

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- While Libya and Nigeria acknowledged limited upside for production, damage has already been done, as their current output level weakens the effectiveness of OPEC/Non-OPEC agreement.
- The JPY benefitted mostly from the weaker greenback this year as global risk aversion peaked through mid-year. Growth in Japan has been impressive, expanding by 1.7% in 1Q2017, the third consecutive quarter in which growth exceeds 1%.
- Soft commodities appear to be holding their grounds as global demand is recovering and global inflation is rising.
- The inflation rate registered another contraction as the headline index declined by 0.7% annually during the month of May. We expect the depressed level of oil prices and the economic slowdown to continue pressuring the monetary system of the Kingdom in 2017.
- If the experience of UAE and Qatar in 2013 is a blueprint, the Saudi market can expect huge inflows following the announcement and its weight in the index can range from 2% to as high as 5%, if Saudi Aramco's IPO goes through.
- The UK Financial Conduct Authority will phase out LIBOR by 2021 and is currently reviewing numerous alternatives to minimize transition costs and disruptions to the market.
- Encouragingly, non-oil exports have been growing more rapidly than oil exports in recent years reflecting a degree of success in that regard despite structural challenges.

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View of the Month

Given Vision 2030's drive towards attracting foreign investors into the local economy, as well as creating an investment tycoon worth SAR7 trillion through the Public Investment Fund, the international economic linkages are critical for identifying opportunities and avoiding risks.

Macroeconomic Indicators

	2011	2012	2013	2014	2015	2016P	2017F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	50.2	40.9	50.6
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.4	10.1
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,799.9	2,836.3	2,444.1	2,398.6	2,525.5
GDP at Current Market Prices, USD billion	670.4	734.9	747.6	757.4	652.6	640.5	674.4
Real GDP Growth Rate*	10.0%	5.7%	2.7%	3.7%	4.1%	1.4%	-0.7%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.2%	3.5%	2.5%
External Sector							
Current Account Balance, USD billion	158.5	164.8	135.4	73.8	-51.6	-53.4	-35.3
Current Account Balance/GDP	23.6%	22.4%	18.1%	9.7%	-7.9%	-8.3%	-5.2%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	609.7	529.3	489.5
Fiscal Sector (Central Government)							
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1,044.4	612.3	528.0	700.0
Actual Expenditure, SAR billion	826.7	873.3	976.0	1100.0	978.0	825.0	890.0
Expenditure Overrun, %	42.5%	26.6%	19.0%	28.7%	13.7%	-1.8%	0.0%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-55.6	-365.7	-297.0	-190.0
Budget Balance/GDP	11.6%	13.6%	6.4%	-2.0%	-15.0%	-12.4%	-7.5%
Break-Even Oil Price	75.3	73.9	82.6	99.1	82.9	62.6	66.8
Financial Sector							
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	13.3%	13.9%	10.9%	11.9%	2.6%	0.7%	0.9%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	9.8%	2.2%	2.3%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	0.9%	2.1%	2.5%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.2%	0.3%	0.7%	1.7%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	70.4	56.4	134.7	80.0

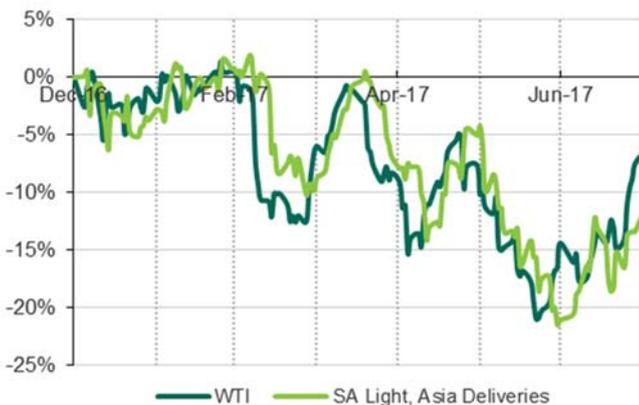
Sources: Thomson Reuters, SAMA, General Authority for Statistics, and NCB
 Note: Saudi Economic Review Data, April 2017 Update (Historical and Projections)

Oil Market

Returned Supply Stall Price Recovery

Brent crude prices averaged USD46.0 a barrel in June, marking the first month of 2017 in which Brent crude prices averaging below USD50.0 a barrel. The lower prices in June is attributed to the return of Libyan and Nigerian supplies, Chinese economic concern, and still high level of inventories. The most growing concern for OPEC producers relates to the shale oil breakeven price, as US Shale oil producers proved they can grow their production at USD50.0 a barrel, and can grow at an accelerated level at USD55-60 a barrel. Although growth in US shale oil output is decelerating due to rising cost inflation, slowing of rig count growth and constraining capital market access, these dynamics do not undermine the viability of shale oil production. While Libya and Nigeria acknowledged limited upside for production, damage has already been done, as their current output level weakens the effectiveness of OPEC/Non-OPEC agreement. The conformity with production quotas was strong during the first months of the year, but it is not incremental to the outlook for the balance of the year, as Iraq's compliance continues to deteriorate. The uncertainty remains regarding the compliance to production cuts, which could influence prices in either direction. In light of these developments, along with continued commitment of Saudi Arabia and Russia to the production cut's deal, Brent prices are expected to be in the USD50-55 range in 2H'17 and to be in the same range in 2018.

Chart 1: Oil Price Developments, YTD

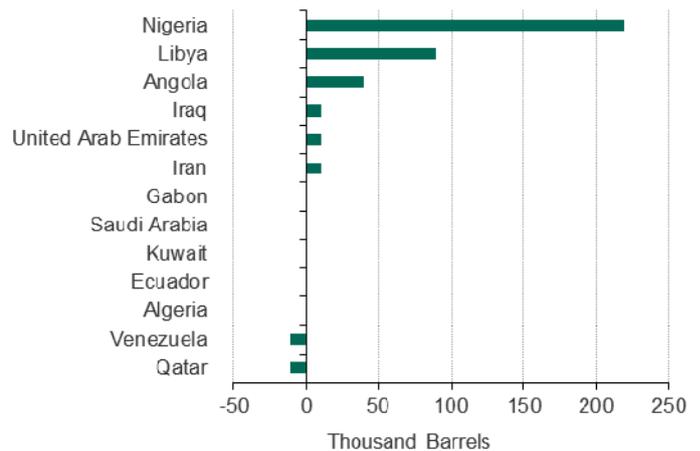


Source: Thomson Reuters

On the supply side, oil production rose by 0.72mb/d in June to 97.46mb/d, standing 1.2mb/d above a year ago with non-OPEC back in growth mode, according to IEA. OPEC crude output rose by 0.34mb/d in June to 32.6mb/d after Saudi output increased and Libya and Nigeria, spared from cuts, produced at stronger rates. While Nigeria agreed to adjust its production as soon as it reaches a

sustainable level of 1.8mb/d, Libya did not make any statements concerning its production level. Light-heavy crude Libyan output already ramped up to 1.0mb/d. Iraq, on the other hand, expressed its intention to increase its oil production to about 5mb/d by the end of the year. OPEC compliance dropped to 78% in June, the lowest rate this year, while non-OPEC group compliance rate improved to 82%. On a yearly basis, OPEC crude oil production is expected to decline by 0.2mb/d in 2017, according to EIA, as OPEC members have reduced production based on the November 2016 agreement, and in May 2017, this agreement was extended through the first quarter of 2018. EIA forecasts non-OPEC oil production to rise by 1.0mb/d in 2017 and by 1.2mb/d in 2018, as US production increases by 0.8mb/d and 1.0mb/d, respectively, attributed to improving oil prices and increasing drilling activity. Kazakhstan is expected to be a notable source of non-OPEC production growth, as annual average production is forecast to be 0.2mb/d and 0.1mb/d in 2017 and 2018, respectively. The OECD commercial inventory overhang has decreased 90mb, with the preliminary IEA data through June putting the surplus of the 5-year range closer to 255-260mb.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, global oil consumption growth is expected to be 1.5mb/d in 2017 and 1.6mb/d in 2018, with 1.2mb/d of the growth in both years coming from countries outside OECD, according to EIA. As consumption growth in Europe slows, OECD consumption is forecast to reach 0.3mb/d in 2017 from 0.4mb/d in 2016. China and India are expected to be the largest contributors to non-OECD oil consumption growth. China's consumption growth is forecast to average more than 0.3mb/d in both 2017 and 2018, while India's consumption is forecast to grow by 0.2mb/d in 2017 and by almost 0.3mb/d in 2018.

Foreign Exchange

Narrowing Interest Rate Differentials

Reaching mid-year, the USD had already completed its secular bull run and is expected to weaken towards year-end. US growth and interest rate advantage are already factored at current levels. Moreover, positive developments elsewhere such as improved inflation and growth prospects in Europe are luring investors away from the US, lessening the impact of the monetary policy divergence narrative. In addition, the ongoing Russia investigation remains a hanging cloud which adds to the risk premium on the greenback. We expect to see more weakening despite continued Fed hikes which currently stand at 1.25%. Another 25bps rate hike is expected this year, leaving the Fed's funds rate at 1.5%. Looking into next year, the Fed is likely to continue normalizing monetary policy, targeting 2% in 2018 and 3% in 2019. The unemployment situation is currently at the lowest levels since 2001, standing at 4.4% as of June. With the exception of the March blip, in which non-farm payroll dipped to just 50,000, jobs creation has been steady, posting 222,000 new jobs in June. The DXY index fell below the 100 mark in April and continued downward trending through July, hovering around 95 points.

Chart 3: Trade-Weighted Dollar and the Euro

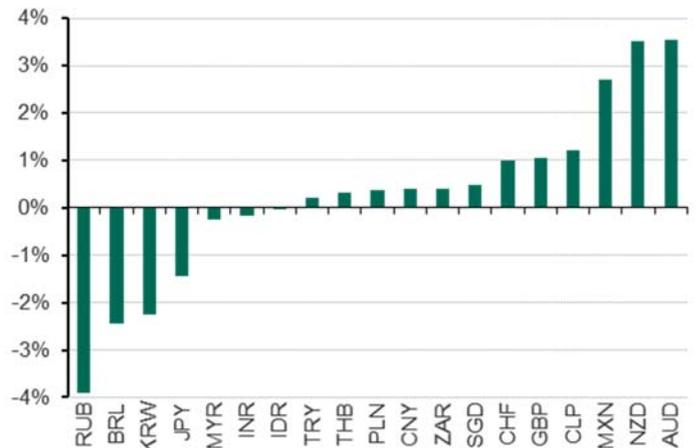


Source: Thomson Reuters

The outlook for the euro is improving beyond what was previously expected. The subsiding Brexit aftermath and lesser geopolitical impact from the French election have been supportive for market stability, easing off investor concerns on rising populism in Europe. The German Federal Elections which are scheduled on the 24th of September are already gaining traction. The Christian Democratic Union which is led by Angela Merkel (center right) is running against the Social Democratic Party under Martin Schulz (center left) with early polls showing the wave of

right-wing populism ebbing away. Hence, we expect the EUR to maintain broad-based strengthening alongside higher gains in European stock markets as they provide better returns and lower risks compared to the US. The EUR surged around 10% YTD by mid-July to USD1.15, and continues to have plenty of momentum to appreciate further.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

The GBP struggled prior to the snap elections but regained strength upturning by 5% YTD to USD1.3. The Brexit aftermath manifested itself in a slower 1Q growth of just 0.2%, the weakest growth rate in almost a year. However, hopes of a rebound in 2Q are justified by positive PMI surveys and retail sales. Consequently, the IMF cut its outlook forecast for the UK this year to 1.7%, around 0.3% less than previous forecast. Inflation rose above the Bank of England's target of 2%, standing at a three-year high of 2.9% Y/Y in the month of May before moderating to 2.6% Y/Y the following month. Imported inflation helped push the CPI higher, however, wage increases have not kept up, rising by 1.8% year-to-March. As domestically induced inflation remains muted, we expect to see CPI returning to the BoE's target in the coming months. Hence, we also expect the BoE policy to remain on hold this year.

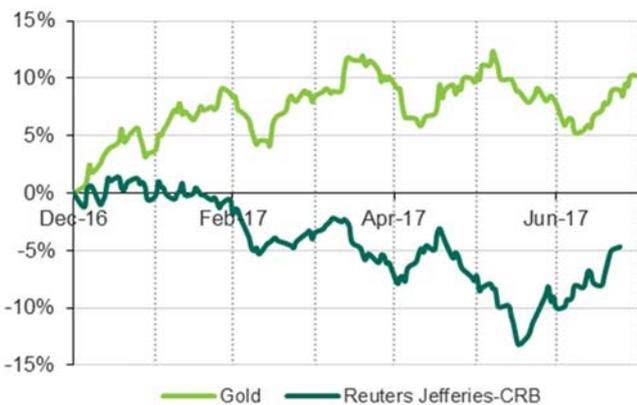
The JPY benefitted mostly from the weaker greenback this year as global risk aversion peaked through mid-year. Growth in Japan has been impressive, expanding by 1.7% in 1Q2017, the third consecutive quarter in which growth exceeds 1%. The IMF forecasts headline growth for Japan to be at 1.3%, underpinned by a rise in private consumption, investment and exports. The JPY remained hovering around 112/USD, upturning by 4.4% YTD.

Commodities

Gold Strengthens on Risk Aversion

Global momentum remains strong despite oil declines with fundamentals playing a major role in supporting metals and soft commodities. Uncertainty surrounding the oil markets cloud the outlook for commodities due to the inter-relatedness of the oil market and other commodity markets. The Thomson Reuters/Jeffries commodity index fell by 7.2% in July, standing at 178.6. The fading effect of the Chinese credit stimulus had slowed activity in metal-intensive sectors such as manufacturing and construction, although we expect global demand to balance out the shortage in Chinese demand. The theme for copper and aluminum remains the same while gold prices appear to be firming up on higher global risk and a weaker USD. Food grains remain affected by oversupply although some grains have found price support due to drought expectations.

Chart 5: Reuters Jefferies vs. Gold

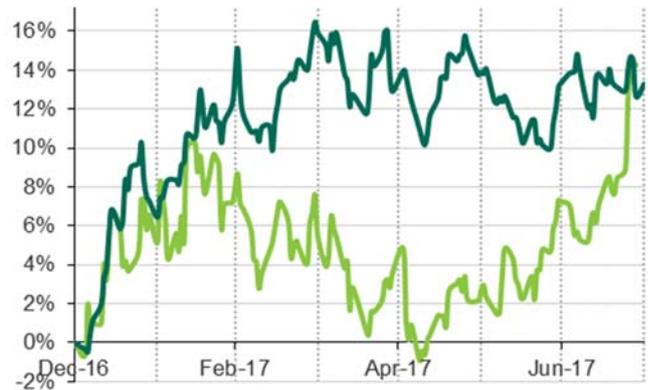


Source: Thomson Reuters

The World Bank expects industrial commodity prices to rise this year on the back of less smelting capacity in China driven by environmental concerns. Labor strikes and contractual disputes on mines in Latin America may also constitute a bottleneck for ore supply. In addition export bans in Malaysia and Indonesia may drive prices higher once re-enacted. Copper prices stood at USD5,966.5/ton in July, upturning by 7.8% YTD. Aluminum is facing strong global demand, keeping its price at USD1,920 by the end of July. The US fiscal stimulus plan is likely to contribute to increased demand for infrastructure projects; however, demand from China will continue to have key influence on aluminum price trends. Recent China growth worries led to higher volatility in base metals; however, the IMF revised the China 2017 growth forecast up to 6.7% from 6.5% earlier due to policy support. As China speeds up its transition to a more sustainable growth model, its mone-

tary policy will remain accommodative. This resulted in Q1 and Q2 growth results being higher than expected, recording 6.9% Y/Y, the strongest since 3Q2015. Gold prices continue to run on renewed momentum owing to shifting interest rate expectations. The Fed is likely to continue normalizing monetary policy, but the USD's interest rate differential isn't capturing investors' attention. A December rate hike is still likely and gold prices might moderate to low USD1,200/oz levels by year end if global risk remained contained. The current rally might be short-lived under the premise that the USD is bottoming out but recurrent geopolitical tensions in the US or Europe are likely to keep gold afloat. Gold traded for USD1,238/oz by the end of July, and is expected to have some room on the upside due to the relative weakness of the USD. Also, as equity markets setting on fresh highs, an expected market correction might fuel demand for gold as a safe haven.

Chart 6: Base Metals



Source: Thomson Reuters

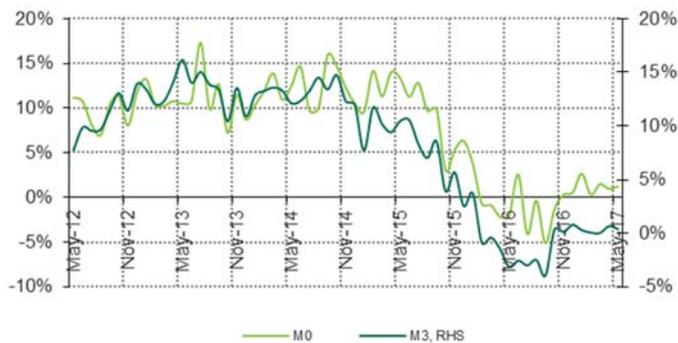
Soft commodities appear to be holding their grounds as global demand is recovering and global inflation is rising. A weaker USD helped to boost food grains which also helps to firm prices against over-stocked inventories. Moreover, drought expectations are well anchored in grains futures markets. According to the Goldman Sachs agricultural commodity index, soft commodities rose by 3.4% YTD, standing at 301 by the end of July. Wheat prices surged by a staggering 22.7% YTD to 500 cents/bushel, whereas corn prices upturned by 9.9% to 386.75 cents/bushel. We expect to see a positive trend for grains inversely correlated with the USD given that supply shocks that drastically affect the market are avoided.

Money & Inflation

Monetary System Still Liquid

The definition of money is “something generally accepted as a medium of exchange, a measure of value, or a means of payment,” according to Merriam-Webster’s dictionary. Cattle, grains, spices and metal coins made from gold or silver were used over the centuries before the current widely used banknotes became the means to exchange goods and services. The earliest banknotes date back to the 7th century in China as the population grew, consumption continued to diversify and money needed to become easier to exchange. However, it was almost 1000 years later when central banks were created in Europe, mainly to finance wars, that the current monetary system was established. Depositors place their money with the bank who usually offers interest payments to grow their funding base. These funds are then lent to businesses and individuals with a higher interest rate, the bank keeps the spread differential as profits. Governance by the central bank requires banks to maintain reserves to accommodate depositors accessing and withdrawing their money. These reserves along with currency in circulation become the narrowest form of money supply, called M0. By adding other assets to M0, such as demand deposits, time and savings deposits and other semi-liquid assets, the money supply becomes M1, M2, and M3, the broadest measure in current monetary systems.

Chart 7: Growth in Monetary Aggregates

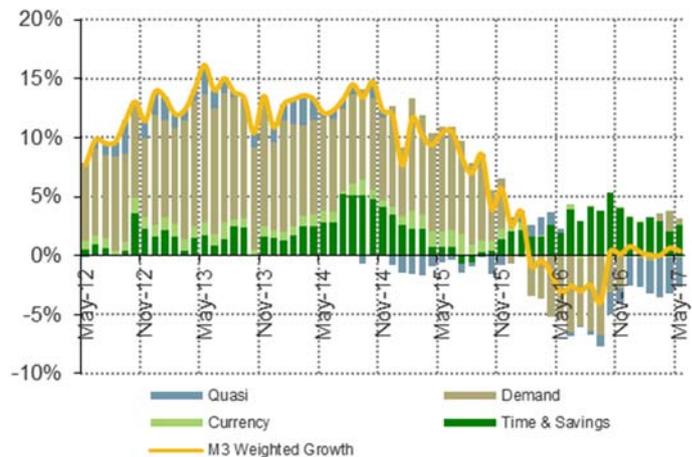


Sources: SAMA and NCB Estimates

The monetary base in Saudi reached its highest level in 2017 at SAR306.6 billion by the end of May, gaining 1.3% on an annual basis. This was mainly attributed to an increase of 4.1% Y/Y in deposits with SAMA, coupled with a rise of 4.3% Y/Y in cash in vault levels. Currency outside banks gained when compared to the previous

month, albeit contracting on an annual basis by 1%. Additionally, demand deposits registered a benign expansion during May by 0.8% annually while time and savings deposits rose by 11.4% annually to reach SAR455.7 billion. Meanwhile, other quasi-monetary deposits continued their accelerated declines, declining by 23.7% Y/Y as government entities’ holdings of foreign currency contracted by 65% as the government manages cash flow needs. Accordingly, the broadest measure of money supply, M3, marginally gained by 0.4% on an annual basis. We expect the depressed level of oil prices and the economic slowdown to continue pressuring the monetary system of the Kingdom in 2017.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The inflation rate registered another contraction as the headline index declined by 0.7% annually during the month of May. The food and beverages sub-index represents the share in the basket of goods, which remained in the negative territory with a drop of 2.3% Y/Y. However, the recent excise tax on harmful products, including soft drinks, will raise prices over the next half of 2017. Water, electricity, and gas prices subsidies were planned to be removed in July. The hike in prices were conditional following the first month of the Citizen’s Account program cash grants. Although a delay to the latter means utility prices remain in place, possibly till the fourth quarter of this year. Consequently, the consumer price index is expected to average lower than previously estimated in 2017, particularly as the unemployment rate maintains an upward trend and consumer demand weakens amidst the macroeconomic backdrop.

Capital Markets

Why MSCI EM Inclusion is Needed

The Saudi bourse continued its volatile performance, with the headline index rising by 8.1% to end the month of June at 7,426. Surprisingly, the move higher materialized amidst the decline in oil prices, with the WTI and Brent falling respectively by 6.4% and 5.5% M/M, despite the recent agreement by OPEC and non-OPEC members to extend the cuts well into 2018. In our opinion, the short-term will be largely driven by the oil specter, the impact of subsidy reductions later this year and the effect of MSCI's recent announcement of adding TASI to its watch list for a possible inclusion in the emerging markets index.

Chart 9: Tadawul All-Share Index

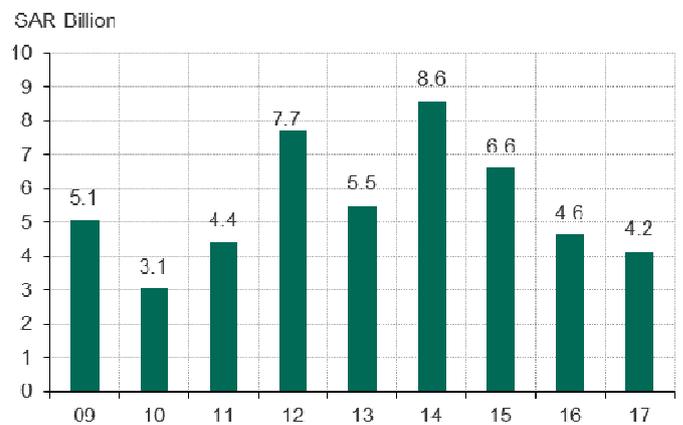


Source: Tadawul

Performance-wise, the heavyweight sectors remained in the red despite the monthly gains, namely materials and capital goods that registered annual declines by 2.7% and 17%, respectively, by the end of June. The weakest sector was transportation, recording a decline of around 24% since the beginning of the year, followed by media, which fell by 20.4%. Investors' appetite, represented by the average daily trading volumes, rose during June to SAR3.4 bn from SAR2.8 bn a month earlier, yet lower than last year's average of SAR4.6 bn, underscoring the wait-and-see theme. The majority of trading continues to be attributed to Saudi individuals, representing around 69.5%. Individuals continued to be net sellers in addition to GCC investors while Saudi institutional investors and QFIs were net buyers. Notably, the share of Saudi institutional investors out of the total value traded had registered 21.5% given their highest net investment since November 2016 that amounted to SAR9.7 bn. On the reform-side, the Capital Market Authority (CMA) and Tadawul had recently implemented a

slew of reforms in order to enhance TASI's bid for a possible inclusion in MSCI's EM index in 2018. Amending the settlement cycle to T+2 starting April and changing the tick size in May are critical changes, with the former seen as bringing the market closer to standard practices in developed markets and the latter as providing additional price bands to attract more investors. Additionally, the CMA had started to enforce the new mechanism for companies with accumulated losses reaching 20% or more of its capital, which will replace the old framework that required companies to report and take actions when accumulated losses reach 50%. Four companies that were not able to rectify their positions and bring their accumulated losses below 50% of their share capital were delisted.

Chart 10: Average Daily Traded Value



Source: Tadawul

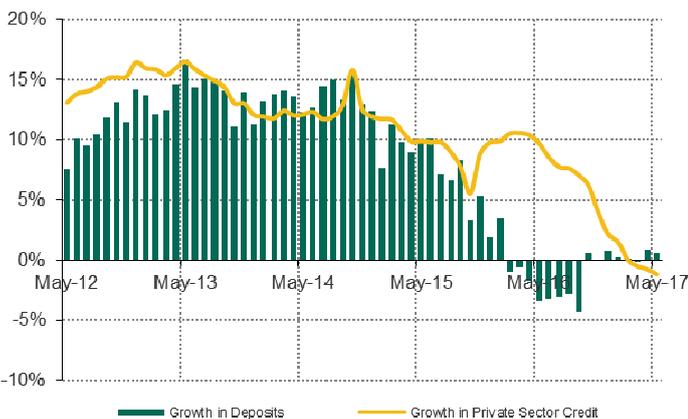
The inclusion of TASI into the MSCI EM index is not only a way to attract portfolio investments, but it is also a seal of endorsement to the current economic and financial developments going on in the Kingdom. A significant USD1.5 trillion is tracking this index and the bylaws of major pension and insurance funds stipulate that the targeted markets must be part of this index. If the experience of UAE and Qatar in 2013 is a blueprint, the Saudi market can expect huge inflows following the announcement and its weight in the index can range from 2% to as high as 5%, if Saudi Aramco's IPO goes through. We do believe that these positive reforms had brought the Saudi market closer to emerging market accessibility standards and as such will enhance the appetite of foreign investors towards domestic equities.

Loans Market

LIBOR to Be Phased Out

Banks borrow and lend money to manage liquidity and meet central bank requirements regularly. The majority of these transactions are short-term in nature, as short as overnight, within the interbank market. Domestic markets determine the rate of financial transactions for local banks. The London Interbank Offered Rate (LIBOR) is the most widely known and largest in size, estimated to underlie USD350 trillion worth of financial instruments annually. London banks estimate and submit the average rate of lending between each other for five different currencies in seven maturity periods. The recent controversy surrounding the manipulation of LIBOR involving the world's largest banks resulted in jail sentences for several traders and hefty fines and settlements for banks, reaching almost USD10 billion. The scandal exacerbated the proposal to replace LIBOR as regulators were skeptical regarding the structure and size of underlying transactions for the benchmark rate. The UK Financial Conduct Authority will phase out LIBOR by 2021 and is currently reviewing numerous alternatives to minimize transition costs and disruptions to the market.

Chart 11: Private Sector Financing

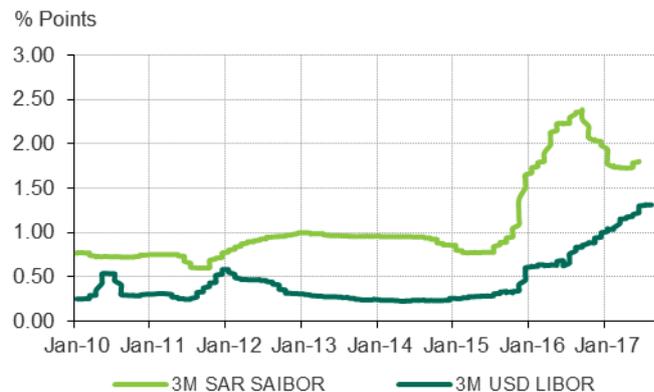


Sources: SAMA and NCB Estimates

As for the Saudi interbank market, SAIBOR, the rate averaged around 1.73% during the second quarter of 2017, well below 2016's peak of 2.4%. Given that the Saudi government halted domestic debt issuances since October, risk levels mitigated and liquidity rebounded. The first domestic sukuk sale of SAR17 billion received bids over SAR51 billion, reflecting strong local appetite. The majority of the bonds matures within five years, while tranches of seven and ten years were also offered. Due to the currency peg with the US dollar, we expect further pressures to arise as the US Fed continues its normalization policy

with further interest rate hikes in 2017 and 2018. The asset/liability composition in the form of loans and deposits continues to be reshaped as the depositary base stagnates while the loans portfolio contracts on an annual basis. Demand deposits registered an annual increase of 0.8% while time and savings deposits attracted more funds by expanding at an annual 11.4%. Accordingly, total deposits marginally grew by 0.5% Y/Y during the month of May. Assessing the other side of the balance sheet, total claims of the banking system, excluding T-bills and government bonds, registered an annual contraction of 0.9% to settle at SAR1.4 trillion. Therefore, the loans-to-deposits (L/D) ratio reached 88.6%, the highest level since October 2016. SAMA's current 90% L/D limit will likely remain, however, easing the limit to 100% in line with regional counterparts can alleviate further pressures in the market.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

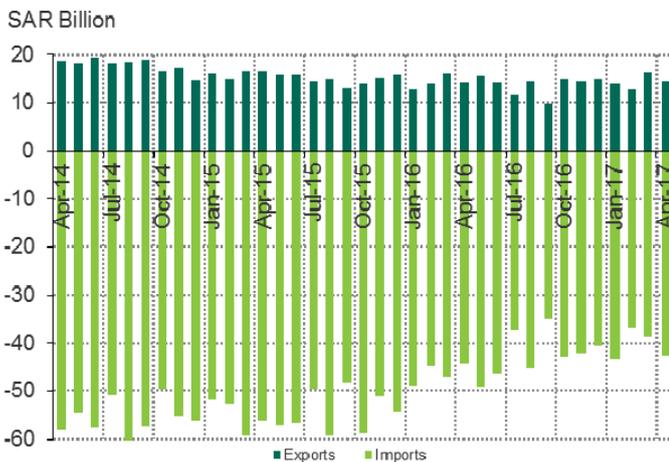
As for the private sector, banks credit decreased by 1.2% on an annual basis by the end of May, reflecting the challenging economic conditions. The credit cycle's delayed downturn was supported largely by corporate credit which utilized financing to manage their cash flows up until 1Q2016, however, corporate credit decelerated significantly in 2016 and inflicted negatively by the end of the first quarter of 2017 by 1.3% Y/Y. Additionally, claims on the public sector reached SAR261.7 billion during May. As treasury bills held by banks declined by 77.5% Y/Y to settle at SAR13.8 billion, allowing banks to shift their assets to government bonds which gained 28.9% annually to reach SAR197.8 billion, a record high. The resumption of domestic debt issuances will possibly hinder the domestic credit market by crowding-out the private sector. Although, we do believe the government has become wary to avoid a repetition of last year's scenario.

External Trade

Non-oil Trade Remains Pressured

As oil dependency in the Kingdom is a major concern, diversification efforts have intensified, putting more emphasis on growth of non-oil exports. Encouragingly, non-oil exports have been growing more rapidly than oil exports in recent years reflecting a degree of success in that regard despite structural challenges. The Saudi Export Development Authority assumed responsibility for promoting the Kingdom's non-oil products abroad and assisting domestic companies in exporting their goods. This rise has boosted the share of non-oil exports in non-oil GDP by three percentage points since 2004, reaching 13.6% by 2013, according to the IMF. As the oil shock took place during the second half of 2014, and the USD gained strength, much of non-oil Saudi exports took a hit due to their oil-relatedness. During the month of April 2017, the Kingdom's non-oil trade recorded a 1.9% annual growth, standing at SAR14.5. On the other hand, lower government expenditure, namely on infrastructure projects also reduced demand for imports which inched lower by 3.3% Y/Y to SAR42.8 billion.

Chart 13: Saudi Non-Oil Trade Balance

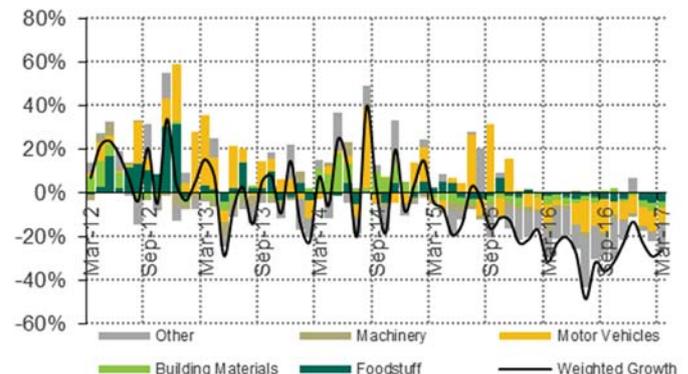


Sources: SAMA and NCB

Non-oil exports largely consist of chemicals and plastics, accounting for around 60% in value terms. According to the General Authority of Statistics, plastics contributed SAR4.7 billion in April, upturning by 6.8% Y/Y. Chemical products on the other hand recorded SAR 3.9 billion, inching down by 1.8% Y/Y. Base metals accounted for a further 9.8% of total non-oil exports, or SAR1.3 billion, surging by 9.8% Y/Y. By destination, the UAE account for most of the non-oil export contribution by value at SAR2.1 billion (14.6% of the monthly total.) In compari-

son to last year, non-oil exports to the UAE declined 8.8%. China came in second, contributing for 10.8% of exports at SAR1.6 billion. By annual comparison, exports to China surged by 36.9% Y/Y. Exports to Singapore during the month totaled SAR1 billion, rising by 70.9% Y/Y.

Chart 14: Attribution Analysis of Letters of Credit Opened



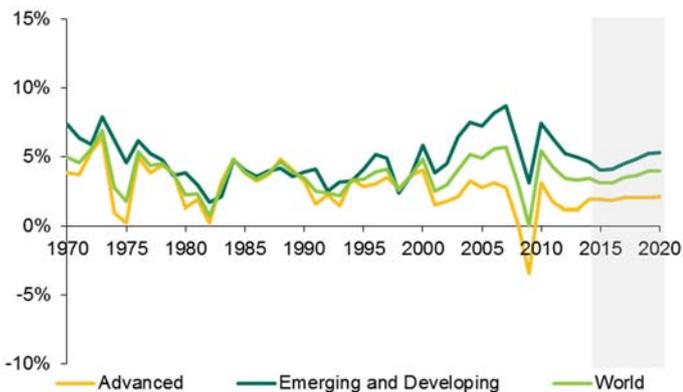
Sources: SAMA and NCB

On the import side, declines across all main categories were registered which impacted by the Kingdom's fiscal consolidation efforts. Imports of machinery and electrical equipment account for 23.4% of the import bill, representing almost SAR10 billion, declined by 4.4% Y/Y. Imports of transport equipment reached SAR6.2 billion during April falling the most in terms of annualized percentage change by 25.3%. Imports of chemical products are the third largest item in the import bill accounting for 8.4%. Their total for the month recorded SAR3.6 billion, falling by 8.6% Y/Y. By import origins, China accounted for as much as 15.4% of the import bill at SAR6.6 billion. Compared to last year, Chinese imports to the Kingdom surged by 11.7%. Imports from the US make up about 13.6% of the total import bill at SAR5.8 billion. By annual comparison, however, imports from the US upturned by 3.7%. The UAE is the third largest trade partner by import value. The Kingdom's imports from the UAE make up 6.3% at SAR 2.7 billion, declining by 4.1% Y/Y.

Special Focus: A Global Review

It is imperative to review the global macroeconomic outlook and monitor developments to gauge the spillover effects into the Saudi economy. Given Vision 2030's drive towards attracting foreign investors into the local economy, as well as creating an investment tycoon worth SAR7 trillion through the Public Investment Fund, the international economic linkages are critical for identifying opportunities and avoiding risks. The latest World Economic Outlook released by the International Monetary Fund (IMF) in April raises the forecast for global economic growth to 3.5% and 3.6% in 2017 and 2018 following 2016's 3.2% annual increase. Advanced economies are gaining traction, albeit at slow pace with an expected 2% growth this year and next year, while emerging economies have benefitted from recovering commodity prices, thus economic growth is likely to accelerate to 4.6% in 2017 and 4.8% in 2018.

Chart 15: Global GDP Growth

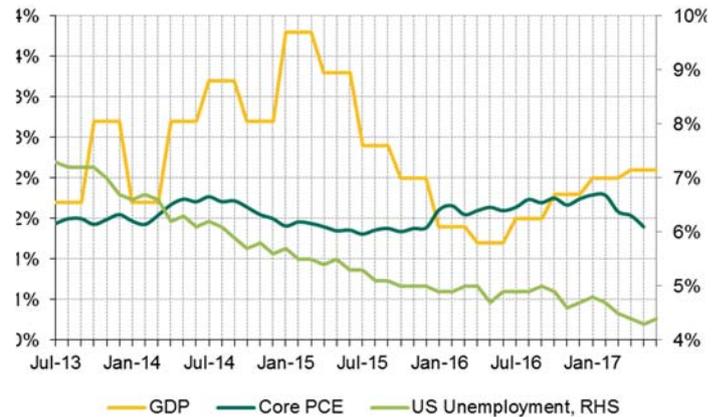


Source: IMF

In the US, economic performance has been steadily rising since the last recessionary period eight years ago. As Donald Trump became the 45th president of the largest economy in the world, campaign promises revolving around slashing taxes, spending on infrastructure, and reassessing trade agreements, fueled equity markets which was dubbed the "Trump Effect". The main three indices, the Dow, S&P500, and NASDAQ, have been setting record highs in 2017 on the assumption that Trump's pro-growth agenda materializes. Furthermore, the Federal Reserve have decided to increase the benchmark interest rate in four separate occasions over the past 18 months. The normalization policy will likely result in another several hikes over the next two years to bring the interest rate closer to 3%. The Fed's main focus areas have been im-

proving as the unemployment rate maintained a downward trend, reaching 4.4% in June. However, as wage growth remains weak and the labor force participation rate remains close to all-time lows, the core inflation rate has been relatively subdued and unable to reach the 2% target. We expect the US to continue on an upward trajectory, yet Trump's 4% GDP growth is extremely unlikely.

Chart 16: US Economic Snapshot



Source: BEA and DOL

In the Eurozone, the European Central Bank's (ECB) main figure, Mario Draghi, saved the Euro currency five years ago but the peril still exist in a region battling economic stagnation and resolving the aftermath of Britain's decision to leave the trade bloc. The ECB's balance sheets doubled since the unveiling of the quantitative easing program in a similar fashion to the US Fed's balance sheets. Additionally, core inflation in the Euro area remains below 1% and the IMF predicts a drop in economic growth to 1.7% in 2018 from a forecasted 1.9% this year. Meanwhile, the UK is expected to face disruptions in trade which would result in economic expansion declining to an expected 1.5% in 2018, down from 1.7% in 2017. As for Asia, Japan is on the path towards another "lost decade" as stagnation prevails. Despite implementing a multi-tier policy rate that falls below zero, a shrinking labor force and muted economic growth will undermine the Shinzu Abe's economic reform plans. In China, an economic model shifting from a manufacturing based economy towards a service based economy is expected to limit growth. Risks revolve around additional capital flight and possible global trade protectionism. The IMF expects China to grow at 6.7% and 6.4% for 2017 and 2018, respectively.

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