United Arab Emirates

مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

Annual Report

2014

President of the United Arab Emirates

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Board of Directors and Senior Management

Board of Directors

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Message from the H.E. the Chairman
Of the Board of Directors

The UAE has the capacity to weather well the combined impacts of the prospective continued global economic slowdown and the oil price slump. The observed resiliency in the non-hydrocarbon activities during 2014 was achieved thanks to the large gains made over an extended period of the country's history in terms of economic diversification. Our efforts have paid off to decrease significantly the economy's reliance on oil and natural gas. Further, the country's ample financial buffers, namely the Central Bank foreign currency assets and the accumulated savings of the country's Sovereign Wealth Funds, provide the needed financial buffers against the adverse oil price shock on economic activity, preventing an abrupt sharp revision of public spending and infrastructure projects.

Inflation remained also subdued during 2014, due to low inflation abroad in tandem with a strengthening Dirham, which kept imported inflation under control. Housing and prices of other services witnessed a moderate increase due to ample supply, although pent up rent increases demand vigilance to keep inflation under control.

The current consensus is that oil prices will remain low for an extended period of time. The goal is to safeguard spending that is deemed vital to economic growth, particularly on infrastructure and public services. In this context, the Central Bank will continue with policies that are deemed supportive of growth and economic diversification through liquidity support to the banking system. In parallel, we are working diligently with major stakeholders to reactivate Federal Law No. 2 of 2014 so that small and-medium sized enterprises can have access to financing at affordable costs, in addition to other support.

Last but not the least, the Central Bank has joined efforts with Ministry of Finance to contribute to the development of Dirham-denominated government bonds and Sukuks in order to benchmark a yield-curve for corporate issuance and provide banks and the central bank the kind of liquid assets we need to better manage liquidity and risk. Deepening the financial market through the issuance of government debt will expedite our plan to implement Basel III requirements towards improving financial soundness indicators and the capacity of the banking system to mobilize growth in the non-energy sector of the economy.

Message from H.E. the **Governor**

Of the Central Bank

Against the backdrop of the Dirham peg to the US dollar, 2014 was a year of currency appreciation while interest rates continue to be aligned with the direction of monetary policy in the USA. As we continue to monitor developments in the global economy, our eyes are focused on developments in the banking sector of the UAE. Due to a strong capital base as well as a strong deposit base, bank lending has remained robust in support of resilient economic activity, particularly in the non-hydrocarbon sector.

During 2014, the Central Bank boosted its regulatory framework by issuing new regulations targeting: (1) the large exposure limits in order to rein in the borrowing of government-related entities (GREs), (2) a cap on loan-to-value for bank mortgage loans to individuals in order to minimize risk-taking, and (3) licensing and monitoring of exchange houses in order to protect both customers and money changers, while allowing the large expatriate community affordable means of fund transfers. Such regulations have paid off to mitigate the risk taking by banks, a direction banks have appreciated as they continue to strive to achieve the delicate balance between growth and stability.

As we continue to mobilize our efforts in support of liquidity in the banking system, the year 2014 saw the launch of the Interim Marginal Lending Facility enabling banks to sign up and borrow overnight Dirham funds from the Central Bank by pledging their eligible securities as collateral. We have laid the foundations to establish a Collateralized Murabaha Facility to provide Islamic banks Sharia-compliant securities. Such securities can be used, on an overnight basis, as collateral for access to Central Bank liquidity, thereby putting Islamic banks on equal-footing with conventional banks.

A newly set-up Research and Statistics Department (RSD) was established at the Central Bank in 2014 to close an important statistical and analytical gap. We aim to enhance our capacity for the implementation of an international transactions reporting system to improve data compilation, particularly for the external sector. In addition to upgrading the quality, coverage, periodicity, and timelines of Central Bank statistics, we aim to increase our capacity to provide quality research and publications.

Going forward, the Central Bank will continue with its commitment to the fixed exchange rate peg, by invoking the necessary measures to accommodate the expected increase in interest rates in the U.S., and enhance our capacity to manage liquidity in the banking system as necessary. The Central Bank continues to stand ready to provide banks with the needed support facilities to ensure that credit growth supports targeted growth of the non-energy sector and continued economic diversification.

Our Vision

Leadership and excellence in preserving banking and financial stability

Our Mission

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

Our Values

Transparency - Committed to transparency and continuous improvement.

Professionalism - Practice sound governance.

Participation - Achieve excellence through teamwork.

Collaboration - Build and develop integrative partnerships.

Trustworthiness - Maintain the confidence of our stakeholders.

List of Abbreviations

UAE:	United Arab Emirates
AED:	Arab Emirates Dirham
STRs:	Suspicious Transaction Reports
FIU:	Financial Intelligence Unit
FATF:	Financial Action Task Force
MENAFATF:	Middle East & North Africa Financial Action Task Force
GREs:	Government Related Enterprises

Chapter One. International Economic Developments

Despite a pickup in Advanced Economies, global growth in 2014 remained at the same rate of the previous year, due mainly to a slowdown in some major emerging economies on account of a buildup in debt, appreciation of the US dollar and the fall of prices for major commodity exports. Meanwhile, inflation remained below target in advanced countries and unemployment remained in the double digits in the Euro Area.

Growth Picked Up in the US, but Remains Anemic in Europe

Global growth remained at 3.4% in 2014, i.e., in line with growth achieved in 2013. This was mainly due to a slowdown in Emerging Economies, while a pickup was observed in Advanced Economies with growth increasing from 1.3% in 2013 to 1.8% in 2014.

The U.S., in particular, achieved better growth performance reaching 2.4% in 2014. The recovery was mainly due to an early aggressive Quantitative Easing (QE) program adopted by the Federal Reserve System, which resulted in a reduction in long-term interest rates, from 4% in 2008 to about 1.5% in the end of 2014. Also, the reduction in interest rates on mortgages led to improvements in the real estate sector and boosted demand in the U.S., supported by the marked reduction in oil prices and a pickup in consumer spending. Meanwhile exports of goods and services were adversely affected by the dollar appreciation.

The decline in the unemployment rate below the 6.5% threshold allowed the Fed to end its Quantitative Easing program in November 2014, leading to speculations about possible increase in the policy interest rate later in 2015.

Similarly, the UK’s growth performance is primarily credited to the policies adopted by the Bank of England, specifically its early use of Quantitative Easing, underpinned by fiscal and structural reforms, as other forms of monetary and fiscal policies, such as lowering interest rates and further fiscal stimulus have been already exhausted.

In the Euro Area, economic growth remained anemic at 0.9% in 2014, albeit better than the negative 0.5% growth achieved in 2013. In Germany, economic growth increased from 0.2% in 2013 to 1.5% in 2014, while in France growth remained at 0.3% and 0.4%, respectively. This dismal growth performance is due to the delay in invoking the necessary Quantitative Easing by the European Central Bank, which embarked on the first round of sovereign bonds purchases in early 2015. Despite this announcement, analysts remain skeptical regarding the results of monetary easing, absent policies to tackle high debt and the structural problems related to low productivity and external competitiveness in the context of the currency union that eliminates the possibility of exchange rate adjustment, particularly for Southern Europe.

In Japan, a weak performance in the second half of the year due to weak consumer confidence following the implementation of the second phase of the consumption tax, falling residential investment, and slowdown in exports, led to a slightly negative growth for the year (-0.1%).

In the Commonwealth of Independent States, economic growth slowed down markedly from 2.2% in 2013 to 1% in 2014, due to the fact that Russia was hardly hit by: (1) the economic sanctions imposed in the wake of the Ukraine crisis in the summer of 2014, and (2) the oil price slump in the second half of the year which led to the Ruble losing 40.1% of its value relative to the US dollar, during this period, and 75.2% during the whole year 2014. Sliding oil prices aggravated the impact of the European and US sanctions already in place on the country since the start of the war in Ukraine. As a result, both contract prices for energy products and the quantity exported declined. As the trade deficit soared and foreign currency receipts tumbled, the exchange rate risk increased for all Russian entities dealing in the foreign exchange market in tandem with a rise in the domestic value of outstanding external debt which reached 33% of GDP, while economic growth fell from 1.3% in 2013 to 0.6% in 2014.

In Emerging and developing Asia, growth remained roughly at the same level of 6.8% in 2014, due to a limited slow-down in China, from 7.8% in 2013 to 7.4% in 2014, while growth increased in India from 5% to 7.2%.

In the Middle East and North Africa (MENA) region, economic growth was affected by the oil price slump for the GCC countries and by the global economic slowdown for oil importing countries, especially the countries that rely heavily on exports and tourism. The GCC countries, however, can use the financial buffers that have been built up during the oil price boom in the form of international reserves and savings in sovereign wealth funds. Given the size of these buffers, GCC countries in general, and the UAE in particular, have the capacity to sustain development programs and contain the risks of spillover to the non-energy sectors. As a result, Saudi Arabia achieved 3.6% growth in 2014, compared with 1.3% in 2014 in Kuwait, 3.4% in Oman, 6.1% in Qatar, and 4.8% in Bahrain.

For the UAE, the growth estimate of 4.6% in 2014 was boosted by 4.8 % growth in the non-oil activities. (See details in Chapter 2). The relatively resilient growth performance in other GCC countries helped achieve this result, while, growth in UAE real estate and tourism, was backed by the demand of UAE nationals.

Oil importers, such as Morocco and Jordan achieved 2.9% in 2013 and 3.1% growth in 2014, respectively. In post-revolutionary Tunisia, growth remained at 2.3% in 2014, due to social unrest, loss of investors' confidence and a slow- down of tourism, while in Egypt, economic growth was 2.2% in 2014, but it is expected to improve thanks to financial support from GCC countries, and the success of the Economic Development Conference which was organized in March 2015.

Looking forward, developments in the global economy matter to the UAE on two fronts: First the impact of a slowdown in the global economy and the appreciation of the US dollar to which the dirham is pegged. For the UAE, the impact may be felt particularly in tourism. The fall in the number of Russian tourists had a serious impact on hotel and retail trade activities in Abu Dhabi and Dubai, although mitigated by increased numbers of tourists from China, in particular. Secondly, the continued decline of the Euro relative to the US dollar is likely to discourage tourism from Europe and the price competitiveness of non-energy exports. However, appreciation of the dirham decreases the cost of imports, in support of competitiveness, given the high import content for the non-energy export sector (more analysis is in Chapter 2).

On the positive side, however, relatively high growth in emerging Asia, particularly in China and India, is beneficial to the UAE economy. Given its geographical proximity and strong trade as well as financial ties, the UAE stands in a good position to benefit from positive growth prospects in these large economies, which were enhanced in India by the wide range of domestic reforms.

Table 1.1.a. Annual Real GDP Growth in Advanced Economics (in %)

	2013	2014
Advanced Economies	**1.3**	**1.8**
- USA	2.2	2.4
- Canada	2.0	2.5
- United Kingdom	1.7	2.6
- Japan	1.6	-0.1
- **Euro Area**	**-0.5**	**0.9**
• **Germany**	0.2	1.5
• **France**	0.3	0.4
Commonwealth of Independent States	**2.2**	**1.0**
- **Russia**	1.3	0.6
Emerging & Developing Asia	**6.6**	**6.8**
- **China**	7.8	7.4
- **India**	5.0	7.2

Source: IMF, World Economic Outlook April 2015.

Table 1.1.b. Annual Real GDP Growth in Emerging Economics (in %)

	2013	2014
Middle East & North Africa		
- Oil Exporters	2.4	1.9
• Saudi Arabia	3.6	2.7
• Bahrain	4.8	5.3
• Kuwait	1.3	1.5
• Oman	3.4	4.8
• Qatar	6.1	6.3
• UAE	4.6	4.3
- Oil Importers		
• Egypt	2.2	2.1
• Jordan	3.1	2.8
• Morocco	2.9	4.4
• Tunisia	2.3	2.3

Source: IMF, World Economic Outlook April 2015, Regional Economic Outlook for MENAP, May 2015, and National Bureau of Statistics for the UAE.

Looming Risks of Deflation in Developed Countries

The growth prospect going forward is closely tied to the ability to arrest deflationary pressures that have challenged efforts to revive growth, particularly in the Euro Area and have hampered a reversal of monetary easing by central banks, awaiting solid evidence of a pickup in inflation in line with set targets for monetary policy.

In 2014, inflation remained subdued at 1.4% in the Advanced Economies. Indeed, even in the U.S., core inflation (i.e., excluding volatile food and energy prices) may not reach the target set at 2% by the Fed. The personal consumption expenditure price index, as an example, fell largely in connection to the decline in energy prices during this period and sluggish wage growth.

The Euro area may have entered into a deflationary cycle in 2014, with an average inflation rate of 0.4%. Near-zero or negative inflation discourages spending and increases the debt burden of households, corporates and governments alike. Therefore, the deflationary risks in these countries counter plans to stimulate growth, absent policies to address structural weaknesses and revive consumers' confidence.

Inflation remains high, however, in the Commonwealth of Independent States, increasing from 6.4% in 2013 to 8.1% in 2014; due mainly to inflation in Russia which reached 7.8% in 2014, on account of severe depreciation of the Russian currency and large capital outflows, while capital inflows dried-up.

In emerging Asia, inflation remained particularly high in India, reaching 6% in 2014, albeit lower than in 2013. The reduction in inflation was attributed to successive tightening by the Reserve Bank of India (RBI) over the year, which has moved to adopt formal inflation targeting in the country to rein in hikes in the prices of goods and services. The tightening stance which was pursued for most of the year paved the way for the RBI to cut interest rates in order to encourage corporate borrowing and boost economic growth which also benefited of low oil prices.

Meanwhile, inflation remained in China at 2.6% in 2013 and 2% in 2014, due to tight fiscal and monetary policies implemented during this period, in order to mitigate the risks of asset bubbles that developed as a result of the huge fiscal stimulus package adopted in response to the global financial crisis of 2008. This stance was reversed towards the end of 2014 in order to boost growth by decreasing reserve requirements on deposits in the banking system and lowering the interest rates in order to boost lending amidst evidence of significant slowdown in the demand for real estate.

Inflation in MENA Countries

In the MENA region, some oil importing countries like Jordan and Morocco have benefited from the decline in international food and fuel prices, thereby achieving low inflation rates of 2.9% and 0.4%, respectively in 2014.

Countries that remain in post-revolutionary turmoil, however, witnessed a large increase in food prices, fueled by disruptions in local production and depreciating local currencies. The slump in world oil prices benefited mostly governments where fuel subsidies are dominant, e.g., in Egypt, thereby blocking the transmission channel from lower energy prices to domestic inflation. In Egypt, inflation reached 10.1% in 2014, while the estimate for Tunisia is 4.9%. Continued inflationary pressures in these countries against the backdrop of currency depreciation have increased the price of food items and fueled popular discontent and labor demand for higher wages.

In the GCC countries, lower international oil prices did not translate into proportional lower prices at the pump, due to the fact that energy products remain heavily subsidized. Nonetheless, the pressure on prices in these countries was muted during 2014 due to low import prices, as a result of low international inflation and the strengthening US dollar to which the GCC currencies are pegged.

Table 1.2. Annual Inflation (in %)

	2013	2014
Advanced Economies	1.4	1.4
- USA	1.5	1.6
- Canada	1.0	1.9
- United Kingdom	2.6	1.5
- Japan	0.4	2.7
- Euro Area		
• Germany	1.6	0.9
• France	1.0	0.7
Commonwealth of Independent States	6.4	8.1
- Russia	6.8	7.8
Emerging & Developing Asia		
- China	2.6	2.0
- India	9.5	6.0
Middle East & North Africa		
- Oil Exporters		
• Saudi Arabia	3.5	2.7
• Bahrain	3.3	2.5
• Kuwait	2.7	2.9
• Oman	1.2	1.0
• Qatar	3.1	3.0
• UAE	1.1	2.3
- Oil Importers		
• Egypt	9.5	10.1
• Jordan	5.6	2.9
• Morocco	1.9	0.4
• Tunisia	6.1	4.9

Source: IMF, World Economic Outlook April 2015 and Regional Economic Outlook for MENAP, May 2015.

Mixed Record in Job Markets

Globally, the unemployment rate fell in 2014 to its 2007 pre-crisis level of 5.6%, with notable differences observed between regions and countries of the world.

In the U.S. where economic growth picked up, job creation increased steadily to reach an impressive average of 280 thousands per month during 2014 H2, thereby bringing the unemployment rate down from an average of 7.4% in 2013 to 6.2% in 2014 (5.6% as at the end of December).

Despite the strong performance of the job market in the U.S., however, the recovery did not support an increase in wages during 2014. As unemployment dipped below 6%, earnings were expected to increase albeit at a slow pace. This will support household demand and put more pressure on prices so that core inflation (i.e., outside volatile energy and food prices) may get close to the 2% target, which is expected to influence the Fed's decision to lift short-term interest rates later in 2015.

For the year 2014 as a whole, unemployment reached 6.2% in the U.K. and 6.9% in Canada, compared with a historically low unemployment rate in Japan, in the order of 3.6% during 2014.

In the Euro Area, unemployment remained in the double digit range. With the exception of Germany and high – performing North European countries, high unemployment in the Euro Area is due mainly to sluggish growth in the post-global financial crisis era and to structural problems, namely the lack of flexibility in labor markets and a dismal productivity performance in several countries.

In 2014, double digit unemployment rates are observed particularly in France (10.2%) and Portugal (14%), while, in Spain and Greece the rate of unemployment is even higher, hovering at about 25%.

Youth unemployment remains a major problem in these countries as it stands at an alarming average of 23%, due mainly to failure to create jobs in the private sector. Furthermore the slowdown in bank lending and austerity programs have limited the scope to create public employment jobs and resulted in persistent mismatch between the education systems and globalized job market requirements, in the context of the monetary union.

In Emerging Economies, outside the MENA region, unemployment is generally in the single digit due to the absence of unemployment benefits, absence or non-binding minimum wage and other legal restrictions, in addition to region and country – specific programs that aim at reviving employment.

Table 1.3. Annual Unemployment Rate (%)

	2013	2014
Advanced Economies	7.9	7.3
- USA	7.4	6.2
- Canada	7.1	6.9
- United Kingdom	7.6	6.2
- Japan	4.0	3.6
Euro Area	11.9	11.6
• Germany	5.3	5.0
• France	10.3	10.2
Commonwealth of Independent States		
- Russia	5.5	5.1
Emerging & Developing Asia		
- China	4.1	4.1

Source: IMF, World Economic Outlook April 2015.

Stock Markets: Strong but Volatile

After remaining mostly flat during the first quarter, stock markets continued an upward trend in the rest of 2014 with QE in the U.S., low interest rates on government securities and abundant liquidity in the system that left investors with no other choice, but to buy risky assets, primarily stocks.

The overall bullish stance in international stock markets was reflected in the performance of the Dow Jones in the US which after a slight decrease during the first quarter, it increased by 2.3% in the second quarter, 1.3% in the third quarter and by 4.6% in the fourth quarter of 2014, thereby leading to 7.5% year-on-year increase. Similarly, year-on-year increase in stock prices during 2014 reached 7.1% for Nikkei in Japan and 2.7% for the German Stock Index DAX, while the Financial Times Stock Exchange FTSE100 decreased by 2.7% and the benchmark French Stock Market Index CAC40 decreased 0.5%, (See Table 1.4). In the U.S., in particular, the above-average returns on stocks could be explained by improving investors' sentiment and increased corporate earnings. In addition, signs of a pickup in growth in the U.S. and continued signs of slowdown in other advanced countries have provided a pronounced divergence in the stance of monetary policies adopted in these countries and increased capital inflows to the US.

Table 1.4. International Stock Markets (2013 – 2014)

	Dow Jones	NIKKEI 225	FTSE 100	DAX	CAC 40
2014					
Q4	17,823	17,451	6,566	9,806	4,273
Q3	17,043	16,174	6,623	9,474	4,416
Q2	16,827	15,162	6,744	9,833	4,423
Q1	16,458	14,828	6,598	9,556	4,392
2013					
Q4	16,577	16,291	6,749	9,552	4,296
Q3	15,130	14,456	6,462	8,594	4,143
Q2	14,910	13,677	6,215	7,959	3,739
Q1	14,579	12,398	6,412	7,795	3,731
2012					
Q4	13,104	10,395	5,898	7,612	3,641

Source: Bloomberg Data

As regards to the GCC securities markets, the first three quarters of 2014 witnessed a period of resiliency when share prices increased by 8.8% in Bahrain, 0.6% in Kuwait, 9.1% in Oman, 17.9% in Qatar, and 14.6% in Saudi Arabia. A slump, however, took place during the last quarter of 2014, with the general share price index decreasing by 23.2% in Saudi Arabia, 15.3% in Oman, 14.3% in Kuwait, 10.5% in Qatar, and 3.4% in Bahrain. By comparison, the share price index decreased in the UAE by 9.6% during the same period. The fact that the slump in the securities markets took place in tandem with continuing dipping oil prices and that the economies most dependent on oil - Saudi Arabia, Oman and Kuwait - witnessed higher decrease in share prices, points to the fact that the collapse in oil prices may have been a major driver behind the diving securities markets, during this period.

Table.1.5. GCC Securities Markets
- Share Price Index in 2014 –

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia
2014					
Q4	1,426.57	6,535.72	6,343.22	12,285.78	8,333.30
Q3	1,476.02	7,621.51	7,484.17	13,728.31	10,854.79
Q2	1,427.61	6,971.44	7,008.27	11,488.87	9,513.02
Q1	1,356.91	7,572.81	6,856.89	11,639.79	9,473.71

Source: Bloomberg Data

Chapter Two. Domestic Economic Developments

Economic growth as well as banking activity remained resilient in the UAE while inflation remained subdued during 2014. Securities markets, however, recovered in early 2014 before tumbling as a result of sharp reduction in oil prices.

2.1 Resilient Economic Growth

Economic growth reached 4.6% in 2014, according to the National Bureau of Statistics (NBS), which is slightly higher than 4.3% growth registered in 2013. Growth remained robust in the non-oil activities, due mainly to the fact that the reduction in the oil price did not trigger any announcement of revision of public spending and infrastructure projects by the Government and GREs. It is noteworthy that the UAE is in a comfortable position to weather the shock of lower oil prices due to large accumulated assets in its various Sovereign Wealth Funds.

The capacity of the UAE to weather the impact of a lower oil price was recently recognized by the IMF [2015]: "*The UAE has large buffers in the form of foreign assets which imply that financing of [possible fiscal deficit] is not an issue*." A point that was echoed by World Bank [2014], which cited the UAE and most other GCC countries as having "*sizeable reserve buffers that could help them withstand the pressure from lower oil prices without having to make significant adjustments in infrastructure spending or debt levels*."

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

Table 2.1. Economic Growth in the UAE

Year	2010	2011	2012	2013	2014
Total GDP (at constant prices)	1.6%	5.2%	6.9%	4.3%	4.6%
• Oil GDP	3.8%	6.6%	7.6%	2.9%	4.0%
• Non-Oil GDP of which:	0.7%	4.5%	6.6%	5.0%	4.8%
- Manufacturing	2.6%	9.7%	5.6%	1.2%	3.2%
- Construction	-0.7%	-1.8%	5.5%	3.4%	7.3%
- Wholesale & Retail Trade	1.8%	0.6%	0.3%	4.9%	5.6%
- Real Estate & Business Services	-0.2%	11.1%	12.1%	6.6%	-4.1%
- Transport & Communications	0.7%	4.6%	5.0%	-1.1%	8.6%

Source: National Bureau of Statistics.

Average oil price remained high in 2014 as a whole, hovering around $95 per barrel. Therefore, public spending continued to provide support to growth in the UAE, averting an abrupt fiscal retreat that would have threatened its thriving non-oil sectors and compromised the country's position as the most diversified economy among oil producing countries in the region. In addition, the UAE economy benefited, during this period, from the growth momentum in other GCC countries as well as growth achieved in emerging Asian economies and in Africa.

The US dollar appreciation was also a boon for exports to the UAE. Due to the fixed peg regime, the Dirham appreciated during 2014 by 13.7% against the Japanese Yen (the Yen accounts for 3.6% of UAE imports), 11.4% against the Euro (the Euro area accounts for more than 17.2% of UAE imports), 4.2% against the British Pound (the U.K. accounts for 5.8% of UAE imports), 2.8% against the South Korean Won (South Korea accounts for 2.4% of UAE imports), 4.3% against Singapore dollar (Singapore accounts for 2.4% of UAE imports), 1.3% against the Indian Rupee (India accounts for 13.6% of UAE imports), and 1.9% against the Chinese Yuan (the Chinese Yuan accounts for 14.3% of the UAE imports). The collective currency depreciation provides a weighted appreciation of the Dirham by 6.7% with respect to the currencies of these trading partners that account for 59.3% of total imports of the UAE. The resulting local currency depreciation gave these countries a price advantage in their exports to the UAE and concurrently also reduced the cost of imports for consumption and investment purposes in the UAE.

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

Currency	Share of UAE imports	Currencies per Dirham		Dirham Appreciation (Dec. – Dec.)
		Dec.2013	Dec.2014	
Euro	0.172	0.201	0.224	11.4%
Chinese Yuan	0.143	1.659	1.690	1.9%
Indian Rupee	0.136	16.984	17.206	1.3%
UK Pound	0.058	0.167	0.174	4.2%
Japanese Yen	0.036	28.649	32.571	13.7%
South Korean Won	0.024	289.154	297.121	2.8%
Singaporean dollar	0.024	0.345	0.360	4.3%
Total	59.3%			
Weighted Appreciation				6.7%

Source: Fxtop.com

Growth in non-oil activities during 2014 was balanced among the main economic growth sectors. Manufacturing (9% of GDP) is estimated to have grown by 3.2% due to investments in the free trade zones as well as in the mainland. Industry clusters further developed, in particularly construction material sector, food processing, aluminum and petrochemicals. Khalifa Industrial Zone Abu Dhabi (Kizad), as an example, became one of the world's largest industrial clusters.

Similarly, Construction (9% of GDP) is benefiting from housing and infrastructure developments as well as landmark tourism projects. In the Emirate of Abu Dhabi, notable progress has been achieved in Saadiyat Island's cultural district to meet the opening deadline announced for 2015 for Louvre Museum, 2016 for Zayed National Museum, and 2017 for Guggenheim Museum. In Dubai, infrastructure projects implemented in preparation for Expo 2020 are estimated to be in the order of AED 30 billion.

Moreover, Trade, Transport and Communications, received a boost from the slump in fuel prices and lower travel costs. "Real Estate and Business Services" however contracted by 4.1% in 2014, due probably to over-supply, particularly in Dubai.

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

Currency	Percent of UAE Non-oil Exports	Currencies per Dirham		Dirham Appreciation (Dec.-Dec)
		Dec.2013	Dec 2014	
Indian Rupee	0.19	16.842	17.086	1.4%
Turkish Lira	0.12	0.561	0.625	11.4%
Swiss franc	0.06	0.243	0.265	9.1%
Egyptian pound	0.03	1.88	1.947	3.6%
Chinese Yuan	0.02	1.654	1.685	1.9%
Iranian rial	0.02	6774.726	7345.024	8.4%
Netherlands - Euro	0.01	0.437	0.486	11.2%
Japanese yen	0.01	28.151	32.476	15.4%
Total	46.0%			
Weighted Appreciation				2.8%

Source: Fxtop.com

The Dirham appreciation during 2014 is expected to make UAE non-oil exports more expensive, especially that the appreciation was particularly high with respect to a composite of currencies of Turkey, Switzerland, Iran, the Netherlands and Japan.

Nonetheless, as indicated in table 2.2.b, the weighted average appreciation reached 2.8% during 2014, relative to partners that represent 46% of UAE non-oil exports.

The combined evidence in Tables 2.2.a. and 2.2.b indicates higher appreciation with respect to major sources of imports, compared to currency appreciation with respect to major destinations of non-energy exports. Hence, the UAE is in a position to benefit, on a net basis, from the US dollar appreciation given the high import content of non-energy exports. *This rests on the assumption that there is high pass-through reflecting cheaper cost of imports in the price of non-energy exports, thereby boosting competitiveness.*

2.2. CPI inflation

The year-on-year increase in the General Consumer Price Index (CPI) remained moderate during 2014, albeit rising from 1.5% in January to 3.1% in October, before slowing down to 2.8% in November and to 1.6% in December. For 2014 as a whole, year-on-year average inflation reached 2.3%.

Housing remains the main driver of the CPI due to its weight in the consumer price basket (39%). Year-on-year, the housing component of the CPI increased steadily, from 1.8% in January to 4.4% in November, before slowing down to 2.4% in December, with an average increase of 2.9% in 2014.

Other notable drivers of inflation include Education, which accounts for 4% of the CPI basket and increased by 4.1%, annual average year-on-year. Further, Miscellaneous goods and services, which account for 5.3% of the CPI basket, increased by 2.9% annual inflation.

For other so-called non-tradables, prices were supposed to clear the domestic market and therefore they could be subject to a large increase, if local demand is high. In the period under review, however, year-on-year increase in prices remained subdued at an average of 0.5% for Communications (7% weight in the CPI basket), 1.2% for Restaurants and Hotels (4.4% weight in the CPI basket), 1.3% for Transportation (10% weight in the consumer basket), 0.8% for Recreation and Culture (3.1% weight in the basket) and 0.4% for Medical Care (1.2% weight in the basket).

As regards the price of tradables [Food; Beverages and Tobacco; Textiles, Clothing and Footwear Products; and Furniture and Household Goods represent 26% of the total CPI basket in the UAE], the strengthening of the dollar during the second half of the year is expected to have slowed down import prices, due to the fixed peg of the Dirham to the US dollar. The general depreciation of foreign currencies vis-à-vis the dirham, in tandem with very low international inflation particularly for commodity prices on account of a slowdown in the global economy explain how items of the CPI that rely heavily on imports exhibited moderate inflation in 2014. Year-on-year increase in the price of Textiles, Clothing and Footwear products (7.6% weight in the CPI basket) was less than 0.5% for most of the months of 2014, before it turned negative 1.1% in November and it remained flat in

December, resulting in a yearly average of 0.3%. The latter reached 2.1% for Food products (14% weight in the CPI basket), 2.9% for Beverages and Tobacco (0.2% in the basket) and 4.1% for Furniture and Household Goods (4.2% weight in the CPI basket).

Table 2.3. UAE Consumer Price Index* (2014)

Year-on-Year Percent Change

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

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

2.3. Diving Share Prices

The UAE markets benefited from their upgrade to Morgan Stanley Capital International MSCI emerging markets status since it took effect in May 2014, underpinned by supporting macroeconomic policies. Clarity about medium-term targets for fiscal spending and financing helped maintain confidence in support of development plans and non-energy growth. The Central Bank's capacity to avail liquidity in support of financial sector stability further reinforced prospects for non-energy growth. In addition, listed companies in the stock market gained greater investor trust by making their strategy clear with the design and implementation of an effective investor relations program, while prudent regulations help improve trading and liquidity in the markets.

Consistent with rising share prices in the U.S., Europe and in some emerging markets, steady gains were made in the UAE Securities Markets during the first three quarters of the year, with the exception of the month of June, reaching 24.7% for the share price index.

However, looming uncertainty about the prospect of global economic recovery, particularly in the Euro area and the decline in the oil price weighed in negatively on volatility in the UAE securities markets and triggered the drive for major sell-offs in the last quarter of 2014. Nonetheless, year-on-year increase in the general share price index reached 4.5% for the year, in contrast to the previous year when share prices increased steadily, reaching 68.4%, year-on-year.

Table 2.4. UAE Securities Markets

	2013	2014											
	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Number of Listed Companies	120	120	120	120	120	120	120	120	120	121	122	125	125
Share Price Index	4,313.6	4,670.4	5,035.6	5,083.6	5,349.7	5,535.3	4,657.8	5,285.1	5,356.9	5,378.0	5,092.4	4,886.9	4,508.1
Monthly change in Share price index (%)	11.6	8.3	7.8	1.0	5.2	3.5	-15.9	13.5	1.4	0.4	-5.3	-4.0	-7.8
Market Capitalization	646.3	699.9	754.9	763.1	803.1	831.0	699.2	793.8	804.6	808.3	801.0	771.0	728.4
Traded Value Monthly	38.1	59.4	58.4	44.3	67.5	64.2	48.3	43.2	21.6	32.2	28.5	26.4	31.8

Source: UAE Securities and Commodity Authority

2.4. Increasing CDS Premiums following the Oil Price Slump

Credit Default Swaps (CDS) indicate the risk related to the entities issuing debt. Table 2.6 shows a steady decrease in the risk premium for most of UAE entities issuing debt instruments in international markets, during the first two quarters of 2014: a decrease of 65 basis points for Dubai Sovereign, 16.2 basis points for DP World and 43.8 basis points for Dubai Holding. While for Abu Dhabi Sovereign, CDS decreased from a low level of 55 basis points at the end of 2013 to 49.5 basis points at the end of June 2014.

Table 2.6. UAE - Credit Default Swaps (CDS)

In basis points

	2008	**2013**	**2014**			
	Dec.	**Dec.**	March	June	Sept.	Dec.
Sovereigns :						
- Abu Dhabi	229.2	55.0	53.0	49.5	54.5	63.5
- Dubai	470.0	220.0	173.2	155.0	170.0	226.0
GREs :						
- DP World	762.0	167.5	148.9	151.3	145.0	212.0
- Dubai Holding	869.7	325.8	287.8	282.0	316.0	330.7
- Emaar Sukuk	--	113.3	114.3	113.1	112.2	110.7
- Aldar Sukuk	--	101.5	103.0	104.3	104.8	104.8

Source: Bloomberg data.

This was followed by an increase in CDS during 2014 H2 which accelerated during the last quarter of the year, in tandem with the slump in oil prices. For both sovereigns and GREs, however, the risk premiums remain well below the levels reached during the global financial crisis. Using end of 2008 as a benchmark, CDS premiums at the end of 2014 are 72.2% lower for the government of Abu Dhabi, 51.9% lower for the government of Dubai, 72.2% for DP World and 62% for Dubai Holding.

References

IMF, 2015, Regional Economic Report on MENAP, May

World Bank, 2014, MENA Quarterly Economic Brief, June

2.5. The fiscal stance

In 2014, the revenues of the consolidated government in the UAE decreased by 5% on account of a reduction in the revenues of local governments. Taxes, mostly fees paid by hotels and restaurants, fees on foreign banks' profits, and royalties on oil and natural gas, fell by AED 39 billion or 12.2%, in line with the fall in oil prices.

The fiscal stance, however, remained expansionary as total expenditures increased by 10.7%, from AED 434.5 billion in 2013 to AED 480.8 billion in 2014. Public spending by local governments increased by AED 44.9 billion or 13.1%, reflecting a drive to keep up planned spending programs and refrain from adopting an abrupt downward revision of capital spending that would have compromised e support for non-energy real growth.

Table. 2.7. Government Revenue

In billions of Dirhams

	2012	*2013*	*2014*	*Percent Change*
Consolidated Revenue	550.0	582.9	553.9	-5.0%
Taxes	312.8	319.1	280.1	-12.2%
Social Contributions	4.5	5.1	5.3	3.9%
Grants	0.0	0.0	0.7	-
Other Revenue	232.7	258.7	267.8	3.5%
Federal Government Revenue	61.2	62.6	61.8	-1.3%
Taxes	5.0	5.3	5.3	0.0%
Social Contributions	4.4	5.1	5.3	3.9%
Grants	16.6	17.7	17.2	-2.8%
Other Revenue	35.2	34.5	34.0	-1.4%
Local Governments Revenue	488.8	520.3	492.1	-5.4%
Taxes	307.8	313.8	274.8	-12.4%
Social Contributions	0.1	0.0	0.0	-
Grants	-16.6	-17.7	-16.5	-6.8%
Other Revenue	197.5	224.2	233.8	4.3%

Source: Official estimates, based on ADNOC transfers and government investment income. Data for 2014 are preliminary estimates subject to revision.

Table. 2.8. Government Expenditure

In billions of Dirhams

	2012	*2013*	*2014*	*Percent Change*
Consolidated Expenditure (a+b)	400.9	434.4	480.8	10.7%
Expenses(a)	356.6	401.0	446.1	11.3%
Compensation of employees	39.1	42.1	47.2	12.1%
Use of goods and services	40.4	43.2	54.4	25.9%
Consumption of fixed capital	3.5	3.3	3.7	12.1%
Interest	4.3	5.9	3.1	-47.5%
Subsidies	8.4	10.1	19.8	96.0%
Grants	2.6	21.6	21.9	1.4%
Social Benefits	48.8	52.4	54.7	4.4%
Other expenses	209.5	222.3	241.3	8.5%
Net acquisition of nonfinancial assets (b)	44.3	33.5	34.7	3.6%
Federal Government Expenditure (a+b)	63.9	59.4	62.8	5.7%
Expenses(a)	58.5	57.5	57.8	0.5%
Compensation of employees	18.2	18.5	19.8	7.0%
Use of goods and services	17.0	16.8	17.0	1.2%
Consumption of fixed capital	0.4	0.4	0.4	-
Interest	0.0	0.0	0.0	-
Subsidies	0.1	0.0	0.0	-
Grants	2.1	0.8	0.9	12.5%
Social Benefits	11.0	13.9	12.9	-7.2%
Other expenses	9.7	7.1	6.8	-4.2%
Net acquisition of nonfinancial assets (b)	5.4	1.9	5.0	163.2%
Local Governments Expenditure (a+b)	337.0	375.0	418.0	11.5%
Expenses(a)	298.1	343.4	388.3	13.1%
Compensation of employees	20.9	23.6	27.4	16.1%
Use of goods and services	23.4	26.4	37.4	41.7%
Consumption of fixed capital	3.1	2.9	3.3	13.8%
Interest	4.3	5.9	3.1	-47.5%
Subsidies	8.3	10.1	19.8	96.0%
Grants	0.5	20.8	21.0	1.0%
Social Benefits	37.8	38.5	41.8	8.6%
Other expenses	199.8	215.2	234.5	9.0%
Net acquisition of nonfinancial assets (b)	38.9	31.6	29.7	-6.0%

Source: Official estimates. Data for 2014 are preliminary estimates subject to revision.

The consolidated budget remained in surplus though, albeit decreasing from AED 148.3 billion in 2013 to AED 73.1 billion in 2014.

The consolidated fiscal surplus declined from 10.4% of total GDP and 16.6% of Non-oil GDP in 2013, to 5% and 7.6%, respectively, in 2014, reflecting higher expansionary spending stance, compared to the pace of revenue increase. Underlying the surplus of the consolidated budget is the surplus in local government's budgets, while the federal budget registered a narrow deficit of 0.1% of Non-oil GDP in 2014, after a surplus of 0.4% of non-oil GDP in 2013.

Table.2.9. The Fiscal Balance in the UAE (2012-2014)

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

Source: Official estimates. Data for 2014 are preliminary estimates subject to revision.

2.6. The External Sector

The oil price slump during the second half of 2014 led to a decrease in hydrocarbon exports by 13.8% or AED 65.5 billion, due mostly to a decrease in crude oil exports which represent 81% of hydrocarbon exports. This decrease was partially compensated by a rise in non-hydrocarbon exports by 8% or AED 30.4 billion. Moreover, re-export activities were boosted by lower transport costs and robust economic growth in the region, thereby increasing by AED 22.1 billion. As a result, total exports (FOB), excluding re-exports, decreased by AED 35.1 billion in 2014 and by AED 13 billion when re-exports are included.

Meanwhile, total imports (CIF), i.e., including insurance and freight, increased by AED 42.5 billion, in 2014, which led to a reduction in the surplus of the trade balance (CIF) from AED 529.7 billion in 2013 to 480.6 billion in 2014. The surplus remains however substantial, reaching 32.8% of GDP.

As regards to services, both the credit and debit in travel and transport items were boosted by lower fuel prices. Inbound tourism was strong in the UAE during 2014 despite the fact that some tourism partner countries were hardly hit by large currency depreciation, particularly Russia, Iran and the Euro area. Nonetheless, this was compensated by the increase in the number of visitors from other countries. Moreover spending by tourists in the UAE increased, according to World Travel and Tourism Council, by 3.5%, from AED 83.4 billion in 2013 to AED 86.3 billion in 2014, while employment in the sector increased by 7.5%, from 285.7 thousand employees in 2013 to 307.1 thousands in 2014.

Since Credit of the balance of services increased roughly in line with Debit, the deficit increased only slightly in 2014. Moreover, transfers abroad conducted by expatriate workers increased, thereby widening the net outflow by AED 4.9 billion. As a result, the surplus of the current account decreased by 23.5% in 2014, albeit it remained also substantial at AED 200.6 billion, or 13.7% of GDP.

The deficit of the financial account increased by 13 billion during 2014, reaching AED 194.6 billion or 13.3% of GDP. This was due to an increase in private capital outflow by AED 12.1 billion, mostly driven by a larger size in bank's investments in securities, which increased by AED 17.5 billion. Meanwhile, the increase in inward foreign direct investment (FDI) by AED 9 billion was more than compensated by an increase in bank's outflows in the form of investment abroad in the amount of AED 18.3 billion, while outward flows by public sector entities remained roughly at the same level, reaching AED 119.8 billion in 2014.

The surplus of the overall balance of payments reached AED 34 billion in 2014 or 2.3% of GDP, a decline from 5.1% in 2013. As a result net foreign assets of the Central Bank increased, during the same period.

Foreign assets of the Central Bank reached AED 320.6 billion, as at the end of 2014, against foreign liabilities in the amount of AED 25.6 billion. Therefore, net foreign assets reached AED 295.1 billion, i.e., 7.1 months of imports (net of re-exports) 2014, up from 6.6 months in 2013.

Table 2.10.The Balance of Payments of the UAE

In billions of Dirhams

	2012	2013	2014 *
Current Account Balance	**292.2**	**262.1**	**200.6**
- in percent of GDP	21.3%	18.4%	13.7%
Trade Balance (CIF)	**520.3**	**529.7**	**480.6**
- in percent of GDP	37.9%	37.2%	32.8%
Trade Balance (FOB)	**379.0**	**380.6**	**325.1**
Total Exports of Hydrocarbon	**464.1**	**475.2**	**409.7**
Crude Oil Exports	378.6	392.4	331.0
Petroleum Products Exports	35.3	35.0	32.2
Gas Exports	50.1	47.8	46.5
Total Exports of Non-Hydrocarbon	**367.2**	**382.4**	**412.8**
Free Zone Exports	197.4	234.2	280.6
Other Exports [1]	169.7	148.2	132.2
Re Exports [2]	**489.9**	**516.7**	**538.8**
Total Exports & Re Exports (FOB)	**1,321.1**	**1,374.3**	**1,361.3**
Total Imports (FOB)	**-800.8**	**-844.6**	**-880.8**
Total Imports (CIF)	**-942.1**	**-993.7**	**-1,036.2**
Other Imports [3]	-667.5	-685.1	-696.4
Free Zone Imports	-252.4	-286.1	-318.0
Imports (gas)	-22.2	-22.5	-21.8
Services (NET)	**-173.2**	**-181.0**	**-186.5**
- in percent of GDP	-12.6%	-12.7%	-12.7%
Credits	**59.0**	**66.7**	**75.7**
Travel	40.1	45.5	51.3
Transport	16.0	18.2	21.3
Government Services	2.9	3.0	3.1
Debits	**-232.3**	**-247.7**	**-262.2**
Travel	-55.4	-59.5	-65.2
Transport	-32.1	-35.4	-37.6
Government Services	-3.5	-3.8	-4.1
Freight & Insurance	-141.3	-149.1	-155.4
Investment Income (NET)	**1.1**	**0.7**	**1.0**
- in percent of GDP	0.1%	0.0%	0.1%
Banking System [4]	-5.2	-5.7	-6.0
Private non-banks	-5.6	-6.5	-6.9
Enterprises of Public Sector	27.0	29.8	30.1
Official Debt Services (Interest)	-4.1	-4.8	-5.0
Foreign Hydrocarbon Companies in UAE	-11.0	-12.1	-11.3
Transfers (NET)	**-55.9**	**-87.2**	**-94.4**
- in percent of GDP	-4.1%	-6.1%	-6.4%
Public	-3.1	-21.3	-23.6

Private	-52.8	-65.9	-70.8
Financial Account Balance	**-168.7**	**-181.7**	**-192.6**
- in percent of GDP	-12.3%	-12.8%	-13.1%
Capital Account	-	-	-
Financial Account	-168.7	-181.7	-192.6
a. Private capital	-53.7	-62.8	-72.9
a-1 Direct Investment	5.3	6.1	14.4
a-1-1 Outward	-30.0	-32.4	-33.1
a-1-2 Inward	35.3	38.5	47.5
a-2 Portfolio Investment	3.6	4.1	4.6
a-3 Banks	-32.1	-45.5	-63.8
a-3-1 Securities	-5.1	-22.1	-39.6
a-3-1 Other investment (loans, deposits)	-27.0	-23.3	-24.2
a-4 Private nonbanks	-30.5	-27.5	-28.0
b. Enterprises of Public Sector	-115.0	-118.9	-119.8
Errors and omissions	**-86.7**	**-7.4**	**26.0**
Overall balance	36.7	73.1	34.0
- in percent of GDP	**2.7%**	**5.1%**	**2.3%**
Change in Reserve **	**-36.7**	**-73.1-**	**-34.0**
UAE Central Bank	-	-	-
Foreign Assets	205.2	282.9	320.6
Foreign Liabilities	17.0	21.8	25.6
Net Foreign Assets	188.2	261.2	295.1
Change in Net Foreign Assets	36.6	73.0	33.9
Reserve Position with IMF	1.4	1.5	1.6
SDR	3.1	3.1	3.1
Reserve Position [5]	4.5	4.6	4.6
Change in Reserve Position with IMF + SDR	**0.1**	**0.1**	**0.0**
Memorandum Items:			
Net Foreign Assets in months of net imports (CIF)	5.0	6.6	7.1

Source: Official estimates

1) Including Estimates of other Exports from all Emirates

2) Including Re-exports of Non-Monetary Gold

3) Including Estimates of Imports from all Emirates and Imports of Non-Monetary Gold

4) Central Bank and all Banks.

5) Including IMF and SDR position

*Preliminary Estimates Subject to Revision

**Negative indicates an increase, positive indicates a decrease

Chapter Three. Monetary & Banking Developments

3.1. Monetary Expansion

Money supply M1 increased year-on-year up to December 2014 by 14.9%, against 26.2% in 2013, reaching AED 451.6 billion. Currency in Circulation (13.1% of M1) contributed with 2.2% to this increase, while Monetary Deposits (83.5% of M1) contributed with 12.2% and cash at Banks (3.4% of M1) contributed with 0.5% increase.

M2 increased year-on-year up to December 2014 by 8.1%, against 22.4% in 2013, reaching AED 1,156.6 billion. This was brought about by a contribution of 0.8% increase in Currency in Circulation (5.1% of M2), 0.2% increase in Cash at Banks (1.3% of M2), 4.5% contribution of increase in Monetary Deposits (24.2% of M2), while Quasi-Monetary Deposits (61% of M2) contributed with increase of 26%.

Meanwhile, M3 increased year-on-year up to December 2014 by 9.3%, against 12.6% in 2013, reaching AED 1,347.6 billion, due mainly to 4.1% contribution of Monetary Deposits (28.2% of M3), while Quasi-Monetary Deposits (52.1% of M3) contributed with an increase of 2.1% and Government Deposits (14.2% of M3) contributed with increase in the order of 2.3%.

3.2 Resilient Banking Activity

The 23 locally-incorporated banks increased their branches from 841 at end of 2013 to 869 at end of 2014, while the 6 banks from the GCC countries remained with 4 branches, and the number of the remaining foreign banks decreased from 22 banks at the end of 2013 to 20 at the end of 2014, due to: (1) Barclays' transformation into a wholesale bank and (2) HSBC branch's acquisition of Lloyd's Bank.

Wholesale banks are allowed to conduct all commercial activities in the UAE except retail operations with natural persons, i.e., opening all types of accounts and letters of credit for companies and granting all types of lending facilities. In addition to Barclays PLC, MBC Bank Limited is the second wholesale bank to open in the UAE in 2014 Q4, which brings to seven the total number of wholesale banks operating in the country.

As regards banking activity, the oil price slump is expected to increase the downside risks for banks operating in the UAE, due to a slowdown in the real estate sector, more volatile securities markets and added uncertainties about banks' exposure to business partners in hardly hit oil-dependent economies.

Table. 3.1 Monetary Developments: 2013 – 2014

In billions of Dirhams

	2013		2014					
	December		March	June	September	December	Year- on-Year Change	Contribution to Aggregate Growth
	Amount	Year- on -Year Change						
Money Supply M1	**393.1**	**26.2%**	**423.9**	**447.2**	**444.6**	**451.6**	**14.9%**	
Currency in Circulation	50.4	10.5%	53.4	54.9	57.3	59.0	17.1%	2.2%
Cash At Banks	13.5	10.7%	11.9	12.9	13.5	15.5	14.8%	0.5%
Monetary Deposits	329.2	29.8%	358.6	379.4	373.8	377.1	14.6%	12.2%
Money Supply M2	**1070.3**	**22.4%**	**1136.2**	**1,155.5**	**1149.6**	**1,156.6**	**8.1%**	
Currency in Circulation	50.4	10.5%	53.4	54.9	57.3	59.0	17.1%	0.8%
Cash At Banks	13.5	10.7%	11.9	12.9	13.5	15.5	14.8%	0.2%
Monetary Deposits	329.1	29.8%	358.6	379.4	373.8	377.1	14.6%	4.5%
Quasi Monetary Deposits	677.2	20.2%	712.3	708.3	705.0	705.0	4.1%	2.6%
Money Supply M3	**1233.4**	**12.6%**	**1292.1**	**1341.3**	**1357.7**	**1347.6**	**9.3%**	
Currency in Circulation	50.4	10.5%	53.4	54.9	57.3	59.0	17.1%	0.7%
Cash At Banks	13.5	10.7%	11.9	12.9	13.5	15.5	14.8%	0.2%
Monetary Deposits	329.1	29.8%	358.6	379.4	373.8	379.5	15.3%	4.1%
Quasi Monetary Deposits	677.2	20.2%	712.3	708.3	705.0	702.7	3.8%	2.1%
Government Deposits	163.1	-26.1%	155.9	185.8	208.1	190.9	17.0%	2.3%

Table. 3.2.a Banks and Other Financial Institutions

	2013	2014			
	Dec.	**March**	**June**	**Sept.**	**Dec.**
Locally Incorporated Banks :					
- Main Branches	23	23	23	23	23
- Additional Branches	841	843	858	866	869
- Electronic Banking Service Units	29	29	33	33	34
- Cash Offices	89	89	89	89	90
GCC Banks :					
- Main Branches	6	6	6	6	6
- Additional Branches	4	4	4	4	4
Foreign Banks :					
- Main Branches	22	22	22	22	20
- Additional Branches	83	83	83	83	82
- Electronic Banking Service Units	52	53	53	54	49
- Cash Offices	1	1	1	1	1
Other Financial Institutions:					
- Wholesale Banks	4	4	5	5	7
- Representative Offices	120	120	122	121	121
- Finance Companies	25	25	26	26	26
- Financial Investment companies	25	25	25	25	25
- Moneychangers	134	134	137	138	140
- Offices for Intermediating in Currency Trading & Money Market Operations	12	12	12	12	12

Source: Banking Supervision Department of the Central Bank of the UAE

Despite the slowdown in customer deposits at banks during 2014 H2, deposits increased by 11.1% during the whole year, reaching AED 1,421.3 billion, compared with bank loans and advances in the amount of AED 1,200.1 billion, while the ratio of bank lending to stable resources reached 85.2% (see Table 3.3 for definition).

Loans and advances increased by 10.1% during 2014 as a whole, despite a decrease by 1% in 2014 Q4. Robust growth in the non-oil sectors (more than 60% of GDP) sustained demand on bank credit, in addition to the fact that even though some banks' foreign business partners suffered from tumbling oil prices, some other partners benefitted from it, particularly India (38.6% of UAE exports) and China (11.5% of UAE exports).

Table 3.2.b. UAE Banking Indicators

In billions of Dirhams

	2013	2014				
	Dec.	March	June	Sept.	Dec.	Year- on- Year Percent Change
Total Bank Assets	2,100.3	2,180.4	2,236.9	2,311.3	2,304.9	9.7%
Loans & Advances	1,090.4	1,144.5	1,174.6	1,215.9	1,200.1	10.1%
Of which: Personal loans to residents	279.5	285.7	295.9	307.5	299.9	7.3%
Customer Deposits at Banks	1,278.9	1,331.7	1,400.2	1,414.5	1,421.3	11.1%

Source: Banking Supervision Department of the Central Bank of the UAE

Quarterly credit sentiment survey (Central Bank survey of credit officers at banks) confirmed in the 4th quarter of 2014 that credit conditions within the UAE remain supportive of economic growth with near–term expectations that such trends will continue. The same survey shows expectations of further credit demand from corporates and small businesses in 2015.

Islamic banks continued to thrive during this period. Their total assets increased by 10.7%, year-on-year up to December 2014 reaching AED 405 billion, keeping their share in total assets at 17.6%. Meanwhile their financing increased by 22% reaching AED 266 billion, thereby increasing their share total bank Loans and Advances from 20% at the end of 2013 to 22.2% at the end of 2014.

Table 3.2.c. Assets and financing of Islamic Banks (2013 – 2014)

In billions of Dirhams

	2013	2014			
	Q4	Q1	Q2	Q3	Q4
Assets	366	378	389	402	405
Percent of total banking assets	17.4%	17.3	17.4%	17.4%	17.6%
Islamic financing	218	229	244	260	266
Percent of total bank Loans & Advances	20.0%	20.0%	20.8%	21.4%	22.2%

Source: Banking Supervision Department of the Central Bank of the UAE

3.3 Financial Soundness Indicators

The UAE banking system remained resilient during the year, despite the collapse in oil prices. The ratio of lending-to-Stable Resources of banks remained during the whole year above 85%. This coincided with a pickup in bank lending.

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

The quality of the loan portfolio of banks operating in the UAE remained roughly at the same level during the first three quarters of the year, with the ratio of non-performing loans (NPLs) at about 8%, before declining to 7% in the fourth quarter. These NPLs, moreover, were fully provisioned during this period.

Banks operating in the UAE maintained high capitalisation, stable funding and ample liquidity during the year. The capital adequacy ratio of banks reached 18.2% (16.2% for Tier1 capital), which is well above the regulatory requirements set by the Central Bank (12% and 8%, respectively). And liquid assets which include reserve requirements, certificates of deposit held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets, increased steadily from 14.7% at the end of 2013 to 15.7% at the end of 2014.

Table 3.3. Financial Soundness Indicators in the UAE

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

Source: Banking Supervision Department of the Central Bank of the UAE

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

Chapter Four. Central Bank Financial Position

4.1- Central Bank Balance Sheet

The total assets of the Central Bank of the UAE expanded by 10.3%, from AED 305.8 billion at the end of 2013 to AED 337.4 billion at the end of 2014. This was mainly the result of an increase in Central Bank “Cash and Bank balances” by AED 27.4 billion, that banks boosted in order to invest in “Held-to-Maturity Foreign Bonds” which increased by AED 29.5 billion, during the same period. Meanwhile deposits at banks abroad decreased by AED 23.0 billion and Held-to-Maturity Bonds Issued by the Ministry of Finance decreased by AED 5.9 billion.

On the liabilities side, “Current Accounts and Deposits” of banks at the Central Bank increased by AED 30.2 billion, during 2014, and “Currency Issued” increased By AED 10.5 billion, while banks’ balance of “Certificates of Deposit” issued by the Central Bank decreased by AED 8.4 billion.

Table 4.1: Central Bank Balance Sheet

In millions of Dirhams

	2013	2014
Assets		
Cash & Bank Balances	14,592	42,001
Deposits	99,927	76,917
Liquidity Support Facility	513	321
Held-To-Maturity Foreign Bonds	128,263	157,753
Held-To-Maturity Bonds Issued by Ministry of Finance & Dubai Government	55,361	49,443
Available-for-sale investments	385	378
Advances to Government	-	2,500
Other Assets	6,624	7,996
Fixed Assets	97	79
Total Assets	**305,762**	**337,388**
Off Balance Sheet Commitments	129,367	134,105
Liabilities		
Current Accounts & Deposits	111,973	142,168
Certificates of Deposit	107,896	99,534
Currency Issued	63,927	74,472
Other Liabilities	697	1,683
Total Liabilities	**284,493**	**317,857**
Capital & Reserves		
Authorized Issued & Fully Paid Capital	2,500	2,500
Other Reserve	-	-
Fair Value Reserve	-5	-11
General Reserve	16,080	16,080
Retained Earnings	2,694	962
Total Liabilities & Capital	**305,762**	**337,388**
Off Balance Sheet (FX swaps)	129,367	134,105

Source: Financial Control Division, Central Bank of the UAE

4.2- Earnings for the Year

The Central Bank's investment income decreased from AED 2.69 billion in 2013 to AED 1.58 billion in 2014, due to a decrease in the return on investments in Held-to-maturity bonds issued by Dubai Government and Held-to-maturity bonds issued by the Ministry of Finance. As a result, the net interest and investment income decreased from AED 2.64 billion in 2013 to AED 1.61 billion in 2014, while earnings for the year decreased from AED 2.17 billion in 2013 to AED 1.19 billion in 2014.

Table 4.2: Statement of Earnings for the Year

In millions of Dirhams

	2013	2014
Interest Income	398	474
Investment Income	2,689	1,583
Interest Expense	-352	-354
Murabahah Profit Expenses	-92	-95
Net Interest & Investment Income	**2,643**	**1,608**
Other Income	-92	54
Staff & Administration Expenses	-420	-477
Earnings For The Year	**2,167**	**1,185**

Source: Financial Control Division, Central Bank of the UAE

4.3- Central Bank Financial Results

The Central Bank's balance of foreign currency assets increased by 13.3% during 2014, reaching AED 320.6 billion at the end of the year. This was mainly due to an increase in Central Bank's "Investments Abroad in Highly Rated Securities, Government Bonds and Treasury Bills" by AED 29.5 billion, an increase in "Deposit Account, Cash with Banks Abroad and Loans to Banks against Certificates of Deposit" by AED 7.3 billion.

Table 4.3: Investment of the Central Bank's Foreign Currency Assets

In billions of Dirhams

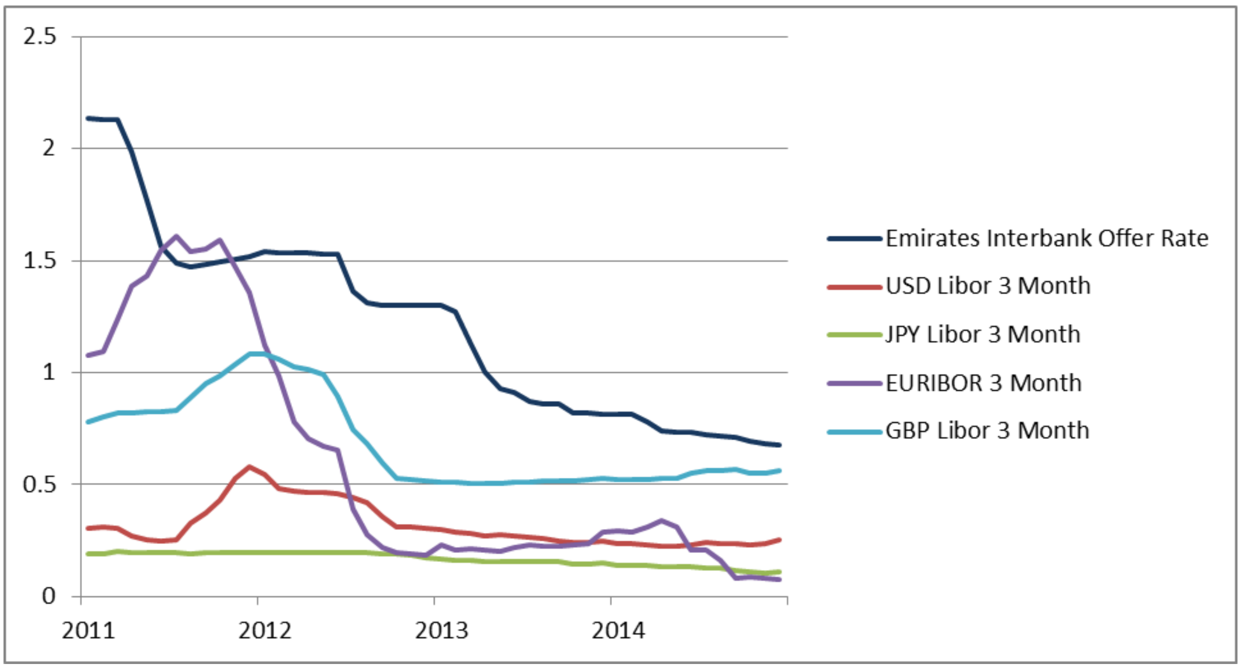
	2013	2014
Total Foreign Currency Assets	**282.9**	**320.6**
Central Bank's Investments Abroad In Highly Rated Securities, Government Bonds And Treasury Bills	128.3	157.8
Deposit Account, Cash with Banks Abroad And Loans to Banks Against Certificates of Deposit	108.1	115.4
Central Bank's Investment In Local Government Bonds	36.7	36.7
Other Foreign Assets	9.8	10.7
Earnings For The Year From Treasury Operations	**1.4**	**1.0**

Source: Financial Control Division, Central Bank of the UAE

The fixed peg of the exchange rate of the dirham to the US dollar, at a rate of 3.6725 dirhams per US dollar, means that the CBUAE has limited degree of freedom to set interest rates, independently from the direction of the interest rate as laid out by the US monetary policy which is defined by the Federal Reserve System in the United States. Nonetheless, the CBUAE uses monetary tools to manage liquidity in the banking system, in order to support credit growth and stem the risks to financial vulnerability, while defending the fixed peg regime.

5.1. Short-term interest rates

In 2014, short-term interest rates measured by the 3-month EIBOR (Emirates Interbank Offer Rate) came down from 0.81% to 0.67%. The Eibor is calculated by the Central Bank of the UAE, comprising daily quotes of the largest banks in the UAE. During 2014, the spread between EIBOR and the US 3-month Libor continued to narrow as it tightened from 0.56% to 0.42%.

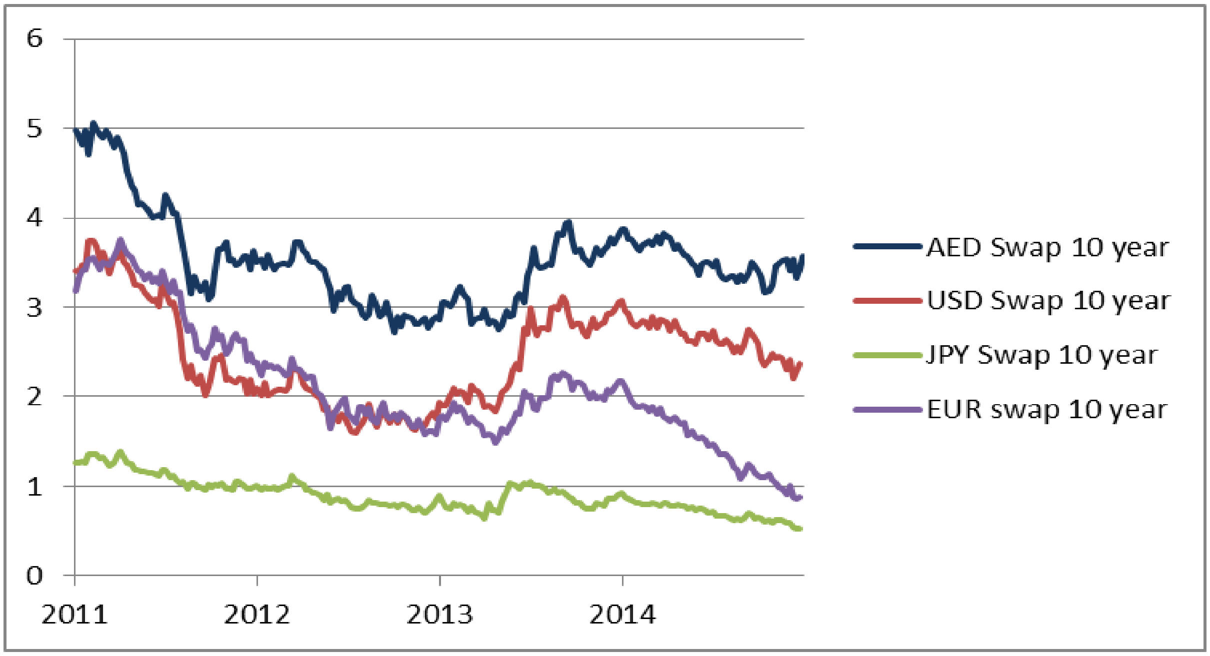


Source: Bloomberg

By the end of 2014, market participants anticipated that the FED was going to raise rates during 2015, which lifted the USD rates by a small margin. In contrast to the US situation, investors became confident in the second half of the year that the ECB (European Central Bank) was going to resort to further monetary easing measures. This sent short-term interest rates on the Euro to almost zero, even lower than their Japanese counterparts.

5.2. Long-term swap rates

As the UAE does not have a deep and liquid government bond market, one has to resort to the swap market to analyze the yields at various maturities. The swap market reflects mainly the supply and demand of corporates to hedge their interest rate risk with the most liquid assets. Over the course of 2014, it is evident that the AED swap curve has increased slightly. Specifically, spreads over the USD 10-year swap widened to 120 bps, reflecting the decline in the oil price and continued improvement in the outlook for the US economy. In addition, the widening of the spreads of AED 10-year swaps mirrors technical supply and demand considerations



Source: Bloomberg

5.3. Monetary Tools

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

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

5.4 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 offered banks an alternative tool of investing their excess liquidity in dirhams instead of investing it 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 were also offered the possibility of redeeming their CDs, before maturity, allowing them to get immediate liquidity when needed.

In 2007, the CBUAE shifted from a demand-based CD issuance system, whereby banks could buy any amount of CDs they desire at the prevalent interest rate, to a new auction system, where the CBUAE determines issuance by setting a cut-off interest rate for bids posted by banks. This was complemented in 2010, when Islamic Sharia–compliant CDs were made available to Islamic banks operating in the country, to put them on equal-footing with conventional banks, in this regard.

The global financial crisis and the resulting liquidity squeeze for banks operating in the UAE gave an impetus to the CBUAE to take the following decisions:

1. Transition from a six-day Reserve Maintenance Cycle (RMC) within each calendar month to a rolling seven-day RMC in order to remove unnecessary volatility in dirham money market rates at the end of each month. Indeed, the weekly cycle for maintaining reserves completely removed the end of month variations that were previously predominant.

2. Introduction of a dirham repurchase (repo) facility for CDs, which became a useful source of liquidity for banks that hold CDs but face temporary cash flow variations.

3. Introduction of a dollar funding facility for banks holding CDs, whereby banks could borrow up to US $200 million per day against their CDs and up to a maximum outstanding amount of US $1 billion per bank. A similar funding facility in the form of an Islamic swap was introduced for Islamic banks.

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

5.5 Bank Liquidity Developments

The main liquidity indicator monitored at the Central Bank in this regard is banks' excess reserves, i.e., their current account at the Central Bank and their holding of CDs. Despite the erosion in the second half of 2014, banks' current account at the Central Bank registered an increase by AED 8.5 billion compared to the same period of the previous year, AED 30 billion at the end of 2014, thereby compensating the decrease in CDs held by banks from AED 118.3 billion at the end of 2013 to AED 99.5 billion at the end of 2014 (See Table 3.4).

Moreover, reserve requirements that banks hold at the Central Bank increased .to AED 104.1 billion at the end of 2014 ., bringing total liquid assets of banks to the amount of AED 233.1 billion or 10.1% of total assets. It should also be noted that there was no use by banks of CBUAE's facilities to borrow Dirhams, namely the CDs Repo and the Interim Marginal Lending facility.

5.6 Reserve Management

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

CBUAE's global financial reserves are managed with a goal to strike a balance between guaranteeing a reasonable return while ensuring adequate liquidity buffers. The objectives of the investment strategy for the Central Bank reserves aim to ensure adequate liquidity, capital preservation and appropriate return, with liquidity being the most important driver to ensure banking stability. Investments are based on the Reserve Management Policy approved by the Board of Directors and in consistency with Union Law 10 of 1980, concerning the Central Bank, The Monetary System and Organization of Banking.

CBUAE's foreign currency assets at the end of 2014 comprise AED 115.5 billion deposits at banks abroad and AED 194.5 billion Held – to – Maturity Securities, in foreign currencies, including USD 10 billion Dubai Government Bonds, in addition to other reserves amounting to AED 10.7 billion, which brings total foreign currency reserves at the end of 2014 to AED 320.6 billion.

5.7 Risk Management

The management of risks in the Central Bank is coordinated by the Risks Identification and Monitoring Committee, chaired by His Excellency the Governor of the Central Bank and having as members Senior Managers from all relevant business areas. To assist the Committee in its work, the Central Bank created in 2014 a Risk Management Unit reporting directly to His Excellency the Governor and, in parallel, to the Risks Identification and Monitoring Committee.

The use of monetary tools and the management of its reserves expose the Central Bank to financial risks and in particular market, credit and liquidity risks. These risks are, however, limited as a result of the existing restrictions imposed by the Central Bank's policies and the use of appropriate hedging and risk control tools.

Thus, currency risks incurred by holding fixed-income instruments denominated in currencies other than the US dollar are systematically hedged out. Deposits are only placed with highly creditworthy financial institutions and the size of such deposits is controlled against the established limits. Finally, the overall liquidity of the reserves is guaranteed by investing a large part of the reserve management portfolio in very liquid instruments. Liquidity providing operations expose the Central bank to counterparty risk. This risk is, however, limited by the fact that, as a rule, such operations are adequately collateralized.

The Central Bank is also exposed to operational risk, defined by the Basel Committee for Banking Supervision as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risks identified by the Risk Management Unit, in close cooperation with the relevant business areas, are evaluated by the Risks Identification and Monitoring Committee. Depending on the likelihood and potential impact of such risks, appropriate controls are introduced and the level of the residual risk, after the implementation of the controls, is monitored over time.

Chapter Six. Banking Supervision and Regulatory Developments

The year 2014 witnessed intense activity in supervision while the regulatory framework was strengthened.

I. Banking Supervision

Banking supervision aims at monitoring risk-taking by banks in order to protect depositors and the economy as a whole against systemic bank failure.

Banking Supervision in the present form was set up in compliance with Chapter 2 of the 1980 Union Law No. (10), which made mandatory the supervision of the financial sector under its jurisdiction and strengthened the Central Bank functions in this regard.

After an institution is licensed by the Central Bank, it is subject to ongoing supervision to ensure the institution is managing its risks prudently and that it is meeting prudential requirements, this includes both banks and non-bank financial institutions.

Accordingly, the Banking Supervision Department expanded over the years and a branch opened in Dubai to conduct supervision in Dubai and in the Northern Emirates.

As the financial sector developed over time, the associated risks from domestic and international developments increased. To achieve a higher level of efficiency and effectiveness in performing the supervision role, the Banking Supervision Department (BSD) expanded further to meet these new challenges. BSD presently consists of Licensing, On-site and Off-site Examination and Supervision, Regulatory Development, Payment System Oversight, and Consumer Protection and Customer Services.

As at the end of December 2014, the core functions of the banking supervision and examination are attended by a team of 65 examiners and 7 reviewers based in Abu Dhabi and Dubai. Since 1991, the CBUAE has been following risk-based supervisory programs, examining banks' credit, operational, market and other risks, and monitoring remedial measures taken by banks to address these risks.

Besides the banking sector, Central Bank supervision extends to the other segments of the financial sector, i.e., investment banks, finance companies and money exchanges. The examination schedule during 2014 completed 50 examinations at non-bank financial institutions, 61 exchange houses and 61 examinations at banks covering full scope as well as thematic reviews, 172 in total.

The Supervisory Structure

The Examination and Supervision Division within BSD is broadly delineated along the lines of the requirement to physically verify and report on institutions under Central Bank jurisdictions. On-site examination undertakes field inspections, while off-site work focuses on analysis and review of the reports received from bank examiners and follow-up of relevant issues with the concerned institutions. In reality though, both teams are closely linked and there is always significant interaction between the two functions before, during and after the examination itself.

The on-site examination is conducted by examiners whose main tasks are:

1. Prepare an annual examination program for banks and other financial institutions, which is based on the pre-examination notes that highlight specific areas of supervisory concern.
2. Review and report on compliance with Central Bank regulations and the requirements placed on the institution by Union Law 10 of 1980.
3. Assess the adequacy of risk management systems and internal controls at the institution.
4. Carry out selective review of credit portfolios in order to identify delinquent accounts and check regulatory compliance.
5. Report to the Higher Management of the Central Bank about major findings of the examination exercise.
6. Inform concerned banks and regulated non-bank institutions of all matters that are considered of serious supervisory concerns, like some key risk areas and the recommendations thereof.

The off-site examination at the head office of the Central Bank is the responsibility of the reviewers. Their main functions are as follows:

1. Update summarized records on operational performance of banks and other financial institutions.
2. Analyze the submitted periodical return forms from banks and other financial institutions, and identify the possible risks as well as the extent of regulatory compliance.
3. Prepare a report for the concerned banks and other financial institutions that contains the Central Bank diagnostic of their situation and the recommended remedial measures if any, and advise the examination team leader to carry out specific examinations, if needed.
4. Follow up with banks and other financial institutions on the main supervisory concerns.
5. Process banks' and other financial institutions' requests regarding the appointment of external auditors.
6. Review reports of foreign supervisory bodies on branches of local banks operating abroad, and submit examination findings accordingly to the Higher Management of the Central Bank.

7. Attend the reviewers meetings organized at the head office of the Central Bank in order to identify specific areas of risk in the banking system, share market intelligence and report any unusual/abnormal developments to the Higher Management of the Central Bank.

The increase in complexity of banking and non-banking activities, emergence of new risk factors and continuous change in financial landscape resulted on the need to undertake risk assessment both at individual institution level as well as on a system-wide basis. For this reason, BSD is working to enhance its risk-based supervision processes to ensure that the department continues to support the strategic results and the desired outcomes of the Central Bank.

The year 2014 has been an important year for BSD as the examination process and team structures have been under review with the strategic objectives of more efficient resource use, greater regulatory consistency, transparency and escalation and enforcement as a priority. These changes have meant a significant investment in improving the skill levels of all members of the team as well as in the time and effort involved, not only regarding the development of processes and systems but in the implementation of these initiatives.

There has been a significant amount of regulatory change over the last few years and this has required a constant upgrading of rule books to ensure consistency in the way the Central Bank assesses banks. In this respect, 2014 saw the completion of a major project that provided a significant improvement in banks' reporting and the collection and utilization of data.

An important element of the enhancement of the risk-based examination process has been the introduction during 2014 of an all-encompassing dashboard for banks designed to quickly assess the strengths and weaknesses of an individual institution, not only in terms of regulatory compliance, but also in terms of the institutions governance, control and risk management capabilities benchmarked against global best practice as well as domestic peer groups. Balance and proportionality are important considerations in assessing the capacity of institutions.

This important regulatory tool looks in detail at twelve evaluation criteria:

1. The role of the board of directors and governance
2. Management structure and efficiency of systems
3. Large exposures
4. Asset quality
5. Capital Adequacy
6. Real estate loans to deposits ratio
7. Liquidity
8. Lending to deposit ratio
9. Operational and other risks
10. Adequacy of internal controls
11. The role of audit and compliance
12. Conduct of business and complaints

Each of these criteria has further sub-criteria which feed into the result which is then weighted and a score produced. The score triggers a traffic light system for each criteria, red, amber, and green, each of which also contains a high level explanation. Consistency is ensured by the use of scorecards that are detailed as well as granular.

Perhaps even more important, the dashboard drives the regulatory concerns to both the senior management of the Central Bank and the concerned bank, in a concise and easily understandable way. The benchmarking and scoring process, as well as the ability of the system to be proportional allows the senior management of the Central Bank to allocate examination resources effectively, on the basis of risk. It is the key tool used to review and highlight key concerns as well as potential enforcement responses.

Ensuring Capital Adequacy of Banks

Capital Adequacy is a key pillar for ensuring the safety and soundness of banks. The Central Bank currently requires all banks operating in the UAE to comply with the Basel II Standardized approach in assessing their regulatory capital adequacy. BSD has a team dedicated to ensuring that banks are assessing, planning and reporting their capital requirement in strict accordance with the Basel Committee rules. This includes a thorough review of the Central Bank's pillar II responsibilities as regards the ICAAP (Internal Capital Adequacy Assessment Process) as well as the SREP (Supervisory Review and Evaluation Process) which are prepared by the banks themselves. It is also worth highlighting that the move forward to meet Basel III standards will significantly enhance the quality of banks' core capital as well as banks' holding of liquid assets.

Maintaining Close Relationship with Other Related Institutions

BSD has maintained a close relationship with the financial sector, including the UAE Banks Federation, rating agencies, audit and consultancy firms, in addition to the Arab Monetary Fund, the IMF and the World Bank. Regular meetings with these institutions and the Central bank are scheduled throughout the year. Also a new requirement was made for banks in the UAE to comply with the FATCA (Foreign Account Tax Compliance Act), which affected their customers based in the US. BSD was instrumental in facilitating the compliance process in this respect.

The Department also participated in the international regulatory development of Islamic finance at the Islamic Financial Services Board and the International Islamic Liquidity Management. This helped maintain a good understanding of current issues and developments and contributed to the improvement of its supervisory oversight.

Anti-money laundering

BSD is responsible for implementing anti-money laundering regulations. Examiners are instructed to make sure during their on-site visit that banks comply fully with FATF recommendations in this respect, based on an Examination Manual that contains KYC procedures, record keeping and reporting of Suspicious Transaction Repots (STRs).

After a review at the Central Bank's head office, an Examination Report is forwarded to the Higher Management in this regard, describing bank's degree of compliance, possible violation and recommendations.

II. Regulatory Developments

Introduction

The Regulatory Development Division (RDV) was established in December 2012 at the Central Bank of the UAE. The broad mandate of the Division is to continuously review and develop the regulatory framework for financial institutions licensed by the Central Bank, in line with best international practice.

The main objective of the Division is to establish and maintain a regulatory framework for financial institutions in the UAE that is appropriately designed to foster sound and robust financial institutions, provide protection to consumers, and enable the financial sector to develop in a stable and prudent manner.

In this context, the Central Bank has conducted a review of the existing regulatory frameworks for all financial institutions under its remit. Arising from this review, new regulations are being introduced and existing regulations enhanced. The objective is to ensure that the regulatory system is robust and cohesive across the various financial sectors regulated by the Central Bank.

In what follows a presentation of the three regulations which were issued during 2013-2014, and CBUAE priorities for the period ahead.

Issued Regulations

The need to diversify risk is a key principle in banking. The importance of placing limits on banks' exposures to large borrowers and concentrated credit risk in general is well known. A 'large exposure' regulatory framework seeks to contain the maximum loss to a bank in the event of a failure of counterparty, so that the bank's solvency position is not threatened. The Central Bank wishes to ensure that the banking system remains appropriately protected from over exposure to any single, or connected parties.

Therefore, the Central Bank conducted extensive consultation with banks and made certain important enhancements to the 'large exposure' regulatory framework for banks operating in the UAE. The changes include the introduction of caps on exposures to local governments as well as government related entities (GREs), mainly some large property developers. Also, a requirement was made to include off-balance sheet exposures, in calculating the individual and aggregate large exposure limits.

The new limits will not apply at the federal government level, but banks' exposure to all local governments and their non-commercial entities should not exceed 100% of the bank's capital base, and the cap for each non-commercial entity is set at 25%. Moreover, the aggregate cap is 100% for commercial GREs, and 25% for each GRE, taken individually.

For a single borrower, or a group of related borrowers, there is a maximum individual limit of 25% and aggregate limit of 100% of the bank's capital base. Large exposure limits are also set for certain categories, such as banks' own shareholders, subsidiaries and affiliates, as well as Board members.

Retail mortgage lending

The Central Bank introduced 'Regulations regarding Mortgage Loans' with the main purpose of developing an effective framework of mortgage underwriting standards in financial institutions and providing the needed transparency for consumers of banking and financial services. The regulations include caps on loan-to-value, debt burden ratio limits and a requirement for financial institutions to have proper processes and procedures in place to properly assess the borrower's ability to repay the loan.

In introducing these regulations, the Central Bank wishes to ensure that banks, finance companies and other financial institutions providing mortgage loans to individuals do so in accordance with best practice.

The regulations also seek to provide the Central Bank with policy response options which, if required, can be used at a macro level to help prevent excessive build-up of risks in the mortgage market. Under the regulations, the Central Bank may set lower 'loan to value' or 'debt burden' ratio requirements for all financial institutions to adhere to, should economic or market circumstances warrant such action.

Circular 31/2013 defined loan-to-value (LTV) ratio as the amount of the mortgage loan outstanding to the appraised value of the residential property. The regulation required the lenders to ensure that LTV takes into account current, latent, or emerging risk factors that may impact on the value of the collateral and the lenders' ability to realize it. The value of collateral should be suitably discounted to take account of these risk factors.

The level of downpayment required from the borrower should be drawn from the borrower's own resources and not from other sources of borrowing (including personal loans or credit cards). Therefore, according to Circular 31/2013, the LTV ratio should be as follows:

A. For UAE Nationals

For First House/Owner Occupier, the value of the property of less or equal to AED 5 million, the LTV ratio should not exceed 80% of the value of the property, while the maximum LTV ratio is 70% for properties of more than AED 5 million.

For second and subsequent properties, the LTV ratio is set at 65% of the value of property, regardless of value.

B. For Expatriates

For first House/Owner Occupier, the LTV ratio should not exceed 75% of the value of property of less than AED 5 million, and 65% for properties of more than AED 5 million.

Money Exchange Business

The Central Bank is seeking to enhance the regulatory and supervisory framework for Money Exchange Business in the UAE, to ensure the continued development of this sector in a planned and prudent manner. An extensive internal study of the money exchange sector was carried out in 2014 and 'Regulations re Licensing and Monitoring of Exchange Business' were issued in the first quarter of the year. The new regulations are designed to protect both the institution and the consumers alike and ensure that risks in the business are properly managed within a well-defined control framework.

Other regulatory developments

Following an extensive analysis of the banking regulatory and supervisory oversight framework conducted at the Central Bank, gaps were identified in comparison to international best practice. The work plan which was set-up as a result covered the liquidity requirements for banks as well as the capital requirements.

Liquidity requirements for banks

The prudent management of liquidity is vital to the proper functioning and resilience of individual banks and the banking sector as a whole. In order to enhance the prudential liquidity framework for banks operating in the UAE, the Central Bank is currently in the process of finalizing new liquidity regulations. The regulations emphasize the need for each bank to have in place a proper liquidity risk management framework to minimize the likelihood of a liquidity stress occurring and also minimize the impact on the bank should such a stress occur.

In developing such a framework, the Central bank will require each bank to hold sufficient liquid assets that are of the highest quality to ensure that they will be able to meet their individual liquidity needs on an on-going basis, especially in a stress scenario.

The draft regulations take account of the direction of the reforms regarding liquidity regulation and the timescales set out by the Basel Committee on Banking Supervision in its publication entitled *'Basel III: International framework for liquidity risk measurement, standards and monitoring'* which was issued in December 2010, the subsequent publications entitled, '*Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools',* issued in January 2013 and '*Basel III*: *the net stable funding ratio*, issued in October, 2014.

The Central Bank has issued these draft regulations for consultation. It is intended to closely engage with all banks to ensure a smooth implementation of the new liquidity regulations from 2015 onwards, taking into account the Basel III implementation dates and the transition provisions for approved banks.

Capital requirements for banks

In order to maintain and enhance the strength and resilience of the UAE banking sector, the Central Bank is revising the regulatory capital requirements for banks operating in the UAE.

The new capital regime will be aligned with the Basel III capital framework and will include requirements for enhanced capital in terms of quality and quantity, the introduction of capital buffers and the application of a new leverage ratio. The definition of capital will also change with a higher emphasis on paid-up capital, retained earnings and disclosed reserves.

In accordance with Basel III, the timeframe for full implementation of the new capital regime is end 2018. The Central Bank intends to begin the engagement process with banks towards implementing the new capital regime, including consultation on the new regulations, in 2015.

Risk Management

Risk management, together with internal control, compliance and audit comprise key control functions in a financial institution. These control functions are an essential foundation for effective corporate governance. The Central Bank is in the process of reviewing and upgrading its regulations on risk management, internal control and financial reporting/external audit. The objective is to ensure that financial institutions' approach to the control and management of risk is in line with leading international practice. It is intended that this program of work will commence in 2015 and continue into 2016.

Regulatory Consistency

As part of the regulatory enhancement program the Central Bank is seeking to build consistency and transparency in the development, implementation and enforcement of the regulations for licensed financial institutions. To this end, work is underway to develop a definitive library of all regulations, categorized by sector and risk area that will be publicly available. It is intended that as new regulations come on stream, existing circulars, notices etc. that no longer apply will be withdrawn.

Islamic Banks

Islamic banks are exposed to specific risks, including: (1) compliance risk, since inadequate compliance with Islamic Sharī'ah law could lead to depositors' loss of confidence, (2) equity investment risk which arises from entering into a partnership for the purpose of undertaking or participating in a business activity and in which the provider of funds shares the business risks, (3) the rate of return risk which arises when an increase in benchmark rates results in expectations of higher rates of return on investment accounts, even though the actual rate cannot be exactly determined until the end of the investment holding period, and (4) displaced commercial risk which arises when an Islamic Bank is under pressure of paying its investment account holders a rate of return higher than what would be payable by another bank.

Therefore, Islamic banks need a prudential framework that address their specific risks as well as the governance challenges they face, including safeguarding the interests of investment account holders and defining the role of Sharīʼah compliance governance.

In 2014, the Central Bank conducted a joint study with Dubai Islamic Economy Development Centre on models of Sharīʼah boards which culminated in a proposal to establish a national Sharīʼah Authority in the UAE. The proposal was later reviewed by the Board of Directors at the Central Bank, which decided to form a Joint Committee with the UAE Banks Federation, in order to develop a charter, including terms of reference and operational process for the Authority.

Anti-money Laundering

The Anti-money Laundering Suspicious Case Unit (AMLSCU) is the Financial Intelligence Unit (FIU) of the UAE. It is the sole national center for receiving, analyzing, and disseminating suspicious transaction reports (STRs) filed by banks and other financial institutions and designated non-financial businesses and professions (DNFBPs). AMLSCU links the private and the public sectors in combating money laundering, terrorist financing and proliferation.

AMLSCU is also empowered to exchange information on suspicious transactions with its counterpart FIUs and provides training, technical assistance and guidance on evolving standards and best practices to all stakeholders with the aim to strengthen the AML/CFT framework in the country.

Major Achievement:

AMLSCU in coordination with the main stakeholders continued its effort to bridge the observed gaps in the UAE's AML/CFT framework and took the necessary measures to comply with FATF Recommendations. The Middle East & North Africa Financial Task Force (MENAFATF) plenary decided in November 2014 that UAE has fulfilled all its obligations and criteria in this regard and removed the UAE from Regular Follow-up to Biennial update. This achievement is a reflection of cooperation and coordination among the public and private entities in the UAE to complying with the evolving FATF standards for combating money laundering, terrorist financing and proliferation of nuclear weapons.

Legal Framework

The legal AML/CFT framework in the UAE has undergone the following changes in 2014:

1) Issuance of Federal Law No. (9) of 2014 regarding the amendment of some provisions of the Federal law No. (4) of 2002 on Criminalization of Money Laundering, to bring it in conformity with the FATF standards. The law was published in the Official Gazette 571, dated 30/10/2014.

   The revised law includes, among other provisions, the following:

   - The term money laundering has been replaced with, "Money Laundering, Terrorist Financing & Illicit Organizations Financing", thereby broadening its scope and application.

- The National Anti-Money Laundering Committee has been renamed as the “National Anti-Money Laundering and Combating Financing of Terrorism Committee” to reflect the mandate of the committee in line with the provisions of the revised law.
- The provision on predicate offences goes beyond the FATF recommendations as it includes any felony or misdemeanor as a predicate offence, thereby further strengthening the UAE AML/CFT legal framework. This very wide scope would also cover any further expansion in the list of predicate offences by the FATF.
- For cases related to terrorist financing crimes, the revised law stipulates that such crimes will be tried in the highest court of the land, that is, the Federal Supreme Court, reflecting its significance.
- Administrative sanctions for breach of non-compliance ranging from fines to revocation of licenses of reporting entities.

2) Issuance of Executive By-Law to the Federal law no. (4) of 2002

The 2014 Executive By-Law No. (38) has been signed by H.H. the Prime Minister of the UAE. The said By-Law has provisions on Customer Due Diligence (CDD), Beneficial Ownership, Designated Non-Financial Businesses and Professions (DNFBPs), Risk Based Approach, Compliance functions, Reporting of STRs & Record Keeping among others.

3) Issuance of the revised Anti-terrorism law titled Federal Law No. (7) of 2014 regarding combating Terrorism Offences:

The UAE issued in 2004 Federal law No. (1) Of 2004 on combating terrorism offences. The 2004 law has been expanded and the law titled Federal Law No. (7) of 2014 on combating terrorism offences was signed by H.H. the President in August 2014. The new law has strengthened UAE’s defenses against such heinous crimes.

Other Achievements of AMLSCU during 2014:

- The number of STRs received from banks and other financial, commercial & economic entities including 887 STRs on fraudulent activities, increased by of 48% to reach 4,265 STRs, of which:
- 3,896 STRs (91%) were reviewed and analyzed during the year.
- 80% of STRs were filed by banks,
- 355 STRs were referred to law enforcement authorities in the UAE, for further investigation.
- 319 search and/or freeze requests processed on 711 natural and juridical persons, received from law enforcement, public prosecution and other domestic authorities.

AMLSCU was also active in 2014 in what follows:

- AMLSCU instructed financial institutions to repatriate unauthorized transfers amounting to USD 28.89 million related to 88 cases.
- AMLSCU attended 3 sessions in courts as expert witness for the Public Prosecution in relation to financial crimes.
- AMLSCU staff attended 29 meetings of 15 Bilateral Committees established by decision of Dubai Public Prosecution for investigating money laundering and other financial crimes related to 207 STRs received by AMLSCU from different reporting entities.
- Initiated 8 special examinations of banks & moneychangers on AML/CFT compliance issues and related matters.
- Conducted 32 reviews of nominations to the board of directors of national banks.
- Processed 617 Nostro account applications for exchange companies.
- Processed 137 requests for senior management positions in banks.
- Received 392 requests for information from 79 counterpart FIUs and responded accordingly.
- Initiated 61 requests for information to 26 foreign FIUs.
- Hosted delegates from counterpart FIU~~s~~ and various other foreign stakeholders.
- Conducted workshops, seminars, meetings and other outreach programs which benefited a total of 1981 persons, representing public and private sector companies including foreign FIUs.
- Hosted 5th MENAFATF Workshop for Assessors in December 2014.
- Provided Technical Assistance on AML/CFT to the private and public sector entities including foreign authorities which benefited 540 persons.
- Provided guidance to supervisory authorities and free zones to issue/amend AML/CFT regulations, in conformity with FATF standards.
- Published the Annual Report for 2013.
- Submitted the 7th follow-up Report on the UAE AML/CFT achievements to the MENAFATF Plenary.
- Finalized system enhancement project with additional tools for analysis, which was launched in 2013, in order to make it more user friendly.
- Participated in various international, regional and domestic training programs and other capacity-building events.

AMLSCU will continue to focus on capacity building, systems development, domestic coordination, as well as regional and international cooperation in order to face the evolving ML/FT challenges, and to prepare for the next round of mutual evaluation of AML/CFT Framework in the UAE.

The Risk Bureau

In order to provide a sound business environment, which would help banks, finance companies and financial investment companies make informed decisions when extending credit facilities to their respective customers, the Risk Bureau was established in April 1982 at the Central Bank of the UAE.

The Risk Bureau provides available information on total credit facilities extended to one customer, amounting AED 500,000 or more; which was later reduced to AED 250,000 in November 1989, so as to cover the largest possible number of borrowers.

The Risk Bureau also developed a system for blacklisting customers with returned unpaid cheques, in order to encourage a higher sense of commitment amongst bank customers. In addition, a customer rating system and a database of names of bank customers who fail to honor their obligations was introduced at the Bureau in October 1998.

In May 2005, the Central Bank started "live" operations of these systems, enabling financial institutions to disclose data on their borrowing customers through their own terminals linked to the Bureau's database. This allowed continuous updating of borrower data in real time.

The volume of data made available to member financial institutions was further expanded to include, along with the total credit facilities extended to one customer from all financing sources in the UAE, the total number of securities pledged against extended loans, total provisions, and interest in suspense, the lowest classification of extended facilities and a detailed statement of accounts related to the borrower.

Chapter Seven. Payment Systems Developments

Introduction

Payment systems comprise the cultural, political, legal, economic and business practices and arrangements used within a market economy to determine, store and exchange value or ownership of goods and services. In its simplest form, a payment either stems from a trade between buyers and sellers in a market, or from a financial obligation.

Payment systems can be modelled in three major segments:

- The instruments used to deliver payments
- The clearing and settlement process involved in a payment transaction, and
- The actual transfer of funds between institutions

The UAE's payment systems have evolved over the years, driven by technological progress, changing consumer needs and development of new financial activities. It evolved over the years from paper and cash-based transactions to a diverse range of cashless payment instruments, and efficient and reliable clearing and settlement systems that serve both retail payments, small value payments (SVP), and large value payments (LVP).

Payment Methods & Instruments

Cash

Like most countries, currency remains the most accepted means of payment medium for small value transactions in the UAE. CBUAE has the sole right to issue currency and coins in the UAE. Notes in circulation are denominated in AED 5, AED 10, AED 20, AED 50, AED 100, AED 500 and AED 1,000. Coins are issued in denominations of AED 0.01, AED 0.05, AED 0.10, AED 0.25, AED 0.50 and AED 1.00. Arab Emirate Dirhams (AED) in circulation is fully backed by various investments.

Cheques

Cheques are commonly used in the UAE by consumers for bills and small value payments and among businesses for regular payments such as purchases of goods and services. In 2014, the CBUAE processed over 32 million cheques worth AED 1.6 trillion. In the UAE, the majority of the cheques issued are valid for no more than six months from the date indicated on the cheque.

Electronic Funds Transfer (EFT)

In an EFT, the payer instructs his bank to debit his account and transfer the fund to the payee. In the UAE, credit transfers can be originated for any of the pre-determined reasons. Payroll crediting is the most common direct credit transfer. Some banks have recently offered direct credit services to their individual customers, mainly through Internet banking and ATMs (Automated Teller Machines). These individual instructions are processed together with the bulk credit instructions for that day. In 2014, a total of 20 million SVP transactions for a total value of AED 2.45 trillion and 400 thousand LVP transaction for a total value of AED 6.24 trillion were processed.

Direct Debits

Direct Debits is another variation of the electronic funds transfer. In debit transfers, the payee instructs his bank to collect payment from the paying party, often on a recurring basis. Direct Debit payments are pre-authorized by the paying customer, who gives permission to his bank to debit his account upon receipt of instructions initiated by the specified originator. Examples of such pre-authorized recurring payments include utility bill payments or payments for telecommunication services. CBUAE has mandated that all loans advanced to customers, both individual and juridical must be repaid only by way of direct debits. Direct Debits as a payment method was introduced in the UAE in the year 2013.

Debit Cards

Debit cards allow cardholders to make payments or withdraw cash from their deposit accounts through an Automatic Teller Machine (ATM) or an Electronic Funds Transfer at Point of Sale terminal (EFTPOS). The payment or cash withdrawal is effected through an on-line transfer of funds from the cardholder’s account. VISA Electronic card, Debit Master Card and UAESWITCH Debit Cards are examples of debit cards in the UAE. A total of 7.73 million debit cards were reported as issued by the banks as of December 2014.

Credit Cards

All major credit cards are offered in the UAE. The issuance of credit cards is subject to guidelines and regulations as provided by the card scheme. CBUAE issues guidelines and regulations on credit card related issues such as the eligibility criteria of card applicants and marketing of credit cards. A total of 3.85 million debit cards were reported as issued by the banks as of December 2014.

Automated Teller Machines (ATM)

Automated Teller Machines (ATM) are one of the channels that allow banks' customers to perform routine banking transactions without having to visit a bank branch. The first ATM in the UAE was installed in the 1980's. Since then, many banks have followed suit, installing their own models of ATMs. Most of the ATMs installed in the country are interlinked through the UAESWITCH. Since their introduction, ATMs have played a major role in promoting a cashless society and in bringing greater convenience to customers. ATMs allow consumers greater ease in making deposits to and withdrawals from their bank accounts. The first ATM in the UAE was installed by Mashreq (earlier known as Bank of Oman Limited). In addition, ATMs also provide other services such as shares applications, third party funds transfers, and bill payments. As of the end of December 2014, there were 4,847 ATMs in the UAE, representing a penetration rate of about 600 ATMs per million inhabitants (assuming a total population of around 8 million).

Point of Sale (PoS)

The development of the UAE as a cashless society was boosted by the introduction of the POS service by 3 major local banks. POS is a card based retail payment system allowing a cardholder to use his/her debit/credit card to pay a merchant for the purchase of goods and services. A total of 105 thousand PoS terminals are installed across the UAE as of December 2014.

1. Payment and Settlement Systems & Participation

ATM Switch (UAESWITCH)

The UAESWITCH is designed to act as a switch for Electronic Funds Transfer (EFT) and authorizations for DEBIT (ATM) cards. It allows groups of institutions to provide a wider area of service to their customers by sharing their card processing facilities. Therefore, customers will not be restricted to use terminal devices owned by their own card issuing institution, as they can use any terminal device that is connected to the network. The basic purpose of the UAESWITCH is to allow member institutions the ability to authorize the transactions of its customers initiated at other UAESWITCH bank locations. In addition, a switch can communicate with other "remote" switches to further broaden the area in which institutions can offer customers their services.

A transaction acquirer is the bank (as opposed to a particular bank branch) that receives the transaction from a card acceptor. Usually, the acquiring bank controls a network of directly connected terminal devices in its branches, but it may also control bank sponsored merchant terminal devices.

An acquirer bank's transaction processing system will process its own customer's transactions ("on-us" transactions) and will forward all other bank customer transactions ("not-on-us" transactions) to the switch. The UAESWITCH operates 24/7 all year round. Settlement of the transactions between acquirers and issuers is executed on a daily basis in the respective accounts held in the books of CBUAE.

The Central Bank of the UAE implemented the enhancements required to accept and process cards issued by "China Union Pay" across all UAE ATMs, thereby enabling tourists from China to easily withdraw funds using their cards. The acceptance of the cards is currently being tested out by the participating banks and will be fully implemented in early 2015.

2- Image Cheque Clearing System (ICCS)

The objective of the Image Cheque Clearing System is to allow for the truncation of cheques at the point of acceptance whilst providing a safe, secure, efficient and robust payment mechanism in the United Arab Emirates. Banks will settle cheques issued on accounts held by them on the basis of electronic images of these cheques. The ICCS reduces the dependence of the payment infrastructure on the physical movement of paper, and therefore facilitates shorter clearing and settlement cycles. It also facilitates quicker realization of funds on these items. Cheques deposited at the teller counters at any bank-branch by 10am get cleared at 4pm on the same day. Banks are mandated to afford credit to the depositors account at the latest by 6pm on the same day.

The model adopted by CBUAE is one where a cheque envelope (CE) encapsulates the images of the individual items. A Presenting Bank generates the CE for delivery to the Issuing Bank. CBUAE plays the vital role of ensuring that delivery and settlement happen in a timely, predictable and efficient manner. CBUAE is the Clearing House for all cheques, acting as the intermediary for all data and image flow between the collecting and paying bank.

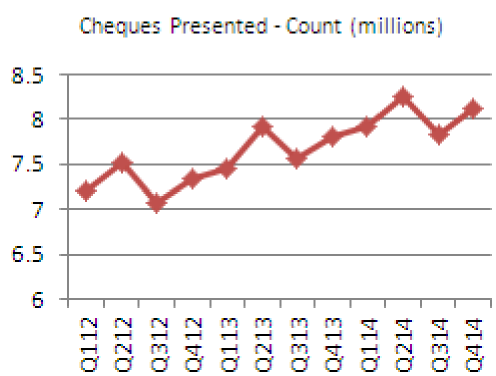
CBUAE also acts as the national central archive for all items delivered via the Image Cheque Clearing System (ICCS). The ICCS Cheque Archive is available to all banks, providing access to the images of cheques cleared via ICCS. Individual items within the archive will be available to the Presenting Bank, the Issuing Bank and the Clearing House.

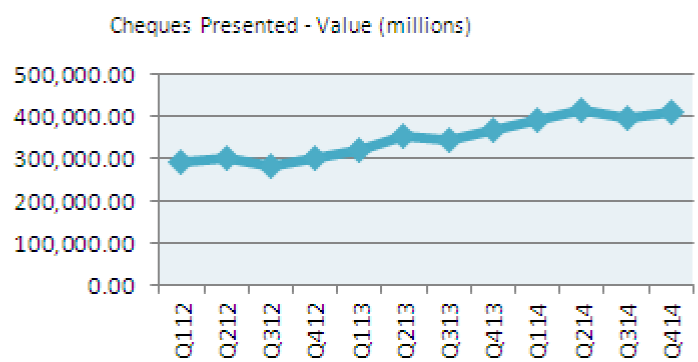
The ICCS has 82 Direct Participants (56 BANKS, 22 Ministries, 4 Non-Banking Finance Companies) and clears an average of about 2 million items per month.

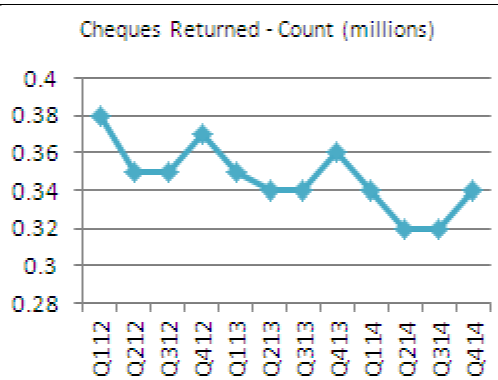
Table-7.1. Image Cheque Clearing Statistics

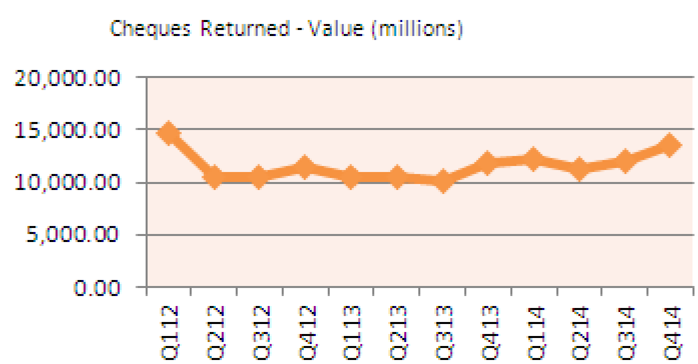
In millions

	Cheques Presented		Cheques Returned		%CHANGE		%RETURNS	
	Count	**Value**	**Count**	**Value**	**COUNT**	**VALUE**	**By Count**	**By Value**
2012								
Q1	7.20	290,858.90	0.38	14,588.71	-0.4%	-17.1%	5.3%	5.0%
Q2	7.52	300,397.69	0.35	10,428.27	4.5%	3.3%	4.7%	3.5%
Q3	7.08	282,863.92	0.35	10,562.68	-5.9%	-5.8%	5.0%	3.7%
Q4	7.35	299,308.45	0.37	11,475.58	3.9%	5.8%	5.1%	3.8%
2013								
Q1	7.46	320,870.84	0.35	10,500.09	1.5%	7.2%	4.7%	3.3%
Q2	7.91	350,683.37	0.34	10,436.34	5.9%	9.3%	4.3%	3.0%
Q3	7.56	343,726.49	0.34	10,020.55	-4.4%	-2.0%	4.5%	2.9%
Q4	7.80	367,021.28	0.36	11,842.11	3.1%	6.8%	4.6%	3.2%
2014								
Q1	7.93	392,742.85	0.34	12,189.58	1.7%	7.0%	4.3%	3.1%
Q2	8.25	412,039.89	0.32	11,154.21	4.2%	4.9%	3.8%	2.7%
Q3	7.84	395,717.24	0.32	11,917.48	-5.0%	-4.0%	4.1%	3.0%
Q4	8.12	407,912.42	0.34	13,556.27	3.6%	3.1%	4.2%	3.3%









Cheques presented in the ICCS for clearing and settlement may be returned by the issuing bank. Whilst lack of funds in the payer's account constitutes the bulk of no pay responses, cheques are also returned unpaid due to lack of proper scrutiny by the presenting banks and/or the issuing banks. With a view to reducing the quantum of no pay responses due to technical reasons, CBUAE implemented the process of tracking and levying non-compliance fees on the participant institutions. All no pay responses are tracked on a daily basis and responsibility for having presented such items into clearing is assigned to either the issuing or presenting participant.

Cheques issued in the UAE carry details of the account, bank, branch and sequence number of the item in an internationally acceptable machine readable format called MICR E13B. The bank branch identifier on the MICR code line is referred to as the Routing and Transit Number (R/T). The R/T incorporated in the MICR code line of the cheque in the UAE is composed of 4 pieces of information as depicted below:

The R/T has the capability of accommodating up to 999 institutions in ICCS for clearing and settlement. However, since its inception in 1994, the system was designed to accommodate only 99 institutions.

Starting 1st November 2014, the system has been enhanced to allow up to 999 institutions to participate in the ICCS. This change was necessitated due to the interest expressed by the Non-Banking Financial Institutions to participate in ICCS as a presenting institution.

3- Real-time Gross Settlement System (UAEFTS*)*

The UAE Funds Transfer System (UAEFTS) is the Real Time Gross Settlement (RTGS) system of the United Arab Emirates, hosted by the Central Bank of the UAE. The system has been operational since August 25, 2001. The latest edition, UAEFTS 3.0, has been functioning since March 2012. The system facilitates the transfer of funds between banks and other financial institutions in the UAE via their accounts held with the Central Bank. The objective is to provide a system that enables entities of all sizes to participate, irrespective of their size or nature of business.

All RTGS transfer requests submitted by participants are queued for immediate action by the system. Processing and final settlement of transfer instructions take place continuously, in real time. Transfers are settled individually without netting debits against credits. Authorized users of the requesting participant can review the status of their requests throughout business hours. Once a transfer request is processed, the system sends it to all participants affected by the transfer. Payment instructions are irrevocable and final.

The UAEFTS provides full straight through processing (STP) of payment requests by enabling processing of prescribed message formats using Secure File Transfer Protocol (SFTP). In addition, this UAEFTS also allows for messages to be keyed-in using a web-browser interface named the UAEFTS Transactions & Enquiry Portal (TEP). As of December 2014, a total of 108 entities participate in the UAEFTS (52 Banks; 22 Ministries; 4 Non-Banking Finance Companies (NBFC) and 47 Exchange Houses). UAEFTS processes more than 1 million customer credit transfers and about 3,500 institutional credit transfers, monthly.

Table.7.2. Funds Transfer System (UAEFTS)

	Customer Transfer		%Change		Institutional Transfers		%Change	
	Count (in millions)	Value (in billions of Dirhams)	Count	Value	Count (in thousands)	Value (in billions of Dirhams)	Count	Value
2012								
Q1	2.17	85.58			491.15	2,021.02		
Q2	3.01	400.80	39.14%	368.31%	96.25	1,213.14	-80.40%	-39.97%
Q3	3.40	419.94	12.93%	4.77%	96.87	1,360.55	0.64%	12.15%
Q4	3.85	480.16	13.07%	14.34%	95.36	1,359.06	-1.56%	-0.11%
2013								
Q1	4.06	490.39	5.53%	2.13%	92.09	1,325.30	-3.43%	-2.48%
Q2	4.29	545.53	5.53%	11.24%	93.03	1,570.34	1.02%	18.49%
Q3	4.34	520.75	1.25%	-4.54%	92.39	1,659.30	-0.69%	5.66%
Q4	4.65	544.28	7.08%	4.52%	93.63	1,469.34	1.34%	-11.45%
2014	4.86	576.42	4.49%	5.90%	96.43	1,394.63	2.99%	-5.08%
Q1								
Q2	5.13	628.69	5.55%	9.07%	103.19	1,597.31	7.01%	14.53%
Q3	5.16	581.81	0.63%	-7.46%	101.96	1,533.67	-1.19%	-3.98%
Q4	5.55	666.09	7.57%	14.49%	108.94	1,716.49	6.84%	11.92%

4- Direct Debit System (UAEDDS)

The Direct Debit System is yet another strategic initiative from the Central Bank. The introduction of the Direct Debit System is a step in the right direction towards increasing the efficiency of the UAE banking system, and elevating it in line with the global best practices, thereby strengthening the country's status as a global financial hub.

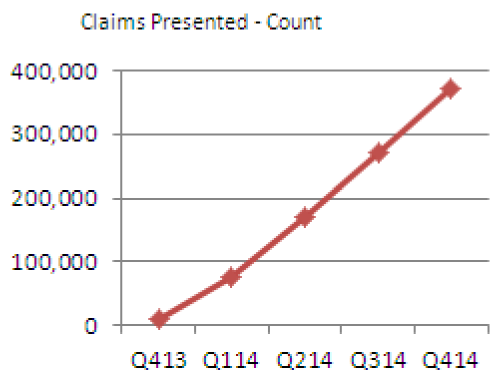
A Direct Debit is a safe and convenient method of making payments and is ideally suited for regular payments with fixed or variable amounts. A direct debit instruction can be setup by submitting a signed Direct Debit Authority (DDA) to the service provider. Once a DDA has been successfully set-up then the payments are made automatically by the customer's bank from the account designated by the customer in the DDA, upon receiving a request through the UAEDDS from the creditor.

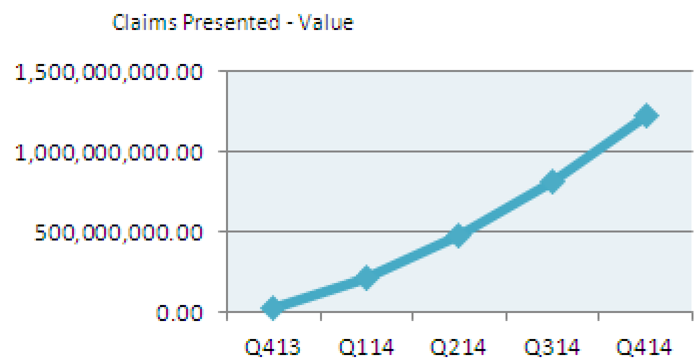
The adoption of the 'Direct Debit System' has been mandated for all loans and finances granted by banks and finance companies. The facility is designed to eliminate the need to sign several post-dated cheques for instalments upon obtaining a loan/finance, allowing banks and finance companies to reduce their reliance on post-dated cheques. Monthly instalments can be claimed by using the Direct Debit Request.

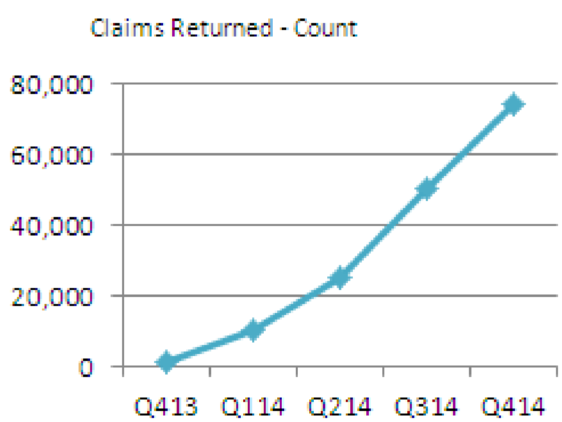
The subsequent phases of the 'Direct Debit System' will facilitate payments towards services such as electricity, water, telecom, credit card dues and insurance premiums. With the proper adoption of the 'Direct Debit System' by service providers, a substantial reduction can be achieved on the need for paper based payment instructions for recurring payments.

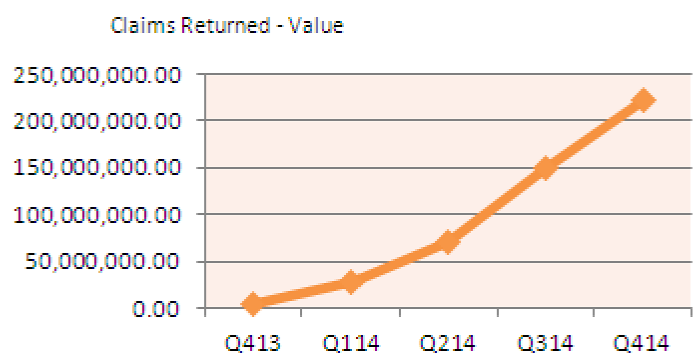
Table 7.3. Direct Debit System (UAEDDS

	Claims Presented		Claims – No-Pay Response		% CHANGE		% No Pay Response	
	Count	Value (in millions of Dirhams)	Count	Value (in millions of Dirhams)	COUNT	VALUE	By Count	By Value
2013								
Q4	9,305	25.6	1,375	3.8				
2014								
Q1	74,654	210.2	10,396	28.0	702.3%	720.9%	13.9%	13.3%
Q2	168,714	478.0	25,293	70.1	126.0%	127.4%	15.0%	14.7%
Q3	269,455	818.6	50,590	148.6	59.7%	71.3%	18.8%	18.2%
Q4	372,585	1,225.0	74,243	222.1	38.3%	49.6%	19.9%	18.1%









5- Wages Protection System (UAEWPS)

The Wages Protection System (WPS) was implemented at the CBUAE to meet the desired objectives of the Ministry of Labour (MoL). The objective of UAEWPS is to provide a safe, secure, efficient and robust mechanism to streamline the timely payment of wages to employees. The UAEWPS has been adopted by other authorities in the UAE such as Economic Zones World (EZW).

The model adopted by CBUAE is one where information flows from the employer to one or more of the contracted agents for payment of the wages to their employees. Funds from the employers are secured by CBUAE prior to dispatching the wage information to the agents.

The system empowers CBUAE, and thereby the LRA, with the functionality that would allow effective monitoring of the payment of wages by the employers to their respective employees.

The UAEWPS has been processing salaries since 1st of October 2009. As at the end June 2013, a total of 108 Entities participate in the UAEWPS (52 Banks, 4 Non-Banking Finance Companies (NBFCs), 5 Third Party Service Providers and 47 Exchange Houses).

Table 7.4. Wages Protection System (UAEWPS) Statistics

Year	Employers (in thousands)	Employees (in millions)	Salaries (in billions of Dirhams)	Returns	Returns	Percent Change from Previous Quarter			
						Employers	Employees	Salaries	Returns
2012									
Q1	453.46	9.22	30.55	0.09	0.29%	1.77%	0.29%	1.61%	-34.23%
Q2	464.02	9.46	31.33	0.04	0.12%	2.33%	2.58%	2.57%	-57.10%
Q3	469.98	9.58	31.01	0.04	0.13%	1.28%	1.30%	-1.03%	9.30%
Q4	505.26	10.14	33.90	0.03	0.08%	7.51%	5.82%	9.31%	-32.43%
2013									
Q1	517.24	10.02	35.23	0.03	0.08%	2.37%	-1.16%	3.93%	5.11%
Q2	530.05	10.17	36.18	0.02	0.07%	2.48%	1.46%	2.70%	-18.27%
Q3	524.53	10.08	36.11	0.03	0.07%	-1.04%	-0.87%	-0.19%	10.06%
Q4	531.73	10.53	39.38	0.03	0.07%	1.37%	4.49%	9.05%	2.91%
2014									
Q1	536.16	10.32	40.46	0.03	0.08%	0.83%	-1.99%	2.75%	26.06%
Q2	555.26	10.78	42.13	0.03	0.07%	3.56%	4.38%	4.13%	-19.21%
Q3	544.40	11.10	42.69	0.03	0.07%	-1.96%	3.02%	1.33%	12.48%
Q4	561.72	11.37	45.38	0.05	0.10%	3.18%	2.42%	6.30%	45.55%

Domestic remittance between customers is facilitated using UAEFTS. In the interest of improving customer service and traceability of transactions, CBUAE implemented in 2014 Q4 a mandate for beneficiary institutions to confirm applying credits to beneficiary accounts. After a successful testing for a period of 3 months, the feature was implemented on the 1st of November 2014. With the introduction of this development, remitting banks (and therefore their customers) are provided information regarding the progress of the transactions propagated by them to the beneficiary institutions. More than 80% of the transactions are confirmed by the beneficiary institutions within the same day. The CBUAE also applies a financial hold on the account of the beneficiary banks for those transactions that are not confirmed to be applied to the customer accounts.

CBUAE continuously strives to improve the payment systems across all facets such as ease –of-use, efficiency, reliability, security and cost-effectiveness. The efficiency of all payment and settlement systems depends on customers, both individual and juridical keeping information about themselves constantly updated in the records maintained by their banks. One of the key pieces of information that needs to be updated by the individual customers is their “Emirates ID” number. This will ensure that their transactions are processed in a timely manner without delays.

From a retail consumer perspective, the cost of transferring funds using the UAEFTS is set to decrease sharply from a current maximum of AED 50 to a maximum of AED 6. CBUAE has mandated all the participants to ensure that all funds transfer instructions secured using on-line channels costs the individuals a total of AED 2 and those secured and executed using non on-line channels costs a maximum of AED 6. The time window for ordering credit transfers by the originator is also set to increase in 2015. Banks are gearing up to accept and process credit transfer instructions from customers up until 3 pm through online channels.

Payment Systems Oversight Unit (PSOU)

Over the last decades, the payment systems worldwide witnessed a plethora of new products, services and players in an ever-competitive market-place, due mainly to the introduction of the credit card, the internet and mobile technology.

The UAE, as an open and competitive economy, was part of this technological change. In addition to the payment and transfer systems developed in-house at the Central Bank, there is the Emirates ID card, the Ministry of Finance's eDirham card and the RTA's Nol card.

The Central Bank, as the main regulator of the banking sector in the UAE, developed a body of regulations defining roles, responsibilities and the terms of doing business in an accurate efficient and secure way. The main challenge in this regard was to strike the right balance between the safety of payment systems, efficiency, innovation, fair competition and consumer protection.

The Central Bank established the Payment Systems Oversight & Information Security Unit in 2008 to ensure the safety and efficiency of payment systems in the UAE. In carrying out its tasks, the Unit applies the Core Principles published by the Bank for International Settlements (BIS). The main purpose of these Principles is to avoid systemic failure through the proper management of legal, credit, liquidity and operational risks.

The work of the Unit has evolved over time. It is now responsible for the Central Bank's Information Security Policy, its Disaster Recovery planning, in addition to the implementation of the BIS's revised Core Principles published under the aegis of Financial Market Infrastructure (FMI). These new FMI Principles are both broader and deeper than the original Core Principles.

In November 2014, a committee was set up at the Central bank to review the emerging payments landscape, formulate a national vision in this regard, including a regulatory framework for digital payments in the UAE. The committee has invited proposals from expert consultants with a view to submitting formal recommendations in this respect by the end of April 2015.

Chapter Eight: Central Bank Strategy and Consumer Protection

I. Central Bank Strategy and Performance

The purpose of the Central Bank Strategy adopted during 2014 is to be consistent with the UAE Vision 2021 and the Federal Government Strategy. In this regard, the Central Bank adopted initiatives and programs that support a competitive, knowledge-based economy. Preparations for the Strategic Plan 2014 – 2016 were initiated in September 2012, and revised through consultation with the senior management and representatives of the staff. Finally, an agreement upon the Plan was reached during a two-day strategic meeting held at Al Ain under the chairmanship of H.E. the Governor.

The Strategic Plan 2014 – 2016 included 16 strategic indicators for the five strategic goals of the Central Bank. In addition, 64 Central Bank services were identified and improved based on the result of customers' satisfaction. In the same context, the Operational Plan 2014 included 41 initiatives adopted to improve institutional performance. Such initiatives are subject to a follow- up and their respective achievements are being regularly measured through 240 operational indicators.

Monetary and Reserve Management Department, Banking Supervision Department and Banking Operations and Payment Systems Department provided 16 services, 19 services and 29 services, respectively. The ratios of customer satisfaction regarding such services and employee satisfaction amounted to 75% and 66%, respectively.

In order to provide the highest quality of services, the Central Bank, through its various departments and divisions, adopted several improvement initiatives, which included 6 initiatives at Monetary and Reserve Management Department, 4 initiatives at Banking Supervision Department, 3 initiatives at Anti-Money Laundering and Suspicious Cases Unit and 10 initiatives at Banking Operations and Payment Systems Department, in addition to 18 administrative initiatives for ensuring the provision of highest quality services, hiring and retention of qualified staff and better use of the Central Bank human resources.

By the end of 2014, 81% of the Strategic Plan 2014 targets and 87% of the targets of the Operational Plan and Performance Indicators of Government Enablers have been achieved. Accordingly, 84% of the Central Bank Strategy was achieved. In this regard, the Central Bank's Strategic Planning team was keen to review the results of the Strategic and Operational Plans and to cooperate with concerned departments and divisions to develop initiatives and enhance the effectiveness of the Central Bank's performance.

During 2014, Strategy and Organization Excellence Division exerted tremendous efforts for setting the Central Bank's institutional excellence enablers through the development of 34 methodologies related to administrative work restructuring and organization. In addition, the Division held workshops for all employees and various staff categories at the Central Bank to raise awareness regarding institutional excellence criteria and the importance of providing outstanding government services. The Central Bank participated also at the third cycle of Mohamad Bin Rashed Government Excellence Award, part of Sheikh Khalifa Government Excellence Program, through the submission of 12 participation files. The Cabinet Office decided to include one of those files in the finals for the selection of the best three participations at the national level.

In addition to coordination with strategic partners, the Central Bank was always keen to participate to numerous community events which enhance the role it plays in society and spread awareness regarding its vision, mission, conformity with UAE Vision 2021 and in compliance with the directives of HH Sheikh Mohamad Bin Rashed, Ruler of Dubai, UAE Prime Minister, to improve public service and adopt effective communication strategy in this regard. The Central Bank therefore held numerous events during 2014 such as the celebrations of UAE Humanitarian Work Day, National Day, Flag Day and Mother's Day, in addition to participation at "Thank You Protectors of the Country" Initiative, Compassion Campaign, and others.

II. Consumer Protection

In 2012, the Consumer Protection Division (CPD) was established as part of the Banking Supervision Department (BSD), consistent with the new organizational structure of the Central Bank; a Consumer Service Center was affiliated to it. The latter receives clients of banks and financial institutions licensed by the Central Bank who wish to submit complaints or have enquiries regarding their services. The Center received 8,483 visitors in 2013 and 15,118 visitors in 2014, i.e., about 40 persons per day in average. The significant increase in 2014 is due to the opening of similar centers at the Central Bank branches in other Emirates.

CPD aims at ensuring a fair, transparent, honest and sincere treatment of clients when they deal with financial institutions, they encounter when dealing with affordable and high quality services provided in line with the Central Bank regulations. CPD also contributes to the development of regulations related to its mandate.

The Central Bank aims at increasing financial awareness among customers as well as owners of small and medium size enterprises, so as they understand their rights and obligations when executing financial transactions, taking into account the risks they encounter when dealing with financial services.

An integral strategy for this purpose was initiated in 2014 through the following initiatives:

- Participate at awareness exhibitions which are annually organized by various government entities.
- Publish an introductory brochure which introduces consumers to their rights and obligations regarding banks and other financial institutions and the way to submit complaints when needed.
- Disseminate financial culture by welcoming visits from schools and universities to the Central Bank.
- Post videos on the Central Bank website presenting true stories, such as temptations, credit card risks, and rules for personal loans.

In addition, CPD launched a new and highly developed online complaint management system (OCMS) in 2014, through which complaints, requests and comments are received, and referred to concerned banks and other financial institutions reviewed by OCMS team. Concerned clients are noticed about actions taken in their regard.

Registered complaints decreased by 32%, from 9,898 complaints in 2013 to 6724 complaints in 2014.

Table. 8.1. Shows that all the shares of all types of complaints increased in 2014 while complaints regarding early settlement fees, mostly related to Islamic banks, dropped from 1,423 complaints in 2013 to 451 complaints in 2014.

Table. 8.1. Complaints Received by the Customer Service Centre

Types of Complaints	2013		2014	
	Number	Percentage	Number	Percentage
Request for Documents (Liability Letter, Clearance Letter, Contract & Agreements, Account Statements)	1744	18%	1353	20%
Credit Cards (Charges & Fees, Interest)	1181	12%	946	14%
Personal Loans (Outstanding Balance, Charges & Fees, Deferment of installments)	884	9%	725	11%
Early Settlement Fees (Outstanding Balance-Islamic Banks)	1423	14%	451	7%
Charges & Fees	428	4%	342	5%
Sub Total	5660	57%	3817	57%
Others Examples: (Rescheduling, Delay in cheque clearing, EOSB, Open/ Closure of account, Request for consolidation, Top up, credit rating, ATM)	4238	43%	2907	43%
Total	9898	100%	6724	100%

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