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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- On the supply side, OPEC oil production fell to 29.4mb/d in December, the lowest level since May 2011, amid output declines in Iraq and Saudi Arabia
- Over the past year, foreign exchange markets were led by three core themes; global central bank policy, relative growth prospects and politics
- The year 2013 was not among the best years for commodities. Oversupply and supply overhangs halted any inclination for price pick-up
- The broadest money supply measurement (M3) surged by 13.5% Y/Y mainly due to the upturn in demand deposits that reached SAR 849 billion. Time and Savings deposits increased by 6.7% to SAR 330.7 billion in a stark contrast to demand deposits.
- The level of activity, measured by the average daily traded volumes, was considerably lower last year in comparison to 2012. Investors exchanged stocks at a daily average worth SAR5.5 billion, 28% lower than the previous year's average
- Over the past 11 months, Saudi banks awarded SAR113.4 billion to the private sector to cumulatively rack up SAR1.07 trillion in loans. This indicates resilient activity in the private sector, which continues despite the ongoing labor market reforms
- On a yearly basis, the kingdom's value of imports declined by 12.5% Y/Y, underpinning a 22.9% Y/Y reduction in the balance of trade deficit

View of the Month

We do believe that policy normalization and the eventual rise of interest rates in the US will not weigh heavily on internal lending activity [in the Kingdom] given the divergent economic fundamentals between the two countries. External borrowing, however, will most likely be much tighter and more costlier than before.

Macroeconomic Indicators

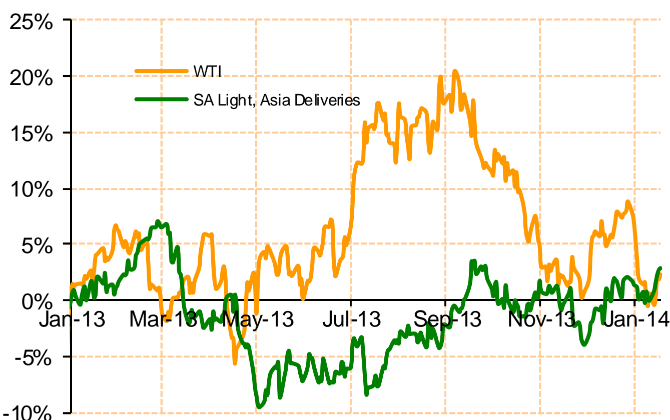
	2008	2009	2010	2011	2012	2013P	2014F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	94.9	59.2	77.6	108.1	110.2	106.4	100.0
Average Daily Crude Oil Production, MMBD	9.2	8.2	8.2	9.3	9.8	9.6	9.4
GDP at Current Market Prices, SAR billion	1,949.2	1,609.1	1,975.5	2,510.7	2,666.4	2,794.8	2,835.0
GDP at Current Market Prices, USD billion	520.5	429.7	526.8	670.4	712.0	746.3	757.0
Real GDP Growth Rate	8.4%	1.8%	7.4%	8.6%	5.1%	3.8%	4.1%
Oil Sector GDP Growth Rate	4.3%	-8.0%	0.3%	11.0%	5.5%	-0.6%	-1.2%
Non-oil Sector GDP Growth Rate	9.8%	5.3%	9.6%	8.0%	5.0%	5.0%	5.4%
Population, million	25.8	26.7	27.6	28.4	29.2	30.1	31.0
Population Growth Rate	3.4%	3.4%	3.4%	2.9%	2.9%	3.0%	3.0%
GDP /Capita, USD	20,184.2	16,116.2	19,112.7	23,625.3	24,387.0	24,816.2	24,440.6
CPI Inflation, Y/Y % Change, Average	6.1%	4.1%	3.8%	3.7%	2.9%	3.6%	3.3%
External Sector							
Merchandise Trade Balance, USD billion	212.0	105.2	153.7	244.7	246.6	214.2	185.5
Oil Exports, USD billion	281.0	163.1	215.2	317.6	357.1	315.3	283.0
Non-oil Exports, USD billion	32.5	29.3	35.9	47.1	51.0	52.2	58.0
Merchandise Imports, USD billion	-100.6	-86.4	-96.7	-119.0	-140.7	-153.3	-155.5
Net Unilateral Transfers, USD billion	-23.0	-27.7	-27.9	-29.4	-30.4	-33.2	-36.2
Current Account Balance, USD billion	132.3	21.0	66.8	158.5	164.8	130.0	105.2
Current Account Balance/GDP	25.4%	4.9%	12.7%	23.6%	23.1%	17.4%	13.9%
Net Foreign Assets with SAMA, USD billion	438.5	405.9	441.0	535.9	648.5	713.3	749.0
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	410	475	540	580	690	820	855.0
Actual Revenues, SAR billion	1,101.0	509.8	741.6	1,117.8	1,247.4	1,131.0	972.8
Actual Expenditure, SAR billion	520.1	596.4	653.9	826.7	873.3	925.0	952.8
Expenditure Overrun, %	26.8%	25.6%	21.1%	42.5%	26.6%	12.8%	11.4%
Total Revenues/GDP	56.5%	31.7%	37.5%	44.5%	46.8%	40.5%	34.3%
Total Expenditure/GDP	26.7%	37.1%	33.1%	32.9%	32.8%	33.1%	33.6%
Overall Budget Balance, SAR billion	580.9	-86.6	87.7	291.1	374.1	206.0	20.0
Budget Balance/GDP	29.8%	-5.4%	4.4%	11.6%	14.0%	7.4%	0.7%
Break-Even Oil Price	40.2	60.8	64.1	75.3	73.9	81.1	86.8
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)	17.6%	10.7%	5.0%	13.3%	13.9%	10.9%	10.0%
Growth in Credit to the Private Sector	27.9%	-0.6%	4.8%	11.0%	16.4%	13.5%	13.8%
Average 3M SAR Deposit Rate	3.3%	0.9%	0.7%	0.7%	0.9%	1.0%	1.2%
Average 3M USD Deposit Rate	3.0%	0.7%	0.4%	0.3%	0.4%	0.4%	0.7%
Spread, in Basis Points, SAIBOR-LIBOR	37.4	26.4	39.8	40.9	55.2	60.0	50.0

Oil Market

OPEC's Production Near 3-Year Low

Global crude oil prices were relatively stable throughout December before declining at the beginning of January. Brent crude futures have slipped during January, trading around USD107 a barrel, amid speculation that demand will remain constrained while shale output from US climbs, and as geopolitical tensions in the Middle East gradually moderate. Brent crude oil prices averaged USD106 a barrel in 2013, but is project to average lower at USD100 a barrel in 2014, as non-OPEC supply growth is projected to exceed growth in world consumption. The WTI crude price is expected to average at USD92 a barrel in 2014, and the WTI-Brent spread, which averaged USD12 a barrel in the 4Q 2013, is predicted to be tighter averaging USD10 a barrel in 2014. Meanwhile, Brent crude oil and the U.S. dollar index showed a near zero correlation, which is inconsistent to the historically strong negative correlation between these two series. This negative correlation broke down during the crude oil supply disruptions at the end of the third quarter 2013, which suggests that recent Brent crude oil price movements have been more strongly influenced by supply side factors rather than demand side ones.

Chart 1: Oil Price Developments, YTD

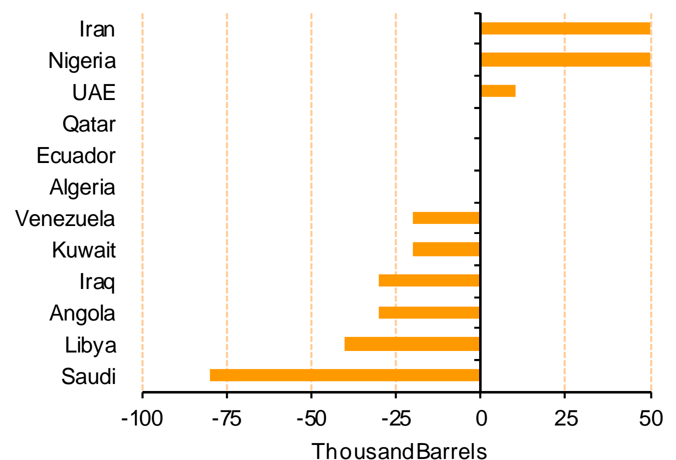


Source: Thomson Reuters

Global oil demand is expected to increase by 1.05mb/d, or 1.2%, to average 90.9mb/d in 2014. Producers outside OPEC, led by US, Canada, and Brazil, will increase supplies by 1.27mb/d to 55.38mb/d. As a result of supply expansion by these countries, demand for OPEC crude is more likely to decline by 0.3mb/d in 2014 compared to last year. In china, second largest consumer of oil, slower economic growth dragged down implied demand, which rose by only 2.4% Y/Y to 9.83mb/d in 2013, the weakest rate in five years. Crude imports, although were 13% higher Y/Y in December, the full-year growth was also modest at 4.3% Y/Y.

On the supply side, OPEC oil production fell to 29.4mb/d in December, the lowest level since May 2011, amid output declines in Iraq and Saudi Arabia. This is below the average of 29.6mb/d the group predicts of demand on its oil, and below the 30mb/d ceiling it reaffirmed in December. Production in Iraq dropped to 2.98mb/d in December, which resulted from a limited export capacity out of Basra due to maintenance, halting of field operation due to security conditions, and some interruptions in northern exports. In Saudi Arabia, production declined to 9.62mb/d, while output from Libya, which has been paralyzed by protests at oil fields and export terminals was unchanged in December at 0.26mb/d. Production in Iran, which agreed in November with the West to curtail its nuclear program in return for relaxing of sanctions, moved marginally higher to 2.73mb/d.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

OPEC's excess capacity was at 3.37mb/d in November, but it is expected that the unused capacity to rise to 6mb/d by 2018, as the group cuts output to offset rising global supplies, particularly in the US, owed to its shale revolution. Advances in extracting oil from shale rock increased US production by 39% since 2011, and will boost output to a 28-year high of 8.5mb/d in 2014, according to EIA. Meanwhile, interest in shale industry is reaching Europe, as the 28 members will be urged to follow a non-binding guidelines for shale drilling under a proposal that facilitate the use of fracturing without interference in a nation's right to ban the practice. Moreover, horizontal drilling already started recently in Bazhenov formation in Russia, reckoned to be one of the world's largest deposits of shale oil.

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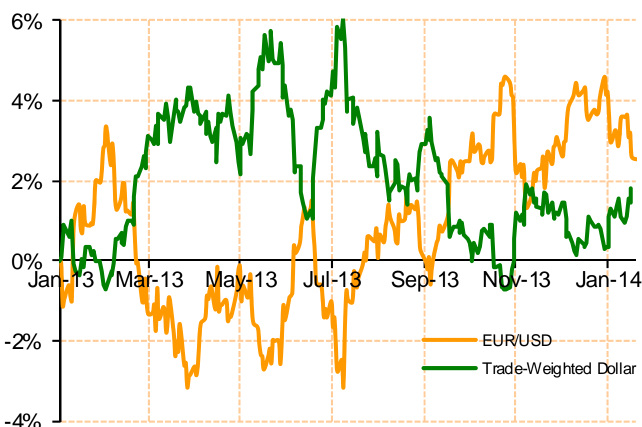
Foreign Exchange

Strong Fundamentals to Underpin USD

There is no doubt that the year 2013 was a year of relative stability. The unconventional fiscal and monetary policies that went in place successfully barred economies from hard landing. As economic sentiment improved – supported by fundamental indicators – central bankers began to revisit their expansionary policies in order to adjust them for the next phase of global recovery. Over the past year, foreign exchange markets were led by three core themes; global central bank policy, relative growth prospects and politics. Citing recent improvements in the labor market, the Fed made its most anticipated move on December 18th slashing USD 10 billion from its massive USD 85 billion monthly asset purchases. The comfortably low 7% unemployment rate (as of November) and climbing housing prices reflect easing caution on both the part of consumers and businesses. Sustainable growth in 2013, albeit subpar, and low inflation rate reinforced the Fed's commitment to a near 0% federal funds rate. Investors seeking higher yield might tap into government bonds as the Fed's exit steepens the yield curve. On a month-to-month basis, US 10-year yield rose by 9.7%, breaking the 3% barrier. However, US equities remained favored over bonds as they capped 2013 with fresh records. The S&P 500 edged 2% higher since November, closing at 1,848.4 and the Dow rose by 3.5%, reaching 16,576.7. Consequently, the USD ended the year dominating its rivals, strengthening by 0.2% M/M at 80 points. Moving onto January, a weaker dollar is expected to ensue from the weaker-than-expected 74,000 new jobs in December.

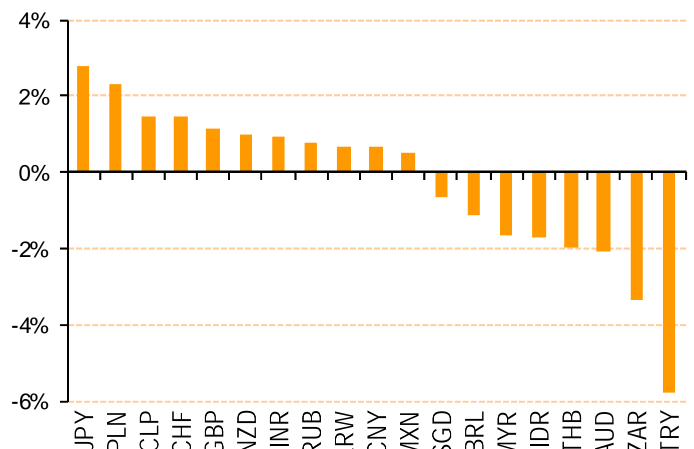
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

On the other hand, the ECB has altered many times between dovish and hawkish comments throughout last year. Most notably, however, the implicit guarantee given by Draghi to "do whatever it takes" marked a turning point for the ailing European peripheries. Spanish and Italian bonds in December inched up respectively by 0.4% and 1.1% to stand at 4.1%. As the Euro area grew more stable, no LTROs were deemed necessary in 2013. However, the pressures of disinflation grew to pose a serious threat to the union's well-being and stability as inflation slipped to 0.8%, less than half the target inflation of 2% . Therefore, the ECB opted for a dovish turn in May and November, cutting its refinance rate by 0.25% each to end the year standing at 0.25%. European banks are still reluctant to lend, hobbled by existential doubts over the sustainability of the union, credit degradation, and financial fragmentation. Progress in the formation of a European banking union was pushed by the Troika in order to unify the fragmented nature of the European financial system, but remains in a stalemate state due to opposition from Germany. Nevertheless, the resilience of the single currency continues to surprise as it strengthened by 1.1% versus the dollar in December, closing at USD 1.37.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

A more aggressive stance is expected to be adopted by the Bank of Japan in 2014 to meet its inflation target of 2% by 2015. The increase in retail sales tax from 5% to 8% due on April makes the task of pushing the wheels of consumption and growth quite a tall order. With a disappointing growth in 3Q of a little over 1%, the BoJ will have to act unconventionally, juxtaposed to government expenditure in order for the 3-arrow strategy to function effectively. On the bright side, the JPY dropped by 2.8% M/M in December, closing at 105.3 for the first time.

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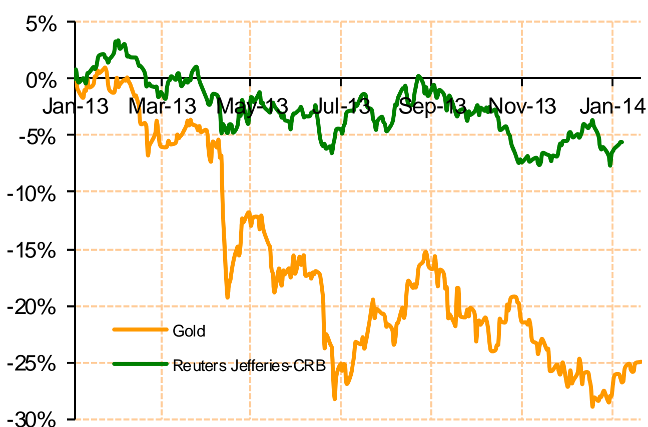
Commodities

Weak Commodities to Plateau in 2014

The year 2013 was not among the best years for commodities. Oversupply and supply overhangs halted any inclination for price pick-up. Following a higher-than-expected record harvest yield mid-2013, higher plantings are expected in 2014 that will continue to put a dent on prices of grains and agricultural commodities. Notably, last year, precious metals were stripped off of their status as “safe havens”, as the higher yielding equity markets enticed risk appetite, with the S&P500 and Dow Jones gaining around 30% in 2013. The attractiveness of the yellow metal have clearly been negatively impacted due to the fact that fear factors emanating from inflationary pressures, dollar debasement and an economic relapse have subsided during 2013. Industrial metals also bottomed out after the taper talk, especially that its dollar positive implementation will reduce the appeal of commodities as alternative investments.

In the month of December, the Reuters Jeffries CRB index inched up by 1.9%. Performance of copper and aluminum turned green as key countries such as China and the US continue their relative recovery in the manufacturing sector. China’s imports of copper rose 1.3% M/M to 441.3 thousand tons in December. The surge in demand pushed prices up by 4.3% compared to November, closing at USD 7,360/ton on the London Metal Exchange (LME). As a result, copper stocks in the LME warehouses fell by 13.1% to a one-year-low of 365.7 thousand tons. Although with a lesser intensity, aluminum moved on a similar trajectory as demand spiked for the metal, adding upward pressures on prices. It ended

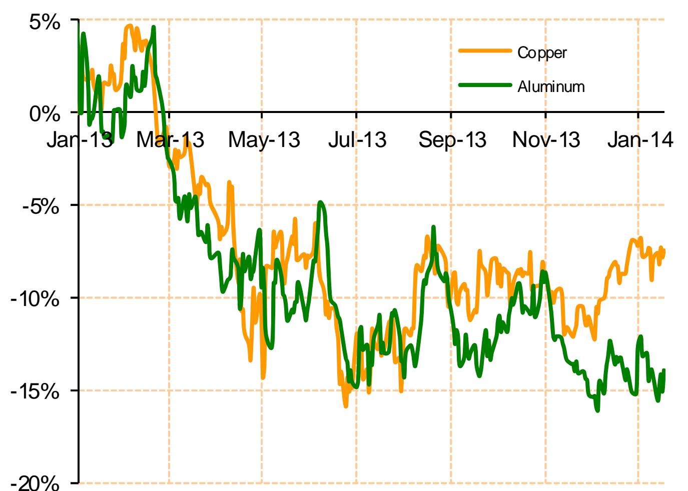
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

the month closing at USD 1,800/ton, which is a 2.6% improvement over the past month, although still hovering around multi-year lows after 7 consecutive months of oversupply. Alcoa Inc. reported massive quarterly losses as rapid price declines led to a USD 1.7 billion non-cash Goodwill write-down for legacy acquisition in smelting. However, the rosier global outlook for 2014 led the company to move forward with an investment target of USD 125 million for the next phase of its Saudi joint-venture, Ma’aden-Alcoa. Gold prices closed twice below USD 1,200/Oz in December, coinciding with the Fed’s announcement. It gracefully rebounded, however, to close at USD 1,206/oz, thus, losing 3.9% since its last closing in November. The commodity transaction tax and import bans in India are affecting the physical demand of the metal.

Chart 6: Base Metals



Source: Thomson Reuters

The S&P/Goldman Sachs Agricultural index sagged by 3.7% in December. In addition, to the less accommodative Fed policy, the leveling of biofuel demand – due on part to the maturity of the industry and weaker political incentives – has allowed for oversupply, which created downward pressures on oilseed prices. The three major grains incurred losses in December. In an extremely bearish market, wheat was hit the hardest tumbling by 9.25% to USD 6.08/bushel. The sharp increase in wheat supplies in Canada and Australia, in addition to the US will intensify price competition in 2014. The world wheat production forecast for 2013-2014 soared 5 million tons this month, breaking the record output of 2011-2012. In addition, as wheat is being replaced by corn and rye in livestock feeding, more wheat becomes allocated for export, creating more global price competition. Higher imports projected for Egypt, Japan and Syria are offsetting reductions in other countries. Corn prices fell by 0.4% M/M to USD 4.23/bushel, continuing its freefall post the recovery from 2012’s historic drought.

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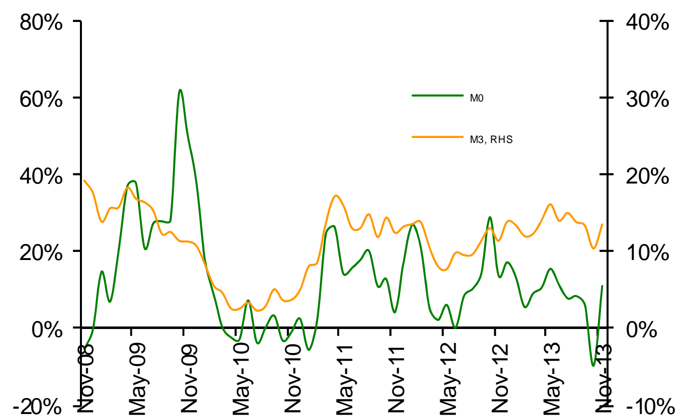
Money & Inflation

Growing M3 Amid Strong Demand

In 2013, strong fundamentals manifested in elevated oil prices and healthy internal demand have put money supply on the rise. Narrow money (M1) has been increasing on an annual basis at a double-digit rate, peaking in May and November at 18.6%. The strong growth trajectory of the most liquid component of money supply reflects a strong and steady demand for money in circulation. Demand deposits, which make up more than 85% of M1 showed a 20.4% annual growth, the largest seen this year. This also indicates the Saudi Arabian Monetary Agency's confidence in the price stability of essential goods. In November, the monetary base (M0) returned to positive growth trajectory after October's blip, realizing 11% Y/Y. Bank reserves and currency outside banks have increased by 12.8% and 8.9%, respectively. Currency outside banks remains at highest levels, owing to the Ministry of Labor's market reform. Near money (M2) have also shown a 15.4% rise over last year, which is in line with the general rise in liquidity.

The broadest money supply measurement (M3) surged by 13.5% Y/Y mainly due to the upturn in demand deposits that reached SAR849 billion. Time and Savings deposits increased by 6.7% to SAR 330.7 billion in a stark contrast to demand deposits. This on part is due to the structural nature of the economy which favors liquid non-interest bearing deposits over the low-yielding time deposits.

Chart 7: Growth in Monetary Aggregates

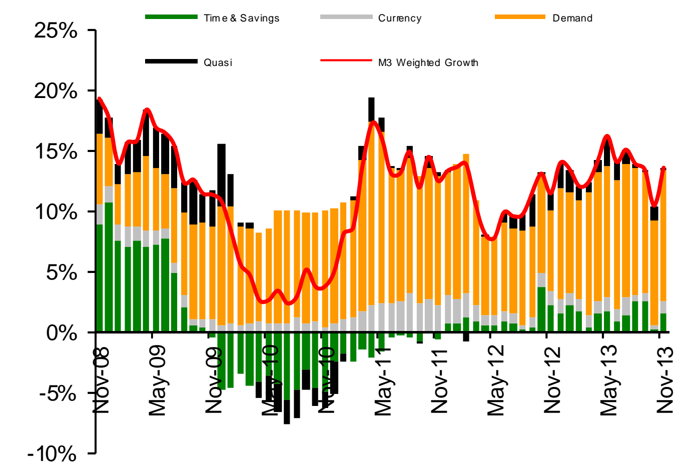


Source: SAMA, NCB Estimates

Moreover, the net foreign assets managed by SAMA rose to SAR 2.68 trillion, advancing by 12.6% over last year, accentuating SAMA's direction towards cementing the Saudi financial system against global macroeconomic fluctuations.

In 2013. inflation rates have become comfortably low after they were rebased on 2007 from 1999 previously. In November, the Cost of Living Index (CLI) mildly accelerated in the last 12 months, marking a 3% increase to 128.2. According to the Central Department of Statistics and Information, food and non-alcoholic beverages, which account for 21.7% of the CLI edged up by 5.4%. Housing and utilities, which makes up 20.5% of the CLI, bumped up 3.5%.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

The factors affecting these categories vary between demand push and supply pull. The heavily subsidized energy and essential goods stimulates demand, whereas an increasing demand for housing amid shortage of housing units provides upward pressures for rent prices. The bullish outlook on the USD in 2014 given the low downside risks will allow the pegged SAR to counter any imported inflation spillover from external trade. Depending on the pace of economic growth in the US and the developments on the fiscal and budget side, the price levels of imported goods and services should remain stable. Consumer spending and confidence are key indicators on a healthy economic performance. Consumer spending, as indicated by Points-of-Sale transactions have increased by 15.2% Y/Y, reflecting consumer's preference for present consumption over saving.

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Capital Markets

Annual Financial Results Buoying Tadawul

Business sentiment in the Saudi economy remains on a positive trajectory as consumer expenditure, government spending, and healthy credit to the private sector support profitability and project expansions for domestic companies. This translated to higher corporate earnings and as we start another fiscal year, investors are expecting strong annual announcements to reflect the bullish momentum witnessed throughout 2013. During December, the main index climbed 2.5%, which brings total gains for Tadawul last year at a hefty 25.5%, reaching 2008 level.

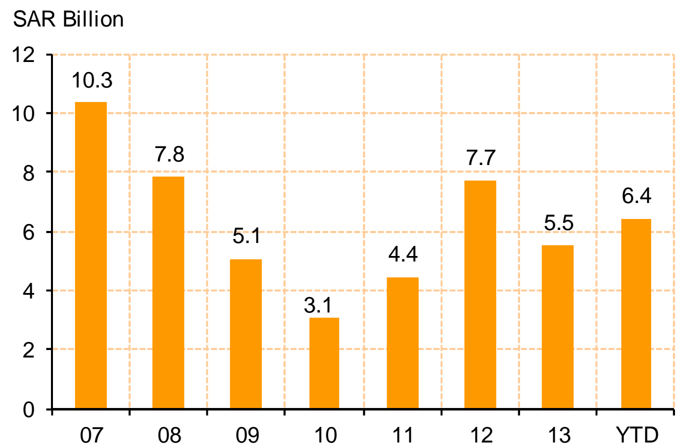
At a sectoral level, the hotel sub-index recorded the highest growth during the year, posting a staggering 123% Y/Y. Although minor in terms of size, with a market capitalization of only SAR17.1 billion, less than 1% of total market, the three listed stocks within the sector attracted over 2.4% of total value traded in the market during 2013. Despite the tremendous rise in the sector, its price-to-earnings ratio is at 16.49, marginally higher than the market's 15.52. Additionally, the real estate and construction sector have recorded strong gains by climbing 42.4% and 24.2%, respectively, on an annual basis. The expansionary fiscal policy of the Saudi government had created the largest market for mega-projects in the MENA region, providing lucrative opportunities for local businesses and supporting their bottom-lines.

Chart 9: Tadawul All-Share Index

Source: Tadawul

Moreover, the petrochemicals sector benefited greatly from the recovering global economy and elevated oil prices. The sector registered a rise of 28.8% during last year by attracting 14.3% of total value traded in 2013, equaling SAR196.4 billion. Oil prices are expected to slightly drop this year, however; it will be countered by rising global demand, which will underpin the healthy corporate profitability levels witnessed last year. Furthermore, Saudi banks are set to record another robust year in profits driven by an expansionary credit market and higher quality investments. Accordingly, the banking sub -index recorded a gain of 22% Y/Y by the end of December. Clearly, banking stocks provide lucrative investment opportunities as the sector's P/E ratio is the lowest in the market at 12.78, and since they are considered part of the "blue chip" category, long-term investors will most likely increase their exposure to them.

Chart 10: Average Daily Traded Value



Source: Tadawul

The level of activity, measured by the average daily traded values, was considerably lower last year in comparison to 2012. Investors exchanged stocks at a daily average worth SAR5.5 billion, 28% lower than the previous year's average. The rising stock prices amidst lower volumes reflects the reduced volatility seen in investors' trading behavior. Notably, the insurance sector, widely known for its speculative nature, declined by 11.3% during 2013. We believe the rising level of awareness and increased knowledge in financial trading guided investors to seek fundamentally sound stocks to maintain healthy portfolios with long-term outlooks. Moving forward, it will certainly prove challenging to mimic the performance of 2013 for a consecutive year. Global factors such as the start of US Fed tapering, effectiveness of policy decisions, and political uncertainty will limit the rise of stock prices. We do not see a greener side over the fence, yet it's still green nonetheless.

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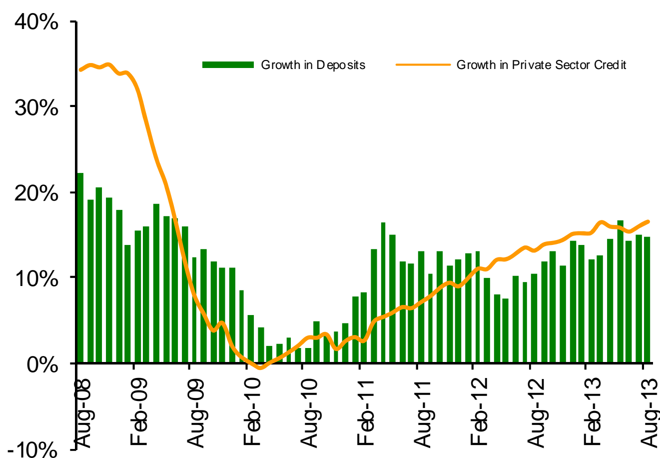
Loans Market

Sustainable Credit Growth

In the month of November, the loans market remains on solid grounds as the year 2013 comes to a closure. Local banks took advantage of the highly liquid state to expand credit allocations in their portfolios. The stable growth in deposits underpinned credit growth, as consolidated bank deposits surged by 14% Y/Y to SAR1.37 billion, the highest thus far. Demands deposits, followed by time and savings continue to constitute the bulk of deposits in Saudi banks at 62.1% and 24.2%, respectively. On an annual basis, demand deposits surged by 20.4%, while time and saving inched up by a mere 6.7%, mainly due to the low interest rate environment for the latter. The relatively benign credit risk results in higher capacity utilization, with the loans to deposits ratio, standing at a healthy 82.1%. On the other hand, foreign currency deposits declined on an annual basis by 3.6% while quasi deposits inched up by 1.9%.

Chart 11: Private Sector Financing

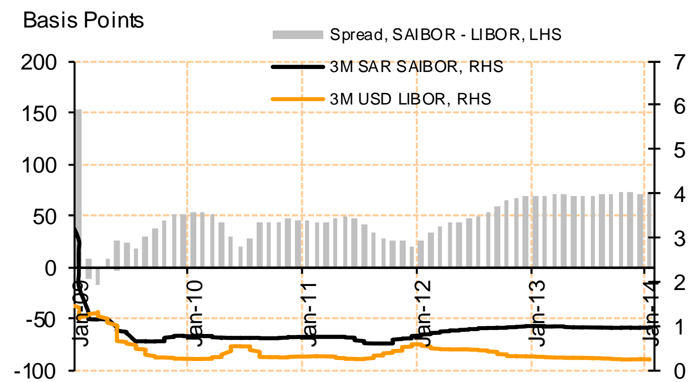


Source: SAMA, NCB Estimates

By maturity, short-term loans, which make up 53% of bank loans have increased 6% Y/Y in November. Additionally, medium-term loans, on the other hand, grew by 13.3% annually. With default and solvency risks at low levels, long-term loans are gaining favoritism receiving a sizeable boost of 27.3%. Annual growth in the private sector credit is up 13.1% in November while credit to the public sector, excluding investments in T-bills and government bonds rose by 15.3%. The deceleration in the private sector's growth rate since May is due to SAMA's active engagement with open market operations in order to keep credit in check. Compared to last year, T-bills grew by 27.8%, amounting to SAR 169.2 billion.

Over the past 11 months, Saudi banks awarded SAR113.4 billion to the private sector to cumulatively rack up SAR1.07 trillion in loans. This indicates resilient activity in the private sector, which continues despite the ongoing labor market reforms. The shortage of cheap labor and rising costs of inputs resulting from the crack-down on illegal workers will have a short-term impact on profitability, yet it is not expected to derail long-term expansionary strategies, as companies adapt accordingly.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

The SAIBOR interbank rate shows stability around the 100bps, which is 72 bps above LIBOR. Given the buoyancy of the economy, we expect that these prevailing rates will remain in place for much of 2014, with a possibility of a 20bps rise that is based on favorable market dynamics emanating from increased demand for funds rather than counterparty related risk. We do believe that policy normalization and the eventual rise of interest rates in the US will not weigh heavily on internal lending activity given the divergent economic fundamentals between the two countries. External borrowing, however, will most likely be much tighter and more costlier than before.

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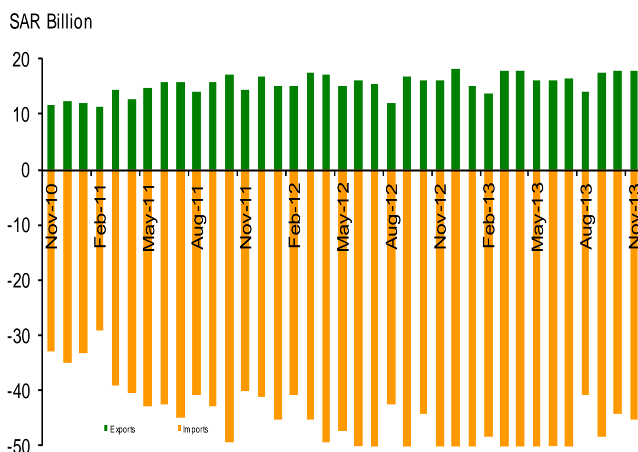
External Trade

An Improvement in the Balance of Trade

In November, Saudi external trade was positively affected by two main factors; one of which is the ongoing global recovery in manufacturing that stimulated demand for industrial inputs. The Kingdom's production of input materials such as chemical products, plastics and base metals supported the growth in non-oil exports that soared by 10.4% Y/Y. The second factor – which pertains to imports – is lower imported inflation, which is by large owed to the strengthening of the dollar against most emerging market currencies as well as the globally subdued inflation levels. On a yearly basis, the kingdom's value of imports declined by 12.5% Y/Y, underpinning a 22.9% Y/Y reduction in the balance of trade deficit. Tonnage-wise, both exports and imports declined by 3.7% and 3.6%, respectively.

The largest export category remains chemical products, with a 35% contribution to overall non-oil exports. Revenue from chemical products was unchanged from last year's SAR6.2 billion. Plastics, which make up 31.3% of exports surged by 7.6% to SAR5.6 billion. Exports of transport equipment spiked by a staggering 92.4%, realizing SAR1.7 billion, a 9.6% of total export value. Machinery and electrical equipment exports also made a positive progress compared to last year, advancing by 24.9% to SAR1.1 billion.

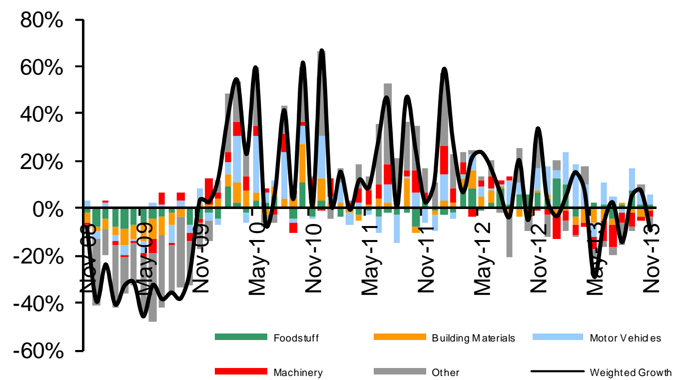
Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

The largest recipients of Saudi exports are the UAE, China and Singapore, with their shares at 19.3%, 13.8% and 6.9%, respectively. The UAE surpassed China as exports soared by 82% Y/Y, recording SAR 3.4 billion. In contrast, exports to China lessened by 6.7% Y/Y despite its invigorated manufacturing activity, amounting to SAR 2.4 billion. Exports to Singapore rose 7% Y/Y, totaling SAR1.2 billion. Moving onto imports, machines and electrical equipment remains the largest import category, contributing 23.9% to total imports value. This category receded in November by 18.7% Y/Y, falling to SAR10.8 billion. The value of transport equipment which makes up 21.6% of the import bill also fell, marking a 13.6% annual decline at SAR9.8 billion. Finally, the value of base metals imports dropped 21.8% to SAR5.3 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

The largest trade partners in terms of imports value is the United States, acquiring 14.2% of the import bill. Compared to the same period last year, the value of US imported goods declined by 9.7%, registering SAR6.4 billion. Chinese imports to the Kingdom picked up by 10.1% Y/Y, totaling SAR 6.3 billion. The contribution of Chinese imports stands at 14% of the month's total value. Also goods originating from Germany make up 7.2% of total non-oil imports, declining by 15.4% compared to previous year's figure at SAR3.3 billion.

Settled LCs totaled SAR19 billion in November, plunging by 14.4% Y/Y. The main contributors by weight are motor vehicles (26%), machinery (9%), and building materials (9%). Growth was affected mainly by steep declines in orders for machinery that fell by 16.7% Y/Y, and have been declining since August 2012. Motor vehicles, however, retained their double-digit positive growth of 23.3% Y/Y, owing to strong local demand. LCs for building materials moderated from sharper declines in most of 2013, standing at -8% Y/Y. Opened LCs for November posted a 14.4% downturn that was across-the-board, as motor vehicles, machinery and building materials declined by 25.4%, -32.7%, and -35.5%, respectively.

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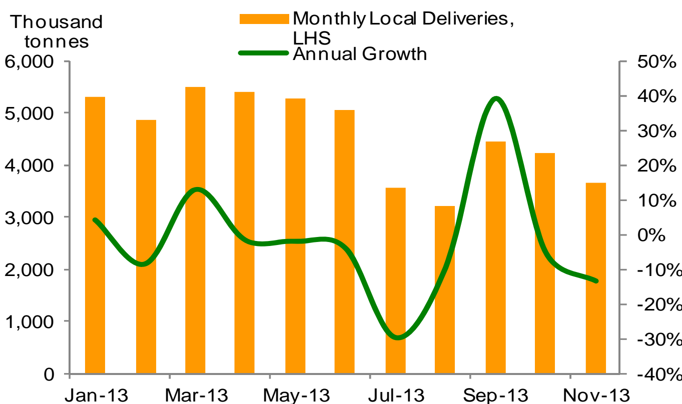
Special Focus:
Cement: A Positive Long-Term Trajectory

Saudi Arabia's robust economy and fiscal expansionary policy nourished mega projects, which currently stands just above USD900 billion, the highest in the MENA region. The trajectory is certainly positive as the government is adamant in pursuing long-term sustainable development that requires investments in infrastructure, education, healthcare, and social and economic development projects. One of the most fundamental and undervalued elements is the 50kg cement bag, which costs a maximum SAR12/bag for wholesales and SAR14/bag for end users, set by the Ministry of Commerce and Industry. Cement plays a pivotal role in the construction, maintenance, repair, and renovation of structures. Domestically, 15 companies are supplying demand by the local market. Regardless of the purpose of use, local deliveries amounted to 50.2 million tonnes in the first eleven months of 2013, in comparison to 48.2 million tonnes for the same period in the previous year, marking a 4.1% annual increase.

Table 15: Local Deliveries by Domestic Cement Companies

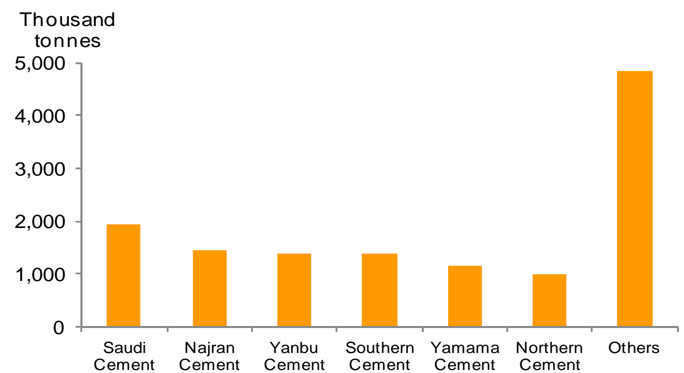


Source: Yamama Cement Company and NCB

According to the Central Department of Statistics and Information, the average for the 50Kg bag during 9M2013 stood at SAR14.3, marginally higher than the SAR14.2 registered by the end of 2012. Total revenue is expected to reach above SAR15.5 billion for 2013. Local production of clinkers reached 49.4 million tonnes by the end of November, a 10.9% Y/Y rise. Also, cement, which is typically clinkers with additives, achieved a production level of 50.7 million tonnes for the same period.

The government continuously provides the support needed for local businesses to develop and contribute to the economy. The main costs for cement production are raw materials, energy, fuel, transport, labor, and maintenance. Limestone, the initial component in the production process, is heavily subsidized by the government as well as natural gas, which is set at USD0.75 MMBtu, in comparison to an average of USD2.5-5.5 MMBtu for international spot market prices. In addition, transport expenses are significantly lower due to cheap gasoline/ diesel relative to other markets. Obviously, these factors provide strong competitive advantages compared to international counterparts. However, a conditional ban on cement exports limits the possibility for future expansion into overseas markets. Furthermore, given the labor intensive nature of the business, the recent crackdown on illegal workers and deportation of over one million immigrants, created a shortage for the cement industry and the construction industry, which is the demand side. This resulted in putting projects on-hold, thus, spiking inventory levels, which reached 13.1 million tonnes of clinkers by the end of November, a record high.

Table 16: Clinker Inventories by Company Jan-Nov 2013



Source: Yamama Cement Company and NCB

Moving forward, We believe the short-term challenges facing the market are contained and will be transitory in nature. The robust economy will facilitate further opportunities in the local market. Input costs are subsidized and will continue to be for the foreseeable future. The transitional phase of Saudization will also run its course and redress the shortage of workers. The government's continuous diversification plans in various sectors will ensure a consistent rise in demand over the medium-term. Once the projects are completed, demand will remain through maintenance and renovation needs for already built structures. We believe cement companies are poised for a profitable year, albeit an expected shortfall in the first quarter of 2014. Nonetheless, the 15 companies will compete for local market share and the competitive edge will reside in geographical proximity to projects.

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