January 2014

www.alahli.com

NCB الأهلي

# Saudi Economic Review

## NCB Monthly Views on Saudi Economic and Financial Developments

## Contents




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

**Tamer El-Zayat**
Senior Economist / Editor | t.zayat@alahli.com

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

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


## Executive Summary


- Aside  Spot prices have fallen so far below future prices with traders taking advantage of “contango” in the oil market, buying oil now, storing it and then selling it at a higher price. The size of the recent rally has been driven by market dynamics, short covering and bargain hunting.
- The SNB was not the sole central bank to surprise investors with policy changes recently. In Asia, the Bank of Japan, Reserve Bank of India, and Monetary Authority of Singapore have eased their polices in a surprise move to aid economic growth.
- Gold prices during December increased by 1.4% M/M, to cap 2014’s decline at 1.8%. However, it continued to extend its gains through January, climbing by almost 9% as investors attempt to mitigate risks.
- Although time and savings deposits account for only a quarter of deposits, the moderation in infrastructure capex expected to take place going forward led to a lesser need for cash on stand-by.
- While the opening and inclusion of Tadawul into the MSCI could raise the risk of stock over-pricing, the role of the foreign institutional investors whom the CMA will be granting direct access to the Saudi Stock Exchange is to provide more stability via longer investment horizons.
- The double-digit acceleration in loans of longer tenors is predicated by the premise that a moderation in infrastructure capex will leave some short-run liquidity unutilized.
- Softer global demand is affecting the Kingdom’s export markets, particularly China and Singapore, while the Kingdom’s continued expenditure on megaprojects expected in 2015 led to a lesser impact on imported goods, particularly in machinery and electrical equipment.


## View of the Month

Taking notes on the great strides the sukuk market made in 2014, we expect continued record issuances of over USD100 billion in 2015; supported by a recovering global economy and more sovereigns tapping into the USD 200 billion market. While the secondary market development is still lagging behind, we expect the primary market to house a greater diversity in currency denominations, cross-border listings, and an enhanced compliance with Basel III.

NCB الأهلي

# Macroeconomic Indicators

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014P | 2015F |
|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | |
| Average KSA Crude Spot Price, Arab Light, USD/BBL | 59.2 | 77.6 | 108.1 | 110.2 | 106.4 | 102.0 | 80.0 |
| Average Daily Crude Oil Production, MMBD | 8.2 | 8.2 | 9.3 | 9.8 | 9.6 | 9.7 | 9.5 |
| GDP at Current Market Prices, SAR billion | 1,609.1 | 1,975.5 | 2,510.7 | 2,752.3 | 2,806.7 | 2821.7 | 2662.6 |
| GDP at Current Market Prices, USD billion | 429.7 | 526.8 | 670.4 | 734.9 | 749.4 | 753.5 | 711.0 |
| Real GDP Grow th Rate* | 1.8% | 7.4% | 8.6% | 5.8% | 4.0% | 3.6% | 3.4% |
| CPI Inflation, Y/Y % Change, Average | 4.1% | 3.8% | 3.7% | 2.9% | 3.5% | 2.7% | 2.5% |
| | | | | | | | |
| **External Sector** | | | | | | | |
| Current Account Balance, USD billion | 21.0 | 66.8 | 158.5 | 164.8 | 132.8 | 106.5 | 36.3 |
| Current Account Balance/GDP | 4.9% | 12.7% | 23.6% | 22.4% | 17.7% | 14.1% | 5.1% |
| Net Foreign Assets w ith SAMA, USD billion | 405.9 | 441.0 | 535.9 | 648.5 | 717.7 | 710.1 | 678.0 |
| | | | | | | | |
| **Fiscal Sector (Central Government)** | | | | | | | |
| Actual Revenues, SAR billion | 509.8 | 741.6 | 1,117.8 | 1,247.4 | 1,156.4 | 1046.0 | 848.1 |
| Actual Expenditure, SAR billion | 596.4 | 653.9 | 826.7 | 873.3 | 976.0 | 1100.0 | 995.5 |
| Expenditure Overrun, % | 25.6% | 21.1% | 42.5% | 26.6% | 19.0% | 28.7% | 15.8% |
| Overall Budget Balance, SAR billion | -86.6 | 87.7 | 291.1 | 374.1 | 180.3 | -54.0 | -147.4 |
| Budget Balance/GDP | -5.4% | 4.4% | 11.6% | 13.6% | 6.4% | -1.9% | -5.5% |
| Break-Even Oil Price | 60.8 | 64.1 | 75.3 | 73.9 | 82.6 | 96.2 | 89.7 |
| | | | | | | | |
| **Financial Sector** | | | | | | | |
| USD/SAR Exchange Rate | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Grow th in Broad Money (M3) | 10.7% | 5.0% | 13.3% | 13.9% | 10.9% | 12.1% | 10.4% |
| Grow th in Credit to the Private Sector | -0.6% | 4.8% | 11.0% | 16.4% | 12.1% | 12.1% | 8.4% |
| Average 3M SAR Deposit Rate | 0.9% | 0.7% | 0.7% | 0.9% | 1.0% | 1.0% | 1.0% |
| Average 3M USD Deposit Rate | 0.6% | 0.3% | 0.3% | 0.4% | 0.3% | 0.3% | 0.4% |
| Spread, in Basis Points, SAIBOR-LIBOR | 26.4 | 39.8 | 40.9 | 55.2 | 68.7 | 70.0 | 60.0 |

Sources: Thomson Reuters, SAMA, and NCB

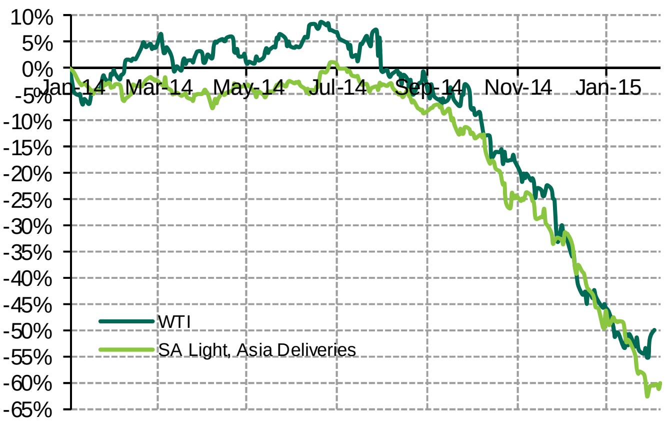
* All historical growth rates prior to 2013 are based on 1999 prices. However, 2013, 2014P, and 2015F are based on 2010 prices.

# Oil Market

## Oil Finds a Floor

Oil prices have staged a rebound from the lowest levels seen in almost six years amid signs that US production will decline in response to the market's collapse. Spot prices have fallen so far below future prices with traders taking advantage of "contango" in the oil market, buying oil now, storing it and then selling it at a higher price. The size of the recent rally has been driven by market dynamics, short covering and bargain hunting. The future curves for WTI and Brent have become steeper since last month. The WTI for March delivery rose to the lower 50USD's range, and Brent was up to the upper 50USD's range, both benchmarks turning positive year to date. Brent closed at the beginning of this month at more than 20% above its mid January's settlement, meeting a common definition of a bull market. The increased demand for oil to store has contributed to the recent recovery in prices. Apparently, there are signs that oil prices are stabilizing as US rig counts fall and global investment plans are abandoned or postponed. However, it will be unlikely for crude prices to return to the 100USD a barrel level in 2015.

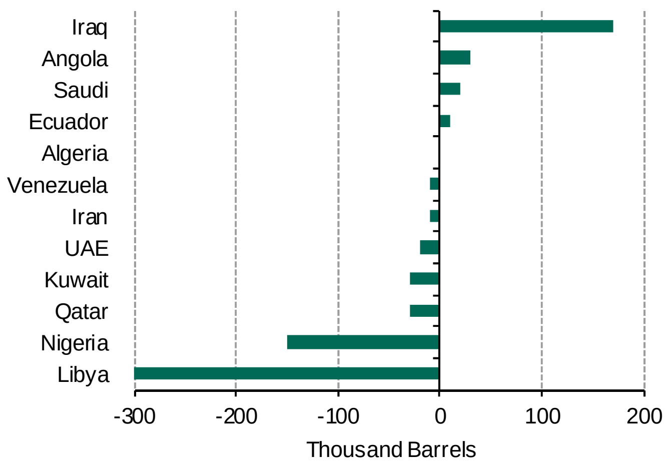
**Chart 1: Oil Price Developments, YTD**




Source: Thomson Reuters

On the supply side, in the US, it is expected that production at three major shale formations to increase 0.7m-0.9mb/d even with possible 40% cut in rig counts in the first half of the year. According to the American Petroleum Institute, crude inventories increased by 6.1 million barrels last week. The Baker Hughes oil rig count fell by 94, in an eighth straight week of declines, with oil rigs reaching 1223, the fewest since 2012. Meanwhile, the slump in oil prices to less than 50USD a barrel from more than $100 seven months ago already has forced producers, especially of expensive oil such as shale oil, to review projects, slash spending and slow investment. While the debate intensifies over whether Keystone pipeline should be approved, traders are quietly setting up alternative routes to ship Canadian oil from US ports in Washington and Oregon. Republicans, whom currently are controlling US Senate passed a bill last month to approve the Keystone pipeline, but some Democrats oppose the project, and Obama has already promised to veto it. Meanwhile, it looks increasingly likely that the shale-oil producers are going to assume the role of the swing producer. The realistic oil outlook is probably for a smaller surplus in the medium term rather than any near - term return to balance.

**Chart 2: OPEC's Monthly Oil Production Changes**




Source: OPEC Survey

The collapse in oil prices will provide a boost to most emerging economies, which may stimulate demand in the medium term, but this happens at the cost of weaker growth in oil producing countries, and even deep recession in Russia and Venezuela. The GCC countries are relatively well-placed to withstand the impact of low oil prices. While fiscal account positions are certain to slip into deficit in 2015, the low debt levels and large foreign reserves will surely lessen the pressure on public spending, providing GCC governments with options to finance budgetary deficits. Nonetheless, 2015 GDP growth will slow, due to the contraction in the oil sector GDP, but it will be partially offset by the rather strong non-oil GDP growth.

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

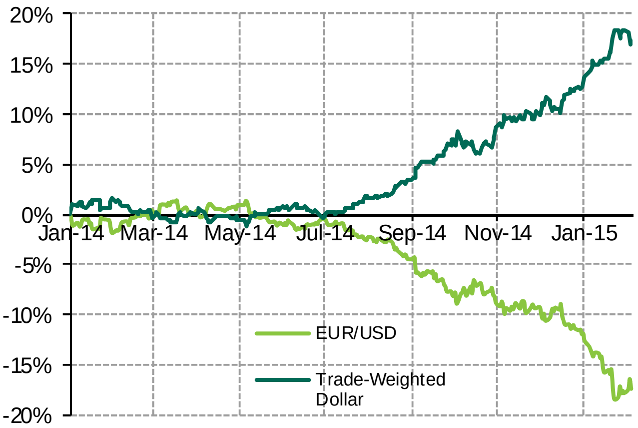
NCB الأهلي

# Foreign Exchange

## Volatility Spikes On ECB & Greek Elections

The European region took center stage in the currency market recently as surprising decisions, along with expected ones, pressured the single currency to the lowest level in over a decade. The European Central Bank's Mario Draghi finally announced a decisive decision to tackle the regional economic decline by pledging 60 billion euros per month from March through to September 2016, around 10% of the Eurozone's GDP. The majority of central bankers support the decision to lift the economy out of stagnation and avoid deflation for the bloc. The quantitative easing program will target sovereign bonds according to their relative size. Moreover, stronger economies have been shielded from defaults as only 20% of the risk is held collectively while the remaining 80% will be the liability of national governments.

**Chart 3: Trade-Weighted Dollar and the Euro**

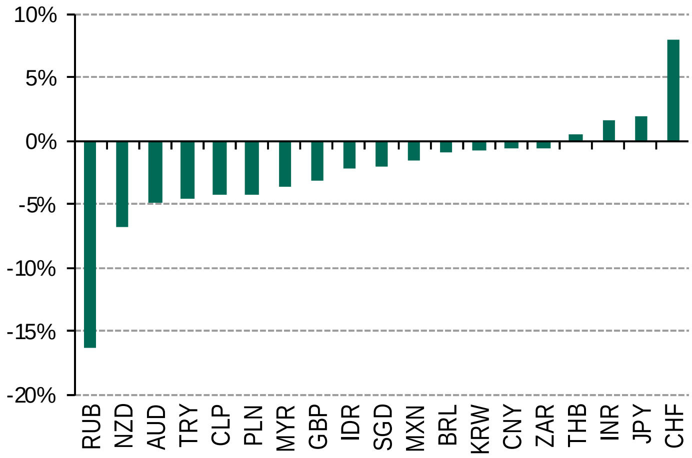



Source: Thomson Reuters

Additionally, Greece may possibly be the recipient of such capital as long as they remain committed to their bailout terms. However, newly elected Greek Prime Minister Tsipras from the Syriza party is another concern for the region's stability. Syriza was two seats shy of a majority as their anti-austerity campaign gained domestic publicity while the economy burdened with austerity following their bailout. As such, the common currency depreciated against the greenback to as low as 1.098, the lowest level since September 2003. The euro lost 2.84% during the last month of 2014 to bring the annual loss at almost 12% against the US dollar. The CBOE EuroCurrency Volatility Index (EVZ) which measures the market's expectation of 30-day volatility of the EUR/USD exchange rate ended 2014 at 9.74, up from 8.17 by the end of 2013. The recent policy decisions accelerated the index to as high as 14.55, the highest level in 3 years.

Further adding to the Euro's woes, the long standing cap on the Franc against the Euro at 1.2 was unexpectedly abandoned by the Swiss National Bank (SNB) on January 15. The decision rocketed the Franc to as high as 0.85, only to settle back just above parity as an official from SNB said they remain ready to intervene in markets. We believe, the single currency will remain under pressure throughout 2015 given their economic risks, even more so as the US is expected to start increasing the Fed Funds rate within 2015, however, their latest FOMC meeting indicated their willingness to be patient as plummeting petroleum prices subdued consumer prices.

**Chart 4: Monthly Foreign Exchange Rate Changes**




Source: Thomson Reuters

The SNB was not the sole central bank to surprise investors with policy changes recently. In Asia, the Bank of Japan, Reserve Bank of India, and Monetary Authority of Singapore have eased their polices in a surprise move to aid economic growth. The Central Bank of Turkey also made a 50bps on their repo rate to 7.75%. Similarly, the Royal Bank of Canada cut their benchmark interest rate to 0.75% while Russia's interest rate hike to 17% from 10.5% to contain the ruble's collapse resulted in a downgrade by S&P to Junk as the economy struggles with low oil prices and sanctions due to the Ukraine turmoil. The currency markets have been extremely volatile with investors facing to adjust their strategies frequently as unexpected policy decisions derail forecasts and projections. As the trade weighted dollar index nears 95, the highest level in over a decade, one view is clear, Dollar is King, the greenback that is.

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

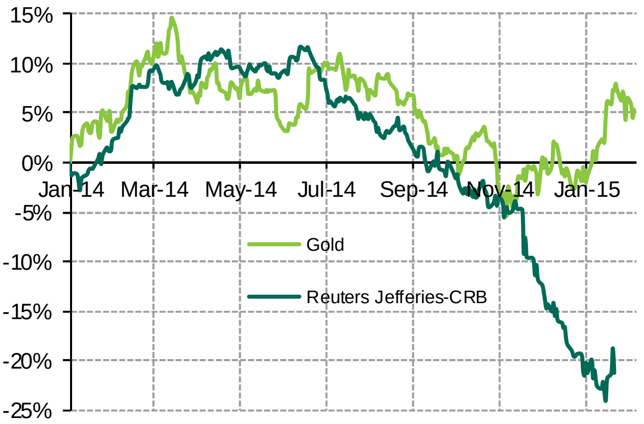
NCB الأهلي

# Commodities

## Gold Gains Momentum, Commodities Tank

The negative trend in commodity prices carried through into 2015 with a few exceptions. Oil markets stabilized in the USD40's range and are expected to remain subdued for the first half of this year. OPEC remains firm on their stance as they refrain from remedying a supply glut caused by new entrants to the market. Furthermore, inventory levels in the US, the world's largest consumer, reached 406.7 million barrels, the highest level on the Energy Information Administration's records. Furthermore, during the pre-financial crisis era, businesses in farming, mining, and other raw commodity related markets heavily increased their output to gain from record prices. However, markets are now suffering from oversupply and large inventory levels given the deceleration in the global economy. Businesses are pressured to reduce spending and cutback on production as profit margins shrink. The iron ore supply glut is forecasted to expand to 260 million tons by 2018 from 47 million this year, according to Goldman Sachs. Prices have fallen to five year lows around USD70/tonne. Additionally, copper prices have dropped 14% during January as global sentiment continues to fade and Chinese demand slows. Meanwhile, aluminum's extensive uses in the manufacturing resulted in growing demand for the versatile metal. Unlike other commodities, aluminum inventories dropped to the lowest level since 2009 which is expected to support prices in the near-term.

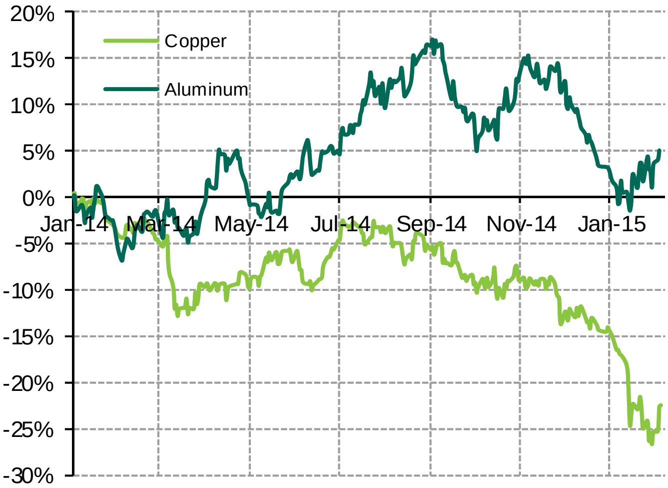
**Chart 5: Reuters Jefferies vs. Gold**




Source: Thomson Reuters

The yellow metal, which has been considered more of an alternative currency rather than a commodity, is maintaining its price level around the USD1'300. Gold prices during December increased by 1.4% M/M, to cap 2014's decline at 1.8%. However, it continued to extend its gains through January, climbing by almost 9% as investors attempt to mitigate risks. The precious metal is likely to face pressures from an improving US economy. The Fed has stated the rigidity of the labor market and the economy, yet they remain vigilant of the global economic standpoint. Markets will be anticipating the Fed's first interest rate hike from near zero between the second and third quarter of 2015. Furthermore, silver prices accelerated by 14.3% by the end of January 28 as central bankers across the world surprised investors with policy decision which triggered capital movements towards safe havens.

**Chart 6: Base Metals**




Source: Thomson Reuters

As for agricultural commodities, the S&P/Goldman Sachs Agricultural Index is on track to post its third consecutive monthly decline by end of January. Wheat prices continue to fall as global output increased albeit US which harvested the smallest crop in three years. Despite climbing in December, corn futures declined to 374 cents/bushel last week to post a 14.5% YTD decline, while soybean futures dropped to 971 cents/bushel to lose 6.1% YTD. As most commodity trades are denominated in US dollars, prices have been heavily pressured by the recent strength of the greenback coupled with record high production levels for wheat, corn and soybean. We expect prices to recover in the short-term as production levels start to moderate and inventory levels decline in the second half of 2015.

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

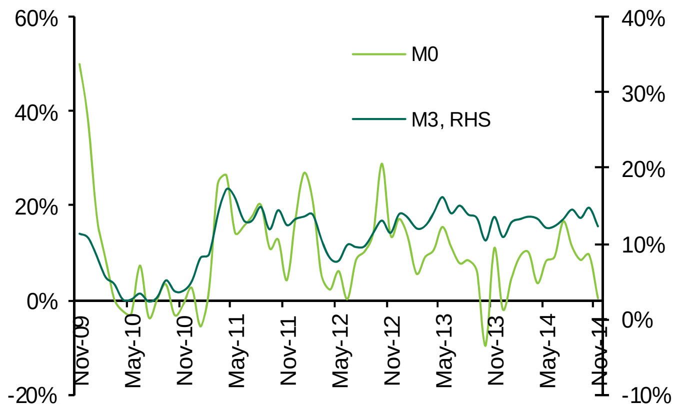
NCB الأهلي

# Money & Inflation

## Continued Steady Growth of Money

In 2014, the annualized growth in money supply maintained elevated levels despite tumbling oil prices in the second half of the year. The last quoted price of USD55.5/bbl for Brent in 2014 concluded a 52% downturn in benchmark oil prices from the June peak of USD115.6/bbl. Nevertheless, other fundamentals within the internal economy remain sound as reflected by continued strong money demand by businesses and individuals. Although moderated slightly for the first time since August 2013, the annualized growth rate of money supply (M3) recorded yet another double-digit rate of 12.3%, on par with the growth rate in June. The growth was mainly driven by a strong 12.5% Y/Y surge in demand deposits; the largest component in the Saudi money supply. Demand deposits reached SAR955.2 billion, of which over 93% belong to businesses and individuals. On the other hand, time and savings deposits, which rapidly accelerated since July, posted an 18.7% Y/Y upturn. Although time and savings deposits account for only a quarter of deposits, the moderation in infrastructure capex expected to take place going forward led to a lesser need for cash on stand-by. This, in turn, allowed banks to adjust their portfolios accordingly, catering for longer maturity loans (see Loans Market). The lower excess reserve ratio of 39.7% in tandem with the rising issuance of bills by 32.7% Y/Y indicates SAMA's active liquidity management. Total issuances of SAMA bills reached SAR224.6 as it mops up of excess liquidity in order to keep up with a stronger dollar.

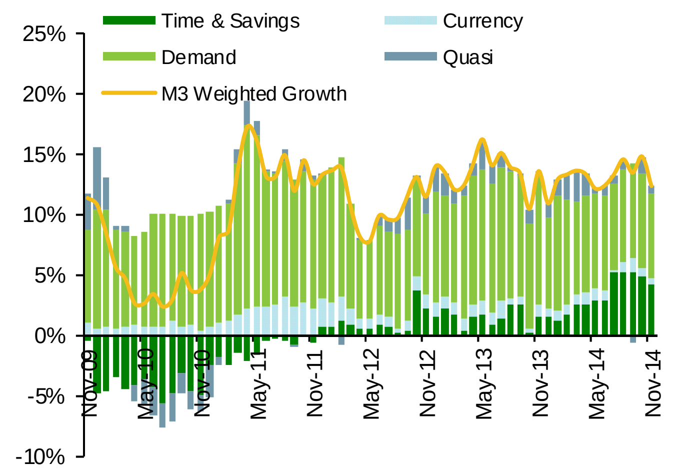
**Chart 7: Growth in Monetary Aggregates**




Sources: SAMA and NCB Estimates

Our proxy for gauging consumer demand is the volume of point of sale (POS) transactions. In 2014, the number of POS transactions peaked at 32.4 million, resulting in sales worth SAR14.3 billion. In comparison to last year, sales at POS terminals surged by 10% in November. The widespread use of convenient POS terminals, which in 2014 saw an exceptional growth (27.5% Y/Y by November) reduced the reliance on paper money which allowed for better monitoring of household consumption.

**Chart 8: Money Supply, Contribution**




Sources: SAMA and NCB Estimates

The latest inflation report in the Kingdom shows the lowest annualized growth in the general cost of living index (CLI) of 2.4% in December, bringing average inflation in 2014 to 2.7%. The strengthening of the greenback is a key factor in lowering imported inflation which increased the purchasing power of the Saudi riyal, particularly against commodities. Food and beverages, the largest category affecting consumer prices in the Kingdom, recorded a 2.6% upturn. It is notable by annual comparison that a deceleration in food prices occurred in 2014, whereas in 2013, food prices soared by over 5.8%. Housing and utility prices are also downward trending, recording 2.5%, the lowest since December 2011. Although most of the drag in this category comes from an 11% decline in water supply bills, housing rentals also moderated to 3.2%, the lowest since July. The only category that reached a double-digit price increase in 2014 was recreation and culture related items which soared during the peak of Summer festivities in August to 10.9% before retreating to 9% by December. The main contributor to the price level increase in this category was a 28.5% spike in equipment for the reception recording for sound and pictures. Despite this outlier, we expect that overall consumer prices will range between 2.5% and 3% in 2015.

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

NCB الأهلي

# Capital Markets

## Petchems and Financials Lead the Pack

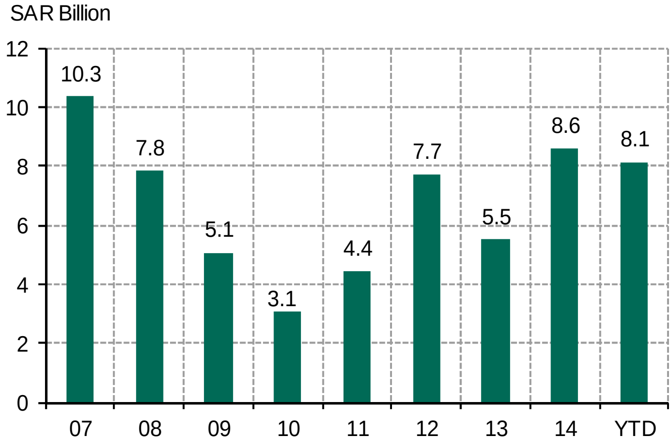
Between July and September 2014, the Saudi stock market (Tadawul) experienced some "irrational exuberance" driven by the announcement effect of allowing foreign institutional investors to trade in the local market. The decision which is yet to come to effect led to a persistent and rapid increase in stock prices that propelled the main index up by over 30% by late September, breaching the 10,000 point mark for the first time in six years. However, the turn of events thereafter, which included a strengthening US dollar and falling oil prices, embroiled the Saudi stock market with speculation and heightened volatility, resulting in the TASI index ending the year at 8,333.3 at a 2.4% annualized loss. Although the correlation between oil prices and the TASI benchmark in recent years has been shown to be low, major trends in the oil market do impact individual investors' sentiments, most of which tend to hold short positions. Moving on to 2015, reports on declining US tight oil excavation rigs to a 3-year low are signaling that the oversupply scenario for oil might not become prolonged, and that oil prices have bottomed out. The unchanged oil production policy in the Kingdom following the passing of King Abdullah reaffirms that direction, and that an oil price rebound is likely to be seen in 2015. In addition, lower valuations are increasing stocks' attractiveness to investors, with a price-to-earnings ratio around 14 which may help further decoupling the USD511.7 billion market from the oil market.

**Chart 9: Tadawul All-Share Index**


Source: Tadawul

At the end of January, 2015, TASI closed at a level of 8,878.5, advancing over the previous month by 6.5%. The total value of shares traded that month reached SAR162.5 billion, decreasing by 20% M/M while the total number of shares traded reached 6.7 billion, retracting by 12.9% M/M. Although the market is still bearish, financial services and petrochemicals, which respectively constitute 18.1% and 11.7% of the market share led the strong rebound, receiving SAR29.5 billion and SAR19.1 billion.

**Chart 10: Average Daily Traded Value**




Source: Tadawul

While the opening and inclusion of Tadawul into the MSCI could raise the risk of stock over-pricing, the role of the foreign institutional investors whom the CMA will be granting direct access to the Saudi Stock Exchange is to provide more stability via longer investment horizons. According to the CMA, retail investors reached 4.4 million by mid-2014, holding over a third of listed shares by value. With such a relatively large proportion of traded volumes held by individual investors, the stock market becomes ever more volatile due to the risk-taking nature of individuals and shorter investment horizons. Hence why the CMA only approved institutional investors as it aims to stabilize the market rather than seek capital injections and raise market capitalization. Opening up the domestic market will reduce the likelihood of irrational exuberance and herd behavior to better channel capital from individual savings into capital markets with more stable and predictable outlook; a crucial step towards global market integration. Furthermore, using the Shanghai Stock Exchange opening as a model for comparison, we can expect a limited availability of stock for select investors on par with the Qualified Institutional Investor program (QFII) in China, where progress is slow but steady.

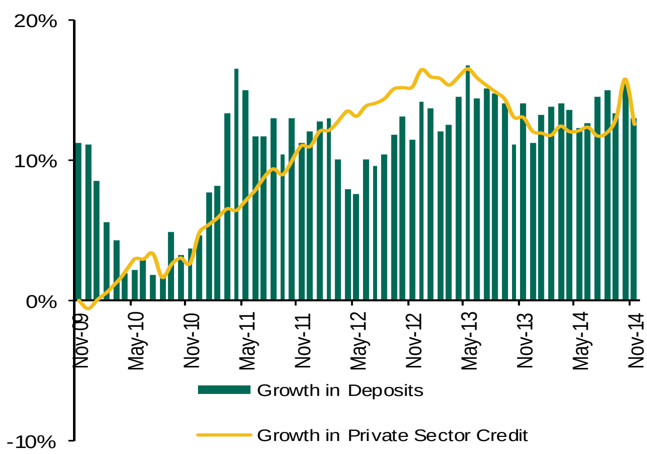
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

# Loans Market

## Expansionary Fiscal Policy Boosts Credit

The loan market in Saudi Arabia continues to grow driven by a favorable business cycle, sound credit worthiness and high liquidity. Despite plunging oil prices and geopolitical turmoil in many of the MENA region countries, the investment prospect is growing strong, marking a 17.4% Y/Y upturn in the second quarter 2014, the highest since 2Q2012. The lower benchmark risk and interest rate environment significantly lowers borrowing costs, increasing its attractiveness for businesses and individuals who make up over 60% of the Saudi credit market. In November, the annual growth in private sector credit rose by 12.6%, around the year's average, reaching SAR1.2 trillion. This brings total fresh credit extended to the private sector up until November to SAR132.5 billion. Excluding treasuries and bonds, the public sector credit climbed by 12.6% up to SAR319.9 billion. On the other hand, SAMA's treasury bills and the Saudi government bonds grew by 32.7% Y/Y and 11% Y/Y, respectively, totaling SAR277 billion. SAMA's open market operations act as a liquidity management tool ensuring price stability as inflation stood at 2.5% in November.

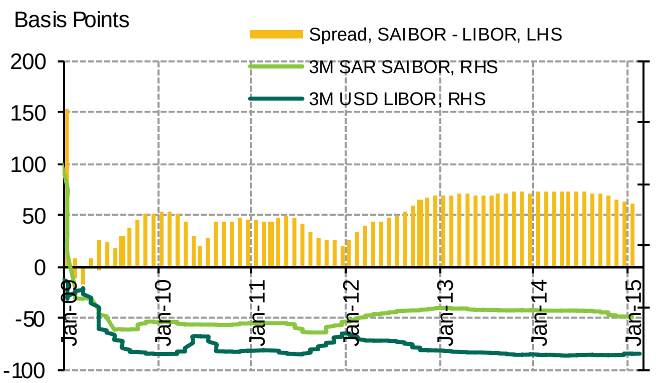
**Chart 11: Private Sector Financing**




Sources: SAMA and NCB Estimates

On the liability side, high liquidity, manifested in growth of deposits, facilitates local banks' willingness to lend as deposits surged by an average of 12.9% in the last 12 months in November to SAR1.5 trillion. Demand deposits still retain the lion's share in the composition of deposit accounts by almost 62% of total deposits, amounting to SAR955.2 billion. However, the rapid acceleration in time and savings deposits which annually surged by a 18.7% contributed to primarily by government entities, allowed local banks to find niche opportunities in longer maturity loans. As it stands, over 50% of the SAR1.25 trillion cumulative bank loans are with medium and long-term maturities. Medium-term loans make up 17.9%, while long-term loans account for 32.4% of total bank loans. The double-digit acceleration in loans of longer tenors is predicated by the premise that a moderation in infrastructure capex will leave some short-run liquidity unutilized. Nevertheless, the loans-to-deposit ratio (L/D) in November was 81.2%, indicating a healthy level of capacity utilization.

**Chart 12: Liquidity and Risk Detector**




Source: Thomson Reuters

Although recurrent US jobs market data have become largely positive, the low inflation specter, and worries about persistent global qualms continue to keep the interest rate landscape unchanged. The peg with the US dollar will typically form a positive correlation between the SAIBOR and LIBOR. Eventually, rising interest rates in the US will prompt SAIBOR to rise accordingly, keeping interest rate differentials between the SAR and USD deposits at comparable levels of around 70 basis points. In November, SAIBOR inched downwards by 3 basis points to 0.89 as interbank lending moderates towards year end. Moving further into 2015, we expect to see benchmark interest rates moving up by 25 basis points as the Fed decides to normalize its monetary policy.

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

NCB الأهلي

# External Trade

## Improving Trade Activity in November

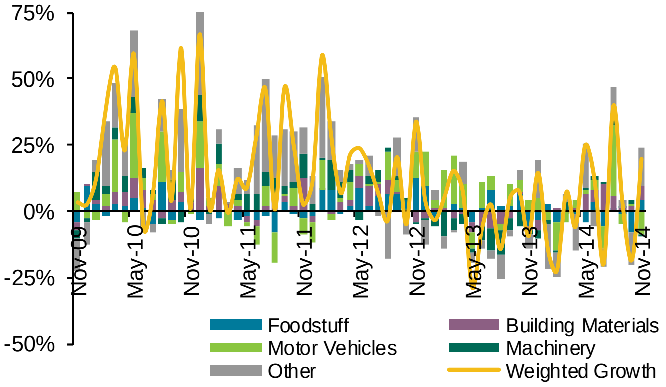
In November, trade activity showed a slight rebound from its lowest point in October although still below last year's figures. Softer global demand is affecting the Kingdom's export markets, particularly China and Singapore, while the Kingdom's continued expenditure on megaprojects expected in 2015 led to a lesser impact on imported goods, particularly in machinery and electrical equipment. In value terms, non-oil exports totaled SAR17.4 billion, falling short of last year by 0.3%, whereas by weight, non-oil exports reached 3.8 megatons, a 10.2% downturn. On the other hand, the import bill in November amounted to SAR50.8 billion, rising over last year by 4.6%. By weight, however, imports recorded 5 megatons, dwindling by 26.6% Y/Y. The weakening of the euro and other major currencies against the US dollar resulted in a lower cost of importing foodstuff and base metals despite the relative rebound in commodities that took place since late September. By measuring the returns of non-oil exports to the cost of imports, we notice that the non-oil balance of trade gap has widened by 7.3% in November compared to the same period in 2013.

**Chart 13: Saudi Non-Oil Trade Balance**


Sources: SAMA and NCB

Non-oil export composition remains led by plastics and chemical products which weight respectively 32% and 28.4% of the monthly total value. The high inelasticity towards the Kingdom's production of plastics kept annualized growth figures positive, albeit by a small margin of 0.1% Y/Y. In contrast, exports of chemical products were impacted by the compounded effect of cheaper oil and weaker global demand, sliding by 13.5% Y/Y. Exports of base metals surged by 35.5% on the back of edging up aluminum prices. Indonesia's export ban on bauxite, the ore used in the production of aluminum, resulted in a negative supply shock, leading to a bid up in aluminum prices. In addition, Ras Al Khair, the first Saudi aluminum smelter and the world's largest, has entered the production phase, with a capacity output of 1.8 megatons of smelter-grade alumina per year. The Kingdom's key non-oil export markets remain the UAE, China and Singapore, with sizeable declines from the latter two countries. While the UAE posted a 3.1% Y/Y increase in non-oil exports to SAR2.7 billion, China's imports of the Kingdom's non-oil exports tumbled by 22.2% to SAR2.5 billion. More so, Singapore slashed its imports of Saudi non-oil exports by 24.3% Y/Y.

**Chart 14: Attribution Analysis of Letters of Credit Opened**




Sources: SAMA and NCB

On the import front, imports of machinery and electrical equipment, which account for around 28.5% of the import bill surged by 17.8% Y/Y to SAR14.5 billion. Imports of transport equipment also marked a notable increase of 15.6% as they were valued at SAR 10 billion. Conversely, the Kingdom's imports of base metals were trimmed by 12.3% from last year, down to SAR 5 billion. Although soft commodities appeared to have bottomed up in September and started to climb back up, the Kingdom's imports of food stuff fell by 24.3% in value terms on the back of stronger purchasing power. The main trading partners by origin of imports are China, the US, and Germany. Imports from China account for about 15.7% of the import bill which substantially rose by 43.4% to SAR8 billion. On the other hand, imports from the US ticked down by 2.9% to SAR6.8 billion, whereas German imports dwindled by 18.3% to SAR3.2 billion.

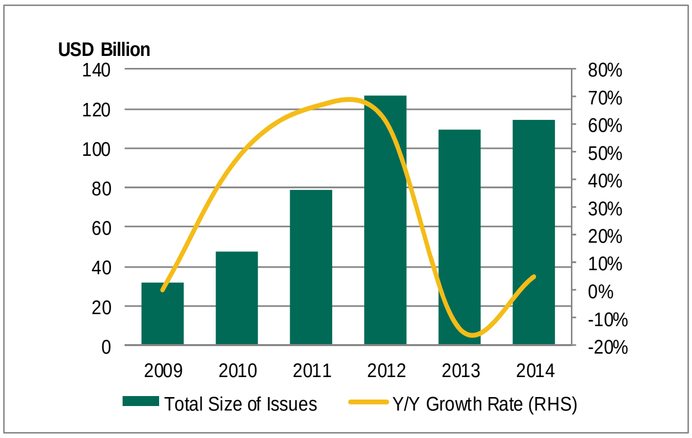
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

# Special Focus:

## Sukuk Leap Towards Global Integration

The rapid development of Islamic financial institutions and markets have enabled the penetration of mainstream finance and gaining relevance to global economic and financial flows. On the Islamic equity front, the S&P 500 Shariah index ended 2014 standing at a record 1801.9, thus surging by 11.2% on a YTD basis. The USD 3-month murabahah deposit rate, the equivalent of an interbank offered rate, stood unchanged at 0.65% in 2014 compared to the 3-month LIBOR which averaged 0.23% on USD deposits in the same year. According to Standard and Poor's, around USD1.8 trillion worth of assets are managed in accordance to Islamic investment principles. Sukuk is one of the fastest growing instruments in the Islamic finance sector, and the resemblance it holds to conventional bonds aided its inclusion in many bond benchmark indices recently, notably Barclays. Recognizing the great potential the sukuk securities hold for investors, regulatory bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are established, and performance-monitoring indices such as the Thomson Reuters Sukuk Index and the Dow Jones Sukuk Index were created. In 2014, a total of 806 sukuk were issued, reaching the value of USD114.1 billion, surpassed only by 2012. On a Y/Y basis, the growth rate of sukuk issues reached 4.8%, decelerating from the 2011 peak of 66%. The Dow Jones Sukuk Index rose by 2.6% compared to the previous year to 103.1, whereas the Thomson Reuters All Sukuk Index recorded an all-time-high of 117.3, an upturn of 6.9% Y/Y.

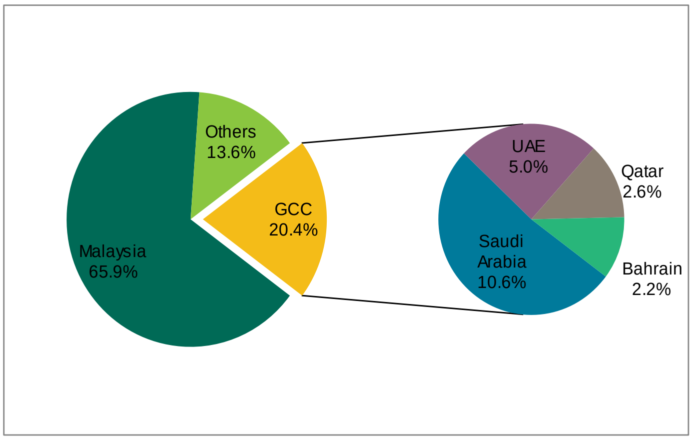
**Table 15: Global Sukuk Issues by Value**




Sources: Zawya, and NCB

Around 62.7% of the global issuances were sovereign, leaving corporate and quasi-sovereign at a respective 21.9% and 15.4%. Malaysia is still the dominant issuing country of sukuk with 510 issues made in 2014, valued at USD75.2 billion. Saudi Arabia came as the second largest issuer by total size, reaching USD12.1 billion, followed by the UAE at USD5.7 billion. On June 2014, the UK became the first non-Muslim sovereign to issue sukuk which were estimated around USD339 million, maturing on July 22nd, 2019. Furthermore, on September, Hong Kong inaugurated its first sukuk issuance, raising USD1 billion, followed by South Africa's debut of USD500 million offering. Given that the largest issuers of sukuk are sovereigns, 62.3% of issues pertained to government institutions. On the other hand, 19.1% were related to financial services, and around 5.5% related to power and utilities. The Murabaha sukuk constituted around 47.6% of global sukuk issues, amounting to USD54.4 billion while Ijrarah made 18.3% at USD20.8 billion, followed by Wakala sukuk at around 10% or USD11.4 billion. The breakdown by currency reveals that 61.2% of the 2014 sukuk were issued in Malaysian ringgit, followed by a 23.4% that were issued in USD. As of January 2015, outstanding sukuk amount to SAR300.5 billion, 56.5% of which are issued by Malaysia. Respectively, Saudi Arabia, UAE and Indonesia account for 15.6%, 9.2%, and 5.7% of outstanding issues.

**Table 16: 2014 Global Sukuk Issues by Country**




Sources: Zawya, and NCB

Taking notes on the great strides the sukuk market made in 2014, we expect continued record issuances of over USD100 billion in 2015; supported by a recovering global economy and more sovereigns tapping into the USD 200 billion market. While the secondary market development is still lagging behind, we expect the primary market to house a greater diversity in currency denominations, cross-border listings, and an enhanced compliance with Basel III.

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

NCB الأهلي

# The Economics Department Research Team


**Head of Research**

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

**Macroeconomic Analysis**

**Tamer El Zayat**
Senior Economist/Editor
t.zayat@alahli.com

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

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

**Sector Analysis/Saudi Arabia**

**Albara'a Alwazir**
Senior Economist
a.alwazir@alahli.com

**Shahrazad A. Faisal**
Economist
s.faisal@alahli.com

**Management Information System**

**Sharihan Al-Manzalawi**
Economist
s.almanzalawi@alahli.com


## To be added to the NCB Economics Department Distribution List:


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