Annual Report and Accounts 1998

البنك الأهلي التجاري
THE NATIONAL COMMERCIAL BANK

1998 Sustaining the momentum of change

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بسم الله الرحمن الرحيم

King Fahd Bin Abdulaziz Al-Saud
The Custodian of the
Two Holy Mosques

His Royal Highness
Prince Abdullah Bin Abdulaziz Al-Saud
Crown Prince, First Deputy Premier
and Head of the National Guard

His Royal Highness
Prince Sultan Bin Abdulaziz Al-Saud
Second Deputy Premier, Minister of Defence
and Aviation and Inspector General

Key facts

Saudi Arabia's oldest and largest bank;

A network of 249 branches and offices Kingdom-wide;

47 branches dedicated to Islamic banking;

375 Al-Ahli Express ATMs in service with an overall market share of 21%;

3,013 Point of Sale terminals in operation throughout the country;

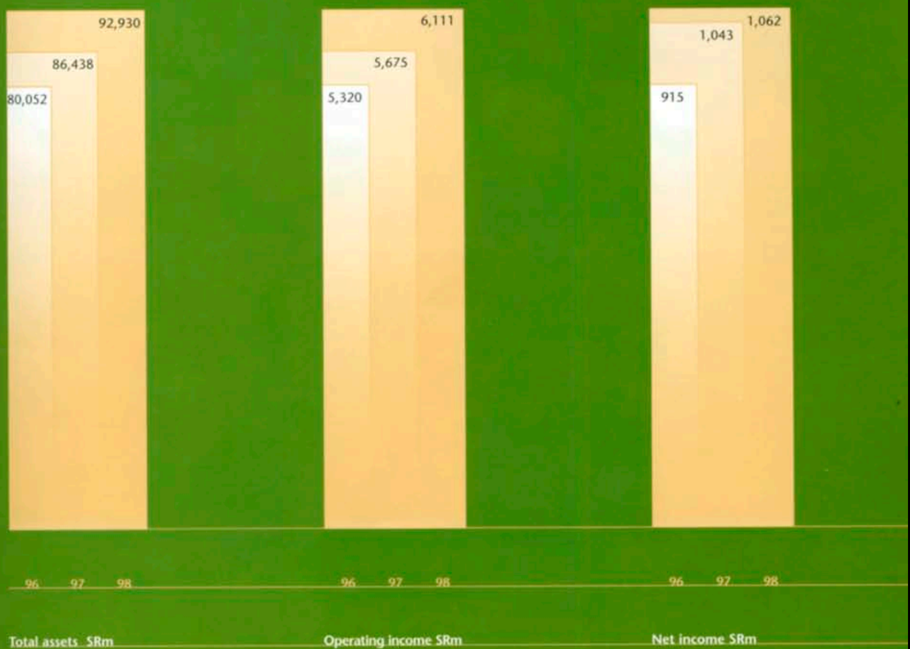
NCB voted "Best Bank in Saudi Arabia" for 1998 by Euromoney Magazine;

Saudisation has reached 70% bank-wide;

NCB's customers benefit from more than 600 correspondent banking relationships, spread over 70 countries worldwide;

NCB's Global Trading Equity Fund, with almost SR two billion in assets under management, is the world's largest Sharia-compliant fund;

ISO certification for data processing technology has been retained.


92,930
86,438
80,052
96
97
98
Total assets SRm
6,111
5,675
5,320
96
97
98
Operating income SRm
1,062
1,043
915
96
97
98
Net income SRm

Our vision

NCB is the leading bank in Saudi Arabia;

NCB's purpose is to enhance the value of the Bank and to serve society;

NCB is the first choice for customers and talented employees;

NCB is primarily a consumer bank, providing deposit, investment and innovatively tailored asset products to retail, affluent and high net worth customers;

NCB engages selectively in corporate business with a full range of banking services for the commercial segment, and corporate finance services for large corporate clients;

NCB is building a diversified portfolio with returns commensurate with the risks;

NCB's core values are customer service, reward for performance and teamwork.

We are pleased to welcome you to the Annual Report and Accounts of The National Commercial Bank for the year ended 31st December 1998. You will find that they reflect another successful year for the Bank.

Since then, there have been some significant changes which we would like to report.

We are pleased to confirm that the Public Investment Fund (PIF), an important investment arm of the Ministry of Finance, has acquired a 50 percent interest in the Bank. This will greatly assist the creation of an orderly market in which NCB's shares will be traded. This will permit the Bank to manage its objective of enabling shares in NCB to be acquired by the investing public over a period of time, depending on market conditions. This change in ownership will be reflected in the composition of the Board of Directors. Meanwhile, we are pleased to report that the continuity provided by NCB's professional managers is maintained.

The first six months of 1999 have seen some important changes in the structure of the Bank's balance sheet, with a marked reduction in Loans and Advances, and further increases in our Investment Securities portfolio. These changes not only greatly enhance the Bank's liquidity but have led to overall improvements in our principal ratios, which will provide a stable environment in which the new shareholders and the Board of Directors can apply their experience and expertise in assisting management in the pursuit of NCB's long term objectives.

We are pleased to take this opportunity to pay tribute to the encouragement and support of the Ministry of Finance and National Economy and the Saudi Arabian Monetary Agency who create a healthy and well regulated financial climate under which the nation's banking community can continue to serve, to flourish and to develop.

We wish to record our profound gratitude to the Custodian of the Two Holy Mosques, King Fahd bin Abdulaziz Al-Saud; HRH Crown Prince Abdullah Bin Abdulaziz Al-Saud, First Deputy Premier and Head of the National Guard; and HRH Prince Sultan Bin Abdulaziz Al-Saud, Second Deputy Premier, Minister of Defence and Aviation and Inspector General, under whose leadership the Kingdom's banking community has benefited from, and can look forward to receiving, unequivocal support and guidance.

The satisfactory financial performance of NCB in 1998 has been achieved in sometimes difficult conditions. It is due to the continued loyalty and support of our customers and the commitment of NCB's staff to providing excellence in all departments and at all levels. To them, and to our valued correspondents, we extend our sincere thanks.

Abdullah Salim Bahamdan
Vice Chairman and Deputy General Manager
for the Board of Directors

The Board of Directors' report 1998

The Board of Directors of The National Commercial Bank is pleased to submit its report on the Bank's performance for the year ended 31st December 1998.

This year represented the Bank's first full year as a Saudi joint stock company and is best described as a year of consolidation and preparation. Nevertheless, NCB has continued to use its substantial investment in both human resources and technological infrastructure to maintain its momentum of change in service performance, responsiveness to market conditions and customer driven innovation.

Financial Results and Position

NCB's net operating profit before loan loss provisions rose in 1998 by a healthy 14.3% to SR 1.6 billion while its net profit for 1998 increased by 1.8% to SR 1,062 million over the SR 1,043.3 million achieved in 1997. This improvement in net profit was achieved in the context of an increase of over 40% in loan loss provisions - from SR 450 million in 1997 to SR 646.8 million in 1998.

NCB's total assets at the end of 1998 were up by 7.5% to SR 92.9 billion compared to SR 86.4 billion at the end of 1997. This rise included a growth in Loans and Advances - up from SR 46.3 billion to SR 56.4 billion - and an increase in the Investment Securities Portfolio from SR 16.9 billion in 1997 to SR 19.2 billion in 1998, thus maintaining NCB's premier position among banks in the Middle East.

Deposits increased by a further 6.2% - from SR 61.9 billion in 1997 to SR 65.7 billion - and this reflects the dominant role which NCB plays in the Kingdom, through its comprehensive network of branches, ATMs and POS terminals, in attracting new customers.

Total shareholders' equity in 1998 was over SR 8 billion and the Bank has maintained its capital adequacy ratio at over 15% - well in excess of international and domestic requirements.

Year 2000

Special attention is being paid by the Bank to the potential difficulties associated with technology and the Year 2000. We are pleased to report that all computer programs and core systems of the Bank have been successfully converted and comply with the guidelines established by SAMA. In addition, NCB has been at the forefront of increasing public awareness of this important issue and is providing assistance to its customers in order to help them meet its challenges.

Human Resources

NCB recognises the value of well trained and well motivated employees and in 1998 continued to recruit fresh graduates and to train and develop its workforce through its own training centre, in SAMA's Institute of Banking, as well as overseas. The Bank's aim is to improve the professionalism of its management and staff.

The focus of recruitment has been the continuation of NCB's successful programme of attracting and retaining Saudi nationals. By the end of 1998, the Bank had achieved a 70% level of Saudisation - among the highest in the Saudi banking sector. This achievement was recognised by the "Award of Saudisation" received from HRH Prince Naif bin Abdulaziz Al-Saud, the Minister of Interior and Chairman of the Saudi Workforce Committee.

The sincere and rigorous attention of NCB's management and staff to providing, at all times, a quality service within the parameters of banking prudence and best practice, were rewarded by NCB being granted the accolade of "Best Bank in Saudi Arabia for 1998" by the prestigious Euromoney magazine.

Directors' Remuneration

Amounts received by the Board of Directors, including directors' remuneration, attendance fees and expenses reimbursed, amounted to SR 1,744,680. Amounts received by the directors for services rendered in their capacities as executive officers, including salaries, allowances and benefits paid, amounted to SR 7,444,152.

The Board of Directors 1998









Khalid Salim Bin Mahfouz
Chairman

Abdullah Salim Bahamdan
Vice Chairman

Abdulrahman Khalid Bin Mahfouz

Saleh Hussein Kaki

Sultan Khalid Bin Mahfouz

Mar'ie Abdullah Bugshan

Dr. Naser Ibrahim Al Qaud

Abdulrahman Abdulaziz Al Ohaly

Mutlaq Abdullah Al Mutlaq

The Board of Directors' report 1998

Distribution of Profits

The Board of Directors has recommended the distribution of SR 795 million to shareholders, corresponding to a dividend of SR 13.25 per share. The Board has also recommended the appropriation of retained earnings as follows:

	SR 000's
Net Income	1,061,987
25% Transfer to Statutory Reserve	(265,497)
Retained Earnings from 1997	25,061
Profits available for distribution	821,551
Distributed as follows:	
Proposed dividend to the shareholders	795,000
Zakat	26,092
Retained Earnings for 1998	459
	821,551

Donations

In 1998 NCB continued its long established practice of contributing to social, cultural, charitable and educational activities in the Kingdom. Contributions and donations to a wide variety of deserving causes, including educational and charitable societies, individuals and social activities, amounted to SR 41.1 million for 1998.

Audit Committee

Pursuant to the requirements of SAMA and The Ministry of Trade, NCB has formed a three member audit committee, which commenced its work on the 1st July 1998.

Appointment of Auditors

The first general meeting of the Bank's shareholders held on 11-2-1418 H (corresponding to 16th June 1997), appointed Messrs. Al-Sayed Al Ayouti & Co. and Messrs. Whinney Murray Co. jointly as Auditors of the Bank for a period of two years, effective from 1st July 1997, the date of converting the Bank into a joint stock company, and determined their fees in accordance with Article 37 of the Bank's Articles of Association.

Finally, we wish to pay tribute to the guidance and assistance we have received from the supervisory authorities; and we would also like to thank the Bank's customers, correspondents and employees for their support and commitment in 1998, and their continuation in the coming years.

The Board of Directors

Commitment and meaningful dialogue leads to lasting relationships with our customers.

Review of operations

1998 has seen the Bank successfully meet each one of the objectives set out in our strategy document three years ago. Against a background of unprecedented turbulence in world markets, historically low oil prices and a fierce squeeze on domestic liquidity, I am pleased to report that we have met our budget targets for the year.

Saleh Hussein Kaki
Deputy General Manager for Banking Operations

Customer satisfaction has remained at gratifyingly high levels and our delivery channels have improved significantly, particularly through our ATM network and the 24-Hour Call Centre. By April 1999, we expect to be fully Year 2000 compliant.

For NCB a new cycle is beginning. We will continue to develop the role of our branch network and enlarge our customer base, principally by targeting the student/youth market and those currently outside the banking system. We have set ourselves the target of 75% Saudisation by the year 2000 and will continue to seek the optimum balance between staffing levels and technological advances. In summary we will follow a course of measured expansion.

Retail Banking

Retail banking remains the bedrock for NCB's operations and ensures we remain responsive to our customers' needs. In a market which grew modestly during 1998 NCB's share increased encouragingly. 1998 has also seen a healthy rise in Saudisation within the division, from 71% to 76%.

Our branch network has now reached 249 Kingdom-wide and continues to provide an extremely valuable distribution channel for the products and services our customers require. In keeping with our historical commitment to providing services throughout the Kingdom, we operate a number of branches in more remote locations, which perform an important social function. Through these, the government payroll to its staff can be delivered conveniently and efficiently.

We have undertaken a comprehensive review of our branches, their look and feel, in order to improve the transaction environment still further. In 1997, we introduced the concept of the electronic, or virtual, branch. During 1998, this has evolved into the self-assisted branch, with an ATM, a utility payment terminal, a deposit facility and an interactive information terminal. Each branch of this type is also staffed by two bank employees. The first was opened in the north terminal of Jeddah's King Abdulaziz International Airport.

The Al Wessam Prime Service, introduced last year for the Bank's upscale customers, has enjoyed a satisfying record of growth and amply demonstrates the popularity of conducting business in the comfortable surroundings of dedicated, well-equipped private lounges.

During the year, we launched an innovative new programme, Al-Maziah, targeted at our upper middle-market customers. The launch was supported by an extensive marketing campaign which, for the first time, included advertising on both local and satellite television networks. Besides providing the usual benefits associated with a traditional current account, the Al-Maziah programme offers a unique package of eight valuable benefits which can be selected as appropriate to meet customers' needs.

During the year, the Al Asriyah programme for ladies was successfully relaunched with an upgrading of the services provided and has resulted in a substantial increase in our customer base. Equally rewarding was the performance of the Al Ajyal programme which was launched in 1996. Targeted at the student/youth market, the programme grew remarkably over the year.

The popularity of telephone banking continues to rise. Indeed, the Call Centre has become an important hub for communication with our customers, for enquiries and marketing. Call volumes to the toll-free number have risen annually and staffing levels have been increased appropriately. Despite the rapid growth, response times are currently running at an average of four seconds. Furthermore, to monitor service quality and help identify further improvements, we have launched a Management Call-Back initiative, designed to gauge customer reaction to our performance and delivery. Saudisation within the Centre has now reached an impressive 81%.

NCB's ATM network, which now stands at 375 machines across the Kingdom, represents a market share of 21%. During 1998, ATM transactions have grown strongly, rising more than 30% compared with the previous year. POS terminals, on the other hand, have seen a decline as we continue to restructure the distribution network in order to improve quality.

Following new initiatives, credit card business has grown substantially during 1998, particularly among non-bank customers. Two major programmes were launched – the MasterCard World Cup card and the MasterCard and VISA Al Fursan co-branded cards. A measure of our success was reflected in the award we received from Mastercard International against competition from 11 countries in the Middle East and Africa. VISA International also acknowledged NCB's successes with the Al Fursan co-branded card.

We will continue our commitment to upgrade and improve the range of services offered through our alternative distribution channels, of which Telephone Banking and ATMs are the backbone. 1999 will see considerable improvements in these areas as well as the testing of other channels becoming available through new technology. We anticipate the launch of the Internet in the Kingdom with enthusiasm. We believe it represents an exciting new medium for delivering the Bank's products and services to an even wider customer base in a fast changing environment.

Corporate & Institutional Banking Division

Within the Corporate & Institutional Banking Division (CIBD), it is the quality of relationships with our customers and the in-depth development of our human resources which matter. We seek to build the best team of corporate bankers in the Kingdom, with a wide range of experience and a high level of enthusiasm and motivation. We operate a 14-year training programme designed to create bankers of international quality with the broadest possible perspectives. Our long term commitment ensures a ready supply of quality personnel to fuel the Bank's future expansion in every business sector.

During 1998, CIBD has been regrouped into three separate sub-divisions. This permits the consolidation and centralisation of business functions and a reduction of administrative layers in the back office.

Corporate Banking Group (CBG) serves large corporate entities. Its objective is to deliver innovative tailor-made products and services which reflect the complexities and corporate banking needs of NCB's larger business customers. Typically, these will include financing expansion and working capital requirements, trade, project and contract financing. CBG is ranked number one among Saudi banks, with a large share of the market.

Over the course of the year, the Corporate Business Banking Group (CBBG) has been split into two – the Middle Market Unit which focuses on medium sized businesses and the Business Banking Unit which meets the needs of small businesses. The service includes short, medium and long term loans, letters of credit and guarantee, foreign exchange and a full range of commercial banking products. In its sectors, CBBG enjoys a good share of middle market business and a larger share among smaller businesses.

The Special Assets Group (SAG), introduced this year, concentrates on corporate recovery and the remedial management of problem relationships. Recognising the challenges of today's turbulent business climate, SAG develops proactive action plans to explore alternatives for improvement with difficult credits – thus creating profitable performing assets and minimising potential losses.

CIBD has completed a number of significant transactions during 1998. These include over SR 1.5 billion in syndications and SR 500 million in project finance. Working closely with Islamic Banking, CIBD is making substantial progress in devising new, high-added value solutions within an Islamically acceptable structure. 1998 witnessed the birth of new transactions that offer considerable potential for our customers. Working in tandem with our Islamic Banking Division, we granted a loan worth SR 375 million to a major corporate entity in the Kingdom and have secured deposit funds in excess of SR 700 million from a semi-governmental institution.

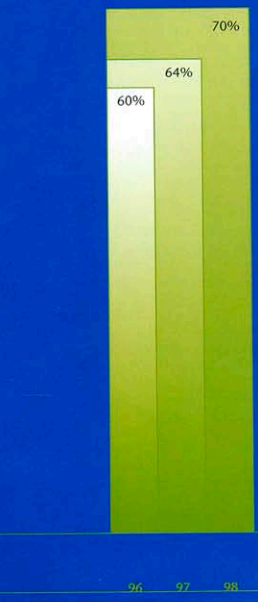
Corporate Finance

Formed nearly four years ago under the umbrella of the CIBD, Corporate Finance enjoys a substantial level of autonomy due to the nature of its business, geographic spread and its product range. The department is a major regional player, active in the GCC countries, Egypt and the Levant, and acts as CIBD's marketing arm in those areas. Its activities are divided into M & A, advisory services, structured finance and direct equity investment. This structure generates a large measure of cross fertilisation, and leads to much broader penetration of the market.

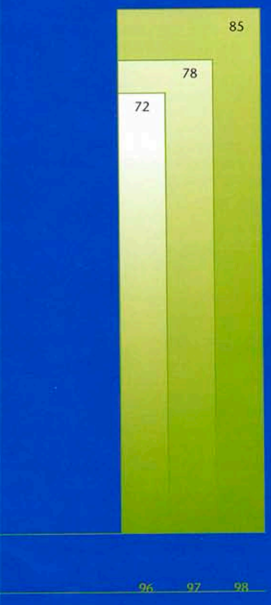
The Bank's sophisticated new computer system gives access to NCB's database of customers with an appetite for regional investments. This combination of connections and placing power ensures that American and European financial institutions regard the Bank as having the most significant placing power in the Kingdom; augmented by the tactical alliances forged with other dominant players in the GCC region.

High profile deals, concluded during 1998, include the first Master Lease Facility Agreement and Heavy Equipment Receivables Asset-Backed Securities in the Kingdom. We have now begun to export our expertise, as demonstrated by the first Asset-Backed Securities transaction in Egypt and a private placing of US$ 15,000,000 on behalf of a group of Saudi investors in an American entity.

We have served the Kingdom, providing a high level of products and services to successive generations of Saudi citizens.



Saudisation performance



Customer deposits & liabilities SRbn

Formed some 15 months ago, the Direct Equity Investments team is due to launch the first Direct Equity Fund in the region, targeting small and medium-sized unlisted companies in Saudi Arabia and other GCC countries. This market segment offers considerable potential as family-run trading establishments and manufacturing groups address the key issues of succession, wealth transfer and continuity.

Looking to the future, NCB is keen to explore corporate finance opportunities and Sharia-compliant structured finance. We view the forthcoming privatisation programmes in the region with keen anticipation.

Investment Services

As the investment services pioneer in the Kingdom, NCB enters its twentieth year in the mutual fund business with a 60% market share of open-ended funds sponsored by Saudi banks. We continue to be the provider of choice to the vast majority of Saudi households investing in mutual funds. This is confirmed by our annual customer satisfaction ratings which exceed 90%.

Over the past twenty years, NCB has recognised that its investors' needs and goals evolve with time. As the choice of available investments is constantly improving and increasing in complexity, we have consistently demonstrated to our customers our ability to match their growing financial needs with solutions that are appropriate, competitive and convenient.

NCB currently offers twenty-six mutual funds with different risk profiles. The range of Al-Ahli Funds includes eighteen open-ended funds, of which eight are fully Sharia-compliant. Our mutual fund account holders number more than 34,000 – about one in every two investors. To increase accessibility and liquidity, Al-Ahli fund customers can subscribe to or redeem our short term funds daily, and our medium and long term funds twice weekly.

The appetite for Sharia-compliant investment vehicles continues to grow. As a major player since 1987, NCB remains committed to developing and delivering products under the guidance of our Board of Islamic scholars. Launched in 1995, the Al-Ahli Global Trading Equity Fund (GTEF) is now the world's largest Sharia-compliant fund with just under SR 2 billion of assets under management. The fund has also generated a highly competitive return of 118% since inception. At the end of the first quarter of 1998, NCB signed an historic agreement with the National Bank of Kuwait (NBK) to launch the Al-Kawther Fund, which now offers Kuwaiti investors the opportunity to invest in this highly successful fund.

This year, NCB launched two new Sharia-compliant funds: the Al-Ahli Saudi Equity Trading Fund and the Al-Ahli Small Cap Trading Equity Fund. In addition, the Al-Ahli European Equity and Al-Ahli US Equity funds have been redesigned to become Sharia-compliant as well.

During 1998, our series of open-ended Capital Protected Funds (CPF) have remained highly popular with our investors. In 1996 NCB was the first bank in the Kingdom to offer this type of fund, which provides the ideal entry point into the world of investments. It combines the features of a fixed deposit with equity investment at relatively low risk. During the year, NCB's CPF 4, US Equity Protected Fund (USEPF) and Europe Equity Protected Fund (EEPF) have attracted more than SR1.6 billion between them.

The percentage of Saudi households investing in mutual funds is relatively low by world standards. But, as the leader in a growing market, NCB is actively developing the market and raising public awareness. In September, we participated in the third Annual Investment Symposium held at the Institute of Banking in Riyadh, where NCB received five 1998 Saudi Investment Fund awards. We have introduced a new range of literature, including our quarterly newsletter "Investment Horizons", to help our customers plan for their life's needs.

We are committed to growing the market and maintaining our position of leadership by continuing to listen to our customers and delivering products that are appropriate, innovative and competitive.

Treasury

1998 was a roller coaster year for the world's financial markets and their participants, with levels of volatility rising by a factor of four. Perhaps the lowest point was reached during the third quarter, when events in Russia, the Far East, the United States and Latin America caused major concern worldwide.

Like most banks, NCB's treasury operations suffered from the volatility; however losses

Review of operations

sustained in trading were largely offset by a strong increase in customer related activity. In fact, 1998 was a record year for customer generated revenues.

Risk management has been one of the year's highlights in a tough trading environment. Our market risk management systems met and survived the challenges we faced and provided good analyses of potential losses at all times.

1998 was also a tough year for the domestic markets. Low oil prices combined with public sector retrenchment resulted in a sharp decline in domestic liquidity, as demonstrated by the increase in spread between the Saudi Riyal and the US Dollar. Responding to the change in market conditions, SAMA introduced the Market REPO Rate (MRR) in October and, two months later, launched a 10-year Saudi Government Development Bond (SGDB) and, more importantly, de-linked SGDB pricing from US Treasury yields. This resulted in the creation of a domestic Saudi Riyal Yield Curve.

The decline in liquidity did not translate into a decline in deposits. Indeed, customer deposits rose by 9.6%, or SR 5.9 billion, and represented one of the strongest growth rates in recent years. Accordingly, NCB's share of this extremely important market rose sharply.

Due to the amount of de-leveraging in global markets during the second half of 1998, we expect volatility will decline in 1999 and, therefore, do not expect a repeat of the broad-based asset price deflation that occurred in September and October. However, there are still many imbalances in the global system, so 1999 will be a difficult year for investors. Domestically, liquidity will continue to be a problem. This will put pressure on interest rates, and perhaps even on the parity, but we do not expect to see a devaluation of the Saudi Riyal.

Islamic Banking

Over the course of the year, Islamic banking has continued to gain ever wider acceptance as the benefits of this type of finance become increasingly apparent. Indeed, in 1998 the Islamic Banking Division has managed to record above average growth.

Somewhat exceptionally among banks, NCB offers a full range of Islamic financial products, these include Musharaka, Mudaraba, commercial and personal Murabaha, as well as Ijara, Bai Salam and Istisna'a financing facilities. All are subject to the stringent criteria laid down by our own Sharia Board, composed of leading scholars drawn from across the Kingdom. Under their invaluable guidance, we continue to develop new and innovative products specifically targeted at our customers' needs in the investment, finance and retail sectors.

During 1998, we have launched two new structured finance products in addition to two new Islamic investment funds. Three further investment funds are due to be introduced in 1999.

The number of NCB branches dedicated to Islamic banking has now reached 47 and the level of Saudisation within the division stands at more than 70%. It is particularly noteworthy that every senio management position is held by a Saudi national.

NCB's offshore banking unit in Bahrain, which is widely perceived as a centre for Islamic banking, offers a powerful springboard from which to launch Islamic banking products into other countries within the GCC region and beyond. At the same time, we are actively co-operating with other divisions within the Bank to offer Islamic products to a wider clientele.

Consistent with our role as an educator in the field, NCB sponsored a symposium to investigate the parameters and feasibility of establishing an Islamic credit card which would be fully Sharia-compliant. The event was extremely well attende

During 1999, we plan to introduce a number of new products and broaden our customer base, with a special focus on the retail sector.

Private Banking

Since its establishment in 1993, NCB Private Banking has delivered a highly focused service to high net worth individuals in Saudi society, who seek the best in investment management, financial advisory and personalised banking services. We regard private banking as a people business, with the emphasis on customer service and relationship management, in which we shar both the vision and the reward.

Our core objectives remain constant from one yea to the next – to grow, protect and provide efficiently for the transfer of wealth from one generation to the next. Such objectives require ski

To understand our customers' needs, we take a proactive approach to developing solutions.

Review of operations

knowledge and experience: qualities we carefully nurture to ensure we maintain a team of top flight private bankers with a long term perspective.

Our international brokerage was subsumed within Private Banking in 1996, since which time income has doubled year-on-year. This broking service provides exciting investment opportunities for our clients on a global scale, at competitive prices, from people with whom they have built an established relationship.

With Saudisation standing at 83%, we bring dedication, commitment and understanding to the task of meeting our clients' challenging requirements. These often extend far beyond the purely financial, into areas such as property, education overseas and, indeed, the Millennium Bug problem. We have advised many of our clients about the implications of Year 2000 and its likely impact, both privately and professionally.

Operating without territorial restrictions, we aim to deliver wholly impartial advice, and thus maintain our hard won reputation as trusted advisors. Through a complex network of connections, allies and strategic partnerships, we offer ingenious solutions to challenges, even if they fall outside our own direct areas of expertise.

Systems & Operations

The division performs two distinct but related functions within the Bank. The IT Group is responsible for planning, developing and managing the complex computer systems and network, which is indispensible to every facet of the Bank's operations. The Operations Group provides the extensive and all important back-office processing services on behalf of the front-line business units.

The IT Group's mission is to provide a timely, consistent and reliable banking system which performs smoothly and efficiently at the operational level. During the year, the group has focused on ensuring that all systems are fully Year 2000 compliant. It has also played a major part in planning and re-engineering the Bank's operations by increasing the automation process.

To achieve this objective, the underlying communications backbone is being upgraded and an advanced network protocol has been put in place. The core systems supporting the Bank's various divisions are being integrated and the data warehouse has been enriched to enhance the level of customer service. These measures will redefine and drive forward NCB's new delivery channels. Two of these, the Call Centre and the PC Banking system are close to being finalised. Future delivery channels, which include the Internet, extranet and kiosks, will position the Bank to take full advantage of the growing opportunities of e-commerce.

The Operations Group's activities are divided between three separate departments. Centralised Operations handles clearing through SAMA, the processing of utility bills, payrolls and loans, vault and off-site ATM cash management, as well as local and overseas fund transfers. Trade Services deals with all aspects of letters of credit, letters of guarantee, documentary collections, shipping guarantees and bill discounting. The department maintains a team of highly skilled trade specialists to guide and advise our customers. Treasury Operations offers a comprehensive execution service on behalf of the Bank's Treasury, which includes foreign exchange transactions, money an capital markets, derivatives and private portfolios.

During 1998, the Operations Group has continued to improve service levels for clients both within and outside the Bank. The year's achievements have included the centralisation, in Jeddah, of all outgoing local bank transfers through SARIE, as well as the automation of all trade finance transactions. Currently, the group is undertaking fully automated payroll processing o behalf of a number of external entities.

At present, the trade finance system is being integrated with SWIFT and BANCS, which will eliminate the Y2K problem and effect considerable gains in operational efficiency. A ne service is to be launched shortly, which will allow customers to enquire about and initiate trade finance transactions using a PC, via the Internet, in their own offices. This will be followed, later in the year, by an automated direct debit service operating through SARIE and straight through processing (STP).

The group will continue to add value to its servic by streamlining systems and developing human resources still further. Over the course of the yea the division's level of Saudisation rose to 65%.

Year 2000

The Year 2000 problem is one of the most critic issues confronting business and the wider community across the world. NCB has been conscious of its responsibility to be fully compliant well in advance, not only Kingdom-wide, but overseas as well. The Year 2000 Project Office was established in January 1997 with the clear mandate to initiate, manage and co-ordinate the Bank's efforts. This mammoth undertaking is being tackled by dedicated teams of professionals representing every one of NCB's divisions.

Under comprehensive guidelines issued by the Saudi Arabian Monetary Agency (SAMA), all banks in the Kingdom are required to have their mission critical systems fully compliant by 30 April 1999. NCB has committed substantial financial and human resources to meet the key deadlines and ensure that none of its customers will suffer any interruption in service.

Mindful of our obligation to the wider community, we have published an extensive range of literature on the topic and held seminars for our customers and business partners Kingdom-wide, to raise awareness of the problem and exchange ideas.

Audit

The division's primary objectives are to promote a comprehensive control structure at every level within the Bank and to provide an efficient, value-added service to management. In doing so, we use the most up-to-date techniques including risk-based audit methodologies.

Our participation in the process of enhancing NCB's policies and procedures is on-going. We devote substantial resources to consultancy and advisory activities for other divisions. These activities include assessing new product developments, identifying the risks and recommending adequate controls, as well as proposing strategies to improve the quality of NCB's loan portfolio. We also publish bulletins on topics such as fraud and money laundering.

During the course of the year, the value of the division's consultancy role has been underscored by the number of assignments undertaken in many different business areas. Our involvement in the Year 2000 compliance project is a case in point, where we have raised awareness at a senior level and participated in the formation of the Y2K task force.

Training has remained a priority. We launched our own computer-based training programme on money laundering – the first of its kind in Arabic- which can be accessed by PC. We have also developed from conception a modern bank audit training programme in Arabic, which reinforces the transition from traditional audit methods to the latest international standards. Again, this is a first.

The year has also seen the creation of an Audit Committee, composed of non-executive directors, which is briefed by the Audit Director. Its function is to address issues of corporate governance and to ensure that NCB continues to comply with its obligations to customers and shareholders, and with legal and regulatory requirements.

International Division

The division serves two distinct customer groups. The first consists of overseas banks and financial institutions which wish to conduct business with Saudi Arabia. Within this group are the 600 plus institutions in over 70 countries with which NCB maintains business relationships. The second group comprises customers of the Bank within Saudi Arabia, who wish to transact business outside the Kingdom and require a business partner or intermediary. International Division manages the relationship with those intermediaries.

The Jeddah-based division is supported by branches in Bahrain and Beirut and representative offices in London, Frankfurt, Singapore, Seoul and Tokyo. The unit in Bahrain manages all offshore lending business for the Bank and its customers, whilst the branches and representative offices are business development and service units, each of which has a defined catchment area covering Saudi Arabia's major trading partners. The division is a significant contributor to the Bank's profitability – and 1998 proved to be a record year.

In the face of continuing economic turbulence, International Division has managed the Bank's international exposure prudently. The division's main focus has been to service our domestic customer base and international correspondents in their payment and trade needs without increasing NCB's risk exposure. We have played an important role in meeting the needs of the Kingdom's largest exporters and importers, having provided support to international clients bidding for contracts in Saudi Arabia and helped the development of the growing non-oil export sector. An area of particular focus has been our work with international institutions to develop Islamic products for transactions, both within the Kingdom and overseas.

Retail banking lies at the heart of NCB's operations, where our dedication to customer satisfaction is never-ending.

The arrival of the Euro represents an exciting challenge, since it helps our customers to reduce the cost of cross border transactions with Europe – a significant trading partner. The division was actively involved in ensuring that the Bank was ready to provide our customers with a range of Euro related products which fully meet their requirements. During the coming year, we will seek to ensure that our customers receive a problem-free service while continuing to transact international business, despite the challenges which the new millennium is expected to bring. Similarly, we will be selecting our international partners carefully to protect our customers and operations against Year 2000 non-compliance.

Finance & Accounting

The division's primary responsibilities continue to be the delivery of timely, accurate financial information and the maintenance of strong and comprehensive financial and internal controls.

The division ensures the availability of fast, accurate, reliable and relevant financial information, which strictly conforms with national and international accounting standards, to support the decision-making process throughout the Bank and which actively enforces a culture of strong financial and budgetary control.

During the year, the division has been one of the leading participants in the planning, testing and implementation of strategic management information and control systems, with a view to improving the efficiency, productivity and flexibility of information access across the Bank.

Significant progress has been made in maintaining and enhancing the internal and financial control structure of the Bank, by migrating from detective and reactive controls to a more proactive and preventative approach.

The division's contribution to the Year 2000 project has focused on developing contingency planning and compliance testing of financial accounting systems.

General Support Services

The General Support Services Division implements the Bank's plan for the training and recruitment of local talents to fulfill its national and social role in creating job opportunities for Saudi youths. To that end 241 Saudis were recruited and 186 graduates joined the Bank's training programme during the year, thus raising the level of Saudisation to 70% by the end of 1998.

The Bank actively pursued training programmes for its employees to prepare them for the changes and the challenges ahead and to improve its services. In this respect the Bank organised more than 30,000 training days, 16,000 of which were at its Training Centre. A plan has also been drawn up to prepare and provide the human resources required to meet the expected expansion in Islamic Banking.

The division always endeavours to improve its services and increase its cost-effectiveness through the rationalisation and automation of some of its processes, and contracting out some others to companies that are better qualified and equipped to provide such services. In this respect a contract was signed with a specialist medical insurance company to provide healthcare and treatment for the Bank's employees and their families.
A contract was also signed with a company to maintain the Bank's headquarters in Jeddah. A third contract was signed with a company to deliver mail within the Bank's headquarters and between various divisions and branches.

The division also prepared a number of operational guides and established a system for liaison with employees, and through the Bank's Purchase Office all its needs are met at optimum prices. On the other hand the office of Buildings and Engineering is building new branches and identifying positions for new ATMs.

Public Relations

Open dialogue is a hallmark of NCB's way of doing business and the division maintains strong links with a large sector of the community, including customers and the media.

The division prepares and organises conferences and exhibitions inside the Kingdom and abroad to ensure an open and useful exchange of views and a climate conducive to development and progress.

The division also supports wide-ranging educational, social, health, sport and literary activities. It does this through active participation in organising information weeks and art exhibitions, as well as cultural and sports competitions.

The division also receives guests from the Kingdom and abroad and supervises the senior management's programme of visits to various

NCB acknowledges its responsibility to the wider community and participates in a large range of projects.

parts of the Kingdom and its meetings. It also supplies the media with statements and publishes the Bank's Consolidated Balance Sheet.

To further open dialogue between senior management and staff, the division publishes a monthly newsletter which contains information about all aspects of the Bank's activities. The division also oversees the publication of the Bank's annual report which is sent out to local and international banks and correspondent banks. It also organises ceremonies to honour members of staff. The Bank remains committed to supporting worthy causes and, during 1998, the Bank's charitable donations doubled, reflecting a principle laid down by our founder Sheikh Salim Bin Mahfouz.

Finally, 1998 was a year of consolidating our activities and during the year we maintained the momentum created in previous years. In this respect we regard the Award for Excellence received by the Bank from *Euromoney* in 1998 as an incentive to improve our services even further to meet the needs and expectations of our customers, partners, staff and shareholders alike. To attain these goals we shall remain committed to serving our customers wherever they are.

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Whinney Murray & Co.
Ernst & Young International
P.O. Box 1994, Jeddah 21441
Saudi Arabia

Al Sayed El Ayouty & Co.
Member of Moore Stephens International Limited
Accountants and Auditors
P.O. Box 780, Jeddah 21421
Saudi Arabia

To the Shareholders of
The National Commercial Bank

We have audited the balance sheet of The National Commercial Bank (the "Bank") (a Saudi Joint Stock Company) as of 31 December 1998 and the related statements of income, changes in shareholders equity, and cash flows for the year then ended, including notes 1 to 25 which form part of these financial statements. These financial statements, which have been derived from computerised accounting records maintained in Arabic in the Kingdom of Saudi Arabia, are the responsibility of the Bank's Board of Directors and have been prepared by them in accordance with the provisions of Article (123) of the Regulations for Companies and the Banking Control Law and submitted to us together with all the information and explanations which we required. Our responsibility is to express our opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable degree of assurance to enable us to express an opinion on the financial statements.

In our opinion, the financial statements taken as a whole:

- present fairly, in all material respects, the financial position of the Bank as of 31 December 1998 and the results of its operations and its cash flows for the year then ended in accordance with Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Agency and International Accounting Standards; and

- comply with the requirements of the Regulations for Companies, Banking Control Law and the Bank's Articles of Association in so far as they affect the preparation and presentation of the financial statements.

Whinney Murray & Co

Dr Abdullah Abdulrahman Baeshen
Registration No. 66

Al Sayed El Ayouty & Co
Accountants and Auditors

Al Sayed El Ayouty
Registration No. 36

Jeddah: 15 Safar 1420 H
Corresponding to: 30 May 1999

Balance sheet

as at 31 December 1998 (in thousands of Saudi Riyals)

		Note	1998	1997
Assets	Cash and balances with SAMA	3	**2,900,493**	2,899,160
	Due from banks	4	**7,914,644**	14,144,783
	Trading securities	5	**1,462,027**	1,320,500
	Loans and advances, net	6&21	**56,414,407**	46,290,109
	Investment securities, net	7	**19,178,481**	16,863,104
	Fixed assets, net	8	**1,693,792**	1,702,017
	Other real estate	9	**1,367,988**	1,030,880
	Other assets	10	**1,998,706**	2,187,589
Total assets			**92,930,538**	86,438,142
Liabilities and shareholders' equity	Liabilities			
	Customers' deposits	11&21	**65,743,653**	61,929,185
	Due to banks	12	**15,998,878**	13,919,435
	Other liabilities	13	**3,160,356**	2,802,766
Total liabilities			**84,902,887**	78,651,386
Shareholders' equity	Share capital	14	**6,000,000**	6,000,000
	Statutory reserve	15	**2,027,192**	1,761,695
	Retained earnings		**459**	25,061
Total shareholders' equity			**8,027,651**	7,786,756
Total liabilities and shareholders' equity			**92,930,538**	86,438,142
Contra accounts		18-2&21	**89,488,848**	90,029,505

The accompanying notes 1 to 25 form an integral part of these financial statements.

for the year ended 31 December 1998 (in thousands of Saudi Riyals)

		Note	1998	1997
Operating income	Special commission income		**4,300,565**	3,711,756
	Gain on foreign exchange		**110,616**	115,057
	Gain on trading securities		**106,312**	91,783
	Income from investment securities		**1,109,191**	1,278,691
	Income from other real estate	19	**26,134**	27,543
	Fees and income from banking services		**458,825**	450,453
Total operating income			**6,111,643**	5,675,283
Operating expenses	Special commission expenses		**2,905,642**	2,613,597
	Provision for loan losses	6	**646,802**	450,494
	Salaries and other staff related costs		**865,566**	864,536
	Rent and premises related costs		**100,305**	94,030
	Directors' fees and remuneration		**1,745**	-
	Depreciation of fixed assets and other real estate	8&9	**172,663**	162,105
	Other general and administrative expenses		**435,276**	514,948
Total operating expenses			**5,127,999**	4,699,710
Net operating income			**983,644**	975,573
Other income (expenses)	Other income	20	**119,447**	166,394
	Donations and charitable contributions		**(41,104)**	(86,673)
			78,343	79,721
Net income before Zakat			**1,061,987**	1,055,294
	Zakat	2-k	**-**	(12,003)
Net income			**1,061,987**	1,043,291
Earnings per share (SR)		16	**17.7**	17.4

The accompanying notes 1 to 25 form an integral part of these financial statements.

Statement of changes in shareholders' equity

for the year ended 31 December 1998 (in thousands of Saudi Riyals)

		Note	Share capital	Statutory reserve	Retained earning
1998	Balance at beginning of the year		**6,000,000**	**1,761,695**	**25,061**
	Net income		-	-	**1,061,987**
	Transfer to statutory reserve	15	-	**265,497**	**(265,497)**
	Proposed dividend and zakat	17	-	-	**(821,092)**
	Balance at end of the year		**6,000,000**	**2,027,192**	**459**
1997	Balance at beginning of the year		6,000,000	1,500,871	153,969
	Net income		-	-	1,043,291
	Transfer to statutory reserve	15	-	260,824	(260,824)
	Proposed dividend and Zakat	17	-	-	(314,710)
	Profit distributed to partners		-	-	(596,665)
	Balance at end of the year		6,000,000	1,761,695	25,061

The accompanying notes 1 to 25 form an integral part of these financial statements.

for the year ended 31 December 1998 (in thousands of Saudi Riyals)

		1998	1997
Cash flows from operating activities	Net income	**1,061,987**	1,043,291
	Adjustments to reconcile net income to net cash from operating activities:		
	Depreciation of fixed assets and other real estate	**172,663**	162,105
	Gain on disposal of fixed assets and depreciation differences	**(31,828)**	(1,175)
		1,202,822	1,204,221
Net decrease/(increase) in operating assets	Due from banks	**6,230,139**	(1,466,688)
	Trading securities	**(141,527)**	(193,322)
	Loans and advances–net	**(10,124,298)**	(8,119,037)
	Other real estate	**(345,510)**	(5,826)
	Other assets	**235,010**	(133,348)
Net increase/(decrease) in operating liabilities	Customers' deposits	**3,814,468**	3,925,105
	Due to banks	**2,079,443**	2,488,614
	Other liabilities	**(165,626)**	101,814
Net cash from/(used in) operating activities		**2,784,921**	(2,198,467)
Cash flows from investing activities	Net (increase)/decrease in investment securities	**(2,315,377)**	3,791,636
	Purchase of fixed assets	**(179,679)**	(195,999)
	Proceeds from disposal of fixed assets	**11,468**	10,211
Net cash (used in)/from investing activities		**(2,483,588)**	3,605,848
Cash flows used in financing activities	Dividends distributed	**(300,000)**	(1,129,168)
Net increase in cash balances with SAMA		**1,333**	278,213
	Cash and balances with SAMA at beginning of the year	**2,899,160**	2,620,947
Cash balances with SAMA at the end of the year		**2,900,493**	2,899,160

The accompanying notes 1 to 25 form an integral part of these financial statements.

Notes to the financial statements

31 December 1998 (in thousands of Saudi Riyals)

1. General

The National Commercial Bank (the Bank) is a Saudi Joint Stock Company in accordance with a Cabinet Resolution No. 186 dated 22 Dhul Qida 1417 H (corresponding to 30 March 1997) and Royal Decree No. M/19 dated 23 Dhul Qida 1417H (corresponding to 31 March 1997) approved the Bank's conversion from general partnership to a Saudi Joint Stock Company. The partnership was established in accordance with a registration certificate authenticated by a Royal Decree in Rajab 1369 (corresponding to May 1950) and registered under commercial registration No. 1588 issued in Dhul Hijjah 1376 H (corresponding to July 1957). The date of 1 July 1997 was determined to be the effective date of the Bank's conversion from general partnership to a Saudi Joint Stock Company.

The objectives of the Bank are to provide all banking services. The Bank operates through 245 branches (1997– 245 branches) in the Kingdom of Saudi Arabia and 2 overseas branches (Beirut and Bahrain).

The Bank has 60% ownership in a subsidiary, the Commercial Real Estate Markets Company, a Limited Liability Company registered in Saudi Arabia under commercial registration number 4030073863 dated 5 Rabi Thani 1411 H (corresponding to 24 October 1990). The company is engaged in owning, maintaining and managing the Jamjoom Centre in Jeddah. The financial statements of the subsidiary have not been consolidated with the Bank's financial statements on the grounds that the activities of the subsidiary are dissimilar to the Bank's activities. This subsidiary has been accounted for on equity basis and included in investment securities.

2. Summary of significant accounting policies

2-a) Regulatory requirements

The Bank is subject to the Regulations for Companies and the Banking Control Law in the Kingdom of Saudi Arabia. The financial statements are prepared in accordance with the Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Agency (SAMA), the requirements of the Regulations for Companies, the General Presentation and Disclosure Standard issued by the Saudi Arabian Ministry of Commerce and comply with the International Accounting Standards.

2-b) Accounting convention

The financial statements are prepared under the historical cost convention.

2-c) Trading and investment securities portfolios

The Bank maintains two separate and distinct securities portfolios, namely "investment securities" and "trading securities". The designation of investments is made by the Bank's management between the two portfolios at the time of purchase and no transfers are made between them after such date unless the management has justifications for such transfers.

2-c-i) Trading Securities

Securities purchased for trading purposes are recorded at cost of acquisition at the date of purchase and are marked to market at the balance sheet date. The realised and unrealised gains or losses are included in income from operations. Yield from these securities is classified as other income (expenses).

2-c-ii) Investment securities

Investment securities are stated in the balance sheet at cost adjusted for amortisation of premiums and accretion of discounts, when applicable, net of provision for any permanent decline in value. Investment in subsidiary is accounted for on equity basis.

Amortisation and accretion are computed using the straight line method over the remaining period to maturity. The amortised premium and discount and the income earned by the Bank on these securities are included in operating income.

In case of a permanent diminution in the value of any individual security, a provision is made for the amount of diminution. Such provision, as well as gains and losses arising on disposal of investment securities, are classified as other income (expense).

2-d) Provision for loan losses

Provision is made against specific loans and advances following a study of the portfolio that takes into account the recoverability of those debts and the general economic conditions. Such provision is charged to operating expenses.

Loans and advances are written off only in circumstances where all possible means of recovery have been exhausted and after taking into account the guarantees provided in respect of such loans. Provision for loan losses is deducted from loans and advances in the balance sheet.

2. Summary of significant accounting policies (continued)

2-e) Fixed assets
Fixed assets are stated in the balance sheet at cost net of accumulated depreciation.

Freehold land is not depreciated. The cost of other fixed assets is depreciated using the straight line method over their expected useful lives, based on the following annual percentage rates:

Freehold Buildings	2.5%
Furniture, Vehicles and Equipment	10% to 25%
Leasehold Buildings	over the lease period

2-f) Other real estate
The Bank occasionally acquires real estate against settlement of overdue loans and advances. Such real estate is recorded at the lower of fair market value of the acquired real estate or the present value of outstanding loan or advance at the settlement date.

Other real estate is valued periodically by independent appraisers. The unrealised loss arising on periodical valuations of other real estate and gains/losses on disposal are included in operating income.

The cost of buildings included under other real estate is depreciated using the straight-line method at an annual rate of 2.5%.

Other real estate is stated in the balance sheet net of accumulated depreciation and provision for decline in book value.

2-g) Income recognition
Income and expenses are recognised on an accrual basis. However, income on loans and advances classified as non-performing is recognised on a cash basis until the loan or advance is reclassified as performing whereupon the recognition of income reverts to an accrual basis.

Income from Islamic products is recognised on an accrual basis except for income from musharakah transactions which is recognised on a cash basis.

2-h) Foreign currencies
Transactions in foreign currencies are translated to Saudi Riyals at the exchange rates prevailing on the dates of the transactions. Assets and liabilities in foreign currencies at the balance sheet date are translated to Saudi Riyals at the rates of exchange prevailing at that date.

Realised and unrealised gains and losses on exchange are credited or charged to operating income.

2-i) Financial instruments
Financial instruments include both on and off balance sheet instruments.

2-i-1 On-balance sheet financial instruments
On-balance sheet financial instruments comprise cash and balances with SAMA, due from banks, trading securities, loans and advances, investment securities, certain other assets, customer deposits, due to banks and certain other liabilities.

The fair values of on-balance sheet financial instruments, except for investment securities and loans and advances, are not significantly different from the carrying values included in the financial statements. The estimated fair value of the investment securities is based on quoted market prices when available or pricing models in the case of certain fixed rate bonds and estimated fair values for non-quoted securities. It is not practical to determine the fair value of loans and advances to customers with sufficient reliability.

The maximum credit risk from on-balance sheet financial instruments is equal to the carrying value disclosed in the financial statements, excluding fair values of collateral received.

2-i-2 Off-balance sheet financial instruments (contra accounts)
Off-balance sheet financial instruments comprise letters of credit, letters of guarantee, commitments to purchase and sell foreign currencies, interest rate and foreign currency related swaps, forward rate agreements, interest rate and foreign currency options, futures and other miscellaneous contingent liabilities.

The Bank enters into forward and future transactions, swaps and options to hedge the risks accompanying the management of its assets and liabilities, or for trading purposes. Trading transactions are also undertaken to service customer needs. Forward foreign exchange contracts are recorded in Saudi Riyals at the spot rates prevailing at the deal date. Premiums and discounts on forward foreign exchange contracts are amortised or accredited on a straight line basis over the period of the contracts. Contracts outstanding at the balance sheet date are valued at the spot exchange rate prevailing at that date. Realised and unrealised gains and losses on exchange are credited or charged to operating income.

31 December 1998 (in thousands of Saudi Riyals)

2. Summary of significant accounting policies (continued)

2-i-2 Off-balance sheet financial instruments (contra accounts) (continued)
Financial instruments concluded to hedge asset and liability risks are treated in the same manner as that adopted in respect of the item hedged. Commission income/expense from such instruments is included in operating income. Transactions concluded for trade purposes are marked to market; realised and unrealised gains or losses are included in operating income.

The fair value of off-balance sheet financial instruments is determined on the basis of market values.

The maximum credit risk from off-balance sheet financial instruments is substantially less than the carrying values in the balance sheet excluding fair values of collateral received.

2-i-3 Offsetting of financial assets and liabilities
Financial assets and liabilities are offset and reported net in the accompanying balance sheet when a legally enforceable right to set off the amounts exists or when the Bank intends to settle on a net basis or to realise the asset and settle the liability simultaneously.

2-i-4 Risk management
As part of the Bank's strategy, the Bank's management controls risks associated with financial instruments by hedging risk exposures, avoidance of undue concentration of risk and requirements for collateral to mitigate credit risks.

2-j) Employee's end of service indemnity
End of service indemnity payable to the employees of the Bank are provided for in accordance with the guidelines set by the Saudi Arabian Labour and Workman Law and is included in other liabilities.

2-k) Zakat
Zakat is the liability of the shareholders and is paid by the Bank on their behalf. Zakat is computed in accordance with the Regulations of the Department of Zakat and Income Tax based on the financial statements as at end of the year and is charged to the retained earnings. Up to 30 June 1997 and prior to the conversion of the Bank to a Joint Stock Company, Zakat was charged to the statement of income.

3.Cash and balances with SAMA		**1998**	1997
	Cash on hand	**733,447**	790,174
	Balances with SAMA		
	Statutory deposit	**2,161,048**	2,086,563
	Current accounts	**5,998**	22,423
Total cash and balances with SAMA		**2,900,493**	2,899,160

In accordance with Article (7) of the Banking Control Law, the Bank is required to maintain a statutory deposit with SAMA at stipulated percentages of its call, time, savings and other deposits determined at the end of each Gregorian month.

4. Due from banks		**1998**	1997
	a) Domestic		
	Call and current accounts	**301,654**	466,806
	Time deposits	**635,600**	1,790,030
		937,254	2,256,836
	b) Foreign branches of domestic banks		
	Time deposits	-	150,000
	c) International		
	Call and current accounts	**640,198**	1,263,040
	Time deposits	**6,337,192**	10,474,907
		6,977,390	11,737,947
Total due from banks		**7,914,644**	14,144,783

31 December 1998 (in thousands of Saudi Riyals)

5. Trading securities

	1998	1997
a) Domestic		
Units in Mutual funds managed by the Bank	**131,096**	188,913
Fixed rate Government bonds	**150,101**	169,895
	281,197	358,808
b) International		
Floating rate Government bonds	**19,176**	-
Fixed rate Corporate bonds	**28,787**	-
Floating rate Corporate bonds	**67,492**	-
Externally managed portfolios (shares, bonds and others)	**1,065,375**	961,692
	1,180,830	961,692
Total trading securities (at market value)	**1,462,027**	1,320,500

The cost of acquisition of trading securities as at 31 December 1998 amounted to SR 1,449 million (1997 - SR 1,238 million). The net unrealised gains on the trading portfolio resulting from marked to market valuation during the year amounted to SR 13 million (1997 - SR 82.5 million).

6. Loans and advances, net

6-1 Loans and advances comprise the following:

	1998	1997
Loans and advances, gross	**60,011,208**	49,946,765
Provision for loan losses	**(3,328,826)**	(3,150,943)
Accumulated commission in suspense	**(267,975)**	(505,713)
Loans and advances - net	**56,414,407**	46,290,109

Non-performing loans and advances as at the year end, net of accumulated commission in suspense, amounted to SR 5,816 million (1997 - SR 6,005 million). The commission in suspense earned on non-performing loans and advances but not recognised as income during the year amounted to SR 104 million (1997 - SR 48 million). In addition to the above provision, the Bank maintains collateral in kind against certain loans and advances.

6-2 Breakdown of loans and advances (gross) by major economic sector:

	1998	1997
a). Domestic		
a-1) Private sector		
Real estate	**1,787,279**	2,057,320
Agriculture	**61,977**	151,123
Manufacturing	**1,381,685**	1,669,169
Trading	**10,197,122**	10,065,549
Services and contracting	**16,858,205**	7,723,188
Other	**7,985,709**	1,285,965
a-2) Government, government agencies, quasi government and other public institutions	**20,999,170**	25,838,621
	59,271,147	48,790,935
b) International		
b-1) Private sector		
Other	**235,320**	541,268
b-2) Government, government agencies, quasi government and other public institutions	**251,720**	396,710
b-3) Banks	**253,021**	217,852
	740,061	1,155,830
Total loans and advances - Gross	**60,011,208**	49,946,765

Notes to the financial statements

31 December 1998 (in thousands of Saudi Riyals)

6. Loans and advances, net continued

6-3 Movement in the provision for loan losses.

		1998	1997
	Balance at beginning of the year:	**3,150,943**	2,923,698
	Amounts written off	**(772,900)**	(223,249)
	Additions during the year	**646,802**	450,494
	Adjustment	**303,981**	
Balance at end of the year		**3,328,826**	3,150,943

The above adjustments amounting to SR 303,981 thousand represent surplus in accumulated commission in suspense that the Management has decided transfer to the provision for loan losses.

7. Investment securities, net		1998	1997
	a) Domestic		
	Shares and investment in companies	**2,000,348**	1,747,849
	Units in Mutual funds	**65,832**	64,01
	Fixed rate Government bonds	**7,314,497**	6,439,314
	Floating rate Government bonds	**3,601,090**	3,151,090
	Fixed rate treasury bills	**737,081**	493,94
		13,718,848	11,896,21
	b) International		
	Shares	**54,144**	51,45
	Fixed rate treasury bills	**218,659**	328,39
	Fixed rate Government bonds	**396,750**	691,359
	Floating rate Government bonds	**205,923**	
	Fixed rate Corporate bonds	**126,112**	680,97
	Floating rate Corporate bonds	**3,325,082**	2,009,73
	Other investments (Islamic products)	**1,132,963**	1,204,96
		5,459,633	4,966,89
Total investment securities - net		**19,178,481**	16,863,10

The market/fair value of investment securities as at the balance sheet date amounted to SR 18,930 million (1997 - SR 17,275 million). These investments a intended for long-term investment purposes, with debt securities to be held until maturity at which point the face value of such securities will be realised.

8. Fixed assets, net		Land	Buildings	Furniture, vehicles and equipment	Tot
	Cost:				
	Balance at beginning of the year	325,379	1,537,824	841,967	2,705,17
	Additions	19,425	72,808	87,446	179,67
	Disposals	-	(6,097)	(35,982)	(42,079
	Adjustments	34,618	(68,524)	(12,221)	(46,127
Balance at end of the year		379,422	1,536,011	881,210	2,796,64
	Accumulated depreciation:				
	Balance at beginning of the year	-	465,031	538,122	1,003,15
	Additions	-	43,756	120,505	164,26
	Disposals	-	(2,286)	(28,624)	(30,910
	Adjustments	-	(12,667)	(20,986)	(33,65
Balance at end of the year		-	493,834	609,017	1,102,85
Net book Value at 1998		**379,422**	**1,042,177**	**272,193**	**1,693,79**
Net book Value at 1997		325,379	1,072,793	303,845	1,702,01

Adjustments represent split between cost of land and cost of buildings, and transfer of properties under construction and unused telecommunication equipme to other assets. This has resulted in differences in depreciation which was taken to other income.

31 December 1998 (in thousands of Saudi Riyals)

9. Other real estate		1998	1997
	Balance at beginning of the year, net	**1,030,880**	1,033,182
	Additions	**386,570**	23,766
	Disposals, net	**(41,060)**	(17,940)
	Depreciation on buildings for the year	**(8,402)**	(8,128)
Balance at end of the year, net		**1,367,988**	1,030,880

10. Other assets		1998	1997
	Customers' liabilities on acceptances	**1,107,595**	1,020,272
	Accrued commission receivable	**452,725**	549,746
	Other	**438,386**	617,571
Total other assets		**1,998,706**	2,187,589

11. Customers' deposits		1998	1997
	a) Domestic		
	Current and call accounts	**26,289,974**	25,725,861
	Saving	**530,311**	600,059
	Time deposits	**14,910,545**	13,120,608
	Other	**2,495,044**	2,680,612
		44,225,874	42,127,140
	b) International		
	Current and call accounts	**133,815**	61,423
	Saving	**12,909**	14,172
	Time deposits	**21,014,744**	19,347,291
	Other	**12,596**	4,884
		21,174,064	19,427,770
	c) Accrued commission payable	**343,715**	374,275
Total customers' deposits		**65,743,653**	61,929,185

Customers' deposits include foreign currency deposits equivalent to SR 18,421 million (1997 - SR 15,452 million).

Customers' deposits include an amount of SR 1,314 million (1997 - SR 194 million) representing liabilities against the sale of fixed rate bonds with agreements to repurchase at fixed future dates.

12. Due to banks		1998	1997
	a) Domestic		
	Current and call accounts	**203,371**	264,536
	Time deposits	**10,820,133**	7,534,719
		11,023,504	7,799,255
	b) Foreign branches of domestic banks		
	Time deposits	**281,250**	147,500
	c) International		
	Current and call accounts	**900,840**	1,404,232
	Time deposits	**3,702,564**	4,457,102
		4,603,404	5,861,334
		15,908,158	13,808,089
	d) Accrued commission payable	**90,720**	111,346
Total due to banks		**15,998,878**	13,919,435

Due to Banks include an amount of SR 1,526 million (1997 - SR 1,169 million) representing liabilities against the sale of fixed rate bonds with agreements to repurchase at fixed future dates.

Notes to the financial statements

31 December 1998 (in thousands of Saudi Riyals)

13. Other liabilities

		1998	1997
	Acceptances outstanding	**1,107,595**	1,020,272
	Proposed dividend to the shareholders (Note 17)	**795,000**	300,000
	Zakat (Note 17)	**26,092**	29,963
	Other	**1,231,669**	1,452,531
Total other liabilities		**3,160,356**	2,802,766

14. Share capital

The authorised, issued and fully paid share capital at 31 December 1998 consists of 60 million shares of SR 100 each.

15. Statutory reserve

In accordance with the Banking Control Law, a minimum of 25% of the annual net income is required to be transferred to a statutory reserve until this reserve equals the paid up share capital of the Bank. This reserve is not available for distribution.

16. Earnings per share

The calculation of earnings per share is based on the net income for the year amounting to SR 1,062 million (1997 - SR 1,043 million) divided by 60 million nominal shares.

17. Proposed dividend and Zakat

The Board of Directors has proposed a dividend amounting to SR 821.1 million (1997 - a six month period - SR 314.7 million). Zakat attributable to the shareholders amounting to SR 26.1 million (1997 - a six month period SR 14.7 million) will be deducted from the gross dividend resulting in a net dividend of SR 795 million at the rate of SR 13.25 per share net of Zakat (1997 - SR 300 million at the rate of SR 5 per share). The proposed dividend is included in other liabilities.

18. Financial instruments

18-1 On balance sheet financial instruments - commission rate risk

Commission rate risk is the uncertainty of future earnings resulting from fluctuations in commission rates. The risk arises when there is a mismatch in the assets and liabilities which are subject to commission rate adjustment within a specified period. The most important source of such rate risk is the Bank's lending, funding and investments activities, where fluctuations in commission rates are reflected in commission margins and earnings. The Bank also faces such rate risk in its trading portfolio, where rate changes may result in fluctuations in portfolio market values.

Commission rate gap is a common measure of rate risk. A positive gap occurs when more assets than liabilities are subject to rate changes during a prescribed period of time. A negative gap occurs when liabilities exceed assets during a prescribed period of time.

The commission rate gap position and term to maturity, based on contractual maturity dates or re-pricing, whichever is earlier for on balance sheet financial instruments are as follows:

31 December 1998 (in thousands of Saudi Riyals)

18. Financial instruments (continued)

18-1 On balance sheet financial instruments - commission rate risk (continued)

31 December 1998

		Commission Sensitive Within 3 months	3 to 12 months	Over 1 year	Non-commission sensitive	Total
Assets	Cash and balances with SAMA	-	-	-	2,900,493	2,900,493
	Due from banks	4,332,372	2,981,062	-	601,210	7,914,644
	Trading securities	29,992	656,602	360,963	414,470	1,462,027
	Loans and advances, net	32,189,873	4,434,147	16,102,432	3,687,955	56,414,407
	Investment securities, net	7,863,842	2,658,370	6,535,947	2,120,322	19,178,481
	Fixed assets, net	-	-	-	1,693,792	1,693,792
	Other real estate	-	-	-	1,367,988	1,367,988
	Other assets	-	-	-	1,998,706	1,998,706
Total assets		44,416,079	10,730,181	22,999,342	14,784,936	92,930,538
Liabilities and shareholders' equity	Customers' deposits	23,252,184	13,373,243	-	29,118,226	65,743,653
	Due to banks	10,841,665	4,081,365	-	1,075,848	15,998,878
	Other liabilities	-	-	-	3,160,356	3,160,356
	Shareholders' equity	-	-	-	8,027,651	8,027,651
Total liabilities and shareholders' equity		34,093,849	17,454,608	-	41,382,081	92,930,538
	On-balance sheet gap position	10,322,230	(6,724,427)	22,999,342	(26,597,145)	
	Off-balance sheet gap position	190,150	335,888	(526,038)	-	
	Combined gap position	10,512,380	(6,388,539)	22,473,304	(26,597,145)	
	Cumulative gap position	10,512,380	4,123,841	26,597,145	-	

31 December 1997

		Commission Sensitive Within 3 months	3 to 12 months	Over 1 year	Non-commission sensitive	Total
Assets	Cash and balances with SAMA	-	-	-	2,899,160	2,899,160
	Due from banks	11,493,292	1,824,133	-	827,358	14,144,783
	Trading securities	-	184,394	705,399	430,707	1,320,500
	Loans and advances, net	17,374,631	10,359,666	15,757,017	2,798,795	46,290,109
	Investment securities, net	5,854,988	2,750,038	6,368,866	1,889,212	16,863,104
	Fixed assets, net	-	-	-	1,702,017	1,702,017
	Other real estate	-	-	-	1,030,880	1,030,880
	Other assets	-	-	-	2,187,589	2,187,589
Total assets		34,722,911	15,118,231	22,831,282	13,765,718	86,438,142
Liabilities and shareholders' equity	Customers' deposits	25,685,566	7,402,147	6,821	28,834,651	61,929,185
	Due to banks	9,988,383	2,471,545	-	1,459,507	13,919,435
	Other liabilities	-	-	-	2,802,766	2,802,766
	Shareholders' equity	-	-	-	7,786,756	7,786,756
Total liabilities and shareholders' equity		35,673,949	9,873,692	6,821	40,883,680	86,438,142
	On-balance sheet gap position	(951,038)	5,244,539	22,824,461	(27,117,962)	
	Off-balance sheet gap position	1,655,000	(587,000)	(1,068,000)	-	
	Combined gap position	703,962	4,657,539	21,756,461	(27,117,962)	
	Cumulative gap position	703,962	5,361,501	27,117,962	-	

The off-balance sheet gap represents the net notional amounts of financial instruments, which are used to manage commission rate risk.

Notes to the financial statements

31 December 1998 (in thousands of Saudi Riyals)

18. Financial instruments (continued)

18-2 Off-balance sheet financial instruments (contra accounts)

Term to maturity for off-balance sheet items is as follows:

31 December 1998		Within 3 months	3 to 12 months	Over 1 year	Total
	a) Contingent liabilities				
	Letters of credit	2,791,132	978,816	-	3,769,948
	Letters of guarantee	2,713,013	2,280,112	2,498,318	7,491,443
	Commitments to extend credit (irrevocable)	-	1,147,860	389,800	1,537,660
		5,504,145	4,406,788	2,888,118	12,799,051
	b) Forward foreign exchange				
	Contracts				
	Purchases	8,168,967	17,346,882	171,944	25,687,793
	Sales	12,965,764	22,176,530	547,099	35,689,393
		21,134,731	39,523,412	719,043	61,377,186
	c) Derivatives				
	Commission rate swap	3,579,829	1,720,307	1,780,826	7,080,962
	Futures	348,500	825,000	1,444,000	2,617,500
	Currency options	4,014,559	1,599,590	-	5,614,149
		7,942,888	4,144,897	3,224,826	15,312,611
Total contra accounts		34,581,764	48,075,097	6,831,987	89,488,848

31 December 1997		Within 3 months	3 to 12 months	Over 1 year	Total
	a) Contingent liabilities				
	Letters of credit	2,274,636	824,143	197,794	3,296,573
	Letters of guarantee	3,259,588	2,011,235	1,664,471	6,935,294
	Commitment to extend credit (irrevocable)	-	846,000	1,367,087	2,213,087
		5,534,224	3,681,378	3,229,352	12,444,954
	b) Forward foreign exchange				
	Contracts				
	Purchases	12,184,939	15,594,478	155,000	27,934,417
	Sales	5,973,000	16,244,000	438,000	22,655,000
		18,157,939	31,838,478	593,000	50,589,417
	c) Derivatives				
	Commission rate swap	9,624,130	2,695,086	606,320	12,925,536
	Forward rate agreements	4,271,888	-	-	4,271,888
	Futures	2,082,357	341,116	1,995,877	4,419,350
	Currency options	5,209,360	157,000	12,000	5,378,360
		21,187,735	3,193,202	2,614,197	26,995,134
Total contra accounts		44,879,898	38,713,058	6,436,549	90,029,505

The maturities set out in the above table are based on contractual re-pricing or maturity dates, whichever is earlier.

The fair value of off-balance sheet financial instruments (contingent liabilities) is not significantly different from the book value. In respect of the commitments f forward foreign exchange and derivative products, the amounts recorded are gross values and do not reflect the extent to which positions may offset one anothe The amounts subject to market and credit risks are substantially smaller than the notional amounts.

Management does not anticipate any material loss as a result of these contingencies and commitments.

31 December 1998 (in thousands of Saudi Riyals)

18. Financial instruments (continued)

18-3 Foreign exchange position

The Bank had a net open foreign exchange position (principally in U.S. Dollars), of SR 4,288 million (1997 - SR 2,168 million).

19. Income from other real estate

		1998	1997
	Gain/(loss) on sale of other real estate	221	(54)
	Rental income	25,913	27,597
Total income from other real estate		26,134	27,543

20. Other income

		1998	1997
	Gain on investment securities	11,675	146,554
	Gain on disposal of fixed assets	299	1,175
	Yield on trading securities	31,841	9,348
	Other	75,632	9,317
Total other income		119,447	166,394

21. Transactions with related parties

During its ordinary course of business, the Bank transacts business with related parties. The balances from such transactions in the balance sheet are as follows:

Related party	Nature of transactions	1998	1997
Directors and members of senior management	Loans and advances	296,355	101,822
	Customers' deposits	325,365	155,002
	Contra accounts	53,830	19,282

22. Investment services

The Bank provides certain investment management services to its customers. These services include the management of a variety of mutual funds, some of which are in association with professional fund managers. The assets of these funds do not form part of the Bank's assets and, accordingly, are not included in these financial statements.

23. Assets and liabilities maturities

	1998		1997	
	Assets	Liabilities	Assets	Liabilities
Less than one month	26,494,310	59,343,970	41,876,100	53,717,563
One month to one year	34,368,051	22,398,561	16,544,893	22,121,301
One to five years	19,510,402	-	15,245,730	9,756
Over five years	7,497,289	-	7,850,933	-
	87,870,052	81,742,531	81,517,656	75,848,620

The above reflects the contractual maturities of the assets and liabilities, and accordingly does not represent the anticipated maturities based on the Bank's experience of retaining deposits and managing its liquidity. The maturity profile is monitored by management on a daily basis to ensure adequate liquidity is maintained by the Bank to meet its obligations.

The above asset and liability amounts do not include fixed assets, other real estate and other assets and liabilities due to the special nature of these accounts.

24. Lease commitments

Total future lease commitments under non-cancellable leases of the Bank's buildings expire on the residual term of the leases during:

	1998	1997
Less than one year	17,997	13,186
One to five years	17,619	9,633
Over five years	7,883	1,907
	43,499	24,726

25. Year 2000

The Bank incurred certain expenditure during the year relating to modifications as deemed necessary to deal with the Year 2000 issue in connection with computers. Further expenses relating to these costs will be expensed as incurred.

Saudi Arabia: Adapting to the realities of lower oil revenues

In order to free itself from being dependent on oil revenues, Saudi Arabia has focused its development plans on economic diversification. While considerable resources have been allocated to restructure the economy with significant progress in import substitution, work is still going on to expand the share of the non-oil industrial sector in gross domestic product (GDP), (chart 1). Lower oil prices last year resulted in declining oil revenues, which prompted the Government to rationalise spending. In order to build the social and physical infrastructure necessary for growth, the fiscal balance has been running a deficit averaging well in excess of 5% to GDP over the last ten years (chart 2). The large proportion of Government expenditures to GDP at about 40% is double the average for emerging markets. Apparently, it is becoming increasingly necessary to adapt to the new realities of lower oil revenues. Obviously, pressure is building on the private sector to generate growth without a steady flow of Government expenditures.

The Government has committed itself to a set of policies aimed at liberalising trade, privatising public enterprises, and deregulating the capital market. These reform measures were given impetus by the processes of globalisation and trade liberalisation taking place in the world economy. Saudi Arabia has repeatedly stated its commitment towards economic liberalisation and privatisation as necessary steps toward reducing the economy's vulnerability to adverse oil developments. However, implementing the necessary adjustments has been expedited recently. While there has been progress recorded in the removal of subsidies and lately in the privatisation of the public entities, deepening of capital market and, to some extent, attracting of foreign portfolio investments appears to be still under review.

Saudi Arabia with its large, open, and liberal trade regime is well suited to reap the benefits of global trade liberalisation. However, the extent of Saudi Arabia's economic integration with the world economy necessitates further qualification. While the share of the external sector to GDP is among the highest worldwide, this measure of openness is greatly influenced by oil exports, as the share of non-oil exports to GDP amounted to a modest level of 4.3% in 1998. Given the current production and export structure, the direct benefits to the country from the liberalisation of

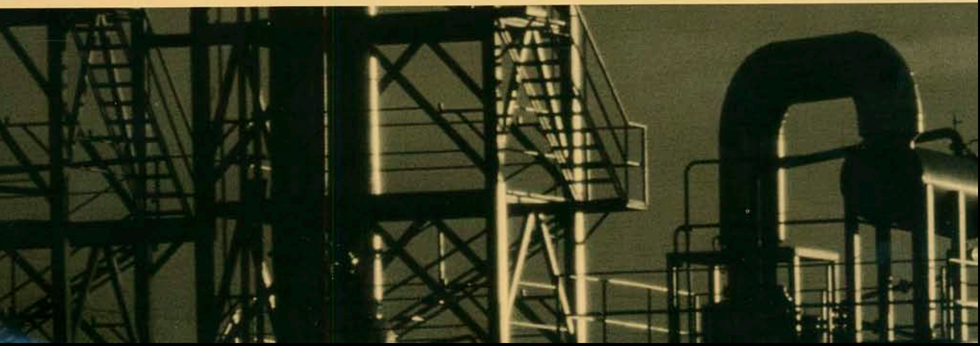
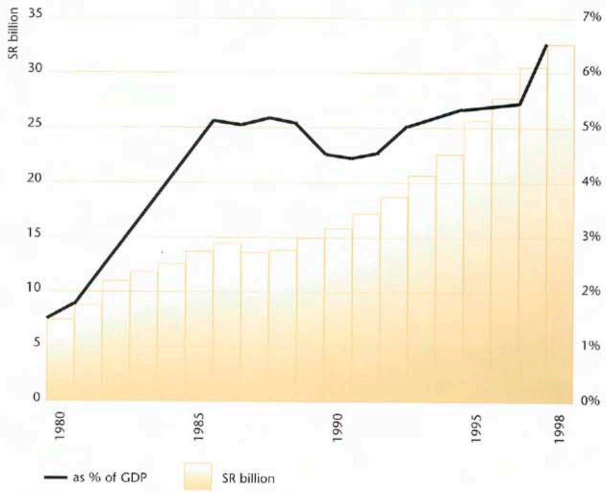


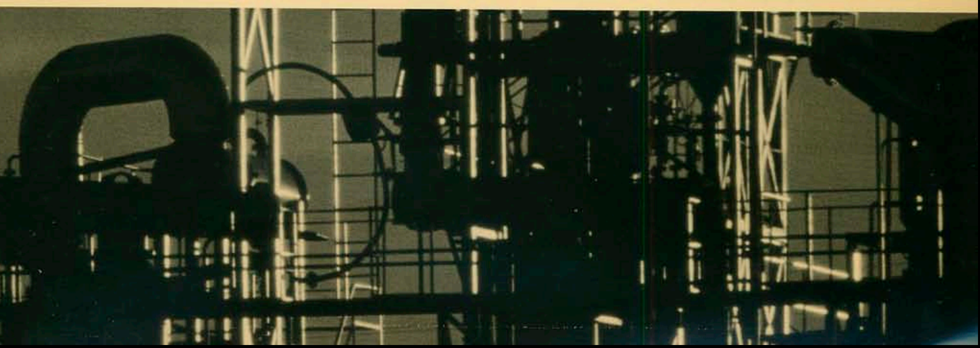
Chart 1: Non-Oil Industrial GDP as % of total GDP, 1980-1998



global trade are likely to be minimal, at least initially. On the export side, the reforms would be neutral to exports of oil and oil-related products since these are not covered by the World Trade Organisation (WTO). In addition, the benefits accruing to petrochemical exports would be minimal if the existing high tariffs imposed by industrialised countries are not lifted. On the import side, it is believed that the expected gradual reduction in food subsidies in European countries will raise the cost of food imports. The impact on the Kingdom's food imports would be relatively limited, however, as the country is increasingly becoming self sufficient in basic foodstuffs and is relying, to a large extent, on food imports from the region. With the import tariffs to be reduced gradually as Saudi Arabia joins the WTO, the long-term benefits to the Saudi economy will depend on how successful is the diversification of the economy's production structure.

Pressured by declining oil revenues, the Government has moved toward privatising some utility companies to reduce its fiscal burden and improve efficiency in resource allocation. In the hope of enabling the private sector to grow at a faster rate, privatisation has been the focus of the Government's official policy since 1985. The first step in the Government privatisation programme was supposed to involve the sale of the Government's share in companies whose stocks are already publicly traded. The second step should involve the transformation of certain public institutions that can run on a commercial basis, such as telecommunications, electricity and airlines, to joint stock companies and subsequently offering them to the general public. Although the push towards privatisation slowed in the 1990's, the Government has recently introduced a programme to privatise the telecommunication sector, and towards the end of 1998 has announced the merger of the ten electricity companies and adjusted electricity tariffs upwards to prop up their profitability.

The transformation of public companies to private entities will allow the Government to focus its attention and resources on providing the physical and social infrastructure, particularly in the development of human resources. It will also enable the Government to utilise accrued funds from privatisation in carrying such tasks more forcefully, which will strengthen the role of the private sector and prepare it for global



Saudi Arabia: Adapting to the realities of lower oil revenues continued

competition. Moreover, a gradual but steady transformation may work to remove the fears of unemployment among the labour force. The emergence of a relatively active stock market and its increasing popularity may smooth the transition toward liberalisation and integration with the world economy, as additional steps still need to be taken regarding opening the Saudi stock market for foreign investment. Allowing in foreign portfolio investors will deepen the market, lead to greater competition and improve the balance of payments.

Saudi Arabia has had a long tradition of private sector dominance in a wide range of activities from agriculture, trade, and construction to small-scale manufacturing and services. However, Government ownership in the productive assets increased substantially in the 1970s. Backed by large financial resources afforded by the oil boom, Government ownership expanded to cover basic economic activities, such as upstream oil production and refining, the petrochemical industry, airlines and railroad transportation, and utilities. Government ownership in the Saudi stock market stood at 33% of the market's capitalisation of SR160 billion at the end of 1998, suggesting huge potential for attracting private capital should the Government decide to offload part of its ownership in these companies. With $400 billion in liquid assets (SR1.5 trillion) estimated to be held abroad by Saudi individuals and corporations, there is no shortage in financing such privatisation projects or, for that matter, other potential investments in new industries, infrastructure, commercial and social services projects. However, external financing of such projects should proceed, once progress in structural reforms is underway.

Privatisation efforts will lead to their desired successes only through the functioning of an efficient capital market where publicly transformed companies can raise capital from non-traditional sources. In addition to opening the market to foreign investors, the process of financial legal reform may need to be accelerated. The creation of an efficient and investor-friendly capital market hinges on the availability and reliability of information regarding public enterprises and the rate at which information is disseminated to all market participants. Currently, issues of transparency remain an obstacle confronting local investors as some financial

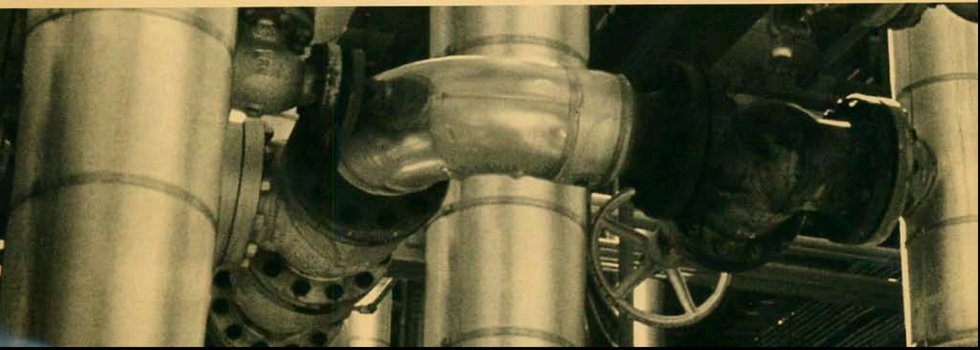
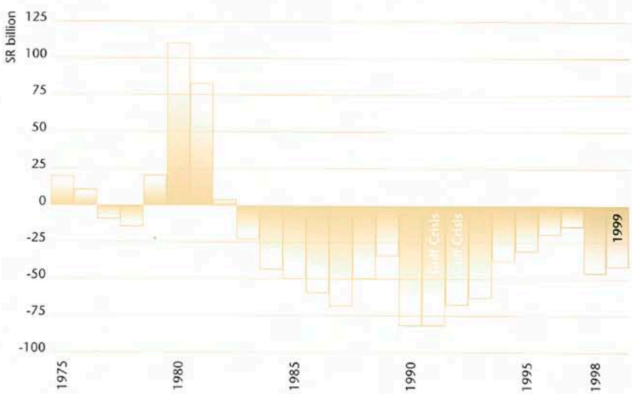


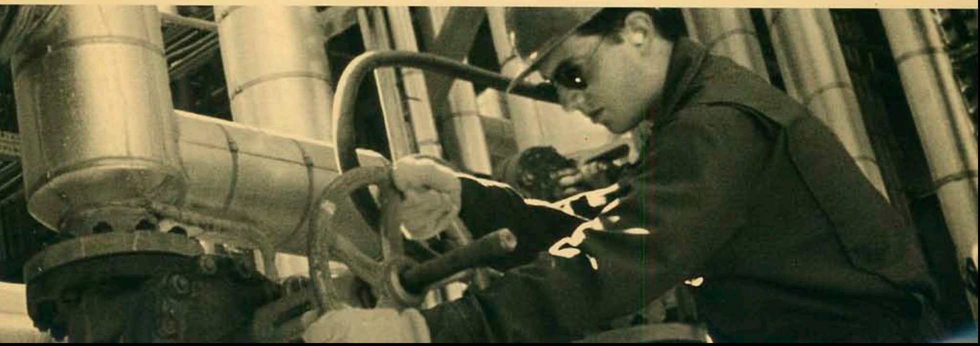
Chart 2: Saudi Arabian Government deficits and surpluses, 1975-1999



statements either do not conform to internationally acceptable standards or are made available only with a considerable time lag.

The private sector is wasting no time in preparation for the country's accession to the World Trade Organisation and the subsequent entrance of foreign competition to the local market. In line with the global trend, firms in the region are employing a growth strategy through mergers. During the past two years, four such events occurred involving four banks and two industrial and services companies. With most mergers occurring among banks, it seems this sector is eyeing foreign competition more cautiously, taking the necessary steps to strengthen its balance sheet and income generating capacity while cutting costs and expenses.

If it was not due to the collapse of oil prices, the path towards a balanced budget by the year 2000, as set in the current 5-year development plan, would have been attained. While such goals may becomes difficult to realise, it is certainly expected to accelerate the implementation of fiscal reforms and to stimulate effective actions on privatisation and deregulation. If oil prices remain subdued throughout this year, greater challenges will be put on the Government to meet the growing demand of social and physical infrastructure expenditures. The Government's recent privatisation effort in the telecommunication and electricity sectors may help reduce budgetary expenditures this year, however, it is not expected to leave a significant impact on this year's projected deficit. The major economic slowdown last year has highlighted, in addition to the structural imbalances of the fiscal and current accounts, the need to pursue economic reforms more aggressively. The Government was highly commended as it rightly exercised a greater fiscal discipline last year. A comprehensive strategy aimed at reducing current expenditures and raising non-oil revenues, once taken more expeditiously, would enrich competition, lure more foreign investments, and effectively enhance the repatriation of vast Saudi capital from abroad.



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