Quarterly Economic Review

Second quarter 2021

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List of Abbreviations

ADX	*Abu Dhabi Securities Exchange*
AED	*United Arab Emirates Dirham*
BIS	*Bank for International Settlements*
CAR	*Capital Adequacy Ratio*
CBUAE	*The Central Bank of the UAE*
CDs	*Certificates of Deposit*
CET	*Common Equity Capital*
CPI	*Consumer Price Index*
DFM	*Dubai Financial Market*
ECB	*European Central Bank*
EIBOR	*Emirates Inter-Bank Offer Rate*
EMDEs	*Emerging Markets and Developing Economies*
FCSC	*Federal Competiveness and Statistics Center*
Fed	*The US Federal Reserve*
GCC	*Gulf Cooperation Council*
GDP	*Gross Domestic Product*
GREs	*Government Related Entities*
IMF	*International Monetary Fund*
LTD	*Loan-to-Deposit*
LIBOR	*London Inter-Bank Offer Rate*
M1	*Monetary Aggregate 1*
M2	*Monetary Aggregate 2*
M3	*Monetary Aggregate 3*
M-o-M	*Month-on-Month*
MENA	*Middle East North Africa*
NEER	*Nominal Effective Exchange Rate*
NBFI	*Non-Banking Financial Institutions*
OPEC	*Organization of Petroleum Exporting Countries*
PMI	*Purchasing Managers' Index*
Q-o-Q	*Quarter-on-Quarter*
REER	*Real Effective Exchange Rate*
SCA	*Securities and Commodities Authority*
TESS	*Targeted Economic Support Scheme*
UAE	*United Arab Emirates*
UK	*United Kingdome*
USA/US	*United States of America*
USD	*United States Dollar*
VAT	*Value Added Tax*
Y-o-Y	*Year-on-Year*

Executive Summary

Global economic growth for the year 2021 remained strong, in the second quarter of 2021 at 6.0%, as the IMF's upward revision of growth for Developed Economies was offset by a downward revision for Emerging Markets and Developing Economies. The divergence of growth rates within the two blocks was largely due to higher vaccine access and consequent return to normal activities in the former.

Economic activity in the UAE continued its recovery in the second quarter, with growth reaching almost pre-COVID-19 levels. For the year 2021, CBUAE forecasts real total GDP growth to reach 2.1%, with the real non-hydrocarbon GDP projected to increase by 3.8%. For 2022, CBUAE foresees real total GDP to grow at a stronger pace by 4.2% and non-hydrocarbon real GDP to increase by 3.9%. However, economic projections are susceptible to uncertainties amidst COVID-19 repercussions and are thus subject to revisions.

CPI inflation remained negative for the second quarter at –0.5% Y-o-Y, as tradable and non-tradable inflation remained at -0.3% and -0.6%, respectively. The fall in the non-tradable subcategory was mainly driven by the continued fall in prices of housing rents, being partially offset by the increase in transportation prices, in tandem with recovery in domestic demand. Residential real estate sales prices in Abu Dhabi rose for a second consecutive quarter Y-o-Y after five years of decline, while in Dubai the decline slowed down Q-o-Q. The Dirham appreciated in both nominal and real terms Q-o-Q, in line with the strengthening of the USD.

Total bank deposits increased on both yearly and quarterly basis. Gross credit increased on a quarterly basis, although it did not yet recover to pre-COVID-19 levels. Overall, the financial soundness indicators remained healthy during this period, on the back of the gradual recovery of the economy.

Finally, the 3-month USD LIBOR declined during the second quarter of the year. Meanwhile, monetary aggregates M_1, M_2 and M_3 increased Q-o-Q by 2.7%, 0.1% and 0.4%, respectively, due to an increase in resident deposits, including government deposits at CBUAE and commercial banks.

Chapter 1. International Economic Developments

The IMF maintained its yearly growth forecast of the global economy in Q2 2021 at a relatively strong rate of 6.0%. The upward revision of growth for Developed Economies was offset by a downward revision for Emerging Markets and Developing Economies (EMDEs). The divergence in growth rates for the two blocks was largely due to the fact that the EMDEs reopened thanks to their higher vaccine rollout. Meanwhile, inflation surged in the US due to some supply bottlenecks, higher energy prices, and base effect, albeit the surge is expected to be transitory , while price pressures are accentuated in many EMDEs by imported inflation, resulting from the depreciation of the local currency.

1.1 Economic Growth

The IMF's growth projections of the global economy for the year 2021 remained strong at 6.0% in Q2 as it was the case in the previous quarter, due to the fact that increasing growth forecasts in advanced economies from 4.5% in Q1 to 5.6% in Q2 was offset by lower growth forecasts in EMDEs, from 6.7% to 6.3%, respectively. Higher vaccine access and return to normal activities explain the differing paths. In addition, a smooth and durable recovery in the second half of the year remain threatened by the Delta variant of COVID-19, which turned out to be more contagious than the original coronavirus, and which is currently triggering a new wave in many parts of the world.

In the United States, Y-o-Y real GDP growth shot up to 12.2% in Q2 boosted by vaccination, unleashed consumer spending, an accommodative monetary policy, in tandem with the USD 1,400 stimulus checks, which are part of the USD1.9 trillion stimulus bill which passed in March, and a proposed USD 1 trillion Infrastructure Bill which was approved by the Senate on 10 August 2021.

Private Consumption in the US increased Y-o-Y by 11.8% in the second quarter, up from 11.4% in the first quarter, boosted by services. And, fixed investment grew at a seasonally adjusted annual rate of 3.0% in Q2, albeit it slowed down from 13.0% from the previous quarter due in part to a fall in basic inventories of goods and materials.

In the Eurozone, seasonally adjusted Y-o-Y real GDP grew in Q2 by 14.3% for the first time after 4 quarters of contraction, and is forecast to reach 4.8% in the year 2021, according to IMF forecasts. The services sector was the main driver of the recovery, boosted by pent-up demand which was satisfied as economies reopened, while consumption increased in all member countries.

In the UK, Y-o-Y real GDP growth is estimated to have grown by 22.2% in the 2nd quarter, as restrictions on economic activity were progressively eased, with a large share of the population vaccinated and the number of reported infections was halved. However, there are signs that the recovery slowed down by June with factories reporting supply shortages, and the Delta variant continues to hamper business activity.

The forecast for EMDEs' growth for the year was revised downward by 0.4 percentage points by the IMF, compared to the April WEO. This is mainly due to the worsening health situation and its fallout on economic activity. In India, as an example, a severe second COVID wave took place in March-May which led to strict containment measures. Many other developing economies are still suffering from a weak health system, with a return to lockdowns in an attempt to rein in the second wave of Delta variant, in addition the continued loss of tourism and remittances from abroad.

In contrast, South Korea's Y-o-Y growth surged from 1.9% in Q1 to 5.9% in Q2, underpinned by manufacturing exports, while China's growth, albeit it scaled back from the previous quarter, remained at 7.9%, i.e., higher than the official target of 6%, owing to the rise in industrial production and mining.

Table.1: Y-o-Y Real GDP Growth Rates in Selected Countries (%)

	2019	2020	2021	
			Q1	Q2
USA	2.6	-2.3	0.5	12.2
UK	1.2	-7.3	-6.1	22.2
France	0.9	-4.2	1.5	18.7
Germany	0.2	-2.3	-3.1	9.4
China	5.8	6.5	18.3	7.9
Japan	-1.4	-1.1	-1.3	7.5
India	3.3	0.4	1.6	20.1

Source: National Statistical Authorities

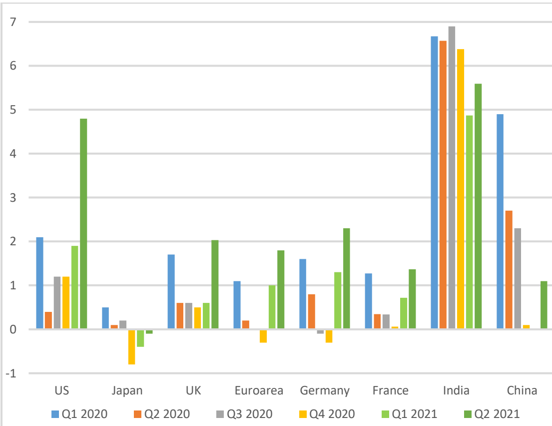
1.2 Inflation

In advanced economies, average headline Y-o-Y inflation remained at 1.8%, i.e., at below target in the Eurozone as a whole while it reached 2.3% in Germany. The surge in these countries was mostly driven by the rise in the energy prices.

In the US, Y-o-Y average CPI inflation accelerated to 4.8% in Q2 2021, mainly due to continuing supply-chain bottlenecks, which led to a rise in the prices, higher energy prices, pent up demand which benefited from the reopening of the economy, in addition to base effect, albeit, the surge is expected to be "transitory"[1].

In EMDEs, inflation may persist due mostly to rising food prices and imported inflation as a result of the depreciation of the local currency. India for instance witnessed Y-o-Y average CPI inflation of 5.6% in the ongoing fiscal year 2021, due mostly to restrictions introduced to rein in the surge in the Delta variant and higher commodity prices, especially for oil which led to higher transportation costs.

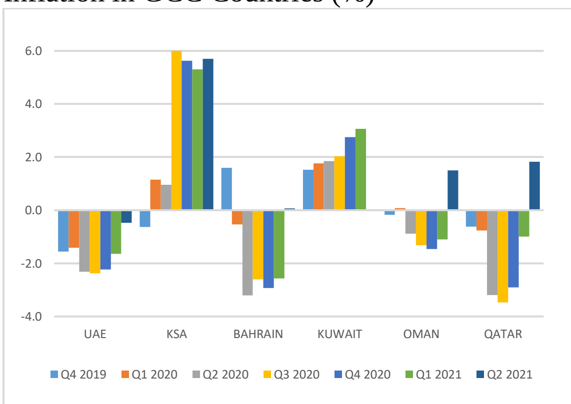
Figure 1.2.a: Y-o-Y Average Headline Inflation in Selected Economies (%)



Source: Bloomberg

In the GCC, Saudi Arabia's Y-o-Y inflation rate increased from 5.3% in Q1 2021 to 5.7% in Q2, owing mainly to high food prices and the delayed impact of the tripling of the value-added tax to 15% last year. All other GCC countries experienced positive inflation in Q2 2021 except the UAE, which is still witnessing negative inflation due mostly to falling rents.

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



Source: Bloomberg

[1] According to the Fed's newly-adopted Average Inflation Targeting, higher than 2% inflation is allowed for a period of time to compensate for below target inflation in the past.

1.3 Commodities Prices

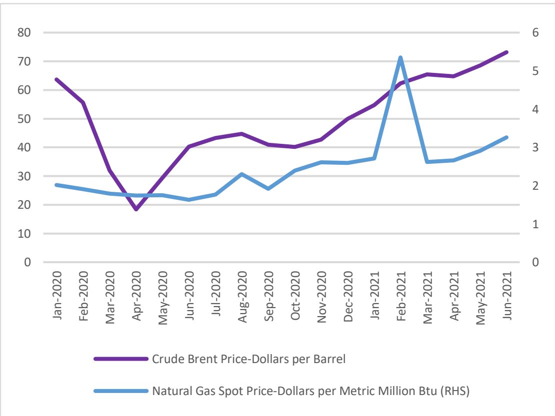
The price of Brent crude rose firmly from USD 65.4 per barrel at the end of March 2021 to USD 73.1 per barrel at the end of June 2021, and from an average of USD 60.8 per barrel in Q1 2021 to USD 68.8 per barrel in Q2 2021.

Higher prices are mostly linked to lifts of lockdowns in advanced economies, the partial revival of international travel and tourism activities, and resilient growth in some parts of the emerging world. Increasing oil consumption combined with production restraint from OPEC+ and relatively flat crude oil output in the United States have kept global oil consumption above global oil supply, draining inventories.

Natural gas prices decreased on average from USD 3.56/MMBtu in Q1 to USD 2.94/MMBtu.

Gold continues to benefit from a fall in real rates during Q2 2021, with its price rising from an average of USD 1,763 per ounce in Q1 2021 to USD 1,815 per ounce in Q2 2021.

Figure 1.3: Brent Crude and Natural Gas Prices



Source: US Energy Information Administration (EIA)

Monetary policy

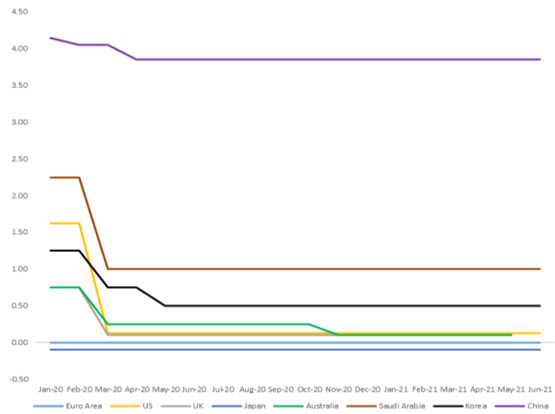
With policy rates in the US, UK and the Eurozone already at or near zero, the monetary authorities kept their rates unchanged in Q2 2021, while continuing with quantitative easing.

The Fed continued its asset purchasing program at USD 120 billion a month, which led to the expansion of the Fed's balance sheet to USD 8.0 trillion by the quarter end.

Bank of England's Monetary Policy Committee (MPC) kept its policy rate at 0.1%, during the second quarter, while maintaining its target stock of asset purchases at GBP 895 billion (USD 1.2 trillion). The MPC announced also that it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made with respect to the elimination of spare capacity and the achievement of the 2% inflation target, in a sustained manner.

Meanwhile, the ECB left its policy rates at their current levels (0.00% on refinancing operations, 0.25% on the marginal lending facility, and -0.50% on the deposit facility), while it continued to conduct net asset purchases under the Pandemic Emergency Purchase Programme (PEPP) with a total envelope of EUR 1,850 billion until, and maintained its purchases under the Asset Purchase Programme (APP) at a monthly pace of EUR 20 billion.

Figure 1.4: Policy Rates in Selected Advanced Economies (%)



Source: BIS

Chapter 2: Domestic Economic Developments

Economic activity in the UAE continued its recovery in the second quarter, with estimated Q2 growth reaching close to the pre-pandemic level. Total real GDP growth in 2021 is projected at 2.1%, while it has been revised upwards to 4.2% for the following year. Headline CPI inflation rate remained negative during the quarter, due to continued fall in rents, albeit at a reduced pace, thanks to higher energy prices and aggregate demand. The Dirham appreciated in nominal and real terms Q-o-Q, while depreciating compared to a year ago.

2.1 Economic Activity and Growth

Non-oil sector continued to improve in Q2 2021, benefiting from the recovery in global travel and pick up in local and global demand, while the country continued to be a leader in containing the spread of the virus. The real non-oil GDP growth forecast for the year 2021 has been kept at 3.8%. The UAE kept its top position globally since the beginning of the pandemic in the number of tests and in the distribution of the vaccine per capita, with 57.7 million tests and 15.3 million vaccines rolled out by the end of June 2021, which corresponded to over 627 tests performed and 166 vaccines administered per 100 people, respectively.

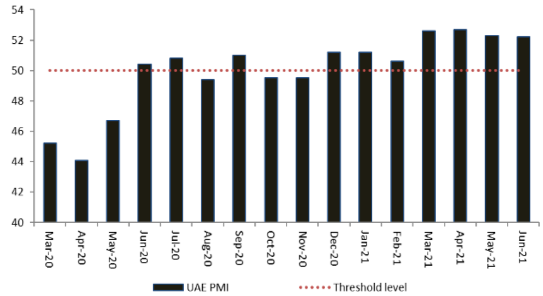
Residential real estate market kept improving, with prices in Abu Dhabi registering Y-o-Y gains for the second consecutive quarter in more than five years, while still declining in Dubai albeit at a slower pace.

Employment and average salary remained roughly flat during the quarter, while they were higher than the last pre-crisis month – Februrary 2020, as proxied by CBUAE's Wage Protection System (WPS) data[2].

The average UAE PMI increased by 11.3% Y-o-Y in Q2, moving further up in the expansion zone to 52.2 in June. The improvement reflects the better sentiment boosted by the wide vaccination program and the Dubai World EXPO being only three months away.

Tourism and hospitality data in Dubai in the first six months of 2021 showed a recovery in hotel occupancy to 62%, up from 54% recorded during 2020, owing mostly to the resumption of international travel.

Figure 2.1.a. UAE PMI (0-100 Index (> 50 = improvement since previous month))



Source: IHS Markit

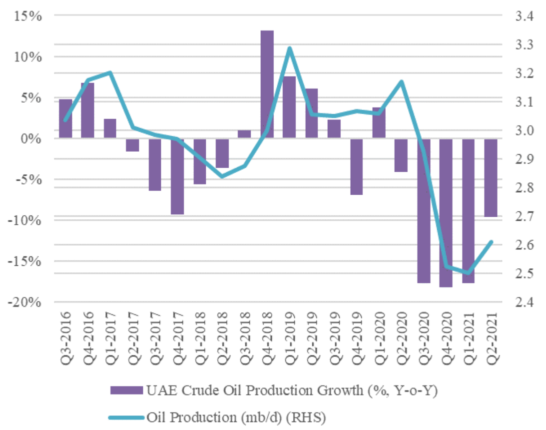
Meanwhile, the Oxford Stringency Index[3] went down from 53 at the end of March 2021 to 47 at the end of June, affirming the relative openness of the economy compared to regional and international peers, benefiting the UAE, given its role as a regional trade, transportation and travel hub.

UAE's oil production fell by 9.6% Y-o-Y, while increasing by 1.4% Q-o-Q, in line with the agreement by OPEC+. Real oil GDP growth projection has been revised to -2.0% in 2021, down from -1.0% previously, corresponding to an average oil production of 2.72 mb/d for the year as a whole.

[2] Including employees under the Ministry of Human Resources and Emiratization, Jebel Ali Free Zone Authority and some employed by licensed financial institutions, where the labor related authority is not participating in the WPS.

[3] A measure, produced by the University of Oxford, between 0 and 100, indicating the level of closure, due to restrictions, aiming to reduce the spread of COVID-19.

Figure 2.1.b. Average UAE Crude Oil Production (in mb/d)



Source: OPEC

CBUAE projects overall real GDP to grow by 2.1% during this year[4,5], due to the revised decline in projected real oil GDP, based on UAE's realized production in the first seven months of the year, OPEC+ announcements and the anticipated output schedule.

For 2022, CBUAE has revised upwards its projections to 4.2% overall real GDP growth, up from 3.8% previously, with the non-oil real GDP rising by 3.9%. This is expected to be the result of the continued increase in public spending, banks' credit outlook, higher employment and better business sentiment, as Dubai World EXPO will continue to take place in Q1 2022. Furthermore, being a major tourism, transit and trade hub in the region, the UAE is expected to benefit from the opening of travel restrictions and events such the FIFA World Cup which is planned to take place in Qatar in 2022.

Real oil GDP growth projection has been revised upwards to 5.0%, from 3.5% in the previous quarter, reflecting the the expected increase in demand with majority of the world economies being vaccinated.

Table 2.1. Annual Real GDP Growth Rates in the UAE (%)

	2019	2020	2021F	2022F
Overall GDP	3.4	-6.1	2.1	4.2
Non-oil GDP	3.8	-6.2	3.8	3.9
Oil GDP	2.6	-6.0	-2.0	5.0

Source: FCSC for 2019 and 2020 and CBUAE projections for 2021 and 2022.

[4] Forecasts subject to revision, due to the high uncertainty around COVID-19.
[5] CBUAE forecasts the real non-oil GDP using univariate model where the quarterly real non-oil GDP Y-o-Y growth is explained by the lagged Y-o-Y growth of the fiscal spending, and the Y-o-Y growth of the quarterly credit, UAE real estate sales prices, PMI and employment. The real oil GDP growth is estimated/projected based on hydrocarbon output and considering other value adding activities in the sector. The contribution of the real non-oil GDP is approximately 70% of the total GDP.

BOX 1: Recent structural reforms to boost FDI and economic growth

The UAE has made significant strides in becoming a global investor hub thanks to its corporate tax-free status, business friendly and stable environment, and state of the art infrastructure. Recent improvements in this regard took the form of regulatory changes, such as Golden Visa for expatriates, amendments to the commercial companies' law, and citizenship for talented residents.

In 2019, the UAE introduced the Golden Visa, which is designed to enable foreigners to live, work and study in the UAE without the need for a national sponsor. Investors can be entitled to the Golden Visa if they invest a minimum of AED 10 million to establish a company or hold the amount in an investment fund. Eligible candidates include also specialized talents, doctors, scientists, inventors, as well as creative individuals in the fields of culture and art, among others.

In addition, the Cabinet adopted a Resolution on the Determination of the Positive List of the Economic Activities and Sectors in which full foreign ownership is permitted, except in the strategic sectors, such as oil and gas, and defense. This is change to the previous regulations, which restricted full ownership to designated Free Zones and specific sectors, while limiting foreign ownership for the rest to a maximum of 49%, with the majority stake being held by an Emirati partner. The positive list in the new law, which went into effect in June 2021 includes the following: transport and storage; agriculture; space; manufacturing industry; renewable energy; hospitality and food services; information and communication; professional, scientific and technical activities; administrative and support services; educational activities; healthcare; art and entertainment; and construction.

The recent reforms and related initiatives are expected to enhance investor confidence and increase investment opportunities.

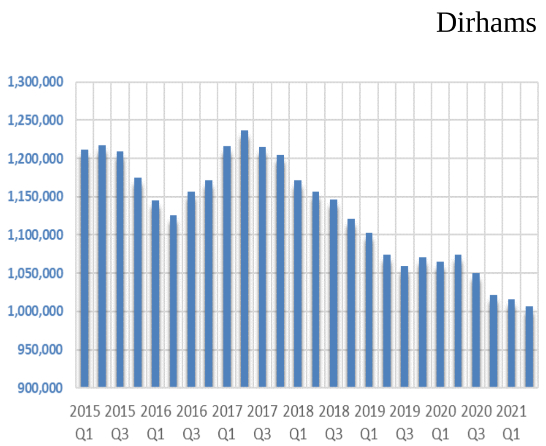
2.2 Developments in the Residential Real Estate Market

In Q2 2021, residential real estate prices marked a second quarter of significant Y-o-Y increase in Abu Dhabi, however slightly declining Q-o-Q, after three consecutive positive quarters of Q-o-Q growth. In Dubai sales prices continued to decline, with Q-o-Q drop reducing further.

Dubai Residential Market

According to recent data from Dubai Land Department (DLD),[6] residential property prices in the Emirate declined on average by 6.3% Y-o-Y in Q2 2021, while rents rose by 1.7% Y-o-Y. The implied rental yield[7,8] moved to 7.2% in Q2 2021, up from 6.7% in the previous quarter, as a result of rise in rents and decline in sales prices.

Figure 2.2.a. Average Dubai Residential Unit Sale Prices

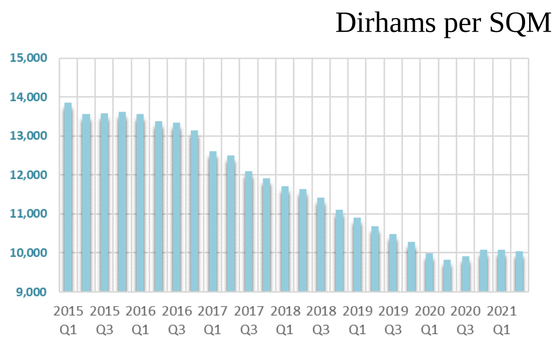


Source: DLD

Abu Dhabi Residential Market

According to the REIDIN[9] house price index, the average price in the Abu Dhabi housing market increased for a second consecutive quarter compared to a year ago. Average Abu Dhabi residential prices registered a growth of 2.2% Y-o-Y in Q2 2021.

Figure 2.2.b. Abu Dhabi Residential Prices



Source: REIDIN

Rents in Abu Dhabi declined in the second quarter of 2021 by 5.7% Y-o-Y. The decline in rents by 1.1% Q-o-Q, in parallel with the drop in sales prices Q-o-Q by only 0.5%, resulted in declining rental yield to 6.5%, compared to 6.6% in the first quarter of the year.

[6] Data from DLD remain subject to revisions.
[7] The rental yield measures the rate of income return over the cost associated with an investment (the property price).
[8] 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.
[9] REIDIN Residential Price Index in Abu Dhabi covers 7 areas and 5 districts.

2.3 The Consumer Price Index and Inflation

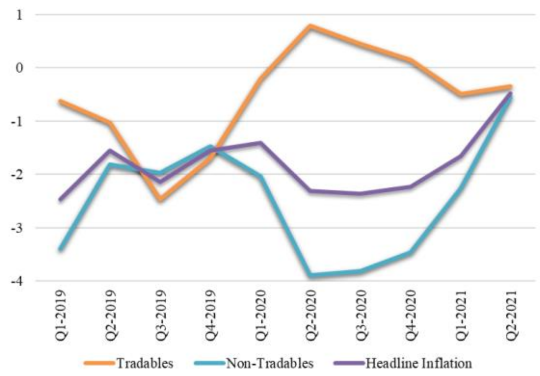
Inflation remained negative in the second quarter of 2021 as the headline consumer price index declined by 0.5% Y-o-Y, compared to a drop by 1.7% in the previous quarter. This was the result of a decline by 0.6% in the price of non-tradables, i.e. goods and services that are not traded across borders, therefore their prices are mainly determined by domestic supply and demand conditions[10]. Meanwhile, tradables[11] prices fell by 0.3%.

Tradables prices, accounting for 34% of the CPI consumption basket, decreased in Q2 due to the decline in most categories except transportation; and furniture and household goods. Prices of furniture increased to a lesser extent, while the spike by more than 13% in oil prices during the quarter put pressure on the prices of the transportation category. Prices of food and soft drinks shifted from positive inflation in the last quarter of 2020 to negative at -2.9% in the second quarter of the year. The prices of the other subcategories of the tradable basket continued their Y-o-Y decline.

The continued drop in the housing component prices (34% weight in the consumer basket) by 3.6% Y-o-Y was the main driver of the drop in price of non-tradeables during Q2. Prices of all other non-tradeables were increasing, except for communications and miscellaneous where they were slightly falling.

Based on its model and analysis, the CBUAE projects the average CPI inflation for 2021 to remain at about -0.2%, being negative in the first half of the year at -1.1%, in view of the still recovering real estate market and private consumption, and the uncertain economic environment. CBUAE expects a move into positive territory in the second half of 2021.

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



Source: FCSC and CBUAE calculations

[10] 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.

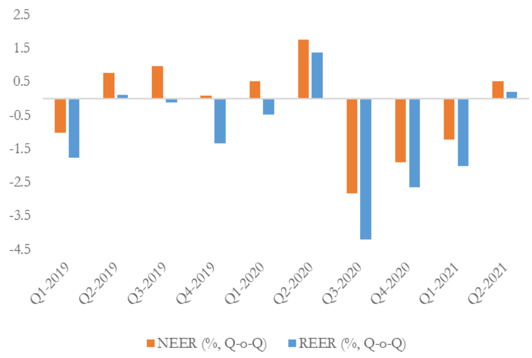
[11] As per CBUAE calculations, tradables include the following categories of goods and services: food and soft drinks; beverages and tobacco; textiles, clothing and footwear; furniture and household goods; transportation; and miscellaneous goods and services.

2.4 Exchange Rates and Outward Personal Remittances

2.4.1 Exchange Rate

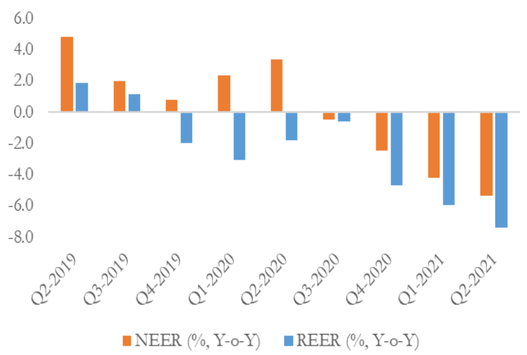
The average Nominal Effective Exchange Rate (NEER) of the Dirham, which takes into account the bilateral exchange rates of the UAE's trading partners, appreciated in Q2 2021 by 1.2% Q-o-Q, while depreciating by 5.4% Y-o-Y, after a depreciation of 1.2% and 4.2% Q-o-Q and Y-o-Y, respectively, in line with the USD appreciation.

Figure 2.4.1.a. Q-o-Q Nominal and Real Effective Exchange Rates Appreciation/Depreciation (%)



Source: BIS

Figure 2.4.1.b. Y-o-Y Nominal and Real Effective Exchange Rates Appreciation/Depreciation (%)



Source: BIS

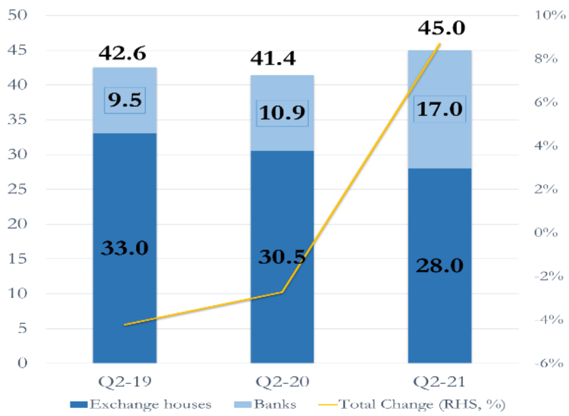
In real terms, the Dirham Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, also appreciated by 0.2% Q-o-Q and depreciated by 9.4% Y-o-Y in the second quarter. The lower appreciation Q-o-Q (higher depreciation Y-o-Y) in the REER compared to the NEER was due to the lower and negative inflation in the UAE compared to the inflation rates prevailing in the trading partners.

2.4.2 Outward Personal Remittances

In Q2 2021, outward personal remittances increased by 8.7% or AED 3.6 billion Y-o-Y. There was a rise of outward remittances through banks by AED 6.1 billion, while transfers through exchange houses dropped by AED 2.5 billion.

Figure 2.4.2. Outward Personal Remittances Settled Through Banks and Exchange Houses, Q2 2019-2021

Billions of Dirhams



Source: CBUAE

The top five countries for outward personal remittances during the second quarter were India, Pakistan, the US, the Philippines and Egypt, accounting for 28.8%, 12.0%, 6.9%, 6.2% and 6.1%, respectively, of the total. Outward personal remittances rose on an annual basis to all five major countries of destination.

Chapter 3. Banking and Financial Developments

While credit contracted Y-o-Y and remained below pre-COVID levels, it rebounded Q-o-Q supported by corporate, SME, and retail lending. Deposit growth continued and overall, the financial soundness indicators remained healthy, positioning the banking system towards further supporting the UAE economy's recovery phase.

3.1 Banking Structure

The number of licensed commercial banks remained unchanged at 58 in the second quarter of 2021. The total of 58 banks comprises of 21 national banks and 37 foreign banks (including 10 wholesale banks). Moreover, the need for cost effectiveness and digitalization led to the closure of national branches, whose number decreased from 534 at the end of Q1 2021 to 522 at the end of Q2 2021. Meanwhile, the number of banks' staff fell by 414 (1.3% Q-o-Q) to reach 32,623 employees at the end of June 2021.

3.1.1 Bank Deposits

Resident deposits (88.2% of total deposits) increased by 1.0% Y-o-Y in the second quarter of 2021, owing mainly to an increase in government and private sector deposits. Private sector deposits increased by 3.8% Y-o-Y (AED 42 billion), while non-resident deposits (11.8% of total deposits) increased by 12.6% Y-o-Y (AED 25 billion).

About 77.6% of deposits at the end of Q2 2021 are at conventional banks and the remaining 22.4% at Islamic banks. Also,the share of national and foreign banks represented 88.3% and 11.7%, respectively.

Table 3.1.1. Total Deposits at UAE Banks

Billions of Dirhams

Item	Dec-20	Mar-21	Jun-21
Bank Deposits	1,885	1,881	1,909
(Y-o-Y change %)	0.8%	1.6%	2.3%
(Q-o-Q change %)	-1.2%	-0.2%	1.5%
Resident Deposits	1,682	1,678	1,683
(Y-o-Y change %)	2.0%	2.6%	1.0%
(Q-o-Q change %)	-2.0%	-0.3%	0.3%
Government Sector	287	277	282
(Y-o-Y change %)	-4.6%	8.7%	-2.6%
(Q-o-Q change %)	-13.9%	-3.5%	1.6%
GREs	255	246	227
(Y-o-Y change %)	3.9%	-5.3%	-5.5%
(Q-o-Q change %)	3.8%	-3.4%	-7.7%
Private Sector	1,100	1,117	1,134
(Y-o-Y change %)	4.0%	3.8%	3.8%
(Q-o-Q change %)	0.5%	1.5%	1.5%
NBFI	40	37	41
(Y-o-Y change %)	-9.9%	-14.4%	-8.8%
(Q-o-Q change %)	-5.2%	-6.3%	8.6%
Non-Resident Deposits	202	204	226
(Y-o-Y change %)	-8.6%	-6.1%	12.6%
(Q-o-Q change %)	5.8%	0.5%	10.9%

Source: CBUAE
Note: Data as of end of period. June data are preliminary.

3.1.2 Banks' Assets and Credit

Total assets increased in the second quarter by 0.6% Y-o-Y. However, aggregate bank credit decreased by 1.2% Y-o-Y amid contraction on corporate loan portfolio compared to a year ago. Nonetheless, Q-o-Q credit growth rebounded in Q2 2021, in particular for the corporate, retail, and SME sectors. Domestic credit decreased by 1.9% driven mainly by reduction in lending to the government and the private sector, while domestic quarterly credit growth recovered moderately.

Table 3.1.2.a. Assets and Credit at UAE Banks

Billions of Dirhams

Item	Dec-20	Mar-21	Jun-21
Total Assets	3,188	3,176	3,209
(Y-o-Y change %)	3.4%	1.5%	0.6%
(Q-o-Q change %)	-2.0%	-0.4%	1.0%
Gross Credit	1,779	1,754	1,769
(Y-o-Y change %)	1.2%	-0.8%	-1.2%
(Q-o-Q change %)	-1.4%	-1.4%	0.9%
Domestic Credit	1,597	1,590	1,596
(Y-o-Y change %)	0.3%	-0.3%	-1.9%
(Q-o-Q change %)	-0.9%	-0.4%	0.4%
Government	252	253	246
(Y-o-Y change %)	-2.1%	10.2%	-2.7%
(Q-o-Q change %)	-1.4%	0.2%	-2.7%
GREs	220	215	224
(Y-o-Y change %)	18.7%	7.0%	2.5%
(Q-o-Q change %)	1.0%	-2.1%	3.9%
Private Sector	1,108	1,106	1,113
(Y-o-Y change %)	-2.3%	-3.8%	-2.3%
(Q-o-Q change %)	-1.2%	-0.2%	0.6%
NBFI	16.6	16.2	14
(Y-o-Y change %)	8.5%	1.9%	-20.6%
(Q-o-Q change %)	-0.6%	-2.4%	-16.7%
Foreign Credit	182	165	174
(Y-o-Y change %)	9.8%	-4.8%	5.9%
(Q-o-Q change %)	-5.5%	-9.6%	5.5%

Source: CBUAE
Note: Data as of end of period. June data are preliminary.

In lending to domestic economy, the highest increase was in Mining and Quarrying by 33.4% Y-o-Y (AED 3.8 billion), followed by Electricity, Gas and Water by 8.3% Y-o-Y (AED 2.2 billion). Lending in all other activities declined with the total falling by 1.9% Y-o-Y.

Total assets of national banks increased by 1.1% Y-o-Y, while total assets of foreign banks fell by 3.1% Y-o-Y. Foreign banks had a 12.5% share in total assets and a 9.8% share in gross credit. Meanwhile, total assets of Islamic banks increased by 0.3% Y-o-Y while assets of conventional banks increased by 0.6% Y-o-Y. Analysis by type of banks shows that the share at the end of June 2021 of Islamic banks was 18.7% in total assets and 21.9% in total gross financing of the banking system.

Table 3.1.2.b. Bank Lending by Economic Activity

Billions of Dirhams

Economic Activity	Mar-21	Jun-21
Total	**1,589.6**	**1,595.6**
(Q-o-Q change %)	-0.4%	0.4%
(Y-o-Y change %)	-0.3%	-1.9%
Of which:		
Mining and Quarrying	**14.6**	**15.3**
(Q-o-Q change %)	-2.0%	4.2%
(Y-o-Y change %)	24.0%	33.4%
Manufacturing	**72.9**	**74.7**
(Q-o-Q change %)	-0.8%	2.4%
(Y-o-Y change %)	-10.7%	-6.3%
Electricity, Gas and Water	**28.0**	**28.9**
(Q-o-Q change %)	2.6%	3.2%
(Y-o-Y change %)	19.1%	8.3%
Construction and Real Estate	**322.9**	**323.7**
(Q-o-Q change %)	-1.4%	0.3%
(Y-o-Y change %)	0.9%	-0.9%
Trade	**139.6**	**137.4**
(Q-o-Q change %)	0.6%	-1.5%
(Y-o-Y change %)	-10.4%	-12.6%
Transport, Storage and Communication	**84.7**	**83.1**
(Q-o-Q change %)	-0.1%	-1.9%
(Y-o-Y change %)	33.9%	-1.0%
All Others	**148.0**	**149.0**
(Q-o-Q change %)	1.2%	0.7%
(Y-o-Y change %)	-0.7%	1.1%

Source: CBUAE
Note: Data as of end of period. June data are preliminary.

With regard to bank lending to Micro, Small and Medium Enterprises (MSMEs), it increased by 2.1 billion to reach AED 94.6 billion at the end of the second quarter, 2.3% Y-o-Y higher than the level at the end of Q2 2020.

3.1.3 Financial Soundness Indicators

The Advances to Stable Resources Ratio (ASRR) of the banking system increased from 77.5% at the end of March 2021 to 77.7% at the end of June 2021, which indicates that the structural liquidity of the banking sector remained sound. Eligible Liquid Assets[12], as a percent of total liabilities[13] fell to 18.3%, however well above the 10% minimum regulatory requirement, constituting an adequate buffer for the banking system.

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

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

Total liquid assets at banks at the end of the second quarter of 2021 stood at AED 476.2 billion, increasing by 10.1% Y-o-Y (AED 43.8 billion higher compared to the end of June 2020).

Overall, the UAE banking system remained well capitalized, with an average Capital Adequacy Ratio (CAR) at 17.5%, Tier 1 Capital Ratio at 16.3%, and Common Equity Tier 1 Ratio (CET 1) at 14.5%.[14]

Table 3.1.3. UAE Financial Soundness Indicators

	Dec-20	Mar-21	Jun-21
Total Banking System			
Advances to Stable Resources Ratio (ASRR)	77.6%	77.5%	77.7%
Eligible Liquid Assets Ratio (ELAR)	18.4%	18.8%	18.3%
Capital Adequacy Ratio (CAR)	18.2%	17.9%	17.5%
Tier 1 Capital Ratio	17.1%	16.7%	16.3%

Source: CBUAE
Note: Data as of end of period. June data are preliminary.

Loans to Deposits (LTD) ratio for the whole banking system decreased to 92.7% at the end of the second quarter, slightly below the 93.3% at the end of the previous quarter.

3.2 Financial developments

3.2.1 Share Prices

Stock markets continued their upward trend worldwide in the second quarter, mainly due to improved investor sentiment, monetary policy stimulus and economic recovery. The MCSI world Index gained 39.4% Y-o-Y during this period.

In the UAE, the Abu Dhabi Securities Exchange (ADX) share price index increased by 15.6% Q-o-Q and by 59.5% Y-o-Y, while the Dubai Financial Market (DFM) index rose by 2.3% Q-o-Q and by 44.0% Y-o-Y.

The big increase in ADX general share price index and market capitalization was due to the listing of Alpha Dhabi Holding which caused ADX to surpass AED 1tn in market capitalization for the first time ever.

Table 3.2.1. UAE – Securities Markets

			2021 Q1	2021 Q2
Abu Dhabi	Share Price Index	Q-o-Q	17.2%	15.6%
		Y-o-Y	58.3%	59.5%
	Market Capitalization	Q-o-Q	15.9%	35.7%
		Y-o-Y	104.7%	136.3%
		AED	861 bn	1.2 tn
	Traded Value	Q-o-Q	156.3%	39.3%
		Y-o-Y	359.8%	692.4%
		AED Billion	22	30
Dubai	Share Price Index	Q-o-Q	2.3%	10.2%
		Y-o-Y	44.0%	43.8%
	Market Capitalization	Q-o-Q	4.7%	8.8%
		Y-o-Y	32.4%	32.3%
		AED Billion	356	388
	Traded Value	Q-o-Q	-24.8%	9.9%
		Y-o-Y	-33.5%	-25.3%
		AED Billion	4.2	4.7

Source: SCA
Note: Changes are based on quarterly averages for the share price index and market capitalization

3.2.2 Credit Default Swaps (CDS)

CDS decreased generally worldwide during the second quarter of 2021 compared to 2020 levels with improving economic conditions. The government of Abu Dhabi CDS premium fell by 1.8 basis points (bps) to 42.9 bps, remaining the lowest CDS premium in the Middle East and Africa region, while for the Emirate of Dubai, the premium decreased by 14.3 bps to 93.5 bps.

Table 3.2.2. UAE – Sovereign Credit DefaultSwaps (CDS) (in bps)

	2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2
Emirate of Abu Dhabi	61.1	104.5	52.2	40.5	44.7	42.9
Emirate of Dubai	144.0	244.7	168.0	127.5	107.8	93.5

Source: Bloomberg
Note: All data are quarterly averages

[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.

Chapter 4. Interest Rates and Money Supply

LIBOR rates fell during the second quarter of the year, while EIBOR declined in the first 2 months, before recovering in June. Meanwhile, monetary aggregates increased in the UAE, owing to an increase in resident deposits, including government deposits at CBUAE and commercial banks.

4.1 Interest rates

4.1.a Short-term interest rate

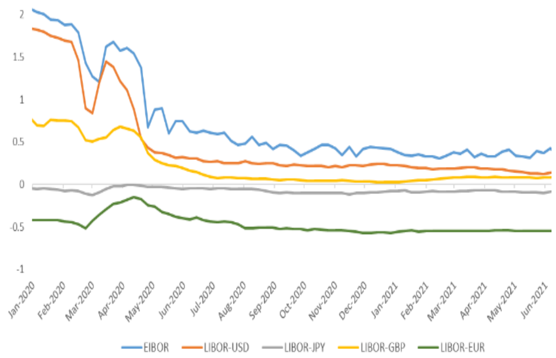
The 3-month USD LIBOR decreased from 0.19% in the last week of March to 0.12% in the second week of June 2021, in line with the US Fed's continued commitment to keep its policy rate steady at 0.00-0.25% through 2023, while maintaining its monthly purchases at USD 120 billion (USD 80 billion in Treasuries and USD 40 billion in asset-backed securities).
The Fed announced an increase in the interest rate on excess reserves by 5 bps on 16 June 2021. This was a technical adjustment by the Fed to ensure that short interest rates stay within its policy corridor.

In the UAE, the 3-month EIBOR fell from 0.41% at the end of March to a trough of 0.31% in the end of May, before increasing to 0.42% by the end of June. CBUAE announced on 17 June an increase in its base rate applicable on the Overnight Deposit Facility (ODF) by 5 basis points to 15 bps, consistent with Fed's decision in the previous day.

The above developments resulted in the spread of 3-month EIBOR vis-à-vis 3-month USD LIBOR increasing from 21 bps at end of March to a peak of 29 bps in the third week of June, before declining to 18 bps by the end of the quarter.

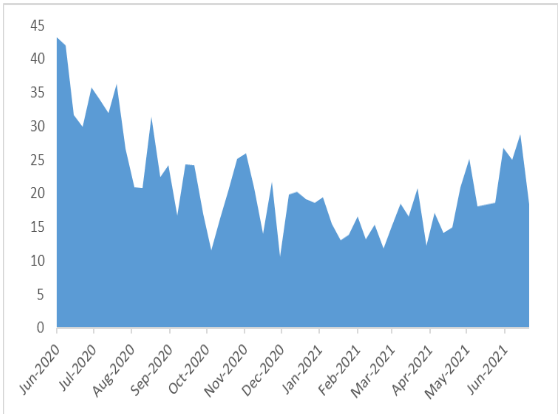
The GBP LIBOR remained roughly flat during the quarter, while both the 3-month EURIBOR and the JPY LIBOR rates remained in negative territory, consistent with the policy orientation of the ECB and the Bank of Japan.

Figure 4.1.a: EIBOR Rates in the UAE and LIBOR Rates in Selected Advanced Economies (%)



Source: Bloomberg
Note: Based on weekly data

Figure 4.1.b. Spread of 3-month EIBOR vs. 3-month USD LIBOR (bps)



Source: Bloomberg
Note: Based on weekly data

Box 2: CBUAE's base rate applicable to the overnight deposit facility

As a first step in the adoption of CBUAE's new monetary framework, the Overnight Deposit Facility (ODF) was introduced on 12 July 2020, enabling banks operating in the UAE to deposit excess liquidity at the Central Bank on an overnight basis. The ODF replaced the one-week Certificates of Deposit program, thereby becoming the prime facility through which banks can deposit excess liquidity on a daily basis.

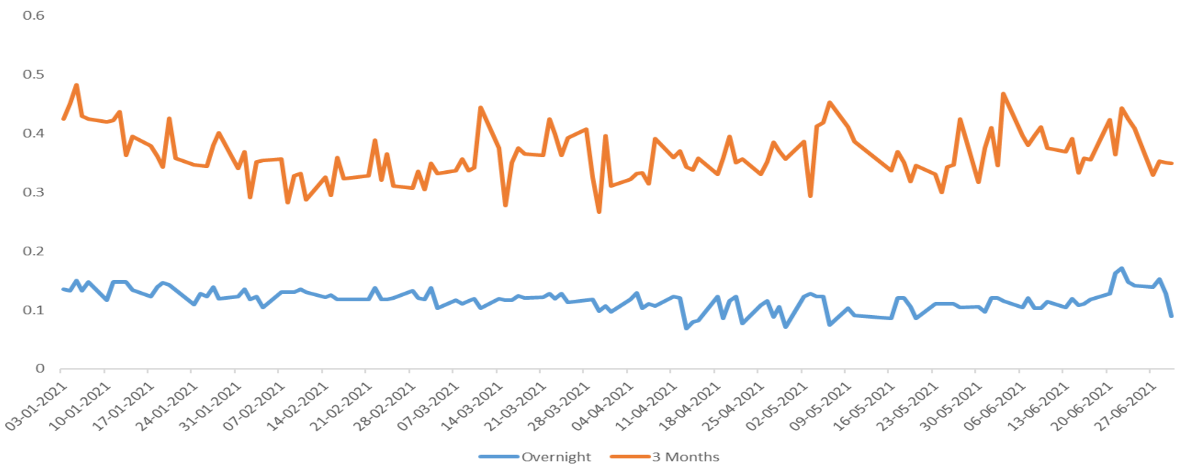
The interest rate paid on the ODF (known as the Base Rate) constitutes therefore a floor to overnight interbank rates. This rate constitutes a floor as banks wishing to deposit their excess liquidity with other banks will typically do so at or above the Base Rate. Given structural excess liquidity in the banking system, the Base Rate constitutes CBUAE's main monetary policy rate. This rate is anchored to the US Federal Reserve's Interest on Reserve Balances (IORB) rate, necessary to ensure stability of the peg of the Dirham to the US Dollar.

For licensed financial institutions that carry on all or part of their activities and business in accordance with the provisions of Sharia rules, CBUAE continues to offer its one-week commodity Murabaha-based Islamic Certificate of Deposits, which is redeemable on a daily basis.

Data show that ODF monthly average increased from AED 61.0 billion during July -December 2020 to AED 81.9 billion during January – June 2021, reflecting of an increase an increase in liquidity absorption through this facility.

The Base Rate was increased by 5 bps to 15bps on 17 June 2021, following FOMC's decision in this regard the previous day. CBUAE also maintained the rate applicable to borrowing short-term liquidity from the CBUAE through all standing credit facilities at 50 basis points above the Base Rate.

Figure 1. EIBOR Rates and Overnight rate in the UAE (%)

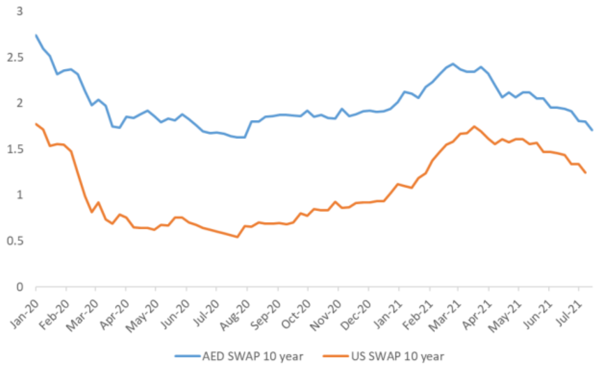


Source: CBUAE
Note: Based on daily data

4.1.b Long-term swap rates

The 10-year swap rate on the Dirham declined from 2.34% in the last week of March to 1.71% in the last week of June.

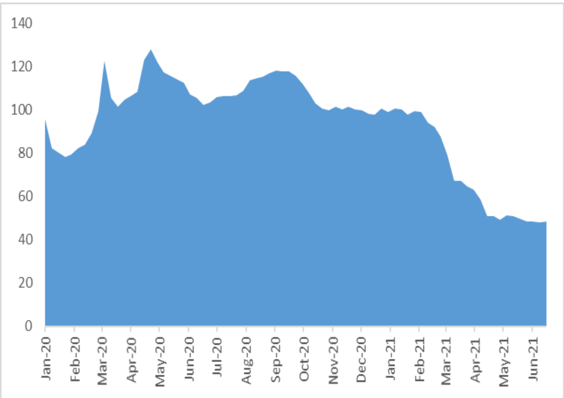
Figure 4.1.c 10-year Interest Rate Swaps (%)



Source: Bloomberg
Note: Based on weekly data

The spread of the 10-year swap rate on the Dirham vs. that on the USD declined from 67 bps at the end of Q1 to 48 bps at the end of Q2 2021.

Figure 4.1.d Spread 10-year AED Swap vs. USD Swap (bps)



Source: Bloomberg
Note: Based on weekly data

4.2 Money supply

The monetary aggregate M_1[15] rose by 2.7% Q-o-Q (AED 17.2 billion) to reach AED 659.5 billion, driven by an increase in monetary deposits (85.4% of M_1) by 3.2% (AED 17.3 billion), reaching AED 563.7 billion, while currency in circulation (14.5% of M_1) declined by 0.1% (AED 0.1 billion).

M_1 moved up by 18.3% Y-o-Y due to an increase in monetary deposits and currency in circulation by 21.3% and 3.5%, respectively.

Table 4.2.1. Money Supply in the UAE

Billions of Dirhams

	M_1	M_2	M_3
Dec-20	600.0	1,478.5	1,769.3
Mar-21	642.3	1,487.5	1,766.4
Jun-21	659.5	1,488.5	1,772.6

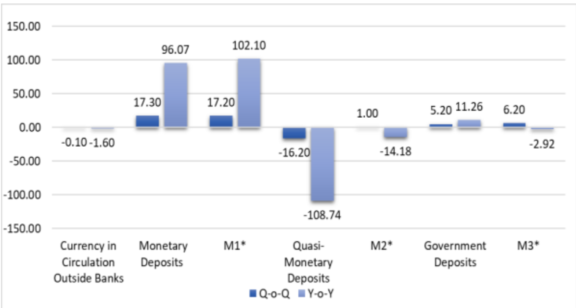
Source: CBUAE

Monetary aggregate M_2[16] increased by only 0.1% (AED 1.0 billion) Q-o-Q to reach AED 1,488.5 billion, owing to the increase in M_1, which was partially offset by the decline in quasi-monetary deposits (55.6% of M_2) by 1.9% (AED 16.2 billion) to reach AED 829.0 billion. The latter dropped as term deposits were not attractive for savers due to the low interest rates.

On a Y-o-Y basis, M_2 increased by 2.1 %, as the increase in M_1 by 18.3% was offset by the drop in quasi-monetary deposits by 8.0%.

Figure 4.2: Q-o-Q Change in Monetary Aggregates in 2021 Q2

Billions of Dirhams



Source: CBUAE

[15] Currency in Circulation outside banks + Monetary Deposits

[16] M_1 + Quasi Monetary Deposits

M_3[17] grew slightly on a quarterly basis by 0.4% (AED 6.2 billion) to reach AED 1,772.6 billion, driven by the rise in M_2 and the government deposits at commercial banks and CBUAE (16.0% of M_3). The latter increased by 1.8% (AED 5.2 billion), reaching AED 284.1 billion.

M_3 rose by 1.2% Y-o-Y, as the increase in M_2 more than compensated the decline in government deposits, during this period.

[17] M_2 + Government Deposits at commercial banks and CBUAE

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