March, 2014
www.alahli.com

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

Executive Summary

- Given the European dependence on oil and gas from Russia, it is very unlikely for the EU to consider energy sanctions, as they might hurt their own economies, as much as they hurt Russia.
- Given the gloomy outlook in China's growth, an expected weaker Yuan would be in favor for Chinese exports as they become more competitive internationally.
- Soaring geopolitical risks increased the bid for safe havens, accordingly; gold is in its highest levels since August 2013, however; it might face resistance at the 1,400 level
- SAMA remains committed to overseeing price stability in the kingdom and protecting purchasing power via monetary policy if deemed necessary. We expect inflation to be above 3% this year, supported by an improving commodity outlook
- Investors are likely to skim profits as Tadawul gained a further 3.1% during the first two weeks of trading this month. There are expectations of the market ending its run with a likely "correctional" drop in the near future.
- SAMA governor announced Saudi's intention of maintaining its current monetary policy despite the tapering in the US. However, we expect a change in tone once the US completely withdraws its QE program and starts to hike rates.
- The improving dynamics in China's manufacturing which took place at the end of 2013 and early 2014 most likely had a positive effect on non-contractually traded goods.

View of the Month

The strategic allocation of investments along with an overhaul in the asset/liability composition and expanding the maturity curve, aided banks in announcing record income levels. SAMA's adoption of Basel III, starting early 2013, along with its prudent guidelines of raising banks' capital adequacy ratio will position the banking system on a much sturdier foothold relative to regional peers.

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**

Macroeconomic Indicators

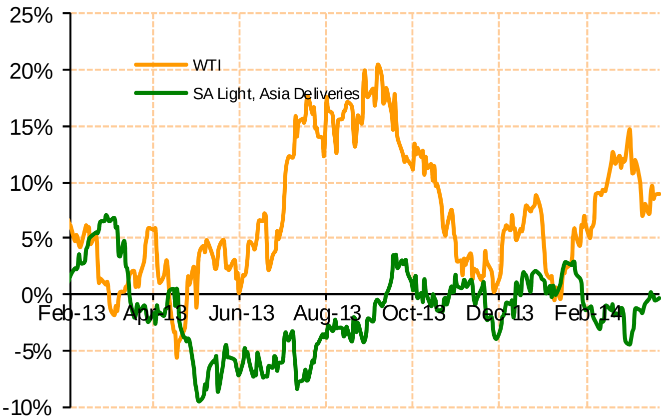
	2008	2009	2010	2011	2012	2013P	2014F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	94.9	59.2	77.6	108.1	110.2	106.4	100.0
Average Daily Crude Oil Production, MMBD	9.2	8.2	8.2	9.3	9.8	9.6	9.4
GDP at Current Market Prices, SAR billion	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,794.8	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

Sanctions On Russia Are Unlikely to Bite

Brent crude oil spot price in February averaged near USD110 per barrel for the eighth consecutive month, while WTI crude oil prices increased by $6 per barrel from the previous month to reach $101. The spread of Brent to WTI crude oil, which averaged more than USD13 per barrel from November through January, fell to USD8 per barrel in February. WTI slid to USD98 on March 12, the lowest settlement since early February, on data showing a slump in China's exports in February, bolstering speculation of an economic slowdown. However, WTI prices rose marginally to USD99.5 a barrel on March 21 after President Vladimir Putin signed a legislation to annex Crimea into Russia, brushing aside western countries' threats, with prices showing no reaction to the potential for a sanctions induced supply disruption. Given the European dependence on oil and gas from Russia, it is very unlikely for the EU to consider energy sanctions, as they might hurt their own economies, as much as they hurt Russia.

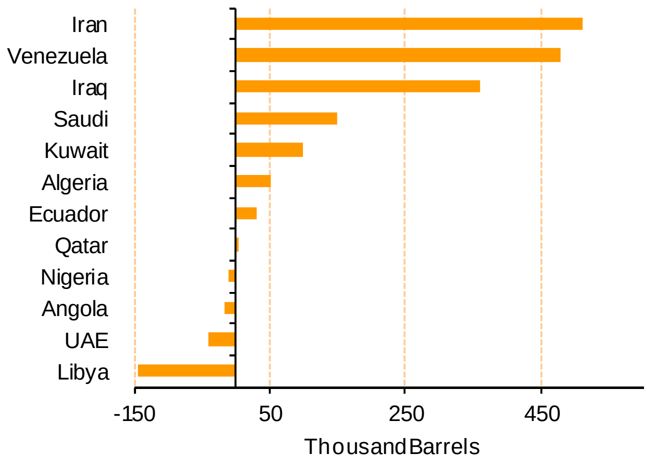
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, EIA projects world petroleum production to rise by 1.3MB/D in 2014, with most of the growth coming from countries outside of OPEC. US, Canada, and Brazil, will account for much of this growth. Non-OPEC supply growth will contribute to an increase in global surplus oil output from an average of 2.1MB/D in 2013 to 3.9MB/D in 2015. Meanwhile, total production by OPEC increased by 0.26MB/D in February to 30.1MB/D, the highest level since August 2013, and in line with its current collective target of 30MB/D. Saudi Arabia produced 9.8MB/D in February, up from 9.77MB/D in January. According to IEA, Iran's production amounted to 2.69MB/D, and it exported 1.41MB/D in February. International sanctions have cut Iran's oil exports from 2.5MB/D in early 2012, but the western countries agreed to ease sanctions on Iran in November in return of curbing its own nuclear program. Potential production in Iran is currently at 3.85MB/D, and it plans to boost its production capacity by 3.0MB/D before 2025. Iraq's production jumped by 0.4MB/D to 3.4MB/D, the highest level since 1980, and it exported 2.8MB/D in February. Kuwait, also, plans to increase capacity by 0.15 MB/D by mid 2015, and to add up 0.5MB/D over the coming five years to 2020. In the US, production climbed to 8.22MB/D in the week ended March 14, the most since May 1988.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, Non-OECD countries are expected to account for all of the consumption growth in 2014. China, still remains as the leading consumer to projected global growth, with demand expected to rise by nearly 0.4MB/D in 2014. However, China's economic and oil consumption growth rates have moderated compared with rates before 2012, when annual GDP growth exceeded 9% and oil consumption growth averaged 0.7MB/D from 2009 through 2012. OECD consumption in 2014 is expected to decline, led by lower projected consumption in both Japan and Europe. EIA expects Japan's oil consumption to fall by an annual average of 0.15MB/D in 2014, as the country continues to shift to natural gas consumption in the electricity sector and returns some nuclear power plants to service. Europe's consumption, which dropped by 0.06MB/D in 2013, will decline by another 0.06MB/D in 2014. In the US, consumption, which increased by 0.4MB/D in 2013, is expected to remain flat in 2014.

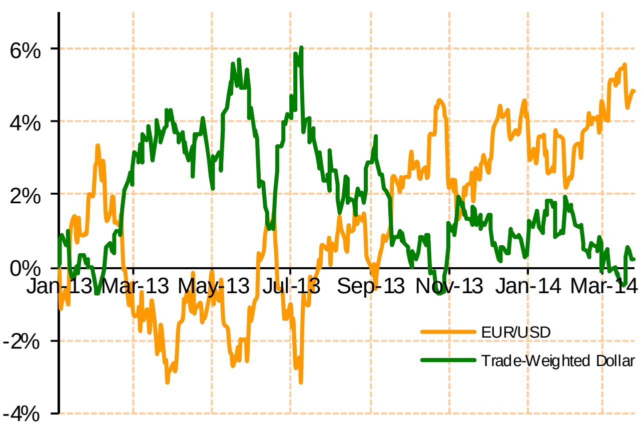
Said A. Al Shaikh
Group Chief Economist | **s.alshaikh@alahli.com**

Foreign Exchange

Weaker Dollar As Geopolitics Soar

Despite a G20 pledge to boost growth by more than USD 2 trillion in the next five years, Chinese manufacturing recorded an 8-month-low in February. HSBC/Markit PMI decreased to 48.3 from 49.5; whereby a reading above 50 indicates expansion, and a reading below 50 indicates a contraction. Some analysts attribute the drop in activity to the long Lunar New Year holiday which may have skewed the results. Nevertheless, China's official GDP growth rate in Q4 stood at 7.7%, a six month-low. A slowdown might be on the horizon this year for China as it endures short-term pains while it revamps its long-term growth model. In retrospect, China's GDP target for 2014 stands less ambitious than before at 7.5%, reaffirming a move away from the unsustainable growth-centric model it adopted during its growth spurt. Curbs on the shadow banking system and the real estate sector will provide headwind for growth amid the current social transition in China. Consequently, the CNY weakened by 1.4% against the dollar to 6.15 in February. Moreover, the People's Bank of China (PBoC) doubled the yuan's trading band to 2% above or below the parity rate. Given the gloomy outlook in China's growth, an expected weaker yuan would be in favor for Chinese exports as they become more competitive internationally. The governor of the Saudi Arabian Monetary Agency (SAMA) acknowledged the potential for the yuan as an option to diversify the kingdom's foreign reserves, benefiting from the strong trade ties (see External Trade). It is currently, however, still ruled out from becoming a currency of reserve.

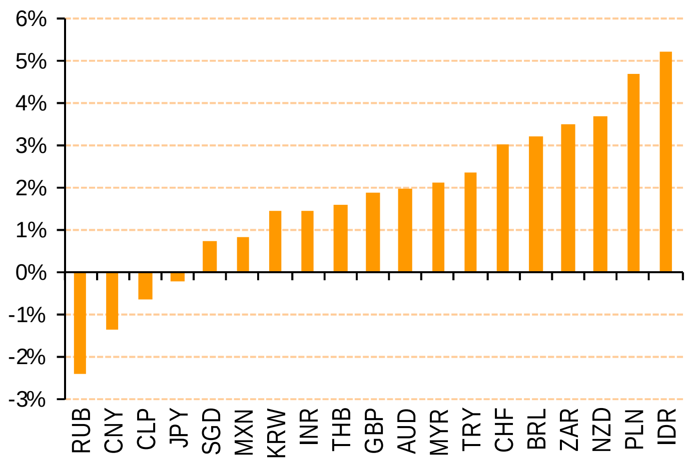
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

In the US, non-farm payrolls added 175,000 jobs in February, beating expectations. Unemployment, however, rose a notch to 6.7% from 6.6% a month earlier; due to discouraged workers rejoining the workforce. The Fed maintains a relatively bullish view for the recovery dynamics in the US as it cautiously unwinds its massive bond-purchasing program; therefore, we assert a similar view to reflect on the greenback. The US government revised its Q4 GDP growth estimate down to 2.4% from an initial 3.2%; a sharp decrease, largely attributed to the fiscal impasse and the winter cold wave. The US dollar retracted by 2% versus a basket of currencies to 79.7 in February, following a period of strength in January. Positive consumer sentiments alongside resumed factory activity reflect improving labor market dynamics, which confirms that the tapering process will likely to stay on course. After breaching 3% in December, benchmark 10 year treasury yields have been moderating to end February situated around 2.7%; a meager -0.2% M/M change. On the other hand, US equity market rebounded after the Ukraine crisis cooled to a standoff. The Dow recorded a 4% M/M gain at 16,321.7 while S&P 500 edged up 4.3% M/M at 1,859.5.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the Eurozone, a sterilization suspension is being considered as a viable option to rectify its disinflationary situation. Although the inflation rate slightly improved in February to 0.8% from 0.7% a month earlier, it remains a long shot below its 2% target. The 175 billion euros/week liquidity absorption that was meant to mitigate inflationary pressures from the Securities Market Program (SMP) might come to a halt. The ECB, however, sees no urgency to act as of yet. Monetary easing expectations and tensions over Ukraine caused heightened volatility for the single currency which stood resilient, gaining 2.3% against the dollar at 1.38.

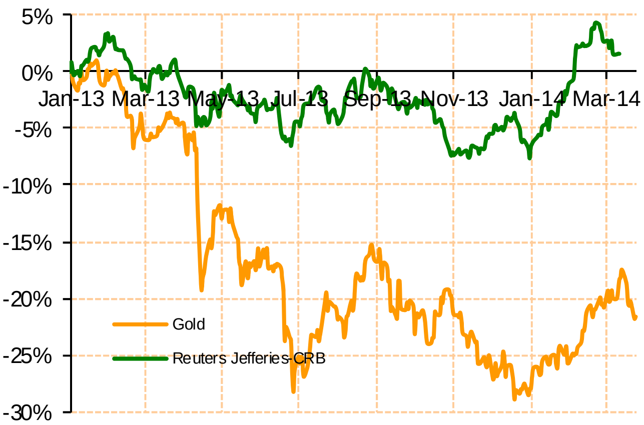
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Commodities

Commodities Catch A Glimpse Of Hope

Putting energy aside, all key commodity price indices heavily tumbled in 2013. The Thomson Reuters/Jeffries CRB index (TRJCRB) recorded an across-the-board 5% decline Y/Y. Spot gold was down 28%, while industrial metals such as copper and aluminum, respectively, edged lower 7.2% and 15.3%. Soft commodity prices were depressed due to ample supply following the Summer 2012 drought in the US, and a weaker global demand. The S&P Goldman Sachs Agricultural Commodity Index (SPGSAG) receded by over 22%, signifying weak corn, wheat and soybeans performance. According to the macroeconomic baseline scenario which assumes no further supply disruptions or new uncertainties, the general prospect shows most commodity prices to remain bearish and subdued throughout 2014.

Chart 5: Reuters Jefferies vs. Gold

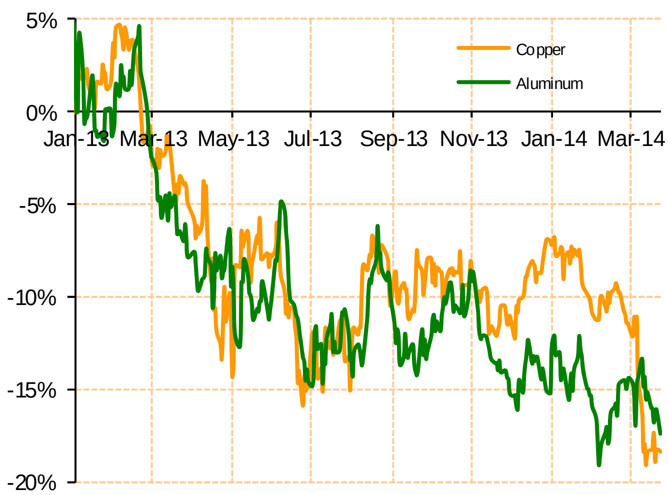


Source: Thomson Reuters

Despite the reserved expectations, commodity prices in the month of February were out of sync; the weather-related supply shock and geopolitical uncertainty in Ukraine played a major role behind the upbeat prices. Moreover, from a risk perspective, the likelihood of prices to fall have declined, which boosted the prices of options and futures.

In February, the TRJCRB surged by 6.7%, breaking 300 points for the first time since July 2012. Aside from copper, commodity spot prices have enjoyed a notable upturn. Although copper recovered moderately towards the end of 2013, supported by improved Chinese manufacturing activity, the Lunar New Year holiday may have had to do with a 0.8% M/M downturn, standing at USD 7,010/ton. In addition, brewing concerns over China's curbs on the banking and property sectors are having a drag effect. Moving onto March, Chinese exports reported the sharpest drop since the financial crisis of 18.1% Y/Y, reflecting a weakening demand. This –in turn – levied downward pressures on copper which plummeted below USD 6,500/ton for the first time since May 2010. This might be an outlier as the Lunar holiday normally distorts the data, yet in the coming months we should be able to assess the credit situation and ascertain the existence of inflection points. Demand for aluminum regained momentum after a short slump in January as prices advanced by 2.8% M/M to USD 1,754/ton. The London Metal Exchange (LME) recorded a warehouse stock movement that resulted in a decrease in LME aluminum and copper stockpile. Aluminum ended the month standing at 5.3 million tons, a -2.1% monthly change, while LME copper recorded -12.8% change in inventory, standing at 273.7 thousand tons. Soaring geopolitical risks increased the bid for safe havens, allowing spot gold to breach the 1,300 level, inching up by 6.6% M/M to USD 1,327 per troy ounce. While gold is in its highest levels since August 2013, it might face resistance at the 1,400 level. Silver prices saw a double-digit increase by 10.7%, leaving prices at USD 21.26/oz.

Chart 6: Base Metals



Source: Thomson Reuters

Soft commodity prices made a solid 9.7% upturn according to the SPGSAG index, which stood at 380.8 by the end of February. On the Chicago Board of Trade (CBOT), major grains such as corn, wheat and soybeans all ended up positive. CBOT corn futures for May contracts recorded a 3.7% upturn, closing at USD 4.56/bushel. The US Department of Agriculture USDA projects ending stock to be lowered 25 million bushels due to rising exports with a projected average of USD 4.25 – 4.75/bushel in 2014. Soft red winter wheat surged by 5.9% on the back of an expected 23% drop in US harvest this year, pricing at USD 5.92/bushel. Soybeans made a 10% upsurge compared to last month, standing at USD 13.9/bushel. The IMF revised its estimate for the likelihood of per bushel soybean prices dropping below USD 8 to 2.3% from 2.6$ earlier. Likewise, the likelihood of soybean prices to breach USD 17/bushel increased to 0.6% from 0.2%, reflecting expectations of a higher import demand and a tighter stock.

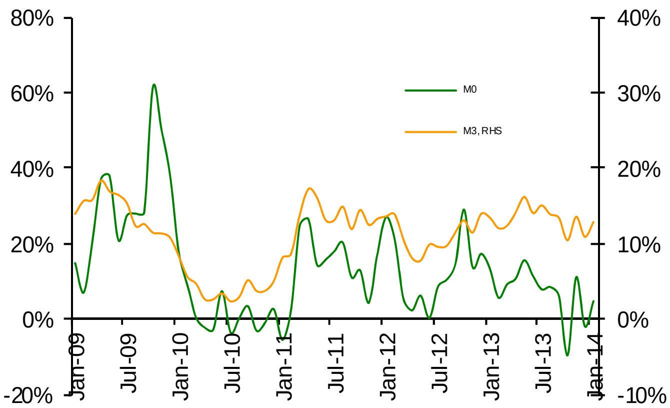
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Money & Inflation

Money Supply Inline with Solid Demand

In January, money supply recorded an annual expansion of 12.8%, standing at SAR1.57 trillion, owing that to an increase in narrow money (M1) by 16% Y/Y. Demand deposits surged by 17.3% compared to last year to settle at SAR894.5 billion, while currency outside banks grew by 8.5% to SAR145.5 billion. The governor of SAMA reassured the Saudi market of price stability and that rates will remain within reasonable levels, alleviating concerns surrounding the impact of the Fed's tapering on the kingdom's monetary direction. Several factors can be attributed to the current sense of optimism, one of which is the upgrade of Fitch's sovereign rating of the kingdom to AA from a AA-. In addition, SAMA's real growth prospects for 2014 remain upbeat, in line with the IMF's forecast of 4.4%, well above the projected global average of 3.6%. We, however, forecast growth this year to stand at a more conservative 4.1%, due to the expected 1.2% contraction in the oil sector. The private sector is indicated to be the main engine for growth this year, evident by the rise of strong demand fundamentals. Although the Global economy is not yet out of the woods given the uneasy situation of many emerging economies, SAMA confirmed leaving main interest rates unchanged. The Repo rate is currently at 2% and reverse repo is at 0.25%, which had been the case since the global financial meltdown. As a consequence to the stronger money demand, Time and Savings receded by 1.3% from last month, although maintained a 5.3% Y/Y growth.

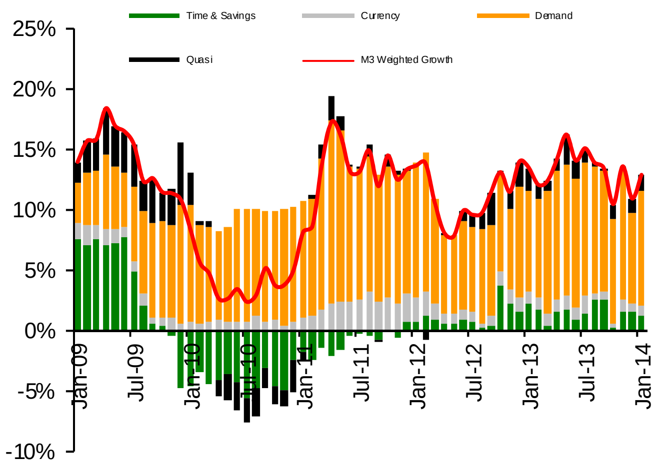
Chart 7: Growth in Monetary Aggregates



Source: SAMA, NCB Estimates

The monetary base (M0) shows a 4.7% annual upturn after deposits with SAMA returned positive. Reserve money is currently at SAR355.1 billion, providing ample buffer for future lending activities. Broad money (M3) remains hugely influenced by demand deposits, which constitute 56.6% of money supply, followed by Time and Savings and Quasi, respectively at 21.6% and 12.6%. Time and Savings deposits recorded a 5.3% growth Y/Y to SAR340.6 billion despite unattractively low interest rates. This reflects a growth in money supply that is independent of shifts in preference. Quasi monetary deposits continued their double-digit growth of 10.6%, amounting to SAR199.1 billion. Currency in circulation climbed 9.1% while currency held at SAMA inched down by 0.8% reflecting the liquid state of the market. Government reserve went up to SAR 851.6 billion, a 17.6% upsurge compared to last year. Net foreign assets withheld at SAMA amounts to SAR2.7 trillion, a 10% Y/Y change, continuing a pace moderation, reflecting lower oil revenues.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Inflation rates in January declined by 0.1% since the previous month to 2.9%. The decrease in the annual rate can be attributed to some of the main categories such as housing and transport, which receded to 3.7% and -1.9%, respectively, down from 4% and -1.6% a month earlier. SAMA remains committed to overseeing price stability in the kingdom and protecting purchasing power via monetary policy if deemed necessary. We expect inflation to be above 3% this year, supported by an improving commodity outlook

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

Capital Markets

A Likely Correction in the Offing

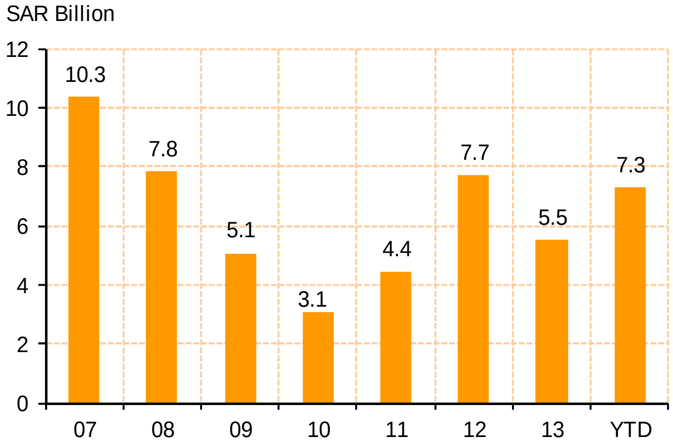
It was September 14, 2008 when Lehman brothers made history as the largest ever firm to file for bankruptcy. This is arguably the date when the financial crisis started in the US and the world economy alike. However, for many Saudi investors, February 26, 2006 resonates as an even worse event, with the terrible memories of the domestic stock market crash. The market, which lacked institutional traders and market movers, and still does, saw traders with questionable knowledge in financial markets, let alone the assets being purchased, lift the index to a peak of 20,634.86. The subsequent outcome could be seen by only a few who weren't blinded by greed as price-to-earnings ratio averaged around 50. Since then, Tadawul has been struggling to match its regional peers as businesses overhauled their financials that was intoxicated by the market rush. Subsequently, the 2008 global financial crisis hindered the local market further. Fast forward to 2013, Tadawul gained a staggering 25.5% Y/Y backed by strong economic fundamentals, an expansionary fiscal policy, and strong corporate performances. The index maintained the bullish momentum going into 2014 as it posted a sixth-consecutive monthly increase during February, with a rise of 3.9% M/M, breaking through the stubborn 9,000 level.

Chart 9: Tadawul All-Share Index

Source: Tadawul

Investors have been reorganizing their portfolios to adjust for expectations and risk exposure following the annual financial filings. Last month, the hotel sector and the real estate development sector were the best performers, rising by 13.9% and 13.8%, respectively. The industrial investment sector posted a growth of 9.5%, as businesses announced strong corporate profitability for the year 2013. Although the market is supported by strong economic conditions, given the elevated prices of oil, the pace of the upward trajectory is a cause for concern. The market P/E ratio stood at 16.13 by the end of last month compared to 13.15 during February of 2013. Investors are likely to skim profits as Tadawul gained a further 3.1% during the first two weeks of trading this month. There are expectations of the market ending its run with a likely "correctional" drop in the near future.

Chart 10: Average Daily Traded Value



Source: Tadawul

The current level of activity reflects the increase in stock prices as by the end of March 13, average daily traded volumes reached SAR7.2 billion in comparison to 2013's SAR5.5 billion average. Investors exchanged as much as SAR11.7 billion worth of stocks on March 5, the highest level since April 2012. We still believe that the majority of trading being attributed to individual investors keeps Tadawul susceptible to negative capital withdrawals. The foreign investor is non-existent with a share of less than 5% trading from GCC and foreign SWAPs, while institutional trading only represented 10.7% last month. However, in our opinion, the market has already established a higher floor as businesses are expected to maintain their current performances. The recent comments by SAMA's governor, Fahad Al-Mubarak, will ease investors' worries regarding negative spillovers from the US tapering program and oil shocks.

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

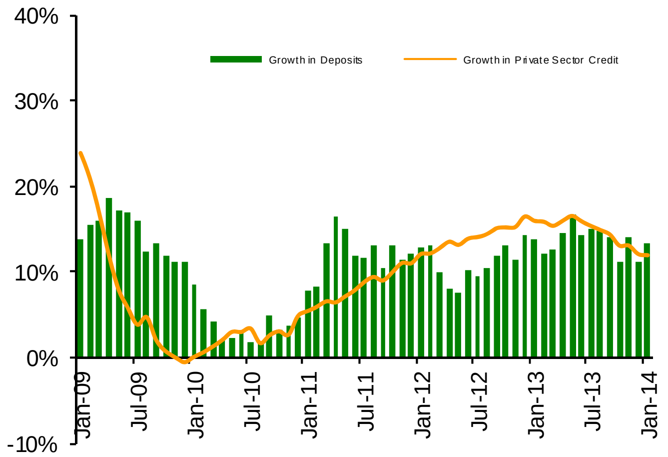
Loans Market

Embarking on New Heights

The Saudi banking system is embarking on a new playing field, as the majority of banks are increasing their capital as much as 100%, as in the case of Riyad bank. The new capital infusion will provide banks with the opportunity to increase their lending activities and avoid breaching the credit concentration requirements, stipulated in the banking control law of 1966. Given that the loans-to-deposits (L/D) ratio peaked last August at 83.1, banks have been attempting to lower that ratio as per SAMA's guidelines. SAMA's policies have been essential in guiding banks through the financial crisis and supporting banks to reach new feats.

The bulk of banks' deposit liabilities is represented by demand deposits which gained 17.3% Y/Y by the end of January. Businesses and individuals have added 16.4% Y/Y to their demand deposits while government entities increased their demand deposits by 28.5% on annual basis to reach a record SAR75.7 billion. Meanwhile, the interest-bearing counterpart lags behind, as it is difficult to lure businesses and individuals given the low interest rate environment. However, government entities' pursuit of longer maturities has increased their time and savings deposits to SAR153.0 billion, a gain of 20.3% annually by the end of January. Furthermore, other quasi-monetary deposits increased at an annual 10.6%, with a notable deceleration in the outstanding remittances following the correctional program of the labor market.

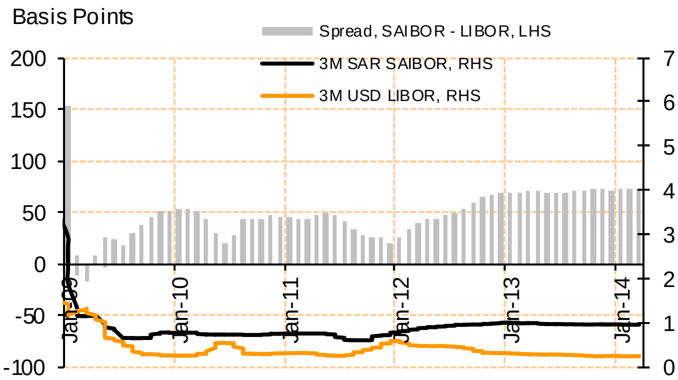
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

On the assets side, total claims of the banking system, excluding T-bills and government bonds, maintained its pace at an annual 12.0% gain for the month of January. Given the higher base in 2013, growth rates were anticipated to slow after peaking at 16.7% in December 2012. Regardless of the deceleration, the credit market is likely to maintain a stable upward trajectory. The fiscal expansionary policy of the Kingdom will maintain demand for financing. As total loans were outpaced by total deposits' growth, the L/D ratio dropped to 79.0, reflecting a lower utilization ratio. Regarding the maturity of credit, banks continue to seek longer-term opportunities. Short-term credit gained by 9.5% Y/Y and medium-term credit expanded by only 7.4% annually during January. Meanwhile, long-term credit accelerated at 20.8% Y/Y to reach SAR330.9 billion, a new record.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

The private sector is expected to drive the economy this year. Consequently, private sector credit will likely maintain double-digit growth rates throughout 2014. Banks were able to expand their portfolio by extending credit to the private sector with an additional SAR116.0 billion during the twelve months through January, an 11.9% annual addition. Furthermore, claims on the public sector grew by 24.7% Y/Y driven by the increase in T-bill issuances. The government's control on excess liquidity resulted in a 29.5% rise in T-bills, reaching SAR185.4, another record high achieved this January. Additionally, government bonds rose by 19.0% on an annual basis. As for the government's policies, SAMA governor announced Saudi's intention of maintaining its current monetary policy despite the tapering in the US. However, we expect a change in tone once the US completely withdraws its QE program and starts to hike rates. Saudi is accustomed to the wait-and-see approach and a preemptive decision regarding its policy is highly unlikely.

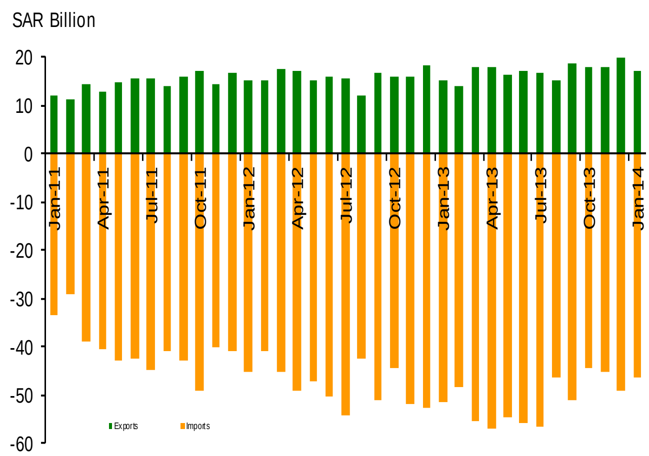
Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

External Trade

Exports Climb On A Double-Digit

In January, non-oil exports enjoyed a demand spike, which resulted in a value-term return increase of 13% Y/Y at a total of SAR 17.1 billion. The import bill, on the other hand, retracted by 9.5% compared to last year to SAR 46.5 billion; due on part to a subsiding imported inflation. Downward pressure on the exchange rates of most emerging markets currencies yielded a stronger purchasing power for the SAR (See Foreign Exchange.) Furthermore, the remarkably low commodity prices throughout 2013 suggestively lowered the cost of the factors of production, exerting an added downward pressure on prices (See Commodities.) Therefore, the balance of trade (BOT) gap narrowed this month compared to the same period of last year by 18.8%. The weight of non-oil exports reached 3.9 million tons which measures a 0.2% increase compared to last year. Conversely, the weight of imports recorded a 11.9% downturn, standing at 5.3 million tons.

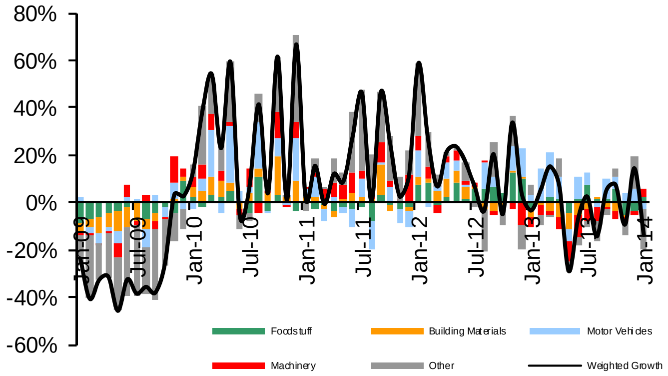
Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

Non-oil export analysis shows that 34.7% of the exported goods consisted of plastics which rose by 27.9% Y/Y to SAR 5.9 billion; significantly contributing to the monthly overall upturn. Chemical products, accounting for 32% for non-oil exports, inched downwards by 3.7% to SAR 5.5 billion, slightly moderating export figures. Exports of base metals which make up as much as 5.5% of the total monthly figure were also on the downside, reporting SAR 0.9 billion, a -2.2% yearly change. The largest export destinations were China, UAE and Singapore. The improving dynamics in China's manufacturing which took place at the end of 2013 and early 2014 most likely had a positive effect on non-contractually traded goods. China's share of the kingdom's exports in January amounted to 2.3 SAR billion, which exceeds 13.3% of non-oil exports of the month. The UAE's imports from the kingdom amounts to SAR 1.7 billion, accounting for 10.2% of total non-oil exports, thus, marking a 23.7% upturn. Singapore, acquired 7.2% of total non-oil exports or SAR 1.2 billion, and hence, advanced over last year by 61%.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

On the import side, the two main categories, machinery and transport equipment, considerably dropped, contributing to the markedly lower import value. At SAR 12.7 billion, Machinery accounts for 27.2% of the import bill, which inched below last year by 12.6%. Transport equipment, which make up 16% of imports by weight, diminished by 21% Y/Y after amounting to SAR 7.7 billion. Imports of base metals, which account for 14% of the bill, diverged from the downward trend by reporting a positive annual change of 2.7% at SAR 6.5 billion. The US maintained its position as the largest supplier of imports to the kingdom. As measured by outbound capital, 14.3% of imports (the worth of SAR 6.6 billion) were of US origin; which is below last year's figure by 2.6%. Chinese imports, which contribute to 13.7% of the import bill, moderated sharply by 9.4% to SAR 6.4 billion. German imports, however, remained unchanged, recording SAR 3.4 billion, or 7.3% of the value of imports. Settled Letters of Credit (LCs) for January totaled SAR 18.1 billion, receding by 14.3% Y/Y. Save electrical appliances, main private sector LCs tumbled. LCs for motor vehicles, the most significant category by weight, which lost 32.2% annually to SAR 3.3 billion. LCs for machinery slid by 24.8% Y/Y, standing at SAR 1.6 billion whereas LCs for building materials trimmed 10.5% compared to last year, recording SAR 1.6 billion.

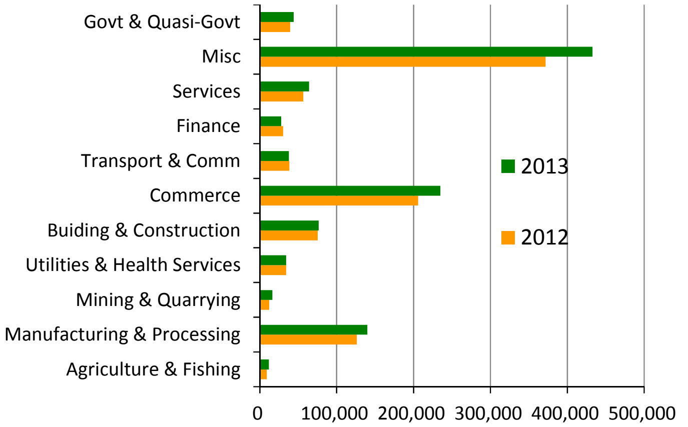
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Special Focus:

Strategic Credit Directions

Local banks have been keen on grasping lending opportunities over the last couple of years and it has reflected positively on their profitability. The strategic allocation of investments along with an overhaul in the asset/liability composition and expanding the maturity curve, aided banks in announcing record income levels. During 2013, total claims of the banking system, excluding T-bills and government bonds, expanded by 12.0% Y/Y, reaching SAR1.12 trillion. A total of SAR120.5 billion worth of fresh lending was added to banks' balance sheets last year. The miscellaneous sector, which is largely composed of consumer lending, grew by 16.4% during last year. Analyzing the remaining sectors in absolute terms, the commerce sector increased its share by SAR28.7 billion to reach SAR234.8 billion, which translated to a gain of 14.0% on an annual basis. The mining and quarrying sector has more than doubled in a span of two years and recorded the highest growth rate at 34.3% Y/Y last quarter. Projects such as Ma'aden and Alcoa's aluminum refinery worth SAR5.6 billion and Hanwha's gold processing plant worth SAR1 billion were captured by banks as they diverse their portfolios.

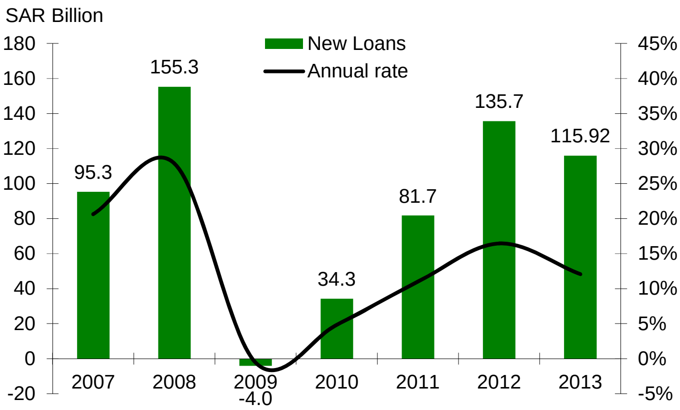
Table 15: Credit by Economic Activity



Source: SAMA

We do see that the elevated oil prices will support the government in maintaining its fiscal expansionary policy going forward, albeit our expectation of a substantially lower budget surplus this year. The influx of revenues will trickle down to businesses via project finance, thus, underpinning private sector growth. Credit to the manufacturing and processing sector recorded an annual rise of 10.7%, reflecting the rising contribution of the private sector to the economy's GDP. Saudi is import dependent and, hence, growth in the manufacturing segment is crucial to sustain an expanding economy. Furthermore, the building and construction sector recorded a benign 1.6% increase annually, dropping 3.3% Q/Q in the fourth quarter from the previous period. The 2011 royal decrees included a huge vision for the residential market by announcing the plan to construct an additional 500,000 units worth SAR250 billion. However, very few projects have commenced past the initial planning and design phases, which limited opportunities for banks to secure new financing deals within this category. Furthermore, the transport sector contracted by 1.2% annually, the third consecutive annual decline. Numerous projects have been announced in the transport sector and some have been awarded during the third quarter such as Riyadh's light rail transit lines that is valued at SAR87.0 billion and is expected to increase the level of activity within the sector moving ahead. Notably, NCB's Construction Contracts Index fell from the record set in 3Q at 494.09 to 465.03 by the end of 4Q, yet the total value of contracts still managed to reach SAR293.4 billion, a new record high.

Table 16: Fresh Lending to the Private Sector



Source: SAMA

The Saudi financial system has implemented safety measures that limited the banking system's susceptibility to external shocks. SAMA's adoption of Basel III, starting early 2013, along with its prudent guidelines of raising banks' capital adequacy ratio will position the banking system on a much sturdier foothold relative to regional peers. Unsurprisingly, a recent decision by Fitch to reassess the Saudi banking industry reaffirmed its stable outlook, with the renowned rating agency upgrading three banks from negative to a stable outlook, namely SABB, BSF, and ANB. Furthermore, the sovereign credit rating of the Kingdom was also upgraded this month to AA with a stable outlook from AA-.

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

Please contact: Mr. Noel Rotap
Tel.: +966-2-646-3232
Fax: +966-2-644-9783
Email: n.rotap@alahli.com