جدوى للإستثمار
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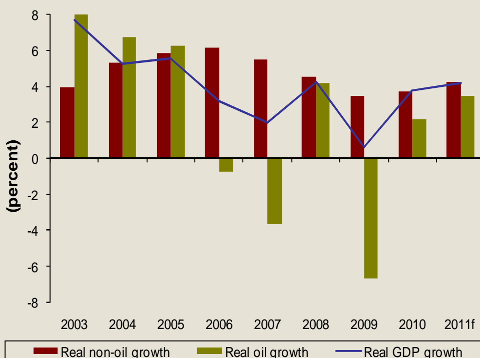

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The Saudi economy in 2011

The Saudi economy is expected to strengthen in 2011. Economic growth will rise, financial conditions will get better, inflation will be contained and the budget will remain in surplus. Government spending will continue to be the main driver of growth, with the contribution from the private sector expanding as the availability of bank credit improves and business and consumer confidence revives. Oil prices should rise owing to robust demand from emerging markets, though the economies of major developed countries will remain subdued.

We forecast that economic growth in Saudi Arabia will rise to 4.2 percent in 2011. Growth in both the oil and non-oil sectors will pick up. Oil production is forecast to respond to rising demand. High government spending will remain the main driver of the non-oil economy, supported by greater bank lending. The fastest growing sectors of the economy, utilities and construction, rely heavily on government spending.

Government investment spending is not expected to rise in 2011, it will probably fall a little; but it is the level of, rather than the growth in, this spending that is important. Government investment spending is budgeted at SR256 billion in 2011, equivalent to nearly 15 percent of GDP. High spending will not prevent the government from running a budget surplus of around 6 percent of GDP, though it will require an oil price of nearly $70 per barrel to balance the budget. Any shortfall would be covered by drawing down foreign assets. Rising imports associated with the government project spending are expected to dent the current account surplus.

Inflation will stay at elevated levels in 2011, averaging 5.3 percent. Rents will remain the leading source of inflation; other inflationary pressures will be external, mainly in the form of commodity prices. Domestically-driven inflationary pressures should still be muted, though there is a risk of a gradual increase in inflation expectations. Although inflation will be well above the historical norm, we expect interest rates to remain very low and do not anticipate the adoption of new policy measures to tackle rising prices. We do not foresee any changes to the riyal’s peg to the dollar.

While the economic picture will improve, performance will still be very heavily dependent on the government. Tough credit conditions and a weak global economy will keep growth of the non-oil private sector below that of the boom years around the middle of the last decade and activity will be dominated by government contractors. Non-oil growth will be slower than in 2004 to 2007, despite a doubling of government investment spending since then.

The global economic outlook

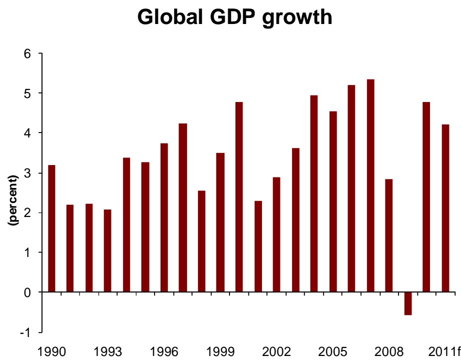
The global economic recovery will continue in 2011. There will be a clear divergence in performance between the developed economies of North America, Europe and Japan that make up the G7, and emerging markets. Growth in the G7 will be weak. It is likely to moderate until the middle of 2011 as the impetus of government stimulus fades. The subsequent recovery will be very sluggish, held back by the need to repay debt and cutbacks in government spending. Concerns about government debt mean that virtually all forthcoming economic stimulus will be in the form of looser monetary policy. With interest rates already exceptionally low, and expected to stay low for some time, the stimulus will take the form of creating new money (known as quantitative easing). This is likely to be much less effective than the burst of government spending when the world fell into recession in 2008. Inflation will not be a concern for some time in the G7; in the near term, the risks of deflation are greater.

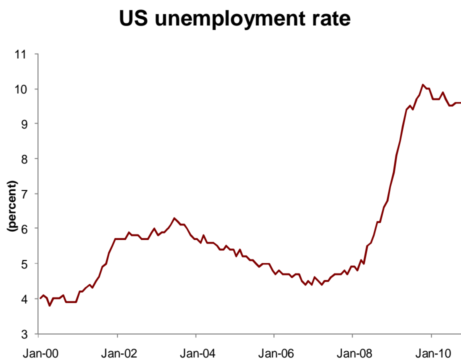
Global GDP growth
(IMF data and projections; percent)

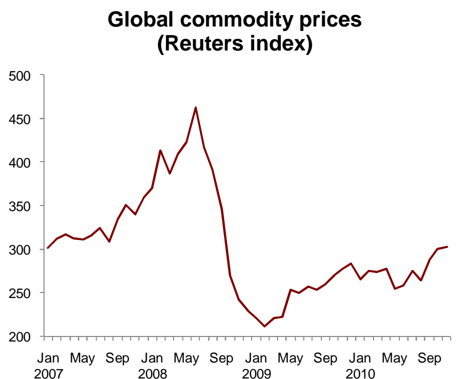
	2007	2008	2009	2010f	2011f
World	5.3	2.8	-0.6	4.8	4.2
US	1.9	0.0	-2.6	2.6	2.3
Japan	2.4	-1.2	-5.2	2.8	1.5
EU	3.1	0.6	-3.9	1.0	1.6
UK	2.7	-0.1	-4.9	1.7	2.0
China	14.2	9.6	9.1	10.5	9.6
Emerging Markets	8.7	6.0	2.5	7.1	6.4

The table above shows that growth will slow across the world in 2011. This reflects the fading impact of earlier stimulus that generated strong growth in the first half of 2010. In fact, on average, growth during 2011 is likely to be little changed on the slower pace that has been experienced through the second half of 2010. The US will be the only country growing faster than in 2007, the last boom year for the global economy. This is because the US economy began weakening earlier than other economies (the US recession stated in December 2007, around nine months before most other countries) and because of the recent approval of a package that extends tax cuts and contains new stimulus spending. Nonetheless, compared with earlier years, the high debt and unemployment of consumers will restrict the growth of the US economy. US companies are in a much better position and hold a large amount of cash.

Prospects for emerging markets are much brighter, though they also face challenges. Emerging economies continue to reap the benefit of long-term reforms that have stimulated domestic demand and moved them up the sustainable economic growth path. With generally healthy financial sectors, low debt and stronger budgetary positions, they have rebounded rapidly from the global recession and are well placed for robust growth in 2011. In addition, further falls in unemployment are likely and with wage rates rising, consumer spending will continue to go up. High commodity prices are also supportive for emerging markets. However, commodity prices have fed into inflation and, unlike in the G7, this is becoming a problem for some. In response, interest rates are likely to be raised, which will slow growth. Rising commodity prices and very low interest rates in the G7 have encouraged large capital inflows into some emerging markets, which are putting upward pressure on exchange rates.







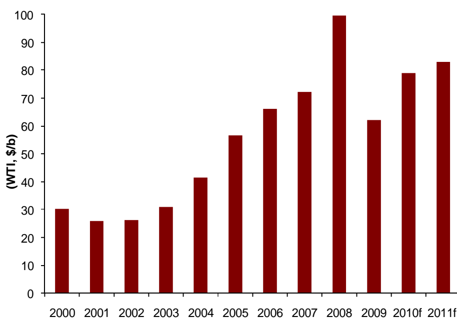
Managing these inflows is likely to be one of the main economic challenges for emerging market governments in 2011.

Most risks to this sluggish outlook are on the downside. Perhaps the greatest concern is that political pressure undermines economic policy. High unemployment in the US, tensions between the core and periphery of the eurozone and some key emerging markets trying to keep their exchange rates down in the face of large capital inflows could all result in policy decisions that would disrupt the still fragile global economic recovery. In particular, tougher restrictions on capital flows, policies more overly aimed at exchange rate manipulation and outright trade protectionism would all have a negative impact. Another source of uncertainty is the impact of the tightening of fiscal policy, generally in the form of lower spending, which has been adopted by many countries. The health of the financial sector is also a concern given the risk of a renewed fall in real estate prices and uncertainties around new bank regulation.

The oil market in 2011

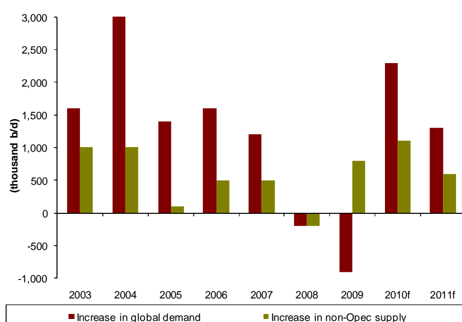
Oil prices are expected to be fairly stable during 2011, with WTI forecast to average $83 per barrel (equivalent to $78 per barrel for Saudi export crude). Ongoing demand growth will be offset by a gradual increase in supply from both Opec and non-Opec producers. As a result, we forecast that Saudi oil production will rise by 2 percent to just over 8.3 million barrels per day. Oil prices are likely to spend most of the year within the $70-90 per barrel band that we think Opec is comfortable with and we do not expect a formal change in Opec production quotas unless there is a sharp and sustained break from this range.

Average oil price



- Oil demand will rise as a result of the growth in the global economy. Demand growth will be fastest among emerging markets, who account for the bulk of new consumption. Demand growth consistently exceeded expectations during 2010, both from emerging markets and OECD countries, and is set to be the second highest in the past 30 years. While this pace will fade, the International Energy Agency (IEA) predicts oil demand growth of 1.3 million barrels per day in 2011, higher than in 2007, when the global economy was booming.

Change in oil demand and non-Opec supply
(IEA data)



- Producers will respond to the increase in demand by gradually raising supply. Non-Opec production is expected to climb by 0.8 million barrels per day in 2011 according to the IEA, down from 1.1 million barrels per day in 2010. Opec output should creep up. We do not think that a formal increase in production quotas will be considered unless prices exceed $100 per barrel for a sustained period. With Opec concerned about the global economic outlook, we do not expect compliance with existing quotas to deteriorate rapidly.

- Oil stocks should continue to fall. In 2010 much of the decline was in oil stored offshore and so was not captured in the data on the stocks held by individual countries. With little oil now being stored offshore, the decline should be more visible. Nonetheless, stocks are likely to remain above their five-year average.

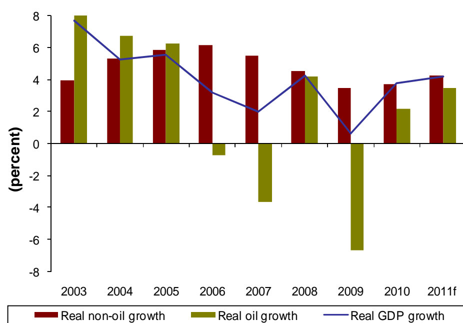
Financial flows can play an important role in oil price movements, particularly over the short term. A strong relationship between oil

prices and global stock markets, the dollar and other proxies for sentiment about the global economy has emerged in recent years. Movements in investment flows are difficult to predict. Based on our expectations of an improving global economy and a fairly stable dollar (see Exchange rates) we do not think that financial flows will push oil prices too far from the level justified by the fundamentals. Oil has not really been caught up in the surge in commodity prices during 2010, but if other commodity prices plunged there would be a negative impact on oil prices.

Economic growth

We forecast that economic growth in Saudi Arabia will rise to 4.2 percent in 2011 from 3.8 percent in 2010. Growth in both the oil and non-oil sectors will pick up. Oil production is forecast to respond to rising demand from emerging economies. High government spending will remain the main driver of the non-oil economy, supported by greater bank lending, very low interest rates and improving consumer and corporate confidence. Non-oil growth will still be below that of the boom years around the middle of the last decade owing tougher credit conditions and a weaker global economy.

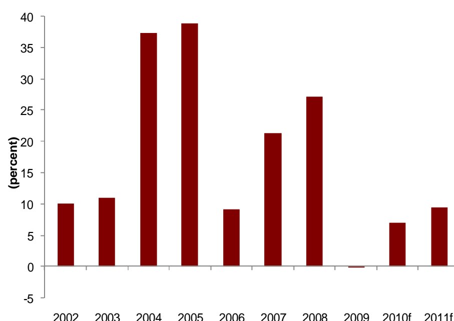
Real GDP growth



Government expenditure will be vital to the economy. We do not expect government investment spending to rise in 2011, it will probably fall a little, but it is the level of, rather than the growth in, this spending that is important. Government investment spending is budgeted at SR256 billion for 2011, the equivalent of almost 15 percent of GDP. Although this level of spending is not expected to be attained, spending around our forecast level of SR170 billion will provide a huge stimulus to the economy and ensure another very good year for government contractors. The fastest growing sectors of the economy in 2011, utilities and construction, will be heavily dependent on government spending.

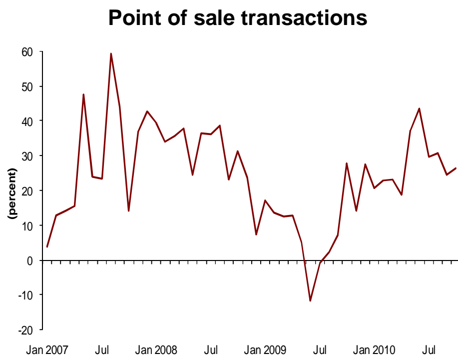
The performance of those parts of the non-oil private sector that are not direct beneficiaries of government contracts should improve. The lack of availability of suitably priced bank credit has been the major factor holding back much of the non-oil private sector. Total bank credit to the private sector climbed by only 6 percent in the first ten months of 2010, following average annual growth of 27 percent between 2004 and 2008. Credit growth should pick-up in 2011 for the following reasons:

Bank lending to the private sector



- The improvement in the economy should make banks more comfortable about the lending environment.
- Bank provisioning for bad loans has increased (and is likely to exceed 100 percent of total non-performing loans by the end of 2010) which should give banks greater reassurance about their own financial positions.
- The low investment returns available elsewhere means the lack of lending is hitting bank profits.
- Demand for bank credit from the private sector will increase.

Better bank performance should trigger an improvement in the stock market, which has an important impact on consumer confidence given the large presence of retail investors in the market. With banks likely to have completed the bulk of their provisioning in the final quarter, the improvement and probable better stock market



performance should be apparent from the first quarter results. Ongoing reforms and rising foreign investment will also underpin the strength of the economy (the Kingdom rose to become the eleventh best place in the world to do business in according to the latest World Bank ratings).

Economic data highlight that the economy has gained momentum through 2010. Indicators of consumer spending, such as point of sales transactions and cash withdrawals from ATMs, point to healthy growth during the year. Cement sales, a good gauge of construction activity, are 13 percent higher in the first ten months of 2010 than they were in the same period of the previous year. Furthermore, the performance of listed companies continues to improve, with profits up by 19 percent year-on-year in the third quarter. Finally, surveys point to an increase in new orders for local businesses.

Given the strengthening fundamentals of the economy, we expect growth to accelerate in most sectors. Our expectations for growth in the key sectors of the economy are as follows:

- Growth in the **oil** sector is forecast to pick up owing to an increase in oil production (see The oil market in 2011). It is likely that, as with previous years, the oil sector will grow faster than the increase in oil output given the project work taking place in the sector. Most of this work is concentrated on exploring and developing the Kingdom's gas reserves.

Economic growth by sector
(percent)

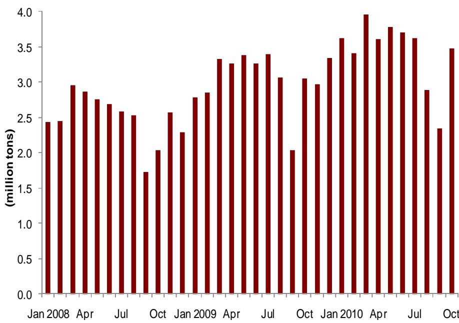
	2008	2009	2010	2011f
Agriculture	0.7	0.6	1.8	1.0
Manufacturing	6.0	2.3	5.0	5.5
Electricity, gas and water	6.7	6.8	6.0	6.5
Construction	1.5	4.7	3.7	4.5
Wholesale & retail trade	6.5	2.5	4.4	4.8
Transport & communication	12.2	6.9	5.6	5.0
Finance	2.4	3.7	1.4	2.1
Non-oil private sector	**4.6**	**3.5**	**3.7**	**4.2**
Oil	4.3	-8.0	2.1	3.5
Government services	2.4	3.8	5.9	5.0
Total	**4.2**	**0.6**	**3.8**	**4.2**

- Activity in the **manufacturing** sector is likely to rise as a result of strengthening global demand and an increase in production capacity. Two major petrochemicals facilities are set to start operations in the second half of 2011; Saudi Kayan and the SIIG/ ChevronPhillips complex in Jubail. In addition, production will be ramped up at several major plants that opened recently. Output from oil refineries, the other major component of the manufacturing sector, should be up modestly due to the increase in oil production. No new domestic refineries are scheduled to open until 2013. Manufacturing will receive a boost from the giant Ma'aden phosphate project, which is set to begin production in the second half of 2011. With new plants coming on stream and demand growing, we also expect higher output of plastics, cement and other manufactured goods.

- **Electricity, gas and water** is expected to be the fastest growing

sector of the economy in 2011. The sector has seen huge investment from the government in order to keep up with growth in demand of around 7 percent per year. Several major projects are coming to fruition in 2011, the largest of which are the Riyadh Power Plant 10, with capacity of 2,000 megawatts and the Shaibah power plant extension, with capacity of 1,200 megawatts. Together these will add around 7 percent to total power generation capacity. In addition there will be the first full year of output from the Jubail and Shuqaiq independent water and power projects, which started operations in the second half of 2010 with a combined capacity of 3,595 megawatts of power and 1 million cubic meters of water.

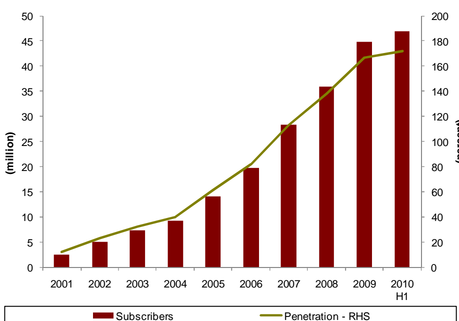
Cement sales



- Performance in the **construction** sector will remain fairly strong, driven by the high level of government investment spending. According to Middle East Economic Digest, there are projects underway or planned in the Kingdom worth over $600 billion; virtually all of these involve some element of construction. Import data for 2010 show a decline in imports of machinery, equipment and tools and a jump in imports of raw materials, suggesting that more projects have moved from the equipment procurement stage to actual construction. Strong demand for residential accommodation and improved availability of bank credit means that the private sector will be a growing source of demand for construction projects during the year.

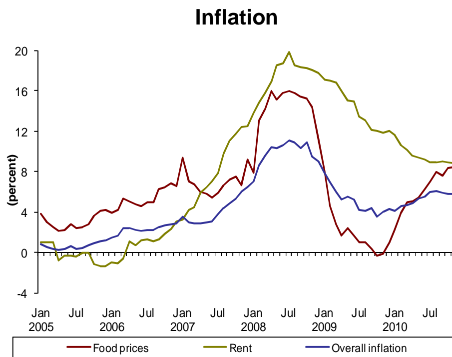
- The ongoing improvement in the economy should boost the **wholesale and retail** sector. Data on point of sales transactions and cash withdrawals from ATMs suggest that consumer spending has picked up in 2010 and we anticipate further growth in 2011. Healthy economic conditions, improved availability of bank credit, a probable rise in the stock market and the pay rise for the military will all feed into stronger consumer spending. However, we think that inflation, particularly for rents and foodstuffs, will eat into disposable incomes and restrain the growth in spending.

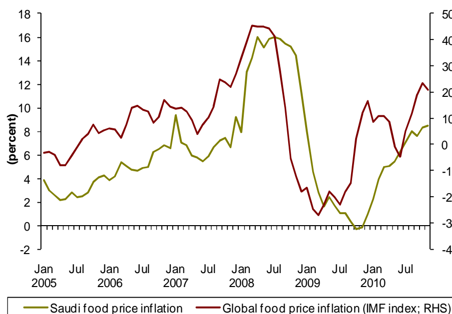
Mobile phone penetration

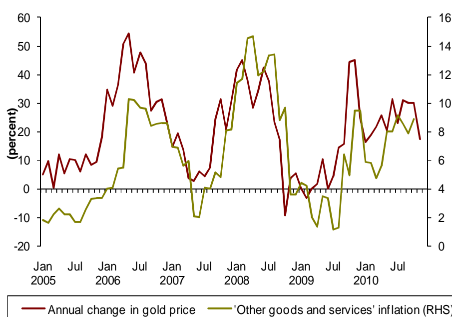


- **Telecoms and transport** is one of the few sectors for which growth is expected to fall in 2011. This is because of the slowdown in the take-up of mobile phones. Telecoms and transport was the fastest growing sector in the Kingdom in each of the years from 2004 to 2009, propelled by the number of mobile subscribers expanding at an annual average rate of 36 percent over the period. The number of mobile subscribers rose by only 4.9 percent in the first half of 2010 and with mobile penetration at 172 percent, there is little scope for further rapid growth. The take-up of internet and broadband services has also slowed, but with penetration at 40 percent and 34 percent, respectively, there is more room for growth. It is likely that the most dynamic part of the telecoms sector will be the provision of content and applications. We expect the transportation component of this sector to grow in line with a rising volume of imports and exports and the ongoing implementation of infrastructure projects that involve the movement of equipment and material around the Kingdom.

- The revival of private sector activity should feed into higher growth for the **finance** sector. On top of the anticipated rise in bank lending, we think that many investment banking transactions put on hold in the past few years will resume. Use of







the nascent insurance industry is also set to rise. Business services such as legal, marketing and consultancy (which are all captured in the finance sector) will benefit from the greater use of financial services and the broader pick up of the private sector.

Inflation

Inflation will remain at elevated levels in 2011, averaging 5.3 percent, little changed from the likely 2010 average of 5.4 percent. Rents will remain the main source of inflation; other inflationary pressures will be external, principally in the form of commodity prices. Domestically -driven inflationary pressures should still be fairly subdued, though there is a risk of a gradual increase in inflationary expectations. Although inflation will be well above the historical average, we do not think any new policy steps will be taken to tackle it.

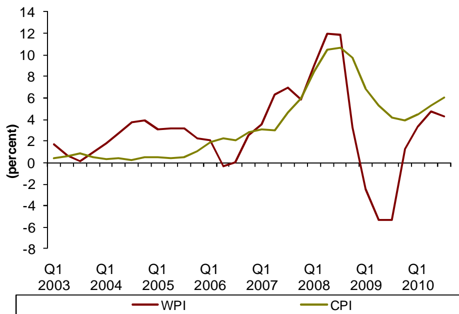
Inflation has rebounded over 2010 and while the August figure, of 6.1 percent, may well be the peak for the year, inflationary pressures remain strong. Rents have been the main source of inflation since early-2007 and we do not expect this to change in 2011. However the growth in rental inflation has stabilized at around 9 percent over the past six months, down from a high of almost 20 percent in mid-2008. We think rental inflation will continue to hover close to 10 percent during 2011. Local population dynamics should ensure high demand, though this is being tempered slightly as a lack of affordability may be deterring some from seeking accommodation. A steady increase in new supply should also contain rental inflation. We do not think a mortgage law would have an immediate impact on inflation if it were introduced in 2011.

The bulk of the other upward pressure on inflation during 2011 will emanate from commodity prices. The impact of commodity prices on inflation varies depending upon whether the commodity is consumed as a final product (such as foodstuffs) or as an input into other products (such as metals). Food accounts for 30.4 percent of the total basket of goods and services that makes up the cost of living index. Global food prices have jumped in recent months owing to poor weather conditions that have particularly damaged the wheat crop in Eastern Europe, which encouraged export restrictions and hoarding by importers; prices of fresh vegetables and potatoes have also shot up. The IMF's food price index was up by 21 percent in year-on-year terms in November.

In its mid-November food outlook report, the UN Food and Agriculture Organization expected food prices to rise further in 2011, though the outlook is not as bad as it was in 2008, as global stocks are much higher. Nonetheless, the run-up in recent months means even a modest rise in global food prices would put them well above where they have been for most of 2010 and will therefore keep year-on-year food price inflation high. Even if international food prices fall it may not have a direct impact on prices in the Kingdom, as issues with domestic supply networks mean that falls in global food prices tend not get passed on to Saudi consumers.

The other commodities that directly feed into inflation are precious metals, particularly gold, which through their impact on jewelry prices play a large role in the "other expenses and services" component of the cost of living index. The gold price is currently around an all-time high and consensus forecasts suggest a further rise in 2011. Other

Consumer and wholesale price inflation



precious metal prices are also expected to go up. Prices of other commodities, such as base metals, minerals and construction materials are captured in the wholesale price index.

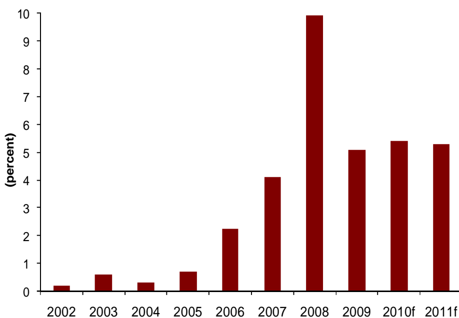
Wholesale price inflation data does not point to strong inflationary pressures in the pipeline. In the third quarter, year-on-year wholesale price inflation was 4.2 percent, down from 4.7 percent in the second quarter. Although it takes some time for raw materials to find their way to consumers in the form of finished goods, the data do not indicate any lag between changes in wholesale and consumer prices (see chart). Prices of raw materials are heavily influenced by demand from emerging markets, particularly China (China accounts for 40 percent of global demand for base metals), so the ongoing strength of these countries should put upward pressure on prices. However, metals prices have already risen sharply, partly because of financial inflows, and slipped recently owing to steps taken by the Chinese government to tackle inflation, so any rise in prices should be moderate.

A fall in the dollar would add to these imported inflation pressures and would spread them to other imported goods. As we outline in the Exchange rate section, we think that the dollar will be fairly stable against euro and yen in 2011 and that it will decline against many emerging market currencies, notably China. With emerging markets the origin of 43 percent of the Kingdom's imports there is likely to be an exchange rate impact on inflation in 2011, though this will not be great. Inflation in trading partners is another important contributor to inflation in the Kingdom. The IMF expects inflation in both advanced economies and emerging economies to fall slightly in 2011, to 1.4 percent and 5.2 percent, respectively, suggesting that this should also not be a concern.

Inflation breakdown
(percent)

	2008	2009	2010f	2011f
Foodstuffs & beverages	14.1	2.0	6.3	6.2
Fabrics, clothing & footwear	0.4	0.5	-0.6	0.8
Renovation, rent, fuel & water	17.5	14.1	9.5	9.3
Home furniture	7.7	8.5	2.8	3.5
Medical care	5.0	0.7	0.4	0.5
Transport & telecoms	0.2	1.0	1.1	1.0
Education & entertainment	2.1	1.3	0.9	1.0
Other expenses & services	10.7	4.3	7.4	5.5
Overall	**9.9**	**5.1**	**5.4**	**5.3**

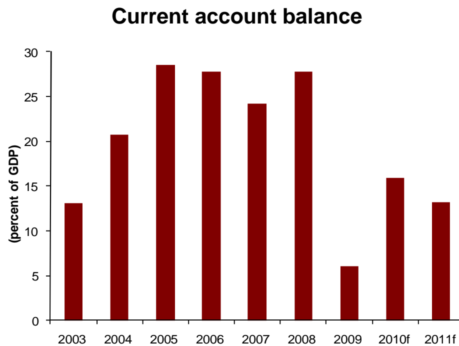
Inflation



It is clear that external factors will contribute to inflation in the Kingdom. We are less worried about domestic price pressures. Inflation in the components of the cost of living index that are less influenced by international trends—clothing, home furniture, medical care, transport and education—has fallen or changed little in 2010. Strong government capital spending may be adding to inflationary pressure at the wholesale level, but it should not impact on consumer prices. A pay rise for the military, the decision to retain the 15 percent inflationary allowance for public sector workers (introduced in three equal stages from 2008) and the broader improvement in economic conditions and consumer confidence will add to domestically-driven inflation, but this will stay fairly subdued.

One potential concern would be the emergence of inflation expectations among consumers. This would involve consumers anticipating further price increases and demanding compensating pay rises. By stimulating demand, higher pay rises would add to inflationary pressures. Inflationary expectations would also give retailers more flexibility to lift prices. We do not think this will be a problem, but there has nonetheless been a clear shift from the years up to 2006 when both inflation and inflation expectations were zero.

Current account



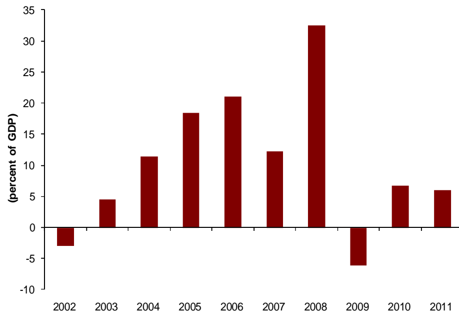
The current account surplus is expected to shrink in 2011, to 13.2 percent of GDP from 16 percent of GDP in 2010, owing to a worsening of both the visible and invisible trade balance. Growth in imports is expected to exceed that of exports; higher outflows of expatriate remittances and payments for imported services will contribute to the deterioration.

Although we expect oil prices and production to rise slightly, oil export revenues are forecast to be little changed owing to higher domestic consumption (the more oil that is consumed domestically, the less available for export). Non-oil exports are expected to rise in line with higher production of petrochemicals and plastics and modestly higher prices. Imports will increase owing to the needs of the government's investment program and higher consumer spending. Higher commodity prices will add to the import bill. Note that it is probable that Asia excluding Japan will take over from the Eurozone to become the Kingdom's largest source of imports for the first time in 2011. We project that the trade surplus will fall slightly, to $147 billion in 2011 from $149 billion in 2010.

Current account
($ billion)

	2008	2009	2010	2011f
Oil Exports	281.0	163.1	203.2	205.3
Other Exports	32.3	29.1	33.1	35.7
Imports	-100.6	-86.4	-87.0	-94.0
Trade balance	**212.0**	**105.2**	**149.3**	**147.1**
Invisibles balance	**-79.7**	**-82.4**	**-79.7**	**-84.8**
Current account balance	**132.3**	**22.8**	**69.6**	**62.3**
(percent of GDP)	27.8	6.1	16.0	13.2

Ongoing infrastructure work and the expansion of the economy will generate the requirement for more imported services (such as communications, construction and insurance). While domestic capacity is being built, payments for foreign services will be large and growing. The number of expatriate workers will also rise, as therefore will expatriate remittances. The results of the 2010 census show that the government underestimated the expatriate population by around 25 percent. We think that a lot of funds are remitted outside of the formal banking sector and that total remittances ($25.1 billion in 2009) are underestimated by a similar amount. Investment income will remain the main source of non-trade income. Despite the very high and rising level of government foreign assets, investment income will probably be little changed from the past few years owing to the ongoing low interest rates on US government bonds, which we think constitute the bulk of Saudi government foreign assets.



Fiscal policy

High government spending will remain central to the healthy performance of the Saudi economy in 2011. Total expenditure is budgeted at SR580 billion, 7 percent above the amount budgeted for 2010. Budgeted capital spending is down on the 2010 level, at SR256 billion versus SR260 billion in the previous budget. This is the first decline in budgeted investment spending for many years, but it is not a cause for concern. Most investment projects take several years and it is reasonable for the government to sequence its spending in order to avoid stoking inflationary pressures.

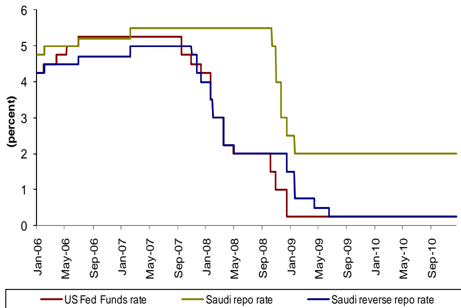
It is more important to consider the actual level of investment spending, which at 14.4 percent of expected GDP is still very high. Indeed, budgeted capital spending in 2011 is greater than actual capital spending for the 11 years between 1993 and 2004 and nearly double the 2008 level. Spending is in line with the recent five-year plan, which itself continues the themes of recent budgets, with expenditure on enhancing human capital (education and healthcare), infrastructure and housing prioritized.

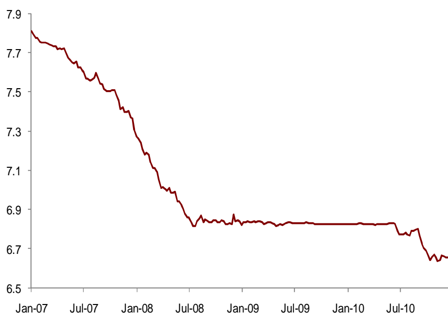
With revenues expected rise owing to a combination of higher oil prices and production, we expect a budget surplus in 2011 of SR106 billion (6 percent of GDP), compared to the budgeted deficit of SR40 billion (2.2 percent of GDP). We think that the budget was based on a price for Saudi oil of $56 per barrel ($60 for WTI) and production of 8.3 million barrels per day, but given the likely overspending think that it will require an oil price of $67 per barrel (Saudi export crude) in order to balance the 2011 budget. Oil prices below this level would not jeopardize the spending target, as the government will draw down its huge stock of foreign assets ($429 billion at the end of October) to finance any shortfall. These foreign assets will provide a significant cushion for several years to come. However, the 2011 breakeven oil price compares to one of $28 per barrel in 2004, highlighting the long-term need for budgetary reform.

Monetary policy

Interest rates are forecast to remain very low throughout 2011. The exchange rate peg to the US dollar and the lack of capital controls mean that interest rates in the Kingdom need to broadly shadow those in the US. We see little chance of noticeably higher interest rates in the US in 2011. Currently, the US is loosening monetary policy. With the main US interest rate, the Fed funds rate, effectively as a low as it can go, the Fed is stimulating the economy through the creation of new money (known as quantitative easing). The current program of quantitative easing is set to run until the middle of 2011. It is too early to determine whether this will then cease, but even if it does it will not signal that a rise in interest rates is imminent. We assume the US Fed funds rate will remain unchanged throughout 2011. (Note that the US Fed tends to be fairly rapid in increasing interest rates once it has made the first move.)

SAMA has some scope to move interest rates independently from the US and we do anticipate a modest increase (of 0.25 percentage points) in both the repo and reverse repo rate towards the end of the year. We think this will be prompted by the gradual normalization of credit conditions and more specifically, by the likely return of annual bank lending growth to close to double-digits. The other instance in





which SAMA would look at hiking interest rates would be if serious domestic inflationary pressures emerge, which we do not anticipate. Although inflation will remain high, it will be driven by rents and imported price pressures and will therefore not be affected by interest rates in the Kingdom. There are other policies that could be adopted to encourage banks to lend more, such as reducing reserve requirements, increasing government deposits in the banks and reducing outstanding debt. As the issue is the unwillingness, rather than the inability, of banks to lend, it is unlikely that any of these would be effective and we do not expect any of these changes to be implemented.

Exchange rate

The riyal will remain pegged to the US dollar during 2011. We do not expect any serious discussion on breaking the peg or speculative pressure against the peg. Dollar movements are likely to be driven by the same themes as 2010; weakness in developed economies and strength in emerging economies. As with 2010, we expect currency movements will be volatile and subject to swings in sentiment about the relative health of the economies of the US, Japan and Eurozone. These are likely to cancel each other out over the course of the year and therefore think the dollar will be relatively little changed during 2011. Consensus forecasts point to a modest strengthening of the dollar against euro and weakening of the dollar against yen by the end of 2011.

A further depreciation of the dollar against emerging market currencies is anticipated. The more robust economic performance of emerging economies will continue to draw in financial flows from developed economies, which will be exacerbated by creation of very cheap money through quantitative easing. To manage these inflows more countries are expected to resort to capital controls, which could raise international trade tensions. The main pressure point is currently the inflexibility of the Chinese yuan. There are unlikely to be formal US sanctions against China for currency manipulation, but pressure for swifter appreciation of the yuan will remain strong, not just from the US, but increasingly from emerging markets, as most emerging market currencies have appreciated strongly against the yuan. Faster yuan appreciation appears inevitable.

The strength of emerging market currencies against the riyal could well put upward pressure on inflation, as emerging markets are becoming an increasingly important source of imports. The table on the following page shows how the sources of the Kingdom's imports have changed between 2004 and 2009. Emerging markets were the origin of 42.8 percent of total imports in 2009 compared to 36.6 percent in 2004. Stripping out the countries with dollar pegs in the GCC lowers the totals to 37.9 percent in 2009 and 31.8 percent in 2004. China was the fastest growing supplier of imports over this period and is now the second largest source of the Kingdom's imports, so the anticipated appreciation of the yuan against the riyal is likely to be reflected in higher prices for Chinese goods in the Kingdom.

Origins of the Kingdom's imports
(percent)

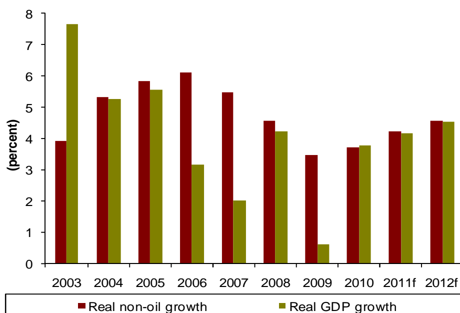
	2004	2009
GCC	4.8	4.9
Other Middle East	3.4	3.4
Brazil	1.8	2.5
Russia	0.6	0.7
India	3.2	3.7
Turkey	1.3	1.8
China	6.6	11.3
Other Asia	10.4	11.4
Emerging markets	**36.6**	**42.8**
Japan	9.9	7.6
Eurozone	23.6	25.3
UK	5.5	3.6
US	15.2	14.2

We expect little progress towards a GCC single currency. The introduction of the currency was targeted for 2010, but has been delayed. A Monetary Council, the forerunner of a regional central bank, was launched in March 2010. It will determine the new date for the issuance of the currency. The Monetary Council is scheduled to meet six times a year and so should ensure some momentum in tackling various technical issues, though the process will be hindered by the absence of the formal commitment from the UAE and Oman to join the proposed monetary union. Prospects for a single currency have also been set back by the serious problems in the Eurozone. The GCC has drawn heavily on the EU monetary integration model in its approach to a single currency.

The economic outlook for 2012

The global recovery will gain traction in 2012. Business and consumer spending should pick up, supported by a healthier financial sector. Growth in major economies will still be fairly subdued owing to continued high unemployment and deleveraging and the impact of further government budgetary tightening. Emerging economies will remain the main driver of the global economy. High growth in emerging economies will lift demand for oil and as a result, we forecast that WTI will rise to an average of $85 per barrel (equivalent to $80 per barrel for Saudi export crude).

Real GDP growth



A strengthening global economy and higher oil prices will provide a supportive backdrop for the Kingdom's economy in 2012. We expect a further rise in the pace of oil and non-oil growth, which will lift total real GDP growth to 4.5 percent, its highest level since 2005. The stimulus from high government spending will remain central to the economy, with work continuing on many megaprojects initiated in recent years and new enhancements to infrastructure commencing. Performance of the non-oil private sector should be boosted rising corporate confidence, as bank credit becomes more easily accessible (annual bank lending growth should be in low double digits) and the impact of earlier problems with some private sector companies fades.

Inflation is forecast to fall because of external price pressures easing. The recent pace of growth of commodity prices is not expected to be maintained, exchange rate movements are unlikely to

be a major factor and, according to the IMF, global inflation is forecast to decline. Rental inflation will continue to be the main source of local inflation. We do not see other domestically-driven inflationary pressures. Higher oil revenues and lower, though still high, investment spending means that the budget surplus should rise. In contrast, further growth in imports and domestic oil consumption will cause the current account surplus to fall. The will be no change to the riyal’s peg to the dollar.

Key data

	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F
Nominal GDP									
(SR billion)	938.8	1182.5	1335.6	1442.6	1786.1	1409.1	1634.3	1773.1	1902.4
($ billion)	250.3	315.3	356.2	384.7	476.3	375.8	435.8	472.8	507.3
(% change)	16.7	26.0	12.9	8.0	23.8	-21.1	16.0	8.5	7.3
Real GDP (% change)									
Oil	6.7	6.2	-0.8	-3.6	4.2	-6.7	2.2	3.5	4.3
Non-oil private sector	5.3	5.8	6.1	5.5	4.6	3.5	3.7	4.2	4.6
Government	3.1	4.0	3.1	3.0	3.7	4.4	5.9	5.0	5.0
Total	5.3	5.6	3.2	2.0	4.2	0.6	3.8	4.2	4.5
Oil indicators (average)									
WTI ($/b)	41.5	56.6	66.1	72.3	99.7	62.0	79.0	83.0	85.0
Saudi ($/b)	34.7	49.5	60.5	68.1	93.4	60.5	74.7	78.4	80.3
Production (million b/d)	9.0	9.5	9.2	8.7	9.2	8.1	8.2	8.3	8.6
Budgetary indicators (SR billion)									
Government revenue	392	564	674	643	1101	510	735	764	789
Government expenditure	285	346	393	466	520	596	627	658	682
Budget balance	107	218	280	177	581	-87	109	106	107
(% GDP)	11.4	18.4	21.0	12.2	32.5	-6.1	6.6	6.0	5.6
Domestic debt	614	475	366	267	237	225	167	160	160
(% GDP)	65.4	40.2	27.4	18.5	13.3	16.0	10.2	9.0	8.4
Monetary indicators (average)									
Inflation (% change)	0.3	0.7	2.3	4.1	9.9	5.1	5.4	5.3	4.4
SAMA base lending rate (%, year end)	2.50	4.75	5.20	5.50	2.50	2.00	2.00	2.25	2.75
External trade indicators ($ billion)									
Oil export revenues	110.4	161.6	188.2	205.3	281.0	163.1	203.2	205.3	201.5
Total export revenues	125.7	180.4	210.9	233.1	313.4	192.2	236.3	241.0	240.9
Imports	41.1	53.8	63.0	81.5	100.6	86.4	87.0	94.0	103.4
Trade balance	84.6	126.6	147.8	151.6	212.7	105.8	149.3	147.1	137.5
Current account balance	51.9	90.0	98.9	93.3	132.3	22.8	69.6	62.3	52.0
(% GDP)	20.7	28.5	27.8	24.3	27.8	6.1	16.0	13.2	10.3
Official foreign assets	127.9	195.5	273.4	359.8	502.0	474.2	519.9	567.4	607.8
Social and demographic indicators									
Population (million)	22.7	23.4	24.1	24.8	25.5	26.3	27.1	27.9	28.8
Unemployment (male, 15+, %)	11.0	11.5	12.0	11.0	9.8	10.5	10.2	9.8	9.6
GDP per capita ($)	11039	13503	14806	15523	18651	14276	16060	16927	17641

Sources: Jadwa forecasts for 2010 to 2012. 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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