Quarterly GDP update:
Manufacturing and oil lead growth in Q1

Real GDP growth
(percent)

	Quarterly change	Annual change
2014-Q1	3.7	4.7
2013-Q4	3.7	3.8

Comparative economic growth
(2014-Q1, year-on-year change)

For comments and queries please contact:
Fahad Alturki
Head of Research
falturki@jadwa.com

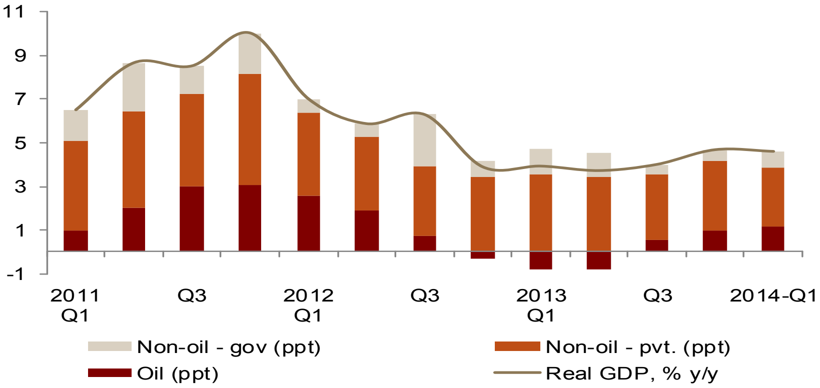
Head office:
Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

- In real terms, the Saudi economy was 4.7 percent larger in the first quarter of 2014 than in the same quarter of 2013.
- Growth was unchanged compared to the previous quarter and was more dependent on the oil sector.
- We assume that year-on-year economic growth will ease further in the second quarter owing to seasonal factors and lower annual growth in oil production.

The Central Department of Statistics and Information (CDSI) has released GDP data for the first quarter this year showing an improvement in real economic growth to 4.7 percent year-on-year compared with 3.8 percent in the first quarter of 2013 (Figures 1 and 2). Growth was unchanged compared to the previous quarter and was more dependent on the oil sector as structural changes in the labor market continued to affect the non-oil economy. The contribution of the oil sector improved to 1.1 percentage point of the overall economic growth in the first quarter, the largest in almost two years. The non-oil sector, however, recorded its slowest annual growth since such data was published in 2010, though it still remains robust at 4.4 percent year-on-year. The deceleration was mainly due to a moderation in the non-oil private sector which also recorded its slowest quarterly growth for which data is available. The slower growth was observed in the construction, wholesale & retail trade and transport, storage & communication subsectors.

The **oil sector** grew by 5.8 percent (Figures 2 and 4), the highest quarterly reading in almost two years. Oil production is the central driver of the performance of the oil sector. Oil output rose by 6 percent over the same period to 9.7 million barrel per day. Looking forward, we think the contribution of the oil sector to the overall

Figure 1: Flat growth rate, but different composition



At 4.7 percent, real economic growth was unchanged compared to previous quarter...

...though the composition of growth have shifted...

...with manufacturing and hydrocarbon sectors recording the highest growth.

Elevated demand on government services maintained a strong public sector growth.

The non-oil private sector expanded at a slower pace…

...but remained robust at 4.4 percent.

Non-refining manufacturing grew at an accelerated pace of 6.3 percent.

economic growth is likely to shrink slightly as the large base effects of the summer months starts to affect annual growth.

Non-oil GDP growth expanded by 4.4 percent year-on-year compared with 4.8 percent in the previous quarter and 6 percent in the same period last year. Within the non-oil sector, the **government sector** expanded by 4.1 percent year-on-year, almost double its growth in the previous two quarters. Most of this growth was sourced from higher government services which expanded by 3.5 percent year-on-year during the same period. The contribution of government services to overall economic growth is likely to decline due to larger base effect in the next quarter before picking up again toward the end of the year. We still maintain our view that labor market reform and enforcement of labor law will maintain an elevated demand for government services.

At annual growth rate of 4.4 percent, the **non-oil private sector** remained the main contributor to overall economic growth, despite the decline in growth from 5.7 percent in the previous quarter and 5.9 percent in the same period last year. According to official data, we calculate that the sector contributed 57.8 percent of the annual growth in the first quarter of this year. Despite slower growth, we expect the private sector to maintain the current level of growth supported by strong domestic demand, rising bank lending and public sector investment.

While all sectors registered a positive year-on-year growth in the first quarter, their performance varies (Figures 2, 3 and 5). **Manufacturing** was the fastest growing private sector in the first quarter, rising by 6.5 percent, driven by a 6.3 percent increase in non - refining manufacturing. In real terms, the latter accounts for 88 percent of the manufacturing sector and its growth rate is heavily

Figure 2: GDP growth composition

	Percentage change (q/q)				Percentage change (y/y)			
	2013	2013	Q1-14		2013	2013	Q1-14	
	Q1	Q4	q/q	Contribution (ppt)	Q1	Q4	y/y	Contribution (ppt)
Oil Sector	-2.2	-1.5	-1.1	-0.2	-3.7	4.6	5.8	1.1
Non-Oil Sector	5.8	2.3	5.4	4.2	6.0	4.8	4.4	3.5
Private Sector	12.4	0.7	11.0	6.3	5.9	5.7	4.4	2.7
Government Sector	-11.5	7.1	-10.0	-2.1	6.5	2.3	4.1	0.8
By sector								
Agriculture	22.7	-9.4	24.0	0.7	0.8	0.8	1.9	0.1
Mining and quarrying	-1.1	-1.5	-0.8	-0.2	-3.7	5.1	5.5	1.0
Of which: crude petroleum & natural gas	-1.8	-1.2	-1.4	-0.3	-3.9	5.2	5.6	1.0
Manufacturing	9.5	1.9	11.7	1.5	4.8	4.5	6.5	0.9
Electricity, gas and water	-18.3	-31.0	-17.9	-0.4	1.6	1.4	1.9	0.0
Construction	16.1	-1.6	12.5	0.9	9.0	8.9	5.6	0.4
Wholesale & retail trade	12.1	8.9	10.1	1.3	6.0	5.8	3.8	0.5
Transport & communication	11.0	8.7	9.0	0.9	6.3	7.8	6.0	0.6
Finance	12.8	-0.7	11.2	1.5	5.6	5.0	3.5	0.5
Personal services	6.8	-2.4	5.8	0.2	5.0	2.8	1.8	0.1
Government services	-17.4	7.9	-15.4	-2.5	6.8	1.1	3.5	0.5
Real GDP	**3.7**	**1.6**	**3.7**	**3.7**	**3.8**	**4.7**	**4.7**	**4.7**

The contribution of crude petroleum and natural gas manufacturing is set to increase as refining complexes reach full capacity.

influenced by the production of petrochemicals, plastics and related products and greater output of construction materials. Crude petroleum and natural gas manufacturing expanded by 7.8 percent, which is heavily influenced by the oil sector. We expect the contribution of the petroleum refining to overall economic growth to gradually increase as the country expands its refining capacity over the next few years.

As expected, changes in labor market pushed down the growth of some leading sectors to two year lows…

...though their growth remained strong.

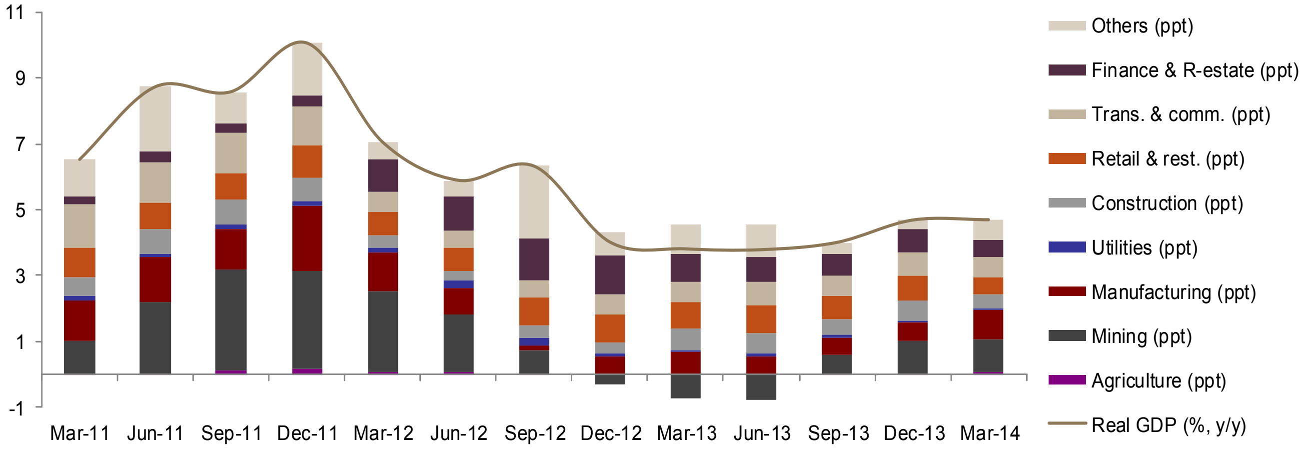
As expected, year-on-year growth in **construction and wholesale and retail trade and transport and communication** all dropped to their lowest levels in two years. In all cases however, growth was still robust, at 5.6 percent, 3.8 percent and 6 percent respectively. While the slower growth can be attributed to structural changes in the labor market, the robust growth is a direct result of the massive resources and investments that are active in each of these sectors. We maintain our view that while the growth in these three sectors is likely to gradually slowdown over the coming quarters, they will still remain among the fastest growing sectors in the Kingdom. The construction sector will remain the prime beneficiary of massive investments in building infrastructure, commercial and increasingly residential projects. The retail sector is likely to maintain a robust growth over the coming quarters as indicated by the solid domestic consumption demand. Transport growth stems from the need to move a high volume of goods around the Kingdom (both imports and construction materials).

In quarter-on-quarter terms, the economy expanded by 3.7 percent…

...with most non-oil sectors recording double digit growth.

In quarter-on-quarter terms, the economy expanded by 3.7 percent compared with 1.6 percent in the previous quarter. Most of this growth was generated by the non-oil private sector which expanded by 11 percent, while both the oil and government sectors shrunk by 1.1 percent and 10 percent respectively. Three sectors recorded large quarterly drops in output in the first quarter. The first was utilities (down by 17.9 percent quarter-on-quarter), which reflects the drop in residential and commercial power demand due to much lower use of air conditioning. The second was government services (down by 15.4 percent quarter-on-quarter) reflecting a seasonal trend. The third was the oil sector (down by 1.1 percent quarter-on-quarter) as oil production fell compared to the last three months of last year. For most other sectors of the economy, quarterly output recorded double digit growth, again due to seasonal factor, the impact of Eid al-Adha, which in recent years has fallen in the fourth quarter.

Figure 3: Sectoral contribution to real GDP growth



We assume that year-on-year economic growth will ease further in the second quarter…

...owing to both seasonal factors as well as lower growth in oil production...

...but other sectors of the economy will benefit from solid local fundamentals.

We expect the year-on-year economic growth will ease further in the second quarter. In addition to much lower growth in oil production (1.5 percent year-on-year in the second quarter), the new norm for the domestic labor market will maintain its negative impact on annual growth of the next two quarters. Nonetheless, we expect both government and private sectors to maintain their solid performance which will maintain a healthy economic performance. Year-on-year growth in bank lending remained at double digit for almost two consecutive years (Figure 6) and business surveys point to expanding private sector (Figure 7). With solid local fundamentals, but considerable uncertainty over regional instability, we maintain our forecast for total real GDP growth for 2014 at 3.8 percent with risks tilted toward the upside if oil production remains elevated for the rest of the year.

Figure 4: Oil production and real oil GDP
(year-on-year)

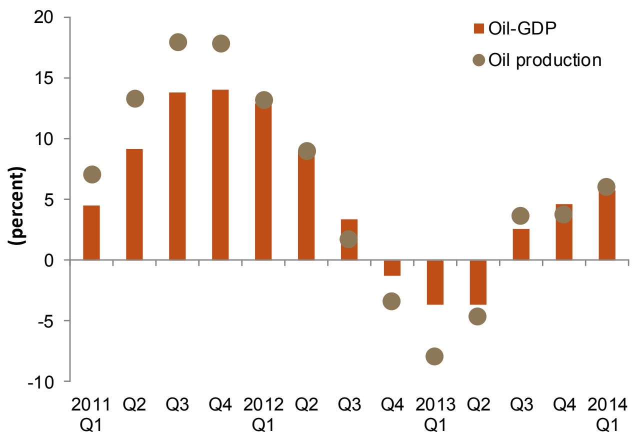


Figure 5: Quarterly real GDP growth
(year-on-year)

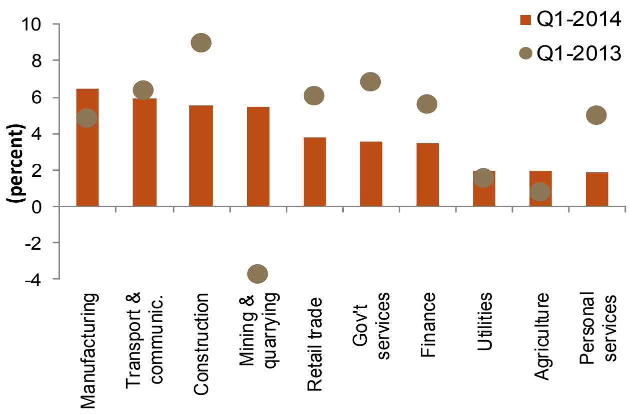


Figure 6: Credit to private sector

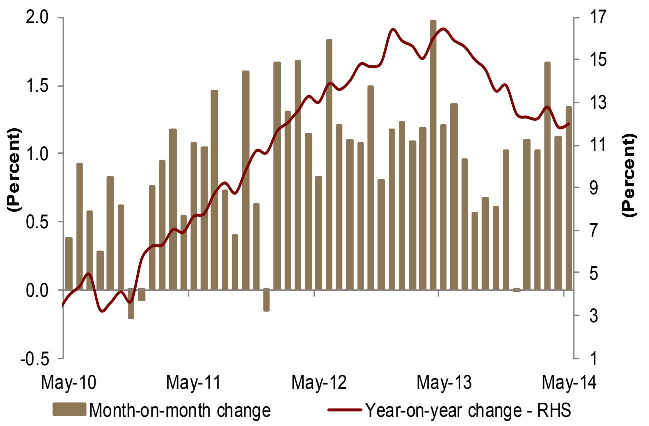
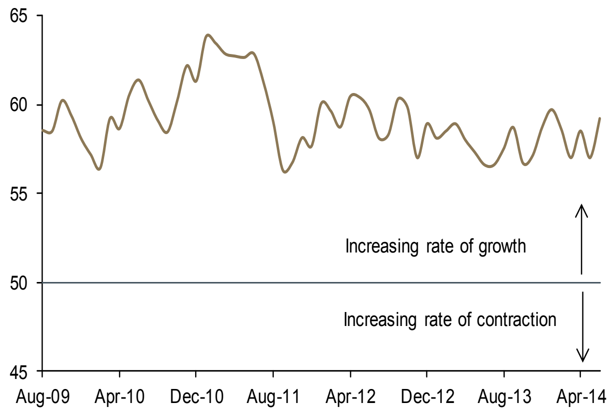


Figure 7: Purchasing Manager Index



Disclaimer of Liability