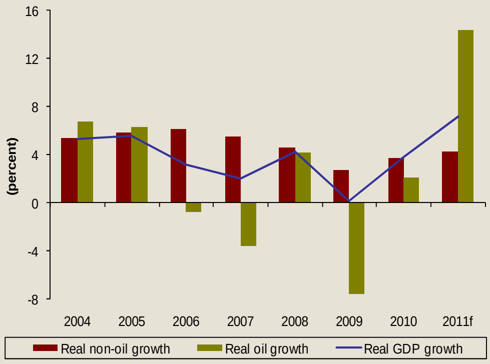
جدوى للإستثمار
Jadwa Investment

October 2011

Economic projections for 2011 revised up

We have revised some of our 2011 forecasts to take account of a recent flow of data that has generally been stronger than we had anticipated. Oil production has been lifted to close to all-time highs and, despite a difficult global environment, oil prices have held up. As a result, we have raised our projections for both the budget and current account surpluses. At the same time, inflation has been below our expectations. Although risks to our outlook are on the downside for the remainder of the year given the uncertainty over events in the Eurozone, 2011 will be a year of strong performance for the Saudi economy.

Real GDP growth



Economic growth

An upward revision to our oil production forecast is the main reason for the jump in our real GDP growth projection to 7.1 percent from 5.6 percent. Oil production has been raised to long-term highs this year to compensate for the disruption to Libyan output. Although Libyan output is resuming (it reportedly hit 350,000 barrels per day in early October), Saudi oil production has remained high. In recent days Oil Minister Naimi said production was 9.39 million barrels per day in September, compared to 8.1 million barrels per day in September 2010. We assume that Saudi production will fall in order to keep oil prices fairly stable while Libyan output is ramped up, but have revised up our projection for average production this year to 9.2 million barrels per day from 8.8 million barrels per day.

Our overall forecast for non-oil growth is little changed, though we have made adjustments to some sectors. These take account of data released so far this year and the deterioration in the global economy and are as follows:

- Monthly data points to very strong growth in consumer spending. The value of cash withdrawals from ATMs in the first eight months of this year is 24 percent higher than for the same period of last year; for point of sales transactions, the growth is 37 percent. This suggests rapid growth for the retail sector. With 4.93 million pilgrims arriving so far this year, a 60 percent increase on last year, retail, which includes wholesale, restaurants and hotels, is expected to be the fastest growing non-oil sector this year. However the impact of the strong retail sector on the rest of the economy will be relatively mild, as much consumer spending is on imported goods; the volume of consumer goods imports through the ports over the first seven months of this year is 15 percent higher than in the same period of 2010.

- Data also point to healthy growth in the construction sector. Cement sales over the first nine months of the year are 12.6

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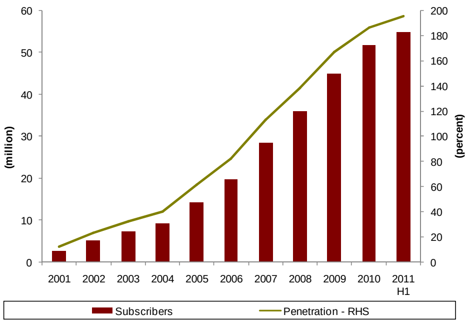
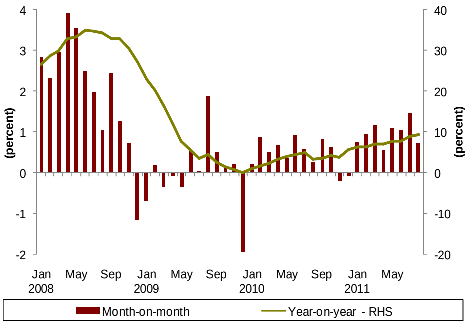
Mobile phone penetration



Bank lending to the private sector



percent higher than in the same period of last year and the volume of imports of construction goods through the ports between January and July are 8 percent greater than in the first seven months of 2010. With the government committed to a substantial house-building program over the next few years, construction should remain one of the fastest growing sectors.

- Growth of the telecoms sector, which had been the fastest growing part of the economy in recent years, seems to be slowing, though it remains brisk. The number of mobile phone subscribers rose by 6.2 percent in the first half of 2011, compared to annual growth of 15 percent last year and an average of 25.6 percent over the previous two years. In contrast, the number of internet users increased by 9.7 percent in the first half, almost the same as the growth for the whole of 2010. Numbers of mobile broadband subscribers continue to surge.

- Information on manufacturing output is not produced, though port data give a guide to the volume of exports of manufactured products. It shows that exports of petrochemicals were 5 percent higher over the first seven months of this year compared to the corresponding period of 2010 and those of industrial products were 11 percent greater during the same period. The weakening of the global economy may dampen manufacturing export growth over the remainder of the year.

The global economy

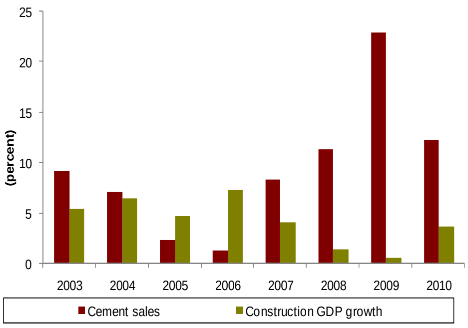
The global economy is in a difficult phase. Developed markets are dangerously close to recession. Emerging markets are stronger, but also showing some vulnerabilities. A lack of economic policy ammunition is hindering recovery and in many cases policy, or constraints on the ability and willingness to implement policy, is reinforcing negative dynamics.

The key problems facing the global economy are the lack of economic growth and rapidly rising public-sector debt, which is feeding into major stresses in the banking sector. At the center of these tensions is Greece. A lack of clarity and commitment on how the debt problems in that country are dealt with is creating pressure elsewhere in the region.

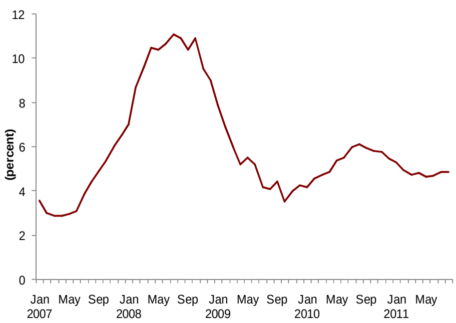
It is too early to tell if the current slowdown is transitory or more persistent. For the rest of the year the current turmoil will definitely impact on confidence, though the fading effects of the Japanese earthquake and falling commodity prices should provide a partial stimulus. The kind of slowdown currently occurring is in line with the usual pattern of recovery after a financial crisis. The world is still highly leveraged and it will take a long time to clear the debt overhang and to conduct the necessary restructuring and recapitalization of the banking sector. Any global recession would be shallow and not like the one in 2008.

An important factor supporting the private sector has been the revival in bank lending. Year-on-year bank lending growth is running slightly ahead of our expectations and at 9.4 percent in August was the highest since April 2009. Monthly growth has averaged 1 percent so far this year, a level not seen since the final quarter of 2008. High

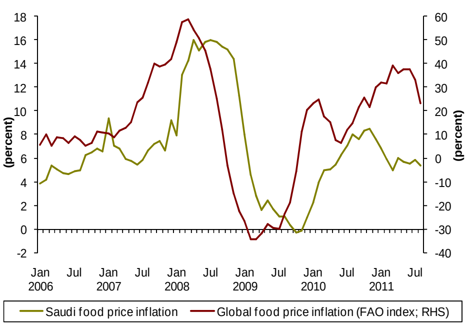
Cement sales and construction growth



Inflation



Food price inflation



government spending has made lenders and borrowers more comfortable with the economic environment. At the same time, banks have covered all the non-performing loans that built up on their books in recent years and so have much less need to devote funds to building up provisions, rather than lending. The local outlook is supportive for continued growth in bank lending, but this would be disrupted by a dramatic intensification of the banking problems in the Eurozone, even though the Kingdom's banks would probably not be directly impacted.

Aside from the problematic global situation, there are two factors that temper our optimism. The first is that the purchasing managers' index (PMI) fell to the lowest level in its two-year history in September. Although it still points to an expanding economy, the decline may reflect the impact troubles in the Eurozone and financial markets are having on the economy. Second, while there is clearly a logical link between cement sales and construction GDP, the chart to the left shows there is no relationship between the two series. It is a similar situation for ATM and point of sale data and growth in the retail sector.

Inflation

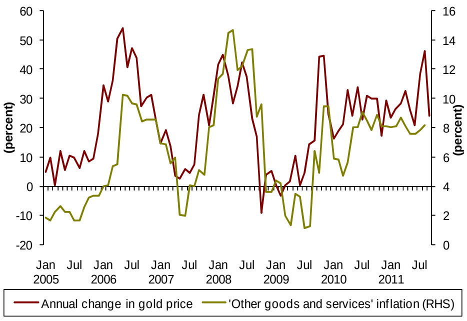
Inflation is another area where performance has been better than we had anticipated. Over the first eight months of the year, year-on-year inflation has averaged 4.8 percent and despite the jump in consumer and government spending has been little changed, staying in a range of between 4.6 percent and 4.9 percent since February. We still see the potential for inflation to break above 5 percent before the end of the year, but have revised down our forecast for average inflation for this year to 4.9 percent from 5.4 percent.

The key inflationary trends so far in 2011 have been:

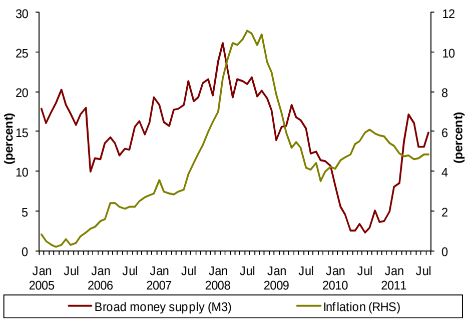
- **Surprisingly subdued food price inflation:** Food price inflation has fallen this year, from 7.6 percent in December to 5.4 percent in August. The decline is surprising given the trends in international food prices over the period. According to the UN Food and Agriculture Organization, global food prices were an average of 34 percent higher in the first eight months of this year than in the corresponding period of 2010. In late 2007 and early 2008, when global food price inflation exceeded 40 percent, local food price inflation reached almost 16 percent. There is a lag in the time it takes for international price trends to be reflected in local markets, but the lack of response is unusual (see chart). We think this is because higher international prices are not being passed on to the consumer. Dairy company Almarai disclosed in July that it was told by the Ministry of Commerce to reverse a recently implemented increase in milk prices. It is likely that there has been tougher government scrutiny across the supply chain causing companies to squeeze profit margins. With global food prices now falling, local food price inflation should remain around current levels.

- **Broadly declining rental inflation:** Rental inflation has been on a downward trend for most of the year, falling from 8.5 percent in December to a three-year low of 7 percent in May. However, it has ticked up over the past few months to stand at 7.8 percent in August. Rental inflation had been falling in response to an increase in supply of accommodation; high prices have also

Inflation for "other goods and services"



Broad money supply and inflation



deterred some from entering the rental market. It is not clear whether the recent rise is a blip or part of a more sustained revival. We think it more likely to be the former, with public-sector workers using their bonuses and, in some cases, salary increases, to return to the rental market and landlords raising rents owing to higher consumer disposable incomes. The prospect of a much greater supply from the government house-building program means that rental inflation will probably be fairly stable for the remainder of the year.

- **High inflation for "other goods and services":** Inflation for "other goods and services" is the highest of any of the components of the cost of living index, averaging 8 percent so far this year. Inflation in this area has a close relationship to the gold price (jewelry is one of the main components of "other goods and services"). Gold is benefitting from uncertainty in global financial markets and for the remainder of this year its price is likely to remain comfortably above where it was in the final quarter of 2010. Strong demand for other components of this sub-index, notably, hotels and furnished apartments, will keep inflation for "other goods and services" fairly high for the rest of the year.

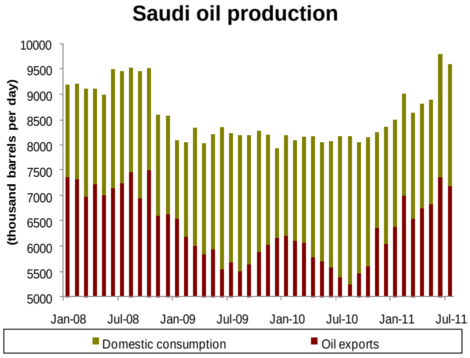
- **Rising, but still low inflation for consumer goods:** There has clearly been a large increase in spending on consumer goods, but prices have shown little response. Inflation for clothing and footwear, home furniture and education and entertainment have all gone up this year, but at 0.5 percent, 0.2 percent and 1 percent respectively in August, are still very low. Even if there are further rises, we do not see these areas making a notable contribution to headline inflation.

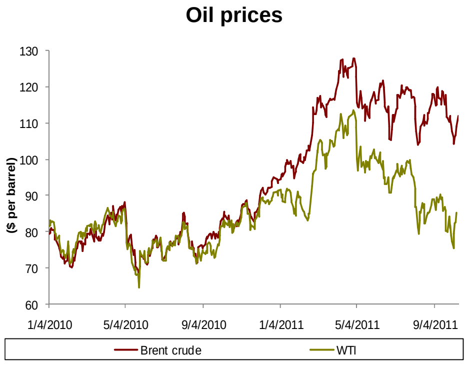
Prospects for inflation over the remainder of the year are mixed. There remain inflationary pressures within the economy, but these are less than in the immediate aftermath of the bonus to public-sector employees. Broad money supply growth has come down from its highs of earlier this year, but is still fairly high, at almost 15 percent. Government investment spending remains strong and prices of raw materials do have the potential to push inflation up, though there is little evidence they have done so yet.

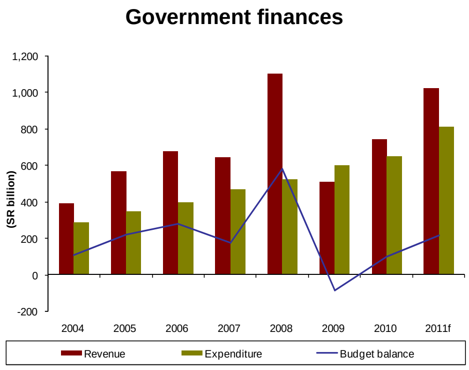
Wholesale price inflation is only available for the first quarter, when the rate was 5 percent. Data on the prices of some key construction materials is available for the second quarter. This shows that while timber was up by 7.3 percent and cement up by 4.1 percent compared with the first quarter, the price of iron was unchanged and concrete and cable prices were down. External factors point to a moderating of inflationary pressures. The weakening global economy is pulling down food and other commodity prices and causing a flow of investor funds into dollar assets, strengthening the dollar and therefore the riyal.

Oil prices

Oil prices have fallen by around 20 percent from their highs of the middle of this year as sentiment about the global economy has deteriorated. Although prices have been fairly closely aligned with moves in global stock markets and prices of industrial metals, the decline has not been as sharp owing to various supply factors. Aside from the cessation of output in Libya, small output disruptions have







occurred in Nigeria, some non-Opec areas (Yemen, Gulf of Mexico), and there has been heavy maintenance of facilities on the North Sea. As a result, global stocks of oil have fallen.

However, supply from Libya is returning at a fairly rapid rate (production was around 350,000 barrels per day in early-October), Iraqi output has risen rapidly to a post-war high and the country will soon open new export terminals, and other short-term supply issues are being alleviated. If the global economic slowdown worsens and has a more pronounced effect on emerging markets, the main source of growth in oil demand, then a combination of weak demand and rising supply will put downward pressure on prices. Prices will be a vital factor in determining the pace of the Kingdom's production cuts. The flow of news from the global economy will continue to have a major influence on prices and could cause significant volatility over the remainder of the year.

Complicating our forecast is the wide gap that has opened between the prices of the two leading oil price benchmarks, Brent and WTI. So far this year Brent has averaged $112.7 per barrel and WTI $94.7 per barrel. The two blends of crude tend to trade fairly closely in line with one another. Between 2006 and 2010 WTI average just $0.5 per barrel higher than Brent. In contrast, at times in September, the premium of Brent over WTI exceeded $30 per barrel. There are several reasons for this differential including bottlenecks at the location at which the pricing of WTI is determined, greater demand for Brent owing to its closer characteristics to Libyan crude and distortion caused by trading in financial products based on both types of crude.

The gap between Brent and WTI should close over time, but it will remain prominent for the rest of this year. We have therefore revised our forecast for Brent for 2011 up to $110 per barrel from $105 per barrel and for WTI down to $90 per barrel from $95 per barrel. Our projection for Saudi export crude is unchanged at $99 per barrel.

Government finances

Even though government spending will jump this year, we have revised up our projection for the budget surplus to 10.5 percent of GDP (SR213 billion) from 6.4 percent of GDP. This is due to the increase in our oil production, and therefore oil revenue, forecast. It is also notable that domestic consumption over the first seven months of the year is down slightly on the same period of 2010, lifting the proportion of total production that has been exported.

No data is available on government spending. It is nonetheless clear that spending has been high. Spending on existing projects has remained strong and around SR160 billion of expenditure announced in the Royal Decrees in February and March will take place this year (note that this includes transfers of funds from the government to other government bodies, such as the Real Estate Development Fund, who will not spend all of their new funds this year). Based on our new oil production forecast, we estimate that the breakeven price for the budget, at which total revenues would cover total expenditure for the year, is $76.4 per barrel (Saudi export crude).

Trade

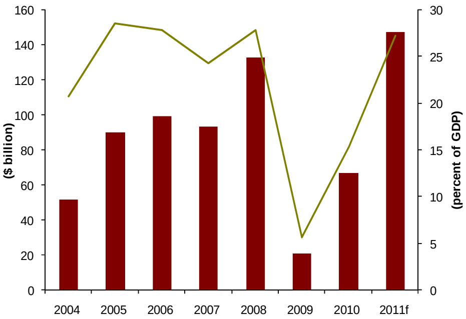
Our expectation of higher oil production has also pushed up our forecast for the current account surplus, which we now expect to be 27.3 percent of GDP ($147 billion) up from 24.6 percent of GDP. Non-oil exports have also been greater than we had anticipated, while imports have been less.

Balance of payments data is only available for the first quarter and this is subject to revision. It puts the current account surplus at $36 billion, almost double the level of the first quarter of 2010, as a result of much higher oil revenues. Services payments (for such things such as transport, travel and communications) were little changed. The transfers position worsened slightly owing to a 5 percent increase in workers' remittances.

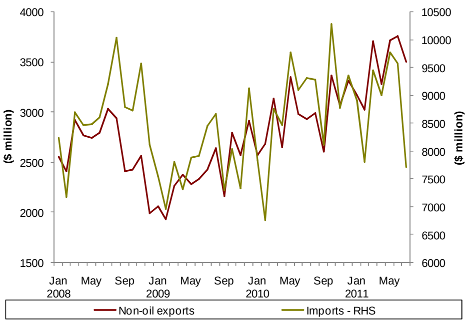
More recent data is available on the trade position. Imports over the first seven months of the year are 4 percent higher than in January to July of last year. Most categories of imports are up over this period except transportation equipment. This growth is slower than we had anticipated and is not distorted by changes in prices, as the volume of imports through the ports over the same period is up by just over 1 percent. Based on production and price data we think that oil exports averaged over $20 billion per month so far this year. Non-oil exports are up by 19 percent year-on-year in the first seven months, with both petrochemicals and plastics up by over 30 percent. The bulk of this gain is due to higher prices. Exports through the ports excluding refined products and gas are just 4.5 percent greater this year.

Over the remainder of the year we expect a slowdown in export growth owing to falling oil, petrochemical and plastics prices. The weaker global economy could also pull down export volumes, though some of this could be offset by increased petrochemicals production (Saudi Kayan began commercial operations at the beginning of October). The pace of import growth should pick up. Letters of credit opened at commercial banks for imports for the three months to end-August are 23 percent higher than in the corresponding period of 2010. Ongoing construction work should also stimulate demand for imports. In the absence of new data, we have not changed our forecasts for the other components of the current account. We do not think that the Nitaqat program (the new Saudiization strategy) will have a notable impact on remittances over the remainder of the year.

Current account



Import and non-oil exports



Key data

	2004	2005	2006	2007	2008	2009	2010	2011F	2012F
Nominal GDP									
(SR billion)	938.8	1182.5	1335.6	1442.6	1786.1	1397.5	1630.0	2023.7	1950.4
($ billion)	250.3	315.3	356.2	384.7	476.3	372.7	434.7	539.7	520.1
(% change)	16.7	26.0	12.9	8.0	23.8	-21.8	16.6	24.2	-3.6
Real GDP (% change)									
Oil	6.7	6.2	-0.8	-3.6	4.2	-7.6	2.1	14.4	-2.9
Non-oil private sector	5.3	5.8	6.1	5.5	4.6	2.7	3.7	4.2	4.9
Government	3.1	4.0	3.1	3.0	3.7	5.2	5.9	5.0	5.0
Total	5.3	5.6	3.2	2.0	4.2	0.2	3.8	7.1	2.6
Oil indicators (average)									
WTI ($/b)	41.5	56.6	66.1	72.3	99.7	62.0	79.5	90.0	82.0
Saudi ($/b)	34.7	49.5	60.5	68.1	93.4	60.5	77.7	99.3	88.8
Production (million b/d)	9.0	9.5	9.2	8.7	9.2	8.1	8.2	9.2	8.8
Budgetary indicators (SR billion)									
Government revenue	392	564	674	643	1101	510	742	1022	775
Government expenditure	285	346	393	466	520	596	645	809	753
Budget balance	107	218	280	177	581	-87	97	213	22
(% GDP)	11.4	18.4	21.0	12.2	32.5	-6.2	5.9	10.5	1.1
Domestic debt	614	475	366	267	237	225	167	160	160
(% GDP)	65.4	40.2	27.4	18.5	13.3	16.1	10.2	7.9	8.2
Monetary indicators (average)									
Inflation (% change)	0.3	0.7	2.3	4.1	9.9	5.1	5.3	4.9	4.4
SAMA base lending rate (%, year	2.50	4.75	5.20	5.50	2.50	2.00	2.00	2.00	2.00
External trade indicators ($ billion)									
Oil export revenues	110.4	161.6	188.2	205.3	281.0	163.1	214.9	289.5	226.0
Total export revenues	125.7	180.4	210.9	233.1	313.4	192.2	251.0	331.0	270.4
Imports	41.1	53.8	63.0	81.5	100.6	86.4	96.7	102.5	114.7
Trade balance	84.6	126.6	147.8	151.6	212.7	105.8	154.3	228.5	155.7
Current account balance	51.9	90.0	98.9	93.3	132.3	22.8	66.8	147.1	74.8
(% GDP)	20.7	28.5	27.8	24.3	27.8	6.1	15.4	27.3	14.4
Official foreign assets	127.9	195.5	273.4	359.8	502.0	474.2	520.3	626.1	681.5
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	11.0	10.5
GDP per capita ($)	11039	13503	14806	15523	18651	14158	16017	19320	18058

Sources: Jadwa forecasts for 2011 and 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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