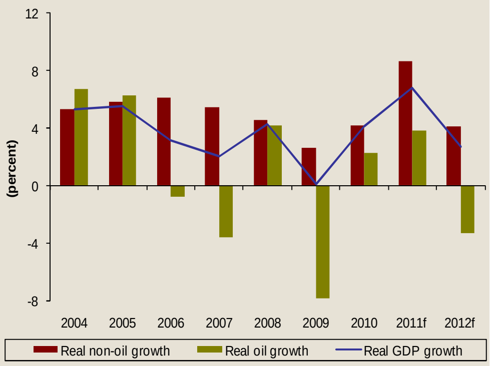
Jadwa Investment

December 2011

The Saudi economy in 2012

Real economic growth



We expect another year of reasonable economic performance in 2012. Non-oil growth be strong and inflation should ease. Lower oil production will cause total real economic growth to slow, and combined with lower oil prices, will reduce the budget and current account surpluses. High government spending will remain the engine of the non-oil economy.

We expect economic growth to fall to 3.1 percent in 2012, from 6.8 percent in 2011. This sharp decline is because oil production is forecast to drop after a large rise in 2011. Growth in the non-oil economy will be 4.7 percent. Government spending will be supported by greater bank lending and high consumer spending. Construction, the main beneficiary of government spending, should be the fastest growing sector.

Budgeted government spending for 2012 is well below the actual level for 2011, but this latter figure was distorted by one-time payments. Investment is budgeted at a record high and total spending will provide an important stimulus to the economy. We expect another budget surplus in 2012. The government will draw down its foreign assets, which stood at around $520 billion at the end of October, to finance its expenditure plans in the event of any shortfall in revenues.

Inflation is forecast to moderate to an annual average of 4.4 percent in 2012. Negligible external price pressures, due to lower commodity prices, a strong dollar and subdued inflation in trading partners, will underpin the decline. This will be supported by lower rental inflation, as more properties enter the market, though the amount of new supply, and therefore its impact on inflation, is not clear. These factors should offset the local inflationary pressures caused by the high level of consumer and government spending. Interest rates will remain exceptionally low. This will bolster the economy, though it will hinder the government should it need to tackle inflation. We do not expect any change to the riyal's peg to the dollar.

The main risks to our forecast stem from the external environment. There is a danger that the debt crisis in the Eurozone could spiral out of control, causing renewed global recession and a shock to the global financial sector similar to that of late 2008. The implications for the Kingdom would be serious, but not disastrous, given the government's willingness and ability to honor its spending commitments. Regional political uncertainty will continue to hang over the economy and any heightening of tensions would hit business and consumer confidence. Absent serious reform, ongoing high growth in government spending and domestic energy consumption mean that 2012 is the last year we can confidently forecast a fiscal surplus in the foreseeable future.

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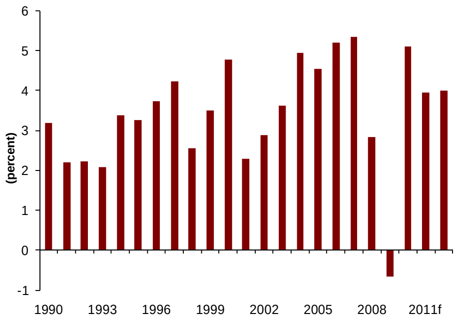
The global economic outlook

The global economy will face a difficult year in 2012. The Eurozone is likely to be in recession and growth in the other leading economies will be sluggish. Emerging markets are stronger, but also show some vulnerability. 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.

Global GDP growth

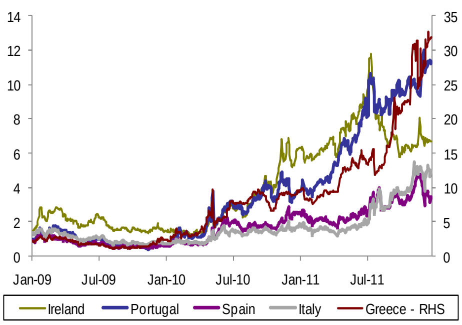


The debt crisis in the Eurozone is taking its toll on the region's economy. Business and consumer confidence have plunged and financing conditions have become significantly tougher. Eurozone banks are reliant on wholesale markets (rather than deposits) for 60 percent of their funding, but as they are also the main holders of Eurozone debt, other institutions have cut back greatly their exposure to European banks and European banks are reducing lending inside and outside the region. With austerity measures taking effect across the region, the region's economy has probably stopped growing and is likely to shrink in 2012.

Global GDP growth
(percent; IMF projections)

	2008	2009	2010	2011f	2012f
US	-0.3	-3.5	3.0	1.5	1.8
Japan	-1.2	-6.3	4.0	-0.5	2.3
EuroZone	0.4	-4.3	1.8	1.6	1.1
UK	-0.1	-4.9	1.4	1.1	1.6
China	9.6	9.2	10.3	9.5	9.0
Emerging Markets	6.0	2.8	7.3	6.4	6.1
Middle East	4.6	2.6	4.4	4.0	3.6

10-year Eurozone bond yields
(Spread over 10-year German yield; percentage points)



The US economy has been performing better recently. Its banking sector is in a stronger condition that of the Eurozone, financial conditions are healthier and monetary policy has been more aggressive. Nonetheless, serious weaknesses in the housing and labor markets, recession in the Eurozone and continued deleveraging will hold back growth; this could be aggravated by political tensions ahead of the presidential election. Japan is the only leading economy where growth will be significantly stronger in 2012 than 2011, though this is almost entirely due to the post-natural disaster rebound. We do not expect that growth in the developed world will be sufficient to have a meaningful impact on unemployment or to provide much relief to the growing debt/GDP burden. Subdued economic growth means that inflation will not be a concern. There is still slack in the leading economies and weak demand should keep commodity prices under control. Nonetheless, it is unlikely that the US or EU will experience deflation.

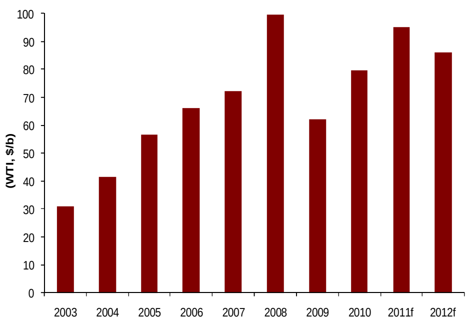
Emerging markets will continue to perform strongly, led by Asia. Robust growth in domestic demand should offset most of the negative impulse from the weaker global economy and banks are much healthier than in developed markets. There is also far more scope to ease fiscal and monetary policy; the Chinese government recently signaled that its policy stance has move from containing inflation to bolstering growth. Recent sharp exchange rate falls in many countries will improve their export competitiveness, though exports will be affected by the recession in the Eurozone. Nonetheless, emerging markets will face the consequences of strong credit growth in recent years and their reliance on developed markets to provide funding for this credit boom.

The main risks to the outlook are on the downside and center on the Eurozone. The steps Eurozone leaders need to take to deal with the crisis are understood, but a lack of political commitment to the necessary concessions is hindering implementation. As a result, the pace of change is much slower than that required by financial markets. The longer the wait, the higher the cost and the greater risk that the situation gets out of control. A disorderly breakup of the euro would cause a global recession and the collapse of some Eurozone financial institutions. For the US, the risks stem from the political environment. The inability of the two main parties to agree on budgetary issues could have an immediate as a well as a long-term impact on the economy. Budgetary problems remain a serious concern for Japan and while the country has been able to maintain a rising debt burden for many years, at some point this will become unsustainable.

The oil market in 2012

Oil prices are forecast to fall in 2012 owing to a weakening of the global economy. We forecast that Saudi export crude will average $92 per barrel (equivalent to $95 per barrel for Brent and $86 per barrel for WTI). With Libyan production likely to return to very close to pre-conflict levels by the end of 2012 and output from Iraq steadily rising, we expect Saudi oil production to fall by 4.4 percent to 8.8 million barrels per day.

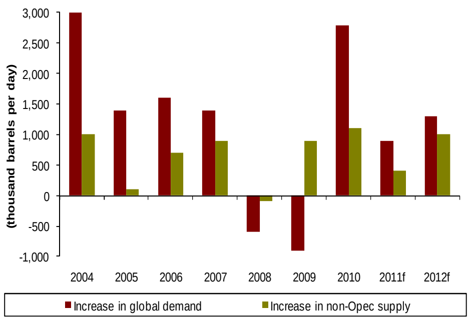
Average oil price



- Global oil demand is expected to rise in 2012 as a result of continued solid growth in emerging markets, primarily Asia. According to the International Energy Agency (IEA), Asia will be the source of over 60 percent of global oil demand growth in 2012. Demand growth from elsewhere will be fairly sluggish as economic growth slows. A deep recession in Europe would have a significant impact on oil demand; the fall in demand in Europe in 2009 was greater than the growth in demand from all emerging markets that year.

- Oil supply should rebound after various disruptions in 2011. The largest of these was the civil conflict in Libya, which took about 1.5 million barrels per day off global markets for around seven months. Libyan production has reportedly already reached 1 million barrels per day and should be close to its pre-conflict level by the end of 2012. Iraqi production is also set to continue to rise. In addition, the IEA projects non-Opec supply to rise by 1 million barrels per day, the highest level since 2002 (though these projections tend to be overoptimistic).

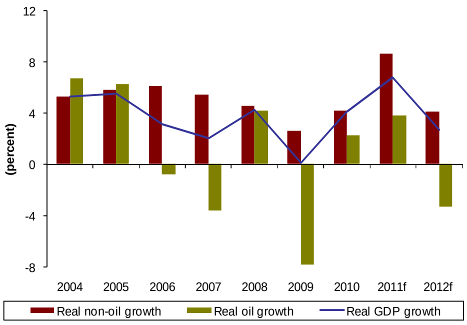
Change in oil demand and non-Opec supply
(IEA data)



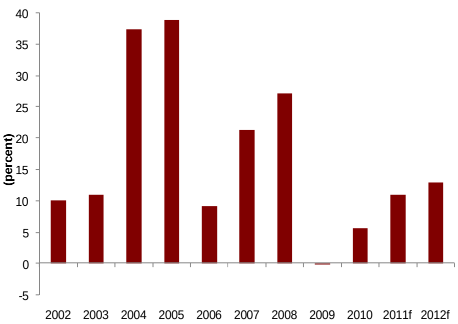
- Replenishment of oil stocks should give some support to prices. Oil stocks are at their lowest level, in terms of days of forward demand, since the end of 2008. Total OECD stocks have spent four consecutive months below their five-year average for the first time since 2004.

Geopolitical risks and financial flows also need to be considered when forecasting prices. The turbulence in the Middle East and North Africa added a risk premium to prices in 2011 and this will

Real GDP growth



Bank lending to the private sector



remain in place in 2012 as uncertainty is likely to linger. Tensions surrounding Iran also have the potential to cause oil prices to jump, particularly given that global spare production capacity is low. Financial flows have also influenced oil prices in recent years, as is clear from the close relationship between oil prices and stock markets and other proxies for sentiment about the global economy. In the tough global environment expected for 2012, gains in global stock markets are likely to be modest, at best, meaning they will not exert much pressure on the oil price.

Economic growth

Economic growth in Saudi Arabia is forecast to fall to 3.1 percent in 2012, from 6.8 percent in 2011. This sharp decline is because oil production is expected to drop after a large rise in 2011. (Note that we assume there will be large revisions to breakdown of growth in the budget that shows oil sector growth of just 4.3 percent and unexpectedly high non-oil private sector growth.) High government spending will continue to be the engine of the non-oil economy, supported by greater bank lending. We expect construction, the main beneficiary of government spending, to be the fastest growing sector. Concern about global economic and regional political risks will weigh on the private sector.

Government spending will remain central to the economy. Investment spending is budgeted at a new all time high and we forecast that total government expenditure will be equivalent to 36 percent of GDP, compared to an average of 30.1 over the five years to 2008. This will be a huge stimulus to the economy. The impact of government spending across the sectors of the economy is likely to be different in 2012 than in 2011. In 2011, bonuses for public-sector employees stimulated very high growth in consumer spending, benefitting the wholesale and retail industries, importers and local producers of consumer goods. With the bonus unlikely to be repeated in 2012, we expect construction companies and producers of associated goods, raw materials and services to be the main gainers from the high level of government spending.

High spending is also psychologically important for the private sector. The government spending packages announced in the first quarter of 2011 reassured businesses and consumers about the government’s commitment to support the economy and gave banks more confidence in the lending environment. This willingness and ability to support the economy will be important in 2012 as events outside the Kingdom are dampening sentiment and have the potential to damage the economy. The main economic risk is from the situation in the Eurozone (see box). The fluid regional political situation will continue to make foreign investors wary and hit the sales of companies that export to the region; it also brings the risk of stock market and oil price volatility.

We expect 2012 to be the fourth consecutive year that the economy is driven by government spending. Non-oil private sector growth is forecast at 4.7 percent, still well below the boom years of the mid-2000s, when a dynamic non-oil private sector grew at an average of almost 6 percent per year.

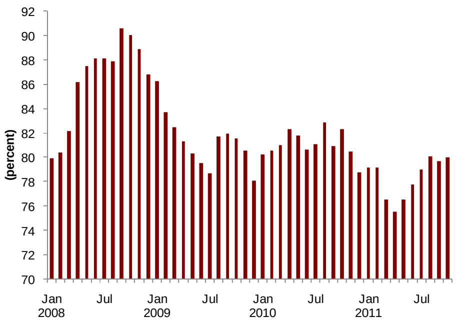
Aside from government expenditure, the revival in bank lending growth will be an important supportive factor for the private sector.

Saudi Arabia and the Eurozone crisis

The outlook for the euro is unclear. This produces a range of scenarios that vary from the benign (necessary reforms are enacted and money becomes available to allow the crisis to ease) to the alarming (a collapse of the currency, banking crisis and recession worse than that of 2008). Our core forecast is that the euro will survive, but that the Eurozone will enter recession and the region's banks will have a tough year. This will impact on the Kingdom in the following ways:

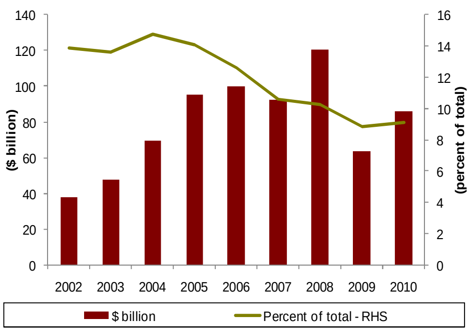
Financial conditions: The abrupt deterioration in financial conditions after the collapse of Lehman Brothers had a significant impact on the Saudi economy in late-2008 and 2009. Now, the Kingdom's banking sector is in a lot better position. Lending growth more subdued, deposits are much higher (the loan-to-deposit ratio is 80 compared to 90.6 in September 2008) and foreign deposits are a smaller proportion of total deposits (14 percent versus 18 percent in September 2008). In addition, Saudi banks are fully financed through deposits, whereas Eurozone banks are heavily reliant on wholesale funding (funding in excess of their deposit base), which has become a lot less readily available. Our central scenario is that the impact on the Kingdom will be limited to the reduced participation of European banks in project financing and other local activity. A more serious outcome could shut off international bank lending and lessen the lending appetite of local banks, though Saudi government agencies will continue to provide funding. Saudi banks have virtually no holdings of peripheral Eurozone debt, but do own small amounts of Spanish and Italian government debt.

Loan-to-deposit ratio



Oil prices: A Eurozone recession will have a notable impact on oil demand, putting downward pressure on oil prices and reducing the requirement for Saudi crude. European members of the OECD consume 50 percent more oil than China and the fall in oil demand from the region in 2009 was greater than increase in total non-OECD demand. We are not convinced that the outlook for the Eurozone is consistent with the buoyant consensus forecasts for oil demand and oil prices. The deeper the recession in the Eurozone gets and the further it spreads, the lower oil price and oil production will fall. We expect the government to draw on its foreign reserves ($519 billion at the end of October) rather than disrupt spending, if there was a sharp fall in oil revenue.

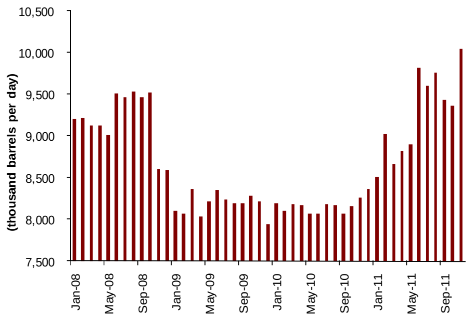
Saudi exports to the Eurozone



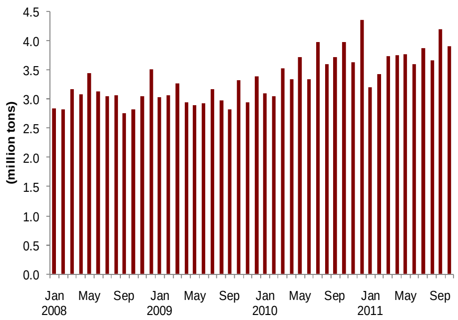
Trade: In 2010, the Eurozone was the destination for around 8.5 percent of the Kingdom's total exports and 7.5 percent of non-oil exports, much of which were petrochemicals and plastics. Recession would clearly hit sales of these products. It would also hit other trading partners the EU is China's largest trading partner) and potentially their trade with the Kingdom.

Stock market: Listed company exposure to the Eurozone economy is small and largely confined to the petrochemical producers. More important for the market is the impact of events in the Eurozone on local sentiment. The deteriorating situation in the Eurozone pulled down stock markets throughout the world in 2011 and contributed to the decline in the TASI. With retail investors dominating the local stock market, moves in share prices effect consumer confidence and spending. Stock market volatility would probably influence the timing of any further opening to foreign investors.

Oil production



Volume of non-oil and gas exports



Data for the first ten months show that bank lending rose consistently during 2011; if continued, 2011 would be the first year without any monthly declines in lending since 2005. With banks comfortable with lending conditions and their own financial health, year-on-year lending growth should average around 13 percent, the highest since 2008, and much more sustainable than the rates of two-to-three times this level in the mid-2000s. In an environment of very low interest rates and low investment returns available elsewhere, banks are likely to put more emphasis on lending to smaller business that have struggled to access credit in recent years.

Although we expect non-oil economic growth to pick up, the trend varies across the key sectors of the economy. Our expectations for growth in the main sectors are as follows:

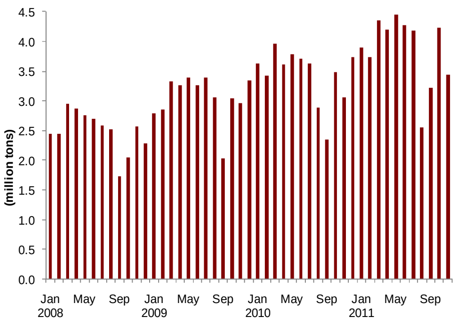
- **Oil** is by far the largest sector of the economy, accounting for around 25 percent in real terms, and the decline in oil production we expect in 2012 is the main reason that economic growth will slow. There were three clear increases in oil production in 2011. A jump occurred in February, when the bulk of Libyan production ceased. There was a further rise in June owing to concern about high prices after that month's Opec meeting collapsed. Finally, the Oil Minister stated that production exceeded 10 million barrels per day in November (versus 8.3 million barrels per day in November 2010) ahead of the Opec meeting in December. Each of the steps appears to have achieved its goals; the shortfall in Libyan production was covered, oil prices declined and the Kingdom reemphasized its preeminent role within Opec. With Libyan production rapidly returning to the market, Opec agreeing a new production quota (which incorporates Libya and Iraq) that is below current production and troubles in the global economy hitting demand, we think that production will be cut in 2012.

Real GDP growth
(percent)

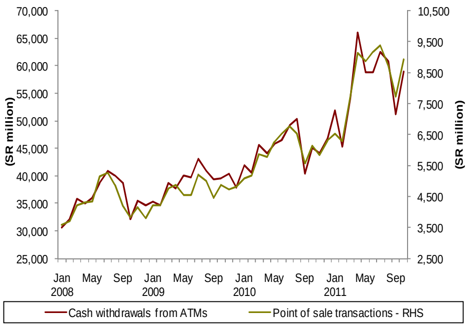
	2008	2009	2010	2011f	2012f
Agriculture	0.7	-0.5	1.1	1.0	1.0
Manufacturing	6.0	1.5	4.4	15.0	4.5
Electricity, gas and water	6.7	6.8	7.9	4.2	7.0
Construction	1.5	0.6	4.1	11.6	8.0
Wholesale & retail trade	6.5	2.5	5.8	6.4	4.6
Transport & communication	12.2	7.4	8.0	10.1	7.0
Finance	2.4	2.6	1.6	2.7	3.0
Non-oil private sector	**4.6**	**2.7**	**4.2**	**8.7**	**4.1**
Oil	4.3	-8.8	2.2	3.8	-3.3
Government services	2.4	5.0	6.1	6.7	5.2
Total	**4.2**	**0.1**	**4.1**	**6.8**	**3.1**

- **Manufacturing** growth is likely to slow in 2012. Up to the third quarter of 2011 the worsening global economy had not caused any impact on the sales volumes of Kingdom's petrochemical producers, but we think volumes will be hit as the slowdown extends into 2012. Political uncertainty will continue to impact on performance of many other countries in the region, which will dampen demand for other locally manufactured exports. Furthermore, refinery output is expected to fall given lower oil production. However, local demand for manufactured products,

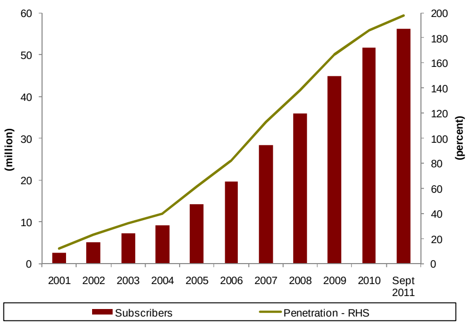
Cement sales



Indications of consumer spending



Mobile phone penetration



especially those used for construction, such as cement and steel, will be pick up. No new major manufacturing projects are set to come on stream in 2012, with the possible exception of Saudi Polymers, which was set to begin production before the end of 2011, but has yet to formally announce whether this has happened. The sector will benefit from the ramp-up of some facilities that entered production towards the end of 2011, notably the Ma'aden phosphate project and Saudi Kayan petrochemicals plant.

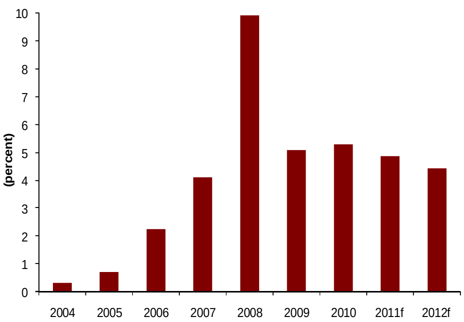
- **Electricity, gas and water** will remain one of the quickest growing parts of the economy. Sectoral growth has averaged 6.4 percent in the past decade and should be faster in 2012 with new housing, commercial and office space coming on stream in addition to rising industrial demand. No major additions to capacity are set to come on stream in 2012, though there will be increases at regional facilities in Qassim, Tabuk and Yanbu. We do not expect any change in utility pricing, even though it would slow consumption growth and promote more efficient use.

- **Construction** is forecast to be the fastest growing sector in 2012. To date, we think there has been relatively little physical progress in the government's plan to build 500,000 new housing units, announced in March 2011. Growth in cement sales and imports of construction materials in 2011 was in line with the historical trend. This is probably because of the time it is taking to build momentum at the new housing ministry and because the initial work would involve sourcing the land and designing the properties and associated infrastructure. In 2012 there should be much more construction activity. In addition, there are a vast amount of private-sector projects, infrastructure development and other government schemes that have an element of construction. According to Middle East Economic Digest, there are around $660 billion of projects either planned or under way in the Kingdom, a total that does not include the bulk of the government's house-building program.

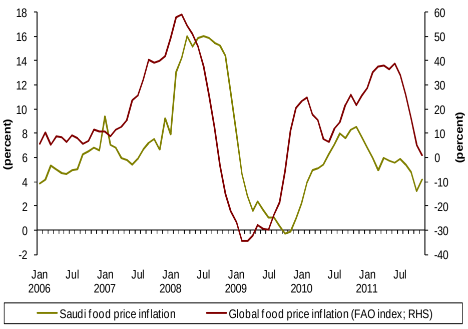
- The **wholesale and retail** sector benefitted greatly from the award of a two-month salary bonus to government employees in March; point of sale transactions were up by close to 40 percent in 2011. We do not think such a payment will be repeated and therefore forecast a sharp slowdown in growth for this sector. Nonetheless, growth will remain reasonable, as the economy strengthens and the benefits of government spending trickle down. In particular, spending by low income consumers should rise owing to the introduction of unemployment benefit together with the ongoing effect of a higher public-sector minimum wage and the widening of social benefits. Those on low incomes tend to spend a high proportion of their salaries.

- We expect that growth for the **telecoms and transport** sector will slow. This is because the stimulus resulting from the surge in mobile phone use in recent years will fade. Mobile phone penetration hit 198 percent (1.98 phones per person) at the end of September 2011, a level from which there seems limited room for further growth. Mobile subscriptions were up by 8.7 percent over the first nine months of 2011, compared to an annual average growth of over 30 percent in the previous five years. Broadband and mobile applications will remain an important

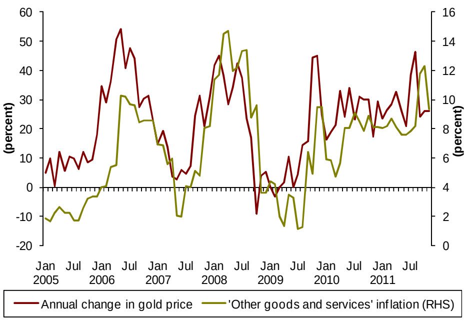
Inflation



Food price inflation and global food prices



Gold and "other expenses and services"



source of growth. For transport, rising import volumes and the need to move large amounts of construction materials around the country should keep growth healthy.

- Growth in the **finance** sector will pick up, though it is likely to remain fairly sluggish. Although bank lending and profits should rise, investors will be cautious, with little improvement in the stock market and a slim flow of deals likely. Growth in insurance should continue to rise in line with the increasing take-up of health and vehicle insurance (gross insurance premiums have grown at an annual average of 24 percent over the past five years). The increase in the supply of housing will lift the value added generated by real estate services (such as estate agents). Use of other business services such as legal, marketing and consultancy should rise in line with the growth in the private sector as a whole.

Inflation

Inflation is expected to fall to an average of 4.4 percent owing to an easing of price pressures from outside of the Kingdom. We think there will be some local inflationary pressure as a result of the high level of consumer and government spending. Rental inflation should decline as more properties enter the market, but it has been rising in recent months owing to higher consumer disposable income, which should mean that the drop will not be large.

International conditions provide a benign backdrop to inflation in the Kingdom. Moves in global food prices have been a leading source of inflation in the past few years, but for 2012 these should be more favorable. According to the UN Food and Agriculture Organization (FAO) global food prices have been falling since they hit an all-time high in February 2011. By November they were down by 10 percent from their peak, but still slightly above their level of one year earlier. According to the FAO's November *Food Outlook* report, production of food crops is up and stocks have risen. This suggests a further decline in food prices is likely in 2012, though market conditions remain tight, meaning there is potential for sharp price rises in the event of weather-related disruption.

Domestic policies should also moderate food price inflation. It appears that pressure from government agencies across the domestic supply chain prevented local prices from rising in response to the surge in global prices in late-2010 and early-2011. We think there will be further intervention to cap any food price rises in 2012.

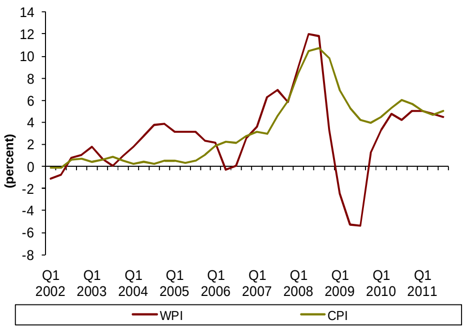
The commodity that is currently having the greatest impact on inflation in the Kingdom is gold. Gold, and to a lesser extent other precious metals, is the main material for jewelry, which is a key component of the "other expenses and services" sub-index of the cost of living index. This is currently the area where prices are rising fastest; inflation for "other expenses and services" in November was 9.4 percent, down from a three-year high of 12.3 percent in October. Gold is one of the most difficult commodity prices to forecast as demand for its use as a hedge or safe haven has much greater impact on prices than physical demand and supply conditions. The consensus forecast is for a slight fall in gold prices in 2012.

International raw material prices are expected to rise modestly.

Although growth in the global economy will slow, China, which is the main source of demand for industrial materials, should still grow rapidly. With vast construction work planned, high demand for some building materials in the Kingdom could cause supply bottlenecks and will put upward pressure on the prices. These products are captured in the wholesale price index, rather than the cost of living index, though there would be an impact on the latter. Wholesale price inflation was 4.5 percent year-on-year in the third quarter of 2011, the lowest since the third quarter of 2010.

Lower commodity prices, particularly for oil, will contribute to subdued inflation in the Kingdom's main trading partners, a key source of local inflation. Lower oil prices will also reduce the cost of transporting goods. In addition, there is still slack in many of the leading global economies following the 2008/09 recession, evidenced by high unemployment rates. With weak growth likely in the US and a renewed recession in the EU (combined, these are the source of 42 percent of the Kingdom's imports) inflationary pressures in these areas should subside. For advanced economies as a whole, the IMF forecasts that inflation will drop to 1.4 percent in 2012 from 2.6 percent in 2011; for emerging and developing economies the fall is predicted to be to 5.9 percent in 2012 from 7.5 percent in 2011.

Wholesale and consumer price inflation

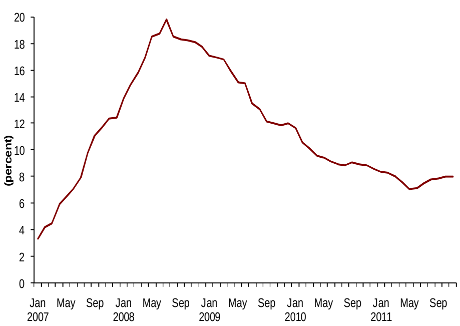


Finally, we do not expect the exchange rate to be a source of inflationary pressure. The dollar has retained its safe haven status owing to the liquidity, size and breadth of its capital markets despite a credit rating downgrade of the US earlier in the year. With the Eurozone problems set to linger, consensus forecasts are for a further slight strengthening of the dollar and therefore the riyal (see Exchange rates).

Inflation breakdown
(percent)

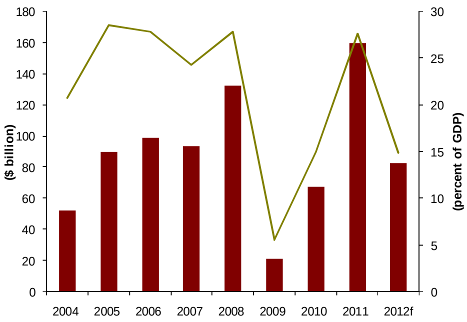
	2008	2009	2010	2011f	2012f
Foodstuffs & beverages	14.1	2.0	6.2	5.4	5.2
Fabrics, clothing & footwear	0.4	0.5	-0.7	0.0	1.2
Renovation, rent, fuel & water	17.5	14.1	9.5	7.8	6.5
Home furniture	7.7	8.5	2.8	0.4	4.0
Medical care	5.0	0.7	0.4	1.0	2.0
Transport & telecoms	0.2	1.0	1.1	2.1	2.5
Education & entertainment	2.1	1.3	0.9	1.4	3.0
Other expenses & services	10.7	4.3	7.4	8.6	3.2
Overall	**9.9**	**5.1**	**5.3**	**4.9**	**4.4**

Rental inflation

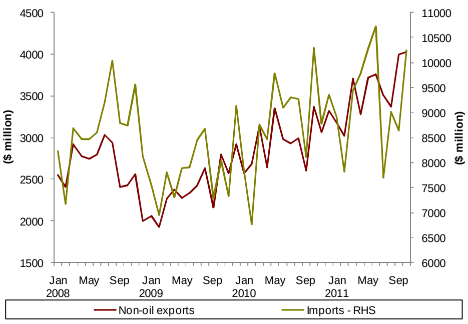


Rents have been the main source of inflation in the Kingdom for most of the past five years. They were surpassed by "other expenses and services" in 2011, but after being on a sustained downward trend since mid-2008, rental inflation picked up in the second half of the year. We think this is the result of the increase in consumers' disposable incomes raising demand for property and encouraging landlords to raise prices. At the same time, the provision of new property has so far not been sufficient to keep up with demand. Over 2012 we think that more housing will become available, though it will take longer before the government housing-building program announced in March 2011 delivers a significant number of units. It is therefore likely that rental inflation will ease, though it will remain fairly high and will resume its position as the largest single contributor to inflation in the Kingdom.

Current account balance



Non-oil exports and imports



Inflationary pressures elsewhere in the economy are stronger. High consumer spending, double-digit money supply growth, rising bank lending and exceptionally low interest rates will lift inflation in areas such as home furniture, education and entertainment, transport and telecoms and medical care. However this comes from a low base (inflation for these four sectors averaged 2.1 percent in November). Even if domestically generated inflation is above our forecast we do not see headline inflation getting to anywhere near the highs of 2008, as back then very strong domestic demand was accompanied by rapidly rising commodity prices, a falling dollar and global inflation much higher than today.

Current account

We expect a large fall in the current account surplus in 2012 because of lower oil export revenues. The surplus is forecast to decline to 14.9 percent of GDP from 27.6 percent of GDP in 2012. In dollar terms the surplus is expected to almost halve to $82.2 billion from the all-time high of $159.5 billion recorded in 2011. Imports should grow faster than non-oil exports. The invisibles balance, which consists of flows of remittances, incomes and payments and receipts for services, will stay in a large deficit.

Current account
($ billion)

	2008	2009	2010	2011f	2012f
Oil Exports	281.0	163.1	214.9	302.4	229.3
Other Exports	32.3	29.1	36.1	40.8	43.2
Imports	-100.6	-86.4	-96.7	-98.7	-110.5
Trade balance	212.0	105.2	154.3	244.5	162.1
Invisibles balance	**-79.7**	**-84.3**	**-87.0**	**-89.5**	**-89.9**
Current account balance	**132.3**	**21.0**	**67.0**	**159.5**	**82.2**
(percent of GDP)	27.8	5.6	15.0	27.6	14.9

Oil revenues constitute between 85 and 90 percent of total export revenue, so the decline in oil production and prices we are forecasting for 2012 will cause a substantial fall in total exports, though they are still forecast to be the second highest on record. Non-oil exports should rise modestly. Non-oil exports hit an all-time high of $4 billion in October, with petrochemicals accounting for one-third of the total. We do not expect much growth in petrochemicals revenue in 2012 as prices are likely to fall and the absence of new capacity coming on stream means there is little room to increase volumes. Exports of plastics and other downstream production should continue to benefit from high demand from Asia.

Import growth is expected to pick up as implementation of the housing construction and other government infrastructure programs lifts the demand for construction raw materials and machinery. High consumer spending will boost imports of household goods, vehicles and electronics. We therefore expect the trade surplus to fall to $162 billion in 2012 from $244 billion in 2011.

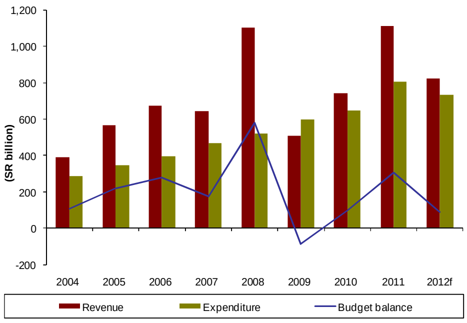
Remittances of foreign workers will remain the main source of outflows from the invisibles accounts. The huge amount of construction work will necessitate a continued inflow in foreign workers. Despite measures to increase the number of nationals in the private sector, we think that the total number of foreign workers will rise and their remittances will approach $30 billion in 2012. There will also be higher outflows to foreign companies providing construction and related services. As the economy expands, payments to foreign providers of other services, such as communications, insurance and financial, should also rise.

Returns on the government's investment portfolio are the main source of non-trade revenues. We expect a little growth in 2012, as the stock of foreign assets will rise further. The bulk of these revenues are invested in foreign government bonds, primarily US, and with global interest rates expected to remain very low, investment inflows will stay well below their total in 2008 and 2009. Receipts from foreign pilgrims, the other main source of non-trade revenues, should continue to grow given the expansion work underway in Mecca.

Fiscal policy

High government spending will continue to underpin the economy. The 2012 budget projects a surplus of SR12 billion, based on revenues of SR702 billion and expenditure of SR690 billion. This is the first year since 2008 that the Kingdom has budgeted for a surplus. Defense, education and healthcare remain the focus of government spending. Allocations for the house-building program are not included in the budget; the full SR250 billion financing for the program has been deposited into a special account at SAMA.

Budgetary performance



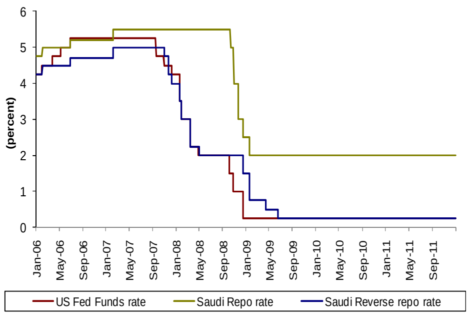
The budget highlights the government's intention to continue to stimulate the economy. Budgeted investment spending, raised slightly to an all-time high of SR265 billion, will support healthy economic growth and provide encouragement and opportunities for the private sector at a time of global and regional uncertainty. Budgeted spending is some way below the actual level in 2011. This is not a concern. It is normal for the government to exceed the spending projection outlined in the budget and therefore for the budgeted total to be below the actual total for the previous year. Furthermore, large one-time payments in 2011 distorted total spending that year.

The revenue projection is less conservative than in previous years. We estimate that a price of $69 per barrel for Saudi export crude (around $65 per barrel for WTI and $73 per barrel for Brent) and production of 8.8 million barrels per day are consistent with the revenue projection contained in the budget. We expect both revenues and expenditures to be above the budgeted level and forecast a budget surplus of SR91 billion. The oil price level necessary for revenues to balance our forecast level of government spending, the breakeven price, is $74 per barrel for Saudi export crude (equivalent to around $70 per barrel for WTI and $78 per barrel for Brent). In the event of a shortfall in revenues, any deficit can be financed comfortably by drawing from SAMA's huge stock of foreign assets, which stood at $519 billion at the end of October

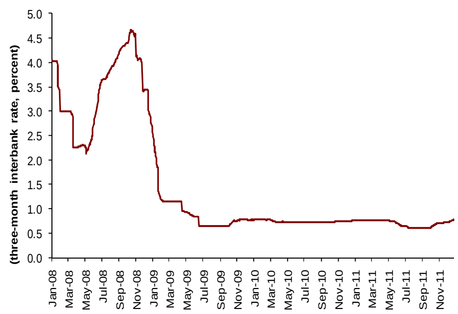
Monetary policy

Interest rates will remain exceptionally low in 2012. This will support the economy, though it will hinder the government should it need to tackle inflation. As a result of the exchange rate peg and the open capital account, interest rates in the Kingdom need to shadow those

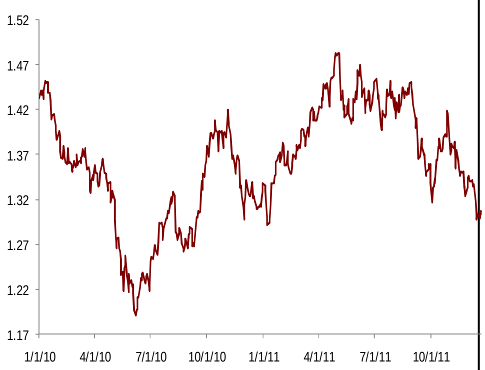
Interest rates



Interbank rate



Dollar/euro



in the US. Although the US economy is growing, it is still weak and unemployment is stubbornly high. In August the US Federal Reserve (central bank) said that it would not change interest rates for two years and the consensus among economists is that rates will not be increased until the second half of 2013. We therefore expect the Saudi repo and reverse repo rates to remain at 2 percent and 0.25 percent respectively in 2012.

Interbank rate interest rates are expected to rise. These are the rates at which banks lend to one another and provide the basis for much corporate borrowing. Bank nervousness over financial conditions, primarily in the Eurozone, has seen interbank rates rise across the world and until financial makers are comfortable with the Eurozone's plans for dealing with its problems, they will continue to go up. In the Kingdom, the three-month interbank rate has increased from an all-time low of 0.6 percent at the end of September to 0.74 percent in late December.

It is likely that other monetary policy tools would be used to contain any emerging inflationary pressures. There was active issuance of Treasury bills early in 2011 to mop up liquidity caused by the bonus for public-sector workers. A mooted sukuk by a government agency could also be used for liquidity management, if it is followed by regular issuance. Adjustments to bank reserve requirements and government deposits in the banking sector could also occur if inflation begins to take off. Finally, small changes to the repo and reverse repo rates independent of the US Fed are possible, with the reverse repo being the most likely target, but at present do not see this happening.

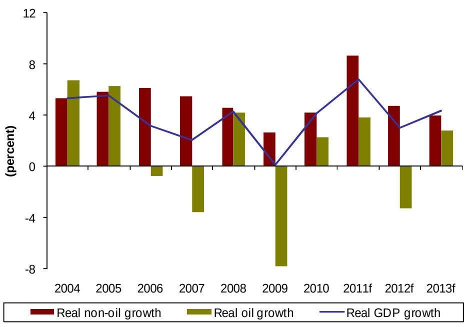
Exchange rates

The riyal will remain pegged to the US dollar. We do not expect any threats to the peg to emerge in 2012. The dollar should strengthen against most major currencies in 2012. It will benefit from its status as a safe haven and the liquidity, size and breadth of its capital markets at a time of ongoing uncertainty in the global economy, particularly in the Eurozone. Current consensus forecasts point to only a modest strengthening of the dollar, but there are several conceivable scenarios under which the euro will fall sharply. However, in the event that market concerns about the situation in the Eurozone diminish, the focus could shift to the troubling debt dynamics of the US, which would put downward pressure on the dollar.

The Eurozone is the largest single source of the Kingdom's imports, at 24 percent in 2010, so the anticipated weakness of the euro against the dollar will ease local inflationary pressure. Exchange rate movements against other currencies are unlikely to be a major source of inflation. Combined, emerging markets accounted for 46 percent of imports in 2010. It is likely that the dollar will decline against most emerging market currencies, though our assumption of high levels of global risk aversion and reasonable US economic performance means the decline will not be too great.

The problems in the Eurozone have made clear the importance of having an appropriate institutional framework for the proposed GCC common currency; in particular, the need for a formal system of budgetary transfers between countries and for a regional central

Real GDP growth



bank to have the authority to purchase the debt of member countries and provide all liquidity necessary. Agreeing to these measures will take strong cross-country support, which the single currency project has lacked in recent years. Countries in the region are watching very closely what happens in the Eurozone and future plans will be shaped heavily by the outcome of the current crisis. We do not expect serious steps toward GCC monetary union in 2012.

The outlook for 2013

Global economic growth will pick up modestly from 2012, but conditions will be far less benign than they were in the few years prior to the global financial crisis. The outlook for the US and EU will improve, though government austerity, banking sector caution, deleveraging and high unemployment will keep growth low. Emerging markets will continue to lead the way and will pull up oil demand. Oil supply is also forecast to be up, both from Opec and non-Opec producers. With the political situation in the Middle East stabilizing, we expect the risk premium on oil prices to fall, and as a result forecast that Saudi export crude will slip to an average of $86.5 per barrel (equivalent to around $84 per barrel for WTI and $88 per barrel for Brent).

An improving global economy and relatively high oil prices provide a reasonable environment for the Kingdom’s economy, but the activity will remain dependent primarily on very high government spending. Work on the housing program will accelerate and infrastructure improvement will continue. Real GDP growth is forecast to rise to 4.3 percent, with oil production expanding in response to higher global demand, and non-oil growth remaining close to 5 percent. Bank lending growth should be in line with 2012. Although interest rates are likely to rise, they will remain low on an historical basis and negative when adjusted for inflation.

With more of the planned supply of housing entering the market, we expect inflation to fall further, to an average of 4 percent. The improvement in the global economy is unlikely to be sufficient to lift global inflation or commodity prices, though it will probably cause a modest weakening of the dollar. Domestic inflationary pressure should lessen. Total oil revenues are expected to be lower than in 2012, with the fall in prices and rise in domestic consumption offsetting the increase in production. With both imports and government spending growing, we therefore expect the current account and budget surpluses to shrink; the budget is likely to be very close to a deficit. We do not foresee any change to the exchange rate peg to the dollar.

Key data

	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Nominal GDP									
(SR billion)	1182.5	1335.6	1442.6	1786.1	1412.6	1679.1	2163.0	2068.4	2122.3
($ billion)	315.3	356.2	384.7	476.3	376.7	447.8	576.8	551.6	566.0
(% change)	26.0	12.9	8.0	23.8	-20.9	18.9	28.8	-4.4	2.6
Real GDP (% change)									
Oil	6.2	-0.8	-3.6	4.2	-7.8	2.2	3.8	-3.3	2.8
Non-oil private sector	5.8	6.1	5.5	4.6	2.7	4.2	8.7	4.7	4.0
Government	4.0	3.1	3.0	3.7	5.2	6.3	6.7	6.7	6.7
Total	5.6	3.2	2.0	4.2	0.1	4.1	6.8	3.0	4.3
Oil indicators (average)									
WTI ($/b)	56.6	66.0	72.3	99.7	62.0	79.5	94.7	86.0	84.0
Saudi ($/b)	49.5	60.5	68.1	93.4	60.5	77.7	105.0	92.0	86.5
Production (million b/d)	9.4	9.2	8.8	9.2	8.2	8.2	9.3	8.8	9.0
Budgetary indicators (SR billion)									
Government revenue	564	674	643	1101	510	742	1110	824	784
Government expenditure	346	393	466	520	596	645	804	733	770
Budget balance	218	280	177	581	-87	97	306	91	14
(% GDP)	18.4	21.0	12.2	32.5	-6.1	5.8	14.1	4.4	0.7
Domestic debt	475	366	267	237	225	167	135.5	160	160
(% GDP)	40.2	27.4	18.5	13.3	15.9	9.9	6.3	7.7	7.5
Monetary indicators (average)									
Inflation (% change)	0.7	2.3	4.1	9.9	5.1	5.3	4.9	4.4	4.0
SAMA base lending rate (%, year	4.75	5.20	5.50	2.50	2.00	2.00	2.00	2.00	2.50
External trade indicators ($ billion)									
Oil export revenues	161.6	188.2	205.3	281.0	163.1	214.9	302.4	229.3	201.4
Total export revenues	180.4	210.9	233.1	313.4	192.2	251.0	343.2	272.6	249.8
Imports	53.8	63.0	81.5	100.6	86.4	96.7	98.7	110.5	123.8
Trade balance	126.6	147.8	151.6	212.7	105.8	154.3	244.5	162.1	126.0
Current account balance	90.0	98.9	93.3	132.3	21.0	67.0	159.5	82.2	42.9
(% GDP)	28.5	27.8	24.3	27.8	5.6	15.0	27.6	14.9	7.6
Official foreign assets	195.5	273.4	359.8	502.0	474.2	520.3	634.8	695.3	728.3
Social and demographic									
Population (million)	23.4	24.1	24.8	25.5	26.3	27.1	27.9	28.8	29.7
Unemployment (male, 15+, %)	11.5	12.0	11.0	9.8	10.5	10.2	11.0	10.5	9.4
GDP per capita ($)	13503	14806	15523	18651	14311	16500	20650	19151	19066

Sources: Jadwa forecasts for 2011 and 2013. 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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