March 2014

www.alahi.com

NCB الأهلي

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

Said A. Al Shaikh
Chief Economist | s.alshaikh@alahli.com

Tamer El-Zayat
Senior Economist / Editor | t.zayat@alahli.com

Yasser A. Al-Dawood
Economist | y.aldawood@alahli.com

Majed A. Al-Ghalib
Senior Economist | m.alghalib@alahli.com

Executive Summary

- Currently, Iran's nuclear negotiations with the West is taking the limelight, especially that a final resolution in June that lifts sanctions, in place since 2012, will increase Iran's oil exports that at present stands at 1 MMBD to 2.5 MMBD, the level witnessed pre-sanctions.
- In The world's reserve currency enjoys a broad-based upward movement underpinned by positive macroeconomic data and a large demand for dollar-denominated securities. Investor speculation pushed the trade-weighted dollar index above the 100 mark mid-March, strengthening by over 10% YTD.
- The ongoing panic over a slower pace of growth in China, and the two-week Lunar New Year holiday early this year also reinforced a dismal outlook on industrial metals. Additionally, agricultural commodities upticked at the beginning of the year on the back of weather concerns but relapsed by 9% towards the end of the quarter.
- The main downward price pressure comes from cheaper commodities and a higher purchasing power for the dollar-pegged Saudi riyal. The heavy reliance on imported food stuff in the Kingdom leaves a high exposure level to imported inflation, which turned to be favorable under the current global disinflationary trend.
- Trading through SWAP agreements has declined as international investors expect the opening of the market to foreign financial intuitions in the coming months. As the market awaits the decision, it remains dominated by individual investors with a speculative mindset.
- The Saudi government appears to be adopting a wait-and-see approach in regards to moving rates in tandem with the US Federal Reserve. Currently low inflationary pressures and expectations make it unlikely that we will see a preemptive decision regarding policy this year.
- Saudi Arabia's non-oil trade activity extended last year's deceleration, posting a total of SAR15.6 billion of non-oil exports in January. Compared to SAR17.2 billion in the same period last year, non-oil exports declined by 9.1%, the lowest level since August 2013. Imports, on the other hand, registered a smaller decline on an annual basis in the tune of 4.7%, settling at SAR47.5 billion.

View of the Month

As banks successfully reduced risk levels, provisions for possible credit losses declined by SAR218 million to settle at SAR6.8 billion, the lowest level since 2011. In our opinion, the banking system will continue to rise on growing volumes, yet, competition on diminishing margins will intensify. Product development will be key as the market becomes more developed with higher consumer and businesses awareness.

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

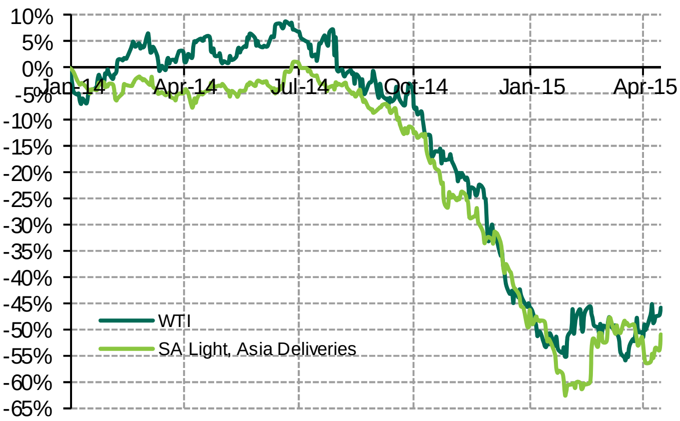
* All historical growth rates prior to 2013 are based on 1999 prices. However, 2013, 2014P, and 2015F are based on 2010 prices.

Oil Market

The Range-bound Theme Continues

Oil benchmarks have been range-bound since the beginning of the year, contained within the USD40-50/bbl range. The three benchmarks, Brent, WTI and the Arabian Light languish in the red, falling by 11%, 4% and 5% in 2015YTD, respectively. The oversupply theme continues to gain traction in addition to the global economic slowdown and weak oil demand. The supply side had been negatively impacted by rising crude stockpiles and the elevated non-OPEC production. In the US, the biggest oil consumer, crude inventories increased unabatedly to 471.4 million barrels by the end of 1Q2015, the highest level in around 80 years. Additionally, the OECD's commercial total oil inventories rose to around 2.73 billion barrels, a record level that is equivalent to 60 days of consumption. Currently, Iran's nuclear negotiations with the West is taking the limelight, especially that a final resolution in June that lifts sanctions, in place since 2012, will increase Iran's oil exports that at present stands at 1 MMBD to 2.5 MMBD, the level witnessed pre-sanctions. Most importantly, Iran, according to myriad sources, have stored more than 30 MMBD during the past two and a half years on supertankers, which will surely expedite the export pace following an agreement. Yet, it is our opinion that any deal struck will lift sanctions gradually and as such the impact will be felt over an extended time frame rather than instantaneously.

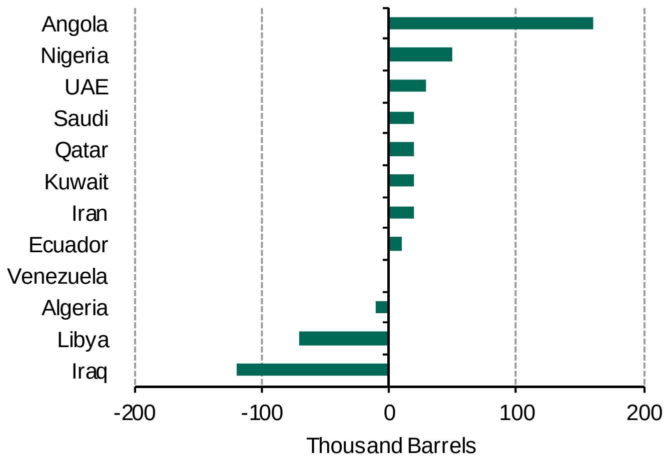
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

The demand for oil will continue to be hampered by global economic growth that continues to be revised downwards, with the IMF in January reducing its forecast for global growth in 2015 to 3.5%, down from an October prediction of 3.8%. Notably, this was the third revision downwards by the IMF since January 2014, underscoring the headwinds facing the global economy. The weak and uneven economic recovery of the Eurozone will remain a hanging cloud on world markets, with the Greek debt crisis far from over and deflation lurking in the background. Despite the sharp decline in prices since June, demand has not edged higher, with the IEA predicting just tentative signs of recovery, with global oil demand growth expected to register 1 MMBD in 2015.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

The aforementioned factors coupled by OPEC's elevated crude production added to concerns that a market glut scenario will continue to haunt the oil markets. The 12-nation group increased production to 30.63 MMBD in March from a revised 30.07 MMBD in February. Interestingly, the geopolitical tensions that erupted in Yemen, which had initially supported oil prices quickly dissipated, reflecting the reduced impact emanating from geopolitical tensions on market participants during the past couple of months. It is our opinion that oil markets will remain inherently volatile and that OPEC's June meeting will be instrumental in testing the resolve of the cartel and unity amongst its members. We do believe that the second half of this year will break the anomaly of lower rigs and higher US crude production, as the shale oil business model faces tough economic realities.

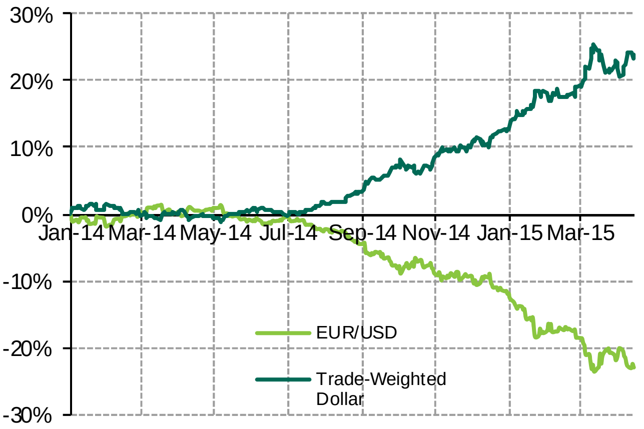
Tamer El-Zayat
Senior Economist/Editor | **t.zayat@alahli.com**

Foreign Exchange

Strong USD Gets The Fed's Attention

Global central banks' policy dynamics have become more distinct in 2015 after over twenty central banks took clear decisions to adopt monetary easing by the end of first quarter of the year. Focus on the Federal Reserve, which took a lonesome path towards lesser accommodation, has intensified after it abandoned most of previously set quantitative metrics for qualitative ones. Favorable economic fundamentals including unemployment falling to 5.5%, the lowest since May 2008, and non-farm employment consistently posting the creation of over 200,000 jobs/month since March 2014 are increasing the likelihood of policy normalizing. The world's reserve currency enjoys a broad-based upward movement underpinned by positive macroeconomic data and a large demand for dollar-denominated securities. Investor speculation pushed the trade-weighted dollar index above the 100 mark mid-March, strengthening by over 10% YTD, and US equities reached new all-time-highs with the S&P 500 breeching the 2,100 level and the Dow trading above the 18,000 points. On the flip side, the consumer surplus coming from cheaper commodity prices and a stronger purchasing power is creating little pressure on wages and prices to go up, translating into inflation levels being below the Fed's 2% target.

Chart 3: Trade-Weighted Dollar and the Euro

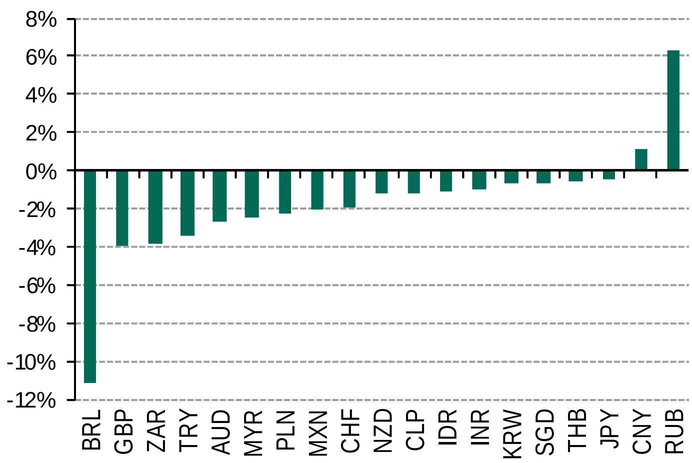


Source: Thomson Reuters

The March FOMC meeting emphasized the importance of adequate inflation levels for creating a wage/price spiral in a virtuous economic cycle. Addressing the soft growth in wages and housing prices in addition to the dollar's rally eroding the earning of US multinationals and exports indicated that the Fed is not yet reasonably confident that the economy can withstand higher interest rates. Consequently, the USD index edged down slightly towards the end of March, standing at 98.4.

The Euro area's subpar growth is putting the single currency under pressure, with some of the peripheries such as Italy relapsing into a triple-dip recession. The IMF's World Economic Outlook revealed a more uneven growth outlook on the member countries compared to 2014 which could increase the policy rift between Germany and the ailing nations. The ECB's recent quantitative easing program, in addition to the negative interest rates which drove currency outflows led the single currency to depreciate by over 10% YTD, approaching parity with the dollar at 1.07 by the end of March. Bearish sentiments kept volatility relatively low, although positive PMI and consumer sentiment data from Germany and Spain, mostly influenced by cheaper commodity prices and a weaker Euro, could positively impact local demand and export competitiveness.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the UK, growth looks well positioned to accelerate over the year after a short deceleration at the end of 2014. Households disposable income will gain from lower inflation in addition to solid job creation. Easy money in the Euro area should have a positive spillover effect and could possibly push GDP growth in the UK closer to 2.7% this year. In addition, the windfall from lower energy prices last year should create a base effect for annualized future inflation rate, if oil prices rebound, potentially boosting it to around 2%. As of February, price levels recorded no change from last year, making the likelihood of a rate hike by the Bank of England in the near term quite low. The Monetary Policy Committee maintained the BoE rate at 0.5% and will probably maintain this rate until sustained adjustments are seen in the path of inflation. By the end of March, the GBP weakened versus the USD by around 5% YTD, standing at USD1.48/GBP.

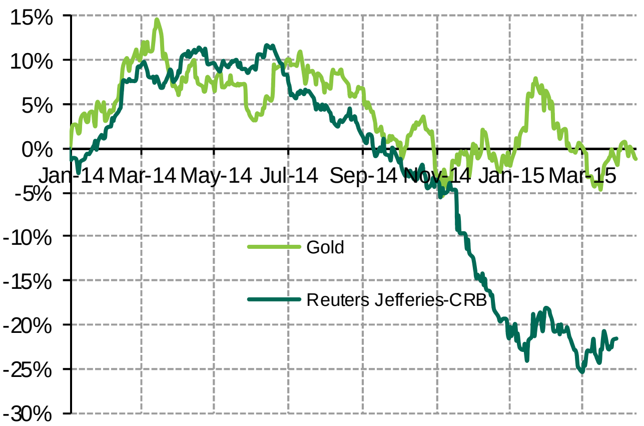
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

Commodities

Commodities Are Yet to Find Floor

As the Federal Reserve and the Bank of England look for more economic traction to pursue the path of normalization, the dry up in liquidity from the emerging market has caused a cool down in investment in commodity based economies. In order to stimulate their economies, emerging markets' central banks deployed loose monetary policy, thus devaluing their respective currencies. In addition, demand prospects were also dented as the propensity to save intensified due to inflationary expectations being low. The ongoing panic over a slower pace of growth in China, and the two-week Lunar New Year holiday early this year also reinforced a dismal outlook on industrial metals. Additionally, agricultural commodities up-ticked at the beginning of the year on the back of weather concerns but relapsed by 9% towards the end of the quarter. The short-lived 12.7% surge in oil prices in February assisted the regaining of an upward momentum in the overall Thomson Reuters/Jeffers CRB index, rising by 2.4% M/M. Persistent oil supply glut, however, coupled with weak global demand prospects amid appreciating US dollar led oil prices to plunge again, pulling the index down to by 5.5% M/M in March.

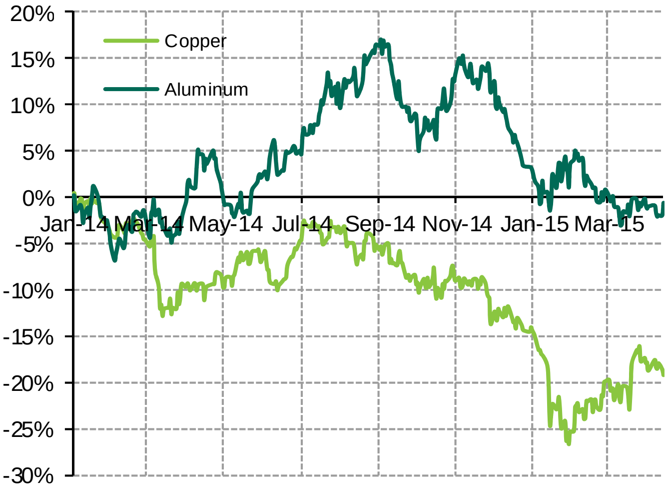
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Copper prices are up 3.8% M/M in March amid speculation that demand for the industrial metal will increase due to accommodative policies in most central banks. LME copper stood at USD6,076/ton, up from USD5,854/ton a month earlier. This led LME warehouse copper stock to surge around 19% on a monthly basis to 297.2 thousand tons in anticipation for stronger demand. LME aluminum prices remained unchanged at around USD1,804/ton during March as prices remain supported by a positive PMI in the US, particularly in the automobile industry. Gold prices rallied in January and February on risk aversion amid renewed uncertainty in Europe as the Russian/Ukrainian conflict intensified, breaking the 1,300 level on late January. Gold prices dwindled the following month as investors gravitated towards riskier assets, driven by a positive US outlook. Late March, the Saudi-led military campaign against Houthi militias in Yemen pushed gold prices to increase by around 2% while the dollar weakened. By the end of March, gold erased all gains made since the beginning of the year, standing at USD1,183.9/oz.

Chart 6: Base Metals



Source: Thomson Reuters

According to the S&P / Goldman Sachs Agriculture Index, agricultural commodities tumbled by 4.3% M/M to 293.5 by the end of March. Extreme weather conditions in the US mostly affected Eastern and Western states, with California entering the fourth consecutive year of drought. While most central plains also received less precipitation than normal, Southern storms produced disruptive amounts of snow detrimental to the health of Winter wheat. Therefore, wheat futures inched up by 1.2% in February to 513 cents/bushel. However, favorable weather elsewhere such as Europe and Turkey, Eastern Asia, and Northwestern Africa forced Winter wheat out of dormancy earlier than usual, fueling ample supply prospects. Consequently, CBOT Wheat futures remained almost unchanged in March. On a similar note, corn futures surged by around 4% in February to 393.3 cents/bushel before erasing gains the following month on higher yield expectations from South America and Southeast Asia. Meanwhile, after Soybean futures soared by 6.6% in February, reaching 1,031 cents/bushel, beneficial rain in Brazil helped stabilizing soybean crop yield prospects, bringing prices down to 973.3 cents/bushel by the end of March.

Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

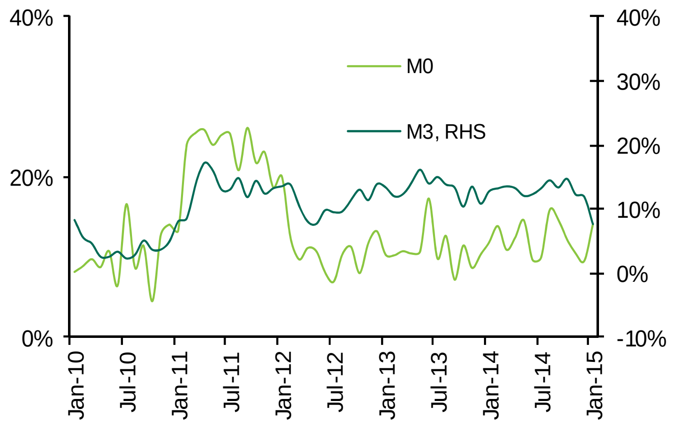
NCB الأهلي

Money & Inflation

Money Supply Growth Moderates

In the month of January, overall money supply rose by a margin of an annualized 7.7%, the lowest since May 2012. Looking deeper into monetary composition, we note that growth in the monetary base was around 9.5% compared to last year, reaching SAR283.1 billion. Although on an annual basis, currency outside banks, cash in vault, and most deposits with SAMA rose at comparable rates to previous months, public financial institutions' deposits with SAMA registered a decline of 6.1% Y/Y, falling down to SAR5.9 billion. Demand deposits, which constitute 58% of the money supply maintained a growth of just over 10% to SAR986 billion, the lowest in six years. Time and savings deposits which make up 22.5% of the money supply advanced by 12.2% Y/Y to SAR382.2 billion, also the slowest pace since May last year. This brings near money M2 to a total of SAR1.5 trillion, up by 10.5% compared to the same period last year.

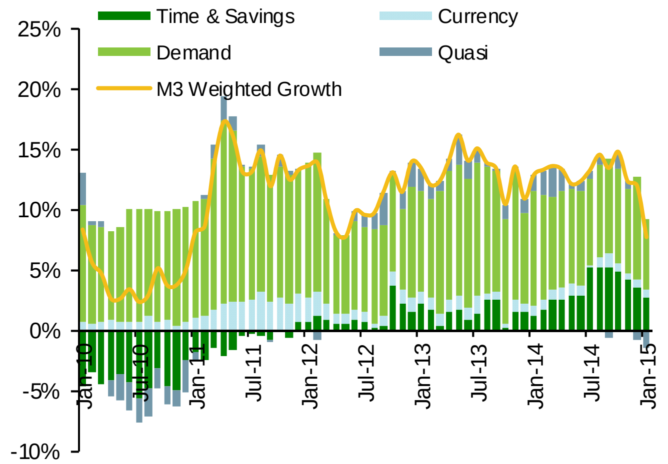
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

On the other hand, quasi monetary deposits which include foreign currency deposits and private sector repo transactions tumbled by 11.7% to SAR175.8 billion, denting bottom-line money growth. Delving deeper into quasi monetary deposits we notice a 14% decline in foreign currency deposits, in addition to a substantial 37% annualized decline in foreign currency deposits made by governmental entities amounting to SAR33.6 billion. This is in line with the government's expansionary phase as it continues to draw down from its foreign reserves in order to finance its fiscal budget spending. Almost 75% of SAMA's SAR2.7 trillion reserve assets are in the form of foreign securities such as treasuries, while around a quarter are in the form of foreign currency deposits abroad. The government's winding down of its foreign reserve assets comes at a time when oil prices are plummeting, eroding fiscal revenue which is over 90% oil dependent.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

In the month of January, the general annualized rate of inflation stood at 2.18%, the lowest in 9 years. The main downward price pressure comes from cheaper commodities and a higher purchasing power for the dollar-pegged Saudi riyal. The heavy reliance on imported food stuff in the Kingdom leaves a high exposure level to imported inflation, which turned to be favorable under the current global disinflationary trend. Food prices recorded a 2.1% Y/Y upturn, the lowest rate since July last year. Vegetable prices fell by 1.1% compared to last year while mineral waters, and soft drinks inched down by 1.6%. Moving to the next largest expenditure group, housing and utility prices rose by 2.74%, below last year's average of 3.45% mainly due to a 23.8% decline in the cost of water supply. Transport prices only edged up by 0.5% by annual comparison affected by a 3.7% decline in the prices of motor cars, and a 1% decline in the prices of spare parts and accessories. We expect the theme of moderate price levels to continue this year given low imported inflation and low commodity prices.

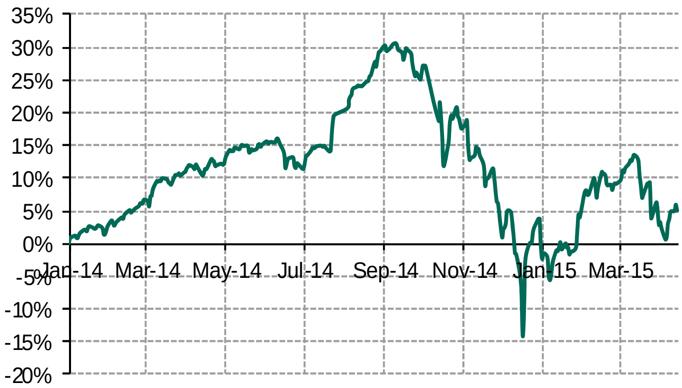
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

NCB الأهلي

Capital Markets
Treading Carefully

The Saudi economy has been burdened with multiple challenges towards the end of last year and the hurdles continued into 2015. Saudi's main source of income, oil, suffered a collapse which began in the third quarter of 2014 on a supply glut, pressuring prices to multi-year lows. Additionally, in the beginning of 2015, citizens mourned the loss of King Abdullah following nine prosperous years, yet the transition phase to current King Salman was executed smoothly to eliminate succession worries. The government reassured their expansionary policy position by announcing royal decrees with an expense bill of more than SAR100 billion. Saudi's expenditures are expected to be sustained by utilizing its excessive level of net foreign assets which have been accumulating over the years, peaking at USD736 billion during last August. Furthermore, Saudi initiated operation Decisive Storm, an airborne military action against the Houthi revolt in Yemen to restore power to Hadi's regime and provide a means of stability. Despite the aforementioned drawbacks on the Saudi economy, Moody's have affirmed Saudi's Aa3 rating with a stable outlook on strong fiscal buffers. The oil market is expected to gradually rise which would see the Economy's asset side increase over the long-tem.

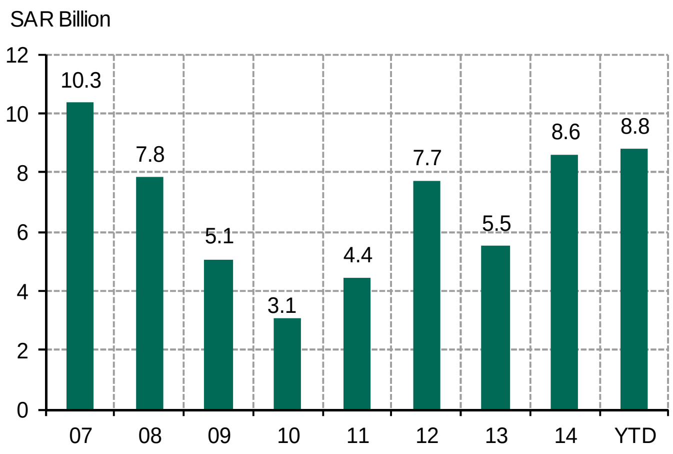
Chart 9: Tadawul All-Share Index



Source: Tadawul

Consequently, domestic equities have been fluctuating heavily as investors seem reluctant to maintain long term positions despite the attractive valuations as the market's price-to-earnings ratio dropped by the end of March to 15.4 from 16.4 during February. The main index declined by 5.7% during last month, ending the first quarter with a 5.3% gain, well below its peak at 16.3% mid-March. Tadawul has fallen below the 9'000 level by the end of the month to settle at 8'778.89 amidst corporate earnings announcements for the first quarter pave the outlook for the year. Given the circumstances in the oil market, the petrochemical sector recorded the worst performance last month, losing 10.1%. Furthermore, other heavyweight sectors, namely energy and banking, posted declines by 8.4% and 7.7% M/M, respectively. During the first quarter, the real estate sub-index recorded the largest increase at 29.2% while the telecom sub-index contracted by 8.8% as Mobily's accounting inconsistencies weighed down the sector.

Chart 10: Average Daily Traded Value



Source: Tadawul

Investor appetite, as gauged by the average daily traded volumes, increased on an annual basis by 5.7% to reach SAR9.3 billion, albeit declining by 4.1% in comparison to the previous month. Trading through SWAP agreements has declined as international investors expect the opening of the market to foreign financial intuitions in the coming months. As the market awaits the decision, it remains dominated by individual investors with a speculative mindset. The recent drop in stock prices has created attractive opportunities as we expect portfolios to reshuffle their holdings following the corporate profitability announcements currently underway. As for the primary market, it remained non-existent in the first quarter. However, the market will introduce two initial public offerings during April. Middle East Paper Co and Saudi Company for Hardware will offer 15 million and 7.2 million shares, respectively, both representing 30% of the company's equity. We do not expect the primary market in 2015 to outperform last year on value terms as an IPO with the magnitude of NCB is not a frequent event.

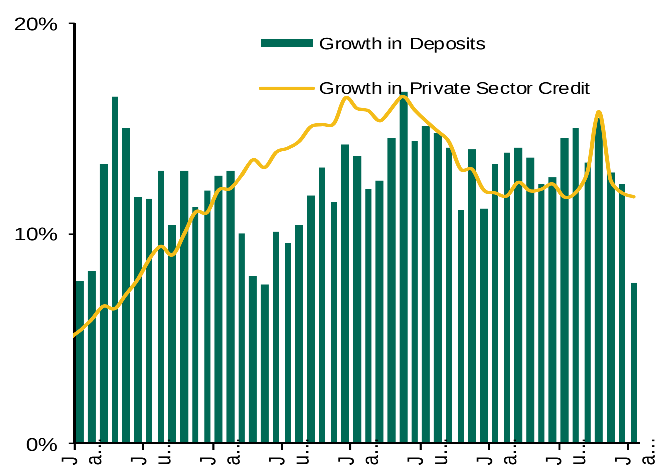
Tamer El-Zayat
Senior Economist / Editor | **t.zayat@alahli.com**

Loans Market

Private Sector Credit Moderates

The year 2015 kicked off with a subpar growth in total deposits of 7.7% Y/Y met by a moderating lower-bound double-digit growth in total credit of 11.2%. The depositary base which stands around SAR1.5 trillion is mostly supported by a 10.2% growth in demand deposits and a 12.2% growth in time and savings. The constituents promoting growth in these deposits differ however. In contrast to demand deposits, which are over 90% by businesses and individuals, time and savings deposits are driven by the contribution of government entities that make up over a half of this deposit type. By the end of January, demand deposits stood at SAR986 billion, whereas time and savings reached SAR382.2 billion. On the other hand, quasi monetary deposits which are by large deposits of foreign currencies made by businesses and individuals account for 11.4% of the depositary base. In January, quasi monetary deposits saw the largest decline since the financial crisis by 11.7%, standing at SAR175.8 billion.

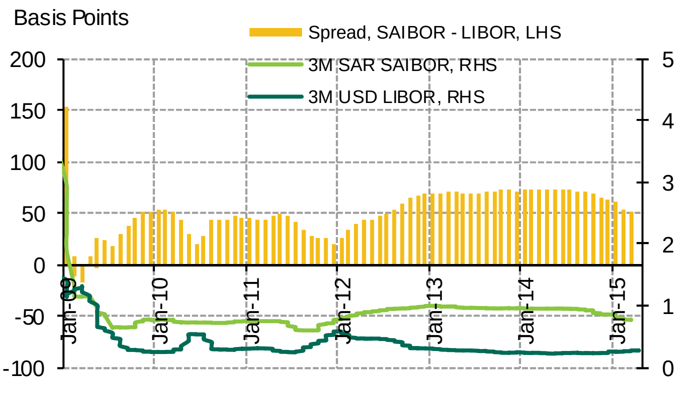
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Moving to the assets side, the loan portfolio for Saudi banks shows signs of moderation compared to previous years, albeit still thriving. Fresh credit extended by local banks in January was SAR9.2 billion, while total credit outstanding reached SAR1.26 trillion. Private sector credit accounts for 96.5% of total bank credit sustained by strong credit worthiness and a stable business climate. Despite oil prices tumbling to multi-year lows, eroding government revenues from oil exports, the Kingdom's business outlook remains positive due to the massive liquidity and strong fiscal position. The financial system's loans-to-deposit ratio (L/D) by the end of January stood at 81.6%, around 2% higher than year's end, indicating a healthy level of capacity utilization. Bank credit has been shifting towards longer terms, with short-term loans accounting for less than half of the credit portfolio at SAR617.5 billion. Medium-term loans now account for 17.9% of total loans at around SAR226 billion, and long-term loans at a record 33.1%, valued at SAR416.4 billion by the end of January.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Banks' holdings of government securities reached SAR274 billion in January, surging by 15.4% Y/Y. Treasuries account for over 80% of government securities issued to control liquidity levels. The pace of T-bills recorded the slowest annualized growth since January 2013 at 19.5%, given the low inflation specter, standing at SAR221.6 billion. The Saudi government appears to be adopting a wait-and-see approach in regards to moving rates in tandem with the US Federal Reserve. Currently low inflationary pressures and expectations make it unlikely that we will see a preemptive decision regarding policy this year. The interbank market shows that the average 3-month SAIBOR is at 0.85, the lowest level since February 2012, indicating ample liquidity and low risk premiums among Saudi banks. Interest rate differentials between SAIBOR and LIBOR are also narrowing as the average for 3-month dollar deposits inched higher than last year's average of 0.23 to 0.25 in January. The current spread between LIBOR and SAIBOR is 60 bps.

Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

External Trade

Trade Affected By Uneven Global Recovery

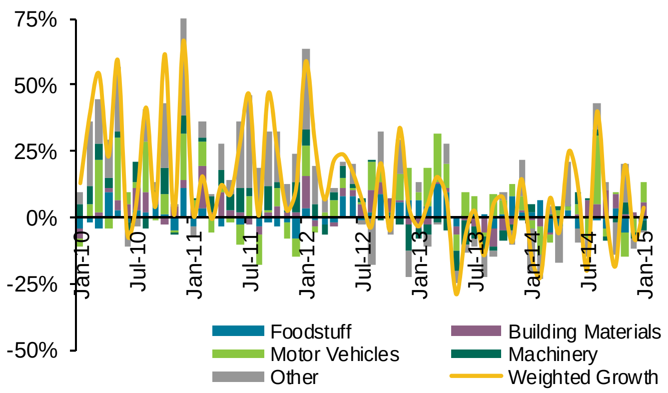
Saudi Arabia's non-oil trade activity extended last year's deceleration, posting a total of SAR15.6 billion of non-oil exports in January. Compared to SAR17.2 billion in the same period last year, non-oil exports declined by 9.1%, the lowest level since August 2013. Imports, on the other hand, registered a smaller decline on an annual basis in the tune of 4.7%, settling at SAR47.5 billion. Fundamental analysis indicates that several factors contribute to the downturn, including stronger dollar, plummeting oil prices, and the Chinese Lunar New Year holiday. Lower global inflation also affected the import bill as cheaper factors of production contributed to lower prices. In value terms, total non-oil exports reached 32.9% of the value of imports, around 1.6% less than last year. On the other hand, the annualized change in net exports shows that the balance of trade gap had also shrunk by 2.4%.

Chart 13: Saudi Non-Oil Trade Balance

Sources: SAMA and NCB

By export composition, plastics remained the dominant non-oil export category, posting close to SAR5 billion, thus accounting for 31.7% of the total. By annual analysis, exports of plastics show a sizeable 16.6% decline, the largest among all export categories. Exports of chemical products followed closely as they posted SAR4.9 billion, recording a 12.5% annualized downturn. The declines in oil prices were factored into the value-added chain, leading to decreased bottom-line prices. On the other hand, exports of base metals reversed the gloomy figures, advancing by a staggering 28.1% Y/Y at SAR1.2 billion. Base metals constitute the largest export category in the Kingdom that is not an extension of the oil industry, hence why its correlation with oil shocks tends to be weaker. Despite efforts to diversify the country's production base, the Kingdom made significant progress in import substitution while the export base remained narrow as the composition of exports is much simpler compared to its imports. Export competitiveness in horizontal diversification is expected to be slow as the Kingdom moves up towards more processed goods, such as aluminum smelting and potentially automobile manufacturing. The main recipient countries of Saudi non-oil exports are the UAE, China and Singapore, with the UAE notably increasing its share compared to last year. Non-oil exports to the UAE saw a 33.1% Y/Y surge in January, reaching SAR2.3 billion, accounting for almost 15% of the monthly total. China's share was at around 11.1% at SAR1.7 billion, dwindling by 23.5% due to a softening investment outlook in China. Non-oil exports to Singapore also downturned by19.3% versus last year, recording SAR 990 million.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

Well over a quarter of the Kingdom's imports consist of machinery and electrical equipment which amounted to SAR13.2 billion in January, only 3.8% short of last year's bill. Transport equipment make up 19.8% of the import bill at around SAR9.4 billion, surging by 17.7% Y/Y. On the other hand, imports of base metals tumbled by 21.2% to SAR5.4 billion, in line with the country's shift to local production. The main countries of origin are China, the United States, and Germany. Chinese exports to the Kingdom surged by 11% Y/Y to SAR7.5 billion, accounting for about 15.8% of the import bill. The latter two countries saw a decline in imports in value terms, particularly Germany. US imports, which account for about 14.5% of the import bill, slid 3.4% Y/Y in January to SAR6.9 billion. German imports tumbled by 21.7% Y/Y to SAR2.9 billion, around 6.2% of the import bill.

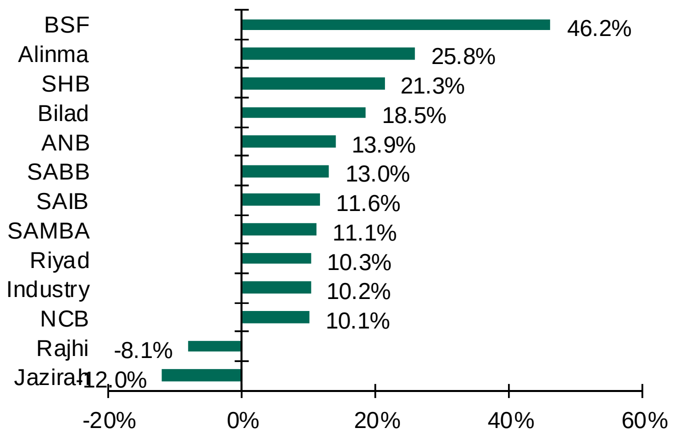
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

NCB الأهلي

Special Focus:
Moderation in the Horizon

The Saudi economy expanded by 3.6% during 2014, outperforming 2013's 2.7%, based on 2010 prices. The non-oil sector underpinned the economy by growing 5.2%, supported by private sector construction, trade, and manufacturing sectors that grew 6.7%, 6.0%, and 6.5%, respectively, during 2014. This constituted the framework for the stellar performance recorded by the domestic banking system. The twelve locally incorporated banks, accounting for 98.4% of the financial system's total assets, posted record high profits last year, growing by 10.2% Y/Y to reach SAR41.6 billion. The highest growth was by Bank Saudi Fransi which increased its net income by 46.2% as their provisions dropped by 66.5%, thus reducing their operational expenses by 14.3% Y/Y. The only two banks to decline on income levels were Alrajhi and Aljazira banks, dropping 8.1% Y/Y and 12.0% Y/Y, respectively. Additionally, banks strategically focus their operations according to their strengths, weaknesses and market determinants. As the economy fostered the projects market for the past couple of years, profits by business segments reflect a significant shift towards the corporate segment than the retail and treasury segments. During last year, 41.5% of total net income emanated from the corporate side, rising from 37.1% during 2013. Meanwhile, the treasury segment generated 29.2% and the consumer segment only contributed 26.4%, the lowest since the new millennium. However, given the current developments in the domestic economy, we expect the banking system to moderate this year and register smaller growth rates.

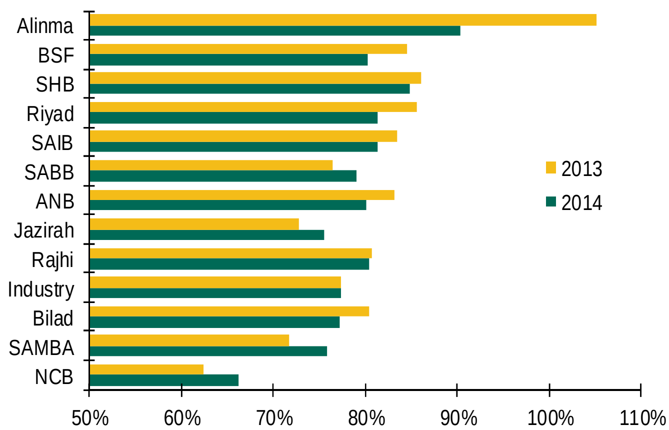
Table 15: Net Income Growth, 2014



Sources: Respective Annual Reports, and NCB

Local banks expanded their balance sheets by extending credit lines to businesses as their loans portfolio grew by 12.1% Y/Y during 2014. Notable increases in loans to the agricultural, mining & quarrying, and building and construction as they increased by an annual 94.2%, 59.0%, and 24.1%, respectively. According to our NCB Construction Contracts Index, the total value of awarded contracts during 2014 settled at SAR220.8 billion, declining by 25% annually. This will resonate on financing opportunities within 2015 and beyond as ongoing projects progress through their executional phases. Nonetheless, the government is adamant in maintaining its expenditures regardless of the recent oil market drawbacks on the economy's capital inflow as Saudi maintains adequate buffers. Saudi banks continue to expand their depositary base as total deposits gained an additional SAR176.6 billion, an increase of 12.1% Y/Y. The majority of deposits reside in current accounts, almost two thirds, while time deposits grew moderately at 10.0% on an annual basis. The asset/liability composition in the form of the loans-to-deposits ratio maintained a relatively low 77.4% ratio which allows banks to grasp new lending opportunities with ease. NCB has improved its L/D ratio to 66.3%, while Alinma bank posted the highest ratio at 90.3% given its younger lifespan.

Table 16: Loans to Deposits Ratio



Sources: Respective Annual Reports, and NCB

Despite accelerating growth throughout 2014, Saudi banks have also maintained their safe positions and capital adequacy levels. Non-performing loans in the financial system were reduced to SAR14.4 billion, only 1.1% of total loans by the end of last year. Moreover, the NPL coverage ratio increased from 157.4% in 2013 to 182.9% in 2014. As banks successfully reduced risk levels, provisions for possible credit losses declined by SAR218 million to settle at SAR6.8 billion, the lowest level since 2011. In our opinion, the banking system will continue to rise on growing volumes, yet, competition on diminishing margins will intensify. Product development will be key as the market becomes more developed with higher consumer and businesses awareness.

Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

The Economics Department Research Team

Head of Research

Said A. Al Shaikh
Group Chief Economist
s.alshaikh@alahli.com

Macroeconomic Analysis

Tamer El Zayat
Senior Economist/Editor
t.zayat@alahli.com

Majed A. Al-Ghalib
Senior Economist
m.alghalib@alahli.com

Yasser A. Al-Dawood
Economist
y.aldawood@alahli.com

Sector Analysis/Saudi Arabia

Albara'a Alwazir
Senior Economist
a.alwazir@alahli.com

Shahrazad A. Faisal
Economist
s.faisal@alahli.com

Management Information System

Sharihan Al-Manzalawi
Economist
s.almanzalawi@alahli.com

To be added to the NCB Economics Department Distribution List:

Please contact: Mr. Noel Rotap

Tel.: +966-2-646-3232 / Fax: +966-2-644-9783 / Email: n.rotap@alahli.com