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Saudi Economic Review

NCB Monthly Views on Saudi Economic and Financial Developments

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Executive Summary

- Saudi Arabia adjusted its official selling prices and has taken an immediate action to manage its production. After eight months of production at 9.74MB/D, the Kingdom decided to cut its output by 0.4MB/D in August, mainly due to weakening demand in Asia and a decline of exports to the US.

- The benchmark 10-year US treasury yield slumped by 21bps M/M, standing at 2.3%. The shift in the relationship among global interest rates are reversing short-term positions on 10-year treasury futures and creating a bull run which defies expectations, especially after the Fed had paved the way to tighten its monetary policy in 2015.

- Bullion closed at USD1,288 per troy ounce on the last trading day in August, with a net appreciation of 0.4% M/M. However, the low global inflation specter and continued disinflationary trend in Europe, with Italy falling into a technical recession, prompted investors to seek alternative investments.

- The level of liquidity is likely to maintain an upward trajectory for the remainder of the year; albeit the composition appears to be shifting towards favoring time and savings deposits at the expense of their non-yielding counterparts.

- The current coverage ratio recorded a comfortable 165.7% in June. The pursuit for safer portfolios coincided with the implementation of Basel III in early 2013. The capital adequacy ratio for tier 1 and 2 reached 16.0% and 17.8%, respectively by 2Q2014. The Saudi banking system is on a positive trajectory, underscoring the fact that becoming safer do not necessarily undermine revenue generation.

- The looming interest rates hike by the Fed could put a dent on local lending growth as SAMA will follow suit with its contractionary monetary policy. Nevertheless, in contrast to the US, we expect the impact to be limited due to the different composition in deposits.

- The shifting seasonality of Ramadan, to some extent, rendered the annualized change in imports at a double digit decline. Imports fell by an annualized 17%, which consequently narrowed the balance of trade gap down by 29%.

View of the Month

The GCC region has outperformed their peers as the MSCI GCC index registered a growth of 25% YTD by mid-September. The Saudi stock market recorded the highest growth last month at 8.8%, followed by Qatar and Dubai's indices at 5.6% and 4.6%, respectively. The global equity outlook for 2014 is likely to end positively given there are no major setbacks affecting investors' incentives.

Macroeconomic Indicators

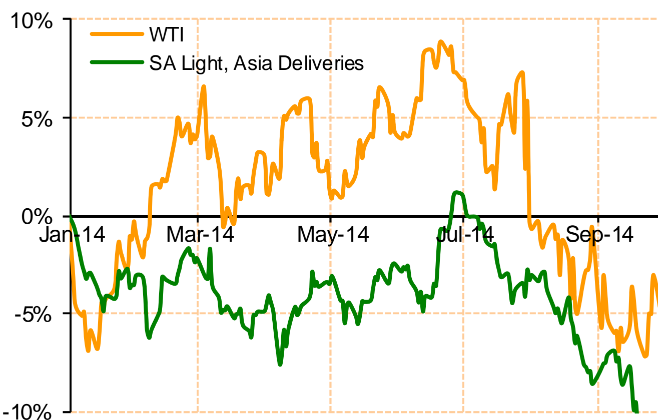
	2008	2009	2010	2011	2012	2013P	2014F
Real Sector							
Average KSA Crude Spot Price, Arab Light, USD/BBL	94.9	59.2	77.6	108.1	110.2	106.4	102.0
Average Daily Crude Oil Production, MMBD	9.2	8.2	8.2	9.3	9.8	9.6	9.6
GDP at Current Market Prices, SAR billion	1,949.2	1,609.1	1,975.5	2,510.7	2,752.3	2,806.7	2,863.4
GDP at Current Market Prices, USD billion	520.5	429.7	526.8	670.4	734.9	749.4	764.6
Real GDP Growth Rate	8.4%	1.8%	7.4%	8.6%	5.8%	4.0%	4.3%
Oil Sector GDP Growth Rate	4.3%	-8.0%	0.3%	11.0%	5.7%	-1.0%	0.0%
Non-oil Sector GDP Growth Rate	9.8%	5.3%	9.6%	8.0%	5.8%	5.4%	5.4%
Population, million	25.8	26.7	27.6	28.4	29.2	30.0	30.7
Population Growth Rate	3.4%	3.4%	3.4%	2.9%	2.9%	2.7%	2.5%
GDP /Capita, USD	20,184.2	16,116.2	19,112.7	23,625.3	25,172.6	24,986.4	24,869.4
CPI Inflation, Y/Y % Change, Average	6.1%	4.1%	3.8%	3.7%	2.9%	3.5%	3.0%
External Sector							
Merchandise Trade Balance, USD billion	212.0	105.2	153.7	244.7	246.6	222.7	206.1
Oil Exports, USD billion	281.0	163.1	215.2	317.6	357.1	324.9	303.1
Non-oil Exports, USD billion	32.5	29.3	35.9	47.1	51.0	54.1	57.7
Merchandise Imports, USD billion	-100.6	-86.4	-96.7	-119.0	-140.7	-152.0	-154.7
Net Unilateral Transfers, USD billion	-23.0	-27.7	-27.9	-29.4	-30.4	-35.9	-38.7
Current Account Balance, USD billion	132.3	21.0	66.8	158.5	164.8	132.6	124.3
Current Account Balance/GDP	25.4%	4.9%	12.7%	23.6%	22.4%	17.7%	16.3%
Net Foreign Assets with SAMA, USD billion	438.5	405.9	441.0	535.9	648.5	717.7	753.6
Fiscal Sector (Central Government)							
Budgeted Expenditure, SAR billion	410	475	540	580	690	820	855
Actual Revenues, SAR billion	1,101.0	509.8	741.6	1,117.8	1,247.4	1,156.4	1,085.6
Actual Expenditure, SAR billion	520.1	596.4	653.9	826.7	873.3	976.0	1,005.3
Expenditure Overrun, %	26.8%	25.6%	21.1%	42.5%	26.6%	19.0%	17.6%
Total Revenues/GDP	56.5%	31.7%	37.5%	44.5%	45.3%	41.2%	37.9%
Total Expenditure/GDP	26.7%	37.1%	33.1%	32.9%	31.7%	34.8%	35.1%
Overall Budget Balance, SAR billion	580.9	-86.6	87.7	291.1	374.1	180.3	80.3
Budget Balance/GDP	29.8%	-5.4%	4.4%	11.6%	13.6%	6.4%	2.8%
Break-Even Oil Price	40.2	60.8	64.1	75.3	73.9	82.6	87.5
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)	17.6%	10.7%	5.0%	13.3%	13.9%	10.9%	11.7%
Growth in Credit to the Private Sector	27.9%	-0.6%	4.8%	11.0%	16.4%	12.1%	9.8%
Average 3M SAR Deposit Rate	3.3%	0.9%	0.7%	0.7%	0.9%	1.0%	0.9%
Average 3M USD Deposit Rate	3.0%	0.7%	0.4%	0.3%	0.4%	0.3%	0.3%
Spread, in Basis Points, SAIBOR-LIBOR	37.4	26.4	39.8	40.9	55.2	68.7	60.0

Oil Market

Saudi Adjusts Output To Weaker Demand

Brent crude prices have hit two-year lows, as November settlement traded at USD97 a barrel on the ICE Future Europe Exchange. Brent premium to WTI, which has averaged USD 6.59 a barrel in the 3d quarter, shrank to USD3.46 a barrel this month, the smallest since September 2013. WTI prices for November delivery settled at USD93.5 a barrel on NYMX. The drop in oil price, which has seen prices holding below USD100 a barrel since the beginning of this month, took place despite a cut in Saudi production by 0.4MB/D in August. However, if it were not for rising production of shale oil in the US, EIA predicts that oil would cost USD150 a barrel, mainly due to supply disruption in the Middle East and North Africa. Oil prices are expected to hover around USD100 a barrel in 2015, as the threat from ISIS will continue to keep geopolitical risk premium elevated. Moreover, the incursion of ISIS is likely to leave a permanent damage on Iraq's northern oil infrastructure and thus stands to suspend Iraq's capacity to supply additional oil output n the medium term.

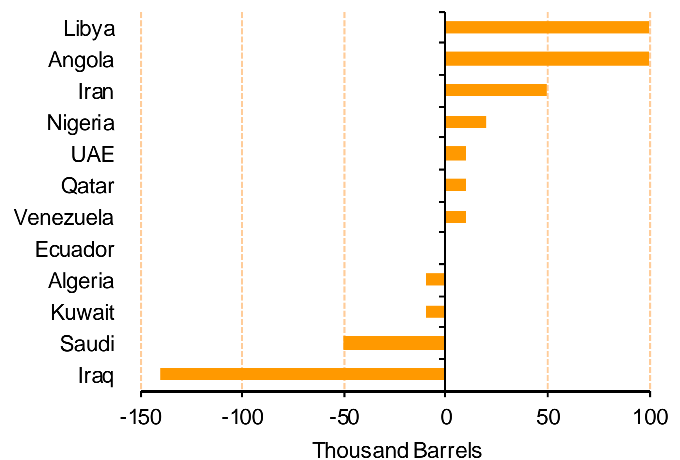
Chart 1: Oil Price Developments, YTD



Source: Thomson Reuters

On the supply side, OPEC production reached 30.4MB/D in August, attributed to rising output in Nigeria and Angola, and supplemented by the recovery of production in Libya. This represented the third consecutive month where production exceeds the agreed OPEC's target of 30MB/D. Taking a long-term view of the market fundamentals, Saudi Arabia adjusted its official selling prices and has taken an immediate action to manage its production. After eight months of production at 9.74MB/D, the Kingdom decided to cut its output by 0.4MB/D in August, mainly due to weakening demand in Asia and a decline of exports to the US. In Libya, production surpassed the 0.85MB/D mark and was heading towards the 1.0MB/D, defying the political instability. But the recent spread of fighting from Tripoli to near the oil port and refinery complex at Zawiya has caused a major setback to the Libya's resurgent oil production. In Iraq, while war continues in the northern half, output from the southern region appears to have risen, as oil production reached 3.09MB/D, and exports recovered to nearly 2.6MB/D last month. In the US, crude oil production increased by 0.25MB/D, reaching a record level of 8.8MB/D this month, a level not seen since 1986.

Chart 2: OPEC's Monthly Oil Production Changes



Source: OPEC Survey

On the demand side, China and Japan, the two largest oil consumers in Asia, consumed 1.6% less oil y/y in the year to July. The rapid expansion of the Chinese refinery sector has acted as a serious headwind to oil products imports, which dropped by 30% y/y, reflecting lower imports of fuel oil and kerosene. Fuel oil demand remains week, lower by 8.6% y/y in the year to August. In the year to August, implied oil demand growth in China was flat y/y, the slowest pace of Chinese growth since 1990. Therefore, OPEC is facing a growing pressure to act at its late November meeting, in response to this ever-weakening demand for its oil and to rising non-OPEC supplies. Forecasts of oil demand growth and call on OPEC have been cut in each of the last three months. IEA adjusted recently its estimate of world demand on OPEC's crude by 0.36MB/D to 29.5MB/D in 2015, from 29.9MB/D this year.

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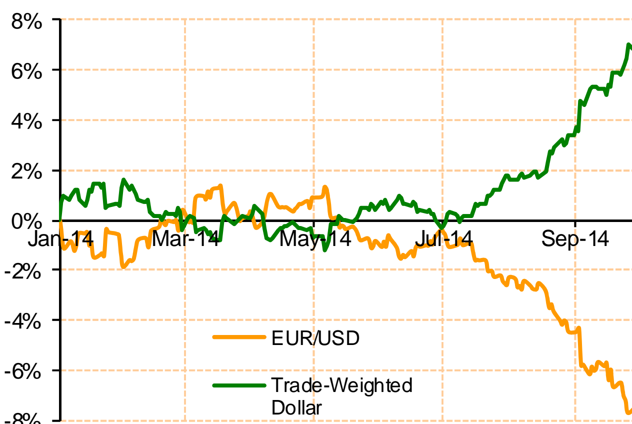
Foreign Exchange

Divergent Paths Continue

Foreign exchange market developments continue to offer a mixed landscape. After the divergent policies between the Fed and the ECB took shape, investors have been raising their bets on the dollar in anticipation for an interest rate hike by the former. However, the weather-related subpar first quarter real GDP growth of -2.1% in the US kept the Fed treading carefully as it unwinds its unconventional monetary policy. Strong jobs data in the past months led to a better-than-expected growth in the second quarter GDP which rebounded strongly by an annualized 4.2% whereas In regards to the month of August jobs data, non-farm payroll recorded the creation of 142,000 jobs; a long shot below expectations. The data which is marred by noise alleviated some concerns of a premature interest rate hike this year. Although the Fed is likely to remain accommodative through 2Q2015, the possibility of a market shock a la Bernanke's tapering announcement in June last year is not ruled out. In addition to the supportive macroeconomic fundamentals, Investors are holding net long positions in dollar denominated securities. Consequently, the trade-weighted dollar inched up from July by 1.6% to 82.7 at the end of August.

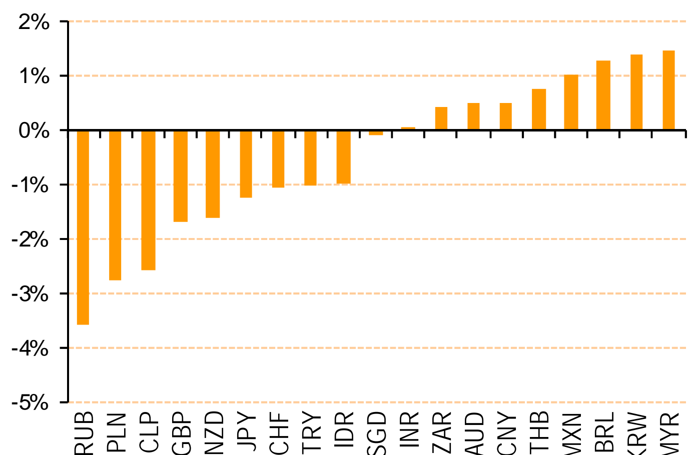
Chart 3: Trade-Weighted Dollar and the Euro



Source: Thomson Reuters

Juxtaposed to the ongoing Ukrainian geopolitical tension, the "Draghi effect" of further lowering the ECB's refinancing rate to 0.05% only two months after introducing negative deposit rates and a targeted LTRO caused a stampede towards the safety of US treasuries which looked attractive in comparison to its European counterparts despite being at historical lows. The benchmark 10 -year US treasury yield slumped by 21bps M/M, standing at 2.3%. The shift in the relationship among global interest rates are reversing short-term positions on 10-year treasury futures and creating a bull run which defies expectations, especially after the Fed had paved the way to tighten its monetary policy in 2015. German bund yield tumbled by 28bps to fresh lows of 0.88% after Italy fell back to deflation, recording the lowest inflation in the EU to-date of -0.2% according to Eurostat. The Governing Council at the ECB unanimously agreed on using unconventional instruments such as asset-backed securities and covered bonds to pull the area away from deflation as its CPI touched 0.3%, the lowest since 2009. Furthermore, the absence of structural and fiscal reforms in the Euro area kept fundamentals and technicals bearish, weighing on the single currency which deteriorated by 1.9% in August, hovering just above USD1.30. We expect the EUR to remain range-bound towards year-end despite breaking below USD1.30 early September.

Chart 4: Monthly Foreign Exchange Rate Changes



Source: Thomson Reuters

In the UK, real GDP growth is set to outpace its G7 peers at a rate of 2.9%, and inflationary pressures are subsiding (1.6% in July). However, the BoE's hawkish vote to tighten its monetary policy by increasing rates by 25 bps was put on hold following less encouraging wage data. In addition, the Pound Sterling plunged in August on fears over the outcome of Scotland's independence referendum. The UK holds a much brighter outlook than the Euro zone, especially with the referendum risk averted post September the 18th, and the GBP rebounded. The Sterling edged 1.7% lower against the dollar closing at USD1.66 on the last trading day in August due to contrasting pre-referendum polls increasing volatility. Nevertheless, we expect the GBP to remain resilient, and that the BoE will begin its tightening cycle on February 2015.

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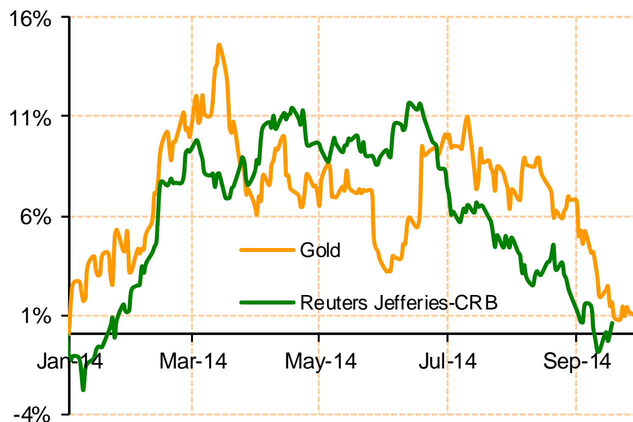
Commodities

Commodities Tank on Stronger Dollar

Commodity prices were depressed throughout most of August, reflecting on the Thomson Reuters/Jeffries CRB index which ended 0.6% lower than a month earlier to 292.7. Heightened market volatility and risk aversion stemming from the Iraq/Syria, and Ukraine/Russia conflicts supported precious metals such as gold which remained range-bound throughout the past couple of months. Bullion closed at USD1,288 per troy ounce on the last trading day in August, with a net appreciation of 0.4% M/M. However, the low global inflation specter and continued disinflationary trend in Europe, with Italy falling into a technical recession, prompted investors to seek alternative investments. The stronger dollar and buoyant economic activity in the US fueled risk appetite, reflecting on the equity market as the S&P500 breached the 2000 level for the first time in August. As positive economic outlook in the US outweigh geopolitical uncertainty, gold futures for December tumbled to an eight-month low of 1,231/oz early September. Last year alone, gold lost 28% of its value following the QE3 normalization announcement. This year we infer that speculation of a nearing interest rate hike in the US will further pressure the metal to possibly, yet not likely, trade below the USD1,200 level by year end. Fundamentally, however, this would instigate a correction driven by a physical demand response by China, which seeks to diversify its USD4 trillion worth of foreign assets, as well as India. Thus, the likelihood of breaching the 1,200 support level diminishes although we maintain a bias to the downside.

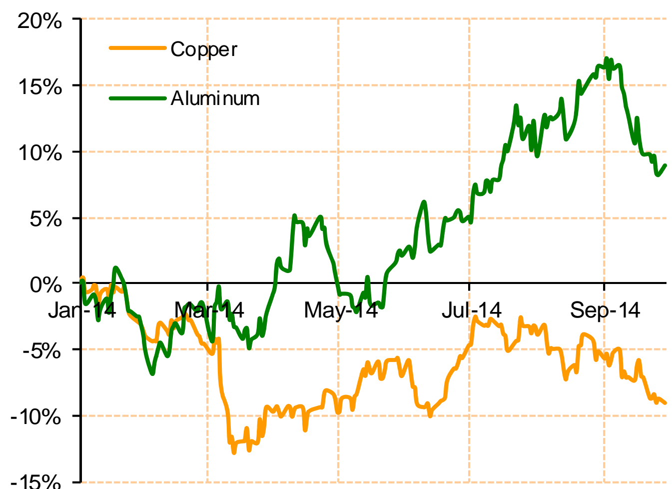
Chart 5: Reuters Jefferies vs. Gold



Source: Thomson Reuters

China's composite PMI data turned positive for the fourth successive month posting 52.8 from 51.6 in July, thus signaling a smoothing business activity during August. Most of the growth in the headline index was attributed to the service sector which rebounded to a 17-month high, followed by an easing in manufacturing. On the other hand, downside risks still persist from the property sector as policy makers contemplate further easing measures. As a result from the improving business sentiments, demand for industrial metals such as aluminum and nickel increased. Aluminum saw a solid 5.5% M/M upturn at USD2,096 per metric ton, while nickel rose by 1.6% to USD18,800/ton. Copper prices inched downward by 1.9% to USD6,982/ton. Although improved industrial output provided some support, the strong dollar effect overshadowed the limited gains seen in August. Divergent paths in prices also reflect supply conditions and prospects, with some like nickel which is up 34% year-to-date due to facing export bans from Indonesia and the Philippines. Conversely, new capacity is expected to come from Australia, the largest exporter of iron ore, and Chile, the world's largest copper producer.

Chart 6: Base Metals



Source: Thomson Reuters

Soft commodities futures gained over concerns of an El-Nino induced drought. The S&P/Goldman Sachs Agricultural Index saw a 1% uptick from July. September's deliveries of wheat surged by 5.6% to USD5.35/bushel, the biggest rally among grains. In addition, the Russian/Ukrainian tension added to the risk premium for wheat as economic sanctions on Russia, the fourth largest wheat producer, are likely to weight on supply prospects. The strong dollar erased wheat futures gains early September landing at four-year lows. The US government also forecasts record global output and rising inventories to cap potential gains. Corn futures gains were muted in August on the back of ample supply met by a weaker demand, inching up by a mere 0.8% to USD3.58/bushel. Soybean futures for September deliveries lost 1.1% in August to USD11.1/bushel.

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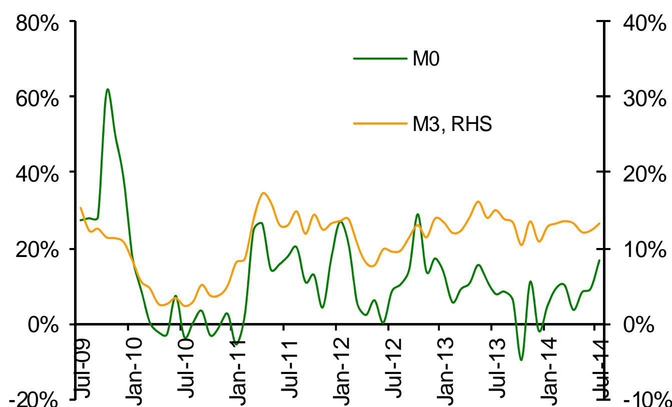
Money & Inflation

Liquidity Continues to Surge on Demand

Soaring geopolitical tensions in Iraq and Syria elevated oil prices in June which reflected positively on the Kingdom's balances. Anchored by government support for SMEs, the positive growth in the private sector ensures a highly liquid state in the economy. Thus, the growth of the monetary base (M0) climbed at the fastest pace this year in July, advancing by 16.7% Y/Y to SAR348 billion. Cash in vault set a record of SAR30.7 billion while deposits with SAMA surged by an annualized 35.1% to SAR168.7 billion. This reflects Saudi banks' regulatory constrains to utilize excess cash to expand their lending portfolio. Excess liquidity is mopped by SAMA via the issuance of T-bills which recorded an annual growth of 22.2% to reach SAR312.8 billion. Narrow money (M1) saw the weakest growth this year as demand deposits climbed by 12.5% Y/Y while currency outside banks inched by a meager 1.7% Y/Y. Conversely, we find that (M2) accelerated the double-digit growth trend that started since March this year as near money surged by 14.2% to SAR1.47 trillion. M2 composition analysis indicates that time and savings, compared to July last year, deposits recorded a staggering growth of 24.8%, reaching SAR388.5 billion.

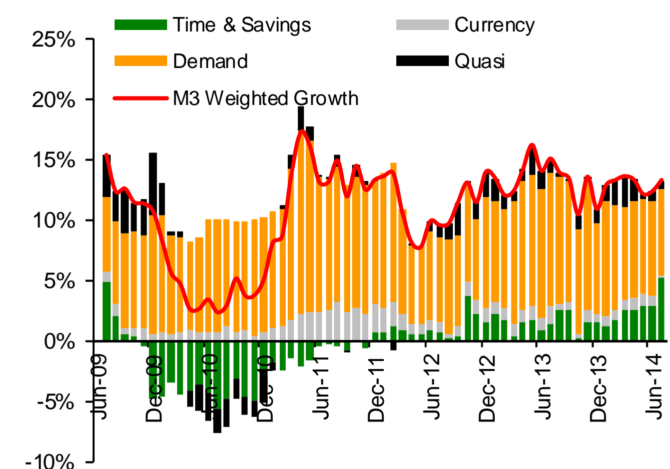
Chart 7: Growth in Monetary Aggregates



Source: SAMA, NCB Estimates

Quasi monetary deposits advanced by 6.5% to SAR196 billion, constituting 11.7% of total money supply. M3, the broadest measure of money supply, therefore reached SAR1.67 trillion, growing by an annualized 13.2%. The level of liquidity is likely to maintain an upward trajectory for the remainder of the year; albeit the composition appears to be shifting towards favoring time and savings deposits at the expense of their non-yielding counterparts. At around 93.7%, demand deposits are still dominated by businesses and individuals who require frequent and easy access to their funds, whereas government entities constitute 53.2% of SAR388.5 billion time and savings deposits. Furthermore, we expect SAMA's monetary policy to remain in lockstep with the US due to the fact that the overwhelming majority of Saudi exports and foreign assets are dollar denominated. Moving in parallel with the US monetary policy is vital to preserving the purchasing power of the massive SAR 3 trillion worth of net foreign assets, in addition to avoiding the damaging effects of capital outflows that result from interest rate arbitrage.

Chart 8: Money Supply, Contribution



Source: SAMA, NCB Estimates

Consumer demand in Saudi Arabia remains supported at a double digit growth as indicated by the points of sale transactions; the proxy which we use to gauge consumption levels. The volume of transactions grew by 13.4% Y/Y in July to SAR15 billion indicating high, albeit moderating, velocity of money in the local economy. The general inflation index grew at the slowest pace this year in July by just 2.6%, well below last year's average of 3.5%. Food and beverages indicate the lowest inflation on record for this category of just below 2%. Housing and utilities are at 3.4%, whereas recreation and culture-related products recorded a 10.4% upsurge due to the "Saudi Summer" festivals, which are estimated to have generated over SAR10 billion and attracted more than 10 million visitors this year, according to the Saudi Commission for Tourism and Antiquities.

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Capital Markets

Saudi Banks: As Safe As it Gets

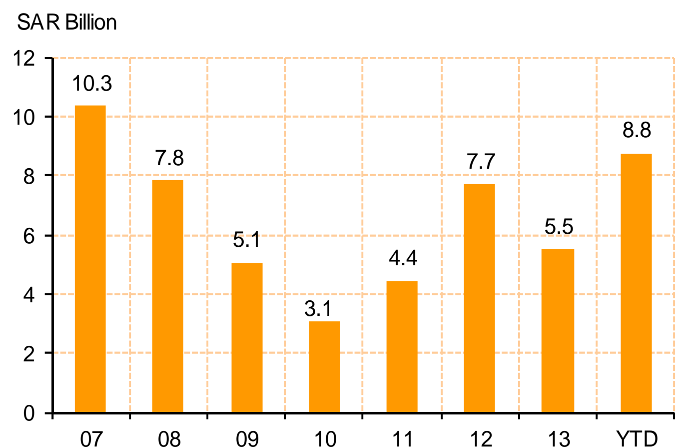
The domestic banking system capitalized on strengths that emanated from a buoyant economy and an expansionary fiscal policy. Elevated oil prices over the past few years have translated into higher revenues for Saudi which supported consistent growth. The influx of capital led the government to implement diversification plans to expand the absorptive capacity of the local economy. This provided banks with the opportunity to extend credit lines to businesses in various sectors. The Saudi Arabian Monetary Agency (SAMA) was keen to control the growing credit market and maintain a sustainable trajectory to avoid the recurrence of a credit slump similar to the one experienced in 2009. By the end of July, credit to the private and public sector enterprises grew at an annual rate of 10.8% to reach SAR1.2 trillion. Despite the lucrative benefits of expanding their balance sheets, there are certain drawbacks to a growing credit base. The possibility of defaults increases, which are gauged by the level of non-performing loans (NPL). Following the recovery from troubled family conglomerate businesses in 2012, banks incorporated cost more effective risk management policies to limit their exposure to NPLs. SAMA's vigilant and prudent guidance directed banks to a safer environment amid the regional turmoil and global uncertainty.

Chart 9: Tadawul All-Share Index

Source: Tadawul

Accordingly, the record level of NPLs reached in 2009, SAR25.8 billion, has subsided over the years, thus, lessening the pressure on the banking system. By the end of the first half of 2014, NPLs stood at SAR16.1 billion, decreasing by 4.2% over the previous 12 months. The top three most successful banks in reducing their NPLs during the period were Bank Aljazira, Arab National Bank, and National Commercial Bank by 26.5%, 25.7%, 19.9% Y/Y, respectively. Meanwhile, the Saudi Investment bank recorded an in increase in their NPLs by 20.8%, as they recorded the highest growth in net loans over the trailing 12 months at 35.5%. Pipeline risk judged by the NPL ratio (NPLs divided by gross loans) reflects the safer dynamics of the current credit market, which has been encouraged by SAMA's guidance. By the second quarter of 2014, the 12 locally incorporated banks registered a collective NPL ratio of 1.3%, in comparison to the 1.5% recorded in 2Q2013. The youngest Saudi bank, Alinma, has the lowest NPL ratio at 0.7%, however, as the bank continues to grow in line with its capital size, the ratio will reach closer to the market average.

Chart 10: Average Daily Traded Value



Source: Tadawul

Banks operate various tools to mitigate risks to safeguard their portfolios and investments. Allocating funds in the form of provisions is an essential part of risk management and provides a cushion to withstand systematic risks. The vigorous provisioning cycle has diminished and given the stable increase in loan, provision levels have been growing at a correlated pace, reaching SAR26.6 billion last quarter to represent 2.2% of net loans. SAMA's supervisory framework directed banks to an informal 150% coverage ratio (provisions divided by NPLs), which was reached during the first half of 2013. The current coverage ratio recorded a comfortable 165.7% in June. The pursuit for safer portfolios coincided with the implementation of Basel III in early 2013. The capital adequacy ratio for tier 1 and 2 reached 16.0% and 17.8%, respectively by 2Q2014. The Saudi banking system is on a positive trajectory, underscoring the fact that becoming safer do not necessarily undermine revenue generation.

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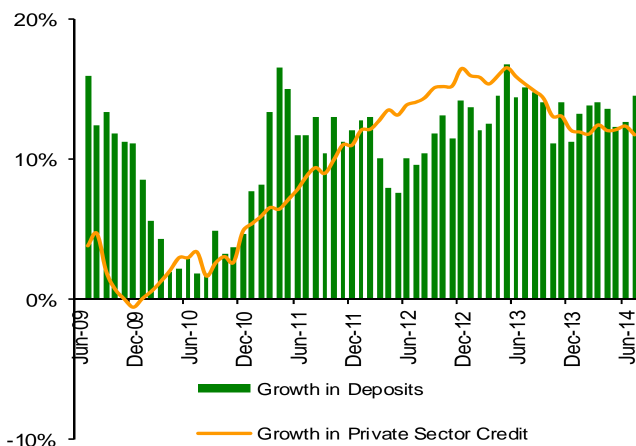
Loans Market

Saudi Lenders: A Strong Growth Trajectory

The high levels of deposits in local banks give the credit market the ability to expand each year. The depositary base in the Saudi financial system continued at an all-time high of SAR1.5 trillion, surging by 14.5% compared to the same period last year. The soaring stock market activity maintained the upward trend of demand deposits as investors park their money for stock trading. On an annual basis, the consolidated capital of Saudi banks rose 27.5%, a record high which indicates banks in the process of expanding their operations in order to achieve better market penetration. The strong capital positions also suggest that banks are bulking in anticipation for a surge in demand for loans, especially when Saudi banks are considered “well-capitalized” beyond Basel III capital requirements.

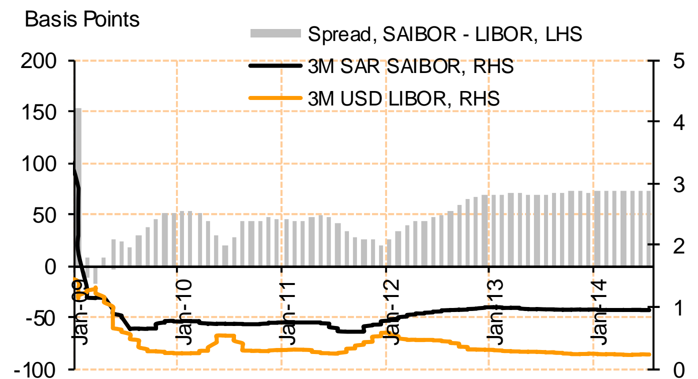
Chart 11: Private Sector Financing



Source: SAMA, NCB Estimates

Total credit extended by banks reached SAR1.2 trillion in July. Loans to the private sector, which by weight makes up over 96% of total loans, surged by 11.7% to SAR 1.16 trillion. Despite the tough SAMA regulations, the suppressed interest rate environment keeps demand for lending high under the currently sound economic fundamentals. However, the looming interest rates hike by the Fed could put a dent on local lending growth as SAMA will follow suit with its contractionary monetary policy. Nevertheless, in contrast to the US, we expect the impact to be limited due to the different composition in deposits. Demand deposits, which are favored by banks over their interest-bearing counterparts constitute over 60% of banks' liabilities. Thus, unrealized losses on deposits are much smaller in comparison to the US. Despite the lower financial leverage, the conventional nature of the Saudi banking system reflects the current cycle which remains on an uptrend, supported by continued expansionary fiscal policy. Banks continue to post a double-digit growth in assets of 13% with an excess reserves (held at SAMA) ratio of 47.3%, ensuring adequate coverage for clients.

Chart 12: Liquidity and Risk Detector



Source: Thomson Reuters

Average capacity utilization (L/D) in Saudi banks is at 80%, extending SAR93,2 billion of fresh loans this year. Short term loans have fallen for the first time below 50% in favor of medium and long-term loans which account for 18.1% and 32.4%, respectively. The tendency arises from a lesser need for funds on standby, lowering liquidity shortage risks, and allowing banks to tie assets to longer maturities while the demand side is benefitting from the cheap cost of financing. Although the bulk of loans is issued to the private sector, the growth in government securities investments sky-rocketed since early last year, and continued to grow at a double-digit, recording 23.1% Y/Y, totaling SAR269 billion. The spread between the London Interbank Offered Rate (LIBOR) and the Saudi counterpart (SAIBOR) stands at 72 basis points. We expect SAMA to maintain the same margin after the US interest rate hike by adjusting interest rates accordingly.

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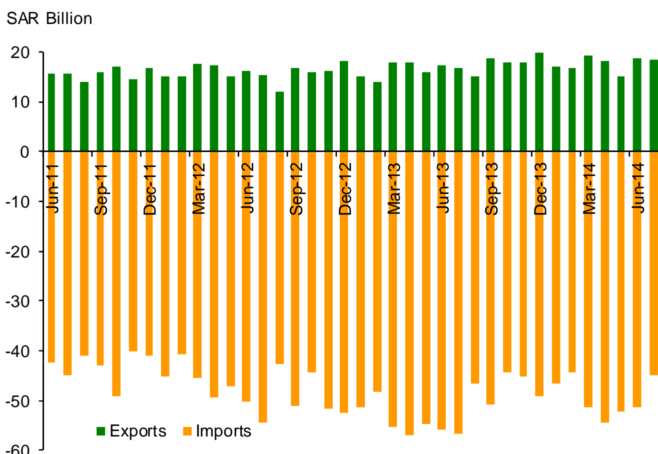
External Trade

Range-bound Exports as Imports Moderate

In the month of July, Saudi non-oil exports continued their rebound from May's dip on the back of surging oil prices. In addition, the improving fundamentals in China and the US were supportive of trade activity. Although the contractual nature of the petrochemicals trade provides a streamlined flow of capital and goods, soaring oil prices in June have marginally contributed to the upturn. Moreover, the inclusion of re-exports, such as transport equipment, in the Central Department of Statistics and Information's non-oil export data also helped keeping the headline growth rate positive. In value terms, non-oil exports climbed by 12.4% Y/Y to SAR18.3 billion. Tonnage-wise, exports recorded 3.98 mega tons in July which is on par with the same period last year. This indicates, given the weights of export categories, that the oil risk premium has been factored into petrochemicals and plastics, translating into a higher export revenue. On the other hand, the shifting seasonality of Ramadan, to some extent, rendered the annualized change in imports at a double digit decline. Imports fell by an annualized 17%, which consequently narrowed the balance of trade gap down by 29%.

Chart 13: Saudi Non-Oil Trade Balance

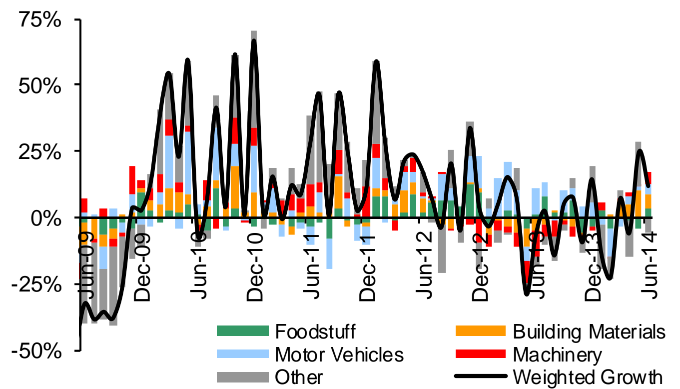


Source: CDSI, NCB Estimates

Plastics and Chemical products, which respectively represent 32.8% and 30.7% of the export return revenue ended up mixed when compared annually. Exports of plastics surged by 12.5% Y/Y, recording SAR6 billion while exports of chemical products retracted by 4.4% down to SAR5.6 billion. We notice that in value terms, exports unrelated to the oil industry, save foodstuff, were negatively impacted. Exports of food and beverages inched up by 1.6% on an annual basis. In regards to exports destinations, the UAE was the largest recipient of Saudi exports, accounting for 13.5% of the total value or SAR2.5 billion. Compared to last year, non-oil exports to the UAE surged by 66.8%. This most likely reflects a rising manufacturing activity in China as most exports to the UAE tend to be re-exported. China, which a month later posted a record trade surplus of USD49.8 billion on the back of rising exports, increased its demand of Saudi exports in August by 2.4% compared to last year. Interestingly enough, exports to Bahrain were valued at SAR1.2 billion, advancing by 248.4% Y/Y.

On the import side, the Kingdom reduced its import bill sizably as indicated by an 18.6% annualized downturn in machinery and electrical equipment; the category which solely represents a quarter of the imports. Following closely by weight is transport equipment, which tumbled by 6.9% valued at SAR8.3 billion. Imports of base metals decreased in value terms by 18.3%, recording SAR5.9 billion. Most of Kingdom's imports originated from China, accounting for 15.1% of the import bill at SAR5.8 billion, thus receding by 9.3% on an annual basis. US imports were substantially lower, trimming 20% off the bill at SAR5.8 billion. German imports to the Kingdom saw the largest annual decline of 28.4% as the import bill was reduced to SAR2.8 billion.

Chart 14: Attribution Analysis of Letters of Credit Opened



Source: SAMA, NCB Estimates

In July, settled letters of credit (LCs) saw the largest annualized decline since August last year. The bulk of the month of Ramadan this year coincided with most of July, contributing to subdued trade. LCs dropped by 24.1% Y/Y to SAR 17.2 billion, a trend that took shape most of this year, indicating a slowdown. LCs for motor vehicles indicate a sharp 40.6% decline as consumers seek to benefit from the stock market rally. LCs for machinery and equipment nose-dove by 27.7% compared to the same period last year. In a stark contrast, however, LCs for building materials surged by 24.2%, indicating an anticipated rise in building activity.

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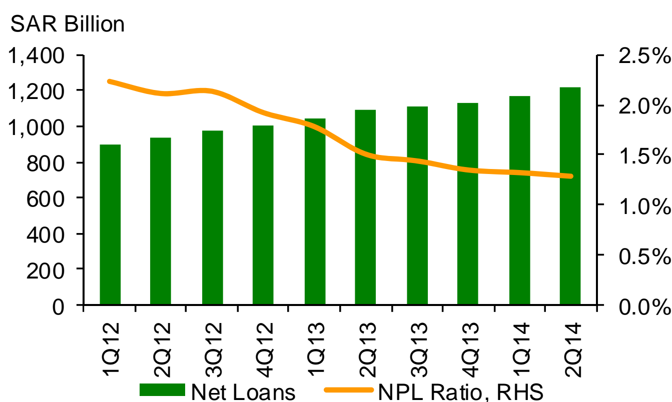
Special Focus:

Setting New Grounds

Earlier in 2014, it was expected that equity markets on a global scale would moderate on the back of strong performances in 2013. However, nearing the end of the third quarter, indices continue to reach new highs and record significant growth levels. Based on the MSCI World index, markets registered a 2.0% growth last month, withstanding concerns relating to the Russian-Ukrainian standoff and an expanding ISIL threat. In the US, the Dow and the S&P500 have recorded new highs above 17'000 and 2'000, respectively. Markets received a boost with a clear statement from the Fed expressing its intentions to maintain an accommodative stance following the end of QE3 next month. In Europe, the 18-nation currency bloc is finding difficulty in sustaining a notable recovery. Yet, markets have been undeterred as the STOXX600 posted a 1.8% rise in August. The GCC region has outperformed their peers as the MSCI GCC index registered a growth of 25% YTD by mid-September. The Saudi stock market recorded the highest growth last month at 8.8%, followed by Qatar and Dubai's indices at 5.6% and 4.6%, respectively. The global equity outlook for 2014 is likely to end positively given there are no major setbacks affecting investors' incentives.

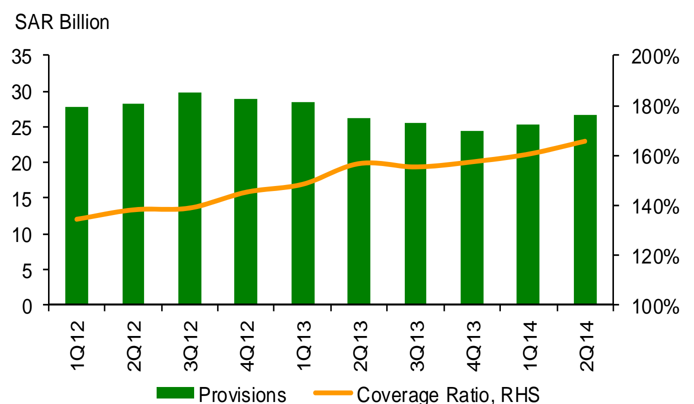
Table 15: Increased Lending Quality



Source: SAMA, NCB

Domestically, the index was heavily boosted by the recent decision to open the market to foreign institutions. Tadawul broke the 11'000 level last month, reaching 11'149.36 on September 9th, a level unseen since January 2008. The market has experienced some hesitance and investors opted for capital gains, which derailed the trajectory of the market as it currently fluctuates just above 11'000. Looking ahead, we still expect the market to continue to move upwards up until 1H2014 when foreign investors start their trading. By the end of last month, only the media and publishing sector posted a YTD decline of 0.1%. The remaining sectors posted significant double-digit growth rates, ranging from telecommunication at 17.0% to real estate at 53.0% YTD. Quarterly corporate profitability announcements will commence following the Hajj break and the general outlook is strongly positive as business activity has picked up on the back of a growing economy. Given the liquid state of the economy, Tadawul might near the 12'000 level by the end of the year.

Table 16: Precautionary Measures Lead to Safer Banks



Source: SAMA, NCB

The bullish movement of stock prices supported activity levels as average daily traded volumes peaked on August 25 at SAR16.1 billion to support the monthly average that reached SAR9.9 billion, a substantial 45.6% rise over the previous month. In comparison to the same month last year, the number of transactions rose by 79.5% while market capitalization increased 46.3% to reach SAR2.26 trillion by the end of August. Saudi investors identified the lucrative opportunity to enter the market before foreign institutions inject up to an expected USD60 billion into the market. Saudis traded 94.3% of July's total value while they increased their activity to 96.1% last month. However, the rise of stock prices decreased valuations as the trailing price-to-earnings ratio rose to 18.23 last month, up from 16.95 during July. Additionally, the primary market remained non-active during August and September, but it is expected to register some activity in the fourth quarter on the back of a vibrant secondary market.

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