الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

United Arab Emirates

December, 2019

TRUST . TRANSPARENCY . INDEPENDENCE

ECONOMIC OVERVIEW

UAE's economy is the second largest in the GCC with aGDP of USD433bn estimated for 2018.It is a federation of seven Emirates with a combined population of about 10.1m[1] in 2018 (around 1mn of which constitutes nationals). UAE's GDP per capita of around USD43k, positions it as a 'high income' earning country as per theWorld Bank.

Table 1: UAE - Key Economic Indicators

Figures as stated	2015	2016	2017	2018P	2019P	2020P
Real GDP Growth (%)	5.1	3.0	0.8	2.9	3.7	3.6
Hydrocarbon	5.2	2.6	-3.0	2.9	3.1	3.2
Non-hydrocarbon	5.0	3.2	2.5	2.9	3.9	4.2
Average CPI Inflation (%)	4.1	1.6	2.0	3.5	1.9	2.2
Current Account % of GDP	4.9	3.7	6.9	7.1	7.9	5.1
Fiscal Balance % of GDP	-3.4	-2.0	-1.6	-1.6	1.8	0.2
Total Gross External Debt % of GDP	67.6	70.8	73.5	66.9	63.8	62.5

Tailwinds to the current economic situation include weakness in private sector jobs as companies restructure and cut costs; in addition, rising taxes and stagnant wages pressure expatriates' spending and depress consumer demand. Imposition of VAT and rising health & education costs, have driven up the cost of living. Despite this, latest estimates and forecasts[2] of CBUAE point to 1.7% (2.8% and 1.3% for oil and non-oil sector respectively) and 2.4% (5.0% and 1.4% for oil and non-oil sector respectively) GDP growth in 2018 and 2019 respectively. Federal budget for 2019 is one of the largest budgets set forth, being 17% higher than prior year and with fiscal deficit expected to be reined in further and forecasted to fall to zero from 1.8% of GDP in the prior year.

In 2019, reforms and incentives aimed at improving business climate, increased FDI stimulus programs to bolster government spending, Dubai EXPO 2020 and modestly higher oil output would help accelerate economic activity.In the beginning of May 2019, IMF noted that GDP growth could exceed 2% in the ongoing year and converge to its long-term economic potential of 3% in 2020 & 2021 on the back of increasing public spending, ahead of Expo 2020.

To improve the business climate, UAE Cabinet announced permitting 100% foreign ownership of companies in specified sectors and long-term visas for specific categories of expatriates. According to the World Bank's Ease of Business Rankings, UAE climbed to 11th position in 2019 from 21st in 2018, while ranking 27th in terms of Global Competitiveness Index.

Abu Dhabi Government announced an AED50bn (USD13.6bn) economic stimulus program 'Ghadban 21' in June 2018 to promote private sector development, job creation and tourism over the next three years, for which AED20bn is allocated for 2019.

On the other hand, sales prices and rental prices for the mainstream residential properties in UAE maintained their downtrend indicating softness in the real estate sector. In December 2018, YoY decline in sales prices in Abu Dhabi and Dubai were registered at 6.8% and 8.6% respectively.

Headline inflation, CPI, decelerated to 1.1% in Q4'18 (3.6% in the prior quarter) as the impact of excise taxes dissipated, transportation inflation retreated and softness in rental and housing sectors persisted. Given the pegged currency regime, the CBUAE's monetary policy decisions trail those of the FED with the CBUAE having raised the benchmark interest rate on issuance of certificate of deposits ("CDs")four times during the year2018 by 25bps each. This has led to overall tightening in the credit marketsand adversely affected corporates' repayment ability. After being steady in the first half of 2019, the CBUAE cut the rates twice by 25bps each, so far in the second half, in line with the rate cuts by the FED.

Banking Sector

Concentrated at the top-end and fragmented at the smaller end of the market, the banking sector in UAE is deemed highly

[1] *IMF Country Report, January 2019*
[2] *Quarterly Economic Review by CBUAE for Q2'19[3] bbl: barrel; Source: EIA – Brent spot price*

competitive. As of year-end 2018, the share of the largest three banks amounted to 53% of total banking assets.

Aggregate asset base of UAE banks grew by 6.5% in 2018 to AED 2.87trn, following a much subdued 1.4% expansion in the prior year. In the first quarter of the current year, the sector showed signs of slowing down and grew by 0.9% only. Gross impairment in the sector stood at 6.8% of financings at the end of 2018, slightly higher than prior years with specific provisioning coverage of 77.4% (2017: 75.1%). Going forward, depressed labor market activity could weigh negatively on asset quality in consumer lending, while prolonged decline in real estate prices would dampen the outlook for the real estate segment exposures.

Capitalization indicators of the system have been relatively stable with average CAR ranging within a band of 18.1% and 19.3% in the period 2013-2018. The system's CAR stood at 18.2% at the end of 2018 vis-à-vis 18.1% in 2017 while tier-1 CAR improved more significantly to16.9% vis-à-vis 16.6% in 2017. Banking system's liquidity as indicated by the Eligible Liquid Asset Ratio (ELAR), registered at17.5% at the end of 2018 compared to 18.3% in 2017, well above the regulatory minimum of 10%.

Average yield on credits were more or less stable within the range of 5.0%-5.5% in the same period reaching 5.5% in 2018 (5.1% in 2017-end) as the portfolio yields increased following the rate hikes by CBUAE albeit at a slower pace; on the other hand, cost of deposits increased to 1.8% vis-à-vis 1.3% in 2017 (1.0% in 2013) owing to competition, tighter liquidity conditions, and a generally higher rate environment. This resulted in narrower spreads, being 3.7% in 2018, down from 4.1% in 2013, and declined further by 10bps in H1'19, with yields on financings dropping 10bps on average and cost of funding remaining steady.

Mergers have been gaining traction inthe UAE banking system, as it is in the GCC in general. At the beginning of 2019, talks between Abu Dhabi Commercial Bank, Union National Bank, and Al Hilal Bank were confirmed. In addition, the country's second largest Islamic bank, Abu Dhabi Islamic Bank PJSC, is also in potential merger discussions. The mergers are expected to generate efficiencies across the sector, in the prevailing, strained economic conditions.

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Table 2: Snapshot of the UAE Banking Sector (%)[3]

Amounts in AED'b, unless otherwise stated	Overall Banking			Islamic Banking ("IB")		
	2016	2017	2018	2016	2017	2018
Gross Assets	2,593	2,694	2,869	505	550	583
Gross Financings	1,554	1,580	1,656	335	354	373
Deposits	1,563	1,627	1,756	349	384	402
Eligible Liquid Assets Ratio ("ELAR")(%[4]	16.2	18.3	17.5	16.8	20	20.2
NPFs Ratio (%)	6.4%	6.7%	6.8%	7.6%	6.3%	N.A.
RoA (%)	1.4%	1.5%	1.6%	1.5%	1.7%	N.A.
Total CAR (%)	18.9	18.1	17.5	17.1	16.4	15.8
Tier 1 Ratio (%)	17.3	16.6	16.2	16.5	16.4	14.6
CET 1 Capital Ratio (%)	N.A.	14.6	14.3	N.A.	16.4	10.9

[3] CBUAE 2018 Annual Report

[4] The ratio of liquid assets, which include reserve requirements, mandated by the Central Bank, certificates of deposits held by banks at the Central Bank, excess reserves at the Central Bank, in addition to zero-risk weighted government bonds and public sector debt and cash at banks, as a share of the total liabilities.

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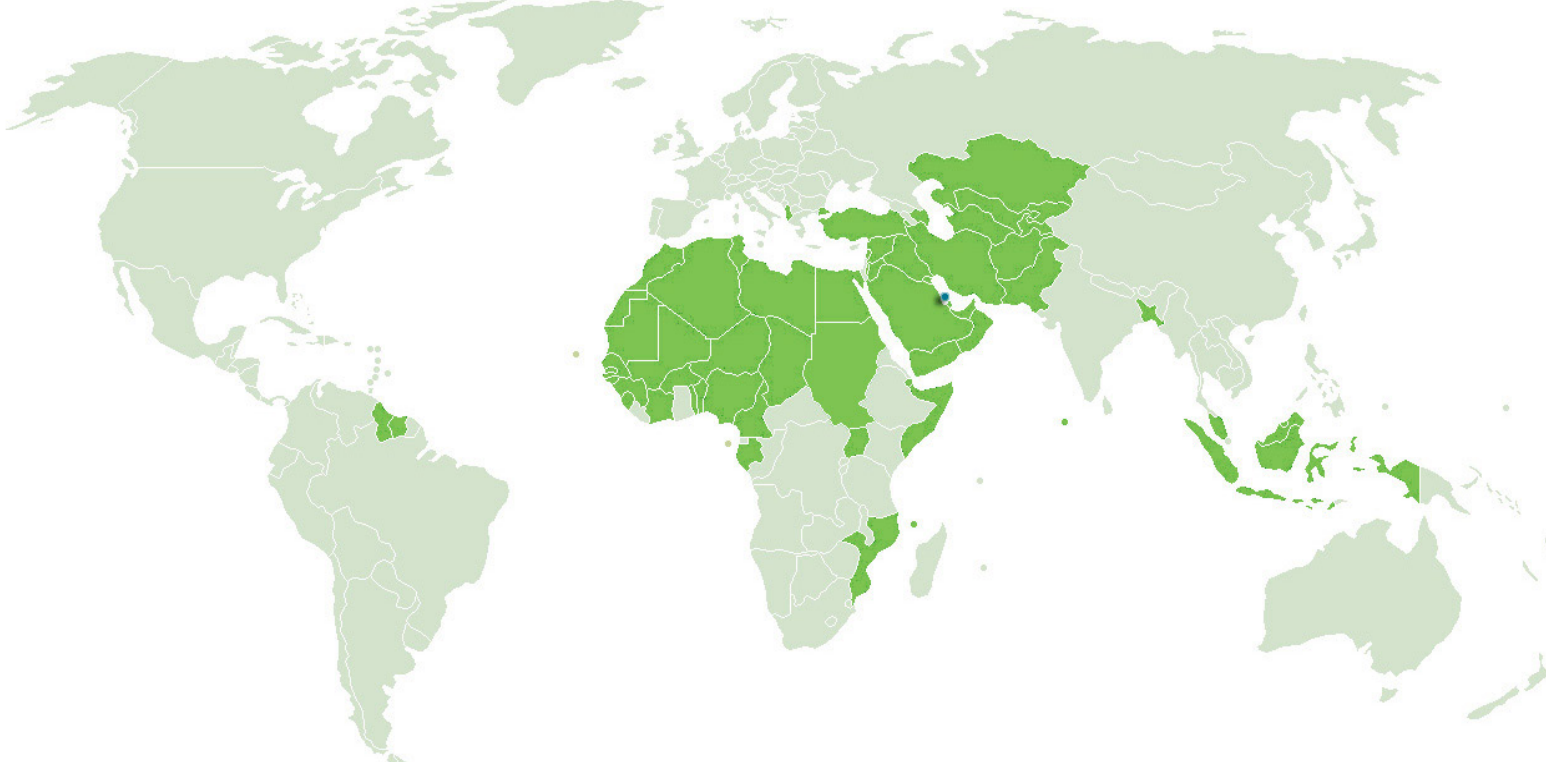
[3] Capital ratios for the period starting from Dec 2017 are calculated according to Basel III Guidelines issued by CBUAE while the ratios for the period prior to Dec 2017 are following Basel II Guidelines.
[4] https://gulfnews.com/business/banking/adcb-unb-and-al-hilal-bank-combine-to-create-the-third-largest-uae-bank-1.1548759538936
[5] https://www.bloomberg.com/news/articles/2019-02-14/abu-dhabi-islamic-said-to-weigh-merger-as-bank-considers-options



الوكالة الإسلامية الدولية للتصنيف

Islamic International Rating Agency

, P.O. Box 20582, Kingdom of Bahrain
Tel: +973 17211606, Fax: +973 17211605
Website: www.iirating.com | Email: iira@iirating.com