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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Said A. Al Shaikh
Chief Economist | **s.alshaikh@alahli.com**

Tamer El-Zayat
Senior Economist | *Editor* | **t.zayat@alahli.com**

Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

Executive Summary

- OPEC raised its projection for global demand for OPEC's crude to 29.7mb/d, down by nearly 0.4mb/d from the 2013 level, which suggests that OPEC will maintain its current output cap at 30mb/d in its next group's meeting on June 11 in Vienna.
- The move towards currency liberalization by the People's Bank of China nullified the unidirectional appreciating bias against the USD, and thus, with almost USD 4 trillion of foreign reserve assets, the Chinese government can target the USD/CNY at ease.
- The newfound appeal in gold emerged as the Fed kept its dovish policy in place. Institutional investors, therefore, reinstated the safe-haven status of gold, albeit less attractive than prior to October 2012.
- The positive correlation between the monetary base and monetary aggregates led to a solid annualized growth rate in broad money (M3) advancing by 13.6% Y/Y in March to SAR1.6 trillion.
- The focus on light weight stocks indicates the speculative trend through April's trading activities. It will be difficult to maintain the market's growth as investors will opt to reap capital gains with such stocks due to lack of dividends and healthy financial indicators.
- Short-term credit lines still represent the bulk of credit extended by local banks advancing from last year by 8.5%. In retrospect, the rise in longer maturity loans is a result of a more regulated market with reduced risk factors.
- Although half bank loans in the kingdom are still short-term, the credit composition continues shows a gradual shift towards longer maturities which implies better market regulation and higher consumer confidence.

View of the Month

Saudi Arabia recorded a remarkable development in the world of Islamic finance by issuing the largest ever Sukuk in 2013. GACA's Guaranteed Senior Sukuk II topped the scale with USD4 billion. Furthermore, SEC issued a two-tranche Islamic bond with a tenor of 10 years and a first ever 30 year Sukuk, each with a value of SAR3.75 billion.

Macroeconomic Indicators

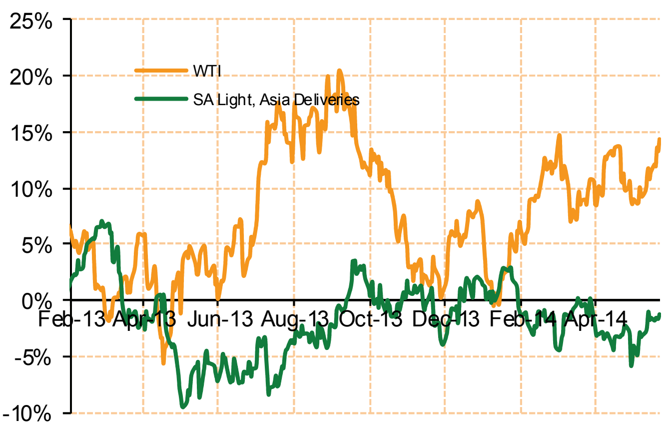
	2008	2009	2010	2011	2012	2013P	2014F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	94.9	59.2	77.6	108.1	110.2	106.4	100.0
Average Daily Crude Oil Production, MMBD	9.2	8.2	8.2	9.3	9.8	9.6	9.4
GDP at Current Market Prices, SAR billion	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,794.8	2,835.0
GDP at Current Market Prices, USD billion	520.5	429.7	526.8	670.4	734.9	746.3	757.0
Real GDP Growth Rate	8.4%	1.8%	7.4%	8.6%	5.8%	3.8%	4.1%
Oil Sector GDP Growth Rate	4.3%	-8.0%	0.3%	11.0%	5.7%	-0.6%	-1.2%
Non-oil Sector GDP Growth Rate	9.8%	5.3%	9.6%	8.0%	5.8%	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	25,172.6	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%	22.4%	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%	45.3%	40.5%	34.3%
Total Expenditure/GDP	26.7%	37.1%	33.1%	32.9%	31.7%	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%	13.6%	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

Supply Shortages Support Oil Prices

Brent crude prices averaged USD108 a barrel April, continuing to fall within a rather narrow range of USD107 to USD112 a barrel for the tenth consecutive month, supported by continued tensions between Russia and Ukraine and supply outages in OPEC and non-OPEC countries. WTI crude prices increased from an average of USD94 a barrel in January to USD102 a barrel in April, with the discount of WTI to Brent declining to an average of less than USD6 a barrel compared to an average of USD13 a barrel in the period of November 2013 to January 2014. Meanwhile, the differential is expected to rise back again, averaging at USD10 a barrel for 2014. Crude oil futures prices rose in April, and despite giving back on most of the gains at the end of the month, they increased again on both sides of the Atlantic in mid May on concerns over the possibility of tougher sanctions on Russia and potential supply disruption amid escalating tensions. Futures prices were also supported by positive US economic data and stronger US gasoline demand. Moreover, Saudi Arabia's oil minister statement that the Kingdom will step in to cover any potential shortage arising from the Ukraine crisis has kept the price rise in check.

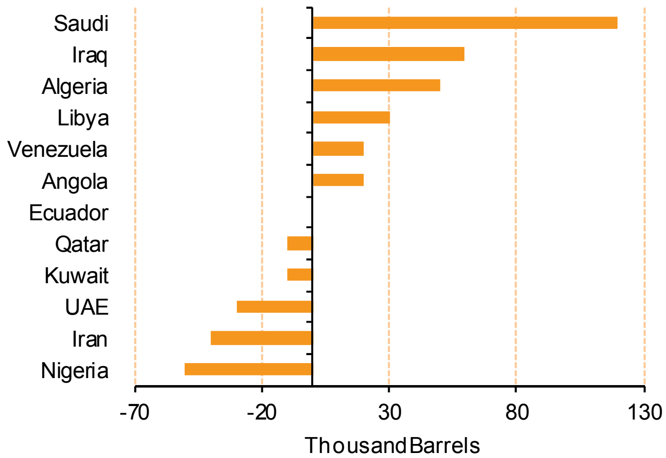
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, global output plunged by 1.2mb/d during March to 91.75mb/d, due to lower production by OPEC in the month. Non-OPEC growth of 1.98mb/d more than offset a nearly 1.0mb/d decline in OPEC crude. After hitting five-month lows in March, OPEC crude oil production rebounded by 0.4mb/d in April to 29.9mb/d. Iraq's exports reached 2.51mb/d in April compared to 2.37mb/d in March, but remained 1.1mb/d higher than a year earlier. In Saudi Arabia, current production is around 9.6mb/d, while the Kingdom has the capacity of 12.5mb/d.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

For 2014, non-OPEC production growth is expected to average 1.38mb/d, as most of this growth is expected to come from non-conventional sources. In the US, total crude oil production averaged 8.3mb/d, which is the highest domestic monthly oil production since March 1988. Attributed to the revolutionary drilling technologies, which allowed US to access unconventional oil trapped in shale formations, EIA forecasts US oil production to rise, averaging 8.5mb/d in 2014 and 9.2mb/d in 2015. According to EIA, by the end of next year, domestic crude oil production will approach 10mb/d, reaching the all-time record level of 10.04mb/d recorded back in November 1970. On the demand side, IEA raised its forecast of global demand growth marginally to 1.32mb/d, on higher first quarter data, reaching 92.8mb/d. It is expected that half of the incremental demand will be coming from China, despite its recent economic slowdown, and the Middle East. Meanwhile, China imported a record volume of Iranian oil in April, averaging around 0.80mb/d, almost 40% more than in March. Moreover, OPEC raised its projection for global demand for OPEC's crude to 29.7mb/d, down by nearly 0.4mb/d from the 2013 level, which suggests that OPEC will maintain its current output cap at 30mb/d in its next group's meeting on June 11 in Vienna.

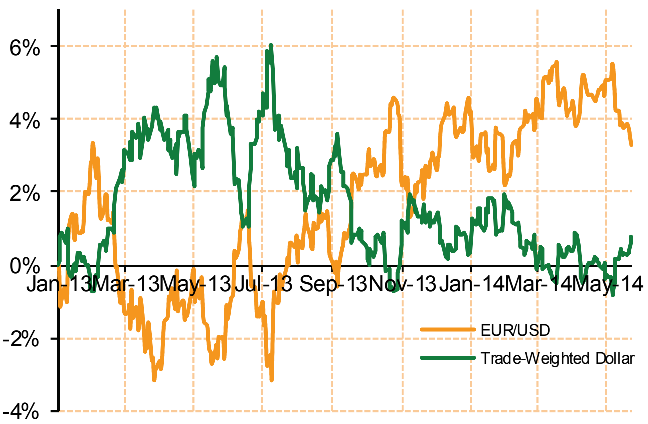
Said A. Al Shaikh
Group Chief Economist | **s.alshaikh@alahli.com**

Foreign Exchange

Sound US Fundamentals Amid Chinese Perils

Improving fundamentals in the US have not yet spurred a broad rally for the greenback, showing signs of disconnect between the momentum shaping the US economy and the trade-weighted dollar's performance. Despite isolated bilateral gains against select currencies, the trade-weighted dollar index edged 0.8% lower in April from a month earlier, standing at 79.5. The peculiarly suppressed 10 year benchmark treasury yield continues to persist at levels below 3%, influenced largely by the Fed's dovish stance. 10-year bond yield lost 8 basis points M/M, ending April at 2.6%. The affirmation of the Federal Open Market Committee in its April meeting that interest rates will remain near 0% eased off resurfacing concerns after the jobs report beat expectations. Nonfarm payrolls added 288,000 jobs to the economy, pushing unemployment rate down to 6.3%. The Fed's forward guidance, which previously set 6.5% as a joblessness threshold to raise the Fed funds rate given that interest rates remain below 2.5% (currently at 1.5%), was scrapped; shifting to a more qualitative dimension. The minutes of the Fed abated further speculation that the first interest rate rises were underway and confirmed that it will remain "accommodative" until confidence in the economic recovery is fully absorbed and reflected on the labor market and consequently, economic growth.

Chart 3: Trade-Weighted Dollar and the Euro

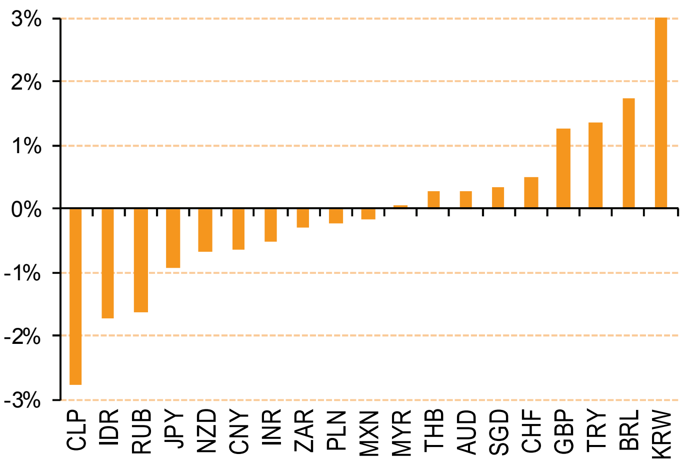


Source: Thomson Reuters

Judging from the current scenario, the US is at least two years away from reaching its longer-run unemployment rate of 5.2% - 5.6%, also known as the Non-Accelerating Inflation Rate of Unemployment (NAIRU). However, since the Great Recession in 2008, the US labor market has underwent significant structural changes, one of which is raising unemployment benefits to 99 weeks from 26 weeks pre-crisis, which in turn might actually raise the NAIRU rate closer to current levels.

China continues to dominate sentiments over core emerging market currencies. The directional shift in the value of the Chinese yuan prompted a deeper look into China's exchange rate policy and the outlook of China overall. The move towards currency liberalization by the People's Bank of China nullified the unidirectional appreciating bias against the USD, and thus, with almost USD 4 trillion of foreign reserve assets, the Chinese government can target the USD/CNY at ease. Market determinants, however, appear to still favor a weaker yuan, which in April depreciated by 0.7% M/M against the dollar at 6.25. Renewed bouts in the Chinese equity market evident by the 14% loss in the CSI300 index over the past five months, the burst of China's real estate bubble, and the cooling down in manufacturing, the CNY is posed to weaken further while potential downside risks exist.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The severity of China's property market correction is not yet clear, although indicators, such as China's current account posted a surplus of USD 7 billion in the first quarter, the smallest in three years. According to Nomura, property investment turned negative in four of China's 26 provinces in Q1, two of which (Heilongjiang and Jilin) recorded a contraction below 25%, risking a domino effect. A fall in investment would lead to declines in construction and sales , and given the property market's significant weight in the Chinese economy, could render the 7.5% growth bottom line unattainable. On the manufacturing front, HSBC/Markit posted a PMI of 48.1 in April up from 48.0 the previous month, indicating a slowing pace of deterioration in business conditions. Decreases in input costs and output charges helped easing the rate of contraction; however, cost-cuts also included workforce reduction, which recorded the sixth consecutive month in April.

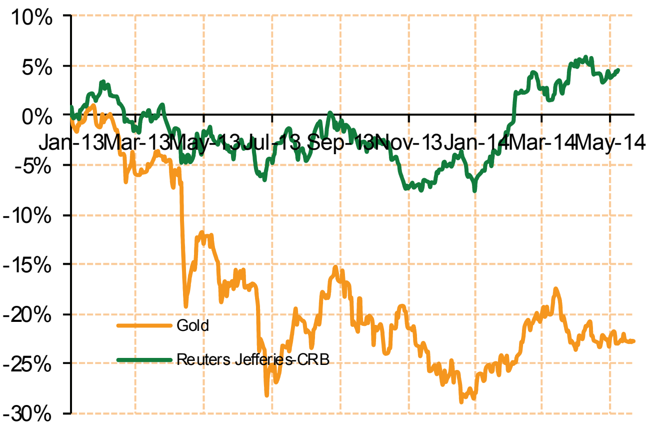
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Commodities

Commodities Edge Higher

Commodity prices rebounded slightly in April on the back of firmer gold and agricultural commodities. The Thomson Reuters/Jeffries CRB inched up 1.6% in April from the previous month to stand at 309.5. The performance of base metals was mixed. Indonesia's ban on the export of nickel ore propelled LME nickel to two-year highs. Since the beginning of the year the metal surged by 43% to levels not seen since early 2012. In the month of April, nickel closed at USD18,325/ton, appreciating by 15.3% M/M. It continued to march upwards supported by supply constraints to a hundred dollars shy of the 20,000 dollar mark in early May. The metal is poised to appreciate further under prospects of short-term supply shortages after Vale, the second largest producer of nickel, shut down its Goro, New Caledonia plant due to acid leakage. On the other hand, copper prices moderated on the back of brighter economic data. US wholesale inventories rose by 1.1% in March, higher than the expected 0.5%, suggesting that restocking of goods may revise the US Q1 growth rate slightly upwards. The LME 3-month copper prices remained unchanged in April as positive data from the US counter-balanced the negativity from China's manufacturing slowdown, standing at USD6,642/ton.

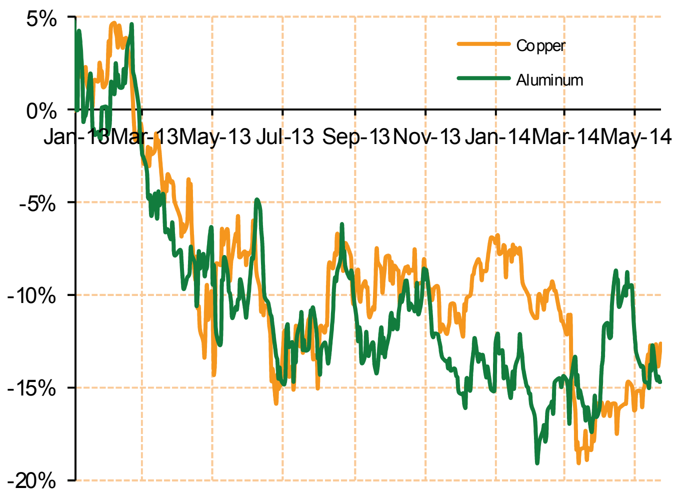
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Warehouse stock at the LME recorded an 8.8% contraction in copper stockpiles, closing at 231 thousand tons. The use of copper as collateral is supporting demand for the metal, although with the curbs on the shadow banking system in China, we expect a collateral reversal in the short to medium-term, especially if copper prices continue to slide downwards. Aluminum prices are gaining traction as LME aluminum inched up by 0.8% in April, closing at USD1,800/ton. Although well below the USD3,500/ton peak of mid-2008, key producers such as Rusal, the largest aluminum producer responsible for 9% of the world's output, slashed production last year by 8% to 3.9 megatons. This, given the indispensable nature of aluminum as a main component in many industries, should provide upward pressure on prices, expected to continue throughout the second half of 2014. The LME warehouse movement closed at 5.3 megatons, contracting by 0.6% from March. Precious metals found some stability in Q1 following the sharp declines instigated by the Fed's taper talk in 2013. The newfound appeal in gold emerged as the Fed kept its dovish policy in place. Institutional investors, therefore, reinstated the safe-haven status of gold, albeit less attractive than prior to October 2012. Spot gold ended April gaining 0.6% to 1.292.5 on the prospect that interest rates will remain low. We expect range-bound gold prices, facing resistance at the 1,300 level. Persistent weaknesses provide a downside bias given the import ban in India, the curbs on shadow banks in China, and the improving economic conditions in the US.

Chart 6: Base Metals



Source: Thomson Reuters

Outlook for agricultural commodities improved after adverse weather in Q1 gave a boost to grains prices. Consequently, the Goldman Sachs Agricultural Commodity index rose 3.6% M/M in April, standing at 423.8. Corn prices reversed course after reaching record low in December, edging 5.3% higher. Through April, per bushel price of corn futures closed at USD5.16, around 2.6% higher than a month earlier. Wheat futures advanced 2.4% M/M to USD7.17/bushel. Fears of a price spike from the Russia/Ukraine tension did not yet materialize and the market remains well-supplied as per the US Department of Agriculture's estimates.

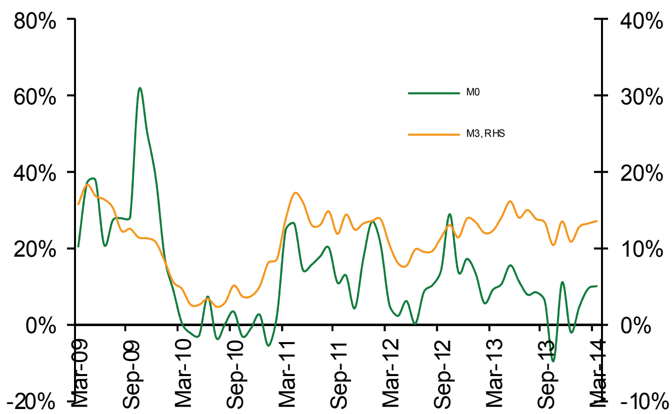
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Money & Inflation

A Shift Towards Longer-Term Horizons

The monetary situation in the largest rentier economy in the world remains with an upside trajectory. The country's large revenue stream owed to recent years' oil returns has created a tendency towards economic diversification and increased support for the private sector. Therefore, the level of growth in the monetary system accelerated in tandem with the fiscal expansionary policy, benefiting from the currently low inflationary pressures. The monetary base (M0) recorded a 10.1% upturn compared to last year, mostly due to an 11.3% rise in bank reserves. Deposits with SAMA represent over half of the monetary base, and thus we can attribute the bottom line figure change to SAMA's liquidity management. Given the highly liquid state of the Saudi market, required reserves have been gradually increasing since December 2008, reaching an all-time high of SAR85.6 billion. The liquidity absorption mechanism of SAMA is also pronounced in open market operations whereby T-bills reached SAR480.6 billion, a 10.5% annual upturn.

Chart 7: Growth in Monetary Aggregates

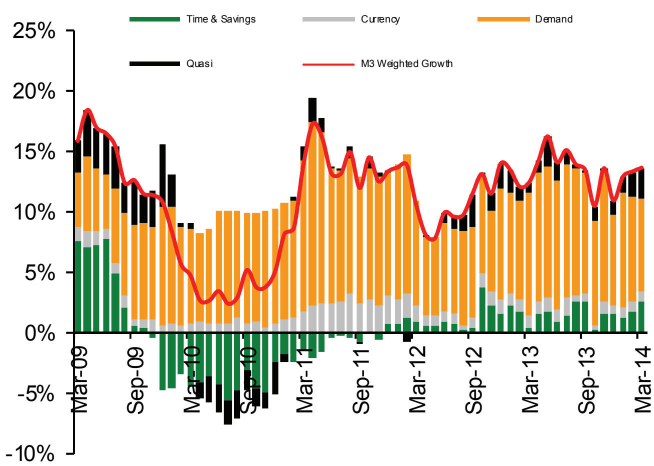


Source: SAMA, NCB Estimates

Currency outside banks noticeably on the rise after a hiccup in September last year, recording SAR146.7 billion, an 8.4% Y/Y increase. Also, cash in vault marked SAR24.5 billion, leaping over last year's figure by 18.3%. The positive correlation between the monetary base and monetary aggregates led to a solid annualized growth rate in broad money (M3) advancing by 13.6% Y/Y in March to SAR1.6 trillion.

Furthermore on the money supply side, we notice that demand deposits, the largest accounts in Saudi commercial banks (over half of M3), are registering a sizeable annualized increase of 13.6% compared to the same period last year, totaling SAR915.2 billion. Time and saving, albeit to a lesser degree due to unattractive interest rates, joined momentum surging by 11.5%, reaching SAR348 billion. The latest trends reveal a gradual shift predominately by government entities from demand deposits towards time and saving. This came contemporizing with plateauing mega projects following the 2011-2012 peak, indicating a decline in short-term financing amid lower projected government expenditure. Other quasi-money deposits managed to expand by a staggering 21.1% to SAR210.8 billion , owing to a rise in foreign currency deposits.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Headline inflation in March receded further to 2.63% down from 2.79% a month earlier, which is the lowest rate since May 2012. Housing and utilities exerted upside price pressure rising by 4.1% followed by food stuff which gained 3.8% Y/Y. The S&P/Goldman Sachs Agricultural index recorded a 7.5% surge the same month, which is expected to have an impact on future food stuff prices. Furnishing and household equipment have been gaining traction since July last year, recording a 5.23% increase in the consumer price index. Inflation in education remains elevated above 3% since October 2013, while restaurants and hotels are charging up, ahead of the Summer season, with 3.5%. On the downside, transport and communication have been on the forefront of negativity with -3% and -0.32%, respectively.

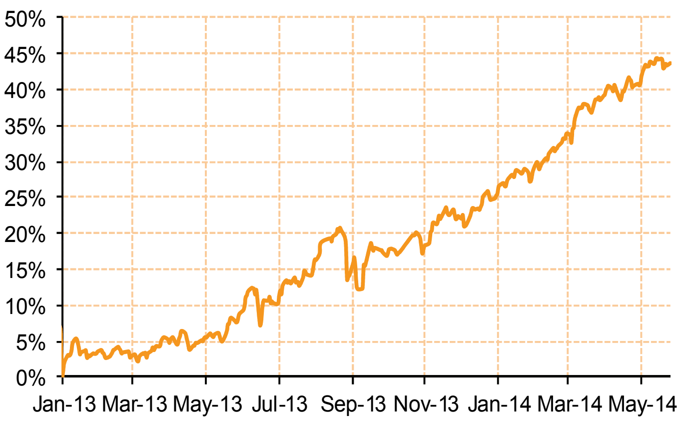
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Capital Markets

Corporate Profitability Supports Tadawul

Regional stocks have outperformed their global counterparts as the MSCI GCC equity index rose by 6.8% last month in comparison to the MSCI World index which inched higher by 0.7%. Oman and Kuwait equity markets were the only negative performers while Dubai and Qatar indices increased by 13.7% and 8.9% during April, respectively. Meanwhile in Saudi, business sentiment remains on a positive trajectory as consumer expenditure, government spending, and strong credit to the private sector support profitability and project expansions. Corporate profitability for the first quarter of 2014 reflected positively on stock prices which posted yet another monthly gain by 1.2% during April, to edge close to the psychological 10'000 level. Going into May, Tadawul maintained its upward momentum with a gain of 2.3% by May 15 as the index closed at 9'807.37, a figure unseen for the past six years. On a sectoral basis, Media posted the highest growth during April at a staggering 25.4% and the Multi-investment sector recorded the second highest growth at 17.4% while the Insurance sector rose by 16.7%. Meanwhile, the Energy, Banking, and Petrochemicals sectors recorded a contraction of 6.0%, 3.8%, and 2.1% last month, respectively. The focus on light weight stocks indicates the speculative trend through April's trading activities. It will be difficult to maintain the market's growth as investors will opt to reap capital gains with such stocks due to lack of dividends and healthy financial indicators.

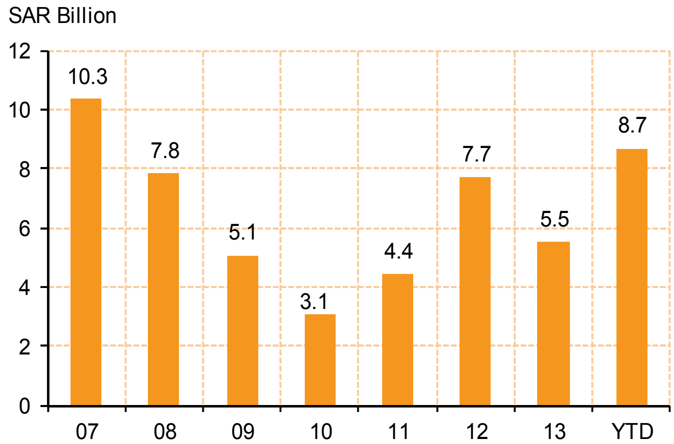
Chart 9: Tadawul All-Share Index



Source: Tadawul

The speculative environment supported higher activity levels as average daily traded volumes peaked on April 9th at SAR15.7 billion to support the monthly average that reached SAR10.6 billion for April, a 19.8% rise over the previous month. The index's gain continues to attract more capital as investors are keen to profit from the market's bullish trajectory. During April, traders exchanged SAR232.3 billion worth of stocks through 3.9 million transactions which represent almost half of the SAR468.4 billion traded in the first three months of 2014 and just over 50% of the 7.8 million transactions conducted. The market is still predominantly driven by Saudi individual investors representing 92.2% of total traded value through April. Institutional trading only composed 6.8% while Foreign SWAPs marked 1.0% last month. An absence of key market makers continues to risk exposing stocks towards sharp declines and hinder their long-term prospects. The summer vacation is upon us and it will coincide with Ramadan which could limit the activity in the market as well as withdraw some capital towards consumption expenditure. The following weeks will decide the direction of the index for the second and third quarter of 2014.

Chart 10: Average Daily Traded Value



Source: Tadawul

The primary market concluded the initial public offering (IPO) of Umm Al-Qura Cement Company last month. The company offered 27.5 million shares at book value, representing 50% of the company. Unsurprisingly, the IPO witnessed strong demand as the offering was oversubscribed by 848% which ended early this month. Additionally, already in the pipeline are two IPOs, Al-Hokiar Group for Tourism and Development and Al-Hammadi Company For Development & Investment offering 16.5 million and 22.5 million shares, respectively. Both companies are selling 30% of their capital to the public during the next month.

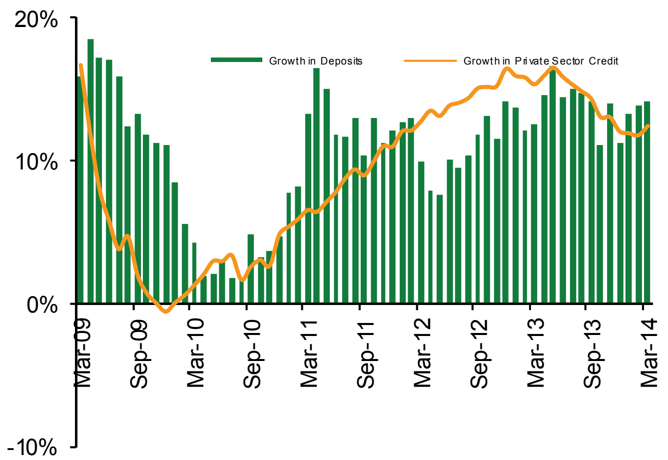
Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

Loans Market

Longer Tenor Credit On the Rise

The conducive macroeconomic conditions in the Kingdom have created an investment-friendly environment which allows the financial system to flourish through plentiful viable opportunities as local businesses grow. The tangible efforts of the Ministry of Commerce and Industry, Capital Market Authority, and the General Investment Authority significantly contributed to boosting consumer confidence via enforcing market regulation, competitiveness protection, and fair pricing. The lending activity in Saudi banks remains at healthy double-digit levels as low risk premiums are translating into attractively low interest rates. However, factors such as the US policy rate expectations and Saudi domestic credit growth are key drivers of the Saudi Interbank Rate (SAIBOR), currently standing at 0.95%. The decoupling from the London Interbank Offered Rate (LIBOR) as of late implies that Saudi banks are relatively safer from external shocks compared to the 2008-2009 financial crisis, thanks to SAMA's substantial accumulation of foreign assets, geared towards providing ample cushioning. This leaves SAIBOR influenced mostly by internal dynamics, manifested in domestic credit activity. In this regard, we observe that the base rate of 0.25%, often called the reverse repo rate, which SAMA used to influence the short-term interest level has been fixed since 2009. Despite that, SAIBOR has been trending higher by influence of strong demand for credit. Therefore, the rise in SAIBOR was found to be correlated with the double-digit growth in credit extended to the private sector, which, not including T-bills, grew by 11.7% Y/Y in March.

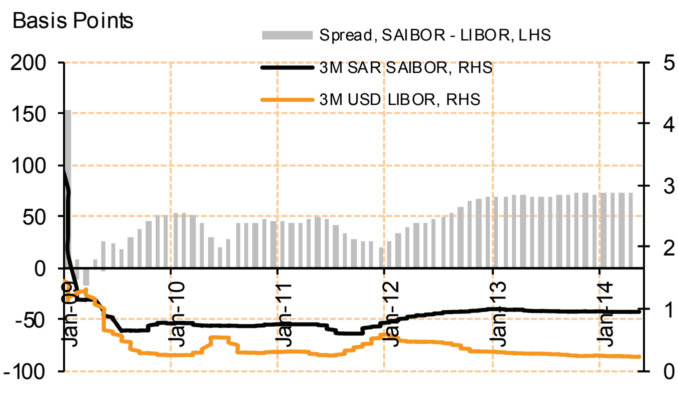
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

Since January of 2013, credit growth decelerated while deposits grew rapidly reaching 14.1% in March, leading to a loan-to-deposit ratio of 78.8%. The expansionary fiscal policy pursued by the Saudi government as an attempt to diversify the economic base amid prospects of softer oil revenues has its hopes hinging on higher growth coming from the private sector, which in turn holds SMEs at the core. Furthermore, we expect demand for credit to ease throughout 2014, pushing SAIBOR down to 0.8% while SAMA, on the other hand, will most likely follow suit with the Fed as policy rate hikes are expected in mid-late 2015. Consequently, the reverse repo rate will rise, absorbing some liquidity from the market, effectively bringing SAIBOR back close to 1%. In March, the combined loans portfolio for Saudi banks reached an all-time high of SAR 1.16 trillion, surging by 11.7% on an annual basis. The pace of credit growth continues to slow for the 11th consecutive month to below pre-crisis levels.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Although half bank loans in the kingdom are still short-term, the credit composition continues shows a gradual shift towards longer maturities which implies better market regulation and higher consumer confidence. Short-term loans grew by an annualized 6.1%, below last year's average of 6.4%, amounting to SAR603.3 billion. Medium-term loans, which constitute 18.4% of total loans show a 9.7% growth compared to March 2012 at SAR213.9 billion. Long-term loans make up 29.6% of loans extended this month reaching SAR344.4 billion, advancing by 12.7% Y/Y. Point of sale transactions recorded for March show a double-digit growth of 14.2% despite last year's high base, reaching SAR14.2 billion in volume.

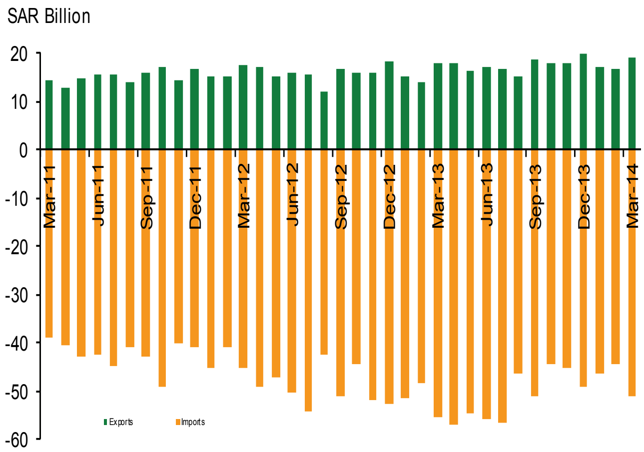
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

External Trade

Global Prices Support Trade Balance

Non-oil trade balance deficit in the kingdom continued to shrink in March, completing a quarter of improvement. Exports recorded an annualized 12.5% increase in value terms, reaching SAR19.2 billion. Strong fundamentals, manifested in sound internal dynamics in the Saudi economy as well as improving global outlook have greatly aided trade activity. Government support which aims to streamline access for small and medium enterprises to the global market have raised the prospect for short to medium-term investments. The increasing reliance on the private non-oil sector came about as diversifying exports away from oil became a strategic move for the Kingdom in the wake of the shale revolution and rising non-OPEC oil production.

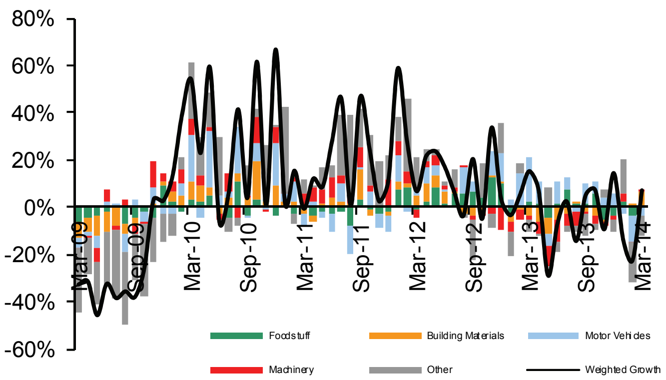
Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

The inception of the Saudi Export Development Authority (SEDA) reaffirms the government's direction towards reinforcing the pivotal role which private non-oil exports are set to play in future economic growth. The subsiding frictional unemployment which resulted from the labor reforms, coupled with a lower cost of inflation led to less work backlog and rising productivity. According to Markit/HSBC, Saudi Arabia's purchasing managers' index (PMI) rose to 58.5 from 57 a month earlier, indicating the first positive rebound since January. On the other hand, imports declined by 9.1% Y/Y, bringing the balance of trade gap less by 18.5%. Annualized analysis of export composition in April shows that non-oil exports of chemical products, which account for 32.6% of the monthly total, retracted by 8.6%, attracting SAR6.3 billion. Plastics advanced by a sizeable 21.7%, reaching SAR5.9 billion, which is approximately 30.6% of non-oil exports in value terms. Base metals inched upwards by a meager 1.9% to SAR 1.3 billion. Analysis for exports by destination reveals that around 13.8% of non-oil exports headed to the UAE, racking up SAR2.7 billion, which is a hefty 51.8% boost over last year. China, despite its relative slowdown in manufacturing, maintained a strong demand for the kingdom's non-oil exports. This, on part, is due to the nature of contractual obligations in which most of the kingdom's exports take place, in addition to the inelastic attitude towards petrochemicals and plastics in China. For SAR2.2 billion, it accounts for 11.4% of the monthly total which advanced by 21.1% Y/Y. Exports to Singapore surged by 43.5% to SAR1.5 billion, making 7.7% of non-oil exports.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

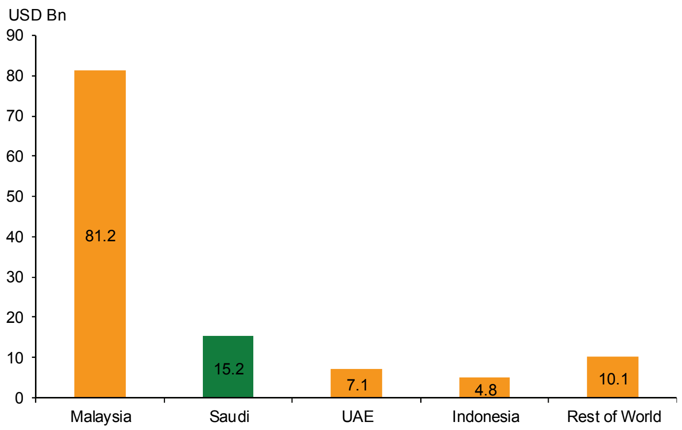
On the imports side, we notice a continuing downward trend which is likely a result of lower imported inflation, namely in Europe faced by the relatively stronger dollar. Around 24.1% of imports consisted of machinery and electrical equipment. In March, imports of this category nosedove by 17.8% to SAR12.3 billion. Imports of transport equipment came second in value terms at SAR9.8 billion. The softer figure recorded a 7.5% contraction over last year, accounting for 19.1% of imports. Base metal imports slipped by 12.9% to SAR6.3 billion. The major exporting countries to the kingdom remain the US, China and Germany, with an allocation of 13.2%, 12.1% and 7.1% of the import bill, respectively. The value of goods imported from the US tumbled by 10.8% down to SAR6.7 billion. In contrast, imports from China inched up by 1.2% annually, reaching SAR6.2 billion. German imports to the kingdom declined by 6.6% Y/Y, recording SAR3.6 billion.

Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Special Focus:
Sukuk: A Viable Financing Alternative

As Muslim countries develop and grow economically, the need to integrate their economies into the global financial system is a must. Hence, Islamic scholars extensively researched and created the Islamic alternative to conventional financing. Islamic law prohibits trading debt or collecting interest on debt. It also prohibits allocating a fixed rate of return on investments and shielding the investor from losses. Accordingly, the emergence of Sukuk addressed these issues and underpinned the rapid growth in Islamic finance not only in Muslim countries but advanced economies as well. Shariah compliant financial assets are estimated well over USD1 trillion and are expected to double within the next 3-5 years. The holder of Sukuk typically owns a share of the underlying asset, expects a share in return from the performance of the investment, and accepts the possibility of sharing losses, if any. There are many types of Sukuk, the most common are Murabaha and Ijarah. Murabaha pertains to selling an asset with a cost-plus agreement and payment is either upfront, in installments, or one future lump sum. Meanwhile, Ijarah is a lease based Sukuk which provides the owner with a share of the assets, thus, a share of the profits or loss.

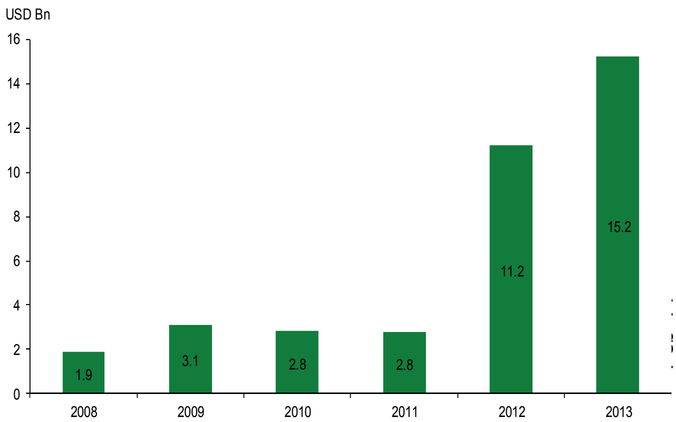
Table 15: Global Sukuk Issuances, 2013



Source: IMF and NCB Estimates

Global Sukuk issuances reached USD118.2 billion during 2013, dipping lower than the record set in 2012 with a total amount of USD139.3 billion. As the Islamic alternative is relatively new, the majority of issuances are sovereign with a share of 65.5% last year. However, the rising demand for corporate Sukuk issuances lifted the total amount from USD24.4 billion in 2012 to USD32.2 billion in 2013, a gain of 32.0% Y/Y on a global scale. Malaysia holds the top spot for Islamic financing with a total number of 637 issues last year worth USD80.9 billion. Saudi Arabia firmly came in second with a record setting USD15.2 billion worth of Sukuk, up 36.4% Y/Y, through 20 issues during 2013. Subsequently, UAE and Indonesia complete the top four countries and between them, USD108.2 billion issuances or 91.5% of total issuances originated from one of these regions. The demand for Islamic financing is on an upward trajectory. Given the rise in Muslim population and wealth, which are both growing rapidly, Sukuk markets are expected to maintain growth as they continue to develop into a mature and viable financing alternative.

Table 16: Key Central Bank Rate Decisions



Source: Central Banks

Saudi Arabia recorded a remarkable development in the world of Islamic finance by issuing the largest ever Sukuk in 2013. GACA's Guaranteed Senior Sukuk II topped the scale with USD4 billion followed by Aramco's Sadara Sukuk at USD2 billion, both were issued in Saudi Riyals. Furthermore, SEC issued a two-tranche Islamic bond with a tenor of 10 years and a first ever 30 year Sukuk, each with a value of SAR3.75 billion. The extended maturity will provide a pricing benchmark for longer-tenor Sukuk and energize an alternative venue for financing infrastructure projects. In order to comply with Basel III requirements and boost their tier 2 capital, Saudi banks are becoming more inclined towards issuing Sukuk for long term financing such as Saudi British Bank, National Commercial Bank, and the upcoming Banque Saudi Fransi issuance (SAR2 billion). Moving into 2014, Saudi had already registered over USD6 billion worth of issuances and is set to record another robust year for Sukuk.

Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

www.alahli.com

Economics Department

The Economics Department Research Team

Head of Research

Said A. Al Shaikh
Group Chief Economist
s.alshaikh@alahli.com

Macroeconomic Analysis

Tamer El Zayat
Senior Economist/Editor
t.zayat@alahli.com

Majed A. Al-Ghalib
Senior Economist
m.alghalib@alahli.com

Yasser Al-Dawood
Economist
y.aldawood@alahli.com

Sector Analysis/Saudi Arabia

Albara'a Alwazir
Senior Economist
a.alwazir@alahli.com

Mai Al-Swayan
Economist
m.alswayan@alahli.com

Shahrazad A. Faisal
Economist
s.faisal@alahli.com

Management Information System

Sharihan Al-Manzalawi
Financial Planning & Performance
s.almanzalawi@alahli.com

To be added to the NCB Economics Department Distribution List:

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