



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

**United Arab
Emirates (UAE)**

August, 2016

UAE's real GDP growth is estimated to have slowed to 3.4% in 2015, amid the significant drop in international crude oil prices. The slowdown is also noted in the non-oil sector given implications of oil price drop on government spending, liquidity in the financial sector and the overall investor sentiment. Akin to other GCC countries, the impact is most pronounced on the country's fiscal position, with deficit - a first since 2009 –around 4.9% in 2015. Nonetheless, with greater economic diversification vis-à-vis regional standards¹; significant sovereign reserves; and sociopolitical stability promoting UAE's status as a regional business, financial and trading hub; the adverse spillovers of oil price drop are contained and largely manageable. Fiscal reforms entailing increase in electricity and water tariff, deregulation in fuel prices, and expected implementation of value added tax in conjunction with other GCC countries are considered positive developments for the country's long-term economic structure. The planned 'Expo 2020' in Dubai is also likely to support economic growth in the coming periods.

| Table 1: Economic Indicators | 2012 | 2013 | 2014 | 2015 | 2016 (P) |
|--|-------------|-------------|-------------|-------------|-----------------|
| GDP growth (Annual %) | 6.8% | 4.7% | 4.0% | 3.4% | 3.1% |
| Hydrocarbon | 7.6% | 2.9% | 0.8% | 2.8% | 2.1% |
| Non-Hydrocarbon | 6.4% | 5.6% | 5.5% | 3.7% | 3.6% |
| Total Investment (% of GDP) | 23.1% | 23.2% | 24.7% | 23.8%* | 25.7% |
| Inflation | 0.6% | 1.1% | 2.4% | 4.1% | 3.0% |
| Population (Millions) | 8.8 | 9.0 | 9.3 | 9.6 | 9.9 |
| Fiscal Account Balance (% of GDP) | 10.9% | 10.4% | 5.0% | -4.9%* | -10.8% |
| Current Account Balance (% of GDP) | 21.3% | 18.4% | 13.7% | 3.9%* | -1.0% |
| Regulatory Policy Rates | 1.0 | 1.0 | 1.0 | 1.25 | 1.25 |
| <i>*Estimated</i> | | | | | |
| <i>Source: Central Bank of UAE, IMF, WEO Oct'15, World Bank, EIU, CIA World Factbook</i> | | | | | |

However, inflationary pressures have increased against the backdrop of these fiscal measures and rental inflation. Slower growth in money supply has tightened market liquidity, and concurrently, the twelve-month emirates interbank offer rate increased by 46bps to 1.47% by end-2015. Given the dollar peg, monetary policy options available to the UAE Central Bank are limited and the market benchmark rates are directly influenced by policy rates prevalent in the United States. Since the 2008 financial crisis, monetary policy pursued by the US Federal Reserve has been expansionary. However, the policy rate was revised marginally upwards to 0.5% in December 2015 from 0.25% after seven years, in the wake of the country's improving economic performance. Further increases in the Fed rate may result in higher lending rates in the GCC, at a time when market liquidity is already stretched.

Banking Sector

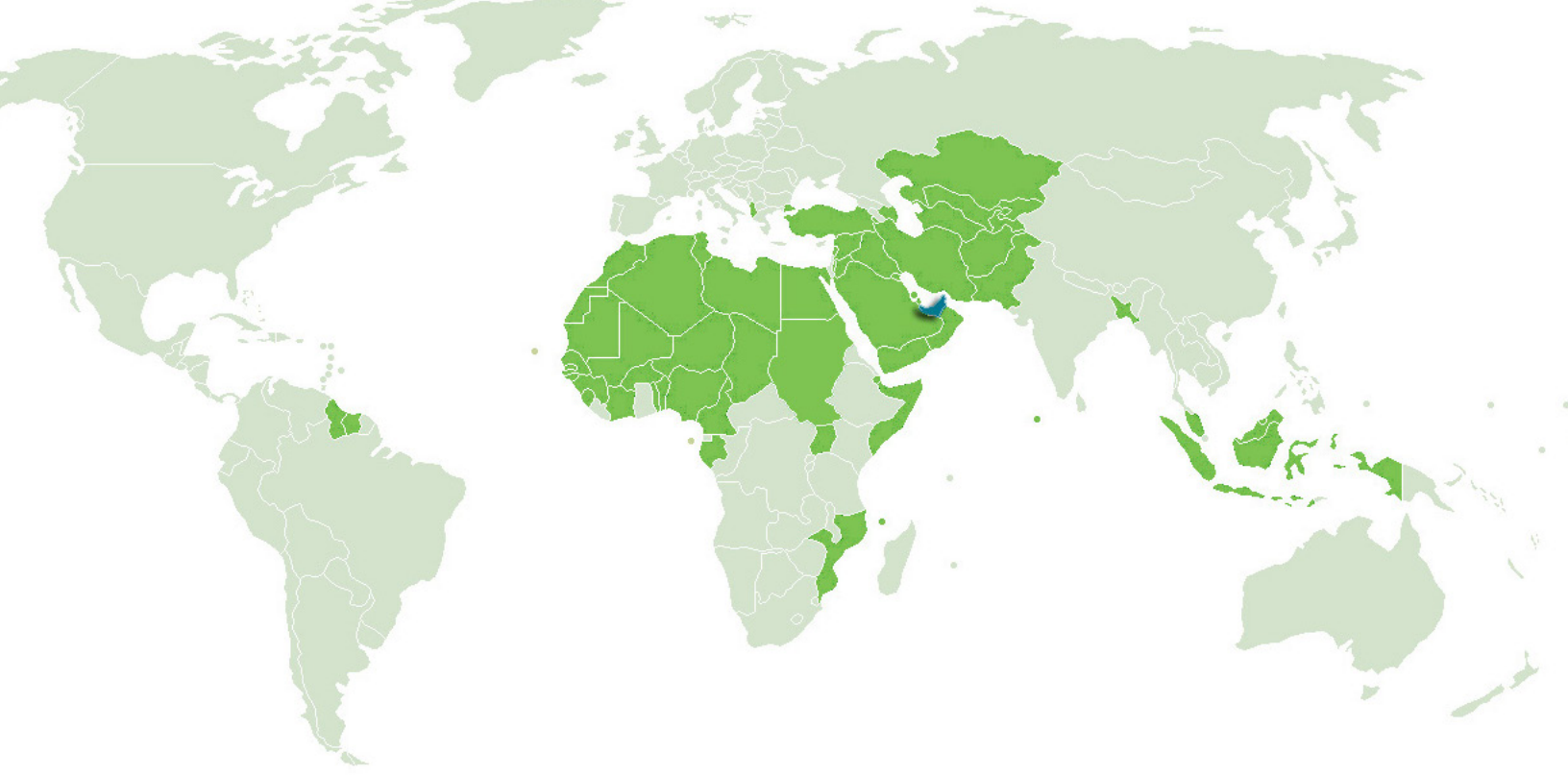
Financial sector development and inclusiveness in UAE is high, and the country boasts the highest credit and deposit penetration as a percentage of GDP in the GCC. The banking sector comprises 23 local and 26 foreign banks, which collectively manage a delivery network of around 950 branches and more than 5,000 ATMs in the country. Larger players dominate the market with five largest banks accounting for about 60% of banking sector assets. Islamic banking comprises 8 full-fledged Islamic banks and 23 Islamic windows set up by conventional banks, collectively accounting for 19% of total sector assets.

Banking sector financial soundness indicators are healthy, with adequate capitalization and impairment levels and strong profitability metrics. Growth rate and liquidity position have however come under pressure in the wake of recent economic slowdown. With the corporate sector dominated by large government related entities (GREs) and family group holdings, concentration in financings extended by banks is largely noted on the higher side.

¹ Two-thirds of country's GDP pertains to non-oil sector

In recent periods, UAE Central Bank has strengthened its regulatory framework to enhance risk buffers and to improve the sector's overall financial health. The introduction of limits and conditions in the area of consumer financing is noteworthy. In addition, combined exposure limits for GREs and local emirates along with counterparty exposure limits were also introduced by the Central Bank. Further, a credit bureau became operational in November 2014, with data covering the past 24 months and 97% of UAE's active credit population. Steps taken to modernize risk reporting include phased implementation of Liquidity Coverage Ratio (LCR), although UAE Central Bank has yet to issue guidelines vis-à-vis comprehensive implementation of Basel III capitalization framework.

| Table 2: Key Banking Industry Indicators <i>(AED Billions)</i> | Dec'12 | Dec'13 | Dec'14 | Dec'15 |
|--|---------------|---------------|---------------|---------------|
| Gross Banking Assets | 1,877 | 2,100 | 2,305 | 2,474 |
| Gross Credit | 1,184 | 1,276 | 1,378 | 1,486 |
| Gross Investments | 155 | 187 | 228 | 250 |
| Bank Deposits | 1,168 | 1,279 | 1,421 | 1,472 |
| ROAA | 2.0% | 1.5% | 1.7% | n/a |
| ROAE2 | 11.5% | 11.6% | 13.6% | n/a |
| Gross Impairment Ratio ² | 8.4% | 8.2% | 7.0% | 6.3%* |
| Provision Coverage | 85.1% | 94.1% | 102.0% | 106.0%* |
| Liquid Assets Ratio | n/a | 14.7% | 15.7% | 17.4% |
| Capital Adequacy Ratio | 21.0% | 19.3% | 18.2% | 18.3% |
| <i>*Provisional Data</i> | | | | |
| <i>Source: Central Bank of UAE, IMF Report Aug'15</i> | | | | |



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