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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

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Executive Summary

- The output freeze agreement is unlikely to have an immediate impact on oil market balances, given that producers who have agreed to freeze production are already producing at record levels.

- The UK's EU membership referendum which is expected to take place in May, and the huge influx of refugees from war-ridden Syria are also main EUR-negative themes. Nevertheless, the single currency held its own during January inching down by only 0.2% at USD1.08.

- Codelco, the Chilean state-owned copper producer which is also the world's largest, vowed to keep its USD25 billion investment plan unchanged despite dwindling prices. Continued increased supply nullified the positive announcement effect made earlier by Glencore and Anglo-American regarding reducing output by 30,000 tons/year.

- The government is taking unprecedented measures to shore up public finances and reduce the economy's reliance on oil amid plunging oil prices. However, the military intervention in Yemen and the probable military mobilization in Syria constitute major economic hurdles which will likely dictate more stringent consolidation and revenue-generating strategies.

- The price-to-earnings ratio for the market declined to 11.87, down from 13.8 by the end of 2015. This will provide lucrative opportunities for investors to allocate long term investments.

- The Official repo transaction rate remains unchanged at 2%; however, reverse repo transaction rate rose by 25 bps in December to 50 bps. We don't expect another eminent hike especially as the Fed's likelihood of a second rate hike in 1Q2016 is declining.

- The decline in December is considered the largest since June 2014, influenced mostly by a 24.4% decline in foodstuff LCs totaling SAR1.9 billion.

View of the Month

The recent measures by central bankers will need time to reveal whether they have a positive impact on the economy or not. As peaks become lower in subsequent cycles, these unconventional measures could become the norm in a complex global economy that will require innovative methods to maintain a positive trajectory.

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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	50.2	50.0
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	2,826.9	2,449.6	2,346.6
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	754.8	654.1	626.6
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.6%	3.4%	2.1%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.2%	2.7%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.5	76.9	-41.3	-47.4
Current Account Balance/GDP	23.6%	22.4%	18.2%	10.2%	-6.3%	-7.6%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	640.2	580.4
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	608.0	629.1
Actual Expenditure, SAR billion	826.7	873.3	976.0	1140.0	975.0	897.0
Expenditure Overrun, %	42.5%	26.6%	19.0%	33.3%	13.4%	6.8%
Overall Budget Balance, SAR billion	291.1	374.1	180.3	-95.6	-367.0	-267.9
Budget Balance/GDP	11.6%	13.6%	6.5%	-3.4%	-15.0%	-11.4%
Break-Even Oil Price	75.3	73.9	82.6	103.6	79.2	69.2
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%	6.8%	6.6%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	6.8%	5.2%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	1.0%	1.4%
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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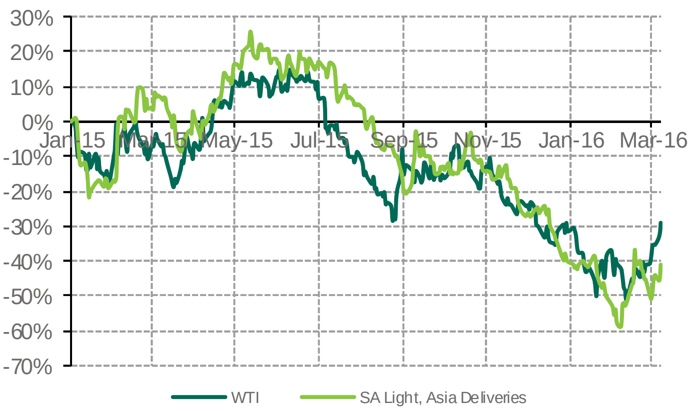
Oil Market
Brent Catches A Respite

Oil traded near an eight-week high last week at USD34 a barrel as the Doha's accord fanned speculation that cooperation between OPEC and Russia could at least prevent the current supply glut from expanding. As the current global oil glut takes longer to clear than previously estimated and likely to persist into 2017, the chance of a price rebound in the short term seems to be limited. So far this year both Brent and WTI have averaged above USD30/barrel and although WTI fell below that level last week, Brent has so far managed to stay above it. The output freeze agreement is unlikely to have an immediate impact on oil market balances, given that producers who have agreed to freeze production are already producing at record levels. While building trust among OPEC and non-OPEC is challenging, the harsh price impact on fiscal balances is slowly starting to unite producers with differing views, while the desire for producing at capacity continues to exist. There is potential for trust among producers to build through more negotiations, but building the needed trust will only be successful if special provisions are made for certain producers, such as Iran, are included. Iran is already selling heavy crude grade for March to buyers in Asia at a discount to Saudi Arabia's prices, as it seeks to regain its lost market share after sanctions have been lifted. OPEC's balancing role in the supply-demand equation has been deferred, at least temporarily, instituted on defending the market share principle. In turn, OPEC faces serious internal and external vulnerabilities, which point to the increasingly uncertain future of the organization. The path ahead for oil prices looks more uncertain in this business cycle given the elasticity of shale output, oil's declining share in the energy mix, and Iraq and Iran potential production levels.

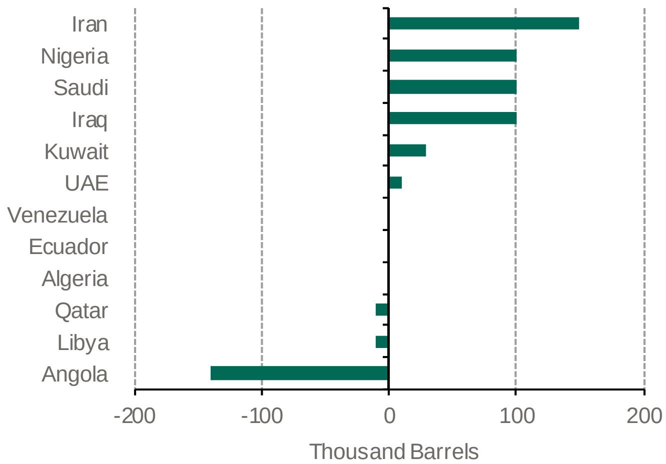
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, Iran is seeking to win back market share and planning to boost exports by 0.5mb/d immediately. According to IEA, it produced 2.9mb/d in December, before sanctions were lifted. It used to export 2.3mb/d, but its crude exports fell to 1.0mb/d in 2012. On February 16th, Saudi Arabia, Russia, Qatar and Venezuela agreed that they would freeze production, if other producers followed suit, in an effort to tackle the global oversupply. However, freezing production will do little to reduce the surplus, especially as Iran, which intends to increase exports by 1.0mb/d this year, dismissed the proposal as unrealistic. In the US, crude output has begun to drop since hitting a record 9.7mb/d in April 2015, although not as steeply as many had predicted, with preliminary February data showing the US is still producing above 9.0mb/d. In turn, crude stocks continue to rise, marking a record 518 million barrels at the end of February. US shale companies had a key role in bringing prices that low by adding over 4.0mb/d in less than four years. However, currently around 74 of these companies face significant difficulties in sustaining debt, according to Moody's Investors Service. So far, shale bankruptcies have been limited to smaller companies.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, the US imported 7.90mb/d of crude in December and is continuing to import at 7.9mb/d levels in January and February, the highest volume since September 2013, according to EIA. Following the lifting of a 40-year old ban on crude exports in December of last year, US exports of light sweet crude reached 0.45mb/d, while its refineries imported more heavier sour grades to compensate. Imports' share of US crude supply edged near 40% in December for the first time in two years. US oil Imports from OPEC countries, especially from the GCC, which are overwhelmingly heavy, rose back above 3mb/d in December for the first time in 16 months.

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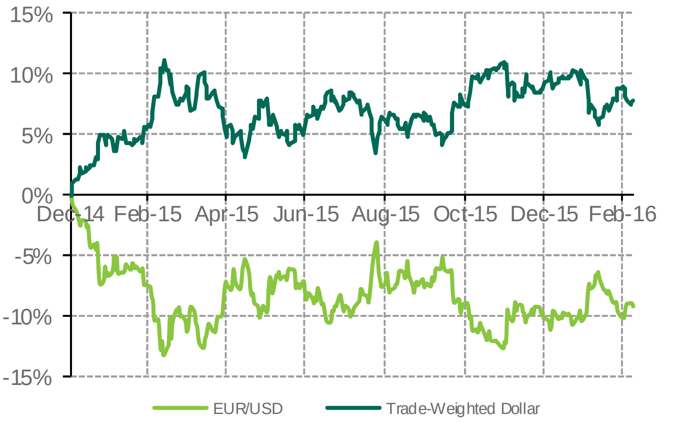
Foreign Exchange

New Bouts of Volatility Surrounding Brexit

The month of January was marred by dismal performance in global equity markets led by bear Chinese equities, tumbling by over 20%. Surprise central bank policy measures, notably Bank of Japan's (BoJ) adoption of negative interest rates intensified risk aversion, providing a boost for the JPY and gold. Moreover, as investors scour the markets for clues on a second Fed rate hike, the likelihood for a March hike is slimming when US fundamentals are stacked up against global markets' volatility. The continued strengthening of the USD is also raising red flags at the Fed pertaining to the negative impact the stronger dollar has on US exports. Economic data from Europe, including the slightly improved GDP growth in 4Q still keeps a dovish bias at the ECB, and further easing is likely given the stubbornly low levels of inflation. The People's Bank of China is increasingly likely to ease monetary policy this year amid rising risk sentiment throughout Asia.

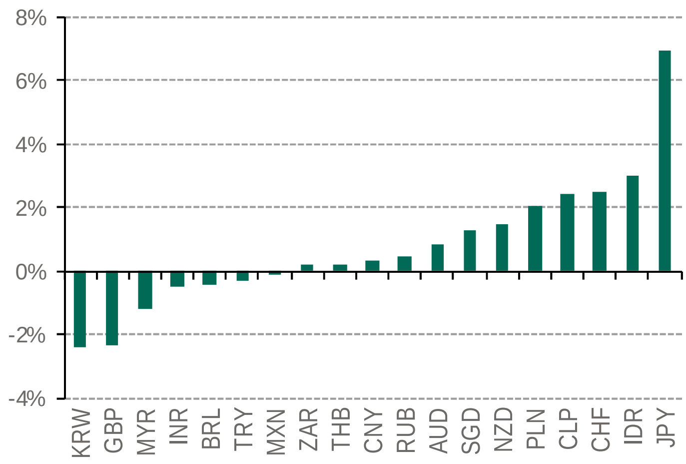
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

During the first 30-day period of 2016, the USD remained on an appreciating bias despite the halted growth momentum in Q4. The US economy grew by an annualized 1.0% during the last quarter of 2015. The Fed will maintain a balanced approach in assessing overall policy, weighing the positive labor market outlook against volatile financial markets. The trade-weighted USD edged up by 1% in January, standing at 99.6. Central banks peered into unchartered waters with the ECB's introduction of negative deposit rates mid 2014 at -0.1%, ending 2015 further below zero at -0.3%. The Eurozone/US policy divergence narrative thus intensified, allowing for a more bearish outlook on the EUR. Under the backdrop of weak economic performance at currently near-zero inflation and near-zero interest rates, the only room for policy at the ECB was to go sub-zero. ECB President Draghi is still committed to doing "whatever it takes" to save the union, and may reconsider monetary policy settings in March. Heightened uncertainty pressured German 10-year bonds to the lowest levels since April last year, sliding 47.2% in January alone to 33.5bps. The UK's EU membership referendum which is expected to take place in May, and the huge influx of refugees from war-ridden Syria are also main EUR-negative themes. Nevertheless, the single currency held its own during January inching down by only 0.2% at USD1.08.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

Further to the BoJ's quantitative and qualitative monetary easing, a surprise negative deposit rate decision took place on January 29th that was intended to ease more liquidity in the Japanese economy and boost export competitiveness. However, the JPY's downward movement remained constrained by global risk aversion, allowing for a strengthening bias in 2016. The JPY closed flat in January at 121 yens for the dollar, and appreciated to 5.7% mid-February. USD/SAR forwards were elevated through January, implying heightened devaluation risk. While we acknowledge the 0.7% weakening of the forward Saudi riyal as indicative of market vulnerability, SAMA will almost certainly not allow the de-pegging of the currency which has been standing at 3.75/USD since the mid-1980s. Despite mounting economic and geopolitical challenges, historical accounts have consistently proven the government's adamancy on maintaining the peg. Moreover, the Saudi economy is yet far from needing such a trump card; the presence of multiple levers including the utilization of its massive foreign reserves, spending adjustments, enhanced revenue generation, in addition to oil supply adjustments should all alleviate any real currency concern.

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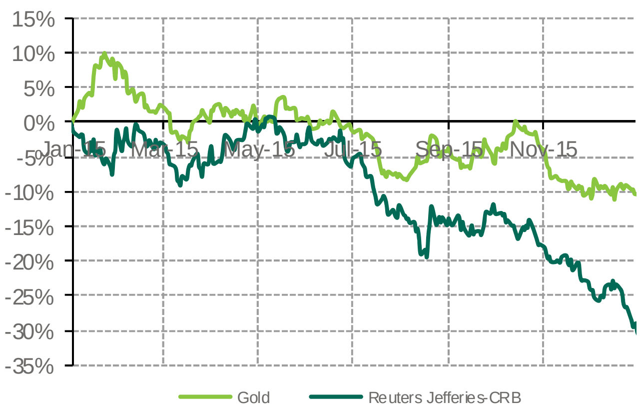
Commodities

No Bottom on the Near Horizon

The sharp declines in commodity prices over the past five years are one of the byproducts of the two-speed global growth and abundant supply resulting from the commodity super-cycle. Sound US fundamentals are building up momentum, allowing the Federal Reserve to revert back to normal monetary policy once again, strengthening the USD. On the other hand, emerging markets are pummeled by a barrage of subpar economic data, adversely affecting commodity currencies, and exacerbating the fall in commodity prices. Oil prices which collapsed in Summer 2014 reached below USD30/bbl mid-January. Industrial metals fell sharply to their lowest levels since 2009 on the back of softer economic prospects in China and continued supply increase due to earlier over-investments. Low energy prices and local currency depreciation delayed closures of high-cost smelters and mines. Agricultural commodities marked the seventh consecutive quarterly decline by the end of 2015 as El Nino-related concerns were geographically limited to support global prices. In January, the Reuters-Jeffries commodity index slipped 5.3%, standing at a historical low of 166.8.

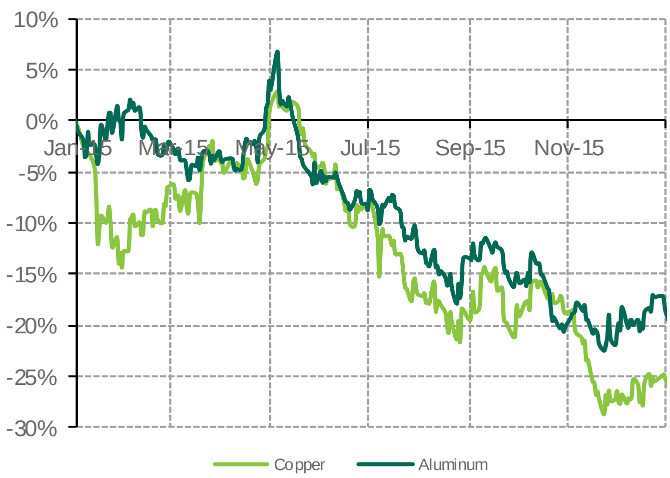
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Copper outlook remains bearish despite plummeting by over 30% since January 2015. Massive surpluses are expected to run through 2017 before a price correction takes place. Capacity closures are currently the only factor allowing for upward price speculation, although with the gloomy manufacturing data coming from China, calling a bottom remains a unclear. During the first month of 2016, copper prices slid 3.1% further, closing at USD4,561/ton. Codelco, the Chilean state-owned copper producer which is also the world's largest, vowed to keep its USD25 billion investment plan unchanged despite dwindling prices. Continued increased supply nullified the positive announcement effect made earlier by Glencore and Anglo-American regarding reducing output by 30,000 tons/year. Aluminum is in the same bandwagon as copper although price falls haven't been as severe owing to the more diversified and intensive use for this metal. In addition, high-cost smelter shutdowns in China, and Alcoa's announcement to cut production by 500,000 tons have been smoothing out the downtrend which only briefly touched below 20% from January 2015. During January, aluminum prices held up, edging by 0.8% at USD1,519/ton. Aluminum is still not immune from the weakness plaguing other industrial metals, and the growth in low-cost smelters may provide further downward pressure in 2016. Gold prices closed at their lowest 2015 levels mid-December around USD1,063/oz, which is around 11.2% YTD. In January, however, gold prices rebounded by 5.3% to USD1118.4/oz fueled by risk aversion from the highly volatility of global equity markets. Lower likelihood of a second Fed rate hike allowed investors a respite to bid gold prices back up. Safe-haven buying should remain supportive throughout 2016, especially as geopolitical and financial jitters continue.

Chart 6: Base Metals



Source: Thomson Reuters

Agricultural commodities are still pressured by ample supply exceeding global demand. The Goldman Sachs Agricultural Index slid 12.1% in 2015 and continued to inch down another percentage point in January. Global production of wheat is expected to reach a new record in 2016 with output increases in Australia, China, and Ukraine offsetting declines in Argentina and Canada. Wheat futures for March deliveries edged up 2% in January, standing at 479.25 cents/bushel. We expect some volatility in the first quarter of the year as adverse winter weather provide upward pressure for prices although we maintain a bearish bias towards grains and commodities in general.

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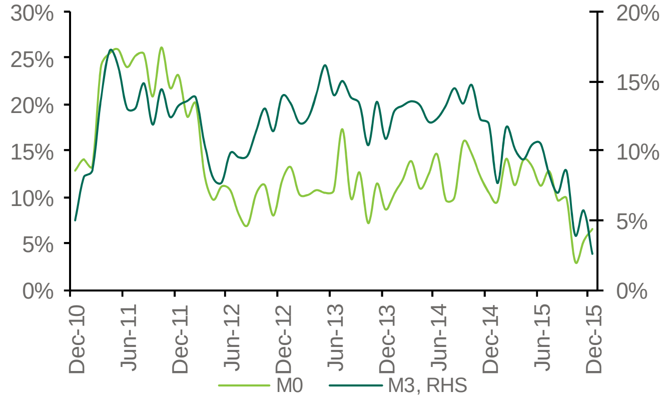
Money & Inflation

Money Growth Feels the Oil Heat

In the month of December, the Saudi money supply concluded the year 2015 with the lowest growth rate in five years, recording only 2.6% at SAR1.77 trillion. Economic activity in the world's biggest oil exporter started to moderate as global oil prices dented the fiscal budget, trickling down to its money supply. The monetary base (M0) witnessed a single-digit annualized growth of 6.6% to SAR301.5 billion, affected by the dwindling of public financial institutions' deposits by 50.7% Y/Y to SAR4.6 billion. Currency outside banks held a steady yearly growth of 10.1%, reaching SAR169.3 billion. Furthermore, Demand deposits which account for 55% of the broad money supply declined for the first time on a Y/Y basis, inching down by 1.3% to SAR976.2 billion. In contrast, time and savings deposits crept up 9% Y/Y in December, registering the fourth consecutive incline. Time and savings deposits account for 24.5% of M3 money supply at SAR434.5 billion. The shift from demand deposits to the interest-bearing time and savings deposits can be associated with a tighter business cycle amid fiscal consolidation. The lockstep nature of SAMA's repo and reverse repo rates with the Fed had already warranted an interest rate hike in December which in turn are likely to impact the composition of Saudi deposits. The 3-month SAIBOR rate average currently stands at a 7-year high of 1.74%, showing signs of liquidity concerns.

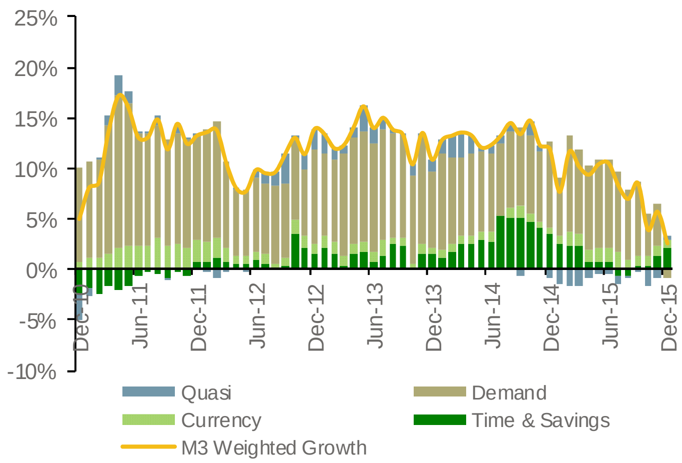
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Quasi monetary deposits stood at SAR194 billion in December, rising 3.4% Y/Y, marking the first upturn in a 12-month period. The main contributing factors which helped returning quasi deposits back to positive territory was a 2.3% Y/Y increase in foreign currency deposits, in addition to a 22.9% surge in government entities' deposits at SAR80.1 billion. Furthermore, in the midst of the liquidity squeeze concerns, Saudi banks' holdings of SAMA bills dwindled significantly to SAR136.3 billion, down 39.7% from a year ago. This implies looser liquidity control by SAMA in order to free up liquidity for the absorption of government bonds. The government is taking unprecedented measures to shore up public finances and reduce the economy's reliance on oil amid plunging oil prices. However, the military intervention in Yemen and the probable military mobilization in Syria constitute major economic hurdles which will likely dictate more stringent consolidation and revenue-generating strategies. The IMF expects economic growth to be subpar this year growing by 1.2%, the slowest since 2002, and that the Kingdom will issue debt worth SAR120 billion. While the inherent volatility of the oil markets adds much opacity to the matter, better fiscal and prudential policies in the Kingdom are essential regardless to whether or not oil prices rebound.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

Inflation levels in December remained low at an annualized 2.3%, mainly due to global disinflationary pressures. Low energy and commodity prices exerted a downward pressure on the consumer basket, and the strengthening USD provided a higher purchasing power for the Saudi riyal. Due to high reliance on imported goods in the Kingdom, food and beverages which weigh around 21.7% of the index inched up by just 1.4%. Housing and utilities which weigh 20.5% of the index recorded a 4% Y/Y upturn, providing most of the upward pressure in the index.

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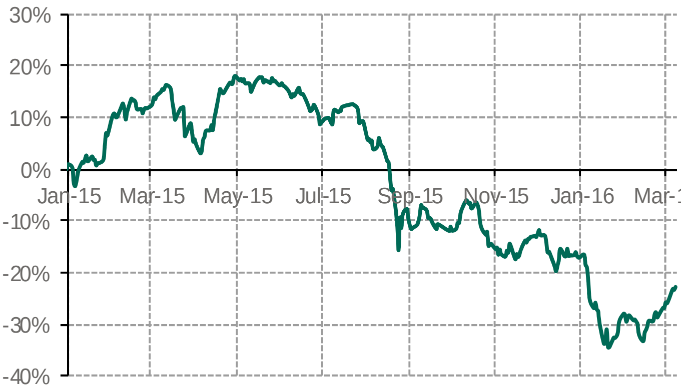
Capital Markets

Rebounding From the Dreadful January

Global equity markets recorded the first annual drop in four years. According to the MSCI world index, equities fell by 4.3% Y/Y by the end of 2015. The Chinese market's collapse resonated throughout global indices and the momentum carried through 2016. January's 6.1% downfall in the MSCI world index was the worst start for a financial year since 2009. Global macro challenges pertaining to China's economic slowdown, the Fed's divergence with other central banks, the political uncertainty in Brazil, and "Brexit" fears prompted the IMF to downwardly revise the global outlook for 2016 and 2017 at 3.4% and 3.6%, respectively. The capital exodus from equity markets pressured central banks to intervene and assure markets of their willingness and commitment to support their respective economies. The Fed's pace of interest rate hikes will be reduced, while Draghi is prepared to introduce additional monetary policy easing at the ECB, and the BOJ announced a multi-tier policy rate which includes negative rates on some deposits to spur lending and investments. Markets were able to cap their losses towards the end of January. The DOW closed 5.5% lower, the S&P500 lost 5.1%, the Euro STOXX600 and FTSE declined by 6.4% and 5.0%, respectively, while the Shanghai Composite ended January with a colossal 22.6% drop.

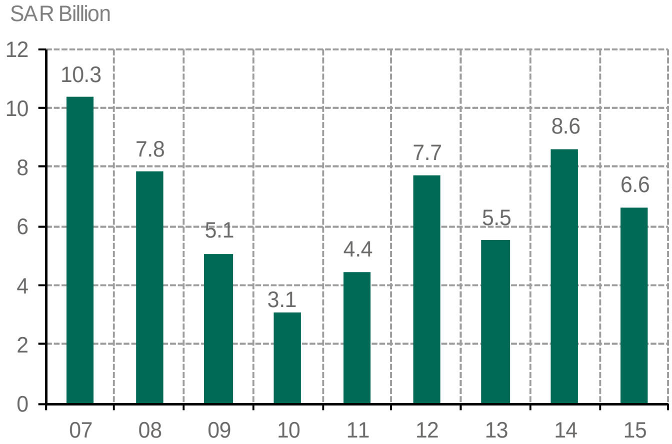
Chart 9: Tadawul All-Share Index



Source: Tadawul

The economic slowdown was bound to affect Saudi listed companies' corporate profitability. Aggregate net profits for the market decreased by13.7%, falling below the SAR100 billion mark to settle at SAR98.7 billion for 2015. Additionally, oil prices recorded another decline during the month of January as WTI and Arabian Light crude dropped 9.3% and 7.7%, respectively. Given the strong correlation between oil prices and Tadawul, the main index contracted significantly by 13.2% during the month of January. Furthermore, index bottomed out at 5'459.84, representing a staggering 44.4% from 2015's peak of 9'834.49 in April. The worst performing sector was the Hotel and Tourism sub-category, dropping by 30.1% in January. Meanwhile, the "blue chip" sectors namely, Banking, Cement, and Petrochemicals, declined to a relatively lesser degree at 10.3%, 10.5%, and 12.3%, respectively. Following the recent rebound in oil prices, the market was able to regain most of its losses, yet we expect limited upside movement as risk levels are high.

Chart 10: Average Daily Traded Value



Source: Tadawul

Despite the contraction in profits, overly pessimistic traders drove price to lower lows, resulting in improved valuations by the end of January. The price-to-earnings ratio for the market declined to 11.87, down from 13.8 by the end of 2015. This will provide lucrative opportunities for investors to allocate long term investments. Negativity will continue to remain a hurdle for capital inflows as the geopolitical situation remains unsustainable. Accordingly, the average daily traded value contracted by 1.1% during January, settling at SAR5.4 billion from December's SAR5.5 billion. Market capitalization reached SAR1.4 trillion, losing a substantial SAR547.5 billion over the previous twelve months, representing 28.5%. Furthermore, Saudi institutions were the only category to increase their holdings of stocks with a net increase of SAR9.5 billion. Meanwhile, Saudi individuals, GCC investors, and other foreign investors were all net sellers as risk averseness was the trading theme in January. As for the primary market, the Middle East Healthcare Company will be offered to the public during the month of March, offering 27.6 million shares with a value of SAR1.8 billion which marks the first initial public offering in 2016. We do not expect a majorly active primary markets as the economic slowdown will limit companies going forward.

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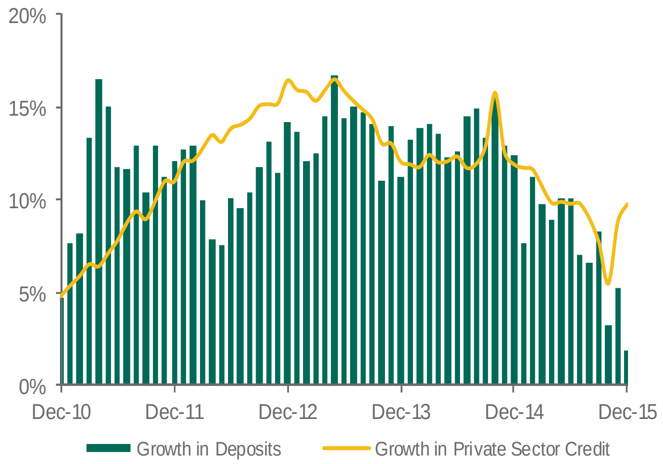
Loans Market

Cost of Credit is on the Rise

Bank deposits in the Kingdom averaged 7.5% in 2015 compared to an average of 13.6% a year ago. The year 2015 ended on a deadbeat growth in deposits by just 1.9%, the slowest growth in five years. In the context of sharp oil price declines trickling down to the depositary base, SAMA raised the implicit loan-to-deposit ratio (L/D) limit up to 90% from 85% previously thus allowing more asset utilization for banks which seek to expand their credit portfolios. The decision could reflect positively on banks' profits and spark a credit-induced economic growth; however, from a credit standpoint it entails relaxing one of SAMA's proudly held safeguards against over-leverage. SAMA's conservative prudential policies are considered a strength in the traditional Saudi banking system, and despite raising the L/D ratio, Saudi banks will still meet Basel III standards albeit with lesser liquidity buffers. Effective L/D ratio increased to 84.8%, up from 79.4% the same month in 2014. The traditional Saudi banking system relies on bank deposits as a primary source of funding, and the dominance of demand deposits have been historically a structural limitation to long-term loans extended by banks.

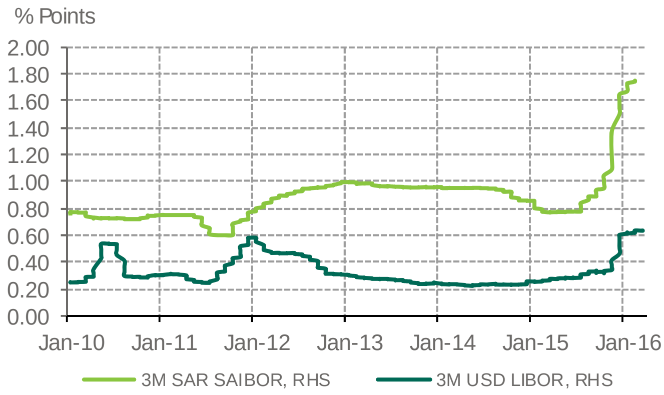
Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

In December, we find that demand deposits declined by 1.3%, representing 55% of broad money supply, while time and savings deposits rose by 9%, making up 24.5%. Meanwhile, private sector credit maintained 9.8% Y/Y growth which is markedly lower than 2014's average of 12.5%. We expect lower government revenue from oil to further affect loan performance. In addition, the Federal Reserve's expected rate hikes in 2016 will contribute to tightening liquidity owing to the USD/SAR peg, and the Saudi Interbank Offered Rate (SAIBOR) currently at 1.7% will increase the cost of funding. Credit activity is expected to catch up with the slowdown in deposits, we expect a fall to mid-single digits in 2016 although softer regulations will likely widen the gap between credit and deposit growth.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

The loan composition by maturity during the month stood at 50.3% for short-term, 17.7% for medium term, and 31.9% for long term loans. Asset reallocation revealed a fall in T-bills by 39.7% and credit for public sector enterprises by 15.3%, meanwhile annualized growth in government bonds is at 62.2%. The deficits will result in less government spending which is a key engine for the Saudi non-oil sector. Therefore, in order to stimulate growth, we expect continued issuances of bonds throughout 2016. Prolonged low oil prices, however, will start to strain banks' profitability margins as lower volume growth will undermine rising interest rates. Reflecting the trickle-down effect on the economy, the value of Point-of-Sale transactions (POS) marked 6.5% Y/Y despite the number of transactions during December surging to a record high of 43.9 million transaction.

The SAIBOR currently stands 1.7%, the highest since September 2009. Liquidity squeeze concerns are bidding the interbank rate higher, making it more difficult for banks to maintain profit margins. With a higher benchmark interest rate, we expect to see tighter consumer loans amid weaker fundamentals, further exposing banks to funding volatility. While we expect growth in lending this year to moderate, possibly to 5% Y/Y, softer SAMA prudential policies should provide some noticeable support.

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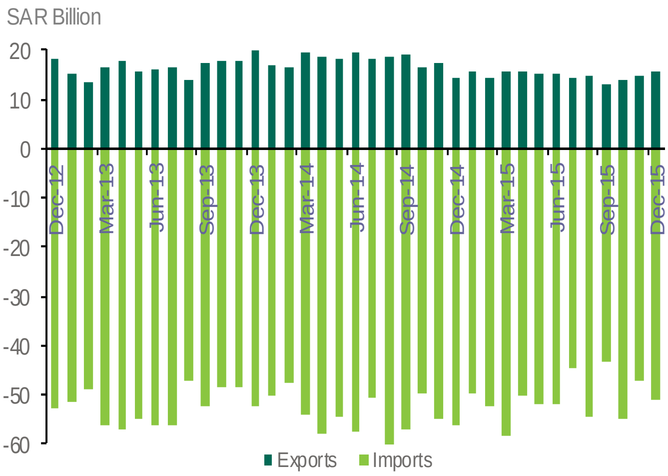
External Trade

Fiscal Consolidation Reflects on Imports

Despite showing some semblance of recovery in Q4 after bottoming out in September, non-oil trade in the Kingdom ended the year 2015 on a negative note compared to 2014. In the month of December, total non-oil exports were valued at SAR15.9 billion, down 3.4% from the same month last year. Imports were also subject to some downsizing despite stronger Saudi riyal. The import bill recorded a total of SAR51.1 billion, sliding by 8.8% compared to the same period last year. By weight, non-oil exports surged 15.6% Y/Y at 4.5 million tons whereas the weight of imports declined 20.3% Y/Y at 5.5 million tons. The change in net exports shows that the balance of non-oil trade gap had shrunk by an annualized 11%.

Chart 13: Saudi Non-Oil Trade Balance

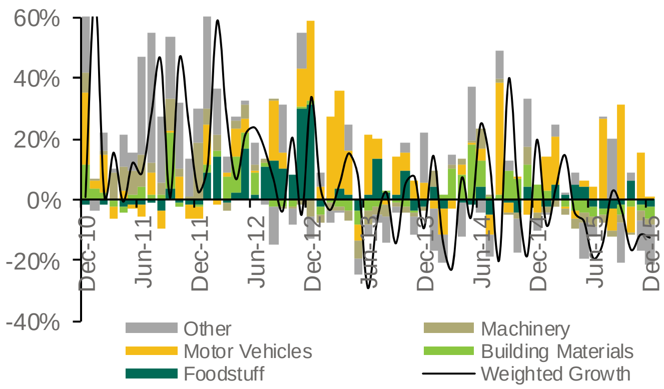


Sources: SAMA and NCB

In value terms, around 30.8% of non-oil exports in December consisted of chemical products which by totaling SAR4.8 billion declined by 8.9% Y/Y. Plastics account for 28.4% of the monthly total at SAR4.5 billion, tumbling by 18.7% Y/Y. Exports of base metals which make up around 7.6% of non-oil exports slid 3.4% Y/Y after posting SAR1.2 billion. The largest export destinations in December were the UAE, accounting for 14.7% of the total, China, accounting for 13%, and Bahrain, making up around 5% of the monthly total. In comparison to last year, non-oil exports to the UAE grew markedly by 96.5% to SAR2.3 billion. In contrast, the Chinese economic slowdown has dented export figures for most of 2015 which were marked by double-digit declines. In December, non-oil exports to China stood at SAR2.1 billion, sliding by 10.7% Y/Y. Exports to Bahrain overtook India and Singapore as the third largest non-oil export destination in December after surging by 46.1% Y/Y to SAR0.8 billion.

On the import side, machinery and electrical equipment constitute around a quarter of the import bill, followed by transport equipment at 24.1%, and chemical products at 8.5%. In value terms, imports of machinery and electrical equipment reached SAR12.8 billion, dwindling by 16.6% Y/Y. Imports of transport equipment on the other hand surged by 16.8% standing at SAR12.3 billion. Imports of chemical products fell 14.1% Y/Y, standing at SAR4.3 billion. Origins of imports include the United States accounting for 15.5% of the monthly total, China making up 11.6% of the total, and Germany, accounting for 7%. The US has regained its position as the largest trade partner by import value, surging by 11.1% Y/Y to SAR8 billion. Chinese imports to the Kingdom reflected a double-digit annual decline of 28.2%, settling at SAR5.9 billion. Imports from Germany also posted a sizeable decline in value by 10.5% Y/Y at 3.6 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

In the month of December, settled letters of credit (LCs) of private sector imports show a 21.4% decline compared to last year, totaling SAR16.7 billion. The dwindling of LCs has been volatile albeit constituting a downward trend especially in 4Q. The decline in December is considered the largest since June 2014, influenced mostly by a 24.4% decline in foodstuff LCs totaling SAR1.9 billion. Motor vehicles LCs recorded a decline of 5.4% Y/Y at SAR4.8 billion, which despite its weight remained highly volatile. LCs for building materials tumbled by an annualized 39.3% at a total of SAR1.2 billion.

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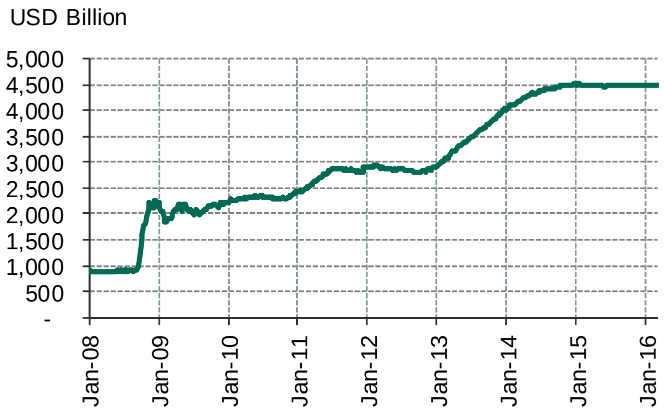
NCB الأهلي

Special Focus:

Desperate Times Call for Desperate Measures

The global financial crisis in 2008 could shape up to be the worst economic event of the 21st century. Starting from the sub-prime mortgage, the domino effect dragged economies into recession with some still recovering from the aftermath till this day. Given the magnitude of the catastrophe in financial markets, governments needed to intervene and mitigate the landslide. When financial giant, Lehman Brothers, filed the largest bankruptcy in US history, the government bought and supported major companies to stabilize markets, coining the term “too big to fail”. However, the economy contracted by 8.2% in 3Q 2008, leading to a dovish monetary policy. The US Federal reserve cut the benchmark interest rate to 0-0.25% by the end of 2008 and kept it near zero for the next seven years in order to stimulate a fragile economy. Furthermore, as the conventional arsenal in monetary policy showed benign effects, the government announced an unconventional quantitative easing plan, which later spanned over six years. The Fed started buying government securities to lower and flatten the yield curve to subsequently increase money supply. The program experienced three phases in which the balance sheet of the Fed expanded by a monstrous 400% from pre-crisis levels to reach USD4.5 trillion.

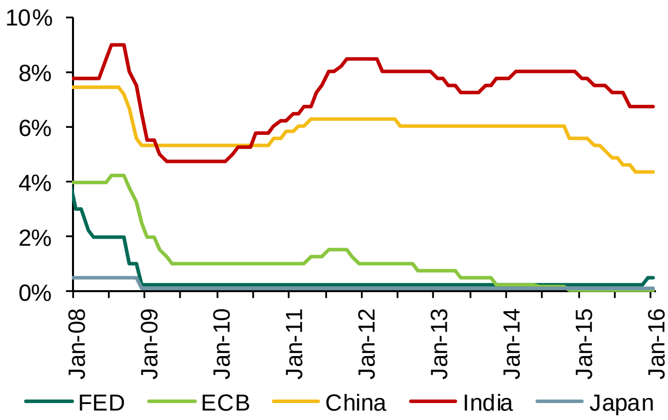
Chart 15: US Federal Reserve Balance Sheet



Source: US Federal Reserve

On a global scale, central bankers announced over 600 interest rate cuts post the financial crisis. As the rate cutting option was exhausted, a combined USD12 trillion worth of asset purchasing was injected by central banks into their respective economies to further support financial markets. The European Central Bank (ECB) struggled with stubbornly low inflation and record unemployment levels, hindering its economic outlook and pressuring the stability of the trading bloc. Buying assets from troubled economies at the time, namely Spain, Portugal, and Greece, failed to stave off a double dip recession. The bond-buying program has now extended to better performing economies, such as German bunds, and is expected target a wider range of assets in the near future. However, as measures proved ineffective, the ECB ventured into negative deposit rates, the first major central bank to implement the unorthodox tool, following Sweden, Switzerland, and Denmark. Over the course of 18 months, the ECB has made three 10bps cuts below zero to encourage lending and investments rather than parking assets and another cut is expected in the ECB’s March meeting.

Chart 16: Global Monetary Policy Rate Decision



Sources: Thomson Reuters and NCB

The central Bank of Japan (BOJ) is desperate to avoid another “lost decade” as Prime Minister Shinzo Abe and Governor of BOJ Haruhiko Kuroda have deployed most of their arsenal in the face of stagnation. Mirroring the ECB in its latest decision, the BOJ implemented a multi-tier policy rate that falls below zero. Existing balances will continue on the current 0.1% rate to minimize the impact on earnings projections. Meanwhile, a rate of 0% will be applied for required reserves and ongoing lending support programs. Any additional reserves will be penalized with a negative rate of 0.1% to stimulate the economy. There are concerns as banks could transfer the burden onto clients which could lead to a bank run for cash to exit the banking system. Additionally, a capital exodus is possible as investments will seek other regions with better opportunities. The recent measures by central bankers will need time to reveal whether they have a positive impact on the economy or not. As peaks become lower in subsequent cycles, these unconventional measures could become the norm in a complex global economy that will require innovative methods to maintain a positive trajectory.

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