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NCB الأهلي

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

Executive Summary

- Downward momentum in oil prices has swollen, attributed to a range of bearish factors, from the return of Iranian oil, the resilience of US shale oil to the slowdown in Chinese economic growth.
- The Chinese equity market sell-off increased bearishness in off-shore renminbi, and the Chinese economic model reform towards a more consumer-based economy is lessening growth prospects to below 7%.
- The shake-up of China's manufacturing-based economic model is hugely impacting its demand for base metals which hit a multi-year low on the London Metal Exchange (LME.) Copper slipped below the psychological barrier of USD5,000/ton late November and continued to dwindle, ending the year at USD4,705/ton.
- Our view is that upside inflationary pressures are yet to induce any drastic change in the overall index, and so we expect inflation to average 2.2% in 2015, and edge up to 2.7% in 2016.
- Qualified Foreign Investors (QFIs) that were allowed to access the market in the first half of 2015 did not provide the institutional support expected yet, even though by the end of December signs of increased activity started to appear, with their total holdings increasing by SAR655 million, a 48% from November 2015 level.
- The Official repo transaction rate remains unchanged at 2%; however, reverse repo transaction rate rose by 25 bps in December to 50 bps. We don't expect another eminent hike especially as the Fed's likelihood of a second rate hike in 1Q2016 is declining.
- Letters of credit settled and bills received in November acknowledge a slight decrease of 0.7% Y/Y, posting SAR18.9 billion. The negative annual growth is an indicator of a slower business cycle and tighter liquidity.

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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.

Macroeconomic Indicators

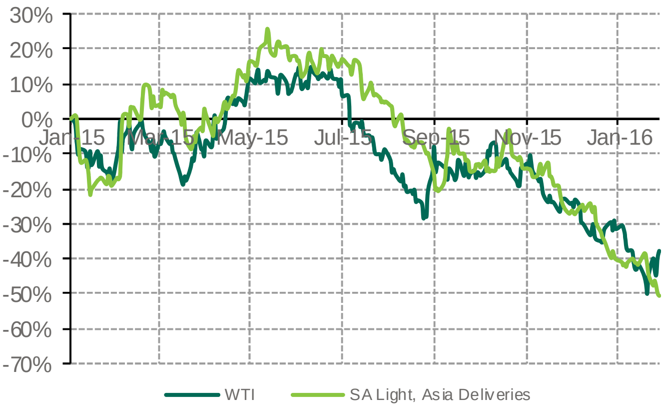
	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	50.2	50.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.2
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,826.9	2,449.6	2,346.6
GDP at Current 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
The Oversupply Theme will Remain in 2016

Brent and WTI Crude prices edged above USD30/bbl recently, but the market remains firmly bearish, having hit 12-year lows of around USD27/bbl in mid-January. Downward momentum in oil prices has swollen, attributed to a range of bearish factors, from the return of Iranian oil, the resilience of US shale oil to the slowdown in Chinese economic growth. However, sustained high levels of US crude production in the face of sharp falling oil prices continue to challenge OPEC's market share prioritization strategy. In leading OPEC countries into maintaining high production levels, Saudi Arabia and its GCC allies calculated that the resultant oil price fall would drive out higher priced competitors. Although US output has begun to fall in recent months, the desired price recovery remains elusive. With many bearish factors are already priced into the market, participants may begin to focus on bullish indicators. These are likely to emerge in the coming months, thus projecting the potential of a gradual recovery that may begin in the second half of 2016 and likely bring Brent prices to the USD40/bbl level.

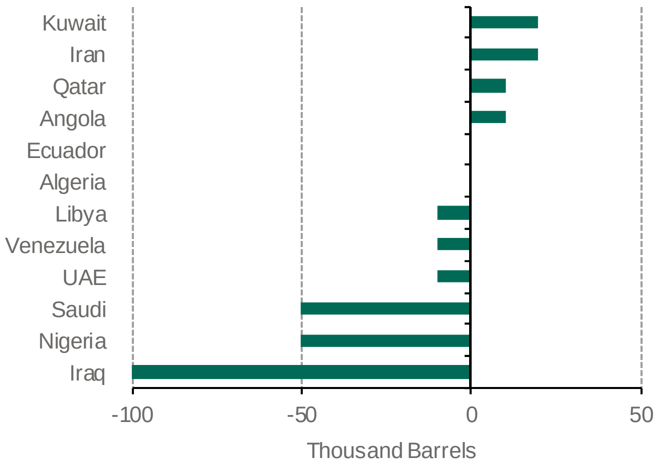
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, oil market balances placed the surplus in the market over Q4'15 at 2.1mb/d, but is expected narrow to 1.2mb/d over Q1'16. While large scale oil related capital investment in the amount of $200bn has been deferred, which will lessen out the upstream project pipeline, the market still focuses on the prompt surplus. The EIA adds that the expectation of reduced cash flows in 2016 and 2017 has prompted many companies to scale back investment programs. In the US, output has not been as badly hit as the number of rigs operating, which has fallen steeply from 1,931 in September 2014 to just 664 rigs at the beginning of January, according to Baker Hughes. US crude stocks of 482mn barrels at the end of January were back near its record levels set in April 2015, reversing a mid-2015 dip.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

In Iran, production reached 2.89mnb/d in December, little changed from the average of 2014's level, but 0.7mb/d below its level before the sanction of 3.6mb/d in 2011. Iran's exports in 2015 remained range bound at 1.0-1.3mb/d, but they were at 2.5mb/d in 2011, indicating sizable potential gains. The IEA in its latest monthly report noted that the oil market faces the prospect of a third successive year when supply will exceed demand by 1mb/d, putting a massive strain on the ability of the oil system to absorb efficiently. It projects a 0.6mb/d fall in non-OPEC output for 2016, which will inevitably be largely offset by higher production from Iran. Moreover, Saudi Arabia and other GCC members of OPEC will be less likely to cut production to make way for Iran. In Saudi Arabia, production reached 10.18mb/d in December, maintaining output above10mb/d for the last ten straight months. The supply cuts are only filtering through, but the outlook for demand growth cools further as global macro sentiment weakens. The IEA expects demand in China to increase in 2016, but by only 0.35mb/d, well below 2015's 0.56mb/d level. China's December imports were at all-time record levels, taking advantage of lower prices to build its new strategic reserves. The expectations of Chinese economic growth of any kind for 2016 keeps getting revised down. The World Bank, in its latest 'Global Economic Prospects', revised its 2016's Chinese growth forecast down to 6.7% from 7.0%. This Chinese slowdown adds yet more downwards pressure on oil prices. Moreover, in the longer-term, China's crude import growth is expected to decline, as the country's economy becomes less reliant on energy-intensive manufacturing.

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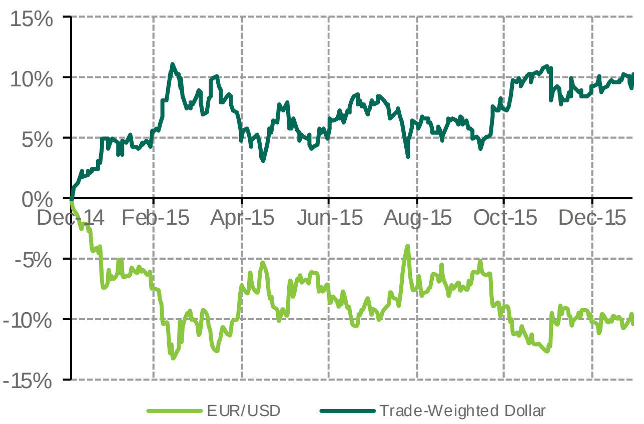
Foreign Exchange

Financial Markets React to Fed Lift-off

The year 2015 was marked by the divergence of the Federal Reserve from the rest of the world's central banks, concluding with the first interest rate hike since the Great Recession. Strong economic data from the US suggested that the era of easy money was coming to a closure and the USD ended 2015 with a 9% rise versus major currencies. We expect the appreciating trend to continue in 2016; however, as the normalization cycle matures, we expect a more volatile, range-bound movement in the trade-weighted dollar due to global headwinds. The Fed's rhetoric of gradual 25bps hike each quarter this year is being challenged by global concerns including negative commodity price dynamics, disruptive developments in China, and escalating geopolitical tension in the Middle East. Thus, many market speculators predict that only two of the scheduled hikes will materialize. The recent plunge of Wall Street and the lackluster manufacturing data is expected to keep the Fed fairly accommodative. By mid-January, the Dow tumbled 7.7% Y/Y to 15,988.1 points, the lowest levels since late August. The S&P 500 index also indicates a collapse in US equities as it fell by 5.6% Y/Y to 1,880.3. US manufacturing was hurt by the strengthening USD and weakening global demand. The Institute of Supply Management recorded the third consecutive monthly contraction in December at 48.2. Despite low energy prices providing average consumers with more discretionary income; as global demand prospects remaining weak, the future outlook of US manufacturing remains pessimistic.

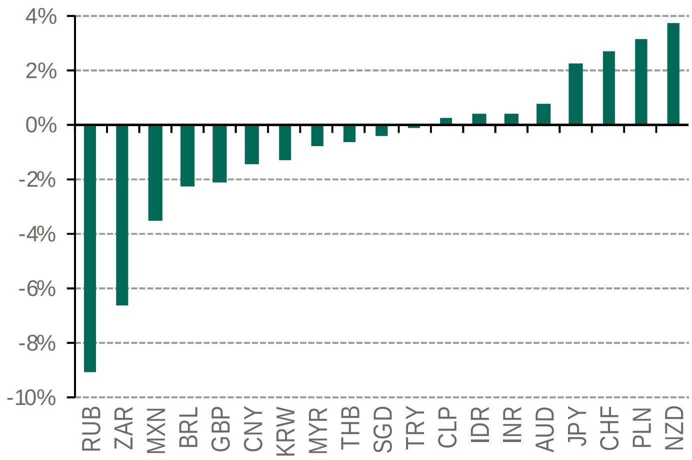
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The EUR will continue to weaken in 2016 as the ECB retains its monetary easing stance. Interest rate differentials between the Eurozone and the US have widened to 140bps at the short end of the curve, allowing for the largest yield advantage since 2006. However, interest rate arbitrage is expected to provide support for the currency from falling far below par value. Upon the conclusion of 2015, the single currency closed 10.2% down YTD, standing at USD1.09. We don't see much of an upside potential in 2016 for the EUR as it remains vulnerable to economic uncertainty. Inflation is currently flat at 0.2% as of December indicating a state of stagnation in the Union. The GBP is facing a bearish momentum exacerbated by the prospects of a Brexit. Given that the annualized 3Q growth in the UK was 2.1% as opposed to the initially reported 2.3%, and inflation remained at around 0.2% in December, the Bank of England is not expected to hike interest rates soon. The GBP ended 2015 at USD1.5, sliding by 5.4% since the beginning of the year.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The Asian forex market is highly vulnerable to the developments in China as the renminbi remains on the defensive. In December, the CNY depreciated the most among emerging market currencies after the IMF's decision to include the currency in its SDR basket. The Chinese equity market sell-off increased bearishness in offshore renminbi, and the Chinese economic model reform towards a more consumer-based economy is lessening growth prospects to below 7%. In turn, the CNY ended year 2015 sliding 4.4%, standing at CNY6.5/USD. In addition, the JPY will be positively affected as a result of policy shifts and high volatility in the Asian financial market. Safe haven flows have already provided a boost for the yen amid elevated uncertainty ending the year nearly flat, standing at JPY120.3 for the dollar.

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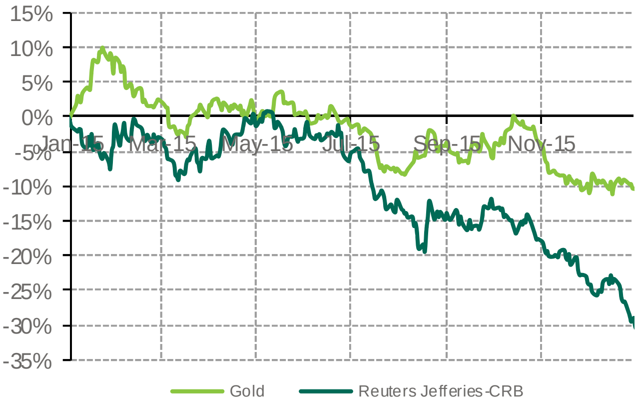
Commodities

Weakening to Persist Through 2016

Commodity prices extended seven months of consecutive declines tumbling by near 25% in 2015. Energy prices continued their free-fall in December despite escalating geopolitical tension between Iran and Saudi Arabia. Subdued global aggregate demand and the removal of the US export ban and Iran's economic sanctions exacerbated the perceived oversupply glut in the oil market. In addition, the Fed rate lift-off propelled the USD to rally against its major peers, pushing global commodities to their lowest points since 1991. The Reuters/ Jeffries Commodity Research Bureau's index records a year-end index reading of 176.1, tumbling by 23.4% from a year earlier. Years of big investment-led supply were not met by equal demand as global economic growth has been much slower since the Great Recession, and the Chinese growth deceleration constitutes a major headwind in the commodity futures market. Therefore, it is not likely to witness a serious rebound in commodities in 2016 due to lack of short-term drivers. On the other hand, the commodity outlook should improve over time as oil prices currently remain in contango, indicating that most of the pain is over.

Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

The shake-up of China's manufacturing-based economic model is hugely impacting its demand for base metals which hit a multi-year low on the London Metal Exchange (LME.) Copper slipped below the psychological barrier of USD5,000/ton late November and continued to dwindle, ending the year at USD4,705/ton, erasing 25.3% of its price value. Aluminum prices also slid on a yearly basis albeit to a lesser extent, losing 18.7% at USD1,507/ton. Despite the stubbornly bearish outlook on base metals, the decline in Chinese aluminum smelting capacity could provide support for the metal. The current status of gold reflects its response to US real yields. While the demand base is dwindling as investors flock to other safe havens such as the Japanese yen, the strengthening USD constitutes another downside risk for the yellow metal. Upon the conclusion of 2015, gold prices stood at USD1061.7/oz, shedding 10.4% Y/Y. We expect some stability in gold prices and industrial metals this year as investors may include it in their portfolios to hedge against uncertainty. Nevertheless, persistent oil oversupply glut, protracted Chinese slowdown under capital repatriation, and strong USD are major headwinds that may prolong the supply-adjustment cycle.

Chart 6: Base Metals

Source: Thomson Reuters

Agricultural commodities ended the year on the lowest note since April, as the Goldman Sachs Agriculture index closed at 210.3, a point 12.1% below the end of December 2014. Despite the bearish bias overall, agricultural commodities rallied 20% during the final quarter of 2014 which went unnoticed with the oil market crash. The relatively high base mainly came from increased sovereign risk for Russia during the Russia/Ukraine standoff. We should also not discount that fuel accounts for around 10% of the variable cost of producing various grains, allowing the market to adjust for lower prices. Some wild bets were made in the last quarter of this year that El-Nino would lead to a sizeable shortage in crop yields; however, the geographical limitation and the extent of weather event did not measure up to the ample global supply vastly exceeding demand. Wheat near future prices ended 2015 standing at 470 cents/bushel, dwindling by 24.1% Y/Y, whereas corn prices ended the year at 360 cents/bushel, sliding by 14.5% Y/Y.

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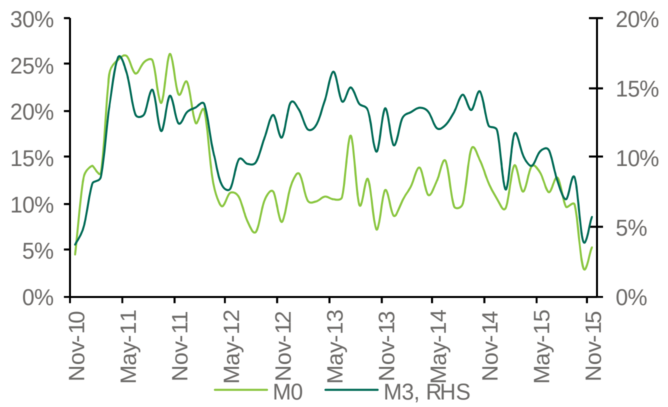
Money & Inflation

Money Supply at a Five-Year-Low

Plummeting oil prices are prompting Saudi banks to brace for a liquidity squeeze. Despite the SAR52 billion excess reserves in Saudi banks which leave the ratio at 35.1%, government draw-downs from deposits, in addition to deferred payments to government contractors are hurting the depositary base. In October, deposits grew at the slowest pace since the 1990s, recording 3.9% Y/Y, and bank borrowing costs started to creep up over the 100bps; an evidence for the oil market's large trickle-down effect on the Saudi economy. In addition, towards year-end, banks tend to be more aggressive in shoring up balance sheets; therefore, we might see lesser lending and capacity utilization. In response to the fiscal deficit conundrum, the Kingdom ordered a series of cost-cutting/revenue-generating measures to smooth out the bear cycle. It also issued bonds worth SAR98 billion in 2015 to bridge the budget deficit gap; all of which would impact deposits negatively.

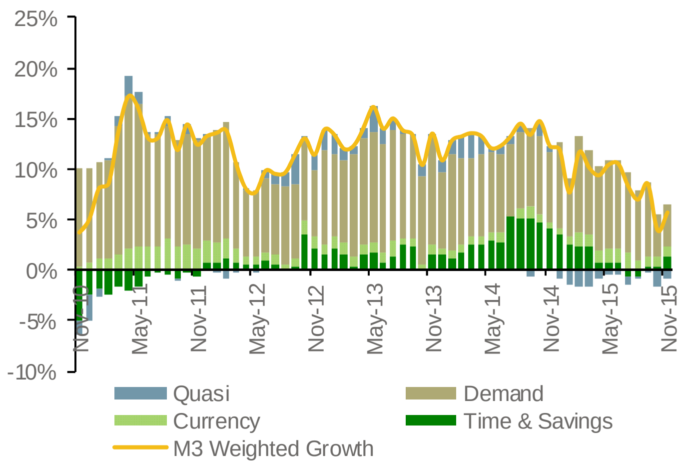
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

In the month of November, broad money supply (M3) recorded a 5.7% annualized upturn, conforming with the single-digit trend which appeared since June 2015. The monetary base grew by 5.3% Y/Y reaching SAR298.4 billion affected by declining bank and public deposits with SAMA. Compared to the same month last year, deposits with SAMA slid 2.1%, settling at SAR101 billion. The negative growth is largely due to sizeable withdrawals by banks and public financial institutions in which the latter tumbled 58% from last year down to SAR4.8 billion. Bank deposits with SAMA recorded the lowest growth since December 2009, posting 4.9% Y/Y at SAR 96.1 billion. In addition, cash in vault is witnessing a sub-par growth for the second consecutive month in November after posting a 6.8% annualized growth, standing at SAR 29.3 billion. Demand deposits which constitute roughly 57.3% of broad money supply at SAR1.02 trillion also recorded the lowest upturn in nine years of 7.4% Y/Y. Time and saving deposits returned to positive territory for the third month marking a 6.1% annualized upturn, standing at SAR416.2 billion, thus accounting for 23.2% of M3 money supply. Quasi monetary deposits on the other hand completed a full 12-month period of declines, posting a downturn of 6.9% Y/Y at SAR180.9 billion. Short-term liquidity squeeze and tighter credit conditions might lead Saudi banks to raise provisions while SAMA might counteract the cycle by freeing some liquidity tied to T-bills and reserve requirements. Inflation in the Kingdom remains moderate owing to the appreciation of the dollar-pegged Saudi riyal and ample global supply of energy and commodities.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

Headline inflation rose 2.28% as downside pressure from foodstuff, the largest category in the consumer basket, remains persistent. Foodstuff inched up a minute 0.8% Y/Y marking the lowest price change in this category since 2002. Housing appears to provide the largest upside potential as it rose 4.4% Y/Y. Our view is that upside inflationary pressures are yet to induce any drastic change in the overall index, and so we expect inflation to average 2.2% in 2015, and edge up to 2.7% in 2016.

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Capital Markets

A Rocky Year for Tadawul

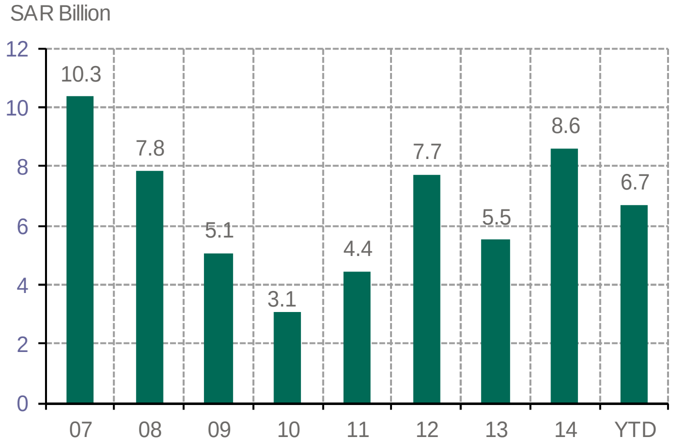
There is no denial that the capital market is in need of a long-term plan to change structure from an individually-driven base to a professional one, where decisions are relatively long-term and fundamental in nature. Qualified Foreign Investors (QFIs) that were allowed to access the market in the first half of 2015 did not provide the institutional support expected yet, even though by the end of December signs of increased activity started to appear, with their total holdings increasing by SAR655 million, a 48% from November 2015 level. In contrast to developed markets, where investment funds provide diversification and professional advice, they still play a marginal role in the local scene. Additionally, with the Saudi stock market reaching multi-year lows, there was a negative spillover effect on the funds, as reflected by the end of year statistics that have been recently released by SAMA.

Chart 9: Tadawul All-Share Index

Source: Tadawul

A couple of factors will shed a light on their 2015's performance and challenges going forward. As reiterated earlier, the declining valuations on Tadawul and international bourses had underpinned the decline in total assets for the funds that have registered SAR103 billion, a 7.1% annual decline compared to 2014 and the lowest value-wise since 2012. Nevertheless, this annual decrease remained below TASI's plunge that was around 17.1%. On the composition-front, domestic assets continued to dominate, with their share steady at 74% of total assets, which amounts to SAR75.9 billion. Growth-wise, domestic assets and foreign assets shrank at a similar pace, registering around 7.3% and 6.4% Y/Y, respectively.

Chart 10: Average Daily Traded Value



Source: Tadawul

The most important trends from the data included the following: (1) a double-digit decline in the value of their holdings of domestic shares by 18.2%, which mimicked the headline index and underscored the ineffectiveness of diversification strategies given the intensity of the broad market sell-off, (2) stagnation in real estate investments after the surge witnessed in 2013, falling by 5.5% to around SAR3.4 billion last year, and (3) the shift from domestic money market instruments to domestic bonds, which is justified by the increased expectation for higher rates going forward. Ostensibly, investment funds remain challenged by a client base that continue to shrunk by 3.7% last year, with the number of subscribers falling to just 237 thousand. The extent of the decline is accentuated when compared with the 568 thousand subscribers by the end of 2005. Ostensibly, the dominance of individual investors and the lack of investment prowess makes the idea of investing through a fund exotic and unfathomable for most. In our opinion, there is no reason to believe that the abovementioned trend that continued unabatedly since 2005 will reverse course. Additionally, concerning Tadawul, the role of investment funds is insignificant due to: (1) an asset structure in which their portfolio of domestic stocks represent a 1.46% of the overall market capitalization, and (2) a small share of trading activity, where investment funds account for 5.29% and 2.91% of the total value of stocks bought and sold, respectively.

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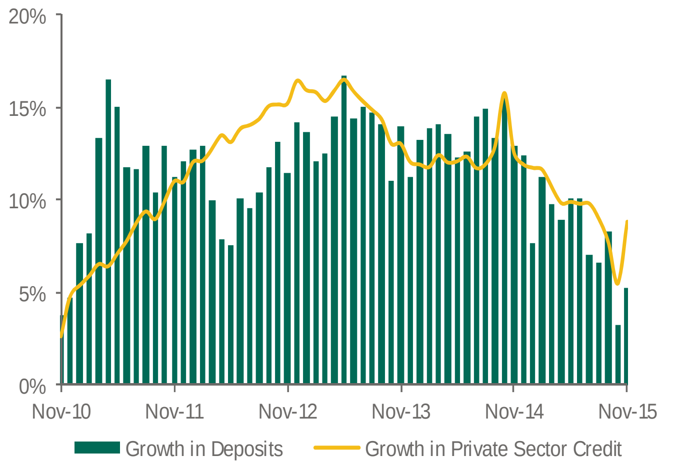
Loans Market

Credit Growth on a Decelerating Phase

In 2015, the turn of events leading to November were mainly negative to depositors and lenders. The oil supply shock that started in the second half of 2014 have worsened by Iran's expected addition of 500,000 bbpd, and OPEC's inability to close a deal with Russia regarding output reduction. The drop in bank deposits in October is considered to be the largest since the 1990s, and the rising cost of funding could dent Saudi banks' profitability over the medium term. Government borrowing is also putting a squeeze on profits as both deposits and loans decline to multi-year lows.

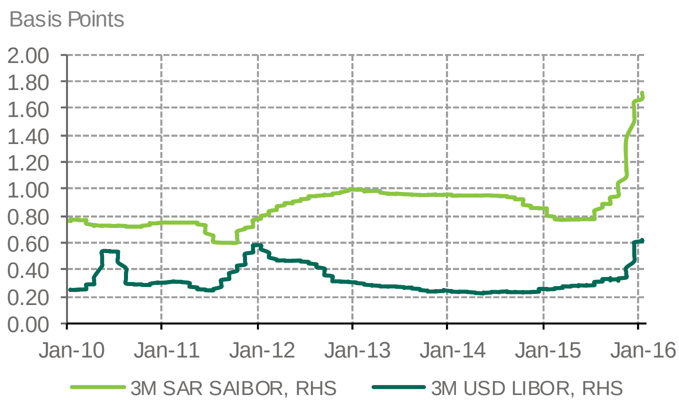
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Broad money supply in November posted an annualized growth of 5.7% continuing the single-digit trend resulting from heavy government withdrawals and lower deposits by businesses and individuals. Public institutions' deposits with SAMA tumbled 58% from last year down to SAR4.8 billion decelerating growth in the monetary base to 5.3% Y/Y reaching SAR298.4 billion. Demand deposits which make up 57.3% of broad money supply were also affected by declining public capital expenditure, rising by 7.4% Y/Y to SAR1.02 trillion. Time and savings deposits which account for 23.2% of broad money supply upturned 6.1% Y/Y, standing at SAR416.2 billion. Quasi monetary deposits such as deposits of foreign currency, remittances and letters of credit marked a full year of consecutive declines, ending November down by 6.9% Y/Y at SAR180.9 billion. Moving onto the asset side, growth in total bank credit outstanding to public and private sectors experienced a four-year low of 8.3% reaching SAR1.4 trillion. Noting the strong correlation between oil prices, government expenditure, and overall credit growth, new credit decelerated in 2015 mainly affected by the trickle-down effect of the oil plunge. In addition, new regulations implemented in 2014 requiring higher down-payment on housing loans contributed to the down-trend. Fresh credit extended in 2015 in the months leading to November totaled SAR104.6 billion, around 20.3% lower than a year ago. Credit to the private sector which represent 97.1% of bank loans surged by 8.8% Y/Y, standing at SAR1.3. On the other hand, bank loans to the public sector shrank by 7.7% Y/Y to SAR39.5 billion as more of the lending began to take place in the form of bond purchases. Local Saudi banks' holdings of government bonds surged to the highest level since March 2009 recording a total of SAR80.2 billion, representing a 52.9% Y/Y growth. We are also noticing a 32.7% Y/Y decline in SAMA bill issuances to a total of SAR151.1 billion as an attempt from SAMA to free up bank liquidity in favor of the longer maturity government bonds.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

The consolidated balance sheet of Saudi banks shows that the loan composition by maturity in November is 52.2% short-term at SAR707.7 billion, 16.5% medium-term at SAR223.1 billion, and 31.3% long-term at SAR424.2 billion. Compared to late 2014/early 2015, we see the composition moving back towards favoring short-term loans as opposed to long-term, possibly due to the anticipation of the Fed rate hike by banks, in addition to tighter risk criteria; especially as the government reduced capital expenditure in 2015 by 60%. The interest rate environment is on the rise as reflected by SAIBOR surging to the highest level since January 2009 at 170bps. Official repo transaction rate remains unchanged at 2%; however, reverse repo transaction rate rose by 25 bps in December to 50 bps. We don't expect another eminent hike especially as the Fed's likelihood of a second rate hike in 1Q2016 is declining.

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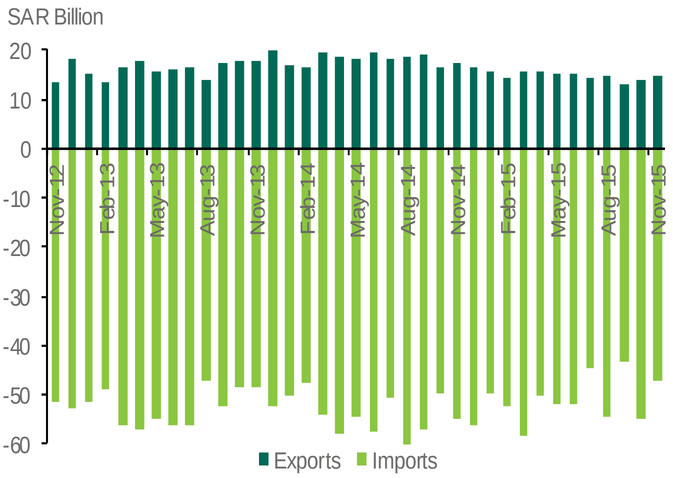
External Trade

Trade Gap Widens on Weak Commodities

The collapse in oil prices has been a focal point for the global economy, leading to an oversupply theme that coincided with waning demand, expected to stretch into 2016. The Saudi economy is still heavily reliant on oil as its main revenue source. However, the government is trying to change this growth model through economic diversification strategies. The government is improving its spending efficiency, adapting to oil price changes and expanding non-oil revenues as a part of its fiscal consolidation strategy. The government is in the process of implementing long-term economic plans by the year of 2025, and have presented measures to promote trade, and attract more foreign direct investment to support economic growth.

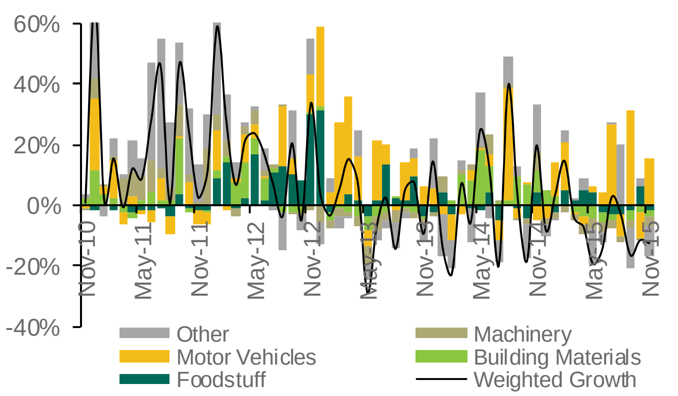
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

During November; non-oil trade continued a declining trend on exports as well as imports, falling in comparison to the same period last year. In value terms, non-oil exports reached SAR15 billion compared to SAR17.2 billion 12 months ago, sliding by 12.5% Y/Y. In contrast, imports slid 14.4% on a Y/Y basis after posting a total of SAR47.2 billion. In weight terms, total non-oil exports during the month weighed 4.3 million tons, rising up by 9.9% Y/Y, whereas imports weighed 5 million tons, deteriorating by almost 24.5% compared to last year. By composition, plastics accounted for 30.7% of November's non-oil exports, valued at SAR4.6 billion, followed by petrochemicals representing 29.4% at SAR4.4 billion. Moreover, in comparison with last year's performance, exports of plastics fell by 18.3%, while exports of petrochemicals faced a decline by 15.2%. Exports of base metals which account for 8.1% of total non-oil exports at SAR1.2 billion recognized a 10.5% Y/Y drop. The leading export destination during November were the UAE, China and Singapore. Each respectively accounting for 14.3%, 9.4% and 4.9%. Conversely to the rest of export destinations, nonoil exports to the UAE amounted to SAR2.1 billion, edging up by 0.5%Y/Y. On the other hand, exports to China fallen 25.7% Y/Y after posting SAR1.4 billion. Exports to Singapore recorded SAR0.74 billion, dropping of the last year's figure by 21% Y/Y.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the imports side, machinery and electrical equipment held for the largest share at 27.8%, with a total value SAR13.1 billion, compared to the same period last year, imports of machinery and equipment descend by 16.2%. According to NCB's construction contracts fourth quarter 2015 index, a significant decrease in awarded contracts value occurred specially in November and December. Thus, less imports of machinery and equipment decreased since the construction activities are weak. In contrast, imports of transport equipment which represent 21.2% of total imports marked a slight decay at SAR10 billion, declined by 1.9%. Furthermore, imports of base metals plummeted for the second month in row by 25.9% Y/Y, posting SAR4.1 billion. The main countries of source were the United States, China and Germany, each accounting respectively for 15.2%, 14.4% and 17.4%. Imports from the US were valued at SAR6.8 billion, declined by 6.2% Y/Y. Imports from China also recede by 19.1% Y/Y at SAR6.1 billion. In comparison, Germany's imports gain a little momentum by 2% Y/Y at SAR3.5 billion. Additionally, letters of credit settled and bills received in November acknowledge a slight decrease of 0.7% Y/Y, posting SAR18.9 billion. The negative annual growth is an indicator of a slower business cycle and tighter liquidity..

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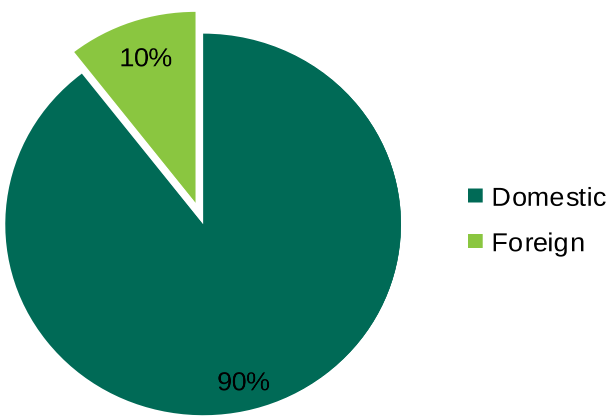
Special Focus:
SCIs: Moderation this year

2016 government budget allocations to specialized credit institutions (SCIs) have moderated significantly, yet their continuation reflects adamancy to support the economy. According to the budget announcement, SAR49.9 billion will be allocated to SCIs, namely the Public Investment Fund (PIF), Saudi Industrial Development fund (SIDF), Saudi Credit & Saving Bank (SCSB), and the Real Estate Development Fund (REDF). According to the latest available data published in SAMA's 4Q2015 bulletin, the consolidated balance sheet for government SCIs points to: (1) a significant increase in the disbursements of new loans by SAR27.3 billion during the first two quarters of 2015, a 17% Y/Y growth rate that is the highest since 2Q2013, (2) an increase of in the total value of investments to around SAR133.04 billion by the end of 2Q2015, which was attributed to a growing domestic portfolio that rose from SAR115.9 billion by the end of 2014 to SAR119.1 in 2Q2015, (3) an insignificant increase in foreign investments that remained around SAR14 billion mark, and (4) a 4.5% Y/Y decrease in deposits with SAMA that stood at SAR74.5 billion, reflecting the withdrawal of such deposits in order to extend loans to local companies rather than passively investing them whether internationally or locally. These latest data reflect the central role played by SCIs as a catalyst in the domestic economy.

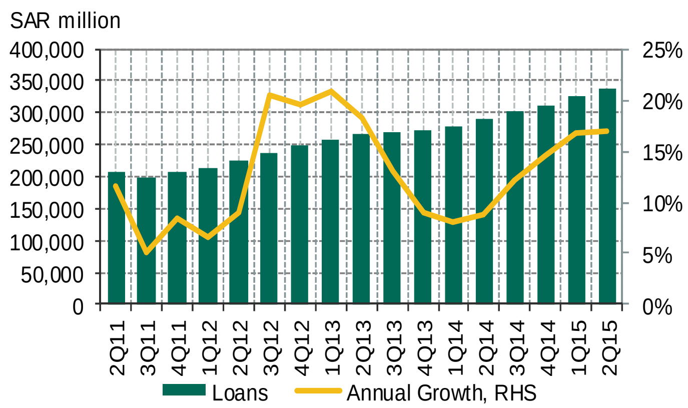
Chart 15: Investment by Type



Source: SAMA and NCB

As expected, the REDF was largest among these institutions in terms of the outstanding loans that registered SAR141.5 billion, and it is our believe that such figure might have crossed the SAR150 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 Saudi Credit &Saving Bank 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 SAR96.4 billion and SAR44.4 billion, respectively. 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 1H2015 to 752 establishments, representing 12% 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.

Chart 16: Loans



Sources: NCB

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