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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Said A. Al Shaikh
Head of Economics | s.alshaikh@alahli.com

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

Executive Summary

- Although the market is in the process of rebalancing, the overhang has not been wiped out yet, and will undoubtedly take more time than some OPEC officials currently anticipated.

- In the aftermath of Brexit, the pound sterling sank to 31-year lows. At USD1.3, the GBP lost 10.8% YTD by mid-July. The German ZEW investor sentiment has deteriorated to -6.8 in July from 19.2, indicating concerns that Britain's decision to leave the European Union could weaken the region's fragile economic recovery.

- Gold currently stands at the highest levels since March 2014, and despite its steady appreciation, there are several catalysts that could dampen its rally, including a more hawkish Fed.

- Despite crude prices rebounding around 50% since the beginning of the year, the government is currently gearing up to debut the sale of its first international bond on par with other gulf states, mandating several international investment houses to lead the process.

- Domestically, the month of June corresponded with the holy month of Ramadan, which muted the market's activity. Tadawul marginally gained 0.8% on a monthly basis despite announcing of the National Transformation Plan earlier in June.

- By The 3-month Saudi Interbank Offered Rate currently stands at 2.2%, rising above SAMA's repo rate of 2%. Thus, we note a substantial activity pick-up in repo transactions, reaching SAR3.6 billion in May, as banks borrow against their holdings with SAMA amid liquidity shortage in the interbank market.

- The cumulative impact of subpar economic indicators has weighed on the country by recording the slowest growth since 2002 as 1Q GDP grew by 1.5% Y/Y. .

View of the Month

Saudi's NTP plans to raise non-oil revenues to SAR530 billion in 2020, up from 2015's SAR163.5 billion. The plan allocates an estimated SAR446 billion over a five-year timeframe, of which the government assigned SAR268 billion, while the private sector will contribute an expected SAR178. Attracting the private sector's capital will be challenging considering the weakening domestic economy and the geopolitical risks in neighboring countries.

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Macroeconomic Indicators

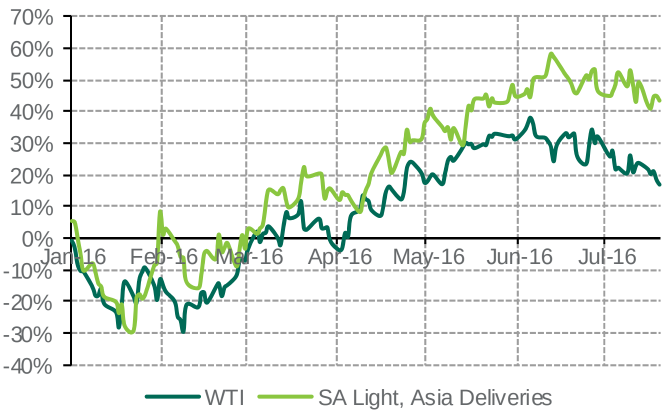
	2011	2012	2013	2014P	2015F	2016F
Real Sector						
Average KSA Crude Spot Price, Arab Light, USD/BBL	108.1	110.2	106.4	97.2	50.2	45.0
Average Daily Crude Oil Production, MMBD	9.3	9.8	9.6	9.7	10.2	10.2
GDP at Current Market Prices, SAR billion	2,510.7	2,752.3	2,791.3	2,826.9	2,449.6	2,322.3
GDP at Current Market Prices, USD billion	670.4	734.9	745.3	754.8	654.1	620.1
Real GDP Growth Rate*	10.0%	5.4%	2.7%	3.6%	3.4%	1.7%
CPI Inflation, Y/Y % Change, Average	3.7%	2.9%	3.5%	2.7%	2.2%	4.5%
External Sector						
Current Account Balance, USD billion	158.5	164.8	135.4	73.8	-53.5	-63.7
Current Account Balance/GDP	23.6%	22.4%	18.2%	9.8%	-8.2%	-10.3%
Net Foreign Assets with SAMA, USD billion	535.9	648.5	717.7	725.2	609.7	539.0
Fiscal Sector (Central Government)						
Actual Revenues, SAR billion	1,117.8	1,247.4	1,156.4	1044.4	608.0	586.3
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	-310.7
Budget Balance/GDP	11.6%	13.6%	6.5%	-3.4%	-15.0%	-13.4%
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%	2.6%	2.5%
Growth in Credit to the Private Sector	11.0%	16.4%	12.1%	11.9%	9.8%	5.3%
Average 3M SAR Deposit Rate	0.7%	0.9%	1.0%	0.9%	0.9%	2.5%
Average 3M USD Deposit Rate	0.3%	0.4%	0.3%	0.2%	0.3%	0.9%
Spread, in Basis Points, SAIBOR-LIBOR	40.9	55.2	68.7	70.4	56.4	160.0

Sources: Thompson Reuters, SAMA, and NCB

Oil Market
Oversupply Caps Crude Rally

Brent crude has been trading near USD50.0 a barrel in June, up over 70% from its early year lows, bringing 1st half average up to US42.5 a barrel. Oil markets have been buoyed by a number of supply disruptions, notably in Nigeria, Canada and Libya, and evidence of sustained oil demand, particularly from China, India and the US. These developments have been sufficient to offset the return of Iranian output. But, the crude rally stalled since early July, as the turmoil surrounding Brexit and resurgent concerns over a supply glut have pulled prices down. Due to the Brexit driven economic uncertainty, oil demand growth concerns have intensified. This has followed recent developments in Nigeria and Libya, suggesting that the unplanned oil supply outages, owed to pipeline attacks and continued conflicts, respectively, are starting to fade. Also, oil supply disruption attributed to the wildfires in Canada has eased. These have weighed negatively on oil prices, trading near the USD42-46 a barrel range this week. Moreover, the returning supplies are tentatively counteracting the narrowing of non-OPEC supply, thus more likely extending the rebalancing process. The market focus has shifted back to the overflowing inventory, which apparently would put a lid on the current crude prices.

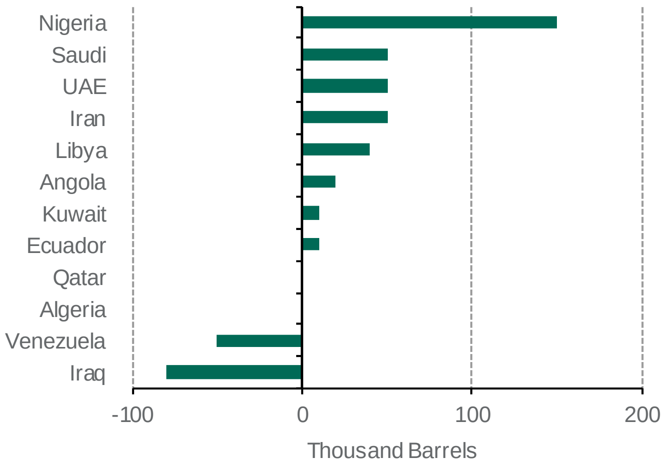
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, OPEC's production increased by 0.28mb/d to 32.63mb/d in June, according to IEA. Saudi Arabia's output is near-record, reaching 10.45mb/d last month. The Kingdom is not intending to flood the market, but will continue to raise production to meet growing demand. In Iran, output has risen from 2.8mb/d at end of 2015 to 3.6mb/d in June. However, whether Iran can increase production is less certain given the difficulties it is facing in securing investment. Libya's oil exports amounted to 0.25mb/d in June, according to the Libyan national oil company, but still vulnerable to a relapse, given the political turmoil. In the US, the crude stockpiles are still totaling 524.0 million barrels, 100 million barrels above the five year average. US shale oil drillers have made big strides in cutting costs and improving productivity. Given recovery in oil prices, attention is turning to US shale producers, which are likely to be profitable at USD50.0 a barrel. The fall in rig counts appears to have bottomed out, and over the last few weeks there has been small increases, which could gather steam if oil prices continue to hold at USD45-50 a barrel. Meanwhile, US production has fallen by 1.0mb/d from its highs in June 2015, to stand at around 8.7mb/d in June this year, according to EIA.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

Despite the early year uncertainty over global growth prospects, recent import and consumption data suggest that China, India and the USA will again contribute towards annual global oil demand growth of 1.3mb/d. Growth in Europe may slow, but this should not have major impact on global demand. Although the market is in the process of rebalancing, the overhang has not been wiped out yet, and will undoubtedly take more time than some OPEC officials currently anticipated. It is expected that supply will exceed consumption by an average of 1.75mb/d in the current period, compared with an estimate of 1.5 million in June, and the excess supply could rise if OPEC producers continue to add more output.

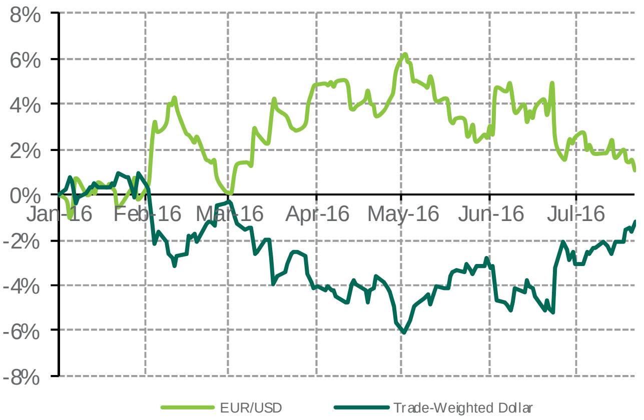
Said A. Alshaikh
Head of Economics | s.alshaikh@alahli.com

Foreign Exchange

USD Moderates on Fed Accomodation

Foreign exchange markets are witnessing a relative recovery in emerging market currencies owing to a delay in the Fed's action. In early July, the JPY strengthened to the highest levels since November 2013, and the GBP hit a 31-year low against the dollar. The unanticipated Brexit vote, in addition to China's mixed macroeconomic figures are holding the Fed back from its second rate hike, which would support the rebound of the greenback during 2Q2016. On the other hand, the closer we approach the US presidential elections, the more challenging it would be for the Fed to ascertain the movement of market fundamentals. A strengthening US dollar, particularly after the Brexit vote, continues to weigh on US growth through more expensive exports. US jobs report shows that non-farm payroll returned stronger at 287,000 jobs after slacking in May at just 11,000. In addition, the US consumer price index increased 1% in June on an annual basis, underpinning the US dollar's appreciating track. Against this backdrop, the Fed will likely remain accommodative pending better inflation and global macroeconomic data. By mid-July, the trade-weighted USD stood at 96.6, down by 2.1% YTD.

Chart 3: Trade-Weighted Dollar and the Euro

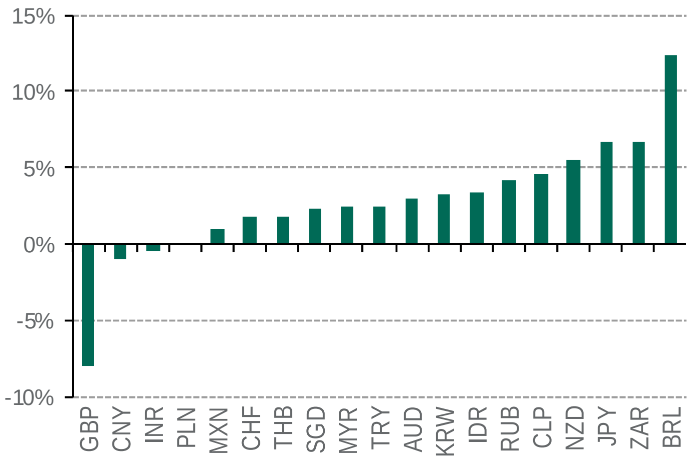


Source: Thomson Reuters

China is on the forefront of risks to global markets despite 2Q GDP figures being in line with expectations, coming in at 6.7% Y/Y. Fixed asset investment growth in 1H slowed to 9%, the lowest since March 2000. The solid GDP performance was due to a surge in property and construction, which is unlikely to be sustainable. Officially, China's statistics bureau aims for an annual growth in the range of 6.5%-7%, which appears to be ambitious given expected market headwinds. With private investment dwindling, state investment rose 23.5% in 1H and government spending increased 19.9%, eventually leading bank credit to increase 14.3% Y/Y by the end of June. The People's Bank of China reiterated its commitment to the renminbi's liberalization while maintaining its stability. By mid-July, the CNY recorded the lowest levels versus the dollar since 2010, standing at 6.7 yuans, down by 3.2% Y/Y.

The Japanese yen hit its highest YTD level of 100.5 against the USD on the 8th of July on the back of safe-haven seeking. The Japanese parliamentary elections, which were won by the ruling coalition, sparked the rhetoric of Abe's three-arrowed reform. While the first two arrows, fiscal and monetary stimulus, are already in place, regulatory reform seems to be lagging behind. Although Abe decided to delay the second consumption tax again, the Bank of Japan is still likely to pursue further monetary stimulus despite negative interest rates.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the aftermath of Brexit, the pound sterling sank to 31-year lows. At USD1.3, the GBP lost 10.8% YTD by mid-July. The German ZEW investor sentiment has deteriorated to -6.8 in July from 19.2, indicating concerns that Britain's decision to leave the European Union could weaken the region's fragile economic recovery. The European Central Bank pledged to provide any needed liquidity to avert Brexit's negative impact on growth. The EUR Fell back to March's levels after a brief recovery in 2Q, standing at USD1.1, upturning by 2% Y/Y.

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

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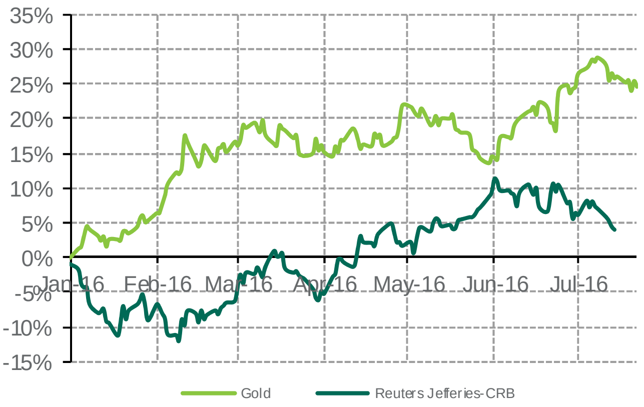
Commodities

Commodities Extends Rally Into July

Commodities price outlooks improved after the Fed lowered the tone on the interest rate hike rhetoric. The Fed is likely to remain accommodative throughout the year, which supported an appreciation in commodity prices. In addition, risk aversion following Brexit increased the attractiveness of gold and precious metals, while seasonal increase in oil demand allowed crude to creep up. Industrial metals rebounded since June on the back of delayed Fed action and improving interest rate differentials in the emerging markets. The Reuters/Jeffries CRB index surged 10.3% by mid-July, standing at 232.

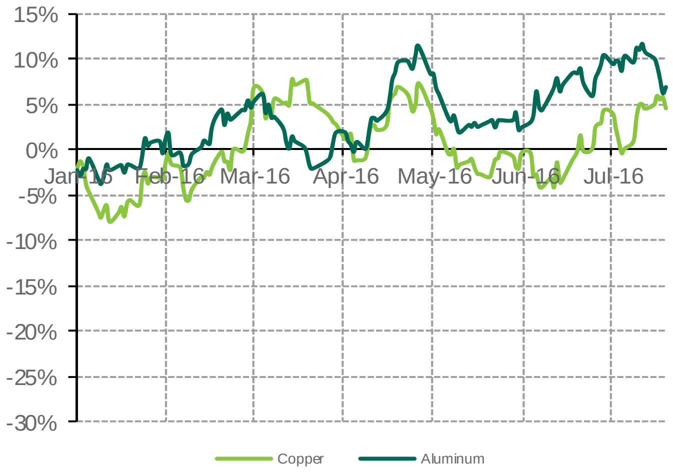
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

By mid-July, copper prices increased 5% since the beginning of the year to USD4,941/ton while aluminum surged 10.7% YTD to USD1,669/ton, underpinned by high cost smelter closures and overcapacity production. The demand spike in base metals may well be attributed to China's restocking than actual end-user demand, as port inventories in China rose to the highest levels since December 2014. London Metal Exchange (LME) inventories in June show that aluminum stock was down 5.5% M/M at 2.3 million tonnes, while LME copper stock surged 22.5% M/M to 189.1 thousand tonnes. Furthermore, the official Chinese purchasing managers index edged down to 50 in June, indicating a stand-still, while the Caixin manufacturing PMI recorded the fastest industrial cool-down in four months in June, coming in at 48.6. We expect to see some consolidation in base metals prices as the USD regains some strength, and the US economy's performance continues to diverge from Europe and emerging markets. As financial markets turn their attention to the UK's Brexit repercussions, risks such as the Spanish elections, the US presidential elections, and rising corporate debt in China are solidifying demand for safe assets such as gold which surged 26.1% Y/Y by mid-July, standing at USD1,338.3/oz. Gold currently stands at the highest levels since March 2014, and despite its steady appreciation, there are several catalysts that could dampen its rally, including a more hawkish Fed. On the other hand, Japan and Europe's borrowing rates which fell below zero are underpinning bullion's value and providing a price floor above last year's levels. In addition, expectations of further monetary stimulus in Japan is favorable for gold as it usually offers a safe store of value and inflation hedge.

Chart 6: Base Metals



Source: Thomson Reuters

Soft commodities rose 6.2% YTD according to the Goldman Sachs agricultural commodity index which stood at 300.9 mid-July. Since the beginning of the year, ample supply of wheat, particularly cheaper black sea crops kept prices depressed at 426 cents/bushel, thus falling by 14.6% YTD. Limited El-Nino effect did not substantially weaken supply outlooks which remains at record yield. As of mid-July corn futures prices were down 7.5% YTD, standing at 347 cents/bushel. Soybeans, on the other hand, recorded a double-digit surge of 21.1% YTD, appreciating to 1,065.2 cents/bushel.

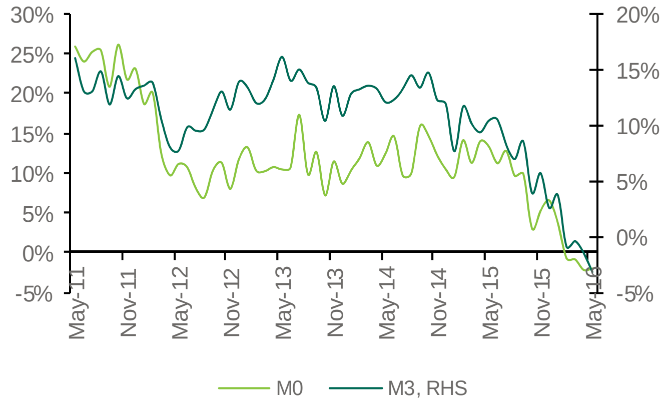
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

Money & Inflation

Liquidity Concerns Deepen

In the month of May, the Kingdom's broad money supply (M3) shrank by a record 3.2% affected by dwindling deposits. The monetary base (M0) stood at SAR302.7 billion, shrinking by 2% Y/Y. Despite deposits of public financial institutions with SAMA inching up since January to SAR3 billion, bank deposits with the central bank remain weak, standing at SAR96 billion. By annual comparison, public financial institutions' deposits tumbled by 51.6% since May 2015 while bank deposits with SAMA shrank 5.1% over the same period. The heavy withdrawals are a result of the government budget shortfall, which is stressing banks' liquidity levels due to bond issuances. Outstanding government bond issuances held by Saudi banks nearly tripled from last year, standing at SAR153.5 billion by the end of May. Despite crude prices rebounding around 50% since the beginning of the year, the government is currently gearing up to debut the sale of its first international bond on par with other gulf states, mandating several international investment houses to lead the process. This represents a capital inflow, which in-turn, would ease liquidity tightness and lessen the burden on the local monetary system. The size of the issuance is still a matter of speculation, although, we expect a gradual approach as the issuer gauges market response. Government expenditure will leave a funding gap of SAR375 billion this year despite fiscal consolidation and optimization efforts as bond sales in tandem with utilizing net foreign assets will be directed to plug the budget deficit.

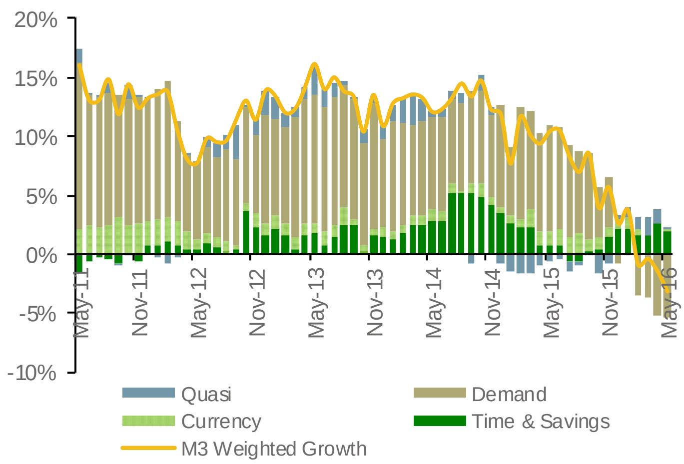
Chart 7: Growth in Monetary Aggregates



Sources: SAMA and NCB Estimates

Demand deposits, the largest component in the Saudi depositary base, stood at SAR987.3 billion as of May. Annualized comparison shows that demand deposits tumbled 9%, recording the largest monthly downturn thus far. Deposits of businesses and individuals, which account for 92.3% of demand deposits, shrank 8.6% Y/Y to SAR911.7 billion, while government entities' share of 7.7% was down 13.3% Y/Y to SAR75.6 billion. During May, time and savings deposits recorded the 9th consecutive annual increase by 9.7% Y/Y, standing at SAR409.3 billion as banks offer competitive interest rates to motivate investors to switch to saving accounts. Moreover, quasi currency deposits rose for the 6th consecutive month by 2.7% Y/Y, reaching SAR193.1 billion. Growth in quasi money deposits were underpinned by a 50.7% Y/Y growth in letters of credit with a value of SAR18.7 billion. On the other hand, deposits of foreign currency slid 2% Y/Y to SAR158.3 billion.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The annualized inflation rate in May recorded 4.1%, the lowest reading since the beginning of the year. Since the government decided to reduce energy subsidies in January, the utilities and transport sub-indices have more than doubled. Housing and utilities sub-index recorded a 7.7% increase compared to last year, mostly influenced by the rise in utility bills while the transport sub-index surged by 11.3% Y/Y. Downside pressure comes from the food and beverages sub-index which up-ticked by 0.3% Y/Y in addition to restaurants and hotels sub-index which is down 2.2% Y/Y. We expect inflation to remain steady, hovering around 4.2% this year.

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

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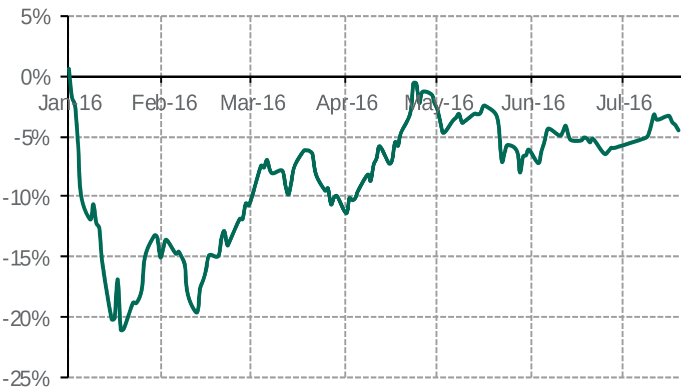
Capital Markets

Ramadan Mutes Global Volatility

Equities over the past month have been extremely volatile as unexpected events heightened risk levels. The Brexit referendum heavily impacted financial markets as the GBP touched 31-year lows, while the FTSE recovered its initial losses and continued to reach 10-month highs. Additionally, the US Fed opted to maintain its benchmark interest rate following a dismal jobs report, which revealed a mere 11,000 new jobs in May. These developments followed a stream of terror attacks in the US and France, and a failed military coup attempt in Turkey by a faction in the army ranks. Going forward, these events encapsulate the uncertainties that equity investors must account for as economic decisions are greatly influenced by political events. By the end of last month, the US DOW marginally gained 0.8% and the S&P500 was stagnant at 0.1%, while the NASDAQ index declined by 2.1%. Across the Atlantic, UK's FTSE surprisingly gained 4.4%, while the French CAC40 and Germany's DAX lost 6.0% and 5.7%, respectively. In Asia, China's Shanghai index edged higher by 0.4%, while Japan's Nikkei 225 was burdened with an appreciating currency, thus, declining by 9.6% during the month of June. Investors are likely to remain on edge building up to November's US presidential elections, until then, volatility will be the main theme for the remainder of 2016.

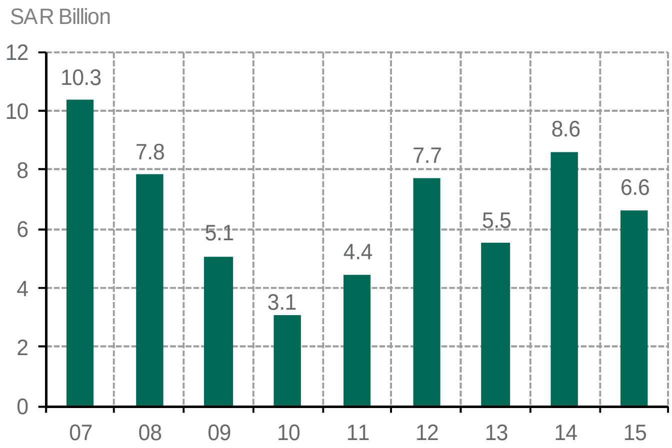
Chart 9: Tadawul All-Share Index



Source: Tadawul

Domestically, the month of June corresponded with the holy month of Ramadan, which muted the market's activity. Tadawul marginally gained 0.8% on a monthly basis despite announcing of the National Transformation Plan earlier in June. The average daily traded value dropped to SAR3.8 billion, the lowest monthly average since September 2011. Tadawul had announced a hike in the commission fee as well as an elimination of the minimum commission of SAR12. The new commission rate on buy and sell transactions will be 0.155%, a 29.2% increase over the previous 0.12% rate. The Capital Market Authority and Tadawul are seeking to implement global best practices to target an inclusion into MSCI indices. Along with the revised rate, Tadawul is planning to implement (T+2) settlement cycle for transactions and introduce securities lending and covered short selling during the first half of 2017. Additionally, a market for Small to Medium Enterprises (SME) is under development with a substantial amount of Initial Public Offerings over the coming years. This will provide SMEs with an alternative source of financing and reduce the load on the domestic banking system. Developing the market's depth will attract international investors as the level of activity for qualified financial institutions remains low with an ownership of 0.09% of the total market by the end of June.

Chart 10: Average Daily Traded Value



Source: Tadawul

The Islamic financing alternative, Sukuk, has completed six issuances this year with a total value of USD3.2 billion. In comparison, over the same period last year, eight issuances raised a total value of USD3.8 billion. This comes in line with our expectations of a moderating market for Islamic financing. The recent bond sales by the government raised total claims on the government by SAR175 billion since July 2015. June's SAR20 billion issuance offered fixed and floating rate securities ranging from 5-10 years with attractive yields. The government's issuances might contribute to further strain liquidity in the domestic market and crowd-out private businesses seeking financing. Nevertheless, Saudi's net foreign assets, at SAR572.9 billion by the end of May, provide the option for government to limit bond issuances and utilize other sources of funding.

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

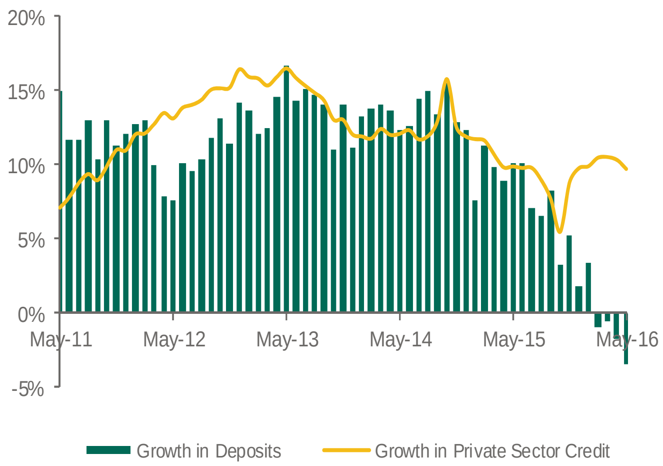
Loans Market

Credit Momentum Moderates

The month of May witnessed a continuation in the expansion of credit despite dwindling deposits; the primary source of funding in Saudi banks. Total claims of Saudi banks, excluding government bonds, stood at SAR1.43 trillion, surging over last year by 9.5%. On the other hand, deposits marked the fourth consecutive annualized decline, sliding by 3.4%. Deposits account for 70.9% of total bank liabilities, and since Saudi banks adopt a conventional credit model, the capacity to lend is directly linked to the inflow of deposits. Demand deposits which make up over half the money supply (56% by May) have dwindled 9% Y/Y due to lower oil revenue. In contrast, the propensity to save had increased as evident by the rise of time and savings deposits by 9.7% annually. Quasi monetary deposits inched up by 2.7% Y/Y, mainly due to rising letters of credit by 50.7% Y/Y.

On the asset side, the annual growth in private sector credit was at 9.7%, displaying resilient credit demand despite the liquidity squeeze. The surge in credit in May was induced by an added capacity for lending allowed by SAMA. The maximum allowable loan-to-deposit ratio (L/D) rose from 85% to 90% providing a momentum boost. On the flip side, with private credit falling back to the single digit in just three months. This could be indicative of deceleration, especially that the consolidated L/D ratio for Saudi banks as of May already stands at 89.9%.

Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

Credit-induced growth will be a highlight for the coming years as the Kingdom seeks to finance its spending gap via the issuance of government bonds. By the end of May, government bond issuances show a surge of 191.8% Y/Y, standing at SAR153.5 billion. On the other hand, treasury bill holdings in Saudi banks have declined by 73.2% to SAR61.2 billion in order to free up liquidity for the longer maturity issuances. Annualized growth in credit to public sector enterprises turned positive for the second month following twelve months of decline. In search of new revenue streams, the government's National Transformation Plan aims to boost non-oil revenue to SAR530 billion via the introduction of value-added taxes, the utilization of untapped resources such as mining and tourism, in addition to large-scale privatization. Efficiency measures will also be implemented as the government optimizes spending which would have a positive long-term effect.

Chart 12: Liquidity and Risk Detector

Source: Thomson Reuters

The composition of bank credit by maturity reveals 51.4% in short-term periods, valued at SAR734.4 billion. Medium-term credit accounts for 19.3% at SAR276.3 billion, while long-term credit accounts for 29.3%, standing at SAR418.8 billion. By annual comparison, short-term loans rose 11.3% Y/Y, while medium and long-term loans surged by 19% Y/Y and 9.5% Y/Y, respectively. The 3-month Saudi Interbank Offered Rate currently stands at 2.2%, rising above SAMA's repo rate of 2%. Thus, we note a substantial activity pick-up in repo transactions, reaching SAR3.6 billion in May, as banks borrow against their holdings with SAMA amid liquidity shortage in the interbank market.

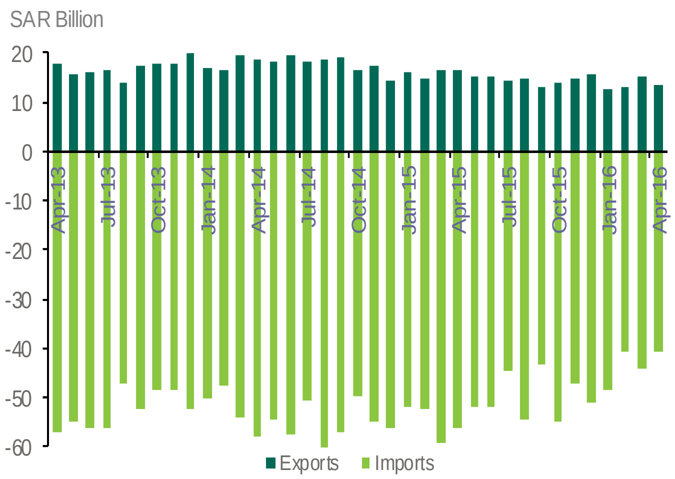
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

External Trade

Imports Sink in Response to Spending Cuts

In the month of April, the Kingdom's non-oil trade recorded another month of decline in both exports and imports. The cumulative impact of subpar economic indicators has weighed on the country by recording the slowest growth since 2002 as 1Q GDP grew by 1.5% Y/Y. Oil prices remain pummeled by oversupply and the strong dependence on the single commodity left the government struggling with its finances, effectively reducing economic activity across sectors. Despite the resilience of the Saudi Arabian oil industry owing to cheaper cost of production compared to other OPEC members, the larger role that oil plays as a share of GDP necessitates immediate reform. The National Transformation Plan aims to restructure the economy to rely less on oil and the public sector and more on non-oil and the private sector for growth. However, government spending and subsidy cuts introduced at the beginning of this year weighed heavily on the sector, pushing it into a technical recession. In the first quarter, the non-oil economy contracted by 0.7% Y/Y following a weak fourth quarter in 2015 which was revised down to -0.5% Y/Y. The impact on non-oil trade comes in the form of declining demand for imports and less competitive non-oil exports. The reduction of government subsidies is eroding profit margins as inflation nearly doubled to 4.1%, which along with a stronger USD is suppressing competiveness for Saudi exports.

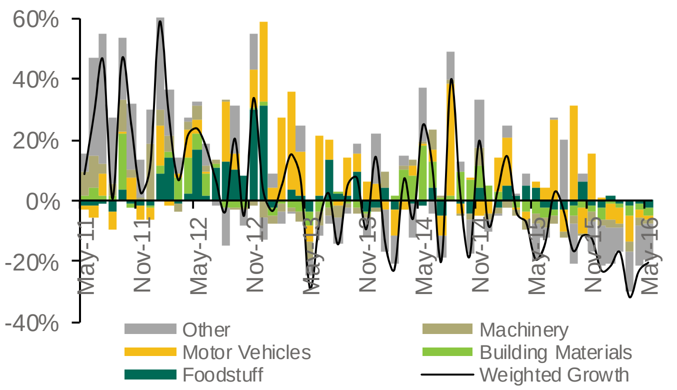
Chart 13: Saudi Non-Oil Trade Balance



Sources: SAMA and NCB

Saudi non-oil exports slid 18.4% Y/Y to SAR13.5 billion in April on the back of declining exports of chemical products, plastics, and base metals. Moreover, imports tumbled 27.2% Y/Y to SAR40.8 billion affected by sharp declines in imports of machinery and electrical equipment, transport equipment, and base metals. The balance of trade gap shrunk 30.9% compared to last year, and the size of non-oil exports in value terms during the month equated to 33% of the import bill. By composition, exports of plastics accounted for 32.8% of the monthly total at SAR4.4 billion, sliding by 9.1% Y/Y. Exports of chemical products nose-dove by 35.5% Y/Y to SAR 3.4 billion, accounting for 25.1% of the monthly total. Exports of base metals which make up 8.8% of non-oil exports fell 8.3% Y/Y to SAR 1.2 billion. By destination, the UAE accounted for the bulk of non-oil exports at SAR2.3 billion, upturning by 6.3% Y/Y. Non-oil exports to China tumbled 49.4% Y/Y on the back of slowing demand to just SAR1 billion, while exports to India dwindled 32.9% Y/Y to SAR0.8 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA and NCB

On the imports side, imports of machinery and electrical equipment imports tumbled 37.4% Y/Y to SAR9.5 billion, accounting for 23.2% of total imports. Transport equipment declined 18% Y/Y to SAR7.9 billion, while imports of base metals fell 38.1% Y/Y to SAR 3.8 billion. Imports by country source show that China accounted for 13.1% of the import bill, which at SAR 5.3 billion have contracted by 26% Y/Y. The United States was a close second accounting for 13% of imports at SAR5.3 billion, declining by 24.5% Y/Y. Japan came as the third largest trade partner by destination, accounting for 6.4% of the import bill at SAR 2.6 billion, sliding by 23.7 %..

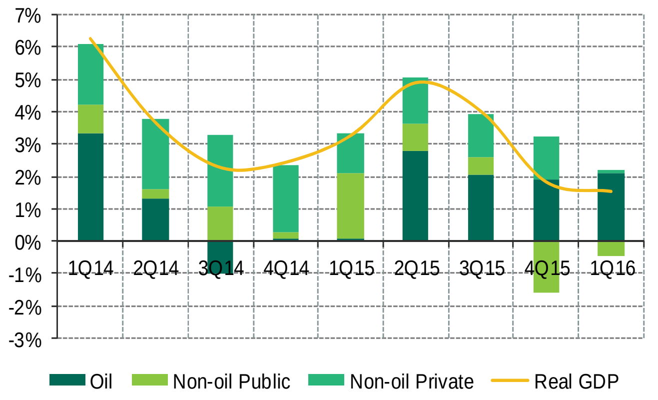
Yasser A. Al-Dawood
Economist | **y.aldawood@alahli.com**

NCB الأهلي

Special Focus:
Oil Weighs on Saudi Economy

Saudi Arabia faced numerous challenges over the past 18 months, both economically and politically. These challenges were culminated by the weakest economic expansion during the first quarter of 2016 since 1Q2013. OPEC's decision to fend off competition by producing record levels pressured oil prices to as low as USD25/bbl in January 2016. While the country's main source of income reduced the inflow of revenues, the Kingdom's engagement in several political agendas in the region have further hampered its ability to maintain an expansionary domestic fiscal policy. Public spending adjustments resulted in real GDP decelerating to grow by 1.5% on an annual basis through January to March, following a revised 1.8% growth in 4Q2015. The Arabian Light crude prices averaged USD30.6/bbl during 1Q2016, acting as the main drag on the economy. However, a rebound back to around USD50/bbl will certainly ease some of the pressure on the government. The figures released by the General Authority for Statistics reveal the oil sector expanded by 5.1% Y/Y in real terms, up from 4.5% Y/Y in the previous quarter, driven mainly by record oil production that remained above the 10MMBD level throughout 2016. The government has opted not to invest in production capacity beyond the 12.5MMBD, and given the moderation of oil prices, the oil sector contribution to the economy will remain limited going forward.

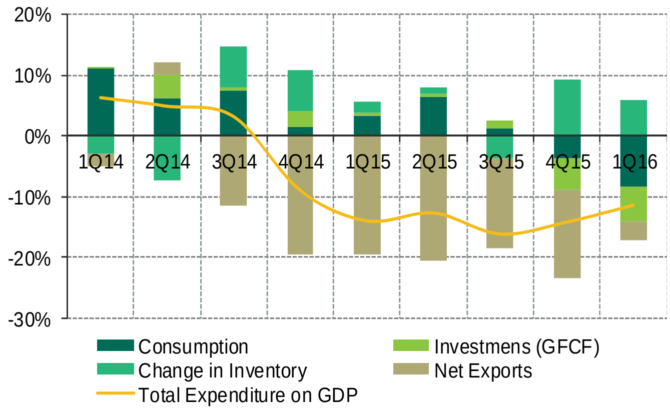
Chart 15: Real GDP, Contribution



Source: General Authority of Statistics, NCB

Lesser oil revenues trickling down into the economy, especially as the government had to reduce spending to minimize the budget deficit greatly affected the non-oil sector. During 1Q2016, the sector's contraction of 0.7% Y/Y at constant prices, the second consecutive quarterly contraction, is expected to raise alarms as the government plans to rely heavily on the non-oil sector in its National Transformation Plan (NTP). Attributed to lower government expenditure, the private non-oil sector marginally grew by 0.2% annually, while the government non-oil sector receded by 2.6% annually. Gross fixed capital formation registered a second consecutive decline by 20.1% Y/Y in 1Q2016, following 4Q2015's drop of 16.7% Y/Y, putting downward pressure on potential economic growth in the medium-term. Furthermore, the construction sector's nominal decline of 2.8% annually is expected to intensify over the next few quarters as NCB Construction Contract Award Index dropped 81 points during the first three months of this year. Imports of goods declined by 14.2% Y/Y as demand for machinery and equipment slows as a result of lesser construction activity, while exports of goods declined by 28.0% Y/Y due to lower oil prices, worsening a widening trade deficit. As economic uncertainty looms and the effect of the two-month salary bonus fades, consumption expenditure witnessed a significant moderation within the private sector, decelerating to 2.9% annually in 1Q2016 from 14.9% during 1Q 2015. Furthermore, the finance, insurance and real estate sector maintained a relatively strong growth at 3.3% Y/Y, yet we expect liquidity constraints in the domestic market to weigh on the future performance of the sector.

Chart 16: Expenditure on GDP, Contribution



Sources: General Authority of Statistics, NCB

In nominal terms, GDP contracted by 11.5%, the sixth consecutive contraction, mainly due to the oil sector's GDP decline. However, the non-oil sector's decline of 5.0% is more of a concern going forward. Saudi's NTP plans to raise non-oil revenues to SAR530 billion in 2020, up from 2015's SAR163.5 billion. The plan allocates an estimated SAR446 billion over a five-year timeframe, of which the government assigned SAR268 billion, while the private sector will contribute an expected SAR178. Attracting the private sector's capital will be challenging considering the weakening domestic economy and the geopolitical risks in neighboring countries. However, the government is adamant to guide the Saudi economy towards its planned Vision 2030, which envisages a diversified economy that is unreliant on an inherently volatile commodity.

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

The Economics Department Research Team

Head of Research

Said A. Al Shaikh
Head of Economics
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

Ahmed Maghrabi
Associate Economist
a.maghrabi@alahli.com

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

Sultan Mandili
Economist
s.mandili@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

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