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Quarterly Economic Review

First quarter 2018

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Executive Summary

The global economy continued to build momentum in 2017 Q4. In the US, y-o-y growth rates are up from 2.5% in 2017 Q4 to 2.9% in 2018 Q1, boosted by expansionary fiscal outlook in the US, following the adoption of an ambitious tax cut program by Congress as well as a pickup in investment and consumer confidence. Y-o-Y growth in the Eurozone was maintained at 2.5% in 2018 Q1 following 2.8% achieved in 2017 Q4, expected to rebound during the rest of the year, due to supportive monetary policies and improvements in the labor market. Meanwhile, the recovery in commodity prices supported resource-rich Emerging Countries, while export-oriented economies benefited from higher demand in export markets.

Inflation edged up in 2018 Q1, boosted by higher commodity prices and sustained demand, even though it remains below target in Advanced Economies. The steps towards monetary policy normalization that took place in some Advanced Economies lifted up interest rates and government bond yields worldwide. This could be of particular concern for emerging countries where sovereigns as well as corporates accumulated large debts in the previous period denominated in US dollars, which could be difficult and more costly to roll over in the coming period.

In the UAE, based on revised new figures of growth projections, global economic developments and final data releases, the Central Bank of the UAE has updated the projections for 2018, and published its Economic Composite Index (ECI) estimates for the first quarter of 2018. In fact, Non-oil GDP in the preliminary official data release by the Federal Competitiveness and Statistics Authority (FCSA) is estimated to have grown by 3.4% in 2017, while the oil GDP contracted by 2.8%. The forecast for 2018 is for the Non-hydrocarbon GDP to grow by 3.9%, while its energy component to decline by 0.3%. The combined effect is official estimate of growth of Real GDP at 1.5% in 2017 and a projected growth of 2.7% in 2018. The ECI estimates for 2018 Q1 are of 1.2% for the whole economy with non-oil GDP growing at 3.1% in the same quarter. Inflation increased in the first quarter of 2018 to 4.2% Y-o-Y compared to 1.8% in the previous quarter, reflecting an increase in both, tradable and non-tradable inflation. Housing prices went down by 4.2% and 7.8% in Dubai and Abu Dhabi, respectively, Y-o-Y.

Regarding banking activity, Government deposits increased at a higher pace in the first quarter of 2018 compared to the previous quarter, both on Y-o-Y and Q-o-Q basis. . Banks' credit increased by 1.8% Q-o-Q and grew by 2.1% on a Y-o-Y basis providing some support to the non-oil growth. The soundness of the banking sector remained positive during 2018 Q1.

The Central Bank balance sheet exhibited a decrease in 2018 Q1, reflecting mainly a decrease in Central Bank's Deposits at Banks Abroad and Other Advances, as well as a decrease in investments in Foreign Securities. Interest rates in the UAE continued their upward trend in line with the Fed's decision announced in March to increase its policy rate. Nonetheless, the Dirham spread with respect to the USD LIBOR as well as the spread relative to the USD Swap rate continued to shrink, thanks to improved risk premium for the UAE, due to ample liquidity. .

Chapter 1. International Economic Developments

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The global growth momentum continued in 2018 Q1. Despite some emerging risks of potential trade war, growth estimates in the USA remain strong, reflecting a pickup in investment and consumer confidence, on the back of the announced tax cuts. Growth was revised upward in Japan and in the Euro Area, owing to continued monetary policy support. Meanwhile, the recovery in commodity prices supported resource-rich Emerging Economies. Inflation edged up in most countries in 2018 Q1, even though it remains below target in Advanced Economies. Monetary policy normalization continued in the US with the Fed's decision to increase its policy rate in March, while the policy rate remained the same in the Euro Area and the UK and is still negative in Japan. As regards the yield on government treasuries, it increased in the US, but decreased in both the Euro Area and Japan.

Global Economic Growth:

The upswing in the global economy continues to rise as global investment and trade rally in the first quarter of 2018. Growth is expected to increase from 3.8 percent in 2017 to 3.9 percent in 2018 and 2019. According to IMF's April 2018 *World Economic Outlook* (WEO), global growth strengthened on the back of investment recovery in advanced economies, growth in emerging Asia, a notable upswing in emerging Europe, and signs of recovery in several commodity exporters. The growth outlook is mainly driven by strong momentum, favorable market sentiment, accommodative financial conditions, and the domestic and international repercussions of expansionary fiscal policy in the United States.

Table. 1.1 Real GDP Growth in Selected Advanced Countries

	2016	2017	Q1 2018
USA	**1.5**	**2.3**	**2.9**
EURO Area	**1.8**	**2.3**	**2.4**
France	1.2	1.8	1.9
Germany	1.9	2.5	2.5
United Kingdom	**1.9**	**1.8**	**2.1**
Japan	**0.9**	**1.7**	**1.2**

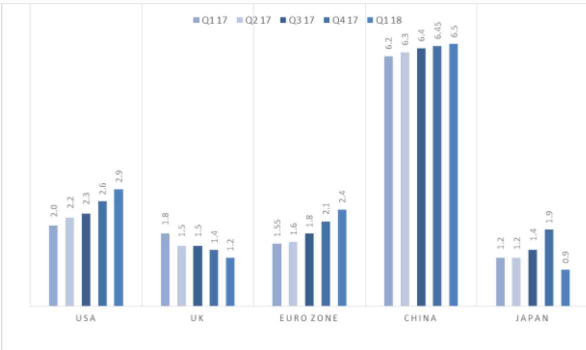
Source: IMF, World Economic Outlook, April 2018

The outlook for the US economy has improved since November mainly due to stronger than expected economic momentum at the end of 2017, boosted by expansionary fiscal outlook, following the adoption by US Congress of tax cuts in December, which are considered the largest overhaul of the tax code in 30 years.

As shown in Table 1.1, US real GDP growth is expected to reach 2.9% in 2018, which is an upward revision by 0.2 percentage points from the January WEO issue. Compared to the previous quarter, the US economy grew by 2.9% Y-o-Y in the first quarter of 2018. Consumer confidence reached 10-year high in February, albeit it fell in March. Meanwhile, the labor markets in the US have continued to tighten with the unemployment rate at a record low of 4.1%.

The IMF's World Economic Outlook (WEO), April 2018, upgraded its **growth projections for the UK** economy to 2.1 percent, up from its previous forecast of 1.5% for the year 2018. However, growth was weaker for the first quarter as the economy grew by 1.2 percent Y-o-Y. Despite slightly stronger than expected consumer spending, the growth rate is set to remain well below the historical average. According to WEO forecasts, the UK economy will remain among the worst performing economies in the G7 until 2020.

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



Source: Bloomberg

Furthermore, the World Economic Outlook (April 2018) shows a growth uptick, in general, in **Emerging Economies** thanks to higher growth in commodity exporting countries as well as better export prospects.

China's GDP growth stabilized at 6.8% in the first quarter of 2018 driven by quicker expansion in industry, retail sales' growth, real estate investment, and overseas demand. However, total fixed asset investment, particularly infrastructure investment, growth fell to the slowest level in two years.

Similarly, **The Indian economy started to gradually improve** this quarter, supported by the recovery in investment and consumer spending, from the shocks following the large-value currency ban in November 2016 and the new goods and services tax (GST) introduced in July 2017.

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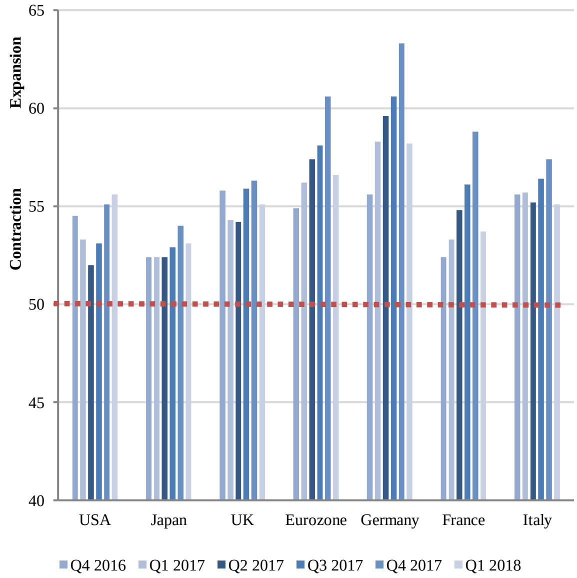
In the region of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)1 as defined by the IMF, economic growth is expected to rise to 3.4% in 2018 up from 2.6% in 2017, supported by higher commodities' prices and stronger growth in the main trading partners.

In the GCC, real non-oil GDP growth continues to improve in 2018 on the back of recovery in oil prices, and gradual fiscal consolidation. The Saudi economy is expected to emerge from recession in 2018 to record a growth in the order of 1.7 percent. Moreover, private consumption is forecast to grow modestly in 2018 as consumer spending is impacted by the GCC value-added tax (VAT) of 5% introduced in January 2018. Similarly, economic growth in 2018 is expected to reach about 3 percent in Bahrain, 1.3 percent in Kuwait, 2.1 percent in Oman, and 2.6 percent in Qatar.

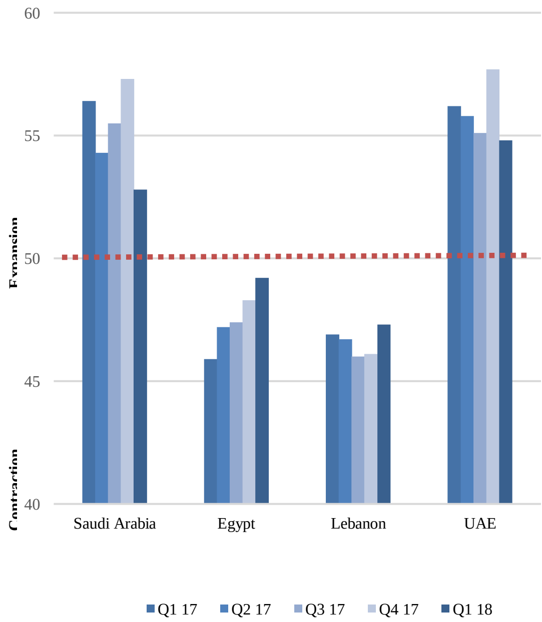
The Purchasing Managers' Index (PMI) has, however, mixed movements in the first quarter of 2018. Looking at some selected developed economies, the index for the United States points to an increase from 55.1 in the fourth quarter of 2017 to 55.6 during the first quarter of 2018. The reading points to the strongest pace of expansion in the manufacturing sector since March 2015. The main component driving this expansion is the significant growth of output and new orders. Meanwhile, PMI in Japan eased slightly from 54 to 53.1, in the UK from 56.3 to 55.1, and in the Euro zone from 60.6 to 56.5. In Saudi Arabia, the PMI in the non-oil private sector fell from 57.3 in 2017 Q4 to 52.8 in 2018 Q1, implying that the country's non-oil private sector is expanding at the slowest pace in nine years. Meanwhile, the PMI for Egypt increased from 48 to 49.2, but it remains below the 50 mark, i.e., in a contractionary zone.

Figure 1.2. PMI Levels for Selected Developed Countries



Source: Bloomberg

Figure 1.3. PMI levels for selected MENA countries



Source: Bloomberg

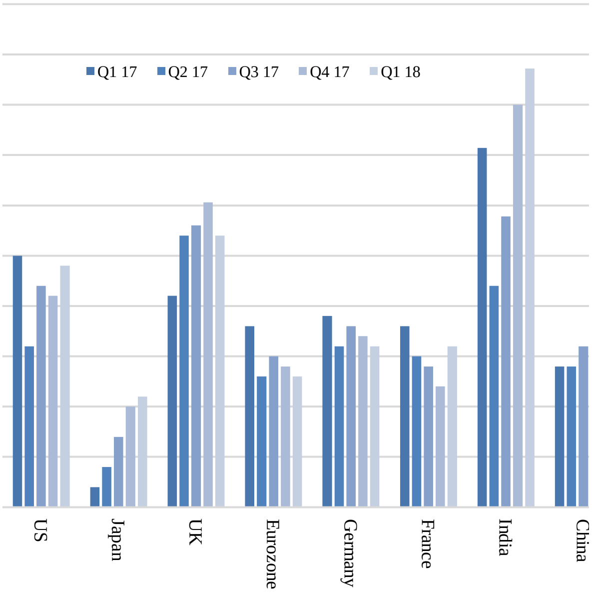
Inflation:

Headline Inflation increased in 2018 Q1 in most developed and emerging economies on the back of higher commodity prices and enhanced demand. However, core inflation – i.e., when fuel and food prices are excluded – remains generally soft. In most advanced economies, core inflation remains below target, but seems to be increasing in response to

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

stronger demand. In the US, core personal consumer expenditure inflation has begun to firm as it stood at about 1.9 percent Y-o-Y in March. While in the Euro area, core inflation notched up to 1 percent. As for Japan and the UK, core inflation rose in March to 0.3 percent and 2.3 percent, Y-o-Y, respectively.

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



Source: Bloomberg

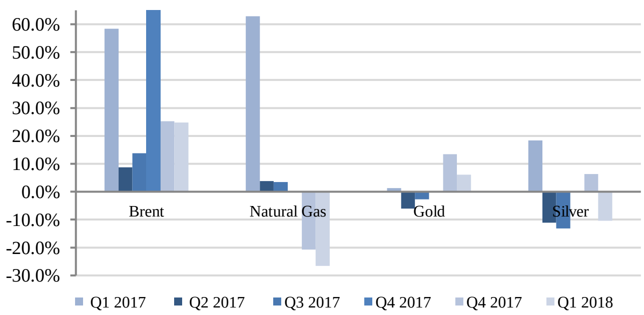
In Emerging Economies, inflation remained, in general, under control thanks to low imported inflation and some currency appreciation against the US dollar. In China, for instance, inflation increased from 1.6 percent in 2017 to 2.5 percent in 2018. While in India, inflation increased from 3.6 percent to 5 percent. Russia's inflation, however, exhibited a decrease from 3.7% in 2017 to 2.8 percent in 2018. In Brazil, core inflation remained around historical lows while overall inflation remained flat at 3.4 percent in 2017 and 3.5 percent in 2018.

Commodity prices:

Commodity prices moved in different directions in the first quarter of 2018. The price of Brent crude oil continued to improve reaching the 72 dollars per barrel threshold. Compared to the first quarter of 2017, Brent crude oil price increased by 25% in the first quarter of 2018. This owes mainly to the extension of the OPEC agreement as well as global supply risks. Political uncertainties in oil producing countries such as Libya and Iran continue to solidify the increase of oil prices. Moreover, the escalation of tensions in the Middle East affected the prices of oil. As for world oil demand growth, projections have been revised higher for 2018 by 30 thousand barrels per day, which stands at 1.63 million barrels per day. According to OPEC monthly Oil Market Report, the growth in world oil demand mainly reflects the positive momentum in the OECD in the first quarter of 2018 on the back of better-than-expected data, and supported by development in industrial activities and colder-than-anticipated weather and strong mining activities in the OECD Americas and the OECD Asia Pacific. Total world oil demand for 2018 is forecast to average 98.70 million barrels per day.[2]

Similarly, gold price increased by 6% Y-o-Y compared to 13.5% increase in the previous quarter (2017 Q4) as the dollar weakened further. Natural Gas and Silver decreased by 26%, and 10% respectively (Figure 1.5). According to the World Bank, prices of energy commodities, which include natural gas and coal, are projected to increase by 8 percent in 2018.

Figure 1.5. Selected commodity price levels (Y-o-Y, % change)



Source: Bloomberg

Policy Interest Rates:

Table. 1.2 The Policy Interest Rates for Selected Advanced Countries

Date	US Fed Funds	BoJ Overnight Call Rate	ECB Refinancing Rate	BoE Policy Rate

[2] Source: OPEC *Monthly Oil Market Report*, April 2018.

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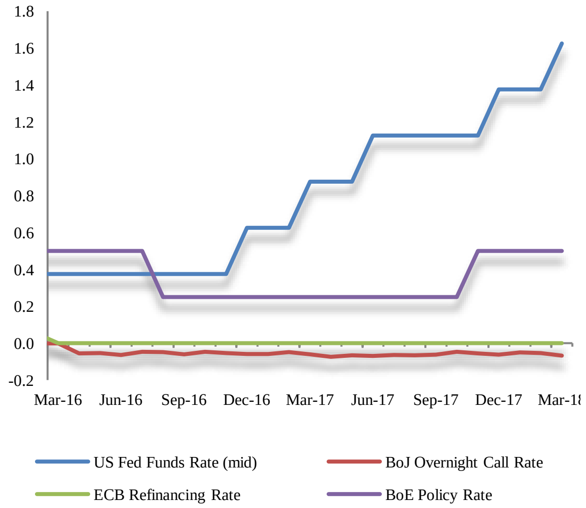
	Rate (mid)			
30.6.17	1.1	-0.1	0	0.3
31.7.17	1.125	-0.064	0	0.25
31.8.17	1.125	-0.066	0	0.25
29.9.17	1.125	-0.063	0	0.25
31.10.17	1.125	-0.046	0	0.25
30.11.17	1.125	-0.055	0	0.5
29.12.17	1.375	-0.062	0	0.5
31.1.18	1.375	-0.05	0	0.5
28.2.18	1.375	-0.053	0	0.5
30.3.18	1.625	-0.068	0	0.5

Source: Bloomberg

Policy normalization by the Federal Reserve continued in 2018 Q1, as the Federal Reserve's Open Market Committee (FOMC) decided in its March 20-21 meeting to increase by 25 basis points the target range for the federal funds rate, ranging from 1.50% to 1.75%. Nonetheless, The Bank of England's monetary policy committee voted in March to keep its policy rate at 0.5%.

Figure 1.6. Policy rates for selected developed countries (%)



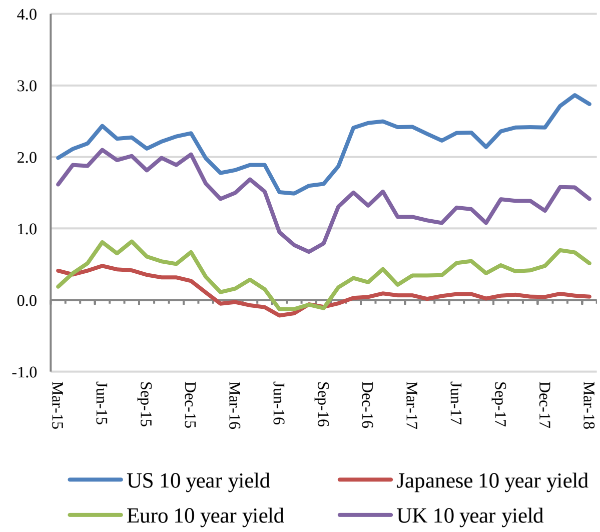
Source: Bloomberg

Meanwhile, the European Central Bank's Governing Council took a decision in its 8th of March meeting to maintain the interest rate on refinancing operations, on the marginal lending facility and on the deposit facility, unchanged, at 0.00%, 0.25% and -0.40%, respectively. The statement indicates that ECB expects the key interest rates to remain at their present levels for an extended period of time. The Governing Council confirms that unconventional monetary policy, namely the net asset purchases by ECB, will stay at the current monthly pace of €30 billion and is expected to run until the end of September 2018, or beyond, if necessary. In the case of The Bank of Japan, the committee decided to leave its key short-term interest rate unchanged at -0.1 percent at its March 2018 meeting (Figure 1.6).

Government Bond yields:

During the first quarter of 2018, US government bond yields increased, with the 10-year US Treasury rate in touching distance of the 3% mark, in expectation of further rate hikes by the US Federal Reserve. Meanwhile, the yield on 10-year government bonds in the Euro area decreased from 0.8% in January to 0.7% in February and to 0.5% in March. Similarly, the yield in Japan decreased from 0.06% in February to 0.05% in March.

Figure 1.7. The 10-year government bond yields for selected countries (%)



Source: Bloomberg

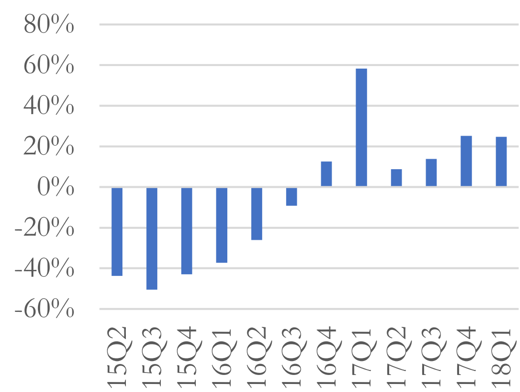
Chapter 2: Domestic Economic Developments

According to the index of non-oil activity constructed by CBUAE (Non-Oil ECI), the non-hydrocarbon sector in the UAE grew by 3.1% in the first quarter of 2018, driven mainly by continued improvement in global economic conditions and the positive economic sentiment triggered by higher oil prices, increasing fiscal space for priority spending in the near future. Underpinned by the stronger non-energy growth, the overall Economic Composite Index rebounded to reach 1.2% growth despite the oil production cut stipulated by the OPEC agreement to which the UAE has committed. The inflation rate picked up in the first quarter of 2018 by 4.2% against 1.8% in the last quarter of 2017 on the back of the VAT implementation in January which pushed tradables' prices up by 7.6%, adding to a previous jump by 4% in the fourth quarter of 2017. Transportation costs jumped by 10.7% in the first quarter of 2018 in line with higher international fuel prices. Employment expanded by 3.2% Y-o-Y, on average, in the first quarter of 2018, registering a recovery.

2.1. Economic Activity and Growth

Economic activity in the UAE has continued to improve during the first quarter of 2018. Supported by the revival of oil prices, growth in the non-oil economic activity has registered yet a stronger growth in the first quarter of 2018. The OPEC agreement, stipulating a coordinated oil production cut among oil producers, has proven to be successful to solidify oil prices since January 2017; the date when the agreement took effect. Indeed, Brent crude oil prices has exceeded the 50$ psychological threshold since the first quarter of 2017, increasing confidence in the outlook of the UAE's economy. The average quarterly growth rate on an annual basis of the oil price has reached 26% since the first quarter of 2017 (see Figure 2.1.a). In the first quarter of 2018, oil prices rebounded by 25% on an annual basis supported by a further increase of 9% compared to the last quarter of 2017.

Figure 2.1.a Quarterly Brent crude oil prices (%, Y-o-Y

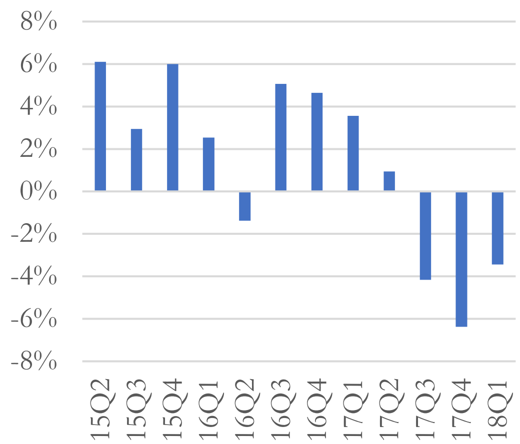


Source: EIA

Further to supply-cuts, these positive developments in oil prices were backed by a strong international demand driven by higher investment and exports.[3] In line with its commitment to the OPEC agreement, the UAE has reduced its oil production by 3% compared to the first quarter of 2017, for the fifth consecutive quarter (Figure 2.1.b and Figure 2.1.c).

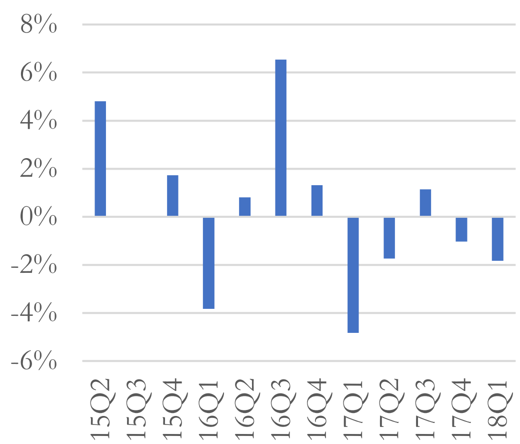
[3] See the latest World Economic Outlook, IMF, April 2018.

Figure 2.1.b UAE's quarterly oil production growth (%, Y-o-Y)



Source: OPEC (as of April 2018)

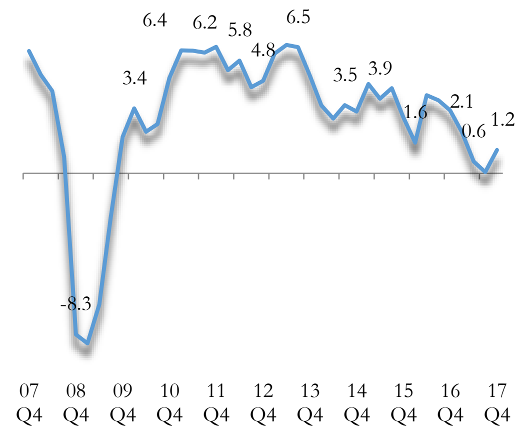
Figure 2.1.c Quarterly Oil Production Growth (%, Q-o-Q)



Source: OPEC (as of April 2018)

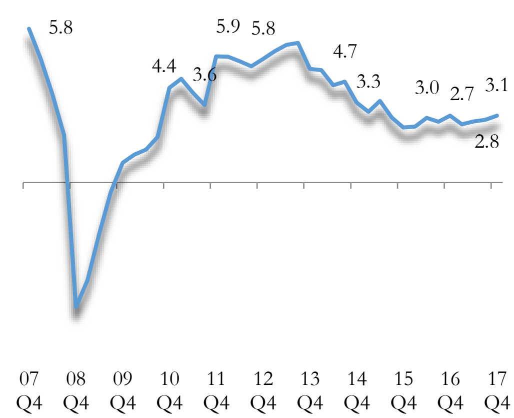
Improvement in the economic sentiment, supported by the oil price recovery, has helped to offset the negative impact of the production cut on the general economic-activity's trackers. For instance, the Economic Composite Indicator (ECI[4]) registered an improvement in the Overall Indicator, while for the Non-oil Indicator it was close to the level in the previous quarter (Figures 2.1.d and 2.1.e and Box 1).

Figure 2.1.d Overall Quarterly Economic Composite Indicator (%, Y-o-Y)



Source: CBUAE

Figure 2.1.e Non-Oil Quarterly Economic Composite Indicator (%, Y-o-Y)



Source: CBUAE

Based on revised improved global indicators and the improved estimates of the first quarter growth in the UAE, growth projections have been revised, signifying better outlook of domestic economic conditions (Box 1). Box 2 illustrates recent developments in the real estate market.

[4] The ECI was revised backwards for the period 2011 Q1 to 2017 Q4, based on the latest data published by the Federal Competitiveness and Statistics Authority (FCSA).

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Box 1: Economic Activity: GDP estimates and projections

Quarterly Economic Growth

The Central Bank of the UAE has been publishing estimates of quarterly economic activity in the absence of published data for quarterly GDP, both, for overall and non-oil output using the Economic Composite Indicator (ECI[5]). Non-oil ECI indicates the performance of the economy, which is not affected by oil production and signifies the strength of the diversification of the UAE economy.

The latest estimates produced by the CBUAE are shown in Table 1 below. The non-oil ECI is estimated to have reached a growth rate for 2018 Q1 of 3.12% Y-o-Y, slower than growth in the previous quarter of 3.43% Y-o-Y. In general, robust non-oil growth is solidified by the higher growth rates of GDP in the US and the Eurozone GDP, based on the IMF April 2018 World Economic Outlook *(WEO)*. Other positive drivers boosting the non-oil ECI are the high levels of the Dubai Economic Tracker (DET), being at 55.2 in 2017 Q4 and at 55.7 in the first quarter of 2018, some signs of improvement in Domestic private Credit growth and the depreciation of the AED recently, weighing positively on competitiveness and the growth of non-energy GDP.

Table 1. Quarterly Y-o-Y Growth of the ECI and Non-oil ECI (%)

	ECI Y-o-Y	Non-oil ECI Y-o-Y
1Q 15	2.94	3.19
2Q 15	4.25	2.82
3Q 15	3.55	3.26
4Q 15	4.06	2.59
1Q 16	2.55	2.57
2Q 16	1.41	2.62
3Q 16	3.57	3.02
4Q 16	3.33	2.84
1Q 17	3.01	3.66
2Q 17	1.97	3.18
3Q 17	0.55	3.33
4Q 17	0.06	3.43
1Q 18	1.21	3.12

Source: Central Bank of the UAE

Underpinned by growth of the non-oil ECI, the ECI for the overall economic activity has improved, as shown in Table 1, from almost zero growth in 2017 Q4 to 1.21% Y-o-Y growth in the first quarter of 2018. Growth has further benefited by the higher oil price in 2018 Q1, reaching USD 66.8 per barrel, compared to USD 61.5 per barrel in the previous quarter. Oil production in the UAE decreased in comparison to 2017 Q4 from an average of 2.89mn barrels a day to 2.84mn barrels a day, registering lower pace of production cuts on an annual basis from -6.3% in the last quarter of 2017 to -3.5% in 2018 Q1.

[5] Firstly introduced in Box 2 of the 2015 Q3 QER and further developed and presented as a working paper in June 2017. It was revised backwards for the period 2011 Q1 to 2017 Q4, based on the latest data published by the Federal Competitiveness and Statistics Authority (FCSA).

Revised Annual Economic Growth Projections

CBUAE has updated its projections using the latest projections concerning the global economy released in the IMF April *WEO*, coupled with some revisions to other variables in the Central Bank's Macroeconomic Model (Table 2 below).

World and US GDP growth figures were revised up, as per the April 2018 IMF *WEO*. For 2017, the last global GDP growth was revised upward to 3.8%, compared to 3.5% earlier. The projections were further upgraded to 3.9% for both 2018-19, from 3.6% and 3.7% respectively. Similarly, the US GDP growth was revised upward from 3.5% for 2017 and 2.1% for 2018-19 to 2.3%, 2.9% and 2.7% for 2017-2019, respectively.

The main UAE trading partners' performance has also improved as of January 2018. Oil prices[6] have been also revised upward. We assume that the UAE fiscal framework remains unchanged, compared to previously projected by the IMF and we project inflation for 2018-19 at 3.5% and 2.5% respectively.

Table 2. Economic Growth in the UAE (%)

	2015	2016	2017(E')	2018(P)	2019(P)
Real GDP	3.7	2.7	1.5	2.7	3.1
Real Oil GDP	5.4	2.6	-2.8	-0.3	0.1
Real Non-Oil GDP	3.0	2.8	3.4	3.9	4.3

Source: Federal Competitiveness and Statistics Authority (FCSA) for 2014, 2015, and 2016, and FCSA preliminary release (E) for 2017 and Central Bank of the UAE projections (P) for 2018 and 2019.

The composite effects of revised growth figures and estimates have weighed in positively on growth projections in the UAE and the medium term outlook for the non-energy growth.

Overall, there is an improvement in the growth projections of the non-oil GDP, due to improved international economic conditions. In parallel, the projected oil output is lower for 2018, based on the first three months' realization in the current year, which has impacted negatively oil GDP, and hence overall GDP growth in 2018. In 2019, non-oil GDP growth would further improve, without further contraction in the oil output, improving overall GDP growth.

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[6] Based on realized values and latest futures prices.

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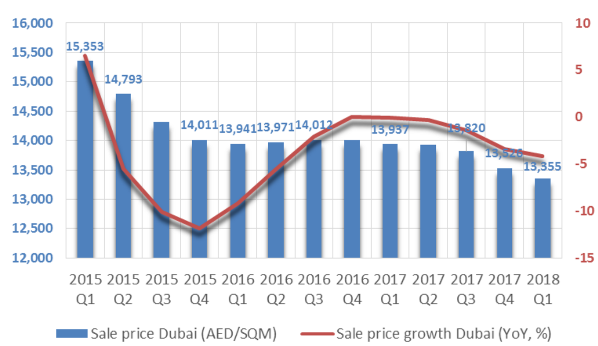
Box 2: Recent Developments in the Real Estate Market

According to recent data using REIDIN Price Index[7], the UAE residential Market continues to decline moderately in the first quarter of 2018. In Dubai, on an annual basis the property prices decreased by 4.2%, registering a decline of 1.3% compared to the previous quarter to AED 13,355/m². In Abu Dhabi the annual drop in property prices was 7.8%, registering 1.5% fall compared to the previous quarter to AED 11,785/m². The gross rental yield, which measures the rate of income return over the cost associated with an investment property decreased slightly in Dubai to 6.92% and to 6.96%in Abu Dhabi.

Dubai residential Market

In the first quarter of 2018, the real estate property price, which measures the average sample price in dirham per square meter of residential properties, decreased by 4.2% Y-o-Y compared to 3.4% decline in the previous quarter (Figure 1).

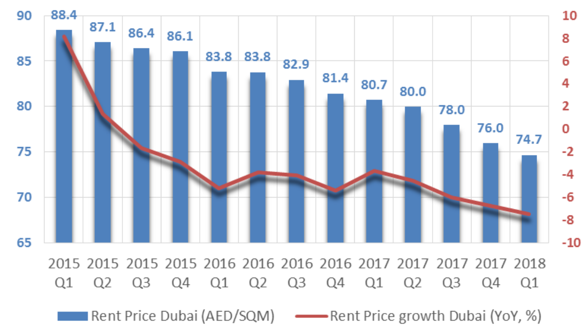
Figure 1: Dubai Residential Sale Prices



Source: REIDIN

The Dubai market continues to exhibit decline in rent (Figure 2), due to high supply and lower demand. The rent prices declined by an annual rate of 7.5% in the first quarter of 2018, following a decrease of 6.7% in the previous quarter.

Figure 2: Dubai Residential Rent Prices



Source: REIDIN

As regard to investment in Dubai's real estate market, it is clear that 2017 was marked by a slowdown in rental yield from a high of 7.2% in the first quarter to a low of 6.95% in the last quarter of 2017 (Figure 3). This trend was the result of relatively stable prices towards the end of the year, combined with further decline in rents. More recently, the rental yield further declined to 6.9% in the first quarter of 2018.

[7] 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.

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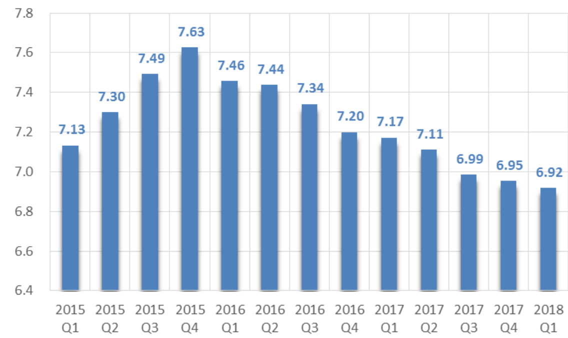
Figure 3: Dubai Gross Rental Yield (%)

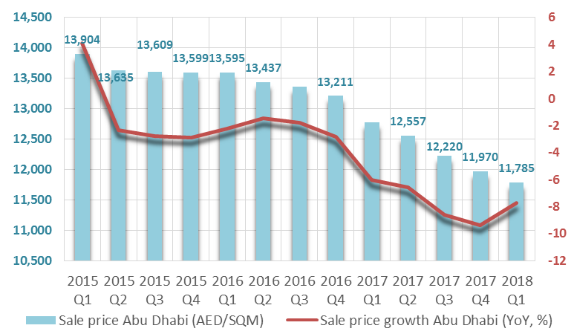


Source: REIDIN

Abu Dhabi residential Market

For Abu Dhabi, the REIDIN Price Index exhibited a continued fall in residential property prices, albeit at a more moderate rate of 7.8% Y-o-Y in the 2018 Q1, following a decrease of 9.4% in the previous quarter (Figure 4).

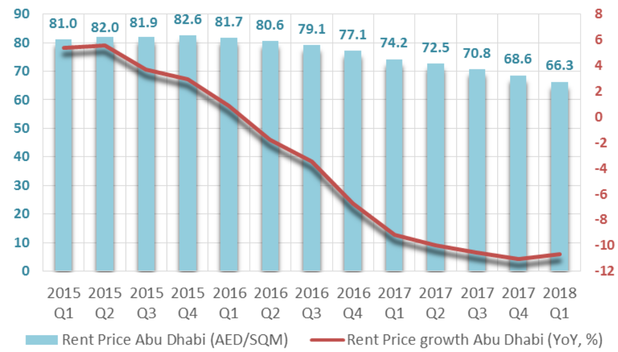
Figure 4: Abu Dhabi Residential Prices



Source: REIDIN

As for the rental market, the rent values in Abu Dhabi continued to decline by an annual rate of almost 10.7% on average in the first quarter of 2018, after a reduction of 11% in the previous quarter. This trend is reflecting the impact of softer job market which continues to weigh in on demand in the housing market (Figure 5).

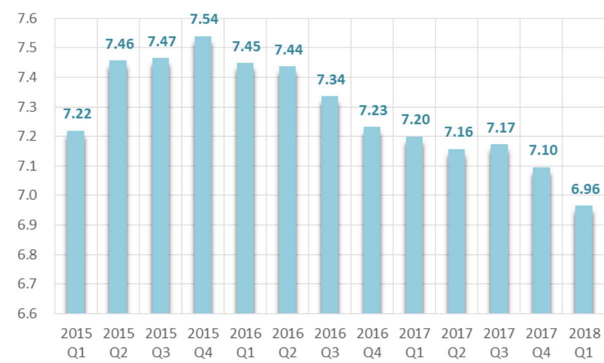
Figure 5: Abu Dhabi Residential Rent Prices



Source: REIDIN

Concerning the gross rental yield, Abu Dhabi registered a yield of 6.96% for 2018 Q1, a marginal decline of 0.14 precentage points from the previous quarter (Figure 6). The observed pattern in rental yield reflects a constant pace of decline in rent along with continued decline in demand reflecting a weaker job market which has weighed in adversely on the investment sentiment in properties.

Figure 6: Abu Dhabi rental yield (%)



Source: REIDIN

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2.2 Consumer Price Index and Inflation

The headline inflation jumped in the first quarter of 2018 to regain 2015-levels, mainly driven by the implementation of the Value Added Tax (VAT) in January 2018, which triggered a rebound of average consumer prices by 4.2% on an annual basis (table 2.2).

Inflationary pressures built up in the last quarter of 2017 after a significant period of disinflation on the back of an economic slowdown, in the aftermath of the adverse oil price shock in 2014. Overall price levels increased by 1.8% in the fourth quarter of 2017, including December's price inflation of 2.7% because of the excise tax implementation on energy beverages and tobacco.

The VAT's implementation in January pushed the Consumer Price Index (CPI) inflation to reach 4.8% compared to the same month a year earlier, the highest monthly reading since August 2015 (4.9%). Furthermore, the CPI rose by 4.4% and 3.4% in February and March, respectively, leading to a 4.2% increase of the average CPI for the first quarter of the year. Both tradables and non-tradables prices have increased significantly in the first quarter of 2018 (Figure 2.2.a and 2.2.b).

The most important increase in price inflation was attributed to tradables, which drove the headline inflation for the first time, despite their smaller weight compared to non-tradables in the consumption basket, summing up to 34% of the consumption basket in the UAE against 66% for non-tradables. Average tradables' prices grew by 7.6% in the first quarter of the year adding to 4% in the last quarter of 2017 on an annual basis. Prices of all tradable goods and services increased significantly in the first quarter of 2018 on account of the recent Dirham depreciation and the VAT implementation. Average prices of food and soft drinks jumped by 6.3% during the first quarter after a 2.4% increase in the last quarter of 2017. Prices of beverages and tobacco continued their sharp expansion until March 2018 for the sixth consecutive month, growing by the same rate of 84% in January-February against an average increase of 70.2% in the last three months of 2017. Moreover, Prices of textile, clothing and footwear jumped reaching 8.6% during the first quarter of the year. Furniture and household's goods prices were subject to high inflationary pressure, leading further to an increase of their average prices by 4.2% in 2018 Q1.

Table 2.2. UAE CPI inflation (%, Y-o-Y)

	Weight	2017				2018
	%	Q1	Q2	Q3	Q4	Q1
CPI Inflation (period average)	100	2.7	2	0.8	1.8	4.2
CPI Inflation (end-of-period)	100	3	2	0.5	2.7	3.4
Tradable Inflation	34	3.4	2.7	1.8	4	7.6
Non-tradable Inflation	66	2.9	2.1	0.5	0.7	2.5
Housing Inflation	34	2.1	1.3	-0.6	-1	-0.8
Transportation Inflation	15	8.5	5	2	6.4	10.7
Other Inflation	51	2.4	2.3	1.8	2.6	6

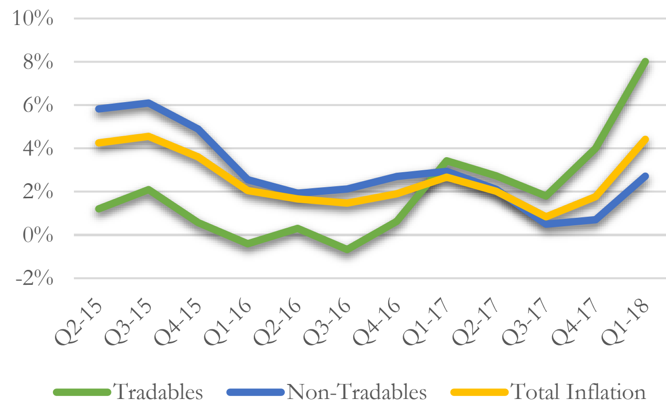
Source: Federal Competitiveness and Statistics Authority (FCSA).

Note: All the changes are computed on an annual basis and based on the quarterly average CPI, unless otherwise indicated. The Tradables and non-tradables inflation rates were computed using the on an annual basis growth of weighted-average CPI of different sub-components

Non-tradables generally defined the inflation's trend in the UAE before the VAT's implementation last January. However, more recently especially with subdued housing prices, tradables' inflation has dominated. Non-tradables' price inflation is dominated by the developments of housing prices which account for more than 51%. Rental and utilities prices continued their deflation for the third consecutive quarter. Average housing costs declined by 0.8% on an annual basis in the first quarter of 2018 driven by an important decline of rental prices, adding to a previous drop of 1% in the last quarter of 2017 and a decline of 0.6% in the third quarter of the same year (Figure 2.2.a). In the UAE, the excess supply in the real estate market, relative to slower demand, has had an important downward pressure on rental prices on the back of a weaker employment activity (Box 3 and Box 4).

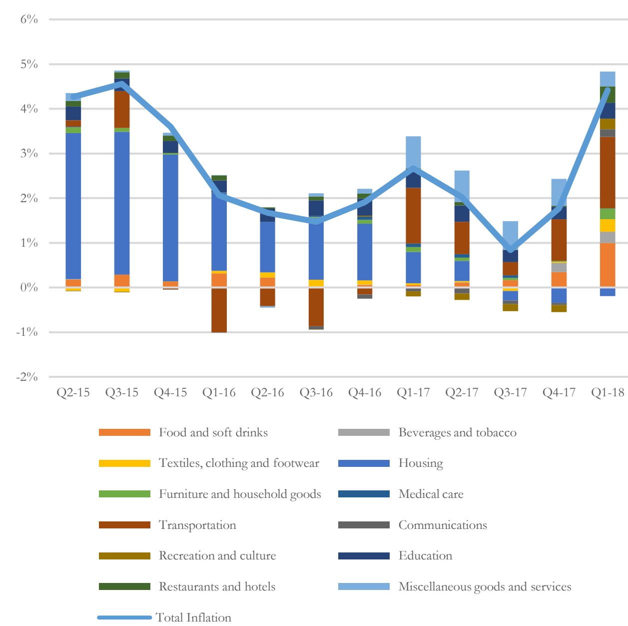
Transportation costs which account for around 15% of the total consumption basket, contribute equally to both tradables and non-tradables prices. In the first quarter of 2018, the transportation prices increased by 10.7% due to the recovery of international energy prices. Effective August 2015, the UAE's government has embarked on an energy-subsidy cut reform, putting retail domestic energy prices in line with international oil prices. The implementation of the energy price reform has increased its volatility in line with the international fuel price. In fact, the volatility of transportation costs[8] increased by 12% compared to the period prior to the reform.

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

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



Source: Federal Competitiveness and Statistics Authority (FCSA).

[8] The volatility is computed using the standard deviation of the CPI.

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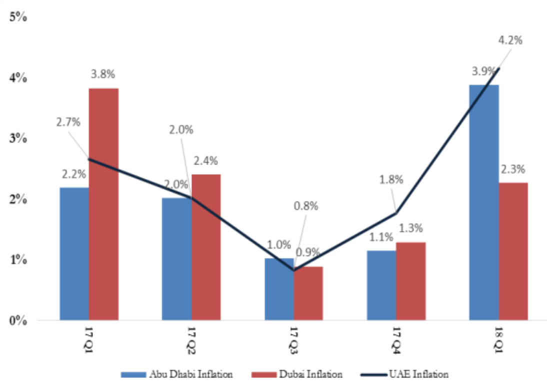
Box 3: Inflation in the UAE: Comparison By Emirate

The inflation rate in the UAE has slowed down until 2017 Q4, where it reached 1.8% Y-o-Y UAE-wide, while in Dubai and Abu Dhabi it was respectively at 1.3% and 1.1% Y-o-Y respectively.

However, after the introduction of the Value Added Tax (VAT) in January 2018 the inflation rate had a significant upward shift, reaching 4.2% Y-o-Y in 2018 Q1 UAE-wide and 3.9% and 2.3% in Abu Dhabi and Dubai respectively (Figure 1).

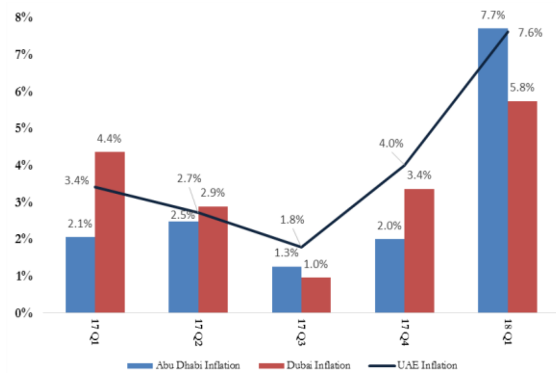
Figure 1. Quarterly Y-o-Y Headline Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD, DSC and Central Bank of the UAE

The main drivers of inflation, both, at the aggregate and Emirate levels are the prices of tradables. They increased by 7.6% in the first quarter of 2018 compared to a year earlier, while in Abu Dhabi and Dubai the increase in tradable inflation was 7.7% and 5.8% for the prices of goods and services. They marked a huge increase compared to the previous quarter, where the quarterly inflation rate Y-o-Y was of 4%, 2% and 3.4% for the UAE, Abu Dhabi and Dubai respectively (Figure 2).

Figure 2. Quarterly Y-o-Y Tradable Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD, DSC and Central Bank of the UAE

The main drivers of the tradeable inflation by Emirates and UAE-wide in 2018 Q1 Y-o-Y were the Transport, Foodstuff and Tobacco categories, increasing by 10.7%, 6.2% and 84.2% respectively UAE-wide, 10%, 5.3% and 100.5% respectively in the Emirate of Abu Dhabi and 8.9%, 5.5% and 74.2% respectively in Dubai. The Transport category was heavily affected by the increase in oil prices to USD 66.8 per barrel in 2018 Q1 from USD 61.5 per barrel in the previous quarter with an annual increase of 24.8%, which has inflated the price of domestic fuel that adjusts to the international price. Prices of Foodstuff were also affected by the continued depreciation of the AED (-5.1% decline of the REER Y-o-Y), while the Tobacco products were affected by the recently introduced excise tax in October 2017 at the rate of 100 percent.

In the Non-tradable category, the Y-o-Y inflation remained much more moderate in the first quarter of 2018. For the UAE it was at 2.5%, in Abu Dhabi at 1.9%, while in Dubai it stayed at 1% (Figure 3).

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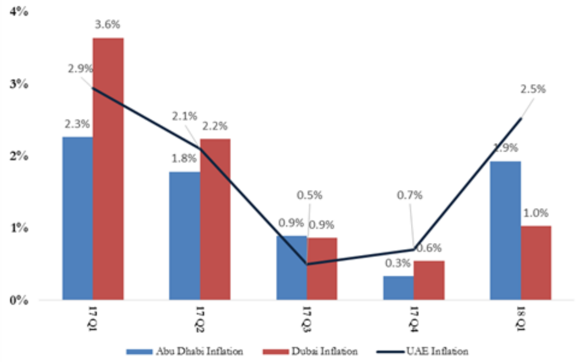
Figure 3. Quarterly Y-o-Y Non-Tradable Inflation in the UAE and the Emirates of Abu Dhabi and Dubai



Source: FCSA. SCAD, DSC and Central Bank of the UAE

In the non-tradable category, there were sectors with big increase in prices, such as Restaurants and hotels with an increase of 9.1% Y-o-Y in 2018 Q1 UAE-wide, 9.8% in the Emirate of Abu Dhabi and 12.2% in Dubai. However, the increase in those categories was fully offset by the decline of prices in the Housing category, which has a much bigger weight. UAE-wide, the decline was of 0.8% Y-o-Y for the first quarter of 2018, in Abu Dhabi the index decreased by 3%, while in Dubai the index decreased by 1.1%.

As to the difference across Emirates compared to UAE-wide inflation, the difference in inflation could be mainly explained by the weights the Statistical Authorities are attributing to the categories of the CPI basket (Table 1). For instance, a category such as Transportation with a big weight in the tradable inflation has a much lower weight in Dubai than in Abu Dhabi or for the UAE-wide CPI basket. Similarly, in Dubai, the Housing category has a much bigger weight, than in Abu Dhabi and UAE-wide. Hence, both tradable and non-tradable inflation are lower in Dubai, compared to Abu Dhabi and UAE-wide inflation.

Table 1. Weights assigned for the different categories per Statistic Authority

Major Groups of Expenditure	Weight		
	UAE	Abu Dhabi	Dubai
All items of consumer price index	**100**	**100**	**100**
Food and soft drinks	14.3	12.3	13.1
Textiles, clothing and footwear	3.2	5.4	2.0
Housing	34.1	31.2	43.6
Furniture and household goods	5.6	7.2	3.8
Medical care	1.4	1.6	0.8
Transportation	14.6	14.7	10.6
Communications	5.4	5.0	5.2
Recreation and culture	3.2	4.8	2.3
Education	7.7	6.9	8.5
Restaurants and hotels	4	3.8	4.0
Miscellaneous goods and services	6.3	7.0	5.6

Source: FCSA. SCAD and DSC

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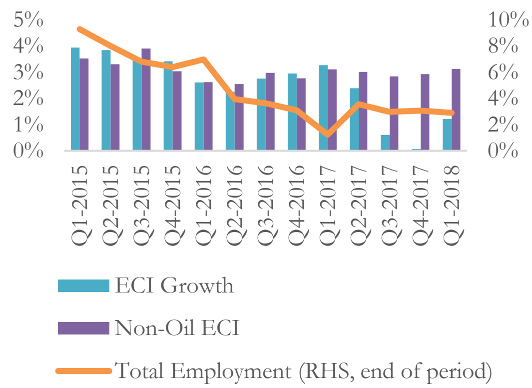
2.3 Employment and labor market dynamics

Notwithstanding recent slowdown, the labor market in the UAE remains vibrant as the demand for labor continued its increase until the end of 2017. Employment growth averaged 3.2% in the first quarter of 2018 on an annual basis against an average annual growth of 1.2% in 2017, following a growth rate of 3.1% in the last quarter of 2017.

The improvement in oil prices and the resulting positive economic sentiment encouraged key sectors to expand their demand for labor and stimulated the dynamics of the labor market in general. In addition, the resiliency of the non-oil sector and the ongoing drive for further economic diversification have solidified employment growth, especially in the real estate, renting and business activities.

Figure 2.3.a. Employment growth and economic activity in the UAE (%, Y-o-Y)



Source: Ministry of Human Resources and Emiratization and CBUAE.

The resiliency of the non-oil sector was depicted by the good performance of the Non-Oil Economic Composite Indicator (ECI) which expanded by 3.1% on an annual basis in the first quarter of 2018 (Figure 2.3.a). The positive economic sentiment was accompanied by an expansion of employment by 2.9% in the first quarter (end of period) on an annual basis, to which all economic sectors have contributed except the transport, storage and communication sectors, where demand for labor declined by 1.7% on an annual basis after a null growth in the last two quarters of 2017. Employment in the services sector recorded growth for the first time since the last quarter of 2016. Notable employment growth was evident in the wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods. Other non-classified services are part of the 'other sectors' category. Labor demand for this category rebounded by 4.2% in the first quarter of 2018, adding to a previous growth of 2.8% in the last quarter of 2017.

In general, employment in the services sector has improved in the first quarter of 2018 compared to the same period of the last year. The real estate and the construction sectors remained the top contributors in terms of employment growth, expanding by 6.6% on an annual basis in the first quarter of 2018 against 2.9% in the last quarter of 2017; the highest reading since the third quarter of 2016. The construction sector, which accounts for 34% of the total labor force, increased its labor demand by 4%, the slowest rate since the end of 2016. These developments are explained by the surge of growth in the real estate sector and consequently, the increasing need for labor force. The manufacturing sector, which absorbs around 9% of the labor force, underperformed in terms of employment growth since its labor-demand did not grow (0.3%) in the first quarter of 2018, after a 4.2% increase in the last quarter of 2017. This performance could be explained by the output cut attributed to the higher cost of imports and the VAT's implementation (Figure 2.3.b).

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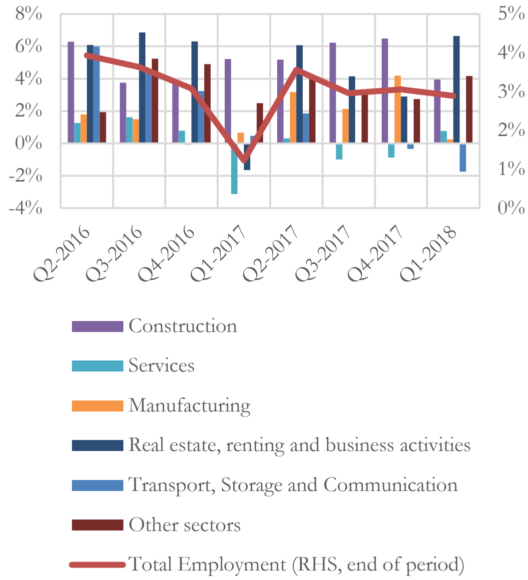
Figure 2.3.b. Employment growth by sector (%, Y-o-Y, end of period)



Source: Ministry of Human Resources and Emiratization

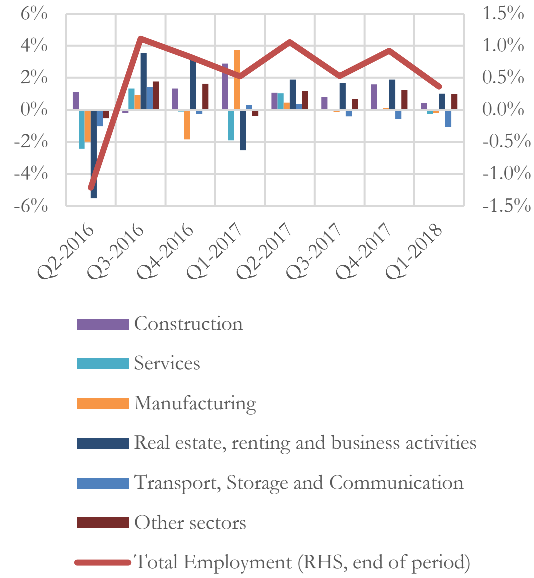
On a quarterly basis, the highest employment growth went to the real estate and the 'other' sector where labor demand rose by 1% for both sectors, compared to the last quarter of 2017. Employment in the construction sector rose by 0.5% on a quarterly basis.

Manufacturing employment almost stagnated in the first quarter of 2018 compared to the last quarter of 2017, increasing only by 0.4% quarterly, which is the lowest reading since mid-2016 (See Figure 2.3.c).

Notwithstanding annual increase, employment growth in the services sector in the first quarter of 2018 declined by 0.3%, confirming the firms "wait-and-see" attitude in the aftermath of the VAT's implementation and its likely impact on consumers' demand.

Labor demand declined by 1.1% in the transport, storage and communication sectors, compared to the last quarter of 2017.

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



Source: Ministry of Human Resources and Emiratization

The surge of labor demand in the construction and the real estate sectors was accompanied by an increase in domestic credit allocated to both sectors. The construction and real estate sectors altogether absorb around 45.9% of the labor force in the UAE. Employment in both sectors increased by 4.6% in the first quarter of 2018 on an annual basis, against a 5.5% in the previous quarter. However, there was a 12.6% surge in domestic credit for the same period (Figure 2.3.d). The quarterly growth rate of employment in the construction and real estate sectors and domestic credit in both sectors were at 0.4% and 1% during the first quarter of 2018, respectively. Credit growth bodes well for further employment growth in the sectors.

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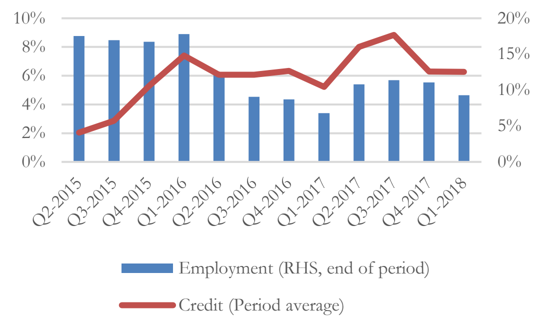
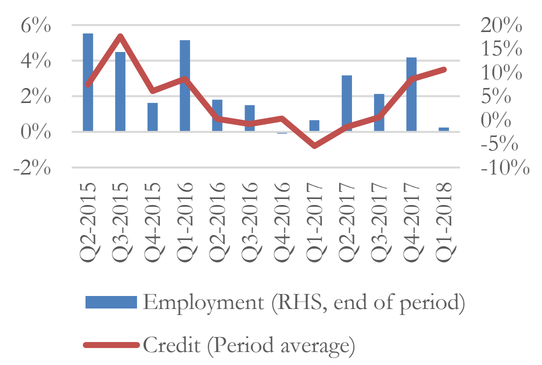
Figure 2.3.d Employment and domestic credit developments in the construction and real estate sector (%, Y-o-Y)



Source: Ministry of Human Resources and CBUAE

The expansion of labor demand in the manufacturing sector was not compatible with the increase in domestic credit allocated to this sector since 2015 Q3. Employment in the manufacturing sector grew by 0.3% on an annual basis in contrast to the 10.6% increase in the domestic credit (Figure 2.3.e). The quarterly domestic credit to the manufacturing sector increased by 0.4% during the first quarter of 2018, while employment in the manufacturing sector declined by 0.2% on a quarterly basis.

Figure 2.3.e Employment and Credit developments in the Manufacturing sector (%, Y-o-Y)



Source: Ministry of Human Resources and Emiratization and CBUAE

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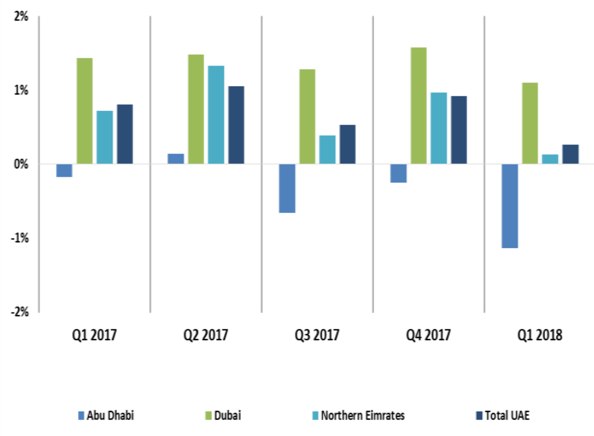
Box 4: Developments in the Labor Markets in the UAE

The UAE labor market is split geographically into three big segments: Abu Dhabi, Dubai and Northern Emirates. As of the end of 2018 Q1 the participants in the labor market in the UAE are 5,052 thousands of which 28% of the total working population or 1,413 thousands are based in Abu Dhabi, 50.6% or 2,558 thousands in Dubai and 21.4% or 1,082 thousands in the Northern Emirates.

Figure 1. Employment change (%, Q-o-Q), quarter average



Source: Ministry of Human Resources and Emiratisation.

As per Figure 1, the main drivers of employment growth in the UAE for the last four quarters remains the Emirate of Dubai with an average quarterly growth of 1.4% for the last twelve months. In 2018 Q1, the Emirate added 27.8 thousand new jobs or a growth of 1.1% Q-o-Q, compared to the previous quarter where there was an increase of 39.2 thousands additional jobs registering an increase of 1.6% Q-o-Q. On a Y-o-Y basis, the average employment growth rate in 2018 Q1 was of 5.8 (Table 1), adding 134.5 thousands extra jobs over the last 12 months.

Table 1. Employment change (%, Y-o-Y), quarter average

	Abu Dhabi (28% of total for UAE)	Dubai (50.6% of total for UAE)	Northern Emirates (21.4% of total for UAE)	UAE
2017 DEC	-0.9%	5.9%	3.4%	3.3%
2018 JAN	-0.7%	6.1%	3.7%	3.6%
2018 FEB	-1.1%	5.8%	3.5%	3.3%
2018 MAR	-1.9%	5.6%	2.8%	2.8%
2018 Q1	-1.2%	5.8%	3.4%	3.2%

Source: Ministry of Human Resources and Emiratization.

In parallel, the Emirate of Abu Dhabi had an average drop of employment of 0.5% Q-o-Q in the last four quarters, registering a drop of 16.1 thousand jobs in 2018 Q1 or a decline of 1.1% Q-o-Q. Similarly, the average annual growth for 2018 Q1 declined by 1.25 compared to a year earlier. As of the end of 2018, Q1 27.2 thousands jobs were lost in the Emirate.

The Northern Emirates exhibited employment growth in the job market, increasing by 0.7% on average Q-o-Q for the past year, adding 1.4 thousand additional workers to the job market in 2018 Q1 or a growth rate of 0.1% Q-o-Q. Y-o-Y the average growth rate of employment in the Northern Emirates for the first quarter of the year was of 3.4% as 29.9 thousands new jobs were created.

As a result, the quarterly average growth rate of employment in the UAE for the last three months was 0.3% Q-o-Q with 13.1 thousand extra jobs added in 2018 Q1. On a Y-o-Y basis, the average number of employed people grew by 3.2%. For the last 12 months ending March 2018 as 137.2 thousands extra jobs were added in the UAE.

The sectors with the highest shares of total employment remain Construction, Services and Real Estate. The three sectors account for 68% of total employment. The growth of employment in these sectors was 4.3%, 0.2% and 6.6% for Construction, Services and Real Estate respectively

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Y-o-Y as of the end of March 2018, adding 111.4 thousands new jobs over the last 12 months or 81% of the newly created jobs. On Q-o-Q basis, as of the end of 2018 Q1 employment in the three sectors grew by 0.4%, -0.2% and 1% for Construction, Services and Real Estate respectively as of the end of March 2018. While the Services sector shed some jobs, the Construction and Real Estate sectors added 10.5 thousands new jobs in the first quarter of 2018, 79.5% of the newly created jobs.

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2.4 Exchange Rate Fluctuations

During the first quarter of 2018, the Dirham has depreciated after a brief rebound in the last quarter of 2017. A depreciation trend was observed starting from 2017 where the Dirham lost on average around 0.3 % against its main import partners, after a previous average quarterly gain of 1.1% and 0.5% in 2015 and 2016, respectively. The same pattern was recorded against the UAE's main non-oil export partners' currencies.

On the import side, the dirham depreciated against its top non-dollarized import partners on a quarterly basis in the first quarter of 2018. The weighted Dirham's depreciation was 1.38% compared to the last quarter of 2017 (Table 2.3.a.). Exacerbated by its important share in the imports to the UAE (11.86%), the losses of the Dirham against the Chinese Renminbi were remarkable starting from January 2017. The evidence is solidified by a depreciation of the Dirham against the Chinese currency (3.76%) in the first quarter of 2018 on a quarterly basis. The Dirham has also depreciated against the Indian Rupee by 0.51% where India is providing more than 9% of the total imports. In addition, the Dirham weakened significantly against the euro by 4.17%, which affected imports mainly from Germany, Italy and France summing up to 10.23% of total imports. Moreover, the Dirham lost 4.07%, 4.6%, 3.05%, 3.95% against the Japanese Yen, British Pound, South Korean Won and the Swiss Franc, respectively. In contrast, the Dirham appreciated against the Turkish Lira by 0.48%.

Table 2.3.a. Dirham appreciation against currencies of top non-dollarized import partners (%, Y-o-Y)

Imports	Share of total imports	Q1-Q2 (2017)	Q2-Q3 (2017)	Q3-Q4 (2017)	Q4 2017 - Q1 (2018)	Q1 2017 - Q1 2018
China	11.86	-0.42	-2.76	-0.87	-3.76	-7.62
India	9.62	-3.69	-0.28	0.66	-0.51	-3.82
Germany	4.95	-3.12	-6.44	-0.22	-4.17	-13.33
Japan	4.75	-2.22	-0.07	1.70	-4.07	-4.67
Turkey	4.47	-3.06	-1.88	8.19	0.48	3.39
Italy	2.84	-3.12	-6.44	-0.22	-4.17	-13.33
UK	2.75	-3.11	-2.30	-1.41	-4.60	-10.96
France	2.44	-3.12	-6.44	-0.22	-4.17	-13.33
South Korea	2.44	-1.86	0.17	-2.33	-3.05	-6.91
Switzerland	2.21	-1.89	-2.31	2.53	-3.95	-5.62
Weighted Average	**48.32**	**-1.14**	**-1.21**	**0.34**	**-1.38**	**3.30**

Source: Data on Imports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2017. Data for the exchange rates are the quarterly average observations, recorded and displayed by Bloomberg.

On the non-energy export side, the Dirham depreciated by 0.43% in the first quarter of 2018 against its top non-dollarized non-oil export partners (Table 2.3.b). These developments were mainly driven by the Dirham's weakening against all major non-oil export partners, except for the Turkish Lira, Iraqi Dinar and the Pakistani Rupee, dampening somewhat the weighted depeeciation. In fact, Turkey, Iraq and Pakistan add up to more than 16% of the total destinations of UAE's non-energy exports. The Dirham gained against these three currencies 0.48%, 0.32% and 4.49%, respectively. Meanwhile, the Dirham depreciated by 0.5% against the Indian Rupee in the first quarter of 2018 where 12% of the UAE's non-oil exports go to India.

Table 2.3.b. Dirham appreciation against currencies of top non-dollarized partners for non-oil Exports (%, Y-o-Y)

Exports	Share of total exports	Q1-Q2 (2017)	Q2-Q3 (2017)	Q3-Q4 (2017)	Q4 2017 - Q1 (2018)	Q1 2017 - Q1 2018
India	**11.99**	3.69	-0.28	0.66	-0.51	-3.82
Turkey	**10.62**	3.06	-1.88	8.19	0.48	3.39
Iraq	**4.02**	0.96	-1.19	0.50	0.32	-1.33
Kuwait	**3.36**	0.40	-0.67	0.04	-0.65	-1.67
Singapore	**3.36**	-1.67	-2.27	-0.51	-2.57	-6.85
China	**3.27**	-0.42	-2.76	-0.87	-3.76	-7.62
South Korea	**3.20**	-1.86	0.17	-2.33	-3.05	-6.91
Switzerland	**2.77**	-1.89	-2.31	2.53	-3.95	-5.62
Pakistan	**1.62**	-0.04	0.44	1.09	4.49	6.04
Netherlands	**1.55**	-3.12	-6.44	-0.22	-4.17	-13.33
Weighted Average	**45.77**	**-1.05**	**-0.62**	**0.93**	**-0.43**	**1.17**

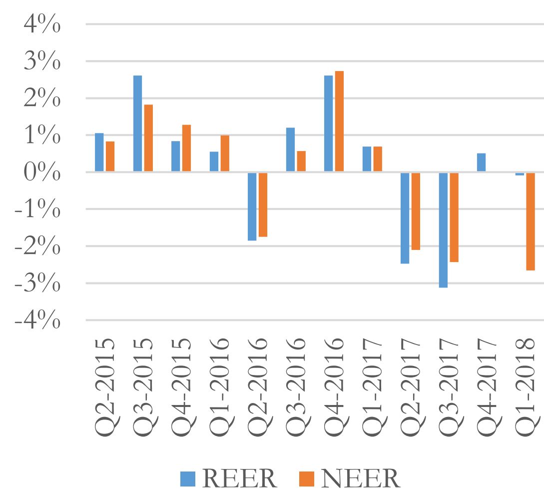
Source: Data for Exports shares (weights) are provided by the Federal Competitiveness and Statistics Authority (FCSA) for 2017. Data for the exchange rates are the quarterly average observations, recorded and displayed by Bloomberg.

On an annual basis, the Dirham's depreciation was even sharper. The Dirham has depreciated by 3.3% in the first quarter of 2018 against its main import partners compared to the same period a year earlier, driven by a loss of 8%, 13% and 11% against the Chinese Yuan, the Euro and British Pound, respectively, compared to the same quarter a year earlier. Similarly, the Dirham depreciated by 1.17% against its non-oil Export partners in the first quarter of 2018 on an annual basis. It lost 4%, 1% and 7% against the Indian Rupee, Iraqi Dinar and Singaporean Dollar, respectively, on an annual basis.

Accounting for all trading partners to the UAE, the Nominal Effective Exchange Rate (NEER) displays the same pattern of change as the weighted change of the Dirham against major import and non-oil export partners. The quarterly average NEER has declined by 2.7% in the first quarter of 2018, compared to the last quarter of 2017 (Figure 2.4.a). However, higher inflation in the UAE has moderated the pace of nominal depreciation as the Real Effective Exchange Rate (REER) declined at a slower pace by 0.1% in the first quarter of 2018 compared to the UAE's major trading partners.

Box 5 illustrates developments in the outward remittances and the effects of developments in the exchange rate on bilateral flows. Box 6 assesses the impact of exchange rate developments on the indicators of the tourism industry.

Figure 2.4.a Nominal and Real Effective Exchange rates developments (%, Q-o-Q)



Source: Bank for International Settlement (BIS)

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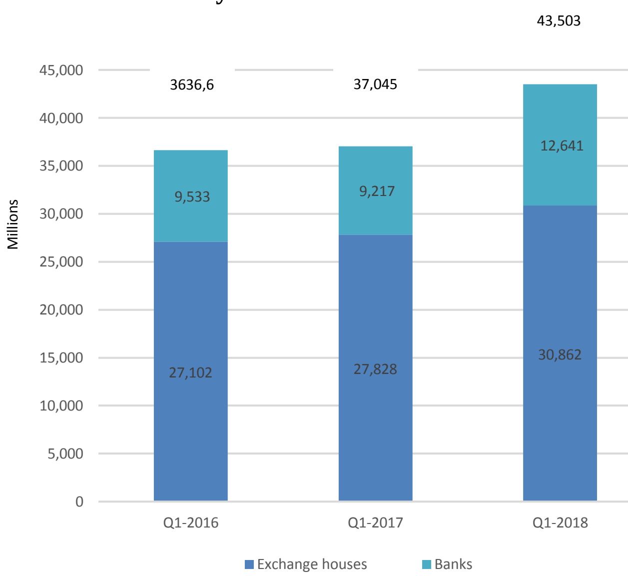
Box 5: Outward Personal Remittances

The workers' remittances outflows in the period January-March of 2018 recorded AED 43.5 billion, an increase of 17.4% or AED 6.5 billion compared to the same period of 2017 (AED 37.1 billion) (figure 1). The data capture the outflows reported from the exchange houses and the banks to the Banking Supervision Department of the Central Bank (BSD). The outflows of the workers' remittances that were settled only through the exchange houses recorded AED 30.9 billion in the first quarter of 2018 (10.9% or AED 3 billion increase compared to the same period of 2017).

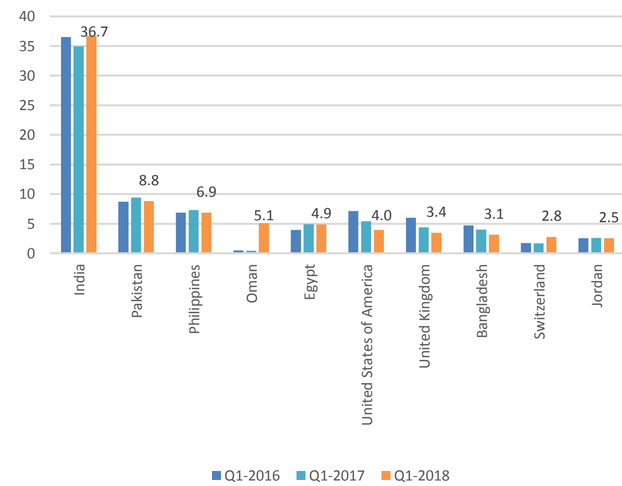
Figure 1. Evolution of workers' remittances settled through Banks and Exchange houses in the UAE January-March 2016-2018



Source: CBUAE

The most important country of destination for workers' remittances during the period January-March 2018 was India accounting for 36.7% of the outflows (figure 2). This high share is in accordance with the significant share of expats from India in the UAE. According to available statistics, dated October 2008 from the Federal Competitiveness and Statistics Authority, 82.7% of the employees in the UAE belong to Asian Non-Arab Countries, which include India. The next five most important countries in the share of outflows of remittances were Pakistan (8.8%), Philippines (6.9%), Egypt (4.9%) and the United States (4%). Significant increase was recorded for the outflows to Oman accounting for 5.1% of the total for the first quarter of 2018 (figure 2).

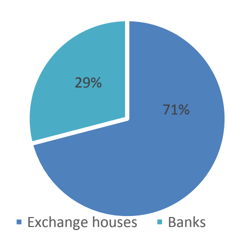
Figure 2. Share of the major countries for workers' remittances during January-March 2016-2018 (percentage of total, exchange houses and banks)



Source: CBUAE

In the first quarter of 2018, the data provided by BSD indicate that 71% of the workers' remittances outflows are through the exchange houses and 29% through the banks. Figure 3 illustrates the shares of exchange houses and banks in the total transactions of remittances.

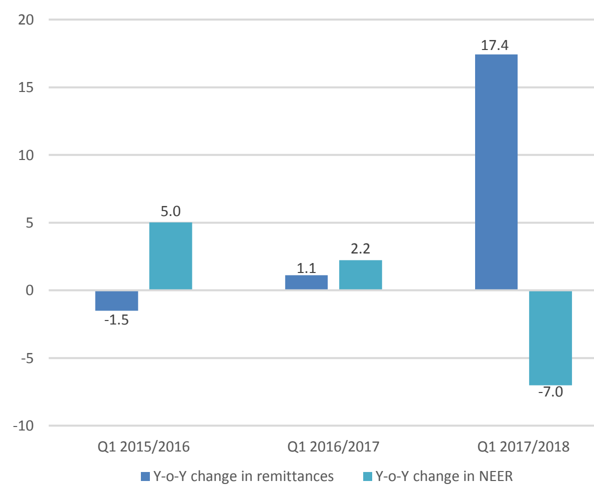
Figure 3. Share of settlement of total workers' remittances



Source: CBUAE

The total recorded workers' remittances outflows for the first quarter of 2018 (AED 43.5 billion) represent 26.5% of the total outward remittances in the UAE's balance of payments for the full year of 2017 (at AED 164.4 billion) and 117.3% of the outward remittances of the first quarter of 2017.

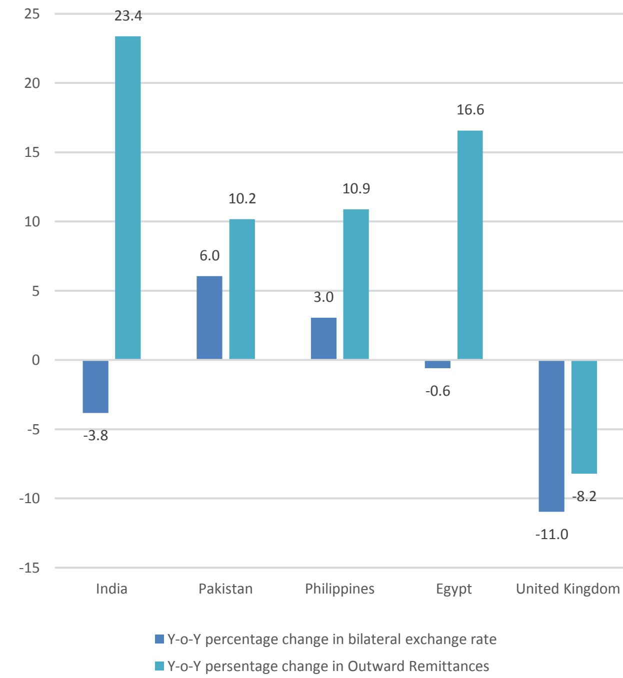
Figure 4. Percentage change of total outward remittances versus the percentage change of nominal effective exchange rate, January-March 2016-2018



Source: CBUAE; Bank of International Settlements

The annual growth rate of remittances in the period of January-March of 2018 is 17.4%. The average nominal effective exchange rate of the dirham in the same period (Figure 4) was 112.6 based on data provided by the Bank for International Settlements (BIS), lower than the average for the first quarter of 2017 at 121.1.

Figure 5. Percentage change of outward remittances of top countries versus the percentage change of the bilateral exchange rate with the dirham January-March 2016-2018



Source: CBUAE, Bloomberg

Figure 5 depicts the percentage change of outflows of remittances from the UAE to the top destination countries compared to the evolution of the bilateral exchange rate of the dirham relative to the currencies of the recipient countries. For the first quarter of 2018, the remittances outflows to Egypt and India increased despite the appreciation of their respective currencies relative to the dirham, whereas a reduction was recorded in the remittances outflows to the United Kingdom in line with the appreciation of the British pound. Consistent with the appreciation of the dirham relative to the respective currencies, remittances outflows to Philippines and Pakistan increased.

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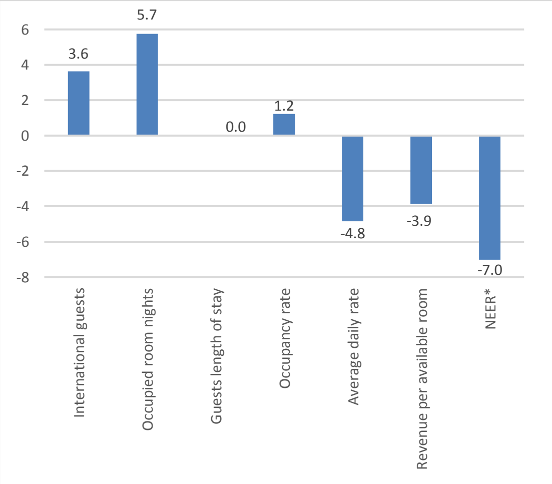
Box 6: Tourism Activity in the UAE

This box focuses on the effect of the change of bilateral exchange rates of the dirham on tourism indicators for the Emirates of Dubai and Abu Dhabi, the two major tourist destinations in the UAE that contribute the largest shares of the total aggregates during January-March 2018 compared to the same period of the previous year.

The number of international tourists combined in Dubai and Abu Dhabi emirates increased by 3.6% in the period of January-March 2018 compared to 2017 (figure 1), confirming an increasing trend in attracting international visitors. Simultaneously, the average daily rate and the revenue per available room decreased by 4.8% and 3.9%, respectively (weighted average prices of the two emirates) for the same period. These evolutions resulted in an increase in occupied room nights by 5.7%. In addition, the hotel occupancy rate on average increased by 1.2% in January-March 2018, compared to the same period of the previous year.

Figure 1: Major combined indicators of Dubai & Abu Dhabi inbound tourism January-March 2018-17 (% difference)

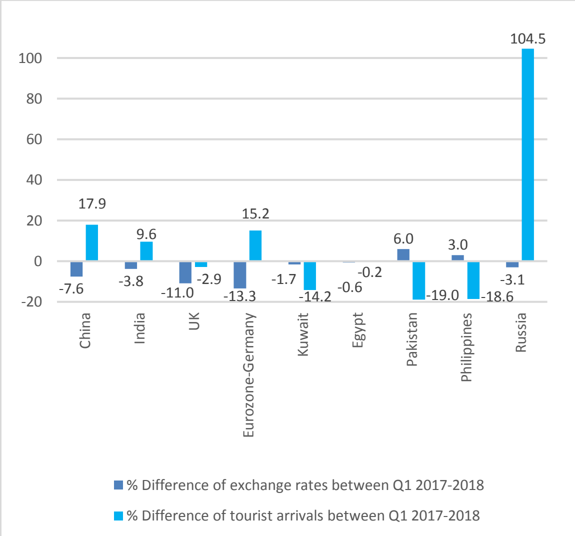


Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bank for International Settlements
*nominal effective exchange rate

Moreover, tourists from China recorded increase (17.9%) along with a small appreciation of their currency relative to the dirham. The incoming tourists from India increased by 9.6% following small depreciation of the dirham relative to the rupee. The incoming tourists from the UK, however, recorded a decrease despite the depreciation of the dirham relative to the pound. Tourists from Pakistan and Philippines recorded decrease due to the appreciation of the dirham relative to their respective currencies.

Figure 2 shows the effect of the bilateral exchange rate movements on tourism between January-March 2018 and the same period of 2017. Among the international visitors, incoming tourists from Russia more than doubled (104.5%) following the easing of visa rules along with moderate depreciation of the dirham relative to the ruble.

Figure 2. Guest arrivals and exchange rate on selected countries January-March 2018-17 (% difference)

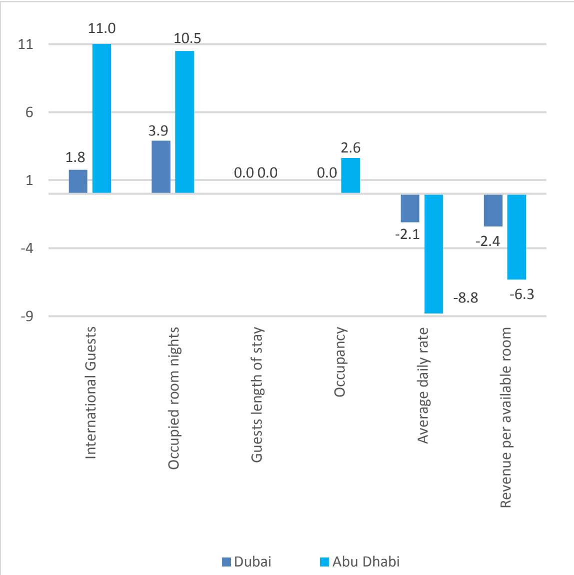


Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority, Bloomberg

In figure 3, the data for the Dubai emirate indicate that the number of international visitors increased by 1.8% in January-March 2018 compared to the same period of 2017. However, the average daily rate and the revenue per available room decreased by 2.1% and 2.4%, respectively. This evolution resulted in an increase in occupied room nights by 3.9%. Simultaneously, the average hotel occupancy rate remained stable at 87%, for January-March 2018, compared to 88% in the same period of 2017.

International visitors to the Abu Dhabi emirate increased by 11% in the first quarter of 2018 compared to the same period of 2017. However, the reduction in the average room rate by 8.8% contributed to the decrease in total revenues by 4.4% in January-March 2018 compared to the same period of 2017.

Figure 3: Major indicators of Dubai & Abu Dhabi inbound tourism January-March 2018-17[9] (% difference)

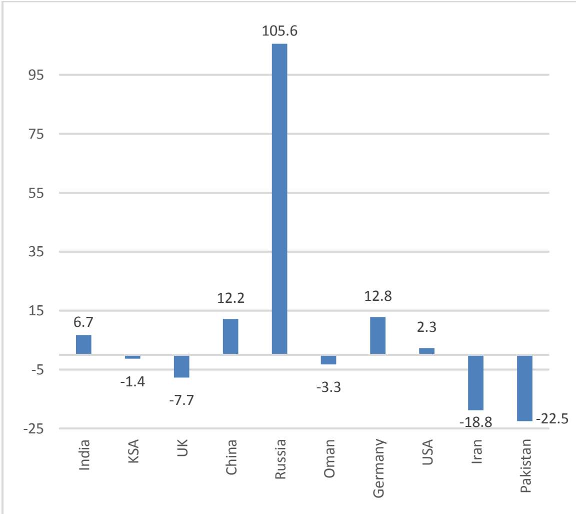


Source: Dubai Corporation of Tourism and Commerce Marketing, Abu Dhabi Tourism & Culture Authority

Most of the countries that are the major markets for inbound tourism to Dubai show increase in the arrivals of tourists with the highest increase recorded for Russia (105.6%) and China (12.2%). The vast majority of tourists to Dubai originate from GCC countries and the MENA region (38% combined, 17% and 11% respectively), while Western Europe and North America cover 23% and 6% of inbound tourism. Finally, 17% of inbound tourism comes from the region of South Asia. For the Abu Dhabi Emirate, most of the countries that are major markets of inbound tourism recorded increase in guest arrivals apart from Saudi Arabia.

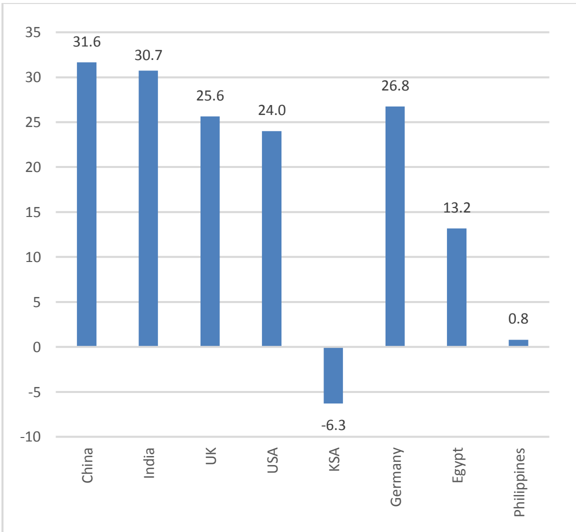
Figure 4. Major markets of inbound tourism January-March 2018-17 (% difference)

a. Dubai



Source: Dubai Corporation of Tourism and Commerce Marketing

b. Abu Dhabi



Source: Abu Dhabi Tourism & Culture Authority

[9] Data are 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. Estimates were used for data not available until the report publication.

2.5 Consolidated Fiscal Stance

2.5.1 Expenditures

The sharp decline of oil prices in mid-2014 triggered a sharp fiscal consolidation in 2015, reflected by a cut in government spending of 10.7%. The contractionary impact on non-oil GDP growth led the government to adopt a more growth-friendly fiscal policy in 2016. Consequently, total spending increased by 19.3% in 2016, supported by expansion of non-oil revenues that helped support increase in public capital spending. Notwithstanding these positive developments, the fiscal stance has changed in 2017, where Expenditure declined by 7.7%, driven by a fall in both, Expense (current spending by 6%) and Net acquisition of non-financial assets (capital spending by 19.5%).

The fiscal policy stance in 2017 was mostly a-cyclical considering the recent rally of oil prices. In fact, in the Expense category consumption of fixed capital, interest paid, grants declined compared to 2016 by 15.3%, 3.2% and 38.5%. In addition, other expenses, which cover all of Abu Dhabi government's transfers made on behalf of the Federal Government, decreased by 41.1% in 2017, after an increase of 34.8% in 2016.

On the other hand, spending on other current social items rebounded significantly, mitigating the adverse impact of fiscal consolidation while safeguarding social spending and strengthening the social safety net in the UAE. The compensation of employees increased by 17.8%, higher than the increase in 2016 (3.5%). Use of goods and services also rose by 51% compared to 2016, when the improvement was of 4.1%. Subsidies, which contain transfers to GREs, rebounded by 148.9%, notwithstanding recent reforms that aimed at reducing the amount of price subsidies. The continued increase of Subsidies in 2017 indicates a surge in the Government's transfers to GREs. Social benefits increased for the first time by 16.8% after a drop of 17.2% in 2016.

2.5.2 Revenues

Total revenues increased by 1.3% in 2017, driven mainly by a significant jump in Taxes.

In consistency with oil price improvement in 2017, tax revenues which cover royalties on oil companies rebounded by 53.4% after a consecutive tightening, by 42.8% and 32% in 2015 and 2016, respectively. It is the first annual increase since 2013.

Social contributions declined in 2017 by 2.3%, compared to a drop of 18.9% in 2015 and an increase by 10.1% in 2016.

Other revenues, which include principally the property income, sales of goods, services, fines, and penalties, dropped by 18.5% after consecutive years of expansion. These revenues do not include profit transfers from the national oil company to the sovereign wealth fund neither do they include the government's investment income.

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Table. 2.5. Annually Consolidated Government Finances

Fiscal Consolidation	2015			2016			2017		
	(AED, Billions)	(%, share of GDP)	(%, Y-o-Y)	(AED, Billions)	(%, share of GDP)	(%, Y-o-Y)	(AED, Billions)	(%, share of GDP)	(%, Y-o-Y)
Revenues (a)	**281.3**	**21.4**	**-26.1**	**399.8**	**30.5**	**42.1**	**404.8**	**28.8**	**1.3**
Taxes	160.0	12.2	**-42.8**	108.8	8.3	**-32.0**	166.9	11.9	**53.4**
Social contributions	4.3	0.3	**-18.9**	4.7	0.4	**10.1**	4.6	0.3	**-2.3**
Other revenues	116.9	8.9	**22.5**	286.3	21.8	**144.8**	233.3	16.6	**-18.5**
Expenditure (b)	**370.4**	**28.2**	**-10.7**	**442.1**	**33.7**	**19.3**	**408.1**	**29.0**	**-7.7**
Expense	**335.3**	**25.5**	**-10.5**	**386.2**	**29.5**	**15.2**	**363.1**	**25.8**	**-6.0**
Compensation of employees	63.0	4.8	**32.6**	65.2	5.0	**3.5**	76.9	5.5	**17.8**
Use of goods and services	59.8	4.5	**20.8**	62.3	4.7	**4.1**	94.0	6.7	**51.0**
Consumption of fixed capital	4.6	0.3	**21.9**	5.9	0.5	**29.4**	5.0	0.4	**-15.3**
Interest	2.8	0.2	**-31.5**	2.0	0.2	**-28.7**	1.9	0.1	**-3.2**
Subsidies	12.3	0.9	**1.7**	8.8	0.7	**-28.4**	21.9	1.6	**148.9**
Grants	8.8	0.7	**-60.0**	15.9	1.2	**81.6**	9.8	0.7	**-38.5**
Social benefits	42.6	3.2	**-30.7**	35.3	2.7	**-17.2**	41.2	2.9	**16.8**
Other expenses	141.5	10.8	**-18.9**	190.8	14.6	**34.8**	112.3	8.0	**-41.1**
Net acquisition of non-financial assets	**35.1**	**2.7**	**-12.1**	**55.9**	**4.3**	**59.4**	**45.0**	**3.2**	**-19.5**
Total Nominal GDP (AED, Billions)	**1,315**		**-11.2**	**1,311**		**-0.3**	**1,405**		**7.2**

Source: UAE Ministry of Finance, revenues do not include ADNOC transfers and government investment income.

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

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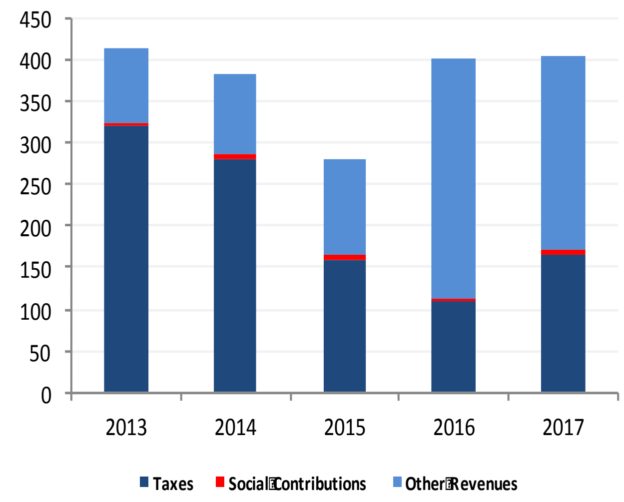
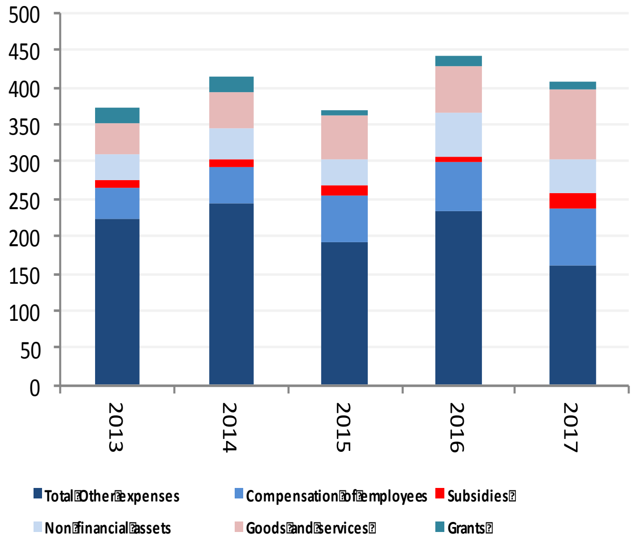
Government Finances

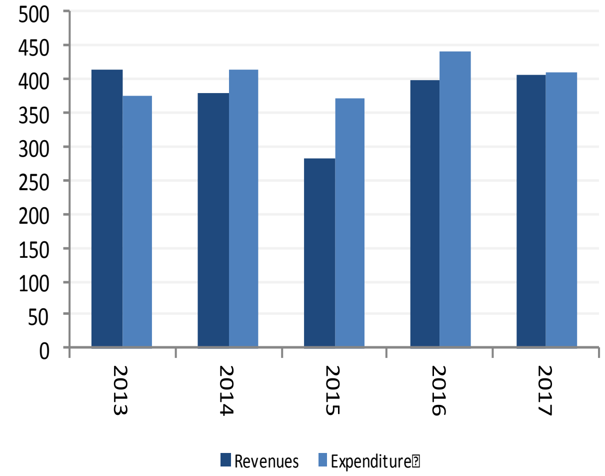
2.5.a. General government revenues
(Billions of Dirhams)



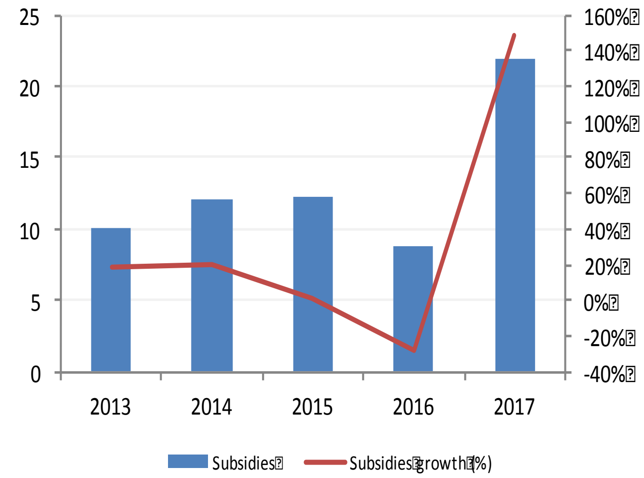
2.5.b. General government expenditures
(Billions of Dirhams)



2.5.c. Fiscal stance
(Billions of Dirhams)



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



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

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Chapter 3. Banking and Financial Developments

In the first quarter of 2018, deposits have continued to grow, mainly due to the increase in Government and GREs' deposits, while bank credit growth remained moderate. Financial Soundness Indicators (FSIs) solidify that the UAE banking system is sound and stable.

3.1 Banking Structure

The 22 national banks have decreased the number of branches to 761 at the end of 2018 Q1 compared to 771 at the end of 2017. The number of foreign banks has remained unchanged at 27 from the previous quarter and the number of foreign banks branches was reduced to 81 at the end of 2018 Q1 compared to 82 at the end of 2017. At the same time, the number of bank employees has increased for the national banks and remained almost unchanged for the foreign banks. It moved from 29,056 and 5,619 for national and foreign banks, respectively at the end of 2017 to a headcount of 29,414 and 5,598, respectively at the end of 2018 Q1.

3.1.1. Banks' Deposits

Total Customer Deposits at banks increased in the first quarter of 2018 by AED 35.1 billion due to the increase in Resident Deposits by AED 37.3 billion, while Non-resident Deposits decreased by AED 2.2 billion.

The growth in Resident Deposits in 2018 Q1 is essentially due to the steady rise in all components, except NBFIs: Government sector deposits increased by 10% or AED 21.2bn, GREs' by 5.1% or AED 9.8bn, Private sector deposits by 0.7% or AED 6.7bn, while NBFIs' declined by 1.3% or AED 0.4bn. The Non-Resident deposits decreased by 1.1% or AED 2.2bn during the first quarter of 2018, with their share in total deposits declining compared to the previous quarter at 11.4%. In the banking system, deposits by the type of banks, i.e., Conventional or Islamic, represent respectively 76.2% and 23.8% of the total deposits. Figures 3.1.1.a and 31.1.b, and Table 3.1.1.b show that in the first quarter of 2018 the growth in Islamic banks is at 3.3% and Conventional banks is at 1.8%, and on a Y-o-Y basis the increase of Islamic deposits has reached 8%, while for the Conventional banks it was at 2.5%. Looking at the subcategories, the growth in Islamic banks in the first quarter is stronger in the Private sector, NBFIs and Non-Resident deposits, while the Conventional banks were dominating for the deposits of Government and GREs sectors.

Table 3.1.1.a. Deposits at UAE Banks

	2017				2018
	Mar	Jun	Sep	Dec	Mar*
Bank Deposits	**1602.0**	**1589.1**	**1595.8**	**1627.3**	**1662.4**
(Q-o-Q change %)	2.5	-0.8	0.4	2.0	2.2
(Y-o-Y change %)	6.6	6.4	5.8	4.1	3.8
Resident Deposits	**1413.0**	**1433.5**	**1407.5**	**1435.6**	**1472.9**
(Q-o-Q change %)	3.6	-0.3	-0.1	2.0	2.6
(Y-o-Y change %)	6.6	7.1	6.5	5.3	4.2
Government Sector	**194.0**	**196.8**	**201.2**	**212.0**	**233.2**
(Q-o-Q change %)	3.9	1.4	2.2	5.4	10.0
(Y-o-Y change %)	24.8	5.9	18.7	13.5	20.2
GREs	**192.0**	**189.6**	**183.0**	**191.5**	**201.3**
(Q-o-Q change %)	14.0	-1.3	-3.5	4.9	5.1
(Y-o-Y change %)	-0.7	17.4	6.9	14.0	4.8
Private Sector	**998.3**	**983.6**	**991.9**	**1001.0**	**1007.7**
(Q-o-Q change %)	1.8	-1.5	0.8	0.9	0.7
(Y-o-Y change %)	5.3	4.1	3.7	2.1	0.9
NBFI	**28.7**	**39.3**	**31.4**	**31.1**	**30.7**
(Q-o-Q change %)	1.8	36.9	-20.1	-1.0	-1.3
(Y-o-Y change %)	1.8	69.4	27.6	10.3	7.0
Non-Resident Deposits	**189.0**	**179.8**	**188.3**	**191.7**	**189.5**
(Q-o-Q change %)	-5.0	-4.9	4.7	1.8	-1.1
(Y-o-Y change %)	6.5	1.5	0.7	-3.7	0.3

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

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Table 3.1.1.b. Deposits at Conventional/Islamic Banks

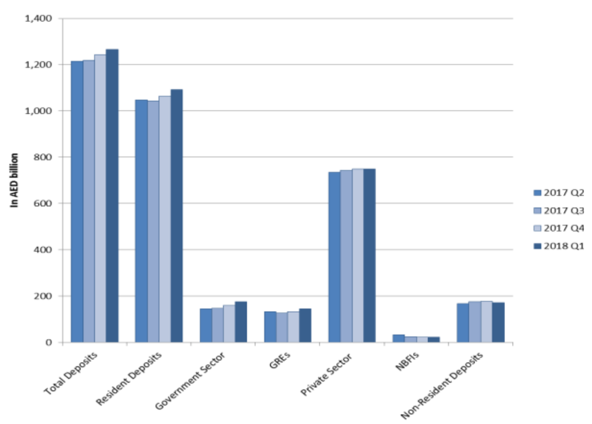
	Conventional		Islamic	
	2017	2018	2017	2018
	Dec	Mar*	Dec	Mar*
Bank Deposits	**1243.5**	**1266.0**	**383.8**	**396.4**
(Q-o-Q change %)	2.0	1.8	2.0	3.3
(Y-o-Y change %)	2.4	2.5	10.1	8.0
Share of Total, %	76.4	76.2	23.6	23.8
Resident Deposits	**1064.6**	**1093.7**	**371.0**	**379.2**
(Q-o-Q change %)	2.0	2.7	1.9	2.2
(Y-o-Y change %)	3.9	3.5	9.4	6.5
Share of Total, %	74.2	74.3	25.8	25.7
Government Sector	**159.0**	**176.8**	**53.0**	**56.4**
(Q-o-Q change %)	8.0	11.2	-1.9	6.4
(Y-o-Y change %)	11.1	22.4	21.3	13.7
Share of Total, %	75.0	75.8	25.0	24.2
GREs	**132.8**	**144.8**	**58.7**	**56.5**
(Q-o-Q change %)	5.0	9.0	4.6	-3.7
(Y-o-Y change %)	11.0	2.3	21.3	11.9
Share of Total, %	69.4	71.9	30.6	28.1
Private Sector	**749.5**	**749.9**	**251.5**	**257.8**
(Q-o-Q change %)	0.7	0.1	1.5	2.5
(Y-o-Y change %)	1.6	0.3	3.5	3.0
Share of Total, %	74.9	74.4	25.1	25.6
NBFI	**23.3**	**22.2**	**7.8**	**8.5**
(Q-o-Q change %)	-7.5	-4.7	25.8	9.0
(Y-o-Y change %)	-2.9	-3.1	85.7	46.6
Share of Total, %	74.9	72.3	25.1	27.7
Non-Resident Deposits	**178.9**	**172.3**	**12.8**	**17.2**
(Q-o-Q change %)	1.5	-3.7	4.9	34.4
(Y-o-Y change %)	-5.7	-3.3	36.2	57.8
Share of Total, %	93.3	90.9	6.7	9.1

Source: CBUAE

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

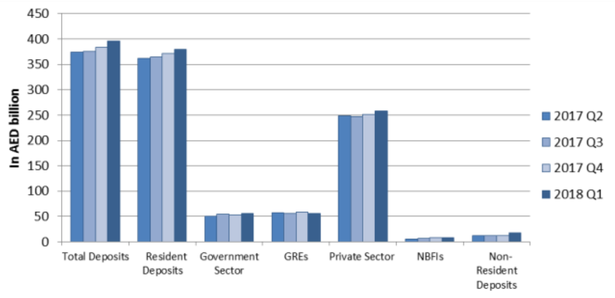
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

The breakdown of National and Foreign banks in Figures 3.1.1.c and 3.1.1.d show that National banks experienced an increase in deposits, while Foreign banks experienced a drop in 2018 Q1 Q-o-Q. National banks' deposits grew at a rate of 2.7% and 4.6% Q-o-Q and Y-o-Y respectively in contrast to Foreign banks for which deposits decreased by 1.3% on a Q-o-Q basis and by 2.1% Y-o-Y. At the end of 2018 Q1, 87.7% of the total deposits are in National banks and 12.3% are in Foreign banks.

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

	National		Foreign	
	2017	2018	2017	2018
	Dec	Mar*	Dec	Mar*
Bank Deposits	**1,419.9**	**1,457.7**	**207.4**	**204.7**
(Q-o-Q change %)	2.1	2.7	1.3	-1.3
(Y-o-Y change %)	5.0	4.6	-1.8	-2.1
Share of Total, %	87.3	87.7	12.7	12.3
Resident Deposits	**1,261.4**	**1,302.1**	**174.2**	**170.8**
(Q-o-Q change %)	2.1	3.2	1.6	-2.0
(Y-o-Y change %)	5.9	5.3	1.2	-3.0
Share of Total, %	87.9	88.4	12.1	11.6
Government Sector	**210.1**	**230.4**	**1.9**	**2.8**
(Q-o-Q change %)	5.4	9.7	5.6	47.4
(Y-o-Y change %)	13.3	19.8	46.2	64.7
Share of Total, %	99.1	98.8	0.9	1.2
GREs	**182.4**	**193.4**	**9.1**	**7.9**
(Q-o-Q change %)	3.6	6.0	39.4	-13.2
(Y-o-Y change %)	13.5	5.6	24.3	-11.2
Share of Total, %	95.2	96.1	4.8	3.9
Private Sector	**842.9**	**853.2**	**158.1**	**154.4**
(Q-o-Q change %)	1.0	1.2	0.1	-2.3
(Y-o-Y change %)	2.4	1.8	0.3	-3.2
Share of Total, %	84.2	84.7	15.8	15.3
NBFI	**26.0**	**25.1**	**5.1**	**5.6**
(Q-o-Q change %)	-0.8	-3.5	-1.9	9.8
(Y-o-Y change %)	16.6	10.1	-13.6	-5.1
Share of Total, %	83.6	81.8	16.4	18.2
Non-Resident Deposits	**158.5**	**155.6**	**33.2**	**33.9**
(Q-o-Q change %)	2.1	-1.8	0.0	2.1
(Y-o-Y change %)	-1.0	-0.3	-14.9	2.7
Share of Total, %	82.7	82.1	17.3	17.9

Source: CBUAE

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

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

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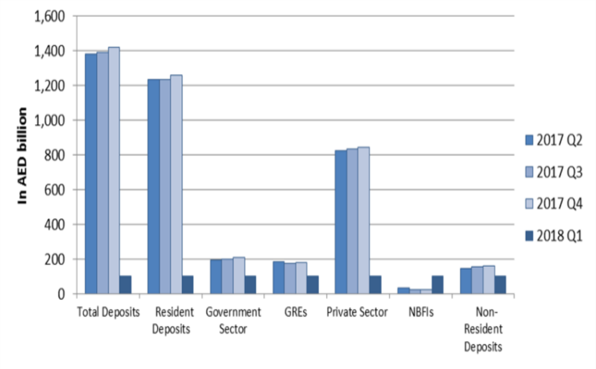
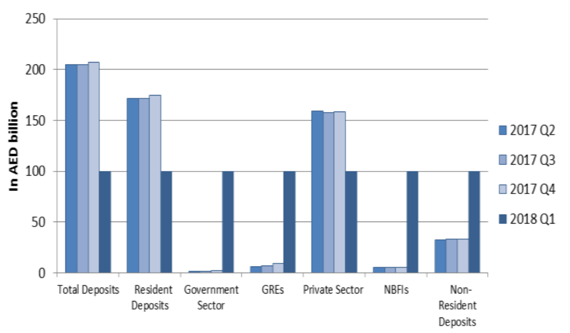
The sectors growing the most in 2018 Q1 for National banks were the Government sector by 9.7% Q-o-Q (19.8% Y-o-Y) and the GREs sector by 6% Q-o-Q (5.6% Y-o-Y), reflecting the ongoing fiscal consolidation and improved oil price.

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



Source: CBUAE

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



Source: CBUAE

3.1.2. Banks' Credit

Domestic Credit increased in 2018 Q1 by AED 20.1bn (1.4%), which corresponded to a growth of a 1.5% Y-o-Y. For the underlying domestic credit, there was an increase in lending to the Government by 3.2% Q-o-Q or AED 5.7bn and deleveraging by GREs by AED 2.1bn (1.2%). Nonetheless, credit to NBFIs grew by AED 2.2bn (11.8%) and Foreign credit grew by AED 7.7bn (6.0%) quarterly. Meanwhile, the Private Sector was borrowing at a pace of 1.3% and 3.9% Q-o-Q and Y-o-Y respectively (Private Corporate credit grew at 2% and 4.5% Q-o-Q and Y-o-Y, respectively, while Credit to Individuals decreased by 0.3% Q-o-Q and increased by 2.6% Y-o-Y).

Islamic banks have a share of 20.6% in the assets and 22.3% in the gross financing of the total banking system. The breakdown of the assets and lending by Conventional and Islamic banks in Figures 3.1.2.a. and 3.1.2.b. indicates that Islamic banks' financing was increasing by 1.1% during the first quarter of 2018 due to Domestic Credit rising in all categories, except for credit to NBFIs, GREs and the Government, where there was a decline or no increase Q-o-Q. In parallel, credit to the Non-residents category increased by AED 0.7bn or 2.9% in 2018 Q1. For the same period, conventional banks had their lending increased by 1.9% Q-o-Q, with several of their sectors experiencing deleveraging, such as GREs and Individuals, which moderated the overall growth.

On an annual basis, as of March 2018, conventional banks marked an increase of 1.5% and a reduction of 0.3% for banks' assets and gross credit, respectively, while for the Islamic banks they were both growing at 7.1% and 4.4%, respectively.

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Table 3.1.2.a. Assets and Credit at UAE Banks

	2017				2018
	Mar	Jun	Sep	Dec	Mar*
Total Assets	**2,627.0**	**2,632.0**	**2,643.0**	**2,693.8**	**2,718.3**
(Q-o-Q change %)	1.3	0.2	0.4	2.0	0.9
(Y-o-Y change %)	6.3	5.4	4.5	4.0	3.5
Gross Credit	**1,575.0**	**1,569.0**	**1,580.0**	**1,580.3**	**1,608.1**
(Q-o-Q change %)	1.4	-0.4	0.7	0.0	1.8
(Y-o-Y change %)	5.2	3.0	2.2	1.7	2.1
Domestic Credit	**1,451.0**	**1,435.0**	**1,447.0**	**1,452.7**	**1,472.8**
(Q-o-Q change %)	1.2	-1.1	0.9	0.4	1.4
(Y-o-Y change %)	4.8	2.0	1.5	1.4	1.5
Government	**177.0**	**178.0**	**182.0**	**175.4**	**181.1**
(Q-o-Q change %)	2.6	0.6	2.0	-3.4	3.2
(Y-o-Y change %)	4.8	5.5	4.3	1.7	2.3
Public Sector (GREs)	**195.0**	**179.0**	**175.0**	**172.3**	**170.2**
(Q-o-Q change %)	3.9	-8.1	-2.0	-0.7	-1.2
(Y-o-Y change %)	7.7	-4.6	-6.7	-7.0	-12.7
Private Sector	**1,059.0**	**1,058.0**	**1,070.0**	**1,086.4**	**1,100.7**
(Q-o-Q change %)	0.4	-0.1	1.1	1.4	1.3
(Y-o-Y change %)	2.8	0.6	0.4	2.9	3.9
Business & Industrial Sector Credit	**731.0**	**729.0**	**735.0**	**748.9**	**764.2**
(Q-o-Q change %)	0.4	-0.4	0.8	1.8	2.0
(Y-o-Y change %)	5.5	2.7	2.0	2.6	4.5
Individual	**328.0**	**330.0**	**335.0**	**337.5**	**336.5**
(Q-o-Q change %)	0.4	0.6	1.7	0.7	-0.3
(Y-o-Y change %)	3.5	2.5	3.1	3.5	2.6
Non-Banking Financial Institutions	**20.0**	**20.0**	**21.0**	**18.6**	**20.8**
(Q-o-Q change %)	5.8	-3.0	5.1	-9.3	11.8
(Y-o-Y change %)	-20.6	6.0	12.6	-2.1	4.0
Foreign Credit	**125.0**	**134.0**	**133.0**	**127.6**	**135.3**
(Q-o-Q change %)	3.7	7.7	-1.0	-4.2	6.0
(Y-o-Y change %)	10.3	14.8	10.9	5.8	8.2

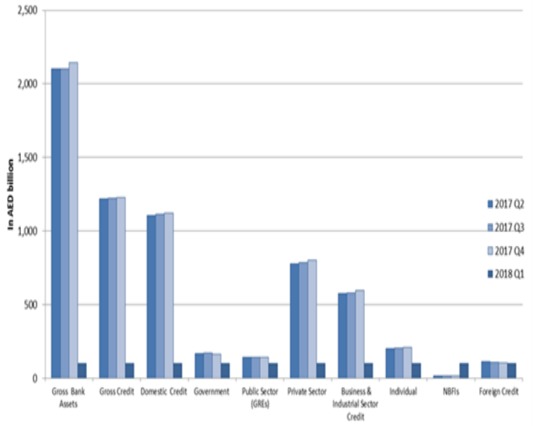
Source: CBUAE
Note: All data indicate the end-of-quarter values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

Table 3.1.b Assets and Credit across Conventional and Islamic Banks

	Conventional		Islamic	
	2017	2018	2017	2018
	Dec	Mar*	Dec	Mar*
Total Assets	**2,143.6**	**2,159.6**	**550.2**	**558.7**
(Q-o-Q change %)	2.0	0.7	1.9	1.5
(Y-o-Y change %)	2.8	1.5	8.8	7.1
Gross Credit	**1,226.3**	**1,250.1**	**354.0**	**358.0**
(Q-o-Q change %)	0.4	1.9	-1.1	1.1
(Y-o-Y change %)	0.7	-0.3	5.6	4.4
Domestic Credit	**1,123.1**	**1,139.9**	**329.6**	**332.9**
(Q-o-Q change %)	1.0	1.5	-1.4	1.0
(Y-o-Y change %)	0.8	-0.7	3.6	2.5
Government	**163.5**	**169.4**	**11.9**	**11.7**
(Q-o-Q change %)	-4.1	3.6	8.1	-1.7
(Y-o-Y change %)	0.2	1.2	29.0	24.5
Public Sector (GREs)	**139.3**	**137.3**	**33.0**	**32.9**
(Q-o-Q change %)	0.3	-1.4	-4.6	-0.3
(Y-o-Y change %)	-8.2	-14.4	-1.8	-4.4
Private Sector	**805.6**	**816.3**	**280.8**	**284.4**
(Q-o-Q change %)	2.5	1.3	-1.4	1.3
(Y-o-Y change %)	2.8	1.6	3.2	2.7
Business & Industrial Sector Credit	**596.8**	**608.4**	**152.1**	**155.8**
(Q-o-Q change %)	3.0	1.9	-2.6	2.4
(Y-o-Y change %)	2.6	4.9	2.7	3.0
Individual	**208.8**	**207.9**	**128.7**	**128.6**
(Q-o-Q change %)	1.2	-0.4	0.0	-0.1
(Y-o-Y change %)	3.4	-7.1	3.7	2.4
Non-Banking Financial Institutions	**14.7**	**16.9**	**3.9**	**3.9**
(Q-o-Q change %)	-11.4	15.0	0.0	0.0
(Y-o-Y change %)	-7.5	5.6	25.8	-4.9
Foreign Credit	**103.2**	**110.2**	**24.4**	**25.1**
(Q-o-Q change %)	-5.9	6.8	3.4	2.9
(Y-o-Y change %)	-0.4	3.4	43.5	37.9

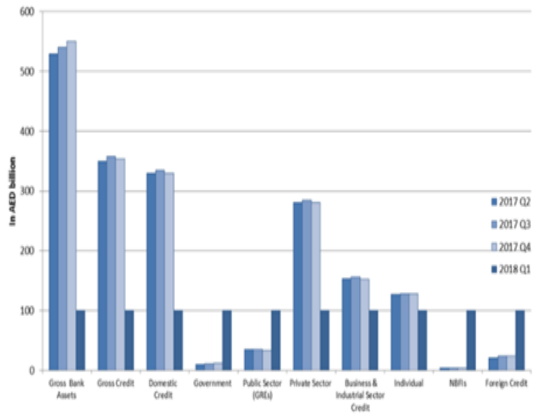
Source: CBUAE
Note: All data indicate the end-of-period values. Values are expressed in billions of Dirhams.
***:** Preliminary figures subject to revision.

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



Source: CBUAE

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



Source: CBUAE

Foreign banks have a share of 13.4% of the system in terms of assets and 12.2% in terms of gross credit in 2018 Q1, lower than the previous quarter. The split of the assets and credit by national and foreign banks in Figures 3.1.2.c. and 3.1.2.d. indicates that National banks' assets were growing by 0.9%, while gross credit increased by 1.5% compared to the previous quarter. All sectors were growing with exception of GREs and Individual sectors, which partially offset the gains in the other categories in 2018 Q1. For the same period, Foreign banks had their assets increasing by 0.7% and gross credit growing by 3.6% (see Table 3.1.2.c).

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

	National		Foreign	
	2017	2018	2017	2018
	Dec	Mar*	Dec	Mar*
Total Assets	**2,333.4**	**2,355.4**	**360.4**	**362.9**
(Q-o-Q change %)	2.5	0.9	-1.6	0.7
(Y-o-Y change %)	5.3	3.9	-3.8	-4.9
Gross Credit	**1,391.3**	**1,412.3**	**189.0**	**195.8**
(Q-o-Q change %)	0.0	1.5	0.7	3.6
(Y-o-Y change %)	2.5	0.8	-3.6	-0.4
Domestic Credit	**1,289.6**	**1,306.6**	**163.1**	**166.2**
(Q-o-Q change %)	0.5	1.3	-0.1	1.9
(Y-o-Y change %)	2.4	0.6	-5.7	-4.3
Government	**170.1**	**174.8**	**5.3**	**6.3**
(Q-o-Q change %)	-3.6	2.8	3.9	18.9
(Y-o-Y change %)	2.2	1.6	-11.7	31.3
Public Sector (GREs)	**152.5**	**149.7**	**19.8**	**20.5**
(Q-o-Q change %)	0.3	-1.8	-7.9	3.5
(Y-o-Y change %)	-3.2	-10.2	-29.1	-27.0
Private Sector	**949.0**	**962.1**	**137.4**	**138.6**
(Q-o-Q change %)	1.3	1.4	2.2	0.9
(Y-o-Y change %)	3.3	2.1	0.2	0.1
Business & Industrial Sector Credit	**644.0**	**657.6**	**104.9**	**106.6**
(Q-o-Q change %)	1.7	2.1	2.3	1.6
(Y-o-Y change %)	3.0	5.2	0.7	0.4
Individual	**305.0**	**304.5**	**32.5**	**32.0**
(Q-o-Q change %)	0.6	-0.2	1.9	-1.5
(Y-o-Y change %)	4.1	-3.9	-1.2	-0.9
Non-Banking Financial Institutions	**18.0**	**20.0**	**0.6**	**0.8**
(Q-o-Q change %)	-1.6	11.1	-72.7	33.3
(Y-o-Y change %)	5.3	12.4	-68.4	-65.2
Foreign Credit	**101.7**	**105.7**	**25.9**	**29.6**
(Q-o-Q change %)	-6.5	3.9	6.2	14.3
(Y-o-Y change %)	4.3	3.7	12.2	29.3

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

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

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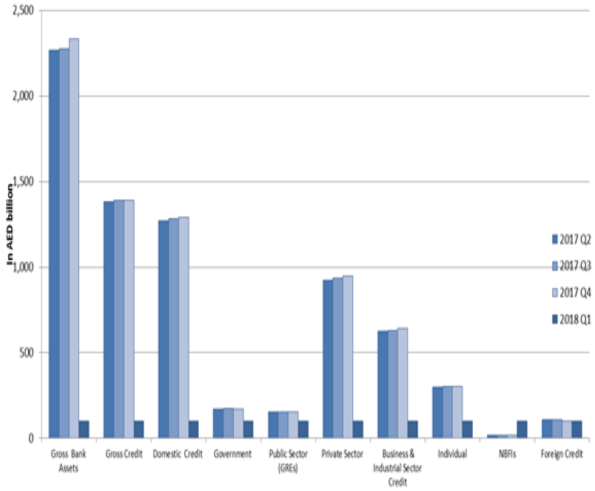
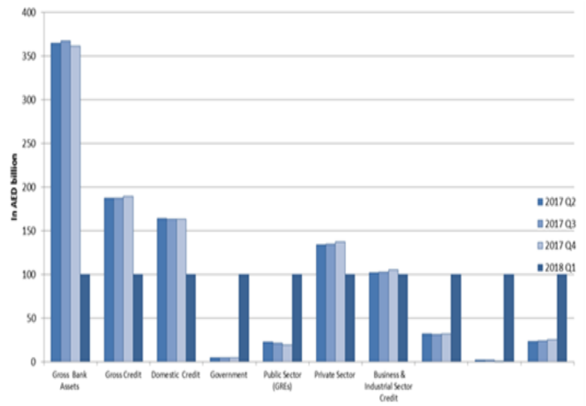


Source: CBUAE

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



Source: CBUAE

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

(End of Period , In Billions of AED)

	2017				2018
Economic Activity	**Mar**	**Jun**	**Sep**	**Dec**	**Mar***
Agriculture	**1.2**	**1.1**	**1.2**	**2.1**	**2.0**
(Q-o-Q change %)	-15.1	-2.5	7.7	77.3	-4.1
(Y-o-Y change %)	-7.7	-5.3	3.9	54.8	70.0
Mining and Quarrying	**19.0**	**13.9**	**12.2**	**12.1**	**12.1**
(Q-o-Q change %)	40.4	-26.8	-12.5	-0.8	-0.3
(Y-o-Y change %)	62.3	11.9	-13.1	-10.7	-36.5
Manufacturing	**68.3**	**70.3**	**72.0**	**75.2**	**75.5**
(Q-o-Q change %)	-1.7	3.0	2.4	4.5	0.4
(Y-o-Y change %)	-5.5	-1.5	0.6	8.6	10.6
Electricity, Gas and Water	**18.1**	**17.4**	**17.0**	**16.7**	**18.9**
(Q-o-Q change %)	-1.8	-3.9	-2.6	-1.6	12.9
(Y-o-Y change %)	-2.5	-6.4	-5.2	-9.3	4.4
Construction and Real Estate	**267.0**	**281.2**	**295.2**	**298.1**	**300.5**
(Q-o-Q change %)	0.9	5.3	5.0	1.0	0.8
(Y-o-Y change %)	10.4	16.0	17.7	12.6	12.6
Trade	**152.3**	**149.5**	**147.7**	**152.8**	**157.1**
(Q-o-Q change %)	-2.1	-1.8	-1.2	3.4	2.9
(Y-o-Y change %)	-5.2	-7.0	-6.7	-1.7	3.2
Transport, Storage and Communication	**60.4**	**63.1**	**63.7**	**54.9**	**52.7**
(Q-o-Q change %)	-4.7	4.4	1.0	-13.8	-4.0
(Y-o-Y change %)	-3.2	-1.3	1.6	-13.5	-12.7
Financial Institutions (Excluding Banks)	**151.9**	**138.9**	**130.3**	**127.5**	**133.6**
(Q-o-Q change %)	5.2	-8.5	-6.2	-2.1	4.8
(Y-o-Y change %)	8.9	-4.1	-12.2	-12.4	-12.0
All Others	**130.0**	**126.2**	**132.9**	**138.3**	**139.2**
(Q-o-Q change %)	2.7	-2.9	5.3	4.0	0.7
(Y-o-Y change %)	15.0	4.6	9.0	10.4	7.1

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

Banks' lending by economic activity shows an increase in the first quarter of 2018 Q-o-Q by 0.4%, 12.9%, 0.8%, 2.9%, 4.8% and 0.7% in the Manufacturing, Electricity, Gas and Water, Construction and Real Estate, Trade, Financial Institutions (excluding banks) and All Other sectors respectively, while their growth Y-o-Y was 10.6%, 4.4%, 12.6%, 3.2%, -12% and 7.1% respectively. For the other sectors, credit declined on Q-o-Q during the first quarter of 2018. The growth rates for other sectors are: Agriculture -4.1% Q-o-Q and 70% Y-o-Y, Mining and Quarrying -0.3% Q-o-Q and -36.5% Y-o-Y and in Transport, Storage and Communication, -4% Q-o-Q and -12.7% Y-o-Y.

3.1.3. Financial Soundness Indicators

Financial soundness indicators solidify that the banking sector has remained sound and stable.

The percentage of the number of returned cheques has declined from 4.5% in December 2017 to 4.3% in March 2018. The total amount of returned cheques, as a share of the total presented amount however increased to 4.5% in 2018 Q1 compared to 4.2% in 2017 Q4.

Aggregate Capital and Reserves of banks operating in the UAE decreased quarterly by 6.2%, reaching to AED 316.3 billion at the end of the first quarter of 2018 compared to a 3.1% quarterly reduction at the end of the same period of 2017. However, the total Capital Adequacy Ratios remain well above the 12.375% Capital Adequacy ratio, which includes the 1.875% Capital Conservation Buffer requirement, and 8.5% Tier1 ratio as prescribed by the Central Bank regulations in compliance to Basel III guidelines[10]. Banks have been following Basel III principles for calculating the Capital Adequacy Ratios since December 2017 in line with the Guidelines issued by the Central Bank. The capital adequacy ratio (CAR), Tier 1 capital and Common Equity Tier 1 capital (CET 1) stood at 17.5%, 16% and 14% respectively in 2018 Q1 from 18.1%, 16.6% and 14.6% respectively in 2017 Q4, which is well above the regulatory requirements set

by the Central Bank.

The Loans to Deposits (L/D) ratio for the whole banking system declined from 97.1% in December 2017 to 96.7% at the end of 2018 Q1, a level which is also lower than the 98.3% in 2017 Q1, mainly due to the lower growth in lending compared to deposits.

Looking at the breakdown between Conventional and Islamic banks, the L/D ratio is respectively 98.7% and 90.3%, increasing by 0.1 percentage points from the previous quarter for the Conventional banks, however declining by 1.9 percentage points for the Islamic banks.

Loans to Deposits ratio for Conventional banks in March 2018 has improved compared to a year ago when it was 99.8%. Also, for Islamic banks' L/D ratio has declined from 93.4% in March 2017. On the other hand, National banks have L/D ratio of 96.9% (with a decline of 1.1 percentage points compared to December 2017), while the ratio for foreign banks is 95.7%, higher than the 91.1% at the end of 2017 Q4.

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 18.2% at the end of December 2017 to 17.4% at the end of 2018 Q1. The level of total liquid assets at banks at the end of 2018 Q1 remains at AED 385.3bn, AED 12.6bn lower than at the end of 2017 Q4, registering a decline of 3.2% in the first quarter of 2018, explaining the decrease in the Liquid Assets Ratio (LAR). On a Y-o-Y basis, total liquid assets at banks also increased by AED 24.5bn registering a growth of 6.8%. In addition, looking at the split between Islamic, Conventional, National and Foreign banks, data show that for all segments the LARs increased during 2017 Q4. On a Y-o-Y basis, LAR has declined for all types of banks, except for the Islamic segment.

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

Total system	2017			2018
	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	85.9	86	84.6	84.2
The Liquid Assets Ratio (LAR)	17.1	17.6	18.2	17.4
Capital Adequacy Ratio (CAR)	18.5	18.7	18.1*	17.5*
Tier 1 Capital	16.9	17.1	16.6*	16.0*
CET 1			14.6*	14.0*

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

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

[10] Please refer to the 2017 Central Bank of the UAE Annual Report (page 66, Box 1) for details.

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Conventional	2017			2018
	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	86.6	86.6	85.0	84.8
The Liquid Assets Ratio (LAR)	16.9	17.2	17.7	16.2
Capital Adequacy Ratio (CAR)	18.9	19.1	18.5*	18.0*
Tier 1 Capital	17.1	17.3	16.9*	16.4*
CET 1			15.4*	14.7*

Source: CBUAE
Note: All data indicate the end-of-quarter values
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

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

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

Table 3.1.3.d. Financial Soundness Indicators

	2017			2018
Islamic	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	83.5	83.8	83.1	82.1
The Liquid Assets Ratio (LAR)	17.1	17.8	20.0	20.2
Capital Adequacy Ratio (CAR)	16.7	17.0	16.4*	15.8*
Tier 1 Capital	16.0	16.3	15.3*	14.6*
CET 1			11.4*	10.9*

in the UAE for National Banks (in %, unless otherwise indicated)

National	2017			2018
	Q2	Q3	Q4	Q1
Lending to Stable Resources Ratio	87.6	87.6	86.1	85.3
The Liquid Assets Ratio (LAR)	15.7	16.1	17.1	16.6
Capital Adequacy Ratio (CAR)	18.1	18.4	17.7*	17.1*
Tier 1 Capital	16.7	17.0	16.3*	15.6*
CET 1			14.0*	13.3*

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

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

Foreign	2017			2018
	Q2	Q3	Q4*	Q1*
Lending to Stable Resources Ratio	75.0	75.7	74.8	76.6
The Liquid Assets Ratio (LAR)	25.9	26.5	26.2	23.0
Capital Adequacy Ratio (CAR)	21.0	20.7	21.1*	20.9*
Tier 1 Capital	18.1	18.0	18.9*	18.7*
CET 1			18.9*	18.7*

Source: CBUAE
Note: All data indicate the end-of-quarter values.
***:** Reported as per Basel III guidelines issued by CBUAE in 2017.

3.2 Financial developments

3.2.1. Share Price Movement

Higher oil prices during the first quarter of 2018 gave more confidence to the investors in Abu Dhabi, as evident by the increase of share price indices on the Abu Dhabi securities markets. However, in

Dubai the share price index lost value. The market capitalization on Dubai Financial Market (DFM) and Abu Dhabi Securities Exchange (ADX) also increased.

On the ADX, the average Share Price Index increased by 6.4% in the first quarter of 2018 after a decline of 3.5% in the last quarter of 2017. The market capitalization growth moved higher from 0.4% in 2017 Q4 to 9.2 % during 2018 Q1 (see Table 3.2.1.).

The average Share Price Index in Dubai fell by 6.5% in the first quarter of 2018. However, the market capitalization rose by 1.9% during the same quarter against an increase of 2.4% in 2017 Q4 mainly due to the increase of the number of listed companies from 65 at the end December 2017 to 67 in March 2018.

Table 3.2.1. UAE – Securities Markets

		2017				2018
		Q1	Q2	Q3	Q4	Q1
Abu Dhabi	Change of Share Price Index (%)	3	-1.2	0.4	-3.5	6.4
	Change of Market Capitalization (%)	1.4	-1.4	-0.3	0.4	9.2
Dubai	Change of Share Price Index (%)	5.2	-5.6	6.8	-3.8	-6.5
	Change of Market Capitalization (%)	18.8	-7.8	5.7	2.4	1.9

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

3.2.2. Credit Default Swaps Premiums

The default risk premium for the Emirate of Abu Dhabi remains at a very low level, which decreased in Q1 2018, after a marginal increase in Q4 2017. While in the Emirate of Dubai, it further improved against the previous quarter (see Table 3.2.2).

Table 3.2.2. UAE – Sovereign Credit Default Swaps (CDS)

	2017				2018
	Q1	Q2	Q3	Q4	Q1
Emirate of Abu Dhabi	51.1	43.8	57.3	62.9	56.2
Emirate of Dubai	128.6	114	121.4	130.6	106.8

Source: Bloomberg.
Note: All data are the average of daily observations for each quarter. Premiums are expressed in basis points.

In the first quarter of 2018, the CDS of the UAE Sovereigns decreased by 6.7 basis points (bps) for the Emirate of Abu Dhabi after a previous increase by 5.6 (bps) in the fourth quarter of 2017. In Dubai, the CDS declined by 23.8 basis points (bps) after an increase of 9.2 (bps) in the fourth quarter of 2017. The reduced risks reflect recent firming up of oil prices and progress on fiscal reforms.

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

*The Central Bank balance sheet exhibited a decrease in 2018 Q1, as evident by a decrease in Central Bank's Deposits at Banks Abroad and Other Advances, as well as a decrease in investments in Foreign Securities. Interest rates in the UAE continued their upward trend in line with the Fed's decision announced in March to increase its policy rate. Nonetheless, the Dirham **spread** with respect to the USD LIBOR as well as the **spread** relative to the USD Swap rate continued to shrink, thanks to improved risk premium for the UAE, due to ample liquidity in the banking system and better growth outlook.*

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4.1 Monetary Aggregates

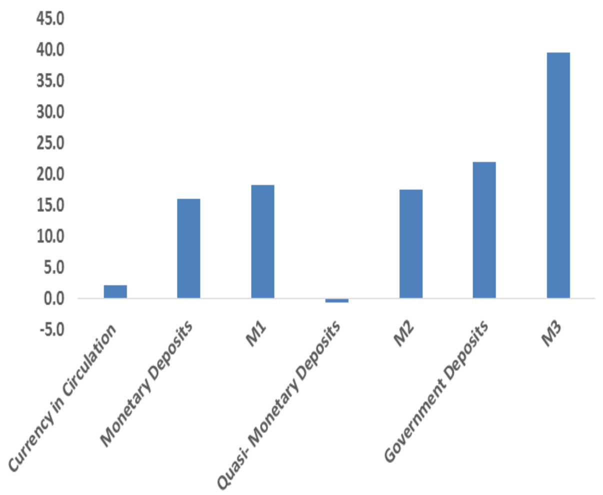
During 2018 Q1, M1 increased by 3.7% reaching AED 510.6 billion, as a result of an increase in Currency in Circulation by AED 2.2 billion to reach AED 69.9 billion, and an increase in Monetary Deposits by AED 16 billion to reach AED 440.7 billion.

Meanwhile, the monetary aggregate M2 increased by 1.4% to reach AED 1,293.8 billion, due to the above-indicated increase in M1 and a decrease in Quasi-Monetary deposits by AED 0.6 billion, reaching AED 783.2 billion.

M3 increased by 2.7%, to reach AED 1,526.7 billion, due to an increase in Government deposits by AED 22 billion, reaching AED 232.9 billion, in support of bank liquidity.

Figure 4.1 Change in Monetary aggregates in 2018 Q1

In billions of Dirhams



Source: Central Bank of the UAE

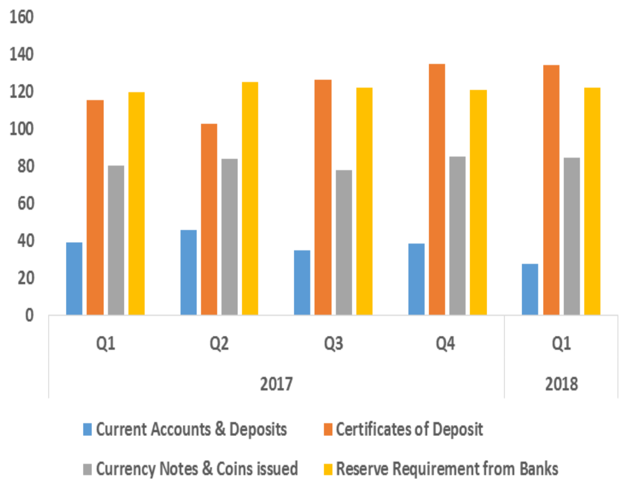
4.2. Central Bank Balance Sheet

The Central Bank balance sheet's changes are triggered by liquidity in the banking system, reflecting developments in the oil price and capital flows, in tandem with the change in assets at banks operating in the UAE. During 2018 Q1, total assets of the Central Bank decreased by 2.3% (AED 9.3 billion) to reach AED 395.6 billion. The reduction is due mainly to a decrease in Deposits at banks abroad and Other Advances by AED 20.8 billion, and a decrease in investments in securities by AED 30.8 billion. The latter reflects CBUAE's current investment strategy to stay oriented towards cash and short-term investments in light of the continued normalization of monetary policies by major central banks and increasing prospects of higher interest rates.

On the liabilities side, a decrease was recorded mainly in Current Accounts and Deposits by AED 10.9 billion, while the Certificates of Deposits issued by CBUAE and purchased by banks remained at AED 134.3 billion at end of March, which is testament of sufficient liquidity in the banking system.

Figure 4.2 Central Bank Liabilities

In billions of Dirhams



Source: Central Bank of the UAE

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Table 4.1 Central Bank Balance Sheet

In billions of Dirhams

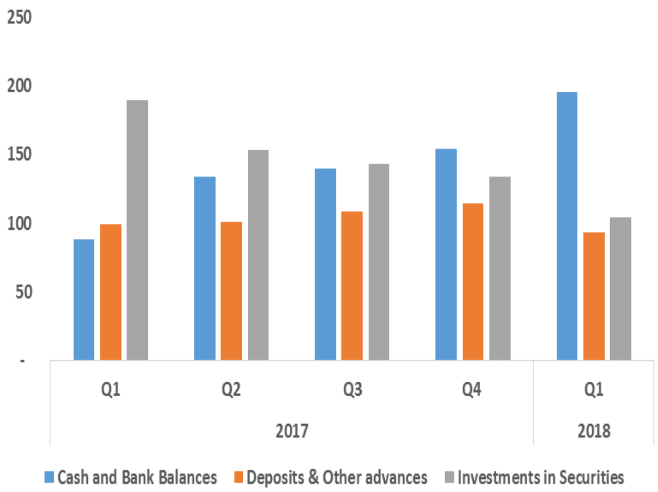
	2017				2018
	Q1	Q2	Q3	Q4	Q1
Total Assets,	**379.5**	**392.0**	**396.1**	**404.9**	**395.6**
Of which:					
Cash and Bank Balances	88.1	133.5	140.0	154.2	195.2
Deposits & Other advances	98.9	101.2	108,.3	114.5	93.6
Investments in Securities(1)	189.7	153.4	143.5	133.7	104.2
Gold Bullion	1.1	1.1	1.1	1.2	1.2
Total Liabilities,	**358.4**	**371.0**	**375.5**	**384.3**	**373.6**
Of which:					
Current Accounts & Deposits	39.4	46.0	35.0	38.6	27.7
Reserve Requirement from Banks	120.0	125.3	122.1	121.2	122.0
Certificates of Deposit	115.3	103.0	127.0	135.1	134.3
Currency Notes & Coins issued	80.1	83.9	78.3	85.4	84.7

Source: Financial Control Division, Central Bank of the UAE

(1) Including foreign securities and Securities of Ministry of Finance and Dubai Government

Figure 4.3 Central Bank Assets

In billions of Dirhams



Source: Central Bank of the UAE

The CBUAE Balance Sheet is affected directly on the liabilities' side by banks' accounts and reserves at the Central Bank, in addition to their investments in Certificates of Deposits (CDs). Moreover, banks' credit investment in foreign assets as well as external sources of funding affect banks' liquidity position at the Central Bank as well as their investments in CDs.

During 2018 Q1, there was a decrease in banks' funding from abroad. "Due to Headquarters and/or Branches Abroad", which is basically foreign banks getting short-term liquidity from their headquarters, decreased by AED 12.7 billion, while "Due to Other Banks Abroad" which is borrowing in US dollars, including Money at Call and Short – Notice, Nostro Balances, Bills and Lending under Repurchase Agreement, and Term Placements and Loans, decreased by AED 2.2 billion. Therefore, the increase in banks' "Capital Market Funding" which is medium-term funding from overseas by AED 5.9 billion was offset by the reduction in other borrowing, resulting in a net decrease in external sources of funding for banks in the order of AED 9 billion.

4.3 Central Bank Foreign Assets

As shown in Table 4.2, the balance of foreign assets decreased by 3%, from AED 347.7 billion at the end of 2017 Q4 to AED 336.3 billion at end of 2018 Q1, due to the decrease in foreign currency receipts into the banking system.

Table 4.2 Central Bank's Foreign Assets

In billions of Dirhams
Source: Central Bank of the UAE, end of quarter data
*Excluding IMF Reserve Position and SDR Holdings

	2017				2018
	Q1	Q2	Q3	Q4	Q1
Total Foreign Assets*	325.0	338.3	344.1	347.7	336.3
Foreign Securities	140.5	104.3	94.3	84.5	55.2
Current Account Balances & Deposit with Banks Abroad	178.8	227.6	241.5	256.6	271.2
Other Foreign Assets	5.7	6.4	8.3	6.6	9.9

4.4. International Reserves Position

The credibility of the fixed exchange rate peg arrangement requires the Central Bank to hold sufficient foreign currency reserves. To this end, Article 75 of the Union Law No. 10 of 1980 concerning the Central Bank stipulates under The Monetary System and Organization of Banking that the Central Bank is required to maintain a "Currency Cover Ratio" where "internationally recognized reserves assets" should correspond to at least 70% of the Currency in Circulation and Demand Deposits. As at the end of March 2018, the Cover Ratio reached 291.6%, i.e., well above the minimum required.

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Table 4.3 International Reserves

In billions of Dirhams

	2017				2018
	Q1	Q2	Q3	Q4	Q1
1. **International Reserve Position***	**327.7**	**341.1**	**347.0**	**350.3**	**339.0**
Of which					
– Current Account Balances & Deposits with Banks Abroad	178.8	227.7	241.5	256.6	271.2
– Foreign Securities	140.5	104.3	94.3	84.5	55.2
– IMF Reserves Position + SDR Holdings	2.7	2.8	2.8	2.6	2.7
2. Monetary Base	**351.5**	**355.0**	**358.7**	**377.4**	**365.2**
Of which					
– Currency Issued	80.1	83.9	78.3	85.4	84.7
– Reserve Requirements	119.9	125.5	122.4	121.4	122.0
–					
– Banks & OFCs Current Accounts at CBUAE	36.2	42.8	31.4	35.5	24.2
Ratio (1/2)	93.2%	96.1%	96.7%	92.8%	92.8%

Source: Central Bank of the UAE, end of quarter data
* Gross International Reserves including IMF Reserve Position and SDR Holdings

Table 4.3 reports the ratio of the International Reserves Position of the Central Bank to the monetary base, which includes all banks' reserves at the Central Bank and Certificates of Deposits. This ratio reflects a cover of the commitment of CBUAE to banks operating in the country, which is of a larger amount as the monetary base reached AED 365.2 billion at the end of March. The monetary base is about 3.2 times the denominator of the above – indicated Cover Ratio which amounted to AED 112.4 billion (Currency Issued: AED 84.7 billion and Demand Deposits: AED 27.7 billion). However, the International Reserves Position remained at 92.8% of the monetary base, which supports the credibility of the fixed exchange rate peg and the Central Banks' ability to defend it.

4.5. Developments in Banks' Liquidity at the CBUAE

Banks' liquid assets at the Central Bank are composed mainly of their current accounts at the Central Bank, their reserves requirements, and their holdings of certificates of deposits. They decreased by AED 12.5 billion from end of 2017 Q4 to end of 2018 Q1, mainly due to a decrease in Banks' Current Accounts at the Central Bank by roughly the same amount. Liquidity at banks, including liquidity parked at the central bank, remained sufficient. Nonetheless, as banks' Total Liquid Assets Ratio remained at 17.4% at the end of 2018 Q1, i.e., well above the mandatory minimum of 10%.

4.6. Interest Rates

The fixed peg of the exchange rate of the Dirham to the US dollar requires that the CBUAE to peg its policy rate to the direction of the interest rate policy in the U.S. Therefore, the Central Bank of the UAE announced in March, June, and December 2017 and again in March 2018 an increase in interest rates applied to its Certificates of Deposits, in line with the Fed's decision that brought the target Federal Fund rate to the 1.50–1.75% range. Similarly, the Repo Rate applicable to banks' borrowing of short-term liquidity from the Central Bank against their holdings of CDs has increased from 1.75% to 2%.

4.6.a. Short-term interest rates

The Emirates Interbank Offer Rate (EIBOR) comprises the daily quotes of the largest banks operating in the country, based on the average interest rate at which banks offer to lend secured funds to other banks in the Dirham wholesale money market. New "Regulations on Interbank Rate Submissions by EIBOR Panel Banks" were issued on 25 March 2018, in line with the recommendations of the International Organization of Securities Commissions (IOSCO), with the aim to enhance governance, standardization and transparency in the rate-setting process at Panel Banks.

The main requirements of the new regulations are:

(1) EIBOR Panel Banks are to rely, as much as possible, on the use of available transaction data, otherwise they need to base their estimates on unsecured interbank transactions of greater than AED 20 million, unsecured wholesale deposits greater than AED 20 million from GREs, corporates and NBFIs, and internally developed expert judgment, and

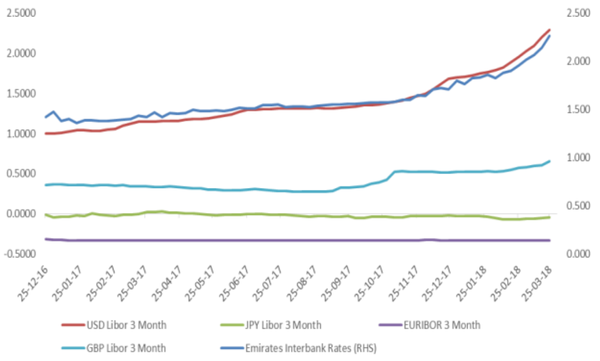
(2) Panel Banks are required to appoint an independent auditor from a panel of audit firms nominated by the CBUAE.

It is expected that there may be short term volatility in EIBOR fixings when the new regulations are launched but such volatility will be reflective of the fact that future fixings will be largely based on actual transactions.

During 2018 Q1, EIBOR rose in line with the USD LIBOR on the back of expected interest rate lift in the US, which materialized on 21 March when the Fed announced an increase in the Federal Funds rate by 25 basis points. EIBOR 3-month rate increased as a result by about 6.2 basis points (bps) in January, 9.8 bps in February and by 3.1 bps in March to reach 2.27% at the end of the quarter.

Similarly, the GBP LIBOR 3–month rate increased during most of the 1st quarter from 0.52% in January to 0.57% at end of February and to 0.66% at end of March. The LIBOR rates on the Euro and Japanese Yen remained in negative territory, fluctuating around an average of -0.33% and -0.05% respectively, in line with the directions of continued accommodative monetary policy adopted by the respective central banks.

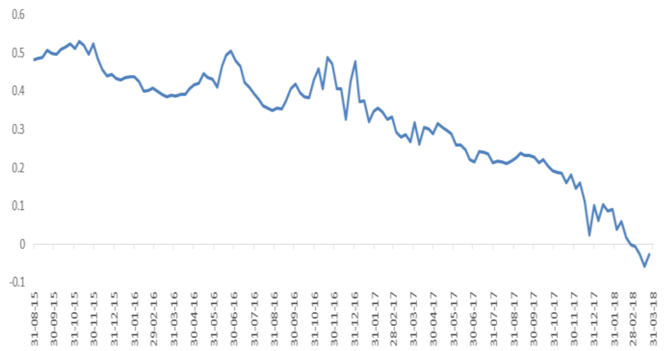
Figure 4.5. a LIBOR rates (3-month) for the Dirham and key other currencies (%)



Source: Bloomberg

As regards the EIBOR ***spread*** vis-à-vis the USD LIBOR (3–month rates), despite some fluctuations, the trend was a continued decline in the spread in the first quarter of 2018, from 6 bps in early January to 1.6 bps in mid- February before turning negative until the end of March. The LIBOR on USD has been increasing by more than the Fed's increase in its policy rate, by 50.7 bps until the third week of March and by 9 bps after that, due to strong economic performance in the US. In parallel, there is expected further tightening by the Fed as it unwinds its balance sheet and US firms repatriate money out of foreign dollar funds in response to tax cuts signed into law in December 2017. However, the increase in EIBOR was limited to 47 bps, as liquidity remained satisfactory in the UAE in the face of improving growth in non-oil activities and higher oil price.

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

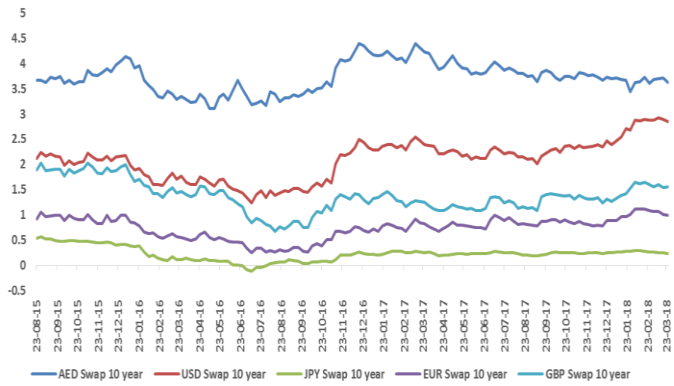


Source: Bloomberg

4.6. b Long-term swap rates

Given the absence of a government bond market in local currency in the UAE, the swap market reflects the yields of long-term securities (11). As shown in Figure 4.6.a, the 10-year swap rates for the Dirham increased only slightly during most of the first quarter of 2018 from an average of 3.62% in January to 3.65% in February and to 3.68% in March, despite the liftoff in interest rates in the US and international financial markets. This is a testament of the decline in investors' perceived risk regarding the UAE, reflecting ample liquidity in the banking system and improved economic outlook. Meanwhile, the10-year Swap rates for USD, the Euro and the British Pound increased in line with global rising interest rates as major central banks have or in the process of embarking on normalization of policies, while higher uncertainty as measured by the VIX index volatility during 2018 Q1 has weighed in positively on the price of credit.

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



Source: Bloomberg

As regards the spread between the Dirham 10-year swap rate and the US dollar, Figure 4.6.b shows that the decline observed during the previous year continued in 2018 Q1. The spread reached an average of 91 basis points, down from an average of

(11)By definition, interest rate swaps correspond to an exchange of a fixed rate for a floating payment that is linked to an interest rate, most often the London Interbank Offer Rate (LIBOR).

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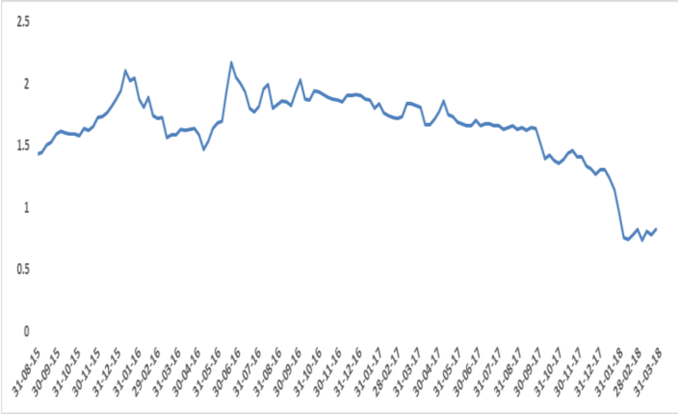
172 basis points in 2017 Q2, 165 basis points in Q3 and 139 basis points in 2017 Q4. The narrowing of the spread attests to less perceived risk, as the UAE economic outlook improved along with the recent recovery in oil prices that firmed oil revenues and improved the fiscal outlook, and the outlook for non-energy growth, boosted by improved growth in the main UAE main export markets. On a monthly basis, however, the spread decreased from an average of 116 bps in January to about 78 bps in February and March. More recently, an increase was evident in the spread from 74 bps in early March to 83 bps at the end of the month, due mainly to an increase in the 10–year Dirham Swap rate by 11 bps.

Figure 4.6.b Spread 10-year swap vs. Dirham/USD (%)



Source: Bloomberg