Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- As it returns to the negotiation table, if no Iran deal is forthcoming by end of Q2, there will be more aggressive western rhetoric against Iran, which will likely put upward pressure on oil prices.
- The draconian terms of the troika's EUR10 billion bailout, including a levy of 5.8 billion Euros to be imposed on insured depositors in Cypriot banks, are elongating worries over the financial system's downside risks.
- Base metals were largely impacted as copper slumped in Shanghai to the lowest level since August amid concerns that China, which accounts for approximately 40% of global copper consumption and the world's top consumer, might cut its demand for copper.
- The option to have quick access to liquidity in order to grasp investment opportunities will hold back the appetite for the currently low interest rate products as demand deposits hold 55% of total deposits.
- SEC's first ever 30 year sukuk issuance will benefit the Islamic bond market by expanding the yield curve to accommodate institutional investors who are seeking assets to match their long term liabilities.
- The treasury bill issuances increased by 28.3% annually to reach SAR167.9 billion, used as a liquidity control tool as of late given the interest rate link with the US economy.
- We expect to see a moderation throughout 2013 as 2012 was a peak year in regards to LCs.

View of the Month
'Construction & Manufacturing'

We believe that the government's adamancy in pursuing diversification have to be matched by strong supervisory structure that ensures execution within strict timeframes given the enormity of the projects whether in size or number.

Macroeconomic Indicators

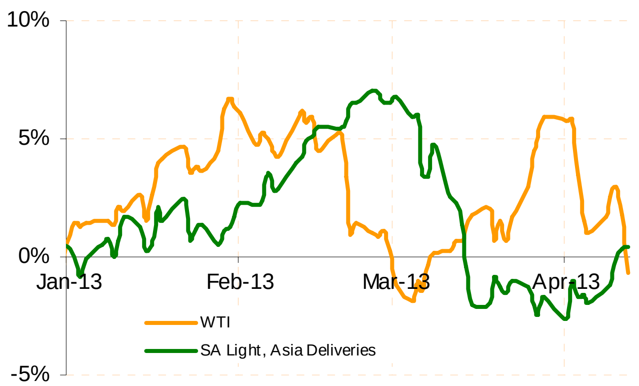
	2007	2008	2009	2010	2011P	2012F	2013F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	68.3	94.9	59.2	77.6	108.1	110.2	105.0
Average Daily Crude Oil Production, MMBD	8.8	9.2	8.2	8.2	9.3	9.9	9.5
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,690.5	2,511.4	2,727.4	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

Demand Continues to Weaken

Crude oil prices edged lower recently with the front month Brent contract touching a fresh low for the year. Brent prices, which continue to see range-bound movements trading around USD111 a barrel, fell by more than six dollars last week to USD104. This softness in prices reflects largely the limited appetite from refineries due to weakening refinery margins along with ongoing maintenance season, which is expected to be transient and to recede by the end of Q2. Fundamentally, the current decline in demand from major industrial countries was offset by rising consumption in emerging countries, including China, India, and Brazil. With respect to supply, rising US oil production was offset by drops in the remaining non-OPEC members, while OPEC's ability to meet sudden supply disruption continues to lessen on intensifying geopolitical developments in the Middle East. The impact of western sanctions has brought Iran back to the negotiation table, but its nuclear program continues and the recent installation of more advanced centrifuges could allow it to rapidly increase its overall enriched uranium stockpile. If no Iran deal is forthcoming by end of Q2, there will be more aggressive western rhetoric against Iran, which will likely put upward pressure on oil prices.

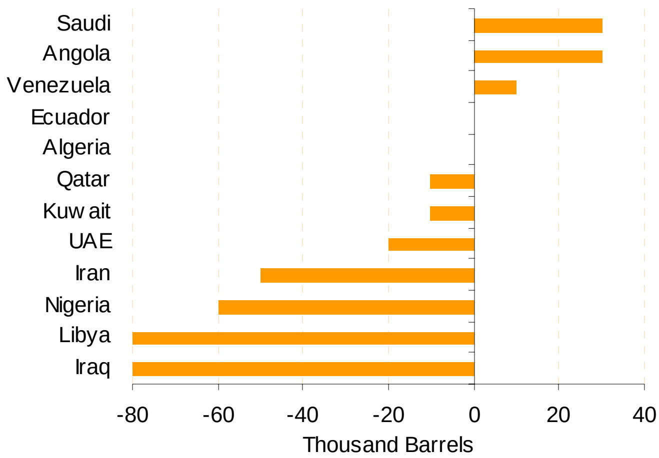
Chart 1: Oil Price Developments, YTD



Source: Thompson Reuters

Since the beginning of the year, however, demand has been declining month on month, attributed largely to weaker regional demand in Asia. China's oil demand growth this year seems modest by recent standards, but emerging economies' oil demand overall is strong, as Q2 non-OECD oil demand is expected to match that of the OECD for the first time. With Europe still struggling with its debt crisis and the US consuming more of its own oil, demand from Asia, particularly, China, is the main driver of incremental demand. Moreover, Q2 is likely to see a strong swing up in oil demand as refiners start to return from an unusually intense phase of maintenance. Meanwhile, the IEA trimmed its global oil demand growth estimate for 2013 amid weak economic environment, to rise by only 795,000 mmbd, its third straight reduction. This follows similar move by the US EIA, which lowered its forecast growth to 960,000 mmbd, while OPEC revised its global increment demand to 800,000 mmbd. Despite tough global economic conditions, as demand for oil fluctuates, the prospect for global demand still positive. Saudi Arabia expects the world economy to expand by 3 percent next year, resulting in a gain in oil demand of as much as 1.2 mmbd.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the supply side, rising oil demand is also likely to be met by supply. It is expected that OPEC oil production averaged 30.4 mmbd in March; nearly 1.15 mmbd lower than March 2012. This drop reflects continuing global economic slowdown and competition from other sources, especially, US shale oil. Saudi Arabia increased its production to 9.18 mmbd in March. Iraq continued its recent production surge, rising by more than 70,000 mmbd in March despite continuing infrastructure and security problems. Kuwait's oil output, on the other hand, because of maintenance, declined slightly to 2.9 mmbd in March. Iran oil production fell to 2.68 mmbd, the lowest level seen this year, and exports to its major buyers, including China, South Korea, and Japan, dropped by 250,000 mmbd in March, as sanctions took its toll. The return of volumes from Sudan, recent improvement in North Sea supplies and a record shipment of crude cargoes by Russia through the Pacific port of Kozmino are helping to improve the poor performance of non-OPEC so far this year.

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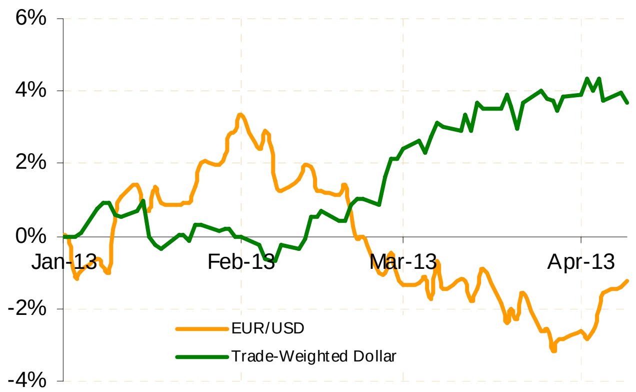
Foreign Exchange

Cypriot Privation Cushions the Greenback

The month of March was marked by considerable volatility in the foreign exchange market. With many economic indicators reaching inflection points, and uncertainty increasing their defiance to expectations, we find that major hard currencies were impacted subsequently. Mixed data from the US and Europe led the Yen to hitting a month's high against its peers as the USD was down 0.3%, breaking 92.94 yen; however, these gains were limited due to expectations of nearing monetary easing in Japan which sent the USD/Yen pair down to 99.80, a 47-month-low, aiming for the 100 threshold. Similarly, the Chinese Yuan strengthened on the back of weak US and European data, allowing it to break the 6.196 mark. This level is also supported primarily by a high Purchasing Managers' Index for manufacturing which rose to 51 in March, indicating smooth expansion. In addition, the People's Bank of China raised the fixing of its currency by 0.08% to 6.268/USD, the highest in 10 months.

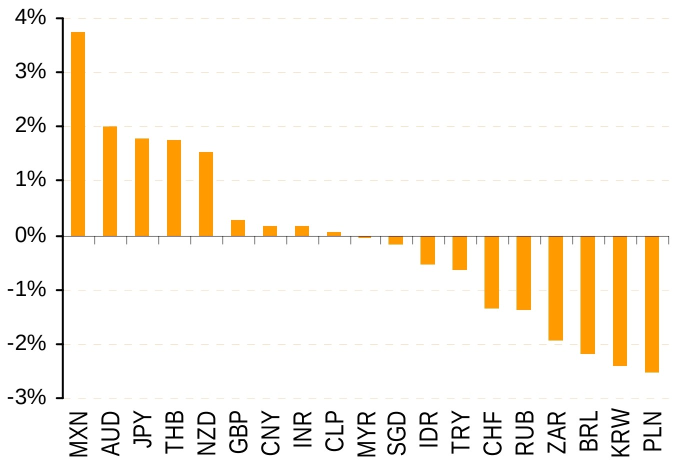
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thompson Reuters

After near-bankrupt Cyprus lost its bid to attract any financial support from Russia, it was forced to turn back to its 17-country bloc. Germany, the overseer of the union, however, in addition to facing elections this year, became frustrated with the mounting cost of bailing out its southern partners. Therefore, the draconian terms of the troika's EUR10 billion bailout, including a levy of 5.8 billion Euros to be imposed on insured depositors in Cypriot banks, are elongating worries over the financial system's downside risks. A wait-and-see approach is adopted by other European peripheries such as Slovenia, Portugal, and Spain which are also facing difficulties meeting their fiscal and financial dues. And although Cyprus makes up barely 0.2% of the Eurozone's GDP and is inhabited by a mere 1.1 million people, a bailout in which bank depositors forcefully share the burden is a precedent that raises concerns of future bank-runs from troubled Eurozone peripheries. This in-turn prompted the European Central Bank to hold the Eurozone's interest rates at 0.75% again for the ninth month, and consequently, the single currency weakened to a four-month low of USD1.2750 before it inched up above the 1.30 mark, supported by a waning greenback.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

A subdued US non-farm payrolls of 88,000 jobs added on March (far below the targeted 200,000) capped the strengthening trend of the USD. This came about after jobless rate fell to 7.6% from 7.7%, the data which propelled the Dow and S&P to new highs. It is expected that the weak data will only stiffen the Fed's resolve to continue with its USD85 billion/month bond-buying program in an attempt to boost the economy. While the greenback is facing a drop in momentum, the weak headlines, however, are not expected to cause a turning point as it still outperforms its peers, keeping sentiment neutral. In comparison to February, the trade-weighted dollar climbed to USD83.2, strengthening by 1.6% M/M. Moving onto April, we see the USD weakening again as the steep Dow and S&P gains which hit new trading highs of 14,826.66, and 1,589.07, respectively, are expected to moderate. Impact on the US GDP from the USD85bn sequestration that started since March 1st, coupled with the fiscal dissidence of the bipartisan politics are expected to weigh down on the greenback. Meanwhile, gold prices fell below the USD1,500/oz for the first time since July of 2011, triggered by a fall in US wholesale prices and fears of Cyprus' sell off of the precious metal. That, in addition to the uncertainty associated with the Cypriot bailout's repercussions in the Euro, will keep volatility high, leaving hard currencies capricious in the short and medium term.

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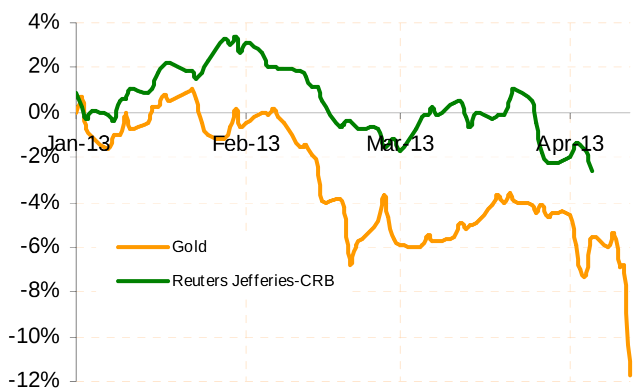
Commodities

Dipping Amid Slow Global Growth

Commodities posted lower figures this month as demand for raw materials declined on the continued slowdown in global growth. Base metals were largely impacted as copper slumped in Shanghai to the lowest level since August amid concerns that China, which accounts for approximately 40% of global copper consumption and the world's top consumer, might cut its demand for copper. The main downside drivers for copper were: (1) the recent housing regulations announced by two major Chinese cities, Beijing and Shanghai, to curb the property bubble, with Beijing banning single-person households from buying more than one house and Shanghai prohibiting banks from giving loans to third-home buyers, (2) the highest inventory buildup since October 2003, with inventories tracked by the London Metal Exchange (LME) rising by 78% Y/Y in the first quarter to nearly 569,775 tons and (3) the lower than expected Chinese Purchasing Managers' Index (PMI) for the month of March that came out at 50.9 in contrast to an expected 51.2. Thus, we expect, on a near to a medium term note, that these drivers can put a lid on the consumption of copper, thus placing a downward pressure on prices. Copper has coasted in a range of about USD 7,500-7,900 a ton during the month of March falling by 3.5%. Aluminum also fell as much as 5% to USD 1904.00/ton by March 29th.

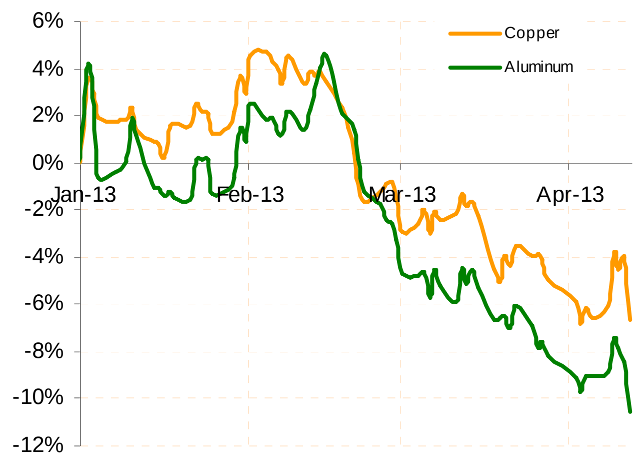
Chart 5: Reuters Jefferies vs. Gold



Source: Thompson Reuters

On the precious metals side, gold prices fell for nearly two quarters, the first back-to-back decline since 2001 amid speculation that a US recovery and stronger dollar may cut demand. Yet, the banking crisis in Cyprus contained this decline of gold prices since it acted as a reminder that the European sovereign debt crisis is far from over. Gold traded at USD1600.00/ounce on the last trading day of March. Silver plunged to the lowest level as well since August and was on the edge of a bear market falling by 0.8% to USD 28.31/ounce on March 29th.

Chart 6: Base Metals



Source: Thompson Reuters

As for grains, corn and wheat prices reached the lowest this month as bigger than expected US grain supplies and increased planting signal abundant supplies. According to the US Department of Agriculture (USDA), corn inventories in the US are lower than last year's number, but higher than a forecasted 5.399 billion bushels. USDA reported that farmers are expected to plant 97.282 million acres this year. The May-delivery contract led the way down at the Chicago Board of Trade, falling as much as 4.7% to USD6.6275 a bushel, the lowest level since July 3. Wheat for May delivery dipped 1.5% to USD6.7725 a bushel in Chicago, the lowest level since June 22. Palm oil, on the other hand, fell to the lowest level in more than two months as Malaysian palm oil exports declined as a result of Europe's financial crisis and the decelerating Chinese economy. The contract for delivery in June dropped as much as 1.1% to USD 760/metric ton on the Malaysia Derivatives Exchange.

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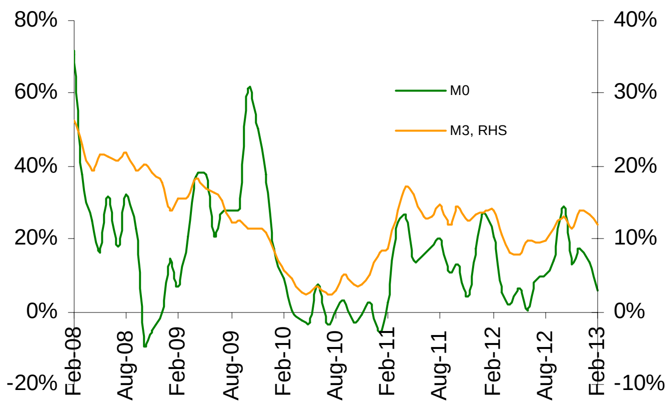
Money & Inflation

Liquidity to Raise Prices

The Saudi economy continues to maintain an upward trajectory and record robust growth figures despite the fragility of the global economy. The monetary base (M0) recorded a 5.6% growth on an annual basis to settle at SAR 310 billion by the end of February. Currency outside banks, cash in vault, and deposits with SAMA grew on an annual basis of 11.2%, 6.6%, and 1%, respectively. However, on a monthly basis, M0 recorded a second consecutive monthly decline of 8.6%, declining by SAR 29.3 billion over the previous month. The monthly contraction was mainly due to the reduction in deposits with SAMA as it recorded a decline of 16% M/M totaling SAR 155.2 billion. The decline was also due to the reduction of cash in vault by 5.2% M/M amounting to SAR 19.2 billion. The third component of M0, currency outside banks, has reversed the negative trend to rise by SAR 1.5 billion (1.1% M/M) to reach SAR 135.6 billion during February. It is important to note that currency outside banks and has increased its contribution in the total monetary base from 39.5% in January to 43.8% in February.

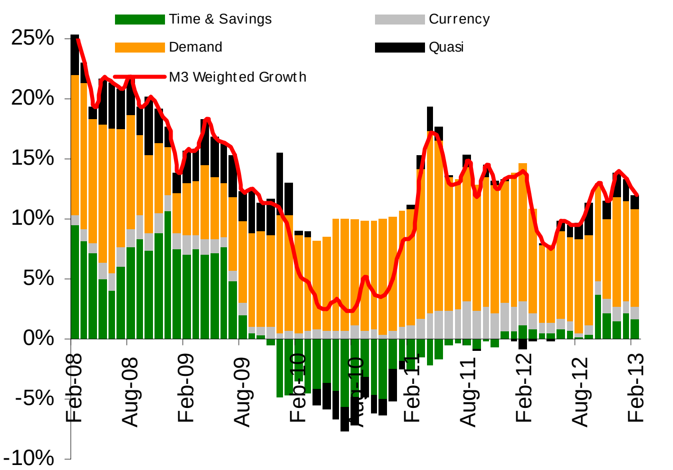
Chart 7: Growth in Monetary Aggregates



Source: SAMA, NCB Estimates

Although broad money (M3) edged slightly lower than the all-time high recorded in December, M3 posted an annual growth of 12% during the month of February reaching SAR 1.39 trillion. Representing the largest share of broad money, demand deposits have witnessed a growth of 15% on an annual basis to reach SAR 769.5 billion during February. Time and savings deposits decelerated to an annual growth of 6.6% during February as opposed to January's 9% rise, reaching SAR 324.6 billion. Additionally, other quasi-monetary deposits rose by 9.7% Y/Y. On a monthly basis, demand deposits expanded by less than one percent and time and savings deposits gained 0.4% M/M. Other quasi-monetary deposits continued to drop for the second month by 6.4% M/M. The lack of attractive yields continues to persuade investors away from time and savings deposits and to look more into equity markets (see Capital Markets). The option to have quick access to liquidity in order to grasp investment opportunities will hold back the appetite for the currently low interest rate products. The composition of M3 is still dominated by demand deposits with 55.0%, followed by time and savings deposits with 23.2%, other quasi-monetary deposits with12.1%, and currency outside banks with 9.7%.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

As for inflation, the annual inflation rate remained stable at 3.9%. Foodstuff is one of the influential categories in the benchmark inflation rate as Saudi is import oriented. In February, food prices maintained its upward trend since December 2012, increasing by 5.5% Y/Y. Most of the increase is due to the rise in the fruit and nuts category by 11.5% Y/Y, meat and poultry category by 6.9% Y/Y. additionally, the bread and cereal category rose by 6.3% Y/Y as a result of the increasing prices of Indian rice (basmati) in response to the high demand from several countries following their preferences' switch to import Indian rice instead of Pakistani rice. Rental prices continued their decelerating trend which lowered the category's inflation rate to 2.9% Y/Y during February in anticipation of codifying of the mortgage law. The liquid state of the economy suggests that prices should remain somewhat contained while raising concerns for policy makers.

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Capital Markets

Breaking Psychological Barriers

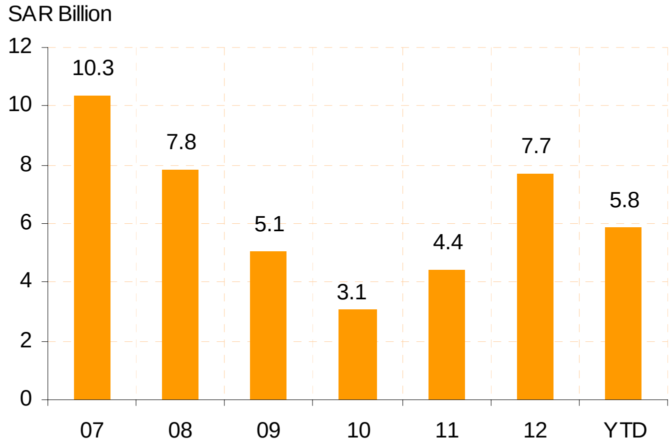
The Saudi stock market, Tadawul, finally broke off the negative backdrop and rose by 1.8% during the month of March. The All-Share index dropped during the previous month on the back of pessimistic trading and portfolio reshuffling as companies announced dividends and share splits. As of last week, Tadawul has remained above the 7'000 level for 22 consecutive sessions, matching September 2012's streak. The retail subcategory recorded the highest growth last month with an increase of 7.7%, raising its sectoral price-to-earnings ratio to 17.34 which might indicate a near end to its momentum. However, retail companies have been supported by higher consumer spending and the companies' expansion plans signal further growth. Additionally, the retail sector posted an earnings-per-share ratio at 4.40, second highest to hotel & tourism sector's 5.04 by the end of March. The highly speculative insurance sector rose by 7.5% last month, second highest growth and followed by the real estate sector with a gain of 7.3% M/M. in addition, the energy sector increased by 3.4% during last month as Saudi Electricity Company (SEC) issued the first ever 30 year Sukuk. Moving forward, trading in early April faced some pressures with investors partially reaping capital gains. We expect the market to remain above the 7'100 level during this month as it penetrated the psychological 7,200 barrier last week.

Chart 9: Tadawul All-Share Index

Source: Tadawul

Investor appetite, represented by average daily trading volumes, dropped during March; however, market capitalization rose to SAR1.45 trillion, a gain of 1.5% over February's SAR1.43 trillion. Investors traded a total of SAR122.0 billion last month which calculates at an average daily SAR5.5 billion, 6.2% lower than the previous month. Since the beginning of the year, daily volumes have averaged at SAR5.7 billion, 25.5% lower than 2012's average. The majority of trading is attributed to Saudi individuals, representing around 90%. Saudi and GCC institutions have been increasing their shares in the market over the past few months as valuations attracted long term investors. The remainder of activity, around 3%, was attributed to foreign traders.

Chart 10: Average Daily Traded Value



Source: Tadawul

The highlight of the month was the issuance of four Sukuks in the Saudi market. Almarai Company issued a floating rate Modarabah-Murabaha Sukuk. The SAR denominated issuance raised SAR1.3 billion for the company. Similarly, Saudi Binladen Group also raised SAR1.3 billion by offering a 3-month SAIBOR plus 170 bps margin. However, the main roadshow was that of SEC which issued a two-tranche Islamic bond with a tenor of 10 years and a first ever 30 year Sukuk, each with a value of SAR3.75 billion. The dollar denominated issuance attracted investors worldwide and will set the foundation for future long-term Islamic debt issuances. Margins have been set at 3.473% and 5.06% for the 10 and 30 year portions, respectively. This will benefit the Islamic bond market by expanding the yield curve to accommodate institutional investors who are seeking assets to match their long term liabilities. During early April, Sadara Chemical Company, a subsidiary of Aramaco, completed the issuance of a SAR denominated Musharaka Sukuk with a 6-month SAIBOR plus 95 bps margin. The total value of issuances YTD reached SAR19.1 billion and is expected to set a new record this year by breaking 2012's SAR39.5 billion tally.

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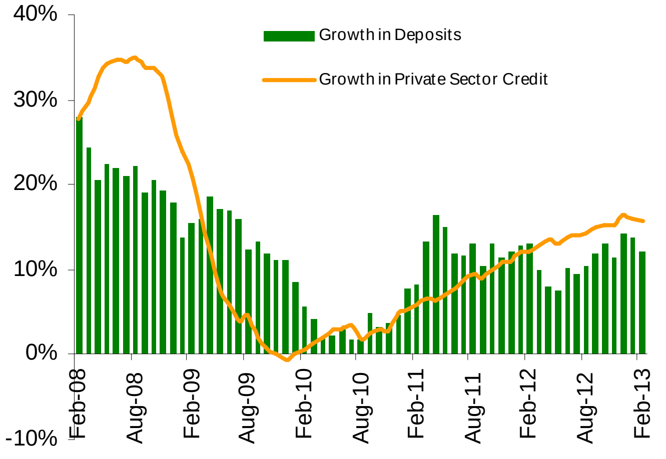
Loans Market

Extending the Maturity Curve

The asset/liability composition in the form of loans and deposits continues to be at healthy levels with the growth of total credit slightly outpacing that of total deposits. Providing opportunities to expand the financing capabilities of the banking system, deposits expanded at an annual rate of 12.1% during the month of February. However, it is the second consecutive deceleration from 2012's 14.2% growth rate. Consequently, this has led to a better utilization ratio represented by the loans-to-deposits ratio which edged higher, settling at 81% by the end of February. Government demand deposits grew by 51.6% while business and individuals added 13.2% to bring the total tally for demand deposits at SAR769.5 billion, an increase of 15.2% Y/Y. Furthermore, time and savings deposits lost some steam by increasing at an annual 6.6%, in comparison to January's 9.1% Y/Y. Businesses and individuals only added 0.6% to the interest earning deposits over the past twelve months. We expect the level of growth to be pressured if the local market continues its latest bullish rebound (See Capital Markets). Additionally, other quasi-monetary deposits grew by 9.7% annually, driven by its main component, foreign currency deposits, which increased by 10.1% Y/Y.

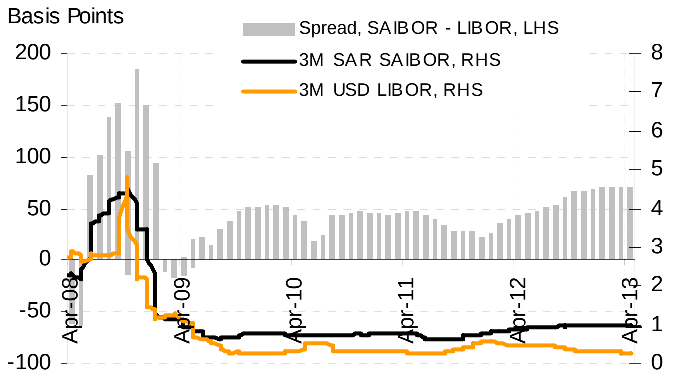
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

On the financing front, total claims of the banking system, excluding T-bills and government bonds, posted an annual increase of 15.9% during February. As expected, the level of credit growth decelerated for the second consecutive month. Peaking during December at 16.7%, the pace of growth was entering unsustainable levels. Longer maturities are currently preferred by local banks as long term credit expanded by 32.2% Y/Y by the end of February, reaching a record SAR274.0 billion. In addition, medium term credit increased 26.1% annually while short term credit only grew by 6.5% Y/Y. However, short term credit lines still represent more than half of total credit with a share of 54.4% whereas long and medium term credit hold 26.8% and 18.8%, respectively. Despite the recent moderation, the pace of credit growth will surely alert SAMA given the effects of money creation into the economy resulting in higher inflationary pressures.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

The private sector secured SAR22.1 billion of funding from local banks during the first two months of 2013. Annual growth in private sector credit recorded 15.8% during February, to settle at SAR982.5 billion. Additionally, credit to the public sector gained 15.2%, the fastest pace since October 2011. Bank credit to public enterprises decelerated to 17.9% Y/Y while government bonds recorded their eighth consecutive annual decline by 17.6% during February. 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 control tool as of late given the interest rate link with the US economy. During the month of February, treasury bill issuances increased by 28.3% annually to reach SAR167.9 billion. As previously mentioned, SAMA has been wary of liquidity pressures and the rise of inflation (new 2007 base), albeit slowly, over the past few months.

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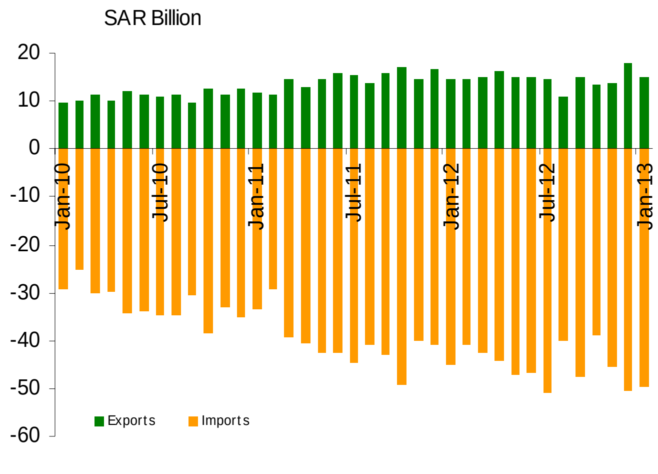
External Trade

Moderation of Last Year's Figures

On the external trade front, the volume of Saudi non-oil exports fell by 7.7% Y/Y in January, amounting to 3,783 thousand tonnes, indicating a moderation following the surge witnessed in 2012. In value terms, however, revenues lessened by only 1.1% to register SAR15.1 billion, indicating a good level of competitiveness for the kingdom's exports. Although by a lower margin of 0.2% Y/Y, non-oil imports increased to 5,673 thousand tonnes accompanied with expenses rising by 10.2% compared to last year. By composition, petrochemicals continued to top revenue generators with 36% of exports consisting of this category which climbed sharply over plastics, making a 4.8% Y/Y upturn. Plastics, which make up 30.7% of non-oil exports, shrank by 5.5% annually. In contrast, base metals, the third largest category which makes 6.3% of exports revenue surged by a sizeable 19.6%, reflecting increasing demand. Foodstuffs, however, marked the highest annual decline of 12.1%.

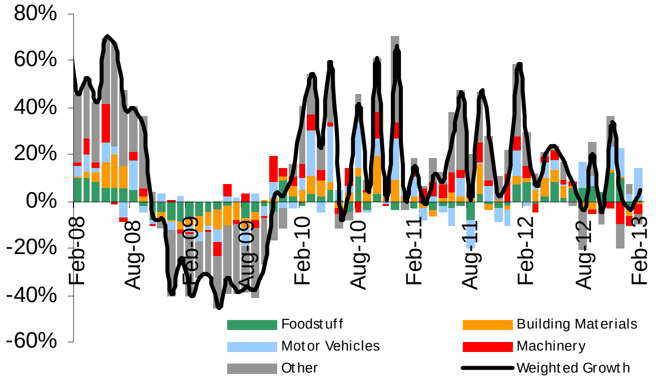
Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

By destination, 14.9% of Saudi non-oil exports continued to be directed towards China in which improved manufacturing data reflected positively on demand for the kingdom's exports, allocating SAR2.2 billion, which grew by 9.1% over last year. Secondly, UAE which acquired 9.3% of non-oil exports traded a worth of SAR1.4 billion, falling short of last years' figures by 4.8%. The US, for the first time, became the third largest trading partner attracting SAR1 billion worth of goods, which makes close to 7% of non-oil exports for this January, growing by a hefty 107% over last year. Saudi non-oil imports by composition show that machinery remains by far the largest import category in January, constituting 28.2% of all non-oil imports. It rose by 14.2% Y/Y, making SAR14 billion. Following machinery is transport equipment, which make up 19.4% of imports. It mounted by 28.7%, indicating a surge in local demand. Foodstuffs show annual decrease in vegetable products and prepared foodstuffs and beverages by 14.3% and 2.6%, respectively, whereas livestock increased by 12.6%.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

By origin, as much as 13.7% of Saudi non-oil imports come from the China, which rose over the US as the largest producer of the kingdom's imports. The surge over last year measures 18.2%, rendering into SAR6.8 billion. USA which is the second largest originator of imports making 13.4% of imports securing SAR6.7 billion which rose by 7.6% over last year. South Korea, the third largest exporter to Saudi, and weighing 7.3% of import allocations, made a 40.4% Y/Y upturn, surpassing Germany and Japan.

Settled letters of credit (LCs) for the month of February subsided by 4.9% compared to the same period last year to register SAR19.1 billion. They were affected by a decline in motor vehicles, machinery, and building materials which fell by 8.4%, 21.1%, and 32.8% Y/Y, respectively. On a positive note, LCs pertaining to foodstuff improved, rising by 85.4% Y/Y, softening the impact of other declining categories. This increase was affected by a remarkable upturn in fruits and vegetables LCs by 482.5%, as well as a 119.5% surge in food grains, indicating possible restocking. As a future indicator, Opened LCs recorded SAR17.8 billion, making a 4.9% annual growth over last year. Supported by demand for motor vehicles regaining traction and spiking by 101.9%, other main categories, such as machinery and building materials, nose-dove on an annual basis by 29.6% and 8.2%, respectively. We expect to see a moderation throughout 2013 as 2012 was a peak year in regards to LCs.

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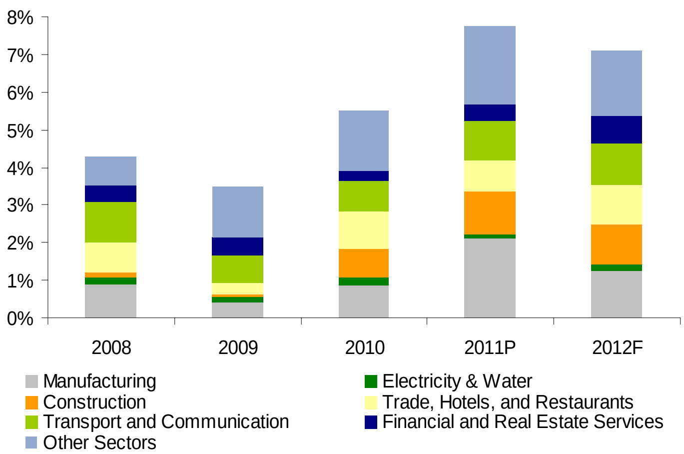
Special Focus:
Construction and Manufacturing

Construction and manufacturing will remain the key beneficiaries in 2013, growing at 10.5% and 8.5%, respectively. Our projections for the two sectors are supported by buoyant activity in the projects' market and strong business confidence. During 2012, the value of awarded construction contracts remained above the SAR200 billion threshold, registering SAR235 billion, albeit falling short from the historical record of SAR270 billion in 2011. The awarded contracts in the manufacturing sector reached SAR17.8 billion in 2012, the fourth largest share across all sectors, surpassed only by the oil, transportation and power sectors, with Ma'aden aluminum smelter awarding the highest contracts by value. Ostensibly, the role of the government is critical, whereby it signed approximately 3,117 CAPEX-related contracts with the private sector valued at an estimated SAR172.9 billion, according to the Ministry of Finance. However, we are concerned about the recently released report by the Saudi Control and Investigation Board (SCIB) that detailed 650 projects facing delays and that will need to be financed from excess surpluses of previous budgets.

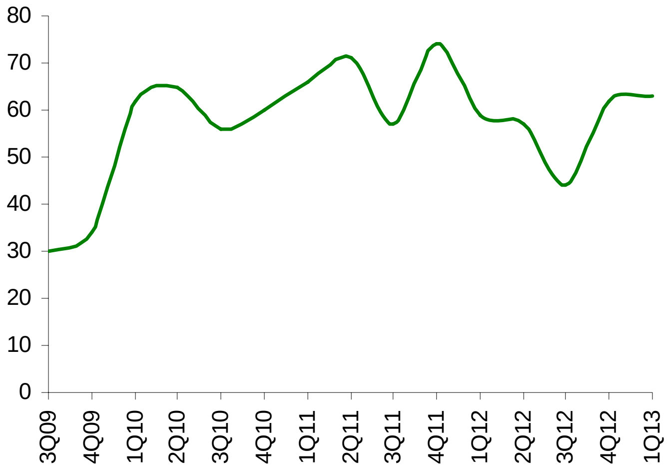
Table 15: Non-oil GDP Growth, Contribution



Source: MOF, NCB Estimates

We believe that the government's adamancy in pursuing diversification have to be matched by strong supervisory structure that ensures execution within strict timeframes given the enormity of the projects whether in size or number. Accordingly, the recent decision by the Ministry of Transportation to withdraw a number of failed projects from contractors facing myriad challenges is a step in the right direction. Looking ahead, among the various sectors surveyed in NCB's Business Optimism Index (BOI), construction, trade & hospitality, and manufacturing were the only sectors to register index values similar to or above the composite index for the non-hydrocarbon sector in 1Q 2013, standing at 63, 57 and 55 points, respectively, which indicates expectations of further expansion on the back of higher volume of sales and new orders. Optimism levels in the construction sector were the highest among all sectors, with 50% of the firms planning to invest in business expansion.

Table 16: Construction Composite, Business Optimism Index



Source: Dun & Bradstreet, NCB

Obviously, approving the mortgage law back in July have impacted sentiments positively and will continue to do so as SAMA finalizes the regulations on real estate financing and leasing along with the supervisory guidelines. The role of the Real Estate Development Fund (REDF) will also be important in propelling residential building construction by accelerating loans to the 537 thousand applicants currently on the waiting list and the additional 1.7 million electronic applications that are yet to be examined for eligibility. The REDF is apparently aware of the long-queue that will take more than 10 years to substantially reduce given the current capacity of the fund that can hand loans to just 40 thousand applicants per year, thus, it is in the process of devising and implementing an expedited loan scheme with local banks that will allow applicants to avail the SAR500 thousand loan with REDF paying the interest. In our opinion, the momentum of awarded construction contracts coupled with expansionary business sentiment will ensue, thus, supporting both construction and manufacturing going forward.

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