July 2018
www.alahli.com

NCB الأهلي

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

3 Oil Market
4 Foreign Exchange
5 Commodities
6 Money and Inflation
7 Capital Markets
8 Loans Market
9 External Trade
10 Special Focus: *A Turning Point*

Executive Summary

- OPEC and Russia's willingness to increase production would seem to reflect confidence that strong global oil demand and further short-run supply disruptions will remain in place.
- The USD extends rally reversing last year's trend while structural challenges keep the long-term USD outlook bearish.
- Gold will likely remain under pressure as Fed hike expectations build up with recurrent periods of uncertainty that will propel it back to the 1,300 level.
- Although crude prices are at a much better position than they were last year, the government is keeping its options open as far as tapping international debt markets is concerned.
- Following a series of reforms and enhancements by the Capital Market Authority and Tadawul, the largest market in the GCC has been promoted to emerging market status by FTSE Russell and MSCI.
- As demand for credit is expected to progressively rise, we believe SAMA might resort to either direct liquidity injections, reducing reserve requirements, reducing the loans-to-deposits ratio limit of 90%, or possibly a combination to tackle any shortage of liquidity and reduce the risk of a monetary drag offsetting the announced fiscal stimuli.
- We expect external trade to continue to strengthen and gain momentum as the Kingdom's vision is being carried out, fostering new trade agreements such as the sizeable bilateral Saudi/UK trade and investment plan announced in March.

View of the Month

Policymakers in the Kingdom realized the negative spillover effects and opted towards policy dynamism and a more gradual approach to stimulate economic growth going forward. The initial signs of an inflection are appearing and we believe 2018 will be the turning point.

Said A. Al Shaikh
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 A. Al-Dawood
Associate Economist | y.aldawood@alahli.com

Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018F	2019F	2020F
Real Sector								
Average KSA Crude Spot Price, Arab Light, USD/BBL	106.4	97.2	50.2	40.9	52.5	67.1	63.7	58.0
Average Daily Crude Oil Production, MMBD	9.6	9.7	10.2	10.5	10.0	10.4	10.7	10.5
GDP at Current Market Prices, SAR billion	2,799.9	2,836.3	2,453.5	2,418.5	2,575.3	2,931.3	3,015.7	3,035.3
GDP at Current Market Prices, USD billion	747.6	757.4	655.1	645.8	687.7	782.7	805.3	810.5
Real GDP Growth Rate	2.7%	3.7%	4.1%	1.7%	-0.9%	2.6%	2.7%	1.2%
CPI Inflation, Y/Y % Change, Average	3.5%	2.2%	1.2%	2.1%	-0.8%	3.0%	2.0%	2.2%
External Sector								
Current Account Balance, USD billion	135.4	73.8	-56.7	-23.8	15.2	71.8	81.7	81.2
Current Account Balance/GDP	18.1%	9.7%	-8.7%	-3.7%	2.2%	9.2%	10.1%	10.0%
Net Foreign Assets with SAMA, USD billion	717.7	725.2	609.7	529.3	489.5	481.9	479.1	462.8
Fiscal Sector (Central Government)								
Actual Revenues, SAR billion	1,152.6	1,040.1	612.7	519.4	691.5	931.8	977.1	972.5
Actual Expenditure, SAR billion	994.7	1140.6	1001.3	830.5	930.0	978.0	1006.0	1050.0
Expenditure Overrun, %	21.3%	33.4%	16.4%	-1.1%	4.5%	0.0%	0.0%	0.0%
Overall Budget Balance, SAR billion	157.9	-100.5	-388.6	-311.1	-238.5	-46.2	-28.9	-77.5
Budget Balance/GDP	5.6%	-3.5%	-15.8%	-12.9%	-9.3%	-1.6%	-1.0%	-2.6%
Break-Even Oil Price	84.8	103.7	85.3	63.0	70.8	69.5	67.2	70.6
Financial Sector								
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	10.9%	11.9%	2.5%	0.8%	0.2%	1.7%	4.4%	4.9%
Growth in Credit to the Private Sector	12.1%	11.9%	9.8%	2.2%	-0.9%	0.9%	4.5%	5.6%
Average 3M SAR Deposit Rate	1.0%	0.9%	0.9%	2.1%	1.8%	3.1%	3.6%	3.6%
Average 3M USD Deposit Rate	0.3%	0.2%	0.3%	0.7%	1.3%	2.8%	3.3%	3.3%
Spread, in Basis Points, SAIBOR-LIBOR	68.7	70.4	56.4	133.7	54.8	30.0	30.0	30.0

Sources: Thomson Reuters, SAMA, General Authority for Statistics, MOF, and NCB
Note: Saudi Economic Review Data, March 2018 Update (Historical and Projections)

NCB الأهلي

Oil Market

Prices Surge on Supply Concerns

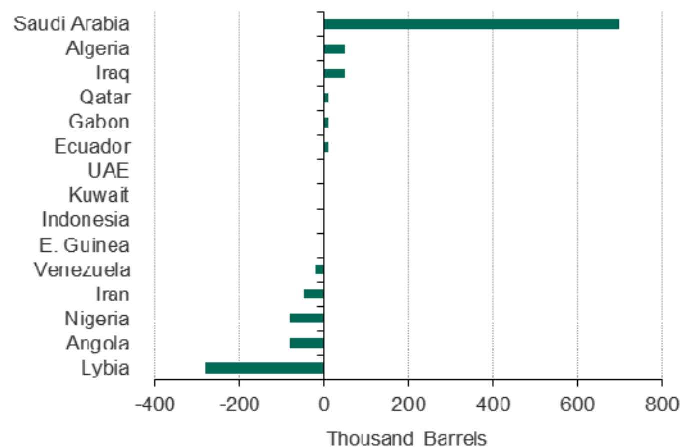
Oil prices reached new highs for the year, peaking at USD79.0 a barrel with the last push given by US re-imposition of sanction on Iranian oil exports. In addition, oil prices have been lifted recently as crude exports from several OPEC producers, including Venezuela and Libya, have been falling. With Brent crude recently touching USD80.0 a barrel, prices are in danger, reaching levels that may spur a global capital investment wave that could reignite severe downside risks over the long-run. The desire to keep oil prices relatively stable around current levels underpins recent OPEC's decision to lessen its output curbs. OPEC and Russia's willingness to increase production would seem to reflect confidence that strong global oil demand and further short-run supply disruptions will remain in place. However, the outlook for oil prices remains highly uncertain implying the interplay of short-run supply disruptions, still firm but slowing global demand and booming US shale oil supply. Although, in the short term, oil prices may be pushed higher by Iranian sanction, later in the year prices are expected to moderate. Saudi Arabia has already announced that it will act in co-ordination with other countries to mitigate the effect of supply shortages. EIA has projected Brent crude prices will average USD73.0 a barrel in the second half of 2018 and will average USD69.0 a barrel in 2019.

Chart 1: Oil Price Developments, YTD

Source: Thomson Reuters

Over the period since October 2016 OPEC's deal, US oil production has continued to surge, rising by almost 1.7mb/d to reach 10.4mb/d. As US shale looks set to remain in force, average breakeven price for shale oil producers continue to drift towards USD50.0 a barrel. The Permian basin in Texas and New Mexico are the region delivering most supply gains and with the greatest future potential. But in the short-term, production bottle-necks, due to a lack of pipeline capacity, are limiting the flow out of the region. New pipeline projects are currently under way but a major increase in the Permian's capacity looks unlikely until second half 2019. OPEC and Russia concluded their June's meetings by agreeing on a production increase for the first time in nearly two years. Rather than the combined 1.8mb/d agreed reduction, the group's output has actually fallen by 2.3mb/d from October 2016's levels. The main reason of over-compliance has been the collapse of Venezuelan output, which has plunged by 0.7mb/d, surpassing its agreed commitment by 0.6mb/d. In addition, Libyan's crude production had fallen to 0.53mb/d from a high of 1.28mb/d in February. Accordingly, output cuts, which were extended to mid-2018, have helped restoring balance to the oil market. OECD inventories have pulled back towards their longer-run norms.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

The potential supply disruption facing OPEC is the risk of US sanction on Iran, removing 0.9mb/d from the market, and the deteriorating political and economic situation in Venezuela. Moreover, infrastructure bottlenecks in US shale oil fields have constrained the near-term outlook for US supply growth. On the demand side, IEA retained its view that global oil demand in 2018 will be 1.4mb/d, driven by global GDP growth, which is approaching a seven- year high close to 4% this year, and a colder than normal of past winter. In the US, net imports of petroleum, at 2.6mb/d, continued to slide on robust output growth, growing exports and slowing demand growth y/y. Meanwhile, global demand growth is likely to weaken as we expect global economic growth to slow and high prices to incentivize energy efficiency.

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

NCB الأهلي

Foreign Exchange

Greenback Continues the Rally

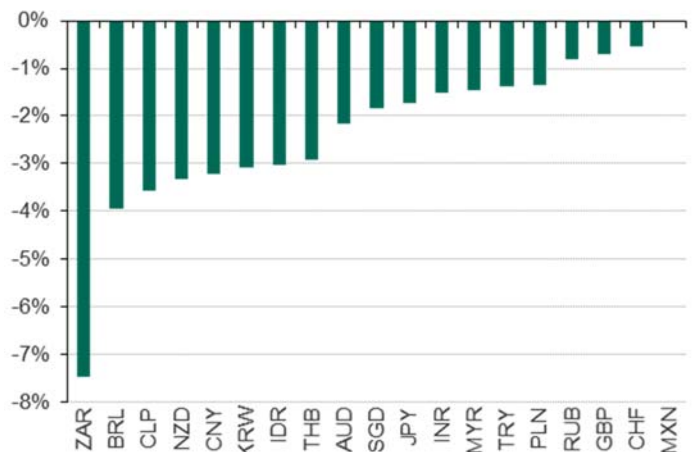
Prospects for global economic growth remain strong as confirmed by the International Monetary Fund in its World Economic Outlook update. Global growth is expected to register 3.9% this year, marginally upturning from last year's 3.8%. The USD extends rally reversing last year's trend while structural challenges keep the long-term USD outlook bearish. Some of the positive short-term effect on the USD is attributed to the possibility of a successful NAFTA conclusion while the rally is capped by worries over reciprocal trade policies with the US from China and Europe. The EUR is under pressure from policy normalization expectations as market participants adjust for a possible scenario. Asian currencies are benefitting from easing geopolitical tension between the North and South Korea in addition to the former agreeing to dismantle its nuclear program.

Chart 3: Trade-Weighted Dollar and the Euro

Source: Thomson Reuters

The US dollar's rebound came as yields have risen notably compared to last year. Ten year treasury yields surged as high at 29% year-to- May surpassing 3% for the first time since 2011. By the end of June, however, yields subsided, ending the month at 2.85%. Interest rates have reached a point where it reflects the Fed's confidence in the economy; with the rate hiked by another 25 bps to the 1.75% - 2.00% range during the FOMC meeting in June. Despite the intensifying tariff war between the US and China, and the expected higher levies on European auto imports to the US, the Fed remains confident in US growth. The stock market received a boost from the Fed's reassurance with the S&P gaining 100 points to the 2700 level, inching up by 2.3% YTD and NASDAQ closing at record 7000 level, surging by 10.7% YTD. Unemployment recorded 4.0% in June while non-farm payroll posted a solid gain of 213,000 jobs created during the month. The trade-weighted USD stood at 94.6 by the end of June, thus strengthening by 2.7% YTD. The EUR extended the sell-off that started in May onto June on the back of Italian and Spanish markets' volatility. In addition, uncertainty is rising as inflationary pressures are becoming increasingly supportive of the European Central Bank's (ECB) policy normalization. The harmonized index of consumer prices stood at 2% in June, meeting the ECB's target and marking the highest inflation level since February 2017. The EUR hence ended June down by 2.6% from the beginning of the year, standing at USD1.17/EUR.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In Asia, we expect the JPY to have a more downside potential as the Bank of Japan (BoJ) continues to pursue its accommodative policy. The BoJ's president Kuroda stressed that the central bank will keep its ultra-loose stance until inflation hit its 2% target. The inflationary situation in Japan is still sub-optimal although it has moved away from negative territory since December 2016. The latest reading for inflation in Japan indicates that it stood at 0.7% by the end of June. As such, the JPY weakened considerably from its 105 yens per dollar peak in March down to JPY110.7/USD by the end of June.

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

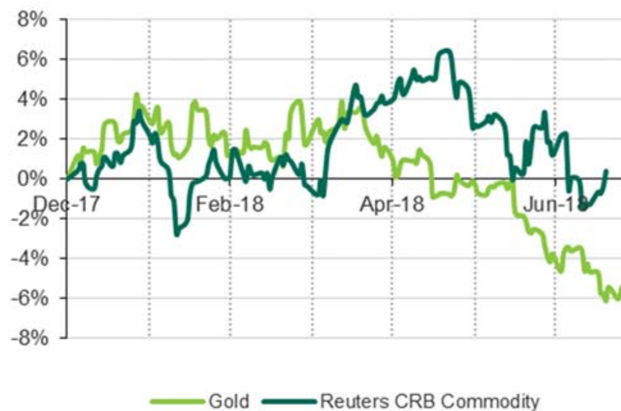
NCB الأهلي

Commodities

Base Metals Fall on a Stronger USD

Commodities have reversed course since May affected by a rallying USD, further Fed hike expectations, and lower Chinese manufacturing activity. The Bloomberg Commodity Index peaked in May at 91.6 marking a 3.9% upturn since the beginning of the year before falling throughout June and July to stand at 83.5, thus losing 5.2% YTD. Last year, China's effective efforts to curb its shadow banking sector and the aversion of a real estate market collapse have relaxed off-balance sheet lending which mostly went to metals which helped rejuvenate and boost consumer and investor confidence. The onslaught of the US/Chinese trade disputes, however, have dented the Caixin manufacturing PMI which fell to its lowest levels this year in June, posting a score of 51. Bullion have traded lower as the Federal Reserve forecast more US rate increases this year after hiking rates in June although lingering worries over trade tensions between Washington and Beijing prevented steeper losses. Agricultural commodities are expected to remain mixed as yield uncertainty is shouldered by record inventories.

Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

Copper prices fell 15.2% during 1h2018 at USD6,147.5/ton. This double-digit decline have been the outcome of speculation and worries over the US/Chinese trade levies as President Trump hinted to impose tariffs on a USD500 billion worth of imported goods from China. On the other hand, supply concerns are helping to limit the decline of copper prices as the continued ban of high-carbon footprint smelters have countered the negative implications of potential trade-war. Moreover, anti-dumping probes initiated by China which are worth USD1.3 billion will likely create an upward pressure on prices. Aluminum also tumbled double-digit from the beginning of the year affected by similar dynamics. By the end of June, the price of aluminum declined 10.5% YTD, standing at USD2,133/ton. Gold has been falling on the back of a stronger USD and Fed hikes, in addition to reduced uncertainty in Europe. On the other hand, the Fed Chairman Jerome Powell warned from potential higher inflation that the import tariffs could generate and erode domestic consumption. Hence, we expect that investor hedging against inflation in case that scenario materializes will support gold prices. After a sustained performance above the 1,300 level until May, gold prices started to slip in June, closing the month at USD1,253.8/oz, declining by 3.8% YTD. Gold will likely remain under pressure as Fed hike expectations build up with recurrent periods of uncertainty that will propel it back to the 1,300 level.

Chart 6: Base Metals

Source: Thomson Reuters

Agricultural commodities dipped to their lowest levels this year in June after five months of recovery. Goldman Sachs Agricultural index stood at 285.7 by the end of June; down by 1.8% YTD, reflecting the accumulating impact of a stronger USD. After the seasonal worries of adverse weather conditions in the US and Central America subsided, grains reversed some gains on the back of ample supply. Corn prices remained flat at 350.3 cents/bushel whereas soy beans tumbled 8.2% to 858.5 cents/bushel. On the other hand, wheat prices behaved in contrary the former soft commodities, surging by 16.5% YTD on robust demand and less supply from Eastern Europe and Russia.

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

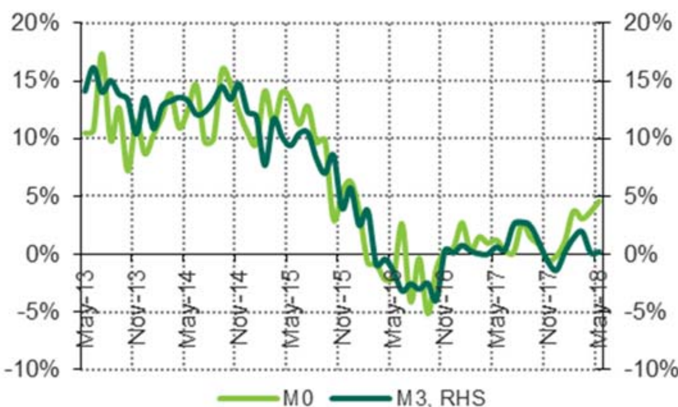
NCB الأهلي

Money & Inflation

The Depositary Base Continues to Dwindle

In the month of May, the Kingdom's broad money supply ticked down by 0.3% affected by dwindling deposits. The monetary base (M0) stood at SAR302.5 billion, rising by 4.6% Y/Y. Of the monetary base components, currency outside banks, which accounts for 58% of the monetary base grew by 8.8% Y/Y. Bank deposits with SAMA remain weak, standing at SAR98.9, whereas public financial institution deposits have been declining since October of 2017 to SAR3 billion. By annual comparison, public financial institutions tumbled by 75.7% from May of 2017 while bank deposits remained almost flat over the same period. Outstanding government bond issuances held by Saudi banks surged by 42.2% from last year, standing at SAR281.7 billion. And although crude prices are at a much better position than they were last year, the government is keeping its options open as far as tapping international debt markets is concerned. The size of future issuances is a matter of speculation although we expect a gradual approach as the issuer gauges market response and funding needs.

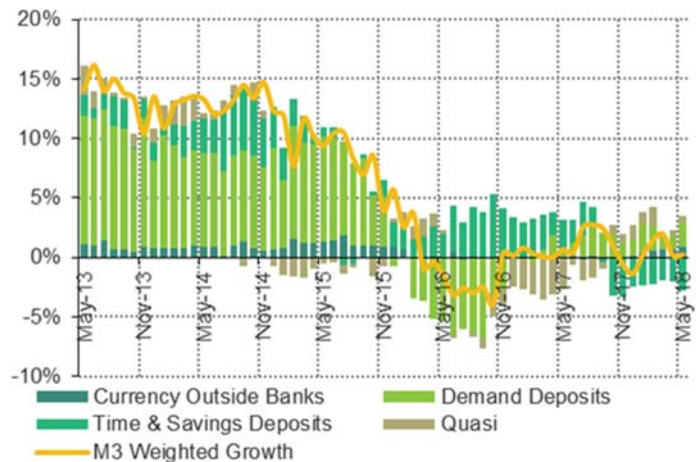
Chart 7: Growth in Monetary Aggregates



Sources: SAMA

Demand deposits, the largest component in the Saudi depositary base stands at SAR1.03 trillion as of May. Annualized comparison shows that demand deposits inched up 3.6%, marking an upswing. Deposits of business and individuals which account for 90% of demand deposits upturned by 3% Y/Y to SAR928.7 billion while government entities share of 10% was up 12% Y/Y to SAR102.8 billion. Time and savings deposits recorded the 9th consecutive month of decline which by the end of May stood at SAR405.7 billion, declining by 11% Y/Y. Moreover, quasi monetary deposits rose for the 8th consecutive month in May by 6% Y/Y, reaching SAR156.7 billion. Growth in quasi money deposits were underpinned by a 13% Y/Y growth in foreign currency deposits in the value of SAR132.9 billion. On the other hand, letters of credit tumbled 14% Y/Y to SAR14.5 billion. We expect SAMA to remain supportive of liquidity needs by utilizing appropriate easing policies and direct liquidity injections. However, as the Fed continues to normalize monetary policy, the cost of funds will likely increase in tandem, making such monetary adjustments more challenging while maintaining the USD peg.

Chart 8: Money Supply, Contribution



Sources: SAMA and NCB Estimates

The annualized inflation rate in May recorded 2.3%, the lowest reading since the beginning of the year. Since the government decided to remove energy subsidies in January, categories such as housing, utilities, and transport soared. However, as base effect sat in, we noted that inflationary pressures have subsided consequently. The downside pressure which came from food and beverages last year have shown an inflection in 2018 as the category recorded a 5.2% increase over last year. Transport remains notably 10% over last year's price levels due to subsidy removal and the levy of the VAT. The health sector shows a 3.6% increase reversing last year's negative trend. We expect inflation this year to average around 3%, a global average, which is in line with the government's price stability objective.

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

NCB الأهلي

Capital Markets
Inclusions to Provide Substantial Inflows

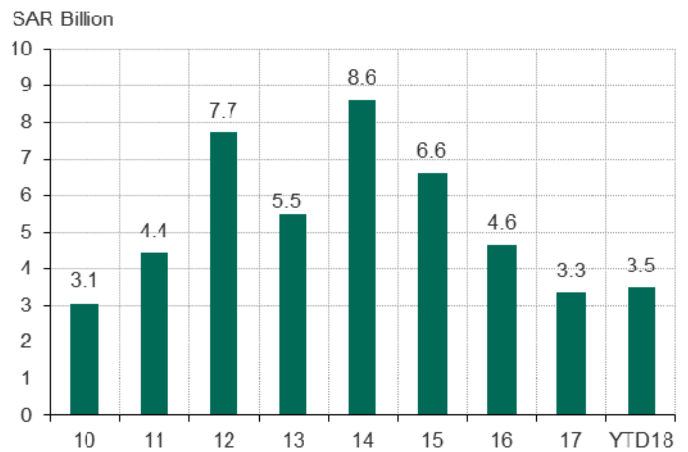
It has been a stellar run for the Saudi stock market during the first half of 2018. The index is among the top performers on a global scale, ending the month of June with a 15.1% gain since the beginning of the year. Following a series of reforms and enhancements by the Capital Market Authority and Tadawul, the largest market in the GCC has been promoted to emerging market status by FTSE Russell and MSCI. Among the notable reforms since 2015 are opening the market to foreign investors through Qualified Financial Institutions (QFI), increasing the settlement cycle from T+0 to T+2, reclassification of sectors according to GICS standards, launching the parallel market, NUMO, as a less stringent market for companies to go public, introduced real estate investment traded funds, and several enhancements to price calculation mechanisms. These regulatory and operational improvements raised the profile of the market and aligned the market with global best practices. The FTSE inclusion process will be conducted through five tranches and is estimated to reach USD5 billion worth of inflows as Tadawul will represent 2.7% in the FTSE Emerging Market index and 0.25% in the FTSE Global Equity Index Series. Meanwhile, the two-step MSCI inclusion for Tadawul will equate around 2.6% of the MSCI Emerging Markets Index by August 2019, the larger MSCI pool might raise inflows over USD50 billion.

Chart 9: Tadawul All-Share Index

Source: Tadawul

On a monthly basis, the Saudi stock market registered a growth of 1.9% last month, rebounding from May's 0.6% drop. Recently, OPEC and other oil-producing countries, namely Russia, agreed to raise production levels as oil prices rose to almost USD80/bbl and the oversupply theme has somewhat abated given the production shortages in Venezuela and Libya coupled with an expected drop in Iranian oil given the reinstated sanctions by Trump. Saudi production was raised to 10.7MMBD in June, comparatively higher than an average of 9.9MMBD in the first five months of 2018. Accordingly, these developments have reflected positively on domestic stock prices. On a sectoral level, the energy sector registered the highest gain during the month of June, rising by 7.2%, followed by the commercial and professional services sector which gained 5.9% M/M. The Media sector was the third best performer with a rise of 5.3% last month. However, the consumer durables, utilities, and retailing sectors registered declines by 6.3%, 2.7%, and 0.1%, respectively.

Chart 10: Average Daily Traded Value



Source: Tadawul

Market capitalization increased by 1.3% by the end of June to reach SAR1.98 trillion, which equates to a rise of 12.4% over the past twelve months. Meanwhile, the average daily traded value declined by 12.6% during June following May's decline of 27.9% as the Ramadan season usually mutes the market's activity. Trading has been mostly concentrated in the materials, banks, and real estate sectors representing 30.0%, 24.0%, and 15.6% of total traded values. Analyzing Tadawul's report on ownership reveals that the majority of stocks are owned by Saudi institutions with a share of 67.1% by the end of June, followed by Saudi individuals representing 25.9% of the market's ownership. QFIs have increased their investments in Tadawul by SAR11.9 billion during the first half of 2018 and we expect further increases in their ownership levels over the next year. Additionally, the valuations reached by the end of June, represented by the price-to-earnings ratio at 18.1, pose a challenge to the upside momentum of the market.

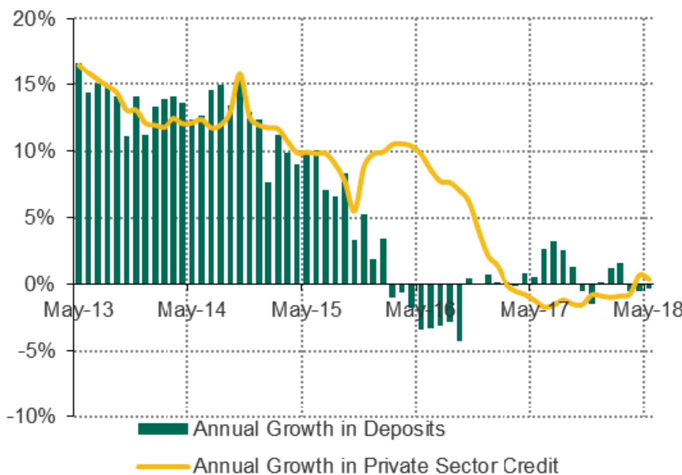
Majed A. Al Ghalib
Senior Economist | **m.alghalib@alahli.com**

NCB الأهلي

Loans Market
Credit Heads Towards Recovery

The month of May marked an inflection following 14 months of declines for credit extended by Saudi banks. Total credit reached the highest level since September 2017 at SAR1.42 trillion by the end of May, inching up by 0.1% on an annual basis. On the other hand, deposits marked the third consecutive annualized decline, sliding by 0.3%. Deposits account for 70% of total bank liabilities, and since Saudi banks adopt a conventional credit model, the capacity to lend is directly linked to the inflow of deposits. Demand deposits which make up over half the money supply (58% by May) have shown a relative improvement since March 2017 by returning to positive territory, albeit to lower single-digit growth. In May, demand deposits rose by 3.6% Y/Y, marking the 15th consecutive month of positive growth. In contrast, the propensity to save has declined, especially on the government's side, as evident by the sharp fall of time and savings deposits by 11% Y/Y in May, marking the 9th consecutive month, standing at SAR405.7 billion. Quasi monetary deposits rose up by 6.4% Y/Y, mainly due to a 12.5% Y/Y increase in foreign currency deposits which are standing at SAR132.9 billion.

Chart 11: Private Sector Financing



Sources: SAMA and NCB Estimates

On the asset side, the annual growth in private sector credit posted the first increase in over a year, albeit a minute 0.1% Y/Y, after 14 months of decline. At 30%, excess reserve ratio is at its lowest since August 2016. As demand for credit is expected to progressively rise, we believe SAMA might resort to either direct liquidity injections, reducing reserve requirements, reducing the loans-to-deposits ratio limit of 90%, or possibly a combination to tackle any shortage of liquidity and reduce the risk of a monetary drag offsetting the announced fiscal stimuli. Given the fiscal deficit of the Kingdom's finances, the funding gap is tackled via the issuance of government bonds. By the end of May, government bond holdings in local banks reached SAR281.6, surging by 42.4% Y/Y. On the other hand, Treasury bill holdings in Saudi banks have declined by 5.0% Y/Y to 13.1 billion as their need has diminished given the current dynamics. Annualized growth in credit to public sector enterprises registered the third consecutive decline this year as it fell below last year's level by 9%, standing at SAR45.6 billion. As government pursues new revenue streams, consolidates and optimizes expenditure, and utilizes untapped sources of funding such as international debt markets, we expect the liquidity to ease, underpinning the credit market and economic growth going forward.

Chart 12: Liquidity and Risk Detector

Source: Thomson Reuters

The composition of bank credit by maturity shows 50.8% is short term, valued at SAR719.4 billion. Medium-term credit accounts for 18.5% at SAR262.0 billion, while long-term credit accounts for 30.7%, standing at SAR435.3 billion. By annual comparison, short-term loans rose 1.8% Y/Y while medium-term loans edged up by 2.0%. In contrast, long-term loans declined by 3.8% Y/Y. The 3-month Saudi Interbank Offered Rate currently stands at 2.6%, slightly above SAMA's repo rate of 2.5%.

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

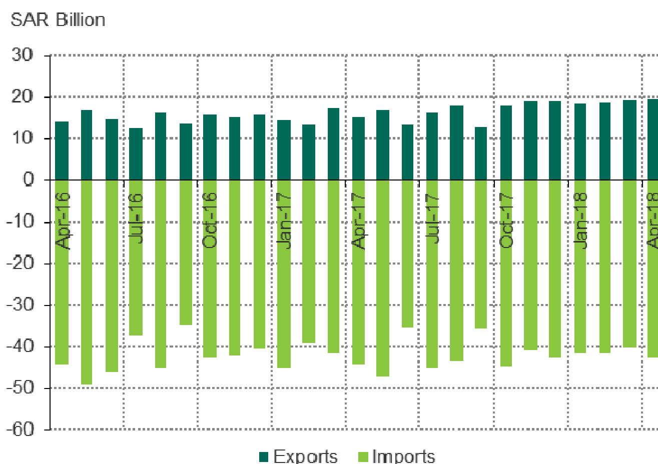
NCB الأهلي

External Trade

Non-oil Exports End the Year Positive

The Kingdom's non-oil trade figures released for the month of April show that non-oil exports surged 26.5% Y/Y valued at SAR19.5 billion. The series of gradual improvements came in tandem with recovering oil prices which have been firming up since OPEC and non-OPEC members agreed to curb oil production in order to prop up prices. Moreover, the shifting focus of Saudi exports is promising more weight for non-oil exports in the country's trade balance. This direction comes as a part of the National Transformation Plan which aims to increase the export share of nominal non-oil GDP from currently 16% to 50% by 2030. As a reflection of this reform, the Saudi non-oil private sector PMI recorded a six-month high of 55 in June from 53.2 in a month earlier. On the other hand, according to the General Authority of Statistics, imports declined 3.3% Y/Y, standing at SAR42.7 billion. The government's adoption of new efficiency measures coupled with the returning dollar strength have contributed to keeping imports muted. We expect external trade to continue to strengthen and gain momentum as the Kingdom's vision is being carried out, fostering new trade agreements such as the sizeable bilateral Saudi/UK trade and investment plan announced in March.

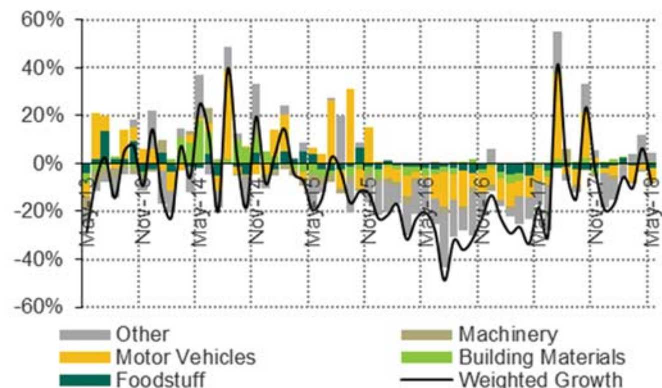
Chart 13: Saudi Non-Oil Trade Balance



Sources: GAS

By composition, the value of non-oil exports in April was concentrated in plastics and chemical products at 32.8% and 28%, respectively. Exports of plastics were valued at SAR6.4 billion surging by 37.1% Y/Y while exports of chemical products stood at SAR5.5 billion, marking a double-digit growth of 22.4% Y/Y. Exports of base metals also rose on an annual basis, posting a 29% soaring to SAR 1.7 billion. By destination, around 12.4% of non-oil exports headed to China valued at SAR2.4 billion, surging by 51.1% Y/Y. The strained trade relationships between the US and China should leave gaps for other trade partners to fill, including the Kingdom. In addition, the Chinese initiative dubbed "One Belt – One Road" which includes Saudi Arabia as an essential trade route will further enhance and streamline the trade activity between the two countries. The UAE accounted for a similar weight of exports in value terms at SAR2.4, upturning by 2.9% Y/Y. Singapore's share of the exports topped SAR1.3 billion during the month, accounting for 6.8% of the monthly total. On a Y/Y basis, exports to Singapore were up by a staggering 27.5%.

Chart 14: Attribution Analysis of Letters of Credit Opened



Sources: SAMA

On the import side, machinery and electrical equipment accounted for 22.3% of the import bill at SAR 9.5 billion, dwindling by 7.4% Y/Y. In contrast, imports of transport equipment make up around 15.8% of the import bill which at 6.7 billion have increased by 10.2% Y/Y. Moreover, imports of base metals rose by 4.2% Y/Y to SAR4.2 billion in line with improving economic activity. The largest share of the import bill came from China which at SAR6.5 billion accounted for 15.3% of the monthly total. In comparison to last year, the growth of Chinese imports to the Kingdom was almost flat. Imports from the US which account for 14.5% of imports indicate an upturn of 4.9%, standing at SAR6.2 billion. Imports from Germany declined by 2.6% to SAR2.3 billion pressured by a slowing demand in the Kingdom in addition to favorable foreign exchange rates.

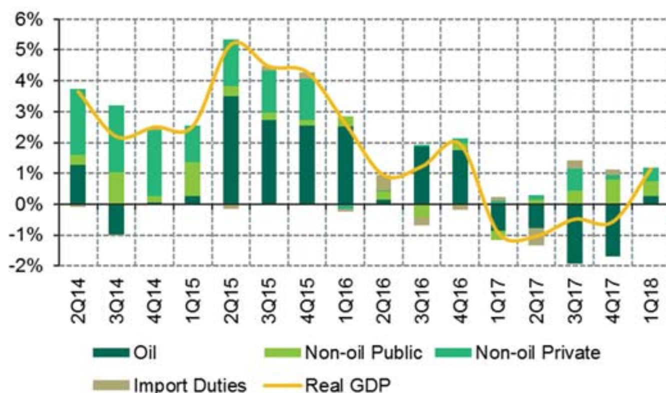
Yasser A. Al-Dawood
Associate Economist | **y.aldawood@alahli.com**

NCB الأهلي

Special Focus:
A Turning Point

Saudi Arabia slipped into recession in 2017 as the dual impact of collapsing oil prices and a transformative strategy pressured the economy. Saudi has been reliant on the inherently volatile commodity ever since the oil discovery on Saudi land in 1938. Despite numerous attempts at diversification, the oil sector remained the key driver of economic growth. Following the collapse of oil prices towards the end of 2014, Saudi's oil revenues dwindled which limited the flow of government expenditures into the economy. During previous favorable business cycle, policies to enhance the absorptive capacity resulted in significant budget overruns which had unsustainably raised the expense bill on the government. Accordingly, a new era of fiscal consolidation and adjustment had commenced in the form of Saudi Vision 2030 to avoid a repeat of the 1980s and 1990s. However, the structural shift to lessen the dependence on the government has taken its toll on domestic business activities. Real GDP had contracted in four consecutive quarters last year. In addition, real private sector growth remained near zero by the end of 2017, registering a mere 0.7% gain on an annual basis. Consequently, policymakers in the Kingdom realized the negative spillover effects and opted towards policy dynamism and a more gradual approach to stimulate economic growth going forward. The initial signs of an inflection are appearing and we believe 2018 will be the turning point.

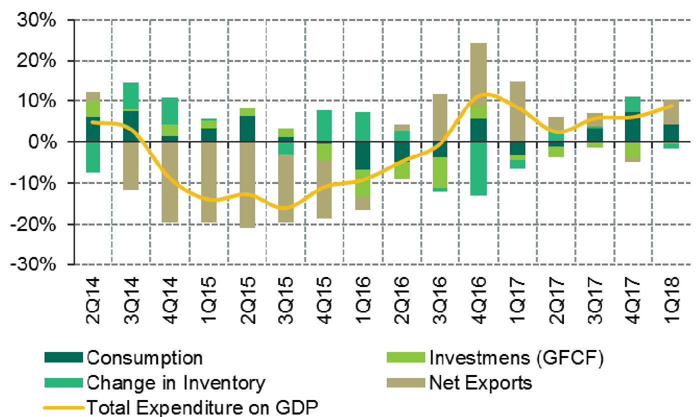
Chart 15: Real GDP, Contribution



Source: General Authority for Statistics, NCB

The latest figures released by the General Authority for Statistics reveal a rebound in Saudi real GDP through the first quarter by registering a gain of 1.2% on an annual basis. The oil sector, which constituted the main drag in 2017, registered a growth of 0.6% Y/Y as oil production was marginally higher by 0.7% Y/Y during the first three months of 2018. Additionally, the non-oil sector increased by 1.6% annually, underpinned by a 2.7% Y/Y expansion in the government sector. Efficiency and viability has been the adopted strategy in capital expenditures as the Spending Rationalization office was handed the task of reviewing SAR1.4 trillion worth of projects in 2016. Furthermore, rising capital expenditure allocations, National Transformation Plan stimulus, the PIF strategy, and government support measures will contribute to economic growth over the secular horizon. As for the non-oil private sector, challenges remain despite the a rise of 1.1% on an annual basis in the first quarter, a slight improvement in comparison to 2017's 0.7% gain. Going forward, we expect the government to maintain a considerable contribution to growth especially as new sectors are being established and developed, which are initially considered riskier for the private sector, coupled with additional unplanned oil revenues.

Chart 16: Expenditure on GDP, Contribution



Source: General Authority for Statistics, NCB

Nominally, Saudi GDP gained 8.8% on an annual basis, underpinned by elevated oil prices which were 23.5% higher through the first three months of 2018 compared to the same period of 2017. Meanwhile, gross fixed capital formation recorded a decline at 2.3% annually, the fifth consecutive contraction albeit the smallest. The construction sector continues to struggle, evident by the quarterly contraction of 1.7% Y/Y in nominal terms, the ninth consecutive decline. According to GOSI, total employment was reduced by 698,124 workers since the end of 2016, out of which 442,155 came from the construction sector. However, according to MEED Projects, awarded construction contracts have increased by 17.5% during the first half of 2018, indicating an increase in construction activity within the next 6-12 months. In our projections, we upwardly revised real GDP growth from 1.6% to 2.6% in 2018 and from 1.9% to 2.7% in 2019.

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

NCB الأهلي

The Economics Department Research Team

Head of Research

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

Macroeconomic Analysis

Tamer El Zayat
Senior Economist/Editor
t.zayat@alahli.com

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

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

Sector Analysis

Ahmed Maghrabi
Economist
a.maghrabi@alahli.com

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

Sultan Mandili
Associate Economist
s.mandili@alahli.com

Economic Update Analysis

Amal Baswaid
Senior Economist
a.baswaid@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

Disclaimer:

The information and opinions in this research report were prepared by The Economics Department of The National Commercial Bank (NCB) and are only and specifically intended for general information and discussion purposes only and should not be construed, and should not constitute, as an advertisement, recommendation, invitation, offer or a solicitation of an offer to buy or sell or issue, or invitation to purchase or subscribe, underwrite, participate, or otherwise acquire any securities, financial instruments, or issues in any jurisdiction.

Opinions, estimates and projections expressed in this report constitute the current opinion of the author(s) as of the date of this report and that they do not necessarily reflect either the position or the opinion of NCB as to the subject matter thereof. NCB is not under any obligation to update or keep current the information contained and opinions expressed herein and accordingly are subject to change without notice. Thus, NCB, its directors, officers, advisors, employees, staff or representatives make no declaration, pronouncement, representation, express or implied, as to the accuracy, completeness or fairness of the information, estimations, opinions expressed herein and any reliance you placed on them will be at your own risk without any recourse to NCB whatsoever. Neither should this report be treated as giving a tax, accounting, legal, investment, professional or expert advice.

This report may not contain all material terms, data or information and itself should not form the basis of any investment decision and no reliance may be placed for any purposes whatever on the information, data, analyses or opinions contained herein. You are advised to consult, and make your own determination, with your own independent legal, professional, accounting, investment, tax and other professional advisors prior to making any decision hereon.

This report may not be reproduced, distributed, transmitted, published or further distributed to any person, directly or indirectly, in whole or in part, by any medium or in any form, digital or otherwise, for any purpose or under any circumstances, by any person for any purpose without NCB's prior written consent. NCB reserves the right to protect its interests and take legal action against any person or entity who has been deemed by NCB to be in direct violation of NCB's rights and interest including, but not limited to, its intellectual property.