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NCB الأهلي

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

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Executive Summary

- In June, Iran pumped 2.85mb/d, compared with an average of 3.63mb/d in 2011, the year before the imposition of western sanctions. After the removal of sanctions, following the UN Security Council that unanimously approves Iran nuclear agreement, crude production is expected to rise to full capacity of 3.5mb/d by the end of 2016.

- We expect the euro to maintain a weakening bias against the dollar as the ECB's massive asset-purchases and negative deposit rates will continue to weigh on the currency, although shifts in investor sentiments may lend brief support.

- Despite two interest rate cuts in three months and the removal of property restrains, Chinese imports of base metals will remain impacted significantly by lower growth projections as GDP rose 7% in the first quarter, the lowest rate in a decade.

- The rapid declines in global energy prices, in addition to a stronger dollar lowered imported inflationary pressures. This is evident as the largest category in the consumer basket, foodstuff, only rose by 1.4% Y/Y. Housing and utilities rose by 3.1%, below last year's average of 3.5%.

- Tadawul's trading continues to be majorly attributed to Saudi individuals, however, institutional trading has been on the rise as declining prices provide a lucrative long term investment.

- The Analyzing banks' credit activity shows that with the current pace of growth in deposits, the loan/deposit ratio is at a healthy 79.3% as of May. Such level of capacity utilization indicates a low risk environment despite looming US Fed rate hikes and Saudi fiscal challenges.

- Save unusual spikes such as that which occurred last year in August, we expect LCs to grow modestly on a Y/Y basis, supported by the sharp declines we saw last year.

View of the Month

The Greek government has pledged to meet the requirements by mid-August to meet their next payments. For now, the possibility of a "Grexit" has been sidelined and the third Greek bailout is much needed to ensure Greece, at least, remains in the currency bloc and avoid deepening their crisis.

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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

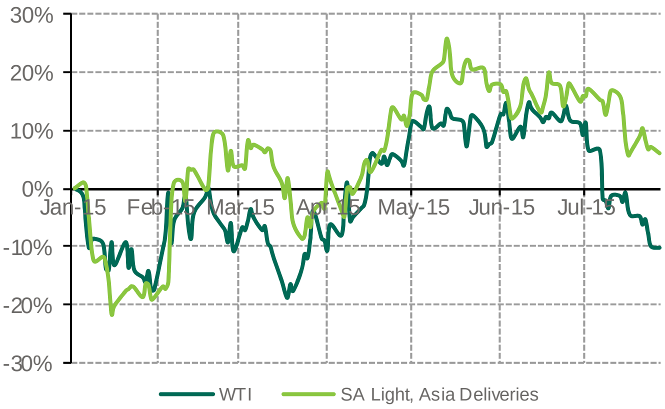
Sources: Thomson Reuters, SAMA, and NCB

Oil Market

Oversupply Theme is Far from Over

Brent crude price is up 15% from 1Q 15, but still low in absolute terms, averaging USD 61.9 a barrel in the 2Q15. Oil price's rebound from a six-year low in March has faltered again on signs a global surplus will continue. Brent crude price fell recently to around USD56.0 a barrel on the ICE Futures Europe exchange as increased production from the Middle East to the US expanded supplies. WTI crude price closed last week 20% below the peak reached in June, meeting the definition of a bear market, to settle at around USD48.0 a barrel on the NYMEX. The continued headwinds facing the oil markets signifies that rebalancing, which started when oil markets set off on its initial 60% price drop last June, has yet to run its course. Supply growth has continued unwavering, as surging OPEC output has come at a time when US shale oil supplies are still proving to be resilient despite the lower oil prices, and the same time world oil demand growth remains muted. The US shale oil is demonstrating more flexibility in terms of capital cost and production, running counter to the perception of investors, who largely see shale oil occupying the high end of the cost curve. Accordingly, as oil prices rebound, so will investment in the shale oil.

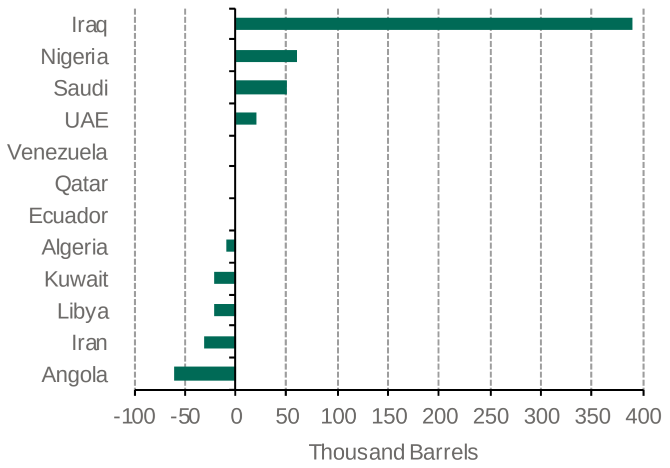
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, crude output in the US slipped marginally to 9.56mb/d in the week ending July 17, according to EIA. Oil rig counts, according to Baker Hughes, were down 7 to 638 rigs. Moreover, US Crude inventories rose 2.5 million barrels in the week ending July 17 to reach 463.89 million barrels, 100 million barrels above the five-year seasonal average for this week. Iran exports so far in July are 0.860mb/d, while its production is forecast to rise from March next year, expanding by 0.6mb/d by the end of 2016, as shut-in wells are reopened. In June, Iran pumped 2.85mb/d, compared with an average of 3.63mb/d in 2011, the year before the imposition of western sanctions. After the removal of sanctions, following the UN Security Council that unanimously approves Iran nuclear agreement, crude production is expected to rise to full capacity of 3.5mb/d by the end of 2016. However, incremental oil will likely enter the market in April of 2016, as Iran seeks to regain its lost market share. This would add to the record production from Saudi Arabia and Iraq, as Saudi Arabia produced 10.56mb/d in June, exceeding a previous record set in 1980, while Iraq boosted its production to 4.38mb/d last month, the highest level in records dating back to 1985. According to IEA, the Global markets remain massively oversupplied.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, OPEC forecasts incremental world oil demand to outpace projected non-OPEC supply and OPEC NGLs, resulting in demand for OPEC crude at 30.1mb/d, a projected increase of 0.9mb/d over the current year. This would imply an improvement towards a more balanced market in 2016, according to OPEC. Although low oil prices should support global growth, high debt levels in OECD countries, high unemployment rate in the Eurozone, expectation of rising interest rates in the US, and a slowing economy in China, these factors will present downside risks to OPEC's forecasts. Meanwhile, crude oil imports in China, the world's biggest energy consumer, declined 11% in May from a year earlier, according to the Beijing-based Customs General Administration, and also its shipments from Saudi Arabia fell 18% over the same period to the lowest level since August 2012.

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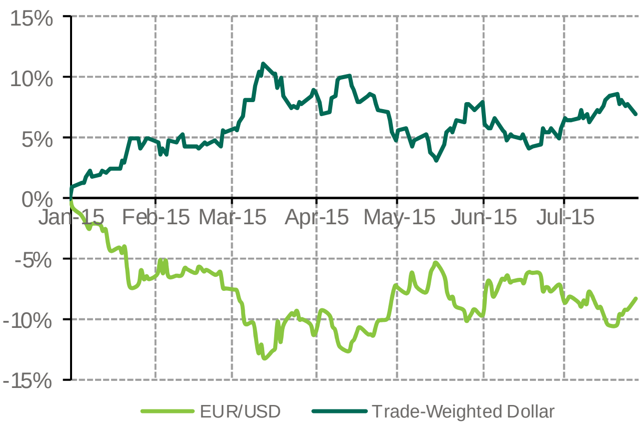
Foreign Exchange
EUR Finds Floor After Greek Deal

Although the trade-weighted USD softened during June by around 1.5% to 95.5 on the back of delayed monetary policy unwinding, strong short-term economic data, and technical drivers allowed it to resume the bullish trend. We expect the world's reserve currency to remain in favor in the months leading to the Fed's gradual process of monetary policy normalization, provided that the Fed maintains reasonable confidence that inflation will reach its 2% target over the medium term. The rise in shelter cost helped push core inflation by 1.7% in May over the previous year, allowing the Fed to stay on track for policy normalization this year. Support for the USD will also come from other fundamental factors such as risk aversion in the Eurozone and Emerging Markets. The unemployment rate in the US edged down to a new post-crisis record of 5.3% in June, the lowest since April 2008. Moreover, non-farm payrolls registered the creation of 223,000 jobs in the same month, beating market expectations. These data points firmed the dollar's position against a basket of other major currencies, increasing the likelihood of its appreciation above May's high point of 97.4.

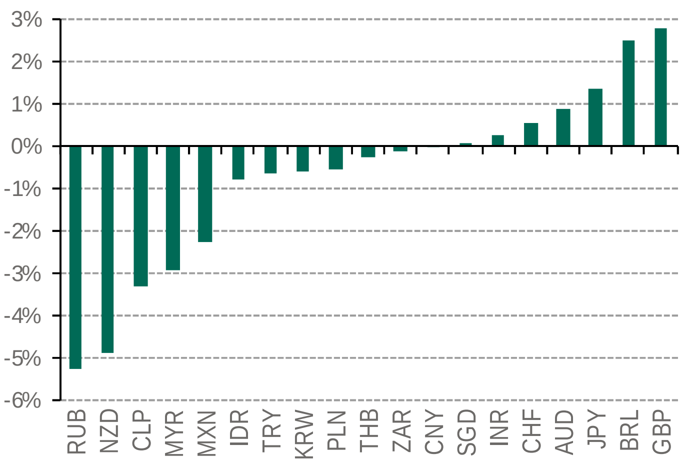
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The Euro was placed on the defensive after a brief respite in June in which the currency appreciated by 1.4% M/M. The ECB's aggressive QE is rejuvenating growth drivers in the Euro Area, and is pushing inflation out of the first quarter's negative territory to 0.2% in June. Despite the shaky landscape for the Euro whereby the union still lacks a uniform position towards Greece, and lags behind in many of its structural reforms, the single currency carved a bottom between April and May, indicating lesser exposure to Greece's credit conditions. The upturn from the EUR/USD pair at 1.057 marked a floor from which the establishment of trade patterns with the Swiss franc and the Russian ruble became easier. The EUR rallied by over 9% from its mid-March lows, peaking at USD1.145 mid-May before resuming a bearish trend. We expect the euro to maintain a weakening bias against the dollar as the ECB's massive asset-purchases and negative deposit rates will continue to weigh on the currency, although shifts in investor sentiments may lend brief support.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The Japanese yen remained on a depreciating trend throughout the year on the back of monetary policy divergence, interrupted by global risk aversion-induced strength. By the end of June, the yen traded for JPY122.5/USD, inching up by 1.4% from May. Fundamentals remain soft as the Bank of Japan struggles to meet its 2% inflation target given low global energy and commodity prices, and economic performance is still impacted by the April 2014 tax hike which stemmed much of the upside potential for price levels. The accommodative monetary policy for the Bank of Japan will need to be prolonged and be more aggressive in order to pin down the JPY amid global risk aversion. We expect the yen to trade between 119 and 123 per USD in the coming months, with a possibility to reach JPY125/USD by year end.

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Commodities

Metals Slide on Weak Economic Backdrop

Cheaper energy prices and a stronger USD are exacerbating the downward pressure on commodities. Price forecasts of all industrial metals are cut amid China's softening demand. As the world's top consumer of copper and other bulk commodities extends its biggest annual slump yet since the Financial Crisis. According to the Chinese General Administration of Customs, imports of copper in June tumbled the most in four years to 350,000 metric tons, a decline of 11% Y/Y. Despite two interest rate cuts in three months and the removal of property restrains, Chinese imports of base metals will remain impacted significantly by lower growth projections as GDP rose 7% in the first quarter, the lowest rate in a decade. The Flash China Manufacturing PMI for June recorded 49.6, indicating further deterioration in operating conditions. Softer internal and external demand coupled with job cuts by many Chinese manufacturers are behind the dismal outlook on industrial output. Excluding energy prices, the Reuters/Jeffries CRB Index recorded 233.3 by the end of June, indicating that non-oil commodity prices have fallen about 4.3% since the beginning of the year. On the other hand, concerns over excessive moisture in the US Midwest induced a rally in soft commodities futures propelled the S&P Goldman Sachs Agricultural Commodity Index to 326.6 by the end of June, edging up by 1.3% YTD.

Chart 5: Reuters Jefferies vs. Gold

Source: Thomson Reuters

LME copper prices dipped to its lowest price since February of USD5,654/ton, before moderating slightly, concluding the month at USD5,765/ton, sliding by 8.5% YTD. The slowdown of China's property market and stock market crash is expected to elongate the negative cycle, possibly pushing the metal to trade at the USD5,500/ton level. In like-manner, after a respite early May, aluminum extended a downward trend, reaching its lowest point this year by the end of June, trading at USD1,691/ton, sliding 8.7% YTD. The LME inventory movement in June was flat compared to the previous month, closing at 323.5 thousand tons of copper, and 3.5 million tons of aluminum. After gold's brief rally mid-May on the back of uncertainty over Greece's prospects, prices remained unchanged in June. The range-bound price movement will continue to be predicated by risk aversion in Europe and interest rate speculation in the US. In the month of June, spot gold traded narrowly between USD1,172.8/oz and USD1,201.2/oz, ending the month USD1,173/oz. Safe-haven buying is overcome by confidence in the US recovery and looming interest rate hikes, whereas festival-related consumption in India remains constrained under government efforts to control fiscal deficit. Gold prices are projected to fall 2% this year as the dollar strengthens in response to interest rate hikes.

Chart 6: Base Metals

Source: Thomson Reuters

In June, Wheat futures prices upturned markedly among other food grains, recording 2.9% YTD at cents 614.75/bushel. Corn futures erased this year losses, returning to cents 414/bushel. Soybeans also rallied by 1.9% on a YTD basis, trading at cent 1056.25/bushel. Although, a well-supplied market coupled with a strong USD would still pressure prices downward, weather-related concerns are increasing the upward pressure.

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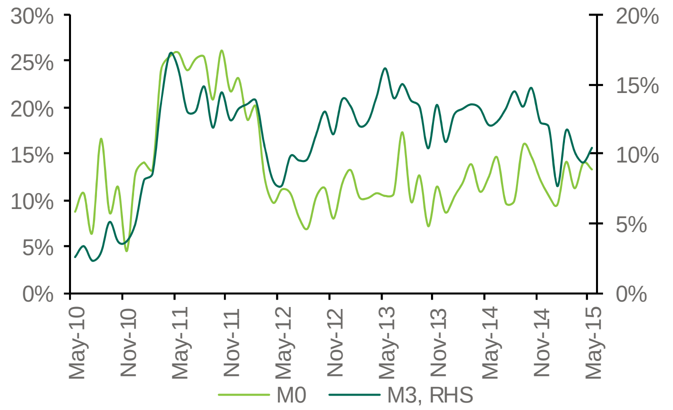
Money & Inflation
Strong Money Demand Despite Challenges

In the month of May, the annualized growth rate of broad money supply (M3) recorded 10.4% Y/Y, to reach 1.8 trillion, reflecting the Kingdom's continued strong internal dynamics. Although the growth rate is below last year's average of 13.1% due to base effect, we still expect to see lower bound double-digit growth this year. Analysis of money supply components shows that the monetary base surged by 13.3% to SAR308.9 billion, supported by a 14% increase in currency outside banks to SAR173.5 billion, followed by a 13% upturn in local banks' deposits with SAMA to SAR101.2 billion. On the other hand, public financial institutions' deposits with SAMA fell the most since December 2013 to SAR6.2 billion, marking a 25.6% annualized downturn.

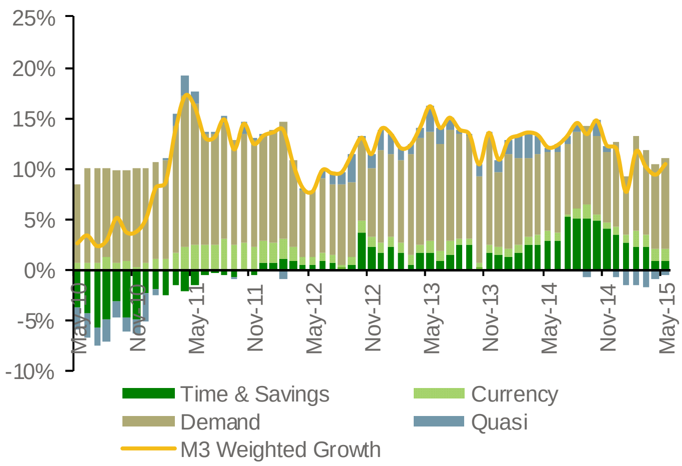
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Demand deposits, which represent a hefty 59.6% of the Saudi economy's money supply maintained a strong Y/Y growth of 15.7%, reaching SAR1.1 trillion. Time and savings deposits are the second largest type of deposits in the Kingdom, making around 20.5% of the money supply. Despite their relative notable growth last year by rates as high as 24.8% last July, the trend does not seem to hold this year as their annualized growth in April and May were 3.7% and 3.5%, respectively. Time and savings deposits stood at SAR 373.1 billion in May, continuing to slide from the all-time high of SAR401.6 billion in September last year. This brings M2 money supply to a total of SAR1.6 trillion, advancing over last year by 12.5%. Quasi money deposits stood around SAR188 billion, recording the sixth consecutive annualized decline by 4.5%. SAMA bills stood at SAR 228.5 billion in May, edging down 3.1% Y/Y. The low inflation specter led to a lesser need for the securities issuances which SAMA uses to mop up excess liquidity. The money supply at this point is responsive to demand which by looking at the point-of-sale transactions we note a 10% surge compared to last year in sales, amounting to SAR16.7 billion. Last year, point-of-sale transactions averaged a 17.6% annualized growth rate, which will likely cap growth this year to lower double-digit.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

Annualized inflation for the month of May recorded 2.08% which falls below last year's average of 2.7%. The rapid declines in global energy prices, in addition to a stronger dollar lowered imported inflationary pressures. This is evident as the largest category in the consumer basket, foodstuff, only rose by 1.4% Y/Y. Housing and utilities rose by 3.1%, below last year's average of 3.5%. Furnishings, household equipment and maintenance edged up by 3%, whereas last year's average stood at around 4.4%. Commodity prices will remain pressured in the short term due to abundant supply and pinned by an appreciating USD. We expect inflation to remain subdued under the global theme of lowflation. Hence, we expect headline inflation this year to remain below 2.5%.

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Capital Markets

Muted Trading

Global equity markets were fragile last month mainly due to Greece and China. The Greek economy took center stage, yet again, as it pushed negotiations with European economies to the brink of a “Grexit”. Greek Prime minister announced a referendum for citizens to vote on austerity measures imposed by Eurozone leaders. The majority voted ‘No’, yet Greece had to succumb to the pressures and an agreement has been reached to keep Greece within the single currency bloc. Meanwhile, China’s stock market bubble burst rippled through global markets during June. The Shanghai composite index closed at 5’166.35 on June 12, a staggering 149.5% growth over the past twelve months, only to drop 32.1% by July 8 to 3’507.19. Chinese regulators have released a string of interventions to combat the market-wide selloff. An estimated 5 trillion Yuan was mobilized to stimulate the market out of its landslide. Measures ranging from suspending over 1000 stocks to allowing pension funds to invest up to 30% of their assets supported the index back above the 4’000 level. China represents the sixth largest market globally which dragged the MSCI World Index to post a monthly decline of 2.5% during June.

Chart 9: Tadawul All-Share Index

Source: Tadawul

Domestically, the Saudi stock market posted a larger loss last month, losing 6.2% despite finally opening the market to qualified foreign institutions (QFI). During June, all sub-sectors posted losses ranging from 1.4% for the media sector to 12.4% for the energy sector. Additionally, the suppressed oil market equates to slower economic growth for the Saudi economy as it is heavily reliant on the oil industry. As such, the anticipation of quarterly corporate profitability coupled with the seasonally diluted trading of Ramadan pressured stock prices. By the end of the first half of 2015, the main index gained 9.0% and the best performing sector was the transport at 41.8% followed by the real estate sector at 28.7%, while telecommunications, agriculture, and cement sectors recorded declines at 9.3%, 1.2%, and 1.0%, respectively. Despite the recent drawbacks, market capitalization by the end of June was at SAR2.0 trillion, up from SAR1.8 trillion by the end of 2014.

Chart 10: Average Daily Traded Value

Source: Tadawul

As expected, the holy month of Ramadan muted daily investor activity which dropped to as low as SAR3.8 billion, the lowest since November 2013. Working hours in Ramadan are reduced, yet, trading hours are kept the same for Tadawul. The average daily traded volumes during June declined by a third to settle at SAR5.1 trillion. Tadawul’s trading continues to be majorly attributed to Saudi individuals, however, institutional trading has been on the rise as declining prices provide a lucrative long term investment. Following the first two weeks of QFI trading, a net inflow of SAR18.2 million was announced by Tadawul which only represents 0.02% of June’s trading. Foreign capital will gradually enter the local market as stocks increase in value due to their declining prices. The market’s price-to earnings ratio dropped to 16.78x by the end of June from 17.9x in May. We expect the second half of 2015 to improve as trading levels return to their normal levels.

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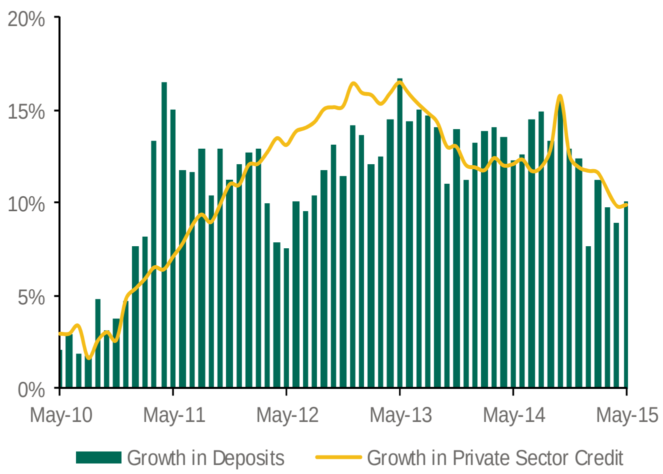
Loans Market

Growth in Moderation

The consolidated balance sheet of Saudi national banks in the month of May shows that total credit, excluding investments in securities, have reached a record of SAR1.3 trillion. By annual comparison, total credit expanded by 9.6% from May last year, indicating a continued momentum, albeit decelerating. About 96.5% of credit extended by Saudi financial institutions goes to businesses and individuals, which we find to move in response to growth in deposits. As the annualized growth in deposits subsided to lower double-digits, recording 10.1% in May, the annualized growth in private sector credit have also fallen to 9.9% Y/Y. Bank credit to the public sector stands at SAR45.8 billion, inching up by 2.1%Y/Y. Investment in government securities, however, edged 2.5% lower compared to last year, standing at SAR281.1 billion. By the end of May, total fresh loans extended by Saudi banks to public and private entities reached 54.9 billion since the beginning of the year, around 21.3% less than total fresh loans during the same period last year.

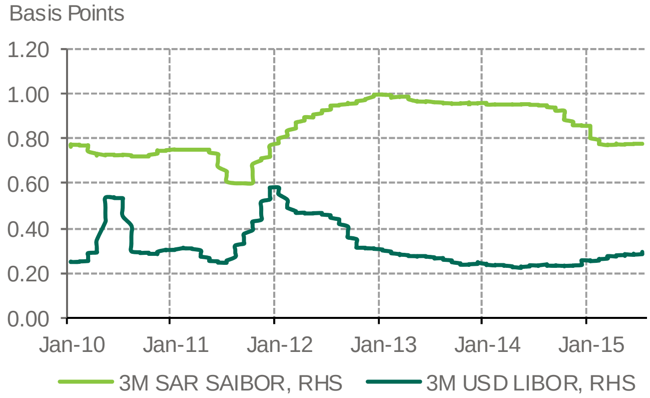
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Looking at the composition of deposits, we note that businesses and individuals hold around 92% of demand deposits, which in turn make up 65.9% of total deposits. The need for cash on standby in such composition limits banks' ability to fully utilize deposited funds while complying to SAMA's capital adequacy regulations. In addition, the low yields from time and savings deposits discourage the bulk of depositors, whom are individuals and businesses, to tie their deposits to a certain maturity date. Furthermore, quasi monetary deposits shrunk by an annualized 4.5% as foreign currency deposits dropped by 5.2% Y/Y to SAR161.4 billion. Meanwhile, letters of credit surged the most since January by 18.4% to SAR 12.5 billion. Although the growth rate in the depositary base decelerated owing to the staggering growth in the years since 2011, it will remain enough to warrant adequate credit activity in the coming years.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Analyzing banks' credit activity shows that with the current pace of growth in deposits, the loan/deposit ratio is at a healthy 79.3% as of May. Such level of capacity utilization indicates a low risk environment despite looming US Fed rate hikes and Saudi fiscal challenges. The government's opting to tap into its massive foreign reserves over issuing debt reflects its adamancy to maintain low debt levels while pursuing its expansionary policies. Half of outstanding bank loans in the Saudi market are short term, although medium and long-term loans have been gaining momentum in the past year, currently making around 17.8% and 31.7%, respectively. Local banks' direction towards longer maturities is a result of better market regulation, namely in the mortgage criteria. We expect that as credit risks diminish and credit worthiness improves for businesses and individuals that Saudi banks will likely extend more long-term loans in the coming years. Additionally, the high level of liquidity pressured the 3-month Saudi interbank lending rate (SAIBOR) below last year's average of 92 bps dropping by as much as 14 bps to 77bps.

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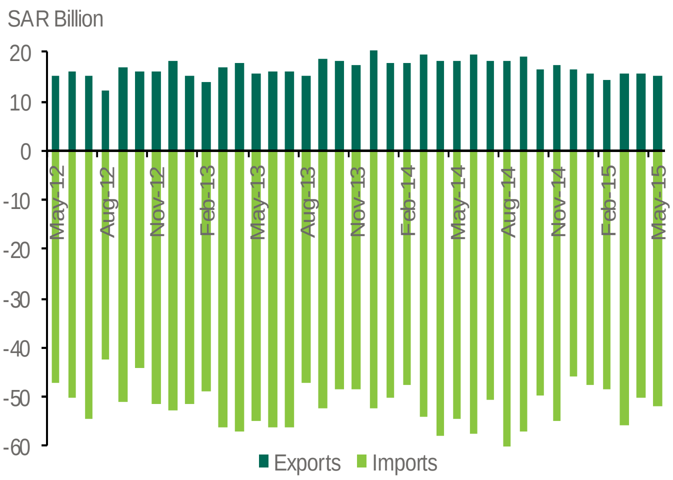
External Trade

Trade Activity Subdued by Global Qualm

The Kingdom's external trade saw a moderation in non-oil export activity in May, recording the second largest slump since February, slowing by 16.7% Y/Y. Total non-oil exports were valued at SAR15.2 billion affected by sharp declines in the largest export categories, plastics, chemical products, and base metals. On the import side, we notice that headline import figures also declined in value, albeit to a lesser extent, at SAR51.7 billion. On an annual basis, imports slipped 5.1% on the back of large declines in imports of base metals and chemical products. Tonnage-wise, non-oil exports recorded 4.1 million tons; around 5.7% less compared to the same period last year. Additionally, the weight of imports dwindled more drastically at 5.8 million tons, registering a 10.7% annualized downturn. The change in net exports show that the balance of trade gap had widened in May by around 0.8% compared to last year.

Chart 13: Saudi Non-Oil Trade Balance

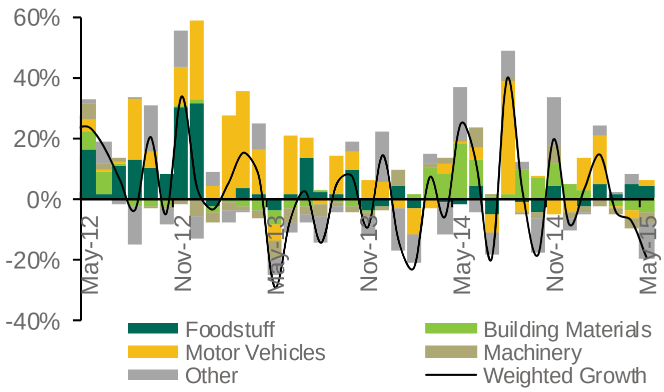


Sources: SAMA and NCB

Another plunge in global oil prices, in addition to a slowdown in China, affected the returns on exports of plastics, chemical products, and base metals. In value terms, plastics make up around 31.4% of May's total non-oil export revenue at SAR4.8 billion, falling by 18.4% compared to May 2014. Chemical products, which also represent a hefty 30.9% of non-oil exports at SAR4.7 billion, slid by 15.1% Y/Y. Exports of base metals recorded SAR 980 million, falling by 17.2% from last year. The largest trade partners, China at 12.6% and the UAE at 12.5%, account for over a quarter of the Kingdom's demand for non-oil exports. Both countries imported less in value terms during May compared to the same period in 2014, recording roughly SAR1.9 billion each. Exports to China and the UAE thus declined by an annualized 9.3% and 18.1%, respectively.

Concerning imports, despite the 5.1% upturn in machinery and electrical equipment valued at SAR14.5 billion, and the 8.7% surge in transport equipment at SAR8.5 billion, the sharp declines in multiple smaller categories shrunk the Kingdom's import bill by 5.1%. Imports of base metals tumbled by 25.9% at SAR5.5 billion, and imports of chemical products dwindled by 14.8% at SAR4.1 billion. The import bill from China, which accounts for around 14% of total imports to the Kingdom remained almost unchanged from last year at SAR7.2 billion. US imports up-ticked by 4.2% to SAR7 billion, whereas imports from Germany plummeted by 14.3% to SAR3.4 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

Settled letters of credit (LCs) totaled SAR19.8 billion in May, registering a moderate annualized growth of 2.2%. Despite falling LCs for motor vehicles and machinery/electrical equipment by 6.9% and 8.4% to SAR3.6 billion and SAR1.7 billion, respectively, LCs of food grains recorded a staggering 29.6% upturn. Food grains LCs recorded a SAR1.1 billion, providing support for bottom line annual growth rate. This is likely due to restocking in preparation for the month of Ramadan, as demand for food stuff usually surges. Save unusual spikes such as that which occurred last year in August, we expect LCs to grow modestly on a Y/Y basis, supported by the sharp declines we saw last year.

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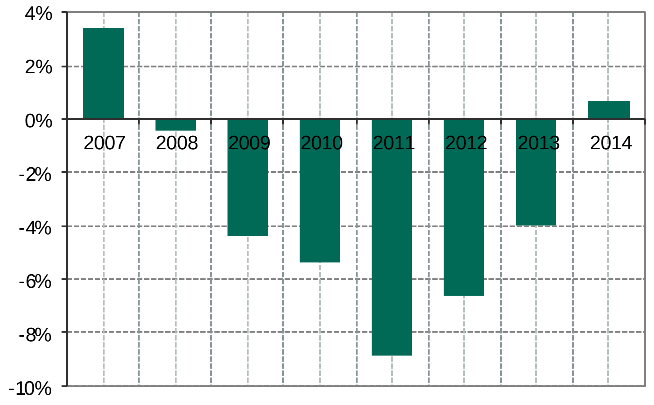
Special Focus:

Third Time Lucky?

In 2001, Greece adopted the Euro to embark on a new era of European unity and prosperous growth. Trade barriers were eased, funds were easily accessible, and within a year, the Euro surpassed the dollar. In addition to hosting the Olympics in the summer of 2004, the Greeks were on track to global recognition. However, rumors of Greece "cooking the books" to enter the European Union (EU) materialized into facts, and the damages were amplified by the global financial crisis. An economic convergence requirement by the EU was that countries needed to limit the budget deficit to 3% of GDP, yet it was not strictly enforced. Greece had initially applied to join the EU on the basis of a 1.5% budget deficit, only to be later revealed it was at 8.3% and their balances were far from consolidation. In 2008, several European countries were affected by the global financial crisis namely Spain, Portugal, Ireland, as well as Greece. The interconnections formed by economies meant that a default by any distressed economy would cause a contagious effect and drag the region into years of recession. Greece was downgraded by Fitch in 2009, the first of several downgrades by the big three credit ratings over the coming years.

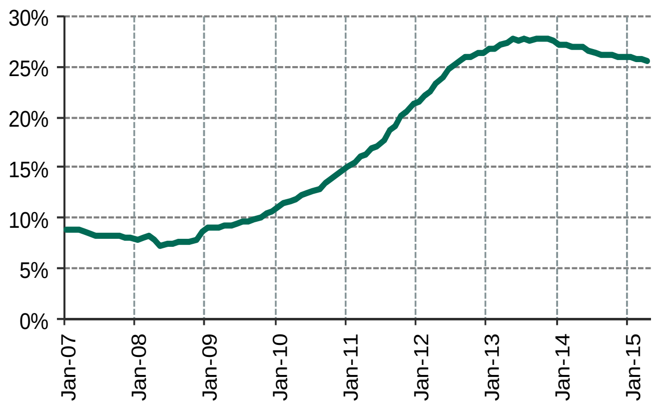
Table 15: Greece GDP, Annual Growth Rate



Source: Thomson Reuters

Markets were roiled over the amount of debt Greece was burdened with, almost 150% of GDP in 2010. The government announced austerity packages to calm creditors and markets in an effort to demonstrate it can cut its deficit. Shortly after, Prime Minister Papandreou sought the help of Eurozone leaders and the first bailout was agreed. The European Commission, European Central Bank, and International Monetary Fund (IMF), so called Troika, provided EUR110 billion to avoid a sovereign default, conditional with even more austerity measures. The Greek government was challenged with cutting spending while maintaining peace on the streets as riots and protests were spreading across the nation. Following several austerity packages, sovereign credit ratings continued to be slashed, youth unemployment nears 50%, and the economy continued to pile on the debt. The possibility of Greece exiting the EU spread further turmoil in bond markets as yields reach historical highs. Consequently, a second bailout was agreed to bring total rescue funds to EUR246 billion, including a 50% haircut to private creditors and extending maturities.

Table 16: Greece's Unemployment Rate



Sources: Thomson Reuters

A couple of years later and the country is led by leftist Tsipras of the Syriza Party. Gaining popularity by his anti -austerity mandate, Tsipras announced a referendum in 2015 to vote on further austerity measures demanded by European leaders, citizens voted 'No' to reflect their confidence in their new Prime Minister. The domestic financial system was halted and capital controls were enforced. Citizens could only withdraw EUR60/day and most foreign transfers were banned. However, after missing a repayment to the IMF, Tsipras has succumbed to the demands of creditors and the Greek Parliament has passed two rounds of austerity measures to secure another bailout, Greece's third within five years. The Greek government has pledged to meet the requirements by mid-August to meet their next payments. For now, the possibility of a "Grexit" has been sidelined and the third Greek bailout is much needed to ensure Greece, at least, remains in the currency bloc and avoid deepening their crisis.

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