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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

Executive Summary

- There are a number of risks to oil price forecasts. On the downside, they include higher Iranian exports, and continued slowdown in China and other emerging economies. On the upside, risks include stronger consumer demand, especially gasoline, delay in implementing Iranian agreement, and decline in non-OPEC output.
- The gradual yet sustained labor utilization in the US is increasing the Fed's confidence in the overall economic recovery; however, increasingly bearish sentiments in the global recovery is putting global macroeconomic concerns at the heart of the Fed's rate hike decision.
- China's New Normal policies have burst the petrochemicals and base metals bubble as the country shifted from solely focusing on growth via exports to boosting domestic consumption. This policy attempts to limit the country's high exposure to global trade dynamics, and provide a more sustainable albeit lower base for growth.
- In the current theme of low global inflation, we expect CPI inflation in the Kingdom to average 2.3% in 2015, and inch higher next year by base effect to 2.5%.
- The oil market remains a main drag on stock prices as leading companies' revenues are directly affected by low oil prices. The index recorded its fifth monthly decline in the last six months, dropping 3.8% by the end of October. .
- We expect to see banks' holdings of short-term government securities such as SAMA bills to fall accordingly as banks aim to free liquidity in order to absorb the government's longer term issuances.
- the Kingdom's non-oil exports slid 19% Y/Y in value terms in August at SAR14.9 billion while the import bill declined by 11%Y/Y at a total of SAR54.3 billion.

View of the Month

Cement plays a pivotal role in the construction, maintenance, repair, and renovation of building structures. Domestically, 15 companies are supplying the local market's demand. The production of clinkers precedes the final cement product, clinker production in the first nine months of 2015 reached 42.8 million tonnes, almost the same figure for the period of 2014. Cement production posted an 8% growth for 9M2015 at 45.3 million tonnes.

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Macroeconomic Indicators

	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	55.0	60.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.2
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,798.4	2,509.4	2,724.4
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	747.2	670.1	727.5
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.5%	3.9%	2.2%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.3%	2.5%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.5	76.9	-38.6	-36.0
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.3%	-5.8%	-4.9%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	640.2	578.2
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	665.3	703.7
Actual Expenditure, SAR billion	826.7	873.3	976.0	1109.9	1032.2	980.6
Expenditure Overrun, %	42.5%	26.6%	19.0%	29.8%	20.0%	12.9%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-65.5	-366.9	-276.9
Budget Balance/GDP	11.6%	13.6%	6.5%	-2.3%	-14.6%	-10.2%
Break-Even Oil Price	75.3	73.9	82.6	100.1	88.7	85.4
Financial Sector						
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	13.3%	13.9%	10.9%	11.9%	10.3%	9.5%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	10.4%	9.3%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	0.9%	1.3%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.3%	0.4%	0.7%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	69.5	60.0	70.0

Sources: Thomson Reuters, SAMA, and NCB

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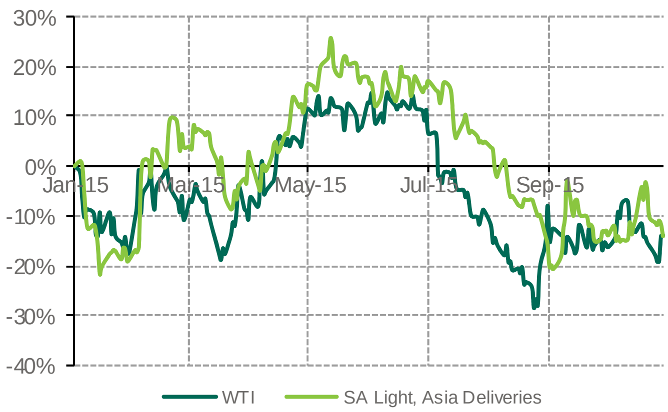
Oil Market

Oversupplied Market Despite Shale Decline

Crude oil prices dropped slightly, hovering around the level of $45/b for the entire month. In the 3Q, 2015, oil price averaged USD48.8/b, down 19% from 2Q. Prices have been driven by lower expectations of slowing global growth, particularly in China, ongoing oversupply pressure, and projected larger production by Iran next year. While the fundamental factors that have been negatively affecting oil prices since last year persist, there are emerging signs of alleviations, as demand picked up and stocks were drawn in some regions. In turn, crude oil futures were up after two months of steep declines. Brent was trading around USD48.5/b, while WTI jumped by USD2.6/b, trading around USD45.5/b. The Brent premium over WTI narrowed substantially over the month by more than USD2/b, as the US market was supported by inventory draws, while Brent was pressured by oversupply. In addition, WTI prices have been affected by declining production of shale oil and falling imports of Canadian light oil. There are a number of risks to oil price forecasts. On the downside, they include higher Iranian exports, and continued slowdown in China and other emerging economies. On the upside, risks include stronger consumer demand, especially gasoline, delay in implementing Iranian agreement, and decline in non-OPEC output.

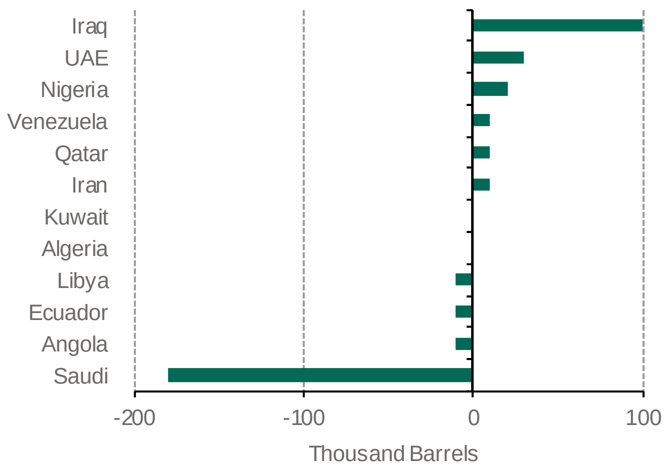
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, total output grew by 1.8mb/d y/y in 3Q, 2015, and is down from more than 3mb/d gain in the 1H, 2015. OPEC production increased by 1.3mb/d in 3Q, 2105, and non-OPEC supply also grew by 1.3mb/d, while the US accounted for less than half of non-OPEC supply growth at 0.6mb/d. In Iraq, production rose to 4.3mb/d in September, with output from southern fields accounting for much of the gain. In Saudi Arabia, production eased in August and September, but total OPEC output was still 1.7mb/d above the 30mb/d target. In the US, production peaked in April at 9.6mb/d, but declined below 9.4mb/d in July, largely due to lower shale oil output. According to EIA, US oil production will decline to 9.0mb/d in 4Q, 2015, and is projected to reach 8.7mb/d in 4Q, 2016. The drop is attributed to lower shale oil drilling and also to reduced investment. Thus, it is expected that the oil market will rebalance and reduce the large inventory overhang next year. On the other hand, IEA believes that global oil glut will persist through 2106, as demand growth slows from a five-year high, and key OPEC members maintain the near-record production. OPEC will meet in December 4th to discuss production, but Gulf countries, led by Saudi Arabia, seem to be determined on keeping their strategy to pursue market share despite low prices and reduced export earnings.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, world oil incremental demand increased by 1.9mb/d in the first three quarters this year. Oil demand growth was concentrated in the US and China, increasing by 1.1mb/d, with also a gain in Indian demand by 0.2mb/d. The US oil demand rose by 0.5mb/d, or 2.6%, primarily for gasoline, as lower oil prices stimulated people to drive more. China's oil demand increased by 0.6mb/d, or 5.9%, also due to larger increase of demand for gasoline. However, world oil demand is expected to slow slightly in the 4th Q, 2015, putting annual global demand growth at 1.8mb/d, up 1.9%. Non-OECD demand is expected to rise by 1.2mb/d, while OECD demand is projected to increase by 0.6mb/d. In 2016, global oil demand is forecast to slow to 1.2mb/d, up 1.3% with increases mainly in the non-OECD and OECD Americas. The stimulus of lower oil prices on consumer demand is expected to subside next year.

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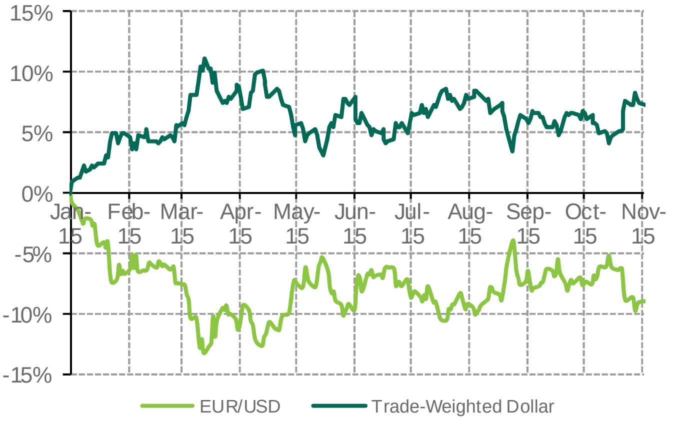
Foreign Exchange

USD Rallies as Fed Hike Looms

In the wake of a sustained US economic recovery, market participants are gearing up for a potential policy tightening in Q4. The USD is expected to remain broadly supported by strong demand for USD denominated assets, impeding recovery for commodity currencies. Throughout the second half of the year, we notice that that USD traded on a narrower range than what we saw back in the first half, indicating that the greenback is consolidating its strength against its major peers. Unemployment in the US stood at 5.1% as of September, the lowest since March 2008. The gradual yet sustained labor utilization in the US is increasing the Fed's confidence in the overall economic recovery; however, increasingly bearish sentiments in the global recovery is putting global macroeconomic concerns at the heart of the Fed's rate hike decision. The Fed's data dependence evolved from a threshold unemployment level to more inclusive and holistic parameters such as wage growth, export competitiveness and consumer prices. We expect global factors such as growth in China and emerging markets to play a significant role in the upcoming rate lift-off. The trade-weighted dollar index stood at 96.35, appreciating by 6.7% during 9M2015. We expect the Fed to raise interest rates by 25 bps by the end of 2015 unless it drastically alters its near-term outlook on global economic performance; an unlikely occurrence.

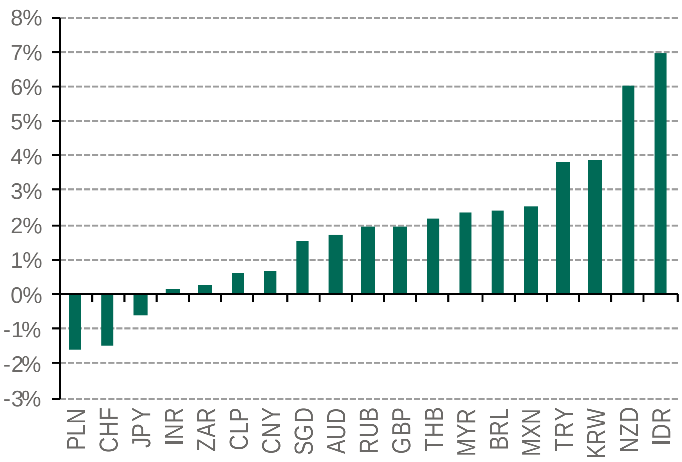
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

The EUR began its inflection point on March 13th after it closed lowest at USD1.049 (-13.2%.) By mid-October we see that it has reached the midpoint of its YTD range appreciating back to USD1.147, leaving it at -5.2% YTD. The single currency owes its resilience to the subsiding Greek debt conundrum, giving the Eurozone a less gloomy outlook relative to the EM. The Eurozone is expected to have a heterogeneous economic performance where Germany remains to be the engine for growth hovering around 1.5% Y/Y. However, weaker demand from China, in addition to the recent Volkswagen emissions scandal are expected to dent German output considerably. Spain is expected to maintain a strong growth momentum this year according to an IMF survey, growing at 2.8%, thanks to thorough policy reforms and fiscal consolidation. Meanwhile, France and Italy are struggling with a more muted performance. The ECB indicated that it will not hesitate to unleash a more aggressive round of quantitative easing if the current stimulus proved to be insufficient to lift inflation towards its 2% target. Hence, the increasing likelihood for further ECB action exacerbates the downside potential for the EUR.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the Emerging Market, the Brazilian real (BRL) and the Turkish lira (TRY) have both reached record lows versus the USD late September. Having lost 36.4% YTD versus the dollar at 4.17, the depressed BRL reflects that the Brazilian economy is under severe melancholy resulting from the political uncertainty engulfing the country. The inability of the various political parties to reach a consensus over unwinding fiscal imbalances leaves the country's investment grade rating at a risk of a downgrade. Similarly, the TRY continued to extend losses against the dollar under a backdrop of political uncertainty and capital outflows. Closing at 3.05 liras for the dollar on the 28th of September, the Turkish currency had fallen by 23.6% from the beginning of the year.

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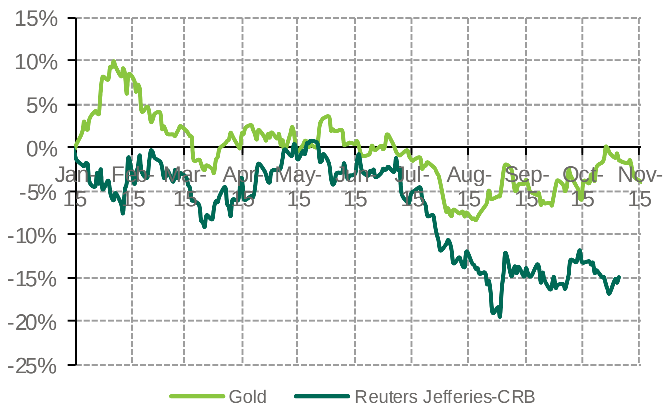
Commodities
Gloomy Outlook on Weaker Demand

Big investment in commodities during the commodity super cycle allowed the formation of a market bubble which resulted in abundant supply meeting much lesser demand. A stronger US dollar amid global macroeconomic perils affected many export dependent economies, in particular net commodity exporters such as Brazil, Chile, and Australia. Uneven growth prospects led to a repatriation of capital and a divergence between monetary policies in major economies such as the US and the Euro Area. The prolonged and protracted oil oversupply theme resulted in a noticeable wealth effect to consumers initially from lower energy prices. Yet as the cost of production fell, producers suffered lower returns, and lower consumer prices consequently yielded lower wage growth, thus lower demand. However, large commodity feedstock growth during the super cycle is expected to keep commodity prices depressed in the short to medium term. The Thomson Reuters/Jeffries Commodity Research Bureau (TRCRB) index indicates that commodities are at record lows, falling 15.7% this year by the end of September, standing at 193.76.

Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

China's New Normal policies have burst the petrochemicals and base metals bubble as the country shifted from solely focusing on growth via exports to boosting domestic consumption. This policy attempts to limit the country's high exposure to global trade dynamics, and provide a more sustainable albeit lower base for growth. Moreover, the shift in policy is also creating new challenges that depended on the previous Chinese growth model. Currently, two of the BRIC nations, Brazil and Russia are in recession as their export returns tumbled and the global demand outlook for commodities is negative. Nickel prices experienced a free-fall this year reaching their lowest levels of USD9,515/ton, slashing around 37.2% of their year-beginning price. The indispensable nature of copper and aluminum in construction and manufacturing helped soften their downturn although prices have also experienced double-digit declines, eroding the profitability of miners and smelters. Copper and aluminum prices slid 18.1% and 14.9% during 9M2015, standing at USD5,160/ton and USD1,577/ton, respectively.

Chart 6: Base Metals

Source: Thomson Reuters

Bullion prices have fallen a long way from their 2011 highs; partly due to the lack of gold appeal to investors as they flock towards other assets, and the declining industrial use of silver as it is replaced by other metals/alloys. Equity market selloff in China and other emerging markets provided renewed buying for gold since mid-August which has been trading at a narrow USD100 range between USD1,085/oz and USD1,185/oz. India's gold import ban remains a major barrier for a gold upswing although China's stacking of gold reserves is still supportive of physical demand. The bid against silver started to subside as China began shoring up the stability of the yuan by massive purchases of the precious metal in order to hedge against economic uncertainties. Hence, the China Construction Bank signed to join the London Bullion Market Association (LBMA) in October in order to help set a daily price for silver. Consequently, during the month silver surged 11.1% to USD16.18/oz on the 14th, erasing losses since June. If the November vote of the IMF comes in favor of the renminbi's inclusion in the SDR basket, we should see silver prices edge higher in response to more demand for the metal by the PBoC.

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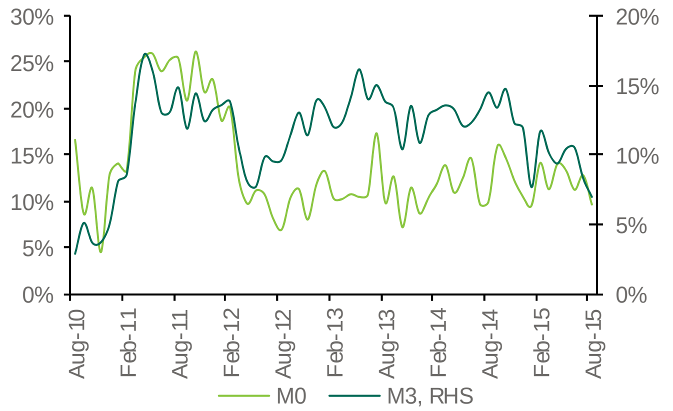
Money & Inflation

Lower Deposits from Government Entities

Growth in the Kingdom's broad money supply recorded yet another deceleration in August, sliding to 7% Y/Y. In retrospect, the rate indicates the lowest annualized upturn since December 2010, and is well below last year's average of 13.1%. The growth moderation in the money supply comes at a time where the government is consolidating its spending on infrastructure projects in order to manage its tighter fiscal situation. SAMA's monthly bulletin for the month of August shows that allocated deposits for government projects shrunk by 27.8% Y/Y to SAR373.8 billion. Depressed oil prices have protracted to the point where their repercussions became well anchored into every sector in the Kingdom. The monetary system is no exception, although the previous positive business cycle had some residual effects which helped maintaining the momentum well after the oil shock began in the second half of last year.

Chart 7: Growth in Monetary Aggregates

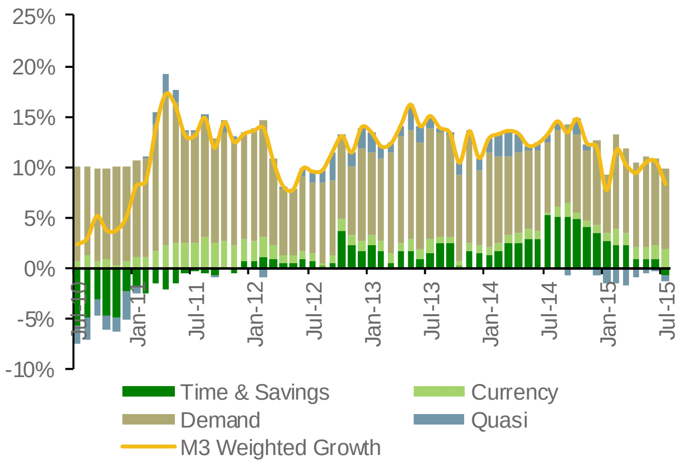


Sources: SAMA and NCB Estimates

The financial sector is increasingly reflecting the economic realities as the monetary base (M0) decelerated in growth, posting an annualized 9.6%, largely affected by a reduction of banks' holdings at SAMA. The recent issuances of sovereign debt urged banks to free some of its resources which were previously held as excess reserves to absorb the longer, higher yielding debentures. The consolidated balance sheet of Saudi banks shows that excess reserves ratio has fallen to 29.8%, the lowest levels since late 2008. Demand deposits which constitute the majority of deposits in the Saudi banking system (around 65.3%) have also shown a pronounced growth deceleration to 12.2% Y/Y compared to an average of 14.2% last year. This brings the broadest measurement of money (M3) to grow by 7% annually, the lowest growth rate since December 2010.

Meanwhile, the biggest chunk of the Saudi depositary base, demand deposits, stood at SAR1.06 trillion. It was mainly affected by a moderation in deposits by businesses and individuals which – in turn – make up 92.5% of demand deposits at SAR980.8 billion. Time and savings, which has a more balanced composition of government and private entities at 50.3% and 49.7%, respectively, reached a total of SAR380.6 billion. The government's portion of the time and savings account fell markedly by 9.5% on a Y/Y basis, indicating the government's higher need for cash on standby compared to last year as it continues its fiscal spending. Furthermore, quasi monetary deposits slid 2.7% to SAR183.5 billion on the back of reduced deposits of foreign currency by government entities.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The Consumer Price Index (CPI) is at a moderate 2.14%, benefitting from compressed commodity prices, as food and beverages account for 21.7% of the consumer basket. Upward inflationary pressures are concentrated in housing, particularly in rent as high demand and short supply continues to underpin housing prices. Housing and utilities posted an annualized 3.88% on August, which is considered the highest monthly appreciation since June last year. In the current theme of low global inflation, we expect CPI inflation in the Kingdom to average 2.3% in 2015, and inch higher next year by base effect to 2.5%.

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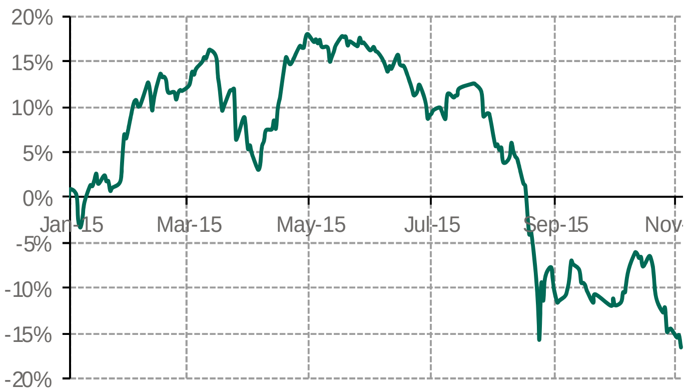
Capital Markets

Establishing a Floor

Starting the second quarter of 2015, the collapse of the Shanghai Composite Index pressured global equities into the negative territory. Fears over the solidity of the Chinese economy engulfed investors like wildfire. It is now widely accepted that China will not be able to generate the same growth momentum. However, the government's loosening policy will likely stop the deceleration following the latest GDP announcement of 6.9% for the second quarter, the slowest since the 2008 financial crisis. During October, the notion that China is stabilizing supported a 10.8% rebound which lifted stocks around the globe. The MSCI World index registered a growth of 7.8% last month following a drop of 3.8% during September. Easing monetary policies in most economies are supporting stock markets as Europe's STOXX600 gained 8.0% during October. Additionally, the reluctance of the US Fed to increase rates has benefited equities recently, giving investors more time with riskier assets. We do not expect global markets to post the robust growth figures registered in the past couple of years but we are likely to end the year on a positive note as we finalize the last quarter of 2015.

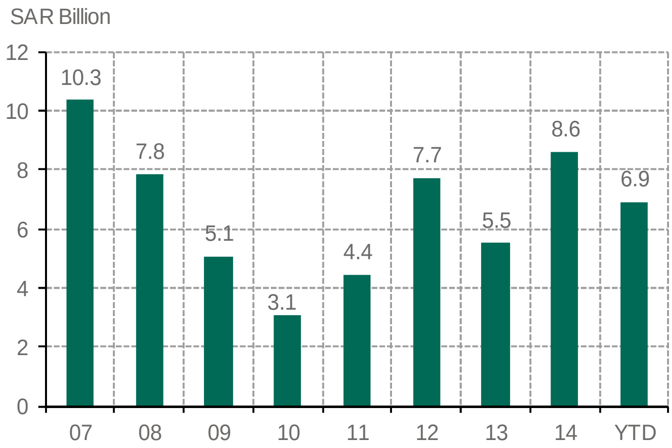
Chart 9: Tadawul All-Share Index



Source: Tadawul

As for the local stock market, Tadawul has not mirrored its international counterparts as local investors anticipated the corporate profitability announcements. The oil market remains a main drag on stock prices as leading companies' revenues are directly affected by low oil prices. The index recorded its fifth monthly decline in the last six months, dropping 3.8% by the end of October. Recently, S&P downgraded Saudi's debt rating from AA- to A+ as the economy's fiscal challenges are expected to hinder growth over the coming years. The downgrade culminated a weak performance for Tadawul which has struggled to attract international investors after finally allowing qualified financial institutions (QFI) to enter the market back in mid-June. On a sectoral basis, the hotel and tourism sector registered the greatest loss at 10.1% last month, followed cement sector at 7.9% and the real estate sector at a decline of 7.3% M/M. Despite the overall negativity in the market, the media sector posted a significant 20.5% gain through October as rumors lifted prices prior to a large ownership shift in the sector's Saudi Research and Marketing Group stock.

Chart 10: Average Daily Traded Value



Source: Tadawul

The level of activity showed great fluctuation during last month as daily traded volumes ranged from SAR2.5 billion to SAR6.4 billion, averaging SAR4.8 billion which equates to a 3.6% gain on September's average. Tadawul's weekly ownership and trading activity report reveals that the majority of selling is driven by Saudi retail individuals while Saudi institutions have been on the buy side during last month. Additionally, QFIs have been increasing their exposure to the Saudi market, albeit at a slow pace. By the end of October, total ownership of QFI and foreign SWAP holdings stood at 1.06% of the market. Tadawul's price-to-earnings ratio of 14.23x by the end of October is attractive for long-term investment opportunities as the economy is weathering this challenging business cycle. We expect the domestic market to remain volatile yet we believe the market has established a floor to rise from over the medium-term.

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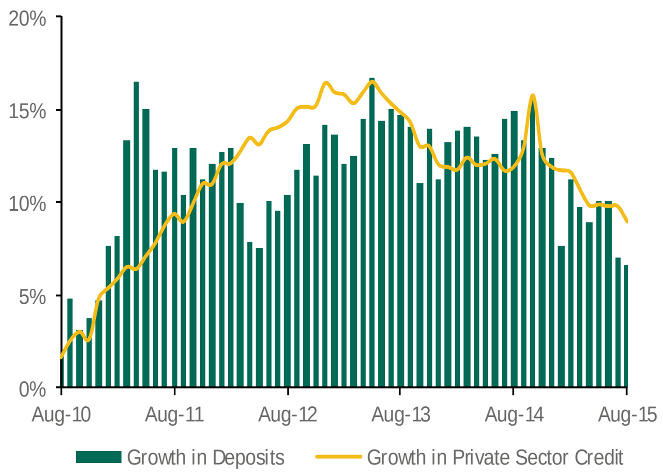
Loans Market
Lower Growth in Credit, Interbank Rises

The consolidated balance sheet of Saudi banks indicates further waning in the loans portfolio during the month of August. With the late government issuances of development bonds crowding out the private sector, the annualized growth rate of private sector credit stood at 9%, the lowest since July 2011. We expect the moderation in private sector credit to continue as the government proceeds to issue these debt instruments. Fresh private sector credit up until August amounts to SAR81.7 billion making total outstanding private sector credit at a total of SAR1.29 trillion. The private sector thus accounts for 96.9% of total bank credit, leaving the public sector with SAR41.4 billion. shrinking by 4.7% Y/Y. Moreover, we expect to see banks' holdings of short-term government securities such as SAMA bills to fall accordingly as banks aim to free liquidity in order to absorb the government's longer term issuances. Compared to the same periods last year, SAMA bills have been in consistent decline since April. In August, commercial banks' share of SAMA bills plummeted 20.3%, down to 185.8 billion, the lowest level since January 2014. In contrast, the annual growth in government bonds' holdings surged by 19.4% Y/Y to SAR65 billion.

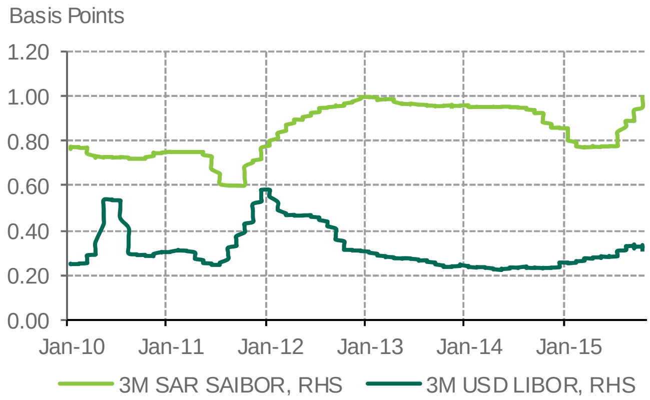
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

On the liability side, demand deposits which account for 59% of broad money supply (M3) recorded a 12.2% annualized growth at SAR1.06 trillion. Despite the double-digit growth, demand deposits decelerated to the lowest growth rate since January. We note that narrow money (M1) remains resilient at a 12% Y/Y growth, standing at SAR1.23 trillion. On the other hand, less liquid forms of deposits such as time and saving deposits posted the second consecutive annualized decline of 2.5% in August, bringing M2 money supply to SAR1.61 trillion. Quasi monetary deposits also shrank 2.7% compared to the same period last year at SAR183.4 billion, bringing M3 money supply to SAR1.80 trillion.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

The Federal Reserve settled its October meeting in favor of keeping interest rates unchanged. Rattled emerging markets are experiencing an exodus of capital under the premise that currency mismatches could erode the value of investments. Moreover, the waves of emerging market sell-offs were exacerbated by China's currency devaluation in August and subsequent concerns over the Chinese economy. The IMF, thus, urged the Fed to wait until next year before hiking its short term funds rate. Cheap cost of borrowing aided the global economic recovery since the onset of the Great Recession. However, the surge in corporate leverage which quadrupled between 2004 and 2014 left the average ratio of emerging market corporate debt at 26%. The Fed's rate hike would certainly increase the likelihood of a credit crunch in the EM, leading corporate bond yields to rise. The USD/SAR peg eliminates much of the currency risks associated with a Fed monetary normalization; however, maintaining the peg implies that interest rates in the Kingdom will have to move in lockstep with the Fed. The 3-month average rate for the Saudi riyal deposits stood at 82 bps, creeping up by 4bps from July's 3-month average.

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External Trade

Double-Digit Declines in Non-Oil Trade

Uneven global growth in 2015 is expected to weigh on the Kingdom's external balance. Weaker demand for exports and a lower import bill led to a narrowing of the balance of trade gap in August by an annualized 7.5%. The weakening of the emerging market, the stagnation in Europe, and the strong growth in the US are forcing a divergence in central banks policies whereby the US Fed is expected to hike its benchmark interest rate to reflect the strengthening economy. Meanwhile, currency devaluations in the EM and Europe continue in order to spur growth, allowing them export competitiveness. Therefore, the Kingdom's non-oil exports slid 19% Y/Y in value terms in August at SAR14.9 billion while the import bill declined by 11%Y/Y at a total of SAR54.3 billion.

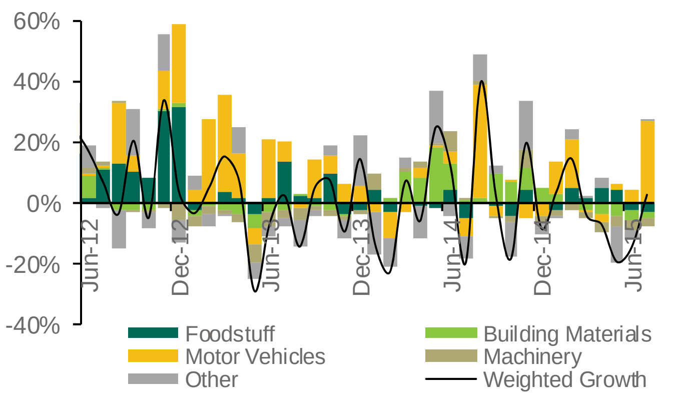
Chart 13: Saudi Non-Oil Trade Balance

Sources: SAMA and NCB

On the export side, the largest components of non-oil exports consist of around 31.8% plastics, 29% chemical products, and 8.5% base metals. Exports of plastics in the month of August totaled SAR4.7 billion, tumbling by 25.6% from last year. Chemical products recorded an even larger slump in the same month after posting a return of SAR4.3 billion, thus falling by 27.3% compared to the same period last year. Moreover, exports of base metals dwindled by 27.3% Y/Y, posting SAR1.3 billion. By export recipient countries, the UAE remains the top non-oil trading partner globally with around 15.1% of the monthly total. China accounts for 10.1% and Singapore for 6%. Non-oil exports to the UAE totaled SAR2.2 billion displaying resilience as its monthly figure surged 16% Y/Y. China's share of August's non-oil exports reached SAR1.5 billion, plummeting by 22%Y/Y. Lastly, exports to Singapore stood at SAR893 million, declining by 12.3%Y/Y.

On the import side, the largest components consist 26.1% of machinery and electrical equipment, 17.3% transport equipment, and 10.5% of base metals. By value, the Kingdom's imports of machinery and electrical equipment fell 18.5% Y/Y to SAR14.2 billion. In contrast, transport equipment recorded a 5% upturn in August, standing at SAR9.4 billion. Imports of base metals tumbled 23.7% Y/Y, at SAR5.7 billion, reflecting the impact the USD's strengthening is having on commodity exporters' currencies. The majority of the Kingdom's imports originate from China (14.5%), the US (13.7%), and Germany (7%.) Imports from China saw a double-digit decline of 12.2%, posting SAR7.9 billion. Imports from the US inched down by 1.4% at SAR7.4 billion. Meanwhile, imports from Germany dose-dove 14.5% as they recorded SAR3.8 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

Settled letters of credit (LCs) in the month of August slid 4.2% Y/Y as they totaled SAR19.9 billion. The majority of LCs consist of LCs for motor vehicles (21.5%), foodstuff (14.1%), building materials (9.3%). LCs for motor vehicles have been posting solid double-digit growth figures last year owing to strong domestic demand. We note that growth in this category of LCs has been very resilient, inching down by 0.5% in August at SAR4.3 billion. LCs for foodstuff took a hit of 20.7% Y/Y, declining the most since February at SAR1.3 billion. Moreover, LCs for building materials tumbled 12.8% Y/Y at SAR1.9 billion.

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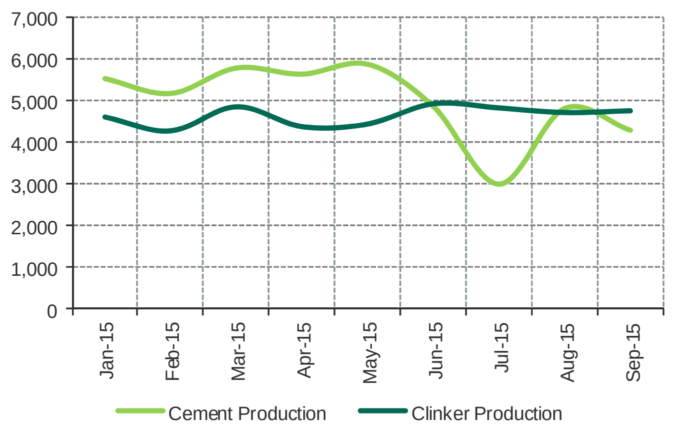
NCB الأهلي

Special Focus:

Subdued Cement Outlook

Saudi's robust business cycle took a turning point with tumbling oil prices back in 2014. The economy's fiscal account recorded its first deficit since 2009 and has been shouldering the burden of maintaining their oil share in global markets throughout this year. The strategy to push out high cost oil producers has kept oil prices in the USD40-50/bbl range for almost a year as shale producers have shown more resilience than initially expected. This has impacted the balances of the Saudi economy, yet the government has been adamant in avoiding to pass the burden on its citizens by using foreign assets to cover the fiscal deficit as well as tapping into the unutilized debt capacity. Going forward, the government is expected to prioritize its capital expenditure to decrease its overall expenses in the short-term. The colossal value of mega projects in Saudi provides the construction market with abundance of opportunities yet competition will likely extend. Recently, Saudi's largest construction company, Bin Laden Group, has been suspended from any new bidding for contracts while also being under investigation on projects under their management. This will potentially provide smaller companies the ability to secure contract awards directly rather than being sub-contracted by their larger competitors which will develop the market's dynamics.

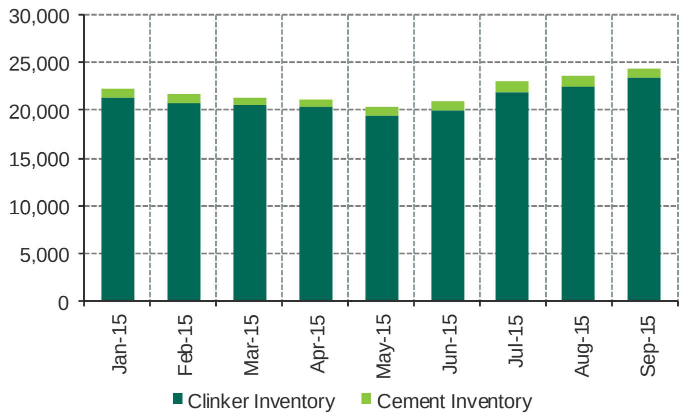
Chart 15: Cement Industry Production, Thousand Tonnes



Source: Yamama Cement Company

Cement plays a pivotal role in the construction, maintenance, repair, and renovation of building structures. Domestically, 15 companies are supplying the local market's demand. The production of clinkers precedes the final cement product, clinker production in the first nine months of 2015 reached 42.8 million tonnes, almost the same figure for the period of 2014. Cement production posted an 8% growth for 9M2015 at 45.3 million tonnes. The Ministry of Commerce and Industry set the price ceiling of a 50kg cement bag at SAR12/bag for wholesales and SAR14/bag for end users. According to the Central Department of Statistics and Information, the price averaged around SAR13.7/bag for 9M2015. As local deliveries reached 44.6 million tonnes by the end of the third quarter, total revenue for 2015 is expected to be just under SAR16 billion as sales and prices during the fourth quarter are likely to decline further. Competition is expected to intensify as clinker inventory levels reached a record 23.4 million tonnes by the end of September and cement inventories reached just above one million tonnes.

Chart 16: Industry Inventory Levels, Thousand Tonnes



Sources: Yamama Cement Company

The muted outlook for the sector will represent a challenge for market share. This year had witnessed a reduced budget for capital expenditure by 25%, a situation that had materialized with the MOF contract signings falling by 47% in 9M2015. However, we believe the challenges are skewed to the short-medium term as the government will pursue its expansionary policy once oil markets return to their previous levels. Additionally, a conditional ban on cement exports currently limits the possibilities for regional expansion which could possibly be revisited by officials. On the equity front, the 14 listed companies have reported a 5% drop in net profits to SAR4.5 billion and the sector sub-index has fell over 30% YTD as the whole market struggles with risk averseness.

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