United Arab Emirates

مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

Quarterly Economic Review

First quarter 2017

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Executive Summary

In 2017, Global economic growth is expected to be better than the year 2016, according to available economic data for the first quarter of 2017. In fact, the global recovery, is driven mainly by the improved growth prospects in the developed countries, supported by a robust domestic demand, especially in the Euro area and the United States. However, a number of events are threatening the nascent global economic recovery, such as the uncertainty surrounding policies, Brexit, the election cycles in Europe and the ongoing civil war in Syria.

Oil prices increased in the first quarter of 2017, thanks to the OPEC agreement to cut production, but it has not been enough to induce a significant increase in price. In this context, the US economic data continue to be generally positive, following the presidential election, triggering the decision by the US Federal Reserve Board for an interest rate hike in March. While data in the Eurozone point to signs of recovery, the ECB has maintained its commitment to extend its quantitative easing program. Thus, all developed financial markets registered positive annual returns during the first quarter of 2017.

In the UAE, based on revised new figures of growth projections and global economic developments, the Central Bank of the UAE has revised the Real GDP growth and its components for 2017 and 2018. In fact, Non-oil GDP growth has grown by 2.7% in 2016, while oil GDP growth has increased by 3.8%. The combined effect is growth of Real GDP at 3% in 2016. The economy is projected to rebound with non-oil GDP growing at 3.1% in 2017 and 3.7 % in 2018, driven mainly by slower pace of fiscal consolidation, and a pickup in UAE trading partners' growth. The rebound of inflation continued for the second consecutive quarter after a disinflation period, in line with recovery in economic activity. The average Consumer Price Index (CPI) increased by 2.7% in the first quarter of 2017.

Regarding banking activity, Government deposits increased significantly in the first quarter of 2017, with the private sector contributing also to the deposit growth. As a result, monetary aggregates increased. Banks continued to increase credit at a rate that supports growth in the non-oil activities. The Financial Soundness Indicators (FSIs) improved significantly, showing that the UAE banking system is sound and enjoys financial stability.

In addition, the Central Bank balance sheet exhibited an increase in 2017 Q1, triggered by increases on the liabilities' side. As a result, Total Assets increased owing mainly to rising Cash and Bank Balances and Central Bank's Deposits abroad. Meanwhile, interest rates in the UAE continued their upward trend in line with the Fed's decision announced on the 15th of March 2017.

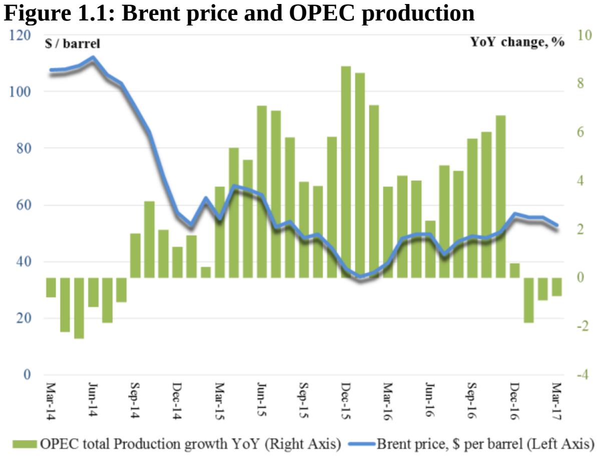
Chapter 1. International Economic Developments

Oil prices increased in the first quarter of 2017, thanks to the OPEC agreement to cut production, but it has not been enough to induce a significant increase in price. In this context, the US economic data continue to be generally positive, following the presidential election, triggering the decision by the US Federal Reserve Board for an interest rate hike. While data in the Eurozone point to signs of recovery, the ECB has maintained its commitment to extend its quantitative easing program. All developed financial markets registered positive annual returns during the first quarter of 2017 .

During the first quarter of 2017, Oil prices were mixed three months following the agreement of the Organization of Petroleum Exporting Countries (OPEC) with non-OPEC producers to reduce oil production, for the first time since 2008. This agreement has helped to avert further reduction in the oil price, but has proven to be inadequate to sustain continued surge in the oil price, given continued weak demand and an increase in the supply by shale oil producers.

In fact, OPEC has reached a deal among all 14 member countries to cut production from 33.8 million barrels a day (b/d) to 32.5 million b/d during the first half of the year, in an effort to rein in a global supply overhang and prop up prices. As the deal was announced in November 2016, Brent crude prices increased from an average of $48.3/b in October to $56.8/b in December 2016 (see Figure 1.1). However, the price started to decline since January 2017, reaching an average of $52.8/b in March 2017. This drop is due to a continued increase in US crude inventories and a rise in drilling activity, which counterbalanced production cuts elsewhere in the world.

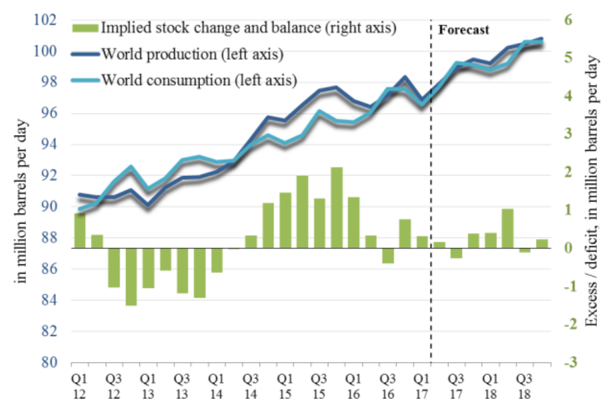
Figure 1.1: Brent price and OPEC production



Source: OPEC and Bloomberg

According to the Energy Information Administration (EIA), in the Short-term Energy Outlook report for April 2017 presented a relatively mixed picture regarding the state of the global oil supply and demand (see Figure 1.2). Updated figures in the report indicate a finely balanced market that is projected to oscillate between surplus and deficit from quarter to quarter till the end of 2018. Regarding the Price outlook, EIA forecasts Brent prices to average $54/b in 2017 and $57/b in 2018, factoring in projected demand growth and the increase in shale oil production

Figure 1.2: World liquid petroleum production and consumption, in million barrels per day



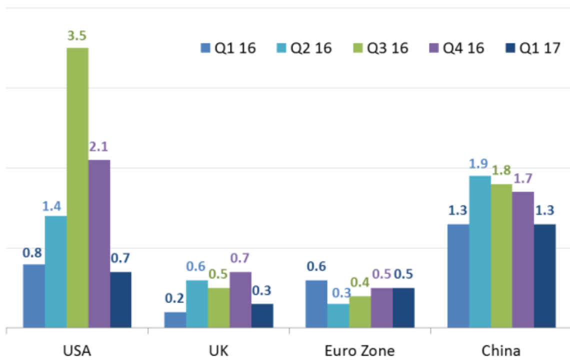
Source: Energy Information Administration (EIA)

In this context, the momentum remained firm in the Eurozone's economy, growing by 0.5% in the first quarter of 2017 on a quarterly basis, while compared to the same quarter of 2016, the GDP expanded 1.7% after 1.8% increase in Q4.

However, the US economy grew by 0.7%, as compared to a rise of 2.1% in the fourth quarter of 2016, the weakest in three years. Similarly, the UK GDP increased by 0.3% in the first quarter of 2017, down from 0.7% in 2016's fourth quarter, mainly due to a slowdown in the services industry.

Concerning the Chinese economy, the GDP advanced 1.3% quarter on quarter, following a 1.7% growth in the previous three months, the weakest expansion since the first quarter 2016. But, the year on year growth was 6.9%, compared to a 6.8% in the fourth quarter 2016, the strongest expansion since the third quarter 2015, supported by faster increase in industrial output and an increase in fiscal spending.

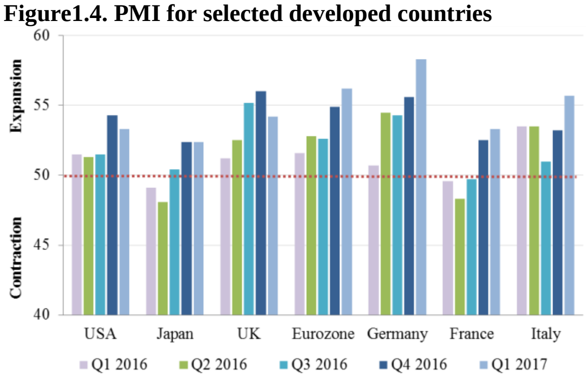
Figure1.3. GDP growth for selected countries (Q-o-Q, %)



Source: Bloomberg

These developments are confirmed by the Purchasing Managers' Index (PMI), which has seen general improvement in the first quarter of 2017, remaining above the 50 mark for all selected developed countries, pointing to expansion (see Figure 1.3).

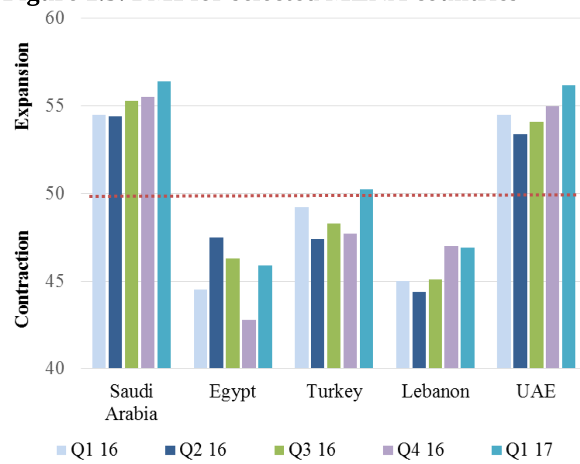
Figure1.4. PMI for selected developed countries



Source: Bloomberg

In fact, the Eurozone economy showed signs of recovery, with the PMI index hitting a six-year high in March. The index reached 56.2 in 2017 Q1 after 54.9 in the previous quarter, led by the improvement of the Eurozone's three largest economies, Germany, France and Italy. Indeed, the PMI index for Germany registered a significant improvement from 55.6 in 2016 Q4 to 58.3 this quarter. The index for France reached 53.3 in 2017 Q1 from 52.5 in the last quarter of 2016, while the PMI index for Italy averaged 55.7 after 53.2 in the previous quarter. However, the PMI level in the US and the UK decreased from 54.3 and 56 to 53.3 and 54.2 respectively.

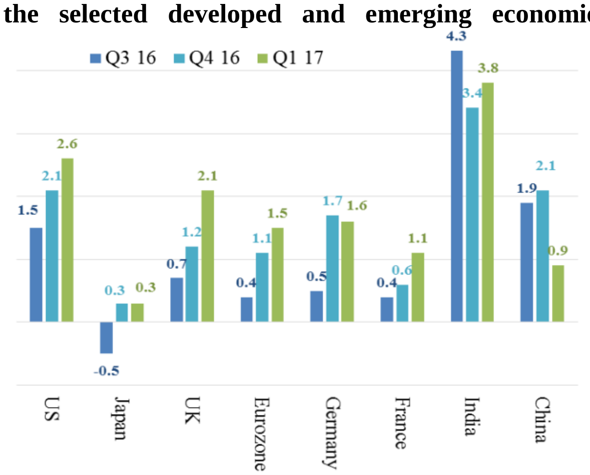
Figure 1.5. PMI for selected MENA countries



Source: Bloomberg

In the Middle East and North Africa (MENA) region, the Saudi Arabia Non-Oil Private Sector PMI increased to 56.4 in Q1 of 2017, while the PMI in Turkey reached 50.2 during this quarter, pointing to the first expansion in activity since February last year and the strongest since February of 2014. Nonetheless, the PMI in Egypt and Lebanon remained at a level below the 50 point threshold, indicating economic contraction (see Figure 1.4).

Figure 1.6. Year-on-Year Consumer Price change in the selected developed and emerging economies

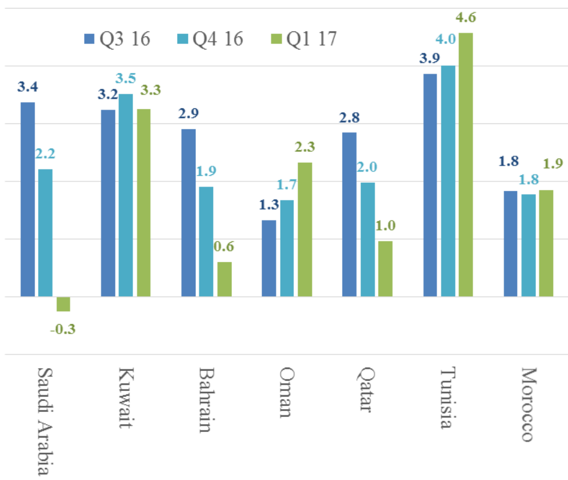


Source: Bloomberg

Consumer prices for all the selected economies in Figure 1.5 have experienced an increase in inflation compared to 2016 Q4, with the exception of China, Germany and

Japan. In fact, China's consumer price inflation slowed down to 0.9% year-on-year in 2017 Q1, from 2.1% in 2016 Q4, while Japan's inflation rose by 0.3%, at the same pace of last quarter, sustaining continued achievement in the government's long battle against deflation.

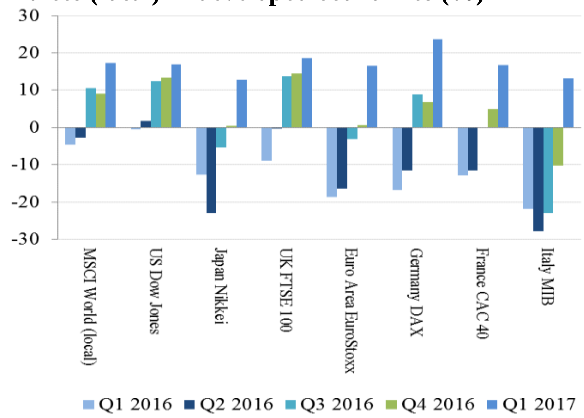
Figure 1.7. Year-on-Year Consumer Price change in selected MENA countries



Source: Bloomberg

For the MENA region, the CPI inflation rate is moderating in most of the region, with the exception of Oman, Morocco, Tunisia and Egypt (not shown). In both the latter cases, prices continue to surge following the devaluation of domestic currencies to restore economic stabilization. Likewise, the acceleration in inflation has been sustained in the oil-importing countries as higher energy prices are slowly feeding into the real economy. But, although inflation among oil-exporting nations has been picking up, price pressures remain more contained due to the strength of the exchange rate of their currencies relative to the currencies of major importing countries (see Figure 1.6).

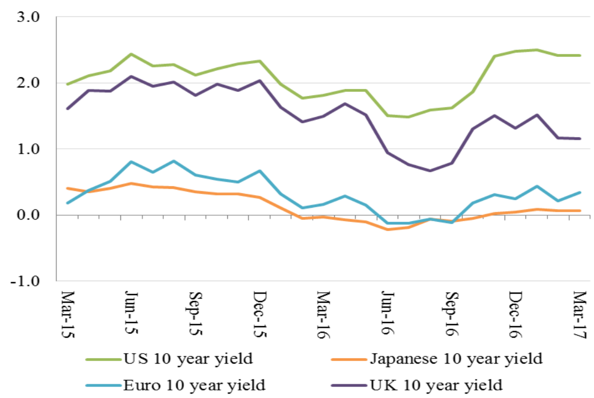
Figure 1.8. Annual percentage change of equity indices (local) in developed economies (%)



Source: Bloomberg

Regarding the financial sector, all developed equity markets (see Figure 1.7.) registered positive annual returns during the first quarter of 2017. The highest return increase was for the Germany DAX, which grew by 23.6% compared to the same period of 2016 in further evidence of continued improvement in investors' confidence regarding recovery in the Euro area.

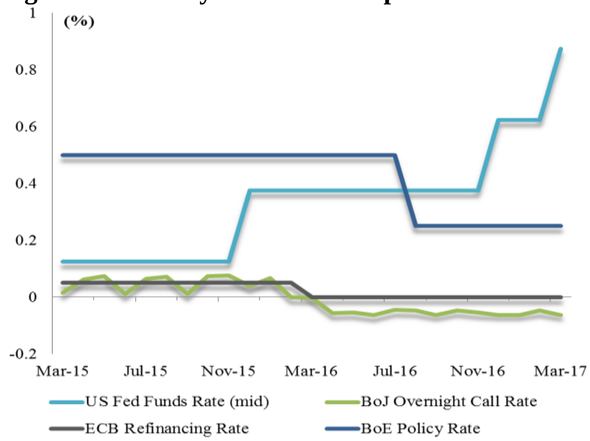
Figure 1.9. 10-year government bond yields (%)



Source: Bloomberg

During the first quarter of 2017, government bond yields moved higher, in general, reflecting stronger outlook of rising inflation and rising expectation of tighter liquidity going forward. Indeed, this quarter saw government bond yields rise in the US (see Figure 1.8.) amid expectations of continued Fed's commitment to raise interest rates and additional fiscal stimulus spending. In the Eurozone, government bond yields made gains thanks to the ECB's commitment to extend its quantitative easing program through the end of 2017 and signs of economic recovery. Similarly, UK bond yields also moved slightly higher, while Japanese bond yields were strong, supported by a weaker exchange rate for the British pound and the Japanese yen during the last quarter of 2016.

Figure 1.10. Policy rates of developed countries



Source: Bloomberg

In terms of monetary policy, the U.S. Federal Reserve raised on March 15 2017 its federal funds rate by 25 basis points to 1%, as widely expected, and forecast that it would raise its rate two more times in 2017, to 1.5%. The Fed signaled that it will raise rates to 2% in 2018 and 3% in 2019. Moreover, the ECB decided on March 9 2017 that the interest rate will remain unchanged and extended its asset purchase program until the end of December 2017 from the end of March 2017, but reduced monthly purchases to 60 billion euros from 80 billion.

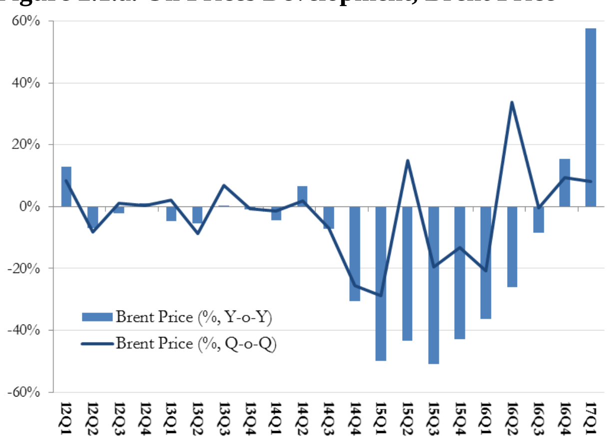
Chapter 2: Domestic Economic Developments

Non-oil GDP growth grew by 2.7% in 2016, while oil GDP growth increased by 3.8%. The combined effect is growth of Real GDP at 3% in 2016. The rebound of inflation continued for the second consecutive quarter after a disinflation period, in line with the recovery in economic activity. The average Consumer Price Index (CPI) increased by 2.7% in the first quarter of 2017.

2.1 Economic Activity and Growth

The improvement of the global oil prices continued in the first quarter of 2017. The average Global Brent Oil price increased by 58% on a year-on-year basis, reaching an average price of 54$ and hitting the highest reading for the quarter in February (55$). Compared to the previous quarter, oil prices rose by 8.1%. It is the second consecutive increase after the amelioration in the last quarter of 2016 where global oil prices jumped by around 15% on a year-on-year basis (see Figure 2.1.a).

Figure 2.1.a. Oil Prices Development, Brent Price

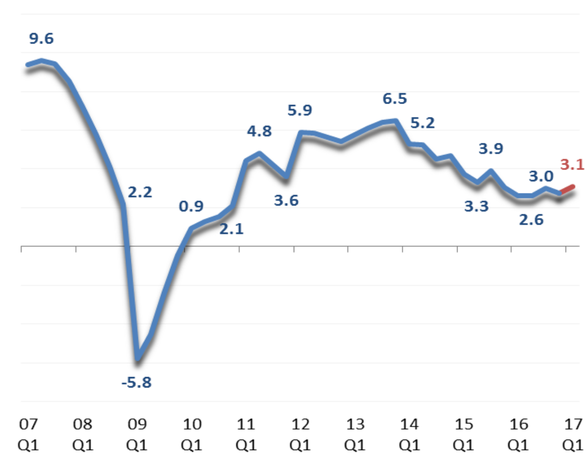


Source: IMF

In oil-exporting countries, the decline of oil prices that started mid-2014 weighed significantly on economic activity, the terms of trade as well as the fiscal stance in these countries. The consequent negative impact on their external financial positions was fast. The stock of international reserves for the UAE fell in 2016 by around 9%. However, the competitiveness of the UAE non-energy exports has contributed to the diversified structure of the economy in general and export growth in particular (see Box 1 for more details on the developments of international reserves and the diversified structure of exports in the UAE).

On the other hand, the improvement of the oil prices recently has revived the positive sentiment regarding the outlook of economic activity in the UAE and especially in the non-oil private sector. The Non-Oil Economic Composite Indicator (Non-Oil ECI), showed an improvement of the non-oil economic activity in the UAE during the first quarter of 2017 (see Figure 2.1.c). The Non-Oil ECI grew by 3.1% in the first quarter of 2017, increasing growth compared to the last quarter of 2016 on a year-on-year basis.

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

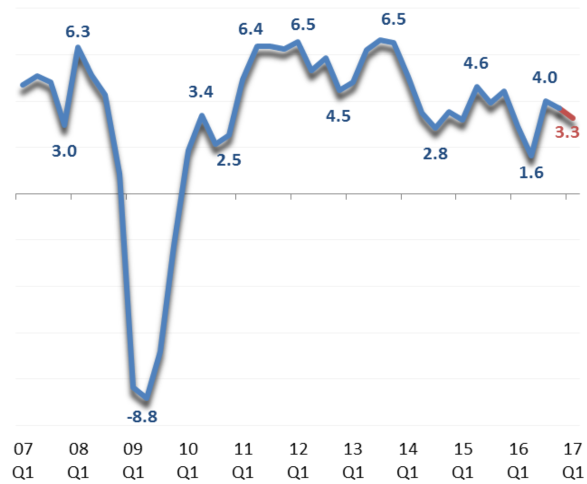


Source: CBUAE

On the other hand, the overall Economic Composite Indicator (ECI) is showing a slowdown. According to this index, the overall economy expanded by 3.3% during the first quarter of 2017 (see Figure 2.1.d). The slowdown was due to slower rate of growth in oil production in the first quarter of 2017. In fact, oil production increased by 3.6% in the first quarter of

2017 on a year-on-year basis against an increase of 4.6% in the previous quarter. The oil production is expected to slow down further in 2017 since the UAE has committed, among other OPEC members, to cut oil production by 139k barrel/day during a renewable period of six months, effective January 2017.

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



Source: CBUAE

Taken these facts into consideration and following revised official data, the new figures of Real GDP released by FCSA point to a 3% pick-up in 2016 (see Box 2. for more details on the Real GDP growth revision). The Real Non-Oil GDP has grown by 2.7% in 2016.

Table 2.1 Economic Growth in the UAE (%)

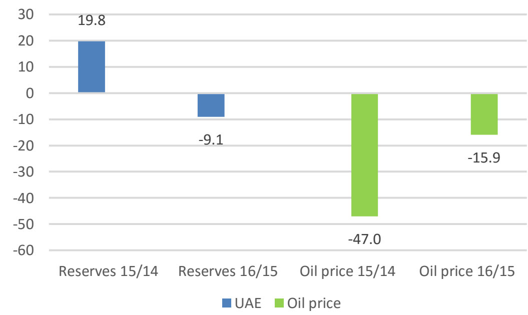
	2014	2015	2016
Real GDP	3.3	3.8	3.0
Real Oil GDP	0.4	5.4	3.8
Real Non-Oil GDP	4.6	3.2	2.7

Source: Federal Competitiveness and Statistics Authority (FCSA)

Box 1. The Effect of Oil Price change on Exports and International Reserves

This box describes the effect of the oil price reduction on international reserves and exports of the UAE. As shown in Figure 1, the stock of international reserves for the UAE increased from 2014 to 2015 by 19.8%. However, international reserves declined by 9.1% in 2016. The diversified structure of the UAE economy and exports has maintained the growth of non-energy exports in 2015 and 2016.

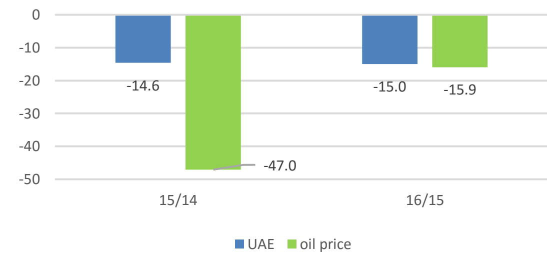
Figure 1. Percentage difference of the stock of total international reserves in the UAE and change in the oil price (2014-2016)



Source: IMF, International Financial Statistics

Figure 2 illustrates the evolution of exports in the UAE. As shown in the graph, between 2014 and 2015 the exports of the UAE decreased by 14.6% when the oil price recorded decrease of 47%. In addition, between 2015 and 2016 whereas the oil price recorded decrease of 15.9% the UAE exports decreased by 15%. These evolutions show the capacity of the UAE economy to withstand the effect of oil price decrease on international reserves, underpinned by the diversification of exports and the higher ratio of non-oil exports to total exports. The UAE economy possesses high ratio of non-oil exports to total merchandise exports. Specifically, the ratio was 65% in 2013; estimated to have increased to 83% in 2016. It is also noteworthy that the travel receipts and inward foreign investment have provided further support to sustain the resilience of international reserves despite the decline in oil exports.

Figure 2. Percentage difference of exports (FOB) in the UAE and percentage change in the oil price (2014-2016)

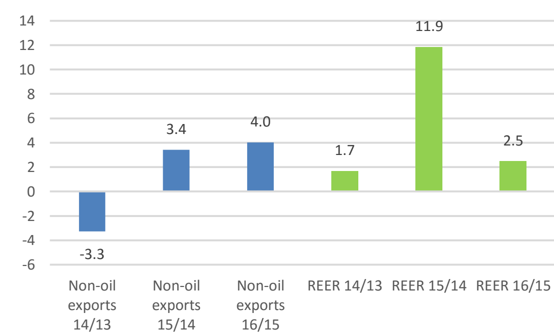


Source: IMF, Direction of Trade Statistics

The growth of non-oil exports in the UAE has mitigated the effect of the decline of oil exports and sustained the surplus in the trade and current account balances. In parallel, international reserves continued to provide adequate coverage for the payments of imports and the stability of the exchange rate peg.

Figure 3 depicts the changes in non-oil exports in the UAE along with the percentage change of the real effective exchange rate. Non-oil exports have recorded large increase since 2014, notwithstanding the continued appreciation of the real effective exchange rate. This evidence attests to the capacity of the UAE economy to diversify the structure of exports and sustain competitiveness.

Figure 3. Percentage difference of non-oil exports of UAE percentage change in the real effective exchange rate (2013-2016)

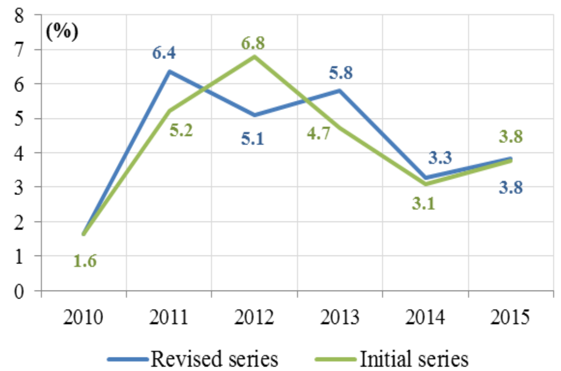


Source: CBUAE, Bank of International Settlements

Box 2. Revised Official Figures of GDP

The Federal Competitiveness and Statistics Authority (FCSA) has released new GDP figures for 2016. In this new update, the FCSA used 2010 as the base year instead of 2007, and also revised the Real GDP series during the period 2010-2016 (Figure 1).

Figure 1: Revised Official Figures of GDP



Source: FCSA

The Central Bank of the UAE (CBUAE) has updated the assumptions of the drivers of growth to take into account the revised GDP figures and updates to the drivers. Specifically, the analytical framework for projections and the construction of the Economic Composite Index (ECI) integrate the recent updates, regarding the Brent prices and the UAE oil production fluctuations amid the OPEC agreement, as well as the recent economic development and projections for the main UAE's economic partners (Table 1).

Table 1: Revised Assumptions

	2016		2017	
	Initial	**Revised**	**Initial**	**Revised**
Oil Brent futures price US dollars per barrel	45.3	44	52.6	56.2
UAE Oil production Million barrels per day	2.9	3.1	2.9	2.9
Economic Partner Index Year on year growth %	2.5	2.5	2.6	2.7

Source: Bloomberg, OPEC, IMF and CBUAE

Revised assumptions for the drivers of growth are likely to boost the prospects of growth in the UAE in several directions. First, the firming of the oil price is likely to boost government revenues and liquidity in the banking system with direct and indirect positive effects on the growth of non-oil GDP. Moreover, the prospect of higher global growth in 2017 is likely to boost non-oil growth of the UAE economy that is highly integrated through trade, financial and tourism channels, all of which are likely to solidify the potential of higher growth going forward.

2.2 Consumer Price Index and Inflation

Following the end of the disinflation period in the last quarter of 2016 where the inflation rate rebounded to reach 1.9%, a pickup in inflation was confirmed by the price developments in the first quarter of 2017. The average quarterly CPI inflation increased by 2.7% in the first quarter of 2017 (see Table 2.2) with an end-of-period jump by 3%. This rebound of prices was driven mainly by the increase of the prices of tradables, while the non-tradables inflation remained almost constant (see Figures 2.2.a and 2.2.b).

Tradables' prices, which account for 34% of the consumption basket in the UAE, increased by 3.2% in the first quarter of 2017 against a modest increase of 0.6% in the last quarter of 2016 and a decline of 0.7% in the third quarter. This rebound was driven by the increase of the tradable part of transportation costs. Effective August 2015, the energy subsidy-cut has aligned the domestic transportation costs to international prices of energy. The increase of oil prices in the first quarter of 2017 by around 58% y-o-y induced a jump of transportation costs in the UAE by 8.5% y-o-y after a deflation period starting from the fourth quarter of 2015. This reform had contributed to the increased volatility of transportation costs by around 28%.

Foods and soft drinks prices increased mildly by 0.3% in the first quarter of 2017 against a previous growth of 0.4%. On the other hand, the furniture and households goods inflation displayed an increase from 1.5% in the last quarter of 2016 to reach 1.9% in the first two months of 2017.

The price inflation of non-tradables, accounting for 66% of the standard consumption basket in the UAE, remained almost stable in the first quarter of 2017. It was 2.9% y-o-y against 2.7% in the last quarter of 2016. The price inflation of housing costs (rental prices and utilities costs) which account for 34% of the consumption basket and 52% of the non-tradables in the UAE, continue its decreasing trend that started in the third quarter of 2015. Housing prices increased by 2.1% in the first quarter of 2017 after an average quarterly growth of 4.1% in 2016. Notwithstanding the pickup in total inflation, housing prices are lagging due to increasing supply. According to the JLL[1] report, the rental prices of apartments in Dubai declined by 1.1% on a quarter-on-quarter basis and by 2.9% on a year-on-year basis in the first quarter of 2017.

Table 2.2 UAE CPI Inflation (%)

	Weight %	2016				2017
		Q1	Q2	Q3	Q4	Q1
Total CPI Inflation	100	2.1	1.7	1.5	1.9	2.7
Total CPI Inflation (end-of-period)	100	1.4	1.8	1.4	1.2	3.0
CPI Inflation of Tradable	34	-0.4	0.3	-0.7	0.6	3.4
CPI Inflation of Non-tradable	66	2.6	1.9	2.1	2.7	2.9
Housing CPI inflation	34	5.1	3.3	4.1	3.7	2.1
Transportation CPI inflation	15	-6.7	-2.7	-5.9	-1.1	8.5

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.
***:** Computed as the average of the CPI annual inflation for the three months

The rental prices of villas declined also by 0.7% compared to the last quarter of 2016 and by 7.9% on a year-on-year basis. In addition, additional 2600 units (apartments and townhouses) were completed in the first quarter of 2017. A further 28000 units are currently under construction and are scheduled for delivery by the end of 2017, which will exert a much more downward pressure on rental prices in Dubai. On the other hand, no change in the rental prices of offices has been recorded so far.

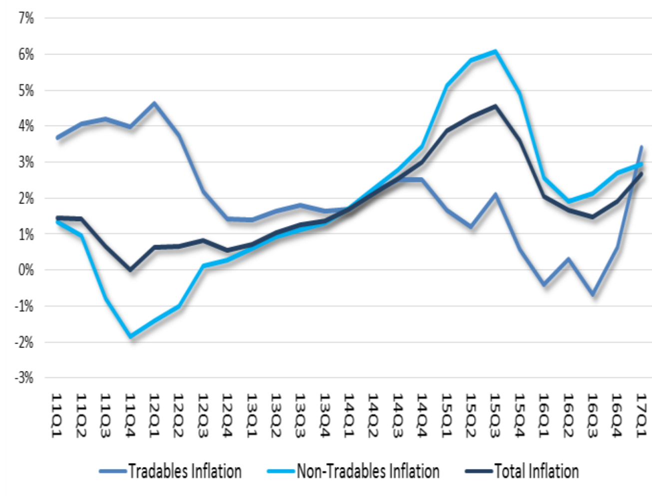
In Abu Dhabi, the decline of office rents was the main driver of the global decline in rental prices in the city. They have already fallen by 8% in 2016 and they are expected to drop by 5% in 2017. The office market was particularly hit by the mergers of some of the capital's largest companies. In addition according to a Cluttons's[2] report released recently, the average rents in Abu Dhabi are 15% lower year-on-year in the first quarter of 2017. (see more details on Real Estate market developments in Box 3.).

[1] It refers to Jones Lang LaSalle, which is an American professional services and investment management company specialized in real estate.

[2] Its is an international firm of chartered surveyors and property consultants based in London.

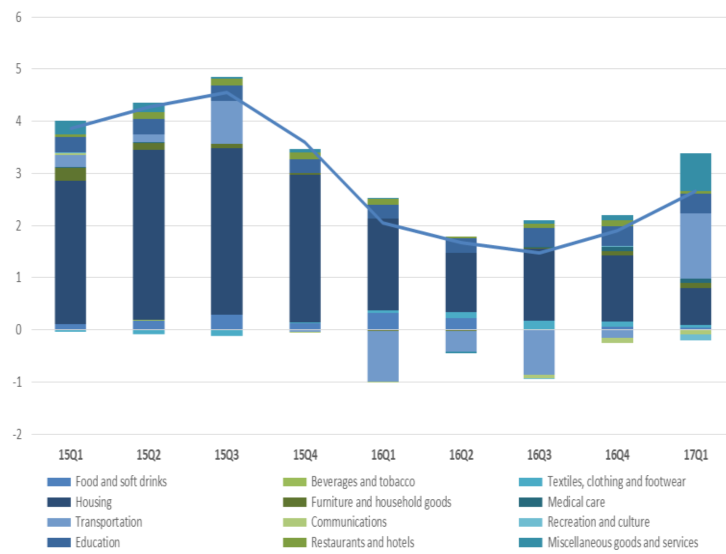
Price inflation of education, which accounts for around 7.7% of the standard consumption basket, remained constant in the first quarter of 2017 and reached 5%. Education costs kept increasing from the end of 2015 and realized an average increase of 4.2% in 2016.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

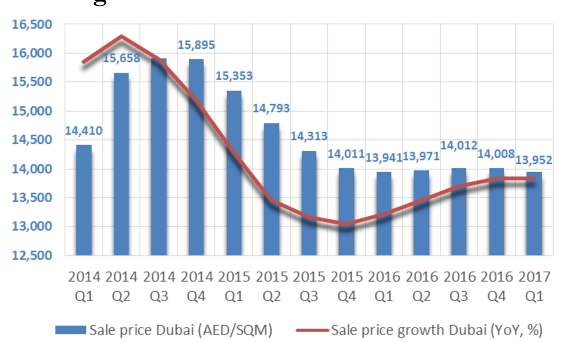
Box 3: Recent Developments in the Real Estate

In the beginning of 2017, the UAE Real Estate Market was marked by a general softening in the residential segment, but with different patterns of change in Abu Dubai and Dubai markets, according to REIDIN Price Index[3]. In fact, during the first quarter of 2017, the annual change in property prices increased slightly by 0.08% in Dubai, while the prices declined by 6.2% in the Abu Dhabi market. Moreover, the rental yield in both emirates has contracted during the first quarter of 2017, due to the more pronounced fall in rents, but remains attractive for investors (7.05% for Abu Dhabi and 7.17% for Dubai).

Dubai residential Market

In the first quarter of 2017, the change in property prices, which measures the average sample price in dirham per square meter, improved marginally by 0.08% compared to last year, performing better than the previous quarter (see figure 1). Therefore, the trend observed since 2016 has started to show signs of price stabilization in the residential market in Dubai during 2017.

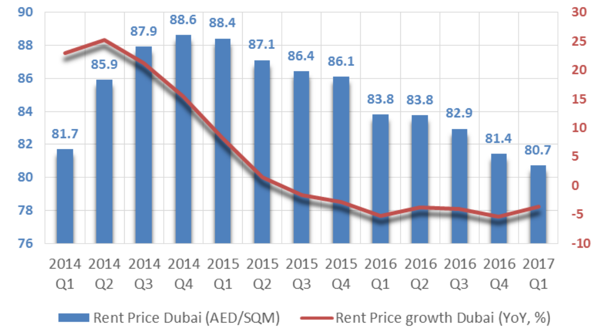
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

Since the beginning of the downward cycle in mid-2014, the fall in property prices has been in parallel to the fall in rents in Dubai (see figure 2). Indeed, the rent prices declined by an annual rate of 3.7% in the first quarter, but at a slower pace than in 2016.

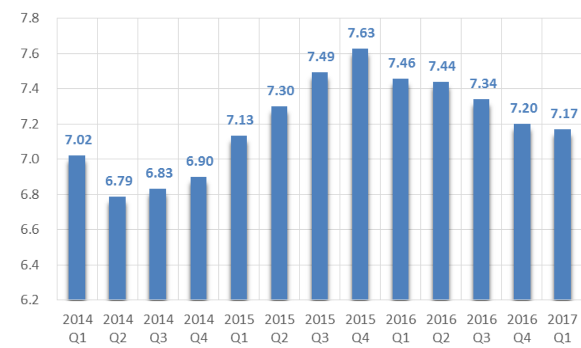
Figure 2: Dubai Residential Rent Prices



Source: REIDIN

Concerning investment in Dubai's real estate market, 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 (See 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 reached 7.17% during the first quarter of 2017, but remains attractive for investors.

Figure 3: Dubai rental yield (%)



Source: REIDIN

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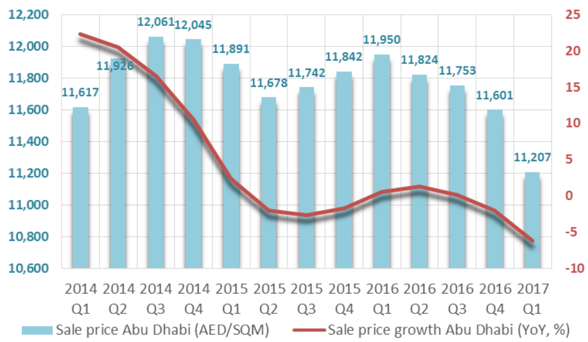
[3] REIDIN Residential Sales Price Index series are calculated on a monthly basis and cover 21 areas and 6 districts in Dubai. For Abu Dhabi, the indices cover 7 areas and 5 districts.

Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index showed a continued fall in residential property prices of 6.2% y-o-y on average in the first quarter of 2017, following a decrease of 2% in the previous quarter (See Figure 4).

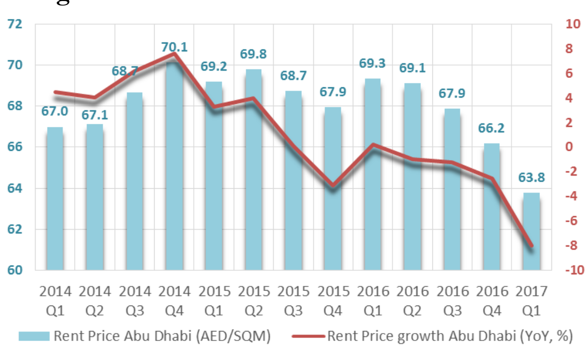
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

Regarding the rental market, Abu Dhabi reinstated the 5% residential rent cap in mid-December 2016. This comes three years after the rent cap was suspended, and at a time marked by a more pronounced fall in rents. In fact, rent values declined by an annual rate of 8% on average in the first quarter of 2017, after a reduction of 2.56% in the last quarter of 2016, reflecting the impact of softer job market and the cuts in public expenditures, which continue to suppress demand (See Figure 5).

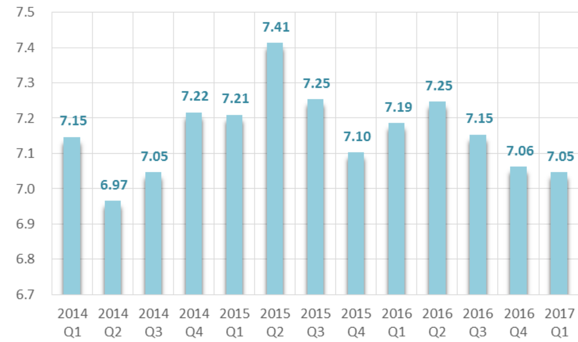
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

As for the rental yield, Abu Dhabi registered a yield of 7.05% for the first quarter of 2017, down from 7.06% in the previous quarter (See Figure 6). The observed pattern in rental yield reflected a faster pace of decline in rent relative to property values, in consistency with the lagged effect on the job market relative to the speculative nature of investment in properties, and in line with the outlook for the economy given the persistence of low oil prices.

Figure 6: Abu Dhabi rental yield (%)



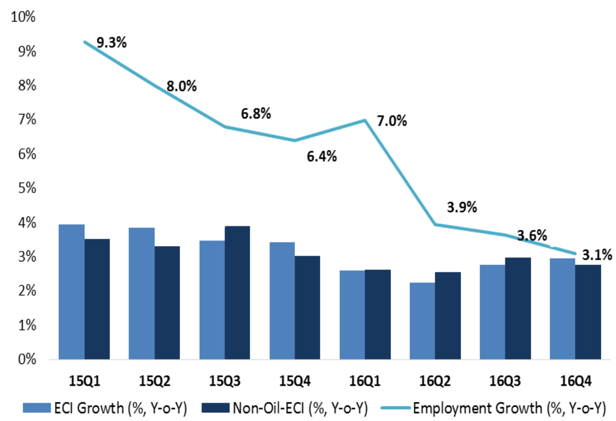
Source: REIDIN

2.3 Employment and labor market dynamics

Employment has slowed down in the fourth quarter of 2016 displaying a growth rate of 3.1% on a year-on-year basis[4] (see Figure 2.3.a). The number of employed persons by the UAE economy for different sectors has increased during the fourth quarter of 2016 by 0.8% against a 1.1% growth during the previous quarter on a quarter-on-quarter basis.

Given the available information, the decreasing trend for employment started in the third quarter of 2014, following the developments of oil prices, although it showed some resiliency to the adverse oil price shock.

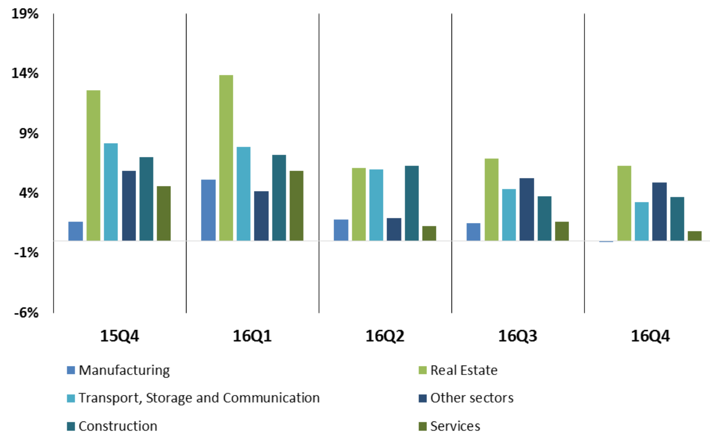
Figure 2.3.a. Employment Growth and Economic Activity in the UAE



Source: Available data from Ministry of Human Resources and Emiratisation and CBUAE

The economic slowdown, charted by the ECI and the Non-Oil ECI (see Figure 2.3.a), has weighed on labor demand in all sectors of the economy on a year-on-year basis (see Figure 2.3.b). For example, the employment growth in the services sector declined from 1.6% in the third quarter of 2016 to 0.8% in the last quarter of 2016. While maintaining some hiring activity, the transports, storage and Communication sector has dropped its demand for labor which grew only by 3.2% in the last quarter of 2016 (4.3% in the previous quarter compared to average growth of 8.5% for 2015).

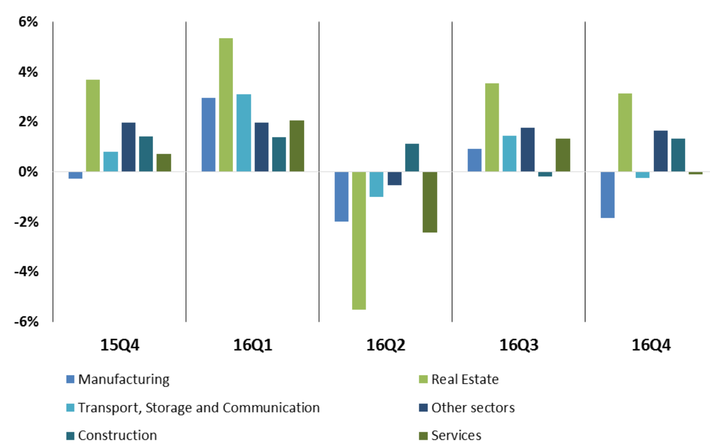
Figure 2.3.b. Employment Growth by Sector (%, Y-o-Y)



Source: Available data from Ministry of Human Resources and Emiratisation

Figure 2.3.c presents the short-term developments of labor demand in all sectors. Total employment grew by 0.8% compared to the third quarter of 2016, to which the construction sector contributed by 1.3% and the real estate sector contributed 3.1%. Labor demand declined in the services, manufacturing and Transports sectors by 0.1%, 1.9% and 0.3%, respectively.

Figure 2.3.c. Employment Growth by Sector (%, Q-o-Q)



Source: Available data from Ministry of Human Resources and Emiratisation

[4] Data for the first quarter of 2017 are not available yet.

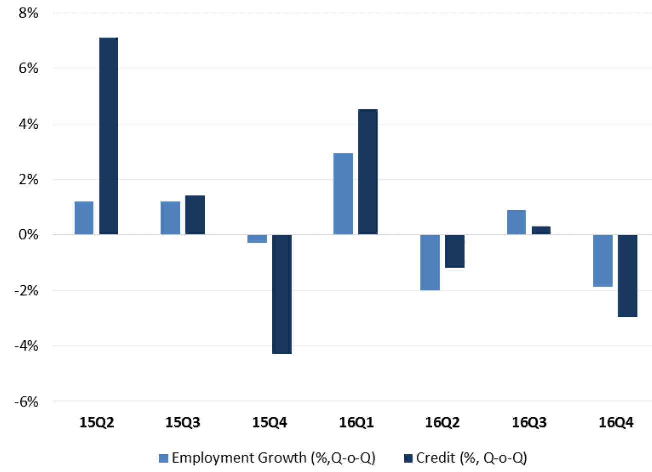
The services sector, which absorbs around 24% of the total employment, cut its labor demand by 0.1% in the last quarter of 2016 compared to the previous quarter. This is the second quarterly decline, after a stable average increase of 1.2% since 2014 (see Figure 2.3.c). The first time was in the second quarter of 2016 when the services jobs declined by 2.4%.

Employment in the Transport, storage and Communication sector dropped by 0.3% in the last quarter of 2016 after a first time drop by 1% in the second quarter of 2016. This sector is absorbing around 8% of the total labor force.

On the other hand, the most important decline of employment was in the manufacturing sector where labor demand fell by 1.9% in the last quarter of 2017. Among all sectors, the manufacturing sector has shown the highest sensitivity to the economic slowdown. On average, labor demand for the sector has stagnated during 2016 and increased only by 0.4% in 2015, while the average quarterly growth of the total employment was around 1.6% in 2015 and 0.8% in 2016.

These developments in manufacturing employment can be explained by the slowdown of the manufacturing investments. The domestic credit allocated to the manufacturing sector declined by 3% in the last quarter of 2016 compared to the previous quarter (see Figure 2.3.d). The quarterly domestic credit growth and the quarterly employment growth in the manufacturing sector exhibit a correlation of 88%. For example, the manufacturing employment level fell by 2% in the second quarter of 2016 whereas the manufacturing domestic credit dropped by 1.2% during the same period. In the last quarter of 2016, the reduction in credit and employment in the manufacturing sector is also evident.

Figure 2.3.d. Employment and Credit Growth in the Manufacturing Sector (%, Q-o-Q)



Source: Available data from Ministry of Human Resources and Emiratisation and CBUAE

2.4 Exchange Rate and Foreign Trade Balance

The Dirham continued to appreciate, although at a slower pace, in the first quarter of 2017 for the twelfth consecutive quarter, except for the second quarter of 2016 where the Dirham depreciated slightly. With a few exceptions, the Dirham appreciated against most of the UAE's main trade partners.

From the import side, the weighted Dirham's appreciation against its top-nine non-dollarized import partners was 0.37% in the first quarter of 2017 (see Table 2.4.a) lower than the appreciation of the last quarter of 2016 (1.57%) and comparable to the average appreciation in 2016 (0.36%). Except for the Indian Rupee and the South Korean Won, the Dirham has appreciated against all its main import partners, with a simple average bilateral appreciation of 1.2% during the first quarter of 2017[5].

The highest quarterly appreciation was against the Japanese Yen, where the Dirham gained around 3.6%. Japan is contributing around 5.7% in the total imports of the UAE. On the other hand, the Dirham gained 1.2% against the Euro. Imports from Germany, Italy and France account altogether for more than 24% of total imports. The Dirham gained also 0.7% and 0.3% against the Chinese Yuan and the GB Pound. As the top-one importer to the UAE, China is contributing 12.4% to the total imports.

On a year-on-year basis, after an appreciation by 1.49% during the fourth quarter of 2016, the Dirham continued on the same trend and appreciated by 1.36% during the first quarter of 2017. The most important recorded gains were against the GB Pound (15.6%), the Chinese Yuan (5.3%) and the Euro (1.5%) accounting for 27.8% of total imports. However, the Dirham lost around 4% against the South Korean Won on a year-on-year basis.

On the export side, except for the Indian Rupee, the Dirham has appreciated against its top-nine non-dollarized export partners. The weighted appreciation was 0.63% in the first quarter of 2017 compared to the previous quarter (see Table 2.4.b), with a simple average bilateral exchange rate appreciation of 1.9%.

[5] The bilateral appreciation against the top-seven import-partners (Indian Rupee and South Korean Won are excluded).

Table 2.4.a Dirham appreciation against currencies of top non-dollarized import partners

Currency	Share of UAE imports (%) 2015	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham (Q4-Q3) 2016	% Change of Currencies per Dirham (2017Q1 -2016Q4)	% Change of Currencies per Dirham (2017Q1 -2016Q1)
Chinese Yuan	12.40	2.02	2.53	0.71	5.25
Indian Rupee	9.70	0.05	0.76	-0.72	-0.76
Germany (EUR)	6.48	1.16	3.54	1.20	3.58
Japanese Yen	5.65	-5.19	7.08	3.64	-1.40
UK Pound	3.35	9.21	5.67	0.30	15.63
Italy (EUR)	2.99	1.16	3.54	1.20	3.58
South Korean Won	2.87	-3.69	3.48	-0.61	-3.99
France (EUR)	2.53	1.16	3.54	1.20	3.58
Swiss Franc	2.53	0.47	2.60	0.30	1.07
Total	**48.50**				
Weighted Appreciation		**0.32**	**1.57**	**0.37**	**1.36**

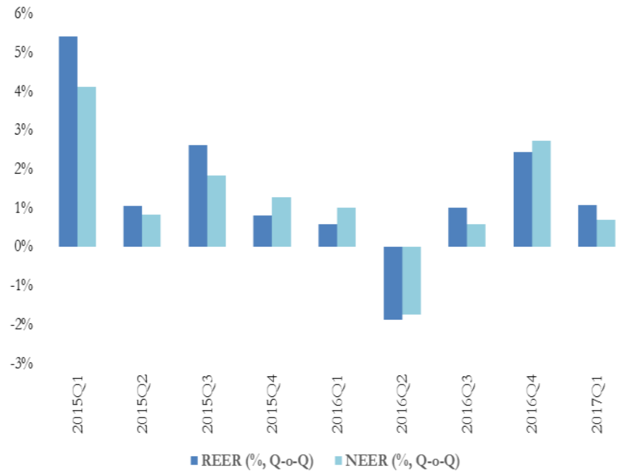
Source: Data on Imports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2015.Data for the exchange rate are the quarterly average observations, recorded and displayed by Bloomberg.

Table.2.4.b Dirham appreciation against currencies of top non-dollarized partners for non-oil Exports

Currency	Share of UAE Exports (%) 2015	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham (Q4-Q3) 2016	% Change of Currencies per Dirham (2017Q1 -2016Q4)	% Change of Currencies per Dirham (2017Q1 -2016Q1)
Indian Rupee	12.47	0.05	0.76	-0.72	-0.76
Swiss Franc	5.64	0.47	2.60	0.30	1.07
Iraqi Dinar	5.61	0.16	0.29	0.11	0.67
Turkish Lira	5.16	2.32	10.95	12.24	25.62
Singapore Dollar	4.26	-0.41	4.34	0.34	1.01
Kuwaiti Dinar	4.01	0.05	0.80	0.37	1.18
Chinese Yuan	2.34	2.02	2.53	0.71	5.25
Netherlands (EUR)	1.84	1.16	3.54	1.20	3.58
Pakistan	1.78	0.01	0.16	0.05	0.1
Total	**43.11**				
Weighted Appreciation		**0.22**	**1.17**	**0.63**	**1.61**

Source: Data on Exports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2015. Data for the exchange

Figure 2.4.a Nominal and Real Effective Exchange rates Developments



Source: Bank of International Settlement (BIS)

In addition, the Dirham appreciated by 1.25% on a year-on-year basis. The most important appreciation of the Dirham was against the Turkish Lira by 12.2%, where Turkey is receiving around 5.2% of the total UAE non-oil exports, after India (12.5%), Switzerland (5.6%) and Iraq (5.6%). The weakening of the Turkish Lira against the Dirham constituted the main driver of the total weighted Dirham's appreciation on a year-on-year basis. In fact, the Dirham gained 25.6% in the first quarter of 2017 against the Turkish Lira compared to the same quarter of the previous year. Another driver of the Dirham's appreciation against its non-hydrocarbon export partners is the weakening of the Chinese Yuan. China is receiving around 2.3% of UAE's non-oil exports and the Dirham appreciated by 5.3% against the Renminbi.

The Real and the Nominal Effective Exchange Rates developments in the first quarter of 2017 have confirmed the general patterns of the Dirham's appreciation with respect to its top-nine trade partners (imports and non-oil exports) as analyzed above (see Figure 2.4.a).

The quarterly average REER, has increased by 1.1% compared to the last quarter of 2016 and by 2.6% on a year-on-year basis. Similarly, the NEER grew by around 0.7% for the same period. The contribution of the relative price change to the REER appreciation was insignificant during the first quarter of 2017.

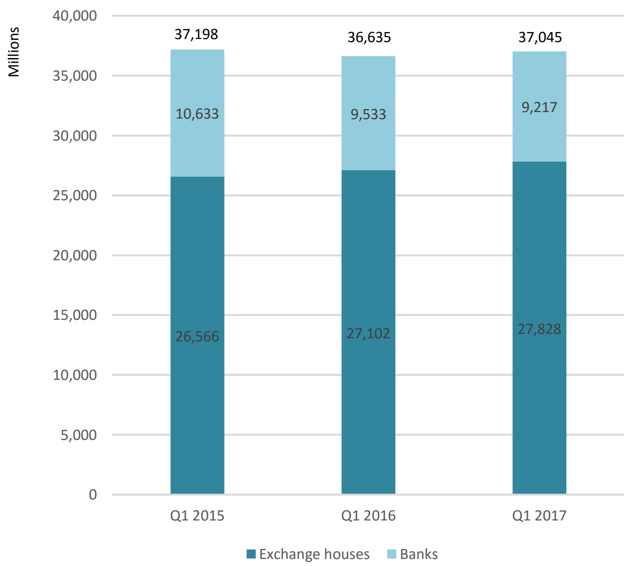
It is noteworthy to examine the impact of the continuous Dirham's appreciation on the remittances' outflows as well as on tourism activity, given the openness of the country and the importance of the expats community in the UAE. In fact, the remittances outflows increased by 7.2% during the first two months of 2017, where India continues as the leading destination of remittances' outflows with a share of 34.9% during the same period (see Box 4. for more details).

On the other hand, an improvement of the tourism activity in the UAE has been recorded during the first two months of 2017. The number of international visitors has increased by around 11% in the first two months of 2017 compared to the same period in 2016. However, the average daily rate and the revenue per available room have declined by 3.3% and 1.9% respectively in Dubai and Abu Dhabi, offset by an increase in occupied room nights by 4.9% (see Box 5. for more details).

Box 4: Workers' Remittances

The workers' remittances outflows in the first quarter of 2017 registered AED 37.1 billion, an increase of 1.1% or AED 0.4 billion compared to the same period of 2016 (AED 36.6 billion) (figure 1). The data capture the outflows reported from the exchange houses and the banks to the Banking Supervision Department of the Central Bank (BSD). The outflows of the workers' remittances that were settled only through the exchange houses recorded AED 27.8 billion in the first quarter of 2017 (2.7% or AED 0.7 billion increase compared to the first quarter of 2016).

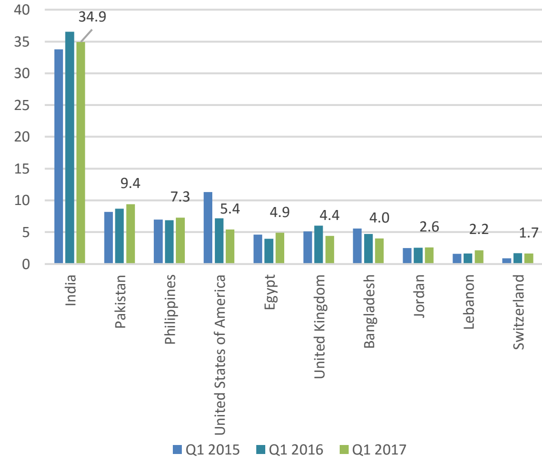
Figure 1. Evolution of Workers' remittances settled through Banks and Exchange houses in the UAE Q1 2015-2017



Source: CBUAE, Banking Supervision Department

The most important country of destination for workers' remittances during the first quarter of 2017 was India that accounted for 34.9% of the outflows of workers' remittances. This high share is in accordance with the significant share of expats from India in the UAE (figure 2). According to available statistics, dated October 2008 from the Federal Competitiveness and Statistics Authority, 82.7% of the employees in the UAE belong to Asian Non-Arab Countries, which include India. The next five most important countries in the share of outflows of expat workers were Pakistan (9.4%), Philippines (7.3%), the United States of America (5.4%) and Egypt (4.9%).

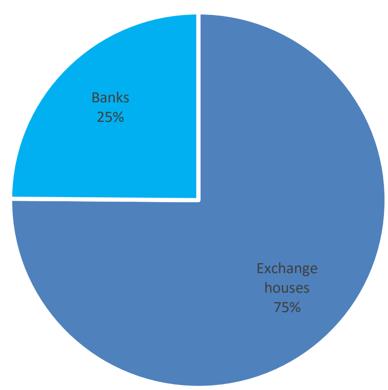
Figure 2. Share of the major countries for workers' remittances during Q1 2015-2017 (percentage of total, exchange houses and banks)



Source: CBUAE, Banking Supervision Department

In the first quarter of 2017, the data provided by BSD indicate that 75% of the financial transfers are being conducted through the exchange houses and 25% through the banks. Figure 3 illustrates the shares of exchange houses and banks in total transactions of remittances.

Figure 3. Share of settlement of total workers' remittances

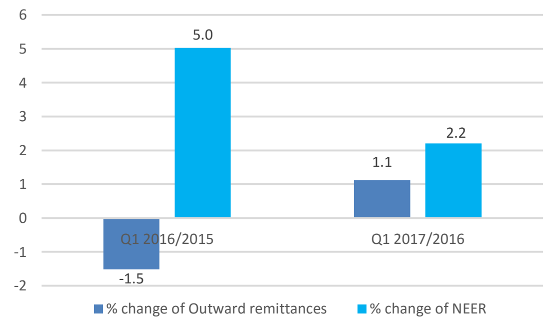


Source: CBUAE, Banking Supervision Department

The total recorded workers' remittances outflows for the first quarter of 2017 represent 23% of the total estimated remittances in the UAE balance of payments for 2016 (at AED 160.8 billion).

The increasing trend of the total outflows of private transfers in the first quarter of 2017 could be attributed also to the continued appreciation of the nominal effective exchange rate of the dirham which increased by 2.2% on average during the first quarter of 2017 (the average index for Q1 2017 was 121.1 based on data provided by the Banks of International Settlements (BIS)) compared to Q1 2016.

Figure 4. Percentage change of total outward remittances versus the percentage change of nominal effective exchange rate (Q1 2015-2017)



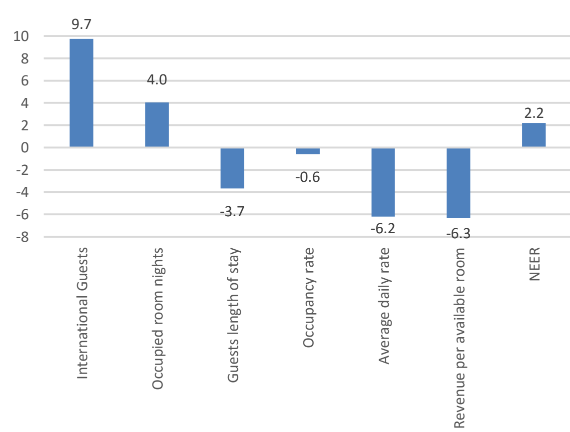
Source: CBUAE, Banking Supervision Department,
Bank of International Settlements

Box 5: Exchange Rate Appreciation and Tourism Activity in the UAE

This box describes the effect of the dirham appreciation on tourism to the UAE for the period of the first quarter of 2017 compared to the first quarter of 2016 based on the most recent data available for Dubai and Abu Dhabi emirates. The figures of the two emirates contribute the largest share of the total aggregates.

In the first quarter of 2017, compared to the same period in 2016, the number of international tourists increased by 9.7% (figure 1) showing an increasing trend in attracting international visitors. The increase in the specific period records high seasonality compared to the rest of the year due to the UAE's good climate. The average daily rate and the revenue per available room decreased by 6.2% and 6.3% respectively (average prices of the two emirates) for the same period. These evolutions resulted in an increase in occupied room nights by 4%. Despite the appreciation of the dirham in terms of the nominal effective exchange rate by 2.2% on a year-to-date basis, guest arrivals increased. In addition, the average hotel occupancy rate records small decrease by 0.6% for the first quarter of 2017, compared to the same period of 2016.

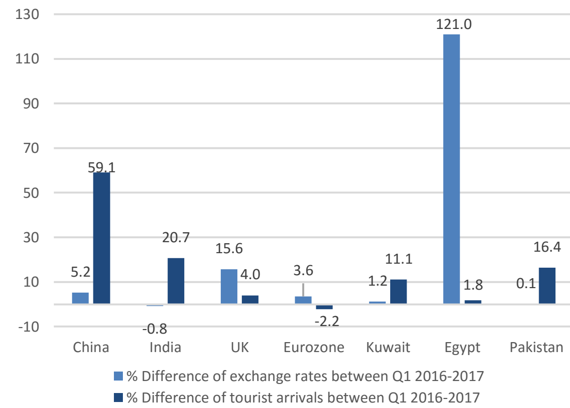
Figure 1: Major combined indicators of Dubai and Abu Dhabi inbound tourism Q1 2017-16 (% difference)



Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority, Bank of International Settlements

Figure 2 shows the effect of the bilateral exchange rate movements on tourism between the first quarter of 2017, compared to the first quarter of 2016. Despite the appreciation of the dirham with respect to other currencies, tourists' arrivals increased from major countries except from Germany in the Eurozone. Specifically, China, India, Pakistan and Kuwait recorded larger increase in tourist arrivals despite the appreciation of the dirham relative to their currencies. The incoming tourists from the UK, however, recorded a smaller increase reflecting larger appreciation of the dirham relative to its currency. Tourists from Egypt recorded small increase due to the largest appreciation of the dirham relative to the Egyptian pound.

Figure 2. Guest arrivals and exchange rate on selected countries Q1 2017-16 (% difference)

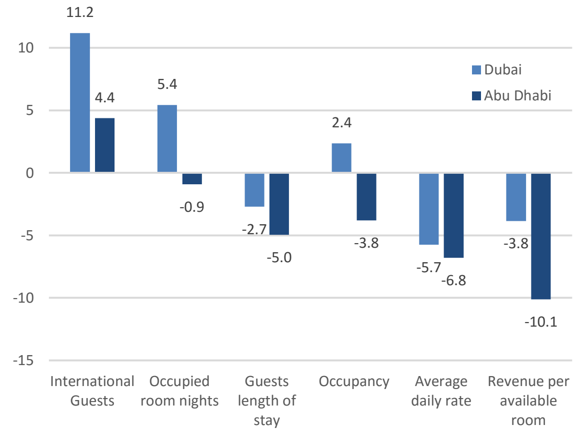


Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority, Bloomberg

In figure 3, the data for the Dubai emirate indicate that the number of international visitors increased significantly by 11.2% in the first quarter of 2017 compared to the same period of 2016. However, the average daily rate and the revenue per available room decreased by 5.7% and 3.8% respectively. This evolution resulted in an increase in occupied room nights by 5.4%. Simultaneously, the average hotel occupancy rate increased from 85% to 87%, for the first quarter of 2017, compared to 2016.

The guest arrivals in the Abu Dhabi emirate increased by 4.4% in the first quarter of 2017 compared to the same period in 2016 following a similar trend. However, the average room rate was lower by 6.8% which resulted in 10.2% decrease in total revenues in the first quarter of 2017 compared to the same period of 2016.

Figure 3: Major indicators of Dubai and Abu Dhabi inbound tourism Q1 2017-16 (% difference)



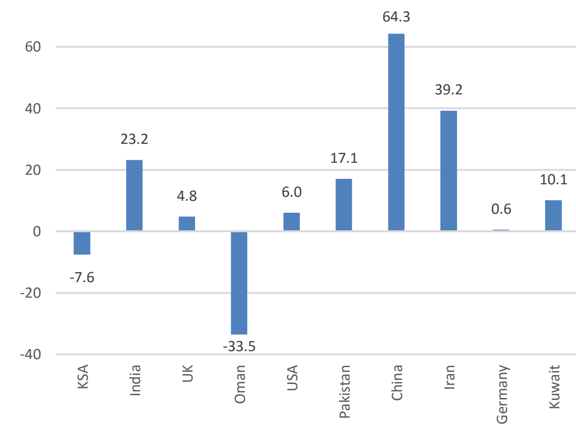
Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority[6]

The countries that are the major markets for inbound tourism to Dubai show increase in the arrivals of tourists, except from Oman. The vast majority of tourists to Dubai originate from GCC countries and the MENA region (19% and 12% respectively), while Western Europe and North America cover 22% and 6% of inbound tourism. Finally, 18% of inbound tourism comes from the region of South Asia.

Most of the countries that are major markets of inbound tourism for the Abu Dhabi Emirate recorded increase in guest arrivals, apart from Germany (-13.9%) and Jordan (-4.9%). The largest increase in guest arrivals was recorded from China (48%), Philippines (12.3%) and Pakistan (11.1%).

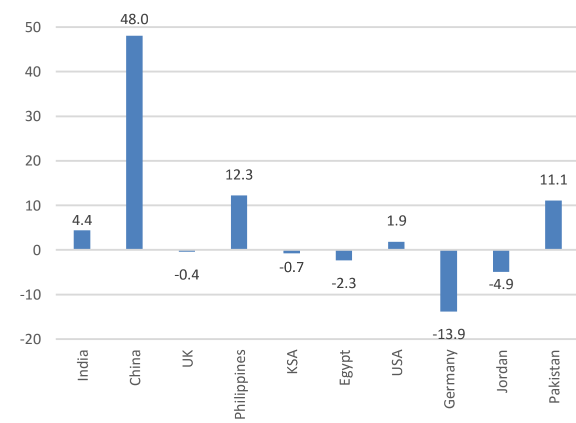
Figure 4. Major markets of inbound tourism Q1 2017-16 (% difference)

a. Dubai



Source: Dubai Tourism Authority

b. Abu Dhabi



Source: Abu Dhabi Tourism Authority

[6] Data are for based on the official tourism authorities publications. Dubai Tourism Authority publishes *International Guests* whereas Abu Dhabi Tourism 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.

2.5 Financial developments

2.5.1 Share Price Volatility

The year 2017 started in a very good mood for financial markets in Abu Dhabi and Dubai. On account of an improvement of oil prices and the commitment of the UAE to the OPEC production cut decision, effective January 2017, the investors' confidence has been solidified reflecting less uncertainty. The positive sentiment was materialized by an increase of share price indices as well as market capitalization in both Emirates and a declining volatility after a gloomy picture in the last quarter of 2016.

In Abu Dhabi, the average Share Price Index increased by 3% in the first quarter of 2017 after a decline of 2.7% in the final quarter of 2016. The market capitalization followed the same trend. It increased by 1.4% in the first quarter after dropping by 3% in the previous quarter (see Table 2.5.1). In addition, the improvement of the securities market in Dubai was more noticeable. The average Share Price Index rose by 5.2% in the first quarter of 2017. The market capitalization jumped by 18.8% in the first quarter against a deterioration of 3.3% in the previous quarter.

The increase in the share price indices was accompanied by declining volatility[7]. The price volatility started declining from the last quarter of 2016 in both Emirates. In Abu Dhabi, the price volatility dropped by 4.8% Q-o-Q in the first quarter of 2017 after a 2.7% reduction in the fourth quarter of 2016. Similarly, the volatility of the Share Price Index in Dubai has declined by 5.5% in the first quarter against a drop of 5% in the previous quarter.

Table 2.5.1 UAE – Securities Markets

		2016				2017
		Q1	Q2	Q3	Q4	Q1
Abu Dhabi	Change of Share Price Index (%)	-0.5	3.9	1.7	-2.7	3.0
	Change of Market Capitalization (%)	1.0	1.9	5.8	-3.0	1.4
Dubai	Change of Share Price Index (%)	-2.7	5.5	3.4	-2.3	5.2
	Change of Market Capitalization (%)	-3.4	6.4	1.4	-3.3	18.8

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.

2.5.2 Credit Default Swaps Premiums

The decline of uncertainty in the financial markets stemming from the improvement of oil prices was projected into a decline of the likelihood of default of sovereigns and GREs. As a proxy to the default risk premium, the spreads of Credit Default Swaps (CDS) have largely tightened during the first quarter of 2017. They continue on a decreasing trend that has started in 2016 (see Table 2.5.2).

The CDS of Sovereigns fell by 33.5% in Abu Dhabi after a previous decline of 17% in the last quarter of 2016. Similarly, in Dubai, the CDS dropped by 23.6% against a previous decline of 10.5% Q-o-Q.

The CDS of DP World declined by 4.7% in the first quarter of 2017 with an average quarterly level of 136.8 bps, the lowest reading since the third quarter of 2014. The CDS of Dubai Holding decreased by 5.6%, showing the lowest reading since the fourth quarter of 2015.

Globally, the UAE sovereigns are well ranked, which solidifies the position of the UAE in the international markets.

Table 2.5.2. UAE - Credit Default Swaps (CDS)

	2016				2017
	Q1	Q2	Q3	Q4	Q1
Sovereigns					
Abu Dhabi	93.6	87.5	74.3	61.5	40.9
Dubai	215	182.5	167.3	149.8	114.5
GREs					
DP World	196.9	202.3	146.8	143.6	136.8
Dubai Holding	352	336.3	311.7	303.8	286.9

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

[7] The volatility is measured by the standard deviation

Chapter 3. Monetary & Banking Developments

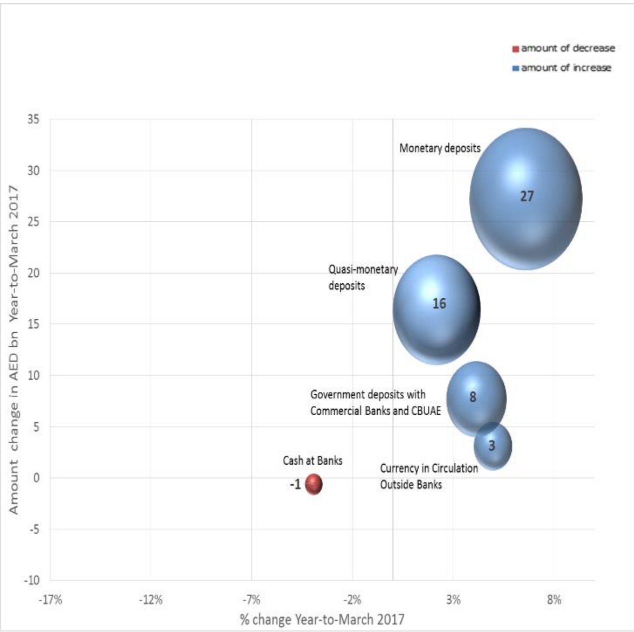
Government deposits increased significantly in the first quarter of 2017, with the private sector contributing also to the deposit growth. As a result, monetary aggregates increased. Banks continued to increase credit at a rate that supports growth in the non-oil activities. The Financial Soundness Indicators (FSIs) improved, boosting confidence that the UAE banking system is sound and enjoys financial stability.

3.1 Monetary Aggregates

During the first three months of 2017, all the Money Supply Aggregates increased. For M1, the increase was of 6.4%, while M2 and M3 grew by 3.8% and 3.9% Q-o-Q, respectively.

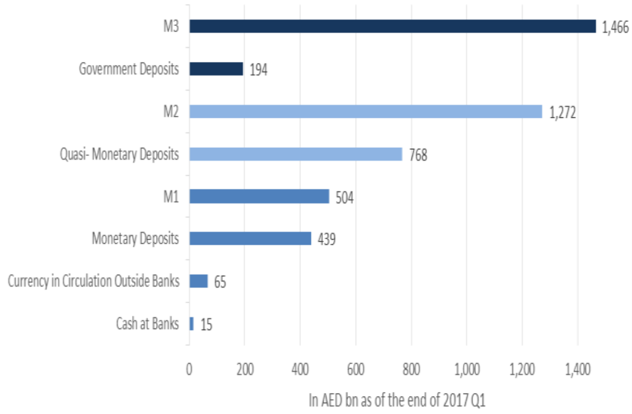
The growth in M1 is due to the increase in Currency in Circulation outside banks and monetary deposits that rose by 5% and 6.6% Q-o-Q respectively (AED 3.1bn and AED 27.2bn respectively). The more moderate growth in M2 compared to M1 is due to the 2.2% (AED 16.4bn) increase in Quasi-monetary deposits over the same period. Meanwhile, M3 grew by 3.9% (AED 54.4bn), faster than M2, due to the increase in Government deposits by AED 7.7bn (4.1%), during the first three months of 2017.

Figure 3.1.a.UAE Monetary aggregates components growth



Source: Central Bank of the UAE and Central Bank of the UAE analysis

Figure 3.1.b.Stock of UAE Monetary aggregates and their components



Source: Central Bank of the UAE and Central Bank of the UAE analysis

3.2 Banking Activity

The 23 locally-incorporated banks have further decreased the number of branches to 834 at the end of 2017 Q1 compared to 846 at the end of 2016, due to banks looking for higher efficiency. The 26 foreign banks have kept the number of branches at 85 at the end of March 2017, same as in December 2016.

3.2.1 Banks' Deposits

Total Customer Deposits at banks increased in the first quarter of 2017 by AED 39.1bn due to the increase in Resident Deposits by AED 49.1bn, while Non-resident Deposits declined by AED 10bn.

Table 3.2.a.Deposits at UAE Banks

	2016				2017
	March	**June**	**Sep**	**Dec**	**Mar**
Bank Deposits	**1,502.6**	**1,493.0**	**1,508.7**	**1,562.9**	**1,602.0**
(Q-o-Q change %)	2.1	-0.6	1.1	3.6	2.5
(Y-o-Y change %)	3.7	3.4	5.0	6.2	6.6
Resident Deposits	**1,325.1**	**1,315.9**	**1,321.8**	**1,363.9**	**1,413.0**
(Q-o-Q change %)	1.9	-0.7	0.4	3.2	3.6
(Y-o-Y change %)	1.8	2.1	3.4	4.9	6.6
Government Sector	**155.5**	**185.9**	**169.5**	**186.8**	**194.0**
(Q-o-Q change %)	-1.2	19.5	-8.8	10.2	3.9
(Y-o-Y change %)	-15.4	14.1	3.2	18.7	24.8
GREs	**193.3**	**161.5**	**172.2**	**168.2**	**192.0**
(Q-o-Q change %)	1.3	-16.5	6.0	-1.8	14.0
(Y-o-Y change %)	0.7	-12.3	-1.2	-11.8	-0.7
Private Sector	**948.1**	**945.3**	**956.6**	**980.7**	**998.3**
(Q-o-Q change %)	2.6	-0.3	1.2	2.5	1.8
(Y-o-Y change %)	6.7	4.2	5.0	6.2	5.3
NBFI	**28.2**	**23.2**	**24.6**	**28.2**	**28.7**
(Q-o-Q change %)	0.4	-17.7	6.0	14.6	1.8
(Y-o-Y change %)	-24.2	-32.4	-16.6	0.4	1.8
Non-Resident Deposits	**177.5**	**177.1**	**186.9**	**199.0**	**189.0**
(Q-o-Q change %)	3.5	-0.2	5.5	6.5	-5.0
(Y-o-Y change %)	19.9	13.7	17.9	16.0	6.5

Source: Central Bank of the UAE
Note: All data indicate the end of period values. Values are expressed in billions of Dirhams.

The increase in Resident Deposits in 2017 Q1 is essentially due to the growth in the Government sector deposits by AED 7.2bn or 3.9% and GREs by 14% or AED 23.6bn, and the increase in Private Sector deposits by AED 17.8bn or 1.8%. It is worth mentioning that after a long period of decline in GREs' deposits during 2016, on Y-o-Y basis they remain almost flat. In contrast, the Non-Resident deposits declined by AED 10bn or 5% during the first quarter of 2017, with their share in total deposits at 11.8%.

In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 77.1% and 22.9% of the total deposits. Figures 3.3.a and 3.3.b, and Table 3.2.b show that in the first quarter of 2017 the growth of deposits in Islamic banks is much stronger than that in the Conventional banks for all sectors with exception of GREs, in contrast to the previous quarter where Conventional banks' growth dominated that of Islamic banks.

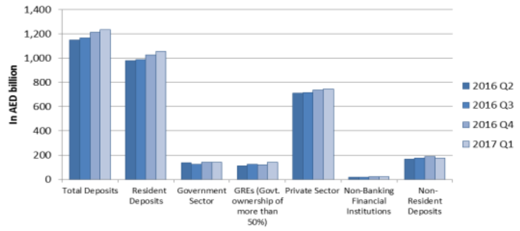
Table 3.2.b.Deposits at Conventional/Islamic Banks

	Conventional		Islamic	
	2016	**2017**	**2016**	**2017**
	Dec	**Mar**	**Dec**	**Mar**
Bank Deposits	**1,214**	**1,235**	**349**	**367**
(Q-o-Q change %)	4.2	1.7	1.6	5.3
(Y-o-Y change %)	6.6	6.6	5.0	6.7
Share of Total, %	77.7	77.1	22.3	22.9
Resident Deposits	**1,024**	**1,057**	**339**	**356**
(Q-o-Q change %)	3.8	3.1	1.4	5.0
(Y-o-Y change %)	5.1	6.9	4.2	5.8
Share of Total, %	75.1	74.8	24.9	25.2
Government Sector	**143**	**144**	**44**	**50**
(Q-o-Q change %)	15.7	0.9	-4.6	13.5
(Y-o-Y change %)	33.9	32.1	-13.5	7.4
Share of Total, %	76.6	74.4	23.4	25.6
GREs	**120**	**142**	**48**	**51**
(Q-o-Q change %)	-5.2	18.1	8.0	4.3
(Y-o-Y change %)	-11.7	5.2	-12.2	-14.1
Share of Total, %	71.2	73.7	28.8	26.3
Private Sector	**738**	**748**	**243**	**250**
(Q-o-Q change %)	3.0	1.4	1.2	3.0
(Y-o-Y change %)	4.0	3.9	13.2	9.6
Share of Total, %	75.2	74.9	24.8	25.1
NBFI	**24**	**23**	**4**	**6**
(Q-o-Q change %)	16.0	-4.2	7.5	34.9
(Y-o-Y change %)	5.3	-8.0	-20.4	75.8
Share of Total, %	84.8	79.8	15.2	20.2
Non-Resident Deposits	**190**	**178**	**10**	**11**
(Q-o-Q change %)	6.3	-6.1	10.6	16.0
(Y-o-Y change %)	15.0	4.6	40.3	49.3
Share of Total, %	95.3	94.2	4.7	5.8

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

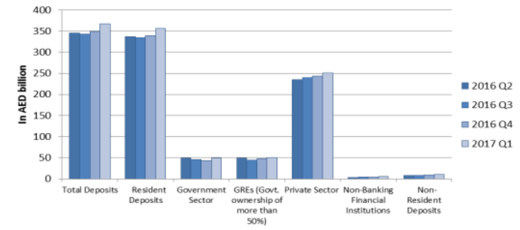
The more robust growth in Islamic deposits in 2017 Q1 (Q-o-Q growth of 3.1%) might be also explained by the ambition of Dubai to become a world capital for Islamic banking and the efforts made by many entities to promote this vision. However, as it comes to the GREs, the growth in 2017 Q1 is stronger for the Conventional banks (18.1%), in line with the increased confidence in the UAE economy in general.

Figure 3.3.a.Banking System Deposits for Conventional Banks



Source: Central Bank of the UAE

Figure 3.3.b.Banking System Deposits for Islamic Banks



Source: Central Bank of the UAE

The breakdown of Local and Foreign banks in Figures 3.4.a and 3.4.b provides a clear trend that deposits in Local banks continued to grow in 2017 Q1, while Foreign banks experienced a decline. Deposits in local banks grew at a rate of 3% and 9.4% Q-o-Q and Y-o-Y respectively in contrast to Foreign banks for which deposits declined by 1% on a Q-o-Q basis and 9% compared to 2016 Q1. At the end of 2017 Q1, 87% of the total deposits are in Local banks and 13% are in Foreign banks.

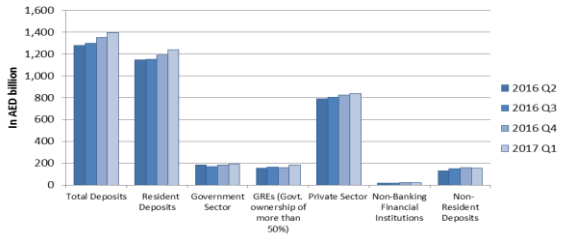
The sector growing the most in 2017 Q1 for Local banks was the GRE, growing by 13.9% on a quarterly basis (growth of -0.3% on Y-o-Y basis). For the Foreign banks in the first quarter of 2017, the breakdown shows that the biggest increase was for the Government sector deposits, growing by 30.8% Q-o-Q, an increase of AED 400mn, reflecting the ongoing fiscal consolidation and improved oil price. However this sector has a very low base, hence the impact of the overall growth remains marginal.

Table 3.2.c.Deposits at UAE Local/Foreign Banks

	Local		Foreign	
	2016 Dec	2017 Mar	2016 Dec	2017 Mar
Bank Deposits	**1,352**	**1,393**	**211**	**209**
(Q-o-Q change %)	4.0	3.0	1.1	-1.0
(Y-o-Y change %)	8.1	9.4	-4.6	-9.0
Share of Total, %	86.5	87.0	13.5	13.0
Resident Deposits	**1,192**	**1,237**	**172**	**176**
(Q-o-Q change %)	3.4	3.8	1.4	2.1
(Y-o-Y change %)	6.2	7.8	-3.4	-1.0
Share of Total, %	87.4	87.5	12.6	12.5
Government Sector	**186**	**192**	**1**	**2**
(Q-o-Q change %)	10.2	3.7	18.2	30.8
(Y-o-Y change %)	19.2	25.0	-27.8	6.3
Share of Total, %	99.3	99.1	0.7	0.9
GREs	**161**	**183**	**7**	**9**
(Q-o-Q change %)	-1.4	13.9	-8.6	20.3
(Y-o-Y change %)	-11.4	-0.3	-20.4	-8.2
Share of Total, %	95.6	95.4	4.4	4.6
Private Sector	**823**	**839**	**156**	**160**
(Q-o-Q change %)	2.6	1.9	1.9	1.1
(Y-o-Y change %)	8.2	6.5	-3.2	-0.6
Share of Total, %	83.9	84.0	16.1	16.0
NBFI	**22**	**23**	**6**	**6**
(Q-o-Q change %)	19.9	2.2	-1.7	0.0
(Y-o-Y change %)	-5.9	2.7	34.1	-1.7
Share of Total, %	79.1	79.4	20.9	20.6
Non-Resident Deposits	**160**	**156**	**39**	**33**
(Q-o-Q change %)	8.3	-2.6	-0.5	-14.9
(Y-o-Y change %)	24.5	24.2	-9.3	-36.4
Share of Total, %	80.5	82.5	19.5	17.5

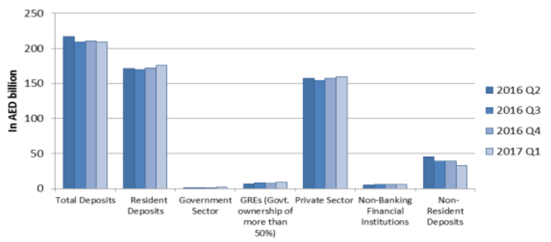
Source: Central Bank of the UAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.

Figure 3.4.a.Banking System Deposits for Local Banks



Source: Central Bank of the UAE

Figure 3.4.b.Banking System Deposits for Foreign Banks



Source: Central Bank of the UAE

3.2.2 Banks' Credit

Domestic Credit grew in 2017 Q1 by AED 18bn, benefiting mainly from the increase in credit to GREs, both, quarterly and annually, by AED 7.4bn (3.9%) and AED 14bn (7.7%) respectively. Meanwhile Credit to the Government grew at a slow pace of 2.6% and 4.8% Q-o-Q and Y-o-Y, leaving room for the private sector to use more banking sources of financing. However, Y-o-Y Private sector's credit grew only by 5% while on a quarterly basis as at the end of March 2017 the growth was only 0.5%.

Table 3.3.a.Assets and Credit at UAE Banks

	2016				2017
	Mar	**Jun**	**Sep**	**Dec**	**Mar**
Total Assets	**2,491**	**2,519**	**2,550**	**2,611**	**2,648**
(Q-o-Q change %)	**0.5**	**1.1**	**1.3**	**2.4**	**1.3**
(Y-o-Y change %)	**4.7**	**4.1**	**5.3**	**5.4**	**6.3**
Gross Credit	**1,518**	**1,543**	**1,566**	**1,574**	**1,597**
(Q-o-Q change %)	2.2	1.7	1.5	0.5	1.4
(Y-o-Y change %)	7.6	6.7	5.9	6.0	5.3
Domestic Credit	**1,404**	**1,426**	**1,446**	**1,454**	**1,472**
(Q-o-Q change %)	1.7	1.6	1.4	0.5	1.2
(Y-o-Y change %)	7.7	6.8	5.8	5.2	4.8
Government	**168.7**	**168.6**	**174.1**	**172.5**	**176.8**
(Q-o-Q change %)	1.3	-0.1	3.3	-0.9	2.6
(Y-o-Y change %)	4.8	0.1	4.6	3.5	4.8
Public Sector (GREs)	**180.8**	**187.7**	**188.0**	**187.1**	**194.8**
(Q-o-Q change %)	5.4	3.8	0.2	-0.5	3.9
(Y-o-Y change %)	8.3	12.1	6.3	9.2	7.7
Private Sector	**1,030**	**1,052**	**1,066**	**1,076**	**1,081**
(Q-o-Q change %)	1.1	2.1	1.4	1.0	0.5
(Y-o-Y change %)	7.7	7.1	6.2	5.6	5.0
Business & Industrial Sector Credit	**693.5**	**709.7**	**720.0**	**727.8**	**731.4**
(Q-o-Q change %)	0.9	2.3	1.5	1.1	0.4
(Y-o-Y change %)	7.3	7.1	6.9	5.8	5.5
Individual	**336.1**	**341.9**	**345.8**	**348.2**	**349.3**
(Q-o-Q change %)	1.6	1.7	1.1	0.7	0.6
(Y-o-Y change %)	8.5	7.1	4.9	5.3	3.9
Non-Banking Financial Institutions	25.3	18.4	18.2	18.0	20.1
(Q-o-Q change %)	2.4	-27.3	-1.1	-1.1	5.8
(Y-o-Y change %)	30.4	1.1	-8.5	-27.1	-20.6
Foreign Credit	**113.1**	**117.1**	**119.9**	**120.4**	**124.8**
(Q-o-Q change %)	8.9	3.5	2.4	0.4	3.7
(Y-o-Y change %)	6.1	5.6	6.9	15.9	10.3
of which: Loans & Advances to Non-Residents in AED	**11.2**	**12.8**	**14.4**	**14.6**	**15.2**
(Q-o-Q change %)	21.7	14.3	12.5	1.4	4.1
(Y-o-Y change %)	10.3	29.3	49.4	58.7	35.7

Source: Central Bank of the UAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.

Table 3.3.b.Assets and Credit at UAE Conventional/Islamic Banks

	Conventional		Islamic	
	2016	**2017**	**2016**	**2017**
	Dec	**Mar**	**Dec**	**Mar**
Total Assets	**2,105**	**2,127**	**506**	**522**
(Q-o-Q change %)	**2.7**	**1.0**	**1.1**	**3.2**
(Y-o-Y change %)	**4.5**	**5.9**	**8.9**	**8.0**
Gross Credit	**1,239**	**1,254**	**335**	**343**
(Q-o-Q change %)	0.1	1.2	1.9	2.3
(Y-o-Y change %)	5.1	4.4	9.4	8.4
Domestic Credit	1,135	1,148	318	325
(Q-o-Q change %)	0.2	1.1	1.8	2.1
(Y-o-Y change %)	4.5	4.1	8.2	7.4
Government	163	167	10	9
(Q-o-Q change %)	-0.8	2.7	-3.1	-1.1
(Y-o-Y change %)	3.9	4.8	-2.1	4.4
Public Sector (GREs)	153	160	34	34
(Q-o-Q change %)	-1.6	4.6	5.0	1.8
(Y-o-Y change %)	7.4	7.8	17.8	7.5
Private Sector	804	804	272	277
(Q-o-Q change %)	0.7	0.0	1.7	1.9
(Y-o-Y change %)	4.9	4.1	8.0	7.6
Business & Industrial Sector Credit	580	580	148	151
(Q-o-Q change %)	0.9	0.0	2.0	2.4
(Y-o-Y change %)	5.7	4.9	6.3	7.6
Individual	224	224	124	126
(Q-o-Q change %)	0.3	-0.2	1.4	1.3
(Y-o-Y change %)	2.7	2.0	10.2	7.6
Non-Banking Financial Institutions	15	16	3	4
(Q-o-Q change %)	0.7	7.4	-8.8	32.3
(Y-o-Y change %)	-27.3	-24.9	-26.2	2.5
Foreign Credit	103	107	17	18
(Q-o-Q change %)	-0.3	3.1	4.9	7.1
(Y-o-Y change %)	12.8	7.7	39.3	29.1

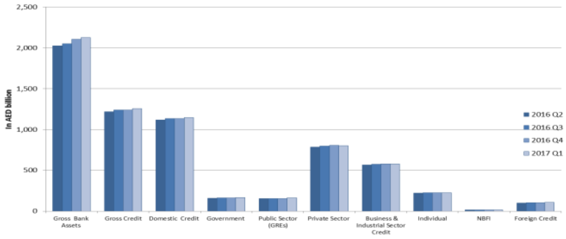
Source: Central Bank of the UAE

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

The split between Conventional and Islamic banks in Figures 3.6.a and 3.6.b indicates that the growth in Islamic financing is much steeper than that for the Conventional banks' loans. In 2017 Q1, Islamic banks' assets had a higher growth (3.2%) than the Conventional ones (1%), while on an annual basis Islamic banks grew by 8% and continued to dominate the Conventional banks growth (increase of 5.9%) . The share of Conventional banks' assets at the end of 2017 Q1 is 80.3% of the total, while the share of the Islamic banks assets is 19.7%.

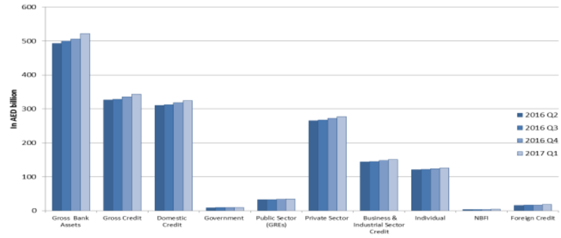
Islamic banks' financing growth has been dominating the Conventional banks' loans increase in the first quarter of 2017 in almost all subcategories, with exception of financing to Government and GREs.

Figure 3.6.a.Banking System Assets and Credit for Conventional Banks



Source: Central Bank of the UAE

Figure 3.6.b.Banking System Assets and Financing for Islamic Banks



Source: Central Bank of the UAE

The breakdown of the assets and credit by local and foreign banks in Figures 3.7.a and 3.7.b indicates that both national and foreign banks were growing, for both assets and gross credit in 2017 Q1, with a few exceptions.

On an annual basis, as of March 2017, National banks marked an increase of 8% and 7.2% for banks' assets and gross credit respectively, while for the Foreign banks they were both declining.

Table 3.3.c.Assets and Credit at UAE Local/Foreign Banks

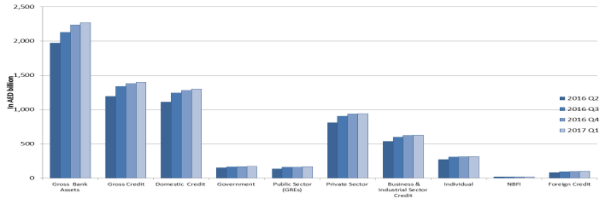
	Local		Foreign	
	2016 Dec	2017 Mar	2016 Dec	2017 Mar
Total Assets	**2,236**	**2,267**	**375**	**382**
(Q-o-Q change %)	**2.7**	**1.4**	**0.6**	**1.7**
(Y-o-Y change %)	**7.0**	**8.0**	**-3.6**	**-2.7**
Gross Credit	**1,379**	**1,401**	**195**	**197**
(Q-o-Q change %)	1.0	1.6	-2.9	0.8
(Y-o-Y change %)	8.1	7.2	-6.8	-6.6
Domestic Credit	1,281	1,299	172	174
(Q-o-Q change %)	1.2	1.4	-4.4	0.9
(Y-o-Y change %)	7.4	6.8	-8.6	-7.6
Government	167	172	6	5
(Q-o-Q change %)	-0.8	3.3	-3.2	-20.0
(Y-o-Y change %)	4.8	6.5	-22.1	-33.3
Public Sector (GREs)	159	167	28	28
(Q-o-Q change %)	-0.1	4.6	-2.5	1.1
(Y-o-Y change %)	14.1	11.4	-12.6	-9.6
Private Sector	939	942	138	139
(Q-o-Q change %)	1.8	0.4	-4.6	0.7
(Y-o-Y change %)	7.8	6.9	-7.2	-6.7
Business & Industrial Sector Credit	624	625	104	106
(Q-o-Q change %)	2.3	0.2	-5.5	2.4
(Y-o-Y change %)	8.5	7.8	-7.9	-6.3
Individual	314	317	34	32
(Q-o-Q change %)	1.0	0.8	-2.0	-4.4
(Y-o-Y change %)	6.5	5.3	-5.1	-8.0
Non-Banking Financial Institutions	17	18	1	2
(Q-o-Q change %)	1.2	4.1	-30.8	155.6
(Y-o-Y change %)	-28.5	-26.1	12.5	91.7
Foreign Credit	98	102	23	23
(Q-o-Q change %)	-1.7	4.5	10.6	0.0
(Y-o-Y change %)	17.5	12.5	9.6	1.8

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

Local banks' assets have increased in the first quarter of 2017 by 1.4% with all of the loan asset classes growing for the period. The only category that recorded a decline on Y-o-Y basis as of the end of March 2017 continues to be the NBFI, which deleveraged by AED 6.3bn or 26.1%. Assets and gross credit of Local banks represent 85.6% and 87.7% of the UAE banking system's assets and credit respectively. Assets of foreign banks declined by 2.7% Y-o-Y with all the underlying categories declining, except for NBFIs and Foreign credit that grew by 91.7% and 1.8% respectively or AED 1.1bn and AED 400mn. As the base for those two asset classes remains low, the impact on overall credit and assets remains marginal. Assets and gross credit of foreign banks represent only 14.4% and 12.3%, of the banking system's assets and gross credit respectively, as of the end of 2017 Q1.

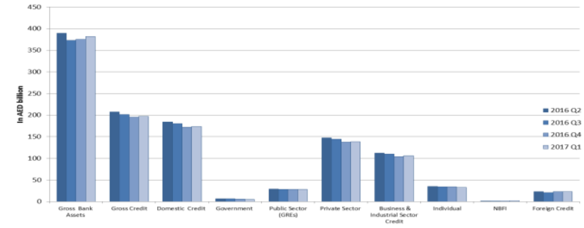
For the Foreign banks, the asset class with the highest deleveraging percentage for the quarter was Government at -20% growth Q-o-Q in 2017 Q1, with an outstanding amount of only AED 4.8bn (2.7% of the total banks' Government lending).

Figure 3.7.a.Banking System Assets and Financing for Local Banks



Source: Central Bank of the UAE

Figure 3.7.b.Banking System Assets and Financing for Foreign Banks



Source: Central Bank of the UAE

Table 3.4.Banks credit to residents by economic activity

Source: Central Bank of the UAE

(End of Period , In Billions of AED)

	2016				2017
Economic Activity	Mar	Jun	Sep	Dec	Mar
Agriculture	1.3	1.2	1.2	1.4	1.2
(Q-o-Q change %)	-19.1	-4.9	-1.9	16.7	-15.1
(Y-o-Y change %)	-23.3	-5.7	-9.0	-11.9	-7.7
Mining and Quarrying	11.7	12.4	14.0	13.5	19.0
(Q-o-Q change %)	-1.8	6.2	12.7	-3.4	40.4
(Y-o-Y change %)	9.0	18.9	26.6	13.6	62.3
Manufacturing	72.2	71.4	71.6	69.5	68.3
(Q-o-Q change %)	4.5	-1.2	0.3	-3.0	-1.7
(Y-o-Y change %)	8.7	0.3	-0.9	0.5	-5.5
Electricity, Gas and Water	18.6	18.6	17.9	18.4	18.1
(Q-o-Q change %)	-9.4	0.2	-3.8	3.1	-1.8
(Y-o-Y change %)	-0.1	-17.3	-13.8	-10.0	-2.5
Construction and Real Estate	241.8	242.4	250.8	264.7	267.0
(Q-o-Q change %)	2.9	0.2	3.5	5.5	0.9
(Y-o-Y change %)	14.8	12.1	12.2	12.6	10.4
Trade	160.7	160.7	158.2	155.5	152.3
(Q-o-Q change %)	-0.6	0.0	-1.5	-1.7	-2.1
(Y-o-Y change %)	0.2	-2.5	-4.0	-3.8	-5.2
Transport, Storage and Communication	62.5	64.0	62.7	63.5	60.4
(Q-o-Q change %)	5.6	2.4	-2.0	1.2	-4.7
(Y-o-Y change %)	5.0	5.1	6.6	7.3	-3.2
Financial Institutions (Excluding Banks)	139.6	144.9	148.4	144.3	151.9
(Q-o-Q change %)	2.9	3.8	2.4	-2.7	5.2
(Y-o-Y change %)	4.8	13.0	9.5	6.4	8.9
All Others	113.1	120.6	122.0	126.6	130.0
(Q-o-Q change %)	0.4	6.7	1.1	3.8	2.7
(Y-o-Y change %)	3.6	7.8	7.9	12.4	15.0

Note: All data indicate the end-of-quarter values.

Banks' lending by economic activity shows an increase in the first quarter of 2017 Q-o-Q by 40.4%, 0.9%, 5.2% and 2.7% in the Mining and Quarrying, Construction and Real Estate, Financial Institutions (excluding banks) and All others sector, while their growth Y-o-Y was of 62.3%, 10.4%, 8.9% and 15% respectively . For the other sectors the credit declined on Q-o-Q, during the first quarter of 2017 (for more details refer to Table 3.4).

Results from the 2017 March quarterly Credit Sentiment Survey published by the Central Bank of the UAE revealed a modest demand growth in overall credit appetite. The demand for both business and personal loans has improved, moving back into the positive territory for the first time since Q3 2016, partially reflecting the recovery of the oil price.

Lending to Corporates & Small Businesses – According to survey respondents, demand for business credit has increased modestly in the 2017 first quarter. By loan type, the increase in credit demand was most significant in Conventional Loans and Large Firms. At the same time, survey respondents reported a tightening in credit standards that occurred most with respect to Collateralization Requirements and Premiums Charged on Riskier Loans. Tightening of credit standards pertaining to all the terms and conditions was also noted. For the June quarter, survey respondents were optimistic and expected the demand for business loans to increase, and credit standards would continue to tighten.

Lending to Individuals – Echoing results for business lending, demand for personal loan in aggregate also slightly tightened in the 2017 first quarter. The increase in demand was most notable among Personal (other), Credit Card, and Islamic Loans. For the June quarter, survey respondents showed an optimistic stance and suggested a demand growth. With respect to credit availability, survey respondents reported a marginal easing of credit standards across all the categories. In terms of outlook, the credit standards in aggregate were expected to modestly tighten for the June quarter.

3.3 Financial Soundness Indicators

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

Banks' specific provisions for NPLs increased from AED 79bn at the end of December 2016 to AED 80.1bn in the first quarter of 2017, thereby ensuring that NPLs are fully provisioned. The level has increased also compared to the end of 2016 Q1, when the specific provisions were at AED 74.4bn.

The percentage of the number of presented and returned cheques, as well as the total amount of returned cheques as a share of the total presented amount has declined to 4.3% and 4.6% respectively in 2017 Q1 compared to 4.8% and 5.2% respectively in 2016 Q4 or 4.6% and 4.9% respectively for the whole 2016. The decline supports improvement in the private sector's economic performance.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio (CAR) and Tier 1 capital of banks marginally decreasing compared to the previous quarter and improving compared to a year earlier to 18.6% for CAR (16.9% for Tier1 capital) at the end of 2017 Q1, remaining well above the regulatory requirements set by the Central Bank (12%

and 8%, respectively), with Conventional banks being better capitalized compared to the Islamic ones (CAR of 19% vs. 16.7% and Tier 1 capital 17.1% vs. 16% respectively). Foreign banks remain better capitalized than the Local banks (21.3% vs. 18.2% for CAR and Tier 1 capital of 18.5% vs. 16.7% respectively) due to the much lower growth in credit during 2017 Q1 and decline in lending compared to the year before.

To capture the composite effects of changes in loans and deposits, the key ratio related to the funding of banks is considered: the Lending to the Stable Resources Ratio (LSRR[1]).

As illustrated above, loans' growth was slower than the increase in deposits. The Lending to Stable Resources Ratio (LSRR) improved from 86.2% at the end of 2016 Q4 to 85.4% in March 2017. This ratio is also the lowest recorded value over the past two years, reflecting higher growth in stable resources compared to the slower pace of credit growth at banks.

In the segmentation, Islamic, Conventional, Local and Foreign banks, only the foreign banks LSRR has increased in the first quarter of 2017, while for all other types of banks it has declined. The increase of the indicator for foreign banks reflects a relatively higher pace of credit growth compared to deposits growth, and increased dependence on market financing than on customer deposits. On an annual basis, only foreign banks' LSRR increased, while for the National, Conventional and Islamic banks' the ratio decreased.

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 16.2% at the end of December 2016 to 16.8% at the end of 2017 Q1. This is the highest observed since December 2015. The level of total liquid assets at banks at the end of 2017 Q1 remains at AED 360.8bn, AED 19.6bn higher than at the end of 2016, registering growth of 5.7% in that quarter, supporting a higher Liquid Assets Ratio (LAR). On a Y-o-Y basis total liquid assets at banks also increased by AED 41bn or a growth of 12.8%. In addition, looking at the split between Islamic, Conventional, Local and Foreign banks, the data show that all segments' LARs increased during 2017 Q1. On a Y-o-Y basis only Islamic banks' LAR has decreased while for the Conventional, Local and Foreign banks the LAR has increased.

Table 3.5.a.Financial Soundness Indicators in the UAE (in %, unless otherwise indicated)

Total system	2016				2017
	Q1	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	85.5	88.1	88.9	86.6	85.4
The Liquid Assets Ratio (LAR)	14.1	15.8	15.6	16.2	16.8
Capital Adequacy Ratio (CAR) of which:	18.4	18.9	19.1	19.0	18.6
Tier 1 Capital	16.3	17.0	17.1	17.3	16.9

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values

Table 3.5.b.Financial Soundness Indicators in the UAE for Conventional Banks (in %, unless otherwise indicated)

Conventional	2016				2017
	Q1	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	83.0	86.4	85.7	86.6	85.8
The Liquid Assets Ratio (LAR)	17.5	17.0	16.4	16.0	16.5
Capital Adequacy Ratio (CAR) of which:	16.2	16.5	16.7	19.4	19.0
Tier 1 Capital	15.4	15.9	16.1	17.5	17.1

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values

Table 3.5.c.Financial Soundness Indicators in the UAE for Islamic Banks (in %, unless otherwise indicated)

Islamic	2016				2017
	Q1	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	86.2	89.3	89.9	86.8	83.7
The Liquid Assets Ratio (LAR)	13.2	14.6	14.4	16.8	17.9
Capital Adequacy Ratio (CAR) of which:	17.8	18.1	18.2	17.1	16.7
Tier 1 Capital	16.2	16.6	16.7	16.5	16.0

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

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

Table 3.5.d.Financial Soundness Indicators in the UAE for Local Banks (in %, unless otherwise indicated)

Local	2016				2017
	Q1	Q1	Q3	Q4	Q1
Lending to Stable Resources Ratio	86.8	87.7	88.2	88.6	86.6
The Liquid Assets Ratio (LAR)	15.6	16.0	15.7	14.8	15.4
Capital Adequacy Ratio (CAR) of which:	18.0	18.4	18.6	18.6	18.2
Tier 1 Capital	16.3	16.8	16.9	17.1	16.7

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

Table 3.5.e.Financial Soundness Indicators in the UAE for Foreign Banks (in %, unless otherwise indicated)

Foreign	2016				2017
	Q1	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	79.1	78.8	78.3	74.8	77.6
The Liquid Assets Ratio (LAR)	21.8	24.0	23.5	24.2	25.4
Capital Adequacy Ratio (CAR) of which:	18.6	20.7	21.3	21.5	21.3
Tier 1 Capital	15.8	17.7	18.3	18.6	18.5

Source: Central Bank of the UAE.
Note: All data indicate the end-of-quarter values.

The banking sector, as a whole, has kept its positive outlook at the end of 2017 Q1 based on the Financial Soundness Indicators (FSIs). Deposits and Banks' assets growth accelerated in the first quarter of 2017 compared to the previous quarter. However credit growth, albeit still robust, has declined primarily on account of lower credit growth to the Government.

Overall, as of the end of the first quarter of 2017, banks' assets, credit and deposits grew by 6.3%, 5.3% and 6.6% respectively Y-o-Y and with average monthly growth for 2016 of 0.4%, 0.4% and 0.8% respectively, a healthy level in support of non-oil GDP growth. The financial soundness indicators continue to solidify the financial stability of the UAE's banking system to provide efficient intermediation in support of non-energy growth and further diversification of the economy while adhering to prudent and sound management of available resources.

Chapter 4. Central Bank Financial Position & Reserve Management

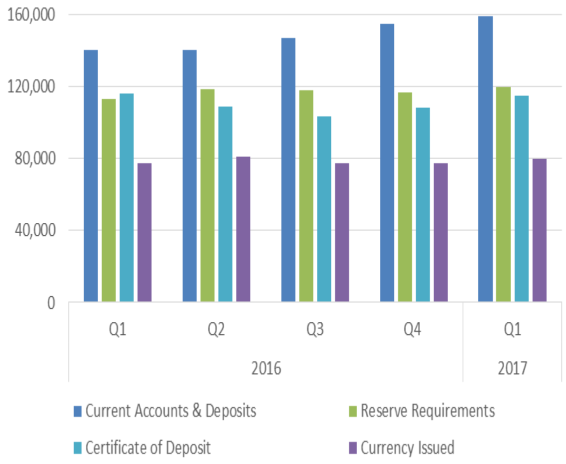
The Central Bank balance sheet exhibited an increase in 2017 Q1, triggered by increases on the liabilities' side. As a result, Total Assets increased owing mainly to rising Central Bank's Deposits abroad. Meanwhile, interest rates in the UAE continued their upward trend in line with the Fed's decision announced on the 15th of March 2017.

4.1 Central Bank Balance Sheet

Changes in the Central Bank balance sheet are triggered by changes on the liabilities' side, which exhibited an increase by 4.4% in 2017 Q1. This was mainly due to an increase in banks' required reserves by 2.5% and more importantly by an increase in banks' holding of "Certificates of Deposit" (CDs) issued by the Central Bank by AED 7.1 billion. The latter reached AED 115.3 billion at the end of 2017 Q1, which is testament to sufficient liquidity at banks.

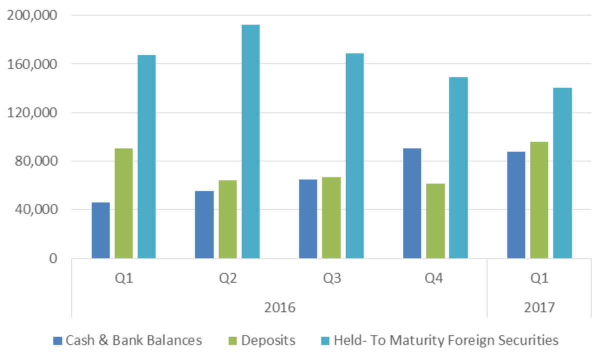
Meanwhile, "Derivative Liabilities" reached AED 2.1 billion at the end of 2017 Q1 owing to a revaluation impact on Open Swap Contracts due to changes in the exchange rate of the Japanese Yen, the currency in which some liabilities are denominated.

Figure 4.1. Central Bank Liabilities
In millions of Dirhams



Source: Central Bank of the UAE

Figure 4.2. Central Bank Assets
In millions of Dirhams



Source: Central Bank of the UAE

With the above-indicated increase in liabilities being the main driver, the total assets of the Central Bank increased by 4.1% during 2017 Q1, reaching AED 379.5 billion. This was mainly the result of an increase in Central Bank's Deposit abroad by AED 34.5 billion. Meanwhile, Held-To-Maturity Foreign Securities fell by AED 8.9 billion, as some proceeds from these securities were not re-invested in the same instruments.

Table 4.1. Central Bank Balance Sheet

In Millions of Dirhams

	2016				2017
	Q1	**Q2**	**Q3**	**Q4**	**Q1**
Assets					
Gold Bullion	1,085	1,164	1,171	1,015	1,099
Cash & Bank Balances	46,029	55,656	65,037	90,149	88,061
Deposits	90,434	63,850	66,917	61,147	95,687
Tri-Party Deposits	826		551	551	-
Liquidity Support Facility	214	214	200	200	200
Held-To-Maturity Foreign Securities	167,508	192,094	168,988	149,337	140,487
Held-To-Maturity Bonds Issued by MOF & Dubai Government:	49,198	49,198	49,165	49,165	49,165
Available-for-sale foreign Investments	356	372	374	359	359
Advances to Government	2,500	-	-	3,000	3,000
Available-for-sale foreign securities	75	76	76	74	74
Derivative Assets	175	151	566	8,746	715
Other Assets	461	401	490	611	548
Property and Equipment's	113	103	93	99	93
Total Assets	**358,,975**	**364,748**	**353,628**	**364,453**	**379,488**
Off Balance Sheet Commitments	**198,254**	**262,631**	**211,456**	**188,892**	**179,903**
Liabilities and Capital					
Current Accounts & Deposits	140,363	140,351	146,920	154,775	159,330
- Of which:					
Reserve Requirements	113,500	118,500	118,200	116,600	119,500
Banks' Current account	23.100	19,300	25,800	34,900	35,700
Certificates of Deposit	116,393	109,083	103,797	108,193	115,301
Currency Issued	77,208	81,317	77,267	77,551	80,130
Derivative Liabilities	4,468	11,684	2,508	312	2,093
Other Liabilities	1,177	1,853	2,667	2,651	1,579
Total Liabilities	**338,611**	**344,287**	**333,159**	**343,483**	**358,434**
Authorized Issued & Fully Paid Capital	2,500	2,500	2,500	2,500	2,500
Fair Value Reserve	-33	-15	-14	-31	-31
Gold Revaluation Reserve	85	165	171	15	100
General Reserve	17,812	17,812	17,812	18,486	18,486
Total Liabilities & Capital	**358,975**	**364,748**	**353,628**	**364,453**	**379,488**
Off Balance Sheet Commitments related to foreign exchange fluctuations	**198,254**	**262,631**	**211,456**	**188,892**	**179,903**

Source: Financial Control Division, Central Bank of the UAE

4.2 Central Bank Foreign Assets

The balance of foreign assets increased from AED 310.9 billion at end of 2016 Q4 to AED 325 billion at end of 2017 Q1, with the increase in liabilities being the main driver. This was mainly due to the above-indicated increase in Central Bank's deposits at banks abroad.

Table 4.2. Central Bank's Foreign Assets

In billions of Dirhams

	2016				**2017**
	Q1	**Q2**	**Q3**	**Q4**	**Q1**
Total Foreign Assets	306.2	314.1	301.6	310.9	325.0
Held-To-Maturity Foreign Securities	167.5	192.1	169.0	149.3	140.5
Current Account Balances & Deposit with Banks Abroad	132.8	116.9	127.0	147.9	178.8
Other Foreign Assets	5.9	5.1	5.6	13.7	5.7

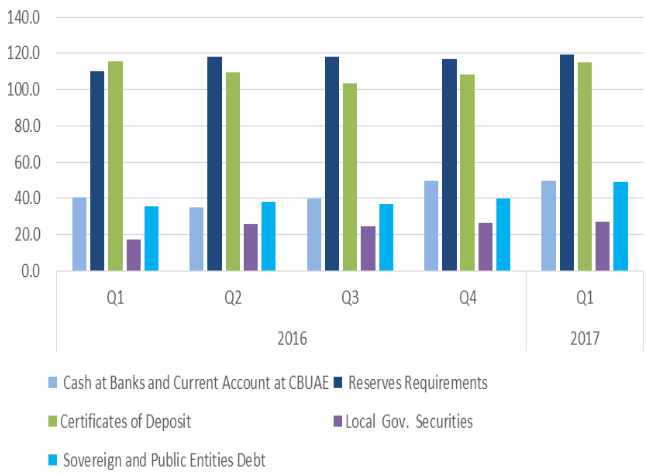
Source: Central Bank of the UAE, end of quarter data

4.3 Banks' Excess Liquidity Developments

Banks' liquid assets are composed of cash, reserves at the Central Bank and the highly-rated public sector's debt securities. Total liquid assets held by banks operating in the UAE increased during 2017 Q1 by AED 19.6 billion, reaching AED 360.8 billion. Underlying the increase is a rise in excess reserves held at the Central Bank and a rise in some sovereign debt instruments.

Figure 4.3. Liquid Assets at Banks

In billions of Dirhams



Source: CBUAE Data

A few banks tapped CBUAE's facilities to borrow Dirhams during 2017 Q1, namely through the Interim Marginal Lending facility, the Collateralized Murabaha Facility, and the CDs Repo Facility.

4.4 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 interest rate policy in the U.S. Therefore, the Central Bank of the UAE announced on the 16th of March 2017 an increase in interest rates applied to its Certificates of Deposits, in line with the Fed's decision that brought the target Fed Funds interest rate to the range of 0.75% - 1%. Similarly, the Repo Rate applicable to banks' borrowing of short-term liquidity from the Central Bank of the UAE against their holdings of CDs, has increased from 1% to 1.25%.

It is worth-noting in this regard that the CBUAE uses monetary tools at its disposal to manage liquidity in the banking system, with a goal to strike a balance between supporting credit growth and stemming the risks to financial stability, while maintaining its continued commitment to the fixed peg regime.

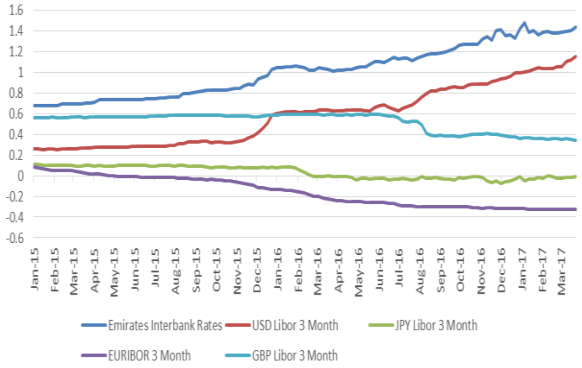
4.4.1 Short-term interest rates

Figure 4.4 shows the 3-month Emirates Interbank Offer Rate (Eibor), which comprises the daily quotes of the largest banks operating in the country, and published by the Central Bank of the UAE. Eibor was reformulated in 2016 Q2 to include the cost of attracting deposits from larger clients, in order to better reflect the true cost of funds for banks.

Eibor continued its upward trend during 2017 Q1 in line with the renewed commitment by the Federal Reserve for further rate hikes, which materialized on the 15th of March. Nonetheless, there has been some decline in the 3-month Eibor during January and February as liquidity constraints eased in banks operating in the UAE thanks to improved oil prices and a noticeable increase in UAE government deposits.

The 3-month Libor rate in the Euro Area and in Japan remained in negative territory during 2017 Q1, reflecting the action adopted by the European Central Bank (ECB) and the Bank of Japan (BOJ). This is likely to increase the prospect of further divergence with interest rates prevalent in the U.S., especially given the fact that the Fed may adopt in the near future a quicker pace of interest rate liftoff than previously expected, with inflation nearing the target of 2% annual increase in the Core Personal Consumption Expenditures Index.

Figure 4.4. Libor Rates 3-month



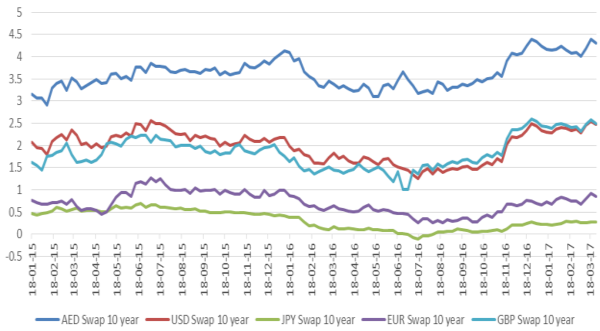
Source: Bloomberg

4.4.2 Long-term swap rates

Given the absence of a deep and liquid government bond market in the UAE, the swap market is the only way to get an idea about yields at longer maturities. Interest rate swaps correspond to an exchange of a fixed payment for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.5, the AED 10-year swap rate continued its upward trend in 2017 Q1, which may indicate continued higher risk premium as investors became averse to the potential adverse effect of persistent low oil prices on the UAE, in tandem with the impact of higher interest rates.

Similarly, the upward trends in the swap rates of the US dollar, the Euro and the yen are testament to the heightened global uncertainties, whereas the increase for the British Pound is linked to the persistent fallout of the Brexit vote, which was recently solidified by the official triggering of Article (50) by the UK, and the uncertainties surrounding its long-term impact.

Figure 4.5. 10-year swap rates



Source: Bloomberg

4.5 Monetary Tools

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

4.6 Certificates of Deposits

Certificates of Deposits (CDs) were first issued by the Central Bank in 1988, in tenors varying from 1 month to 6 months. This program offers banks an alternative tool of investing their excess liquidity in Dirhams instead of investing in dollars abroad. The initial program was revamped in 1994 when it was made available for daily issuance, with tenors extended up to 18 months. Banks have also the possibility of redeeming their CDs before maturity, allowing them to get immediate liquidity when needed at a rate set by the Central Bank.

The system was revamped again in 2007 with the move to an auction system, whereby the CBUAE determines issuance by setting a cut-off interest rate for bids posted by banks, while Islamic CDs were introduced in 2010 to allow Islamic banks to better manage their excess liquidity, putting them on equal footing with conventional banks.

4.7 Reserve Management

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