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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

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Executive Summary

- The sharp move higher last week was due to positioning and macro moves than a turnaround to a state of constructive market balances. Crude oil prices continue to reflect weak fundamentals.

- Interest rate differentials should exert downward pressure on emerging market currencies, especially commodity currencies such as the AUD, and those affected by a term-of-trade shock, such as the Mexican and Chilean peso.

- The physical demand for gold recovered in India after the first quarter owing to Summer festivities. Subdued demand in China, on the other hand, emanating from a weaker economic backdrop and a flocking towards equities had adversely capped price appreciation. .

- Despite the residual effects of Iran's nuclear deal, and the re-plunge in the oil market, the Kingdom's internal dynamics are still displaying signs of a positive business cycle; largely the result of adamant expansionary fiscal and monetary policies.

- The landslide in the domestic market wiped out almost SAR500 billion in market capitalization which will deter investors to seek different alternatives. The current muted appetite reflects the weak confidence in the domestic equity market.

- Internal dynamics related to household spending as indicated by the value of retail loans (excluding finance leasing and margin lending), credit card loans, and real estate loans register a moderation to 8.1% Y/Y in H12015, compared to 10.9% Y/Y over the same period last year.

- China's share stands at 11.3% of non-oil exports, valued at SAR 1.7 billion. This marks an annualized downturn of 32.2%, the largest slump since August 2012.

View of the Month

The most recent step forward in technology was the evolvement of "SPAN" into "MADA", the new electronic payment system. The new system will increase reliability and convenience for consumers while reducing costs for business and increasing efficiency. In our opinion, the aforementioned improvements in technology utilization will drive the economy towards a cashless society.

Macroeconomic Indicators

	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	65.0	75.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.0	10.0
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,798.4	2,548.0	2,752.7
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	747.2	680.4	735.0
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.5%	3.5%	2.7%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.3%	2.5%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.5	76.9	-16.8	20.1
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.3%	-2.5%	2.7%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	655.5	633.4
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	741.6	871.0
Actual Expenditure, SAR billion	826.7	873.3	976.0	1109.9	1032.2	980.6
Expenditure Overrun, %	42.5%	26.6%	19.0%	29.8%	20.0%	12.9%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-65.5	-290.7	-109.6
Budget Balance/GDP	11.6%	13.6%	6.5%	-2.3%	-11.4%	-4.0%
Break-Even Oil Price	75.3	73.9	82.6	100.1	91.9	88.2
Financial Sector						
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	13.3%	13.9%	10.9%	11.9%	10.3%	9.5%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	10.4%	9.3%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	0.9%	1.3%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.3%	0.4%	0.7%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	69.5	45.0	60.0

Sources: Thomson Reuters, SAMA, and NCB

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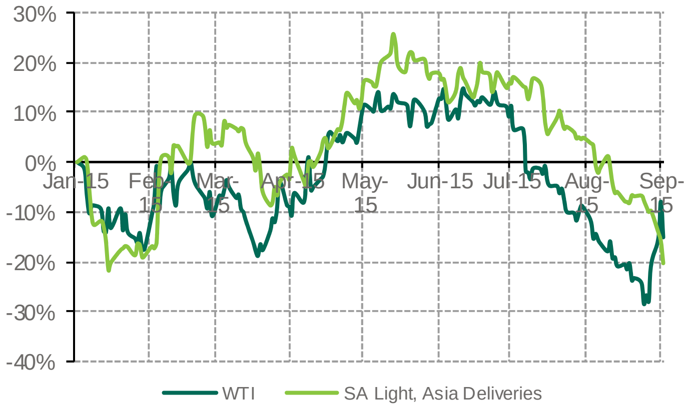
Oil Market

Unbalanced Market Shares Threaten Upturn

Crude oil prices headed for a fourth monthly decline as global supply continued to exceed demand. Brent crude price has fallen 15% this year after falling by 48% in 2014. Brent for October settlement traded between USD48 and USD52 a barrel on the ICE Futures Europe exchange. WTI for October delivery ranged between USD45 and USD48 a barrel on the New York Mercantile Exchange, trading at around USD4.0 discount to Brent. The sharp move higher last week was due to positioning and macro moves than a turnaround to a state of constructive market balances. Crude oil prices continue to reflect weak fundamentals. At present, however, the oil market balances imply a demand-supply surplus over 3mb/d in Q2 15, which is still affecting the third quarter and likely to continue in the remainder of the year. Prices fell again as Chinese manufacturing slowed and US crude stockpiles were forecast to have increased. A drop in a Chinese factory index PMI to 49.7, the lowest in three years, prompted speculation that Chinese economy is slowing. Oil prices are expected to remain at USD40 to USD60 a barrel into 2016, as rising supplies outpace demand.

Chart 1: Oil Price Developments, YTD

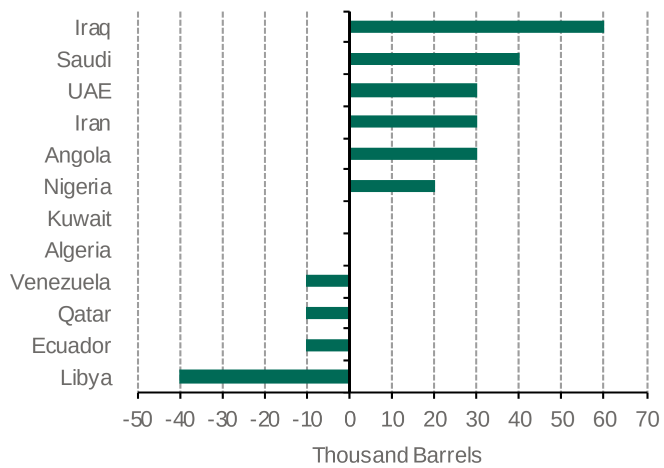


Source: Thomson Reuters

According to its bulletin, OPEC stated that it will not shoulder the burden of strengthening prices by cutting supply on its own, and non-member countries would have to contribute. The group said it will protect its own interests and that there is "no quick fix" for oil market instability. Meanwhile, even if other producers agree to do their part, getting the OPEC members to adhere to a coordinated response will be a problem, especially with Iran seeking to boost output and regain market share as it emerges from the grip of sanction. The group continues to produce above its 30mb/d quota, fueling the over-supply that has driven oil prices lower.

On the supply side, OPEC boosted its production to 32.3mb/d, the 15th straight month the group has pumped above its quota, as Iranian oil production climbed to 2.8mb/d, its highest in 3 years. Iran plans to boost output by 1.0mb/d within five months after sanctions against it are lifted, expected to reach 3.8mb/d of crude by March 2016. Iraq's August oil exports reached 3.1mb/d, while Libya's August crude exports fell to 0.24 mb/d. In the US, drillers showed no signs of letting up even as supply glut persists. The number of active rigs seeking oil in the US increased for a sixth week to 675, the most since the start of May, according to Baker Hughes Inc. The EIA reduced its US crude production estimate for the first five months of the year to about 9.44mb/d, down from a previous estimate of 9.53mb/d. The crude stockpiles in the US were at 450.8 million barrels, about 90 million above the five-year seasonal average, according to EIA.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, the growth of the surplus in the market has come despite a surge in global oil demand growth, rising to 1.7mb/d over H1 2015, compared to 0.8mb/d, in 2014, driven largely by consumer elasticities to lower prices. Nevertheless, strong demand growth has been overshadowed by rising supplies, namely resilient non-OPEC output and 1.5mb/d increase in OPEC supplies since the start of the year. It is likely that the demand growth will hold close to 2mb/d over 2015 and 2016, and thus help the balancing process. Supply adjustments are likely to follow, and the likelihood of a swift reaction is now increasing given the price fall.

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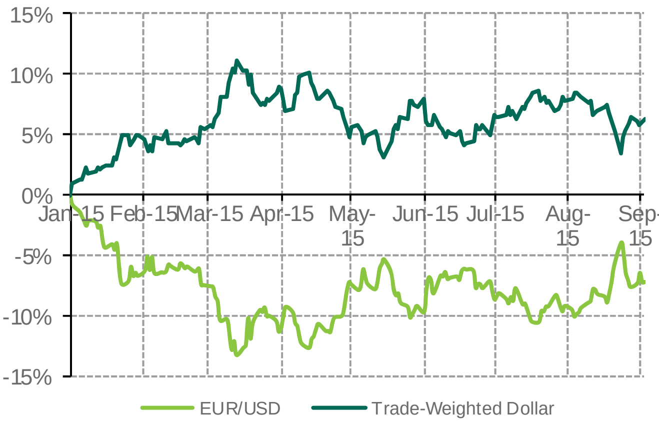
Foreign Exchange

Yuan Devaluation Underpins the USD

Broad-based movements in the currency markets are still in favor of the US dollar. Although a moderation has occurred since Q1 this year, the greenback climbed by 7.8% YTD in July, moving the trade-weighted index to 97.3. In the wake of a stock market crash in China and adverse credit conditions in Greece, fundamentals in the US relative to other markets, encourage market participants to increase their holding of US denominated debt and securities. The looming policy normalization at the Fed is very likely to occur this year as unemployment stood at 5.3% in July, the lowest since April 2008. In addition, the strong Q2 GDP growth at 3.7% feeds the Fed's confidence to go forth. Interest rate differentials should exert downward pressure on emerging market currencies, especially commodity currencies such as the AUD, and those affected by a term-of-trade shock, such as the Mexican and Chilean peso.

Chart 3: Trade-Weighted Dollar and the Euro

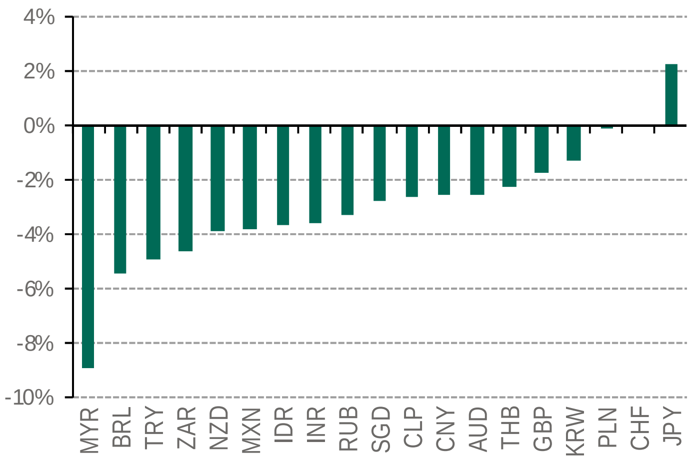


Source: Thomson Reuters

The Euro is still on the defensive, ending July at 1.09 dollars, thus nearly depreciating by 9.2% on a YTD basis. Heightened uncertainty regarding the fate of Greece in the EU largely contributed to the single currency's depreciation since the beginning of the year. While some peripheries such as Spain, Ireland, and Portugal have made some meaningful progress towards fiscal reform, a Greek default would ripple negatively across the union, reducing growth outlook to about 1.5% this year. Headline inflation in the Euro Area was recorded at 0.2% in July, marking the third consecutive month of above zero inflation. Although indicators show that the second and third quarters (expected) are technically better than the first, which was deflationary, the current pace of inflation growth does not rule out the risk of more deflation.

The disparity in the inflation outlook between the US and the Euro region drives divergence in borrowing costs in favor of the USD, making it difficult for the ECB to stimulate demand for the euro despite its easy monetary policy. In the UK, growth is poised to stand at 2.5% for Q2 as the sustained momentum from wage gains is expected to last through year-end. However, until base effect from energy prices pushes inflation above 0%, it is unlikely that the Bank of England will begin its tightening cycle this year. Hence, the GBP's rally which started in April may fade on the back of delayed monetary tightening. By the end of July, the pound sterling had reached USD1.56, erasing this year's losses, and edging up by 0.3% YTD.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In China, policymakers are moving ahead with structural reform towards more interest rate liberalization as market-determined rates are a prerequisite for joining the IMF's unit of account, the Special Drawing Rights (SDR.) The inclusion of the renminbi in the IMF's reserves is a new hallmark for the China as it is the first emerging market currency to join the IMF's basket. This opens new possibilities for the country as a major economic player which could have an influence in the global lender's decisions in the future. The tightly controlled currency was heavily affected by the dollar's appreciation in the past months due to its crawling dollar peg. Surprisingly, however, China allowed its currency to devalue by 2.8% on August 12th to 6.38/USD, the lowest in two decades on the back of weak trade figures, and cut its benchmark one-year lending rate by 25bps to 4.6% on August 25th in order to stimulate the waning economy.

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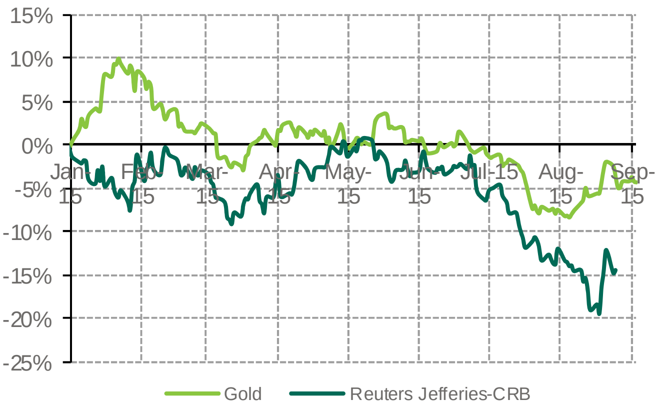
Commodities

Chinese Equity Support Pressures Gold

Commodity prices were under fire in July from multiple facets; the Greek debt situation which is yet uncertain, the sharp correction in China's equity markets which fell 32% from peak to trough, the eventual return of the Iranian oil export market. The immanent lift-off of Fed's fund rate this year has been reinforcing bullish sentiment in favor of the USD. In addition, lower-than-expected bullion purchases by China and the import ban in India are working against gold's appreciation, suppressing it at 5-year lows. By the end of July, the Reuters/Jeffries Core Commodity Index stood at 202.57, falling by 11.9% YTD.

Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

After metals rallied briefly in April amid falling stocks, rising seasonal demand and some supply shortage, prices of metals, namely base metals, resumed sharp declines during the remainder of the quarter. Concerns over China's faltering demand, the sell-off in the Chinese stock market and renewed dollar strength have all pinned-down base metal prices. Weakness in Chinese construction, infrastructure spending, and manufacturing directly impacted demand for copper, which by the end of July had fallen by 17% YTD, standing at USD 5,230/ton. Despite falling LME inventories of aluminum which resulted from world-wide smelter closures, the faltering demand in China pushed prices down 12.7% YTD at USD1,618/ton. Nevertheless, aluminum's diversified use across sectors will keep it in deficit outside of China, thus providing an upturn potential going forward. Downside risks include a continued slower demand in China, tighter environmental constraints, and systemic risks such as producer currency devaluation.

Bullion prices declined on low investment demand as US interest rate hike expectations dampened investor sentiment. Despite a strong start this year, gold dropped 7.5% YTD by the end of July, to USD1095.9/oz, the lowest level since 2010. The initial fall contemporized with the news of the ECB's quantitative easing, followed by a looser monetary policy in China and the emerging market. The US interest rate increase will be a key negative driver for gold prices as investor seek yield-bearing assets. The physical demand for gold recovered in India after the first quarter owing to Summer festivities. Subdued demand in China, on the other hand, emanating from a weaker economic backdrop and a flocking towards equities had adversely capped price appreciation. Falling production costs in gold-producing countries in Asia, Latin America, and Africa was supported by depreciating currencies, resulting in a surge in supply. We expect, however, that falling producer profitability will impede future capital expenditures, and hence, the growth in supply.

Chart 6: Base Metals

Source: Thomson Reuters

Agricultural commodities rallied by late June on the back of supply concerns caused by an adverse El-Nino effect, leading the Goldman Sachs Agriculture Index to edge up by 1.3% YTD. The gloomy scenario did not materialize, however, removing support from the index which tumbled back a month later by 12% YTD, standing at 285.97. Grain prices continued their broad-based declines in July, led by wheat which nose-dove by almost 17.4% YTD at cents 499.25/bushel. Corn futures followed downward trending, plummeting by 10.7% YTD at cents 371/bushel. Soybean futures were least impacted as oversupply concerns were not as founded. The extent of price fall in Soybean futures was around 6.4% YTD, standing at cents 953.25/bushel.

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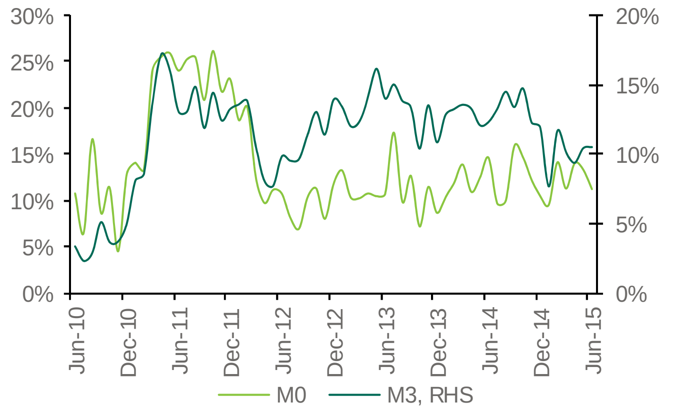
Money & Inflation
Money Demand Holds Despite Fiscal Deficit

In the month of June, broad money supply (M3) rose by an annualized 10.5%, indicating continued expansion of economic activity. Despite the residual effects of Iran's nuclear deal, and the re-plunge in the oil market, the Kingdom's internal dynamics are still displaying signs of a positive business cycle; largely the result of adamant expansionary fiscal and monetary policies. Although the pace of annual growth has been in deceleration since the beginning of the year, low inflation and abundant fiscal buffers will continue to support the banking system with ample liquidity. By the end of the second quarter, the Kingdom drew down about USD60 billion from its USD732 billion reserve assets this year, covering around 42% of its budget deficit. Moreover, for the first time in eight years, the government is also expected to issue local bonds worth USD30.7 billion (SAR115) through the second half of 2015 to cover around a third of the deficit. The Kingdom is capable to withstand external shocks with its globally lowest debt/GDP ratio of 1.6% in 2014 and massive foreign reserves.

Chart 7: Growth in Monetary Aggregates

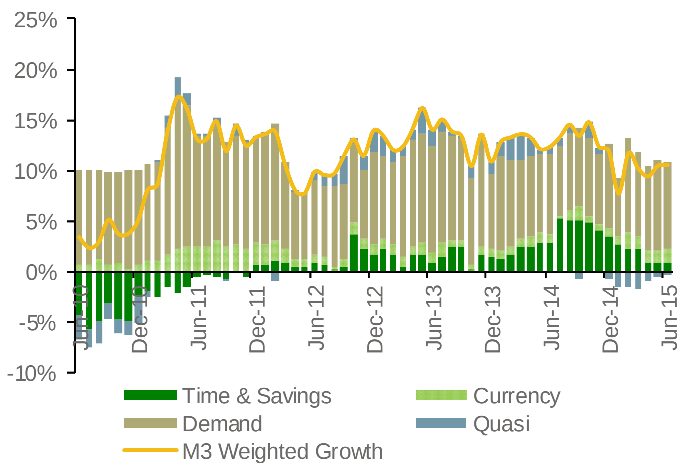


Sources: SAMA and NCB Estimates

The monetary base grew by 11.2% Y/Y, thus reaching SAR313.3 billion. Currency outside banks was the main contributor to the upturn as it surged by 14.9% compared to the same period last year, reaching SAR174.1 billion. The second largest contributor to the growth in the monetary base is deposits with SAMA which rose by 4.2% to SAR107.4 billion, affected by a 48.2% plunge in deposits of public financial institutions down to SAR6.6 billion. On the other hand, deposits of local banks continued to surge, reaching SAR100.8 billion, marking an annualized upturn of 11.6%.

Looking at the money supply, near money (M2) surged by 12.4%, supported by strong growth in its main components, narrow money (M1), and time deposits. Among the most liquid components of the money supply, M1, demand deposits dominate around 86.2%, and make up around 59.5% of the broadest measure, M3. Demand deposits soared by 15.3%, reaching SAR1.08 trillion by June. It is worth-noting that about 92% of demand deposits are owned by businesses and individuals whom preference for cash and its equivalents outweighs that for low-yielding time and saving accounts. That being said, the relative moderation in economic activity last year had resulted in a lower need for cash on stand-by, mainly by government entities, leading to a record growth in time and savings of 23.2% mid-2014. Government entities deposits, which constituted over 57.5% of these deposits at the time reached record highs of SAR229.4 billion by year end. Although government entities are still the growth driver for this type of deposits, they recorded the first annualized decline in June by around 5.4% to SAR195.7 billion, and their share has been reduced to 52.5%.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The inflationary situation in the Kingdom remains subdued at an annualized 2.2%. Renewed bouts of declining food and energy prices added a downward pressure on imported goods, while the stronger dollar subsequently increased the Saudi riyal's purchasing power. Food prices in the Kingdom rose 2.2% Y/Y, affected by a 15.7% surge in fish and seafood prices. Housing and utilities recorded a 3.6% upturn from last year, mainly due to a rise in two of its components, rent and home renovation by 4.8% and 4.2%, respectively. We expect headline inflation to remain at remain between 2.0%-2.5% throughout the remainder of the year.

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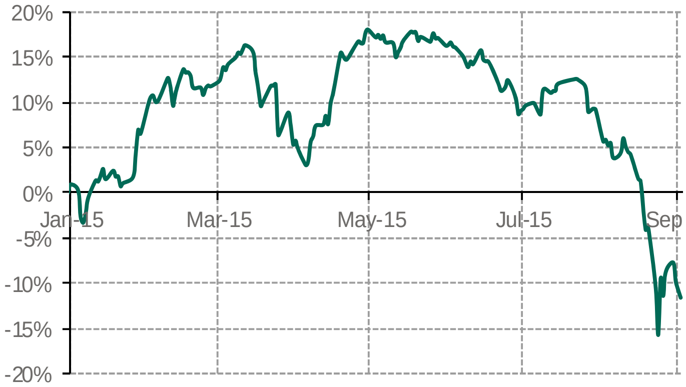
Capital Markets
Domestic Free Fall

Stocks have been a lucrative asset class over the past three years. According to the MSCI World index, equities gained 13.4%, 20.2%, 2.1% during 2012, 2013, and 2014, respectively. The global financial crisis provided investors with cheap prices for long-term investment horizons. As business activities recovered and continued to rise, so did stock prices. The Dow and S&P500 reached record highs earlier this year. The stock market in the second largest economy, the Shanghai composite, peaked in the first half of 2015 with a rise of almost 60% to surpass 2014's 52.9% gain. However, the anticipation of normalization in the US, weakening Chinese growth, and suppressed commodity prices triggered a landslide in Chinese stocks which capped all of this year's gains by the end of August, losing 0.9% YTD. The Chinese government intervened through various measures ranging from suspending over 1000 stocks to allowing pension funds to cutting their benchmark interest rate and devaluing the Yuan peg. The downfall rippled through global equities as stocks in the US, Europe, and Asian markets suffered substantial losses. The US VIX index, which represents sentiment and market volatility over the next 30-day period, climbed to 40.74 last week during the peak of volatility, the highest since October 2011.

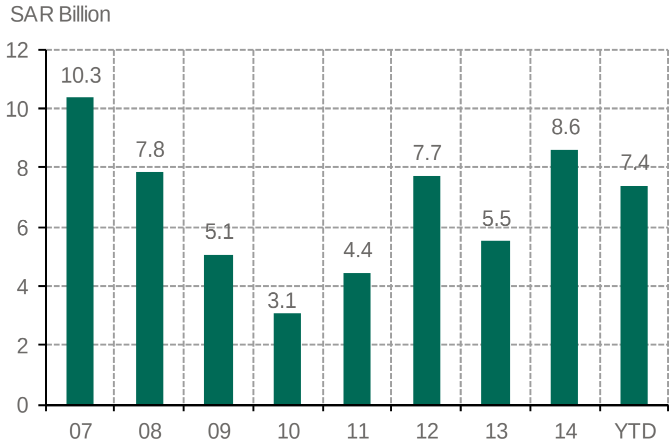
Chart 9: Tadawul All-Share Index



Source: Tadawul

The Saudi stock market has been experiencing low activity for the past 3 months which started during Ramadan. The seasonal drop in trading continued to pressure the market and gradually dragged the index lower. Additionally, the persistently low oil prices and increased global risk averseness led to the wide sell-off in the domestic market. The bearish momentum dragged the index to as low as 6'920.96 during August, the lowest level in over two years. However, the market rebounded on the back of global optimism which led the market to end last month at 7'522.47, a monthly drop of 17.3%. All sub-indices posted losses during August, the worst performer was the Media sector dropping by 34.0% followed by the construction sector with a loss of 26.3% M/M. The smallest drop was recorded by the energy and banking sectors, declining by 9.9% and 14.1%, respectively.

Chart 10: Average Daily Traded Value



Source: Tadawul

The average daily traded value volumes increased from SAR4.7 billion in July to SAR5.3 billion during August, yet it remains much lower than first half of 2015's average of SAR8.2 billion. During last month, daily trading reached as low as SAR2.9 billion, the lowest since September 2014. The landslide in the domestic market wiped out almost SAR500 billion in market capitalization which will deter investors to seek different alternatives. The current muted appetite reflects the weak confidence in the domestic equity market. However, despite weakening corporate profitability announcements on the back of a slowing business cycle and cheaper commodity and energy prices, stocks are providing lucrative long-term investment opportunities. The price-to-earnings ratio dropped to the 13-14x range after peaking above 19x a few months ago. We expect the domestic market to remain volatile and susceptible to external shocks in the short-term as global volatility has intensified lately.

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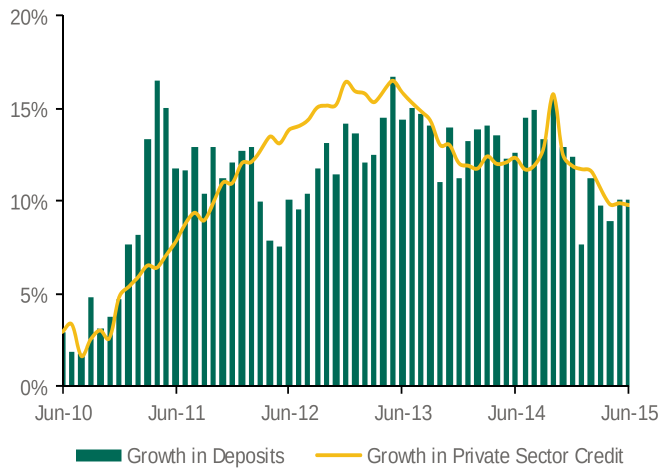
Loans Market

Lower Deposits Affect Credit Growth

The consolidated balance sheet of Saudi banks for the month of June shows that total bank credit to private and public sectors (excluding T-bills and government bonds) reached SAR1.32 billion, surging by an annualized 8.9%. This rate of growth marks the largest deceleration since September 2011, and is due to a single-digit growth in private sector credit which accounts for 96.9% of total bank credit. Bank credit extended to the private sector rose by 9.8% Y/Y in June, standing at SAR1.28 trillion, whereas public sector credit contracted by 9.2% in the same period. The Kingdom is expected to pass a short-term moderation phase owing to the fiscal challenges stemming from lower oil returns. Internal dynamics related to household spending as indicated by the value of retail loans (excluding finance leasing and margin lending), credit card loans, and real estate loans register a moderation to 8.1% Y/Y in H12015, compared to 10.9% Y/Y over the same period last year. Retail loans which include loans for renovation and home improvement, vehicles and transport means extended by Saudi banks in 2015 totaled SAR627.8 billion by the end of 2Q, up by 4.7% Y/Y. Over the same period, total fresh consumer credit card loans reached SAR19.2 billion, surging by 10.8% Y/Y. On the other hand, new retail real estate loans by banks totaled SAR193.7 billion by mid-2015, surging by 20.2%.

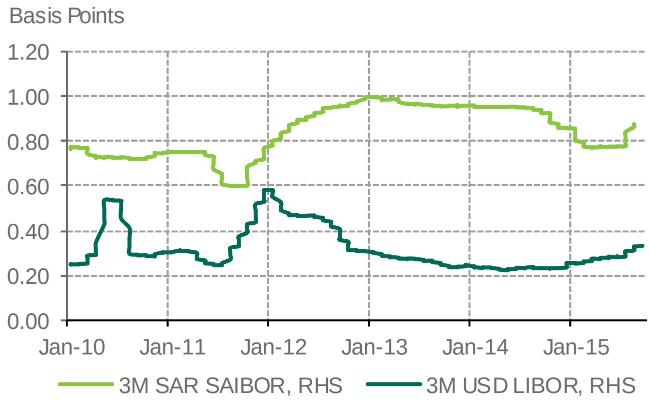
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Bank credit classified by economic activity shows that 20.5% of credit in the first half of the year was commerce-related, while 12.5% was related to manufacturing and processing, and 7.2% went into building and construction. In value terms, bank credit for commercial purposes was valued around SAR532.5 billion, surging by 11.7%Y/Y. Credit for manufacturing and processing reached SAR326.4 billion while credit for building and construction totaled SAR182.7 billion, leading to annualized growth rates of 8.2% and 12.3%, respectively.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Banks loans portfolio continue to move in response to the expansion in their depositary base which has been in deceleration since the beginning of the year, falling to lower double-digit growth. The annual growth in deposits recorded a 10.1% Y/Y upturn in June, below last year's average of 13.7%. Growth in deposits is largely influenced by growth in demand deposits, which account for 65.8% of deposits in Saudi banks, standing at SAR1.1 trillion. The second largest deposit type is time and savings which constitute 22.7% of deposits at SAR373 billion. In June, demand deposits posted growth of 15.7% Y/Y, while time and savings rose 3.5% Y/Y. The drawdown of reserves and excess liquidity led to diminishing deposits of time and savings as the government rebalances its fiscal position. Banks, however, maintain high liquidity levels as loan/deposit ratio is at a high 80.1%. Looking into loans by maturity, we note that short-term loans account for 51.7% of Saudi banks' portfolio, while medium and long-term loans account for 17.4% and 30.9%, respectively. This high capacity utilization and long-term horizon indicate optimistic views on the Saudi monetary situation despite the turmoil in the oil market. The interest rate environment remains low as the 3-month Saudi Interbank Offered Rate (SAIBOR) remains at 77 bps, which is lower than last year's average of 97 bps. However, we expect to see a rise in SAIBOR in the short term as lesser liquidity resulting from the development bond purchases may tighten credit availability for some banks.

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External Trade

Trade Activity Subdued by Global Qualm

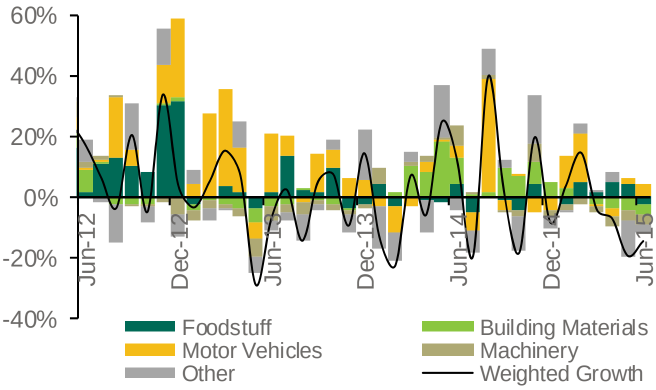
The kingdom's external trade in the month of June displayed further moderation, affected by persisting economic perils in major trade partners; such as China. The People's Bank of China's decision to weaken its national currency, the renminbi, is aimed at boosting its export advantage while the trade-off of the devaluation would be lesser imports. The world's second largest economy reaffirmed its push for export competitiveness after five consecutive rate cuts that took place between November 2014, and August 2015, bringing its benchmark one year lending rate from 6 % to 4.6%. That being said, endogenous factors such as lower commodity prices and a stronger dollar have had an adverse effect on the Kingdom's trade bottom-line. In the month of June, Saudi non-oil exports tumbled 21.1% compared to the same period last year, registering around SAR15.4 billion in value terms. Tonnage-wise, total non-oil exports during the month weighed around 4.1 million tons, a reduction of 11.1% Y/Y. On the other hand, imports recorded the third month of annual decline at 9.9%, posting a total SAR57.5 billion. Imports by weight also edged lower, albeit by a mere 1.8% Y/Y to 6.6 million tons, benefitting from the resilient local demand, in addition to low imported inflation.

Chart 13: Saudi Non-Oil Trade Balance

Sources: SAMA and NCB

The composition of Saudi non-oil exports consist mainly of chemical products and plastics accounting for 32.2% and 31.9% of total non-oil exports by value. Due to the high correlation these categories have with the oil market, dwindling oil prices impacted their returns as they have subsequently fallen in prices. The slowdown in China, Saudi Arabia's largest export market, has also affected demand negatively. In June, exports of chemical products fell to SAR4.95 billion, down 27.5% from last year. Plastics tumbled by a similar magnitude, trimming 21.8% of annualized returns at SAR4.9 billion. Exports of base metals which make up around 8.7% of the non-oil exports' composition slid 3.9% Y/Y, standing at SAR 1.3 billion. The non-oil export market relies mostly on demand from the UAE and China, and Singapore. UAE's share of the Kingdom's non-oil exports was 12.8% in June, although at SAR1.96 billion, it is down by 14.2% Y/Y in value terms. China's share stands at 11.3% of non-oil exports, valued at SAR 1.7 billion. This marks an annualized downturn of 32.2%, the largest slump since August 2012. Non-oil exports to Singapore slimmed down by a quarter in June, standing at 0.9 billion, thus accounting for 6.4% of total non-oil exports.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the import side, machinery and electrical equipment account for 28.2% of the import bill, totaling SAR14.4 billion in the month of June. By annual comparison, imports of this category declined by 3.7% as imports from Asia and the Eurozone countries become relatively cheaper. Imports of transport equipment inched down by 1% to SAR 8.5 billion. Meanwhile, imports of base metals, which make up around 9.8% of the import bill, saw the largest decline of any category, tumbling by around 34.9% Y/Y to SAR5.1 billion. The main sources of imports to the Kingdom are China, the US, and Germany, with each respectively accounting for 15.1%, 14.1%, and 6.6%. Imports from China shrunk in value by 5.8% Y/Y, standing at SAR7.9 billion, whereas imports form the US posted an upturn of 6.6% to SAR7.3 billion. German imports recorded the largest slump in value terms, declining by 29% Y/Y to SAR3.4 billion.

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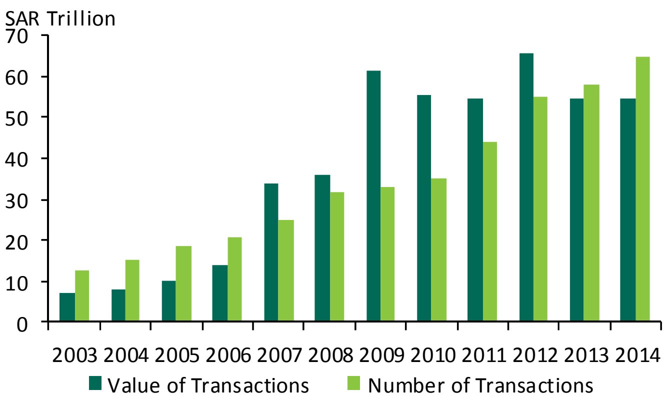
Special Focus:
Technological Banking System

The pace of technological advancement continues to play a huge role in the development of the banking landscape and in turn, the overall macroeconomic environment. By providing more efficient ways for banks to compete and undertake their operational activities, technology had increased the speed of business and consumer transactions, which was an element in improving the absorptive capacity of the Saudi economy. The five parameters for the domestic utilization of technology include the Saudi Arabian Riyal Interbank Express System (SARIE), SADAD bill payment system, the banks' clearing system, Automated Teller Machines (ATMs) and Points of Sale (POS) terminals

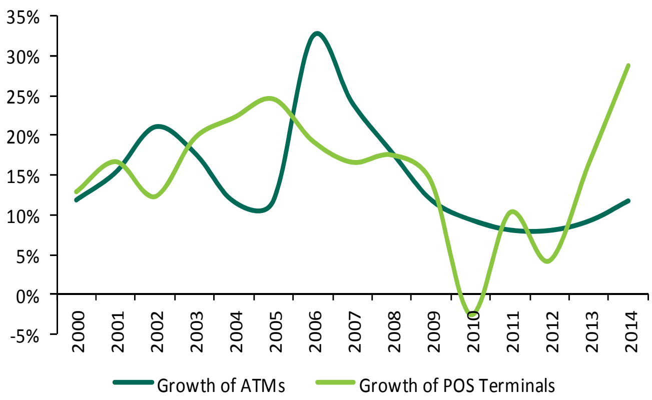
Table 15: SARIE System Transactions



Source: Thomson Reuters

In terms of value, SARIE system, which commenced on May 14th 1997, is the largest of these channels, with transactions that amounted to SAR54.5 trillion by the end of 2014, a substantial increase from a mere SAR8.0 trillion ten years ago in 2004. Volume-wise, the number of transactions conducted via SARIE more than quadrupled during 2004-2014, reaching 64.6 million transactions. The relatively new SADAD system that became operational on October 4th 2004 had exhibited similar growth trends. In 2014 the payments' value through SADAD increased to SAR187.3 billion, growing by an annual 9.4%. The volume of bills paid through SADAD also rose to 154.6 million last year from 147.0 million in 2013. It is important to note that SADAD was instrumental in reducing the front-office burden on banks and the manual labor associated with these paper-based transactions, given the fact that around 70% of the bills pre-SADAD were paid in cash. An additional channel is banks' clearance of commercial, personal and interbank cheques, which has been experiencing growth deceleration given the advancements in technological alternatives. The total value of cheques cleared between banks, commercial, and personal has reached SAR897.4 billion. Meanwhile, the number of cheques cleared has posted declines in 2013 and 2014 at 3.3% and 4.5%, respectively, given the aforementioned reasons.

Table 16: ATM and POS Growth



Sources: Thomson Reuters

The last two channels that encompass ATMs and POS are largely used as proxies for measuring retail activity as well as technology penetration in the economy. Cash withdrawals from ATMs had remarkably increased from SAR200.4 billion in 2004 to around SAR722.0 billion in 2014, an indication that people are relatively at ease with the use of technology and less dependent on branch visits to meet their liquidity needs. Meanwhile, POS transactions that are an integral part of a cashless economy are quickly gaining ground. Apart from 2009, the value of sales through POS has been posting double -digit growth rates since 1996, reaching SAR169.9 billion in 2014. Additionally, POS transactions grew by 23.3% Y/Y last year, thus, maintaining its 5th consecutive annual double-digit growth since 2010. The most recent step forward in technology was the evolvement of "SPAN" into "MADA", the new electronic payment system. The new system will increase reliability and convenience for consumers while reducing costs for business and increasing efficiency. In our opinion, the aforementioned improvements in technology utilization will drive the economy towards a cashless society.

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