مصرف الإمارات العربية المتحدة المركزي
CENTRAL BANK OF THE U.A.E.

Quarterly Economic Review

2016 Q4

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Executive Summary

The global economic growth remained soft in 2016 for numerous reasons which vary by region. Generally, the culprits include structural adjustments in many countries, efforts to reduce overcapacity, recurring natural disasters, geopolitical events—such as Brexit, a Coup d'Etat in Turkey and the ongoing civil war in Syria, among others—and heightened uncertainty related to the U.S. presidential election, as well as potential policy changes in the U.S. and a number of other major economies.

In the US, following the presidential election, economic data have been broadly positive. Steady gains in the labor market, including a steady drop in the unemployment rate, have made the headlines. Personal disposable income and household spending have remained fairly solid throughout the last quarter of 2016.

In the Eurozone, data for the final quarter of 2016 point to a modest pick-up in momentum. The unemployment rate inched down in October and economic sentiment rose in November. In addition, the Euro fell to the lowest level seen in years following the U.S. Federal Reserve's decision to hike interest rates. The depreciated currency should bode well for the region's exports, which have been hurt by subdued volumes of global trade. China has remained the world's major growth engine in the last quarter of 2016, shoring up global economic growth through such channels as trade, market and investment. China's economy is shifting toward a development model of lower rate and higher quality, while more structural reforms should allow its economy to upgrade and eventually unleash new vitality and continue to serve as an engine of global economic growth.

In the UAE, based on revised new figures of growth projections and global economic developments, the Central Bank of the UAE has revised its estimate of the Real GDP growth and its components. Non-oil GDP growth is estimated to have grown by 2.7% in 2016, while oil GDP growth is estimated to have increased by 2.4%, given the increase in oil production in 2016. Real GDP is expected to have grown by 2.6% in 2016 and projected to expand by 2.3% in 2017, comprising 0.8% growth of oil GDP and 2.9% growth of non-oil GDP. The slowdown is driven mainly by the fiscal consolidation and the expected fall of oil production in 2017 following the commitment of the UAE to the OPEC production-cut decision. In 2018, the economy is expected to regain momentum and grow by 3%, comprising 3.8% growth of non-energy GDP and 1.4% growth of oil GDP.

Inflation trend in the UAE has picked up during the fourth quarter of 2016 after a period of declining inflation extended over four consecutive quarters. The average Consumer Price Index (CPI) increased on average by 2.2% in the fourth quarter of 2016. Housing prices continue to be the main driver of the Consumer Prices in the UAE; Rental prices and housing utilities increased by 4.3% in the fourth quarter of 2016 against 4.1% previously.

The UAE improved significantly its ranking to 16th worldwide in the 2015-2016 competitiveness report. In addition, the UAE ranked 1st internationally in the "Quality of roads" sub-indicator, and second position in "Airports and airlines infrastructure quality". The UAE ranks also 1st in ease of paying taxes, 4th in the ease of obtaining construction permits and ease of connecting electricity, 9th in the protection of minor investors and 11th in the ease of registration of properties.

Regarding banking activity, the banking sector, as a whole, has improved at the end of 2016 compared to the end of September 2016 based on the Financial Soundness Indicators (FSIs). Deposits and Banks' assets growth accelerated in the last quarter of 2016 compared to the previous quarter, however credit growth marginally declined compared to the period June to September mainly due to deleveraging of the Government sector.

The Central Bank balance sheet exhibited an increase in 2016 Q4 triggered by an increase in liabilities. As a result, total assets increased by 3.1% owing mainly to an increase in "Cash & Bank Balances" while "Held-To-Maturity Foreign Securities" decreased. Meanwhile, interest rates continued their upward trend in the UAE in line with the announced increase in the policy interest rate in the US, which materialized on 14 December 2016, to maintain the stability of the exchange rate peg.

Chapter1. International Economic Developments

In the US, following the presidential election, economic data have been broadly positive. Steady gains in the labor market, including a continued drop in the unemployment rate, have made the headlines. In the Eurozone, data for the final quarter of 2016 point to a pick-up in momentum. The unemployment rate inched down and economic sentiment rose. In addition, the euro-dollar exchange rate fell to the lowest level seen in years following the Fed's decision to hike interest rates. China has remained the world's major growth engine in the last quarter of 2016, shoring up global economic growth through such channels as trade, market and investment.

For the fourth quarter of 2016, the GDP figures releases for the US and the UK showed that the collective economies performed relatively well, with the Eurozone's GDP numbers suggesting a recovery in the 19-nations area.

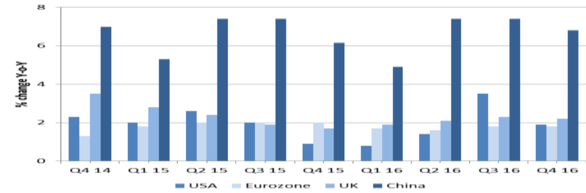
GDP in the US increased at an annual rate of 1.9% in 2016 Q4 compared to the 3.5% for the third quarter of 2016. The increase in real GDP in the fourth quarter reflected positive contributions from personal consumption expenditures (PCE), private inventory investment, residential fixed investment, non-residential fixed investment, and state and local government spending that were partly offset by negative contributions from exports and federal government spending. Imports, which are a subtraction in the calculation of GDP, increased. The deceleration in real GDP in the fourth quarter, compared to 2016 Q3, reflected a downturn in exports, an acceleration in imports, due also to the appreciation of the USD, a deceleration in PCE, and a downturn in federal government spending that were partly offset by an upturn in residential fixed investment, an acceleration in private inventory investment, an upturn in state and local government spending, and an acceleration in non-residential fixed investment.

In the Eurozone, the 2016 Q4 growth was of 1.8% annualized, same as in Q3, suggesting that the recovery in the 19-nation single currency area is gaining momentum amid fears about the fallout of Brexit and implications on the stability of the banking system. A number of headwinds make it far from certain the Eurozone is set to embark on a more dynamic recovery after more than three years of modest growth, such as rising energy prices threaten to dampen consumer spending unless workers can secure similarly large wage rises. Additional risks surrounding the euro area growth outlook remain tilted to the downside and relate predominantly to global factors, such as the impact on Europe if President Trump follows through on his antitrade rhetoric with protectionist policies.

The UK's GDP growth was 2.2% higher in 2016 Q4 compared with the same quarter a year ago. The data were closely watched as Q4 was just the second full quarter of activity after Britain's historic vote to leave the European Union. Initial predictions of economic doom after the Brexit vote have so far failed to materialize, with the exception of the crashing pound, and economic data have broadly held up well. Growth in the quarter was once again largely driven by a booming services sector, which grew 0.8% from the previous three months. Services is the dominant sector the UK economy, making up roughly 80% of all GDP.

China's GDP grew by 6.8% Y-o-Y in the fourth quarter of 2016, below the third quarter growth of 7.4%, however signaling growth was stabilizing. Consumption accounted for 64.6% of GDP in 2016, while per capita consumption rose 8.9% on year to 17,111 Yuan (USD 2,490). Property development also contributed to growth, with total investment rising 6.9 percent for the year, up 5.9 percentage points from 2015. This may be China's slowest pace of growth in 26 years, but it remains within the range for Beijing to meet its longer-term goal of doubling GDP and per capita income by 2020 from 2010 levels.

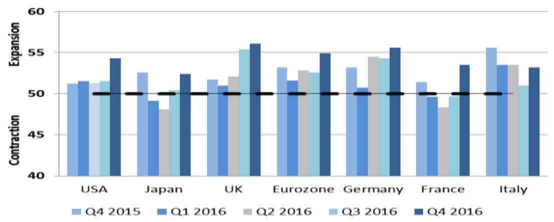
Figure 1.1. GDP growth for selected economies



Source: Bloomberg

Economic activity in the developed world as measured by the Purchasing Management Index (PMI) shows that for the selected economies in Figure 1.2 it has seen an improvement in 2016 Q4 compared to the previous quarter.

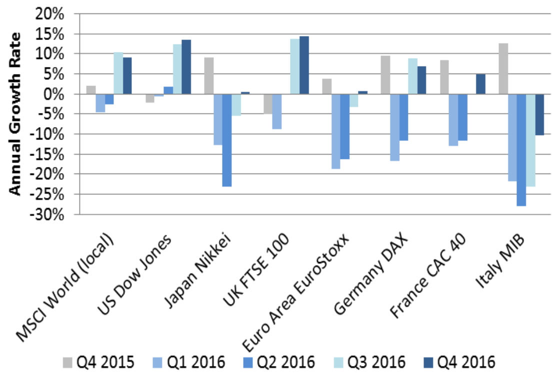
Figure 1.2. PMI levels



Source: Bloomberg

The US, in particular, saw a significant improvement in the PMI level from 51.5 to 54.3, while the UK PMI improved at a lesser extent from 55.4 to 56.1. In addition, the Eurozone's PMI level was at 52.6 at the end of 2016 Q3 and ended the fourth quarter of 2016 at 54.9, which is above the 50 mark, pointing to expansion. The French PMI notched up from 49.7 at the end of the 2016 Q3 to 53.5 at the end of quarter four 2016 and by growing Q-o-Q, it exceeded the 50 mark. A PMI reading above 50 indicates expansion and below 50 a contraction. All the advanced selected economies in Figure 1.2 are expanding in 2016 Q4.

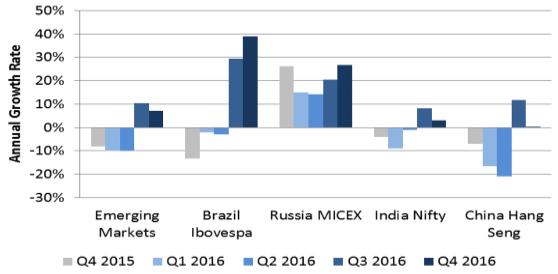
Figure 1.3. Annual percentage change of equity indices (local) in developed economies



Source: Bloomberg

In Figure 1.3., all developed equity markets experienced positive annual returns during the fourth quarter of 2016, with the exception of the Italian MIB, which declined by 10.2%. The highest return increase was for the US Dow Jones and the UK FTSE 100, which grew by 13.4% and 14.4% respectively.

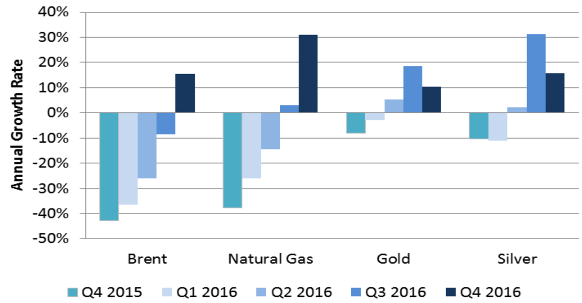
Figure 1.4. Annual stock market index percent changes in BRIC countries (local)



Source: Bloomberg

Similarly, in Figure 1.4., equity markets have had a positive return on an annual basis for the BRIC, with Brazil and Russia being the top performers with 38.9% and 26.8% Y-o-Y, in the fourth quarter of 2016.

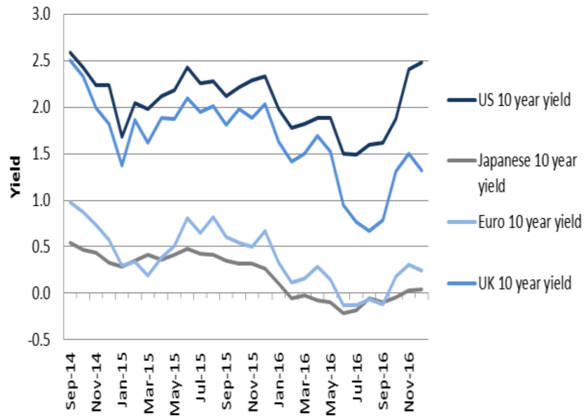
Figure 1.5. Selected commodity price levels annual changes



Source: Bloomberg

The fourth quarter of 2016 saw an improvement of all selected commodity prices, Y-o-Y (Figure 1.5.). On an annual basis, the oil (Brent) price, natural gas, gold and silver managed to post improvements in the last quarter of 2016 of 15.3%, 30.9%, 10.3% and 15.9% respectively.

Figure 1.6. 10-year government bond yields (%)



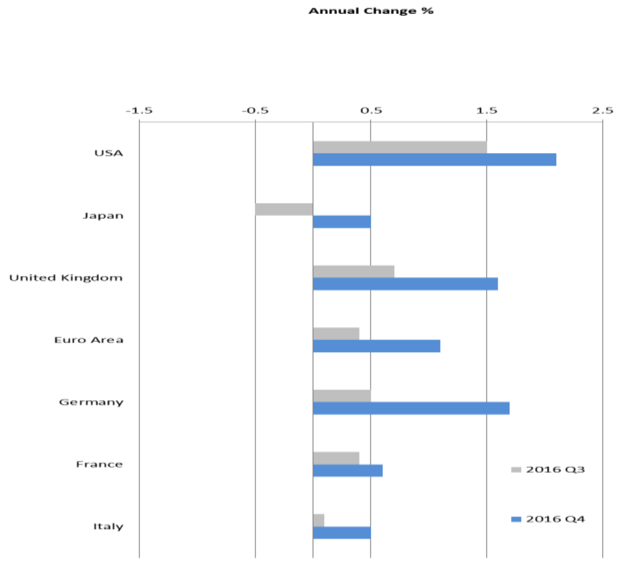
Source: Bloomberg

The last quarter of 2016 saw government bond yields rise (Figure 1.6.) amid expectations for higher inflation after the US election victory for Donald Trump and expectations of additional fiscal stimulus spending. Markets generally gained, with financial stocks performing well. The quarter was dominated by the US presidential election results and subsequently the Fed's move to raise interest rates.

In the Eurozone, government debt yields made gains. Financials performed well amid higher bond yields and the ECB's commitment to extend its quantitative easing program through end of 2017. UK bond yields also moved higher. Japanese bond yields were strong, drawing support from the currency as the yen weakened in November and December. In general, government bond yields moved higher and yield curves steepened, reflecting stronger outlook of rising inflation and rising expectation of tighter liquidity.

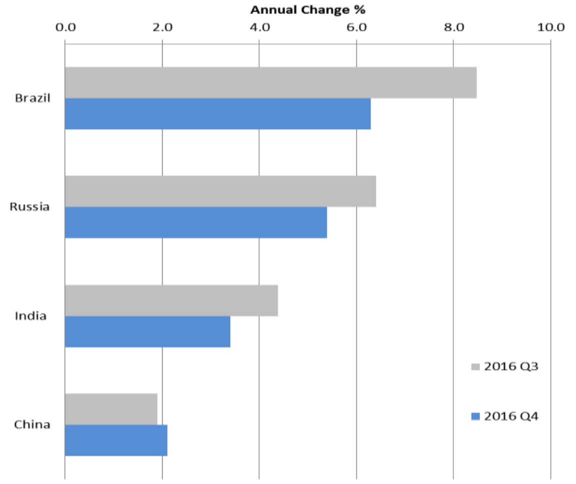
The charts below on consumer prices shows the difference between the developed and the developing world. Whereas the developed world is struggling with lower inflation rates, with exception to the US, the developing world experienced higher inflation rates with the exception of China. However, in the last quarter of 2016, all of the selected developed economies have experienced an increase in inflation compared to 2016 Q3, aiming to achieve an inflation at around 2% Y-o-Y. For the BRIC economies, the inflation is moderating, with exception of China.

Figure 1.7. Year-on-Year consumer price change in the developed economies



Source: Bloomberg

Figure 1.8 Year-on-Year consumer price change in emerging economies



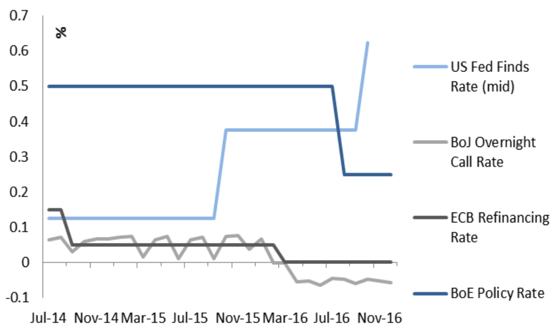
Source: Bloomberg

In terms of monetary policy, the U.S. Federal Reserve on December 14 2016 raised its federal funds rate by 25 basis points to 0.75%, as widely expected, and forecast that it would raise its rate three times in 2017. The Fed said the decision to raise the rate was "in view of realized and expected labor market conditions."

The ECB on December 8 2016 extended its asset purchase program until the end of December 2017 from the end of March 2017 but reduced monthly purchases to 60 billion euros from 80 billion. ECB also broadened the maturity range of public sector bonds that it will purchase by lowering the maturity to one year from two years, and will buy bonds that have a yield below the ECB's deposit rate of minus 0.40%.

On the other hand, Bank of England and Bank of Japan did not have any major interventions during the last quarter of 2016.

Figure 1.9. Policy rates of developed countries



Source: Bloomberg

Growth in the Middle East and North Africa (MENA) region is estimated to have slowed in the last quarter of 2016, reflecting fiscal consolidation in some countries and oil production constraints in others.

Growth slowed in the Gulf Cooperation Council (GCC) countries as oil sector weaknesses continued to spread to non-oil sectors in 2016 Q4, against the backdrop of continued fiscal consolidation. At the same time, output is estimated to have accelerated in Iran and Iraq thanks to large gains in oil production and, in Iran due to a recovery in agriculture, automotive production, trade and transport, following the sanctions removal.

Among oil-importing economies, such as Egypt, growth dipped slightly as foreign currency shortages held back manufacturing and the tourism industry slowed during the fourth quarter of 2016.

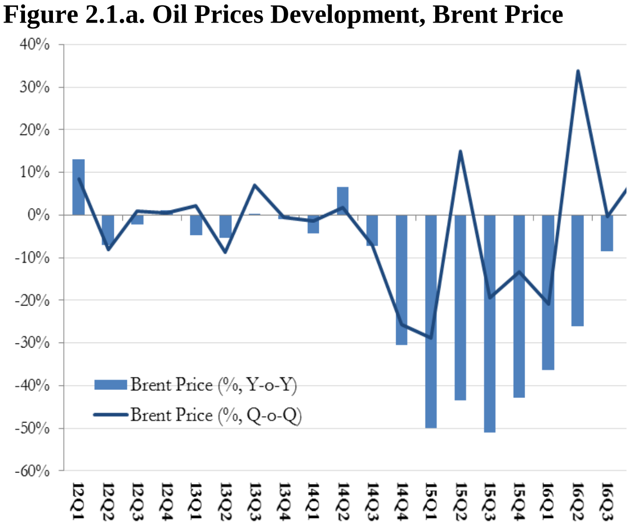
Chapter 2: Domestic Economic Developments

The Real GDP in the UAE is expected to grow by 2.6% in 2016 and reach 2.3% in 2017 before regaining momentum to 3% in 2018. The slowdown is driven mainly by the fiscal consolidation that continued until the beginning of 2016 and the expected fall of oil production in 2017 following the commitment of the UAE to the OPEC production-cut decision. Non-oil GDP growth is estimated to have grown by 2.7% in 2016, while oil GDP growth is estimated to have increased by 2.4%, given the increase in oil production in 2016. Inflation has picked up during the fourth quarter of 2016 after a period of decreasing inflation that extended over four consecutive quarters. The average Consumer Price Index (CPI) increased by 2.2% in the fourth quarter of 2016. Housing prices continue to be the main driver of the Consumer Prices in the UAE; Rental prices and housing utilities increased by 4.3% in the fourth quarter of 2016 against 4.1% previously. The UAE improved significantly its ranking to 16th worldwide in the 2015-2016 competitiveness report. In addition, the UAE ranked 1st internationally in the "Quality of roads" sub-indicator, and second in "Airports and airlines infrastructure quality". The UAE ranked also 1st in ease of paying taxes, 4th in the ease of obtaining construction permits and ease of connecting electricity, 9th in the protection of minor investors and 11th in the ease of registration of properties.

2.1 Economic Activity and Growth

The fourth quarter of 2016 was marked by a significant improvement of global oil prices. The average Global Brent Oil price increased by 15% on a year-on-year basis, reaching a 50$-average price for the quarter with a 54$ average price for December: the highest reading since July 2015 (56$). Oil prices rose in the fourth quarter of 2016 by 9% compared to the previous quarter where they declined by 0.3% after rebounding by 33.7% in the second quarter of 2016 (see Figure 2.1.a).

Figure 2.1.a. Oil Prices Development, Brent Price



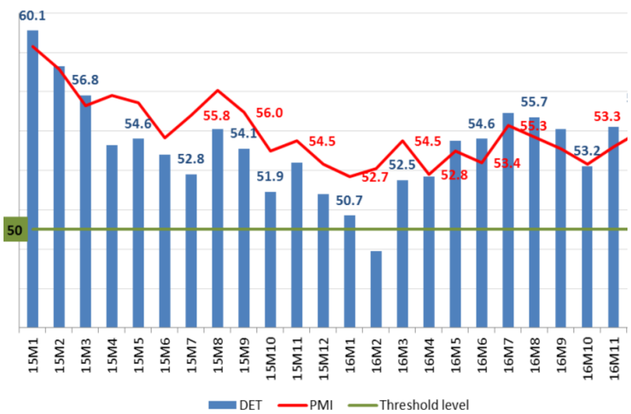
Source: IMF

The gradual improvement of oil prices during the fourth quarter of 2016 was mirrored by a gradual improvement of the non-oil private sector's economic activity. While it has been evolving in the expansion area (above the 50-level threshold), the Purchasing Managers' Index (PMI) has increased from 53.3 in October to 55 in December (see Figure 2.1.b), the highest level since July 2016.

The Dubai Economy Tracker (DET) followed the same development path as the PMI. The DET reached in December 55.9 from a 53.2 in October, the highest reading since July 2016. This increasing trend for both economic indicators was driven mainly by the output and new-export orders and new-orders sub-indices. Output increased at the fastest rate since last year and rose the most in 16 months in December 2016. Most of the surveyed firms reported higher production and reflected more optimism regarding the economic activity during the coming 12 months in the UAE. The Output sub-index reached 62.7 in December, growing from 59.8 and 60.6 in November and October, respectively. The output rise was supported by increased crude oil production recently, before the OPEC Agreement, which has fed through to oil-related manufacturing. The price cut strategy adopted by firms in order to increase their sales and stimulate output has contributed to the output rebound. Consequently, the output price sub-index stood under the 50-level threshold during the last quarter of 2016. It averaged around 49.

On the other hand, the new orders increased markedly amid a return to growth of new export business. It reached 56.2 in December, above the neutral 50-level, displaying a quarterly average of 55.3. The new-export orders jumped significantly during the last month of the year to reach 52.8 in December from a 48.9 in November.

Figure 2.1.b Purchasing Managers' Index (PMI) and Dubai Economic Tracker (DET)



Source: Markit & Emirates NBD

Notwithstanding overall improvement, employment and backlogs of work sub-indices showed a decline, offsetting partially the positive development triggered by output and new export orders. The average quarterly employment and backlogs of work sub-indices declined by 1.4% and 2.5% in the fourth quarter, respectively. The overall average quarterly PMI is around 54.2, lower than the 54.7 average level observed during the previous quarter.

All these developments were confirmed by the Central Bank's Economic Composite Indicator (ECI) Index. The Non-Oil Economic Composite Indicator (Non-Oil ECI), perfectly mimics the PMI (contemporaneous correlation of 95%), showed a slight slowdown for the fourth quarter of 2016 compared to the previous one (see Figure 2.1.c). The Non-Oil ECI grew by 2.8% in the fourth quarter against a quarterly growth of 3%in the third quarter.

However, the Economic Composite Indicator (ECI) showed an improvement of the overall economy by 3% during the fourth quarter (see Figure 2.1.d) against a 2.8% in the previous quarter. This improvement was boosted mainly by the increase of the oil production which rose by 6% in the fourth quarter against a 3.5% increase during the previous one, on a year-on-year basis. Thus, the real oil GDP growth was estimated to be around 2.4% in 2016. This figure is expected to decline significantly in 2017 to reach 0.8% (see Table 2.1) since the UAE has pledged, among other OPEC members, to cut oil production by 139k barrel/day during a renewable period of six months, effective January 2017. On the other hand, the Real Non-Oil GDP is estimated to grow by 2.7% in 2016 with an expected improvement during the subsequent years, 2017 and 2018 where the growth is foreseen to be around 2.9% and 3.8%, respectively. Therefore, Real GDP growth is estimated to be 2.6% in 2016, 2.3% and 3% in 2017 and 2018, respectively.

The UAE economy has shown a remarkable resilience to external and adverse oil price shocks, confirmed by the growth of per capita GDP (Box 1) and the ranking indicators released recently. These indicators chart the achievements in the UAE economy and measure its attractiveness for foreign investors. According to the 2015 Global Investment Report, the UAE is the second largest FDI recipient in the West Asia region, after Turkey. The ratio of net foreign direct investment rose from 2.66% in 2014 to 2.96% in 2015. In addition, according to the 2016-2017 competitiveness report, the UAE topped Arab countries and moved from 17th to 16th position in the 2015-2016 period.

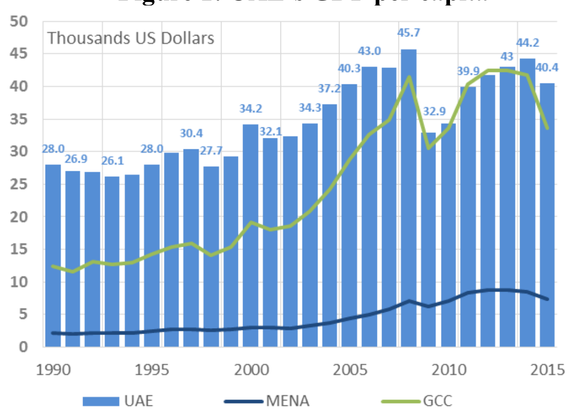
The analysis of the sub-indicators shows that the UAE was among the first 20 countries in 76 out of 114 sub-indicators. UAE also ranked 1st in the sub-indicator "Absence of crime and violence in business", and 2nd in "People's confidence in the leadership", along with the sub-indicator "Lack of wasteful government spending".

Regarding infrastructure, the UAE ranked 1st internationally in the "Quality of roads" sub-indicator, and second position in "Airports and airlines infrastructure quality". The UAE ranked 1st in ease of paying taxes, 4th in the ease of obtaining construction permits and ease of connecting electricity, 9th in the protection of minor investors and 11th in the ease of registration of properties.

Box 1: UAE's Development in GDP per Capita

The UAE belongs to the group of countries with the highest GDP per capita[1], reflecting its very high income level, abundant hydrocarbon reserves with low cost of extraction, a growing and more diversified non-oil economy, and well-developed infrastructure. Thus, UAE's GDP per capita is well above the MENA region average (7,407 US dollars in 2015) and the GCC average (33,671 US dollars in 2015) (Figure 1).

Figure 1: UAE's GDP per capita

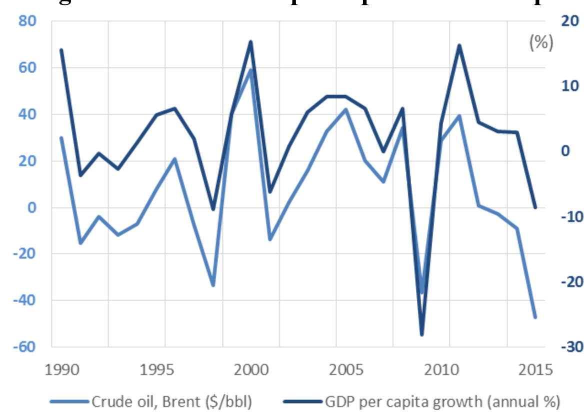


Source: FSCA, World Bank

However, nominal income per capita has declined in 2015. In fact, the GDP per capita in the UAE was last recorded at 40,439 US dollars in 2015, following 44,239 US dollars in 2014 and 42,987 US dollars in 2013, but still higher than the income observed during the financial crisis (32,905 US dollars in 2009).

This decline is mainly due to the sharp drop in oil prices. In fact, Figure 2 shows the high correlation between the UAE's GDP per capita and the Brent oil prices. Thus, given the continued fall of the oil revenue, the Government had less resource to support the economy, resulting in a reduction in public investments in the non-oil sector. In this context, the authorities responded with a significant fiscal consolidation in 2015, amounting to 8.5% of non-hydrocarbon GDP. In addition, they plan to continue its fiscal strategies in 2016 given the uncertain oil price outlook, although the latest evidence indicates a slower pace and more growth conducive strategy of fiscal consolidation.

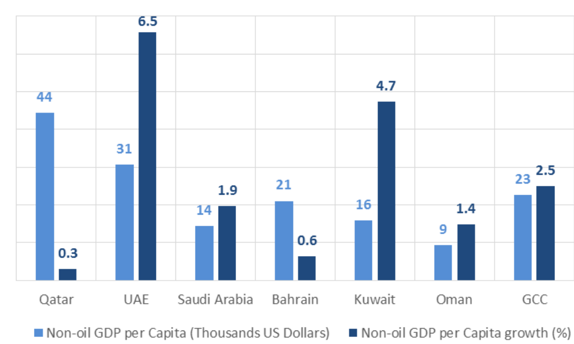
Figure 2: UAE's GDP per capita and Brent price



Source: FSCA, World Bank

Despite the decline in oil prices and global trade slowdown, the UAE's economy demonstrated resilience to this current situation, much more resilient than its neighbors did, thanks to its advanced economic diversification and its large financial buffers (Figure 3). In fact, the UAE's non-oil GDP per capita grew by 6.5% in 2015, above the growth recorded in all GCC countries.

Figure 3: Non-oil GDP per capita in the GCC



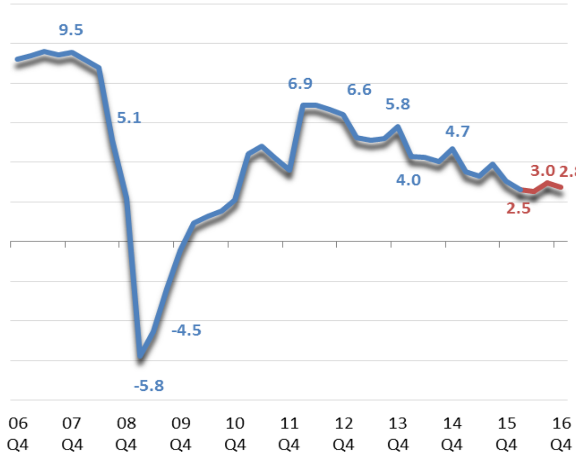
Source: National Authorities and World Bank.

In purchasing power parity[2] (PPP) terms, the GDP per capita reached 67,617 US dollars in 2015, growing by 2% compared to 2014 (Figure 2). Therefore, The UAE's GDP per capita ranked in the Top10 in 2015, well above many developed economies.

[1] The GDP per capita is obtained by dividing the country's gross domestic product by the total population.

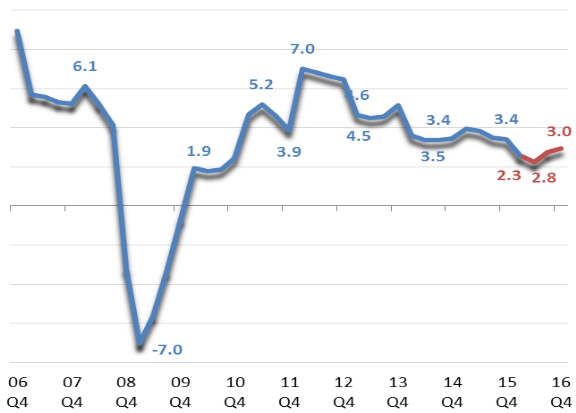
[2] This measure is used as the main proxy for income level, taking into consideration relative prices.

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



Source: CBUAE

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



Source: CBUAE

Table 2.1 Economic Growth in the UAE (%)

	2014	2015	2016 (P)	2017 (P)	2018 (P)
Real GDP	3.1	3.8	2.6	2.3	3.0
Real Oil GDP	0.8	5.0	2.4	0.8	1.4
Real Non-Oil GDP	4.1	3.2	2.7	2.9	3.8

Source: Federal Competitiveness and Statistics Authority (FCSA) for 2013, 2014 and 2015, and Central Bank projections for 2016-2017.
Note: For more details concerning the Central Bank projections, see "Box: GDP forecasting model of the Central Bank of the UAE" in the Quarterly Economic Report for Q4 2015 in the CBUAE website.

2.2 Consumer Price Index and Inflation

The inflation rate in the UAE has rebounded after a period of slower inflation that started from mid-2015. The average quarterly CPI increased by 2.2% in the fourth quarter of 2016 (see Table 2.2) after a 1.5% average increase in the previous quarter[3]. This rebound of prices was driven, although in different scales, by the increase of the prices of both non-tradables and tradables (see Figures 2.2.a and 2.2.b).

Accounting for 66% of the standard consumption basket in the UAE, non-tradables' prices grew by 3.1% in the fourth quarter of 2016 against a 2.1% increase in the third quarter. The housing costs covering rents and utilities account for 34% of the consumption basket grew by 4.3% after an increase of 4.1% previously. Notwithstanding the recent pickup in price inflation, housing prices are growing at a very slower pace than last year. The average quarterly inflation of housing prices was around 8.8% in 2015 with an average housing inflation rate of 8.3% during the last quarter of 2015. However, the average quarterly inflation of housing prices is around 4.2% in 2016.

Table 2.2 UAE CPI Inflation (%)

	Weight %	2015		2016			
		Q3	Q4	Q1	Q2	Q3	Q4*
Total CPI Inflation	100	4.6	3.6	2.1	1.7	1.5	2.2
Total CPI Inflation (end-of-period)	100	4.3	3.6	1.4	1.8	1.4	2.6
CPI Inflation of Tradable	34	2.1	0.6	-0.4	0.3	-0.7	0.6
CPI Inflation of Non-tradable	66	6.1	4.9	2.6	1.9	2.1	3.1
Housing CPI inflation	39	9.4	8.3	5.1	3.3	4.1	4.3
Transportation CPI inflation	10	5.6	-0.2	-6.7	-2.7	-5.9	-1.3

Source: Federal Competitiveness and Statistics Authority (FCSA).
Note: All the changes are computed on a Y-o-Y basis and based on the quarterly average CPI, unless otherwise indicated.
***:** Only the CPI for October and November are available.

[3] The average quarterly inflation rate for Q4 is covering only October and November because of lack of available data. Figures will be updated whenever the CPI for December is released.

The diminishing demand for housing as well as the increasing supply had an impact on its price in 2016. Notwithstanding, the recent improvement in rental prices in Dubai, they underwent minor drops in Abu Dhabi during the fourth quarter of 2016. The real estate market in Dubai has been buoyed by a spate of recent project launches by notable names in the industry, a development that has stirred up interest in the market once again.

Abu Dhabi, on the other hand, has not seen similar activity, resulting in a more stable market. In Dubai, the average apartment rent climbed to AED 127k in November, exhibiting a 2% increase over the average rental value in both October and the third quarter of 2016. The average rental yield is around 5.7% for November. In Abu Dhabi, at AED 129k, there was a small month-on-month drop of 1% in average apartment rents in November, and a similarly negligible drop when considered against the average apartment rent in the third quarter of 2016. Overall, the average yield stayed stable at 6.75% (see Box3 for more details on the Real Estate Market Developments).

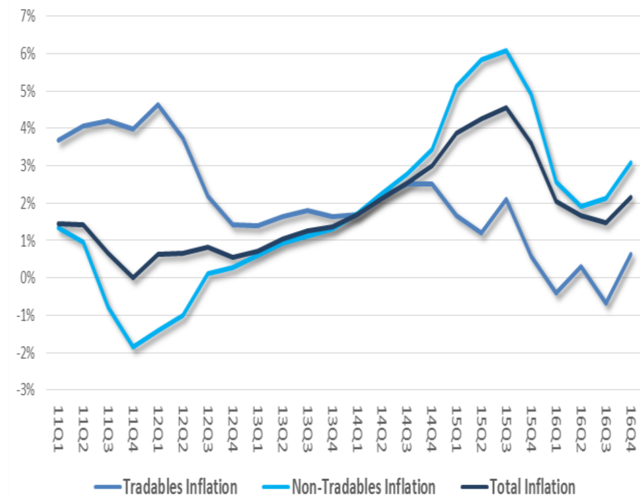
The price of tradables increased by 0.6% for the fourth quarter of 2016 on a year-on-year basis. The average prices of Food and Soft Drinks sub-category which accounts for more than 42% of the tradables, have increased by 0.7% in the fourth quarter of 2016 against an increase of 0.1% previously. In addition, the average prices of Furniture and Household Goods sub-category which accounts for more than 16% of the tradables have increased by 1% during the fourth quarter of 2016 against a 0.3% increase in the third quarter.

The cost of transportation constitutes another source of price fluctuation in the UAE since prices moves with the market rate since the full removal of energy-subsidies in the third quarter of 2015. Transportation prices are aligned to international oil prices, leading to more volatility of the CPI since transportation costs account for 14.6% of the consumption basket. While they continue on a decreasing trend, the transportation costs fell by 1.3% during the fourth quarter against a more important drop of 6% during the previous quarter, on account of fluctuations of international oil prices.

On the other hand, the price of Textiles, Clothing and footwear continued on an upward trend for the fifth consecutive quarter, although at a slower pace. They grew by 3% in the fourth quarter of 2016 against a 4.8% increase in the previous quarter.

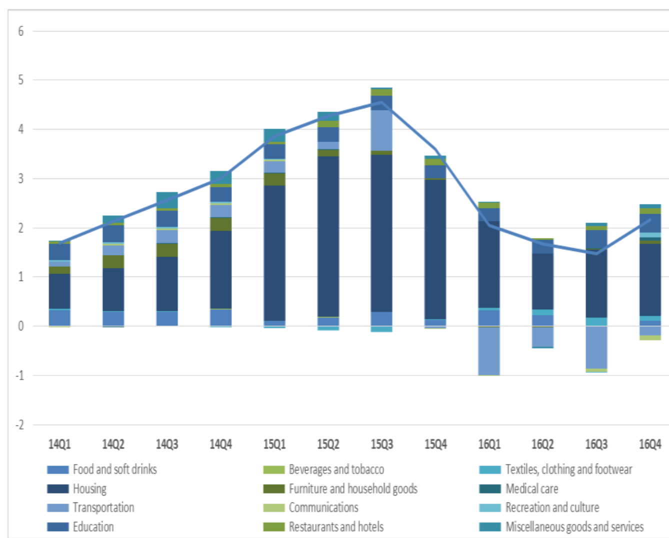
Education costs which account for around 7.7% of the standard consumption basket, have been following an increasing trend from the beginning of the year. They increased by 5% during the fourth quarter of 2016 against an increase by 3.8% and 4.6% in the second and the third quarters, respectively.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

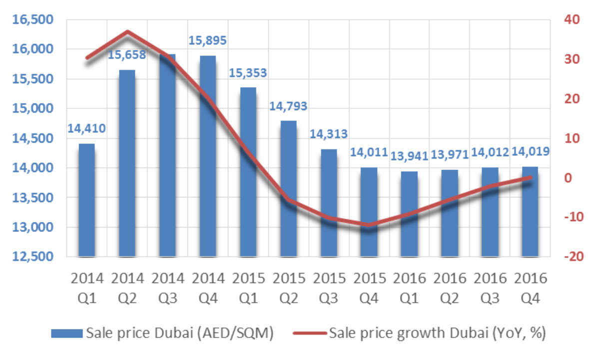
Box 2: Recent Developments in the Real Estate

Abu Dubai and Dubai have witnessed different patterns of change in Real Estate market, according to REIDIN Price Index[4], for the residential segment. In fact, during the fourth quarter of 2016, the change in property prices in Dubai increased slightly, as opposed to the decline in the Abu Dhabi market (0.05% y-o-y against -2% respectively). Moreover, the rental yield in both emirates has contracted during 2016 due to the more pronounced fall in rents, but remains attractive for investors (7.06% for Abu Dhabi and 7.2% for Dubai).

Dubai residential Market

In Q4 2016, the change in property prices, which measures the average sample price in dirham per square meter, improved marginally compared to last year, but performing better than the previous quarter (see figure 1). Therefore, the trend observed during 2016 showed a slight recovery in the residential market in Dubai.

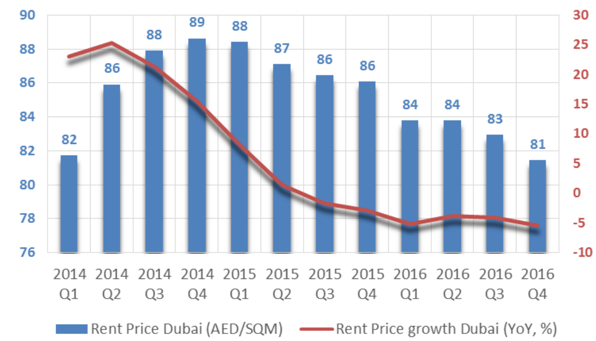
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

Since the beginning of the downward cycle in mid-2014, the fall in prices has outpaced the fall in rents in Dubai (see figure 2). Indeed, the rent prices declined by an annual rate of 5.4% in the fourth quarter, following -4% in the third quarter.

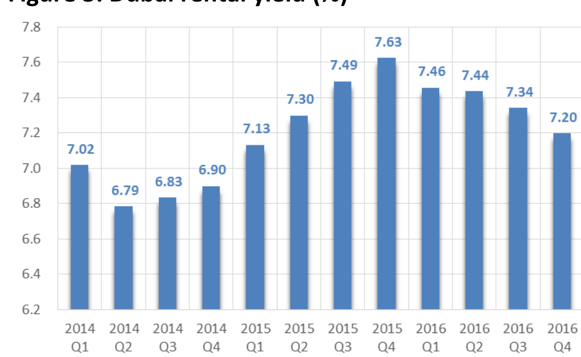
Figure 2: Dubai Residential Rent Prices



Source: REIDIN, Central Bank of the UAE

The more pronounced fall in prices relative to rents has led to an increase in rental yield from a low of 6.79% in second quarter of 2014 (the beginning of the price correction) to a high of 7.63% in the fourth quarter of 2015 (See Figure 3). However, during 2016, relatively stable prices combined with further decline in rents have led the rental yield to contract reaching 7.2% in the last quarter of 2016. The pattern observed in rental yield is typical of the real estate market and is due to two main reasons. First, rent adjustments tend to lag price adjustments, leading rental yield to increase at the initial phase of the correction driven by lower prices, and then to decrease when prices start stabilizing. Second, real estate prices tend to be more speculative and sentiment driven.

Figure 3: Dubai rental yield (%)



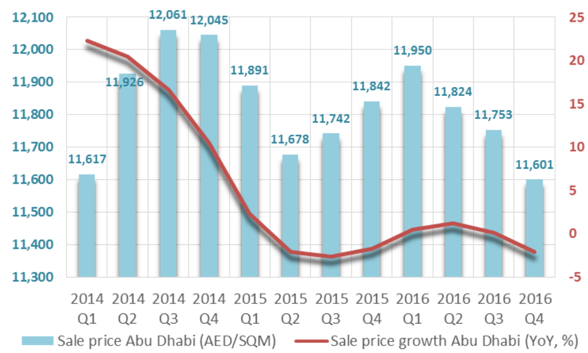
Source: REIDIN, Central Bank of the UAE

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

Abu Dhabi residential Market

For Abu Dhabi, the recent data showed a fall in residential property price of 2% y-o-y in the fourth quarter, following a marginal increase of 0.1% in the previous quarter (See Figure 4).

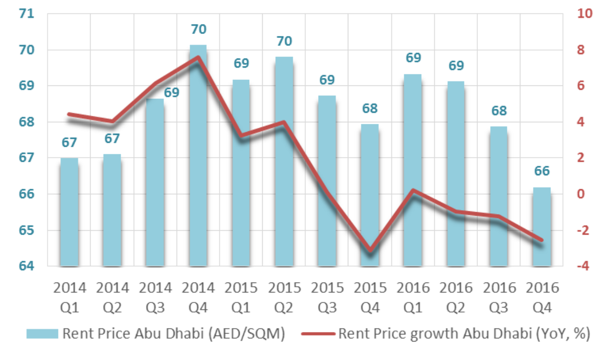
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

Concerning the rental market in Abu Dhabi, rent values declined by an annual rate of 2.56% in the last quarter of 2016, after a reduction of 1.25% in the previous quarter, reflecting the decline of demand in line with developments in the job market, compared to existing supply, during this period (See Figure5).

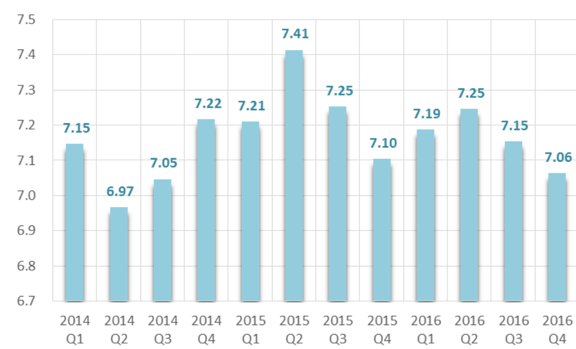
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

As for the rental yield, Abu Dhabi registered a yield of 7.06% for the fourth quarter of 2016, down from 7.15% in the previous quarter (See Figure 6), reflecting a faster pace of decline in rent relative to property values in consistency with the lagged effect on the job market relative to the speculative nature of investment in properties with the outlook for the economy given fluctuations in the oil price.

Figure 6: Abu Dhabi rental yield (%)

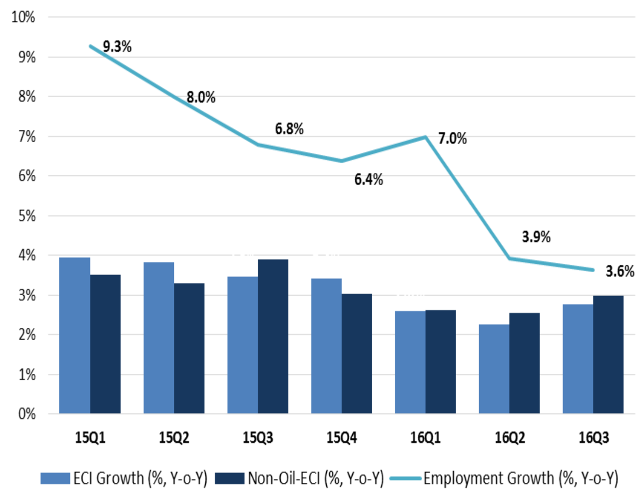


Source: REIDIN

2.3 Employment and labor market dynamics

The number of employed persons by the UAE economy for different sectors has increased during the third quarter of 2016[5]. Despite the impact of the adverse oil price shock, the labor market has shown a remarkable resilience so far. The employment level has increased by 3.6% during the third quarter on a year-on-year basis against a 3.9% increase during the second quarter (see Figure 2.3.a).

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

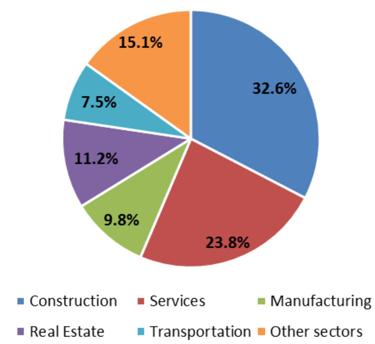


Source: Central Bank of UAE and Ministry of Human Resources and Emiratisation

The slowdown of the Economic activity, charted by the ECI and the Non-Oil ECI (see Figure 2.3.a), has weighed on the labor demand, triggering a decreasing trend for employment growth which declined from 9.3% in the first quarter of 2015 to reach 3.6% in the third quarter of 2016, with a unique seasonal pick up of 7% in the first quarter of 2016.

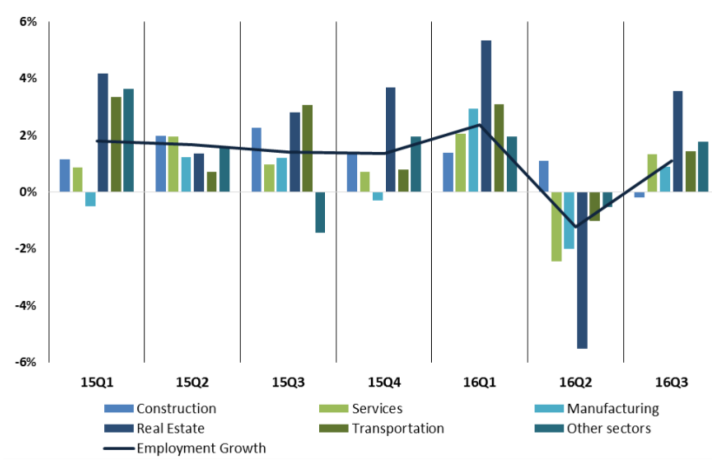
The short-run variations of employment show a more detailed picture about the labor market dynamics. In fact, employment has declined by 1.2% in the second quarter of 2016 on a quarter-to-quarter basis, after a stable period of growth. Employment grew on average by 2% from the second quarter of 2014 to the first quarter of 2016.

Figure 2.3.b. Composition of Employment in the UAE by Sector (quarterly average 2014-2016)



Source: Ministry of Human Resources and Emiratisation

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



Source: Ministry of Human Resources and Emiratisation

The developments of employment are driven mainly by economic activity and demand for labor in construction, services and real estate sectors. They account altogether for around 68% of the total employment in the economy (see Figure 2.3.b).

The construction sector which absorbs around 33% of the total employment has cut its labor demand by 0.2% in the third quarter of 2016 compared to the previous quarter for the first time, after a stable average increase by 1.6% since 2014 (see Figure 2.3.c).

[5] Data for the fourth quarter of 2016 are not available yet. The analysis will be updated whenever the data are released.

The services sector (around 24% of the total employment) has increased its labor demand by 1.3% in the third quarter of 2016 after plunging by 2.4% during the second quarter of 2016. The employment level by the services sector increased on average by 1.7% during the period from the first quarter of 2014 to the first quarter of 2016. Employment growth for the sector attained its maximum in the second quarter of 2014 as labor demand rebounded by 2.9%.

The real estate sector which accounts for around 11% of the total employment has increased its labor demand by 3.5% in the third quarter of 2016 compared to the previous quarter. The employment for the real estate sector dropped significantly during the second quarter of 2016; it fell by 5.5% compared to the first quarter of 2016 where it realized its highest record from 2014 (5.4% increase compared to the fourth quarter of 2015). The quarterly average growth of employment for the real estate sector was around 2.6% until the first quarter of 2016.

2.4 Exchange Rate and Foreign Trade Balance

The Dirham continued its appreciation for the second successive quarter. It started the year by appreciating against its main trade partners' currencies to plunge during the second quarter of 2016 and rebound again during the third and fourth quarters following an increasing path.

From the import side, the weighted Dirham's appreciation against its top-nine non-dollarized import partners was 1.57% in the fourth quarter of 2016 (see Table 2.3.a). It is the highest reading since the first quarter of 2015, where the Dirham appreciated against its main import partners by 1.91%. The Dirham has appreciated significantly against all its main import partners, with an average bilateral appreciation of 3.6% during the fourth quarter of 2016.

The highest appreciation was against the Japanese Yen and the Great Britain Pound, where the Dirham gained around 7% and 5.7%, respectively. The post Brexit effect continues to weigh on the Pound for the second consecutive quarter. The UK and Japan are contributing by around 9% to the total imports. The Dirham gained also 2.5% and 3.5% against the Chinese Yuan and the Euro, respectively. Imports coming from China and the main Eurozone trade partners (Germany, Italy and France) account for more than 24% of total imports.
The Dirham gained also 3.5% and 2.6% against the South Korean Won and the Swiss Franc, respectively. On a year-on-year basis, the Dirham followed the same trend and appreciated by 1.49% during the fourth quarter, driven mainly by important gains against the GB Pound (22%), the Chinese Yuan (6.9%) and the Euro (1.5%) accounting for 27.8% of total imports.
On the export side, the Dirham has appreciated against its top-nine non-dollarized export partners by 1.17% in the fourth quarter of 2016 compared to the previous quarter and by 1.25% on a year-on-year basis (see Table 2.3.b). The most important gain of the Dirham was around 10.95% against the Turkish Lira, where Turkey constitutes the fourth export partner, receiving 5.16% of the total UAE non-oil exports, after India (12.47%), Switzerland (5.64%) and Iraq (5.61%). The Dirham appreciated also against the Singaporean Dollar by 4.34% where Singapore receives around 4.3% of the total non-oil exports. The Dirham has appreciated against all its main export partners and the average bilateral appreciation was around 2.9%.

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

Currency	Share of UAE imports (%) 2015	% Change of Currencies per Dirham (Q2-Q1) 2016	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham (Q4-Q3) 2016	% Change of Currencies per Dirham (2016Q4 -2015Q4)
Chinese Yuan	12.40	-0.09	2.02	2.53	6.91
Indian Rupee	9.70	-0.85	0.05	0.76	2.35
Germany (EUR)	6.48	-2.28	1.16	3.54	1.54
Japanese Yen	5.65	-6.29	-5.19	7.08	-9.73
UK Pound	3.35	-0.09	9.21	5.67	22.03
Italy (EUR)	2.99	-2.28	1.16	3.54	1.04
South Korean Won	2.87	-3.07	-3.69	3.48	1.54
France (EUR)	2.53	-2.28	1.16	3.54	0.13
Swiss Franc	2.53	-2.25	0.47	2.60	1.54
Total	**48.50**				
Weighted Appreciation		**-0.87**	**0.32**	**1.57**	**1.49**

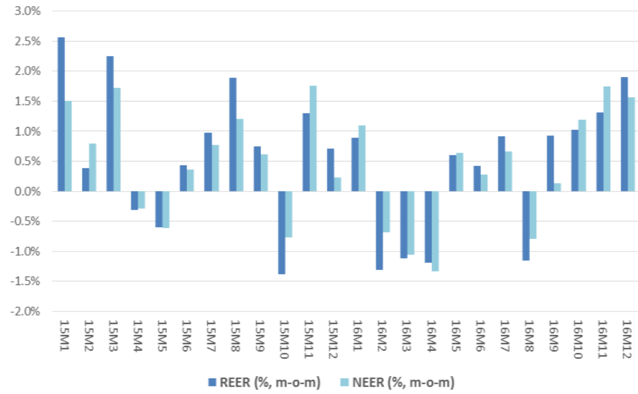
Source: Data on Imports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2015.Data for the exchange rate are the quarterly average observations, recorded and displayed by Bloomberg.

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

Currency	Share of UAE Exports (%) 2015	% Change of Currencies per Dirham (Q2-Q1) 2016	% Change of Currencies per Dirham (Q3-Q2) 2016	% Change of Currencies per Dirham (Q4-Q3) 2016	% Change of Currencies per Dirham (2016Q4 -2015Q4)
Indian Rupee	12.47	-0.85	0.05	0.76	2.35
Swiss Franc	5.64	-2.25	0.47	2.60	1.04
Iraqi Dinar	5.61	0.12	0.16	0.29	0.08
Turkish Lira	5.16	-1.41	2.32	10.95	13.17
Singapore Dollar	4.26	-3.12	-0.41	4.34	0.27
Kuwaiti Dinar	4.01	-0.04	0.05	0.80	0.30
Chinese Yuan	2.34	-0.09	2.02	2.53	6.91
Netherlands (EUR)	1.84	-2.28	1.16	3.54	1.54
Pakistan	1.78	-0.12	0.01	0.16	-0.10
Total	**43.11**				
Weighted Appreciation		**-0.48**	**0.22**	**1.17**	**1.25**

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

Figure 2.4.a Nominal and Real Effective Exchange rates Developments



Source: Bank of International Settlement (BIS)

The rebound of the Dirham against its trade partners is confirmed by the Real and the Nominal Effective Exchange Rates developments in the fourth quarter of 2016 (see Figure 2.3.a). The quarterly average REER, has increased by 2.7% to which the NEER growth contributed totally by a quarterly average increase of 2.7%. The contribution of the relative price change to the REER appreciation was negligible during the fourth quarter of 2016.

The continuous appreciation of the Dirham during 2016 had a significant impact on the remittances outflows as well as on tourism activity in the UAE. The remittances outflows during the first eleven months[6] of 2016 has increased by 9.9% compared to the same period of 2015, where India continues being the leading destination of remittances outflows with a share of 35.4% (see Box 3 for more details).

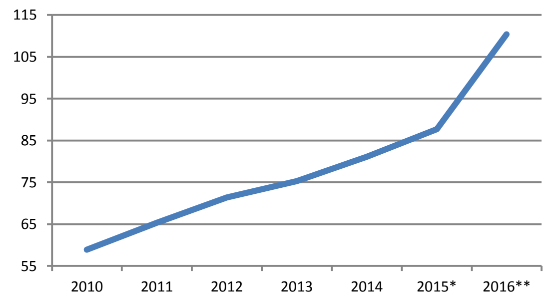
On the other hand, tourism activity picked up due to flexibility in pricing, notwithstanding the Dirham appreciation. In fact, the number of visitors has increased by 4.9% in the first eleven months of 2016 compared to the same period in 2015. However, reduction is recorded in the average daily rate and the revenue per available room by 10.1% and 11.2% respectively in Dubai and Abu Dhabi which resulted in an increase in occupied room nights by 4.1% (see Box 4 for more details).

[6] The remittances and Tourism data are available only for the first eleven months.

Box 3: Dirham's Appreciation and Workers' Remittances

The payments (outflows) of workers' remittances[7] show an increasing trend for the period 2010-2016 as depictured in the Figure 1.

Figure 1. Evolution of Private Transfers (in billions of Dirhams)

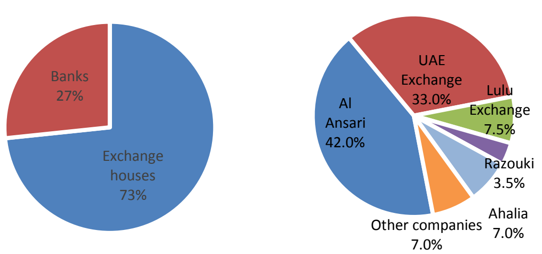


** Provisional data, ** Estimation*
Source: CBUAE

In the first eleven months of 2016 the Banking Supervision Department of the Central Bank (BSD) indicated that 73% of the financial transfers are conducted through the exchange houses and 27% through the banks (figure 2.a).

According to the market participants' estimates and the latest available data of the third quarter of 2016, the major companies in the field of exchange houses that possess the largest market share account for around 93% of the market for workers' remittances outflow from the UAE through exchange houses (figure 2.b).

Figure 2. Share of settlement of total workers' remittances and shares of major exchange companies



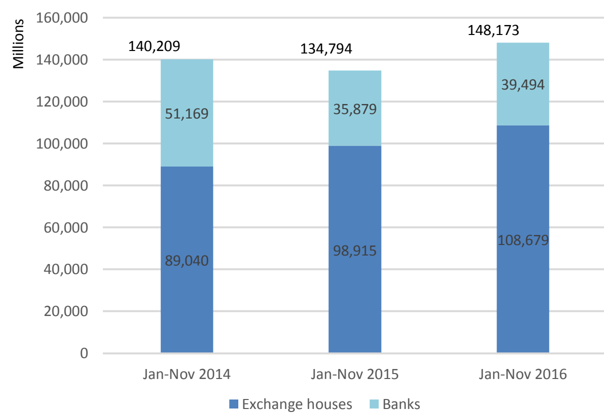
Source: CBUAE, Banking Supervision Department

The combined data reported from the exchange houses and the banks to BSD recorded AED 148.2 billion outflows in the first eleven months of 2016 and 9.9% or AED 13.4 million increase compared to the same period of 2015 (AED 134.8 billion) (figure 3).

The outflows of the workers' remittances that were settled through the exchange houses only recorded AED 108.7 billion in the period January-November 2016 (9.9% or AED 9.8 billion increase compared to 2015).

The increasing trend in the first eleven months of 2016 of the total outflows of private transfers could be attributed to the rate of appreciation of the nominal effective exchange rate of the dirham by 2.7% on average (the average index for the first eleven months of 2016 117.7) compared to the same period of 2015 encouraging less outflows.

Figure 3. Evolution of Workers' remittances settled through Banks and Exchange houses in the UAE 2015 Q1 – 2016 Q3



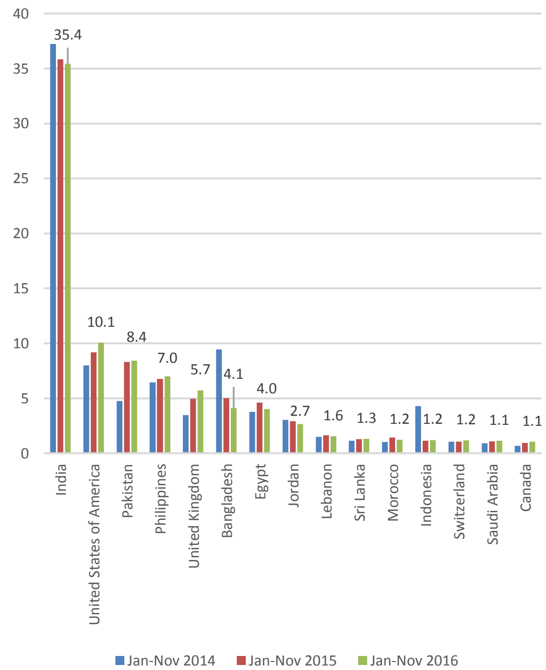
Source: CBUAE, Banking Supervision Department

The most important country of destination for workers' remittances during the period January-November 2016 was India that accounted for 35.4% of the outflows of workers' remittances in accordance with the significant share of expats from India in the UAE (figure 4). According to available population statistics, dated October 2008 from the Federal Competitiveness and Statistics Authority, 82.7% of the employees in the UAE belong to Asian Non-Arab Countries which include India.

[7] The private transfers in the balance of payments include personal transfers (workers' remittances) and other current transfers. Other current transfers include, for example, current taxes on income, wealth etc., social contributions, benefits and current international cooperation. Information on other transfers is not currently available.

The next five most important countries in the share of outflows of expat workers were the United States of America (10.1%), Pakistan (8.4%), Philippines (7.0%), and the United Kingdom (5.7%).

Figure 4. Share of the major countries for workers' remittances during January-November 2014-2016 (percentage of total, exchange houses and banks)



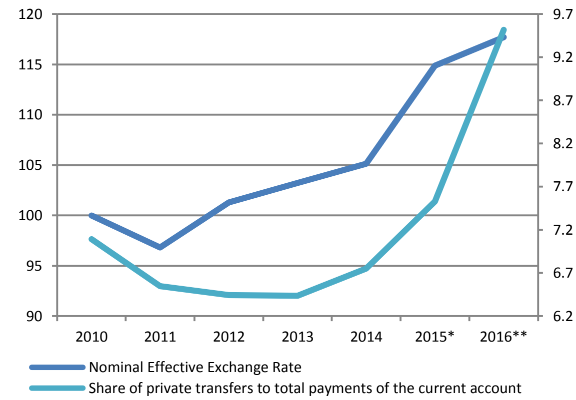
Source: CBUAE, Banking Supervision Department

Between the period January – November of 2015 and 2016, the United Kingdom was the country with the largest increase in outflows, reflecting continued depreciation of the British pound relative to the dirham, pegged to the US dollar.

The total recorded workers' remittances for the first eleven months of 2016 represents 169% of the total for 2015 (at AED 87.7 billion).

The share of private transfers to the total payments of all components of the current account shows an increasing trend over time. The Figure 5 depicts this pattern since 2010 along with movement in the nominal effective exchange rate of the dirham relative to the currencies of major trading partners. Higher outflows, coupled with less oil receipts has squeezed the surplus of the current account balance.

Figure 5. Share of Private Transfers to the total payments of the Current Account (%) and the NEER (2010-2016)



** Provisional data, ** Estimation*

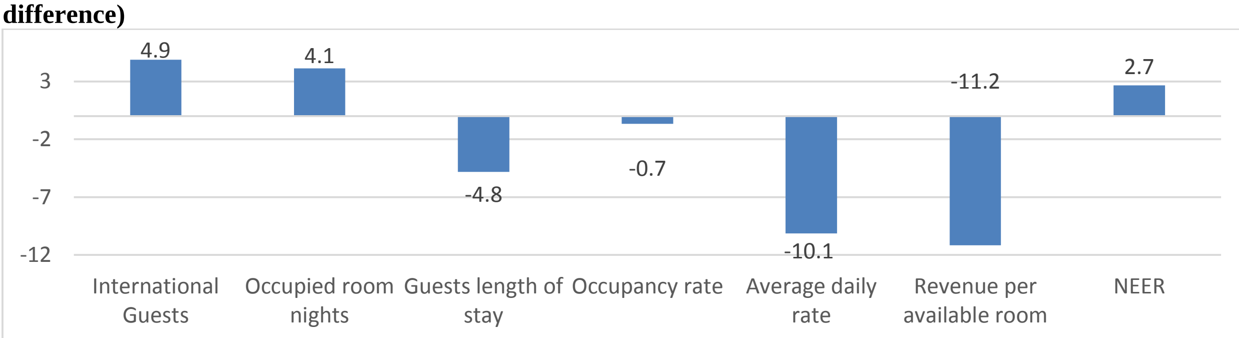
Note: Annual average of NEER and average of first eleven months for 2016

Source: CBUAE, Bank of International Settlements

Box 4: Dirham's Appreciation and Tourism Activity in the UAE

The analysis below tracks the effect of the dirham appreciation on UAE tourism for the period January – November 2016 compared to January – November 2015 based on the most recent data available from Dubai and Abu Dhabi Emirates which contribute the largest shares of the total aggregate. Figure 1 illustrates an increasing trend in attracting international visitors, the number of which has increased by 4.9% in the first eleven months of 2016 compared to the same period in 2015. However, reduction is recorded in the average daily rate and the revenue per available room by 10.1% and 11.2% respectively (average prices of the two emirates) which resulted in an increase in occupied room nights by 4.1%. More specifically, the appreciation of the dirham in terms of the nominal effective exchange rate by 2.7% on a year-to-date basis correlates with the increasing trend of guest arrivals. However, the average hotel occupancy rate decreased marginally by 0.7% for the first eleven months of 2016, compared to 2015.

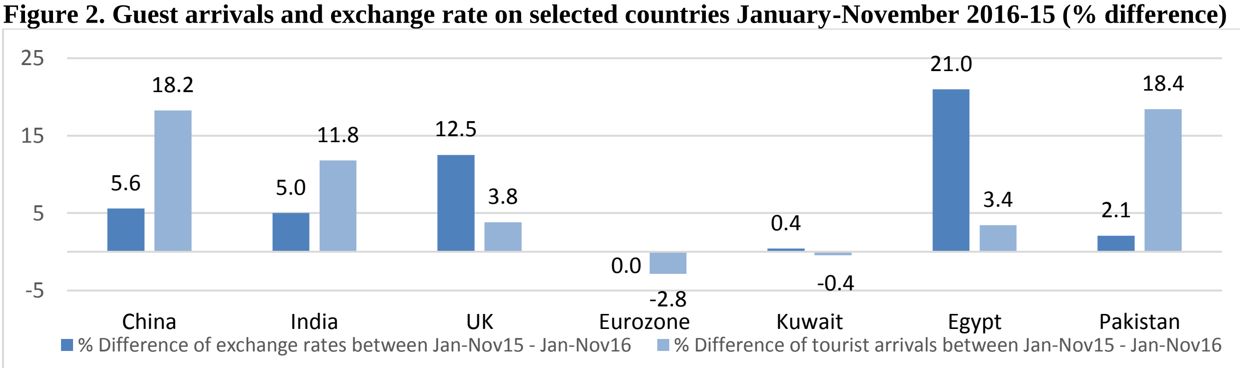
Figure 1: Major combined indicators of Dubai and Abu Dhabi inbound tourism January-November 2016-15 (% difference)



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

The effect of the bilateral exchange rate movements on tourism between January-November 2016, compared to January-November 2015 is depicted in figure 2 where the appreciation of AED is depicted with respect to the currencies of major countries for tourists, combined with their tourists' arrivals. For all countries below, there has been a surge in the number of tourists, despite the appreciation of the dirham, except for Germany in the Eurozone and Kuwait. Specifically, Pakistan, China and India recorded larger increase in tourist arrivals despite the appreciation of the dirham relative to their currencies. In contrast, Egypt and the UK recorded a relatively slower influx of tourists, reflecting larger appreciation of the dirham relative to their respective local currencies.

Figure 2. Guest arrivals and exchange rate on selected countries January-November 2016-15 (% difference)



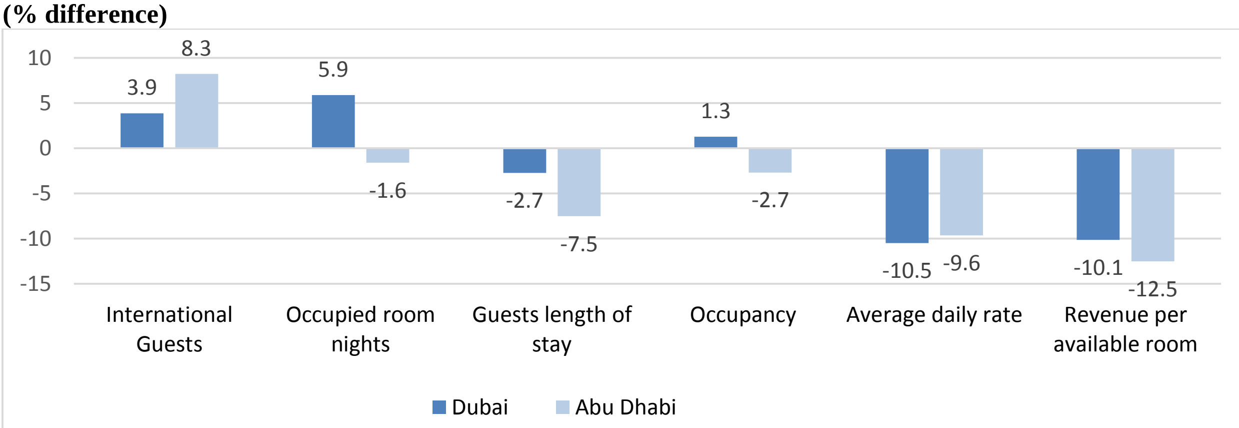
Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority, Bloomberg

Focusing on the developments in the emirates of Dubai and Abu Dhabi, Figure 3 demonstrates that the appreciation of the dirham correlates with increasing trends of guest arrivals, both in Dubai and in Abu Dhabi. In parallel, there is evidence of decreased average length of tourists' stay despite the increase in tourist arrivals, which adversely affect the evolution of receipts. The evidence suggests a strategy to retain tourists by providing more discounts to avert a slowdown in the growth rate of tourism.

Specifically, for the Dubai emirate, an increasing trend is recorded in attracting international visitors, the number of which increased by 3.9% in the first eleven months of 2016 compared to the same period of 2015. However, reduction is evident in the average daily rate and the revenue per available room by 10.5% and 10.1% respectively, which resulted in an increase in occupied room nights by 5.9%. Simultaneously, the average hotel occupancy rate increased from 77% to 78%, for the first eleven months of 2016, compared to 2015.

The effect of dirham appreciation on tourism in the Abu Dhabi emirate depicts similar pattern, although with notable increase in guest arrivals (8.3%) in the first eleven months of 2016 compared to the same period in 2015. However, the lower average room rate (9.6% decrease) resulted in 9.2% decrease in total revenue per room for the first eleven months of 2016 compared to the same period of 2015.

Figure 3: Major indicators of Dubai and Abu Dhabi inbound tourism January-November 2016-15 (% difference)



Source: Dubai Tourism Authority, Abu Dhabi Tourism Authority[8]

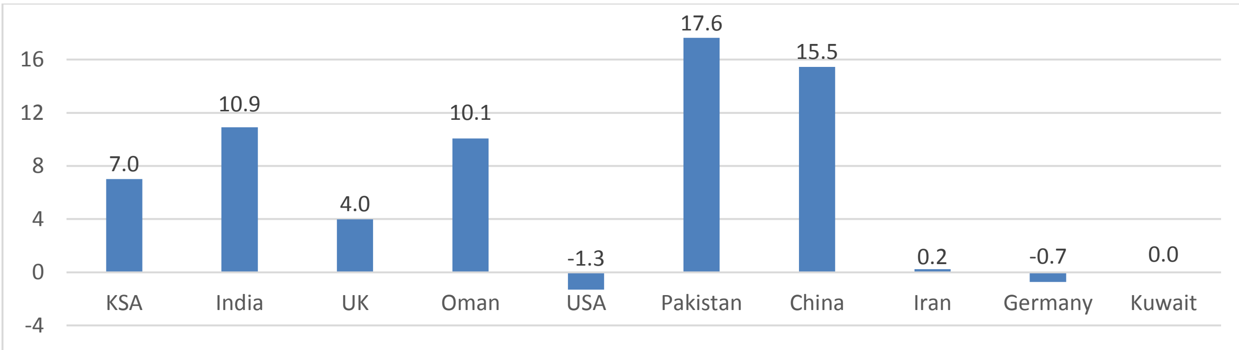
Most of the major countries that are the markets of inbound tourism to Dubai show increase in the arrivals of tourists, except from Germany and USA. Nonetheless, the vast majority of tourists originate from GCC countries and the MENA region (24% and 11% respectively) while Western Europe and North America cover 21% and 6% of inbound tourism. Finally, 17% of inbound tourism comes from the region of South Asia.

Between the major markets of inbound tourism for the Abu Dhabi Emirate, all countries recorded increase in guest arrivals apart from Germany (-9.2%) and the US (-11.9%). The largest increase in guest arrivals is evident from Jordan (27.9%), China (25.3%) and Philippines (25.1%).

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

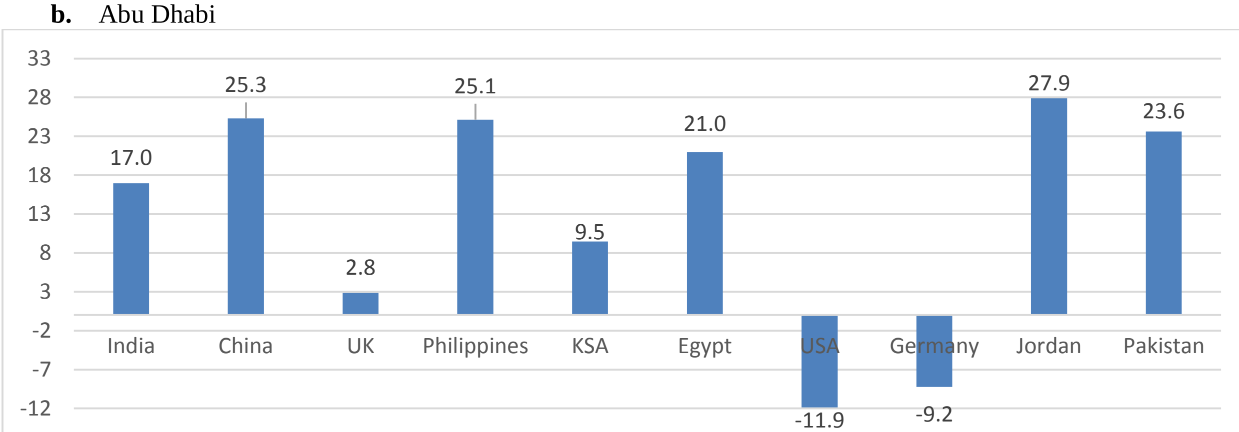
Figure 4. Major markets of inbound tourism January-November 2016-15 (% difference)

a. Dubai



Source: Dubai Tourism Authority

b. Abu Dhabi



Source: Abu Dhabi Tourism Authority

2.5 Fiscal Stance

The fiscal consolidation initiated by the government in 2015, after an important plunge of oil prices since mid-2014, has slowed down during the second and the third quarters of 2016.

After a sharp decline of government spending during the first quarter of 2016 where spending was cut by 43.3% on a year on year basis, the government started a growth-friendly fiscal policy during the second quarter of 2016. Government spending increased by 8.3% and 28% during the second and third quarters of 2016, respectively (see Table 2.5).

The third quarter of 2016 was marked by an increase of all public spending items, except for interest payments on outstanding debt and social benefits expenditures. They declined by 45.5% and 60.4%o a year-on-year basis, respectively.

The rebound of public spending in the third quarter of 2016 was driven mainly by a jump of capital spending by 109% as well as grants by 247%. In addition, the compensation of employees and the consumption of fixed capital increased by 8.8% and 31.8%, respectively.

Other expenses which cover all Abu Dhabi's transfers made on behalf of the Federal Government and accounts mainly for military expenditures, rose by around 49.8% during the third quarter of 2016 after an important decline that started in 2015 and was accelerated in the first quarter of 2016 where the drop was by 88.7%.

Subsidies and transfers to GREs continued their increasing trend during the third quarter of 2016. They grew by 24.2% during the third quarter of 2016 against a previous sharp increase by 108.5% during the second quarter. Given the ongoing energy-subsidy cut, this development may be considered as the net impact of an increase of transfers to GREs.

On the Other hand, total revenues continued their improvement for the third consecutive quarter in 2016. They increased by 31% during the third quarter of 2016, on a year-on-year basis after an increase of 22% during the previous quarter. The increase of revenues was triggered by a 15% increase of social contributions and an increase of others revenues by 151%. These other revenues include principally the property income, sales of goods and services and fines and penalties. It is noteworthy that these revenues do not include profit transfers from the national oil company to the sovereign wealth funds, neither the government investment income.

Nonetheless, tax revenues have declined during the third quarter of 2016 by 30.9% on account of a reduction of taxes on oil companies. It is the seventh consecutive decline in taxes. The most important decline was during the first quarter of 2016 where taxes tumbled by 61.5% on a year-on-year basis with the sharp reduction in the oil price.

Table.2.5 Consolidated Government Finances

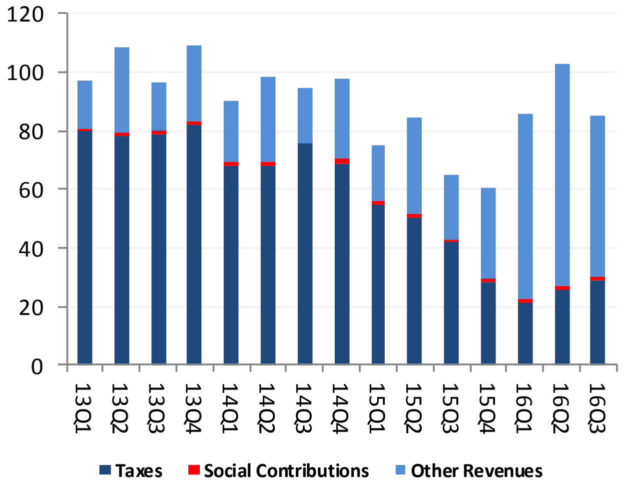
	2014	2015					Change (%, Y-o-Y)					2016			Change (%, Y-o-Y)		
		Q1	Q2	Q3	Q4	2015	2015Q1	2015Q2	2015Q3	2015Q4	2015	Q1	Q2	Q3	2016Q1	2016Q2	2016Q3
Revenues (a)	**380.7**	**74.9**	**84.2**	**64.8**	**60.7**	**284.7**	**-17.0**	**-14.2**	**-31.5**	**-37.9**	**-25.2**	**85.7**	**102.7**	**84.9**	**14.3**	**21.9**	**31.1**
Taxes	279.9	54.9	50.6	41.9	28.1	175.4	-19.4	-25.4	-44.5	-59.0	-37.3	21.1	26.0	28.9	-61.5	-48.5	-30.9
Social contributions	5.3	1.1	1.1	1.0	1.3	4.5	14.0	-27.8	172.1	-46.5	-14.6	1.5	1.2	1.2	37.5	3.4	15.0
Other revenues	95.5	19.0	32.5	21.8	31.4	104.7	-10.4	13.2	17.1	16.6	9.7	63.1	75.5	54.8	232.2	132.2	151.0
Expenditure (b)	**414.6**	**89.9**	**96.1**	**85.6**	**93.3**	**364.8**	**-13.6**	**-7.4**	**-13.5**	**-13.6**	**-12.0**	**51.0**	**104.0**	**109.5**	**-43.3**	**8.3**	**28.0**
Compensation of employees	47.5	14.4	15.8	14.5	14.4	59.1	36.4	38.0	27.3	2.1	24.4	15.5	15.8	15.8	7.6	0.1	8.8
Use of goods and services	49.5	10.5	13.5	10.8	16.3	51.0	18.3	11.5	-22.0	10.4	3.0	10.4	14.8	11.1	-0.6	9.5	3.6
Consumption of fixed capital	3.8	0.9	1.1	0.9	1.5	4.4	0.3	48.1	-14.8	37.7	16.7	1.1	1.5	1.2	32.1	38.2	31.8
Interest	4.1	0.5	0.5	0.6	1.3	2.9	-52.4	-49.1	-38.3	13.8	-29.5	0.2	0.4	0.3	-49.0	-16.0	-45.5
Subsidies	12.1	3.1	3.1	3.1	3.1	12.3	22.1	-14.1	-10.3	19.9	1.7	4.3	6.4	3.8	41.4	108.5	24.2
Grants	21.9	3.1	2.8	2.5	2.1	10.6	-67.9	-54.9	-55.1	507.3	-51.8	0.5	0.5	8.6	-85.4	-81.3	247.0
Social benefits	61.4	12.9	15.2	13.5	11.6	53.2	2.2	9.5	-16.1	-38.4	-13.4	6.3	5.4	5.4	-51.6	-64.7	-60.4
Other expenses	174.4	39.9	35.4	33.4	37.0	145.7	-23.8	-13.6	-10.2	-15.7	-16.4	4.5	47.8	50.1	-88.7	34.8	49.8
Net acquisition of non-financial assets	39.9	4.7	8.7	6.4	5.9	25.6	-15	-36.7	-33.3	-47.2	-35.8	8.1	11.4	13.3	73.8	31.2	109.7

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

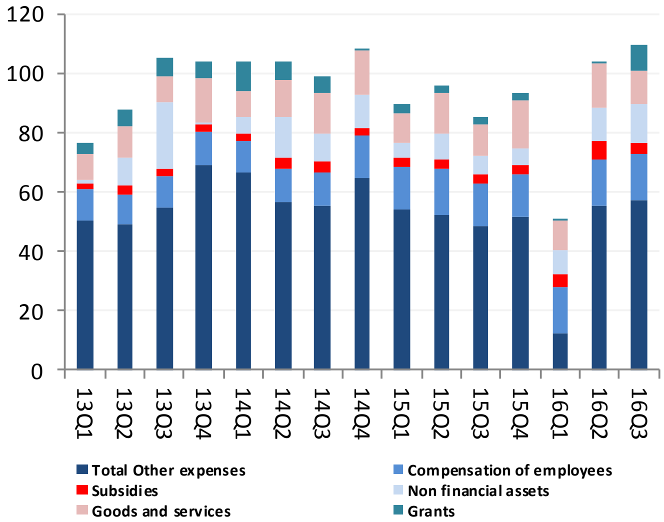
Note: All values are expressed in Billions of Dirhams unless otherwise indicated.

Government Finance

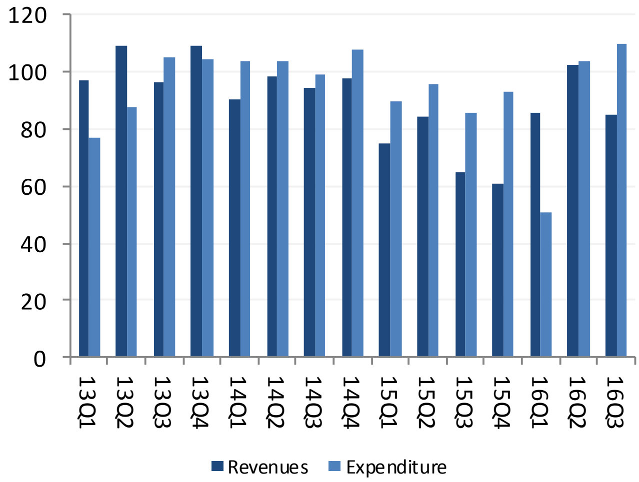
2.5. a General Government Revenues
(Billions of Dirhams)



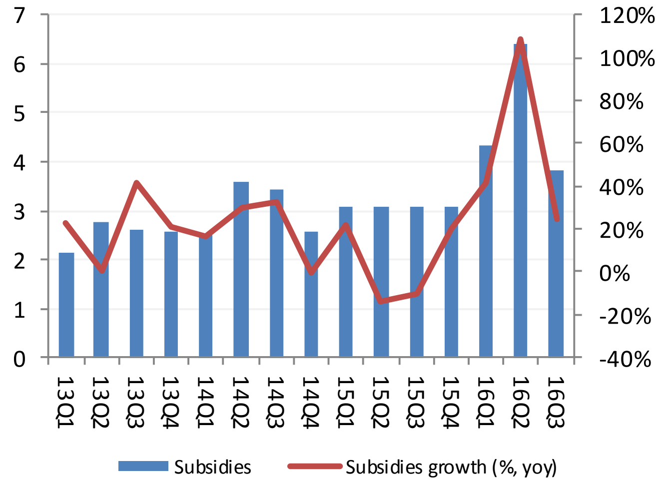
2.5.b General Government Expenditures
(Billions of Dirhams)



2.5.c Fiscal Stance
(Billions of Dirhams)



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



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

2.6 Financial developments

2.6.1 Share Price Volatility

After a rebound of share prices and market capitalization in both Abu Dhabi and Dubai during the second and third quarters of 2016, a declining trend started in the fourth quarter despite the improvement of oil prices in the fourth quarter (9.3% Q-o-Q and 15.3% Y-o-Y).

In Abu Dhabi, the average Share Price Index fell by 2.7% in the fourth quarter of 2016 against an increase of 1.7% in the previous quarter. Following the same momentum, the market capitalization dropped by 3% in the fourth quarter after an important increase (5.8%) in the previous one (see Table 2.6.1).

The securities market's situation in Dubai is quite similar. The Share Price Index declined by 2.3% in the fourth quarter. On the other hand, the market capitalization dropped in the fourth quarter on average by 3.3%.

Despite the deterioration of the Share Price Indices and the Market Capitalization in both markets, the price volatility[1] continued, albeit declining. In Abu Dhabi, the price volatility dropped by 2.7% Q-o-Q in the fourth quarter. Moreover, the volatility of the Share Price Index in Dubai has declined by 5% compared to the previous quarter.

The volatility decline in both securities markets is due to the positive sentiment regarding the resiliency of the non-oil sector which helped re-establishing investors' confidence and reduced uncertainty. In addition, the improvement of oil prices and the commitment of the UAE to the OPEC agreement regarding oil production cut reinforced optimism and confidence in financial markets.

Table 2.6.1 UAE – Securities Markets

		2015		2016			
		Q3	Q4	Q1	Q2	Q3	Q4
Abu Dhabi	Change of Share Price Index (%)	-0.5	-7.0	-0.5	3.9	1.7	-2.7
	Change of Market Capitalization (%)	2.2	-1.4	1.0	1.9	5.8	-3.0
Dubai	Change of Share Price Index (%)	-6.9	-13.5	-2.7	5.5	3.4	-2.3
	Change of Market Capitalization (%)	-1.6	-10.3	-3.4	6.4	1.4	-3.3

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

2.6.2 Credit Default Swaps Premiums

The positive spillovers stemming from the recent positive developments of oil prices and the resilience of the non-oil sector has removed an important part of uncertainty and reduced default likelihood of sovereigns and GREs. The spreads of Credit Default Swaps (CDS) has largely tightened during the fourth quarter of 2016.

The CDS of Sovereigns fell by 17% and by 10.5% in Abu Dhabi and Dubai, respectively, in the fourth quarter of 2016 compared to the previous one.

The CDS of DP World declined by 2.2% in the fourth quarter with an average quarterly level of 143.6 bp, the lowest reading since the third quarter of 2014. The CDS of Dubai Holding decreased by 2.5%, showing the lowest reading since the fourth quarter of 2015.

Table 2.6.2. UAE - Credit Default Swaps (CDS)

	2015			2016			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sovereigns							
Abu Dhabi	52.0	77.4	92.6	93.6	87.5	74.3	61.5
Dubai	191.4	196.9	233.7	215.0	182.5	167.3	149.8
GREs							
DP World	188.5	190.0	183.9	196.9	202.3	146.8	143.6
Dubai Holding	340.8	322.5	421.0	352.0	336.3	311.7	303.8

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

[1] The volatility is measured by the standard deviation

Chapter 3. Monetary & Banking Developments

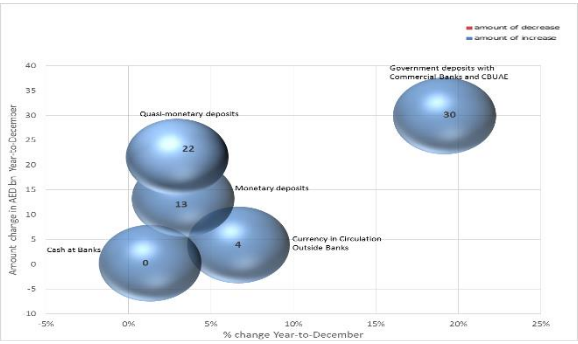
Government deposits increased significantly in the last quarter of 2016, with the private sector contributing also to the deposit growth. As a result, monetary aggregates increased. Banks continued to increase credit at a rate that supports growth in the non-oil activities. The Financial Soundness Indicators (FSIs) improved significantly, showing that the UAE banking system is sound and enjoys financial stability.

3.1 Monetary Aggregates

During the last quarter of 2016, all the Money Supply Aggregates increased. For M1 the increase was marginal, while M2 and M3 grew by 2.1% and 3.1%, respectively.

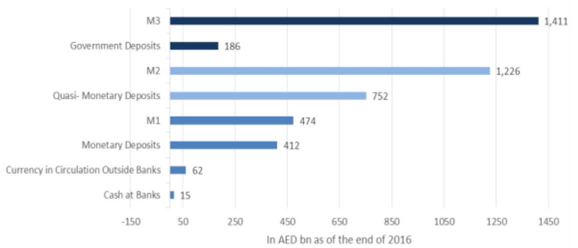
The reason for M1 remaining almost unchanged at the end of December compared to September 2016 is the decline of cash at banks by 1.3%, which was fully compensated for by the increase in Currency in circulation outside banks and Monetary Deposits, that grew by 0.8% and 0.2% respectively compared to the end of 2016 Q3. The strong growth in M2 is due to the important increase in Quasi-monetary deposits by AED 23.8bn (3.3%). Meanwhile, M3 grew even faster due to the increase in Government deposits by AED 17.5bn (10.4%), during this period.

Figure 3.1.a.UAE Monetary aggregates components growth



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

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



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

3.2 Banking Activity

The 23 locally-incorporated banks have further decreased the number of branches at 846 at the end of 2016 Q4 compared to 857 at the end of September 2016, due to banks looking for higher efficiency. The 26 foreign banks have kept the number of branches at 85 at the end of 2016 Q4, same as at the end of September.

3.2.1 Banks' Deposits

Total Customer Deposits at banks increased in 2016 Q3 by AED 15.7bn due to the increase in Resident Deposits by AED 5.9bn and Non-resident Deposits by AED 9.8bn.

Table 3.2.a.Deposits at UAE Banks

	2015	2016			
	Dec	March	June	Sep	Dec
Bank Deposits	**1,471.6**	**1,502.6**	**1,493.0**	**1,508.7**	**1,562.9**
(Q-o-Q change %)	2.4	2.1	-0.6	1.1	3.6
(Y-o-Y change %)	3.5	3.7	3.4	5.0	6.2
Resident Deposits	**1,300.2**	**1,325.1**	**1,315.9**	**1,321.8**	**1,363.9**
(Q-o-Q change %)	1.7	1.9	-0.7	0.4	3.2
(Y-o-Y change %)	2.6	1.8	2.1	3.4	4.9
Government Sector	**157.4**	**155.5**	**185.9**	**169.5**	**186.8**
(Q-o-Q change %)	-4.2	-1.2	19.5	-8.8	10.2
(Y-o-Y change %)	-16.6	-15.4	14.1	3.2	18.7
GREs	**190.8**	**193.3**	**161.5**	**172.2**	**168.2**
(Q-o-Q change %)	10.1	1.3	-16.5	6.0	-1.8
(Y-o-Y change %)	10.1	0.7	-12.3	-1.2	-11.8
Private Sector	**923.8**	**948.1**	**945.3**	**956.6**	**980.7**
(Q-o-Q change %)	1.4	2.6	-0.3	1.2	2.5
(Y-o-Y change %)	6.3	6.7	4.2	5.0	6.2
NBFI	**28.1**	**28.2**	**23.2**	**24.6**	**28.2**
(Q-o-Q change %)	-4.7	0.4	-17.7	6.0	14.6
(Y-o-Y change %)	-22.8	-24.2	-32.4	-16.6	0.4
Non-Resident Deposits	**171.5**	**177.5**	**177.1**	**186.9**	**199.0**
(Q-o-Q change %)	8.2	3.5	-0.2	5.5	6.5
(Y-o-Y change %)	11.4	19.9	13.7	17.9	16.0

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

The increase in Resident Deposits in the last quarter of 2016 is essentially due to the growth in the Government sector deposits by AED 17.3bn or 10.2% and the rise in Private Sector deposits by AED 24.2bn or 2.5%. The growth in Private Sector and Government sector deposits compensated for the withdrawal of GREs' deposits during the fourth quarter by AED 3bn or -1.8% contraction. In parallel, the increase in Non-Banking Financial Institutions (NBFIs) deposits by AED 3.6bn further reinforced the positive move in Resident Deposits.

In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 77.7% and 22.3% of the total deposits. Figures 3.3.a and 3.3.b, and Table 3.2.b show that in the last quarter of 2016 the growth in Conventional banks is much stronger than that in the Islamic banks for all sectors with exception of GREs and Non-resident deposits. Similarly, the growth for Conventional banks is stronger than that of Islamic banks at the end of December on a Y-o-Y basis (6.6% vs. 5%).

Table 3.2.b.Deposits at Conventional/Islamic Banks

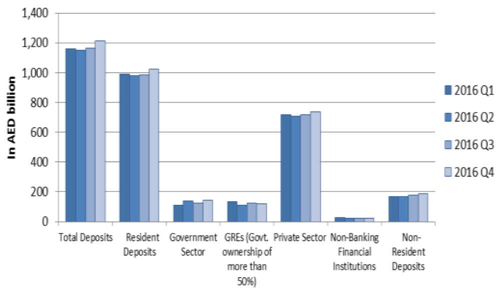
	Conventional		Islamic	
	2016		2016	
	Sep	**Dec**	**Sep**	**Dec**
Bank Deposits	**1,166**	**1,214**	**343**	**349**
(Q-o-Q change %)	1.5	4.2	-0.5	1.6
(Y-o-Y change %)	4.4	6.6	7.2	5.0
Share of Total, %	77.3	77.7	22.7	22.3
Resident Deposits	**987**	**1,024**	**335**	**339**
(Q-o-Q change %)	0.8	3.8	-0.7	1.4
(Y-o-Y change %)	2.4	5.1	6.5	4.2
Share of Total, %	74.7	75.1	25.3	24.9
Government Sector	**124**	**143**	**46**	**44**
(Q-o-Q change %)	-9.6	15.7	-6.7	-4.6
(Y-o-Y change %)	8.2	33.9	-8.4	-13.5
Share of Total, %	73.0	76.6	27.0	23.4
GREs	**126**	**120**	**45**	**48**
(Q-o-Q change %)	12.9	-5.2	-9.5	8.0
(Y-o-Y change %)	-2.7	-11.7	3.2	-12.2
Share of Total, %	73.8	71.2	26.2	28.8
Private Sector	**717**	**738**	**240**	**243**
(Q-o-Q change %)	0.9	3.0	2.0	1.2
(Y-o-Y change %)	2.9	4.0	11.7	13.2
Share of Total, %	74.9	75.2	25.1	24.8
NBFI	**21**	**24**	**4**	**4**
(Q-o-Q change %)	2.5	16.0	29.0	7.5
(Y-o-Y change %)	-12.3	5.3	-33.3	-20.4
Share of Total, %	83.7	84.8	16.3	15.2
Non-Resident Deposits	**178**	**190**	**9**	**10**
(Q-o-Q change %)	5.5	6.3	6.3	10.6
(Y-o-Y change %)	17.0	15.0	41.7	40.3
Share of Total, %	95.5	95.3	4.5	4.7

Source: Central Bank of the UAE

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

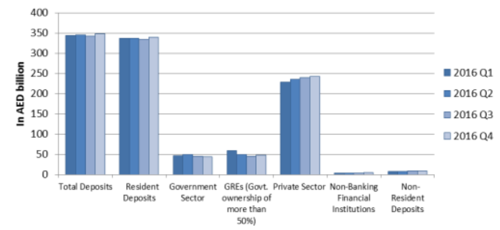
The more robust growth in Islamic deposits for GREs (Q-o-Q growth of 8% and Y-o-Y growth of -12.2%) might be also explained by the ambition of Dubai to become a world capital for Islamic finance and many GREs being attracted to the Sharia compliant products. On the other hand, the growth of Non-resident Islamic deposits (growth of 10.6% and 40.3% on a Q-o-Q and Y-o-Y basis respectively) that exceeded that of Conventional deposits (growth of 6.3% and 15% on a Q-o-Q and Y-o-Y basis respectively) could be explained by the continued geopolitical conflicts in neighboring countries and the safe economic and political positions of the UAE. On a Y-o-Y basis

Figure 3.3.a.Banking System Deposits for Conventional Banks



Source: Central Bank of the UAE

Figure 3.3.b.Banking System Deposits for Islamic Banks



Source: Central Bank of the UAE

The breakdown of Local and Foreign banks in Figures 3.4.a and 3.4.b provides a clear trend that deposits in Local banks and Foreign banks grew in the last quarter of 2016. Local banks grew at a higher rate on both Q-o-Q and Y-o-Y basis by 4% and 8.1% respectively compared to Foreign banks which increased by 1.1% on a Q-o-Q basis and declined by 4.6% compared to December 2015. At the end of 2016 Q4, 86.5% of the total deposits are in Local banks and 13.5% are in Foreign banks.

The sectors growing the most in 2016 Q4 for Local banks were the NBFIs and Government by 19.9% and 10.2% respectively on a quarterly basis (growth of –

5.9% and 19.2% on Y-o-Y basis). For the Foreign banks in the last quarter of 2016, the breakdown shows that the biggest increase for the Foreign banks was also for the Government sector deposits of 18.2% Q-o-Q, however the sector deposits declined compared to the end of 2015 by 27.8%.

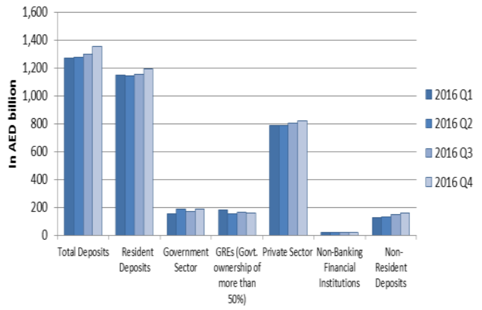
Table 3.2.c.Deposits at UAE Local/Foreign Banks

	Local		Foreign	
	2016		2016	
	Sep	**Dec**	**Sep**	**Dec**
Bank Deposits	**1,300**	**1,352**	**209**	**211**
(Q-o-Q change %)	1.8	4.0	-3.6	1.1
(Y-o-Y change %)	7.2	8.1	-6.9	-4.6
Share of Total, %	86.2	86.5	13.8	13.5
Resident Deposits	**1,152**	**1,192**	**170**	**172**
(Q-o-Q change %)	0.6	3.4	-0.7	1.4
(Y-o-Y change %)	5.2	6.2	-7.2	-3.4
Share of Total, %	87.1	87.4	12.9	12.6
Government Sector	**168**	**186**	**1**	**1**
(Q-o-Q change %)	-8.8	10.2	-8.3	18.2
(Y-o-Y change %)	3.4	19.2	-26.7	-27.8
Share of Total, %	99.4	99.3	0.6	0.7
GREs	**163**	**161**	**8**	**7**
(Q-o-Q change %)	5.6	-1.4	15.7	-8.6
(Y-o-Y change %)	0.6	-11.4	-27.7	-20.4
Share of Total, %	95.3	95.6	4.7	4.4
Private Sector	**802**	**823**	**155**	**156**
(Q-o-Q change %)	1.8	2.6	-1.9	1.9
(Y-o-Y change %)	7.7	8.2	-7.1	-3.2
Share of Total, %	83.8	83.9	16.2	16.1
NBFI	**19**	**22**	**6**	**6**
(Q-o-Q change %)	3.3	19.9	15.4	-1.7
(Y-o-Y change %)	-27.6	-5.9	57.9	34.1
Share of Total, %	75.6	79.1	24.4	20.9
Non-Resident Deposits	**148**	**160**	**39**	**39**
(Q-o-Q change %)	12.4	8.3	-14.3	-0.5
(Y-o-Y change %)	26.4	24.5	-6.0	-9.3
Share of Total, %	79.1	80.5	20.9	19.5

Source: Central Bank of the UAE

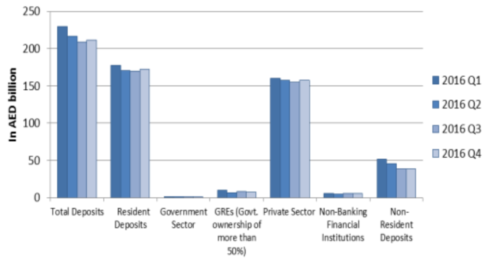
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.

Figure 3.4.a.Banking System Deposits for Local Banks



Source: Central Bank of the UAE

Figure 3.4.b.Banking System Deposits for Foreign Banks



Source: Central Bank of the UAE

3.2.2 Banks' Credit

Domestic Credit increased in 2016 Q4 by AED 7.5bn (AED 72.4bn in 2016), benefiting mainly by the increase in credit to the Private Sector, both, quarterly and annually, by AED 10.2bn and AED 57.5bn respectively. Meanwhile Government and GREs were deleveraging by AED 1.6bn (0.9%) and AED 900mn (-0.5%) respectively in the last quarter of 2016, helping freeing up resources in support of private sector activity, but growing by AED 5.9bn (3.5%) and AED 15.7bn (9.2%) respectively for the entire 2016.

Table 3.3.a.Assets and Credit at UAE Banks

	2015	2016			
	Dec	**Mar**	**Jun**	**Sep**	**Dec**
Total Assets	**2,478**	**2,491**	**2,519**	**2,550**	**2,611**
(Q-o-Q change %)	**2.3**	**0.5**	**1.1**	**1.3**	**2.4**
(Y-o-Y change %)	**7.5**	**4.7**	**4.1**	**5.3**	**5.4**
Gross Credit	**1,485**	**1,518**	**1,543**	**1,566**	**1,574**
(Q-o-Q change %)	0.4	2.2	1.7	1.5	0.5
(Y-o-Y change %)	7.8	7.6	6.7	5.9	6.0
Domestic Credit	1,381	1,404	1,426	1,446	1,454
(Q-o-Q change %)	1.1	1.7	1.6	1.4	0.5
(Y-o-Y change %)	8.1	7.7	6.8	5.8	5.2
Government	166.6	168.7	168.6	174.1	172.5
(Q-o-Q change %)	0.1	1.3	-0.1	3.3	-0.9
(Y-o-Y change %)	8.8	4.8	0.1	4.6	3.5
Public Sector GREs)	169.8	180.8	187.7	188.0	187.1
(Q-o-Q change %)	-2.4	5.4	3.8	0.2	-0.5
(Y-o-Y change %)	2.8	8.3	12.1	6.3	9.2
Private Sector	1,020	1,030	1,052	1,066	1,076
(Q-o-Q change %)	1.4	1.1	2.1	1.4	1.0
(Y-o-Y change %)	8.5	7.7	7.1	6.2	5.6
Business & ndustrial Sector redit	689.3	693.5	709.7	720.0	727.8
(Q-o-Q change %)	1.9	0.9	2.3	1.5	1.1
(Y-o-Y change %)	7.7	7.3	7.1	6.9	5.8
Individual	330.7	336.1	341.9	345.8	348.2
(Q-o-Q change %)	0.3	1.6	1.7	1.1	0.7
(Y-o-Y change %)	10.3	8.5	7.1	4.9	5.3
Non-Banking inancial Institutions	24.7	25.3	18.4	18.2	18.0
(Q-o-Q change %)	24.2	2.4	-27.3	-1.1	-1.1
(Y-o-Y change %)	27.4	30.4	1.1	-8.5	-27.1
Foreign Credit	103.9	113.1	117.1	119.9	120.4
(Q-o-Q change %)	-7.4	8.9	3.5	2.4	0.4
(Y-o-Y change %)	3.5	6.1	5.6	6.9	15.9
of which: Loans & dvances to Non-esidents in AED	9.2	11.2	12.8	14.4	14.6
(Q-o-Q change %)	-4.6	21.7	14.3	12.5	1.4
(Y-o-Y change %)	-9.8	10.3	29.3	49.4	58.7

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

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

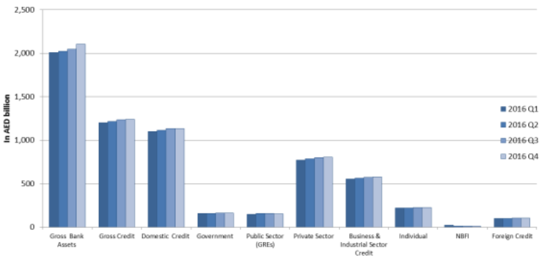
	Conventional		Islamic	
	2016		**2016**	
	Sep	**Dec**	**Sep**	**Dec**
Total Assets	**2,050**	**2,105**	**500**	**506**
(Q-o-Q change %)	**1.2**	**2.7**	**1.5**	**1.1**
(Y-o-Y change %)	**4.0**	**4.5**	**10.7**	**8.9**
Gross Credit	**1,237**	**1,239**	**329**	**335**
(Q-o-Q change %)	1.7	0.1	0.8	1.9
(Y-o-Y change %)	5.0	5.1	9.6	9.4
Domestic Credit	1,134	1,135	313	318
(Q-o-Q change %)	1.6	0.2	0.7	1.8
(Y-o-Y change %)	5.1	4.5	8.7	8.2
Government	164	163	10	10
(Q-o-Q change %)	2.9	-0.8	8.9	-3.1
(Y-o-Y change %)	4.5	3.9	7.7	-2.1
Public Sector GREs)	156	153	32	34
(Q-o-Q change %)	0.4	-1.6	-0.9	5.0
(Y-o-Y change %)	5.3	7.4	11.4	17.8
Private Sector	799	804	267	272
(Q-o-Q change %)	1.6	0.7	0.8	1.7
(Y-o-Y change %)	5.3	4.9	9.2	8.0
Business & ndustrial Sector redit	575	580	145	148
(Q-o-Q change %)	1.7	0.9	0.3	2.0
(Y-o-Y change %)	6.1	5.7	10.4	6.3
Individual	224	224	122	124
(Q-o-Q change %)	1.1	0.3	1.2	1.4
(Y-o-Y change %)	3.3	2.7	7.9	10.2
Non-Banking inancial Institutions	15	15	3	3
(Q-o-Q change %)	1.4	0.7	-10.5	-8.8
(Y-o-Y change %)	-0.7	-27.3	-32.0	-26.2
Foreign Credit	104	103	16	17
(Q-o-Q change %)	2.4	-0.3	2.5	4.9
(Y-o-Y change %)	3.9	12.8	30.6	39.3

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

The split between Conventional and Islamic banks in Figures 3.6.a and 3.6.b indicates that the growth in Islamic financing is much steeper than that for the Conventional banks' loans. However in 2016 Q4, Conventional banks' assets had a higher growth (2.7%) than the Islamic ones (1.1%), while on an annual basis Islamic banks grew by 8.9% and continued to dominate the Conventional ones (growth of 4.5%) . The share of Conventional banks' assets at the end of 2016 Q4 is 80.6% of the total, while the share of the Islamic banks assets is 19.4%.

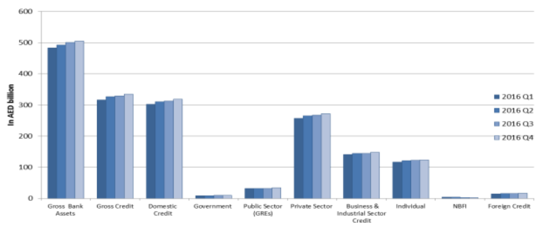
Islamic banks' financing growth has been dominating the Conventional banks' loans increase in the last quarter of 2016 in almost all subcategories, with exception of credit to the Government and NBFIs. Similar trend was observed and for the annual growth, where Islamic banks dominated again Conventional banks with exception of the Government sector.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

The breakdown of the assets and credit by local and foreign banks in Figures 3.7.a and 3.7.b indicates that national banks were growing, while for the foreign banks the levels were declining or remained almost unchanged, for both assets and gross credit in 2016 Q4.

For the whole 2016, National banks marked an increase by 7% and 8.1% for banks' assets and gross credit respectively, while for the Foreign banks they were both declining.

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

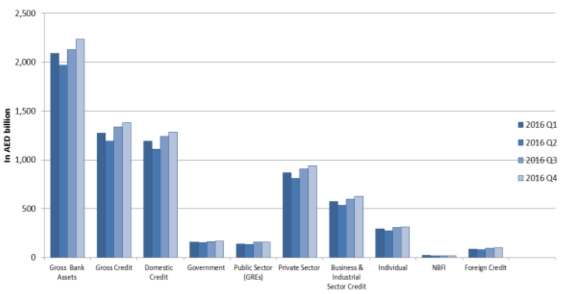
	Local		**Foreign**	
	2016		**2016**	
	Sep	**Dec**	**Sep**	**Dec**
Total Assets	**2,177**	**2,236**	**373**	**375**
(Q-o-Q change %)	**2.2**	**2.7**	**-4.1**	**0.6**
(Y-o-Y change %)	**7.4**	**7.0**	**-5.7**	**-3.6**
Gross Credit	**1,365**	**1,379**	**201**	**195**
(Q-o-Q change %)	2.1	1.0	-2.9	-2.9
(Y-o-Y change %)	8.4	8.1	-8.2	-6.8
Domestic Credit	1,266	1,281	180	172
(Q-o-Q change %)	1.9	1.2	-2.0	-4.4
(Y-o-Y change %)	7.9	7.4	-6.6	-8.6
Government	168	167	6	6
(Q-o-Q change %)	3.4	-0.8	0.0	-3.2
(Y-o-Y change %)	6.5	4.8	-28.7	-22.1
Public Sector (GREs)	160	159	29	28
(Q-o-Q change %)	0.6	-0.1	-2.4	-2.5
(Y-o-Y change %)	11.1	14.1	-14.7	-12.6
Private Sector	922	939	144	138
(Q-o-Q change %)	1.9	1.8	-2.0	-4.6
(Y-o-Y change %)	8.0	7.8	-3.9	-7.2
Business & Industrial Sector Credit	610	624	110	104
(Q-o-Q change %)	2.2	2.3	-2.4	-5.5
(Y-o-Y change %)	9.1	8.5	-3.9	-7.9
Individual	311	314	35	34
(Q-o-Q change %)	1.4	1.0	-0.9	-2.0
(Y-o-Y change %)	5.9	6.5	-3.6	-5.1
Non-Banking Financial Institutions	17	17	1	1
(Q-o-Q change %)	-1.7	1.2	8.3	-30.8
(Y-o-Y change %)	-11.5	-28.5	62.5	12.5
Foreign Credit	99	98	21	23
(Q-o-Q change %)	5.5	-1.7	-10.4	10.6
(Y-o-Y change %)	14.9	17.5	-20.1	9.6

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

Local banks' assets have increased in the last quarter of 2016 by 2.7% (7% Y-o-Y) with all of the loan asset classes growing for the period, with exception of the GREs and Foreign credit that declined by 0.1% or AED 200mn and 1.7% or AED 1.7bn respectively. The only category that recorded a decline on Y-o-Y basis as at the end of 2016 the NBFI, which deleveraged by AED 6.8bn or 28.5%. Assets and gross credit of Local banks represent 85.6% and 87.6% of the UAE banking system's assets and credit respectively. Assets of foreign banks marginally increased by 0.6% with all the underlying categories declining, except for Foreign credit that grew by 10.6% or AED 2.2bn. Assets and gross credit of foreign banks represent only 14.4% and 12.4%, of the banking system's assets and gross credit respectively, as of the end of 2016.

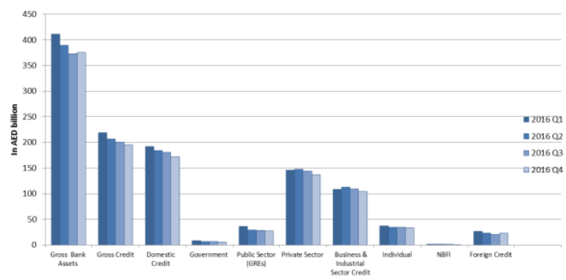
For the Foreign banks, the asset class with the highest deleveraging percentage for the quarter was NBFIs at -30.8% growth Q-o-Q in 2016 Q4, with an outstanding amount of only AED 900mn (5% of the total banks' NBFIs lending). On an annual basis, as of the end of 2016 Q4, the highest decrease for the Foreign banks has been observed in the Government sector, which deleveraged by AED 1.7bn or 22.1%, while the NBFIs' credit Y-o-Y grew by AED 100mn or 12.5%.

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



Source: Central Bank of the UAE

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



Source: Central Bank of the UAE

Table 3.4.Banks credit to residents by economic activity

(End of Period , In Billions of AED)

	2015	2016			
Economic Activity	Dec	Mar	Jun	Sep	Dec
Agriculture	1.6	1.3	1.2	1.2	1.4
(Q-o-Q change %)	20.5	-19.1	-4.9	-1.9	16.7
(Y-o-Y change %)	-42.2	-23.3	-5.7	-9.0	-11.9
Mining and Quarrying	11.9	11.7	12.4	14.0	13.5
(Q-o-Q change %)	7.7	-1.8	6.2	12.7	-3.4
(Y-o-Y change %)	29.9	9.0	18.9	26.6	13.6
Manufacturing	69.1	72.2	71.4	71.6	69.5
(Q-o-Q change %)	-4.3	4.5	-1.2	0.3	-3.0
(Y-o-Y change %)	6.1	8.7	0.3	-0.9	0.5
Electricity, Gas and Water	20.5	18.6	18.6	17.9	18.4
(Q-o-Q change %)	-1.2	-9.4	0.2	-3.8	3.1
(Y-o-Y change %)	8.2	-0.1	-17.3	-13.8	-10.0
Construction and Real Estate	235.0	241.8	242.4	250.8	264.7
(Q-o-Q change %)	5.1	2.9	0.2	3.5	5.5
(Y-o-Y change %)	10.6	14.8	12.1	12.2	12.6
Trade	161.7	160.7	160.7	158.2	155.5
(Q-o-Q change %)	-1.9	-0.6	0.0	-1.5	-1.7
(Y-o-Y change %)	3.8	0.2	-2.5	-4.0	-3.8
Transport, Storage and Communication	59.2	62.5	64.0	62.7	63.5
(Q-o-Q change %)	0.6	5.6	2.4	-2.0	1.2
(Y-o-Y change %)	4.7	5.0	5.1	6.6	7.3
Financial Institutions (Excluding Banks)	135.6	139.6	144.9	148.4	144.3
(Q-o-Q change %)	0.1	2.9	3.8	2.4	-2.7
(Y-o-Y change %)	2.9	4.8	13.0	9.5	6.4
All Others	112.7	113.1	120.6	122.0	126.6
(Q-o-Q change %)	-0.3	0.4	6.7	1.1	3.8
(Y-o-Y change %)	17.1	3.6	7.8	7.9	12.4

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

Banks' lending by economic activity shows an increase in the fourth quarter of 2016 Q-o-Q by 16.7%, 3.1%, 5.5% and 1.2% in the Agriculture, Electricity, Gas and Water, Construction and Real Estate, and Transport, Storage and Communication sectors respectively, while their growth Y-o-Y was of -11.9%, -10%, 12.6% and 7.3% respectively . For the other sectors the credit declined on Q-o-Q, during the final quarter of 2016. The growth in Mining and Quarrying was -3.4% Q-o-Q and 13.6% Y-o-Y, in Manufacturing -3% Q-o-Q and 0.5% Y-o-Y, in Trade -1.7% Q-o-Q and -3.8% Y-o-Y, and in Financial Institutions (Excluding banks) -2.7% Q-o-Q and 6.4% Y-o-Y.

3.3 Financial Soundness Indicators

The overall outlook regarding the soundness of the banking sector remains positive during the fourth quarter of 2016.

Banks' specific provisions for NPLs increased from AED 77.9bn at the end of September 2016 to AED 78.5bn in the last quarter of 2016, thereby ensuring that NPLs are fully provisioned. The level has increased also compared to the end of 2015, when the specific provisions were at AED 72.4bn.

Banks operating in the UAE remain highly capitalized, with the capital adequacy ratio (CAR) and Tier 1 capital of banks increasing compared to the previous quarter and a year earlier to 19% for CAR (17.3% for Tier1 capital) at the end of 2016, which is well above the regulatory requirements set by the Central Bank (12% and 8%, respectively), with Conventional banks being better capitalized compared to the Islamic ones (CAR of 19.4% vs. 17.1% and Tier 1 capital 17.5% vs. 16.5% respectively). Foreign banks remain better capitalized than the Local banks (21.5% vs. 18.6% for CAR and Tier 1 capital of 18.6% vs. 17.1% respectively) due to the much lower growth in credit during 2016 Q4 and decline in lending compared to year before.

To capture the composite effects of changes in loans and deposits, two key ratios related to the funding of banks are considered: the Loan-to-Deposit (L/D) ratio and the Lending to the Stable Resources Ratio (LSRR[1]).

L/D ratio for the overall banking system has moved from 103.8% at the end of September to 100.7% at the end of 2016, which is mainly due to the stronger growth in Deposits compared to Loans, with a sector like the Government contributing to the decline in loan to deposits ratio by deleveraging and increasing deposits in parallel. The level at the end of 2016 remains also below the value in December 2015 which was at 100.9%. Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 102% and 96.1%, decreasing by more than four percentage points from the previous quarter for the Conventional banks.

The level for Conventional banks in December 2016 has improved compared to a year ago when it was 103.4% while Islamic banks' L/D has worsen being at 92.2% in December 2015.On the other hand, Local banks have L/D ratio of 102% (with a decrease of three percentage points compared to September), while the ratio for foreign banks is 92.4%. It is clear that in 2016 Q4 funding became more stable, using more deposits and less market finance and reflecting more conservative banks' policies in lending. LSRR also improved from 88.2% to 86.6% in 2016 Q4, as well on an annual basis, being at 87.1% a year ago, reflecting higher increase in stable resources compared to the slower credit growth at banks. In the segmentation, Islamic, Conventional, Local and Foreign banks, only the Islamic banks LSRR has increased in the last final quarter of 2016, while all other types of banks declined. The increase of the indicator for Islamic banks might be due as well to the relatively higher pace of credit growth and them relying more on market financing than on customer deposits. On an annual basis comparison, only Foreign banks LSRR improved, while the National, Conventional and Islamic banks' ratio deteriorated. One of the reasons for that is the significant decline in the credit exposure Foreign banks have in the UAE.

Meanwhile, liquid assets which include reserve requirements mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a ratio of total assets moved from 15.7% at the end of September 2016 to 16.2% at the end of 2016. The ratio was at 17.4% at the of 2015. The level of total liquid assets at banks at the end of 2016 remains at AED 340.8bn, AED 17.5bn higher, registering growth of 5.4% than in September 2016, which is one of the reasons for the higher Liquid Assets Ratio (LAR). On a Y-o-Y basis total liquid assets at banks declined by AED 10.4bn or a decrease of 3%. In addition, looking at the split between Islamic, Conventional, Local and Foreign banks, data show that all segments' LARs increased during 2016 Q4. On a Y-o-Y basis only Foreign banks' LAR has increased while the Islamic, Conventional and Local banks has declined.

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

	2015	2016			
	Q4	Q1	Q2	Q3	Q4
Lending to Stable Resources Ratio	87.1	86.8	87.7	88.2	86.6
The Liquid Assets Ratio (LAR)	17.4	15.6	16.0	15.7	16.2
Capital Adequacy Ratio (CAR) of which:	18.3	18.0	18.4	18.6	19.0
Tier 1 Capital	16.6	16.3	16.8	16.9	17.3

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

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

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

	2015	2016			
	Q4	Q1	Q2	Q3	Q4
Lending to Stable Resources Ratio	87.3	85.5	88.1	88.9	86.6
The Liquid Assets Ratio (LAR)	17.5	14.1	15.8	15.6	16.0
Capital Adequacy Ratio (CAR) of which:	18.9	18.4	18.9	19.1	19.4
Tier 1 Capital	16.9	16.3	17.0	17.1	17.5

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

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

	2015	2016			
	Q4	Q1	Q2	Q3	Q4
Lending to Stable Resources Ratio	86.1	83.0	86.4	85.7	86.8
The Liquid Assets Ratio (LAR)	17.0	17.5	17.0	16.4	16.8
Capital Adequacy Ratio (CAR) of which:	15.6	16.2	16.5	16.7	17.1
Tier 1 Capital	14.9	15.4	15.9	16.1	16.5

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

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

	2015	2016			
	Q4	Q1	Q2	Q3	Q4
Lending to Stable Resources Ratio	88.6	86.2	89.3	89.9	88.6
The Liquid Assets Ratio (LAR)	16.5	13.2	14.6	14.4	14.8
Capital Adequacy Ratio (CAR) of which:	18.0	17.8	18.1	18.2	18.6
Tier 1 Capital	16.5	16.2	16.6	16.7	17.1

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

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

	2015	2016			
	Q4	Q1	Q2	Q3	Q4
Lending to Stable Resources Ratio	78.6	79.1	78.8	78.3	74.8
The Liquid Assets Ratio (LAR)	22.2	21.8	24.0	23.5	24.2
Capital Adequacy Ratio (CAR) of which:	20.2	18.6	20.7	21.3	21.5
Tier 1 Capital	17.1	15.8	17.7	18.3	18.6

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

The banking sector, as a whole, has improved at the end of 2016 compared to the end of September 2016 based on the FSIs. Deposits and Banks's assets growth accelerated in the last quarter of 2016 compared to the previous quarter, however credit growth marginally declined compared to the period June to September mainly due to deleveraging of the Government sector.

On a Y-o-Y basis, the last quarter of 2016, has shown also improvements, based on the FSIs, with exception of the LAR.

Overall, as of the end of the last quarter of 2016, banks' assets, credit and deposits grew by 5.4%, 6% and 6.2% respectively Y-o-Y and an average monthly growth for 2016 of 0.4%, 0.5% and 0.5% respectively, a healthy level in supporting of non-oil GDP growth and at the same time securing the financial stability of the UAE banking system, as evident by the prudence of the financial soundness indicators.

Chapter 4. Central Bank Financial Position & Reserve Management

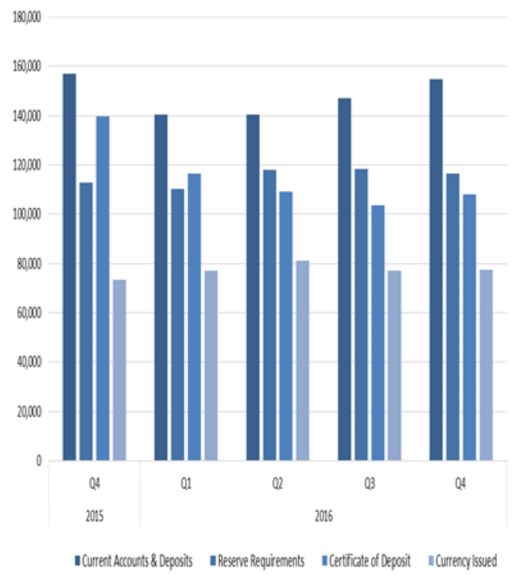
The Central Bank balance sheet exhibited an increase in 2016 Q4 triggered by an increase in liabilities. As a result, total assets increased by 3.1% owing mainly to an increase in "Cash & Bank Balances" while "Held-To-Maturity Foreign Securities" decreased. Meanwhile, interest rates continued their upward trend in the UAE in line with the announced increase in the policy interest rate in the US, which materialized on 14 December 2016.

4.1 Central Bank Balance Sheet

Changes in the Central Bank balance sheet are triggered by changes on the liabilities' side. Total liabilities increased by 3.1% in 2016 Q4. This was mainly due to an increase in bank's current account at the Central Bank by AED 9.3 billion and an increase in banks' holding of "Certificates of Deposit" (CDs) issued by the Central Bank by AED 4.4 billion. The latter reached AED 108 billion, at the end of December 2016, which indicates sufficient liquidity at banks. Meanwhile, "Derivative Liabilities" decreased by AED 2.2 billion, owing to the impact on Open Swap Contracts due to changes in the exchange rate of the Japanese Yen, the currency in which some liabilities are denominated.

Figure 4.1. Central Bank Liabilities

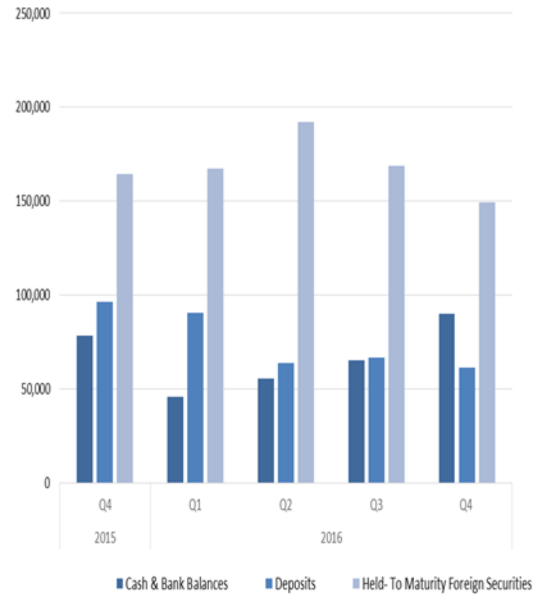
In millions of Dirhams



Source: Central Bank of the UAE

Figure 4.2. Central Bank Assets

In millions of Dirhams



Source: Central Bank of the UAE

With the above-indicated decrease in liabilities being the main driver, the total assets of the Central Bank increased during 2016 Q4, reaching AED 364.5 billion, owing mainly to the increase in "Cash & Bank Balances" by AED 25.1 billion. Meanwhile, "Held-To-Maturity Foreign Securities" fell by 19.7 billion, due to the fact that at maturity, the proceeds from these securities were not re-invested in the same instruments.

Table 4.1. Central Bank Balance Sheet

In Millions of Dirhams

	2015	2016			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Assets					
Gold Bullion	934	1,085	1,164	1,171	1,015
Cash & Bank Balances	78,611	46,029	55,656	65,037	90,149
Deposits	96,362	90,434	63,850	66,917	61,147
Liquidity Support Facility	228	214	214	200	200
Held-To-Maturity Foreign Securities	164,495	167,508	192,094	168,988	149,337
Held-To-Maturity Bonds Issued by MOF & Dubai Government:	49,231	49,198	49,198	49,165	49,165
Available-for-sale foreign Investments	361	356	372	374	359
Advances to Government	2,500	2,500	-	-	3,000
Available-for-sale foreign securities	74	75	76	76	74
Derivative Assets	334	175	151	566	8,746
Other Assets	445	437	401	490	611
Property and Equipment's	79	113	103	93	99
Total Assets	**393,660**	**358,675**	**364,748**	**353,628**	**364,453**
Off Balance Sheet Commitments	**199,681**	**198,254**	**262,631**	**211,456**	**188,892**
Liabilities and Capital					
Current Accounts & Deposits	157,031	140,363	140,351	146,920	154,775
- Of which:					
Reserve Requirements	112,900	110,300	118,100	118,229	116,600
Banks' Current account	36,400	25,100	17,800	25,817	33.800
Certificates of Deposit	139,773	116,393	109,083	103,797	108,193
Currency Issued	73,522	77,208	81,317	77,267	77,551
Derivative Liabilities	1,310	4,468	11,684	2,508	312
Other Liabilities	2,275	1,177	1,853	2,667	2,651
Total Liabilities	**373,910**	**338,611**	**344,287**	**333,159**	**343,483**
Authorized Issued & Fully Paid Capital	2,500	2,500	2,500	2,500	2,500
Fair Value Reserve	-29	-33	-15	-14	-31
Gold Revaluation Reserve	-60	85	165	171	15
General Reserve	17,339	17,812	17,812	17,812	18,486
Total Liabilities & Capital	**393,660**	**358,975**	**364,748**	**353,628**	**364,453**
Off Balance Sheet Commitments related to foreign exchange fluctuations	**199,681**	**198,254**	**262,631**	**211,456**	**188,892**

Source: Financial Control Division, Central Bank of the UAE
Data for 2016 Q4 are for November.

4.2 Central Bank Foreign Assets

The Central Bank's balance of foreign assets increased from AED 301.6 billion at the end of 2016 Q3 to AED 310.9 billion at the end of 2016 Q4, with the increase in liabilities being the main driver. This increase was mainly due to the increase in "Current Account Balances & Deposits with Banks Abroad" by AED 20.9 billion.

Table 4.2. Central Bank's Foreign Assets

In billions of Dirhams

	2015	2016			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Total Foreign Assets	341.1	306.2	314.1	301.6	310.9
Held-To-Maturity Securities	164.5	167.5	192.1	169.0	149.3
Current Account Balances & Deposit with Banks Abroad	171.8	132.8	116.9	127.0	147.9
Other Foreign Assets	4.8	5.9	5.1	5.6	13.9

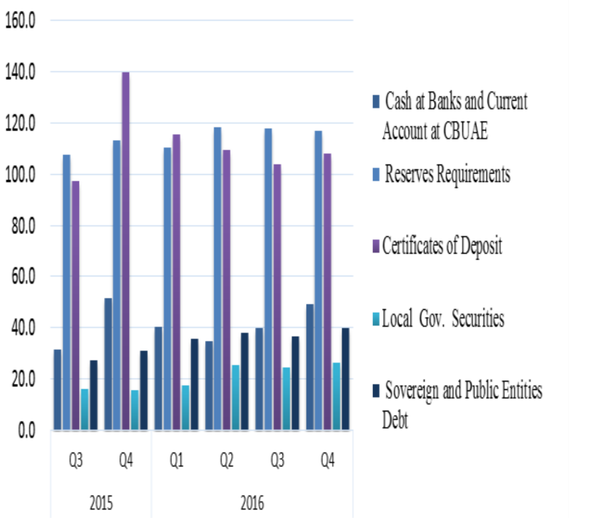
Source: Central Bank of the UAE. Data for 2016 Q4 are for November.

4.3 Banks' Excess Liquidity Developments

Banks' liquid assets are composed of cash, reserves at the Central Bank and the highly-rated public sector's debt securities. Total liquid assets held by banks operating in the UAE increased during 2016 Q4 by AED 17.6 billion, reaching AED 340.8 billion. Underlying the increase is a rise in excess reserves held at the Central Bank and a rise in some sovereign debt instruments.

Figure 4.3. Liquid Assets at Banks

In billions of Dirhams



Source: CBUAE Data

A few banks tapped CBUAE's facilities to borrow Dirhams during 2016 Q4, namely through the Interim Marginal Lending Facility, the Collateralized Murabaha Facility, and the CDs Repo Facility.

4.4 Interest Rates

The fixed peg of the exchange rate of the Dirham to the US dollar means that the CBUAE has to peg its policy rate to the direction of the interest policy in the U.S. Therefore, the CBUAE policy rate was maintained during the first three quarters of 2016 in line with the Federal Reserve's decision to postpone the planned increase in its policy rate. On 15 December 2016, however, the Central Bank of the UAE announced the increase in interest rates applied to its Certificates of Deposits by 25 basis points, in line with FOMC decision in this regard.

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

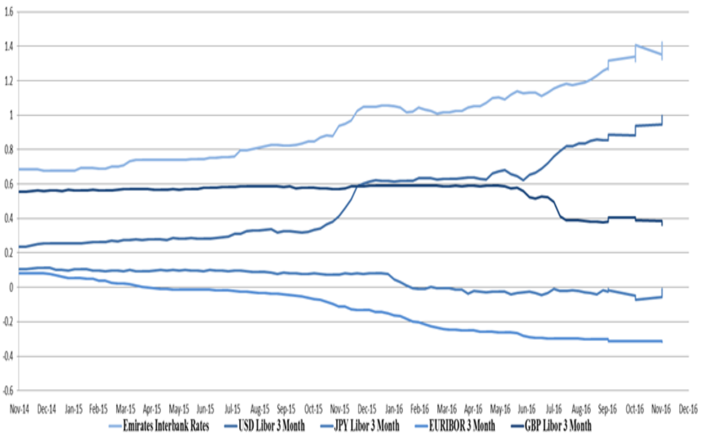
4.4.1 Short-term interest rates

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

Eibor continued its upward trend during 2016 Q4 in line with the renewed commitment by the Federal Reserve for further rate hikes, which materialized on 14 December when the FOMC increased its policy rate "the Federal Funds Rate" by 25 basis points. Nonetheless, in early December, the 3-month Eibor saw some decline as liquidity eased slightly with improved oil prices and increase in UAE government deposits.

The 3-month Libor rate in the Euro Area and in Japan, remained in negative territory during 2016 Q4, reflecting the action adopted by the European Central Bank (ECB) and the Bank of Japan (BOJ), thereby increasing the prospect of further divergence with interest rates prevalent in the U.S, especially given the fact that the FOMC minutes of December 2016 meeting indicated a quicker pace of interest rate increases in the coming future.

Figure 4.4. Libor Rates 3-month



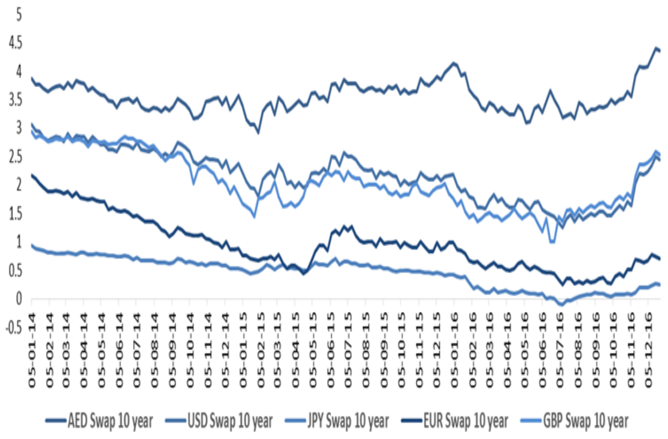
Source: Bloomberg

4.4.2 Long-term swap rates

Given the absence of a deep and liquid government bond market in the UAE, the swap market is the only way to get an idea about yields at longer maturities. Interest rate swaps correspond to an exchange of a fixed payment for a floating payment that is linked to an interest rate, most often the LIBOR. As shown in Figure 4.5, the AED 10-year swap rate continued its upward trend in 2016 Q4, which may indicate continued higher risk premium as investors in the UAE became averse to the potential adverse effect of persistent low oil prices and expected higher interest rates, in line with the interest rate liftoff in the US.

Similarly, the upward trend in swap rates of the US dollar, the Euro and the yen are testament to the heightened global uncertainties, whereas the shot-up for the British Pound is linked to the negative fallout of the Brexit vote and rising concerns about the economic outlook in the UK.

Figure 4.5. 10-year swap rates



Source: Bloomberg

4.5 Monetary Tools

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

4.6 Certificates of Deposits

Certificates of Deposits (CDs) were first issued by the Central Bank in 1988, in tenors varying from 1 month to 6 months. This program offers banks an alternative tool of investing their excess liquidity in dirhams instead of investing in dollars abroad. The initial program was revamped in 1994 when it was made available for daily issuance, with tenors extended up to 18 months. Banks have also the possibility of redeeming their CDs before maturity, allowing them to get immediate liquidity when needed at a rate set by the Central Bank. The system was revamped in 2007 with the move to a new auction system, where the CBUAE determines issuance by setting a cut-off interest rate for bids posted by banks, while Islamic CDs were introduced in 2010 to allow Islamic banks to better manage their excess liquidity, putting them on equal footing with conventional banks in this regard.

4.7 Reserve Management

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