March 2017

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# Saudi Economic Review

## NCB Monthly Views on Saudi Economic and Financial Developments

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*A Promising Service Sector*



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## Executive Summary


- Lower oil prices have raised the possibility of an extension to OPEC's agreement to cut oil production, which is due to expire at the end of June.
- Given Brexit, the UK's economy appears to be holding on well as it grew by 2% in 4Q2016. In addition, the Bank of England adopted a neutral policy bias in March, keeping policy rate unchanged at 0.25%.
- Higher political risks in some of the major EMDEs such as Brazil will also exacerbate the slowdown in investment, trickling down to the commodities exported by these countries.
- Elevated economic and credit risks triggered a wait-and-see approach by Saudi banks as the excess reserve ratio, which is represented by deposits with SAMA other than statutory deposits, increased to 53.7%
- The Saudi stock market, Tadawul, continues to diverge from its international counterparts registering a year to date decline of around 4%, with 14 out of the 20 subsectors in the negative territory.
- The macroeconomic backdrop will continue to pressure the loans market in 2017 and 2018 as restructuring the economy will lessen the need for financing during the transitional phase.
- The vertical diversification of hydrocarbons puts the Kingdom at a key global advantage, extending the chain of production for the largest holder of proven oil reserves in the world.


### View of the Month

Vision 2030 targets to expand Umrah visitors from 8 million annually to 30 million annually, and to provide extendable visas for tourism purposes. The outlook for Saudi tourism remains bright as the non-religious segment of the market is largely untapped which will underpin a strategic service industry towards Saudi Vision 2030.

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## Macroeconomic Indicators

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016P | 2017F |
|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | |
| Average KSA Crude Spot Price, Arab Light, USD/BBL | 108.1 | 110.2 | 106.4 | 97.2 | 50.2 | 40.9 | 50.6 |
| Average Daily Crude Oil Production, MMBD | 9.3 | 9.8 | 9.6 | 9.7 | 10.2 | 10.4 | 10.1 |
| GDP at Current Market Prices, SAR billion | 2,510.7 | 2,752.3 | 2,799.9 | 2,836.3 | 2,444.1 | 2,398.6 | 2,525.5 |
| GDP at Current Market Prices, USD billion | 670.4 | 734.9 | 747.6 | 757.4 | 652.6 | 640.5 | 674.4 |
| Real GDP Growth Rate* | 10.0% | 5.7% | 2.7% | 3.7% | 4.1% | 1.4% | -0.7% |
| CPI Inflation, Y/Y % Change, Average | 3.7% | 2.9% | 3.5% | 2.7% | 2.2% | 3.5% | 2.5% |
| **External Sector** | | | | | | | |
| Current Account Balance, USD billion | 158.5 | 164.8 | 135.4 | 73.8 | -51.6 | -53.4 | -35.3 |
| Current Account Balance/GDP | 23.6% | 22.4% | 18.1% | 9.7% | -7.9% | -8.3% | -5.2% |
| Net Foreign Assets with SAMA, USD billion | 535.9 | 648.5 | 717.7 | 725.2 | 609.7 | 529.3 | 489.5 |
| **Fiscal Sector (Central Government)** | | | | | | | |
| Actual Revenues, SAR billion | 1,117.8 | 1,247.4 | 1,156.4 | 1,044.4 | 612.3 | 528.0 | 700.0 |
| Actual Expenditure, SAR billion | 826.7 | 873.3 | 976.0 | 1100.0 | 978.0 | 825.0 | 890.0 |
| Expenditure Overrun, % | 42.5% | 26.6% | 19.0% | 28.7% | 13.7% | -1.8% | 0.0% |
| Overall Budget Balance, SAR billion | 291.1 | 374.1 | 180.3 | -55.6 | -365.7 | -297.0 | -190.0 |
| Budget Balance/GDP | 11.6% | 13.6% | 6.4% | -2.0% | -15.0% | -12.4% | -7.5% |
| Break-Even Oil Price | 75.3 | 73.9 | 82.6 | 99.1 | 82.9 | 62.6 | 66.8 |
| **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) | 13.3% | 13.9% | 10.9% | 11.9% | 2.6% | 0.7% | 0.9% |
| Growth in Credit to the Private Sector | 11.0% | 16.4% | 12.1% | 11.9% | 9.8% | 2.2% | 2.3% |
| Average 3M SAR Deposit Rate | 0.7% | 0.9% | 1.0% | 0.9% | 0.9% | 2.1% | 2.5% |
| Average 3M USD Deposit Rate | 0.3% | 0.4% | 0.3% | 0.2% | 0.3% | 0.7% | 1.7% |
| Spread, in Basis Points, SAIBOR-LIBOR | 40.9 | 55.2 | 68.7 | 70.4 | 56.4 | 134.7 | 80.0 |

Sources: Thompson Reuters, SAMA, General Authority for Statistics, and NCB
Note: Saudi Economic Review Data, March 2017 Update (Historical and Projections)

# Oil Market

## Crude Falls on Doubts Over Cut Extension

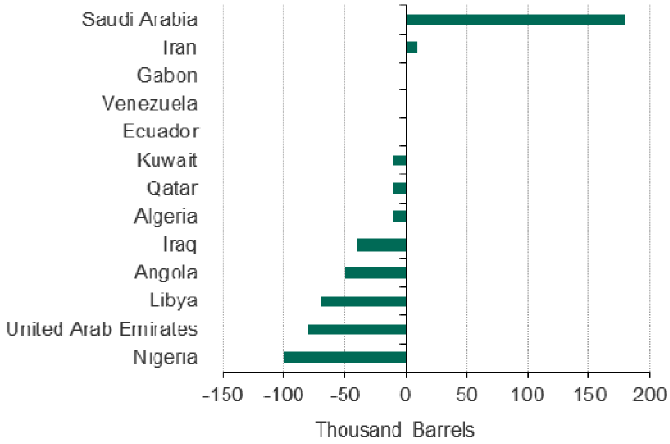
The mid-March weakness in oil prices is temporary, and is not a major concern to OPEC producing countries. The main trigger of the fall was a comment by the Saudi Oil Minister that prompted doubt about OPEC member countries commitment to the November's deal and also was caused by IEA data that showed inventories built in January to be erasing some of the progress made in inventory drawdown. Although OECD countries built inventories in January, it is forecasted that they should continue to draw from a peak of more than 3 billion barrels reached in July 2016. It is unlikely for this weakness to last in the second quarter, as the global market balance has already shifted from a period of supply surplus to a period of supply deficit.

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


Source: Thomson Reuters

The lower oil prices have raised the possibility of an extension to the OPEC's agreement to cut oil production, which is due to expire at the end of June. Overall, the bigger picture is more positive in 2017 than 2016, but three main uncertainties could pose risks to the expected USD55.0 a barrel average of Brent crude price. The first risk is weather OPEC members agree to renew its November's cuts deal in the second half of 2017 and, if so, in what form. The second risk is due to the rising shale production in the US, as the rig counts reached 756 by beginning of March, with output growth of 0.6mb/d since the beginning of this year. The third risk is related to the political conflicts in Nigeria and Libya, as their production could either tighten or loosen the market supply. On the supply side, in the US, shale producers continue to focus their capital on the Permian basin, as output in this basin is expected to rise by 0.4mb/d y/y in 2017. Meanwhile, drilling activity in the Eagle Ford has ramped up recently after the sharp declines in 2016, while Bakken drilling activity remains sluggish, according to the EIA. Beyond the concerns of rising production from some of non-OPEC countries, the implementation of OPEC production agreement appears in February to have maintained a solid start as seen in January. The compliance rate averaged 98% in the first two months, as this rate is influenced by Saudi Arabia whose compliance rate was much higher at 135%. In the other eleven non-OPEC countries part of the deal, including Russia, that pledged to cut 0.6mb/d of production the data are far less visible. Russia, which makes up more than half the total non-OPEC reduction, has repeatedly confirmed that its cut would be gradual. According to IEA, the non-OPEC countries have cut production by 37% of their commitment in the first two months of the year.

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




Source: OPEC Survey

On the demand side, world oil demand grew by 1.4mb/d in 2016 to average 95.05mb/d, according to OPEC Bulletin. It was revised up as a result of positive adjustments in the 4Q16 data, accounting for the most up-to-date figures from regions around the world. OPEC forecasts oil demand in 2017 to reach 96.3mb/d, showing an increase of 1.26mb/d. The majority of the incremental oil demand in 2017 is anticipated to originate from Asia, led by India, followed by China, then OECD America. But it is expected that demand by OECD Asia Pacific to reduce its oil requirements in 2017 compared to 2016.

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# Foreign Exchange

## Fed Reaffirms Monetary Normalization

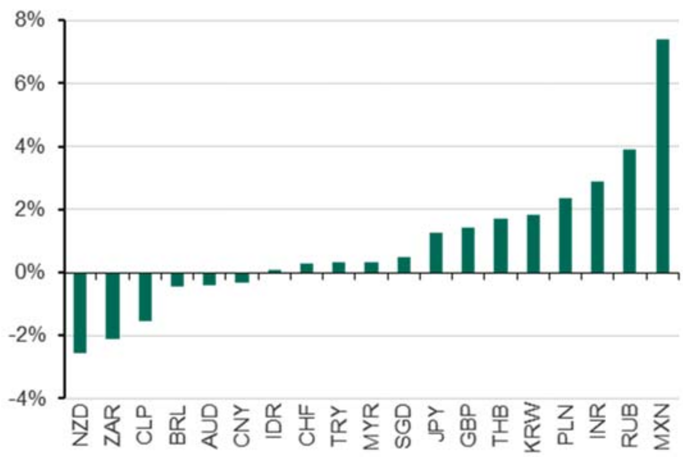
Forex markets are bullish on the dollar which began regaining momentum in February on the back of a rising March rate hike expectation. On the March FOMC meeting the hike expectations were actualized as the Fed announced the new target for the Fed's funds rate to rise by 25 bps to range between 0.75%-1%. Barring unexpected shocks for the US and the global economy, the probability remains high for another two rate hikes this year. Labor market conditions indicate that the recovery has been sustainable with unemployment remaining below the non-accelerating inflation rate of unemployment (NAIRU) of 5%, standing at 4.7% in February. Non-farm payrolls continue to demonstrate solid job creation of over 200,000 positions during the same month.

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


Source: Thomson Reuters

In addition, core PCE inflation stand at 1.7%, approaching the 2% Fed target which it deems appropriate for price stability and maximum employment. However, uncertainty emanating from the new pro-business, pro-growth fiscal policies might impact the profit margins of transnational US corporations as they will be aimed at encouraging exports and penalizing imports, in addition to repatriating corporate off-shore profits. As it appears, the strengthening outlook for the USD will evidently be at conflict with the fiscal direction of increasing export competitiveness although the Fed strongly remarks its independence from Washington. Predicated on the premise that the US remains the least challenged advanced economy, we expect to see above trend GDP, higher inflation, and higher US corporate profitability, all of which will underpin upcoming Fed tightening. The USD had already factored in the rate hike, evident by the trade-weighted dollar standing at 100.7 by mid-March, ticking down by 1.4% since the beginning of the year.

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




Source: Thomson Reuters

The Eurozone is still dealing with the Brexit aftermath, and Prime Minister May invoked article 50 which starts the formal process of withdrawing from the EU this week. Given Brexit, the UK's economy appears to be holding on well as it grew by 2% in 4Q2016. In addition, the Bank of England adopted a neutral policy bias in March, keeping policy rate unchanged at 0.25%. However, as inflation approaches the central bank's 2% target at 1.8%, the BOE is expected to turn hawkish in the coming months. The GBP's movement has been range-bound since the beginning of the year, hovering around USD1.23. The EUR, on the other hand, started the year trading at the lowest levels since 2003, bottoming up at 1.038 for the dollar on the back of a strong USD and extended quantitative easing. However, the single currency showed resilience as it regained around 2.1% YTD by mid-March, standing at USD1.07. Diverging growth and monetary policy between the US and the Eurozone will keep the EUR under pressure in 2017, potentially pushing it below par with the USD. The JPY was the worst G10 performer in the fourth quarter of 2016 due to higher interest rates in the US which led to a wider US-Japan interest rate differential. The pro-risk environment has been positive for US equities and risky assets while negatively impacting safe-havens such as the yen. Nevertheless, the Bank of Japan's rate announcement was uneventful, opting to keep rates at negative 0.1%. Consequently, the JPY strengthened by 3.1% YTD by mid-March to 113.4/USD.

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# Commodities

## Commodities Maintain Upside Momentum

Starting the year 2017, we witnessed the firming up of several commodities, namely oil, base metals, and food grains. Declining investment in emerging and developing economies (EMDEs) and capital repatriation reflect that investors are seeking to benefit from interest rate differentials as US yield curves steepen. Investment growth in commodity exporting EMDEs fell from 7.1% in 2010 to just 1.6% in 2015 indicating lower growth prospects and deteriorating terms of trade. Higher political risks in some of the major EMDEs such as Brazil will also exacerbate the slowdown in investment, trickling down to the commodities exported by these countries. According to the World Bank, the fall of commodity prices account for 1.5% of the total decline in investment growth between 2011 and 2015. The repatriation of investment money from EMDEs unwinded the commodity super-cycle which tumbled the Reuters-Jeffries commodity index from 370.6 on April 2011 to 155 on February 2016, approximately 139% from peak to trough. Commodity prices stabilized into 2017 despite the terms of trade shocks that befell commodity exporters in 2015-2016.

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


Source: Thomson Reuters

Weaker investment prospect let to expectations of tighter future supply of commodities, namely base metals such as copper and aluminum. On a YTD basis, copper upturned by 5.9% by mid-March, standing at USD5,863/ton. Despite the Chinese New Year, which should effectively decrease trade volumes as China accounts for half of the world's demand for the red metal, copper maintained upward trajectory supported by speculation of the USD1 trillion infrastructure bill in the US. Nevertheless, the US accounted for only 8% of global copper demand in 2015, and the impact of the Trump infrastructure plan should span over 10 years. The closures of high-cost and high-carbon print smelters, in addition to ore export bans, will provide support to metals such as aluminum which marked a surge of 11.5% YTD by mid-March at USD1,887/ton. The demand for aluminum was robust in 2016 despite the slowdown in China. According to the National Bureau of Statistics, aluminum semis grew by 12% YTD as of November, with China consuming around 55% of the global total. Construction and automobile production are expected to keep demand for aluminum high throughout 2017, underpinning prices.

**Chart 6: Base Metals**


Source: Thomson Reuters

Falling investment demand on gold in response to a stronger USD and higher interest rates in the US led the yellow metal to fall below the USD1,300 level seen during 2H2016. However, President Trump's recent rhetoric that the dollar is "too strong", coupled with his fiscal stimulus plan pressured the trade-weighted USD to moderate versus a basket of currencies. Consequently, gold prices caught respite from January through mid-March, rising by 5.9% YTD to USD1,220/oz. Downside risks for gold in 2017 include strong economic growth and more rate hikes in the US. On the other hand, upside risks include geopolitical tension, stronger physical demand in India and China, and mining shortfalls. The S&P/Goldman Sachs agricultural index edged up 2.3% YTD to 297.7. Improved yield prospects for food grains will limit their recovery in 2017. However, conditions for global production are favorable as higher production is expected to be met with increasing demand. By mid-March wheat prices increased 6.9% YTD to 436 cents/bushel whereas corn prices inched up by 3.3% to 363.5 cents/bushel over the same period.

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# Money & Inflation

## Negative Income Effect Reduces Demand

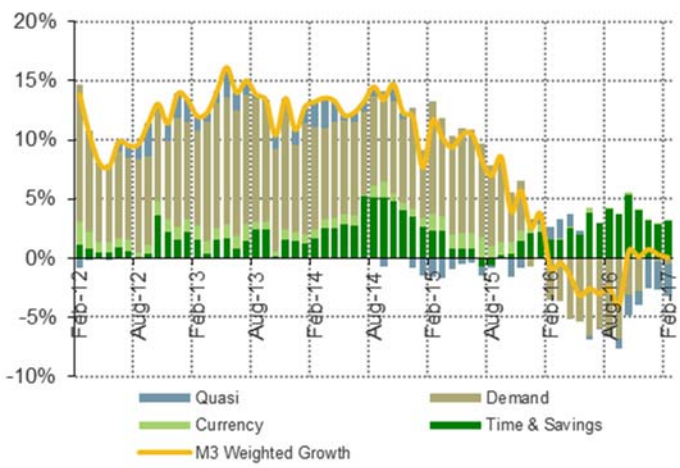
An oversupplied oil market continues to weigh on prices and in turn on Saudi finances. The domestic monetary system remained pressured for the majority of 2016 as the economy undergoes an ambitious transformation plan. Saudi Vision 2030 and the National Transformation Plan 2020 as well as the recently announced Fiscal Balance Program are providing the framework to create a sustainable economy by increasing non-oil revenues and reducing reliance on oil. This transition has pressured local liquidity, however, following a series of SAMA interventions over the past six months, as well as an oil accord between OPEC and non-OPEC oil producers, the narrowest measure of money supply (M0) registered its highest annual growth at 2.7% in January. The largest component of M0, currency outside banks, reached SAR169.3 billion, gaining 1.1% on an annual basis, while cash in vault spiked 8.7% to SAR31.2 billion, possibly due to the issuance and rolling out of new currency note bills. Meanwhile, deposits with SAMA rose by 3.6%.

**Chart 7: Growth in Monetary Aggregates**


Sources: SAMA and NCB Estimates

As for the broadest measure of money supply (M3), annual growth remained almost flat at 0.3% to settle at SAR1.77 trillion. Representing 55.4% of M3, demand deposits registered SAR980.6 billion by the end of January, the highest level since May 2016 albeit posting the 14th consecutive annual decline at 0.5%. Meanwhile, time and savings deposits rose by 12.0% Y/Y to SAR469.8 billion. The varying pace of growth between these types of deposits is likely to continue as the interest rate environment maintains its upside movement, given the monetary normalization by the US. Additionally, the elevated economic and credit risks triggered a wait-and-see approach by Saudi banks as the excess reserve ratio, which is represented by deposits with SAMA other than statutory deposits, increased to 53.7%, the highest level since January 2014. The government is expected to announce stimulus package targeting the private sector over the coming months which will provide banks with a strategic direction going forward.

**Chart 8: Money Supply, Contribution**




Sources: SAMA and NCB Estimates

The annual inflation rate fell into the negative territory for the first time since the index was rebased to 2007. Largely due to the base effect, the cost of living index registered a contraction of 0.4% on an annual basis as the effects of last year's subsidy reductions on energy mitigated and the negative income effect from reduced allowances reduced consumer demand. Accordingly, the transport sub-index contracted by 3.1% annually, while the housing and utilities sub-index posted a gain of 1.2% Y/Y in January 2017 in comparison to rise of 8.3% Y/Y in January 2016. The uncertainty revolving around the Ministry of Housing's initiatives and implementation of white land tax have also contributed to weakening the real estate market. In addition, prices for food and beverages posted the seventh consecutive annual decline at 4.2% for the month of January as global food prices stagnated in the second half of 2016 coupled with a strong US dollar, thus, reducing the import bill domestically. Prices for tobacco soared 19.9% as the government plans to penalize demand for harmful goods. Additional taxes on tobacco, soft drinks, and energy drinks over the coming months will support prices even higher. Subsidies on electricity and gasoline will be removed in July this year, raising the headline inflation and reducing disposable income for individuals which could hinder demand for other non-durable goods in the short-term. We expect the inflation rate to average around 2.5% in 2017 largely driven by cost-push inflation.

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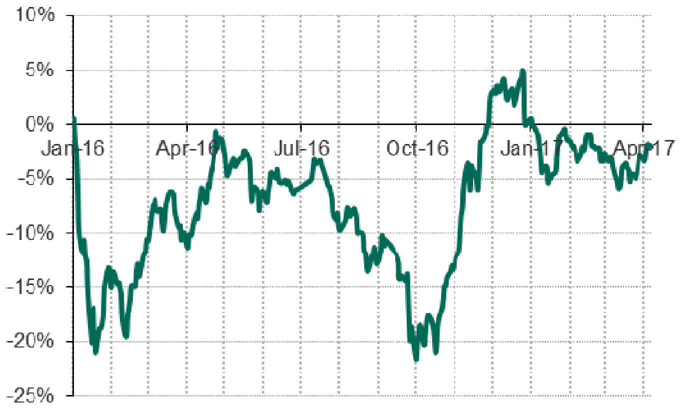
# Capital Markets
## Range-bound Market

Global equity markets maintained their positive stance well into this year, a clear inflection from the rout witnessed at the beginning of 2016. It seems investors' obsession with the Fed rate increases had relatively abated, trumped by the growing understanding that the hiking cycle will be a gradual one. The benchmark indices for the world, G7 and emerging markets had registered gains of around 7%, 6% and 12%, respectively according to the MSCI World indices.

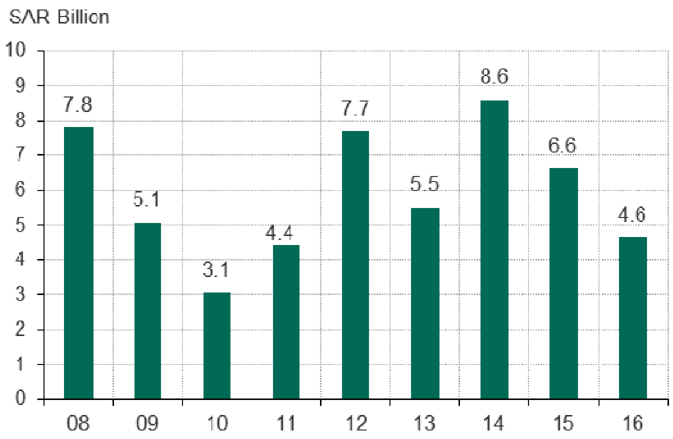
**Chart 9: Tadawul All-Share Index**




Source: Tadawul

The Saudi stock market, Tadawul, continues to diverge from its international counterparts registering a year to date decline of around 4%, with 14 out of the 20 subsectors in the negative territory. During February, the market declined by 1.82% to close at 6,972.39, which follows a 1.5% decrease in January. Ostensibly, there are no driving factors at the moment, given the negative income effect from last year's decision to freeze salaries and slash allowances as well as the lack of an upside momentum in oil prices, with markets weighing the possibilities of extending the agreed upon cuts by OPEC members that will end this June. Looking ahead, the economy is undergoing a transition that will be structurally challenging and as such a wait-and-see approach had been adopted by individuals and businesses. The coming months will witness the introduction of an excise tax on harmful products in 2Q, an expat levy starting 3Q and a full adjustment to electricity prices that will be linked to international levels. Given the aforementioned, we do believe that TASI will remain range-bound during the medium-term. Regarding the sectoral performance, the heavyweight sectors remained in the red, namely materials, food & beverage, and banks, that registered year-to-date declines by 0.7%, 3.1%, and 5.2%, respectively, by the end of February. The weakest sector was media and publishing, recording a decline of around 18% since the beginning of the year, followed by the transportation sector, which fell by 15%. Investors' appetite, represented by the average daily trading volumes, fell during February to SAR3.8 billion from SAR4.5 billion during the previous month, underscoring the wait-and-see theme mentioned earlier. The majority of trading continues to be attributed to Saudi individuals, representing around 87%. Individuals, QFIs and the government funds were net sellers while Saudi institutional investors and GCC investors were net buyers. Interestingly, even though direct investment by QFIs was permitted since June 2015, the capital inflows to Saudi equities have been limited, standing at a meager SAR1.9 billion, equating to 0.1% of market capitalization.

**Chart 10: Average Daily Traded Value**




Source: Tadawul

In line with the volatile secondary market, the primary market witnessed just a single activity since the beginning of the year, AlJazira Mawten REIT Fund. Ostensibly, IPOs for this year and next will be delayed, with companies factoring in the current dynamics in the secondary market and the broader moderate business cycle. Yet, the government's privatization program might counter the slowdown on the part of businesses, especially that the National Center for Privatization was established with the aim of privatizing sectors such as utilities, healthcare and education. Going forward, developments concerning government funds will be critical to the market, given that they have been net sellers of late, with no investments in January and February, the first time since investors breakdown data became available.

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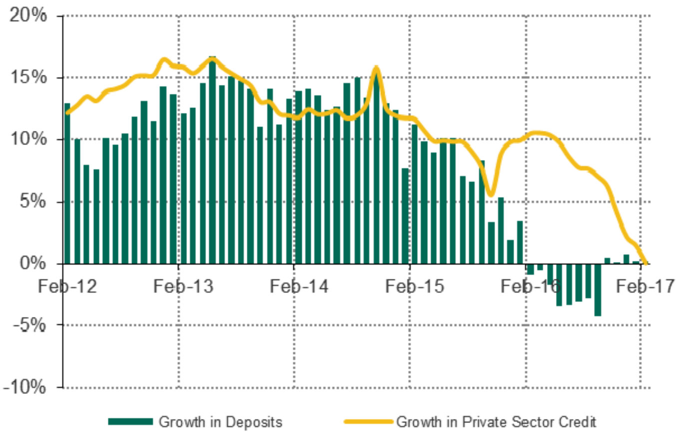
# Loans Market
## Saudi Transition Hinders Credit Market

The fiscal deficit is expected to remain in place for the fourth year running on the back of higher government expenditure towards targeted programs. During the past two years, reduced inflows from oil revenues have limited the spillovers into the banking system. Forming the base of banks' balance sheets, total deposits in the Saudi financial system reached SAR1.6 trillion by the end of January, registering a marginal growth of 0.2% on an annual basis. Banks utilize deposits to provide financing needs and SAMA regulates the banking system leverage to mitigate risks domestically. The majority of deposits are demand based with a share of 61.3% as businesses and individuals contribute 93.6% while government entities hold the remaining 6.4%. The drop of 0.5% Y/Y in demand deposits was undermined by a 12.0% Y/Y rise in time and savings deposits. Additionally, other quasi-monetary deposits dropped by 22.1% annually as foreign currency deposits decreased by 23.9% Y/Y, the sixth consecutive drop as government entities continued their substantial withdrawals to cover their cash flow needs. Outstanding remittances continued its sharp downfall by 23.6% while letters of credit declined by 3.5% on an annual basis.

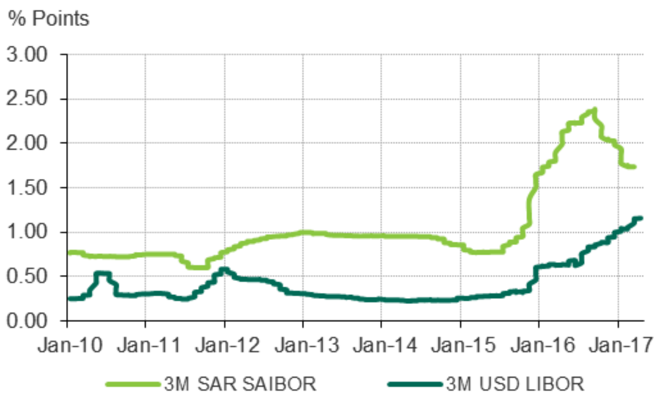
**Chart 11: Private Sector Financing**




Sources: SAMA and NCB Estimates

Assessing the other side of the balance sheet, total credit of the banking system decelerated to an annual pace of 1.6% during January, the slowest pace since April 2010. The loans-to deposits ratio reached 87.3% in January, well below the 90% limit that was breached during last year's liquidity strain. By Maturity, short term credit's share of total credit fell below 50% as short term credit posted SAR696.7 billion, losing 0.8% annually. Banks' attempts to raise their depositary base by offering lucrative rates on time and savings products is reflected by the rise in long-term credit by 1.6% Y/Y, reaching a record SAR438.7 billion. Meanwhile, medium-term credit contracted by 3.8% annually to settle at SAR261.0 billion. The macroeconomic backdrop will continue to pressure the loans market in 2017 and 2018 as restructuring the economy will lessen the need for financing during the transitional phase.

**Chart 12: Liquidity and Risk Detector**




Source: Thomson Reuters

As for the private sector, banks extended credit lines to businesses in the amount of SAR4.2 billion during the month of January. On an annual basis, credit to the private sector grew by 1.4% to reach SAR1.36 trillion. The credit cycle's delayed downturn was supported largely by corporate credit which utilized financing to manage their cash flows up until 1Q2016, however, corporate credit decelerated significantly in 2016 to register a mere gain of 0.5% by the end of the year. Additionally, claims on the public sector gained 2.4% Y/Y as government bonds climbed to SAR178.3 billion, an annual spike of 105.8%. meanwhile, treasury bills holdings have been reduced to SAR26.1 billion, the lowest level since 2007. Liquidity strains in the domestic market peaked in October, pressuring the Saudi interbank rate (SAIBOR) to 2.39%, rising above SAMA's repo rate of 2%. The emerging market's record sovereign bonds issuance along with SAMA's interventions eased domestic pressures, driving the SAIBOR to 1.79% by the end of February. The recent increase from the Federal Reserve in their main benchmark interest rate by 25bps triggered SAMA to mirror the decision by raising the reverse repo rate from 75bps to 100bps which did not affect the local market. However, two more hikes are anticipated by the Fed in 2017 and another three in 2018, which will force SAMA to raise accordingly due to the currency peg and, in our opinion, this will be countercyclical for the local economy.

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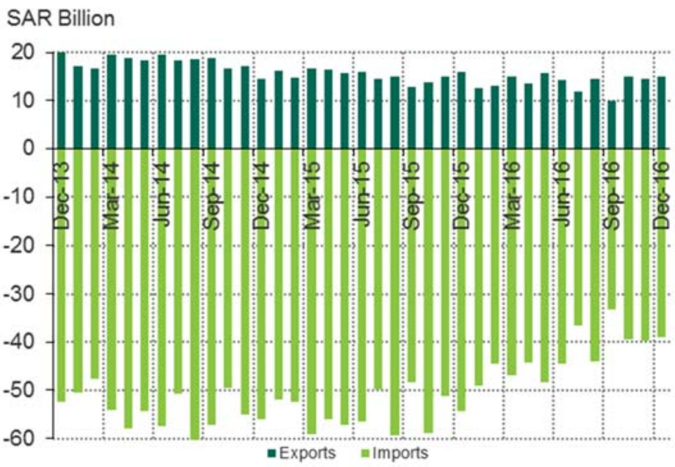
# External Trade

## Trade Reflect Global Dynamics

Upon concluding year 2016, non-oil trade remained down-trending as a sign of persistently weak global and local demand. Weak global commodities also play a role in lower non-oil trade growth as over 60% of non-oil exports are essentially oil derivatives such as plastics and chemical products. In the month of December, total non-oil exports reached SAR14.9 billion, sliding by 10.3% Y/Y. On the other hand, total imports recorded SAR38.9 billion, tumbling by 28.4% compared to the same period last year. In addition, the National Transformation Plan 2020 and Vision 2030 mandates exacerbate and reinforce this trade pattern as a consequence of the structural change underway. The Kingdom is moving away from oil reliance; a transition that proves challenging under the current circumstances. Moreover, the Kingdom's adamancy to reduce the government deficit meant tighter control over fiscal spending and a higher focus on efficiency; thus, the import bill was slashed by over a quarter compared to last year.

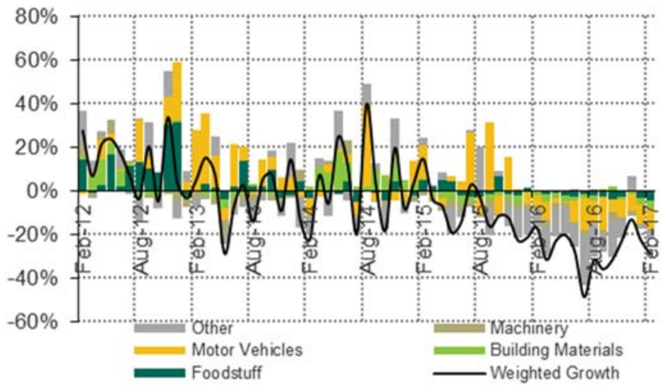
**Chart 13: Saudi Non-Oil Trade Balance**




Sources: SAMA and NCB

By composition, exports of plastics which account for 31.9% of the monthly total stood at SAR4.8 billion, upturning 5.3% Y/Y. Despite the slowdown in China, global demand for plastics have been resilient. Annualized increases in plastics have become more common after August, indicating a spillover from the OPEC deal. Exports of chemical products on the other hand continued declining on an annual basis, sliding by 12% at SAR4.5 billion. The vertical diversification of hydrocarbons puts the Kingdom at a key global advantage, extending the chain of production for the largest holder of proven oil reserves in the world. The chemical complex in Saudi Arabia which is a pioneer in the GCC since the early 1970s via the inception of SABIC and its likes benefitted as a first mover from the acquisition of patents and licenses from major technology providers compared to its GCC counterparts. In addition, relatively low feedstock cost, economies of scale, access to cheap capital, and unwavering government support are key enablers for the sector, allowing the Kingdom to become the 9th largest polymer producer in the world. Furthermore, exports of base metals declined by 3.9% Y/Y to SAR1.2 billion. Regarding export destinations, the UAE received 15.2% of the monthly total at SAR2.3 billion. Compared to last year, non-oil exports to the UAE tumbled 17.7% on the back of slowing re-exports to China. Moreover, exports to China declined by 18.5% Y/Y, valued at SAR1.7 billion whereas exports to Singapore surged by 12.9%Y/Y to SAR0.8 billion.

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




Sources: SAMA and NCB

On the imports side, the bill for machinery and electrical equipment was slashed by 31.8% Y/Y, standing at SAR9.3 billion as construction activity is slowing down. Imports of vehicles and transport equipment recorded the largest annualized decline during the month, tumbling by 41.8% to SAR7.6 billion, indicating lower demand. Furthermore, imports of chemical products declined by a sizeable 16.4% on an annual basis on the back of slower manufacturing. The nature of items imported shows that 73% of all imports are finished goods, while 24% are semi-finished and only 3% were raw materials. The United States accounted for 18.8% of the import bill by origin at SAR7.3 billion, falling by 10.6% annually. China comes second accounting for 13.1% at SAR5.1 billion, tumbling by 20.7% Y/Y whereas German imports saw an annualized 39.2% decline in value terms, posting SAR2.3 billion.

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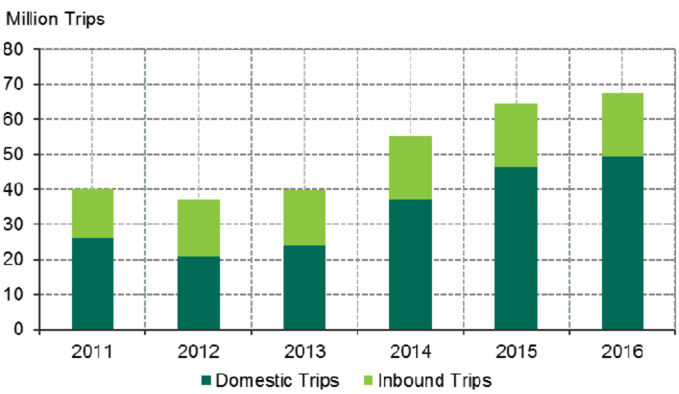
# Special Focus:
## A Promising Service Sector

Saudi Arabia embarked on reforming the tourism sector less than 20 years ago when the Supreme Commission for Tourism was founded in 2000, currently known as the Saudi Commission for Tourism & National Heritage (SCTH). The main aim of the commission is the development, promotion, and enhancement of Saudi Arabia as a domestic and international tourist destination. The continued government support to SCTH was underscored by raising the budget allocation from just SAR45 million in 2001 to SAR814 million in 2015. The tourism sector's contribution to GDP reached 3.8% in 2016, representing SAR91.3 billion. By the year 2020, SCTH is targeting to reach 1.2 million direct jobs in the sector, increase local and foreign investments, and expand the tourism market to SAR118.8 billion. The government set SAR10.5 billion to achieve the abovementioned targets as part of the National Transformation Plan 2020.

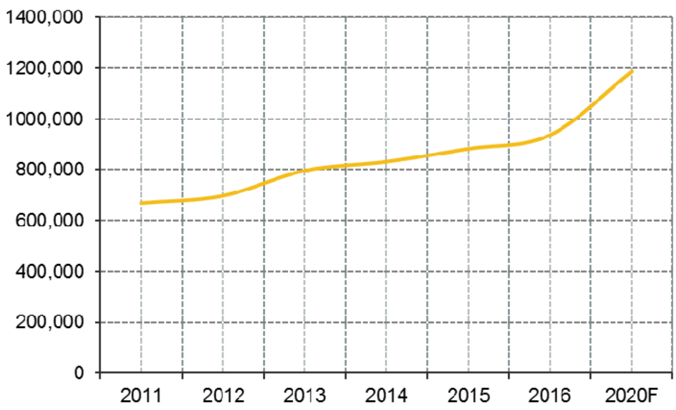
**Chart 15: Saudi Domestic and Inbound Trips**




Sources: MAS and NCB Estimates

Domestic (citizens and residents touring local destinations) and inbound (international tourists arriving to Saudi for religious/leisure or business purposes) trips registered a 4% annual growth in 2016 by reaching an estimated 67.4 million trips, according to our forecasts. Religious trips for Hajj and Umrah constitute the bulk of local tourism and given the geographical location of the Holy mosques, the western region is the recipient of almost 60% of all trips. The completion of the northern expansion of the Holy Mosque in Makkah, coupled with the Haramain railway which connects Madinah-Jeddah-Makkah will support the increasing demand for religious trips. Earlier this year, the government announced gradually increasing quota limits for Hajj pilgrims from last year's 1.9 million to 2012's peak of 3.2 million, a rise of almost 70%. In addition, Jeddah's airport mega project and Madinah's recently built airport will provide the capacity needed for the influx of domestic and international trips.

**Chart 16: Tourism Sector Direct Jobs**




Sources: MAS

Travelers to Saudi provided an estimated influx of SAR90.8 billion in 2016 as inbound expenditure registered a growth of 10.2% on an annual basis. Meanwhile, domestic tourism expenditure is expected to have reached SAR53.4 billion in 2016, rising from SAR47.9 billion in 2015. Additionally, over 20 million outbound tourism flights have been recorded last year. According to VISA's Global Travel Intentions Study 2015, despite the general trend in decreasing leisure expenditures, Saudis claimed top spot by spending an average USD5'866 per trip. The government is keen on diverting Saudis from foreign leisure as the recently established General Entertainment Authority (GEA) sponsored over 50 events YTD such as the internationally recognized Comic-con in Jeddah and the cultural King Abdulaziz Camel Festival in Riyadh. Building on the Kingdom's geographical diversity, SCTH have registered four UNESCO World Heritage sites with additional submissions still under review. Furthermore, the government is actively investing in the development of Farasan Islands, Okaz City, and Ola City, as well as planning the largest Islamic museum. Archaeological excavations are underway to preserve rock art in Jabbah and Shuwaimis similarly to the Nabataean city of Mada'in Salih. Saudi is aiming to increase household spending on entertainment from the current 2.9% to 6% by 2030. In addition, Vision 2030 targets to expand Umrah visitors from 8 million annually to 30 million annually and to provide extendable visas for tourism purposes. The outlook for Saudi tourism remains bright as the non-religious segment of the market is largely untapped which will underpin a strategic service industry towards Saudi Vision 2030.

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