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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

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Executive Summary

- If OPEC commits fully to its production target, at 32.5mb/d and Non-OPEC producers implement the agreed cuts of 0.56mb/d, the market is likely to move into a deficit of 0.56mb/d in the first half of 2017.

- Against the USD, the EUR will weaken further in response to rising USD yields and widening interest rate differentials. As the USD yield advantage becomes larger, the single currency might reach parity following the next Fed meeting

- Copper's aggressive rally is an overreaction to a transient market tightness subsequent to lower production forecasts. Investors continue to build long positions on the red metal as China's industrial activity picked up in November.

- Eight months of consecutive declines in broad money rendered broad money at SAR1.75 trillion down from the all-time-high SAR1.82 trillion a year ago.

- Analyzing Tadawul's report on ownership and trading activity reveals that mutual funds were net buyers, injecting almost SAR24 billion, thus, increasing their ownership in the market by 1.6% last month.

- Tweaking repo rates by availing longer maturity dates such as seven, twenty eight, and ninety in addition to the one-day repo will ease the upturn in the coming months.

- Exports of base metals slid 4.5% Y/Y to SAR1.2 billion affected by softer demand for base metals from China, the global industrial hub, in addition to the stronger USD.

View of the Month

The transitional period was unquestionably going to register a contraction which we expect in 2017. The latest figures released by the General Authority for Statistics reflect a decelerating trend as the market adjusts to the new norms. Real GDP registered a growth of 1.4% on an annual basis from April through June, following a 1.5% rise in the first quarter of 2016.

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Macroeconomic Indicators

	2011	2012	2013	2014	2015	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	50.2	45.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.5
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,826.9	2,422.5	2,274.0
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	754.8	646.9	607.2
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.6%	3.5%	1.5%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.2%	4.0%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.4	73.8	-53.5	-45.9
Current Account Balance/GDP	23.6%	22.4%	18.2%	9.8%	-8.3%	-7.6%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	609.7	544.5
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1,044.4	596.9	602.8
Actual Expenditure, SAR billion	826.7	873.3	976.0	1109.9	969.6	892.1
Expenditure Overrun, %	42.5%	26.6%	19.0%	29.8%	12.7%	6.2%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-65.5	-372.8	-289.3
Budget Balance/GDP	11.6%	13.6%	6.5%	-2.3%	-15.4%	-12.7%
Break-Even Oil Price	75.3	73.9	82.6	100.1	82.1	68.1
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%	2.6%	-1.4%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	9.8%	6.6%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	0.9%	2.5%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.2%	0.3%	0.9%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	70.4	56.4	160.0

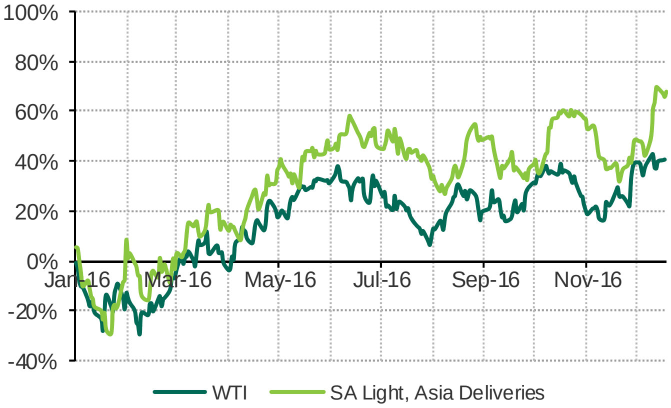
Sources: Thompson Reuters, SAMA, General Authority for Statistics, and NCB
Note: Saudi Economic Review Data, October 2016 Update (Historical and Projections)

Oil Market

Crude Rallies on Cut Agreement

Crude Brent prices moved sharply higher to around USD55.0 a barrel in December, following a decision by OPEC and non-OPEC to cut output in OPEC's November 30th meeting, with the average price for the year estimated to reach USD46 a barrel, falling by 20% from the 2015 average of USD58.0 a barrel. Heightened concern over the slow rebalancing in the oil market and fiscal pressures for a second year due to weak oil prices have forced OPEC members to overcame their political differences and to reverse its "market share" strategy, which was introduced two years ago. In its last November meeting, OPEC members have reached an agreement to cut production by 1.2mb/d to 32.5mb/d starting in January 2017 for an initial period of 6 months, with a further 0.56mb/d in cuts to come from non-OPEC producers, mainly Russia. The agreement will certainly help to clear the huge overhang in oil stocks at a time when the market is already slowly rebalancing. However, the price outlook largely depends on compliance to the production targets. The downside risks stem from recovering of Libyan and Nigerian oil production. In addition, reviving US shale oil production will restrain the pace of oil price recovery. Nonetheless, assuming OPEC compliance, Brent prices are forecast to average USD56.0 a barrel in 2017.

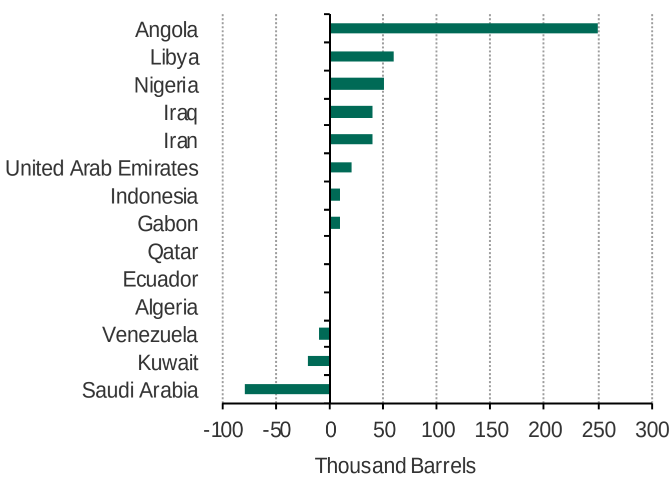
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, global oil supplies in November edged up to a record high at 98.2mb/d, as a drop in non-OPEC output was more than offset by higher OPEC production, according to IEA. With the market share strategy in place, OPEC production has risen during the year, reaching 34.2mb/d in November, a record high, and 0.3mb/d higher than in October, standing at 1.4mb/d higher than 2015. This increase has offset oil supply disruption in Nigeria, while at the same time Russia has pushed its oil production up to a record 11.2mb/d. While OECD commercial inventories fell by 75mb in October after reaching a historical high in July, they are still 302mb above its five-year average. However, if OPEC commits fully to its production target, at 32.5mb/d and Non-OPEC producers implement the agreed cuts of 0.56mb/d, the market is likely to move into a deficit of 0.56mb/d in the first half of 2017. The non-OPEC oil supply in 2016 is estimated to contract by 0.78mb/d. The main contributors to this decline are the US, China, Mexico, Colombia and other OECD Europe, while growth is anticipated to come from Russia, Brazil, Congo and the UK. It is the low oil prices that led to a decline of 0.42mb/d in the US shale oil production. Declines are also seen coming from Colombia and China, as well as Canadian conventional crude output. For 2017, the non-OPEC oil supply growth was revised up by 70,000b/d to 0.30mb/d, mainly due to higher price expectations next year. According to OPEC Bulletin, the main contributors to the non-OPEC supply growth are Brazil with 0.25mb/d, Kazakhstan with 0.21mb/d, and Canada with 0.17mb/d. However, these projections are subject to a few uncertainties, including the pace of economic growth, potential new policies and price developments.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, global oil demand growth for 2016 is estimated at 1.4mb/d, and growth demand is forecast to reach 1.3mb/d in 2017, according to IEA. In OECD, oil demand is projected to rise in OECD Americas, flatten in Europe and continue declining in Asia Pacific. Other Asia and China witnessed steady oil demand growth in 2016. In Latin America and the Middle East, oil demand was lower than initial projections due to slower economic growth and a high level of substitution. According to OPEC, the demand for OPEC crude in 2017 is expected to stand at 32.6mb/d, which is slightly higher than the 32.5mb/d level referred to in the recent OPEC meeting. In turn, the joint cooperation with the non-OPEC countries, particularly Russia, in cutting production by nearly 0.56mb/d, will speed up the reduction of global inventories and advance the oil market rebalancing to the beginning of the second half of 2017.

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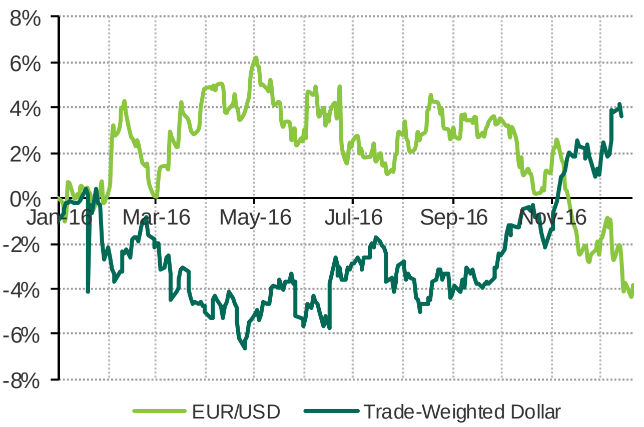
Foreign Exchange
USD Rallies to New Highs

Global growth is expected to pan out around 3% this year, marking the lowest annualized growth rate since the Great Financial Crisis. Economic shifts and geopolitics contributed to the subpar growth. In addition, market volatility, namely in oil markets dented short-term investment decisions. Structural adjustments and overcapacity reduction in the EM coupled with Brexit and US elections were main drags that kept economic performance subdued. On the flipside, the abatement of the Brazil Crisis on the back of President Roussef's impeachment, and improving key indicators in Europe and China are keeping the global economy afloat.

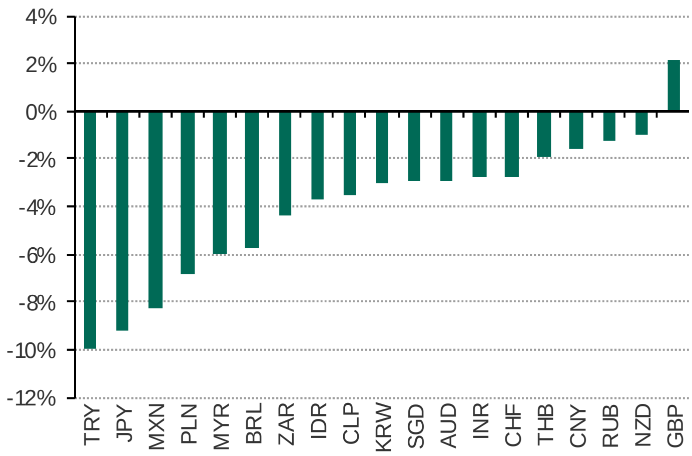
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

In the US, the greenback continued to strengthen despite the election of Donald Trump as President of the United States. In fact, strong US fundamentals underpinned the world's reserve currency to the highest levels since 2002. The Trade-weighted dollar reached 101.7 by the end of November, and only softened to the 100 levels as the OPEC meeting approached. US unemployment stood at 4.9% in October, continuing the downward trend. Nonfarm payroll recorded 161,000 jobs created during the month beating most expectations. Consumer prices also stood at a 0.4% annualized upturn, the highest since April. We expect the US dollar to maintain a broad-based appreciation well into next year at least three 25 bps interest rate hikes. Downside risks to this view include increasing global worries from a stronger USD. Inflation is expected to edge higher next year owing to base effects in addition to an improvement in the oil markets. In the Eurozone, we expect the ECB to remain accommodative while it assesses the impact of negative interest rates on banks' profitability. As of September, unemployment across the bloc recorded 10% for the third consecutive month which is the lowest rate since June 2011. Inflation stood at 0.5% Y/Y in October which is the highest since June 2014, and is expected to edge up in November. We note that neither inflation nor inflationary expectations have drastically changed since the ECB's unconventional easing program, raising questions over its efficacy. Downside risks from Brexit coupled with the financial sector challenges will tilt annualized growth outlook down to 1.6% this year and perhaps 1.3% in 2017. Against the USD, the EUR will weaken further in response to rising USD yields and widening interest rate differentials. As the USD yield advantage becomes larger, the single currency might reach parity following the next Fed meeting. By the end of November, the EUR closed as low at 1.056 for the dollar but regained strength as the USD momentum eased.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the Emerging Markets, manufacturing PMIs for China and Russia posted strong data for the month of November. The Chinese Caixin index recorded 50.9 down from 51.2 in October which remains the strongest since July 2014. Moreover, Markit's PMI for Russia posted 53.6, indicating the highest industrial activity since early 2011. However, the Chinese yuan continues to weaken against the rallying USD hitting an 8-year low of CNY6.92 on the back of sustained capital outflows. The CNY plummeted by 6.2% YTD which can be largely attributed to the currency liberalization efforts undertaken by the government following the renminbi's inclusion in the IMF basket. On the other hand, the Russian ruble started a new rally late November ending the month surging by 13.9% YTD to RUB64.1 against the greenback.

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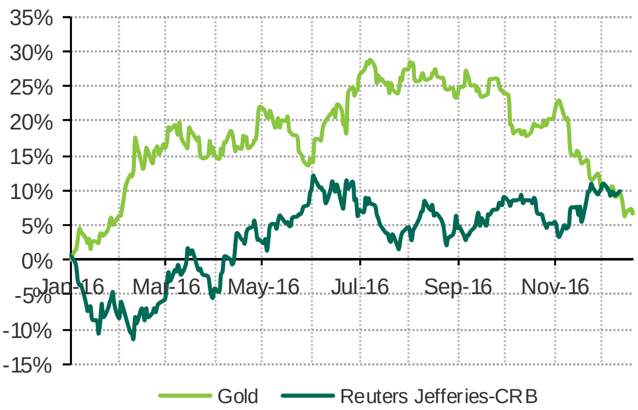
Commodities

Commodities Soften on Fed Decision

Commodity prices ended the month of November upturning by 7.5% YTD according to the Reuters/Jeffries CRB index which stood at 189.3. Industrial metals reached their highest levels since June 2015 while agricultural commodities recovered from August's dip yet remain significantly below this years' highs on the back of subsiding supply concerns and weaker commodity currencies. Following the US presidential election gold prices tumbled unexpectedly as it weighed in the Fed's decision to hike interest rates. Conversely, the recent recovery of oil which was sparked by the late OPEC deal has added to the upside pressure on global commodities while the strengthening USD, in addition to weak global demand, continue to exert downward pressure.

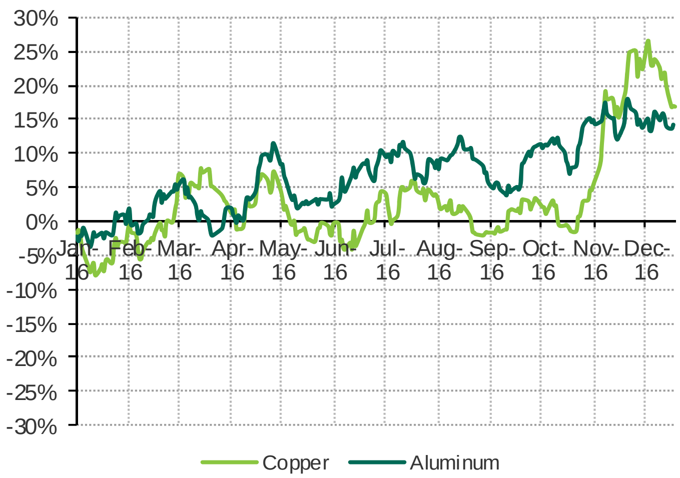
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Copper surged 20% during the month of November in its highest rally in 18 months, standing at USD5,825/ton. This aggressive rally is an overreaction to a transient market tightness subsequent to lower production forecasts. Investors continue to build long positions on the red metal as China's industrial activity picked up in November. Policymakers in China performed six surprise interest rate cuts last year, bringing the one-year lending rate down to a record low of 4.35%. In addition, the deposit cap has been scrapped in order to further liberalize the Chinese yuan this year, a prerequisite for its inclusion in the IMF's SDR basket. These easing measures are signaling that the country is combatting deflationary pressures which are the culprit for the country's lowest economic performance since the Great Recession. Aluminum followed the same path as the industrial metal complex, surging by 14.9% YTD at USD1,722/ton. Gold weakened by rising Fed hike expectations and a softening safe-haven demand. Pre-US elections rally was fueled by uncertainty, pushing the yellow metal to peak at USD1,304.8/oz on November 4th. However, post-elections performance was bearish as the Fed hike expectation intensified. By the end of November, gold stood at USD1,173.5/oz marking a 10.5% YTD upturn. Strong US economic fundamentals and a strengthening US dollar will make gold less attractive to investors who will benefit from higher yields next year.

Chart 6: Base Metals



Source: Thomson Reuters

The S&P/Goldman-Sachs Agriculture index stood at 294.3 points by the end of November, declining 3.9% YTD as the December Fed rate hike is becoming increasingly likely. Easing supply concerns and expectations of a faster pace of normalization in the US are adding downward pressure on grain futures which tumbled more than 20% since June. By the end of November, wheat futures stood at 380.5 cents/bushel, a decline of 25% YTD. Likewise, corn futures settled at 336.7 cents/bushel by the end of the month, marking a loss of 12.1% YTD. The agricultural outlook remains stable given the supply conditions, and the base effect from lower food grain prices this year should provide a boost next year as an expected market correction takes place. We expect a 2.9% rebound in grain prices as upside risks include worsening weather conditions and a larger than expected increase in energy prices. The commodity markets narrative remains a gloomy one for 2017 with no broad-based recovery in sight. Special focus on OPEC production may sway market fundamentals but non-energy commodity prices are expected to rise 2% on tighter markets.

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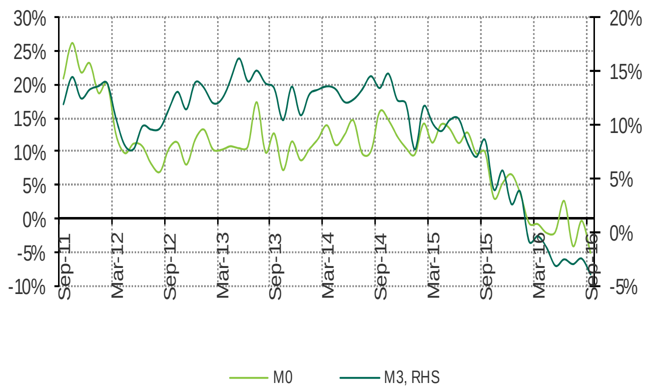
Money & Inflation

Money Growth Falls to New Lows

As the government grapples with low oil revenues, the issuance of SAR97 billion worth of local bonds this year pushed money supply growth to decline by 4% Y/Y, the lowest since 1994. Eight months of consecutive declines in broad money rendered broad money at SAR1.75 trillion down from the all-time-high SAR1.82 trillion a year ago. The monetary base is at SAR304.4 billion, sliding by 5.1% Y/Y on the back of significant declines in deposits of banks and currency outside banks respectively by 5.3% Y/Y and 1% Y/Y. Moreover, cash in vault marked the first decline since October 2013, falling by 7.9% Y/Y. Albeit relatively small in value at SAR2.3 billion, public financial institutions deposits declined the most among the components of monetary base, tumbling by 73.9% Y/Y.

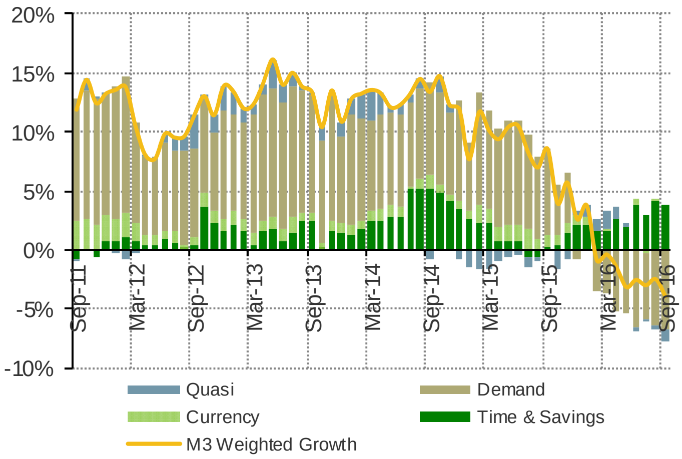
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Demand deposits stood at SAR942.5 billion by the end of September, marking an 11.5% annualized decline, the largest seen this year. Demand deposits constitute the bulk of deposits which are the main source of liquidity in Saudi banks. Such a decline in deposits can consequently constrain the lending capacity for Saudi banks, evident by the rise of the 3-month SAIBOR average above 2%. Looser lending restrictions and direct cash injections have been implemented by SAMA in order to alleviate the liquidity tightness in banks. Starting in November, SAMA added a 90-day maturity for repo transactions, reduced the cap on SAMA bill issuance to SAR3 billion from SAR9 billion. In addition, the USD17.5 billion global bond issuance will offer the government's an alternative to local funding into 2017, offering banks a respite. Time and savings deposits stood at SAR475.1 billion, surging by 16.8% Y/Y in line with fiscal austerity. The less immediate need for cash to businesses and individuals in a contractionary business cycle contributed to more saving, marking four months of double-digit increase. Quasi monetary deposits saw the largest decline since October 2015, sliding by 9.4% Y/Y on the back of an 11% annualized decline in foreign currency deposits to SAR134.5 billion. The government's share of such deposits represent 37.5% valued at SAR50.4 billion, plummeting by 25% from a year ago. Outstanding remittances posted the largest annualized decline since June, nose-diving by 44.6% to SAR9.6 billion. The accelerating outflow of remittances posed a challenge to the local economy as it reduces the effect of money multiplier. According to the world Banks's Migration and Remittances fact book for 2016, Saudi Arabia is the largest source of remittances in the world as a percentage of GDP in 2014, accounting for 5%. It is also the second largest remittance-sending country in absolute terms, with an annual value approaching USD40 billion.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The inflationary situation in the Kingdom appears to be moderating with September's headline inflation posting below 3% for the first time since December 2015. Downward pressure mostly came from food, restaurants and hotels, and recreation, as these categories declined by 1.3%, 1.5%, and 0.1%, respectively. Upside pressure persists in housing and utilities which gained 6.7%, and health by rising 6%, while transport prices increased 7.3% on an annual basis. We expect inflationary pressures to ease as base effect sets in for next year's inflation data.

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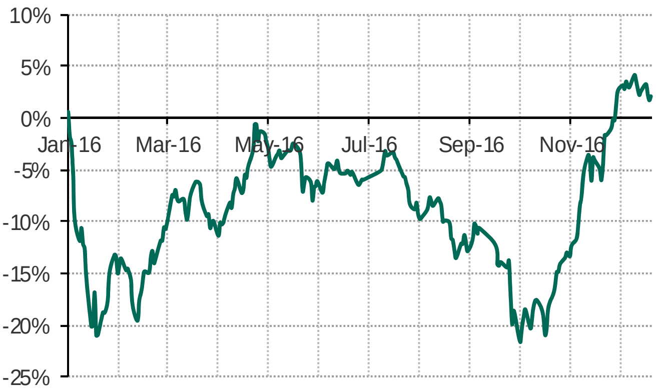
Capital Markets
From Bear to Bull

A mixture of shortcomings pressured the Saudi stock market to enter bear market territory in early October as it registered the lowest closing level for the index this year at 5'416.47, a decline of 21.6% since the beginning of 2016. Prior to this drop, the local financial system witnessed a liquidity squeeze which raised the interbank lending rate (SAIBOR) to worrying levels near 2.5%, up from 0.9% a year ago. Accompanying the liquidity crunch, a Royal decree announced salary cuts to top government officials, and public sector employees' allowances were reduced as they were deemed unnecessary and wasteful. The negative sentiment weighed on the performance of Tadawul as the index remained in a tight range for most of October. However, the international bond sale of USD17.5 billion, coupled with abstaining from the monthly domestic bond issuance in October, alleviated pressures on the banking system and SAIBOR dropped to around 2.1% by the end of November. Additionally, the government recently announced that payments to local contractors will proceed, amounting SAR100 billion, which were previously delayed as projects worth SAR1 trillion are still being reassessed. The market rebounded from its trough and became a bull market by the 10th of November and maintained that momentum to gain 29.2% by the end of the month from its lowest closing in October.

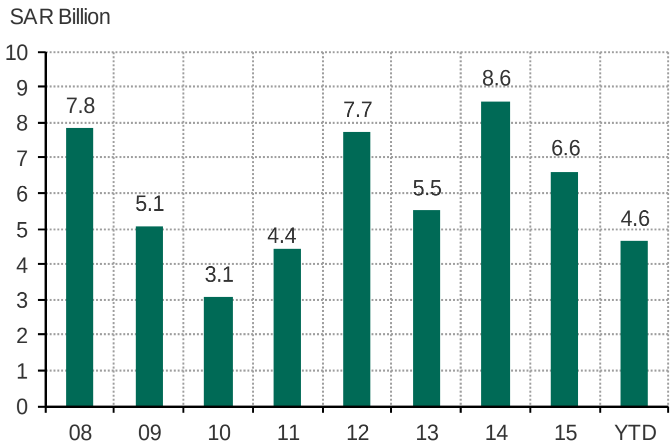
Chart 9: Tadawul All-Share Index



Source: Tadawul

On a monthly basis, the Saudi stock market registered a growth of 16.4% last month following October's 6.9% monthly rise. On a sectoral level, the media sector recorded a substantial 66.3% hike, while the energy sector registered the smallest gain at 6.4% during November. The heavyweight sectors, namely cement, telecommunications, petrochemicals, and banking grew by 27.2%, 26.9%, 15.6%, and 12.5%, respectively. Investments into equities increased considerably following the aforementioned decisions by the government to ease domestic challenges for businesses. In addition, the valuations reached by the end of September, represented by the price-to-earnings (P/E) ratio at 11.87, attracted capital into the riskier asset class. By the end of last month, the P/E ratio rose to 15.26 due to rising prices. Tadawul monthly traded value reached a robust SAR119.0 billion for November, equating to a daily average of SAR5.4 billion, an 81.2% jump over October's SAR3.0 billion daily average. During November, the banking, petrochemical, and real estate sectors were the largest recipients of this turnover with shares of 15.2%, 14.9%, and 14.4%, respectively.

Chart 10: Average Daily Traded Value



Source: Tadawul

The current market capitalization reached SAR1.6 trillion by the end of November, gaining 15.3% over the previous month. Analyzing Tadawul's report on ownership and trading activity reveals that mutual funds were net buyers, injecting almost SAR24 billion, thus, increasing their ownership in the market by 1.6% last month. The majority of trading was conducted by Saudi individuals, representing 60%-70% of trading, yet their ownership in the market is only around 12.5% as of November. As for qualified financial institutions, their share of ownership remains non-existent with a 0.1% share as the Capital Market Authority continues to seek new measures to attract foreign investments into the market. Going forward, OPEC's deal to reduce production by almost 5%, which resulted in spike in oil prices by over 15%, should offer support for the coming few months. However, the announcement of the Saudi budget later this month will be highly anticipated to manage the expectations of 2017 and we believe portfolios will be repositioned accordingly.

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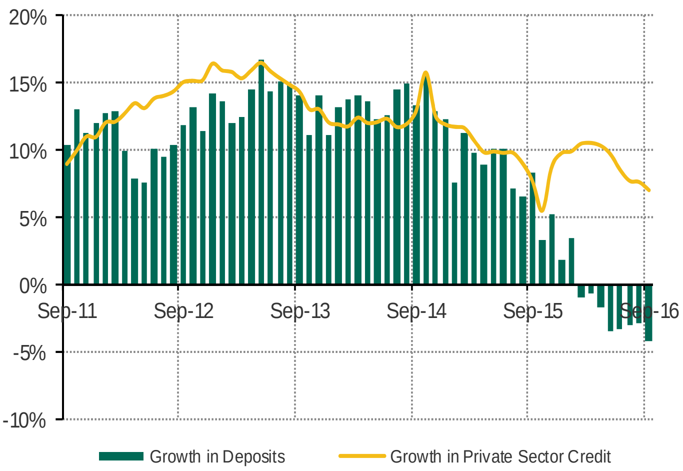
Loans Market

Tight Liquidity Strains Borrowing

The loans market has been experiencing some tightness on the back of a decline in deposits in 2016 following the decelerating growth of 2015. On September, the annualized decline in broad money (M3) bottomed at 4%, standing at SAR1.75 trillion. The categories that most influenced broad money supply were an 11.5% Y/Y decline in demand deposits to SAR942.5 billion and a 9.4% Y/Y slide in quasi monetary deposits to SAR164.9 billion. The trickle-down from reduced government expenditure reflected on the depositary base, the main source of funding for Saudi banks. Consequently, the liquidity squeeze pushed the 3-month average interbank rate to soar to 2.39%, the highest levels since September 2008. Rising above the 2% repurchase rate which SAMA uses for overnight funds is indicative of unusual stress emanating from heavy government withdrawals and dwindling private deposits. Tweaking repo rates by availing longer maturity dates such as seven, twenty eight, and ninety in addition to the one-day repo will ease the upturn in the coming months.

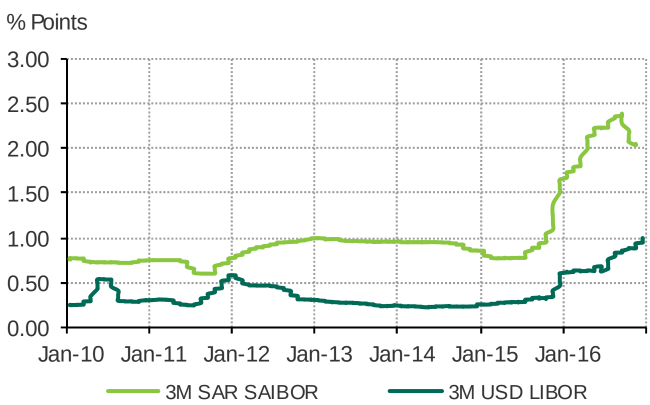
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

The ease on liquidity will also come from the successful sovereign bond issuance of USD17.5 billion which will alleviate the pressure on Saudi banks and provide a further boost to liquidity. Moreover, the recent overdue payments made by the government to the private sector will improve liquidity conditions and credit facilities from banks after months of delayed payments. In the month of September, credit to the private sector stood at SAR1.38 trillion, upturning by 7%, the lowest since October 2015. As deposits reached a new low in September, we expect a more muted growth in lending activity in the coming months. Credit to the public sector stood at SAR47.4 billion, surging by 23% Y/Y, the fourth consecutive month of double-digit growth. Despite the large increase of government bonds holdings at banks by 158.2% Y/Y to SAR173 billion by the end of September, banks' investments in government securities declined overall by 13.1% Y/Y to SAR208.1 billion. The culprit lies in SAMA limiting the re-issuance of its short-term bills and capping the weekly issuance to just SAR3 billion down from SAR9 billion. The move came in an effort to rectify the liquidity tightness faced by Saudi banks as they continued to absorb the large issuances of local bonds. SAMA bills stood at SAR35 billion by the end of September plummeting by 79.7% Y/Y.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Bank credit classified by maturity shows that in September, short-term credit accounted for 51.8% of the total, valued at 740.9 billion. Medium-term credit accounted for 19.1% of the total at 273.5 billion, while long-term credit accounted for 29% at SAR415.3 billion. The loans-to-deposit ratio for Saudi banks averaged 90.3% in September, exceeding the 90% SAMA threshold. Consumer demand in the Kingdom can be inferred by using the point-of-sale activity as a proxy. Sales volumes stood at SAR14.2 billion inching up by 0.9% on an annual basis after two consecutive months of decline. Increasing government austerity measures will likely dent disposable income further reducing the consumer's propensity to spend.

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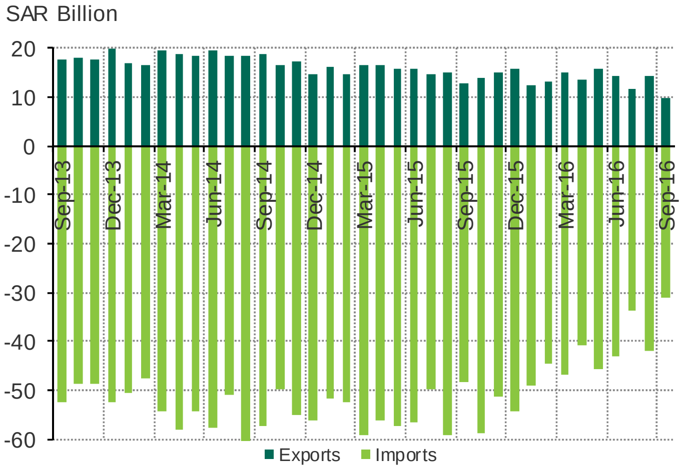
External Trade

Faltering Demand of Emerging Economies

Non-oil exports reached SAR14.5 billion during the month of August, declining by 11.1% Y/Y in value terms. Persistently low oil prices still affect the Kingdom's non-oil export revenue due to the positive correlation of non-oil exports to oil. Around 60.8% of non-oil exports by value consist of plastic products and chemical products in which oil is a major input in the production chain. On the other hand, imports have also been downward-trending on the back of falling oil revenues, exacerbated by a contractionary fiscal policy. Imports during the month posted a 29.5% annualized decline highlighting a considerable reduction in imports of machinery, electrical equipment and vehicles. The sharp decline in value for both imports and non-oil exports also reflect weak global commodity prices which will likely persist amid a stronger outlook for the USD against commodity currencies. Lower disposable income resulting from the various government fees also created expectations of weaker local consumption, softening the demand for imports.

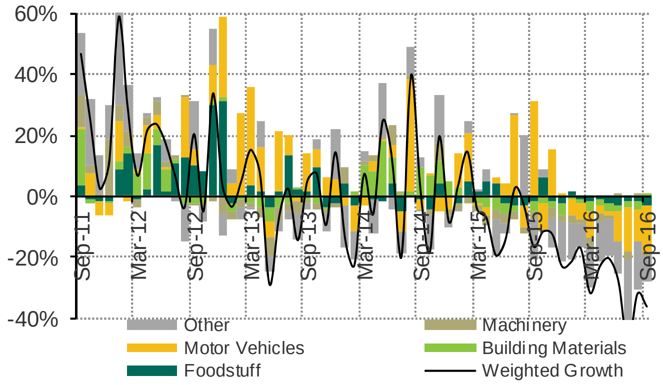
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

Exports of plastics were the largest single category by contribution during the month, amounting to SAR5.1 billion. By annual comparison, plastics were the only main category that recorded an annualized upturn of 6.2%. Petrochemical complexes in the Kingdom export about 87% of their polymer production, which enjoys the lowest production cost globally. Global demand for Saudi-produced plastics heightened as the production of solar panels picked up due to the use of ethyl-vinyl acetate (EVA) sheets. Also. the advancements made in polymer production and treatment ensure the reliability of plastics as a component in the automobile industry. On the other hand, exports of chemical products plummeted 31.3% Y/Y, standing at SAR3.7 billion. Exports of base metals slid 4.5% Y/Y to SAR1.2 billion affected by softer demand for base metals from China, the global industrial hub, in addition to the stronger USD. By destination, exports to the USA, China and India accounted for 14.3%, 8.7%, and 5.9%, respectively. Exports to the UAE were valued at SAR2.1 billion, falling by 14.3% Y/Y whereas exports to China plummeted 28.1% Y/Y. Moreover, exports to India declined by 23% compared to a year ago.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the import side, machinery and electrical equipment represent around a quarter of the monthly import bill, standing at SAR10.2 billion. By annual comparison, imports of machinery and electrical equipment declined 34.1% on the back of falling construction activity. Imports of vehicles during the month make up 17.6% of the import bill, valued around SAR7.4 billion. Due to cooling economic activity in the Kingdom, imports of vehicles fell 25.9% Y/Y. Imports of base metals which account for 9.9% of monthly imports reached SAR4.1 billion in August, declining by 30.7% Y/Y. About 15.9% of imports came from China, valued at SAR6.6 billion. Compared to last year, imports from China fell 22% in line with fiscal consolidation. The second largest source of imports was the US, accounting for 14.2% at SAR5.9 billion, recording an annualized decline of 27.6%. Moreover, imports from Germany which make up 6% of the import bill tumbled by 42.1% Y/Y.

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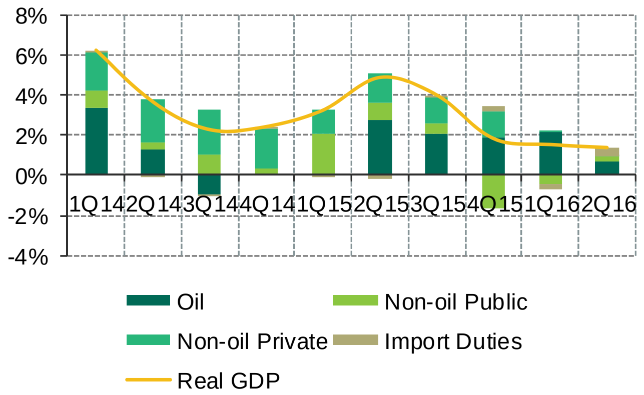
NCB الأهلي

Special Focus:
Short-term Drawbacks Towards Vision 2030

The notion to diversify away from the oil industry was a staple in the past nine five-year plans for Saudi Arabia, yet comparatively, the progress has been somewhat lagging. Recently, the traditional five-year plan has been ditched for a much needed reform and transition for the largest economy in the GCC in the form of Saudi Vision 2030. The goal is to shield Saudi Arabia's economy from oil shocks, similar to the one experienced now, and develop the economy to compete regionally and globally. The vision was revealed in late 2015 as a response to the drop in oil prices which was triggered in 2014 due to rising oil production from shale formations and OPEC's decision to fight for market share through pumping at record levels. Saudi's oil revenues dropped around 43% annually in 2015 as oil prices averaged USD50/bbl, collapsing from an average of USD97/bbl in 2014. Going into 2016, prices continued to be pressured to as low as USD25/bbl. The Saudi government had to contain the alarming rise in expenditures since 1999, the last time the economy contracted. Over the past 15 years, Saudi's total expenditures sky rocketed by 312% to reach SAR969.6 billion in 2015 from SAR235.3 billion in 2000. A series of subsidy cuts, project reassessments, and reductions in the public sector wage bill were announced to wane a 15.4% budget deficit in 2015.

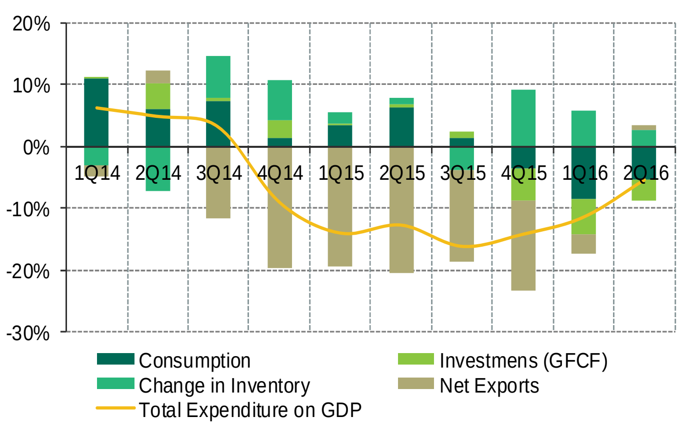
Chart 15: Real GDP, Contribution



Source: The General Authority of Statistics, NCB

The transitional period was unquestionably going to register a contraction which we expect in 2017. The latest figures released by the General Authority for Statistics reflect a decelerating trend as the market adjusts to the new norms. Real GDP registered a growth of 1.4% on an annual basis from April through June, following a 1.5% rise in the first quarter of 2016. The oil sector acted as the main drag, decelerating from 5.1% in 1Q16 to 1.6% in 2Q16 due to base effects. Despite an expected rise in 3Q16 as oil production peaked in July at 10.7MMBD, the recent OPEC accord will result in a contractionary sector as production levels revert back to 10MMBD beginning 2017. As for the non-oil sector, 2Q16 recorded a marginal growth of 0.4% Y/Y following two consecutive negative quarters. The positivity is mainly attributed to a rebound in non-oil government sector, rising by 1.3% as higher fees and lesser subsidies contributed greatly. Analyzing GDP by economic activity shows a significant contraction in the electricity, gas, and water category as higher energy prices squeezed profit margins for the sole providers in the country. Additionally, the construction sector deepened its contraction to 3.1% Y/Y in the second quarter. While the sector might find some respite from a recent announcement by the government that delayed payments will commence over the coming few months.

Chart 16: Expenditure on GDP, Contribution



Sources: The General Authority of Statistics, NCB

In nominal terms, GDP contracted by 5.4% to settle at SAR597.3 billion mainly due to the low level of oil prices as the oil sector registered a 21.5% decline. Gross fixed capital formation registered a third consecutive decline at 11.7% annually as USD123.5 billion worth of projects has been placed on hold since 2014 and a further USD76.3 billion have been cancelled, according to MEED Projects. In addition, private sector consumption expenditure reached 4.8% Y/Y in 2Q, up from 2.9% Y/Y in 1Q. We expect the recent reduction in public sector allowances to reflect a lower propensity towards consumption as two thirds of the work force will face diminishing income surpluses in 2017. In the government's view, the overhaul and restructuring of the economy will be challenging for businesses and consumers, yet will provide the foundations for a strong and diversified economy heading towards vision 2030.

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