Quarterly Economic Review

Third Quarter 2020

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List of Abbreviations

AED	*United Arab Emirates Dirham*
BIS	*Bank for International Settlements*
CAR	*Capital Adequacy Ratio*
CBUAE	*Central Bank of the UAE*
CDs	*Certificates of Deposit*
CET	*Common Equity Capital*
CPI	*Consumer Price Index*
DFM	*Dubai Financial Market*
ECB	*European Central Bank*
EIBOR	*Emirates Inter-Bank Offer Rate*
EMDEs	*Emerging Markets and Developing Economies*
FCSC	*Federal Competiveness and Statistics Center*
Fed	*The US Federal Reserve*
GCC	*Gulf Cooperation Council*
GDP	*Gross Domestic Product*
Q-o-Q	*Quarter on Quarter*
GREs	*Government Related Entities*
IMF	*International Monetary Fund*
LTD	*Loan-to-Deposit*
LIBOR	*London Inter-Bank Offer Rate*
M1	*Monetary Aggregate 1*
M2	*Monetary Aggregate 2*
M3	*Monetary Aggregate 3*
MENA	*Middle East North Africa*
NEER	*Nominal Effective Exchange Rate*
OPEC	*Organization of Petroleum Exporting Countries*
PMI	*Purchasing Managers' Index*
SCA	*Securities and Commodities Authority*
SDR	*Special Drawing Rights*
TESS	*Targeted Economic Support Scheme*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States of America*
USD	*United States Dollar*
VAT	*Value Added Tax*
Y-o-Y	*Year on Year*
WEO	*World Economic Outlook*

Executive Summary

The global economy improved in the third quarter more than initially expected. This was mainly due to the easing of lockdowns and the partial return of international travel, in addition to unprecedented fiscal and monetary support programs adopted by governments. Although the global economy may still contract this year by 4.4%, it is a much-improved outlook than initially projected in Q2 by the IMF. The IMF envisages in its October 2020 World Economic Outlook that the Eurozone projected to contract by 8.3%, the UK by 9.8%, and the US by 4.3%, whereas emerging and developing economies are expected to contract at a comparatively slower pace of - 3.3% thanks among others to positive growth in China.

Inflation in developed economies remained well below target, mainly due to persistent low oil prices and subdued demand. In the USA, the persistence of below 2% target inflation led the Federal Reserve to adopt a new framework of average inflation targeting, whereby the inflation target will exceed 2% to compensate for below target in the previous years. The ECB also initiated its monetary policy strategy review to consider whether to reformulate its main target of price stability of annual inflation “below, but close to 2% over the medium term”, using the appropriate instruments and communications.

Domestically, economic activity in the UAE recovered partially in the third quarter, albeit the bounce back remained fragile. CBUAE projected real total GDP growth for the year 2020 to be around -6%, with the real non-hydrocarbon GDP projected to decline by around 5%. For 2021, CBUAE foresees real total GDP to grow by 2.5% and non-hydrocarbon real GDP by 3.6%. However, economic projections include exceptional uncertainty amidst Covid-19 repercussions and are thus subject to revisions.

CPI inflation remained negative for the third quarter at –2.4% Y-o-Y, driven by negative inflation in non-tradables (–3.8%) with decline in rents and in the price of fuel and recreation and culture, in tandem of overall subdued domestic demand. Real estate prices continued to decline, while the Dirham depreciated, in both, nominal and real terms in line with the weakening of the US dollar.

With regard to the fiscal stance in Q2 2020, the most recent period for which data is available, the net operating fiscal balance recorded a surplus at AED 4.2 billion, despite fiscal revenues declining by 41.3% Y-o-Y to AED 85.1 billion, while expenditures declined by 14.4% to AED 80.9 billion.

Most banking indicators improved during the third quarter supported by the enhanced Targeted Economic Support Scheme (TESS) extended by the CBUAE to banks. Deposits increased on a yearly basis by 5.8%, led by the government and GREs. Meanwhile, credit increased by 4.9%, supported by healthy financial soundness indicators.

Finally, interest rates in interbank markets continued to decrease in the third quarter due to global monetary easing, and the EIBOR vs. USD LIBOR spread also fell.

Chapter 1. International Economic Developments

Global economic growth improved in the third quarter, owing to unprecedented fiscal and monetary support programs, in tandem with easing of lockdowns and partial opening to international travel. Meanwhile, inflation remained well below target in developed countries and oil prices remained at a record low.

1.1 Economic growth

In its October World Economic Outlook (WEO), the IMF revised its forecast of global growth for the year 2020 upward to -4.4%, compared to its earlier projection of -4.9% in June. The recent forecast of a less severe contraction reflects better than anticipated third quarter economic developments, mostly in advanced economies, where lockdowns were scaled back and international travel started to resume.

In the United States, economic activity recovered thanks to timely and swift action by the Federal Reserve and the US Treasury, which succeeded in shoring up financial and labor markets. The easing of lockdowns led to a significant fall in the unemployment rate from 11.1% at the end of June to 7.9% at the end of September. As a result, real GDP contraction during 2020 is now forecasted at -4.3%, compared to -8.0% foretold in June. Nonetheless, uncertainty remains regarding a second wave of Covid-19 and the outcome of the US presidential elections, especially the deadlock at the US Congress about the fiscal stimulus.

In the Eurozone, the economy is projected to contract by 8.3% in 2020 (compared to -12.2% forecast made in June). The improvement is mainly due to better economic sentiment, especially in the services sector. Nonetheless, the contraction remains higher than in the US, as an example, as the Eurozone economies were already close to recession before they were hit by the pandemic.

In the UK, there was a smaller improvement compared to the forecasted contraction of 10.2% made in June. The still high October projection of a -9.8% contraction is a testament to the impact of the lockdowns and the remaining risks related to uncertainties surrounding the Brexit.

Table.1.1.a: Real GDP Growth in Selected Countries/Groups (%)

	2019	2020*		
		April	June	October
World Output	2.9	-3.0	-4.9	-4.4
USA	2.3	-5.9	-8.0	-4.3
Advanced Economies	1.7	-6.1	-8.0	-5.8
Eurozone	1.3	-7.5	-10.2	-8.3
France	1.5	-7.2	-12.5	-9.8
Germany	0.6	-7.0	-7.8	-6.0
United Kingdom	1.4	-6.5	-10.2	-9.8
Japan	0.7	-5.2	-5.8	-5.3
EMDEs[1]	3.7	-1.0	-3.0	-3.3
China	6.1	1.2	1.0	1.9
India	4.2	1.9	-4.5	-10.3
MECA[2]	1.0	-2.8	-4.7	-4.1

Source: IMF, *WEO*; October 2020
*Projected
[1] Emerging Market and Developing Economies
[2] Middle East and Central Asia

Emerging Markets and Developing Economies (EMDEs) are expected to contract by 3.3% during the year. These countries have inadequate public health care and social protection systems, in addition many economies were highly indebted before the crisis and the narrow fiscal and monetary policy spaces limited the authorities' response.

Moreover, these economies generally depend on severely affected sectors such as primary commodities, tourism and manufacturing exports, while some financial inflows reversed course and non-resource rich countries suffered as a result of reduced remittances from abroad.

East Asia remained an exception in this regard, most notably China, where economic activities normalized after a short break and most of the country reopened by early April. As a result, third quarter growth shot up on the back of strong policy support and resilient exports, which grew by 9.9% Y-o-Y in September while retail sales grew by 3.3% For 2020 as a whole, China is expected to achieve a positive growth of 1.9%, being the only large economy in the world to do so.

In contrast, India's weak public health system and lagged government response led to a projected slump in the economy in the order of 10.3% for the year 2020, taking into account the fact that the high infection rate in the country continues to impose localized restrictions on mobility.

Table.1.1.b: Quarterly Y-o-Y Real GDP Growth Rates in Selected Countries (%)

	2019		2020		
	Q3	Q4	Q1	Q2	Q3
USA	2.1	2.3	0.3	-9.5	-2.9
Eurozone	1.2	1.1	-3.3	-15.0	-8.0
France	1.4	1.2	-5.4	-19.0	-4.3
Germany	0.5	0.4	-2.3	-11.3	-4.3
China	6.1	6.0	-6.8	3.2	4.9

Source: Bloomberg

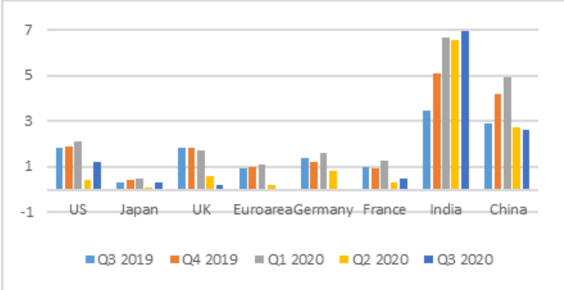
1.2 Inflation

In the third quarter, Y-o-Y headline inflation remained well below the 2% target in developed countries (1.2% in the US, 0.2% in the U.K., 0.0% in the Eurozone, and 0.3% in Japan), due to low oil prices and subdued demand.

Under these conditions, the ECB initiated its monetary policy strategy review to consider whether its main objective of price stability with the annual inflation target set at "below, but close to 2% over the medium term" needs to be reformulated. Similarly, the Fed adopted a new framework of average inflation targeting, whereby the inflation target will exceed 2% in the future to compensate for below target in the previous years (Box 1).

In emerging markets and developing economies, CPI inflation declined sharply in the initial stages of the pandemic as economies ground to a halt. Recently, there was a pick up in prices in some countries as economies managed to return to normal. In India, as an example, inflation is expected to reach 5% this year, reflecting supply disruptions and rise in food prices due to shortages.

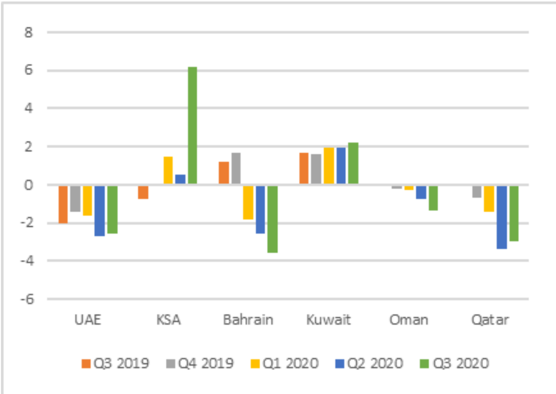
Figure 1.2.a: Y-o-Y Headline Consumer Price Inflation in Selected Advanced and Emerging Economies (%)



Source: Bloomberg

In the GCC, Saudi Arabia's annual inflation rate increased from 0.5% in Q2 to 6.2% in Q3, mainly due to the tripling of the value-added tax rate from 5% to 15% in July and an increase in some customs duties. All other GCC countries, except Kuwait, experienced negative inflation due to subdued economic activities, and as is the case in the UAE, falling housing and energy prices.

Figure 1.2.b: Y-o-Y Consumer Price Inflation in GCC Countries (%)



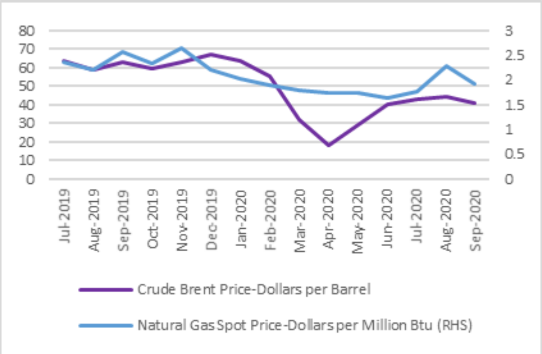
Source: Bloomberg

1.3 Commodities Prices

The US Energy Information Administration (EIA) estimated that the World demand for oil declined by 9.5 million barrels per day (mb/d) compared to the same period of the previous year reaching 90.3 mb/d at the end of Q3. This fact accounts for lower fuel consumption in the US and other countries. The price of Brent Crude increased from USD 40.2 per barrel at the end of June to USD 44.7 per barrel at the end of August. After which, in September 2020, the OPEC+ alliance's supply cuts stabilized the oil price at about USD 40.9 per barrel.

Gold continued to benefit from its safe haven status and the low levels of real interest rates. As a result, gold price rose from USD 1,801 per ounce at the end of June to USD 1,886 per ounce at the end of September 2020.

Figure 1.3.a: Crude Brent and Natural Gas Prices

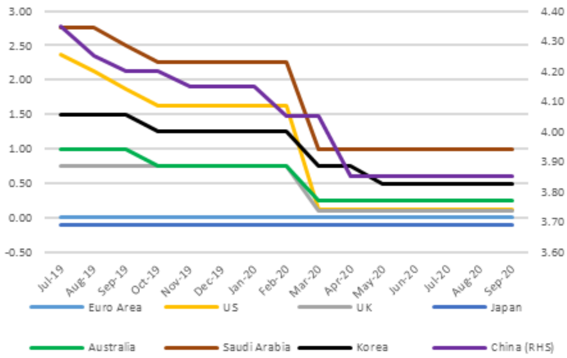


Source: US Energy Information Administration (EIA)

1.4 Monetary policy

With policy rates in the US, UK and the Eurozone already at or near zero, the monetary authorities kept their policy rates unchanged in Q3 and opted for monetary easing instead.

Figure 1.4 Policy Rates in Selected Economies (%)



Source: HAVER

Box 1: Fed's New Average Inflation Targeting Framework

While the ECB initiated its monetary policy strategy review, the Fed announced on 27 August the adoption of average inflation targeting in place of its previous single-year inflation-targeting framework. The box focuses on the new framework in the US, since it is the anchor country for the currency peg regime in the UAE.

The global financial crisis led to major changes in central bank policies in the developed world, with unprecedented recourse to monetary easing. Inflation remained subdued, though, and below target. Under these conditions, the European Central Bank (ECB) initiated its monetary policy strategy review to consider whether the ECB's current inflation target of "below, but close to, 2% over the medium term" should be reformulated and over which time horizon prices should be stabilized[1].

Meanwhile, the Federal Reserve (Fed) moved last August to average inflation targeting. The new framework should replace the single year 2% inflation target adopted in 2012, with the Personal Consumption Expenditures Index, as the official indicator. Since then, however, inflation was below target most of the time, despite the large fall in unemployment in recent years, until before the Covid-19.

On 27 August 2020, the Fed announced the adoption of average inflation targeting. Governor Powell explained[2] it as follows: "we will seek to achieve inflation that averages 2% over time. Therefore, following periods when inflation has been running below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time."

To this end, the Fed is expected to keep its policy rate, the overnight Fed Funds Rate, low for longer than in the previous framework to allow for higher inflation in the future. It also signaled to keep its policy rate in the current range of 0-0.25% through at least 2023.

Some uncertainties remain about the new framework, especially the difficulty for the public to understand the new framework and the fact that the announcement did not mention the elimination of the effective lower bound rate (ELB), which was expected to be a normal product of the new framework.

The announcement led to a decrease in interest rates, while the US dollar index fell against the currencies of the main trading partners by about 0.6% during the 2 weeks following the Fed's announcement.

Low US interest rates for long periods will result in low interest rates in the UAE, consistent with the currency peg arrangement. This will benefit all borrowers. Meanwhile, the USD and thus the Dirham may weaken (against currencies with higher interest rates), boosting the price competitiveness of the UAE non-hydrocarbon exports, which have shown resiliency in the recent period, despite the global economic slowdown.

[1] See ECB monetary policy review, available online: https://www.ecb.europa.eu/home/search/review/html/index.en.html

[2] https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm

Chapter 2: Domestic Economic Developments

Economic activity in the UAE recovered partially in the third quarter, although it remained weak compared to pre-pandemic levels and GDP growth for the year is expected to remain negative. Moreover, negative CPI inflation rates declined further, as a result of the fall in rents, lower energy prices and an overall subdued demand. The Dirham depreciated in nominal and real terms and the consolidated fiscal balance remained in surplus, due to the decline in government expenses.

2.1 Economic Activity and Growth

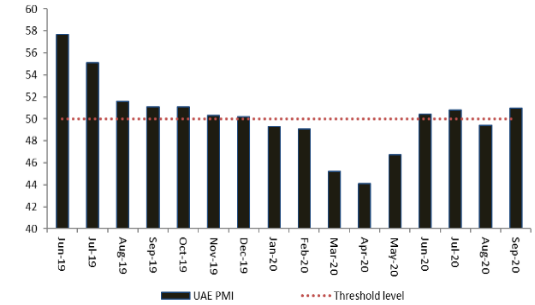
Real GDP is projected to recover to 2.5% in 2021, with non-oil GDP growing by 3.6% and oil GDP remaining flat following OPEC+ production schedule. Real non-oil GDP growth is expected to be driven by increasing fiscal spending, pick up in credit and employment, relative stabilization of the real estate market, boosted by recovery in confidence and the Dubai EXPO 2021.

More significant economic improvement of the non-oil sector is expected to start in Q4 2020, conditional on the containment of the virus. Banks' credit growth is foreseen to increase, together with slower annual real estate price decline and pick-up in employment. Sentiment is expected to improve in preparation for the Dubai EXPO which was postponed to 2021. Better tourism and hospitality data in Abu Dhabi in October show a recovery of occupancy and revenue, the best performance achieved since March 2020, and the improvement is expected to continue further.

During the third quarter of 2020, economic activity in the UAE recovered partially, after the waiver of lockdowns in the country and the resumption of international travel. This benefited the UAE, given its role as a regional trade, transportation and travel hub. Manufacturing production was also boosted as the supply chain resumed from the disruptions seen in Q2. However, the recovery was not as robust as expected, in addition to the weaker than intially expected fiscal spending growth and second wave of COVID-19 globally. As a result, real GDP growth projection for the year 2020 was revised to around -6%[3,4].

The real non-hydrocarbon GDP was projected to decline by around 5% in 2020, after a drop of 2.7% Y-o-Y in the first quarter of the year. CBUAE estimates that the third quarter real non-oil GDP growth has recorded a milder contraction and is expecting better economic performance in the fourth quarter of 2020, conditional on the containment of the virus.

Figure 2.1.a: UAE PMI



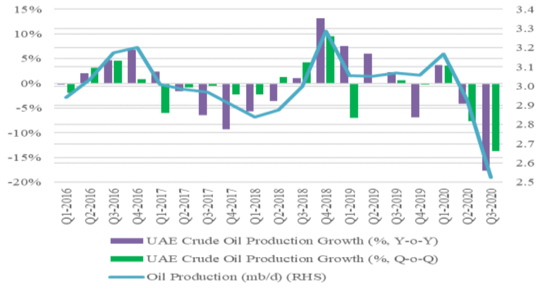
Source: IHS Markit

As an oil exporter, the UAE is likely to feel the fallout from reduced global demand for oil due to the contraction of economic activities worldwide, including transportation and international travel. UAE oil production fell by 4.1% Y-o-Y in Q2 and by 17.7% in Q3, in line with the agreement by OPEC+. Real oil GDP is projected to contract in 2020, corresponding to an average oil production of 2.8 mb/d for the year as a whole.

[3] Forecasts subject to revision, due to the high uncertainty around COVID-19.

[4] CBUAE forecasts the real non-oil GDP using an univariate model where the quarterly real non-oil GDP Y-o-Y growth is explained by the lagged Y-o-Y growth of the fiscal spending, and the Y-o-Y growth of the quarterly credit, UAE real estate sales prices, PMI and employment. The real oil GDP growth is estimated/projected based on hydrocarbon output and considering other value adding activities in the sector. The contribution of the real non-oil GDP is approximately 70% of the total GDP.

Figure 2.1.b: UAE Crude Oil Production Level and Growth



Source: OPEC

2.2 Developments in the Residential Real Estate Market

In Q3 2020, residential real estate prices continued to decline Q-o-Q and Y-o-Y as a result of oversupply, and the fall in demand, due to the economic contraction.

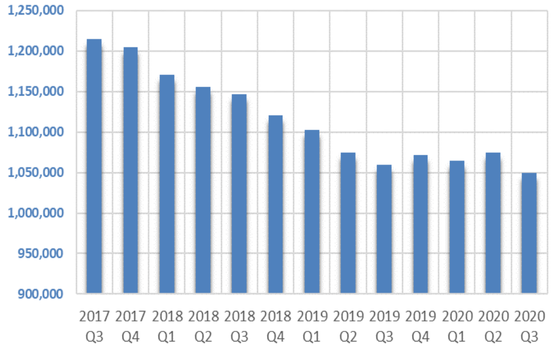
Dubai Residential Market

According to recent data from Dubai Land Department (DLD), residential property prices in Dubai declined on average by 0.9% Y-o-Y in Q3 2020.

Meanwhile, rents in Dubai continued their declining trend, decreasing by 6.9% Y-o-Y in the third quarter. The implied rental yield[5,6] in Dubai moved to 6.6% in the third quarter up from 6.3% in the previous quarter.

Figure 2.2.a: Average Dubai Residential Unit Sale Prices

Dirhams



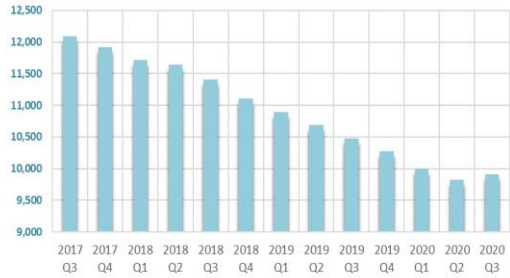
Source: DLD

Abu Dhabi Residential Market

According to the REIDIN[7] house price index, average price in the Abu Dhabi housing market increased Q-o-Q by 0.9% in Q3 2020. Although prices showed quarterly improvement, this was not enough to offset the negative momentum in earlier quarters, leading to an annual decline by 5.5%.

Figure 2.2.b Abu Dhabi Residential Prices

Dirhams per SQM



Source: REIDIN

Rents in Abu Dhabi declined by 3.9% Y-o-Y in Q3 2020, after 4.9% drop in the previous quarter. The decline in rents by 0.4% Q-o-Q compared to the increase in sale prices resulted in declining rental yield to 7.0% in Q3 compared to 7.1% in the second quarter.

[5] The rental yield measures the rate of income return over the cost associated with an investment (the property price).
[6] CBUAE calculates the implied rental yield in Dubai, by dividing the annual rent by the average Dubai residential unit sale prices. Annual rent and average Dubai residential unit sale prices are provided by DLD.
[7] REIDIN Residential Price Index in Abu Dhabi covers 7 areas and 5 districts.

2.3 The Consumer Price Index and Inflation

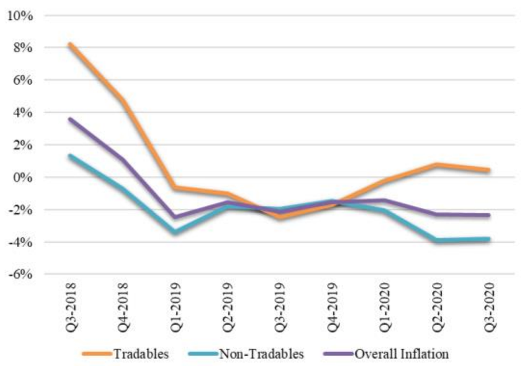
During the third quarter of the year, inflation remained negative in the UAE as the consumer price index declined by 2.4% Y-o-Y, compared to a drop by 2.3% in the second quarter. This was the result of a significant drop by 3.8% in the price of non-tradables, i.e. goods and services that are not traded across borders, therefore their prices are mainly determined by domestic supply and demand conditions[8], while tradables[9] prices rose by 0.4%.

Tradables prices, accounting for 34% of the CPI consumption basket, increased in Q3 owing mainly to the increase in the price of food and soft drinks; beverages and tobacco; and textile, clothing and footwear. Prices of food, beverages and tobacco increased to a lesser extent than in the second quarter, due to the partial recovery in the supply chains, while textiles and clothing prices rose significantly by 8.5% Y-o-Y, driven by the increasing import prices of raw materials, needed for their production.

The continued decline in the housing component (34% weight in the consumer basket) by 3.0% Y-o-Y, transportation by 8.1%; and recreation and culture by 30.5%, as well as the softening in most other components of non-tradables, contributed to the significant drop in this segment during Q3.

Based on its analytical model and analysis, the CBUAE projects the average CPI inflation for 2020 to remain negative at about -2.1%, in view of the softening of the real estate market, the subdued demand, and the uncertain economic environment.

Figure 2.3: Headline, Tradable and Non-Tradable Inflation (Y-o-Y)



Source: FCSC

Box 2: Methodology of Forecasting Inflation in the UAE

CBUAE initiated the process of forecasting the inflation rate in the UAE based on the monthly CPI data published by the FCSC.

To this end, a Vector Autoregressive (VAR) model is adopted. The selected endogenous variables are: Purchasing Managers' Index for the UAE (PMIUAE), housing price growth (HPI) and the CPI inflation (PI). The sample covers the period from September 2009 to September 2020 using monthly observations[10].

The estimated model is represented as follows:

$$y_t = \mathrm{C} + \sum_{i=1}^{n} A_i \, y_{t-i} + \varepsilon_t,$$

where $y_t = [PMIUAE_t, HPI_t, PI_t]'$ and the vector of errors $\varepsilon_t \xrightarrow{iid} N(0, \Sigma)$. The selected lag structure indicates that the model should be a VAR(3).

[8] As per CBUAE calculations includes the following categories of goods and services: housing; medical care; transportation; communications; recreation and culture; education; restaurants and hotels; and miscellaneous goods and services.

[9] As per CBUAE calculations, tradables include the following categories of goods and services: food and soft drinks; beverages and tobacco; textiles, clothing and footwear; furniture and household goods; transportation; and miscellaneous goods and services.

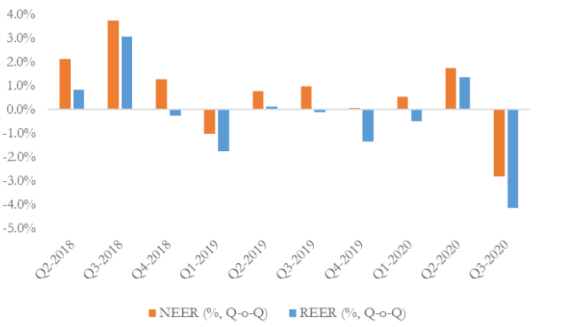
[10] The choice of the period under consideration is due to the set of available data.

2.4 Exchange Rates and Outward Personal Remittances

2.4.1 Exchange Rate

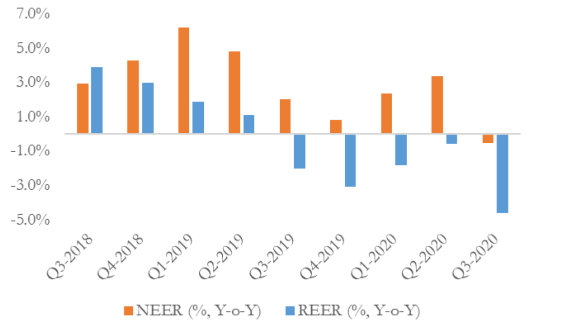
In Q3 2020, taking into account all of the UAE's trading partners, the Nominal Effective Exchange Rate (NEER) of the Dirham depreciated, due to the strong depreciation of the US Dollar. During the third quarter, the average quarterly NEER depreciated by 2.8% and 0.5% on a Q-o-Q and Y-o-Y basis, respectively, after an appreciation of 1.8% and 3.4%, respectively, in the previous quarter.

Figure 2.4.1.a: Q-o-Q Nominal and Real Effective Exchange Rates Developments



Source: BIS

Figure 2.4.1.b: Y-o-Y Nominal and Real Effective Exchange Rates Developments



Source: BIS

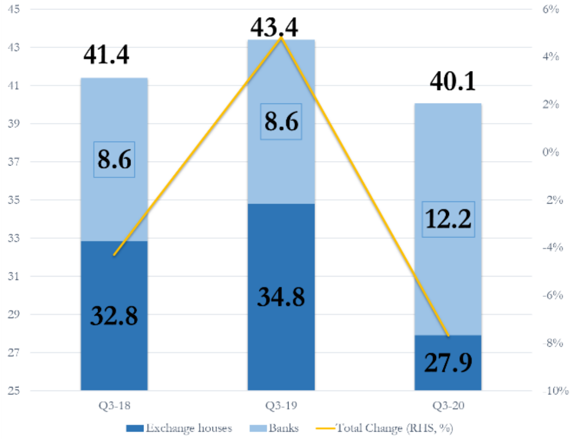
In real terms, the Dirham Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, also depreciated by 4.1% and 4.6% on a Q-o-Q and Y-o-Y basis, respectively, in the third quarter of 2020. The higher depreciation in the REER compared to the NEER was due to the lower and negative inflation in the UAE compared to the inflation rates prevailing in trading partners' economies.

2.4.2 Outward Personal Remittances

Outward personal remittances declined by 7.7% or AED 3.3 billion in the third quarter of 2020, compared to the same period in 2019. There was a reduction in transfers through exchange houses by AED 6.9 billion, while outward remittances through banks increased by AED 3.6 billion.

Figure 2.4.2: Outward Personal Remittances Settled Through Banks and Exchange Houses, Q3 2018-2020

Billions of Dirhams



Source: CBUAE

The top three destination countries for outward personal remittances during the third quarter were India (30.8%), Pakistan (11%) and Egypt (6.5%). With the exception of India, where outward personal remittances declined on an annual basis by 27.8%, there was an increase by 1.6% in outward remittances to Pakistan and by 1.4% to Egypt.

2.5 The Consolidated Fiscal Stance

The latest available data for Q2 2020 show that the decline in oil prices and slower economic activity led to a decrease in government revenues in the first two quarters of 2020.

On the expenditure side, total expenses and capital spending decreased on a Y-o-Y basis by 22.5% in Q1 and by 3.2% in Q2 standing at AED 101.0 billion in the second quarter of 2020.

As a result, the Net Operating Balance registered a surplus of AED 4.2 billion in Q2 2020 compared to an AED 12.9 billion surplus in the previous quarter.

2.5.1 Revenues

Government revenues registered a decline in Q2 2020 by 41.3% Y-o-Y to AED 85.1 billion as a result of the decline in tax and other revenues. Taxes fell by 31.0% and 59.1% Y-o-Y in Q1 and Q2, respectively. In the first quarter of the year, the collected taxes amounted AED 29.2 billion compared to AED 29.5 billion in the second quarter. Other revenues also dropped in Q2 2020 by AED 19.3 billion or 27.0% Y-o-Y, to reach AED 52.2 billion.

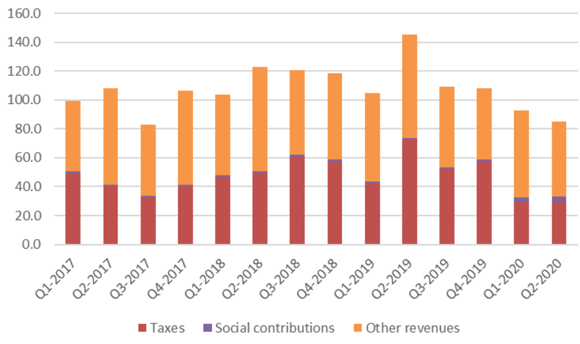
2.5.2 Expenditures

On the expenditure side, total expenses (current spending) declined Y-o-Y by 14.4% in Q2 2020, compared to a decline of 24.4% in the previous quarter. The fall in expenses is attributed to the decline in all categories, except the compensation of employees and subsidies.

Moreover, capital spending, measured by the net acquisition of non-financial assets, declined Y-o-Y by 2.7% in Q2 2020, reaching AED 9.6 billion.

Figure 2.5.a. General Government Revenues

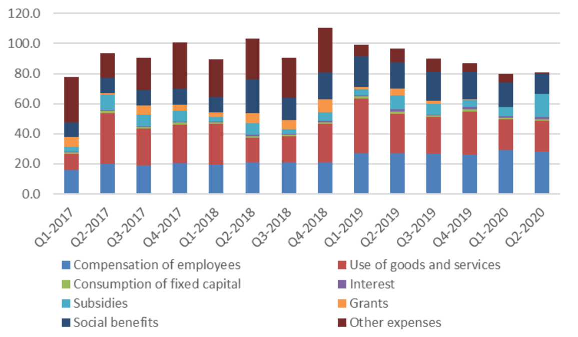
Billions of Dirhams



Source: UAE Ministry of Finance

Figure 2.5.b General Government Expenses

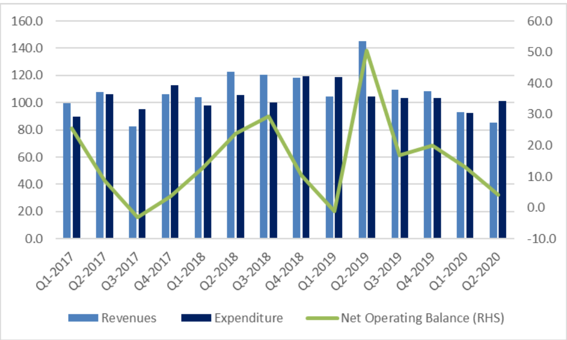
Billions of Dirhams



Source: UAE Ministry of Finance

Figure 2.5.c Fiscal Stance

Billions of Dirhams



Source: UAE Ministry of Finance

Table 2.5 Consolidated Government Finances

Billions of Dirhams

	2019				2020		2019 (% Y-o-Y)				2020 (% Y-o-Y)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
Net Operating Balance	**-1.2**	**50.6**	**16.9**	**19.9**	**12.9**	**4.2**	**-----**	**112.0%**	**-42.6%**	**91.6%**	**-----**	**-91.7%**
Revenues (a)	**104.8**	**145.1**	**109.3**	**108.1**	**93.0**	**85.1**	**0.9%**	**18.2%**	**-9.4%**	**-8.8%**	**-11.2%**	**-41.3%**
- Taxes	42.4	72.3	52.1	57.8	29.2	29.5	-9.3%	46.1%	-14.0%	0.6%	-31.0%	-59.1%
- Social contributions	1.3	1.3	1.1	1.2	3.3	3.4	-0.3%	-2.4%	-14.3%	0.6%	161.7%	158.6%
- Other revenues	61.2	71.5	56.4	49.1	60.5	52.2	9.5%	-0.5%	-4.0%	-18.0%	-1.1%	-27.0%
Expenditure	**119.0**	**104.4**	**103.2**	**103.6**	**92.2**	**101.0**	**21.6%**	**-1.4%**	**3.3%**	**-13.2%**	**-22.5%**	**-3.2%**
-Expense (b)	**105.9**	**94.5**	**92.4**	**88.3**	**80.1**	**80.9**	**16.3%**	**-4.4%**	**1.3%**	**-18.4%**	**-24.4%**	**-14.4%**
Compensation of employees	27.3	27.1	26.6	26.2	29.0	28.0	39.8%	28.1%	26.0%	23.7%	6.2%	3.4%
Use of goods and services	36.4	25.9	24.3	28.3	20.6	20.4	34.7%	61.8%	42.1%	12.3%	-43.4%	-21.4%
Consumption of fixed capital	1.1	1.5	1.1	1.5	1.1	1.2	-3.8%	43.3%	5.4%	53.6%	8.0%	-22.1%
Interest	0.8	1.6	0.7	1.7	1.1	1.4	68.8%	39.5%	13.8%	20.8%	35.1%	-10.1%
Subsidies	3.8	9.5	7.4	4.7	5.9	15.7	16.7%	26.0%	138.7%	-12.1%	56.2%	65.2%
Grants	8.6	1.9	4.3	1.6	0.3	0.2	111.1%	-28.1%	-38.4%	-73.8%	-96.6%	-92.0%
Social benefits	20.2	17.5	19.4	18.4	16.4	13.0	92.1%	-21.1%	31.3%	0.7%	-19.0%	-25.6%
Other expenses	7.8	9.4	8.7	5.9	5.7	1.1	-69.1%	-65.4%	-67.2%	-80.2%	-26.9%	-88.5%
Net acquisition of non-financial assets	13.1	9.9	10.8	15.4	-1.8	9.6	94.1%	41.2%	23.8%	36.2%	-----	-2.7%
Net Operating Balance (a-b)	**-1.2**	**50.6**	**16.9**	**19.9**	**12.9**	**4.2**	**-----**	**112.0%**	**-42.6%**	**91.3%**	**-----**	**-91.7%**

Source: UAE Ministry of Finance

Note:

- UAE Ministry of Finance, revenues do not include ADNOC transfers and government investment income.
- Other Revenues covers: Property income (interest, dividends, rent), Sales of goods and services (including administrative fees), Fines and penalties and other revenues not elsewhere classified.
- Effective 2016Q1, the Emirate of Abu Dhabi has added some transfers of important investment authorities from financing accounts to revenues, included in the distributed profit computation.
- Other expenses include the payments of Abu Dhabi made on behalf of the Federal Government.
- Subsidies include social and price subsidies as well as transfers to GREs.
- Grants include current or capital transfers from the Government to other Government units, international organizations or foreign Governments, excluding transfers between Federal and Local Governments

Chapter 3. Banking and Financial Developments[11]

Deposits at banks increased in the third quarter of 2020 driven by the increase in government and private sector deposits, while gross credit grew despite the economic contraction. Overall, the financial soundness indicators remained healthy during this period, which is testament to the positive impact of the CBUAE's enhanced Targeted Economic Support Scheme (TESS) and the gradual recovery of the economy.

3.1 Banking Structure[12]

The number of licensed commercial banks remained unchanged in the third quarter of 2020 at 59, comprising 21 national banks and 38 foreign banks (including 11 wholesale banks). Nonetheless, the digitization of financial services led national banks to rely less on branches, whose number decreased from 611 at the end of Q2 two to 559 at the end of Q3, while the number of banks' staff fell by 1,532 to reach 33,891 employees at the end of September 2020.

3.1.1. Bank Deposits

Resident deposits (90.0% of total deposits) increased by 3.0% in the third quarter of 2020 owing mainly to an increase in government deposits by AED 44.6 billion and a rise in private sector deposits by AED 2.9 billion. Meanwhile, non-resident deposits (10.0% of total deposits) decreased by 4.5% Q-o-Q in the third quarter of 2020.

Table 3.1.1.a: Total Deposits at UAE Banks

Item	Mar-20	Jun-20	Sep-20
Bank Deposits	1851.9	1866.2	1907.2
(Y-o-Y change %)	5.9%	5.2%	5.8%
Resident Deposits	1635.1	1665.8	1715.9
(Y-o-Y change %)	6.2%	5.6%	6.4%
Government Sector	255.1	289	333.6
(Y-o-Y change %)	-6.6%	-0.8%	5.4%
GREs	260.1	240.5	245.5
(Y-o-Y change %)	33.6%	10.6%	12.6%
Private Sector	1076.2	1091.8	1094.7
(Y-o-Y change %)	4.4%	6.0%	5.8%
NBFI	43.7	44.5	42.1
(Y-o-Y change %)	6.1%	13.8%	-3.0%
Non-Resident Deposits	216.8	200.4	191.3
(Y-o-Y change %)	4.1%	1.9%	0.8%

At the end of September 2020, data by bank type show the share of deposits at the end of September were 78.2% and 21.8% in conventional and Islamic banks, respectively. Similarly, the share of national and foreign banks in customer deposits represented 88.2% and 11.8%, respectively.

3.1.2. Banks' Assets and Credit

Total assets increased in the third quarter by 2.0% Q-o-Q while Gross Credit increased by 0.8%. However, domestic credit decreased by 0.9%, owing mainly to the private sector credit (AED 17.6 billion decrease).

Table 3.1.2.a: Assets and Credit at UAE Banks

Item	Mar-20	Jun-20	Sep-20
Total Assets	3128	3190.2	3252.5
(Y-o-Y change %)	8.1%	7.8%	7.6%
Gross Credit	1768.2	1791	1805
(Y-o-Y change %)	5.6%	5.8%	4.9%
Domestic Credit	1595	1626.9	1611.7
(Y-o-Y change %)	4.3%	5.5%	2.9%
Government	229.1	252.4	255.5
(Y-o-Y change %)	16.2%	25.2%	16.4%
GREs	201.1	218.1	217.7
(Y-o-Y change %)	17.1%	23.7%	21.7%
Private Sector	1148.9	1139.4	1121.8
(Y-o-Y change %)	0.7%	-0.7%	-2.5%
NBFI	15.9	17	16.7
(Y-o-Y change %)	-20.1%	0.6%	-2.3%
Foreign Credit	173.2	164.1	192.9
(Y-o-Y change %)	18.8%	9.3%	24.3%

Lending by economic activity shows that the highest quarterly reduction was in trade by 5.6% Q-o-Q (AED 8.9 billion) followed by manufacturing by 3.9% (AED 3.1 billion). Despite the overall decrease, lending to construction and real estate increased marginally by 0.1% Q-o-Q (AED 0.2 billion).

[11] In this chapter unless specified otherwise: (1) all data indicate the end-of-period values, (2) Values are expressed in billions of AED, unless specified otherwise and (3) The source of the data is the Central Bank of the UAE.

[12] In this section, all September 2020 data are preliminary and subject to revision.

Table 3.1.2.b: Bank Lending by Economic Activity

Economic Activity	Jun-20	Sep-20
Total	**1,626.9**	**1,611.7**
(Q-o-Q change %)	2.0%	-0.9%
(Y-o-Y change %)	5.5%	2.9%
Of which:		
Construction and Real Estate	**326.5**	**326.8**
(Q-o-Q change %)	2.1%	0.1%
(Y-o-Y change %)	-2.9%	-1.9%
Trade	**157.2**	**148.3**
(Q-o-Q change %)	0.9%	-5.6%
(Y-o-Y change %)	2.1%	-5.5%
Transport, Storage and Communication	**84**	**82.1**
(Q-o-Q change %)	32.7%	-2.2%
(Y-o-Y change %)	51.9%	52.1%
Manufacturing	**79.7**	**76.5**
(Q-o-Q change %)	-2.4%	-3.9%
(Y-o-Y change %)	4.6%	1.8%

Analysis by type of banks shows that the share at the end of Q3 for Islamic banks was at 19.0% in total assets and 21.9% in total gross financing of the banking system. The main drivers of gross domestic lending growth were government and GREs for both conventional and Islamic banks.

Foreign banks had a 12.6% share in total assets and 10.6% share in gross credit. On a quarterly basis, total assets of national banks expanded by 2.4% while total assets of foreign banks declined by 0.8%.

With regard to bank lending to Micro, Small and Medium Enterprises (MSMEs), it remained roughly flat at AED 92.6 billion at the end of the third quarter, albeit 3.5% higher than the level at the end of 2019. This is testament to the success of the enhanced TESS, which allowed MSMEs to benefit from the provision of temporary relief by banks and other measures.

3.1.3. Financial Soundness Indicators

The Advances to Stable Resources Ratio (ASRR) of the banking system decreased from 81.9% in the second quarter to 78.6% in the third quarter, due to faster growth of deposits compared with lenidng. Eligible Liquid Assets,[13] as a ratio of total liabilities[14] remained at 16.9%, i.e., well above the 10% regulatory minimum requirement, constituting an adequate buffer for banks, which allows them to weather potential worsening of liquidity conditions.

Total liquid assets at banks at the end of the third quarter of 2020 stood at AED 448.3 billion, i.e., AED 15.9 billion higher compared to the end of the second quarter of 2020 (3.7% increase).

Banks operating in the UAE remain well capitalised, on average, with an average Capital Adequacy Ratio (CAR) at 18.0%, Tier 1 Capital Ratio at 16.9%, and Common Equity Tier 1 Ratio (CET 1) at 15.1%.[15]

Table 3.1.3.a: UAE Financial Soundness Indicators (in %, unless otherwise indicated)

	Mar-20	Jun-20	Sep-20
Total Banking System			
Advances to Stable Resources Ratio (ASRR)	82.3%	81.9%	78.6%
Eligible Liquid Assets Ratio (ELAR)	17.3%	16.6%	16.9%
Capital Adequacy Ratio (CAR)	16.9%	17.6%	18.0%
Tier 1 Capital Ratio	15.8%	16.4%	16.9%
CET 1 Ratio	13.9%	14.7%	15.1%

Loan to Deposit (LTD) ratio for the whole banking system decreased to 94.6%, well below the 100% requirement, at the end of the third quarter, from 96.0% at the end of the second quarter.

[13] In the ELAR, the eligible liquid assets include required reserves, mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks.
[14] Balance sheet total assets less (capital and reserves + all provisions except staff benefit provisions + refinancing + subordinated borrowing/deposits).

https://www.centralbank.ae/sites/default/files/2020-08/Credit%20Sentiment%20Survey%20-%20Q2%202020.pdf
[5] The minimum regulatory requirement for CAR is 13% (10.5% minimum adequacy and 2.5% capital conservation buffer), 8.5% for Tier 1, and 7% for CET 1.

3.2 Financial developments

3.2.1. Share Prices

Stock markets continued their rally worldwide in the third quarter despite the continued economic contraction and rising risk, with the MSCI World Index increasing by 9.3%.

Consistent with the global developments, the Abu Dhabi Securities Exchange (ADX) share price index increased by 5.4% Q-o-Q, while the Dubai Financial Market (DFM) index increased by 16.3% over the same period of time.

Table 3.2.1: UAE – Securities Markets

			2020	
			Q2	Q3
Abu Dhabi	Share Price Index	Q-o-Q	14.8%	5.4%
		Y-o-Y	-13.9%	-10.7%
		YTD	-15.6%	-11.0%
	Market Capitalization	Q-o-Q	17.6%	38.3%
		Y-o-Y	-4.9%	29.6%
		YTD	-6.9%	28.8%
	Turnover (Traded Value)	Q-o-Q	-19.2%	112.6%
		Y-o-Y	9.0%	112.8%
		YTD	3.3%	119.7%
Dubai	Share Price Index	Q-o-Q	10.4%	16.3%
		Y-o-Y	-26.5%	-18.3%
		YTD	-29.3%	-17.8%
	Market Capitalization	Q-o-Q	8.9%	8.2%
		Y-o-Y	-17.1%	-13.3%
		YTD	-21.7%	-15.3%
	Turnover (Traded Value)	Q-o-Q	-2.1%	21.9%
		Y-o-Y	119.5%	44.1%
		YTD	49.4%	82.1%

Source: SCA

Note: Changes computation are based on quarterly average values for the share price index and market capitalisation

3.2.2. Credit Default Swaps (CDS)

CDS, i.e. the insurance premium the lender pays to be reimbursed in case the borrower defaults, decreased generally worldwide during the third quarter of 2020, as a result of the easing of COVID-19 restrictions. The Government of Abu Dhabi's premium decreased by 52.3 bps to 52.2 bps, while for the Emirate of Dubai, the premium decreased by 76.7 to 168.0 bps.

Table 3.2.2: UAE – Sovereign Credit Default Swaps (CDS) (in bps)

	2020		
	Q1	Q2	Q3
Emirate of Abu Dhabi	61.1	104.5	52.2
Emirate of Dubai	144	244.7	168

Source: Bloomberg

Note: All data are quarterly average

Box 3: UAE Small Business Facing Covid-19 Repercussions

Micro, Small and Medium Enterprises (MSMEs) play a vital role in economic growth, exports, innovation and job creation. Therefore, they are among the main target sectors of the TESS adopted by the Central Bank. This helped MSMEs in maintaining credit and other banking facilities during the third quarter of the year, despite the economic contraction.

Bank credit to MSMEs

CBUAE's enhanced TESS continued to support MSMEs through banks to mitigate the effects of COVID-19. The announced measures include:

- Provision of temporary relief by banks to all affected private sector corporates, especially payment deferrals for MSMEs until the end of 2020, which was later extended to June 2021.
- Reduction of risk weights applicable for rated MSMEs to 75%, and 85% for unrated SMEs.
- Expanding the definition of SMEs so that a larger segment will be in a position to qualify for SME lending.
- Issuance of SMEs bank account opening regulation for improved processing and turnaround time limiting bank fees charged to SMEs.

In august 2020, the CBUAE relaxed:

- The Net Stable Funding Ratio (NSFR) by 10%, allowing banks to go below the 100% threshold to 90%.
- The Advances to Stable Resources Ratio (ASRR) by 10% permitting banks to go above the 100% threshold to 110%.

These measures that were initially effective until 31 December 2020 were extended on 16 November to June 2021.

Bank Lending to MSMEs in the UAE

		in billions of Dirhams			
		2019	2020		
			Q1	Q2	Q3
1	Micro	11.4	10.9	10.5	10.6
	-Share of SME lending	12.7%	11.7%	11.4%	11.5%
2	Small	28.2	29.4	29.6	28.9
	- Share of SME lending	31.5%	31.5%	32%	31.3%
3	Medium	49.9	53.1	52.3	52.9
	- Share of SME lending	55.7%	56.8%	56.6%	57.2%
4	Total	89.5	93.4	92.4	92.6

Source: CBUAE

Banks' lending to MSMEs remained mostly stable in the third quarter of 2020, 3.4% higher compared to the end of 2019. This is a testament to the success of the TESS, in encouraging banks to help small business adjust to lockdowns through payment deferrals to banks and access to new credit lines.

The Zero Cost Facility (ZCF) provided by CBUAE to banks benefited MSMEs as the number of beneficiaries reached 9,826 companies at the end of September.

After an increase in the second quarter of 2020, the number of MSMEs accounts at banks decreased by 10,574 accounts during the third quarter of 2020, mainly due to a decrease in micro and small size companies.

Number of MSMEs Accounts at Banks Operating in the UAE

	2020		
	Mar	Jun	Sept
Microenterprises	30,625	32,021	30,843
Small Enterprises	60,510	63,147	54,514
Medium Enterprises	29,137	29,767	29,004
Total	120,272	124,935	114,361

Source: CBUAE

Chapter 4. Interest Rates and Money Supply

LIBOR rates continued to decline during the third quarter, while the spread between EIBOR and the USD LIBOR narrowed. Meanwhile, the 10-year swap interest rate on the Dirham increased and the money supply expanded thanks to higher resident deposits, especially by the public sector.

4.1 Interest rates

4.1.a Short-term interest rate

The 3-month USD LIBOR continued its steady decline during the third quarter, from 0.3% at the end of Q2 to 0.2% at the end of Q3, as a result of the substantial monetary easing engineered by the Fed, which suppressed the credit risk during this period.

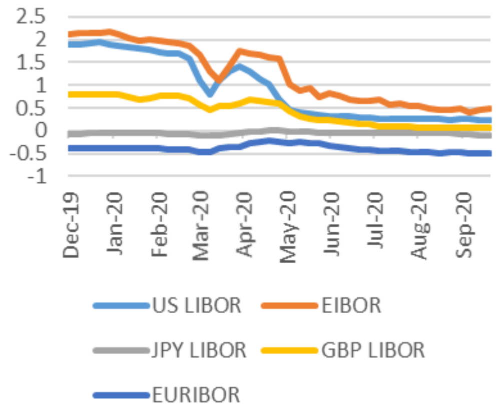
In addition, the sluggish growth prospects in the US had a negative impact on interest rates as the recovery remained fragile and uncertainties rose regarding the outcome of the November 2020 elections. The average 3-month USD LIBOR fell from 0.6% during Q2 2020 to 0.3% during Q3.

The GBP LIBOR fluctuated around a declining trend, from 0.2% at the end of the second quarter of 2020 to 0.1% at the end of Q3. This was mainly due to the slow recovery and rising uncertainties about the pandemic and the post-Brexit trade with the European Union. The average GBP LIBOR decreased from 0.4% in Q2 to 0.1% in Q3 2020.

The 3-month EURIBOR remained in negative territory, declining from -0.4% at the end of Q2 to -0.5% at the end of Q3, with the ECB providing surplus cash to banks operating in the Eurozone. Similarly, JPY LIBOR rates remained in negative territory, consistent with the policy orientation of the Bank of Japan.

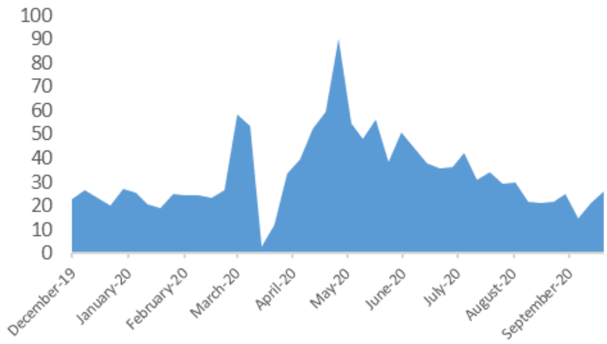
In the UAE, the 3-month EIBOR was mostly on a declining trend, following the fall in the USD LIBOR. It decreased from 0.7% at the end of Q2 to 0.4% in mid-September, before increasing to 0.5% at the end of the third quarter of 2020. The average 3-month EIBOR declined from 1.1% in the second quarter to 0.5% in the third quarter.

Figure 4.1.a: EIBOR and USD-LIBOR



Source: Bloomberg

Figure 4.1.b. Spread of 3-month EIBOR vs. 3-month USD LIBOR (bps)



Source: Bloomberg

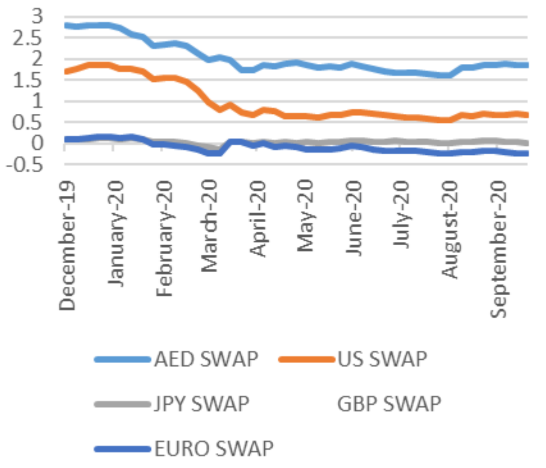
The Spread 3-month EIBOR vis-à-vis 3-month USD LIBOR declined from a peak of 42.1 bps in mid-July to 14.6 bps in mid-September, before increasing to 26.0 bps at the end of the third quarter of 2020.

4.1.b Long-term swap rates

Interest rate swaps involve an exchange of a fixed rate for a floating rate payment that is linked to a specified benchmark rate. The 10-year swap rate on the Dirham increased from

1.7% at the end of Q2 to 1.9% at the end of Q3, while the average declined from 1.82% to 1.75%.

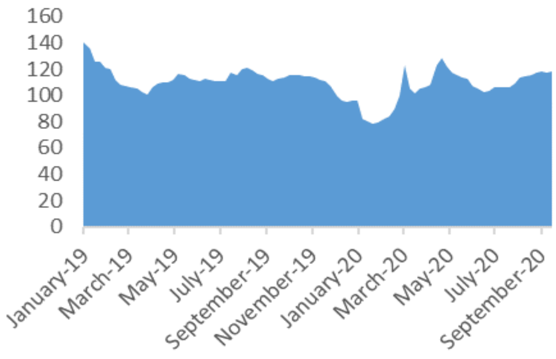
Figure 4.1.c Selected 10-year interest rate Swaps (%)



Source: Bloomberg

The spread of the 10-year swap rate on the Dirham vs. that on the US dollar witnessed a rising trend during Q3. The quarterly average decreased slightly from 112.8 bps in Q2 to 111.7 bps in Q3.

Figure 4.1.d Spread 10-year AED Swap vs. USD Swap (bps)



Source: Bloomberg

4.2 Money supply

Monetary aggregates increased in September 2020 as the economy started recovering and banks' liquidity improved.

Money Supply M_1[16] increased by 1.9% Q-o-Q (AED 10.6 billion) to reach AED 568.0 billion, driven by a rise in Monetary Deposits (82.3% of M_1) by 1.4% (AED 6.5 billion) reaching AED 471.3 billion and an increase in Currency in Circulation (17.0% of M_1) by 4.4% (AED 4.1 billion). On a Y-o-Y basis, M_1 increased by 11.0% due to an increase in Currency in Circulation by 26.2% and an increase in Monetary Deposits by 8.3%.

Table 4.2.1. Money supply in the UAE

Billions of Dirham

	M_1	M_2	M_3
June	557.4	1,458.0	1,752.3
July	559.4	1,492.1	1,777.8
August	566.9	1,513.5	1,797.1
September	568.0	1,468.7	1,805.7

Source: CBUAE

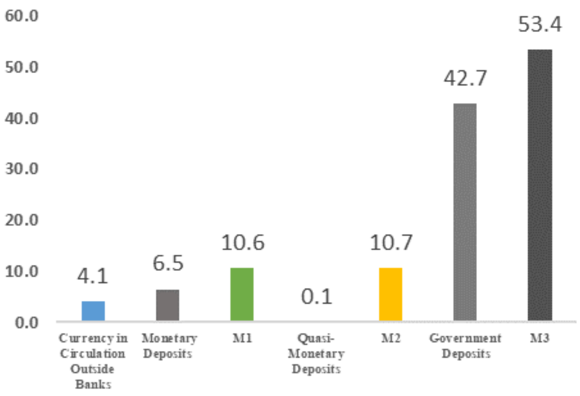
On a quarterly basis, Money supply M_2[17] increased by 0.7% (AED 10.7 billion) to reach AED 1,468.7 billion, brought about by an increased M_1, while Quasi-Monetary Deposits (61.3% of M_2) remained flat at about AED 900.7 billion, as record low interest rates are unattractive for term deposits and some households drew on their savings to make for income losses. On a Y-o-Y basis, M_2 increased by 7.9% in September 2020, due to the increase in M_1 and a 6% increase in Quasi-Monetary Deposits.

[16] Currency in Circulation outside banks + Monetary Deposits

[17] M1 + Quasi Monetary Deposits

Figure 4.2: Q-o-Q Change in Monetary aggregates in 2020 Q3

Billions of Dirhams



Source: CBUAE

M_3[18] also increased on a quarterly basis by 3.0% (AED 53.4 billion) to reach AED 1,805.7 billion, driven by increased M_1 and M_2 and a 14.5% rise in Government Deposits (18.7% of M_3) (AED 42.7 billion), reaching AED 337.0 billion. Y-o-Y, M_3 increased by 7.5% due to the increases in M_2 by 7.9% and in government deposits by 5.8%.

[18] M2 + Government Deposits at banks and CBUAE

Statistical Appendix

Balance Sheet of the Central Bank of the UAE

Millions of Dirhams

	2019		2020		
	Q3	Q4	Q1	Q2	Q3
ASSETS					
Cash and Bank Balances	238,539	254,446	255,014	244,694	285,407
Deposits	113,821	116,393	112,902	86,282	62,967
Tri-Party Deposits	16,521	11,198	7,159	-	-
Marginal Lending Facility	-	-	190	38,705	38,133
Advance to Government	-	-	-	-	-
Foreign Investments	485	498	505	530	502
Derivative Assets	2,459	3,818	917	1,377	283
Certificate of Deposits under Repo	-	-	8,334	5,673	4,835
Liquidity Support Facility	71	50	29	7	-
Investments	51,568	54,814	58,229	59,698	53,043
Gold Bullion	2,709	4,044	5,951	6,580	8,961
Other Assets	674	839	687	540	240
Property & Equipment	123	126	124	148	165
TOTAL ASSETS	**426,970**	**446,246**	**450,041**	**444,235**	**454,537**
LIABILITIES					
Current Accounts & Deposits	26,145	30,972	38,771	56,884	22,939
Overnight Deposit Facility	-	-	-	-	60,760
Reserve Requirement from Banks	126,233	129,735	132,583	73,287	75,105
Certificates of Deposit	153,765	160,183	144,578	178,471	151,347
Currency Issued	90,781	93,729	105,200	106,141	111,316
Derivative Liabilities	198	17	847	244	2,616
Other Liabilities	6,407	6,562	2,790	3,281	3,946
TOTAL LIABILITIES	**403,530**	**421,197**	**424,769**	**418,308**	**428,029**
EQUITY					
Fully Paid Up Capital	20,000	20,000	20,000	20,000	20,000
Fair Value Reserve	21	34	41	66	88
Gold Revaluation Reserve	311	412	629	1,258	1,818
General Reserve	3,108	4,603	4,603	4,603	4,603
TOTAL EQUITY	**23,440**	**25,049**	**25,273**	**25,926**	**26,508**
TOTAL LIABILITIES & EQUITY	**426,970**	**446,246**	**450,041**	**444,235**	**454,537**

Source: CBUAE

CBUAE Classification: Public
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