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# Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

## Contents




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## Executive Summary


- Oil prices seem overstretched, though the market needs some trigger to release a correction. Prices are expected to weaken from the current levels, as the market fundamentals do not support these levels, but are unlikely to fall below the USD100's level.

- The US dollar's gain during the Chinese lunar New Year holiday helped set a slightly weaker midpoint for the CNY, counteracting the effect of Japan's new policy announcement.

- Overall, gold had been outperformed by every other precious/base metal so far this year. It seems the reduced inflationary pressures across the globe had impacted the demand for the yellow metal as an inflation hedge.

- Given the direct link between the Saudi and US economies, we expect the current wait and see approach of Saudi Arabian Monetary Agency to continue into the foreseeable future.

- Individual Saudi investors still represent the bulk of traders but CMA is expected to remedy and stabilize the situation by allowing foreigners to invest through channels other than equity swaps and equity traded funds.

- The focus towards longer credit maturities has been apparent by local banks since May 2012 when growth rates started diverging.

- China remains the crucial trading partner and it appears that the slight recovery in its manufacturing activity has left its imprints on the trade balance sheet.


### View of the Month

**'Saudi Arabia's Water Networks'**

The Kingdom of Saudi Arabia has been categorized as a country with absolute water scarcity necessitating the implementation of cost-reflective utility prices, the development of renewable energy sources and undertaking conservationist initiatives.

# Macroeconomic Indicators

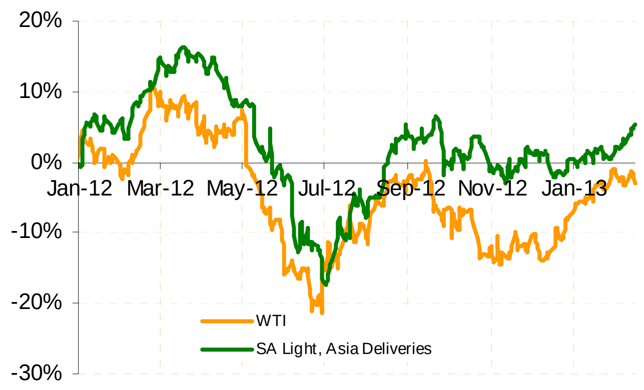
| | 2007 | 2008 | 2009 | 2010 | 2011P | 2012F | 2013F |
|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | |
| Average KSA Crude Spot Price, Arab Light, USD/BBL | 68.3 | 94.9 | 59.2 | 77.6 | 108.1 | 105.0 | 110.0 |
| Average Daily Crude Oil Production, MMBD | 8.8 | 9.2 | 8.2 | 8.2 | 9.3 | 9.9 | 9.7 |
| 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 | 2,908.4 |
| GDP at Current Market Prices, USD billion | 385.2 | 476.9 | 377.2 | 450.8 | 670.6 | 728.3 | 776.6 |
| Real GDP Growth Rate | 2.0% | 4.2% | 0.1% | 4.6% | 8.5% | 6.8% | 3.4% |
| Oil Sector GDP Growth Rate | (3.6%) | 4.2% | (7.8%) | 2.4% | 4.3% | 5.5% | -1.2% |
| Non-oil Sector GDP Growth Rate | 4.7% | 4.3% | 3.5% | 5.5% | 7.8% | 7.2% | 7.4% |
| 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 | 25,797.2 |
| 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 | 258.2 |
| Oil Exports, USD billion | 205.3 | 281.0 | 163.1 | 215.2 | 317.6 | 347.6 | 348.1 |
| Non-oil Exports, USD billion | 27.8 | 32.3 | 29.1 | 35.8 | 46.9 | 48.9 | 45.2 |
| 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) | (35.1) |
| Current Account Balance, USD billion | 93.3 | 132.3 | 21.0 | 66.8 | 158.5 | 178.7 | 144.4 |
| Current Account Balance/GDP | 24.2% | 27.7% | 5.6% | 14.8% | 23.6% | 24.5% | 18.6% |
| Net Foreign Assets with SAMA, USD billion | 301.3 | 438.5 | 405.9 | 441.0 | 535.9 | 640.2 | 709.8 |
| **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 | 1,146.9 |
| 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% | 39.4% |
| Total Expenditure/GDP | 32.3% | 29.1% | 42.2% | 38.7% | 32.9% | 31.3% | 29.9% |
| Overall Budget Balance, SAR billion | 176.6 | 580.9 | (86.6) | 87.7 | 291.1 | 386.5 | 276.8 |
| Budget Balance/GDP | 12.2% | 32.5% | (6.1%) | 5.2% | 11.6% | 14.2% | 9.5% |
| Break-Even Oil Price | 40.5 | 40.2 | 60.8 | 64.1 | 71.7 | 67.2 | 70.9 |
| **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% | 10.7% | 9.1% |
| Growth in Credit to the Private Sector | 20.6% | 27.9% | -0.6% | 4.8% | 11.0% | 17.2% | 16.0% |
| Average 3M SAR Deposit Rate | 4.9% | 3.3% | 0.9% | 0.7% | 0.7% | 0.8% | 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 | (31.9) | 29.7 | 17.5 | 38.0 | 39.5 | 40.0 | 60.0 |

# Oil Market

## Prices on the Rise Again

Brent crude oil prices have closed above USD110 a barrel every day in January moving into a higher range of USD112 to USD118 a barrel in February. WTI Crude oil for March delivery advanced to USD98 a barrel, while Brent oil futures have increased by 7% this year amid signs of economic recovery in US and China and concern that political tension may disrupt Middle East oil supplies. Oil prices climbed to the highest level in February with Brent crude reaching USD118 a barrel, as market has overreacted to production cuts by Saudi Arabia, OPEC boosted demand forecast for its crude this year to 29.8 mmbd, and the G-7 pledged to avoid devaluating exchange rates. According to OPEC, the global crude market is well-balanced, and it is expected to remain well-supplied into 2013 to meet projected global demand growth. Oil prices seem overstretched, though the market needs some trigger to release a correction. Prices are expected to weaken from the current levels, as the market fundamentals do not support these levels, but are unlikely to fall below the USD100's level.

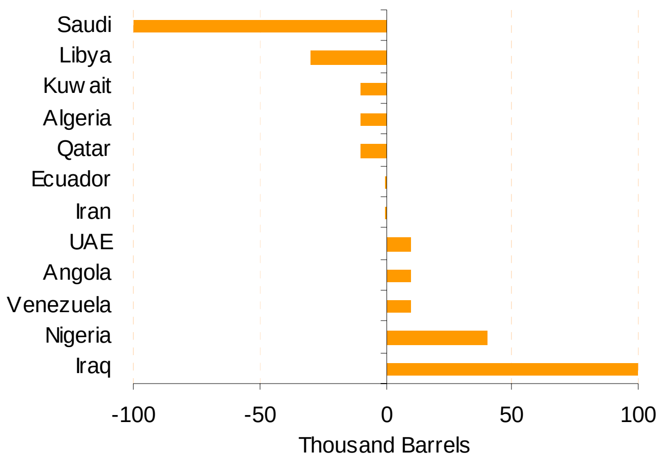
**Chart 1: Oil Price Developments, YTD**




Source: Thompson Reuters

On the demand side, IEA trimmed forecasts for global oil demand by 90 thousand barrels a day in 2013 for the first time in three months, following weaker economic outlook by the IMF, and predicted that world oil demand will increase by 0.84 mmbd, or 0.9% to 90.7 mmbd. Despite signs of improvement in US and China, weak macroeconomic conditions are forecast to keep global oil demand growth capped. According to Paris-based IEA, China crude imports rose to the highest level in eight months in January as refineries enhanced runs amid signs of economic recovery. In addition, China's oil consumption is expected to reach 9.98 mmbd in 2013, and China's biggest suppliers include Saudi Arabia, Angola, Russia, and Iran. Overall, global oil markets will remain tight through the first quarter, attributed to robust fuel demand in emerging economies.

**Chart 2: OPEC's Monthly Oil Production Changes**




Source: OPEC Survey

Rising global demand, coupled with a reduction in Saudi Arabia production, and tighter constraints on Iranian exports taking effect in February, together seem to be limiting world supplies. OPEC produced in January less than in December, when output was 30.52 mmbd, while Saudi Arabia produced 9.2 mmbd last month, Libyan output dropped to 1.2 mmbd in January versus December amid protests at oil facilities. Iraq output gained 100 thousand barrels a day to reach 3.1 mmbd, mainly from southern fields. Northern production is still hampered by the ongoing conflict between the Kurdistan regional government and the central government. Iran exports fell to 1.2 mmbd in December, and even estimated to have declined to 1 mmbd in January, which is less than half of what Iran shipped on average during first 10 months of 2011. In February, Iran faced additional obstacles to turning its oil exports into dollar cash as the US tightened sanctions to keep importers from paying for oil with Dollars and Euros. Under the penalty of expulsion from the US banking system, Iranian crude customers such as China, Japan , and India will be restricted to use only their own currencies for the purchases, and in turn compelling importers to retain payments in escrow accounts that Iran can use to buy only locally produced goods and services. In the US, production climbed to 7 mmbd in January, according to EIA, the highest level since 1993. In addition, stockpiles of the feedstock rose 0.7% to 371 million barrels.

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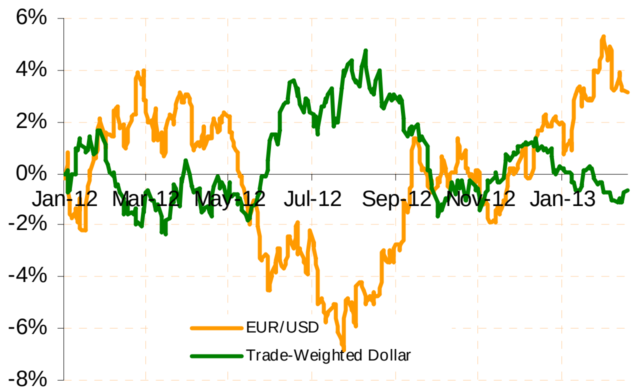
# Foreign Exchange

## Precursors for Currency Wars

The late announcements by the Japanese government in regards to adopting a fiscally accommodative policy, and the Bank of Japan's promise to aid in regaining competitiveness in the export-oriented economy via expansionist monetary policy has sparked new fears of currency wars. The extrapolated results of such action would devalue the yen, giving Japan the edge over rival economies, especially China, the world's second largest economy, and South Korea. Therefore, state intervention in exchange rates was on top of the recent G20 meeting's agenda. The finance ministers of the countries that generate 90% of the world's GDP gathered in Moscow mid-February, acknowledging the perils associated with currency manipulation, and declaring that the collective good entails commitment to market-determined exchange rates. While it ostensibly pointed towards Japan's deliberate targeting of the yen, the G20 delegation's mixed tone refrained from singling it out from other nations that have also been engaging in the same act.

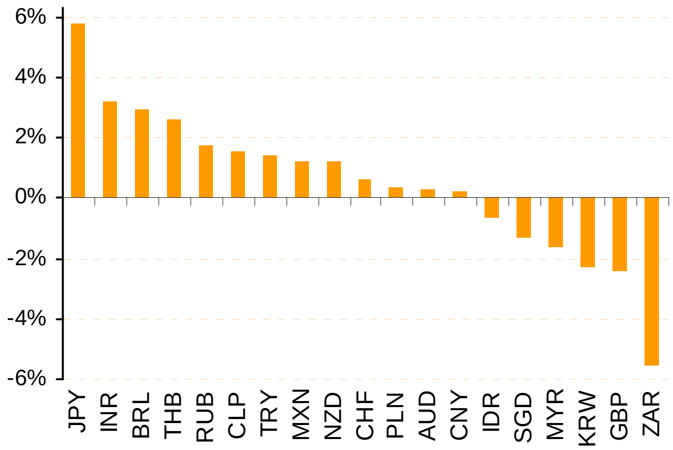
**Chart 3: Trade-Weighted Dollar and the Euro**




Source: Thompson Reuters

The joint statement made by the G7 in order to sway Japan from its pursuit outlined a bold position reaffirming that it was time for the country to emerge out of its lost decade, and that it would do so in a manner that puts all variables into consideration. As a result, the yen continued to slide further from the mid 70 - high 80 range seen in previous months to bottom at 94.35 Yen/USD with a volatility of a few hundred pips. The growth versus austerity dichotomy was overshadowed by convergence of both developed and emerging economies towards full-throttle fiscal and monetary stimuli in order to spur domestic demand and preclude the global economy from faltering. As China's slowing economic activity becomes increasingly worrisome, the new central government has set the fiscal deficit for this year to increase significantly to 2% of GDP (approximately USD190bn). Subsequently, the Yuan's spot trading remained steady around 6.23, although there has been a recent weakening of Asian currencies. The Korean won lost 1.4% versus the USD to close at the 1080.0 mark amid the G20 summit talks.

**Chart 4: Monthly Foreign Exchange Rate Changes**




Source: Thompson Reuters

The US dollar's gain during the Chinese lunar New Year holiday helped set a slightly weaker midpoint for the CNY, counteracting the effect of Japan's new policy announcement. The average-weighted dollar advanced by 1.02% against several of its higher-yielding currency rivals following the ECB president's comment warning that the impact of a strong euro on a weak euro zone economy might raise monetary loosening prospects. The statement came out after the euro rallied past the 1.36 mark against the USD, the highest level in over a year as the ZEW German investor sentiment neared a 3-year high of 48.2. Expectations from unsterilized quantitative easing led to a rebound for the single currency back to 1.33 by mid-February. In Latin America, the Brazilian riyal weakened by 3.47% since the beginning of the month, and the Chilean peso devalued by 0.7%, a pre-marker of emerging markets contending in currency warfare.

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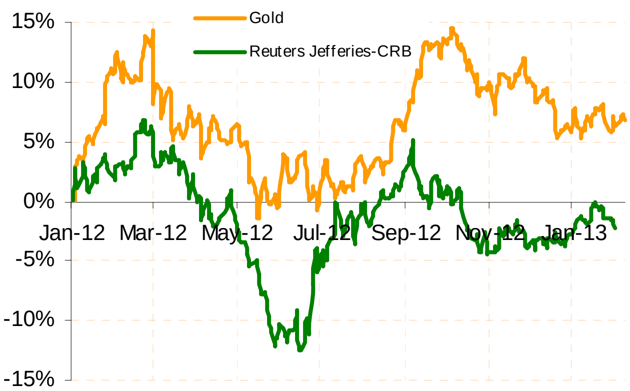
# Commodities

## Mixed Results

The relative stability in the global economy at the beginning of the year boded well for the economically sensitive commodities. The Standard & Poor's GSCI Spot Index of 24 raw materials traded within 0.1% of a four-month high on Feb. 8th. Interestingly, the commodity gauge is off to the best start since 2005, up 4.9% YTD.

On the base metals front, copper rose by 3.5% in 2013 YTD on signs that the Chinese economy is gaining traction after snapping seven quarters of economic slowdown, with the second-largest economy growing by 7.9% in the fourth quarter of last year. More specifically, the expansion in Chinese manufacturing will underpin copper, with China being the largest consumer of the metal, accounting for 40% of global demand. Chinese manufacturing expanded for the fourth month in a row as the Purchasing Managers' index registered 50.4 in January 2013. Nevertheless, this upside trend was derailed by the stronger dollar and the Lunar New Year holiday in much of Asia that drained liquidity from the market. On a medium-term note, there are other downside risks that can impact the industrial metal, notably the ailing status of industrial production in Europe and the US that can curb demand and the rising inventories tracked by the London Metal Exchange, which reached the highest level since November 2011. As for precious metals, gold prices has been range-bound since the beginning of the year, however, during the second week of February, gold prices dropped for the first time since August, as signs of a relatively stable US economy and lower risk averseness reduced demand for the precious metal as a store value. It hit a five-week low, around USD 1609.83/Oz, which increased the YTD decline to 3.9%. Overall, gold had been outperformed by every other precious/

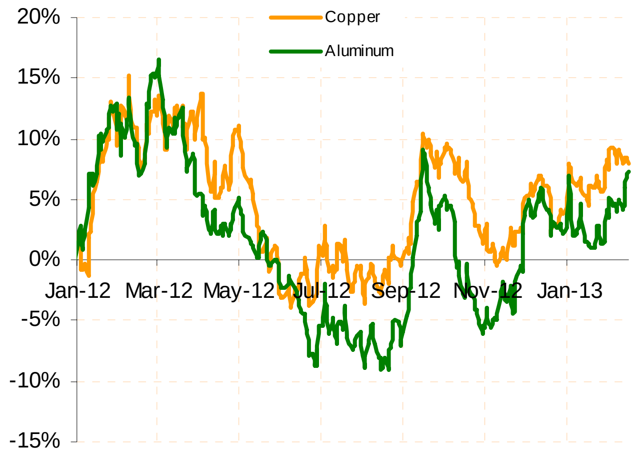
**Chart 5: Reuters Jefferies vs. Gold**




Source: Thompson Reuters

base metal so far this year. It seems the reduced inflationary pressures across the globe had impacted the demand for the yellow metal as an inflation hedge.

**Chart 6: Base Metals**




Source: Thompson Reuters

On the agricultural side, the National Cotton Council projects that the United States will plant less cotton acres in 2013. Bloomberg reports that cotton crops are heading for the biggest drop in more than two decades as farmers from the U.S. to India reduce planting and China increases demand for higher- quality imports. Prices that fell almost 62% from a record in 2011, and urged farmers to shift to soybeans and corn, are poised to rally by 15% to 95 cents a pound by the end of 2013. Furthermore, it is expected that both Brazil and Argentina's production for soybean will jump by 28% to a record of 136.5 million metric tons in 2013, and corn will rise 5.9% to an all-time high according to the US Department of Agriculture, which is expected to pressure prices in the near-term. Commodity Weather Group reports that rain during the beginning of February will lessen crop stress to less than a third of Argentina fields, as well as supporting crops in Brazil. Soybean futures for March delivery fell 1.2% to USD14.355 a bushel on the Chicago Board of Trade.

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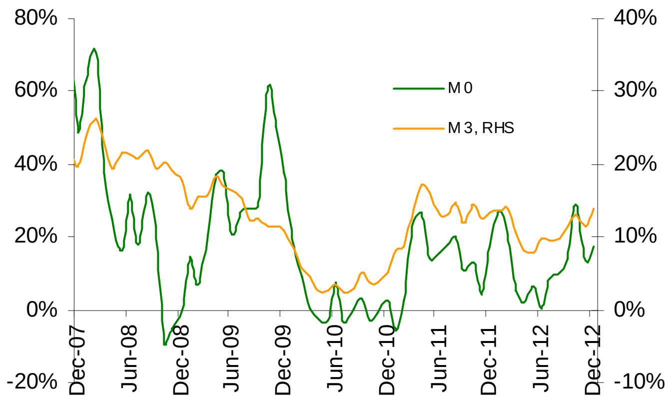
# Money & Inflation
## Liquidity Risks Subdued

Over the course of 2012, the monetary situation reflected the robust economic status of the Saudi economy. The Saudi economy continues to maintain an upwards trajectory and record robust growth figures despite the fragility of the global economy. This has been partially driven by utilizing large amounts of excess liquidity due to the large influx of oil revenues. The monetary base (M0) recorded a substantial 17.2% growth by the end of 2012, almost matching 2011's 17.4%. The increase was mainly driven by the cyclical increase in deposits with SAMA during the fourth quarter of the fiscal year which has been apparent over the past five years as banks overhaul their balance sheets for annual reporting towards the end of the year. Deposits with SAMA expanded by 24.2% to reach a record SAR197.8 billion in December. In addition, currency outside banks recorded a growth of 11.0% Y/Y to reach SAR133.1 billion by the end of the year. Meanwhile, cash in vault reached SAR19.7 billion, an annual decrease of 1.3% during the same period. Given the direct link between the Saudi and US economies, we expect the current wait and see approach of Saudi Arabian Monetary Agency (SAMA) to continue into the foreseeable future. As long as the inflation rate remains contained, SAMA's versatility in using conventional tools will limit risks from excess liquidity levels.

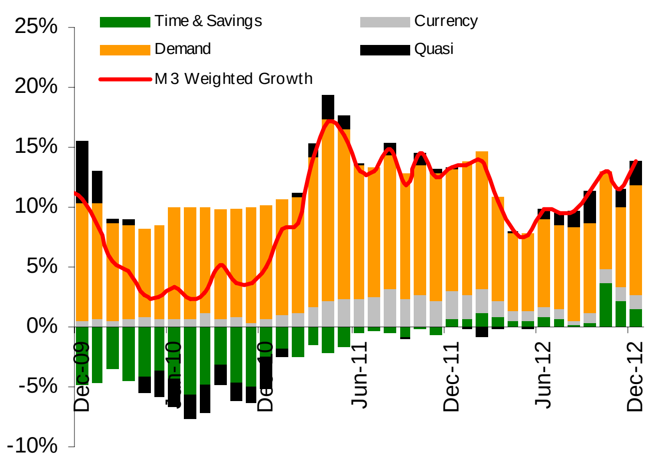
**Chart 7: Growth in Monetary Aggregates**




Source: SAMA, NCB Estimates

The fact that credit activity regained its momentum by recording an average of 14.0% annually might prop up the money supply (M3) in the near-term via the multiplier effect. In 2012, M3 expanded by 13.9% on an annual basis. The main driver of M3 continues to be represented by demand deposits which gained by 17.6% in December. Nonetheless, the level of demand deposits has somewhat stagnated during the mid-2012. Meanwhile, time and saving deposits have held their positive trajectory for the 13th consecutive month as they expanded by 6.2% Y/Y to reach SAR324.4 billion by the end of 2012. The suppressed interest rates environment pressured time and saving deposits which decreased their share of M3 to 23.3% in comparison to 25% by the end of 2011. We expect their growth to remain sluggish throughout this year as the global economic turmoil keeps interest rates at all-time lows. Furthermore, other quasi-monetary deposits rapidly accelerated at 16.0% Y/Y, reflecting the growth in Saudi trade activities (see External Trade section). Given the utilization of liquidity witnessed recently, we expect M3 to post an annual gain of 9.1% for 2013.

**Chart 8: Money Supply, Contribution**




Source: SAMA, NCB Estimates

As for inflation, consumer prices recorded an average of 4.5% last year as December's rate remained stable at 3.9% Y/Y. The main driver for inflation is currently food prices which surpassed the category of renovation, rent, fuel & water. The food index climbed 5.1% during December despite global prices registering decreases over the fourth quarter of 2012 as the Reuters/Jefferies CRB Index dropped 1.3% during the same month. Al Madinah recorded the largest increase across major cities with an annual rate of 12.1%, while Jeddah and Riyadh's pace accelerated to 6.3% and 5.6% Y/Y, respectively. The gain in local food prices could be attributed to the recent weakening of the dollar which drives imported inflation and to a lesser extent the lack of rigid regulations in some local food markets. We do believe that the foodstuff category will hover around 5% for the first half of 2013 and expect the inflation rate to jump above 4% early 2013 and recording an average of 4.5% for the whole year.

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# Capital Markets

## Foreign Investment to Spur Tadawul

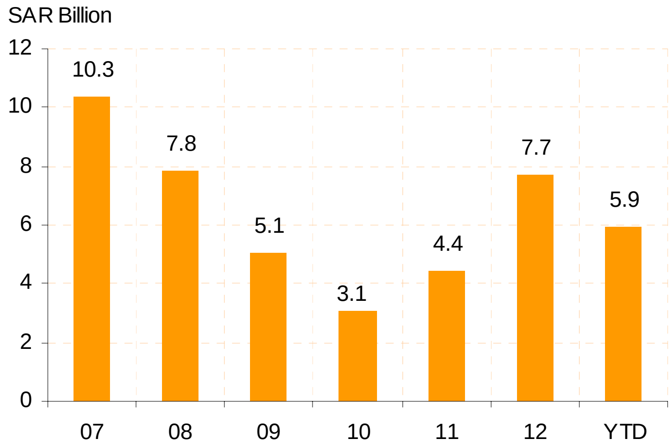
Business sentiment in the Saudi economy remains on a positive trajectory as consumer expenditure, government spending, and strong credit to the private sector support profitability and project expansions. The Saudi stock market, Tadawul, maintained its trajectory as it gained for a second consecutive month ending January. The All -Share Index recorded a gain of 3.6% on a monthly basis as the market's cumulative corporate earnings reached SAR97.7 billion, restating the relatively cheap opportunities available for investors. The best performing sector was hotels and tourism, increasing by 20.5% during the month of January. The tourism sector is expanding in Saudi Arabia and an estimated SAR10 billion worth of investments over the next two years are to be implemented. The Saudi Commission for Tourism and Antiquities also struck a deal with Saudi Arabian General Investment Authority to facilitate licensing of tourism projects and issuance of licenses related to the sector. The tourism industry generated SAR59 billion in revenues during 2011; in addition, listed companies' net profits grew 24.6% last year. The Capital Market Authority's (CMA) head has been changed early February. As such, investors have been reluctant to maintain January's momentum. However, Abdulmalik Al-Shiekh, the new CMA Head, has announced the importance of opening the market further to foreign investors, a critical decision for Tadawul's development.

**Chart 9: Tadawul All-Share Index**


Source: Tadawul

The total number of listed companied has reached 159 and the average daily traded volumes stood at SAR5.8 billion during January. The level of activity in the local equity market is considerably lower than last year's average of SAR7.7 billion. Investor appetite remains a challenge as stock fundamentals are largely overlooked due to the majority of speculative investors. The market offers lucrative opportunities as valuations remain cheap; sectoral price-to-earnings ratios of tourism, telecom, and banks registered 10.2, 10.45, and 11.2, respectively, last month. Individual Saudi investors still represent the bulk of traders but CMA is expected to remedy and stabilize the situation by allowing foreigners to invest through channels other than equity swaps and equity traded funds.

**Chart 10: Average Daily Traded Value**




Source: Tadawul

The primary market concluded the initial public offering (IPO) of National Medical Care Company during early February. The company offered 13.5 million shares at a price of SAR27, representing 30% of the company. Retailers were offered 50% of aforementioned stocks and the offering was oversubscribed by 5.75, indicative of a strong appetite for IPOs in the Saudi market. Tadawul started off 2013 with two IPOs with a total value of SAR1.3 billion and is set to outperform regional markets again this year. As for the Sukuk market, Savola Group issued corporate Sukuks worth SAR1.5 billion at 110 bps over six months SAIBOR during January. The economy remains supportive to the market's expansion as 11 companies are rumored to turn public this year which will certainly attract retail and institutional investors. Sukuk issuances are also expected to increase this year as companies venture into alternative financing methods.

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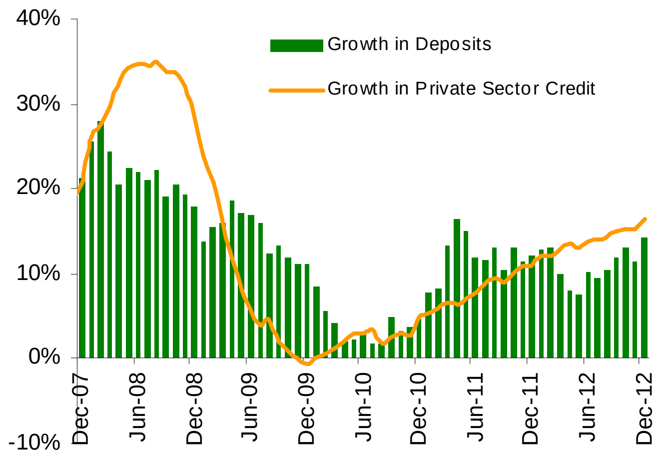
# Loans Market

## Credit Expected to Moderate

The macroeconomic conditions remain supportive of the financial system with non-oil GDP expected to grow over 8% this year following 7.5% in 2012, driven by the benefits of economic diversification and vast projects sourced by record oil revenues. The asset/liability composition in the form of loans and deposits have been on a positive trajectory and offer improvement opportunities for 2013 as the loans-to-deposits ratio slid to 79.3 by the end of December, down from 82.7 during the previous month. As a catalyst for future financing, total deposits set a record level at SAR1.26 trillion by gaining 14.2% Y/Y by the end of last year. Over 2012, total deposits added a substantial SAR157 billion which have been mainly sourced from demand deposits as interest rates remain relatively subdued. Furthermore, businesses and individuals have increased their demand deposits by 13.7% annually, while the government almost doubled their holdings by reaching SAR58.7 billion. The sluggish growth of time and savings deposits, 6.2% Y/Y during December, is likely to continue throughout 2013 as economic conditions pressure interest margins. Additionally, foreign currency deposits rose by 16.8% on an annual basis during December.

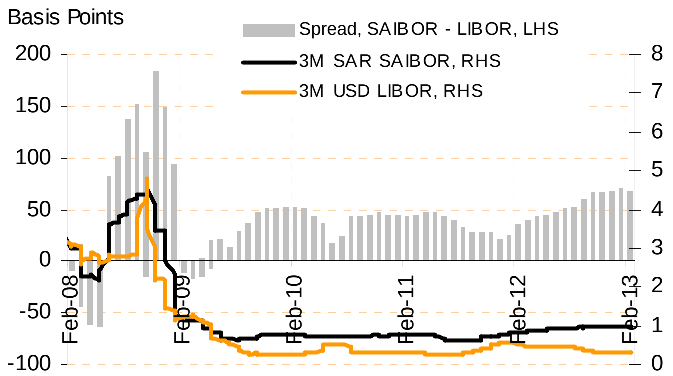
**Chart 11: Private Sector Financing**




Source: SAMA, NCB Estimates

On the financing front, total claims of the banking system, excluding T-bills and government bonds, posted an increase of 16.7% to break a key milestone of SAR1 trillion. The strong performance throughout 2012 is expected to stagnate with a slight moderation. However, we do expect long and medium term credit to gain more appeal given the rise in business activities within the economy. Starting off 2013, short term credit represents 53.7%, the lowest level on record. Meanwhile, medium term credit expanded by a staggering 47.2% annually during December while long term credit rose by 12.0% during the same period. The focus towards longer credit maturities has been apparent by local banks since May 2012 when growth rates started diverging.

**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 20.6% of banks' total financing, SAR206 billion. The fastest growing category was mining and quarrying with an annual rate of 59% as local banks are more comfortable with joint financing with state sponsors given the large nature of the projects. Considering the pickup in lending activities and the anticipation of codifying mortgage law, the finance category posted a 35.5% increases by the end of the year. The estimated consumption of electricity is projected at 240,296 GW for 2012 and expansionary plans are needed to meet the estimated consumption of 289,437 GW by 2015, financing for the electricity, water, and healthcare sector rose by 33.4% Y/Y. Meanwhile, the only sector to record a contraction during 2012 was transport and communication by declining 1.3% annually. However, we expect this category to rebound as railway projects proceed within the Kingdom's transportation grid.

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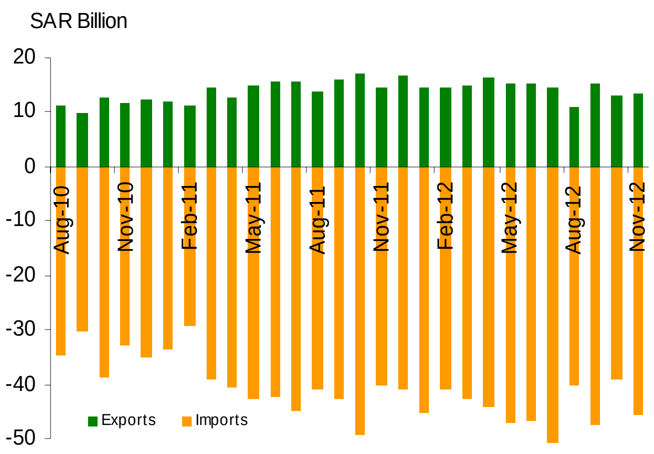
# External Trade

## Strong Performance for 2012

Year 2012 ended on a high note regardless of the holiday season. Both export and import activities remained buoyant, marking year highs. Export tonnage recorded a 4.7% annual increase with a 7.9% rise in returns, reflecting improving demand prospects from the Kingdom's trading partners. Export composition-wise; petrochemicals regained its position as the top non-oil export in December after it was dominated by plastics since July. Petrochemicals accounted for approximately 35% of all exports, a 24.2% increase in value compared to last year. Plastics garnered the second highest non-oil export, accounting for roughly 32% of exports, inching higher by 10.4% Y/Y. Re-exports, the third highest exports by weight, made a sizable jump of 21.7% in comparison to last year. By destination, China remains the largest recipient of Saudi exports. In December, however, both China and UAE, imported around SAR2.3bn each from the Kingdom, with both countries securing approximately 13% of non-oil exports. Landing third is Singapore, with an allocation of 7.5% from the sum of exports, retreating by 10% on an annual basis.

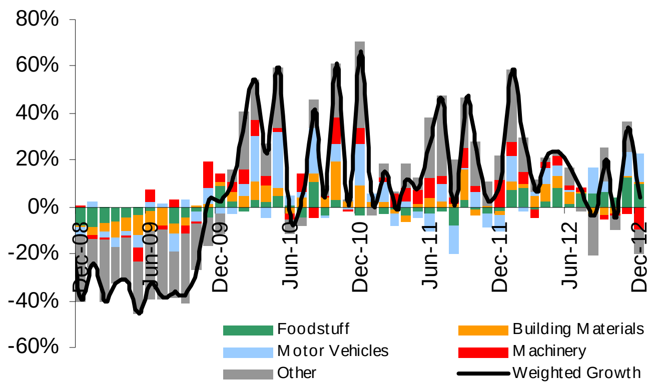
**Chart 13: Saudi Non-Oil Trade Balance**




Source: CDSI, NCB Estimates

On the import side, an annual surge of 39.3% in tonnage reflects a growing domestic demand as well as business activities. However, there was a 38% increase in value terms, which indicates that prices are still supportive. The largest chunk of goods imported consisted of machinery and electrical equipment, which make up 26.8% of imported articles. They registered a hefty 33.1% Y/Y growth. Transport equipment was third, which constituted 20.4% of the kingdom's imports, and grew by 67.8% Y/Y. Finally, foodstuffs kept its steady share of 11.5% of imports overall, and surged by 22% Y/Y. On the other hand, the US registered the highest annual record of import apportionment of 15.8%, edging higher by 58.8% than last year. China, albeit lower in pace, follows the same trajectory, acquiring 13.4% of import allocations, boosting its figures by 31.8%. Germany, which provides 7% of the kingdom's imports showed a 28% hike over 2011's figures.

**Chart 14: Attribution Analysis of Letters of Credit Opened**




Source: SAMA, NCB Estimates

Settled LCs showed interesting developments as the year 2012 ended. A 82.8% rise Y/Y reflected high demand on durables in the Kingdom. Machinery climbed by 7.6% Y/Y, and demand on building materials propagated by 14.3% over last year, indicating vibrancy in construction. Opened LCs showed a 122% increase for motor vehicles, while demand on machinery is expected to retreat given the 43% downturn in LCs. Building materials will maintain a steady demand as a 12% increase Y/Y was recorded in December.

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# Special Focus:

## Additional Pressure on Water Networks

The water-power nexus is a time-sensitive challenge faced by countries worldwide, with especially grave consequences for countries in the MENA region and especially Saudi Arabia. The Kingdom's rapidly rising population, expansionary fiscal policies and large investments in social and physical infrastructure, have exerted pressure on the existing water networks.

Total population has grown at a CAGR of 3% over the past two decades, and is expected to continue rising at a similar pace over the next five years. While water consumption over the same period has fallen by approximately 1.5% annually, the demand on desalinated water has increased by more than double that of the population growth, at 6.27%. The accelerated pace of water consumption relative to that of population is attributed to the low utility rates faced by the public, as the water sector is heavily subsidized by the government.

The Kingdom's average water tariffs are the lowest within the Gulf Co-operation Council countries and among the lowest in the world. The tariff structure for water provided by the government is based on block tariffs for consumption, ranging from SAR0.15–SAR6 per m3/month (Table 1). As the Saudi population is estimated to reach 31.69 million in 2015, additional pressure will be placed on energy intensive desalination plants for potable water.

**Table 15: Kingdom's Water Tariffs (SAR/$m^3$/month): 2011**

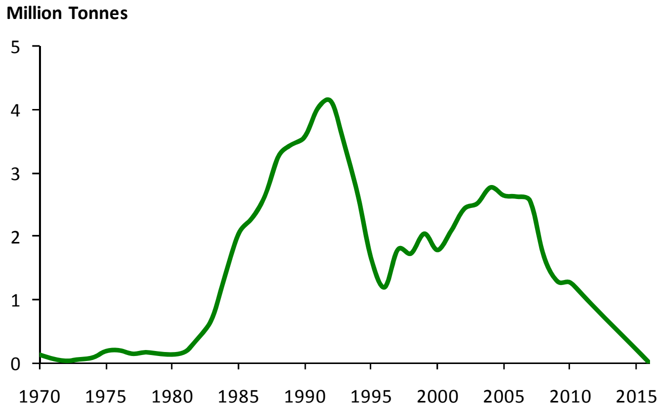
| Consumption Range (m3/ month) | SAR |
|---|---|
| 1-50 | 0.10 |
| 50-100 | 0.15 |
| 100-200 | 2.00 |
| 200-300 | 4.00 |
| over 300 | 6.00 |

Source: MOWE

Furthermore, the abundance of oil and gas reserves provides the Kingdom with both a comparative advantage in energy costs and funding sources. This acts as a driver in the project market, increasing the share of industrial water consumption. In 2012, contracts in the water sector amounted to a total of SAR8.9 billion, and those in the waste water sector amounted to SAR2.6 billion.

Active players in the Kingdom's water sector include the Ministry of Water and Electricity (MOWE), the National Water Company (NWC), and the Saline Water Conversion Company (SWCC). Additionally, participants from the private sector include independent power/ water/ steam producers (IPPs, IWPPs and IWSPPs), as well as smaller scattered private companies.

**Chart 16: Wheat Production with Forecast (000 Tonnes): 1970-2016**




Source: USDA, EPI

The Kingdom of Saudi Arabia has been categorized as a country with absolute water scarcity necessitating the implementation of cost-reflective utility prices, the development of renewable energy sources and undertaking conservationist initiatives. Given that the agricultural sector commands the largest share of water consumption in the Kingdom, in November 2007, the Council of Ministers approved Resolution No. 335 entitled "Rules and Procedures to Rationalize the Use of Water and Manage its Use in Agriculture for all the Kingdom of Saudi Arabia". It removes the incentives for wheat production—which is to be phased out by 2016 (Chart 1)—and fodder production and establishes mechanisms for better control and protection of water.

Consequently, greater desalination and wastewater treatment capacity will be required over the upcoming years to sustain the Kingdom's level of economic development.

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