

Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

Contents

3	<i>Oil Market</i>
4	<i>Foreign Exchange</i>
5	<i>Commodities</i>
6	<i>Money and Inflation</i>
7	<i>Capital Markets</i>
8	<i>Loans Market</i>
9	<i>External Trade</i>
10	<i>Special Focus: Cement Sector</i>

Executive Summary

- The flow of global oil supply and demand data has been relatively positive recently, creating some momentum for demand prospects with Brent approaching USD113 per barrel.
- The situation still holds much obscurity concerning the fate of the Euro as mixed sentiments arise from weakening Chinese data and the expectation of the Euro bond short-selling ban; such ban should lay a cap on yields at current levels causing a large-scale squeeze in bonds.
- Extreme drought conditions that have plagued most of the US, affecting both their corn and soybean harvest, as well as speculative trading in anticipation of slashed production forecasts, to be released by the USDA, are applying upward pressure on prices.
- Despite experiencing suppressed interest rates, the local banking system managed to attract time and saving deposits and increase their share of M3 to 24% following their record low figure of 23% during April.
- The primary equity market is expected to remain inactive through August, yet there is one announced IPO for September to raise almost SAR100 million for City Cement Company.
- The share of medium term credit has gained to a record 17.8% as banks have been drawn to finance SMEs on larger scale to diversify their portfolios. As a result of the pickup in lending activity, the L/D ratio has been supported to reach 80.7% for June.

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.alddawood@alahli.com

View of the Month

'Prosperous Cement Market'

A key challenge to the sector is the ongoing export ban, which will serve to constrain growth for Saudi cement producers. In the almost four years since its introduction, neighboring and regional countries have developed their cement markets, becoming substitutes to the Saudi production.

Macroeconomic Indicators

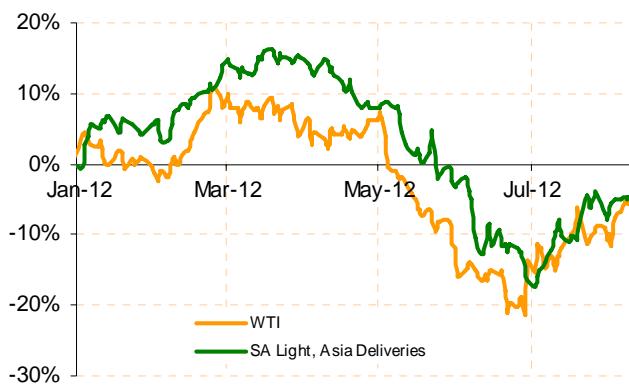
	2007	2008	2009	2010	2011P	2012F	2013F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	68.3	94.9	59.2	77.6	108.1	105.0	100.0
Average Daily Crude Oil Production, MMBD	8.8	9.2	8.2	8.2	9.3	9.4	9.7
GDP at Current Market Prices, SAR billion	1,442.6	1,786.1	1,412.6	1,679.1	2,163.1	2,217.9	2,272.3
GDP at Current Market Prices, USD billion	385.2	476.9	377.2	447.8	577.6	592.2	606.8
Real GDP Growth Rate	2.0%	4.2%	0.1%	4.6%	6.8%	3.9%	4.4%
Oil Sector GDP Growth Rate	(3.6%)	4.2%	(7.8%)	2.4%	4.3%	1.8%	3.2%
Non-oil Sector GDP Growth Rate	4.7%	4.3%	3.5%	5.5%	7.8%	4.7%	4.9%
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%	3.0%	3.0%	3.0%
GDP /Capita, USD	15,444.2	18,495.4	14,147.9	16,244.8	20,344.8	20,252.6	20,144.9
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	254.6	253.4
Oil Exports, USD billion	205.3	281.0	163.1	215.2	317.6	335.9	330.1
Non-oil Exports, USD billion	27.8	32.3	29.1	35.8	46.9	45.8	53.7
Merchandise Imports, USD billion	(81.5)	(100.6)	(86.4)	(96.7)	(119.1)	(127.1)	(130.4)
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	151.7	150.4
Current Account Balance/GDP	24.2%	27.7%	5.6%	14.9%	27.4%	25.6%	24.8%
Net Foreign Assets with SAMA, USD billion	301.3	438.5	405.9	441.0	535.9	636.7	702.7
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	380.0	410.0	475.0	540.0	580.0	690.0	759.0
Actual Revenues, SAR billion	642.8	1101.0	509.8	741.6	1110.0	1092.5	1075.7
Actual Expenditure, SAR billion	466.2	520.1	596.4	653.9	804.0	771.8	818.2
Expenditure Overrun, %	22.7%	26.8%	25.6%	21.1%	38.6%	11.9%	7.8%
Total Revenues/GDP	44.6%	61.6%	36.1%	44.2%	51.3%	49.3%	47.3%
Total Expenditure/GDP	32.3%	29.1%	42.2%	38.9%	37.2%	34.8%	36.0%
Overall Budget Balance, SAR billion	176.6	580.9	(86.6)	87.7	306.0	320.7	257.5
Budget Balance/GDP	12.2%	32.5%	(6.1%)	5.2%	14.1%	14.5%	11.3%
Break-Even Oil Price	40.5	40.2	60.8	64.1	70.4	65.4	67.6
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%	10.9%	11.4%
Growth in Credit to the Private Sector	20.6%	27.9%	-0.6%	4.8%	11.0%	12.7%	14.0%
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%	0.5%	0.8%
Spread, in Basis Points, SAIBOR-LIBOR	(31.9)	29.7	17.5	38.0	39.5	30.0	25.0

Oil Market

Prices Rebound

Crude oil prices took recovery recently, reaching their highest levels since mid-May with Brent approaching USD113 per barrel. The market sentiment has become more positive, trending upward, as the scale of the rally since June 22nd is nearing 30%, and reaching in absolute terms around USD25 per barrel. While the USD110 level was attained fairly easily, the USD115 appears achievable on the current trend in fundamental data and, especially, geopolitical developments. The factors that have been driving this rally include: 1) supply and demand fundamentals, attributed to prompt market tightness and a series of outages and disruptions, and combined with modest demand and weaker prospects for non-OPEC supply; 2) geopolitical developments, which have been intensifying on the escalation of violence in Syria with potential spillovers of the conflict into the region, as seen by upsurge of violence in Iraq, attacks on pipeline in Turkey, and increase in international tension over Iran's nuclear program; 3) the macroeconomic context, with Euro-sovereign debt worries currently being treated less critical, yet still represent the main mitigating factor for any lengthening of the oil prices rally.

Chart 1: Oil Price Developments, YTD

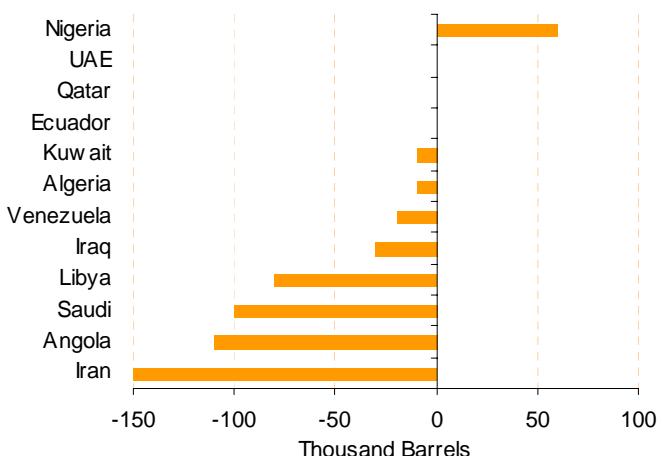


Source: Thompson Reuters

The flow of global supply and demand data has been relatively positive recently, creating some momentum for demand prospects. In its monthly oil market report, OPEC has changed demand outlook, revising expected growth for 2012 up by 0.01 mmbd to 0.9 mmbd, and revising 2013 down by 0.01 mmbd to 0.81 mmbd. Complementing OPEC's projections, after being bearish on the prospects for demand in its previous report, US Energy Information Administration (EIA) went back the other way in its latest report, increasing the 2012 demand

growth forecast from 0.67 mmbd to 0.76 mmbd, and the 2013 forecast from 0.73 mmbd to 0.87 mmbd. The non-OPEC supply growth forecast was cut from 0.75 mmbd to 0.57 mmbd for 2012, and kept unchanged at 1.26 mmbd for 2013. Accordingly, the implied call on OPEC crude would increase by about 0.5 mmbd for both 2012 and 2013. EIA revised its estimate of the call on OPEC crude for Q3 up by 0.2 mmbd to 31.5. It, also, projected that surplus capacity in OPEC will average 2.3 million barrels a day in 2012 and 2.6 million in 2013. The general trend in the forecasts appears to reinforce Q3 as being likely to be the tightest quarter of the year from a fundamental viewpoint.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

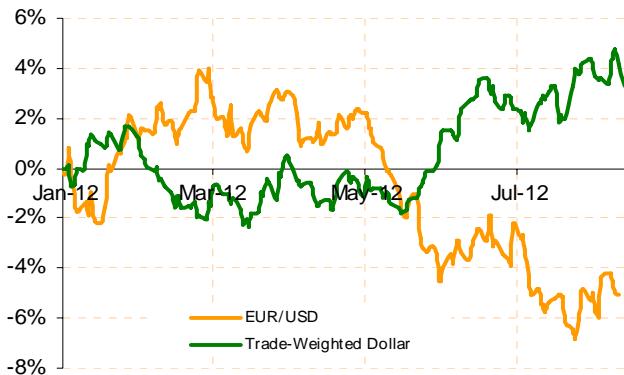
Iraq's crude output averaged 3.08 mmbd in July for the first time since the 2003 U.S.-led invasion, 115,000 barrels more than the previous month. Iraq for a second month outpaced Iran, whose output fell by 173,000 barrels. Shipments from Iran have declined by 1.2 million barrels a day, or 52% since the sanctions banning the purchase, transport, financing and insuring of Iranian crude took effect July 1st. It is estimated that Iran is exporting 1.1 mmbd of oil, down from an average of 2.3 mmbd in 2011. Daily production fell by 9.5% in July to 2.86 million barrels, the lowest level since February 1990. The reduction from Iran led to the third monthly decline in OPEC's output, reaching 31.2 mmbd in July, versus 31.35 mmbd in June. While Crude oil output in Nigeria reached an all-time high of 2.4mmbd after security improved in the southern oil-producing region, Saudi Arabian crude oil production was cut by 0.3 mmbd in July, taking it below 10 mmbd.

Foreign Exchange

EUR: What Light at the End of the Tunnel?

In continuation to the ongoing European conundrum, FX trade over the month of July suffered another hammer-blow in the European market as the Euro continued to debase, closing at 1.229 against the USD last week. The Euro lost almost 3% of its value against the USD on the back of weak companies and jobs data, which sustained a huge hit. According to EuroStat, after 14 consecutive months of rising unemployment, the seasonally adjusted rate currently stands at 11.2%, a record high, while inflation continues to hover around 2.4%. The odds proceed to stack up against the Euro zone leaders as they are over crumbed by the phenomenal task of saving the 17 bloc economy. The situation still holds much obscurity concerning the fate of the currency as mixed sentiments arise from weakening Chinese data and the expectation of the Euro bond short-selling ban; such ban should lay a cap on yields at current levels causing a large-scale squeeze in bonds.

Chart 3: Trade-Weighted Dollar and the Euro



Source: Thompson Reuters

The USD/JPY bounced down to 78.15 as worries regarding the slowing pace of China and the global economy resulted in increasing risk aversion, and thus, pressuring the JPY. Downbeat consumer confidence played a major cause after the Bank of Japan refrained from monetary loosening, irrespective of the IMF's recent statement that the Yen's exchange rate is moderately overvalued. Meanwhile, attention is turned towards the Fed in anticipation of any plans to stimulate the US economic recovery to boost the global economy while the Japanese currency's risk revulsion continues to act as the safe haven of choice. The Chinese Yuan inched lower as it closed at 6.3608 losing 0.1% since end of June versus the USD on the back of weakening interna-

tional trade, as well as a slowing domestic economy, posting its first annual decline this year since 2005. China's economic growth slowed to 7.6% Y/Y, which is the slowest pace in more than three years. Additionally, the Mexican Peso depreciated by 2.1% against the USD as it closed at 13.09 by the end of July. This, by large, is attributed to the slowdown of US/Mexican trade which in turn reflects a weakening consumer demand on goods and services between the two countries. The Chilean Peso closed at 483.2, losing 3.5% versus the USD, largely afflicted by slowing US trade. On the other hand, the Brazilian Real gained 3.62% against the USD, closing at 2.057 by the end of July after Bernanke renewed his commitment to act should the economy face further deterioration. However, no clear statements were made regarding a new stimulus package.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thompson Reuters

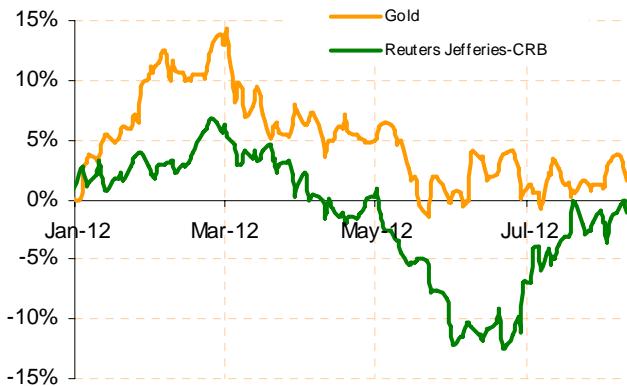
The Trade-Weighted Dollar closed at 82.6, gaining 0.9% over a basket of currencies, including the troubled EUR. The sense of unceasing tensions of the Euro zone and China give the USD a contrived momentum in the absence of real market catalysts. Although the European Central Bank pledged to purchase Euro debt, such purchases are stringent on the criteria of the European Stability Mechanism while is yet to prove its efficacy at preserving the status quo.

Commodities

Propelling Forward After a Bearish Start

Commodities rallied for the period that marked the end of July's trading week. Spurred by an expansion of 163,000 workers in non-farm payrolls, the US Labor Department's data sent optimism afresh through the market. The weighted greenback traded lower as it dropped from its peak on July 24th at 84 down to 82.553 by the end of last week, losing 1.7% during the period. The cheaper dollar, in addition to EIA data reflecting a decline of 6.5 million barrels in US crude inventories, led to a rebound in crude prices. WTI closed at USD91.40/ barrel, increasing by 4.90% and Brent closing at USD109.54/ barrel for the same period. Throughout the month of July, prices averaged at USD88/ barrel and USD100/ barrel for WTI and Brent, respectively. ICE Futures European volumes for the two contracts were approximately 2.64 million and 13.1 million. Arab Light continued to climb, increasing by approximately 8% in July to settle at USD104.25/ barrel.

Chart 5: Reuters Jefferies vs. Gold



Source: Thompson Reuters

Bullish sentiment also spilled into other classes, with the yellow metal closing at above the USD1,600/ ounce mark, after hovering at an average of USD1,586/ ounce for the majority of the month. Nonetheless, its approximate 1% gain during July is minimal and remains lower than June's 2.3%. This signals, that although there appears to be an upward trajectory in the interim in precious metals, the positive commodity price momentum has stalled this year. US gold futures for September delivery closed at USD1,592.8/ ounce with that for December delivery rising by USD18.60 to USD1,609.30/ ounce. However, both copper and aluminum closed the trading week of August 3rd lower, falling 2% to USD7,445/ tonne and 3% to USD1,860/ tonne, respectively.

The grain complex witnessed a boost in prices on the back of extreme drought conditions that have plagued most of the US—especially the Midwest according to data from the US Drought Monitor—affecting both their corn and soybean harvest. Speculative trading in anticipation of slashed production forecasts, to be released by the USDA, is also applying upward pressure. Corn for December delivery rose to USD8.075/ bushel, with the agricultural commodity having reached an all-time high of USD8.205/ bushel on July 31st. Soybean for November delivery rose to USD16.2875/ bushel. Damaged crops in Europe and Australia and news of Russia imposing a 30% export tax pushed wheat prices higher.

Chart 6: Base Metals



Source: Thompson Reuters

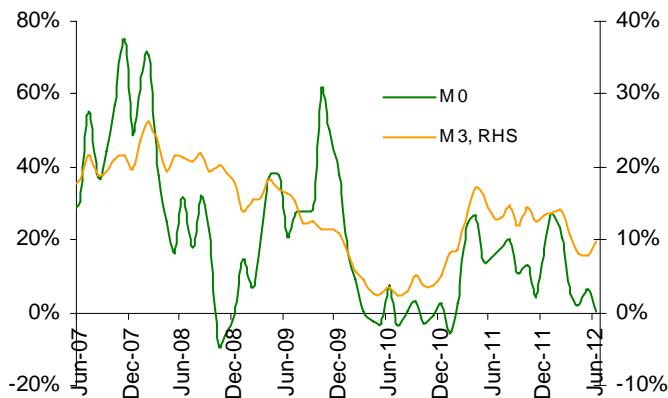
The month of July also saw cocoa futures jump to the upper range of their trading pattern with prices settling at USD2,398/ metric ton for September delivery by the end of the trading period. Poor quality cocoa beans emerging from the Ivory Coast and Ghana in addition to the growing concern of El Nino—change in the current of the pacific ocean—threatening global supplies are contributing factors. However, there have also been signs of weakening demand. The European Cocoa Association grind stats showed an 18% decrease in Q2 of this year. Similarly, the National Confectioner's Association which covers grinds for the US, Canada and Mexico reflected a fall of 9.8% for the same period. Grindings gauge demand as they measure the tons of cocoa beans to be processed.

Money & Inflation

Broad Money Expands, Inflation Subdues!

The Saudi economy continues to maintain an upwards trajectory and record robust growth figures despite the fragility of the global economy. This has been partially driven by utilizing large amounts of excess liquidity and benefiting from the cautious approach of the financial system last year. The monetary base (M0) recorded its slowest growth as it remained almost stagnant during June with a 0.2% annual change, a slight gain of SAR510 million. This was mainly attributed to local banks withdrawing SAR10.4 billion from SAMA as their deposits now rest at SAR120.7 billion, the lowest level this year. Meanwhile, cash in vault and currency outside banks rose by 23.1% and 7.5%, respectively, on an annual basis due to the Ramadan season. This is expected to slow down after the Holy month and pick up again during Hajj.

Chart 7: Growth in Monetary Aggregates

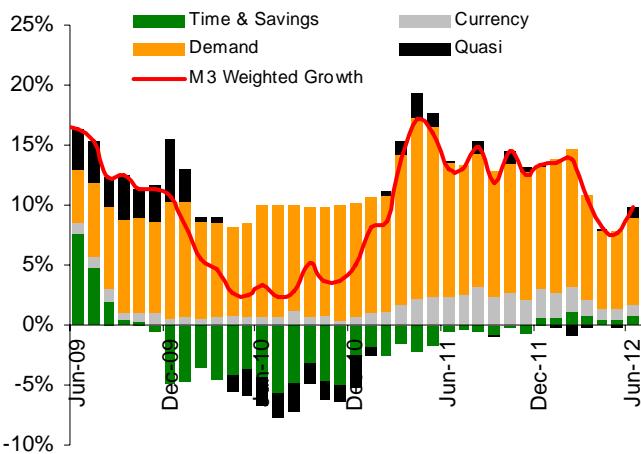


Source: SAMA, NCB Estimates

As for broad money (M3), growth remained well below 2011's performance, recording 9.8% Y/Y during June. However, it comes as a healthy rebound from May's growth of 7.7% Y/Y. The main driver of M3 continues to be demand deposits which gained by 14.4% in June over the same month last year. Nonetheless, the level of demand deposits has somewhat stagnated during the second quarter of 2012 on a monthly basis. Meanwhile, time and saving deposits have held their positive trajectory for the seventh consecutive month as they expanded by 3.6% Y/Y. Despite experiencing suppressed interest rates, the local banking system managed to attract time and saving deposits and increase their share of M3 to 24% following their record low figure of 23% during April. We expect their growth to remain sluggish throughout the third quarter of 2012. Additionally, we

expect M3 to post an annual growth for 2012 at 10.9%, a more conservative figure than the International Monetary Fund's (IMF) 12.2% projection.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Inflationary pressures have eased once more as June's rate dropped to 4.9%, the lowest level since August 2011. The drop was mostly attributed to the decelerating rate of real estate and rental prices which fall under the category of renovation, rent, fuel & water. The elevated prices have prompted officials to follow through with the mortgage law. However, the effect of the soon to be formulated law is still to be seen and is expected to have an impact over the medium and long term. During June, the category of renovation, rent, fuel & water posted an annual rate of 8.8%, the lowest this year. Additionally, food and beverage prices recorded 4.7% Y/Y as the Holy month of Ramadan drives prices upwards. Furthermore, imported inflation has a great influence on local prices as the economy heavily relies on imports. Similar to M0 components, local food prices should ease for coming few months and pick up again as we near Hajj. Nevertheless, the inflation rate is projected to remain between 4.5% - 5% for 2012.

Given the fact that the Saudi Riyal is pegged to the US Dollar, the benchmark policy rate is expected to remain unchanged for an extended period. The IMF has recently remarked on the conduct of Saudi monetary policy as "the use of macroprudential and liquidity management tools remains key to effective policymaking". The Saudi Arabian Monetary Agency has steered the Saudi economy through the global financial crisis and is keen on supporting and maintaining the growth of the economy by managing its monetary tools effectively.

Capital Markets

Activity Rebounds Slightly

On a global scale, equity markets have recorded gains for the month of July. The European Central Bank (ECB) attempted to ease some of the concerns of investors last month. Stock prices continued to gain going into August as ECB President, Draghi, reassured the survival of the Euro. The global MSCI index rose by 1.3% during July and a further 2.3% since the beginning of August. The sole Saudi stock market, Tadawul, followed suit with a gain of 2.5% for the month of July. The index remained range bound and traded within 300 points but managed to rise 7.2% YTD. The only sector to record a loss was cement, losing 1.2% M/M. Meanwhile, the top performers were insurance, media, and agriculture registering 18.6%, 10.0%, and 6.8%, respectively, on a monthly basis. The upsurge in insurance stocks is largely attributed to speculative trading. On the other hand, "blue chip" sectors, namely petrochemicals and banking, recorded a healthy gain of 1.8% and 1.7% M/M, respectively. Tadawul seems likely to end Ramadan sessions on a positive note as it hovers around the 7'000 level going into the last week of trading.

Chart 9: Tadawul All-Share Index

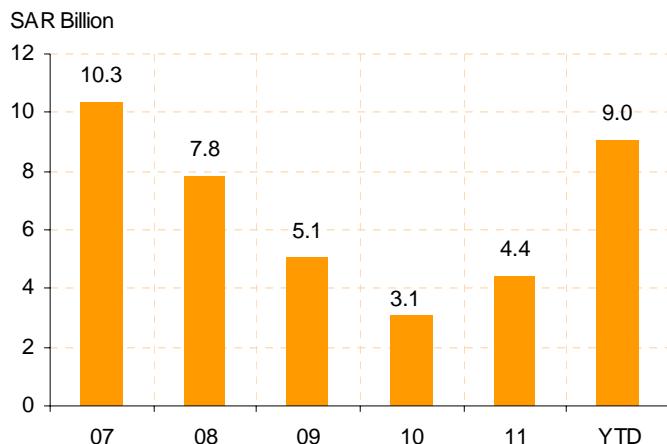


Source: Tadawul

Investor appetite continues to deteriorate on a monthly basis as July's daily traded volumes averaged at SAR6.0 billion following June's SAR6.2 billion. However, over the past two weeks, the level of activity started to gain by averaging close to SAR7 billion during August through to last Wednesday. The weaker appetite in comparison to the level of activity seen earlier this year can be attributed to the reduced attractiveness of the riskier assets during the Ramadan and the anticipation of second quarter corporate earnings which also occurs during the peak of the summer holidays. Tadawul, whether

compared on an annual or monthly basis, is on the right track taking into consideration the market's P/E ratio which stood at 12.25 by the end of last month. Furthermore, market capitalization expanded by 7.5% Y/Y by the end of July to reach SAR1.37 trillion. The composition of trading between different types of investors, Saudis, GCC citizens, Arabs, and foreigners, holds relatively the same weights and the distribution is not expected to change anytime soon. The Capital Market Authority needs to develop easier processes for non-Saudis to trade in the local stocks to add depth and scope to the market.

Chart 10: Average Daily Traded Value



Source: Tadawul

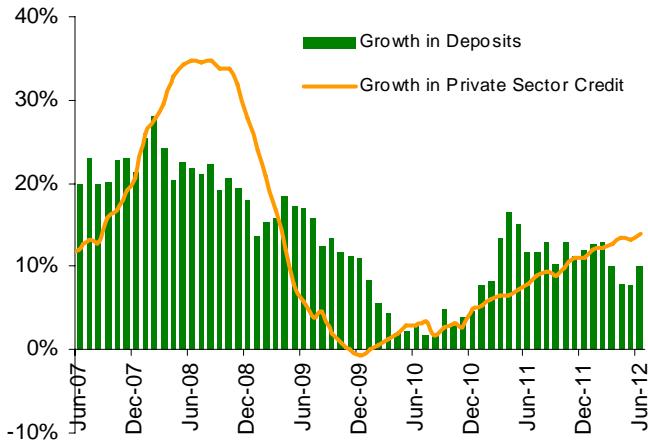
The primary market was nonexistent last month with no initial public offerings (IPO). The last IPO in the Saudi market, Saudi Airlines Catering Co., was listed in the market, the 154th stock in Tadawul. Additionally, Zain telecommunications, which was burdened with large amounts of debt, decreased its paid up capital to SAR4.8 billion but only to raise another SAR6 billion through rights issuance. The primary market is expected to remain inactive through August, yet there is one announced IPO for September to raise almost SAR100 million for City Cement Company.

Loans Market

Building and Construction Loans Hike

Saudi banks' force of lending is largely driven by the level of deposits they accumulate. Following rigorous rules and regulations set by SAMA, deposits are the main component in deriving the level of financing the bank can write on their balances. Local banks have amassed large levels of deposits over the past couple of years and have been rather stringent in lending. This has pressured the loans-to-deposits ratio to as low as 74.8% during April last year. However, towards the end of 2011, Saudi banks have started to utilize the liquid situation and expand their loans portfolios. The pace of growing deposits has decelerated during the first half of 2012, recording a gain of 10.1% during June against the same month last year. Following May's relatively modest 7.6% Y/Y growth, June's rise was attributed to the sudden surge of other quasi-monetary deposits which are largely composed of foreign currency deposits, the latter expanding in June by 12.1% on an annual basis.

Chart 11: Private Sector Financing



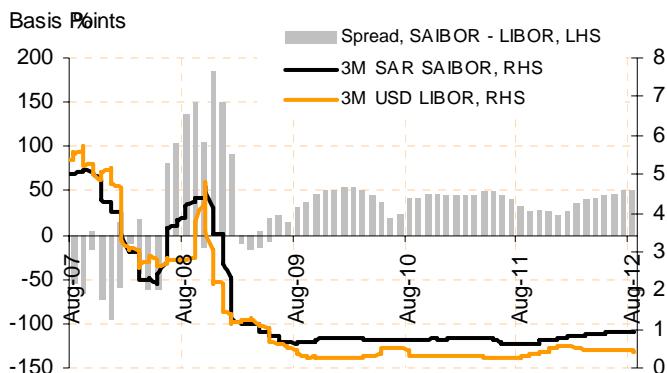
Source: SAMA, NCB Estimates

The combined loans portfolio for local banks reached an all-time high during June at SAR936.7 billion, a 15.1% gain over June 2011. During the first half of 2012, banks have increased their balance sheets by SAR80.1 billion in fresh lending, almost the same amount for the whole of 2011 which stood at SAR81.3 billion. However, the maturities of the newly added assets differ from last years'. The focus has shifted to medium and short-term credit as oppose to long-term credit. The share of medium term credit has gained to a record 17.8% as banks have been drawn to finance SMEs on larger scale to diversify their portfolios. As a result of the pickup in lend-

ing activity, the L/D ratio has been supported to reach 80.7% for June.

As for the private sector, total claims expanded by 13.9% on an annual basis during June. Furthermore, credit to the building and construction posted the highest growth across all economic activities increasing by 49.4% Y/Y to reach SAR73.4 billion. This hardly comes as a surprise as NCB's Construction Index reached 309.12 by the end of the second quarter of 2012. The building and construction sector will remain one of the strongest for the next few years as demand is far ahead of current supply levels. Additionally, the services sector posted the second highest growth at 47.1% Y/Y, followed by the utilities and health service at 45.6% Y/Y. Meanwhile, total claims on the public sector contracted by 8.7% Y/Y as the level of treasury bills dropped drastically, which followed the elevated issuances last year in an attempt from SAMA to mop up excess liquidity in the market.

Chart 12: Liquidity and Risk Detector



Source: Thompson Reuters

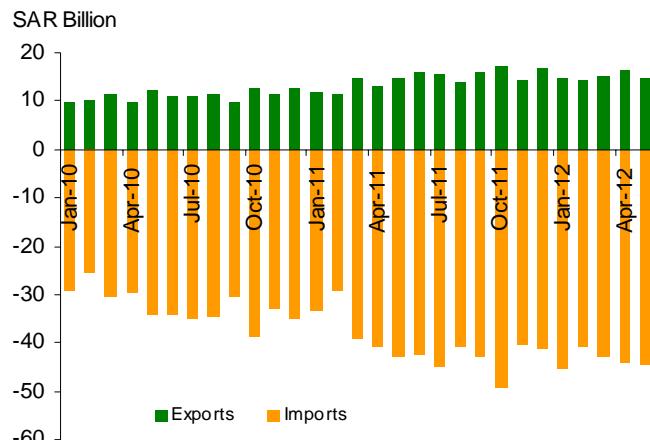
As the US Fed is expected to keep the interest rate at near zero till 2014, Saudi is likely to echo the decision by maintaining the current policy rate. Currently, inflationary pressures are subdued and price hikes can be handled by nonconventional methods such as adjusting the required reserve requirement, a decision opted by SAMA in 2008. The Saudi interbank overnight rate (SAIBOR) gained marginally but remains under 100bps which creates a very accommodative environment for banks to easily manage cash levels in order to expand their balance sheet items and support local business and the economy as a whole.

External Trade

Exports Resist Global Qualm

According to the Central Department of Statistics and Information (CDSI), overall Saudi exports increased by SAR50 million Y/Y during May after they registered SAR14.8 billion. This shows resilience despite the ubiquitous growing pains predominating international trade. In export categories, Petrochemicals, with SAR5.5 billion in value terms represent a sizable 37.2% of all non-oil exports. Save a retraction of 3% month on, it marked the highest surge of all exports over the course of the past 12 months of 14.8%. Plastics ranked second amounting to 29.9% of exports. Notably, Food Stuffs was the only category that displayed a monthly upward trend with 7.1% M/M, in addition to a 6.2% increase year on. Base metals showed the biggest yearly decline of 11.2% with a monthly downturn of 13%.

Chart 13: Saudi Non-Oil Trade Balance



Source: CDSI, NCB Estimates

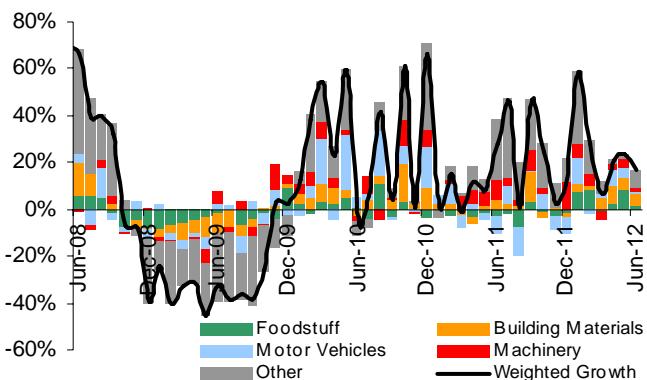
As for exports by country groups, the European Union (EU), which accounts for 12% of exports predictably marked the sharpest downslope in both annual and monthly data as their imports of the kingdom's non-oil exports landed with a thud, recording -9.8% and -17.3%, respectively. The GCC's Y/Y upturn of 3.5% suggests that it remains minimally affected by the Euro zone's uncertainties. Meanwhile, Singapore also shows a remarkable upturn in May by 44%, compared with last year. In addition, India increased its dependency on the kingdom's non-oil exports, rising by 19.8% on an annual basis.

On the other hand, Saudi imports jumped by a slight 1% since April, recording a 4.2% increment over last year.

Heavily revolving around Machinery and Mechanical Appliances, which accounts for over 26% of all imports, it swelled by 5.4 M/M and a 4.8 Y/Y. Second in proportion was Transport Equipment, which notably rose by 53.5% compared to the same month last year. Food stuffs demonstrated a 4.2% rise in May this year compared with the last; however, it shrank by 1.3% M/M.

The EU, the second biggest exporter of Saudi imports also exhibited a boost of 2.7% M/M, and a 10% Y/Y. China, United States, and Japan all showed Y/Y surges of 7.9%, 28.4%, and 113.4% respectively. GCC intra-trade balance shows that the kingdom imports are valued at SAR3.7 billion in May 2012.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

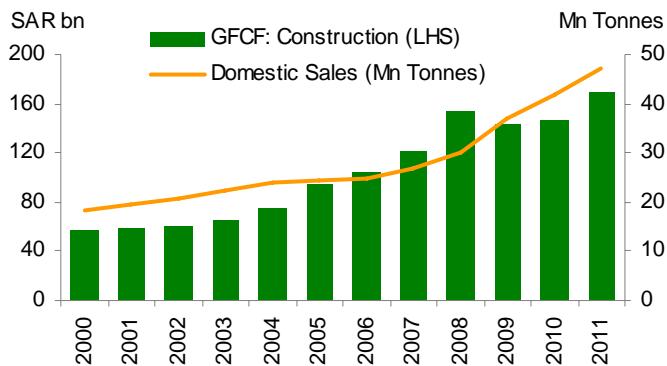
Settled Letters of Credit (LCs) grew by 16.3% annually in June, while gaining a margin of 1.9% over the previous month. With the exception of Sugar, Tea and Coffee which retrenched by 30% M/M and a 58.6% Y/Y, Foodstuff were denoted by a positive net change of 24% compared with June, and a 9.6% downturn compared with last year. Food Grains registered a 19.9% increment following two months of decrease. Fruits and Vegetables were boosted by 41.7%, while Livestock and Meat accrued 2.4%. Building Materials downsized by 4.1% monthly; however, it managed to boost up by 41.8% annually. Motor Vehicles went up by 29.6% Y/Y, marking a 9% growth over the past month. Machinery went up by 70.2% Y/Y, a 2.4% increase over June. Although deemed expansive on an annual basis, gaining 17.1%, newly opened LCs for June express a retraction as the defining trait in comparison with May. On a monthly basis, the main categories dropped by 51% in Foodstuff, 7% in Building Materials, 41% in Motor Vehicle, and a 4% in Machinery. However, on Y/Y basis, they surged by 29%, 57%, 6%, and 10%, respectively.

Special Focus: Prosperous Cement Market

The Saudi cement sector is fuelled by strong domestic fundamentals, namely: (1) the government's continued high expenditure on physical and social infrastructure, driven by positive oil price movements, and buoyed by a young demographic structure; (2) relatively low fuel and raw material costs as a result of the subsidized power/gas, and minimal royalty mining fees, sustaining domestic producers' competitive advantage; and (3) new market entrants, leading to an influx in capacity dispersed geographically in areas of concentrated demand.

The size of the current cement market can be determined using the Kingdom's construction activity as a proxy. Given the recent spike in construction, it is important to differentiate between core demand and transient demand for cement. Core is identified as the 2002-2006 CAGR demand for cement, which was equivalent to 5%. This period is generally representative of a natural business cycle for the Kingdom, excluding the intermittent construction boom. Transient is that generated from ongoing mega-project construction activity which we have identified as commencing in 2007. Using the 2007-2011 CAGR of 15%, it can be assumed that the differential 10% represents transient demand because this trend is unlikely to continue in the long-term as the pace of new projects is likely to slow in the medium-term. Consequently, while in absolute terms transient demand appears to have increased since 2007, the overall growth trajectory is decelerating, with transient demand decreasing by 30.9% in 2011.

Chart 15: Cement Domestic Sales vs Construction GFCF

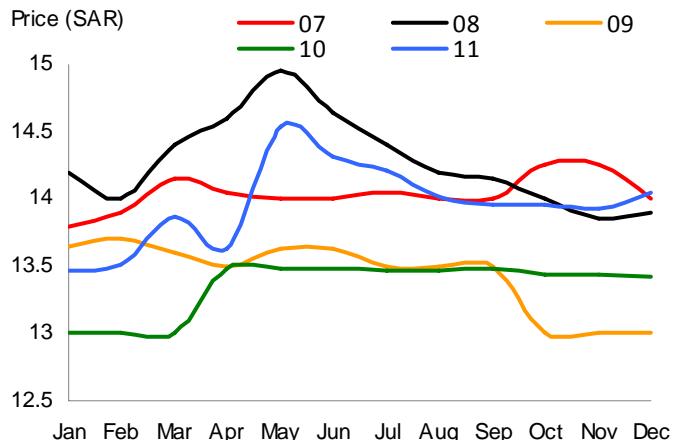


Source: NCB Estimates

By the end of 2011, total local sales amounted to 47 million tonnes, a 12.3% Y/Y increase. Of this total, an estimated 16 million tonnes represented transient demand.

According to the Central Department of Statistics and Information, a 50kg bag of cement in 2011 costs SAR13.96 on average, which translates into SAR279 per tonne. Thus, total revenues are estimated to have reached SAR13 billion. NCB estimates that total expenditure in the Saudi construction sector, as measured by its components in the country's gross fixed capital formation (GFCF), reached SAR169 billion by the end of 2011. This represented a 200% increase from 2000, and a 16% rise from 2010. The GFCF is composed of two components; Residential Building Construction (RBC), and Non-Residential Building Construction (NRBC). Examining the relationship between GFCF and the SAR value of local cement consumption from 2006-2011, it can be estimated that, on average, the SAR value of local cement consumption accounts for an estimated 6.7% share of GFCF. According to market insights, the cost of cement accounts for a range of 3%-7% of the awarded contract value. It is important to note that GFCF is not accounting for the total value of contracts awarded, thus the two values are not equivalent.

Chart 16: Annual Cement 50kg Bag Prices



Source: NCB Estimates

A key challenge to the sector is the ongoing export ban, which will serve to constrain growth for Saudi cement producers. In the almost four years since its introduction, neighboring and regional countries have developed their cement markets, becoming substitutes to the Saudi production. This will make it difficult for local producers to retain their high levels of exports should the export ban be removed. In addition, fuel shortages reported by some cement companies in recent months is another important challenge that the sector faces. According to market insights, it is new fuel allocation that is causing the delay, which is affecting the start of new production lines and output. Consequently, this will put upward pressure on cement prices, due to the increased reliance on inventory, which lowers stockpile levels, and results in a non-optimal utilization of resources.



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

Jarmo Kotilaine, Ph.D

Chief Economist

j.kotilaine@alahli.com

Tamer El Zayat, Ph.D

Senior Economist/Editor

t.zayat@alahli.com

Sector Analysis/Saudi Arabia

Albara'a Alwazir

Senior Economist

a.alwazir@alahli.com

Paulina Chahine

Senior Economist

p.chahine@alahli.com

Sultan Khoja

Economist

sw.khoja@alahli.com

Majed A. Al-Ghalib

Senior Economist

m.alghalib@alahli.com

Jellian Nour

Economist

j.nour@alahli.com

Yasser Al-Dawood

Economist

y.aldawood@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

Disclaimer: The information and opinions in this research report were prepared by NCB's Economics Department. The information herein is believed by NCB to be reliable and has been obtained from public sources believed to be reliable. However, NCB makes no representation as to the accuracy or completeness of such information. Opinions, estimates and projections in this report constitute the current judgment of the author/authors as of the date of this report. They do not necessarily reflect the opinions of NCB as to the subject matter thereof. This report is provided for general informational purposes only and is not to be construed as advice to investors or an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or other securities or to participate in any particular trading strategy in any jurisdiction or as an advertisement of any financial instruments or other securities. This report may not be reproduced, distributed or published by any person for any purpose without NCB's prior written consent.