Quarterly Economic Review

Second quarter 2020

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List of Abbreviations

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

Executive Summary

Global economic growth for the year 2020 was revised downward to –4.9% as the Covid-19 pandemic continued to have a more persistent impact on economic activity (IMF's *World Economic Outlook*, June 2020). Developed economies are expected to have a significant contraction, with negative real GDP growth of -10.2% in the Eurozone and the UK, followed by the US (- 8.0%) and Emerging and Developing Economies (- 3.0%). The large contraction is mainly due to a slump in Q2 when some activities were grounded to a halt as a result of widespread lockdowns, and a halt in business travel and tourism activities.

In the UAE, many activities shut down in March, and the situation further deteriorated in the second quarter, resulting in negative real GDP growth in Q2 estimated at -7.8% Y-o-Y and -9.3% for the non-hydrocarbon sector. As the economic activity is expected to improve subsequently, non-energy GDP contraction is projected at -4.5% for the year 2020 as a whole. Meanwhile, employment declined on average in the second quarter, while marking almost a full recovery in June 2020.

Y-o-Y CPI inflation remained negative at –2.3%, driven by negative inflation in non-tradables (–3.9%), owing to the decline in rents and fuel prices, subdued domestic demand, and some exchange rate appreciation vs. the currencies of the UAE's main trading partners.

Bank deposits increased Y-o-Y by 5.2%, led by an increase in GREs and private sector deposits, while credit grew by 5.8% underpinned by healthy financial soundness indicators and supported by the enhanced Targeted Economic Support Scheme (TESS) which was expanded by the Central Bank in early April.

Finally, interest rates continued their decline during the second quarter, while the spread EIBOR vs. USD LIBOR fluctuated around a declining trend. Monetary aggregates increased mostly during the quarter, which is a testament to the success of the enhanced TESS to support the most affected activities and boost the financial system liquidity.

Chapter 1. International Economic Developments

The world growth outlook was further revised downward in the second quarter due to the impact of Covid-19pandemic, while inflation remained subdued. Major central banks, particularly the Fed and the Bank of England, kept their policy rates at near zero, in tandem with unprecedented liquidity injections.

1.1 Economic growth

The world growth outlook for the year 2020 was further revised downward by the International Monetary Fund (IMF), due to the worsening fallout of Covid-19 pandemic. According to June projections of the World Economic Outlook (WEO), global growth would decline in 2020 to -4.9% from April's forecast of -3.0% (i.e., 1.9 percentage points lower). The worsening situation is due to the economic slump in Advanced Economies (-8.0%) as well as the contraction in Emerging and Developing Economies (-3.0%).

In the United States, the economy is projected to decline by 8.0% in 2020 due to an escalation in pandemic-related risks, the political deadlock in the U.S. Congress over the fiscal stimulus, uncertainty regarding the coming presidential elections, in addition to the risks associated with the escalating tensions between the United States and China.

Both, the Eurozone and the UK economies are expected to shrink by a high rate (-10.2%), due to the fact that European economies are heavily reliant on tourism and manufacturing exports, which where almost grounded to a halt as the pandemic worsened and cross-border movements were severely restricted. Meanwhile in Japan the contraction is estimated at negative 5.8% due to the fact that the containment measures are less stringent.

Table.1.1.a: Real GDP Growth in Selected Country Groups (%)

	2019	2020*	
		April	June
World Output	2.9	-3.0	-4.9
USA	2.3	-5.9	-8.0
Advanced Economies	1.7	-6.1	-8.0
Eurozone	1.3	-7.5	-10.2
France	1.5	-7.2	-12.5
Germany	0.6	-7.0	-7.8
United Kingdom	1.4	-6.5	-10.2
Japan	0.7	-5.2	-5.8
EMDEs[1]	3.7	-1.0	-3.0
China	6.1	1.2	1.0
India	4.2	1.9	-4.5
MECA[2]	1.0	-2.8	-4.7

Source: IMF, *WEO*; June 2020
*Projected
[1] Emerging Market and Developing Economies
[2] Middle East and Central Asia

Growth in the group of Emerging Markets and Developing Economies is forecast to be negative but at a slower pace of 3.0%. Some of these economies were hardly hit by the pandemic due to weak public health systems, chronic economic weaknesses and limited fiscal and monetary spaces, which limited the scope for public policy response. Therefore, the lower contraction compared to developed economies is attributed mainly to the positive growth stemming from China, which recovered faster than expected.

Quarterly data show that the negative growth for the year in developed economies is mostly the result of a large slump in the second quarter, as economic activity dried up and uncertainties remained regarding possible second waves of the pandemic, which is compromising the slow bounceback hoped for in the second half of the year.

Table.1.1.b: Quarterly data on Y-o-Y GDP Growth Rates in Selected Advanced Countries (%)

	2019			2020	
	Q2	Q3	Q4	Q1	Q2
USA	2.3	2.1	2.3	0.3	-9.5
Eurozone	1.2	1.2	1.1	-3.3	-15.0
France	1.4	1.4	1.2	-5.4	-19.0
Germany	0.3	0.5	0.4	-2.3	-11.7
China	6.2	6.1	6.0	-6.8	3.2

Source: Bloomberg

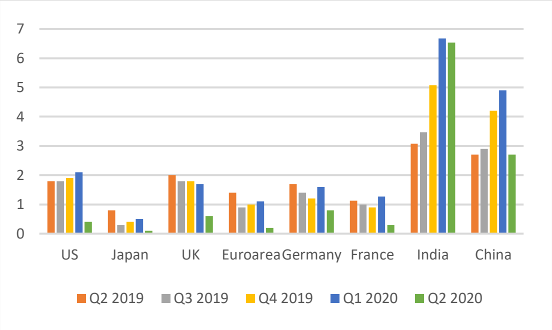
1.2 Inflation

In the second quarter, inflation remained well below the 2% target in developed countries (0.6% Y-o-Y in the US and the U.K., 0.2% in the Eurozone, and 0.1% in Japan). This reflects a combination of weak demand coupled with the effects of lower oil prices, which offset upward cost-push pressures due to inadequate supply of goods and services.

In Emerging Market Economies, CPI inflation had fallen Y-o-Y by 1.2 percentage points to reach

4.2%. The downward price pressures resulted from the lost incomes, as these economies lost access to crucial export and tourism markets, and generally lacked adequate social safety nets to support demand.

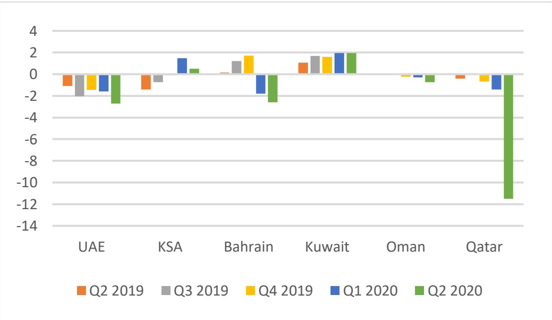
Figure 1.2.a: Y-o-Y Consumer Price Inflation for Selected Advanced and Emerging Economies (%)



Source: Bloomberg

In the GCC, CPI inflation has averaged less than 1% in the second quarter. Saudi Arabia's annual inflation rate decreased from 1.1% in Q1 to 0.5% in Q2 of 2020, before the value-added tax was tripled from 5% to 15% on the 1st of July, which is expected to boost inflation in the second half of the year. All other GCC countries, except Kuwait, experienced either very low or negative inflation.

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

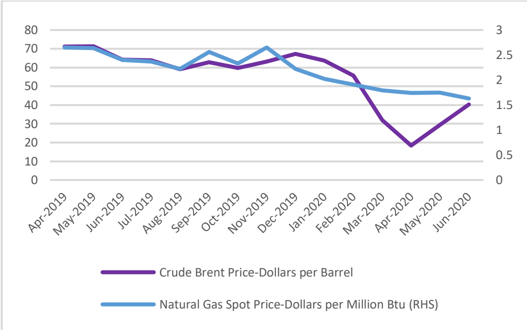


Source: Bloomberg

1.3 Commodities Prices

Robust compliance with the OPEC+ output deal reducing oil production, in tandem with a steep decline in production from other non-OPEC+ members, led by the United States and Canada, has cut world oil output by nearly 14.0 million barrels per day since April, while demand fell by 16.4 million barrels per day Y-o-Y as a result of economic slowdown and lockdowns imposed in response to Covid-19 pandemic[1]. Therefore, the price of Brent Crude declined from USD 32.0 per barrel at the end of March, to USD 18.4 per barrel at the end of April, before increasing to USD 40.3 per barrel at the end of June.

Figure 1.3.a: Crude Brent and Natural Gas Prices



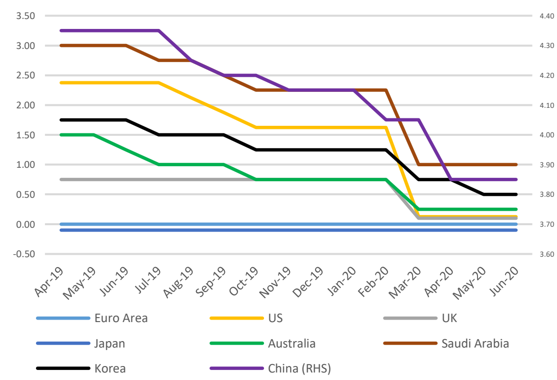
Source: US Energy Information Administration (EIA)

The price of gold soared to USD 1,800.5 per ounce at the end of Q2 (27.4% increase Y-o-Y), up from USD 1,583.4 per ounce at the end of Q1, as investors turned away from low interest deposits and depressed bond yields, seeking safety in gold.

1.4 Monetary policy

With policy rates at or near zero, in the US, the UK and the Eurozone, monetary authorities preferred not to venture into negative territory, but to purchase more bonds instead.

Figure 1.4 Policy Rates in Selected Economies (%)



Source: HAVER.

[1] International Energy Agency: Oil Market Report, July 2020.

In the U.S., the Fed kept its target Federal Funds rate unchanged at 0-0.25 % in Q2 while announcing a USD 2.3 trillion program in an effort to bolster local governments and small and mid-sized businesses.

The Bank of England voted unanimously to maintain the key bank rate at a record low of 0.1% while the size of its bond-buying program was increased from GBP 645 in March to GBP 745 billion in June. Similarly, the ECB left its policy rates unchanged while adopting Euro 1,350 billion pandemic emergency purchase program (PEPP), aiming at lowering the borrowing costs for business and increasing lending in the euro area. Additional longer-term refinancing operations (LTROs) are also conducted to provide immediate liquidity support to banks and to safeguard money market conditions.

Monetary authorities in emerging economies, meanwhile, seized the opportunity of record low interest rates in international markets to implement several rate cuts in an attempt to boost demand, in tandem with unprecedented local bond purchase programs. In Brazil, as an example, lawmakers changed the country's constitution on May 7 to allow the central bank to carry out monetary financing operations, including directly buying government debt.

Currency depreciation took also place in many countries in an attempt to limit the pressures in Forex markets, discourage imports and encourage foreign currency inflows.

Chapter 2: Domestic Economic Developments

The shutdown of many economic activities in the UAE while others slowed down significantly in March, pushed growth further into negative territory in the second quarter as a result of the continued restrictions put in place locally and globally. Meanwhile, CPI inflation rates remained negative and decreased further, reflecting the fall in rents and lower energy prices, as well as falling demand. The Dirham appreciated in nominal and real terms.

2.1 Economic Activity and Growth

During the second quarter, there was a significant decline in economic activity in the UAE due to lockdowns which started in March and continued up to May, in line with the recommendations of the World Health Organization (WHO). As a regional trade, tourism and transportation hub, the UAE economy was hit by the genetral ban on travel, while manufacturing production shrunk due to supply chain disruptions, limited export opportunities and subdued domestic demand. Overall GDP growth for the year 2020 is expected to contract by 5.2%, according to CBUAE forecasts.[2,3]

The non-hydrocarbon GDP is estimated to have declined by 9.3% Y-o-Y in the second quarter, after a drop of 2.7% in the previuos quarter. It is projected that the third quarter would register a milder contraction of the non-hydrocarbon GDP that could linger, albeit at a much milder pace, in the fourth quarter, assuming the virus is finally contained.

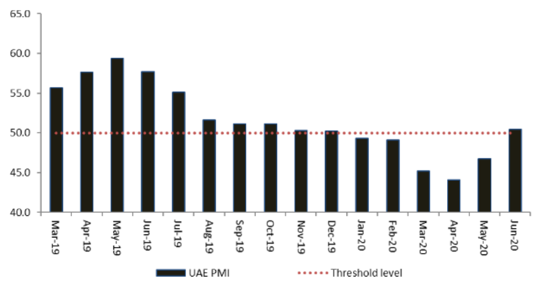
The non-energy growth is projected by CBUAE at -4.5% for the year 2020 as a whole due to the adverse implications of the Covid-19 on economic activity and sentiments, reflected by PMI, and the slowdown in credit growth. Moreover, the decline in employment across the UAE, would have further adverse implications on demand.

Forecast assumptions for the year 2020 are as follows:

- An increase in government spending averaging close to 28% in 2020, corresponding to the projected fiscal stimulus.
- Credit growth slowdown in the third quarter and to start recovering slowly after that.
- Further drop of real estate prices in the third quarter before moderating in the last quarter of the year.
- Following the drop in employment in the second quarter, a recovery is expected by the end of the third quarter to further improve in the second half of 2020.
- Following the decline of 19.2% Y-o-Y in the second quarter of the year , the expansion in the PMI in Juneis likely to further increase in the second half of the year, reflecting the improved sentiment and the preparations for the Dubai EXPO in 2021.

Furthermore, being an oil exporting and open economy, the UAE is likely to feel the fallback from reduced global demand for oil as well non-oil exports, while tourism and related services, particularly hospitality and retail trade were severely affected. In addition, Foreign Direct Investment (FDI) is assumed to fall due to the detoriaration in investors' sentiments.

Figure 2.1.a: UAE PMI



Source: IHS Markit

While the bounceback in economic activity is expected in the second half of the year,

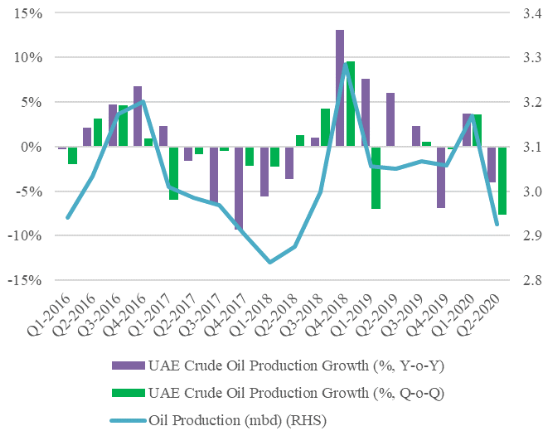
[2] Due to the high uncertainty, there might be revisions of the GDP forecasts and estimates.

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

recovery of economic sentiment will hinge on the extent of the policy support measures. The enhanced Targeted Economic Support Scheme (TESS) adopted by CBUAE and the economic stimulus packages announced by both local and federal governments are likely to boost the non-hydrocarbon activities, real estate prices, employment and credit growth with a positive impact on the overall sentiment, once the virus risks are under control (See Box 1 on UAE policy response).

As regards oil production, it increased by 3.7%, in Q1, then it fell by 4.1% in Q2, in line with the agreement by OPEC+. As a result, the UAE average oil production is projected at 2.8 million barrels per day in the year 2020 as a whole.

Figure 2.1.b: UAE Crude Oil Production Level and Growth



Source: OPEC

Oil prices are expected to further recover, given the reduced supply and pickup in global demand, which is expected to return back to its normal levels by the end of the year (see commodity prices in chapter 1).

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

Item	2019	2020		2020
		Q1	Q2	
Overall GDP	1.7%	-0.8%	-7.8%	-5.2%
Non-oil GDP	1.0%	-2.7%	-9.3%	-4.5%

Source: FCSA for 2019 and Q1 2020 and CBUAE estimates and projections for Q2 2020 and 2020 as a whole.

2.2 Developments in the Residential Real Estate Market

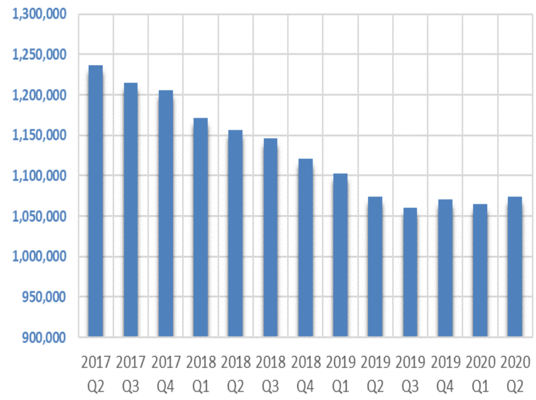
Figures for Q2 2020 may not provide a fully objective representation of the real estate market in the UAE as they do not reflect measures being taken to counter the effects of Covid-19 and to extend relief to property owners and tenants. Such measures included suspension of eviction in cases of non-payment of the rent or some owners being allowed to extend the term of the lease contract without the need to renew.

Dubai Residential Market

According to recent data from Dubai Land Department (DLD) the residential property prices in Dubai, following a Y-o-Y decrease in Q1 2020 by 3.5%, remained roughly at the same level as a year ago in Q2.

Meanwhile rents in Dubai continued their declining trend in Q2 2020. The implied rental yield[4,5] in Dubai moved to 6.3% in the second quarter from 6.5% in the previous quarter.

Figure 2.2.a: Average Dubai Residential Unit Sale Prices (AED)

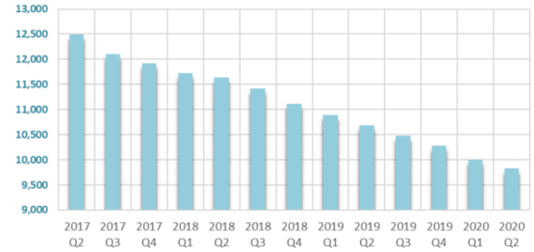


Source: DLD

Abu Dhabi Residential Market

According to the REIDIN[6] Price Index the average price in the Abu Dhabi housing market declined by 8.1% Y-o-Y in Q2 2020.

Figure 2.2.b Abu Dhabi Residential Prices (AED/SQM)



Source: REIDIN

Rents in Abu Dhabi declined by 4.9% Y-o-Y in Q2 2020, as in the previous quarter. The lower pace of decline in rents compared to prices resulted in rising rental yield to 7.1% in Q2 compared to 7.0% in the first quarter of the year.

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[4] The rental yield measures the rate of income return over the cost associated with an investment (the property price).

[5] CBUAE calculates the implied rental yield in Dubai, by dividing the annual rent by the average Dubai residential unit sale prices. Annual rent and average Dubai residential unit sale prices are provided by DLD.

[6] REIDIN Residential Price Index in Abu Dhabi covers 7 areas and 5 districts.

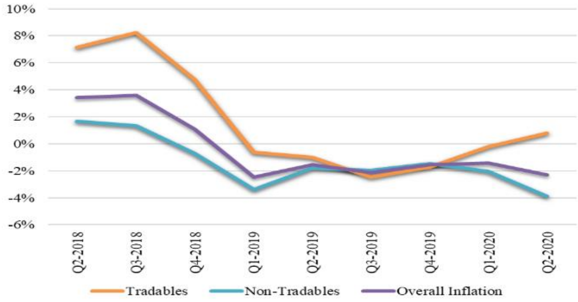
2.3 Consumer Price Index and Inflation

During the second quarter of the year, inflation remained negative in the UAE as the Consumer Price Index declined by 2.3%, on a Y-o-Y basis, compared to a drop by 1.4% in the first quarter. This was the result of an increase by 0.8% in the price of tradables[7] and a significant drop by 3.9% in the price of non-tradables[8].

Tradable prices, accounting for 34% of the CPI consumption basket, increased in Q2 owing mainly to the increase in the price of food and soft drinks; beverages and tobacco; and textile, clothing and footwear. Prices of food, beverages and tobacco increased also due to the disruption in the supply chains, while textiles and clothing prices rose significantly by 11.5% Y-o-Y, driven by the increasing import prices of raw materials, needed for their production.

The continued decline in the housing component (34% weight in the consumer basket) by 3.7% as well as the significant softening in almost all other components of the non-tradables, contributed to the higher drop in this segment in Q2, compared to 2.0% drop in Q1.

Figure 2.3: Tradable and Non-Tradable Inflation (Y-o-Y)



Source: Federal Competitiveness and Statistics Authority (FCSA)

[7] As per CBUAE calculations, tradables include the following categories of goods and services: food and soft drinks; beverages and tobacco; textiles, clothing and footwear; furniture and household goods; transportation; and miscellaneous goods and services.

[8] As per CBUAE calculations includes the following categories of goods and services: housing; medical care; transportation; communications; recreation and culture; education; restaurants and hotels; and miscellaneous goods and services.

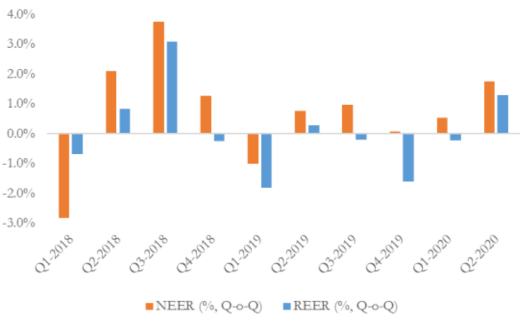
2.4 Exchange Rates and Outward Personal Remittances

2.4.1 Exchange Rate

In Q2 2020, the Dirham appreciated in nominal terms due mainly to the appreciation of the USD against the currencies of the top-10 non-dollarized import partners of the UAE, by 0.8% Q-o-Q and by 1.7% Y-o-Y. Against the currencies of the top-10 non-dollarized non-oil export partners, the appreciation was 1.2% and 1.7%, respectively.

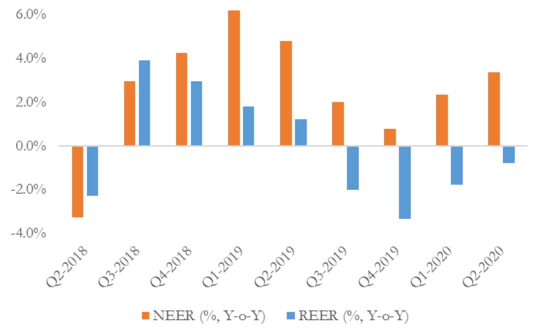
Accounting for all of the UAE's trading partners, the Nominal Effective Exchange Rate (NEER) displayed the same pattern of appreciation relative to the basket of the weighted average of the currencies of the major trading partners. In particular, the average NEER appreciated by 1.8% and 3.4% Q-o-Q and Y-o-Y, respectively, in the second quarter of 2020, compared to an appreciation of 0.5% and 2.4%, respectively, in the previous quarter.

Figure 2.4.1.a: Nominal and Real Effective Exchange Rates Developments (%, Q-o-Q)



Source: Bank for International Settlements (BIS)

Figure 2.4.1.b: Nominal and Real Effective Exchange Rates Developments (%, Y-o-Y)



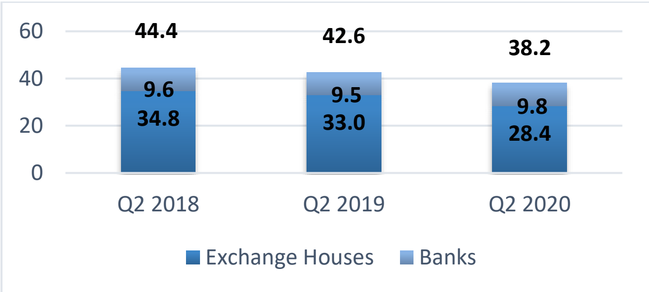
Source: Bank for International Settlements (BIS)

In real terms, the Real Effective Exchange Rate (REER), which takes into account the inflation differential between the UAE and its trading partners, appreciated by 1.3% Q-o-Q but depreciated by 0.8% Y-o-Y, in the second quarter of 2020. The depreciation in the REER in Q1 2020 was the result of the continued deflationary cycle in the UAE, offsetting the nominal Dirham appreciation. However, in Q2 2020, the strong appreciation of the NEER led to the appreciation of the REER even though the UAE inflation remained negative, during this period.

2.4.2 Outward Personal Remittances

Outward personal remittances declined by 10.3% or AED 4.4 billion in Q2 2020, compared to the same period in 2019. There was a reduction in transfers through exchange houses by AED 4.6 billion, while outward remittances through banks increased by AED 0.3 billion.

Figure 2.4.2: Outward Personal Remittances Settled Through Banks and Exchange Houses, April – June 2018-2020 (AED Billions)



Source: CBUAE

The top 5 destination countries for outward personal remittances during the second quarter were: India (34.3%), Pakistan (13%), Egypt (6.4%), Philippines (6.1%) and Bangladesh (4.8%). With the exception of Bangladesh and Pakistan, where outward personal remittances rose Y-o-Y by 7.0% and 2.1%, respectively, there was a decline by 30.6% for the Philippines, 24.1% for India, and 16.2% for Egypt.

Box 1: The UAE Policy Response to Covid-19 Repercussions

The UAE government continued to take all necessary measures to mitigate the persistent impact of the Covid-19 pandemic on the economy. To this end, the Targeted Economic Support Scheme (TESS) adopted by the Central Bank in March was further enhanced in April and August, while the federal and local governments took further initiatives to complement the stimulus packages announced during the first quarter.

Central Bank's Enhanced TESS

The CBUAE's TESS launched on the 14th March 2020 in the amount of AED 100 billion was expanded with the adoption of the enhanced scheme on the 4th of April to the amount of AED 256 billion. The main additions of the enhanced scheme included: (1) a cut by half of the required reserve ratio to 7% on demand deposits, which became effective on the 7th of April, freeing up about AED 61 billion for banks, and (2) AED 95 billion equivalent in relief through reduced liquidity requirements for banks.

Additional TESS measures were introduced by the CBUAE on the 8th of August, in relation to stable funding relief, which has further enhanced banking sector's capacity to support the UAE economy.[9] Furthermore, the Central Bank endorsed banks' progressive steps to support customers affected by the Covid-19 pandemic. The Central Bank published the names of banks that actively participated in the TESS and availed more than 50% of their allocated Zero Cost Facility (ZCF) under TESS. Up to the 18th July, 87% of the aggregate AED 50 billion ZCF were drawn down by banks, equivalent to AED 43.6 billion of allocated funds.[10]

The CBUAE has also welcomed initiatives taken by banks to support and relieve their impacted customers through their own programs and initiatives undertaken beyond the TESS.

Government fiscal support

The federal and local governments announced several initiatives, which totaled about AED 31 billion with AED 16 billion announced by the federal government, including measures such as suspension of work permit fees, reduction of labor and other charges to cut the cost of doing business and support of the Small and Medium Enterprises (SMEs).

Meanwhile, the remaining AED 15 billion announced by local governments in several packages aimed at enhancing liquidity at particularly affected activities like retail, foreign trade, tourism and the energy sector.

Other packages included initiatives such as postponing rent payments and refunding security deposits as well as reimbursement of customs and further support to the education and tourism sectors.

Fiscal and monetary authorities cooperated to support the national economy

Both fiscal and monetary authorities continue to monitor the implementation of all announced initiatives to mitigate the repercussions of the Covid-19 pandemic on the UAE economy.

[9] Press release: The Board of the CBUAE decides on additional measures within the Targeted Economic Support Scheme, on 8th of August 2020.

[10] Press Release: Minister of Economy reviews Interim Committee's efforts to deal with impact of Covid-19 on national economy, on 29th July 2020.

Chapter 3. Banking and Financial Developments[11]

Deposits at banks increased in the second quarter driven by the increase in government and private sector deposits, while credit growth grew supported by lending to Government Related Entities (GREs). The financial soundness indicators remained healthy, underpinned by the enhanced Targeted Economic Support Scheme (TESS) implemented by the CBUAE in response to the Covid-19 repercussion, thereby safeguarding the stability of the financial sector.

3.1 Banking Structure[12]

The number of licensed commercial banks remained unchanged in Q2 at 59, comprising of 21 national banks and 38 foreign banks (including 11 wholesale banks). Nonetheless, the digitization of financial services led national banks to rely less on branches, whose number decreased from 640 at the end of Q1 to 611 at the end of Q2 2020, while the number of bank Staff decreased by 415 to reach 35,423 employees.

3.1.1. Bank Deposits

Resident deposits (89% of total deposits) increased by 1.9% Q-o-Q in Q2 owing mainly to an increase in government deposits by AED 33.9 billion and a rise in private sector deposits by AED 15.6 billion, as households became thriftier in their day-to-day expenses, therefore saving more as a precaution against rising uncertainties.

Meanwhile, non-resident deposits (11% of total deposits) decreased by 7.6%, probably due to declining income worldwide in relation to the Covid-19 pandemic, and the need for some non-residents to withdraw from their deposit accounts in the UAE.

Table 3.1.1.a: Total Deposits at UAE Banks

Item	Dec-19	Mar-20	Jun-20
Bank Deposits	1870.2	1851.9	1866.2
(Y-o-Y change %)	6.5%	5.9%	5.2%
Resident Deposits	1648.8	1635.1	1665.8
(Y-o-Y change %)	6.9%	6.2%	5.6%
Government Sector	301.3	255.1	289.0
(Y-o-Y change %)	3.8%	-6.6%	-0.8%
GREs	245.3	260.1	240.5
(Y-o-Y change %)	18.4%	33.6%	10.6%
Private Sector	1057.9	1076.2	1091.8
(Y-o-Y change %)	4.8%	4.4%	6.0%
NBFI	44.3	43.7	44.5
(Y-o-Y change %)	24.8%	6.1%	13.8%
Non-Resident Deposits	221.4	216.8	200.4
(Y-o-Y change %)	3.7%	4.1%	1.9%

Data by bank type show the share of deposits at the end of June representing 78.2% for conventional banks compared to 21.8% for Islamic banks. Meanwhile, the share of national and foreign banks' in customer deposits represented 88.0% and 12.0%, respectively.

[11] In this chapter unless specified otherwise: (1) all data indicate the end-of-period values, (2) Values are expressed in billions of AED, unless specified otherwise and (3) The source of the data is the Central Bank of the UAE.

[12] In this section, all June 2020 data are preliminary and subject to revision.

3.1.2. Banks' Assets and Credit

Total assets increased in the second quarter by 2.0% Q-o-Q while Gross Credit increased by 1.3%, and domestic credit increased by 1.9%, owing mainly to government (AED 23.3 billion increase).

Table 3.1.2.a: Assets and Credit at UAE Banks

Item	Dec-19	Mar-20	Jun-20
Total Assets	3082.9	3128.0	3190.2
(Y-o-Y change %)	7.5%	8.1%	7.8%
Gross Credit	1758.6	1768.2	1791.0
(Y-o-Y change %)	6.2%	5.6%	5.8%
Domestic Credit	1592.6	1595.0	1626.9
(Y-o-Y change %)	5.5%	4.3%	5.5%
Government	257.4	229.1	252.4
(Y-o-Y change %)	34.4%	16.2%	25.2%
GREs	185.3	201.1	218.1
(Y-o-Y change %)	10.4%	17.1%	23.7%
Private Sector	1134.6	1148.9	1139.4
(Y-o-Y change %)	0.4%	0.7%	-0.7%
NBFI	15.3	15.9	17.0
(Y-o-Y change %)	-23.5%	-20.1%	0.6%
Business & Industrial Sector Credit	802.2	818.7	814.7
(Y-o-Y change %)	1.2%	1.4%	-0.1%
Individuals	332.4	330.2	324.7
(Y-o-Y change %)	-1.5%	-1.0%	-2.3%
Foreign Credit	166.0	173.2	164.1
(Y-o-Y change %)	13.1%	18.8%	9.3%

Despite the lockdown measures, some sectors increased borrowing in Q2, the highest being Transport, Storage and Communications (AED 20.7 billion) and Construction and Real Estate (AED 6.7 billion).

Table 3.1.2.b: Bank Lending by Economic Activity

Economic Activity	Mar-20	Jun-20
Total	**1,595.1**	**1,626.8**
(Q-o-Q change %)	0.2%	2.0%
(Y-o-Y change %)	4.3%	5.5%
Of which:		
Construction and Real Estate	**319.8**	**326.5**
(Q-o-Q change %)	2.8%	2.1%
(Y-o-Y change %)	-1.1%	-2.9%
Trade	**155.7**	**157.2**
(Q-o-Q change %)	2.0%	0.9%
(Y-o-Y change %)	0.7%	2.1%
Transport, Storage and Communication	**63.3**	**84.0**
(Q-o-Q change %)	10.9%	32.7%
(Y-o-Y change %)	22.6%	51.9%
Manufacturing	**81.6**	**79.7**
(Q-o-Q change %)	1.5%	-2.4%
(Y-o-Y change %)	5.7%	4.6%

Analysis by type of banks shows that the share at the end of Q2 of Islamic banks was 18.8% in total assets and 22.6% in total gross financing of the banking system. The main drivers of domestic lending growth were Government and GREs for both conventional and Islamic banks.

Meanwhile, foreign banks have a share of 12.1% of the system in terms of assets and 11.0% in terms of gross financing. Total assets of national banks expanded by 1.7% Q-o-Q while total assets of foreign banks grew by 3.4%.

As regards to bank lending to Micro, Small and Medium Enterprises (MSMEs), which increased from AED 89.5 billion at the end of 2019 to AED 93.4 billion at the end of Q1 2020, it declined by 1.1% to AED 92.4 billion at the end of June. The latter remained however 10.4% higher than the level during the same period one year earlier, which is testament to the success of the enhanced TESS, which allowed MSMEs to benefit from the provision of temporary relief by banks and other measures (see Box 2 at the end of the chapter).

3.1.3. Financial Soundness Indicators

The Advances to Stable Resources Ratio (ASRR) of banks decreased from 82.3% in Q1 to 81.9% in Q2. Meanwhile, the Eligible Liquid Assets,[13] as a ratio of total liabilities[14] remained at 16.6%, i.e., well above the 10% regulatory minimum requirement, constituting an adequate buffer for banks which allows them to weather situations of liquidity squeeze.

The level of total liquid assets at banks at the end of Q2 2020 stood at AED 432.4 billion, i.e., AED 10.4 billion lower compared to the end of Q1 2020 (2.4% decrease).

Banks operating in the UAE remain well capitalised, with an average Capital Adequacy Ratio (CAR) of 17.6%, Tier 1 Capital Ratio at 16.4%, and Common Equity Tier 1 Ratio (CET 1) at 14.7%.[15]

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

	Dec-19	Mar-20	Jun-20
Total Banking System			
Advances to Stable Resources Ratio (ASRR)	81.0%	82.3%	81.9%
Eligible Liquid Assets Ratio (ELAR)	18.1%	17.3%	16.6%
Capital Adequacy Ratio (CAR)	17.7%	16.9%	17.6%
Tier 1 Capital Ratio	16.5%	15.8%	16.4%
CET 1 Ratio	14.7%	13.9%	14.7%

The Loan to Deposit (LTD) ratio for the whole banking system increased to 96.0% at the end of Q2, from to 95.5% at the end of Q1 2020.

3.2 Financial developments

3.2.1. Share Prices

The second quarter was marked by an exuberance of stock markets worldwide. While most economies grounded to a halt due to lockdowns, share prices soared with the MSCI World Index increasing by 16.6%.

Consistent with the global bullish sentiment, the Abu Dhabi Securities Exchange (ADX) share price index increased by 14.8% Q-o-Q, while the Dubai Financial Market (DFM) index increased by 10.4%.

Table 3.2.1: UAE – Securities Markets

			2020	
			Q1	Q2
Abu Dhabi	Share Price Index	Q-o-Q	-26.4%	14.8%
		Y-o-Y	-26.4%	-13.9%
		YTD	-26.4%	-15.6%
	Market Capitalization	Q-o-Q	-20.8%	17.6%
		Y-o-Y	-18.7%	-4.9%
		YTD	-20.8%	-6.9%
	Turnover (Traded Value)	Q-o-Q	27.8%	-19.2%
		Y-o-Y	31.4%	9.0%
		YTD	27.8%	3.3%
Dubai	Share Price Index	Q-o-Q	-35.9%	10.4%
		Y-o-Y	-32.8%	-26.5%
		YTD	-35.9%	-29.3%
	Market Capitalization	Q-o-Q	-28.1%	8.9%
		Y-o-Y	-23.2%	-17.1%
		YTD	-28.1%	-21.7%
	Turnover (Traded Value)	Q-o-Q	52.5%	-2.1%
		Y-o-Y	58.3%	119.5%
		YTD	52.5%	49.4%

Source: Securities and Commodities Authority (SCA)
Note: Changes computation are based on quarterly average values for the share price index and market capitalisation.

3.2.2. Credit Default Swaps (CDS)

The CDS, i.e., the premiums that buyers of debt have to pay to ensure repayment in case of default, increased worldwide in the second quarter of 2020, mainly due to the Covid-19 pandemic-induced uncertainties and market worries about impending credit quality. For the government of Abu Dhabi, the premium increased by 43.4 basis points (bps), while for the Emirate of Dubai, the premium increased by 100.7 bps (See Table 3.2.2).

Table 3.2.2: UAE – Sovereign Credit Default Swaps (CDS) (in bps)

	2019	2020	
	Q4	Q1	Q2
Emirate of Abu Dhabi	53.6	61.1	104.5
Emirate of Dubai	132.5	144.0	244.7

Source: Bloomberg.
Note: All data are quarterly average

[13] In the ELAR, the eligible liquid assets include required reserves, mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks.
[14] Balance sheet total assets less (capital and reserves + all provisions except staff benefit provisions + refinancing + subordinated borrowing/deposits).

6 https://www.centralbank.ae/sites/default/files/2020-08/Credit%20Sentiment%20Survey%20-%20Q2%202020.pdf
[15] The minimum regulatory requirement for CAR is 13% (10.5% minimum adequacy and 2.5% capital conservation buffer), 8.5% for Tier 1, and 7% for CET 1.

Box 2: UAE Small Business Facing Covid-19 Repercussions

Micro, Small and Medium Enterprises (MSMEs) play a vital role in economic growth, exports, innovation and job creation. Therefore, they are among the main target sectors of the TESS adopted by the Central Bank. The MSME sector succeeded in maintaining credit and other banking facilities in the second quarter of the year despite the economic contraction.

Bank credit to MSMEs

Well aware of the particular vulnerability of MSMEs to Covid-19 repercussions on the national economy, the CBUAE's enhanced TESS provided exceptional support to this sector, through:

- Provision of temporary relief by banks to all affected private sector corporates, especially payment deferrals for MSMEs to the end of 2020.
- Reduction of risk weights applicable to rated SMEs to 75%, and to 85% for unrated SMEs.
- Expanding the definition of SMEs so that a larger segment will be in a position to qualify for SME lending.

The sector also benefited from the broader set of TESS measures introduced to enhance the financial system stability and liquidity.

Bank Lending to MSMEs in the UAE

in billions of Dirhams

		2019	2020	
			Q1	Q2
1	Microenterprises	11.4	10.9	10.5
	Share of total SME lending	12.7%	11.7%	11.4%
2	Small Enterprises	28.2	29.4	29.6
	Share of total SME lending	31.5%	31.5%	32%
3	Medium Enterprises	49.9	53.1	52.3
	Share of total SME lending	55.7%	56.8%	56.6%
4	Total	89.5	93.4	92.4

Source: CBUAE

Bank lending to MSMEs at the end of June was 3.2% higher compared to end of 2019. This is a testament to the success of the TESS in encouraging banks to help small business adjust to lockdowns, through payment deferrals and access to new credit facilities.

Also the Zero Cost Facility (ZCF) provided by CBUAE to banks benefited MSMEs as the number of beneficiaries reached 9,527 companies by July corresponding to differed amount of AED 4.1 billion.[16] And the number of their deposit accounts at banks increased by 3.9% in Q2 to reach 124.9 thousand accounts.

Number of MSMEs accounts at banks operating in the UAE

	2020	
	March	June
Microenterprises	30,625	32,021
Small Enterprises	60,510	63,147
Medium Enterprises	29,137	29,767
Total	120,272	124,935

Source: CBUAE

[16] Press Release: Minister of Economy reviews Interim Committee's efforts to deal with impact of Covid-19 on national economy, on 29th July 2020.

Chapter 4. Interest Rates and Money Supply

LIBOR rates continued to decline while the spread EIBOR vs. USD LIBOR fluctuated around a downward trend. The 10-year Dirham interest rate swap also fluctuated due to market volatility. Money supply increased due to increase in resident deposits as a result of enhanced TESS the bounceback in economic activity by the end of the quarter.

4.1 Interest rates

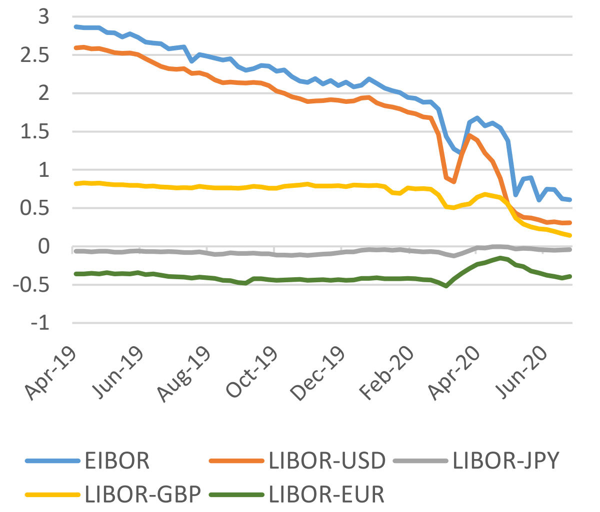
4.1.a Short-term interest rates

The 3-month LIBOR on USD continued to fall from 1.45% at the end of March to 0.30% at the end June, mainly due to the impact of the Fed's zero policy rate and further injection of liquidity as the Fed took additional actions to provide up to USD 2.3 trillion in loans to support the economy. The average 3-month USD LIBOR fell to 0.61% in Q2 2020, down from 1.54% in Q1 2020.

Meanwhile, the Euro and JPY LIBOR rates remained in negative territory consistent with the policy orientation in the Euro Zone and Japan. While, LIBOR on the GBP fluctuated around a declining trend, reaching an average of 0.38% in Q2, down from an average of 0.67% in Q1 2020. The increase in LIBOR in some short periods was an indication that banks started to face substantially higher funding costs, which was reversed once monetary authorities intervened with massive liquidity injections.

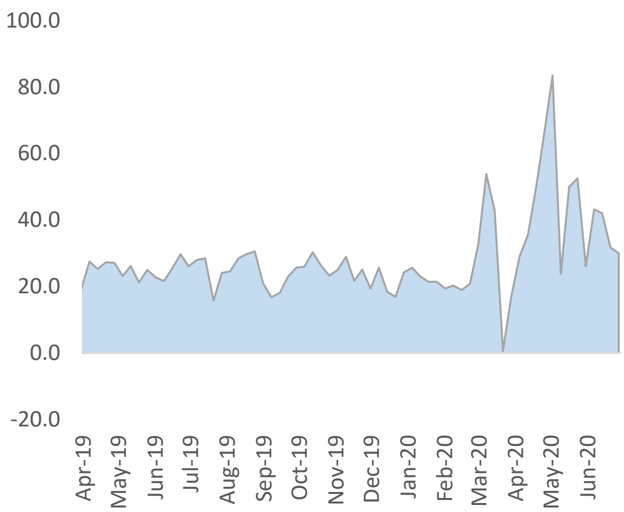
In the UAE, 3-month EIBOR decreased from 1.62% at the end of March to 0.76% at the end of June, in line with the decline in the USD LIBOR. The average 3-month EIBOR declined from 1.78% in the first quarter to 1.05% in the second quarter.

Figure 4.1.a: EIBOR and USD-LIBOR



Source: Bloomberg

Figure 4.1.b. Spread of EIBOR 3-month vs. USD LIBOR 3-month (bps)



Source: Bloomberg

The Spread 3-month EIBOR vis-à-vis 3-month USD LIBOR remained positive during this period, increasing from 29.1 bps in early April to a peak of 83.5 bps in the first week of May, before declining to 30 bps at the end of the quarter.

4.1.b Long-term swap rates

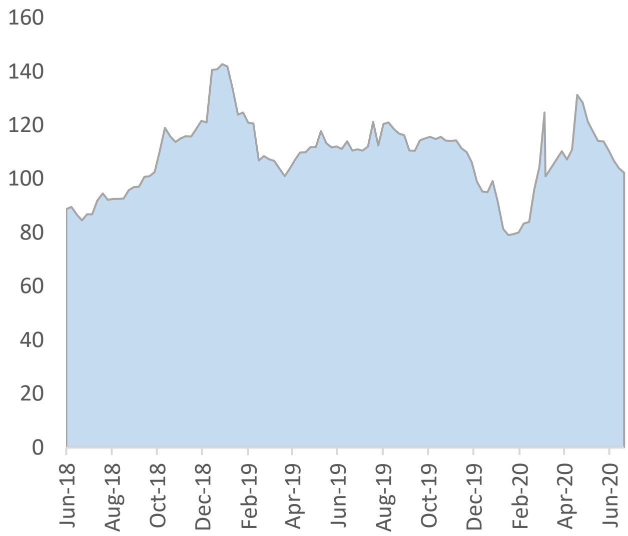
Interest rate swaps involve an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the LIBOR. The 10-year Dirham interest rate swap fluctuated during the second quarter due to increased market volatility and rising risk. The 10-year swap rate on the AED increased from 1.6% at the end of Q1 to a peak of 1.9% at the first week of the June, before falling to 1.6% at the end of the month. The average of 10-year Dirham interest rate swap declined from 2.24% in Q1 to 1.82% in Q2.

Figure 4.1.c the 10-year interest rate Swaps (%)

Source: Bloomberg

The spread of the 10-year AED vs. USD interest rate swap was fluctuating in the second quarter of 2020, first from 110 bps in early April to 131 bps at the end of the month, before declining to 102 bps at the end of the quarter. The quarterly average increased, however, from 92 bps in Q1 2020 to 113 bps in Q2 2020.

Figure 4.1.d Spread 10-year AED Swap vs. USD Swap (bps)



Source: Bloomberg

4.2 Money supply

Monetary aggregates increased in April as liquidity conditions were boosted by the TESS initiatives, before declining subsequently due to economic contraction (See Table 4.2.1).

Money Supply M1[17] increased by 2.7% Q-o-Q (AED 14.7 billion) to reach AED 557.4 billion, driven by a rise in Monetary Deposits (83.3% of M1) by 1.8% (AED 8.3 billion) reaching AED 464.8 billion, and an increase in Currency in Circulation (16.6% of M1) by 7.4% (AED 6.4 billion). Y-o-Y, M1 increased by 9.7% due to an increase in Currency in Circulation by 19.8% and an increase in Monetary Deposits by 7.9%.

[17] Currency in Circulation outside banks + Monetary Deposits

Table 4.2.1. Money supply in the UAE

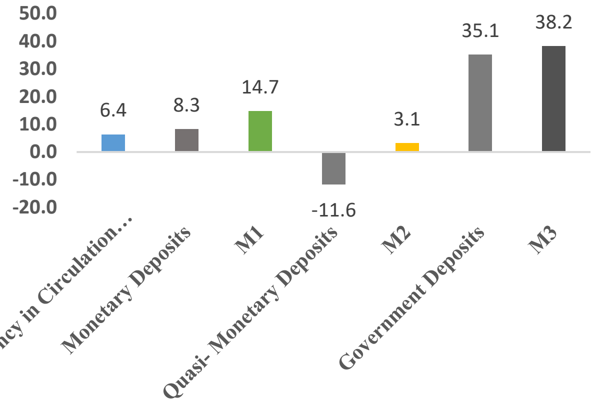
In billions Dirhams

	M_1	M_2	M_3
March	542.7	1,454.9	1714.1
April	560.3	1,464.8	1751.5
May	564.3	1,451.9	1747.8
June	557.4	1,458.0	1752.3

Source: CBUAE

Money supply M2[18] increased by 0.2% Q-o-Q (AED 3.1 billion) to reach AED 1,458.0 billion, due to the increase in M1 while Quasi-Monetary Deposits (61.8% of M2) decreased by 1.3% (AED 11.6 billion), reaching AED 900.6 billion, as record low interest rates made term deposits less attractive, while some residents drew down on their savings. Y-o-Y, M2 increased in June by 7.9% due to the increase in M1 and the increase in Quasi-Monetary Deposits by 6.8%.

Figure 4.2: Change in Monetary aggregates in 2020 Q2 (in billions of Dirhams)



Source: CBUAE

Meanwhile, M3[19] increased Q-o-Q by 2.0% (AED 38.2 billion) to reach AED 1,752.3 billion, due to an increase in Government Deposits (16.7% of M3) by 13.5% (AED 35.1 billion) reaching AED 294.3 billion. Y-o-Y, M3 increased by 6.5% due to the increase in M2 by 7.9%, while government deposits decreased slightly.

[18] M1 + Quasi Monetary Deposits

[19] M2 + Government Deposits at banks and CBUAE

Statistical Appendix

Balance Sheet of the Central Bank of the UAE

In millions of AED

	2019			2020	
	Q2	Q3	Q4	Q1	Q2
ASSETS					
Cash and Bank Balances	204,313	238,539	254,446	255,014	244,694
Deposits	118,372	113,821	116,393	112,902	86,282
Tri-Party Deposits	19,642	16,521	11,198	7,159	-
Marginal Lending Facility	-	-	-	190	38,705
Advance to Government	3,000	-	-	-	-
Foreign Investments	485	485	498	505	530
Derivative Assets	256	2,459	3,818	917	1,377
Certificate of Deposits under Repo	-	-	-	8,334	5,673
Liquidity Support Facility	93	71	50	29	7
Investments	71,988	51,568	54,814	58,229	59,698
Gold Bullion	1,247	2,709	4,044	5,951	6,580
Other Assets	13,958	674	839	687	540
Property & Equipment	110	123	126	124	148
TOTAL ASSETS	**433,462**	**426,970**	**446,246**	**450,041**	**444,235**
LIABILITIES					
Current Accounts & Deposits	31,117	26,145	30,972	38,771	56,884
Reserve Requirement from Banks	124,828	126,233	129,735	132,583	73,287
Certificates of Deposit	155,822	153,765	160,183	144,578	178,471
Currency Issued	91,291	90,781	93,729	105,200	106,141
Derivative Liabilities	2,398	198	17	847	244
Other Liabilities	4,630	6,407	6,562	2,790	3,281
TOTAL LIABILITIES	**410,086**	**403,530**	**421,197**	**424,769**	**418,308**
EQUITY					
Fully Paid Up Capital	20,000	20,000	20,000	20,000	20,000
Fair Value Reserve	21	21	34	41	66
Gold Revaluation Reserve	247	311	412	629	1,258
General Reserve	3,108	3,108	4,603	4,603	4,603
TOTAL EQUITY	**23,376**	**23,440**	**25,049**	**25,273**	**25,926**
TOTAL LIABILITIES & EQUITY	**433,462**	**426,970**	**446,246**	**450,041**	**444,235**

Source: CBUAE

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