Quarterly Economic Review

Third quarter 2019

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List of Abbreviations

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

Executive Summary

Global growth was revised downward by the IMF in its latest release of the *World Economic Outlook* to 3% for 2019 and to 3.4% for 2020 owing to sluggish growth in emerging economies—mainly China and India—as well as the worsening economic outlook in major advanced economies. Geopolitical tensions, including those related to trade tariffs, and the decline in international trade have continued to weigh on the private sector confidence especially in the industrial sector. Growth is expected to decline this year to 2.4% in the US, to 1.2% in both the Eurozone and the UK, and to 3.9% in Emerging and Developing Economies. In accordance with the global slowing economy, expectations are that inflation would remain weak hinting towards a prolonged period of low interest rates.

Real growth in the UAE exhibited Y-o-Y growth of 1.3% in 2019 Q3, moderating compared to the previous quarter, on the back of a moderating non-oil growth from 1.8% in Q2 to 0.9% in Q3. The softening in non-oil activities is also reflected in the mixed economic sentiment indicators—the IHS UAE Purchasing Managers' Index (PMI) reached an average of 52.6 for the third quarter of 2019, while employment in the private sector picked up further momentum to solidify its recovery for the first three quarters—Y-o-Y growth of 1.1% in the third quarter.

Meanwhile, Y-o-Y CPI inflation is negative for the third quarter recording –2.1% due to negative inflation for both tradable (–2.5%) and non-tradable (–2.0%) goods and services reflecting the movements of rent prices and fuel prices in the domestic market, the continued fading effect of VAT, as well as the nominal exchange rate appreciation.

In the third quarter of 2019, deposits increased on a yearly basis, mainly driven by the increase in GREs and Government deposits. Gross credit continued its solid growth pace, registering 5% growth, higher than in 2019 Q2, underpinned by healthy Financial Soundness Indicators (FSIs) signifying an overall sound and stable banking system.

The Central Bank balance sheet exhibited a decrease in 2019 Q3, reflecting some decline in commercial banks' holdings at the CBUAE. Meanwhile, interest rates in the UAE Interbank witnessed a downward trend in 2019 Q3 in line with current and future expectations of the US Federal Reserve's interest rate policy announcements.

Chapter 1. International Economic Developments

Global growth for 2019 was revised downward by the IMF in its latest release of the World Economic Outlook for the fifth consecutive time due to rising uncertainties and continued trade frictions, while inflation remains below target in the developed world. Meanwhile, oil and other commodity prices remained firm despite the slow growth in global demand. Yields on 10-year government bonds fell owing to low inflation expectations, and a weaker growth outlook.

1.1 Economic Growth

Global growth projection has been revised downward for the fifth consecutive time with an expected growth of 3% in 2019, the slowest since the global financial crisis (see Table 1.1.a). According to the International Monetary Fund's World Economic Outlook (WEO), the slowdown in global growth—from 3.8% in 2017—is a consequence of rising trade barriers, geopolitical uncertainty, idiosyncratic factors causing macroeconomic strain in several emerging market economies, and structural factors such as low productivity growth and aging demographics in advanced economies.

Global growth is projected to pickup in 2020 to a downgraded 3.4% (compared to a projection of 3.6% in April). The group of emerging market economies, such as Argentina, Turkey, and Venezuela, which have contributed to slower growth in 2019, are mainly under severe strain or have underperformed compared to their past growth figures

In the US, growth is expected to decline from 2.9% in 2018 to 2.4% in 2019 and to 2.1% in 2020. On a quarterly basis, Y-o-Y growth slowed down from 2.1% in Q2 to 1.9% (Table 1.1.b), a slowdown that was signaled in the ISM Manufacturing PMI, which decreased to 47.8 during the end of third quarter. The US economy maintained momentum during the first half of the year, despite the sluggish investment.

In the Eurozone, growth was further downgraded to 1.2% and 1.4%, for both 2019 and 2020, respectively. According to the IMF *WEO* report, the main driver of growth in major EU countries is the automobile industry, which witnessed a drop in both demand and supply after the expiration of tax incentives in China and possible preference shifts in consumers' preferences as they shift to cars reflecting the changing technology and emission standards changing in many countries. The Y-o-Y quarterly growth of the Eurozone is estimated at 1.1%, similar to the previous quarter. Meanwhile, the IHS Markit Eurozone Manufacturing PMI pointed to almost 46 at the end of the quarter, reflecting a contractionary sentiment in the manufacturing activities.

In the UK, growth for 2019 was also revised down by 0.1% to 1.2%, and growth for 2020 is expected to be at 1.4%. Meanwhile, the Markit/CIPS Manufacturing PMI showed some recovery, while remaining in the contraction area, to 48.3 at the end of the quarter, following half a year of contracting manufacturing activities. The main risks to the UK economy remain related to the negative impact of the ongoing uncertainty surrounding the Brexit negotiations.

Growth projections for Japan remained similar to the last WEO publication at 0.9% for this year while the projection for next year was revised upward by 0.1% to 0.5% as temporary measures are expected to cushion part of the anticipated decline in private consumption following the October 2019 increase in the consumption tax rate.

Growth estimates for Emerging Markets and Developing Economies (EMDEs) declined from 4.5% in 2018 to 3.9% in 2019, due to the near-term risks. These risks include intensifying geopolitical tensions, increased uncertainties, regarding a no-deal Brexit, and market reassessment of the monetary policy outlook of major central banks due to serious pressures in some countries.

The slowdown in the two large emerging economies, China and India, significantly contributed to the global growth downgrade, even though these economies continue to achieve relatively high growth rates of 6.1% in China and 6.0% in India in 2019, with an expected decline to 5.8% next year for China and a pickup to 7.0% for India.

Table. 1.1.a Real GDP Growth in Selected Advanced Countries (%)

	2018	2019*	2020*
World Output	3.6	3.0	3.4
Advanced Economies	2.3	1.7	1.7
USA	2.9	2.4	2.1
Eurozone	1.9	1.2	1.4
France	1.7	1.2	1.3
Germany	1.5	0.5	1.2
United Kingdom	1.4	1.2	1.4
Japan	0.8	0.9	0.5
EMDEs [1]	4.5	3.9	4.6
China	6.6	6.1	5.8
India	6.8	6.0	7.0
MENA[2]	1.1	0.1	2.7

Source: IMF, WEO, October 2019
*Projected
[1] Emerging Market and Developing Economies
[2] Middle East and North Africa

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

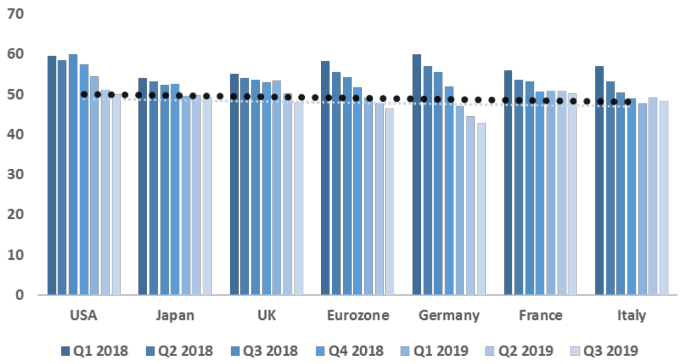
	Q4 2018	Q1 2019	Q2 2019	Q3 2019
USA	3	3.2	2.1	1.9
Eurozone	1.2	1.2	1.1	1.1
France	1	1.2	1.3	1.3
Germany	0.9	0.6	-0.3	
United Kingdom	1.4	1.8	1.2	1
China	6.4	6.4	6.2	6.0
Japan	0.3	1.0	1.2	1.3

Source: Bloomberg

In the Middle East and North Africa (MENA), the economic growth forecast was revised downward from 1.1% in 2018 to 0.1% this year owing to weak output growth for oil producers, and lower export prospects for export-oriented economies.

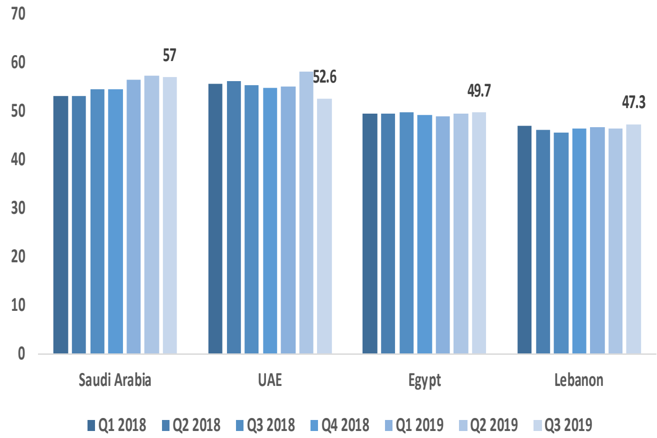
The IMF projects a growth recovery for 2020 as the region is forecasted to achieve 2.7% growth, thanks to expected oil sector growth in countries like Saudi Arabia and better export prospects for export-oriented economies. GCC economies growth is projected to pickup in 2020, thanks to expected higher oil prices, which would enable supportive fiscal policy.

Figure 1.1.a PMI Levels for Selected Countries



Source: Bloomberg

Figure 1.1.b PMI levels for Selected MENA Countries



Source: Bloomberg

1.2 Inflation

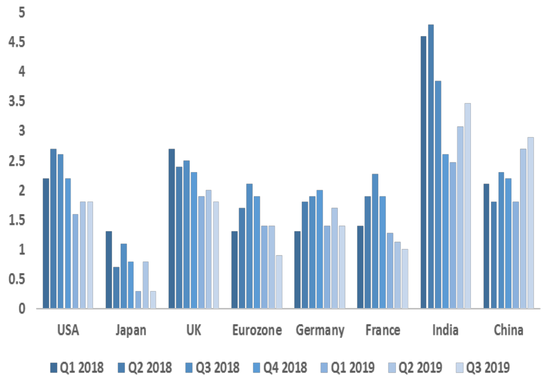
Since mid-2018, inflation has slid further below target across advanced economies and below historical averages in many emerging and developing economies. Consumer price inflation is expected to average 1.5% this year in advanced countries compared to 2% in 2018.

Y-o-Y inflation in the US averaged 1.8% in the third quarter, below expectations, as energy prices fell.

In the Eurozone, inflation remained subdued in 2019 Q3 averaging 0.8%, below ECB's 2% target, as cost of energy dropped further.

Inflation in emerging market and developing economies is expected to edge down to 4.7%. Yet, inflation is expected to rise in some countries owing to country specific developments such as the depreciation of the Argentinian currency, the increase of the value added tax (VAT) in Russia, and the rising prices of pork in China (Table 1.2.a).

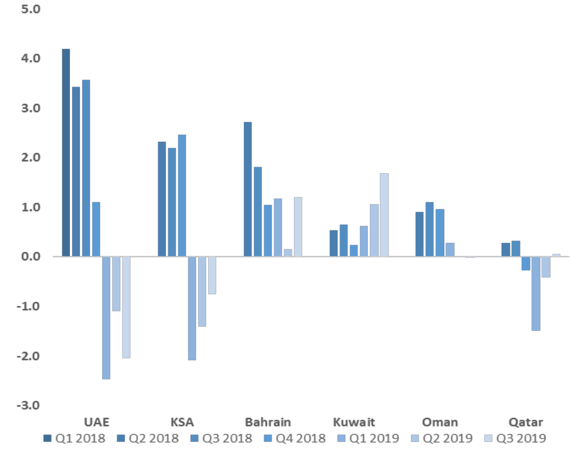
Figure 1.2.a Y-o-Y Consumer Price Inflation for Selected Developed and Emerging Economies (%)



Source: Bloomberg

In the GCC, Y-o-Y CPI inflation in 2019 is expected to exhibit mixed movements. In countries that have applied the VAT in 2018—Saudi Arabia, and the UAE—prices have been declining due to deflation pressures. Whereas, Bahrain, which introduced the VAT since the beginning of 2019, registered positive inflation and prices in Kuwait are increasing at moderate rates (see Table 1.2.b).

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



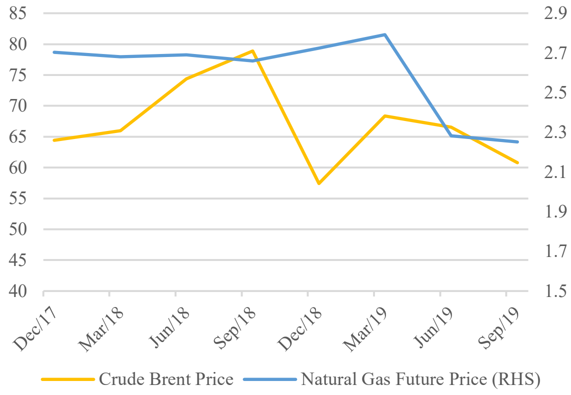
Source: Bloomberg

1.3 Commodities and Precious Metals

Commodities and precious metals witnessed mixed changes during the third quarter. For oil, Table 1.3.a shows that prices slightly declined following a record high US production growth and weaker economic prospects. Total oil supply in Q3 deceased by 1.5 mb/d to 99.3 mb/d, according to the International Energy Agency (IEA). Meanwhile the OPEC Reference Basket (ORB) declined by an average of 0.5% during the third quarter reaching 64.71 dollars per barrel.

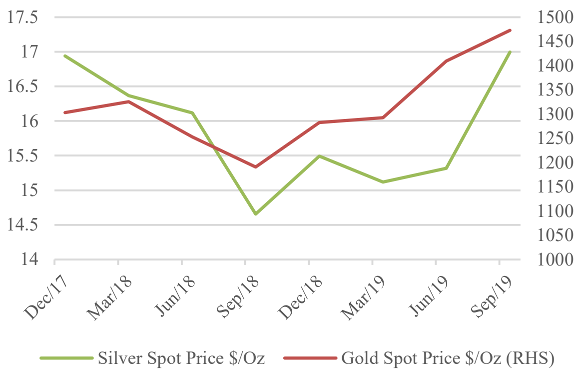
Meanwhile, the natural gas future price slightly increased to $2.5 per Metric Million British Thermal Unit (MMBtu). Gold witnessed a large increase in price from an average of $1332 per ounce during the second quarter to $1468 in the third quarter—driven by declining interest rates and global uncertainties—which boosted the safe haven status of the precious metal (Table 1.3.b).

Figure 1.3.a Crude Brent and Natural Gas Prices (in USD)



Source: Bloomberg

Figure 1.3.b Selected Commodity Prices (in USD)



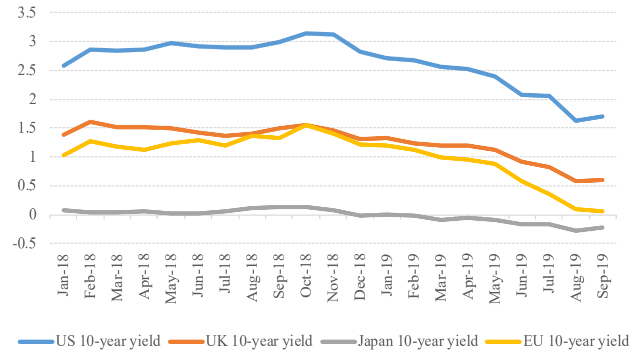
Source: Bloomberg

1.5 Government Bond yields

Government bond yields worldwide continued a downward trend in 2019 Q3 due to expectations of weaker economic growth (Table 1.5). US treasury 10-year yields fell in the US to 1.7% at the end of 2019 Q3 from 2.1% at the end of the previous quarter, mainly reflecting investors' caution over growth prospects, low inflation and expected Fed policy rate cuts. Meanwhile, the UK 10-year bond yield fell from 0.92% to 0.60%, amid persistent uncertainties surrounding Brexit.

In the Eurozone, the yield on the 10-year index Euro Generic Gov bond index (GECU10YR Index) was negative in Q3 as investors scrambled to buy less risky assets. In Japan, the BoJ opted to buy large amounts of bonds to keep the yields on 10-year Japanese government bonds at the target range of 0-0.1%, which led to an increase in bond prices and consequently forcing yields further into negative zone.

Figure 1.4 The 10-Year Government Bond Yields for Selected Countries (%)



Source: OECD, monthly average yields

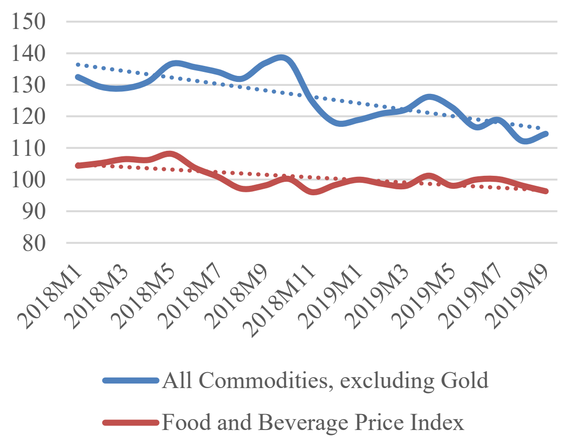
Although GCC bond yields followed the world downward trend during the second quarter of the year, it witnessed a record month during mid third quarter, fueled by the global demand for high-grade debt. The average yield on Bloomberg Barclays GCC Bond Index returned to an average of 3.5% during Mid-Q3.

Box 1 discusses the global trends in the conduct of monetary policy and prospects of interest rates.

Box 1: Global Trends in the Conduct of Monetary Policy

Global growth has been decelerating since the beginning of the year as a consequence of the trade tariff escalation, Brexit uncertainty and geopolitical conflicts. The prevailing uncertainties are expected to persist and many central banks, both in developed and emerging economies, further marked down their economic forecasts leading to a global trend of monetary easing. Similarly, commodity-producing countries were hit by the decelerating global demand—notably from China and India—and the long-lasting adjustment to the 2015 decline in oil prices. The low for long commodity prices have contributed to lower than targeted inflation. Indeed, inflation remains below target for many central banks despite persistent expansionary monetary policy, capitalizing on both conventional and unconventional monetary policy tools (see Figure 1).

Figure 1: Trends in Commodity Prices



Source: OECD Statistics and CBUAE calculations

In September and October 2019, 10 central banks lowered interest rates to remedy anemic growth rates and help stimulate economic growth and hedge against external shocks, primarily attributed to slowdown in major advanced and emerging economies (see Table 1).[1]

Table 1: Central Bank Announcements (September and October)

	Announcement Date		New Rate	Previous Rate
United States	10/30/2019	↓	1.75 %	2.00 %
Russia	10/25/2019	↓	6.50 %	7.00 %
Turkey	10/24/2019	↓	14.00 %	16.50 %
Chile	10/23/2019	↓	1.75 %	2.00 %
South Korea	10/16/2019	↓	1.25%	1.50 %
India	10/4/2019	↓	5.15%	5.40 %
Australia	10/1/2019	↓	0.75 %	1.00 %
Mexico	9/26/2019	↓	7.75 %	8.00 %
China	9/20/2019	↓	4.20 %	4.25 %
Norway	9/19/2019	↑	1.50 %	1.25 %
Brazil	9/18/2019	↓	5.50 %	6.00 %

Source: Listed Central Banks' announcements

Looking ahead, major economic indicators are pointing to a synchronized slowdown —the IMF and the OECD are projecting a modest global growth of 3% and 3.4% in 2019 and 2020, respectively. The 2019 growth projection would be the lowest in a decade, since the Global Financial Crisis. On a country level, the expected output gap levels are generally negative up to end 2020, hinting to a prolonged period of low interest rates, even negative in some cases, in most advanced countries as well as in major emerging economies, namely China and India (see Table 2).

[1] Exceptions comprise the Bank of Canada, Bank of Japan and Bank of England, which maintained policy rates unchanged in October announcements.

When it comes to the GCC region and the UAE in particular, the fixed exchange rate policy has served the economy very well to anchor expectations and foster confidence in the stability of the domestic economy. The easing cycle that started in July 2019 will help support further non-energy growth recovery. The flexibility of wages and prices in the UAE has supported competitiveness as evident by the recent cycle of depreciation of the real effective exchange rate with respect to major trading partners. Combined with the plans to roll out the fiscal stimulus packages, the accommodative monetary conditions would support growth in the non-oil activity.

Table 2: Forecasted Output gap*

	2019	2020		2019	2020
Australia	-0.30	-0.07	Poland	0.03	-0.72
Austria	-0.71	-0.57	Portugal	-0.36	-0.27
Belgium	-0.43	-0.34	Slovak Republic	-0.14	-0.23
Canada	-0.38	0.34	Slovenia	-0.31	-0.56
Chile	1.02	0.95	Spain	-0.88	-1.15
Czech Republic	-1.22	-1.29	Sweden	-1.25	-1.29
Denmark	-0.01	-0.39	Switzerland	-0.75	-0.29
Estonia	-0.31	-0.75	Turkey	-7.39	-3.26
Finland	-0.57	-0.64	United Kingdom	-0.62	-0.86
France	-0.21	-0.25	United States	0.44	-0.10
Germany	-1.14	-0.69	**OECD - Total**	-0.52	-0.49
Greece	1.48	1.31	**Non-OECD Econ.**	-0.01	0.24
Hungary	0.20	-0.80	Argentina	-2.02	1.85
Iceland	-4.16	-2.79	Brazil	2.53	3.45
Ireland	-3.26	-3.86	China	-0.56	-0.74
Italy	-1.09	-0.57	Colombia	1.16	1.35
Japan	-0.48	-0.52	India	-0.44	-0.16
Korea	-0.47	-0.38	Indonesia	0.03	0.03
Latvia	-0.94	-0.88	Russia	0.91	1.60
Luxembourg	-0.64	-0.10	South Africa	0.21	0.77
Mexico	-0.94	-0.55	**Dynamic Asian Econ.**	-0.19	-0.45
Netherlands	-0.78	-0.95	**Other oil producers**	-0.30	0.46
New Zealand	-0.75	-0.94			
Norway	0.13	0.46	**World**	-0.22	-0.04

Source: OECD Statistics and CBUAE calculations
* The gap is calculated as a difference between the OECD forecast and the last 5-year average growth.

Chapter 2: Domestic Economic Developments

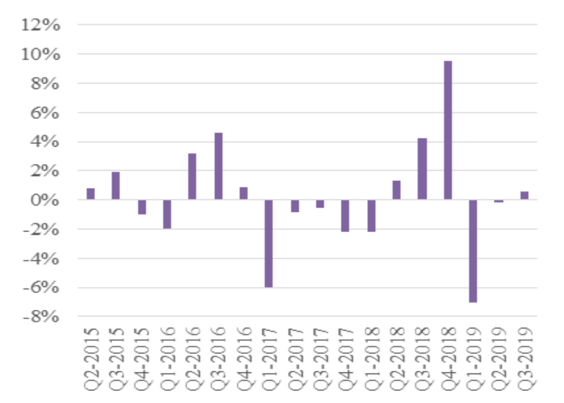
According to the quarterly CBUAE GDP growth estimate of non-oil activity for the UAE, the pace of economic growth moderately declined in the third quarter of 2019. Meanwhile, CPI inflation rates decreased further compared to the previous quarter, reflecting the movements of rent prices as well as fuel prices in the domestic market. However, employment remained robust for the third consecutive quarter. The AED appreciated in nominal terms, while depreciating in real terms.

2.1 Economic Activity and Growth

In 2019 Q3, oil prices declined following concerns about global economic growth with intensifying trade disputes between the US and China, uncertainties around Brexit, and a buildup in the US crude oil inventories (see chapter 1).

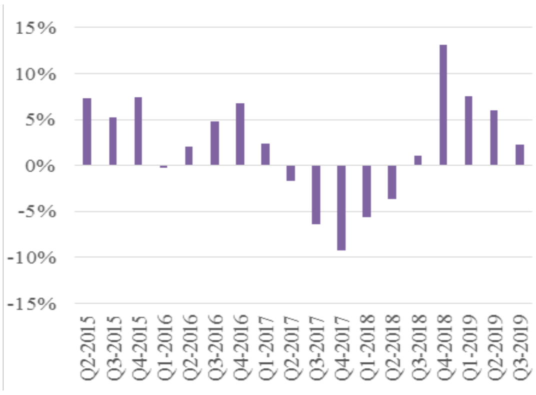
On the supply side, this quarter was marked by the attack that affected the state-owned Saudi Aramco processing facilities in September. In parallel, most of OPEC members (11 countries) were participating in production curbs. In contrast, six out of ten OPEC producers reduced output by more than promised, providing a counterweight to Russia's lack of conformity. In the UAE, oil production increased in the third quarter of 2019 Q-o-Q by 0.6%, averaging 3.07 mb/d (see Figure 2.1.a) compared to 0.2% Q-o-Q decline in the second quarter. On a yearly basis output increased by 6.0% and 2.3% in the second and the third quarters of 2019, respectively, due to the base effect of the declining output in the corresponding quarters of 2018 below the 3.0 mb/d threshold (see Figure 2.1.b).

Figure 2.1.a UAE Oil Production Growth (%, Q-o-Q)



Source: OPEC

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



Source: OPEC

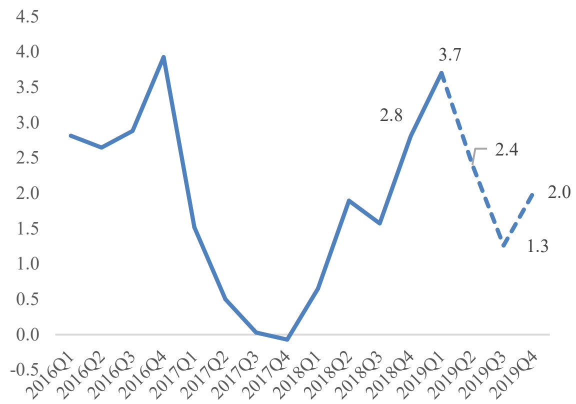
Estimated real growth in the UAE by CBUAE[2] exhibited a Y-o-Y growth of 1.3% in 2019 Q3 (see Figure 2.1.c).

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

Moreover, the non-oil real GDP is estimated to remain robust at a Y-o-Y growth level of 0.9% compared to an estimated growth of 1.8% in the second quarter (see Figure 2.1.d).

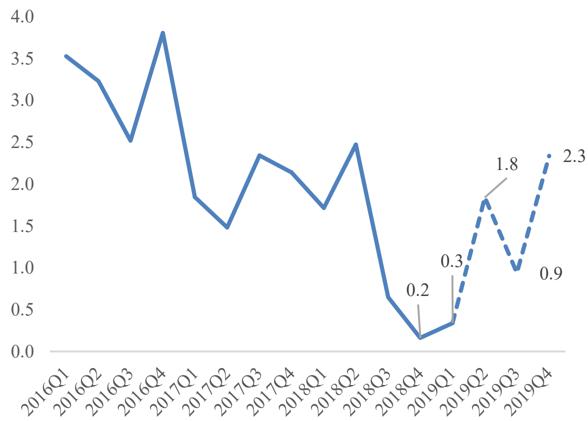
Economic sentiment is estimated to have moderated in the third quarter of the year based on the following indicators: (i) a reduction Y-o-Y in government spending by 1.4% in the second quarter of 2019, compared to an increase by 21.6% in the previous quarter (see Section 2.5); (ii) a weaker Purchasing Managers' Index (PMI), which dropped to 52.6 in 2019 Q3, compared to 58.2 in the second quarter; and (iii) a drop in the real estate sector by 7.5% Y-o-Y. In parallel, robust performances are registered in the labor and credit markets. In particular, employment in the private sector increased by 1.1%, compared to a 1% rise in the previous quarter while total credit expanded by 5%, compared to its growth rate of 4.3% in 2019 Q2.

Figure 2.1.c Overall GDP Growth (Y-o-Y)



Source: FCSA for 2016Q4–2019Q1 and CBUAE estimates and projections for 2019 Q2-Q4.

Figure 2.1.d Non-Oil GDP Growth (Y-o-Y)



Source: FCSA for 2016Q4–2019Q1 and CBUAE estimates and projections for 2019 Q2-Q4.

The overall real GDP is projected to grow by 2.3% in 2019 driven by the growth in the non-oil sector—expected to reach 1.4% in 2019 compared to 1.3% in 2018—and by the oil sector— growth forecast of 4.9% in 2019 compared to 2.8% in 2018. Improved outlook for growth is due to expected rising public and private spending at the Federal and Emirate levels, higher investment ahead of the Expo 2020 and continued regional economic recovery in light of the monetary policy easing in the US.

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

Item	2018	2019				2019
		Q1	Q2	Q3	Q4	
Overall GDP	1.7%	3.7%	2.4%	1.3%	2.0%	2.3%
Non-oil GDP	1.3%	0.3%	1.8%	0.9%	2.3%	1.4%
Oil GDP	2.8%	12.4%	3.7%	2.0%	1.3%	4.9%

Source: FCSA for 2018 and 2019 Q1 and CBUAE estimates and projections for the whole 2019 and 2019 Q2-Q4.

Box 2 describes the recent developments in the real estate market in the UAE.

Box 2: Recent Developments in the Residential Real Estate Market

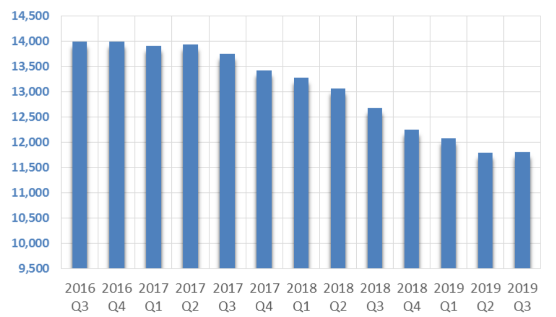
According to recent data from REIDIN[3], the UAE average residential house prices continued to decline in the third quarter of 2019 in both Dubai and Abu Dhabi, in line with the long-term trend. The drop in average house prices in annual terms decelerated from the previous quarter in Dubai, while it remained unchanged in Abu Dhabi. Average rents continued to decrease, however, at a slower pace in both Emirates, compared to the previous quarter.

Dubai average residential property prices declined by 6.9% from a year ago. In quarterly terms, prices slightly increased. The drop was higher in Abu Dhabi on Y-o-Y basis, where the average of property prices declined by 8.2% from a year ago, however Q-o-Q the drop was of 1.9%. The rental yield, which measures the rate of income return over the cost associated with an investment property, improved in Abu Dhabi, reaching 6.88%, while declining in Dubai to 6.7%.

Dubai residential Market

In the third quarter of 2019, the real estate property price, which measures the average sample price in dirham per square meter of residential properties, decreased by 6.9% Y-o-Y compared to 9.7% decline in the previous quarter (Figure 1). Prices increased, Q-o-Q, corresponding to the first growth over two consecutive quarters since 2016 Q2.

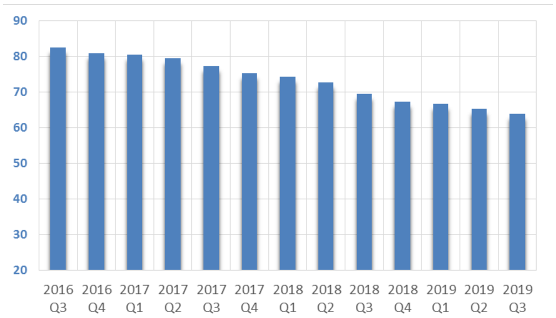
Figure 1: Dubai Residential Sale Prices (AED/SQM)



Source: REIDIN

The Dubai market continues to exhibit decline in rent per square meter (Figure 2), due to excess supply. The average rent price per square meter declined by an annual rate of 8.1% in the third quarter of 2019, following an annual decrease of 10% in the previous quarter.

Figure 2: Dubai Residential Rent Prices (AED/SQM)

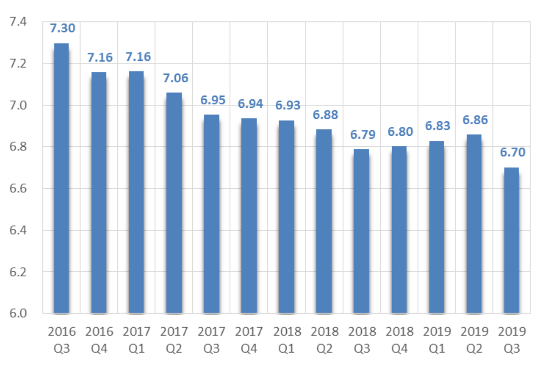


Source: REIDIN

As regard to the yield on investment in Dubai's real estate market, it deteriorated to 6.7% from 6.86% in 2019 Q2 (Figure 3). This trend was the result of relatively lower drop in sale prices compared to rents.

[3] REIDIN Residential Sales Price Index series are calculated on a monthly basis and cover 21 areas and 6 districts in Dubai. For Abu Dhabi, the indices cover 7 areas and 5 districts.

Figure 3: Dubai Rental Yield (%)

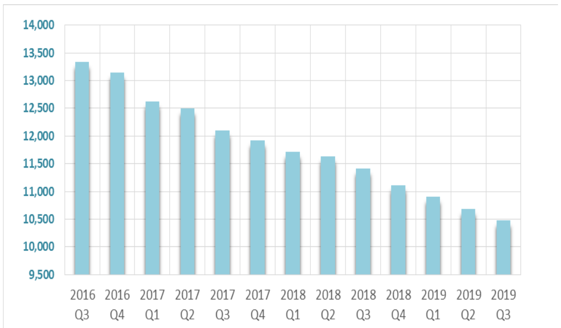


Source: REIDIN

Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index exhibited a continued fall in residential property price at a rate of 8.2% Y-o-Y in the 2019 Q3, same as in the previous quarter (Figure 4). On a quarterly basis prices declined by 1.9%.

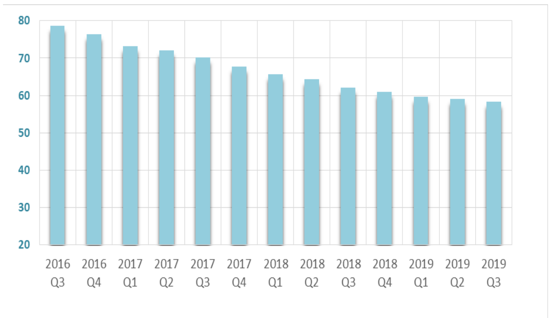
Figure 4: Abu Dhabi Residential Prices (AED/SQM)



Source: REIDIN

As for the rental market, the rent values per square meter in Abu Dhabi continued to decline by an annual rate of 6.2% on average in the third quarter of 2019, after a reduction of 8.1% in the previous quarter. This trend is reflecting the impact of softer, but improving, job market, which continues to weigh in on demand in the housing market (Figure 5).

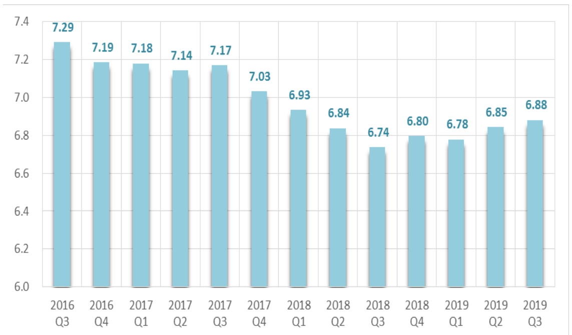
Figure 5: Abu Dhabi Residential Rent Prices (AED/SQM)



Source: REIDIN

Concerning the rental yield, Abu Dhabi registered a yield of 6.88% for 2019 Q3, the highest yield in one and a half years, compared to the previous quarter when it was at 6.85% (Figure 6).

Figure 6: Abu Dhabi Rental Yield (%)



Source: REIDIN

2.2 Consumer Price Index and Inflation

The decline in oil prices Y-o-Y by 10.4% during the first three quarters of 2019 as well as the continued fall in rent prices have affected inflation in the UAE as it declined in the third quarter of 2019 Y-o-Y by 2.1% compared to a drop of 1.6% in the previous quarter (see table 2.2 and Figure 2.2).

Table 2.2 UAE CPI Inflation (%, Y-o-Y)

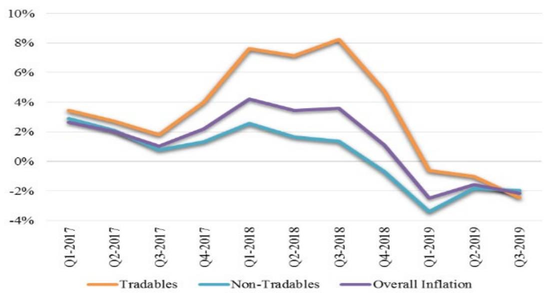
	Weight	Q2-19		Q3-19	
	%	Y-o-Y	Contribution	Y-o-Y	Contribution
Total Inflation	100	-1.6	-1.6	-2.1	-2.1
Tradables	**34**	**-1.0**	**-0.3**	**-2.5**	**-0.8**
Food and soft drinks	14.3	-1.3	-0.2	-1.6	-0.2
Beverages and tobacco	0.3	2.2	0.0	0.6	0.0
Textiles, clothing and footwear	3.2	-4.9	-0.2	-6.0	-0.2
Furniture and household goods	5.6	2.1	0.1	0.1	0.0
Transportation	7.3	-1.0	-0.1	-5.5	-0.4
Miscellaneous goods and services	3.2	-1.6	-0.1	0.2	0.0
Non-Tradables	**66**	**-1.8**	**-1.2**	**-2.0**	**-1.3**
Housing	34.1	-5.5	-1.9	-4.7	-1.6
Medical care	1.4	-0.1	0.0	0.0	0.0
Transportation	7.3	-1.0	-0.1	-5.5	-0.4
Communications	5.4	0.4	0.0	0.3	0.0
Recreation and culture	3.2	15.7	0.5	20.5	0.7
Education	7.7	1.3	0.1	0.8	0.1
Restaurants and hotels	4	5.2	0.2	-0.5	0.0
Miscellaneous goods and services	3.2	-1.6	-0.1	0.2	0.0

Source: Federal Competitiveness and Statistics Authority (FCSA)

The decline in tradable prices—accounting for 34% of the CPI consumption basket—reached 2.5% on a Y-o-Y basis and was mainly attributed to the decline in prices of food and soft drinks; transportation; and textile, clothing and footwear. The decline was a result of the price movements of some basic commodity prices in international markets, such as wheat, rice and corn.

Moreover, the prices of textiles clothing, and footwear as well as in the group of transportation decreased Y-o-Y by 6% and 5.5%, respectively. However, beverages and tobacco, textiles and clothing, furniture and household goods and miscellaneous experienced an increase Y-o-Y, which was not significant enough to overturn the deflationary effect.

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



Source: Federal Competitiveness and Statistics Authority (FCSA)

Non-tradable prices—accounting for 66% of the CPI consumption basket—recorded a persistent decline since end-2018 as a result of the fall in the housing group prices, which declined in 2019 Q3, Y-o-Y, by 4.7% compared to a sharper decline of 5.5% in the previous quarter.

The main contributor of the housing price decline was the rent of residential and retail units, which slowed down Y-o-Y by 6.2% and 8.1% in Abu Dhabi and Dubai during 2019 Q3 compared to a decline of 8.1% and 10% in the previous quarter, respectively.

Moreover, prices of the groups of transportation and restaurants and hotels declined by 5.5% and 0.5%, respectively, in 2019 Q3, compared to a decline of 1% for transportation and increase by 5.2% for restaurants and hotels in the previous quarter.

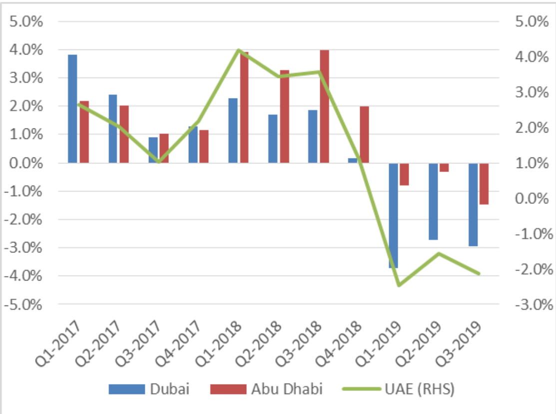
Inflation, excluding housing and transportation, eased in the third quarter of 2019 Y-o-Y by 1.3% compared to an increase of 0.9% in the previous quarter.

Box 3 below discusses and compares inflation developments by Emirate, while Box 4 describes the relation between innovation and inflation.

Box 3: Inflation in the UAE: Comparison by Emirate

During the third quarter of 2019, inflation in the UAE reached -2.1%, on a Y-o-Y basis, compared to a smaller decline of 1.6% in the previous quarter. The continued decline in the rent prices as well as the softening in domestic fuel prices contributed to the decline of prices compared to the previous year.

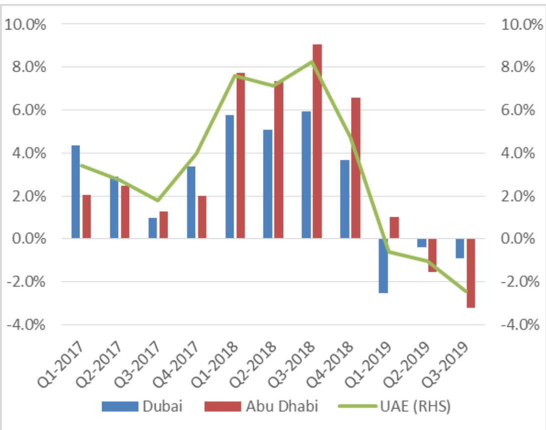
Figure1 Quarterly Y-o-Y Headline Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD and DSC

At the Emirate level, inflation registered Y-o-Y -1.5% and -3% in Abu Dhabi and Dubai, respectively, compared to a decline of 0.3% and 2.7% in the previous quarter (see Figure 1).

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

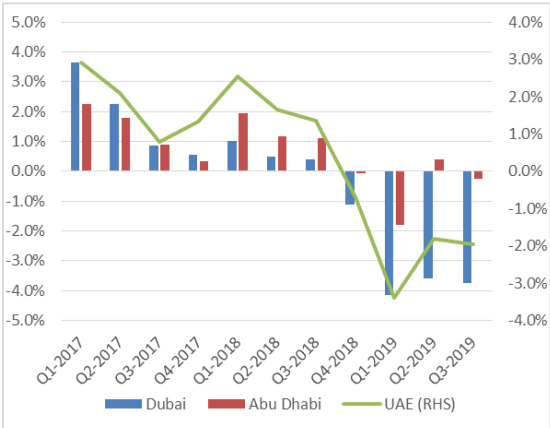


Source: FCSA. SCAD, DSC and CBUAE

The negative CPI inflation in 2019 Q3 resulted from the decline in the tradable and non-tradable prices Y-o-Y by 0.9% and 3.7%, respectively, in Dubai. On the other hand, the drop of tradable and non-tradable prices was by 3.2% and 0.2%, respectively, in the Emirate of Abu Dhabi.

The decline in the tradable prices in the UAE came as a result of the decreasing tradable inflation in Abu Dhabi and Dubai Y-o-Y by 3.2% and 0.9%, respectively (see Figure 2). The Emirate of Abu Dhabi witnessed larger declines in the groups of food & beverages and clothing & footwear, as well as transportation, which declined by 3.3%, 7% and 6.8%, respectively, compared to an increase in food prices by 1.1% and a milder drop in clothing and footwear and transportation in the Emirate of Dubai.

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



Source: FCSA. SCAD, DSC and CBUAE

On the other hand, non-tradable prices witnessed divergent levels in both emirates as it slightly declined by 0.2% in Abu Dhabi and more significantly in Dubai by 3.7%. Housing prices continued their downward trend in both emirates, declining by 3.6% and 6.1% in Abu Dhabi and Dubai, respectively. Moreover, the emirate of Abu Dhabi witnessed a significant increase in prices for the groups of recreation and culture, surging Y-o-Y by 30.4%, compared to a rise of 4.7% in Dubai (see Figure 3).

One of the reasons for differences in inflation rates across Emirates is attributed to the weights of the different components in the consumption basket (Table 4). For instance, the Transportation category, which accounts for a large weight in the tradeable inflation, has a lower weight in Dubai than in Abu Dhabi as well as in the UAE aggregate consumption basket. Further, in Dubai, the Housing category has a larger weight compared to Abu Dhabi and the UAE.

Table 1 Weights Assigned for the Different Categories per Statistic Authority (in%)

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

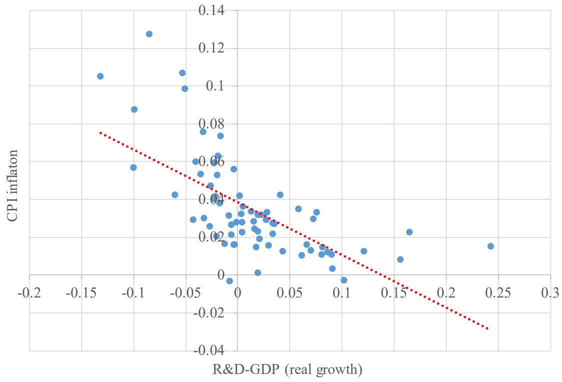
Source: FCSA. SCAD and DSC

Box 4: Innovation and Inflation

Looking at the historical relation between technological innovation and the evolution of inflation, findings suggest a negative relation between the two variables. Further, innovation—generally measured by Research and Development (R&D) spending—seems to be one of the major drivers of the decline in inflation in many countries around the world. Positive innovation and technology generally lead to higher labor productivity, which generates an increase in output supply and a decline in prices.

Focusing on recent evidence over a long time span, the last half century was characterized by remarkable innovations—including new computers, telecommunication, and networking technologies—data from the U.S. unambiguously illustrates this negative correlation (see Figure 1).

Figure 1: R&D Real Growth and Inflation in the U.S.



Source: FRB of St. Louis Economic Data and CBUAE calculations

As R&D spending time series are not available for the GCC, this study adopts as a proxy for technology and innovation that comprises the high-technology exports (measured as a share of non-oil manufactured exports). This category of exports comprises products with R&D intensity such as aerospace, computers, pharmaceutical, scientific instruments, and electrical machinery.[4] Table 1 shows that all countries in the region witnessed positive progress in the degree of technology sophistication of the exported manufactured goods, particularly in the UAE where high-technology exports tripled during the most recent decade, reaching 4.42% in 2017.

Table 1: High-Technology Exports in the GCC

	High-technology exports (% of manufactured exports)		
	1990-1999	2000-2009	2010-2017
Bahrain	2.71	0.30	0.67
Kuwait	3.40	0.26	2.31
Oman	8.23	1.73	2.80
Qatar	0.00	0.02	0.45
Saudi Arabia	0.41	0.60	0.97
United Arab Emirates	**0.33**	**1.47**	**4.42**

Source: Science and Technology World Bank database

In order to analyze the impact of innovation on inflation in the GCC, a panel regression model is estimated including 6 cross-sections. Inflation is assumed to be explained by real GDP growth, oil prices, and innovation.[5]

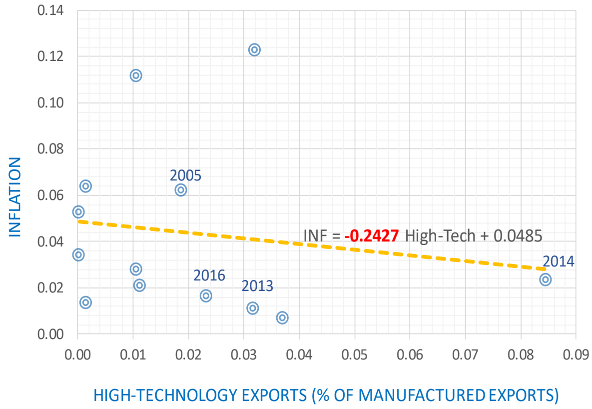
Based on the estimated model, a 1% increase in the share of high-technology exports implies a reduction in inflation of 0.12%, which confirms the common wisdom that innovation reduces production costs and prices. Further, the elasticity between innovation and inflation seems to be higher in the GCC compared to the G7 countries, which corresponds to -0.12 and -0.03, respectively. The rationale could be related to a non-linear relation between the two variables that seems to weaken once a high degree of sophistication is reached—i.e., 15.1% in the G7 versus 2.6% in the GCC in 2017.

Focusing on the UAE, the implied relation between inflation and technology innovation is stronger than other countries in the GCC (in absolute terms). As illustrated in Figure 2, inflation rates in the UAE is twice more responsive to the share of high-technology exports.

[4] Data are available for the GCC from 1988 until 2017 and provided by the Science and Technology World Bank database.

[5] An intercept is also introduced as well as a lag of inflation to account for autocorrelation. The model with a fixed effect was selected based on the Hausman test.

Figure 2: Innovation and Inflation in the UAE



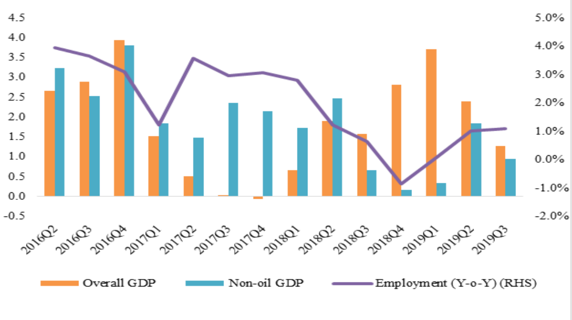
Source: Science and Technology World Bank database and CBUAE estimations

Interestingly, the two countries with the highest inflation elasticities—namely the UAE and Oman—are characterized with the highest levels of high-technology export shares in the region. In addition, the two countries account for the lowest shares of minerals and crude material products in total exports.

2.3 Employment and Labor Market Dynamics

This section covers only employment in the private sector based on data provided by the Ministry of Human Resources and Emiratization (MOHRE).[6] The employees in the private sector represented about 81.5% of total registered employees at MOHRE at the end of 2018 compared to 80.7% at the end of 2017. Positive macroeconomic developments during the first three quarters of 2019 were reflected on the labor market as employment in the private sector increased by 1.1% in 2019 Q3 compared to an increase of 1% in the previous quarter (Figure 2.3.a).

Figure 2.3.a GDP Growth and Employment (Y-o-Y, %)



Source: MOHRE, FCSA for GDP growth for 2016 Q2 – 2019 Q1 and CBUAE estimate for GDP growth for 2019 Q2&Q3

The real estate and business services sector and other sectors increased Y-o-Y in 2019 Q3 by 6% and 9.3% compared to a similar rise of 5% and 8.2% in the previous quarter, respectively (Table 2.3).

Moreover, the construction sector—32.7% of total private sector employment—declined Y-o-Y by 2.3% in 2019 Q3 compared to the drop of 1.3% and 1.1% during the first and the second quarters, respectively. Employment in the services sector—21.6% of total private sector employment—has shown some recovery while remaining negative as it fell by 1% Y-o-Y in 2019 Q3 compared to a decline by 1.8% and 1.1% during the first and the second quarters, respectively.

Table2.3 Employment Growth by Sector

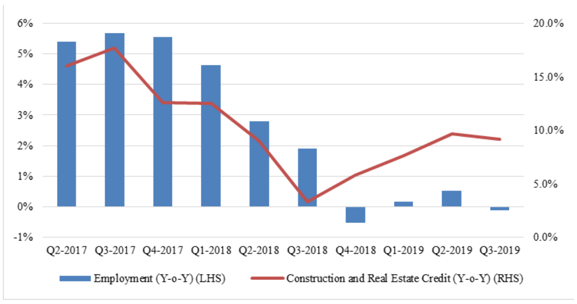
Sector	Share in Employment	Q-o-Q Growth	Contribution to Growth Q-o-Q	Y-o-Y Growth	Contribution to Growth Y-o-Y
Construction	32.7%	-1.3%	-0.4%	-2.3%	-0.8%
Services	21.6%	-0.4%	-0.1%	-1.0%	-0.2%
Manufacturing	9.2%	-0.2%	0.0%	0.0%	0.0%
Real estate and Business services	12.7%	1.6%	0.2%	6.0%	0.8%
Transport, Storage and Communication	6.9%	1.0%	0.1%	-1.5%	-0.1%
Other sectors	16.9%	1.8%	0.3%	9.3%	1.6%
Total Employment	**100.0%**	**0.0%**	**0.0%**	**1.1%**	**1.1%**

Source: MOHRE and CBUAE

Furthermore, employment in the manufacturing sector, which constitutes around 9.2% of total employment in the private sector, remained unchanged on a Y-o-Y basis in 2019 Q3 compared to a decline of 0.1% in the previous quarter. In addition, the transport, storage and communication sector, which has the lowest share of private sector employment at 6.9%, declined by 1.5% Y-o-Y compared to a decline of 3.5% in the previous quarter.

The construction and real estate and business services sectors together absorb 45.4% of the labor force in the UAE. Employment in both sectors declined by 0.1% Y-o-Y in the third quarter of 2019, against a rise of 0.5% Y-o-Y in the previous quarter. Credit extended to these sectors rose Y-o-Y by 9.2% at the end of the third quarter of 2019 compared to an increase of 9.7% in the previous quarter (Figure 2.3.b). Box 5 illustrates the developments in the labor market by Emirate and by categories of workers.

Figure 2.3.b Employment and Domestic Credit Developments in the Construction and Real Estate sector (%, Y-o-Y)



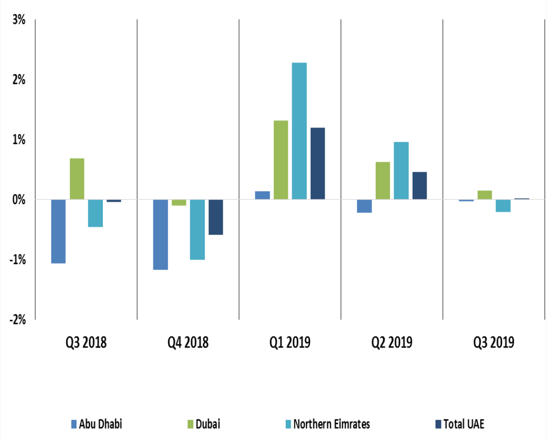
Source: MOHRE and CBUAE

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

Box 5: Developments in the Labor Markets by Emirate

The labor market in the UAE encompasses three main regional groups: Abu Dhabi, Dubai and Northern Emirates; and covers the private sector (excluding the Free Zones). Data from the Ministry of Human Resources and Emiratization show that the total private sector employment in the UAE at the end of Q3 of 2019 was 5.08 million, of which 26.9% are based in Abu Dhabi, 51.7% are in Dubai and 21.4% are in the Northern Emirates.

Figure 1 Employment Change (%, Q-o-Q)



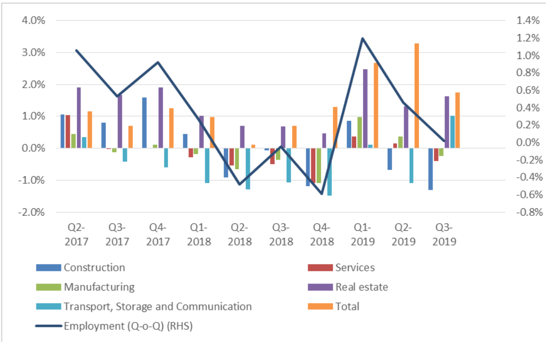
Source: Ministry of Human Resources and Emiratization.

In Abu Dhabi (Figure 1), employment remained unchanged Q-o-Q in 2019 Q3, compared to a drop of 0.2% in the previous quarter. This was due to an increase of employment in the manufacturing, real estate and business services and other sectors by 0.6%, 1.8% and 0.7%, respectively, Q-o-Q, which was offset by a drop in construction, services and transportation by 1.2%, 0.9% and 0.1%, respectively, over the same time span. These sectors represent 46.3% of total private employment (77% of total employment) in the emirate of Abu Dhabi.

In contrast, employment in Dubai (Figure 1) increased Q-o-Q by 0.1% in 2019 Q3, compared to a growth of 0.6% in the previous quarter. This increase was influenced by the significant rise in job opportunities in the real estate and business services sector, transportation and other sectors, which increased by 1.6%, 1.7% and 3.1%, respectively, Q-o-Q. The growth in these sectors was partially offset by a drop in construction, services and manufacturing by 1.5%, 0.4% and 0.6%, respectively over the same period. The sectors registering an increase in hiring in 2019 Q3 represent 35.7% of total employment in Dubai.

In the Northern Emirates (Figure 1), employment decreased Q-o-Q by 0.2% in the third quarter of 2019. This drop was driven by the construction and manufacturing sectors, declining by 1% and 0.4%, respectively, Q-o-Q. These two sectors employ more than 50% of the total employees in the private sector. However, the increase in employment in the real estate and business services, transportation and other sectors by 1.1%, 0.3% and 0.8%, respectively, did not fully compensate for the drop in construction and manufacturing. In addition, employment in the services sector remained unchanged, compared to 2019 Q2.

Figure 2 Employment Change by Sector (%, Q-o-Q)



Source: Ministry of Human Resources and Emiratization.

Overall, at the aggregate level, employment in the UAE remained unchanged Q-o-Q in 2019 Q3 (Figures 1 and 2), compared to an increase of 0.5% in the previous quarter.

On a sectoral level, real estate and business services, transportation and other sectors increased by 1.6%, 1% and 1.8%, respectively, Q-o-Q, as of 2019 Q3. However, this was offset by a drop in the construction, services and manufacturing sectors by 1.3%, 0.4% and 0.2%, respectively. The sectors experiencing growth account for 36.5% of total employment in the UAE.

Developments in the Labor Market (Working Permits):

According to data from the Ministry of Human Resources and Emiratization, total net newly issued work permits in the UAE increased by 110,912 in the first nine months of 2019 compared to the same period of the previous year. The Emirate of Dubai registered the highest increase (59.5% of the net new permits for the year to date in the UAE) with 82,285 net new work permits in the year to September 2019, compared to 65,663 in the previous year, which corresponds to a rise of 25.3% (Table 1).

In Abu Dhabi, total net work permits issued until the end of 2019 Q3 has significantly improved compared to the same period of last year, reaching 12,650 net new work permits (9.1% of the total net new permits for the year to September 2019). The new permits experienced a growth of 27.5%. Similarly, newly issued work permits in the Northern Emirates increased by 36.5% in the first nine months of 2019 compared to a year ago. The net work permits for the first three quarters for the five emirates were at 34,857 (see Table 1).

Table 1: Work Permits by Emirate

Period		Jan-18 to Sep-2018	Jan-19 to Sep-2019	Change (%)
Abu Dhabi	New	220,191	280,757	27.5
	Cancelled	255,909	268,107	4.8
	Net	-35,718	12,650	-----
Dubai	New	534,935	608,470	13.7
	Cancelled	469,272	526,185	12.1
	Net	65,663	82,285	25.3
Northern Emirates	New	175,069	239,032	36.5
	Cancelled	201,066	204,175	1.5
	Net	-25,997	34,857	-----
Total UAE	New	930,195	1,128,259	21.3
	Cancelled	902,750	989,902	9.7
	Net	27,445	138,357	404.1

Source: Ministry of Human Resources and Emiratization

The labor market in the UAE is classified into seven main types of positions: managers, professionals, technicians, clerks, services and sales professions, skilled laborers and unskilled laborers. Data from the Ministry of Human Resources and Emiratization show that almost all work categories registered an increase in net work permits in the first nine months of 2019 compared to a year ago, except for professionals (Table 2). The latter have decreased by 8.8%. For managers, clerks, services and sales professions and unskilled blue color workers, the figures more than doubled in the first nine months of 2019 compared to the previous year (see Table 2).

Table 2: Work Permits by Type of Position

Period		Jan-18 to Sep-2018	Jan-19 to Sep-2019	Change (%)
Managers	New	34,697	44,330	27.8
	Cancelled	30,519	32,967	8.0
	Net	4,178	11,363	172.0
Professionals	New	98,671	101,849	3.2
	Cancelled	84,075	88,544	5.3
	Net	14,596	13,305	-8.8
Technicians	New	53,538	58,111	8.5
	Cancelled	51,692	55,666	7.7
	Net	1,846	2,445	32.4
Clerks	New	76,398	97,134	27.1
	Cancelled	72,495	76,781	5.9
	Net	3,903	20,353	421.5
Services and sales professions	New	159,729	189,779	18.8
	Cancelled	146,606	155,329	5.9
	Net	13,123	34,450	162.5
Blue Color Skilled Labor	New	281,237	332,206	18.1
	Cancelled	296,360	330,324	11.5
	Net	-15,123	1,882	-----
Blue Color Unskilled Labor	New	225,925	304,850	34.9
	Cancelled	221,006	250,291	13.3
	Net	4,919	54,559	1009.1
Total	New	930,195	1,128,259	21.3
	Cancelled	902,753	989,902	9.7
	Net	27,442	138,357	404.2

Source: Ministry of Human Resources and Emiratization

During the first three quarters of 2019, and in line with the deflationary pressures, the most categories of workers experienced a decline in average salaries, compared to the previous year, attesting to flexibility in the labor market in support of competitiveness.

2.4 Exchange Rate Fluctuations

In 2019 Q3, the dirham appreciated against the currencies of the top-10 non-dollarized import partners by 0.68% Q-o-Q and by 1.1% Y-o-Y (Table 2.4.a). Against the currencies of the top-10 non-oil non-dollarized export partners, the depreciation was of 0.11% Q-o-Q, while it appreciated by 0.13% Y-o-Y (Table 2.4.b).

Table 2.4.a Dirham Appreciation Against Currencies of Top Non-Dollarized Import Partners (%)

Imports	Share of total imports	Q-o-Q		Y-o-Y	
		Q2 2019	Q3 2019	Q2 2019	Q3 2019
China	15.5	1.12	2.88	6.95	3.12
India	9.4	-1.30	1.31	3.79	0.43
Japan	5.6	-0.26	-2.35	0.69	-3.76
Germany	4.5	1.04	1.10	6.02	4.64
UK	3.1	1.40	4.25	5.84	5.79
Vietnam	3.1	0.44	-0.38	2.20	-0.06
Italy	2.7	1.04	1.10	6.02	4.64
France	2.7	1.04	1.10	6.02	4.64
Switzerland	2.4	0.54	-1.65	1.74	0.22
South Korea	2.3	3.64	2.44	7.92	6.56
Weighted Average	51.4	0.29	0.68	2.54	1.10

Source: Data on Import shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2018. Data for the bilateral exchange rates are the quarterly average observations of monthly data, recorded and reported by Bloomberg.

Bilateral exchange rates show that the dirham appreciated, Q-o-Q, mainly against the pound sterling (by 4.25%), the Chinese yuan (by 2.88%), the Korean won (by 2.44%), the Indian rupee (by 1.31%) and the euro (by 1.1%). Furthermore, the dirham depreciated Q-o-Q mainly against the Turkish lira (by 3.34%), the Egyptian Pound (by 2.87%), the Japanese yen (by 2.35%), the Swiss franc (by 1.65%) and Iraqi dinar (by 1.33%) compared to a smaller depreciation or appreciation against these currencies, with exception of the Egyptian pound, where depreciation Q-o-Q was bigger in 2019 Q2.

Table 2.4.b Dirham Appreciation Against Currencies of Top Non-Dollarized Partners for Non-Oil Exports (%)

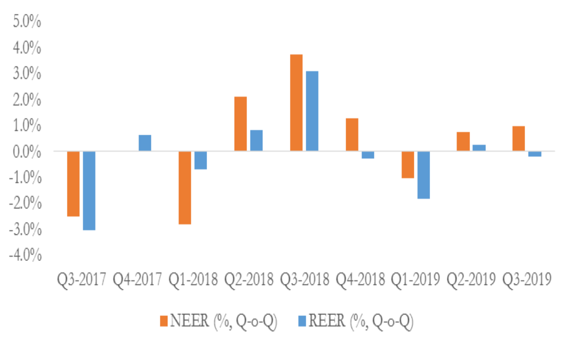
Exports	Share of total exports	Q-o-Q		Y-o-Y	
		Q2 2019	Q3 2019	Q2 2019	Q3 2019
India	8.7	-1.30	1.31	3.79	0.43
Turkey	5.2	9.38	-3.34	34.31	-0.03
Kuwait	5.1	0.20	0.00	0.89	0.40
Iraq	4.4	0.54	-1.33	0.71	-0.67
Switzerland	3.9	0.54	-1.65	1.74	0.22
China	2.5	1.12	2.88	6.95	3.12
Egypt	1.9	-3.44	-2.87	-4.36	-7.64
Netherlands	1.9	1.04	1.10	6.02	4.64
Singapore	1.8	0.61	0.91	2.13	0.55
Germany	1.6	1.04	1.10	6.02	4.64
Weighted Average	36.9	0.44	-0.11	2.60	0.13

Source: Data on Import shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2018. Data for the bilateral exchange rates are the quarterly average observations of monthly data, recorded and reported by Bloomberg.

Using non-oil export weights, the dirham experienced a Q-o-Q depreciation of 0.11% against the currencies of the top-10 non-dollarized non-oil export partners (see Table 2.4.b.) compared to a Q-o-Q appreciation of 0.44% during the previous quarter. The depreciation was mainly due to the appreciation of the Turkish lira, the Egyptian pound and the Swiss Franc. The dirham appreciation against the Indian rupee is the result of the slower pace of growth in India as well as the escalation of trade disputes between China and the US, which has had a negative impact on the Indian economy.

Accounting for all of the UAE's trading partners, the Nominal Effective Exchange Rate (NEER) has displayed the same pattern of appreciation relative to a basket of the weighted average of the currencies of major import partners. In particular, the average NEER increased by 1% in the third quarter of 2019, compared to an appreciation of 0.8% in the previous quarter (see Figure 2.4).

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



Source: Bank for International Settlement (BIS)

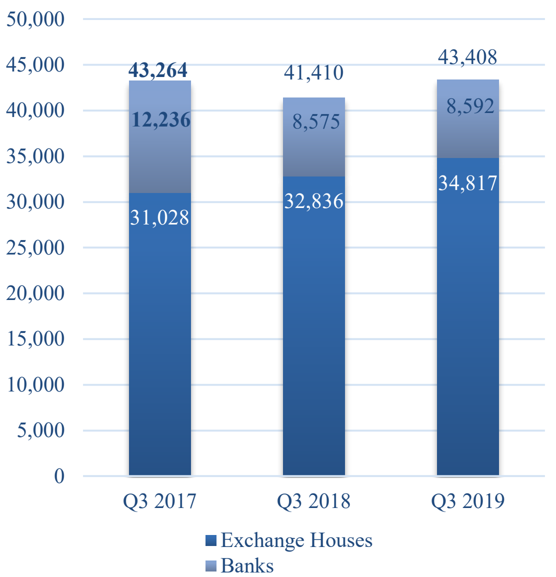
In real terms, the Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, depreciated by 0.2% in the third quarter of 2019 compared to an appreciation of 0.3% in the previous quarter. The mild depreciation in the REER came due to the deflationary cycle in the UAE offsetting the nominal Dirham appreciation.

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

Box 6: Outward Personal Remittances from the UAE

The outward personal remittances, based on data reported by banks and exchange houses, capture expatriates as well as personal transfers by UAE nationals. During July-September 2019, remittances increased by 4.8% or AED 2.0 billion compared to the same period of 2018 (Figure 1). During the third quarter of 2019, the outward personal remittances that were settled through the banks slightly declined by 0.2% or AED 16.8 million. Meanwhile, the outward personal remittances that were settled through the exchange houses registered an increase of 6.0% or AED 2.0 billion, compared to the same period of 2018.

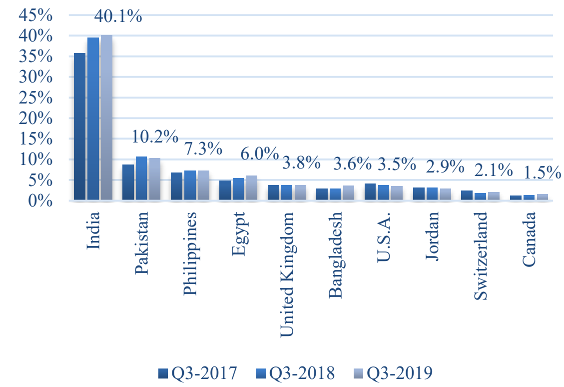
Figure 1: Evolution of Outward Personal Remittances Settled Through Banks and Exchange Houses, July-September 2017-2019 (AED Billions)



Source: CBUAE

The highest destination country for outward personal remittances during July-September 2019 was India (40.1%) (Figure 2). This high share is in accordance with the significant share of expats from India working in the UAE. According to the latest (January 2019) UAE population statistics published by the Global Media Insight, 59.5% of the expat population in the UAE originate from South Asian countries, and expats from India account for 27.5% of the total expat population in the UAE. The next five most important countries in the share of outflows of personal remittances were Pakistan (10.2%), Philippines (7.3%), Egypt (6.0%), the U.K. (3.8%), and Bangladesh (3.6%).

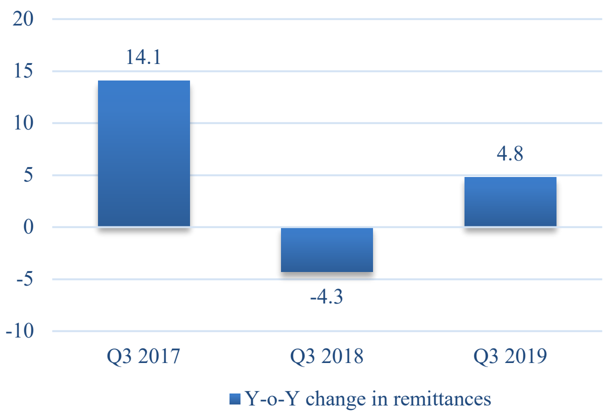
Figure 2: Share of the Major Countries for Outward Personal Remittances during July-September 2017-2019 (percentage of total, exchange houses and banks)



Source: CBUAE

The annual growth rate of outward personal remittances during July-September 2019 was recorded at 4.8% (Figure 3), a significant increase compared to the growth for the same period in 2018 (at negative 4.3%). This increase is in line with the increase in employment in the UAE during 2019 compared to 2018.

Figure 3. Annual Percentage Change of Total outward Personal Remittances



Source: CBUAE

Box 7: Tourism Activity in the UAE

The analysis focuses on developments in tourism activity in the Emirates of Dubai and Abu Dhabi, the two major tourist destinations in the UAE during January-September 2019. For the Dubai Emirate, the Dubai Corporation of Tourism and Commerce Marketing (DTCM) publishes data on international guests covering international tourist arrivals to Dubai regardless of whether they stay at hotels in Dubai or not. On the other hand, Abu Dhabi Tourism and Culture Authority publishes data on international guests covering only tourists that stay at Abu Dhabi hotels (hotel guests).

The total number of international tourist arrivals to the Emirate of Dubai during the period of January-September 2019 registered increase of 4.3% (increased by around 500,000) compared to the same period in 2018 (Figure 1). Based on the data published by DTCM, it is estimated that approximately 56.3% (6.8 millions) of tourists that arrived in Dubai during the period of January-September 2019 stayed at hotels in Dubai. The calculated figures for international hotel guests in the Emirate of Dubai registered an increase of 8.7% (increased by around 550,000) compared to the same period in 2018.

Figure 1: International Tourist Arrivals to Dubai and International Hotel Guests in Dubai and Abu Dhabi January-September 2018-2019 (in Millions)

Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority
* Staff calculation, based on data published by Dubai DTCM (occupied room nights divided by guest's length of stay).

Similarly, the international hotel guests in the Emirate of Abu Dhabi registered increase of 2.9% (around 106,000) compared to the same period in 2018.

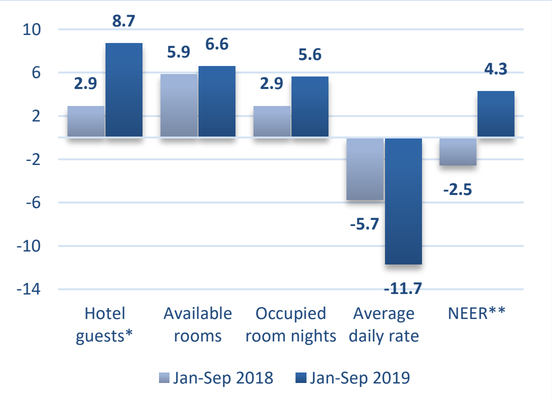
The data for the Dubai Emirate continue to indicate a growing trend in the number of international hotel guests during the first nine months of 2019 as compared to 2018. However, competitiveness required increasing discounts to improve occupancy of existing hotel capacity. In this connection, the revenue per available room significantly decreased compared to the same period in 2018 reflecting continued discounts offered by hotels in Dubai. This strategy aimed at boosting demand and increased the occupied room nights at a faster rate during January-September 2019 (5.6%) compared to the rate of growth during the same period in 2018 (2.9%), which compensated for the continuing decline in revenue per available room (Figure 2.a.).

Although international hotel guests in Abu Dhabi show a slowdown (2.9% increase January to September in the current year, as compared to 3.5% in the first half of 2019 and 4% in the first nine months of the previous year), in terms of occupancy, all indicators point to an ascendant trend during 2019. Combined with higher average daily rate during the reference period, total revenues of hotels in Abu Dhabi, significantly increased, as compared to the similar period of the previous year (Figure 2.b.). International events organized in Abu Dhabi during the first nine months of 2019, such as AFC Asian Cup 2019 (Jan-Feb 2019), IDEX/NAVDEX 2019 (Feb 2019), Special Olympic Games (March 2019), FIA World Rally cross (5-6 April 2019), and Abu Dhabi International Book Fair (24-30 April 2019), Abu Dhabi Showdown Week (1-7 September 2019) indicate a vibrant strategy to attract international guests.

Countries that are the major markets for inbound tourism to Dubai recorded increase in the arrival of international tourists during January-September 2019 compared to the same period in 2018, with the notable increase of Philippines (28.5%) and Oman (28.4%), followed by China (13.7%), Saudi Arabia (2.4 %), Germany (1%), and USA (0.6%). Other countries, such as: India (-5.2%), Russia (-5.9%), U.K. (-1.7%), and Pakistan (-0.3%) continued to evidence decrease in the same period.

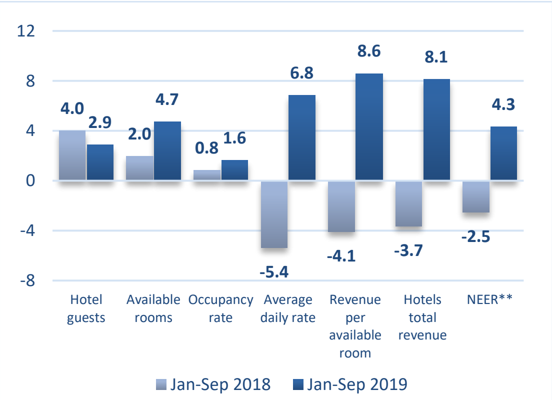
Figure 2: Annual Percentage Change in Major Indicators of Dubai & Abu Dhabi Inbound Tourism January-September[7] 2018-2019 (%)

a. Dubai



Source: Dubai Corporation of Tourism and Commerce Marketing* Staff calculation, based on data published by Dubai DTCM (occupied room nights divided by guest's length of stay).

b. Abu Dhabi.



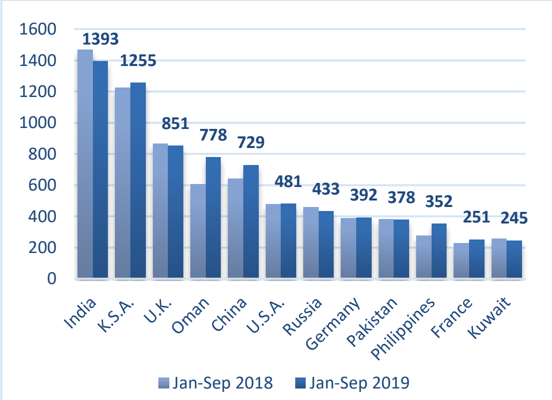
Source: Abu Dhabi Tourism & Culture Authority
** NEER Is the Nominal Effective Exchange Rate (Source: Bank of International Settlement)

The vast majority of tourists to Dubai originate from GCC countries and the MENA region (30% combined, 20% and 10% of the total). While the number of tourists from Western Europe is comparable to GCC with 20%, North America recorded 6% of the total visitors. Finally, inbound tourism originated from South Asia accounted for 16%, North & South East Asia 12%, from Russia and Eastern Europe 8%, whereas visitors from Africa amounted for 6% and Australia 2% respectively.

[7] Dubai Corporation of Tourism and Commerce Marketing has not released September 2019 tourism statistics at the cut-off date of this report hence August data are used for the Emirates of Dubai.

Figure 3. Major Markets of Inbound Tourist Arrivals January-September 2018-2019 (in Millions)

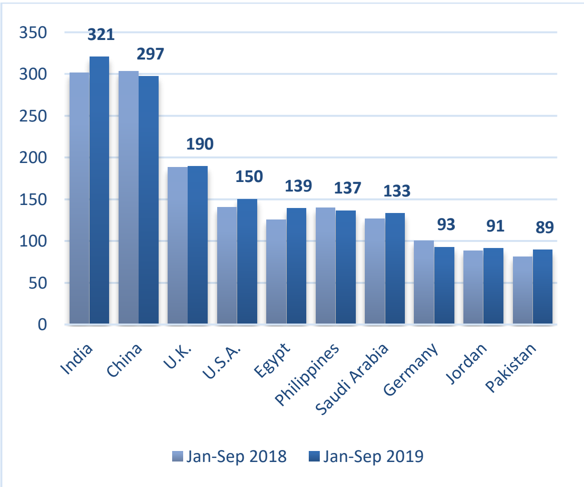
a. Dubai



Source: Dubai Corporation of Tourism and Commerce Marketing

The Abu Dhabi Emirate recorded increase in inbound tourism from some of the top ten countries. Egypt recorded the highest rate of increase (10.5%), followed by Pakistan (9.9%), USA (7.0%), India (6.4%), Saudi Arabia (4.9), Jordan (3.1%), UK (0.7%) during January-September 2019 compared to the same period in 2018. Meanwhile, inbound tourism from Germany, Philippines and China recorded decrease during the same period (Figure 3.b.).

b. Abu Dhabi



Source: Abu Dhabi Tourism & Culture Authority

2.5 Consolidated Fiscal Stance

Recent increase in oil prices during the second quarter of 2019 by 9.2% Q-o-Q has resulted in a higher rate of growth for total government revenues Y-o-Y by 18.2% compared to a growth rate of 0.9% in the previous quarter and 13.7% during the same quarter in the previous year.

On the Expenditure side, total expenses declined Y-o-Y by 4.4% during 2019 Q2. Moreover, capital spending, measured by the net acquisition of non-financial assets, rose Y-o-Y by 41.2%, reaching AED 9.9 billion. As a result, the Net Operating Balance registered a surplus of AED 50.6 billion in 2019 Q2 compared to AED 1.2 billion deficit in the previous quarter (see Table 2.5 and Figure 2.5.c).

2.5.1 Revenues

Revenue growth rates increased during 2019 Q2 (Figure 2.5.a), reaching 18.2% Y-o-Y compared to 0.5% in the previous quarter. This increase came as a result of the sharp rise in tax revenues by 46.1% Y-o-Y to reach AED 72.3 billion compared to AED 49.5 billion in the same quarter of 2018. On the other hand, other revenues dropped by AED 0.4 billion, or 0.5%, to reach AED 71.5 billion, compared to AED 72 billion in the same quarter of 2018. Social contributions remained relatively stable at AED 1.3 billion in 2019 Q2.

2.5.2 Expenditures

On the expenditure side, total expenses declined Y-o-Y by 4.4% in 2019 Q2, compared to an increase of 16.3% in the previous quarter (Figure 2.5.b). The drop in expenses is attributable to the fall in grants, social benefits and other benefits by 28.1%, 21.1% and 65.4%, respectively. These categories represented 30.5% of total expenses during 2019 Q2.

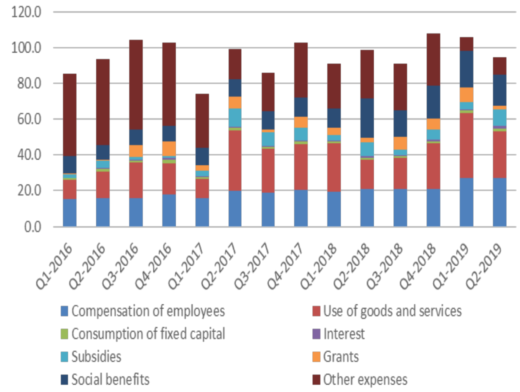
Compensation of employees, use of goods and services and subsidies increased markedly Y-o-Y by 28.1%, 61.8% and 26% (Figure 2.5.d). Both categories, interest and consumption of fixed capital also rose by AED 0.5 billion each. Moreover, capital spending increased Y-o-Y by 41.2% to reach AED 9.9 billion, compared to AED 7 billion in the same quarter of the previous year.

Government Finances

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

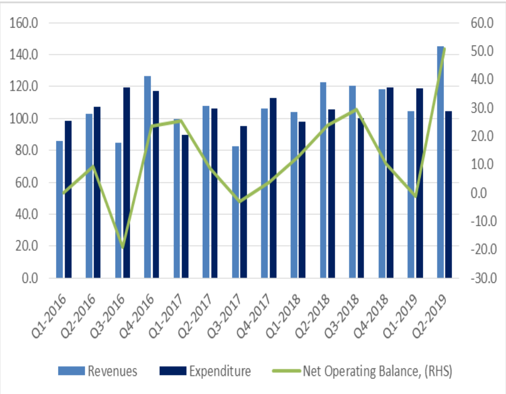
Source: Ministry of Finance

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



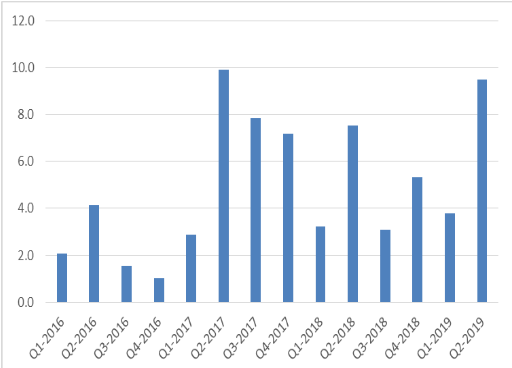
Source: Ministry of Finance

Figure 2.5.c Fiscal Stance (Billions of Dirhams)



Source: Ministry of Finance

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



Source: Ministry of Finance

Table 2.5 Consolidated Government Finances

	2018				2019		2018 (% Y-o-Y)				2019 (% Y-o-Y)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
Revenues (a)	**103.8**	**122.7**	**120.6**	**118.5**	**104.8**	**145.1**	**4.2%**	**13.7%**	**45.7%**	**11.5%**	**0.9%**	**18.2%**
- Taxes	46.7	49.5	60.6	57.5	42.4	72.3	-5.1%	23.7%	86.9%	42.6%	-9.3%	46.1%
- Social contributions	1.3	1.3	1.3	1.2	1.3	1.3	3.9%	24.3%	0.8%	1.5%	-0.3%	-2.4%
- Other revenues	55.9	71.9	58.8	59.9	61.2	71.5	13.6%	7.5%	19.7%	-7.7%	9.5%	-0.5%
Expenditure	**97.9**	**105.9**	**99.9**	**119.4**	**119.0**	**104.4**	**9.4%**	**-0.5%**	**4.9%**	**6.2%**	**21.6%**	**-1.4%**
-Expense (b)	**91.1**	**98.8**	**91.2**	**108.1**	**105.9**	**94.5**	**22.8%**	**-0.5%**	**6.3%**	**5.4%**	**16.3%**	**-4.4%**
Compensation of employees	19.5	21.2	21.1	21.2	27.3	27.1	22.8%	5.1%	12.3%	4.1%	39.8%	28.1%
Use of goods and services	27.0	16.0	17.1	25.2	36.4	25.9	157.0%	-52.4%	-31.4%	-2.0%	34.7%	61.8%
Consumption of fixed capital	1.1	1.0	1.0	1.0	1.1	1.5	-13.1%	-27.3%	3.4%	-29.2%	-3.8%	43.3%
Interest	0.5	1.1	0.6	1.4	0.8	1.6	-2.4%	85.1%	111.0%	168.4%	68.8%	39.5%
Subsidies	3.2	7.5	3.1	5.3	3.8	9.5	12.7%	-23.9%	-60.5%	-26.1%	16.7%	26.0%
Grants	4.1	2.6	7.0	6.1	8.6	1.9	22.6%	-60.5%	487.7%	0.7%	111.1%	-28.1%
Social benefits	10.5	22.2	14.8	18.3	20.2	17.5	7.8%	120.0%	43.6%	68.2%	92.1%	-21.1%
Other expenses	25.2	27.1	26.5	29.6	7.8	9.4	-16.2%	61.7%	23.7%	-2.8%	-69.1%	-65.4%
Net acquisition of non-financial assets	6.7	7.0	8.7	11.3	13.1	9.9	-56.0%	-0.5%	-7.8%	14.3%	94.1%	41.2%
Net Operating Balance (a-b)	**12.7**	**23.9**	**29.5**	**10.4**	**-1.2**	**50.6**	-----	-----	-----	-----	-----	-----

Source: Ministry of Finance

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

Chapter 3. Banking and Financial Developments[8]

In the third quarter of 2019, deposits increased on a yearly basis, mainly driven by the increase in GREs and Government deposits. Credit continued its recovery registering higher growth than in 2019 Q2, with the private corporates leading it, in support of non-energy growth. Healthy Financial Soundness Indicators (FSIs) signify overall sound and stable banking system.

3.1 Banking Structure

In Q3 2019, licensed commercial banks decreased by one, due to a merger between two local banks, reaching 59 in total. Of which 21 are national banks and 38 are foreign banks, including 11 wholesale banks. The number of branches of national banks declined to 664 at the end of September 2019 compared to 713 at the end of June 2019. The number of retail foreign banks remained the same at 27 compared to the previous quarter, while their branches also remained the same at 80 compared to the previous quarter. Moreover, the number of employees in national and foreign banks decreased from 36,448 employees in Q2 of 2019 to 35,518 employees by Q3 of 2019.

3.1.1. Banks' Deposits

Total customer deposits increased in the third quarter of 2019 by AED 27.7 billion, which correspond to 1.6% Q-o-Q and 4.3% Y-o-Y (Table 3.1.1.a).

Table 3.1.1.a Total Deposits at UAE Banks

Item	Mar-19	Jun-19	Sep-19*
Bank Deposits	1748.1	1774.3	1802
(Q-o-Q change %)	-0.4%	1.5%	1.6%
(Y-o-Y change %)	5.2%	5.3%	4.3%

Bank deposits rose mainly due to the increase in resident deposits by AED 34.6 billion. On the other hand, non-resident deposits declined by AED 6.9 billion (Table 3.1.1.b).

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

Item	Mar-19	Jun-19	Sep-19*
Resident Deposits	1539.9	1577.6	1612.2
(Q-o-Q change %)	-0.1%	2.4%	2.2%
(Y-o-Y change %)	4.5%	5.6%	5.9%
Non-Resident Deposits	208.2	196.7	189.8
(Q-o-Q change %)	-2.4%	-5.5%	-3.5%
(Y-o-Y change %)	9.9%	3.5%	-7.6%

The increase in resident deposits was essentially due to the rise in government deposits by AED 25.2 billion, while private sector deposits increased by AED 4.5 billion after a decline in 2019 Q2 (Table 3.1.1.c). Resident deposits constitute the bulk of the total customer deposits at around 89.5% of total deposits.

Table 3.1.1.c UAE Resident Deposits

Item	Mar-19	Jun-19	Sep-19*
Government Sector	273	291.4	316.6
(Q-o-Q change %)	-6.0%	6.7%	8.6%
(Y-o-Y change %)	17.1%	16.3%	10.7%
GREs	194.7	217.4	218
(Q-o-Q change %)	-6.0%	11.7%	0.3%
(Y-o-Y change %)	-3.3%	13.3%	13.1%
Private Sector	1031	1029.7	1034.2
(Q-o-Q change %)	2.2%	-0.1%	0.4%
(Y-o-Y change %)	2.3%	0.9%	2.4%
NBFI	41.2	39.1	43.4
(Q-o-Q change %)	16.1%	-5.1%	11.0%
(Y-o-Y change %)	34.2%	24.5%	27.3%

Deposits by the type of banks—i.e., Conventional vs. Islamic banks—represent 78% and 22% of total deposits, respectively. Deposits at conventional banks exhibited an increase by 1.7% Q-o-Q, equivalent to AED 23.6 billion, while deposits at Islamic banks increased by AED 4.1 billion to reach AED 396 billion. Table 3.1.1.d shows that in the

[8] In this chapter: (1) all data indicate the end-of-period values, unless specified otherwise, (2) Values are expressed in billions of AED, unless specified otherwise, (3) The source of the data is the Central Bank of the UAE, unless specified otherwise and (4) * indicates preliminary figures subject to revision.

third quarter of 2019, on a Y-o-Y basis, Islamic banks' deposits slightly declined, while the Conventional banks deposits increased by 5.9% to reach AED 1,406 billion.

Table 3.1.1.d Total Deposits at the UAE Conventional/Islamic Banks

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Bank Deposits	1382.8	1406.4	391.5	395.6
(Q-o-Q change %)	2.7%	1.7%	-2.6%	1.0%
(Y-o-Y change %)	7.0%	5.9%	-0.2%	-1.2%

Looking at the subcategories, the growth of deposits in Conventional banks in the third quarter was stronger for the Government (Table 3.1.1.f), while non-resident deposits in Islamic banks (Table 3.1.1.e) was a main contributor to the growth in deposits at these banks.

Table 3.1.1.e Resident and Non-resident Deposits at the UAE Conventional/Islamic Banks

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Resident Deposits	1205.6	1239.8	372	372.4
(Q-o-Q change %)	3.9%	2.8%	-2.0%	0.1%
(Y-o-Y change %)	7.9%	8.6%	-1.2%	-2.2%
Non-Resident Deposits	177.2	166.6	19.5	23.2
(Q-o-Q change %)	-4.7%	-6.0%	-12.6%	19.0%
(Y-o-Y change %)	1.8%	-10.2%	21.9%	17.2%

Table 3.1.1.f Conventional/Islamic Banks Resident Deposits

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Government Sector	1205.6	1239.8	372	372.4
(Q-o-Q change %)	3.9%	2.8%	-2.0%	0.1%
(Y-o-Y change %)	7.9%	8.6%	-1.2%	-2.2%
GREs	176.6	177.2	40.8	40.8
(Q-o-Q change %)	22.6%	0.3%	-19.4%	0.0%
(Y-o-Y change %)	24.3%	26.6%	-17.9%	-22.6%
Private Sector	777	780	252.7	254.2
(Q-o-Q change %)	-0.1%	0.4%	-0.3%	0.6%
(Y-o-Y change %)	1.6%	2.8%	-1.2%	1.1%
NBFI	27.2	32.3	11.9	11.1
(Q-o-Q change %)	-7.8%	18.8%	1.7%	-6.7%
(Y-o-Y change %)	26.5%	38.6%	20.2%	2.8%

The breakdown of National and Foreign banks in Table 3.1.1.g show that national banks exhibited growth in customer's deposits by 2% Q-o-Q while foreign banks' deposits declined over the same time span. On a Y-o-Y basis, national banks' deposits grew by 4.8% while foreign banks' deposits slightly dropped. Deposits at national banks constitute around 88.8% of total deposits in the banking system, while 11.2% of total deposits are in foreign banks.

Table 3.1.1.g Total Deposits at the UAE National/Foreign Banks

	National		Foreign	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Bank Deposits	1569.4	1600.5	204.9	201.5
(Q-o-Q change %)	1.4%	2.0%	2.1%	-1.7%
(Y-o-Y change %)	5.7%	4.8%	3.0%	-0.1%

The rise in deposits at national banks was essentially attributed to the increase in the resident deposits by AED 32.9 billion, of which government deposits represented AED 25 billion increase, almost the entire amount of Government deposits increment in the banking sector for the quarter. On the other hand, the decline in foreign banks' deposits, was mainly due to the decrease in the private sector deposits (Tables 3.1.1.h and 3.1.1.i).

Table 3.1.1.h Resident and Non-resident Deposits at the UAE National/Foreign Banks

	National		Foreign	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Resident Deposits	1408.7	1441.6	168.9	170.6
(Q-o-Q change %)	2.6%	2.3%	1.0%	1.0%
(Y-o-Y change %)	6.0%	6.4%	1.9%	2.0%
Non-Resident Deposits	160.7	158.9	36	30.9
(Q-o-Q change %)	-8.1%	-1.1%	8.1%	-14.2%
(Y-o-Y change %)	2.4%	-7.1%	8.4%	-10.2%

Table 3.1.1.i National/Foreign Banks Resident Deposits

	National		Foreign	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Government Sector	290.8	315.8	0.6	0.8
(Q-o-Q change %)	6.7%	8.6%	20.0%	33.3%
(Y-o-Y change %)	16.7%	11.0%	-60.0%	-38.5%
GREs	209.9	206.6	7.5	11.4
(Q-o-Q change %)	12.1%	-1.6%	1.4%	52.0%
(Y-o-Y change %)	13.6%	14.7%	7.1%	-8.8%
Private Sector	875.0	881.6	154.7	152.6
(Q-o-Q change %)	-0.3%	0.8%	0.6%	-1.4%
(Y-o-Y change %)	0.8%	2.3%	1.7%	3.1%
NBFI	33	37.6	6.1	5.8
(Q-o-Q change %)	-7.3%	13.9%	8.9%	-4.9%
(Y-o-Y change %)	26.0%	31.5%	17.3%	5.5%

3.1.2. Banks' Credit

Gross Credit remained robust in the third quarter with an increase of 1.7% Q-o-Q and a rise by 5% Y-o-Y. Total Assets increased by 2.2% Q-o-Q and 6.5% Y-o-Y (Table 3.1.2.a).

Table 3.1.2.a Assets and Credit at UAE Banks

Item	Mar-19	Jun-19	Sep-19*
Total Assets	2894.9	2958.6	3022.7
(Q-o-Q change %)	0.9%	2.2%	2.2%
(Y-o-Y change %)	6.5%	7.6%	6.5%
Gross Credit	1675.1	1692.7	1720.8
(Q-o-Q change %)	1.1%	1.1%	1.7%
(Y-o-Y change %)	4.2%	4.3%	5.0%
Domestic Credit	1529.3	1542.6	1565.6
(Q-o-Q change %)	1.3%	0.9%	1.5%
(Y-o-Y change %)	3.8%	3.8%	4.6%
Foreign Credit	145.8	150.1	155.2
(Q-o-Q change %)	-0.7%	2.9%	3.4%
(Y-o-Y change %)	7.8%	10.6%	9.4%

For the underlying domestic credit, the lending growth was mainly driven by lending to the Government that increased by 8.9% Q-o-Q (18.3% Y-o-Y) and to the GREs that increased by 1.5% Q-o-Q (6% Y-o-Y). Lending to the private sector grew by 0.2% Q-o-Q (2.6% Y-o-Y) (Table 3.1.2.b).

Table 3.1.2.b Domestic Credit

Item	Mar-19	Jun-19	Sep-19*
Government	197.1	201.6	219.5
(Q-o-Q change %)	2.9%	2.3%	8.9%
(Y-o-Y change %)	8.8%	11.5%	18.3%
GREs	171.7	176.3	178.9
(Q-o-Q change %)	2.3%	2.7%	1.5%
(Y-o-Y change %)	0.9%	4.7%	6.0%
Private Sector	1140.6	1147.8	1150.1
(Q-o-Q change %)	0.9%	0.6%	0.2%
(Y-o-Y change %)	3.6%	2.7%	2.6%
NBFI	19.9	16.9	17.1
(Q-o-Q change %)	-0.5%	-15.1%	1.2%
(Y-o-Y change %)	-4.3%	-15.5%	-19.7%

Lending to the private sector was driven by lending to private corporates, which rose by 4.4% Y-o-Y. The decline of lending to individuals had a partially offsetting effect on the healthy growth of the corporates (Table 3.1.2.c).

Table 3.1.2.c Credit to the Private Sector

Item	Mar-19	Jun-19	Sep-19*
Business & Industrial Sector Credit	807.1	815.6	816.5
(Q-o-Q change %)	1.8%	1.1%	0.1%
(Y-o-Y change %)	5.6%	4.6%	4.4%
Individual	333.5	332.2	333.6
(Q-o-Q change %)	-1.2%	-0.4%	0.4%
(Y-o-Y change %)	-0.9%	-1.5%	-1.4%

Table 3.1.2.d. illustrates sectors of lending by economic activity, which increased on a yearly basis. The sectors with highest Y-o-Y growth were Mining and Quarrying; Electricity, Gas and Water; Construction and Real Estate; and Transport, Storage and Communication.

Table 3.1.2.d Lending by Economic Activity with Credit to the Sectors Growing Y-o-Y in 2019 Q3

Item	Jun-19	Sep-19*
Mining and Quarrying	15.5	14.9
(Q-o-Q change %)	-3.0%	-3.9%
(Y-o-Y change %)	19.8%	11.1%
Electricity, Gas and Water	19.5	18.8
(Q-o-Q change %)	5.7%	-3.7%
(Y-o-Y change %)	10.1%	10.6%
Construction and Real Estate	336.2	333.0
(Q-o-Q change %)	4.0%	-1.0%
(Y-o-Y change %)	9.7%	9.2%
Trade	154.0	157.0
(Q-o-Q change %)	-0.4%	2.0%
(Y-o-Y change %)	-3.2%	1.4%
Transport, Storage and Communication	55.3	54.0
(Q-o-Q change %)	7.2%	-2.3%
(Y-o-Y change %)	2.3%	9.2%
Financial Institutions (Excluding Banks)	128.8	135.7
(Q-o-Q change %)	3.0%	5.3%
(Y-o-Y change %)	-0.1%	1.1%

The sectors experiencing a decline on Y-o-Y basis are only three shown in Table 3.1.2.e.

Table 3.1.2.e Lending by Economic Activity with Credit to the Sectors Decreasing Y-o-Y in 2019 Q3

Item	Jun-19	Sep-19*
Agriculture	1.7	1.7
(Q-o-Q change %)	-8.8%	2.8%
(Y-o-Y change %)	-12.5%	-11.7%
Manufacturing	76.2	75.2
(Q-o-Q change %)	-1.4%	-1.3%
(Y-o-Y change %)	3.4%	-1.2%
All Others	146.0	142.1
(Q-o-Q change %)	-7.8%	-2.7%
(Y-o-Y change %)	2.9%	-3.0%

Islamic banks have a share of 18.7% in the assets and 21.4% in the gross financing of the total banking system. The breakdown of the assets and lending by Conventional and Islamic banks in Table 3.1.2.f indicate that Islamic banks' financing increased during the third quarter of 2019, driven by domestic lending, while for conventional banks the growth was driven by both, domestic and foreign credit.

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

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Total Assets	2392.8	2457	565.8	565.7
(Q-o-Q change %)	3.3%	2.7%	-2.2%	0.0%
(Y-o-Y change %)	9.6%	8.8%	0.1%	-2.3%
Gross Credit	1327.9	1353.2	364.8	367.6
(Q-o-Q change %)	1.9%	1.9%	-2.0%	0.8%
(Y-o-Y change %)	5.8%	6.8%	-0.8%	-0.9%
Domestic Credit	1206	1226.2	336.6	339.4
(Q-o-Q change %)	1.8%	1.7%	-2.2%	0.8%
(Y-o-Y change %)	5.2%	6.3%	-1.0%	-1.0%
Foreign Credit	121.9	127	28.2	28.2
(Q-o-Q change %)	3.6%	4.2%	0.4%	0.0%
(Y-o-Y change %)	12.9%	11.7%	1.8%	0.0%

During 2019 Q3, the main drivers of domestic lending were Government and GREs for both, the conventional and Islamic banks. On a Y-o-Y basis, the domestic financing of Islamic banks was driven by the growth in financing in the Government sector, being partially offset by a decline in all other sectors. On the other hand, the Y-o-Y growth of 6.3% of domestic credit for conventional banks was driven by the significant increase in lending to the Government, the GREs and to the private sector (Table 3.1.2.g).

Table 3.1.2.g Domestic Credit at UAE Conventional/Islamic Banks

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Government	187.9	204	13.7	15.5
(Q-o-Q change %)	2.7%	8.6%	-2.8%	13.1%
(Y-o-Y change %)	11.1%	17.9%	17.1%	24.0%
GREs	146.1	147.5	30.2	31.4
(Q-o-Q change %)	3.0%	1.0%	1.0%	4.0%
(Y-o-Y change %)	7.6%	8.5%	-7.4%	-4.0%
Private Sector	857.3	859.9	290.5	290.2
(Q-o-Q change %)	1.6%	0.3%	-2.1%	-0.1%
(Y-o-Y change %)	3.9%	4.0%	-0.5%	-1.3%
NBFI	14.7	14.8	2.2	2.3
(Q-o-Q change %)	-10.4%	0.7%	-37.1%	4.5%
(Y-o-Y change %)	-10.4%	-16.9%	-38.9%	-34.3%

Credit to individuals decreased on a Y-o-Y basis for both types of banks in 2019 Q3; however, it increased on a Q-o-Q basis for the conventional and Sharia compliant institutions. Only credit extended by conventional banks rose for private corporates. Y-o-Y, credit to private corporates increased significantly by 6% for conventional banks, declining for the Islamic ones (Table 3.1.2.h).

Table 3.1.2.h Credit to the Private Sector at UAE Conventional/Islamic Banks

	Conventional		Islamic	
Item	Jun-19	Sep-19*	Jun-19	Sep-19*
Business & Industrial Sector Credit	654.8	656.4	160.8	160.1
(Q-o-Q change %)	2.3%	0.2%	-3.9%	-0.4%
(Y-o-Y change %)	5.9%	6.0%	-0.4%	-1.8%
Individual	202.5	203.5	129.7	130.1
(Q-o-Q change %)	-0.8%	0.5%	0.2%	0.3%
(Y-o-Y change %)	-2.0%	-1.9%	-0.7%	-0.7%

Foreign banks have a share of 12.6% of the system in terms of assets and 11.1% in terms of gross financing in the third quarter of 2019. The breakdown of the assets and credit by national and foreign banks in Table 3.1.2.i indicate that national banks' assets and gross credit were growing at a higher rate compared to the foreign ones. On a Y-o-Y basis, total assets at national banks grew by 6.8% as gross credit rose by 5.9%, while total assets at foreign banks increased by 4.2% and gross credit experienced a decline at the end of the third quarter of 2019.

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

Item	National		Foreign	
	Jun-19	Sep-19*	Jun-19	Sep-19*
Total Assets	2585.1	2643	373.5	379.7
(Q-o-Q change %)	2.0%	2.2%	3.5%	1.7%
(Y-o-Y change %)	8.1%	6.8%	4.6%	4.2%
Gross Credit	1505	1530.3	187.7	190.5
(Q-o-Q change %)	1.3%	1.7%	-0.7%	1.5%
(Y-o-Y change %)	5.5%	5.9%	-4.0%	-1.1%
Domestic Credit	1384.2	1408.4	158.4	157.2
(Q-o-Q change %)	1.1%	1.7%	-1.3%	-0.8%
(Y-o-Y change %)	4.8%	5.6%	-4.6%	-3.2%
Foreign Credit	120.8	121.9	29.3	33.3
(Q-o-Q change %)	3.1%	0.9%	2.4%	13.7%
(Y-o-Y change %)	13.7%	9.1%	-0.7%	10.3%

In 2019 Q3, on Y-o-Y basis, the increase in domestic credit for national banks was due to significant increase in the Government, GREs and private sectors, where the hike in lending to private corporates explained the rise in the latter. For the foreign banks, all categories experienced a decline over the same time span with exception of the NBFIs (Table 3.1.2.j and Table 3.1.2.k).

Table 3.1.2.j Domestic Credit at UAE National/Foreign Banks

Item	National		Foreign	
	Jun-19	Sep-19*	Jun-19	Sep-19*
Government	194.9	212.7	6.7	6.8
(Q-o-Q change %)	3.1%	9.1%	-17.3%	1.5%
(Y-o-Y change %)	11.8%	19.0%	4.7%	-1.4%
GREs	160.9	164.1	15.4	14.8
(Q-o-Q change %)	3.1%	2.0%	-1.3%	-3.9%
(Y-o-Y change %)	7.5%	8.0%	-17.6%	-11.4%
Private Sector	1012.9	1015.8	134.9	134.3
(Q-o-Q change %)	0.8%	0.3%	-0.7%	-0.4%
(Y-o-Y change %)	3.6%	3.4%	-3.7%	-2.7%
NBFI	15.5	15.8	1.4	1.3
(Q-o-Q change %)	-18.4%	1.9%	55.6%	-7.1%
(Y-o-Y change %)	-19.3%	-22.9%	75.0%	62.5%

Table 3.1.2.k Credit to the Private Sector at UAE National/Foreign Banks

Item	National		Foreign	
	Jun-19	Sep-19*	Jun-19	Sep-19*
Business & Industrial Sector Credit	710.4	711.8	105.2	104.7
(Q-o-Q change %)	1.3%	0.2%	-0.8%	-0.5%
(Y-o-Y change %)	5.7%	5.3%	-2.8%	-1.6%
Individual	302.5	304	29.7	29.6
(Q-o-Q change %)	-0.4%	0.5%	-0.7%	-0.3%
(Y-o-Y change %)	-0.9%	-0.9%	-6.9%	-6.3%

To shed more light on the allocation of the National banks' assets abroad, Box 8 below provides details about the UAE National Banks' Cross Border Asset and Liabilities, and Non-resident Foreign Currency Exposure, while Box 9 shows the developments in SME lending.

3.1.3. Financial Soundness Indicators

The overall soundness of the banking sector remained positive during the third quarter of 2019. Banks operating in the UAE remain well capitalized, with the Capital Adequacy Ratio (CAR) at 17.7%, Tier 1 Capital at 16.5%, and Common Equity Tier 1 (CET 1) at 14.7%, which are well above the regulatory requirements set by the CBUAE.[9]

The Loans to Deposits (L/D) ratio for the whole banking system increased only slightly from 95.4% in June 2019 to 95.5% at the end of September 2019, mainly due to the slower growth pace of deposits (Q-o-Q 1.6%) compared to the registered growth in gross credit (Q-o-Q 1.7%). Looking at the breakdown between Conventional and Islamic banks, the L/D ratio stands at 96.2% and 92.9%, respectively, increasing by 0.2 percentage points from the previous quarter for the conventional banks, while declining by 0.3 percentage points for the Islamic banks.

The Loan to Deposit ratio for Conventional banks in September 2019 increased compared to a year ago when it was 95.5%. For Islamic banks, L/D also increased from 92.6% in September 2018 to 93.9% at the end of the third quarter of 2019. On the other hand, National banks have L/D ratio of 95.6%, relatively stable compared to June 2019, while the ratio for foreign banks increased in 2019 Q3 to 94.5% from 91.6% in 2019 Q2.

Meanwhile, the eligible liquid assets,[10] as a ratio of total liabilities,[11] remained at 17.6% at the end of 2019 Q3. This level of liquid assets constitutes an adequate buffer about the 10% regulatory minimum required by the CBUAE.

The level of total liquid assets at banks, as of the end of 2019 Q3, stood at AED 430.6 billion, AED 7.9 billion higher compared to the end of 2019 Q2. On a Y-o-Y basis, total liquid assets at banks rose by AED 58.4 billion, registering an increase by 15.7%. In addition, looking at the breakdown between the banks, data show that for Islamic and National banks the ELARs increased during 2019 Q3 compared to 2019 Q2 while for Conventional and Foreign banks it slightly declined.

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

	Mar-19	Jun-19	Sep-19*
Total Banking System			
Lending to Stable Resources Ratio	82.7%	82.1%	82.1%
The Eligible Liquid Assets Ratio (ELAR)	16.9%	17.6%	17.6%
Capital Adequacy Ratio (CAR)	17.9%	17.9%	17.7%
Tier 1 Capital	16.6%	16.7%	16.5%
CET 1	14.6%	14.9%	14.7%
Conventional Banks			
Lending to Stable Resources Ratio	83.0%	82.0%	82.1%
The Eligible Liquid Assets Ratio (ELAR)	16.2%	17.1%	17.0%
Capital Adequacy Ratio (CAR)	17.9%	18.0%	17.6%
Tier 1 Capital	16.6%	16.7%	16.4%
CET 1	14.9%	15.2%	14.9%
Islamic Banks			
Lending to Stable Resources Ratio	81.6%	82.2%	82.1%
The Eligible Liquid Assets Ratio (ELAR)	18.9%	18.6%	19.0%
Capital Adequacy Ratio (CAR)	17.7%	17.7%	18.4%
Tier 1 Capital	16.6%	16.6%	17.3%
CET 1	13.2%	13.6%	13.9%
National Banks			
Lending to Stable Resources Ratio	84.0%	83.6%	83.6%
The Eligible Liquid Assets Ratio (ELAR)	16.0%	16.2%	16.4%
Capital Adequacy Ratio (CAR)	17.5%	17.6%	17.3%
Tier 1 Capital	16.3%	16.4%	16.1%
CET 1	14.0%	14.3%	14.1%
Foreign Banks			
Lending to Stable Resources Ratio	73.4%	70.4%	71.7%
The Eligible Liquid Assets Ratio (ELAR)	24.4%	26.9%	25.9%
Capital Adequacy Ratio (CAR)	20.7%	20.8%	21.4%
Tier 1 Capital	18.9%	19.4%	20.1%
CET 1	18.9%	19.4%	20.1%

[9] The minimum regulatory requirements for CAR, Tier 1 Capital and CET 1 are 13%, 8.5% and 7%, respectively.

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

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

3.2 Financial developments

3.2.1. Share Price Movement

The Abu Dhabi Securities Exchange (ADX) market capitalization continued to increase at a steady pace since September 2018 on a Y-o-Y basis. The ADX market capitalization decreased Q-o-Q by 1.8%, while it increased on a yearly basis by 2%. Similarly, the Dubai Financial Market (DFM) witnessed an increase in its market capitalization Q-o-Q by 1.1% and by 4.4% in the third quarter of 2019. However, global and regional uncertainties continue to weigh in on the UAE markets.

On the ADX, the average Share Price Index decreased Q-o-Q by 2.1% in the third quarter of 2019, and on a Y-o-Y it decreased by 0.3%. The average Share Price Index in Dubai rose by 0.8% Q-o-Q in the third quarter of 2019, and on a Y-o-Y it increased by 5.5%.

Table 3.2.1 UAE – Securities Markets

			2019		
			Q1	Q2	Q3
Abu Dhabi	Share Price Index	Q-o-Q	3.2%	-1.9%	-2.1%
		Y-o-Y	10.7%	9.2%	-0.3%
		YTD	3.2%	1.3%	2.9%
	Market Capitalization	Q-o-Q	2.4%	0.5%	-1.8%
		Y-o-Y	10.1%	12.8%	2.0%
		YTD	2.4%	2.9%	4.4%
	Turnover (Traded Value)	Q-o-Q	-34.3%	-2.5%	18.2%
		Y-o-Y	15.2%	32.7%	5.9%
		YTD	-34.3%	-36.0%	-30.5%
Dubai	Share Price Index	Q-o-Q	4.2%	0.9%	0.8%
		Y-o-Y	-15.2%	-5.8%	5.5%
		YTD	4.2%	5.1%	9.9%
	Market Capitalization	Q-o-Q	2.0%	0.9%	1.1%
		Y-o-Y	-9.6%	-4.7%	4.4%
		YTD	2.0%	3.0%	6.5%
	Turnover (Traded Value)	Q-o-Q	9.2%	-29.4%	46.7%
		Y-o-Y	-27.7%	-42.3%	31.1%
		YTD	9.2%	-22.9%	43.1%

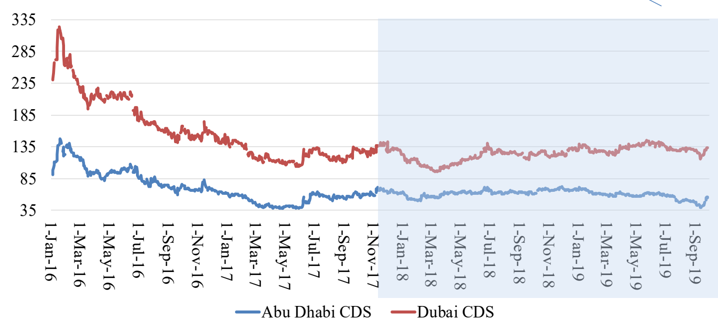
Source: Securities and Commodities Authority (SCA)
Note: Changes computation (Q-o-Q) is based on quarterly average of end-of-month values for the share price index and market capitalization.

3.2.2. Credit Default Swaps Premiums

Movement in sovereign risk premiums, as measured by the respective CDSs was positive. For the Emirate of Abu Dhabi, it decreased in 2019 Q3 to 50.5 basis points (bps) from 59.8 in the previous quarter, close to all time low. For the Emirate of Dubai, the default risk premium also declined compared to the previous quarter to 129.6 bps from 138.1bps previously (see Figure 3.2.1).

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

	2018				2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Emirate of Abu D	56.2	63.7	62.9	67.4	62.6	59.8	50.5
Emirate of Dubai	106.8	116.1	124.4	125.3	129.3	138.1	129.6



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

CDS levels remained low in 2019 Q3, compared to their historical levels.

Box 8: UAE Banks' Foreign Assets & Liabilities

The UAE banking system's total assets stood at AED 3,022.7 billion as of September 2019.[12] Excluding branches and affiliates abroad, UAE banks, have a total of AED 754.2 billion in foreign assets, split into AED 631.5 billion for national banks and AED 122.7 billion for foreign banks. The higher foreign securities investments by banks implied an increase in the foreign assets. In terms of liabilities, UAE banks, excluding branches and affiliates abroad stood at a total of AED 666.4 billion in foreign liabilities, split into AED 564.7 billion for national banks and AED 101.7 billion for foreign banks. The analysis in this section focuses on the exposure of UAE national banks, for both the asset and liabilities sides of their balance sheets abroad. First, is the allocation of the foreign assets and liabilities per category, followed by the top ten countries of exposure and the foreign currency denomination of the on-balance sheet claims/liabilities.

Foreign Assets and Liabilities for UAE National Banks

The total foreign assets exposure of national banks increased Q-o-Q and Y-o-Y by 2.8% and 9.8%, respectively, as of the end of 2019 Q3. Table 1 provides a detailed split of national banks' holdings of foreign assets. The three major categories as of September 2019 are securities with an outstanding amount of AED 203.9 billion, due from HO & branches with an outstanding amount of AED 127.0 billion and due from other banks at AED 126.9 billion. Securities experienced the most Q-o-Q increase by 10.1% followed by other assets 9.1%. Whereas in terms of Y-o-Y, by 38.3% and 2.36%, respectively.

Table 1. UAE National Banks' Foreign Assets' Class (in AED billion)

Asset class	Mar-19	Jun-19	Sep-19
Due from HO & branches	107.5	126.7	127.0
Due from other banks	130.5	134.0	126.9
Securities	182.6	185.2	203.9
Loans	117.1	120.8	121.9
Other assets	44.2	47.3	51.6
Foreign currency Cash in Hand	0.1	0.1	0.1
Total	**582.0**	**614.1**	**631.5**

Source: CBUAE

The total foreign liabilities of national banks also increased Q-o-Q and Y-o-Y at the end of 2019 Q3 by 0.6% and 9.2%, respectively. The liability classes of exposure are split according to the categories in Table 2. The three major categories as of September 2019 are other deposits with an outstanding amount of AED 158.9 billion, capital market funding at AED 144.0 billion and due to other banks abroad with an outstanding amount of AED 115.2 billion. The outstanding balance for the three liability classes changed by -1.1%, 2.9% and 1.6% Q-o-Q, and by -7.1%, 19.2% and 18.5% Y-o-Y, respectively.

Table 2. UAE National Banks' Foreign Liabilities' Class (in AED billion)

Liability class	Mar-19	Jun-19	Sep-19
Due to H.O and/or Branches Abroad	30.8	35.5	34.8
Due to Other Banks Abroad	114.9	113.4	115.2
Capital Market Funding	128.5	140.0	144.0
Other Term Borrowings	49.0	50.4	46.9
Other Deposits	174.9	160.7	158.9
Other Foreign Liabilities	54.1	61.5	64.8
Total	**552.2**	**561.5**	**564.7**

Source: CBUAE

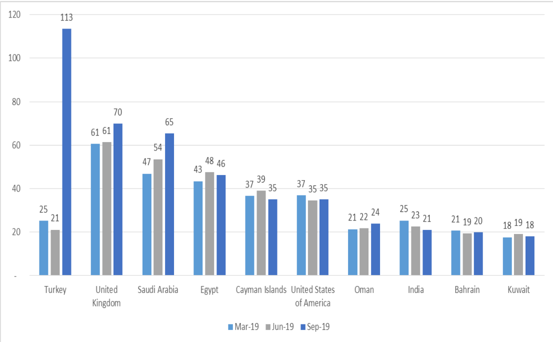
UAE National Banks' Top 10 Countries for Cross Border Exposure

As of September 2019, the largest asset exposure of UAE national banks abroad, including branches and affiliates, was in Turkey at AED 113.5 billion, followed by AED 69.9 billion in the United Kingdom and AED 65.3 billion in Saudi Arabia. Of the top 10 exposures, the three countries that experienced the highest Q-o-Q increase were Turkey by AED 92.4 billion (438%), mainly due to the acquisition of a Turkish bank by a national bank, followed by Saudi Arabia by AED 11.8 billion (22%) and the United Kingdom by AED 8.5 billion (13.9%). Similarly, these countries experienced the largest increase Y-o-Y, 289.0%, 65.6% and 32.1% respectively.

[12] Excluding branches and affiliates abroad.

On the other hand, the top three drops in foreign asset exposure Q-o-Q was for Cayman Islands[13] by AED 3.9 billion (10.1%), followed by India AED 1.5 billion (6.7%) and Egypt by AED 1.4 billion (2.9%). However, the Y-o-Y drop was mainly led by India as it dropped by AED 4.0 billion (15.8%), Egypt by AED 1 billion (2.1%) and Cayman Islands by AED 0.7 billion (2%) (see Figure 1).

Figure 1. Top 10 Foreign Country Assets' Exposures for UAE National Banks (in AED billion)

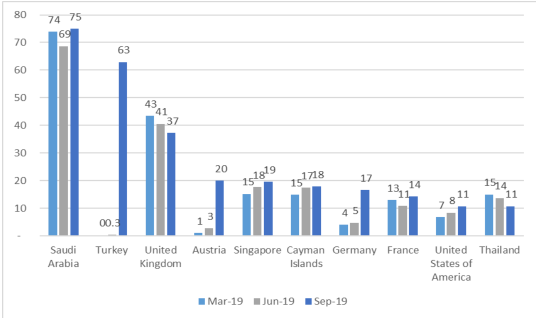


Source: CBUAE

On the other hand, the largest foreign liability exposure of UAE national banks abroad, including branches and affiliates as of September 2019 was in Saudi Arabia at AED 75.0 billion, followed by AED 62.9 billion in Turkey and United Kingdom AED 37.3 billion. The top three countries that experienced the highest increase Q-o-Q were Turkey by AED 62.6 billion, Austria by AED 17.2 billion and Germany by AED 11.8 billion. Similarly, the same countries experienced the largest increase Y-o-Y.

As of September 2019, countries that experienced reduction in foreign liabilities exposure Q-o-Q were Thailand by AED 3.0 billion (21.7%) and the United Kingdom by AED 3.3 billion (8%). A drop of exposure Y-o-Y as of September 2019 was observed only for Thailand where liabilities dropped by AED 2.1 billion (16.4%) (Figure 2).

Figure 2. Top 10 Foreign Country Liabilities' Exposures for UAE National Banks (in AED billion)



Source: CBUAE

Foreign Currency Denomination of UAE Banks' Assets and Liabilities

The major foreign currency claims for UAE banks remain in USD, which stood at 84.7% at the end of the third quarter of 2019 as a percentage of total foreign currency exposure. Followed by Euro, Saudi Riyal, and Pound sterling standing at 7.4%, 2.0% and 1.9% respectively (Table 3).

Table 3. Share of Foreign Currencies of Total UAE Banks' Assets by Denomination

Currency	Mar-19	Jun-19	Sep-19
USD	83.2%	81.1%	84.7%
Euro	9.5%	10.9%	7.4%
Pound Sterling	2.1%	2.0%	1.9%
Japanese Yen	1.3%	1.4%	1.3%
Saudi Riyal	1.2%	1.6%	2.0%
Chinese Yuan	0.2%	0.3%	0.2%
Qatari Riyal	0.2%	0.2%	0.2%
Bahraini Dinar	0.3%	0.2%	0.2%
Kuwaiti Dinar	0.2%	0.2%	0.2%
Swiss Franc	0.1%	0.1%	0.1%
Other Foreign currencies	1.7%	2.0%	1.7%

Source: CBUAE

In terms of the liabilities, the major foreign currency exposure for UAE banks remains also in USD, which stood at 81.9% at the end 2019 Q3 as a percentage of total foreign currency exposure. Followed by Saudi Riyal, Euro, and other foreign currencies standing at 5.5%, 5.1% and 2.8% respectively (Table 4).

[13] The Cayman Islands is the booking jurisdiction for Sukuk issuance

Table 4. Share of Foreign Currencies of Total UAE Banks' Foreign Liabilities by Denomination

Currency	Mar-19	Jun-19	Sep-19
USD	81.0%	81.2%	81.9%
Euro	5.4%	5.5%	5.1%
Pound Sterling	2.5%	2.5%	2.2%
Japanese Yen	0.8%	0.9%	0.8%
Saudi Riyal	6.8%	6.3%	5.5%
Chinese Yuan	0.6%	0.7%	0.6%
Qatari Riyal	0.1%	0.1%	0.2%
Bahraini Dinar	0.0%	0.0%	0.0%
Kuwaiti Dinar	0.2%	0.2%	0.2%
Swiss Franc	0.5%	0.7%	0.7%
Other Foreign currencies	2.0%	1.9%	2.8%

Source: CBUAE

Box 9: Towards Further SME Development and Financial Inclusion in the UAE

A holistic approach, including taking advantage of the full potential of Fintech, is expected to improve the eco-system for the development of MSMEs in the UAE, thereby boosting the profile of bankability and access to finance, and improving their competitiveness and access to markets, consistent with UAE strategy of further economic diversification and the promotion of a knowledge-based economy.

Micro, Small and Medium Enterprises (MSMEs) play a vital role in diversifying the economy and boosting job creation. Therefore, it is important to assess the current limits to MSMEs' access to finance in the UAE, CBUAE's initiatives to facilitate further financing access, in coordination with the concerned stakeholders, and the potential role of Fintech and CBUAE's priority actions.

As shown in Table 1, bank credit to this sector amounted to AED 85 billion at the end of 2019 Q3, which represents 10.4% of credit to the private corporate sector and 5.4% of total domestic credit extended by the banking sector in the UAE. The latter in particular is well below the benchmarks of 8% in MENA countries and 18% in Emerging Economies.

During 2019 Q3, credit decreased by 11.6%, to micro enterprises and by 4.6% to medium enterprises, while increasing by 1.1% for medium enterprises. Moreover, at end of September, medium enterprises got more than half of bank credit allocated to the MSME sector, while the share of small enterprises was limited to 33% and that of micro enterprises represented about 13.4%.

Table 2: Lending to MSMEs in the UAE

In billions of Dirhams

Period		2017	2018				2019		
		Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
1	Microenterprises	11.5	11.1	10.4	11.8	12.2	12.8	12.9	11.4
	- Share of total SME lending	12.5%	12.5%	11.8%	13.4%	13.7%	14.4%	14.6%	13.4%
	- National Banks	9.6	9.2	8.4	9.6	10.0	10.3	10.7	9.1
	- Foreign Banks	1.9	1.9	2.0	2.2	2.2	2.5	2.2	2.3
2	Small Enterprises	33.4	31.3	30.8	29.9	30.0	28.2	27.7	28.0
	- Share of total SME lending	36.4%	35.1%	35.0%	34.0%	33.9%	31.8%	31.3%	33.0%
	- National Banks	24.4	22.4	21.8	20.9	21.1	19.4	18.6	19.2
	- Foreign Banks	9.0	8.9	9.0	9.0	8.9	8.8	9.1	8.8
3	Medium Enterprises	46.8	46.7	46.7	46.2	46.6	47.7	47.8	45.6
	- Share of total SME lending	51.0%	52.4%	53.1%	52.6%	52.5%	53.8%	54.1%	53.6%
	- National Banks	36.9	36.6	36.8	36.0	36.5	36.6	37.6	35.7
	- Foreign Banks	9.9	10.1	9.9	10.2	10.1	11.1	10.2	9.9
4	SME Total (1+2+3)	91.7	89.1	87.9	87.9	88.8	88.7	88.4	85.0
	- National Banks	70.9	68.2	67.0	66.5	67.6	66.3	66.9	64.0
	- Foreign Banks	20.8	20.9	20.9	21.4	21.2	22.4	21.5	21.0

Source: CBUAE, data reported by banks on official definition of MSMEs.

The distinction between Islamic banks and conventional banks in Table 1 shows that the decrease in lending to the MSME sector during 2019 Q3 was witnessed in both conventional and Islamic banks, albeit the decline was more pronounced for Islamic banks (-8%) compared with conventional banks (- 3.6%).

Table 3: MSME Lending - Conventional & Islamic Banks

In billions of Dirhams

Period		2017	2018				2019		
		Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
1	**Microenterprises**	**11.5**	**11.0**	**10.5**	**11.4**	**12.2**	**12.7**	**13.0**	**11.4**
	- Conventional Banks	9.4	9.4	9.0	9.9	10.8	11.3	11.7	10.2
	- Islamic Banks	2.1	1.6	1.5	1.5	1.4	1.4	1.3	1.2
2	**Small Enterprises**	**32.5**	**31.3**	**30.9**	**30.1**	**29.8**	**28.2**	**27.7**	**28.1**
	- Conventional Banks	30.0	29.2	28.7	27.7	27.7	26.1	26.0	26.3
	- Islamic Banks	3.3	2.1	2.2	2.4	2.1	2.1	1.7	1.8
3	**Medium Enterprises**	**46.4**	**46.7**	**46.8**	**46.2**	**46.8**	**47.9**	**47.9**	**45.5**
	- Conventional Banks	41.3	40.9	40.9	40.4	39.7	41.7	42.1	40.4
	- Islamic Banks	5.6	5.9	6.0	5.8	7.1	6.2	5.8	5.1
4	**SME Total (1+2+3)**	**91.7**	**89.1**	**88.3**	**87.7**	**88.8**	**88.8**	**88.6**	**85.0**
	- Conventional Banks	**80.7**	**79.5**	**78.6**	**78.0**	**78.2**	**79.1**	**79.8**	**76.9**
	- Islamic Banks	**11.0**	**9.6**	**9.7**	**9.7**	**10.6**	**9.7**	**8.8**	**8.1**

Source: CBUAE

In order to enhance MSMEs access to finance, country experiences show the need to adopt a holistic approach. The recent IMF Report ***"Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia"***, as an example, stressed the need to focus on "*key elements of reform strategies that will deliver more meaningful, safe, and sustainable access to financing for SMEs than partial policy approaches*," and it identified Fintech as a potential source for additional financing to MSMEs. The latter can be achieved through: (1) lowering the regulatory compliance costs; (2) helping to overcome the lack of credit information and the high cost of servicing financing to these entities; (3) exploring the use of technology to facilitate and enhance the electronic Know-Your-Customer (eKYC) process; (4) enhancing access to banking services through the internet and mobile banking; and (5) developing a trade financing platform using innovative technology to reduce trade financing risks—e.g., fraudulent trade documents and duplicate financing so as to increase trade financing for SMEs.

This is in fact the current approach of CBUAE, which is leading an initiative with the concerned stakeholders, aiming at improving the eco-system and increasing the bankability of the SME sector. To this end, the High Level SME Coordination Committee comprising of CBUAE and concerned stakeholders, namely the Ministries of Economy, Finance, Youth and Justice, as well as the UAE Banking Federation, the Emirates Development Bank, the Etihad Credit Bureau, and SME Development Funds (Khalifa Fund and SME Dubai), met in July 2018 and decided to set up a dedicated Working Group, which came up with a list of priority enablers focusing on:

1. ***The mobilization of additional financing through:***

- A dedicated regulatory framework for SME lending
- Enhanced credit rating data so that banks can assess creditworthiness of SMEs
- Effective use by SMEs of the Movable Collateral Registry to qualify for bank credit at an affordable cost
- Establishment of the Federal Credit Guarantee Scheme
- Diversifying sources of financing outside the banking system via the promotion of Venture Capital, Private Equity Companies and Angel Investors.

2. ***Enhancing the Eco-system through:***

- Improvement of the quality of book-keeping and financial management of SMEs, and better oversight over the audit profession
- Effective implementation of the Bankruptcy Law, adoption of Bankruptcy Regime for Individuals, and establishment of a Credit Ombudsman Office.

- Establishment of one-stop Small Business Administration (at federal or Emirates-level) and a federal Export Promotion Agency.

A national strategy is currently being developed to coordinate among stakeholders and prioritize the set of reforms to ensure simultaneous progress and adherence to the implementation deadlines.

In tandem with the Working Group Agenda, the CBUAE is conducting a survey-based research to assess the degree to which MSMEs are "financially constrained" and the best ways to mitigate the reported obstacles. The survey will cover both the demand side of a large sample of MSMEs, with a focus on the main constraints these companies are facing in their access to financing relative to the firm's specific profile, as well as constraints on the supply side that banks and MSMEs development funds are documenting as main obstacles to facilitate further lending to MSMEs.

As regards Fintech, and as part of the CBUAE's overall strategy in progress, the objective is to position the CBUAE as a Fintech enabler—i.e., a facilitator as well as a coordinator with the key stakeholders to build a mature Fintech ecosystem in the UAE. The key stakeholders include regulatory authorities in both on-shore and financial free zones, relevant Government authorities, banking and financial sector, FinTech service providers, FinTech start-ups, and FinTech-related associations. In this regard, a CBUAE Fintech Strategy and a roadmap have been developed, comprising five strategic focus areas; each one containing a number of specific initiatives, namely:

1) Research, Advisory and Application: an initiator of FinTech industry research in potential application of FinTech solutions

2) Regulatory Interface: an interface between market participants and regulatory functions of CBUAE

3) Collaboration & Liaison: a coordination platform for exchanging ideas of FinTech initiatives and facilitating joint projects and initiatives among key authorities and stakeholders.

4) Talent Development: a facilitator to nurture talents to meet the growing needs of FinTech in the UAE.

5) Cross-border Collaboration: a collaborator to build a partnership model with cross-border key stakeholders.

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

The Central Bank balance sheet exhibited a decrease in 2019 Q3, reflecting a decline in commercial banks' balances at the CBUAE. Meanwhile, interest rates in the UAE interbank edged lower, in line with the widely held expectations of further Fed's policy rate cuts, while the spread of the EIBOR versus the USD LIBOR held steady through the quarter, and the spread of the 10-year swap rate of the AED relative to the USD increased in July–August before declining in September.

4.1 Monetary Aggregates

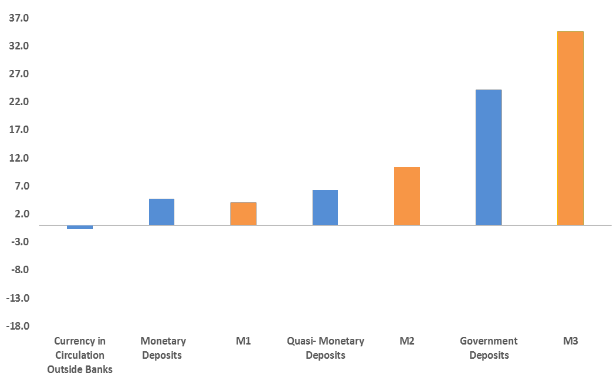
During 2019 Q3, Money Supply M1 (Currency in Circulation outside banks + Monetary Deposits) increased by 0.8% (AED 4.0 billion) to reach AED 511.9 billion, driven by a rise in Monetary Deposits (85% of M1) by 1.1% (AED 4.7 billion) which reached AED 435.3 billion. Y-o-Y up to the end of 2019 Q3, M1 increased by 5.7% due to an increase in Currency in Circulation by AED 7.7 billion and an increase in monetary deposits by AED 20 billion.

Money supply M2 (M1 + Quasi Monetary Deposits) increased by 0.8% (AED 10.3 billion) to reach AED 1,361.3 billion, due to an increase in Quasi-Monetary deposits (62.4% of M2) by AED 6.3 billion, reaching AED 849.4 billion. Y-o-Y up to the end of 2019 Q3, M2 increased by 5.4% due to an increase in Quasi Monetary Deposits by AED 42.5 billion.

Meanwhile, M3 (M2 + Government Deposits at banks and CBUAE) increased at a higher rate of 2.1% (AED 34.5 billion) to reach AED 1,679.9 billion, due to the rise in Government Deposits (19% of M3) by 8.2% (AED 24.2 billion) to reach AED 318.6 billion. Y-o-Y up to the end of 2019 Q3, M3 increased by 6.3% due to an increase in Government Deposits by AED 29.9 billion.

Figure 4.1 Change in Monetary aggregates in 2019 Q3

In billions of AED



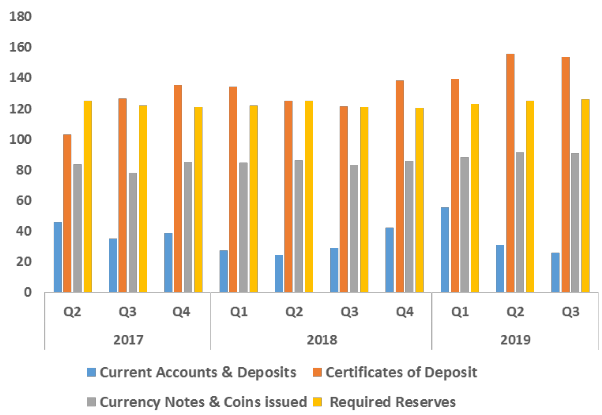
Source: CBUAE

4.2 Central Bank Balance Sheet

The balance sheet of the CBUAE decreased by 1.5% in 2019 Q3 reaching AED 427 billion, at the end of September, due to the decrease in foreign assets while domestic securities remained flat. On the liabilities side of the balance sheet of the Central Bank, there was a decrease in three components: AED 5 billion drop in Current Accounts and Deposits, AED 2 billion drop in Certificates of Deposits (CDs) issued by CBUAE and purchased by banks, and AED 0.5 billion drop in Currency Issued.

Figure 4.2 Central Bank Liabilities

In billions of AED



Source: CBUAE

Table 4.1 Central Bank Balance Sheet

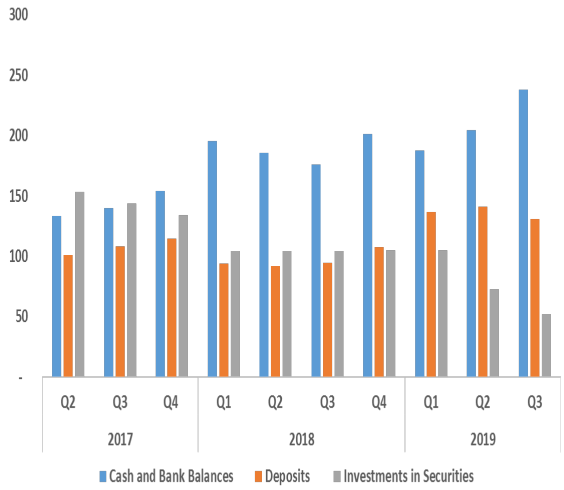
In billions of AED

	2018		2019		
	Q3	Q4	Q1	Q2	Q3
Total Assets,	**380.9**	**417.7**	**432.6**	**433.5**	**427.0**
Foreign Assets	327.3	362.6	377.1	377.2	374.3
Securities-Dubai Government/MoF	49.0	49.0	49.0	46.1	46.1
Other Assets	4.6	6.1	6.5	10.2	6.6
Total Liabilities,	**380.9**	**417.7**	**432.6**	**433.5**	**427.0**
Required Reserves	120.9	120.6	123.1	124.8	126.2
Current Accounts & Deposits	28.8	42.2	55.5	31.1	26.1
Certificates of Deposit	121.4	138.2	139.2	155.8	153.8
Currency Notes & Coins issued	83.2	85.8	88.3	91.3	90.8
Total Capital & Reserves	21.9	23.3	23.3	23.4	23.4
Other Liabilities	4.7	7.6	3.2	7.1	6.7

Source: CBUAE

Figure 4.3 Central Bank Assets

In billions of AED



Source: CBUAE

4.3 Central Bank Foreign Assets

As shown in Table 4.2, the total foreign assets decreased by AED 2,9 billion in 2019 Q3 as matured Foreign Securities are not re-invested in the same instruments but mostly allocated to Current Account Balances and Deposits at Banks Abroad.

Table 4.2 Central Bank's Foreign Assets

	2018		2019		
	Q3	**Q4**	**Q1**	**Q2**	**Q3**
Total Foreign Assets*	**327.3**	**362.6**	**377.1**	**377.2**	**374.3**
Foreign Securities	**55.2**	**55.2**	**55.3**	**39.3**	**6.0**
-USD Treasury Notes	50.7	50.7	50.7	31.1	0.5
-IDB Sukuk	4.6	4.6	4.6	4.6	5.5
- Euro Commercial Papers	--	--	--	3.6	-
Current Account Balances & Deposit with Banks Abroad	**255.1**	**294.1**	**307.6**	**323.5**	**351.0**
-Current & Call Accounts	163.7	187.2	174.1	185.5	220.7
-Deposits	81.3	93.3	117.0	118.4	113.8
-Tri-Party Deposits	10.1	13.6	16.5	19.6	16.5
Other Foreign Assets	**17.0**	**13.3**	**14.2**	**14.4**	**17.4**

4.4. International Reserves Position

The credibility of the fixed peg arrangement requires the Central Bank to hold sufficient foreign currency reserves. To this end, Article 63 of Decretal Federal Law No. 14 of 2018 regarding the Central Bank and Organization of Financial Institutions and Activities, states that the market value of the balance of Foreign Reserves "*shall not, at any time, be less than solvency seventy percent (70%) of the value of the monetary base*."

Table 4.3 reports the International Reserve Position of the Central Bank, which decreased from AED 380.3 billion at the end of 2019 Q2 to AED 377.5 billion at the end of 2019 Q3. As a ratio of the monetary base, however, the International Reserve Position increased during this period, from 95.8% to 96.1%, and it remains higher than the minimum currency cover ratio of 70%, required by Decretal Federal Law No. 14 of 2018.

Table 4.3 International Reserves

In billions of Dirhams

	2018		2019		
	Q3	Q4	Q1	Q2	Q3
1. **International Reserve Position**	**329.8**	**365.4**	**379.9**	**380.3**	**377.5**
– Foreign Assets	**327.3**	**362.6**	**377.1**	**377.2**	**374.3**
– IMF Reserves Position + SDR Holdings	2.5	2.9	2.9	3.1	3.2
2. Monetary Base	**347.7**	**379.7**	**372.9**	**397.1**	**392.8**
– Currency Issued	83.2	85.8	88.3	91.3	90.8
– Require Reserves	120.9	120.6	123.1	124.8	126.2
– Banks & OFCs Current Accounts at CBUAE	22.2	35.1	22.3	25.2	22.0
– Certificates of Deposit	121.4	138.2	139.2	155.8	153.8
Ratio (1/2)	**94.9%**	**96.2%**	**101.9%**	**95.8%**	**96.1%**

Source: CBUAE

4.5 Developments in Banks' Liquidity at the CBUAE

Banks' liquid assets at the CBUAE are mainly composed of Required Reserves, Current Accounts and Deposits, and CDs, which decreased from AED 311.7 billion at the end of 2019 Q2 to AED 306.1 billion at the end of 2019 Q3 (see Table 4.1) owing to the above-indicated decrease in Current Accounts and Deposits, and CDs, (Section 4.2).

4.6 Developments in Interest Rates

The fixed peg of the exchange rate of the AED to the USD requires that the CBUAE has to adjust its policy rate to changes in the federal funds rate. Therefore, the CBUAE announced cuts in interest rates applied to its Certificates of Deposits during 2019 Q3, consistent with FOMC decisions taken in July and September.

4.6.a Short-term interest rates

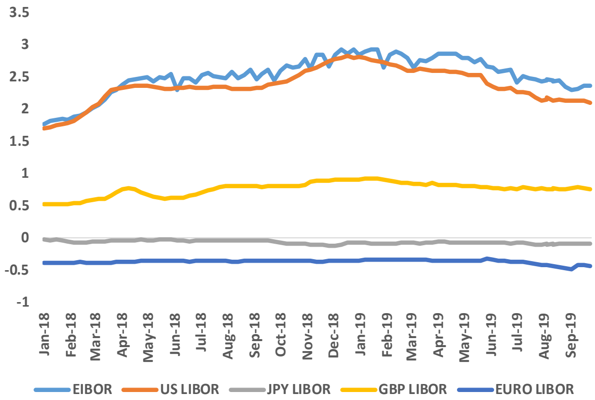
During 2019 Q3, EIBOR 3-month has been mostly declining—from 2.61% at the end of June, 3-month EIBOR decreased to 2.46% at the end of July— reaching a trough of 2.30% in mid-September, before recovering to 2.36% at the end of the quarter. The period average of weekly 3-month EIBOR declined from 2.74% in the second quarter to 2.41% in the third quarter.

The decrease in 3-month EIBOR benefits individual borrowers and businesses supporting non-energy growth and competitiveness indicators in the UAE going forward. In particular, it is a relief for UAE citizens participating in the National Loan Scheme, as EIBOR 3-month serves as a basis for the interest rate cap applied to rescheduled payments in this regard.

US 3-month LIBOR witnessed a sustained fall during this period on the back of the Fed's policy reversal of its previous tightening which started with the first interest rate increase since the great recession, in December 2015. The 3-month USD LIBOR declined progressively from 2.32% at the end of June to 2.18% at the end of July, 2.14% at the end of August and to 2.10% at the end of September—averaging 2.16% in Q3 compared to 2.49% in Q2 and 2.68% in Q1.

Meanwhile, the 3-month LIBOR on GBP decreased only slightly by 0.7 bps during Q3, compared to 22 bps decline for the USD, and the 3-month LIBOR rates on the Euro and the Japanese Yen remained in negative territory, in consistency with the directions of monetary policy adopted by the respective central banks.

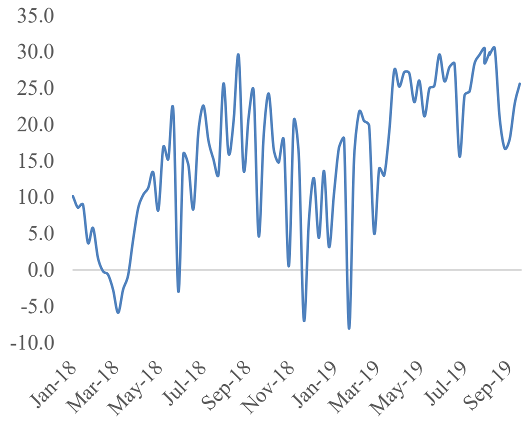
Figure 4.4.a LIBOR rates (3-month) for the AED and key other currencies (%)



Source: Bloomberg

As regards the Spread EIBOR vis-à-vis the USD LIBOR (3–month), it increased from an average 23 basis points (bps) in July to a peak of 31 bps in mid-August, before declining to 28 bps at the end of September.

Figure 4.4.b AED Spread vs. USD LIBOR (3 month, bps)

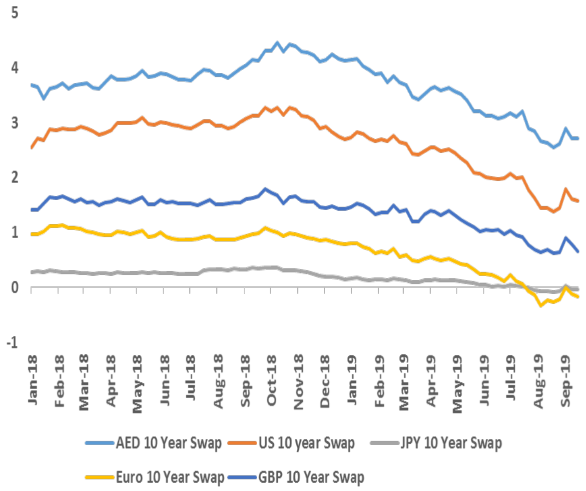


Source: Bloomberg

4.6.b. Long-term swap rates

Interest rate swaps involve an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.5.a, the 10-year swap rates increased at the beginning of the quarter, then declined to a trough at end of August, before recovering in September—the 10-year Swap rate for the Dirham increased from 3.07% at the end of June to 3.21% at the end of July, before declining to 2.86% in the first half of August.

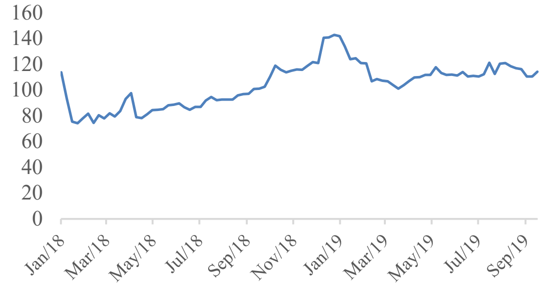
Figure 4.5.a 10-year Swap Rates (%)



Source: Bloomberg

The Spread of the 10-year swap rate for the AED versus the swap rate for the USD continued its upward trend in the third quarter of 2019, increasing from an average of 112 bps in June, to reach a peak of 118 bps in August, as global risks increased, in line with rising geopolitical tensions and global economic slowdown. The decline at the end of Q3 to about 113 bps may be due to the optimism resulting from resumed US-China trade negotiations. Nonetheless, the tight liquidity conditions in the U.S. pushed the federal funds rate well above the upper limit of the target range, triggering the New York Fed's short-term cash injections.

Figure 4.5.b Spread 10-year AED Swap vs. USD Swap (bps)



Source: Bloomberg

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