March 29th, 2020

Ramifications of COVID-19

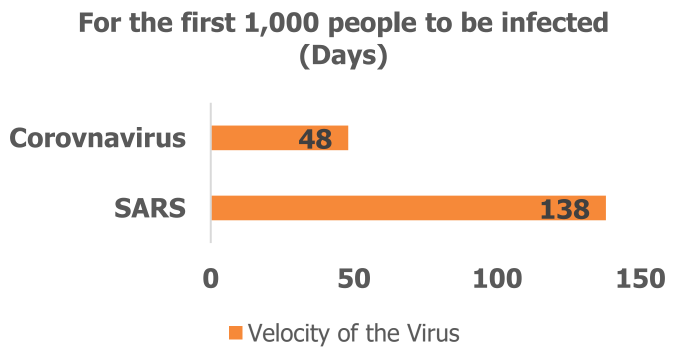
The Coronavirus (COVID-19) pandemic is an extraordinary shock to major global systems, and it has the potential to bring the global economy to a recession. While governments' stimulus programs are fighting the economic impact of the pandemic, the general state of panic in the market seems to have the upper hand as the virus continues to spread worldwide. Since the outbreak in China in January, the turbulence in the Chinese economy has had a domino effect on the rest of the world. In this report, we explore how the outbreak impacted the Saudi Arabian market through a sector by sector analysis.

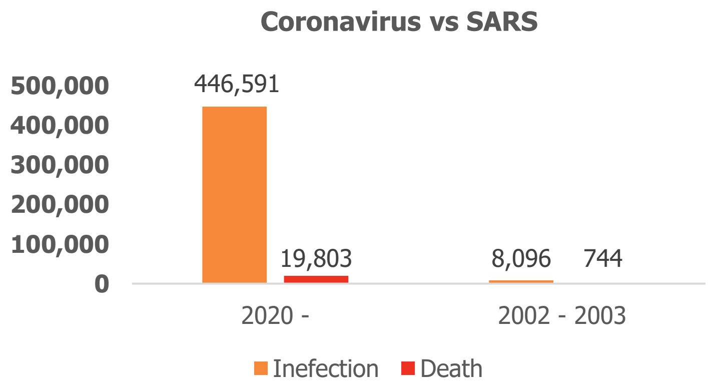
Global Macroeconomic Overview

The Global economy has grown more interconnected than ever; therefore, a drop in one major player in the global economy would start a chain reaction in other economies. Similar to the SARS outbreak in 2002, the COVID-19 was first confirmed in January of this year, in Hubei province, more specifically Wuhan. The province accounts for about 4.5% of China's output. Since the outbreak, China's exports have been hit, global supply chains have been disrupted, retail shops have shut down, tourism has crashed, and oil prices have been falling due to decreasing demand.

China is the world's second-largest economy with a GDP of USD14.2tr, accounting for about 16% of global GDP. In addition to being the largest trade partner for most of its neighbors, China is the world's biggest exporter and second-biggest importer. From iPhones to LCD TVs, much of the world's consumer technology is either made in China or relies on components that are made there, so basically, China functions is considered a huge factory for global manufacturing. Wuhan, the epicenter of the Coronavirus, is a hub for China's booming car parts and accessories exports.

The Coronavirus is expected to hurt the economy more than the SARS outbreak that originated in China in 2002, as the Chinese economy is now 4 times larger than it was. Additionally, the higher number of infections and death tolls from the Coronavirus compared to the SARS, led to subsequent regulatory ramifications that brought the economy to a sudden stop.





Macroeconomic Overview

Production declines in China quickly spilled over businesses around the world, given China's key role in global supply chains as a producer of intermediate goods, particularly in computers, electronics, pharmaceuticals, and transport equipment. Moreover, China is the primary source of demand for many commodities. While temporary supply disruptions can be met by using inventories, inventory levels are lean due to just-in-time manufacturing processes, and alternative suppliers cannot easily be obtained for specialized parts.

Provinces accounting for over 69% of Chinese GDP have been under lockdown, causing major companies around the world to run out of components. Travel restrictions have already limited the movement of 48 million people, and 20 international airlines have canceled flights to China; this curbs the demand for oil and international tourism. It is worth mentioning that every year about 150 million Chinese tourists spend around USD279bn traveling abroad.

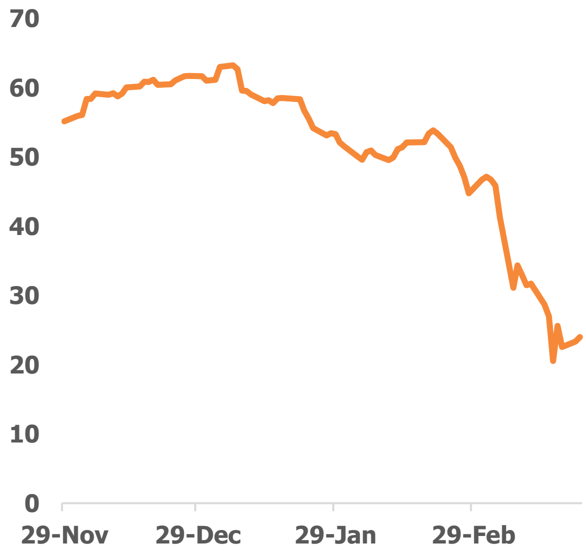
Based on all these negative developments, Goldman Sachs cut its estimate for China's first-quarter gross domestic product to a year-on-year contraction of 9% from a previous forecast of 2.5% growth. After the outbreak, OECD projected GDP growth of only 4.9% (compared to 6.1% in 2019), while Oxford Economics downgraded its outlook for global growth to 2.3%, the weakest annual expansion since 2009. Two of the biggest commodity importers from China (Australia and Brazil), may lose 0.3% of their GDP due to the outbreak.

It is worth mentioning that, pre-Coronavirus, global industrial production was stagnant in late 2019, and the growth of consumer spending lost momentum. Moreover, global trade remained weak as merchandise trade volumes contracted in Q4 2019. The higher tariffs imposed on US-China bilateral trade over the past two years are an essential factor behind the weakness of global demand, trade, and investment. The US-China "Phase One" trade agreement in January is a welcome development that should help to alleviate some of these effects. Nonetheless, the commitment by China to purchase an additional cumulative USD 200 billion of goods and services from the United States over 2020-21 (relative to a 2017 baseline of around USD 180 billion) will now be challenging to achieve amid the Coronavirus outbreak, without distorting third-party trade.

The impact of COVID-19, which is now officially classified as a pandemic, is putting a strain on GCC economies, especially through equity market downsizing and the low oil prices.

Oil Prices Drop: triggered by the outbreak, oil prices witnessed a major decline, partially due to the decreased demand. S&P global ratings has revised its West Texas Intermediate and Brent crude oil price assumptions for 2020 by $10 a barrel. Oil price assumptions are unchanged for 2021 and 2022. This is especially straining, given that oil is one of the principal export products for GCC countries. The oil and gas sector accounts for about 50% of gross domestic product, and about 70% of export earnings. Prices have fallen dramatically after OPEC and its allies failed to reach an agreement to cut production. Crude futures plunged more than 20% after Saudi Arabia announced it would raise production and give discounts on its oil sales. On March 8th, Brent crude was down 6.01% at USD33.64 a barrel, while US crude traded at USD31.15 a barrel, down 5.55%. Similarly, on the 20th of March, U.S. crude futures for April fell USD2.79, or 11.06%, to settle at USD22.43 per barrel. Brent crude futures fell USD1.49 or 5.2%, to settle at USD26.98 per barrel.

Crude Oil Price - USD per Barrel December '19- March '20



As a result of the spread of COVID-19 and the subsequent fall in oil prices, Saudi Arabia announced it will cut budget expenditure for 2020 by almost 5% in an attempt to offset the impact of plunging oil prices on its budget deficit. The year’s budget will be cut by around SAR50bn. According to Reuters, Saudi Arabia needs an oil price of around $85 to balance its budget deficit and $50 to balance the current account.

Macroeconomic Overview

Moreover, the outbreak represents a major hit to the Saudi Arabian tourism and travel sectors. Every year Saudi Arabia receives around 20 million tourists, mostly for religious purposes; an impact on the pilgrimage season is a loss for Saudi Arabia. Saudi Arabia has generally halted international travel into the country and imposed Umrah ban over concerns about the spread of the Coronavirus.

Finally, the psychological well-being of investors and its impact on the capital markets. Since the outbreak, a state of panic and confusion took over individuals and investors, leading to extreme volatility in the GCC capital market. Furthermore, it is likely that corporations with weak credits would not be able to make it to the stock market this year, given the current economic state.

Although supportive macroeconomic policies can help to restore confidence and aid the recovery of demand as Coronavirus outbreaks ease, policies will not be able to offset the immediate disruptions that result from enforced shutdowns and travel restrictions. Moreover, some of the attempts of easing fiscal and monetary policies, like cutting interest rates & providing funds to businesses, had an adverse impact on the equity market. Instead of providing a cushion to the economy from any downside risks associated with the COVID-19 outbreak, the monetary policy and fiscal stimulus delivered a message of how serious the situation is, further increasing the volatility in the equity market.

While no sector was safe from the major turbulence caused by the Coronavirus pandemic, the impact of the virus varied across the different sectors of the Saudi economy. The real estate and REITs sectors don't seem to be affected so far, however, the hospitality and retail sectors are almost completely paralyzed from this unexpected hit. Furthermore, the drop in oil prices amid the pandemic had an exaggerated impact on the energy sector. Due to the varying intensity of the impact of the Coronavirus pandemic, it was deemed important to study the different variables that affect each sector's dynamics to determine the severity and the duration of the impact per sector.

Sector Analysis

Energy Sector

The oil sector is currently facing an unprecedented double hit in the wake of global demand shock from the outbreak of COVID-19 combined with increased production from Saudi Arabia and Russia, following the unsuccessful OPEC+ production cuts agreement. Anticipated production rise coupled during a time of reduced global demand is expected to flood an already oversupplied market. Consequently, the world is currently on the brink of witnessing $20 oil barrel for the first time in almost 20 years.

Since the outbreak of COVID-19 in January 2020, demand for oil has slashed on the back of reduced demand from China and global travel restrictions. Factories shut down and stringent quarantining measures in China, the world's largest oil importer, coupled with global trade and travel restrictions, caused major disruptions for the global oil & gas markets. It is worth noting that China accounted for around 80% of oil demand growth last year.

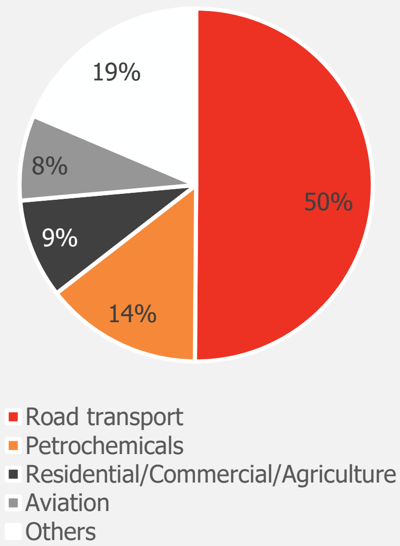
Given that COVID-19 is no longer just an issue for China as it transformed into a global pandemic, resulting in lockdown and more stringent travel restrictions in various countries, the sector is currently witnessing its darkest days in over a decade. Oil consumption reportedly witnessed its first contraction since 2009. According to the International Energy Agency (IEA), global oil demand is forecasted to be cut by 1.1mb/d during 2020, assuming a return to normal operations in H2 2020. China's demand already fell by 1.8mb/d Y-o-Y with global demand down 2.5mb/d.

Following the repercussions in the oil market, **Aramco** announced it is planning to cut CAPEX, amid plunging demand and low prices, to mitigate the ramifications of worsening market conditions. Aramco's market value slumped from a peak of USD2tr in December to USD1.5tr in March.

Going forward, the short-term outlook remains concerning amid continued lower oil demand in the wake of rising regulatory restrictions concerning quarantining and intensifying travel constraints. Oil production ramp-up is expected to further pressure oil prices.

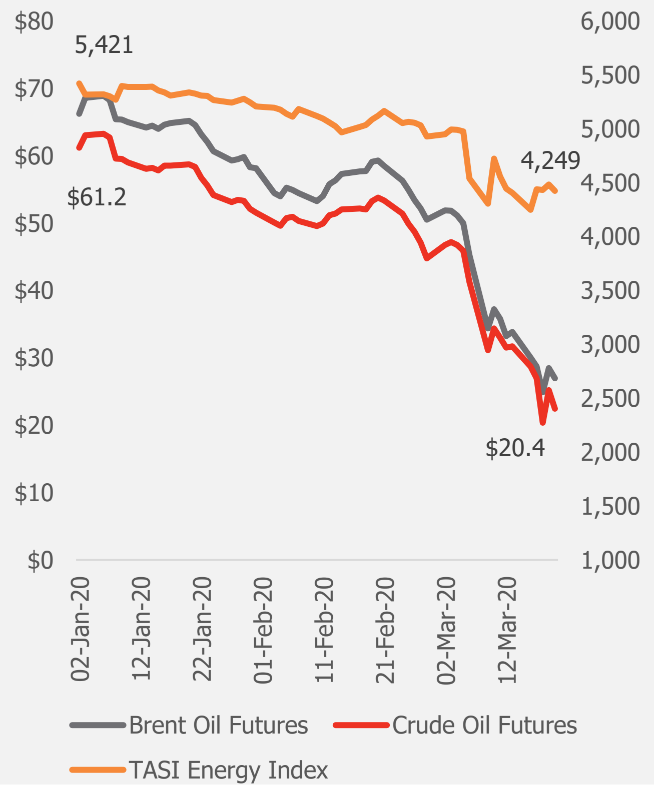
Given the recent precautionary steps in KSA concerning closure of educational and entertainment venues, as well as suspension of attendance at workplace and transportation, the Kingdom is expected to witness more limited movement amid rising calls for quarantine. This will significantly weigh down on gasoline revenues; **Aldrees** and **SASCO** are expected to receive a double hit from lower demand and gasoline prices.

Distribution of Oil Demand by Sector (OECD Countries)



Source: Statista

Oil Prices and TASI Energy Index



Sector Analysis

Consumer Services

COVID-19 has had a severe negative impact on an entire industry, with the tourism and hospitality industry receiving its hardest strike, since 2009, by the global travel restrictions. Airlines are reportedly laying off staff and preparing for huge losses in the coming months. In response, some companies are easing their cancellation policies, including Saudia Airlines, which waived cancellation and change fees on all flights. In addition to the Umrah ban, Saudi Arabia officially announced the suspension of all international flights starting on the 15th of March, as well as local flights starting on the 21st of March. If the Umrah ban is extended through Ramadan and the Hajj season (performed by more than 2 million pilgrims annually), airlines, travel companies, and hotels in the Kingdom are going to receive a further major hit for the year.

Al **Hokair** Group, **Seera** Group Holding, and **Catering** Co. are most impacted by the travel restrictions. Catering's operations are expected to reach a standstill in parallel with the airlines industry as it generates around 70% of its revenue from in-flight catering, with the majority of the remaining 30% still interdependent on the travel industry activity. As a result of the uncertainties ahead, the company announced the postponement of its Q4 2019 dividend payment as a precautionary measure to maintain its cash balance.

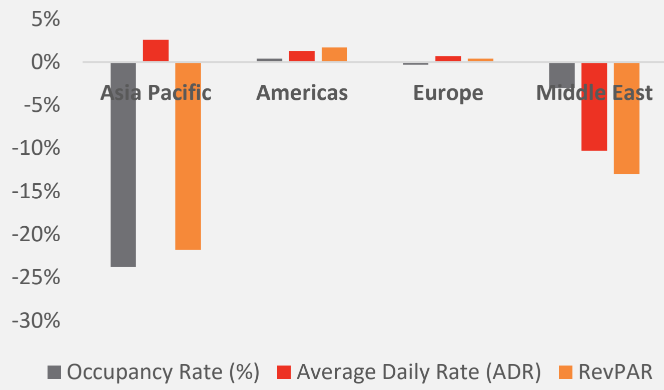
AlHokair group generates more than 50% of its revenues from hotels- which are expected to witness a plunge in occupancy rates- while 40% from entertainment venues, which the company recently announced their closure. The company is already accumulating losses for the past two years amid increased competition and reduced demand and is expected to be hit even further by COVID-19.

Seera Group Holding is expected to face significant business headwinds in H1 2020, being in the core of the most impacted sector, which is airlines and travel services. Seera offers airline ticketing services, hotel booking services, and related travel services. More than 40% of Seera's revenue is generated from airline ticketing services and around 11% from hotel bookings.

Dur Hospitality is another name that could get impacted negatively in the hospitality industry, generating almost 80% of its revenues from hotel operations, with 65% of the rooms operating in Makkah, an annual destination for more than 18 million pilgrims under normal circumstances.

Fitness centers cannot escape the ramifications of COVID-19 either; **Lejaam** Sports announced the shutdown of all of its fitness centers, bringing the company's operations to a pause until further notice. The company announced it is expected to delay non-critical expenses and CAPEX to maintain its cash flow position.

Global Change in Hotel Rates (Feb 2020 vs Feb 2019 Percentage Change)



Source: Smith Travel Research (STR)

*Feb 2020 does not fully capture the impact of COVID-19 on the hospitality industry given that travel restrictions intensified starting end of February 2020

Impact of COVID-19 on the aviation industry

$7.2 billion

revenue lost by Middle East airlines as of 11 March 2020

15.7 million

estimated loss in passenger volume in Saudi Arabia

$3.1 billion

estimated losses in airlines revenue in Saudi Arabia

140,300

jobs at risk in the country

Source: International Air Transport Association (IATA)

Sector Analysis

Retail

While the retail sector did not seem to be on top of the list of the most sensitive sectors following the outbreak of COVID-19, it is on the brink of witnessing significant headwinds on the back of recent precautionary measures. Saudi Arabia announced stringent regulations in its fight against COVID-19, including the shutdown of malls, delivery-only operation of restaurants and coffee shops, and closure of cinemas.

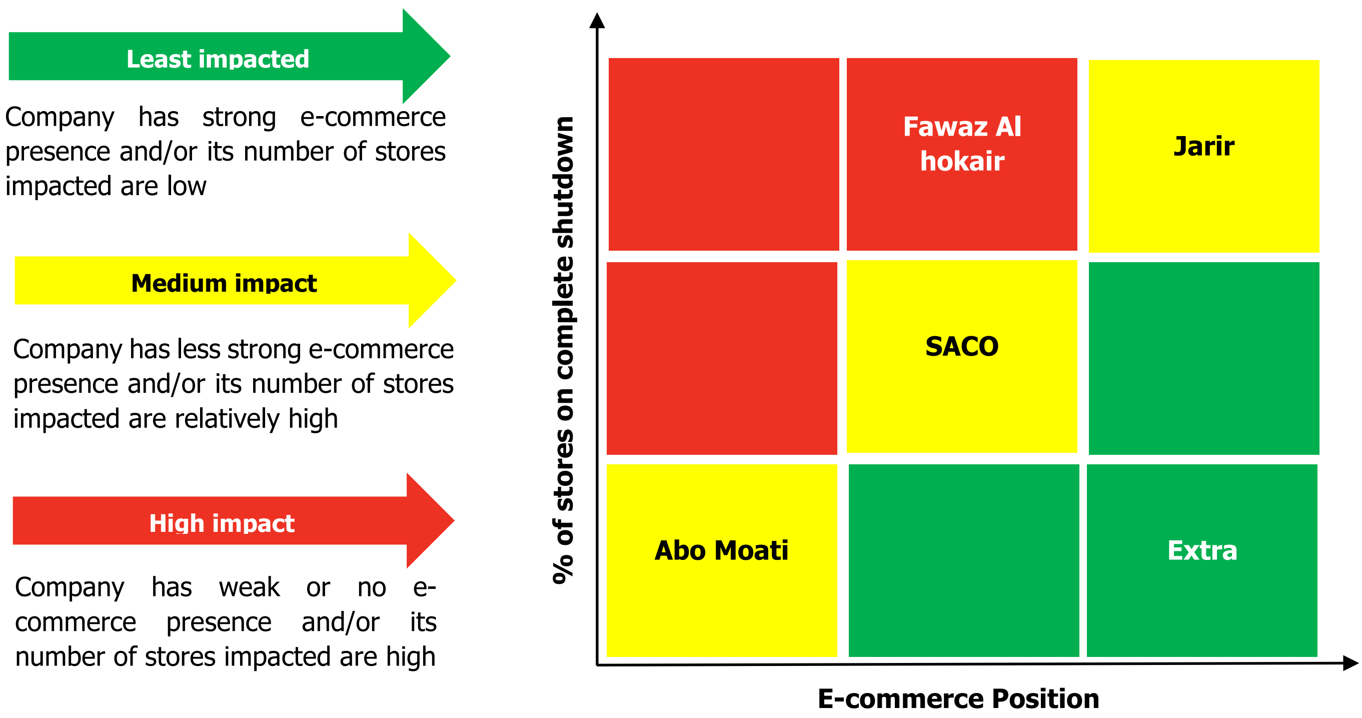
On the supply side, electronics retailers such as **Extra** and **Jarir** might be facing slight supply chain disruptions in their imports, given that electronics giants such as Apple were impacted by factory shutdowns in China. However, since the economic activity in China is starting to turn around, following virus containment in the country, electronics retailers are not likely to face shortages, especially given the subdued demand. While production is not yet back to its normal levels in China, it's ramping up and is not likely to result in significant disruptions for Extra and Jarir.

The real concern, however, currently lies in weak consumer demand in the wake of the shutdown of malls, which impacted **SACO**, **Extra**, **Jarir**, **Lazurde**, and **Fawaz Alhokair** as they closed the stores operating in malls. **Jarir** took a step further, closing down all of its stores in the Kingdom, including those located outside malls. **Extra** should be the most resilient to the shutdown, given that only 10% of its stores were closed down compared to 44% for **SACO** and around 85% for **Jarir**, as per the latest disclosures. Moreover, **Extra** has a significant opportunity to capitalize on its strong e-commerce position, which should be a boon for sales. Retailers with online presence are likely to be the key survivors in the fight against brick and mortar stores shut down. E-commerce is currently a key trend given the circumstances, yet current lower consumer sentiment and shop closure might push companies to slash prices to boost sales, pressuring gross margins.

Moreover, in addition to the closure of some shops, the retail sector is expected to be adversely impacted by the suspension of Umrah and travel bans, reducing footfall in the stores. While the current situation already suggests slashed revenue growth during the year, any further escalations such as full closure of shops, including street shops, or complete lockdown in the Kingdom will bring the retail sector to an unprecedented standstill.

On a different note, the outbreak of COVID-19 is expected to shift retailers’ attention to the essentiality of e-commerce. This might represent a turning point for the retail sector, reshaping consumer behavior, and creating a boon for e-commerce. In such times of crisis, there are significant opportunities for the boost of online shopping. SARS had reportedly contributed to the birth of e-commerce in China back in 2002.

Meanwhile there is no doubt that all consumer discretionary retailers will be hit by COVID-19, some retailers are expected to be more resilient than others.



Sector Analysis

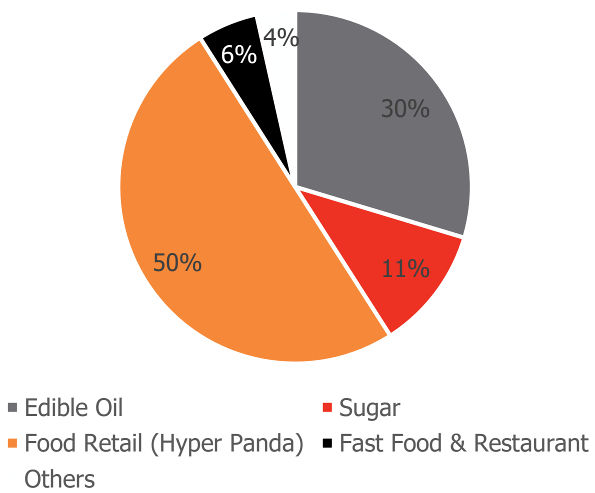
Food & Beverage

Food & beverage retailing or producing companies, including **Othaim** Market, **Alamrai**, **SADAFCO**, and **Savola** Group, might be among the few to witness a short-term positive impact from the outbreak of COVID-19. Amid rising concerns regarding the impact of the virus spread and regulatory escalations on the fundamentals of various sectors, we are least bearish on F&B staples. Evidently, during Q1 2020, F&B staples retailing are expected to witness an increase in basket size, as demand volumes spike, during a time of panic buying and stockpiling. **SADAFCO** is expected to be a key beneficiary given the long shelf life of its dairy products compared to **Almarai**; almost 40% of Almarai's sales are generated from fresh dairy, which might currently witness less demand than long-life milk given the circumstances.

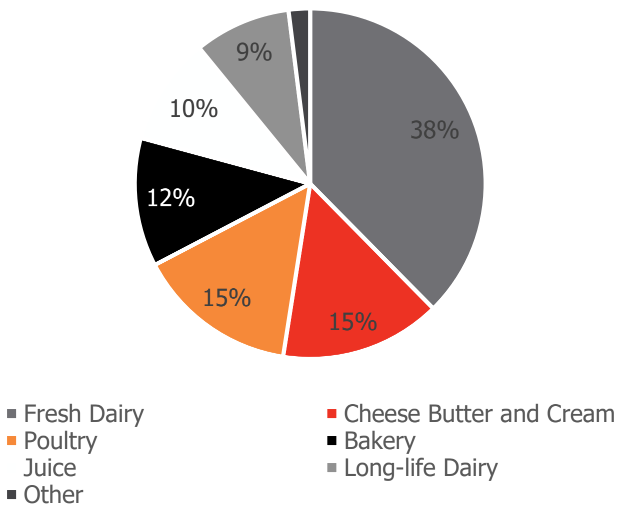
Moreover, grocery stores are the least vulnerable to regulatory escalations pertaining to stores shutdown, given their essentiality, which is set to benefit F&B producers. Even in the event of a full day lockdown, food and beverage retailers are expected to proceed with their normal operations, positioning them as the least vulnerable to escalations. Besides, reduced demand for restaurant food and rising awareness concerning eating out is set to drive growth for F&B producers, given the increased demand for home-made meals.

Restaurants, on the other hand, are expected to witness significant headwinds ahead with the recent decision of suspension of dining-in operations and complete shutdown after 7 pm. With a focus of 85% on restaurant operations, **Herfy's** revenue growth is expected to be slashed during the year. On the other hand, **Herfy** has the opportunity to capitalize on its online food ordering platform, Herfy app. Moreover, the continued operations of drive-throughs, take-out, and delivery during the day are expected to mitigate the impact.

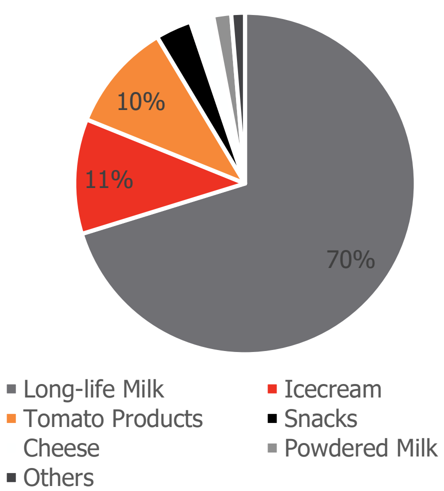
Savola Revenue Segmentation



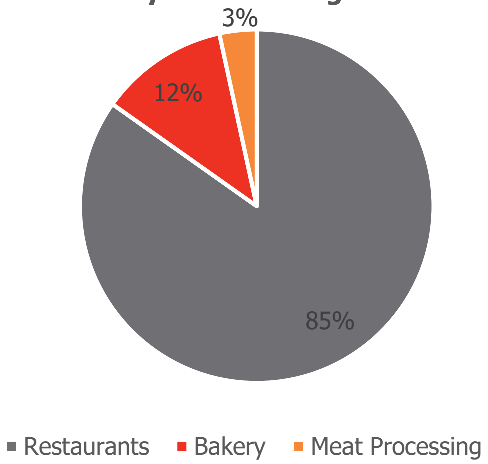
Almarai Revenue Segmentation



SADAFCO Revenue Segmentation



Herfy Revenue Segmentation



Sector Analysis

Real Estate Management & Development

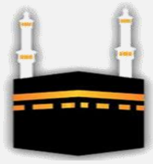
Meanwhile the real estate industry as a whole appears not to be impacted yet by the pandemic to the same degree as travel and entertainment sectors, estimating an impact on the sector depends on many factors. The duration of the outbreak, how quickly it spreads, and the number of people affected are major factors in approximating the actual impact on the sector.

The impact of COVID-19 is expected to vary among different types of real estate. Real estate developers that are mainly focused on offices will witness a change in the type of demand and will have to cater to the new demand, whilst, developers or real estate managers that are focused on commercial and hospitality will experience the greatest hit on the short term and maybe the medium term. However, it seems that the concern regarding the entire real estate sector is in the long term as the Coronavirus outbreak is likely to shift any historical patterns or dynamics in the sector completely.

Offices: Since the outbreak, more employers are encouraging their employees to work from home, which unexpectedly provided employers with a preview of what a significantly smaller office footprint could look like in the future. Telecommunication gains momentum facilitating working from home, which could cause a major shift in the demand for offices. If the technology companies can facilitate a work environment outside the office that delivers results for employers during this outbreak, then expect demand for smaller office footprints to accelerate as a result of the Coronavirus.

Measures by the Saudi Government that could potentially alter the demand on the real estate sector

Banning of Pilgrims from entering the country.

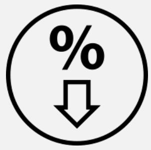


Suspension of all international flights.

Closure of all entertainment zones, malls and restaurants.

Suspension of attendance at workplaces in all entities in the private sector.

SAMA lowered Repo rate to 100bps and reverse repo to 50 bps.



Commercial/ entertainment: Health experts suggest that avoiding crowded areas can be a helpful tool in avoiding the Coronavirus. While at the beginning of the outbreak it was left to the people to follow the social distancing recommendation, due to the severity of the situation the Saudi Ministry of Municipal and Rural Affairs announced that they would be closing all amusement parks and entertainment zones in malls as well as that they would be sterilizing and ventilating all restaurants. The new announcements are expected to have an immediate impact on the retail sector as people avoid grocery stores, shopping centers, and malls.

However, in the longer term, the demand for food and clothes and other essentials won't decrease. Therefore, people are likely to turn to online shopping instead, which could potentially be a tipping point that forever alters some brick and mortar stores and how they accommodate the online consumer. As at-home and curbside deliveries increase in popularity, retailers will need to consider store sizes, layouts, and pick-up points when they design stores.
Al Andalus Real Estate and **Arabian Centers** are among the companies that announced the temporary closure of all its complexes and commercial centers in addition to its subsidiaries and sister companies until further notice.

Sector Analysis

Hospitality: The hospitality sub-sector is expected to suffer the most, especially in the short term. With the suspension of Umrah coupled with the international travel ban, demand on hospitality is bound to drop significantly. Real estate companies with portfolios concentrated in Mecca and Al Madinah, especially in the hospitality sub-sector will be negatively impacted in 2020. **Jabal Omar** and **Taiba Investment** are amongst the companies that are expected to suffer the most during this pandemic, as their activities have already been affected by the significant decrease in occupancy rates in their hotels. In a statement disclosed by **Taiba** investment on Tadawul, the company's direct revenues affected by the activities of Hajj, Umrah, and visitation due to the temporary suspension of Umrah and visit visas as well as the temporary suspension of Umrah For citizens and residents in the Kingdom, in addition to stopping international and domestic flight.

The hospitality sub-sector will remain impacted for as long as the said suspensions persist, however, it is expected to bounce back faster than other sectors as religious tourists will resume visitation as soon as they're allowed.

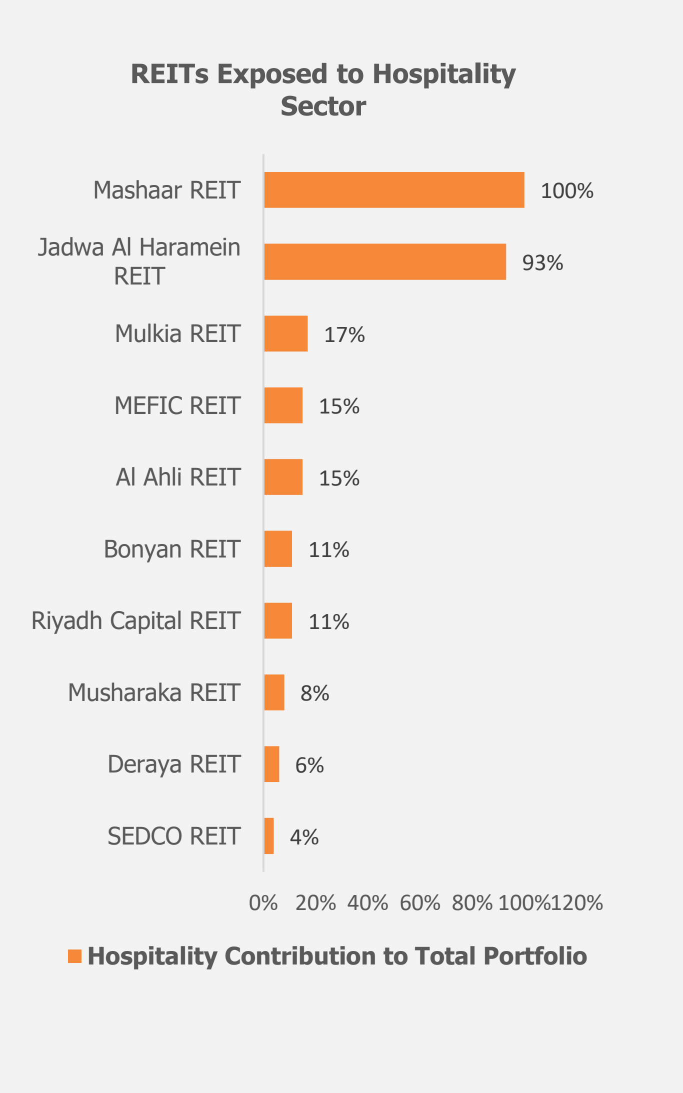
Residential: Residential real estate sub-sector seems to be the least impacted within the real estate sector. The decrease in demand in the short term is an expected response, given the impact on the economy as a whole. However, if the Coronavirus is here to stay, and unemployment rates increase due to the closure of businesses, the expats will be the first to leave the Kingdom. The departure of a large number of expats is bound to significantly decrease the demand for residential real estate, especially in the small apartments' category.

On the upside, the drop-in interest rates might drive more people to rush into borrowing for the purpose of mortgage or real estate purchasing in order to lock in rates that are at historically low levels.

REITs

Even REITs are not immune to the outbreak of COVID-19. Although the majority of REITs are securing long term contracts with fixed rental rates, which in normal conditions would make REITs a relatively defensive bet for investors, the current situation can evidently be classified as a "force majeure", which might lead to the suspension of the secured contracts with tenants. Rental rates are also expected to witness pressure in the wake of COVID-19 as a result of reduced demand, especially in retail and hospitality. Offices, warehouses, and educational properties should prove to be more defensive, given their lower correlation with companies' expansion plans and consumer spending.

Hospitality: The hospitality sector is on the front line of receiving a major hit from the spread of COVID-19, given the expected decline in occupancy rates, which should drive lower room rates as well. Hotels in Mecca and Madina might be the most impacted, given the suspension of Umrah, even for internal umrah performers who live in Saudi Arabia. For instance, 93% of **Jadwa Al Harmein** REIT's revenue is generated from the rental income of hotels in Mecca, which the company secured long-term contracts for. However, the fund announced the suspension of hotel lease contracts, given the nature of the situation. Suspension of **Jadwa's** contracts proves that even the security of long-term contracts with tenants may not prove to be a safe bet in the current unprecedented situation. **Al Mashaaer** REIT also operates its properties for the sole purpose of hosting pilgrims. Meanwhile the fund did not announce any suspension of its lease contracts. This is not a farfetched scenario given the circumstances, placing **Al Mashaaer** REIT under considerable risk.



Sector Analysis

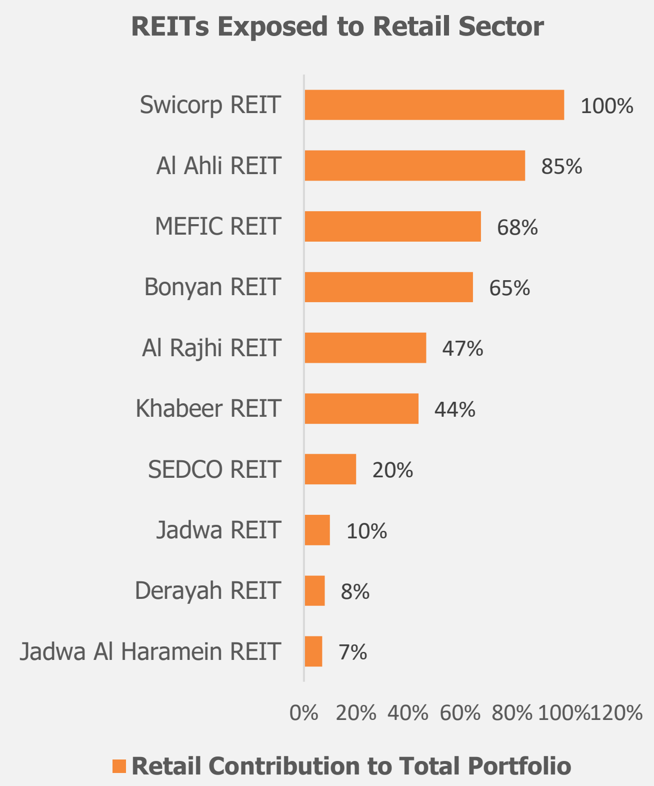
On the other hand, **Al Ahli** REIT operates a hotel in Jeddah, accounting for 12% of its portfolio. Yet, cash inflows are dependent on the hotel's occupancy rates and room rates, which will face an inevitable decline.

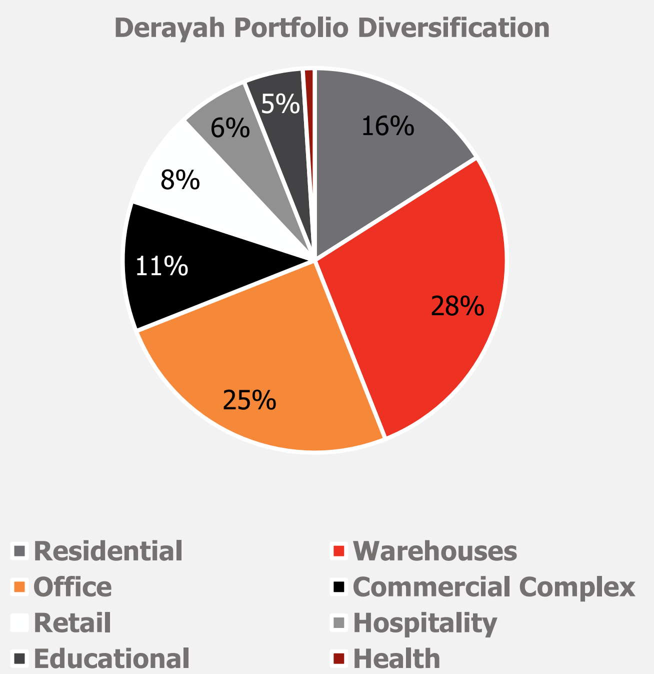
Retail: Retail REITs are also expected to receive a massive hit during 2020 in case the shops' closure period is prolonged. **The majority of REITs** have long-term contracts with tenants, yet given the unprecedented nature of the situation, suspension of contracts might be a valid scenario. Moreover, in the wake of the uncertain days ahead, retail companies are expected to slow down or even halt their expansionary plans during 2020, which will reduce demand on retail space, pressuring rental rates. Retail REITs might also face risk from delays in rent payments by current tenants in the event of continued closure and operational disruptions, or even contract terminations, impacting the financial stability of retail REITs. Current market uncertainties might delay filling the current vacancies, finding new tenants, or renewal of contracts. The intensity of the financial impact, however, greatly depends on the escalations pertaining to the spread of the virus and stores closure period.

Offices: On the other hand, offices are expected to be more defensive in the short term, given their low correlation with a company's downsizing plans, unlike the retail sector. The long-term risk, however, for offices might be evident if the impact of the COVID-19 lingers, reducing demand from new market entrants and SMEs- which are currently key catalysts for Offices market growth in the Kingdom. **SEDCO** REIT has the highest exposure to the offices sub-sector, accounting for 33% of its portfolio. Other key players in the sub-sector are **Al Rajhi** REIT (29%), **Derayah** REIT (25%), and **Jadwa** Saudi REIT (18%).

Residential: REITs with a focus on residential portfolios, on the other hand, including **Jadwa Saudi** and **Musharaka** REIT, should be relatively defensive given that rental housing is a safe play, given its essentiality. If, however, the outbreak worsens and the economy dives into a recession, impacting consumers' income, even the residential sector may not be immune then.

Diversified REITs, such as **Derayah** and **Riyad** REITs, as well as REITs with exposure to relatively safe-haven assets such as residential, educational, and warehouse properties, are expected to be the most resilient in the short term in the fight against COVID-19. In light of reduced consumer demand on products as well as potential halt and delays in production, causing stockpiling for companies, warehouse rental is expected to hold up. **Al Rajhi** REIT is also exposed to warehouse logistics rental, accounting for 15% of its portfolio. The current situation is most favorable, however, for **Al Jazira Mawten** REIT in the short term, which is solely focused on warehouses, though we do not favor the long-term fundamentals of the fund given its low cap rate and lack of diversification. **Taalem** REIT is another defensive bet, given its focus on educational (a highly defensive sector) properties with long-term contracts.





Sector Analysis

Banks

The banking sector in Saudi Arabia consists of 11 banks, 4 of them are classified as Islamic banks (**Al-Rajhi**, **Al Bilad**, **Alinma** and **AlJazira**). During the past few years, Saudi banking sector was considered as one of the most important sectors that support the Saudi economy, in light of the increase in government spending, high interest rates, and government support for mortgage loans.

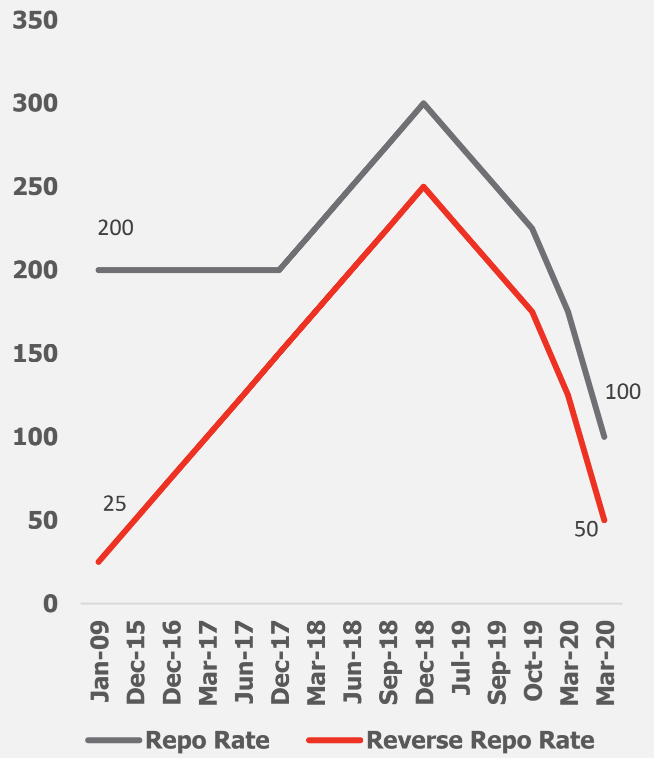
In an attempt to stimulate the economy from the aftermath of the outbreak of the Coronavirus, the US Federal Reserve announced a decrease in the interest rate (on the 3rd March 2020) by 50 basis points followed by another decrease (on 15th March 2020) in less than two weeks. Consequently, the interest rate in the United States stabilized between 0 to 25 basis points, which is the same rate that was set during the 2008 financial crisis.

Accordingly, the Saudi Arabian Monetary Agency (SAMA) announced the reduction of repo and reverse repo rates by 50 and 75 basis points, respectively. Thus, the repo rate reached 100 basis points, while the reverse repo rate reached 50 basis points.

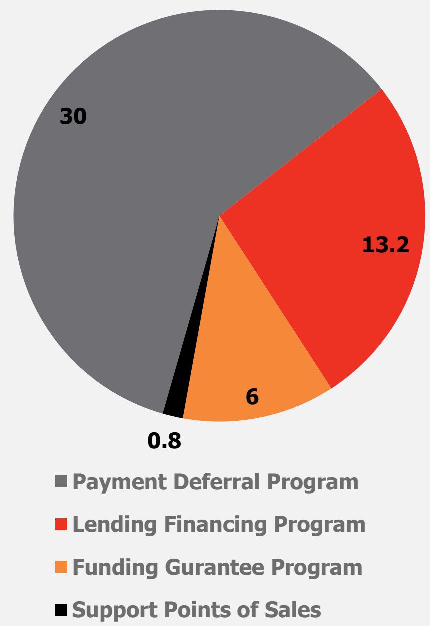
After the Federal Reserve cuts interest rates to reach the 0% range, this step is the last step the Fed can take through its monetary policy to counter the virus, and no other decisions can be taken unless in the event of intervention to help banks and companies financially to limit the negative effects of the spread of this virus. Indeed, the Fed announced its support to companies and the stock market with USD300bn. If the blurry picture of the economic situation lasts longer than that, we will take a serious economic slope that is difficult to predict at the present time.

During this unmitigated global disaster, the Saudi economy depends on (SAMA) to enhance financial stability and support the growth of the private sector within the framework of supporting the state's efforts to fight Coronavirus and reduce its financial and economic effects on the Saudi private sector. Evidently, SAMA not only reduced interest rates, but also announced its support of the private sector, especially the SME's segment by USD13.3bn (SAR50bn) to meet the economic impacts expected due to the Coronavirus. The program includes three basic elements to mitigate the effects of the precautionary measures taken by the Kingdom to combat the virus, specifically reducing the burden of fluctuating cash flows, supporting working capital for this sector and enabling it to maintain growth rates during the coming period.

Saudi Repo & Reverse Repo Rates



SAMA SAR50bn Program



Sector Analysis

First: Supporting the financing of all small and medium enterprises:

A- Payment deferral program: SAR30bn is deposited by SAMA in favor of banks in order to postpone the payments SME's segment for the next six months.

B- Lending Financing Program: SAR13.2bn is deposited by SAMA in favor of banks to support the finance for the SMEs segment.

C- Funding Guarantee Support Program: SAR6bn is deposited by SAMA in favor of banks to enable them to exempt SMEs and reduce the cost of lending in their fiscal year 2020.

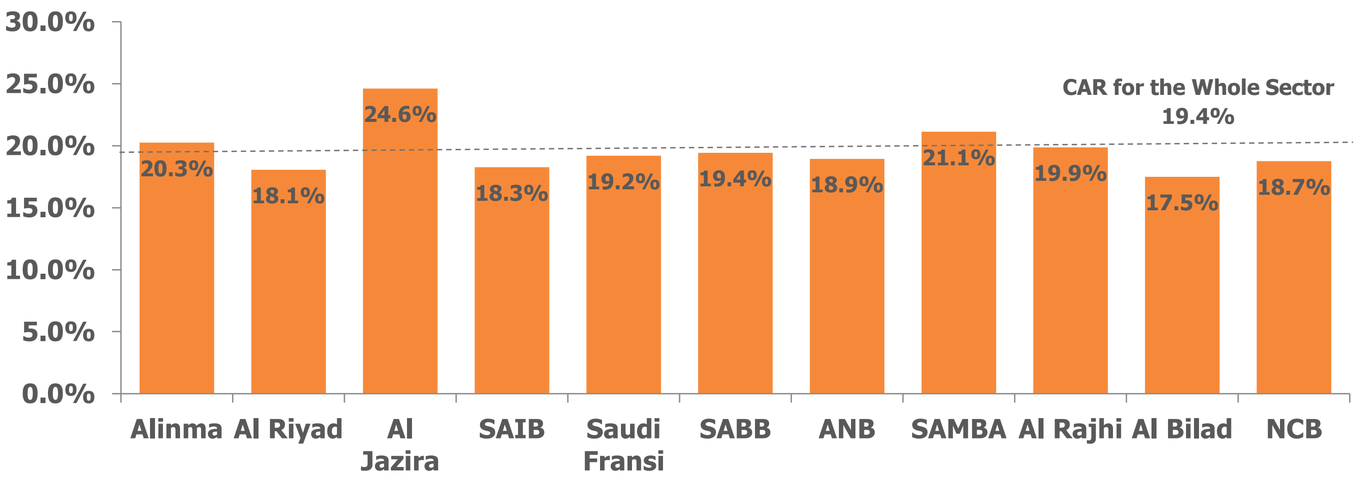
Second: Supporting point of sale and electronic commerce transactions: SAR800mn are deposited by SAMA for the benefit of all stores and private sector facilities for a period of 3 months.

Third: Companies that are negatively affected by taking precautionary measures that were identified before from the Saudi government. For example, the Saudi government announced the suspension of work in the private sector except for the health and food services sectors for a period of 15 days. Consequently, the Foundation is currently coordinating with banks to facilitate payments for these companies.

So far, the financial performance of the banking sector in Saudi Arabia has not been affected by the outbreak of the Coronavirus. The financial indicators for the whole sector are remaining strong and stable. For example, the capital adequacy ratio (CAR) reached 19.4%, while the required percentage, according to (Basel III) to be not less than 10.5%. CAR is a ratio that determines the relationship between the bank's sources of funds (bank's assets) and the risks surrounding it. This ratio is used to identify the ability of banks to bear potential losses. Thus, until the present time, **all banks in Saudi Arabia** have the ability to absorb shocks in the banking sector thanks to well CAR and government support.

Despite the low-interest rates, we expect that 2020 will be a challenging year for the banking sector, especially Q2 2020, as the decrease in demand for loans due to the interruption of some business in general in the Kingdom as a precautionary measure to prevent the virus will affect it. Additionally, the high probability of the private sector not being able to fulfill its commitment to banks, is expecting to negatively impact the banks' liquidity, and increase the Non-Performing Loans (NPL). Consequently, the cost of risk will rise in Saudi banks compared to the previous periods.

Capital Adequacy Ratio (%)



Sector Analysis

Health Care

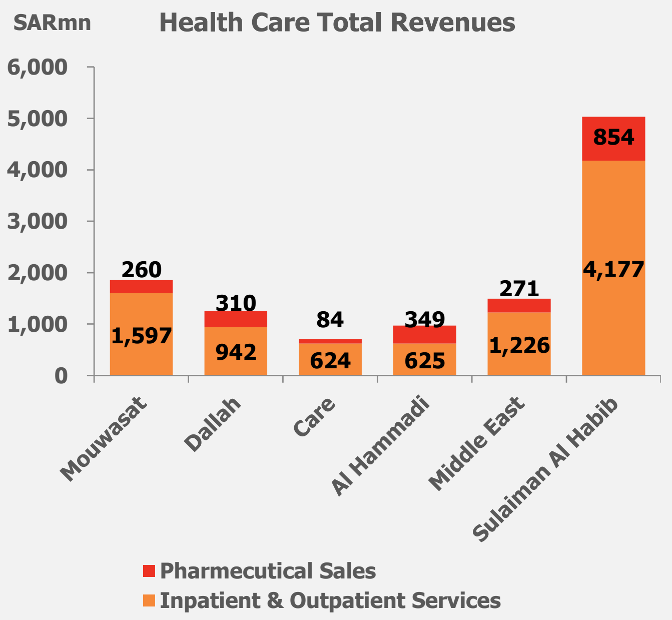
Coronavirus poses a higher risk for older adults aged over 60 and people who suffer from chronic diseases, such as diabetes and blood pressure. The Saudi population is a relatively young population, with only 5.5% of the total population above 60. However, the fast-growing outbreak in Italy was a warning sign for the world, prompting the Kingdom to take many precautions to confront the virus.

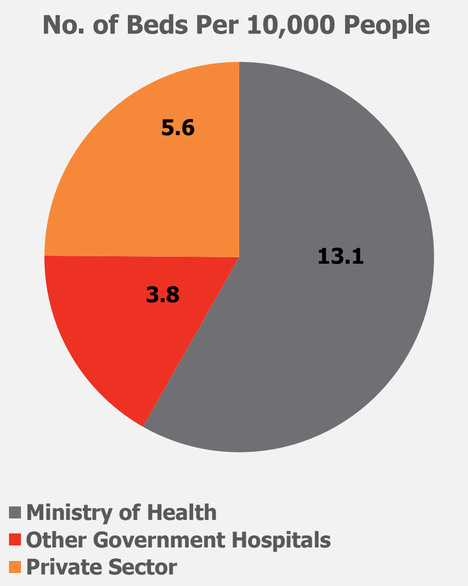
The spread of epidemics and viruses may generally be considered a significant catalyst for the healthcare sector. However, this may not be the case with the spread of COVID-19; we expect that the spread of the virus will have a limited impact on the financial performance of the health sector due to several reasons.

Firstly: The financial performance of the health care sector improves during the outbreak of viruses as a result of the tendency of companies operating in the sector to increase their sales by selling antiviral drugs. While no treatment has been found yet for COVID-19, the only opportunity for companies operating in the sector is to increase their production of medical gloves, masks, and medicines, which help to prevent the spread of the virus. As a result, we expect to see a slight improvement in pharmaceutical segment revenue from the sale of medicines during H1 2020. Pharmaceuticals sales represented 18.8% of the total revenue for the sector in 2019.

Secondly: According to the directives of the Saudi Ministry of Health, patients with symptoms are advised to isolate themselves and avoid visiting hospitals to avoid the spread of the virus. Instead, they can call the hotline announced by the ministry, which will direct them to the nearest isolation hospital. Accordingly, patients are generally expected to delay their hospital visits for outpatient clinics as a preventive measure. We expect a relative slowdown in the performance of outpatient services during H1 2020.

It is worth mentioning that the number of beds per 10,000 people in private hospitals in the Kingdom is about 5.6 beds, according to the latest published data for 2018. Private hospitals' beds account for around 24.9% of the total number of beds available in the Kingdom.





Source: Saudi Ministry of Health

Sector Analysis

Post COVID-19 Crisis: Recovery Phase

A key question that remains is; which sectors are more likely to recover faster than others when the crisis eases?
Generally speaking, the speed of business recovery significantly depends on the period of economic shutdown. The longer the economic suspension period, the more difficult recovery will be for all sectors, as companies' revenues will be drying up faster than they can cut costs. Moreover, given that the shutdown is currently driven by health issues, it is difficult to set a time period for the end of this crisis. With the underlying assumption that the economic shutdown period is short-lived, different sectors are expected to witness varying recovery speeds.

Retail: Although the retail sector is in the frontline of the economic shutdown, it is expected to be among the fastest to rebound to its normal operations once retail shops are reopening. Consumer discretionary retailers are currently witnessing delays in purchases rather than cancelations. This is particularly true to retailers who sell non-seasonal products, like electronics and household equipment; purchases that were postponed will finally be made upon reopening of stores. Accordingly, the sector will relatively be able to compensate for the lost demand during the suspension period. The key advantage of the retail sector compared to other sectors is its ability to recover the lost demand. On the other hand, FMCG companies and restaurants, which were hit by reduced consumer spending, will not be able to recover the lost sales. In addition, restaurants might encounter a slight change in attitude from consumers towards eating out, even when the health crisis ends.

Hospitality & Travel Services: Companies exposed to the Saudi travel services and hospitality sector are expected to make a quick u-turn as the situation returns to normalcy. Meanwhile, global tourism might witness lingering repercussions from the outbreak of COVID-19. The Saudi tourism sector in particular (which is predominantly religious tourism) is expected to show higher flexibility when the crisis ends. In the event of the reopening of Umrah and Hajj for all countries, an influx of pilgrims is expected to enter Saudi Arabia within a short period of time. For pilgrims, their high demand and desire for the pilgrimage are expected to outweigh the lingering fear of safety. The market is already in extremely high demand throughout the year.

Subsequently, airlines and travel services are likely to witness fast recovery. On a different note, airlines can capitalize on lower jet fuel costs as oil prices slump. They might still make up for the lost sales, as some flights were rescheduled rather than canceled. Given that airline operations have a knock-on effect on demand for hotels, the hospitality sector should recover fast in parallel with airlines. We expect to see a v-shaped recovery for companies exposed to travel services in the Kingdom, especially in Mecca and Medina.

Real estate: On the other hand, some sub-sectors in the real estate sector might face recovery lags. The retail real estate sector, for example, might be slower to recover than hospitality as businesses' key focus upon reopening of stores is expected to be on recovering the lost revenues and fast return to normal operations for the existing stores rather than geographical expansion. Accordingly, the retail real estate sector might witness a delayed impact of the end of the crisis.

The hospitality real estate sector, on the other hand, should recover fast as soon as travel bans are lifted.

Demand for offices is not expected to be significantly impacted on the short term. Stimulus programs supporting SMEs and struggling businesses should also aid in the resilience of the offices' sector. Even if the crisis prolongs, the directed efforts should aid in the recovery of such businesses, and subsequently, the offices' real estate sector.

The residential sector is expected to be at relatively low risk in the short term, yet if the crisis prolongs, reduced demand from expats might leave a gap in the market that would be difficult to recover from.

Energy: Although China's economic resumption is underway, which should entice pickup in demand for oil and petrochemicals, it is unlikely that the energy sector will be undergoing recovery soon. Even if the impact of COVID-19 on oil demand proves to be short-lived, there's a significant downside risk that oil prices persist at their current low levels if production cuts are not applied. Given the current situation of continued COVID-19 escalations (reflecting in continued lower oil demand), coupled with the low likelihood of a production cut agreement before June (when OPEC is rescheduled for a meeting), the oil sector is expected to face significant challenges ahead, which might take years to recover from.

Sector Analysis

Banking: The downside risks in the banking sector are expected to prolong even after the containment of the virus. While some businesses might witness fast recovery following the resumption of business operations, the ramifications are much more complicated for the highly regulated financial sector. The financial performance of the banking sector is pinned to interest rates in the economy, which are expected to continue at their low levels in the short term until economic stability is regained. Moreover, as businesses are expected to delay some of their expansion plans even after the end of the outbreak, demand for financing might be delayed in turn.

The key question, however, that will clear up the blurred vision of the intensity of the impact of COVID-19 is: how long is the health crisis, and subsequently, the economic shutdown, going to last. This is the question that even health professionals cannot answer to date. The outbreak of COVID-19 represents an unexpected shock for the global economy, which simultaneously impacted supply and demand, posing an unprecedented economic challenge. Whether COVID-19 is short-lived or is here to stay, there is no doubt that it will permanently reorient people's interaction with the economy.

Events Timeline

31st December 2019:
The WHO China Country Office was informed of cases of pneumonia of unknown etiology (unknown cause) detected in Wuhan City, Hubei Province of China.

2020

9th January:
The first death from the virus occurred in a 61-year-old man who was a regular customer at the Huanan Seafood Wholesale Market (where the disease was first suspected).

14th January:
On 14th January, two of the 41 confirmed cases in Wuhan were reported to include a married couple, raising the possibility of human-to-human transmission.

19th January:
On 19th January, the first confirmed cases were reported in China, outside Wuhan

1st February:
The first air carrier from the middle east**,** Qatar Airways, suspended flights to mainland China from 3rd February until further notice.

5th February:
China, in Wuhan, now reported 10,117 cases in total. Tianjin reported its first death. Chinese experts said that nucleic acid testing was only able to identify 30%-50% positive cases.

7th February:
The Federal Reserve Bank warns that the virus is a potential threat to the growth of the US economy.

9th February:
China (Mainland) now confirmed a total of 40,213 cases, of which 29,631 were in Hubei. The Coronavirus death toll in China rose to 811, surpassing the toll from the SARS epidemic from 2002–03

11th February:
WHO officially names new Coronavirus as COVID-19
The virus is lowering crude prices worldwide, as China's demand for crude oil decreases due to shutdowns, lockdowns, fears, and other measures. Oil prices have just reached a 1-year low again, and have been falling for 5 weeks.

13th February:
The government has issued an extension of order to shut down all non-essential companies, including manufacturing plants, in Hubei Province until at least 24:00 20th February 2020.

Wuhan enacts a new rule prohibiting people from leaving their neighborhoods for non-medical reasons, updating the curfew to a full lockdown.

16th February:
Hubei implements "hard quarantine" in units of natural villages; no outsiders are to be allowed in, and each household is allowed one person every three days to go out for provisions and urgent agricultural material, on designated routes and in limited time. All non-essential public spaces in Hubei are to be closed, and all gatherings were forbidden.

26th February:
Beijing required foreign travelers arriving from areas affected by COVID-19 to be quarantined for 14 days. National measures were introduced to aid business resumption, clamp down on malicious disruptors of traffic and logistics, and prohibit the excessive raising of essential medical supplies or disruption of the market order.

27th February:
Saudi Arabia banned pilgrims and foreigners from entering the country due to the Coronavirus.

Events Timeline

Due to mounting worries about the Coronavirus outbreak, various US stock market indices including the NASDAQ-100, the S&P 500 Index, and the Dow Jones Industrial Average posted their sharpest falls since 2008, with the Dow falling 1,191 points, its largest one-day drop since the 2008 financial crisis.

28th February:
the Foreign Minister of Saudi Arabia announced the temporary suspension of entry for Gulf Cooperation Council (GCC) citizens to Mecca and Medina. Citizens of the GCC who had been in Saudi Arabia for more than 14 continuous days and didn't show any symptoms of COVID-19 would be excluded from this rule.

2nd March:
Saudi Arabia confirmed its first case, a Saudi national returning from Iran via Bahrain.

3rd March:
The Federal Reserve cut short-term interest rates by 50 basis points in an attempt to reverse the slide in equity values and boost consumer and investor confidence.
Similarly, the Saudi Arabian Monetary Authority (SAMA) lowered its repo rate from 225 basis points (bps) to 175 bps, and its reverse repo rate from 175 bps to 125 bps with immediate effect

5th March:
Saudi Arabia announced further precaution steps regarding the Great Mosque of Mecca and the Prophet's Mosque, which include a temporary daily closure of the Great Mosque for sterilization purposes.

8th March:

- Saudi Arabia announced unexpected price discounts of $6 to $8 per barrel to customers in Europe, Asia, and the United States. The announcement triggered a free fall in oil prices and other consequences that day, with Brent crude falling by 30%, the largest drop since the Gulf War.
- The Saudi Arabian government announced that it was temporarily halting all transport in and out of Qatif on its eastern coast. However, Qatif residents will be permitted to enter the territory. Cement blocks were reportedly placed as roadblocks on the main road leading to the area. The country's Interior Ministry claimed that all individuals with confirmed cases in the country were from Qatif.
- The Saudi Ministry of Education announced that schools and universities would be closed in Saudi Arabia from Monday to control the spread of Coronavirus. The decision covers all educational institutions, including public and private schools, and technical and vocational training institutions.

9th March:
- Stock markets worldwide reported major losses thanks in part to a combination of price war and fears over the Coronavirus outbreak. Effects were felt outside of oil prices and stock markets as well; following the announcement, the Russian ruble fell 7% to a 4-year low against the US dollar.
- The Dow Jones fell over 7%, or 2,000 points, exceeding the futures market prediction and becoming history. Other stock markets were similarly affected, with the S&P 500 contracting by 7.6% and the NASDAQ Composite contracting by 7.2%.
- The state oil giant Saudi Aramco led the financial losses, dropping by 10% on Riyadh's Tadawul stock exchange. That forced a halt to Aramco's trading.
- Saudi authorities announced the discovery of four more new Coronavirus cases. The new cases include a Saudi national, two Bahrainis, and an American. All the new cases have been quarantined in Qatif and Riyadh.

10th March:
Saudi Arabia announced that it would increase its production from 9.7 million barrels per day to 12.3 million, while Russia planned to increase oil production by 300,000 barrels per day.

11th March:
The World Health Organization declared the rapidly spreading Coronavirus outbreak a pandemic, acknowledging that the virus will likely spread to all countries on the globe.

Events Timeline

12th March:
Tadawul's market capitalization slid 12.65% week-on-week to about SAR 7.266 trillion in the week ended 12th March 2020

14th March:
- Saudi Arabia confirmed that it was suspending all international flights for two weeks starting from 15th March in a drive against the spread of the global Coronavirus.
- The Saudi Ministry of Municipal and Rural Affairs announced that they would be closing all amusement parks and entertainment zones in malls as well as that they would be sterilizing and ventilating all restaurants. Besides, the Ministry also announced that they would be banning all social events, including funerals and weddings.
- Saudi Arabia has provided similar economic support, pledging a SAR50bn ($13bn) package to help SMEs, e-commerce companies, and entities affected by closures in Mecca and Medina.

15th March:
- The Saudi Ministry announced the closure of all shopping malls, restaurants, coffee shops, and public parks except pharmacies and supermarkets
- The Fed announced it would cut its key interest rate, the federal funds rate, to zero to 0.25%, down from a range of 1% to 1.25%, and launched a USD700bn quantitative easing program.

16th March:
- The Saudi Arabian Monetary Authority (SAMA) lowered its repo rate from 175 basis points (bps) to 100 bps, and its reverse repo rate from 125 bps to 50 bps with immediate effect.
- Crude futures for April delivery fell 10.5% to 28.4 dollars, while Brent fell 12.2% to 29.7 dollars per barrel.

18th March:
- The Ministry of Human Resources and Social Development announced that it would suspend attendance at workplaces in all entities in the private sector for 15 days, out of the determined efforts made by the Kingdom in facing the repercussions of the new Coronavirus and preventing its spread.
- Saudi Arabia announced budget expenditure cuts of 5% for 2020 to offset the impact of the outbreak of COVID-19

19th March:
Saudi Arabia's health ministry said the total number of Coronavirus cases in the Kingdom had reached 274. Two more cases have recovered, bringing the total number of recovered cases to 8. No deaths have been reported.

20th March:
Saudi Arabia suspended entry and prayers to the general public at the two Holy Mosques in Mecca and Medina to limit the spread of the Coronavirus.

The Ministry of Interior suspended domestic flights, trains, buses, and taxis for 14 days in a heightened effort to stop the spread of the COVID-19. The new measure will take effect at 6 am (AST) on Saturday, 21st March 2020

22nd March:
The Saudi Ministry of Health announced 119 new cases, bringing the total in Saudi Arabia to 511.

24th March:
The Saudi Ministry of Health reports its first death for a 51-year-old Afghan national in Medina.

26th March:
The total number of cases in Saudi Arabia tops 1,012 cases, with 33 recoveries and 3 deaths.

Disclaimer

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