February 2014

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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

Executive Summary

- The kingdom in OPEC's November 2014 meeting abandoned its swing supplier role, which was intended to remove the oversupply of expensive shale oil from the market, thus restoring its market share. Indirectly, the Kingdom passed the swing producer role to the non-OPEC expensive producers of oil.
- In the Eurozone, the rising likelihood of a Greek exit will keep volatility on the high end for the single currency which reached the lowest closing price versus the dollar in January at 1.12 before rebounding slightly post -elections.
- As for bullion, reduced physical demand by China and India, in addition to the reduced appeal of gold as a safe haven for investors will keep prices muted. On the other hand, Greek debt restructuring in addition to a flatter yield curve in the bond market this year, gold may be gaining some support.
- We expect the impetus for low prices of goods and services to carry through this year, affected largely by low energy and commodity prices. In contrast, recreation and culture continued to record elevated price levels for the sixth consecutive month.
- The flow of healthy corporate revenue announcements throughout February also supported stock prices higher. The preliminary results indicates an increase in corporate profitability to SAR115.4 billion last year compared to SAR103.3 billion in 2013, an 11.7% increase.
- The US's anchored rate hike expectations which is rattling central banks in emerging markets have not yet had any effect in Saudi Arabia's monetary policy. We expect very gradual increases to take place in tandem with the Fed as SAMA continues to maintain the USD/SAR peg.
- Non-oil exports moderated noticeably during September in 2014, bottoming out in October before a slight rebound. The Central Department of Statistics and Information (CDSI) reported that non-oil exports plunged in December to SAR16.7 billion, falling by more than 17% Y/Y.

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View of the Month

In our opinion, lending to SMEs is critical and there is still room for growth, especially that loans to such asset class is estimated to be just 3% of banks' loan portfolio in contrast to emerging and advanced economies where that percentage stands at 20% and 25%, respectively. The utilization of savings in the most efficient manner will be critical, and apparently the Kingdom is enhancing this virtuous link between savings and investments.

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Macroeconomic Indicators

	2009	2010	2011	2012	2013	2014P	2015F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	59.2	77.6	108.1	110.2	106.4	102.0	80.0
Average Daily Crude Oil Production, MMBD	8.2	8.2	9.3	9.8	9.6	9.7	9.5
GDP at Current Market Prices, SAR billion	1,609.1	1,975.5	2,510.7	2,752.3	2,806.7	2821.7	2662.6
GDP at Current Market Prices, USD billion	429.7	526.8	670.4	734.9	749.4	753.5	711.0
Real GDP Growth Rate*	1.8%	7.4%	8.6%	5.8%	4.0%	3.6%	3.4%
CPI Inflation, Y/Y % Change, Average	4.1%	3.8%	3.7%	2.9%	3.5%	2.7%	2.5%
External Sector							
Current Account Balance, USD billion	21.0	66.8	158.5	164.8	132.8	106.5	36.3
Current Account Balance/GDP	4.9%	12.7%	23.6%	22.4%	17.7%	14.1%	5.1%
Net Foreign Assets with SAMA, USD billion	405.9	441.0	535.9	648.5	717.7	710.1	678.0
Fiscal Sector (Central Government)							
Actual Revenues, SAR billion	509.8	741.6	1,117.8	1,247.4	1,156.4	1046.0	848.1
Actual Expenditure, SAR billion	596.4	653.9	826.7	873.3	976.0	1100.0	995.5
Expenditure Overrun, %	25.6%	21.1%	42.5%	26.6%	19.0%	28.7%	15.8%
Overall Budget Balance, SAR billion	-86.6	87.7	291.1	374.1	180.3	-54.0	-147.4
Budget Balance/GDP	-5.4%	4.4%	11.6%	13.6%	6.4%	-1.9%	-5.5%
Break-Even Oil Price	60.8	64.1	75.3	73.9	82.6	96.2	89.7
Financial Sector							
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	10.7%	5.0%	13.3%	13.9%	10.9%	12.1%	10.4%
Growth in Credit to the Private Sector	-0.6%	4.8%	11.0%	16.4%	12.1%	12.1%	8.4%
Average 3M SAR Deposit Rate	0.9%	0.7%	0.7%	0.9%	1.0%	1.0%	1.0%
Average 3M USD Deposit Rate	0.6%	0.3%	0.3%	0.4%	0.3%	0.3%	0.4%
Spread, in Basis Points, SAIBOR-LIBOR	26.4	39.8	40.9	55.2	68.7	70.0	60.0

Sources: Thomson Reuters, SAMA, and NCB

* All historical growth rates prior to 2013 are based on 1999 prices. However, 2013, 2014P, and 2015F are based on 2010 prices.

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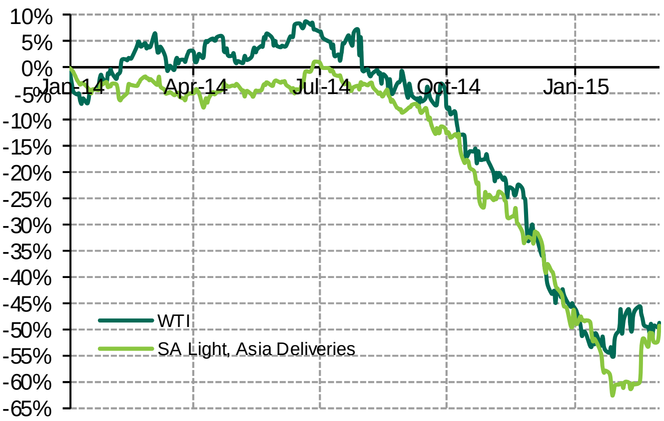
Oil Market

Saudi Abandons Role as Swing Producer

Brent crude future prices have rebounded in February to above USD60 a barrel, and for WTI to around USD50 a barrel. However, it seems that this rally of the last few weeks is coming to an end, with the downside has been influenced by the return of potential supply from Libya. In addition, the declining rig counts in the US, which is unlikely to have much effect on production just yet, have weekend the rally in WTI prices. Meanwhile, WTI outpaces the Brent declines, with premium of Brent over WTI widening close to USD10 a barrel. The oil outlook shows continued rising stocks and oversupply in the oil market, with no signs that OPEC will call for an emergency meeting. The rebound of Brent price and then recent flattening of its futures curve hints that the market is looking beyond the near-term oversupply and towards a gradual price rise, yet slowly, to USD70 a barrel over the medium term. This is also supported by the slow drilling in the US and the expected lower global production growth.

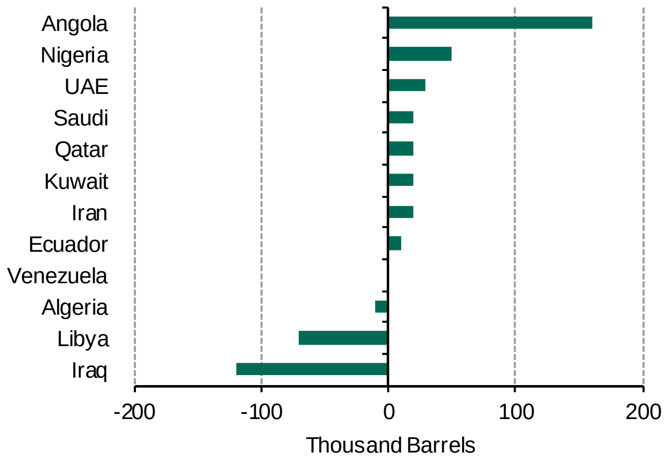
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

Crude supply has taken a hit, despite increasing production by Saudi Arabia and UAE. OPEC supplies reached 30.9mb/d in January, exceeding its target for eight straight months, with Saudi Arabia production increases to nearly 10.0mb/d. The kingdom in OPEC's November 2014 meeting abandoned its swing supplier role, which was intended to remove the oversupply of expensive shale oil from the market, thus restoring its market share. Indirectly, the Kingdom passed the swing producer role to the non-OPEC expensive producers of oil. Saudi Arabia is poised to emerge as the most flexible supplier of petroleum products globally, due to increasing volume of refined products the kingdom is currently exporting. According to JODI, the kingdom's crude oil production averaged 9.7mb/d in 2014, while crude exports, on the other hand, dropped to 7.1mb/d. The decline in crude exports stems in part from rising domestic demand by 207kb/d to 2.4mb/d in 2014, and increasing refinery runs, with the ramp-up of new giant refineries of Jubail and Yasref. Saudi refinery throughputs averaged a record high of 2mb/d in 2014, or 26% y/y. In 2014 as a whole, refined product exports rose by 262kb/d, up 43%.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

Libyan output has declined as Islamic Militants targeted oil infrastructure, but by late February, eastern oil fields resumed pumping oil after fixing port Hariga. In addition, on bad weather, Iraqi loadings from the south dropped, while rising conflict between Kurdish region government (KRG) and the central government curtailed some exports from the north. Iraq's production reached 3.04mb/d in January, compared with 3.35mb/d in December. In Iran, exports also suffered due to lower Indian intake. It is estimated that over the last few weeks nearly 1.5mb/d of crude have been unable to make it to the market. In the US, inventories are estimated to have risen to 429.4mb in week ended 20th February, and despite the drop in rig counts, the EIA forecast that US output will increase to 9.3mb/d in 2015, the highest since 1972. On the demand side, global oil demand in December totaled over 94.0mb/d, a record high, and up y/y by 2.2mb/d, the sharpest increase seen in the last 18 months. European demand came strong at 13.37mb/d, higher y/y by 0.12mb/d. Early country level data in Europe also suggest the continuation of this trend. Demand has surprised significantly to the upside, attributed largely to lower prices. The recent demand momentum is expected to continue through 2015, with global demand growth estimated at 1.0mb/d.

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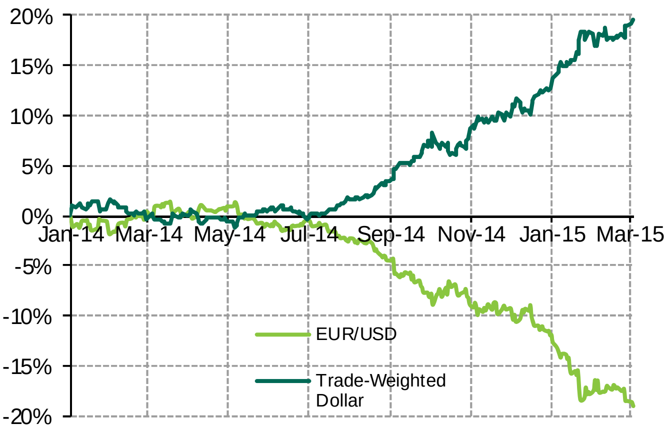
Foreign Exchange

USD to Strengthen on Fundamentals

In the forex arena, uncertain global outlook and uneven growth, in addition to mounting disinflationary pressures are leading central banks to shift gears to higher accommodation. Hence, we note a heightened volatility on all major currencies, which depreciated considerably, save the Swiss franc. Driven by strong fundamentals such as improving labor conditions, rising consumer confidence and overall growth prospects, the US dollar continued to rally throughout January by 5% on a trade-weighted basis, standing at 94.8. The Fed's anticipated interest rate hike is a core driver for global capital flows which are already in favor of the USD and its denominated assets. With that scenario likely to ensue mid this year, the Fed will assess the impact of low oil prices on short term inflation prior to the rate hiking cycle. Thus, we expect the hikes to be incremental and highly dependent on US macroeconomic data, in particular labor participation and wage growth.

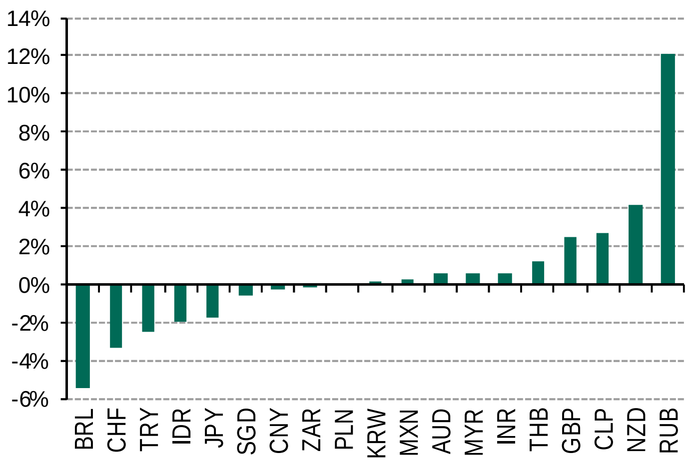
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

So far, the economic stimulus provided by cheap oil helped offsetting the loss of export competitiveness associated with a stronger dollar, especially when exports account for less than 15% of the US GDP. Consumer prices fell in December by 0.4%, marking the second consecutive monthly decline. The general disinflationary trend found in the core Personal Consumption Expenditures index (core PCE) reveals that even when excluding food and energy prices, inflation continues to perplexingly slip further below the Fed target of 2% to 2.5%. On the other hand, the Thomson Reuters/University of Michigan consumer survey indicates that confidence in the US economy surged to its highest levels in a decade, recording 98.1. Upbeat consumer spending will continue to help diminish the labor market slack as expectations of real income gains among Americans are the highest since 2004. While some key economic reports, particularly in the US have continued to show strength, the current volatility in the oil market, Greek debt negotiations, renewed Russian/Ukrainian conflict, and Chinese slowdown all carry potential downside risks. In the Eurozone, the rising likelihood of a Greek exit will keep volatility on the high end for the single currency which reached the lowest closing price versus the dollar in January at 1.12 before rebounding slightly post -elections. According to the flash estimate of Eurostat, the Harmonized Indices of Consumer Prices (HICP) recorded the lowest inflation since September 2009, falling by 0.6% Y/Y (+0.4% Y/Y excluding energy) in January, drifting further below its 2% target. The ECB which launched an expanded asset purchase program in order to boost economic activity in the euro area expects inflation to remain low in the coming months due to the currently low oil prices. Therefore, in the case that no visible improvements were made, the ECB might opt to prolong its stimulus beyond September 2016. In Asia, the Chinese yuan weakened to eight-month-lows as trading activity softened and became more erratic.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The Chinese lunar new year may distort macroeconomic data as it is a moving cyclicality, in addition to causing a boost in trade activity usually prior to the holiday. By the end of January, the CNY depreciated by 0.7% from a month earlier to 6.25/USD. The JPY will maintain a broad weakening bias as it broke the 120 level in December; however, global risk aversion may intermittently pressure the currency to strengthen. As such, the JPY appreciated by 1.9% in January from its last 2014 closing price to JPY117.47/USD.

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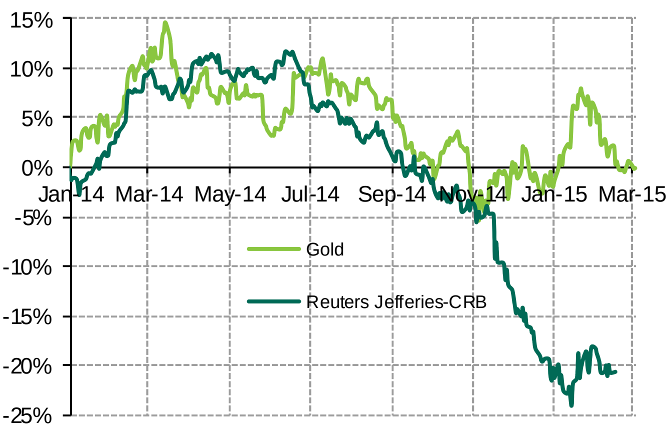
Commodities

Commodities Extend Downturn in January

The second half of 2014 was marked by considerable broad-based commodity price declines. Although most of the declines can be attributed to plunging oil prices due to the pivotal role oil plays as a factor of production, the strengthening dollar and softening global demand magnified the downturn. According to the Thomson Reuters CRB Index, commodities plunged by 6.9% last year and are expected to extend weakness in 2015 as the index slid further by 4.8% in January. Excluding energy, other commodities tanked by 3.3% in the same month, with a downside bias in the near term. Metals are expected to decline 5.3% this year affected by lesser demand for them as industrial materials and as investment vehicles. On the other hand, we are less pessimistic in regards to agricultural commodities such as food grains which will likely be supported by supply concerns following the Winter season. Yet, the Goldman Sachs Agricultural Commodity Index recorded a 7.5% price decline in January on top of the 8.3% price declines that occurred along 2014.

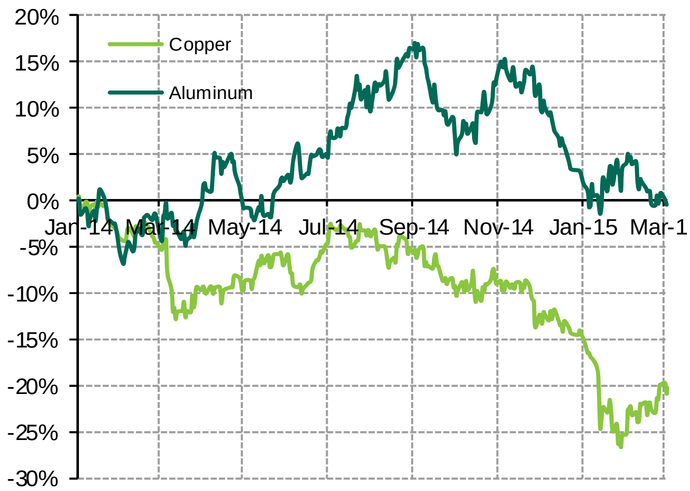
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Base metal prices were largely negative in January. Even aluminum and nickel, the two metals that are fundamentally posed to appreciate amid export bans and supply constraints recorded negative price movements. Copper, the most used industrial metal continued its free-fall in the first month of the year, drifting by an additional 12.8% to close at USD5,495/ton. Aluminum prices entered negative territory during January by around -5.5% before rebounding towards the end of the month, inching up by 0.6% M/M at USD1,864/ton. Nickel followed the same path as aluminum, rebounding back to the same levels at USD15,165/ton. The London Metal Exchange warehouse stock shows that, beside aluminum which saw higher outbound deliveries than inbound shrinking by 3.9%, copper has been stockpiling throughout January, surging by 41.2% compared to December to 250 thousand tons. This indicates a lackluster demand for the metal despite its falling price. Idiosyncratic factors such as tight global supply of aluminum and cooling economic activity in China, which reflects on demand for copper, largely explain the divergence between copper and aluminum warehouse movements.

Chart 6: Base Metals



Source: Thomson Reuters

As for bullion, reduced physical demand by China and India, in addition to the reduced appeal of gold as a safe haven for investors will keep prices muted. On the other hand, Greek debt restructuring in addition to a flatter yield curve in the bond market this year, gold may be gaining some support. As we saw on January 22nd, gold prices surged by 10% YTD, breaking the 1300 level. Nevertheless, we do not expect gold to take a center stage in 2015, mainly due to the stronger dollar and improving US economic fundamentals. We expect gold prices this year to range between USD1,100 and USD1,400 per troy ounce.

The prices of food grains futures tumbled in January given ample supply amid a stronger USD. Current crop yield prospects are not likely to be reversed until the end of the Winter season, and existing crop yield is likely to offset price spikes in the case of a drought. In January, wheat futures price plunged the most among edible grains, measuring -14.5% M/M, standing at cents506.75/bushel. Corn prices followed by a 6.9% monthly downturn to cents371/bushel, and soybeans price declined by 6.1% M/M to cents963/bushel.

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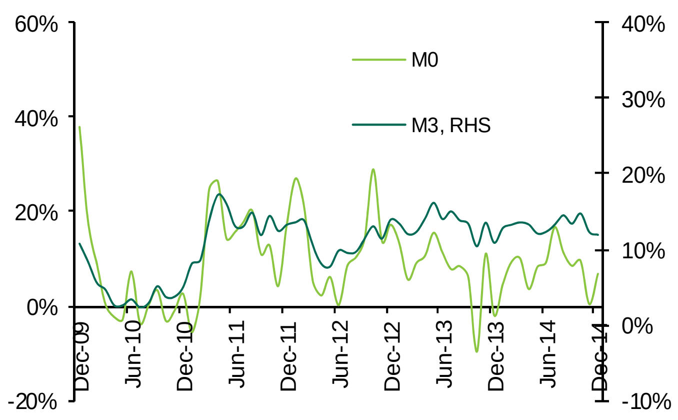
Money & Inflation

Money Supply At All-Time-High

Broad money supply (M3) reached an all-time-high in December 2014 at SAR1.73 trillion as a part of the continuous expansionary phase the economy is undergoing. Looking into more specifics in the composition of money supply, we find that the pace of annualized growth rate decelerated in December to 11.9%, the lowest since December 2013. The monetary base saw a 6.8% annualized upturn in December as currency outside banks and reserves rose by a respective 7.4% and 6.3%, bringing the total to SAR366.9 billion. Money supply M2 has been maintaining a double-digit growth throughout the year, mainly driven by a strong growth in demand deposits. In December, demand deposits surged by the highest rate since February at 15.4% to SAR989.2 billion. On the other hand, time and savings deposits decelerated from July's peak of 24.8%, albeit still at a double-digit of 15.6% Y/Y, recording SAR398.7 billion. Quasi monetary deposits slid in December compared to a year earlier, standing at SAR187.7 billion. The rise in liquidity despite the turbulent oil markets reflects the counter-cyclical monetary and fiscal policy the Kingdom is pursuing. Total reserve assets saw a withdrawal of SAR30.2 billion in December, the largest of the four consecutive withdrawals that took place since September.

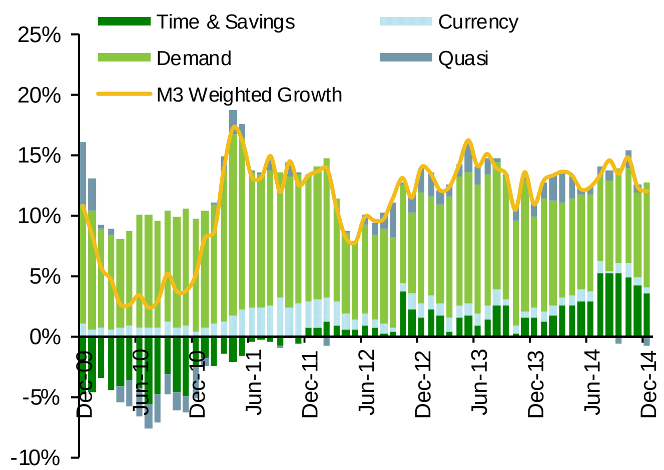
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Statutory reserves required by SAMA reached SAR91.9 billion in line with the growing depositary base. On the other hand, excess reserve ratio reached the highest levels since March at 50.6%, indicating a surge in liquidity. Saudi banks tend to slow down their lending activities by year-end to reflect their liquidity on the balance sheets. SAMA bill issuance rose by 26.2% compared to last year in December to SAR226 billion to control liquidity levels in the market.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

Annualized Inflation in the Kingdom saw a 2.4% upturn in December, the lowest since 2006. Food prices rose by the slowest pace since August, recording 2.6%. Housing and utilities prices edged up by 2.5%, the smallest increase since December 2012. These two categories make up over 42% of the Cost of Living Index, thus contributing to the lower overall change in the general index. The lower inflation figures in the housing category is largely due to a 2.4% decline in the cost of materials for repair and maintenance of urban dwellings. Utility prices plummeted to a larger extent due to a fall in the cost of water supply by around 11.5%. Price levels in the communication category has been notably declining for the last four months leading to December in which prices edged down by 0.5% Y/Y. This is mainly due to a 4.4% annualized decline in the prices of telephone and telefax equipment. We expect the impetus for low prices of goods and services to carry through this year, affected largely by low energy and commodity prices. In contrast, recreation and culture continued to record elevated price levels for the sixth consecutive month. Prices of equipment for the reception recording of sound and pictures surged by 27% in December, contributing to the high inflation in the broader category. Concluding the year, we find that annual inflation rate averaged 2.7% and we expect the growth in general price levels to remain subdued throughout 2015. Low imported inflation driven by a strong US dollar and suppressed commodity prices will continue to have a broad-based effect across all categories, albeit by varying degrees.

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Capital Markets

Equity Market is Gaining Traction

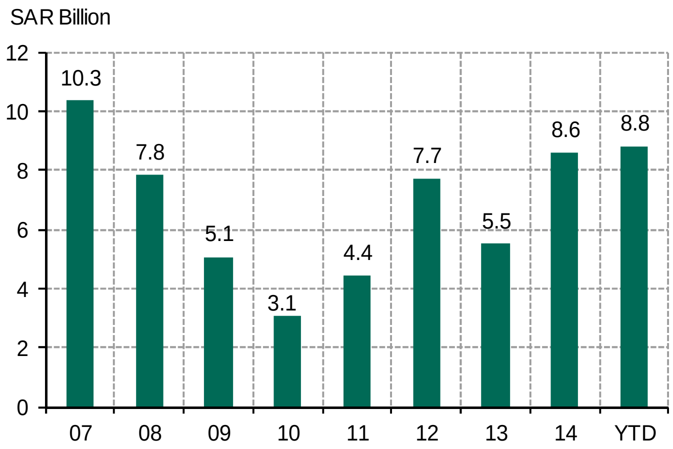
Global equity markets managed to reverse their negative standing into a positive one during February, rising by 5.4% M/M, according to the MSCI World index. The gain was across the board, with emerging and advanced markets increasing by 5.8% and 3% M/M, respectively. The Saudi stock market, Tadawul, that broke off the negative trend in January continued its positive momentum well into February, rising by 4.9% M/M, which propelled the year-to-date gain to 11.76%. The All-Share index increased during the previous month on the back of the smooth succession of King Salman bin Abdulaziz and the follow-up of around 30 Royal decrees that amounted to more than USD30 billion. The market peaked in the middle of the month, reaching the 9,467.06 level before closing the month at 9,313.52, and it is becoming apparent that TASI will remain range-bound up until the CMA's announcement of the final trading regulations for foreign institutions that are expected to access the market before the end of the 1H2015.

Chart 9: Tadawul All-Share Index

Source: Tadawul

The flow of healthy corporate revenue announcements throughout February also supported stock prices higher. The preliminary results indicates an increase in corporate profitability to SAR115.4 billion last year compared to SAR103.3 billion in 2013, an 11.7% increase. Regarding the sectoral performance, the strongest sector was energy, recording a growth of 19.2% for the month, followed by the real estate sector sub-index, which managed to add 15.5%. On an YTD basis, only three sectors remain in the red, namely telecommunications, petrochemicals, and media, edging lower by the end of last month by 33.3%, 16%, and 14.5%, respectively. The more than 60% decline in oil prices and Mobily's accounting scandal had weighed heavily on the aforementioned sectors. Investor appetite, represented by the average daily trading volumes, increased during February to SAR9.72 billion from SAR8.12 billion a month earlier. And market capitalization rose to SAR2.03 trillion, a gain of 5.6% M/M. The majority of trading continues to be attributed to Saudi individuals, representing around 90%. In contrast to the vibrant secondary market, the primary market did not witness any activity, yet there are 7 announced IPOs for this year, mostly from the financial services.

Chart 10: Average Daily Traded Value



Source: Tadawul

Looking ahead, the recent fund managers' January survey conducted by Reuters has reflected the growing interest in the domestic market, with 40% expected to increase Saudi equity allocations, which is a marked shift from the December survey whereby 40% of respondents were expecting a cut in such allocations. The stability in oil prices around the USD50-60/ bbl range in addition to the attractive valuations were cited among many for being the driving factors behind such sentiment. The banking sector was highlighted as an attractive proposition, especially that their low cost funding structure that is dependent on non-interest bearing deposits will ensure improved profitability as interest rates inflect to the upside in 2H2015, with assets adjusted faster than liabilities.

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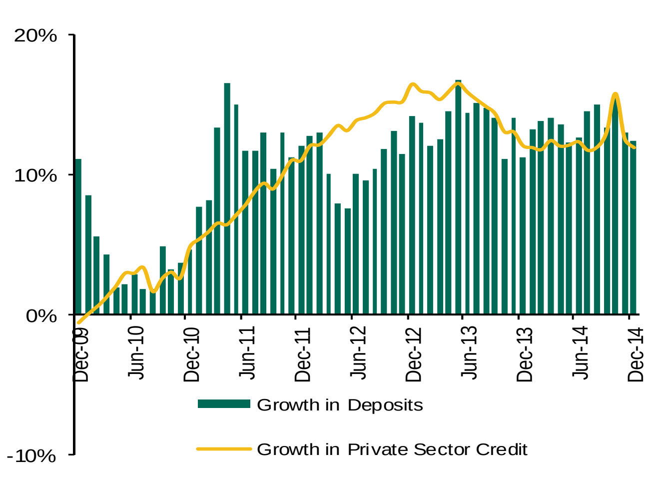
Loans Market

The Saudi loans market continue to be robust supported by strong demand from the private sector. The Kingdom's counter-cyclical monetary and fiscal policies kept liquidity at high levels, and demand for money, especially by businesses and individuals was unshaken by tumbling oil prices. Annual growth in deposits recorded 12.4% in December, reaching SAR1.58 trillion, whereas total bank lending, excluding T-bills and government bonds maintained double-digit growth levels of 11.6%. Total private sector credit of which the majority consists of loans, advances and overdrafts increased over last year by 11.9% to SAR1.2 trillion. On the other hand, total public sector credit remained elevated over last year by around 19% at SAR324.9 billion. Investment in government securities saw a 22% Y/Y upturn in December, reaching SAR279.1 billion. This brings fresh loans extended by banks in 2014 to public and private sectors to SAR130.1 billion.

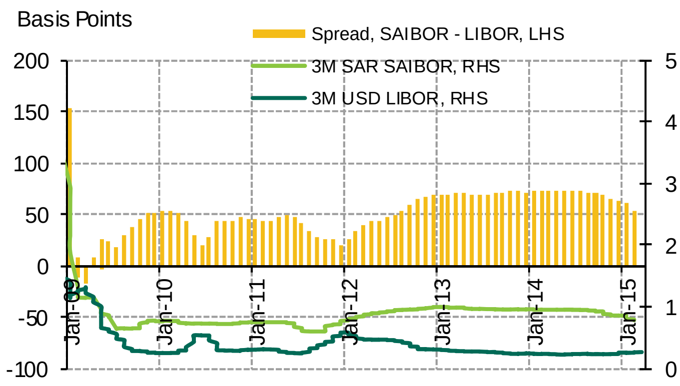
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

From a maturity perspective, close to a half of all bank credit (about SAR621.3 billion) is short-term, while medium-term and long-term loans account for 19% and 31.3% of total bank loans, respectively. Since late 2012, we have been noticing an acceleration in the growth of longer maturity loans met by a deceleration in short-term loans caused by a respite in infrastructure projects. The flurry of 2011's mega projects put loans activity at full swing, thus creating a high base effect. At times where cash is not required for immediate withdrawal, depositors shift towards time and savings accounts which grew by 15.6% Y/Y in December, reaching SAR398.7 billion. Saudi banks, however, still maintains a healthy level of capacity utilization as represented by the loans-to-deposit ratio of 79.4%. Although the year's average has been over 80%, banks tend to reduce exposure at year end in order to assess their portfolios and plan for the coming year.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

As reported by SAMA, the benchmark interest rate in Saudi Arabia, the official repo rate (ORR) remains at 2%, which is well below the long-run average of 3.9%, reflecting a continued loose monetary policy. The US's anchored rate hike expectations which is rattling central banks in emerging markets have not yet had any effect in Saudi Arabia's monetary policy. We expect very gradual increases to take place in tandem with the Fed as SAMA continues to maintain the USD/SAR peg. Internal dynamics will remain largely isolated, however, and we expect liquidity to continue at current levels, especially in the absence of inflationary pressures. The Saudi 3-month interbank rate (SAIBOR) recorded the lowest rate since February 2012 at 86bps, indicating ample liquidity and a low-risk environment. Hence, we induce that the surge in the excess reserve ratio up to 50.6% is due to high liquidity rather than lending concerns. The positive business cycle in the Kingdom encourages active investment despite the lower outlook on its credit grade (AA-) given recently by S&P as the country remains a net lender. The over 50% drop in oil prices does raise the specter on its fiscal positon as the government remains about 90% dependent on oil as the main source of revenue. However, as oil prices are expected to rebound, in addition to the country's substantial foreign reserve, the sustainability of incurred budget deficits in the coming years may not have any serious repercussions on the overall economy.

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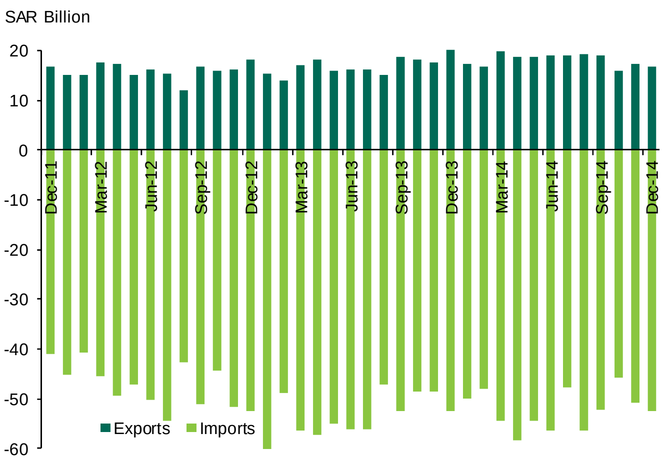
External Trade

Non-Oil Trade Gap Widens by 10.7%

Non-oil trade data for the month of December shows annualized declines in exports in both weight and value terms. Non-oil exports moderated noticeably during September in 2014, bottoming out in October before a slight rebound. The Central Department of Statistics and Information (CDSI) reported that non-oil exports plunged in December to SAR16.7 billion, falling by more than 17% Y/Y. Explanatory variables include declining oil prices, as petrochemicals and plastics constitute around 63% of the value of monthly non-oil exports. Imports, on the other hand, ended the year at comparable levels to 2013's SAR 52.4 billion. Therefore, the balance of trade gap widened by an additional 10.7% in December from a year ago.

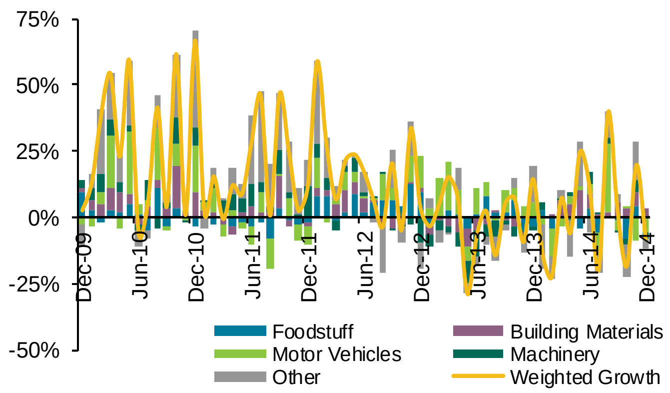
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

Composition-wise, plastics made up around 32.9% of December's trade value at SAR5.5 billion, thus falling by 14.7% compared to the same period last year. Chemical products made a sizeable retreat of 24.4% Y/Y after recording exports of this category valued at SAR5 billion. Conversely, exports of base metals surged by 24.3% Y/Y, recording SAR1.3 billion. The petrochemicals and plastics sector which was certainly dented by cheap oil on a quarterly earning basis might see a rebound in 2015 if the newfound recovery in oil prices is sustained for longer periods. As for non-oil exports' breakdown by destination, China accounts for the largest share of 13.7% at SAR2.3 billion. Exports to China have been impacted in 2014 by the declining global demand prospects. HSBC's Purchasing Managers' Index saw a deterioration in both output and new orders for Chinese manufacturing. The index fell to 49.6 in December from 50 a month earlier, signifying a contraction in business activity and a cut in production. China also reduced its manufacturing employment in December, extending labor downsizing to 14 months. Consequently, China's monthly non-oil trade with the Kingdom fell markedly by 26% in December compared to a year earlier. Contrariwise, Singapore's share of Saudi non-oil exports surged by 18.1% during the month to SAR1.6 billion, roughly accounting for 9.7% of the monthly total. Trade with the UAE was impacted by the general slowdown in global trade. As one of the region's prominent trade hubs, much of the Kingdom's exports to China and other Asian economies are re-exported from the UAE. Hence, non-oil exports to the UAE tumbled drastically in December by 43.4% Y/Y to SAR 1.6 billion, around 8.5% of the total.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the import side, machinery and electrical equipment account for over a quarter of imports, valued at around SAR14 billion, inching up by 1.9% from last year. Transport equipment marked the highest annualized upturn in an import category of 4.8%, valued at SAR 10.2 billion. Imports of base metals were valued at SAR6 billion or 11.5% of the import bill, a level that is in line with last year's. In value terms, the top countries of origin are China, USA and Germany. Chinese imports made up over 15% of December's import bill as they reached SAR 7.9 billion. In comparison to last year, we find that imports from China surged by 22.9%, the highest among trading partners. US imports, on the other hands, made a lesser share of 12.6%, valued at around SAR 6.6 billion, thus declining by 8.4% from a year ago. Imports from Germany remained at comparable levels to last year at SAR3.6 billion or 6.9% of the import bill, inching down by 1.7% Y/Y.

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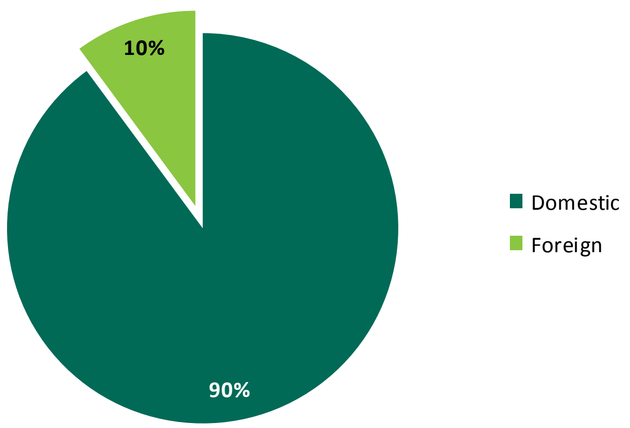
Special Focus:
SCIs Growing Role

The Saudi government is adamant in pursuing policies that continue to support a predominantly young population through the creation of job opportunities, the provision of housing, and the rectification of regional imbalances. This is why Specialized Credit Institutions (SCIs) such as the Public Investment Fund (PIF), Saudi Industrial Development fund (SIDF), Saudi Credit & Saving Bank (SCSB), and the Real Estate Development Fund (REDF) represent a pivotal role in achieving the above-mentioned strategy. According to the latest available data published in SAMA's 4Q2014 bulletin, the consolidated balance sheet for government SCIs points to: (1) a significant increase in the disbursements of new loans by SAR29.5 billion, 12.1% Y/Y growth, during the first three quarters of 2014, which is the largest disbursement on record compared to prior periods, reflecting the drive to support domestic activity, (2) an increase of 6.7% in the total value of investments to around SAR135.04 billion by the end of 3Q2014, which was attributed to a growing domestic portfolio that rose from SAR112.97 billion by the end of 2013 to SAR121.4 in 3Q2014, (3) an insignificant increase in foreign investments that remained around SAR13.6 billion mark, and (4) a 21.7% Y/Y decrease in deposits with SAMA that stood at SAR73.9 billion, reflecting the withdrawal of such deposits in order to extend loans to local companies rather than passively investing them whether internationally or locally. In our opinion, the budget appropriations for 2015 that amounted to SAR73.7 billion coupled with this latest data reflect the central role played by SCIs as a catalyst in the domestic economy, and it will not be surprising if this year posted new historical figures.

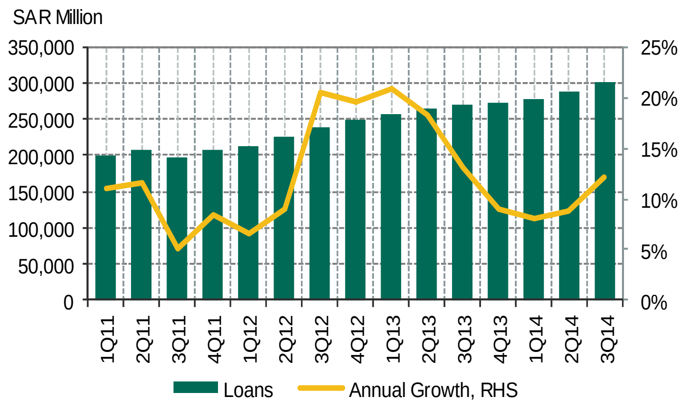
Table 15: Investment by Type



Sources: SAMA and NCB

As expected, the REDF was largest among these institutions in terms of the outstanding loans that registered SAR124.7 billion, and it is our believe that such figure might have crossed the SAR130 billion threshold as will be shown in the coming data releases. It is no surprise that REDF will maintain its status as the largest lender among SCIs with the government trying to mitigate the housing market imbalances especially at the demand side. The PIF and SIDF had also maintained the second and third rank given their participation in project finance across different sectors that enhance the kingdom's absorptive capacity, with the outstanding loans to both standing at SAR87.2 billion and SAR30.5 billion, respectively.

Table 16: Loans



Sources: SAMA, and NCB

On the Small and Medium scale Enterprises (SMEs) front, the Loan Guarantee Program "Kafalah", which is a collaboration between the Ministry of Finance represented by SIDF and Saudi banks continued to gain ground, facilitating credit worth around SAR1.6 billion by the end of 2Q2014 to 1800 establishments, representing 19.9% of the aggregate beneficiaries since the inception of the program in January 2006. In our opinion, lending to SMEs is critical and there is still room for growth, especially that loans to such asset class is estimated to be just 3% of banks' loan portfolio in contrast to emerging and advanced economies where that percentage stands at 20% and 25%, respectively. Bottom-line, although the accumulation of savings from the oil windfall was important, the utilization of savings in the most efficient manner will be critical, and apparently the Kingdom is enhancing this virtuous link between savings and investments.

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