

Market Review and Outlook

NCB Weekly Views on Global, Regional and Local Economic and Financial Developments

August 31, 2009

Special Focus: Bank Credit: The Transition towards a Moderate Credit Cycle

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Saudi Arabia Leading Economic Indicators

	2008	Latest	Period
Average WTI, Cushing 1M, USD/bbl	99.67	55.5	09YTD
Weighted Average Arabian Light, USD/bbl	94.8	55.0	09YTD
Average 3M USD LIBOR	2.93%	0.90%	09YTD
Average 3M SAR SAIBOR	3.41%	0.91%	09YTD
Average Spread, in Basis Points, SAIBOR-LIBOR	48.2	8.6	09YTD
Y/Y Growth in Monetary Base (M0)	-0.35%	14.25%	July09
Y/Y Growth in Money Supply (M3)	17.6%	15.3%	July09

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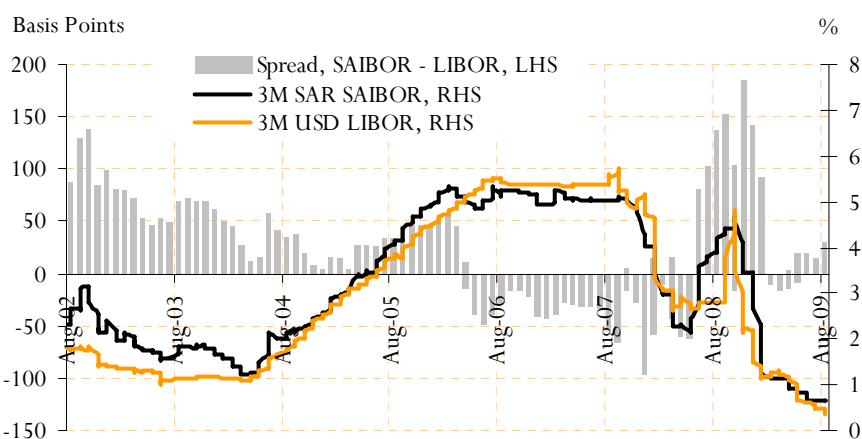
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Saudi Arabia Liquidity and Risk Detector



Sources: Reuters and NCB

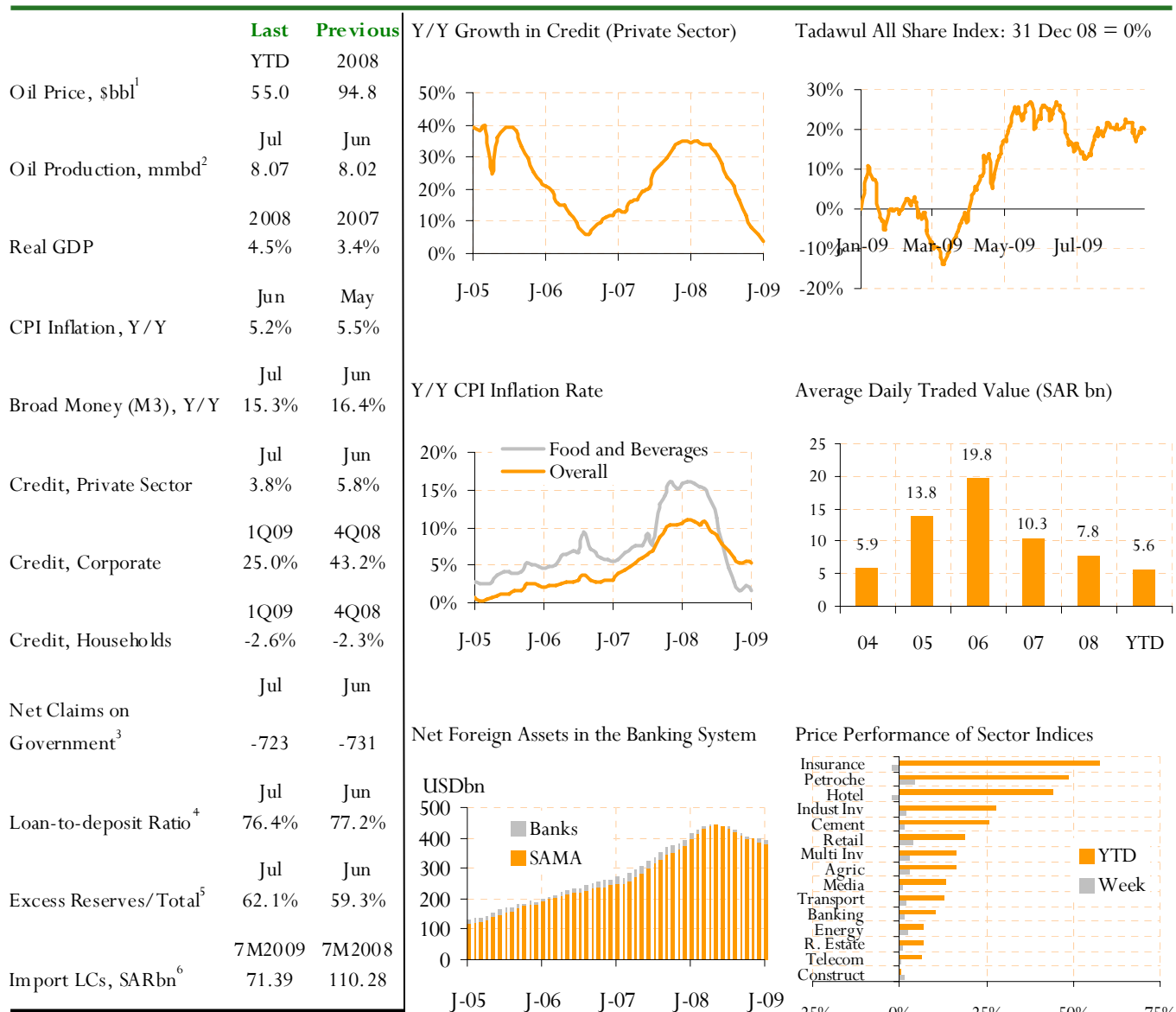
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Saudi Macro and Equity Market

Bank Credit: The Transition towards a Moderate Credit Cycle

Last year, as the global economy tumbled and financial markets became dysfunctional, SAMA was able to navigate the banking system away from the illiquidity that governed money markets, proving to be a pragmatic crisis manager not hostage to policy bias. At the peak of these liquidity concerns, Saudi banks had extended credit at a double digit annual growth rate of 27.9% by the end of Dec08. However, the growth of private credit had dwindled ever since to a relatively meager 3.8% in Jul09. Will monetary policy play any role at this juncture? And who is the main player going forward? It is important to note, that momentarily, monetary policy is extremely accommodative, with the benchmark lending rate and 3M SAIBOR rate at historical lows of 2% and 0.298% respectively, implying that this strategic orientation pertains to domestic banks and their perception of credit risk. Interestingly, Saudi banks continue to keep huge excess reserves, which reached 62% out of the overall deposits held at SAMA (SAR79.9 bn) in Jul09 compared to 4.38% in Oct08. Hovering around 60% since the beginning of the year, excess reserves could either reflect reluctance, lack of opportunities or, in the Saudi case, banks that are recalibrating their portfolio mix to reflect the realities of a moderate business cycle and, in turn, credit cycle.

Key Macroeconomic and Equity Market Indicators



Sources: SAMA, Reuters.

Notes: 1/Oil price: Weighted Average Arabian Light. 2/Oil production: Million barrels per day of crude oil. 3/Net claims on government: Banking sector claims on the central government less central government deposits in the banking system in SAR bn. 4/Loan-to-deposit ratio: The ratio of bank claims on the private sector (excluding investments in private securities) to total deposits, as reported on the consolidated balance sheet of banks. 5/Excess reserves/total: The ratio of excess reserves held by commercial banks in SAMA to total bank deposits in SAMA. 6/ Import LCs: The cumulative value of letters of credit opened by banks to finance private sector imports.

US Macro and Equity Markets

How Sustainable is the US Recovery?

It has been stated time and time again that the US economy is no longer in free-fall. Fundamental economic indicators are beginning to stabilize, if not modestly improve. However how sustainable is this recovery? Preliminary GDP figures seem to support the rosy sentiment. The US economy contracted by 1% at an annual rate in 2Q09 (in line with the advanced estimate) following a downwardly revised 6.4% contraction in 1Q09. The drastically improved performance was largely driven by a smaller decline in exports and a modest recovery in consumer spending, which increased by 0.6% in 1Q09. These factors helped offset the plunge in inventories (USD113.9 bn) that weighed down heavily on overall GDP. Economists expect that the US economy will return to growth in the current quarter. However, less encouraging is that consumer spending, which accounts for 70% of the economy, registered a 1.2% decline in 2Q09. Given that the crisis is a consumer led downturn, a sustainable turnaround in economic conditions cannot be guaranteed without a recovery in household demand. With unemployment expected to remain high at least throughout 2H09, this seems like a distant prospect. What is certain however, is that sustainable or not, any recovery in the US economy will be very sluggish.

Key Macroeconomic and Capital Market Indicators

	Latest	Next		
Real GDP	2Q09(P) -1.00%	2Q09(f) 30-Sep	Real GDP Growth, Annualized	Benchmark Yields, Annualized
Unemployment	Jul 9.40%	Aug 4-Sep		
A. H. Earnings, M/M	Jul 0.20%	Aug 4-Sep	National Unemployment Rate	Benchmark Equity Indices
CPI Inflation, Y/Y	Juk -2.10%	Aug 16-Sep		
Core PCE, Y/Y	Jun 1.50%	Aug 6-Sep	Target Fed Funds Rate/Core PCE	MSCI US Sector Indices
Existing Home Sales, M/M	Jul 7.2%	Aug 17-Sep		
Housing Starts, M/M	Jul -1.0%	Aug 17-Sep		
Trade Balance, \$bn	Jun -27.01	Jul 10-Sep		
Retail Sales, M/M	Jul -0.10%	Aug 15-Sep		
Industrial Production, M/M	Jul 0.5%	Aug 8-Sep		
Capacity Utilization	Jul 69%	Aug 8-Sep		
Fed Funds Rate	Aug 0.25%	Sep 22-Sep		

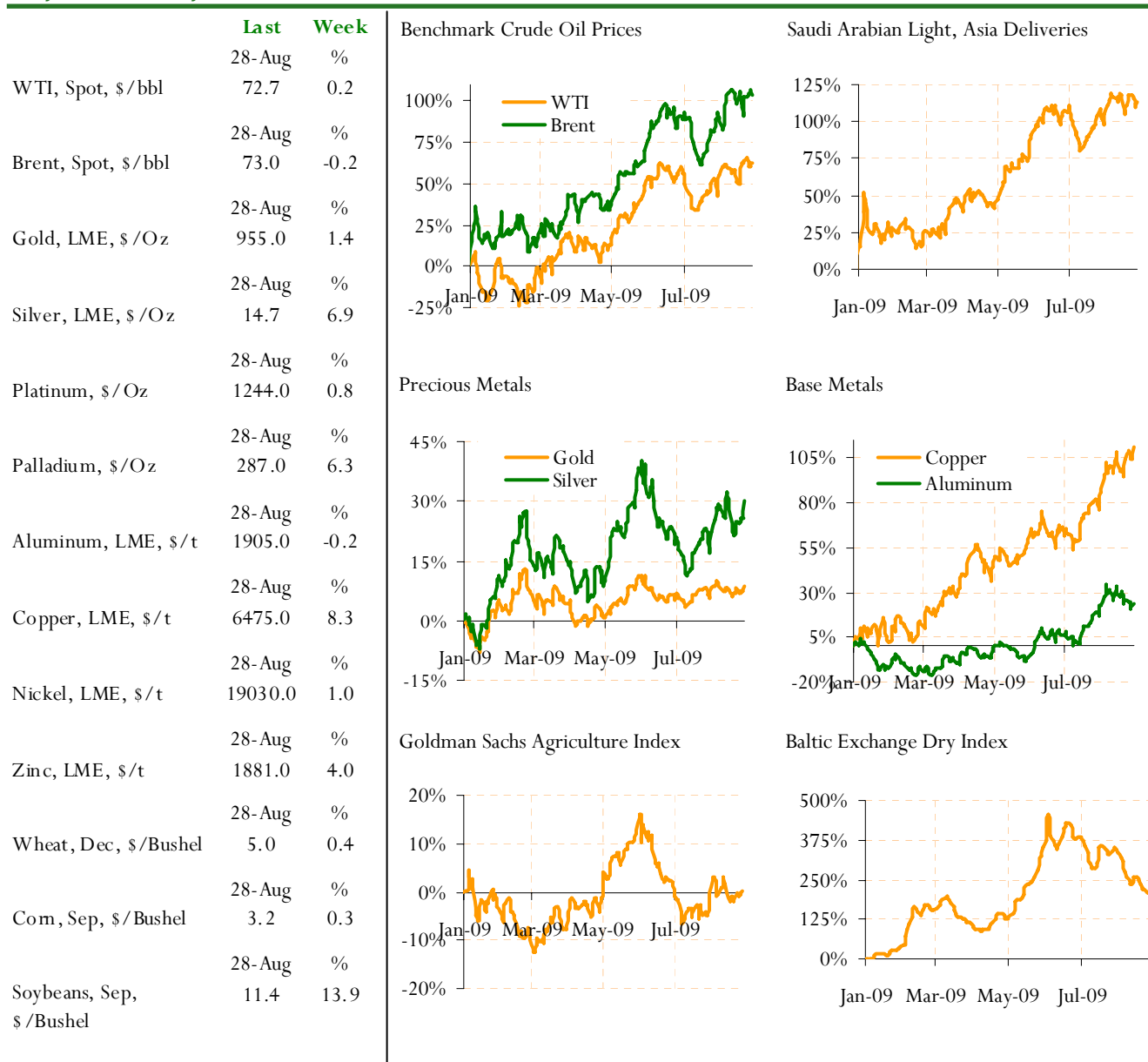
Sources: Reuters, Bureau of Labor Statistics (BLS), and Bureau of Economic Analysis (BEA).

Commodity Markets

Silver Outpaces Gold

In 2008 gold prices rose by 6%, managing to preserve investor wealth and outperform all asset classes besides bonds. Although this safe-haven asset has continued to experience growth in 2009, it is being outpaced by gains in silver futures. Silver spot prices rose by 6.9 % over the week, fixing at \$14.70 an ounce and up 29 % since January. However, gold rose by only 8 percent since January, settling slightly higher over the week at \$955.00 an ounce. This role reversal is mainly due to silver's extensive use in industrial applications. As the overall economic sentiment continues to improve, boosting the risk appetite of investors, a narrowing of the silver-gold price ratio will ensue. Some economists believe that silver is undervalued vis-à-vis gold, thus expecting it to rally further over the short-term. Furthermore, retailers in the GCC, particularly Dubai, claim that silver may recover faster than gold as reports of an increasing trend of local consumers substituting gold purchases for silver are observed. Gold may edge higher later in the year on the back of inflationary concerns and the weakness of the dollar. In the meantime, silver's price growth outshines that of gold.

Key Commodity Prices and Indices



Notes: All variables depicted in the charts above are rebased to 0% in the last trading day in 2008.

Kuwait's Banking Sector: Staging a Recovery

Typically, as with the rest of the GCC, the global financial crisis has relatively impacted Kuwait's banking sector. Nonetheless, owing to the sheltered nature of the sector, conservative bank lending practices and compliance with capital adequacy ratios; banks have entered the crisis with balance sheets strong enough to weather the crisis. In 1H09, sight deposits with the Central Bank of Kuwait (CBK) more than halved to KD308.2 mn, while time deposits showed a moderate increase. This shift in the composition of deposits reflects that local banks now feel less of an urgency to hoard liquidity, reflecting a general calm in conditions. Meanwhile, local interbank deposits on the liability-side have edged lower from KD1248.8 mn in Aug 08 to KD587.7 mn in Jun09, indicative of less stress in the interbank markets. Accordingly there has been some recovery in bank lending, with claims on the private sector increasing by KD534.1 mn in the year-to-Jun. Nevertheless banks remain cautious as their increasing investment in CBK bonds, from KD284.5 mn in Jan to KD463.0 mn in Jun, reveals a still-strong risk aversion. Over time, as economic conditions improve; bank lending practices are expected to further normalize.

Selected Global Macroeconomic Indicators

	Growth*			Inflation*			Policy Rate*			Policy Rate Change
	2007	Last	Period	Last	Date	Target	Last	Decision	Date	Cumulative 09YTD
Europe/Japan/Oceania										
Euro Zone	2.6%	-2.5%	1Q 09	-0.7%	Aug-09	-0.1%	1.00%	Hold	2-Jul-09	E. Zone
UK	3.0%	-1.6%	4Q 08	1.8%	Jul-09	1.8%	0.50%	Hold	9-Jul-09	UK
Japan	2.4%	-3.2%	4Q 08	-2.2%	Aug-09	-1.2%	0.10%	Hold	11-Aug-09	Japan
Australia	4.0%	0.4%	1Q 09	1.5%	Jul-09	1.5%	3.00%	Hold	7-Jul-09	Australia
New Zealand	3.2%	-0.9%	4Q 08	1.9%	Jul-09	1.8%	2.50%	Hold	11-Jul-09	NZ
Latin America /Caribbean										
Mexico	3.2%	-1.1%	2Q 09	6.3%	Nov-08	3.0%	4.50%	-0.25%	17-Jul-09	Mexico
Brazil	5.7%	-1.8%	1Q 09	0.2%	Aug-09	0.3%	8.75%	-0.50%	23-Jul-09	Brazil
Chile	5.1%	-2.4%	1Q 09	7.2%	Dec-08	3.0%	0.50%	Hold	10-Aug-09	Chile
Asia/Southeast Asia										
China	11.9%	7.9%	2Q 09	-1.8%	Aug-09	-1.30%	5.31%	-0.27%	22-Dec-08	China
India	9.0%	5.8%	4Q 08	5.6%	Jan-09	5.50%	5.50%	-1.00%	2-Jan-08	India
Hong Kong	6.4%	1.7%	3Q 08	-0.9%	Jul-09	-0.50%	1.50%	-0.50%	30-Oct-08	H. Kong
Singapore	7.7%	-3.5%	2Q 09	-0.5%	Jul-09	-	-	-	-	Singapore
South Korea	5.0%	2.3%	2Q 09	2.0%	Jul-09	2.30%	2.00%	Hold	9-Aug-09	S. Korea
Indonesia	6.3%	6.1%	3Q 08	3.7%	Jul-09	-	6.75%	-0.25%	3-Jul-09	Indonesia
Thailand	4.9%	-7.1%	1Q 09	-4.0%	Jul-09	-4.10%	1.25%	Hold	15-Jul-09	Thailand
Malaysia	6.3%	4.7%	3Q 08	-1.4%	Jul-09	-1.40%	1.25%	Hold	26-Aug-09	Malaysia
Eastern Europe /Central Asia										
Russia	8.1%	-10.9%	2Q 09	0.6%	Jul-09	0.50%	6.75%	1.00%	28-Nov-08	Russia
Turkey	4.6%	-13.8%	1Q 09	5.7%	Jul-09	-	8.25%	-0.50%	16-Jul-09	Turkey
Middle East/Africa										
Saudi Arabia	3.4%	4.5%	2008	5.5%	May-09	-	2.00%	-0.50%	19-Jan-09	KSA
Kuwait	9.9%	6.3%	2006	11.1%	May-08	-	4.25%	-0.25%	30-Oct-08	Kuwait
Qatar	8.0%	8.5%	2007	14.8%	Mar-08	-	5.50%	Hold	20-May-08	Qatar
UAE	9.4%	5.2%	2007	11.1%	2007	-	1.50%	-0.50%	8-Oct-08	UAE
Oman	7.2%	6.0%	2007	13.2%	May-08	-	2.00%	Hold	20-May-09	Oman
Bahrain	7.9%	6.5%	2006	4.4%	Oct-08	-	0.75%	Hold	21-May-09	Bahrain
Jordan	8.1%	6.2%	2007	13.3%	Jun-08	-	6.00%	-0.50%	25-Nov-08	Jordan
Egypt	6.9%	7.1%	2006/07	21.5%	Sep-08	-	10.50%	-0.50%	30-Jul-09	Egypt
South Africa	5.0%	-3.0%	2Q 09	6.7%	Aug-09	7.90%	7.00%	-0.50%	10-Aug-09	S. Africa

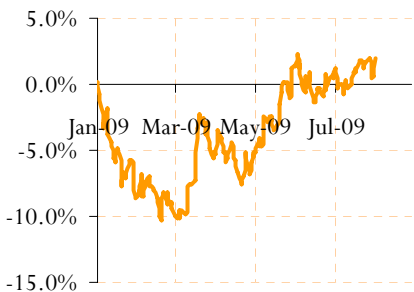
Notes: 1/ Growth: Real GDP Growth Rate, 2007: Y-o-Y % change in full year GDP, Last/Period: Quarterly GDP growth rate annualized unless otherwise indicated. 2/ CPI Inflation: Y-o-Y % Change in CPI, Target: Central bank/monetary authority inflation target. 3/ Policy Rate: Last: Current policy rate, Decision/Date: Decision taken in latest meeting/Date of latest meeting.

FOREX Market

Asian Central Banks Implicit Intervention in Currency Markets

The USD fell to a multi-week low against a basket of currencies over the weekend. The USD trade-weighted index had plunged nearly 12% year to date. This decline in the USD has incited intervention from several Asian central banks worried that the weaker currency could be a further blow to their exports. To improve the competitiveness, the major Asian countries; Malaysia, India and Taiwan are concertedly letting their currencies depreciate after South Korea gave companies an edge by allowing the KRW to weaken 19% against the USD this year. Shipments from South Korea, Indonesia, Taiwan and Malaysia fell 17% to USD79 bn, twice the drop of Apr98 (Asian Financial Crisis). This managed intervention will restore partially the competitive forces in favour of Asian exports. The KRW, INR and TWD declined against the USD by 19.6%, 4.6% and 5.14%, respectively, by the end of Aug09. Much of Asia's economy is geared toward exports, which were hit severely by a drop-off in USA and European demand. The faltering USD had weighed on Asian exports that became more expensive, which necessitated such intervention.

Key Spot Foreign Exchange Rates

\$ per €		Rate versus \$	Last	Week	09YTD
Last 1.4302	Week -0.2%	Europe/Oceania			
09YTD 2.3%		Swiss Franc (CHF)	1.0600	-0.1%	BRL
		Australian Dollar (AUD)	0.8424	0.9%	ZAR
		New Zealand Dollar (NZD)	0.6845	0.2%	AUD
		Latin America /Caribbean			NZD
		Mexican Peso (MXN)	13.2675	-3.3%	CLP
		Brazilian Real (BRL)	1.8825	-2.7%	IDR
		Chilean Peso (CLP)	552.7000	-1.0%	MXN
		Asia/Southeast Asia			TRY
		Chinese Yuan (CNY)	6.8302	0.0%	THB
		Indian Rupee (INR)	48.5500	-0.2%	KRW
		Hong Kong Dollar (HKD)	7.7518	0.0%	CHF
		Singaporean Dollar (SGD)	1.4428	-0.1%	INR
		South Korean Won (KRW)	1,249.60	-0.2%	JOD
		Indonesian Rupee (IDR)	10,055.00	-0.3%	SAR
		Thai Baht (THB)	34.0300	0.1%	QAR
		Malaysian Ringgit (MYR)	3.5230	0.0%	BHD
		Eastern Europe /Central Asia			AED
		Russian Rouble (RUB)	31.6350	0.1%	HKD
		Turkish New Lira (TRY)	1.5005	-0.9%	OMR
		Middle East /Africa			CNY
		Saudi Riyal (SAR)	3.7505	0.0%	EGP
		Kuwaiti Dinar (KWD)	0.2861	0.3%	SGD
		Qatari Riyal (QAR)	3.6415	0.0%	MYR
		UAE Dirham (AED)	3.6731	0.0%	KWD
		Omani Riyal (OMR)	0.3852	0.0%	RUB
		Bahraini Dinar (BHD)	0.3770	0.0%	
		Jordanian Dinar (JOD)	0.7085	0.0%	
		Egyptian Pound (EGP)	5.5320	0.2%	
		South African Rand (ZAR)	7.7750	1.1%	

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