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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- According to Baker Hughes, international drilling showed a steep drop at 12% in rigs drilling between February and March. There are too few new projects being sanctioned by non-state oil companies to offset the inevitable decline in output from existing fields and to meet additional demand.
- The negative impact of a stronger dollar on global commodities and US external trade will also cap the upside potential of the greenback although we retain an optimistic view on US fundamentals.
- Precious metals enjoyed a bull market in March induced by risk aversion after the hopes of a second rate hike at the Fed dissipated. Supply curtailments and financial markets volatility also played a role in pressuring the gold metal which peaked at USD1,271.8/oz on March 10th, almost 20% up YTD.
- Upward inflationary pressure in the Kingdom almost doubled as the Consumer Price Index recorded a general inflation of 4.18% Y/Y. The main sub-categories contributing the upturn were housing and utilities, which recorded a rise of 8.16% Y/Y.
- The real estate sector was the best performer at a 10.6% monthly gain as SAMA increased the maximum loan-to-value for mortgages to 85% from 70%, the additional 15% will be financed by banks and guaranteed by the Ministry of Finance
- Annualized growth in private sector credit surged by 10.5% during February, indicating that banks are utilizing the added lending capacity resulting from SAMA's recent regulation softening
- The value of Saudi non-oil exports in the month of January was estimated around SAR12.5 billion, plunging by 22.2% Y/Y.

View of the Month

According to the World Bank's Doing Business 2016 report, Saudi sits 82nd in an assessment of 189 countries, below UAE, Bahrain, and Oman who have ranked 31, 65, and 70, respectively. The report sheds light on the ease of doing business for small to medium enterprises, a promising segment that is yet to develop and mature.

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Macroeconomic Indicators

	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	50.2	50.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.2
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,826.9	2,449.6	2,346.6
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	754.8	654.1	626.6
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.6%	3.4%	2.1%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.2%	2.7%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.5	76.9	-41.3	-47.4
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.2%	-6.3%	-7.6%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	640.2	580.4
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	608.0	629.1
Actual Expenditure, SAR billion	826.7	873.3	976.0	1140.0	975.0	897.0
Expenditure Overrun, %	42.5%	26.6%	19.0%	33.3%	13.4%	6.8%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-95.6	-367.0	-267.9
Budget Balance/GDP	11.6%	13.6%	6.5%	-3.4%	-15.0%	-11.4%
Break-Even Oil Price	75.3	73.9	82.6	103.6	79.2	69.2
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%	6.8%	6.6%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	6.8%	5.2%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	1.0%	1.4%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.3%	0.4%	0.7%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	69.5	60.0	70.0

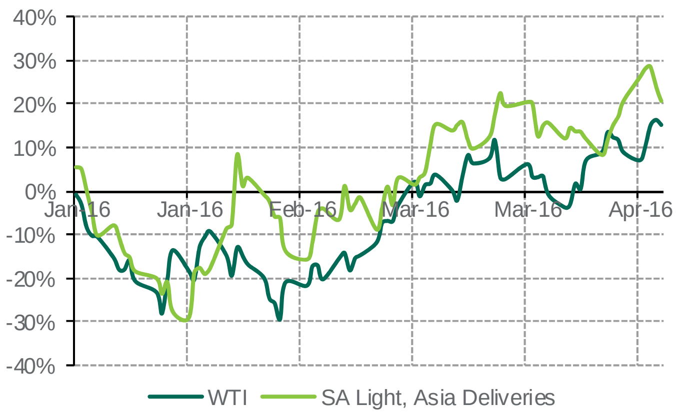
Sources: Thomson Reuters, SAMA, and NCB

Oil Market

Crude Prices Supported by Freeze Talks

WTI crude prices hold near USD40.0 a barrel and Brent prices climb to four months high above USD42.0 a barrel, as market considers the potential of output freeze deal at April 17th producers' meeting. Oil has rallied since mid-February amid speculation that OPEC and other producers including Russia will agree to freeze output and shrink the global oil glut. With major producers already producing near record volumes, the impact of an agreement to keep output at January levels will be limited. Given the excess supply, only small withdrawals from global oil inventories are expected toward the end of 2016, but with likely higher withdrawals beginning in Q3'17, thus supporting an increase in oil prices in the medium term. Meanwhile, the focus is turning to the US rig count data, which fell to 362 rigs, the least since November 2009, confirming that US oil production will decline further.

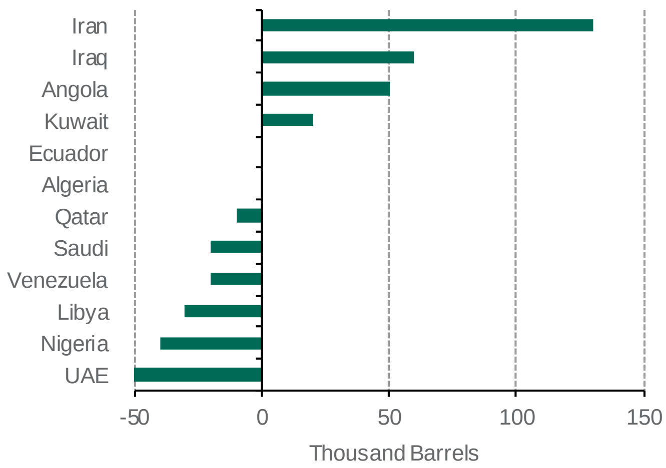
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

The collapse in oil companies' spending is illustrated perfectly by the level of drilling activity. According to Baker Hughes, international drilling showed a steep drop at 12% in rigs drilling between February and March. There are too few new projects being sanctioned by non-state oil companies to offset the inevitable decline in output from existing fields and to meet additional demand. In addition, the IEA has warned that investment cuts taking place now because of the energy downturn will increase the possibility of oil-security surprises in the not-too-distant future. While geopolitical tensions in the Middle East could potentially cause oil market disruptions, high inventory levels and a rapid response from US shale producers should limit the scope for a sharp price adjustment in the near future. On the supply side, US daily oil production has dropped to nearly 9.0mb/d as of early April from its peak of 9.6mb/d last year, while oil-shale output seen reaching 2-year low, according to EIA. OPEC crude oil production, though still well above their target levels, fell by 0.09mb/d in March to 32.4mb/d as ongoing outages in Nigeria, UAE and Iraq more than offset a further increase from Iran and Angola. Supply from Saudi Arabia declined in March but held near 10.2mb/d. Meanwhile, OPEC members and other producers outside the group plan to meet on April 17th in Doha for talks on freezing output. The freeze would not have a big impact on the oil market, as the freeze would not speed up rebalancing of oil market. Moreover, Kuwait plans to boost crude output to 3.16mb/d in 2016/2017 from current 3.0mb/d. Russian output is expected to climb to 11.2mb/d this year from 11.1mb/d in 2015 and is projected to increase to 11.4mb/d in 2017. Iran refuses to join efforts to cap production until it restores output to pre-sanctions levels, and is expected to add 0.45mb/d of oil to the market this year. Iraq increased its production to record high in March, and its southern output will stay at 3.6mb/d in 2016.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, growth in global oil demand will ease to around 1.2mb/d in 2016, below the 1.8mb/d expansion of last year, according to IEA. The pull from the demand side to tighten market balances is still weak, as remarkable decelerations take hold across China, the US and much of Europe. Brazilian and Japanese oil demand has also weakened significantly this year. In addition, lower GDP growth in emerging markets has tended to reduce oil demand growth, especially in light of the increase in global oil efficiency and is expected to continue to do so. However, the expansion of the middle class in emerging countries is expected to increase the demand for transport services and car ownership and, which in turn, will support oil demand growth. The balance among these forces will determine the strength of demand growth.

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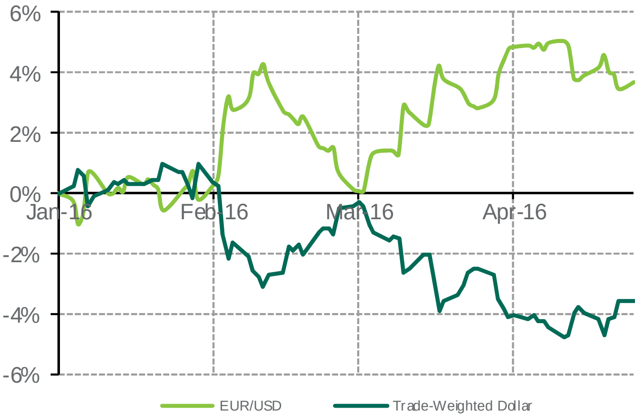
Foreign Exchange

EUR/USD Rallies as ECB Ups the Ante

Global economic performance has been gradual and uneven in the developed world whereas emerging and developing economies are suffering from a highly volatile currency outlook. Intensifying ECB intervention and a more cautious Fed, in addition to Britain's uncertain future in the EU, are setting the market tone for April. The USD rally moderated since the end of January despite underlying economic strength on the back of continued Fed accommodation. The FOMC reiterated concerns of downside risks originating from external factors, skipping the March rate hike. The negative impact of a stronger dollar on global commodities and US external trade will also cap the upside potential of the greenback although we retain an optimistic view on US fundamentals. The trade-weighted dollar slid 3.7% in March to 94.6 on the back of a "double dovish" monetary policy assessment by the Fed. We remain constructive on the USD throughout the year although we expect a more range-bound movement.

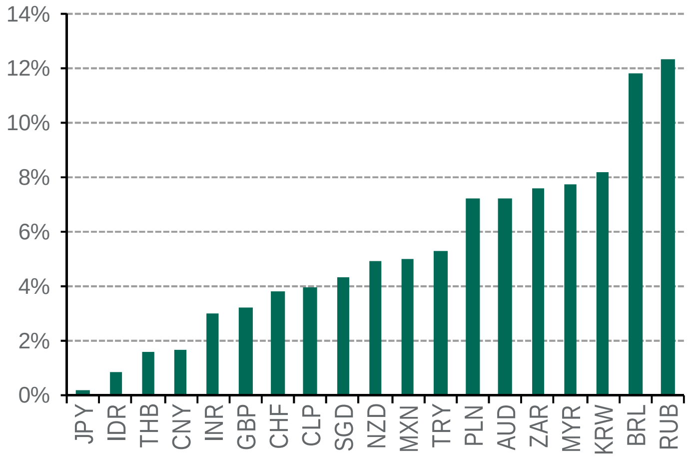
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The EUR/USD pair found some noticeable support in March, upturning by 4.7% to USD1.14 on the back of upscaled monetary policy at the ECB. The persistently low inflation specter posed a major threat to the recovery in the euro area. Economic growth in the currency bloc is set to 1.7% as the largest economies; Germany, France and Italy are expected to register benign economic performance during the first half of 2016. The path of energy prices have not taken a turn yet, and the slowdown in China is perpetuating the deteriorating inflation outlook. Despite the ECB expanding its QE measures by a third to monthly purchases of EUR80 billion, inflation is expected to remain at 0.5% in 2016 due to slower growth in the union coupled with global headwinds. Therefore, the strength of the single currency is expected to be unsustainable and our view remains bearish albeit with a limited decline. The GBP's position is overwhelmed by Brexit speculation. The "stay camp" is losing swing after the terrorist attacks on Brussels, yet we believe the likelihood for a Brexit remains low. If materialized, however, the UK's exit from the union should help with reaching inflation and growth targets, taking the Bank of England back on the path of normalization ala the Fed. The pound sterling rose 3.2% in March, standing at USD1.4. Against a backdrop of low global inflation, we doubt that inflation will creep up significantly in 2016, hence even with Britain's exit, we do not see an eminent BoE rate hike this year

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The Bank of Japan will continue to implement its quantitative and qualitative easing measures with negative interest rates as it attempts to reflate the economy. BoJ's Governor Kuroda is adamant on reaching the 2% inflation target via further easing this year. The 0.1% penalty on excess deposits at financial institutions did little to entice lending and further measures will likely be needed to stimulate inflation away from the 0% bound. The second consumption tax hike from 8% to 10% ,which is scheduled for April 2017, will aim to reflect on consumer prices. However, lack of demand-pull inflation will likely relapse headline inflation rate below target. The JPY has been trading in a tight range pressured by the BoJ's QQE and supported by global risk aversion. In March, it stood at JPY112.6 for the dollar, nearly unchanged from a month ago.

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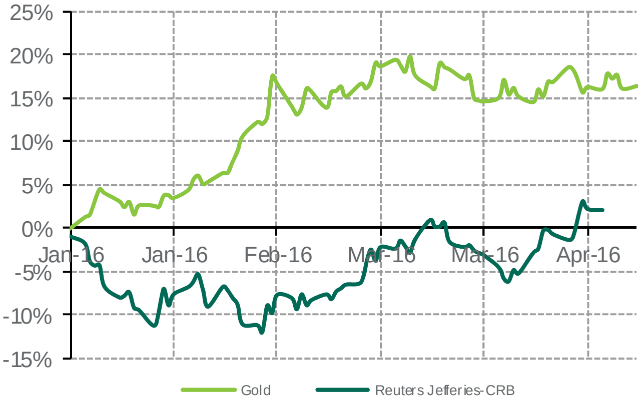
Commodities

Fed Accommodation Jolts Commodities

Global commodity prices remain subdued with economic worries from China prolonging the view of lackluster demand. On the supply side, we continue to witness an oil supply glut, in addition to ample supply of industrial metals and food grains. The USD rally maintains its momentum, thus plunging commodity currencies further which translates as lower cost of production in dollar terms. Most price forecasts were revised downwards for 2016 with no inflection seen in the near-term. During the first quarter of 2016, the Reuters/Jeffries Commodity Research Bureau index slid 2.9% to 171. The Fed's dovish tone in March, however, aided a short-lived surge in commodities that, excluding energy prices, capped 1Q16 declines at 3%. An uncertain energy outlook which is largely attributed to the lack of compliance between OPEC members, a relative improvement in Chinese construction data, and a weakness in the greenback provided a momentary boost for precious and base metals before re-plunging back into negative territory before the end of the month.

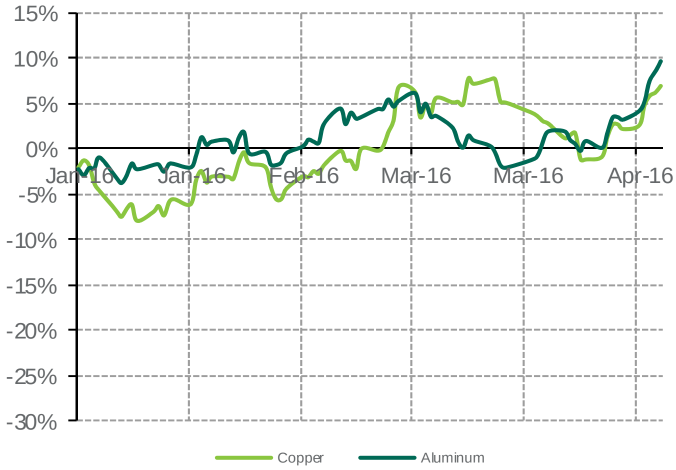
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

In March, copper prices breached the USD5,000 psychological barrier yet it could not sustain such levels and relapsed towards the end of the month to settle at a 3% rise YTD, standing at USD4,847/ton. Chinese imports of copper have been strong since January; however, this is not necessarily indicative of buoyancy on Chinese demand. According to the Shanghai Futures Exchange, copper inventories reached record highs in March of around 368'700 tons, indicating stockpiling rather than economic activity. Copper prices are highly sensitive to investors' sentiments towards China due to the fact that China accounts for over 45% of global copper demand. Hence, when speculation of a new round of PBoC stimulus hits the market it tends to spike copper prices. Nevertheless, Chinese policy makers have already committed to stabilizing economic growth via shifting towards a service based economy. Consequently, growth in China as per the IMF's latest forecasts will likely not exceed 6.3%. Aluminum treads a similar path to copper albeit a weaker correlation with China's economic performance. The metal which gained an increased use in recent years, replacing other base metals, had been supported by high-cost smelter closures due to low profitability. The per metric ton price of aluminum stood at USD1,520 by the end of March, edging up by 0.9% on a YTD basis.

Chart 6: Base Metals



Source: Thomson Reuters

Precious metals enjoyed a bull market in March induced by risk aversion after the hopes of a second rate hike at the Fed dissipated. Supply curtailments and financial markets volatility also played a role in pressuring the gold metal which peaked at USD1,271.8/oz on March 10th, almost 20% up YTD. The migration from financial assets to gold is also related to valuations of global stock markets which enjoyed record highs in 2015 while gold equity indices declined more than 80% from September 2011 to January 2016. It is hard to discern market determinants for gold price movements as many individual investment decisions include alternating economic, monetary, and geopolitical factors. However, at a time where US fundamentals are no longer the metric for Fed policy, gold can attain a portfolio-diversifying role despite its fading safe-haven status.

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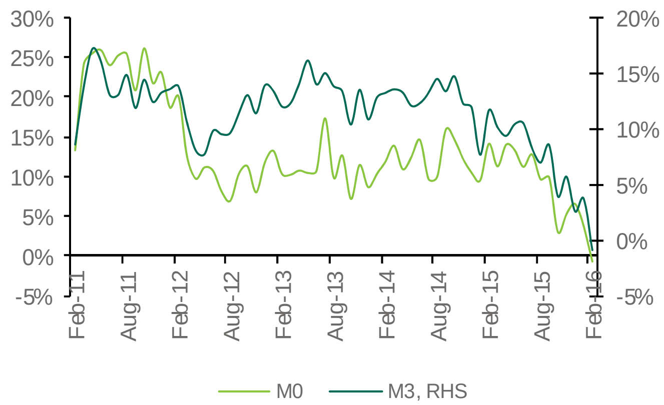
Money & Inflation

First Annualized Decline in Two Decades

The monetary situation in the Kingdom is clearly affected by declining oil revenue and the rationalization of government spending. The trickle-down effect of reduced government expenditure was translated to tighter liquidity in the system, leading to a contraction in money supply. Earlier this year, the beginning of subsidy reforms began by raising energy and water prices, putting a leash on consumer and business spending. In the month of February, the monetary base declined by 0.7% to SAR297 billion as lower bank deposits with SAMA and withdrawals by public financial institutions stifled expansion. Bank deposits with SAMA grew by 2.6% Y/Y to SAR 95.9 billion, while deposits of public financial institutions were at a negative 63.5% Y/Y valued at just SAR3.6 billion. Currency outside banks also declined by 0.2% Y/Y, recording SAR168.8 billion. Consequently, broad money shrank by 0.9% in its first decline in over two decades.

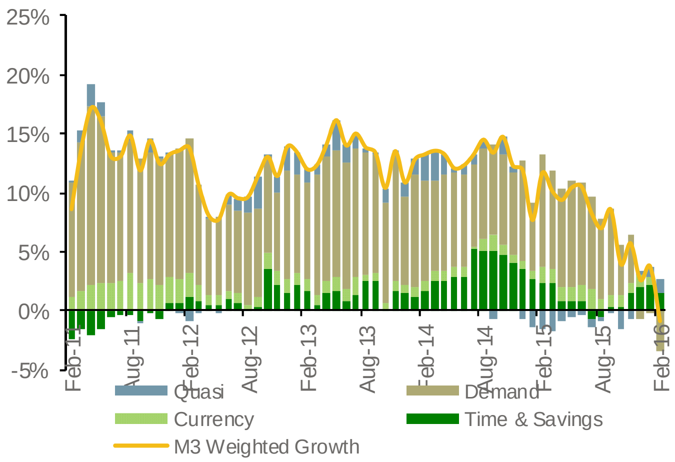
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Demand deposits represent the bulk of money supply in the Saudi monetary system by around 56%, dwindling by an annualized 5.9% to SAR 980.4 billion in February. Businesses and individuals make up 93% of demand deposits which have recorded the largest decline since August 1994. Given the local focus of Saudi banks, waning domestic demand would reflect negatively on their balance sheets. Accordingly, sizeable declines are shown in point of sale transactions and ATM withdrawals by 9% Y/Y and 13% Y/Y, respectively. On the other hand, the propensity to save was bumped up in response to the contractionary trend manifesting in time and savings deposits, rising by 7.2% Y/Y to SAR412.1 billion. Quasi monetary deposits surged to their highest levels since October 2014, marking 10.6% Y/Y at SAR191.4 billion. Foreign currency deposits made by government entities grew by45.9%, thus were the main contributors to this increase. Bank holdings of SAMA bills notably plummeted to their lowest levels since January 2010 at SAR95.2 billion, marking an annualized decline of 56.3%. This indicates SAMA's easing stance in the face of the liquidity shortage emanating from lower government deposits and sovereign debt issuances. Saudi banks' investments in government bonds reached SAR98.6 billion in February, surging by 82% Y/Y.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

Upward inflationary pressure in the Kingdom almost doubled as the Consumer Price Index recorded a general inflation of 4.18% Y/Y. The main sub-categories contributing the upturn were housing and utilities, which recorded a rise of 8.16% Y/Y. The category which weighs the second highest on the consumer basket of goods and services was affected by the reduction of government subsidies from water and electricity. Transportation also saw a double-digit increase of 12.7% due to higher fuel pricing. As the government is on the verge of announcing the blueprint for raising non-oil revenues by USD100 by 2020, we expect further reduction in subsidies that will target industry and higher-income consumers. We believe that inflation will edge higher to average 4.5% for 2016 with domestic inflationary pressures offsetting the positive international dynamics of a resilient USD and contained global commodity prices.

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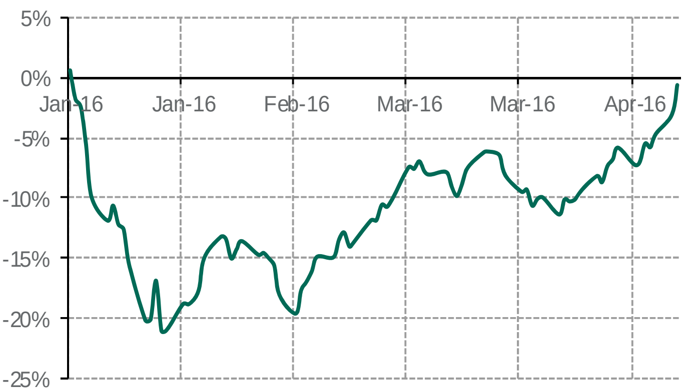
Capital Markets

Tadawul Amid Cross-Currents

The Saudi stock market battled cross currents as investors were hesitant on maintaining a clear direction. On a global scale, ECB's Mario Draghi delivered on his promise and supported markets by reducing the benchmark interest rate to zero, slashing the deposit rate further into negative territory at 0.4%, and increasing bond purchases to EUR80 billion from EUR60 billion. Meanwhile in the US, the Fed opted to reduce the pace of interest rate hikes as international drawbacks hinder growth prospects of US growth. Furthermore, following an initial agreement between Saudi, Russia, Qatar, and Venezuela to freeze oil production at January levels, which later collapsed, Arabian Light spot prices jumped 17.5% during March. In contrast, Saudi's credit rating outlook was lowered to negative for a possible downgrade on the country's Aa3 rating (see Special Focus). Investor sentiment remain hesitant given the macroeconomic backdrop, underpinned by the IMF's recent cut on projected global growth to 3.2% in 2016 and 3.5% in 2017.

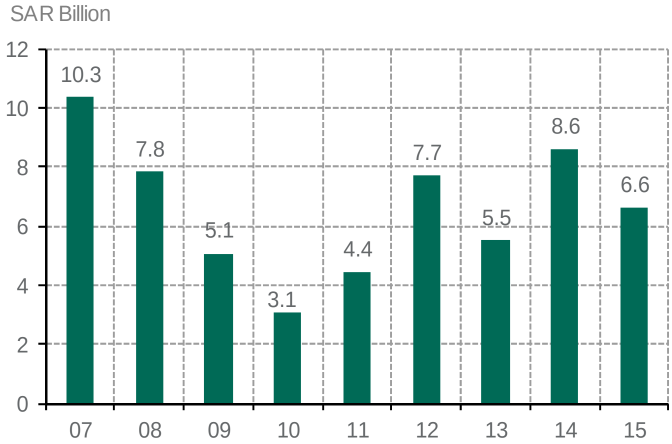
Chart 9: Tadawul All-Share Index



Source: Tadawul

Tadawul capped gains at 2.1% after gaining as much as 6.5% to end last month at 6'223.13, a 10% decline since the beginning of the year. The real estate sector was the best performer at a 10.6% monthly gain as SAMA increased the maximum loan-to-value for mortgages to 85% from 70%, the additional 15% will be financed by banks and guaranteed by the Ministry of Finance which is expected to increase operational activity for real estate companies over the medium term. The insurance sector registered the second highest growth at 9.6% as increased volatility in the market led to speculative trading for insurance stocks. Insurance stocks were exchanged between traders with a total value of SAR20.8 trillion during March, the third highest after banks and petrochemicals sectors. The worst performers were hotel, media, and retail, declining by 6.0%, 5.4%, and 6.0%, respectively. The drop in media stocks is due to the inflated prices which was a result of speculative trading over the past few months. The other two sub-indices were affected by the slow economic cycle that reduced consumption expenditure coupled with the fading of last year's bonus salaries, which will hinder companies' announcements. In addition, the average daily traded value volumes reached SAR5.7 billion, dropping by 2.1% over the previous month's daily average.

Chart 10: Average Daily Traded Value



Source: Tadawul

As for the primary market, the first Initial Public Offering (IPO) of 2016 concluded with an oversubscription of 274.2%. Middle East Healthcare Company issued 27.6 million shares at a price of SAR64 per share. The total amount the company was aiming to raise through the IPO was SAR1.8 billion. Another IPO has been announced for the end of April, Al Yamamah Steel Industries Company will offer 15.2 million shares to institutions and individuals with an allocated share of 70% and 30%, respectively. The Capital Market Authority had recently announced the plan to increase the number of listed companies to 250 from the current 170 within seven years. Additionally, another equity market is under development for Small to Medium Enterprises (SME) to be launched early 2017. This will provide SMEs with an alternative source of financing and reduce the load on the domestic banking system. While the anticipation of the Aramco IPO will be the top priority for investors, a series of government assets will be offered to the public over the next few years, as the government adopts a privatization program.

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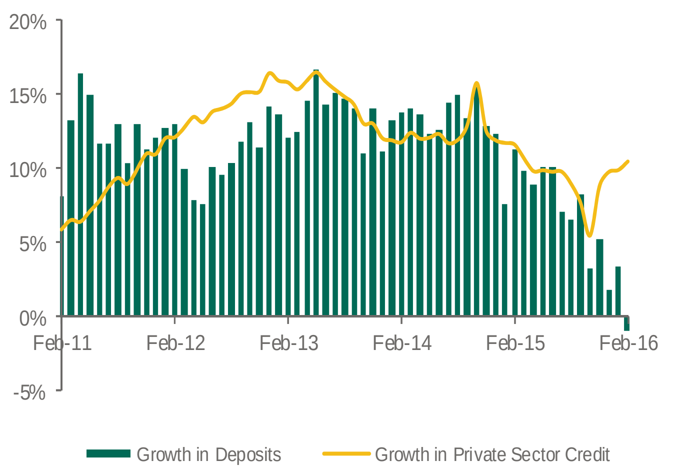
Loans Market

SAIBOR Surge Warns of Liquidity Crunch

The credit situation in the Kingdom is surely tightening as the depositary base breached the negative territory on the back of lower oil revenue. On the other hand, the government issued a plethora of economic reforms dubbed the “National Transformation Plan - NTP” in which the government will plug the fiscal deficit with minimal impact on domestic demand. Although much of the quantitative details remain under wraps, the new vision of the Kingdom paves the way for a post-oil economic era via public-private partnerships, the privatization of national entities such as Saudi Aramco’s IPO, and economic diversification. Reduced bureaucratic red-tape , better access to the Saudi market, and added competitiveness would attract foreign investment and create a more conducive business environment away from current oligopolies.

Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Nevertheless, the growth of money supply turned downwards in February, marking the first decline in over two decades. Broad money supply (M3) shrank by 0.9% to SAR1.75 trillion affected by a 5.9% contraction in demand deposits, the largest component in Saudi money supply. Demand deposits stood at SAR980.4 billion, of which 93% is made by businesses and individuals. Although the government’s share maintained a 7.7% annualized growth, the sheer weight of business and individual deposits which plummeted 6.8% dented the overall figure. We also note a sway towards saving among this group as their time and saving deposits surged by 31% Y/Y during the month. This, in turn, contributed to overall time and savings deposits to rise by an annualized 7.2% to SAR412.1 billion.

Chart 12: Liquidity and Risk Detector

Source: Thomson Reuters

In contrast, the annualized growth in private sector credit surged by 10.5% during February, indicating that banks are utilizing the added lending capacity resulting from SAMA’s recent regulation softening. The central bank raised banks’ guidance limit for loan-to-deposit ratio up to 90% from 85% which will likely allow banks to aid banks in expanding their credit portfolios amid shrinking deposits. Credit-induced economic growth is deemed necessary at the time where the real economy is facing headwinds from lower oil prices and government spending. However, despite the recent loosening, Saudi banks will remain fully compliant to Basel III accord owing to SAMA’s conservative prudential framework. The loan-to-deposit ratio (L/D) stood at 88.1% in February, the highest since November 2008. Around 50.6% of banks loans are short-term maturity, valued at SAR706.2 billion. Medium-term loans make up 19.7% at SAR275.2 billion, whereas long-term loans constitute 29.7% at SAR414.7 billion. Heightened economic uncertainty led banks to revert back to a credit allocation of more short-term to medium-term credit while long-term credit growth remains volatile. The interest rate environment as indicated by the Saudi Interbank Overnight Rate (SAIBOR) is at the highest since January 2009. 3-month SAIBOR currently stands at 1.73%. The 1-month SAIBOR has also breached the 100 bps since January, and stands at 1.47% as of February. Although calling off the second Fed rate hike eased off the pressure on SAMA’s reverse repo transaction rate which remains at 0.5%, we expect the ongoing liquidity shortage in addition to the Fed’s normalization rhetoric to be mainstay for upward interest rate pressure in Saudi Arabia.

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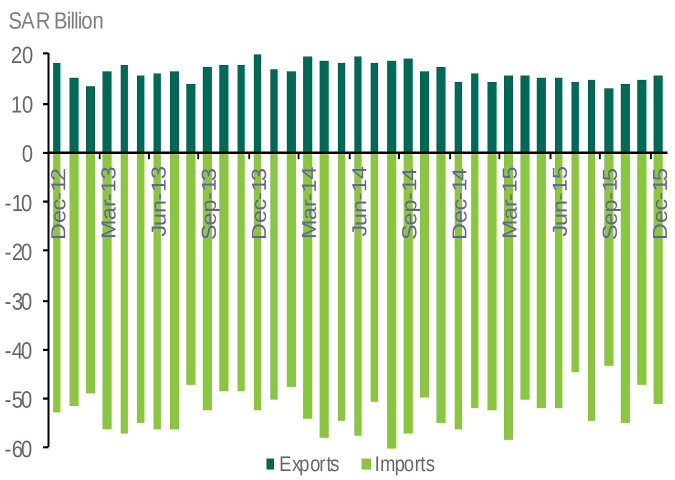
External Trade

Fiscal Consolidation Reflects on Imports

The value of Saudi non-oil exports in the month of January was estimated around SAR12.5 billion, plunging by 22.2% Y/Y. The Kingdom's vertical economic diversification which began in the early 1970s left the country's non-oil production largely a derivative of the oil industry. Around 57.5% of non-oil exports by value are plastic and chemical products. In addition to prolonged low oil prices, industrial demand in China, for which Saudi exports are input material, has softened. The month of January represents a rough patch that held dismal economic data as crude prices fell below USD30/bbl. Furthermore, the slowdown in the Saudi non-oil sector, and the subsequent low non-oil trade figures are a reflection of contractionary fiscal policies. By weight, non-oil exports declined by 9.6% Y/Y standing at 3.7 megatons. Exports of plastic products were valued around SAR4.1 billion, tumbling by 17% Y/Y while exports of chemical products extended declines to 40.4% Y/Y at SAR3.1 billion. Exports of base metals which make up around 9.5% in value, slid 6.6% to SAR1.2 billion. The UAE accounted for 14.5% of the monthly total in value terms, followed by China at 7.5% and India at 5.2%. Exports to UAE plummeted 23.6% Y/Y to SAR1.8 billion in line with the slowdown in China as much of the Kingdom's exports to the UAE are re-exported to China. Furthermore, non-oil exports to China nose-dove 48.9% Y/Y to SAR0.9 billion while exports to India trimmed 23% compared to last year, standing at SAR0.7 billion.

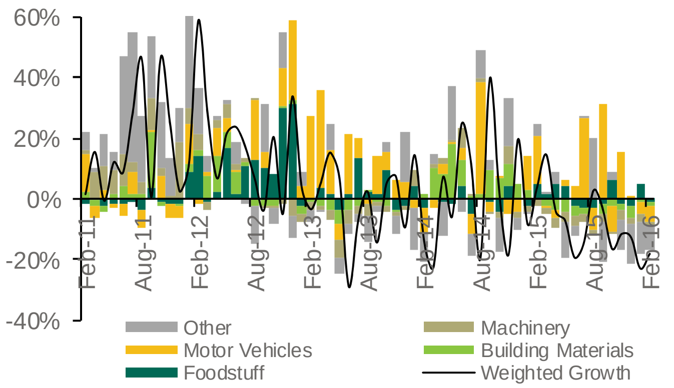
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

Import figures also suffered notable declines whether by value or weight when compared on an annual basis. The value of the Kingdom's imports in the month of January reached SAR48.4 billion, contrasting with SAR51.8 billion in the same period last year, thus falling short by 6.7% Y/Y. By weight, the Kingdom's imports declined 11.2% Y/Y at 5.8 thousand tonnes, indicating that international prices are still supportive. The Kingdom's demand for machinery and electrical equipment – which are essential components of capital expenditure, accounting for 26.5% of the monthly import bill – sank by 12.2% Y/Y to SAR12.8 billion. In addition, imports of transport equipment slid 7% Y/Y to SAR9.1 billion. These declines are in line with the Kingdom's overall direction towards cost-cutting in order to plug the budget deficit. On the other hand, imports of chemical products recorded a 3.1% annualized upturn during the month, reaching SAR4.5 billion. Countries of origin were mainly the US, accounting for 14.5% of the import bill, China, accounting for 14.3%, and Germany accounting for 7%. Imports from the US were valued at SAR 7 billion, sliding 6.5% Y/Y while imports from China recorded SAR 6.9 billion, plummeting by 15.4%. German imports to the Kingdom slid by an annualized 5.4%, standing at SAR 3.4 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

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NCB الأهلي

Special Focus:
When in a Hole, Stop Digging

The oil price slump diminished Saudi oil revenues which have been the major driving force of the economy over the past decade. Revenues from the hydrocarbon sector are estimated at SAR444.5 billion in 2015, 61.2% less than the record reached in 2012 at SAR1'145 billion. As government expenditure is the only channel to convert the country's wealth into economic development, the Kingdom had suffered great scrutiny by the three major rating agencies. S&P was the first to downgrade Saudi to A+ from AA -, keeping its negative outlook, in October 2015 which was followed, four months later, with another two notches downgrade to A-, albeit changing the outlook to stable. As oil prices bottomed-out in February at USD26.19/bbl for WTI crude, Moody's placed the sovereign outlook on watch for a possible downgrade from its Aa3 assessment if low oil prices persist. Recently, Fitch followed its counterparts and reduced Saudi's credit rating by one notch to AA- coupled with a negative outlook, citing "major negative implications for Saudi Arabia's fiscal and external balances." Saudi has been utilizing its massive foreign reserves to finance its expenditures and reduce its deficit, withdrawing USD115.5 billion throughout 2015. Issuances of government debt have also been used in tandem as the Kingdom's debt to GDP ratio edged higher to 5.9% in 2015, up from 1.6% in 2014.

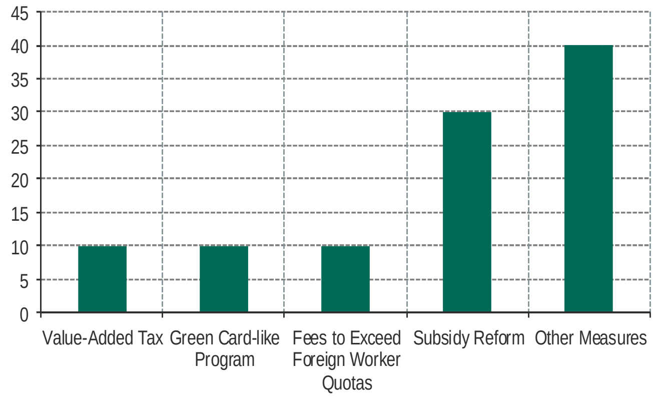
Chart 15: Saudi's Sovereign Rating by Top Three Agencies

	2014 Rating	Latest Rating	Outlook
Moody's	Aa3	Aa3	On Watch
Fitch	AA	AA-	Negative
S&P	AA-	A-	Stable

Source: Respective Websites

Accordingly, the private sector will need to assume a more active role in contributing to the economy's future. However, bureaucracies and long-standing regulations are in need of an overhaul given the country's current global ranking. According to the World Bank's Doing Business 2016 report, Saudi sits 82nd in an assessment of 189 countries, below UAE, Bahrain, and Oman who have ranked 31, 65, and 70, respectively. The report sheds light on the ease of doing business for small to medium enterprises, a promising segment that is yet to develop and mature. Administrative barriers need to be diminished to welcome start-ups as well as foreign investment. Furthermore, the low labor force participation rate at around 40% acts as a drag. Also, government jobs have been preferred over work in the private sector, a gap that will need to be reduced going forward as fiscal pressures will limit government employment. As such, the expected reforms to be announced next week are needed to provide the building blocks that should guide Saudi to a diverse and vibrant economy.

Chart 16: Global Monetary Policy Rate Decision



Sources: Bloomberg

The fiscal consolidation that was initiated to break the reliance on oil as the main source of revenue will include the much anticipated National Transformation Plan (NTP). In a recent interview with Bloomberg, Saudi Deputy Crown Prince Mohammed bin Salman revealed an ambitious plan to overhaul and diversify the economy. Non-oil revenues are planned to raise an additional USD100 billion by 2020 which includes USD30 billion in subsidy reforms which have already been initiated by a recent hike in energy, electricity, and water prices. A GCC-wide agreement on value added tax is likely to commence in 2018, generating an estimated USD10 billion. While another USD20 billion is expected from a US green card-like program and fees to exceed foreign worker quotas for domestic businesses. The remaining USD40 billion will reached by various other projects such as the announced USD2 trillion sovereign wealth fund which would see Saudi's balances shift away from oil towards investment income. Economic diversification is crucial given the extreme volatility in oil prices, a sustainable Saudi future is certainly not in its vast reserves of "black gold."

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