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Quarterly Economic Review

Fourth quarter 2017

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Executive Summary

The global economy continues to build momentum in 2017 Q4. Y-o-y growth rates are up from 2.3% in 2017 Q3 to 2.5% in 2017 Q4, boosted by expansionary fiscal outlook, following the adoption by US Congress of an ambitious tax cut program as well as a pickup in investment and consumer confidence. Similarly, Y-o-Y growth in the Euro Area reached 2.7% in 2017 Q4 following 2.8% growth rate in 2017 Q3, owing mostly to continued monetary policy support by the ECB and improvements in the labor market. Meanwhile, the recovery in commodity prices supported resource-rich Emerging Countries, while export-oriented economies benefited from higher demand in export markets.

Inflation in many countries edged up in 2017 Q4, boosted by higher commodity prices and sustained demand, even though it remains below target in Advanced Economies. And the steps towards monetary policy normalization that took place in the Advanced Economies lifted up interest rates and government bond yields worldwide which could be of particular concern for emerging countries where sovereigns as well as corporates accumulated large debts in the previous period denominated in US dollars, making it difficult and more costly to roll over debt in the coming period.

In the UAE, based on revised new figures of growth projections and global economic developments, the Central Bank of the UAE has revised its estimate of the Real GDP growth for 2017, and published its ECI estimates for the fourth quarter of 2017. In fact, Non-oil GDP is estimated to have grown by 2.9% in 2017, while oil GDP growth declined by 1.5%. The combined effect is estimated growth of Real GDP at 1.5% in 2017. The ECI estimates for 2017 Q4 are of 0.1% for the whole economy with non-oil GDP growing at 2.9% in the same quarter. Inflation increased in the fourth quarter to 1.8% Y-o-Y compared to 0.8% in the previous quarter, reflecting an increase in both, tradable and non-tradable inflation. Housing prices went down by 3.4% and 9.4% in Dubai and Abu Dhabi, respectively, Y-o-Y.

Regarding banking activity, Government deposits increased at a higher pace in the fourth quarter of 2017 compared to the previous quarter, both on Y-o-Y and Q-o-Q basis, while GREs continue deleveraging. Banks' credit remained unchanged on a Q-o-Q and increased by 1.7% on a Y-o-Y basis providing somewhat support to the non-oil growth. The overall outlook regarding the soundness of the banking sector remains positive during the fourth quarter of 2017 signifying a stable and sound financial sector.

The Central Bank balance sheet exhibited an increase in 2017 Q4, reflecting increased foreign income receipts in the economy. Banks, in turn, increased liquidity at the Central Bank as evident by the increase on the liabilities side of the balance sheet by 2.5%. As a result, Total Assets at the Central Bank increased owing mainly to rising Cash and Bank Balances and Deposits at Banks Abroad and Other Advances. Meanwhile, interest rates in the UAE continued their upward trend in line with the Fed's decision announced in September to start winding down its Balance Sheet and its decision in December to increase its policy rate. However, the spreads of the short-term interest rate of the dirham borrowing relative to the US dollar Libor rate as well as the spread for the long-term Swap rates decreased during the fourth quarter as liquidity and perceived risk declined in tandem with subdued global market volatility and a pickup in domestic as well as global economic growth.

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Chapter 1. International Economic Developments

The global economy continued to build momentum in 2017 Q4. Growth projections in the USA have been revised upward, reflecting a pickup in investment and consumer confidence, on the back of planned large tax cuts, higher spending and better global outlook, as growth was also revised upward in Japan and in the Euro Area, owing to continued monetary policy support. The recovery in commodity prices supported also resource-rich Emerging Economies, thereby improving their outlook as well. Inflation edged up in 2017 Q4, even though it remains below target in Advanced Economies, while the steps towards monetary policy normalization that took place in the Advanced Economies lifted up interest rates and government bond yields.

Economic Growth:

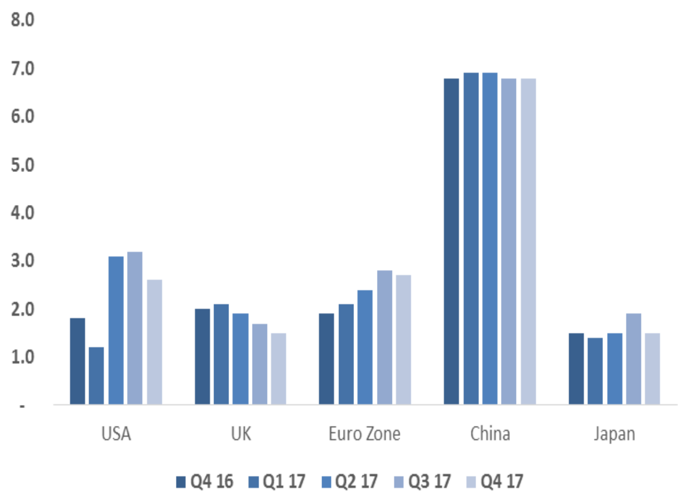
The recovery in global economic growth seems to be well on track in 2017 Q4. According to the International Monetary Fund's January 2018 World Economic Outlook (WEO), the global output is estimated to have grown by 3.7 percent in 2017, which is 0.1 percentage point faster than the projection made in October 2017; and more recent IMF projections brought up global growth 0.2 percentage points to 3.9%, in both 2018 and 2019.

The US economy has improved with US data annualized real GDP growth increasing to 3.2% in Q3, followed by smaller growth in 2017 Q4 at 2.5%. Nonetheless, the US growth momentum remained strong boosted by expansionary fiscal outlook, following the adoption by US Congress of tax cuts which are considered the largest overhaul of the tax code in 30 years. Growth was boosted by strong domestic demand, underpinned by higher investment consumer confidence. While still strong, the PMI showed however a decrease from 60.8 in 2017 Q3 to 59.7 in 2017 Q4.

Growth estimates have been revised up for most of the **Euro Area** countries, including France, Germany, Italy, and Spain. As a result, growth in the 19-nation Euro Area is expected to have reached 2.8% in 2017 Q3 and 2.7% in 2017 Q4, a noticeable improvement from the previous period. The Euro Area's overall PMI shows also an increase from 58.1 in 2017 Q3 to 60.6 in 2017 Q4. For individual Euro Area countries, the PMI increased from 60.6 in 2017 Q3 to 63.3 in 2017 Q4 in Germany, and from 56.1 to 58.8 in France, while a decrease was observed in Italy, from 58.3 to 57.4.

In the UK, the economy grew faster than expected at 1.5% Y-o-Y in the fourth quarter of 2017, up from 0.5% in the third quarter, thanks to high demand in the service sector, which accounts for roughly 80% of the UK's economy. In Japan, the PMI remained flat, during this period, while Q-to-Q real GDP growth in 2017 Q4 turned out to be low at 0.1%, compared with 0.6% in both the 2nd and third quarters, and 0.4% in the same period of the previous year. Weaker growth seems to be the result of weaker export performance that was attributed to the appreciation of the yen, coupled with weak domestic demand.

Figure 1.1. Y-o-Y Economic Growth in Advanced Economies



Source: Bloomberg

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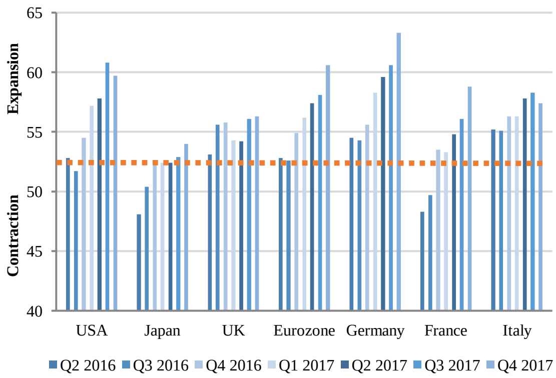
Figure 1.2. PMI Levels for Selected Developed Countries



Source: Bloomberg

The quarterly growth outlook is consistent with the IMF upward revisions, with the rate of growth in 2017 estimated at 2.3% in the US, 2.4% in the Euro Area, 1.7% in the UK and 1.8% in Japan (Table 1).

Table. 1. Real GDP Growth in Selected Advanced Countries

	2016	2017	2018
USA	**1.5**	**2.3**	**2.7**
EURO Area	**1.8**	**2.4**	**2.2**
France	1.2	1.8	1.9
Germany	1.9	2.5	2.3
United Kingdom	**1.9**	**1.7**	**1.5**
Japan	**0.9**	**1.8**	**1.2**

Source: IMF, World Economic Outlook, January 2018

In Emerging Economies, the pickup in growth in 2017 was boosted by higher commodity prices in resource-rich countries, while Y-o-Y real GDP, albeit slightly decreasing in China, it remains at 6.8% in both 2017 Q3 and 2017 Q4, owing to higher exports as well as a pickup in the services sector.

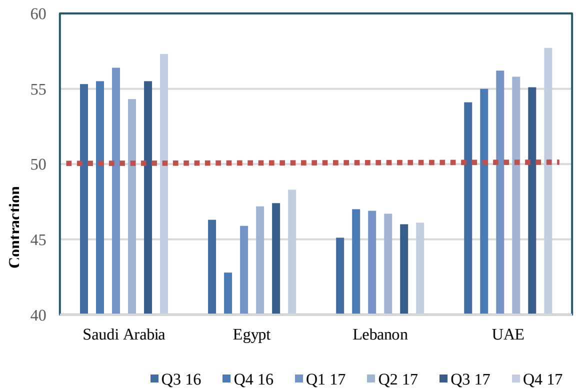
In India, growth estimates show a slowdown to 6.7% in 2017 due mainly to the impact of the demonetarization initiative, i.e., the ban of large currency denominations and the introduction of the tax on goods and services (TGS). The latter is expected, however, to improve the fiscal outlook and result in higher growth of 7.4% in 2018.

In the GCC, real non-oil GDP growth mostly improved in 2017 on the back of more gradual fiscal consolidation enhanced by higher oil prices. In Saudi Arabia, non-oil GDP growth improved from 0.2% in 2016 to 1.7% in 2017, owing to more supportive government spending, despite the cap on oil production and mounting geopolitical risks.

In the region of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)[1] as defined by the IMF, oil importers are expected to grow 1.2 percentage points higher in 2017 at 4.3%, supported by the global recovery, which is expected to boost demand in the region's main export markets.

The PMI levels showed however mixed movements in the fourth quarter. In Saudi Arabia, the PMI in the non-oil private sector rose from 55.5 in 2017 Q3 to 57.3 in 2017 Q4, while the PMI for Egypt increased from 47.4 to 48, but it remains below the 50 mark, i.e., in a contractionary zone.

Figure 1.3. PMI levels for selected MENA countries



Source: Bloomberg

Inflation:

Inflation increased in 2017 Q4 in most developed and emerging economies on the back of higher commodity prices and enhanced demand. In the US, the consumer price index rose by 2.1% Y-o-Y in 2017 Q4, up from 1.9% in the previous quarter. Similarly, Japan and the United Kingdom experienced an increase in inflation, albeit it remains well below the target in the latter, while in Germany,

[1] MENAP oil exporters: Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen. MENAP oil importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Sudan, Syria, and Tunisia.

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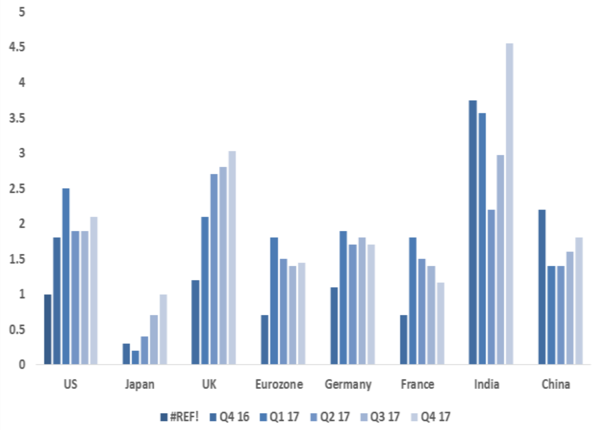
the Y-o-Y inflation decreased from 1.8% in 2017 Q3 to 1.7% in 2017 Q4.

Figure 1.4. Year-on-Year Consumer Price Change for Selected Developed and Emerging Economies (%)



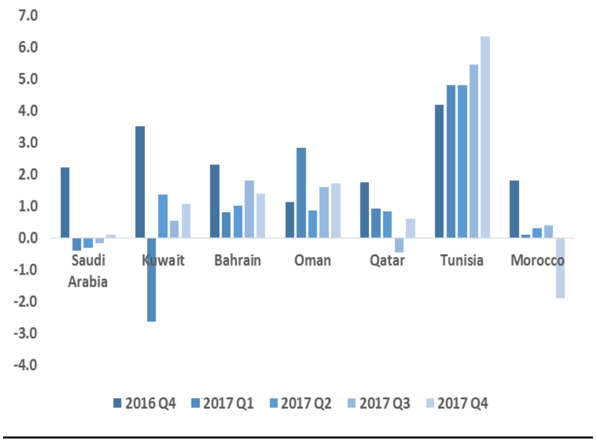
Source: Bloomberg

In Emerging Economies, inflation was mostly up. In India, as an example, inflation reached 4.6% in 2017 Q4, up from 3% in the previous quarter, owing to higher rents caused by the hike in the central government's house rent allowance (HRA) as shown in Figure 1.4.

For the MENA region, there was a mixed movement of inflation during 2017 Q4. According to Figure 1.5, the highest inflation was observed in Tunisia where prices edged up from 5.4% in 2017 Q3 to 6.3% in 2017 Q4, mainly due to increase in food prices. In Morocco, in contrast, inflation was 0.4% in 2017 Q3 before turning negative, -1.9%, in 2017 Q4.

Inflation increased slightly in all GCC countries. In Saudi Arabia, deflation was reversed in the fourth quarter when it became positive at 0.1 percent, while inflation in Qatar moved up from negative territory to reach 0.6% (see Figure 1.5.).

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



Source: Bloomberg

Commodity prices:

In the fourth quarter of 2017, the price of Brent crude increased by about 17.8%, reaching 70 dollars per barrel for the first time since 2014 with Y-o-Y increase of about 25%. This owes mainly to the extension of the OPEC agreement and the political uncertainties in some oil producing countries such as Libya and Iran. Meanwhile, the US daily oil production increased to 9.75 million barrels in the fourth quarter of the year, while the U.S. Energy Information Administration (EIA) forecasted that total U.S. crude oil production will average 10.04 million barrels per day (b/d) in the first quarter of 2018, surpassing Saudi Arabia and rival Russia.

The Y-O-Y increase in other commodities such as Natural Gas, Gold, and Silver reached 79%, 13.5%, and 6%, respectively (see Figure 1.7.). According to the World Bank, prices of energy commodities, which include natural gas and coal, are projected to increase by 8 percent in 2018.

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

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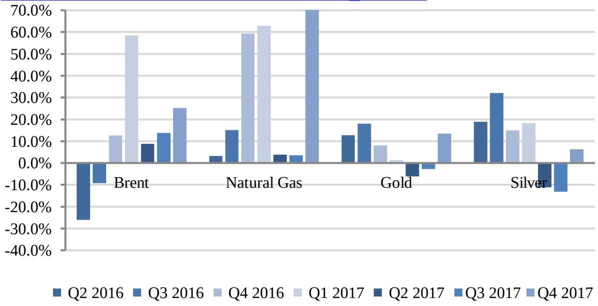


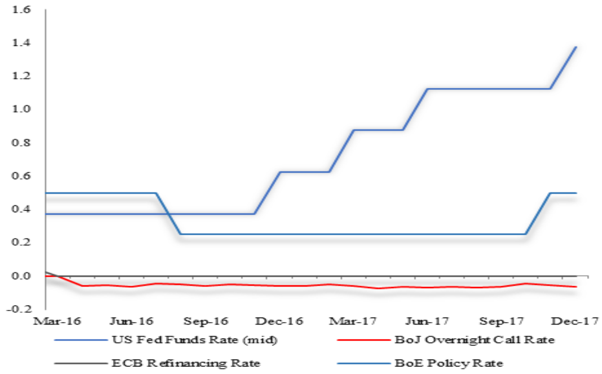
Source: Bloomberg

Policy Interest Rates:

Policy normalization by the Federal Reserve continued in 2017 Q4, marking the FOMC decision in its December meeting to increase the Target Federal Funds Rate by 25 basis points to the range 1.25%-1.5%. Moreover, markets expect further three increases in 2018 by 25 basis points each.

The Bank of England reversed its emergency action which was taken to mitigate the fallback from Brexit, raising its policy rate for the first time since 2007 in November 2017 from 0.25% to 0.5%. The decision was explained as an attempt to protect British households from inflation that has risen since the Brexit vote.

Figure 1.8. Policy rates for selected developed countries (%)



Source: Bloomberg

Meanwhile, the European Central Bank's Governing Council took a decision in its 14th of December meeting to maintain the interest rate on refinancing operations, on the marginal lending facility and on the deposit facility unchanged, at 0.00%, 0.25% and -0.40%, respectively, stating that it expects the key ECB interest rates to remain at their present levels for an extended period of time, except in case of less favorable economic conditions, or if financial conditions become inconsistent with further progress towards a sustained adjustment on the path of inflation. The Governing Council announced also that it will stand ready to increase the Assets Purchase Program (APP) in terms of size and/or duration if needed.

During 2017 Q4, the Bank of Japan announced that as inflation remains well below its 2% target, it is holding its monetary policy steady, i.e., it is holding its short – term policy rate at -0.1% and the target 10 year government yield at 0%. As a result, the policy rate remained in negative territory, decreasing from -0.046% at the end of October, to -0.055% at the end of November and to -0.062% at the end of December (see Figure 1.8.).

Government Bond yields:

During the fourth quarter of 2017, government bond yields increased in developed countries on the back of US monetary policy normalization as well as improved growth and inflation outlook (see Figure 1.8.). In the United States, the government bond yields increased on expectations of continued Federal Reserve's commitment to raise interest rates, which materialized in December 2017, and it is expected to continue in 2018 and beyond.

In the Euro Area, government bond yields reflected economic recovery and expectation of monetary tightening as the ECB announced in October that it will cut its monthly bond-buying program from €60bn to €30bn a month. Similarly, the UK bond yields moved slightly higher, while the Japanese bond yields remain the lowest in the developed world.

Figure 1.9. The 10-year government bond yields for selected countries (%)

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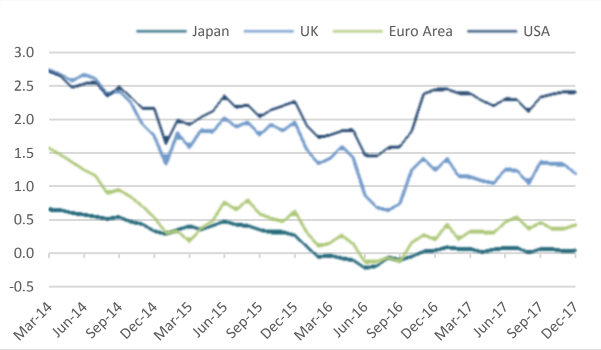

Source: Bloomberg

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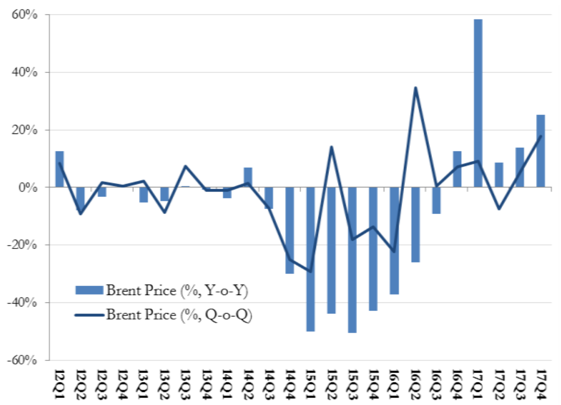
Chapter 2: Domestic Economic Developments

According to the index of non-oil activity constructed by CBUAE (Non-Oil ECI), the non-hydrocarbon sector in the UAE grew by 2.9% in the fourth quarter of 2017, driven mainly by economic recovery, employment resiliency, higher oil prices and improved growth in main UAE's trading partners. However, the growth of the overall Economic Composite Index continued its deceleration to reach 0.1% due to continued commitment to the OPEC-oil production cut agreement. The inflation rate picked up in the fourth quarter to reach 1.8% against 0.8% in the third quarter of the year, primarily driven by the jump of Tobacco and Beverages prices by 72% on account of the excise tax implemented in October and Transportation Price inflation (6.4% against 2%). Employment expanded by 3% in the third quarter of 2017.

2.1. Economic Activity and Growth

Oil prices continued their recovery for the fourth consecutive quarter in response to continued commitments to the OPEC agreement that took effect in January 2017. The agreement stipulates a coordinated oil production cut among its members and was extended last November to the end of 2018. Consequently, the Brent price increased by 25% on a year on year basis during the fourth quarter of 2017 against a previous increase by 14% during the third quarter. The average quarterly increase of the Brent price reached 27% against a decline by 15% in 2016. On a quarter-on-quarter basis, the oil price rebounded by 18% % in the fourth quarter adding to a 5% increase in the third quarter after a drop by 7.5% in the second quarter (see Figure 2.1.a).

Figure 2.1.a Quarterly Oil prices development, Brent price



Source: EIA

These developments were due to the recovery of the global economy and the depreciation of the Dollar, leading to the revival of the oil's global demand. Similarly, the supply side has shrunk significantly. In fact, the decline of US crude oil stocks and a pipeline explosion in Libya during the final week of the year caused the price of crude oil to probe above the $60 per barrel level for the first time since June 2015.

In line with its commitment to the OPEC agreement, the UAE has cut its oil production by 6% on a year-on-year basis in the fourth quarter of 2017 adding to a previous cut by 4% in the third quarter, leading to an average quarterly year-on-year decline by 2% in 2017 (see Figure 2.1.b). The decline in oil production has intensified in 2017 from a quarter to another. It fell by 1% in the fourth quarter compared to the previous quarter of the year, the same rate observed in the third quarter adding to a decline by 2% and 5% in the second and first quarters, respectively. The average quarterly decline in 2017 on a quarter-to-quarter basis was around 2% (see Figure 2.1.c).

Oil production decline has weighed on the overall Economic Composite Indicator (Overall ECI), which increased slightly by 0.1% on a year-on-year basis in the fourth quarter against 0.6% in the third quarter. The average quarterly increase of the Overall ECI reached 1.5% y-o-y (see Figure 2.1.d).

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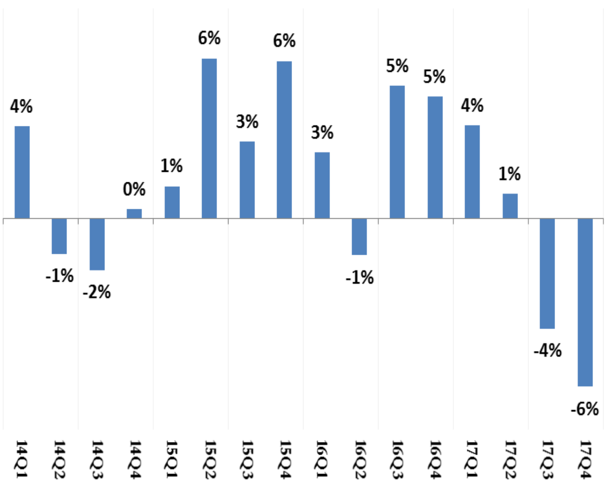
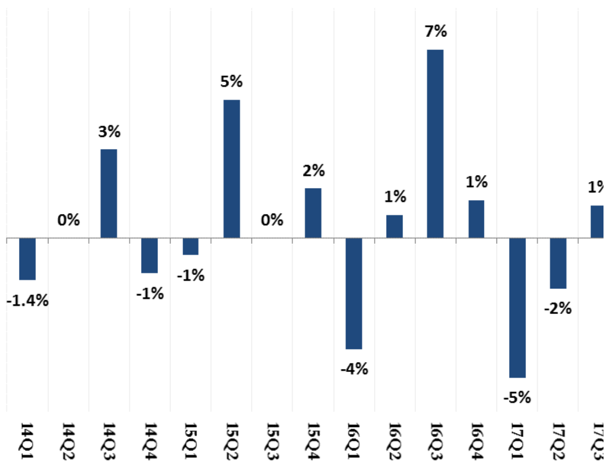
Figure 2.1.b Quarterly Oil Production Growth (%, Y-o-Y)



Source: OPEC (as of January 2018)

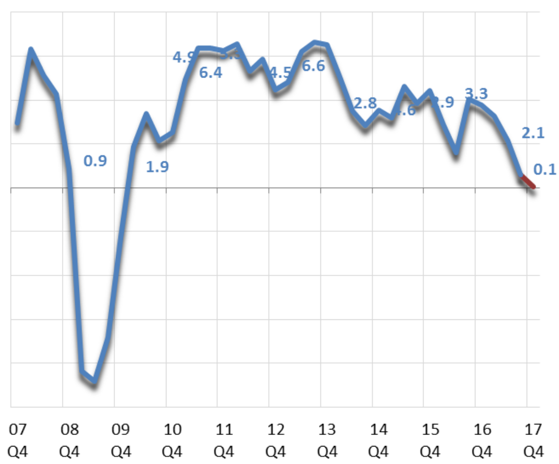
Figure 2.1.c Quarterly Oil Production Growth (%, Q-o-Q)



Source: OPEC (as of January 2018)

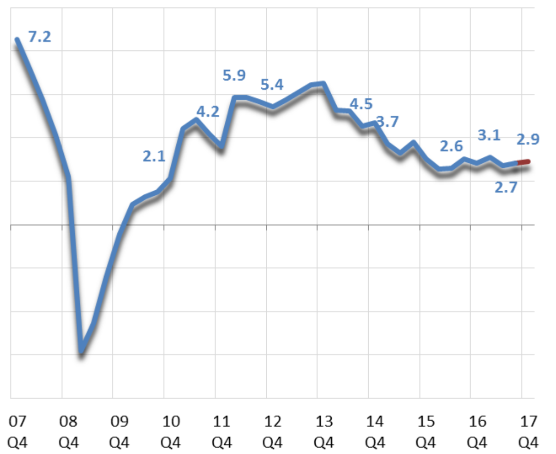
The dampening effect of the oil-production-cut was mitigated by the resiliency of the non-oil sector. Thanks to the improvement of oil prices and the subsequent positive economic sentiment, which boosted economic confidence, the Non-oil Economic Composite Index (Non-oil ECI) expanded by 2.9% y-o-y in the fourth quarter of 2017 adding to a 2.8% growth during the previous quarter (see Figure 2.1.e), leading to an average quarterly growth of 2.9% in 2017. The non-oil ECI is a composite economic index developed by the Central Bank of the UAE and tracks the economic activity quarterly. It takes into account the fluctuations of economic conditions of trading partners as well as it trails changes of domestic economic outlook quarterly. The improvement of the Non-Oil ECI Index was driven mainly by the recovery in the global economy and improved domestic conditions. The US and EU economies grew by 3.1% and 3% in the fourth quarter against 2.3% and 2.8% in the third quarter, respectively. The UAE's industrial production improved by 0.2% y-o-y against a previous decline by 0.3% in the third quarter. Domestic Credit grew by 1.4% y-o-y in the fourth quarter, adding to a previous growth by 1.5%.

Figure 2.1.d Overall Quarterly Economic Composite Indicator (ECI)



Source: CBUAE

Figure 2.1.e Non-Oil Quarterly Economic Composite Indicator (Non-Oil ECI)



Source: CBUAE

The annual economic outlook reflects the ECI developments. The recent Central Bank's revised estimate of the real GDP growth shows the impact of the OPEC agreement on the UAE's economy. Real GDP is estimated to have expanded by 1.5% in 2017 on account of estimated growth of the real Non-Oil GDP by 2.9% in 2017. The real Oil-GDP is estimated

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to have shrunk by 1.4% in 2017 and is expected to continue its decline by 0.2%in 2018. The increase of government spending by 23.3% in the first three quarters of 2017 and the recovery of global external demand for oil is projected to boost the UAE's economy by 2.5% in 2018 to which the non-oil sector will contribute by 3.6% according to the Central Bank's forecasts (see Table 2.1).

Table 2.1 Economic Growth in the UAE (%)

	2014	2015	2016	2017(E)	2018(P)
Real GDP	3.3	3.8	3.0	1.5	2.5
Real Oil GDP	0.4	5.4	3.8	-1.4	-0.2
Real Non-Oil GDP	4.6	3.2	2.7	2.9	3.6

Source: Federal Competitiveness and Statistics Authority (FCSA) for 2014, 2015, and 2016, and Central Bank's estimation (E) and Projections for 2017 and 2018.

2.2 Consumer Price Index and Inflation

The headline inflation rebounded in the fourth quarter of 2017, driven by two main forces: the implementation of the excise tax on Beverages and Tobacco and the recovery of the domestic demand prior to the VAT implementation in January 2018. After a slowdown in prices in the third quarter of 2018, the inflation rate jumped during the fourth quarter of 2017 to reach 1.8% against 0.8% in the third quarter (see Table 2.2.). In December, the overall Consumer Price index (CPI) inflation leaped up to reach 2.7%, the highest monthly reading since March 2017 (3%, y-o-y). Higher inflation for both tradables and non-tradables have resulted in an overall inflationary pressure in the last quarter of the year (see Figures 2.2.a and 2.2.b).

The most important increase in prices was on tradables, which account for 34% of the consumption basket in the UAE. Tradables price inflation reached 4% in the fourth quarter of 2017 from 1.8% in the previous one on a year-on-year basis. Prices of all tradable items increased significantly in the fourth quarter due to the Dirham's depreciation and the implementation of the excise tax on Beverages and Tobacco.

Beverages and Tobacco account for 0.3% of the global consumption basket in the UAE and 1% of the tradables. Prices of Beverages and Tobacco jumped by 70% y-o-y in the fourth quarter after a decline by 0.4% in the previous quarter. Effective October 2017, an excise tax of 200% was imposed on Tobacco products and 50% on sugary and energetic soft drinks. Prices of textiles, clothing and sportswear increased by 0.6% y-o-y in the fourth quarter of 2017 after a drop by 2.3% y-o-y previously. Both items account for more than 10% of tradables in the consumption basket.

Prices of Food and Soft Drinks increased by 2.4% y-o-y in the fourth quarter, the highest reading since the last quarter of 2014 due to the depreciation of the Dirham observed since the second quarter of 2017. Food and Soft Drinks account for 14.3% of the total consumption basket and 42% of tradables.

The cost of the tradable component of transportation costs has increased significantly in-line with the improvement of the international oil prices. The retail prices of tradable energy which account for 21.5% of tradables increased by 6.4% in the fourth quarter after an increase of 2% in the third quarter and 5% in the second quarter. Energy retail prices became indexed to the international oil prices since August 2015 where the subsidy-cut reform was implemented for the first time.

Moreover, although at a slower pace, prices of furniture and households goods' inflation continued their increase for the sixth consecutive quarter. They grew by 0.4% y-o-y adding to a previous inflation of 0.8% in the third quarter of 2017.

Non-tradables constitute 66% of the consumption basket in the UAE and are driving the development of inflation. Their price increased by 0.7% y-o-y during the fourth quarter of 2017 against 0.5% in the previous quarter. Housing and utilities' costs represent around 52% of the tradables and 34% of the overall consumption basket. Rental and utilities prices continued their decline for the second consecutive quarter by 1% y-o-y adding to a previous drop by 0.6% (see Figure 2.2.a).

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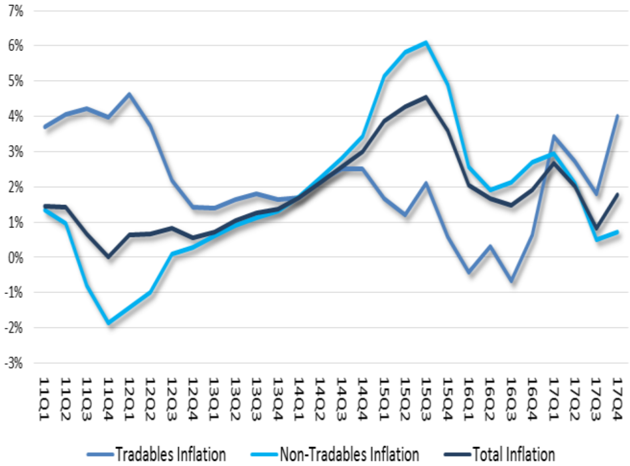
Table 2.2. UAE CPI inflation (%)

	Weight %	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4
CPI Inflation (period average)	100	2.1	1.7	1.5	1.9	2.7	2.0	0.8	1.8
CPI Inflation (end-of-period)	100	1.4	1.8	1.4	1.2	3.0	2.0	0.5	2.7
Tradable Inflation	34	-0.4	0.3	-0.7	0.6	3.4	2.7	1.8	4.0
Non-tradable Inflation	66	2.6	1.9	2.1	2.7	2.9	2.1	0.5	0.7
Housing Inflation	34	5.1	3.3	4.1	3.7	2.1	1.3	-0.6	-1.0
Transportation Inflation	15	-6.7	-2.7	-5.9	-1.1	8.5	5.0	2.0	6.4
Other[2] Inflation	51	1.4	1.2	1.3	1.7	2.4	2.3	1.8	2.6

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

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



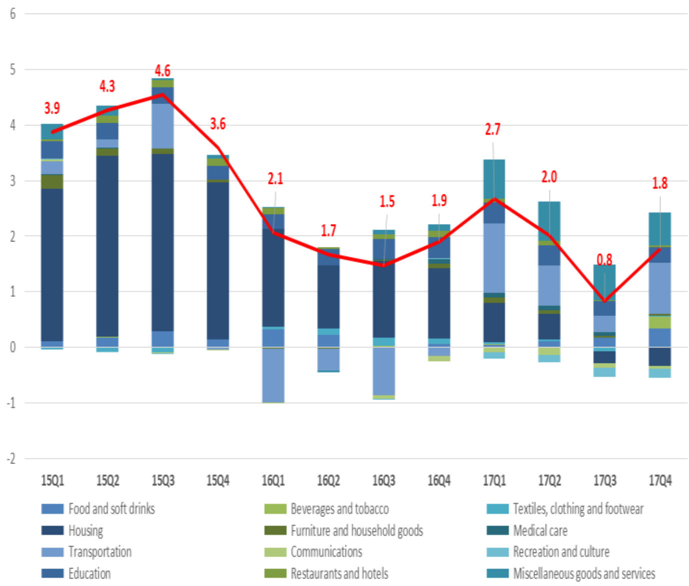
Source: Federal Competitiveness and Statistics Authority (FCSA).

The deflation of quarterly housing costs was intensified in the fourth quarter due to the excess supply in both Emirates, Dubai and Abu Dhabi. In Dubai, lower demand and softer labor market added to the surge of supply to generate further deflationary pressure on rental prices. Rental prices declined by 6.7% y-o-y in the fourth quarter, adding to a previous decline by 6% in the previous quarter. Similarly, rental prices in Abu Dhabi fell by 11% y-o-y in the fourth quarter after a previous decline in the third quarter by 10.5% due mainly to a glut in supply, which has reflected on property prices (see Box 1: Recent Developments in the Real Estate Market, for more details).

Prices of communication continued their deflation for almost a year. Communication spending represents 5.4% of the cost of a standard consumption basket in the UAE. They fell by 0.9% y-o-y in the fourth quarter adding to 1.3% drop in the third quarter of 2017 (see figure 2.2.b.).

Similarly, average quarterly Recreation and Culture costs declined for the fourth consecutive quarter. They dropped by 5% y-o-y in the fourth quarter after a previous similar decline by 5%, leading to an average quarterly deflation of 4.5% in 2017. On the other hand, restaurants and hotels costs kept increasing from the end of 2015 and rebounded by 0.6% in the fourth quarter adding to a 0.3% increase in the third quarter of 2017, with an average quarterly increase of 1.1% in 2017.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

[2] Excluding housing and transportation.

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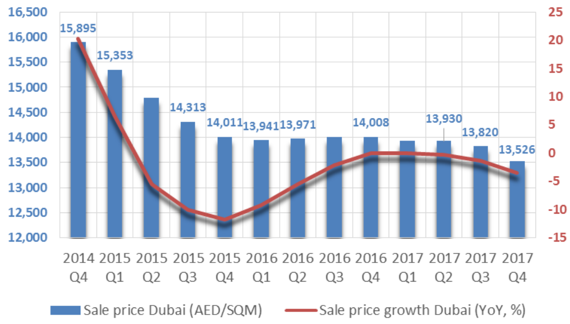
Box 1: Recent Developments in the Real Estate Market

The Price Index[3] of the UAE residential Market continues to decline moderately in the fourth quarter of 2017[4]. In Dubai, on an annual basis the property prices decreased by 3.4% and a decline of 2.1% compared to the previous quarter to AED 13,526/m², and in Abu Dhabi the annual drop in property prices was 9.4% and 2% fall compared to the previous quarter to AED 11,970/m². The rental yield, which measures the rate of income return over the cost associated with an investment property decreased slightly in Dubai to 6.99%, as well as in Abu Dhabi by 0.07 percentage point to reach 7.1%.

Dubai residential Market

In the fourth quarter of 2017, property price, which measures the average sample price in dirham per square meter of residential properties, decreased by 3.4% Y-o-Y compared to 1.4% from previous quarter (Figure 1).

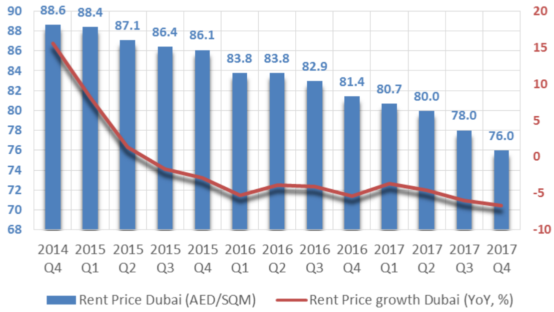
Figure 1: Dubai Residential Sale Prices



Source: REIDIN, CBUAE

Despite the property price relative stability since mid-2016, the Dubai market continues to exhibit decline in rent (Figure 2), due to high supply, lower demand and a softer job market. The rent prices declined by an annual rate of 6.7% in the fourth quarter, following a decrease of 6% in the previous quarter.

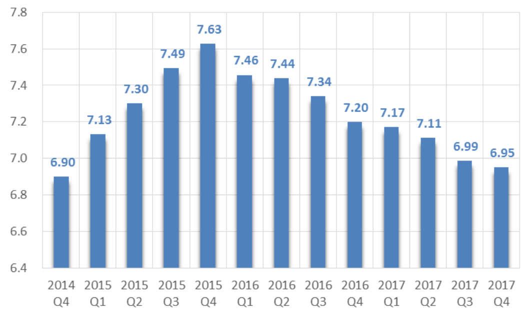
Figure 2: Dubai Residential Rent Prices



Source: REIDIN, CBUAE

As regard to investment in Dubai's real estate market, it is clear that 2016 was marked by a slowdown in rental yield from a high of 7.46% in the first quarter to a low of 7.20% in the last quarter of 2016 (Figure 3). This trend was the result of relatively stable prices towards the end of the year, combined with further decline in rents. More recently, the rental yield declined to 6.95% in the fourth quarter of 2017, but remains attractive for investors.

Figure 3: Dubai rental yield (%)



Source: REIDIN, CBUAE

Abu Dhabi residential Market

For Abu Dhabi, the housing Price Index exhibited a continued fall in residential property prices of 9.4% Y-o-Y in the 2017 Q4, following a decrease of 8.6% in the previous quarter (Figure 4).

---

[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.

[4] All values in this box are quarter average.

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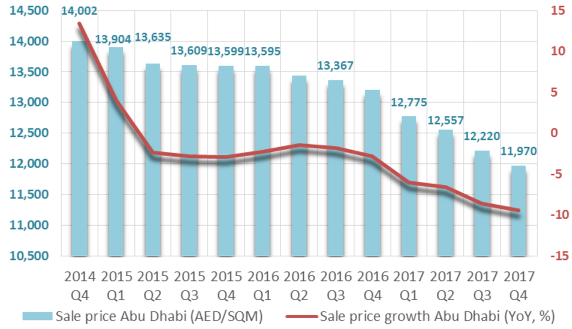
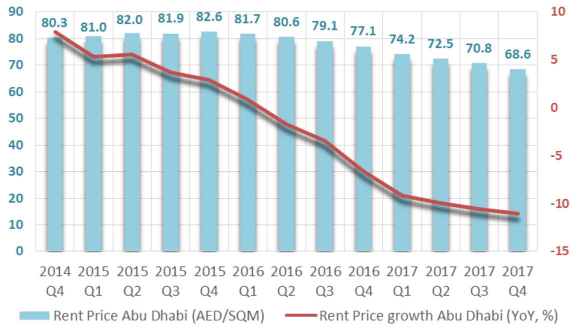
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN, CBUAE

As for the rental market, in addition to the reinstatement of the 5% residential rent cap in mid-December 2016, the rent values in Abu Dhabi continued to decline by an annual rate of almost 11% on average in the fourth quarter of 2017, after a reduction of 10.5% in the previous quarter. This trend is reflecting the impact of softer job market and the cuts in public expenditures, which continue to weigh in on demand in the housing market (Figure 5).

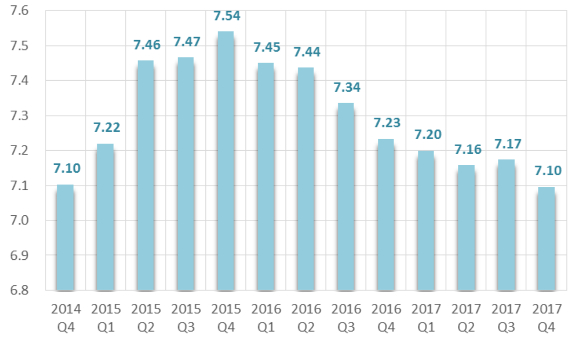
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN, CBUAE

Concerning the rental yield, Abu Dhabi registered a yield of 7.1% for 2017 Q4, a marginal of 0.07 precentage points drop from the previous quarter (Figure 6). The observed pattern in rental yield reflects a constant pace of decline in rent along with softer job market relative to the investment sentiment in properties.

Figure 6: Abu Dhabi rental yield (%)



Source: REIDIN, CBUAE

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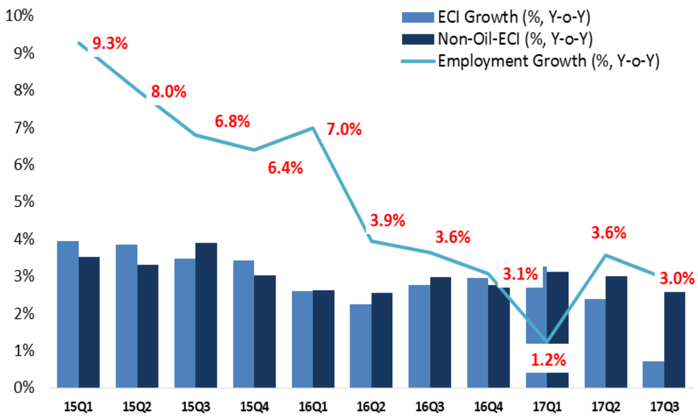
2.3 Employment and labor market dynamics

Although somewhat softer, the labor market in the UAE remains vibrant and the demand for labor continued its increase in the third quarter of 2017. It grew by 3% after an increase by 3.6% in the second quarter on a year on year basis (see Figure 2.3.a). The average quarterly growth rate of employment reached 2.6% in the first three quarters of the year against 4.8% in 2016 and 8% in 2015.

The improvement in oil prices and the resulting positive economic sentiment encouraged key sectors to expand their demand for labor and stimulate the dynamics of the labor market in general. In addition, the resiliency of the non-oil sector and the ongoing economic diversification played a major role in the third quarter, especially in the Real Estate, Construction and Manufacturing sectors.

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



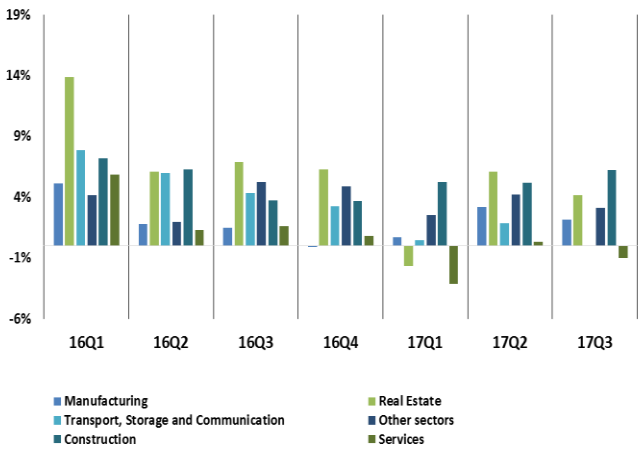
Source: CBUAE of UAE and Ministry of Human Resources and Emiratisation

The resiliency of the non-oil sector was depicted by the improvement of the Non-Oil Economic Composite Indicator (ECI) which expanded by 3.1% on a year on year basis (see Figure 2.3.a) in the third quarter of 2017. The economic rally was accompanied by a positive growth of employment in all sectors, except for the Services sector where the demand for labor declined by 1% on a year-on-year basis after an anemic growth in the second quarter by 0.3% and a crunch by 3.1% in the first quarter. Employment in the Services sector recorded weak performance in the first three quarters of the year, where the average quarterly growth was a decline by 1.3% (see Figure 2.3.b); the Services sector takes 22% of the labor force in the UAE.

On a year-on-year basis, labor demand in the Construction sector, which accounts for 34% of the total labor force, displayed a better performance than previously. It increased by 6.2% in the third quarter against 5.2% in the second quarter, leading to a 5.5% average quarterly increase in the first three quarters of 2017. The Real Estate sector expanded its demand for labor by 4.2% y-o-y in the third quarter, which accounts for 12% of the total labor force, against 6.1% in the second quarter of 2017. Employment in this sector improved significantly during the second and third quarters of the year against a decline by 1.7% during the first quarter of 2017. The Manufacturing sector, which absorbs around 9% of the labor force, expanded its demand for labor by 2.1% y-o-y in the third quarter against 3.2% during the previous one. Lastly, labor growth in the Manufacturing sector averaged 2% during the first three quarters of 2017 against 2.8% and 5.5% in 2016 and 2015, respectively.

Lastly, the demand for labor in Transport, Storage and Communication sector stagnated in the third quarter of 2017 after an expansion by 1.8% y-o-y in the second quarter, the lowest quarterly growth since more than a decade. The average quarterly growth of employment in this sector reached 0.8% in the first three quarters of the year against 6.1% and 8.6% in 2016 and 2015, respectively.

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



Source: Ministry of Human Resources and Emiratisation

On a quarterly basis, employment displayed the same slowdown pattern as the annual labor dynamics. As depicted by Figure 2.3.c, total employment grew by 0.5% in the third quarter of 2017 compared to the previous one where it grew by 1.1%. The Construction

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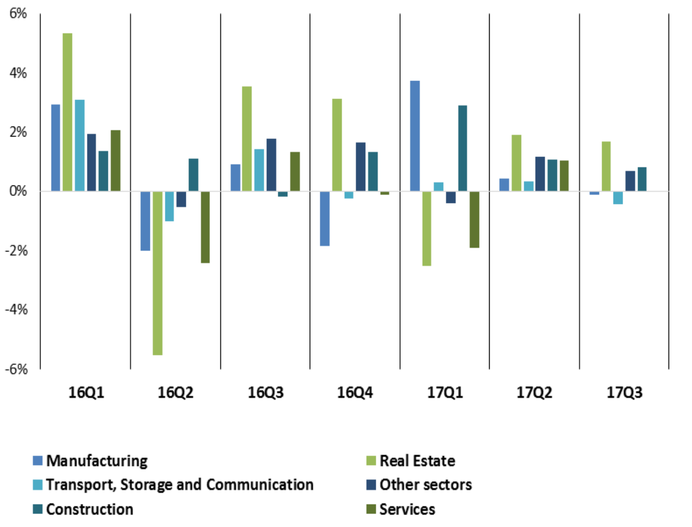
sector was the main contributor to this expansion whose demand for labor increased by 0.8% Q-o-Q. Labor demand declined by 0.1% and 0.4% in the Manufacturing and Transport, Storage and Communication sectors, respectively.

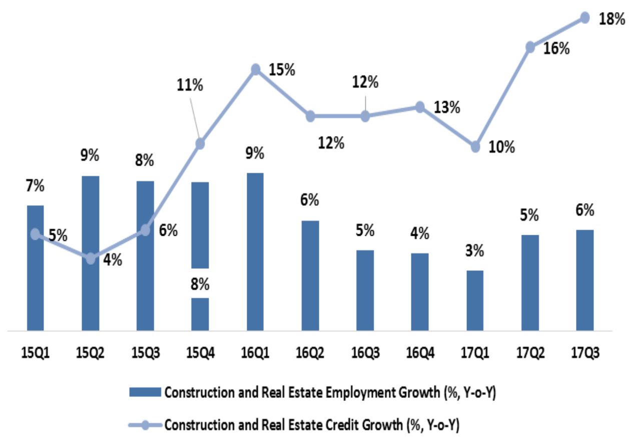
Figure 2.3.c Employment growth by sector (%, Q-o-Q)



Source: Ministry of Human Resources and Emiratisation

The surge of labor demand in the Construction and the Real Estate sectors was accompanied by a jump in domestic credit allocated to both sectors. The Construction and Real estate sectors altogether absorb around 46% of the labor force in the UAE. Employment in both sectors increased by 5.7% in the third quarter of 2017 on a year-on-year basis against 5.4% previously, coinciding with 18% surge in domestic credit for the same period (See Figure 2.3.d). The increase of the domestic credit for the construction and real estate sectors is the highest since the third quarter of 2014. The quarterly growth rate of employment in the Construction and Real Estate sectors and domestic credit in both sectors averaged 4.8% and 15% during the first three quarters of 2017, respectively.

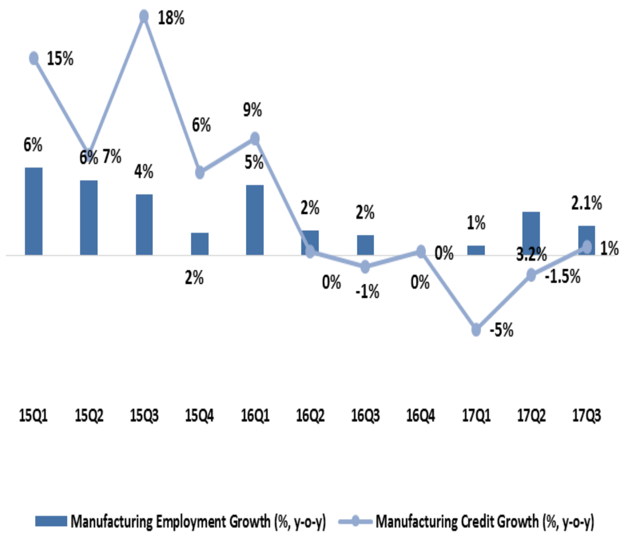
Figure 2.3.d Employment and Domestic Credit developments in the Construction and Real Estate sector



Source: Ministry of Human Resources and Emiratisation and CBUAE

In the manufacturing sector, the expansion of labor demand was accompanied for the first time since the first quarter of 2016 by an increase in domestic credit allocated to this sector. Employment in the Manufacturing sector grew by 2.1% on a year-on-year basis in line with an increase by 1% in the domestic credit (see Figure 2.3.e). On average, quarterly domestic credit to the Manufacturing sector dropped by 2% during the first three quarters of 2017 against a 3% expansion in 2016.

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



Source: Ministry of Human Resources and Emiratisation and CBUAE

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2.4 Exchange Rate and Foreign Trade Balance

The appreciation of the Dirham against the currencies of the UAE's major trade partners resumed in the fourth quarter of 2017 after two consecutive quarters of depreciation (Q2 and Q3). The Dirham had already appreciated for a relatively long period since mid-2014 until the beginning of 2017. The average quarterly weighted appreciation during this period was around 0.76% against the main import partners and 0.65% against non-oil export partners. Starting from the frist quarter of 2017, a depreciation trend has started and lasted for eight consecutive months commencing in February 2017.

On the import side, except for the Indian Rupee, the Japanese Yen and the Turkish Lira, the Dirham has depreciated against its top 9 non-dollarized import partners. The weighted Dirham's appreciation was 0.13% in the fourth quarter of 2017 compared to the previous one, after a depreciation of 1.23% in the previous quarter (see Table 2.3.a.).

The Dirham appreciated for the first time since end-2016 against the India Rupee. It gained 0.66% in the fourth quarter after a previous loss of 0.28%. The Dirham lost on average 1.6% against the Indian Rupee during the first three quarters of 2017; India is the second main source of imports to the UAE after China, accounting for 10% of total imports. The same pattern was observed against the Japanese Yen, where the Dirham appreciated by 1.7% in the fourth quarter of 2017 after previous depreciation by 0.07% and 2.22% in the third and second quarters of 2017. The highest gain of the Dirham was against the Turkish Lira (8.19%); Turkey contributes 2.46% of UAE's imports.

On the other hand, the sharpest depreciation was against the South Korean Won where the Dirham lost around 2.33%. China is the main import partner to the UAE with an import share of 11.85%. The Dirham depreciated against the Chinese Yuan by 0.87% following a larger depreciation of 2.76% in the third quarter. The average quarterly depreciation of the Dirham against the Renminbi was around 0.83% during 2017 against an appreciation of 1.7% and 1% in 2016 and 2015, respectively. In addition, the Dirham lost around 0.22% against the Euro; imports from Germany, Italy, and France account for 12% of total imports to the UAE. The depreciation is in-line with the depreciation of the US Dollar against the Euro, reflecting the positive recent economic developments in the Euro Area.

In addition, the Dirham lost 1.4% in the fourth quarter of 2017 against the UK pound adding to a 2.3% loss in the previous quarter. The appreciation of the UK Pound reflected the positive sentiment that the investors enjoyed following higher expectations of a soft Brexit, reinforced by positive economic data from the UK.

On a year-on-year basis, the Dirham depreciated also by 1.56%, the second depreciation since the third quarter of 2014, driven by 8.5%, 4.6%, 4% and 3.3% loss against the Euro, South Korean Won, Indian Rupee and Chinese Yuan, respectively.

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

Currency	Share of UAE imports (%) 2016	% Change of Currencies per Dirham (2017Q2 -2017Q1	% Change of Currencies per Dirham (2017Q3 -2017Q2	% Change of Currencies per Dirham (2017Q4 -2017Q3)	% Change of Currencies per Dirham (2017Q4 -2016Q4)
Chinese Yuan	11.85	-0.42	-2.76	-0.87	-3.33
Indian Rupee	9.92	-3.69	-0.28	0.66	-4.03
Germany (EUR)	6.66	-3.12	-6.44	-0.22	-8.48
Japanese Yen	5.10	-2.22	-0.07	1.70	2.99
Italy (EUR)	2.86	-3.12	-6.44	-0.22	-8.48
UK Pound	2.75	-3.11	-2.30	-1.41	-6.39
South Korean Won	2.52	-1.86	0.17	-2.33	-4.56
Turkish Lira	2.46	-3.06	-1.88	8.19	15.49
France (EUR)	2.35	-3.12	-6.44	-0.22	-8.48
Total	**46.48**				
Weighted Appreciation		**-1.11**	**-1.23**	**0.13**	**-1.56**

Source: Data on Imports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2016. Data for the exchange rates are the quarterly average observations, recorded and displayed by Bloomberg.

On the export side, the Dirham followed the same pattern and appreciated against all its non-oil export partners, except for the Singaporean Dollar (0.51%), the Chinese Yuan (0.87%) and the Euro (0.51%), which account altogether for 9.7% of total non-oil exports. The dirham's weighted appreciation against its top-nine non-dollarized non-oil export partners was 0.78% during the fourth quarter of 2017 (see Table 2.3.b). This pattern was driven by an appreciation of the Dirham against the Swiss Franc by 2.53% in the fourth quarter knowing that Switzerland receives 12.72% of the UAE's non-oil exports. The Dirham's appreciation against the Indian Rupee and the Turkish lira contributed to a large extent to the overall

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appreciation of the Dirham as the UAE's non-oil exports to India and Turkey account for 15%. The Indian Rupee and the Turkish Lira lost 0.66% and 8.19% against the Dirham, respectively, in the fourth quarter of 2017. In addition, the Dirham appreciated by 0.5%, 0.04% and 1.09% against the Iraqi Dinar, Kuwaiti Dinar and the Pakistani Rupee, respectively. Together, they account for 9.34% of the total non-oil exports from the UAE.

However, on a year-on year basis, the Dirham depreciated by 0.32%. This depreciation was driven by an important annual loss against the Euro and the Indian Rupee by 8.48% and 4.03%, respectively.

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

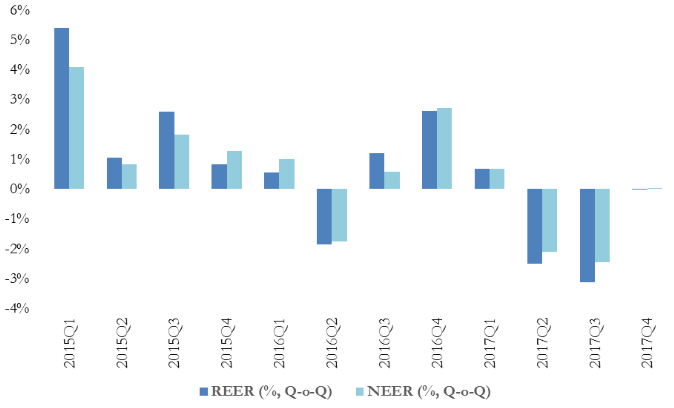
Currency	Share of UAE imports (%) 2016	% Change of Currencies per Dirham (2017Q2 -2017Q1	% Change of Currencies per Dirham (2017Q3 -2017Q2	% Change of Currencies per Dirham (2017Q4 -2017Q3)	% Change of Currencies per Dirham (2017Q4 -2016Q4)
Swiss Franc	12.72	-1.89	-2.31	2.53	-1.44
Indian Rupee	9.96	-3.69	-0.28	0.66	-4.03
Turkish Lira	4.96	-3.06	-1.88	8.19	15.49
Singapore Dollar	4.39	-1.67	-2.27	-0.51	-4.07
Iraqi Dinar	4.37	-0.96	-1.19	0.50	-1.54
Chinese Yuan	3.54	-0.42	-2.76	-0.87	-3.33
Kuwaiti Dinar	3.08	-0.40	-0.67	0.04	-0.65
Pakistani Rupee	1.89	-0.04	0.44	1.09	1.50
Netherlands (EUR)	1.79	-3.12	-6.44	-0.22	-8.48
Total	**46.71**				
Weighted Appreciation		**-0.96**	**-0.79**	**0.78**	**-0.32**

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

Accounting for all trading partners for the UAE, the Nominal Effective Exchange Rate (NEER) displays the same change as the weighted change of the Dirham against its imports and non-oil export partners. In fact, the quarterly average NEER increased slightly by 0.01% in the fourth quarter of 2017 compared to the previous quarter, after a previous decline of 2.4% (see Figure 2.4.a).

However, the Real Effective Exchange Rate (REER) fell slightly by around 0.02% for the same period against a previous decline by 3.1%. The Dirham's Real Effective Exchange Rate declined during the fourth quarter of 2017 on account of higher domestic inflation in the last quarter of the year (see Figure 3.4.a).

Figure 2.4.a Nominal and Real Effective Exchange rates developments



Source: Bank for International Settlement (BIS)

The Dirham's appreciation over an extended period before the second quarter of 2017 and its recent depreciation in the fourth quarter has raised some questions regarding the impact on remittances and Tourism activity in the UAE.

The personal outflows during the fourth quarter of 2017 decreased by 0.03 billion Dirham corresponding to a decrease by 0.1% on account of the recent depreciation of the Dirham. On an annual basis, remittances increased by 2.6%. India remains the main destination of remittance outflows with a share of 34.2% during the fourth quarter of 2017 (see Box 2 for more details).

On the other hand, the fluctuations of the Dirham did not seem to have an adverse impact on the tourism sector thanks to price flexibility. An improvement of the tourism activity has been recorded during the last quarter of 2017. During this period, compared to the same period in 2016, 4.7% more guests stayed in hotels in Abu Dhabi, Dubai and RAK, showing a strong pattern to attract international visitors. Simultaneously, the average revenue per available room increased by 2.7% during the fourth quarter of 2017, compared to a 1% fall during the fourth quarter of 2016 (weighted average prices of the Abu Dhabi, Dubai and Ras Al Khaimah), (see Box 3 for more details).

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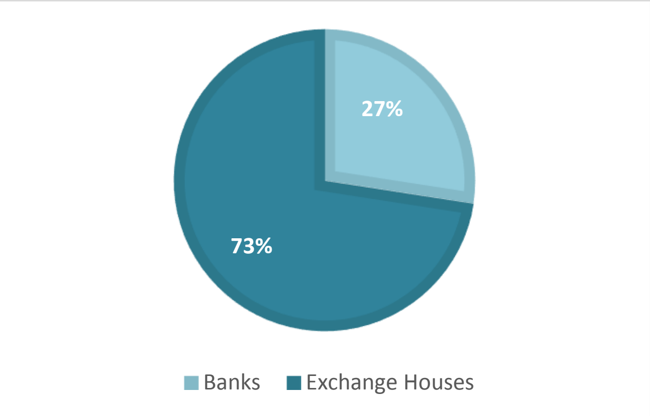
Box 2: Outward Personal Remittances

This Box illustrates developments in the outward remittances by individuals through UAE banks and exchange houses in the fourth quarter of 2017, in comparison to the same period in the previous year. It also analyzes outward remittances to five major destinations and the effect of the change in the exchange rates between the currencies of these countries and the UAE dirham on these remittances in the fourth quarter of 2017.

Statistical data, captured by the Banking Supervision Department, show that in the fourth quarter of 2017, total remittances outflows by individuals from UAE banks and exchange houses combined stood at AED 43.2 billion. Of which, 72.6% of these remittance outflows were through the exchange houses (31.4 billion) and the remaining 27.4% were through banks (11.9 billion) (Figure 1).

Figure 1: Share of Total Outward Individual Remittances by Banks & Exchange Houses Q4/2017

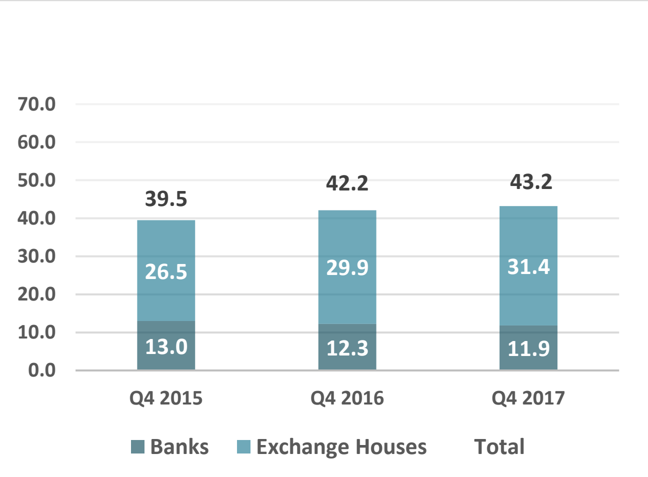


Source: CBUAE

The total outward money transfers by individuals via the UAE banks and exchange houses to their home countries have been growing consistently over the past three years. This is attributed to the rising population of the expatriate workers in the growing UAE economy (Figure 2).

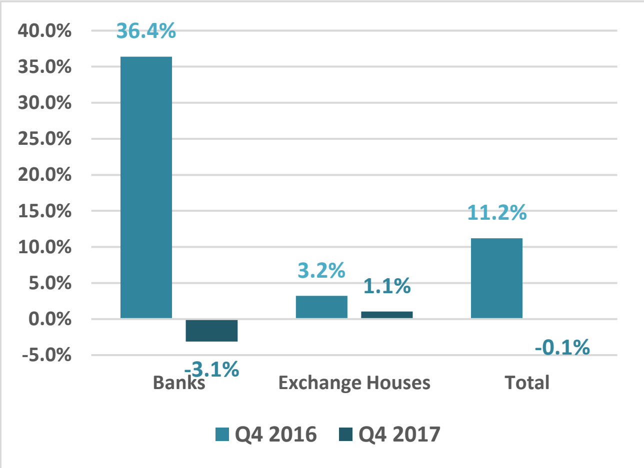
Figure 3 exhibits the quarterly change in outward personal remittances in quarters four of 2016 and 2017. Although the total amount of outward individual remittances is growing on an annual basis, outward individual money transfers fell by 0.1% or AED 0.03 billion, falling from AED 43.26 in Q3 2017 to AED 43.23 billion in the fourth quarter of 2017. Whereas, during the fourth quarter of 2016 there was an 11.2% quarterly increase, rising from AED 37.93 billion in Q3 2016 to AED 42.2 billion in Q4 2016. The total

Figure 2: Evolution of Individual Remittance Outflows through Banks & Exchange Houses in the UAE



Source: Central Bank of the UAE

Figure 3: Quarterly Change in Outward Individual Remittances



Source: Central Bank of the UAE

amount remitted through exchange houses increased by 1.1% or AED 0.33 billion in the fourth quarter of 2017 compared to 3.2% increase in the corresponding quarter of 2016 (AED 29.86 billion). Outward remittances by individuals through banks in quarter four of 2017 decreased by 3% (From AED 12.24 billion to AED 11.86 billion) compared to the 36.4% increase in the fourth quarter of 2016 (from AED 9 billion to AED 12.3 billion).

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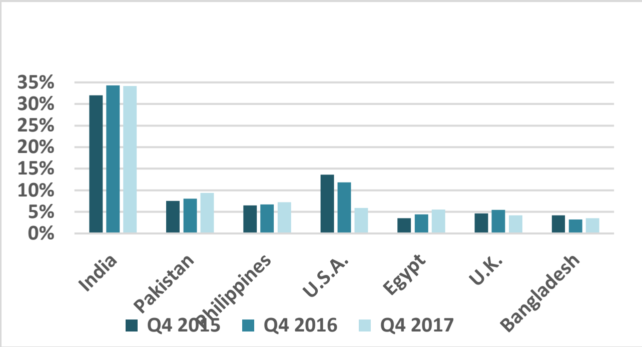
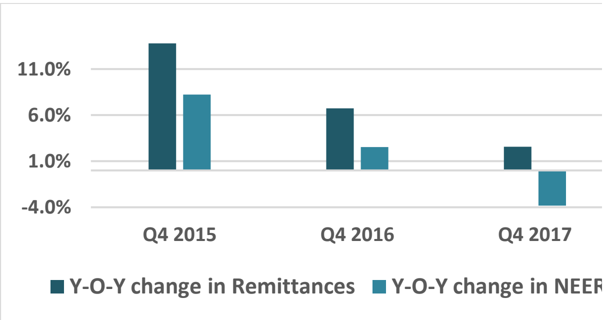
Figure 4: Shares of top seven destinations of personal remittances through banks & exchange houses



Source: CBUAE

Figure 4 shows shares of outflows to top seven personal remittance-receiving countries, from the UAE via banks and exchange houses, in the Fourth quarters of 2015, 2016 and 2017. In Q4 2017, a combined 70% of individual remittances were transmitted from the UAE banks and exchange houses to only seven countries, India accounting for 34.2% of the total outflows (AED 14.8 billion). This is consistent with the highest number of Indian expatriate workers in the UAE. Other countries that significantly contributed to the outflows of remittances are; Pakistan 9.4% (AED 4.1 billion), Philippines 7.1% (AED 3.1 billion), United States of America 5.9% (2.6 billion), Egypt 5.5% (AED 2.4 billion), United Kingdom 4.2% (AED 1.8 billion) and Bangladesh 3.6% (AED 1.5 billion) of the total outflows of remittances from the UAE. These shares of remittances are directly proportional to the percentage of expatriate workforce in the UAE from each country.

Figure 5: Percentage change in total remittances versus the percentage change in nominal exchange rate Q4 2015 - 2017

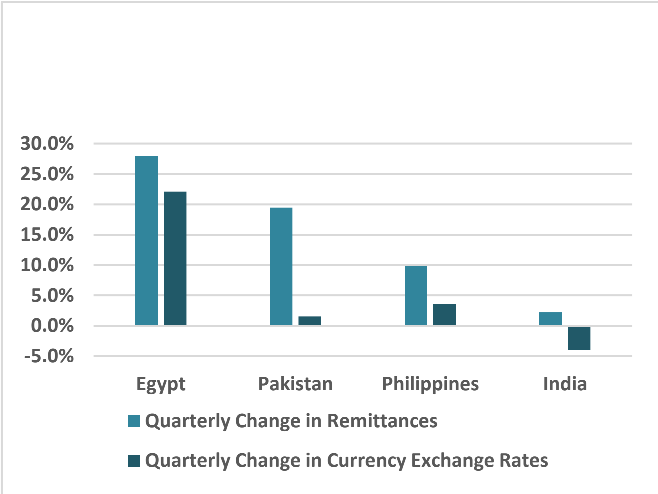


Source: CBUAE and BIS

Furthermore, a distinct direct relation exists between the average nominal effective exchange rate and the average outward personal remittances through banks and exchange houses in the UAE. Based on the Bank of International Settlements data, the average nominal effective exchange rate index for the fourth quarter of 2017 was 115.7 which correspond to a total amount of personal outward remittances through banks and exchange houses of 43.2 billion (Figure 5). In contrast to Q4 2016, remittance outflows grew less in Q4 2017 due to pronounced depreciation of the dirham nominal effective exchange rate in contrast to its appreciation in Q4 2016, which corresponds to a larger growth of remittances outflows.

Figure 6 illustrates the relation between the quarterly change of outflows of individual remittances from the UAE banks and exchange houses to its top four destinations and the evolution of the bilateral exchange rate of the AE dirham relative to the currencies of those countries during quarter four of 2017.

Figure 6: Quarterly change in outward personal remittances to top four countries versus the quarterly change in the bilateral exchange rates of their currencies in Q 4 2017



Source: CBUAE and BIS

During the fourth quarter of 2017, the Egyptian Pound and the Philippine Piso depreciated by 22.1% and 3.6%, respectively, to the AE dirham, which increased the outward personal remittances to Egypt and the Philippines by 28% and 9.9%, respectively.

Similarly, the outward flow of Individual remittances through banks and exchange houses to Pakistan increased by 19.5% when the Pakistani Rupee to AE dirham depreciated by 1.5%.

Whereas, the appreciation of the Indian rupee relative to the AE dirham (quarterly 4% depreciation

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of the dirham relative to the Indian rupee) slowed the outflows of remittances to India to only 2.2% quarterly increase, compared to a larger increase of 14.5% in Q4 2016 when there was a 2.3% quarterly depreciation of the Indian rupee relative to the dirham.

Outflow of remittances sent by individuals to the United States of America through the UAE banks and exchange houses decreased by 48.6% during the fourth quarter of 2017. However, the USA remains in the top five remittance-receiving countries, with AED 2.6 billion sent during the fourth quarter of 2017.

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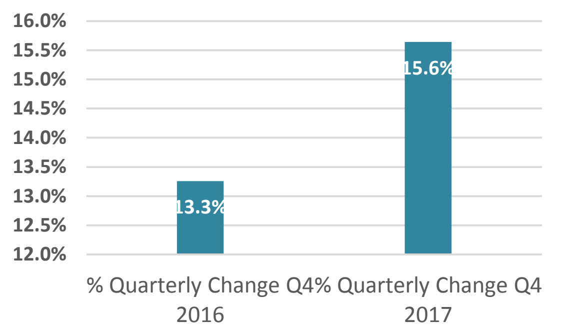
Box 3: Tourism and Hotel Occupancy in the UAE

This box focuses on developments in tourism with respect to hotel occupancy in the Emirates of Dubai, Abu Dhabi and Ras Al Khaimah (RAK), three major tourist destinations in the UAE that contribute the largest shares of the total aggregates, during the fourth quarter of 2017 compared to the same period of 2016. The Box also looks at developments in the average nominal effective exchange rate (NEER) of the AE dirham and implications on the average occupancy rate.

During the fourth quarter of 2017, 5.8 million guests stayed at hotels in Abu Dhabi, Dubai and RAK, registering 4.7% more occupancy than during the fourth quarter of 2016 (5.5 million).

Figure 1: Hotel Guest Occupancy During the Fourth Quarters of 2016 & 2017



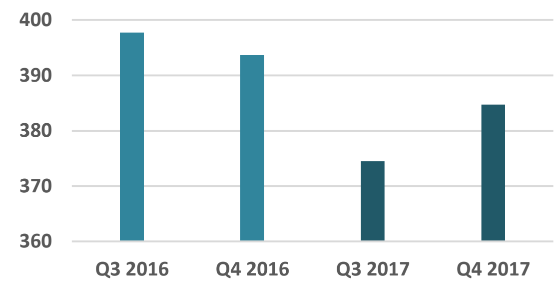
Source: Abu Dhabi Tourism & Culture Authority, Dubai Corporation of Tourism and Commerce Marketing & Ras Al Khaimah Tourism Development Authority

On a quarterly basis, hotel occupancy increased by 15.6% during Q4 2017, whereas, it had increased by 13.3% during the same period in 2016.

The average length of stay (ALOS) of hotel guests, in the three Emirates, during the fourth quarter of 2017 remained the same as during the fourth quarter of 2016, averaging at 3.2 days, with a 2.1% quarterly increase.

During the fourth quarter of 2017, the average revenue per available room in the Emirates of Abu Dhabi, Dubai and RAK, increased by 2.7% compared to a 1% fall during the same period in 2016. The average revenue per room during the third and fourth quarters of 2017 were AED 374.5 and AED 384.7, respectively. In comparison, the average revenue per available room in the three Emirates during the third and fourth quarters of 2016 was AED 397.7 and AED 393.6, respectively. This upturn during the second half of 2017 indicates improvement in the hotel occupancy from the first half of 2017.

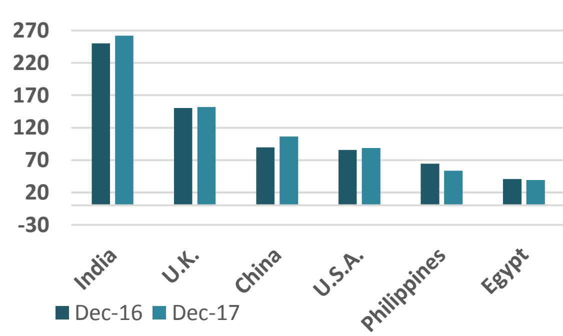
Figure 2: Revenue per Available Room



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

In December 2017, the most numbers of hotel guests in Abu Dhabi, Dubai and RAK, were from India (262.3 thousand), United Kingdom (151.9 thousand), China (106.6 thousand), United States of America (88.6 thousand), Egypt (39.1 thousand) and the Philippines (53.5 thousand). The numbers were comparatively less during December 2016, except for nationals of Philippines, which totaled at 64.3 thousand during December 2016.

Figure 4: Top Five Nationalities Visiting the UAE during December 2016 & 2017



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

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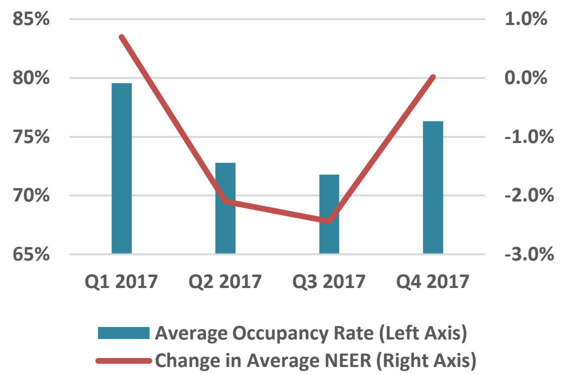
Figure 4 shows the direct relationship between the average occupancy rate and the change in average nominal effective exchange rate (NEER) each quarter.

Figure 4: Average Occupancy Rate vs. Change in Average NEER



Source: Abu Dhabi Tourism & Culture Authority, Dubai Corporation of Tourism and Commerce Marketing, Ras Al Khaimah Tourism Development Authority & Bank of International Settlements (BIS)

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

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2.5 Consolidated Fiscal Stance

The fiscal consolidation initiated at the beginning of 2015 by the UAE in response to the oil price plunge came to an end in the fourth quarter of the same year, resulting in an annual decline of government spending by 10.7% in 2015 (see Table 2.5)[5].

In 2016, fiscal expansion resumed its course, leading to an annual increase of public spending by 19.3% driven by an increase of the capital spending by 59.4%. The highest quarterly increase was recorded in the third quarter of 2016 by 35% y-o-y. Capital spending climbed by 93% in the first quarter of 2016 compared to the same period of 2015. Similarly, government revenues increased by 42% in 2016 boosted by the jump of revenues by 109% in the fourth quarter of which tax revenues, including royalties on oil companies, increased by 16.4%.

The recent rally of oil prices as well as the strategy of the government to adopt a growth-friendly fiscal policy reflected positively on the fiscal developments in the first nine months of 2017. In fact, total public spending increased by 23.3% during the first three quarters of the year compared to the same period of 2016. An important increase of public spending was recorded during the first two quarters, which was partially offset by the decline during the third quarter by 22%.

The fiscal tightening observed during the third quarter of 2017 was driven mainly by the decline of capital spending by 47.6% y-o-y adding to a previous decline by 52.6% in the second quarter. Social benefits fell also by 27.2% in the third quarter compared to the same period of the previous year. In addition, Other Expenses which cover all of Abu Dhabi's transfers made on behalf of the Federal Government dropped by 48% in the third quarter adding to a previous decline by around 14% during the second quarter of 2017.

The development of Official Grants, subsidies and Compensation of Employees in the third quarter represented a remarkable exception. Official grants awarded by the UAE Government increased significantly in the third quarter of 2017 by 62% compared to the same period of 2016 after a persistent decline in 2015. Subsidies, which contain also the transfers to GREs, continued its increasing trend during the third quarter of 2017 and grew by 190%, adding 224.2% and 59.2% in the second and first quarters, respectively. Since the UAE implemented many reforms that are intended to reduce the amount of social subsidies, the developments in the Subsidies line is likely to be attributed to the increase of the Government's transfers to GREs.

The Compensation of employees rebounded by 12% y-o-y in the third quarter of 2017 adding to a previous increase by 47.7%. The highest increase was recorded in the first quarter of 2017 where the compensation for employees jumped by around 50% Y-o-Y.

On the Other hand, total revenues continued their improvement in the third quarter of 2017, confirming an increasd trend that started at the beginning of 2016. They displayed an important increase of 109% during the fourth quarter of 2016, on a year-on-year basis after an increase of 10.3% during the previous quarter, leading to an annual jump of 42% in 2016 against a decline of 26% in 2015. The same pattern was observed in the first three quarters of 2017. Total revenues jumped by 38.5% in the first nine months of 2017 to which the third quarter contributed by 13.2% y-o-y increase. The improvement in revenues was triggered by a 12% increase in tax revenues (royalties on oil companies), the fourth consecutive increase since the third quarter of 2016 in consistency with the recovery of oil prices.

Other revenues, which include principally the property income, sales of goods and services and fines and penalties, jumped by 13.8% after a previous decline by 12%. These revenues do not include profit transfers from the national oil company to the sovereign wealth funds, neither do they include the government's investment income.

Social contributions displayed their first increase since the last quarter of 2016. They expanded by 8.3% in the third quarter of 2017 against an average decline of 5.6% during the first two quarters of the year.

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

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Table. 2.5. Consolidated Government Finances

	2015	Change (%, Y-o-Y)					2016					Change (%, Y-o-Y)					2017				Change (%, Y-o-Y)			
		2015Q1	2015Q2	2015Q3	2015Q4	2015	Q1	Q2	Q3	Q4	2016	2016Q1	2016Q2	2016Q3	2016Q4	2016	Q1	Q2	Q3	First 9 Months	2017Q1	2017Q2	2017Q3	First 9 Months 2017
Revenues (a)	**281.3**	**-34.0**	**-14.2**	**-18.6**	**-38.1**	**-26.1**	**85.7**	**102.7**	**84.9**	**126.5**	**399.8**	**43.9**	**21.9**	**10.3**	**109.0**	**42.1**	**170.9**	**111.6**	**96.1**	**378.6**	**99.5**	**8.7**	**13.2**	**38.5**
Taxes	160.0	-42.1	-25.4	-44.5	-59.0	-42.8	21.1	26.0	28.9	32.7	108.8	-46.5	-48.5	-30.9	16.4	-32.0	70.7	44.1	32.5	147.2	234.8	69.4	12.1	93.5
Social contributions	4.3	14.0	-27.8	172.0	-55.9	-18.9	1.5	1.2	1.2	0.9	4.7	37.5	3.4	15.0	-15.3	10.1	1.3	1.2	1.3	3.8	-10.2	-1.1	8.3	-1.7
Other revenues	116.9	-10.4	13.2	82.6	16.6	22.5	63.1	75.5	54.8	92.9	286.3	232.2	132.2	61.0	196.0	144.8	98.9	66.4	62.4	227.6	56.8	-12.1	13.8	17.7
Expenditure (b)	**370.4**	**-13.3**	**0.1**	**-3.7**	**-22.2**	**-10.7**	**98.3**	**107.0**	**119.6**	**117.1**	**442.1**	**10.1**	**9.5**	**35.1**	**23.5**	**19.3**	**183.8**	**123.4**	**93.4**	**400.6**	**86.9**	**15.3**	**-21.9**	**23.3**
Compensation of employees	63.0	45.6	46.5	35.8	9.0	32.6	15.5	15.8	15.8	18.2	65.2	0.8	-5.7	1.9	17.9	3.5	23.3	23.0	17.7	63.9	49.8	45.7	12.1	35.8
Use of goods and services	59.8	43.1	29.6	-6.1	25.4	20.8	10.4	14.8	19.9	17.1	62.3	-17.9	-5.8	53.9	-7.3	4.1	15.2	20.2	18.1	53.5	46.2	36.4	-9.5	18.4
Consumption of fixed capital	4.6	6.0	54.7	-10.1	42.1	21.9	1.1	1.5	1.2	2.1	5.9	25.0	32.4	24.9	32.4	29.4	1.3	1.6	1.6	4.5	17.9	3.2	33.0	16.6
Interest	2.8	-52.4	-49.1	-38.3	6.9	-31.5	0.2	0.4	0.3	1.0	2.0	-49.0	-16.0	-45.5	-18.8	-28.7	0.8	0.9	0.3	1.9	216.5	98.1	-5.5	95.4
Subsidies	12.3	10.2	-22.8	17.9	6.0	1.7	2.1	4.1	1.6	1.0	8.8	-25.0	50.1	-61.6	-62.5	-28.4	6.7	6.6	4.5	17.8	224.2	59.2	190.1	129.5
Grants	8.8	-86.3	-54.9	-55.1	507.3	-60.0	0.5	0.5	6.9	8.0	15.9	-66.0	-81.3	179.9	276.4	81.6	10.3	17.4	11.2	38.9	2142.3	3196.0	62.1	390.9
Social benefits	42.6	-18.8	-9.7	-32.5	-52.5	-30.7	9.3	8.4	8.5	9.0	35.3	-9.0	-32.5	-22.3	0.8	-17.2	8.3	6.1	6.2	20.6	-11.4	-27.3	-27.2	-21.6
Other expenses	141.5	-24.3	-1.8	7.1	-37.9	-18.9	46.3	47.8	50.1	46.6	190.8	19.4	38.9	54.7	29.7	34.8	83.2	41.2	25.9	150.2	79.6	-13.8	-48.3	4.2
Net acquisition of non-financial assets	35.1	21.2	-18.5	-7.0	-24.9	-12.1	12.8	13.6	15.4	14.1	55.9	93.0	21.6	74.2	67.4	59.4	34.7	6.4	8.1	49.3	171.0	-52.6	-47.6	17.8

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

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

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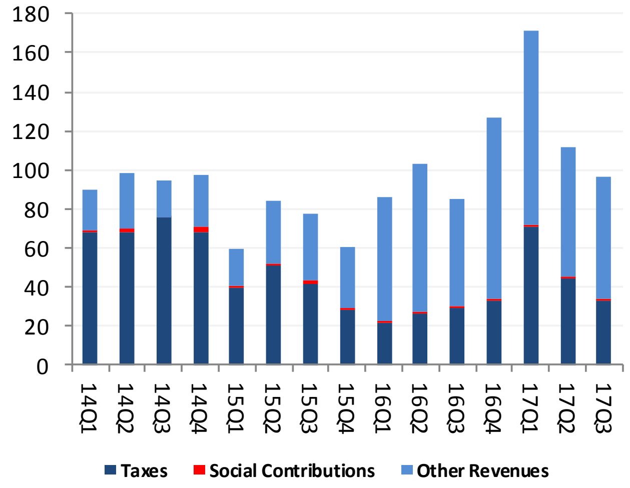
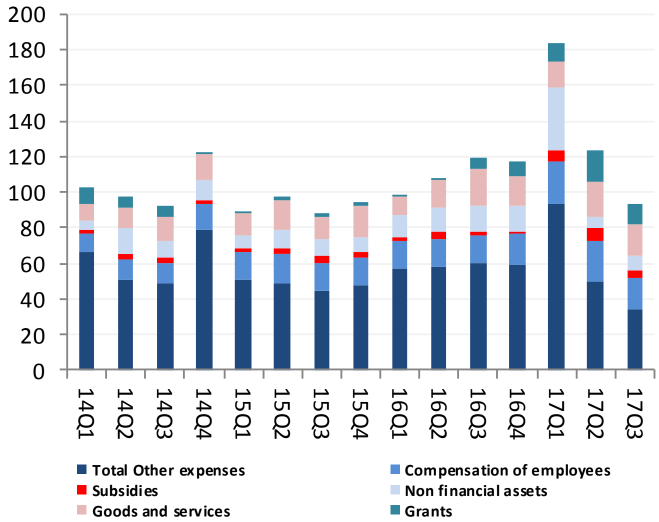
Government Finances

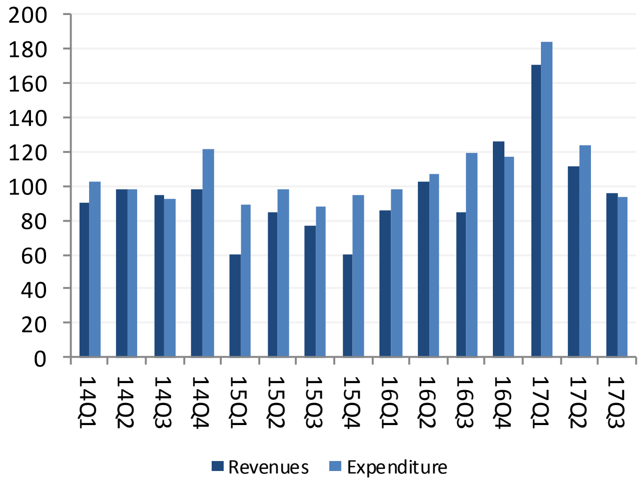
2.5. a. General government revenues
(Billions of Dirhams)



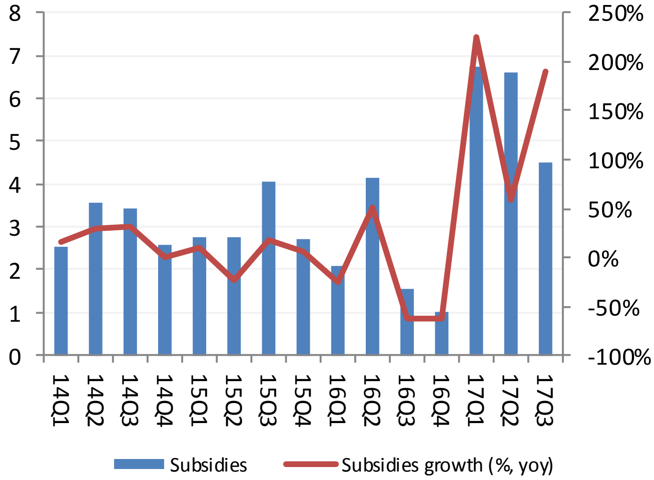
2.5.b. General government expenditures
(Billions of Dirhams)



2.5.c. Fiscal stance
(Billions of Dirhams)



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



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

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Chapter 3. Banking and Financial Developments

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

3.1 Banking Structure

The 22 national banks have decreased the number of branches to 771 at the end of 2017 Q4 compared to 810 at the end of the third quarter of 2017. The number of foreign banks has increased to 27 from 26 in the previous quarter and the number of foreign banks branches was reduced to 82 at the end of 2017 compared to 85 at the end of September. At the same time the number of bank employees has increased for the national banks and remained almost unchanged for the foreign banks. It moved from 28,767 and 7,316 for national and foreign banks, respectively at the end of 2017 Q3 to a headcount of 29,056 and 7,311, respectively at the end of the year.

3.1.1. Banks' Deposits

Total Customer Deposits at banks increased in the fourth quarter of 2017 by AED 31.5 billion due to the hike in Resident Deposits by AED 28.2 billion, while Non-resident Deposits rose by AED 3.3 billion.

The growth in Resident Deposits in 2017 Q4 is essentially due to the steady rise in all components, except NBFIs: Government sector increased by 5.4% or AED 10.8bn, GREs by 4.9% or AED 8.9bn, Private sector by 0.9% or AED 8.8bn, while NBFIs declined by 1% or AED 0.3bn. The Non-Resident deposits increased by 1.8% or AED 3.3bn during the fourth quarter of 2017, with their share in total deposits remaining the same as in the previous quarter at 11.8%. In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 76.4% and 23.6% of the total deposits. Figures 3.1.1.a and 31.1.b, and Table 3.1.1.b show that in the fourth quarter of 2017 the growth in both Islamic and Conventional banks remains at 2%, and on a Y-o-Y basis the increase of Islamic deposits has reached 10.1%, while for the Conventional ones it was at 2.4%. Looking at the subcategories, the growth in Islamic banks in the fourth quarter is stronger for the Private sector, NBFIs and Non-Resident Deposits, while the Conventional banks were dominating for the deposits of Government and GREs sectors.

Table 3.1.1.a. Deposits at UAE Banks

	2016	2017			
	Dec	Mar	Jun	Sep	Dec*
Bank Deposits	**1,562.9**	**1,602.0**	**1,589.1**	**1,595.8**	**1,627.3**
(Q-o-Q change %)	3.6	2.5	-0.8	0.4	2.0
(Y-o-Y change %)	6.2	6.6	6.4	5.8	4.1
Resident Deposits	**1,363.9**	**1,413.0**	**1,433.5**	**1,407.5**	**1,435.7**
(Q-o-Q change %)	3.2	3.6	-0.3	-0.1	2.0
(Y-o-Y change %)	4.9	6.6	7.1	6.5	5.3
Government Sector	**186.8**	**194.0**	**196.8**	**201.2**	**212.0**
(Q-o-Q change %)	10.2	3.9	1.4	2.2	5.4
(Y-o-Y change %)	18.7	24.8	5.9	18.7	13.5
GREs	**168.2**	**192.0**	**189.6**	**183.0**	**191.9**
(Q-o-Q change %)	-1.8	14.0	-1.3	-3.5	4.9
(Y-o-Y change %)	-11.8	-0.7	17.4	6.9	14.0
Private Sector	**980.7**	**998.3**	**983.6**	**991.9**	**1,000.7**
(Q-o-Q change %)	2.5	1.8	-1.5	0.8	0.9
(Y-o-Y change %)	6.2	5.3	4.1	3.7	2.1
NBFI	**28.2**	**28.7**	**39.3**	**31.4**	**31.1**
(Q-o-Q change %)	14.6	1.8	36.9	-20.1	-1.0
(Y-o-Y change %)	0.4	1.8	69.4	27.6	10.3
Non-Resident Deposits	**199.0**	**189.0**	**179.8**	**188.3**	**191.6**
(Q-o-Q change %)	6.5	-5.0	-4.9	4.7	1.8
(Y-o-Y change %)	16.0	6.5	1.5	0.7	-3.7

Source: CBUAE
Note: All data indicate the end of period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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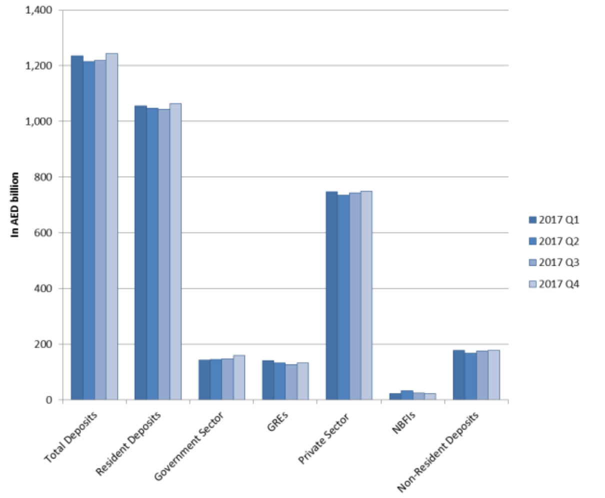
Table 3.1.1.b. Deposits at Conventional/Islamic Banks

	Conventional		Islamic	
	2017 Sep	2017 Dec*	2017 Sep	2017 Dec*
Bank Deposits	**1,220**	**1,244**	**376**	**384**
(Q-o-Q change %)	1.2	2.0	0.4	2.0
(Y-o-Y change %)	4.6	2.4	9.6	10.1
Share of Total, %	76.4	76.4	23.6	23.6
Resident Deposits	**1,044**	**1,065**	**364**	**371**
(Q-o-Q change %)	-0.3	2.0	0.5	1.9
(Y-o-Y change %)	5.7	3.9	8.8	9.4
Share of Total, %	74.1	74.2	25.9	25.8
Government Sector	**147**	**159**	**54**	**53**
(Q-o-Q change %)	1.1	8.0	5.5	-1.9
(Y-o-Y change %)	19.0	11.1	17.9	21.3
Share of Total, %	73.2	75.0	26.8	25.0
GREs	**127**	**133**	**56**	**59**
(Q-o-Q change %)	-4.2	5.0	-1.8	4.6
(Y-o-Y change %)	0.4	11.0	25.2	21.3
Share of Total, %	69.3	69.4	30.7	30.6
Private Sector	**744**	**749**	**248**	**252**
(Q-o-Q change %)	1.3	0.7	-0.4	1.5
(Y-o-Y change %)	3.9	1.6	3.2	3.5
Share of Total, %	75.0	74.9	25.0	25.1
NBFI	**25**	**23**	**6**	**8**
(Q-o-Q change %)	-25.7	-7.5	14.8	25.8
(Y-o-Y change %)	22.3	-2.9	55.0	85.7
Share of Total, %	80.3	74.9	19.7	25.1
Non-Resident Deposits	**176**	**179**	**12**	**13**
(Q-o-Q change %)	5.3	1.5	-2.4	4.9
(Y-o-Y change %)	-1.3	-5.7	43.5	36.2
Share of Total, %	93.5	93.3	6.5	6.7

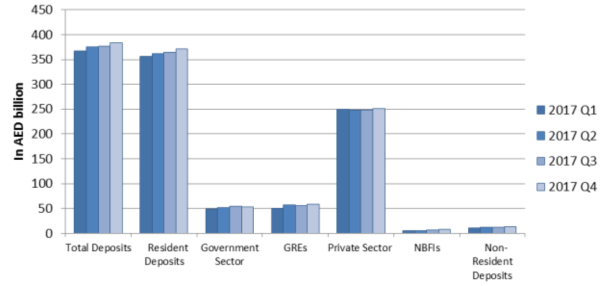
Source: CBUAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

The breakdown of National and Foreign banks in Figures 3.1.1.c and 3.1.1.d show that National and Foreign banks experienced an increase in 2017 Q4 Q-o-Q. National banks grew at a rate of 2.1% and 5% Q-o-Q and Y-o-Y respectively in contrast to Foreign banks for which deposits rose marginally by 1.3% on a Q-o-Q basis and declined by 1.8% compared to 2016 Q4. At the end of 2017 Q4, 87.3% of the total deposits are in National banks and 12.7% are in Foreign banks.

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

	National		Foreign	
	2017 Sep	2017 Dec*	2017 Sep	2017 Dec*
Bank Deposits	**1,391**	**1,420**	**205**	**207**
(Q-o-Q change %)	0.5	2.1	0.1	1.3
(Y-o-Y change %)	7.0	5.0	-2.0	-1.8
Share of Total, %	87.2	87.3	12.8	12.7
Resident Deposits	**1,236**	**1,261**	**172**	**174**
(Q-o-Q change %)	-0.1	2.1	-0.2	1.6
(Y-o-Y change %)	7.3	5.9	1.0	1.2
Share of Total, %	87.8	87.9	12.2	12.1
Government Sector	**199**	**210**	**2**	**2**
(Q-o-Q change %)	2.2	5.4	5.9	5.6
(Y-o-Y change %)	18.4	13.3	63.6	46.2
Share of Total, %	99.1	99.1	0.9	0.9
GREs	**176**	**183**	**7**	**9**
(Q-o-Q change %)	-3.9	3.6	10.0	39.4
(Y-o-Y change %)	8.2	13.5	-18.5	24.3
Share of Total, %	96.4	95.2	3.6	4.8
Private Sector	**834**	**843**	**158**	**158**
(Q-o-Q change %)	1.2	1.0	-0.8	0.1
(Y-o-Y change %)	4.0	2.4	2.1	0.3
Share of Total, %	84.1	84.2	15.9	15.8
NBFI	**26**	**26**	**5**	**5**
(Q-o-Q change %)	-23.6	-0.8	4.0	-1.9
(Y-o-Y change %)	40.9	16.6	-13.3	-13.6
Share of Total, %	83.4	83.6	16.6	16.4
Non-Resident Deposits	**155**	**159**	**33**	**33**
(Q-o-Q change %)	5.4	2.1	1.5	0.0
(Y-o-Y change %)	4.9	-1.0	-15.1	-14.9
Share of Total, %	82.4	82.7	17.6	17.3

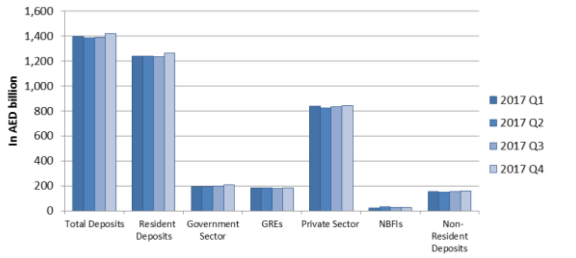
Source: CBUAE

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

***:** Preliminary figures subject to revision.

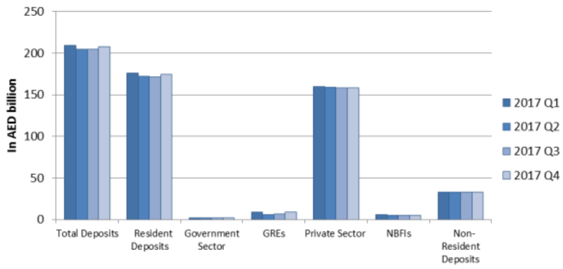
The sectors growing the most in 2017 Q4 for National banks were the Government sector by 5.4% Q-o-Q (13.3% Y-o-Y) and the GREs sector by 3.6% Q-o-Q (13.5% Y-o-Y), reflecting the ongoing fiscal consolidation and improved oil price. For the Foreign banks in the fourth quarter of 2017, the breakdown shows that the biggest increase was for the GREs sector deposits, growing by 39.4% on a quarterly basis. On an annual basis, deposits for this segment grew by 24.3% or AED 1.8bn in Foreign banks. However GREs' deposits are very low in foreign banks, and hence their impact on the overall growth remains marginal.

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



Source: CBUAE

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



Source: CBUAE

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3.1.2. Banks' Credit

Domestic Credit increased marginally in 2017 Q4 by AED 0.7bn (0%), which corresponded to a growth of a 1.7% Y-o-Y. For the underlying domestic credit, there was a decrease in lending to the Government by 3.4% Q-o-Q or AED 6.1bn and deleveraging by GREs by AED 1.2bn (0.7%). Nonetheless, credit to NBFIs grew by AED 1.9bn (9.3%) and Foreign credit grew by AED 5.6bn (4.2%) quarterly. Meanwhile, the Private Sector was borrowing at a pace of 1.4% and 2.9% Q-o-Q and Y-o-Y (Private Corporates credit grew at 1.8% and 2.6% Q-o-Q and Y-o-Y, respectively, while Credit to Individuals increased by 0.7% and 3.5% Q-o-Q and Y-o-Y, respectively), which offset the decline in all other sectors.

Islamic banks have a share of 20.4% in the assets and 22.4% in the gross financing of the total banking system. The breakdown of the assets and lending by Conventional and Islamic banks in Figures 3.1.2.a. and 3.1.2.b. indicates that Islamic banks' financing was declining by 1.1% during the last quarter of 2017 due to Domestic Credit falling in all categories, except for Credit to NBFIs and Individuals, where there was no change Q-o-Q. In parallel, credit to the Non-residents category increased by AED 0.8bn or 3.4% in 2017 Q4, but the decline was not enough to offset the chute in the resident segment. For the same period, conventional banks marked a hike of 0.4% Q-o-Q, notwithstanding several of their credit sectors experienced deleveraging with the exception of credit to GREs, Private Corporates and Individuals, which offset the decline in the other categories.

On an annual basis, as of December 2017, conventional banks marked an increase of 2.8% and a reduction of 0.7% for banks' assets and gross credit, respectively, while for the Islamic banks they were both growing at 8.8% and 5.6%, respectively.

	2016	2017			
	Dec	Mar	Jun	Sep	Dec*
Total Assets	**2,593**	**2,627**	**2,632**	**2,643**	**2695**
(Q-o-Q change %)	**2.5**	**1.3**	**0.2**	**0.4**	**2.0**
(Y-o-Y change %)	**5.4**	**6.3**	**5.4**	**4.5**	**4.0**
Gross Credit	**1,554**	**1,575**	**1,569**	**1,580**	**1,581**
(Q-o-Q change %)	0.5	1.4	-0.4	0.7	0.0
(Y-o-Y change %)	6.0	5.2	3.0	2.2	1.7
Domestic Credit	1,433	1,451	1,435	1,447	1,453
(Q-o-Q change %)	0.6	1.2	-1.1	0.9	0.4
(Y-o-Y change %)	5.2	4.8	2.0	1.5	1.4
Government	172	177	178	182	175
(Q-o-Q change %)	-1.0	2.6	0.6	2.0	-3.4
(Y-o-Y change %)	3.5	4.8	5.5	4.3	1.7
Public Sector (GREs)	187	195	179	175	174
(Q-o-Q change %)	-0.3	3.9	-8.1	-2.0	-0.7
(Y-o-Y change %)	9.3	7.7	-4.6	-6.7	-7.0
Private Sector	1,055	1,059	1,058	1,070	1,085
(Q-o-Q change %)	-1.1	0.4	-0.1	1.1	1.4
(Y-o-Y change %)	5.5	2.8	0.6	0.4	2.9
Business & Industrial Sector Credit	728	731	729	735	748
(Q-o-Q change %)	1.2	0.4	-0.4	0.8	1.8
(Y-o-Y change %)	5.9	5.5	2.7	2.0	2.6
Individual	326	328	330	335	338
(Q-o-Q change %)	0.3	0.4	0.6	1.7	0.7
(Y-o-Y change %)	4.7	3.5	2.5	3.1	3.5
Non-Banking Financial Institutions	19	20	20	21	19
(Q-o-Q change %)	4.4	5.8	-3.0	5.1	-9.3
(Y-o-Y change %)	-23.1	-20.6	6.0	12.6	-2.1
Foreign Credit	120	125	134	133	127
(Q-o-Q change %)	0.4	3.7	7.7	-1.0	-4.2
(Y-o-Y change %)	15.9	10.3	14.8	10.9	5.8
of which: Loans & Advances to Non-Residents in AED	15	15	16	16	16
(Q-o-Q change %)	1.4	4.1	2.0	3.2	-2.5
(Y-o-Y change %)	58.7	35.7	21.1	11.1	6.8

Table 3.1.2.a. Assets and Credit at UAE Banks

Source: CBUAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.
*: Preliminary figures subject to revision.

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	Conventional		Islamic	
	2017 Sep	2017 Dec*	2017 Sep	2017 Dec*
Total Assets	**2,103**	**2,145**	**540**	**550**
(Q-o-Q change %)	**0.0**	**2.0**	**1.9**	**1.9**
(Y-o-Y change %)	**3.7**	**2.8**	**7.9**	**8.8**
Gross Credit	**1,222**	**1,227**	**358**	**354**
(Q-o-Q change %)	0.3	0.4	2.3	-1.1
(Y-o-Y change %)	0.4	0.7	8.9	5.6
Domestic Credit	1,113	1,124	335	330
(Q-o-Q change %)	0.7	1.0	1.5	-1.4
(Y-o-Y change %)	0.0	0.8	7.0	3.6
Government	170	163	11	12
(Q-o-Q change %)	1.4	-4.1	12.1	8.1
(Y-o-Y change %)	3.7	0.2	13.3	29.0
Public Sector (GREs)	141	141	35	33
(Q-o-Q change %)	-2.4	0.3	-0.3	-4.6
(Y-o-Y change %)	-9.8	-8.2	8.4	-1.8
Private Sector	785	805	285	281
(Q-o-Q change %)	1.0	2.5	1.4	-1.4
(Y-o-Y change %)	0.9	2.8	6.5	3.2
Business & Industrial Sector Credit	579	596	156	152
(Q-o-Q change %)	0.6	3.0	1.8	-2.6
(Y-o-Y change %)	0.6	2.6	7.6	2.7
Individual	206	209	129	129
(Q-o-Q change %)	2.1	1.2	0.9	0.0
(Y-o-Y change %)	1.8	3.4	5.2	3.7
Non-Banking Financial Institutions	17	15	4	4
(Q-o-Q change %)	6.4	-11.4	0.0	0.0
(Y-o-Y change %)	12.2	-7.5	14.7	25.8
Foreign Credit	109	103	24	24
(Q-o-Q change %)	-3.8	-5.9	14.0	3.4
(Y-o-Y change %)	5.5	-0.4	45.7	43.5

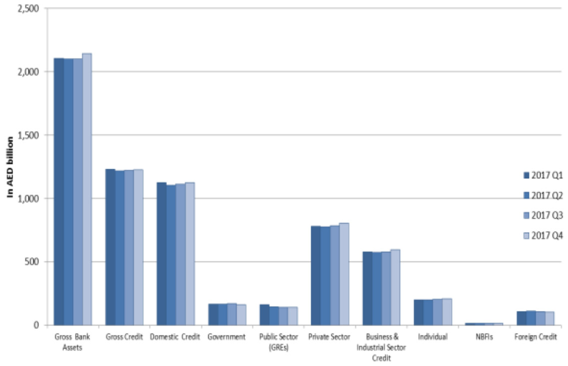
Table 3.1.2.b. Assets and Credit at UAE Conventional/Islamic Banks

Source: CBUAE

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

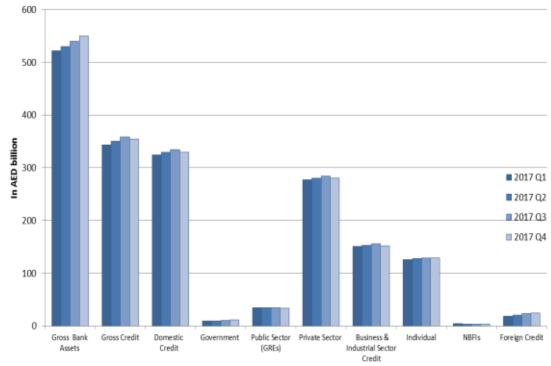
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

Foreign banks have shares of 13.4% of the system in assets and 12% in gross credit. The split of the assets and credit by national and foreign banks in Figures 3.1.2.c. and 3.1.2.d. indicates that National banks' assets were growing, while gross credit remained unchanged compared to the previous quarter. All sectors were growing with exception of credit to Government, NBFIs and Foreign Credit, which offset the gains in the other categories in 2017 Q4. For the same period, Foreign banks had their assets declining and gross credit growing by 0.7 (see Table 3.1.2.c).

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

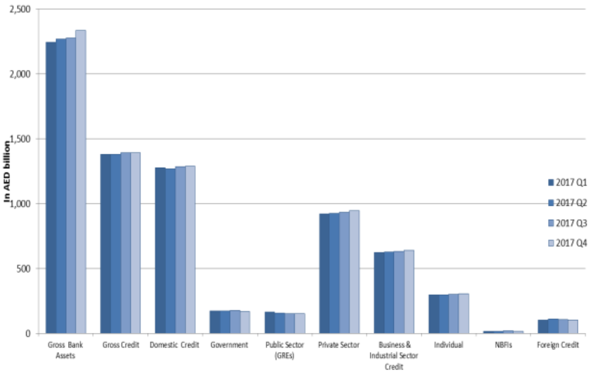
	National		Foreign	
	2017 Sep	**2017 Dec***	**2017 Sep**	**2017 Dec***
Total Assets	**2,276**	**2,334**	**367**	**361**
(Q-o-Q change %)	**0.4**	**2.5**	**0.7**	**-1.6**
(Y-o-Y change %)	**5.6**	**5.3**	**-1.6**	**-3.8**
Gross Credit	**1,392**	**1,392**	**188**	**189**
(Q-o-Q change %)	0.8	0.0	0.0	0.7
(Y-o-Y change %)	3.6	2.5	-6.5	-3.6
Domestic Credit	1,284	1,290	164	163
(Q-o-Q change %)	1.0	0.5	-0.3	-0.1
(Y-o-Y change %)	3.1	2.4	-9.3	-5.7
Government	176	170	5	5
(Q-o-Q change %)	2.0	-3.6	2.0	3.9
(Y-o-Y change %)	5.1	2.2	-17.7	-11.7
Public Sector (GREs)	154	155	21	20
(Q-o-Q change %)	-1.5	0.3	-5.7	-7.9
(Y-o-Y change %)	-3.4	-3.2	-24.9	-29.1
Private Sector	935	947	135	138
(Q-o-Q change %)	1.2	1.3	0.4	2.2
(Y-o-Y change %)	3.8	3.3	-6.5	0.2
Business & Industrial Sector Credit	632	642	103	105
(Q-o-Q change %)	0.8	1.7	0.8	2.3
(Y-o-Y change %)	3.5	3.0	-6.2	0.7
Individual	303	305	32	33
(Q-o-Q change %)	1.9	0.6	-0.6	1.9
(Y-o-Y change %)	4.3	4.1	-7.5	-1.2
Non-Banking Financial Institutions	18	18	2	1
(Q-o-Q change %)	5.2	-1.6	4.8	-72.7
(Y-o-Y change %)	8.3	5.3	69.2	-68.4
Foreign Credit	109	102	24	26
(Q-o-Q change %)	-1.7	-6.5	2.1	6.2
(Y-o-Y change %)	9.6	4.3	17.4	12.2

Source: CBUAE

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

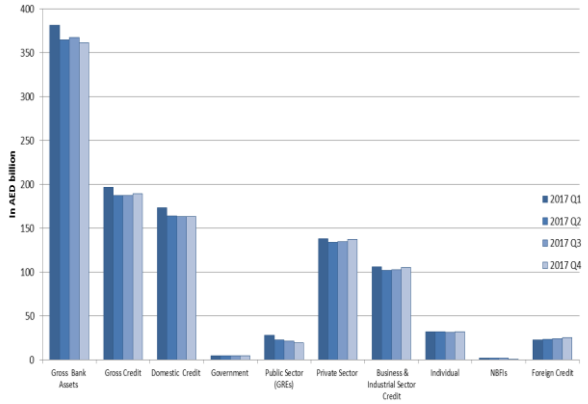
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

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(End of Period , In Billions of AED)

	2016	2017			
Economic Activity	Dec	Mar	Jun	Sep	Dec*
Agriculture	1.4	1.2	1.1	1.2	2.1
(Q-o-Q change %)	16.7	-15.1	-2.5	7.7	73.9
(Y-o-Y change %)	-11.9	-7.7	-5.3	3.9	54.8
Mining and Quarrying	13.5	19.0	13.9	12.2	12.1
(Q-o-Q change %)	-3.4	40.4	-26.8	-12.5	-0.6
(Y-o-Y change %)	13.6	62.3	11.9	-13.1	-10.7
Manufacturing	69.5	68.3	70.3	72.0	75.3
(Q-o-Q change %)	-3.0	-1.7	3.0	2.4	4.5
(Y-o-Y change %)	0.5	-5.5	-1.5	0.6	8.6
Electricity, Gas and Water	18.4	18.1	17.4	17.0	16.7
(Q-o-Q change %)	3.1	-1.8	-3.9	-2.6	-1.3
(Y-o-Y change %)	-10.0	-2.5	-6.4	-5.2	-9.3
Construction and Real Estate	264.7	267.0	281.2	295.2	298.2
(Q-o-Q change %)	5.5	0.9	5.3	5.0	1.0
(Y-o-Y change %)	12.6	10.4	16.0	17.7	12.6
Trade	155.5	152.3	149.5	147.7	153.1
(Q-o-Q change %)	-1.7	-2.1	-1.8	-1.2	3.6
(Y-o-Y change %)	-3.8	-5.2	-7.0	-6.7	-1.7
Transport, Storage and Communication	63.5	60.4	63.1	63.7	55.0
(Q-o-Q change %)	1.2	-4.7	4.4	1.0	-13.8
(Y-o-Y change %)	7.3	-3.2	-1.3	1.6	-13.5
Financial Institutions (Excluding Banks)	144.3	151.9	138.9	130.3	127.5
(Q-o-Q change %)	-2.7	5.2	-8.5	-6.2	-2.1
(Y-o-Y change %)	6.4	8.9	-4.1	-12.2	-12.4
All Others	126.6	130.0	126.2	132.9	138.4
(Q-o-Q change %)	3.8	2.7	-2.9	5.3	4.1
(Y-o-Y change %)	12.4	15.0	4.6	9.0	10.4

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

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

Banks' lending by economic activity shows an increase in the fourth quarter of 2017 Q-o-Q by 73.9%, 4.5%, 1%, 3.6% and 4.1% in the Agriculture, Manufacturing, Construction and Real Estate, Trade, and All Other sectors respectively, while their growth Y-o-Y was 54.8%, 8.6%, 12.6%, -1.7% and 10.4%, respectively. For the other sectors, credit declined on Q-o-Q during the fourth quarter of 2017. The growth in Mining and Quarrying was -0.6% Q-o-Q and -10.7% Y-o-Y, in Electricity, Gas and Water, -1.3% Q-o-Q and -9.3% Y-o-Y, in Transport, Storage and Communication, -13.8% Q-o-Q and -13.5% Y-o-Y, and in Financial Institutions (Excluding banks) a reduction of 2.1% Q-o-Q and 12.4% Y-o-Y.

3.1.3. Financial Soundness Indicators

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

The percentage of the number of returned cheques has declined from 4.6% in September 2017 to 4.5% in December 2017. The total amount of returned cheques, as a share of the total presented amount, also declined to 4.2% in 2017 Q4 compared to 5% in 2017 Q3.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio (CAR) and Tier 1 capital of banks further growing at 18.9% and 17.4% respectively, which is well above the regulatory requirements set by the Central Bank.

The Loans to Deposit (L/D) ratio for the whole banking system declined from 99 % in September 2017 to 97.1% at the end of 2017 Q4, a level which is also lower than the 99.4% in 2016 Q4, mainly due to the lower growth in lending compared to deposits.

Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 98.6% and 92.3%, decreasing by 1.6 percentage points from the previous quarter for the Conventional banks.

The level for Conventional banks in September 2017 has improved compared to a year ago when it was 100.3%. Also, for Islamic banks' L/D has declined from 96.2% in December 2016. On the other hand, National banks have L/D ratio of 98% (with a decline of 2.1 percentage points compared to September 2017), while the ratio for foreign banks is 91.2%, lower than the 91.7% at the end of 2017 Q3.

Meanwhile, liquid assets which include reserves requirements mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets moved from 17.6% at the end of September 2017 to 18.2% at the end of 2017 Q4. This is the highest observed value in the liquid assets ratio since December 2015. The level of total liquid assets at banks at the end of 2017 Q4 remains at

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AED 397.9bn, AED 21.4bn higher than at the end of 2017 Q3, registering growth of 5.7% in the last quarter of 2017, boosting the increase in the Liquid Assets Ratio (LAR). On a Y-o-Y basis, total liquid assets at banks also increased by AED 56.7bn registering a growth of 16.6%. In addition, looking at the split between Islamic, Conventional, National and Foreign banks, data show that for all segments the LARs increased during 2017 Q4. On a Y-o-Y basis, LAR has increased for all types of banks.

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

Total system	2016	2017			
	Q4	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio	86.2	85.4	85.9	86.0	84.6
The Liquid Assets Ratio (LAR)	16.2	16.8	17.1	17.6	18.2
Capital Adequacy Ratio (CAR)	18.9	18.6	18.5	18.7	18.9
Tier 1 Capital	17.3	16.9	16.9	17.1	17.4

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

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

Conventional	2016	2017			
	Q4	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio	86.1	85.8	86.6	86.6	85.0
The Liquid Assets Ratio (LAR)	16.0	16.5	16.9	17.2	17.7
Capital Adequacy Ratio (CAR)	19.3	19.0	18.9	19.1	19.4
Tier 1 Capital	17.4	17.1	17.1	17.3	17.6

Source: CBUAE
Note: All data indicate the end-of-quarter values
***:** Preliminary figures subject to revision.

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

	2016	2017			
Islamic	Q4	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio	86.7	83.7	83.5	83.8	83.1
The Liquid Assets Ratio (LAR)	16.8	17.9	17.1	17.8	20.0
Capital Adequacy Ratio (CAR)	17.1	16.7	16.7	17.0	17.2
Tier 1 Capital	16.5	16.0	16.0	16.3	16.6

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

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

National	2016	2017			
	Q4	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio	88.1	86.6	87.6	87.6	86.1
The Liquid Assets Ratio (LAR)	14.9	15.4	15.7	16.1	17.1
Capital Adequacy Ratio (CAR)	18.5	18.2	18.1	18.4	18.7
Tier 1 Capital	17.1	16.7	16.7	17.0	17.2

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

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

Foreign	2016	2017			
	Q4	Q1	Q2	Q3	Q4*
Lending to Stable Resources Ratio	74.8	77.6	75.0	75.7	74.8
The Liquid Assets Ratio (LAR)	24.3	25.4	25.9	26.5	26.2
Capital Adequacy Ratio (CAR)	21.4	21.3	21.0	20.7	21.0
Tier 1 Capital	18.6	18.5	18.1	18.0	18.8

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Preliminary figures subject to revision.

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3.2 Financial developments

3.2.1. Share Price Movement

Higher uncertainty was observed during the last quarter of 2017 as evident by a decline of share price indices on the Abu Dhabi and Dubai securities markets. The market capitalization on Dubai Financial Market (DFM) and Abu Dhabi Securities Exchange (ADX), however, increased.

On the ADX, the average Share Price Index fell by 3.5% in the fourth quarter of 2017 after a rise of 0.4% in the third quarter of 2017. The market capitalization growth moved from -0.3% at the end of 2017 Q3 to 0.4 % at the end of December 2017 (see Table 3.2.1.).

The decline of the securities market in Dubai was also noticeable. The average Share Price Index fell by 3.8% in the last quarter of 2017. The market capitalization rose by 2.4% in the 2017 Q4 against an increase of 5.7% in the previous quarter.

Table 3.2.1. UAE – Securities Markets

		2016				2017			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Abu Dhabi	**Change of Share Price Index (%)**	-0.5	3.9	1.7	-2.7	3.0	-1.2	0.4	-3.5
	Change of Market Capitalization (%)	1.0	1.9	5.8	-3.0	1.4	-1.4	-0.3	0.4
Dubai	**Change of Share Price Index (%)**	-2.7	5.5	3.4	-2.3	5.2	-5.6	6.8	-3.8
	Change of Market Capitalization (%)	-3.4	6.4	1.4	-3.3	18.8	-7.8	5.7	2.4

Source: Abu Dhabi Securities Exchange and Dubai Financial Market
Note: Changes computation (Q-o-Q) is based on quarterly average of end-of-month values for the share price index and market capitalization.

3.2.2. Credit Default Swaps Premiums

The default risk premium for the Emirate of Abu Dhabi remains at a very low level, notwithstanding a marginal increase, while in the Emirate of Dubai it improved (see Table 3.2.2).

Table 3.2.2. UAE - Credit Default Swaps (CDS)

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Emirate of Abu Dhabi	93.6	87.5	74.3	61.5	40.9	61.1	59.8	61.7
Emirate of Dubai	215.0	182.5	167.3	149.8	114.5	132.0	129.3	122.4

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

Specifically, in the last quarter of 2017, the CDS of Sovereigns increased marginally by 1.9 basis points (bps) in Abu Dhabi after a previous decline by 1.3 (bps) in the third quarter of 2017. In Dubai, the CDS declined by 6.9 bps. The reduced risks reflect recent firming up of oil prices and the speed of fiscal reforms.

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

The Central Bank balance sheet exhibited an increase in 2017 Q4, reflecting increased foreign income receipts, while banks increased reserves and investments at the Central Bank. As a result, Total Assets of the Central Bank increased, owing mainly to rising Cash and Bank Balances and Deposits at Banks Abroad and Other Advances. Meanwhile, interest rates in the UAE continued their upward trend in line with the Fed's decision announced in September to start winding down its Balance Sheet and its decision in December to increase its policy rate. However, both the ***spread*** *relative to the US dollar LIBOR rate as well as the* ***spread*** *related to the Swap rates for the Dirham and the USD decreased during the fourth quarter due to improved risk premium for the UAE, in tandem with subdued global market volatility and a pickup in domestic as well as global economic growth*

4.1 Monetary Aggregates

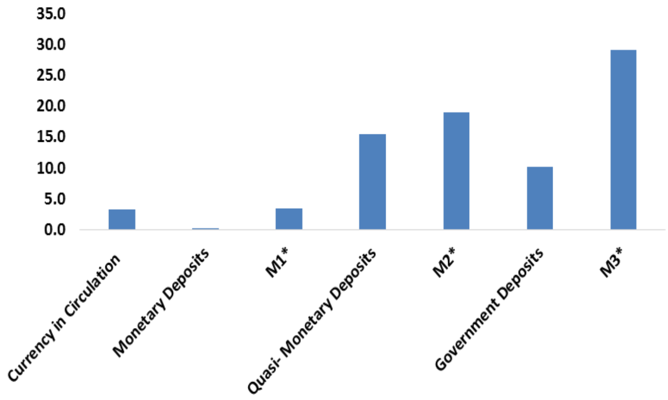
From end of 2017 Q3 to end of 2017 Q4, M1 increased by 0.7% reaching AED 492.4 billion, mainly as a result of an increase in Currency Circulation by 5.1% (AED 3.3 billion) to reach AED 67.7 billion, while Monetary Deposits roughly remained flat at AED 424.7 billion.

Money supply M2 increased by 1.5% to reach AED 1,276.2 billion, due to the above-indicated increase in M1 and the increase in Quasi-Monetary deposits by 2% (AED 15.5 billion), reaching AED 783.8 billion.

Meanwhile, M3 increased by 1.2%, (AED 29.1 billion) to reach AED 1,487.1 billion, due to an increase in Government deposits by 5% or AED 10.1 billion, reaching AED 210.9 billion, in support of bank liquidity.

Figure 4.1 Change in Monetary aggregates in 2017 Q4

In billions of Dirhams



Source: CBUAE

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4.2. Central Bank Balance Sheet

Changes in the Central Bank balance sheet are triggered by changes in liquidity in the banking system, reflecting higher oil prices and financial inflows. The balance sheet increased by 2.5% in 2017 Q4, reaching AED 406.4 billion. This was mainly due to an increase in Currency Notes and Coins Issued by 9.1% to reach AED 85.4 billion and an increase in Certificates of Deposits by 6.6% to reach AED 135 billion; the latter is testament to the sufficient liquidity in the banking sector.

Table 4.1 Central Bank Balance Sheet

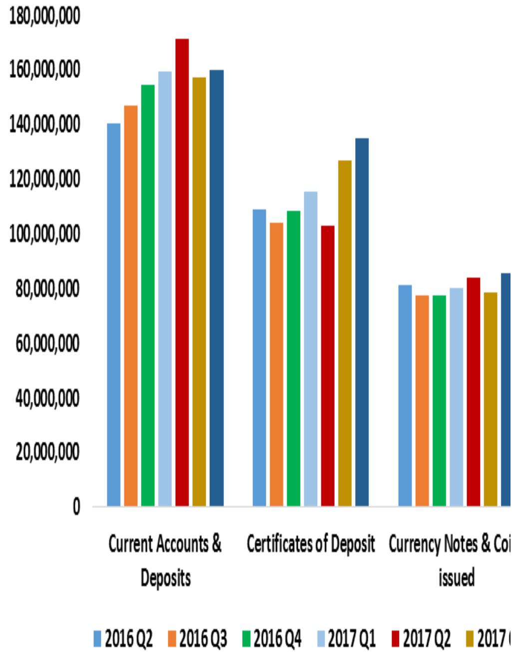
In billions of Dirhams

	2016			2017			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Total Assets	**364,749.0**	**353,631.5**	**364,453.2**	**379,488.1**	**391,956.7**	**396,605.3**	**406,373.4**
Cash and Bank Balances	55,656.2	65,037.0	90,149.2	88,061.1	133,518.1	139,940.9	154,229.6
Deposits & Other advances	65,533.0	67,667.2	64,897.7	98,886.7	101,198.7	108,333.7	114,476.4
Securities - Foreign	192,693.9	170,008.0	158,516.4	141,635.0	106,418.5	97,409.8	85,903.4
Securities - Dxb Govt. & MoF	49,197.9	49,165.2	49,165.2	49,165.2	49,165.2	49,165.2	49,165.2
Gold Bullion	1,164.1	1,170.8	1,014.8	1,099.3	1,101.5	1,135.1	1,152.2
Others	503.9	583.3	709.8	640.8	554.7	620.6	1,446.5
Total Capital & Liabilities	**364,749.0**	**353,631.5**	**364,453.2**	**379,488.1**	**391,956.7**	**396,605.3**	**406,373.4**
Current Accounts & Deposits	140,351.0	146,920.1	154,775.2	159,330.4	171,176.6	157,076.2	159,790.8
Certificates of Deposit	109,082.6	103,796.9	108,192.8	115,301.0	102,858.7	126,639.8	135,051.0
Currency Notes & Coins issued	81,316.9	77,267.1	77,551.5	80,129.9	83,877.6	78,280.6	85,386.2
Capital, Reserves & Other Liabilities	33,998.5	25,647.4	23,933.7	24,726.8	34,043.7	34,608.8	26,145.3

Source: CBUAE

Figure 4.2 Central Bank Liabilities

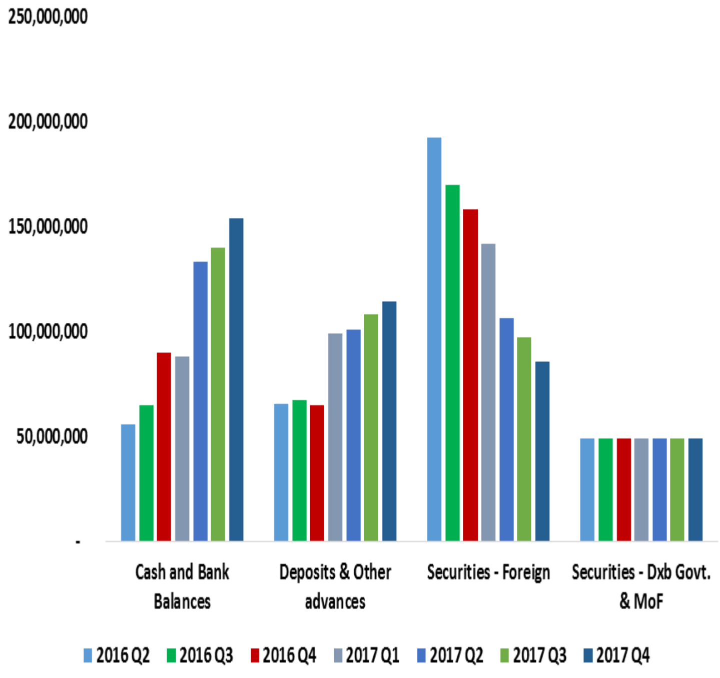
In millions of Dirhams



Source: CBUAE

Figure 4.3 Central Bank Assets

In millions of Dirhams



Source: CBUAE

During 2017 Q4, there has been an increase in funding from abroad on Banks' foreign liabilities side. Due to Headquarters and/or Branches Abroad, which reflects foreign banks getting short-term liquidity from the mother company abroad, increased by AED 6.3 billion, while "Capital Market Funding" which is medium-term funding from

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overseas increased by AED 2.5 billion. Meanwhile, “Due to Other Banks Abroad” which is borrowing in US dollars, including Money at Call and Short – Notice, Nostro Balances, Bills and Lending under Repurchase Agreement, and Term Placements and Loans, decreased by AED 3.9 billion.

The overall increase in banks’ foreign liabilities coupled with increased foreign income receipts led to higher banks’ transfers to the Central Bank. As a result, Cash and Bank Balances increased by 10.2% to reach AED 154.2 billion, while Deposits and other Advances Abroad increased by 5.7% to reach AED 114.5 billion. This took place at the expense of holdings in Foreign Securities which decreased by 11.8%, reflecting a shift in CBUAE investment strategy away from Treasury bills, in favor of Bank Balances which include Nostro Accounts and other deposits abroad.

4.3 Central Bank Foreign Assets

As shown in Table 4.2, the balance of foreign assets increased from AED 344.1 billion at end of 2017 Q3 to AED 347.7 billion at end of 2017 Q4, owing to an increase by AED 15.1 billion in Current Account Balances and Deposit with Banks abroad, while Held – to – Maturity Foreign Securities decreased.

Table 4.2 Central Bank's Foreign Assets

In billions of Dirhams

	2016	2017			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Total Foreign Assets*	310.9	325.0	338.3	344.1	347.7
Held-To-Maturity Foreign Securities	149.3	140.5	104.3	94.3	84.5
Current Account Balances & Deposit with Banks Abroad	147.9	178.8	227.6	241.5	256.6
Other Foreign Assets	13.7	5.7	6.4	8.3	6.6

Source: CBUAE, end of quarter data
*Excluding IMF Reserve Position and SDR Holdings

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 75 of Union Law No. 10 of 1980 concerning the Central Bank, The Monetary System and Organization of Banking mandated the Central Bank to maintain a “Currency Cover Ratio” where “internationally recognized reserve assets” correspond to at least 70% of the Currency in Circulation and Demand Deposits.

Table 4.3 reports the International Reserves Position of the Central Bank, which increased from AED 347 billion at the end of 2017 Q3 to AED 350.3 billion at the end of 2017 Q4. As a ratio of the monetary base, however, the International Reserves Position decreased from 96.7% to 92.8%, during this period. This ratio remains nonetheless at the level reached during the same period in 2016, in support of the credibility of the fixed peg and the Central Banks’ ability to defend it.

Table 4.3 International Reserves

In billions of Dirhams

	2016	2017			
	Q4	Q1	Q2	Q3	Q4
1. International Reserve Position*	313.6	327.7	341.1	347.0	350.3
2. Monetary Base	338.1	351.5	355.0	358.7	377.4
Ratio (1/2)	92.8%	93.2%	96.1%	96.7%	92.8%

Source: CBUAE, end of quarter data
* Gross International Reserves including IMF Reserve Position and SDR Holdings

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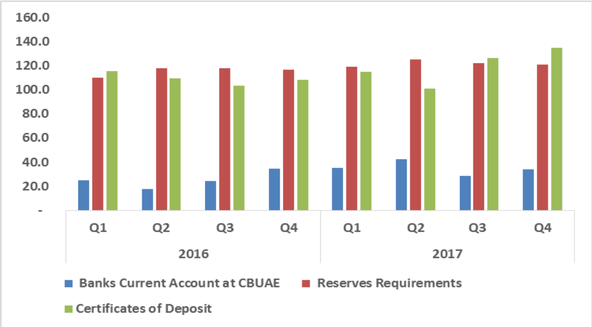
4.5. Developments in Banks' Liquidity at the CBUAE

Banks' liquid assets at the Central Bank are composed mainly of their current account at the Central Bank, reserves requirements, and certificates of deposits. Total liquid assets at the Central Bank held by banks operating in the UAE increased during 2017 Q4 by AED 21.4 billion, reaching AED 397.9 billion. This was due mainly to the above indicated increase in Certificates of Deposits as well as an increase in Banks' Current Accounts at the Central Bank by AED 5.3 billion. As liquidity improved against the backdrop of slowdown in credit growth, a few banks tapped the Central Bank facilities to mobilize funds, during this period.

Figure 4.4 Liquid Assets of Banks at the Central Bank

In billions of Dirhams



Source: CBUAE

4.6. Interest Rates

The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to peg its policy rate to the direction of the interest rate policy in the U.S. Therefore, the Central Bank of the UAE announced in March, June, and again in December 2017 an increase in interest rates applied to its Certificates of Deposit, in line with the Fed's decision that brought the target Federal Fund rate to the 1.25–1.50% range. Similarly, the Repo Rate applicable to banks' borrowing of short-term liquidity from the Central Bank against their holding of CDs, has increased from 1.5% to 1.75%.

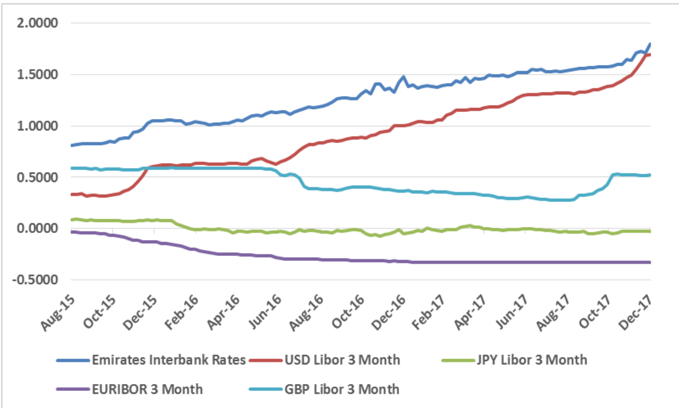
4.6.a. Short-term interest rates

The 3-month Emirates Interbank Offer Rate (EIBOR) comprises the daily quotes of the largest banks operating in the country, and published by the Central Bank of the UAE. During 2017 Q4, EIBOR rose in line with USD LIBOR on the back of expected further interest rate increases in the US which materialized in December when the Fed announced an increase in the Federal Funds rate by 25 basis points.

EIBOR 3-month increased as a result from about 1.56% in October to 1.65% at end of November and to 1.80% at the end of December.

Similarly, the GBP LIBOR 3 – month increased during most of the 4th quarter from 0.34% in early October to 0.52% at the end of December.

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



Source: Bloomberg

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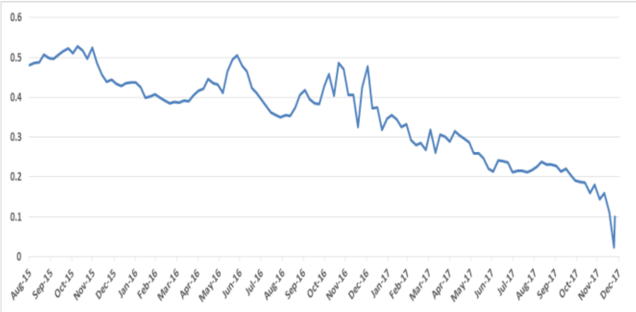
As regards the EIBOR ***spread*** vis-à-vis the USD LIBOR (3 – month), which increased during most of 2016 as bank liquidity tightened in the UAE, it started decreasing in 2017 reflecting improved risk premium for the UAE. In the 4th quarter, the spread decreased from an average of 21 basis points in October to 18 basis points in November and to 11 basis points in December.

Figure 4.5.b Dirham Spread, EIBOR vs. USD LIBOR (3-month, %)

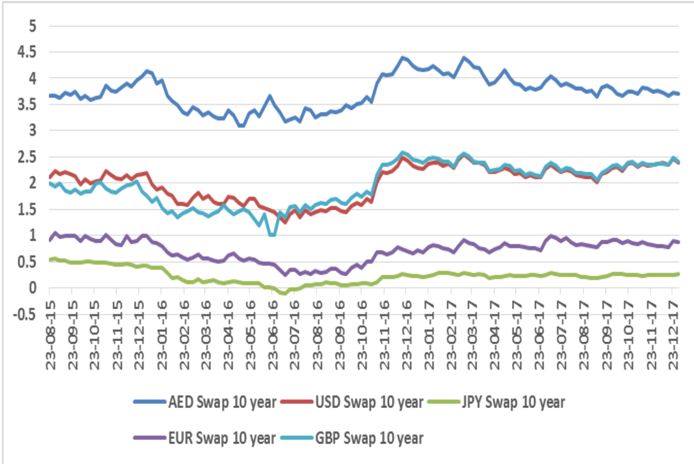


[i]Source: Bloomberg

4.6. b. Long-term swap rates

As shown in Figure 4.6.a, the swap rates decreased during most of the fourth quarter, which is a testament of the decline in investors' perceived risk and subdued volatility in capital markets in general. Indeed, the VIX Index which is a proxy of risk aversion and uncertainty in capital markets reached a record low during this period. For the US dollar, however, there has been an increase from 2.29% in early October to 2.34% at end of December due to uncertainties surrounding US policy announcements.

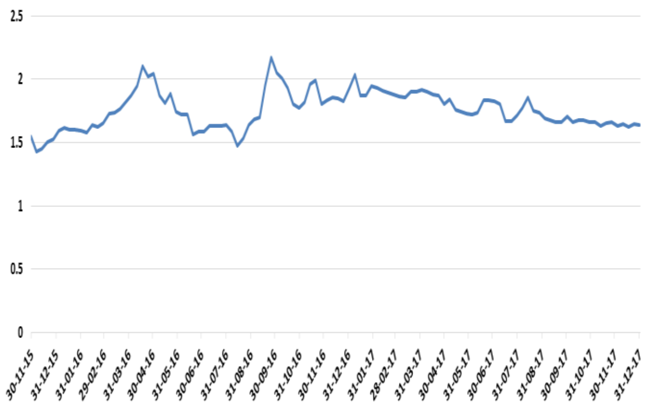
Figure 4.6.a 10-year swap rates (%)



Source: Bloomberg

As regards the spread between the AED 10-year swap rate and the US dollar, Figure 4.6.b shows continued decline from an average of 172 basis points in 2017 Q2, 165 basis points in Q3, to an average of 139 basis points in the fourth quarter. The evidence attests to less perceived risk, as the UAE fiscal outlook improved along with the recovery in oil prices and the improved outlook for non-energy growth, while global growth is also witnessing a pickup, including for the main UAE export markets.

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



Source: Bloomberg

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