مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

Quarterly Economic Review

First Quarter 2015

President of the United Arab Emirates

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Our Vision

Leadership and excellence in preserving banking and financial stability

Our Mission

Through application of effective prudential supervision policies, adoption of efficient monetary policy and operation of payment systems compatible with best practices, we maintain a sound banking sector and support stability of the UAE financial system to ensure balanced economic growth.

Our Values

Transparency – Committed to transparency and continuous improvement.

Professionalism – Practice sound governance.

Participation – Achieve excellence through teamwork.

Collaboration – Build and develop integrative partnerships.

Trustworthiness – Maintain the confidence of our stakeholders.

List of Acronyms

Acronyms	Description
AED:	Arab Emirates Dirham
BPS:	Basis Points
BRIC:	Brazil, Russia, India and China
CAC40	French Stock Market Index
CBUAE:	Central Bank of the UAE
CDS:	Credit Default Swap
CHF	Swiss Franc
CPI:	Consumer Price Index
DAX:	German Stock Market Index
ECB:	European Central Bank
EIBOR:	Emirates Interbank Offered Rate
EUR:	Euro
EuroStoxx:	Euro Area Stock Market Index
Fed	Federal Reserve in the US
FTSE100:	UK Stock Market Index
GBP:	British Pound
GCC:	Gulf Cooperation Council
GDP:	Gross Domestic Product
GREs:	Government –Related Entities
IMF:	International Monetary Fund
JPY:	The Japanese Yen
M1, M2, and M3:	Monetary Aggregates
MENA:	Middle East & North Africa
MENAP:	Middle East, North Africa, Afghanistan and Pakistan
MIB:	Italian Stock Market Index
MSCI	Morgan Stanley Capital International
NBS:	National Bureau of Statistics, UAE
Nikkei:	Japanese Stock Market Index
NPLs:	Non-Performing Loans
UAE:	United Arab Emirates
US:	United States of America
USD:	US dollar

Chapter one. International Economic Developments

The first quarter of 2015 was marked by a slowdown of the US economy, a tepid recovery in Europe, negative growth rates in Brazil and Russia and a continued deceleration in economic growth in China. Inflation remained below the 2 percent target in most developed countries except for Japan, while Brazil and Russia witnessed a sharp increase in consumer prices. Meanwhile, unemployment decreased in developed countries in contrast to major emerging economies, like Russia and Brazil.

1. Global Economy

The global economy continued to witness a slowdown, with year-on-year growth falling from 2.3% in 2014 Q4 to 1.7% in 2015 Q1, with growth in the developed world slowing down from 1.9% to 1.1%, during the same period. While the US economy was affected by bad weather conditions, part of Europe saw the first signs of a tepid recovery supported by the long-awaited ‘quantitative easing’ program launched by the ECB. Both economies, however, still operate well below their potential, reflecting a continued restoration of private balance sheets and hence a shift towards more private savings.

Meanwhile, earlier signs of resilience in emerging economies were reversed, with growth nearly half, on average, compared to previous performance (7.5% in 2011 versus 4.1% on an annual basis in Q1 2015). Among this group, countries which rely on commodity exports – such as Russia and Brazil – have been hit especially hard while commodity-importing countries benefitted, in general, from the windfall of lower prices. The situation was aggravated by a reversal in capital flows out of emerging economies, particularly to the United States on expectations of a higher interest rate before the end of the year.

In 2015 Q1, the stock markets mirrored developments in the underlying fundamentals worldwide with MSCI (Morgan Stanley Capital International) increasing by 4.9% while the FTSE100 (Financial Times Stock Exchange) in the U.K. increased by 3.2%, and Nikkei increased by 10% in Japan . EuroStoxx (Euro Area reference index) increased by 17.5% due to the asset purchase program by the ECB which helped boost investors’ confidence, with the benchmark French Stock Market Index CAC40 increasing by 17.8%, the German Stock Index DAX increasing by 22% and the Milan Exchange (MIB) in Italy increasing by 21.8%.

Table 1.1.a Stock Market Indices in Developed Economies

	MSCI World (local)	US Dow Jones	Japan Nikkei	UK FTSE 100	Euro Area EuroStoxx	Germany DAX	France CAC 40	Italy MIB
Q1 2015	3,556	17,776	19,207	6,773	3,697	11,966	5,034	23,157
Q4 2014	3,391	17,823	17,451	6,566	3,146	9,806	4,273	19,012
Q3 2014	3,284	17,043	16,174	6,623	3,226	9,474	4,416	20,892
Q2 2014	3,257	16,827	15,162	6,744	3,228	9,833	4,423	21,283
Q1 2014	3,119	16,458	14,828	6,598	3,162	9,556	4,392	21,692
Q4 2013	3,088	16,577	16,291	6,749	3,109	9,552	4,296	18,968
Q3 2013	2,848	15,130	14,456	6,462	2,893	8,594	4,143	17,435
Q2 2013	2,676	14,910	13,677	6,215	2,603	7,959	3,739	15,239
Q1 2013	2,631	14,579	12,398	6,412	2,624	7,795	3,731	15,339

Source: Bloomberg

Stock markets in BRIC (Brazil, Russia, India and China) countries improved in 2015 Q. The general share price index increased by 2.3% in Brazil, by 16.4% in Russia, and by 15.9% in China, while in India the increase in the share price index was limited to 1.7%, during the same period.

Table 1.1.b Stock Market Indices in BRIC Countries

	Brazil	Russia	India	China
2015 Q1	51,150	1,626	27,957	3,928
2014 Q4	50,007	1,397	27,499	3,389
2014 Q3	54,116	1,411	26,631	2,475
2014 Q2	53,168	1,476	25,414	2,145
2014 Q1	50,415	1,369	22,386	2,129
2013 Q4	51,507	1,504	21,171	2,214
2013 Q3	52,338	1,463	19,380	2,276
2013 Q2	47,457	1,330	19,396	2,071
2013 Q1	56,352	1,439	18,836	2,341

Source: Bloomberg

Policy Rates by the three main central banks did not change in the last quarter. The Bank of Japan (BOJ) has shifted its monetary policy focus in March 2013 to a targeted monetary base via Japanese government bond (JGB) purchases. Therefore, the overnight call rate is used as a reference rate. The most dramatic change in monetary policy came from the European Central Bank (ECB) where rates stood at 0.75 two years ago and are now at a low of 0.05%.

Yields on 10-year government bonds came down in advanced economies, with the exception of Japan. The decline was mainly driven by a slowdown in growth in the US, which boosted expectations of a delay in raising the short-term policy interest rate by the Fed, and by tepid growth in the Euro Area which raised expectations of continued bond-buying by the ECB. Moreover, subdued prices in major advanced countries further supported low inflationary expectations, thereby suppressing long-term yields.

Table 1.2.a Policy Rates (in %)

	US Fed Funds Rate	BoJ Overnight Call Rate	ECB Refinancing Rate
Q1 2015	0.25	0.02	0.05
Q4 2014	0.25	0.07	0.05
Q3 2014	0.25	0.03	0.05
Q2 2014	0.25	0.06	0.15
Q1 2014	0.25	0.04	0.25
Q4 2013	0.25	0.07	0.25
Q3 2013	0.25	0.06	0.50
Q2 2013	0.25	0.07	0.50
Q1 2013	0.25	0.06	0.75

Table 1.2.b 10-year Government Bond Yields (in %)

	US 10 year yield	Japanese 10 year yield	Euro 10 year yield
Q1 2015	1.99	0.41	0.19
Q4 2014	2.23	0.33	0.58
Q3 2014	2.59	0.54	0.98
Q2 2014	2.64	0.58	1.30
Q1 2014	2.85	0.65	1.63
Q4 2013	3.21	0.76	2.04
Q3 2013	2.76	0.70	1.86
Q2 2013	2.61	0.87	1.80
Q1 2013	1.94	0.56	1.34

Source: Bloomberg

With the prospect of the Fed tightening monetary policy before the end of the year, combined with the 'quantitative easing' by the ECB, the direction of financial flows towards the US resulted in appreciation of the US dollar (USD) against the EURO by 7.2% in January, 0.8% in February and 4.3% in March, while the exchange rate relative to the Japanese yen (USD/JPY) appreciated by 1.8% in February and by 0.4% in March, after a depreciation by 1.2% in January.

The first quarter of 2015 marked also the end of the established 'floor' of the Swiss Franc (CHF) against the EURO when the Swiss National Bank (SNB) decided to let the currency float freely, which resulted in an appreciation against the US dollar by 18% on January 15, resulting in 8% appreciation in the month of January, 3.7% in February and 1.9% in March 2015.

Table 1.3 Exchange Rates against the US dollar

	USD/ EUR	USD/ JPY	USD/ CHF	USD/ GBP	USD/ Russian Ruble
2014					
January	0.7400	102.04	0.9100	0.6100	35.1500
February	0.7246	101.80	0.8803	0.5972	35.8641
March	0.7263	103.23	0.8846	0.6001	35.1734
April	0.7211	102.24	0.8804	0.5927	35.6632
May	0.7335	101.77	0.8952	0.5967	34.8974
June	0.7305	101.33	0.8868	0.5846	33.9823
July	0.7466	102.8	0.9088	0.5922	35.6867
August	0.7615	104.09	0.9182	0.6025	37.1189
September	0.7917	109.65	0.9551	0.6168	39.6003
October	0.7983	112.32	0.9626	0.6252	43.0095
November	0.8033	118.63	0.9653	0.6389	49.4670
December	0.8266	119.78	0.9943	0.6419	60.7360
2015					
January	0.8861	117.49	0.9202	0.6638	69.4666
February	0.8931	119.63	0.9543	0.6480	61.7535
March	0.9318	120.13	0.9727	0.6748	58.1861

Source: Bloomberg

2. United States

The US economy recorded initially a slightly negative growth rate in the first quarter of 2015, which was revised later to a small positive growth of 0.6 percent. Cold weather took its toll on consumer spending and construction activity, while the strong dollar hampered activity in the manufacturing sector as exports became less competitive abroad. Moreover, the energy sector which has grown in importance over the years, due to expansion in shale oil industry, was battered by low oil prices which led to substantial investment cutbacks. These negative effects were not offset by a surge in consumer spending on account of the windfall savings from lower petrol prices, as it was widely expected (Table 1.4).

Table 1.4 Quarter- on-Quarter Real GDP Growth Rates (in %)

	2014 Q4	2015 Q1
Advanced Economies		
- **USA**	**2.20**	**0.60**
- **Japan**	**0.30**	**1.00**
- **United Kingdom**	**0.80**	**0.40**
- **Euro Area**	**0.40**	**0.40**
- **Germany**	**0.70**	**0.30**
- **France**	**0.10**	**0.60**
- **Italy**	**0.01**	**0.31**
Developing Economies		
- **Brazil**	**0.27**	**-0.16**
- **Russia**	**-0.55**	**-1.29**
- **China**	**1.50**	**1.40**

Source: Bloomberg

On the other hand, the labor market continued to show signs of continued recovery. The unemployment rate stood at 5.5% in March. However, labor participation rate, which started to decline following the financial crisis, has come down again in the first quarter of 2015, reaching 62.7%. Tighter conditions in the labor market have reflected positively on wages, which grew by 2.1% at the end of March, providing further evidence of approaching full employment in support of the Fed's plan to start increasing policy rates, albeit gradually. However, the negative growth rate registered in the first quarter, coupled with weaker than expected consumers sentiment, continued to indicate that the growth momentum is still not robust for the Fed to embark on an interest rate increase, especially that year-on-year inflation turned negative 0.1% in 2015 Q1. In parallel, the Personal Consumption Expenditures deflator registered a 1.3% increase (yoy) in 2015 Q1 well below the Fed's target of 2% (Table 1.5).

3. Japan

The Japanese economy was one of the few advanced economies which saw a pick-up in GDP growth in the first quarter of 2015, expanding by 1%. Underlying the pickup is the boost of exports which was supported by the weak yen and cheaper energy imports. Corporate earnings have also recovered, supporting an upbeat sentiment in the export industry. However, the unemployment rate increased only slightly to 3.5%,. In parallel, the strong gains on the Japanese stock market lifted household confidence which was battered by last year's increase in value- added tax from 5% to 8%, which became effective starting April 2014. However, growth in consumer spending is still likely to be modest in the coming quarters. Fiscal policy which aims to meet the medium-term budget target is expected to continue on a path of continued consolidation, which is likely to weigh on private consumption spending due to projected higher taxes. Japanese consumer price inflation which reversed its deflationary path, following last year's VAT hike, stood year-on-year at 2.3% in March 2015. If the effect of higher VAT on consumer prices peters out, inflation figures are expected to come down again, absent a pickup in consumers' demand. In an effort to support the growth momentum, the Bank of Japan has resorted to monetary easing at the end of October 2014, and no further adjustments to the monetary stance occurred in the first quarter of 2015.

Table 1.5 Year-on-Year Consumer Price Change (in %)

	2014 Q4	2015 Q1
Advanced Economies		
- **USA**	**0.80**	**-0.10**
- **Japan**	**2.40**	**2.30**
- **United Kingdom**	**0.50**	**0.00**
- **Euro Area**	**-0.20**	**-0.10**
- **Germany**	**0.10**	**0.20**
- **France**	**0.10**	**0.00**
- **Italy**	**0.00**	**-0.10**
Developing Economies		
- **Brazil**	**6.41**	**8.13**
- **Russia**	**11.40**	**16.90**
- **India**	**5.86**	**6.28**
- **China**	**1.50**	**1.40**

Source: Bloomberg

4. Eurozone

Economic growth in the Eurozone gathered momentum in the first quarter of 2015 when it recorded a growth rate of 0.4% on a quarterly basis and 1% on an annual basis. However, the growth momentum masks a wide disparity among member countries, with a slowdown in Germany and a pickup in France and Italy. In general, the economic outlook has brightened due to expansionary monetary policies by the European Central Bank (ECB), a weaker euro which boosted exports and lower oil prices which benefitted consumers and decreased the imports bill, thereby improving the trade balance.

In a similar vein, industrial production is on a recovery trend largely supported by export growth, reflecting higher competitiveness on account of a weaker Euro. Concurrently, unemployment in the Eurozone continued its downward trend in the first quarter of 2015, decreasing to 11.20%, mainly driven by further reduction in the German unemployment rate to 6.4%. Even in France and Italy, unemployment came down in the first quarter, albeit from a high level (from 10.4% in the 4th quarter of 2014 to 10.3% in the 1st quarter of 2015 for France and from 12.7% in Q4 2014 to 12.4% in Q1 2015 for Italy). This has boosted consumers' confidence in the Euro area (see table 1.6).

Table 1.6 Unemployment Rates (in %)

	2014 Q4	2015 Q1
Advanced Economies		
- **USA**	**5.60**	**5.50**
- **Japan**	**3.47**	**3.50**
- **United Kingdom**	**5.70**	**5.50**
- **Euro Area**	**11.30**	**11.20**
- **Germany**	**6.50**	**6.40**
- **France**	**10.43**	**10.33**
- **Italy**	**12.72**	**12.40**
Developing Economies		
- **Brazil**	**4.30**	**6.20**
- **Russia**	**5.30**	**5.90**
- **China**	**4.09**	**4.05**

Source: Bloomberg

Notwithstanding recent green shoots, domestic demand is likely to witness further moderate growth in the Euro area. The Greek problem was already visible in the first quarter of 2015. Though a very small country that accounts for only 2% of GDP in the Euro area, the continuous prospect of a 'Grexit' distracted EU government efforts to balance public-sector finances. Moreover, the implementation of serious structural reforms is still an anathema in many European capitals towards sustaining better growth prospects going forward.

The downward trend of consumer price inflation in the Euro zone and major member countries had stalled, or was even reversed, following several years of sliding prices. The downward trend was partly driven by lower wage growth which is the only adjustment valve left to gain competitiveness, in the absence of flexibility to invoke necessary currency devaluations in the context of the monetary union. Persistent deflationary price trends prompted action by the European Central Bank to initiate its asset purchase program. The cycle of quantitative easing, buying sovereign and agencies bonds, in the amount of Euro 60 billion a month, started in March 2015 and is planned to last until at least September 2016 for an expected total amount of one trillion Euros. Following the launch of the program, the three-month Euribor dropped into negative territory for the first time since the inception of the monetary union in the Euro area.

5. BRIC economies

GDP growth on a quarter on quarter basis slowed again in the BRIC countries (India has not yet reported any quarterly growth figures) while China reported its lowest GDP growth of 1.4% since the financial crisis. The pronounced contraction in the Russian economy is attributed to the decline in oil prices and the negative effects of economic sanctions. While growth in Brazil continued its downward trend in the first quarter of 2015, growth of the Indian economic activity appears to be resilient, based on the increase of industrial production in the first quarter of 2015 (2.5% on an annual basis up to March 2015, compared to -0.5% recorded during the same period in the previous year).

China is pursuing an increasingly expansionary monetary stance, aided by fiscal policy, with a goal to halt the decline in economic growth rates which are still the highest among the BRIC countries. However, high indebtedness of the local governments, coupled with overcapacity in the manufacturing and construction sectors, still pose considerable downside risks. Brazil's growth is being impeded by rising inflation as a consequence of a sharp depreciation of the Brazilian Real vis-à-vis Brazil's main trading partners, reflecting low commodity prices and a surge in outflows, exceptionally low consumer confidence and a slack in investment activity. As a result of a deteriorating growth momentum, the job market deteriorated in Brazil and Russia, with unemployment rates reaching in March 2015, 6.2% and 5.9%, respectively, while China exhibited 4.1% unemployment during the same period (Table 1.6).

Inflation in the BRIC economies presented a mixed picture. In China, the combination of an appreciation of the nominal effective exchange rate of the Renminbi and lingering overcapacity in some areas of the economy slowed down year-on-year inflation to 1.4% in 2015 Q1, which is well below the Central Bank target of 3%. In India however, year-on-year inflation increased from 5.9% in 2014 Q4 to 6.3% in 2015 Q1, despite the fall in oil prices and commitment by the Central

Bank to inflation targeting, starting 2014. The inflationary pressure was more pronounced in Brazil where year-on year inflation increased from 6.4% in 2014 Q4 to 8.1% in 2015 Q1, and in Russia where inflation shot up from 11.4% to 16.9%, due in part to currency depreciation that resulted in higher import costs.

Consistent with their divergent inflationary paths, these countries also pursued divergent monetary policies. In a bid to boost growth, China's central bank lowered its key interest rate from 5.6% to 5.35% in March 2015 and the required reserve ratio on deposits in the banking system, from 20% to 19.5% in February 2015. In the same vein, the central bank of India reduced its reverse repo rate on March 3, from 6.75% to 6.5%. In an effort to support the economy, the central bank of Russia continued to adjust the policy rate downward from its high level of 17% down to 14% on March 13, in support of credit growth while aiming to strike a balance to avoid a renewed collapse of the Ruble, which fell as low as 70 to the US dollar, but recovered by the end of the quarter to 58 to the US dollar. The Brazilian central bank, by contrast, raised its policy interest rate from 11.75% at the beginning of 2015 to 12.25% in January, and subsequently to 12.75% in March in order to combat inflation and the depreciation of the Brazilian Real on account of continued surge of capital outflows.

6. MENA economies

In the Middle East North Africa (MENA) region, the economy remained resilient in oil-exporting countries, with economic growth expected to remain in 2015 at the same rate of the previous year, i.e., 2.4%. These countries can still resort, at least partially, to the large financial buffers that they have accumulated in the form of international reserves and savings in Sovereign Wealth Funds in order to sustain the growth momentum in the non-energy sector and continue efforts to diversify their economies.

Table 1.7.a. Annual Real GDP Growth in MENA Countries (in %)

	2014	2015
Middle East & North Africa		
- **Oil Exporters**	2.4	2.4
• **Saudi Arabia**	3.6	3.0
• **Bahrain**	4.7	2.7
• **Kuwait**	1.3	1.7
• **Oman**	2.9	4.6
• **Qatar**	6.1	7.1
- **Oil Importers**	3.0	4.0
• **Egypt**	2.2	4.0
• **Jordan**	3.1	3.8
• **Morocco**	2.9	4.4
• **Tunisia**	2.3	3.0

Source: IMF, Regional Economic Outlook for MENA, May 2015

Indeed, growth estimates by the IMF for 2015 are higher compared to 2014 for Kuwait, Oman and Qatar, reaching 1.7%, 4.6% and 7.1%, respectively. While growth in Saudi Arabia is expected to slow down from 3.6% in 2014 to 3% in 2015 and from 4.7% to 2.7%, in Bahrain.

Oil importers are expected to have improved economic outlook in 2015, benefiting from low prices of oil and other primary commodities, with growth expected to reach 4.4% in Morocco and 3.8% in Jordan. In Egypt the expectation is that growth will improve form 2.2% in 2014 to 4% in 2015 thanks to continued drive for reforms and the success of the Economic Development Conference organized in March 2015.

As regards inflation, it remained moderate in oil-exporting countries due to low imported inflation and subdued demand. Jordan and Morocco have benefited from the decline in international food and fuel prices. Therefore, this year's expected inflation in these countries will be in the order of 1.2% and 1.5%, respectively.

Countries that remain in post-revolutionary turmoil, however, continue to witness a large increase in food prices, fueled by disruptions in local production and depreciating local currencies. Continuing low oil prices in 2015 will benefit mostly governments where fuel subsidies are dominant, e.g., in Egypt, thereby blocking the transmission channel from lower energy prices to domestic inflation. In Egypt, inflation is expected to decrease only slightly from 10.1% in 2014 to 9.8% in 2015, while the estimate for Tunisia is 4.9% and 5% respectively. Inflationary pressures in these countries are expected to continue against the backdrop of currency depreciation, which are fueling popular discontent and labor demand for higher wages.

Table 1.7.b. Annual Inflation in MENA Countries (in %)

	2014	2015
Middle East & North Africa		
- **Oil Exporters**	**5.8**	**5.8**
• **Saudi Arabia**	2.7	2.0
• **Bahrain**	2.5	2.1
• **Kuwait**	2.9	3.3
• **Oman**	1.0	1.0
• **Qatar**	3.0	1.8
- **Oil Importers**	**9.4**	**6.9**
• **Egypt**	10.1	9.8
• **Jordan**	2.9	1.2
• **Morocco**	0.4	1.5
• **Tunisia**	4.9	5.0

Source: IMF, Regional Economic Outlook for MENA, May 2015

The general slump in GCC stock markets in 2014 Q4 continued in 2015 Q1 due mostly to continued low oil prices and global economic slowdown, with the exception of Bahrain where share prices increased by 1.6% in 2015 Q1 and in Saudi Arabia where share prices increased by 5.4%. Meanwhile, in post-revolutionary Egypt and Tunisia, share prices increased by 2.3% and 4.4%, respectively, albeit from a relatively low base and in the case of the former the increase was probably boosted by better economic prospects.

Table 1.8 Stock Market Indices in MENA Countries

	Bahrain	Egypt	Jordan	Kuwait	Marocco	Oman	Qatar	Saudi Arabia	Tunisia
2015 Q1	1,450	9,135	2,135	427	8,428	6,238	3,134	8,779	5,313
2014 Q4	1,427	8,927	2,165	439	7,843	6,343	3,151	8,333	5,090
2014 Q3	1,476	9,811	2,115	494	8,254	7,484	3,472	10,855	4,580
2014 Q2	1,428	8,162	2,113	470	7,512	7,008	2,938	9,513	4,596
2014 Q1	1,357	7,805	2,149	483	7,758	6,857	2,992	9,474	4,591
2013 Q4	1,249	6,783	2,066	453	7,418	6,835	2,588	8,536	4,381
2013 Q3	1,194	5,621	1,851	463	7,046	6,647	2,418	7,965	4,462
2013 Q2	1,188	4,752	1,981	447	7,140	6,338	2,349	7,497	4,608
2013 Q1	1,092	5,099	2,101	433	7,364	5,990	2,163	7,126	4,726

Source: Bloomberg

Chapter Two. Domestic Economic Developments

The UAE has benefited in 2015 Q1 from resilient growth and high foreign currency reserves, underpinned by a supportive economic policies and robust credit growth. Securities markets, however, have been volatile during this period.

2.1 Resilient Economic Growth

Economic growth, particularly in non-oil activities, is expected to remain resilient, reaching 4.6% during the year 2015. This is mainly due to the following factors: (1) no sharp revision of public spending and infrastructure projects by the Government and Government-related entities (GREs), and (2) the oil price rebounded upward since February 2015. In addition, the UAE economy is benefiting from growth in other GCC countries, as well as in some emerging Asian economies (see chapter 1). Nonetheless, we project moderate decline in growth forecast in 2015, capturing a combined decline of activity in the non-energy sector on account of weaker than expected growth in major underlying sectors, coupled with more moderate growth in the energy sector.

In February 2015, as an example, both rating companies Standard & Poor's and Fitch maintained AA sovereign investment grade for Abu Dhabi, citing *the Emirate's ability to withstand turbulence in energy prices, thanks to its prudent cost-cutting measures of government expenditures, declining GREs debt level and increasing contributions from non-oil sectors to economic activity.*

Table 2.1. Economic Growth in the UAE

Year	2012	2013	2014	2015
Total GDP (at constant prices)	6.9%	4.3%	4.6%	4.0%
• Oil GDP	7.6%	2.9%	4.0%	2.6%
• Non-Oil GDP of which:	6.6%	5.0%	4.8%	4.6%
- Manufacturing	5.6%	1.2%	3.2%	3.0%
- Construction	5.5%	3.4%	7.3%	7.0%
- Wholesale & Retail Trade	0.3%	4.9%	5.6%	5.0%
- Real Estate & Business Services	12.1%	6.6%	-4.1%	-4.0%
- Transport & Communications	5.0%	-1.1%	8.6%	8.0%

Source: National Bureau of Statistics and Central Bank estimates for 2015.

The US dollar appreciation continues to be a boon for exports to the UAE. Due to the fixed peg regime, the Dirham appreciated during 2015 Q1 by 3.8% against the Japanese Yen (the Yen accounts for 3.6% of UAE imports), 10% against the Euro (the Euro area accounts for more than 17.2% of UAE imports), 4.6% against the British Pound (the U.K. accounts for 5.8% of UAE imports), 2% against the South Korean Won (South Korea accounts for 2.4% of UAE imports), 1.8% against the Indian Rupee (India accounts for 13.6% of UAE imports), and by 0.2% against the Chinese Yuan (the Chinese Yuan accounts for 14.3% of the UAE imports), while the Dirham depreciated by 6.2% against the Singapore dollar (Singapore accounts for 2.4% of UAE imports), during the same period. The collective currency depreciation resulted in a weighted appreciation of the Dirham by 2.3% with respect to the currencies of these trading partners that account for 59.3% of total imports of the UAE. The resulting local currency depreciation gave these countries a price advantage in their exports to the UAE and concurrently also reduced the cost of imports for consumption and investment purposes in the UAE.

Table.2.2.a. Dirham appreciation against currencies of import partners

Currency	Share of UAE imports	Currencies per Dirham		Dirham Appreciation (Dec. – March)
		Dec.2014	Mar.2015	
Euro	17.2%	0.22	0.242	10.0%
Chinese Yuan	14.3%	1.685	1.689	0.2%
Indian Rupee	13.6%	17.086	17.386	1.8%
UK Pound	5.8%	0.174	0.182	4.6%
Japanese Yen	3.6%	32.474	33.72	3.8%
South Korean Won	2.4%	297.121	303.04	2.0%
Singaporean dollar	2.4%	0.36	0.3375	-6.2%
Total	59.3%			
Weighted Appreciation				2.3%

Source: Fxtop.com

Growth in non-oil activities during 2015 is expected to remain balanced among the main economic growth sectors. Manufacturing (9% of GDP) is expected to grow by 3% due to investments in the free trade zones as well as in the mainland. Meanwhile, Construction (10.5% of GDP) is expected to increase by 7% due to housing and infrastructure developments as well as landmark tourism projects. In the Emirate of Abu Dhabi, progress is continuing in Saadiyat Island's cultural district to meet the opening deadlines for Louvre Museum Zayed National Museum, and Guggenheim Museum. In Dubai, infrastructure projects implemented in preparation for Expo 2020 are estimated to be in the order of AED 30 billion.

Moreover, trade as well as transport and communications continue to receive a boost from tourism during the year, which is benefitting from low fuel prices and lower travel costs, even though it is also being hurt by the Dirham appreciation. Nonetheless, these services are expected to grow by 5% and 8%, respectively, in the year 2015. The only exception is “Real Estate and Business Services”.

Table.2.2.b. Dirham appreciation against currencies of non-oil export partners

Currency	Percent of UAE Non-oil Exports	Currencies per Dirham		Dirham Appreciation (Dec.-March)
		Dec 2014	Mar.2015	
Indian Rupee	19.1%	17.086	17.386	1.8%
Turkish Lira	12.2%	0.625	0.705	12.8%
Swiss franc	6.1%	0.265	0.266	0.4%
Egyptian pound	3.0%	1.947	2.076	6.6%
Chinese Yuan	2.1%	1.685	1.689	0.2%
Iranian rial	1.8%	7345.024	7609.204	3.6%
Netherlands - Euro	0.8%	0.22	0.242	10.0%
Japanese yen	0.8%	32.474	33.72	3.8%
Total	45.9%			
Weighted Appreciation				2.3%

Source: Fxtop.com

As regards exports of non-oil activities, the Dirham appreciation during 2015 Q1 is expected to make them more expensive, especially that the appreciation was particularly high with respect to a composite of currencies for Turkey, Egypt, Iran, the Netherlands and Japan. As indicated in table 2.2.b, the average weighted appreciation reached 2.3% during 2015 Q1, relative to partners that represent 45.9% of UAE non-oil exports.

The combined evidence in Tables 2.2.a. and 2.2.b indicates that the Dirham appreciation in 2015 Q1 with respect to major sources of imports was roughly the same as with respect to major destinations of non-energy exports. Therefore, while the US dollar appreciation made UAE non-oil exports more expensive, it may have reduced intermediate and input costs given the high import content of these activities. While data are not readily available to verify the validity of the transmission channel, if lower cost of imports is passed through to the price of exports, competitiveness could be preserved, notwithstanding the appreciation of the Dirham, relative to currencies of major trading partners for export destinations.

2.2. CPI inflation

Inflation measured by the change in the General Consumer Price Index (CPI) increased year-on-year from an average of 2.3% in 2014 to 3.8% in 2015 Q1.

Housing remains the main driver of the CPI during this period due to its weight in the consumer price basket (39%).Year-on-year, the Housing component of the CPI rose by 7.4% in January, 7.2% in February and 9.3% in March, thereby increasing by 7.9% on average in 2015 Q1.

Other drivers of inflation in 2015 Q1 among the non-tradable activities: 1.2% price increase for Restaurants and Hotels (4.4% weight in the CPI basket), 1.6% increase for Transportation (10% weight in the consumer basket), 4% increase for Education (4% weight in the CPI basket), and 1.1% increase for Medical Care (1.2% weight in the CPI). Communications and Recreation and Culture, however, witnessed a moderate year-on-year increase of 0.7% and 0.3%, respectively in 2015 Q1.

As regards the price of tradables [Food, Textiles, and Furniture represent 26% of the total CPI basket in the UAE], the strengthening of the dollar during 2015 Q1 is expected to slow down import prices, due to the fixed peg of the Dirham to the US dollar. The general depreciation of foreign currencies vis-à-vis the Dirham, in tandem with very low international inflation particularly for commodity prices on account of a slowdown in the global economy, explains how some items of the CPI that rely heavily on imports saw either a moderate price increase [e.g., 0.6% increase for Food Products (14% weight in the CPI basket)] or a decrease (e.g., 1.2% decline in the price of Textiles, Clothing and Footwear (7.6% weight in the CPI basket)).The price increase however reached 3.8% for Beverages & Tobacco [0.2%weight in the CPI basket] and 4.4% for Furniture and Household goods (4.2% weight in the CPI basket).

Table 2.3. UAE Consumer Price Index* (2014)

Year-on-Year Percent Change

Major Groups of Expenditure	Weghts	2014											2015			
		Mar.	April	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	2014 Average	Jan.	Feb.	Mar.	Q1 Average
General Consumer Price Index	100.0	1.8%	2.1%	2.0%	2.2%	2.3%	2.4%	2.9%	3.1%	2.8%	1.6%	2.3%	3.7%	3.5%	4.3%	3.8%
Food and soft drinks	14.0	2.0%	2.4%	2.1%	1.7%	1.4%	2.1%	2.5%	3.7%	2.1%	0.8%	2.1%	0.1%	0.4%	1.1%	0.6%
Beverages and tobacco	0.2	1.8%	1.1%	1.1%	3.9%	4.8%	4.8%	4.8%	3.7%	3.6%	2.5%	2.9%	3.6%	3.6%	2.9%	3.4%
Textiles, clothing and footwear	7.6	0.8%	0.5%	0.4%	0.1%	0.0%	-0.3%	0.5%	0.4%	-1.1%	0.0%	0.3%	-0.9%	-1.0%	-1.7%	-1.2%
Housing	39.0	2.4%	2.7%	2.6%	2.4%	2.7%	2.9%	4.1%	4.2%	4.4%	2.4%	2.9%	7.4%	7.2%	9.3%	7.9%
Furniture and household goods	4.2	3.6%	4.5%	4.7%	4.5%	4.6%	4.9%	4.8%	4.6%	4.7%	3.1%	4.1%	5.1%	4.5%	3.7%	4.4%
Medical care	1.2	-0.1%	-0.1%	0.0%	0.0%	0.7%	0.8%	0.7%	0.9%	1.5%	0.7%	0.4%	1.2%	1.2%	0.8%	1.1%
Transportation	10.0	0.7%	1.0%	1.0%	1.9%	2.1%	1.8%	1.6%	1.5%	1.7%	1.1%	1.3%	1.5%	1.6%	1.6%	1.6%
Communications	7.0	-0.1%	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.6%	0.5%	0.7%	0.7%	0.7%	0.7%
Recreation and culture	3.1	0.9%	0.8%	0.9%	0.9%	0.9%	0.9%	0.7%	0.7%	0.7%	0.7%	0.8%	0.8%	0.2%	0.1%	0.3%
Education	4.0	4.4%	4.6%	4.6%	4.6%	4.6%	4.6%	4.0%	4.0%	4.0%	1.4%	4.1%	4.0%	4.0%	4.0%	4.0%
Restaurants and hotels	4.4	1.3%	1.2%	1.2%	1.1%	1.1%	1.3%	1.3%	1.3%	1.4%	0.6%	1.2%	1.4%	1.0%	1.3%	1.2%
Miscellaneous goods and services	5.3	1.0%	1.3%	1.0%	5.2%	5.6%	5.1%	4.5%	4.6%	4.1%	2.7%	2.9%	5.4%	4.0%	3.6%	4.4%

(*) CPI Index= 100 for base year 2007. Source: National Bureau of Statistics

2.3. Volatile Share Prices

Following the oil price slump and tumbling stock markets by 16.2% during 2014 Q4, the UAE share price index decreased by 0.6% in January, increased by 5.9% in February, and decreased again by 5.7% in March, attesting to continued volatility.

Looming uncertainty about the global economic slowdown, as well as regional instability weighed in negatively on volatility in the UAE securities. Confidence was nonetheless maintained, thanks to the large buffers of foreign currency assets and continued drive to sustain growth in the non-energy sector and diversify the economy. Therefore, policies going forward should be focused on anchoring expectations and boosting confidence in the period ahead.

Table 2.4. UAE Securities Markets

(In billions of Dirhams unless otherwise indicated)

	2014										2015		
	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March
Number of Listed Companies	120	120	120	120	120	120	121	122	125	125	126	126	126
Share Price Index	5,083.6	5,349.7	5,535.3	4,657.8	5,285.1	5,356.9	5,378.0	5,092.4	4,886.9	4,508.1	4,480.2	4,744.6	4,476..9
Monthly change in Share price index (%)	1.0	5.2	3.5	-15.9	13.5	1.4	0.4	-5.3	-4.0	-7.8	-0.6	5.9	-5.7
Market Capitalization	763.1	803.1	831.0	699.2	793.8	804.6	808.3	801.0	771.0	728.4	726.2	769.1	726.2
Traded Value Monthly	44.3	67.5	64.2	48.3	43.2	21.6	32.2	28.5	26.4	31.8	19.5	17.7	14.6

Source: UAE Securities and Commodity Authority

2.4. Decreasing CDS Premiums

Credit Default Swaps (CDS) indicate the risk related to the entities issuing debt. Table 2.6 shows some decrease in the risk premium for UAE entities issuing debt instruments in international markets, during the first quarter of 2015: a decrease of 6 basis points for Dubai Sovereign, 17.9 basis points for DP World and 9.4 basis points for Dubai Holding. For Abu Dhabi Sovereign, however, CDS increased, during the same period, but remained at a low level of 72 basis points in March 2015.

Table 2.5. UAE - Credit Default Swaps (CDS)

In basis points

	2008	2013	2014				2015
	Dec.	Dec.	March	June	Sept.	Dec.	March
Sovereigns :							
- Abu Dhabi	229.2	55.0	53.0	49.5	54.5	63.5	72.0
- Dubai	470.0	220.0	173.2	155.0	170.0	226.0	220.0
GREs :							
- DP World	762.0	167.5	148.9	151.3	145.0	212.0	194.1
- Dubai Holding	869.7	325.8	287.8	282.0	316.0	330.7	321.3

Source: Bloomberg data.

2.5. The fiscal stance

The consolidated government revenue is expected to fall by 22.4% in 2015, on account of a reduction in the revenues of local governments. Taxes, mostly fees paid by hotels and restaurants, fees on foreign banks' profits, and royalties on oil and natural gas, are expected to fall by AED 92 billion or 33.4%, in line with the fall in oil prices.

As a result, following an expansionary fiscal stance in 2014 when public expenditure increased by 11.3%, the first step in a gradual fiscal consolidation is expected to start in 2015, with a decrease in public spending by local governments by AED 21.4 billion or 5.5%, reflecting a decrease in Subsidies and Grants in the amount of AED 17.4 billion, due to the partial removal of subsidies of water and electricity in Abu Dhabi, with the aim of taming waste and reinforcing fiscal consolidation.

Table. 2.6. Government Revenues

In billions of Dirhams

	2012	*2013*	*2014*	*2015*	*Percent Change*
Consolidated Revenue	550.0	582.9	553.9	430.0	-22.4%
Taxes	312.8	319.1	280.1	188.4	-32.7%
Social Contributions	4.5	5.1	5.3	5.5	3.8%
Grants	0.0	0.0	0.7	0.0	-100.0%
Other Revenue	232.7	258.7	267.8	236.1	-11.8%
Federal Government Revenue	61.2	62.6	61.8	62.9	1.8%
Taxes	5.0	5.3	5.3	5.5	3.8%
Social Contributions	4.4	5.1	5.3	5.5	3.8%
Grants	16.6	17.7	17.2	17.1	-0.6%
Other Revenue	35.2	34.5	34.0	34.8	2.4%
Local Governments Revenue	488.8	520.3	492.1	367.1	-25.4%
Taxes	307.8	313.8	274.8	182.9	-33.4%
Social Contributions	0.1	0.0	0.0	0.0	0.0%
Grants	-16.6	-17.7	-16.5	-17.1	3.6%
Other Revenue	197.5	224.2	233.8	201.3	-13.9%

Source: Official estimates, based on ADNOC transfers and government investment income. Data for 2014 are preliminary estimates and projections for 2015 are based on IMF 2015 staff report for the UAE.

Table. 2.7. Government Expenditure

In billions of Dirhams

	2012	*2013*	*2014*	*2015*	*Percent Change*
Consolidated Expenditure (a+b)	400.9	434.4	480.8	460.6	-4.2%
Expenses(a)	356.6	400.9	446.1	425.6	-4.6%
Compensation of employees	39.1	42.1	47.2	48.8	3.4%
Use of goods and services	40.4	43.2	54.4	55.3	1.7%
Consumption of fixed capital	3.5	3.3	3.7	3.9	5.4%
Interest	4.3	5.9	3.1	3.1	0.0%
Subsidies	8.4	10.1	19.8	13.0	-34.3%
Grants	2.6	21.6	21.9	11.3	-48.4%
Social Benefits	48.8	52.4	54.7	56.7	3.7%
Other expenses	209.5	222.3	241.3	233.5	-3.2%
Net acquisition of nonfinancial assets (b)	44.3	33.5	34.7	35.0	0.9%
Federal Government Expenditure (a+b)	63.9	59.4	62.8	62.9	0.2%
Expenses(a)	58.5	57.5	57.8	58.7	1.6%
Compensation of employees	18.2	18.5	19.8	20.5	3.5%
Use of goods and services	17.0	16.8	17.0	16.5	-2.9%
Consumption of fixed capital	0.4	0.4	0.4	0.4	0.0%
Interest	0.0	0.0	0.0	0.0	0.0%
Subsidies	0.1	0.0	0.0	0.0	0.0%
Grants	2.1	0.8	0.9	0.9	0.0%
Social Benefits	11.0	13.9	12.9	13.4	3.9%
Other expenses	9.7	7.1	6.8	7.0	2.9%
Net acquisition of nonfinancial assets (b)	5.4	1.9	5.0	4.2	-16.0%
Local Governments Expenditure (a+b)	337.0	375.0	418.0	397.7	-4.9%
Expenses(a)	298.1	343.4	388.3	366.9	-5.5%
Compensation of employees	20.9	23.6	27.4	28.3	3.3%
Use of goods and services	23.4	26.4	37.4	38.8	3.7%
Consumption of fixed capital	3.1	2.9	3.3	3.5	6.1%
Interest	4.3	5.9	3.1	3.1	0.0%
Subsidies	8.3	10.1	19.8	13.0	-34.3%
Grants	0.5	20.8	21.0	10.4	-50.5%
Social Benefits	37.8	38.5	41.8	43.3	3.6%
Other expenses	199.8	215.2	234.5	226.5	-3.4%
Net acquisition of nonfinancial assets (b)	38.9	31.6	29.7	30.8	3.7%

Source: Official estimates. Data for 2014 are preliminary estimates and projections for 2015 are based on the 2015 IMF staff report for the UAE.

The consolidated budget is projected to turn into deficit in 2015 reaching AED 30.6 billion or 2.4% of total GDP and 8.6% of Non-oil GDP. Underlying the deficit of the consolidated budget is the deficit in local government's budgets, since the federal budget is expected to remain balanced in 2015.

Table.2.8. The Fiscal Balance in the UAE (2012-2014)

	2012	*2013*	*2014*	***2015***
In billions of Dirhams				
Consolidated	149.1	148.3	73.1	-30.6
Federal Government	-2.6	3.3	-0.9	0.0
Local Governments	151.7	145.0	74.0	-30.6
In percent of Total GDP				
Consolidated Balance	10.9%	10.4%	5.0%	-2.4%
Federal Government	-0.2%	0.2%	-0.1%	0.0%
Local Governments	11.1%	10.2%	5.0%	-2.4%
In Percent of Non-oil GDP				
Consolidated Balance	17.9%	16.6%	7.6%	-8.6%
Federal Government	-0.3%	0.4%	-0.1%	0.0%
Local Governments	18.2%	16.3%	7.7%	-8.6%

Source: Official estimates. Data for 2014 are preliminary estimates and projections are based on the 2015 IMF staff report for the UAE.

Chapter Three. Monetary & Banking Developments

Growth in monetary and banking indicators was maintained in 2015 Q1 in line with resilient economic growth and continued improvement in the quality of the loan portfolio.

3.1. Monetary Expansion

Money supply M1 increased by 4.8% in 2015 Q1 and by 10.9% year-on-year up to March 2015. Currency in Circulation (12.3% of M1) contributed with 0.7% to the latter, while Monetary Deposits (87.7% of M1) contributed with 10.2%.

M2 increased by 3.3% in 2015 Q1 and by 4.8% year-on-year up to March 2015. The latter was brought about by a contribution of 0.2% increase in Currency in Circulation (4.8% of M2), 3.7% contribution of increase in Monetary Deposits (34% of M2), while Quasi-Monetary Deposits (61.2% of M2) contributed with an increase of 0.9%.

M3 increased by 2.4% in 2015 Q1 and by 6.6% year-on-year up to March 2015. The main contributors to the latter are: (1) Monetary Deposits (29.4% of M3) with 3.3% increase, and Government Deposits (13.6% of M3) with 2.3% increase.

3.2 Resilient Banking Activity

The 23 locally-incorporated banks increased their branches from 869 at the end of 2014 to 871 at the end of March 2015, while the 6 banks from the GCC countries remained with 4 branches, and the number of foreign banks remained at 20, with 82 branches.

Wholesale banks are allowed to conduct all commercial activities in the UAE except retail operations with natural persons, i.e., opening all types of accounts and letters of credit for companies and granting all types of lending facilities. In addition to Barclay's PLC and MBC Bank Limited which started operations in 2014 Q4, Gulf International Bank set up shop in 2015 Q1, which brings to eight the total number of wholesale banks operating in the country.

As regards banking activity, the oil price slump could increase the downside risks for banks operating in the UAE, due to a slowdown in the real estate sector, more volatile securities markets and added uncertainties about banks' exposure to business partners in hardly hit oil-dependent economies. To stem potential risks, the central bank continues to monitor indicators in the banking system to ensure stability and robust growth. These risks appear to be limited in the current environment and the central bank stands ready to invoke the right measures as necessary.

Table. 3.1 Monetary Developments: 2014 – 2015

In billions of Dirhams

	2014				**2015**				
	March	June	Sep.	Dec.	March				
						Year to Date Percent Change	Contribution to Aggregate Growth	Year on Year Percent Change	Contribution to Aggregate Growth
Money Supply M1	**412.0**	**434.3**	**431.1**	**436.1**	**456.9**	**4.8%**		**10.9%**	
Currency in Circulation	53.4	54.9	57.3	59.0	56.2	-4.7%	-0.6%	5.2%	0.7%
Monetary Deposits	358.6	379.4	373.8	377.1	400.7	6.3%	5.4%	11.7%	10.2%
Money Supply M2	**1124.3**	**1142.6**	**1136.1**	**1141.1**	**1178.8**	**3.3%**		**4.8%**	
Currency in Circulation	53.4	54.9	57.3	59.0	56.2	-4.7%	-0.2%	5.2%	0.2%
Monetary Deposits	358.6	379.4	373.8	377.1	400.7	6.3%	2.1%	11.7%	3.7%
Quasi Monetary Deposits	712.3	708.3	705.0	705.0	721.9	2.4%	1.5%	1.3%	0.9%
Money Supply M3	**1280.2**	**1328.4**	**1344.2**	**1332.0**	**1364.1**	**2.4%**		**6.6%**	
Currency in Circulation	53.4	54.9	57.3	59.0	56.2	-4.7%	-0.2%	5.2%	0.2%
Monetary Deposits	358.6	379.4	373.8	377.1	400.7	6.3%	1.8%	11.7%	3.3%
Quasi Monetary Deposits	712.3	708.3	705.0	705.0	721.9	2.4%	1.3%	1.3%	0.7%
Government Deposits	155.9	185.8	208.1	190.9	185.3	-2.9%	-0.4%	18.9%	2.3%

Source: Research & Statistics Department, Central Bank of the UAE

Table. 3.2.a Banks and Other Financial Institutions

	2013	2014				2015
	Dec.	**March**	**June**	**Sept.**	**Dec.**	**March**
Locally Incorporated Banks :						
- Main Branches	23	23	23	23	23	23
- Additional Branches	841	843	858	866	869	871
- Electronic Banking Service Units	29	29	33	33	34	31
- Cash Offices	89	89	89	89	90	90
GCC Banks :						
- Main Branches	6	6	6	6	6	6
- Additional Branches	4	4	4	4	4	4
Foreign Banks :						
- Main Branches	22	22	22	22	20	20
- Additional Branches	83	83	83	83	82	82
- Electronic Banking Service Units	52	53	53	54	48	48
- Cash Offices	1	1	1	1	1	1
Other Financial Institutions:						
- Wholesale Banks	4	4	5	5	7	8
- Representative Offices	120	120	122	121	121	122
- Finance Companies	25	25	26	26	26	26
- Financial Investment companies	25	25	25	25	25	25
- Moneychangers	134	134	137	138	140	140
- Offices for Intermediating in Currency Trading & Money Market Operations	12	12	12	12	12	12

Source: Banking Supervision Department, Central Bank of the UAE

Customer deposits increased by 2% in 2015 Q1 and by 8.8% year-on-year, reaching AED 1,449.3 billion at the end of March, while bank loans and advances increased by 2.2% and 7.7%, respectively reaching AED 1,226.3 billion. Meanwhile, the ratio of Bank Lending to Stable Resources reached 85% in March 2015 (see Table 3.3 for definition).

Bank lending is supported by a strong deposits base, high liquidity and, on the demand side, by the robust growth in the non-oil sectors (more than 60% of GDP). Moreover, even though some banks' foreign business partners suffered from low oil prices, some other partners benefitted from it, particularly India (38.6% of UAE exports) and China (11.5% of UAE exports).

Table 3.2.b. UAE Banking Indicators

In billions of Dirhams

	2014				2015	
	March	June	Sept.	Dec.	March	Year- on- Year Percent Change
Total Bank Assets	2,180.4	2,236.9	2,311.3	2,304.9	2,379.9	9.1%
Loans & Advances	1,144.5	1,174.6	1,215.9	1,200.1	1,226.3	7.1%
Of which: Personal loans to residents	285.7	295.9	307.5	299.9	309.9	8.4%
Customer Deposits at Banks	1,331.7	1,400.2	1,414.5	1,421.3	1,449.3	8.8%

Source: Banking Supervision Department, CBUAE

Quarterly credit sentiment survey (The Central Bank survey of credit officers at banks) confirmed that credit conditions within the UAE remained supportive of economic growth in 2015 Q1.

Islamic banks continued to thrive during this period. Their total assets increased by 6.7%, in 2015 Q1 reaching AED 432 billion, with their share in total assets increasing from 17.6% in 2014 Q4 to 18.2% in 2015 Q1. Meanwhile, their financing increased to reach AED 280 billion in 2015 Q1, thereby constituting 22.8% of total bank Loans and Advances.

Table 3.2.c. Assets and financing of Islamic Banks (2014 – 2015)

In billions of Dirhams

	2014				2015
	Q1	Q2	Q3	Q4	Q1
Assets	378	389	402	405	432
Percent of total banking assets	17.3%	17.4%	17.4%	17.6%	18.2%
Islamic financing	229	244	260	266	280
Percent of Loans and Advances	20.0%	20.8%	21.4%	22.2%	22.8%

Source: Banking Supervision Department, Central Bank of the UAE

3.3 Financial Soundness Indicators

Overall, the outlook regarding the stability of the UAE financial sector remains positive during this period, due to: (1) better quality of loan portfolio, and (2) strong capital base of banks, and (3) high liquidity and profitability, against the backdrop of resilient economic growth, particularly in the non-oil sectors of the economy.

The quality of the loan portfolio of banks continued to improve, as evidenced by the decline of the ratio of non-performing loans (NPLs) from 7% at the end of December 2014 to 6.6% at the end of March 2015, in tandem with decreasing bank specific provisions for these NPLs to AED 71.6 billion in March 2015, down from a peak of AED 91.1 billion (which was reached in November 2014). These NPLs, moreover, remained fully provisioned during this period.

Banks operating in the UAE maintained high capitalisation, stable funding and ample liquidity during this period. The capital adequacy ratio of banks remained at 18.2% (16.2% for Tier1 capital) in 2015 Q1, which is well above the regulatory requirements set by the Central Bank (12% and 8%, respectively). Meanwhile, liquid assets which include reserve requirements, certificates of deposit held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets, decreased from 15.7% at the end of December 2014 to 14.7% at the end of March 2015.

Table 3.3. Financial Soundness Indicators in the UAE

Indicators	2013	2014				2015
	Q4	Q1	Q2	Q3	Q4	Q1
Lending to stable Resources Ratio(*)	84.7%	85.5%	84.5%	86.0%	85.2%	85.0%
Ratio of Non-performing loans	7.8%	8.2%	8.6%	8.3%	7.0%	6.6%
Capital Adequacy Ratio	19.3%	18.5%	18.2%	18.3%	18.2%	18.2%
- of which: Tier 1 Capital	16.9%	16.2%	16.0%	16.3%	16.2%	16.2%
The Liquid Assets Ratio	14.65%	14.74%	15.57%	15.09%	15.67%	14.74%
Quarterly Lending Growth **		5.0%	2.6%	3.5%	-1.3%	2.2%

Source: Research & Statistics Department, Central Bank of the UAE

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

(**) Bank loans and advances.

Chapter Four. Central Bank Financial Position & Reserve Management

Total assets of the Central Bank are consistent with ample liquidity in the banking system, while interest income increased moderately, in line with rising interest rates on the US dollar

4.1- Central Bank Balance Sheet

The total assets of the Central Bank of the UAE decreased by 3.6% during 2015 Q1, reaching AED 332.5 billion. This was mainly the result of a decrease in Central Bank Deposits at banks abroad by AED 6.9 billion, while "Held-to-Maturity Foreign Bonds" increased by AED 2.2 billion.

On the liabilities side, "Current Accounts and Deposits" of banks at the Central Bank decreased by AED 12.8 billion, during 2015 Q1, and "Currency Issued" decreased By AED 5.1 billion, while banks' balance of "Certificates of Deposit" issued by the Central Bank increased by AED 12.2 billion, reaching AED 111.8 billion.

Table 4.1: Central Bank Balance Sheet

In millions of Dirhams

	2013	2014 December	2015 March
Assets			
Cash & Bank Balances	14,592	42,001	42,409
Deposits	99,927	76,917	70,057
CDs Under Repo	-	-	6,000
Liquidity Support Facility	513	321	321
Held-To-Maturity Foreign Bonds	128,263	157,753	159,947
Held-To-Maturity Bonds Issued by MOF & Dubai Government:	55,361	49,443	49,443
Available-for-sale investments	385	378	378
Derivative Assets	6,261	7,530	955
Advances to Government	-	2,500	2,500
Other Assets	6,624	7,996	447
Fixed Assets	97	79	78
Total Assets	**312,023**	**344,918**	**332,535**
Off Balance Sheet Commitments	129,367	134,105	145,303
Liabilities			
Current Accounts & Deposits	111,973	142,168	129,404
Certificates of Deposit	107,896	99,534	111,759
Currency Issued	63,927	74,472	69,353
Other Liabilities	697	1,683	1,810
Derivative Liabilities	-	-	381
Total Liabilities	**284,493**	**317,857**	**312,707**
Capital & Reserves			
Authorized Issued & Fully Paid Capital	2,500	2,500	2,500
Other Reserve	-	-	
Fair Value Reserve	-5	-11	-11
General Reserve	16,080	16,080	17,339
Retained Earnings	2,694	962	
Total Liabilities & Capital	**305,762**	**337,388**	**332,535**
Off Balance Sheet Commitments related to foreign exchange fluctuations	129,367	134,105	145,303

Source: Financial Control Division, Central Bank of the UAE

Central Bank Financial Results

The Central Bank's balance of foreign currency assets which include USD 10 billion Dubai Government bonds, decreased by 4.6% in 2015 Q1, reaching AED 306 billion. This was mainly due to a decrease in "Deposit Account, Cash with Banks Abroad and Loans to Banks against Certificates of Deposit" by AED 9.9 billion.

Table 4.2: Investment of the Central Bank's Foreign Currency Assets

In billions of Dirhams

	2013 Dec.	2014 Dec.	2015 March
Total Foreign Currency Assets	**282.9**	**320.6**	**306.0**
Central Bank's Investments Abroad In Highly Rated Securities, Government Bonds And Treasury Bills	128.3	157.8	159.9
Deposit Account and Cash with Banks Abroad	108.1	115.4	105.5
Central Bank's Investment In Local Government Bonds	36.7	36.7	36.7
Other Foreign Assets	9.8	10.7	3.9
Earnings For The Year From Treasury Operations	**1.4**	**1.0**	**0.5**

Source: Financial Control Division, Central Bank of the UAE

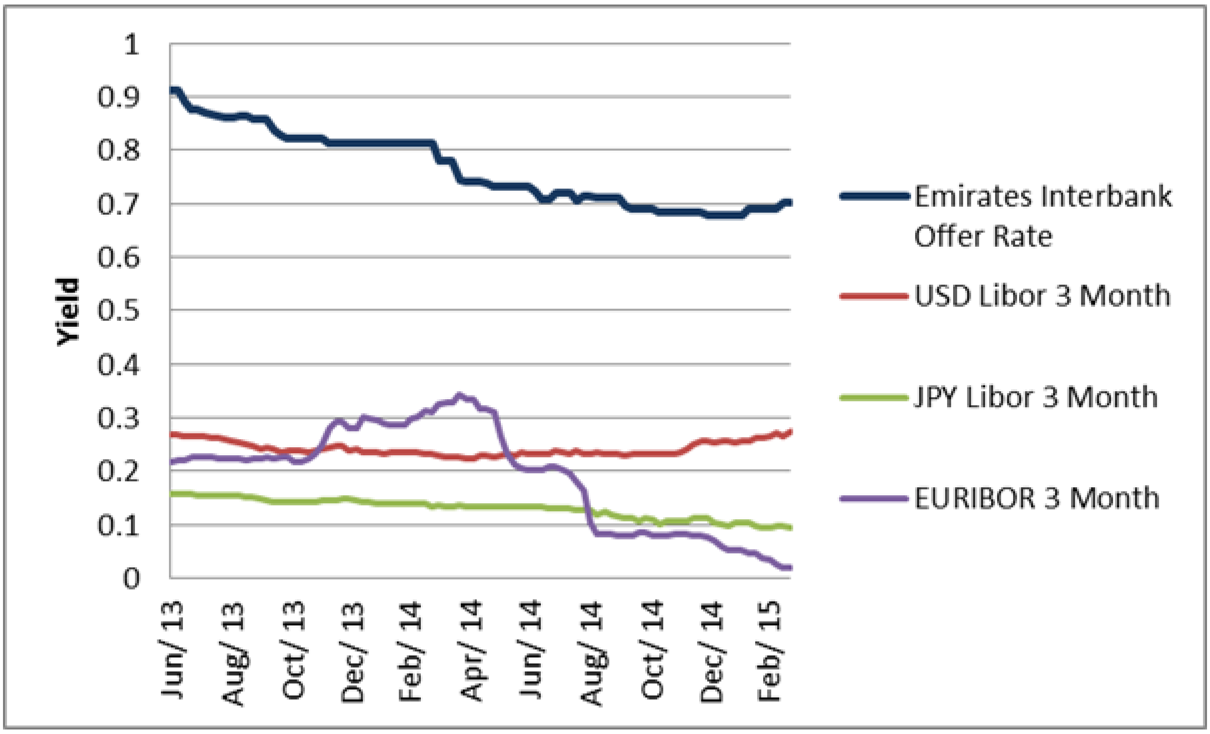
4.2 Interest Rates

The fixed peg of the exchange rate of the dirham to the US dollar means that the CBUAE has limited degree of freedom to set interest rates, independently from the direction of the interest rate as laid out by the US monetary policy which is defined by the Federal Reserve System in the United States. Nonetheless, the CBUAE uses monetary tools at its disposal to manage liquidity in the banking system, in order to support credit growth and stem the risks to financial vulnerability, while defending the fixed peg regime.

Short-term interest rates

The 3-month Emirates Interbank Offer Rate (Eibor) increased from 0.68% at the end of December 2014 to 0.73% at the end of March 2015, in line with the US dollar Libor 3 month, in anticipation of higher interest rates in the US. Accordingly, the spread over the USD 3- month Libor remained stable at around 0.42%. The Eibor is calculated by the Central Bank of the UAE, comprising daily quotes of the largest banks operating in the country. What is noteworthy is the fact that the spread between the best and the worst quote has come down in recent years, from 1.65% in early 2011 to 0.66% in March 2015, which is a sign of normalization of the UAE inter-bank market.

Figure 4.1 Libor Rates 3-month (in %)



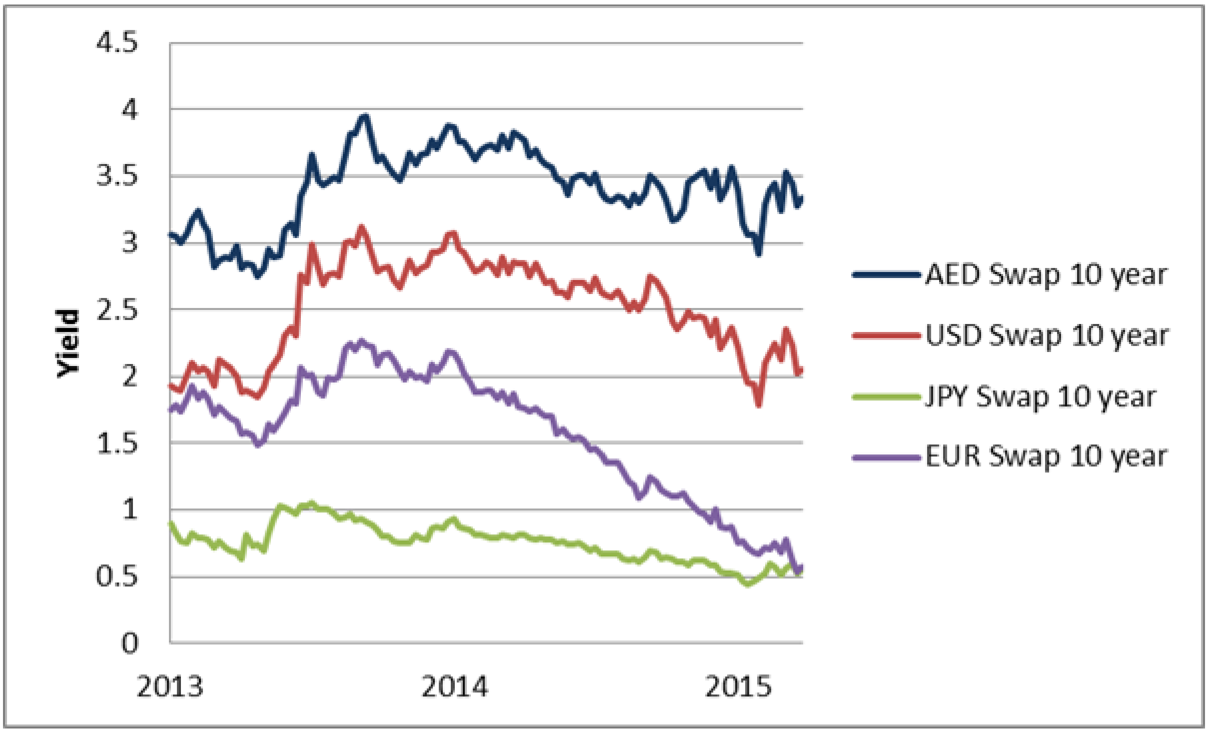
Source: Bloomberg

While the Eibor rates increased marginally by 5 basis points in 2015 Q1, the increase of the 3-month US dollar Libor rate was even more tepid, as it increased from 0.25% to 0.27%. Meanwhile, the Japanese Libor remained at the same level of about 0.11%, while its Euro counterpart fell from 0.07% to 0.01%, thereby undershooting the Japanese Libor.

Long-term swap rates

In absence of a deep and liquid government bond market in the UAE, the swap market is the only way to get an idea about yields at longer maturities. The swap market reflects mainly the supply and demand of corporates to hedge against the interest rate risk. Over the course of the first quarter of 2015, the 10-year AED swap remained basically unchanged at a level of 3.46%. At the same time, the US dollar 10-year swap yield declined from 2.28% to 2.02%, implying that the spread between the two maturities increased from 1.2% to 1.4% within 3 months, a change not seen since 2013.

Figure 4.2 10 - year swap rates



Source: Bloomberg

The most remarkable move happened at the 10-year EURO swap, closing the first quarter at 0.55%, i.e., roughly at the 10 year JPY swap. This drastic fall in yields was the consequence of the massive bond buying program which the ECB initiated in the beginning of March 2015.

4.3 Monetary Tools

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

In addition, the dollar/dirham swap window was expanded by removing limits on the amount of swaps that can be done, and by increasing the tenors on offers to a range from 1 week to 12 months. The confidence in the fixed peg regime was strengthened by the CBUAE's commitment to offer banks a window to borrow dirhams in the forward market.

4.4 Certificates of Deposits

1. The Central Bank launched a new discount window in April 2014, called the Interim Marginal Lending Facility (IMLF). The CBUAE launched this facility, based on internationally accepted tripartite agreements, with two large international custody providers, Clearstream or Euroclear. UAE-based onshore banks can sign up to this agreement to borrow overnight dirham funds from the CBUAE by pledging their eligible securities as collateral.

2. The Central Bank launched in 2015 Q1 the Islamic Sharia – compliant equivalent to IMLF, namely the Collateralized Murabaha Facility to put the Islamic banks on equal footing with conventional banks in this regard.

4.5 Bank Liquidity Developments

The main liquidity indicator monitored at the Central Bank in this regard is banks' excess reserves, i.e., their current account at the Central Bank and their holding of CDs. Banks' current account at the Central Bank decreased by AED 12.9 billion, from AED 29.6 billion at the end of 2014 Q4 to AED 16.7 billion at the end of 2015 Q1, while Certificates of Deposit held by banks increased by AED 12.3 billion, from AED 99.5 billion to AED 111.8 billion (see Table 3.4 above).

Total bank liquidity, including reserve requirements and highly-rated government and public sector debt, decreased by AED 6.6 billion, reaching AED 288.4 billion at the end of 2015 Q1. Meanwhile, there was no use by banks of CBUAE's facilities to borrow Dirhams, namely the Interim Marginal Lending facility and the collateralized Murabaha Facility, while the CDs Repo Facility reached AED 6 billion at the end of March 2015.

4.6 Reserve Management

Foreign currency reserves are managed by the Reserve Management Division within the Monetary and Reserve Management Department.

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

CBUAE's foreign currency assets at the end of 2015 Q1 comprise AED 105.5 billion deposits at banks abroad and AED 196.7 billion Held – to – Maturity Securities, in foreign currencies, including USD 10 billion Dubai Government Bonds, in addition to other reserves amounting to AED 3.9 billion, which brings total foreign currency reserves to AED 306 billion.