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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- Global GDP growth forecasts for 2015 have been reduced from 4% to 3.5%, so despite low oil prices to stimulate crude consumption, demand was less responsive to this moderation in growth.
- A policy reversal in the US will reignite another cycle of capital outflows that will surely weigh negatively on emerging market currencies especially those that suffer from structural deficiencies in their current and fiscal accounts.
- The outlook for base metals are weakening amid signs of a slowdown in Chinese demand that is evident from the lower headline GDP growth rates of recent quarters, with analysts expecting the slowest economic expansion since 1990 this year.
- The correspondence of the holy month with the academic vacation might accelerate prices as consumption expenditure is expected to rise during the festivities, yet, we do not foresee inflationary risks arising during this year as the underlying factors remain favorable domestically.
- The market's price-to-earnings ratio hovers around 17.5x which would provide traders with numerous long-term investment opportunities. We expect trading activity to remain muted during Ramadan with a positive outlook for the second half of 2015.
- The utilization of deposits is represented by the loans-to-deposits ratio that currently stands at 79.2% which reflects the unutilized capacity as banks tread the conservative path.
- According to the Central Department of Statistics and Information, Saudi non-oil exports by value recorded a drop of 16.0% Y/Y April, the seventh consecutive contraction.

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View of the Month

Real GDP growth is expected to rise by 3.4%, due mainly to an expected growth in non-oil sector by 5.1%, driven by the private sector that will compensate for the insignificant contribution of oil. The key beneficiaries in 2015 will remain to be the trade, construction and manufacturing sectors, growing at 7%, 6% and 6%, respectively. Our projections for the three sectors are supported by the recent royal decrees, buoyant activity in the projects' market and resilient business confidence.

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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	9.8	9.8
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,821.7	2,568.3	2,778.0
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	753.5	685.8	741.8
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.6%	3.4%	2.8%
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	81.2	-20.6	12.9
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.8%	-3.0%	1.7%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	652.8	625.4
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1046.0	721.9	842.3
Actual Expenditure, SAR billion	826.7	873.3	976.0	1100.0	1023.0	971.9
Expenditure Overrun, %	42.5%	26.6%	19.0%	28.7%	19.0%	11.9%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-54.0	-301.1	-129.6
Budget Balance/GDP	11.6%	13.6%	6.5%	-1.9%	-11.7%	-4.7%
Break-Even Oil Price	75.3	73.9	82.6	98.1	90.7	87.0
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%	10.6%	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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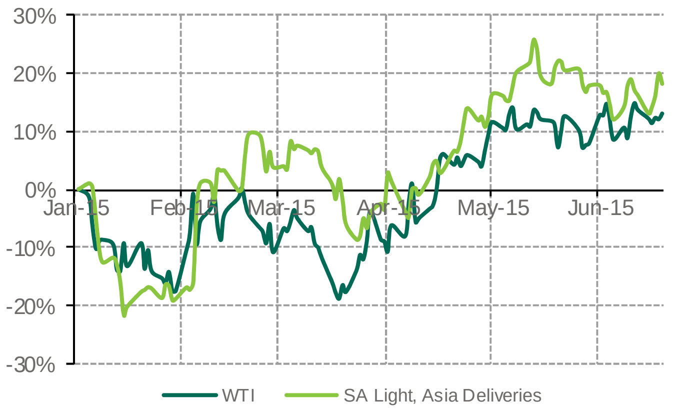
Oil Market
Conflicting Themes

Brent crude oil prices averaged USD64 a barrel in May, the highest monthly average of 2015, and dropped for August settlement to USD63.7 a barrel on the London ICE Futures Europe exchange. The benchmark has risen nearly by 40% since reaching a six-year low of USD45 a barrel in January 2015. WTI crude prices have been fluctuating between USD58 and USD61 a barrel last month, as OPEC's production and the strong dollar are putting downward pressure on WTI crude oil futures. Despite the estimated increase in global inventories by more than 2MMBD, several factors contributed to higher prices in May, including signs of higher global demand growth, expectation of declining US tight oil production, and the risk of supply disruptions in the Middle East. In its June meeting, OPEC appeared to be striking a note of cautious optimism that its decision to let market forces dictate supply and demand is working well, with a modest demand rebound and signs of a slowdown in US crude oil, both pointing toward a better balanced oil market over the near term. However, the incoming oil supply and demand data seem to suggest a different view, as demand is not really picking up, and supply growth has barely slowed, pointing in the wrong direction for OPEC.

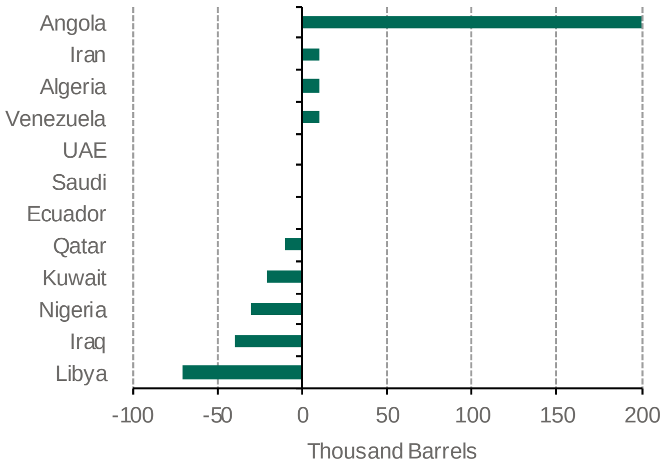
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the demand side, IEA estimated global demand growth at 1.4MMBD in 1Q 2015. It is an improvement from the low point of 2015 demand forecast at 0.8MMBD earlier this year and has been supported by strong US gasoline demand, a decent recovery in Europe and stronger than expected Chinese demand. Oil imports by China in the first five months of 2015 were up by 7.85% Y/Y, but China's demand for oil slumped in May which could be attributed to higher prices, rising by 40% since January's low. However, the big picture is that the recent uptick in the IEA's demand estimates has merely taken 1Q 2015 demand growth back to where it was at 1.5MMBD when the forecast was initiated in July 2014 and oil prices were still above USD100 per barrel. Over the same period, global GDP growth forecasts for 2015 have been reduced from 4% to 3.5%, so despite low prices to stimulate crude consumption, demand was less responsive to this moderation in growth.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the supply side, the EIA reported that weekly US crude oil production rose to 9.61MMBD for the week ending June 5th 2015, rising by 13.5% form the same period last year. OPEC's decision to leave its production target unchanged expected, yet it underlines the prospect of an extended period of ample supply, especially with little signs that the US output is bottoming out. OPEC maintained its target production at 30MMBD, as oil supply exceeded demand globally for the past five quarters. OPEC produced 31.3MMBD in May, and expected to produce around the same level in the coming months, according to IEA's June report. Saudi Arabia, in particular, produced a record 10.3MMBD in May 2015. Moreover, Russia produced 10.71MMBD of crude oil in May 2105, according to the Russian energy minister. Producing at that level by OPEC and Non-OPEC countries would imply a global oversupply of 1MMBD in the third quarter. The glut could swell further if Iran and western powers reach an agreement on Iran's nuclear program. Iran could boost exports by 1MMBD within seven months if sanctions are lifted. Apparently, oversupply will continue to put pressure on crude oil prices over the medium term.

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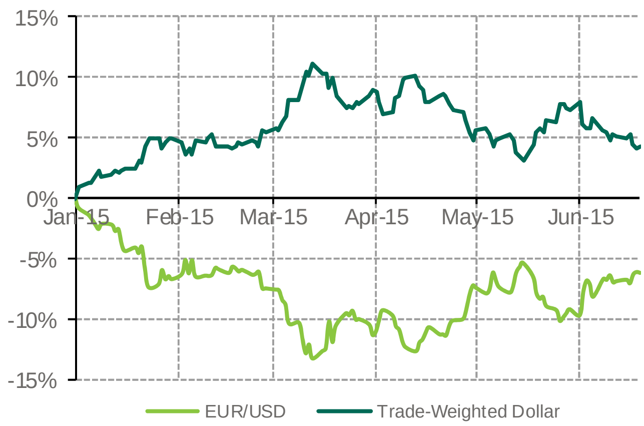
Foreign Exchange

The Greenback Still Going Strong

Uncertain global outlook and uneven growth, in addition to mounting disinflationary pressures are leading central banks to shift gears to higher accommodation. This move by an increasing number of central banks coupled with the anticipated rate hike by the Federal reserve, for the first time since 2006, have been pressuring currencies across the board versus the USD.

Evidently, we do expect a market response similar to 2013's reaction to Ben Bernanke's comments of tapering asset purchases that saw a rout across emerging market assets. There is no denial that monetary accommodation has pumped trillions of cheap money that enabled investors to repair their balance sheets and income statements by making huge gains from interest differentials that was guaranteed by the rhetoric that the US policy stance will remain "exceptionally low" for a "considerable time". A policy reversal will reignite another cycle of capital outflows that will surely weigh negatively on emerging market currencies especially those that suffer from structural deficiencies in their current and fiscal accounts.

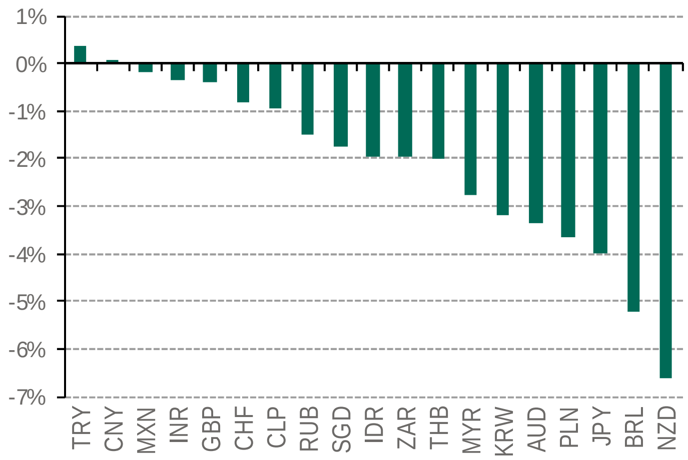
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The aforementioned dynamic of expected lower interest differentials in addition to a strengthening US labor market have clearly helped the greenback, with the trade-weighted dollar rising by around 5% in 2015 YTD, a continuation of last year's 12.8% gain. Recent data from the Commodity Futures Trading commission (CFTC) have clearly indicated that hedge funds and speculators have been wagering more on dollar appreciation, with the total net-long positions reaching a six-week high, rising to USD34.7 billion in the week that ended June 9th. In contrast, the economic outlook of the 19-nation currency block has received another setback, as had been largely expected, from a haggling Greek government that was unable to meet several deadlines for reaching an agreement with lenders to release additional aid. This brinkmanship approach that also delayed payment to the IMF might lead to non-renewal of the existing bailout that expires at the end of this month, forcing Greece to default and withdraw from the Eurozone. Accordingly, the Euro that lost around 7% against the USD till date and is expected to be driven lower in the next couple of weeks.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

On the emerging markets front, capital outflows from equities and bonds had dragged most of their currencies to multi-years lows. Asia had been particularly susceptible, with around USD7.9 billion withdrawn from its equity markets during the second week of June, the most in 15 years. The biggest losing currencies had been Brazil and Turkey that both depreciated by around 15% followed by the Indonesian and Malaysian Ringgit that respectively declined by nearly 7% and 6%. To conclude, it is quite clear that Fed's decision during the next few months will influence the FX markets, which will witness an increased level of volatility as the attractiveness of carry trades ebbs.

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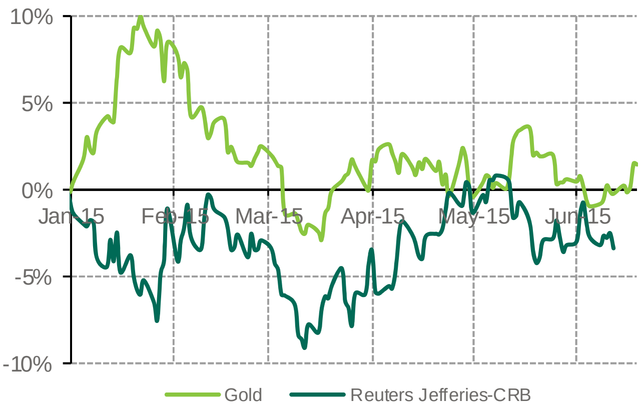
Commodities

Commodities Remain in the Red

Commodity prices from base metals to agriculture had continued to be under pressure since the end of June and well into 2015 on the back of a strengthening greenback, lack of inflationary pressures across the advanced economies, and expectations that supplies will climb during the next five years. We also expect that the anticipated rate increases by the Fed might support this overall weakness in commodity prices, as investors unwind positions that have been built in the heydays of cheap money, a time that resulted in heated debates about the impact of investment flows and speculation on prices relative to the fundamentals of demand and supply.

Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

On the agriculture front, the S&P Goldman Sachs Agriculture Index had remained in the red, falling by around 10% in 2015 YTD, with wheat, corn and soybeans declining by 18%, 10% and 9%, respectively. The extent of the decline can be attributed not only to the USD story, but also to a fundamental picture that points towards adequate supplies of wheat, rice and corn. As for precious metals, gold and silver continue to suffer from the abovementioned normalization talk that contained any rebound in their respective prices that rose by only 0.2% and 2%. It is not expected as such that gold will be able to reach USD1300/Oz and it is becoming increasingly likely that the yellow metal might settle around USD1200/Oz by the end of the year, with most analysts predicting the persistence of such levels during the next couple of years. The lack of inflationary pressures will also contain any rebounds towards the historical high recorded in 2011.

Chart 6: Base Metals

Source: Thomson Reuters

The outlook for base metals are weakening amid signs of a slowdown in Chinese demand that is evident from the lower headline GDP growth rates of recent quarters, with analysts expecting the slowest economic expansion since 1990 this year. Accordingly, copper and aluminum continue to languish in the red, registering around -4% and -5%, respectively till date. China's copper imports fell significantly by 16.3% in May from the previous month, hitting a three-month low. This sharp decline in Chinese imports has suppressed copper prices, and hence the red metal is less likely to recover unless the PBoC continues its easing policies that started back in November, including interest rate cuts and reductions to banks' reserve requirements. Additionally, If Chinese demand was a negative drag on copper, Chinese significant supply growth was the main factor pressuring aluminum. Annualized aluminum production in the world's second-largest economy has increased by around 2 million tonnes to 31.5 million tonnes since the beginning of the year in contrast to the rest of the world, whereby production increased marginally by 255 thousand tonnes. Looking ahead, there is no denial that fundamentals are pivotal, yet speculative outflows might cause a rout in commodities in the few months leading to and following the rate decision by the Fed.

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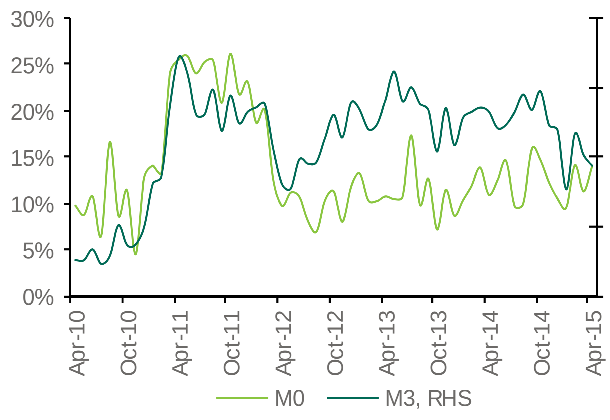
Money & Inflation

Stability and Predictability

Saudi Arabia's main source of revenue, oil, continues to experience oversupply pressures as the latest OPEC meeting opted to maintain its production quota at 30 million barrels. However, the domestic economy is underpinned by a resilient non-oil sector which will support Saudi moving forward. As the Saudi monarchy successfully transitioned from the late King Abdullah to King Salman, the latter issued royal decrees within weeks of ruling the helm. The overhaul decrees included two-month bonus salaries to public sector employees which was mirrored by many private sector businesses. Additionally, another bonus salary to military personnel was issued during Operation Decisive Storm. This influx of cash was reflected in the monetary base (M0) by recording an annual 14% gain to reach SAR304.8 billion by the end of April. Representing over 55% on M0, currency outside banks posted a rise of 13.7% Y/Y to reach SAR169.5 billion while cash in vault grew by an annual 14.4%. Additionally, as local banks expand their loans portfolio, they are required to increase their buffers in the form of deposits with SAMA which crossed the SAR100 billion level by rising 16.4% Y/Y during April. Meanwhile, public financial institutions withdrew 14.4% of their deposits with SAMA.

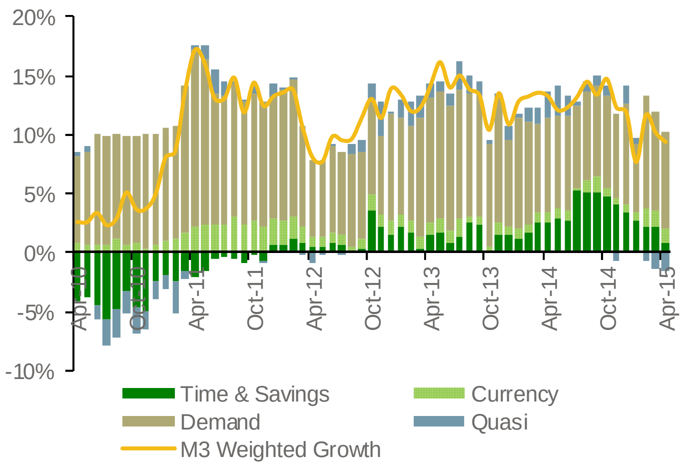
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

As for the money supply (M3), growth decelerated to 9.4% Y/Y from 10.2% Y/Y during the previous month. Demand deposits, the largest component of M3, was the main driver as it expanded by 14.5% Y/Y during April. The non-yielding deposit type allows businesses and individuals quick access to funds for their investment needs as time and savings deposits decelerated to an annual rise of 3.7%, the slowest since October 2013. The suppressed interest rate market will continue to pressure time and savings deposits especially that the US Fed is not expected to decide on a significant interest hike during this year as the strong US dollar eroded the US economy's growth momentum. Additionally, the smallest component of M3, other quasi-monetary deposits, contracted for the fifth consecutive month, declining by 7.5% Y/Y. Furthermore, SAMA's reserve assets have been on a downward trend since July as net foreign assets have posted monthly declines in seven out of the past eight months. During 2015, a total of SAR170.4 billion have been withdrawn to compensate the shortage in oil revenues, yet we still believe that Saudi's conservative and prudent policies over the past years will support the economy going forward.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

As the Kingdom imports around SAR50 billion worth of products on a monthly basis, a stronger US dollar greatly reduces imported inflation on consumer goods. Consumer prices have been range-bound as the benchmark inflation rate recorded a rise of 2.01% in local prices during April, the slowest since the re-basing of the general index for cost of living in Saudi. The category of food and beverages rose by 1.25% Y/Y, while the housing and utilities category recorded a rise of 3.14% on an annual basis. Both categories represent over 42% of the index and, therefore in our opinion, prices will start rising due to the summer vacation and the holy month of Ramadan. The correspondence of the holy month with the academic vacation might accelerate prices as consumption expenditure is expected to rise during the festivities. We do not foresee inflationary risks arising during this year as the underlying factors remain favorable domestically.

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Capital Markets

Festivities Mute Trading Activity

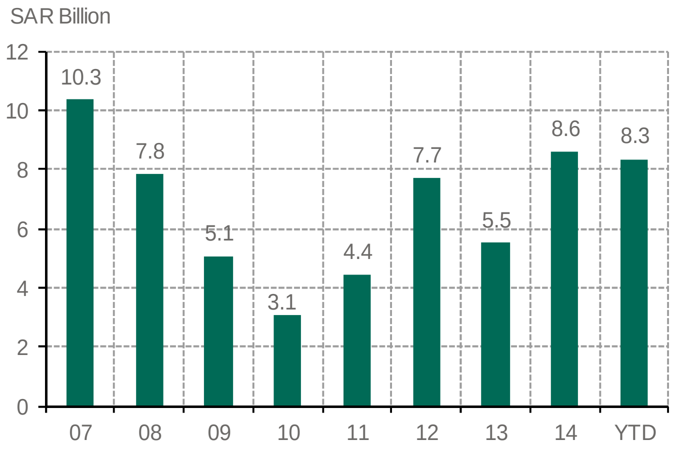
The Saudi Arabian stock market, Tadawul, is one of the last major indices to open up globally as it is by far the largest in the Arab world. Last month, the Capital Market Authority released the final regulations for Qualified Foreign Institutions (QFI) to invest in Tadawul. Consequently, the MSCI revealed that it will launch a standalone index for Saudi Arabia to track the largest 19 stocks. Additionally, Tadawul's development and progress will provide the opportunity for the market to be listed in its emerging markets indices, expected in 2017. Throughout the first five months of 2015, Tadawul had climbed 16.3% to close 9'688.69 by the end of May. The transport category recorded the largest increase at 44.4% since the beginning of the year while the industrial investment and real estate categories recorded 40.6% and 35.9%, respectively. Given its considerable market capitalization, the telecommunications sector's contraction of 7.3% during 5M2015 contained Tadawul's performance as the ongoing issues regarding Mobily's accounting discrepancies continue to unfold. On a monthly basis, the main index declined by 1.5%, the anticipation of the academic holidays which coincided with Holy month of Ramadan weighed on capital inflows to the market. The media category lost 4.6% and the petrochemical category contracted by 4.4% last month.

Chart 9: Tadawul All-Share Index

Source: Tadawul

The setback in the index was the result of the lowest level of activity since November. The average daily traded volumes during the month of May only reached SAR7.7 billion, 13.8% lower than the activity during the month of April. However, the slight drop in prices were attractive enough for institutional investors to increase their trading as they represented 12.0% last month, rising from 9.6% during the previous month. Trading activity continues to be led by the retail segment which represented 87.2% of total trading during last month. Market capitalization on June 14 was USD558.4 which would provide QFIs with a maximum of USD55.8 billion as their investment capacity is limited to 10% of the market capitalization. The market's price-to-earnings ratio hovers around 17.5x which would provide traders with numerous long-term investment opportunities. We expect trading activity to remain muted during Ramadan with a positive outlook for the second half of 2015.

Chart 10: Average Daily Traded Value



Source: Tadawul

As for the primary market, the offering of Saudi Ground Services Company represented the third initial public offering (IPO) of the year. The company offered 30% of its SAR1.88 billion capital in the form of 56.4 million shares. The stock was offered with a premium SAR40 in addition to the nominal value of SAR10, resulting in the largest offering YTD with a total value of SAR2.82 billion. Individual investors were offered 40% of the IPO which was oversubscribed by 339% by 1.86 million individuals with a total value of SAR3.8 billion. The appetite for the primary market continues to reflect the confidence of investors in the local businesses and economy as a whole.

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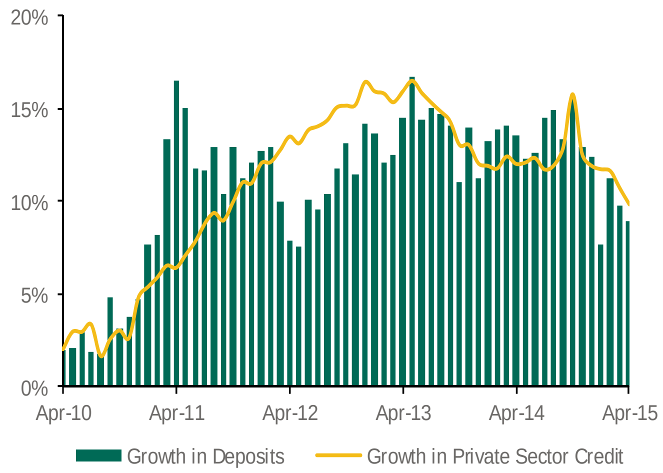
Loans Market

A Moderating Business Cycle

Forming the base of banks' balance sheets, total deposits in the Saudi financial system reached SAR1.63 trillion by the end of April, adding SAR50.3 billion YTD. Following more than two years of double-digit growth coupled with the drop in oil revenues for the Saudi economy, banks' total deposits moderated to an annual rise of 8.9% during April. The majority of deposits are demand based with a share of 66.1% as they climbed 14.5% Y/Y. Businesses and individuals hold 92.6% of demand deposits while government entities make up the remaining 7.4% portion. However, government entities have significantly increased their demand deposits, 27.8% Y/Y during April as a means to have quick access to funds given the shortage in oil revenues. Furthermore, government entities reduced the pace of growth in their time and savings deposits to 16.6% in comparison to 52.9% Y/Y by the end of last year. The unattractive yields by time and savings deposits have been unable to attract businesses and individuals, posting the ninth consecutive annual decline of 7.8% to settle at SAR169.5 billion. Additionally, other quasi-monetary deposits dropped by 7.5% annually as foreign currency deposits decreased by 7.6% Y/Y annually and letters of credit declined by 13.5% Y/Y during the month of April.

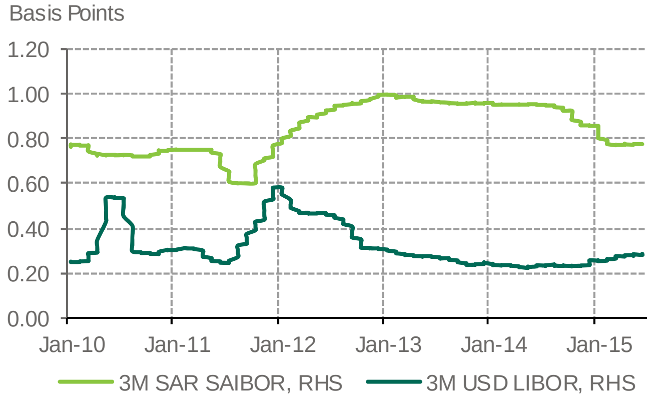
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Assessing the other side of the balance sheet, total claims of the banking system, excluding T-bills and government bonds accelerated at an annual pace of 9.8% during April, the slowest pace since October 2011. Given the stable growth of credit over the last few years, it is expected to pass a moderation phase especially that the economy will face challenges over the short term (See Special Focus). However, the utilization of deposits is represented by the loans-to-deposits ratio that currently stands at 79.2% which reflects the unutilized capacity as banks tread the conservative path. Local banks' efforts to expand their maturity curve remains evident by the rise in medium and long term credit. By the end of April, short term credit represented 51.2% and medium term and long term periods held 18.8% and 30.0%, respectively. While the moderate macroeconomic backdrop will limit growth in credit to single digits, it is certainly more sustainable over the long run.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

As for the private sector, banks extended credit lines to businesses in the amount of SAR5.4 billion during the month of April. On an annual basis, credit to the private sector grew by 9.9%, as total fresh lending reached SAR37.7 billion during the first four months of 2015. Meanwhile, credit to the public sector contracted by an annual rate of 1.0%. Additionally, government bonds posted a mere rise of 1.9% Y/Y while treasury bills declined by 1.7% Y/Y to settle at SAR231.7 billion which reflects the government willingness to maintain its low debt levels and tap into its massive foreign reserves for spending expenditure needs. As for the interbank market, healthy liquidity levels have pressured the 3-month interbank to as low as 77bps in the first quarter of 2015 and we do not foresee any shortages in liquidity even in the case of raising the repo and reverse repo rates to mimic a possible move from the US Fed.

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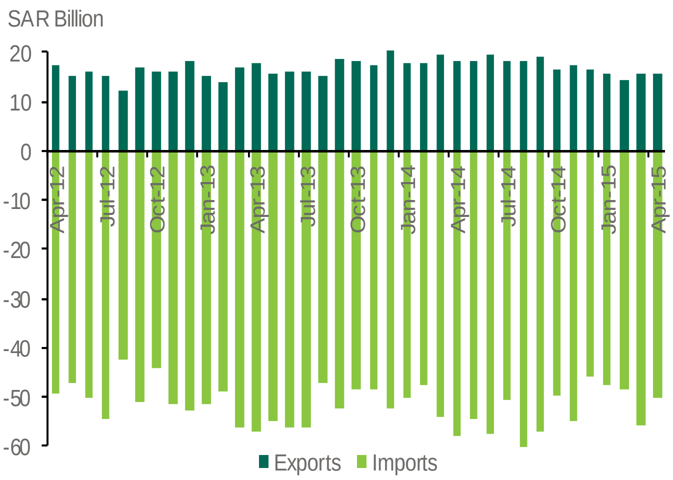
External Trade

Trade Gap Shrinks on Cheaper Imports

Being the largest economy in the region and the largest OPEC oil producer, Saudi Arabia has established strong bilateral trade agreements across various regions. According to the World Investment Report 2014, issued by the United Nations Conference on Trade and Development (UNCTAD), the Kingdom was the third-largest FDI recipient in West Asia, with receipts totaling USD9.3 billion in 2013, surpassed only by Turkey that posted USD12.9 billion and followed by a fellow GCC member, the UAE, that came in second with USD10.5 billion. However, the inflows fell by 23.7% compared to USD12.2 billion in 2012, as oil market remains in oversupply and megaprojects in Saudi relatively moderate in accord with its business cycle. According to the Central Department of Statistics and Information, Saudi non-oil exports by value recorded a drop of 16.0% Y/Y April, the seventh consecutive contraction. During April, exports by weight decreased by 6.8% as the oil supply glut hinders Saudi's market share. The main bulk of non-oil exports are plastic products which are valued at SAR4.8 billion, 30% of the total value. Expectedly, the second largest category is chemical products at SAR4.5 billion for the month of April, an annual decline of 31.1% as a result of collapsing oil prices. By destination, the UAE is the largest recipient of Saudi goods at SAR2.1 billion as most of the goods are likely re-exported to reach international markets given its status as the leading regional hub for businesses. The second largest recipient was China at SAR1.9 billion, a share of 11.8% of total exports by the end of April.

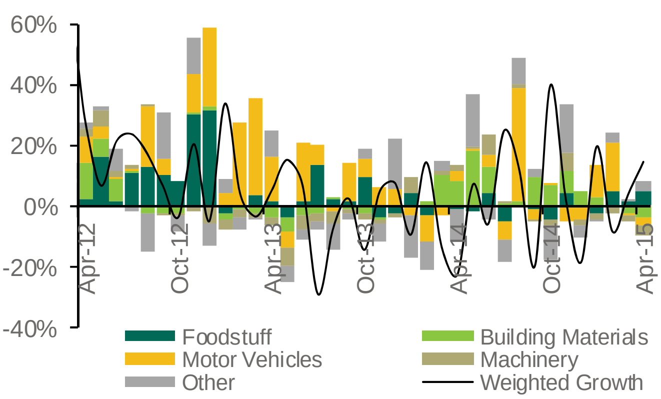
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

As for imports, the domestic economy imported goods worth a total SAR50.1 billion, a decline of 13.6% during April. Furthermore, imports by weight recorded a significant drop of 14.3% annually, declining from 7.0 million tonnes in April 2014 to 6.0 million tonnes twelve months later, marking the fourth consecutive drop. Over a quarter of Saudi imports consist of machinery and mechanical equipment at SAR13.3 billion, dropping by 7.6% Y/Y in April. Additionally, base metals imports' total value declined by 24.9% annually. Commodities have been on a downward trend over the past years and their muted movements this year have reduced the import bill on Saudi. The stronger dollar has also contributed greatly towards reducing expenses for the Kingdom given the SAR-USD currency peg. As the Saudi economy is heavily reliant on imports for consumer goods, inflationary risks are expected to remain subdued. Imports from the European Union represented 25.1% of the total import bill during April, SAR12.6 billion. Meanwhile, China remains the top source of Saudi imports, their competitive edge in costs over other advanced economies have provided the Kingdom with a cheaper alternative, their imports reached SAR6.6 billion during April.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

As one of the main drivers for future consumer expenditure, newly opened Letters of Credit (LCs) through commercial banks have declined by 7.1% annually in April. Throughout the first four months of 2015, newly opened LCs have reached a total of SAR68.8 billion, a benign increase of 0.6% over the same period last year. The main driver was the foodstuff category, rising by 43.7% Y/Y in April. While the main drawbacks were attributed to the machinery and building materials categories, declining by 41.5% and 39.2%, respectively, as the government reduced capital expenditures in 2015's budget which is expected to impact the megaprojects market.

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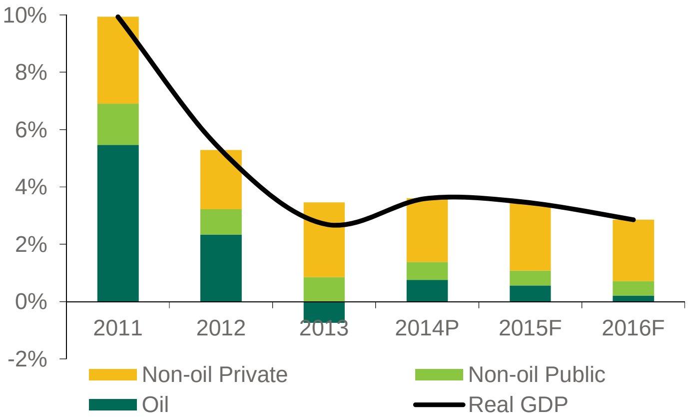
Special Focus:
Tackling Challenges on Solid Ground

In our Saudi Economic Perspectives titled “Tackling Challenges on Solid Ground” issued in June, we have projected that the Kingdom will face a moderate business cycle during 2015 and 2016, growing around 3% in real terms. Our assumptions centered on lesser contribution from the oil sector and moderation in the non-oil sector.

In 2015, our macroeconomic projections were based on an average Arabian Light crude oil price of USD65/bbl and an average daily crude oil production level of 9.8 MMBD. Accordingly, this projected decline in oil prices will result in lower oil revenues, which will weigh negatively on the fiscal and current accounts that will register deficits of 11.7% and 3% out of GDP, respectively. Real GDP growth is expected to rise by 3.4%, due mainly to an expected growth in non-oil sector by 5.1%, driven by the private sector that will compensate for the insignificant contribution of oil. The key beneficiaries in 2015 will remain to be the trade, construction and manufacturing sectors, growing at 7%, 6% and 6%, respectively. Our projections for the three sectors are supported by the recent royal decrees, buoyant activity in the projects' market and resilient business confidence. Notably, the series of royal decrees announced in January and April 2015 will provide favorable stimulus to the non-oil private sector, especially from the bonus payment of two salaries to all public sector employees.

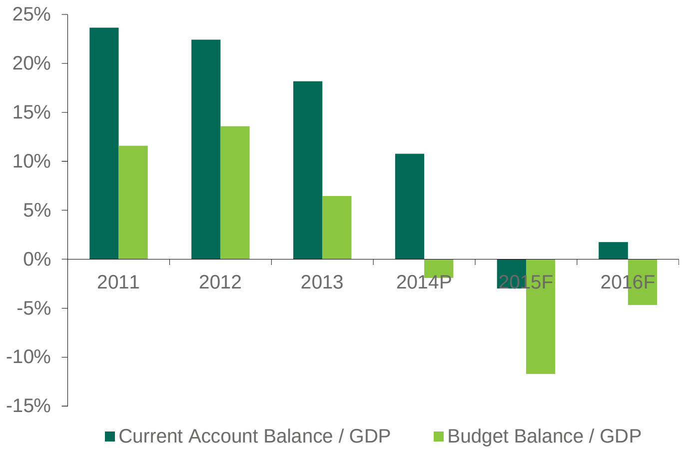
Table 15: Real GDP Growth, Contribution



Sources: SAMA and NCB

Ostensibly, the next five years might prove to be a challenging time for the Kingdom on the back of range-bound oil prices and slower growth in crude production, given the increased possibility of oversupply from OPEC and non-OPEC. The inflection towards fiscal deficits will weigh negatively on net foreign assets going forward, a situation that have materialized with the government drawing down around USD45.5 billion in 2015 YTD. Chinese growth prospects, Federal Reserve monetary policy direction, Iran's nuclear deal with the West are the most notable events that can pose risks to our crude oil prices and production forecasts whether to the upside or downside given the inherent volatility of oil markets.

Table 16: Twin Deficits



Sources: SAMA and NCB

All is quiet on the monetary policy front. Monetary policy in Saudi Arabia is exhibiting a high degree of stability and predictability compared to most emerging markets that suffer from structural deficiencies, which entangled their monetary policy in a balancing act between supporting economic growth and defending currencies. SAMA is mainly concerned these days with price stability and money supply dynamics. On a near-term note, with the Fed expected to raise its target funds rate by the end of the year and gradually thereafter, SAMA will follow suit by increasing the repo and reverse repo rates for the first time since 2009. Yet, it is our opinion that raising the reverse repo and repo rate will not tighten monetary conditions given the ample liquidity, evident from the 3-month interbank market that fell from around 96 bps in 2014 to as low as 77bps in 2Q 2015.

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