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# Saudi Economic Review

## NCB Monthly Views on Saudi Economic and Financial Developments

## Contents




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## Executive Summary


- The correction in the US financial markets provoked a short-lived rebound in the US dollar, which is typically bad news for oil prices since most buyers are non-USD.

- Throughout the second half of 2017, we notice that that USD traded on a narrower range than what we saw back in the first half, indicating that the greenback is consolidating and becoming less susceptible to further weakening.

- An expected equity market correction in the US, Europe and the EM provided renewed buying for gold since late 2016 which has been trading at a USD200 range between USD1,195/oz and USD1,349/oz through 2017.

- Despite a "stable" future outlook expected by Moody in 2018, forecasting the economy to grow by 1.3%, the monetary system is very susceptible to the behavior consumer and government deposits.

- The primary market has been dominated by REITs as four funds were offered during the first quarter, seeking a total of SAR1.9 billion.

- The USD/SAR peg eliminates much of the currency risks associated with a Fed monetary normalization; however, maintaining the peg implies that interest rates in the Kingdom will have to move in lockstep with the Fed.

- Settled letters of credit (LCs) for the month of December totaled SAR10 billion, falling for the 26th consecutive month on an annual basis. .


Ostensibly, the new bylaws will ease the barriers for new Saudi entrants into the workforce. Case in point is the use of part-time workers during negative business cycles in the US economy. Following the Dot-com bubble and leading to 2008, annual growth in part-time workers remained stable, averaging around 1.5% Y/Y.

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## Macroeconomic Indicators

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016P | 2017F | 2018F | 2019F | 2020F |
|---|---|---|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | | | | |
| Average KSA Crude Spot Price, Arab Light, USD/BBL | 108.1 | 110.2 | 106.4 | 97.2 | 50.2 | 40.9 | 50.3 | 50.2 | 50.5 | 51.1 |
| Average Daily Crude Oil Production, MMBD | 9.3 | 9.8 | 9.6 | 9.7 | 10.2 | 10.5 | 10.1 | 10.1 | 10.1 | 10.2 |
| GDP at Current Market Prices, SAR billion | 2,510.7 | 2,752.3 | 2,799.9 | 2,836.3 | 2,453.5 | 2,424.1 | 2,542.5 | 2,653.4 | 2,742.5 | 2,851.8 |
| GDP at Current Market Prices, USD billion | 670.4 | 734.9 | 747.6 | 757.4 | 655.1 | 647.3 | 678.9 | 708.5 | 732.3 | 761.5 |
| Real GDP Growth Rate | 10.0% | 5.4% | 2.7% | 3.7% | 4.1% | 1.7% | -1.2% | 0.7% | 1.2% | 1.9% |
| CPI Inflation, Y/Y % Change, Average | 3.7% | 2.9% | 3.5% | 2.7% | 2.2% | 3.5% | -0.2% | 5.0% | 2.0% | 2.2% |
| **External Sector** | | | | | | | | | | |
| Current Account Balance, USD billion | 158.5 | 164.8 | 135.4 | 73.8 | -56.7 | -27.6 | 18.7 | 25.7 | 39.4 | 58.8 |
| Current Account Balance/GDP | 23.6% | 22.4% | 18.1% | 9.7% | -8.7% | -4.3% | 2.8% | 3.6% | 5.4% | 7.7% |
| Net Foreign Assets with SAMA, USD billion | 535.9 | 648.5 | 717.7 | 725.2 | 609.7 | 529.3 | 475.8 | 419.5 | 374.4 | 350.2 |
| **Fiscal Sector (Central Government)** | | | | | | | | | | |
| Actual Revenues, SAR billion | 1,117.8 | 1,247.4 | 1,156.4 | 1,044.4 | 615.9 | 519.4 | 677.2 | 705.2 | 767.8 | 846.5 |
| Actual Expenditure, SAR billion | 826.7 | 873.3 | 976.0 | 1109.9 | 978.0 | 830.5 | 890.0 | 928.0 | 950.0 | 953.0 |
| Expenditure Overrun, % | 42.5% | 26.6% | 19.0% | 29.8% | 13.7% | -1.1% | 0.0% | 0.0% | 0.0% | 0.0% |
| Overall Budget Balance, SAR billion | 291.1 | 374.1 | 180.3 | -65.5 | -362.1 | -311.1 | -212.8 | -222.8 | -182.2 | -106.5 |
| Budget Balance/GDP | 11.6% | 13.6% | 6.4% | -2.3% | -14.8% | -12.8% | -8.4% | -8.4% | -6.6% | -3.7% |
| Break-Even Oil Price | 75.3 | 73.9 | 82.6 | 100.1 | 82.6 | 61.6 | 69.9 | 70.4 | 68.8 | 63.8 |
| **Financial Sector** | | | | | | | | | | |
| USD/SAR Exchange Rate | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Growth in Broad Money (M3) | 13.3% | 13.9% | 10.9% | 11.9% | 2.5% | 0.8% | 2.5% | 3.4% | 4.0% | 4.6% |
| Growth in Credit to the Private Sector | 11.0% | 16.4% | 12.1% | 11.9% | 9.8% | 2.2% | -0.8% | 3.3% | 5.6% | 6.2% |
| Average 3M SAR Deposit Rate | 0.7% | 0.9% | 1.0% | 0.9% | 0.9% | 2.1% | 1.9% | 2.6% | 3.5% | 4.3% |
| Average 3M USD Deposit Rate | 0.3% | 0.4% | 0.3% | 0.2% | 0.3% | 0.7% | 1.3% | 2.0% | 2.8% | 3.5% |
| Spread, in Basis Points, SAIBOR-LIBOR | 40.9 | 55.2 | 68.7 | 70.4 | 56.4 | 134.7 | 60.0 | 60.0 | 70.0 | 80.0 |

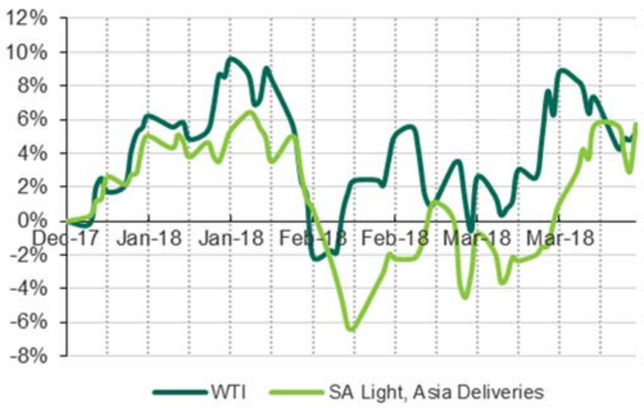
Sources: Thomson Reuters, SAMA, General Authority for Statistics, and NCB
Note: Saudi Economic Review Data, March 2018 Update (Historical and Projections)

# Oil Market

## Short-term Downside Risks Loom

The price of Brent crude oil, which had breached USD70 a barrel for the first time since 2014 in February, retreated to USD62 a barrel later in the month. The correction in the US financial markets provoked a short-lived rebound in the US dollar, which is typically bad news for oil prices since most buyers are non-USD. But as financial markets regained some composure, the dollar weakened again and Brent was back up to around USD 68 a barrel since mid-March. Even so, price of Brent crude oil is still averaging close to USD67 a barrel since start of the year, which is around 20% higher than the same period last year. Oil prices had been supported by stronger-than-anticipated demand growth, coupled by strong production discipline from OPEC and Russia. This had allowed crude oil stocks to fall by around 120 million barrels above the past year, pulling stocks back down to 2015 levels. On an absolute basis, although stocks in OECD countries built by 18mb in January, they grew only half the average rate of m/m builds usually seen versus the past 5-year averages. Preliminary indications are that stocks fell again in February at a steeper pace than the downtrend of the past year.

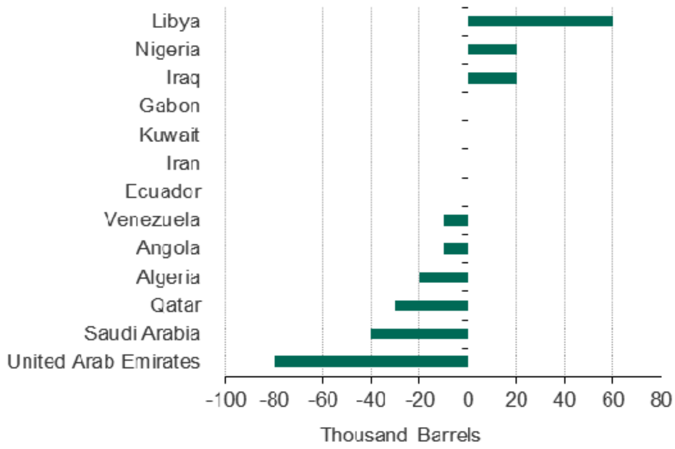
**Chart 1: Oil Price Developments, YTD**




Source: Thomson Reuters

Global oil supply in February eased to 97.9mb/d and was 0.7mb/d above 2017's level due to higher non-OPEC output, according to IEA. Strong US production is expected to boost this year's non-OPEC expansion by1.8mb/d compared to 0.76m/d in 2017. The IEA expects US output growth to outpace global demand growth this year. In line with rising prices, US tight oil outlook continues to improve as crude production is forecast to rise up by 1.6mb/d. The balance of price risks are now skewed to the upside because of the imminent US government' decision on 12th May on whether to unilaterally withdraw from the nuclear deal with Iran, and also due to the continuing economic collapse in Venezuela, as its oil production has been declining and stands to decrease further to 1.2mb/d from current level of 1.5mb/d. OPEC crude oil production edged down in February to 32.1mb/d, attributed to losses in Venezuela and UAE. With the excess stock level continuing its gradual decline, the rebalancing of oil market looks within reach. This trend is attributed to more severe global winter weather in most industrialized countries, and to a global supply and demand balance that has been signaling a deficit in Q1'18 of around 0.6mb/d. While OPEC recently reaffirmed its commitment to rebalancing the market, US oil production is forecast to be reaching 11mb/d by October. As shale oil producers put the US crude on course to become the dominant global producer, the enthusiasm that sent crude futures close to USD70 a barrel so far will likely fade. So far, the output production cuts by OPEC and its non-OPEC partners have managed to keep prices mostly above USD60 a barrel.

**Chart 2: OPEC's Monthly Oil Production Changes**




Source: OPEC Survey

Risk to the downside for oil outlook appears to be limited over the next several months, as global growth backdrop remains strong and geopolitical risks threaten to remove more supply from Iran and Venezuela. OPEC compliance in February was 147%, but even if Venezuela's production were at its allocated level, the compliance would still be close to 100%. However, the current OPEC compliance is expected to wane as the higher prices in Q1'18 in advance of the OPEC meeting are more likely to encourage OPEC/Non-OPEC members of reconsidering the production quotas, therefore, allowing for additional output. If OPEC and its partners do not ease production and allow prices to rise to the range of USD70-80 a barrel, then this would unlock shale oil growth in the two- to three-year timeframe, which would ultimately threaten the rebalancing and the current positive oil demand outlook. The global oil demand growth is expected to increase by 1.5mb/d in 2018 to reach 99.3mb/d, compared to 97.8mb/d in 2017, according to IEA. The provisional data suggests very strong start to the year especially in China and India, which taken together, accounted for nearly 50% of global demand growth in 2017. Moreover, cold weather in some parts of the northern hemisphere in January-February contributed to an increase in heating demand. Demand growth in Q1'18 remains strong because Q1'17 was relatively weak and this year has been comparatively strong, but this trend is likely to dissipate as the year progresses.

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# Foreign Exchange
## USD Weakening Decelerates

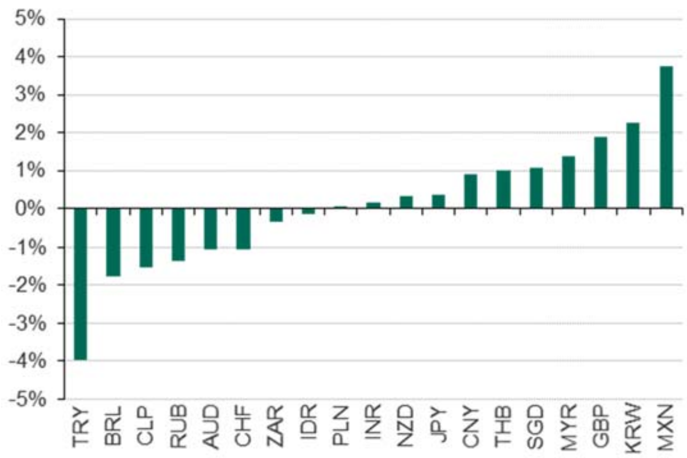
The continued sustained US economic recovery is supported by both fiscal stimulus and market participants, propping the Fed to do more policy tightening in 2018. The USD is expected to remain broadly suppressed by strong demand for its major peers despite widening yield spreads. Throughout the second half of 2017, we notice that that USD traded on a narrower range than what we saw back in the first half, indicating that the greenback is consolidating and becoming less susceptible to further weakening. Unemployment in the US stood at 4.1% as of March, the lowest level in half a century. The gradual yet sustained labor utilization in the US is increasing the Fed's confidence in the overall economic recovery; however, increasingly bearish sentiments of an equity market correction this year is adding concerns to the Fed's rate hike decision. The Fed's data dependence evolved from a threshold unemployment level to more inclusive and holistic parameters such as wage growth, export competitiveness and consumer prices. We expect global factors such as growth in China and emerging markets to play a significant role in the upcoming rate decisions. The trade-weighted dollar index stood at 89.8, declining by 2.5% during 1Q2018. We expect the Fed to raise interest rates by 25 bps three times by the end this year unless it drastically alters its near-term outlook on global economic performance.

**Chart 3: Trade-Weighted Dollar and the Euro**


Source: Thomson Reuters

The EUR began its inflection point last year closing higher by 13.6%, leaving it at USD1.2. The single currency owes its resilience to the subsiding geopolitical issues and improved confidence, giving the Eurozone a more optimistic outlook relative to the US. The Eurozone is expected to have a heterogeneous economic performance where Germany remains to be the engine for growth, hovering around 2.3% Y/Y. Spain is expected to maintain strong growth momentum this year according to an IMF forecast, growing at 2.4%, supported by thorough policy reforms and fiscal consolidation. Meanwhile, France and Italy are struggling with a muted performance. The ECB indicated that it will possibly taper its unconventional targeted LTRO policy by September if inflation is seem moving towards its 2% target. Hence, the increasing likelihood for further ECB action exacerbates the upward potential for the EUR.

**Chart 4: Monthly Foreign Exchange Rate Changes**




Source: Thomson Reuters

In the emerging market, the Brazilian real (BRL) and the Turkish lira (TRY) have both traded low versus the USD despite its weakening. Ending the year flat versus the dollar at BRL3.3/USD, the depressed BRL reflects that the Brazilian economy is under pressure resulting from the political and fiscal uncertainty engulfing the country. The inability of the various political parties to reach a consensus over unwinding fiscal imbalances leaves the country's investment grade rating at a risk of a downgrade. On the other hand, the agriculture sector is spearheading recovery after eight consecutive quarters of decline. Similarly, the TRY continued to extend losses against the dollar under a backdrop of political uncertainty and capital outflows. Closing at 3.76 liras for the dollar in March, thus the Turkish currency had fallen by 5.5%% since the beginning of the year.

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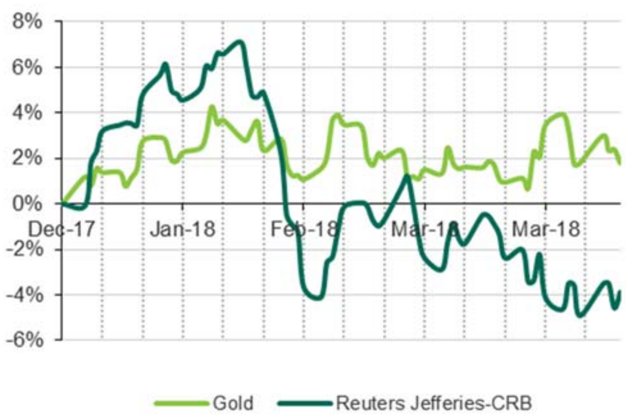
# Commodities

## Base Metals Moderate

Following a surge to multi-year highs by the end of 2017, base metals started to moderate, posting single-digit declines. The effect is exacerbated by the ongoing tariffs war between the US and China. The US plans to apply tariffs of 25%, estimated to be worth USD 50 billion to which China reciprocated. The improvement in global economic activity benefitted many export dependent economies, in particular net commodity exporters such as Brazil, Chile, and Australia. Political uncertainty in the US geared investors' preference towards Europe and the emerging markets. The divergence between US and Europe's monetary policies is less echoed as expectations of an eminent TLTRO taper intensify. The relative improvement in the oil market theme resulted in a noticeable wealth effect to oil producers, raising their prospects. On the other hand, precious metals apparently are regaining momentum as gold breached the USD1300 level. Meanwhile, large commodity feedstock growth during the super cycle is expected to keep commodity prices, namely soft commodities, depressed in the short to medium term. The Thomson Reuters/Jeffries Commodity Research Bureau (TRCRB Ex-energy) index indicates that commodities are range-bound, standing at 226.3 by the end of March.

**Chart 5: Reuters Jefferies vs. Gold**




Source: Thomson Reuters

China's New Normal policies have burst the petrochemicals and base metals bubble as the country shifted from solely focusing on growth via exports to boosting domestic consumption. This policy attempts to limit the country's high exposure to global trade dynamics, and provide a more sustainable albeit lower base for growth. Moreover, the shift in policy is also creating new challenges that depended on the previous Chinese growth model. Nickel prices continued to surge this year reaching USD13,300/ton, upturning by around 4.2% from their year-beginning price. The indispensable nature of copper and aluminum in construction and manufacturing helped push these two metals to multi-year highs last year, yet the US/China tariff decisions combined with high base effect rendered them lower by the end of March. Copper and aluminum prices slid 7.4% and 11.6% during 1Q2018, standing at USD6,714/ton and USD2,004/ton, respectively.

**Chart 6: Base Metals**


Source: Thomson Reuters

Bullion prices have fallen a long way from their 2011 highs; partly due to the lack of gold appeal to investors as they flock towards other assets, and the declining industrial use of silver as it is replaced by other metals/alloys. An expected equity market correction in the US, Europe and the EM provided renewed buying for gold since late 2016 which has been trading at a USD200 range between USD1,195/oz and USD1,349/oz through 2017. India's gold import ban remains a major barrier for a gold upswing as it banned all imports of gold above 22 carats in a move to curb public deficit. However, China's stacking of gold reserves is still supportive of physical demand. The price of a troy ounce of gold closed the first quarter of 2018 at USD1,326, inching up by 1.8% from the beginning of the year. The bid against silver started to subside as China began shoring up the stability of the yuan by massive purchases of the precious metal in order to hedge against economic uncertainties. Consequently, by the end of 2017 silver surged 6.3% to USD16.95/oz, erasing losses of early December.

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# Money & Inflation

## The Depositary Base Continues to Dwindle

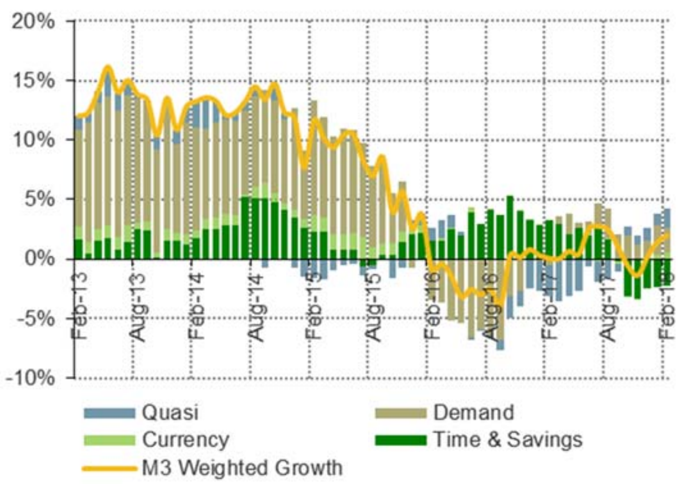
Growth in the Kingdom's broad money supply recorded yet another positive upturn, inching up by 1.4% Y/Y. In retrospect, the rate indicates the highest annualized upturn since August 2017 but well above last year's average of 0.2%. The growth moderation in the money supply came at a time where the government is consolidating its spending on infrastructure projects in order to manage its tight fiscal situation, reducing growth in demand deposits whereas time deposits are in double-digit declines. Despite a "stable" future outlook expected by Moody in 2018, forecasting the economy to grow by 1.3%, the monetary system is very susceptible to the behavior consumer and government deposits. The low base effect helped the monetary base (M0) to post a positive growth of 1.2%, reaching SAR305 billion, largely affected by currency outside banks. The government is likely to issue new bonds this year, marking the third year in a row after last September's USD12.5 billion issue and USD9 billion sukuk. This is likely to provide some much needed liquidity to the Saudi market in order to maintain the money supply out of negative growth territory. The consolidated balance sheet of Saudi banks shows that excess reserves ratio has grown to 53.3%, back to early 2017 levels. Demand deposits which constitute the majority of deposits in the Saudi banking system (around 57%) have also shown a single-digit growth of 4% Y/Y in January compared to an average of 2% last year.

**Chart 7: Growth in Monetary Aggregates**


Sources: SAMA

Meanwhile, the biggest chunk of the Saudi depositary base, demand deposits, stood at SAR1.02 trillion. It was mainly affected by a moderation in deposits by businesses and individuals which – in turn – make up 89% of demand deposits at SAR909.3 billion. Time and savings, which has a more balanced composition of government and private entities at 45% and 55%, respectively, reached a total of SAR427.8 billion. The government's portion of the time and savings account fell markedly by 14% on a Y/Y basis, indicating the government's higher need for cash on standby compared to last year as it continues its fiscal spending, contrasting with a 6% decline in deposits of businesses and individuals. Furthermore, quasi monetary deposits surged 10% to SAR167.3 billion on the back of a 14% increase in deposits of foreign currency by government entities.

**Chart 8: Money Supply, Contribution**




Sources: SAMA and NCB Estimates

The Consumer Price Index (CPI) is at a moderate 3% after rebasing inflation to year 2013. Annualized inflation levels were influenced by a rebound in food and beverages which account for 18.8% of the consumer basket recording a 6.8% increase Y/Y. On the other hand, high base effect from housing and utilities which consistently rose due to cost push showed a 1.3% annualized upturn in January. In the current theme of improving global inflation prospects, we expect CPI inflation in the Kingdom to average 3% in 2018.

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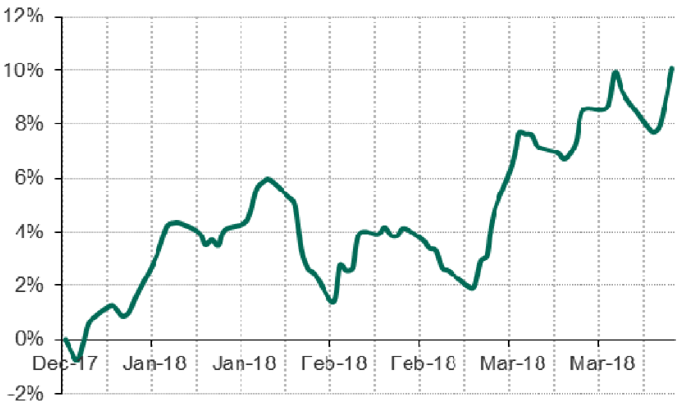
# Capital Markets

## Global Integration in the Offing

The Saudi equity market has been promoted to Secondary Emerging market status by FTSE Russell following two years on its watch list. Representing almost 50% of total GCC market capitalization, the largest market in the middle east joins the likes of China, India, and Russia with a weighting of 2.7% in the FTSE Emerging Index and 0.25% in the FTSE Global Equity Index Series. As recent as 2015, Tadawul was mostly inaccessible for foreign investors, however, Tadawul and the Capital Market Authority (CMA) have implemented a wide range of reforms over the past years to attract investments and adhere to global best practices. Initially, opening the market to Qualified Financial Investors (QFI) has been somewhat below expectations as stringent requirements limited the flow of foreign investments. Accordingly, the CMA had twice eased requirements from the original USD5 billion minimum for assets under management to the current USD500 million. In addition, the settlement cycle has been increased from T+0 to T+2, common practice in European markets which was also adopted by US markets in 2017. Tadawul has also reclassified sectors according to GICS standards, launched the parallel market NUMO as a less stringent market for companies to go public, introduced real estate investment traded funds (REIT) among other reforms that will enhance the market's depth. NCB Capital estimates total inflows to reach USD5 billion over the inclusion timeframe based on the Saudi weightings and the market capitalization of the abovementioned indices.

**Chart 9: Tadawul All-Share Index**




Source: Tadawul

Anticipation of the decision was reflected on stock prices as the index climbed 6.1% during March, bringing Tadawul's YTD gain to 8.9% by the end of the first quarter. Total market capitalization reached SAR1.87 trillion, increasing 14.1% on an annual basis. Additionally, the average daily traded value rose by 23.1% on a monthly basis during March, reaching SAR4.2 billion. Trading has been mostly concentrated in the materials, banks, and real estate sectors representing 28.9%, 23.7%, and 15.8% of total traded values. Another catalyst to the positive trajectory was the announcement of corporate profitability, which climbed back up again above the SAR100 billion threshold in 2017. The top three income generating stocks were SABIC at SAR18.4 billion which rose by 4.7% on an annual basis, followed by STC at SAR10.1 billion rising by 13.9% annually, and NCB at SAR9.8 billion gaining 5.2% Y/Y. According to Tadawul's report on ownership and trading activity, Saudi individual investors were net sellers as their ownership has fallen to 26.4% by the end of March 2018, a reduction of almost 2% over the past twelve months. In addition, GCC investors have also been reducing their exposure to the domestic market, they currently hold 2.1%. Meanwhile, inflows from foreign investors have been on an upward trajectory, increasing their holdings to 4.7% by the end of the first quarter. Tadawul aims to boost their ownership to 25% over the next couple of years.

**Chart 10: Average Daily Traded Value**


Source: Tadawul

The primary market has been dominated by REITs as four funds were offered during the first quarter, seeking a total of SAR1.9 billion. There are currently a total of 12 REITs in the market and we expect a few more initial public offerings for such funds in 2018. The economic slowdown has limited the flow of companies going public despite CMA's objective of increasing listed companies. The recent announcement to list and trade sovereign debt instruments will enhance the market's development. Floating rate, fixed rate, and sukuk instruments with a total value of SAR204.4 billion have been approved, allowing non-institutional investors to diversify their portfolios. In addition, government entities and banks holding such assets will have the opportunity to offload them in the market to manage liquidity levels and grasp other investment opportunities.

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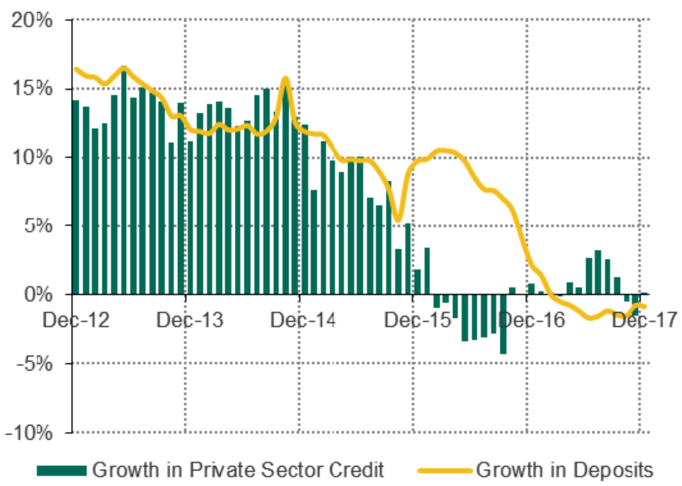
## Loans Market

### Credit Growth End the Year Flat

The consolidated balance sheet of Saudi banks has been marred by negativity for two consecutive years, namely waning in the loans portfolio during 2016 and 2017. The annualized growth rate of private sector credit stood at -1%, marking the 10th consecutive month of decline. We expect the performance of private sector credit to be aided by the SAR500 billion stimulus package as it trickles down the financial system. Fresh private sector credit in January posted SAR3 billion compared to SAR4.2 billion last year, making total outstanding private sector credit at SAR1.34 trillion. The private sector thus accounts for 96.7% of total bank credit, leaving the public sector with SAR46 billion worth of credit allocation which compared to last year surged by 13% Y/Y. Moreover, we expect to see banks' holdings of short-term government securities such as SAMA bills diminished accordingly as banks reallocated their assets. Compared to the same periods last year, SAMA bills have been in consistent decline since April 2015. By January 2018, commercial banks' share of SAMA bills plummeted 65.2%, down to just 7.2 billion, the lowest level since October 2007. In contrast, the annual growth in government bonds' holdings surged by 47% Y/Y to SAR262.2 billion.

**Chart 11: Private Sector Financing**

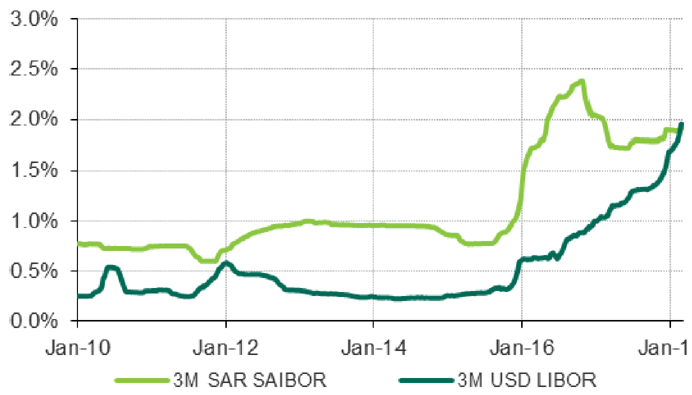



Sources: SAMA and NCB Estimates

On the liability side, demand deposits which account for 63% of broad money supply (M3) recorded a 4% annualized growth at SAR1.02 trillion. Nevertheless, demand deposits recorded the highest growth rate since November 2015. We note that narrow money (M1) remains resilient on a positive territory since February of 2017, growing by 4% Y/Y in January 2018, standing at SAR1.19 trillion.

On the other hand, less liquid forms of deposits such as time and saving deposits posted the second consecutive annualized decline of 2.4% during the month, bringing M2 money supply to SAR1.62 trillion. Quasi monetary deposits surged 12% compared to the same period last year to SAR167.3 billion, marking four consecutive months of growth after sixteen months of contraction bringing M3 money supply to SAR1.79 trillion.

**Chart 12: Liquidity and Risk Detector**




Source: Thomson Reuters

The Federal Reserve is still in favor of keeping its policy normalization unchanged under the new chairman Jerome Powell. The Trump administration/ China tariff and taxation policies are adding to uncertainty for which the Fed will have to carefully account. Moreover, record highs in US capital markets are warning of an eminent market correction which may derail the Fed this year. The USD/SAR peg eliminates much of the currency risks associated with a Fed monetary normalization; however, maintaining the peg implies that interest rates in the Kingdom will have to move in lockstep with the Fed. Accordingly, SAMA raised the reverse repo rate from 1.5% to 1.75%, and – for the first time since 2009 – raised the repo rate from 2% to 2.25%.

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# External Trade

## Non-oil Exports End the Year Positive

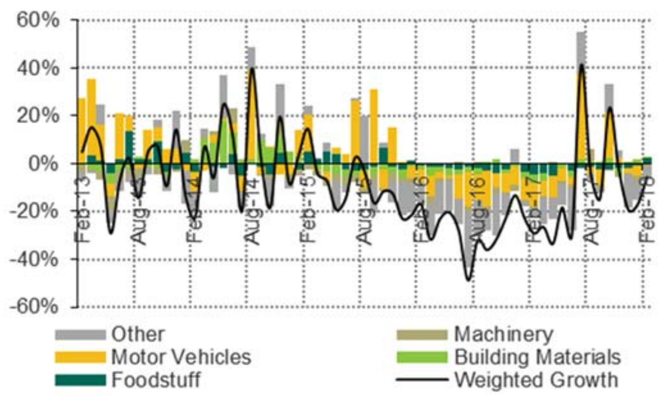
Improving growth prospects in 2018 is expected to reflect on the Kingdom's external balance. Stronger demand for exports and a lower import bill continued to narrow the balance of trade gap in December. The recovery in emerging markets, namely China, and the bouncing off of stagnation in Europe, in addition to sound economic data in the US are aiding the recovery of the Kingdom's non-oil exports. Meanwhile, the recovery in the oil market is also trickling down in the form of higher prices of petrochemicals and plastics. In the month of December, the Kingdom's non-oil exports surged 17.2% Y/Y in value terms to SAR18.6 billion while the import bill declined by 2.6%Y/Y to a total of SAR39.3 billion.

**Chart 13: Saudi Non-Oil Trade Balance**


Sources: SAMA and NCB Estimates

On the export side, the largest components of non-oil exports consist of around 32.9% plastics, 24.6% chemical products, and 9.6% base metals. Exports of plastics in the month of December totaled SAR6.1 billion, surging by 28.2% from last year. Chemical products recorded an annual decline of 6.8% Y/Y during the same month, posting a return of SAR4.6 billion, thus marking an anomaly among top export categories. Moreover, exports of base metals surged by 48.5% Y/Y, posting SAR1.8 billion. By export recipient countries, the UAE remains the top non-oil trading partner globally with around 18% of the monthly total. China accounts for 12.3% and Singapore for 5.8%. Non-oil exports to the UAE totaled SAR3.4 billion displaying resilience as its monthly figure surged 48.4% Y/Y. China's share of December's non-oil exports reached SAR2.3 billion, declining by 2.3%Y/Y. Lastly, exports to Singapore stood at SAR1 billion, surging by 28.6%Y/Y. On the import side, the largest components consist of 26% of machinery and electrical equipment, 15.4% transport equipment, and 10.8% of chemical products. By value, the Kingdom's imports of machinery and electrical equipment rose 6.9% Y/Y to SAR10.2 billion. In contrast, transport equipment recorded an annualized 26.7% plummet in December, standing at SAR6.1 billion. Imports of chemical products increased 6.6% Y/Y, to SAR4.2 billion. The majority of the Kingdom's imports originate from China (17.3%), the US (12.6%), and the UAE (5.9%.) Imports from China saw a double-digit surge of 30.9%, posting SAR6.7 billion. Imports from the US nose-dove by 33.9% Y/Y to SAR4.9 billion. Meanwhile, imports from the UAE inched up 2.3% Y/Y to SAR2.3 billion.

**Chart 14: Attribution Analysis of Letters of Credit Opened**




Sources: SAMA and NCB Estimates

Settled letters of credit (LCs) in the month of January slid 0.8% Y/Y as they totaled SAR11.2 billion. The majority of LCs were issued for motor vehicles (14.7%), building materials (12.6%), and Foodstuff (12%). LCs for motor vehicles posted a solid double-digit growth in January compared to the previous year at 11% Y/Y. However, it is seen as an anomaly that implies restocking rather than stronger consumer demand given the rise in sales over the fourth quarter of 2017; as consumers aimed to avoid the 5% VAT implemented this year. We note that growth in this category of LCs has been in a declining trend since March 2016, falling by an average of 27.4% Y/Y. In January, motor-vehicles LCs stood at SAR 2 billion. LCs for building materials inched down by 2.8% Y/Y, the lowest annualized decline since September 2016. LCs for foodstuff took a hit falling by 25.7% Y/Y, marking the 27th consecutive month of decline, totaling SAR1.3 billion.

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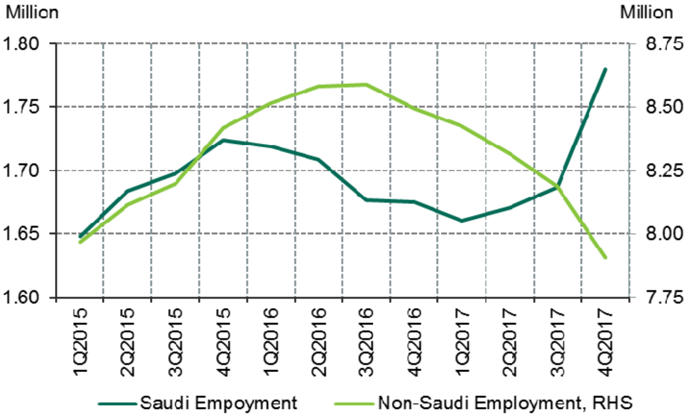
# Special Focus:
## Flexibility into the Labor Market

The Kingdom's fiscal, economic, and social reform agendas are targeted towards a young and energetic population. The Saudi demographic is predominantly youthful with almost 50% of the Saudi population below the age of 24. The utilization of human capital is an integral factor for the success of Saudi Vision 2030 initiatives, especially as a flow of graduates from the domestic education system and extensive scholarship programs enter the workforce. The National Transformation Program 2020 aims to support in generating 1.2 million jobs for Saudis within the private sector and reduce the Saudi unemployment rate from the current 12.8% to, a revised, 10.6% by 2020 and 7% by 2030. Additionally, the government is aiming to increase females' contribution to the economy by raising their participation in the labor force to 30% by 2030. The current labor force composition is largely represented by foreign workers. According to the General Organization for Social Insurance (GOSI), registered foreign workers reached 7.9 million by the end of 2017 while registered Saudis were only 1.8 million. The minimum monthly wage for Saudi workers is set at SAR3'000, acting as a challenge for Saudi job creation given the less costly foreign labor coupled with the current economic slowdown.

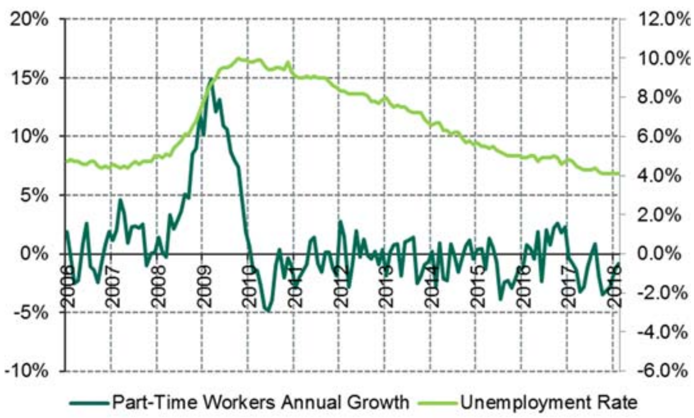
**Chart 15: Saudi private sector labor market**




Source: General Organization for Social Insurance

Obviously, the foreign labor levies contributed towards a shift from foreign to Saudi employment, albeit at a slower substitution rate, as the wage differentials fall over the next three years. Before 2018, companies paid on a monthly basis SAR200 per expat employee that exceeds the number of Saudi employees in their workforce. Starting this year, an increment of SAR200 each year will raise the levy to SAR800 by 2020. Additionally, companies with above 50% Saudization will no longer be waived of levies albeit they will be charged at a discounted rate, SAR100 lower per expatriate compared to the below 50% Saudization category. Recently, the Minster of Labor and Social Development announced that the "flexible work" program which has been in development since last year is near completion. Under the new law, businesses will be able to hire part-time employees and provide compensation on a weekly basis based on an hourly rate. The business will also be exempted from providing paid leave, GOSI subscription payments, health insurance, and end of service benefits.

**Chart 16: US part-time workers pre and post the financial crisis**




Source: US Bureau of Labor Statistics

Ostensibly, the new bylaws will ease the barriers for new Saudi entrants into the workforce. Case in point is the use of part-time workers during negative business cycles in the US economy. Following the Dot-com bubble and leading to 2008, annual growth in part-time workers remained stable, averaging around 1.5% Y/Y. However, during the global financial crisis, annual growth in part-time workers peaked at 14.8% on an annual basis as the unemployment rate more than doubled. Allowing businesses to shift from full-time to part-time employment reduces cost commitments as they assess their risk levels during economic slowdowns while providing workers with a source of income during transitory periods. Given the current dynamics in the Saudi economy, the new program is expected to positively impact the labor market by providing a level playing field with expatriates who are more elastic, with limited household commitments, and flexible working hours. In addition, local businesses can reduce their labor expenses as well as increase their Saudization rate. Furthermore, full-time education will cease to become a hurdle for job seekers, enhancing the discipline and orientation to labor market demands and norms.

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