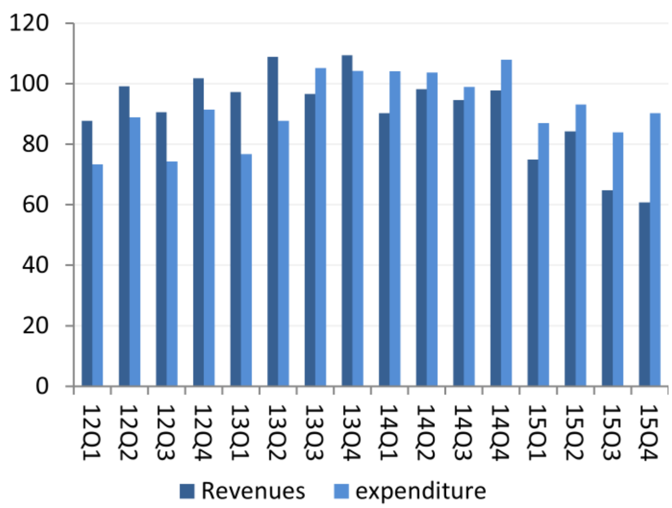
2.4. a General Government Revenues
(Billions of Dirhams)



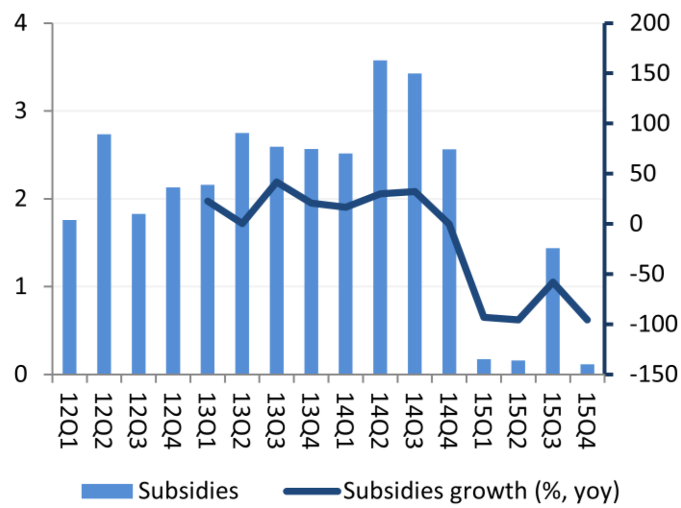
2.4.b General Government Expenditures
(Billions of Dirhams)



2.4.c Fiscal Stance
(Billions of Dirhams)



2.4.d Development in Subsidies and transfers to GREs
(Billions of Dirhams)



Source: Ministry of Finance.
Note: Other expenses cover all the payments of Abu Dhabi Government made on behalf of the federal government, including the Armed Forces expenditures. The total revenues do not include ADNOC transfers and government investment income. Total expenditures are also adjusted so that Abu Dhabi capital transfers are excluded.

2.5 Financial developments

2.5.1 Share Price Volatility

The uncertainty about the global economic growth and the slump in oil prices did not prevent the Emirates Securities Market General Index from recovering. The modest recovery of oil prices at the end of the first quarter of 2016 helped investors to restore their confidence and improve their sentiments regarding markets' developments in the UAE. Consequently, the Emirates Securities Market General Index has gained 5.2% at the end of the first quarter of 2016 with an increase of the market capitalization by more than 5% (see Table 2.5.1). The Traded Value has also increased to reach AED 56.5bn at the end of the first quarter of 2016, compared to a traded value of AED 33.1bn at the end of the fourth quarter of 2015.

Table 2.5.1 UAE – Securities Markets

	2014		2015				2016
	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Change of Share Price Index (%)	15.5	-14.8	-2.3	10.1	-6.4	-7.2	5.2
Change of Market Capitalization (%)	15.6	-9.9	-0.3	10	-6.4	-7.2	5.3
Quarterly Traded Value	97.0	86.7	51.8	81.8	42.7	33.1	56.5

Source: UAE Securities and Commodity Authority and Bloomberg.
Note: Changes computation is based on end-of-period numbers for the share price index and market capitalization.

2.5.2 Credit Default Swaps Premiums

The improvement of the domestic economic sentiment at the end of the first quarter of 2016 has been immediately internalized by financial markets and reflected by a decrease of different risk premiums. Most CDS spreads have declined for both Emirates' governments and their respective GREs. The CDS of Dubai Holding fell by more than 14% in the first quarter of 2016 compared to the last quarter of 2015. In Abu Dhabi, the sovereign's CDS have decreased by more than 11%. These developments were also reflected by the Rating Agencies.

According to Moody's rating, the sovereign credit rating of the UAE, alongside Qatar and Kuwait, is the best in the GCC region (Aa2), where the risk of the sovereign credit in the UAE is considered as the very lowest credit risk in the region.

Table 2.5.2. UAE - Credit Default Swaps (CDS)

	2014		2015				2016
	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Sovereigns							
Abu Dhabi	54.5	63.5	72.0	52.0	77.4	92.6	82.0
Dubai	198.1	201.6	197.4	191.4	196.9	233.7	215.0
GREs							
DP World	145.0	212.0	194.1	188.5	190.0	183.9	195.2
Dubai Holding	316.0	330.7	321.3	340.8	322.5	421.0	360.3

Source: Bloomberg.
Note: All data are the observed end-of-quarter values. Premiums are expressed in basis points.

Chapter3. Monetary & Banking Developments

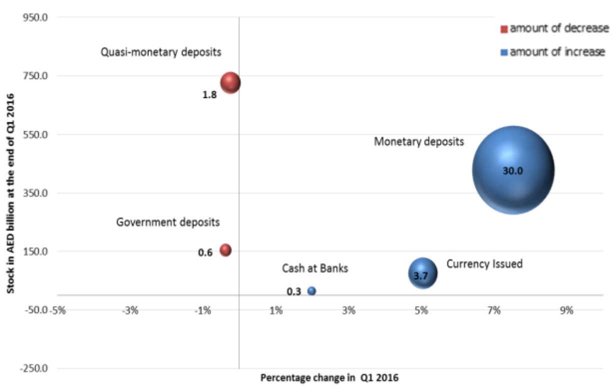
Government deposits roughly stabilized in the 1st quarter of 2016, on the heels of a decline in the previous year, which led to an increase in monetary growth as measured by M3. As a result, banks continued to increase credit at a rate that supports growth in the non-oil activities, thereby providing the needed financing.

3.1 Monetary Aggregates

During 2016 Q1, Money Supply Aggregates exhibited an increase by 7.3% for M1, 2.7% for M2 and by 2.3% for M3.

The main growth in M1 in Q1 2016 could be explained by the increase in monetary deposits by AED 30 billion (7.5%) and an increase in currency in circulation by AED 3.4 billion (5.8%). The slower increase in M2 is due to the marginal decrease in Quasi-monetary deposits by AED 1.8 billion. Meanwhile, M3 exhibited an even slower growth due to the fact that government deposits oscillated around roughly the same level, during this period.

Figure 3.1. UAE Monetary aggregates – 2015



Source: Central Bank of the UAE and Central Bank of the UAE analysis

3.2 Banking Activity

The 23 locally-incorporated banks kept their branches at 874 during 2016 Q1, while for the 26 foreign banks, the number of branches decreased from 86 at the end of 2015 Q4 to 85 at the end of 2016 Q1.

Total Customer Deposits at banks increased in 2016 Q1 by AED 31 billion. Resident Deposits increased during this period by AED 25 billion or 1.9%, as a result of an increase in Deposits of the Private Sector by AED 24.3 billion, while Government Deposits decreased by AED 1.9 billion (-1.2%) and Deposits of Government-Related Entities (GREs) increased marginally by AED 2.5 billion (1.3%). Non-resident Deposits increased by AED 6 billion (3.5%), during 2016 Q1.

Table 3.2.a.Deposits at UAE Banks

	2015				2016
	Mar	Jun	Sep	Dec.	March
Bank Deposits	**1449.3**	**1444.3**	**1436.8**	**1471.6**	**1502.7**
(Q-o-Q change %)	2.0	-0.3	-0.5	2.4	2.1
(Y-o-Y change %)	8.8	3.1	1.6	3.5	3.7
Resident Deposits	**1301.3**	**1288.6**	**1278.3**	**1300.2**	**1325.0**
(Q-o-Q change %)	2.7	-1.0	-0.8	1.7	1.9
(Y-o-Y change %)	7.0	1.7	-0.3	2.6	1.8
Government Sector	**183.8**	**162.9**	**164.3**	**157.4**	**155.5**
(Q-o-Q change %)	-2.6	-11.4	0.9	-4.2	-1.2
(Y-o-Y change %)	20.8	-11.8	-20.8	-16.6	-15.4
GREs (Govt. ownership of more than 50%)	**191.9**	**184.2**	**173.3**	**190.8**	**193.3**
(Q-o-Q change %)	10.7	-4.0	-5.9	10.1	1.3
(Y-o-Y change %)	-6.0	-3.3	-11.5	10.1	0.7
Private Sector	**888.4**	**907.2**	**911.2**	**923.8**	**948.1**
(Q-o-Q change %)	2.3	2.1	0.4	1.4	2.6
(Y-o-Y change %)	7.9	6.0	8.1	6.3	6.7
Non-Banking Financial Institutions	**37.2**	**34.3**	**29.5**	**28.1**	**28.2**
(Q-o-Q change %)	2.2	-7.8	-14.0	-4.7	0.4
(Y-o-Y change %)	2.5	-5.5	-17.1	-22.8	-24.2
Non-Resident Deposits	**148.0**	**155.7**	**158.5**	**171.5**	**177.5**
(Q-o-Q change %)	-3.9	5.2	1.8	8.2	3.5
(Y-o-Y change %)	27.9	17.2	19.6	11.4	19.9

Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values; data for March 2016 are provisional. Values are expressed in billions of Dirhams.

Domestic Credit increased in 2016 Q1 by AED 23.2 billion, benefiting mainly the private sector (AED 11.3 billion) and the government-related entities (GREs) by AED 9.2 billion.

Table 3.2.b.Assets and Credit at UAE Banks

	2015				2016
	Mar	Jun	Sep	Dec.	Mar
Total Assets	**2,380**	**2,420**	**2,422**	**2,478**	**2,491**
(Q-o-Q change %)	**3.3**	**1.7**	**0.1**	**2.3**	**0.5**
(Y-o-Y change %)	**9.1**	**8.2**	**4.8**	**7.5**	**4.7**
Gross Credit	1,410	1,447	1,479	1,485	**1,518**
(Q-o-Q change %)	2.3	2.6	2.2	0.4	**2.2**
(Y-o-Y change %)	8.2	8.8	7.0	7.8	**7.6**
Domestic Credit	1,304	1,336	1,366	1,381	1,404
(Q-o-Q change %)	2.0	2.5	2.3	1.1	1.7
(Y-o-Y change %)	6.5	6.5	5.9	8.1	7.7
Government	161.0	168.5	166.4	166.6	168.7
(Q-o-Q change %)	5.2	4.7	-1.3	0.1	1.3
(Y-o-Y change %)	12.5	13.6	13.2	8.8	4.8
Public Sector (GREs)	165.3	164.6	174.0	169.8	179.0
(Q-o-Q change %)	0.1	-0.4	5.7	-2.4	5.4
(Y-o-Y change %)	-6.6	1.7	7.2	2.8	8.3
Private Sector	958	985	1,006	1,020	1,031
(Q-o-Q change %)	1.9	2.8	2.2	1.4	1.1
(Y-o-Y change %)	9.9	7.8	4.6	8.5	7.7
Business & Industrial Sector Credit	648.1	665.2	676.3	689.3	695.2
(Q-o-Q change %)	1.2	2.6	1.7	1.9	0.9
(Y-o-Y change %)	10.8	7.7	3.3	7.7	7.3
Individual	309.8	319.3	329.7	330.7	336.1
(Q-o-Q change %)	3.3	3.1	3.3	0.3	1.6
(Y-o-Y change %)	8.1	8.1	7.5	10.3	8.5
Non-Banking Financial Institutions	19.4	18.2	19.9	24.7	25.3
(Q-o-Q change %)	0.1	-6.2	9.2	24.2	2.4
(Y-o-Y change %)	-39.8	-40.7	-0.4	27.4	30.4
Foreign Credit	106.6	110.9	112.2	103.9	113.1
(Q-o-Q change %)	6.2	4.0	1.1	-7.4	8.9
(Y-o-Y change %)	34.1	46.9	22.8	3.5	6.1
of which: Loans & Advances to Non-Residents in AED	10.2	9.9	9.6	9.2	11.2
(Q-o-Q change %)	-0.4	-2.5	-2.6	-4.6	21.7
(Y-o-Y change %)	-38.2	-10.8	-12.2	-9.8	10.3

Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values; data for March 2016 are provisional. Values are expressed in billions of Dirhams.

Banks' lending by economic activity shows an increase in the first quarter of 2016 for Manufacturing (4.5%), Construction and Real Estate (2.9%), Transport, Storage and Communication (5.6%) and Non-banking Financial Institutions (2.9%). The sectors in which there is a decrease in credit, during the same period, are Agriculture (-19.1%), Mining & Quarrying (-1.8%), Electricity, Gas and Water (-9.4%) and Trade (-0.6%).

Table 3.2.c. Banks credit to residents by economic activity

(End of Period , In Billions of AEDs)

	2015				2016
Economic Activity	Mar	Jun	Sep	Dec	Mar
Agriculture	1.6	1.2	1.3	1.6	1.3
(Q-o-Q change %)	-39.0	-22.7	1.7	20.5	-19.1
(Y-o-Y change %)	-28.4	-20.8	-41.7	-42.2	-23.3
Mining and Quarrying	10.7	10.5	11.1	11.9	11.7
(Q-o-Q change %)	17.0	-2.6	5.9	7.7	-1.8
(Y-o-Y change %)	-38.5	17.6	10.8	29.9	9.0
Manufacturing	66.5	71.2	72.2	69.1	72.2
(Q-o-Q change %)	2.1	7.1	1.4	-4.3	4.5
(Y-o-Y change %)	14.6	7.4	17.6	6.1	8.7
Electricity, Gas and Water	18.6	22.5	20.7	20.5	18.6
(Q-o-Q change %)	-1.9	21.0	-7.8	-1.2	-9.4
(Y-o-Y change %)	-11.2	11.3	8.0	8.2	-0.1
Construction and Real Estate	210.6	216.2	223.6	235.0	241.8
(Q-o-Q change %)	-0.9	2.6	3.5	5.1	2.9
(Y-o-Y change %)	5.5	4.1	5.7	10.6	14.8
Trade	160.5	164.9	164.8	161.7	160.7
(Q-o-Q change %)	3.0	2.7	0.0	-1.9	-0.6
(Y-o-Y change %)	0.8	10.5	5.3	3.8	0.2
Transport, Storage and Communication	59.5	60.8	58.8	59.2	62.5
(Q-o-Q change %)	5.3	2.2	-3.3	0.6	5.6
(Y-o-Y change %)	39.7	11.9	5.4	4.7	5.0
Financial Institutions (Excluding Banks)	133.1	128.2	135.5	135.6	139.6
(Q-o-Q change %)	1.0	-3.7	5.7	0.1	2.9
(Y-o-Y change %)	1.6	5.2	4.4	2.9	4.8
All Others	109.2	111.9	113.0	112.7	113.1
(Q-o-Q change %)	13.5	2.5	1.0	-0.3	0.4
(Y-o-Y change %)	15.0	-1.1	-3.6	17.1	3.6

Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values; data for March 2016 are provisional.

According to respondents of the Central Bank "Credit Sentiment Survey" the appetite for both business and personal credit improved in 2016 Q1, recovering from the softening loan demand in 2015 Q4. However, the ongoing tightening credit conditions for business loans suggests less willingness to extend business loans among financial institutions, partially reflecting the negative impact of lower oil prices.

Table 3.2.d. Assets and financing of Islamic Banks (2015 – 2016)

	2015				2016
	Q1	Q2	Q3	Q4	Q1
Assets	432	445	452	464	483
Percent of total banking assets (%)	18.2	18.4	18.7	19.0	19.6
Islamic financing	280	290	300	307	316
Percent of Domestic Credit (%)	21.5	21.7	22.0	22.2	22.7

Source: Banking Supervision Department, Central Bank of the UAE
Note: All data indicate the end-of-quarter values. Assets values are expressed in billions of Dirhams.

Islamic banks continued to thrive with their assets increasing by 4.1% in 2016 Q1, reaching AED 483 billion, with their share in total assets increasing to 19.6%. Meanwhile, their financing increased by 3.3%, reaching AED 316 billion, or 22.7% of Domestic Credit.

3.3 Financial Soundness Indicators

The overall outlook regarding the soundness of the banking sector remains positive during this period.

The ratio of non-performing loans (NPLs) increased only slightly from 6.3% at the end of 2015 Q4 to 6.4% at the end of 2016 Q1. The latter however remains well below the peak level of 7% in 2014 Q4. Meanwhile, banks' specific provisions for NPLs increased from AED 72.4 billion to AED 74.4 billion, thereby ensuring that NPLs are fully provisioned. Nonetheless, banks do not want to write off bad loans, which mean that the NPL ratio could decrease below what is reported.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio of banks reaching 18.0% (16.3% for Tier1 capital) in 2016 Q1, which is well above the regulatory requirements set by the Central Bank (12% and 8%, respectively).

To capture the composite effects of changes in loans and deposits, two key ratios related to the funding of banks are considered: the Loan-to-Deposit (L/D) ratio and the Lending to the Stable Resources Ratio (LSRR).

LSRR decreased from 87.1% to 86.8%, reflecting faster increase in stable resources compared to the credit of banks.

Meanwhile, liquid assets which include reserve requirements, certificates of deposit held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets decreased from 17.4% at the end of December 2015 to 15.6% at the end of 2016 Q1. The decrease is a reversal of the exceptionally high level reached last December. The level of total liquid assets at the end of 2016 Q1 remains higher than the levels observed during the first three quarters of 2015.

Table 3.3. Financial Soundness Indicators in the UAE (in %, unless otherwise indicated)

	2015				2016
	Q1	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio[7]	85.0	87.6	88.1	87.1	86.8
Ratio of Non-performing loans	6.6	6.3	6.3	6.3	6.4
The Liquid Assets Ratio (LAR)	14.74	14.3	14.2	17.4	15.6
Capital Adequacy Ratio (CAR) of which:	18.2	18.3	18.3	18.3	18.0
Tier 1 Capital	16.2	16.5	16.5	16.6	16.3

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values; data for 2016 Q1 are provisional.

[7] Net Lending + Net Financial Guarantees+ Stand-by Letters of Credit+ Interbank Placements (3 months and more)/ (Net Free Capital Funds+ Other Stable Resources).

3.4. The international ranking

The UAE ranks favorably in Doing Business Report issued by the World Bank, in both the overall country ranking as well as in Protecting Minority Investors and in Enforcing Contracts. However, the UAE ranked 97 in Getting Credit, due mainly to the absence of Credit Registry, and ranked 91 in Resolving Insolvency due to the absence of a modern bankruptcy framework.

Table 3.4.a. Doing Business 2016 Ranking: UAE and Comparator Countries

(Country ranking out of 189 countries)

	UAE	Qatar	Saudi Arabia	Hong Kong	Malaysia
Overall Ranking	31	68	82	5	18
Getting Credit	97	133	79	19	28
Protecting Minority Investor	49	122	99	1	4
Enforcing Contracts	18	112	86	22	44
Resolving Insolvency	91	51	189	26	45

Source: The World Bank

The UAE ranks 17 worldwide in the Global Competitiveness Index published by the World Economic Forum, which is based on Executive Opinion Survey. The ranking is favorable in all financial sub-components. The 3rd ranking of the UAE in Ease of Access to Loans is based on respondents' reply about the extent to which the financial sector meets the needs of business. While this ranking seems to be inconsistent with the country's low ranking in Getting Credit in Table 3.4.a, the former ranking does not focus on the absence of Credit Registry, but reflects the degree of the overall satisfaction of respondents with the financial sector, while the latter is more focused on lending to SMEs which needs to further grow in the UAE.

Table 3.4.b Global Competitiveness Index 2015/2016: UAE and Comparator Countries

(Country Ranking out of 140 countries)

	UAE	Qatar	Saudi Arabia	Hong Kong	Malaysia
Overall Ranking	17	14	25	7	18
Availability of Financial Services	22	13	47	3	17
Affordability of Financial Services	20	6	29	4	12
Financing through Local Equity Market	21	4	25	2	13
Ease of Access to Loans	3	1	27	5	2
Venture Capital Availability	7	1	27	9	2
Soundness of Banks	21	10	18	7	43

Source: The World Economic Forum

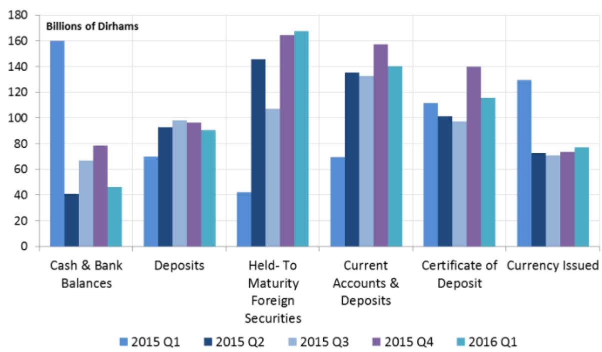
Chapter4. Central Bank Financial Position & Reserves Management

The Central Bank balance sheet exhibited a decrease in 2016 Q1, due to lower banks' reserves at the Central Bank and less investment by banks in Certificates of Deposits, which reflect sufficient liquidity conditions as banks continue to provide the economy with the needed financing.

4.1 Central Bank Balance Sheet

On the liabilities' side, "Current Accounts and Deposits" of banks at the Central Bank decreased by AED 16.7 billion, during 2016 Q1, while banks' holding of "Certificates of Deposit" (CDs) issued by the Central Bank decreased by AED 23.4 billion, reaching AED 116.4 billion. This is due among other factors to the exceptional increase in 2015 Q4. Meanwhile, "Currency Issued" increased by AED 3.7 billion, reaching AED 77.2 billion.

Figure 4.1. Central Bank Balance Sheet



Source: Central Bank of the UAE

The total assets of the Central Bank decreased by AED 34.7 billion or 8.9% during 2016 Q1, reaching AED 359 billion, with the above-indicated decrease in liabilities as the main driver. On the assets side, "Cash and Bank Balances" decreased by AED 32.6 billion, during 2016 Q1, while "Deposits at Banks Abroad" decreased by AED 5.9 billion, during the same period.

Table 4.1. Central Bank Balance Sheet

In Millions of Dirhams

	2015				2016
	Q1	Q2	Q3	Q4	Q1
Assets					
Gold Bullion	-	347	664	934	1,085
Cash & Bank Balances	42,409	40,708	66,883	78,611	46,029
Deposits	70,057	92,880	98,241	96,362	90,434
CDs Under Repo	6,000	-	-	-	-
Liquidity Support Facility	321	321	228	228	214
Held-To-Maturity Foreign Securities	159,947	145,574	107,078	164,495	167,508
Held-To-Maturity Bonds Issued by MOF & Dubai Government:	49,443	49,443	49,231	49,231	49,198
Available-for-sale foreign Investments	378	368	362	361	356
Advances to Government	2,500	-	850	2,500	2,500
Available-for-sale foreign securities	-	-	-	74	75
Derivative Assets	955	1066	47	334	175
Other Assets	447	469	462	445	437
Property and Equipment's	78	85	78	79	113
Total Assets	**332,535**	**331,260**	**324,126**	**393,660**	**358,675**
Off Balance Sheet Commitments	**145,303**	**119,150**	**115,166**	**199,681**	**198,254**
Liabilities					
Current Accounts & Deposits	129,404	135,394	132,727	157,031	140,363
Certificates of Deposit	111,759	101,335	97,365	139,773	116,393
Currency Issued	69,353	72,549	71,047	73,522	77,208
Derivative Liabilities	381	771	1,256	1,310	4,468
Other Liabilities	1,810	1399	1,931	2,275	1,177
Total Liabilities	**312,707**	**311,448**	**304,327**	**373,910**	**338,611**
Authorized Issued & Fully Paid Capital	2,500	2,500	2,500	2,500	2,500
Fair Value Reserve	-11	-21	-26	-29	-33
Gold Revaluation Reserve			-12	-60	85
General Reserve	17,339	17,339	17,339	17,339	17,812
Retained Earnings			-	-	-
Total Liabilities & Capital	**332,535**	**331,260**	**324,126**	**393,660**	**358,975**
Off Balance Sheet Commitments related to foreign exchange fluctuations	**145,303**	**119,150**	**115,166**	**199,681**	**198,254**

Source: Financial Control Division, Central Bank of the UAE.
Note: End-of-quarter data.

4.2 Central Bank Foreign Assets

The Central Bank's balance of foreign assets decreased from AED 341.2 billion at the end of 2015 Q4 to AED 306.2 billion at the end of 2016 Q1 (-10.3%), with the above-described decrease in liabilities being the main driver. The decrease was mainly due to "Current Account Balances & Deposit with Banks Abroad" which fell by AED 39 billion, compared to the last quarter of 2015.

Table 4.2. Central Bank's Foreign Assets

In billions of Dirhams

	2015				2016
	Q1	Q2	Q3	Q4	Q1
Total Foreign Assets	269.3	274.6	267.1	341.1	306.2
Held-To-Mature Securities	160.0	145.6	107.1	164.5	167.5
Current Account Balances & Deposit with Banks Abroad	105.5	124.6	156.4	171.8	132.8
Other Foreign Assets	3.7	4.4	3.7	4.8	5.9

Source: Central Bank of the UAE, end of quarter data

4.3 Interest Rates

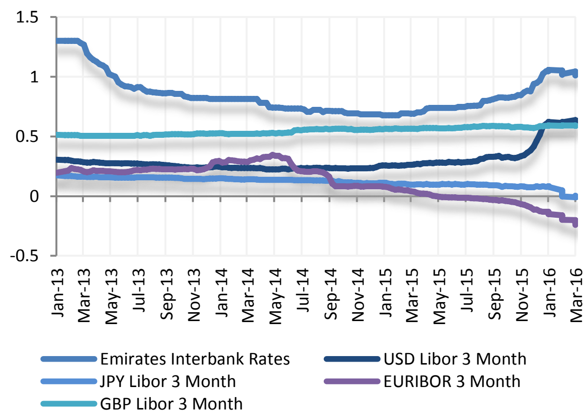
The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to peg its policy rate to the direction of the interest policy in the U.S. as well. Therefore, following the Federal Open Market Committee decision on 16 December 2015 to increase its target for the Federal Funds rate by 25 basis points, the Central Bank of the UAE announced its decision on December 17 to raise its interest rates applied to the Certificates of Deposits it issues to banks, in line with the rate increase on the US dollar. It is also worth-noting that the CBUAE uses monetary tools at its disposal to manage liquidity in the banking system, with a goal to strike a balance between supporting credit growth and stemming the risks to financial stability, while maintaining its continued commitment to the fixed peg regime.

4.3.1 Short-term interest rates

As Figure 4.3.1 shows, the 3-month Emirates Interbank Offer Rate (Eibor), which is calculated by the Central Bank of the UAE, comprising daily quotes of the largest banks operating in the country, after going up by 12 basis points in the fourth quarter of 2015, it fluctuated during 2016 Q1, tracking the fluctuation of the 3-month USD Libor rate during this period, thereby keeping the spread between the two rates at roughly the same level.

Meanwhile, the 3-month Libor rate in the Euro Area as well as in Japan continued its decline, reflecting the tepid economic conditions and heightened uncertainty about the success of European Central Bank (ECB) and the Bank of Japan regarding the continued use of Quantitative Easing, in the absence of supportive fiscal policy and/or structural reforms.

Figure 4.3.1 Libor Rates 3-month (%)



Source: Bloomberg

4.3.2 Long-term swap rates

In the absence of a deep and liquid government bond market in the UAE, the swap market is the only way to get an idea about yields at longer maturities. Interest rate swaps often exchange a fixed payment for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.3.2, the AED 10-year swap rate which increased by 25 bps in in 2015 Q4, consistent with the targeted increase in the policy rate in the U.S, was mostly on a declining trend during 2016 Q1, tracking the decline in the USD 10-year swap rate during this period. This was mainly due to the signals from the Federal Reserve that future increases in the target Federal Funds rate will be more gradual than previously announced. Meanwhile, the Swap rates for the Euro and JPY were in retreat during this period, reflecting continued expansionary monetary policies.

Tracking the spread between the AED 10-year swap and the USD 10-year swap backward, it narrowed since January 2013 on account of the improved fundamentals of the UAE economy. More recently, the spread was roughly maintained at the same level in the period under review.

Figure 4.3.2. 10-year swap rates

Source: Bloomberg

4.4 Monetary Tools

The primary tool for the Central Bank of the UAE is the dollar/dirham spot window which offers banks two-way liquidity, i.e., to exchange dollars against dirhams and vice-versa. This provides confidence to the market in the Central Bank's commitment to defend the exchange rate and enables banks a bigger scope to better manage their liquidity in both currencies.

4.5 Certificates of Deposits

Certificates of Deposits (CDs) were first issued by the Central Bank in 1988, in tenors varying from 1 month to 6 months. This program offers banks an alternative tool of investing their excess liquidity in dirhams instead of investing it in dollars abroad. The initial program was revamped in 1994 when it was made available for daily issuance, with tenors extended up to 18 months. Banks were also offered the possibility of redeeming their CDs, before maturity, allowing them to get immediate liquidity when needed at a rate set by the Central Bank. The system was revamped in 2007 with the move to a new auction system, where the CBUAE determines issuance by setting a cut-off interest rate for bids posted by banks, while Islamic CDs were introduced in 2010 to allow Islamic banks to better manage their excess liquidity, putting them on equal footing with conventional banks.

4.6 Banks' Excess Liquidity at the Central Bank

The main liquidity indicator monitored at the Central Bank in this regard is banks' excess reserves, i.e., their current account at the Central Bank and their holdings of CDs. Banks' current account at the Central Bank decreased by AED 16.6 billion during 2016 Q1, while Certificates of Deposits held by banks decreased by AED 23.4 billion, i.e., a total decline by AED 40 billion.

Total banks liquidity, including reserves requirements and highly-rated government and public sector debt, decreased from AED 351.2 billion at the end of 2015 Q4 to AED 313.8 at the end of 2016 Q1. The 10.7% decrease took place from a high base due to some banks' exceptional and abrupt investment in CDs last December. Moreover, the CBUAE's facilities to borrow Dirhams during 2016 Q1, namely through the Interim Marginal Lending facility, the Collateralized Murabaha Facility, and the CDs Repo Facility, have not been tapped by banks for liquidity shortfall.

4.7 Reserves Management

Foreign currency reserves are managed by the Reserves Management Division within the Monetary and Reserves Management Department. CBUAE's reserves are managed with a goal to strike a balance between guaranteeing a reasonable return on investments, while ensuring adequate liquidity buffers. Following the global financial crisis and subsequent adverse effects on the UAE economy, the CBUAE has adopted a more vigilant strategy towards risk management. As a result, the benchmarks for the investment strategy of the Central Bank reserves aim to ensure adequate liquidity, capital preservation and appropriate return, with liquidity being the most important driver to ensure banking stability. Investments are based on the Reserves Management Policy approved by the Board of Directors and in consistency with Union Law 10 of 1980, concerning the Central Bank, The Monetary System and Organization of Banking.