Quarterly Economic Review

First quarter 2020

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List of Abbreviations

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

Executive Summary

In its April update of the *World Economic Outlook,* the IMF downgraded the global economic growth to –3.0% for 2020 as countries worldwide grapple with the COVID-19 pandemic. Economic growth is estimated to decline this year to –5.9% in the U.S., contract by -7.5% in the Eurozone, and by –1.0% in Emerging and Developing Economies. In accordance with the global recession, expectations are that inflation would remain muted across advanced countries hinting towards a longer period of low interest rates.

Following the sudden and sharp contraction for most of the UAE non-energy sectors in March, due to the COVID-19, the pace of economic growth declined in the first quarter of 2020 after a robust performance in the second half of 2019. Real growth in the UAE is estimated at -1.0% (Y-o-Y) in Q1 2020. Hydrocarbon GDP increased by an estimated 3.7% in the first quarter of the year. However, the non-hydrocarbon GDP growth is estimated to have declined by -3.0% in Q1 2020, compared to 4.4% growth in the previous quarter. As the drop in economic activity is expected to be followed by sharp contractions in the subsequent quarters, non-energy growth contraction is projected at -4.1% for 2020.

Meanwhile, Y-o-Y CPI inflation remained negative for the third quarter recording –1.4% due to negative inflation for both tradable (–0.2%) and non-tradable (–2.0%) goods and services reflecting the movements of rent prices, declining fuel prices, subdued domestic demand and nominal exchange rate appreciation.

Private sector employment, measured by the number of work permit holders, remained robust for a fourth consecutive quarter, registering a Y-o-Y growth of 2.0% in Q1 2020, albeit it masked severe underemployment among permit holders in the sectors affected by the COVID-19 pandemic. Real estate prices continued to decline by -8.3% and -3.5% Y-o-Y in Abu Dhabi and Dubai, respectively. The dirham, in line with the US dollar peg, appreciated in nominal terms, while depreciating in real terms due to price deflation.

During the first quarter of 2020, deposits increased on a yearly basis by 5.9%, led by the increase in GREs and private sector deposits. Credit continued its growth during the first quarter, where it registered a 5.6% annual growth, underpinned by healthy Financial Soundness Indicators (FSIs) that signify a sound and stable banking system.

The prompt policy actions through the Targeted Economic Support Scheme extended by the CBUAE to the banking sector and continued growth in non-government resident deposits helped support the resilience of the banking system. The CBUAE balance sheet expanded, supporting continued growth in the money supply in Q1 2020.

Chapter 1. International Economic Developments

The beginning of 2020 was marked by a global health crisis triggered by the COVID-19 pandemic. The virus and the required containment policies prompted a global recession in the first quarter of the year. Oil prices declined sharply owing to collapsing demand and excess supply in the global markets.

1.1 Economic Growth

The spread of COVID-19 in the first quarter of the year generated unprecedented losses and substantial uncertainties across many countries. According to the International Monetary Fund's April update of the *World Economic Outlook*, global growth would drop to –3.0% in the current year, the sharpest contraction since the global financial crisis. Advanced economies are the most effected exhibiting a significant economic turmoil. Still, large uncertainty characterizes the global growth forecast as the pathway of the pandemic remains unpredictable.

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

	2018	2019	2020*	2021**
World Output	3.6	2.9	-3.0	5.8
USA	2.9	2.3	-5.9	4.7
Advanced Economies	2.2	1.7	-6.1	4.5
Eurozone	1.9	1.2	-7.5	4.7
France	1.7	1.3	-7.2	4.5
Germany	1.5	0.6	-7.0	5.2
United Kingdom	1.3	1.4	-6.5	4.0
Japan	0.3	0.7	-5.2	3.0
EMDEs[1]	4.5	3.7	-1.0	6.6
China	6.6	6.1	1.2	9.2
India	6.8	4.2	1.9	7.4
MECA[2]	1.9	1.2	-2.8	4.0

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

In line with the rest of the world, the MECA region is expected to experience negative growth rates as a result of the COVID-19 outbreak in addition to the reduced demand for oil in the global market.

The expected rebound in 2021 would reflect a normalization of economic activities from the previous year low performance. The recovery assumes a fading pandemic and effective policy measures.

The US economic activity shrank by -1.2% in the Q1 2020 compared to the previous quarter with consumer spending, non-residential investment, exports, and inventories being the biggest drags.

Most countries in the Eurozone witnessed a contraction in businesses in affected sectors including accommodation and food, leisure and transport services.

Growth in China is on a downward path with Gross Domestic Product (GDP) shrinking by 6.8% in Q1 2020 compared to the same period a year ago—the first contraction since 1992.

Table. 1.1.b: Year-on-Year GDP Growth Rates in Selected Advanced Countries (%)

	2019				2020
	Q1	Q2	Q3	Q4	Q1
USA	2.7	2.3	2.1	2.3	0.3
Eurozone	1.4	1.2	1.2	1.1	-3.3
France	1.3	1.4	1.4	1.2	-5.4
Germany	1	0.3	0.5	0.4	-2.3
United Kingdom	2	1.2	1.1	0.9	-1.6
China	6.4	6.2	6.1	6.0	-6.8
Japan	0.8	0.8	1.9	0.5	-2.0

Source: Bloomberg, Federal Reserve Bank of ST. LOUIS, and Eurostat.

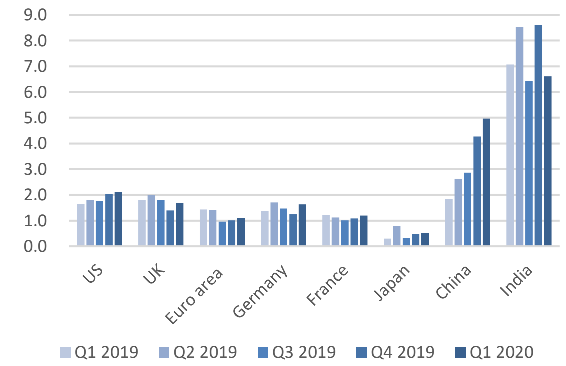
1.2 Inflation

The inflation dynamics in Q1 2020 remained moderate and fell during the last month of the quarter, largely driven by softer fuel prices ahead of the adverse implications of the coronavirus lockdown.

Before the COVID-19 developments, inflation in advanced economies was already set to remain below target over 2020, partly as a result of lower energy prices and the slow economic recovery. Since then, the large shifts in spending patterns and collapse in oil prices have made it likely that inflation will fall below target for a long period.

In China, the pandemic put downward pressure on inflation while supply chain disruptions have kept food prices high—in February, inflation reached its highest level in eight years and moderated in March.

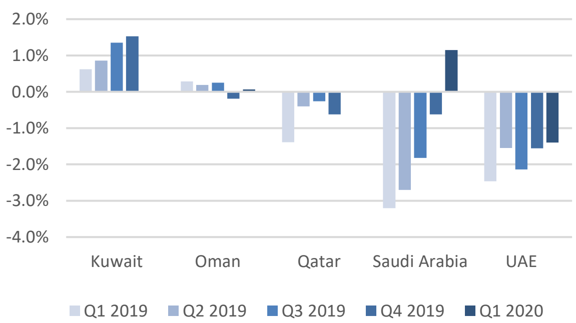
Figure 1.2.a: Y-o-Y Consumer Price Inflation for Selected Advanced and Emerging Economies (%)



Source: Bloomberg

Inflation in the GCC was very moderate while showing some heterogeneity across countries. Saudi Arabia witnessed the highest rate as prices trended positively after a year of negative rates, mainly driven by costs of food and beverage as well as transportation.

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



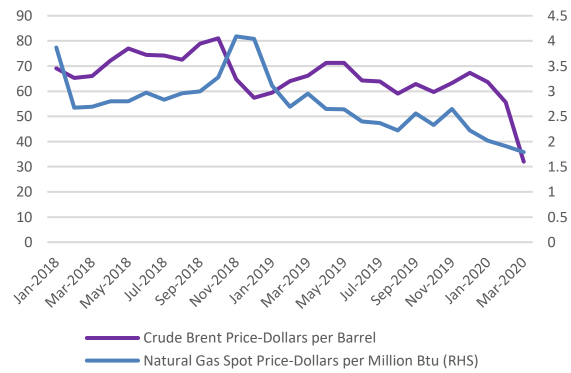
Source: Bloomberg

1.3 Energy Prices

The fast deterioration of the global economic outlook and the breakdown of the OPEC+ negotiations have weighed heavily on oil prices, which have fallen by about 20% in Q1 2020 compared to the same period a year ago and by 52% in March on a Y-o-Y basis. Similarly, the spot price of natural gas dropped by 35%, Y-o-Y.

The downward slope of crude oil prices sparked concerns indicating the depth of the crisis hitting the oil sector after lasting lockdowns were imposed in many of the world's major economies.

Figure 1.3.a: Crude Brent and Natural Gas Prices



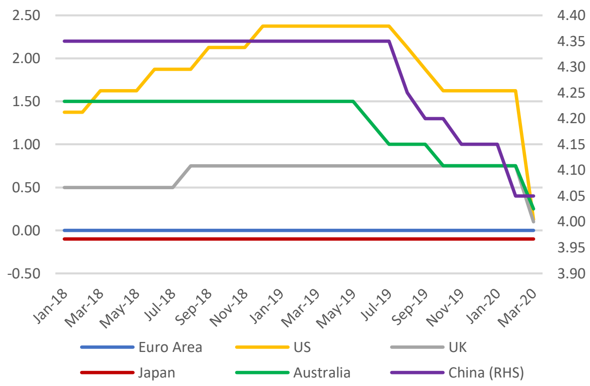
Source: US Energy Information Administration (EIA)

1.4 Global Policy Responses

Monetary measures

As a swift response to the COVID-19 outbreak, monetary policymakers in major economies reduced the benchmark rate—below 1 percent in the U.S., the U.K., and Australia (see Figure 1.4).

Figure 1.4 Policy Rates (%)



Source: HAVER.

Given the limited room for conventional monetary policy, advanced economies initiated an extension of unconventional measures to contain increases in long-term interest rates triggered by lingering uncertainties. This is particularly the case for central banks already experiencing very low interest rates—i.e., Japan and the Euro Area.

In the U.S., the Federal Reserve lowered its rate by 150 bps, expanded the overnight and term repos, and increased purchasing Treasury and agency securities.

The Bank of England also reduced the bank rate by 65 bps, expanded its holdings of government bonds and non-financial corporate bonds by GBP 200 billion, among other measures.

The ECB decided on additional asset purchases of 750 billion euros until end-2020, introduced new liquidity facilities, and announced a broad package of collateral easing measures.

Constrained by the negative policy rate, the Bank of Japan announced a targeted liquidity provision with an increase of government bond purchases and provided loans to financial institutions to facilitate financing of corporates.

After cutting its policy rate to 0.25%, the Reserve Bank of Australia announced purchases of government bonds (3-year bond targeting yield of 0.25%) in addition to extending repo operations and establishing a term funding of at least AUD 90 billion for SMEs.

People's Bank of China injected RMB 3.33 trillion of liquidity in the banking system, expanded the re-lending and re-discounting facilities by RMB 1.8 trillion and reduced the repo rates by 30 bps (7-day) and 10 bps (14-day). Furthermore, the monetary authority announced reserve requirement cuts of 50-100 bps.

Fiscal measures

In addition to the above-mentioned measures, policymakers reacted to this unprecedented challenge by quickly adopting a broad range of fiscal measures.

The US government announced the "CARES Act" of an estimated USD 2.3 trillion stimulus (11% of GDP), which includes tax rebates to individuals, expanded employment benefits, food safety net, and loans and guarantees to prevent corporate bankruptcy.

The UK government implemented measures to support businesses of GBP 27 billion, including tax holidays and direct grants to SMEs.

The government of Japan adopted JPY 117.1 trillion (21.1% of GDP) aiming at protecting employment and businesses through cash handouts, deferral of tax payments, and concessional loans.

In Australia, the economic stimulus amounted to AUD 194 billion (9.9% of GDP) consisting of wage subsidies, cash flow support to SMEs and investment incentives.

Finally, the Chinese fiscal package included an estimated RMB 2.6 trillion (2.5% of GDP) including disbursement of unemployment insurance as well as tax relief and waived social security contributions.

Chapter 2: Domestic Economic Developments

Following the sudden and sharp contraction for most of the UAE non-energy sector in March, due to the COVID-19 pandemic, the pace of economic growth declined in the first quarter of 2020 after a robust performance in the second half of 2019. Meanwhile, CPI inflation rates continued decreasing, reflecting the movements of rent prices as well as diminishing domestic demand. Employment, based on the number of work permits, remained robust for a fourth consecutive quarter, although masking sharp underemployment in sectors adversely affected by COVID-19. The AED appreciated in nominal terms, while depreciating in real terms.

2.1 Economic Activity and Growth

The first quarter economic activities witnessed mixed movements. The UAE economy performed well during the first two months of 2020. However, this was followed by a general slowdown in major activities amid the precautionary measures related to the COVID-19 pandemic. The UAE government, in line with the recommendations of the World Health Organization (WHO), established partial restrictions to limit the spread of the virus, which constrained domestic economic activities, tourism, and consumption. Overall GDP growth for the year 2020 is expected to contract by -3.6%, according to CBUAE estimates.[1]

The non-hydrocarbon GDP is estimated to have declined by -3.0% Y-o-Y in the first quarter. This came on the heels of significant rebound in the second half of 2019, marked by non-energy growth of 2.5% in Q3 and 4.4% in Q4 2019.

The growth momentum has come to a halt, starting in March 2020, which slowed down growth in Q1 2020 significantly. It is projected that the second quarter would encounter a sharp contraction of the non-hydrocarbon GDP Y-o-Y, that could linger, albeit at a milder pace, in the third quarter, assuming the virus is contained.

The non-energy growth contraction is projected by CBUAE at -4.1% for 2020 due to the adverse implications of the COVID-19 on economic activity and sentiments, slowdown in credit growth, and employment across the UAE, as evident by weak PMI data, reflecting the prevailing economic sentiment and declining real estate prices.

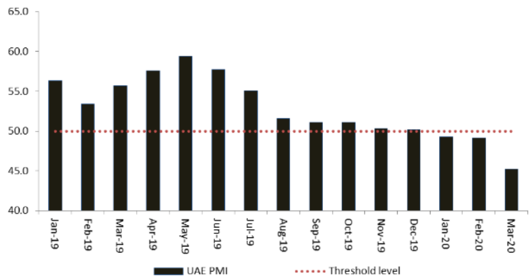
Details on the 2020 forecast assumptions are provided below:

- Fiscal growth (a combination of increase in government spending and a decrease in revenues attributed to fees and tax reductions) will average close to 28% in 2020, corresponding to the projected fiscal stimulus to counter the COVID-19 effects.
- Credit growth is assumed to slow down in the second quarter and to start recovering slowly after that.
- Real estate prices are assumed to decline with a sharper drop in the second and third quarters before moderating in the last quarter of the year.
- Drop in employment is assumed in the second and third quarters, with a recovery in Q4 2020.
- Economic sentiment, reflected by PMI, is assumed to drop further, after a realized decline of in the first quarter of the year, then with the projected economic recovery in the last quarter of the year the drop in PMI is likely to moderate, reflecting the improving sentiment and preparation for the Dubai EXPO in 2021.

Furthermore, as an open economy, the UAE is likely to feel the fallback from reduced global demand on oil as well sa non-oil exports while tourism and related services, parrticularly hospitality and retail trade are grounding to a halt. In addition, Foreign Direct Investment (FDI) is also assumed to fall, from 8% growth between 2017 and 2018, due to detoriaration in the investors' sentiments.

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

Figure 2.1.a: UAE PMI

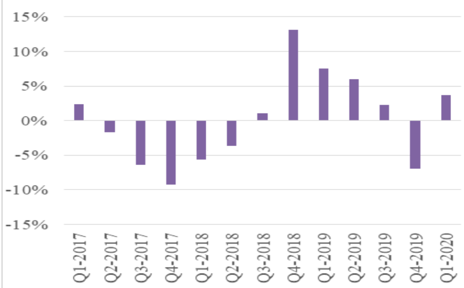


Source: IHS Markit

While recovery of economic activity is projected to commence in the second half of the year, recovery of economic sentiment will hinge on deploying policy support measures. The Targeted Economic Support Scheme (TESS) by CBUAE and the economic stimulus packages announced by both local and federal governments are likely to weigh in positively on the PMI, real estate prices, employment and credit growth with a positive impact on the overall sentiment once the virus risks are under control. Please refer to Box 3 on UAE policy support measures to combat the implications of the COVID-19.

Moreover, given the UAE's commitment to oil production cuts, in the context of the OPEC+ agreement to cut production by 9.7 million barrels per day effective May 2020, oil GDP growth is estimated to contract by -2.4% in 2020. During the first quarter of the year, however, oil production increased by 3.7% as the long-lasting deal on production cut came to end and OPEC+ talks collapsed in March of this year. In line with the agreement by OPEC+, the UAE average oil production is projected at 2.984 million barrels per day in 2020.

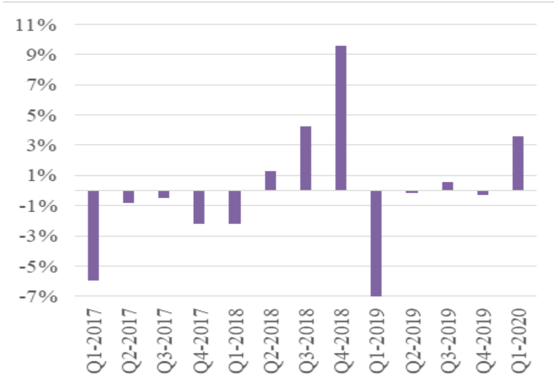
Figure 2.1.b: UAE Crude Oil Production Growth (%, Y-o-Y)



Source: OPEC

On the other hand, oil prices are expected to remain weak throughout the year given the severe fall in global demand, which is not expected to return back to its normal levels this year, coupled with the oversupply (refer to the commodities section in chapter 1).

Figure 2.1.c: UAE Crude Oil Production Growth (%, Q-o-Q)



Source: OPEC

Table 2.1.a: Quarterly and Annual GDP Growth Rates in the UAE (Y-o-Y, %)

Item	2019				2019	2020	2020
	Q1	Q2	Q3	Q4		Q1	
Overall GDP	1.5%	2.0%	2.3%	0.8%	1.7%	-1.0%	-3.6%
Non-oil GDP	-2.2%	-0.7%	2.5%	4.4%	1.0%	-3.0%	-4.1%
Hydrocarbon GDP	11.1%	9.1%	1.8%	-7.0%	3.4%	3.7%	-2.4%

Source: FCSA for 20191 and CBUAE estimates and projections for 2020.

2.2 Developments in the Residential Real Estate Market

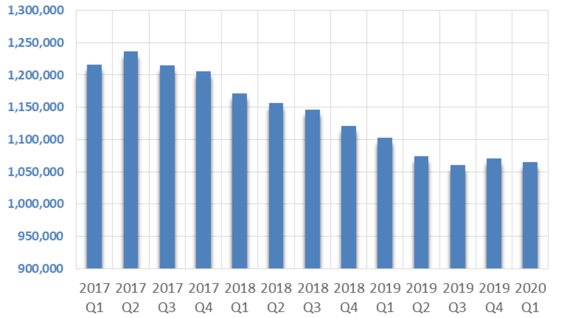
According to data for Q1 2020, the average annual residential real estate prices in the UAE continued to decline, both, on a Y-o-Y and Q-o-Q basis.

Q1 2020 figures do not provide a fully objective representation of the real estate market in the UAE as they do not reflect measures being taken to counter the effects of COVID-19 and to extend relief to property owners and tenants. Such measures included suspension of eviction in cases of non-payment of the rent or some owners being allowed to extend the term of the lease contract without the need to renew.

Dubai Residential Market

According to recent data from Dubai Land Department (DLD) there was a fall in residential property prices by -3.5% Y-o-Y in Q1 2020 in Dubai, following a decrease of 4.4% Y-o-Y in Q4 2019.

Figure 2.2.a: Average Dubai Residential Unit Sale Prices (AED)



Source: DLD

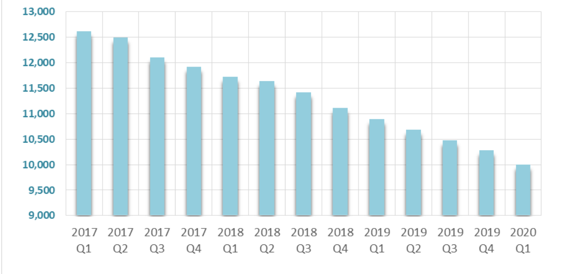
Since the downward cycle started in mid-2014, the fall in prices has been accompanied by a fall in rents, which declined by -13.0% Y-o-Y in Q1 2020.

The implied rental yield[2,3] in Dubai dropped to 6.2% in the first quarter of 2020 from 6.9% in the previous quarter, indicating a faster pace of decline in rent relative to property values.

Abu Dhabi Residential Market

According to the REIDIN[4] Price Index the average price in the Abu Dhabi housing market declined by -8.3% Y-o-Y in Q1 2020.

Figure 2.2.b Abu Dhabi Residential Prices (AED/SQM)



Source: REIDIN

Rents in Abu Dhabi declined by -4.8% Y-o-Y in Q1 2020, a lower rate than the drop of -6.3% during the previous quarter.

The lower pace of decline in rents than prices resulted in rising rental yield at 7.0% in Q1 2020 compared to 6.9% in Q4 2019.

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

Box 1: Recent Oil Price Developments and Implications for the UAE

The fast deterioration of the global economic outlook and the breakdown of the OPEC+ agreement have weighed heavily on oil prices, which have fallen by about 70%, their lowest in more than 20 years. The underperformance of the oil sector is projected to spill over to non-hydrocarbon activities in the region and domestically generating further pressures on government budgets and external accounts, especially if the oil price shock exhibits further persistence.

The UAE economy is the most diversified economy in the GCC region, registering the highest share of non-oil GDP compared to the total—i.e., 70.2% in 2019.

Notwithstanding the increased diversification of the economy, the oil price shocks are transmitted to the economy through the high dependency of government revenues and spending on oil exports. Insulating the economy from the effects of the oil price shock will hinge on domestic policies, refraining from a pro-cyclical stance, which results in decreased spending to accommodate significant declines in oil revenues. Countercyclical fiscal and monetary policies could counter the effects of the lower oil prices on the non-oil sectors, albeit widening the fiscal deficit, which could be managed given low public debt ratio and diversified options of financing.

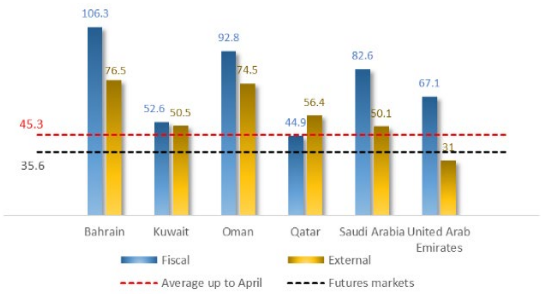
The IMF projects oil prices at $35.6 in 2020; however, the estimated fiscal breakeven for the UAE stands above that (Figure 1). This would lead to a deterioration of the government fiscal space[5]. Sovereign general government debt in the UAE remains low, at 20% of GDP in 2019[6], which will provide options of financing the deficit through borrowing without raising serious risks for the fiscal sustainability—especially in a scenario of a short-lasting low oil prices. Over the medium term, concerns about fiscal sustainability would warrant striking a balance between non-energy growth and public finance reforms to prioritize spending and widen the base of non-oil revenues in the budget.

In the case of a short-term oil price shock, no major correction would be required to maintain the pace of priority government spending and the Government can capitalize on the good ratings and low debt burden to diversity sources of financing. However, if the oil price shock persists for long, adjustments on either the non-oil revenues or government spending would be warranted to safeguard fiscal sustainability. The timing, however, would be crucial to strike the right balance between fiscal sustainability and supporting the recovery of non-energy growth.

The UAE economy is also the most diversified in terms of exports in the GCC—only 18% of the total exports were hydrocarbon products in 2019. However, using data for the first half of 2019, 29% of UAE's non-oil exports and 24% of its re-exports are to the GCC. Hence, the impact of the decline in oil price and the decline in demand in major importing countries could slow down the UAE non-oil exports and re-exports.

The external current account breakeven price stands at around $31, below the projected oil price for 2020 at $35.6 (IMF and crude oil futures). Smaller surplus in the current account could shrink international reserves at CBUAE.

Figure 1: Fiscal and External Current Account Breakeven Prices



Source: IMF Regional Economic Outlook (April 2020)

[5] The IMF projects the UAE fiscal deficit at 11.1% of GDP in 2020 and 7.1% of GDP in 2021.
[6] IMF World Economic Outlook Database

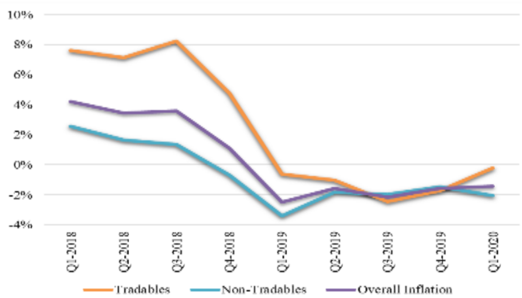
2.3 Consumer Price Index and Inflation

During the first quarter of 2020, deflation in the UAE reached -1.4%, on a Y-o-Y basis, compared to a drop of -1.6% in the fourth quarter of 2019. This was the result of a fall by -0.2% and -2.0% in tradables[7] and non-tradables[8], respectively.

Tradable prices—accounting for 34% of the CPI consumption basket declined at a much lower rate compared to the -1.7% drop in Q4 2019. The softening in deflation was mainly attributed to the increase in prices of food and soft drinks; transportation; and textile, clothing and footwear. Food prices increased due to supply constraints attributed to the COVID-19 outbreak. In parallel, transportation prices did not reflect the sharp drop in oil prices in the international markets at the end of Q1 2020 as fuel prices are based on the oil price of the previous month.

The continued decline in the housing component by -4.5% – accounting for 34% of the consumer basket, as well the significant softening in all other components of the non-tradables, except transportation and education, contributed to the higher drop in this segment, compared to Q4 2019.

Figure 2.3.a: Tradable and Non-Tradable Inflation (%, Y-o-Y)



Source: Federal Competitiveness and Statistics Authority (FCSA)

At the Emirate level, in Q1 2020, deflation registered Y-o-Y -3.1% and -1.4% in Abu Dhabi and Dubai, respectively, compared to a decline of -1.2% and -2.5% in the previous quarter.

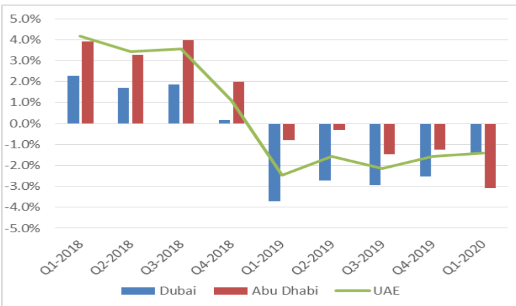
The deflation in Dubai resulted from the decline in the non-tradable prices Y-o-Y by -2.8%, while tradables increased by 2.1%. On the other hand, the drop of tradable and non-tradable prices was by -3.7% and -2.7%, respectively, in the Emirate of Abu Dhabi.

The decline in the tradable prices in the Emirate of Abu Dhabi was the result of larger declines in the groups of food and beverages; clothing and footwear; furnishing as well as miscellaneous goods and services. The housing component continued its downward trend in Abu Dhabi, declining by -6.8%.

At the same time, in Dubai, there was a milder drop in clothing and footwear; and miscellaneous goods and services, resulting in an increase in tradables' prices. On the other hand, non-tradable prices declined in Dubai more significantly than in Abu Dhabi as the housing component continued its downward trend, declining by -6.8%.

One of the reasons for the differences in inflation rates (deflation) across Emirates is attributed to the weights of the different components in the consumption basket. For instance, in Dubai, the housing category has a larger weight compared to Abu Dhabi and the UAE.

Figure 2.3.b: Quarterly Y-o-Y Headline Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA, SCAD and DSC.

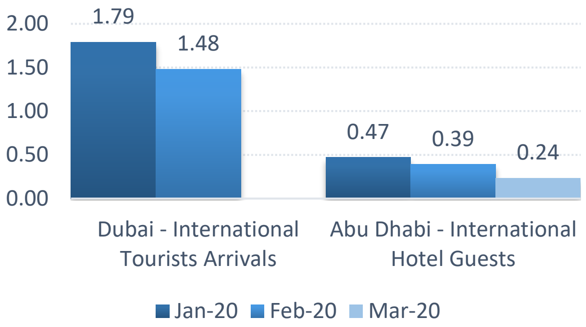
[7] As per CBUAE calculations, tradables include the following categories of goods and services: food and soft drinks; beverages and tobacco; textiles, clothing and footwear; furniture and household goods; transportation; and miscellaneous goods and services.

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

Box 2: Tourism Activity in the UAE

In Dubai, after experiencing an increase in international tourist arrivals during January 2020 (increase by 11.2% or 180,000 tourists compared to January 2019), the number of international tourists during the month of February 2020 decreased by 3.3% compared to February 2019 (decrease by 50,000 tourists), Figure 1.

Figure 1: International Tourist Arrivals to Dubai[1] and International Hotel Guests in Abu Dhabi January-March 2019-2020 (in Millions)



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

[1] Dubai Corporation of Tourism and Commerce Marketing has not released March 2020 tourism statistics at the cut-off date of this report.

The international hotel guests in the Emirate of Abu Dhabi during January 2020 increased by 7.7% or 33,600 tourists. However, the number of international hotel guests in Abu Dhabi decreased in February 2020 by -3.7% (decrease by 14,900 tourists) compared to February 2019. Further, significant decrease was recorded for March 2020 (decrease by -47.1% or 211,470 tourists) compared to March 2019.

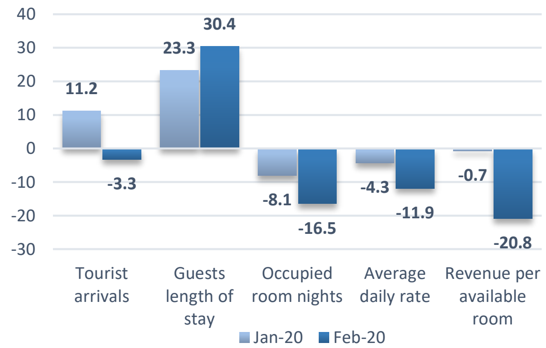
The decrease in tourists' indicators coincides with the COVID-19 outbreak. Several measures taken by the UAE authorities to combat COVID-19 have adversely affected tourism, such as temporary suspension of issuing entry-visa and visa-on-arrival (except for Diplomatic Passport holders), temporary suspension of entry for GCC citizens, and suspension of all inbound and outbound passenger flights and the transit of airline passengers in the UAE.

The decrease in international tourist arrivals in Dubai and international hotel guests in Abu Dhabi, coupled with reduction in hotel rates, resulted in further decline in revenue indicators for both Dubai and Abu Dhabi Emirates during February and March 2020 compared to the same period in 2019, Figure 2.

Hotel's average length of stay (ALOS), however, registered increase in both Dubai and Abu Dhabi Emirates, mainly due to government directive to use 45 hotels, predominantly in Abu Dhabi city, to accommodate quarantined guests in connection to COVID-19 pandemic.

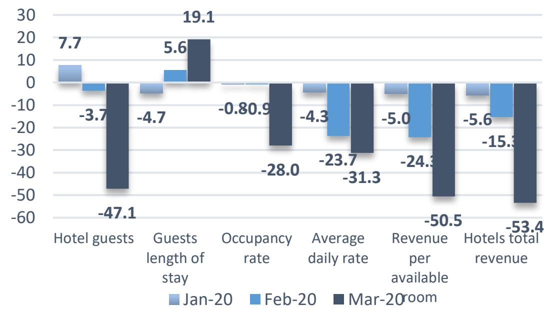
Figure 2: Annual Percentage Change in Major Indicators of Dubai & Abu Dhabi Inbound Tourism January-March 2019-2020 (%)

a. Dubai



Source: Dubai Corporation of Tourism and Commerce Marketing

b. Abu Dhabi



Source: Abu Dhabi Tourism & Culture Authority

2.3 Employment and Labor Market Dynamics

This section covers only employment in the private sector based on data provided by the Ministry of Human Resources and Emiratization (MOHRE).[9] The employees in the private sector represented about 81.5% of all employees in the UAE at the end of 2018.

Table 2.3: Employment Growth by Sector

Sector	Share in Employment	Q-o-Q Growth	Contribution to Growth Q-o-Q	Y-o-Y Growth	Contribution to Growth Y-o-Y
Construction	31.8%	0.0%	0.0%	-3.2%	-1.0%
Services	21.6%	0.7%	0.2%	1.2%	0.3%
Manufacturing	9.2%	1.0%	0.1%	1.3%	0.1%
Real estate and Business services	13.0%	3.3%	0.4%	7.1%	0.9%
Transport, Storage and Communication	6.9%	0.2%	0.0%	0.9%	0.1%
Other sectors	17.6%	3.4%	0.6%	11.3%	1.2%
Total Employment	**100.0%**	**1.3%**	**1.3%**	**2.0%**	**2.0%**

Source: MOHRE and CBUAE

The negative macroeconomic developments due to the COVID-19 pandemic by the end of the first quarter of 2020 were not reflected in the labor market as employment, measured by permit holders, in the private sector increased by 1.3% and 2.0% Q-o-Q and Y-o-Y, respectively, in Q1 2020 compared to an increase of 0.3% and 2.0%, respectively, in the previous quarter.[10] The numbers, however, could mask severe underemployment for visa holders in sectors that have been adversely affected by the COVID-19.

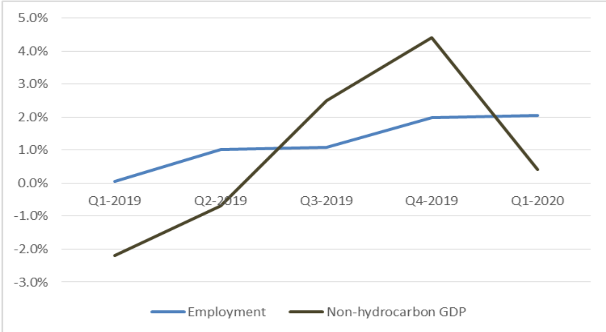
Jobs in the private sector reached 5.159 million employees or 64,000 new positions added in the first three months of 2020.

In 2019, private sector jobs have been growing in line with the non-hydrocarbon GDP, being correlated at 70% in the most recent period.

The Real Estate and Business Services sector and Other Sectors increased jobs Y-o-Y in Q1 2020 by 7.1% and 11.3%, faster than the 6.3% and 10.5% in the previous quarter, respectively.

Moreover, the Construction sector continued its employment contraction. Accounting for 31.8% of total private sector employment, the sector declined Y-o-Y by 3.2% in Q1 2020 compared to the drop of -2.4% in the last quarter of 2019. Employment in the Services sector—21.6% of total private sector employment—has shown further improvement, rising by 1.2% Y-o-Y in the first quarter of 2020 compared to an increase by 0.8% during the last quarter of 2019.

Figure 2.3: Non-energy GDP and Employment Y-o-Y Growth (%)



Source: MOHRE, FCSA for GDP for Q1 2019 – Q4 2019 and CBUAE for GDP estimates for Q1 2020

Furthermore, employment in the Manufacturing sector, which constitutes around 9.2% of total employment in the private sector, continued to grow at the same rate on a Y-o-Y basis in Q1 2020, as in the previous quarter, at 1.3%. In addition, the Transport, Storage and Communication Sector, which has the lowest share of private sector employment of 6.9%, increased employment by 0.9% Y-o-Y.

2.4 Exchange Rate Fluctuations and Outward Personal Remittances

2.4.1 Exchange Rate Fluctuations

In Q1 2020, the AED appreciated in nominal terms on a Y-o-Y and Q-o-Q, due to the appreciation of the USD. Against the currencies of the top-10 non-dollarized import partners, the AED appreciated by 0.1% Q-o-Q and by 1.2% Y-o-Y. Against the currencies of the top-10 non-dollarized non-oil export partners, the appreciation was of 0.4% Q-o-Q and of 0.9% Y-o-Y.

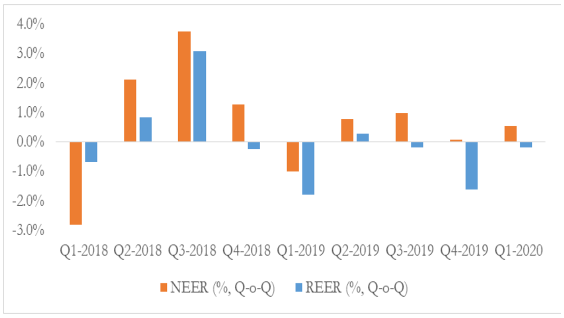
Accounting for all of the UAE's trading partners, the Nominal Effective Exchange Rate (NEER) displayed the same pattern of

[9] The database on private sector employment also excludes the Free Zone activities.

[10] One of the main reasons for that could be that the work permits of many employees have not been cancelled, even though they have been put in temporary leave or made redundant. In addition, the UAE authorities have allowed residents with expired visas to remain legally until the end of 2020.

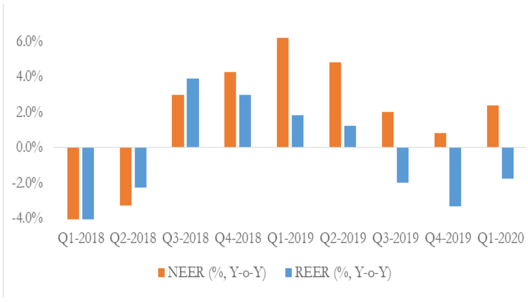
appreciation relative to a basket of the weighted average of the currencies of major trading partners. In particular, the average NEER appreciated by 0.5% and 2.4% Q-o-Q and Y-o-Y, respectively, in the first quarter of 2020, compared to an appreciation of 0.1% and 0.8%, respectively, in the previous quarter.

Figure 2.4.1.a: Nominal and Real Effective Exchange Rates Developments (%, Q-o-Q)



Source: Bank for International Settlements (BIS)

Figure 2.4.1.b: Nominal and Real Effective Exchange Rates Developments (%, Y-o-Y)



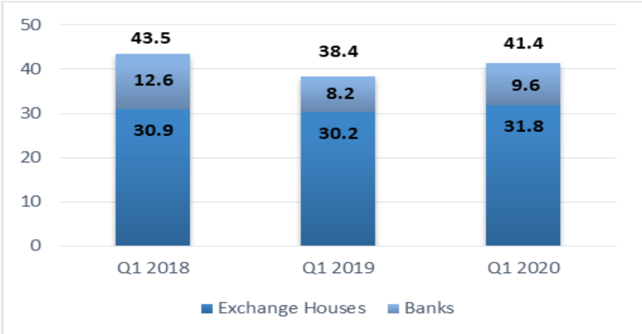
Source: Bank for International Settlements (BIS)

In real terms, the Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, depreciated by -0.2% and -1.7% Q-o-Q and Y-o-Y, respectively, in the first quarter of 2020 compared to a depreciation of -1.6% and -3.3%, respectively, in the previous quarter. The depreciation in the REER was the result of the continued deflationary cycle in the UAE offsetting the nominal AED appreciation.

2.4.1 Outward Personal Remittances

During Q1 2020, outward personal remittances increased by 7.8% or AED 3 billion compared to the same period of 2019. The outward personal remittances that were settled through the banks increased by 16.9% or AED 1.4 billion. Meanwhile, the outward personal remittances that were settled through the exchange houses registered an increase of 5.4% or AED 1.6 billion, compared to the same period of 2019. The figures, including monthly data through March, provide evidence that, COVID-19 outbreak, did not affect the volume of personal funds transferred by expats and UAE nationals abroad thus far in the first quarter of 2020.

Figure 2.4.2: Evolution of Outward Personal Remittances Settled Through Banks and Exchange Houses, January –March 2018-2020 (AED Billions)



Source: CBUAE

The top five destination countries for outward personal remittances during January-March 2020 were India (37.8%), Pakistan (11.4%), Philippines (7.0%), Egypt (6.6%), and the U.S.A. (3.6%). With the exception of Philippines, outward personal remittances to these countries increased by 20.8% (Pakistan), 18.7% (Egypt), 15.2% (U.S.A.), and 9.1% (India). In contrast, outward personal remittances to Philippines decreased by 3.6%.[11]

[11] The quarterly decrease was mainly due to the decreased remittances during March 2020. Y-o-Y growth for January, February, and March 2020 were 7.9%, 2.0%, and -15.6%.

Box 3: Major UAE Policy Responses to COVID-19 Pandemic

The UAE government has been committed and prepared to take all necessary measures promptly to mitigate the impact of the COVID-19 pandemic on the economy. The UAE Central Bank has announced the Targeted Economic Support Scheme (TESS). Announcements by the federal and local governments followed, providing further stimulus packages and measures totaling nearly AED 283 billion.

Central Bank's Policy Responses

The Central Bank of the UAE (CBUAE) launched targeted support measures in two phases, commencing on 14th of March. The objectives of the TESS support measures are to (i) facilitate the provision of temporary relief by banks to all affected private sector corporates, SMEs and individuals, and (ii) facilitate additional lending capacity by banks, through the relief of existing capital and liquidity buffers.

The total amounts of the measures added up to AED 256 billion, consisting of AED 50 billion capital buffer relief, AED 50 billion zero cost funding support facility to banks in exchange for targeted relief to their retail and corporate customers affected by COVID-19 pandemic, AED 95 billion liquidity buffer relief, and reduction by half the reserve requirements on demand deposits for all banks from 14% to 7%, adding AED 61 billion liquidity support. The collective support measures aimed at providing support to banks' lending to the UAE economy and their liquidity management.

Moreover, the CBUAE has reduced the amount of capital banks have to hold for their loans to SMEs by 15 to 25 percent, in line with the minimum standards set by the Basel committee, to facilitate further access of SMEs to financing. Furthermore, all banks will be mandated to open accounts for SME customers within a maximum timeframe of two days, provided acceptable documentation is in place and that the risk is acceptable in view of the AML and CTF obligations.

To mobilize lending to the real estate sector and reduce burden on borrowers, the CBUAE has increased the loan-to-value (LTV) ratios applicable to mortgage loans for first-time home buyers by 5 percentage points. This will contribute to the affordability of housing without unduly increasing inherent risks. First time buyers will benefit from being required to put up less of their own capital when making the first real estate purchase.

In addition, the CBUAE has further extended the duration of the Targeted Economic Support Scheme for affected retail and corporate customers. Banks and finance companies in the TESS programme will be able to extend to their customers' deferrals of principal and interest payments on outstanding loans until 31 December, 2020. Meanwhile, CBUAE has granted an extension of the capital buffer relief to 31 December 2021 for banks participating in the TESS programme.

Federal and Local Governments Policy Responses

The Federal and local governments have also launched AED 27.5 billion package in fiscal measures to invigorate the economy. Out of the 27.5 billion, 16 billions have been made available by the federal government. The collective package embraces a renewable six-month suspension of work permit fees and reduction of labour and other charges to cut the cost of doing business, support for small businesses and acceleration of major infrastructure projects.

Local governments such as Abu Dhabi, Dubai, and Ras Al Khaimah have also announced packages that amount for 9 billion, 1.5 billion, and 50 million dirhams respectively. Meanwhile, the seven emirates announced several interventions that include relieving SMEs and households through a combination of improved access to affordable credit, subsidies, fee exemptions, improved payment terms on government contracts, and additional waivers and rebates initially planned for 3 months. Moreover, planned initiatives were launched to support GREs by injecting liquidity by the governments to ensure the most affected GREs' survival during economic disruptions.

Consumer protection

In addition to the measures undertaken to protect SMEs and sectors affected by the COVID-19 pandemic, the UAE government has taken further measures to maintain the integrity of local consumer markets, and has established a dedicated task force to ensure smooth and uninterrupted supply of consumer goods, as well as enforcing strict monitoring standards to prevent manipulative pricing practices.

Chapter 3. Banking and Financial Developments[12]

In Q1 2020, deposits increased on a yearly basis by 5.9%, mainly driven by the increase in GRE and private sector deposits. Credit growth also increased by 5.6%, supported by lending to GREs. Overall, the financial soundness indicators illustrate the health and stability of the financial sector.

3.1 Banking Structure[13]

In Q1 2020, the number of licensed commercial banks remained unchanged at 59 in total.

The total number of banks comprises 21 national banks and 38 foreign banks, including 11 wholesale banks. National banks continued to decrease their branches, which declined to 640 at the end of Q1 2020 compared to 656 in Q4 2019. The number of employees in national and foreign banks increased by 201 compared to the previous quarter, to reach 35,838 in Q1 2020.

3.1.1. Banks' Deposits

Customer deposits in UAE banks increased by a 5.9% Y-o-Y to reach AED 1,851.9 billion. However, on a Q-o-Q basis, it declined by 1% or AED 18.3 billion. The majority, 88% of total deposits, are held by residents.

Table 3.1.1.a: Total Deposits at UAE Banks

Item	Sep-19	Dec-19	Mar-20
Bank Deposits	1802.0	1870.2	1851.9
(Y-o-Y change %)	4.3%	6.5%	5.9%

Table 3.1.1.b: Resident and Non-resident Deposits at the UAE banks

Item	Sep-19	Dec-19	Mar-20
Resident Deposits	1612.2	1648.8	1635.1
(Y-o-Y change %)	5.9%	6.9%	6.2%
Non-Resident Deposits	189.8	221.4	216.8
(Y-o-Y change %)	-7.6%	3.7%	4.1%

The increase in resident deposits was essentially due to the change in private sector deposits, which increased by AED 18 billion in Q1 2020, in addition to the rise in GRE deposits by AED 14.8 billion.

Table 3.1.1.c: UAE Resident Deposits

Item	Sep-19	Dec-19	Mar-20
Government Sector	316.6	301.3	255.1
(Y-o-Y change %)	10.7%	3.8%	-6.6%
GREs	218	245.3	260.1
(Y-o-Y change %)	13.1%	18.4%	33.6%
Private Sector	1034.2	1057.9	1076.2
(Y-o-Y change %)	2.4%	4.8%	4.4%
NBFI	43.4	44.3	43.7
(Y-o-Y change %)	27.3%	24.8%	6.1%

The share of deposits by the type of banks, i.e., conventional vs. Islamic banks represent 78.4% and 21.6% of total deposits at the end of Q1 2020, respectively. Meanwhile, the share of national and foreign banks' deposits represents 88.2% and 11.8%, respectively.

3.1.2. Banks' Assets and Credit

Total Assets increased by 8.1% Y-o-Y and Gross Credit increased by 5.6% Y-o-Y in Q1 2020. Total Assets increased by AED 45 billion, while Gross Credit increased by AED 10 billion compared to Q4 2019.

Table 3.1.2.a: Assets and Credit at UAE Banks

Item	Sep-19	Dec-19	Mar-20
Total Assets	3022.7	3082.9	3128
(Y-o-Y change %)	6.5%	7.5%	8.1%
Gross Credit	1720.8	1758.6	1768.2
(Y-o-Y change %)	5.0%	6.2%	5.6%
Domestic Credit	1565.6	1592.6	1595
(Y-o-Y change %)	4.6%	5.5%	4.3%
Foreign Credit	155.2	166	173.2
(Y-o-Y change %)	9.4%	13.1%	18.8%

For domestic credit, the lending growth was mainly driven by lending to the GREs, which increased by 17.1% Y-o-Y and by AED 16 billion.

Table 3.1.2.b: Domestic Credit

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

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

Item	Sep-19	Dec-19	Mar-20
Government	219.5	257.4	229.1
(Y-o-Y change %)	18.3%	34.4%	16.2%
GREs	178.9	185.3	201.1
(Y-o-Y change %)	6.0%	10.4%	17.1%
Private Sector	1150.1	1134.6	1148.9
(Y-o-Y change %)	2.6%	0.4%	0.7%
NBFI	17.1	15.3	15.9
(Y-o-Y change %)	-19.7%	-23.5%	-20.1%

Despite the decline in lending to individuals by 1% Y-o-Y, the 1.4% or AED 17 billion increase in credit to private corporates led to a rise in overall credit growth to the private sector.

Table 3.1.2.c. illustrates sectors of lending by economic activity, which increased on a yearly basis. The sectors with the highest Y-o-Y growth were Manufacturing; Electricity, Gas and Water; Transport, Storage and Communication; Financial Institutions (excluding banks), and Trade.

Table 3.1.2.c: Lending by Economic Activity, Sectors with Credit Growth Y-o-Y, March 2020

Item	Dec-19	Mar-20
Manufacturing	80.3	81.6
(Y-o-Y change %)	4.3%	5.7%
Electricity, Gas and Water	22.7	23.5
(Y-o-Y change %)	33.7%	27.7%
Transport, Storage and Communication	56.9	63.3
(Y-o-Y change %)	10.5%	22.6%
Financial Institutions (Excluding Banks)	131.4	132.2
(Y-o-Y change %)	1.0%	5.7%
Trade	152.6	155.7
(Y-o-Y change %)	-0.9%	0.7%

The sectors experiencing a decline in credit on Y-o-Y basis as at the end of Q1 2020 are Agriculture, Mining and Quarrying, Construction and Real Estate, and all others.

Table 3.1.2.d: Lending by Economic Activity, Sectors with Credit Decline Y-o-Y, March 2020

Item	Dec-19	Mar-20
Agriculture	1.1	1.5
(Y-o-Y change %)	-47.0%	-16.0%
Mining and Quarrying	10.7	11.8
(Y-o-Y change %)	-27.6%	-25.9%
Construction and Real Estate	311.4	319.8
(Y-o-Y change %)	-1.3%	-1.1%
All Others	143.2	148.9
(Y-o-Y change %)	-3.8%	-6.0%

Islamic banks have a share of 18.4% in the total assets and 20.9% in the total gross financing of the banking system. During Q1 2020, the main drivers of domestic lending were Government and GREs for both conventional and Islamic banks.

Foreign banks have a share of 12.8% of the system in terms of assets and 11% in terms of gross financing at the end of Q1 2020. Total assets at national banks expanded by 7.7% while total assets at foreign banks grew by 10.5%.

Following a moderate increase from AED 88.8 billion at the end of 2018 to AED 89.5 billion at the end of 2019, bank lending to Micro, Small and Medium Enterprises (MSMEs) rebounded by 4.3% Q-o-Q in Q1 2020 to reach AED 93.3 billion. The majority, 56.9% of the loan book went to medium enterprises, 31.4% to small enterprises and 11.7% to micro firms. At the end of March, the share of MSMEs reached 5.8% of domestic credit and 8.1% of credit to the private corporate sector. Moreover, the increase was higher for Islamic banks as their loan book increased in Q1 by 14.3% (35.3% increase for small size enterprises and 12.7% for medium sized, while lending to micro enterprises declined by 8.3%), reaching AED 9.6 billion or 10.3% of the total.

3.1.3. Financial Soundness Indicators

Banks operating in the UAE remain well capitalised, with an average Capital Adequacy Ratio (CAR) of 16.9%, Tier 1 Capital Ratio at 15.8%, and Common Equity Tier 1 Ratio (CET 1) at 13.9%, by the end of Q1 2020.[14] The Loan to Deposit (L/D) ratio for the whole banking system increased to 95.5% by the end of Q1 2020, compared to 94% in Q4 2019.

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

	Sep-19	Dec-19	Mar-20
Total Banking System			
Lending to Stable Resources Ratio	82.1%	81.0%	82.3%
Eligible Liquid Assets Ratio (ELAR)	17.6%	18.1%	17.3%
Capital Adequacy Ratio (CAR)	17.7%	17.7%	16.9%
Tier 1 Capital	16.5%	16.5%	15.8%
CET 1	14.7%	14.7%	13.9%
Conventional Banks			
Lending to Stable Resources Ratio	82.1%	81.1%	82.3%
Eligible Liquid Assets Ratio (ELAR)	17.0%	17.5%	16.8%
Capital Adequacy Ratio (CAR)	17.6%	17.6%	16.8%
Tier 1 Capital	16.4%	16.4%	15.6%
CET 1	14.9%	15.0%	14.1%
Islamic Banks			
Lending to Stable Resources Ratio	82.1%	80.5%	82.3%
Eligible Liquid Assets Ratio (ELAR)	19.0%	19.8%	18.7%
Capital Adequacy Ratio (CAR)	18.4%	17.9%	17.5%
Tier 1 Capital	17.3%	16.8%	16.5%
CET 1	13.9%	13.4%	13.1%
National Banks			
Lending to Stable Resources Ratio	83.6%	82.6%	84.1%
Eligible Liquid Assets Ratio (ELAR)	16.4%	16.6%	16.0%
Capital Adequacy Ratio (CAR)	17.3%	17.3%	16.4%
Tier 1 Capital	16.1%	16.1%	15.3%
CET 1	14.1%	14.0%	13.2%
Foreign Banks			
Lending to Stable Resources Ratio	71.7%	69.5%	69.8%
Eligible Liquid Assets Ratio (ELAR)	25.9%	28.6%	24.8%
Capital Adequacy Ratio (CAR)	21.4%	21.3%	21.2%
Tier 1 Capital	20.1%	20.1%	20.0%
CET 1	20.1%	20.1%	20.0%

Eligible liquid assets,[15] as a ratio of total liabilities,[16] decreased to reach 17.3% at the end of Q1 2020. This level of liquid assets constitutes an adequate buffer as it is well above the 10% regulatory minimum requirement by the CBUAE. However, as part of the TESS, banks will have the flexibility to maintain a minimum ELAR of 7%.

The level of total liquid assets at banks as at the end of Q1 2020 stood at AED 442.8 billion, or AED 10.1 billion lower compared to the end of Q4 2019, which corresponds to a 2.2% decrease. On a yearly basis however, it increased by 10.8%.

3.2 Financial developments

3.2.1. Share Price Movement

The Abu Dhabi Securities Exchange (ADX) market capitalisation grew by 5.8% Y-o-Y and 3.1% Q-o-Q in Q1 2020. The Dubai Financial Market (DFM) exhibited an increase in its market capitalisation by 9.2% Y-o-Y and by 2.2% Q-o-Q. On the ADX, the average share price index increased by 1.6% on a yearly and quarterly basis in Q1 2020. In Dubai, the average share price index rose by 5.9% Y-o-Y and a slight increase on a quarterly basis by 0.9%.

Table 3.2.1: UAE – Securities Markets

			Q4 2019	Q1 2020
Abu Dhabi	Share Price Index	Q-o-Q	0.4%	1.6%
		Y-o-Y	3.3%	1.6%
		YTD	3.3%	4.9%
	Market Capitalization	Q-o-Q	0.6%	3.1%
		Y-o-Y	5.1%	5.8%
		YTD	5.1%	8.3%
	Turnover (Traded Value)	Q-o-Q	-2.9%	-32.2%
		Y-o-Y	-32.5%	-30.2%
		YTD	-32.5%	-54.2%
Dubai	Share Price Index	Q-o-Q	-0.6%	0.9%
		Y-o-Y	9.3%	5.9%
		YTD	9.3%	10.3%
	Market Capitalization	Q-o-Q	2.4%	2.2%
		Y-o-Y	9.0%	9.2%
		YTD	9.0%	11.4%
	Turnover (Traded Value)	Q-o-Q	-20.8%	-4.9%
		Y-o-Y	13.3%	-1.3%
		YTD	13.3%	7.7%

Source: Securities and Commodities Authority (SCA)
Note: Changes computation are based on annual average values for the share price index and market capitalisation.

[14] The minimum regulatory requirement for CAR is 13% (10.5% minimum adequacy and 2.5% capital conservation buffer), 8.5% for Tier 1, and 7% for CET 1.

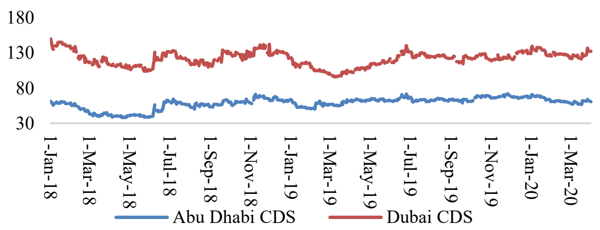
[15] In the ELAR, the eligible liquid assets include required reserves, mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks.

[16] Balance sheet total assets less (capital and reserves + all provisions except staff benefit provisions + refinancing + subordinated borrowing/deposits).

3.2.2. Credit Default Swaps Premiums

Sovereign risk premiums, as measured by the Sovereign Credit Default Swaps, remain low in general compared to historical levels. However, due to the COVID-19 pandemic, it increased in the first quarter of 2020. For the Emirate of Abu Dhabi, the premium increased in Q1 2020 by 7.5 basis points (bps) to reach 61. For the Emirate of Dubai, the premium increased by 11.5 bps to reach 144.

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



	2019		2020
	Q3	Q4	Q1
Emirate of Abu Dhabi	50.5	53.6	61.1
Emirate of Dubai	129.6	132.5	144.0

Source: Bloomberg.
Note: All data are quarterly average.

Box 4: Financial Inclusion in the United Arab Emirates

Introduction

Policymakers around the globe, including the Central Bank of the United Arab Emirates (CBUAE), have adopted financial inclusion as a way to improve people's standards of living, reduce poverty, and advance economic development.

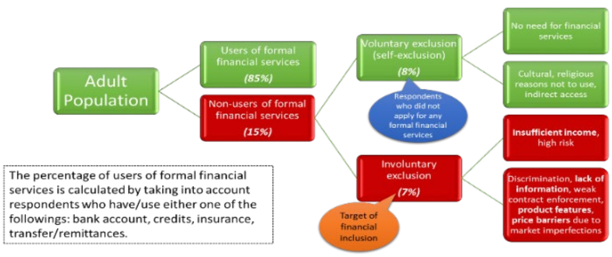
To achieve higher financial inclusion and as part of its strategic objectives, the CBUAE has conducted a survey of 5134 resident individuals, aged 15 years and above across the seven Emirates in the UAE, including students and low and mid-income individuals. The survey aimed to gather inputs to enable the CBUAE to design and implement a comprehensive strategy to increase the degree of financial inclusion in the UAE.

The survey collected information from individuals on their access to formal financial services that are deemed essential enablers to improve their livelihood, such as access to bank account, access to formal credit, access to insurance services, and access and use of money transfer services (remittances).

Outcomes of the Survey

The survey reveals that 85% of adults, aged 15 years and above, are users of at least one formal financial service, while 15% have no access to formal financial services, or in other words "*financially excluded*".

Chart 1. The Degree of Financial Inclusion



Source: CBUAE Survey on Financial Inclusion

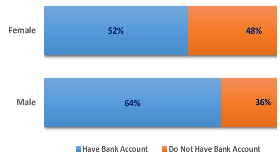
Notwithstanding the relatively high degree of users of financial services (85%), the survey reveals important information regarding individuals' access/usage, or lack, of formal financial services offered by financial institutions in the UAE.

Around 61% of the surveyed adults have bank account, which is less than the world average of 69%, according to the World Bank's 2017 Global Findex Report[17]. Among the 39% of the adults who responded to the survey and do not have bank account, 20% said they did not apply for a bank account, while 19% wanted to apply for a bank account but they did not meet the requirements, either because they are unemployed or have insufficient income.

Charts 2 and 3 illustrate the percentage of adult respondents having bank account, based on gender and age groups.

Chart 2. By Age Group

Chart 3. By Gender



Source: CBUAE Survey on Financial Inclusion

When asked about access and usage of other formal financial services, the survey reveals that 29% of respondents had credit or borrowed money from formal financial institutions, 57% of respondents had insurance, and 69% made or received external transfers (remittances) to/from the UAE.

It is worth highlighting that 39% of unbanked adult respondents are users of remittances services offered by providers in the UAE. This is the reason why even though the percentage of banked adults are merely around 61%, the degree of financial inclusion in the UAE is still relatively high at 85%.

Policy Responses

In April 2020, the Arab Monetary Fund conducted a meeting of Governors and Finance Ministers in the MENA region, in collaboration with the IMF and the World Bank. As part of its contribution to the meeting, CBUAE elaborated that over the past 3 years, it has implemented a number of initiatives to increase financial inclusion, especially for the vulnerable blue-collar workers:

- In 2017, the CBUAE implemented regulatory framework for stored cards and e-payment systems.
- Current CBUAE regulations and standards contain a broad spectrum of other measures, which aim to facilitate financial inclusion, including specific requirements for banks to provide a low cost basic account with no salary or minimum balance requirements.

[17] https://globalfindex.worldbank.org/

Chapter 4: Money Supply, Interest Rates and CBUAE Balance Sheet

Resilient banking sector and prompt policy measures through the Targeted Economic Support Scheme (TESS) undertaken in mid-March underpin continued growth of the money supply. In Q1 2020, CBUAE balance sheet and banks' liquidity at CBUAE grew. Interest rates fell during this period in line with monetary easing by the Fed.

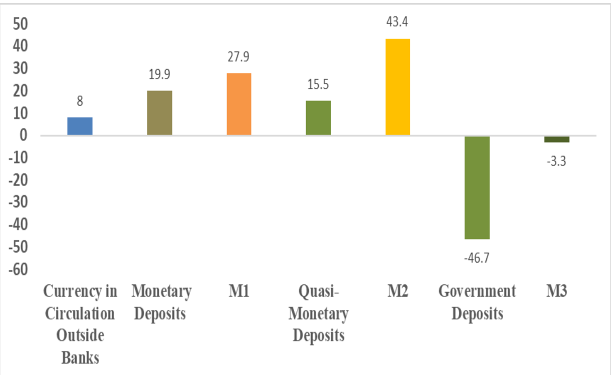
4.1 Money supply increased

During Q1 2020, Money Supply M1 (Currency in Circulation outside banks + Monetary Deposits) increased by 5.4% (AED 27.9 billion) to reach AED 542.7 billion, driven by a rise in Monetary Deposits (84.8% of M1) by 4.6% (AED 19.9 billion) which reached AED 456.5 billion, and an increase in Currency in Circulation (14.2% of M1) by 10.2% (AED 8.0 billion). Y-o-Y, M1 increased by 6.0% due to an increase in Currency in Circulation by 16.6% and an increase in monetary deposits by 4.2%.

Money supply M2 (M1 + Quasi Monetary Deposits) increased by 3.1% Q-o-Q (AED 43.4 billion) to reach AED 1454.9 billion, due to the increase in M1 and an increase in Quasi-Monetary deposits (63.5% of M2) by 1.7% (AED 15.5 billion), reaching AED 912.2 billion. Y-o-Y, M2 increased by 9.5% due to the increase in M1 and the increase in Quasi-Monetary Deposits by 11.7%.

Figure 4.1: Change in Monetary aggregates in 2020 Q1

In billions of AEDs



Source: CBUAE

Meanwhile, M3 (M2 + Government Deposits at banks and CBUAE) slightly decreased Q-o-Q by 0.2% (AED 3.3 billion) to reach AED 1,693.7 billion, due to a decrease in Government Deposits (17.8% of M3) by -15.3 % (AED 46.7 billion) to reach AED 259.2 billion. Y-o-Y, M3 increased by 5.0% due to the increase in M2 while government deposits decreased by 14.5%.

4.2 LIBOR and Swap rates fell

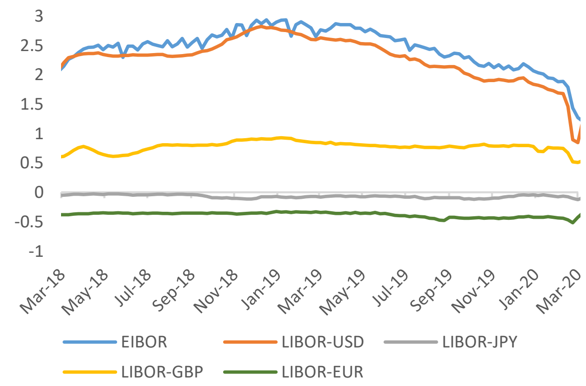
The fixed exchange rate of the Dirham to the US dollar requires that the CBUAE adjusts its policy rate according to changes in the federal funds rate. Therefore, the CBUAE announced the cut in interest rates applied to its Certificates of Deposits consistent with the FOMC decision to counter the economic repercussions of COVD-19 pandemic. CBUAE cut its rate on 1-week CDs by 50 bps on the 4th of March 2020 and again by 75 bps on the 16th of March.

Short-term interest rates

EIBOR 3-month was on a declining trend from 2.2% at the end of December to 1.6% to the end of March in line with the decline in the LIBOR on USD. The latter (LIBOR on USD 3-month) declined as a result of the Fed's easing cycle, as the US economy grounded to a halt and FOMC cut its policy rate by 150 bps, before rebounding in the second half of March in response to signs of strain in the U.S. funding markets. The period average of weekly 3-month EIBOR declined from 2.1% in the fourth quarter of 2019 to 1.8% in the first quarter of 2020.

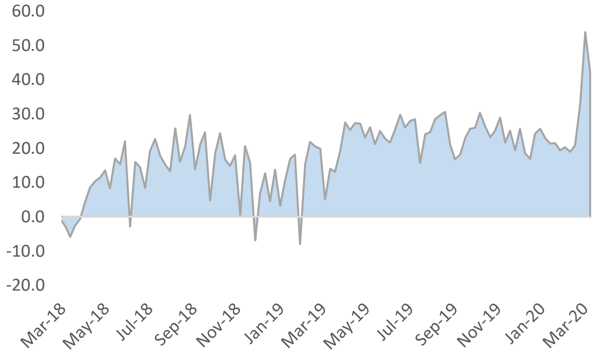
The Spread EIBOR (3-month) vis-à-vis USD LIBOR (3-month) decreased from 25.6 bps in early January to a trough 0f 18.9 bps in the 3rd week of February. In March however, the above-indicated rebound in USD LIBOR 3-month led to a decrease in the Spread from a peak of 53.8 bps in the 2nd week of March.to about 17 bps by the end of the quarter.

Figure 4.2.a: Selected LIBOR Rates (%)



Source: Bloomberg

Figure 4.2.b: AED Spread vs. USD LIBOR (3-month, bps)

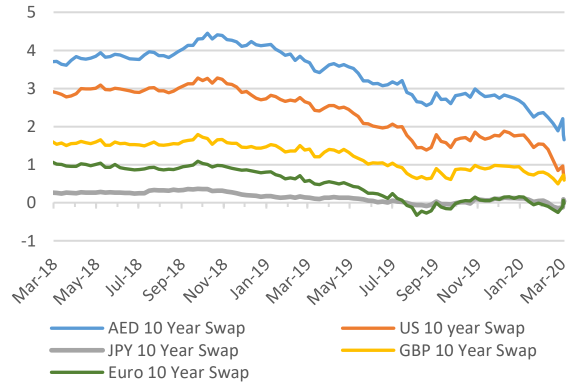


Source: Bloomberg

Long-term swap rates

Interest rate swaps involve an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.2.c, the 10-year swap rates fell significantly in line with the fall in LIBOR.

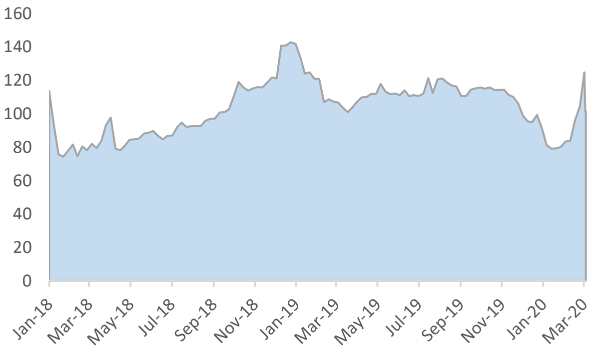
Figure 4.2.c: 10- year Swap Rates (%)



Source: Bloomberg

The Spread of the 10-year swap rate for the AED versus the swap rate for the US dollar increased from 99 bps in early January to 101 bps at the end of March, while the quarterly average declined from 109 bps in 2019 Q4 to 92 bps in Q1 2020.

Figure 4.2.d: Spread 10-year AED Swap vs. USD Swap (bps)



Source: Bloomberg

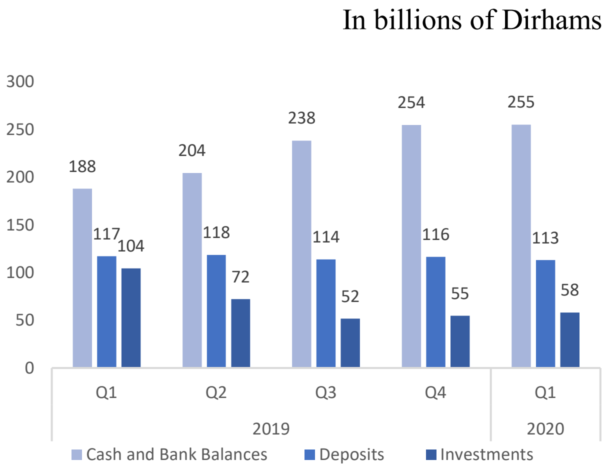
4.3 The CBUAE Balance Sheet

The balance sheet of the Central Bank increased by 0.9% in Q1 2020 to reach AED 450.0 billion, mainly due to an increase in investments by AED 3.4 billion. On the liabilities side, there was an increase in Currency Issued by AED 11.4 billion, Current Accounts and Deposits by AED 7.8 billion and Required Reserves by AED 2.9 billion.[18] Banks' net holdings of Certificates of Deposits decreased by AED 15.6 billion. Ample liquidity supports international reserves at CBUAE, which stood at AED 393.9 billion, providing a cover ratio of 94.8% of the AED

[18] The analysis spans the period through the end of March and does not capture the change in the required reserves ratio that took effect on April 6 and has affected the balance sheet in Q2 2020.

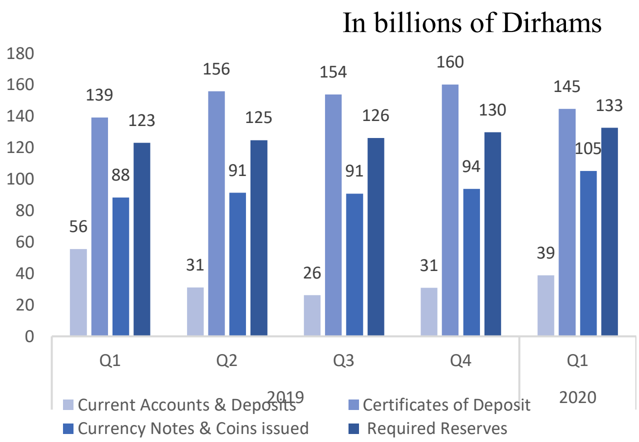
415.1 billion monetary base, comprising currency issued, banks' reserves and banks' holdings of certificates of deposits at CBUAE. The cover ratio is well above the 70% requirement by the CBUAE banking law of 2018 to sustain the stability of the exchange rate peg.

Figure 4.3.a: CBUAE Assets



Source: CBUAE

Figure 4.3.b: CBUAE liabilities



Source: CBUAE.

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