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Quarterly Economic Review

Second quarter 2018

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Executive Summary

Global growth projections released by the IMF showed that prospects for 2018 remained unchanged at 3.9% despite the rising risks of trade war and financial vulnerabilities in Emerging Markets. Growth projections for the US remained unchanged but above potential, which is putting pressure on a tight job market. Other developed countries' growth prospects were revised downward due to increased uncertainties related to the trade war and the lasting impact of Brexit for the UK. As for Emerging Economies, growth projections stood at 4.9% despite serious pressures on some countries facing capital outflows and weakening currencies.

The main risks going forward seem to be: (1)The fallback of the trade war as countries may decide to respond by slapping additional tariffs on US imports, thereby compromising the rule-based world trade order and the relevance of the World Trade Organization altogether, and (2) rising vulnerabilities in some Emerging Economies that may further compromise global growth prospects.

Meanwhile, inflation edged up in the US where core inflation crept higher towards the Fed's target, which explains the Fed's decision to raise its policy rate in June, indicating its commitment for further rate hikes as economic conditions continue to strengthen. In Japan, however, inflation decreased to well below BOJ's target, which reinforces market expectations that the Bank will have no choice but to cut its inflation forecasts in the coming period.

As for the yield on US Treasuries and its global impact, the noticeable development in 2018 Q2 is the flattening of the yield curve, with the yield on 10-year US Treasury falling below 3%, mainly due to serious concerns about long-term growth prospects and inflation. Policy normalization in the US is expected to ease price pressures and investors continue to establish positions in safety haven assets, including long-term US Treasury bonds.

In the UAE, the quarterly Augmented Economic Composite Indicator of Non-Oil activity, constructed by CBUAE, showed a resilient non-hydrocarbon sector in the second quarter of 2018. The resiliency owes mainly to the recovery in oil prices, supporting fiscal policy and resilient tourism and related activities. Moreover, CPI inflation slowed down after the pronounced increase in the first quarter due to the implementation of VAT. Inflation in 2018 Q2 was driven mainly by the prices of Tradables, while moderate inflation in Non-Tradables was the result of continued decline in housing prices. Job creation increased at a slower pace, as a result of the moderation in oil production and slowdown in some Non-Oil activities.

Banking sector developments in the second quarter of 2018 showed a continued growth in deposits, mainly boosted by the increase in Government deposits, in tandem with sufficient liquidity and resilient non-oil activity. This, allowed banks to extend credit, particularly to the private sector.

The Central Bank's balance sheet exhibited a decrease in 2018 Q2, as evident by the decrease in Cash and Bank Balances as well as the decrease in Deposits at Banks Abroad and Other Advances. Meanwhile, the decrease on the liabilities side was mostly the result of a decrease in Current Accounts and Deposits of banks at the Central Bank. Nonetheless, the balance of Certificates of Deposits (CDs) issued by CBUAE and purchased by banks remains high, thereby indicating sufficient liquidity in the banking system.

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Chapter 1. International Economic Developments

The growth outlook remained roughly unchanged in 2018 Q2 for the US, thanks to a pickup in investment and consumer confidence awaiting the delayed impact of the tax cuts. Growth, however, was revised downward for the European Union, the UK and Japan mostly on the fallback of trade war. Meanwhile, Emerging Economies' growth outlook remains positive thanks to higher growth in resource-rich countries benefiting from higher oil prices. As regards inflation, it crept higher towards the Fed's policy target in the US, which explains the decision in June to raise the Fed's policy rate as well as continued commitment for further hikes by this year-end. Bond yields saw a curve-flattening trend because of expected Fed hikes having a dampening effect on both long term growth and inflation and growing concerns about looming trade war that attracted investors to higher positions in safe haven assets, including long-term Treasury bonds.

I.1 Global Economic Growth:

According to the IMF's July 2018 *World Economic Outlook* (WEO), global growth projections for 2018 remained at 3.9%, despite increased risks from the trade war, some regional disturbances, and rising Emerging Markets vulnerabilities. Growth resiliency in this regard relates mainly to strengthened US growth position, relatively high growth in Emerging Asia, and recovery in several commodity exporters.

Table. 1.1 Real GDP growth in Advanced Countries

	2016	2017	2018	
			Q1	Q2
USA	**1.5**	**2.3**	**2.2**	**4.2**
EURO Area	**1.8**	**2.3**	**2.3**	**2.1**
France	**1.2**	**1.8**	**2.1**	**1.7**
Germany	**1.9**	**2.5**	**2.0**	**1.9**
United Kingdom	**1.9**	**1.8**	**1.2**	**1.3**
Japan	**0.9**	**1.7**	**-0.9**	**3.0**

Source: IMF, World Economic Outlook, US data: BEA, Euro Area: Eurostat, France: INSEE, Germany: Federal Statistical office, UK: Office for National Statistics, Japan: Cabinet Office.

The outlook for the US growth was revised upward in 2018 Q2 to 4.2% due to the effect of the tax cuts and deregulation of the Trump administration that led to an increase in non-residential fixed investments, in addition to increase in defense spending and others. The expectation is that the US economy will achieve 3% growth this year, which will increase pressures on a tight job market, leading to an increase in wages in tandem with improved labor force participation, which reached 62.9% at the end of 2018 Q2. The robust growth will keep the Fed on course to further increase the policy rate in the coming months.

In the UK, growth was also revised upward from 1.2% in Q1 to 1.3% in 2018 Q2 due to the increase in business investments and industrial production. The highest revision took place in Japan where annualized growth shot up from a contraction in 2018 Q1 to 3.0% growth in 2018 Q2. The pronounced recovery is due to steady increase in wages, which boosted consumption, while concerns about global trade uncertainties and the threat of tariff on car and auto-part exports to the US are still looming.

For the Euro zone, growth was mostly revised downward from 2.3% in 2018 Q1 to 2.1% in Q2 as most of the member countries GDP decelerated. As an example, German GDP growth was revised, during this period, from 2.0% to 1.9%, while France's was revised from 2.1% to 1.7%. The slowdown in the Euro zone, which is consistent with the cut in growth forecasts conducted by the European Union, is mostly due to the rising oil prices, softened Industrial production and escalating trade tensions.

Rising concerns about trade wars are affecting global growth prospects. The global growth outlook remained tainted by the rising potential of "trade war" between the US and its trading partners. The US imposed tariffs on solar panels and related items, which mostly targeted China, were extended last May 2018 to tariffs on imported steel (25%) and aluminum (10%). Retaliatory tariffs on U.S. goods started in June from The European Union, Canada and China. While they remain manageable at the current levels, additional retaliatory measures may escalate to a full-fledged trade war with serious consequences on the rule-based order and the future of the World Trade Organization altogether.

Growth projections for Emerging Economies as a whole remain at 4.9% at the end of 2018 Q2, thanks to higher growth in some commodity exporting countries as well as resilient export prospects for some others. Nonetheless, serious pressures were observed in some countries where currencies weakened, increasing inflation and deteriorating debt overhang. Global investors withdrew over $14 billion in May and June 2018 in Brazil and Turkey for example, a trend that may worsen with prospective hikes of interest rates in the US and an appreciating US dollar.

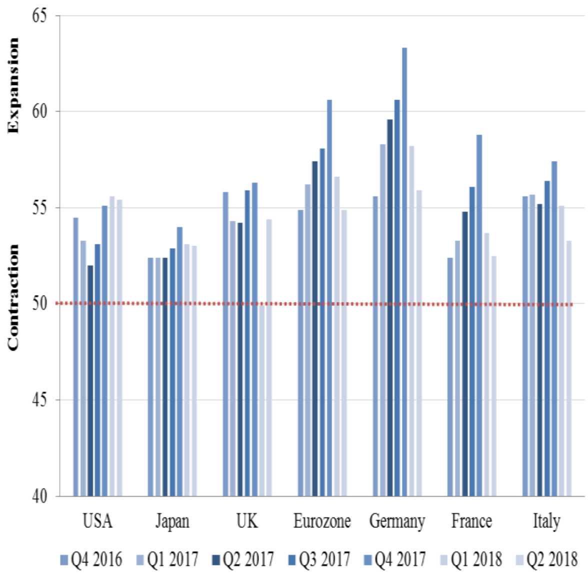
China's annual real GDP growth was revised downward by 0.2 percentage points, amid intensifying trade battles with the US and efforts to reduce the debt overhang and to rein in rising financial risks. Growth remains at 6.6% in the second quarter, i.e., higher than the official target of 6.5%.

For India, growth is expected to reach 7.3% in 2018, making it the highest growth performer among the large economies. Despite the negative impact of higher oil prices, the recovery is supported by private investor confidence and increased public spending, against the backdrop of measures taken by the RBI to strengthen the banking system.

In the region of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)1 as defined by the IMF, economic growth for 2018 was slightly revised upward from 3.4% in Q1 to 3.5% in Q2, owing mainly to higher oil prices for resource-rich countries.

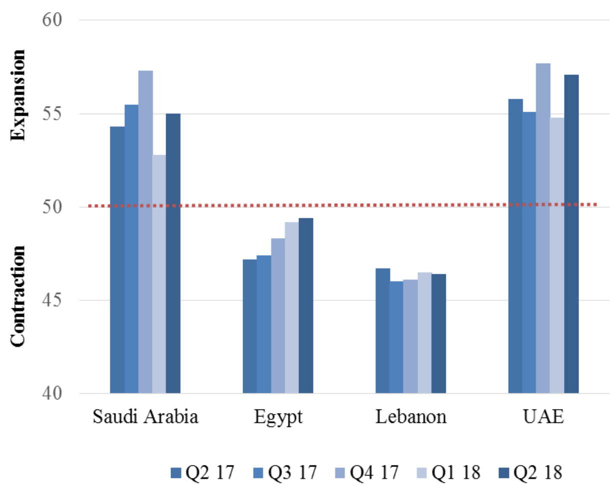
In the GCC, real non-oil GDP growth continues to improve in 2018 on the back of recovery in oil prices, and a more gradual pace of fiscal consolidation. The Saudi growth in 2018 was revised upward from 1.7% in Q1 to 1.9% in Q2, thanks to higher oil prices and supporting fiscal policy undertaken by the government to further diversify the economy and implement its Vision 2030. The PMI in the non-oil private sector increased also to a six month-high of 55 as output growth accelerated in the second quarter.

Figure 1.1. PMI Levels for Selected Countries



Source: Bloomberg

Figure 1.2. PMI levels for selected MENA countries



Source: Bloomberg

[1] MENAP oil exporters: Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen. MENAP oil importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Sudan, Syria, and Tunisia.

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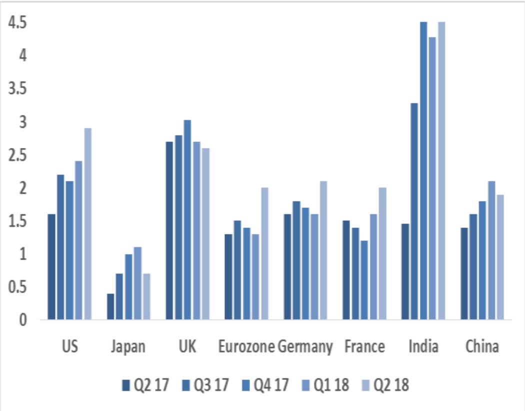
I.2 Inflation:

Y-o-Y CPI inflation reached 2.9% in the US at the end of 2018 Q2, owing mainly to an increase of 24% in gasoline prices, while core CPI inflation (excluding volatile food and energy prices) reached 2.3%. As regards the increase in Core PCE (Public Consumption Expenditure Index), the Fed's preferred index for inflation target, it reached exactly the Fed's target of 2%. Price pressures may increase further in the coming period as import prices rise in the US due to the tariffs imposed by the Trump Administration.

In Japan, Y-o-Y CPI inflation decreased from 1.1% in 2018 Q1 to 0.7% in Q2, while the increase in Core CPI, the index closely watched by Bank of Japan, which excludes food prices but includes oil prices, reached 0.8% Y-o-Y in June up from 0.7% in May. Inflation remains well below the 2% target, which reinforces market expectations that the Bank of Japan will have no choice but to cut its inflation forecasts in the coming period.

Figure 1.3. Year-on-Year Consumer Price Change for Selected Developed and Emerging Economies (%)



Source: Bloomberg

In the MENA region, higher oil prices generally led to increased inflation given the importance of energy and transportation costs in the CPI basket. Higher inflationary pressures led to popular resentment in some oil importers like Jordan.

I.3 Prices of commodity and precious metals

The second quarter saw a continuation of the general mixed movements in commodity prices since the previous quarter. Brent crude oil prices increased from an average of $75.2 per barrel in April to $78.0 in May and to $79.4 in June. Y-o-Y Crude Brent increased by 66%, mainly due to escalating geopolitical tensions and bullish drawdowns in US crude inventories. By mid-June, however, prices fell on the back of potential increase in oil production by 1 million barrels per day, by OPEC and non-OPEC producers, which may add about 1% to global supply.

The agreement between OPEC and other producers was to cut oil production by 1.8 million barrels per day. However, unexpected outages in Venezuela, Libya and Angola have effectively brought supply cuts to around 2.8 million barrels per day. Moreover, Iran's output is likely to drop in the second half of the year due to renewed US sanctions. In contrast, projected Non-OPEC oil supply for 2018 was revised up by 0.13 mb/d (1.86 mb/d Y-o-Y) to 59.75 mb/d. Meanwhile, projected global oil demand in 2018 is estimated to average 98.85 mb/d.

World annual consumption has been increasing at a moderate pace. Compared to 2017, the US oil consumption is projected to increase by 600 thousand barrels per day to 20.667 million barrels per day. China's annual consumption for 2018 and 2019 is expected to reach 13.690 and 14.100 million barrels per day, respectively (Table 1.2).

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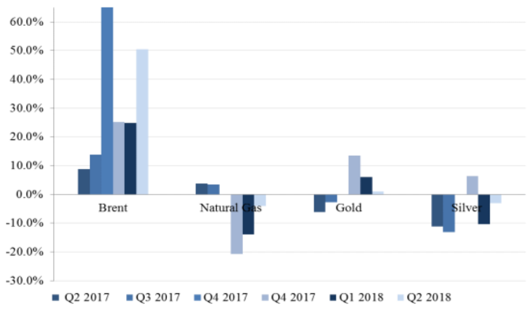
Table. 1.2 Annual Consumption in major economies
In million barrels per day

	Annual Consumption (Million barrels per day)			
	China	U.S.	Other	World
2016	12.810	19.687	64.372	96.869
2017	13.260	19.877	65.355	98.492
2018	13.690	20.407	66.196	100.293
2019	14.100	20.667	67.239	102.005

Source: Short-Term Energy Outlook, June 2018.

Gold price increased Q-o-Q by 6.1% in 2018 Q2 and by 1% Y-o-Y, while Natural Gas and Silver prices decreased by 4%, and 3% Y-o-Y, respectively (Figure 1.4).

Figure 1.4. Selected commodity price levels (Y-o-Y, % change)



Source: Bloomberg, EIA.

I.4 Policy Interest Rates:

Policy normalization by the Federal Reserve continued in 2018 Q2, as the Federal Reserve's Open Market Committee (FOMC) decided on its 13th meeting to increase the interest rates by 25 basis point for the federal funds rate to reach the target of 1.75% - 2% range. The Chairman of the Fed explained that the decision comes as the US economy is picking up and is forecast to pick up at a faster rate in the second part of the year, largely on the back of household spending and growing business investment.

Table. 1.3 The Policy Interest Rates for Selected Advanced Countries

Date	US Fed Funds Rate (mid)	BoJ Overnight Call Rate	ECB Refinancing Rate	BoE Policy Rate
30.6.17	1.1	-0.1	0	0.3
31.7.17	1.125	-0.064	0	0.25
31.8.17	1.125	-0.066	0	0.25
29.9.17	1.125	-0.063	0	0.25
31.10.17	1.125	-0.046	0	0.25
30.11.17	1.125	-0.055	0	0.5
29.12.17	1.375	-0.062	0	0.5
31.1.18	1.375	-0.05	0	0.5
28.2.18	1.375	-0.053	0	0.5
30.3.18	1.625	-0.068	0	0.5
30.4.18	1.625	-0.067	0	0.5
31.5.18	1.625	-0.065	0	0.5
29.6.18	1.875	-0.069	0	0.5

Source: Bloomberg

Meanwhile, the European Central Bank's Governing Council maintained during 2018 Q2 the interest rate on refinancing operations, on the marginal lending facility and on the deposit facility, unchanged, at 0.00%, 0.25% and -0.40%, respectively. The Governing Council decreased in June the net monthly asset purchases by ECB from €30 billion to €15 billion, starting October 2018. While Bank of Japan left its policy interest rate steady at minus 0.01% in its June meeting.

Government Bond yields:

The yield on 10 year US Treasury peaked at about 2.95% at the end of April, before it decreased to about 2.85% in May and June. While many market participants expected bond yields to move further up in line with rising policy rates and inflationary expectations, the strong likelihood of the Fed's continued commitments to rate hikes within an economy growing at almost full employment and the ratcheting up of trade war pressures have flattened the US yield curve. Market expectations have increasingly factored in potential slowdown, resulting in flight to safe haven assets, including long-term Treasury bonds.

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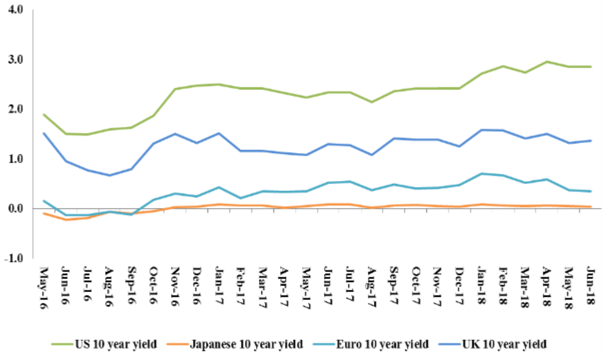
Figure 1.5 The 10-year government bond yields for selected countries (%)



Source: Bloomberg

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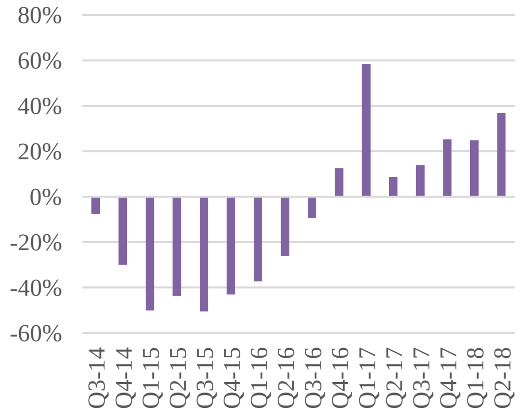
Chapter 2: Domestic Economic Developments

According to the quarterly Augmented Economic Composite Indicator of Non-Oil activity for the UAE, constructed by CBUAE, growth remained resilient in the second quarter of 2018, against the backdrop of firming up of oil prices, supporting fiscal policy and resilient Tourism and related activities. Meanwhile, CPI inflation slowed down after the pronounced increase in the first quarter, following the implementation of VAT, with the increase driven mainly by the prices of Tradables. This is in contrast to a moderate inflation of Non-Tradables, owing to a continued reduction in housing prices. As a result of the contraction in Oil production and some slowdown in Non-Oil activities, employment growth has slowed down.

2.1. Economic Activity and Growth

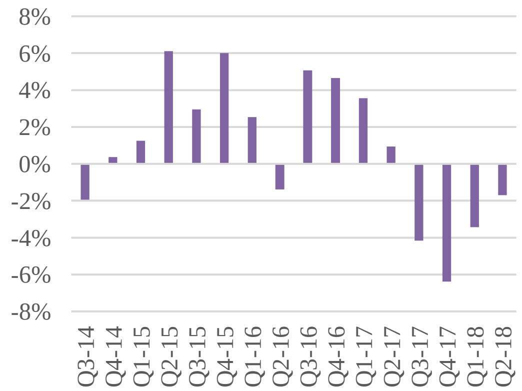
Improved prospects for global Oil demand, coupled with a coordinated supply agreement, boosted oil prices by 25% Y-o-Y in the first quarter of 2018, followed by an increase of 37% in the second quarter (see Figure 2.1.a.). The OPEC agreement that stipulated a coordinated Oil production cut helped solidify the gain in Brent Oil prices by 28% Q-o-Q on average since the agreement took effect in January 2017. The UAE has agreed to reduce its Oil supply since the first quarter of 2017; a cut that lasted until the second quarter of 2018, where Oil production fell by 1.7% Y-o-Y (see Figure 2.1.b.). Moreover, Oil production remained roughly flat on a quarterly basis in the second quarter of 2018 (see Figure 2.1.c.).

Figure 2.1.a Brent crude Oil prices (%, Y-o-Y)



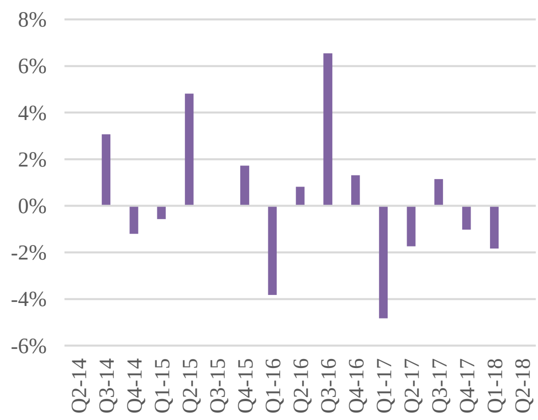
Source: EIA

Figure 2.1.b UAE's Oil Production Growth (%, Y-o-Y)



Source: Bloomberg

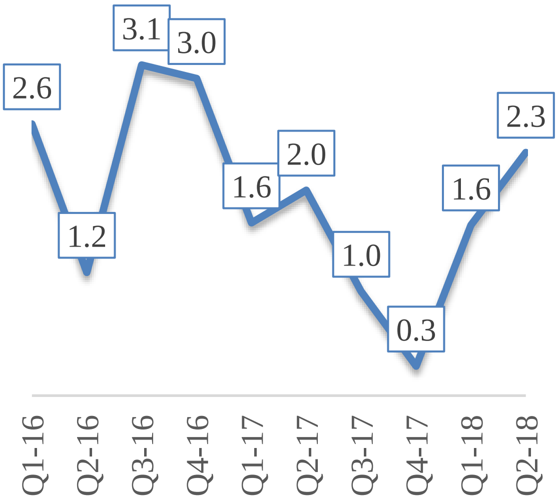
Figure 2.1.c UAE's Oil Production Growth (%, Q-o-Q)



Source: Bloomberg

The Non-Oil activity is proxied by the Augmented Economic Composite Index (AECI), the CBUAE quarterly constructed index. Economic activity remained robust, albeit with some moderation in growth, in the second quarter of 2018. In fact, the Non-Oil ECI growth decelerated to 3.6% Y-o-Y in the second quarter of 2018 following an increase of 3.8% in the first quarter, which was the highest reading since the first quarter of 2016 (5.1% Y-o-Y). The improvement of the economic sentiment amid Oil price rebound boosted the prospects of employment and credit to the private sector, strengthening the resiliency of the Non-Oil sector during the first half of 2018.

Figure 2.1.d Overall Augmented Economic Composite Indicator (%, Y-o-Y)



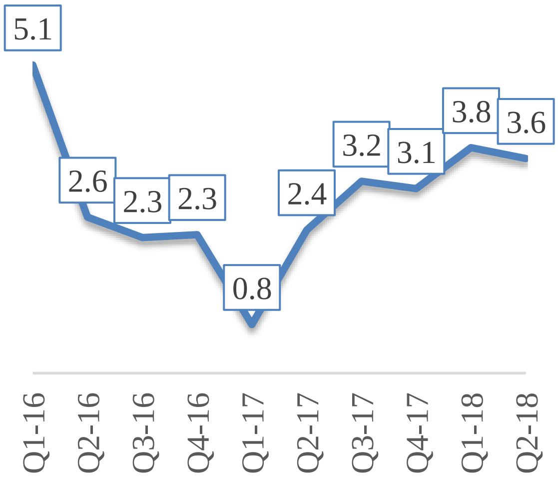
Source: CBUAE

Based on the AECI index of growth in the first half of 2018, both for the non-energy and energy sectors, the CBUAE is now projecting the UAE's Real GDP growth at 2.3% in 2018. Growth projection is underpinned by projected expansion of the Non-Oil sector at 3.6% Y-o-Y. The outlook of non-energy growth is the result of improved growth of the global economy, higher domestic credit growth particularly to the private sector and improved outlook for domestic investment and consumption.

On the Oil side of the economy, the Real Oil GDP is expected to decline by 0.5% Y-o-Y in 2018, against a previous decline of 3% Y-o-Y in 2017, reflecting commitments to increase Oil production by OPEC members effective July 2018 (see Box 1).

Box 2 illustrates recent developments in the Real-Estate sector in the emirates of Abu Dhabi and Dubai.

Figure 2.1.e Non-Oil Augmented Economic Composite Indicator (%, Y-o-Y)



Source: CBUAE

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Box 1: Economic Activity: Augmented ECI and GDP estimates

In the absence of published official data for quarterly GDP, Q-o-Q growth of economic activity, both overall and Non-Oil, follow the CBUAE Economic Composite Index (ECI). Non-Oil ECI proxies the performance of the Non-Oil economy which signifies the degree of the diversification of the UAE economy.

The Central Bank continues to revise its index, based on available quarterly data at the Emirate level. To that end, the revised version of the Augmented ECI (AECI) seeks to better align the overall growth estimate with Emirate-specific Q-o-Q estimates, closing previous gaps between the constructed ECI and the aggregate UAE-wide economic activity.

The Non-Oil AECI, is constructed by considering the average contribution to the UAE Real Non-Oil GDP by the largest Emirates of Abu Dhabi and Dubai. Using historical averages for the period 2014-2017, real non-Oil output represents 49.3% out of the UAE total for Abu Dhabi and 35.8% for Dubai. As no exact information is available for the GDP of the Northern Emirates, the contributions of Abu Dhabi and Dubai are normalized, so their sum adds up to 100, which correspond to a weight of 57.9 for Abu Dhabi and 42.1 for Dubai.

As Q-o-Q GDP is published for both the Abu Dhabi and Dubai Emirates, a composite UAE-wide real non-oil GDP Q-o-Q growth is approximated by the weighted average of Abu Dhabi and Dubai[2]. The approximated figures for the Q-o-Q UAE non-oil real GDP growth follow the results of a regression on leading economic indicators[3]. The fitted values from the estimated regression, shown in Table 1 below, are the basis for the calculation of the Q-o-Q real non-oil UAE GDP.

Table 1. Estimates of the coefficients for the Non-Oil AECI

Variable	Coefficient
CREDIT_YOY	0.330031
USGDP_YOY	0.460786
EMPLOYMENT	0.471593
REDUBAI_YOY	0.062561
D_DET_YOY	0.209235

The Total AECI is computed by considering the shares of both non-oil and oil Real output in the UAE GDP. Based on historical data, 70% is allocated to the non-oil GDP, while 30% is allocated to the oil output.

The estimation of the oil real GDP growth is based on OPEC UAE output production numbers. Combining the growth of this output to Non-Oil Real GDP growth, the total AECI is constructed to proxy total real GDP growth in the UAE.

In order to compare the accuracy of the estimated figures with actual real GDP in the UAE, the weighted average quarterly annual growth of the AECI estimates for the respective year are contrasted to the official statistics published by the Federal Competitiveness and Statistics Authority (FCSA) in Table 2.

Table 2. Annual Total and Non-Oil GDP Growth (%)

	Total GDP Growth Y-o-Y		**Non-Oil GDP Growth Y-o-Y**	
	Model	**Actual**	**Actual**	**Model**
2016	3.0	3.0	3.2	3.1
2017	0.8	0.8	2.5	2.4

Source: Central Bank of the UAE and FCSA

[2] For a specific quarter, the UAE Non-Oil real quarterly GDP growth is approximated by (57.9%*Abu Dhabi non-Oil real quarterly GDP growth) + (42.1%*Dubai non-Oil real quarterly GDP growth).

[3] The explanatory variables of the regression are Credit quarterly growth Y-o-Y, Emirates NBD Dubai Economy Tracker (a PMI for Dubai) quarterly growth Y-o-Y, US real GDP quarterly growth Y-o-Y, Quarterly Employment growth in the UAE Y-o-Y, and Dubai Real-Estate quarterly growth Y-o-Y.

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The latest Q-o-Q estimates produced by the CBUAE are shown in Table 3 below. The Non-Oil AECI is estimated to have reached a growth rate for 2018 Q1 of 3.76% and for 2018 Q2 of 3.58% Y-o-Y, an average improvement over the last quarter of 2017 by 3.08% Y-o-Y.

The main reasons for the improvement in non-oil GDP are the higher growth rates of GDP in the global economy, supported by growth in the US (see Chapter 1), improvements in Dubai Economic Tracker in the first two quarters of 2018, improvement in Credit growth in the UAE, particularly private credit growth and the firming up of the Oil price, availing more resources for government spending and anchoring positive expectations.

Table 3. Y-o-Y Growth of the AECI and Non-Oil AECI (%)

	AECI Y-o-Y	Non-Oil AECI Y-o-Y
1Q 16	2.58	5.14
2Q 16	1.17	2.60
3Q 16	3.14	2.26
4Q 16	3.01	2.31
1Q 17	1.64	0.81
2Q 17	1.95	2.39
3Q 17	0.99	3.20
4Q 17	0.28	3.08
1Q 18	1.62	3.76
2Q 18	2.31	3.58

Source: Central Bank of the UAE

Underpinned by growth of the non-oil AECI, the AECI for the overall economic activity has improved, as shown in Table 3, from almost zero growth in 2017 Q4 to 1.62% Y-o-Y growth in the first quarter of 2018 and 2.31% growth in 2018 Q2. Growth has been solidified by the higher Oil output in 2018 Q2, reaching 2.87 million barrels per day from 2.84 million barrels per day in the first quarter of the year.

Revised Annual Economic Growth Projections

Based on the above revised estimates of quarterly growth, the CBUAE has updated its projections for the UAE 2018 Real GDP growth based on its AECI's estimates for the first half of 2018.

Table 4. Economic Growth in the UAE (%)

	2015	2016	2017	2018(P)
Real GDP	5.1	3.0	0.8	2.4
Real Oil GDP	5.2	2.6	-3.0	-0.5
Real Non-Oil GDP	5.0	3.2	2.5	3.7

Source: Federal Competitiveness and Statistics Authority (FCSA) for 2014, 2015, 2016 and 2017, and Central Bank's Projections (P) for 2018.

The composite effects of the revised growth figures and estimates have weighed positively on growth projections in the UAE and the medium term outlook for the non-energy growth, producing a projection of 3.7% for 2018.

For the Oil component of the GDP, CBUAE projects a marginal contraction by 0.5% in 2018, due to the 2018 H1 decline in output by 2% compared to a year earlier. However, considering the OPEC's decision in 2018 Q2 to increase production, the gap with the 2017 overall output is likely to shrink to only 0.5% for the whole year.

As a result, the overall GDP growth in 2018 is projected at 2.4%, much higher than the 2017 Real GDP growth and close to the 2016 growth of 3%.

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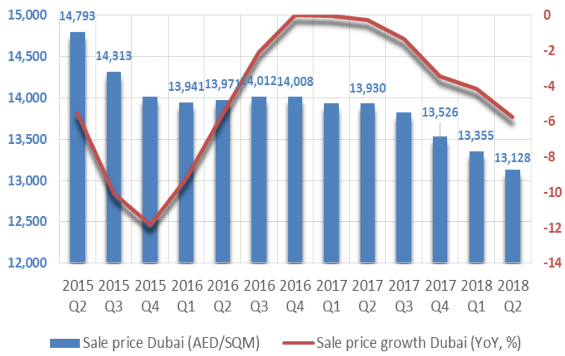
Box 2: Recent Developments in the Real-Estate Market

According to recent data from REIDIN Price Index[4], the UAE residential Market continued to decline in the second quarter of 2018. In Dubai, Y-o-Y the property prices decreased by 5.8% and declined by 1.7% compared to the previous quarter to AED 13,128/m². In Abu Dhabi the annual drop in property prices was 6.9% and 0.8% fall compared to the previous quarter to AED 11,685/m². The rental yield, which measures the rate of income return over the cost associated with an investment property decreased slightly in Dubai to 6.91%, as well as in Abu Dhabi by 0.09 percentage points to reach 6.87%.

Dubai residential Market

In the second quarter of 2018, the Real-Estate property price, which measures the average sample price in dirham per square meter of residential properties, decreased by 5.8% Y-o-Y compared to 4.2% decline in the previous quarter (Figure 1).

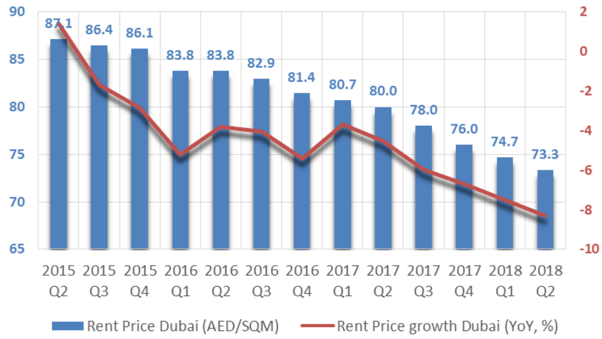
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

The Dubai market continues to exhibit decline in rent (Figure 2), due to high supply and lower demand. The rent prices declined by an annual rate of 8.3% in the second quarter of 2018, following a decrease of 7.5% in the previous quarter.

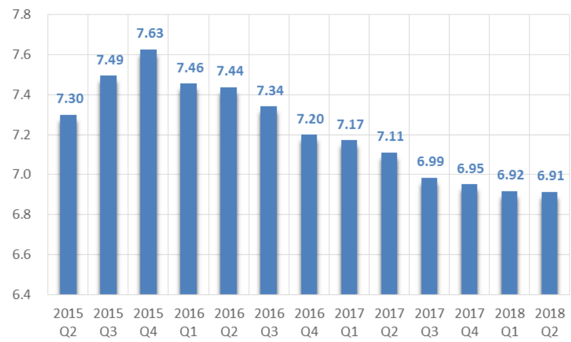
Figure 2: Dubai Residential Rent Prices



Source: REIDIN

As regard to investment in Dubai's Real-Estate market, it is clear that 2017 was marked by a slowdown in rental yield from a high of 7.17% in the first quarter to a low of 6.95% in the last quarter of 2017 (Figure 3). This trend was the result of relatively stable prices towards the end of the year, combined with further decline in rents. More recently, the gross rental yield further declined to 6.92% in the first quarter of 2018, reaching the level of 6.91% in 2018 Q2.

Figure 3: Dubai rental yield (%)



Source: REIDIN

[4] REIDIN Residential Sales Price Index series are calculated on a monthly basis and cover 21 areas and 6 districts in Dubai. For Abu Dhabi, the indices cover 7 areas and 5 districts.

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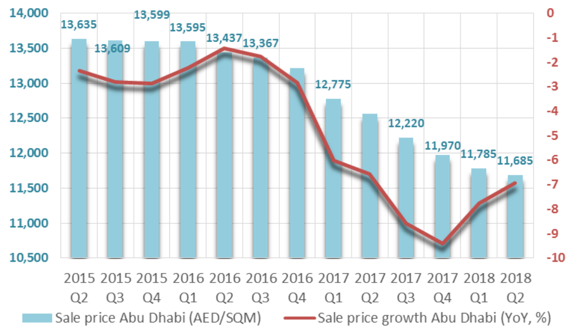
Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index exhibited a continued fall in residential property prices, at a rate of 8.3% Y-o-Y in 2018 Q2, following a decrease of 7.5% in the previous quarter (Figure 4).

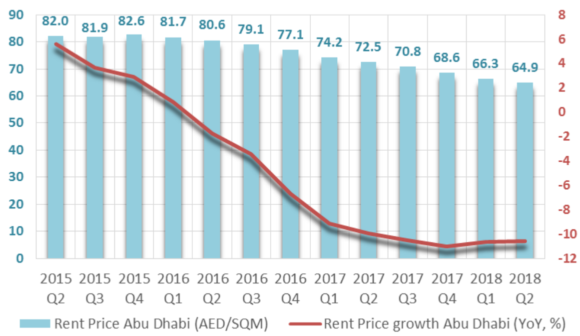
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

As for the rental market, following the reinstatement of the 5% residential rent cap in mid-December 2016, the rent values in Abu Dhabi continued to decline by an annual rate of almost 10.6% on average in the second quarter of 2018, after a reduction of 10.7% in the previous quarter. This trend is reflecting the impact of softer job market and the cuts in public expenditures, which continue to weigh in on demand in the housing market (Figure 5).

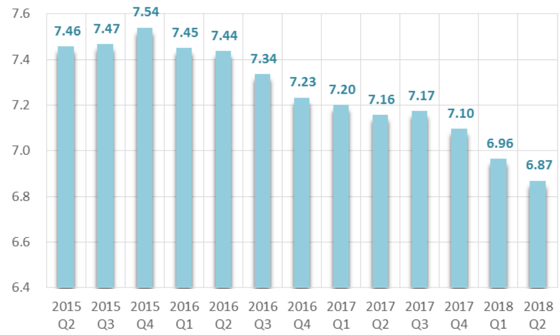
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

Concerning the rental yield, Abu Dhabi registered a yield of 6.87% for 2018 Q2, a marginal decline of 0.09 precentage points from the previous quarter (Figure 6). The observed pattern in rental yield reflects a constant pace of decline in rent along with continued decline in demand reflecting a weaker job market and oversupply, which has weighed on the investment sentiment in properties.

Figure 6: Abu Dhabi rental yield (%)



Source: REIDIN

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2.2 Consumer Price Index and Inflation

The headline CPI inflation decreased to 3.4% Y-o-Y in the second quarter of 2018, after a peak of 4.2% in the first quarter of 2018, remaining at a higher level than in 2017, due mainly to the impact of the VAT implementation and other excise taxes, introduced at the end of 2017 (see Table 2.2.).

Table 2.2. UAE CPI inflation (%, Y-o-Y)

	Weight	2017		2018	
	%	Q3	Q4	Q1	Q2
CPI Inflation (period average)	100	1	2.2	4.2	3.4
CPI Inflation (end-of-period)	100	1.1	2.7	3.4	3.3
Tradable Inflation	34	1.8	4	7.6	7.1
Non-tradable Inflation	66	0.8	1.3	2.6	1.7
Housing Inflation	34	0	0.2	-0.7	-2.5
Transportation Inflation	15	1.9	6.2	10.7	11.3
Other Inflation	51	1.7	2.5	6	5.5

Source: Federal Competitiveness and Statistics Authority (FCSA).

Note: All the changes are computed Y-o-Y and based on quarterly average annual CPI inflation, unless otherwise indicated. The Tradables and Non-Tradables inflation rates were computed using the Y-o-Y growth of weighted-average CPI of different sub-components

Tradables' prices, which account for 34% of the standard consumption basket, continued shaping the overall price fluctuations. Tradables' inflation slowed down in the second quarter of 2018 to 7.1% Y-o-Y, after an increase of 7.6% Y-o-Y in the first quarter, due to lower increase in the price of food & soft drinks and beverage & tobacco (43% of Tradables). Food & soft drinks prices grew by 3.4% in the second quarter of 2018 down from a 6.2% increase in the previous quarter. Beverage & tobacco price inflation slightly slowed to 84.1% Y-o-Y in the second quarter of 2018 after an increase of 84.2% in the previous quarter.

The prices of textile, clothing & footwear along with prices of furniture and household goods (both add up to 26% of Tradables) grew by 14% and 4.6%, respectively, in the second quarter of 2018, after a previous increase of 8.6% and 4.2%, respectively, in the first quarter. Also, the tradable component of transportation costs has contributed significantly to recent Tradables' price development. Transportation prices increased by 11.3% Y-o-Y in the second quarter of 2018 against 10.7% in the previous quarter. The surge in transportation prices came in-line with a recent increase in Oil prices. Fiscal reforms implemented by the government in August 2015 which removed energy subsidy and aligned domestic retail Oil prices to international levels.

Similarly, Non-Tradables' prices (which account for 66% of the standard consumption basket) slowed down on account of the easing in housing prices to reach 1.7% Q-o-Q in the second quarter of 2018 from 2.5% Q-o-Q in the previous quarter. Rental and utilities costs (51.5% of Non-Tradables) continued their decline for the second consecutive quarter by 2.5% Y-o-Y, following a drop of 0.7% in the first quarter.

The rent of residential and retail units has declined by 9% and 5%, respectively, in Abu Dhabi[5] in the second quarter of 2018. In fact, the continuous expansion of residential units' supply, in the face of slowing employment, especially in the hydrocarbon sector, weighed significantly on residential rental prices. On the retail side, the unit vacancy rate increased from 2% in the first quarter of 2017 to 15% in the second quarter of 2018.

Furthermore, in Dubai residential and retail units' rental prices declined Y-o-Y by 7.9% and 13%, respectively and the vacancy rate in the retail units reached 14% in the second quarter of 2018, up from 10% in the same period of 2017.

Recreation & culture price inflation increased significantly Y-o-Y in the second quarter of 2018 to reach 9.4% up from 6.9% in the previous quarter. Education and restaurants & hotels prices (18% of Non-Tradables) slowed-down Y-o-Y in the second quarter of 2018, when they grew by 4.6% and 6.7%, respectively, from a previous increase of 4.7% and 9.1% in the first quarter.

[5] According to Jones Lang LaSalle quarterly MENA report on Real-Estate.

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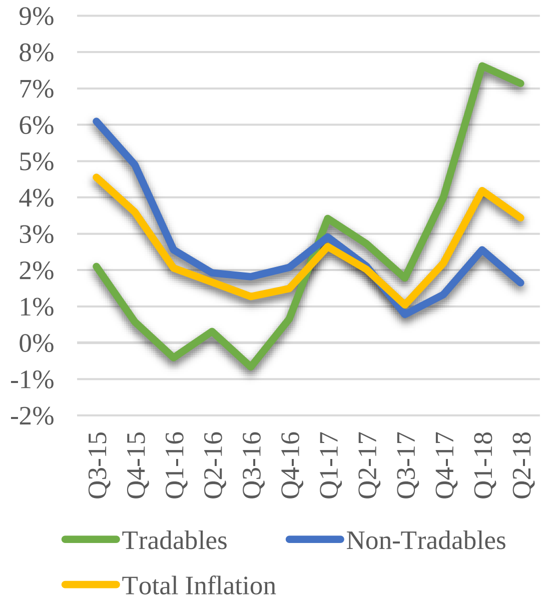
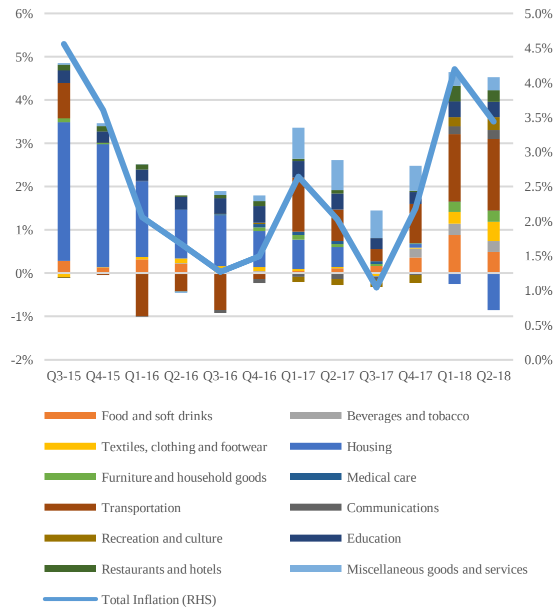
Inflation, excluding housing and transportation declined in the second quarter of 2018 to reach 5.5% Y-o-Y from a previous peak of 6% in the first quarter, mainly due to Tradables' price inflation slowdown.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

Figure 2.2.b. Contribution of different sub-components to the total CPI inflation (%, Y-o-Y)



Source: Federal Competitiveness and Statistics Authority (FCSA)

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2.3 Employment and labor market dynamics

The recent slowdown noted in the Non-Oil sector during the second quarter of 2018 was mainly due to the deceleration in labor demand, with employment growing by 1.2% Y-o-Y in the second quarter of 2018. Growth of employment has slowed down from a 2.8% Y-o-Y increase in the previous quarter, thereby increasing on average by 2% Y-o-Y in the first half of the year, compared to an increase of 2.4% in the first half of 2017.

As shown below, 60.9 thousand net additional jobs were created between June 2017 and June 2018, mostly due to Construction, Real Estate and Manufacturing activities.

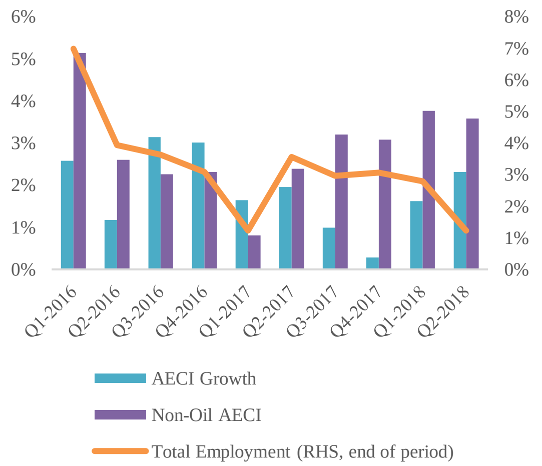
Table 2.3 Total labor in UAE

				Thousand Workers
Sector	Jun-17	17-Dec	18-Mar	18-Jun
Construction	1,671.40	1,711.80	1,719.20	1,703.50
Services	1,121.60	1,121.70	1,118.60	1,112.70
Manufacturing	473.7	473.7	472.8	469.7
Real estate	573.1	593.8	599.8	604
Transport, Storage and Communication	372.1	368.3	364.3	359.6
Other sectors	755.2	770	777.6	778.5
Total	**4,967.10**	**5,039.30**	**5,052.30**	**5,028.00**

Despite the recent improvement in Oil prices, the cut in Oil production as well as the legacies of the adverse Oil-price shock in 2014 continued to weigh on the general economic development and the demand for labor in several sectors. However, the resiliency of the Non-Oil sector played an important role to safeguard an increase in employment.

As it was pointed out, the Overall Augmented Economic Composite Index (AECI) expanded by 3.6% Y-o-Y in the second quarter of 2018, adding to a previous increase of 3.8% in the first quarter of 2018 (see Figure 2.3.a.). The resiliency of the Non-Oil sector helped to maintain a positive level of employment growth, albeit at a slower pace.

Figure 2.3.a. Employment growth and economic activity in the UAE (%, Y-o-Y)



Source: Ministry of Human Resources and Emiratization and CBUAE.

The deceleration of job creation in the second quarter of 2018 was driven by milder labor demand in the transport, storage & communication, manufacturing and services sectors. The transport, storage & communication sector's (7.2% of the total employment in the UAE) demand for labor has followed a declining trend that started in the second half of 2017 to record a fall of 3.4% Y-o-Y in the second quarter of 2018. Also, employment dropped by 0.8% Y-o-Y in both manufacturing and services sectors. On the other hand, employment recorded its highest growth in the Real-Estate sector, increasing by 5.4% Y-o-Y, followed by the construction sector (1.9% Y-o-Y).

Figure 2.3.b. Employment growth by sector (%, Y-o-Y, end of period)

Source: Ministry of Human Resources and Emiratization

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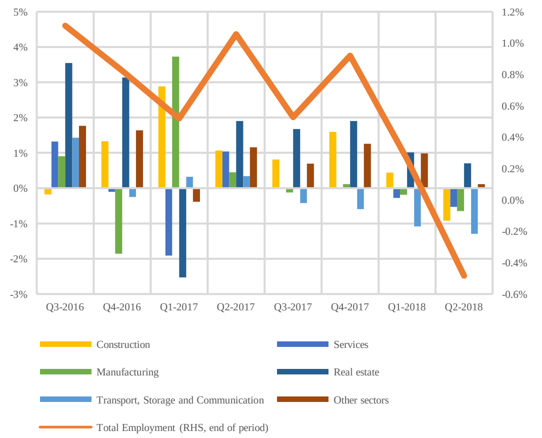
However, the moderate performance of job creation was confirmed by the labor market dynamics, where labor demand generally softened, except in the Real-Estate sector registering an increase by 0.7% Q-o-Q. The demand for labor in the transport, storage & communication sector recorded the sharpest decline (-1.3% Q-o-Q), followed by the construction sector by (-0.9% Q-o-Q), manufacturing sector (-0.6% Q-o-Q) and services sector (-0.5% Q-o-Q). All those sectoral developments led total employment to grow by 0.5% Q-o-Q in the second quarter.

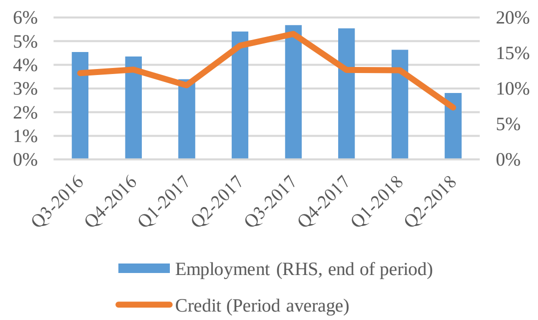
Figure 2.4.c. Employment growth by sector (%, Q-o-Q, end of period)



Source: Ministry of Human Resources and Emiratization

The slowdown of labor demand in the construction and the Real-Estate sectors was parallel to the decline of domestic credit in both sectors. The construction and Real Estate sectors altogether absorb around 45.9% of the labor force in the UAE. Employment in both sectors eased to 2.8% Y-o-Y in the second quarter of 2018, against a 4.6% in the previous quarter. However, credit to both sectors eased to 7% Y-o-Y for the same period (see Figure 2.4.d). The quarterly growth rate of employment in the construction and Real Estate sectors and domestic credit fell by -0.5% Q-o-Q during the second quarter of 2018.

Figure 2.4.d Employment and domestic credit developments in the Construction and Real-Estate sector (%, Y-o-Y)



Source: Ministry of Human Resources and CBUAE

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2.4 Exchange Rate Fluctuations

On a quarterly basis, the Dirham has appreciated against the currencies of both top 10 non-dollarized import and non-oil export partners, due to the strengthening of the US dollar. Meanwhile, Y-o-Y the Dirham depreciated against the currencies of the former and appreciated against the currencies of the latter.

On the import side, the Dirham has appreciated in the second quarter of 2018 against its top 10 Non-Dollarized import partners, which account for 52.3% of the total imports, to reach 1.3% Q-o-Q (see Table 3.2.a.). For instance, the Dirham gained value with respect to the Turkish Lira (14.6%), the Indian Rupee (4.03%) and the Euro (3.16%).

The recent depreciation of the Chinese Yuan against the US Dollar has reinforced the position of the Dirham against the Renminbi. In fact, the dirham has appreciated against the Renminbi by 0.3% Q-o-Q in the second quarter of 2018, as China is the most important exporter of goods to the UAE (18.7% of total UAE imports). Moreover, the Dirham gained 0.78% against the Japanese Yen, 0.75% against the South Korean Won, 2.35% against the British Pound and 3.94% against the Swiss Franc, during the second quarter of 2018.

Table 2.4.a. Dirham appreciation against currencies of top Non-Dollarized import partners (%, Y-o-Y)

Imports	Share of total imports	Q3-Q4 (2017)	Q4 2017 - Q1 (2018)	Q1 2018 - Q2 2018	Q2 2017 - Q2 2018
China	**18.72**	-0.87	-3.76	0.34	-6.91
India	**7.85**	0.66	-0.51	4.03	3.90
Japan	**5.43**	1.70	-4.06	0.78	-1.74
Germany	**4.61**	-0.26	-4.15	3.16	-7.69
South Korea	**3.09**	-2.33	-3.06	0.75	-4.44
Turkey	**2.95**	8.25	0.37	14.57	22.17
Italy	**2.64**	-0.26	-4.15	3.16	-7.69
UK	**2.63**	-1.44	-4.57	2.35	-5.92
France	**2.44**	-0.26	-4.15	3.16	-7.69
Switzerland	**1.96**	2.51	-3.93	3.94	0.04
Weighted Average	**52.32**	**0.14**	**-1.65**	**1.32**	**-1.46**

Source: Data on Import shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2017. Data for the bilateral exchange rates are the quarterly average observations, recorded and displayed by Bloomberg.

Notwithstanding the appreciation of the Dirham during the second quarter of 2018 compared to the previous quarter, the Dirham has depreciated by 1.46% against the currencies of the UAE's top 10 Non-Dollarized import partners, driven by sharp losses against the Chinese Yuan (6.91%), the Euro (7.69%), South Korean Won (4.44%) and the British Pound (5.92%).

On the Non-Oil export side, the Dirham appreciated by 2.09% in the second quarter of 2018 against its top Non-Dollarized Non-Oil export partners (see Table 2.4.b.).

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Table 2.4.b. Dirham appreciation against currencies of top Non-Dollarized partners for Non-Oil Exports (%, Y-o-Y)

Exports	Share of total exports	Q3-Q4 (2017)	Q4 2017 - Q1 (2018)	Q1 2018 - Q2 2018	Q2 2017 - Q2 2018
India	**10.65**	0.66	-0.51	4.03	3.90
Turkey	**9.14**	8.25	0.37	14.57	22.17
Iraq	**4.68**	0.53	0.38	0.54	0.25
China	**3.10**	-0.87	-3.76	0.34	-6.91
Singapore	**3.03**	-0.50	-2.58	1.20	-4.13
South Korea	**2.53**	-2.33	-3.06	0.75	-4.44
Switzerland	**2.04**	2.51	-3.93	3.94	0.04
Pakistan	**1.74**	1.05	4.46	5.01	11.43
Netherlands	**1.67**	-0.26	-4.15	3.16	-7.69
Japan	**1.57**	1.70	-4.06	0.78	-1.74
Weighted Average	**40.17**	**0.84**	**-0.41**	**2.09**	**2.05**

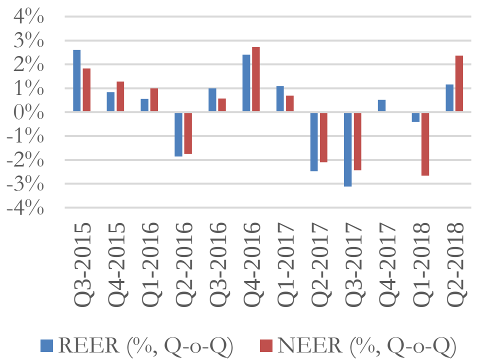
Source: Data for Export shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2017. Data for the exchange rates are the quarterly average observations, recorded and displayed by Bloomberg.

Moreover, the Dirham appreciated by 4.03% against the Indian Rupee (10.7% of the UAE's Non-Oil exports). In addition, the Dirham continued gaining momentum for the third consecutive quarter against the Iraqi Dinar and the Pakistani Rupee, which appreciated Q-o-Q by 0.54% and 5.01%, respectively. Non-Oil exports to both countries account for 6.42% of total Non-Oil exports.

The Dirham appreciated Y-o-Y against its Non-Oil export partners at the same pace up to the second quarter of 2018, where it gained 2.05% in the second quarter of 2018, driven by gains against the Turkish Lira (22.2%), the Indian Rupee (3.9%), and the Pakistani Rupee (11.4%).

Accounting for all UAE's trading partners, the Nominal Effective Exchange Rate (NEER) has displayed the same pattern as the weighted change of the Dirham against major import and Non-Oil export partners. In fact, the average NEER jumped by 2.4% in the second quarter of 2018, compared to the previous quarter, after a drop by 2.7% in the first quarter of 2018 (see Figure 2.4.a.). In real terms, the Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, increased by 1.2% in the second quarter of 2018.

Figure 2.4.a Nominal and Real Effective Exchange rates developments (%, Q-o-Q)



Source: Bank for International Settlement (BIS)

Box 3 illustrates developments in the outward remittances and the effects of developments in the exchange rate on bilateral flows. Parallel to the Dirham's appreciation, the workers' remittances outflows grew by 8.8%, during the second quarter of 2018, where India is the main destination of Remittances outflows from the UAE.

Box 4 assesses the impact of exchange rate developments on the indicators of the tourism industry. The number of international tourists remained stable for the first five months of 2018, compared to the same period of last year, despite the continued fluctuations of the exchange rate.

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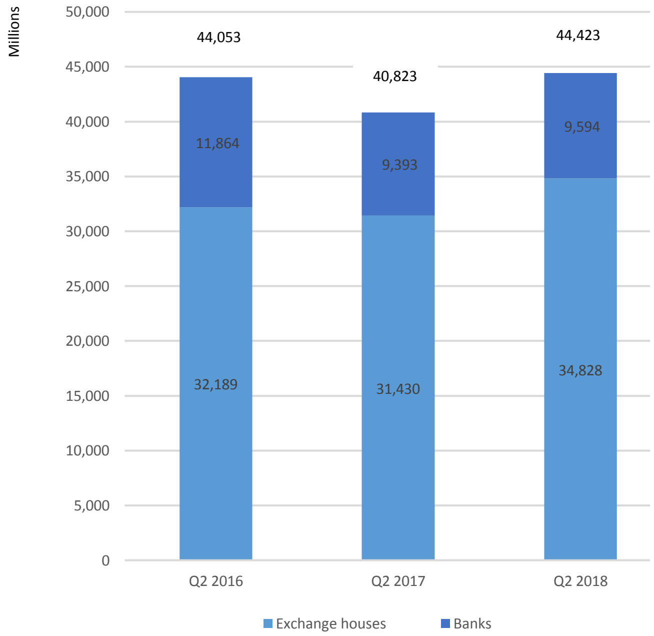
Box 3: Outward Personal Remittances

The workers' remittances outflows in the period April-June of 2018 recorded AED 44.4 billion, an increase of 8.8% or AED 3.6 billion compared to the same period of 2017 (AED 40.8 billion) (figure 1). The data capture the outflows reported from the exchange houses and banks to the Central Bank. The outflows of the workers' remittances that were settled only through the exchange houses recorded AED 34.8 billion in the second quarter of 2018 (10.8% or AED 3.4 billion increase compared to the same period of 2017).

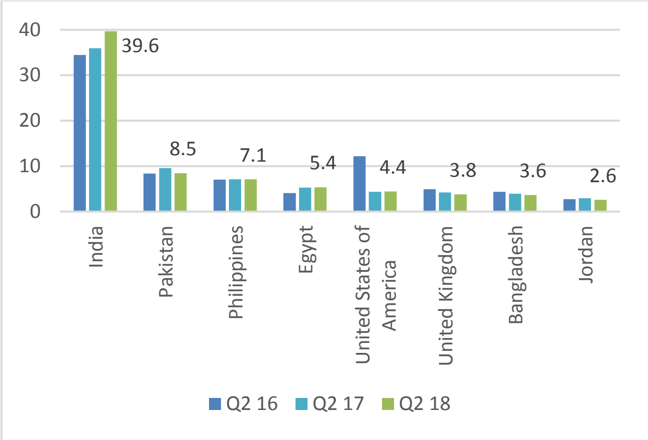
Figure 1. Evolution of workers' remittances Outflows from the UAE April-June 2016-2018



Source: CBUAE

The most important country of destination for workers' remittances during the period April-June 2018 was India, accounting for 39.6% of the outflows (figure 2). This high share is in accordance with the significant share of expats from India in the UAE. According to available statistics, dated October 2008 from the Federal Competitiveness and Statistics Authority, 82.7% of the employees in the UAE belong to Asian Non-Arab Countries, which include India. The next five most important countries in the share of outflows of remittances were Pakistan (8.5%), Philippines (7.1%), Egypt (5.4%) and the United States (4.4%) (Figure 2).

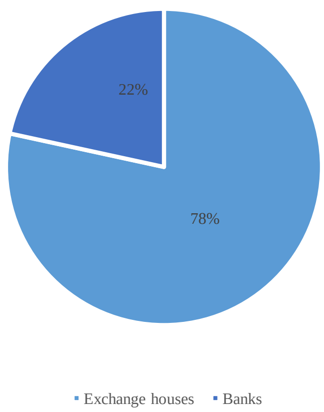
Figure 2. Share of the major countries for workers' remittances during April-June 2016-2018 (percentage of total, exchange houses and banks)



Source: CBUAE

In the second quarter of 2018, available data indicate that 78% of the workers' remittances outflows are through the exchange houses and 22% through the banks. Figure 3 illustrates the shares of exchange houses and banks in the total transactions of remittances.

Figure 3. Share of settlement of total workers' remittances



Source: CBUAE

The total recorded workers' remittances outflows for the second half of 2018 (AED 87.9 billion) represent 53.5% of the total outward remittances in the UAE's balance of payments for the full year of 2017 (at AED 164.4 billion) and 112.9% of the outward remittances of the first half of 2017.

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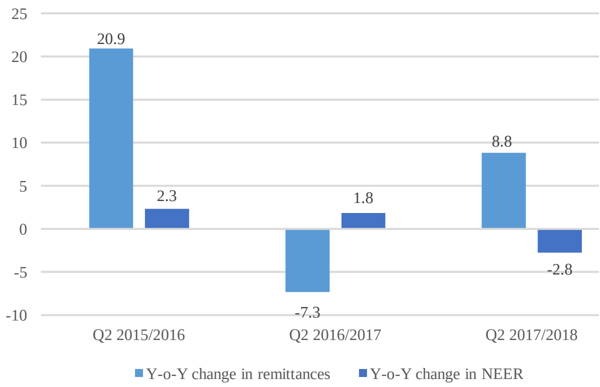
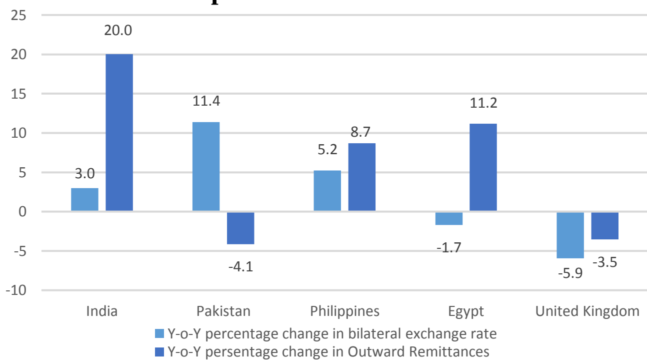
Figure 4. Percentage change of total outward remittances versus the percentage change of nominal effective exchange rate, April-June 2016-2018



Source: CBUAE, Banking Supervision Department; Bank of International Settlements

Figure 5. Percentage change of outward remittances of top countries versus the percentage change of the bilateral exchange rate with the dirham April-June 2016-2018



Source: CBUAE; Bloomberg

The annual growth rate of remittances in the period of April-June of 2018 is 8.8%. The average nominal effective exchange rate of the dirham in the same period (Figure 4) was 115.2 based on data provided by the Bank for International Settlements (BIS), lower than the average for the second quarter of 2017 at 118.5.

Figure 5 depicts the percentage change of outflows of remittances from the UAE to the top destination countries compared to the evolution of the bilateral exchange rate of the dirham relative to the currencies of the recipient countries. For the second quarter of 2018, the remittances outflows to India and Philippines increased in accordance to the appreciation of the dirham relative to their respective currencies. In addition, the outflows to Egypt increased despite some small appreciation of the Egyptian pound relative to the dirham, whereas a decrease was recorded in the remittances outflows to the United Kingdom in consistency with the appreciation of the pound. Despite appreciation of the dirham relative to the respective currency, remittances outflows to Pakistan decreased.

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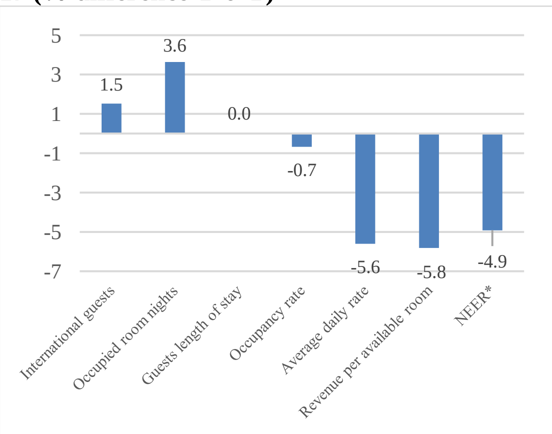
Box 4: Tourism Activity in the UAE

This box focuses on the effect of the change of bilateral exchange rates of the AE dirham on tourists to the Emirates of Dubai and Abu Dhabi, the two major tourist destinations in the UAE that contribute the largest shares of the total aggregates during January-June 2018 compared to the same period of the previous year.

The number of international tourists combined in Dubai and Abu Dhabi emirates slightly increased by 1.5% in the period of January-June 2018 compared to 2017 (figure 1), recording some difference in trends among the two emirates. Simultaneously, the average daily rate and the revenue per available room decreased by 5.6% and 5.8%, respectively (weighted average prices of the two emirates) for the same period. These evolutions resulted in an increase in occupied room nights by 3.6%. In addition, the average hotel occupancy rate decreased by 0.7% in January-June 2018, compared to the same period of the previous year.

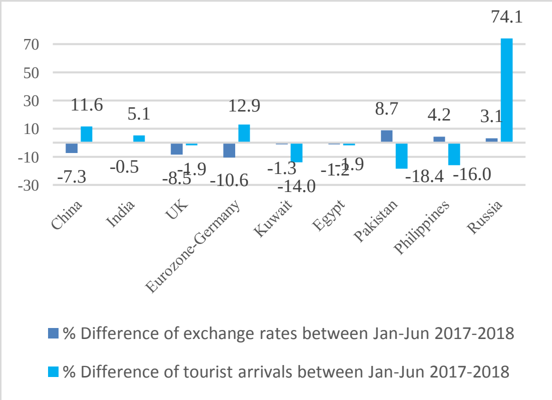
Figure 1: Major combined indicators of Dubai & Abu Dhabi inbound tourism January-June 2018-17 (% difference Y-o-Y)



Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bank for International Settlements
*nominal effective exchange rate

Figure 2 shows the effect of the bilateral exchange rate movements on tourism between January-June 2018 and the same period of 2017. Among the international visitors, incoming tourists from Russia significantly increased (74.1%) following the easing of visa rules despite the moderate appreciation of the dirham relative to the ruble. Moreover, tourists from China and Germany recorded an increase (11.6% and 12.9%) along with a small appreciation of their currencies relative to the dirham. The incoming tourists from India increased by 5.1% following small depreciation of the dirham relative to the rupee. The incoming tourists from the UK, however, recorded a small decrease by 1.9% despite the depreciation of the dirham relative to the pound. Tourists from Pakistan and Philippines recorded decrease by 18.4% and 16%, respectively, due to the appreciation of the dirham relative to their respective currencies.

Figure 2. Guest arrivals and exchange rate on selected countries January-June 2018-17 (% difference Y-o-Y)



Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bloomberg

In figure 3, the data for the Dubai emirate indicate that the number of international visitors, compared to December 2017 (YTD), increased by 5.2%. Occupied room nights and guests length of stay YTD increased by 5.6% and 1.0%, respectively.

International visitors to Abu Dhabi emirate, compared to December 2017 (YTD), during January-June 2018 increased by 4.9%. As in the case for Dubai, Occupied room nights and guests length of stay YTD also increased by 5.1% and 1.0%, respectively.

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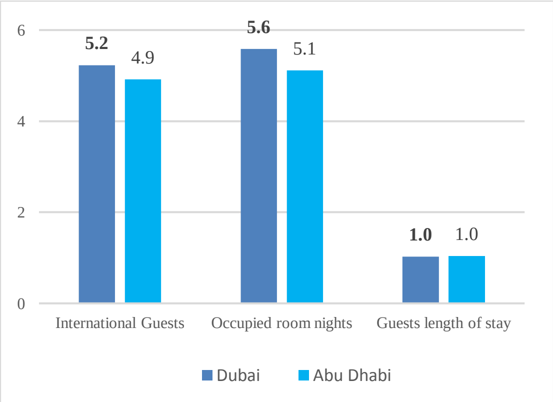
Figure 3: Major indicators of Dubai & Abu Dhabi inbound tourism January-June 2018[6] (% difference YTD)

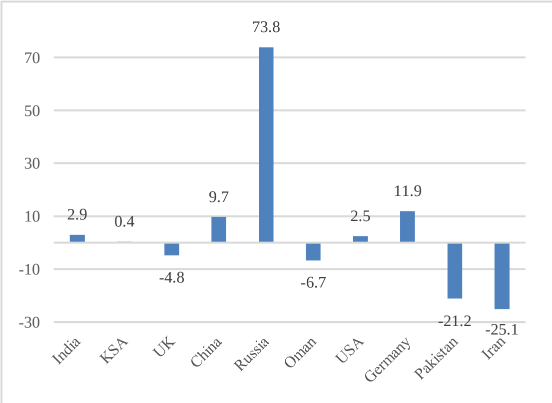


Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority

Most of the countries that are the major markets for inbound tourism to Dubai show increase in the arrivals of tourists with the highest increase recorded for Russia (74%) and Germany (12%). The vast majority of tourists to Dubai originate from GCC countries and the MENA region (27% combined, 17% and 10% respectively), while Western Europe and North America cover 21% and 6% of inbound tourism. Finally, 18% of inbound tourism comes from the region of South Asia. For the Abu Dhabi Emirate, most of the countries that are major markets of inbound tourism recorded increase in guest arrivals, except for Saudi Arabia and Philippines.

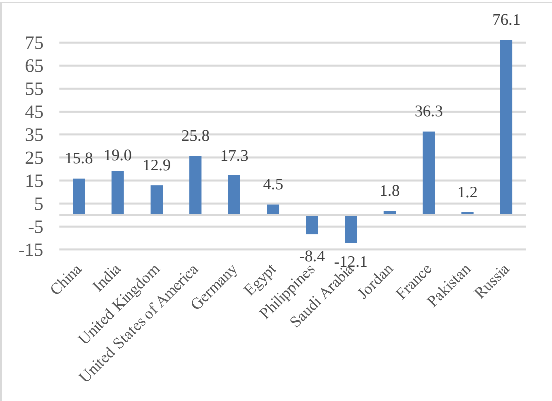
Figure 4. Major markets of inbound tourism January-June 2018-17 (% difference Y-o-Y)

a. Dubai



Source: Dubai Corporation of Tourism and Commerce Marketing

b. Abu Dhabi



Source: Abu Dhabi Tourism & Culture Authority

[6] Data are based on the official tourism authorities' publications. Dubai Tourism Authority publishes *International Guests* whereas Abu Dhabi Tourism Authority publishes *Actual Guest Arrivals.* Also, for the variable *Room Nights* Dubai Tourism Authority publishes *Occupied Room Nights* whereas Abu Dhabi Tourism Authority publishes *Room Nights* that include the number of nights a guestroom is occupied regardless of the number of persons occupying the room. Estimates were used for data not available until the report publication.

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2.5 Consolidated Fiscal Stance

2.5.1 Expenditures

The recent revival of oil prices and related increase of hydrocarbon revenues helped the government to revert to an expansionary fiscal policy, after a period of fiscal consolidation in 2017. The expansionary fiscal stance was mainly driven by a rebound of current spending, notwithstanding a persistent decline of capital spending. In the first quarter of 2018, total spending increased by 15.6% Y-o-Y against a decline by 11% Y-o-Y during the same period of last year.

The spending recovery was driven by the increase of the compensation of employees by 21.7% Y-o-Y, subsidies and transfers to GRE's by 15.9% Y-o-Y, Grants by 15.6% and Social benefits by 7.5% Y-o-Y. The highest increase in terms of current spending items was recorded by the purchases of goods and services, which jumped by 157% Y-o-Y against an anemic increase of 1% Y-o-Y during the same period of last year. On the other hand, spending on consumption of fixed capital and interest payments declined by 13.1% Y-o-Y and 2.4% Y-o-Y, respectively. In addition, other expenses, which cover all of Abu Dhabi governments transfers made on behalf of the Federal government, decreased by 14.7% Y-o-Y in the first quarter of 2018 compared to a sharper decline by 41.1% in first quarter of 2017.

Current spending gained momentum in line with the positive developments of Oil prices. However, capital spending, measured by the net acquisition of non-financial assets, continued its decline for the fifth consecutive quarter. It fell by 56% Y-o-Y in the first quarter of 2018, adding to a previous annual decline of 19.5% in 2017.

Consequently, the fiscal policy stance in the first quarter of 2018 was mostly a-cyclical although the pickup in current spending bodes well for the growth of the Non-Oil sector.

2.5.2 Revenues

Total revenues increased by 3.5% Y-o-Y in the first quarter of 2018, the first increase since the second quarter of 2017 and adding to a minor annual increase of 1.3% in 2017.

The revenues improvement was driven by the rebound of other revenues, which include mainly the property income, sales of goods, services, fines and penalties. They grew by 12.4% Y-o-Y in the first quarter of 2018, after an annual drop by 18.5% in 2017. These revenues do not include profit transfers from the national Oil Company to the sovereign wealth fund neither do they include the government's investment income.

Despite the recent firming up of oil prices during the first quarter of 2018, tax revenues, which cover royalties on Oil companies decreased by 5.4% annually in the first quarter after an important annual increase by 53.4% in 2017.

Social contributions increased by 3.9% Y-o-Y in the first quarter of 2018 against a drop by 18% Y-o-Y during the same period of last year.

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Table. 2.5. Consolidated Government Finances

Fiscal Consolidation	2017				2017 - (%, Y-o-Y)				2018	2018 – Q1 (%, Y-o-Y)
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q1
Revenues (a)	**99.6**	**107.9**	**82.8**	**106.3**	**16.2**	**5.1**	**-2.5**	**-15.9**	**103.1**	**3.5**
Taxes	49.2	40.0	32.4	40.3	133.1	53.7	12.0	23.3	46.5	-5.4
Social contributions	1.2	1.1	1.3	1.1	-18.0	-9.4	8.3	27.7	1.3	3.9
Other revenues	49.2	66.8	49.1	64.9	-22.1	-11.4	-10.5	-30.1	55.3	12.4
Expenditure (b)	**163.7**	**205.7**	**181.0**	**215.1**	**-11.0**	**2.6**	**-19.1**	**-2.3**	**189.3**	**15.6**
Expense	**74.2**	**99.3**	**85.8**	**102.6**	**-13.3**	**6.3**	**-17.7**	**-0.4**	**91.3**	**23.0**
Compensation of employees	15.9	20.1	18.8	20.4	2.1	27.6	19.4	12.1	19.3	21.7
Use of goods and services	10.5	33.7	24.9	25.7	1.0	127.2	25.0	50.4	27.0	157.0
Consumption of fixed capital	1.3	1.4	1.0	1.4	11.7	-6.1	-13.9	-35.2	1.1	-13.1
Interest	0.5	0.6	0.3	0.5	103.8	42.6	-4.6	-48.0	0.5	-2.4
Subsidies	2.9	9.9	7.9	7.2	38.4	139.3	406.3	605.6	3.3	15.9
Grants	3.3	6.7	1.2	6.1	625.6	1169.8	-82.9	-23.9	3.8	15.6
Social benefits	9.8	10.1	10.3	10.9	4.6	19.4	21.8	20.4	10.5	7.5
Other expenses	30.1	16.8	21.4	30.5	-35.1	-64.9	-57.2	-34.6	25.6	-14.7
Net acquisition of non-financial assets	15.3	7.1	9.5	9.9	-83.5	-67.4	-87.2	-85.4	6.7	-56.0

Source: 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.
- Subsidies include social and price subsidies as well as transfers to GREs.
- Other expenses include the payments of Abu Dhabi made on behalf of the Federal Government.
- 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.
- Federal Competitiveness and Statistics Authority (FCSA)

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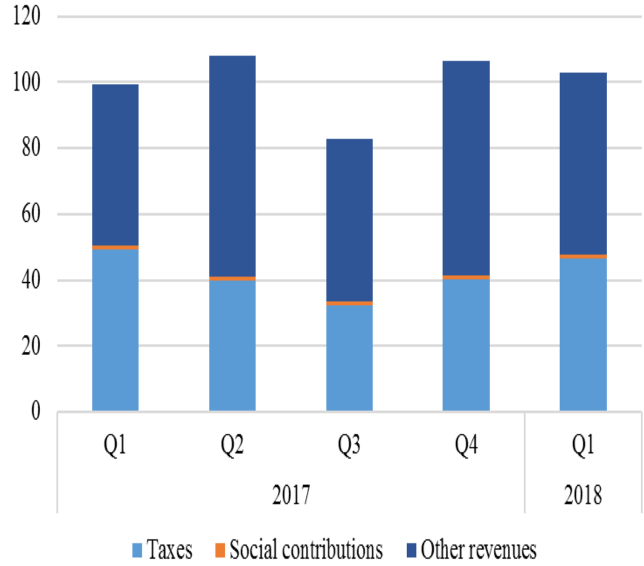
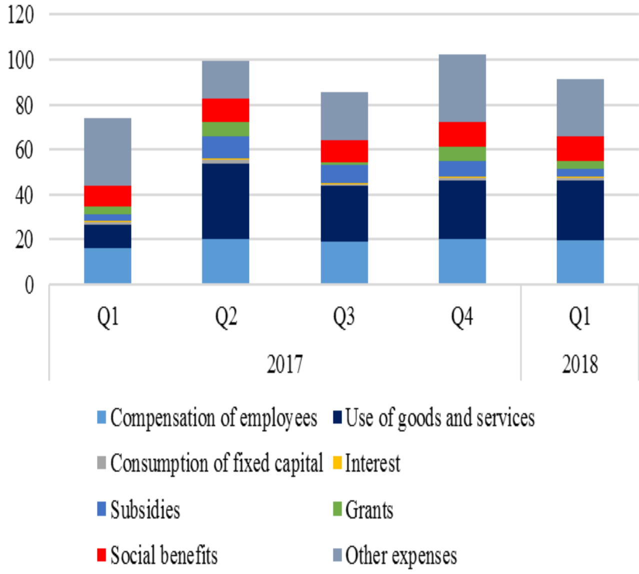
Government Finances

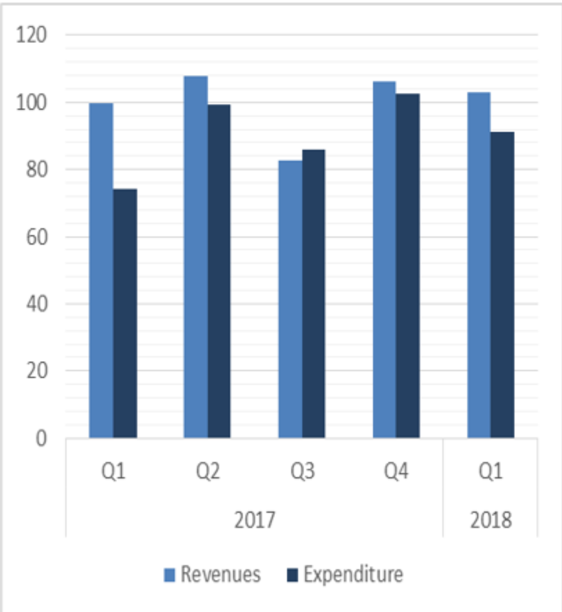
2.5.a. General government revenues
(Billions of Dirhams)



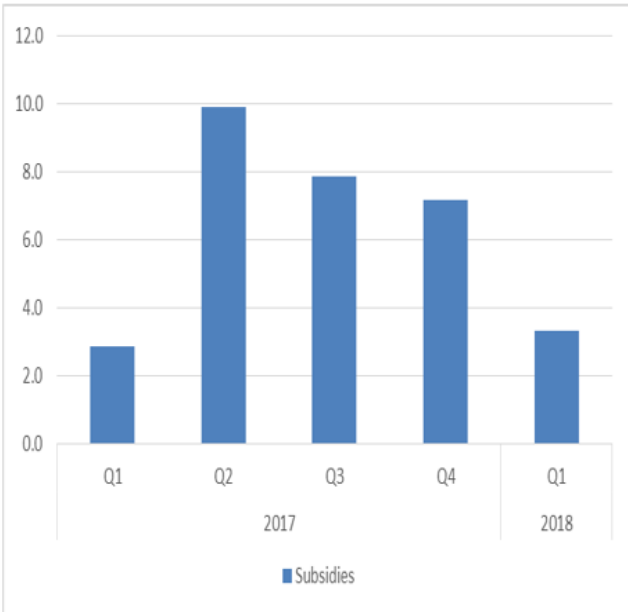
2.5.b. General government expenditures
(Billions of Dirhams)



2.5.c. Fiscal stance
(Billions of Dirhams)



2.5.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. The total revenues do not include ADNOC transfers and government investment income. Total expenditures are adjusted such that Abu Dhabi capital transfers are excluded.

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Chapter 3. Banking and Financial Developments

In the second quarter of 2018, deposits continued to grow, mainly boosted by the increase in Government Deposits. Credit also picked up in tandem with improved growth outlook in non-oil activities, thereby recording the highest increase for the private sector, underpinned by healthy Financial Soundness Indicators (FSIs) that strengthen confidence in sound and stable banking system.

3.1 Banking Structure

The 22 national banks have decreased the number of branches to 755 at the end of 2018 Q2 compared to 761 at the end of 2018 Q1. The number of foreign banks has remained unchanged at 27 from the previous quarter and the number of foreign banks branches was also unchanged to 81 at the end of 2018 Q2. At the same time, the number of bank employees has increased for the national banks and remained almost unchanged for the foreign banks. It moved from 29,414 and 5,598 for national and foreign banks, respectively at the end of 2018 Q1 to a headcount of 29,847 and 5,588, respectively at the end of the second quarter of 2018.

3.1.1. Banks' Deposits

Total Customer Deposits at banks increased in the second quarter of 2018 by AED 21.9 billion. Resident Deposits increased by AED 21.3 billion, while Non-resident Deposits increased by AED 0.6 billion.

The growth in Resident Deposits in 2018 Q2 is essentially due to the steady rise in most components, except GREs: Government sector deposits increased by 7.5% or AED 17.4bn, Private sector deposits by 1.3% or AED 12.7bn, NBFIs' deposits by 2.3% or AED 0.3bn, while GREs' deposits declined by 4.7% or AED 9.5bn. The Non-Resident deposits rose by 0.3% or AED 0.6bn during the second quarter of 2018, with their share in total deposits declining from the previous quarter at 11.3%. Deposits by the type of banks, i.e., Conventional vs. Islamic banks, represent respectively 76.7% and 23.3% of total deposits. Figures 3.1.1.a and 31.1.b, and Table 3.1.1.b show that in the second quarter of 2018 there is a decline in Islamic banks' deposits by 1% while for Conventional banks they grew by 2%. Y-o-Y. The increase of Islamic banks' deposits has reached 4.7%, while for the Conventional banks it was at 6.4%. Looking at the subcategories, the growth in Islamic banks in the second quarter is stronger in the Government sector and NBFIs, while the Conventional banks were dominating for the deposits of GREs, Private sector and Non-resident deposits.

Table 3.1.1.a. Deposits at UAE Banks

	2017			2018	
	Jun	**Sep**	**Dec**	**Mar**	**Jun***
Bank Deposits	**1589.1**	**1595.8**	**1627.3**	**1662.4**	**1684.3**
(Q-o-Q change %)	-0.8	0.4	2.0	2.2	1.3
(Y-o-Y change %)	6.4	5.8	4.1	3.8	6.0
Resident Deposits	**1409.3**	**1407.5**	**1435.6**	**1472.9**	**1494.2**
(Q-o-Q change %)	-0.3	-0.1	2.0	2.6	1.4
(Y-o-Y change %)	7.1	6.5	5.3	4.2	6.0
- Government	**196.8**	**201.2**	**212.0**	**233.2**	**250.6**
(Q-o-Q change %)	1.4	2.2	5.4	10.0	7.5
(Y-o-Y change %)	5.9	18.7	13.5	20.2	27.3
- GREs	**189.6**	**183.0**	**191.5**	**201.3**	**191.8**
(Q-o-Q change %)	-1.3	-3.5	4.9	5.1	-4.7
(Y-o-Y change %)	17.4	6.9	14.0	4.8	1.2
- Private Sector	**983.6**	**991.9**	**1001.0**	**1007.7**	**1020.4**
(Q-o-Q change %)	-1.5	0.8	0.9	0.7	1.3
(Y-o-Y change %)	4.1	3.7	2.1	0.9	3.7
- NBFI	**39.3**	**31.4**	**31.1**	**30.7**	**31.4**
(Q-o-Q change %)	36.9	-20.1	-1.0	-1.3	2.3
(Y-o-Y change %)	69.4	27.6	10.3	7.0	-20.1
Non-Resident Deposits	**179.8**	**188.3**	**191.7**	**189.5**	**190.1**
(Q-o-Q change %)	-4.9	4.7	1.8	-1.1	0.3
(Y-o-Y change %)	1.5	0.7	-3.7	0.3	5.7

Source: CBUAE

Note: All data indicate the end of period values. Values are expressed in billions of Dirhams.

***:** Preliminary figures subject to revision.

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Table 3.1.1.b. Deposits at Conventional/Islamic Banks

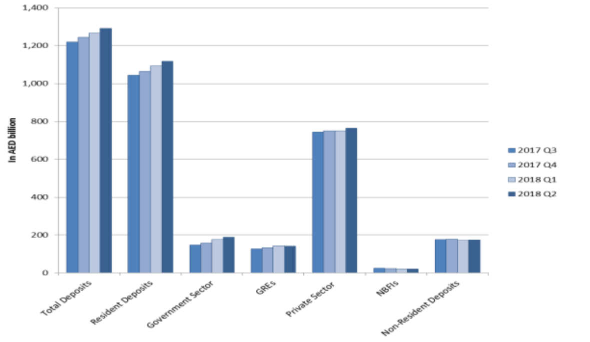
	Conventional		Islamic	
	2018	2018	2018	2018
	Mar	Jun*	Mar	Jun*
Bank Deposits	**1,266.0**	**1,291.9**	**396.4**	**392.4**
(Q-o-Q change %)	1.8	2.0	3.3	-1.0
(Y-o-Y change %)	2.5	6.4	8.0	4.7
Share of Total, %	76.2	76.7	23.8	23.3
Resident Deposits	**1,093.7**	**1,117.8**	**379.2**	**376.4**
(Q-o-Q change %)	2.7	2.2	2.2	-0.7
(Y-o-Y change %)	3.5	6.8	6.5	3.9
Share of Total, %	74.3	74.8	25.7	25.2
Government Sector	**176.8**	**189.5**	**56.4**	**61.1**
(Q-o-Q change %)	11.2	7.2	6.4	8.3
(Y-o-Y change %)	22.4	30.2	13.7	19.3
Share of Total, %	75.8	75.6	24.2	24.4
GREs	**144.8**	**142.1**	**56.5**	**49.7**
(Q-o-Q change %)	9.0	-1.9	-3.7	-12.0
(Y-o-Y change %)	2.3	7.2	11.9	-13.0
Share of Total, %	71.9	74.1	28.1	25.9
Private Sector	**749.9**	**764.7**	**257.8**	**255.7**
(Q-o-Q change %)	0.1	2.0	2.5	-0.8
(Y-o-Y change %)	0.3	4.0	3.0	2.9
Share of Total, %	74.4	74.9	25.6	25.1
NBFI	**22.2**	**21.5**	**8.5**	**9.9**
(Q-o-Q change %)	-4.7	-3.2	9.0	16.5
(Y-o-Y change %)	-3.1	-36.6	46.6	83.3
Share of Total, %	72.3	68.5	27.7	31.5
Non-Resident Deposits	**172.3**	**174.1**	**17.2**	**16.0**
(Q-o-Q change %)	-3.7	1.0	34.4	-7.0
(Y-o-Y change %)	-3.3	4.1	57.8	28.0
Share of Total, %	90.9	91.6	9.1	8.4

Source: CBUAE

Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

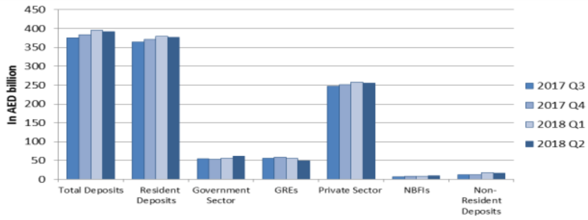
***:** Preliminary figures subject to revision.

Figure 3.1.1.a. Banking System Deposits: Conventional Banks (AED billion)



Source: CBUAE

Figure 3.1.1.b. Banking System Deposits: Islamic Banks (AED billion)



Source: CBUAE

The breakdown of National and Foreign banks in Figures 3.1.1.c and 3.1.1.d show that National banks experienced an increase in deposits, while Foreign banks experienced a decline Q-o-Q in 2018 Q2. National banks' deposits grew at a rate of 1.9% and 7.3% Q-o-Q and Y-o-Y respectively, in contrast to Foreign banks for which deposits decreased by 2.8% Q-o-Q and by 2.7% Y-o-Y. At the end of 2018 Q2, 88.2% of the total deposits are in National banks and 11.8% are in Foreign banks.

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Table 3.1.1.c. Deposits at UAE National/ Foreign Banks

	National		Foreign	
	2018	2018	2018	2018
	Mar	Jun*	Mar	Jun*
Bank Deposits	**1,457.7**	**1,485.3**	**204.7**	**199.0**
(Q-o-Q change %)	2.7	1.9	-1.3	-2.8
(Y-o-Y change %)	4.6	7.3	-2.1	-2.7
Share of Total, %	87.7	88.2	12.3	11.8
Resident Deposits	**1,302.1**	**1,328.4**	**170.8**	**165.8**
(Q-o-Q change %)	3.2	2.0	-2.0	-2.9
(Y-o-Y change %)	5.3	7.4	-3.0	-3.5
Share of Total, %	88.4	88.9	11.6	11.1
Government Sector	**230.4**	**249.1**	**2.8**	**1.5**
(Q-o-Q change %)	9.7	8.1	47.4	-46.4
(Y-o-Y change %)	19.8	27.7	64.7	-11.8
Share of Total, %	98.8	99.4	1.2	0.6
GREs	**193.4**	**184.8**	**7.9**	**7.0**
(Q-o-Q change %)	6.0	-4.4	-13.2	-11.4
(Y-o-Y change %)	5.6	0.7	-11.2	16.7
Share of Total, %	96.1	96.4	3.9	3.6
Private Sector	**853.2**	**868.3**	**154.4**	**152.1**
(Q-o-Q change %)	1.2	1.8	-2.3	-1.5
(Y-o-Y change %)	1.8	5.3	-3.2	-4.5
Share of Total, %	84.7	85.1	15.3	14.9
NBFI	**25.1**	**26.2**	**5.6**	**5.2**
(Q-o-Q change %)	-3.5	4.4	9.8	-7.1
(Y-o-Y change %)	10.1	-23.6	-5.1	4.0
Share of Total, %	81.8	83.4	18.2	16.6
Non-Resident Deposits	**155.6**	**156.9**	**33.9**	**33.2**
(Q-o-Q change %)	-1.8	0.8	2.1	-2.1
(Y-o-Y change %)	-0.3	6.6	2.7	1.8
Share of Total, %	82.1	82.5	17.9	17.5

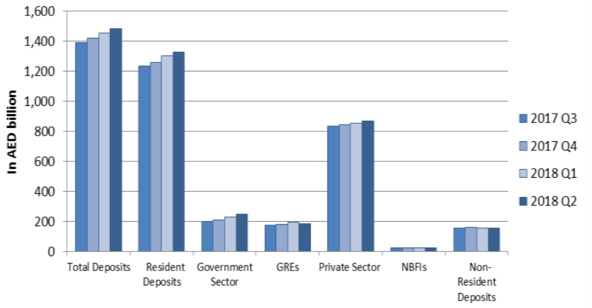
Source: CBUAE

Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

***:** Preliminary figures subject to revision.

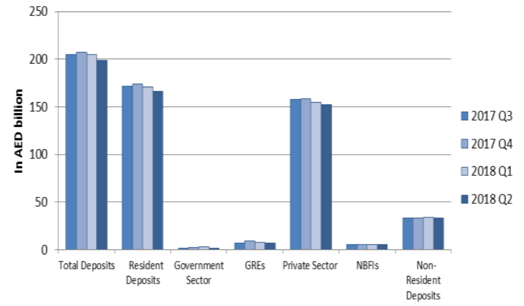
The sector growing the most in 2018 Q2 for National banks were the Government sector by 8.1% Q-o-Q (27.7% Y-o-Y), reflecting the ongoing fiscal consolidation and improved oil price. For Foreign banks in the second quarter of 2018, the breakdown shows that the smallest decrease (as all sectors declined) was for the Private sector, falling by 1.5% Q-o-Q and 4.5% Y-o-Y.

Figure 3.1.1.c. Banking System Deposits: National Banks (AED billion)



Source: CBUAE

Figure 3.1.1.d. Banking System Deposits: Foreign Banks (AED billion)



Source: CBUAE

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3.1.2. Banks' Credit

Domestic Credit increased in 2018 Q2 by AED 13.8bn (0.9%), which corresponded to a growth of a 3.6% Y-o-Y. For the underlying domestic credit, there was a deleveraging by the Government by 0.2% Q-o-Q or AED 0.3bn, by the GREs by AED 1.8bn (1.1%) and by the NBFIs by AED 0.8bn (3.8%), while Foreign credit grew by AED 0.4bn (0.3%) quarterly. Meanwhile, the Private Sector was borrowing at a strong pace of 1.5% and 5.6% Q-o-Q and Y-o-Y, respectively, which marked the highest quarterly growth Y-o-Y since December 2016 (Private Corporate credit grew at 2.1% and 7% Q-o-Q and Y-o-Y, respectively, while Credit to Individuals decreased by 0.2% Q-o-Q and increased by 2.2% Y-o-Y).

Table 3.1.2.a. Assets and Credit at UAE Banks

	2017			2018	
	Jun	**Sep**	**Dec**	**Mar**	**Jun***
Total Assets	**2,632.0**	**2,643.0**	**2,693.8**	**2,718.3**	**2,748.9**
(Q-o-Q change %)	0.2	0.4	2.0	0.9	1.1
(Y-o-Y change %)	5.4	4.5	4.0	3.5	4.4
Gross Credit	**1,569.0**	**1,580.0**	**1,580.3**	**1,608.1**	**1,622.3**
(Q-o-Q change %)	-0.4	0.7	0.0	1.8	0.9
(Y-o-Y change %)	3.0	2.2	1.7	2.1	3.4
Domestic Credit	**1,435.0**	**1,447.0**	**1,452.7**	**1,472.8**	**1,486.6**
(Q-o-Q change %)	-1.1	0.9	0.4	1.4	0.9
(Y-o-Y change %)	2.0	1.5	1.4	1.5	3.6
Government	**178.0**	**182.0**	**175.4**	**181.1**	**180.8**
(Q-o-Q change %)	0.6	2.0	-3.4	3.2	-0.2
(Y-o-Y change %)	5.5	4.3	1.7	2.3	1.6
Public Sector (GREs)	**179.0**	**175.0**	**172.3**	**170.2**	**168.4**
(Q-o-Q change %)	-8.1	-2.0	-0.7	-1.2	-1.1
(Y-o-Y change %)	-4.6	-6.7	-7.0	-12.7	-5.9
Private Sector	**1,058.0**	**1,070.0**	**1,086.4**	**1,100.7**	**1,117.4**
(Q-o-Q change %)	-0.1	1.1	1.4	1.3	1.5
(Y-o-Y change %)	0.6	0.4	2.9	3.9	5.6
- Business & Industrial Sector Credit	**729.0**	**735.0**	**748.9**	**764.2**	**780.1**
(Q-o-Q change %)	-0.4	0.8	1.8	2.0	2.1
(Y-o-Y change %)	2.7	2.0	2.6	4.5	7.0
- Individual	**330.0**	**335.0**	**337.5**	**336.5**	**337.3**
(Q-o-Q change %)	0.6	1.7	0.7	-0.3	0.2
(Y-o-Y change %)	2.5	3.1	3.5	2.6	2.2
Non-Banking Financial Institutions	**20.0**	**21.0**	**18.6**	**20.8**	**20.0**
(Q-o-Q change %)	-3.0	5.1	-9.3	11.8	-3.8
(Y-o-Y change %)	6.0	12.6	-2.1	4.0	0.0
Foreign Credit	**134.0**	**133.0**	**127.6**	**135.3**	**135.7**
(Q-o-Q change %)	7.7	-1.0	-4.2	6.0	0.3
(Y-o-Y change %)	14.8	10.9	5.8	8.2	1.3

Source: CBUAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

Table 3.1.2.b. illustrates sectors of lending by economic activity. The split shows an increase in 2018 Q2 for Mining (7%), Transport, Storage and Communication (2.4%), Construction and Real Estate (2%), and Trade (1.2%). In contrast, lending decreased for Agriculture (-6.9%), Electricity, Gas and Water (-6.4%), and Manufacturing (-2.4%).

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Table 3.1.2.b. Banks' credit to residents by economic activity

(End of Period , In Billions of AED)

	2017			2018	
Economic Activity	Jun	Sep	Dec	Mar	Jun*
Agriculture	**1.1**	**1.2**	**2.1**	**2.0**	**1.9**
(Q-o-Q change %)	-2.5	7.7	73.9	-4.1	-6.2
(Y-o-Y change %)	-5.3	3.9	54.8	75.1	68.5
Mining and Quarrying	**13.9**	**12.2**	**12.1**	**12.1**	**12.9**
(Q-o-Q change %)	-26.8	-12.5	-0.8	-0.3	7.0
(Y-o-Y change %)	11.9	-13.1	-10.7	-36.5	-7.2
Manufacturing	**70.3**	**72.0**	**75.2**	**75.5**	**73.7**
(Q-o-Q change %)	3.0	2.4	4.5	0.4	-2.4
(Y-o-Y change %)	-1.5	0.6	8.6	10.6	4.8
Electricity, Gas and Water	**17.4**	**17.0**	**16.7**	**18.9**	**17.7**
(Q-o-Q change %)	-3.9	-2.6	-1.6	12.9	-6.4
(Y-o-Y change %)	-6.4	-5.2	-9.3	4.4	1.7
Construction and Real Estate	**281.2**	**295.2**	**298.1**	**300.5**	**306.6**
(Q-o-Q change %)	5.3	5.0	1.0	0.8	2.0
(Y-o-Y change %)	16.0	17.7	12.6	12.6	9.0
Trade	**149.5**	**147.7**	**152.8**	**157.1**	**159.1**
(Q-o-Q change %)	-1.8	-1.2	3.4	2.9	1.2
(Y-o-Y change %)	-7.0	-6.7	-1.7	3.2	6.4
Transport, Storage and Communication	**63.1**	**63.7**	**54.9**	**52.7**	**54.0**
(Q-o-Q change %)	4.4	1.0	-13.8	-4.0	2.4
(Y-o-Y change %)	-1.3	1.6	-13.5	-12.7	-14.4
Financial Institutions (Excluding Banks)	**138.9**	**130.3**	**127.5**	**133.6**	**129.0**
(Q-o-Q change %)	-8.5	-6.2	-2.1	4.8	-3.5
(Y-o-Y change %)	-4.1	-12.2	-12.4	-12.0	-7.1
All Others	**126.2**	**132.9**	**138.3**	**139.2**	**142.0**
(Q-o-Q change %)	-2.9	5.3	4.0	0.7	2.0
(Y-o-Y change %)	4.6	9.0	10.4	7.1	12.5

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

Islamic banks have a share of 20.6% in the assets and 22.7% in the gross financing of the total banking system. The breakdown of the assets and lending by Conventional and Islamic banks in Figures 3.1.2.a. and 3.1.2.b. indicates that Islamic banks' financing was increasing by 2.7% during the second quarter of 2018 due to Domestic Credit rising in all categories, except for NBFIs and GREs, where there was a decline. In parallel, credit in Conventional banks grew by 0.4% during the second quarter, reflecting a decline in credit in all categories except for the Private Sector and Business & Industrial Sector.

Table 3.1.2.c. Assets and Credit across Conventional and Islamic Banks

	Conventional		Islamic	
	2018	2018	2018	2018
	Mar	Jun*	Mar	Jun*
Total Assets	**2,159.6**	**2,183.9**	**558.7**	**565.0**
(Q-o-Q change %)	0.7	1.1	1.5	1.1
(Y-o-Y change %)	1.5	3.9	7.1	6.7
Gross Credit	**1,250.1**	**1,254.6**	**358.0**	**367.7**
(Q-o-Q change %)	1.9	0.4	1.1	2.7
(Y-o-Y change %)	-0.3	2.9	4.4	5.0
Domestic Credit	**1,139.9**	**1,146.6**	**332.9**	**340.0**
(Q-o-Q change %)	1.5	0.6	1.0	2.1
(Y-o-Y change %)	-0.7	3.8	2.5	3.2
Government	**169.4**	**169.1**	**11.7**	**11.7**
(Q-o-Q change %)	3.6	-0.2	-1.7	0.0
(Y-o-Y change %)	1.2	0.7	24.5	18.2
Public Sector (GREs)	**137.3**	**135.8**	**32.9**	**32.6**
(Q-o-Q change %)	-1.4	-1.1	-0.3	-0.9
(Y-o-Y change %)	-14.4	-5.7	-4.4	-6.9
Private Sector	**816.3**	**825.3**	**284.4**	**292.1**
(Q-o-Q change %)	1.3	1.1	1.3	2.7
(Y-o-Y change %)	1.6	6.1	2.7	4.1
Business & Industrial Sector Credit	**608.4**	**618.6**	**155.8**	**161.5**
(Q-o-Q change %)	1.9	1.7	2.4	3.7
(Y-o-Y change %)	4.9	7.5	3.0	5.4
Individual	**207.9**	**206.7**	**128.6**	**130.6**
(Q-o-Q change %)	-0.4	-0.6	-0.1	1.6
(Y-o-Y change %)	-7.1	2.3	2.4	2.4
Non-Banking Financial Institutions	**16.9**	**16.4**	**3.9**	**3.6**
(Q-o-Q change %)	15.0	-3.0	0.0	-7.7
(Y-o-Y change %)	5.6	5.1	-4.9	-7.7
Foreign Credit	**110.2**	**108.0**	**25.1**	**27.7**
(Q-o-Q change %)	6.8	-2.0	2.9	10.4
(Y-o-Y change %)	3.4	-5.0	37.9	33.8

Source: CBUAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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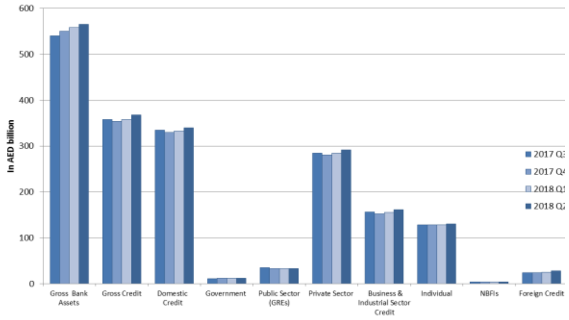
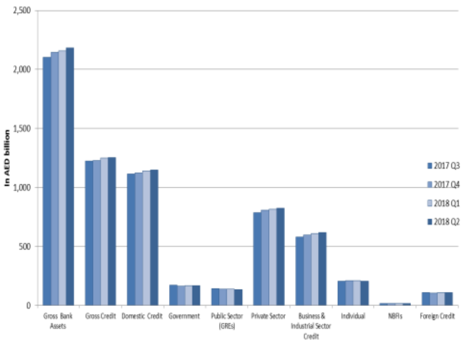
Figure 3.1.2.a. Banking System Assets and Credit: Conventional Banks (AED billion)



Source: CBUAE

Figure 3.1.2.b. Banking System Assets and Financing: Islamic Banks (AED billion)



Source: CBUAE

Foreign banks have a share of 13% of the system in terms of assets and 12.1% in terms of gross credit in 2018 Q2, lower than the previous quarter. The split of the assets and credit by national and foreign banks in Figures 3.1.2.c. and 3.1.2.d. indicates that National banks' assets were growing by 1.5%, while gross credit increased by 1% compared to the previous quarter as of June 2018. For the same period, Foreign banks had their assets declining by 1.6% and gross credit falling by 0.2% (see Table 3.1.2.d).

In terms of domestic credit, for the National banks all sectors were growing with exception of Government and GREs sectors, which partially offset the gains in the other categories in 2018 Q2, while for the Foreign banks all sectors were declining except Government and Private sectors.

Credit to non-residents was growing Y-o-Y for the Foreign banks by 23.9%, while declining marginally by 0.3% Q-o-Q as of June 2018. At the same time for the National banks, credit to non-residents was growing by 0.5% and -4% Q-o-Q and Y-o-Y.

To shed more light on the allocation of the National banks assets abroad, Box 5 below, provides details about the Cross Border Exposure of UAE National Banks and Foreign Currency Exposure to Non-Residents.

Table 3.1.2.d. Assets and Credit at UAE National/Foreign Banks

	National		Foreign	
	2018	2018	2018	2018
	Mar	Jun*	Mar	Jun*
Total Assets	**2,355.4**	**2,391.7**	**362.9**	**357.2**
(Q-o-Q change %)	0.9	1.5	0.7	-1.6
(Y-o-Y change %)	3.9	5.5	-4.9	-2.0
Gross Credit	**1,412.3**	**1,426.8**	**195.8**	**195.5**
(Q-o-Q change %)	1.5	1.0	3.6	-0.2
(Y-o-Y change %)	0.8	3.3	-0.4	4.1
Domestic Credit	**1,306.6**	**1,320.6**	**166.2**	**166.0**
(Q-o-Q change %)	1.3	1.1	1.9	-0.1
(Y-o-Y change %)	0.6	3.9	-4.3	1.2
Government	**174.8**	**174.4**	**6.3**	**6.4**
(Q-o-Q change %)	2.8	-0.2	18.9	1.6
(Y-o-Y change %)	1.6	0.9	31.3	28.0
Public Sector (GREs)	**149.7**	**149.7**	**20.5**	**18.7**
(Q-o-Q change %)	-1.8	0.0	3.5	-8.8
(Y-o-Y change %)	-10.2	-4.2	-27.0	-17.6
Private Sector	**962.1**	**977.3**	**138.6**	**140.1**
(Q-o-Q change %)	1.4	1.6	0.9	1.1
(Y-o-Y change %)	2.1	5.8	0.1	4.4
Business & Industrial Sector Credit	**657.6**	**671.9**	**106.6**	**108.2**
(Q-o-Q change %)	2.1	2.2	1.6	1.5
(Y-o-Y change %)	5.2	7.2	0.4	6.0
Individual	**304.5**	**305.4**	**32.0**	**31.9**
(Q-o-Q change %)	-0.2	0.3	-1.5	-0.3
(Y-o-Y change %)	-3.9	2.7	-0.9	0.0
Non-Banking Financial Institutions	**20.0**	**19.2**	**0.8**	**0.8**
(Q-o-Q change %)	11.1	-4.0	33.3	0.0
(Y-o-Y change %)	12.4	10.3	-65.2	-61.9
Foreign Credit	**105.7**	**106.2**	**29.6**	**29.5**
(Q-o-Q change %)	3.9	0.5	14.3	-0.3
(Y-o-Y change %)	3.7	-4.0	29.3	23.9

Source: CBUAE

Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

***:** Preliminary figures subject to revision.

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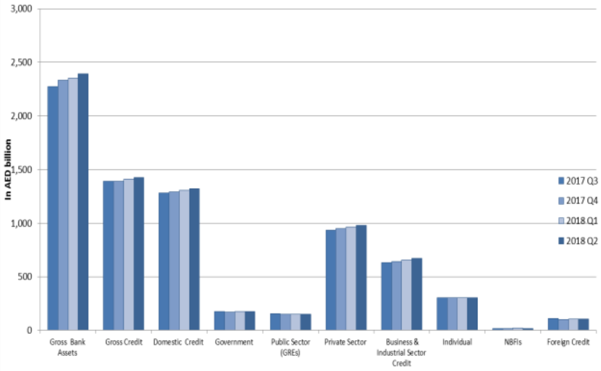
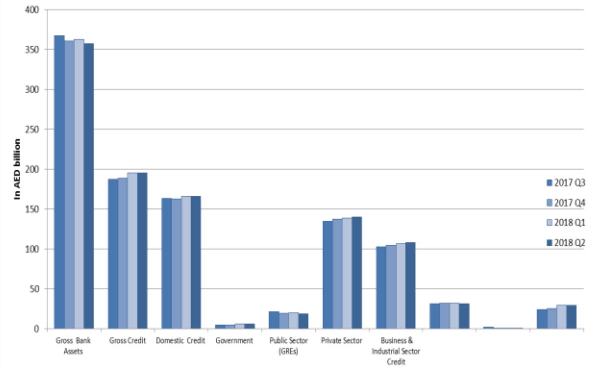
Figure 3.1.2.c. Banking System Assets and Financing: National Banks (AED billion)



Source: CBUAE

Figure 3.1.2.d. Banking System Assets and Financing: Foreign Banks (AED billion)



Source: CBUAE

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Box 5: Cross Border Exposure of UAE National Banks and Foreign Currency Exposure to Non-Residents

The UAE banking system is the largest in terms of assets in the MENA region. As of June 2018, the outstanding amount of assets is at AED 2,749bn[7].

As of end of second quarter 2018, UAE banks, excluding branches and affiliates abroad, have a total of AED 630bn in foreign assets, AED 522.8bn for national banks and AED 107.2bn for foreign banks.

The analysis is focusing on the exposure of UAE national banks to non-residents. First, is the allocation of the foreign assets per asset category, followed by the top ten countries of exposure and the currency denomination of lending to non-residents.

Foreign Assets' Class of UAE National Banks

The foreign assets of national banks increased by 9.3% for the first six months of 2018 and by 22.1% Y-o-Y as of June 2018. The asset classes of exposure are split as per the categories in Table 1. The three major categories as of June 2018 are securities with an outstanding amount of AED 145.3bn, due from other banks at AED 122.3bn and loans at AED 106.2bn that rose by 6.4%, 2.9% and 4.4% year-to-date respectively and by 13%, 13.2% and -4% Y-o-Y. (Table 1).

Table 1: UAE National Banks' Foreign Assets' Class (in AED bn)

	Jun – 17	Dec – 17	Jun – 18
Due from HO & branches	51.3	82.8	104.6
Due from other banks	108.0	118.9	122.3
Cash in hand	0.0	0.0	0.1
Securities	128.6	136.5	145.3
Loans	110.6	101.7	106.2
Other assets	29.6	38.3	44.3
Total	**428.2**	**478.3**	**522.8**

Source: Central Bank of the UAE

UAE National Banks' Top 10 Countries for Cross Border Exposure

As of June 2018, the biggest exposure of UAE banks abroad, including branches and affiliates, was in the UK at AED 50bn, followed by AED 35bn in both, Saudi Arabia and Egypt. The three countries in the top 10 exposures that experienced the highest increase year-to-June 2018 were India by AED 5.4bn (27.3%), Egypt by AED 5.1bn (17.3%) and Bahrain by AED 3.4bn (22.8%), while the top 3 countries with the largest increase Y-o-Y were India by AED 6.3bn (33.3%), US by AED 3.8bn (13.7%) and Turkey by AED 3.4bn (12.5%).

On the other hand, the biggest decline year-to-June 2018 was observed for Qatar by AED 9.5bn (30.2%), followed by Saudi Arabia by AED 7bn (16.6%) and the UK by AED 2.1bn (4%). Y-o-Y Qatar declined by AED 30.6bn (58.2%), followed by the UK decelerating by AED 5.9bn (10.5%) while exposure to Saudi Arabia declined by AED 2.2bn (5.9%) (Figure 1).

[7] Excluding branches and affiliates abroad.

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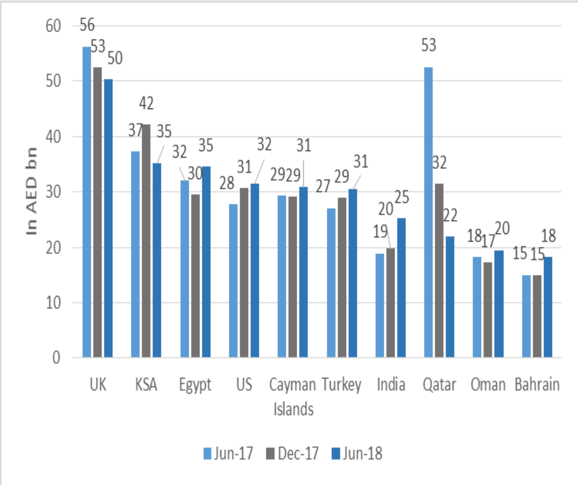
Figure 1: Top 10 Foreign Country Exposures for UAE national banks (in AED bn)



Source: Central Bank of the UAE

Currency Denomination of UAE National Banks' Lending to Non-Residents

The main foreign currency exposure of UAE banks remains in USD, which stood at 81.9% at the end of the first half of 2018 of the total exposure in foreign currencies. The second most important foreign currency exposure is in Euro as of June 2018 (9.2% of the total foreign currency exposure). The third, fourth and fifth currency exposures are in Saudi Riyal, Pound Sterling and Japanese Yen as at the end of June 2018 (Table 2).

Table 2: Share of Foreign Currencies of total UAE National Banks' Lending to Non-Residents)

	Jun-17	Dec-17	Jun-18
US Dollar	86.1%	82.2%	81.9%
Euro	5.2%	9.1%	9.2%
Saudi Riyal	1.1%	3.0%	2.4%
Pound Sterling	4.0%	2.2%	2.1%
Japanese Yen	1.5%	1.5%	1.8%
Qatari Riyal	0.5%	0.5%	0.6%
Kuwaiti Dinar	0.2%	0.2%	0.5%
Bahraini Dinar	>0.1%	>0.1%	0.3%
Swiss Franc	0.3%	0.1%	0.1%
Chinese Yuan	0.1%	0.1%	>0.1%
Other Foreign currencies	1.1%	1.1%	1.2%

Source: Central Bank of the UAE

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3.1.3. Financial Soundness Indicators

The overall soundness of the banking sector remained positive during the second quarter of 2018.

As of 2017 Q4, the Central Bank of the UAE started reporting the quality of the capital in line with Basel III framework[8]. Banks operating in the UAE remain highly capitalized, with the Capital Adequacy Ratio (CAR) at 18.1%, Tier 1 Capital Adequacy at 16.6% and Common Equity Tier 1 (CET) at 14.6%, which are well above the regulatory requirements set by the Central Bank.

The Loans to Deposits (L/D) ratio for the whole banking system declined from 96.7% in March 2018 to 96.3% at the end of 2018 Q2, a level which is also lower than the 98.7% in 2017 Q2, mainly due to the higher growth in deposits compared to lending.

Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 97.1% and 93.7%, decreasing by 1.6 percentage points from the previous quarter for the Conventional banks, however rising by 3.4 percentage points for the Islamic banks.

Loans to Deposits ratio for Conventional banks in June 2018 has improved compared to a year ago when it was 100.4%. For Islamic banks' L/D has increased from 93.4% in June 2017. On the other hand, National banks have L/D ratio of 96.1% (with a decline of 0.8 percentage points compared to March 2018), while the ratio for Foreign banks is 98.2%, higher than the 95.7% at the end of 2018 Q1.

Meanwhile, liquid assets, which 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, as a ratio of total assets moved from 17.4% at the end of March 2018 to 16.8% at the end of 2018 Q2. This level of liquid assets still constitute a significant buffer as it is higher than the 10% minimum required by the Central Bank. The level of total liquid assets at banks at the end of 2018 Q2 remains at AED 376.5bn, AED 8.8bn lower than at the end of 2018 Q1, registering a decline of 2.3% in the second quarter of 2018, explaining the decrease in the Liquid Assets Ratio (LAR). On a Y-o-Y basis, total liquid assets at banks increased by AED 9.4bn, registering a growth of 2.6%. In addition, looking at the split between Islamic, Conventional, National and Foreign banks, data show that for all segments the LARs decreased during 2018 Q1. On a Y-o-Y basis, LAR has declined for all types of banks, except for the National and Islamic segment.

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

Total system	2017		2018	
	Q3	Q4	Q1	Q2*
Lending to Stable Resources Ratio	86.0	84.5	84.2	83.8
The Liquid Assets Ratio (LAR)	17.6	18.3	17.4	16.8
Capital Adequacy Ratio (CAR)	18.7	18.1*	17.5*	18.1
Tier 1 Capital	17.1	16.6*	16.0*	16.6
CET 1		14.6*	13.9*	14.6

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

Table 3.1.3.b. Financial Soundness Indicators in the UAE for Conventional Banks (in %, unless otherwise indicated)

Conventional	2017		2018	
	Q3	Q4	Q1	Q2*
Lending to Stable Resources Ratio	86.6	84.9	84.8	84.4
The Liquid Assets Ratio (LAR)	17.2	17.7	16.2	15.9
Capital Adequacy Ratio (CAR)	19.1	18.5*	18.0*	18.2
Tier 1 Capital	17.3	16.9*	16.4*	16.7
CET 1		15.4*	14.7*	15.1

Source: CBUAE
Note: All data indicate the end-of-quarter values
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

Table 3.1.3.c. Financial Soundness Indicators in the UAE for Islamic Banks (in %, unless otherwise indicated)

Islamic	2017		2018	
	Q3	Q4	Q1	Q2*
Lending to Stable Resources Ratio	83.8	83.1	82.1	81.6
The Liquid Assets Ratio (LAR)	17.8	20.0	20.2	18.7
Capital Adequacy Ratio (CAR)	17.0	16.4*	15.8*	17.5
Tier 1 Capital	16.3	15.3*	14.6*	16.3
CET 1		11.4*	10.9*	12.6

Source: CBUAE
Note: All data indicate the end-of-quarter values.

[8] Please refer to the 2017 Central Bank of the UAE Annual Report (page 66, Box 1) for details.

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***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

Table 3.1.3.d. Financial Soundness Indicators in the UAE for National Banks (in %, unless otherwise indicated)

National	2017		2018	
	Q3	Q4	Q1	Q2*
Lending to Stable Resources Ratio	87.6	86.1	85.3	84.7
The Liquid Assets Ratio (LAR)	16.1	17.1	16.6	15.9
Capital Adequacy Ratio (CAR)	18.4	17.7*	17.1	17.7
Tier 1 Capital	17.0	16.3*	15.6*	16.4
CET 1		14.0*	13.3*	14.0

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

Table 3.1.3.d. Financial Soundness Indicators in the UAE for Foreign Banks (in %, unless otherwise indicated)

Foreign	2017		2018	
	Q3	Q4	Q1	Q2*
Lending to Stable Resources Ratio	75.7	74.6	76.6	77.2
The Liquid Assets Ratio (LAR)	26.5	26.3	23.0	22.4
Capital Adequacy Ratio (CAR)	20.7	21.3*	20.9*	20.7
Tier 1 Capital	18.0	18.9*	18.7*	18.6
CET 1		18.9*	18.7*	18.6

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

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3.2 Financial developments

3.2.1. Share Price Movement

Higher oil prices were observed during the second quarter of 2018, which gave more confidence to investors, as evident by the increase of share price indices on the Abu Dhabi securities markets. However, in Dubai the share price index lost value. The market capitalization on Dubai Financial Market (DFM) and Abu Dhabi Securities Exchange (ADX) also decreased on a Q-o-Q basis, but increased on a Y-o-Y basis.

On the ADX, the average Share Price Index increased by 0.4% in the second quarter of 2018 Q-o-Q and by 3.4% Y-o-Y after a rise by 6.4% Q-o-Q and 1.8% Y-o-Y in the first quarter of 2018. The market capitalization moved from a growth of 9.2% Q-o-Q and 7.6% Y-o-Y in 2018 Q1 to a decline by 2.1 % Q-o-Q, while rising by 6.9% Y-o-Y during 2018 Q2 (see Table 3.2.1.).

The average Share Price Index in Dubai fell by 9.2% Q-o-Q and 12.8% Y-o-Y in the second quarter of 2018. The market capitalization declined by 3.6% during the same quarter Q-o-Q, while increasing by 6.5% Y-o-Y against an increase by 1.9% Q-o-Q and 1.7% Y-o-Y in 2018 Q1.

Table 3.2.1. UAE – Securities Markets

			2017			2018	
			Q2	Q3	Q4	Q1	Q2
Abu Dhabi	Change of Share Price Index (%)	Q-o-Q	-1.2	0.4	-3.5	6.4	0.4
		Y-to-Date	1.7	2.1	-1.5	2.6	6.8
		Y-o-Y	0.6	-0.7	-1.5	1.8	3.4
	Change of Market Capitalization (%)	Q-o-Q	-1.4	-0.3	0.4	9.2	-2.1
		Y-to-Date	-0.1	-0.4	-0.1	9.2	6.8
		Y-o-Y	7.0	-3.4	-0.1	7.6	6.9
Dubai	Change of Share Price Index (%)	Q-o-Q	-5.6	6.8	-3.8	-6.5	-9.2
		Y-to-Date	-0.8	6.0	2.0	-10.0	-15.1
		Y-o-Y	0.3	3.6	2.0	-9.4	-12.8
	Change of Market Capitalization (%)	Q-o-Q	-7.8	5.7	2.4	1.9	-3.6
		Y-to-Date	9.5	15.8	18.5	1.9	-1.8
		Y-o-Y	7.4	12.0	18.5	1.7	6.3

Source: Abu Dhabi Securities Exchange and Dubai Financial Market
Note: Changes computation (Q-o-Q) is based on quarterly average of end-of-month values for the share price index and market capitalization.

3.2.2. Credit Default Swaps Premiums

The default risk premium for the Emirate of Abu Dhabi remains at a low level, which marginally increased in 2018 Q2, after a slight decrease in 2018 Q1. In the Emirate of Dubai, it moved upwards compared to the previous quarter (see Table 3.2.2).

Table 3.2.2. UAE – Sovereign Credit Default Swaps (CDS)

	2017			2018	
	Q2	Q3	Q4	Q1	Q2
Emirate of Abu Dhabi	43.8	57.3	62.9	56.2	63.7
Emirate of Dubai	114	121.4	130.6	106.8	116.1

Source: Bloomberg.
Note: All data are the average of each quarter. Premiums are expressed in basis points.

In the second quarter of 2018, the CDS of the UAE Sovereigns increased by 7.5 basis points (bps) for the Emirate of Abu Dhabi after a previous decrease by 6.7 (bps) in the first quarter of 2018.

In Dubai, the CDS moved up by 9.3 basis points (bps) after a reduction of 23.8 (bps) in the first quarter of 2018. Despite recent increase, the levels remain very low in historical terms and reflect the reduced risks, which are functions of the recent firming up of oil prices and continued progress on fiscal reforms.

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Chapter 4. Monetary Developments and The Central Bank's Financial Position

Monetary aggregates witnessed mostly an increase in 2018 Q2 thanks to the rise in Quasi-Monetary deposits and in Government Deposits in the banking system. Meanwhile, the Central Bank's balance sheet exhibited a decrease, as evident by the decrease in Cash and Bank Balances as well as the decrease in Deposits at Banks Abroad and Other Advances. Meanwhile, EIBOR increased during this period in line with the expectation of the Fed's decision to increase its policy rate, which materialized in June. The Spread of the Swap rates for the Dirham vs. USD remained roughly flat.

4.1 Monetary Aggregates

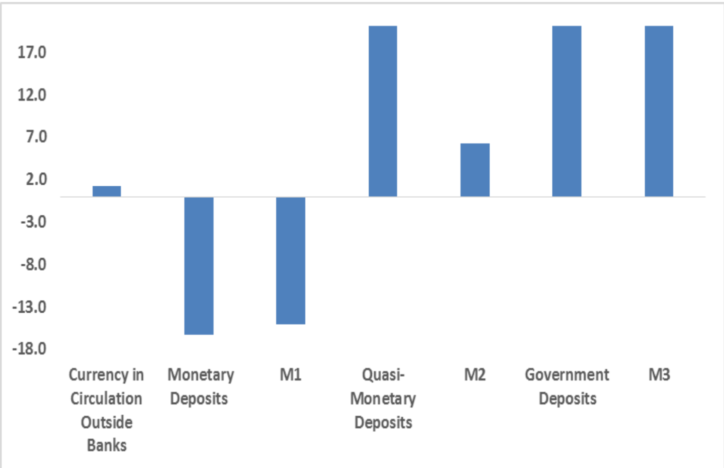
During 2018 Q2, M1 decreased by 3% to reach AED 495.5 billion at the end of June. The decrease was mostly due to the fall in Monetary Deposits by AED 16.3 billion to reach AED 424.4 billion.

Meanwhile, Money supply M2 increased by 0.5% to reach AED 1,300.1 billion, due to an increase in Quasi-Monetary deposits by AED 21.4 billion, reaching AED 804.6 billion.

M3 increased by 1.8%, to reach AED 1,553.6 billion, due to an increase in Government deposits by AED 20.6 billion, which reached AED 253.5 billion.

Figure 4.1 Change in Monetary aggregates in 2018 Q2

In billions of Dirhams



Source: Central Bank of the UAE

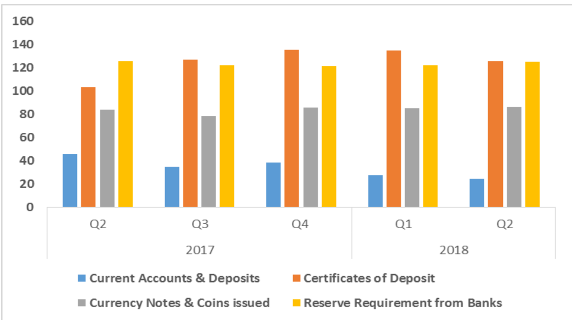
4.2 Central Bank Balance Sheet

Changes in the Central Bank balance sheet are the result of liquidity position at the banking system, reflecting developments in the oil price and capital flows. During 2018 Q2, total assets of the Central Bank decreased by 2.4% (AED 9.5 billion) to reach AED 386.1 billion, due mainly to a decrease in Cash and Bank Balances by AED 8.6 billion and a decrease in Deposits at banks abroad and Other Advances by AED 1.8 billion.

On the liabilities side, a decrease was recorded in Current Accounts and Deposits by AED 3.4 billion and in Certificates of Deposits (CDs) issued by CBUAE and purchased by banks by 9.1 billion. Nonetheless, the balance of CDs at banks remained to the tune of AED 125.2 billion at end of June, which is an indicator of the comfortable liquidity position of the domestic banking sector.

Figure 4.2 Central Bank Liabilities

In billions of Dirhams



Source: Central Bank of the UAE

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Table 4.1 Central Bank Balance Sheet

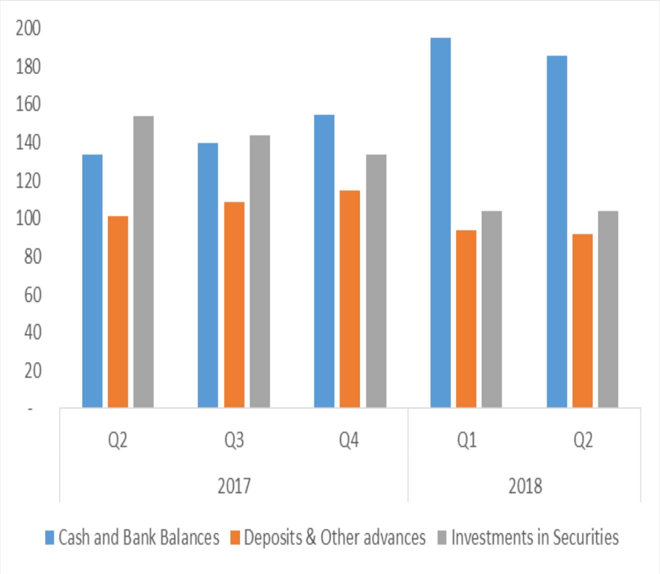
In billions of Dirhams

	2017			2018	
	Q2	**Q3**	**Q4**	**Q1**	**Q2**
Total Assets,	**392.0**	**396.1**	**404.9**	**395.6**	**386.1**
Of which:					
Cash and Bank Balances	133.5	140.0	154.2	195.2	185.6
Deposits & Other advances	101.2	108,.3	115.2	93.6	91.8
Investments in Securities[1]	153.5	143.5	133.7	104.2	104.2
Gold Bullion	1.1	1.1	1.2	1.2	1.1
Total Liabilities,	**371.0**	**375.5**	**384.3**	**373.6**	**364.1**
Of which:					
Current Accounts & Deposits	46.0	35.0	38.6	27.7	24.3
Reserve Requirement from Banks	125.3	122.1	121.2	122.0	125.1
Certificates of Deposit	103.0	127.0	135.1	134.3	125.2
Currency Notes & Coins issued	83.9	78.3	85.4	84.7	86.1

Source: Financial Control Division, Central Bank of the UAE
(1) Including Held-to-Maturity foreign securities and Securities of Ministry of Finance and Dubai Government

Figure 4.3 Central Bank Assets

In billions of Dirhams



Source: Financial Control Division, Central Bank of the UAE

4.3 Central Bank Foreign Assets

As shown in Table 4.2, the balance of foreign assets decreased from AED 336.3 billion at end of 2018 Q1 to AED 331.1 billion at end of 2018 Q2. The 1.6% decrease is due to a fall in Current Account Balances & Deposits with Banks Abroad by AED 10.7 billion.

Table 4.2 Central Bank's Foreign Assets

In billions of Dirhams

	2017			2018	
	Q2	**Q3**	**Q4**	**Q1**	**Q2**
Total Foreign Assets*	338.3	344.1	347.7	336.3	331.1
Foreign Securities	104.3	94.3	84.5	55.2	55.2
Current Account Balances & Deposit with Banks Abroad	227.6	241.5	256.6	271.2	260.5
Other Foreign Assets	6.4	8.3	6.6	9.9	15.4

Source: Central Bank of the UAE, end of quarter data
*Excluding IMF Reserve Position and SDR Holdings

4.4. International Reserves Position

The credibility of the fixed peg arrangement requires the Central Bank to hold sufficient foreign currency reserves. To this end, Article 75 of Union Law No. 10 of 1980 concerning the Central Bank, The Monetary System and Organization of Banking mandated the Central Bank to maintain a "Currency Cover Ratio" where "internationally recognized reserve assets" correspond to at last 70% of the Currency in Circulation and Demand Deposits. As at the end of June 2018, the Cover Ratio reached 281% i.e., well above the minimum required ratio.

Table 4.3 reports the International Reserve Position of the Central Bank, which decreased from AED 339 billion at the end of 2018 Q1 to AED 333.6 at end of 2018 Q2. As a ratio of the monetary base, however, the International Reserve Position increased from 92.8% in 2018 Q1 to reach 94.3% in 2018 Q2.

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4.5 Developments in Banks' Liquidity at the CBUAE

Banks' liquid assets at the Central Bank are composed mainly of their current accounts at the Central Bank, required reserves, and the balance of certificates of deposits held by banks. These assets decreased from AED 385.3 billion at the end of 2018 Q1 to AED 376.5 billion at the end of 2018 Q2 (i.e., by AED 8.8 billion), mainly due to a decrease in Banks' Current Accounts at the Central Bank by AED 6 billion. Nonetheless, liquidity at banks remained sufficient, as the eligible liquid assets ratio remained at 16.8%.

Table 4.3 International Reserves

4.6 Interest Rates

In billions of Dirhams

	2017			2018	
	Q2	Q3	Q4	Q1	Q2
1. **International Reserve Position***	**341.1**	**347.0**	**350.3**	**339.0**	**333.6**
Of which					
– Current Account Balances & Deposits with Banks Abroad	227.7	241.5	256.6	271.2	260.5
– Foreign Securities	104.3	94.3	84.5	55.2	55.2
– IMF Reserves Position + SDR Holdings	2.8	2.8	2.6	2.7	2.6
2. Monetary Base	**355.0**	**358.7**	**377.4**	**365.2**	**353.9**
Of which					
– Currency Issued	83.9	78.3	85.4	84.7	86.1
– Reserve Requirements	125.5	122.4	121.4	122.0	125.1
–					
– Banks & OFCs Current Accounts at CBUAE	42.8	31.4	35.5	24.2	17.5
Ratio (1/2)	96.1%	96.7%	92.8%	92.8%	94.3%

ntral Bank of the UAE, end of quarter data
ernational Reserves including IMF Reserve Position and SDR Holdings

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 rate policy in the U.S. Therefore, the Central Bank of the UAE announced an increase in interest rates applied to its Certificates of Deposits, in line with the Fed's decision to increase its target Federal Funds rate by 25 basis points to reach 1.75–2% range. Similarly, the Repo Rate applicable to banks' borrowing for short-term liquidity from the Central Bank against their holding of CDs, has increased to 2.25%

4.6.a Short-term interest rates

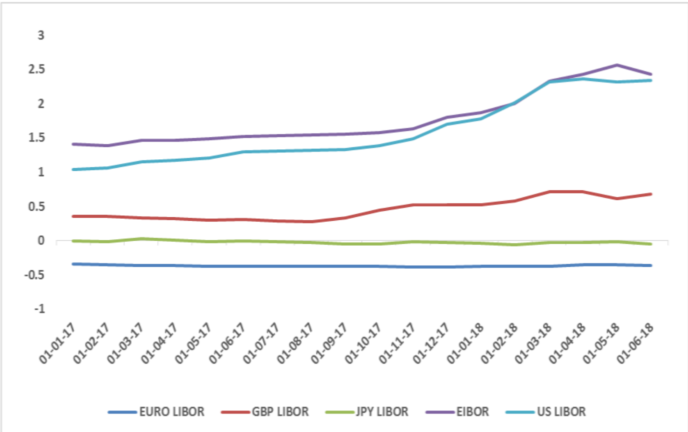
The Emirates Interbank Offer Rate (EIBOR) comprises the daily quotes of the largest banks operating in the country, based on the average interest rate at which banks offer to lend secured funds to other banks in the Dirham wholesale money market and published by the Central Bank of the UAE. New "Regulations on Interbank Rate Submissions by EIBOR Panel Banks" were issued on 25 March 2018, in line with the recommendations of the International Organization of Securities Commissions (IOSCO), with the aim to enhance governance, standardization and transparency in the rate-setting process at Panel Banks.

The main requirements of the new regulations are: (1) EIBOR Panel Banks are to rely, as much as possible, on the use of available transaction data from the day before;, otherwise they need to base their estimates based on unsecured interbank transaction of greater than AED 20 million, unsecured wholesale deposits of greater than AED 20 million from GREs, corporates and NBFIs, and internally developed expert judgment, and (2) Panel Banks are required to appoint an independent auditor from a panel of audit firms nominated by the CBUAE.

During 2018 Q2, EIBOR increased from 2.3% at end of March to 2.4% at end of April and to 2.5% at end of May, before declining to 2.4% at end of June. Meanwhile, the 3-month LIBOR on USD did not increase much during this period as the Fed's decision to increase its policy rate in June was largely expected and therefore already factored in.

The LIBOR rates on the Euro and Japanese Yen remained in negative territory, in line with the directions of monetary policy adopted by the respective central banks.

Figure 4.5. a LIBOR rates (3-month) for the Dirham and key other currencies (%)



Source: Bloomberg

As regards EIBOR vis-à-vis the USD LIBOR (3–month), the negative spread observed at the end of 2018 Q1 has been reversed in Q2, reaching 7 basis

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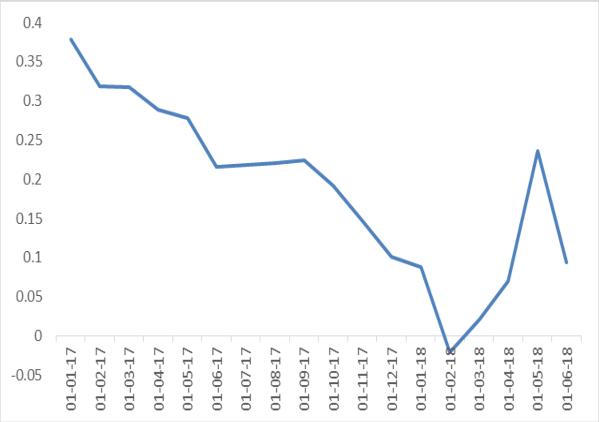
points at end of April and 24 bps at end of May, before declining to 9 bps at end of June.

Figure 4.5.b Dirham Spread vs. USD LIBOR (3 month, %)



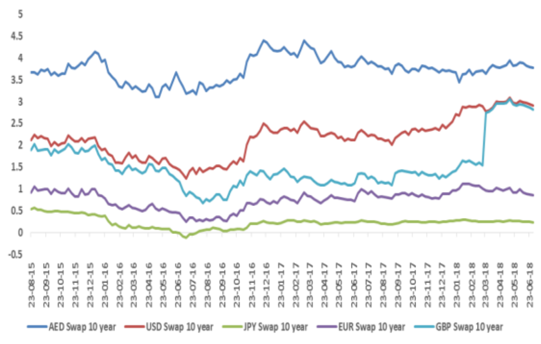
Source: Bloomberg

4.6.b Long-term swap rates

Given the absence of a government bond market in local currency in the UAE, the swap market reflects the yields of long-term securities[9]. As shown in Figure 4.6.a, the 10-year swap rates for the Dirham increased from 3.7% in early April, to peak at 3.9% in May, before decreasing to 3.7% by end of June.

Meanwhile, the10-year Swap rates for USD, the Euro and the British Pound increased in line with global rise in interest rates, mainly triggered by the Fed's continued normalization of monetary policy as well as rising global risks.

Figure 4.6.a 10-year swap rates (%)

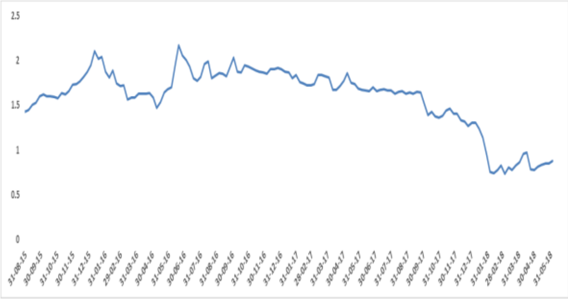


Source: Bloomberg

(1) By definition, interest rate swaps correspond to an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the London Interbank Offer Rate (LIBOR).

As regards the spread between the Dirham 10-year swap rate and the US dollar, Figure 4.6.b shows that this remained roughly flat in 2018 Q2, at around an average of 86 basis points.

Figure 4.6.b Spread 10-year Dirham Swap vs. USD Swap (%)



Source: Bloomberg