الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Kingdom of Saudi Arabia

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Economic Overview – Kingdom of Saudi Arabia (KSA)

KSA is the largest economy in the Middle East with its 2018 GDP of USD700 bn and per capita GDP of USD21,969 (as Q32018). Its economy rests heavily on oil which makes up around 43% of total GDP in 2018. Meanwhile, in the last three years, oil related revenues constituted 69% of government revenues and around 76% of exports on average. On the other hand, geopolitical developments continue to put pressure on defense and security spending.

Country's Vision 2030 reform program, launched in 2016, aims to transform the KSA both economically and socially. The main objectives are to grow and diversify the economy, to increase employment, to strengthen Islamic values and national identity, to offer a fulfilling and healthy life, to enhance government effectiveness and to enable social responsibility. Selected goals and KPIs of the program include lowering the unemployment rate to 7% (12.8% in 2017 for nationals), increasing the share of non-oil exports, improving the share of SME contribution to GDP from 20% to 35%, raising the non-oil government revenue and increasing the participation of women in the workforce to 30% from 22%, among others.

Saudi economy recovered by 2.2 % in tandem with oilGDP (up2.8%) while the non-oil GDP increased by 1.74% in 2018. On the contrary, in 2017, albeit there was a very limited growth in non-oil GDP, the overall GDP had shrunk 0.9 % due to the downward movement of the oil prices and the agreement upon cutting the oil production. Saudi crude oil production reached 10.4 million barrels per day in June 2018, its highest level since December 2016, just before the OPEC+ agreement for limiting production.

Table 1: Economic Indicators

%	2015	2016	2017	2018	2019F	2020F
Real GDP Growth Rate	4.1	1.7	-0.9	2.2	1.9	1.9
Inflation (Annual Average)	1.3	2.0	-0.9	2.4	2.0	2.2
Current Account / GDP	-8.7	-3.7	2.2	15.7	8.8	6.7
Fiscal Balance / GDP	-15.8	-17.2	-9.3	-4.6	-1.7	-2.0
Domestic Debt / GDP	5.8	8.8	10.1	10.7	11.5	12.1
External Debt / GDP	0.0	4.3	7.1	8.5	8.8	9.9

The authorities are implementing tax reforms to reduce the fiscal dependence on oil-based sources. In January 2018, Saudi Arabia began collecting a 5 percent Value Added Tax (VAT). In addition, though their total impact is very limited in terms of volume, excise taxes have been enacted on soft drinks and tobacco. Combined, these new tax measures are expected to support increasing non-oil revenues. With oil prices currently well above conservative reference price estimates in the low US$60/barrel range, fiscal balance is likely to be achieved ahead of the 2023 targets. The fiscal position which improved in 2017, as the budget deficit dropped by 23% and non-oil revenues also increased by 33%, would be further strengthened thanks to the VAT and oil prices.

To mitigate the negative impact of heavy reliance on oil revenues, Saudi government implemented countercyclical fiscal policies aiming to increase spending through the issuance of debt securities. However, the current debt levels are low compared to global peers and indicativeof the sovereign's capacity to stimulate domestic economy through fiscal spending.

The recovery in GDP, on the other hand, prompted an increase in inflation, which reversed the course of deflation experienced last year. In 2018, prices rose by 2.4 percent year-on-year. The adoption of Vision 2030 has spurred reforms in several areas. Efforts have been made to improve the business environment and promote SMEs and financial sector reforms. A draft law on private sector participation was published for public feedback in July 2018, a good move towards greater transparency. Critical reforms are underway in the labor market, targeted to increase the share of nationals in the Saudi workforce with the Saudization program. A large quota-based policy for Saudi nationals ("Nitaqat") has shown positive results in terms of increasing employment of Saudi nationals, including women, in the workforce, though it faces broader question in terms of its impact on private sector growth and productivity. Levies on expatriate labor in Q1 2018 and other disincentives for expatriate employment have resulted in nearly a quarter of a million foreign workers leaving Saudi Arabia especially in construction. However, this initiative triggered a concern over the question of whether the qualified expats will be well replaced or not.

In tandem with increasing oil prices, current account also improved in 2018as15.7% of GDP, vis-à-vis a 2.2% in 2017. Surplus is estimated to have further surged in 2019.

At USD489bn by year-end 2017 (2016: $529bn), strong international reserves of the Central Bank (covering 28months of exports) reinforcethe country's ability to cope with cyclical oil price shocks.

Banking Sector

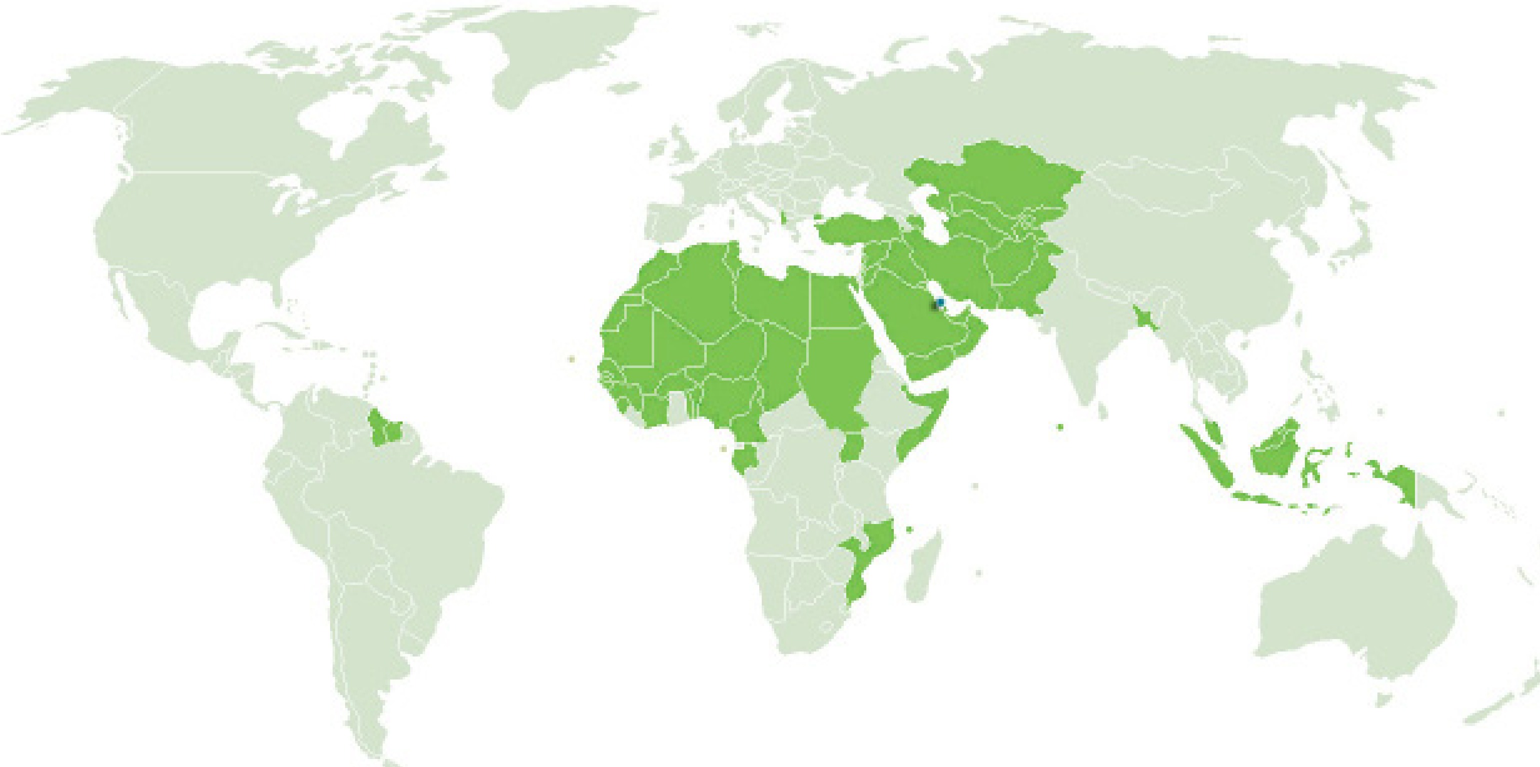
Saudi Arabian banking sector comprised 26 banks (25 active, 1 licenced) at the end of 2018 with a total asset base of SAR2.36trn, being 90% of GDP. Along with Bank AlJazira, there are four banks operating in KSA offering Shari'a compliant products and comprising 25.6% of total banking sector assets.

About 24% of the total banking sector financings constitutespersonal financings whereas commerce, manufacturing, and building andconstruction leadthe sector's aggregatefinancings. After growing by a CAGR of 7.7% from 2013 to 2016, lending volume decreased 1.0% in tandem with slower economic activity in 2017 and recovering back by 5.4% growth in 2018. Heavy dependence on both government deposits and government lending is note-worthy with about 22% and 25% respectively of total deposits and financings of government entities. Despite strong correlation of the economy with a single sector, the banking industry has demonstrated resilience with strong capitalization, high provisioning coverage and low loan-to-deposit ratios.Over time, the sector has generated stable and healthy profitability with consistent lending spreads. Going forward, banking sector profitability is likely to maintain its resilience on the back of rising rates, as well as ongoing government stimuli in support of private sector and individuals.Proactive and effective regulation by SAMA also limits downside risks to the sector.

Table 2: Snapshot of the KSA Banking Sector (%)

%	2014	2015	2016	2017	2018
Gross NPLs to Gross Loans	1.1	1.2	1.4	1.6	2.0
Total Provisions to NPLs	182.9	164.4	177.0	151.9	199.4
Loans to Deposits	74.8	80.0	80.7	80.1	77.4
Capital Adequacy Ratio	17.9	18.1	19.5	20.4	20.3
Average Spread btw. Loans and Deposits	3.5	3.4	3.5	3.5	3.5
Return on Assets	2.0	2.0	1.8	2.0	2.0

The Vision 2030 launched by the government embeds government stimuli for the banking sector, byseekingto increase the SME contribution to the economy up to 35%. In April 2017, Financial Sector Development Program (FSDP) was launched among other delivery programs to realize Vision 2030. FSDP had three main objectives encompassing the formation of advanced capital markets, enabling of financial institutions to support private sector growth, and promotion of financial planning (retirement, savings, etc.). FSDP is committed to increasing the share of SME financing at banks to 5% by 2020 from 2% at the end of 2016. The program is focused on incentivizing the banks to lend to SMEs by improving the SME financing ecosystem andrestructuring the Kafalah Program,enabling the credit bureaus to collect SME data, ensuring government commitment to allocate more contracts directly to SMEs and strengthening the legal framework (including collateral enforcement). As of December 2018, 11,912 SMEs have benefited from the Kafalah program since it was established in 2006. As total funding provided by the contributing banks reached above SAR 25bn, the value of guarantees (kafalaat) provided to banks during the same period crossed SAR 13bn.



Islamic International Rating Agency

, P.O. Box 20582, Kingdom of Bahrain
Tel: +973 17211606, Fax: +973 17211605
Website: www.iirating.com | Email: iira@iirating.com