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# Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

## Contents



Said A. Al Shaikh
*Group Chief Economist* | **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 Al-Dawood*
*Economist* | **y.aldawood@alahli.com**

## Executive Summary

- OPEC production edged down in June for the first time in five months, as supply disruptions in Libya, and Nigeria more than offset the increase of production by Saudi Arabia.

- Investors rushed to park their assets in the dollar, awaiting uncertainty to clear off, allowing the USD to score large gains against its peers after it was weakened earlier by investors leaving to avoid large volatility and event risk.

- China and India are the largest consumers of gold. Therefore, the curbs over India's gold imports and China's cooling economy play major culprits, beside the Fed's announcement effect, in falling gold prices.

- Coupled with the rise of the local stock market and global economic turmoil, which kept interest rates at all-time lows, we expect time and savings deposits' growth to remain sluggish throughout this year.

- Weaker investor appetite can be attributed to the summer vacation as a large part of traders reap their investment gains and turn to consumer spending locally and internationally. In addition, the start of the Holy month of Ramadan is likely to have limited activity in the market.

- Growth in the depositary base continues to provide opportunities to expand the financing capabilities of the banking system as total deposits reached SAR1.3 trillion during May.

- External trade of non-oil goods for the month of May resulted in an increase in returns from exports by 5.9% Y/Y, amounting a total of SAR16 billion.

### View of the Month

Technology utilization will drive the economy towards a cashless society, thus, enhancing the velocity of money. However, it must be noted that a pickup in velocity of money must be matched by an increase in the productive capacity, or else inflationary pressures will materialize rapidly.

# Macroeconomic Indicators

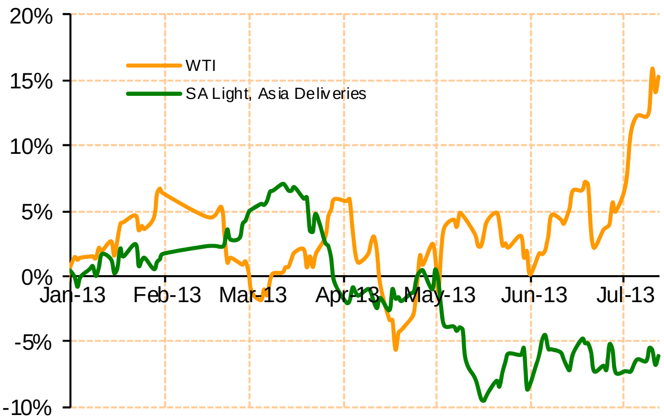
| | 2007 | 2008 | 2009 | 2010 | 2011P | 2012F | 2013F |
|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | |
| Average KSA Crude Spot Price, Arab Light, USD/BBL | 68.3 | 94.9 | 59.2 | 77.6 | 108.1 | 110.2 | 105.0 |
| Average Daily Crude Oil Production, MMBD | 8.8 | 9.2 | 8.2 | 8.2 | 9.3 | 9.9 | 9.5 |
| GDP at Current Market Prices, SAR billion | 1,442.6 | 1,786.1 | 1,412.6 | 1,690.5 | 2,511.4 | 2,727.4 | 2,720.2 |
| GDP at Current Market Prices, USD billion | 385.2 | 476.9 | 377.2 | 450.8 | 670.6 | 728.3 | 726.3 |
| Real GDP Growth Rate | 2.0% | 4.2% | 0.1% | 4.6% | 8.5% | 6.8% | 3.0% |
| Oil Sector GDP Growth Rate | (3.6%) | 4.2% | (7.8%) | 2.4% | 4.3% | 5.5% | -3.1% |
| Non-oil Sector GDP Growth Rate | 4.7% | 4.3% | 3.5% | 5.5% | 7.8% | 7.2% | 7.6% |
| Population, million | 24.9 | 25.8 | 26.7 | 27.6 | 28.4 | 29.2 | 30.1 |
| Population Growth Rate | 3.4% | 3.4% | 3.4% | 3.4% | 2.9% | 3.0% | 3.0% |
| GDP /Capita, USD | 15,444.2 | 18,495.4 | 14,147.9 | 16,354.7 | 23,632.8 | 24,917.7 | 24,127.9 |
| CPI Inflation, Y/Y % Change, Average | 4.1% | 9.9% | 5.1% | 5.3% | 5.0% | 4.8% | 4.5% |
| **External Sector** | | | | | | | |
| Merchandise Trade Balance, USD billion | 150.6 | 212.0 | 105.2 | 153.7 | 244.7 | 268.4 | 231.6 |
| Oil Exports, USD billion | 205.3 | 281.0 | 163.1 | 215.2 | 317.6 | 347.6 | 324.6 |
| Non-oil Exports, USD billion | 27.8 | 32.3 | 29.1 | 35.8 | 46.9 | 48.9 | 42.2 |
| Merchandise Imports, USD billion | (81.5) | (100.6) | (86.4) | (96.7) | (119.1) | (128.2) | (135.2) |
| Net Unilateral Transfers, USD billion | (17.0) | (23.0) | (27.7) | (27.9) | (29.4) | (32.1) | (114.5) |
| Current Account Balance, USD billion | 93.3 | 132.3 | 21.0 | 66.8 | 158.5 | 178.7 | 117.1 |
| Current Account Balance/GDP | 24.2% | 27.7% | 5.6% | 14.8% | 23.6% | 24.5% | 16.1% |
| Net Foreign Assets with SAMA, USD billion | 301.3 | 438.5 | 405.9 | 441.0 | 535.9 | 648.5 | 713.4 |
| **Fiscal Sector (Central Government)** | | | | | | | |
| Budgeted Expenditure, SAR billion | 380.0 | 410.0 | 475.0 | 540.0 | 580.0 | 690.0 | 820.0 |
| Actual Revenues, SAR billion | 642.8 | 1,101.0 | 509.8 | 741.6 | 1,117.8 | 1,239.5 | 1,076.6 |
| Actual Expenditure, SAR billion | 466.2 | 520.1 | 596.4 | 653.9 | 826.7 | 853.0 | 870.1 |
| Expenditure Overrun, % | 22.7% | 26.8% | 25.6% | 21.1% | 42.5% | 23.6% | 6.1% |
| Total Revenues/GDP | 44.6% | 61.6% | 36.1% | 43.9% | 44.5% | 45.4% | 39.6% |
| Total Expenditure/GDP | 32.3% | 29.1% | 42.2% | 38.7% | 32.9% | 31.3% | 32.0% |
| Overall Budget Balance, SAR billion | 176.6 | 580.9 | (86.6) | 87.7 | 291.1 | 386.5 | 206.5 |
| Budget Balance/GDP | 12.2% | 32.5% | (6.1%) | 5.2% | 11.6% | 14.2% | 7.6% |
| Break-Even Oil Price | 40.5 | 40.2 | 60.8 | 64.1 | 71.1 | 67.0 | 72.8 |
| **Financial Sector** | | | | | | | |
| USD/SAR Exchange Rate | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Growth in Broad Money (M3) | 19.6% | 17.6% | 10.7% | 5.0% | 13.3% | 13.9% | 8.1% |
| Growth in Credit to the Private Sector | 20.6% | 27.9% | -0.6% | 4.8% | 11.0% | 16.4% | 18.8% |
| Average 3M SAR Deposit Rate | 4.9% | 3.3% | 0.9% | 0.7% | 0.7% | 0.9% | 1.0% |
| Average 3M USD Deposit Rate | 5.2% | 3.0% | 0.7% | 0.4% | 0.3% | 0.4% | 0.4% |
| Spread, in Basis Points, SAIBOR-LIBOR | (39.2) | 37.4 | 26.4 | 39.8 | 40.9 | 55.2 | 60.0 |

# Oil Market

## Prices Elevated by Geopolitics

Brent crude has lost 8% in June, trading near USD102 a barrel on ICE exchange, as slowing expansion in China, stagnating growth in Europe, and threat to recovery in US constrain energy consumption. In its latest update, IMF trimmed growth projection of the world economy to 3.1% from previous estimate of 3.3%. In addition, World Bank lowered its forecast for China's growth to 7.7% in 2013, which would be the lowest since 1999, and it also reduced its growth forecast for developing economies to 5.1% from earlier estimate of 5.5%. Meanwhile, Brent is set to rebound to the USD105-USD110 a barrel range in the 3Q on short term fundamentals and rising geopolitical risks. Current events in Egypt have brought back geopolitical elements into focus in the oil markets, intensifying the risk profile for the Middle East supply system. The security of the vital Suez Canal was thrust into spotlight, attributed to its importance for shipping oil out of the Gulf into Europe. This recent development in Egypt accentuates the risks to the supply side already escalating from Iraq, Syria, Yemen, Sudan, and Nigeria. Nonetheless, the political risk premium attached to the price of crude remained rather muted, owing to unsold West African crude, moderate levels of floating storage built over 2Q, along with ample inventories in OECD countries.

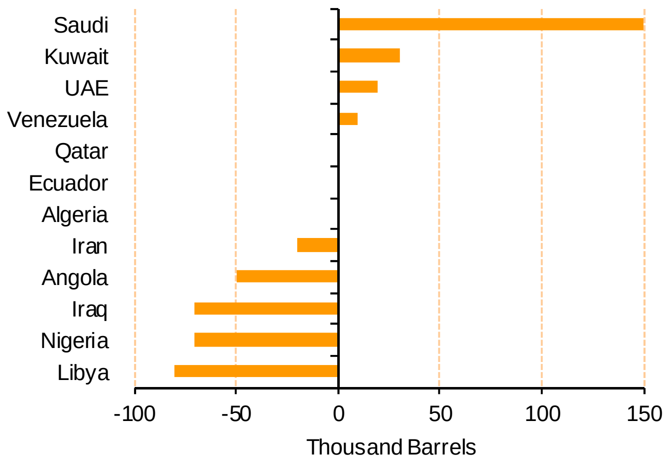
**Chart 1: Oil Price Developments, YTD**




Source: Thompson Reuters

Although Middle East geopolitical factors continue, creating various degrees of risk to the supply side and so far acted to support prices above USD100, the supply buffers and increased uncertainty surrounding growth of global oil demand, on the other hand, played not to push prices above USD110 a barrel. On the fundamental basis, the oil market remains well balanced. Ample crude inventories, fading growth expectations in Emerging economies, and improved supply expectations from North America have kept a cap on demand. Meanwhile, World oil consumption is expected to climb by 1.2mmbd in 2014, up from 0.93mmbd in 2013, to average 92mmbd in 2014, advancing by 1.3% from this year, according to IEA. Supplies from outside OPEC will jump by 1.3mmbd amid booming output in North America, thus shrinking the need for crude from OPEC. In turn, dependence on OPEC is gradually dwindling as new drilling techniques enable US and Canada to unlock reserves from rock formations deep underground.

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




Source: OPEC Survey

On the supply side, OPEC production edged down in June for the first time in five months, as supply disruptions in Libya, and Nigeria more than offset the increase of production by Saudi Arabia. Continuation of violence and protests has pushed Libyan oil production to the lowest level since January 2012, dropping by 0.22mmbd to 1.13mmbd. Angola decreased output by 0.2mmbd to 1.67mmbd, the lowest level since September, while Nigeria's production fell by 0.04mmbd to 1.83mmbd in June. In Iraq, oil exports decreased by 0.153mmbd to 2.23mmbd, as pipeline sabotage incidents amid escalating tension between Kurdistan regional government and central government pushed northern oil exports to their lowest levels in five years. According to IEA, imports of Iranian crude fell to their lowest level of 0.8mmbd in June from 1.25mmbd in May.

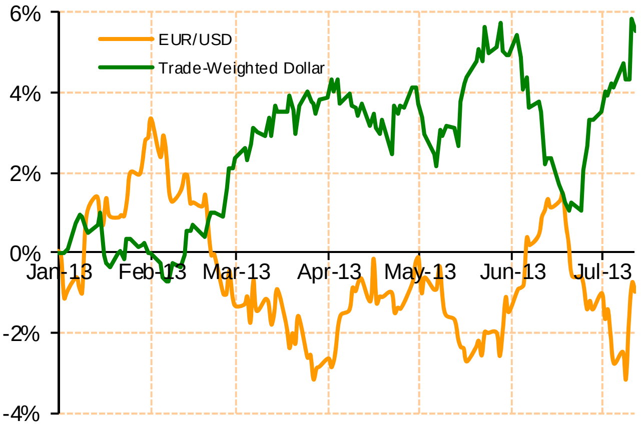
Said A. Al Shaikh
*Group Chief Economist* | **s.alshaikh@alahli.com**

# Foreign Exchange

## The Fed to Slow the Roll

Money markets witnessed strong gains for the dollar in June after the Federal Reserve's most explicit scaling back announcement to date propelled the greenback to levels not seen since July of 2012. The Fed's chairman believes the US economy is improving enough, and the zero-hour to pull off its USD85/month life-support is approaching. In response to the tapering announcement, investors rushed to park their assets in the dollar, awaiting uncertainty to clear off. This allowed the USD to score large gains against its peers after it was weakened earlier by investors leaving to avoid large volatility and event risk. The trade-weighted dollar climbed back and surpassed the 83.1 mark by the end of June after it plunged to 81.4 ahead of the FOMC meeting. It continued to further strengthen above 84.5 early July supported by the positive jobs data which revealed an unchanged unemployment rate of 7.6% with 195,000 additions to June's non-farm payroll, contrary to dismal expectations of only 165,000. The Fed's announcement effect took its toll on assets like stocks and bonds, which plummeted, inversely corresponding with a stronger dollar. The 10 year yield climaxed on the 25th of June as it reached 2.61%, a 22.5% rise over the past month. S&P500 fell by 1.5% to 1,573 points, and the Dow slid down by 1.5% to 14,659 points. Bonds plateaued, however, in a range-bound movement but are set to plummet further in July after the new jobs data came in favor of putting a leash on the bond-purchasing program.

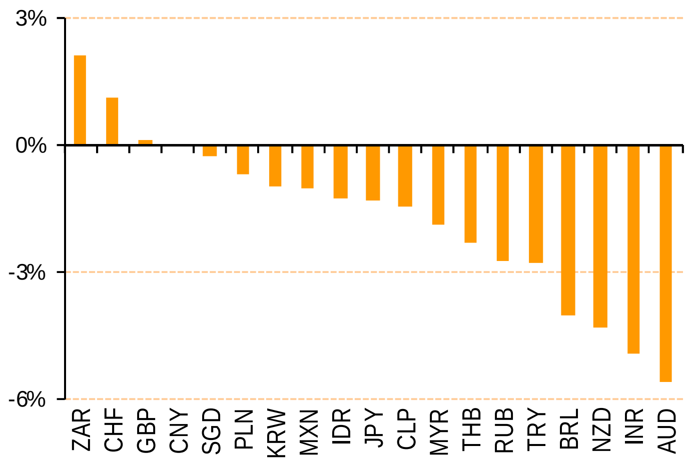
**Chart 3: Trade-Weighted Dollar and the Euro**




Source: Thompson Reuters

In the Eurozone, decision makers of the union are seeking to forge rules in order to force losses on large savers of failing banks. Although politicians tried to portray Cyprus as a one-off case, debt-laden Greece which is struggling to keep up with its privatization plans might face the same fate or be denied future loans. The EUR/USD pair strengthened close to 1.34 during the early part of June as economic morale in the 17-state union improved; however, it fell down to a two-week low of 1.31, affected by the boost gained by its American counterpart. The single currency rebounded towards the end of month, resulting in a 0.07% net gain. The recent developments in Greece and Portugal set up a gloomy outlook for July as political tension combined with the troika's stricter emergency loan conditions will create an added hurdle in front of financial stability in the European periphery.

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




Source: Thompson Reuters

China is engineering a "liquidity crunch" to tackle the shadow banking system. By spiking interest rates, it attempts to rein in rampant informal lending and speculative trading in order to avoid an asset price bubble. Although the People's Bank of China's lending rate has been standing at 6% since July of 2012, China's official tolerance to a slower growth pace allows the bank to gradually raise interest rates in order to manage and eventually curb shadow banking. However, concerns over the cooling Chinese economy along with the Fed's announcement, which led the CNY to end June at a 0.046% loss, closing at the 6.137 mark might postpone any near-term changes in the lending rate. Fears from reverse capital inflows pulled growth forecasts this year down to 7.4% from 7.6, according to the Chinese Academy of Social Sciences. In contrast, China's gross domestic product growth was at 7.8% last year.

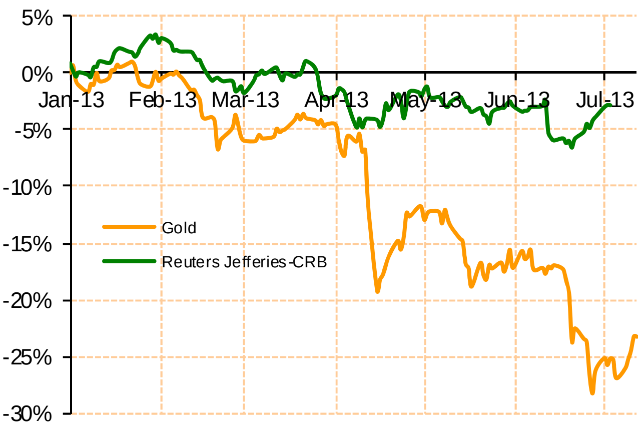
Yasser Al-Dawood
*Economist* | **y.aldawood@alahli.com**

# Commodities

## Is Commodity Supercycle's End Nigh?

During the month of June, bulk commodity prices tumbled as high volatility associated with central bank decisions, namely the Federal Reserve's quantitative easing and the People's Bank of China's credit crunch, weighed on commodity prices. In addition, worries over China's growth outlook continue to exert downward pressure on industrial commodities. The Thomson Reuters/Jefferies CRB Commodity index ended the month of June at 275.6, a drop of 2.2% compared with last month. After Bernanke spooked the markets by announcing that the Fed's unprecedented open-ended stimulus might be coming to a closure, bullion walloped by 22% Y/Y, the biggest annual fall since 1981 which resulted in gold being priced at a trough level as low as USD1,201.71/Oz. China and India are the largest consumers of gold. Therefore, the curbs over India's gold imports and China's cooling economy play major culprits beside the Fed's announcement effect. The precious metal rebounded, however, later on to end the month at USD1,235.36/Oz. The FOMC meeting in July, which indicated that the Fed will continue to back sustained stimulus, helped gold to climb back up to the 1,300 levels again. Silver closed the month of June at USD19.71/Oz, sliding by 11.7% since the end of May.

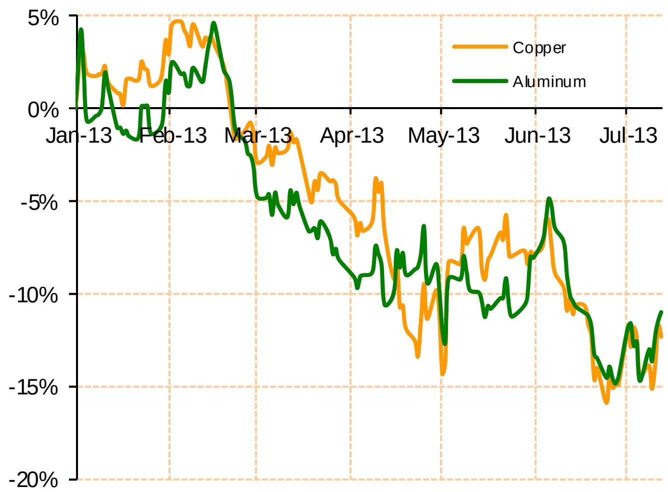
**Chart 5: Reuters Jefferies vs. Gold**




Source: Thompson Reuters

Over the month, industrial metals such as copper and aluminum plunged by 7.6% and 7%, respectively. Copper closed the month at USD6,750/tonne, while aluminum closed at USD1,773/tonne. London Metal Exchange inventories show that aggregate base-metals prices fell by 2%, while copper and aluminum stock has increased by 8% and 5%, respectively. This indicates a weakening demand, with Chinese worries becoming intensified. The liquidity squeeze in China forms an added burden upon metal prices. While average prices increased for some metals, there was a clear downshift in prices of all the metals over the second half of the month of June.

**Chart 6: Base Metals**




Source: Thompson Reuters

On the supply side, market conditions are expected to loosen considerably following the completion of new capacity by major iron ore exporters. In the latest quarterly report from Australia's Bureau of Resources and Energy Economics (BREE), iron ore exports from Australia were forecasted to rise by 16% in both 2013 and 2014, driven largely by expansion undertaken by Australia's largest operators. Brazil's exports are expected to rise by a more modest 3% this year before picking up by 10% in 2014. In contrast, BREE expects government bans on Indian mining to reduce exports further over the next two years, with India becoming a net importer in 2014.

Soft commodities settled mixed. With US corn supply being tight ever since last year's historic drought, prices of corn ended up on the positive side, gaining 3.4% compared to May's contract to reach USD6.85/bushel. Wheat, however, is largely impacted by global demand, which has been weakening along with demand on imports. Prices of wheat, therefore fell by 8% to USD6.48/bushel. OPEC, amongst others are predicting that the commodity super cycle is waning. Such bearish outlook might be less predictable in commodities in general, while agricultural commodities might be an exception as lack of weather extremes could lead to continued decline in prices amid ample supply.

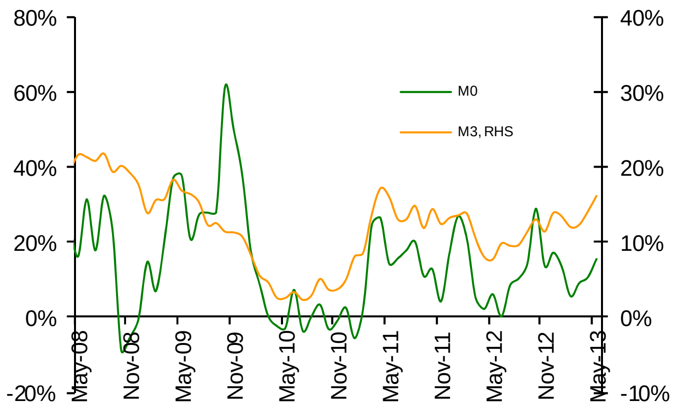
Yasser Al-Dawood
*Economist* | **y.aldawood@alahli.com**

# Money & Inflation

## A Supportive Liquid MArket

The monetary situation in the largest economy in the GCC continues to represent the prosperous state of Saudi. The sustainable level of growth in the monetary system is in line with the fiscal expansionary policy while inflationary pressures are being cautiously monitored. According to the latest SAMA bulletin, The monetary base (M0) rose by 15.5% during the month of May, the fourth consecutive increase given the end of the academic year and start of the summer vacation. Demand deposits with SAMA rose by 20.3% on an annual basis; however, they declined by 5.5% on a monthly basis as the credit market continues to expand. Cash in vault levels also gained annually by 10.7% with a monthly decline of 8.4%, but we expect cash in vault to increase within local banks over the coming months. Furthermore, currency outside banks posted a 11.1% Y/Y growth, which will likely continue to rise as Ramadan season is reflected further in July and August SAMA aggregates. SAMA's macroprudential policy will contain potential liquidity risks by its willingness to use conventional tools such as treasury bills (See Loans Market section).

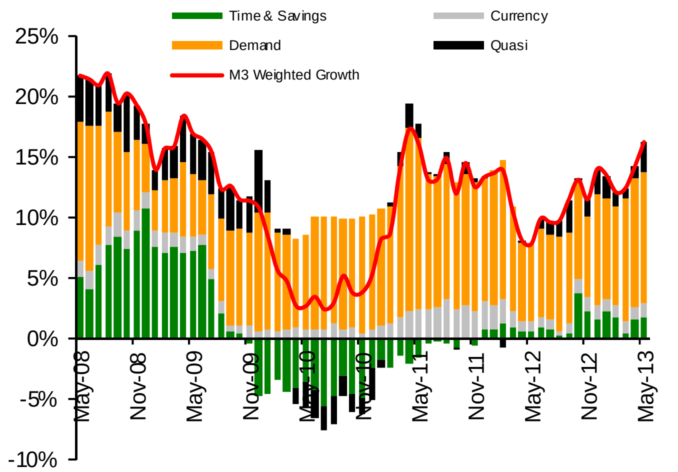
**Chart 7: Growth in Monetary Aggregates**




Source: SAMA, NCB Estimates

Consequently, the broadest measure of money supply (M3) recorded the fastest growth rate over the past two years, expanding at an annual rate of 16.2% to reach an all-time high of SAR1.47 trillion by the end of April. The main driver of M3 was represented by demand deposits which gained by 20.0% Y/Y in May. The non-yielding deposit base has amassed a total of SAR68.0 billion so far this year as local investment opportunities lack diversity. Meanwhile, time and saving deposits have been outpaced once more during May as they only expanded by 7.3% Y/Y. Coupled with the rise of the local stock market and global economic turmoil, which kept interest rates at all-time lows, we expect time and savings deposits' growth to remain sluggish throughout this year. In addition, other quasi-monetary deposits accelerated by 20.0% annually with a share of 13.0% of M3 by the end of May.

**Chart 8: Money Supply, Contribution**




Source: SAMA, NCB Estimates

As for inflation, consumer prices have marginally eased during May as the benchmark index recorded a 3.8% annual increase, 0.2% lower than the previous month. The category of food and beverages rose by 3.8% Y/Y, while the housing and utilities category recorded a rise of 3.6% on an annual basis. Both categories combined represent over 42% of the index and, therefore in our opinion, prices will start climbing due to the summer vacation and the holy month of Ramadan. The transport category, which includes the purchase of new vehicles, decelerated to 2.5% during May, following April's 5.6% Y/Y, attributing to the deceleration of the transport subindex is the decline in purchases of new vehicles as they tend to take place early in the year. We expect the benchmark inflation rate to be contained around the 4% level as SAMA would favor staying below that level. Recently, the private sector has called for efficient management in Saudi ports. As the economy is heavily reliant on imported goods, reducing costs and time would reflect positively on local prices and induce business activities. Saudi Customs is continuously seeking, along with the Council of Saudi Chambers, to lower import costs by reducing procedural operations through incorporating technological solutions and aiming to reach a paper-free exchange between customs and the private sector.

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

# Capital Markets

## Strong Earnings Drive Growth

The Saudi stock market resisted geopolitical pressures to continue its positive trajectory by recording a fourth consecutive monthly increase. During June, the index recorded its largest intra-day drop in over a year, Tadawul plunged by 329.5 points on June 15, a drop of 4.3%. The political standoff in neighboring countries, namely Syria, triggered a selloff across the market which trimmed YTD gains to 7.3% by the end of June 15. However, Tadawul rebounded swiftly and continued the momentum which started mid-May and the index posted a gain of 1.2% during June. The increase will likely create new support levels for the market as YTD growth by the end of last week reached 13.1%.

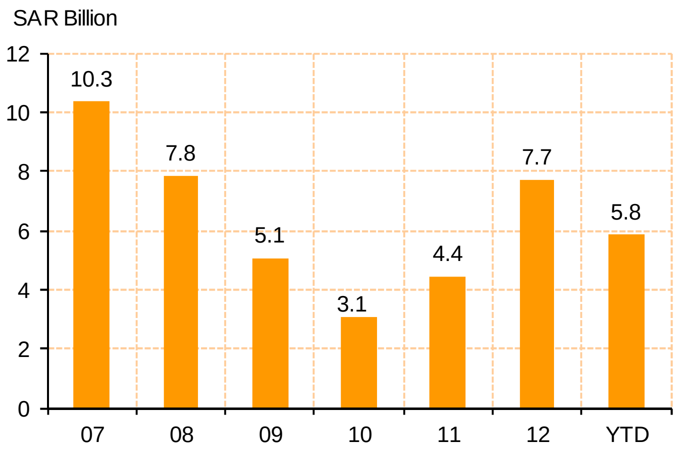
**Chart 9: Tadawul All-Share Index**


Source: Tadawul

During June, the top performing sector was the real estate sector with a rise of 7.3%. The banking sector posted a gain of 4.1% over the month as investors' optimism towards corporate earnings was in line with actual reportings. Banks have reported a 2.9% increase in net profits during the first half of 2013 over the same period last year. Driving banking growth in the Saudi market is largely due to its core banking activities as credit maintains a healthy level. The insurance sector recorded the biggest drop during last month declining by 4.1%. One third of the companies in the insurance sector are reporting losses and the current valuations are high for majority of stocks. However, due to their relatively low weights given the size of their free-floating shares, insurance stocks have been the prime focus for speculative investors.

The level of activity demonstrates the recent appetite of investors as June's daily traded volumes averaged at SAR6.3 billion, peaking at SAR9.7 billion. However, over the past two weeks, the level of activity has deteriorated to an average of SAR4.4 billion. Last week, on July 10, the session ended with a total trading value of only SAR3 billion, the lowest level since September 2011. Investors seem to have halted their trading as companies announce their second quarter corporate earnings, a chance for traders to readjust their portfolios. The weaker appetite can also be attributed to the summer vacation as a large part of traders reap their investment gains and turn to consumer spending locally and internationally. In addition, the start of the Holy month of Ramadan is likely to have limited activity in the market.

**Chart 10: Average Daily Traded Value**




Source: Tadawul

Market capitalization expanded by 12.0% Y/Y by the end of June to reach SAR1.5 trillion. Attractive and lucrative opportunities in the local stock market still exist albeit investors' bullish momentum driving prices higher. Tadawul's valuation remains attractive with a market price-to-earnings ratio at 13.95 by the end of June. The composition of trading between different types of investors, Saudis, GCC citizens, Arabs, and foreigners, holds relatively the same weights and the distribution is not expected to change anytime soon. The bulk of trading, almost 95%, is conducted by Saudi individuals (85%) and institutions (10%) with a noticeable increase in institutional activity on the buy side. Foreign investors are still anticipating decisions to ease their entrance into the market as the Capital Market Authority has highlighted the importance of foreign exposure towards developing the market's depth and scope.

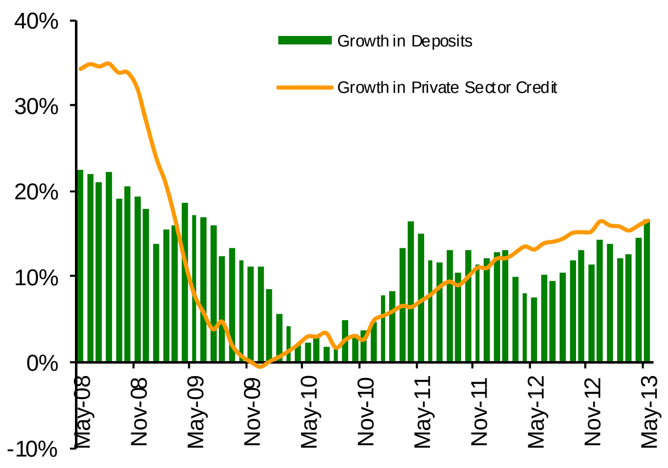
Majed A. Al-Ghalib
*Senior Economist* | **m.alghalib@alahli.com**

# Loans Market

## Credit Continues to Expand

Forming the base of banks' balance sheets, total deposits in the Saudi financial system reached SAR1.3 trillion by the end of May, adding SAR70.5 billion YTD. Growth in the depositary base continues to provide opportunities to expand the financing capabilities of the banking system. The largest portion of deposits are in the form of demand deposits, of which only 8.5% are contributed by government entities. Given businesses and individuals' varying need for the most liquid type of deposits, their demand, time and savings, and foreign currency deposits are distributed at 74.1%, 17.5%, and 8.3%, respectively during May. Meanwhile, the government's long term priority is apparent as time and savings deposits represent 47.7% of their total deposits while demand and foreign currency deposits hold 23.8% and 28.5%, respectively. Collectively, demand deposits increased by 20.0% annually, outpacing time and savings deposits which rose by 7.3% Y/Y as interest rates remain low.

**Chart 11: Private Sector Financing**

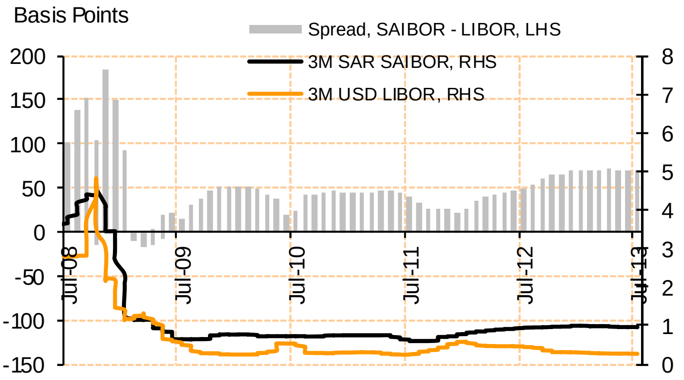



Source: SAMA, NCB Estimates

On the assets side, total claims of the banking system, excluding T-bills and government bonds, accelerated to record an annual growth of 16.0% in May, but decelerated marginally in comparison to April. Total deposits outpaced credit which resulted in a slight decrease of the loans-to-deposits ratio to 80.3 by the end of May. By maturity, short term credit posted the slowest annual increase in over a year at 5.2%, albeit holding the largest share at 53.2%. Ostensibly, local banks have been attempting to expand the maturity curve towards longer term credit. The notion is derived from medium term and long term credit growth rates, which have been substantially higher than short term credit over the past six months. During May, long term credit rose by 37.3%, while medium term credit climbed by 22.2% annually. Local banks are expected to maintain the current level of credit growth as portfolio diversification offers new opportunities to add to their books.

As for the private sector, banks extended credit lines to businesses in the amount of SAR12.8 billion during the month of May. On an annual basis, credit to the private sector grew by 16.5%, as total fresh lending reached SAR61.8 billion during the first five months of 2013. Meanwhile, credit to the public sector increased at an annual rate of 16.0%. Bank credit to public enterprises significantly decelerated to 6.1% Y/Y while government bonds recorded their eleventh consecutive annual decline by 21.9% during May. The bulk of bank claims on the public sector are in the form of treasury bills. The issuance of treasury bills has been used as a liquidity management tool to mop up excess liquidity following bond settlements. As the economy's liquidity levels have increased lately, treasury bill issuances increased by 34.6% annually to reach SAR174.3 billion, a 24-month high.

**Chart 12: Liquidity and Risk Detector**




Source: Thompson Reuters

As for the interbank rate, SAIBOR, the subdued interest environment will aid banks in avoiding any liquidity shortages by allowing them to access funds cheaply. However, given the rise in credit, which translated into larger liquidity movements, the spread between SAIBOR and LIBOR has widened to over 70bps. The pace is far from worrying as SAMA is closely monitoring risk indicators for the Saudi financial system. Accordingly, SAIBOR is expected to hover around 100bps.

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

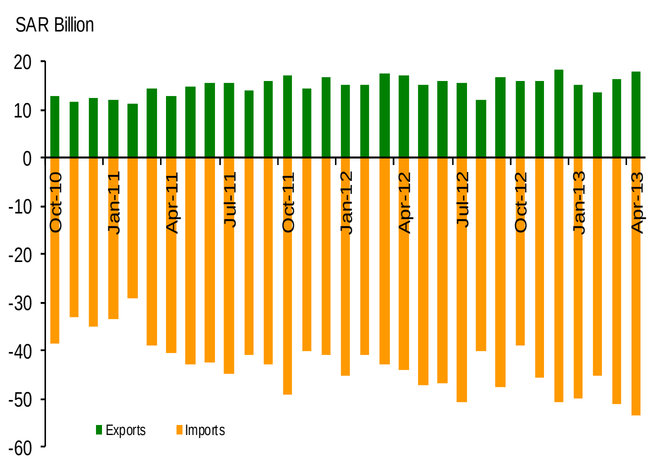
# External Trade

## Trade Gaining Traction

External trade of non-oil goods for the month of May resulted in an increase in returns from exports by 5.9% Y/Y, amounting a total of SAR16 billion – reflecting a solid demand on the kingdom's exports. In regards to tonnage, however, exports recorded an annual decrease of 11.6%, measuring 3.6 megatons. Imports – on the other hand – increased by 2.8% Y/Y in value terms, registering SAR52.4 billion but decreased by 0.7% in tonnage, measuring 4 megatons.

Non-oil exports continued to resume its upward trajectory that took place since march. With the main categories, save chemical products, notably contributing to the surge, plastics, which dominate 32.1% of exports increased by 13.9% Y/Y, registering SAR5.1 billion. Chemical products, which make up 30.8% of exports, retreated by 13.7% in comparison to the last annum, generating a worth of SAR4.9 billion. Transport equipment exports, which took over base metals as the third largest export category, weighing as much as 8.6% of exports, soared by 145% to record SAR1.4 billion. By destination, UAE dominated May's exports as the largest recipient of Saudi exports, acquiring 15.6% of the total. Compared to May of 2012, exports to UAE grew a sizeable 72.6%, marking SAR2.5 billion. China is the second largest trading partner, with 12.8% of the kingdom's non-oil exports traded with Beijing. It registered a 12.8% growth in May, a value of SAR2 billion. Singapore received 7.4% of Saudi non-oil exports in the same month, and thus, it holds its position as the third largest recipient of exports. In value terms, Saudi goods headed to Singapore registered SAR1.2 billion, a 9.2% Y/Y increase.

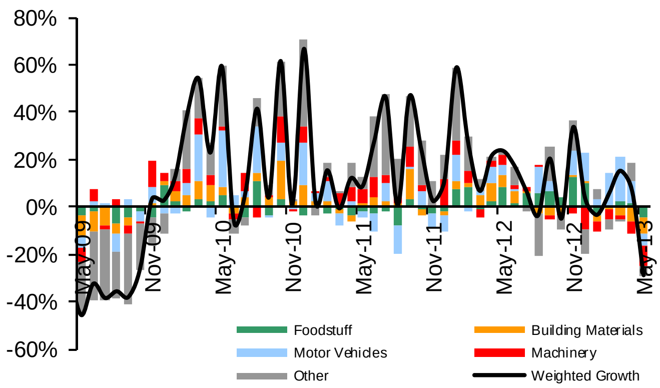
**Chart 13: Saudi Non-Oil Trade Balance**




Source: CDSI, NCB Estimates

In regards to imports in May, Saudi Arabia imported machinery and electrical equipment worth of SAR13 billion, a 1.3% reduction over the same period last year. Analysis shows that 24.6% of the kingdom's non-oil imports are of this category, which links to the country's heavy investment in power and urban development. Transport equipment constitutes 15.2% of the overall value of imports, making it the second most important category. It retreated by 12% Y/Y this month, summing the total of SAR8 billion. Base metals make up13.5% of non-oil imports to the kingdom, which advanced in value terms by 2.6% since last year, amounting to SAR7 billion. The top countries providing non-oil imports to the kingdom by value are; the USA (12.8%), China (12.5%), and Germany (6.8%). Imports from the US grew by 2.2% Y/Y, while imports from China and Germany grew by 3.5% and 3.3%, respectively.

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




Source: SAMA, NCB Estimates

Letters of Credit (LCs) closed for the month of May showing an annual decline by 4.4%, affected by a sharp 26.4% decrease in machinery, appliances, and building materials by 34.2%, 26.4%, and 23%, respectively. Total closed LCs amounted to SAR20.8 billion, cushioned by a 163.3% surge in fruits and vegetables, and a 76.7% upturn in livestock and meat, due to a possible restocking in preparation for Ramadan and Eid season. Opened LCs recorded SAR13.4 billion worth of goods to be imported to the kingdom which is a moderation across the board of categories by 28.9%. Building materials and machinery nose-dove by 51% and 48.2%, respectively, while motor vehicles and food stuff receded by 34.1% and 37.6%, respectively.

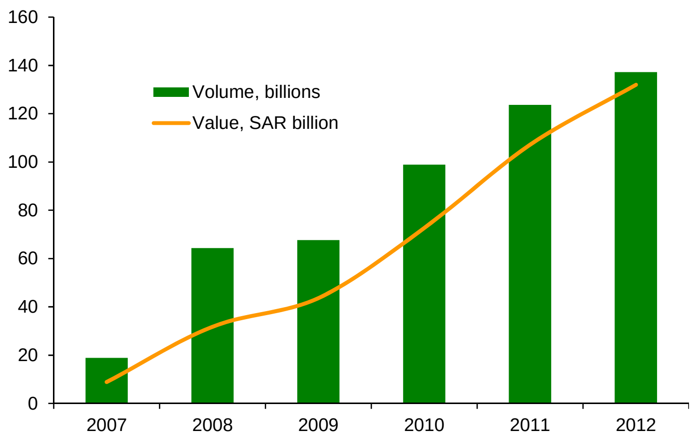
Yasser Al-Dawood
*Economist* | **y.aldawood@alahli.com**

# Special Focus:
## Technology Shaping Banking Landscape

In the last couple of years, technology had ostensibly changed the banking landscape, and in turn, the overall macroeconomic environment. By changing the way banks do business and undertake their operational activities, technology had increased the speed of business and consumer transactions, which was an element in improving the absorptive capacity of the Saudi economy. The five parameters for the domestic utilization of technology include the Saudi Arabian Riyal Interbank Express System (SARIE), SADAD bill payment system, the banks' clearing system, Automated Teller Machines (ATMs) and Points of Sale (POS) terminals.

In terms of value, SARIE system, which commenced on May 14th 1997, is the largest of these channels, with transactions amounting to SAR65.4 trillion by the end of 2012, a substantial increase from a mere SAR7.2 trillion in 2003. Volume-wise, the number of transactions conducted via SARIE had quadrupled during 2003-2012, reaching 54.9 million transactions. The relatively new SADAD system that became operational on October 4th 2004 had exhibited similar growth trends, with the payments' value increasing by 14 times, from SAR8.9 billion in 2007 to around SAR132 billion in 2012. The volume of bills paid through SADAD also rose to 137.3 million last year from 18.9 million in 2007. It is important to note that SADAD was instrumental in reducing the front-office burden on banks and the manual labor associated with these paper-based transactions, given the fact that around 70% of the bills pre-SADAD were paid in cash. An additional channel is banks' clearance of commercial, personal and interbank cheques, which even though have lagged behind in the last two years given the fact that it is the oldest channel of settlement, yet during 2003-2012 time span it grew value-wise by 84.3% to SAR837.6 billion, with the average value of cheques rising at a similar pace.

**Table 15: SADAD Value and Volumes**




Source: SAMA

The last two channels that encompass ATMs and POS are largely used as proxies for measuring retail activity as well as technology penetration in the economy. Cash withdrawals from ATMs had remarkably increased from SAR171.6 billion in 2003 to around SAR625.8 billion in 2012, an indication that people are relatively at ease with the use of technology and less dependent on branch visits to meet their liquidity needs. Meanwhile, Points of Sale transactions that are an integral part of a cashless economy are quickly gaining ground especially since 2007, with the value of sales through POS rising to SAR122.2 billion in 2012 from a meager SAR19.7 billion in 2003. Most recently, POS transactions grew by 24.2% Y/Y by the end of 1Q 2013, thus, maintaining its 14th consecutive double-digit growth since 4Q 2009.

**Table 16: Point of Sale Annual Growth**


Source: SAMA

In our opinion, the aforementioned improvements in technology utilization will drive the economy towards a cashless society, thus, enhancing the velocity of money. However, it must be noted that a pickup in velocity of money must be matched by an increase in the productive capacity, or else inflationary pressures will materialize rapidly. Bottom-line, technology has its pros and cons, and at this juncture of well anchored headline inflation around 4%, the Kingdom is reaping the benefits with no price level challenges.

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

# Economics Department

## The Economics Department Research Team


Head of Research

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

Macroeconomic Analysis

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

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

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

Sector Analysis/Saudi Arabia

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

**Mai Al-Swayan**
*Economist*
m.alswayan@alahli.com

Management Information System

**Sharihan Al-Manzalawi**
*Financial Planning & Performance*
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



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