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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- Although increased geo-political risk, mainly due to Iran, may support prices, increased shale oil production in the US, combined with increasing supplies from Iraq and the continued weakness in the global economy are likely to put downward pressure on the price of oil in the short term.
- The ECB announced the possibility to introduce negative interest rates on Eurozone deposits. This led the single currency to tumble sharply against major currencies down below the 1.30 mark.
- Even though gold prices fell by more than 10% in 2 days during last month, it will remain fundamentally attractive given the limited supply and robust physical demand from India and China.
- We expect the inflation rate to edge slightly higher during April and continue on an upward trajectory during the second quarter of 2013 as the food and beverage category represent a weight of 21.7% in the inflation index.
- Abdulmalik Al-Shiekh, the Capital Market Authority Head, has recently reiterated the need for further foreign exposure in the local market. The decision will certainly develop the market and add depth, thus, breaking speculative pressures.
- In our opinion, credit is likely to maintain the current trajectory as banks are still below SAMA’s limitations and the economy remains robust and absorbent of excess financing.
- Opened LCs show a 15.2% annual upsurge, supported by a boosted demand for motor vehicle suppliers by 105.1% Y/Y, followed by foodstuff’s demand escalating by 38.8%Y/Y.

View of the Month

Despite obstacles such as disputes over different Shariah schools (GCC vs. Malaysia), underdeveloped secondary market, and limited supply, factors that are contributing to the growing popularity of sukuk as a debt instrument include a thriving Islamic funds industry; catered to by large pools of Muslim wealth and abundant liquidity, indicating that demand still exceeds supply.

Macroeconomic Indicators

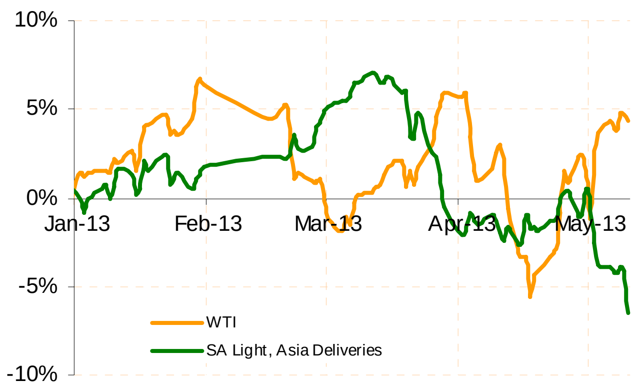
	2007	2008	2009	2010	2011P	2012F	2013F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	68.3	94.9	59.2	77.6	108.1	110.2	105.0
Average Daily Crude Oil Production, MMBD	8.8	9.2	8.2	8.2	9.3	9.9	9.5
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,690.5	2,511.4	2,727.4	2,720.2
GDP at Current Market Prices, USD billion	385.2	476.9	377.2	450.8	670.6	728.3	726.3
Real GDP Growth Rate	2.0%	4.2%	0.1%	4.6%	8.5%	6.8%	3.0%
Oil Sector GDP Growth Rate	(3.6%)	4.2%	(7.8%)	2.4%	4.3%	5.5%	-3.1%
Non-oil Sector GDP Growth Rate	4.7%	4.3%	3.5%	5.5%	7.8%	7.2%	7.6%
Population, million	24.9	25.8	26.7	27.6	28.4	29.2	30.1
Population Growth Rate	3.4%	3.4%	3.4%	3.4%	2.9%	3.0%	3.0%
GDP /Capita, USD	15,444.2	18,495.4	14,147.9	16,354.7	23,632.8	24,917.7	24,127.9
CPI Inflation, Y/Y % Change, Average	4.1%	9.9%	5.1%	5.3%	5.0%	4.8%	4.5%
External Sector							
Merchandise Trade Balance, USD billion	150.6	212.0	105.2	153.7	244.7	268.4	231.6
Oil Exports, USD billion	205.3	281.0	163.1	215.2	317.6	347.6	324.6
Non-oil Exports, USD billion	27.8	32.3	29.1	35.8	46.9	48.9	42.2
Merchandise Imports, USD billion	(81.5)	(100.6)	(86.4)	(96.7)	(119.1)	(128.2)	(135.2)
Net Unilateral Transfers, USD billion	(17.0)	(23.0)	(27.7)	(27.9)	(29.4)	(32.1)	(114.5)
Current Account Balance, USD billion	93.3	132.3	21.0	66.8	158.5	178.7	117.1
Current Account Balance/GDP	24.2%	27.7%	5.6%	14.8%	23.6%	24.5%	16.1%
Net Foreign Assets with SAMA, USD billion	301.3	438.5	405.9	441.0	535.9	648.5	713.4
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	380.0	410.0	475.0	540.0	580.0	690.0	820.0
Actual Revenues, SAR billion	642.8	1,101.0	509.8	741.6	1,117.8	1,239.5	1,076.6
Actual Expenditure, SAR billion	466.2	520.1	596.4	653.9	826.7	853.0	870.1
Expenditure Overrun, %	22.7%	26.8%	25.6%	21.1%	42.5%	23.6%	6.1%
Total Revenues/GDP	44.6%	61.6%	36.1%	43.9%	44.5%	45.4%	39.6%
Total Expenditure/GDP	32.3%	29.1%	42.2%	38.7%	32.9%	31.3%	32.0%
Overall Budget Balance, SAR billion	176.6	580.9	(86.6)	87.7	291.1	386.5	206.5
Budget Balance/GDP	12.2%	32.5%	(6.1%)	5.2%	11.6%	14.2%	7.6%
Break-Even Oil Price	40.5	40.2	60.8	64.1	71.1	67.0	72.8
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)	19.6%	17.6%	10.7%	5.0%	13.3%	13.9%	8.1%
Growth in Credit to the Private Sector	20.6%	27.9%	-0.6%	4.8%	11.0%	16.4%	18.8%
Average 3M SAR Deposit Rate	4.9%	3.3%	0.9%	0.7%	0.7%	0.9%	1.0%
Average 3M USD Deposit Rate	5.2%	3.0%	0.7%	0.4%	0.3%	0.4%	0.4%
Spread, in Basis Points, SAIBOR-LIBOR	(39.2)	37.4	26.4	39.8	40.9	55.2	60.0

Oil Market

Demand Continues to Weaken

Brent crude has recovered back to its recent USD100-110 range after falling to an eight-month low of USD97 a barrel on April 18, on speculation that the collapse in prices was excessive. While oil prices have weakened in April, 1Q13 saw a strong average of USD112.5 a barrel for Brent crude. Meanwhile, June settlement for Brent dropped to USD102 a barrel on the ICE Futures Europe exchange, and WTI for June delivery fell to USD93.4 a barrel on the NYMEX. The front-end of the ICE Brent forward curve shifted in April from backwardation into contango (a condition in which distant delivery prices for futures exceed spot prices, mostly due to the costs of storing and insuring the underlying commodity) for the first time since July 2012. The shift into contango at the front end and flattening of the forward curve reflects rising global commercial stock cover. Although increased geopolitical risk, mainly due to Iran, may support prices, increased shale oil production in the US, combined with increasing supplies from Iraq and the continued weakness in the global economy are likely to put downward pressure on the price of oil in the short term. Saudi Oil Minister stated recently that oil at USD100 a barrel is a reasonable price that will not choke global economy growth, while higher prices threaten global recovery.

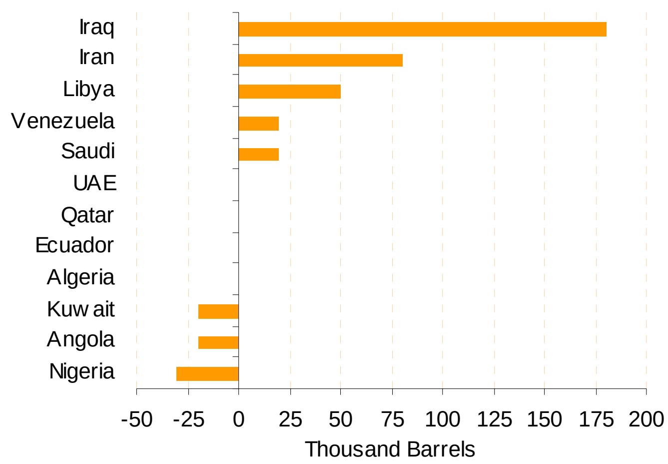
Chart 1: Oil Price Developments, YTD



Source: Thompson Reuters

On the production side, Non-OPEC has continued its steady growth amounting to 0.78 mmbd Y/Y. In North America, US output reached 7.33 mmbd, while Canadian production has averaged over 3.0 mmbd so far this year. Outside of North America, production has been rising in Colombia and non-OPEC Middle East, where production by Oman and Yemen is up 0.12 mmbd Y/Y. After years of trend decline, output from UK showed increasing optimism in harder areas to reach region to the north of the Northern Sea, owed to technological advances, which have made drilling in inhospitable waters viable. OPEC crude production climbed in April to the highest level in five months, led by gains in Saudi Arabia, UAE and Kuwait, rising by 0.6%, to an average of 30.95 mmbd. Saudi Arabia produced 9.2 mmbd in April, up 80,000 barrels from March. The UAE pumped 2.75 mmbd, the highest level since September, while Kuwaiti output rose to 2.9 mmbd, the most since January. Iran's production, on the other hand, dropped to 2.55 mmbd in April, the lowest level since Feb 1990. Iraqi production is likely to rise with the start-up of Majnoon field in Southern Iraq, with Iraq aiming to increase output to 3.8 mmbd by the end of 2013 compared to current production of 3.1 mmbd.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

The global oil markets are seen to bewell- balanced, and there is no over supplies of crude. OPEC, responsible for 40% of global oil supply, will decide this month whether to adjust its collective production ceiling of 30 mmbd. Renewed concerns over the Chinese economy could be another risk for demand, as real GDP growth slowed to 7.7% Y/Y in 1Q13 from 7.9% in 4Q12. The world's second-largest oil consumer accounted for 11% of global consumption last year, only behind the US at 21%, according to IEA, which predicted that China's demand would grow by only 0.38 mmbd in 2013, accounting for almost half of the net increase in global consumption. While Saudi Arabia has been willing to make large cuts to production in the past, its resolve to continue will be tested if other OPEC members raise their own production during 2013. Saudi Arabia may have to persuade other OPEC members to reduce output to its current official target level of 30 mmbd by 2Q13 in order to maintain an oil price above USD100 for the rest of 2013, which may prove to be a more difficult proposition than if the Kingdom were to act unilaterally as in the recent past.

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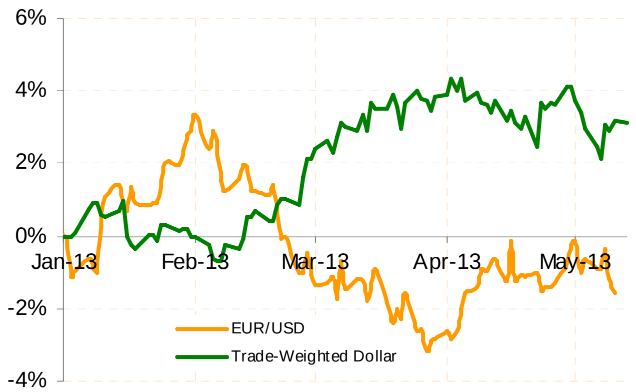
Foreign Exchange

US Jobs Report Hoists USD

In the Forex arena, the specter of "currency wars" continues to escalate. Finance ministers and central bankers are ubiquitously resorting to competitive currency devaluations in order to stimulate their economies in the current economic malaise. In this respect, the US Federal Reserve has been piloting a loose monetary policy since the dawn of the great recession; the third of which is open-ended, and bound to a target of 6.5% unemployment rate, provided that inflation is around 2.5%. In the month of April, the USD weakened by 1.8% against a basket of currencies closing at 81.74. This came about as investors initially assumed the Fed to have signaled the possibility of shifting the existing USD85billion/month bond-purchasing program into a higher gear following the disappointing service sector report. The dollar rebounded, however, following April job data's arrival. The data showed an addition of 165,000 new jobs, reducing unemployment rate down to 7.5%, the lowest rate yet

Chart 3: Trade-Weighted Dollar and the Euro

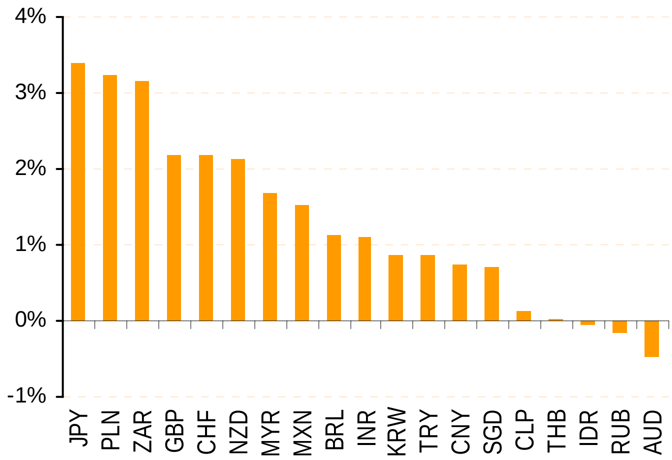


Source: Thompson Reuters

since December of 2008. Although the job creation figures are not higher than the first quarter's average of 206,000, they were above expectations, and indicate that the 0.1% decline in joblessness essentially occurred due to rising employment, rather than opting out of the labor force. This – on part – alleviated growth concerns emanating from the belt-tightening fiscal policy enacted since March. And while the US economy is undoubtedly not out of the woods yet; the upbeat job figures were sufficient enough to sway the fed's decision away from injecting the US economy with a higher dose of QE, at least in the short-run. The strong jobs data sent buoyancy rippling across US equities. Both the Dow and S&P 500 advanced to all-time highs above the 15'000 and 1'600 marks, respectively.

In the Euro zone, German bunds hit contract highs of 146.77 after the German purchasing managers index (PMI) fell to 48.8 points in April from 50.6 in the preceding month. This suggests that Europe's biggest economy is losing steam in the second quarter of this year, and that the output slump of 0.6% seen in the first quarter may protrude onto the second and even third quarters. If such anemic growth prolongs, it may rule out any foreseeable future where Europe plays a role in boosting the world's economy.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

Consequently, the ECB responded by cutting its main refinance rate by 0.25% down to 0.50%. The outcome, however, was on the negative side as yields for 10-year bunds plummeted to a record low of 1.16%, alarming a deflationary crisis. While the EU's troubled nations long for a rescue package on par with Federal Reserve, the ECB's chief restated that the bank stands "ready to act" but insisted on his commitment to price stability, the single mandate which does not include spurring growth. The ECB announced the possibility to introduce negative interest rates on Eurozone deposits. This led the single currency to tumble sharply against major currencies down below the 1.30 mark.

In regards to the JPY, analysts are expecting an eminent stimulus package to take place. Therefore, throughout April, the yen hit 99.80, the lowest point since April 2009. Supported by an appreciating USD on early May, the Yen weakened even further, breaking the psychological 100 yen mark.

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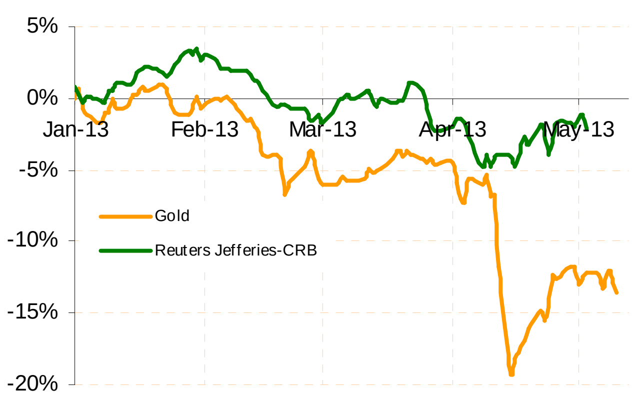
Commodities

Fundamental Pressures

Given the cloudy projections about global economic growth, April witnessed a collapse in the price of commodities from copper to oil. Commodity indices fell across the board, with the benchmark Thompson Reuters/Jefferies CRB index losing around 3% on the back of the less-than-expected GDP figure for the US and signs of a stagnating Chinese economy. The International Monetary Fund had even revised downwards its forecasts for global and regional growth. World economic growth this year was cut to 3.3% from 3.5%. The fact that this figure is way below the recovery witnessed in 2010 after the global economic crisis indicates the fragility of real growth drivers.

Based on the aforementioned, base metals were hit hard, with copper falling by 6.4% last month, which was the steepest drop since May 2012 that extended losses to 11% YTD. The thirteenth week of accelerating LME copper inventories that rose by 92% to 614,350 tons supported the downtrend in copper. On the precious metal front, the less than expected GDP expansion in the US and China reduced demand for precious metals as a hedge against inflation. During April, the price of gold touched USD1,321.50/Oz, the lowest in 26 months. Nevertheless, higher physical demand trimmed the worst monthly loss since December 2011, thus, countering the decline From ETPs, whereby investors cut assets in gold-backed exchange-traded products to 2,294.5 metric tons, the lowest since October 2011. Even though gold prices fell by more than 10% in 2 days during last month, it will remain fundamentally attractive given the limited supply and robust physical demand from India, largely jewelry, and China that is trying to diversify its net foreign assets, worth USD3.4 trillion,

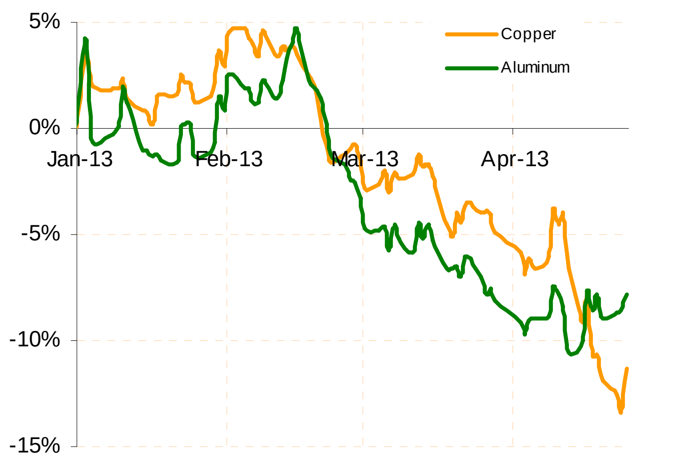
Chart 5: Reuters Jefferies vs. Gold



Source: Thompson Reuters

away from the greenback. Most Importantly, the attractive prices of gold that plunged by 12% YTD had propelled trading for the metal by 50%, which is higher than the 100 days average, which explains the quick rebound witnessed after the fall.

Chart 6: Base Metals



Source: Thompson Reuters

Silver prices have mimicked gold with more intensity to the downside, tumbling around 14% in April, the worst loss since December 2011. The decline last month has propelled the YTD losses to 19.7% that makes silver the worst performer on the S&P GSCI index. Yet, a further retreat might not easily materialize especially that the amount held in exchange-traded products globally remains 2.3% higher in 2013, with holdings in silver-backed ETPs standing at 19,353.38 tons on April 26, compared with 18,916.92 tons at the end of last year. In a similar fashion to gold, silver trading almost tripled after the sharp fall.

As for agricultural commodities, soybeans rallied as a result of the increased demand for US supplies amid slowing exports from Brazil as a result of the congestions in Brazilian ports. The Chicago board of trade showed that soybeans for July delivery advanced as much as 0.4% to USD14.15 a bushel, which is the highest price for the most-active contract since March 28th. Palm oil also gained this month after declining for four straight months especially after Indonesia, the world's largest palm oil producer, decided to cut export taxes to 9% in May instead of April's 10.5% tax rate. It is expected that demand for palm oil may accelerate during the month of July which marks the beginning of Ramadan as it is used heavily in cooking. The contract for July delivery advanced as much as 1.3% to USD759/metric ton on the Bursa Malaysia Derivatives.

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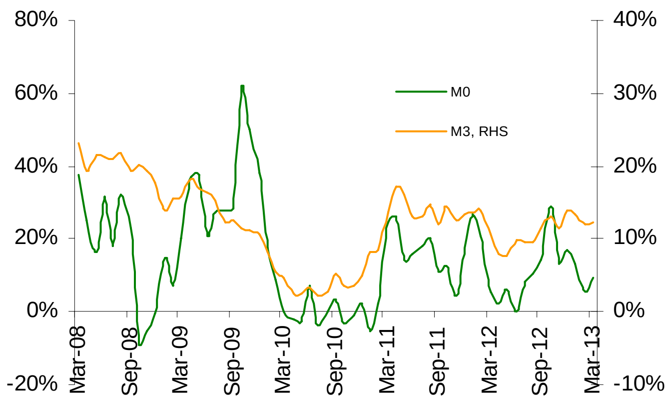
Money & Inflation

Aggregates on the Rise

The monetary situation in the largest economy in the GCC continues to represent the prosperous state of Saudi. The sustainable level of growth in the monetary system is in line with the fiscal expansionary policy while the extent of inflationary pressure remains subdued. A glance at Saudi Arabia's monetary aggregates in March reveals expanding liquidity which could trickle down to the consumer by raising local prices, but that is not the case for the latter. The monetary base (M0) increased by 9.1% annually during March. The main contributors to the gain were; deposits with Saudi Arabian Monetary Agency (SAMA), currency outside banks, and cash in vault, all growing at an annual rate of 7.3%, 10.3%, and 16.3%, respectively. However, on a monthly basis, deposits with SAMA expanded during March by 3.6% M/M to reach SAR160.8 billion. Additionally, local banks increased their cash in vault which recorded a growth of 9.6% M/M amounting to SAR20.9 billion. Currency outside banks has reversed the positive trend to decline by SAR299 million during March to amount to SAR135.3 billion. The liquid state of the economy will continue to contribute to the growth of the financial system.

Chart 7: Growth in Monetary Aggregates

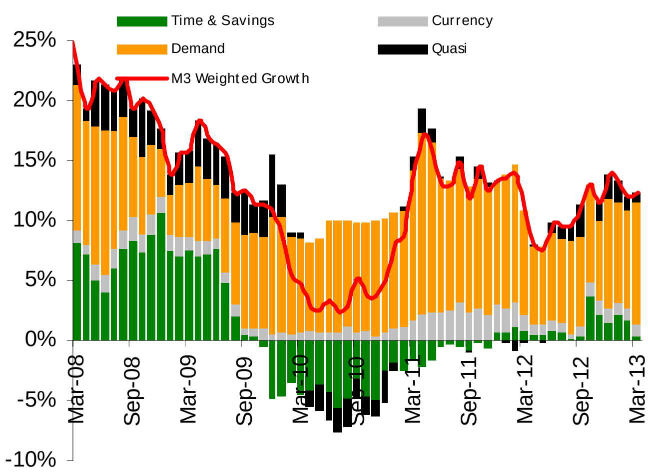


Source: SAMA, NCB Estimates

The money supply (M3) undoubtedly has a positive correlation with M0. Consequently, M3 recorded a rise of 12.3% Y/Y by the end of March to reach an all- time high at SAR1.43 trillion. On an annual basis, demand deposits (weighing 56.4% of M3) unsurprisingly outpaced time and savings deposits by posting a gain of 18.9% and 1.7% respectively. However, on a monthly basis, demand deposits grew by 4.7% M/M to reach SAR805.6 billion, while time and savings deposits dropped by SAR 12.5 billion (- 3.9% M/M) to amount to SAR312 billion.

Other quasi-monetary deposits managed to expand by 3.4% on a monthly basis, while registering a 6.6% Y/Y gain reaching SAR174.1 billion, which is in line with the growth of Saudi's trade activities (see External Trade section).

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

As for inflation during March, the rate of inflation sustained the 3.9% Y/Y increase for the third consecutive month this year. The inflation rate for the single category of housing, water, electricity, gas, and other fuels reached its highest level of 3.1% Y/Y since May 2012, as the rent subcategory accelerated to 3.7% Y/Y during March against 2.9% in February. It is expected that the anticipation of the mortgage law and the possibility of passing a new tax law on "white land", has kept the real estate market on hold for the time being. The regulatory framework of the new law will unfold the direction of the real estate market, albeit having its full impact on the medium to long term.

The Reuters/Jefferies CRB Index gained 1.2% during March which was partially reflected in the food and beverage category rising by 5.3% Y/Y as food prices are majorly influenced by imported inflation. More specifically, bread & cereal category as well as the meat and poultry category both have increased the inflation benchmark to 6.5% and 7.2% respectively. As a result, we expect the inflation rate to edge slightly higher during April and continue on an upward trajectory during the second quarter of 2013 as the food and beverage category represent a weight of 21.7% in the inflation index.

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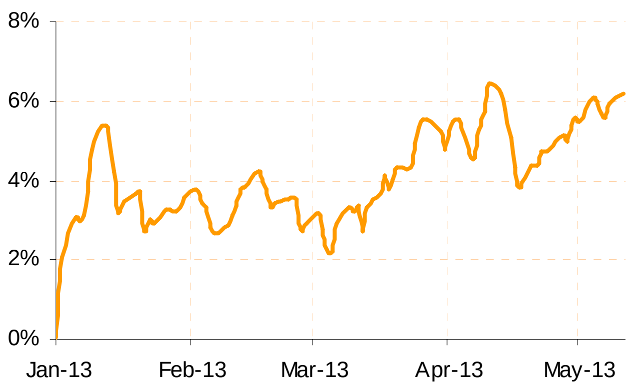
Capital Markets

The Start of Tadawul's Reform

Global equity markets managed to gain 2.6% last month according to the MSCI World index. Advanced economies made substantial gain, with US's Dow and S&P500 continuing their momentum into this month and recording all-time highs. Following the strong first quarter announcements from the market, Tadawul gained 0.8% during the month of April and continues on an upward trajectory, albeit slowly. The market's price-to-earnings ratio increased to 13.45 by the end of last month as stock prices rose. The best performing sector was hotels and tourism, increasing by 19.1% during April and reaching a staggering 65.1% YTD. The Saudi Commission for Tourism and Antiquities has been actively expanding the sector's opportunities. An estimated SAR10 billion worth of investments, over the next two years, are expected to be invested in the tourism sector. In addition, cement companies posted a rise in production for the first four months of 2013, producing 21.0 million tons representing a rise of 7.6% Y/Y. Furthermore, local deliveries, which represents sales, increased by 8.8% annually. Consequently, cement companies' stocks rose and lifted the sector by 10.2% last month. The worst performing sectors were energy and petrochemicals as both recorded declines of 7.8% and 5.2%, respectively, during April. The index has been hovering around the 7'100 level and it seems to be setting a new normal. The trajectory remains positive and we expect Tadawul to achieve 10-15% by the end of 2013.

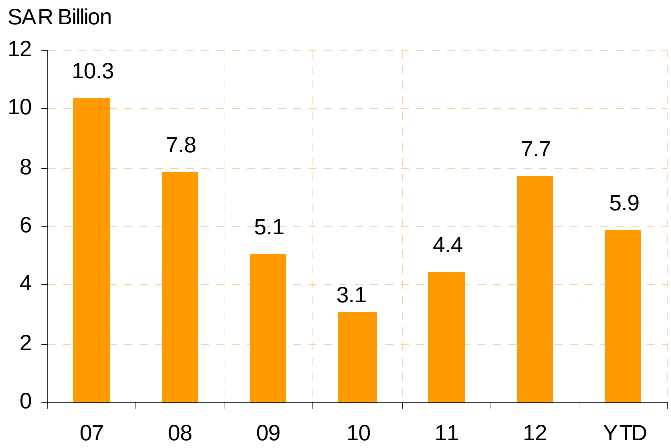
Chart 9: Tadawul All-Share Index



Source: Tadawul

The total number of listed companied has reached 160, including four suspended companies, and the average daily traded volumes currently stands at SAR5.9 billion YTD. Investor appetite increased during April with average daily trading reaching SAR6.6 billion over the month. Investors' bullish momentum lifted the daily average of traded shares, rising to 227.3 million shares against March's 179.9 million. The rise in stock prices also raised the price-to-earnings ratio to 13.45 by the end of the month, still reflecting a cheap market. The majority of trading continues to be dominated by speculative investors as around 90% of trading is conducted by Saudi individuals. Non-Saudi trading represents around 5%, however; Abdulmalik Al-Shiekh, the Capital Market Authority (CMA) Head, has recently reiterated the need for further foreign exposure in the local market. The decision will certainly develop the market and add depth, thus, breaking speculative pressures.

Chart 10: Average Daily Traded Value



Source: Tadawul

The primary market concluded the month of April with no activity. However, the market is expecting two initial public offerings (IPO) this month, both in the insurance sector. Aljazira Takaful will be issuing 10.5 million shares, representing 30% of the company's capital, to the public. The share price has been set at the minimum limit, SAR 10 riyals, which will provide the company with SAR105 million worth of funds. Additionally, Arab National Bank have partnered with American giants, AIG, to establish a cooperative insurance company which will offer 5.25 million shares at a price of SAR10 riyals. The latter IPO will have the subscription phase push into June. Interestingly, the CMA has announced a 10% growth cap for first day listings. In our opinion, appetite for IPOs should remain the same, despite an expected reduction in oversubscription, with no pressure on underwriters. The usual spike in daily trading volumes will undoubtedly halt as the possibilities of "easy money" have been prevented.

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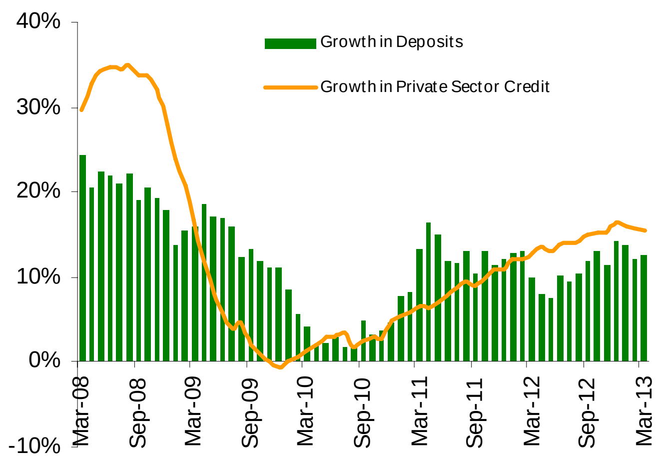
Loans Market

Maintaining a Healthy Balance

Saudi banks continue to support the macroeconomic conditions by providing the necessary financing for local businesses. The depositary base reached an all-time high at SAR1.29 trillion, increasing 12.5% on an annual basis. The pace of growth has been stable and supportive of local banks' financing expansions. The majority of deposits are demand based with a share of 62.4% as they climbed 18.9% Y/Y during March. Businesses and individuals hold 92.5% of demand deposits while government entities make up the remaining 7.5% portion. However, government entities have recorded a staggering hike of 76.2% Y/Y to reach SAR60.3 billion, more than doubling the level reached by the end of 2011. In our opinion, we might see a shift in some of these funds towards interest yielding products to accommodate the government's long term outlooks. Bank wide time and savings deposits recorded the slowest growth rate over the past six months at 1.7% annually. Government entities added 12.5% to reach SAR140.0 billion, a figure which is likely to grow further over the coming months, while businesses and individuals withdrew 5.8% of their time and savings deposits. Additionally, other quasi-monetary deposits grew by 6.6% annually as foreign currency deposits increased by 5.1% Y/Y and outstanding remittances posted a record high by climbing 50.8% annually during the month of March.

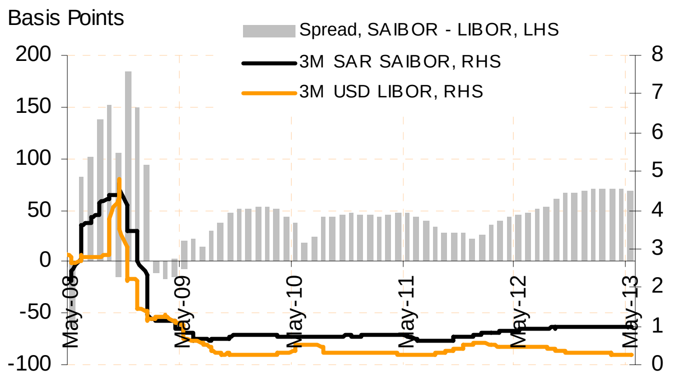
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

The combined loans portfolio for local banks reached an all-time high during March at SAR1.04 trillion, a 15.8% gain over March 2012. The pace of credit growth in the Saudi economy continues to soften by recording the third consecutive deceleration. The current rate of growth is far below the exceptional levels seen in 2004-2005 periods where annual growth reached near 40% or the 2007-2008 periods where rates reached as high as 34.9% Y/Y during August 2008. Local banks' efforts to expand their maturity curve remains evident by the rise in medium and long term credit. Credit maturing within one year, short term credit, posted its slowest growth in eleven months at 5.6% Y/Y. Meanwhile, medium term credit added SAR40.9 billion over the past twelve months, a 26.7% increase on an annual basis. Furthermore, long term credit, which mainly focuses on larger projects and corporations expanded by a substantial 32.6% annually to reach SAR291.7 billion by the end of the first quarter of 2013.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

The credit portfolio of Saudi banks continues to be largely compromised of the commerce sector which holds 20.4% of banks' total financing, SAR212.5 billion. The commerce sector recorded a relatively modest growth at 12.2% Y/Y as other sectors gain momentum due to the efforts of the government to diversify the Saudi economy. Additionally, the vast projects in mining and quarrying have been captured by local banks as the sector recorded the highest annual growth at 59.0% with projects such as Maaden and Alcoa's aluminum refinery worth SAR5.6 billion and Hanwha's gold processing plant worth SAR1 billion. The only sector to post a decline was the transport and communication which dropped by 14.4% as the Haramain railway project shifts beyond the financing phase. The healthy growth in lending this year and the stable pace of deposits has taken the loans to deposits ratio to 80.5% in March from 79.3% last December. In our opinion, credit is likely to maintain the current trajectory as banks are still below SAMA's limitations and the economy remains robust and absorbent of excess financing.

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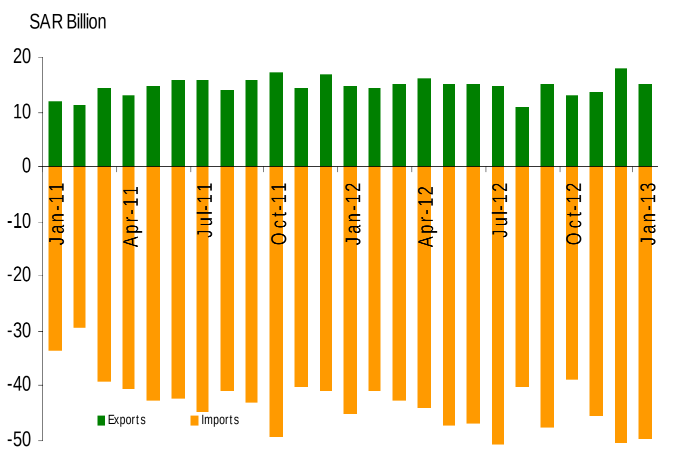
External Trade

Trade Moderates Under Global Pressure

In the month of February, the value Saudi non-oil exports reached SAR13.7 billion, falling short of last year's SAR15.2 billion by 10%. Volume-wise, they amounted to 3.43 megatons versus 3.92 megatons in the same month last year, a -13.5% change on an annual basis. Such weakening demand comes affected by global economic cooling which did not spare the kingdom's trading partners.

The monthly bulletin of the Central Department of Statistics and Information (CDSI) shows that plastics dominated exports by 35.3%, advancing by 5.9% over last year to rack up a total of SAR4.8 billion. Revenues from chemical products exports make up 31.3% of the overall non-oil exports' return. Compared to last year, exports of this category receded by 25.7% allowing it to fall behind plastics, totaling SAR4.28 billion. Base metals leaped significantly over last year's figure by 33.8%, to record SAR1.1 billion of revenue.

Chart 13: Saudi Non-Oil Trade Balance

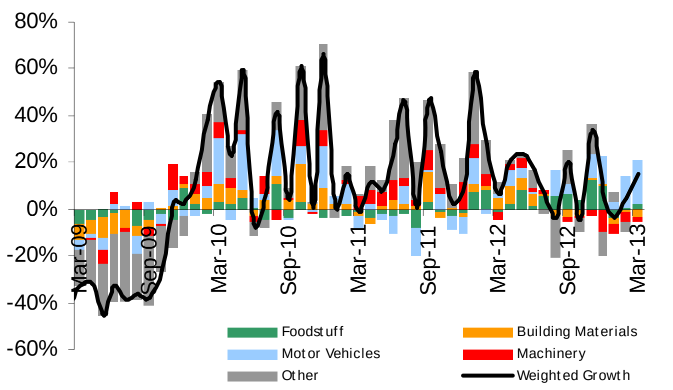


Source: CDSI, NCB Estimates

Exports destinations were led by China, which imported a worth of SAR2 billion, registering a decline of 8.1% Y/Y. It, however, boosted its share of Saudi exports allocation up to 14.8% from a 14.4% last year. UAE comes in second, with exports valued at SAR1.5billion, a 19.4% decline from February 2012. The share of total exports in which the UAE contributed was also downsized to 10.9% from 12.1% Y/Y. Singapore, the third largest trading partner also slashed its demand for the kingdom's exports by 25.3% to stand at SAR0.6bn from SAR0.8billion last annum.

Saudi imports in February continued to moderate following the surge that peaked in July last year. Total non-oil imports reached the value of SAR45billion, a 4% Y/Y upturn. In terms of volume, however, imports showed a considerable 12.6% decline compared to last year, weighing 5.8 megatons. This indicates that global inflationary pressures are beginning to hamper demand for more imports. By categories, machinery and electrical equipment occupied 28.2% of total imports, registering a 7.5% rise Y/Y with an amount of SAR12.7billion. Transport equipment constitutes 16.6% of this month's total imports. With SAR7.5billion, it lessened by 3% compared to February of last year. Base metals imports were valued at SAR5.7billion, making up 12.6% of imports. They slumped by 9.3% Y/Y.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

By origin, the United States earned the lion's share of SAR6billion, predominating 13.5% of imports to the kingdom, and surging by 21.4% over last year's figures. China, a close second, also imported a worth of SAR6billion, a 3.5% annual increase. Germany was the third largest importer with a share of 6.4% of total non-oil imports. Its imports fell by 15% in the last 12 months to SAR2.9billion.

Settled letters of credit (LCs) in the month of March show a general improvement compared to the last couple of months. On annual basis, settled LCs grew by 8.1% supported by a surge in foodstuff and motor vehicles by 61.6% and 45.8% respectively. Machinery and building materials both appeared on the negative side, showing a -23.8 and -10.2% growth, respectively. Opened LCs show a 15.2% annual upsurge, supported by a boosted demand for motor vehicle suppliers by 105.1% Y/Y, followed by foodstuff's demand escalating by 38.8% Y/Y. Machinery and building materials will continue the negative trend, receding annually by 12.7%, and 28.9% respectively.

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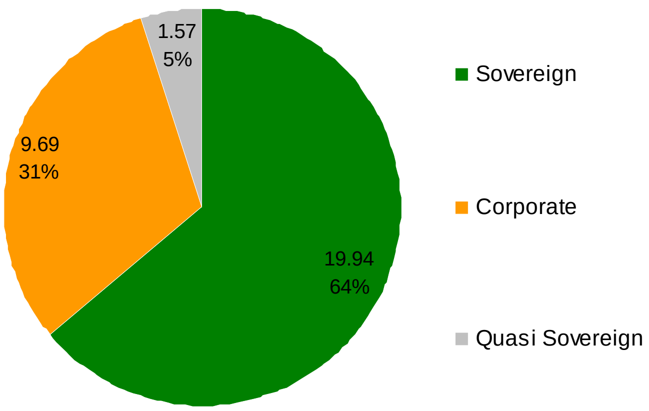
Special Focus:
Evolving Alternative to Conventional Bonds

Sukuk is now the bellwether of the Islamic finance industry. As Shariah compliant structures are becoming increasingly understood by stakeholders, and as the development of risk management tools is progressing; removing infrastructural rigidities, the global sukuk market has been gaining momentum in recent years. The negative impact of the crisis and the asset bubble burst in the GCC downsized the issuance to USD20.6 billion in 2008. However, an exponential growth took place the following years which resulted a spike in sukuk issuance worth USD85.1 billion in 2011, surpassing pre-crisis levels. Last year, sukuk issuances reached USD139.4 billion; a 63.8% growth over 2011. Despite obstacles such as disputes over different Shariah schools (GCC vs. Malaysia), underdeveloped secondary market, and limited supply, factors that are contributing to the growing popularity of sukuk as a debt instrument include a thriving Islamic funds industry; catered to by large pools of Muslim wealth and abundant liquidity, indicating that demand still exceeds supply. The Eurozone debt crisis is pushing investors and borrowers to other financial institutions less connected to the European melancholy. In addition, the drying up of syndicated loans market, and the collateral gap in peripheral Europe is eliciting a divergence from risky assets towards the safe havens of sukuk, which are asset -backed/based

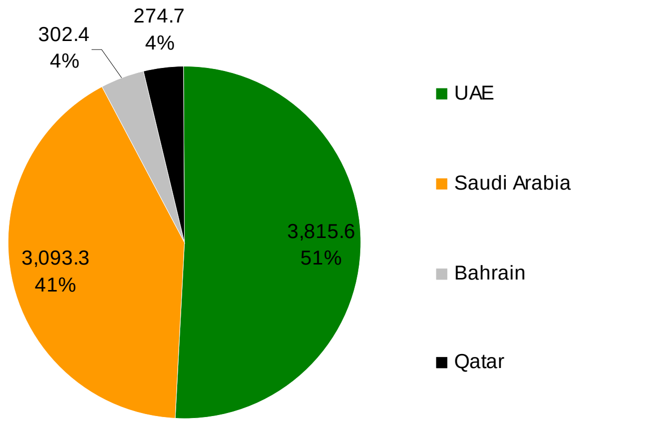
Table 15: Value of Sukuk Issuance by Type, USD billion 1Q13



Source: Zawya

In 1Q13, a total of 173 sukuk issuances worth 31.2 billion were actualized, indicating a 29.1% decline over 1Q12. The number of countries issuing sukuk almost doubled from 9 to 19 between 2006 and 2012, and the trend is expected to continue as more countries join the league. Issuances by value remain dominated by Malaysia (63%), followed by GCC (24%). The UAE and Saudi Arabia account for 12.2% and 9.9% of global sukuk issuances, respectively. Since sovereign and sovereign-related sukuk are considered the safest bets for investors, 73 sovereign sukuks were issued worth USD19.7 billion, arising from funding and infrastructure investment needs represent the bulk of issuances this quarter. This type of sukuk most likely will continue to shape and underpin the market. Secondly, 94 issuances of corporate bonds were realized in 1Q, and although greater by number, they amount to USD9.7 billion. Finally, only 6 quasi-sovereign bonds worth a meager USD1.6 billion were issued.

Table 16: Total Size of Issues in GCC, USD billion 1Q13



Source: Zawya

The Murabaha structure remains the most favorable, capturing 58.9% of issuances, followed by Ijarah, and Modarabah, which make up 28.5% and 3.6%, respectively. Although the MYR is becoming the currency of choice, as 78% of global issuances are denominated in the ringgit, the improving liquidity manifested in large and more frequent issuance coupled with tighter yields is drawing out GCC issuers. This is likely to drive the USD to catch up. The greenback accounts for 22% of global sukuk issuance, followed by the Indonesian Rupiah, and the Saudi Riyal, accounting for 7.1% and 3.6%, respectively. Saudi Arabia's General Authority of Civil Aviation (GACA) USD4 billion sukuk acts as a catalyst for more issuance out of the Kingdom which sold USD7.8 billion in the first 5 months of 2012. In 1Q this year, the Saudi Electricity Global Sukuk II raised USD2 billion worth of issuance, the highest issue, followed by Indonesia Retail Sukuk which recorded a worth of USD1.5 billion. According to a base-case scenario, investment spending in Saudi Arabia, UAE, and Qatar is expected to see a high single-digit growth for 2013 in a continuation to the moderating trend seen in 2012. Excluding central banks, the top lead managers of sukuk in 1Q were Maybank (Aseambankers) with 31% market share, HSBC Bank Middle East, holding 26% of market share, and Standard Chartered Bank, which holds 17% of market share.

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