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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

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Executive Summary

- The Brent crude and WTI futures for October delivery are trading just above USD47 and USD44.0 a barrel, respectively, in September, on signs that global glut is sustained.
- Most major currencies are expected to stabilize in 2016 by covered interest parity, although we see continued weakness for the EUR and the JPY.
- The commodity market downfall extended to financial markets as a liquidity crisis hit the world's largest multinational commodity trading company, Glencore. The company suffered a 29% plunge in its shares by the end of September.
- The recent announcement to convert the government-owned Real Estate Development Fund into a bank offers respite for housing appreciation. The bank is expected to offer more financing options in cooperation with the private sector, and also a larger funding base, allowing for economies of scale.
- Even though foreign institutional investment was permitted since June of this year, the fact that valuations remain high at 14x compared to international peers hovering around 10-11x have not increased capital inflows to Saudi equities.
- The bonds which were sold to local banks and institutions in three tranches of five, seven, and 10 year maturities are expected to crowd out credit for the private sector, the largest consumer of credit in the Kingdom.
- The surge in non-oil exports in the past years set a high base for growth where it becomes increasingly challenging to maintain the upward momentum.

View of the Month

The fact that the government's capital expenditure drive is easing underscores this [downward] investment trend, with the Ministry of Finance signing construction contracts worth SAR68.3 billion by the end of 1H2015, a significant 25.7% Y/Y decline. The moderation of private credit growth around 9.8% for two consecutive months might reflect a tendency to avoid cyclical risks by deficit financing the government at the expense of financing private projects.

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Macroeconomic Indicators

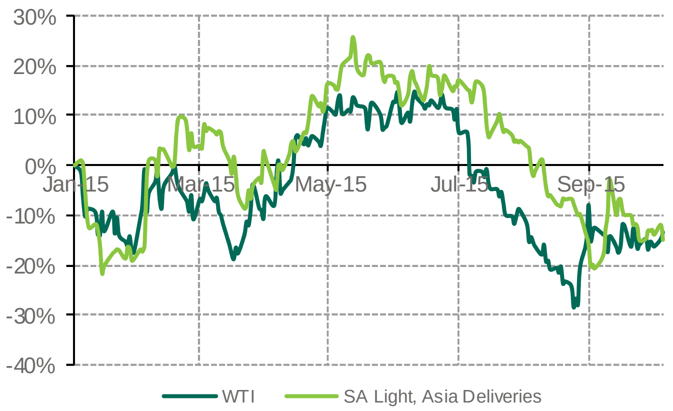
	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	55.0	60.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.2
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,798.4	2,509.4	2,724.4
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	747.2	670.1	727.5
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.5%	3.9%	2.2%
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	-38.6	-36.0
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.3%	-5.8%	-4.9%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	640.2	578.2
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	665.3	703.7
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	-366.9	-276.9
Budget Balance/GDP	11.6%	13.6%	6.5%	-2.3%	-14.6%	-10.2%
Break-Even Oil Price	75.3	73.9	82.6	100.1	88.7	85.4
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	60.0	70.0

Sources: Thomson Reuters, SAMA, and NCB

Oil Market
Uncertainty Weighs on Crude's Future

Brent and WTI crudes are both trading near their lowest levels since 2009 over the last month. Brent crude and WTI futures for October delivery are trading just above USD47 and USD44.0 a barrel, respectively, in September, on signs that global glut is sustained. The consensus of slowing US oil production and at the same time rising crude oil inventory are influencing the direction of WTI prices. The EIA estimates that WTI price would average USD49.2 a barrel in 2015, and USD53.7 a barrel in 2016. Meanwhile, the Brent-WTI premium has compressed considerably recently, narrowing from $7 in mid-August to $1.5 last week. Several themes have been driving the reduction in the spread, including a shifting North American landscape, light oil abundance in the Atlantic Basin and concerns about the overall health of the global economy. This downward revision of crude oil prices has fueled pessimistic sentiments of longer than anticipated crude oil glut market.

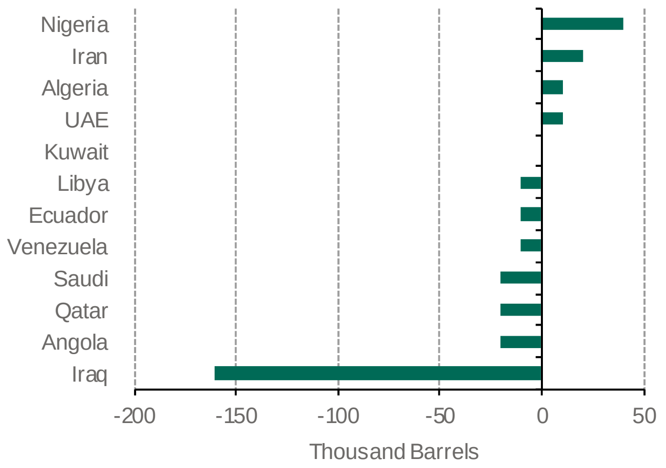
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, weekly crude oil production in the US fell by 83kb/d to 9.14mb/d for the week ending September 4th, following 9.22mb/d in the previous week, compared to its peak at 9.61mb/d in April 2105, according to EIA. The API said the US crude stockpiles rose 4.6 million barrels in the week ending September 25th to reach 457.8 million barrels. According to Baker Hughes, the US crude shale oil rigs fell by 10 to 653 for the week ending September 11th 2105, for the second consecutive week, as lower oil prices are contributing to the closure of high cost shale oil wells. The IEA expects the shale production to fall by 385kb/d next year to 3.9mb/d unless prices rebound in coming months. Currently, the US crude rig counts are 940 rigs lower than 1584 rigs in 2014. OPEC's oil production is still above target quota at 31.6mb/d in August, while Russia and African producers, Angola and Nigeria, are producing at their peak capacity, thus bringing more additional supply to the market. In Iraq, oil output increased by 579kb/d y/y in September. The rising global inventory and the potential for additional Libyan barrels are expected to weigh on the crude oil market.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, the IEA expects world demand to grow by 1.71mb/d in 2105, a five-year high, and sees slower non-OPEC supply growth. It also forecasts demand at 95.8mb/d in 2016, compared to 94.4mb/d in 2015. Demand in IEA member countries barely growing. China's implied oil demand, adjusted for inventories, came in higher y/y by 660kb/d, at 6.46% y/y in August. High refinery throughput was a feature over the month with Chinese refineries processing 10.5mb/d crude in August, gaining 1.9% m/m and 7.7% y/y. Indian oil demand is up 242kb/d at 7% y/y in the year to August, more than double the average rate of growth achieved in 2014. In addition, OPEC officials point to stronger growth in world oil demand since its policy shift and to slower growth in non-OPEC supply. Meanwhile, Chinese slowdown, Brazilian downgrade, Russian recessionary concerns, and Europe's slower than expected recovery are likely to weigh on the crude oil market in the medium term. Without a strong economic revival in China, it will be difficult to develop enough incremental demand to absorb likely increases in OPEC production. Beyond that, there are huge uncertainties about both market fundamentals and geopolitical risk.

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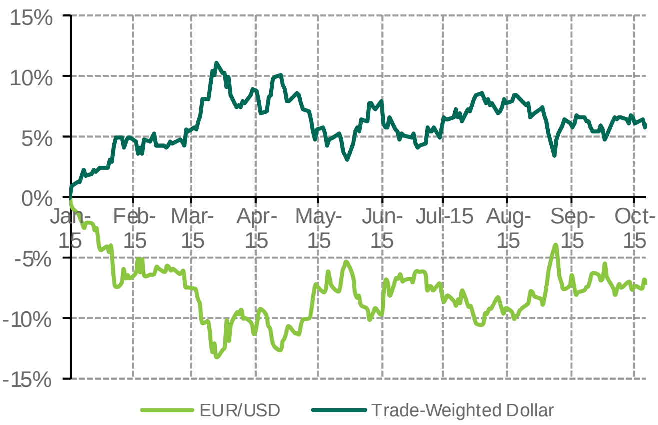
Foreign Exchange

USD Dominates as EM Currencies Sink

The USD is expected to continue its appreciating bias, accentuating the emerging market currencies' debacle. The consistency of strong US fundamentals has increased confidence, and thus, the likelihood of monetary policy normalization at the Fed. However, with the commodity market shock still in place, and the ongoing deleveraging in China, the Fed is concerned of a spillover from global headwinds. Therefore, the Federal Open Market Committee may be swayed by global bearishness to delay its policy rate hike until the global situation had stabilized. That being said, the Fed is expected to raise its federal funds target range by 25 bps at its December meeting as it proceeds cautiously in policy normalization to ultimately reach 1.75% by the end of 2016. Looking into US fundamentals, unemployment recorded yet another 7-year low of 5.1% in August, and payroll employment saw the creation of 136,000 jobs during the same month, adding to the confidence in the economic recovery. The IMF revised its forecasts for US growth to 2.5% this year and 3% in 2016 as the inflow of capital and utilization of labor should underpin growth. The divergence in monetary policy between the US and other major economies should create pronounced interest rate differentials through 2016. Most major currencies are expected to stabilize in 2016 by covered interest parity, although we see continued weakness for the EUR and the JPY. Towards the end of August, the trade-weighted USD retreated by 1.6% M/M against its major rivals on the back of continued monetary accommodation, ending the month at 95.8. Minutes from the Fed released on August 19th revealed some semblance weakness in the inflation data, raising doubt over October's rate hike.

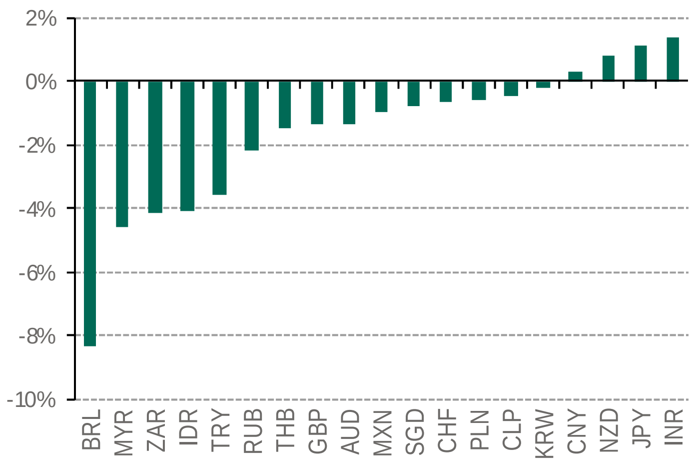
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The EUR remains under pressure versus the greenback as the European Central Bank (ECB) signaled a high likelihood for extending its unconventional quantitative easing program. The timid recovery in the Eurozone, unattractive interest rates, and the widening growth differential between the US and Europe will weigh further on the single currency in favor of the buck. However, despite that the risk factor associated with the Greek debt situation has become anchored as a European market risk, currency devaluations/depreciation in the emerging market has led to an exodus of capital towards Europe, pushing the EUR/USD above USD1.17 for the first time since mid-January. Moving towards year-end, we expect the EUR to underperform driven by considerations of the ECB's monetary policy relative to the Fed. By the end of August, the single currency stood at USD1.12, appreciating by 2.1% M/M.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

China took a front and center stage of economic developments in August. The swift official intervention in the securities markets, the lowering of reserve requirements, and the acceptance of a weaker renminbi hints towards a phase of broad stimulus aimed at rejuvenating economic activity. This also marks a step forward in interest rate liberalization as the ceiling on deposits was removed which is a critical part of China's ongoing economic reform. The remedy to China's growth ailments is yet to be found; however, the government's efforts to ease market conditions, and consequently increasing banks' willingness to lend is expected to boost consumption, while the cheaper currency should nudge Chinese exports against competing goods and services. The rationale behind the PBoC can also be found in the low inflation specter (standing at 1.6% as of July.) The Chinese yuan ended August standing at 6.37 for the dollar, sliding 2.7% Y/Y.

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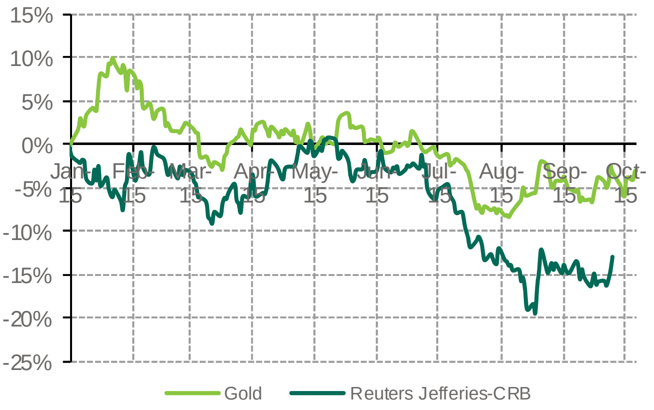
Commodities

Commodities Trade at Year Lows

After a month-long respite caused by adverse weather speculation and a moderation in the dollar's appreciation, commodities relapsed mid-July, and throughout August, reaching their lowest levels this year. By the end of August, the Reuters/Jeffries CRB Commodity Index fell 19.4% since the year's beginning, closing at 185.27 before finding support. Commodity prices are on the path to hit a 6-year record low, driven by sharp declines in metals and energy. Alongside the Fed rate hike expectations, the macroeconomic risks that persist in Greece, China, and other major emerging markets are the main catalysts for the carry trade resulting in stronger demand for the greenback, and thus its appreciation against commodity currencies. Weaker demand for base metals is emanating from China's contracting manufacturing sector. According to China's Caixin Manufacturing PMI, Chinese manufacturing contracted for the sixth consecutive month in August, setting a record low of 47.3.

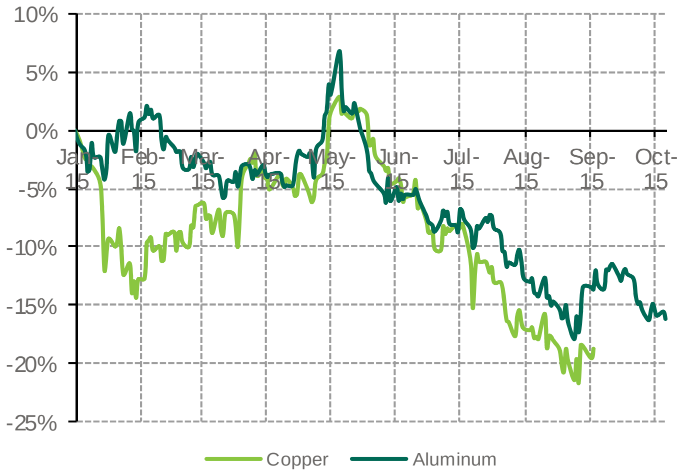
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

The position of copper as a key contributor to reliable, efficient and sustainable buildings earned it a large exposure to the Chinese real estate bubble. China is by far the largest consumer of the red metal, accounting for over 70% of global refined imports, and as China's huge manufacturing sector slowed down, so did the demand for copper. By the end of August, copper dipped further reaching as low as USD4,945/ton, sliding by 21.7% YTD. Since March, aluminum prices appeared to move in parallel with copper on the back of alleviated supply constraints and lower demand prospects. Aluminum fell to its lowest YTD point on the 26th of August, trading at USD1, 531.5/ton, losing 17.3% since the beginning of the year. The IMF's latest World Economic Outlook report warns that investment outside of mining was not picking up, threatening growth prospects for commodity-export-dependent economies, such as Chile, Australia, and Brazil. Moreover the commodity market downfall extended to financial markets as a liquidity crisis hit the world's largest multinational commodity trading company, Glencore. The company suffered a 29% plunge in its shares by the end of September. Its EUR1.25 billion reached a record low of 68.9 cents on September 28th,

Chart 6: Base Metals



Source: Thomson Reuters

As for bullion, gold prices sharply declined to their lowest levels this year from late June to the end of July and remained range bound before finding some support mid-August. The commodity super-cycle which started in the year 2000 began to reverse course 11 years later as growth decelerated in the emerging markets. The two most populous countries, China and India, account for a third of the global physical demand for gold among other commodities, hence the large exposure in the commodity market to the macroeconomic fundamentals in these countries. The USD's appreciation is encouraging risk-taking which compromises gold's status as a safe haven. In addition, the gold import ban placed by India as an attempt to tackle external imbalances will hinder future demand for gold. On the other hand, on and off risk aversion led the metal to trade within a tight range throughout August between USD1,000/oz and USD1,100/oz. Market forces, however, indicate that lower demand for the yellow metal in favor of other US denominated assets will is projected to decline 9% in 2015.

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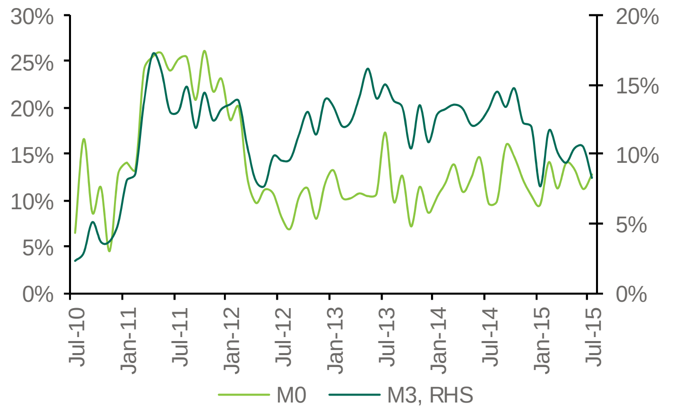
Money & Inflation

Moderation in Demand for Liquidity

Money supply in the Kingdom is witnessing a slower pace of growth affected by lower oil revenues. The budget overrun which is expected to range between 15% to 20% of GDP this year led to many deferrals of mega projects, leaving growth potentially hovering around 3.9%. While the government reassesses and prioritizes its expenditures, the domestic activity is expected to remain resilient, partly offsetting the oil shock. The widening budget deficit is not yet a matter of huge concern due to the abundance of fiscal buffers, valued at over USD600 billion, in addition to the world's lowest debt to GDP ratio of less than 2%. This allows the government ample space and flexibility to restructure its spending plans with minimal impact to the growth prospect.

Chart 7: Growth in Monetary Aggregates

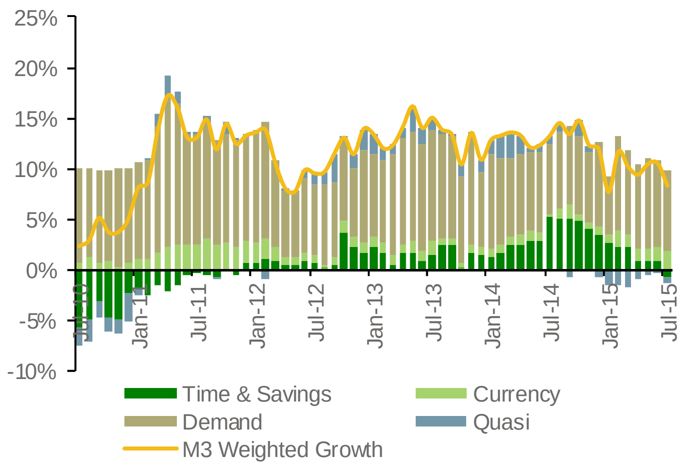


Sources: SAMA and NCB Estimates

The monetary base (M0) recorded an annualized growth of 12.8% in July mainly supported by bank deposits with SAMA, reaching SAR100.4 billion. The growth in M0 contrasted with the growth rate of broader money supply, whereby a decline in time and savings deposits and quasi monetary deposits contributed largely to a weaker overall growth. Currency outside banks surged to the highest levels since February 2012, marking 20.5% Y/Y. Demand deposits make up 59.1% of broad money supply (M3) which still maintains a strong double-digit growth of 14.1%, thus standing at SAR1.07 trillion. Time and savings deposits, on the other hand, which account for 20.9% of total money supply slid by 3% Y/Y to 377 billion. Quasi monetary deposits, which include deposits of foreign currencies, remittances, marginal deposits for LCs, dwindled the most of all deposit categories by around 6.4% Y/Y, standing at SAR183.4 billion.

Inflationary pressures in the Kingdom remains subdued, mainly due to low imported inflation and cheaper commodity prices such as food grains and the likes. The general Consumer Price Index (CPI) inflation stood at an annualized 2.15% in July, influenced by a modest growth in its main categories, foodstuff, housing and utilities, and transport. Foodstuff rose 2.2% Y/Y pinned by agricultural commodities weakness and the USD's continued broad-based strengthening. Housing, on the other hand still holds an upward potential as huge demand for housing units persists in the lack of adequate supply. Despite the Ministry of Housing's efforts which are preceded by royal decree to resolve the housing shortage in the Kingdom, we expect housing, and particularly rent, to be the main contributor to the headline CPI inflation. Downside risks in the housing price level are predicated by the efficiency and timeliness in which the housing/real estate reform is being implemented. The recent announcement to convert the government-owned Real Estate Development Fund into a bank offers respite for housing appreciation. The bank is expected to offer more financing options in cooperation with the private sector, and also a larger funding base, allowing for economies of scale. The selection criteria is also expected incorporate risk assessment, bringing the bank's function closer to a conventional mortgage firm. In July, housing and utilities recorded an upturn of 3.6%, the highest on a YTD basis. Inflationary pressures from the transport category have been muted since mid-2013, rising by a mere 1.1% Y/Y. Overall, we expect inflation in 2015 to average about 2.3%

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

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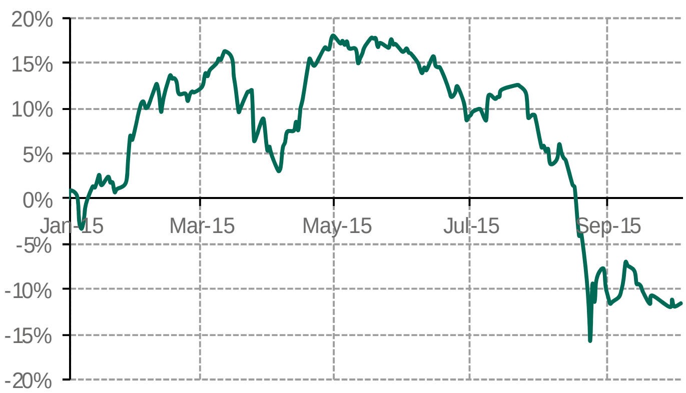
Capital Markets
Equity Market Remains Range-Bound

Global equity markets have plunged deeper into the negative territory during the last couple of weeks, registering -10.2% YTD, according to the MSCI World index. The decline was across the board, with emerging and advanced markets falling by 18.8% and 9% YTD, respectively. The Saudi stock market, Tadawul, mimicked its international counterparts registering a year to date double-digit decline around 12% by early October. During September, the market touched a low of 7,227.83 by the beginning of the month, as the Chinese economic story and currency devaluation impacted global equities, yet the local benchmark was able to rebound by mid-month to 7,812.16 before closing the month at 7,404.14. In our opinion, it is becoming apparent that TASI will remain range-bound going forward, as participants' wait-and-see the flow of corporate revenue announcements, the momentum of oil prices as well as the government budget announcement for 2016.

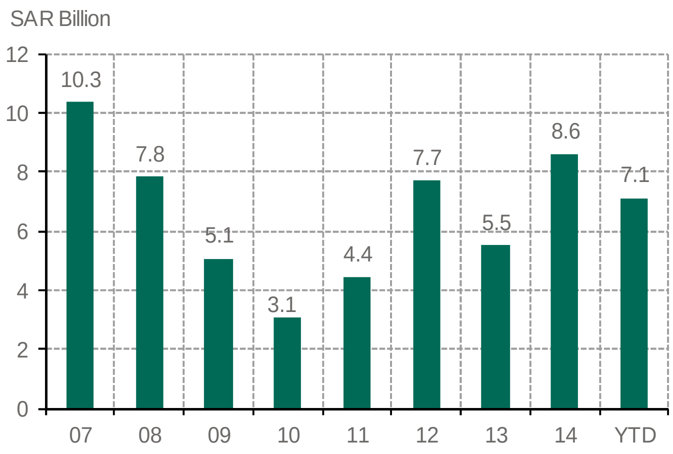
Chart 9: Tadawul All-Share Index



Source: Tadawul

Regarding the sectoral performance, the heavyweight sectors remained in the red, namely cement, petrochemicals, and banks, edging lower by the end of last month by 4%, 3.7%, and 3.4%, respectively. The strongest sector was telecommunications, recording a growth of 4.9% for the month, followed by the transport sector sub-index, which managed to add 4%. Investor appetite, represented by the average daily trading volumes, declined during September to SAR4.7 billion from SAR5.3 billion a month earlier. And market capitalization fell to SAR1.65 trillion, a loss of around 2% M/M. The majority of trading continues to be attributed to Saudi individuals, representing around 90%. In contrast to the volatile secondary market, the primary market did not witness any activity since the beginning of the second half, yet there are 2 announced IPOs for this year, one from the agriculture sector and the other from industrial manufacturing. Ostensibly, most of the announced IPOs for this year and next have been delayed, with companies factoring in the current dynamics in the secondary market and the broader business cycle.

Chart 10: Average Daily Traded Value



Source: Tadawul

Looking ahead, the recent fund managers' September survey conducted by Reuters has reflected continued interest in the domestic market, the second most favored after the UAE, with 33% expected to increase Saudi equity allocations. Yet, 20% of respondents were expecting a cut in such allocations, much higher than the 13% registered in the August survey. Concerns pertaining to the heavy exposure to petrochemical sector earnings, the suppressed oil prices and the government's fiscal policies were cited among many for being the driving factors behind such sentiment towards the largest Arab bourse. Even though foreign institutional investment was permitted since June of this year, the fact that valuations remain high at 14x compared to international peers hovering around 10-11x have not increased capital inflows to Saudi equities.

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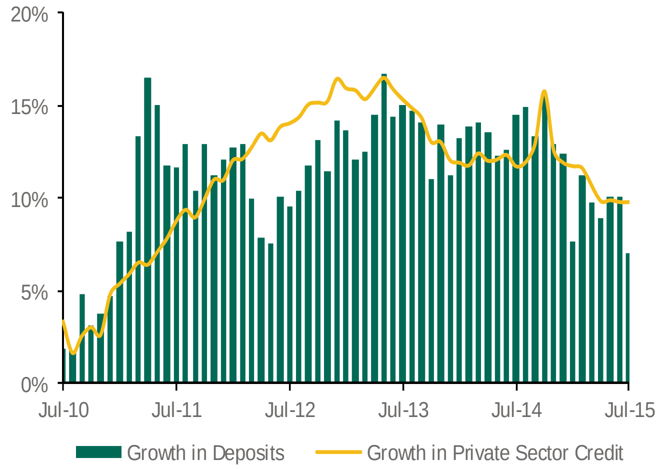
Loans Market

Lower Deposits Affect Credit Growth

The Saudi Arabian monetary system remains resilient despite mounting fiscal pressures emanating from the oil plunge. Until July, Saudi banks maintained low interbank rates as the average for 3 month SAR deposits stood at 77 bps compared to an average of 94 bps in 2014. The spread between SAR USD deposits have also shrank to 48 bps on the same month, well below last year's average of 70 bps. The low inflation specter relaxes banks demand for risk premiums and alleviates concerns for solvency, allowing for cheaper borrowing costs. In addition, the US Federal Reserve's continued monetary accommodation helped Saudi banks maintain high liquidity so far.

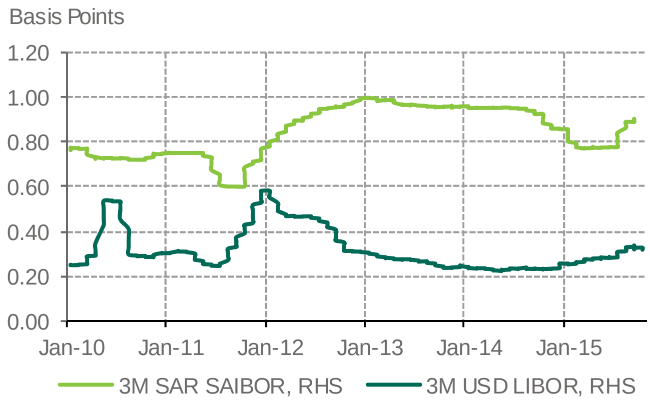
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Going forward, however, we expect tighter liquidity, especially with the Saudi government issuing development bonds in order to maintain its spending plans. The bonds which were sold to local banks and institutions in three tranches of five, seven, and 10 year maturities are expected to crowd out credit for the private sector, the largest consumer of credit in the Kingdom. This is evident as through August and September, we noticed that the Saudi Offered Interbank Rate (SAIBOR) crept up gradually, reaching 90 bps. Compared to last year where demand for credit was the main driver for the interbank rate rising, this year, the slowdown in credit activity is accompanied by a tighter availability of liquidity. Broad money supply (M3) recorded an 8.3% annualized growth, falling short of the double-digit trend we witnessed the last two years. Total deposits recorded a subpar 7.1% annualized growth in July, affected by a contraction in time and savings deposits and quasi deposits by 3% and 6.4%, respectively. Lower growth in the depositary base which is the main source of credit is expected to lead banks to provision for their loans, complying to SAMA's regulations. It's worth-noting that Saudi banks' excess reserve ratio fell to 27.9% in July, the lowest since November 2008.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Moving onto the assets side, the auto synchronicity between loans and deposits is clearly displayed by the deceleration in bank credit to the private sector to 9.8%, the lowest level in four years. Total fresh credit extended to the private sector this year reached SAR79.9 billion by the end of July making total outstanding credit to private debtors at SAR1.28 trillion. In regards to credit to public institutions, which represent a meager 2.9% of banks' credit portfolio, it stood at SAR38.2 billion, down by around 12.8% by annual comparison. Saudi banks' holdings of government bonds stood at SAR52.6 billion, upturning by 6.8% Y/Y and we expect to see a sizeable surge in the coming months owing to the recent issuances, potentially pushing outstanding government bonds to SAR100 billion by the end of the current year. The government is not expected to completely phase out tapping into its foreign reserves despite the debt issuances. SAMA's foreign assets stood at around USD664 billion by the end of the second quarter, down by more than 9% a year earlier. Saudi banks consolidated credit portfolio shows that around 51.8% of loans are short term, with medium term, and long term loans accounting for 16.8% and 31.4%, respectively.

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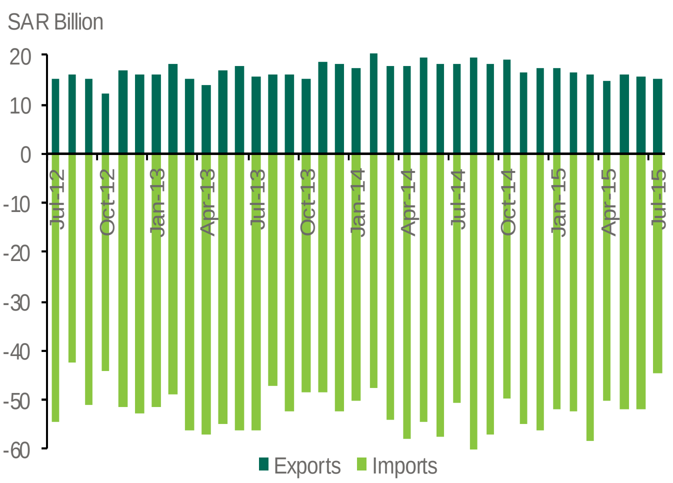
External Trade

External Trade Suffers on Global Weakness

The Kingdom's external trade continues to show signs of waning as non-oil exports tumbled by 20.6% Y/Y in July, recording SAR14.5 billion, the lowest monthly figure YTD. Imports also nose-dove in value terms, slashing 12.2% Y/Y at SAR44.6 billion, the lowest monthly total since October 2012. The Kingdom's efforts to diversify its revenue base via non-oil exports is one of the main strategic moves that become increasingly important during oil crises. Therefore, the surge in non-oil exports in the past years set a high base for growth where it becomes increasingly challenging to maintain the upward momentum. In addition, the Kingdom has partnered throughout the years with many of the world's largest industrial economies. Some of whom, like China, experienced a market bonanza in 2010 and 2011, rejuvenating manufacturing activity, and thus demand for the Kingdom's exports as input. However, as a slowdown ensued in the following years, the trading partners reduced their demand for the Kingdom's non-oil exports. The Kingdom's lower revenues from oil have also had an impact on its expenditure on imports by deferring some mega projects it previously had been working on. By weight, overall non-oil exports weighed 3.9 million tons in July, falling by 8.3% Y/Y. The weight of imports have also declined by annualized comparison, sliding 23.1% Y/Y at 5.3 million tons.

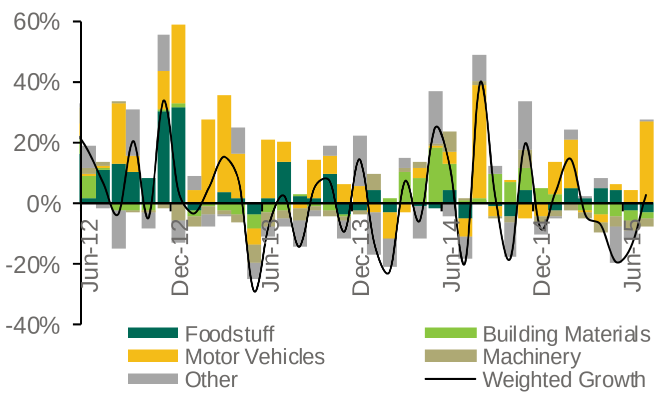
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

The main export categories remain plastics and chemical products, which respectively account for 33.8% and 31.8% of non-oil exports, registered double-digit declines of 18.5% and 25%. The large exposure these categories hold to the oil market from the supply side, and to manufacturing from the demand side inflicted a double whammy to the trade of these goods. In contrast, base metals, which account for 7.4% of the monthly non-oil export return inched up by 1.4% in July. The main destinations for Saudi non-oil exports are the UAE, China, and Singapore. The UAE's share of the monthly total represents 14.1% at SAR2.1 billion, thus inching down by 1.1% Y/Y. Non-oil exports to China tumbled by 18.7% compared to last year posting SAR1.95 billion. Despite the large annualized decline, China's share constitutes a hefty 13.5% of the monthly non-oil exports. Singapore came as the third largest trading partner with the Kingdom. Its share of non-oil exports was around 5.5% at SAR804 million in July, therefore declining by around19.2% Y/Y.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the import side, we notice a broad-based decline across all major categories. Machinery and electrical equipment which account for 27.9% of the import bill at SAR12.4 billion slid by 2.8% Y/Y. Moreover, transport equipment which make up around 17.5% of the value of imports dipped 6% compared to last year at SAR 7.8 billion. A more sizeable plunge in base metal imports took place in July, pulling its imports down by 26.6% to SAR4.6 billion. Around 15.3% of July's imports in value-terms originated from China, valued at SAR6.8 billion. By annual comparison, Chinese imports to the Kingdom were trimmed by as much as 5.4% and yet the country still maintained its rank as the Kingdom's biggest trading partner. US imports have been garnering much attention by sometimes over-taking China by the value of trades. US imports to the Kingdom make up 12.9% of July's total; however, compared to the same month last year, they dwindled by 15.1% at SAR5.8 billion. To the contrary of the previous countries' figures, imports from Germany upturned by 4.6% Y/Y, recording SAR3.3 billion, thus accounting for about 7.4% of the import bill.

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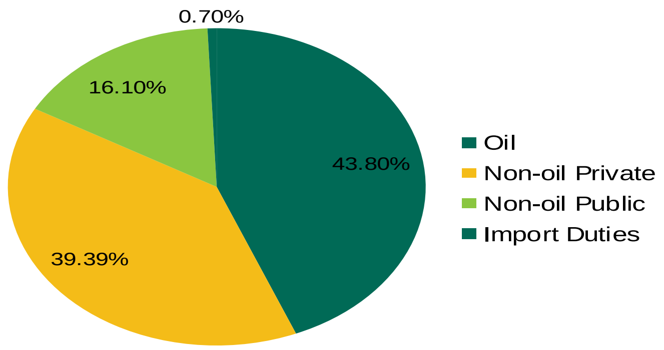
NCB الأهلي

Special Focus:

The Moderate Business Cycle is Taking Hold

.The Kingdom continues to face a moderate business cycle that have started during 2014 and persisted well into this year, growing around 3-4% in real terms. While the oil sector will be supportive given the increased crude production, moderation in the non-oil sector will continue to be a drag. In nominal terms, we expect the weighted average Arab light prices to end the year at an estimated USD55/bbl, a close figure compared to the Energy Information Administration's (EIA) USD54/bbl for the benchmark Brent. Additionally, the oil strategy will remain as is, with protecting market share and undermining high cost producers the main pillars, hence the Kingdom will continue to produce above 10 MMBD, averaging 10.2 MMBD for 2015.

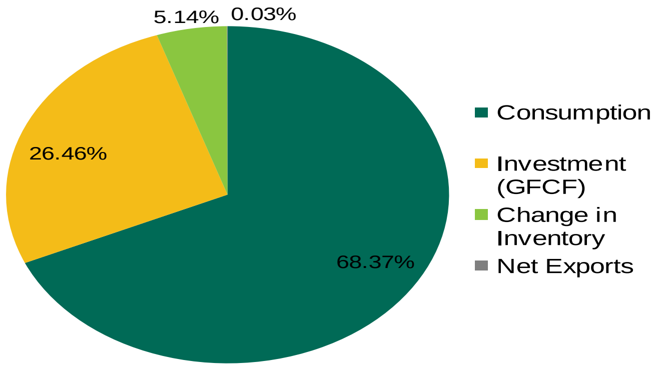
Table 15: Real GDP Consumption



Source: CDSI, NCB

The latest figures released by the Central Department of Statistics and Information (CDSI) pertaining to the second quarter underscores the abovementioned assumptions. The real GDP registered a 3.8% annual growth rate, which was higher than 1Q2015 that posted a mere 2.4%. The contribution of oil was supportive of this headline figure, growing by 5.1%Y/Y that is much higher than the previous quarter's 1.8%, with Saudi pumping a record 10.56 MMBD by the end of June. Meanwhile, non-oil GDP remained within the 3% range, posting 3.1% in 2Q2015. The deceleration in non-oil vibrancy is attributed to both the private and public sectors that respectively grew by 3.1%, a multi-year low. Analyzing the breakdown of non-oil private GDP by sector reveals that construction, manufacturing and trade, which represent around 40% of real GDP, respectively grew annually by 4.2%, 2.4% and 3.3%, much slower than 6.7%, 6.3% and 5.98% recorded by the end of last year.

Table 16: ATM and POS Growth



Sources: CDSI, NCB

The nominal GDP under the expenditure approach reflects a pickup in consumption that represents 68.4% of total spending in the Kingdom. After a near zero growth, total consumption grew annually by 8.5%, with private and public consumption growing by 8.2% and 8.9%, respectively. The growth in public consumption was a turnaround from the negative growth in the first quarter of this year. On the contrary, investment spending languished in the negative territory, falling by 1.8% and 0.6% during the first two quarters. The fact that the government's capital expenditure drive is easing underscores this investment trend, with the Ministry of Finance signing construction contracts worth SAR68.3 billion by the end of 1H2015, a significant 25.7% Y/Y decline. The moderation of private credit growth around 9.8% for two consecutive months might reflect a tendency to avoid cyclical risks by deficit financing the government at the expense of financing private projects. All of the abovementioned data illustrates that moderation is gaining traction, and given the current dynamics a similar performance next year is the most likely scenario.

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