Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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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**

Sara Faidy
Economist | **s.faidy@alahli.com**

Executive Summary

- The spread between Brent and WTI is forecast to average USD16 a barrel this year, and to narrow to USD9 a barrel in 2014, as the increasing pipeline capacity will lower the cost of shipping oil from the central US to refineries on the Gulf of Mexico coast.
- The Yen has been steadily assuming a downward trajectory since the beginning of the year, mainly influenced by announcements of fiscal and monetary stimuli.
- China's consumption for copper by 8% to a record 8.8 million metric tons in 2013 driven by an improving Chinese manufacturing sector.
- Even though M0 gained 13.3% Y/Y, the M/M contraction was mainly due to deposits with SAMA, as banks opted to utilize their funds by withdrawing nearly SAR 12.9 billion to accommodate credit expansions and customer withdrawals.
- Local investor's pessimistic approach has been pressuring stock prices and the confidence post the 2006 market collapse has never been regained.
- The banking system is expected to soften the pace of credit to avoid overheating their balance sheets. In our opinion, the pace of credit will slightly moderate during 2013.
- Supported by the recent strengthening of the greenback, lower prices of imports encouraged demand for LCs.

View of the Month

'Saudi Arabia's Non-Oil Sector'

Implementing broad-based structural reforms over recent years has largely improved the Kingdom's business environment and its attractiveness for foreign capital inflows. We believe that FDI will continue to be one of the driving forces behind higher investment spending in the Kingdom...

Macroeconomic Indicators

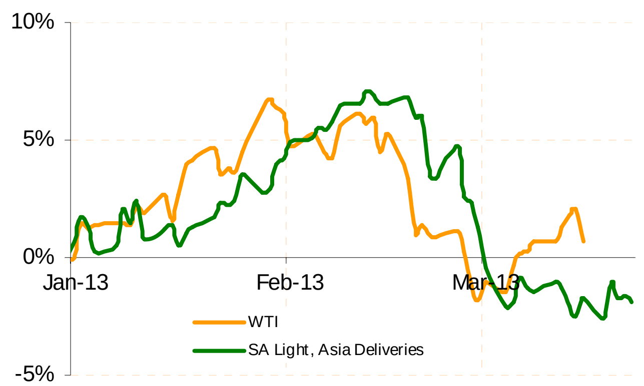
	2007	2008	2009	2010	2011P	2012F	2013F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	68.3	94.9	59.2	77.6	108.1	105.0	110.0
Average Daily Crude Oil Production, MMBD	8.8	9.2	8.2	8.2	9.3	9.9	9.7
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,690.5	2,511.4	2,727.4	2,908.4
GDP at Current Market Prices, USD billion	385.2	476.9	377.2	450.8	670.6	728.3	776.6
Real GDP Growth Rate	2.0%	4.2%	0.1%	4.6%	8.5%	6.8%	3.4%
Oil Sector GDP Growth Rate	(3.6%)	4.2%	(7.8%)	2.4%	4.3%	5.5%	-1.2%
Non-oil Sector GDP Growth Rate	4.7%	4.3%	3.5%	5.5%	7.8%	7.2%	7.4%
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	25,797.2
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	258.2
Oil Exports, USD billion	205.3	281.0	163.1	215.2	317.6	347.6	348.1
Non-oil Exports, USD billion	27.8	32.3	29.1	35.8	46.9	48.9	45.2
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)	(35.1)
Current Account Balance, USD billion	93.3	132.3	21.0	66.8	158.5	178.7	144.4
Current Account Balance/GDP	24.2%	27.7%	5.6%	14.8%	23.6%	24.5%	18.6%
Net Foreign Assets with SAMA, USD billion	301.3	438.5	405.9	441.0	535.9	640.2	709.8
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	1,146.9
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%	39.4%
Total Expenditure/GDP	32.3%	29.1%	42.2%	38.7%	32.9%	31.3%	29.9%
Overall Budget Balance, SAR billion	176.6	580.9	(86.6)	87.7	291.1	386.5	276.8
Budget Balance/GDP	12.2%	32.5%	(6.1%)	5.2%	11.6%	14.2%	9.5%
Break-Even Oil Price	40.5	40.2	60.8	64.1	71.7	67.2	70.9
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%	10.7%	9.1%
Growth in Credit to the Private Sector	20.6%	27.9%	-0.6%	4.8%	11.0%	17.2%	16.0%
Average 3M SAR Deposit Rate	4.9%	3.3%	0.9%	0.7%	0.7%	0.8%	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	(31.9)	29.7	17.5	38.0	39.5	40.0	60.0

Oil Market

China to Surpass US as Net Importer

Brent Crude prices have averaged USD113.3 a barrel so far this year, compared with USD111.16 in 2012. The decline in the price of Brent crude since early February reflects the faltering in the global economy and, more recently, the fears about the Eurozone triggered by the uncertainty surrounding the future of Cyprus and the risk of the country existing the single currency. Moreover, hedge funds reduced their oil bullish bets to a two-month low in March, as the surging supplies pushed WTI prices on the New York Mercantile Exchange below USD90 a barrel for the first time this year. Meanwhile, the geopolitical developments in the Middle East still suggest that the Brent prices will remain above the USD100 a barrel for the rest of 2013. The US Energy Information Administration (EIA) reduced its Brent average price forecast to USD108 a barrel in 2013, and USD101 a barrel in 2014. However, the spread between Brent and WTI is forecast to average USD16 a barrel this year, and to narrow to USD9 a barrel in 2014, as the increasing pipeline capacity will lower the cost of shipping oil from the central US to refineries on the Gulf of Mexico coast.

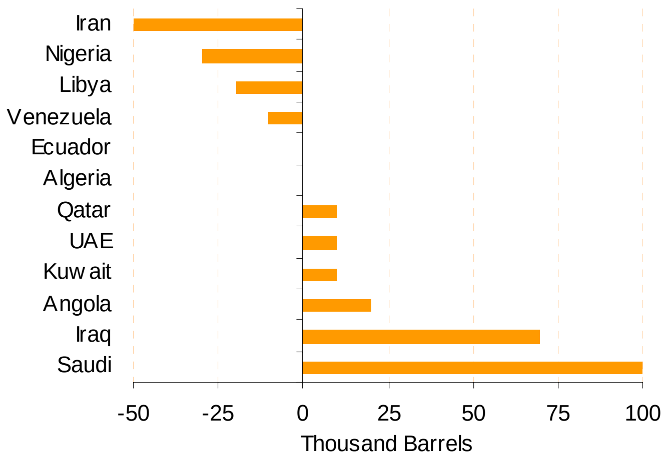
Chart 1: Oil Price Developments, YTD



Source: Thompson Reuters

On the demand side, rising consumption by China is moving closer to surpass the US as the largest global net importer. Although Chinese domestic crude processing plus net imports reached 10.2 mmbd, the least since October, it was up 4.4% from a year ago. Modest macroeconomic growth targets introduced at China's annual National People's Congress raised concerns about the country's commodities demand; however, these targets are unlikely to dampen oil demand prospects, which are still expected to grow by 5% in 2013. Moreover, manufacturing activity were already returning to mild expansionary phase, supported by the end of destocking in many downstream sectors and a recovery of domestic and export demand. The IEA's oil Market Report estimates incremental oil demand in 2012 at 0.9 mmbd, and in 2014 at 0.8 mmbd. In addition, it projects North American demand growth flipping into positive territory in 2013 after two years of decline.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the supply side, EIA estimates oil production outside OPEC to rise by 2.2% to 53.8MB/D in 2013, while the US and Canada account for almost 75% of the gain. US crude output is forecast to climb from 6.47 mmbd in 2012 to 7.31 mmbd in 2013, and to surge by 7.8% in 2014 to 7.88 mmbd. In turn, US will likely need less imported oil, with net oil imports next year are forecast to fall to 32% of domestic oil demand, compared to 60% of in 2005, as combination of horizontal drilling and hydraulic fracturing has unlocked supplies trapped in shale formations in the states of North Dakota, Texas, and Oklahoma. OPEC, on the other hand, will produce 30.03 mmbd in 2013, according to EIA; however, it pumped 30.01 mmbd in February. OPEC's non-crude oil liquids output was 5.69 mmbd last month. Saudi Arabia raised its production in February to 9.15 mmbd, an increase of 100,000 mmbd from previous month, which served as a cap on oil prices. Iran's exports, which are currently under western sanctions because of its nuclear program, rose slightly to 1.28 mmbd in February, as Iran bought secondhand tankers to ship oil to China. More restricting measures by US on Iran's oil exports already took effect last month, which require importers to pay in local currencies kept in escrow accounts.

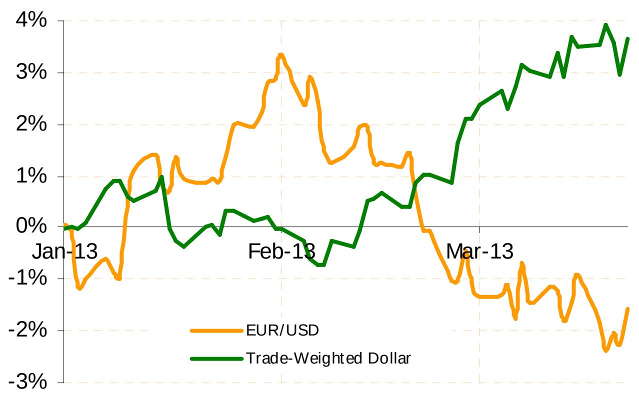
Said A. Al Shaikh
Group Chief Economist | **s.alshaikh@alahli.com**

Foreign Exchange

BoJ Replicates the Fed's QE

The newly nominated governor of the Bank of Japan (BoJ), Haruhiko Kuroda, pledged to use a drastic and aggressive open-ended policy approach. He avidly believes it will solve the deflationary pressures haunting the Japanese economy for almost two decades. In summary, the new policy will include large-scale purchases of longer-dated government bonds, and will have the objective of raising the inflation rate by 2% within two years. To an extent, Japan will attempt to replicate the Fed's QE3 experience. This policy action has now gained merits after the unemployment rate in the US fell to 7.7% in February down from 7.9% during the previous month, its lowest level since December 2008. If Kuroda assumes the BoJ chair position, the program is expected to kick off conceivably sooner than 2014. In scrutiny to the current policies, Kuroda sees that the scale and scope of the assets purchased so far are not of magnitudes sufficient enough to meet the price target. The new policy, however, does not come without a risk-return tradeoff; the downside risks of the new program are increased dependency on the BoJ, and potentially creating a Japanese government bond market bubble. This poses new challenges for the new BoJ governor if he decides to pursue his daring policy.

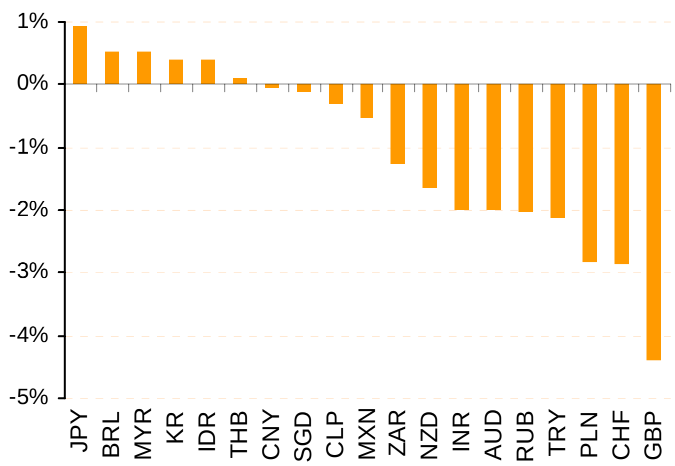
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thompson Reuters

In reaction to the recent developments in the US jobs market, the trade-weighted dollar gained 0.5% in March against its rival currencies. Bond yields bounced off record lows, and the Dow average surged by 10.8% YTD, after reaching yet another record-high of 14,512. The Federal Reserve's dovish monetary policy which maintains a pace of USD85bn/month of bonds purchasing has finally presented tangible results as jobless claims subsided by 7,000 to reach 340,000. Critics, however, speculate that when taking into account the 81,000 addition of discouraged workers in February, the new jobless rate is greatly overstating the actual labor market improvement. The Yen has been steadily assuming a downward trajectory since the beginning of the year, mainly influenced by announcements of fiscal and monetary stimuli. Kuroda's late bold statement, in addition, allowed the Japanese currency to slide further, reaching 96 JPY/USD, its lowest point yet since 2009.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

According to EuroStat, the Euro zone economy shrank by 0.6% in Q4 '12 as no Christmas boost took place amidst falling investment and consumers' reluctance to spend. The single currency regained traction after speculations over the ECB policy rate cuts did not materialize. Compared to last month's figures, however, the EUR/USD pair continued to fall from the 1.36 peak level seen at the beginning of February, hovering around 1.30 in March. According to China's National Bureau of Statistics, consumer price index rose by 3.2% Y/Y in February, while industrial production grew by 9.9%, the lowest since October 2012. In contrast, fixed-asset investment surged by 21.2%, the strongest in 12 months. This sends mixed signals and burdens the recovery of China's domestic economy with much undesirable uncertainty. The Chinese government currently faces the dilemma of finding the delicate balance between containing the asset bubble risk, and saving the economy out of the growth malaise. Therefore, the CNY devalued by 0.15% against the USD this month. Commodity currencies gained on the back of the Dow's rally, recording 1.49% and 0.07% for the BRL and the CLP, respectively.

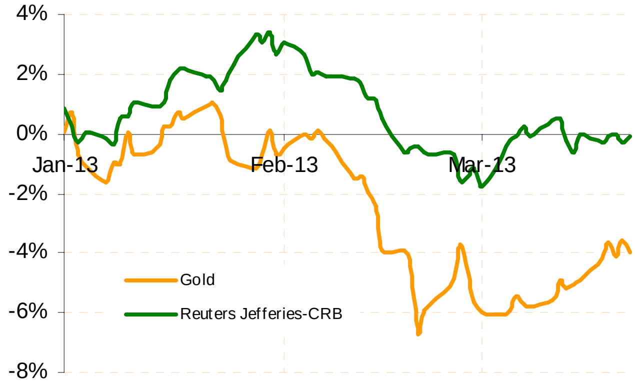
Yasser Al-Dawood
Economist | **y.aldawood@alahli.com**

Commodities

Uneven Economic Environment

Commodity trading posted relatively high figures this month in response to the US Federal Reserve's stimulus program and China's uneven economic recovery with the Thomson Reuters-Jefferies CRB Index gaining 0.6% this month. The instability of the two most powerful economies in the world; US and China was largely reflected in the price of precious metals especially gold dropping by almost 4.0% since the beginning of 2013. Nevertheless, during the end of February/beginning of March, gold prices remained range-bound between USD 1562/ounce and USD 1614/ounce on the Federal Reserve's statement of continued monetary accommodations combined with Italy's uncertain political and economic future as well as the elevated US inflation rate. However, we do expect lower average gold prices until the end of this year on the back of equities' better performance and a stronger US Dollar. By the end of last week, spot gold prices closed at USD 1607.95/ounce which affirms the aforementioned downtrend in gold prices. Silver's performance is similar to gold, registering a fall of around 5.3% YTD, yet there are positive drivers witnessed of late that will support prices of the white metal, namely healthy purchases of exchange-traded products, robust silver coin demand, and an anticipated rise in industrial demand.

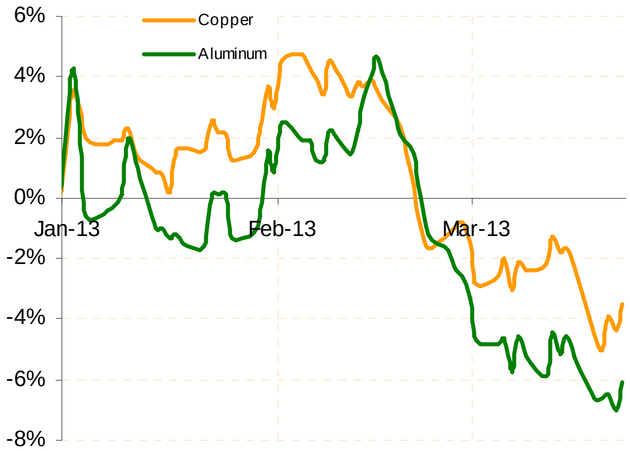
Chart 5: Reuters Jefferies vs. Gold



Source: Thompson Reuters

On the base metal front, copper, aluminum, and zinc advanced on signs of an improving Chinese manufacturing sector and better service sector growth in the US. China's high demand for electric grids, housing, automobiles, and exports has placed an upward demand on copper which will increase China's consumption for copper by 8% to a record 8.8 million metric tons in 2013. The US consumption for copper is most likely to increase as more houses are expected to be built this year which is an important contributor to demand growth. The London Metal Exchange (LME) shows that copper for delivery in 3 months declined 1.9% this month to USD 7660/ metric ton. Despite the fact that China's economy is improving, yet the recent news in the beginning of March show that China is going through its weakest industrial output since 2009 and has recorded a 10-month high inflation rate, as well as weaker consumer confidence and spending. As a result, we do expect, on a medium term note, that copper prices will be pressured.

Chart 6: Base Metals



Source: Thompson Reuters

As for agricultural commodities, soybean's world production is expected to drop because of the dry weather in Argentina; the world's biggest shipper of soybeans. However, soybean prices fluctuated this month especially after soybean shipment deliveries were stuck at Brazilian ports which caused shipping delays to China, the world's biggest buyer, and that pushed prices to increase. The US Department of Agriculture reported that Argentina's crop will be 2.8% lower than February's forecast amounting to 51.5 million metric tons, and the world's production will drop 0.6%, amounting to 268 million tons. Corn supply, on the other hand, is projected to rise 28% to reach 15.18 million bushels in 2013/2014, according to the annual agricultural outlook from the US Department of Agriculture. Nonetheless, farmers this year are eager to grow more mainly after the improved crop weather and several snowstorms that passed by some major US States last month which helped in easing drought conditions and encouraging more crops.

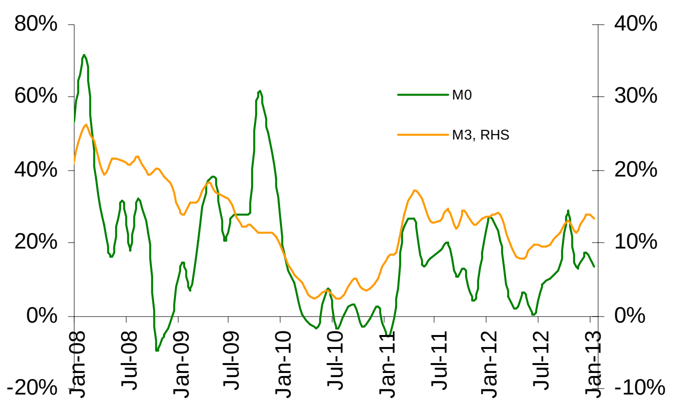
Sara Faidy
Economist | **s.faidy@alahli.com**

Money & Inflation

Thriving Monetary State

The monetary situation in the Kingdom continues to show the thriving state of the Saudi economy. The Year 2013 started off with a lower monetary base (M0) for the month of January as it recorded a decline of SAR11.3 billion to settle at SAR339.28 billion after it reached SAR350.6 billion in December 2012. Even though M0 gained 13.3% Y/Y, the M/M contraction was mainly due to deposits with SAMA, as banks opted to utilize their funds by withdrawing nearly SAR 12.9 billion to accommodate credit expansions and customer withdrawals, which reduced total banks' reserves. However, currency outside banks increased to SAR134.1 billion; an increase of 10.8% Y/Y. Additionally, cash in vault reached SAR20.2 billion, an annual rise of 11.1% during the same month.

Chart 7: Growth in Monetary Aggregates

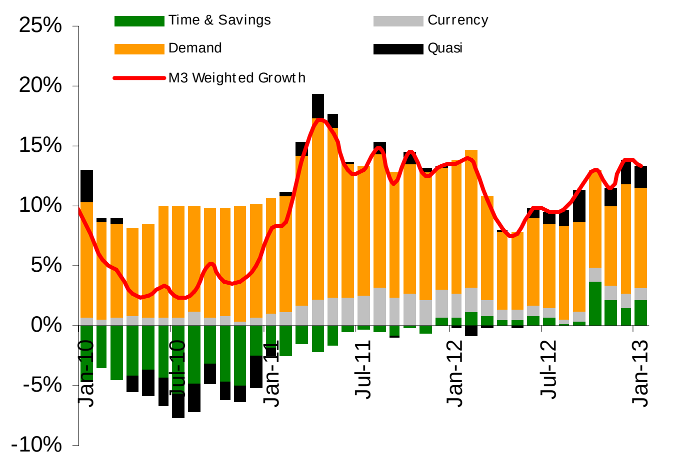


Source: SAMA, NCB Estimates

The money supply (M3) for the month of January reached another record high at SAR 1.4 trillion, posting an increase of 13.4 Y/Y by the end of January. The highlight of the broad money was the sizable growth in demand deposits which constituted 54% of M3 and totaled to SAR 762.6 billion; a 15.5% increase Y/Y, due to the lower volume of trading on the stock market and the subdued interest rate environment. Currency outside banks, constituting 9.58% of M3, recorded a growth of 10.9% Y/Y to reach SAR134.1 billion. Additionally, time and savings deposits and other quasi-monetary deposits increased by 9.1% and 13.2% respectively on an annual basis. Time and savings deposits reached SAR323.4 billion while other quasi-monetary deposits reached SAR180 billion in January.

The liquid state of the economy and its buoyant growth should theoretically drive up local consumer prices. The month of January witnessed increase in the inflation rate to 4.2% following December's 3.9%. The Reuters/ Jefferies CRB Commodity Index gained 0.6% during this month which was reflected in the food and beverage category by rising 6% Y/Y for January, as Saudi is import oriented. More specifically, legumes and tubers contributed to the rise in the benchmark inflation rate as prices accelerated at 24.4% in response to the higher global commodity prices.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Meanwhile, the category of other expenses and services showed a growth of 3.2%. Moreover, the category of rental prices continued their downward trend which lowered the category's inflation rate to 5.1% Y/Y. The anticipation of the mortgage law is expected to further drag down prices on real estate until the complete codifying is announced. We do believe that the food-stuff category will hover around 5% for the first half of 2013 and expect the inflation rate to jump above 4% early 2013 and recording an average of 4.5% for the whole year.

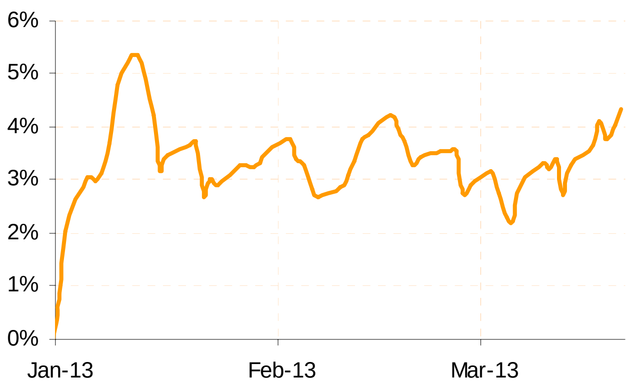
Sara Faidy
Economist | **s.faidy@alahli.com**

Capital Markets

Eclipsed by Pessimistic Trading

Global equities either stagnated or declined slightly over last month with the exception of US markets. The release of better than expected employment data in the largest economy in the world, which saw the unemployment rate drop to 7.7%, supported stocks to record highs. While most economies are finding difficulty in maintaining their momentum, thus, pressuring equities lower, the Saudi economy's robust prospects have been unsuccessful in raising the local market. The Saudi market has been closely correlated with the US's DOW and S&P500 for the second half of 2012; however, a noticeable decoupling has been witnessed during 2013. Tadawul marginally declined during February by 0.6% while the DOW and S&P500 recorded gains of 1.4% and 1.1%, respectively. Local investor's pessimistic approach has been pressuring stock prices and the confidence post the 2006 market collapse has never been regained. Additionally, companies have announced dividends following their successful operations last year. As such, prices were somewhat corrected but we expect this month and April to be on the positive side of the spectrum.

Chart 9: Tadawul All-Share Index

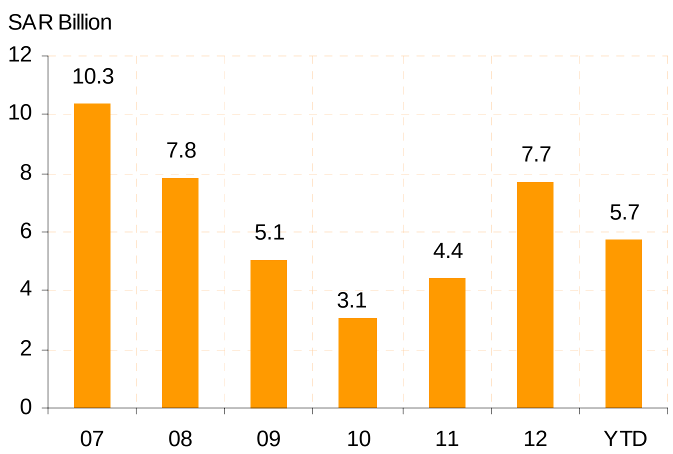


Source: Tadawul

During February, the hotel and tourism sub-index carried forward January's performance by recording a rise of 9.3% on a monthly basis to bring its YTD gains to a staggering 31.7%. The main driver is the Saudi Commission for Tourism and Antiquities' efforts to expand the tourism sector in the Kingdom with investments across the country. Saudi's capital expenditure will support listed companies with investments such as the latest Jeddah transport project worth a total of SAR45 billion to be completed within 7 years. In addition to the hefty size of mega projects, stocks are poised to rise based on fundamentals over the medium term. As of last week, Tadawul has gained 1.4% in March with the insurance, retail, and telecomm sectors leading by recording increases of 5.8%, 5.2% and 4.8%, respectively since the beginning of the month.

Investor appetite declined this year, excluding the listing days of listing Northern Cement and National Medical Care Company into the market. Average daily traded volumes for February dropped to SAR5.6 billion in comparison to January's SAR5.8 billion. Additionally, market capitalization dropped to SAR1.43 trillion by the end of last month. The majority of selling pressures were attributed to Saudi individuals as speculative trading persists. Saudi corporations and mutual funds' buying efforts to offset the downward trajectory succumbed to the over 90% majority of individuals. The market's price-to-earnings ratio dropped to 13.15 by the end of last month. Following annual reportings, investors are likely to reshuffle their portfolios accordingly and numerous stocks remain lucrative opportunities for long-term growth.

Chart 10: Average Daily Traded Value



Source: Tadawul

The primary market concluded the initial public offering (IPO) of National Medical Care Company during early February. The company offered 13.5 million shares at a price of SAR27, representing 30% of the company. The company was listed during March as the 160th stock in the market and investors were quick to repeat Northern Cement's scenario by raising the stock's price by 351% on its first trading day. As for the Sukuk market, Saudi Binladen Group is expected to raise SAR1 billion this month with a rumored rate of 150 basis points above SAIBOR. Diversifying funding resources is by tapping into the debt market is slowly gaining popularity in the Kingdom as we expect this year to be strong for local Sukuks.

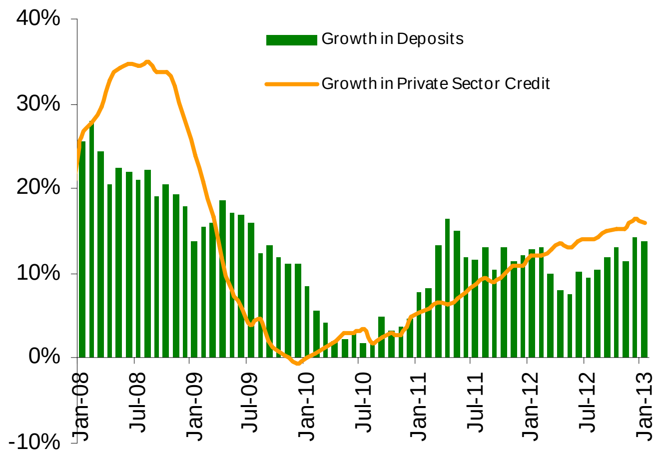
Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

Loans Market

Maintaining Healthy Levels

As one of the essential variables in determining the future of lending, deposits in the Saudi financial system are more than adequate to accommodate the rising credit market and its potential. The depositary base of Saudi banks has reached SAR1.27 trillion during January according to the latest SAMA bulletin, a rise of 13.7% over the same month last year. Representing the largest portion of deposits, demand deposits have increased their share to 60.2% by an annual gain of 15.5%. Businesses and individuals have added 11.9% Y/Y to their demand deposits while government entities amassed a staggering 87.8% on annual basis. The suppressed interest rate environment continues to keep investors away from time and savings deposits. SAMA's policy is likely to mirror that of the US's; consequently, we do not foresee any changes before 2014. However, time and savings deposits managed to increase by 9.1% Y/Y during January to reach SAR323.4 billion. Interestingly, it is still below the peak level recorded by the end of 2008 at SAR367.6 billion. Furthermore, other quasi-monetary deposits increased at an annual 14.9% as foreign currency deposits expanded by 12.8% during January.

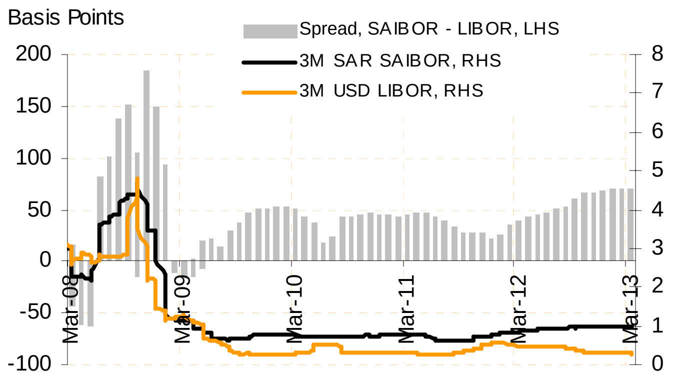
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

Saudi banks' combined loans portfolio rises for another month to reach SAR1.01 trillion, setting an annual rate of 16.3% Y/Y for the month of January, a slight deceleration over the previous month. The robust economy facilitated the possibility of maintaining an elevated level of credit expansions as investments increase within the Kingdom. Local banks are expected to maintain the current level of credit with a more selective approach for 2013. As we have projected, medium and long term credit is outpacing short term credit growth. Despite dropping marginally on a monthly basis, medium term credit grew by 41.6% annually by reaching SAR196.9 billion, a level that has been doubled since March 2009. In addition, long term credit accelerated at an annual pace of 16.5% during January to raise its share of total credit to 26.8% from 26.3% during December. Representing the bulk of credit, short term credit stands with a share of 53.7% following its 9.2% Y/Y growth.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

As for the private sector, total claims expanded by 16.0% on an annual basis during January. The banking system is expected to soften the pace of credit to avoid overheating their balance sheets. In our opinion, the pace of credit will slightly moderate during 2013. Furthermore, credit to the public sector gained 6.8% Y/Y as treasury bills recorded a gain of 13.5% annually. The risks from excess liquidity remain subdued, thus, SAMA will continue their wait-and-see approach. The growth of lending has once again outpaced deposits which contributed to the rise of the loans-to-deposits ratio to 79.9 by the end of January.

As for the interbank rate, SAIBOR, the subdued interest environment will aid banks in avoiding any liquidity shortages by allowing to access funds cheaply. However, given the rise in credit which translated into larger liquidity movements, the differential 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. SAIBOR is expected to hover around 100bps.

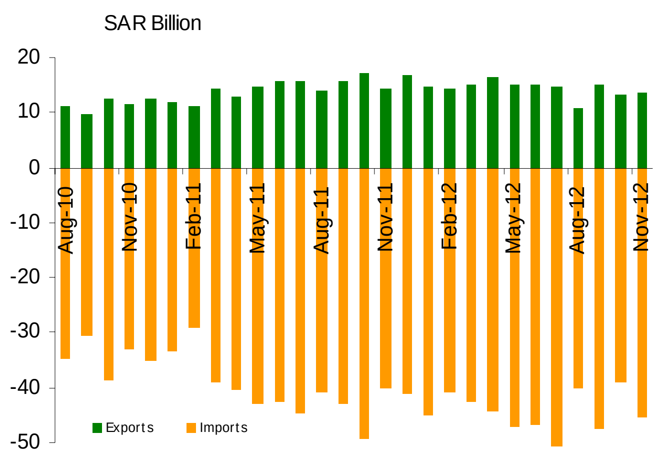
Majed A. Al-Ghalib
Senior Economist | **m.alghalib@alahli.com**

External Trade

Steady Growth Despite Global Commotion

In 4Q 2012, both settled and opened letters of credit (LCs) reflected the vibrancy of the Saudi economy. Settled LCs recaptured the momentum which it lost briefly in the third quarter, posting 26% Y/Y increase. It ensured continued resilience to global economic and political turbulences affecting the US, Europe, Middle East, and some of the major emerging economies. The largest importing country group was the GCC, with a 44% boost over the previous year, followed by Arab countries posting a 101% annual surge. North American settled LCs stumbled by 37% Y/Y, and Western European settled LCs shrank by 60% compared to last year, while keeping a steady, low discrepancy ranging between the value of tens to hundreds of million riyals. Supported by the recent strengthening of the greenback, lower prices of imports encouraged demand for LCs. Save for North America, in which imports to the kingdom remain highly volatile, Q/Q figures of opened LCs display the same pattern as their settled counterparts, indicating no deviation from nominal value trends.

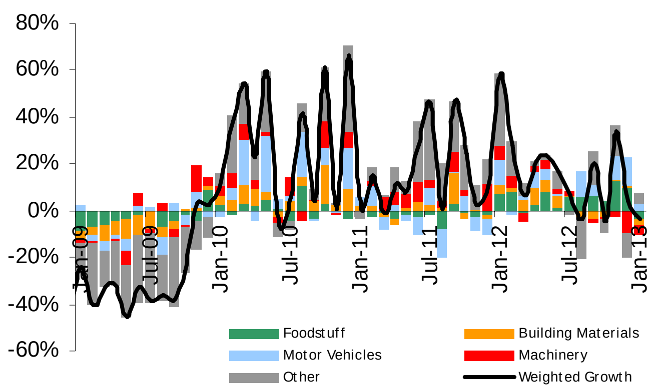
Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

Year 2013 started off with settled letters of credit (LCs) registering a 0.9% Y/Y decline in the month of January. Apart from October's figures, this is not in-line with the general upward trend that was noticeable throughout last year. Most of the decline stems from the fact that last year's figures were well above-average due to the spike in government contract awards. Given the heavy-weight nature of categories such as machinery and building materials, and "others" which constitute at least 74% of total LCs, an annual shrinkage of 21.3%, 13.9%, and 16.6% respectively left only motor vehicles, and foodstuff with a positive note of 42.3% and 58.2% Y/Y, soothing the overall downbeat figures. Compared to the previous month, Settled LCs also reflect a downward movement led by a 3.1% decrease in motor vehicles and a 41.3% downturn in appliances. The positive figures from food stuff and building materials helped mitigating the overall downside trajectory to record a net change of - 5.7%.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

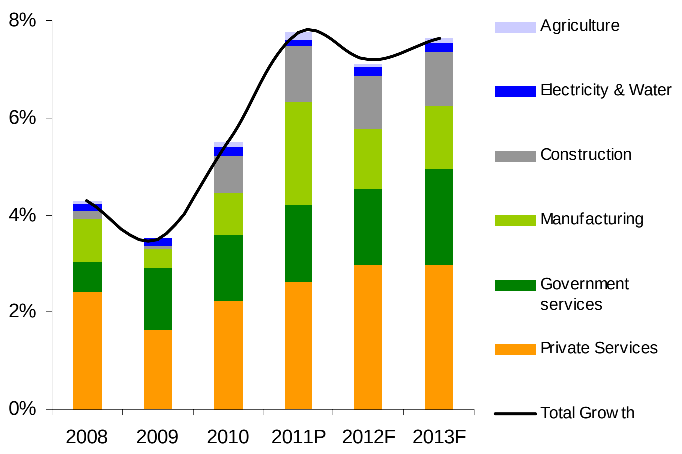
From a forward looking outlook, newly opened LCs fell by 3.5%, affected by a shrinkage in machinery, building materials, and foodstuff by 36%, 28% and 35%, respectively. However, a 22% surge in motor vehicles managed to moderate the downward behavior. On a month-to-month basis, overall settled LCs rose over December's figures by a margin of 4%. Although all of the major categories posted a negative growth, a 41% surge in the category labeled as "others" appears to have cushioned and even counter-balanced the downturn. Motor vehicles receded by 6%, followed by machinery, building materials, and foodstuff with each dipping by 37%, 15%, and 47% respectively.

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

Special Focus:
Saudi Arabia's Non-Oil Sector

Strong private and public investment and consumption spending will support growth in non-oil sectors, particularly construction, manufacturing, and retail trade. Real GDP growth is expected to rise by 3% in real terms, driven by the vibrant non-oil sector that will offset the decline in oil production. Growth in the non-oil sector will remain above the 7% threshold in 2013. Real non-oil GDP in 2012 grew by around 7.2%, which is higher than the 10-year average of 4.7%, largely driven by the stellar performance of the non-oil private sector. The main drivers of private sector growth were the construction, manufacturing, and the retail sectors, which posted 10.3%, 8.3% and 8.3% annual growth, respectively. This vibrancy of the private sector emanated from the royal decrees, the enhanced business confidence, and the improved financing environment. Strengthening of domestic demand is reflected in a rise in private-sector credit (See Loans Market Section) and the double-digit growth in merchandise imports. Evidently, the growth in manufacturing and construction benefited from the pickup in credit, receiving SAR14.5 billion and SAR5.6 billion, respectively, in incremental loans and advances from banks in 2012, which represents an annual increase of 13% and 8%.

Table 15: Non-oil GDP Growth, Contribution



Source: MOF, NCB Estimates

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. Additionally, foreign direct investment inflows are expected to have crossed the USD20 billion mark in 2012. Implementing broad-based structural reforms over recent years has largely improved the Kingdom's business environment and its attractiveness for foreign capital inflows. We believe that FDI will continue to be one of the driving forces behind higher investment spending in the Kingdom, with the share of FDI in gross fixed capital formation (GFCF) registering 14.9% in 2011, significantly higher than the 1.5% average rate posted during the period 1995-2004. Based on the vibrancy witnessed in the projects' market and the near record construction contracts rewarded in 2012, FDI inflows are expected to edge higher in 2012 and 2013 to around USD20 billion and USD25 billion, respectively.

The aforementioned business cycle will likely remain in place on the back of this year's government budget allocation for capital expenditure that will total SAR285 billion as well as the continued spillover effects from the permanent fiscal measures that were triggered by the royal decrees. The unemployment assistance program known as "Hafiz" that started in December 2011 have supported private consumption, with around 2 million Saudis having received SAR30 billion by the end of January 2013. Additionally, the increase by more than SAR10 billion in the government's wage bill as a result of providing regular civil service jobs for temporary public sector workers will continue to act as a catalyst via the multiplier effect. 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.

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

Sara Faidy
Economist
s.faidy@alahli.com

Sector Analysis/Saudi Arabia

Albara'a Alwazir
Senior Economist
a.alwazir@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