

Looking Ahead



Summary

In 2006 the Saudi economy witnessed a healthy expansion, albeit at a slower rate than in 2005. Real GDP grew by 4.2% (against 6.5% in 2005) and nominal GDP grew by 12.4% (against 23.6% in 2005), reaching SR1,301 billion (bn) (\$346.9 bn). This year the economy will witness strong non-oil private sector growth but will continue to witness a slow down in real GDP due to cuts in oil production. For 2007, we forecast real GDP to increase by 3.7% on the back of rising inflation. We also expect non-oil private sector growth of at least 6%, despite the adverse impact of the collapse of the local equity market, and government spending to rise by around 5%. Fiscally the Kingdom is very healthy and spending discipline is well maintained.

However, people now tend to feel less wealthy and that has taken its toll on consumer spending. The worst the economy has witnessed in terms of macro-economic aftershocks are abating but it is of vital importance to recognise the effects of the stock market decline on the consumer in areas such as household indebtedness and spending patterns. Consumer optimism is slowly rising but it hinges on the performance of the stock market. Despite the overall situation arising from the fall in the stock market we remain very optimistic about the growth prospects for the Kingdom's economy over the next five to seven years. The main ingredients supporting strong growth in the Kingdom are high oil revenues, high domestic demand from government and private sector non-oil expansion.

The severity of the stock market correction the country witnessed should have brought the economy to its knees but this did not happen. The economy has been experiencing high growth rates, tantamount to a boom, since 2003 and this cushioned the economy against a severe downside. In fact, all of the regional economies weathered their respective market downturns remarkably well. All currencies held their ground, banks were far from crisis point and, on the macro-economic level, all the regional economies look healthy. However, we do continue to be vigilant on consumer behaviour as consumption is an important contributor to growth.

Whilst the economy continues to expand, prices in Saudi Arabia are beginning to show signs of a significant short-term rise. Inflation has been widely discussed by consumers and businessmen alike over the past months. The causes of inflation are misleading as the view that is strongly held in the minds of both consumers and corporate managements is that a weak dollar will lead to the higher cost of imported goods, i.e. "imported inflation." Contrary to the popular view we believe that the inflationary pressures witnessed over the past 10 months are domestically-generated and not imported. Imported inflation could become a factor, as it did in past years, if the dollar weakens further and importers decide to pass the higher cost of imports on to the consumer.

Another topic of interest over the past few months, more so among businesses, has been speculation about the possible revaluation of the Saudi riyal. We believe that a revaluation of the riyal will make imports cheaper but at the same time will complicate the non-oil export diversification programme as export costs rise. The revaluation of the currency is a remedy for fighting high imported inflation but it is not an appropriate tool in the present environment in the Kingdom.

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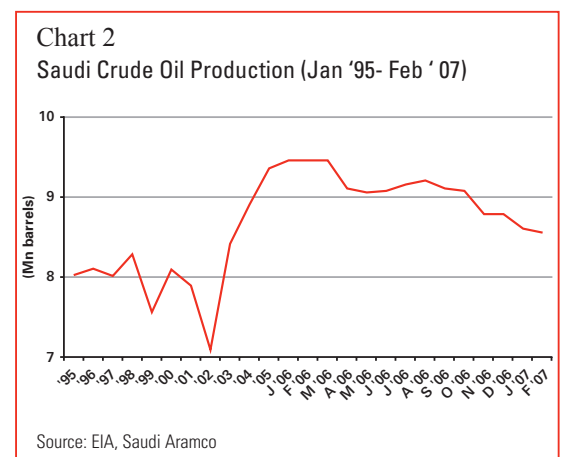
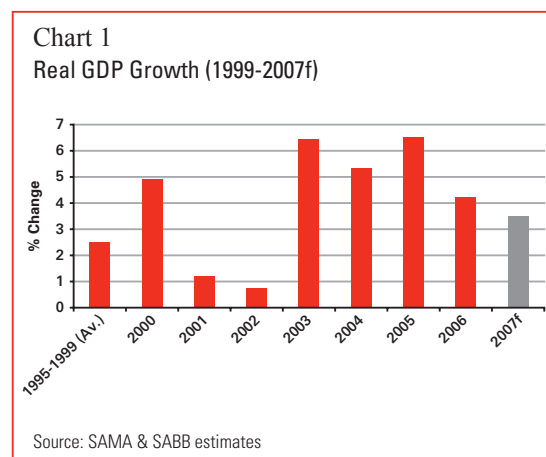
Macro Economic Landscape

Real GDP will reach 3.7% on the back of anticipated minimal oil output increases in 2007.

Saudi Arabia's economy will continue to grow at a healthy pace despite the deceleration it will yet again witness this year. We estimate nominal GDP to decline from SR 1,304.6 bn (\$347 bn) in 2006 to SR 1,275 bn (\$340 bn) in 2007, a 2.2% reduction. Real GDP will reach 3.7% on the back of anticipated minimal oil output increases in 2007. A 3.7% real GDP growth is not negligible. Placed in a regional context, the economy's real GDP growth forecast for 2007 will be double the size of Bahrain's economy. If Saudi Arabia increases its oil output real GDP will rise above our forecast. We estimate that an increase in the Kingdom's oil production of 5% will see an increase of around 1.8% in real GDP (see chart 1).¹

Growth

Real GDP growth for 2006 was below our forecast expectations of 5.1%. We attribute the decline in real GDP to a fall in Saudi oil production, according to government data from 9.5 million barrels a day (mb/d) to 8.55 mb/d between August 2006 and March 2007, as well as subdued consumer spending, which is apparent from the available published data (see chart 2).



¹ A change in oil products affects real GDP growth whereas a change in prices affects nominal GDP growth. Saudi Arabia's nominal GDP cannot be used as an indicator of actual growth nor is it correct in terms of comparative growth with other countries. If we want to do cross-country comparative work we cannot use nominal GDP, we have to use real GDP. If we want to examine long-term growth patterns and assess an economy's ability in generating employment through non-oil private sector growth then we have to use real GDP as an output indicator.

The 'wealth effect' that caused a consumer frenzy in 2005 made many consumers feel more spending cautious in 2006.

Growth in 2007 will be derived from the non-oil private sector as well as government spending.

Real non-oil private sector growth was 6.3%, down from 6.5% in 2005, effectively a drop of 3.2%. A substantial 19.2% fall in wholesale, retail, restaurants and hotels in 2006 was witnessed as was a 33.3% fall in activity in the insurance, real estate, business service and finance sectors. We believe these declines illustrate reduced consumer spending associated with the stock market collapse.² From the market's high (20,966) in February 2006 to the market's low (6,767) at the end of January 2007 the market had shed around 68% of its index value. The 'wealth effect' that caused a consumer frenzy in 2005 made many consumers feel more spending cautious in 2006. The volatility of the stock market does not offer consolation to consumers. The market between February and mid-March rose by more than 28% and during the last eight trading days of March had lost more than 15% of its value.³ Certainly, the macroeconomic effects associated with such a severe reversal in most equity markets was absent from Saudi Arabia, with no inter-related currency or banking crisis of any sort. Economic history shows that the main factor that has pushed stock market crashes into deep recessions in the past was financial weakness. Virtually every severe recession in U.S. history before World War II involved banking panics and severe financial distress. This was also the case for the U.K. in the first two-thirds of the 19th Century. Despite the market collapse the Saudi economy is not entering into a recession.

Moreover, had the Saudi economy slowed down, as it had throughout the 1990s, due to a substantial fall in oil prices, the stock market correction would

have been more deeply felt and would have lasted longer. Empirical evidence (1959-2002) from G-7 countries suggests that on average one crash occurred every 13 years, lasted for 2.5 years and was associated with GDP losses of about 4%. In the case of the U.S. and the U.K. more than half the crashes were associated with recessions, five in the U.K. and nine in the U.S. Linkages between equity and housing prices are of great significance, as equity wealth leads in most cases to increased demand for housing, pushing housing prices up. Evidence from the G-7 sample shows that half of all housing price falls partly overlapped with equity price crashes, while only one-third of all equity price declines overlapped with housing price collapses. Housing price decreases in the same group of countries (1970-2002) were less frequent than equity crashes, one every 20 years, but lasted for 5 years with a GDP loss of around 8%. Of additional note is the fact that a housing collapse creates a sharper fall in consumption and real private gross fixed capital formation in machinery and equipment.

Growth in 2007 will be derived from the non-oil private sector as well as government spending. Corporate growth will be strong on the back of a very respectable year. Net income was up by 19.1% in 2006, albeit down from the 40.1% seen in 2005. Leading this growth will be the construction sector, as fixed capital expenditure continues to grow and the government continues to build large infrastructure projects. We estimate there is more than SR 225 bn (\$60 bn) worth of construction projects underway in the Kingdom and that as construction

² The IMF definition of a stock market collapse is an equity drop greater than 37%.

³ The impetus for the end of March drop was the geopolitical risk associated with Iran.

demand continues to increase an obvious beneficiary will be the cement sector. The eight listed cement companies in the Kingdom have been operating at over 100% capacity utilisation rates for the last two years. The near-doubling of capacity that should be coming on stream in stages by 2008 allied to the plants for which industrial licenses have been issued would raise productive capacity to about 40 mtpy (at the moment Saudi Arabia produces close to 24 mtpy), and involve investment of over SR 18 bn. Looking to the future there could be an over-supply of cement within the entire region that could stir added competition, with the possibility that yet further competition will eventually come from India and China (at the moment China's cement capacity increases by 100 mtpy).

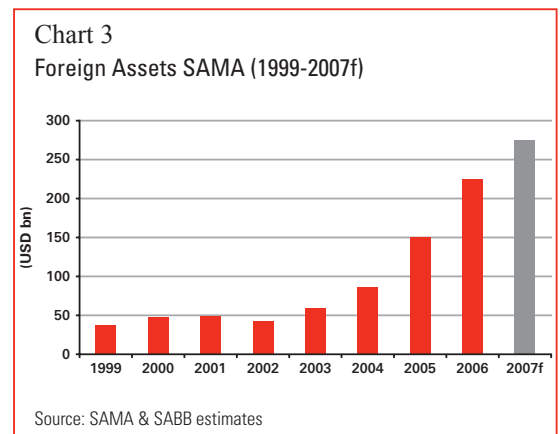
SAMA's total foreign assets will reach SR 1,028 bn (\$274 bn) by the end of 2007 which is 80.6% of GDP.

The financial services sector continues to grow and 49 investment banking licenses were granted as of January 2007.⁴ At the end of 2005, 10 international banks (six have started operations) were awarded full banking licenses by SAMA. Several other banks desire to set up operations but the licensing of additional foreign banks has been put on hold so that SAMA can assess the impact of the new entrants. This decision does not contravene the WTO accords.

Saudi Arabia's import cover is close to 42 months.

Foreign Assets and Government Debt

Compared with previous oil booms, Saudi Arabia is demonstrating impressive fiscal discipline. The Kingdom continues to build liquidity through external reserves such that in December 2006 foreign assets had reached SR 842 bn (\$224.6 bn). We forecast SAMA's total foreign assets will reach SR 1,028 bn (\$274 bn) by the end of 2007 which is 80.6% of GDP (see chart 3). Another SR 190 bn (\$50.6 bn) was held in 2006 as foreign assets by the pension funds. We expect pension funds' foreign assets to reach SR 201.7 bn (\$53.8 bn) through 2007. Hard currency reserves, which have consistently remained above \$19 bn since 2001, currently provide around 5 months worth of Saudi import cover. However, if hard currency reserves are added to overseas foreign assets Saudi Arabia's import cover is close to 42 months.



⁴ The following firms are licensed to conduct securities business in Saudi Arabia but not all firms are permitted to take part in the full spectrum of activities: HSBC Saudi Arabia, The Capital Group, BMG Financial Advisors Office, Financial Transaction House, Al Dukheil for Finance & Investment, Osool Capital Co, Saudi Swiss Securities, Team One, Swisscorp, Al Shemimry Advisory, EFG Hermes KSA, Audi Security Arabia, Al Tawfeek Financial Group, Ernst & Young Consulting, Falcom Investment Co, Al Albab, First for Financial Services, Al Khabeer Financial Advisors, Sadagah Financial Consultants, Al Mal Capital, Capital Advisory, Compass Consulting, Alpha Team, MEFIC, Forsah Investment, KSB Capital Group, Amoal for Security Advising, Jadwa Investment,, Al Wasatah Al Maliah Co, Rasmala Investments (KSA), Gulf Bureau, Naeem Investment Co, Assets Financial, House of Investment & Financial, Capital, Ithraa Capital, Saudi Pioneers Securities Co, Watan Investment & Securities Co, Aloula Geojit, NCB Capital Co, The Investor for Securities, Gulf Investment Co, Al Fransi Tadawul, Arab Co for Financial Paper, Portfolio Brokerage & Financial Services Co, Stock Market Consulting & Financial Services Co.

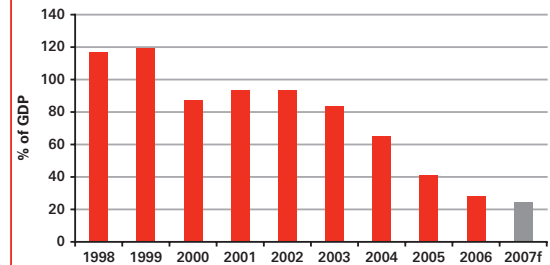
The size of the Kingdom's foreign assets compared to the size of its economy is enormous.

We expect government domestic debt to reach 24% of GDP by the current year end.

Should the currency come under pressure the government will be able to mobilise its foreign assets to defend the currency. The size of the Kingdom's foreign assets compared to the size of its economy is enormous. Although one cannot make a comparison in absolute terms between Saudi Arabia and China (China's foreign assets amounted to \$1 trillion at the end of 2006) the latter's foreign assets comprise only 37% of GDP. Also, foreign asset accumulation brings out the seminal role of high oil revenues as a cornerstone of economic well-being. We do not share the view with some analysts who regard the growth of financial assets as unproductive investment and call for the return of the money to Saudi Arabia. Such a move would prove unsound given the current inflationary pressures witnessed in the country. Adding more money to the system will only lead to more upward price pressures which could be detrimental. Accumulating an added cushion, foreign assets, in times of a windfall does offer protection to the economy when and if oil prices fluctuate downward.

The government will continue to use part of its surplus to pay down domestic government debt. This demonstrates government firmness in adjusting the fiscal imbalances and low oil prices of the past. According to the Ministry of Finance, public debt was expected to drop from SR 475 bn (\$126.6 bn) in 2005 to SR 366 bn (\$97.6 bn) in 2006, accounting for 28% of GDP in the latter year (see chart 4).

Chart 4
Government Domestic Debt (% of GDP) (1998 - 2007f)



Source: Ministry of Finance & SABB estimates

The government has been using its fiscal surplus in the last few years to settle part of its outstanding public debt. As a result, the debt as a percentage of GDP declined precipitously from a high of 119% in 1999 to its current level, all of which is owed to local institutions. As of the 2006 year end, local banks held 31.18% of government debt in the form of government bonds. Most of the remaining debt is held by public institutions including GOSI (General Organisation for Social Insurance) and the Retirement Pensions Agency which the government intends to make them nearly debt free. This debt reduction policy will continue in the wake of the strong surplus expected to be generated by the government. We expect government domestic debt to reach 24% of GDP by the current year end, which is well below the 60% debt to GDP criterion set for GCC economic convergence. The government has stated publicly that it will continue to lower government debt. We believe that this is plausible, given the proper fiscal context is adhered to, as empirical evidence does not reveal optimum levels of debt for emerging economies that would suggest the opposite. Whilst liquidity remains high the government is unable to effect a reduction (by issuing new bonds) as it continues to pay off its debt and so issues very little new (mostly short-term) debt.

Fiscal Policy

Spending is on the increase but is kept under control. Revenues increased in 2006 as oil prices were 15% higher than in 2005. The average price of Saudi oil increased by 124% between 2003 and 2006. Although fiscal discipline is characteristic of the current boom in contrast to that in the 1970s there is one important difference that is often omitted: physical infrastructure. Saudi Arabia in the 1970s had inadequate infrastructure (paved roads, ports, airports) but the pace of spending at that time was fast and compressed in order to address this. For example, in the 1970s Saudi Arabia's cement needs were covered entirely by imports but demand could not keep up with the country's limited infrastructure. In the port of Jeddah, helicopters were often used to support the unloading of cement. During the height of the boom, docking in the port of Jeddah took more than 35 days. The present boom is more fiscally restrained in the light of current government priorities but is also due to the already existing infrastructure base.

Another expansionary budget was announced for 2007. In 2006, the budget surplus rose to a record high of SR 265 bn (\$ 70.6 bn) or 20.3% of GDP (see chart 5) which approximated to the combined 2006 GDP of Bahrain, Jordan and Qatar.

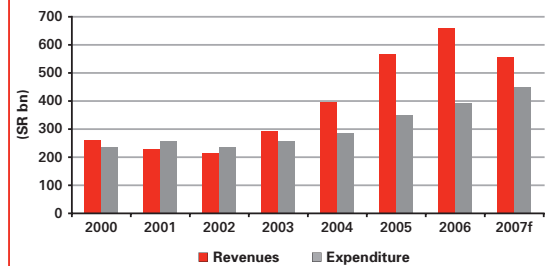
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We expect the surplus to decline to SR 129.45 bn (\$34.5 bn) for 2007 or 10.1% of GDP as oil earnings decline and strong spending growth is sustained. In 2006, fiscal revenue (around 90% being oil revenues) amounted to SR 655 bn (\$ 174.6 bn), which was 16.1% higher than in 2005, whilst spending is estimated to have increased by 12.7% to SR390 bn (\$104 bn), which surpassed the initial projection by 16%.

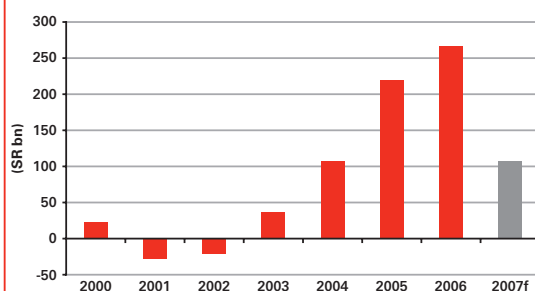
The 2007 budget envisages revenues of SR 400 bn (\$106.6 bn) and expenditure of SR 380 bn (\$101.3 bn), and thus a surplus of SR 20 bn (see chart 6).

Chart 6
Revenues & Expenditure (2000 - 2007f)



Source: Ministry of Finance

Chart 5
Government Budget Surplus (2000 - 2007f)



Source: Ministry of Finance & SABB estimates

Estimated revenue will reach SR 574 bn and expenditure will reach SR 444.6 bn.

Domestic inflationary pressures indicate that real growth in the budget will be lower than outlined.

In 2007, Infrastructure, education, health and technology, are slated to receive SR 140 bn, an 11% increase over the previous year.

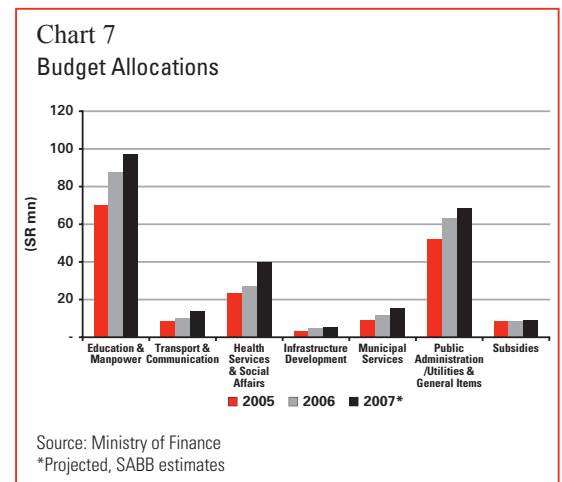
It is customary practice for the Saudi government to announce conservative budgets for both expected revenues and expenditure and thus we believe that budgeted revenue and expenditure will be outstripped once again this year, but with over-spending remaining at a conservative level. Estimated revenues will reach SR 574 bn (\$153 bn) and expenditure will reach SR 444.6 bn (\$118.5 bn). Actual revenues in 2006 were 68% higher than planned revenues. In addition, the Saudi budget is based on a conservative oil price, which we estimate at \$38 per barrel for 2007, whilst we expect Saudi oil to average \$53.5 per barrel over the year. Domestic inflationary pressures indicate that real growth in the budget will be lower than outlined. As more than 30% of the budget will be allocated to capital expenditure projects and as construction costs rise, the government might increase spending beyond our forecast in order to accommodate inflationary pressures.

In the 2007 budget some SR 40 bn of the surplus will be allocated to additional development projects, a practice that has taken shape since 2005. Besides the SR 100 bn which was earmarked for the government's reserves account, a capital increase of SR 20 bn for the Public Investment Fund (PIF) was outlined. Another SR 10 bn was slated for projects related to the two holy mosques. The PIF is one of five public-sector banks and funds that give concessionary loans to the private sector and invests in new companies.

The government continues to emphasise an increase in capital spending in areas such as infrastructure, education, health and technology, which in 2007 are slated to receive SR 140 bn, an 11% increase

over the previous year. Naturally, an increasing population puts added pressure on the average life of the physical infrastructure which, together with the inclement weather in the country, places additional pressure on the life-cycle of that infrastructure.

The government has proposed increased spending of nearly 11%, amounting to SR 96.7 bn, for education and manpower, including a 17% rise amounting to SR 29 bn for new capital projects (see chart 7).



The government continues to place special focus on general education, having attained a student-teacher ratio of 11:1 which is comparable to that of many developed countries. Some 2,000 new schools will be built, in addition to the 4,800 schools currently under construction, and another 2,000 will be rehabilitated. The 2007 budget has also mandated that four more universities, in Tabuk, Al Baha, Najran and Riyadh, the latter for girls, will be opened additional to the 14 universities already operating in the Kingdom. A new university hospital, in addition to the five university hospitals now under construction, will also be built.

Furthermore, 56 colleges will be constructed and 33 technical and vocational colleges will be opened.

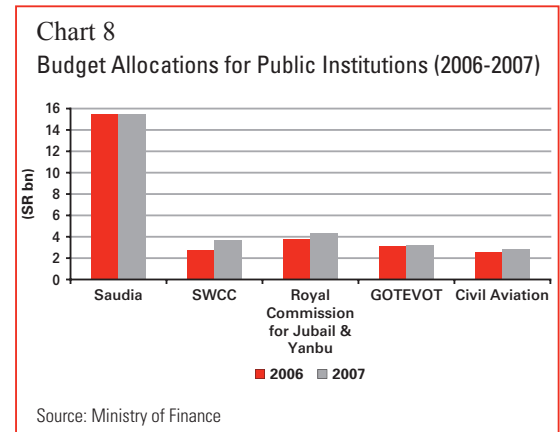
Health spending is on the increase as the demand for healthcare continues to rise. The Kingdom's healthcare system will face a grave challenge in the coming decade and a half as chronic illnesses rise exponentially. Health and social affairs will see a 27% increase in spending for 2007 totalling SR 39.5 bn, including SR 5.6 bn in capital expenditure. Projects include 13 new hospitals and 380 primary care centres. Currently, 89 hospitals are under construction with a capacity of 10,650 beds. Municipal services will witness a 33.6% increase in spending totalling SR 15.5 bn, of which SR 11.1 bn is new capital spending, as flyovers and road improvements are much needed given the increase in traffic throughout the main cities of the Kingdom. Transportation and telecommunications are slated to receive SR 13.6 bn, a 38.7% increase. New projects include roads totalling 8,000 km to be added to 16,000 km of roads under construction. Last but not least, water, agriculture and infrastructure are to receive SR 24.8 bn, SR 21.7 bn for capital spending, an increase of 10.2%, which will go toward upgrading the much needed sewage systems in many parts of the country, especially Jeddah, as well as various water and desalination projects.

Saudi Arabian Airlines (Saudia), the national air carrier, received the single largest budgetary appropriation (SR 15.6 bn) in the 2007 budget. However, the company's budget on a year-on-year basis fell by -0.2% as it is undergoing major restructuring in preparation for its eventual privatisation.

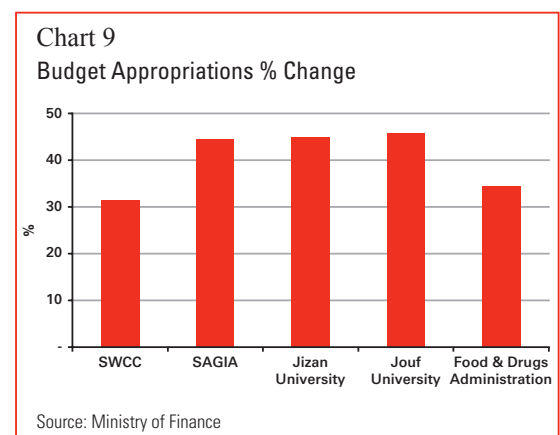
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The Royal Commission for Jubail and Yanbu (SR 4.5 bn) along with the Saline Water Conversion Corporation (SR 3.9 bn) and the General Organization for Technical Education and Vocational Training (GOTEVOT, SR 3.4 bn) were among the other largest recipients of state appropriations. (see chart 8).



Jouf and Jizan universities along with the Saudi Arabian General Investment Authority (SAGIA) witnessed the largest annual percentage increases in their budgets (see chart 9).

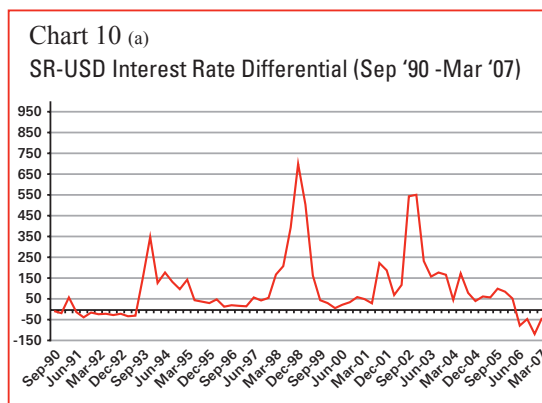


Interest Rates and Money Supply

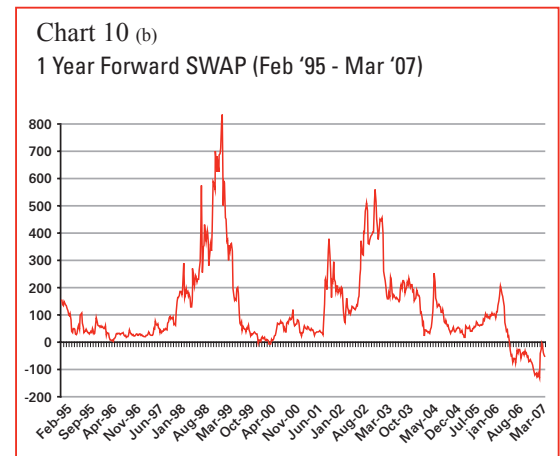
At one point, one year forward tenors reached spreads of negative 150 which indicated high market liquidity.

In early February, SAMA raised interest rates in a move that took everyone by surprise. Rates were hiked by 30 basis points to 5.50% to restore a 25 basis point premium to U.S. rates that had traditionally been in place in order to prevent capital outflows as well as to offset the higher risk of the Saudi stock market for investors. The inter-bank interest rate for three months SIBOR continued to stand below LIBOR, a practice adhered to since March 2006. Prior to March 2006, 3 month LIBOR was below SIBOR since September 11th 2001 (see chart 10a). Prior to the hike Saudi riyal rates were below those for the dollar, which made the latter more attractive. Investors borrowed in Saudi riyals and invested in dollars reaping a premium from the differential created.

The recent hike was motivated by a desire to take liquidity out from the market, something which was partially accomplished since forward tenors continue to be negative.



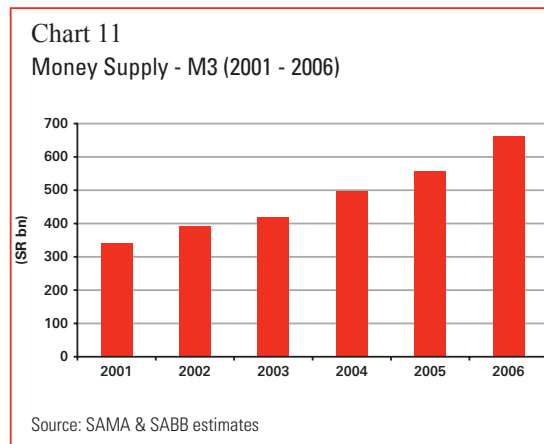
At one point, one year forward tenors reached spreads of negative 150 which indicated high market liquidity due to a rising government surplus and allowed the government to slow down the issuance of Saudi Government Development Bonds (see chart 10b).



As the market was correcting in 2006 rates remained unchanged so as to support the stock market. Downward stock market momentum was very strong and a favourable rate environment did nothing to stop the market from crashing. The recent hike was motivated by a desire to take liquidity out from the market, something which was partially accomplished since forward tenors continue to be negative. A second and more important reason is to try and contain inflationary pressures while the interest rates in the U.S. continue to hold their ground. Matters could get complicated in the event of falling interest rates in the U.S. and rising inflation in Saudi Arabia, which will necessitate following the path of U.S. interest rates due to the peg. If interest rates are kept high in Saudi Arabia and U.S. rates begin to fall, creating again an interest rate differential, investors will be enticed to buy riyals, driving up liquidity at a time when adherence to greater monetary containment is of primary concern. In short, there are no quick monetary fixes to combat inflation in a pegged currency regime.

Money supply in a pegged currency regime does not entirely lie in the hands of the authorities. Monetary policy in times of high government spending, which rose by 12.7% in 2006, as well as oil and non-oil private sector expansion is a challenge. In 2006 money supply (M3) grew by 19.3%, which outpaced the 11.6% growth witnessed during the previous year (see chart 11). As government spending continues to grow in 2007 M3 will grow, albeit at a slower pace when compared to 2006.

Monetary policy in times of high government spending, which rose by 12.7% in 2006, is a challenge.



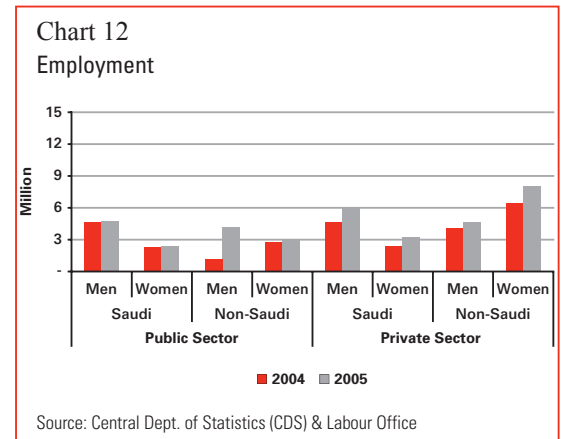
According to an official survey the unemployment rate was 9.1% for men and 26.3% for women.

As the stock market was sliding, renewed interest was seen in time and savings deposits and as a result they rose rapidly by nearly 40% in 2006 compared to a 21.3% increase in 2005. As preference for time deposits increased demand deposits (checking or current accounts) also rose by 11% in 2006. A shift away from time deposits can occur if the stock market picks up but the authorities will be vigilant about borrowing patterns. Although we attributed the growth in money supply to bank lending during 2004 and 2005 we believe now that government spending and capital expenditure related to the expansion plans in the oil (Saudi Aramco) and gas sectors to be

the main contributors. Bank lending (claims on the private sector) between 2003 and 2005 grew strongly by an average 38.12% whereas in 2006 it grew by only 9.2%.

Labour Market

According to an official survey carried out in May 2006, the Minister of Labour in November 2006 stated that the unemployment rate was 9.1% for men and 26.3% for women. According to the Central Department of Statistics (CDS), total unemployment in 2005 for Saudis was 6.9%. The rising unemployment figure reflects not job losses, but an increase in the number of Saudis assumed to be seeking work. According to SAMA, the total labour force (including expatriate workers) grew by 13.6% in 2005 (see chart 12).



Employment among Saudis in the private sector rose by an astounding 28.4% in 2005 compared with 2004, outstripping the growth of private-sector non-Saudi employment, which was also high at 13.8%. Moreover, employment among Saudi women rose by as much as 38%. Nevertheless, the same figures indicate that Saudis still account for only 22% of the total workforce. According to official

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statistics only 1.34 mn Saudis out of an estimated Saudi population of 16.85 mn were working; 53% of employed Saudis worked in the public sector, with women accounting for only 20.4% of the Saudi workforce. The increase in Saudi participation in the labour force, across genders, is indicative of the growing economy and the need to generate income among a very young population entering the labour market in large numbers. According to our estimates, in 2007 the number of Saudis under the age of 16 will be 8.35 mn (47.7% of the total Saudi population) and at least 25% of them will be entering the labour market in search of jobs over the next decade and a half.

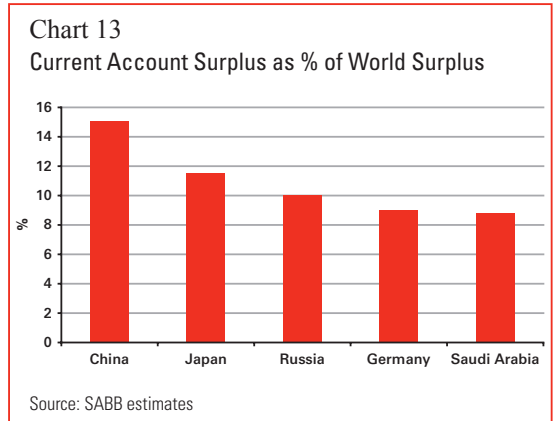
Foreign Trade

Economic theory instructs us that a temporary windfall gain will largely be saved, while a permanent windfall will largely be consumed. Is Saudi Arabia behaving as if oil prices will be permanent or temporary? It is too early to say that Saudi Arabia behaves as if high oil prices are permanent although government and private consumption has gone up whilst exuberant spending is still contained. This is encouraging because it creates fiscal discipline and increases saving rates, which means that oil revenue is not being spent on imports but is being accumulated as foreign assets, which grew by \$ 6.21 bn each month in 2006.

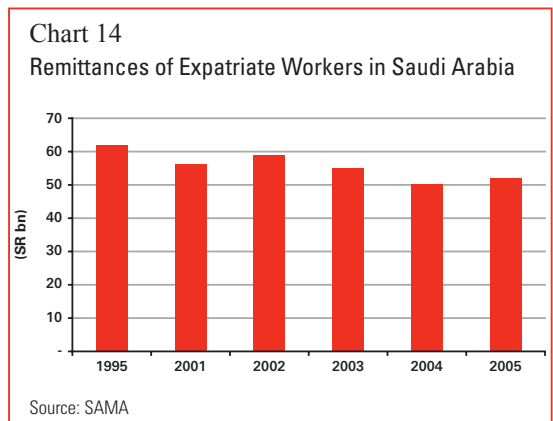
According to SAMA's preliminary data, the trade balance is estimated to record a surplus of SR 553.4 bn (\$148 bn) in 2006, an increase of 17.5%. The current account is estimated to record the highest surplus in the country's economic history, amounting to SR 358 bn (\$95.5 bn) in 2006 compared to SR 337.7 bn (\$90.05 bn) in 2005, an increase of 6%.

Saudi Arabia's current account surplus was 10% of the world surplus in 2006.

Saudi Arabia's current account surplus was 10% of the world surplus in 2006 and among the top five global surplus holders (see chart 13).



In 2007 we expect the current account surplus to reach SR 245 bn (\$65.3 bn) or 19.2% of GDP, a decline of 46.1%, which we attribute to the decrease in oil exports, increase in imports and service and income transfer (expatriate remittances) deficits. Remittances constitute a substantial source of leakage in the Kingdom's balance of payments. We estimate that in 2007 SR 58.1 bn will be remitted abroad compared to SR 52.4 bn remitted in 2005. Around 65%-70% goes to South Asia and the Philippines (see chart 14). After the U.S., Saudi Arabia is the second-biggest source of workers' remittances to developing countries.

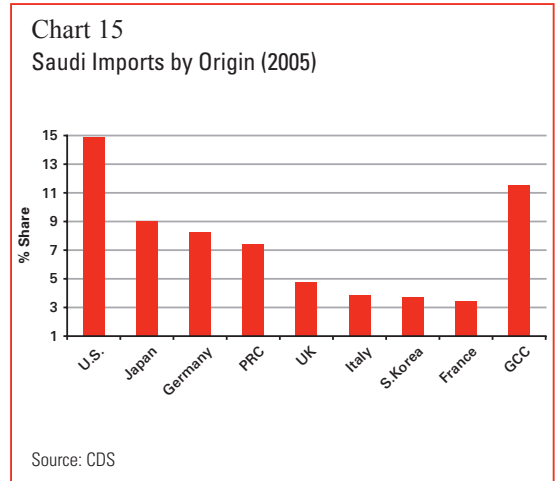


The fall in goods imports, over 2006, could be emblematic of the fall in consumption.

It is expected that a drop in the current account will release some of the upward pressure on the currency. The U.S. remained Saudi Arabia's top supplier with 14.8% of imports, followed by Japan and Germany. China, in fourth place, increased its share of the total to 7.4% from 6.6% in 2004. U.S. imports grew by 60% between 2003 and 2005 whereas Chinese imports rose by 104% over the same period. The growth in Chinese products is not a surprise, however, as we estimate that around 11% of the products exported from China into Saudi Arabia are from U.S. owned firms based in mainland China.

We estimate that goods imports in 2007 will rise by 15% to reach SR 280 bn.

According to the latest data, total imports of goods and services rose by 27.2%, to SR390 bn, of which SR243.7 bn was accounted for by goods imports up by 19.2% in 2006, which was lower than the 33% growth reported between 2004 and 2005 (see chart 15). The fall in goods imports, over 2006, could be emblematic of the fall in demand/consumption caused by the declining stock market rather than the conventional view of depreciating real effective exchange rates (see discussion below). It could also be that certain goods much needed to support the boom such as machines and equipment were already imported in 2005. In 2007, we expect imports to grow by 15%, reaching SR 281.2 bn, as capital expenditure continues to develop on the back of strong government spending.

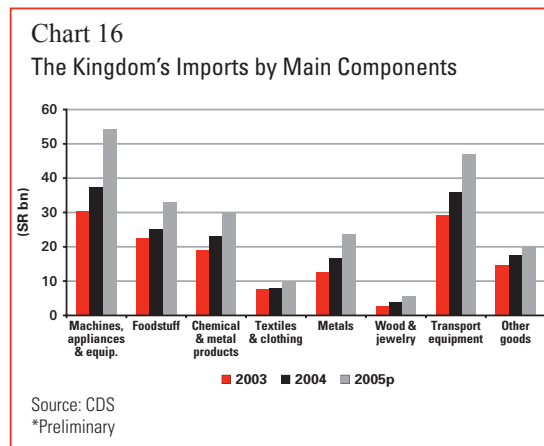


Imports of machinery, appliances and equipment, which constitute the largest single import item, rose particularly rapidly, with a year-on-year increase of 46%. The decline in goods imported is not easily discernible but it could very well be that imports cannot be sustained at the same pace. Another reason could be that goods imports were lower than expected due to a slow down in consumer spending. We estimate that goods imports in 2007 will rise by 15% to reach SR 280 bn. In many ways, the 2006 import data act as proof to those who saw change in the Kingdom's import regime post-WTO. A common fear held prior to the Kingdom's entry into the WTO was that, on accession, the country would be flooded by imports

and that agency agreements would be cancelled. In fact, we have only discovered one major agency transfer post-WTO accession and that was facilitated by the liberalisation of the agency regulatory regime (see chart 16).

Foreign investment in distribution services, wholesale and retail trade including medical retail services, private pharmacies and commercial agencies, except franchise rights is now permitted.

In late March 2007, the negative list of investment was revised to comply with Saudi Arabia's WTO commitments. Foreign investment in distribution services, wholesale and retail trade including medical retail services, private pharmacies and commercial agencies, except franchise rights is now permitted.⁵ The revision of the negative list was a procedural matter since the wholesale and retail sector underwent restructuring upon the Kingdom's WTO accession. Upon accession, foreign companies can hold 51% of the equity in a wholesale or retail distribution business and by December 2008, the maximum foreign equity stake increases to 75%. The already competitive pharmacy sector will now open up to foreign competition which will be a boon for consumers. Finally, upon accession foreign companies can become their own agents in the Kingdom or establish partnerships with local businessmen to distribute their goods. We do not envisage dramatic changes in the company/agent agreements to take place. What will bring needed customer service and agent care is greater regional competition and a functional GCC customs union.



⁵ Foreigners can establish a franchise in Saudi Arabia and own 51% of a company's equity. Three years from the date of accession the maximum equity stake can increase to 75%.

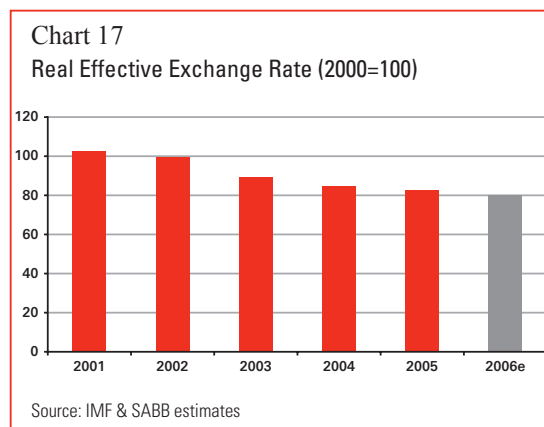
The cause of price rises was not so much due to 'imported inflation' as to other factors.

In 2006, we estimate that petrochemical products comprised around 36% of all non-oil exports.

In 2006 we are expecting non-oil exports of goods to have grown by 10.8% amounting to SR 79 bn (\$21 bn), representing 10.1% of total goods exported. In fact, non-oil exports have been rising over the past several years, partly due to the depreciation of the U.S. dollar. The index of the Real Effective Exchange Rate (REER) declined by 20.24% between 2002-2005 reflecting the movement of the U.S. dollar against other major currencies (see chart 17). The depreciation of the REER during 2006 was not as poignant as before, hence supporting our view that at least during 2006 the cause of price rises was not so much due to 'imported inflation' as to other factors.

A decline in the REER indicates that there was an improvement in the competitive position of Saudi Arabia with its trading partners over the past few years. Thus, the "Dutch disease," where the non-oil export sector gets crowded out by the oil and non-traded goods sectors, which characterized the oil booms of the 1970s, has not yet materialized with the current increase in oil prices and oil wealth.⁶

Although itemised export data have not been published for 2006, we estimate that petrochemical products comprised around 36% of all non-oil exports and anticipate petrochemical exports will grow further given there are no upward pressures on the riyal (revaluation), making exports more costly, hence less competitive in the international market place. Saudi Arabia has plans to increase its petrochemical production and become a leader in the world petrochemical market. According to SABIC, Saudi petrochemicals' output is expected to rise from 40mn MT/year in 2005 to 75 mn MT/year by 2010. The Kingdom's share in the global petrochemicals industry would hence increase from 7% to 13% over the same period. Currently, SABIC is the second largest producer of ethylene glycol and methanol in the world, the third largest producer of polyethylene and, overall, the fourth largest producer of polypropylene and polyolefin (see chart 18).

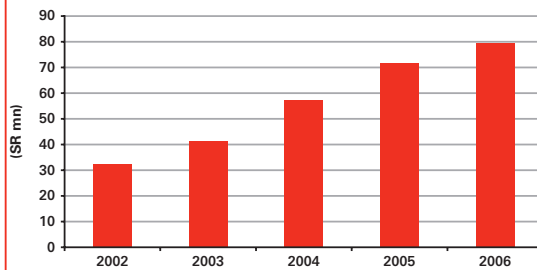


⁶ The Dutch disease is an economic concept that tries to explain the relationship between the exploitation of natural resources and a decline in the manufacturing sector. According to the theory, increases in revenues from natural resources will deindustrialise a nation's economy by raising the exchange rate, making the manufacturing sector less competitive.

Import growth will continue, as the basis of the current boom is infrastructure, fixed business and household investments.

We anticipate global oil prices to hold above \$58 per barrel in 2007 and through 2008.

Chart 18
Non-oil Exports (2002-2006)



Source: CDS

The export of construction materials has also grown between 2002 and 2005 by 77.3% and even more stellar export growth has been witnessed in the agricultural, animal and food products sector, which grew by 136% over the same period. As a result it is now quite common to find, for instance, Saudi dairy products throughout the GCC.

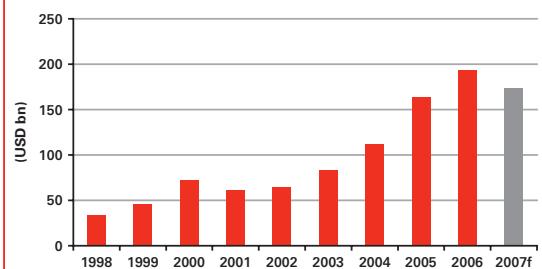
In 2005 machinery, electrical and transport equipment comprised more than a quarter of the Kingdom's imports whereas in 2004 it comprised 22% of the total, with actual growth in imports over the period 2004 to 2005 at 46%. Such a high increase proved not to have been sustainable between 2005 and 2006 (see table 1). Transport equipment, which includes automobiles, trucks and buses, comprised 20% of total imports and year-on-year imports between 2004 and 2005 grew by 21.3%, whereas the year before they grew by 22.6%. We believe that import growth will continue as the basis of the current boom is infrastructure, fixed business (machines, buildings etc) and household investments (a new home). A sector that will grow due to an increase in fixed investments will be the transportation sector, particularly road and rail links.

Oil and Petrodollars

We anticipate global oil prices to hold above \$58 per barrel in 2007 and through 2008, which will provide for a steady flow of revenue. The global economy has absorbed a surge in oil prices to around \$60 per barrel in the past year and oil demand remains robust. High oil prices have not hindered global economic growth partly because of rapid development in India and China. Also, global inflationary pressures have been well managed this time compared to the previous oil spikes in the 1970s.

We are of the view that OPEC is not poised to institute another oil production cut during the coming two quarters and that daily Saudi oil production will be kept at 8.55 mb/d unless there is a major upset in the global economy (recession) or the occurrence of major geopolitical events (Nigeria, Iraq, Iran). In 2007 we expect Saudi Arabia to earn SR 645 billion (\$172 bn) in oil income (see chart 19).

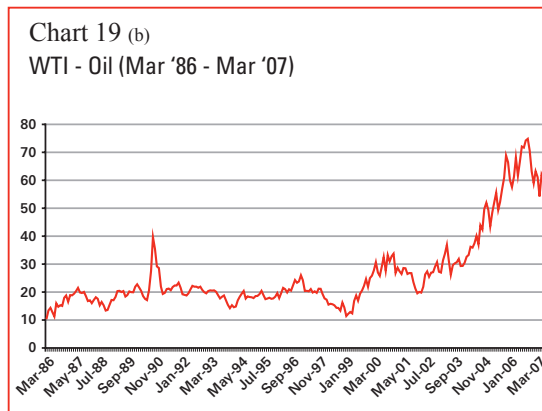
Chart 19 (a)
Oil Revenues (1998-2007f)



Source: SAMA

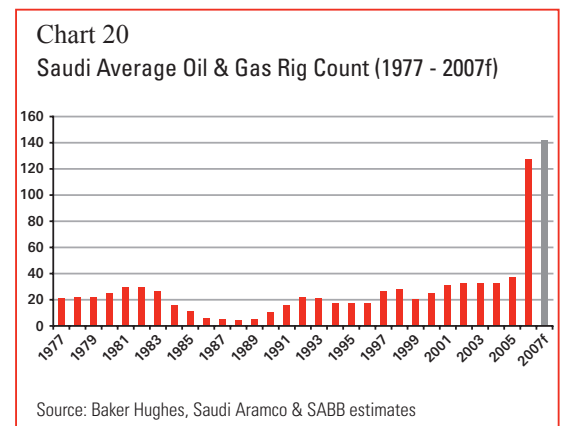
Grey Tuesday, did not immediately affect oil prices, but the downturn in the U.S. housing finance sector did put pressure on oil prices.

The geopolitical risk premium in 2007 will rise above \$12 per barrel, in our view.



What could upset our oil price forecast and as a consequence our oil revenue forecast is a change, for the worse, in global economic conditions. At the moment the U.S. may be slowing, but the global economy is booming driven along by the powerful performance of emerging markets. However, the path of inflation, consumer confidence (spending) and the performance of the American housing market will act as the final arbiters of output and performance in 2007. Although the sell-off in the global equity markets in late February 2007, known as Grey Tuesday, did not immediately affect oil prices, but the downturn in the U.S. housing finance sector did put pressure on oil prices. U.S. crude (WTI) in early March traded downward from \$61 per barrel to \$56 per barrel. London crude (Brent) dipped from a high of \$61 per barrel to below \$60 in early March but has since rebounded. The geopolitical factors regarding Iran helped boost both WTI and Brent crude prices above \$65 per barrel. We estimate that the geopolitical risk premium in 2007 will rise above \$12 per barrel. Also, over the past few months, Brent has risen to trade at a premium over U.S. crude because of production disruptions in Nigeria and a firm North Sea market.

Saudi Aramco's plan to expand its oil production capacity from 10.5 mbpd to 12.5 mbpd by 2009 necessitates capital expenditure of more than \$24 bn. This reflects the Kingdom's interest in maintaining a reasonable spare capacity of at least 1.5 mbpd, and its position as the most important swing producer. Demand for rigs (oil and gas) has increased to a new high in order to meet exploration expectations. This, allied to Saudi Aramco saying in November 2006 that it will have 130 drilling rigs in action by the end of 2007, up from 120 at the end of 2006, implies there might be a shortage in the global supply of rigs (see chart 20).



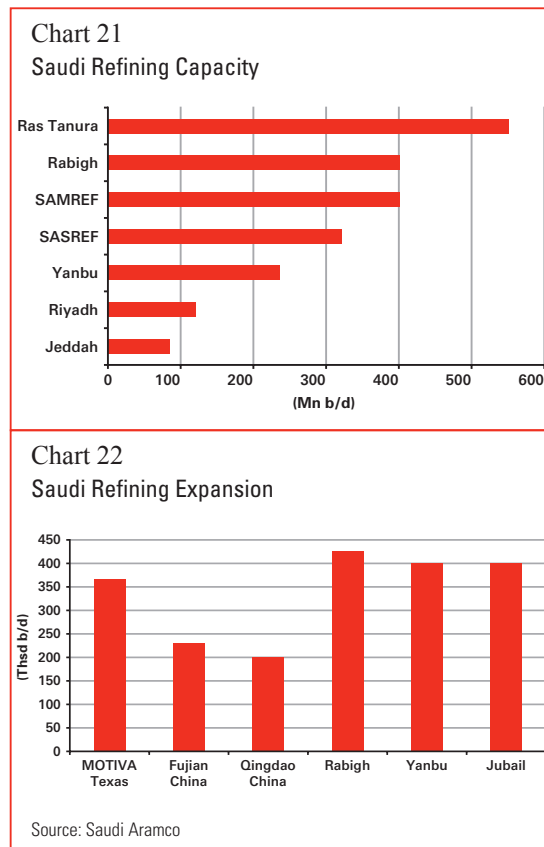
Gas is becoming a seminal ingredient of the country's industrial projects and pressure is building to discover new, non-associated gas fields. Saudi Aramco also wants to focus more on increasing its refining capacity, both to accommodate its rising domestic demand and to increase its exports. In pursuit of this policy the company is in the final stages of formulating a memorandum of understanding with Dow Chemicals to build an estimated \$15 bn refinery and petrochemicals complex at Ras Tanura.

At present, five refineries are owned and operated by Saudi Aramco and two are joint ventures between Saudi Aramco and foreign oil majors with a total refining capacity of 2.1 mb/d.⁷ In addition to Saudi Aramco's 1.7 mb/d of overseas refining capacity another 2.1 mb/d of refining capacity will be added by 2011 within (3) and outside (2) the Kingdom (see chart 21 and 22).

Oil producing economies earned \$900 bn last year from \$251 bn in 2002 in export revenues.

Since 2005, we estimate that Saudi private foreign direct investment in East Asia have not exceeded \$450 mn.

Too much money is chasing too few assets.



The surge in oil prices from an average \$25 per barrel in 2002 to \$66 per barrel last year has rekindled the discourse on the whereabouts of petrodollars. Russia, Saudi Arabia and Norway accounted for 60% of the total oil surpluses. Around 80% of the windfall has flowed to governments in oil

exporting countries. Oil producing economies earned \$900 bn last year from \$251 bn in 2002 in export revenues. Notwithstanding the importance of petrodollars in keeping low real interest rates tracking petrodollars during this boom has is a difficult task. Data published regularly by the Bank for International Settlements only account for 30% of capital outflows from these countries. Since 2002, oil exporters have spent around 50% if the windfall on imports of goods and services, compared to more than 75% during the 1970s oil boom.

After September 11th 2001, we witnessed the repatriation of some Saudi funds away from the U.S. Some of these funds were re-invested in Europe, mostly Western Europe and some were repatriated back to Saudi Arabia. Although sizeable funds are still kept in the U.S., Saudi businessmen have shown an acute preference to invest a large part of their wealth in Saudi Arabia and within the Middle East since 2001. The question is not what happens to the existing funds in the U.S. and Europe but where will future funds, generated from within the region, end up? We are beginning to observe that Saudi investors are more interested in East Asia, spearheaded by the sizeable planned investments in China by Saudi Aramco and SABIC. However, until now private sector investments remain low. Since 2005, we estimate that Saudi private foreign direct investment in East Asia have not exceeded \$450 mn. The region shows signs of a boom-time ailment of too much money chasing too few assets. However, the Saudi public and private sector has not demonstrated such behaviour, for the time being, in its outward investments.

⁷ One further refinery is owned and operated by Saudi Aramco Gulf Operating Company (AGOC) in the neutral zone between Saudi Arabia and Kuwait.

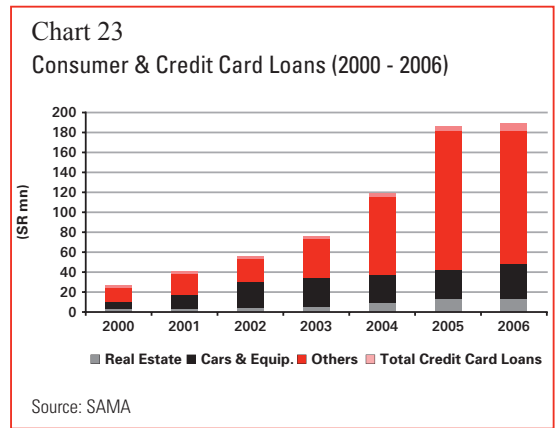
Beyond Luxury Goods

The economy has demonstrated resilience but at the same time we have to take note of the negative impact of the crash on consumer spending and confidence.

There are two views on the Saudi economy post the stock market crash. The first is often voiced by large corporations and established conglomerates : the economy is booming and businesses are expanding. The second view is held by mid-size businessmen, traders and retailers: the economy is growing but consumers have been affected and prefer to spend less this year. We think that the truth lies somewhere in the middle. We are not of the view that Saudi Arabia will experience enormous output losses as some of the above cross country empirical evidence suggests. The economy has demonstrated resilience but at the same time we have to take note of the negative impact of the crash on consumer spending and confidence. It is not coincidental that this year's sales season was extended until later in March. Moreover, our survey shows that inventories are up and have not declined as expected during the sales season, which has prompted retailers to increase the discount on offer from 30-50% to more than 70%. Although we believe that subdued demand accounts, mostly, for prevailing high inventories, we have to consider that retailers are also responsible for this high inventory build up as they anticipated high demand growth in 2006.

Our thesis that consumer lending has been affected in 2006 due to the stock market collapse becomes clear from the latest consumer and credit card loans data published by SAMA. Total consumer loans grew by 56.84% in 2005 whereas in 2006 they dropped by 0.08% by (total consumer loans increased by 630%

between 2000 and 2005). The 2006 drop in consumer loans is miniscule but it is representative of subdued borrowing related to the market crash. Real estate borrowing saw a very small increase, 0.24%, and borrowing for the purchase of cars and equipment, a very respectable increase of 18.03%. We cannot ascertain if people in 2006 used the cars to drive or to resell in order to invest the money elsewhere (mainly in the stock market). Also we do not know if the increase is due to an overall increase in vehicle sales (greater propensity to spend) or due to a fall in disposable income, compelling people to opt for a car loan rather than a straightforward cash payment. The trend has been toward the former for the past five years. Credit card loans including Visa and MasterCard went up by 72% whilst personal finance and what we believe to be margin lending went down by 4% (see chart 23).



Non-luxury passenger vehicle sales witnessed growth in the first three quarters of 2006 but in the last quarter they dipped by more than 25%.

Fast food franchises reported slower sales during the last two quarters of 2006 that went beyond seasonal consumption changes.

The stock market collapse did, however, impact the sale of certain luxury items in the Kingdom, with sales of designer Swiss watches and jewellery dipping by around 20-25%. According to the World Gold Council, gold demand in 2006 fell 16.4% over that in 2005 due to subdued demand, which we think was due more to a fall in disposable income than to price volatility. Anecdotes of people selling their gold to cover their loans supports our thesis. The luxury clothes' retailers saw a dip in sales during the first two quarters followed by higher sales over the rest of the year. However, the effects of the market collapse went beyond the luxury retailers. Passenger automobile sales witnessed a different trend. Non-luxury passenger vehicle sales witnessed growth in the first three quarters of 2006 but in the last quarter they dipped by more than 25%. What kept automobile agents happy were sales to government agencies of light trucks, pickup trucks and other non-passenger transport vehicles. The slight fall seen in luxury passenger vehicle sales had more to do with seasonality than anything else. For example, the discounts offered by BMW and Porsche on the 7-series and Porsche Cayenne models had to do with the anticipated face-lift of their vehicles later in 2007 by the parent company. Lexus has already introduced the new LS series to the Saudi market, as did DaimlerChrysler in latter part of 2006 with their new

S-class series. In the event, the sale of S-class Mercedes vehicles did very well in 2006. We firmly believe that luxury vehicles, like many other luxury items in Saudi Arabia, are demand inelastic (the quantity demanded does not change much with the price change) and hence do not act as a gauge for consumer behaviour or changes in disposable income.

Fast food franchises reported slower sales during the last two quarters of 2006 that went beyond seasonal consumption changes, possibly as a result of the slowdown which usually occurs during Ramadan, school breaks and final year examinations. We estimate that an average Saudi customer spends between SR 18-20 for each fast food meal. Unlike other markets in the developed world, the consumer has a cheaper fast food choice, providing the benefits of a quick meal and the satisfaction of eating out. Although the cost of Shawarma (pitta bread filled with beef or chicken and French fries) has increased on average by 30% over the past year and a half to a current average of around SR 3-3.50, market evidence shows that Shawarma sales, in Riyadh, have jumped by 15% over the past six months. Although we do not have data for the rest of the country the pattern witnessed in Riyadh toward more affordable food choices could be indicative of a country-wide consumer choice pattern among the middle class.

On the housing front, we are witnessing a fast appreciation in prices as there is rising demand.

Finally, in order to gauge the effect of the market collapse at the consumer level we need to estimate the number of investors who are still holding positions in the local market in anticipation of a pick-up. We consider that a substantial number of investors are holding on to their stock market positions in expectation of a market rebound. However, we are not sure if retail investors will return to the market in the short term as financial history shows that a slump is followed by a natural disinterest in equity investing. On the housing front, we are witnessing a fast appreciation in prices as there is rising demand and limited supply and an

inclination to regard real estate as a “safe” investment following the stock market decline. The danger for any economy that has witnessed an asset bubble in the recent past would be the avoidance of another asset class bubble. Prices in Jeddah, especially following the new regulation allowing the construction of seafront high rises, have been on the rise. Commercial real estate activity has also picked up in the central district of Riyadh (the golden square), between King Fahad Road and Olaya Street, as building restrictions for high rises have also been lifted and a building boom is taking shape.⁸

⁸ However, we did witness in Riyadh during the month of January and February land prices falling in certain residential areas, mainly Western and Eastern Riyadh, which could have been indicative of a wait and see policy of some investors and property developers.

Inflation

We estimate inflation to reach 3.5% by year end.

Even if consumer price indices demonstrate a rise in inflation in all GCC countries the measurement methods underestimate the rate of inflation.

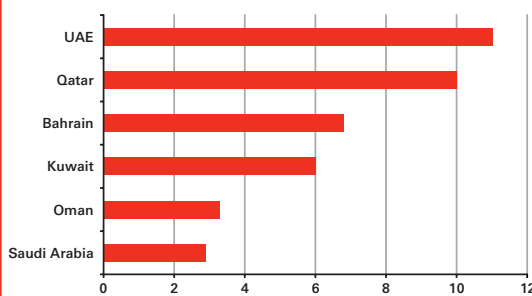
The regional inflation divergence is related to differences in capacity, supply and demand dynamics as well as the pace of growth.

Inflation is one of the most important economic indicators that assess the level of well-being of an economy. We estimate inflation currently in Saudi Arabia to be at 3.5% and rising. Long-term persistence of inflation above real GDP can act as a growth reversal, and gradually erode real per capita GDP. However, we believe that the economy does not face structural inflationary problems and as a result long-term price pressures will probably subside.

Inflation is not a Saudi phenomenon but GCC-wide. Inflation in the UAE, particularly Dubai, as well as Qatar is in double digits (see chart 24). Even if consumer price indices demonstrate a rise in inflation in all GCC countries the measurement methods underestimate the rate of inflation.

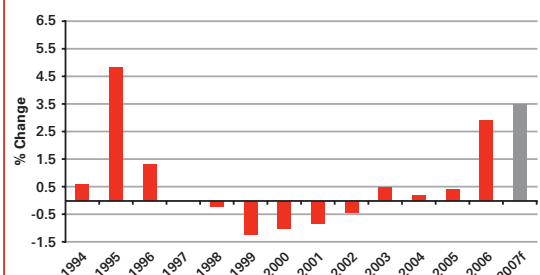
A rise in rents over the past year and a half and supply bottlenecks associated with the regional boom are pushing up prices (see chart 25). The regional inflation divergence is related to differences in capacity, supply and demand dynamics as well as the pace of growth. Although we do not discount the role of “imported inflation” we are attributing the recent spike in prices in Saudi Arabia to domestic factors more so than currency volatility. Also, currency volatility (making imports more expensive) does not translate into automatic price rises by importers. Agents, in agreement with their parent companies, can share the cost of higher imports due to currency volatility so as not to pass along an entire price rise to the consumer. So, for example, if the dollar weakens by 10% the agent will not raise prices by 10%. An important part in all this is the agency agreement of the importer as well as the volume of sales and inventory build up. The sophistication of the importer also comes into play as different currency and commodity hedging strategies can offer some risk protection.

Chart 24
GCC Inflation (2006)



HSBC & SABB estimates

Chart 25
Saudi Cost of Living (1994-2007f)

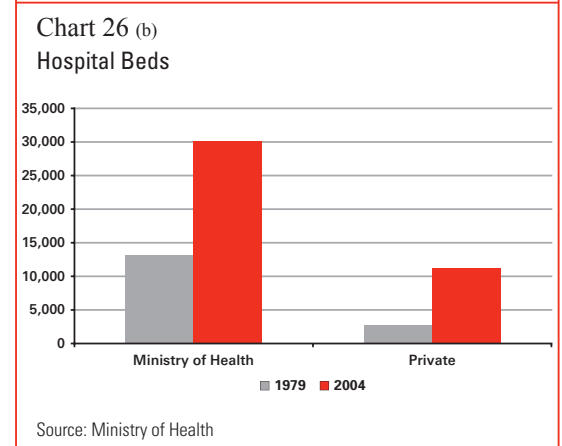
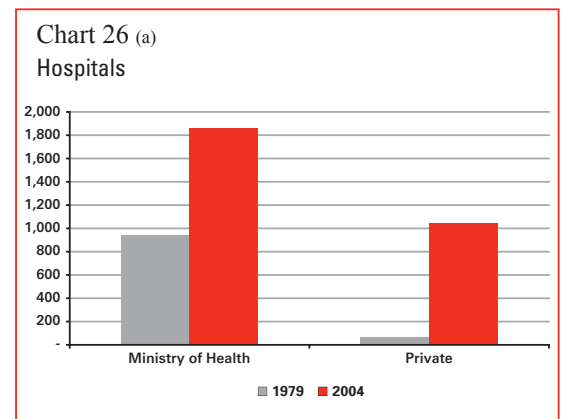


Source: CDS & SABB estimates

We estimate that private health care has increased by more than 27% from 2003 to 2006 and education by 22% over the same period.

Inflation is a rise in the general level of prices measured against a basket of goods and services over a period of time. Adjustments are made for the changes in the goods in the basket itself as consumption preferences and per capita income change. For instance, consumers in Saudi Arabia spend more on private education today compared to 25 years ago as many urbanised Saudis opt for private primary and secondary education. This kind of a consumer change has to be reflected in the weight given to the basket of goods. We are witnessing a similar change in consumer behaviour in the Saudi health sector. Just like education, the demand for private healthcare has grown over the past 25 years as more private providers enter the market place. For example, in 1979 there were 935 Ministry of Health health centres and only 64 private dispensaries, whereas in 2004 the state had increased its centres by 98% and the private sector by 1,530%. We have seen a similar stellar rise in the number of private hospitals. In 1979 the Ministry of Health had 72 hospitals (13,066 beds) and the private sector 28 (2,685 beds). By 2004, there were 213 hospitals (30,020 beds) under the Ministry's control and the private sector had 113 (11,135 beds). The cost of private education and private health care has gone up over the past several years in Saudi Arabia. We estimate that private health care has increased by more than 27% from 2003 to 2006 and education by 22% over the same period. Price increases have been particularly acute in the private clinics that offer services to cardiac and

diabetic patients, where we are witnessing a substantial rise in demand. Also we are witnessing a rise in the expenses patients have to pay for accommodation in many of these private clinics due, in part, to the structure of the healthcare market (see chart 26).

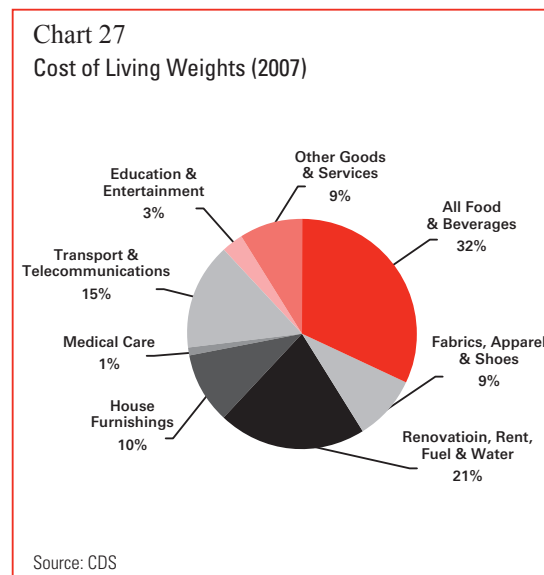


People spend more money on food than on rent which could be the case for rural areas but may be not for the urban areas of Saudi Arabia.

For the purpose of calculating the cost of living index for the entire population some 406 items from 16 cities are surveyed. The issue at hand is not so much the amount of items being surveyed (although a country like Canada surveys more than 600 products) and the geographical reach (in 1985 only 10 cities were surveyed compared to 16 surveyed since 2001) as much as the weights given to each sector. Under the current weight system, healthcare accounts for 1.3% of the basket of goods and education and entertainment accounts for 3%. Fabrics, apparel and shoes have a higher weighting (8.7%) in the basket of goods than education and healthcare put together. According to the CDS food and beverages comprise 32.5% of the basket of goods compared to 20.8% on renovation, rent, fuel and water (see chart 27).

Rents account for 18% of the total weight of the cost of living index, which could be lower than the actual amount spent by the average household.

People spend more money on food than on rent which could be the case for rural areas but may be not for the urban areas of Saudi Arabia. About 88% of the population of Saudi Arabia is urban. Evidence from other countries in the region shows that people in urban areas spend more money now on rent than on food, reversing the pattern of spending that was evident less than a decade ago. However, people could be spending more money to rent a house or an apartment than before due to a rise in rental prices over the past year. Rent data are collected every 6 months in Saudi Arabia, as rents do not change that frequently, but rents have gone up over the past few months which could very well be represented in the next rental survey. Rents account for 18% of the total weight of the cost of living index, which could be lower than the actual amount spent by the average household. Rents are an important component of the average household in Saudi Arabia, for both locals and expatriates. Most of the 6.5 million expatriates living in the Kingdom rent property as owning a home needs approval from the Ministry of Interior. Renovation (housing), fuel and water, with the latter two being heavily subsidized, are weighted at 2.8%. Although people might spend far less in Saudi Arabia on fuel and water, people do tend to spend money on renovating their house.



What costs more and what less?

Reports in the local press and our survey show that the price of fresh fruits has jumped by more than 50-80%, fresh vegetables rose by more than 21-40%.

Food

According to statistics provided by the CDS, the price of foodstuffs and beverages rose by 6.8% on a year-on-year basis from November 2005. Although beverages (particularly soft drinks) are heavily consumed in Saudi Arabia, prices according to our survey, have not picked up even for those imported. Actually, the price of a locally produced canned soft drink is SR 1 (27 Cents) and this price has remained constant since 1982. According to the CDS on a year-to-year (Q3 2006) basis the price of fresh fruits rose by nearly 7.9%. Reports in the local press and our survey show that the price of fresh fruits has jumped by more than 50-80%. Similarly, during the same period of time the price of fresh vegetables rose by more than 21-40% whereas wholesalers have raised prices by between 70% and 100% over the past year. What caused a rise in prices now and not before? There are two main reasons behind the rise in prices of fruits and vegetables. Firstly, farmers are witnessing a shortage in cheap expatriate labour as demand for labour increases in other higher paid sectors such as contracting. This lack of agricultural labour is a direct consequence of limited supply at a time when the economy is witnessing high growth levels. As prices are increasing for domestically produced

horticultural products importers of similar goods (some SR 1.1 bn worth of fresh fruit and vegetable products were imported in 2005) increase their prices as well. Some importers justified the price hikes by citing political conditions in the Levant and the war in Lebanon during the summer, which we have found to be baseless. Most fresh horticultural products imported by the Kingdom come from Egypt and Turkey. The unexpectedly cold weather did probably add to supply problems for both domestically produced and imported goods as the region did experience lower temperatures. Also, the seasonal price hikes during the month of Ramadan helped keep prices on an upward trend. According to our survey we have found that the price of fresh beef (Saudis have a preference for fresh over frozen meat with the exception of frozen poultry products purchased in bulk) by 15% year-on-year to November 2006. We do not hold the view that due to avian flu people have opted to eat fish over chicken, hence justifying the 20-35% price increase in fish. Fish prices have increased due more to increased demand in neighbouring countries and the size of the catches of the eastern and western fishing fleets.⁹ Moreover, fish is not consumed in the same quantities as red meat; in fact meat rightly covers more than a quarter of the food basket in the cost of living index.

⁹ Production of farm fish has been falling over the past few years along with a decline in fish catch from the Red Sea which carries a higher premium over fish catch from the Arabian Gulf.

Labour

Over the past two years, wages in the construction sector rose by 50% for certain jobs.

Wages for skilled and unskilled private sector workers were on the rise in 2006 and we expect them to continue to pick up in 2007.

Demand for labour is clearly on the increase in Saudi Arabia. As the requirement rises due to the many projects being undertaken throughout the Kingdom, supply is limited due to Saudisation restrictions. According to the National Committee for Contractors the government must issue at least 1.2 million recruitment visas to meet the requirements of contractors to enable them to carry out solely government projects. The Labour Ministry has agreed to reduce the Saudisation rate for government contractors from 10% to 5% and increase the validity of work visas from one to two years. However, wages are also a factor in raising the level of inflation but it depends on the type of industry and the amount of flexibility of the producer or business owner whether this is passed on to the consumer by way of price increases. For example, over the past two years, wages in the construction sector rose by 50% for certain jobs such as expatriate and local project managers and local site engineers. We have to note that wages, in general, rise during growth phases and decline during recessions. However, if inflation is alarmingly high, as is being witnessed in the UAE and Qatar, then wages (real) tend to lag behind inflation as adjustments cannot be made as fast as the rate at which prices rise. Saudi Arabia's economy is growing, hence the existence of inflation should not be a surprise to many. For many years, average private sector wages in Saudi Arabia have been in decline as unskilled expatriate labour has been coming from countries like

Nepal, Vietnam and China. According to the Ministry of Labour's latest data, the average monthly wage of workers in the Kingdom stood at SR 1,359 during 2005 compared to SR 1,385 in 2004, a decline of 1.9%. The average wage of female workers amounts to SR1,795, falling by 3% between 2004 and 2005. However, wages for skilled and unskilled private sector workers were on the rise in 2006 and we expect them to continue to pick up in 2007. An expatriate sales person with reasonable experience used to receive a salary of around SR 3,500 plus a commission based on sales performance. Today, the same sales person will demand more than SR 4,700. As the Kingdom's private sector complies this year with the compulsory health insurance scheme for all expatriate workers, profit margins could be affected or the extra cost could be passed on to the consumer. Expatriates tend to comprise 88% of the total private sector labour force (which in 2005 reached 5.4 million) hence expatriate wages are an important component affecting price changes. There are two important developments that have to be accounted for when we examine labour supply forces. The first is linked to the regional boom and high demand for skilled labour which puts pressure on the Saudi private sector. Skilled expatriate workers have opportunities to find employment in the wider region which were not there before due to subdued demand. As the transfer of labour sponsorship remains rigid preventing switching between Saudi employers, the desire to opt for regional jobs increases, hence putting pressure on the available local pool of skilled and

Rents have also gone up over the past few months in Saudi Arabia reflecting the demand for housing and commercial, mainly office, space.

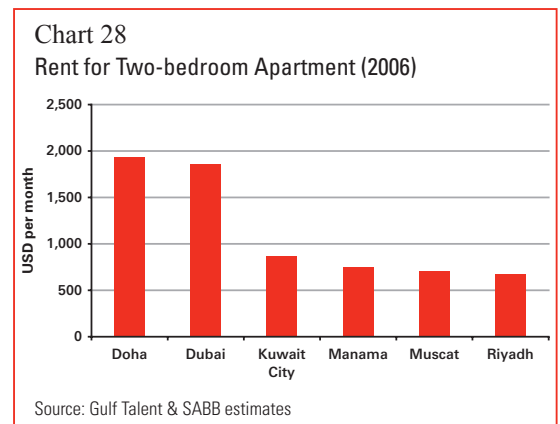
We estimate that 45% of all Saudis are currently renting.

unskilled labour force as demand is rising.¹⁰ Limited supply and high demand creates inflationary pressures. The second development is the decision of the Ministry of Labour to allow expatriate workers to transfer sponsorship to another company or employer if their present company delays payment of their salaries for three consecutive months. Both of these developments will contribute to greater bargaining power for the skilled labour force in the Kingdom, perhaps more so than in the past, although we have to wait and see how the new Ministry of Labour decision will be enforced in the coming months.

Some analysts attribute the rise in inflation to the 15% public sector salary increase which took effect in October 2005. According to the latest statistics issued by the Ministry of Civil Service, the total number of employees in the government sector (mostly ministries and government offices) as at the end of 2005 amounted to 783,000, of which 91% were Saudis. Of course, the wage rise also included employees working for the military, Saudia and Saudi Aramco. Immediately after, the chambers of commerce announced a voluntary private sector wage increase (SR 1500) per month which we believe some businesses implemented and others did not, contributing to an extent to inflation. Overall, we are of the view that the wage increases were a necessary measure, as the government had not instituted such a move for 20 years. Undoubtedly, some inflation was a result of the wage hikes in the public sector, but compared to the rest of the region, public sector wages have been, in our opinion, correctly subdued.

Rents

Rents have also gone up over the past few months in Saudi Arabia reflecting the demand for housing and commercial, mainly office, space in the main urban centres such as Riyadh, Jeddah, Dammam and Al Khobar. Prior to recent rental hikes, rents remained well subdued for many years. However, rents in Saudi Arabia are lower than any other city in the GCC. Comparatively to the region, Riyadh is still a very affordable city (see chart 28).



Not all Saudis are home-owners. According to the latest housing survey (2000) 37.5% of the total population is renting. This figure includes both Saudis and non-Saudis but we believe that preference for home rentals has increased over the past years as young Saudis begin to enter the labour force and look for jobs and affordable housing in the main cities. We estimate that 45% of all Saudis are currently renting. Internal migration from villages to the main cities continues to take place albeit at a slower rate than in past years.

¹⁰ The flight of expatriate labour to regional markets, due to the rigidity of labour law transfer rules, deprives the Kingdom of important skills and the transfer of knowledge.

Housing rents throughout the Kingdom have gone up by 15% in the past year.

If we enter into a negative interest rate environment (inflation above interest rates) buying a home becomes more attractive than renting.

According to the Riyadh Development Authority (RDA) Riyadh's population growth declined to 4.2% between 1996 and 2004 from 8.1% between 1990 and 1996; a figure that is widely quoted today as the growth figure. We estimate that housing rents throughout the Kingdom have gone up by 15% in the past year. Riyadh has witnessed the highest rental increases in the Kingdom at more than 20%, and in the central district of the city by more than 25%. These increases are not due merely to rising demand but also to limited supply. There are few affordable small housing units and apartments around the central district and many people are chasing the few that are to be found. As for housing compounds, prices have gone up by an average of 15-20% over the past year in prime locations and 10-15% for the remainder. Demand has increased such that most of the compounds in Riyadh are now either full or nearly so compared to the situation two years ago when compounds had ample availability. A similar situation is found in Jeddah, albeit prices are more subdued than

Riyadh, where there has been an influx of skilled expatriate workers. The situation in the Eastern Province is better as prices have not increased by more than 10%. However those who have opted to live in neighbouring Bahrain find it increasingly more expensive than a year ago, as inflation in the country is rising at an annual rate of more than 3.5%. Also, as businesses are expanding the demand for commercial, mainly office, space is rising. A supply of new commercial space will not come on stream until 2008. On King Fahad road, the average price of office space per square meter has increased from SR 400 a year eighteen months ago to more than SR 1,400 at present. If we enter into a negative interest rate environment (inflation above interest rates) buying a home becomes more attractive than renting. However, in an inflationary environment faced with housing supply shortages, like in the case of Saudi Arabia, the rise in the price of rents will be more acutely felt as recourse to mortgage finance is still at a nascent phase.¹¹

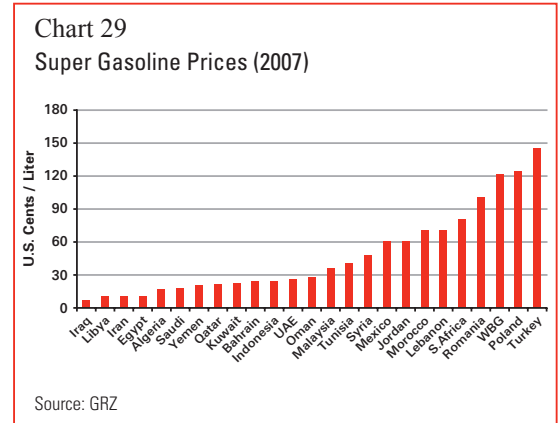
¹¹ Usually, the cost of rentals in an inflationary environment rises faster than mortgage payments pegged to interest rates.

Fuel

In some ways, the decision back in May 2006 to decrease petrol prices by 30% had an anti-inflationary effect, but if we use the CDS's cost of living weighted index then its effect is minimal. The government decided from January 2007 to re-price high-octane RON-95 gasoline from SR 0.60 (16 US cents) per litre to SR0.75/litre. A new low octane RON-91 gasoline was then introduced at the start of this year with a price of SR 0.60/litre. Until now, it appears that consumers have a greater preference for the low octane gasoline, tending to fill their tanks more so now than before. Passenger car ownership is very high in Saudi Arabia; by 2010 we expect that there will be more automobiles per 1,000 persons than fixed telephone lines. Saudi Arabia continues to have one of the cheapest gasoline prices in the world although Iran's low octane gasoline is priced at 0.33 halalas (9 US cents) per litre and Iraq's at 26 halalas (7 US cents, see chart 29).¹² Although the provision of cheap fuel can remain unchanged the provision of cheap electricity and water to a growing population will probably change in the coming period. Utility prices will have to be adjusted upward as the private sector becomes more involved. Price increases in utilities will create temporary inflationary pressures in the future.

In some ways, the decision back in May 2006 to decrease petrol prices by 30% had an anti-inflationary effect.

Telecommunications and transportation have seen prices decreasing over the past few years.



Telecommunications and Transportation

Telecommunications and transportation have seen prices decreasing over the past few years. In fact, prices fell by 14.13% between 2000 and November 2006. The most affected sector has been telecommunications. The mobile phone sector is a duopoly with the introduction of the second mobile phone operator, Mobily, injecting more competition. As a result mobile phone charges have fallen by more than 24% over the past two years. Similar downward price adjustments (around 18%) were made over the past two years in international call charges by the only fixed line operator, Saudi Telecom. A second fixed line operator would bring more competition to the market and would create more competition in the broadband sector, which is currently negligible in the Kingdom. We estimate broadband penetration in Saudi Arabia to be around 1% compared to 5% in the UAE. A third mobile operator, which has been awarded to Kuwait's Mobile Telecommunications Co. for SR 22.91 bn, will add to the competition and will increase mobile penetration (as a percentage of population)

¹² Oil subsidies in Iraq are being phased out over a five-year period ending in 2009.

from a current 76% to 105% in 2010. Another factor keeping telecommunication costs suppressed has been increased competition in the mobile hand-set business as over the past one and a half years prices have gone down by more than 23%.

The cost of transportation is an issue that has to be addressed more closely. Overall, the cost of transportation at the retail level (buses, trains, aeroplanes) has not increased due to the low cost of fuel and equipment, which have remained largely unchanged. What will bring transportation prices down further this year are the two low cost airlines, National Air Services (NAS) and Sama, when they begin operating in the Kingdom. Initial fares for NAS, for the Riyadh-Jeddah route, will be SR 178 whereas Saudi Arabian Airlines currently charges SR 560 for a round trip ticket over the same route. However, we have witnessed an increase in lorry charges within the Kingdom as demand increases and supply is limited. A Jeddah-Riyadh 40-foot container truck has gone up by more than 25% over the past year, and by around 15-20% between the Eastern Province and Riyadh. According to our survey, the additional cost of transport is now passed on to the wholesaler, which eventually translates into higher prices for the retailer and consumer.

Another sector has also received attention over the past year as a culprit for inflation in the Kingdom - the building materials sector, which has seen major price rises due to increased domestic

and global demand. Globally, steel prices rose by 30% in the first half of the year due to strong demand from China and North America and unplanned production outages in North America and Brazil. Cement prices in Saudi Arabia have gone up, after their initial spike in May-June 2005, and have stabilized over the past four months at around SR 14 per bag from a high of SR 22.5 in early 2005. In the summer of 2005, the Saudi government decided to reduce customs duty on cement from 5% to 0% over a six-month period as part of what proved to be a successful move to check the rise in cement prices by liberalising imports. However, the cost of rebar (all domestically produced by three steel factories) increased over the past year by around 150%, whilst the cost of rolled steel (all imported) rose by around 180-200%.

Blame it on the Euro

Most people living in Saudi Arabia would point the finger at imported inflation (mainly from the Euro zone) as the main culprit behind the rise in inflation. Retailers blame the Euro specifically as the cause for recent price rises but, although the Euro has appreciated by around 12.5% during the past year, prices have risen by more than 40% in many retail outlets. Undoubtedly, imported inflation has been a contributor to upward price pressures in the past. As it happens the Euro is a clear case in point as since its introduction in 2002 to the end of 2005 it had gained 32.3%

The Euro has appreciated by around 12.5% during the past year, prices have risen by more than 40% in many retail outlets.

Between 2002-2005 the Euro gained 32.3% against the U.S. Dollar, while average inflation in Saudi Arabia was 0.46% during the same period.

We hold the view that imported inflation has not been the main culprit of the price hikes we have witnessed over the past year.

against the U.S. Dollar. During the same period Saudi Arabia's average inflation rate was a meagre 0.46%. Specifically, between January 2002 and January 2003 the Euro appreciated by 21.2% whereas inflation grew by 0.2% during the same year (see graph). Inflation in 2003 reached 0.61% but between February 2003 and January 2004 the Euro appreciated by 16.7%. As the Euro appreciated the following year by another 7.7%, inflation fell to 0.3%. In 2005 the Euro fell by 14.3% but inflation was on the rise, reaching 0.71% by year end. One can also claim that imported inflation was low due to low import volumes. However, import growth rose strongly averaging 18.5% between 2002 and 2005. So other dynamics have been at play that are not attributable to currency fluctuations. Had the culprit for inflation been imported inflation then inflation rates in many of the GCC states should have moved in tandem but they did not.

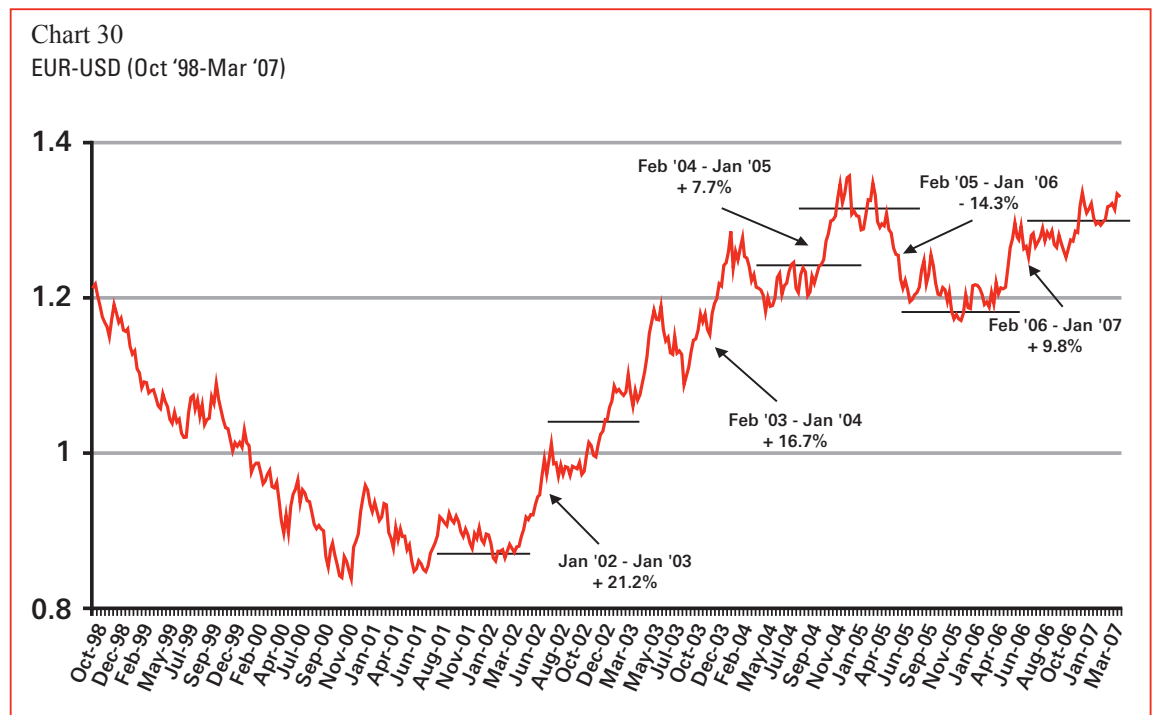
We hold the view that imported inflation has not been the main culprit

of the price hikes we have witnessed over the past year. If the US Dollar weakens further then we could see additional price pressures as importers decide to pass along the higher cost of imported goods to the consumer. International newswires often state that about half the Kingdom's imports are priced in the Euro and the Yen but we do not think this is the case. Around 25% of the Kingdom's imports originate from the Euro zone and around 9% originate from Japan according to the latest available statistics (2005). Around 50% of the Kingdom's imports are priced in U.S. dollars. Not all of the Toyotas driven in the Kingdom are imported from Japan. The best selling car in Saudi Arabia, the Toyota Camry, is manufactured in Australia, as is the Chevrolet Lumina, and the well-known Crown Victoria is manufactured in Canada.¹³ By the same token, U.S. made automobiles should be flooding the Saudi market and market share should be expanding. U.S. automobiles have become more price competitive not so much due to the

¹³ The Australian dollar has lost and gained strength over the past year by around 10.5% and the Canadian dollar has not seen major fluctuations over the same period.

weakening dollar but mainly due to the restructuring undertaken by the big three (GM, Ford, and Chrysler) over the past year and a half. So the terms of trade are somewhat different from what people seem to believe. Also, imports from the GCC hover around 10% on average and there is no currency fluctuation since all GCC currencies are pegged to the dollar. However, in today's market place in Saudi Arabia we find a lot of talk about a weakening dollar and as a consequence a rise in the cost of imports. Retailers would often justify the rise in the price

of their products, often above 40%, to the weakening U.S. dollar which, on average, has fluctuated and year-on-year lost around 12.5%. Only since the end of February has the Yen appreciated in value by around 3% but during the past year its value had appreciated by not more than 0.9%. The way we can justify the unusually high price rises is to suggest retail greed but then again greed is part of the free and competitive market. As long as consumers are willing to buy, retailers will continue to derive the benefit (see chart 30).



The Revaluation Debate

There is also a group of people within Saudi Arabia who regard the revaluation as a possible “sweetener” following the stock market collapse, hence advocate for a revaluation.

We firmly believe that the present-day currency regime will remain unchanged.

For more than ten months rumours have abounded about a possible revaluation. Analysts predicted the end of Ramadan as a possible revaluation date but nothing happened. Weeks go by and nothing is happening to the disgruntlement of many who want to believe that there is an imminent revaluation. There have been market rumours that U.S. hedge funds have been betting on revaluations, as have off-shore banks. In May 2006, Kuwait allowed its currency to appreciate 1% against the dollar within its 3.5% trading band, which only added to the rumours. Speculation about a currency revaluation then increased further following the remarks made by the UAE central bank governor in January 2007 that central bank governors were at liberty to keep or change currency pegs as they wished. International and regional investors took these comments and subsequent ones as a signal that a change in the GCC currency might be plausible. For investors, moving into GCC currencies created a win-win situation. In the event of a currency revaluation investors would be making money since the local currency after a revaluation would have greater purchasing power, hence investors could make money buying back dollars. In the event of no revaluation investors would be accruing interest in a relatively low risk currency environment. Hence, investors took sizeable riyal positions

over the past four months in anticipation of a revaluation. There is also a group of people within Saudi Arabia who regard the revaluation as a possible “sweetener” following the stock market collapse, hence advocate for a revaluation. However, Saudi Arabia stated quite firmly that it has no plans to revalue or abandon its dollar peg.

Kuwait’s revaluation does not represent the mind-set in the rest of the GCC, particularly Saudi Arabia. The Kingdom has been a proponent of the single currency, due in 2010, being pegged to the dollar. For a sudden change in the currency regime to take shape certain domestic factors have to change. First, a substantial weakening of the U.S. Dollar has to take place, which is then translated into immediate price increases in imports that are passed along to the consumer. This is not yet happening. Secondly, inflation has to be on the rise, but the source has to be external and not internally generated. Our long-term view is that the dollar will weaken further giving impetus to a rise in imported inflation. At that juncture, currency reform will be likely. However, we firmly believe that the present-day currency regime will remain unchanged.

The U.S., motivated more by politics than economics, has been concerned that

Revaluing the riyal will not dramatically alter the terms of trade with the U.S. but it could provide a more favourable environment for additional imports outside the dollar trading zone.

Making imports cheaper through a revaluation could be a short term trade-off against long-term non-oil export diversification policies.

half of the deterioration in its current account deficit has been caused by higher oil prices in recent years. But, a GCC-wide currency revaluation would not significantly change the structural imbalances in the U.S. or its current account deficit as oil is priced in dollars. Moreover, it is often neglected that as oil exporters accumulate surpluses so do their appetites grow for imported goods. In a recent study by the New York Federal Reserve, it was shown that 50% of the petrodollar windfall has been used by the GCC and non-GCC petrodollar holders to purchase foreign goods. Most of these imports were not from the U.S. but mainly from Europe and China (the remaining 50% in windfall income has been invested in foreign assets and in the case of Saudi Arabia mostly in U.S. Treasury paper). Revaluing the riyal will not dramatically alter the terms of trade with the U.S. but it could provide a more favourable environment for additional imports outside the dollar trading zone. Similarly, an argument for a revaluation of the Chinese currency, renminbi, has been put forward by the U.S. However, a 2005 scenario study by the Centre for International Economics shows that even a 27.5% revaluation by China would have little impact on the U.S. current account deficit. In other words, a revaluation will not alter the global imbalances and it will only make U.S.-made products marginally more competitive. U.S. trade deficits are a result of its huge fiscal deficits and the fact that Americans do not save.

A significant revaluation, more than 20%, would boost the purchasing power of those living in Saudi Arabia as imports would become cheaper. However, such a move could instigate conspicuous consumption against the interest of saving, which is more important for long-term planning, investment and growth. Another drawback, mentioned earlier, as a result of a revaluation is the effect such a move would have on the competitiveness of non-oil exports. We estimate that a 20% revaluation could cause non-oil exports to become more expensive by an average 12.4%, assuming that currencies do not fluctuate. The link between a revaluation and a fall in imports is not 1 to 1 as intermediate imports become cheaper after a revaluation, hence offsetting a higher cost for exports. Making imports cheaper through a revaluation could be a short term trade-off against long-term non-oil export diversification policies. Although non-oil exports could be hurt there is a solution which could eventually offset the revaluation and eventually lead to lowering the cost of exports: labour efficiency. Labour efficiency has been falling in Saudi Arabia, a GCC-wide phenomenon, over the past five years which directly impacts economic growth. Low cost labour and slow growth in capital investment (e.g. equipment and office buildings) are part of the problem that allows productivity to fall. Technological change and human capital progress (the knowledge and skills workers acquire through education) over time improves productivity and

in both areas the Kingdom, as well as the rest of the region, needs to take important steps forward. In Turkey, technological change grew from an average of 0.5% in the 1990s to 5% in the post-2000 period, accounted for more than half of the increase in real GDP.

If Saudi Arabia decides to revalue without the concert and probable adherence from the rest of the GCC the terms of trade will become lopsided to the disfavour of Saudi exports.

Intra-GCC trade will be affected if unilateralism is pursued, albeit 10% of total exports are intra-regional trade. If Saudi Arabia decides to revalue without the concert and probable adherence from the rest of the GCC the terms of trade will become lopsided to the disfavour of Saudi exports. In 2004 (latest data) Saudi exports to the GCC amounted to SR 30.7 bn and have grown by 128% since 1995. Hence, Saudi products will become more expensive, GCC imports cheaper (2004 imports reached SR 8.2 bn and grew by 191% since 1995). A revaluation will also

make Saudi Arabia more expensive for its visitors although we do not believe religious tourism would be hurt. A region-wide revaluation of around 25% would make it more expensive for tourists at a time when the GCC is competing with other MENA countries which provide high purchasing power for incoming visitors. Hence, the revaluation debate is a hot issue for discussion but is nevertheless far from simple. Any attempt at maintaining an overvalued currency would lead to disaster. It is not sustainable and it has a high cost. Saudi Arabia does not face such a problem. Most of the literature criticizing fixed exchange rates has been about countries like Argentina or Egypt (prior to 2001) that have tried to maintain overvalued exchange rates, not countries such as Saudi Arabia which has a slightly undervalued currency.

Conclusion

We maintain a positive outlook for the Saudi economy in 2007 despite the affects the stock market has had on consumer spending. We believe that the economy weathered the market collapse very well, avoiding either a currency or a banking crisis. Looking forward, we see government spending, buttressed by high oil prices, offering the incentive for non-oil private sector expansion. Our growth projections for the economy are positive through the present decade. Inflation is rising and it will be a central concern for both the government and the

private sector. Contrary to the majority's view, inflation, over the past year and a half, has been rising due to domestically generated dynamics not imported inflation. Price rises due to a weakening of the currency have been an issue before and we do see it as an issue in the future. Hence, the adjustments that are required now have to do more with the structure of internal demand and supply dynamics than to any currency adjustment. General conditions for maintaining a solid pace of growth over the next few years appear very promising.

Saudi Arabia : Key Economic Indicators (USD unless noted otherwise)

	2000	2001	2002	2003	2004	2005	2006	2007f
Nominal GDP (SR bn)	706.66	686.30	707.07	804.65	938.77	1160.74	1304.67	1275.45
USD bn	188.44	183.01	188.55	214.57	250.34	309.53	347.91	340.12
% Change	17.1	-2.9	3.0	13.8	16.7	23.6	12.4	-2.2
Real GDP (% change)	4.90	1.20	0.74	6.40	5.30	6.53	4.20	3.70
Population (million persons)	20.57	21.08	21.60	22.13	22.67	23.11	23.76	24.46
Saudi	14.98	15.35	15.74	16.13	16.53	16.85	17.26	17.71
Non-Saudi	5.59	5.73	5.86	6.00	6.14	6.26	6.45	6.65
GDP/Capita (US\$)	9.161	8.682	8.729	9.696	11.043	13.339	14.642	13.905
Male Unemployment								
(% of Saudi male labour force)	6.54	6.82	7.57	7.80	8.00	8.40	8.70	9.10
(% of Saudi female labour force)	17.64	17.32	21.70	22.40	23.12	24.43	25.70	26.30
Oil Price (\$ barrel)								
West Texas Intermediate	30.61	25.76	26.57	31.05	41.51	57.22	66.69	58.50
Saudi Average	26.81	21.84	23.72	26.92	34.74	49.45	60.53	53.50
Balance of Payments								
Oil Exports	70.65	59.60	63.62	82.02	110.42	161.95	194.34	172.20
Total Exports	77.48	67.97	72.46	93.24	126.19	180.96	212.60	195.36
Total Imports	30.19	31.18	32.29	36.91	41.10	54.50	65.00	75.00
Current account balance	14.32	9.35	11.87	28.05	51.93	90.04	95.50	65.30
% of GDP	7.60	5.11	6.30	13.07	20.74	29.09	27.45	19.20
Net FDI Inflows	0.20	0.50	0.50	0.80	1.90	4.60	5.40	6.50
Government Budget Balance (billion SR)	22.74	-26.98	-20.50	36.00	107.09	217.86	265.00	129.40
Revenues	258.07	228.16	213.00	293.00	393.29	564.34	655.00	574.00
Expenditures	235.32	255.14	233.50	257.00	285.20	346.47	390.00	444.60
Budget balance as percent of GDP	3.2	-3.9	-2.9	4.5	11.4	18.8	20.3	10.1
Government Domestic Debt (billion SR)	616	640	660	660	614	475	366	306.1
as percent of GDP	87	93	93	83	65	41	28	24
Official Foreign Assets								
Central Bank	47.54	48.35	41.89	59.51	86.42	150.28	224.10	274.00
Prices (% change)								
Consumer Prices	-1.00	-1.11	0.20	0.61	0.30	0.71	2.90	3.50
Wholesale Prices	-0.6	-0.9	0	0.9	3.1	2.8	0.5	2.40
Financial Indicators								
Exchange Rate								
SR:USD (av)	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
TASI								Q1
Stock Market Index	2,258.79	2,430.11	2,518.08	4,437.58	8,206.23	16,712.64	7,933.29	7,666.11

Source: SABB forecasts for 2007. Various government departments

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