SAUDI ARABIA ECONOMIC REPORT

CONTINUING ROBUST MACRO DRIVE DESPITE GROWING DOMESTIC AND EXTERNAL CHALLENGES

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- Saudi economic performance remaining on an expansionary path

  Saudi political and macroeconomic stability has held firm amid a drastic drop in oil prices, a royal succession and sectarian conflicts in the MENA region. As a matter of fact, despite lower oil prices, Saudi real GDP growth reported 3.6% in 2014, since, contrary to other previous price slumps, the government refuses to pare back oil production and instead prioritizes its market share. Real GDP growth is projected by the IMF at a healthy 3.5% in 2015, almost unchanged from 2014, with a rise in oil production and continued government spending expected to support the Kingdom's economy.

- Falling oil prices contracting the current account surplus

  The external position of Saudi Arabia was directly shaped by lower oil prices registered during the year 2014. Indeed, the Kingdom's external accounts regressed in 2014, for the second consecutive year, but managed to remain in surplus. For instance, the trade balance stood at US$ 99.16 billion in 2014, down by 37.1% from its 2013 level, as per SAMA. Consequently, the current account surplus accounted for 10.2% of nominal GDP in 2014, down from a share of 18.2% in 2013 and 22.4% in 2012. The year 2015 is expected to register a shift of the current account balance into negative territories.

- First fiscal deficit in 5 years amidst the oil price plunge

  Saudi Arabia's fiscal performance was marked by an extended decrease in revenues that was mainly driven by lower oil revenues, while expenditures registered further expansion amidst high capital spending on enormous infrastructure and industrial projects. Within this context, the Kingdom faced in 2014 its first fiscal deficit in five years, with the latter expected to deteriorate further in the coming period within the context of lower oil prices and elevated government spending. This expenditure path and lower oil revenues would lead to an overall double-digit fiscal deficit in 2015. In parallel, the Kingdom continues to witness one the lowest public debt-to-GDP ratios in the world (1.6% in 2014).

- Decline in SAMA's reserves and eased inflationary pressures

  Monetary conditions in Saudi Arabia were characterized by eased inflationary pressures during the first four months of 2015, a moderate growth in monetary aggregates, and declines in SAMA's foreign assets amidst an oil price slump and ongoing strong government spending. In details, Saudi inflation remained relatively subdued during the first four months of 2015, with the cost of living index increasing by 2.1% on average over the said period after rising by 2.7% on average in 2014. Inflation eased largely due to lower oil and commodity prices and a strong US Dollar that has kept Saudi import costs low. SAMA's reserve assets fell by 6.3% (the equivalent of US$ 45.9 billion) during the first four months of 2015 to reach US$ 686.4 billion at end-April 2015.

- Slight slowdown in banking activity growth this year after a solid 2014

  The Saudi banking sector recorded a strong activity growth during 2014 amid healthy economic momentum and strong liquidity in the economy, yet slowed down slightly so far this year in the aftermath of the acute drop in oil prices from their recent highs. Measured by total assets of banks operating in the Kingdom, total sector activity reported a 12.6% yearly rise in 2014 and a further 1.8% growth in the first four months of 2015 to reach US$ 578.7 billion at end-April 2015. In parallel, sector-wide net profits rose by 12.5% last year to a record high of US$ 10.7 billion and by 2.7% on this year's first four months amidst a structural operational efficiency partly owed to the prevalence of non-interest bearing deposits ensuring a low cost funding structure, the absence of a corporate tax rate, and adequate revenue generation tied to satisfactory economic activity in the Kingdom at large.

- Rebound in equity prices on anticipated market opening

  The first few months of 2015 were characterized by an increased equity market activity along with a rebound in prices that were mainly driven by an anticipated market opening that could result in a measured pick-up in foreign capital inflows and would contribute to diversifying the economy. The Saudi Tadawul witnessed a rise in activity and a pick-up in prices during the first four months of 2015, with the Tadawul All-Share Index surging by 18.0%. In parallel, the fixed income market saw mixed price movements with some papers tracking declines in US Treasuries, while the cost of insuring debt remained stable so far this year after registering a moderate expansion in 2014.

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Saudi political and macroeconomic stability has held firm amid a drastic drop in oil prices, a royal succession and sectarian conflicts in the MENA region. As a matter of fact, despite lower oil prices, Saudi real GDP growth reported 3.6% in 2014, since, contrary to other previous price slumps, the government refuses to pare back oil production and instead prioritizes its market share. Growth was yet somehow constrained by the departure of 1.4 million expatriates over the past 18 months. The effect of these departures was evident in the second half of 2014, when both the construction and retail sectors slowed markedly.

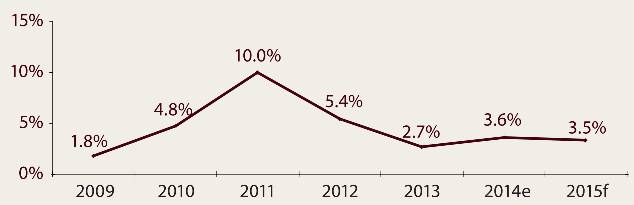
At the monetary level, inflation has fallen to 2.7% in 2014 and is expected to reach 2.0% in the current year on the back of falling commodity prices and a strong US Dollar. Despite the tightening of the Saudisation program, there is little evidence thus far that companies have passed on the resulting higher wage costs to consumers. As the domestic inflation basket is dominated by the food and beverage segment, and given the fact that domestic food prices have a high correlation with global food indices, moderate food inflation is expected in Saudi Arabia going forward on the expectation of softening in global food prices.

Saudi Arabia is continuing to have a healthy foreign exchange reserve base. SAMA's foreign exchange assets reached US$ 732 billion at the end of 2014, according to the Central Bank. They slightly fell to US$ 686 billion in April 2015. But at this level, SAMA's reserves remain strong, equating to more than two and a half years of import spending. The current account surplus and significant build-up of external assets have provided an ample cushion to government finances from external shocks. Central government debt decreased in 2014, with official estimate standing at US$ 11.8 billion, the equivalent of 1.6% of GDP. Such a low debt level provides significant fiscal flexibility should oil prices remain at or near current levels for the next few years.

The Saudi Riyal's peg to the US Dollar, which is unlikely to be changed, means that the main policy rate must roughly track movements in US interest rates, even though this can lead to economic distortions. In particular, the combination of low interest rates and persistent fiscal stimulus has raised concerns over potential asset bubbles, notably in the property market, with real estate lending by banks increasing by 31% in 2014.

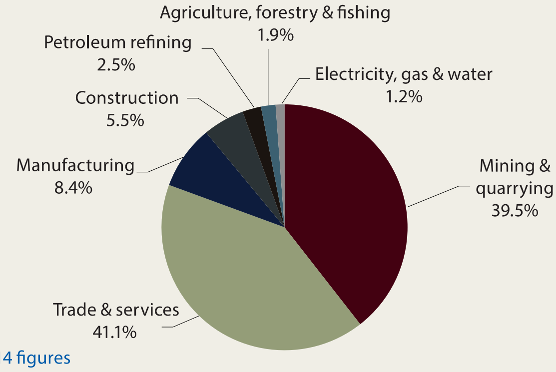
Banking activity continues to be strong, coupled with good financial soundness indicators. Deposits grew by 12.4% in 2014 (3.2% in the first four months of 2015), while loans increased by 11.8% over the year (2.9% in the first four months of 2015). At the level of asset quality, the ratio of non-performing loans to outstanding loans declined further to 1.1% at end-2014, although this also reflects strong growth in the denominator. Notwithstanding a significantly high capital adequacy, which stands at circa 18% in 2014, though primary liquidity is at a six-year low of 16.6% of deposits. In parallel, banking sector profitability has been buoyant, with the return on equity estimated at about 15% in 2014.

REAL GDP GROWTH RATES



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



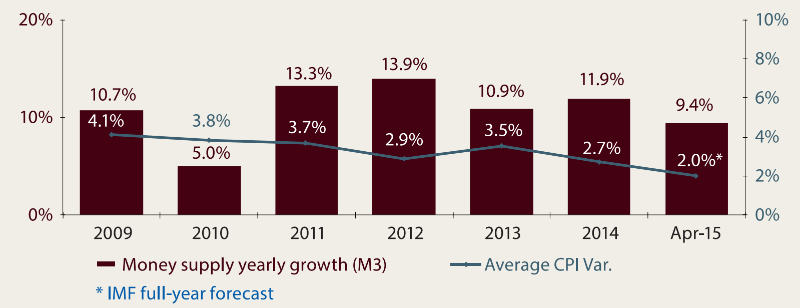
* 2014 figures

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

At the capital markets level, activity has been significantly buoyant this year. The Tadawul general price index rose by 18% over the first four months of 2015, raising market capitalization to a record high of US$ 576 billion, the equivalent of 81.2% of GDP. The price surge was realized amidst a strong trading activity, with an annualized trading value in excess of market capitalization. MSCI, the index compiler, launched its Saudi Arabia indices for QFIs, effective as of 1 June 2015, with the pro-forma MSCI Saudi Arabia Index having 19 constituents. The opening of the Saudi Stock Exchange to qualified foreign investors this month is a promising development that will help deepen the market and broaden the investor base.

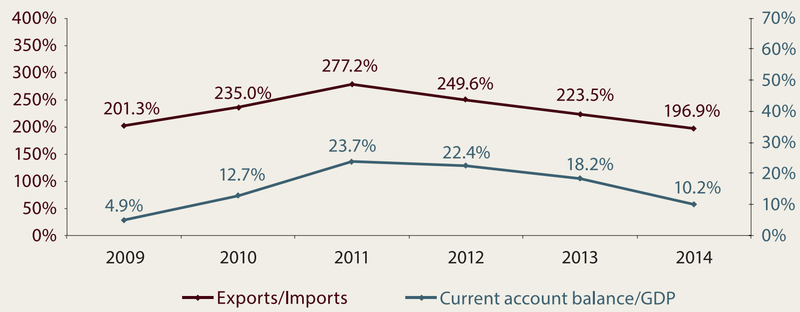
The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address the Kingdom's near term economic outlook looking forward.

MONEY SUPPLY AND INFLATION



Sources: Saudi Arabian Monetary Agency, IMF, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



Sources: Saudi Arabian Monetary Agency, IMF, Bank Audi's Group Research Department

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbon Sector

Oil production at slightly higher levels with an expansion in the oil sector

Saudi Arabia pumped relatively higher levels of oil in 2014, and witnessed an expansion in its oil sector. However, the oil price drop led to an 11.8% annual contraction in actual oil revenues during the year. Despite going through a challenging year in 2014, the Kingdom's oil sector was supported by Saudi Aramco which invested heavily in upstream activities to maintain its position as the world's top crude oil exporter.

In 2014, Saudi Arabia's crude oil production went up by 0.8% to 3,545.1 million barrels in 2014 from 3,517.6 million barrels in 2013, according to the Saudi Arabian Monetary Agency (SAMA). Thus, the Kingdom's daily average output was 9.71 million barrels in 2014, against 9.64 million barrels in the previous year. Moreover, the Kingdom's proven reserves of crude oil stood at 266.58 billion barrels at the end of 2014, rising by 0.79 billion barrels over the preceding year.

More specifically, despite a 38.4% annual drop in the commodity price of oil globally by end-2014, Saudi Arabia's oil sector accounted for 41.8% of GDP in 2014, compared to 46.2% of GDP in the previous year. On the other hand, the Kingdom's oil sector expanded by 1.5% in 2014 against a contraction of 1.6% in 2013.

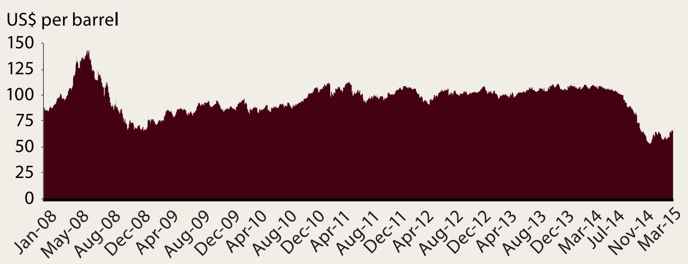
On the external front, the Kingdom's crude oil exports fell by 5.5% to 2,611.0 million barrels during 2014 from 2,763.3 million barrels in 2013, according to SAMA. In contrast, Saudi Arabia's exports of refined products rose by 24.4% to 360.6 million barrels in 2014 from 289.8 million barrels in 2013.

Within this context, the bulk of the Kingdom's exports of crude oil and refined products during 2014 were accounted for by countries of Asia and the Far East region, with the region receiving 61.7% of the Kingdom's total crude oil exports and 55.6% of its total exports of refined products. North American countries came in next, importing 17.5% of the Kingdom's total exports of crude oil and 1.3% of its total exports of refined products. They were followed by Western European countries, accounting for 13.3% of the Kingdom's total exports of crude oil and 11.4% of its total exports of refined products.

Moving on to the impact of oil on the Kingdom's public finances, Saudi Arabia's actual oil revenues went down by 11.8% to SR 913.3 billion (US$ 243.5 billion) in 2014, as compared to a decline of 9.6% in the preceding year. Furthermore, actual oil revenues accounted for 87.5% of total actual revenues in 2014, compared to 89.5% in 2013.

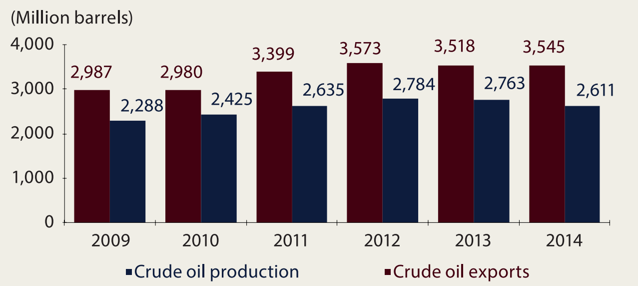
As for Saudi Arabia's gas segment, the Kingdom's reserves rose by 2.1% to 299.74 trillion standard cubic feet at the end of 2014, compared to 293.68 trillion standard cubic feet at the end of 2013. Gas production

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

OIL PRODUCTION AND EXPORTS



Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

in the country also reached an estimated 93 million tons of oil equivalent in 2014, but would rise to 148.8 million tons of oil equivalent in 2020, according to the Economist Intelligence Unit.

With regards to consumption of hydrocarbons, the Kingdom's total domestic consumption of refined products, crude oil and natural gas increased by 6.7% to reach 1,516.8 million barrels in 2014 from 1,442.0 barrels in 2013, as per SAMA. The increase in domestic consumption during 2014 was owing to a 5.4% rise in public consumption and a 19% increase in oil industry consumption. A breakdown of the relative shares of total domestic consumption shows that natural gas accounted for 37.2% of total consumption, followed by diesel (19.3%), crude oil (15%), gasoline (14.1%) and fuel oil (9.3%).

It is worth noting that Saudi Aramco pledged to spend US$ 35 billion over the next five years in oil exploration and production as part of an effort to maintain capacity. Saudi Aramco's investments in the downstream sector would be more than US$ 100 billion over the coming decade as the global oil demand increases by circa 25% in the coming 25 years. The company also discovered eight new oil and gas fields in the east of the country in 2014. The six new gas fields were named Abu Ali, Faras, Amjad, Badi, Faris and Qadqad, and two oil fields were named Sadawi and Naqa. Also, the China Petroleum & Chemical Corporation (Sinopec) would partner Saudi Aramco in a new US$ 10 billion JV named Yanbu Aramco Sinopec Refining Company (YASREF). The JV plans to construct and operate the YASREF refinery project in Yanbu Industrial City, which would supply 400,000 barrels per day.

Last but not least, Saudi Arabia is expected to keep oil production high in 2015 as maintaining market share would prioritize supporting oil prices. Average production of crude and other liquids would be around 11.84 million b/d in 2015, a marginal increase from 2014 levels of 11.51 million b/d, as per BMI Research. Nonetheless, output is expected to stay relatively flat from 2015 to 2019, with global oversupply persisting.

1.1.2. Non-hydrocarbon Sector

Growth at a slower pace, yet still serving the diversification strategy

The non-oil sector in Saudi Arabia contributed to 58% of the total GDP in 2014, up from around 53% in 2013 amid continued diversification of the national economy. In real terms, the sector grew by 5.0% last year, down from 6.4% reported a year earlier, as regional political tensions continues to cast a shadow over the economy. This came along with a slowdown in both the private and public components of the sector, whereas the growth in the former declined from 7.0% in 2013 to 5.6% in 2014, while the latter recorded a decrease from 5.1% to 3.7% over the same period.

REAL SECTOR INDICATORS

	2010	2011	2012	2013	2014	Var 14/13
Industrial production						
Number of operating industrial units	4,858	5,001	5,979	6,471	6,871	6.2%
Number of workers in operating industrial units	544,484	595,134	778,461	861,665	935,256	8.5%
Power generation capacity (in MW)	40,697	43,070	44,371	45,908	49,025	6.8%
Number of subscribers (in 000s)	5,998	6,341	6,731	7,143	7,602	6.4%
Power sold (in millions of KWh)	212,263	219,662	240,288	256,688	274,502	6.9%
Construction activity						
Cement production (in 000s of tons)	34,309	48,588	53,117	55,322	55,858	1.0%
Domestic cement sales (in 000s of tons)	33,072	47,018	52,882	54,918	55,243	0.6%
Trade and services						
Foreign trade (US$ million)	358,006	496,285	543,994	544,028	516,132	-5.1%
Number of passengers at the airports (all airlines, in millions)	45	52	65	68	75	9.7%
Number of flights	439,510	468,648	558,791	565,631	589,216	4.2%
Cargo handled at the airports (in 000s of tons)	571	642	1,018	1,059	1,020	-3.7%

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

According to the Saudi Arabian Monetary Agency (SAMA), the construction sector contributed by 5.5% to the country's GDP, growing by 6.7% in 2014, against 7.8% a year earlier. In this context, cement production and domestic cement sales increased by 1.0% year-on-year to reach 55,858 thousand tons and by an annual 0.6% to record 55,243 thousand tons in 2014 respectively. The value of construction contracts awarded in the first quarter of 2015 registered US$ 15.3 billion, down from US$ 16.5 billion reported in the last quarter of 2014. Healthcare was the primary contributing sector, whereby it accounted for 26% of the awarded contracts (US$ 4.0 billion), followed by residential real estate (US$ 3.2 billion) and industrial (US$ 1.6 billion). Moreover, the Riyadh region captured the lion's share of the value of awarded contracts, which is largely attributed to the new military medical city. The value of awarded contracts during the first quarter of 2015 highlights the construction industry's continued strength and also shows that the Kingdom can afford to keep spending near its recent past levels, despite lower oil prices.

In parallel, the share of manufacturing in the country's GDP reached 8.4% in 2014, whereby this sector grew by 6.3% during the year, nearly unchanged from the level seen a year earlier. The number of operating industrial units in the sector grew from 6,471 units in 2013 to 6,871 units in 2014, spread over multiple productions. However, the total financing for these factories edged down by 0.4% year-on-year from US$ 265.9 billion in 2013 to US$ 264.9 billion in 2014. The number of workers in those industrial units reached 935,256 workers in 2014, up by 8.5% year-on-year. On a side note, other indicators of industrial production maintained a positive trend, whereby the power generation capacity grew by a yearly 6.8% to reach 49,025 MW in 2014, while the power sold increased by 6.9% year-on-year to register 274,502 million KWh in 2014. This sign of progress in the sector show the country's drive to create a more extensive manufacturing industry as a way of reducing dependence on oil.

It is worth noting that trade and services had the highest contribution among other non-hydrocarbon components to the GDP, registering 41.1% in 2014. Looking at some of its indicators, the number of passengers at the airport reached around 75 million in 2014, up by 9.7% from 68 million in 2013. The number of flights also rose to 589,216 in 2014, up by 4.2% year-on-year, while the cargo handled at the airports declined by an annual 3.7% to 1,020 thousand tons in the aforementioned year.

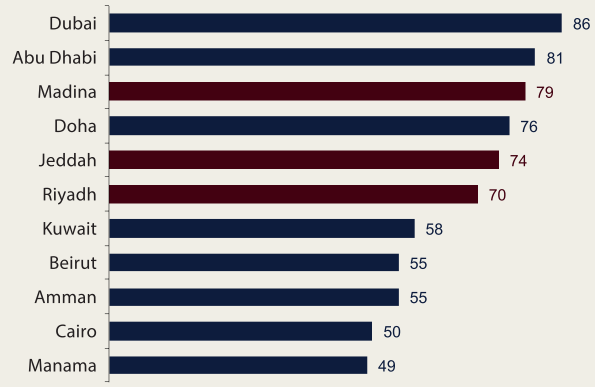
In addition, the transport, storage, and communication sector grew by a yearly 6.2% in 2014, compared to 6.4% in the previous year. The sector of wholesale and retail trade, restaurants and hotels grew by 6.0% last year, against 6.6% in the previous year.

As a matter of fact, the evolution of tourism activity was positive in 2014. Inbound tourism trips increased by 15.8% from 15,772 thousands in 2013 to 18,259 thousands in 2014. Moreover, tourist spending registered US$ 15,963 million in 2014, up from US$ 15,478 million in 2013.

EVOLUTION OF TOURISM ACTIVITY

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



*First 5 months of 2015

Sources: Ernst & Young, Bank Audi's Group Research Department

On another note, occupancy rates of four and five star hotels in Riyadh increased from 69.0% in the first five months of 2014 to 70.0% in the corresponding period of 2015, those of Jeddah declined from 77.0% to 74.0% in the aforementioned period, while Madina's occupancy rates remained unchanged at 79.0% in the first five months of 2015.

In this context, Madina's average room rate increased by a yearly 15.9% from US$ 164 in the first five months of 2014 to US$ 190 in the first five months of this year. Jeddah's average room rate rose by 1.8% year-on-year to US$ 259 in the aforementioned period of 2015, while that of Riyadh declined by an annual 5.4% to register US$ 218 in the previously mentioned period of this year. Consequently, rooms' yield declined in both Jeddah and Riyadh, while that of Madina adopted a positive trend.

In sum, Saudi Arabia's non-hydrocarbon sector maintained positive growth rate over the past year. Despite its slowdown, it continues to serve the ongoing diversification strategy of the country.

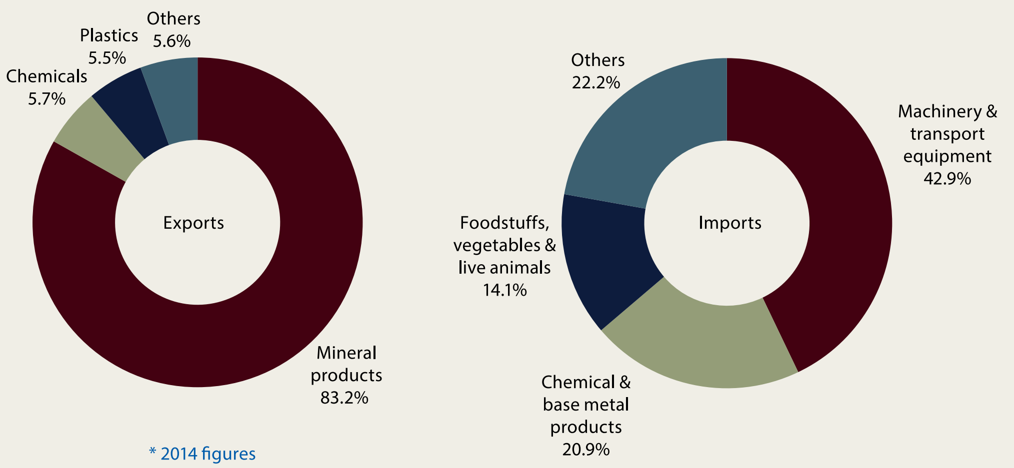
1.2. EXTERNAL SECTOR

Falling oil prices contracting the current account surplus

The external position of Saudi Arabia was directly shaped by lower oil prices registered during the year 2014. Indeed, the Kingdom's external accounts regressed in 2014, for the second consecutive year, yet managed to remain in surplus. For instance, the trade balance stood at US$ 99.16 billion in 2014, down by 37.1% from its 2013 level, as per SAMA. Consequently, the current account surplus accounted for 10.2% of nominal GDP in 2014, down from a share of 18.2% in 2013 and 22.4% in 2012.

On the trade front, overall activity in 2014 declined by 5.1% from that reported in 2013, where a 3.4% increase in the size of imports was outweighed by an 8.9% decrease in exports. In fact, exports in 2014 stood at US$ 342.3 billion, down from US$ 375.9 billion in 2013 and US$ 388.4 billion in 2012. Such a decrease in exports was mainly driven by a price effect. Indeed, with the average price of Arab light crude at US$ 97.23/barrel in 2014, compared to US$ 106.53/barrel in 2013, the total value of Saudi oil exports decreased to US$ 288.4 billion in 2014, down by 11.6% from US$ 321.9 billion in 2013. This comes despite the increase in the average production of crude oil from 9.64 million bpd in 2013 to 9.71 million bpd in 2014. Indeed, a 14.8% decrease was registered in the value of crude oil exports, outweighing the

EXPORTS AND IMPORTS*



* 2014 figures

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

22.0% increase registered in the value of refined oil products. The decrease in the value of oil exports follows another one of 4.2% registered in 2013, driven solely by a quantity effect. Accordingly, the share of crude oil out of total exports accounted for 73% of the total in 2014, compared to a higher share of 86% in 2013. Non-oil exports, accounting for 17% of the total, recorded a rise of 7.2% in 2014 following another one of 6.0% in 2013. The rise within this category was mostly attributed to the stronger growth of exports at the level of petrochemicals, which edged up by 9.2% in 2014, reaching US$ 38.3 billion. Also, construction materials reported a significant rise of 16.6% in 2014 to US$ 3.7 billion, while exports within the agricultural, animal and food products category increased by 6.2% to US$ 3.6 billion.

Imports amounted to US$ 173.8 billion in 2014, rising by 3.4% from 2013, year during which they increased by 8.1%. While all imports' categories managed to report positive growth, the breakdown of imports shows that the slowdown was mainly driven by weaker growth in imports of foodstuffs (14% of the total), wood and jewelry (4%), electrical equipment (26%), and transportation equipment (17%).

The slowdown in exports, along with a rise in imports, has driven the trade surplus to shrink by 37.1%. Overall, the current account surplus in Saudi Arabia recorded a decrease, from US$ 135.4 billion in 2013 to US$ 76.9 billion in 2014, according to data published by the IMF. With regards to the financial account, the surplus went down by 48.2% to US$ 65.5 billion in 2014, mainly driven by lower incurrence of liabilities in other investment as well as weaker reserve position.

Looking forward, despite lower oil prices, the trade balance is expected to continue to register large surpluses. However, these will be more than offset by a large services deficit and private transfers, driven mainly by government payments and growing workers' remittances. Accordingly, the year 2015 is expected to register a shift of the current account balance into negative territories.

1.3. PUBLIC SECTOR

First fiscal deficit since 2009 amidst an oil price plunge

Saudi Arabia's fiscal performance in 2014 was marked by an extended decrease in revenues that was mainly driven by lower oil revenues, while expenditures registered further expansion amidst high capital spending on enormous infrastructure and industrial projects. Within this context, the Kingdom faced in 2014 its first fiscal deficit in five years, with the latter expected to deteriorate further in the coming period within the context of lower oil prices and elevated government spending. In parallel, the Kingdom continued to witness one the lowest public debt-to-GDP ratios in the world.

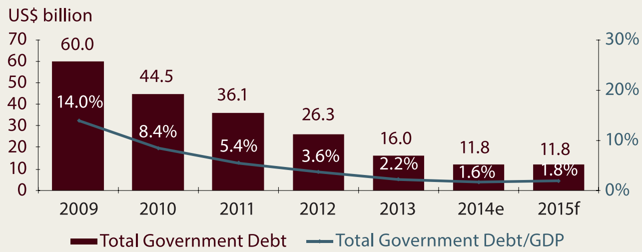
In details, fiscal revenues, originally budgeted at US$ 228.0 billion, totalled US$ 278.5 billion over the year 2014, moving down by 9.7% from 2013, and extending last year's downward trajectory (-7.3%). The fall in revenues is mainly driven by an 11.8% drop in oil revenues (accounting for 87.5% of the total) given an oil price slump after OPEC decided in November 2014 to maintain its output target at 30 million barrels per day despite oversupplied global oil markets. Non-oil revenues reached an all-time high of US$ 34.9 billion during the year 2014, up by 8.0% relative to the previous year.

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	2010	2011	2012	2013	2014
General government revenues	197.8	298.1	332.6	308.4	278.5
General government revenues/GDP	37.5%	44.5%	45.3%	41.4%	37.0%
General government expenditures	174.4	220.5	232.9	260.3	296.0
General government expenditures/GDP	33.1%	32.9%	31.7%	35.0%	39.3%
General government fiscal balance	23.4	77.6	99.8	48.1	-17.5
General government fiscal balance/GDP	4.4%	11.6%	13.6%	6.5%	-2.3%

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS AND DEBT RATIO



Sources: IMF, Bank Audi's Group Research Department

Total government expenditures, also originally budgeted at US$ 228 billion, rose by 13.7% in 2014 to attain a total of US$ 296.0 billion, following a rise of 11.8% in 2013. Current expenditures, which account for 66.6% of total expenditures, grew by 11.4% to reach US$ 197.2 billion. Capital expenditures, which account for the remaining 33.4% of total spending, rose by 18.7% over the year 2014 to reach US$ 98.7 billion, as several enormous infrastructure and industrial projects are underway, including the expansion of the rail network, the construction of the Riyadh Metro and the Sadara integrated petrochemicals complex.

Accordingly, the Kingdom faced a fiscal deficit of US$ 17.5 billion in 2014, which is its first deficit since 2009, accounting for 2.3% of GDP, as per SAMA, amidst reduced oil revenues. Despite the fiscal deficit, Saudi Arabia's gross public debt declined further in 2014 to reach US$ 11.8 billion at the end of the year, accounting for 1.6% of GDP, following the redemption of US$ 4.2 billion in government debt.

In parallel, Saudi Arabia has set a State budget for 2015 with total revenues projected to reach US$ 190.7 billion, down by 16.4% relative to last year's budget, while total spending is expected to reach a new historical high level of US$ 229.3 billion, with a marginal growth of 0.6% relative to the budgeted level. Accordingly, the Kingdom projected for the first time since 2011 a fiscal deficit of US$ 38.6 billion in 2015.

Although the aforementioned spending figure marks the slowest growth since 2002, it underscores the government's determination and ability to support economic activity despite the prevailing subdued oil pricing environment. The increase in overall budgeted spending for 2015 was entirely due to higher current spending while investment spending was reduced. Budgeted current spending has been raised to SR 675 billion or by 18% compared to the level budgeted for last year. Wages and salaries are the largest component of current spending and are certain to be a major contributor to the higher spending especially that the 2015 budget includes a massive government spending on exceptional bonuses for civil servants and projects for developing public services. Operations and maintenance costs are also likely to be a growing source of current spending in future years as major projects become operational. At the same time, investment spending was cut by 35% to SR 185 billion for 2015, noting that this is the first time that the government has reduced its budgeted investment spending since 2002.

On the revenue side, oil revenues are projected to drop by 20.9% in 2015 to reach US$ 155.0 billion, which is its first decline since 2009. As to non-oil revenues, they are expected to widen by 11.4% to reach US$ 35.7 billion.

Looking forward, lower projected oil prices and a slight decline in oil exports are expected to lead to a fall in oil revenues. Public investment is projected to initially rise as a share of GDP until 2016 as the metro, housing, and Mecca and Medina expansion projects pick up pace, and then ease slightly thereafter, but remain at high levels. The wage bill is forecast to grow in line with inflation, and spending on goods and services in line with non-oil GDP. This expenditure path and lower oil revenues would lead to an overall double-digit fiscal deficit in 2015, as per the IMF, and the deficit is expected to continue over the next five years. Under these conditions, the IMF saw merit in slowing, over time, the pace of government spending and increasing non-oil revenues so as to preserve fiscal buffers, while striking a balance between achieving current development goals and ensuring intergenerational equity.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Decline in SAMA's reserves amidst oil price slump and strong government spending

Monetary conditions in Saudi Arabia were characterized by eased inflationary pressures during the first four months of 2015, a moderate growth in monetary aggregates, and declines in SAMA's foreign assets amidst an oil price slump and ongoing strong government spending.

In details, Saudi inflation remained relatively subdued during the first four months of 2015, with the cost of living index increasing by 2.1% on average over the said period after rising by 2.7% on average in 2014.

Inflation eased largely due to lower oil and commodity prices and a strong US Dollar that has kept Saudi import costs low. Within this context, the IMF expects inflation to average 2.0% in 2015, which would be its lowest level in nine years, despite the tightening of the Saudisation employment programme as there is little evidence so far that companies have passed on the resulting higher wage costs to consumers. However, should subsidies on domestic water and power prices be eased, as recommended by the Ministry of Electricity and Water, a knock-on impact on prices in the near-term may be witnessed.

The breakdown of the cost of living index by category during the first four months of 2015 shows that the recreation and culture segment rose by 8.9% on average, followed by the health segment with +3.1%, the furnishings, household equipment & routine household maintenance segment with +3.0%, the housing, water, electricity, gas, and other fuels segment with +2.7%, the clothing and footwear segment with +2.5%, the tobacco segment with +2.3%, the heavyweight food and non-alcoholic beverages segment with +1.7%, the miscellaneous goods and services segment with +1.5%, the transport segment with +0.6%, the education segment with +0.5%, the communication segment with +0.4% and the restaurants and hotels segment with +0.2%. Given the contained level of inflation, SAMA kept its key policy rates unchanged, with the repo rate standing at 2.0% since January 2009 and reverse repo rate at 0.25% since June 2009.

The narrow measure of money supply (M1) widened by 8.8% (the equivalent of US$ 26,871 million) during the first four months of 2015 to reach US$ 332 billion in April, following a 14.2% expansion in 2014. The growth in M1 was driven by an 8.6% rise in demand deposits and a 10.2% growth in currency outside banks during the first four months of 2015. The broader Money Supply (M2) expanded by 4.0% during the said period (the equivalent of US$ 16,622 million) to reach US$ 428 billion, following a 14.6% growth in 2014. Finally, money supply in its broadest sense (M3) widened by 3.8% during the first four months of 2015 (the equivalent of US$ 17,607 million) to reach US$ 479 billion, after rising by 11.9% in 2014. Given the relatively higher growth in demand deposits during the first four months of 2015, the demand deposits to broader money supply (M3) ratio moved up from 57.2% at end-December 2014 to 59.8% at end-April 2015, and the M1/M3 ratio rose from 66.1% to 69.3% over the same period.

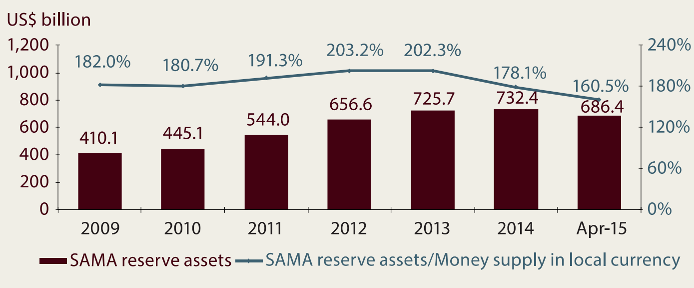
SAMA's reserve assets fell by 6.3% (the equivalent of US$ 45.9 billion) during the first four months of 2015 after rising by a mere 0.9% in 2014, to reach US$ 686.4 billion at end-April 2015, within the context of an 18.2% drop in foreign currency and deposits abroad (the equivalent of US$ 34.1 billion) and a 2.1% decline in investment in foreign securities (the equivalent of US$ 10.9 billion). The decrease in SAMA's reserve assets is mainly explained by a lower growth in oil revenues and increased government spending. In fact, deposits and reserve of the central government at SAMA dropped by US$ 63.8 billion during the first four months of 2015 to reach US$ 313 billion at end-April, mainly driven by Royal handouts in February 2015. Accordingly, SAMA's reserve assets covered 160.5% of Money Supply in Saudi Riyals at end-April 2015, down from 178.1% at end-2014.

EVOLUTION OF MONETARY SITUATION

Variation (US$ million)	2010	2011	2012	2013	2014	4M-15
Net foreign assets	**31,644**	**104,111**	**112,439**	**69,886**	**13,666**	**-30,851**
SAMA	35,061	94,817	112,396	69,126	7,519	-45,451
Commercial Banks	-3,417	9,294	43	761	6,147	14,600
Domestic Assets	**8,505**	**18,078**	**38,254**	**36,319**	**36,736**	**9,571**
Claims on private sector	11,072	22,029	37,537	33,205	35,351	9,563
Claims on public sector	-3,673	-3,830	-1,350	1,903	935	9
Claims on Nonfinancial Public Sector Enterprises	1,106	-121	2,068	1,211	450	-1
Broad Money (M3)	**13,714**	**38,185**	**45,384**	**40,372**	**49,122**	**17,607**
Money Supply (M1)	27,742	36,105	33,635	30,222	38,000	26,871
Quasi-Money	-14,029	2,080	11,750	10,150	11,121	-9,264
Government Deposits	**18,541**	**51,851**	**87,669**	**33,279**	**-21,556**	**-63,016**
Other Items (Net)	**7,894**	**32,153**	**17,639**	**32,555**	**22,836**	**24,130**

Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

FOREIGN EXCHANGE MARKET INDICATORS



Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

Looking forward, while short-term interest rates would rise as the US Federal Reserve eventually raises its policy rate (given the pegged exchange rate), high levels of banking system liquidity are likely to slow the pass-through to deposit and lending rates, mitigating the impact on the real economy, as per the IMF. Inflation is expected to edge up in the near-term as food price inflation stabilizes, government spending continues to put pressure on prices, but rents ease as new housing supply comes to the market, as per the Fund.

1.4.2. Banking Activity

Slight slowdown in activity growth this year after a solid 2014

The Saudi banking sector recorded a strong activity growth during 2014 amid healthy economic momentum and strong liquidity in the economy, yet slowed down slightly so far this year in the aftermath of the acute drop in oil prices from their recent highs. Measured by total assets of banks operating in the Kingdom, total sector activity reported a 12.6% yearly rise in 2014 and a further 1.8% growth in the first four months of 2015 to reach US$ 578.7 billion at end-April 2015.

Total deposits remain a major activity driver for banks, accounting for three quarters of total balance sheets and ensuring the bulk of banks' funding needs. A quick look at the liabilities section of the consolidated balance sheet shows that wholesale funding remains quite limited in the sector, thus shielding banks from potentially harmful swings in investor sentiment and credit market conditions.

Total deposits surged by 12.4% year-on-year in 2014 and rose by an additional 3.2% in this year's first four months to reach US$ 433.6 billion at end-April 2015. The solid increase in funds parked at Saudi banks can be explained by the healthy economic activity in the Kingdom and mostly countercyclical policies adopted by authorities since the sharp oil price drop late in 2014 that ensured liquidity stayed more or less abundant, generating additional deposits for banks.

The analysis of the deposit structure shows that demand deposits, accounting for almost two thirds of the total, were responsible for the bulk of the deposit increase last year, largely due to higher private sector deposits, while government entities injected more time and savings deposits and were also a major contributor to the rise. This year however, while the rise in demand deposits continued (due to both the private sector and government entities, yet with an advantage to the former), time and saving deposits retreated due to lower public sector deposits within the context of lower oil prices at large.

BANKING SECTOR RATIOS

US$ million	2010	2011	2012	2013	2014	Apr-15
Banking sector dimension in economy						
Assets/GDP	71.6%	61.5%	63.0%	67.8%	75.6%	89.2%
Deposits/GDP	49.9%	44.0%	45.8%	50.2%	55.8%	66.8%
Loans to private sector/GDP	37.6%	32.9%	34.9%	38.6%	42.7%	51.1%
Loans to public sector/GDP	1.6%	1.3%	1.4%	1.6%	1.6%	1.9%
Growth rates (YTD)						
Assets	3.3%	9.1%	12.3%	9.2%	12.6%	1.8%
Investments	11.3%	1.6%	1.0%	16.9%	21.6%	3.0%
Deposits	4.7%	12.1%	14.2%	11.2%	12.4%	3.2%
Capital and reserves	8.8%	6.8%	10.2%	7.8%	9.9%	13.4%
Profit growth (year-on-year)	-2.6%	18.4%	8.4%	6.5%	12.5%	2.7%
Financial ratios						
Primary liquidity/Deposits	22.6%	22.5%	23.5%	19.5%	18.5%	16.6%
Loans to the private sector/Deposits	75.4%	74.7%	76.2%	76.8%	76.5%	76.4%
Capital accounts/Assets	14.4%	14.3%	14.0%	13.8%	13.5%	13.7%
ROAA	1.88%	2.09%	2.04%	1.97%	2.00%	2.09%
ROAE	13.2%	14.5%	14.4%	14.1%	14.6%	15.4%

Sources: Saudi Arabian Monetary Agency, IMF, Bank Audi's Group Research Department

It is worth noting that while banks operating in the Kingdom maintain a strong funding profile, there is a high concentration in deposits. Yet, one must also acknowledge that most of the largest depositors are part of the public sector, and provide some stability to the sector all the more so the government benefits from ample liquidity accumulated throughout the past few years.

In tandem with higher liquidity on the overall during the covered period, banks have had room to increase further their contribution to private sector financing. Claims on the private sector indeed grew by 11.8% last year, though somehow decelerating in the last couple of months before resuming a slightly slower growth (+2.9%) so far in 2015.

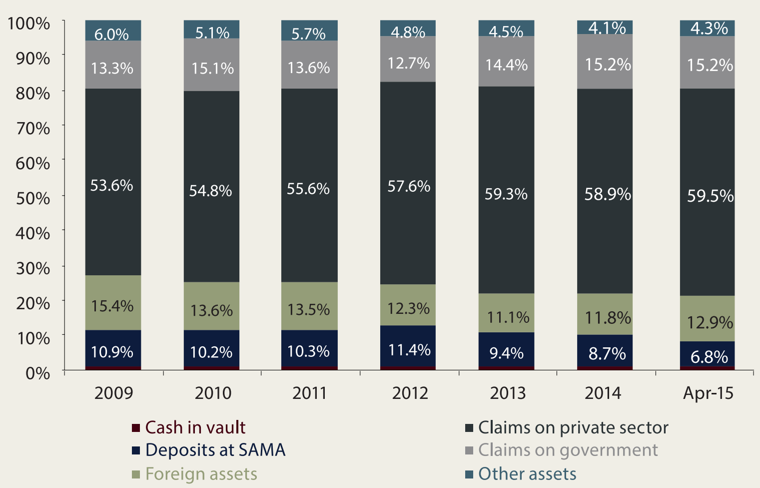
This happened as oil prices started declining in the last few months of 2014, which is likely to start denting the credit appetite, and as new mortgage lending rules were introduced late in 2014, while authorities also implemented countercyclical policies aimed at countering the oil price drop and thus favored lending activity this year. As a matter of fact, headwinds to lending activity include the cap placed by authorities on the loan-to-value ratio at 70% when it comes to mortgage lending (this follows rapid growth in real estate lending after the mortgage law was passed in 2012), in addition to the single obligor regulation limiting single exposure to 15% of capital and reserves with full implementation by 2019 (instead of 25%).

In parallel, claims on the public sector rose by 5.5% last year before standing still in this year's first four months. Details show that both credit to public sector enterprises, which were already not growing that fast last year, and government bond investments, stalled this year.

A look at bank credit by maturity shows that last year, around two-thirds of the credit volume increase was due to an increase in those with long-term maturities (over three years) which increased their share in the total from 27% at end-2013 to 31% at end-2014. Banks' continued extension of their credit maturity curve sheds light on the banking sector's widening asset liability maturity gaps. As a matter of fact, the predominance of demand deposits entails a non-negligible reliance on short-term funding sources to finance longer-term financing. Nonetheless, local short-term deposits proved rather stable in recent years, which somewhat attenuates the asset liability mismatch risk. Besides, this year has so far seen an inversion of the tendency observed in the last couple of years, as practically the entire credit growth is attributed to short-term financing, which brought back the share of long-term credit outstanding slightly back to 30% of the total at end-April 2015.

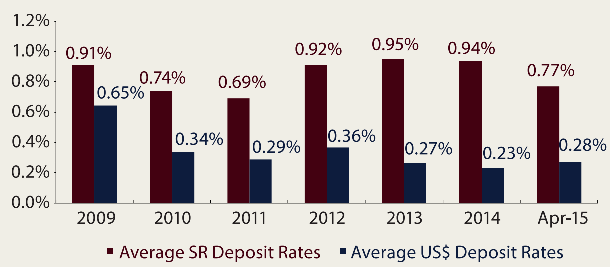
Banks still enjoy further room to extend credit and enhance their financial intermediation role. The sector-wide loan (excluding investment in securities) to deposit ratio remains below the 80% mark and, as such, under the SAMA-set 85% ceiling. Saudi banks also boast a more or less satisfactory liquidity position.

BANKING SECTOR ASSET COMPOSITION



Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

BANKING SECTOR INTEREST RATES



Sources: Saudi Arabian Monetary Agency, Bank Audi's Group Research Department

Their primary liquidity, i.e. reserves and placements with banks in the Kingdom and abroad, reached 17% of their total deposits at end-April 2015. This compares to a slightly higher 19% at end-2013, as over the 16 months to end-April 2015, primary liquidity was somewhat constrained by lower deposits with SAMA, which caused it to fall short of the total deposit growth. It is important to mention that when including rather liquid assets such as government securities and SAMA bills, the ratio reached 34% of total deposits.

The healthy activity growth observed last year did not come at the expense of asset quality. Saudi banks boast one of the best asset quality ratios in the world. Non-performing loans accounted for barely 1.1% of total loans at end-2014 as per the IMF, down from an already very low 1.3% in the previous year, favored by healthy economic momentum and some lending to government-related ventures. The NPL ratio declines in recent times are also due to sound credit risk management and underwriting practices. Furthermore, loan loss coverage is more than ample, standing at a high of 182.9% at end-2014 (157.4% at end-2013), thus providing banks with strong countercyclical buffers. This is actually aimed for by authorities as well to ensure high resilience to absorb shocks during stress times. Banks are required to increase their reserves during upturns to use them during downturns and thus minimize the impact of adverse occurrences.

Along the same lines, banks operating in Saudi Arabia maintain solid capitalization ratios. The IMF data points out to a high Basle III regulatory capital to risk-weighted assets ratio of 17.9% at end-2014, much higher than the minimum requirement of authorities (10.5%). This mostly consists of Tier 1 capital (mostly equity capital and freely available disclosed reserves at close to 90% of total regulatory capital), and provides notable mitigation against concentration on the asset side of banks' balance sheets and the general exposure of the sector to oil price volatility.

Last but not least, banks' bottom lines have been growing, with sector-wide net profits rising by 12.5% last year to a record high of US$ 10.7 billion and by 2.7% in this year's first four months. Banks' strong profitability was achieved amidst a structural operational efficiency partly owed to the prevalence of non-interest bearing deposits ensuring a low cost funding structure, the absence of a corporate tax rate, and adequate revenue generation tied to satisfactory economic activity in the Kingdom at large.

1.4.3. Equity and Bond Markets

Rebound in equity prices on anticipated market opening, mixed price movements on bond market

The first few months of 2015 were characterized by an increased activity on the equity market along with a rebound in prices that were mainly driven by an anticipated market opening that could result in a measured pick-up in foreign capital inflows and would contribute to diversifying the economy. In parallel, the fixed income market saw mixed price movements with some papers tracking declines in US Treasuries, while the cost of insuring debt remained stable so far this year after registering a moderate expansion in 2014.

In details, the Saudi Tadawul witnessed a rise in activity and a pick-up in prices during the first four months of 2015, with the Tadawul All-Share Index (TASI) surging by 18.0% after falling by 2.4% in 2014. The strong momentum over the January-April 2015 period was mainly driven by two factors: first, an anticipated opening of the Arab World's biggest bourse to direct foreign investment on June 15, 2015, a move that is set to promote international institutional investments, which would help, among other things, to deepen the equity market and broaden the investor base, as per the IMF. Under the new stock market rules, institutional foreign investors with a minimum of SR 18.75 billion (US$ 5 billion) under management and at least five years of experience would be allowed to invest directly in the stock market. Holdings in a single equity for a Qualified Foreign Investor are capped at 5%, while QFIs holdings in a single stock are capped at 20%. It is worth mentioning that prior to new stock market rules, foreign investors were only able to buy Saudi stocks via exchange-traded funds and swap agreements. On the back of these developments, index compiler MSCI recently said that it would seek feedback from investors on the accessibility of Saudi Arabia's market following its opening and gather information before considering whether to add the Saudi index to the review list for potential inclusion in its emerging markets index. Saudi Arabia is targeting to be part of MSCI Emerging Markets Index in 2017, as per the Chief Executive Officer of the stock exchange.

The second factor that triggered price increases on the Saudi Tadawul is the massive US$ 30 billion government spending on exceptional bonuses for civil servants and projects for developing public services in February 2015, which sent signals to financial markets that the Kingdom is not slashing expenditures in the face of falling oil prices. Third, the Saudi King pledged in March 2015 to speed up efforts to end a shortage of homes.

Under these conditions, the Saudi Tadawul benefited from improved investor sentiment during the first four months of 2015 despite concerns over the Yemeni crisis and although the Saudi cabinet approved a proposal to tax undeveloped land in urban areas. Yet, the TASI slid by 1.5% in May 2015 relative to the previous month, bringing the year-to-date increase down to 16.3%, within the context of some profit-taking operations amidst expensive market pricing ratios. In fact, Saudi stocks traded at a P/E of 18.11x at end-April 2015 as compared to a P/E of 14.00x at end-December 2014. This also compared to a lower P/E ratio of 13.01x in the MENA region at end-April 2015.

The breakdown of the TASI by sector during the first four months of 2015 shows that the real estate development sector reported the highest index surge with +40.7%. The second best performer is the industrial investment sector with +39.2%, followed by the transport sector with +35.0%, the insurance sector with +30.4%, the energy and utilities sector with +29.3%, the hotel and tourism sector with +24.4%, the petrochemical industries sector with +19.2%, the banking and financial services sector with +19.0%, the multi–investment sector with +17.9%, the retail sector with +14.7%, the building and construction sector with +14.6%, the media and publishing sector with +10.4%, the agriculture and food industries sector with +5.4%, and the cement sector with +3.1%.

Alongside a significant rise in equity prices over the first four months of 2015, the number of listed companies declined slightly from 169 companies at end-2014 to 168 companies at end-April 2015. Within this context, the market capitalization surged by 19.2%, moving from US$ 483.4 billion at end-2014 to US$ 576.1 billion at end-April 2015 after rising by 3.4% in 2014 due to an increase in the number of listed companies. The market capitalization represented 81.2% of GDP at end-April 2015, up from 64.2% in 2014, which reflects the rising dimension of the Tadawul in the Saudi economy.

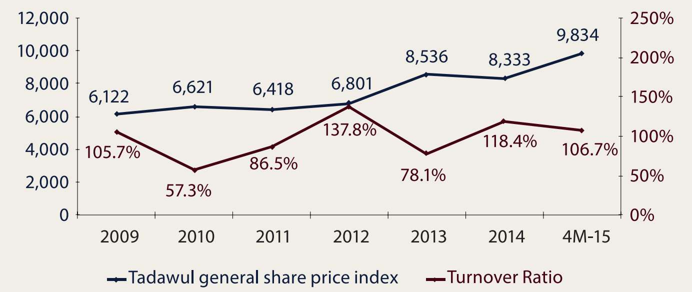
The total trading value amounted to US$ 205 billion during the first four months of 2015, rising by 9.7% relative to the corresponding period of the previous year. The division of the total trading value by category during the first four months of 2015 showed that the banking and financial services sector captured 15.8% of activity, followed by the petrochemical industries sector with 14.8%, the real estate development sector with 14.0%, the insurance sector with 13.6%, the industrial investment sector with 9.1%, the telecommunication and information technology sector with 7.0%, the building and construction sector with 6.0%, the agriculture and food industries sector with 4.9%, the retail sector with 3.7%, the cement sector with 3.1%, the transport sector with 2.8%, the multi-investment sector with 2.2%, the hotel and tourism sector with 1.7%, the energy and utilities sector with 0.9% and the media and publishing sector with 0.3%. Given a lower rise in the total trading value than the market capitalization over the first four months of 2015, the annualized turnover ratio stood at 106.7% during the first four months of 2015 as compared to 107.7% during the corresponding period of 2014.

SELECTED STOCK MARKET INDICATORS

	2010	2011	2012	2013	2014	Apr-15
Market capitalization (US$ billion)	353.3	338.9	373.3	467.5	483.4	576.1
Market capitalization/GDP	67.1%	50.6%	50.9%	62.8%	64.2%	81.2%
Trading value (in US$ billion)	202.4	293.0	514.5	365.2	572.4	204.9
Number of transactions (in millions)	19.5	25.6	42.1	29.0	35.8	12.8
Number of listed companies	145	150	158	163	169	168
Change in share price index	8.2%	-3.1%	6.0%	25.5%	-2.4%	18.0%
Price/Earnings ratio	15.3x	12.3x	12.8x	15.5x	14.0x	18.1x
Price/Book value ratio	2.1x	1.8x	1.8x	2.2x	2.0x	2.3x

Sources: Tadawul, IMF, Bank Audi's Group Research Department

CAPITAL MARKETS PERFORMANCE



Sources: Tadawul, Bank Audi's Group Research Department

As to fixed income markets, Saudi debt papers witnessed mixed price movements so far this year, with some papers attracting a decent bid, while others tracked declines in US Treasuries amidst signs of improvement in the US economy. SABIC'18 was up by 0.63 pt, while SABIC'20 closed down by 1.50 pt. Prices of SECO'17 and '22 increased by 0.25 pt and 0.13 pt respectively. In contrast, SECO'24, '43 and '44 traded down by 0.13 pt, 2.13 pts and 3.00 pts respectively. Dar Al Arkan'16 closed lower by 0.25 pt, while Dar Al Arkan'18 and '19 were up by 3.13 pts and 4.63 pts respectively. As to financials, Banque Saudi Fransi'17 was down by 0.75 pt. At the level of the cost of insuring debt, Saudi Arabia's five-year CDS spreads remained stable so far this year at 67 bps, which is currently the second lowest CDS level in the MENA region after Abu Dhabi. This followed a 12 bps expansion in 2014.

As to sovereign credit ratings, Standard & Poor's revised in February 2015 the outlook on the Kingdom of Saudi Arabia to "negative" from "stable". This reflects its view that Saudi Arabia's general government fiscal position is weakening. Also, S&P affirmed in May 2015 its long-term and short-term foreign and local currency sovereign credit ratings on the Kingdom of Saudi Arabia at "AA-/A-1+", with "negative" outlook. The ratings are supported by the very strong external and fiscal positions Saudi Arabia has built up over several years, as per S&P. The rating agency views Saudi Arabia's economy as undiversified and vulnerable to a steep and sustained decline in the oil price, notwithstanding government policy to encourage non-oil private sector growth. S&P finds that the non-hydrocarbon sector relies to a large extent on government spending and downstream hydrocarbon activities.

In parallel, Moody's indicated in April 2015 that Saudi Arabia's "Aa3" government bond rating and "stable" outlook are supported by "very high" economic and fiscal strengths. Strong growth in oil revenues in the past several years generated very large fiscal surpluses through 2013, allowing the government to build a sizeable asset cushion and reduce sharply its debt ratios to levels much lower than rating peers. The "Aa3" rating incorporates the expectation of continued strength in government finances and the debt metrics remaining in a very strong position. The current account surplus and substantial build-up of external assets have provided an ample cushion to government finances from external shocks. The "stable" outlook is premised on the success of the authorities to manage the fiscal position against petroleum price volatility.

Looking forward, creating a deep and liquid bond market would not only help monetary policy transmission, but also increase financing options for companies, particularly at longer maturities, and support growth, as per the IMF. The authorities saw limited scope for expanding the issuance of government securities, but are exploring ways to deepen the market through greater issuance by State-owned companies and other entities. Given the decline in sovereign debt outstanding, Saudi Arabia does not have a benchmark yield curve that could support the development of a broader fixed income market. The Fund considered that anchoring a robust yield curve would require an active and liquid secondary market for government securities. At the level of the stock market, the IMF indicated that if equity prices keep rising strongly, consideration should be given first to specific measures to limit lending for equity investments. If ineffective, steps to reduce liquidity including by raising the reserve requirement ratio would be needed, as per the IMF. The authorities argued that given strengthened prudential regulation of financial market participants in recent years, there was little likelihood of an equity market bubble developing.

2. CONCLUDING REMARKS

The outlook for the Kingdom looking ahead entails both opportunities and challenges. Real GDP growth is projected by the IMF at a healthy 3.5% in 2015, unchanged from 2014, with a rise in oil production and continued government spending expected to support the Kingdom's economy. The strong government spending in 2015 is partly due to a number of one-off factors. Growth will be actually driven by progress on several enormous infrastructure projects which in turn will provide a host of opportunities for the private sector. Growth is yet projected to slow to 2.7% in 2016 (3% in the medium term) as government spending begins to mirror lower oil prices.

A gradual deterioration in Saudi Arabia's fiscal performance is expected over the next few years. The government's 2015 budget suggests a general government deficit of about 6% of GDP over the year. However, it is widely believed that the deficit could be around double that amount, based on oil price assumptions and the government's social, investment and defense spending priorities. Fiscal deficits are also expected over the subsequent years, the financing of which is likely to result in a pronounced decline in the government's net asset position. A sizeable fiscal policy consolidation will be needed over the next few years to put the deficit on a gradual downward path, though it is inappropriate for the time being given the large stock of government deposits at SAMA and the very low government debt.

In order to build a proper outlook for the Kingdom looking ahead, it is important to assess its strengths, weaknesses, opportunities and threats in an overall SWOT analysis as per the below.

At the level of strengths, we mention Saudi Arabia's vast wealth on the basis of large hydrocarbon reserves, the country's global strategic importance as the lynchpin of OPEC, the Kingdom's external buffer with a net foreign asset position of 113% of GDP, the well capitalized strictly regulated banking sector with good financial soundness indicators, and the low indebtedness with a general government debt of 1.6% of GDP.

At the level of weaknesses, we mention the large commodity dependence with oil accounting for 90% of fiscal revenues and 40% of GDP, the early stage of development of political institutions, the limited monetary policy flexibility, the narrow tax base vulnerable to oil price volatility, the relatively high unemployment, the institutional weaknesses with unsatisfactory World Bank governance indicators and the prominent political role in a turbulent region potentially exposing it to high political risks.

At the level of opportunities, we mention the key role in the global oil market on the back of the World's largest exporter and the only producer with significant spare production capacity, the smooth transfer of power amidst growing political and economic challenges facing the Kingdom, and major projects coming on stream supporting economic activity.

At the level of threats, we mention deficiencies in economic policy as fiscal policy is not grounded in a formal medium term framework and overspending is common, the relatively large public sector corporation contingent liabilities, the erosion of the current account surplus to its lowest level since 1999, the dip in economic growth caused by lower oil prices and the rising regional geopolitical threats.

Having said that, there is no doubt that strengths exceed weaknesses and opportunities outpace threats at the horizon. Still, the decline in oil prices has emphasized the importance of economic diversification. As well outlined by the IMF 2015 Article IV mission to Saudi Arabia, policies are continuing to strengthen the business environment, but more needs to be done to encourage firms to focus more on tradable rather than non-tradable production in the non-oil sector at large.

DISCLAIMER