Please Rate this Report

Quarterly Economic Review

Third quarter 2017

[Please Rate this Report]

Table of contents

[Please Rate this Report]

Figures

Please Rate this Report

Tables

Please Rate this Report

Executive Summary

The global upswing in economic activity is strengthening during the third quarter of the year as many economies have reported better than expected GDP figures, especially the Euro Area and the US. The International Monetary Fund (IMF) revised upwardly the global output growth to reach 3.6% in 2017 and 3.7% in 2018. However, these growth projections mask somewhat different contributions at the country level. US growth projections have been revised up, reflecting a pickup in economic activity than previously anticipated. Growth has been revised up for Japan and the Eurozone, where positive surprises to activity in late 2016 and early 2017 point to solid momentum. China's growth projections have also been revised up, reflecting strong second and third quarters of 2017 and expectations of continued fiscal support.

Oil prices continued their recovery for the fourth consecutive quarter in response to the OPEC agreement that became effective on January 2017 and expected to be extended into end-2018. It stipulates a coordinated oil production cut among OPEC members to which the UAE contributed by a 4% Y-o-Y cut in the third quarter of 2017. In fact, the Brent price increased by 13.8% on a year on year basis during the third quarter of 2017 adding to a previous increase of 8.8% in the previous quarter. On a quarterly basis, the oil price rebounded by 5.1% in the third quarter against a previous drop by 7.5% in the second quarter.

In the UAE, based on revised new figures of growth projections and global economic developments, the Central Bank of the UAE has revised its projections of the Real GDP growth for 2017, and published its ECI estimates for the third quarter of 2017. In fact, Non-oil GDP is estimated to grow by 3% in 2017, while oil GDP growth is projected to decline by 1.4%. The combined effect is estimated growth of Real GDP at 1.6% in 2017. The ECI estimates for 2017 Q3 are of 0.7% for the whole economy with non-oil GDP growing at 3.1% in the same quarter. Inflation declined in the third quarter to 0.8% Y-o-Y compared to 2% in the previous quarter, reflecting a fall in both, tradeable and non-tradeable inflation. Housing prices went down by 0.6% Y-o-Y.

Regarding banking activity, Government deposits increased at a slower pace in the third quarter of 2017, while GREs continue deleveraging. As a result, M2 and M3 declined marginally. Banks' credit increased by 0.7% on a Q-o-Q and by 2.3% on a year-on-year basis providing support to the non-oil growth. The overall outlook regarding the soundness of the banking sector remains positive during the third quarter of 2017 signifying a stable and sound financial sector.

In addition, the Central Bank balance sheet exhibited an increase in the third quarter, triggered by increases of banks' holdings of Certificates of Deposits on the Liabilities' side. As a result, Total Assets increased owing mainly to rising foreign assets in the form of Cash and Bank Balances and Central Bank's Deposits abroad. Meanwhile, interest rates in the UAE remain stale during the third quarter of 2017 after the June's hike in line with the Fed's decision.

Please Rate this Report

Chapter 1. International Economic Developments

The global upswing in economic activity is strengthening. Global growth, is projected to rise to 3.6% in 2017 and to 3.7% in 2018. These growth projections mask somewhat different contributions at the country level. US growth projections have been revised up, reflecting a pickup in economic activity than previously anticipated. Growth has been revised up for Japan and the Eurozone, where positive surprises to activity in late 2016 and early 2017 point to solid momentum. China's growth projections have also been revised up, reflecting strong second and third quarters of 2017 and expectations of continued fiscal support.

The recovery in global growth remains on track with somewhat different contributions at the country level. According to the International Monetary Fund's (IMF) October 2017 World Economic Outlook (WEO) update, the global economy is expected to grow by 3.6% in 2017 and 3.7% in 2018, 0.1 percentage points higher for both years compared to the projections in July 2017. Contributions to growth by country have been revised. US growth projections have been revised up, primarily reflecting a pickup in activity going forward than previously anticipated. Growth has been revised up for Japan and for the Euro Area as well, where positive surprises to activity in late 2016 and early 2017 point to solid momentum. China's growth projections have also been revised up, reflecting a strong second quarter of 2017 and expectations of continued fiscal support.

Among the UAE's major trading partners, Japan, India, China, and Saudi Arabia, the growth forecast is mixed.

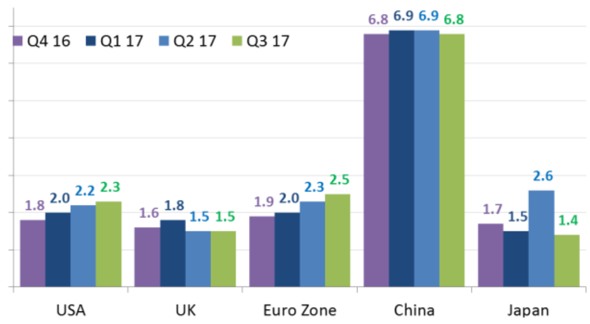
For Japan, the IMF upgraded its forecast for the world's third-largest economy to 1.5% in 2017 from a July projection of 1.3%. The forecast for 2018 was also pushed upwards to 0.7%, up by 0.1 percentage points. Strong net exports and increases in inflation and factory output will contribute to the growth prospects. Meanwhile, Japan's third quarter GDP matched expectations for growth mainly supported by exports while business spending rose at a slower pace and private consumption fell for the first time in nearly two years. The positive contribution to GDP largely came from net exports (0.5 percentage points). On the other hand, contraction of household consumption subtracted 0.3 percentage points from the growth while stagnant capital expenditure and government spending gave no contribution to growth. Meanwhile, changes in private inventories added 0.2 percentage points to quarterly growth. Quarter-on-quarter, the economy expanded by 0.3% from the second quarter. Year-on-year, the Japanese economy expanded by 1.4% in the third quarter (see Figure 1.1.).

For India, growth is forecast to slow down in 2017 and to recover in 2018, by 6.7% and 7.4% respectively, lower than the July forecast by 0.5 percentage points for 2017 and by 0.3 percentage points for 2018. While activity slowed following the currency exchange initiative, growth for 2016, at 7.1%, was higher than anticipated due to strong government spending and data revisions that show stronger momentum in the first part of the year.

For China, the IMF expects growth to remain at 6.8% in 2017, higher than in 2016, and to decline only modestly in 2018 to 6.5%. The forecast for both years was revised up by 0.1 percentage points from the July forecast, reflecting the stronger than expected outturn in the first quarter of the year underpinned by previous policy easing and supply-side reforms (including efforts to reduce excess capacity in the industrial sector). This reflects the expectation that the authorities might delay the needed fiscal adjustment (especially by maintaining high public investment) to meet their target of doubling 2010 real GDP by 2020. Official statistics from the Chinese government showed that the third quarter 2017 growth beat expectations –at 6.8% higher than the previous year (see Figure 1.1.).

Please Rate this Report

Figure 1.1. GDP growth for selected countries (Y-o-Y, %)



Source: Bloomberg

For Saudi Arabia, growth is expected to be 0.1% in 2017, as per the October IMF Regional Economic Outlook because of lower oil production and ongoing fiscal consolidation. According to the IMF, non-oil growth is projected to pick up to 1.7% in 2017 while the oil growth is projected to contract by 1.9% as oil GDP declines in line with Saudi Arabia's commitments under the OPEC agreement[1]. Growth is expected to strengthen over the medium-term as structural reforms are implemented. Employment growth has also weakened, and the unemployment rate among Saudi nationals has increased to 12.3%.

The growth forecast for the United States has been revised up from 2.1% to 2.2% in 2017 and from 2.1% to 2.3% in 2018. The major factor behind the revision, especially for 2018, is the assumption that fiscal policy will be more expansionary than previously assumed together with the positive data releases. However, official statistics showed that GDP increased by 2.3% Y-o-Y[2] in the third quarter of 2017 compared to 2.2% in the second quarter of 2017 (see Figure 1.1). The increase in real GDP in the third quarter reflected positive contributions from personal consumption expenditures (PCE), private inventory investment, nonresidential fixed investment, exports, and federal government spending. These increases were partly offset by negative contributions from residential fixed investment and state and local government spending. Imports decreased, further boosting real growth.

The growth forecast has been kept at the same levels as of the July 2017 release for the United Kingdom for 2017. In the third quarter, GDP increased by 0.4%, a slight improvement from the previous quarter. Growth accelerated in the third quarter thanks to a rebound from the services sector. Year-over-year, the UK economy grew by 1.5% in the third quarter, keeping the same level of annual growth as in 2017 Q2 (see Figure 1.1.).

By contrast, growth projections for 2017 have been revised up for many euro area countries, including France, Germany, Italy, and Spain, where growth for the second quarter of 2017 was generally above expectations. Growth in the 19-nation Eurozone in 2017 is expected to be 2.1% – a noticeable improvement from the previous year. Meanwhile, official statistics from Eurostat showed that GDP in the Eurozone increased 0.6% in the third quarter compared to 0.7% in the previous quarter. Year-on-year, GDP increased by 2.5% in 2017 Q3 compared to the same period last year (see Figure 1.1.).

In the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)[3] region, the global factors shaping the world economic outlook for 2017 will be reflected in the outlook for the region through their impact on commodity prices, export demand, remittance flows, exchange rates, and financial conditions. The IMF suggests that the global outlook is consistent with somewhat higher commodity prices and stronger global trade, which will support economic activity in the MENAP region. In addition, stronger growth in China will also support anticipated investment in some countries. However, the outlook also implies higher interest rates, which will at varying degrees, increase fiscal vulnerabilities across the region. For MENAP oil exporters, growth is expected to slow in 2017 because of the oil production cuts agreed to under the terms of the OPEC deal. In contrast, although the outlook varies across individual countries, overall growth in the non-oil sector is expected to increase in 2017 as the pace of fiscal consolidation eases. For MENAP oil importers, growth is expected to increase from 3.7% in 2016 to 4.3% in 2017 and to 4.4% in 2018. In addition, growth will be

[1] In November of 2016, OPEC reached an agreement to cut oil production to 32.5 million barrels a day.

[2] The annualized quarterly growth for 2017 Q3 is 3.3%.

[3] 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.

[Please Rate this Report]

supported by the broader global recovery, which is expected to boost demand from the region's main export markets (see Table 1.1.).

Table 1.1. Real GDP growth in the MENAP region

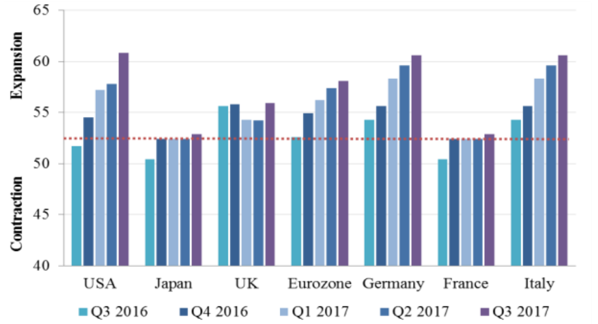
	2014	2015	2016	Projections 2017	Projections 2018
MENAP	**2.8**	**2.7**	**3.9**	**2.6**	**3.5**
MENAP oil exporters	**2.6**	**2.1**	**4.0**	**1.7**	**3.0**
MENAP oil importers	**3.1**	**3.9**	**3.7**	**4.3**	**4.4**

Source: IMF

The growth figures described in previous paragraphs are reflected in the Purchasing Manager's Index (PMI) for the respective economies.[4] The Eurozone economies show continued improvements in both manufacturing and services PMIs. The Eurozone's overall PMI increased from 57.4 in the second quarter to 58.1 in the third quarter. For individual Eurozone countries, Germany's PMI increased from 59.6 to 60.6, France from 52.4 to 52.9, and Italy from 59.6 to 60.6. The PMI levels for the US and the UK increased also. Japan's PMI also showed improvements in the third quarter of 2017. Japan's PMI continued to rise for the third quarter to 52.9, extending the current sequence of expansion to ten months (see Figure 1.2.).

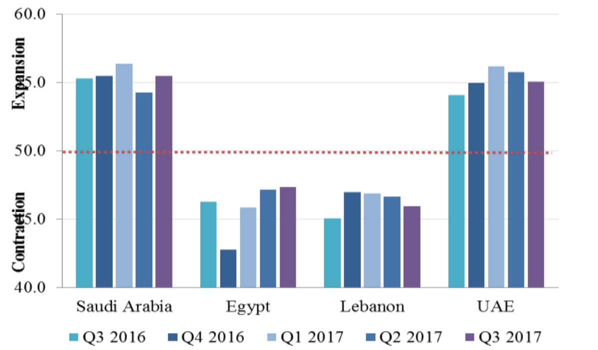
In the Middle East and North Africa (MENA) region, PMI levels showed mixed movements in the third quarter. In Saudi Arabia, PMI in the non-oil private sector economy rose from 54.3 in 2017 Q2 to 55.5 in 2017 Q3. PMI for Egypt also increased to 47.4 compared to 47.2 in the previous quarter, but remains below the 50 mark, i.e., in a contractionary zone. PMI levels for both the UAE and Lebanon decreased slightly from the second to the third quarter (see Figure 1.3.).

Figure 1.2. PMI levels for selected developed countries as of end of period



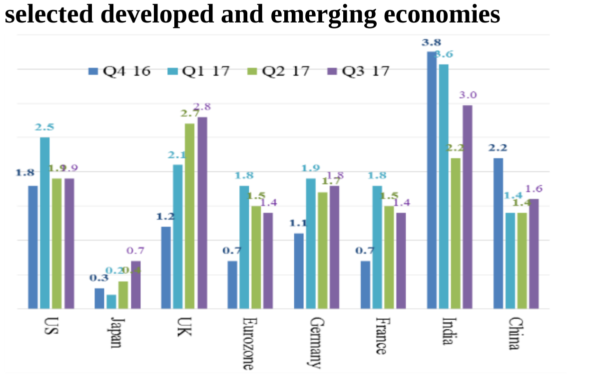
Source: Bloomberg

Figure 1.3. PMI levels for selected MENA countries as of end of period



Source: Bloomberg

Figure 1.4. Year-on-year consumer price change for selected developed and emerging economies



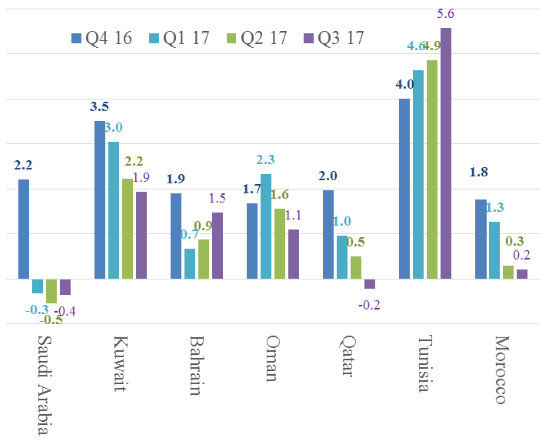
Source: Bloomberg

Inflation of consumer prices decreased, year-on-year, for the Eurozone and one of its members – France. All other selected economies in Figure 1.4 have seen a rise or no change in inflation in 2017 Q3. These figures suggest that

[4] A PMI reading above 50 indicates expansion and below 50 a contraction.

price developments have been relatively strong. However the major central banks are still struggling to meet their inflation targets. The Bank of Japan, for example, pushed back by a year the timing for hitting its 2% inflation target, a blow to the bank's radical monetary experiment aimed at sustainably ending deflation.

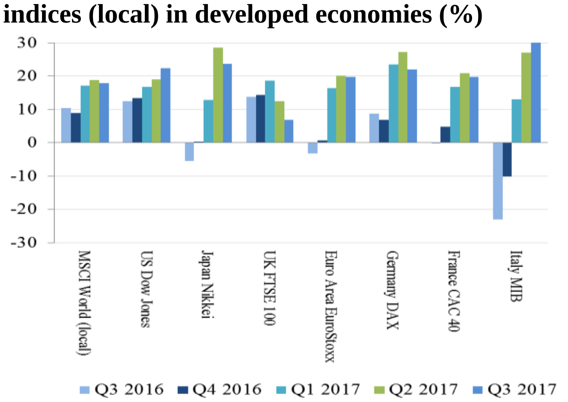
Figure 1.5. Year-on-year consumer price change for selected MENA countries



Source: Bloomberg

For the MENA region, there was a mixed movement of inflation during 2017 Q3. In Tunisia, prices edged up slightly, as prices accelerated for transport and some tradable goods. Bahrain's inflation rate increased slightly as prices of food and non-alcoholic beverages, which account for 16% of consumer expenses rose further from a year earlier. In Saudi Arabia, deflation continues as prices fell for the third consecutive quarter – reaching 0.4%. Prices declined for almost all tradable categories. In contrast, the cost of housing and utilities went up at a faster pace (see Figure 1.5.).

Figure 1.6. Annual percentage change of equity indices (local) in developed economies (%)

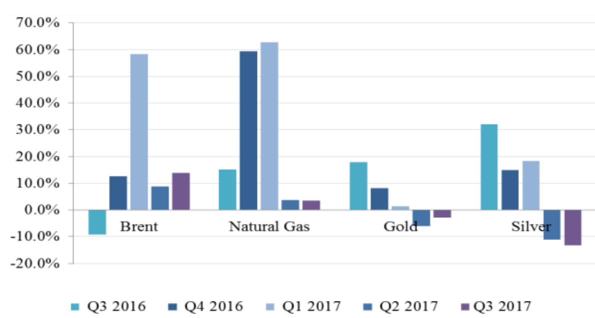


Source: Bloomberg

In the third quarter of 2017, the price levels of Brent crude and natural gas increased while the price levels of gold and silver decreased from the same period last year. Brent crude prices increased 13.8% and natural gas increased 3.5%. Gold prices decreased by 2.7%, and silver decreased by 13.1%, as investors' concerns about US future Federal Reserve interest rate hikes, and political uncertainty outside the US factored into prices (see Figure 1.7.).

Quarter-on-quarter, oil prices increased 5.1% (from \$49.6 to \$52.1) in the third quarter mainly due to the extension of the OPEC agreement. As a result, the US daily oil production increased to 9.5 million barrels in the third quarter of the year. The U.S. Energy Information Administration (EIA) forecasted that total U.S. crude oil production will average 9.3 million barrels per day (b/d) in 2017, up 0.5 million b/d from 2016. In 2018, the EIA expects crude oil production to reach an average of 9.9 million b/d, which would surpass the previous record of 9.6 million b/d set in 1970.

Figure 1.7. Selected commodity price levels (Y-o-Y, %)



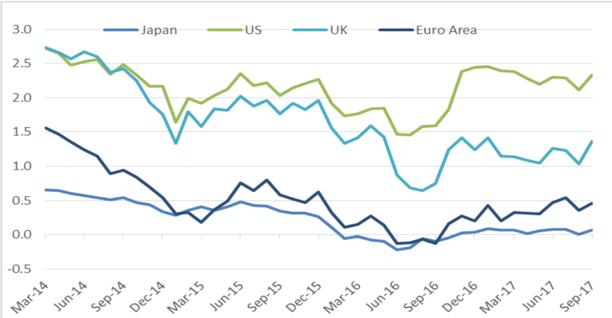
Source: Bloomberg

During the third quarter of 2017, government bond yields moved higher, in general, reflecting stronger outlook of rising inflation and rising expectation of tighter liquidity going forward (see Figure 1.8.). In the United States, government bond yields increased amid expectations of continued Federal Reserve (Fed) commitment to rising interest rates in 2017 and 2018. The strong jobs numbers are also likely to encourage the Fed to further tighten monetary policy. In the Eurozone, government bond yields reflected signs of economic recovery in many Eurozone economies and expectation of monetary tightening by the ECB in the near future. Similarly, the UK bond yields also moved slightly higher, while the Japanese bond yields remain the lowest, however in

[Please Rate this Report]

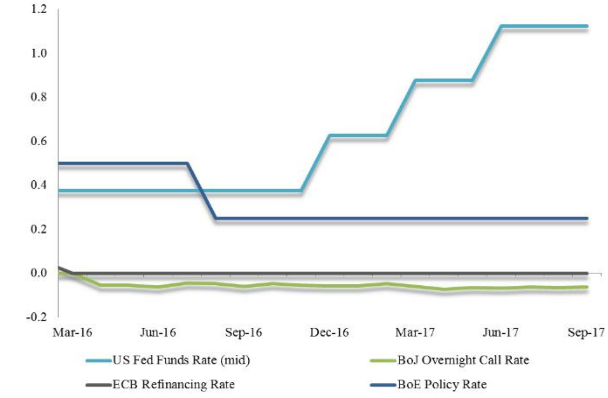
positive territory. The increase in its July value, the highest since January 2016, is due to the pickup in inflation, following persistent negative interest rates set by the Bank of Japan.

Figure 1.8. 10-year government bond yields for selected countries (%)



Source: Bloomberg

Figure 1.9. Policy rates for selected developed countries (%)



Source: Bloomberg

In terms of monetary policy, the Fed did not do any further increase of its Federal Funds rate in the third quarter. However expectations remain bullish for further rate hikes, with the probability for December being of more than 90% as there are many signs that the central bank believes the U.S. economy is on solid ground. The Fed's key interest rate now ranges between 1% and 1.25%. The ECB left its benchmark interest rate unchanged at 0.00% in its September meeting – marking 19 consecutive months of 0.00% interest rates. The ECB also announced that it expected interest rates to remain at present levels for an extended period of time and that it would be ready to extend its quantitative easing (QE) program if needed. The Bank of England (BoE) has also left the UK interest rates at their current low record of 0.25%. According to the BoE, a combination of weak UK economic data and uncertainty surrounding Brexit talks contributed to their decision to keep rates unchanged, although a probability of a rate hike has surfaced recently to counter inflationary pressures (see Figure 1.9.).

Please Rate this Report

Chapter 2: Domestic Economic Developments

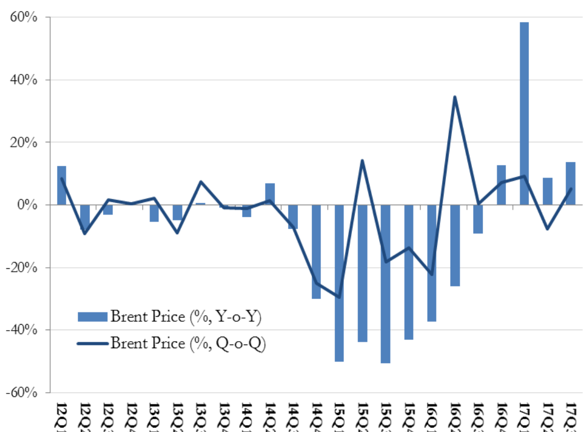
According to the index of non-oil activity constructed by CBUAE (Non-Oil ECI), the non-hydrocarbon sector in the UAE grew by 3.1% in the third quarter of 2017, driven mainly by the pick-up of government spending and employment, higher oil prices and improved growth in the main UAE trading partners. However, the growth of the overall Economic Composite Index decelerated to 0.7% on account of the oil production cut to which the UAE has committed. The inflation rate declined again to reach 0.8% against 2% in the second quarter of the year, primarily driven by the deflation of Housing and Utilities Prices (-0.6% against 1.3%) and the slowdown of Transportation Price inflation (2% against 5%). Employment expanded by 3.6% in the second quarter of 2017 after a subdued growth previously (1.2%).

2.1. Economic Activity and Growth

Oil prices continued their recovery for the fourth consecutive quarter in response to the OPEC agreement that became effective on January 2017 which stipulates a coordinated oil production cut among its members. In fact, the Brent price increased by 13.8% on a year on year basis during the third quarter of 2017 against an 8.8% increase in the previous quarter, leading to a quarterly average increase of 23.4% in 2017. On a quarterly basis, the oil price rebounded by 5.1% in the third quarter compared to a previous drop by 7.5% in the second quarter (see Figure 2.1.a). In addition to the recent recovery of the global demand and the OPEC agreement, the revival of oil prices can also be attributed to the disruption of oil production due to a natural disaster which occurred around oil production sites and security incidents (e.g. hurricanes in the US and the Civil War in Libya).

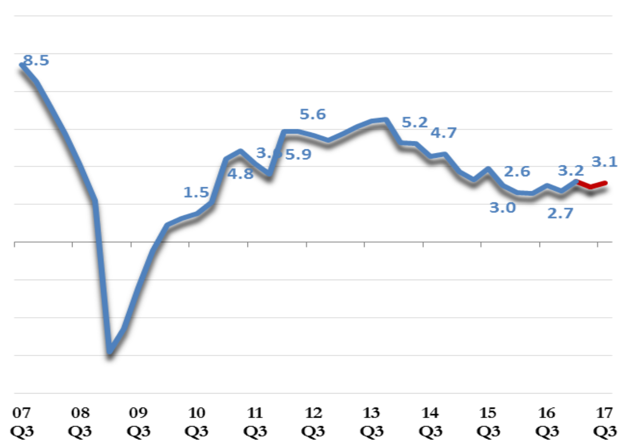
In the UAE, the recent improvement in oil prices has shed a positive sentiment on the economic activity in the non-oil sector and boosted economic confidence. The Non-oil Economic Composite Index (Non-oil ECI) expanded by 3.1% y-o-y in the third quarter of 2017 adding to a 3% growth during the previous quarter (see Figure 2.1.b), leading to an average quarterly growth of 3% for the first three quarters of 2017. The non-oil ECI is a composite economic index developed by the Central Bank of UAE and tracks the economic activity quarterly. It takes into account the fluctuations of economic conditions of trading partners as well as it trails changes of domestic economic outlook quarterly. Historically, it grew on average by 5.4% y-o-y during the post-financial crisis period to decelerate during the post-oil price drop period (3.3% y-o-y on average).

Figure 2.1.a Quarterly Oil prices development, Brent price



Source: EIA

Figure 2.1.b Non-Oil quarterly Economic Composite Indicator (Non-Oil ECI)

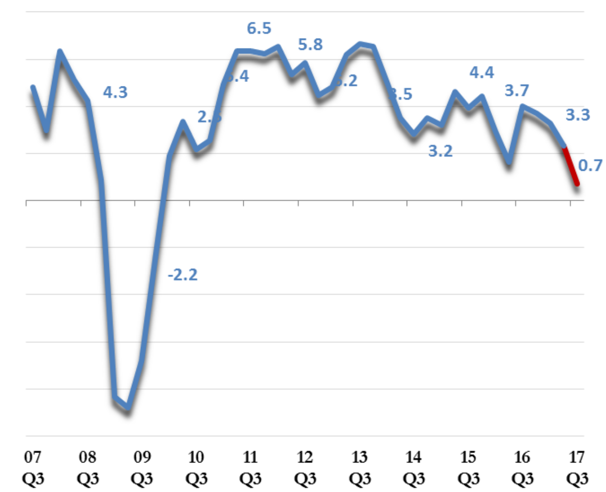


Source: CBUAE

Please Rate this Report

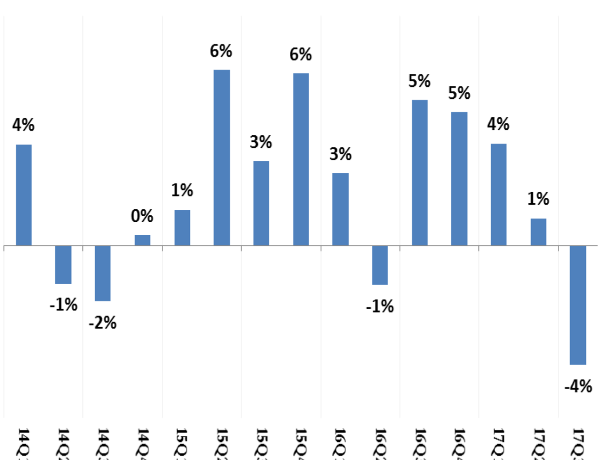
The overall ECI which covers in addition to the non-oil activity the oil sector, expanded only by 0.7% y-o-y in the third quarter of 2017 from 2.3% in the previous quarter (see Figure 2.1.c). This slowdown is due mainly to the decline in oil production in-line with the UAE's commitment to the OPEC agreement. The oil production fell by 4% y-o-y in the third quarter of 2017 after a previous expansion of 1% y-o-y (see Figure 2.1.d). It is the first annual production cut observed since the second quarter of 2016 and came as a result of a declining quarterly trend that started from the first quarter of 2017 where oil production initially dropped by 5% q-o-q with further cuts at 2% in the second quarter (see Figure 2.1.e).

Figure 2.1.c Overall quarterly Economic Composite Indicator (ECI)



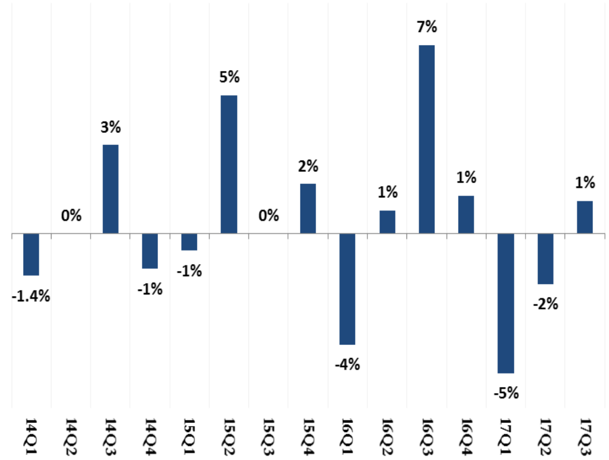
Source: CBUAE

Figure 2.1.d Quarterly Oil production Growth (%, Y-o-Y)



Source: OPEC (as of October 2017)

Figure 2.1.e Quarterly Oil production Growth (%, Q-o-Q)



Source: OPEC (as of October 2017)

The impact of the UAE's commitment to the OPEC agreement is also reflected by the recent central bank's revised estimate of the real oil GDP. The latter is expected to shrink by 1.4% in 2017 (see Table 2.1). Moreover, the Annual Non-oil GDP is expected to grow by 3% in 2017 after expanding by 2.7% in 2016, leading to an overall expansion of the real GDP by 1.6% in 2017 against 3% in 2016. The underperformance of the economy and the declining trend of the GDP growth rate since 2014 can be attributed mainly to the decline of the government and private spending in the UAE during the period following the adverse oil price shock in 2014 (see Box 1 for details).

Table 2.1 Economic Growth in the UAE (%)

	2014	2015	2016	2017(E)
Real GDP	3.3	3.8	3.0	1.6
Real Oil GDP	0.4	5.4	3.8	-1.4
Real Non-Oil GDP	4.6	3.2	2.7	3.0

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

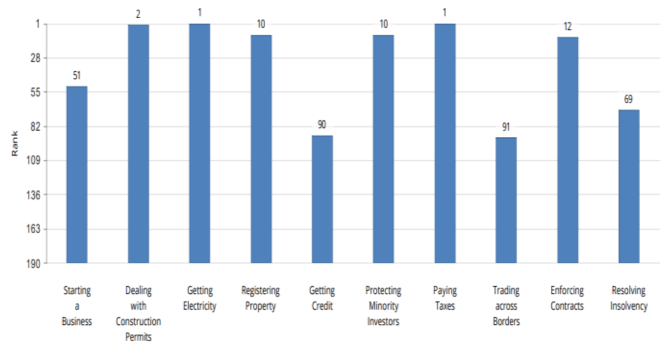
The resiliency of the UAE's economy, especially the non-oil sector, to the challenging environment which is characterized by low and volatile oil prices is supported by a high quality infrastructure, a vibrant

[Please Rate this Report]

business environment and a competitive economic framework. In its 2018's Doing Business Report which provides an objective measure of business regulation and their enforcement, the World Bank ranked the UAE as the 21st best regulatory environment applicable to local firms among 191 countries around the world and the first among the MENA countries.

The breakdown of the doing business indicator shows that the UAE holds the first place in the world for getting electricity and business taxation sub-indicators. It ranks the second in the world for dealing with construction permits while Registering Property and Protecting Minority Investors share the tenth place (see Figure 2.1.f).

Figure 2.1.f Ranking of the Doing Business Sub-Indicators



Source: Doing Business Report, 2017, WB

Please Rate this Report

Box 1: Private and Public Expenditures and the Economic Cycle

Private and Public Expenditures

Based on the latest data published by the Federal Competitiveness and Statistics Authority (FCSA) for the period 2011-2016 for the GDP by type of expenditure (Table 1), Final Consumption as a whole moved from 9.3% growth in 2014 to 9.1% decline in the following year, a period that coincided with strong fiscal consolidation and low oil prices. However, in 2016 it has marginally declined by just 0.1% as the pace of fiscal consolidation slowed down. Disaggregating the Final Consumption by Government and Private sectors, both were growing at a very high pace in 2014, with the Private sector consumption recording a double-digit growth. In 2015, the main reason for the decline of the overall final consumption was the deep fall in Private sector final consumption by 11.7%, while the Government consumption continued to grow at 3.8%. In 2016, Government and Private Final Consumption stabilized with the Government consumption marginally growing by 0.4%, while Private consumption marginally declined by 0.3%.

Table 1: Growth rates by Type of Expenditure in real values

	2011	2012	2013	2014	2015	2016
Final Consumption Expenditure :	**11.7**	**-1.8**	**7.9**	**9.3**	**-9.1**	**-0.1**
Government Expenditure	20.1	4.4	22.4	5.2	3.8	0.4
Private Expenditure	10.4	-2.8	5.3	10.1	-11.7	-0.3
Gross Fixed Capital Formation: :	**5.1**	**3.7**	**-8.8**	**11.1**	**6.1**	**-1.6**
Public	5.0	3.6	4.0	12.8	8.0	0.4
Private	5.1	3.8	-17.5	9.6	4.4	-3.5

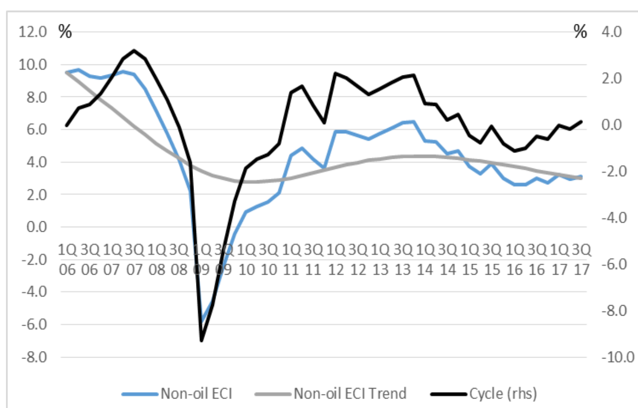
Source: FCSA

Gross Fixed Capital Formation grew in 2014 and 2015 by 11.1%, 6.1% but declined in 2016 by 1.6%. Gross Fixed Capital Formation for the Public sector remained positive through the three past years, although the rate of growth slowed down with the decline in the oil price and fiscal consolidation. It grew by 12.8% in 2014, rising by 8% in 2015, to reach 0.4% in 2016. The Private Sector Gross Fixed Capital Formation registered positive growth rate in 2014 of 9.6%. However, the growth momentum slowed down with the oil price cycle to 4.4 in 2016 and 3.5% in 2016.

The Economic Cycle

To better understand in which phase of the economic cycle the UAE stands and to further analyze whether the economy is underperforming or over-performing compared to its long term trend a two sided HP (Hodrick Prescott) filter[5] has been applied on the quarterly non-oil ECI produced by the CBUAE for the period 2006 Q1 – 2017 Q3 (See Figure 1).

Figure 1: Non-oil ECI, Trend and Cycle



Source: CBUAE and CBUAE analysis

For the period prior to the Global Financial Crisis the non-oil ECI was over-performing, in general, relative to its long term trend. Subsequently, the economy moved to a downturn at the peak of the financial crisis in 2008

5 A smoothing parameter of λ = 1,600 was used for the quarterly series.

Please Rate this Report

Q3, which lasted up to 2011 Q1. Subsequently, the cycle remained positive, i.e., the non-oil ECI was over-performing relative its long term trend before the decline in the oil price in mid-2014. Starting from 2015 Q1, as a result of the lower oil prices and fiscal consolidation, the economy was underperforming, i.e., the non-oil ECI was below its long-term trend. However, as of 2017 Q3, the cycle moved again into positive territory. Hence, the third quarter of 2017 is the first quarter since the beginning of the oil price fall that marks the recovery of the non-oil ECI to its long-term trend, signifying a rebound towards further growth.

Please Rate this Report

2.2 Consumer Price Index and Inflation

The headline inflation declined for the second consecutive quarter to continue on disinflationary pattern similar to its path in 2016. Following a temporary rebound in the first quarter of 2017, the inflation rate dropped during the third quarter of 2017 to reach 0.8% against 2% in the second quarter (see Table 2.2.). In September, the annual inflation rate of the Consumer Price index (CPI) increased by 0.5%, the lowest monthly reading since January 2013 (0.4%, y-o-y). This trend was the result of a decline in both tradables and non-tradables inflation (see Figures 2.2.a and 2.2.b).

The Price inflation for Tradables, which account for 34% of the consumption basket in the UAE, increased by 1.8% in the third quarter of 2017 against 2.7% in the previous quarter on a year-on-year basis. Except for prices of food and soft drinks whose inflation increased from 0.8% y-o-y in the second quarter to 1.2% in the third quarter in line with the Dirham's deprecation, price inflation of all tradable items has declined.

The prices of Beverages and Tobacco declined by 0.4% y-o-y in the third quarter after an increase by 1.2% in the previous one, the first deflation since the first quarter of 2016. Similarly, prices of textiles, clothing and sportswear dropped by 2.3% y-o-y against an increase by 1% previously. Both items account for more than 10% of tradables in the consumption basket.

The decline in the tradable component of transportation costs has contributed significantly to the slowdown of the tradables' inflation. The retail prices of tradable energy which account for 21.5% of tradables increased by 2% in the third quarter after an increase of 5% in the second quarter and 8.5% in the first quarter, in line with the slowdown in international oil prices on a year-on-year basis. The energy subsidy-cut reform implemented by the government in August 2015 has marked the beginning of energy-retail price indexation to international oil prices.

Moreover, the furniture and households goods' inflation displayed a drop from 1.2% in the second quarter to stand at 0.8% in the third quarter of 2017. The declining trend for major tradable items was triggered by the large sales promotions and discounts associated with the back-to-school season.

The consumption of non-tradables constitutes the major part of the consumption basket in the UAE for a share of 66%. Similar to tradables prices, the price inflation of non-tradables decelerated to 0.5% in the third quarter of 2017 against 2.1% previously with an end-of-period non-tradable inflation in the second quarter of 0.3%, the first monthly non-tradable deflation since July 2012 (see Figure 2.2.a).

This decline in inflation for non-tradables was triggered by the declining housing costs which cover rental prices and utilities costs and account for 52% of the non-tradables.

Table 2.2. UAE CPI inflation (%)

	Weight %	2016				2017		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
CPI Inflation (period average)	100	2.1	1.7	1.5	1.9	2.7	2.0	0.8
CPI Inflation (end-of-period)	100	1.4	1.8	1.4	1.2	3.0	2.0	0.5
Tradable Inflation	34	-0.4	0.3	-0.7	0.6	3.4	2.7	1.8
Non-tradable Inflation	66	2.6	1.9	2.1	2.7	2.9	2.1	0.5
Housing Inflation	34	5.1	3.3	4.1	3.7	2.1	1.3	-0.6
Transportation Inflation	15	-6.7	-2.7	-5.9	-1.1	8.5	5.0	2.0
Other[6] Inflation	51	1.4	1.2	1.3	1.7	2.4	2.3	1.8

Source: Federal Competitiveness and Statistics Authority (FCSA).
Note: All the changes are computed on a Y-o-Y basis and based on the quarterly average CPI, unless otherwise indicated. The Tradables and non-tradables inflation rates were computed using the Y-o-Y growth of weighted-average CPI of different sub-components

The inflation of quarterly Housing costs slowed down significantly since the last quarter of 2015 but they registered the first deflation since 2013. Housing prices (including rents and utilities) declined by 0.6% during the third quarter of 2017 against a 1.3% increase in the second quarter on account of a drop by

[6] Excluding housing and transportation

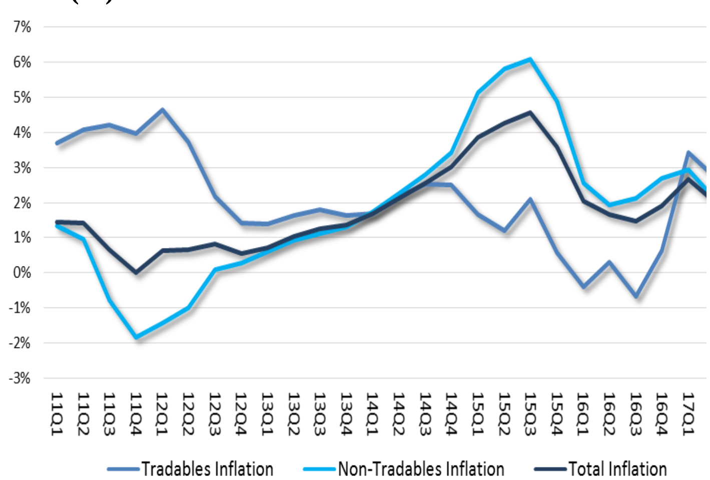
Please Rate this Report

1% in August followed by a further decline of 1.9% in September. The average monthly housing prices for the first nine months of 2017 increased by 0.9% y-o-y against 4.2% during the same period in 2016 and 9% during the same period in 2015. The housing rental prices declined by 10.5% and 6% in Abu Dhabi and Dubai, respectively during the third quarter of 2017 adding to a previous decline in the second quarter by 10% and 4.5% in both emirates. These developments can be explained by a glut in supply relative to the decline in demand and a softer job market, which has reflected on property prices (see Box 2: Recent Developments in the Real Estate Market, for more details).

In addition, the prices of communication continued their deflation for the tenth consecutive quarter. Communication spending represents 5.4% of the cost of a standard consumption basket in the UAE. They fell by 1.3% in the third quarter of 2017 adding to a maximum price decline recorded in the previous quarter (2.5% y-o-y) (see figure 2.2.b.).

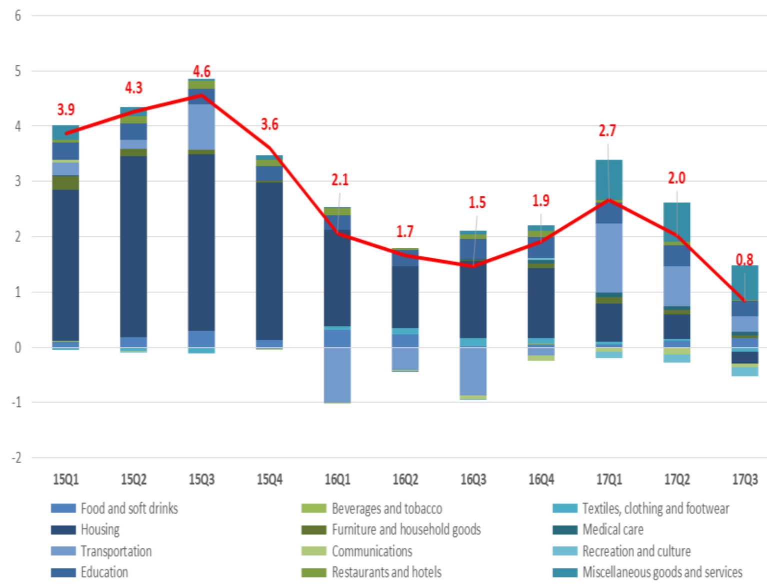
Similarly, average quarterly Recreation and Culture costs declined for the third consecutive quarter. They dropped by 5% y-o-y in the third quarter after previous decline by 4.5%, leading to an average quarterly deflation of 4.4% during the first three quarters of 2017. On the other hand, education costs kept increasing from the end of 2015 and jumped by 3.5% in the third quarter adding to a 4.7% increase in the second quarter of 2017.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

Please Rate this Report

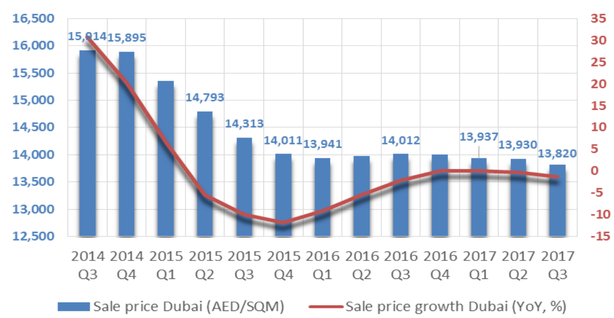
Box 2: Recent Developments in the Real Estate Market

According to recent data for REIDIN Price Index[7], the UAE residential Market continues to decline moderately in the third quarter of 2017. In Dubai, on an annual basis the property prices decreased by 1.37% with a decline of 0.8% compared to the previous quarter, and in Abu Dhabi the annual drop in property prices was 8.6% with 2.7% fall compared to the previous quarter. The rental yield, which measures the rate of income return over the cost associated with an investment property decreased slightly in Dubai to 6.99%, and increased in Abu Dhabi by 0.01 percentage point to reach 7.17%.

Dubai residential Market

In the third quarter of 2017, property prices, which measures the average sample price in dirham per square meter of residential properties, decreased by 1.37% Y-o-Y compared to 0.29% in the previous quarter (Figure 1).

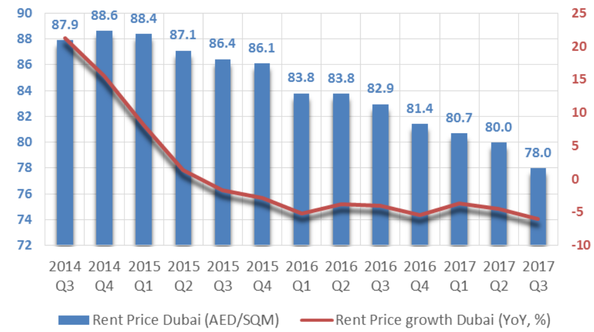
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

Despite the property price relative stability since mid-2016, the Dubai market continues to exhibit decline in rent (Figure 2), due to high supply, lower demand and a softer job market. The rent prices declined by an annual rate of 6% in the third quarter, following a decrease of 4.5% in the previous quarter.

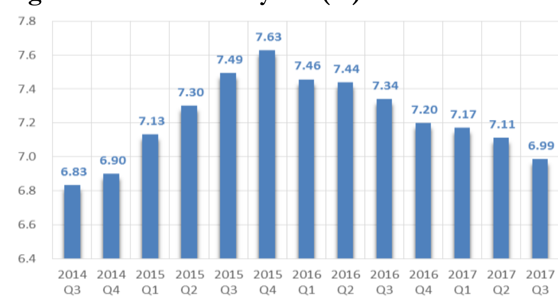
Figure 2: Dubai Residential Rent Prices



Source: REIDIN

As regard to investment in Dubai's real estate market, it is clear that 2016 was marked by a slowdown in rental yield from a high of 7.46% in the first quarter to a low of 7.20% in the last quarter of 2016 (Figure 3). The declining trend was the result of sharper decline in rent compared to the pace of decline in property prices. More recently, the rental yield declined to 6.99% in the third quarter of 2017, but remains attractive for investors.

Figure 3: Dubai rental yield (%)



Source: REIDIN

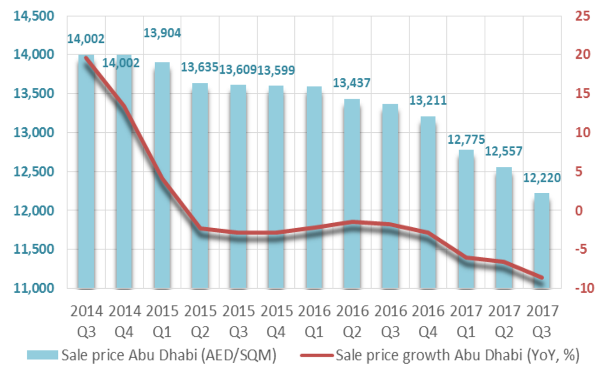
Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index exhibited a continued fall in residential property prices of 8.6% Y-o-Y in the third quarter of 2017, following a decrease of 6.6% in the previous quarter (Figure 4).

[7] 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.

[Please Rate this Report](#)

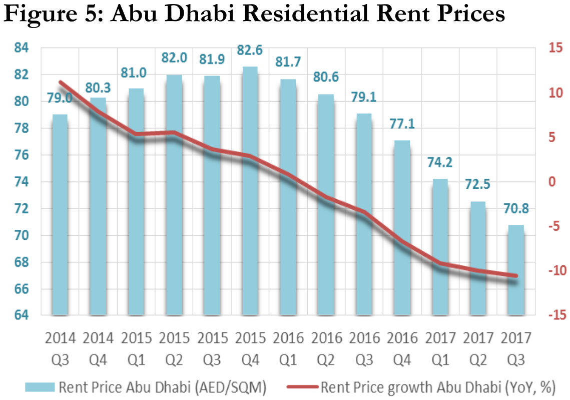
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

As for the rental market, in addition to the reinstatement of the 5% residential rent cap in mid-December 2016, the rent prices in Abu Dhabi continued to decline by an annual rate of almost 10.5% on average in the third quarter of 2017, after a reduction of 10% in the previous quarter. This trend is reflecting the impact of softer job market and the cuts in public expenditures, which continue to weigh in on demand in the housing market (Figure 5).

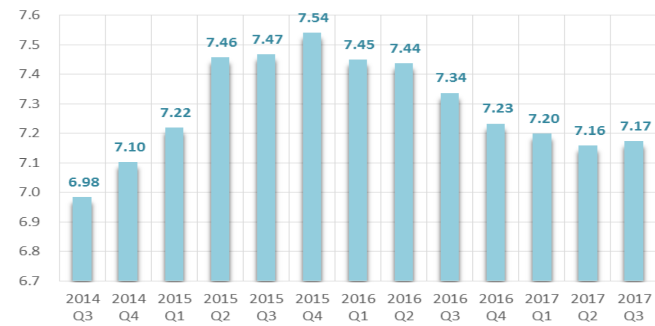
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

Concerning the rental yield, Abu Dhabi registered a yield of 7.17% for the third quarter of 2017, a marginal increase from the previous quarter (Figure 6). The observed pattern in rental yield reflects a constant pace of decline in rent along with continued decline in the job market relative to the investment sentiment in properties, against the backdrop of the outlook for the economy given the persistence of low oil prices.

Figure 6: Abu Dhabi rental yield (%)



Source: REIDIN

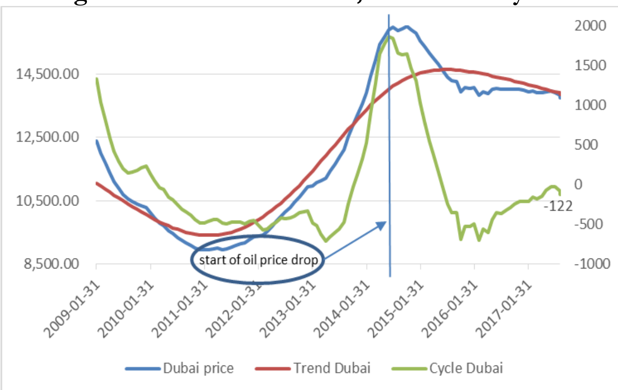
Real Estate Prices, Trend and Cycle

Using a two-sided Hodrick-Prescott (HP) filter[8] on the Dubai property sale prices the long-term trend and cycle have been extracted (Figure 7). From 2010 until late 2013 the gap (or cyclical component) was negligible oscillating around zero. From end of 2013 until mid-2014 the gap moved into positive territory signaling overheating of the real estate market. Since mid-2014, marking the beginning of decline of oil price, the gap started to decline, moving to negative territory by the end of 2015. Subsequently, it started recovering with the cyclical downturn being negligible, but still negative as of September 2017, which indicates that the prices are close to their long term-trend, and hence the market is neither overheating, nor underperforming.

[8] A smoothing parameter of λ = 14,400 was used for the monthly series.

[Please Rate this Report]

Figure 7: Dubai Sales Price, Trend and Cycle

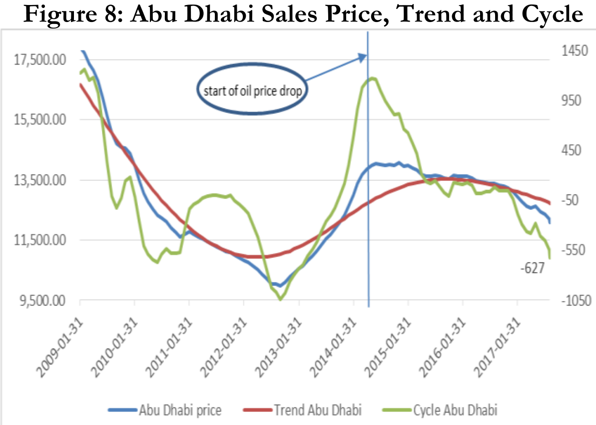


Source: REIDIN and CBUAE

When it comes to Abu Dhabi real estate market (Figure 8), the cyclical component of the price declined gradually starting in 2009, moving to negative territory in the middle of the year (during the Global Financial Crisis), with a slight recovery during 2011-12, reverting to a new low in 2013 and subsequently overheating to reach a peak of more than AED 1,000 per square meter excess of price compared to the long term trend in mid-2014.

Since then, with the oil price decline and lesser government spending the positive cycle started to shrink, reversing to a negative cycle of AED 627 per square meter difference relative to the long-term trend, i.e., the market is underperforming relative to its historical trend.

Figure 8: Abu Dhabi Sales Price, Trend and Cycle



Source: REIDIN and CBUAE

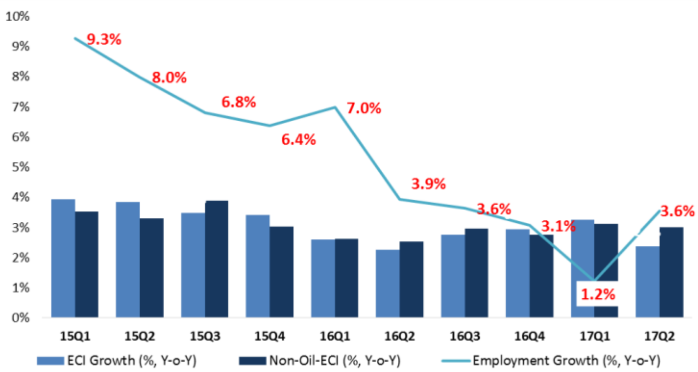
[Please Rate this Report]

2.3 Employment and labor market dynamics

After a slowdown in the demand of labor during the first quarter of 2017 where it grew by 1.2%, the demand for labor rebounded as growth reached 3.6% in the second quarter of 2017 on a year on year basis (see Figure 2.3.a). This growth rate is the highest reading since the third quarter of 2016 and higher than the average growth rate of 3.1% during the last 5 quarters.

This positive development in the second quarter shows the positive economic sentiment that has developed following the rebound of oil prices and its positive impact on employment and the dynamic of the labor market. The resiliency of the non-oil sector has positively impacted labor in the second quarter, especially in the Real Estate, Construction and Services sectors.

Figure 2.3.a. Employment growth and economic activity in the UAE



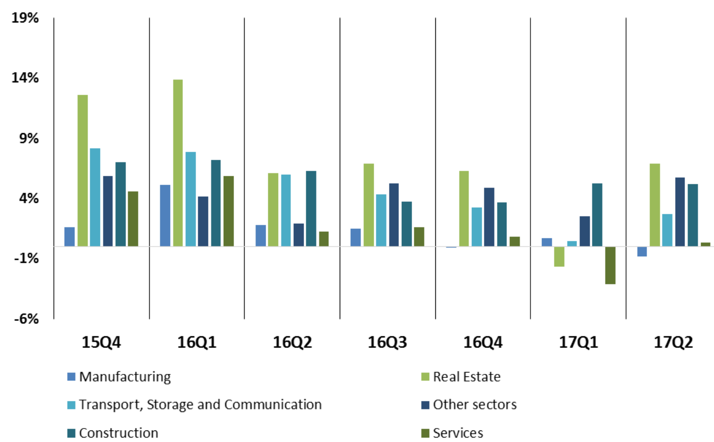
Source: Central Bank of UAE and Ministry of Human Resources and Emiratisation

The employment rally was a reflection of the resilience of the UAE economic activity depicted by the expansion of the overall economic composite index (ECI) by 2.3% to which the non-oil sector contributed by 3% on a year on year basis (see Figure 2.3.a) in the second quarter of 2017.

On a year-on-year basis, labor demand increased in all sectors except manufacturing where it declined by 0.8% (see Figure 2.3.b). The most important recovery was evident in the Real Estate sector which accounts for 12% of the total labor force, respectively, in the second quarter of 2017. Employment in this sector expanded by 6.9%, after a contraction by 1.7% during the first quarter of 2017. The Construction sector which absorbs around 34% of the labor force expanded its demand for labor by 5.2% in the second quarter, similar to the previous one. Lastly, labor in the Services sector which account for 23% of the employment increased by 0.3% after a shrinking by 3.1% previously.

The transport, Storage and Communication sector expanded its demand for labor by 2.7% in the third quarter of 2017 against 0.5% in the previous quarter which was the lowest quarterly growth since more than a decade.

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

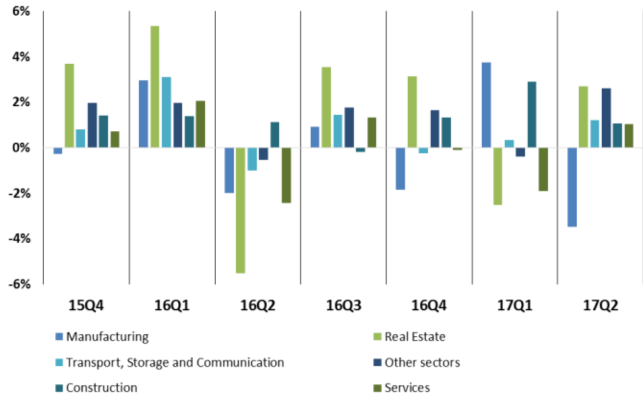


Source: Ministry of Human Resources and Emiratisation

On a quarterly basis, the development of employment displayed the same pattern as the annual fluctuations. As depicted by Figure 2.3.c, total employment grew by 1.1% compared to the first quarter of 2017, the highest quarterly growth since the third quarter of 2016. The main contributor to this achievement was the Real Estate sector whose demand for labor jumped by 2.7% Q-o-Q. The Construction sector contributed by 1.1%, Transport, Storage and Communication sector by 1.2% and the Services sector by 1%. However, the labor demand in the Manufacturing sector shrank by 3.5%.

Please Rate this Report

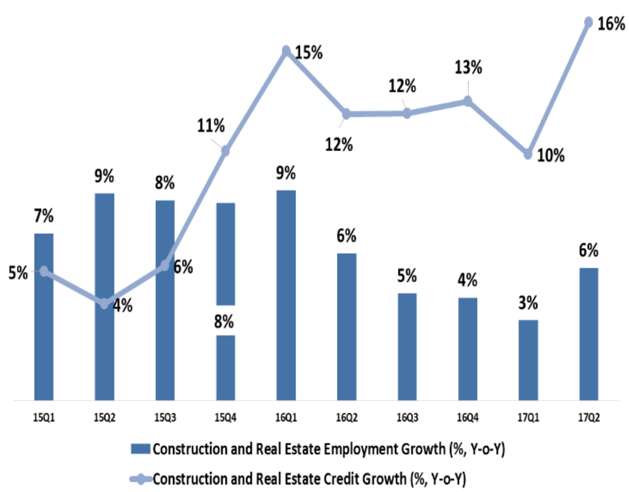
Figure 2.3.c Employment growth by sector (%, Q-o-Q)



Source: Ministry of Human Resources and Emiratisation

The positive growth of labor demand in the construction and the real estate sectors was in-line with the rebound of the domestic credit allocated to both sectors. The construction and real estate sectors absorb all together around 46% of the labor force in the UAE. Employment in both sectors increased by 5.6% in the second quarter of 2017 on a year-on-year basis against 3.4% previously, coinciding with a 16% jump in domestic credit for the same period (See Figure 2.3.d). The increase of the domestic credit for the construction and real estate sectors is the highest since the third quarter of 2014. The growth rate of employment and domestic credit in the Construction and Real Estate sectors shows a contemporaneous correlation of 63% during the period 2016Q1-2017Q2.

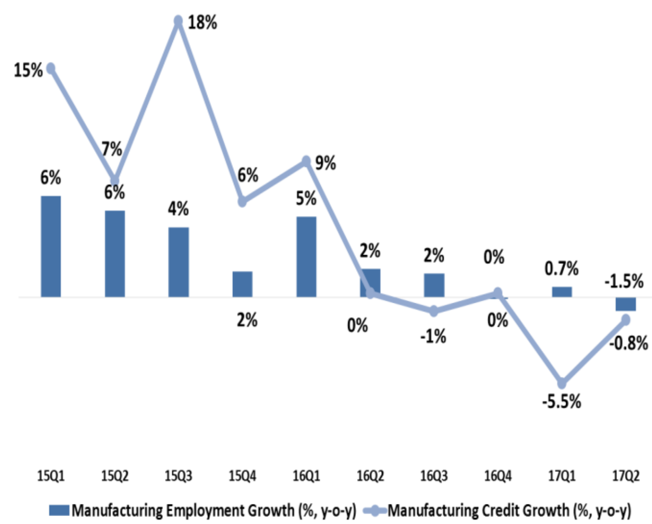
Figure 2.3.d Employment and Domestic Credit developments in the Construction and Real Estate sector



Source: Ministry of Human Resources and Emiratisation and CBUAE

While the figures look positive for the Construction and Real Estate sectors, the manufacturing sector is displaying a different pattern. The domestic credit allocated to the manufacturing sector declined for the second consecutive quarter showing a slowdown in the sector's activity, which is reflected by the 0.8% drop of employment on a year-on-year basis (see Figure 2.3.e). The Manufacturing sector which absorbs around 9% of the labor demand in the second quarter of 2017 dropped its demand for domestic credit by 1.5% y-o-y after an anemic growth of 0.7% in the first quarter of the year. The growth rates of employment and domestic credit in the Manufacturing sector display a contemporaneous correlation of 81% during the period 2016Q1-2017Q2.

Figure 2.3.e Employment and Credit developments in the Manufacturing sector



Source: Ministry of Human Resources and Emiratisation and CBUAE

Please Rate this Report

2.4 Exchange Rate and Foreign Trade Balance

The depreciation of the Dirham continued against the currencies of the UAE's major trade partners for the second consecutive quarter. After a relatively long period of appreciation starting from the third quarter of 2014 until the first quarter of 2017, where the Dirham gained quarterly on average 0.9% and 0.6% against its imports and non-oil export partners, respectively, a depreciation trend has started in the second quarter of 2017.

On the import side, the Dirham depreciated against its all top 9 non-dollarized import partners except the South Korean Won. The weighted Dirham's depreciation was 1.28% in the third quarter of 2017 compared to the previous one, after a depreciation of 1.12% in the previous quarter (see Table 2.3.a.). The sharpest depreciation was against the Euro where the Dirham lost around 6.4%. Imports from Germany, Italy, and France account for more than 12% of total imports to the UAE. It is the highest quarterly depreciation against the Euro for more than a decade, in-line with the depreciation of the US Dollar against the Euro, reflecting the uncertainty surrounding the implementation of fiscal measures in the US and the positive signs delivered by recent economic developments in the Eurozone.

In addition the Dirham depreciated against the Chinese Yuan by 2.76% which is the most significant loss since the financial crisis, where china represents the largest import partner to the UAE that accounts for 12.4% of the total imports. Moreover, the Dirham lost more than 2% in the third quarter of 2017 against the UK pound adding to a 3% loss in the previous quarter.

Moreover, the Dirham lost around 0.3% and 2.3% against the Indian Rupee and the Swiss Franc which cover together more than 12% of UAE's imports. On the other hand, the Dirham appreciated by 0.17% against the South Korean Won. This gain can be attributed to the recent depreciation of the South Korean Won against the US Dollar related to concerns about recent economic sanctions imposed by China.[9] China absorbs around 25% of South Korean exports and supplies 63% of South Korea's tourism revenue.

On a year-on-year basis, the Dirham depreciated also by 0.5%, the first depreciation since the third quarter of 2014, driven by a 5% and 3.9% loss against the Euro and the Indian Rupee, respectively.

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

Currency	Share of UAE imports (%) 2015	% Change of Currencies per Dirham (2017Q1 -2016Q4)	% Change of Currencies per Dirham (2017Q2 -2017Q1	% Change of Currencies per Dirham (2017Q3 -2017Q2	% Change of Currencies per Dirham (2017Q3 -2016Q3)
Chinese Yuan	12.40	0.71	-0.42	-2.76	-0.01
Indian Rupee	9.70	-0.72	-3.69	-0.28	-3.93
Germany (EUR)	6.48	1.20	-3.12	-6.44	-5.03
Japanese Yen	5.65	3.64	-2.22	-0.07	8.44
UK Pound	3.35	0.30	-3.11	-2.30	0.33
Italy (EUR)	2.99	1.20	-3.12	-6.44	-5.03
South Korean Won	2.87	-0.61	-1.86	0.17	1.11
France (EUR)	2.53	1.20	-3.12	-6.44	-5.03
Swiss Franc	2.53	0.30	-1.89	-2.31	-1.37
Total	**48.50**				
Weighted Appreciation		**0.37**	**-1.12**	**-1.28**	**-0.50**

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

On the export side, the Dirham followed a similar pattern. Its weighted deprecation against its top-nine non-dollarized non-oil export partners was 0.63% during the second quarter of 2017 (see Table 2.3.b). The Dirham depreciated against all its non-oil export partners, except the Pakistani Rupee where it gained 0.4% compared to the previous quarter. The sharpest depreciation was against the Swiss Franc and the Euro by 2.3% and 6.4%, respectively. Together, they account for 7.5% of the total non-oil exports from the UAE. It is the second consecutive depreciation of the Dirham against both currencies since the second quarter of 2016.

[9] China started a series of economic sanctions against South Korea in response to the US army's deployment of an anti-ballistic missile system into its site in South Korea. Some economic sanctions started in the third quarter of 2017 (e.g. suspension of tour packages to South Korea, some cosmetic exports are banned…), while others are under study.

Please Rate this Report

The Dirham depreciated against the Iraqi Dinar and the Turkish Lira by 1.19% and 1.88%, respectively. Together, they account for 10.8% of non-oil exports from the UAE. However, on a year-on year basis, the Dirham appreciated by 0.23%. This appreciation was driven by an important gain against the Turkish Lira by 18.5% while the sharpest loss was again relative to the Indian Rupee by 3.9%.

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

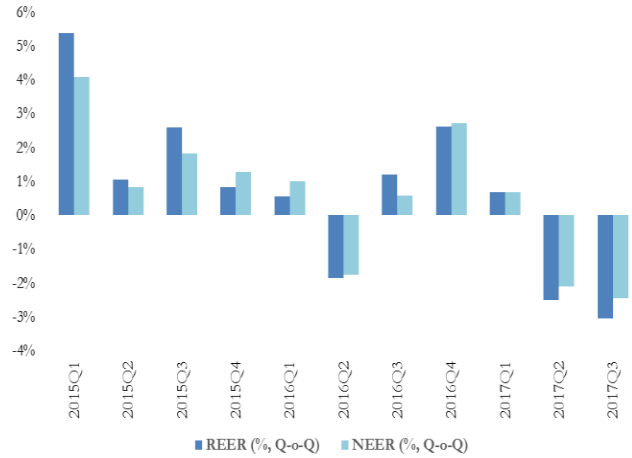
Currency	Share of UAE Exports (%) 2015	% Change of Currencies per Dirham (2017Q1 -2016Q4)	Change of Currencies per Dirham (2017Q2 -2017Q1)	Change of Currencies per Dirham (2017Q3 -2017Q2)	% Change of Currencies per Dirham (2017Q3 -2016Q3)
Indian Rupee	12.47	-0.72	-3.69	-0.28	-3.93
Swiss Franc	5.64	0.30	-1.89	-2.31	-1.37
Iraqi Dinar	5.61	0.11	-0.96	-1.19	-1.75
Turkish Lira	5.16	12.24	-3.06	-1.88	18.44
Singapore Dollar	4.26	0.34	-1.67	-2.27	0.60
Kuwaiti Dinar	4.01	0.37	-0.40	-0.67	0.09
Chinese Yuan	2.34	0.71	-0.42	-2.76	-0.01
Netherlands (EUR)	1.84	1.20	-3.12	-6.44	-5.03
Pakistani Rupee	1.78	0.05	-0.04	0.44	0.60
Total	**43.11**				
Weighted Appreciation		**0.63**	**-0.93**	**-0.63**	**0.23**

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

When considering all trading partners for the UAE, the Nominal Effective Exchange Rate (NEER) displays the same behavior as the weighted change of the Dirham against its imports and non-oil export partners separately. In fact, the quarterly average NEER dropped by 2.4% in the third quarter of 2017 compared to the previous quarter, adding to a previous decline of 2.1% (see Figure 2.4.a).

Similarly, the Real Effective Exchange Rate (REER) fell by around 3% for the same period against a previous decline by 2.5%. In both Nominal and Real terms, the Dirham's Effective Exchange Rate's decline was sharper during the third quarter of 2017, suggesting a further depreciation of the Dirham even when the price differential is taken into account. The difference between the REER and the NEER accounts for the inflation differential in the UAE relative to major trading partners. Figure 3.4.a shows an important price differential, reinforcing the depreciation of the dirham in real effective terms, reflecting the slowdown of domestic inflation in the UAE and the pickup of inflation in major trading partners.

Figure 2.4.a Nominal and Real Effective Exchange rates developments



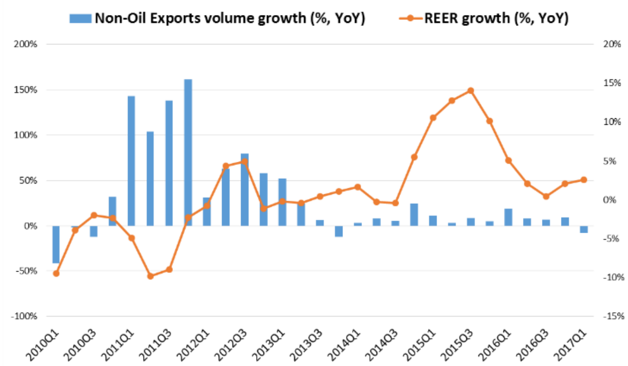
Source: Bank for International Settlement (BIS)

The Dirham's appreciation over an extended period before the second quarter of 2017 and its recent depreciation has raised some questions regarding the impact on the non-oil exports' competitiveness.

As shown in the Figure 2.4.b, during the whole period of Dirham's appreciation, there is no evidence of loss of competitiveness. In fact, the quarterly volume of non-oil exports expanded by 9% on average from the first quarter of 2014 until the last quarter of 2016, coinciding with an average appreciation of the Dirham in real effective terms by 5.3%. However, the first decline was recorded in the first quarter of 2017 where the volume of non-oil exports dropped by 8% on a year-on-year basis.

[Please Rate this Report]

Figure 2.4.b Nominal and Real Effective Exchange rates developments



Source: Federal Customs Authority and Bank for International Settlement (BIS)

In addition, the impact of the Dirham's depreciation on the personal outflows during the third quarter of 2017 was examined. Despite the depreciation of the dirham more recently, the remittances' outflows increased by 14.1% in the third quarter of 2017 on a year-on-year basis against a decline of 7.3% in the previous quarter. India remains the main destination of remittances outflows with a share of 35.7% during the third quarter of 2017 (see Box 3 for more details).

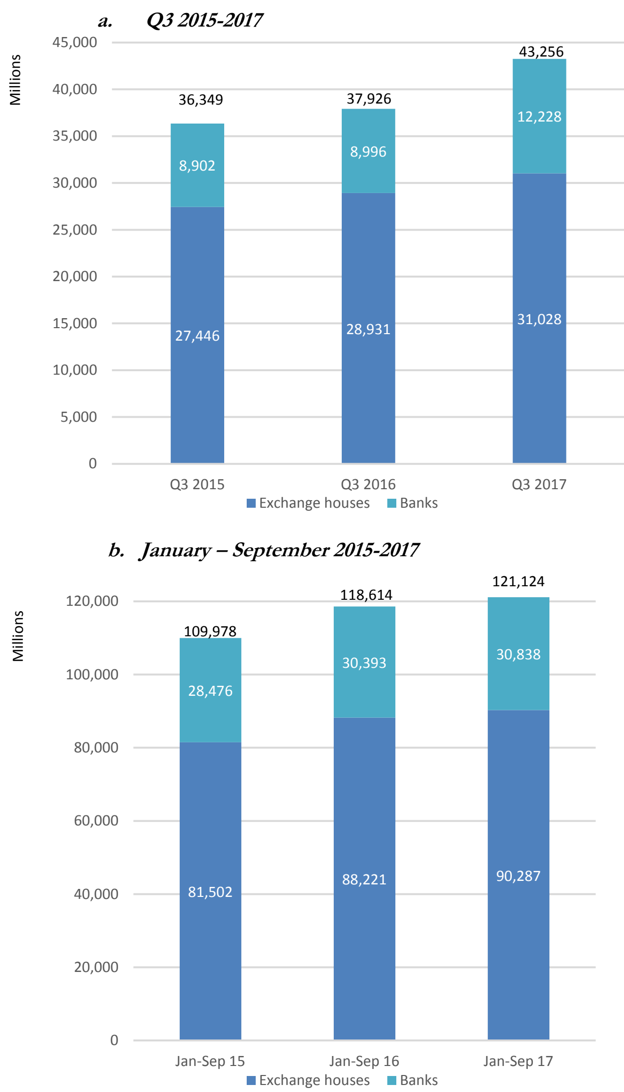
On the other hand, the fluctuations of the Dirham did not seem to have an adverse impact on the tourism sector thanks to price flexibility. An improvement of the tourism activity has been recorded during the first two quarters. In the first eight months of 2017, compared to the same period in 2016, the number of international tourists increased by 7.9% showing a solid trend in attracting international visitors Simultaneously, the average daily rate and the revenue per available room decreased by 4.8% and 5.4%, respectively (weighted average prices of the Abu Dhabi, Dubai and Ras Al Khaimah) for the same period. Consequently, the occupied room nights increased by 3.6%. However, the average hotel occupancy rate decreased by 1.1% for the first eight months of 2017, compared to the same period of 2016 (see Box 4 for more details).

Please Rate this Report

Box 3: Workers' Remittances

The workers' remittances outflows in the third quarter of 2017 recorded AED 43.3 billion, an increase of 14.1% or AED 5.3 billion compared to the same period of 2016 (AED 37.9 billion) (figure 1a). The data capture the outflows reported from the exchange houses and the banks to the Banking Supervision Department of the Central Bank (BSD). The outflows of the workers' remittances that were settled only through the exchange houses recorded AED 31 billion in the third quarter of 2017 (7.3% or AED 2.1 billion increase compared to the third quarter of 2016).

Figure 1. Evolution of workers' remittances settled through Banks and Exchange houses in the UAE, a. Q3 2015-2017, b. January-September 2015-2017

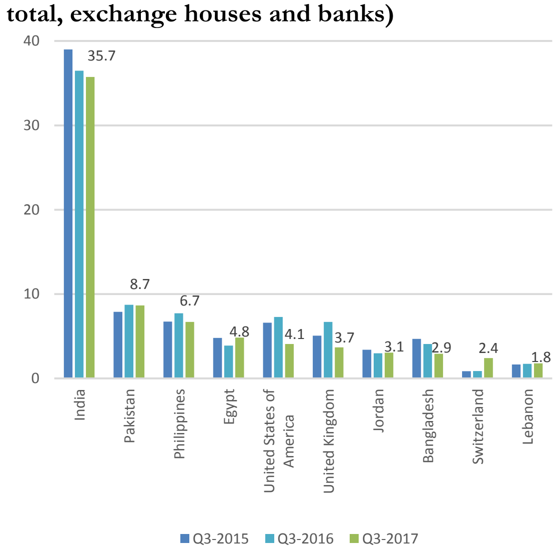


Source: CBUAE, Banking Supervision Department

Whereas, the workers' remittances outflows for the first nine months of 2017 recorded AED 121.1 billion, an increase of 2.1% or AED 2.5 billion compared to the same period of 2016 (AED 118.6 billion) (figure 1b). The outflows of the workers' remittances that were settled only through the exchange houses recorded AED 90.3 billion in the first nine months of 2017 (2.3% or AED 2.1 billion increase compared to the first nine months of 2016).

The most important country of destination for workers' remittances during the third quarter of 2017 was India accounting for 35.7% of the outflows (figure 2). This high share is in accordance with the significant share of expats from India in the UAE. According to available statistics, dated October 2008 from the Federal Competitiveness and Statistics Authority, 82.7% of the employees in the UAE belong to Asian Non-Arab Countries, which include India. The next five most important countries in the share of outflows of remittances were Pakistan (8.7%), Philippines (6.7%), Egypt (4.8%) and the United States (4.1%) (figure 2).

Figure 2. Share of the major countries for workers' remittances during Q3 2015-2017 (percentage of total, exchange houses and banks)

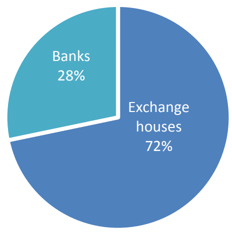


Source: CBUAE, Banking Supervision Department

In the third quarter of 2017, the data provided by BSD indicate that 72% of the workers' remittances outflows are through the exchange houses and 28% through the banks. Figure 3 illustrates the shares of exchange houses and banks in the total transactions of remittances.

[Please Rate this Report]

Figure 3. Share of settlement of total workers' remittances

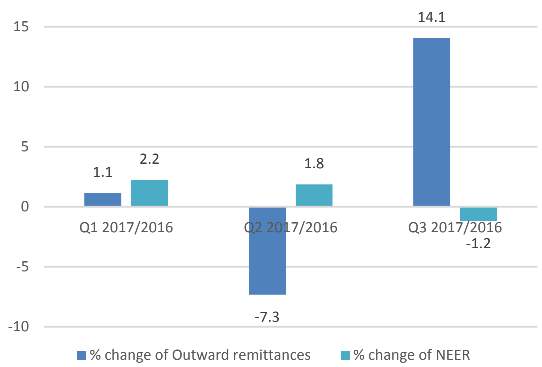


Source: CBUAE, Banking Supervision Department

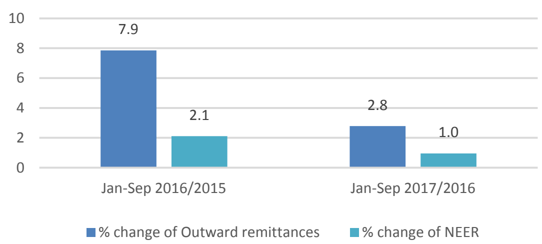
The total recorded workers' remittances outflows for the nine months of 2017 (AED 121.1 billion) represent 75.3% of the total estimated outward remittances in the UAE balance of payments for the full year of 2016 (at AED 160.8 billion).

Figure 4. Percentage change of total outward remittances versus the percentage change of nominal effective exchange rate, a. Q1-Q3 2016-2017, b. January-September 2015-2017

a. Q1-Q3 2016-2017



b. January – September 2015-2017

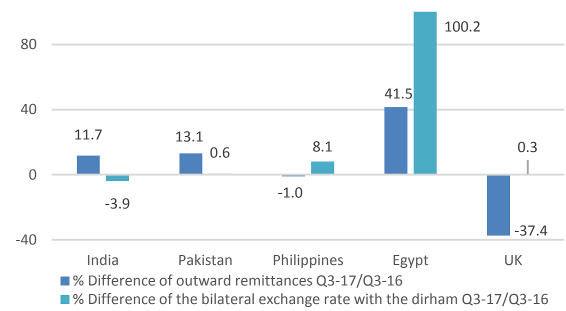


Source: CBUAE, Banking Supervision Department; Bank of International Settlements

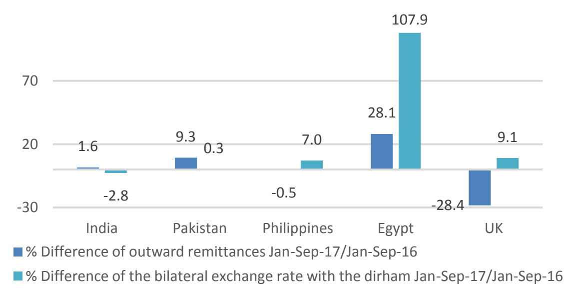
The annual growth rate of remittances in the third quarter of 2017 is 14%. In contrast, the annual increase of remittances over the first nine months of 2017 is smaller at 2.8%, reflecting a significant reduction in outflows during the second quarter. The average nominal effective exchange rate of the dirham in the third quarter (Figure 4a) was 115.6 based on data provided by the Bank for International Settlements (BIS), lower than the average for the first nine months of 2017 at 118.4.

Figure 5. Percentage change of outward remittances of top countries versus the percentage change of the bilateral exchange rate with the dirham, a. Q3 2016-2017, b. January-September 2015-2017

a. Q3 2015-2017



b. January – September 2015-2017



Source: CBUAE, Banking Supervision Department; Bloomberg

Figure 5 depicts the percentage change of outflows of remittances from the UAE to the top destination countries compared to the evolution of the bilateral exchange rate of the dirham relative to the currencies of the recipient countries. For the third quarter of 2017, the remittances outflows to Egypt and Pakistan increased along with the appreciation of the dirham relative to their currencies, whereas a decrease was recorded in the remittances outflows to the United Kingdom and the Philippines. The continuous appreciation of the rupee relative to the dirham did not discourage the remittances outflows to India.

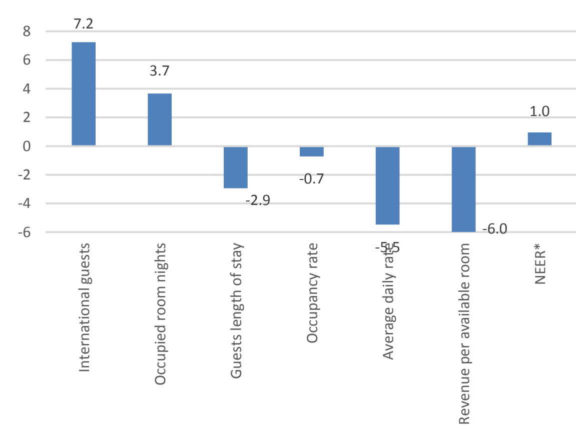
Please Rate this Report

Box 4: The Impact of Exchange Rate Fluctuations on Tourism Activity in the UAE

This box describes the effect of the dirham appreciation on tourism to the UAE for the period of January - September of 2017 compared to the same period of 2016 based on the most recent data available for Dubai, Abu Dhabi and Ras Al Khaimah (RAK) emirates. The figures of the three emirates contribute the largest share of the total aggregates.

During January-September of 2017, compared to the same period in 2016, and despite the appreciation of the dirham in terms of the nominal effective exchange rate by 1% on a year-to-date basis, the number of international tourists increased by 7.2% (figure 1) showing an increasing trend in attracting international visitors. Simultaneously, the average daily rate and the revenue per available room decreased by 5.5% and 6%, respectively (weighted average prices of the three emirates) for the same period. These evolutions resulted in an increase in occupied room nights by 3.7%. In addition, the average hotel occupancy rate decreased by 0.7% for the first nine months of 2017, compared to the same period of 2016.

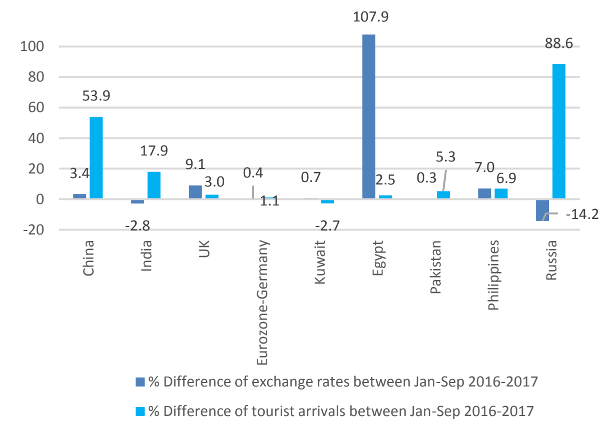
Figure 1: Major combined indicators of Dubai, Abu Dhabi & RAK inbound tourism January-September 2017-16 (% difference)



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

Figure 2 shows the effect of the bilateral exchange rate movements on tourism between the first nine months of 2017 compared to the first nine months of 2016. Despite the appreciation of the dirham with respect to other currencies, tourists' arrivals increased from major countries except from Kuwait. Among the countries that recorded increase, tourists from Russia almost doubled following the easing of visa rules along with some depreciation of the dirham relative to the ruble. Moreover, China, Philippines and Pakistan recorded larger increases in tourist arrivals despite the appreciation of the dirham relative to their currencies. The incoming tourists from India increased following some depreciation of the dirham relative to the rupee. The incoming tourists from the UK, however, recorded a smaller increase reflecting larger appreciation of the dirham relative to the pound. Tourists from Egypt recorded small increase due to the largest appreciation of the dirham relative to the Egyptian pound.

Figure 2. Guest arrivals and exchange rate on selected countries January-September 2017-16 (% difference)



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

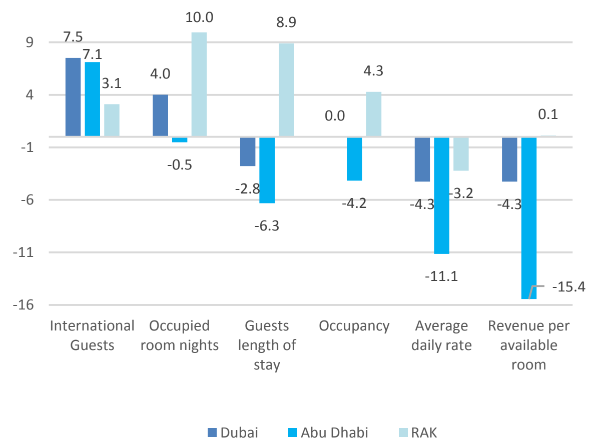
In figure 3, the data for the Dubai emirate indicate that the number of international visitors increased by 7.5% in the first nine months of 2017 compared to the same period of 2016. However, the average daily rate and the revenue per available room decreased by 4.3%. This evolution resulted in an increase in occupied room nights by 4%. Simultaneously, the average hotel occupancy rate remains stable at 76%, for the first nine months of 2017, compared to 2016.

[Please Rate this Report]

The guest arrivals in the Abu Dhabi emirate increased by 7.1% in the first nine months of 2017 compared to the same period in 2016 following a similar trend. However, the reduction in the average room rate by 11.1% contributed to the decrease in total revenues by 10.7% in the first nine months of 2017 compared to the same period of 2016.

Available data for tourism in the emirate of Ras Al Khaimah show that the guest arrivals increased by 3.1% for the first nine months of 2017 compared to the same period of 2016. All other indicators, apart from the avegare room rate, for the emirate recorded an increasing trend.

Figure 3: Major indicators of Dubai, Abu Dhabi & RAK inbound tourism January-September 2017-16 (% difference)



Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority[10], Ras Al Khaimah Tourism Development Authority

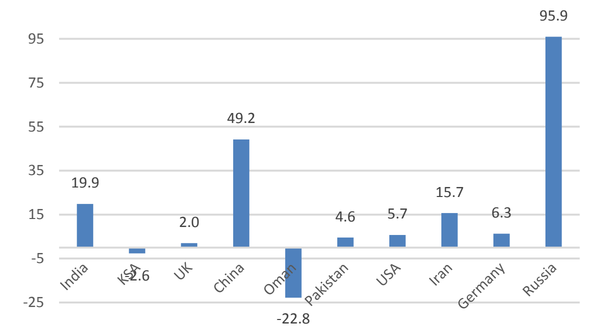
The countries that are the major markets for inbound tourism to Dubai show increase in the arrivals of tourists, except from Oman and Saudi Arabia. The vast majority of tourists to Dubai originate from GCC countries and the MENA region (21% and 11% respectively), while Western Europe and North America cover 20% and 6% of inbound tourism. Finally, 18% of inbound tourism comes from the region of South Asia. The largest increase for January-September 2017 was from Russia (95%) and China (49%).

Most of the countries that are major markets of inbound tourism for the Abu Dhabi Emirate recorded increase in guest arrivals, apart from Germany which recorded reduction (-5.2%). The largest increase in guest arrivals was recorded from China (64.9%), Russia (53.3%) and the United States (12.1%).

The major sources of guests for the emirate of Ras Al Khaimah include Germany, Russia, the United Kingdom and India. However, the largest change compared to the first nine months of 2016 was recorded for tourists from Poland, Russia and the Czech Republic.

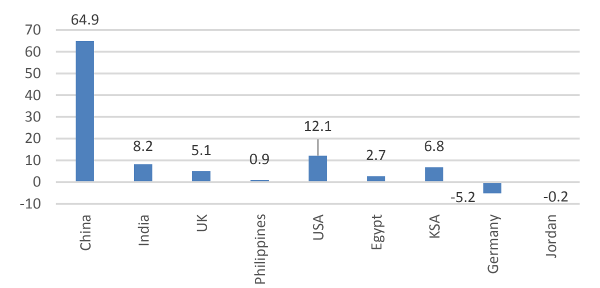
Figure 4. Major markets of inbound tourism January - September 2017-16 (% difference)

a. Dubai



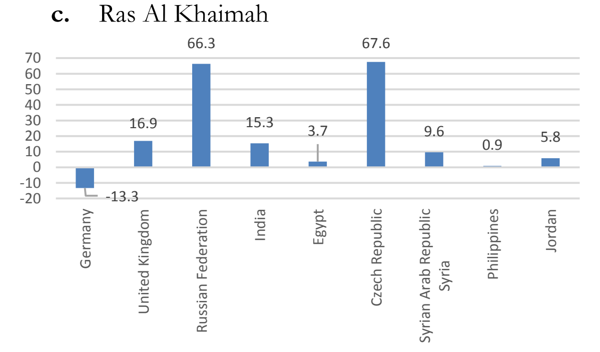
Source: Dubai Corporation of Tourism and Commerce Marketing

b. Abu Dhabi



Source: Abu Dhabi Tourism & Culture Authority

c. Ras Al Khaimah



---

[10] Data are based on the official tourism authorities' publications. Dubai Tourism Authority publishes *International Guests* whereas Abu Dhabi Tourism Authority publishes *Actual Guest Arrivals.* Also, for the variable *Room Nights* Dubai Tourism Authority publishes *Occupied Room Nights* whereas Abu Dhabi Tourism Authority publishes *Room Nights* that include the number of nights a guestroom is occupied regardless of the number of persons occupying the room.

Please Rate this Report

Source: Ras Al Khaimah Tourism Development Authority

2.5 Consolidated Fiscal Stance

The decline of oil prices which started mid-2014 has triggered an important fiscal consolidation in 2015. Government spending fell by 10.7% in 2015 displaying an average quarterly decline by 9.8% y-o-y, with a trough of 22% in the fourth quarter of 2015 (see Table 2.5)[11].

In 2016, the pace of the fiscal consolidation was reversed and public spending started increasing again in the first quarter of 2016. The highest quarterly increase was recorded in the third quarter of 2016 by 35% y-o-y, leading to an annual increase of 19.3%. Capital spending rebounded by 59.4% in 2016 with a considerable jump by 93% in the first quarter of 2016 compared to the same period of 2015.

On the other hand, government revenues increased by 42% in 2016 boosted by the jump of revenues by 109% in the fourth quarter of which the tax revenues, including royalties on oil companies, have increased by 16.4%.

The recent rally of oil prices as well as the strategy of the government to adopt a growth-friendly fiscal policy reflected positively on the fiscal developments in the first half of 2017. The GDP forecasting model built by the Central Bank of the UAE[12] shows correlations of the real government spending with the real total GDP and the real non-oil GDP over the period 2000-2016 of 86% and 88%, respectively. In addition, the estimation of the model suggests an increase by 0.33% of the real non-oil GDP growth for every 1% hike in the government spending.

The total public spending increased by 192.3% and 12.4% in the first and second quarters of 2017, respectively compared to the same period of 2016, corresponding to a total increase of 71.6% in the first half of the year. All public spending items have increased in the first half of 2017 with an important upturn of Grants. The Official Grants awarded by the UAE Government increased significantly in the first half of 2017 compared to the first half of 2016 after a persistent decline in 2015. The second important increase was for the Interest Payments, which expanded by 140.4% Y-o-Y in the first half of 2017. The recovery of government spending has contributed to the recent rebound of non-energy GDP growth and the improved projection for 2018. The quarterly non-oil ECI sustainable quarterly average growth of 3.3% during the post-oil prices crush in 2014, has coincided with an average quarterly growth of government spending of 4.3% Y-o-Y.

Moreover, capital spending, one of the main drivers of the non-oil economic growth has increased by 111.5% in the first half of 2017 on a year-on-year basis. The highest increase was recorded in the first quarter of 2017 where the public capital spending jumped by 329.3% confirming the fifth consecutive increase from the last quarter of 2015 and signaling the reversal of the fiscal policy direction which became more growth-friendly. The capital spending component of the budget, as a percentage of total spending has followed an increasing trend since 2012. Its share was around 9.5% in 2012, reaching 12.6% in 2016 and 15.5% in the first half of 2017. The correlations between the growth of government spending on capital (net acquisition of non-financial assets) over the period 2000-2016 and the growth of real GDP and non-oil real GDP are 83% and 80%, respectively.

The Compensation of employees rebounded by 47.7% during the first half of 2017 compared to the same period of 2016. The highest increase was recorded in the first quarter of 2017 where the compensation for employees jumped by around 50% Y-o-Y.

Other expenses which cover all of Abu Dhabi's transfers made on behalf of the Federal Government rose by around 137.8% during the first half of 2017 with the highest increase recorded in the first quarter. It is the fifth consecutive quarter of increase after an important decline that started in 2015 and was accelerated in the last quarter of 2015 when they dropped by 37.9%.

[11] The analysis is based on new fiscal data released by the Ministry of Finance in September 2017. The data were revised based on new available fiscal sectoral and local inflow of information from Emirates.

[12] The details on the model's design, estimation and results are provided in a dedicated box in the Quarterly Economic Review of the fourth quarter of 2015, available at https://www.centralbank.ae/en/pdf/dataroom/CBQrterRev_Q4 2015_En.pdf.

Please Rate this Report

Subsidies, which contain also the transfers to GREs, followed an increasing trend during the first two quarters of 2017. They grew by 224.2% and 59.2% consecutively on a year-on-year basis, leading to a jump by 114.3% during the first half of 2017.

On the Other hand, total revenues continued their improvement for all quarters in 2016 confirming an increasing trend that started at the beginning of 2016. They displayed an important increase of 89.6% during the fourth quarter of 2016, on a year-on-year basis after an increase of 31% during the previous quarter, leading to an annual jump of 36.5% in 2016 against a decline of 25% in 2015. The increase in revenues was triggered by a 15.8% increase in tax revenues (royalties on oil companies) for the first time since the last quarter of 2014 in consistency with the recovery of oil prices.

Other revenues, which include principally the property income, sales of goods and services and fines and penalties, jumped by 160%. These revenues do not include profit transfers from the national oil company to the sovereign wealth funds, neither the government's investment income.

Social contributions displayed their first decline since the end of 2015. They fell by 13.8% in the fourth quarter of 2016 against an increase of 15% in the previous quarter. The annual growth rate was, however, positive (9.2%) against a negative growth in 2015 (-46.5%).

Please Rate this Report

Table. 2.5. Consolidated Government Finances

	2015	Change (%, Y-o-Y)					2016					Change (%, Y-o-Y)					2017			Change (%, Y-o-Y)		
		2015Q1	2015Q2	2015Q3	2015Q4	2015	Q1	Q2	Q3	Q4	2016	2016Q1	2016Q2	2016Q3	2016Q4	2016	Q1	Q2	H1	2017Q1	2017Q2	2017H1
Revenues (a)	**281.3**	**-34.0**	**-14.2**	**-18.6**	**-38.1**	**-26.1**	**85.7**	**102.7**	**84.9**	**126.5**	**399.8**	**43.9**	**21.9**	**10.3**	**109.0**	**42.1**	**170.9**	**111.6**	**282.5**	**99.5**	**8.7**	**50.0**
Taxes	160.0	-42.1	-25.4	-44.5	-59.0	-42.8	21.1	26.0	28.9	32.7	108.8	-46.5	-48.5	-30.9	16.4	-32.0	70.7	44.1	**114.7**	234.8	69.4	143.5
Social contributions	4.3	14.0	-27.8	172.0	-55.9	-18.9	1.5	1.2	1.2	0.9	4.7	37.5	3.4	15.0	-15.3	10.1	1.3	1.2	**2.5**	-10.2	-1.1	-6.1
Other revenues	116.9	-10.4	13.2	82.6	16.6	22.5	63.1	75.5	54.8	92.9	286.3	232.2	132.2	61.0	196.0	144.8	98.9	66.4	**165.3**	56.8	-12.1	19.3
Expenditure (b)	**370.4**	**-13.3**	**0.1**	**-3.7**	**-22.2**	**-10.7**	**98.3**	**107.0**	**119.6**	**117.1**	**442.1**	**10.1**	**9.5**	**35.1**	**23.5**	**19.3**	**149.1**	**116.9**	**266.0**	**51.6**	**9.3**	**29.5**
Compensation of employees	63.0	45.6	46.5	35.8	9.0	32.6	15.5	15.8	15.8	18.2	65.2	0.8	-5.7	1.9	17.9	3.5	23.3	23.0	**46.3**	49.8	45.7	47.7
Use of goods and services	59.8	43.1	29.6	-6.1	25.4	20.8	10.4	14.8	19.9	17.1	62.3	-17.9	-5.8	53.9	-7.3	4.1	15.2	20.2	**35.4**	46.2	36.4	40.5
Consumption of fixed capital	4.6	6.0	54.7	-10.1	42.1	21.9	1.1	1.5	1.2	2.1	5.9	25.0	32.4	24.9	32.4	29.4	1.3	1.6	**2.9**	17.9	3.2	9.4
Interest	2.8	-52.4	-49.1	-38.3	6.9	-31.5	0.2	0.4	0.3	1.0	2.0	-49.0	-16.0	-45.5	-18.8	-28.7	0.8	0.9	**1.7**	216.5	98.1	140.4
Subsidies	12.3	10.2	-22.8	17.9	6.0	1.7	2.1	4.1	1.6	1.0	8.8	-25.0	50.1	-61.6	-62.5	-28.4	6.7	6.6	**13.3**	224.2	59.2	114.3
Grants	8.8	-86.3	-54.9	-55.1	507.3	-60.0	0.5	0.5	6.9	8.0	15.9	-66.0	-81.3	179.9	276.4	81.6	10.3	17.4	**27.7**	2142.3	3196.0	2706.0
Social benefits	42.6	-18.8	-9.7	-32.5	-52.5	-30.7	9.3	8.4	8.5	9.0	35.3	-9.0	-32.5	-22.3	0.8	-17.2	8.3	6.1	**14.4**	-11.4	-27.3	-18.9
Other expenses	141.5	-24.3	-1.8	7.1	-37.9	-18.9	46.3	47.8	50.1	46.6	190.8	19.4	38.9	54.7	29.7	34.8	83.2	41.2	**124.3**	79.6	-13.8	32.2
Net acquisition of non-financial assets	35.1	21.2	-18.5	-7.0	-24.9	-12.1	12.8	13.6	15.4	14.1	55.9	93.0	21.6	74.2	67.4	59.4	34.7	6.4	**41.2**	171.0	-52.6	56.0

Source: - UAE Ministry of Finance, revenues do not include ADNOC transfers and government investment income.

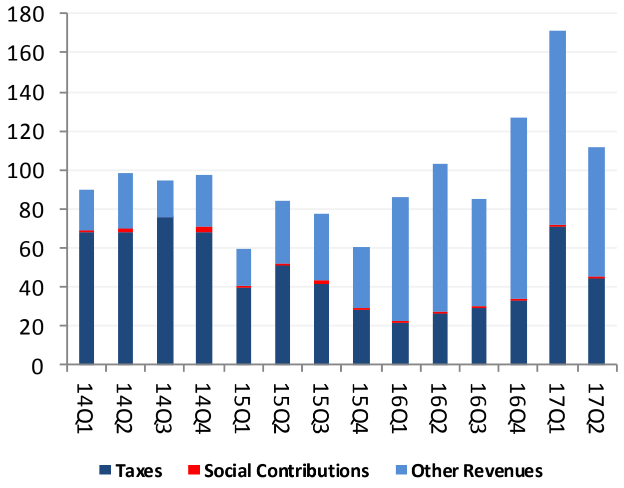
- Other Revenues covers: Property income (interest, dividends, rent), Sales of goods and services (including administrative fees), Fines and penalties and other revenues not elsewhere classified. Effective 2016Q1, the Emirate of Abu Dhabi has added some transfers of important investment authorities from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

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

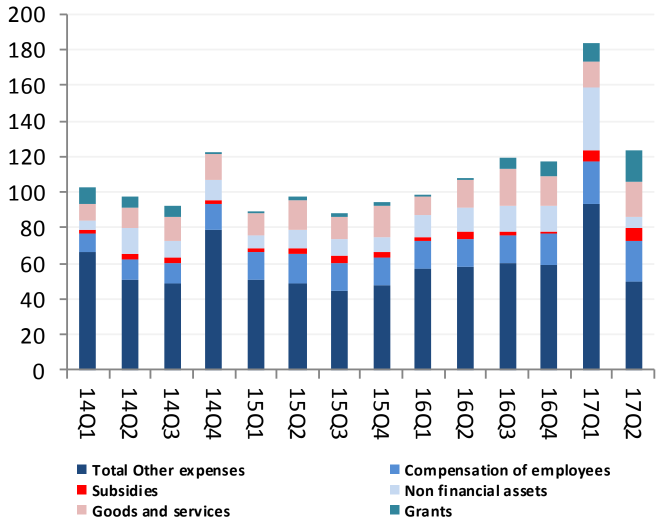
[Please Rate this Report](#)

Government Finances

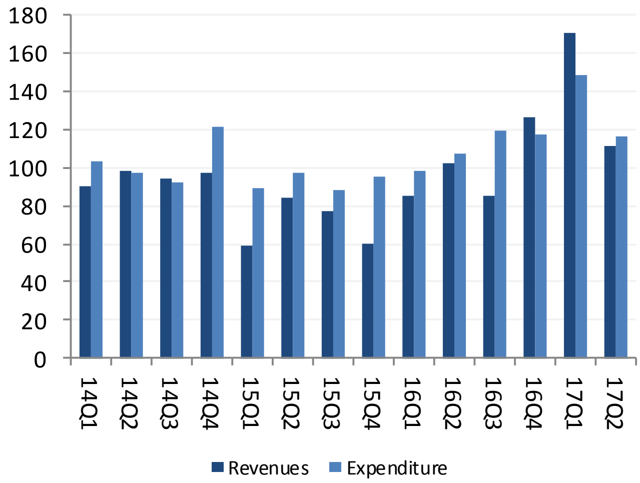
2.5. a. General government revenues
(Billions of Dirhams)



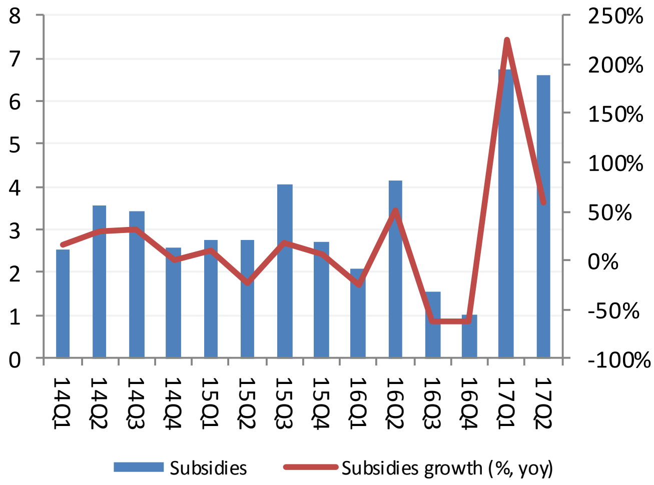
2.5.b. General government expenditures
(Billions of Dirhams)



2.5.c. Fiscal stance
(Billions of Dirhams)



2.5.d Development in subsidies and transfers to GREs
(Billions of Dirhams)



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

Please Rate this Report

Chapter 3. Banking and Financial Developments

In the third quarter of 2017 deposits have continued the pace of recovery, mainly boosted by the increase in non-resident deposits, while credit growth has shown signs of recovery. Ample liquidity in the banking system coupled with improved outlook for growth underpinned by healthy Financial Soundness Indicators (FSIs) boost confidence that the UAE banking system is sound and stable.

3.1 Banking developments

The 22 national banks have decreased the number of branches to 810 at the end of 2017 Q3 compared to 816 at the end of the second three months of 2017. The 26 foreign banks have kept the number of branches at 85 at the end of September 2017, same as in June 2017. At the same time the number of bank employees has declined for both, national and foreign banks from 28,986 and 7,365, respectively at the end of 2017 Q2 to 28,767 and 7,316, respectively after the first nine months of the current year, mainly due to consolidation in banking activity and cost efficiency.

3.1.1. Banks' Deposits

Total Customer Deposits at banks increased in the third quarter of 2017 by AED 6.7 billion due to the decrease in Resident Deposits by AED 1.8 billion, while Non-resident Deposits grew by AED 8.5 billion.

The decline in Resident Deposits in 2017 Q3 is essentially due to the decrease in the NBFIs deposits by AED 7.9 billion or 20.1% and deposits of GREs by 3.5% or AED 6.6 billion. The growth in the Government sector by 2.2% or AED 4.4 billion and Private sector deposits by 0.8% or AED 8.3 billion was not sufficient to sustain the overall positive growth for the Resident deposits. The Non-Resident deposits increased by AED 8.5 billion or 4.7% during the third quarter of 2017, with their share in total deposits increasing to 11.8% compared to the 11.3% share in the previous quarter. In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 76.4% and 23.6% of the total deposits. Figures 3.1.1.a and 31.1.b, and Table 3.1.1.b show that in the third quarter of 2017 the growth in Islamic and Conventional banks remains moderate, and on a Y-o-Y basis both are growing with the increase of Islamic deposits reaching 9.6%. Looking at the subcategories, the growth in Islamic banks in the third quarter is stronger than that in conventional banks, with exception of Private sector deposits and Non-resident deposits.

Table 3.1.1.a. Deposits at UAE Banks

	2016		2017		
	Sep	Dec	Mar	Jun	Sep
Bank Deposits	**1,508.7**	**1,562.9**	**1,602.0**	**1,589.1**	**1,595.8**
(Q-o-Q change %)	1.1	3.6	2.5	-0.8	0.4
(Y-o-Y change %)	5.0	6.2	6.6	6.4	5.8
Resident Deposits	**1,321.8**	**1,363.9**	**1,413.0**	**1,433.5**	**1,407.5**
(Q-o-Q change %)	0.4	3.2	3.6	-0.3	-0.1
(Y-o-Y change %)	3.4	4.9	6.6	7.1	6.5
Government Sector	**169.5**	**186.8**	**194.0**	**196.8**	**201.2**
(Q-o-Q change %)	-8.8	10.2	3.9	1.4	2.2
(Y-o-Y change %)	3.2	18.7	24.8	5.9	18.7
GREs	**172.2**	**168.2**	**192.0**	**189.6**	**183.0**
(Q-o-Q change %)	6.0	-1.8	14.0	-1.3	-3.5
(Y-o-Y change %)	-1.2	-11.8	-0.7	17.4	6.9
Private Sector	**956.6**	**980.7**	**998.3**	**983.6**	**991.9**
(Q-o-Q change %)	1.2	2.5	1.8	-1.5	0.8
(Y-o-Y change %)	5.0	6.2	5.3	4.1	3.7
NBFI	**24.6**	**28.2**	**28.7**	**39.3**	**31.4**
(Q-o-Q change %)	6.0	14.6	1.8	36.9	-20.1
(Y-o-Y change %)	-16.6	0.4	1.8	69.4	27.6
Non-Resident Deposits	**186.9**	**199.0**	**189.0**	**179.8**	**188.3**
(Q-o-Q change %)	5.5	6.5	-5.0	-4.9	4.7
(Y-o-Y change %)	17.9	16.0	6.5	1.5	0.7

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

Please Rate this Report

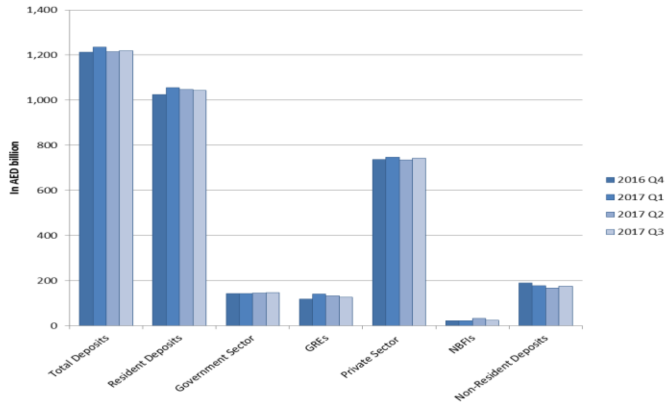
Table 3.1.1.b. Deposits at Conventional/Islamic Banks

	Conventional		Islamic	
	2017 Jun	**2017 Sep**	**2017 Jun**	**2017 Sep**
Bank Deposits	**1,214**	**1,220**	**375**	**376**
(Q-o-Q change %)	-1.7	1.2	2.1	0.4
(Y-o-Y change %)	5.8	4.6	8.7	9.6
Share of Total, %	76.4	76.4	23.6	23.6
Resident Deposits	**1,047**	**1,044**	**362**	**364**
(Q-o-Q change %)	-0.9	-0.3	1.7	0.5
(Y-o-Y change %)	6.9	5.7	7.5	8.8
Share of Total, %	74.3	74.1	25.7	25.9
Government Sector	**146**	**147**	**51**	**54**
(Q-o-Q change %)	0.8	1.1	3.2	5.5
(Y-o-Y change %)	6.4	19.0	4.3	17.9
Share of Total, %	74.0	73.2	26.0	26.8
GREs	**133**	**127**	**57**	**56**
(Q-o-Q change %)	-6.4	-4.2	13.1	-1.8
(Y-o-Y change %)	18.3	0.4	15.4	25.2
Share of Total, %	69.9	69.3	30.1	30.7
Private Sector	**735**	**744**	**249**	**248**
(Q-o-Q change %)	-1.7	1.3	-0.7	-0.4
(Y-o-Y change %)	3.5	3.9	5.7	3.2
Share of Total, %	74.7	75.0	25.3	25.0
NBFI	**34**	**25**	**5**	**6**
(Q-o-Q change %)	48.0	-25.7	-6.9	14.8
(Y-o-Y change %)	68.7	22.3	74.2	55.0
Share of Total, %	86.3	80.3	13.7	19.7
Non-Resident Deposits	**167**	**176**	**13**	**12**
(Q-o-Q change %)	-6.1	5.3	14.7	-2.4
(Y-o-Y change %)	-1.1	-1.3	56.3	43.5
Share of Total, %	93.0	93.5	7.0	6.5

Source: Central Bank of the UAE

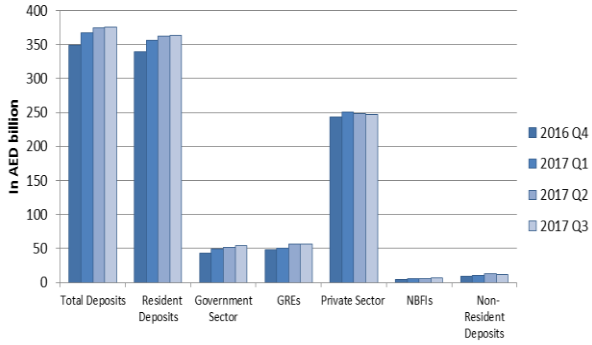
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

The breakdown of National and Foreign banks in Figures 3.1.1.c and 3.1.1.d show that National and Foreign banks experienced a slight increase in 2017 Q3 Q-o-Q. National banks grew at a rate of 0.5% and 7% Q-o-Q and Y-o-Y respectively in contrast to Foreign banks for which deposits rose marginally by 0.1% on a Q-o-Q basis and declined by 2% compared to 2016 Q3. At the end of 2017 Q3, 87.2% of the total deposits are in National banks and 12.8% are in Foreign banks.

Please Rate this Report

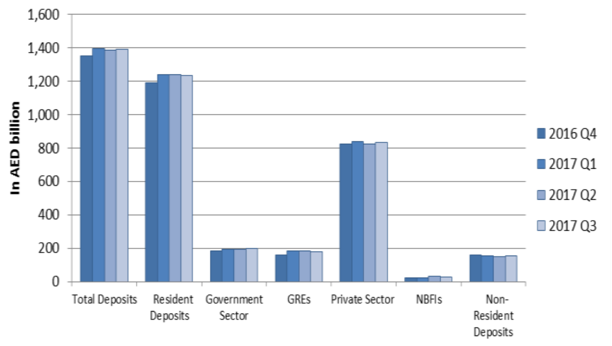
Table 3.1.1.c. Deposits at UAE National/Foreign Banks

	National		Foreign	
	2017 Jun	2017 Sep	2017 Jun	2017 Sep
Bank Deposits	**1,385**	**1,391**	**205**	**205**
(Q-o-Q change %)	-0.6	0.5	-2.2	0.1
(Y-o-Y change %)	8.5	7.0	-5.6	-2.0
Share of Total, %	87.1	87.2	12.9	12.8
Resident Deposits	**1,237**	**1,236**	**172**	**172**
(Q-o-Q change %)	0.0	-0.1	-2.3	-0.2
(Y-o-Y change %)	8.1	7.3	0.5	1.0
Share of Total, %	87.8	87.8	12.2	12.2
Government Sector	**195**	**199**	**2**	**2**
(Q-o-Q change %)	1.5	2.2	0.0	5.9
(Y-o-Y change %)	5.6	18.4	41.7	63.6
Share of Total, %	99.1	99.1	0.9	0.9
GREs	**184**	**176**	**6**	**7**
(Q-o-Q change %)	0.3	-3.9	-32.6	10.0
(Y-o-Y change %)	18.8	8.2	-14.3	-18.5
Share of Total, %	96.8	96.4	3.2	3.6
Private Sector	**824**	**834**	**159**	**158**
(Q-o-Q change %)	-1.7	1.2	-0.2	-0.8
(Y-o-Y change %)	4.7	4.0	1.0	2.1
Share of Total, %	83.8	84.1	16.2	15.9
NBFI	**34**	**26**	**5**	**5**
(Q-o-Q change %)	50.4	-23.6	-15.3	4.0
(Y-o-Y change %)	90.6	40.9	-3.8	-13.3
Share of Total, %	87.3	83.4	12.7	16.6
Non-Resident Deposits	**147**	**155**	**33**	**33**
(Q-o-Q change %)	-5.6	5.4	-1.2	1.5
(Y-o-Y change %)	11.9	4.9	-28.4	-15.1
Share of Total, %	81.9	82.4	18.1	17.6

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

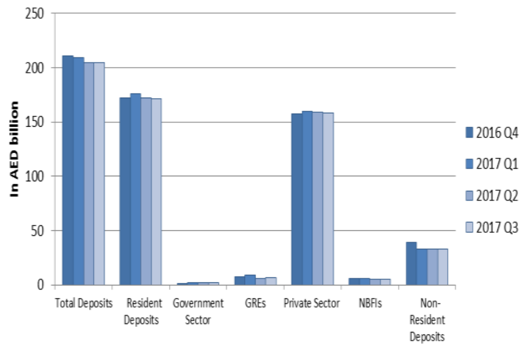
The sectors growing the most in 2017 Q3 for National banks were the Non-resident deposits by 5.4% on a quarterly basis (growth of 4.9% on Y-o-Y basis) and the Government sector by 2.2% Q-o-Q (18.4% Y-o-Y), reflecting the ongoing fiscal consolidation and improved oil price. For the Foreign banks in the third quarter of 2017, the breakdown shows that the biggest increase was for the GREs sector deposits by 10%. Despite the growth Q-o-Q, the segment decreased by 18.5% Y-o-Y or AED 600 million for the foreign banks. However GREs deposits are very low in foreign banks, and hence the impact of the overall growth remains marginal.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

Please Rate this Report

3.1.2. Banks' Credit

Domestic Credit increased in 2017 Q3 by AED 12.7 billion (0.9%), which corresponded to a growth of a 1.6% Y-o-Y, mainly the result of the growth in lending to Government by 2% Q-o-Q (or AED 3.6 billion) and 4.3% Y-o-Y and lending to the Private sector by 1.1% Q-o-Q (or AED 11.7 billion) and 2.4% Y-o-Y. This growth was partially offset by deleveraging by GREs, by AED 3.6 billion (2%) and Foreign credit by AED 1.4 billion (1%) quarterly.

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 were growing, with exception of the GREs category where the decline was -0.3% or AED 1 billion in 2017 Q3. For the same period, Conventional banks had all their assets and credit sectors deleveraging with exception of credit to Government, Private Corporates, Individuals and NBFIs (see Table 3.1.2.b).

On an annual basis, as of September 2017, Conventional banks marked an increase of 3.7% and 0.5% for banks' assets* and gross credit*, respectively, while for the Islamic banks they were both growing at a much higher pace: 7.9% and 8.9% respectively.

Table 3.1.2.a. Assets and Credit at UAE Banks

	2016		2017		
	Sep	**Dec**	**Mar**	**Jun**	**Sep**
Total Assets*	**2,529**	**2,592**	**2,626**	**2,632**	**2,643**
(Q-o-Q change %)	**1.2**	**2.5**	**1.3**	**0.2**	**0.4**
(Y-o-Y change %)	**5.2**	**5.4**	**6.3**	**5.4**	**4.5**
Gross Credit*	**1,545**	**1,554**	**1,575**	**1,569**	**1,580**
(Q-o-Q change %)	1.4	0.6	1.4	-0.4	0.7
(Y-o-Y change %)	5.9	6.0	5.2	3.0	2.3
Domestic Credit*	1,425	1,433	1,450	1,434	1,447
(Q-o-Q change %)	1.4	0.6	1.2	-1.1	0.9
(Y-o-Y change %)	5.8	5.3	4.8	2.0	1.6
Government	174.1	172.5	176.8	177.9	181.5
(Q-o-Q change %)	3.3	-0.9	2.6	0.6	2.0
(Y-o-Y change %)	4.6	3.5	4.8	5.5	4.3
Public Sector GREs)	188.0	187.1	194.8	179.0	175.4
(Q-o-Q change %)	0.2	-0.5	3.9	-8.1	-2.0
(Y-o-Y change %)	6.3	9.2	7.7	-4.6	-6.7
Private Sector*	1,045	1,054	1,059	1,058	1,070
(Q-o-Q change %)	1.3	0.9	0.4	-0.1	1.1
(Y-o-Y change %)	6.2	5.6	4.9	2.6	2.4
Business & ndustrial Sector redit	720.0	727.8	731.4	728.6	734.5
(Q-o-Q change %)	1.5	1.1	0.4	-0.4	0.8
(Y-o-Y change %)	6.9	5.8	5.5	2.7	2.0
Individual*	324.5	326.0	327.3	329.3	335.1
(Q-o-Q change %)	1.0	0.5	0.4	0.6	1.7
(Y-o-Y change %)	4.5	4.8	3.5	2.5	3.3
Non-Banking inancial Institutions	18.2	18.0	20.1	19.5	21.1
(Q-o-Q change %)	-1.1	-1.1	5.8	-3.0	5.1
(Y-o-Y change %)	-8.5	-27.1	-20.6	6.0	12.6
Foreign Credit	119.9	120.4	124.8	134.4	133.0
(Q-o-Q change %)	2.4	0.4	3.7	7.7	-1.0
(Y-o-Y change %)	6.9	15.9	10.3	14.8	10.9
of which: Loans & dvances to Non-esidents in AED	14.4	14.6	15.2	15.5	16.0
(Q-o-Q change %)	12.5	1.4	4.1	2.0	3.2
(Y-o-Y change %)	49.4	58.7	35.7	21.1	11.1

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

*After reflecting the adjusted credit numbers applying the accounting adjustments backward for the Sheikh Khalifa Fund for housing loans for UAE nationals which was instituted recently.

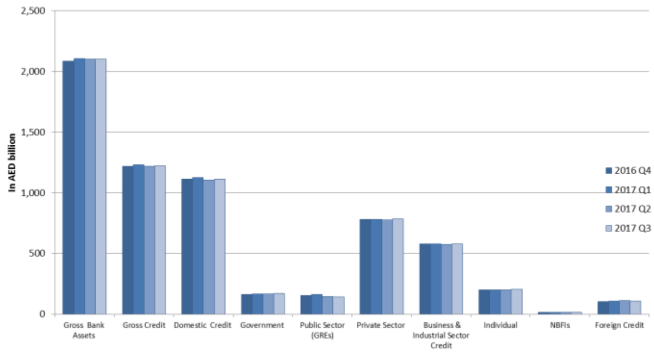
[Please Rate this Report]

Table 3.1.2.b. Assets and Credit at UAE Conventional/Islamic Banks

	Conventional		Islamic	
	2017	2017	2017	2017
	Jun	Sep	Jun	Sep
Total Assets	**2,125***	**2,103**	**530**	**540**
(Q-o-Q change %)	**-0.1**	**0.1**	**1.5**	**1.9**
(Y-o-Y change %)	**4.9**	**3.7**	**7.4**	**7.9**
Gross Credit	**1,218***	**1,222**	**350**	**358**
(Q-o-Q change %)	-1.1	0.3	2.1	2.3
(Y-o-Y change %)	1.8	0.5	7.3	8.9
Domestic Credit	1,105*	1,113	330	335
(Q-o-Q change %)	-1.8	0.7	1.4	1.5
(Y-o-Y change %)	0.9	0.0	6.1	7.0
Government	168	170	10	11
(Q-o-Q change %)	0.4	1.4	5.3	12.1
(Y-o-Y change %)	5.3	3.7	10.0	13.3
Public Sector (GREs)	144	141	35	35
(Q-o-Q change %)	-10.2	-2.4	1.7	-0.3
(Y-o-Y change %)	-7.2	-9.8	7.7	8.4
Private Sector	777*	785	281	285
(Q-o-Q change %)	-0.6	1.0	1.4	1.4
(Y-o-Y change %)	1.5	1.0	5.8	6.5
Business & Industrial Sector Credit	575	579	153	156
(Q-o-Q change %)	-0.8	0.6	1.3	1.8
(Y-o-Y change %)	1.8	0.6	6.1	7.6
Individual	202*	206	128	129
(Q-o-Q change %)	0.1	2.3	1.5	0.9
(Y-o-Y change %)	0.6	2.1	5.5	5.2
Non-Banking Financial Institutions	16	17	4	4
(Q-o-Q change %)	-2.5	6.4	-4.9	0.0
(Y-o-Y change %)	6.8	12.2	2.6	14.7
Foreign Credit	114	109	21	24
(Q-o-Q change %)	6.7	-3.8	13.7	14.0
(Y-o-Y change %)	12.2	5.5	31.0	45.7

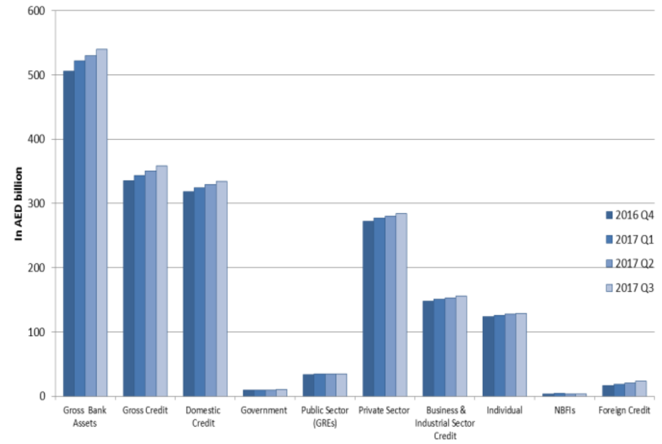
Source: Central Bank of the UAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

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 were growing, with exception of credit to GREs and Foreign credit in 2017 Q3. For the same period, foreign banks had their assets growing and gross credit remained unchanged (see Table 3.1.2.c).

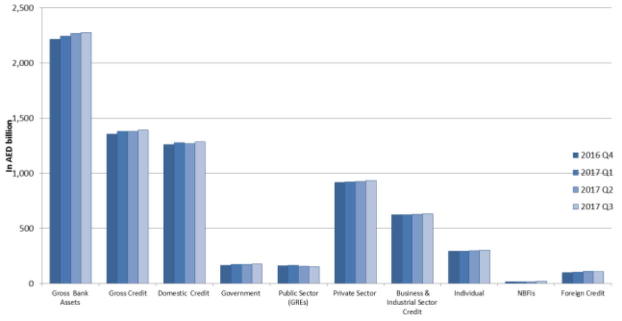
Please Rate this Report

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

	National		Foreign	
	2017	**2017**	**2017**	**2017**
	Jun	**Sep**	**Jun**	**Sep**
Total Assets	**2,267***	**2,276**	**364**	**367**
(Q-o-Q change %)	**1.0**	**0.4**	**-4.5**	**0.7**
(Y-o-Y change %)	**7.5**	**5.6**	**-6.3**	**-1.6**
Gross Credit	**1,381***	**1,392**	**188**	**188**
(Q-o-Q change %)	0.2	0.8	-4.5	0.0
(Y-o-Y change %)	4.9	3.6	-9.2	-6.5
Domestic Credit	1,270*	1,284	164	164
(Q-o-Q change %)	-0.5	1.0	-5.6	-0.3
(Y-o-Y change %)	4.0	3.1	-10.8	-9.3
Government	173	176	5	5
(Q-o-Q change %)	0.5	2.0	4.2	2.0
(Y-o-Y change %)	6.5	5.1	-19.4	-17.7
Public Sector GREs)	156	154	23	21
(Q-o-Q change %)	-6.2	-1.5	-19.2	-5.7
(Y-o-Y change %)	-1.4	-3.4	-22.3	-24.9
Private Sector	924*	935	134	135
(Q-o-Q change %)	0.4	1.2	-3.1	0.4
(Y-o-Y change %)	4.5	3.8	-8.8	-6.5
Business & ndustrial Sector redit	627	632	102	103
(Q-o-Q change %)	0.2	0.8	-3.9	0.8
(Y-o-Y change %)	4.9	3.5	-9.2	-6.2
Individual	297*	303	32	32
(Q-o-Q change %)	0.8	2.0	-0.6	-0.6
(Y-o-Y change %)	3.7	4.5	-7.8	-7.5
Non-Banking inancial Institutions	17	18	2	2
(Q-o-Q change %)	-2.2	5.2	-8.7	4.8
(Y-o-Y change %)	1.2	8.3	75.0	69.2
Foreign Credit	111	109	24	24
(Q-o-Q change %)	8.5	-1.7	3.9	2.1
(Y-o-Y change %)	17.7	9.6	3.0	17.4

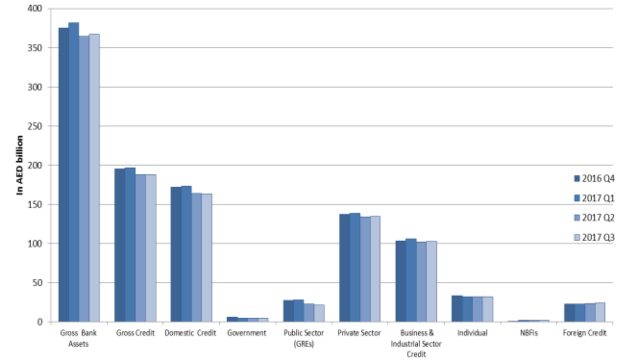
Source: Central Bank of the UAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

Please Rate this Report

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

(End of Period , In Billions of AED)

	2016		2017		
Economic Activity	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**
Agriculture	1.2	1.4	1.2	1.1	1.2
(Q-o-Q change %)	-1.9	16.7	-15.1	-2.5	7.7
(Y-o-Y change %)	-9.0	-11.9	-7.7	-5.3	3.9
Mining and Quarrying	14.0	13.5	19.0	13.9	12.2
(Q-o-Q change %)	12.7	-3.4	40.4	-26.8	-12.5
(Y-o-Y change %)	26.6	13.6	62.3	11.9	-13.1
Manufacturing	71.6	69.5	68.3	70.3	72.0
(Q-o-Q change %)	0.3	-3.0	-1.7	3.0	2.4
(Y-o-Y change %)	-0.9	0.5	-5.5	-1.5	0.6
Electricity, Gas and Water	17.9	18.4	18.1	17.4	17.0
(Q-o-Q change %)	-3.8	3.1	-1.8	-3.9	-2.6
(Y-o-Y change %)	-13.8	-10.0	-2.5	-6.4	-5.2
Construction and Real Estate	250.8	264.7	267.0	281.2	295.2
(Q-o-Q change %)	3.5	5.5	0.9	5.3	5.0
(Y-o-Y change %)	12.2	12.6	10.4	16.0	17.7
Trade	158.2	155.5	152.3	149.5	147.7
(Q-o-Q change %)	-1.5	-1.7	-2.1	-1.8	-1.2
(Y-o-Y change %)	-4.0	-3.8	-5.2	-7.0	-6.7
Transport, Storage and Communication	62.7	63.5	60.4	63.1	63.7
(Q-o-Q change %)	-2.0	1.2	-4.7	4.4	1.0
(Y-o-Y change %)	6.6	7.3	-3.2	-1.3	1.6
Financial Institutions (Excluding Banks)	148.4	144.3	151.9	138.9	130.3
(Q-o-Q change %)	2.4	-2.7	5.2	-8.5	-6.2
(Y-o-Y change %)	9.5	6.4	8.9	-4.1	-12.2
All Others	122.0	126.6	130.0	126.2	132.9
(Q-o-Q change %)	1.1	3.8	2.7	-2.9	5.3
(Y-o-Y change %)	7.9	12.4	15.0	4.6	9.0

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

Banks' lending by economic activity shows an increase in the third quarter of 2017 Q-o-Q by 7.7%, 2.4%, 5% and 1% in the Agriculture, Manufacturing, Construction and Real Estate, and Transport, Storage and Communication sectors respectively, while their growth Y-o-Y was 3.9%, 0.6%, 17.7% and 1.6%, respectively. For the other sectors credit declined on Q-o-Q, during the third quarter of 2017. The growth in Mining and Quarrying was -12.5% Q-o-Q and -13.1% Y-o-Y, in Electricity, Gas and Water -2.6% Q-o-Q and -5.2% Y-o-Y, in Trade -1.2% Q-o-Q and -6.7% Y-o-Y, and in Financial Institutions (Excluding banks) a reduction of -6.2% Q-o-Q and -12.2% Y-o-Y.

3.1.3. Financial Soundness Indicators

The overall outlook regarding the soundness of the banking sector remains positive during the third quarter of 2017.

Banks' specific provisions for NPLs increased from AED 81.7 billion at the end of June 2017 to AED 83.1 billion in the third quarter of 2017, thereby ensuring that NPLs are fully provisioned, considering that in parallel there was a decline in lending. The level has also increased compared to the end of 2016 Q3, when the specific provisions were at AED 77.9 billion.

The percentage of the number of presented and returned cheques has increased from 4.3% in June 2017 to 4.6% in September 2017. The total amount of returned cheques from the total presented amount also increased to 5% in 2017 Q3 compared to 4.5% in 2017 Q2.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio (CAR) and Tier 1 capital of banks further growing at 18.7% and 17.1% respectively compared to the previous quarter and a year earlier, which is well above the regulatory requirements set by the Central Bank.

The Loans to Deposit (L/D) ratio for the whole banking system declined from 100.1% in June 2017 to 99% at the end of 2017 Q3, a level which is also lower than the 103.8% in 2016 Q3 mainly due to the decline in lending, while the deposits were growing. Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 100.2% and 95.2%, decreasing by two percentage points from the previous quarter for the Conventional banks. The level for Conventional banks in September 2017 has improved compared to a year ago when it was 106.1%, the same being the case for Islamic banks' L/D which has declined from 95.8% in September 2016. On the other hand, National banks have L/D ratio of 100.1% (with a decline of 1.3 percentage points compared to June 2017), while the ratio for foreign banks is 91.7%, marginally lower than the 91.8% at the end of 2017 Q2, reflecting decline in credit growth.

Lending to Stable Resources Ratio (LSRR) increased from 85.9% at the end of 2017 Q2 to 86% in September 2017. In the segmentation, Islamic, Conventional, National and Foreign banks, the

Please Rate this Report

Conventional and Foreign banks LSRR increased in the third quarter of 2017, for National banks it remained the same, while for Islamic it declined. On an annual basis, all banks' LSRR declined as the growth of deposits outpaced that of credit.

Meanwhile, liquid assets which include reserves requirements mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets moved from 17.1% at the end of June 2017 to 17.6% at the end of 2017 Q3. This is the second highest observed value in the liquid assets ratio since December 2015, the first being in August 2017. The level of total liquid assets at banks at the end of 2017 Q3 remains at AED 76.5 billion, AED 9.4 billion higher than at the end of 2017 Q2, registering growth of 2.6% in that quarter, boosting the increase in the Liquid Assets Ratio (LAR). On a Y-o-Y basis, total liquid assets at banks also increased by AED 53.3 billion or a growth of 14.2%. In addition, looking at the split between Islamic, Conventional, National and Foreign banks, data show that for all segments the LARs increased during 2017 Q3. On a Y-o-Y basis LAR has increased for all types of banks.

To sum, the banking sector, as a whole, has remained stable at the end of 2017 Q3 based on the Financial Soundness Indicators (FSIs).

On a Y-o-Y basis, the third quarter of 2017, has also shown improvements, based on the FSIs.

Overall, as of the end of September 2017, banks' assets, credit and deposits grew by 3.7%, 0.9% and 5.8%, respectively Y-o-Y and with an average monthly growth for 2017 of 0.1%, 0.0% and 0.2%, respectively. There is a slowdown in lending growth, due to accounting adjustments made by banks to set-off the amount of refinancing against related personal loans. However, the banking sector's indicators and the outlook of improved growth going forward bode well for the health of the banking system to support non-oil GDP growth, underpinned by sound indicators of financial stability.

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

Total system	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	88.9	86.6	85.4	85.9	86.0
The Liquid Assets Ratio (LAR)	15.6	16.0	16.8	17.1	17.6
Capital Adequacy Ratio (CAR)	19.1	19.4	18.6	18.5	18.7
Tier 1 Capital	17.1	17.5	16.9	16.9	17.1

Source: Central Bank of the UAE.
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	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	85.7	86.8	85.8	86.6	86.6
The Liquid Assets Ratio (LAR)	16.4	16.8	16.5	16.9	17.2
Capital Adequacy Ratio (CAR)	16.7	17.1	19.0	18.9	19.1
Tier 1 Capital	16.1	16.5	17.1	17.1	17.3

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

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

Islamic	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	89.9	88.6	83.7	83.5	83.8
The Liquid Assets Ratio (LAR)	14.4	14.8	17.9	17.1	17.8
Capital Adequacy Ratio (CAR)	18.2	18.6	16.7	16.7	17.0
Tier 1 Capital	16.7	17.1	16.0	16.0	16.3

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

Please Rate this Report

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

National	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	88.2	86.6	86.6	87.6	87.6
The Liquid Assets Ratio (LAR)	15.7	16.2	15.4	15.7	16.1
Capital Adequacy Ratio (CAR)	18.6	19.0	18.2	18.1	18.4
Tier 1 Capital	16.9	17.3	16.7	16.7	17.0

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

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

Foreign	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Lending to Stable Resources Ratio	78.3	74.8	77.6	75.0	75.7
The Liquid Assets Ratio (LAR)	23.5	24.2	25.4	25.9	26.5
Capital Adequacy Ratio (CAR)	21.3	21.5	21.3	21.0	20.7
Tier 1 Capital	18.3	18.6	18.5	18.1	18.0

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

3.2 Financial developments

3.2.1. Share Price Movement

A positive investors' confidence was observed during the third quarter of 2017. The optimism regarding the global economic outlook and the economic recovery weighed in on investors' confidence. The positive sentiment was evident by an increase of share price indices on the Abu Dhabi and Dubai securities markets. Market capitalization on Dubai Financial Market (DFM) rose, while on the Abu Dhabi Securities Exchange (ADX) it marginally declined.

On the ADX, the average Share Price Index rose by 0.4% in the third quarter of 2017 after a decline of 1.2% in the second quarter of 2017. The market capitalization growth moved from -1.4% at the end of 2017 Q2 to -0.3% at the end of September 2017 (see Table 3.2.1.).

The rise of the securities market in Dubai was very noticeable. The average Share Price Index grew by 6.8% in the third quarter of 2017. Similarly, the market capitalization rose significantly by 5.7% in the third quarter against an important fall of 7.8% in the previous quarter.

Table 3.2.1. UAE – Securities Markets

		2016				2017		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Abu Dhabi	**Change of Share Price Index (%)**	-0.5	3.9	1.7	-2.7	3.0	-1.2	0.4
	Change of Market Capitalization (%)	1.0	1.9	5.8	-3.0	1.4	-1.4	-0.3
Dubai	**Change of Share Price Index (%)**	-2.7	5.5	3.4	-2.3	5.2	-5.6	6.8
	Change of Market Capitalization (%)	-3.4	6.4	1.4	-3.3	18.8	-7.8	5.7

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 growth in indices in the financial markets coincided with an increase in the default risk premium for the Emirate of Dubai, while in the Emirate of Abu Dhabi it improved (see Table 3.2.2).

Table 3.2.2. UAE - Credit Default Swaps (CDS)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Emirate of Abu Dhabi	93.6	87.5	74.3	61.5	40.9	61.1	59.8
Emirate of Dubai	215.0	182.5	167.3	149.8	114.5	132.0	146.8

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

In the third quarter of 2017, the CDS of Sovereigns increased by 16.8 basis points (bps) in Dubai after a previous increase of 17.5 (bps) in the second quarter of 2017. In Abu Dhabi, the CDS declined by 1.3 bps, also due to the recent firming up of oil prices and the speed of fiscal reforms, after a previous increase by 20.2 bps Q-o-Q.

Please Rate this Report

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

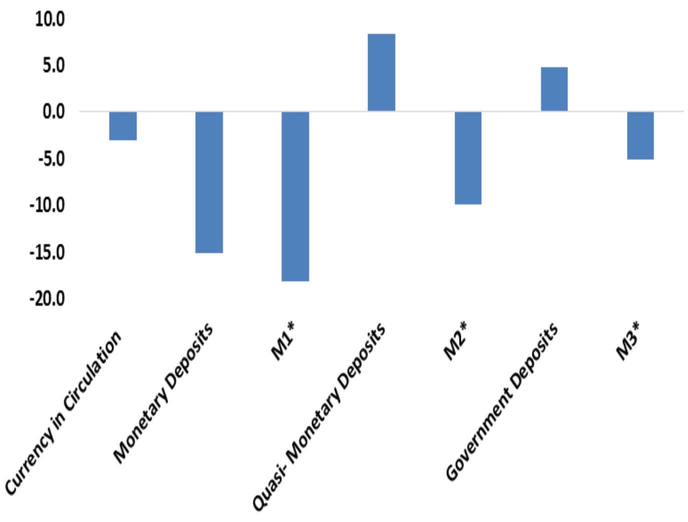
The Central Bank balance sheet exhibited an increase in 2017 Q3, reflecting increased foreign income receipts. Banks, in turn, increased reserves at the Central Bank as evident by the increase on the liabilities side of the balance sheet. As a result, Total Assets increased owing mainly to rising Central Bank's Cash and Cash Equivalents and Deposits at Banks abroad and other Advances. Meanwhile, interest rates in the UAE continued their upward trend in line with the Fed's decision announced in September to start winding down its Balance Sheet and to continue increasing interest rates. The ***spread*** *relative to the US dollar Libor as well as the* ***spread*** *related to the US dollar Swap rates decreased during the third quarter as liquidity and perceived risk declined in tandem with subdued global market volatility.*

4.1 Monetary Aggregates

From end of 2017 Q2 to end of Q3, M1 decreased by 3.6%, M2 by 0.8% and M3 by 0.3%.The decrease in M1 is mainly due to the decrease in Monetary Deposits by 3.5%. The slower decline in M2 is due to an increase in Quasi-monetary deposits by 1.1%, during the same period. Meanwhile, M3 fell by less than M2, due to an increase in Government deposits by AED 2.4%, in support of bank liquidity.

Figure 4.1 Change in Monetary aggregates in 2017 Q3

In billions of Dirhams



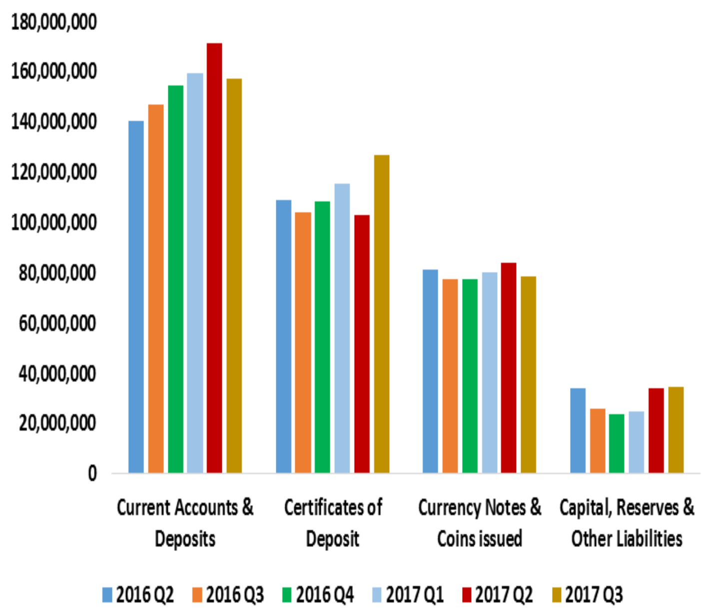
Source: Central Bank of the UAE

4.2. Central Bank Balance Sheet

Changes in the Central Bank balance sheet are triggered by changes on the liabilities' side, which increased by 1.2% in 2017 Q3. This was mainly due to an increase in Certificates of Deposits by 23.1% or AED 23.8 billion, reaching AED 126.6 billion, which is a testament to the improved liquidity situation at banks operating in the UAE.

Figure 4.2 Central Bank Liabilities

In millions of Dirhams



Source: Central Bank of the UAE

Please Rate this Report

Table 4.1 Central Bank Balance Sheet

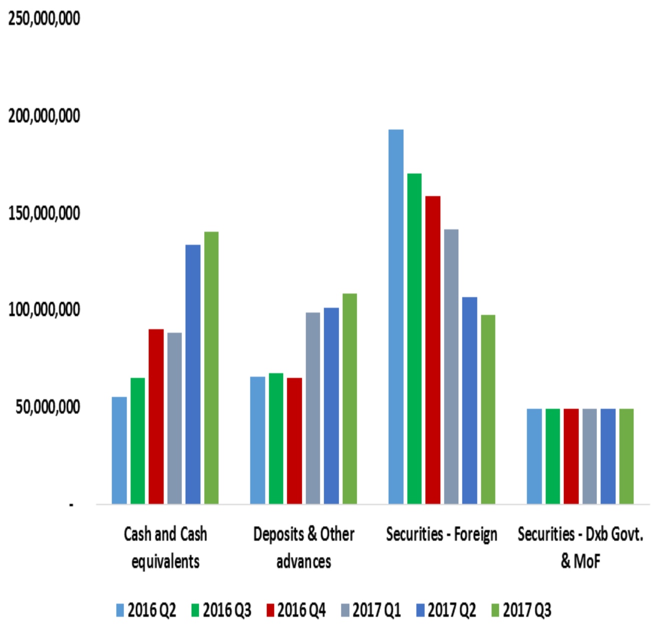
In Billions of Dirhams

	2016			2017		
	Q2	Q3	Q4	Q1	Q2	Q3
Assets						
Cash and Cash equivalents	55,656.2	65,037.0	90,149.2	88,061.1	133,518.1	139,940.9
Deposits & Other advances	65,533.0	67,667.2	64,897.7	98,886.7	101,198.7	108,333.7
Securities - Foreign	192,693.9	170,008.0	158,516.4	141,635.0	106,418.5	97,409.8
Securities - Dxb Govt. & MoF	49,197.9	49,165.2	49,165.2	49,165.2	49,165.2	49,165.2
Gold Bullion	1,164.1	1,170.8	1,014.8	1,099.3	1,101.5	1,135.1
Others	503.9	583.3	709.8	640.8	554.7	620.6
Total Assets	364,749.0	353,631.5	364,453.2	379,488.1	391,956.7	396,605.3
Capital & Liabilities						
Current Accounts & Deposits	140,351.0	146,920.1	154,775.2	159,330.4	171,176.6	157,076.2
Certificates of Deposit	109,082.6	103,796.9	108,192.8	115,301.0	102,858.7	126,639.8
Currency Notes & Coins issued	81,316.9	77,267.1	77,551.5	80,129.9	83,877.6	78,280.6
Capital, Reserves & Other Liabilities	33,998.5	25,647.4	23,933.7	24,726.8	34,043.7	34,608.8
Total Capital & Liabilities	364,749.0	353,631.5	364,453.2	379,488.1	391,956.7	396,605.3

Source: Financial Control Division, Central Bank of the UAE

Figure 4.3 Central Bank Assets

In millions of Dirhams



Source: Central Bank of the UAE

During 2017 Q3, banks operating in the UAE increased their balances of Certificates of Deposits, reflecting the increase in their dollarized income. In addition, Banks' foreign liabilities increased. . First, is the increase in "Due to Headquarters and/or Branches Abroad" by AED 3.8 billion, which is basically foreign banks getting short-term liquidity from the mother company abroad. Second is the increase in "Due to Other Banks Abroad" by AED 11.4 billion, 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. Third is the increase in "Capital Market Funding" by AED 24.2 billion, which is medium-term funding from overseas.

As a result of the above-indicated increase in banks' foreign liabilities, coupled with increased foreign income receipts in the economy, banks' dollar receipts were transferred to the Central Bank in return for dirham liquidity. Against this backdrop, the total assets of the Central Bank increased by 1.2% during 2017 Q3, reaching AED 396.6 billion at the end of September. This was mainly the result of an increase in Cash and Cash Equivalents by AED 6.4 billion and an increase in Deposits at Banks Abroad and Other Advances by AED 7.1 billion. Meanwhile, held-to-maturity foreign securities decreased, as the proceeds from maturing securities were not re-invested in the same instruments.

4.3 Central Bank Foreign Assets

The balance of foreign assets increased from AED 338.3 billion at end of 2017 Q2 to AED 344.1 billion at end of 2017 Q3, owing to an increase by AED 13.9 billion in Current Account Balances and Deposits with Banks abroad, while Held – to – Maturity Foreign Securities declined.

Table 4.2 Central Bank's Foreign Assets

In billions of Dirhams

	2016		2017		
	Q3	Q4	Q1	Q2	Q3
Total Foreign Assets	301.6	310.9	325.0	338.3	344.1
Held-To-Maturity Foreign Securities	169.0	149.3	140.5	104.3	94.3
Current Account Balances & Deposit with Banks Abroad	127.0	147.9	178.8	227.6	241.5
Other Foreign Assets	5.6	13.7	5.7	6.4	8.3

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

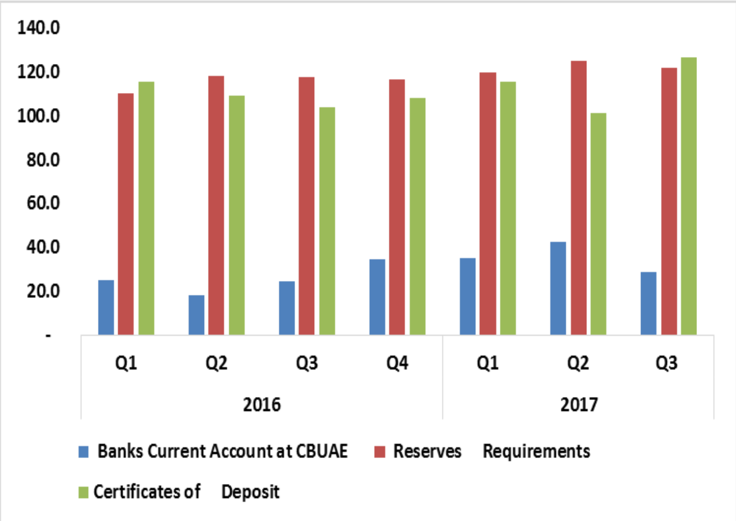
4.4 Developments in Banks' Liquidity at the CBUAE

[Please Rate this Report](#)

Banks' liquid assets at the Central Bank are composed mainly of their current account at the Central Bank, reserve requirements, and certificates of deposits. Total liquid assets at the Central Bank held by banks operating in the UAE increased during 2017 Q3 by AED 9.4 billion, reaching AED 376.5 billion. Underlying this increase is the increase in Certificates of Deposits. As liquidity improved against the backdrop of slowdown in credit growth, a few banks tapped the Central Bank facilities to mobilize funds, during this period.

Figure 4.4 Liquid Assets at Banks

In billions of Dirhams



Source: CBUAE Data

4.5. Interest Rates

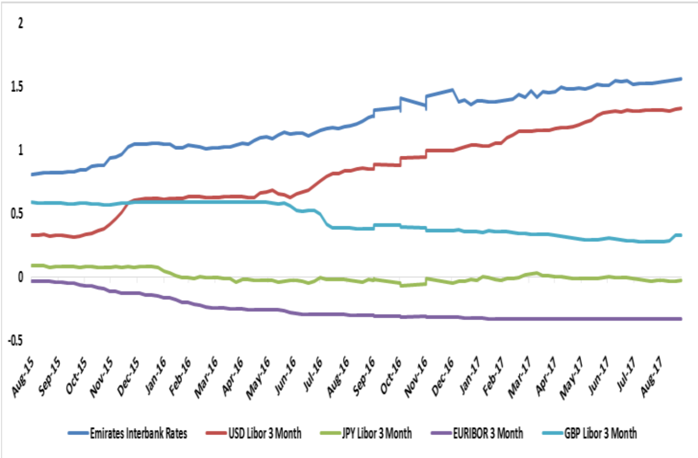
The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to peg its policy rate to the direction of the interest rate policy in the U.S. Therefore, the Central Bank of the UAE announced in March and again in June 2017 an increase in interest rates applied to its Certificates of Deposit, in line with the Fed's decision that brought the target Federal Fund rate to the 1 – 1.25% range. Similarly, the Repo Rate applicable to banks' borrowing of short-term liquidity from the Central Bank against their holding of CDs, has increased from 1% to 1.25%.

4.5.a Short-term interest rates

The 3-month Emirates Interbank Offer Rate (Eibor) comprises the daily quotes of the largest banks operating in the country, and published by the Central Bank of the UAE. During 2017 Q3, Eibor rose in line with USD Libor on the back of expected further interest rate increases in the US and the Fed's announcement on 20 September that it is going to start winding down its $4.5 trillion balance sheet.

Similarly, the GBP Libor 3 – month increased during most of the 3rd quarter from 0.31% in early July to 0.33% at the end of September, while the Libor rates on the Euro and Japanese Yen remained in negative territory, fluctuating around an average of -0.33% and -0.02% respectively, in line with the directions of monetary policy by the respective central banks.

Figure 4,5. a Libor rates (3-month) for the Dirham and key other currencies (%)

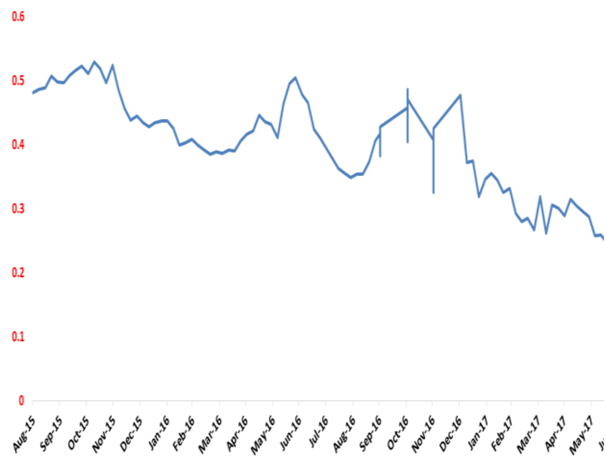


Source: Bloomberg

As regards the ***spread*** vis-à-vis the USD Libor (3 – month), it increased during most of 2016 as bank liquidity tightened in the UAE. However, the spread started decreasing as domestic liquidity improved in the recent period, from an average of 28 basis points in 2017 Q2 to 23 basis points in July and to 21 basis points in August, before returning to 23 basis points in September.

Figure 4.5.b Dirham Spread with USD Libor (3 month, %)

[Please Rate this Report]



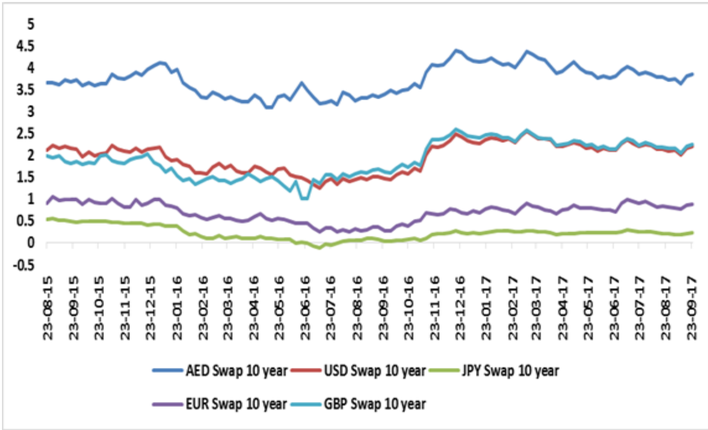
Source: Bloomberg

4.5. b Long-term swap rates

Given the absence of a deep and liquid government bond market in the UAE, the swap market reflects the yields of long-term securities. By definition, interest rate swaps correspond to an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the London Interbank Offer Rate (LIBOR).

As shown in Figure 4.6.a, the swap rates decreased during most of the third quarter, for the Dirham and other key currencies in testament of the decline in investors' perceived risk regarding the UAE, and subdued volatility in capital markets in general. Indeed, the VIX Index which is a proxy of risk aversion and uncertainty in capital markets reached a record low during this period.

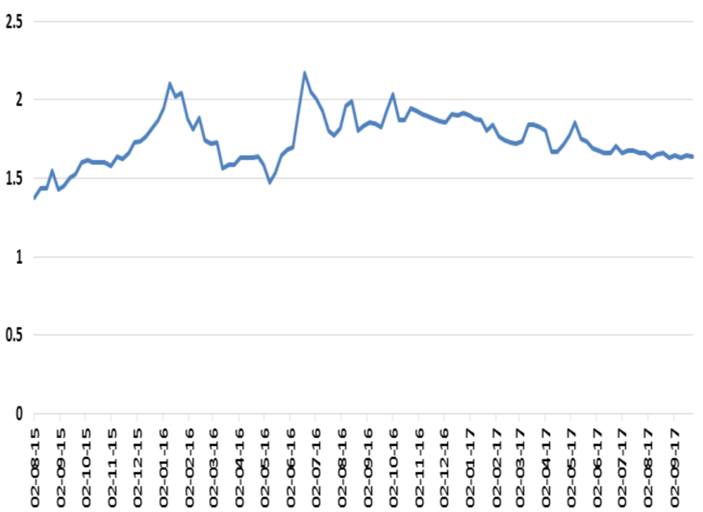
Figure 4.6.a 10-year swap rates (%)



Source: Bloomberg

As regards the spread between the AED 10-year swap rate and the US dollar, Figure 4.6.b shows a decline from an average of 172 basis points in 2017 Q2 to an average of 167 basis points in July and 164 basis points in August and September. The evidence attests to less perceived risk, as the UAE fiscal outlook improved along with the recovery in oil prices and the improved outlook for non-energy growth.

Figure 4.6.b Spread 10-year swap Dirham/USD (%)



Source: Bloomberg