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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- Lower than previously forecasted global economic growth combined with expanding non-OPEC output, especially in North America, will put a gradual downward pressure on oil prices.
- The ECB also justified its inaction of the Euro's appreciation by indicating that exchange rates are not a primary focus on its current agenda, as it has more pressing matters at stake.
- Looking forward into 2013, global growth and geopolitical tensions across the Middle East will dictate commodity performance as energy, in addition to agricultural sectors will continue to be volatile.
- The continuous acceleration of credit in the local economy aided SAMA in controlling the monetary situation throughout last year as inflation was subdued.
- The anticipation for earnings season has attracted capital flows into the market with high expectations, additionally, the bullish momentum was carried over to 2013.
- Given the robust economic conditions, the private sector had a pivotal role in driving the economy forward. Local banks are expected to maintain the current level of activity with a more selective approach for 2013.
- China remains the crucial trading partner and it appears that the slight recovery in its manufacturing activity has left its imprints on the trade balance sheet.

View of the Month

'Saudi Arabia's Aviation'

Booming religious tourism, growing population, and rising purchasing power of Saudis has further increased the demand for travel. In 2012 alone, domestic and international passengers in all Saudi airports reached more than 59 million passengers; an increase of 1.08% over 2011.

NCB

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	9.7
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,690.5	2,511.4	2,727.4	2,908.4
GDP at Current Market Prices, USD billion	385.2	476.9	377.2	450.8	670.6	728.3	776.6
Real GDP Growth Rate	2.0%	4.2%	0.1%	4.6%	8.5%	6.8%	3.4%
Oil Sector GDP Growth Rate	(3.6%)	4.2%	(7.8%)	2.4%	4.3%	5.5%	-1.2%
Non-oil Sector GDP Growth Rate	4.7%	4.3%	3.5%	5.5%	7.8%	7.2%	7.4%
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	16,354.7	23,632.8	24,917.7	25,797.2
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	268.4	258.2
Oil Exports, USD billion	205.3	281.0	163.1	215.2	317.6	347.6	348.1
Non-oil Exports, USD billion	27.8	32.3	29.1	35.8	46.9	48.9	45.2
Merchandise Imports, USD billion	(81.5)	(100.6)	(86.4)	(96.7)	(119.1)	(128.2)	(135.2)
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	178.7	144.4
Current Account Balance/GDP	24.2%	27.7%	5.6%	14.8%	23.6%	24.5%	18.6%
Net Foreign Assets with SAMA, USD billion	301.3	438.5	405.9	441.0	535.9	640.2	709.8
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	380.0	410.0	475.0	540.0	580.0	690.0	820.0
Actual Revenues, SAR billion	642.8	1,101.0	509.8	741.6	1,117.8	1,239.5	1,146.9
Actual Expenditure, SAR billion	466.2	520.1	596.4	653.9	826.7	853.0	870.1
Expenditure Overrun, %	22.7%	26.8%	25.6%	21.1%	42.5%	23.6%	6.1%
Total Revenues/GDP	44.6%	61.6%	36.1%	43.9%	44.5%	45.4%	39.4%
Total Expenditure/GDP	32.3%	29.1%	42.2%	38.7%	32.9%	31.3%	29.9%
Overall Budget Balance, SAR billion	176.6	580.9	(86.6)	87.7	291.1	386.5	276.8
Budget Balance/GDP	12.2%	32.5%	(6.1%)	5.2%	11.6%	14.2%	9.5%
Break-Even Oil Price	40.5	40.2	60.8	64.1	71.7	67.2	70.9
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%	10.7%	9.1%
Growth in Credit to the Private Sector	20.6%	27.9%	-0.6%	4.8%	11.0%	17.2%	16.0%
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

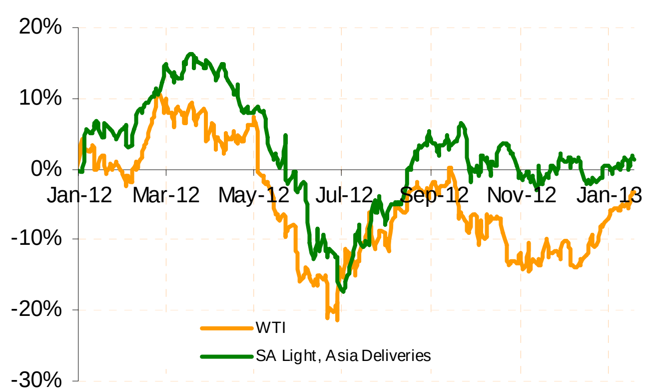
Oil Market

Producers Increase Supply in 2013

Crude oil markets have started the year on a positive tone, amid signs of a recovery in China and lower production by Saudi Arabia, with Brent marginally crossing its recent range of USD105-S110/bbl. After gaining 3.3% last year, however, the Brent continues to lack strong directional momentum for prices to be moving away from the USD111/bbl mark, as the threats to supply in the Middle East were balanced by risks to demand owing to the Europe's debt crisis and the persistence of US fiscal uncertainties. Meanwhile, lower than previously forecasted global economic growth combined with expanding non-OPEC output, especially in North America, will put a gradual downward pressure on oil prices. Given that the underlying trend of weaker economic growth and rising crude supplies are strong, it is more likely that they will offset any upward pressure on oil prices, except if a major crisis takes place, such as a break-up of war between US and Iran, or a disruption of oil supplies from any other major oil producing country.

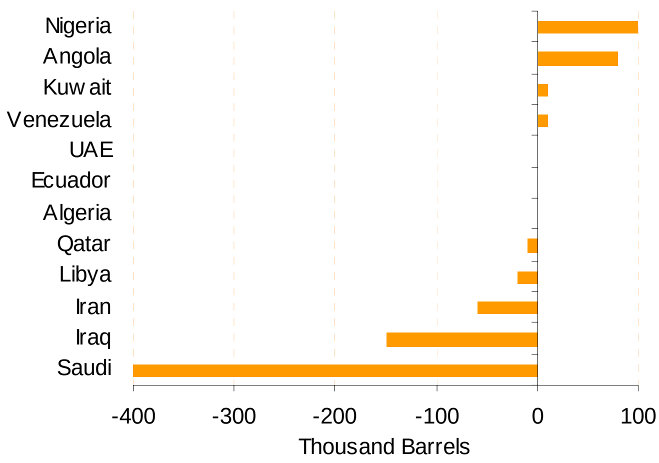
On the demand side, the IEA raised its forecast for global oil demand by 0.24 mmbd to 90.8 mmbd for 2013, citing expectation of higher demand from China. The non-OECD Asia, particularly China, which accounted for two thirds of total incremental demand in the four years to 2011, would likely underpin a rise in demand in the current year. In 2012, China imported 217 million metric tons of crude oil, 6.8% more than 2011. South Korea oil demand was also up 4% Y/Y last year, attributed partially to extremely cold and long winter in the 4th quarter. Elsewhere, in Japan, although annual growth rates have flattened, oil consumption remains on a high base. However, the picture of gathered strength from seasonal winter demand and geopolitical concerns comes at a time of falling production from OPEC, recording in December its lowest level in a year. This, in turn, means that oil prices are well supported at the current levels

Chart 1: Oil Price Developments, YTD



Source: Thompson Reuters

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the supply side, oil output is expected to increase in 2013, owing to growth from OPEC and Non-OPEC producers. The production capacity of OPEC will expand by an estimated 0.7 mmbd on additional supply from Iraq, Angola, and Nigeria. Production in Iraq is surging, as the country rebuilds its oil industry with output reaching its highest level since 1979. Supply from countries outside OPEC is expected to rise by 0.8mb/d, to reach a total of 54 mmbd in 2013. In the US, oil production crossed 7 mmbd early this year, the highest in almost 20 years. Although oil output from Bakken shale formation in North Dakota declined by 2.2% in November 2012, as such wells tend to have steep depletion rates, EIA predicts production from Bakken shale formation, Eagle Ford formation in South Texas, and Permian Basin in West Texas to record a bigger increase in 2013. In its monthly report, OPEC indicates that world oil supply will easily outstrip demand in the first half of 2013, even after Saudi Arabia cut back its production by 0.46 mmbd in December. In addition, demand for OPEC crude oil will average 29.07 mmbd in the first half of 2013, the report estimated, and implying inventories could build up by about 1.3 mmbd should OPEC maintain its December's production level.

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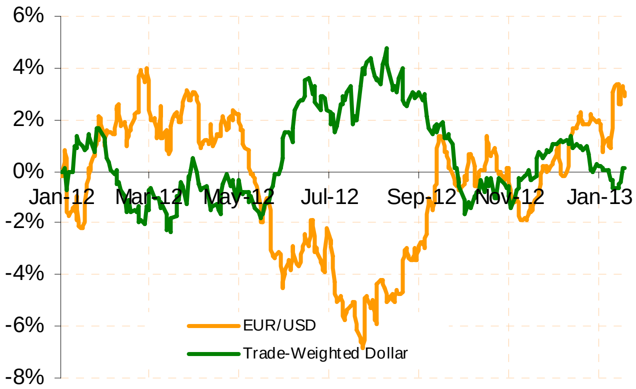
Foreign Exchange

Turning the Wheel for the Euro

The global economy still treads on water, with developed nations either growing at a slow rate, or in the case of Japan and Europe, decelerating and slowing down. Uncertainty is becoming the ubiquitously dominant trait in all financial markets as high volatility continues to make it difficult to forecast or notice any upcoming trends. Hence, recent appreciation of precious metals had transpired from the risk aversive behavior in the market, despite Chinese manufacturing posting a previously underestimated HSBC PMI growth of 51.0 in December from 50.6 in the previous month, the strongest pace since May 2011. The late analysis released by the Fed's chairman regarding the lower-than-anticipated impact of the QE3+ in extenuating the prolonged high levels of unemployment has caused inflation-hedging against the USD towards gold and precious metals. It, therefore, lost 0.74% of its value against a basket of currencies since late November.

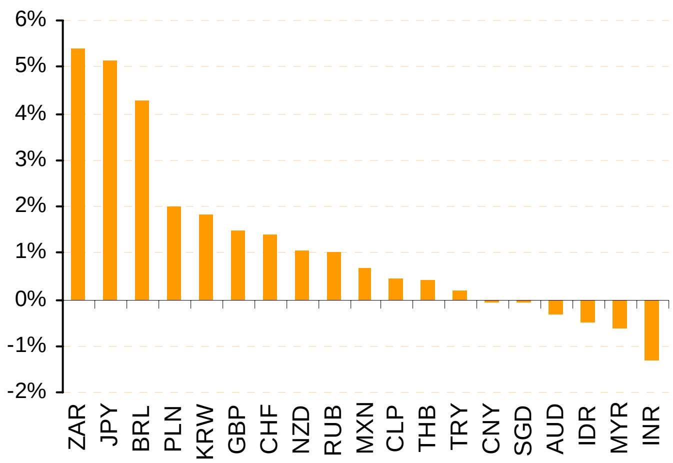
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thompson Reuters

Investors are keeping a sharp eye out for China's 4Q GDP figures to see if a hard landing was avoided. After the newly appointed politburo adopted an accommodative stance, and reaffirmed growth as a chief priority, the Chinese government agreed to expand its fiscal deficit by 50% to CNY1.2 trillion (about USD192bn) in 2013. That, in addition to the rising hopes for an upcoming monetary stimulus package, have attributed to the Yuan's devaluation of 3 pips since mid-December, standing at 6.21. China's weakening performance has prompted the expansion of the Renminbi Qualified Foreign Institutional Investors (RQFII) and the Qualified Foreign Institutional Investors (QFII) programs which already account for more than 1.5% of funds invested in Chinese stocks. Such decision could potentially increase the size of these programs 10 fold, which sends a positive signal to global hedge fund managers and investors. This comes as a part of the ongoing Chinese reform which expresses commitment to financial and market openness.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

As for the Euro, the 17-country-bloc currency, it was propelled to a 10-month high of around USD1.34 by mid-January. This is due to tail-risk experiencing a mild mitigation after Spanish bonds fell at EUR4.5bn auction which increased confidence in the European debt market. However, this development constitutes an added burden on the economy that is yet struggling to regain export competitiveness in the world. Upon the news, the ECB signaled that it won't try to counteract the Euro's appreciation as it remains committed to its sterilized form of monetary policy aimed towards stimulating market dynamics without stoking inflation, dubbed "Outright Monetary Transactions". The ECB also justified its inaction by indicating that exchange rates are not a primary focus on its current agenda, as it has more pressing matters at stake.

Concurrently, the Bank of Japan (BoJ) continues skirmishing against the deflation plaguing its economy. The soaring EUR levied downward pressures on all of its 16 peers, including the JPY which touched a two and a half-year low, offering the BoJ a prime opportunity to announce the implementation of quantitative easing, anticipated by next week.

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Commodities

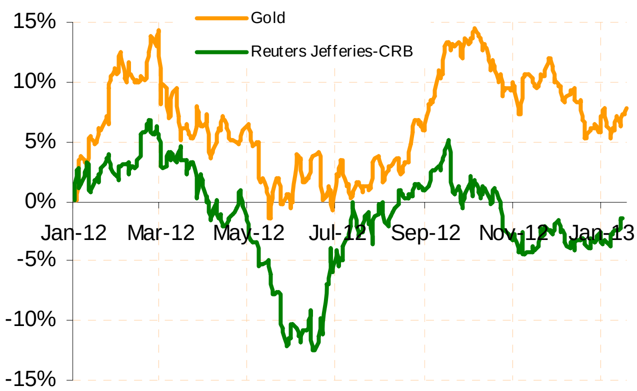
Closing the Year Lower

Commodity investors closed 2012 with overall asset class prices dipping by December. Lower prices were attributed to lower global growth figures especially decelerated ones emerging from China, as well as sentiment clouded by uncertainty regarding the US fiscal cliff. The Dow Jones-UBS Commodity Index Total Return was lower by 2.61% in the last month.

Precious metals and industrial metals fell by 3.81% and 0.74%: the latter partly due to stockpiling of refined metals in China and London Metal Exchange (LME) warehouses. Backlogs in LME warehouses, registered by Trafigura (the world's second largest metals trader following Glencore) in cities like Antwerp extend to August 2013 due to LME load-out rates which limit the daily release of inventories.

As for copper, demand continued to exceed supply with the International Copper Study Group highlighting demand of 13.66 million tonnes outstripping that of production which amounted to 13.14 million tonnes during the first 8 months of 2012. Since 2000, China's consumption of global copper production has grown at an annual rate of 15%, with its share amounting to 40%. Silver, in return, surpassed gold in 2012, returning over 20% by December. The yellow metal opened the year at USD1,536.20/ troy ounce, and closed it at USD1,674.80/ troy ounce.

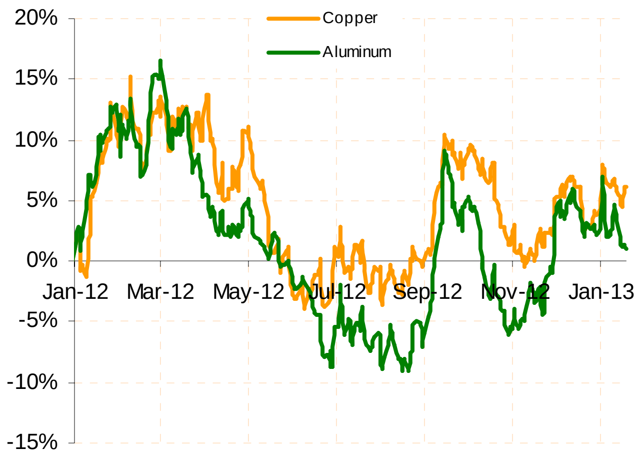
Chart 5: Reuters Jefferies vs. Gold



Source: Thompson Reuters

In agriculture, figures from the United Nation's Food & Agriculture Organization (FAO) reflected sharp declines in both dairy and sugar, with global food average prices ending 7% lower Y/Y. FAO's agricultural market information system (AMIS) illustrates a dip in production, supply and export volumes over the 2012/2013 harvest year in total cereals. Their monthly food price indices showed a contraction in December with Sugar and Oils contracting the most by 16% and 14% for the same month in 2011. Further supporting this downward movement was data from the US Department of Agriculture, which says global production in Maize will likely fall by 4.5% over 2012/2013. Wheat appears to be bucking this trend with constrained supply—due to climatic changes—buoying prices.

Chart 6: Base Metals



Source: Thompson Reuters

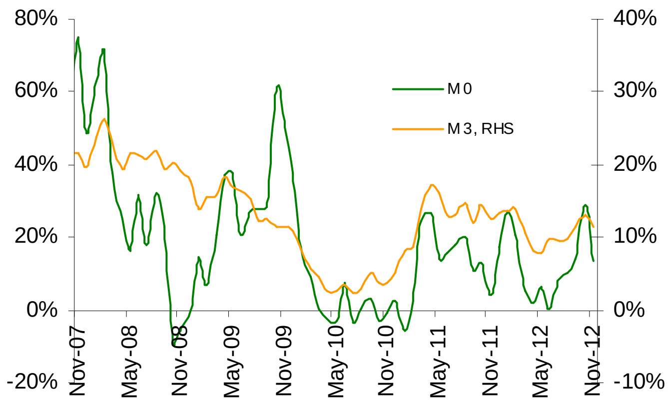
Looking forward into 2013, global growth and geopolitical tensions across the Middle East will dictate commodity performance. Energy, in addition to agricultural sectors will continue to be volatile. In terms of livestock, Russia recently enacted a ban on US meat exports due to a contentious feed additive. As Europe recovers from its debt crisis, the manufacturing sector will trigger an upward push on industrial metals.

Money & Inflation

Consumer Prices Stabilize

The Saudi economy has registered a record SAR1.24 trillion in actual revenues during 2012, yet liquidity levels remain relatively subdued. The composed policy of the Saudi Arabian Monetary Agency (SAMA) has been successful at mitigating the risks of excess liquidity and inflationary pressures have been limited as of late. Furthermore, the continuous acceleration of credit in the local economy aided SAMA in controlling the monetary situation throughout last year. The monetary base (M0) reached an all time high during October at SAR334.9 billion, only to decline by SAR38.7 billion to settle at SAR296.2 billion for November. The contraction was mainly attributed to deposits with SAMA as banks withdrew SAR24.7 billion to accommodate credit expansions and customer withdrawals which reduced total banks' deposit base. Additionally, cash in vault decreased by 31.1% M/M while currency outside banks dropped 4%, SAR5.6 billion, during November on a monthly basis. However, in comparison to November 2011, M0 grew by 13.7%. As the financial year came to an end, we expect the monetary base during December to have picked up as local banks overhaul their balance sheets for their annual reports.

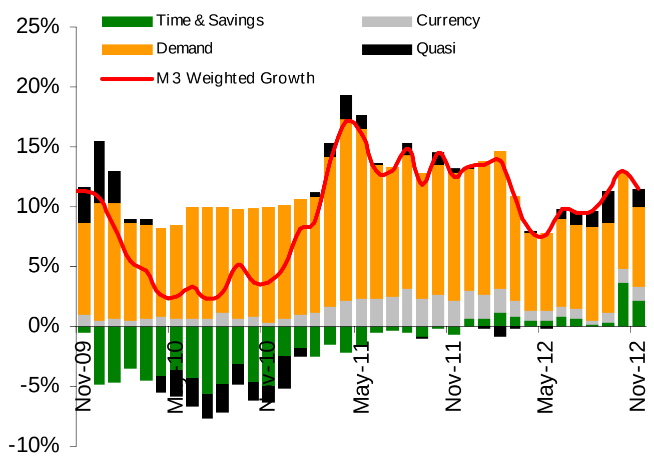
Chart 7: Growth in Monetary Aggregates



Source: SAMA, NCB Estimates

Consequently, money supply (M3) decelerated to a still elevated level of 11.4% Y/Y during November. Demand deposits, forming the largest share of M3, posted the second slowest growth rate during 2012, an annual increase of 12.7% to reach SAR705.3 billion. Due to Islamic preferences and the risk averse mentality of customers, the majority of deposits reside in non-yielding accounts. In addition, given the robust economy which aided higher interest rates, albeit rising at a slow pace, a shift towards time and savings deposits has been observed. By the end of November, time and savings deposits recorded a growth of 9.3% Y/Y. However, on a monthly basis, demand deposits as well as time and savings deposits declined by 0.6% and 4.7% respectively. Despite the fact that M3 decreased by 1.2% from October to November of 2012, other quasi-monetary deposits managed to expand by 4.6% M/M while registering a 10.8% Y/Y gain.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Consumer prices picked up slightly driven by globally rising commodity prices. The inflation rate increased to 3.9% during November compared to the same month of the previous year. The Reuters/Jefferies CRB Index gained 1.1% during the month which was reflected in the food and beverage category by rising 4.8% Y/Y for November. On a regional basis, the city of Al-Madinah's food and beverage prices have been recording significant increases mainly due to base effects owing to a spike in prices earlier this year. Prices are now rising at normal pace, however the annual change in food prices recorded 13.2% while other cities are in line with the national level. Meanwhile, the category of renovation, rent, fuel & water posted its slowest annual growth since April 2007. The decelerating rate of rental prices decreased the category's rate to 6.5% on an annual basis for November. The main two cities facing rental pressures, Jeddah and Dammam, have recorded a rise in rent prices by 10.4% and 9.3% Y/Y respectively. We expect the inflation rate to edge slightly higher for December and continue on an upward trajectory during the first quarter of 2013.

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Capital Markets

Fresh and Positive Start

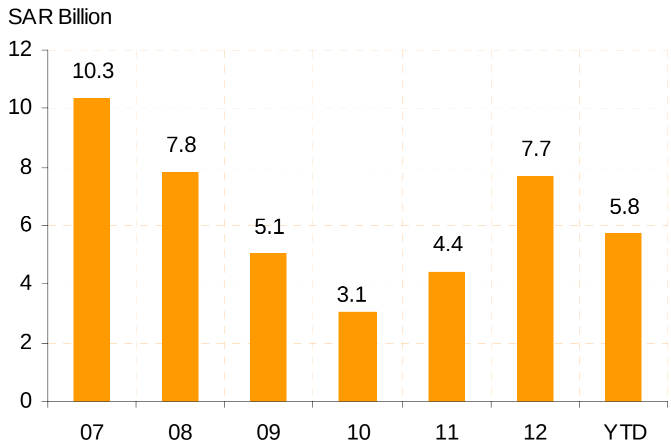
Globally, equities have experienced fruitful events during 2012, prompting investors to be more comfortable holding risk assets. According to the MSCI World index, equities have increased during December by 2.1% which contributed to the 13.4% rise throughout the whole year. Furthermore, according to EPFR Global, 2013 started with equity flows exceeding bond flows on a global scale, a positive indicator for this year. The Saudi stock exchange outperformed the global index during December as Tadawul climbed 4.1% over the month. The anticipation for earnings season has seen capital flows into the market with high expectations. The bullish momentum was carried over to 2013 as the index continued to gain 3.5% by the end of 16 January. The concise press releases have showed strong performances with banks beating estimates. Listed banks have announced aggregate net profits at SAR28.6 billion for 2012 against SAR25.6 billion for 2011, an 11.9% increase. The financial sub-index has gained 5.3% since the beginning of the year, the third best performing sector following hotel & tourism and insurance. The latter two sectors increased by 10.0% and 6.6%, respectively in 2013. We expect a slight drop in stocks as companies announce their detailed annual reports which will prompt investors to reshuffle their portfolios accordingly.

Chart 9: Tadawul All-Share Index

Source: Tadawul

The increased appetite for stocks lifted market capitalization to SAR1.4 trillion by the end of last year, a gain of 4.8% over November's SAR1.3 trillion. The attractiveness of stock evaluations and the anticipation of strong corporate earnings have raised the daily traded volumes from SAR4.9 during November to SAR5.4 billion during December, setting the average for 2012 at SAR7.7 billion. Local stocks are relatively cheap with a market price-to-earnings ratio at 12.75 by the end of last year. Furthermore, the activity in the market is predominantly from Saudi individuals. However, Saudi corporates have contributed in buying 5% of total volumes worth 6.5% of total value during the month, indicative of a long-term approach.

Chart 10: Average Daily Traded Value



Source: Tadawul

Saudi was the leading market with regards to initial public offerings (IPO) across the GCC during 2012. Tadawul added seven companies last year with a total value of SAR5.3 billion worth of stocks for the public. The local stock exchange is expected to expand further during 2013 with an IPO already closed in January for Northern Cement which offered 50% of its capital in the form of 90 million shares at a price of SAR10 per share. The second IPO has already been announced, National Medical Care Company, offering 30.1% of its capital during February.

On a global scale, Sukuk issuances increased 55% Y/Y by posting USD144 billion during 2012. Saudi had its fair share as it issued USD10.5 billion, ranking second to Malaysia last year. During December, Banque Saudi Fransi and Saudi ORIX Leasing Company closed two issuances worth USD570 million. For 2013, the Sukuk market is expected to attract more investors as stocks are still recovering from gyrations.

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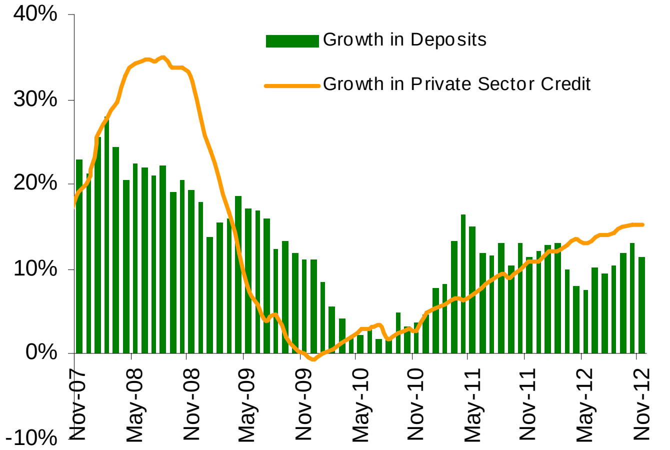
Loans Market

Peaking Credit to Slow Marginally

Saudi banks' performance last year has outperformed 2011 on the back of exceptional efficiency, cost control measures, core banking improvements as well as an accelerating credit market. The latter was facilitated by a bulky depositary base which has kept banks comfortable with the expanding their credit lines. Although on a monthly basis total deposits marginally contracted by SAR11.2 billion, or 0.9%, they have risen by over SAR123 billion over the twelve months through November, an annual growth of 11.5%. Furthermore, taking into consideration the pace of loans' growth, total deposits are at a positive level with a healthy trajectory. The composition of deposits has hardly changed since last year. Demand deposits hold the largest share with 58.9%, or SAR705.3 billion, which are mostly sourced from businesses and individuals as government entities only represent 5.3%. Meanwhile, time and savings deposits continue to be outpaced by their non-yielding counterpart. Deposits made by government entities increased by 15.9% Y/Y while business and individuals' deposits grew by 5.1% Y/Y to bring the total growth for time and savings deposits at 9.3% during November on an annual basis.

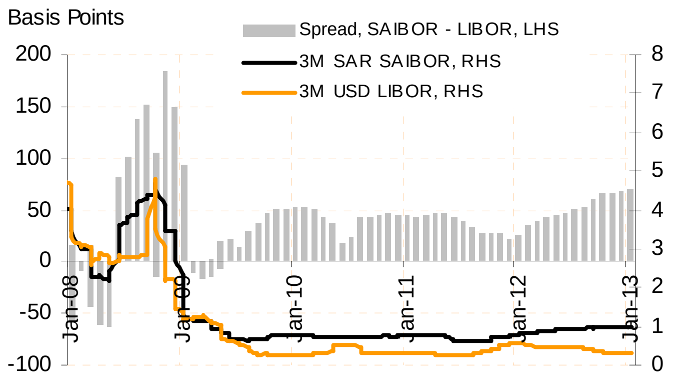
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

As mentioned earlier, the total loans portfolio in the local banking system has been accelerating since its contraction at the end of 2009. During November, combined loans expanded by 15.7%, matching the previous month's growth rate. Local banks are expected to maintain the current level of activity with a more selective approach for 2013. Banks shifting their maturity distribution in their loans portfolios, as medium term credit decelerated to 35.6% on an annual basis, the first deceleration since March 2012. At SAR181.9 billion, medium term credit now holds 18.4% of total credit. Meanwhile, short term credit, which grew by 12.4% Y/Y during November, represents the majority with a share of 56.2%. Additionally, long term credit has posted its third consecutive double digit growth at 11.0% as banks attempt to utilize their liabilities more efficiently via participating in project finance. In our opinion, the fact that credit has peaked in October and November might signals a lower growth trajectory in the near term.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

Given the robust economic conditions, the private sector had a pivotal role in driving the economy forward. As such, credit to the private sector witnessed a 15.2% gain Y/Y during November. Meanwhile, credit to the public sector contracted by 2% annually while gaining 3% M/M. The growth of lending has once again outpaced deposits which contributed to the rise of the loans-to-deposits ratio to 82.7 by the end of November. The Saudi banking system is nearing completion of Basel 2.5 standards and will start implementing Basel 3 standards in the near future. The capital requirements could hinder conventional growth and banks will likely grasp opportunities while they are available. Furthermore, SAMA's strict monitoring over the rigidity of the financial system in the Saudi economy will ensure the soundness of banks amidst ongoing global turmoil.

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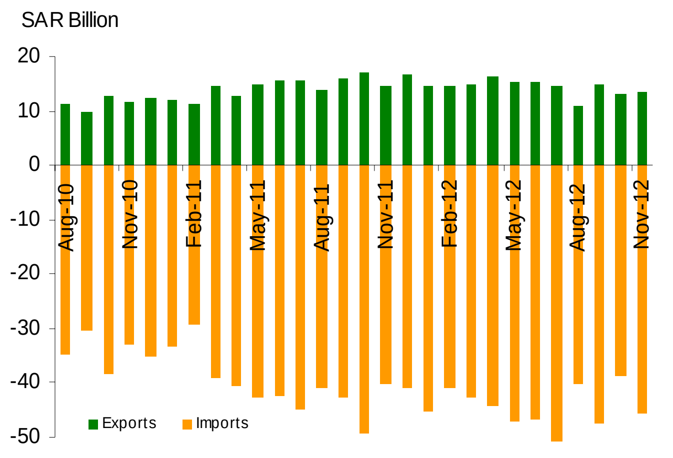
External Trade

Gaining Traction

Saudi Arabia's international trade has rebounded on the back of elevated oil prices. Exports have recorded an increase following October's decline, posting SAR13.6 billion, a 4.6% increase on an annual basis. These upbeat figures come alongside an 8% decline in tonnage compared to last year, which reflects that price levels are still supportive. As for imports, we also notice a surge of 17.1% M/M during November, SAR45.6 billion, which translates into a whopping growth of 35% Y/Y. Export analysis show that plastics remain the top non-oil export by category which surpassed petrochemicals in August. Since then, however, we have been noticing a positive correlation between these two categories. A slight dip was recorded in October which regained traction and continued to spike. In November, plastics, which make up almost 39% of all exports, registered a 17.7% increase Y/Y, followed by chemical products constituting close to 36% which rose by 5.7% Y/Y.

Chart 13: Saudi Non-Oil Trade Balance

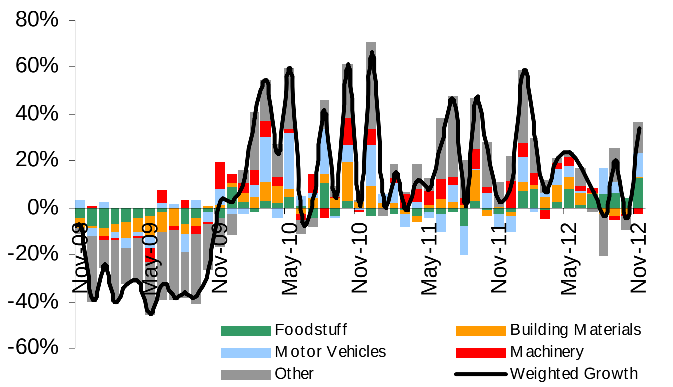


Source: CDSI, NCB Estimates

China remains the crucial trading partner and it appears that the slight recovery in its manufacturing activity has left its imprints on the trade balance sheet. Saudi Arabia allocated a sizable 18% of its non-oil exports to China alone, which in November brought a 40% increase Y/Y to SAR2.5 billion, the highest figure yet seen in 2012. Singapore comes at a distant second, receiving 8.5% of non-oil exports. On an annual basis, Singapore reduced its demand by 9.8% in value terms, allocating SAR1.2 billion worth of Saudi exports. UAE, on the other hand is continuing a downward trend; a summing up SAR95 million, which shrank the Y/Y figures by 19.3%.

Saudi imports leaped upwards again after a dampened movement last month. Most imports consisted of machinery equipment and transport equipment worth SAR11.9 billion and SAR9.6 billion respectively, mainly originating from the US, Germany and Asian countries. More than a quarter of imports are machinery equipment which soared by 28.9% Y/Y. 21% of imports are transport equipment which made a hefty 65.9% Y/Y upturn. Base metals, imports jumped by 22.4% annually, indicative of growing manufacturing activity. Imports by origin show a decline in Chinese imports down to SAR5.5 billion after it remained flat for the past two months at SAR6.5 billion. US imports, however, lost the momentum which they gained back in July to remain stable at SAR6.5 billion. German imports regained third place, after it was topped by Japan and South Korea the past two months by importing SAR3.6 billion worth of goods.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

Newly opened Letters of Credit (LCs) in November increased as orders for motor vehicles jumped by 67% Y/Y, while foodstuffs posted a 220% increase over the same period. Machinery, however, posted a decline of 16% Y/Y. meanwhile, settled LCs show a 106% increase over November of last year in foodstuffs, largely attributed to food grains, and marginally offset by sugar, tea and coffee. Building materials rose a 7% Y/Y, while motor vehicles orders were boosted by 89.7% Y/Y.

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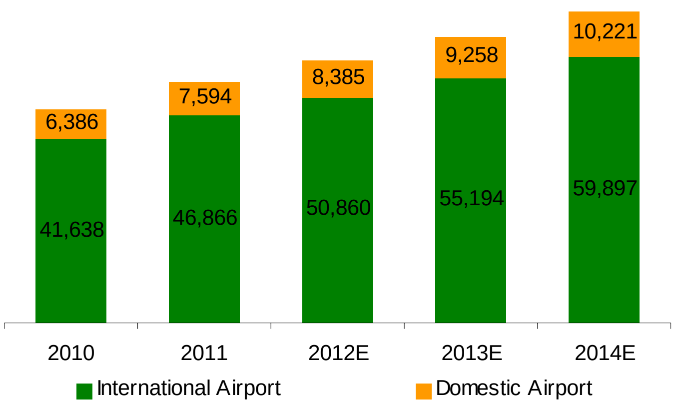
Special Focus:
Saudi Arabia's Aviation

Aviation sector contributed nearly SR30.2 billion (1.8% share) to the Kingdom's GDP in 2010, according to the International Air Transport Association. The Saudi aviation market has witnessed an incredible growth mainly attributed to relaxing the barriers of entry, partially liberalizing the sector, restructuring and privatizing the Saudi Arabian Airlines. Budget allocation for airports has been growing at a 3-year CAGR of 18.4 percent and is expected to reach SR13 billion in 2014. On the demand side, booming religious tourism, growing population, and rising purchasing power of Saudis has further increased the demand for travel. In 2012 alone, domestic and international passengers in all Saudi airports reached more than 59 million passengers; an increase of 1.08% over 2011. Flights have also increased by 5.3% Y/Y and reached around 502,512 operations in 2012.

Presently, Saudi Arabian Airlines (SAA) and National Air Services (NAS) operate within the Kingdom. SAA, currently in the restructuring and privatizing process, receives fuel at subsidized prices, which allows it to counterbalance the limits of the price cap on domestic ticket prices. Other private airlines face high fuel prices and domestic ticket price caps which forced some to cease their operations (such as Sama and Kayala Airlines) as they struggled with their profit margins. To alleviate these challenges, a comprehensive strategic plan for the General Authority of Civil Aviation (GACA) was approved by the council of ministers, mandating GACA to review fuel prices and the domestic ticket pricing system. In turn, this change may lead to an increase in domestic prices that will surely improve airline services. Even though there will be an initial increase in prices, it is expected that, in the medium term, the intensity of competition and the entry of new airlines will be positive in terms of better services and attractive prices.

The newly developed Public-Private Partnerships model has been an integral part of the government's policy to upgrade airports as it assigned the private sector with the management of several expansion projects. King Abdul Aziz International Airport is currently being expanded and expected to be completed by 2035. The project consists of three phases, with the first phase costing around SAR27.1 billion and financed by the issuance of GACA Sukuk guaranteed by the Ministry of Finance. In our opinion, this issuance will be beneficial as a benchmark for pricing corporate Sukuk. The appetite for such Sukuk had been evident from the 3.5 times oversubscription given the Kingdom's macroeconomic stability and the competitive profit rate of 2.5%. Due to this strong demand, the government opted to complete financing the rest of the project via Sukuk which is expected to be issued in 2013. Prince Mohammed Bin Abdul Aziz International Airport is another big expansion project costing around SR4.3 billion, which will be financed through syndicated lending by three domestic Saudi banks.

Chart 15: Passenger Traffic at Airports



Source: GACA

According to MEED Projects, 10 aviation contracts were completed between 2008 and 2012 amounting to approximately SR 3.6 billion. Additionally, projects in execution phases till 2016 are valued at roughly SR 35 billion, meanwhile, SR 6.4 billion worth of projects are expected to be awarded in 2013. We do expect based on the 9th Development Plan that flights are likely to reach 557,702 operations in 2014, and the total number of international and domestic passengers is expected to reach in 2014 over 60 million passengers (40.3 million international passengers departing from international airports, and 20.3 million domestic passengers departing from international airports).

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