جدوى للإستثمار
Jadwa Investment

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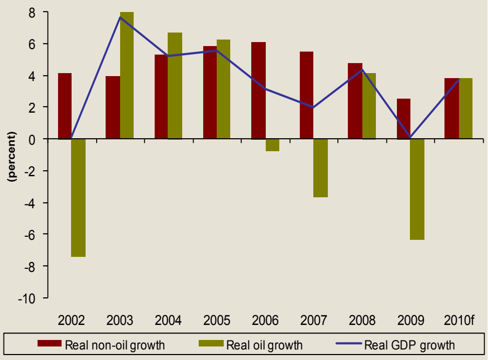
The Saudi economy in 2010

The Saudi economy is expected to improve in 2010. Growth will pick up, credit will become more readily available and the government budget will return to surplus. High government spending will be the main engine of growth, with the private sector making a greater contribution as credit conditions improve. A reviving global economy should keep oil prices around their current levels and will increase demand for the exports.

Real GDP growth



Lack of confidence was an important factor holding back the Kingdom's economy in 2009. This was reflected in a fall in bank lending, restrained corporate and consumer spending and a subdued stock market. Economic data suggest that confidence has begun to improve and we expect a virtuous circle in which this feeds into higher spending, boosting corporate performance, lifting share prices and encouraging banks to lend. As a result, real growth of the non-oil private sector is forecast to rise to 3.8 percent; total real GDP growth is projected at the same level.

The key issue for economic policymakers will be maintaining an environment that supports this recovery. We therefore think that government spending will be in excess of the high level set out in the budget and that interest rates will remain very low. These simulative policies are not expected to have negative consequences elsewhere in the economy. Higher average oil prices and production should generate sufficient additional revenue to ensure a budget surplus. In the event of a deficit, it would be comfortably financed using the Kingdom's huge stock of foreign assets.

As bank lending will only slowly respond to low interest rates, inflation will not be a problem, though at an average of 4.5 percent it will be high on an historical basis. We anticipate that inflation will pick up over the first few months of the year, before gradually declining from the second quarter. Rents will remain the main source of inflation in the Kingdom, though the spike early in the year will be the result of external factors. With interest rate needs broadly aligned between the Kingdom and the US, we do not anticipate significant speculative pressure against the exchange rate peg.

Although the economic recovery will gain momentum, activity will be less vigorous than in recent years as the legacy from the economic and financial turmoil lingers. The global economic recovery does not appear built on solid foundations and once stimuli are removed, growth is likely to be weak. Within the Kingdom, bank lending practices have permanently changed and credit growth will remain well below the level of the boom years to 2008, constraining the private sector. Government spending is central to relatively healthy economic outlook, but after years of strong growth it is likely to require an oil price in excess of $70 per barrel to balance the budget.

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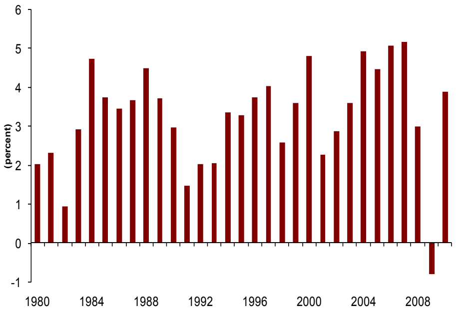
The global economic outlook

The global economy entered 2010 in far better health than it started 2009. A depression has been avoided and growth has resumed across the world, but it has taken extraordinary measures to get to this situation. Government spending has shot up, interest rates have been cut to exceptionally low levels and unprecedented measures have been taken to support the financial system. These policies are unsustainable. The unwinding of these stimuli and need for longer-term adjustments to consumption patterns mean that once the initial boost to the global economy fades, growth over the next few years will be tepid.

The global recovery that is underway will be pretty strong until the middle of the year. The factors behind this are supportive fiscal and monetary policy, the rebuilding of stocks, rising corporate profits boosting investment and housing not being such a big drag. Economic growth will moderate in the second half of 2010 as the policy stance moves to restraint, inventory replenishment runs its course, deleveraging continues, low capacity utilization restrains investment and emerging economies supply their own demand; tighter financial regulation could be additional burden.

Risks to this weak outlook are on the downside. The withdrawal of policy has to be careful; too soon and it brings the risk of a double-dip recession, too late raises the prospect of inflation and currency depreciation. Political pressures also pose a major risk. Growth is unlikely to be at a pace necessary to dent unemployment and with elections due this year in several leading economies greater protectionism is a possibility. Seventeen of the G20 members have introduced protectionist measures since they pledged not to do so in late 2007. There are still serious problems within financial sector. More needs to be done to clean bank balance sheets (to date, only around half of the $3.4 trillion in write-downs projected by the IMF have occurred) and there is an increasing divergence in performance between weak and strong banks. Ongoing fallout from the crisis, such as recent problems in Dubai and Greece, also remains a risk.

Global real GDP growth



Source: IMF

US unemployment

Oil price

The oil market in 2010

Assuming no major shocks to the global economy or events that would disrupt supply, we expect the recent stability in oil prices to continue. Our forecast is for WTI to average $75 per barrel in 2010 (equivalent to $71 per barrel for Saudi crude). Average Saudi oil production is forecast to be 8.3 million barrels per day, up by 2.3 percent from its estimated average for 2009.

- Global oil demand is expected to rise during 2010 as the global economic recovery continues. Emerging markets will remain the main source of consumption growth. Leading developed economies still face deep problems and their growth momentum will ease in the second half of the year once the impact of stimulus policies fades, restraining their demand for oil.

- Non-Opec supply is projected to rise slightly owing to higher output from the former Soviet Union and Latin America.

- Financial flows are likely to have less impact on oil prices in 2010. The need for investors to use oil as a hedge against the dollar should diminish as we expect the dollar to be relatively stable. The likely introduction of new rules by the US Commodity Futures and Trading Commission to curb speculation should also reduce the impact of financial flows.

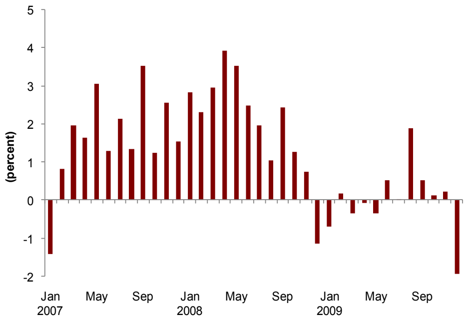
The Kingdom is likely to respond to these trends by gradually raising production in the first part of the year in response to higher demand. Other Opec members are expected to do likewise and the Kingdom will probably be more cautious than most in order to hold prices around current levels. Production is likely to be kept unchanged in the second half of the year as the pace of global economic growth slows. Saudi Arabia will be mindful of its role in the G20 and will increase production in the event that prices head towards a level that would threaten the fragile global economic recovery.

Economic growth

Economic growth is forecast to rise to 3.8 percent this year from 0.15 percent in 2009. Growth will be lifted by improved performance from both the oil and non-oil sectors. For the oil sector, the expansion reflects higher production in line with a stronger global economy. Growth in the non-oil sector will result from an easing of credit conditions, high government spending and low interest rates, all of which should generate a broad revival in confidence. Transport and telecoms and power and water are forecast to be the fastest growing sectors.

We had anticipated that oil prices would be the main source of weakness in the Kingdom's economy last year, with prices falling by nearly 60 percent over the final six months of 2008. However, oil prices quickly recovered to comfortable levels and the government drew down reserves to finance its spending. Instead, it was access to credit that held the economy back. Defaults by two local firms and concerns about the health of the private sector caused banks to adopt a very cautious attitude to lending. Bank lending to the private sector fell in 2009, the first annual decline since 1990.

Bank lending to the private sector
(month-on-month change)



Lending is set to pick up this year. The absence of new public financial problems within the private sector has reassured the banks, who appear to have become more comfortable with their exposures. Even though local banks set aside over SR7 billion in 2009 to cover losses, all were profitable. Furthermore, they remain very liquid. Bank deposits in excess of the statutory requirement at SAMA were at an all-time high of SR98.3 billion at the end of December. However, lingering uncertainty within the banks and the possibility of other corporate defaults (many companies have large amounts of short-term debt that needs to be rolled over) means that lending growth will not return to pre-crisis levels.

Prospects for raising capital through the equity and sukuk markets have also improved in line with better market conditions. Over 50 IPOs have been announced for 2010. However, there will be little financing forthcoming from foreign banks. General risk aversion among foreign banks was heightened by an opaque partial settlement of the debts of one of the defaulting local companies that appeared to exclude foreign creditors. The debt standstill announced by Dubai World in December further tarnished the image of the region in the eyes of many foreign banks.

Point of sale terminal transactions
(year-on-year change)

Henry Hub natural gas price

Growth in lending should boost business sentiment and performance, lifting share prices, which in turn will bolster consumer confidence. More credit and higher confidence should ensure that the private sector is able to take greater advantage of a very supportive economic policy framework. Interest rates are expected to remain very low and government spending is forecast to rise further this year. Government spending will continue to provide the main stimulus to the Saudi economy. In addition to the direct boost it gives to sectors such as construction, there will be efficiency savings throughout the economy as more government projects are completed (for example, better roads lower transport costs). (See monetary and fiscal policy sections for more details.)

Recent economic data give signs of a revival in the economy that is starting to build momentum. Most of the indicators we track have turned up since the third quarter. Notably, point of sales transactions (the closest proxy for retail sales) are growing at double-digit annual rates for the first time since mid-2008 and the results of listed companies for the fourth quarter were generally positive. Lending to the private sector rose in each of the four months to November (albeit sometimes at a very sluggish pace), though these gains were unwound by a large fall in December.

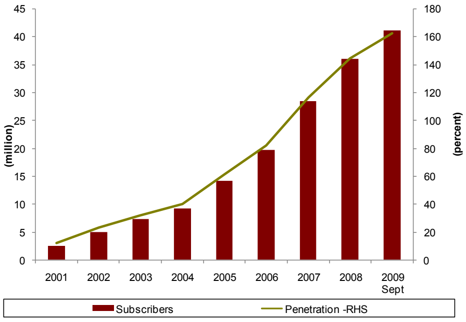
Given this generally improving backdrop, growth in all sectors is forecast to rebound in 2010. Our expectations for growth in the key sectors of the economy are as follows:

- Growth in the **oil** sector is forecast to be above the 2.3 increase in oil production we expect as growth will be boosted by the project work occurring in the sector. Over the five years to 2009, the oil sector grew by an average of 1.8 percentage points more than oil production; in 2009 the difference was 5.7 percentage points.

- **Manufacturing** growth is expected to recover from an 18-year low in 2009. Although last year was a difficult one for the global petrochemical industry, Saudi Arabia increased its market share owing to the very low input costs enjoyed by the Kingdom's producers. Nonetheless, weak demand meant that the commencement of production at some petrochemical facilities was pushed back. With the global economy reviving, demand for petrochemicals should pick up. Large new facilities scheduled to commence or ramp up production include Saudi Kayan, Yansab and Sharq, PetroRabigh and the Sahara/Tasnee joint venture. Rising natural gas prices reinforce the advantage of Saudi-based producers, who pay a fixed rate of $0.75 per million British thermal units (mbtu); in North America the Henry Hub natural gas price has nearly doubled since September and is at its highest for over a year of $5.6/mbtu due to recent cold weather. Elsewhere in the manufacturing sector, growing demand from Asia should boost plastics production and cement producers will benefit from the ongoing construction work within the Kingdom.

- The **construction** sector will be one of the main beneficiaries of continued large government investment spending. There will be a full year of work on several very large projects that were started last year after delays owing to retendering in order to lock in lower raw material costs. Improving credit availability for the private sector should allow a recovery in smaller-scale construction activity later in the year.

Mobile phone penetration



Source: CITC

- **Telecoms and transport** is expected to remain the fastest growing sector. Growth has been led by rising mobile phone penetration. With penetration at 162 percent at the end of the third quarter, the pace of this growth will slow. Data services, internet provision and the activities of the new entrants to the fixed line market should take on some of the momentum. Transport growth should pick up as a result of higher foreign trade volumes and the revival in the domestic economy.

Real GDP growth by sector
(percent)

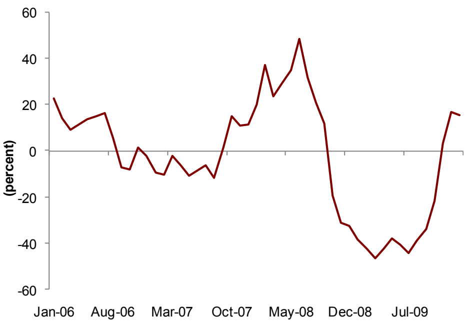
	2007	2008	2009	2010f
Agriculture	1.9	1.1	0.2	2.0
Manufacturing	5.7	6.0	1.7	3.0
Electricity, gas and water	4.1	6.7	3.4	5.0
Construction	4.1	2.2	3.9	4.8
Wholesale & retail trade	6.2	6.5	2.0	3.5
Transport & communication	10.2	12.2	6.0	6.5
Finance	3.8	2.8	1.8	3.0
Non-oil private sector	**5.5**	**4.8**	**2.5**	**3.8**
Oil	-4.1	4.3	-7.6	3.8
Government services	1.9	2.4	3.8	3.6
Total	**2.0**	**4.3**	**0.1**	**3.8**

- Stronger growth in consumer spending will boost the **wholesale and retail trade** sector. Unlike in many other parts of the world, Saudi Arabia has not been affected by widespread redundancies or pay cuts, meaning that the weaker retail sales during 2009 was the result of uncertainty and the effect of stock market losses. The impact of both of these factors should fade this year. The sector should also benefit from greater tourist arrivals. The number of Umrah pilgrims was up by 9 percent last year (to 3.38 million) even though concerns about H1N1 are thought to have deterred many people from travelling.

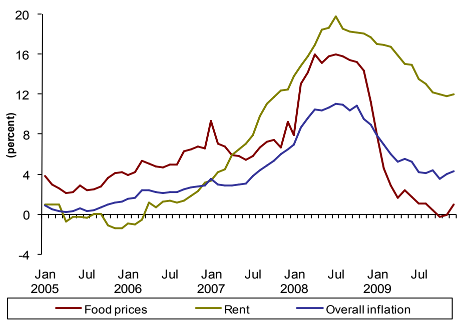
- Activity in the **finance** sector should rise this year as banks become less averse to lending and greater business confidence leads to more transactions. There is growing speculation that the mortgage law will soon be passed. The law has been imminent for several years and even if it is approved there is unlikely to be a major short-term impact (though it will have important long-term implications). Rising use of insurance services will support growth in the sector.

- Ongoing government investment and greater usage stemming from a revival in industrial activity and a higher number of residential units should result in strong growth in the **power and water** sector. The sector has been prioritized by the government and the necessary infrastructure is being built up rapidly to cope with an annual demand growth of around 7 percent per year. The allocation for the water sector has been the fastest growing in the budget in recent years, nearly doubling between 2007 and 2010. The main project opening in 2010 is the Jubail independent water and power project, which will add about 7 percent to total power generating capacity in addition to 800,000 cubic meters per day of desalinated water.

Reuters commodity price index
(year-on-year change)



Inflation



Inflation

Inflation is forecast to average 4.5 percent this year, slightly down on the 2009 average, but slightly above the current level. We anticipate that inflation will pick up over the first few months of the year, before gradually declining from the second quarter. Rents will remain the main source of inflation in the Kingdom, though the spike early in the year will be the result of external factors.

Year-on-year inflation in the early part of 2010 will be distorted by the low commodity prices and exchange rate strength of early 2009. For example, commodity prices are currently around 20 percent higher than the average for the first quarter of last year and even after its recent strengthening, the dollar is 7 percent weaker over the same period on a trade-weighted basis. These factors should be sufficient to push inflation above 5 percent for the first time since June.

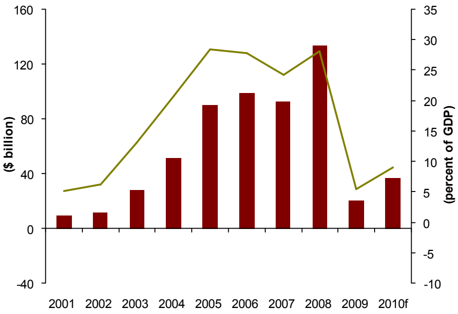
External influences will ease as the year proceeds and we do not see new sources of imported inflation during the year. Inflation in trading partners is a key determinant of inflation in the Kingdom and given the significant spare capacity within the global economy this will be low. The IMF projects that inflation in advanced economies will rise by just 1.3 percent in 2010. Food price inflation should be subdued; a US Department of Agriculture report issued earlier this year projected that global food stocks would remain high and possibly rise as a result of weak demand and robust supply. A slowing global economy should keep the prices of other commodities stable, and the dollar is expected to be flat (see Exchange rate).

Inflation breakdown
(percent)

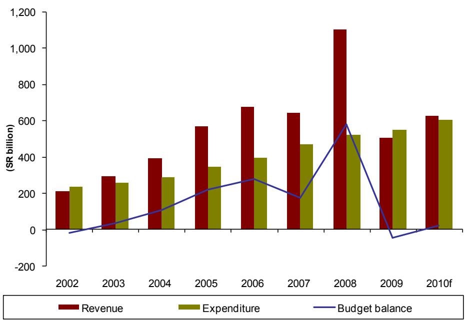
	2007	2008	2009	2010f
Foodstuffs & beverages	7.0	14.1	2.0	3.2
Fabrics, clothing & footwear	-2.4	0.4	0.5	0.0
Renovation, rent, fuel & water	8.1	17.5	14.1	10.0
Home furniture	1.3	7.7	8.5	3.5
Medical care	4.2	5.0	0.7	0.5
Transport & telecoms	-0.9	0.2	1.0	0.0
Education & entertainment	0.2	2.1	1.3	1.2
Other expenses & services	5.3	10.7	4.3	4.5
Overall	**4.1**	**9.9**	**5.1**	**4.5**

Rents will remain the main source of domestic inflation, as the supply of new property fails to keep up with demand. Greater provision of real estate should ease rental inflation through the year. However, it is notable that rental inflation increased in year-on-year terms in December, the first time this has happened since July 2008 (in month-on-month terms the rate of increase was at a seven-month high). Inflation from other domestic sources should be small. While interest rates will remain exceptionally low, sluggish, albeit rising, bank lending means the bottlenecks that helped to lift prices during 2008 are not expected to reemerge. Furthermore, wholesale price data show little sign of inflationary pressures that could be passed through to the consumer beyond the effects of the low prices in early 2009 (wholesale price inflation was 1.2 percent in the final quarter of 2009). Given the larger share of commodities in its composition, the pickup in wholesale price inflation may well be above that for consumer price inflation.

Current account balance



Budget



Current account

We expect the current account surplus to widen in 2010 owing to higher oil export revenues. Oil export revenues are forecast to rise owing to higher prices and production, though continued rapid domestic consumption growth will limit growth in the volume of exports. With new plants coming on stream and the global economy improving, petrochemicals exports should also benefit from increased volumes and higher prices. Ongoing government investment spending will suck in more imports, though we expect total import growth to be restrained as prices of most imported goods are not expected to go up significantly.

Higher investment spending will raise outlays on imported services, which combined with a rise in expatriate remittances stemming from the continued growth in the foreign labor force will result in a rise in the deficit on the invisible trade account. Income from the government's foreign investments will be the main source of inflow. This is likely to be little changed because interest rates on US government bonds (which we think account for the bulk of the government's investment portfolio) are expected to remain very low.

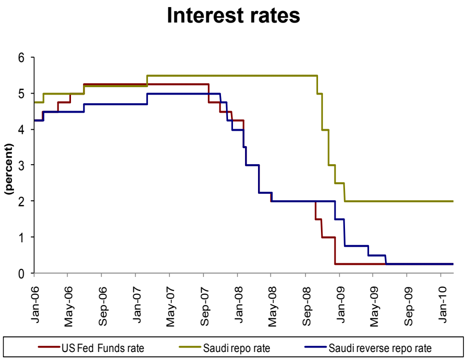
Fiscal policy

Government spending will provide the main stimulus to the economy in 2010. Total expenditure is budgeted at SR540 billion, 14 percent above the level budgeted for 2009. Revenues are projected at SR470 billion, resulting in a deficit of SR70 billion. This is the largest ever deficit the Kingdom has budgeted for in nominal terms and the highest as a percent of GDP since 2003. Defense, education and healthcare continue to account for the bulk of spending. Another large increase in investment spending is projected. We estimate that oil production of 8.3 million barrels per day at a price for Saudi oil of \$50 per barrel (\$51 per barrel for WTI) is consistent with the oil revenue projection used in the budget.

We forecast a budget surplus of SR15 billion in 2010. This is because we expect the oil price to be higher than that used in the budget and therefore that oil revenues will exceed the budgeted total. We forecast total oil revenues to the budget at SR538 billion and non-oil revenues at SR80 billion. Spending will be in excess of the budgeted level. Actual spending has averaged 21 percent greater than that budgeted over the last 10 years and even though oil prices were below the budget assumption for part of last year, the budget was still overspent by 16 percent. We project total spending in 2010 at SR603 billion. (For a detailed assessment of the 2010 budget see our budget report issued on December 22, 2009.)

Monetary policy

Interest rates are expected to remain very low. The exchange rate peg to the US dollar means that Saudi interest rate policy is guided by that in the US, though there is some room for maneuver. We see no scope for higher interest rates in the US while major credit and liquidity creation programs (known as quantitative easing) remain in place. These are set to be phased out during the year and there is the prospect of slightly higher interest rates towards the end of the year provided the US economy does not relapse in recession.



For the moment very low interest rates are also appropriate in Saudi Arabia, as they are an important condition for the revival of bank lending. The reverse repo rate (the rate that SAMA pays on deposits) is at an all-time low of just 0.25 percent. While it is possible this could be cut further to reduce the attractiveness for commercial banks of depositing money in SAMA, the impact of such a move would be small and likely have very little impact on bank lending. There are other policies SAMA could adopt to free more money for the banks to lend, such as lowering reserve requirements, but the fundamental issue is a lack of willingness rather than ability to lend. We expect this to be gradually resolved as confidence improves and therefore forecast a modest increase in interest rates before the year-end.

Exchange rate

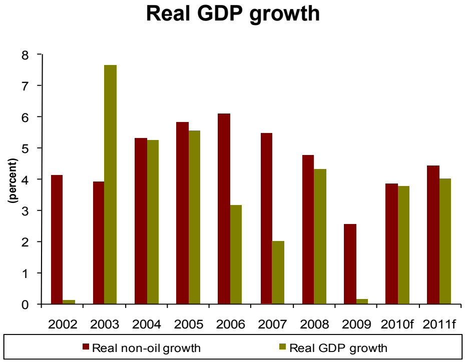
The riyal will remain pegged to the dollar. There is a broad consensus that the dollar will be on a downward trend over the medium term owing to the vast number of new dollars created by the US stimulus program, the unwinding of global imbalances and the gradual diversification of central bank reserve holdings. However, we think that the dollar will be relatively stable during 2010. The slowing global growth anticipated for the second half of the year will temporarily revive demand for safe haven dollar assets and support the value of the currency. Furthermore, with the outlook for eurozone and Japan also weak, interest rates in both economies are set to remain very low and budget deficits should rise, meaning that there is little reason for the currencies of these regions to strengthen against the dollar. Further weakness against the currencies of fast-growing emerging markets with higher interest rates is likely.

A GCC single currency had been scheduled for 2010, but is certain to be delayed. The Gulf monetary union agreement was ratified by the four members of the GCC still committed to the project (Bahrain, Kuwait, Qatar and Saudi Arabia) in mid-December. The first meeting of the Monetary Council, the body tasked with drawing up the timeframe for the launch of the currency, is scheduled for March. We are doubtful that the project will go ahead and do not expect any form of regional currency to be launched over the next few years. Officials of member governments have said it will be between five and ten years before a GCC single currency is issued. By this time the exchange rate needs of GCC members are likely to have splintered as their economies continue to diversify at differing paces, diminishing the logic of a single currency.

The economic outlook for 2011

Global economic growth in 2011 will gradually pick up from the weak pace over the second half of 2010 but the phasing out of stimulus packages (particularly the need for budgetary tightening, requiring a combination of lower spending and higher taxes) and ongoing deleveraging will constrain the pace of expansion. Growth will remain stronger in emerging economies, notably Asia. This will support oil demand and as a result we expect a small rise in average oil prices to $80 per barrel (WTI). Sluggish growth and high spare capacity mean that inflation will remain subdued.

The improvement in global economic conditions will provide a supportive backdrop for the Saudi economy. In addition, government spending will remain high, owing to the ongoing implementation of



investment projects, and interest rates, while rising, should still be low. Credit conditions are likely to have recovered, though we think that annual credit growth is unlikely to exceed 15 percent (it averaged 27 percent between 2004 and 2008). We therefore forecast that non-oil private sector growth will rise. With oil production also up, real GDP is forecast at 4 percent.

Surpluses are anticipated on both the budget and the current account, though these will be small in the context of the prevailing oil price. With inflation in the global economy remaining subdued and a continuing new supply of housing gradually easing pressure in the rental market, a further decline in inflation is likely. We expect a weakening of the dollar in 2011. In the event of rapid dollar depreciation, inflation would be greater than we currently anticipate. It is also possible that a misalignment of interest rate needs between the Kingdom and the US could emerge, resulting in some speculative pressure against the exchange rate peg. However, the riyal will remain pegged to the dollar.

Key data

	2003	2004	2005	2006	2007	2008	2009	2010F	2011F
Nominal GDP									
(SR billion)	804.6	938.8	1182.5	1335.6	1442.6	1781.6	1384.4	1554.0	1680.1
($ billion)	214.6	250.3	315.3	356.2	384.7	475.1	369.2	414.4	448.0
(% change)	13.8	16.7	26.0	12.9	8.0	23.5	-22.3	12.2	8.1
Real GDP (% change)									
Oil	17.2	6.7	6.2	-0.8	-3.6	4.2	-6.4	3.8	3.9
Non-oil private sector	3.9	5.3	5.8	6.1	5.5	4.8	2.5	3.8	4.4
Government	3.1	3.1	4.0	3.1	3.0	3.7	4.0	3.6	3.4
Total	7.7	5.3	5.6	3.2	2.0	4.3	0.1	3.8	4.0
Oil indicators (average)									
WTI ($/b)	31.1	41.5	56.6	66.1	72.3	99.7	62.0	75.0	80.0
Saudi ($/b)	26.9	34.7	49.5	60.5	68.1	93.4	60.5	71.3	74.8
Production (million b/d)	8.8	9.0	9.5	9.2	8.7	9.2	8.1	8.3	8.5
Budgetary indicators (SR billion)									
Government revenue	293	392	564	674	643	1101	505	618	672
Government expenditure	257	285	346	393	466	520	550	603	621
Budget balance	36	107	218	280	177	581	-45	15	51
(% GDP)	4.5	11.4	18.4	21.0	12.2	32.6	-3.3	1.0	3.0
Domestic debt	660	614	475	366	267	237	225	220	215
(% GDP)	82.0	65.4	40.2	27.4	18.5	13.3	16.3	14.2	12.8
Monetary indicators (average)									
Inflation (% change)	0.6	0.3	0.7	2.3	4.1	9.9	5.1	4.5	3.4
SAMA base lending rate (%, year end)	1.75	2.50	4.75	5.20	5.50	2.50	2.00	2.25	3.00
External trade indicators ($ billion)									
Oil export revenues	82.0	110.4	161.6	188.2	205.3	281.0	157.4	186.3	192.1
Total export revenues	93.0	125.7	180.4	210.9	233.1	313.3	184.5	215.6	223.7
Imports	33.9	41.1	53.8	63.0	81.5	100.6	80.4	86.8	95.5
Trade balance	59.1	84.6	126.6	147.8	151.6	212.7	104.1	128.8	128.2
Current account balance	28.0	51.9	90.0	98.9	93.3	134.0	20.5	37.2	34.2
(% GDP)	13.1	20.7	28.5	27.8	24.3	28.2	5.6	9.0	7.6
Official foreign assets	97.1	127.9	195.5	273.4	359.8	502.0	461.1	491.1	519.0
Social and demographic indicators									
Population (million)	22.0	22.5	23.1	23.7	24.2	24.8	25.5	26.3	27.0
Unemployment (male, 15+, %)	8.2	8.5	8.8	9.1	9.0	8.8	8.5	8.2	8.0
GDP per capita ($)	9745	11112	13640	15041	15868	19151	14462	15774	16572

Sources: Jadwa forecasts for 2010 and 2011. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.

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