

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- On fundamentals, while the market continues to be fairly balanced, it points to market weakness in the months ahead. The supply side, however, continues to face shortfalls with the North Sea, in particular, seeing several cargoes delayed in October.
- Even though the Trade-weighted Dollar had intensified its losses since last month, losing 2.17% YTD, we expect to see a range-bound movement in the coming weeks.
- Commodity trading posted lower figures as demand for raw materials faltered on the continued slowdown in global growth. Metals were largely impacted as copper posted its biggest weekly fall in two months.
- A glance at Saudi Arabia's monetary aggregates in August reveals expanding liquidity which should support elevating local prices, but that is not the case for the latter.
- A handful of companies have already announced healthy third quarter corporate earnings albeit missing on estimates. While investors anticipate the remaining announcements, stock prices are expected to be pressured throughout October.
- Local banks continue to demonstrate their willingness to expand their balance sheets; however, the expected difficulties from Al Mojil Group (MMG) might derail the risk taking stance.
- In our opinion, seasonality was an important factor at play that can justify the negative monthly growth rates on the export and import side based on historical data that reflects a consistent decline in the summer months.

View of the Month

'Residential Real Estate Financing'

The residential lending market in the kingdom overwhelmingly consists of loans by commercial banks, however, the mortgage market, upon the implementation of the mortgage law, has the potential to attract non-bank lenders to this market.

Macroeconomic Indicators

	2007	2008	2009	2010	2011P	2012F	2013F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	68.3	94.9	59.2	77.6	108.1	105.0	110.0
Average Daily Crude Oil Production, MMBD	8.8	9.2	8.2	8.2	9.3	9.9	10.1
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,679.1	2,163.1	2,272.3	2,437.3
GDP at Current Market Prices, USD billion	385.2	476.9	377.2	447.8	577.6	606.8	650.8
Real GDP Growth Rate	2.0%	4.2%	0.1%	4.6%	6.8%	5.1%	4.2%
Oil Sector GDP Growth Rate	(3.6%)	4.2%	(7.8%)	2.4%	4.3%	6.4%	2.2%
Non-oil Sector GDP Growth Rate	4.7%	4.3%	3.5%	5.5%	7.8%	4.7%	4.9%
Population, million	24.9	25.8	26.7	27.6	28.4	29.2	30.1
Population Growth Rate	3.4%	3.4%	3.4%	3.4%	2.9%	3.0%	3.0%
GDP /Capita, USD	15,444.2	18,495.4	14,147.9	16,244.8	20,355.1	20,760.4	21,619.2
CPI Inflation, Y/Y % Change, Average	4.1%	9.9%	5.1%	5.3%	5.0%	4.8%	4.5%
External Sector							
Merchandise Trade Balance, USD billion	150.6	212.0	105.2	153.7	244.7	276.3	306.8
Oil Exports, USD billion	205.3	281.0	163.1	215.2	317.6	355.1	379.1
Non-oil Exports, USD billion	27.8	32.3	29.1	35.8	46.9	48.4	61.7
Merchandise Imports, USD billion	(81.5)	(100.6)	(86.4)	(96.7)	(119.1)	(127.1)	(134.1)
Net Unilateral Transfers, USD billion	(17.0)	(23.0)	(27.7)	(27.9)	(29.4)	(32.1)	(35.1)
Current Account Balance, USD billion	93.3	132.3	21.0	66.8	158.5	171.1	199.8
Current Account Balance/GDP	24.2%	27.7%	5.6%	14.9%	27.4%	28.2%	30.7%
Net Foreign Assets with SAMA, USD billion	301.3	438.5	405.9	441.0	535.9	642.5	718.3
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	380.0	410.0	475.0	540.0	580.0	690.0	759.0
Actual Revenues, SAR billion	642.8	1101.0	509.8	741.6	1110.0	1146.8	1220.1
Actual Expenditure, SAR billion	466.2	520.1	596.4	653.9	804.0	771.8	818.2
Expenditure Overrun, %	22.7%	26.8%	25.6%	21.1%	38.6%	11.9%	7.8%
Total Revenues/GDP	44.6%	61.6%	36.1%	44.2%	51.3%	50.5%	50.1%
Total Expenditure/GDP	32.3%	29.1%	42.2%	38.9%	37.2%	34.0%	33.6%
Overall Budget Balance, SAR billion	176.6	580.9	(86.6)	87.7	306.0	375.0	402.0
Budget Balance/GDP	12.2%	32.5%	(6.1%)	5.2%	14.1%	16.5%	16.5%
Break-Even Oil Price	40.5	40.2	60.8	64.1	70.4	62.2	65.0
Financial Sector							
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	19.6%	17.6%	10.7%	5.0%	13.3%	9.7%	7.7%
Growth in Credit to the Private Sector	20.6%	27.9%	-0.6%	4.8%	11.0%	15.9%	15.1%
Average 3M SAR Deposit Rate	4.9%	3.3%	0.9%	0.7%	0.7%	0.8%	1.0%
Average 3M USD Deposit Rate	5.2%	3.0%	0.7%	0.4%	0.3%	0.4%	0.4%
Spread, in Basis Points, SAIBOR-LIBOR	(31.9)	29.7	17.5	38.0	39.5	40.0	60.0

Oil Market

Demand Still Subject to Uncertainty

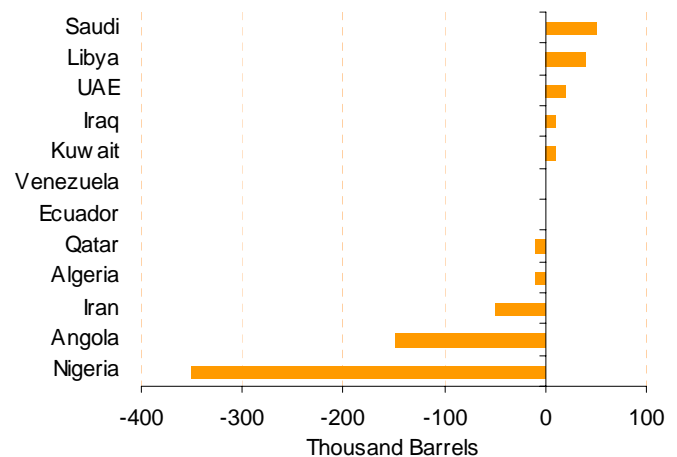
Since early October, oil prices have seen a divergence with Brent surging above USD115/bbl as the situation in Syria has deteriorated. Crude oil markets drifted higher, departing from its relatively tight trading range. The balance between economic fears and the deepening of geopolitical complexity has been broken, with Brent prices surging by more than USD6 over the past week. The upward momentum is driven by deepening of geopolitical developments, especially with rising conflict on the Turkey-Syria border, and tightening of inventories. The front month Brent contract surged above the USD115/bbl mark, to levels last seen in mid September, and registered relatively stronger gains than the equivalent WTI contract. As a result, the prompt month WTI - Brent differential has continued to widen, settling above USD23/bbl and reaching its highest value since October of last year.

On fundamentals, while the market continues to be fairly balanced, it points to market weakness in the months ahead. The supply side, however, continues to face shortfalls with the North Sea, in particular, seeing several cargoes delayed in October. In addition, preliminary August data shows that total OECD commercial oil stocks dropped by 29 mmbd, and were 46 mmbd below the five-year average. In addition, The US latest data release shows a further decline in oil product inventories, with distillate inventories now 30.3 mmbd below their five-year average. While forward cover stood at a rather comfortable 58.4 days at the end of August, clearly tightening inventories are supporting prices.

Meanwhile, the biggest market uncertainty is the production trajectories of Iran, and Iraq. Iraq produced 3.3

mmbd at the end September, the highest rate since 1979. In June it surpassed Iran as the second-biggest producer in OPEC. Iran can probably maintain a production level of 2.7 mmbd at the current level of sanctions. One unforeseen consequence of the sanctions has been to support prices, and in doing so soften their impact on the Iranian government. Meanwhile, Saudi Arabia stated that its crude supply at 10 mmbd is adequate for now. In addition, the Kingdom reiterated its position to meet the market demands fully and to see Brent crude prices decline closer to USD100/bbl.

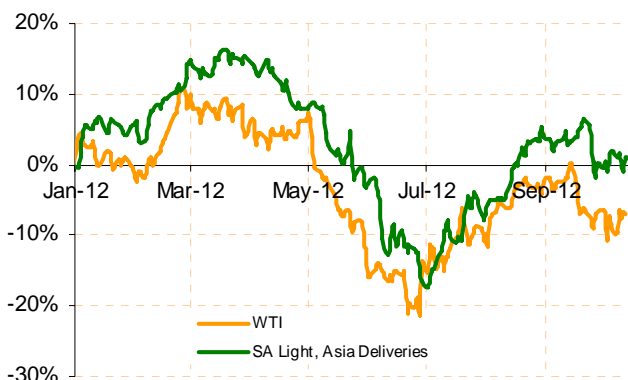
Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, OPEC's report raised its estimate for the Call on OPEC crude by 220,000 barrel per day and 250,000 barrel per day for 2012 and 2013, respectively, despite lowering its projections for 2012 economic growth by 0.2% to 3.1%. Demand continues to be subject to extreme uncertainty. The current unclear economic picture is making next year's oil demand growth forecast a difficult task, not only due to economic growth projections, but also affected by retail petroleum prices, and possible abnormal weather. While the sovereign debt issues of Spain and Italy, which constitute almost a third of the Euro-zone's economy, have so far been contained, risks to the global economy have increased as European policymakers continue to grapple with the ongoing debt crisis. Accordingly, excluding oil, prices broadly moved lower across the commodities complex, triggered by resurgence in macro pessimism, particularly focused on the growth outlook for China.

Chart 1: Oil Price Developments, YTD



Source: Thompson Reuters

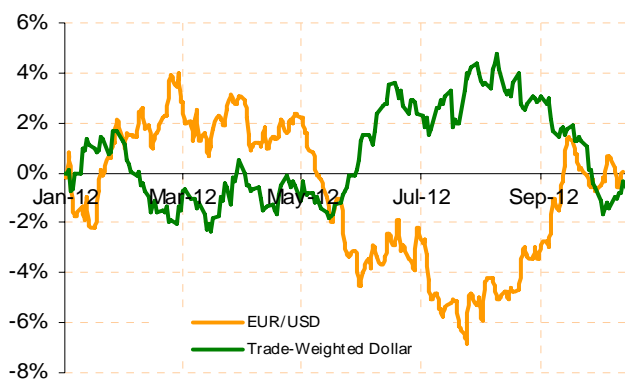
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Foreign Exchange

Central Banks to Maintain Composure

Financial markets sent mixed signals in reaction to the Fed's and the ECB's announcement last September concerning new rounds of quantitative easing. Conversely, the anticipation for the European Stability Mechanism (ESM) to kick in added volatility after the German constitutional court turned down pleas to block it, and approved a new bailout fund for the Euro region. Even though the EUR lost against most of its counterparts during last week, the improved business sentiments for the second consecutive month in October, from -23.3 to -22.2, according to Sentex Research Group, given the German constitutional court's ruling in favor of the ESM had helped to cushion the currency from further downfall. The EUR closed last week at a loss of 0.7% against the greenback, which reduced its YTD gain to just 0.10%. In addition, another factor that supported the Euro is the rise in German exports by 2.4% M/M; although Germany is predicted to slowdown in Q3. The Euro is expected to maintain a range-bound tone against USD in the short run within 1.28 – 1.31, due to uncertainties surrounding Spain's request of a sovereign bail-out and Italy's political direction.

Chart 3: Trade-Weighted Dollar and the Euro



Source: Thompson Reuters

The JPY remains on the positive side against the USD, posting a 1.62% YTD gain, even after the Bank of Japan's decision on further monetary easing in their meeting last month. The bank will expand its asset purchasing program by JPY 10bn to JPY 55bn, a process that is expected to raise real interest rates and add more appeal to the currency of the world's third largest economy, which is targeting an inflation rate of 1%. The Yen owes its appreciation to the constant announcements of quantitative easing programs by the US and EU, with the Fed's recent announcement of QE3 adding to the fears

from debasement effects. Japan, which continues to look for an export-led recovery is expected to carry out its easing cycle into next year as the IMF's outlook on global economic and trade growth continues to be revised downwards. A sideways movement will remain the order of the day for the USD/JPY, with the pair being capped below 79 mark since May.

The Chinese Yuan weakened slightly against the USD as firms' demand for cash lessened after the long holiday; although, the CNY reached an all-time high of 6.2849 which was spot-traded on September 28th, a level that almost hit the non-trading band. The Yuan closed on 6.2882 on October 8th, losing 0.05% against the greenback. China has been displaying weak economic data since April which is affected, on part by the slowdown in US and Eurozone demand for Chinese exports, as well as a waning local demand.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

In Latin America, Brazil's central bank proactively intervened to curb the real's gains in order to defend it from losing comparative advantage in exports, driving it to trade close to 2 reals per dollar. However, the recent Euro region's developments, manifested in the German constitutional court's ruling managed to exert additional upside pressure on the BRL that maintains a 9.03% YTD gain. Elsewhere in Latin America, the Mexican Peso along with the Chilean traded mixed as positive news from Europe failed to have a significant impact on both currencies. To conclude, even though the Trade-weighted Dollar had intensified its losses since last month, losing 2.17% YTD, we expect to see a range-bound movement in the coming weeks with so many factors negating each other, whether it be the US elections, EU sovereign woes or China's worst economic performance since 1990s.

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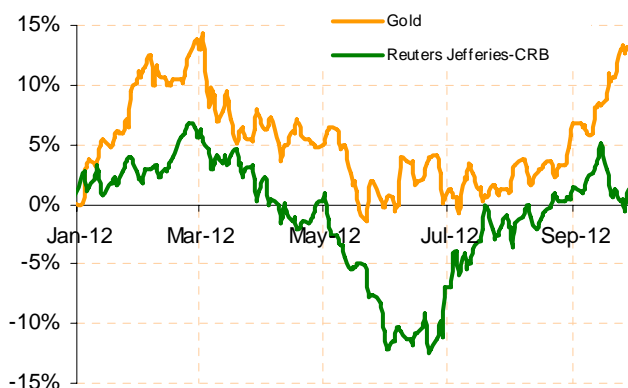
Commodities

Tumbling Amid Slow Global Growth

Commodity trading posted lower figures as demand for raw materials faltered on the continued slowdown in global growth. Metals were largely impacted as copper posted its biggest weekly fall in two months as top consumer, China, which accounts for approximately 40% of global copper consumption, might have difficulty sustaining its current pace of buying. Copper has coasted in a range of about USD8,100-8,400 a ton for the past month. Three month copper on the London Metal Exchange (LME) was last at USD8,125 a ton.

Gold posted its biggest weekly fall since June on the back of improved US consumer sentiment and improved jobs data. There some expectations that gold would rebound because of the ongoing euro zone debt worries. Gold fell nearly 1% this past Friday, its biggest daily drop in more than two months. US COMEX gold futures for December delivery settled down USD10.90 at USD1,759.70, with trading volume at 40% lower than its 30-day average. In other metals, Shanghai zinc dropped 3% and the three-month LME contract was on track to shed 6.5%. Three-month aluminum closed at USD1,995 a ton from a closing bid of USD2,015 on Thursday, while nickel closed at USD17,075 from USD17,7725. Tine closed at USD21,315 from USD21,900 a tone and lead at USD2,121 from USD2,183.

Chart 5: Reuters Jefferies vs. Gold

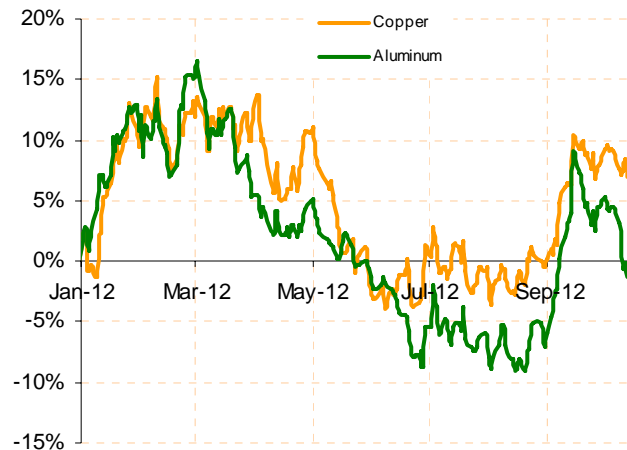


Source: Thompson Reuters

As for grains, US grain futures also slipped this week by 3.3% for the biggest loss in more than a week, on the lowest export sales in months and traders locking in profits after big gains this week. Wheat futures led the way down at the Chicago Board Trade, falling USD29-1/4 cents to USD8.56-4/4 per bushel, effectively eliminating all the gains from earlier in the week. Soybean

futures also dipped, posting a fourth straight weekly decline. Soybeans for November delivery settled down USD26 cents at USD15.22-1/2 per bushel, shedding 1.7% in the session and nearly 5% for the week. Soy prices have declined more than 15% since reaching a record of USD17.94-3/4 in September.

Chart 6: Base Metals



Source: Thompson Reuters

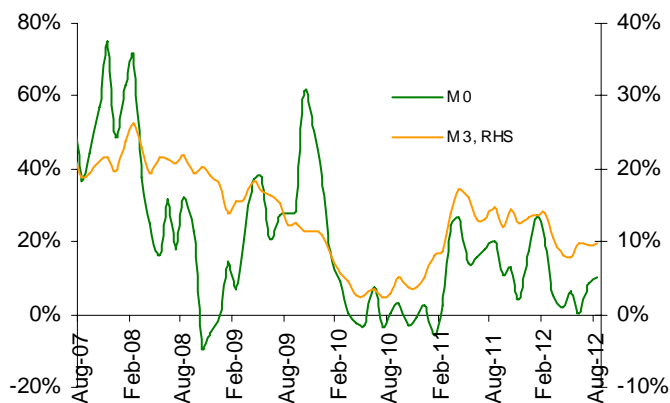
Raw sugars on ICE extended losses to close at a three-week low this Friday as funds continued to sell. Raw sugar fell 2% with front-month contract in New York settling at USD20.05 cents per pound, its lowest close since September 20. Arabica coffee futures turned higher in options-related dealings. December Arabica coffee futures on ICE rose USD95 cents, to close at USD1.6170 per pound, after touching USD1.5970 earlier in the session, the lowest level for the front month since September 7. On the other hand, cocoa futures turned higher after initially falling ahead of next Tuesday's third-quarter grindings data for Europe, which is expected to show a fall of 15 to 20% compared with the same period a year ago. The US market faced strong support around the 200-day moving average at USD2,341 per ton. ICE December cocoa closed up USD15 at USD2,366 per ton, after dipping to its lowest level since July 31 at USD2,338. We believe commodities will continue to be range bound given the ongoing quantitative easing in the US and because of the pace at which the global economy is growing.

Money & Inflation

Aggregates Continue to Rise

The Saudi economy is absorbing large amounts of liquidity as banks remain relatively conservative compared to pre-crisis levels and as the Saudi economy receives huge influx of oil revenues. A glance at Saudi Arabia's monetary aggregates in August reveals expanding liquidity which should support elevating local prices, but that is not the case for the latter. The monetary base (M0) increased by 10.3% annually during August. The main contributor to the gain was deposits with Saudi Arabian Monetary Agency (SAMA), rising by 18.9% Y/Y. The rise is partly due to the raising of three local banks' capital which requires them to increase their deposit by regulations. Additionally, the cash in vault category accelerated by 9.7% as the banking system prepares to accommodate almost 2 million pilgrim travelers for Hajj season. Furthermore, currency outside banks added SAR4.3 billion, a gain of 3.3% against August 2011.

Chart 7: Growth in Monetary Aggregates

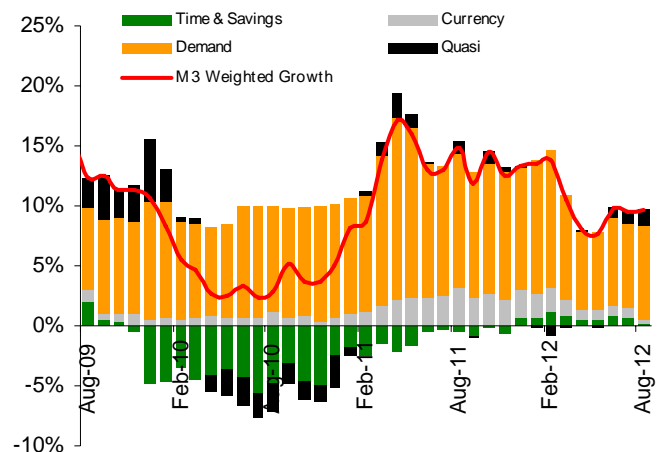


Source: SAMA, NCB Estimates

The aforementioned contributed to a pickup in money supply (M3) which hit an all-time record at SAR1.29 trillion. Money currently in circulation grew by 9.7% during August on an annual basis. Demand deposits, weighing 54.3% of M3, rose by 15.3% Y/Y, the fastest pace in five months. Meanwhile, the semi-available time and savings deposits have recorded the slowest growth this year at 0.4% given the suppressed interest rate environment. The International Monetary Fund have recently downwardly revised global economic growth as the European region struggles to structurally contain its debt burdens and the US attempts to resolve its fiscal cliff while going through a presidential race. Furthermore, other quasi-monetary deposits rose by 9.6% to reach SAR171.9 bil-

lion by the end of August. We expect M3 to continue its expanding pace throughout 2012 which will most likely breach the SAR1.3 billion level before the end of the year.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

The liquid state of the economy and its buoyant growth should theoretically drive up local consumer prices, but that is not the case of late. The inflation rate has dropped for the sixth consecutive month to 3.8%, the lowest since October 2009. The rate of inflation for renovation, rent, fuel, and water decelerated to 7.7% Y/Y during August. It is expected that the anticipation of the mortgage law has kept household seekers on hold for the time being. The regulatory framework of the new law will unfold the direction of the real estate market, albeit having its full impact on the medium to long term. Another major contributor to the inflation rate, food and beverage prices recorded an annual growth of 3.3% as food prices are majorly influenced by imported inflation (see Commodities Section). However, during Hajj, local livestock prices are pushed higher due to the seasonal rituals, coupled with a recent chicken price hike, the food category is expected to accelerate its pace for September-October. Addressing the category labeled "other expenses and service", due to base effects, the category posted a 1.9% Y/Y change and it likely to contract for September figures as a significant hike was recorded during September 2011. This will probably pressure the inflation rate lower for last month but we expect price levels to rise by the end of 2012.

Capital Markets

Awaiting Quarterly Earnings

Global equity markets managed to gain a marginal 2.9% last month according to the MSCI World index. As the global economic uncertainty continues to unfold, stock prices were lifted higher by the efforts of governments to contain the never ending global slowdown. However, in Saudi, the anticipation of quarterly corporate earnings saw investors withdrawing from the local stock market and reaping recent capital gains. The All-Share index was pressured and recorded a drop of 4.2% during the month of September. The only sub-index to record an increase last month was the insurance sector, increasing by 3.9% against August to reach a 46.4% YTD rise. The worst performing sector was media with a loss of 10% for the month followed by real estate with a drop of 8.3%. The losses continued through this month as Tadawul lost a further 2.3% by the end of 13 October. The heavy weight sectors, Petrochemicals, Banking, and Cement fell 2.8%, 2.7%, and 0.9%, respectively MTD. A handful of companies have already announced healthy third quarter corporate earnings albeit missing on estimates. While investors anticipate the remaining announcements, stock prices are expected to be pressured throughout October.

Chart 9: Tadawul All-Share Index

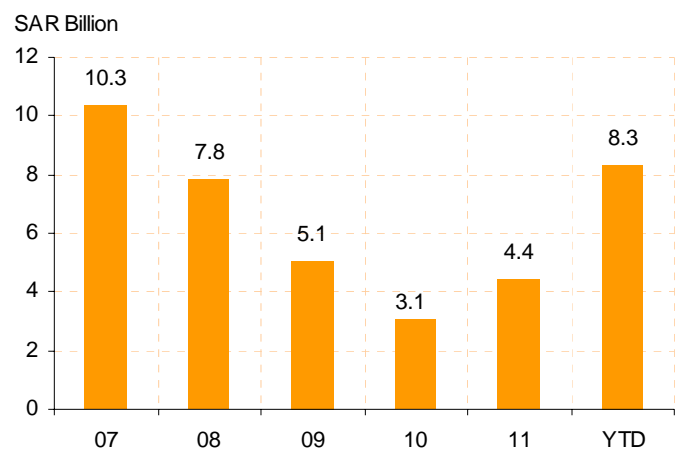


Source: Tadawul

The total number of listed companies has reached 157 and the average daily traded volumes currently stands at SAR8.3 billion YTD. However, the level of activity in the local equity market continues to deteriorate on a monthly basis. The average daily traded volumes for September dropped to SAR6.1 billion in comparison to its peak during March at SAR15.2 billion. Investors' bearish momentum pressured the daily average of traded shares, settling at 221.3 million shares against August's 258.9 mil-

lion. Additionally, market capitalization dropped to SAR1.37 trillion by the end of last month. The majority of selling pressures were attributed to Saudi individuals. Saudi corporations and mutual funds' buying efforts to offset the downward trajectory succumbed to the over 90% majority of individuals. The remainder of activity, less than 5%, was between GCC and Arab non-GCC buyers and foreign sellers. The key influencer in the market is obviously individuals who risk taking the index on a turbulent path.

Chart 10: Average Daily Traded Value



Source: Tadawul

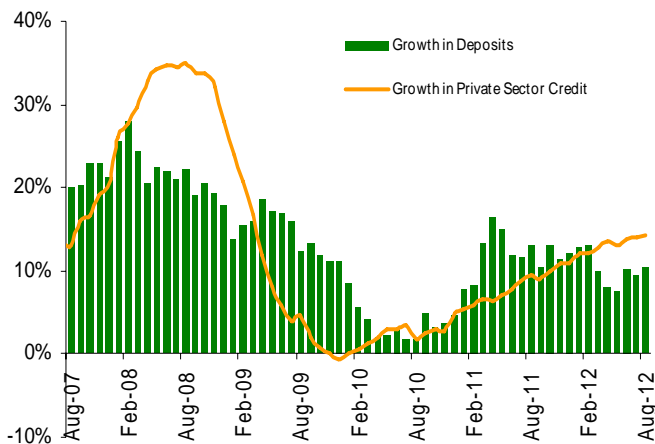
The secondary market concluded the initial public offering (IPO) of City Cement Company during September. The company offered 94.6 million shares at a price of SAR10, representing 50% of the company. The offering was oversubscribed by 3.02, indicative of a strong appetite for IPOs in the Saudi market. The offering adds to the tally of 2012 IPOs to reach SAR4.8 billion raised for new entrants. The Saudi market is regaining its status as a leading market in the region with respect to growth and depth. Additionally, the Sukuk and Bonds market is still in the early stages of its lifetime as activity was none existent during September.

Loans Market

Private Sector Credit Maintains Trajectory

Local banks have benefited from the large deposit base which has been accumulated due to the global financial crisis. Total deposits grew by 10.4% during August against the same month last year, reaching SAR1.16 trillion. Representing the largest portion of deposits, demand deposits have increased their share to 60.6% by an annual gain of 15.3%. Businesses and individuals have added 14.4% Y/Y to their demand deposits while government entities amassed an annual 31.9%. As for, the currently unattractive, time deposits, businesses and individuals withdrew SAR1.3 billion over the past twelve months while government entities added SAR2.3 billion. Elevated oil prices and production levels have aided the government in building up their funds in order to support their fiscal expansionary plans. Additionally, foreign currency deposits rose by 18.6% during August which is probably due to the poor performance of the US dollar lately which will likely continue as a result of the third round of quantitative easing.

Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

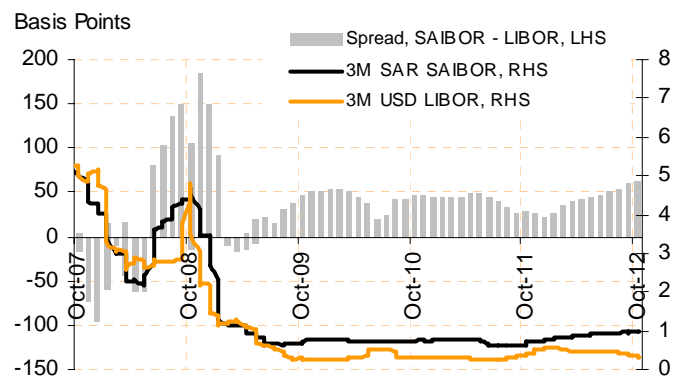
On the financing front, total claims of the banking system, excluding T-bills and government bonds, posted an increase of 15.6% to reach SAR960.9 billion. Banks have recently shifted their focus to fund small to medium enterprises and the maturity of credit reflects the initiative. Short term credit increased by an annual rate of 15.7% while long term credit gained a relatively small 8.4% Y/Y. Meanwhile, medium term credit added the highest percentage at 27.4% to reach SAR168.3 billion by the end of August. The pickup in lending has outpaced the flow of deposits which led to the improvement

in the loans-to-deposits ratio to reach 83.2%, the highest since April 2009. This will support banks in growing their profit levels which have already made a strong recovery from the financial crisis.

As for the private sector, total claims increased by an annual 14.4% during August. The momentum of private sector growth continues to climb as business activity grows. Fresh lending to the private sector has reached SAR93.1 billion for the first eight month of 2012 in comparison to 2011's SAR81.7 billion for the whole year. Local banks continue to demonstrate their willingness to expand their balance sheets; however, the expected difficulties from Al Mojl Group (MMG) might derail the risk taking stance. Meanwhile, total claims on the public sector contracted by 12.4% Y/Y as the level of treasury bills dropped drastically due to the elevated issuances last year in an attempt from SAMA to mop up excess liquidity in the market which is unlikely to occur this year.

Saudi interbank overnight rate (SAIBOR) has been rising since late September 2011 from 60bps to 97bps by mid-October 2012; however, the interbank market remains subdued owing to the low policy rate taken by SAMA. Interestingly, interbank liabilities have gained a substantial 20.7% Y/Y, far below the peak of 78.2% during May. We expect SAIBOR to remain around the 100bps level in the short-term due to the healthy cash levels of most Saudi banks.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

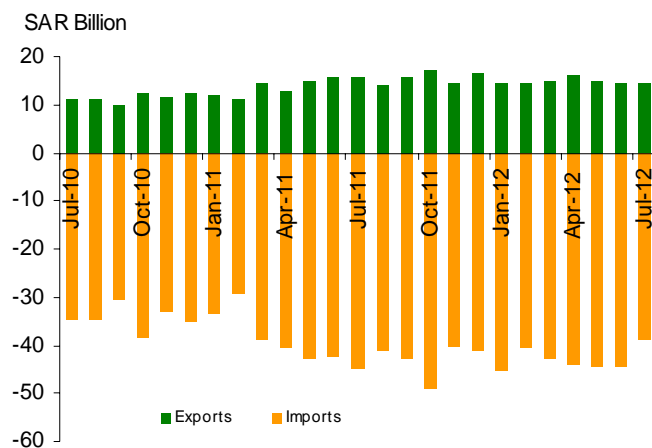
External Trade

Seasonality Impacts Monthly Figures

Saudi external trade balance for July showed a slight 1.06% retraction in exports compared to June as it racked up a total of SAR14.336 bn, albeit a 9.32% increase on annual basis. A much pronounced monthly change is found in imports which shrank by 12.42%, while making SAR38.8 bn. Volume of exports have registered 3,925 tons; that is 3% more exports than last month, 5.56% less than the same period last year.

The breakdown by composition showed Petrochemicals dominating export revenue by 35.8% as it reflected a positive growth of 13.9% Y/Y, however, it retrenched from the previous month by 3.3%. Plastics came in second with their contribution of 30.7% of the revenue. Plastic products inched upwards in both monthly and annual figures, consolidating an increase of 2.2% and 21.1%, respectively. Re-exports, which make up more than 11% of export revenue leaped on the positive side by a considerable 11.6% M/M, while a negative progression of 9.7% is seen on Y/Y analysis.

Chart 13: Saudi Non-Oil Trade Balance



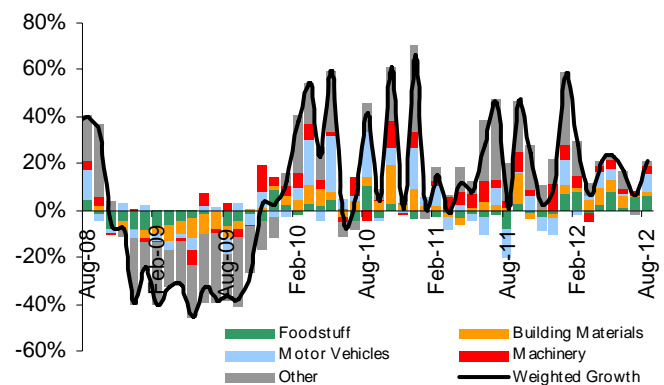
Source: CDSI, NCB Estimates

Saudi imports fell back from June's figures by 12.4%, recording SAR38.8bn. Annually, however, they climbed by 34.3%. By composition, more than a quarter (26.7%) of import expenses were allocated to the category of Machinery, Mechanical Appliances, Electrical Equipment & Parts Thereof which declined by a noticeable 14.2% M/M but rose by 33.8% Y/Y. Secondly, Transport Equipment which accounts for 17.7% of imports dipped down by 11.2% compared to the previous month, whereas 60.3% spike was witnessed when comparing it to July of

last year. Base Metals & Articles of Base Metals lands third with 14% of imports allotted to it. It demonstrated a monthly shrinking by 17.27%, nevertheless, this category maintains a 26.9% Y/Y increase.

On the financing side, Saudi new Letters of Credit (LCs) for the month of August showed a 55% monthly growth in Motor Vehicles, which accounts for 17% of LCs allocations, thus, pushing the annual growth rate to 56%. Machinery, which by weight makes up 14% of LCs, declined by 25% since July; however, it still managed to grow by 26% Y/Y. Building Materials that accounts for 10% of opened LCs shrank by 22% M/M, while recording a rise of 18% year on year. In our opinion, seasonality was an important factor at play that can justify the negative monthly growth rates on the export and import side based on historical data that reflects a consistent decline in the summer months. This leads us to believe that after the summer and the Eid season, an expected improvement in the monthly figures will take place.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

Special Focus:

Residential Real Estate Financing

Despite the lack of a mortgage law in the Kingdom, local banks have been offering residential finance to their customers. However, its growth has been rather modest compared to other types of consumer finance like auto-lease. To minimize risks in the absence of robust regulatory framework governing this type of financing, banks with varying degrees opted to enforce strict loan criteria. Some of these borrowing criteria include: limiting residential loans to payroll-only customers, providing loans in cities where bank branch operates and in some cases in predetermined regions where risk is perceived to be lower, restricting the type of property that can be purchased and in most cases the prohibition of off-plan financing.

In anticipation of the approval of the mortgage law, the Saudi market witnessed the entrance of new non-bank players, signaling a growing attraction to the Saudi housing market. Although their impact has been minimal, these non-bank residential finance providers expanded their loan offerings to include non-payroll customers, and off-plan financing. These credit institutions will play a critical role in the development and evolution of the mortgage lending landscape in the future.

Additionally, the recent establishment of the Dhamen program, which provides buyers with added financing above and beyond the SAR500,000 in the form of bridge loans provided by local banks, will provide buyers the ability to buy a home without having to acquire land. The Dhamen program stipulates that the desired housing unit must already be built and does not offer bridge loans to finance the construction of a home.

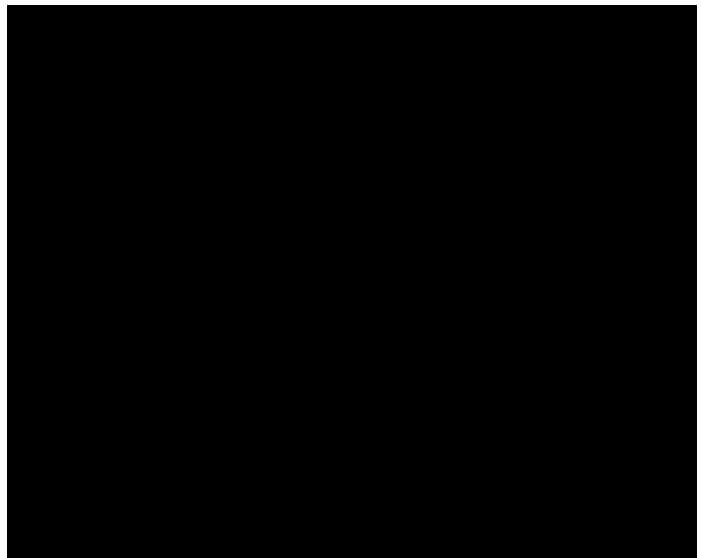
According to SAMA, the total real estate financing by local banks reached SAR29.3billion in 2011. During the second quarter of 2012 alone, total real estate lending grew by SAR17 billion. This significant growth in real estate bank lending highlights a historical shift away from the conservative lending that has been practiced in previous years. Thus, we estimate the total real estate market financing to reach SAR60 billion in 2012.

The residential lending market in the kingdom overwhelmingly consists of loans by commercial banks, however, the mortgage market, upon the implementation of the mortgage law, has the potential to attract non-bank lenders to this market. The Kingdom's current banks' residential finance amounts to a meager 2% to GDP. This reflects the potential that residential financing has in

comparison to other developed economies like Germany, UK and France where the mortgages to GDP ratio stands at 50%, 55% and 32%, respectively.

Meanwhile, we do not expect the supply demand imbalance of the housing market to significantly change in the short-term even after the passing of the mortgage law. The impact of the mortgage law will take time. Banks and non-bank players will need some time to test the robustness of the law. In addition to limited availability of financing, another real constraint has been affordability. As previously mentioned, as long as there is no incentive for land owners to sell (i.e. land prices sky rocketing, no land tax, no capital gains tax), this will continue to restrict availability of affordable land.

Chart 15: Healthcare Sector Construction Projects: Jan-Aug 2012



Source: NCB Estimates



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