Quarterly Economic Review

Fourth quarter 2018

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Executive Summary

The IMF revised global growth downward for 2018 and 2019 to 3.7% and 3.5%, respectively, reflecting the rising risks of trade wars and tighter global financing conditions. Growth in the US is expected to remain above 3%, buoyed by positive data of economic activities. Other developed countries' growth prospects were revised downward owing to increased uncertainties related to the impact of the trade war and Brexit. In Emerging Economies, growth remained resilient at 4.7%, albeit serious pressures continue in some countries. PMI levels showed a slowdown during the fourth quarter, indicating further softening in the manufacturing activities for both Advanced and Emerging Markets.

Meanwhile, inflation edged up to 1.9% in the US, slightly below the Fed's target. The Fed hinted to a normalized interest rate policy in the coming period. In Japan, however, inflation decreased to well below BOJ's target, which reinforces market expectations that the BoJ will have no choice but to cut its inflation forecasts in the coming period. Moreover, the yield on US Treasuries reached its peak in October. Japan's 10-year yield fell below zero for the first time.

In the UAE, the quarterly Augmented Economic Composite Indicator of Non-Oil Activities, constructed by CBUAE, showed continued growth of the non-hydrocarbon sector in the fourth quarter of 2018. Aggregate economic growth was robust, underpinned by government activities and liquidity at banks. Moreover, CPI inflation continued to ease as the impact of excise taxes faded while inflation in Non-Tradables eased as a result of continued decline in housing prices. Job creation declined in labor-intensive sectors.

Deposits at banks continued to rise in the fourth quarter of 2018. This increase, in tandem with sufficient liquidity and higher demand for credit, allowed banks to increase lending, particularly to the private and Government sectors. Based on the Financial Soundness Indicators (FSIs), the overall soundness of the banking system in the UAE remains positive.

The Central Bank's balance sheet exhibited an increase in 2018 Q4 reflecting the increase in Cash and Bank Balances and in Deposits and other Advances. On the liabilities side, the increase was evident in Current and Deposits of banks at the Central Bank and in Certificates of Deposits, signifying sufficient liquidity in the banking system. As for the EIBOR, it exhibited an upward trend in 2018 Q4, while the Spread between the 3-month EIBOR and the US 3-month LIBOR remained mostly positive, fluctuating around an average level of twelve basis points.

Chapter 1. International Economic Developments

The IMF revised global growth downward to 3.7% in 2018. In the Euro Area, growth is moderating due to fiscal challenges in Italy and the looming risks of trade wars. The lingering uncertainty over Brexit negatively affected the economic performance in the UK. Emerging Economies' growth outlook was also revised downward but remained resilient, thanks to recovery in some resource-rich countries benefiting from higher commodity prices. Inflation of Personal Consumption Expenditures (PCE) is roughly at target in the US, which explains the Fed's decision in December to raise the policy rate; the US Treasury yields decreased nonetheless.

I.1 Global Economic Growth:

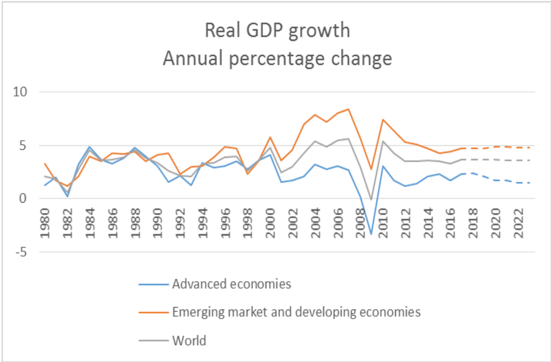
Growth forecasts have been revised downward for most of the advanced and emerging economies. According to the International Monetary Fund's (IMF) January 2019 *World Economic Outlook* (WEO), global growth for 2018 is estimated at 3.7%, despite weak performance in advanced economies. Growth projections for 2019 were revised downward to 3.5%.

As global financing conditions tightened, the projected gradual deceleration of global growth could be more severe than expected. Emerging markets and developing economies have been adversely affected by the rapid appreciation of the US dollar, raising concerns about debt sustainability for economies with large external debt.

In addition, escalating trade tensions have posed major downside risk to the global outlook. According to the World Bank's *"Global Economic Prospects,"* if all tariffs currently under consideration were implemented, they would affect about 5% of global trade flows and could dampen growth in the economies involved, leading to negative global spillovers.

The outlook for the annual US growth remained robust, well above 3% for two quarters. Jobs continue to grow by about 200,000 per month on average, higher than most estimates of the long-run growth potential of the labor force. Nevertheless, some monthly indicators of investment spending are beginning to weaken in line with the global growth slowdown.

Figure 1.1. Real GDP Growth for Selected Group of Economies



Source: IMF

In the UK, substantial uncertainty remains around the baseline projection of about 1.5% growth in 2019 and 2020 due to Brexit developments. According to IMF projection, this baseline projection assumes that a Brexit deal will be reached in 2019 and that the UK will transition gradually to the new regime.

For the Euro zone**,** the second largest economy in the world, GDP rose by 1.2% Y-o-Y in the fourth quarter of 2018, following a 1.6% growth in the previous quarter. Throughout the year 2018, the Eurozone's economy has lost significant momentum mainly due to loss of confidence, dampened external demand and political uncertainty. On a quarterly basis, seasonally adjusted GDP rose by 0.2% Q-o-Q during the fourth quarter of 2018, matching the third quarter growth rate, which is the lowest since the second quarter of 2014.

The Eurozone Composite PMI dropped in Mid-Q4 to its lowest level for over two years, mainly due to worries over global trade trends and political worries around Brexit. Moreover, business confidence was at its lowest level in nearly four years. Among Eurozone's largest economies, the Italian economy remained quite weak in the fourth quarter of 2018, following a third quarter in which shrinking domestic demand led the economy to contract for the first time since the second quarter of 2014. France's GDP growth rose by 0.9% Y-o-Y in the fourth quarter, easing from 1.3% growth, with exports and fixed investment being the main drivers, while household consumption slowed down.

Meanwhile, growth rate in Germany met market expectations of 1.1% Y-o-Y during the fourth quarter of 2018. The slowdown was mainly driven by global economic slowdown, persistent trade tensions with the US, and the risk of Britain leaving the EU without a deal.

The temporary truce on trade tariff hikes agreed by the US and China during the G20 meeting in early December has tempered trade policy uncertainties. Nevertheless, the possibility of escalating trade restrictions with major economies still persist, adversely affecting firms' willingness to invest, export, and engage in global investment. Unsuccessful negotiations could lead to renewed escalations of trade tensions affecting about 2.5% of global goods' trade. In addition, rising interest rates in advanced economies are expected to contribute to slower global investment and trade growth.

Japan's economic activity during the fourth quarter exhibited some recovery compared to Q3 contraction, which was mainly due to bad weather and natural disasters. The recovery comes mainly against the backdrop of highly accommodative financial conditions underpinned by stronger government spending. Meanwhile, the Nikkei Japan Manufacturing PMI average for the fourth quarter was 52.5, implying a decline in both output and new orders.

Growth projections for Emerging Economies were also revised downward, albeit growth remains at 4.7%, both in 2018 and 2019, thanks to higher growth in some commodity exporting countries as well as resilient export prospects for some others. The slowdown is due to serious pressures observed in some countries where currencies weakened, in tandem with inflation and debt overhang; Financial outflows continued on the back of further worsening outlook.

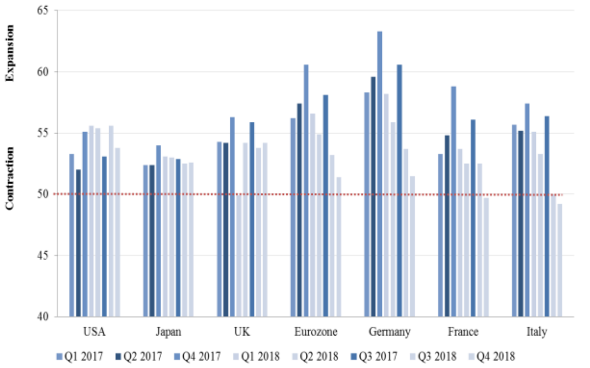
China's annual real GDP growth slowed down to 6.4% Y-o-Y, matching market expectations, down by 0.1% from the previous quarter. This growth rate is the lowest since the global financial crisis. Slowing growth took place against the backdrop of intense trade dispute with the United States, weakening domestic demand and alarming off-balance-sheet borrowings by local governments. On a quarterly basis, the Chinese economy expanded by 1.5% compared to 1.6% in the previous period, in line with market expectations. The growth of the Chinese economy remains stable despite the above listed challenges.

In the region of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)[1], as defined by the IMF, economic growth is expected to remain subdued at 2.4% in 2019 and is projected to recover in 2020 to about 3%. Factors such as weak oil output growth, tightening financing conditions, and economic and geopolitical instability in some countries are affecting the region's outlook.

In the GCC, real non-oil GDP growth continued to improve in 2018 on the back of recovery in oil prices and a more gradual pace of fiscal consolidation. However, oil GDP is expected to grow at a slower rate due to OPEC+'s agreement of cutting oil output. The Saudi growth increased from 1.6% in 2018 Q2 to 2.5% in Q3, which is the highest growth rate since the last quarter of 2017. According to the IMF, growth is projected to reach 2.2% in 2018, thanks to higher oil prices and supporting fiscal policy undertaken by the government to further diversify the economy and implement its Vision 2030. The PMI in the non-oil private sector averaged 54.5 in Q3, up from 53.2 in Q2 of 2018.

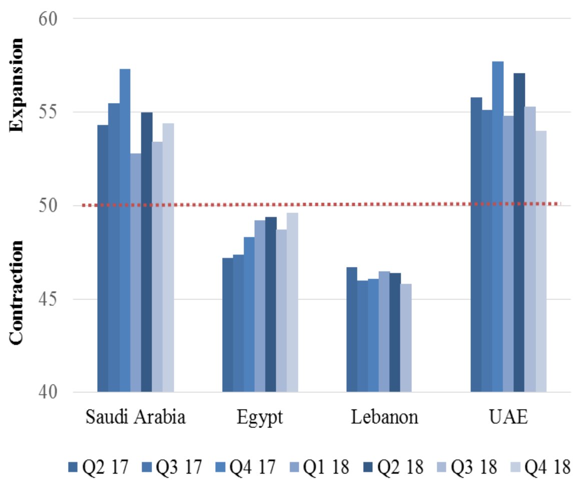
[1] MENAP oil exporters: Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen. MENAP oil importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Sudan, Syria, and Tunisia.

Figure 1.2. PMI Levels for Selected Countries



Source: Bloomberg

Figure 1.3. PMI levels for Selected MENA Countries



Source: Bloomberg

I.2 Inflation:

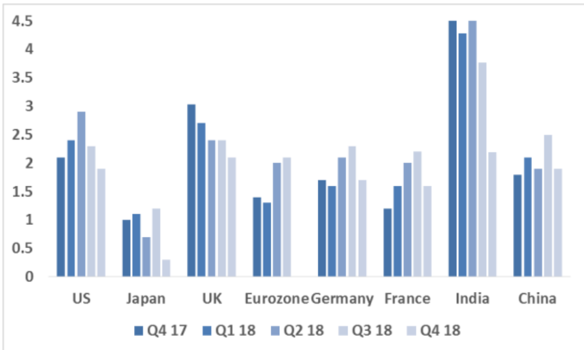
In the US, the core PCE inflation (The Fed's official target) reached 1.9% Y-o-Y, at the end of 2018 Q4, compared to 2 % in Q3. While the core consumer prices, excluding volatile items such as food and energy, rose by 2.2% Y-o-Y, unchanged compared to Q3.

CPI inflation, which measures the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services in the US, increased by 1.9% compared to 2.3% increase in Q3.

CPI inflation in the other selected economies slowed down during the fourth quarter. China's CPI inflation slowed to a six-month low of 1.9% in 2018 Q4. The slowdown was mainly attributed to non-food prices. While Japan's CPI inflation fell to 0.3% down from a peak of 1.4% in October. Compared to the end of the third quarter, Japan's inflation rate slowed down by 0.9 percentage points. Meanwhile, India's CPI inflation matched the expectations of 2.2% Y-o-Y at the end of the quarter, compared to 3.8% of the third quarter. It was the lowest inflation rate since June 2017 as prices of food, clothing, and fuel continued to decline

In the MENA region, higher oil prices generally led to higher inflation given the importance of energy and transportation costs in the CPI basket. According to the Arab Monetary Fund's (AMF), *Arab Economies Outlook* September report, inflation in the region is expected to reach 11.4% for 2018 and 8.3% for 2019. For GCC countries, inflation is expected to be in the range of 3% and 1% for 2018 and 2019, respectively. Whereas inflation for major oil-exporting Arab countries—excluding GCC—is expected to reach 7.6% for 2018 and 6% for 2019. Finally, oil-importing countries' inflation is expected to reach 11.4% in 2018.

Figure 1.4. Year-on-Year Consumer Price Change for Selected Developed and Emerging Economies (%)



Source: Bloomberg

I.3 Commodity and Precious Metals Prices

The fourth quarter of the year 2018 witnessed a continuation of mixed movements in commodity prices. Compared to the fourth quarter of 2017, Brent prices increased by 10% averaging 67.7 dollars per barrel in December, down from an average of 75.2 dollars per barrel in October 2018. However, the price decreased in late 2018 as oil inventories increased due to record levels of crude oil production from the United States, Russia, and Saudi Arabia. In addition, prices were affected as uncertainties about global economic outlook and therefore the demand for oil.

Although OPEC+ producers announced in early December plans to cut production starting in January 2019; Brent crude oil prices continued to fall possibly reflecting market expectations that announced production cuts would not be enough to offset increasing production in North America. Moreover, the potential for weakening global oil demand could lead to a rise in global oil inventory levels.

According to OPEC's December Monthly Oil Market Report, the global oil demand in the last quarter of 2018 was slightly higher compared to the previous quarter, reaching 99.98 million barrels per day. For the year 2019 as a whole, global oil demand is expected to increase by 1.29 million barrels per day to average 100.08 mb/d.

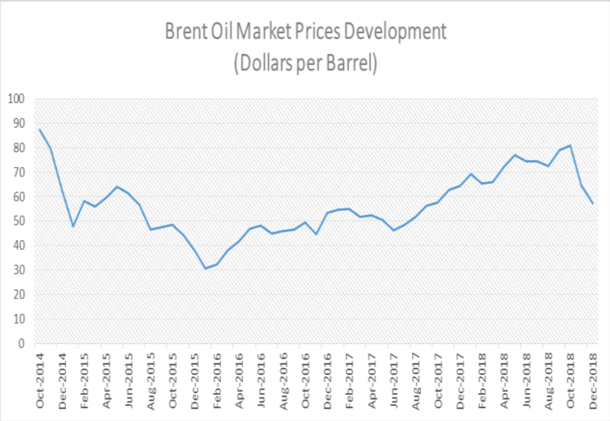
As regards non-OPEC oil supply, it is estimated to reach an average of 62.19 mb/d. The US, Brazil, Russia and the UK are the main drivers for next year's growth, while Mexico, Norway, Indonesia, Vietnam and Egypt are projected to see the largest declines.

World annual oil consumption was up slightly in the final quarter of 2018 compared to the third quarter, reaching 100.94 mb/d. Annual consumption for both the US and China slightly increased indicating improved economic activity. However, the annual consumption for Europe fell by 2.2% during the same period (Table 1).

Meanwhile, gold prices were under pressure during the fourth quarter of 2018 in line with the fall in crude oil prices, and some other commodities. Prices of silver exhibited almost 9% decrease in the fourth quarter Y-o-Y as negative sentiments continued to dominate precious metals markets.

The drop in oil prices has created pessimism as it affects the commodity index funds, which in turn, affects precious metals prices (Figure 1.6). In addition, the US dollar index, which is an index that measures the value of the US dollar relative to a basket of foreign currencies, showed gains throughout the quarter despite some setbacks.

Figure 1.5. Brent Crude Oil Market Prices Development (USD per Barrel)



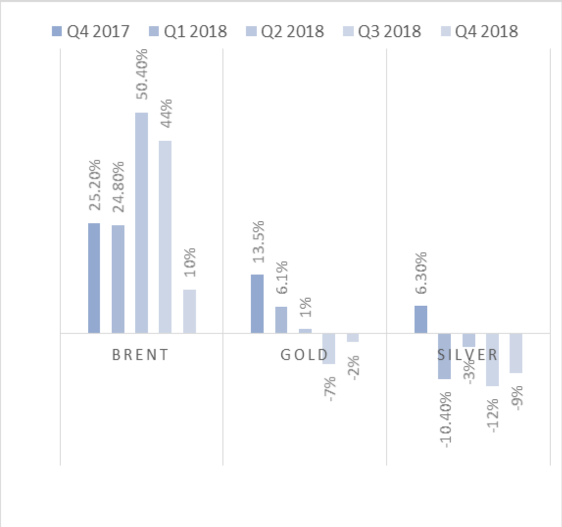
Source: EIA.

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

Country	2018				2019
	Q1	Q2	Q3	Q4	
China	13.80	14.00	13.73	13.95	14.34
U.S	20.24	20.33	20.63	20.64	20.77
Europe	14.05	14.19	14.63	14.31	14.38
World	99.18	99.49	100.37	100.94	101.54

Source: Short-Term Energy Outlook, October 2018.

Figure 1.6. Selected Commodity Price Levels (Y-o-Y, % change)



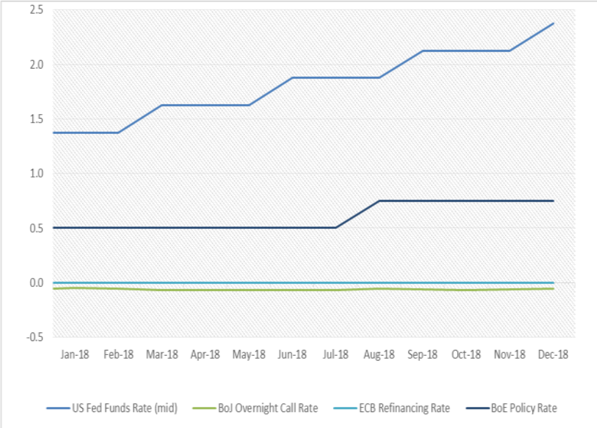
Source: Bloomberg, EIA.

I.4 Policy Interest Rates:

The Federal Reserve (Fed) raised the target range for the federal funds rate by 25bps to 2.25-2.5 percent during its December meeting and lowered forecasts for interest rates hikes in 2019 amid increased volatility in financial markets and slowing global growth (Figure 1.7).

Meanwhile, the European Central Bank's Governing Council maintained the policy interest rates on refinancing operations, the marginal lending facility and the deposit facility, at 0.00%, 0.25%, and -0.40%, respectively, in line with market expectations. The ECB expects key interest rates to remain unchanged at least through the summer of 2019.

Figure 1.7. The Policy Interest Rates for Selected Advanced Countries



Source: Bloomberg

The Bank of Japan kept its short-term interest rate unchanged at -0.1 percent while targeting the 10-year Japanese government bond yield at around zero, emphasizing healthy economic activity despite trade tensions, and below target inflation (Figure 1.7).

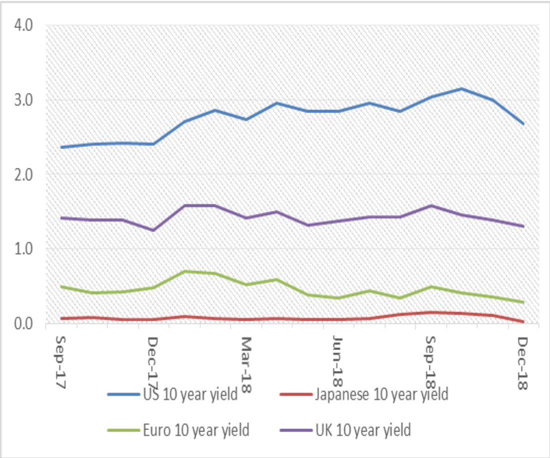
1.5 Government Bond yields:

The yield on 10-year US Treasury reached its peak of 3.15% in October 2018 due to the rising optimism over the strength of the US economy, on the back of the Federal Reserve's announcement that there is more room to lift interest rates, which was decided in December.

The UK 10-year bond yield fell moderately to 1.3% at the end of the year as geopolitical uncertainty increased in Britain after key ministers in the government resigned over the draft Brexit plan.

Meanwhile, the Japanese 10-year government bond yield fell below zero to minus 0.005 percent, as the Nikkei 225 Stock Average declined on its last trading of the year. The Bank of Japan, in line with economic and price developments in Japan, allowed the 10 year yield to fall into negative territory (Figure 1.8).

Figure 1.8. The 10-Year Government Bond Yields for Selected Countries (%)



Source: Bloomberg

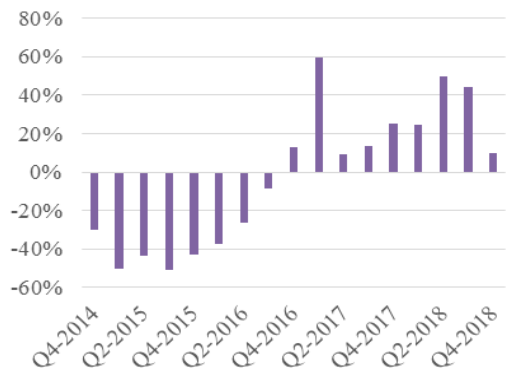
Chapter 2: Domestic Economic Developments

According to the quarterly Augmented Economic Composite Indicator of non-oil activity for the UAE, the pace of economic growth rose in the fourth quarter of 2018, supported by the rise in oil production. Meanwhile, CPI inflation rates eased compared to the previous quarter, reflecting the decline in the non-tradable prices owing to continued decline in housing prices and slower inflation in the tradable prices.

2.1 Economic Activity and Growth

The rise in crude oil production has boosted growth estimates in the UAE for Q4 2018. Real growth in the UAE—proxied by the CBUAE quarterly Augmented Economic Composite Index (AECI)—indicates that non-oil GDP growth Y-o-Y stood at 2.8% compared to a growth of 2.1% in the previous quarter. (For AECI Methodology please refer to box 1 of Q2 2018 report).

Figure 2.1.a. Brent Crude Oil Prices (%, Y-o-Y)

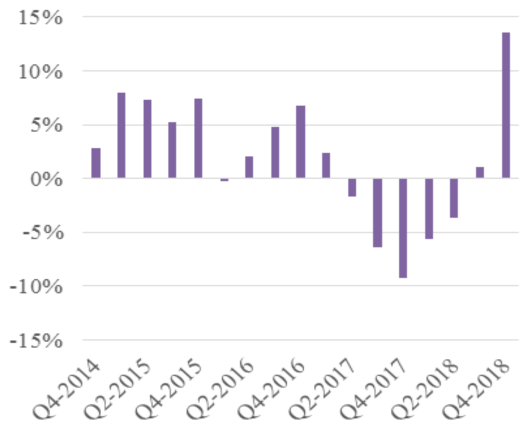


Source: EIA and Bloomberg

Accordingly, the overall GDP growth for Q4 2018 is estimated at 4.4%, driven by the non-oil sector real growth as well as an accelerating oil production since October. Further, the increase of oil prices eased in Q4 2018; increasing by 9.8% Y-o-Y compared to a higher increase of 44.4% in the previous quarter. On a Q-o-Q basis, prices declined by 10.2% compared to an increase of 1.0% in Q3 2018.

Oil production rose in Q4 2018 Y-o-Y by 13.1% compared to a 1% growth in the previous quarter averaging 3.3 mb/d. On a Q-o-Q basis, oil production rose by 9.5% in Q4 2018 compared to a 4.3% increase in Q3 2018. This surge came ahead of the execution of the December's OPEC+ agreement, which aims at correcting the growing imbalance between global oil supply and demand in 2019 through a reduction of the overall production by 1.2 mb/d, effective January 2019 for an initial period of six months.

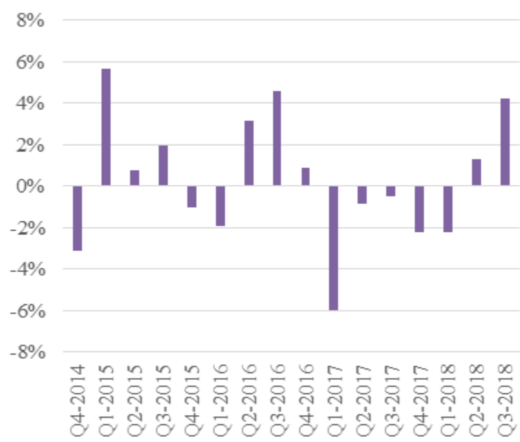
Figure 2.1.b UAE's Oil Production Growth (%, Y-o-Y)



Source: EIA

Consequently, oil production in 2018 grew by 1.1%, averaging 3.0 mb/d compared to a decline of 3.9% in 2017.

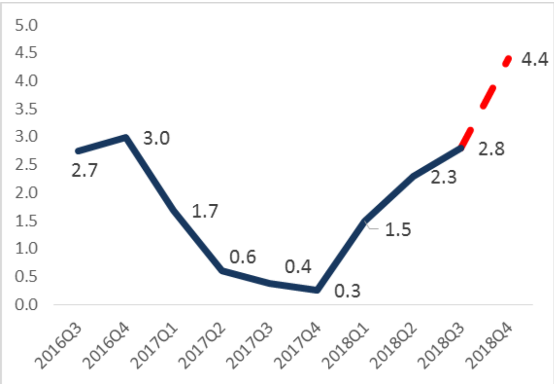
Figure 2.1.b. UAE's Oil Production Growth (%, Q-o-Q)



Source: EIA and Bloomberg

The real non-oil GDP growth is estimated to remain robust in Q4 2018. Further, during Q4 2018, several economic sentiment indicators registered a relative rise. Credit extended to the private sector rose by 3.9% by the end of December 2018 compared to the same period in the previous year. In addition, personal loans for business purposes rose significantly during the same period by 8% compared to a decline at the end of September 2018 of 1%. However, some signs of slowdown were manifested in the decline in the Purchasing Managers' Index (PMI) and Dubai Economic Tracker (DET) from 55.3 and 54.4 in September to 54.0 and 53.7 in December, respectively, due to slower output and new order growth. However, both indicators remain well above the 50 threshold. Moreover, employment in the private sector declined Y-o-Y by 0.5% in Q4 2018, compared to an increase of 1.9% in the previous quarter.

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



Source: CBUAE

Based on the AECI index dynamics, overall Real GDP growth is projected to register a growth of 2.8% in 2018 compared to a 0.8% in 2017. The rise in 2018 economic performance was driven by higher growth rates in the non-oil GDP sector by 2.6% compared to 2.5% in 2017, as well as the increase in oil production in the UAE by 1.2% compared to a 3.9% decline in 2017.

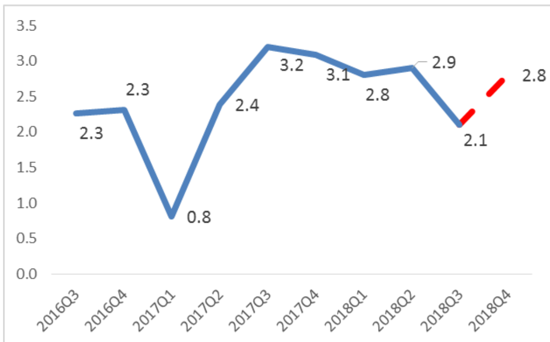
To support the growth momentum, the Federal and Local governments have initiated measures during the second half of 2018 aiming to boost growth prospects in the UAE during 2019. In particular, the government of Abu Dhabi announced 50 billion dirhams (13.6 billion USD) economic stimulus package, as well as 10 economic initiatives to ease the cost of doing business and help boost the non-oil GDP over the medium term.

Moreover, the government of Dubai announced initiatives to stimulate growth focusing on reducing costs of key industries for Dubai—including aviation, real estate, and education—in addition to mitigating the cost of launching new businesses and lowering taxes. These measures along with the Federal government announcement of new measures aiming at relaxing foreign ownership requirements and the introduction of ten-year visas for qualified labor and investors should foster private investment inflows and retention of skilled workers.

These measures are expected to start influence positively UAE growth prospects in 2019 as projections show that economic activity will improve in the non-oil sector due to the effects of the announced fiscal stimulus packages underpinned by the stronger fundamentals of the economy and improved market sentiments.

Overall, GDP is expected to grow by 2.5% in 2019 as non-oil sectors are projected to grow by 3.4%. Box 1 illustrates the Quarterly Economic Growth Estimates and Projections; Box 2 provides some insights on the recent developments in the real estate sector in the Emirates of Abu Dhabi and Dubai; while Box 3 discusses the recent dynamics of FDI Flows as reported in the 2017 World Investment Report.

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



Source: CBUAE

Box 1: Quarterly Economic Growth Estimates and Projections

The CBUAE uses the AECI to proxy the performance of the non-oil economy (see Box 1 in the second quarter of 2018 report for details on the methodology). The Central Bank continues to revise its index, based on available quarterly data at the Emirate level, and consequently updates the quarterly real growth. New data have been released from the Statistics Center of Abu Dhabi (SCAD), which provides the quarterly GDP for the Emirate of Abu Dhabi for the first three quarters of 2018. Based on data released, coupled with updated higher frequency data employed in the in-house CBUAE AECI model, the estimates and projections for 2018-19 GDP have been revised.

In the absence of the Dubai's quarterly GDP for 2018, UAE non-energy growth is a weighted average of Abu Dhabi non-oil GDP and the nowcast estimate of the CBUAE model using high frequency data for the first three quarters of 2018. This methodology has proven to produce better performance in estimating the short-term growth numbers. For the period 2018 Q4 – 2019 Q4 for which no data are available for both the Abu Dhabi and Dubai emirates, estimates are based on a weighted average of projections of the just released Abu Dhabi non-energy growth with a bigger weight assigned to the out of sample forecast of the model using projections of high frequency data.

For the oil GDP, it has been observed that Abu Dhabi oil growth behaves very similarly to that of the hydrocarbon growth at a Federal level—98% from the Abu Dhabi Emirate—hence, CBUAE is using the first three quarters of Abu Dhabi's oil real GDP (RGDP) growth to represent growth at a Federal level. For the period 2018 Q4, a growth rate similar to the one reported by OPEC for the UAE for the fourth quarter of 2018 is used, while for 2019 CBUAE assumes an average production of 3mn barrels per day, in line with the announced oil production cut by OPEC+ (Table 1).

Based on the above, real non-oil GDP economic growth is estimated at a value of 2.8% in Q4 2018, compared to 3.1% a year ago. The overall growth is estimated at 4.4% for the last quarter of 2018, due to the oil output, which is estimated to be growing by 8%.

Accordingly, the non-oil real GDP is estimated to have increased annually by 2.6% in 2018, on average, compared to 2.5% average growth during the same period a year ago, while the overall growth is estimated at 2.8%.

Figure 1. Total, Oil & Non-oil Real GDP growth 2018-2019 (y-o-y%)

	2018				Year 2018
	Q1	Q2	Q3	Q4	
Non-oil	2.8	2.9	2.1	2.8	2.6
Oil	-1.5	1.0	4.5	8.0	3.0
Total	1.5	2.3	2.8	4.4	2.8
	2019				Year 2019
	Q1	Q2	Q3	Q4	
Non-oil	3.1	3.3	3.5	3.7	3.4
Oil	9.1	8.0	3.3	-5.6	3.7
Total	4.2	3.9	2.6	0.4	3.5

Source: CBUAE

The CBUAE projects that the non-oil GDP economic growth in Q1 2019 will reach 3.1% and continue its upward trajectory in 2019, growing by 3.4% in 2019 compared to an estimated growth of 2.6% in 2018. The announced fiscal stimulus packages (See Box 1 in 2018 Q3 *Quarterly Economic Review*) will help lift economic growth, increase consumption, revive the property market, and improve labor markets as the investors and consumers sentiment continues to solidify.

Even though the non-oil growth is expected to reach 3.4% in 2019, supported by stronger fundamentals of the economy. In addition, the CBUAE projects that oil production will reach 3.1 mn barrels per day in 2019, down from an average of 3.285mn barrels per day in 2018 Q4, resulting in a growth of 3.7% in 2019 in the hydrocarbon GDP.

Combining improved outlook of non-energy growth and declining oil production, real GDP growth rate is projected to reach 3.5% in 2019.

Box 2: Recent Developments in the Real Estate Market

According to recent data from REIDIN[1], the UAE residential house prices continued to decline in the fourth quarter of 2018 in both Dubai and Abu Dhabi, in line with long-term trend. The drop in house prices in annual terms accelerated somewhat from the previous quarter in Dubai, but improved in Abu Dhabi. Similarly, rent values also continued to decrease at slightly higher pace in Dubai, while the fall was slower in Abu Dhabi.

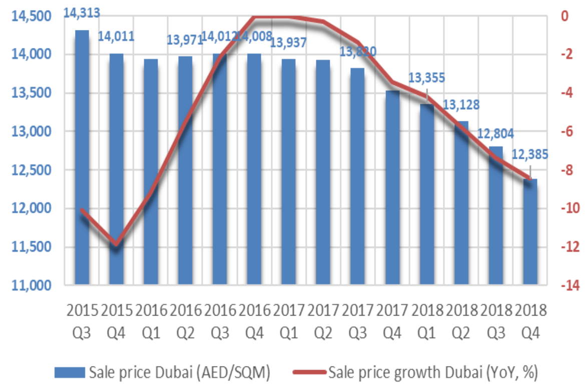
Dubai residential property prices declined by 8.4% from a year ago. In quarterly terms, prices fell 3.3%, moderating to AED 12,385/m². The drop was lower in Abu Dhabi, where property prices declined by 6.4% from a year ago and 2.4% from the previous quarter. Real estate prices in Abu Dhabi fell to AED 11,206/m².The rental yield, which measures the rate of income return over the cost associated with an investment property, stayed the same in Dubai as in the previous quarter at 6.81%, while it increased marginally in Abu Dhabi to reach 6.78%.

Dubai residential Market

In the fourth quarter of 2018, real estate property price, which measures the average sample price in dirham per square meter of residential properties, decreased by 8.4% Y-o-Y compared to 7.3% decline in the previous quarter (Figure 1).

1 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.

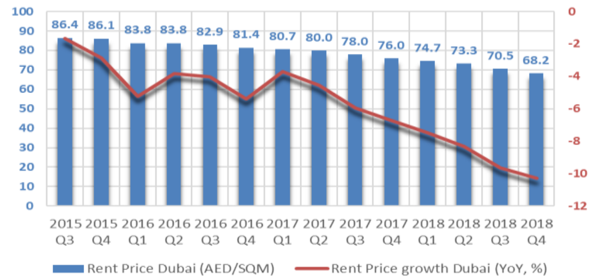
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

The Dubai market continues to exhibit decline in rent (Figure 2), due to high supply and softer job creation. The rent prices declined by an annual rate of 10.3% in the fourth quarter of 2018, following an annual decrease of 9.6% in the previous quarter.

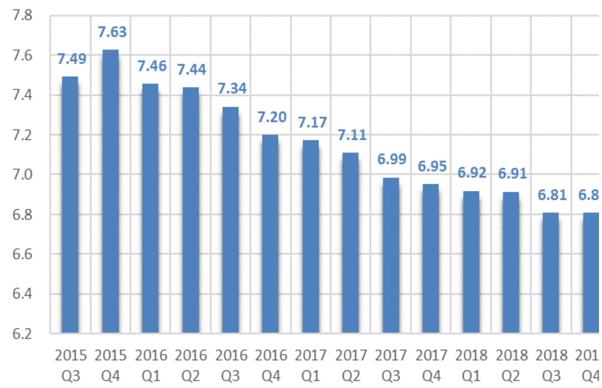
Figure 2: Dubai Residential Rent Prices



Source: REIDIN

As regard to investment in Dubai's real estate market, 2018 was marked by a slowdown in rental yield from a 6.92% in the first quarter to 6.81% in the last quarter of 2018 (Figure 3). This trend was the result of relatively stable prices towards the end of the year, combined with further decline in rent values.

Figure 3: Dubai Rental Yield (%)

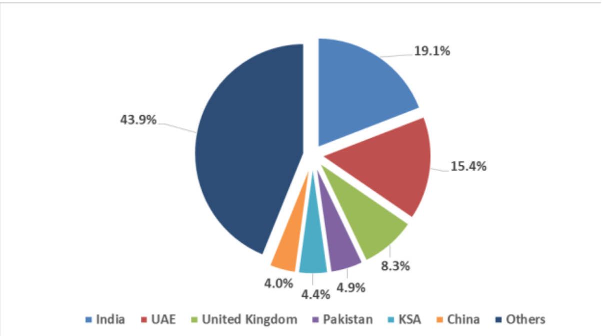


Source: REIDIN

As per the Dubai Land Department (DLD) in 2018 Q3 investment in real estate in the Emirate of Dubai stood at AED 14.4bn, of which AED 11.5bn or 80.2% were cash and AED 2.8bn or 19.8% made through mortgage.

The five major foreign nationalities investing in real estate in Dubai were from India, the UK, Pakistan, Saudi Arabia and China. The purchases from Emiratis were the second highest, following the Indian investors. The investments from buyers originating from the top five countries plus the Emirati buyers represented 56.1% or AED 8.1bn of all purchases made in Dubai in 2018 Q3 (Figure 4).

Figure 4: Share of Emiratis and Top Five Foreign Countries Investing in Dubai

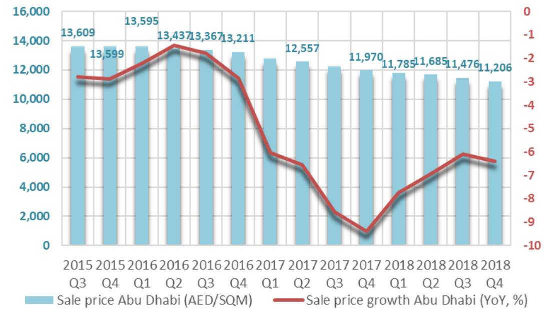


Source: DLD

Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index exhibited a continued fall in residential property prices, albeit at a more moderate rate of 6.4% Y-o-Y in the 2018 Q4; following a decrease of 6.1% in the previous quarter (Figure 5).

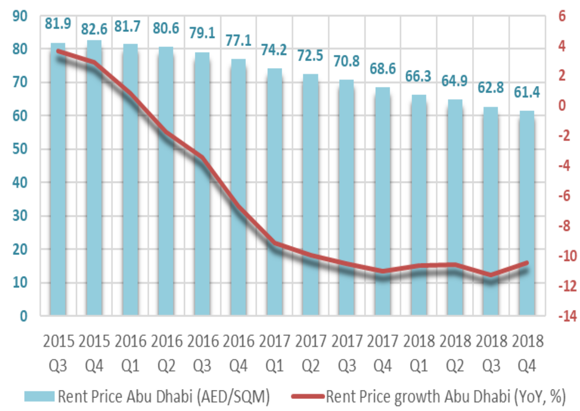
Figure 5: Abu Dhabi Residential Prices



Source: REIDIN

As for the rental market, the rent values in Abu Dhabi continued to decline by an annual rate of 10.4% on average in the fourth quarter of 2018, after a reduction of 11.3% in the previous quarter. This trend is reflecting the impact of softer job market, which continues to weigh in on demand in the housing market (Figure 6).

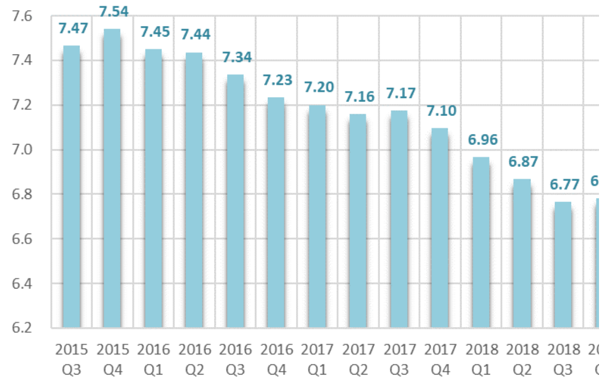
Figure 6: Abu Dhabi Residential Rent Prices



Source: REIDIN

Concerning the rental yield, Abu Dhabi registered a yield of 6.78% for 2018 Q4, a marginal increase of 0.01 precentage points from the previous quarter (Figure 7). The observed pattern in rental yield reflects a constant pace of decline in rent along with continued decline in demand reflecting a weaker job market which has weighed in adversely on the investment sentiment in properties.

Figure 7: Abu Dhabi Rental Yield (%)



Source: REIDIN

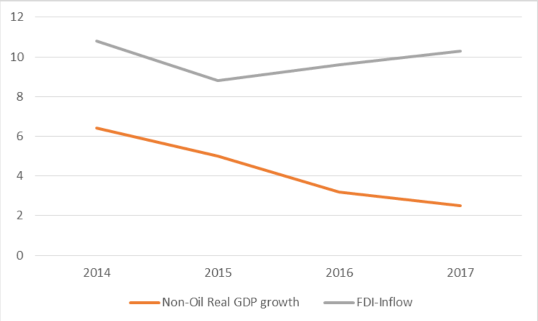
Box 3: FDI Flows in the World Investment Report 2018

Overview

The World Investment Report is a yearly publication of the United Nations Conference on Trade and Development (UNCTAD). The report publishes Foreign Direct Investment (FDI) flows worldwide in addition to analytical chapters about global and regional trends and policy developments in this regard. The focus of the 2018 report is on industrial development strategies, which have emerged in response "to opportunities and challenges associated with a new industrial revolution". The report provides decision makers with options for investment and policy tools that they can use to foster investment particularly in the form of inward FDI.

For 2017, global FDI shows a slowdown by 23% to 1.43 trillion dollars, mainly due to the fall by 22% in the value of cross-border mergers and acquisitions (M&As). Meanwhile, projections for global FDI in 2018 show 10% increase, albeit they remain well below the average over the past 10 years, owing to rising risks, policy uncertainty, escalating trade tensions and more tax competition and tax reforms in the US, and greater tax competition.

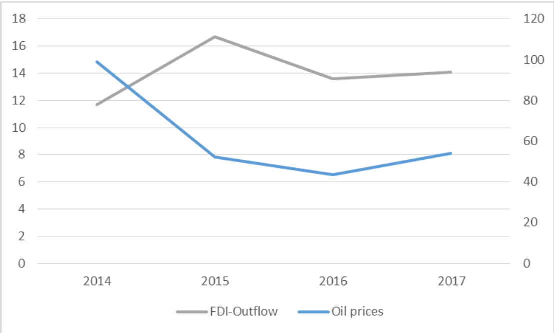
Figure 1. FDI inflow and non-oil growth in the UAE



Source: WIR
*Growth is in %, while FDI Inflows are in billions of US dollars

As shown in the figure above, FDI inflows in the UAE decreased from $10.8 billion in 2014 to an average of $9.2 billion in 2015-16, in tandem with the slowdown in growth of non-oil activities from 6.4% in 2014 to 5% in 2015 and to 3.2% in 2016. FDI inflows recovered in 2017, however, even though non-oil real GDP growth remained subdued at 2.5%. The recovery in FDI inflows signifies renewed confidence in the national economy, as the federal and local governments adopted a supporting fiscal policy stance, and the country's rating was maintained, at Aa2 by Moody's as an example, which helps solidify foreign investors' confidence in the UAE economy, thereby leading to an increase in inward FDI.

Figure 2. FDI Inflow and Non-oil Growth in the UAE



Source: WIR

The Figure above shows two sub-periods:

Sub-period 2014-15: There was an increase in FDI outflows from the UAE as the collapse in oil prices in June 2014 started to slow down non-oil activities, thereby affecting investors' confidence, increasing the drive to search for better opportunities abroad.

Sub-period 2016-17: As the UAE managed to use available fiscal space to safeguard priority spending on infrastructure and vital services, starting 2016, confidence was renewed in the national economy. As a result, outward FDI decreased by about $2.85 billion per year, in 2016-17, to an average of $13.9 billion. The positive oil prices and improved outlook in 2017 may have played a significant role in stemming outflows, which were evident in some Emerging Economies during this period.

As shown above, GCC countries, in general, experienced a decrease in the annual inflow of FDI following the collapse in oil prices in 2014; albeit, a recovery took place in 2017. Meanwhile, FDI outflows continued as Gulf investors sought to mobilize resources in search for opportunities abroad, against the backdrop of rising risks and fewer opportunities in non-oil activities in the domestic markets.

Table 1. FDI Flows to the GCC Countries

In billions of Dollars

	2014			2015			2016			2017		
	Inflow	Outflow	Net	Inflow	Outflow	Net	Inflow	Outflow	Net	Inflow	Outflow	Net
UAE	11.1	11.7	-0.6	8.6	16.7	-8.1	9.6	13.0	-3.4	10.4	14.0	-3.6
Saudi Arabia	8.0	5.4	2.6	8.1	5.4	2.7	7.5	8.9	-1.4	1.4	5.6	-4.2
Bahrain	1.5	-0.3	1.2	.07	3.2	-3.1	0.2	-0.9	-0.7	0.5	0.2	0.3
Oman	1.3	1.4	-0.1	-2.2	0.3	-2.5	1.7	0.4	1.3	1.9	0.4	1.5
Qatar	1.0	6.7	-5.7	1.1	4.0	2.9	0.7	7.9	-7.2	0.1	1.7	-1.6
Kuwait	1.0	-10.5	-9.5	0.3	5.4	-5.1	0.4	4.5	-4.1	0.3	8.1	-7.8

2.2 Consumer Price Index and Inflation

The fading effects of excise taxes, the ease in the transportation component, and the continued decline in the housing sector significantly impacted the CPI inflation in Q4 2018 as it eased Y-o-Y to reach 1.1% compared to 3.6% in the previous quarter. Non-tradable prices, which account for around 66% of the consumption basket, were the main contributor to the ease in headline inflation as they declined Y-o-Y by 0.7%, whereas prices of tradables eased to Y-o-Y 4.8% compared to a rise of 1.3% and 8.2% in the previous quarter, respectively (See table 2.2). Accordingly, the average CPI inflation in 2018 stood at 3.1% compared to 2.0% in 2017.

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

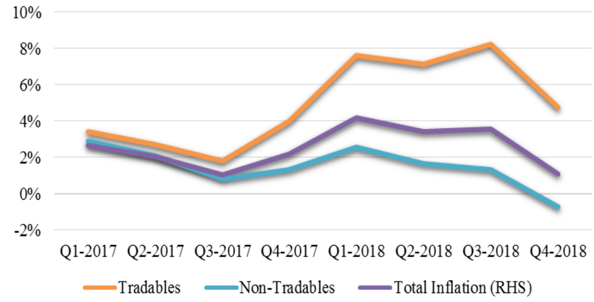
	Weight	Y-o-Y			
	%	Q1-18	Q2-18	Q3-18	Q4-18
Total Inflation	100	4.2%	3.4%	3.6%	1.1%
Tradables	34	7.6%	7.1%	8.2%	4.8%
Food and soft drinks	14.3	6.2%	3.4%	2.9%	1.7%
Beverages and tobacco	0.3	84.2%	84.1%	86.5%	8.5%
Textiles, clothing and footwear	3.2	8.6%	14.0%	20.0%	18.0%
Furniture and household goods	5.6	4.2%	4.6%	5.3%	4.3%
Transportation	7.3	10.7%	11.3%	15.7%	6.6%
Miscellaneous goods and services	3.2	5.0%	4.8%	2.7%	1.5%
Non-Tradables	64	2.6%	1.7%	1.3%	-0.7%
Housing	34.1	-0.7%	-2.5%	-4.0%	-5.2%
Medical care	1.4	0.0%	0.1%	-0.1%	-0.1%
Transportation	7.3	10.7%	11.3%	15.7%	6.6%
Communications	5.4	3.2%	3.8%	3.7%	3.6%
Recreation and culture	3.2	6.9%	9.4%	10.5%	7.5%
Education	7.7	4.7%	4.6%	4.8%	2.5%
Restaurants and hotels	4	9.1%	6.7%	7.4%	6.7%
Miscellaneous goods and services	3.2	5.0%	4.8%	2.7%	1.5%

Source: Federal Competitiveness and Statistics Authority (FCSA).

Prices of tradables eased Y-o-Y to 4.8% in Q4 2018 from an increase of 8.2% in the previous quarter. Food and soft drinks, which account for 14.3% of the consumption basket, were behind the recent developments in tradables prices as it eased to 1.7% compared to an increase of 2.9% in the previous quarter.

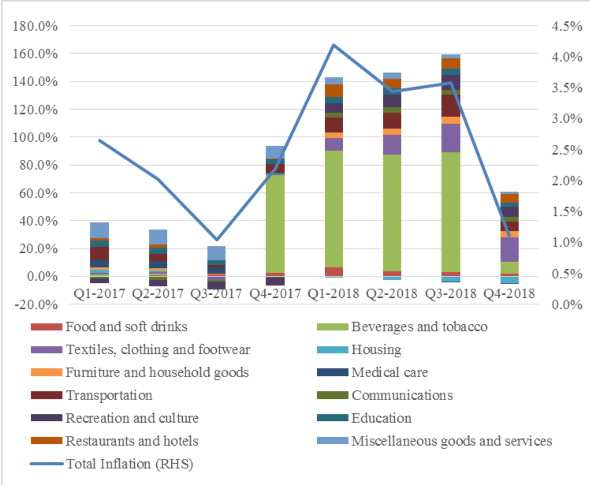
Moreover, the beverages and tobacco group price inflation decreased markedly Y-o-Y from 86.5% in Q3 2018 to 8.5% in Q4 2018 as the base effect of excise taxes has faded during the last quarter of 2018. In addition, textiles, clothing and footwear eased mildly to 18% compared to a 20% increase in the previous quarter.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

Figure 2.2.b. Contribution of Different Sub-Components to the Total CPI Inflation (%, Y-o-Y)



Source: Federal Competitiveness and Statistics Authority (FCSA).

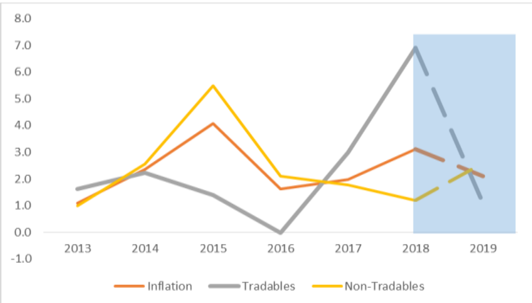
The decline in non-tradable prices came as a result of the continued decline in the price of housing, electricity, gas and water—accounting for 34% of the consumption basket—as it decreased in Q4 2018 Y-o-Y by 5.2% compared to a similar decline in the previous quarter.

The decline in the housing sub-group prices was in part a reflection of falling rent of residential and retail units Prices declined Y-o-Y by 10.4% and 10.3% in Abu Dhabi and Dubai, respectively, in the final quarter of 2018—following a decline of 11.3% and 9.6% in the previous quarter—reaching 68.2 and 61.4 (AED/SQM) in Abu Dhabi and Dubai, respectively.

Furthermore, transportation in Q4 2018 eased Y-o-Y to 6.6% compared to an increase of 15.7% due to a moderation in domestic petroleum products prices—consistent with the decline of oil prices in international markets. In addition, prices of education, recreation and culture, and restaurants and hotels eased to 2.5%, 7.5%, and 6.7% in Q4 2018 compared to an increase of 4.8%, 10.5%, and 7.4%, respectively, in the previous quarter.

Inflation, excluding housing and transportation, eased in the fourth quarter of 2018 to reach Y-o-Y 4.0% from a 5.7% increase in the previous quarter, mainly due to the ease in prices of tradables and the decline in prices of non-tradables. Nonetheless, Inflation, excluding housing and transportation, rose in 2018 by 5.3% compared to 2.2% increase in 2017.

Figure 3. Inflation Data for 2018 & Forecast for 2019



Source: CBUAE

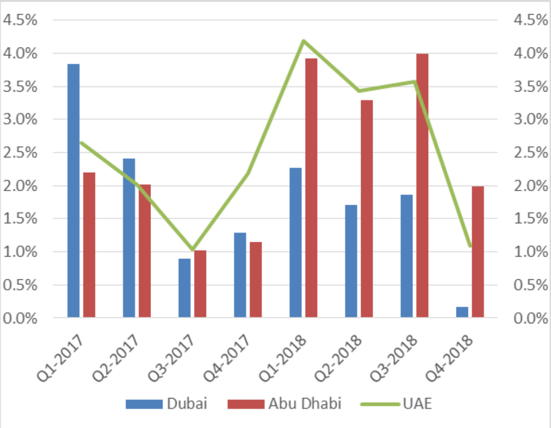
As for 2019, the CBUAE projects that inflation will ease to reach 2.1% owing to some expected softening in international commodity prices in general and oil prices in particular. Prices of tradable goods and services are projected to grow at 1.1% as the VAT inflationary effect imposed in the beginning of 2018 fades; whereas, non-tradable price inflation would increase by 2.6% in line with the projected recovery in non-energy growth and employment.

Box 4 illustrates the recent developments in CPI inflation by emirates in Q4 2018.

Box 4: Inflation in the UAE: Comparison By Emirate

One-off tax administration measures have significantly influenced inflation rates in the UAE in 2018. The implementation of excise taxes on tobacco and beverages in Q4 2017, along with the inception of VAT tax at the beginning of January 2018 have put inflation on an upward path. However, inflationary pressures have eased in Q4 2018 driven by the decline in the price of housing, water, electricity and gas group as well as the decline in oil products' prices in international markets—passed through to the domestic gasoline prices.

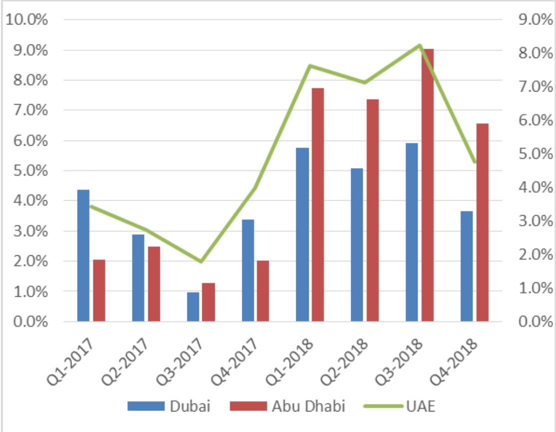
Figure 1. Quarterly Y-o-Y Headline Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD, DSC and Central Bank of the UAE

The inflation rate in the UAE reached Y-o-Y 1.1% in Q4 2018 compared to 3.6% in the previous quarter. At the Emirate level, inflation eased Y-o-Y to 2% and 0.2% in Abu Dhabi and Dubai, respectively, compared to 4% and 1.9% in the previous quarter (see Figure 1).

Figure 2. Quarterly Y-o-Y Tradable Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



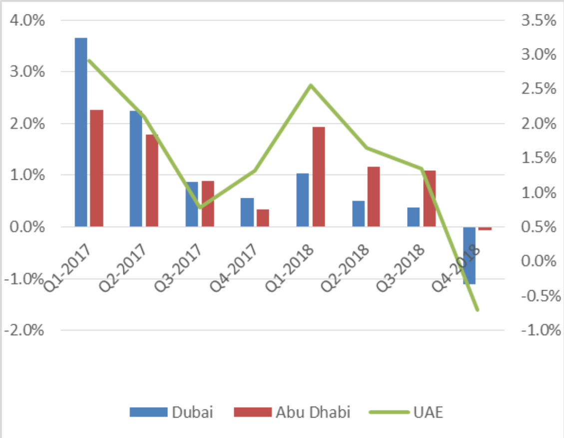
Source: FCSA. SCAD, DSC and Central Bank of the UAE

The slowdown in Q4 2018 of CPI inflation in both Emirates resulted from the decline in non-tradable prices Y-o-Y by 0.1% and 1.1% in Abu Dhabi and Dubai compared to a mild increase of 1.1% and 0.4%, respectively. In addition, tradable prices eased to 6.6% and 3.7% Y-o-Y during the same period in Abu Dhabi and Dubai from 9% and 5.9% in the previous quarter, respectively.

The decline in non-tradable prices came as a result of the continued decline in the housing, electricity, gas and water group in both Emirates, which moderated Y-o-Y by 3.7% and 4.7% in Abu Dhabi and Dubai compared to a decline of 4% and 3.6% in Q3, respectively. Consequently, non-tradable prices declined in the UAE during the fourth quarter Y-o-Y by 0.7% compared to an increase of 1.3% in the previous quarter (see figure 3).

In addition, recreation & culture, education, and restaurants and hotels group eased Y-o-Y in the fourth quarter of 2018 from 10.5%, 4.8%, and 7.4% to 7.5%, 2.5%, and 6.7%, respectively. Prices of the same group of services registered a decrease in both Emirates—from 13.3%, 5.6%, and 5.1% to 9.0%, 3.2%, and 5.1% in Abu Dhabi, respectively; as well as in Dubai from 5.4% 2.5%, and 11% to 5%, 1.0%, and 9.5%, respectively.

Figure 3. Quarterly Y-o-Y Non-Tradeable Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD, DSC and Central Bank of the UAE

It is worth noting that tradable prices eased in both Emirates to 6.6% and -0.1% in Abu Dhabi and Dubai, respectively. Transportation was heavily affected by a Y-o-Y ease in oil prices of 9.8% reaching USD 67.5 per barrel in Q4 2018 from USD 75.2 per barrel in the previous quarter, which contributed to the slowdown in the prices of domestic fuel derivatives, in line with the international price. Therefore, tradable prices in the UAE eased Y-o-Y to 4.8% in Q4 2018 compared to an increase of 8.2% in the previous quarter (see figure 2).

Furthermore, prices of clothing and footwear recorded a slowdown of 18% Y-o-Y in Q4 2018 compared to an increase of 20% in the previous quarter. Consistently, prices of these items eased in Dubai and Abu Dhabi by 4.4% and 26.2%, respectively.

Meanwhile, prices of tobacco products slowed down due to the fading effect of the excise taxes as they rose Y-o-Y by 8.5% in Q4 2018 compared to a surge of 86.5% in the previous quarter. Similarly, tobacco prices eased to 8.6% in Abu Dhabi and 12.3% in Dubai during the same period compared to 102.9% and 78.5%, respectively, in the third quarter of 2018.

Differences in inflation rates across Emirates are attributed to the weights of the different components in the consumption basket (Table 1). For instance, the Transportation category, which accounts for a large weight in the tradeable inflation, has a lower weight in Dubai than in Abu Dhabi as well as in the UAE aggregate consumption basket. Similarly, in Dubai, the Housing category has a larger weight compared to Abu Dhabi and the UAE.

Table 1. Weights Assigned for the Different Categories per Statistic Authority

CPI Main Groups	UAE	Abu Dhabi	Dubai
Food and Beverages	14.3%	12.3%	13.1%
Tobacco	0.3%	0.2%	0.4%
Textiles, Clothing and Footwear	3.2%	5.4%	2.0%
Housing, Water, Electricity, Gas	34.1%	31.2%	43.6%
Furniture and Household Goods	5.6%	7.2%	3.8%
Medical Care	1.4%	1.6%	0.8%
Transportation	14.6%	14.7%	10.6%
Communications	5.4%	5.0%	5.2%
Recreation and Culture	3.2%	4.8%	2.3%
Education	7.7%	6.9%	8.5%
Restaurants and Hotels	4.0%	3.8%	4.0%
Miscellaneous Goods and Services	6.3%	7.0%	5.6%

Source: FCSA. SCAD and DSC

2.3 Employment and Labor Market Dynamics

The developments in the private sector labor market in Q4 2018 reveal a softening in employment. The decline in employment was driven by the construction sector Services, manufacturing, transport storage and communications, continued to decline on an annual basis reflecting a softening in the labor market due to firms trying to cut costs and increase their competitiveness. Employment in the real estate sector eased in Q4 2018.

Overall, the dynamics in the private sector's employment clearly indicate that companies are trying to increase their competitiveness through cost cutting, which drove a correction process in the labor market. Therefore, at the aggregate level, private employment growth in the UAE declined Q-o-Q by 0.6% in Q4 2018 compared to a softer decline of 0.05% in the previous quarter.

2.4 Exchange Rate Fluctuations

On a quarterly basis, the Dirham has appreciated against the currencies of top 10 non-dollarized import and non-oil export partners, due to the strengthening of the US dollar, by 0.74% and 0.3%, respectively. Similarly, on a Y-o-Y basis, the Dirham appreciated against top 10 non-dollarized import and non-oil export partners by 3.55% and 6.09%, respectively.

On the imports side, the Dirham has appreciated in the fourth quarter of 2018 against its top 10 non-Dollarized import partners, which account for 52.3% of the total imports, to reach 3.55% Q-o-Q (see Table 2.4.a.), compared to an appreciation of 3.08% in the previous quarter. Further, the Dirham gained more momentum against emerging market economies' currencies, which depreciated more sharply during the fourth quarter.

Bilateral exchange rates show that the Dirham appreciated mainly against the Chinese Yuan (China has the largest weight in the import basket, around 18.7%) by Q-o-Q 1.57%. Furthermore, the Dirham appreciated against the Indian Rupee Q-o-Q by 2.73% compared to a higher appreciation of 4.7% in the previous quarter.

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

Imports	Share of total imports	Q-o-Q		Y-o-Y	
		Q3 2018	Q4 2018	Q3 2018	Q4 2018
China	**18.72**	6.70	1.57	2.14	4.66
India	**7.85**	4.70	2.73	9.09	11.34
Japan	**5.43**	2.17	1.12	0.46	-0.11
Germany	**4.61**	2.44	1.96	1.02	3.27
South Korea	**3.09**	3.75	0.57	-1.02	1.91
Turkey	**2.95**	29.87	-3.23	61.64	44.51
Italy	**2.64**	2.44	1.96	1.02	3.27
UK	**2.63**	4.29	1.40	0.40	3.30
France	**2.44**	2.44	1.96	1.02	3.27
Switzerland	**1.96**	-0.16	1.22	2.19	0.91
Weighted Average	**52.32**	3.08	0.74	3.08	3.55

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

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

Exports	Share of total exports	Q-o-Q		Y-o-Y	
		Q3 2018	Q4 2018	Q3 2018	Q4 2018
India	**10.65**	4.70	2.73	9.09	11.34
Turkey	**9.14**	29.87	-3.23	61.64	44.51
Iraq	**4.68**	0.04	-0.03	1.50	0.93
China	**3.52**	6.70	1.57	2.14	4.66
Singapore	**3.10**	2.49	0.55	0.53	1.59
South Korea	**3.03**	3.75	0.57	-1.02	1.91
Switzerland	**2.53**	-0.16	1.22	2.19	0.91
Pakistan	**2.04**	6.08	8.37	17.58	26.10
Netherlands	**1.74**	2.44	1.96	1.02	3.27
Japan	**1.67**	2.17	1.12	0.46	-0.11
Weighted Average	**45.77**	3.79	0.30	7.11	6.09

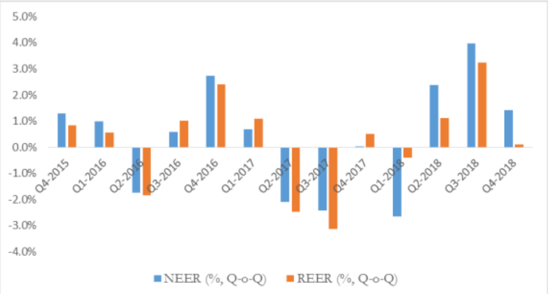
Source: Data on Import shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2017. Data for the bilateral exchange rates are the quarterly average observations, recorded and reported by Bloomberg.

Moreover, the Dirham appreciated against the Japanese Yen (1.12%), the Euro (1.96%), the Sterling pound (1.40%), and the Swiss Franc (1.22%). However, the Dirham depreciated against the Turkish Lira Q-o-Q by 3.23% compared to an appreciation of 29.87% in the previous quarter.

Using non-oil export weights, the Dirham exhibited Q-o-Q appreciation of 0.3% against the currencies of the top 10 Non-Dollarized exports' partners (see Table 2.4.b.) compared to Q-o-Q appreciation of 3.79% during the previous quarter. The appreciation was mainly due to the Dirham gains against the Indian Rupee, Chinese Yuan, and the Swiss Franc by 2.73%, 1.57%, and 1.22%, respectively.[2]

Furthermore, the Dirham gained against other currencies of the main trading partners. It appreciated against the Singapore dollar (0.55%), the South Korean won (0.57%), the Pakistani rupee (8.37%), and the Japanese Yen (2.17%). However, the Dirham remained relatively stable against the Iraqi Dinar, depreciating Q-o-Q only by 0.03%

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



Source: Bank for International Settlement (BIS)

Accounting for all of the UAE's major trading partners, the Nominal Effective Exchange Rate (NEER) has displayed the same pattern as the weighted change of the Dirham against major import and Non-Oil export partners. In particular, the average NEER increased by 1.4% in the fourth quarter of 2018, compared to a surge of 4% in the previous quarter (see Figure 2.4.a.).

In real terms, the Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, appreciated by 0.1% in the fourth quarter of 2018 compared to a rise of 3.2% in the previous quarter.

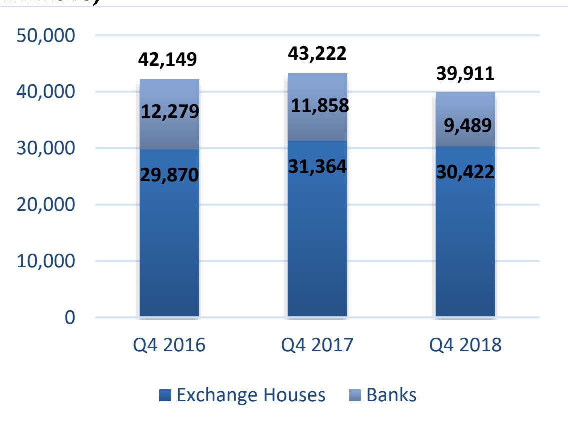
Box 6 presents the developments in the outward remittances and the effects of developments in the exchange rate on bilateral flows, while Box 7 assesses the impact of the exchange rate on the indicators of the tourism industry.

[2] India, China, and Switzerland account for 16.7% of the total non-oil exports of the UAE.

Box 6: Outward Personal Remittances from the UAE

The outward personal remittances[3] in the period of October-December 2018 registered AED 39.9 billion, a decline of 7.7% or AED 3.3 billion compared to the same period of 2017 (AED 43.2 billion) (Figure 1). During the fourth quarter of 2018, the outward personal remittances that were settled through the banks decreased from AED 11.9 billion in the third quarter of 2017 to AED 9.5 billion in the same period of 2018 (declining by 20% or AED 2.4 billion). Meanwhile, the outward personal remittances that were settled through the exchange houses registered AED 30.4 billion (declining by 5.8% or AED 0.9 billion compared to the same period of 2017).

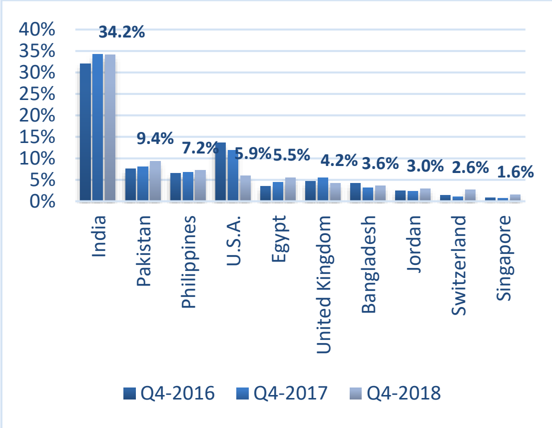
Figure 1. Evolution of outward personal remittances settled through Banks and Exchange houses, October-December 2016-2018 (AED Millions)



Source: CBUAE

The most important destination country for outward personal remittances during the fourth quarter of 2018 was India, accounting for 34.2% of the total outflows (Figure 2). This high share is in accordance with the significant share of expats from India working in the UAE. According to the latest (2018) UAE population statistics published by the Global Media Insight, 59.5% of the expat population in the UAE originate from South Asian countries, and expats from India account for 27.5% of the total expat population in the UAE. The next five most important countries in the share of outflows of personal remittances were Pakistan (9.4%), Philippines (7.2%), the United States of America (5.9%), and Egypt (5.5%) (Figure 2).

Figure 2. Share of the major countries for outward personal remittances during October-December 2016-2018 (percentage of total, exchange houses and banks)

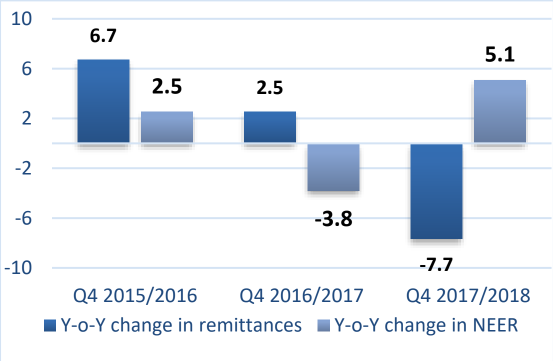


Source: CBUAE, Banking Supervision Department

The annual growth of outward personal remittances during October-December of 2018 is -7.7% (Figure 3). The average nominal effective exchange rate of the dirham in the same period was 121.5 based on data provided by the Bank for International Settlements (BIS)— an appreciation rate of 5.1% compared to average of 115.7 for the fourth quarter of 2017. Despite continued dirham appreciation, there has been a slow down in personal remittances outflow in line with employment slowdown.

[3] The data capture the outward personal remittances reported from the exchange houses and the banks to the CBUAE's Banking Supervision Department (BSD).

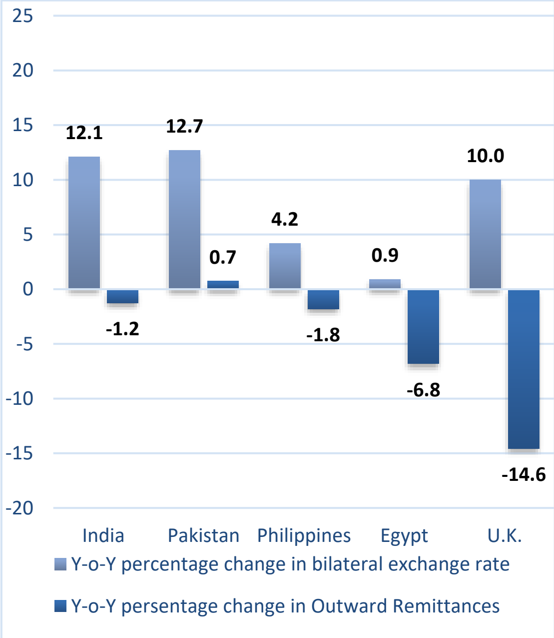
Figure 3. Percentage change of total outward personal remittances versus the percentage change of nominal effective exchange rate, October-December 2016-2018



Source: CBUAE, Bank of International Settlements

Figure 4 depicts the percentage change of outward personal remittances from the UAE to the top destination countries compared to the evolution of the bilateral exchange rate of the dirham relative to the currencies of the recipient countries. For the fourth quarter of 2018, the remittances outflows to India, Philippines, Egypt, and the United Kingdom decreased, despite the dirham's appreciation relative to the respective currencies of the destination countries. In parallel, there was some increase for outward remittances to Pakistan in consistency with the appreciation of the dirham relative to the local currency.

Figure 4. Percentage change of outward personal remittances of top countries versus the percentage change of the bilateral exchange rate with the dirham October-December 2017-2018



Source: CBUAE,; Bloomberg

Box 7: Tourism Activity in the UAE

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

The combined number of international tourists in the Emirates of Abu Dhabi and Dubai in the period of **October-November 2018** registered an increase of 2.6% compared to the same period in 2017 **(Figure 1)**. This increase signaled a rebound for the two emirates in attracting international visitors after a slowdown in tourism during the previous two quarters of 2018 (Table 1). Meanwhile, the average daily rate and the revenue per available room decreased by 4.8% and 8.2%, respectively, compared to the same period last year, due to continuous discounts offered by hotels in the two emirates. As a result, the occupied room nights for October-November 2018 increased by 2.7%, compared to the same period in 2017.

Table 1: Major combined indicators of Dubai & Abu Dhabi inbound tourism 2018-17 (% difference)

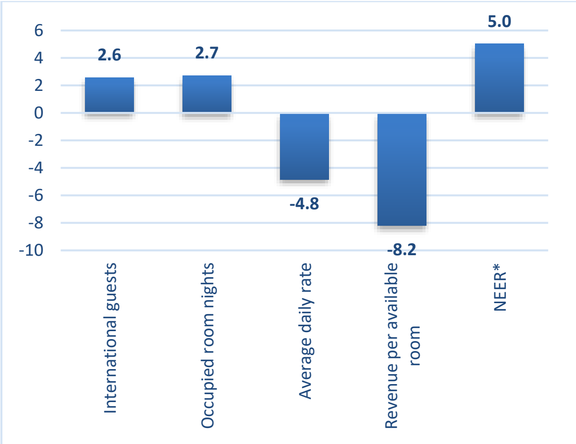
	% Difference 2018-2017			
	Q1	Q2	Q3	Oct-Nov
International Guests	3.6	-1.1	0.2	2.6
Occupied room nights	5.9	2.8	1.8	2.7
Average daily rate	-4.8	-6.8	-5.3	-4.8
Revenue per available room	-3.9	-8.9	-7.9	-8.2
NEER	-7.0	-2.8	3.6	5.0

Source: Staff Calculation, based on data published by Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bank for International Settlements
*nominal effective exchange rate

Figure 2 shows the effect of the bilateral exchange rate movements (average) on tourism during October-November 2018 compared to the same period of 2017. Among the international visitors, tourists from Philippines, Egypt, and China registered relatively high increase of 11%, 10.8%, and 7.1%, respectively, despite depreciation of their currencies relative to the AED. The incoming tourists from Germany, India and Pakistan increased at a slower pace by 4.4%, 2%, and 0.3%, respectively.

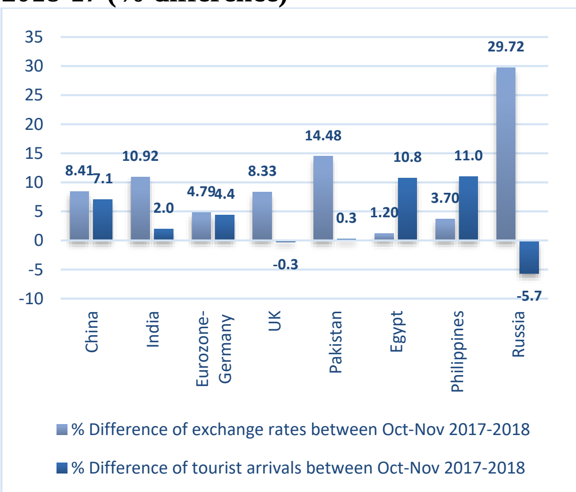
Incoming tourists from Russia and the UK, however, decreased by 5.7% and 0.3%, respectively, possibly due to the depreciation of their currencies relative to the AED.

Figure 1: Major combined indicators of Dubai & Abu Dhabi inbound tourism October-November 2018-17 (% difference)



Source: Staff Calculation, based on data published by Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bank for International Settlements
*nominal effective exchange rate

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

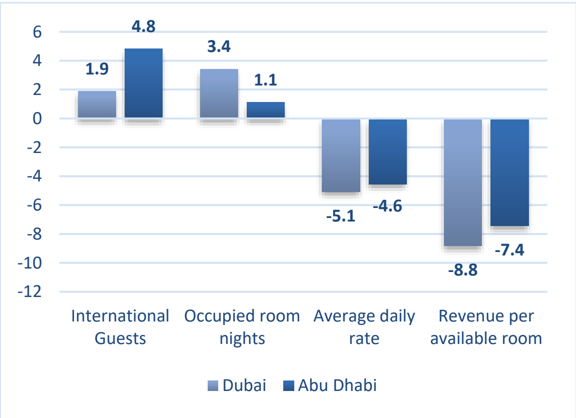


Source: Staff Calculation, based on data published by Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bloomberg

In figure 3, the data for the Dubai emirate indicate that the number of international visitors increased by 1.9% during October-November 2018 compared to the same period of 2017. However, the average daily rate and the revenue per available room decreased by 5.1% and 8.8%, respectively. This evolution resulted in an increase in occupied room nights by 3.4%.

International visitors to the Abu Dhabi emirate increased by 4.8% during October-November of 2018 compared to the same period of 2017. Nevertheless, the reduction in the average room rate by 4.6% contributed to the decrease in total revenues by 7.4% in October-November 2018 compared to the same period of 2017.

Figure 3: Major indicators of Dubai & Abu Dhabi inbound tourism October-November 2018 (% difference)

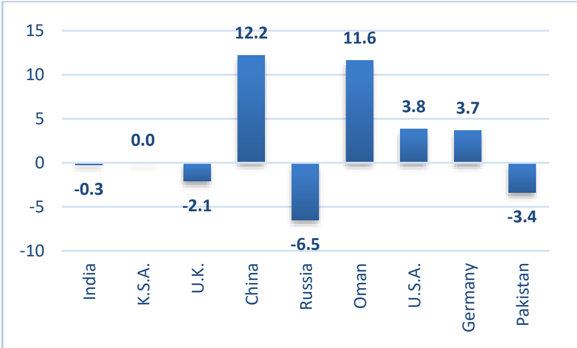


Source: Staff Calculation, based on data published by Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority

Countries that are the major markets for inbound tourism to Dubai show increase in the arrivals of tourists with the highest increase recorded for China (12.2%), Oman (11.6%), USA (3.8%), and Germany (3.7%). The vast majority of tourists to Dubai originate from GCC countries and the MENA region (28% combined, 18% and 10%, respectively), while Western Europe and North America cover 21% and 6% of inbound tourism. Finally, 18% of inbound tourism comes from the region of South Asia. For the Abu Dhabi Emirate, most of the countries that are major markets of inbound tourism recorded increase in guest arrivals, except for China.

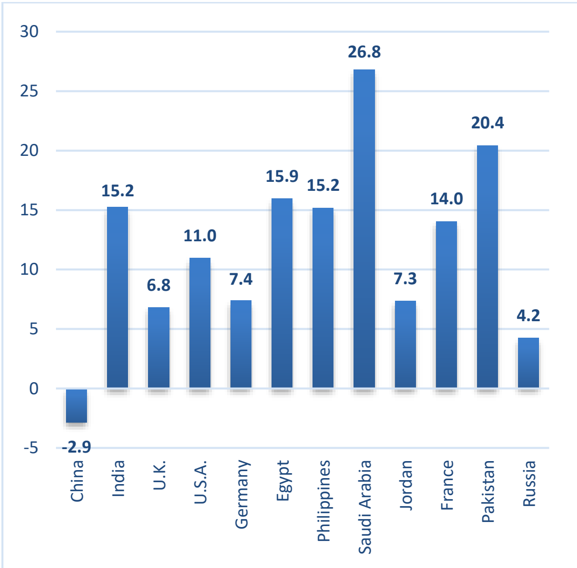
Figure 4. Major markets of inbound tourism January-November 2018-17 (% difference)

a. Dubai



Source: Staff Calculation, based on data published by Dubai Corporation of Tourism and Commerce Marketing

b. Abu Dhabi



Source: Staff Calculation, based on data published by Abu Dhabi Tourism & Culture Authority

2.5 Consolidated Fiscal Stance

Recent increases in oil prices during the second and third quarters of 2018 by 50% and 44.4%, respectively, and ongoing fiscal reforms to diversify sources of non-energy revenues contributed to a rise of total government revenues by 2.4% Y-o-Y compared to 8.1% in the previous quarter Y-o-Y. In particular, tax revenues grew by 66.7%, whereas other revenues declined by 40.1%.

On the expenditure side, total expenses as well as capital spending, measured by the net acquisition of non-financial assets, rose Y-o-Y by 4.8% in Q3 2018. As a result, the Net Operating Balance registered a deficit of AED 5.2 billion in Q3 2018 compared to AED 21.7 billion in the previous quarter (see table 2.5). Accordingly, the Net Operating Balance of the consolidated government finances for the first three quarters of 2018 registered a surplus of AED 28.3 billion compared to AED 31.0 billion during the same period of 2017.

2.5.1 Revenues

Revenues growth rates eased during Q3 2018, reaching 2.4% Y-o-Y compared to 8.1% in the previous quarter. This slowdown came as a result of the decline in other revenues by 40.1% to reach AED 29.4 billion compared to AED 49.1 billion in the same quarter of 2017. Other Revenues capture the property income, sales of goods and services, as well as fines and penalties. It is worth noting that tax revenues increased significantly by 66.7% , compared to a rise of 13.8% in Q2 2018, due to increase in oil prices and production with a positive effect on royalties on oil companies, offsetting the decline in other revenues. Social contributions remained relatively stable at AED 1.3 billion in the third quarter of 2018.

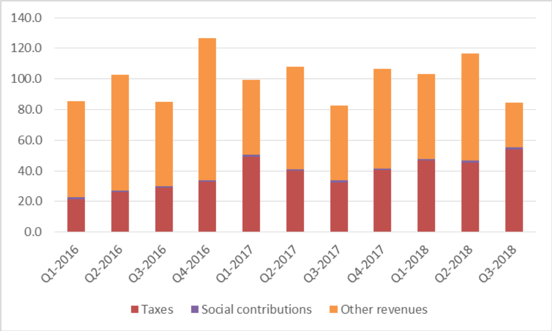
2.5.2 Expenditures

On the expenditure side, total expenses rose Y-o-Y by 4.8% in Q3 2018 compared to a decline of 4.3% in the previous quarter. The increase in expenses is attributable to the rise in grants, other expenses, social benefits, and compensation of employees (representing together around 75.4% of total expenses in Q3 2018) Y-o-Y by AED 16.1 billion; whereas, the use of goods and services and subsidies declined by AED 7.7 billion and AED 4.6 billion, respectively.

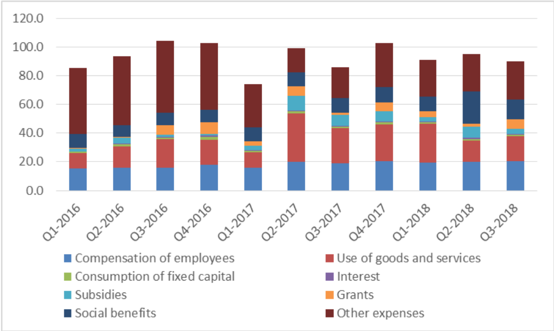
Moreover, consumption of fixed capital rose Y-o-Y by 7.5% in Q3 2018 compared to a decline of 28.4% in the previous quarter. Further, capital spending, measured by the net acquisition of non-financial assets, continued to decline for the sixth consecutive quarter with a Y-o-Y fall of 9.5% in the third quarter of 2018, compared to a decline of 0.5% in the previous quarter Y-o-Y.

Government Finances

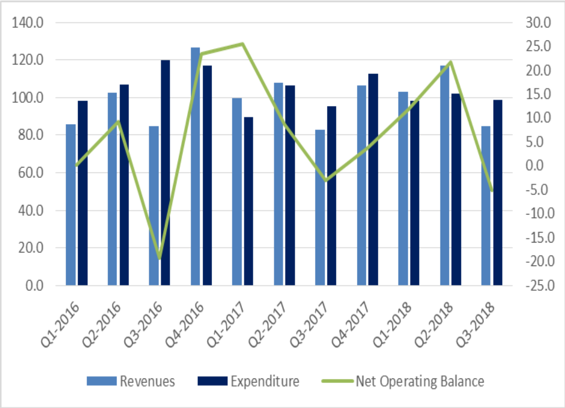
2.5.a. General government revenues (Billions of Dirhams)



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



2.5.c. Fiscal Stance (Billions of Dirhams)



2.5.d. Developments in the Subsidies & transfers to GREs (Billions of Dirhams)

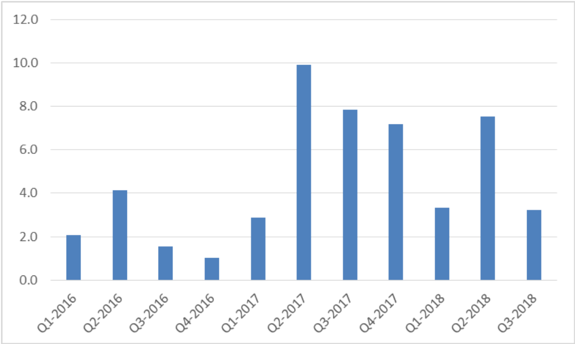


Table. 2.5. Consolidated Government Finances

Billion AED

Consolidated	2016				2017				2018			2017 (% Y-o-Y)				2018 (% Y-o-Y)		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Net Operating Balance	**0.1**	**9.3**	**-19.2**	**23.4**	**25.4**	**8.6**	**-3.0**	**3.7**	**11.8**	**21.7**	**-5.2**	-----	-----	-----	-----	-----	-----	-----
Revenues (a)	**85.7**	**102.7**	**84.9**	**126.5**	**99.6**	**107.9**	**82.8**	**106.3**	**103.1**	**116.7**	**84.7**	**16.2%**	**5.1%**	**-2.5%**	**-15.9%**	**3.5%**	**8.1%**	**2.4%**
Taxes	21.1	26.0	28.9	32.7	49.2	40.0	32.4	40.3	46.5	45.5	54.1	133.1%	53.7%	12.0%	23.3%	-5.4%	13.8%	66.7%
Social contributions	1.5	1.2	1.2	0.9	1.2	1.1	1.3	1.1	1.3	1.3	1.3	-18.0%	-9.4%	8.3%	27.7%	3.9%	24.3%	0.8%
Other revenues	63.1	75.5	54.8	92.9	49.2	66.8	49.1	64.9	55.3	69.9	29.4	-22.1%	-11.4%	-10.5%	-30.1%	12.4%	4.5%	-40.1%
Expenditure (b)	**98.3**	**107.0**	**119.6**	**117.1**	**89.5**	**106.4**	**95.2**	**112.5**	**98.0**	**102.0**	**98.5**	**-9.0%**	**-0.6%**	**-20.4%**	**-3.9%**	**9.5%**	**-4.1%**	**3.4%**
Expense	**85.5**	**93.4**	**104.2**	**103.0**	**74.2**	**99.3**	**85.8**	**102.6**	**91.3**	**95.0**	**89.9**	**-13.3%**	**6.3%**	**-17.7%**	**-0.4%**	**23.0%**	**-4.3%**	**4.8%**
Compensation of employees	15.5	15.8	15.8	18.2	15.9	20.1	18.8	20.4	19.3	20.1	20.6	2.1%	27.6%	19.4%	12.1%	21.7%	-0.3%	9.7%
Use of goods and services	10.4	14.8	19.9	17.1	10.5	33.7	24.9	25.7	27.0	14.5	17.2	1.0%	127.2%	25.0%	50.4%	157.0%	-57.0%	-30.9%
Consumption of fixed capital	1.1	1.5	1.2	2.1	1.3	1.4	1.0	1.4	1.1	1.0	1.1	11.7%	-6.1%	-13.9%	-35.2%	-13.1%	-28.4%	7.5%
Interest	0.2	0.4	0.3	1.0	0.5	0.6	0.3	0.5	0.5	1.1	0.6	103.8%	42.6%	-4.6%	-48.0%	-2.4%	85.1%	111.1%
Subsidies	2.1	4.1	1.6	1.0	2.9	9.9	7.9	7.2	3.3	7.5	3.2	38.4%	139.3%	406.3%	605.6%	15.9%	-23.9%	-58.8%
Grants	0.5	0.5	6.9	8.0	3.3	6.7	1.2	6.1	3.8	2.5	6.7	625.6%	1169.8%	-82.9%	-23.9%	15.6%	-62.7%	464.0%
Social benefits	9.3	8.4	8.5	9.0	9.8	10.1	10.3	10.9	10.5	22.1	14.0	4.6%	19.4%	21.8%	20.4%	7.5%	119.6%	35.9%
Other expenses	46.3	47.8	50.1	46.6	30.1	16.8	21.4	30.5	25.6	26.1	26.5	-35.1%	-64.9%	-57.2%	-34.6%	-14.7%	55.5%	23.5%
Net acquisition of non-financial assets	**12.8**	**13.6**	**15.4**	**14.1**	**15.3**	**7.1**	**9.5**	**9.9**	**6.7**	**7.0**	**8.6**	**19.5%**	**-48.1%**	**-38.6%**	**-29.9%**	**-56.0%**	**-0.5%**	**-9.5%**

Source: Federal Competitiveness and Statistics Authority (FCSA).

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

Chapter 3. Banking and Financial Developments

Deposits at banks continued to rise in the fourth quarter of 2018. This increase in tandem with sufficient liquidity and higher demand for credit allowed banks to increase lending, particularly to the private and Government sectors. Based on the Financial Soundness Indicators (FSIs), the overall soundness of the banking system in the UAE remains positive.

3.1 Banking Landscape

The 22 national banks have decreased the number of branches to 743 at the end of 2018 Q4 compared to 751 at the end of 2018 Q3. The number of foreign banks has remained unchanged at 27 from the previous quarter and the number of foreign banks branches decreased by one, from 81 at the end of 2018 Q3 to 80 at the end of 2018 Q4. At the same time, the number of employees for national and foreign banks has increased from 30,232 and 5,559 at the end of 2018 Q3 to a headcount of 30,966 and 5,663, respectively, at the end of the fourth quarter of 2018.

3.1.1. Banks' Deposits

Total Customer Deposits at banks increased in the fourth quarter of 2018 by AED 27.4bn. Resident Deposits increased by AED 19.4bn, while Non-resident Deposits increased by AED 8bn.

The growth in Resident Deposits in 2018 Q4 is essentially due to the steady rise in all components, but mainly by Government and GREs sectors deposits driven by the recovering oil prices and ongoing fiscal reforms. The Non-Resident deposits rose also during the fourth quarter of 2018, at a lower rate compared to previous quarter, with their share in total deposits increasing from the previous quarter to 12.2%.

Deposits by the type of banks, i.e., Conventional vs. Islamic banks, represent respectively 77.1% and 22.9% of total deposits. Figures 3.1.1.a and 3.1.1.b, and Table 3.1.1.b show that in the fourth quarter of 2018 there is a slight hike in Islamic banks' deposits while for the Conventional banks they grew more substantially. Similarly, on a Y-o-Y basis, the increase of Islamic banks' deposits was lower than that of the Conventional banks. Looking at the subcategories, the growth drivers for the Conventional banks in the fourth quarter were mainly from the Government and GREs sectors whereas public deposits in Islamic banks were decreasing. The NBFIs and Non-resident deposits in Islamic banks rose more than in Conventional banks and were the main drivers for the deposit growth for the Shari 'a compliant lenders.

Table 3.1.1.a. Deposits at UAE Banks

	2017	2018			
	Dec	**Mar**	**Jun**	**Sep**	**Dec***
Bank Deposits	**1627.3**	**1662.4**	**1684.3**	**1728.2**	**1755.6**
(Q-o-Q change %)	2.0	2.2	1.3	2.6	1.6
(Y-o-Y change %)	4.1	3.8	6.0	8.3	7.9
Resident Deposits	**1435.6**	**1472.9**	**1494.2**	**1522.8**	**1542.2**
(Q-o-Q change %)	2.0	2.6	1.4	1.9	1.3
(Y-o-Y change %)	5.3	4.2	6.0	8.2	7.4
Government Sector	**212.0**	**233.2**	**250.6**	**285.9**	**290.3**
(Q-o-Q change %)	5.4	10.0	7.5	14.1	1.5
(Y-o-Y change %)	13.5	20.2	27.3	42.1	36.9
GREs	**191.5**	**201.3**	**191.8**	**192.7**	**205.4**
(Q-o-Q change %)	4.9	5.1	-4.7	0.5	6.6
(Y-o-Y change %)	14.0	4.8	1.2	5.3	7.3
Private Sector	**1001.0**	**1007.7**	**1020.4**	**1010.1**	**1011.0**
(Q-o-Q change %)	0.9	0.7	1.3	-1.0	0.1
(Y-o-Y change %)	2.1	0.9	3.7	1.8	1.0
NBFI	**31.1**	**30.7**	**31.4**	**34.1**	**35.5**
(Q-o-Q change %)	-1.0	-1.3	2.3	8.6	4.1
(Y-o-Y change %)	10.3	7.0	-20.1	8.6	14.1
Non-Resident Deposits	**191.7**	**189.5**	**190.1**	**205.4**	**213.4**
(Q-o-Q change %)	1.8	-1.1	0.3	8.0	3.9
(Y-o-Y change %)	-3.7	0.3	5.7	9.1	11.3

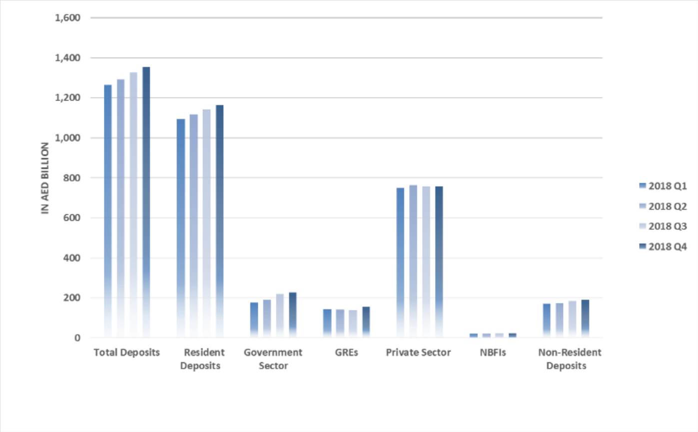
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

Table 3.1.1.b. Deposits at Conventional/Islamic Banks

	Conventional		Islamic	
	2018	2018	2018	2018
	Sep	Dec*	Sep	Dec*
Bank Deposits	**1327.6**	**1354.0**	**400.6**	**401.6**
(Q-o-Q change %)	2.8	2.0	2.1	0.2
(Y-o-Y change %)	8.9	8.9	6.5	4.6
Share of Total, %	76.8	77.1	23.2	22.9
Resident Deposits	**1142.1**	**1163.2**	**380.7**	**379.0**
(Q-o-Q change %)	2.2	1.8	1.1	-0.4
(Y-o-Y change %)	9.4	9.3	4.6	2.2
Share of Total, %	75.0	75.4	25.0	24.6
Government Sector	**220.1**	**226.6**	**65.8**	**63.7**
(Q-o-Q change %)	16.1	3.0	7.7	-3.2
(Y-o-Y change %)	49.5	42.5	21.9	20.2
Share of Total, %	77.0	78.1	23.0	21.9
GREs	**140.0**	**153.7**	**52.7**	**51.7**
(Q-o-Q change %)	-1.5	9.8	6.0	-1.9
(Y-o-Y change %)	10.3	15.7	-6.1	-11.9
Share of Total, %	72.7	74.8	27.3	25.2
Private Sector	**758.6**	**758.7**	**251.5**	**252.3**
(Q-o-Q change %)	-0.8	0.0	-1.6	0.3
(Y-o-Y change %)	1.9	1.2	1.5	0.3
Share of Total, %	75.1	75.0	24.9	25.0
NBFI	**23.3**	**24.2**	**10.8**	**11.3**
(Q-o-Q change %)	8.4	3.9	9.1	4.6
(Y-o-Y change %)	-7.5	3.9	74.2	44.9
Share of Total, %	68.3	68.2	31.7	31.8
Non-Resident Deposits	**185.6**	**190.8**	**19.8**	**22.6**
(Q-o-Q change %)	6.6	2.8	23.8	14.1
(Y-o-Y change %)	5.4	6.7	62.3	76.6
Share of Total, %	90.4	89.4	9.6	10.6

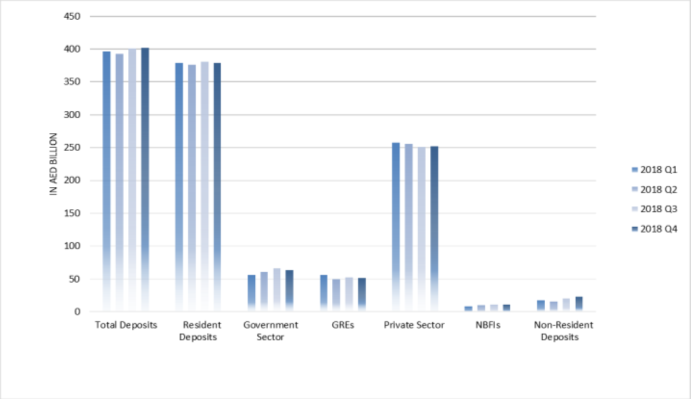
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

The breakdown of National and Foreign banks in Figures 3.1.1.c and 3.1.1.d shows that National banks experienced a stronger increase in deposits compared to the Foreign banks Q-o-Q in 2018 Q4. National banks' deposits were growing Q-o-Q and Y-o-Y, in contrast to the Foreign banks for which deposits declined on an annual and quarterly basis. At the end of 2018, 88.8% of the total deposits are held in National banks and 11.2% are in Foreign banks.

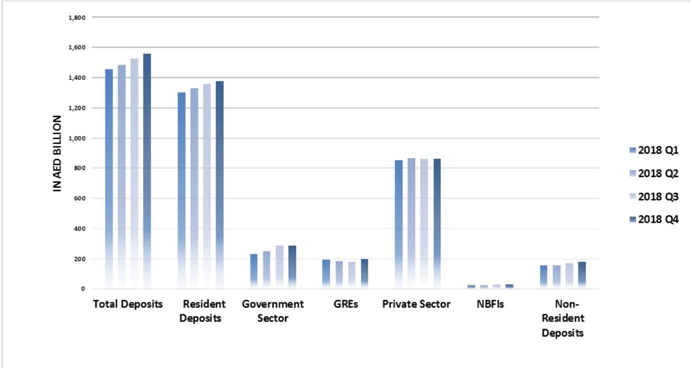
Table 3.1.1.c. Deposits at UAE National/ Foreign Banks

	National		Foreign	
	2018	2018	2018	2018
	Sep	Dec*	Sep	Dec*
Bank Deposits	**1,526.4**	**1,558.7**	**201.8**	**196.9**
(Q-o-Q change %)	2.8	2.1	1.4	-2.4
(Y-o-Y change %)	9.7	9.8	-1.4	-5.1
Share of Total, %	88.3	88.8	11.7	11.2
Resident Deposits	**1,355.4**	**1,378.2**	**167.4**	**164.0**
(Q-o-Q change %)	2.0	1.7	1.0	-2.0
(Y-o-Y change %)	9.7	9.3	-2.4	-5.9
Share of Total, %	89.0	89.4	11.0	10.6
Government Sector	**284.6**	**288.5**	**1.3**	**1.5**
(Q-o-Q change %)	14.3	1.4	-13.3	15.4
(Y-o-Y change %)	42.7	37.5	-27.8	-21.1
Share of Total, %	99.5	99.5	0.5	0.5
GREs	**180.2**	**197.6**	**12.5**	**7.8**
(Q-o-Q change %)	-2.5	9.7	78.6	-37.6
(Y-o-Y change %)	2.2	8.3	89.4	-14.3
Share of Total, %	93.5	96.2	6.5	3.8
Private Sector	**862.1**	**861.5**	**148.0**	**149.5**
(Q-o-Q change %)	-0.7	-0.1	-2.7	1.0
(Y-o-Y change %)	3.4	2.2	-6.3	-5.4
Share of Total, %	85.3	85.2	14.7	14.8
NBFI	**28.6**	**30.3**	**5.5**	**5.2**
(Q-o-Q change %)	9.2	5.9	5.8	-5.5
(Y-o-Y change %)	9.2	16.5	5.8	2.0
Share of Total, %	83.9	85.4	16.1	14.6
Non-Resident Deposits	**171.0**	**180.5**	**34.4**	**32.9**
(Q-o-Q change %)	9.0	5.6	3.6	-4.4
(Y-o-Y change %)	10.2	13.9	3.9	-0.9
Share of Total, %	83.3	84.6	16.7	15.4

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

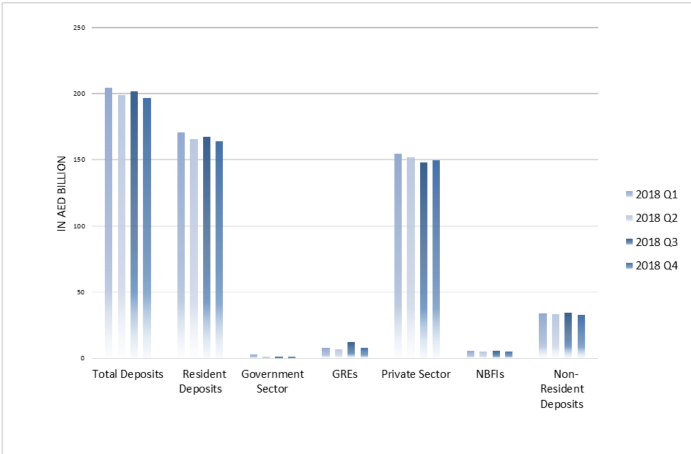
The sector registering the fastest growth in deposits in 2018 Q4 for the National banks was the GREs sector, reflecting the improved oil price and diversifying sources of revenues for the government. All other sectors marked a gain in deposits at National banks, except for the Private sector. For Foreign banks, in the fourth quarter of 2018, the breakdown shows that deposits of all sectors declined except for the Government and Private sectors. The highest rise in deposits was for the Government sector; however, its base remains very small and does not affect significantly the overall deposit growth.

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



Source: CBUAE

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



Source: CBUAE

3.1.2. Banks' Credit

Gross Credit increased in 2018 Q4 by AED 18.3bn, at a slower pace than the previous quarter. For the underlying domestic credit, the lending growth came mainly from the Government and Private Corporates, while GREs were deleveraging. Credit to non-residents rose also at a slower rate than in 2018 Q3, however it contributed by almost one third of the Gross Credit increase in the last quarter of 2018.

Table 3.1.2.a. Assets and Credit at UAE Banks

	2017	2018			
	Dec	Mar	Jun	Sep	Dec*
Total Assets	**2,693.8**	**2,718.3**	**2,748.9**	**2,838.2**	**2,878.0**
(Q-o-Q change %)	2.0	0.9	1.1	3.2	1.4
(Y-o-Y change %)	4.0	3.5	4.4	7.4	6.8
Gross Credit	**1,580.3**	**1,608.1**	**1,622.3**	**1,638.3**	**1,656.6**
(Q-o-Q change %)	0.0	1.8	0.9	1.0	1.1
(Y-o-Y change %)	1.7	2.1	3.4	3.7	4.8
Domestic Credit	**1,452.7**	**1,472.8**	**1,486.6**	**1,496.4**	**1,509.2**
(Q-o-Q change %)	0.4	1.4	0.9	0.7	0.9
(Y-o-Y change %)	1.4	1.5	3.6	3.4	3.9
Government	**175.4**	**181.1**	**180.8**	**185.6**	**191.5**
(Q-o-Q change %)	-3.4	3.2	-0.2	2.7	3.2
(Y-o-Y change %)	1.7	2.3	1.6	2.3	9.2
Public Sector (GREs)	**172.3**	**170.2**	**168.4**	**168.7**	**167.6**
(Q-o-Q change %)	-0.7	-1.2	-1.1	0.2	-0.7
(Y-o-Y change %)	-7.0	-12.7	-5.9	-3.8	-2.7
Private Sector	**1,086.4**	**1,100.7**	**1,117.4**	**1,120.8**	**1,130.1**
(Q-o-Q change %)	1.4	1.3	1.5	0.3	0.8
(Y-o-Y change %)	2.9	3.9	5.6	4.7	4.0
Business & Industrial Sector Credit	**748.9**	**764.2**	**780.1**	**782.4**	**792.7**
(Q-o-Q change %)	1.8	2.0	2.1	0.3	1.3
(Y-o-Y change %)	2.6	4.5	7.1	6.5	5.8
Individual	**337.5**	**336.5**	**337.3**	**338.4**	**337.4**
(Q-o-Q change %)	0.7	-0.3	0.2	0.3	-0.3
(Y-o-Y change %)	3.5	2.6	2.3	1.0	0.0
Non-Banking Financial Institutions	**18.6**	**20.8**	**20.0**	**21.3**	**20.0**
(Q-o-Q change %)	-9.3	11.8	-3.8	6.5	-6.1
(Y-o-Y change %)	-2.1	4.0	2.6	1.4	7.5
Foreign Credit	**127.6**	**135.3**	**135.7**	**141.9**	**147.4**
(Q-o-Q change %)	-4.2	6.0	0.3	4.6	3.9
(Y-o-Y change %)	5.8	8.2	1.0	6.7	15.5

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

Table 3.1.2.b. illustrates sectors' lending by economic activity. The split shows an increase in 2018 Q4 for Agriculture, Mining, Manufacturing, Construction & Real Estate, Transport, Storage & Communication. In contrast, lending decreased for Trade, Financial Institutions "Excluding Banks" while it remained slightly unchanged for Trade.

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

	2017	2018			
Economic Activity	**Dec**	**Mar**	**Jun**	**Sep**	**Dec***
Agriculture	**2.1**	**2.0**	**1.9**	**1.9**	**2.0**
(Q-o-Q change %)	77.3	-4.1	-6.2	1.8	5.3
(Y-o-Y change %)	54.8	70	74	62.3	-4.8
Mining and Quarrying	**12.1**	**12.1**	**12.9**	**13.4**	**14.7**
(Q-o-Q change %)	-0.8	-0.3	7.1	3.7	9.7
(Y-o-Y change %)	-10.7	-36.5	-7.1	9.7	21.5
Manufacturing	**75.2**	**75.5**	**73.7**	**76.1**	**76.9**
(Q-o-Q change %)	4.5	0.4	-2.5	3.3	1.1
(Y-o-Y change %)	8.6	10.6	4.8	5.7	2.3
Electricity, Gas and Water	**16.7**	**18.9**	**17.7**	**17**	**17.0**
(Q-o-Q change %)	-1.6	12.9	-6.4	-4.2	0.0
(Y-o-Y change %)	-9.3	4.4	1.7	-0.3	1.8
Construction and Real Estate	**298.1**	**300.5**	**306.6**	**305**	**315.0**
(Q-o-Q change %)	1.0	0.8	2.0	-0.5	3.3
(Y-o-Y change %)	12.6	12.6	9.0	3.3	5.7
Trade	**152.8**	**157.1**	**159.1**	**154.9**	**154.0**
(Q-o-Q change %)	3.4	2.9	1.2	-2.7	-0.6
(Y-o-Y change %)	-1.7	3.2	6.4	4.9	0.8
Transport, Storage and Communication	**54.9**	**52.7**	**54**	**49.5**	**51.2**
(Q-o-Q change %)	-13.8	-4.0	2.4	-8.5	3.4
(Y-o-Y change %)	-13.5	-12.7	-14.4	-22.4	-6.7
Financial Institutions (Excluding Banks)	**127.5**	**133.6**	**129**	**134.2**	**129.8**
(Q-o-Q change %)	-2.1	4.8	-3.5	4.1	-3.3
(Y-o-Y change %)	-12.4	-12	-7.2	3.0	1.8
All Others	**138.3**	**139.2**	**142**	**146.5**	**148.9**
(Q-o-Q change %)	4.0	0.7	2.0	3.2	1.6
(Y-o-Y change %)	10.4	7.1	12.5	10.3	7.7

Source: CBUAE
Note: All data indicate the end-of-quarter values. (End of Period , In Billions of AED)
***:** Preliminary figures subject to revision.

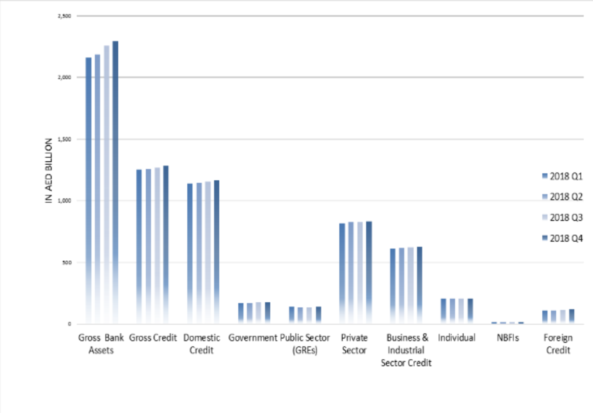
Islamic banks have a share of 20.3% in the assets and 22.5% in the gross financing of the total banking system. The breakdown of the assets and lending by Conventional and Islamic banks in Figures 3.1.2.a and 3.1.2.b indicates that Islamic banks' financing was increasing at a slower rate than for the Conventional lenders. The growth in credit of both types of lenders was lower compared to 2018 Q3. Financing for Shari 'a compliant lenders rose in all categories, except for GREs and NBFIs, where there was a decline. In parallel, credit in Conventional banks increased in all categories, except for Individuals and NBFIs, where a drop in credit was observed.

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

	Conventional		Islamic	
	2018	2018	2018	2018
	Sep	Dec*	Sep	Dec*
Total Assets	**2,259.3**	**2,294.8**	**578.9**	**583.2**
(Q-o-Q change %)	3.5	1.6	2.5	0.7
(Y-o-Y change %)	7.4	7.1	7.2	6.0
Gross Credit	**1,267.4**	**1,282.9**	**370.9**	**373.3**
(Q-o-Q change %)	1.0	1.2	0.9	0.6
(Y-o-Y change %)	3.7	4.6	3.6	5.6
Domestic Credit	**1,153.6**	**1,164.5**	**342.8**	**344.7**
(Q-o-Q change %)	0.6	0.9	0.8	0.6
(Y-o-Y change %)	3.7	3.7	2.5	4.6
Government	**173.1**	**177.2**	**12.5**	**14.3**
(Q-o-Q change %)	2.4	2.4	6.8	14.4
(Y-o-Y change %)	1.6	8.4	12.6	20.2
Public Sector (GREs)	**136.0**	**136.6**	**32.7**	**31.0**
(Q-o-Q change %)	0.1	0.4	0.3	-5.2
(Y-o-Y change %)	-3.2	-1.9	-6.3	-6.1
Private Sector	**826.8**	**834.0**	**294.0**	**296.1**
(Q-o-Q change %)	0.2	0.9	0.7	0.7
(Y-o-Y change %)	5.3	3.5	3.3	5.4
Business & Industrial Sector Credit	**618.6**	**627.6**	**161.5**	**165.1**
(Q-o-Q change %)	0.1	1.5	0.9	2.2
(Y-o-Y change %)	7.1	5.2	4.6	8.5
Individual	**207.4**	**206.4**	**131.0**	**131.0**
(Q-o-Q change %)	0.3	-0.5	0.3	0.0
(Y-o-Y change %)	0.5	-1.1	1.8	1.8
Non-Banking Financial Institutions	**17.8**	**16.7**	**3.5**	**3.3**
(Q-o-Q change %)	8.5	-6.2	-2.8	-5.7
(Y-o-Y change %)	7.2	13.6	-10.3	-15.4
Foreign Credit	**113.7**	**118.4**	**28.2**	**29.0**
(Q-o-Q change %)	5.3	4.1	1.8	2.8
(Y-o-Y change %)	3.9	14.7	19.5	18.9

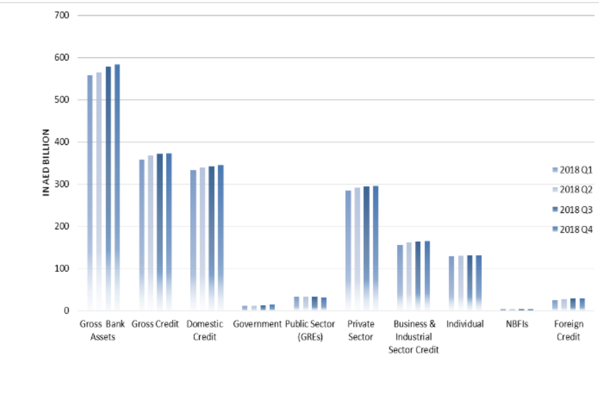
Source: CBUAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

Foreign banks have a share of 12.3% of the system in terms of assets and 11.5% in terms of gross credit in the fourth quarter. The split of the assets and credit by national and foreign banks in Figures 3.1.2.c and 3.1.2.d indicates that National banks' assets were growing at a healthy rate on Y-o-Y and Q-o-Q basis but at a slower pace compared to the previous quarter. For the same period, Foreign banks had their assets decreasing Y-o-Y and Q-o-Q (see Table 3.1.2.d).

In terms of domestic credit, most sectors for the National banks were growing in Q4 2018 except for Individuals and NBFIs; while for the Foreign banks, all asset classes were declining.

Credit to non-residents was growing for the Foreign banks at a higher rate compared to National banks. However, as the base for the National lenders is higher in absolute amount the increase is two times bigger.

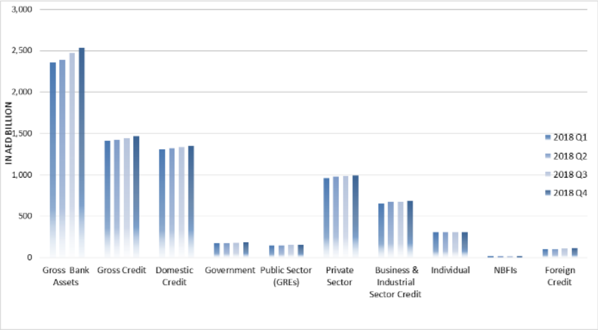
To shed more light on the allocation of the National banks assets abroad, Box 9 below provides details about the Cross Border assets allocation of UAE National Banks and Foreign Currency Exposure to Non-Residents.

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

	National		Foreign	
	2018 Sep	2018 Dec*	2018 Sep	2018 Dec*
Total Assets	**2,473.8**	**2,532.9**	**364.4**	**354.1**
(Q-o-Q change %)	3.4	2.4	2.0	-2.8
(Y-o-Y change %)	8.7	8.2	-0.7	-1.7
Gross Credit	**1,445.7**	**1,466.2**	**192.6**	**190.4**
(Q-o-Q change %)	1.3	1.4	-1.5	-1.1
(Y-o-Y change %)	3.8	5.4	2.6	0.7
Domestic Credit	**1,334.0**	**1,350.8**	**162.4**	**158.4**
(Q-o-Q change %)	1.0	1.3	-2.2	-2.5
(Y-o-Y change %)	3.9	4.7	-0.7	-2.9
Government	**178.7**	**184.8**	**6.9**	**6.7**
(Q-o-Q change %)	2.5	3.4	7.8	-2.9
(Y-o-Y change %)	1.3	8.6	35.3	26.4
Public Sector (GREs)	**152.0**	**152.0**	**16.7**	**15.6**
(Q-o-Q change %)	1.5	0.0	-10.7	-6.6
(Y-o-Y change %)	-1.3	-0.3	-22.0	-21.2
Private Sector	**982.8**	**994.6**	**138.0**	**135.5**
(Q-o-Q change %)	0.6	1.2	-1.5	-1.8
(Y-o-Y change %)	5.1	4.8	2.4	-1.4
Business & Industrial Sector Credit	**676.0**	**687.9**	**106.4**	**104.8**
(Q-o-Q change %)	0.6	1.8	-1.7	-1.5
(Y-o-Y change %)	7.0	6.8	3.4	-0.1
Individual	**306.8**	**306.7**	**31.6**	**30.7**
(Q-o-Q change %)	0.5	-0.03	-0.9	-2.8
(Y-o-Y change %)	1.2	0.6	-0.9	-5.5
Non-Banking Financial Institutions	**20.5**	**19.4**	**0.8**	**0.6**
(Q-o-Q change %)	6.8	-5.4	0.0	-25.0
(Y-o-Y change %)	12.0	7.8	-63.6	0.0
Foreign Credit	**111.7**	**115.4**	**30.2**	**32.0**
(Q-o-Q change %)	5.2	3.3	2.4	6.0
(Y-o-Y change %)	2.8	13.5	24.3	23.6

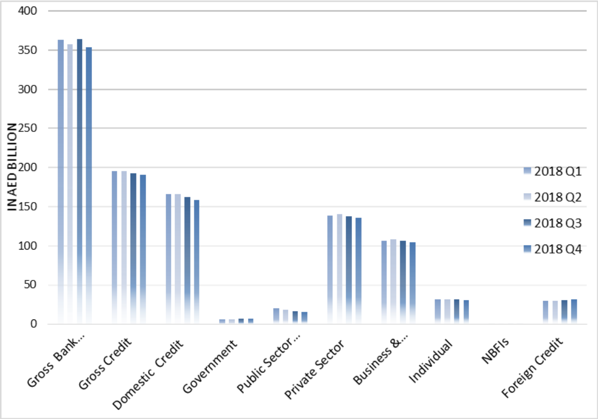
Source: CBUAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

Box 8: UAE National Banks' Foreign Assets and Foreign Currency Exposure to Non-Residents

The UAE banking system is the largest in terms of assets in the MENA region. As of December 2018, the outstanding amount of assets is at AED 2,878bn[4]. As of the end of the fourth quarter 2018, UAE banks, excluding branches and affiliates abroad, have a total of AED 679.5bn in foreign assets, AED 570.1bn for national banks and AED 109.4bn for foreign banks.

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

Foreign Assets' Class of UAE National Banks

The foreign assets of national banks decreased Q-o-Q and Y-o-Y as at the end of 2018 Q4. The asset classes of exposure are split as per the categories in Table 1. The three major categories as of December 2018 are securities with an outstanding amount of AED 149.5bn, Due from Head office & branches at AED 141.1bn and due from other banks at AED 120.2bn that rose by 1.4%, 6.5% and -9.7% Q-o-Q respectively and by 9.5%, 70.4% and 1.1% Y-o-Y. (Table 1).

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

	Jun 18	Sep 18	Dec 18
Due from HO & branches	104.6	132.4	141.1
Due from other banks	122.3	133.2	120.2
Securities	145.3	147.4	149.5
Loans	106.2	111.7	115.4
Other assets	44.3	50.4	43.9
Total	522.8	575.1	570.1

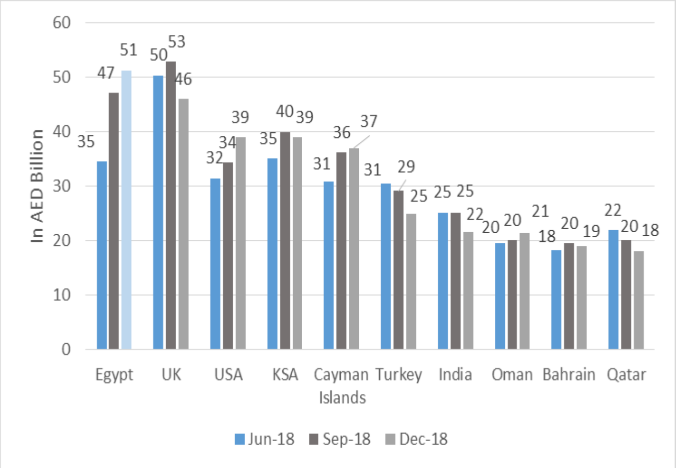
Source: Central Bank of the UAE

UAE National Banks' Top 10 Countries for Cross Border Exposure

As of December 2018, the biggest exposure of UAE banks abroad, on the assets side of their balance sheets, including branches and affiliates, was in Egypt at AED 51.3bn, followed by AED 46.1bn in the UK and by AED 39.1bn in the USA. The three countries in the top 10 exposures that experienced the highest increase Q-o-Q were the USA by AED 4.7bn (13.7%), Egypt by AED 4.1bn (8.7%) and Oman by AED 1.3bn (6.4%). The top 3 countries with the largest increase Y-o-Y were led by Egypt by AED 21.8bn (74%), the USA by AED 8.4bn (27.2%) and Cayman Islands by AED 8bn (27.5%).

On the other hand, the highest decline Q-o-Q as of December 2018 was observed for the UK by AED 6.9bn (13%), Turkey by AED 4.3bn (14.7%) and India by AED 3.6bn (14.1%). Y-o-Y as of December 2018 the highest drop in exposure was observed for Qatar where it dropped by AED 13.3bn (42.3%), while exposure to the UK declined by AED 6.4bn (12.2%) and to Turkey by AED 4bn (Figure 1).

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



Source: Central Bank of the UAE

[4] Excluding branches and affiliates abroad.

Currency Denomination of UAE National Banks' Lending in Foreign Currency

The main foreign currency exposure for UAE banks remains in USD, which stood at 84.5% at the end of the fourth quarter of 2018. The second most important foreign currency exposure is in Euro as of September 2018 (8.6% of the total foreign currency exposure). The third, fourth and fifth currency exposures are in Pound Sterling, Japanese Yen and Saudi Riyal (Table 2).

Table 2: Share of Foreign Currencies of total UAE National Banks' Lending in Foreign Currencies

	Jun-18	Sep-18	Dec-18
U S Dollar	83.4%	79.9%	84.5%
Euro	9.8%	9.3%	8.6%
Pound Sterling	1.6%	1.4%	1.6%
Japanese Yen	1.5%	1.2%	1.3%
Saudi Riyal	1.0%	0.8%	1.4%
Chinese Yuan	0.4%	0.3%	0.2%
Qatari Riyal	0.3%	0.3%	0.3%
Bahraini Dinar	0.2%	0.1%	0.2%
Kuwaiti Dinar	0.2%	0.3%	0.2%
Swiss Franc	0.1%	0.1%	0.1%
Other Foreign currencies	1.5%	6.1%	1.6%

Source: Central Bank of the UAE

3.1.3. Financial Soundness Indicators

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

As of 2017 Q4, the Central Bank of the UAE started reporting the quality of the capital in line with Basel III framework[5]. Banks operating in the UAE remain highly profitable and capitalized, with the Capital Adequacy Ratio (CAR) at 18.2%, Tier 1 Capital Adequacy at 16.9% and Common Equity Tier 1 (CET) at 14.9%, which are well above the regulatory requirements set by the Central Bank that are higher than the Basel III criteria.

The Loans to Deposits (L/D) ratio for the whole banking system declined from 94.8% in September 2018 to 94.4% at the end of 2018 Q4, a level which is also lower than the 97.1% in 2017 Q4, mainly due to the higher growth in deposits compared to lending.

Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 94.7% and 93.1%, decreasing by 0.4 percentage points from the previous quarter for the Conventional banks, while increasing by 0.5 percentage points for the Islamic banks.

L/D ratio for Conventional banks in December 2018 has improved compared to a year ago when it was 98.6%. For Islamic banks' L/D has increased from 92.2% in December 2017. On the other hand, National banks have L/D ratio of 94.1 (with a decline of 0.6 percentage points compared to September 2018), while the ratio for Foreign banks is 96.7%, higher than the 95.5% at the end of 2018 Q3.

Meanwhile, liquid assets, which include required reserves, mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets moved up from the end of Q3 2018 to 17.4% at the end of 2018 Q4 (eligible liquid assets ratio (ELAR)). This level of ELAR still constitutes a significant buffer, as it is higher than the 10% minimum required by the Central Bank. The level of total liquid assets at banks as of the end of 2018 Q4 remains at AED 407.6bn, AED 35.4bn higher than at the end of 2018 Q3, registering a rise of 9.5% in the fourth quarter of 2018, explaining the increase in the ELAR. On a Y-o-Y basis, total liquid assets at banks rose by AED 9.7bn, registering an increase by 2.4%. In addition, looking at the split between Islamic, Conventional, National and Foreign banks, data show that for all segments the ELARs increased during 2018 Q4. On a Y-o-Y basis, ELAR has declined for all types of banks.

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

Total system	2018			
	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio[6]	84.2	83.8	82.3	82.3
The Eligible Liquid Assets Ratio (ELAR)	17.4	16.8	16.1	17.4
Capital Adequacy Ratio (CAR)	17.5	18.1	18.2	18.2
Tier 1 Capital	16	16.6	16.8	16.9
CET 1	13.9	14.6	14.9	14.9

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

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

Conventional	2018			
	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio[6]	84.8	84.4	82.8	82.5
The Eligible Liquid Assets Ratio (ELAR)	16.2	15.9	15.2	16.5
Capital Adequacy Ratio (CAR)	18.0	18.2	18.4	18.4
Tier 1 Capital	16.4	16.7	17.0	17.1
CET 1	14.7	15.1	15.4	15.5

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

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

[6] Also known as Funding to Stable Resources Ratio.

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

Islamic	2018			
	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio[6]	82.1	81.6	80.8	81.6
The Eligible Liquid Assets Ratio (ELAR)	20.2	18.7	18.7	19.7
Capital Adequacy Ratio (CAR)	15.8	17.5	17.5	17.4
Tier 1 Capital	14.6	16.3	16.3	16.2
CET 1	10.9	12.6	12.8	12.7

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

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

National	2018			
	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio[6]	85.3	84.7	83.3	83.4
The Liquid Assets Ratio (LAR)	16.6	15.9	15.3	16.5
Capital Adequacy Ratio (CAR)	17.1	17.7	17.9	17.8
Tier 1 Capital	15.6	16.4	16.6	16.5
CET 1	13.3	14.0	14.4	14.3

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

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

Foreign	2018			
	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio[6]	76.6	77.2	75.4	74.0
The Eligible Liquid Assets Ratio (ELAR)	23.0	22.4	21.7	24.3
Capital Adequacy Ratio (CAR)	20.9	20.7	20.4	21.3
Tier 1 Capital	18.7	18.6	18.4	19.8
CET 1	18.7	18.6	18.4	19.8

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

3.2 Financial developments

3.2.1. Share Price Movement

Global and regional uncertainties decreased investors' confidence, which had impacted also the two stock exchanges in the UAE.

On the ADX, the average Share Price Index decreased in the fourth quarter of 2018 after an increase in the previous quarter Q-o-Q, while marking an increased Y-o-Y. The market capitalization moved from an increase Q-o-Q and Y-o-Y in 2018 Q3 to a decline Q-o-Q, while rising by Y-o-Y during 2018 Q4 (see Table 3.2.1).

The average Share Price Index in Dubai fell Q-o-Q and Y-o-Y in the fourth quarter of 2018. The market capitalization followed the same trend in 2018 Q4.

Table 3.2.1. UAE – Securities Markets

			2018			
			Q1	**Q2**	**Q3**	**Q4**
Abu Dhabi	**Change of Share Price Index (%)**	**Q-o-Q**	6.4	0.4	6.8	-1.3
		Y-to-Date	2.6	6.8	14.1	12.6
		Y-o-Y	1.8	3.4	10	12.6
	Change of Market Capitalization (%)	**Q-o-Q**	9.2	-2.1	4.6	-0.5
		Y-to-Date	9.2	6.8	11.7	11.2
		Y-o-Y	7.6	6.9	12.1	11.2
Dubai	**Change of Share Price Index (%)**	**Q-o-Q**	-6.5	-9.2	-2.5	-7.5
		Y-to-Date	-10.0	-15.1	-17.2	-23.4
		Y-o-Y	-9.4	-12.8	-20.3	-23.4
	Change of Market Capitalization (%)	**Q-o-Q**	1.9	-3.6	-1.2	-5.4
		Y-to-Date	1.9	-1.8	-2.9	-8.2
		Y-o-Y	1.7	6.3	-0.6	-8.2

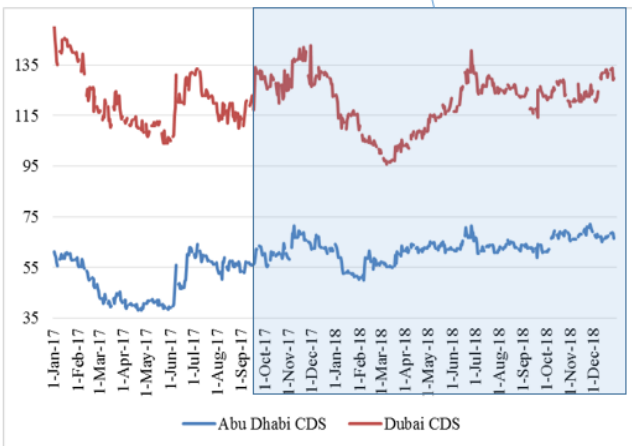
Source: Abu Dhabi Securities Exchange and Dubai Financial Market
Note: Changes computation (Q-o-Q) is based on quarterly average of end-of-month values for the share price index and market capitalization.

3.2.2. Credit Default Swaps Premiums

The default risk premia for the Emirates of Abu Dhabi and Dubai remained stable in 2018 Q4, at low levels in recent history. This reflects the recent firming up of oil prices and continued progress on fiscal reforms and improvement in debt sustainability (see Figure 3.2.1).

Figure 3.2.1. UAE – Sovereign Credit Default Swaps (CDS)

	2017	2018			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Emirate of Abu Dhabi	62.9	56.2	63.7	62.9	67.4
Emirate of Dubai	130.6	106.8	116.1	124.4	125.3



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

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

Monetary aggregates exhibited an increase in 2018 Q4 due mostly to an increase in Quasi-Monetary Deposits as well as Government Deposits. Total Assets of the Central Bank increased owing to increased banks' liquidity. On the Liabilities' side of the Central Bank's balance sheet, the increase took place in the Required Reserves and the Certificates of Deposits. As regards EIBOR, it fluctuated around an upward trend in 2018 Q4, in line with the increase in LIBOR on the US dollar, on the back of the expected Fed decision to increase its policy rate, which materialized in December. Meanwhile, the Spread EIBOR vs. US LIBOR fluctuated around a slightly increasing trend, while the Spread of the 10-year Swap rate for the Dirham vs. USD increased due to the fall of the latter, particularly in December.

.1 Monetary Aggregates

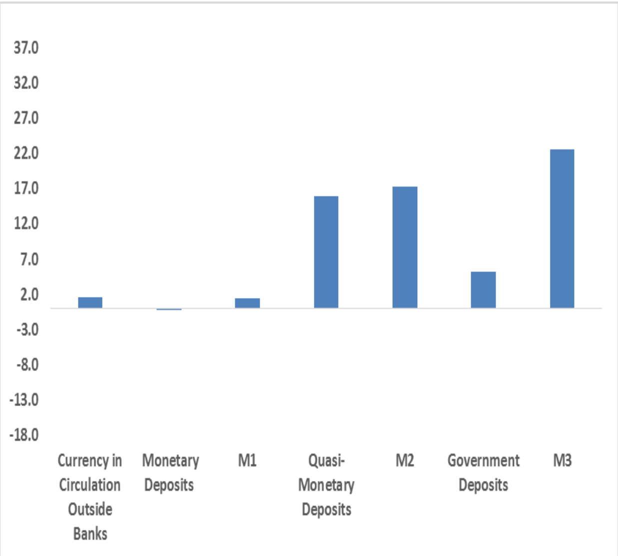
During 2018 Q4, Money Supply M1 increased by 0.3% to reach AED 485.6 billion. The increase was due to the rise in Currency in Circulation by AED 1.6 billion.

Meanwhile, Money supply M2 increased by 1.3% to reach AED 1,308.4 billion, due to the above-indicated increase in M1, and an increase in Quasi-Monetary deposits by AED 15.9 billion, reaching AED 822.8 billion.

Moreover, M3 increased by 1.4% to reach AED 1,602.3 billion, due to an increase in Government Deposits by AED 5.2 billion to reach AED 293.9 billion.

Figure 4.1 Change in Monetary aggregates in 2018 Q4

In billions of Dirhams



Source: Central Bank of the UAE

4.2 Central Bank Balance Sheet

Changes in the Central Bank balance sheet are triggered by the liquidity position in the banking system, reflecting developments in the oil price and foreign currency flows.

During 2018 Q4, there was an increase in funding from abroad on Banks' foreign liabilities side. Due to Headquarters and/or Branches Abroad, which is basically foreign banks getting short-term liquidity from the mother company abroad, increased by AED 3.3 billion, and Other Foreign Deposits increased by AED 8 billion.

Meanwhile "Capital Market Funding" which is medium-term funding from overseas decreased by AED 4 billion, and "Due to Other Banks Abroad" which is borrowing in US dollars, including Money at Call and Short – Notice, Nostro Balances, Bills and Lending under Repurchase Agreement, and Term Placements and Loans, remained roughly flat.

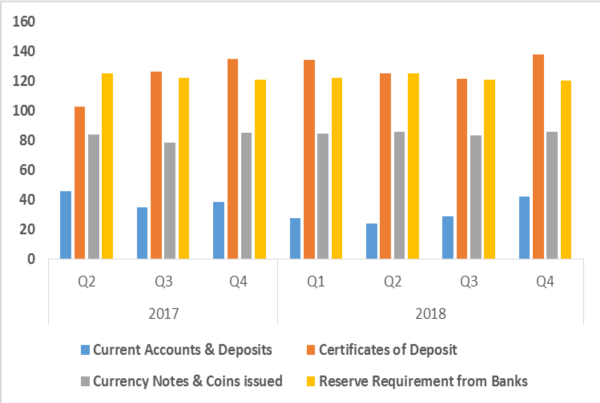
The overall increase in banks foreign liabilities coupled with increased foreign income receipts led to higher banks' foreign reserves transfers to the Central Bank.

As a result, total assets of the Central Bank increased by 11% (AED 36.8 billion) from end of Q3 to end of Q4 to reach AED 417.7 billion, which were mainly allocated as follows: AED 200.9 billion Cash and Bank Balances, AED 106.8 billion Deposits and other Advances Abroad, and AED 104.2 billion investments (AED 55.2 billion foreign securities and AED 49 billion securities of Government of Dubai/ MoF).

On the liabilities side of the balance sheet of the Central Bank, there has been an increase in the Current Account and Deposits by AED 13.4 billion and an increase in Certificates of Deposits (CDs) issued by CBUAE and purchased by banks by 16.8, reaching AED 138.2 billion, which is testament of sufficient liquidity in the banking system.

Figure 4.2 Central Bank Liabilities

In billions of Dirhams



Source: Central Bank of the UAE

Table 4.1 Central Bank Balance Sheet

In billions of Dirhams

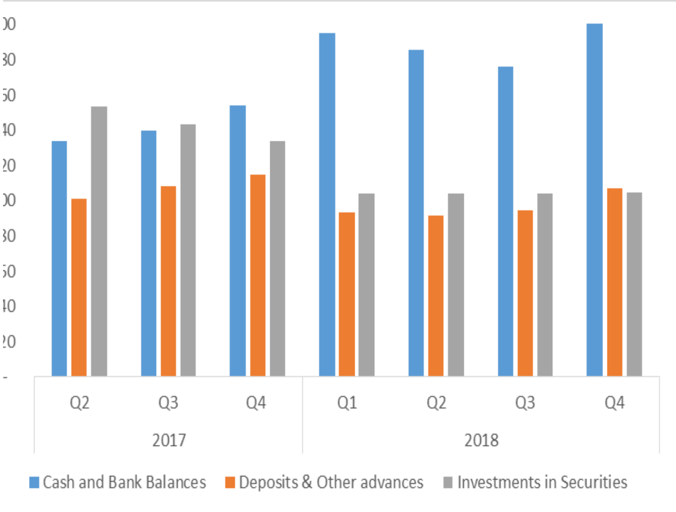
	2017	2018			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Total Assets, Of which:	**406.4**	**395.6**	**386.1**	**380.9**	**417.7**
Cash and Bank Balances	154.2	195.2	185.6	176.0	200.9
Deposits	111.3	90.5	88.5	91.4	106.8
Foreign Securities	84.5	55.2	55.2	55.2	55.2
Securities-Dubai Government/MoF	49.2	49.0	49.0	49.0	49.0
Gold Bullion	1.2	1.2	1.1	1.1	1.1
Total Liabilities, Of which:	**406.4**	**395.6**	**386.1**	**380.9**	**417.7**
Current Accounts & Deposits	38.6	27.7	24.3	28.8	42.2
Reserve Requirement from Banks	121.2	122.0	125.1	120.9	120.6
Certificates of Deposit	135.1	134.3	125.2	121.4	138.2
Currency Notes & Coins issued	85.4	84.7	86.1	83.2	85.8
Total Capital & Reserves	22.1	22.0	22.0	21.9	23.3

Source: Financial Control Division, Central Bank of the UAE

(1) Including Held-to-Maturity foreign securities and Securities of Ministry of Finance and Dubai Government

Figure 4.3 Central Bank Assets

In billions of Dirhams



Source: Financial Control Division, Central Bank of the UAE

4.3 Central Bank Foreign Assets

As shown in Table 4.2, the balance of foreign assets increased from AED 327.3 billion at end of 2018 Q3 to AED 362.6 billion at the end of Q4, which were allocated as follows: AED 55.2 billion foreign securities of which 50.7 USD Treasury Notes, and AED 294.1 billion Current Account Balances & Deposits with Banks Abroad (AED 187.2 billion Current and Call Accounts, AED 93.3 billion Deposits and AED 13.6 billion Tri-Party Deposits).

Table 4.2 Central Bank's Foreign Assets

	2017	2018			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Total Foreign Assets*	**347.7**	**336.3**	**331.1**	**327.3**	**362.6**
Foreign Securities	**84.6**	**55.2**	**55.2**	**55.2**	**55.2**
-USD Treasury Notes	50.6	50.7	50.7	50.7	50.7
-JPY Treasury Bills	29.3	-	-	-	-
-IDB Sukuk	4.6	4.6	4.6	4.6	4.6
Current Account Balances & Deposit with Banks Abroad	**256.6**	**271.2**	**260.5**	**255.1**	**294.1**
-Current & Call Accounts	145.3	180.7	172.0	163.6	187.2
-Deposits	98.8	88.7	77.1	81.3	93.3
-Tri-Party Deposits	12.5	1.8	11.4	10.1	13.6
Other Foreign Assets	**6.6**	**9.9**	**15.4**	**17.0**	**13.3**

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

4.4. International Reserves Position

The credibility of the fixed peg arrangement requires the Central Bank to hold sufficient foreign currency reserves. To this end, Article 63 of Decretal Federal Law No. 10 of 2018 regarding the Central Bank and Organization of Financial Institutions and Activities, states that the market value of the balance of Foreign Reserves "*shall not, at any time, be less than solvency seventy percent (70%) of the value of the monetary base*." Article 62 of the said Law defines Reserves of Foreign Assets as follows:

(1) Gold bullion and other precious metals.

(2) Cash, deposits and other monetary and payment instruments denominated in foreign currencies, freely convertible in global markets.

(3) *Securities denominated in foreign currencies and issued or guaranteed by foreign governments and their related companies, entities, institutions, and agencies, or by international monetary and financial institutions, or by multinational corporations, and are tradable in global markets.*

Table 4.3 reports the International Reserve Position of the Central Bank, which increased from AED 329.8 at end of 2018 Q3 to AED 365.4 billion. As a ratio of the monetary base, the International Reserve Position increased, during this period, from 94.9% to 96.2%, i.e., higher than the above-indicated minimum cover ratio, which supports the credibility of the fixed peg arrangement and the Central Bank's ability to defend it.

Table 4.3 International Reserves

In billions of Dirhams

	2017	2018			
	Q4	Q1	Q2	Q3	
1. **International Reserve Position***	**350.3**	**339.0**	**333.6**	**329.8**	**365.4**
Of which					
– Current Account Balances & Deposits with Banks Abroad	256.6	271.2	260.5	255.1	294.1
– Foreign Securities	84.5	55.2	55.2	55.2	55.2
– IMF Reserves Position + SDR Holdings	2.6	2.7	2.6	2.5	2.9
2. Monetary Base	**377.4**	**365.2**	**353.9**	**347.7**	**379.7**
Of which					
– Currency Issued	85.4	84.7	86.1	83.2	85.8
– Reserve Requirements	121.4	122.0	125.1	120.9	120.6
– Banks & OFCs Current Accounts at CBUAE	35.5	24.2	17.5	22.2	35.1
Ratio (1/2)	**92.8%**	**92.8%**	**94.3%**	**94.9%**	**96.2%**

Source: Central Bank of the UAE, end of quarter data
* Gross International Reserves including IMF Reserve Position and SDR Holdings

4.5 Developments in Banks' Liquidity at the CBUAE

Banks' liquid assets at the Central Bank are composed mainly of their current accounts at the Central Bank, required reserves, and the balance of certificates of deposits held by banks. These assets increased from AED 372.2 billion at the end of 2018 Q3 to AED 407.6 billion at the end of 2018 Q4, i.e., by AED 35.4 billion, mainly due to an increase in Banks' current accounts at CBUAE. As a result, liquidity at banks remained sufficient, with the eligible liquid assets ratio increasing from 16.1% at the end of 2018 Q3 to 17.4% at the end of 2018 Q4.

4.6 Interest Rates

The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to adjust its policy rate to changes in the interest rate policy in the U.S. Therefore, the Central Bank of the UAE announced an increase in interest rates applied to its Certificates of Deposits, in line with the Fed's decision to increase its target Federal Funds rate in December by 25 basis points to reach 2.25 – 2.50% range. Similarly, the Repo Rate, applicable to banks' borrowing of short-term liquidity from the Central Bank against their holding of CDs, has increased by 25 basis points.

4.6.a Short-term interest rates

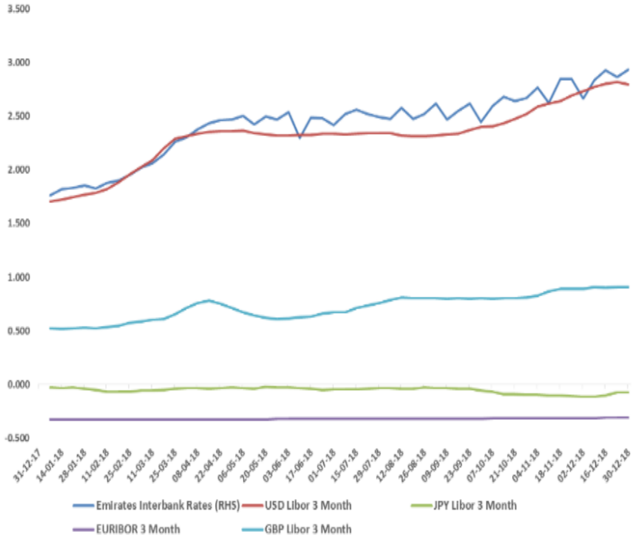
The Emirates Interbank Offer Rate (EIBOR) comprises the daily quotes of the largest banks operating in the country, based on the average interest rate at which banks offer to lend secured funds to other banks in the Dirham wholesale money market and published by the Central Bank of the UAE. New "Regulations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

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

During 2018 Q4, EIBOR 3- month increased from 2.6% in early October to a peak of 2.85% in the last week of November; then it rose again in December consistent with the widely expected Fed decision to increase its policy rate. For the most part, EIBOR has been tracking the change in Libor on the US dollar, which continued to rise in expectation of: (1) the Fed decision to increase its policy rate, (2) higher US government borrowing, and (3) the reduction in the Fed's Balance Sheet, targeted at $50 billion a month.

The 3-month LIBOR on GBP increased by about 10 basis points during 2018 Q4, mostly due to increasing BREXIT uncertainties, as the Bank of England kept on hold its policy rate and inflation eased, while the LIBOR rates on the Euro and the Japanese Yen remained in negative territory, in consistency with the directions of monetary policy adopted by the respective central banks.

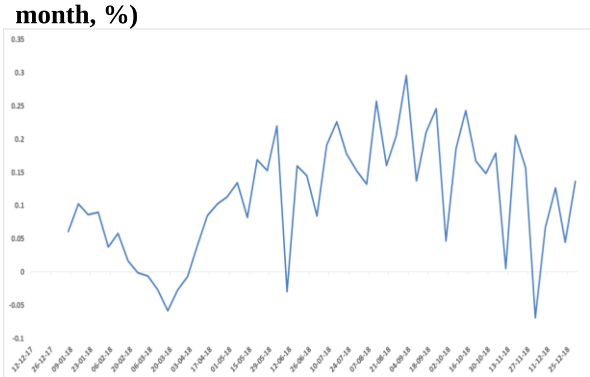
Figure 4.4.a LIBOR rates (3-month) for the Dirham and key other currencies (%)



Source: Bloomberg

As regards the Spread EIBOR vis-à-vis the USD LIBOR (3 –month), it remained positive for most of the 4th quarter of 2018, fluctuating around an average of 12 basis points.

Figure 4.4.b Dirham Spread vs. USD LIBOR (3 month, %)



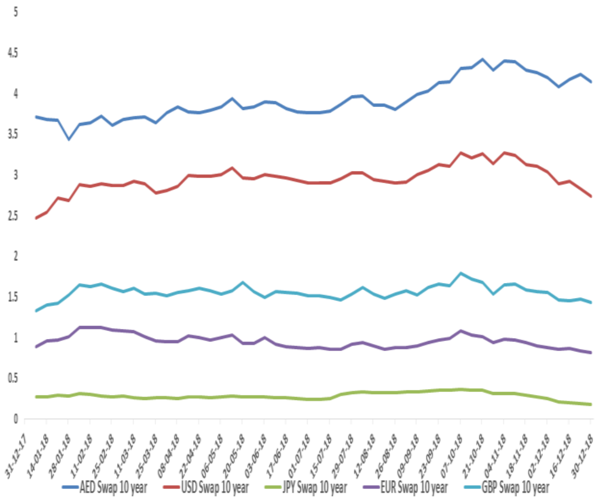
Source: Bloomberg

4.6.b Long-term swap rates

The issuance of the Public Debt Law No. 9 of 2018, which allows for the first time the Ministry of Finance to issue Federal public debt instruments in Dirham, in local securities markets, which will pave the way for the Central Bank to actively conduct open market operations (Box 9 below). Awaiting the issuance of the Federal public debt to benchmark the yield curve, the swap market rates on the Dirham are the only available rates that currently reflect the yields of long-term securities[7].

As shown in Figure 4.6.a, the 10-year swap rates for the Dirham fluctuated around an average of 4.27% in 2018 Q4. Since a peak of 4.42% in the 2nd week of October, however the 10-year swap for the Dirham has been declining by about 25 basis points until the end of December. The decline in the interest rate on swaps in 2018 Q4 extended also to the US dollar and other currencies, despite rising global volatility and associated risks. This "puzzle" may be explained by the fact that markets expected also that the Fed's interest rate hike by 25 basis points in December 2018 will most likely be followed by a pause, while inflation remains below target in the Euro Area and Japan.

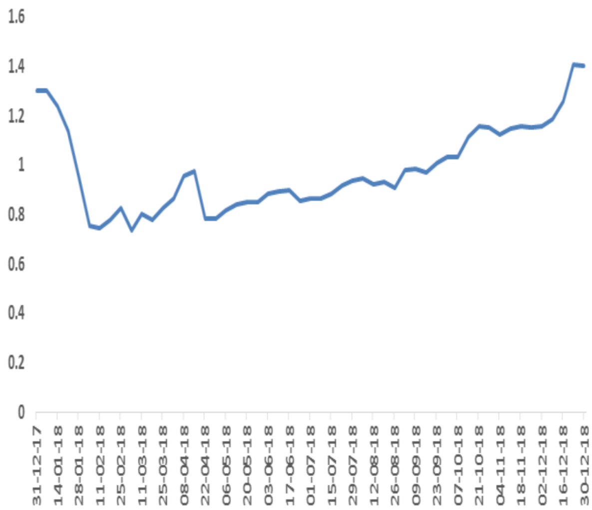
Figure 4.5.a 10-year swap rates (%)



Source: Bloomberg

The Spread of the 10-year swap rate for the Dirham vs. the swap rate for the US dollar increased nonetheless from an average of 1.15% in the period October1st week of December to 1.40% by the end of the month.

Figure 4.5.b Spread 10-year Dirham Swap vs. USD Swap (%)



Source: Bloomberg

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

Box 9 Federal Debt Instruments as per UAE Public Debt Law No. 9 of 2018

The newly-issued Federal Law No. 9 of 2018 (The Public Debt Law) allows for the first time the Ministry of Finance to issue public debt for the Federal Government. Article (2) specifies that such issuance should aim, among others, at **developing the primary and secondary capital markets**, finance infrastructure and development projects, and support the conduct of monetary policy.

As per Article 15, public debt instruments shall be issued in securities markets operating in the UAE, i.e., the public debt will be issued in Dirham and directly support the development of Dubai Financial Market and Abu Dhabi Securities Market, whereas previously local governments and GREs issued debt in foreign currency, abroad. The Law puts some safeguards, nonetheless, on debt issuance by the federal government, with a cap of 250% of its "stable revenues." The Law allows also the federal government to **guarantee debt** issued by GREs, which was previously the domain of local governments, albeit this guarantee requires a Cabinet decision (Article 11). Finally, the Law calls for coordination between the Public Debt Management Office at the Ministry of Finance and the local governments that want to issue public debt instruments, in order to promote primary as well as secondary markets in the Emirate.

As regards the Central Bank, Article (3) stated that the Public Debt Management Office at the Ministry of Finance shall coordinate with the CBUAE on matters relating to **the administration of issuance** as well as the **sale of government bonds and treasuries.** Currently, the Central Bank absorbs Dirham liquidity through issuance of Certificates of Deposits (CDs), including Islamic Sharia – compliant ICDs, and injects liquidity through Repo and Early Redemption of CDs/ICDs, USD/AED Swap Facility, the Interim Marginal Lending Facility (IMLF), and its Sharia compliant equivalent, Collateralized Murabahah Facility (CMF). Following the issuance of the Federal Government debt **the CBUAE will be in a position to conduct Open Market Operations (OMOs)**, i.e., the sale of government bonds to banks to absorb liquidity and vice-versa for injection of liquidity, deepening the domestic capital market.

In sum, managing liquidity using domestically issued government debt will provide CBUAE an additional tool to enhance its capacity for a more proactive liquidity management. When conducted successfully as in the case of Hong Kong and Singapore Monetary Authorities, OMOs proved to be a powerful tool, which insures sufficient liquidity in line with the objectives for the monetary authority, and solidifies the stability of the banking system. To be effective, however, the CBUAE needs to improve its forecasting capabilities of domestic liquidity in order to assess shortages or excesses on a daily basis, and acts accordingly with the conduct of regular open market operations to align domestic liquidity with the objectives for monetary policy and financial stability