United Arab Emirates

مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

Quarterly Economic Review

2016 Q3

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Executive Summary

At the international level, the US economy is back on track of robust growth in 2016 Q3, as monthly indicators strengthened in September. Dynamics in private consumption are intact, as evidenced by September's rise in consumer confidence to a pre-crisis high and an uptick in retail sales. The industrial sector also regained some traction, returning to moderate growth, with the ISM Manufacturing Index rebounding.

Data for 2016 Q3 show that the Eurozone's economic recovery remains shaky. The unemployment rate remained steady for the fourth consecutive month in August and the composite PMI (purchasing manager index) edged down in September. Meanwhile, industrial production rebounded in August and economic sentiment surged to the highest level seen since January in September. The latter evidence reaffirms the health of the Euro Zone economy post Brexit thus far.

Weak global demand, spillovers from the low oil price environment and challenging domestic conditions continued to weigh on economic activity in the MENA region though some tentative signs of improvement have since emerged for both, oil-exporters and oil-importers.

In the UAE, based on revised new figures of growth in 2015 and revised projections of the global economy, the Central Bank of the UAE has revised its estimate of the Economic Composite Indicator (ECI) for the UAE which combines advanced econometric techniques with available economic variables such as CPI (consumer price index) inflation, DET (Dubai Economy Tracker) and oil prices, and updated its econometric model to project economic growth for both oil and non-oil activities over a period of two years.

In this context, the growth of GDP in the UAE is expected to slow to 2.2% in 2016 and regain momentum to 2.4% in 2017, driven mainly by the continued fiscal consolidation and the slowdown of the main UAE trading partners. Non-oil GDP growth is projected to grow by 2.7% in 2016, while oil GDP growth is forecast to increase by 1.2%, given the projected increase in oil production.

The decreasing trend of inflation continued for a fourth consecutive quarter. The average Consumer Price Index (CPI) increased by 0.9% in the third quarter of 2016. One of the main reasons for the continued decline in CPI inflation is reduction in the inflation rate for the housing, transportation and tradables components of the CPI basket. As regards banking activity, Government deposits declined in the 3rd quarter of 2016, but remain above the levels observed at the end of 2015. However, monetary aggregates increased mainly due to the increase in private sector and GREs deposits. Banks continued to increase credit at a rate that supports growth in the non-oil activities. The Financial Soundness Indicators (FSIs) continue to show that the UAE banking system is sound and enjoys strong pillars for continued stability.

The Central Bank balance sheet exhibited a decrease in 2016 Q3, triggered by reduction of liabilities, particularly a return to "normal" for Currency Issued and a fall in Derivative Liabilities. Meanwhile, asset's allocations aim to strike a better balance between return and liquidity. Banks' liquidity position at the central bank bode well for strong and efficient intermediation function going forward.

Chapter1. International Economic Developments

In the US, the economy is back on track of robust growth in 2016 Q3, as monthly indicators strengthened in September. Dynamics in private consumption are intact, as evidenced by the September's rise in consumer confidence to a pre-crisis high and an uptick in retail sales. Data for 2016 Q3 show that the Eurozone's economic recovery remains shaky. The unemployment rate remained steady for the fourth consecutive month in August and the composite PMI edged down in September. The Chinese economy kept up its momentum as increased government spending and a property boom have mitigated the adverse effects of stubbornly weak exports.

For the third quarter of 2016, the GDP figures releases for the US, UK and China showed that the collective economies performed well, while Eurozone's GDP numbers show that recovery is still shaky in the 19-nations area.

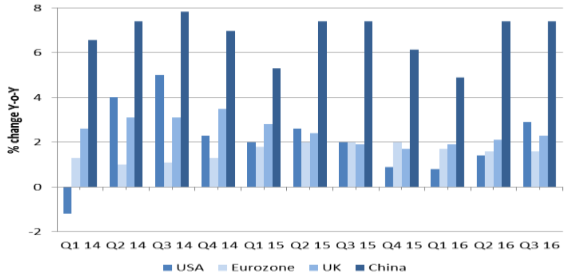
GDP in the US increased at an annual rate of 2.9% in 2016 Q3 compared to the 1.4% for the second quarter of 2016. The increase in real GDP in the third quarter reflected positive contributions from personal consumption expenditures (PCE), exports, private inventory investment, federal government spending, and nonresidential fixed investment that were partly offset by negative contributions from residential fixed investment and state and local government spending. Imports, which are a subtraction in the calculation of GDP, increased benefiting from further dollar appreciation.

In the Eurozone the 2016 Q3 growth was of 1.6% annualized, same as in Q2, suggesting that the recovery in the 19-nation single currency area is gaining momentum amid fears about the fallout of Brexit and implications on the stability of the banking system. The slowdown remains evident as compared to the last three months of 2015, when the economy in the Eurozone grew by an average of 2% on a Y-o-Y basis. While the pace of expansion met forecasts, growth in the Eurozone remains relatively low and the expectations are that the latest figures are unlikely to prompt a radical change of policy by the European Central Bank (ECB).

The UK's GDP growth was 2.3% higher in 2016 Q3 compared with the same quarter a year ago. This is the first release of GDP covering a full quarter of data following the EU referendum. The pattern of growth continues to show resilience following the UK referendum on EU membership, with a strong performance in the services industries offsetting falls in other industrial groups.

The Chinese economy was able to keep up its momentum in 2016 Q3, growing at 7.4% Y-o-Y annualized as increased government spending and a property boom offset stubbornly weak exports. While fears of a hard landing have eased this year, recent data also have highlighted growing imbalances in the world's second-largest economy, with growth increasingly dependent on government spending and ballooning debt as private investment tumbles to record lows. The high-flying property market is also beginning to show signs of overheating.

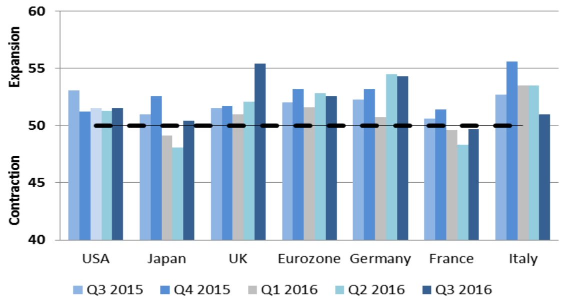
Figure 1.1. GDP growth for selected economies



Source: Bloomberg

Economic activity in the developed world as measured by the Purchasing Management Index (PMI) shows that in the US, Japan, the UK and France it has seen an improvement in 2016 Q3, while in the other countries/regions shown in Figure 1.2 it has experienced a deterioration compared to quarter two 2016.

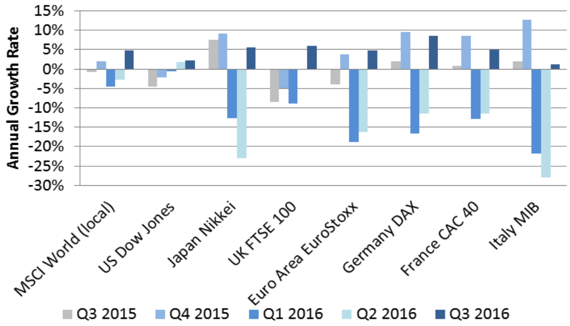
Figure 1.2. PMI levels



Source: Bloomberg

The US saw a marginal improvement in their PMI levels from 51.3 to 51.5, while the UK PMI improved from 52.1 to 55.4. In contrast, Eurozone's PMI level was at 52.8 at the end of 2016 Q2 and ended the third quarter of 2016 at 52.6, which is still above the 50 mark, hence still expanding. On the other hand, the French PMI notched up from 48.3 at end of the 2016 Q2 to 49.7 at the end of quarter three 2016 and even though is growing Q-o-Q, it remains below the 50 mark. A PMI reading above 50 indicates expansion and below 50 a contraction.

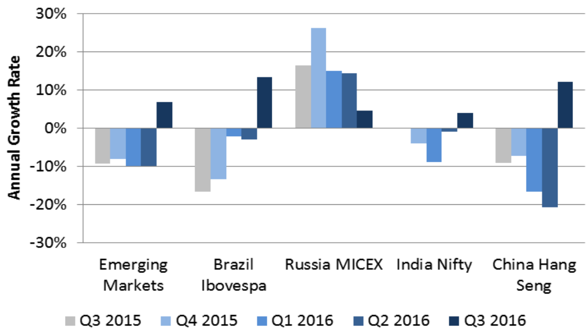
Figure 1.3. Annual percentage change of equity indices (local) in developed economies



Source: Bloomberg

All developed equity markets in the analysis, experienced positive annual returns during the third quarter of 2016, with the highest return being for the German DAX, which grew by 8.6%.

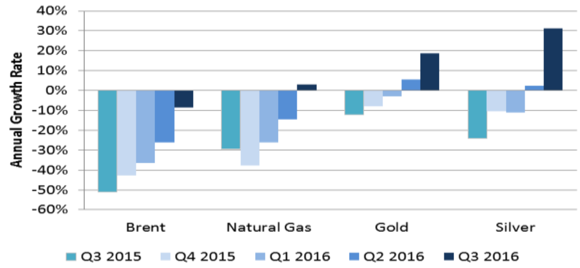
Figure 1.4. Annual stock market index percent changes in BRIC countries (local)



Source: Bloomberg

Similarly, equity markets all have had a positive return on an annual basis for the BRIC, with Brazil being the top performer with 13.3%, in the third quarter of 2016.

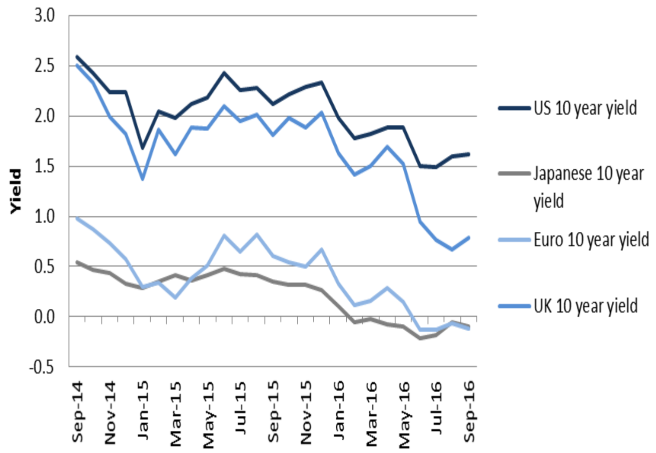
Figure 1.5. Selected commodity price levels annual changes



Source: Bloomberg

The third quarter of 2016 saw an improvement of some selected commodity prices, Y-o-Y, with exception of oil (Brent), which declined by 8.5%, significantly less compared to previous quarters. On an annual basis, the natural gas, gold and silver managed to post improvements in the third quarter of 3.1%, 18.6% and 31.2% respectively.

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

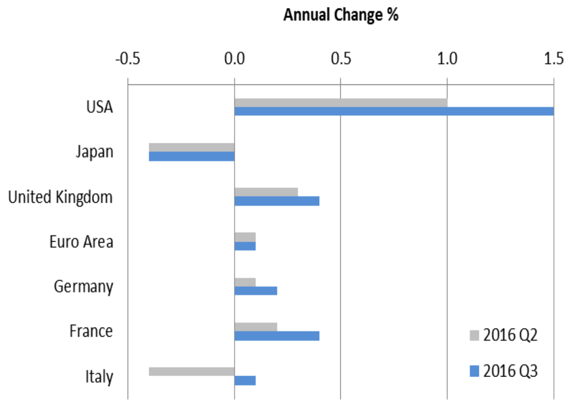


Source: Bloomberg

Markets recovered from the initial shock of the late-June UK's referendum vote to leave the EU, as lower bond yields, expectations of additional monetary accommodation, and somewhat improved global economic data soothed investor concerns. While global liquidity remained ample, monetary policy rates remained relatively unchanged during the quarter. Bond yields rose modestly for the major developed markets, with exception of the UK 10 year government yield, mainly due to the Brexit vote and the Bank of England decision to decrease the policy rate by 25bps, which declined from 0.95% at the end of June 2016 to 0.79% at the end of the third quarter of 2016.

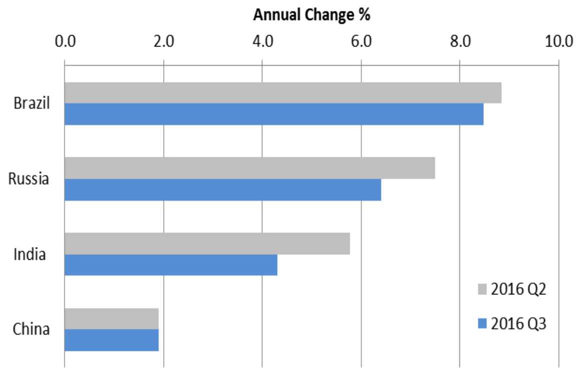
The charts below on consumer prices continue to show the marked difference between the developed and the developing world. Whereas the developed world is struggling with near zero inflation rates, with exception to the US, the developing world experienced higher inflation rates with the exception of China. In Brazil, the continued depreciation of its currency and political instability in the third quarter of 2016 were the driving forces of high inflation.

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



Source: Bloomberg

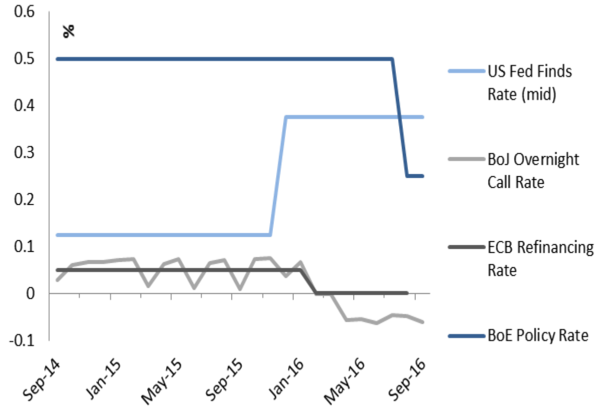
Figure 1.8 Year-on-Year consumer price change in emerging economies



Source: Bloomberg

In terms of monetary policy, the US Federal Reserve once again postponed the rate hike till December 2016. In contrast, the Bank of England took a decision to cut its policy rate by 25bps in order to stimulate the economy further accelerating the rate of Sterling's depreciation post Brexit. The third quarter was also marked by the Bank of Japan's decision to marginally increase the overnight call rate from -0.064% at the end of 2016 Q2 to -0.06% in September 2016, perhaps in an effort to reduce the adverse effects of continued negative interest rates on the banking sector.

Figure 1.9. Policy rates of developed countries



Source: Bloomberg

Middle East and North Africa (MENA) oil exporters continue to face an exceptionally challenging environment as low oil prices and conflicts continue to weigh adversely on economic activity, fiscal and external balances, and the financial sector. Many countries have made progress in fiscal consolidation, yet sustained efforts will be required over the medium term to place public finances on a sound footing. Plans to diversify economies away from oil and create jobs for the fast growing population are underway in many countries.

For the MENA oil importers, macroeconomic stabilization is advancing on the heels of recent energy subsidy reforms and continued low oil prices, which presented some relief for deteriorating public finances and external balances. Yet, growth remains weak and fragile amid ongoing regional conflicts, lingering structural impediments, and subdued external demand. Over the medium term, growth is set to remain too low to address persistently high unemployment and threaten efforts to foster economic inclusiveness.

Chapter 2: Domestic Economic Developments

The growth of GDP in the UAE is expected to slow to 2.2% in 2016 and regain momentum to 2.4% in 2017, driven mainly by the continued fiscal consolidation and the slowdown of the main UAE trading partners. Non-oil GDP growth is projected to grow by 2.7% in 2016, while oil GDP growth is forecast to increase by 1.2%, given the projected increase in oil production. The decreasing trend of inflation continued for a fourth consecutive quarter. The average Consumer Price Index (CPI) increased by 0.9% in the third quarter of 2016. One of the main reasons for the continued decline in CPI inflation is reduction in the indexes for housing, transportation and tradables components of the CPI basket. The UAE improved significantly its ranking to 26th worldwide in Doing Business Report 2017, and to 41st worldwide in the Global Innovation Index, while the country ranked 17th in the Global Competitiveness Index, which is testament to the reforms undertaken and their positive impacts on the country's international standing and competitiveness.

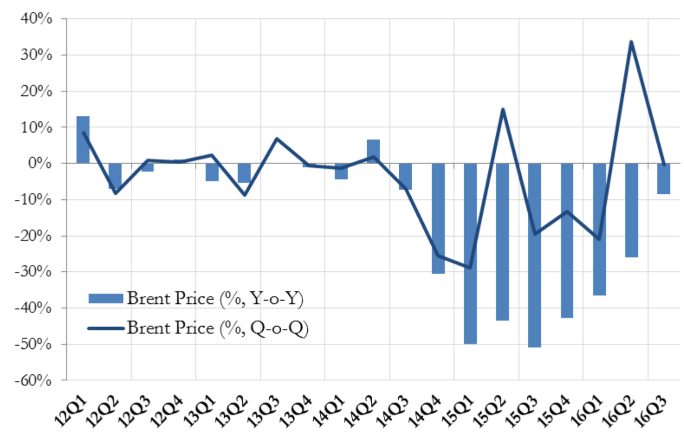
2.1 Economic Activity and Growth

After a significant improvement of the Brent oil price in the second quarter of 2016 (increased on average by 33.7% on a quarter-on-quarter basis), oil prices declined slightly to reach an average price of 45.8$ in the third quarter of 2016, falling on average by 0.3% compared to the previous quarter (see Figure 2.1.a).

Although oil prices declined by 8.5% compared to the third quarter of 2015, the recent developments reflected a stabilization of oil prices around an average level of 45.9$ during the last two quarters, reducing the amount of uncertainty and improving the market sentiment. The improvement of the Purchasing Managers' Index (PMI) and The Dubai Economic Tracker (DET) respectively showed the impact of these positive spillovers on the non-oil private sector (see Figure 2.1.b). While standing above the neutral level (the 50-threshold), the average PMI and average DET increased by 2.4% and 3%, respectively, moving from 53.4 to 54.7 for the PMI and from 53.9 to 55.6 for the DET, displaying a faster rate of expansion of the non-oil private sector in the UAE during the third quarter of 2016, compared to the second quarter.

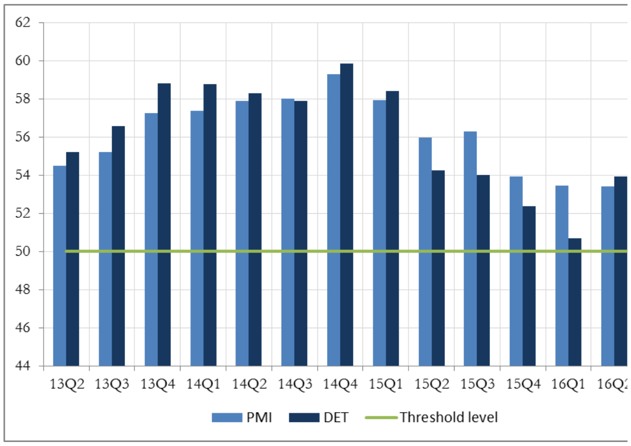
The PMI followed a declining trend during the third quarter of 2016. It dropped in September to reach 54.1 after better readings in July (55.3) and August (54.7). The reason behind these developments was a sharp deceleration in new order growth (accounts for 30% of the PMI), which recorded its weakest result in over six years. On the contrary, the rate of growth in output (accounts for 25% of the PMI) and employment (accounts for 20% of the PMI) was broadly similar to that in August. Input costs dropped for the first time in a year and a half, and output charges also fell. A deeper analysis of the PMI's survey results concluded that the sharp slowdown in new order growth last month appears to be to the result of weaker demand from external markets rather than soft domestic demand.

Figure 2.1.a. Oil Prices Development, Brent Price



Source: IMF

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



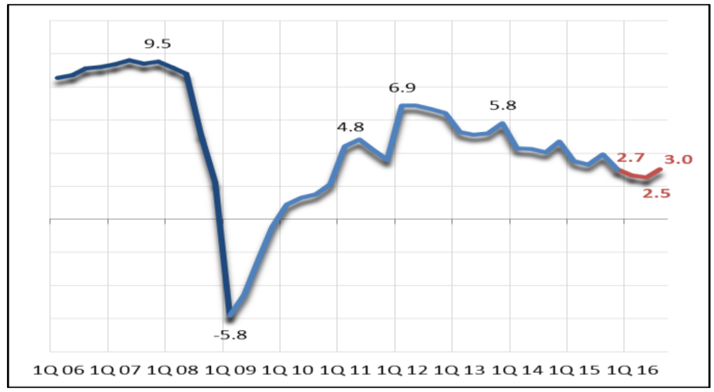
Source: Markit & Emirates NBD

On the other hand, the average DET expanded significantly due to the continuous increase of output and new orders during the third quarter, although it followed a decreasing path; reaching 55.1 in September against 55.7 in August and 55.9 in July.

The strong expansion of the non-oil sector translated to an improvement in the Overall Economic Composite Indicator (ECI)[1] for the third quarter of 2016 as well as an expanding non-oil Economic Composite Indicator (see Figures 2.1.c and 2.1.d). The new reading of the ECI showed a growth rate of the non-oil economic sector by 3% against a 2.5% estimated growth rate during the previous quarter. However, the overall ECI indicated an expansion of the overall economy by 2.3% against an estimated growth rate of 2.5% in the previous quarter. The positive impact of the preliminary oil OPEC deal to limit production in September has been overshadowed by doubts about its implementation. Similarly, signs that global monetary conditions will remain accommodative for the foreseeable future, combined with more stable oil prices, were offset by harsh fiscal consolidation processes amidst looming concerns of rising debt levels.

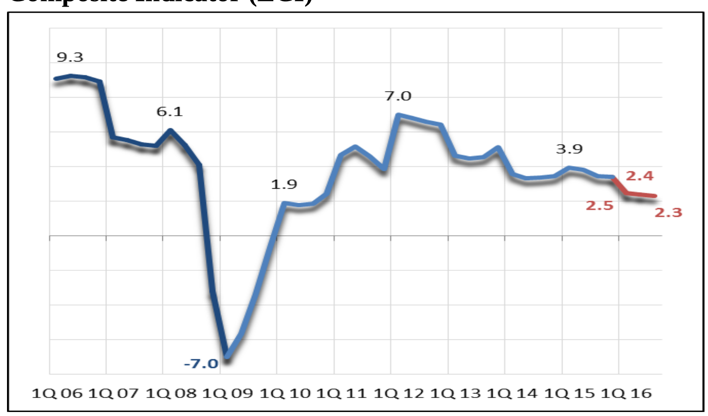
These developments warranted a revision of CBUAE's projections for GDP growth in 2016. The Real Non-Oil GDP is expected to grow by 2.7%, the same projection as before. However, the Real Oil GDP is expected to expand by 1.2% lower than the 1.4%, previously forecast. This revision is due mainly to high likelihood of an OPEC agreement about a production freeze in 2016. Accordingly, The Real GDP growth for 2016 is revised downward to 2.2% (see Table 2.1).

Figure 2.1.c Non-Oil Quarterly Economic Composite Indicator (Non-Oil ECI)



Source: CBUAE

Figure 2.1.d Overall Quarterly Economic Composite Indicator (ECI)



Source: CBUAE

The UAE improved significantly its ranking to 26th out of a total of 190 countries in Doing Business Report 2017, published by the World Bank, up from 34th in the previous year, thereby becoming one of the top 10 most improved business environments in the world, over the past year. The major improvement took place in the field of protection of minority investors, with the UAE's ranking in this regard jumping from 48th in 2016 to 9th, as a result of the new corporate governance rules published by the Exchange Securities and Commodities Authorities (ESCA) which came into force in May. Moreover, the UAE improved its position in the Global Innovation

[1] Please see Box 1

Index, published by the World Intellectual Property Organization, from 47th to 41st worldwide in the report published in August 2016, out of a total of 128 countries. The improvement was mainly attributed to strengthened institutions and market sophistication, as well as development in information technology, communications and infrastructure.

The Global Competitiveness Index, published by the World Economic Forum, ranked the UAE 17th out of 140 countries in its 2015/2016 Report, with the following worldwide ranking: Institutions (30), Infrastructure (31), Macroeconomic Environment (26), Health and Primary Education (13), Higher Education & training (7), Goods Market Efficiency (40), Labor Market Efficiency (36), Financial Market Development (47), Technological Readiness (39), Market Size (17), Business Sophistication (24), and Innovation (57).

Table 2.1 Economic Growth in the UAE (%)

	2013	2014	2015	2016 (P)	2017 (P)
Real GDP	4.7	3.1	3.8	2.2	2.4
Real Oil GDP	2.9	0.8	5.0	1.2	1.5
Real Non-Oil GDP	5.6	4.1	3.2	2.7	2.8

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

Box 1: Economic Composite Indicator (ECI) for the UAE: An updated Methodology for a long horizon

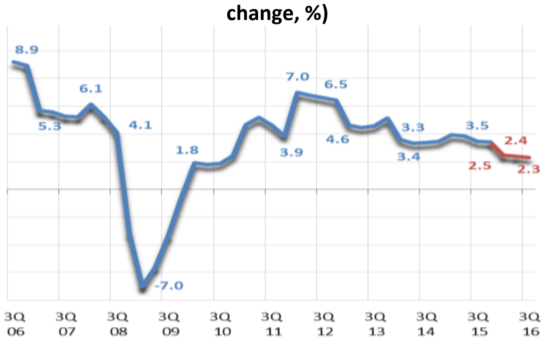
Given the proven importance of the Economic Composite Indicator[2] (ECI) to track closely the economic activity of the UAE on a quarterly basis, the Research and Statistics Department of the CBUAE has updated its methodology and extended its horizon to span the most recent economic history of the UAE.

Updated Methodology

In order to improve the quality of the ECI, the revised index integrates a new variable as a proxy for tourism activity in the dataset that covers a wide range of domestic and international indicators, such as growth of the global economy, sectorial activity, financial markets, the money market, and price trends. The new proxy measures the UAE airport passenger traffic, which could relatively track the performance of the tourism sector as well as logistic activity.

Further, we extended the horizon of all the selected variables to capture domestic and global conditions from the first quarter of 2006 to date, in order to have a clear picture about the UAE economic fluctuations before and during the crisis. Finally, we applied the Principal Component Analysis (PCA) on the extended data set, to extract the first component which reflects the UAE economic activity on a quarterly basis.

Figure 1. Quarterly Economic Composite Indicator (Y-o-Y change, %)



Source: CBUAE

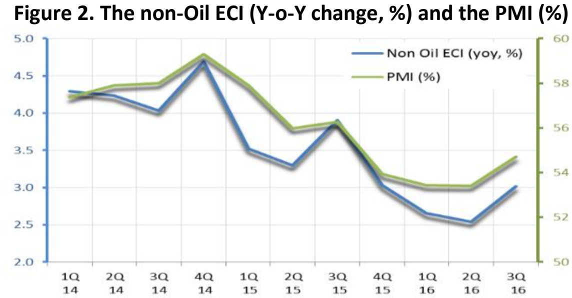
Updated ECI advantages

This index has proven to be a useful tool for the policymakers since it offers a timely clear picture about the current economic situation in the UAE in the absence of official data for quarterly GDP. The updated ECI has three important advantages: first, it captures economic fluctuations for the UAE from 2006 to date, on a quarterly basis, which allows us to better understand the trends and cyclicality of the UAE economy. Secondly, it takes into account all important policy issues by synthesizing a large number of economic variables, both at the national and international levels. Finally, it is a useful tool to give an early indication of turning points and assist near term projections of the annual growth figures in the UAE.

Estimates analysis and results comparison

On a quarterly basis, the non-oil ECI is highly correlated with the Purchasing Managers' Index[3] (PMI) and both indicate the same turning points of the non-hydrocarbon activity.

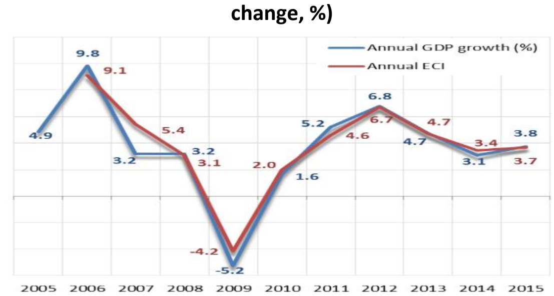
Figure 2. The non-Oil ECI (Y-o-Y change, %) and the PMI (%)



Source: CBUAE

Moreover, the annual updated ECI reflects the economy's historical performance and changes since 2006. There is a high correlation between the constructed ECI and the historical GDP growth of the UAE. The evidence reaffirms the quality of the index and solidifies the robustness of the methodology followed in its construction as this indicator synthesizes a large number of information that best represents economic activity in the UAE.

Figure 3. Annual Economic Composite Indicator (Y-o-Y change, %)



Source: CBUAE

In the absence of published official data of quarterly GDP in the UAE, the ECI has proven to be a valuable tool for policymakers who are constantly looking for timely information about cyclical developments of the UAE's economic activity to inform timely policy decisions and contingency plans.

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

[3] The Purchasing Managers' Index (PMI) measures the performance of UAE's companies in non-oil private sector and is derived from a survey of 400 companies, including manufacturing, services, construction and retail.

2.2 Consumer Price Index and Inflation

Lower inflation continues for the third quarter of 2016. The average Consumer Price Index (CPI) inflation for the UAE has decreased for the fourth consecutive quarter, a steady downward path since the fourth quarter of 2015. The average CPI increased by 0.9% during the third quarter of 2016 on a year-on-year basis against an increase of 1.7% and 2.1% in the second and the first quarters, respectively (see Table 2.2). The end-of-period CPI grew only by 0.6%.

Accounting for 66% of a standard consumption basket in the UAE, non-tradables constitute the principal driver of price inflation (see Figures 2.2.a and 2.2.b). The average price inflation of non-tradables has been following a decreasing trend, reaching 1.3% in the third quarter of 2016 against 2% in the previous quarter. The housing costs[4], covering rents and utilities which account for 39% of the consumption basket, grew by 2.7% after an increase of 3.3% previously. The diminishing demand for housing as well as the increasing supply of ongoing development projects are weighing negatively on rents. According to some real estate specialized sources, the residential investment yields in Dubai have compressed slightly in the third quarter of 2016, as median asking rents were 8% lower than the same period of 2015 and 7.1% lower than the previous quarter.

The price of tradables decreased by 0.8% for the third quarter of 2016 on a year-on-year basis. These developments can be explained by the Dirham's appreciation during the same period (see section 3). In fact, the Dirham appreciated against all its main import partners, except for the Japanese Yen and the South Korean Won. Cheaper imports fueled into low domestic prices for tradables.

The cost of transportation has constituted another source of price fluctuation in the UAE since the full removal of energy-subsidies in the third quarter of 2015. Transportation prices are aligned to international oil prices, leading to more volatility of the CPI inflation since transportation costs account for 10% of the consumption basket. Transportation costs declined by 6% during the third quarter against a decline of 2.7% in the previous quarter, contributing to lower average inflation.

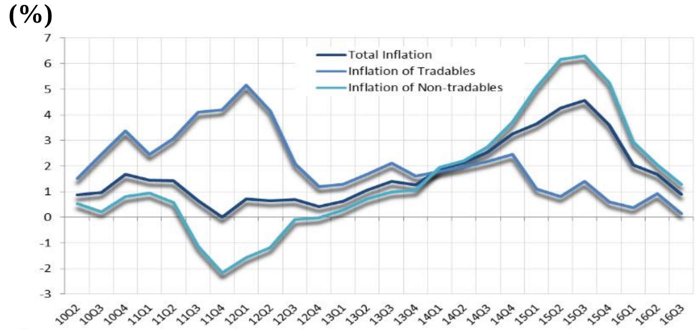
On the other hand, the price of Textiles, Clothing and Footwear category which accounts for 8% of the total consumption basket, continued its increasing trend to reach a price inflation of 4.4% in the third quarter of 2016 after 3.6% and 1.8% in the second and first quarters, respectively. Similarly, the prices of Education and Restaurants and Hotel categories increased by 2.7% and 0.6%, respectively in the third quarter.

Table 2.2 UAE CPI Inflation (%)

	Weight %	2015				2016		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3*
Total CPI Inflation	100	3.7	4.3	4.6	3.6	2.1	1.7	0.9
Total CPI Inflation (end-of-period)	100	4.3	4.2	4.3	3.6	1.4	1.8	0.6
CPI Inflation of Tradable	34	1.1	0.8	1.4	0.6	0.4	0.9	0.1
CPI Inflation of Non-tradable	66	5.1	6.2	6.3	5.2	2.9	2.0	1.3
Housing CPI inflation	39	7.7	9.6	9.4	8.3	5.1	3.3	2.7
Transportation CPI inflation	10	1.5	1.0	5.6	-0.2	-6.7	-2.7	-6.0

Source: Federal Competitiveness and Statistics Authority (FCSA).
Note: All the changes are computed on a Y-o-Y basis and based on the quarterly average CPI, unless otherwise indicated.
***:** The inflation rate is computed based on the available CPI data until August 2016. Quarterly inflation rates will be updated whenever the CPI data for September become available.

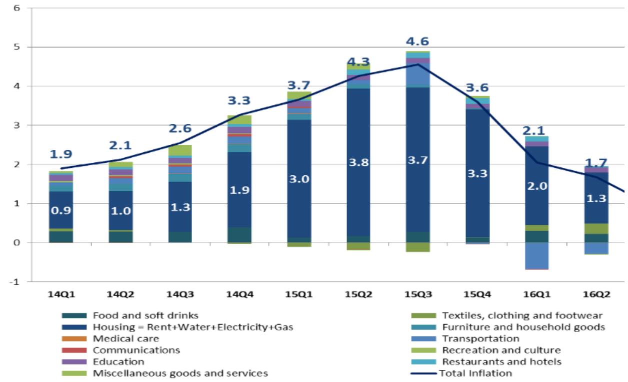
Figure 2.2.a. Tradables and Non-Tradables Inflation (%)



Source: Federal Competitiveness and Statistics Authority (FCSA).

[4] Please see Box 2

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

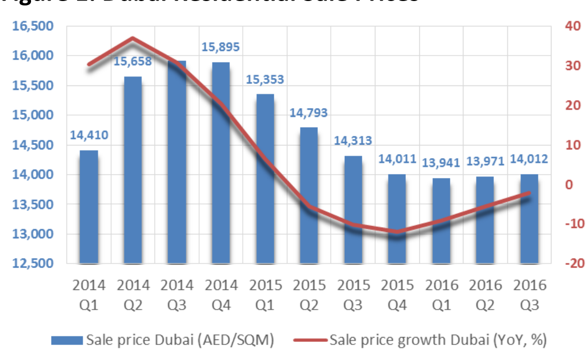
Box 2: Recent Developments in the Real Estate

Real Estate, in Abu Dubai and Dubai, has witnessed different patterns of change in property prices. In the third quarter of 2016, the change in property prices in Abu Dhabi is still positive as opposed to Dubai (0.1% y-o-y against -2.1% respectively). Moreover, the rental yield in both emirates has contracted during 2016 due to the more pronounced fall in rents, but remains attractive for investors (7.15% for Abu Dhabi and 7.34% for Dubai).

Dubai residential Market

In Q3 2016, the property prices as measured by REIDIN Price Index[5], for the residential segment in Dubai (comprised of both Apartments and Villas), which measures the average sample price in dirham per square meter, has decreased by 2.1% y-o-y, but performing better than the previous quarter (see figure 1). In fact, the trend observed during 2016 shows a slight recovery in the residential market in Dubai.

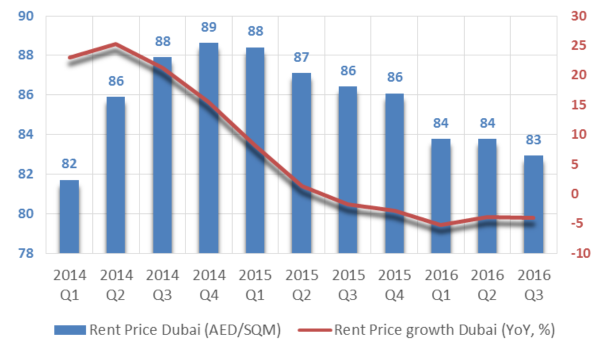
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

Since the beginning of the downward cycle in mid-2014, the fall in prices has outpaced the fall in rents in Dubai (see figure 2). Indeed, the rent prices declined by an annual rate of 4% in the third quarter, following -3.8% in the second quarter.

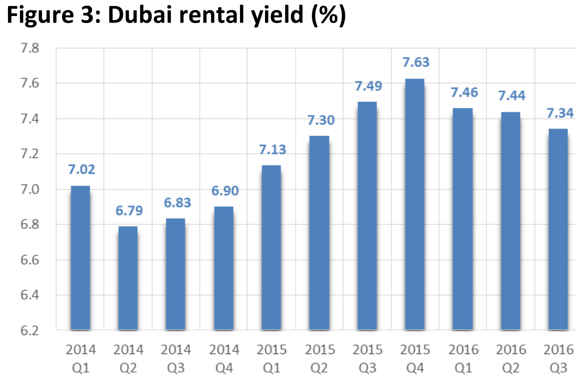
Figure 2: Dubai Residential Rent Prices



Source: REIDIN, Central Bank of the UAE

The more pronounced fall in prices relative to rents has led to an increase in rental yield from a low of 6.79% in second quarter of 2014 (the beginning of the price correction) to a high of 7.63% in the fourth quarter of 2015 (See Figure 3). However, during 2016, relatively stable prices combined with further decline in rents have led the rental yield to contract reaching 7.34% in the third quarter of 2016. The pattern observed in rental yield is typical of the real estate market and is due to two main reasons. First, rent adjustments tend to lag price adjustments, leading rental yield to increase at the initial phase of the correction driven by lower prices, and then to decrease when prices start stabilizing. Second, real estate prices tend to be more speculative and sentiment driven.

Figure 3: Dubai rental yield (%)



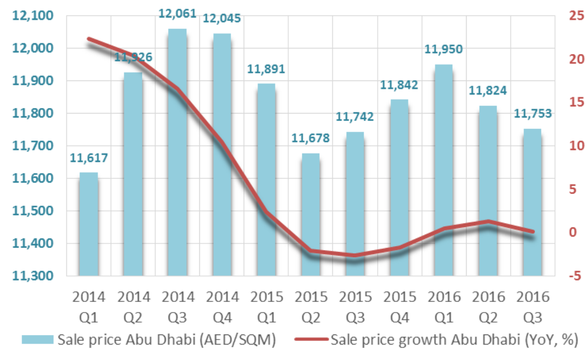
Source: REIDIN, Central Bank of the UAE

[5] 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.

Abu Dhabi residential Market

For Abu Dhabi, the recent data for the property price for the residential segment as a whole, showed a marginal increase of 0.1% y-o-y in the third quarter, following 1.25% in the previous quarter (See Figure 4).

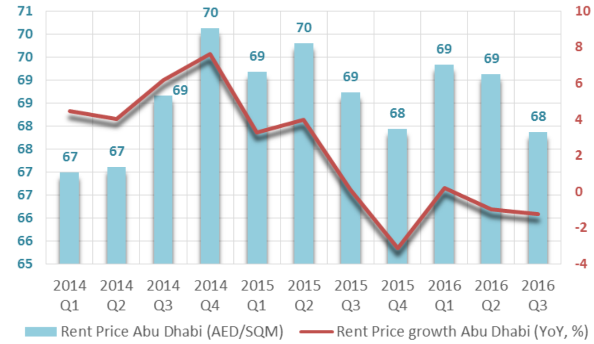
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

Concerning the rental market in Abu Dhabi, rent values declined by an annual rate of 1.25% in the third quarter, after a reduction of 1% in the previous quarter, reflecting the decline of rent prices during this period (See Figure 5).

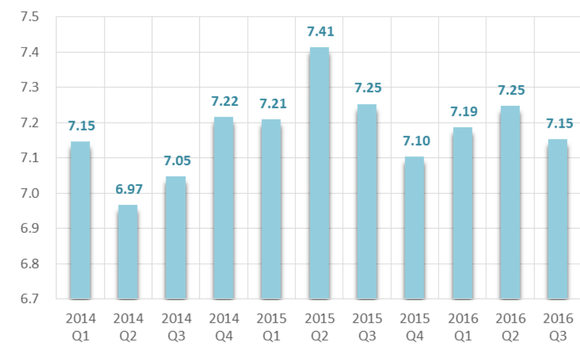
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

As for the rental yield, Abu Dhabi registered a yield of 7.15% for the third quarter of 2016, down from 7.25% in the previous quarter (See Figure 6), reflecting a faster pace of decline in rent relative to a relatively more resilient property values.

Figure 6: Abu Dhabi rental yield (%)



Source: REIDIN

2.3 Exchange Rate and Foreign Trade Balance

The Dirham reverted back to its appreciation trend in the third quarter of 2016 following a brief depreciation during the second quarter. It appreciated against the majority of the currencies for the main trade partners.

From the import side, the weighted Dirham's appreciation against its top-nine non-dollarized import partners was 0.32% in the third quarter of 2016 (see Table 2.3.a). The highest appreciation was against the Great Britain Pound, where the Dirham gained around 9% due to the continued depreciation of the GB Pound after the Brexit. The UK is contributing around 3.4% to the total imports to the UAE. The Dirham gained also 2% and 1.2% against the Chinese Yuan and the Euro respectively. Imports coming from China, Germany, Italy and France account for more than 24% of total imports. Exceptionally, the Dirham lost around 5.2% and 3.7% against the Japanese Yen and the South Korean Won, respectively. On a year-on-year basis, the Dirham followed the same trend and appreciated by 0.56% in the third quarter, driven by important gains against the GB Pound (18%), Chinese Yuan (5.8%) and Indian Rupee (3%) which collectively account for 25.5% of total imports.

On the export side, the Dirham has appreciated against its top-nine non-dollarized export partners by 0.22% compared to the previous quarter and by 0.62% on a year-on-year basis (see Table 2.3.b). The Dirham gained around 2.3% and 2% against the Turkish Lira and the Chinese Yuan, where Turkey and China are importing together a share that accounts for 7.5% of the UAE's total non-oil exports. The only exception was a loss against the Singaporean Dollar where the Dirham depreciated by 0.4%.

The rebound of the Dirham against the currencies of major UAE trading partners is confirmed by developments in the Real and Nominal Effective Exchange Rates in the third quarter of 2016 (see Figure 2.3.a). The quarterly average REER has increased by 0.6%, to which the NEER contributed by a quarterly average increase of 0.58%. The contribution of the relative price change to the REER appreciation is minor because of the continued decline in inflation in the UAE during the third quarter of 2016.

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

Currency	Share of UAE imports (%) 2015	% Change of Currencies per Dirham 2016Q1-2015Q4	% Change of Currencies per Dirham (Q2-Q1) 2016	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham 2016Q3-2015Q3
Chinese Yuan	12.40	2.30	-0.09	2.02	5.75
Indian Rupee	9.70	2.38	-0.85	0.05	3.01
Germany (EUR)	6.48	-0.79	-2.28	1.16	-0.35
Japanese Yen	5.65	-5.12	-6.29	-5.19	-16.20
UK Pound	3.35	5.85	-0.09	9.21	17.95
Italy (EUR)	2.99	-0.79	-2.28	1.16	-0.35
South Korean Won	2.87	3.65	-3.07	-3.69	-4.27
France (EUR)	2.53	-0.79	-2.28	1.16	-0.35
Swiss Franc	2.53	0.27	-2.25	0.47	1.16
Total	**48.50**				
Weighted Appreciation		**0.44**	**-0.87**	**0.32**	**0.56**

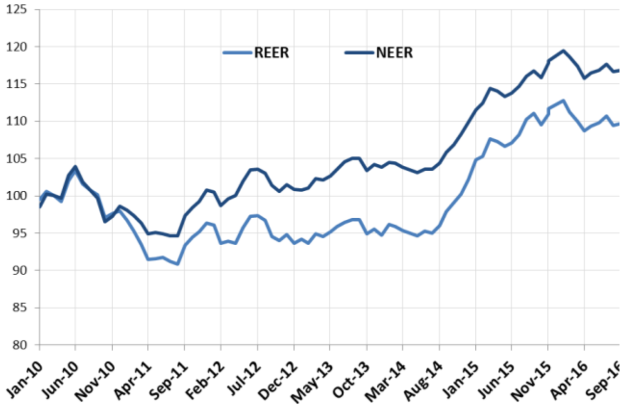
Source: Data on Imports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2015.Data for the exchange rate are the quarterly average observations, recorded and displayed by Bloomberg.

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

Currency	Share of UAE Exports (%) 2015	% Change of Currencies per Dirham 2016Q1-2015Q4	% Change of Currencies per Dirham (Q2-Q1) 2016	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham 2016Q3-2015Q3
Indian Rupee	12.47	2.38	-0.85	0.05	3.01
Swiss Franc	5.64	0.27	-2.25	0.47	1.16
Iraqi Dinar	5.61	-0.49	0.12	0.16	-0.87
Turkish Lira	5.16	1.12	-1.41	2.32	3.88
Singapore Dollar	4.26	-0.40	-3.12	-0.41	-2.77
Kuwaiti Dinar	4.01	-0.51	-0.04	0.05	-0.25
Chinese Yuan	2.34	2.30	-0.09	2.02	5.75
Netherlands (EUR)	1.84	-0.79	-2.28	1.16	-0.35
Pakistan	1.78	-0.16	-0.12	0.01	1.70
Total	**43.11**				
Weighted Appreciation		**0.34**	**-0.48**	**0.22**	**0.62**

Source: Data on Exports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2015. Data for the exchange

Figure 2.3.a Nominal and Real Effective Exchange rates Developments

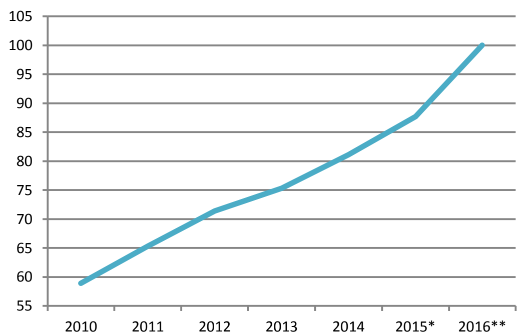


Source: Bank of International Settlement (BIS)

Box 3: Workers' Remittances

The payments (outflows) of workers' remittances[6] show an increasing trend for the period 2010-2016 as depicted in the Figure 1.

Figure 1. Evolution of Private Transfers (in billions of Dirhams)



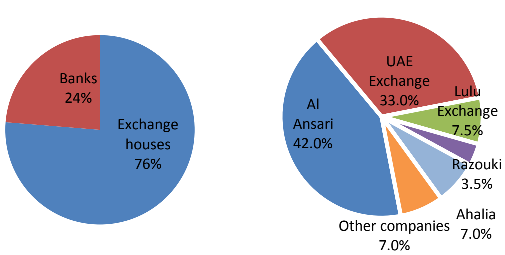
** Provisional data, ** Estimation*

Source: CBUAE

In the third quarter of 2016 the Banking Supervision Department of the Central Bank (BSD) indicated that 76% of the financial transfers are conducted through the exchange houses and 13% through the banks (figure 2.a).

According to the market participants' estimates, the major companies in the field of exchange houses that possess the largest market share account for around 93% of the market for workers' remittances outflow from the UAE through exchange houses (figure 2.b).

Figure 2. Share of settlement of total workers' remittances and shares of major exchange companies (2016 Q3)

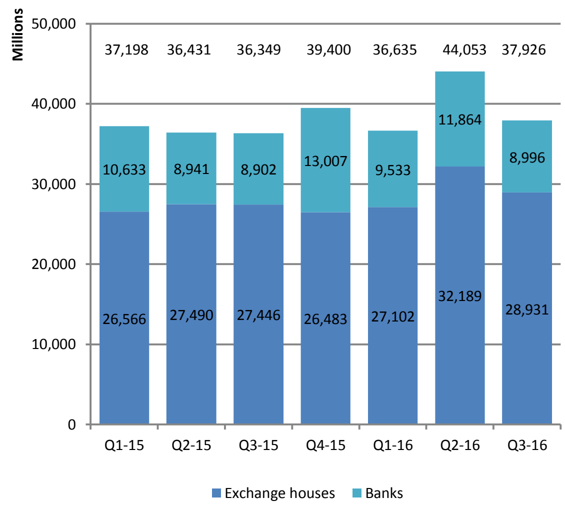


The combined data reported from the exchange houses and the banks to BSD recorded AED 37.9 billion outflows in the third quarter of 2016 and 13.9% or AED 6.1 million decrease compared to the second quarter of 2016 (AED 44.1 billion) (figure 3).

The outflows of the workers' remittances that were settled through the exchange houses only recorded AED 28.9 billion in the third quarter of 2016 (10.1% or AED 3.3 billion decrease compared to 2016 Q2). Similar trend emerges from the data collected directly from selected individual exchange houses.

The decreasing trend in the third quarter of 2016 of the total net outflows of private transfers could be attributed to the slower rate of appreciation of the nominal effective exchange rate of the dirham by 1.1% on average (the average index for the third quarter of 2016 117) compared to the third quarter of 2015 encouraging less outflows.

Figure 3. Evolution of Workers' remittances settled through Banks and Exchange houses in the UAE 2015 Q1 – 2016 Q3



Source: CBUAE, Banking Supervision Department

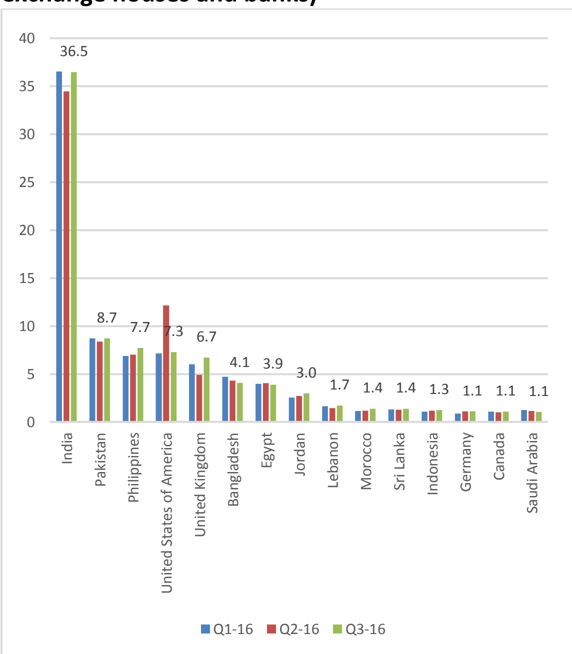
The most important country of destination for workers' remittances during the third quarter of 2016 was India that accounted for 36.5% of the outflows of workers' remittances in accordance with the significant share of expats from India in the UAE (figure 4). According to

[6] The private transfers in the balance of payments include personal transfers (workers' remittances) and other current transfers. Other current transfers include, for example, current taxes on income, wealth etc., social contributions, benefits and current international cooperation. Information on other transfers is not currently available.

available population 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 expat workers were Pakistan (8.7%), Philippines (7.7%), United States of America (7.3%) and United Kingdom (6.7%). Similar picture arises from the direct reporting data through major exchange houses.

Figure 4. Share of the major countries for workers' remittances during 2016 Q1 to Q3 (percentage of total, exchange houses and banks)



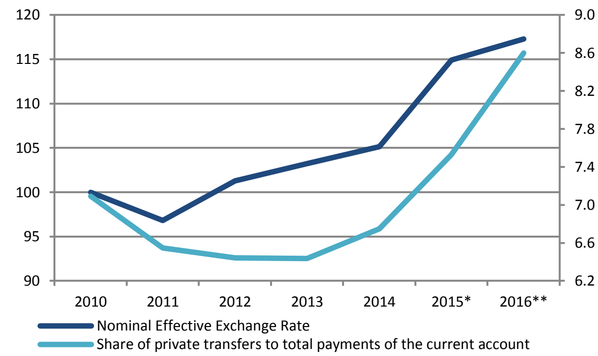
Source: CBUAE, Banking Supervision Department

Between the second and the third quarter of 2016, the United Kingdom was the country with the largest increase in outflows compared to the second quarter, reflecting continued depreciation of the British pound relative to the dirham, pegged to the US dollar.

The total recorded workers' remittances for the first nine months of 2016 represents 103% of the total for 2015 (at AED 87.7 billion) and 90.4% of the latest CBUAE's projection for 2016 (estimated at AED 100 billion).

The share of private transfers to the total payments of all components of the current account shows an increasing trend over time. The Figure 5 depicts this pattern since 2010 along with movement in the nominal effective exchange rate of the dirham relative to the currencies of major trading partners. Higher outflows, coupled with less oil receipts has squeezed the surplus of the current account balance.

Figure 5. Share of Private Transfers to the total payments of the Current Account (%) and the NEER (2010-2016)

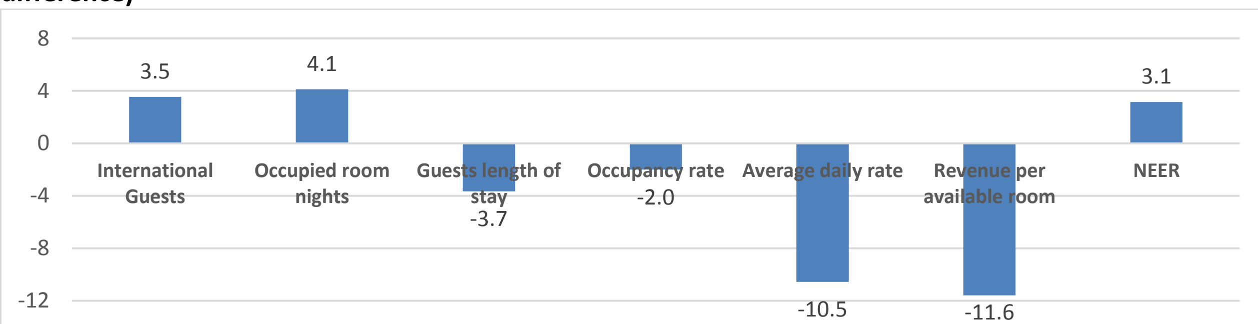


** Provisional data, ** Estimation*
Note: Annual average of NEER and average of first nine months for 2016
Source: CBUAE, Bank of International Settlements

Box 4: Exchange Rate Appreciation and Tourism Activity in the UAE

The analysis below tracks the effect of the dirham appreciation on UAE tourism for the period January – August 2016 compared to January – August 2015 based on data from Dubai and Abu Dhabi emirates which contribute the largest shares of the total aggregate. Figure 1 illustrates an increasing trend in attracting international visitors, the number of which has increased by 3.5% in the first eight months of 2016 compared to the same period in 2015. However, reduction is recorded in the average daily rate and the revenue per available room by 10.5% and 11.6% respectively (average prices of the two emirates) which resulted in an increase in occupied room nights by 4.1%. More specifically, the appreciation of the dirham in terms of the nominal effective exchange rate by 3.1% on a yearly basis correlates with the increasing trend of guest arrivals. However, the average hotel occupancy rate decreased by 2% for the first eight months of 2016, compared to 2015.

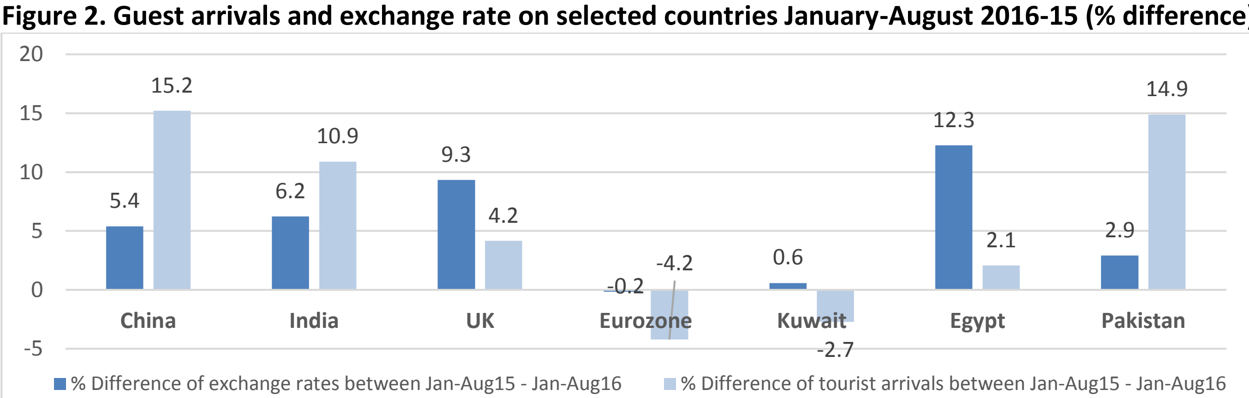
Figure 1: Major combined indicators of Dubai and Abu Dhabi inbound tourism January-August 2016-15 (% difference)



Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority, Bank of International Settlements

The effect of the bilateral exchange rate movements on tourism between January-August 2016, compared to January-August 2015 is depicted in figure 2 where the appreciation of AED is depicted with respect to the currencies of major countries for tourists, combined with their tourists' arrivals. For all countries below there has been a surge in the number of tourists, despite the appreciation of the dirham, except for Germany in the Eurozone and Kuwait. Specifically, Pakistan, China and India recorded larger increase in tourist arrivals despite the appreciation of the dirham relative to their currencies. In contrast, Egypt and the UK recorded a relatively slower influx of tourists, reflecting larger appreciation of the dirham relative to their respective local currencies.

Figure 2. Guest arrivals and exchange rate on selected countries January-August 2016-15 (% difference)



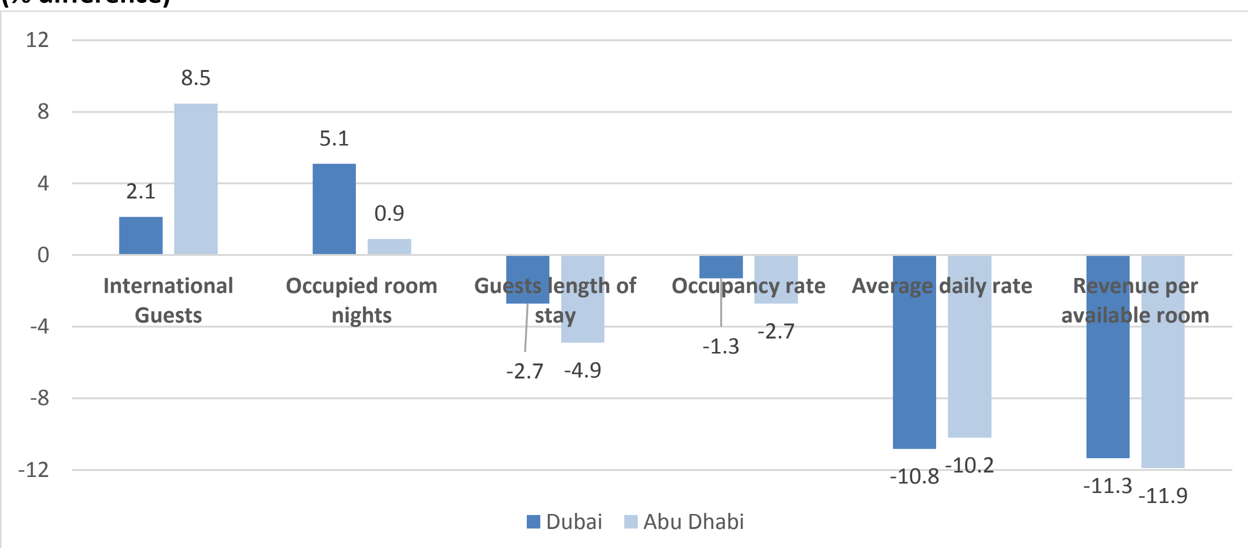
Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority, Bloomberg

Focusing on the developments in the emirates of Dubai and Abu Dhabi Figure 3 demonstrates that the appreciation of the dirham correlates with increasing trends of guest arrivals, both in Dubai and in Abu Dhabi. In parallel, there is evidence of decreased average length of tourists' stay despite the increase in tourist arrivals, which adversely affect the evolution of receipts. The evidence suggests a possible strategy to retain tourists by providing more discounts to avert a slowdown in the growth rate of tourism.

Specifically, for the Dubai emirate an increasing trend is recorded in attracting international visitors, the number of which increased by 2.1% in the first eight months of 2016 compared to the same period of 2015. However, reduction is evident in the average daily rate and the revenue per available room by 10.8% and 11.3% respectively, which resulted in an increase in occupied room nights by 5.1%. However, the average hotel occupancy rate decreased from 77% to 76%, for the first eight months of 2016, compared to 2015.[7]

The effect of dirham appreciation on tourism in the Abu Dhabi emirate depicts a similar pattern, although with notable increase in guest arrivals (8.5%) in the first eight months of 2016 compared to the same period in 2015. However, the lower average room rate (10.2% decrease) resulted in a 7% decrease in total revenue for the first eight months of 2016 compared to the same period of 2015.

Figure 3: Major indicators of Dubai and Abu Dhabi inbound tourism January-August 2016-15 (% difference)



Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority[8]

Most of the major countries that are the markets of inbound tourism to Dubai show increase in the arrivals of tourists, except from Germany, Iran and Kuwait. Nonetheless, the vast majority of tourists originate from GCC

[7] The latest available information from the private company provider STR Global records information that covers the period until the end of the third quarter of 2016. For Dubai the evidence depicts stable occupancy rate (at 76%), increased supply of rooms (5.8%), sharp decrease at the average revenue per available room (-10.7% at 524 AED) and lower average daily rate (-10.7%) that confirms the trends recorded by the official Tourism Authorities until August.

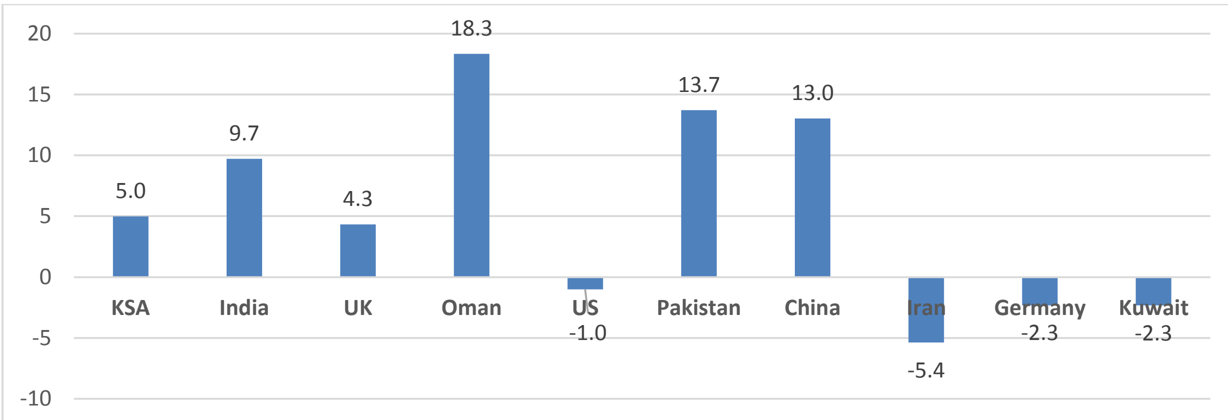
[8] Data are for based on the official tourism authorities publications. Dubai Tourism Authority publishes *International Guests* whereas Abu Dhabi Tourism Authority publishes *Actual Guest Arrivals.* Also for the variable *Room Nights* Dubai Tourism Authority publishes *Occupied Room Nights* whereas 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.

countries and the MENA region (25% and 11% respectively) while Western Europe and America cover 21% and 6% of inbound tourism. Finally, 16% of inbound tourism comes from the region of South Asia.

Between the major markets of inbound tourism for the Abu Dhabi Emirate all countries recorded increase in guest arrivals apart from Germany (-10.1%) and the US (-7.6%). The largest increase in guest arrivals is evident from Jordan (32.4%), Egypt (24%) and Pakistan (23%).

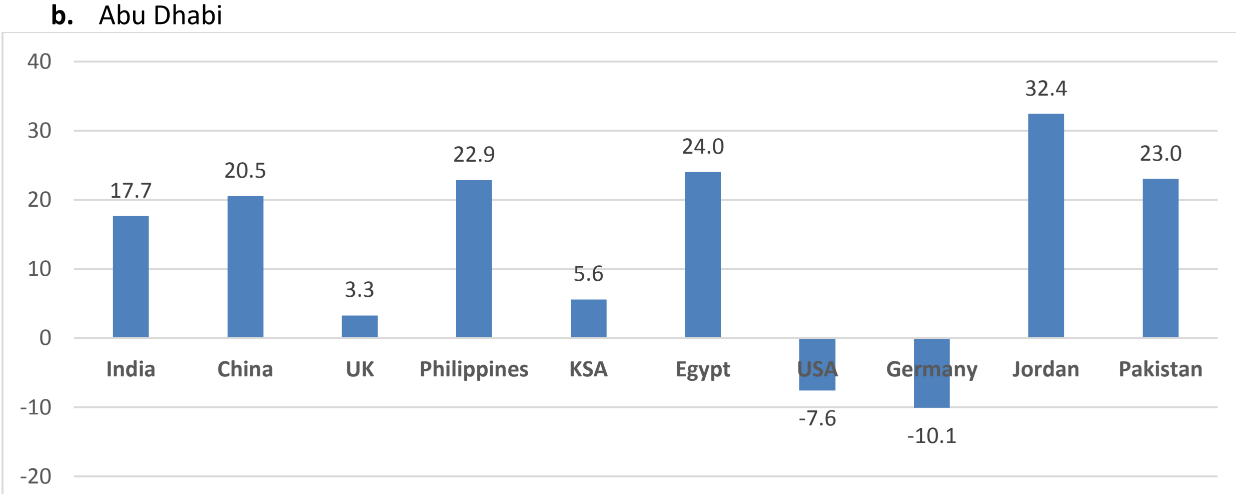
Figure 4. Major markets of inbound tourism January-August 2016-15 (% difference)

a. Dubai



Source: Dubai Tourism Authority

b. Abu Dhabi



Source: Abu Dhabi Tourism Authority

2.4 Fiscal Stance

After an important fiscal consolidation that started in 2015, following the plunge of oil prices since mid-2014, the pace of spending cut has slowed down in the second quarter of 2016.

The fiscal consolidation reached its peak during the first quarter of 2016 where total expenditures declined by 43.3% on a year-on-year basis (see Table 2.4). During the same period, total revenues increased by 14.3% driven by social contributions and other revenues (see Table's footnotes for details).

Fiscal consolidation continued during the second quarter of 2016 and followed a more growth-friendly pace, raising extra revenues rather than continuing with sharp spending cuts. In fact, the total revenues increased by 21.9% on a year-on-year basis, driven by an important increase of "other revenues". Starting from the first quarter of 2016, besides the usual sub-components (Property income, sales of goods and services, fines and penalties), the "Other revenues" section covers the transfers by some investment authorities in Abu Dhabi from the financing account to the revenues side of the budget. However, the rate of increase in social contributions decelerated from 37.5% in the first quarter to 3.4% during the second quarter of 2016.

On the other hand, total expenditures increased by 8.3% in the second quarter against an important decline in the first quarter. This development is due mainly to significant increase of subsidies (including transfers to GREs) in the second quarter.

Another driver of the rebound in total spending is the increase of other expenses which covers all Abu Dhabi's transfers made on behalf of the Federal Government.

Capital spending measured by the developments of "Net acquisition of non-financial assets", continued its growth in the second quarter of 2016, although at a slower pace than in the first quarter. In contrast to the sharp decrease in capital spending in 2015, the sharp increase in in the first half of 2016 reflects a more growth-friendly pace of fiscal consolidation in 2016.

Table.2.4 Consolidated Government Finances

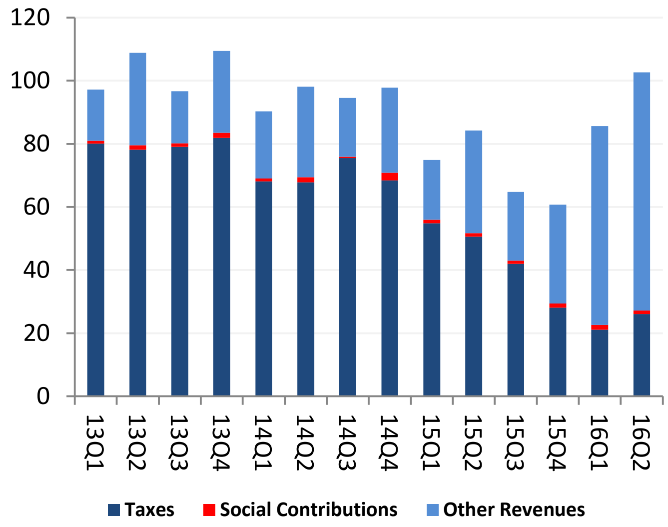
	2014	2015					Change (%, Y-o-Y)					2016		Change (%, Y-o-Y)	
		Q1	Q2	Q3	Q4	2015	2015Q1	2015Q2	2015Q3	2015Q4	2015	Q1	Q2	2016Q1	2016Q2
Revenues (a)	**380.7**	**74.9**	**84.2**	**64.8**	**60.7**	**284.7**	**-17.0**	**-14.2**	**-31.5**	**-37.9**	**-25.2**	**85.7**	**102.7**	**14.3**	**21.9**
Taxes	279.9	54.9	50.6	41.9	28.1	175.4	-19.4	-25.4	-44.5	-59.0	-37.3	21.1	26.0	-61.5	-48.5
Social contributions	5.3	1.1	1.1	1.0	1.3	4.5	14.0	-27.8	172.1	-46.5	-14.6	1.5	1.2	37.5	3.4
Other revenues	95.5	19.0	32.5	21.8	31.4	104.7	-10.4	13.2	17.1	16.6	9.7	63.1	75.5	232.2	132.2
Expenditure (b)	**414.6**	**89.9**	**96.1**	**85.6**	**93.3**	**364.8**	**-13.6**	**-7.4**	**-13.5**	**-13.6**	**-12.0**	**51.0**	**104.0**	**-43.3**	**8.3**
Compensation of employees	47.5	14.4	15.8	14.5	14.4	59.1	36.4	38.0	27.3	2.1	24.4	15.5	15.8	7.6	0.1
Use of goods and services	49.5	10.5	13.5	10.8	16.3	51.0	18.3	11.5	-22.0	10.4	3.0	10.4	14.8	-0.6	9.5
Consumption of fixed capital	3.8	0.9	1.1	0.9	1.5	4.4	0.3	48.1	-14.8	37.7	16.7	1.1	1.5	32.1	38.2
Interest	4.1	0.5	0.5	0.6	1.3	2.9	-52.4	-49.1	-38.3	13.8	-29.5	0.2	0.4	-49.0	-16.0
Subsidies	12.1	3.1	3.1	3.1	3.1	12.3	22.1	-14.1	-10.3	19.9	1.7	4.3	6.4	41.4	108.5
Grants	21.9	3.1	2.8	2.5	2.1	10.6	-67.9	-54.9	-55.1	507.3	-51.8	0.5	0.5	-85.4	-81.3
Social benefits	61.4	12.9	15.2	13.5	11.6	53.2	2.2	9.5	-16.1	-38.4	-13.4	6.3	5.4	-51.6	-64.7
Other expenses	174.4	39.9	35.4	33.4	37.0	145.7	-23.8	-13.6	-10.2	-15.7	-16.4	4.5	47.8	-88.7	34.8
Net acquisition of non-financial assets	39.9	4.7	8.7	6.4	5.9	25.6	-15	-36.7	-33.3	-47.2	-35.8	8.1	11.4	73.8	31.2

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, specially the Armed Forces expenditures.

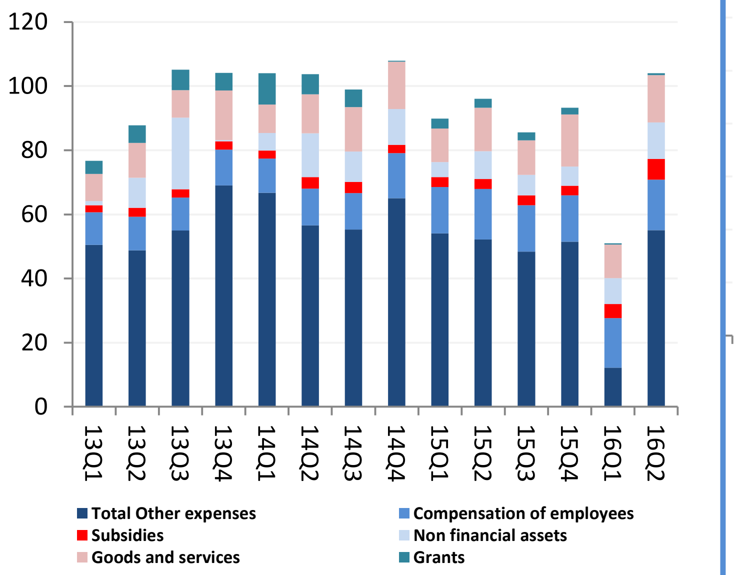
Note: All values are expressed in Billions of Dirhams unless otherwise indicated.

Government Finance

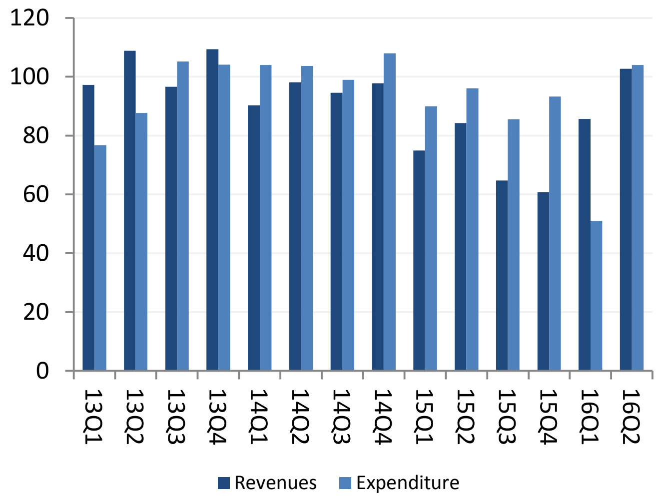
2.4. a General Government Revenues
(Billions of Dirhams)



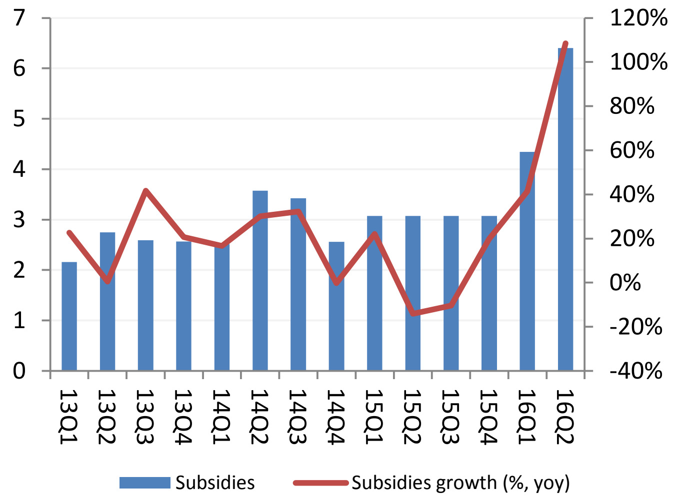
2.4.b General Government Expenditures
(Billions of Dirhams)



2.4.c Fiscal Stance
(Billions of Dirhams)



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



Source: Ministry of Finance.
Note: Total Other expenses cover Other expenses, Consumption of fixed capital, Interests and Social benefits. The total revenues do not include ADNOC transfers and government investment income. Total expenditures are also adjusted so that Abu Dhabi capital transfers are excluded.

2.5 Financial developments

2.5.1 Share Price Volatility

The recovery of the securities market continues for the third quarter of 2016. After a rebound of share prices and market capitalization in both Abu Dhabi and Dubai in the second quarter, the bullish trend continues, albeit at a slower pace, despite the minor decline of oil prices in the third quarter (0.3% Q-o-Q).

In Abu Dhabi, the average Share Price Index grew by 1.7% in the third quarter of 2016 against an increase of 3.9% in the previous quarter. Following the same momentum, the market capitalization rose by 5.8% in the third quarter after a similar increase (1.9%) in the previous quarter.

The securities market's situation in Dubai is quite similar. The Share Price Index improved by 3.4% in the third quarter, lower than the increase of the second quarter (5.5%). On the other hand, the market capitalization deepened further in the third quarter and increased on average by 1.4%.

The improvement of Share Prices Indices was accompanied by a significant decline of price volatility[9]. In Abu Dhabi, the share price volatility dropped by 63% Q-o-Q in the third quarter. Moreover, the volatility of the Share Price Index has declined by 85% compared to the previous quarter.

The continuous improvement of securities markets in the UAE is due to the positive sentiment regarding the resiliency of the non-oil sector which helped solidifying investors' confidence and reduced uncertainty.

Table 2.5.1 UAE – Securities Markets

		2015		2016		
		Q3	Q4	Q1	Q2	Q3
Abu Dhabi	Change of Share Price Index (%)	-0.5	-7.0	-0.5	3.9	1.7
	Change of Market Capitalization (%)	2.2	-1.4	1.0	1.9	5.8
Dubai	Change of Share Price Index (%)	-6.9	-13.5	-2.7	5.5	3.4
	Change of Market Capitalization (%)	-1.6	-10.3	-3.4	6.4	1.4

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.

2.5.2 Credit Default Swaps Premiums

The positive spillovers stemming from the recent developments of the non-oil sector has removed an important part of uncertainty and reduced the default likelihood of sovereigns and GREs. The spreads of Credit Default Swaps (CDS) has largely tightened during the third quarter of 2016.

The CDS of Sovereigns fell by 15% and by 8% in Abu Dhabi and Dubai, respectively, in the third quarter of 2016 compared to the previous one.

The CDS of DP World declined by 27% in the third quarter with an average quarterly level of 146.8 bp, the lowest reading since the third quarter of 2014. The CDS of Dubai Holding decreased by 7%, showing the lowest reading since the fourth quarter of 2015.

Table 2.5.2. UAE - Credit Default Swaps (CDS)

	2015			2016		
	Q2	Q3	Q4	Q1	Q2	Q3
Sovereigns						
Abu Dhabi	52.0	77.4	92.6	93.6	87.5	74.3
Dubai	191.4	196.9	233.7	215.0	182.5	167.3
GREs						
DP World	188.5	190.0	183.9	196.9	202.3	146.8
Dubai Holding	340.8	322.5	421.0	352.0	336.3	311.7

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

[9] The volatility is measured by the standard deviation

Chapter 3. Monetary & Banking Developments

Government deposits declined in the 3rd quarter of 2016, but remain above the levels observed at the end of 2015. However, monetary aggregates increased mainly due to the increase in private sector and GREs deposits. Banks continued to increase credit at a rate that supports growth in the non-oil activities. The Financial Soundness Indicators (FSIs) continue to show that the UAE banking system is sound and enjoys financial stability.

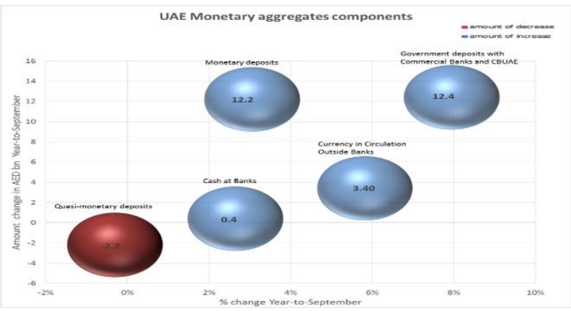
3.1 Monetary Aggregates

During 2016 Q3, the Money Supply Aggregate M1 declined by 1.8%, while M2 and M3 grew by 1.7% and 0.3%, respectively, Q-o-Q.

The reason for the decrease in M1 in 2016 Q3 is the decline in all of its components and most significantly in monetary deposits by AED 5.9bn (-1.4%) and Currency in Circulation outside Banks by AED 2.6bn (-4%) compared to the end of June 2016. The growth in M2 is due to the growth in Quasi-monetary deposits by AED 28.3bn (4%). Meanwhile, M3 grew to a lesser extent due to the decline in Government deposits by AED 16bn (-8.7%), during this period.

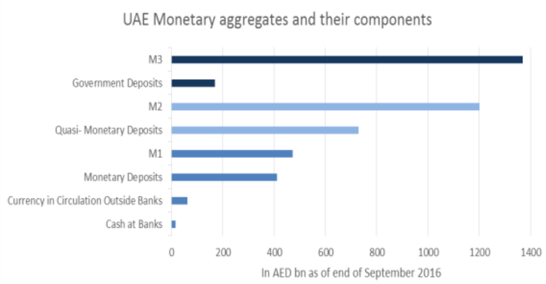
Figure 3.1. UAE Monetary aggregates – year to 2016 Q3

a)



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

b)



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

3.2 Banking Activity

The 23 locally-incorporated banks have further decreased the number of branches at 857 at the end of 2016 Q3 compared to 862 at the end of June 2016, due to banks looking for higher efficiency. The 26 foreign banks also had the number of branches declining to 85 at the end of 2016 Q3, compared to 86 at the end of the previous quarter.

3.2.1 Banks' Deposits

Total Customer Deposits at banks increased in 2016 Q3 by AED 15.7bn due to the increase in Resident Deposits by AED 5.9bn and Non-resident Deposits by AED 9.8bn.

Table 3.2.a.Deposits at UAE Banks

	2015		2016		
	Sep	**Dec**	**March**	**June**	**Sep**
Bank Deposits	**1,436.8**	**1,471.6**	**1,502.6**	**1,493.0**	**1,508.7**
(Q-o-Q change %)	-0.5	2.4	2.1	-0.6	1.1
(Y-o-Y change %)	1.6	3.5	3.7	3.4	5.0
Resident Deposits	**1,278.3**	**1,300.2**	**1,325.1**	**1,315.9**	**1,321.8**
(Q-o-Q change %)	-0.8	1.7	1.9	-0.7	0.4
(Y-o-Y change %)	-0.3	2.6	1.8	2.1	3.4
Government Sector	**164.3**	**157.4**	**155.5**	**185.9**	**169.5**
(Q-o-Q change %)	0.9	-4.2	-1.2	19.5	-8.8
(Y-o-Y change %)	-20.8	-16.6	-15.4	14.1	3.2
GREs	**173.3**	**190.8**	**193.3**	**161.5**	**172.2**
(Q-o-Q change %)	-5.9	10.1	1.3	-16.5	6.0
(Y-o-Y change %)	-11.5	10.1	0.7	-12.3	-1.2
Private Sector	**911.2**	**923.8**	**948.1**	**945.3**	**956.6**
(Q-o-Q change %)	0.4	1.4	2.6	-0.3	1.2
(Y-o-Y change %)	8.1	6.3	6.7	4.2	5.0
NBFI	**29.5**	**28.1**	**28.2**	**23.2**	**24.6**
(Q-o-Q change %)	-14.0	-4.7	0.4	-17.7	6.0
(Y-o-Y change %)	-17.1	-22.8	-24.2	-32.4	-16.6
Non-Resident Deposits	**158.5**	**171.5**	**177.5**	**177.1**	**186.9**
(Q-o-Q change %)	1.8	8.2	3.5	-0.2	5.5
(Y-o-Y change %)	19.6	11.4	19.9	13.7	17.9

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

The hike in Resident Deposits is essentially due to the growth in GREs deposits by AED 9.7bn or 6% and the rise in Private Sector deposits by AED 11.2bn or 1.2%. The growth in Private Sector and GREs deposits compensated for the withdrawal of Government deposits during the third quarter of AED 16.4bn or -8.8% growth. In parallel, the increase in Non-Banking Financial Institutions (NBFIs) deposits by AED 1.4bn further reinforced the positive move in Resident Deposits.

In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 77.3% and 22.7% of the total deposits. It is clear from Figure 3.3, that Islamic banks' deposits are growing much faster than the conventional ones on Y-o-Y basis, with the Islamic deposits growing by 7.2% and the Conventional ones by 4.4%. However comparing the September 2016 figures with 2016 Q2, total Islamic banks' deposits declined by 0.5%, while Conventional banks' deposits grew by 1.5%.

Table 3.2.b.Deposits at Conventional/Islamic Banks

	Conventional		Islamic	
	2016		2016	
	June	Sep	June	Sep
Bank Deposits	**1,148**	**1,166**	**345**	**343**
(Q-o-Q change %)	-0.9	1.5	0.3	-0.5
(Y-o-Y change %)	1.7	4.4	9.4	7.2
Share of Total, %	76.9	77.3	23.1	22.7
Resident Deposits	**979**	**987**	**337**	**335**
(Q-o-Q change %)	-1.0	0.8	0.1	-0.7
(Y-o-Y change %)	-0.1	2.4	9.0	6.5
Share of Total, %	74.4	74.7	25.6	25.3
Government Sector	**137**	**124**	**49**	**46**
(Q-o-Q change %)	25.2	-9.6	6.3	-6.7
(Y-o-Y change %)	19.2	8.2	2.1	-8.4
Share of Total, %	73.6	73.0	26.4	27.0
GREs	**112**	**126**	**50**	**45**
(Q-o-Q change %)	-16.7	12.9	-15.8	-9.5
(Y-o-Y change %)	-17.5	-2.7	-10.2	3.2
Share of Total, %	69.3	73.8	30.7	26.2
Private Sector	**710**	**717**	**235**	**240**
(Q-o-Q change %)	-1.3	0.9	3.0	2.0
(Y-o-Y change %)	1.8	2.9	12.1	11.7
Share of Total, %	75.1	74.9	24.9	25.1
NBFI	**20**	**21**	**3**	**4**
(Q-o-Q change %)	-19.3	2.5	-6.1	29.0
(Y-o-Y change %)	-28.7	-12.3	-49.2	-33.3
Share of Total, %	86.6	83.7	13.4	16.3
Non-Resident Deposits	**169**	**178**	**8**	**9**
(Q-o-Q change %)	-0.6	5.5	9.6	6.3
(Y-o-Y change %)	13.2	17.0	27.0	41.7
Share of Total, %	95.5	95.5	4.5	4.5

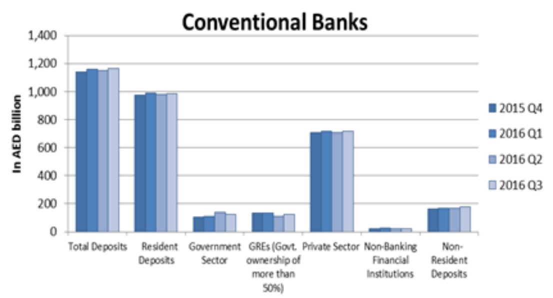
Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.

While the growth in GREs' deposits is mainly concentrated in Conventional banks, the drop in the Government deposits is almost equally distributed between the two types of banks.

The accelerated growth of the Islamic banks' deposits on an annual basis is in line with the UAE's vision to become a world center for the Islamic finance.

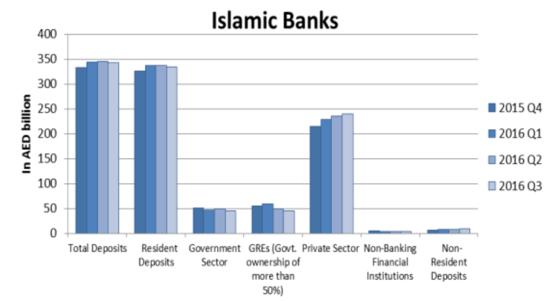
Figure 3.3. Banking System Deposits by Conventional/Islamic Banks split

a)



Source: Central Bank of the UAE

b)



Source: Central Bank of the UAE

The breakdown of Local and Foreign banks in Figure 3.4 provides a clear trend that deposits in Local banks are growing in contrast to a decline in foreign banks. At the end of 2016 Q3, 86.2% of the total deposits are in Local banks and 13.8% are in Foreign banks.

For the third quarter, deposits in the Local banks grew by 1.8% with the sectors growing the most being the Non-Resident and GREs by 12.4% and 5.6% respectively. For the Foreign banks in 2016 Q3, total deposits declined by 3.6% Q-o-Q. The breakdown shows that there was a decline in all subsectors, except for GREs and NBFI that grew by 15.7% and 15.4% respectively.

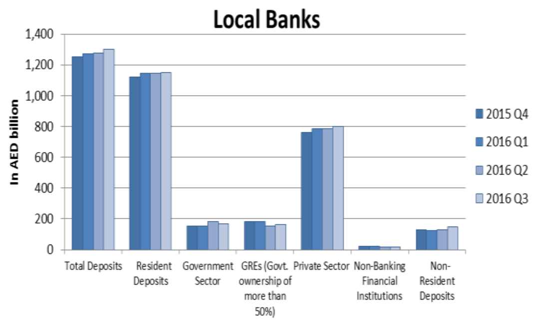
Table 3.2.c.Deposits at UAE Local/Foreign Banks

	Local		Foreign	
	2016		2016	
	June	Sep	June	Sep
Bank Deposits	**1,276**	**1,300**	**217**	**209**
(Q-o-Q change %)	0.3	1.8	-5.7	-3.6
(Y-o-Y change %)	5.8	7.2	-9.1	-6.9
Share of Total, %	85.5	86.2	14.5	13.8
Resident Deposits	**1,145**	**1,152**	**171**	**170**
(Q-o-Q change %)	-0.2	0.6	-3.7	-0.7
(Y-o-Y change %)	4.4	5.2	-11.0	-7.2
Share of Total, %	87.0	87.1	13.0	12.9
Government Sector	**185**	**168**	**1**	**1**
(Q-o-Q change %)	20.0	-8.8	-25.0	-8.3
(Y-o-Y change %)	14.2	3.4	9.1	-26.7
Share of Total, %	99.4	99.4	0.6	0.6
GREs	**155**	**163**	**7**	**8**
(Q-o-Q change %)	-15.8	5.6	-27.8	15.7
(Y-o-Y change %)	-9.9	0.6	-44.9	-27.7
Share of Total, %	95.7	95.3	4.3	4.7
Private Sector	**788**	**802**	**158**	**155**
(Q-o-Q change %)	0.0	1.8	-1.7	-1.9
(Y-o-Y change %)	7.0	7.7	-7.8	-7.1
Share of Total, %	83.3	83.8	16.7	16.2
NBFI	**18**	**19**	**5**	**6**
(Q-o-Q change %)	-18.9	3.3	-13.3	15.4
(Y-o-Y change %)	-33.3	-27.6	-28.8	57.9
Share of Total, %	77.6	75.6	23.4	24.4
Non-Resident Deposits	**132**	**148**	**46**	**39**
(Q-o-Q change %)	4.8	12.4	-12.3	-14.3
(Y-o-Y change %)	20.2	26.4	-1.5	-6.0
Share of Total, %	74.3	79.1	25.7	20.9

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

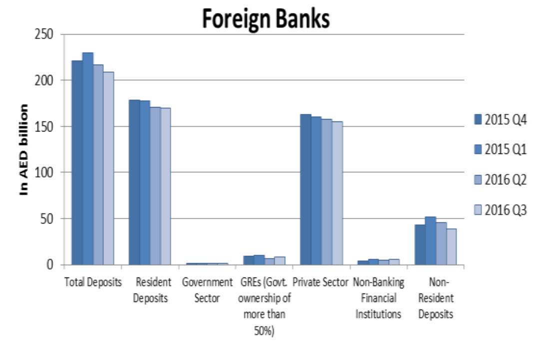
Figure 3.4. Banking System Deposits by Local/Foreign Banks split

a)



Source: Central Bank of the UAE

b)



Source: Central Bank of the UAE

3.2.2 Banks' Credit

Domestic Credit increased in 2016 Q3 by AED 19.8bn, benefiting mainly the increase in credit to the Private Sector by AED 14.2bn and the Government asset class by AED 5.5bn. Meanwhile the Government Related Entities (GREs) and NBFIs remained almost unchanged.

Table 3.3.a.Assets and Credit at UAE Banks

	2015		2016		
	Sep	Dec	Mar	Jun	Sep
Total Assets	**2,422**	**2,478**	**2,491**	**2,519**	**2,550**
(Q-o-Q change %)	**0.1**	**2.3**	**0.5**	**1.1**	**1.3**
(Y-o-Y change %)	**4.8**	**7.5**	**4.7**	**4.1**	**5.3**
Gross Credit	**1,479**	**1,485**	**1,518**	**1,543**	**1,566**
(Q-o-Q change %)	2.2	0.4	2.2	1.7	1.5
(Y-o-Y change %)	7.0	7.8	7.6	6.7	5.9
Domestic Credit	1,366	1,381	1,404	1,426	1,446
(Q-o-Q change %)	2.3	1.1	1.7	1.6	1.4
(Y-o-Y change %)	5.9	8.1	7.7	6.8	5.8
Government	166.4	166.6	168.7	168.6	174.1
(Q-o-Q change %)	-1.3	0.1	1.3	-0.1	3.3
(Y-o-Y change %)	13.2	8.8	4.8	0.1	4.6
Public Sector (GREs)	174.0	169.8	180.8	187.7	188.0
(Q-o-Q change %)	5.7	-2.4	5.4	3.8	0.2
(Y-o-Y change %)	7.2	2.8	8.3	12.1	6.3
Private Sector	1,006	1,020	1,030	1,052	1,066
(Q-o-Q change %)	2.2	1.4	1.1	2.1	1.4
(Y-o-Y change %)	4.6	8.5	7.7	7.1	6.2
Business & Industrial Sector Credit	676.3	689.3	693.5	709.7	720.0
(Q-o-Q change %)	1.7	1.9	0.9	2.3	1.5
(Y-o-Y change %)	3.3	7.7	7.3	7.1	6.9
Individual	329.7	330.7	336.1	341.9	345.8
(Q-o-Q change %)	3.3	0.3	1.6	1.7	1.1
(Y-o-Y change %)	7.5	10.3	8.5	7.1	4.9
Non-Banking Financial Institutions	19.9	24.7	25.3	18.4	18.2
(Q-o-Q change %)	9.2	24.2	2.4	-27.3	-1.1
(Y-o-Y change %)	-0.4	27.4	30.4	1.1	-8.5
Foreign Credit	112.2	103.9	113.1	117.1	119.9
(Q-o-Q change %)	1.1	-7.4	8.9	3.5	2.4
(Y-o-Y change %)	22.8	3.5	6.1	5.6	6.9
of which: Loans & Advances to Non-Residents in AED	9.6	9.2	11.2	12.8	14.4
(Q-o-Q change %)	-2.6	-4.6	21.7	14.3	12.5
(Y-o-Y change %)	-12.2	-9.8	10.3	29.3	49.4

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

Table 3.3.b.Assets and Credit at UAE Conventional/Islamic Banks

	Conventional		Islamic	
	2016		2016	
	Jun	Sep	Jun	Sep
Total Assets	**2,025**	**2,050**	**493**	**500**
(Q-o-Q change %)	**0.9**	**1.2**	**2.1**	**1.5**
(Y-o-Y change %)	**2.6**	**4.0**	**10.8**	**10.7**
Gross Credit	**1,217**	**1,237**	**326**	**329**
(Q-o-Q change %)	1.3	1.7	3.1	0.8
(Y-o-Y change %)	5.3	5.0	12.4	9.6
Domestic Credit	1,116	1,134	311	313
(Q-o-Q change %)	1.2	1.6	2.7	0.7
(Y-o-Y change %)	5.6	5.1	11.2	8.7
Government	160	164	9	10
(Q-o-Q change %)	-0.1	2.9	0.0	8.9
(Y-o-Y change %)	1.3	4.5	-17.4	7.7
Public Sector (GREs)	155	156	33	32
(Q-o-Q change %)	4.3	0.4	1.6	-0.9
(Y-o-Y change %)	11.3	5.3	16.5	11.4
Private Sector	786	799	265	267
(Q-o-Q change %)	1.8	1.6	3.1	0.8
(Y-o-Y change %)	5.2	5.3	13.3	9.2
Business & Industrial Sector Credit	565	575	144	145
(Q-o-Q change %)	2.2	1.7	2.7	0.3
(Y-o-Y change %)	5.2	6.1	15.2	10.4
Individual	221	224	121	122
(Q-o-Q change %)	0.8	1.1	3.5	1.2
(Y-o-Y change %)	5.0	3.3	11.0	7.9
Non-Banking Financial Institutions	15	15	4	3
(Q-o-Q change %)	-31.5	1.4	-5.0	-10.5
(Y-o-Y change %)	22.7	-0.7	-39.7	-32.0
Foreign Credit	101	104	16	16
(Q-o-Q change %)	2.3	2.4	12.1	2.5
(Y-o-Y change %)	1.7	3.9	41.1	30.6

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

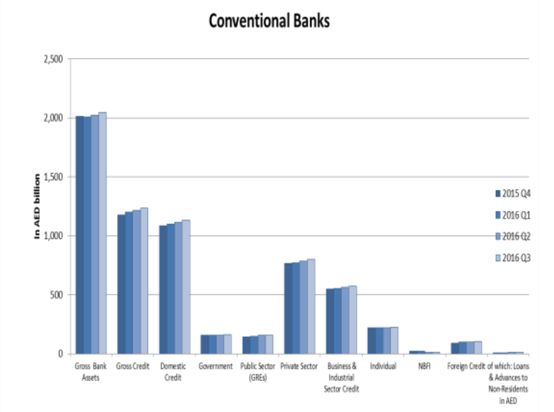
The split between Conventional and Islamic banks in Figure 3.6 indicates that the growth in Islamic financing and assets is much steeper than for the Conventional banks' loans. The share of Conventional banks' assets at the end of 2016 Q3 is

80.4% of the total, while the share of the Islamic banks assets is 19.6%.

Islamic banks had their assets growing by 1.5% in 2016 Q3, more than the increase for the conventional banks (1.3%). Islamic banks' financing has been however dominated by the Conventional banks' loans in the third quarter in almost all subcategories, with exception to the credit to the Government.

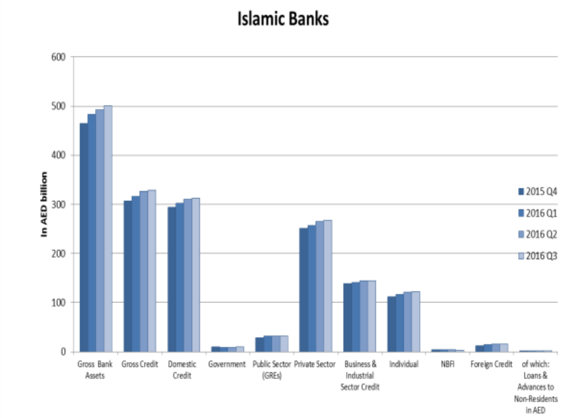
Figure 3.6. Banking System Assets and Financing by Conventional/Islamic Banks split

a)



Source: Central Bank of the UAE

b)



Source: Central Bank of the UAE

The breakdown of the assets and credit by local and foreign banks in Figure 3.7 indicates that national banks were growing, while for the foreign banks there was a decline in both assets and gross credit in 2016 Q3.

Table 3.3.c.Assets and Credit at UAE Local/Foreign Banks

	Local		**Foreign**	
	2016		**2016**	
	Jun	**Sep**	**Jun**	**Sep**
Total Assets	**2,130**	**2,177**	**389**	**373**
(Q-o-Q change %)	**1.4**	**2.2**	**-0.8**	**-4.1**
(Y-o-Y change %)	**5.9**	**7.4**	**-4.8**	**-5.7**
Gross Credit	**1,337**	**1,365**	**207**	**201**
(Q-o-Q change %)	2.3	2.1	-1.7	-2.9
(Y-o-Y change %)	8.9	8.4	-5.7	-8.2
Domestic Credit	1,243	1,266	184	180
(Q-o-Q change %)	2.1	1.9	-2.2	-2.0
(Y-o-Y change %)	8.8	7.9	-5.0	-6.6
Government	162	168	6	6
(Q-o-Q change %)	0.6	3.4	-13.9	0.0
(Y-o-Y change %)	1.2	6.5	-23.5	-28.7
Public Sector (GREs)	159	160	29	29
(Q-o-Q change %)	5.9	0.6	-6.1	-2.4
(Y-o-Y change %)	19.1	11.1	-14.9	-14.7
Private Sector	904	922	147	144
(Q-o-Q change %)	2.6	1.9	-0.9	-2.0
(Y-o-Y change %)	8.8	8.0	-2.1	-3.9
Business & Industrial Sector Credit	597	610	112	110
(Q-o-Q change %)	3.0	2.2	-0.9	-2.4
(Y-o-Y change %)	9.1	9.1	-2.3	-3.9
Individual	307	311	35	35
(Q-o-Q change %)	2.0	1.4	-0.9	-0.9
(Y-o-Y change %)	8.1	5.9	-1.1	-3.6
Non-Banking Financial Institutions	17	17	1	1
(Q-o-Q change %)	-28.6	-1.7	0.0	8.3
(Y-o-Y change %)	-1.1	-11.5	50%	62.5
Foreign Credit	94	99	23	21
(Q-o-Q change %)	3.8	5.5	2.7	-10.4
(Y-o-Y change %)	10.8	14.9	38.9	-20.1

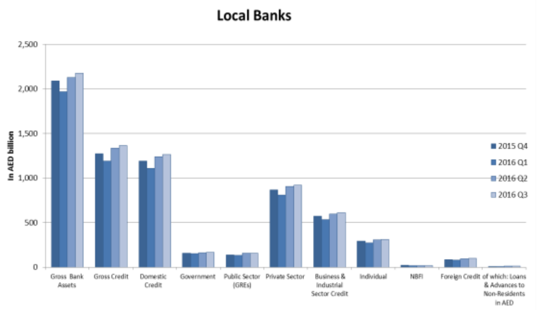
Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams

Local banks' assets have increased in 2016 Q3 by 2.2% with all of the loan asset classes growing for the period, with exception of the NBFIs that declined by 1.7% or AED 300mn. Assets and gross credit of Local banks represent 85.4% and 87.2% of the UAE banking system's assets and credit respectively. Assets of foreign banks declined by 4.1% with all the underlying categories declining, except for loans to Government and to NBFI, representing only 14.6% and 12.8% of the banking system's assets and gross credit respectively.

For the foreign banks, the asset class with the highest deleveraging percentage for the quarter was Foreign credit at -10.4% growth Q-o-Q in 2016 Q3, with an outstanding amount of only AED 21bn (17.3% of the total banks' Foreign lending).

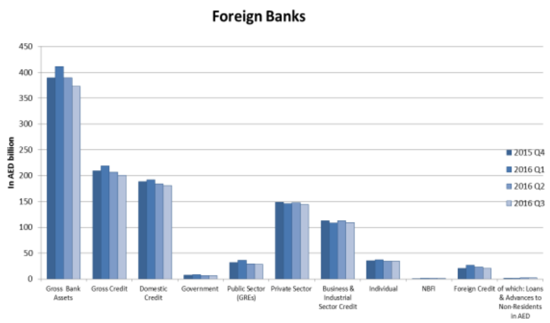
Figure 3.7. Banking System Assets and Credit by Local/Foreign Banks split

a)



Source: Central Bank of the UAE

b)



Source: Central Bank of the UAE

Table 3.4. Banks credit to residents by economic activity

(End of Period , In Billions of AED)

	2015		2016		
Economic Activity	Sep	Dec	Mar	Jun	Sep
Agriculture	1.3	1.6	1.3	1.2	1.2
(Q-o-Q change %)	1.7	20.5	-19.1	-4.9	-1.9
(Y-o-Y change %)	-41.7	-42.2	-23.3	-5.7	-9.0
Mining and Quarrying	11.1	11.9	11.7	12.4	14.0
(Q-o-Q change %)	5.9	7.7	-1.8	6.2	12.7
(Y-o-Y change %)	10.8	29.9	9.0	18.9	26.6
Manufacturing	72.2	69.1	72.2	71.4	71.6
(Q-o-Q change %)	1.4	-4.3	4.5	-1.2	0.3
(Y-o-Y change %)	17.6	6.1	8.7	0.3	-0.9
Electricity, Gas and Water	20.7	20.5	18.6	18.6	17.9
(Q-o-Q change %)	-7.8	-1.2	-9.4	0.2	-3.8
(Y-o-Y change %)	8.0	8.2	-0.1	-17.3	-13.8
Construction and Real Estate	223.6	235.0	241.8	242.4	250.8
(Q-o-Q change %)	3.5	5.1	2.9	0.2	3.5
(Y-o-Y change %)	5.7	10.6	14.8	12.1	12.2
Trade	164.8	161.7	160.7	160.7	158.2
(Q-o-Q change %)	0.0	-1.9	-0.6	0.0	-1.5
(Y-o-Y change %)	5.3	3.8	0.2	-2.5	-4.0
Transport, Storage and Communication	58.8	59.2	62.5	64.0	62.7
(Q-o-Q change %)	-3.3	0.6	5.6	2.4	-2.0
(Y-o-Y change %)	5.4	4.7	5.0	5.1	6.6
Financial Institutions (Excluding Banks)	135.5	135.6	139.6	144.9	148.4
(Q-o-Q change %)	5.7	0.1	2.9	3.8	2.4
(Y-o-Y change %)	4.4	2.9	4.8	13.0	9.5
All Others	113.0	112.7	113.1	120.6	122.0
(Q-o-Q change %)	1.0	-0.3	0.4	6.7	1.1
(Y-o-Y change %)	-3.6	17.1	3.6	7.8	7.9

Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values.

Banks' lending by economic activity shows an increase in the third quarter of 2016 for Mining and Quarrying (12.7%), Manufacturing (0.3%), Construction and Real Estate (3.5%) and Financial Institutions (2.4%). The sectors in which there is a decrease in credit, during the same period, are Agriculture (-1.9%), Electricity, Gas and Water (-3.8%), Trade (-1.5%) and Transport, Storage and Communications (-2%).

3.3 Financial Soundness Indicators

The overall outlook regarding the soundness of the banking sector remains positive during the second quarter of 2016.

Banks' specific provisions for NPLs increased from AED 75.6bn to AED 77.9bn, thereby ensuring that NPLs are fully provisioned. Nonetheless, banks do not want to write off bad loans, implying that the NPL ratio could decrease below what is reported.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio of banks reaching 18.6% (16.9% for Tier1 capital) in 2016 Q3, which is well above the regulatory requirements set by the Central Bank (12% and 8%, respectively), with Conventional banks being better capitalized compared to the Islamic ones (CAR of 19.1% vs. 16.7% and Tier 1 capital 17.1% vs. 16.1% respectively). Foreign banks have better capitalization than the Local banks (21.3% vs. 18.2% for CAR and Tier 1 capital of 18.3% vs. 16.7% respectively).

To capture the composite effects of changes in loans and deposits, two key ratios related to the funding of banks are considered: the Loan-to-Deposit (L/D) ratio and the Lending to the Stable Resources Ratio (LSRR[1]).

L/D ratio for the overall banking system has moved from 103.4% at the end of June to 103.8% at the end of 2016 Q3, which is mainly due to the stronger growth in Loans compared to Deposits. Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 106.1% and 95.8%. On the other hand, Local banks have L/D ratio of 105%, while the ratio for foreign banks is 96.2%.

LSRR[2] increased from 87.7% to 88.2% in 2016 Q3, reflecting slower increase in stable resources compared to the robust credit growth at banks. However, foreign banks have a lower level than the National banks by about 10 percentage points, while Islamic banks have a LSRR that is more than 3 percentage points less than that of the Conventional banks.

Meanwhile, liquid assets which include reserve requirements 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 16% at the end of June 2016 to 15.7% at the end of 2016 Q3. The level of total liquid assets at banks at the end of 2016 Q3 remains at AED 323.2bn, AED 3.2bn lower than at the end of June 2016, which is one of the reasons for the marginally lower Liquid Assets Ratio.

Table 3.5.a Financial Soundness Indicators in the UAE (in %, unless otherwise indicated)

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	88.1	87.1	86.8	87.7	88.2
The Liquid Assets Ratio (LAR)	14.2	17.4	15.6	16.0	15.7
Capital Adequacy Ratio (CAR) of which:	18.3	18.3	18.0	18.4	18.6
Tier 1 Capital	16.5	16.6	16.3	16.8	16.9

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values

Table 3.5.b Financial Soundness Indicators in the UAE for Conventional Banks (in %, unless otherwise indicated)

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	88.5	87.3	85.5	88.1	88.9
The Liquid Assets Ratio (LAR)	13.6	17.5	14.1	15.8	15.6
Capital Adequacy Ratio (CAR) of which:	18.8	18.9	18.4	18.9	19.1
Tier 1 Capital	16.8	16.9	16.3	17.0	17.1

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

Table 3.5.c Financial Soundness Indicators in the UAE for Islamic Banks (in %, unless otherwise indicated)

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	86.5	86.1	83.0	86.4	85.7
The Liquid Assets Ratio (LAR)	16.6	17.0	17.5	17.0	16.4
Capital Adequacy Ratio (CAR) of which:	15.8	15.6	16.2	16.5	16.7
Tier 1 Capital	15.1	14.9	15.4	15.9	16.1

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

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

Table 3.5.d Financial Soundness Indicators in the UAE for Local Banks (in %, unless otherwise indicated)

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	89.9	88.6	86.2	89.3	89.9
The Liquid Assets Ratio (LAR)	13.0	16.5	13.2	14.6	14.4
Capital Adequacy Ratio (CAR) of which:	18.1	18.0	17.8	18.1	18.2
Tier 1 Capital	16.6	16.5	16.2	16.6	16.7

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

Table 3.5.e Financial Soundness Indicators in the UAE for Foreign Banks (in %, unless otherwise indicated)

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	78.8	78.6	79.1	78.8	78.3
The Liquid Assets Ratio (LAR)	20.3	22.2	21.8	24.0	23.5
Capital Adequacy Ratio (CAR) of which:	19.2	20.2	18.6	20.7	21.3
Tier 1 Capital	16.1	17.1	15.8	17.7	18.3

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

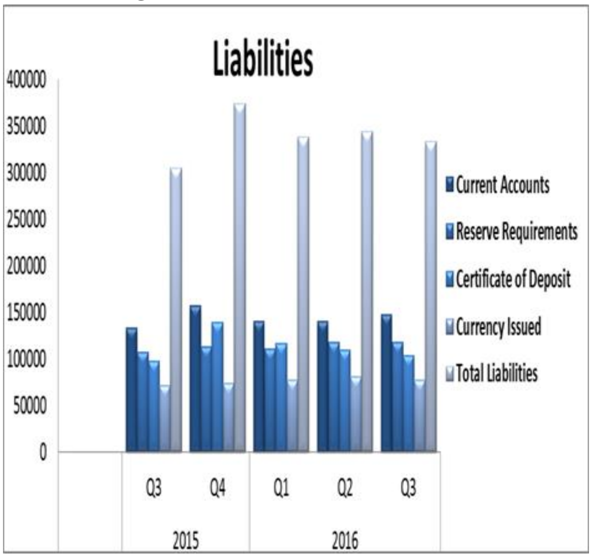
Chapter 4. Central Bank Financial Position & Reserve Management

The Central Bank balance sheet exhibited a decrease in 2016 Q3, triggered by reduction of liabilities, particularly a return to "normal" for Currency Issued and a fall in Derivative Liabilities, while required reserves remained flat. Meanwhile, assets were reallocated from "Held-To-Maturity Foreign Securities" to "Cash and Bank Balances" and to time deposits at banks abroad in an attempt to strike a better balance between return and liquidity.

4.1 Central Bank Balance Sheet

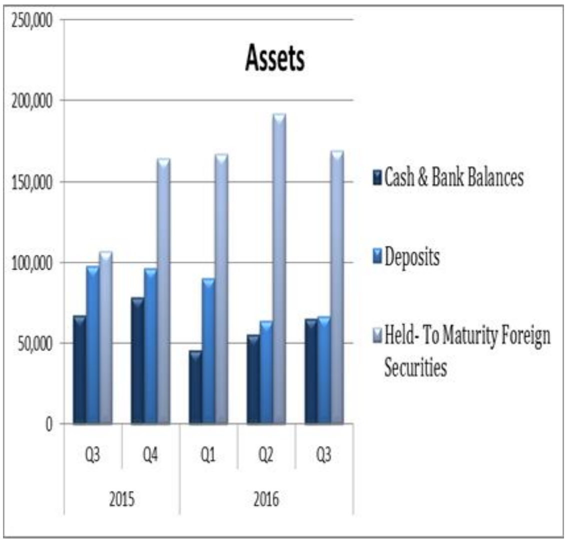
The Central Bank balance sheet moves with changes on the liabilities' side. Total liabilities decreased by 3.2% in 2016 Q3 following a decrease in "Currency Issued" by AED 4.1 billion, i.e., the amount of the exceptional increase last June, which was due to the collection of Zakat, the Islamic donation scheme. Also, "Derivative Liabilities" decreased by AED 9.2 billion, owing to a revaluation impact on Open Swap Contracts due to changes in the exchange rate of the Japanese Yen, the currency in which some liabilities are denominated. Meanwhile, banks' holding of "Certificates of Deposit" (CDs) issued by the Central Bank decreased by AED 5.3 billion, albeit they remain at AED 103.8 billion which indicates sufficient liquidity at banks.

Figure 4.1. Central Bank Liabilities



Source: Central Bank of the UAE

Figure 4.2. Central Bank Assets



Source: Central Bank of the UAE

The above-indicated decrease in liabilities, the total assets of the Central Bank decreased during 2016 Q3, reaching AED 353.6 billion. "Held-To-Maturity Foreign Securities" fell by 23.1 billion during 2016 Q3, due to the fact that at maturity, the proceeds from these securities were not re-invested in the same instruments, but reallocated instead to time deposits at banks abroad, which increased by AED3.1 billion and to Cash and Bank Balances, which increased by AED 9.4 billion.

Table 4.1. Central Bank Balance Sheet

In Millions of Dirhams

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Assets					
Gold Bullion	664	934	1,085	1,164	1,171
Cash & Bank Balances	66,883	78,611	46,029	55,656	65,037
Deposits	98,241	96,362	90,434	63,850	66,917
Liquidity Support Facility	228	228	214	214	200
Held-To-Maturity Foreign Securities	107,078	164,495	167,508	192,094	168,988
Held-To-Maturity Bonds Issued by MOF & Dubai Government:	49,231	49,231	49,198	49,198	49,165
Available-for-sale foreign Investments	362	361	356	372	374
Advances to Government	850	2,500	2,500	-	-
Available-for-sale foreign securities	-	74	75	76	76
Derivative Assets	47	334	175	151	566
Other Assets	462	445	437	401	490
Property and Equipment's	78	79	113	103	93
Total Assets	**324,126**	**393,660**	**358,675**	**364,748**	**353,628**
Off Balance Sheet Commitments	**115,166**	**199,681**	**198,254**	**262,631**	**211,456**
Liabilities and Capital					
Current Accounts & Deposits	132,727	157,031	140,363	140,351	146,920
- Of which:					
Reserve Requirements	107,700	112,900	110,300	118,100	118,229
Banks' Current account	17,700	36,400	25,100	17,800	25,817
Certificates of Deposit	97,365	139,773	116,393	109,083	103,797
Currency Issued	71,047	73,522	77,208	81,317	77,267
Derivative Liabilities	1,256	1,310	4,468	11,684	2,508
Other Liabilities	1,931	2,275	1,177	1,853	2,667
Total Liabilities	**304,327**	**373,910**	**338,611**	**344,287**	**333,159**
Authorized Issued & Fully Paid Capital	2,500	2,500	2,500	2,500	2,500
Fair Value Reserve	-26	-29	-33	-15	-14
Gold Revaluation Reserve	-12	-60	85	165	171
General Reserve	17,339	17,339	17,812	17,812	17,812
Total Liabilities & Capital	**324,126**	**393,660**	**358,975**	**364,748**	**353,628**
Off Balance Sheet Commitments related to foreign exchange fluctuations	**115,166**	**199,681**	**198,254**	**262,631**	**211,456**

Source: Financial Control Division, Central Bank of the UAE

4.2 Central Bank Foreign Assets

The balance of foreign assets decreased from AED 314.1 billion at the end of 2016 Q2 to AED 301.6 billion at end of 2016 Q3 (4% reduction), with the decrease in liabilities being the main driver. The decrease was mainly due to the above-indicated fall in "Held-To-Maturity Foreign Securities" by AED 23.1 billion, while "Current Account Balances & Deposits with Banks Abroad" increased by only AED 10.1 billion.

Table 4.2. Central Bank's Foreign Assets

In billions of Dirhams

	2015		2016		
	Q3	Q4	Q1	Q2	Q3
Total Foreign Assets	267.1	341.1	306.2	314.1	301.6
Held-To-Maturity Securities	107.1	164.5	167.5	192.1	169.0
Current Account Balances & Deposit with Banks Abroad	156.4	171.8	132.8	116.9	127.0
Other Foreign Assets	3.7	4.8	5.9	5.1	5.6

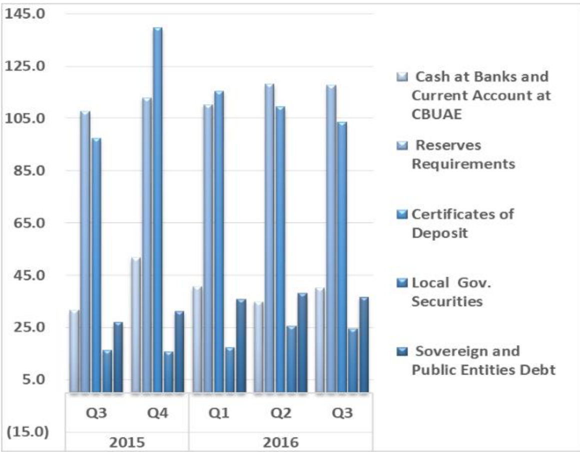
Source: Central Bank of the UAE, end of quarter data

4.3 Banks' Excess Liquidity Developments

Banks' liquid assets are composed of cash, reserves at the Central Bank and the highly-rated public sector's debt securities. Total liquid assets held by banks operating in the UAE decreased during 2016 Q3 by AED 3.2 billion, reaching AED 323.2 billion. Underlying the reduction is a decrease in excess reserves held at the Central Bank and a decrease in highly-rated public sector debt instruments.

Figure 4.3. Liquid Assets at Banks

In billions of Dirhams



Source: CBUAE Data

Few banks tapped CBUAE's facilities to borrow Dirhams during 2016 Q3, namely through the Interim Marginal Lending facility, the Collateralized Murabaha Facility, and the CDs Repo Facility.

4.4 Interest Rates

The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to peg its policy rate to the direction of the interest policy in the U.S. Therefore, the CBUAE policy rate was maintained during the first three quarters of 2016 in line with the Federal Reserve's decision to postpone

the planned increase in its policy rate, due to increasing global economic uncertainty, which increased further, as a result of the Brexit vote last June.
It is also worth noting that the CBUAE uses monetary tools at its disposal to manage liquidity in the banking system, with a goal to strike a balance between supporting credit growth and stemming the risks to financial stability, while maintaining its continued commitment to the fixed peg regime.

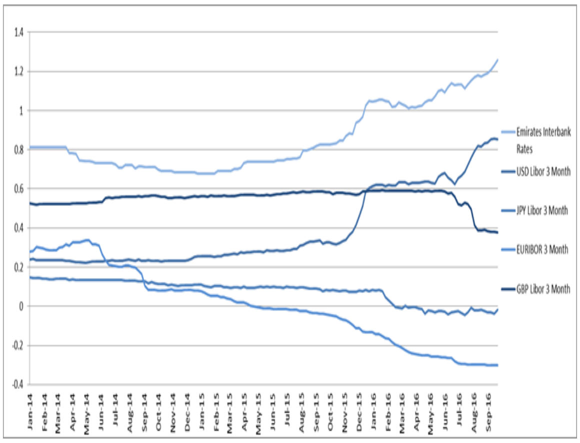
4.4.1 Short-term interest rates

Figure 4.3.1 shows the 3-month Emirates Interbank Offer Rate (Eibor), which comprises the daily quotes of the largest banks operating in the country, and published by the Central Bank of the UAE. Eibor was reformulated in 2016 Q2 to include the cost of attracting deposits from larger clients, in order to better reflect the true cost of funds for banks.

Following the fluctuation early this year, Eibor continued the upward trend of the USD Libor rate, which started in the second quarter and continued during the third quarter. The main reason is the renewed commitment by the Federal Reserve for further rate hikes when the right conditions are met.

The 3-month Libor rate in the Euro Area and in Japan, however, continued their declines during 2016 Q3, reflecting the expectation of further monetary easing, given the failure of the European Central Bank (ECB) and the Bank of Japan (BOJ) to reach their declared objectives, and the limited support from fiscal policy and/or structural reforms. Moreover, the Brexit decision is having a greater impact on the fall of *EURIBOR* and GBP Libor, thereby increasing the prospect of further divergence relative to the U.S interest rate policy where economic activity has been expanding and job gains have been on an upward trend.

Figure 4.4. Libor Rates 3-month



Source: Bloomberg

4.4.2 Long-term swap rates

Given the absence of a deep and liquid government bond market in the UAE, the swap market is the only way to get an idea about yields at longer maturities. Interest rate swaps correspond to an exchange of a fixed payment for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.3.2, the AED 10-year swap rate witnessed an upward trend in 2016 Q3, which may indicate a higher risk premium as investors in the UAE became averse to the potential adverse effect of persistent low oil prices and potential higher interest rates.
Similarly, the swap rates of the US dollar, the Euro, the British Pound and the Japanese Yen witnessed an upward trend, which is testament to the heightened global uncertainties, whereas the shot-up for the British Pound is linked to the negative fallout of the Brexit vote and rising concerns about the outlook.

Figure 4.5. 10-year swap rates

Source: Bloomberg

4.5 Monetary Tools

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

4.6 Certificates of Deposits

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

4.7 Reserve Management

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