



Feature: New data highlight economic trends

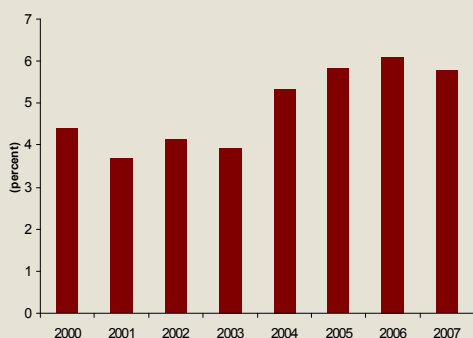
Newly published detailed economic data for 2007 highlights the strength of the Saudi economy last year and illustrates the challenges it faces over the next few years. The headline numbers are in line with those released in the budget at the end of last year; real GDP growth was 3.4 percent and the current account surplus was \$95 billion (24.9 percent of GDP). The breakdown of the data reveals some important trends, not all of which were evident from the earlier data. These are:

- **Strong non-oil growth:** The non-oil sector grew by 5.8 percent, the second highest rate since 1982. Sectors benefitting from liberalization and the investment boom were the best performing.
- **Bottlenecks emerging:** Growth in financial services appears to have been hindered by skill shortages. Utilities grew at their slowest rate in nearly 10 years and growth in the real estate sector barely kept pace with population growth .
- **Declining public sector productivity:** Government services growth slowed again, expanding by less than half the rate of the growth in the public sector workforce, implying reduced productivity within the government sector.
- **Huge oil exports and rapidly growing non-oil exports:** Oil exports exceeded \$200 billion for the first time owing to higher oil prices. Non-oil exports grew by over 20 percent for the fifth consecutive year to \$27.9 billion.
- **Surge in payments for imported services:** Payments for imported services used in the oil sector jumped by 52 percent and imports of other services (including financial, legal, accounting and IT) leapt by 55 percent, reflecting both greater use and rising costs.

Stock market in brief: Our central forecast is that the exchange rate against the dollar will not be changed. If there were a change, however, the impact on the stock market would be as follows: after an initial bounce, we think that a revaluation would have a negative impact, as it makes investment in foreign markets relatively cheaper. Listed companies that import would benefit from a revaluation; those that have foreign earnings may lose out.

Economy in brief: Inflation has broken double-digits for the first time since the late 1970s, with rents continuing to lead the way. Clear statements from GCC central bank governors have further subdued financial market pressure on the exchange rate peg. Strong demand for riyal-denominated funds by local banks has caused interbank rates to surge.

Healthy real non-oil growth



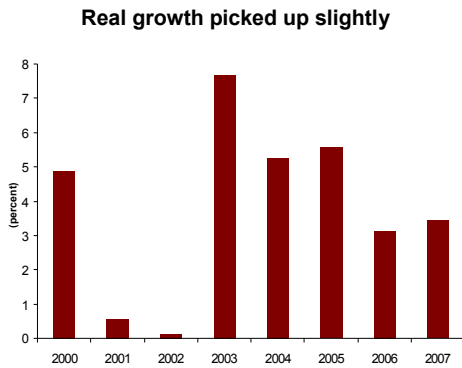
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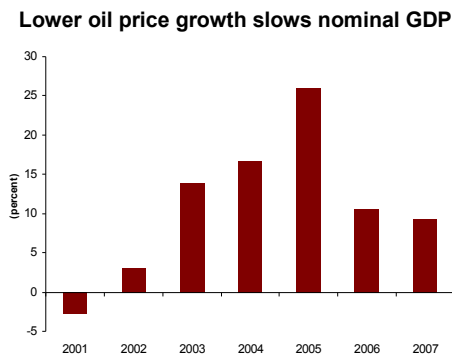


New data highlight economic trends

Newly published detailed economic data for 2007 highlights the strength of the Saudi economy last year and illustrates the challenges it faces over the next few years. The headline numbers are in line with those released in the budget at the end of last year; real GDP growth was 3.4 percent and the current account surplus was \$95 billion (24.9 percent of GDP). The breakdown of the data reveals some important trends, not all of which were evident from the earlier data. These are:



- Strong non-oil growth:** The non-oil sector grew by 5.8 percent, the second highest rate since 1982. Sectors benefitting from liberalization and the investment boom, namely transport and communications, construction and manufacturing, were the best performing.
- Bottlenecks emerging:** Growth in financial services was subdued given liberalization in the sector and the huge volume of business, and appears to have been hindered by skill shortages. Utilities grew at their slowest rate in nearly 10 years as capacity failed to keep up with surging demand, while growth in the real estate sector barely kept pace with population growth despite a significant shortage of accommodation.
- Declining public sector productivity:** Government services growth slowed again, expanding by less than half the rate of the growth in the public sector workforce, implying reduced productivity within the government sector.
- Huge oil exports and rapidly growing non-oil exports:** Oil exports exceeded \$200 billion for the first time owing to higher oil prices. Non-oil exports grew by over 20 percent for the fifth consecutive year and remained focused on downstream and energy-intensive products.
- Surge in payments for imported services:** Payments for imported services used in the oil sector jumped by 52 percent and imports of other services (including financial, legal, accounting and IT) leapt by 55 percent. This reflects both greater use and rising costs of imported professional services associated with the project boom.



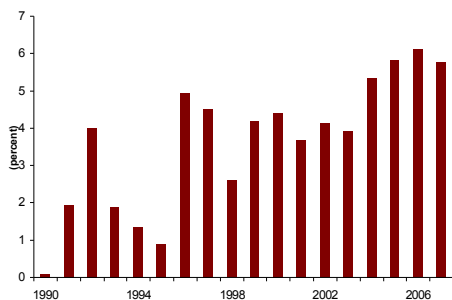
Economic growth

The Saudi economy grew by 9.4 percent last year, compared to the estimate of 7.1 percent contained in the budget. With growth in the oil sector unchanged from the preliminary projection of 8 percent, the increase in the nominal growth was due to the higher value of goods produced in other sectors. The growth rate was the lowest since 2002, but still meant that an extra \$33 billion was added to the value of economic output last year, a sum equivalent to the whole of the Tunisian economy.

Real GDP growth was 3.4 percent in 2007, in line with the preliminary estimate of 3.5 percent. However, the growth rate for 2006 was revised down to 3.1 percent from 4.3 percent. While growth at this level does not appear impressive, the non-oil private sector grew by an average of just under 6 percent over the last two years, the fastest rate since 1982. As the real data is adjusted for



Real non-oil growth remains strong



inflation, it provides a better guide of underlying trends in the economy.

Transport and communications, construction and manufacturing were the fastest growing sectors last year, in line with earlier projections. Transport and communications grew by 10.6 percent, benefitting from the rapid increase in mobile phone use and the liberalization of domestic air travel. Strong growth in construction (7.1 percent) reflects the implementation of the megaproject boom (projects worth \$470 billion are either planned or under way in the Kingdom). For manufacturing, growth of 6.5 percent was largely due to the ramping up of production at petrochemical facilities and greater output of plastics and base metals.

Real GDP growth by sector (percent)

	2004	2005	2006	2007	2008f
Agriculture	3.1	1.2	0.4	1.7	2.5
Manufacturing	6.8	6.9	6.3	6.5	7.6
Electricity, gas and water	6.5	5.4	6.4	4.7	5.0
Construction	6.5	4.8	7.3	7.1	7.5
Wholesale & retail trade	5.0	4.4	6.1	6.2	6.5
Transport & communication	8.0	8.7	9.8	10.6	9.2
Finance	4.4	6.4	4.6	3.7	5.0
Non-oil private sector	5.3	5.8	6.1	5.8	6.7
Oil	6.6	6.6	-1.1	0.2	5.5
Government services	2.2	3.3	1.9	1.3	2.0
Total	5.3	5.6	3.1	3.4	5.4

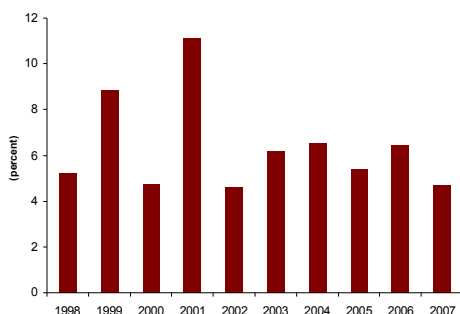
Strong growth in the non-oil sector is a feature of the current economic boom and something we expect to continue for several years to come. However, growth in some parts of the non-oil economy has been disappointing and highlights some potential concerns.

Real estate: Growth in the real estate sector fell to a four-year low of 2.5 percent, despite very strong demand for residential property that pushed up rents by 12.5 percent over 2007. The rising cost of raw materials and a shortage of skilled employees meant that the real estate sector barely keeping pace with the official population growth rate of 2.4 percent (we think this rate is a significant underestimation, as growth in the expatriate population was put at 143,000, even though the ministry of labor issued over one million new work visas to foreigners last year).

Finance: Growth slowed in the finance, insurance and business services sector for the second consecutive year, to 5 percent. On the face of it this is not a bad performance, but given the liberalization (37 new investment companies and several insurance companies started operations last year) and huge volume of business, we think growth should be much higher. It is our view that skill shortages are holding back the sector.

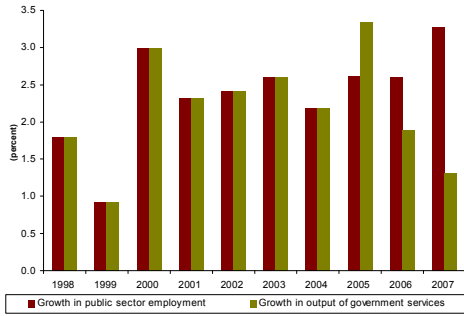
Electricity, gas and water: At 4.7 percent, growth in the electricity, gas and water sector was near a 10-year low and well below the average for the last decade of 6.4 percent. Growth in demand for these utilities is estimated at around 7 percent per year as a result of population growth and greater industrial use and existing facilities are clearly struggling to meet this. New power and water projects are being developed, but the bulk of new capacity is not due to come on

Utilities struggle to keep up with demand





Sign of declining government productivity?



stream until 2009 and 2010.

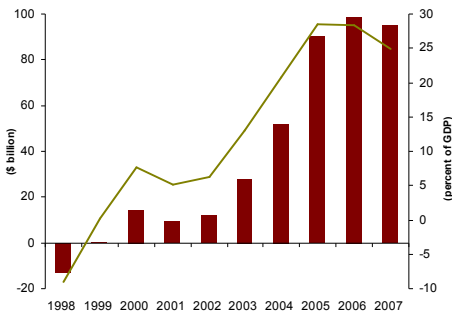
Government services: Growth in output of government services was just 1.3 percent last year and was revised down from 5.7 percent to 1.9 percent in 2006 (this revision explained virtually the entire difference between the preliminary and revised headline 2006 GDP growth data). Output of government services (such as defense, healthcare and education) is difficult to measure, particularly with regard to tracking improvements in quality rather than quantity.

However, it is notable that the slowdown comes in the context of rising public-sector employment. The number of employees in the public sector climbed by 3.3 percent last year, the fastest rate in over a decade, and above the growth in the output of government services of 1.3 percent. In 2006, the public-sector workforce was up by 2.6 percent. Around 48,000 Saudi nationals joined the public sector in the last two years, the number of expatriates was cut by 1,500—both figures exclude defense and security. The data implies that the increase in the public-sector workforce reduced productivity within the government sector. (However, it is notable that for many years growth in public sector employment and output of government services was identical, so this shift may reflect a change in methodology.)

In light of the new data, we have revised our forecasts for economic growth this year. Growth in the finance and electricity, power and water sectors has been trimmed and we have separately slightly lowered of projection for wholesale and retail trade, owing to the impact of inflation on consumers' spending power. We have therefore cut our forecast for non-oil private sector growth to 6.5 percent from 7.6 percent. In addition, we have halved our expectation for government services growth.

However, the prospect of higher oil production means that we have raised our forecast for total real GDP growth to 6.1 percent from 5.5 percent. Ahead of an oil summit in Jeddah on June 22, Saudi Arabia announced that it would increase oil production to 9.7 million barrels per day. We think that oil production will be held around this level for the rest of the year and therefore forecast that oil production will average 9.5 million in 2008, up 8 percent on the 2007 total (we will take a detailed look at the conclusions of the Jeddah meeting in the next *Monthly Bulletin*).

Current account surplus remains very high



Trade and current account data

Detailed trade and current account data were also released. The current account balance was \$95 billion in 2007, very slightly up from the initial projection given in the budget, but down from the record total of \$98.9 billion the previous year. Higher oil revenues were more than offset by increased imports of goods and services.

Total exports climbed by 11 percent last year to \$233.4 billion. Oil continues to dominate exports, accounting for 88 percent of the total in 2007. Non-oil exports grew by over 20 percent for the fifth consecutive year and are now more than triple their level in 2002. Chemical products remain the largest source of non-oil exports, climbing by 18 percent to \$8.3 billion last year, reflecting both higher production and international prices. Similar reasons explain the 18 percent jump in exports of plastic products, to \$6.1 billion.

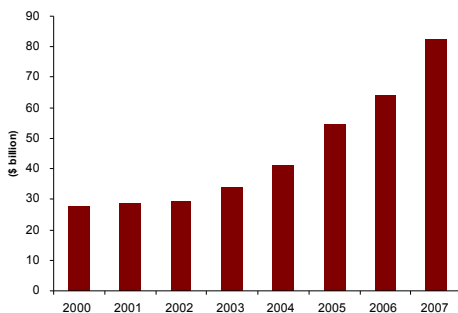


The non-oil trade data illustrates that the diversification going on within the Saudi economy is focused on generating greater value added from the Kingdom's hydrocarbon reserves rather than developing unrelated industries. Excluding oil, all downstream and energy-intensive products and re-exports (goods that have passed through Saudi Arabia in transit to a third country), total exports were just \$5.4 billion.

Non-oil exports
(\$ billion)

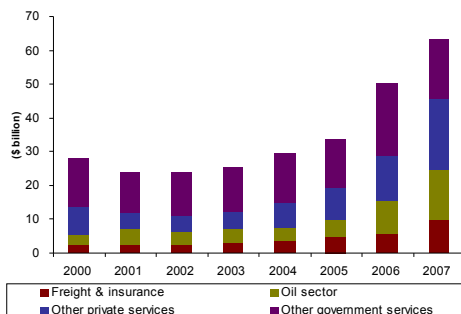
	2002	2003	2004	2005	2006	2007
Foodstuffs	0.5	0.8	1.0	1.2	1.4	2.0
Chemical products	3.7	4.3	5.0	6.5	7.1	8.3
Plastic products	1.5	1.9	3.3	4.7	5.2	6.1
Base metals & related articles	0.7	1.0	1.2	1.3	1.8	2.4
Electrical machines, equip. & tools	0.3	0.4	0.6	0.7	1.0	1.4
Other exports	0.7	1.2	1.6	1.5	2.2	2.0
Re-exports	1.1	1.3	2.5	2.9	3.9	5.3
Total non-oil exports	8.5	10.8	15.1	18.9	22.6	27.5

Imports jumped last year



Import growth was strong, at 29 percent. Goods used in the construction of the multitude of projects under way in the Kingdom are driving this growth. Imports of machinery jumped by 48 percent last year to \$99.7 billion, making them the largest single component of the import bill. Transport equipment, base metals and chemical imports all grew strongly and together now account for 40 percent of total imports. The import data also reveal that confidence in the economic outlook has helped spending on luxury items to rebound since the stock market crash of 2000; jewelry imports were up by 45 percent and imports of collectable art and antiques more than doubled last year.

Service payments have surged



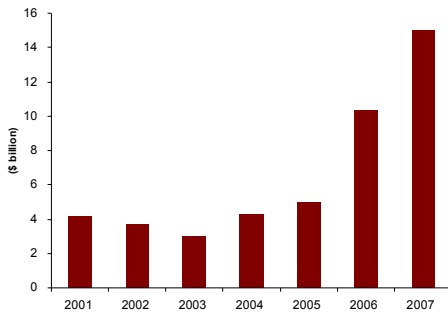
While the visible trade data was in line with our expectations, data on services payments were generally much higher than we had anticipated. This reflects both greater use and rising costs of imported professional services associated with the project boom. Payments for imported services used in the oil sector (such as construction, IT and other technical services) jumped by 52 percent and at \$14.8 billion were almost treble the level of 2005. Imports of other private services (including financial, legal, accounting, communication and advertising services) leapt by 55 percent to \$20.9 billion.

Higher oil prices had a significant impact on the freight and insurance costs paid by importers. These costs had been remarkably steady at 9 percent of total imports for the past decade, before jumping to 12 percent of the total import bill last year. In contrast, payments for imports of other government services fell. These are primarily defense items, and the decline follows a large jump in 2006 which we think was caused by payments for jet fighters. Official transfers (also categorized as other government services) almost certainly rose because of payments to help with the reconstruction of Lebanon.

Outflows of private transfers, which are remittances to home countries by expatriate workers, climbed by only 3 percent, to \$16.1 billion. We have long thought that these payments are significantly under-recorded and the new data supports this view. With work visas issued to over one million foreign nationals last year and remittance



Investment income up strongly



payments increasing by \$476 million, the new data implies that each new worker sent home less than \$500.

The only area of revenues that posted a major rise was investment income. This is revenue earned on the country's stock of foreign assets. Investment income jumped by 45 percent to \$15 billion and is now over triple the level of 2005. Official foreign assets were up by only 84 percent over the same period. We think that higher average interest rates for US Treasuries rather than a diversification into higher yielding assets explain the bulk of the remainder of the increase in investment income.

Current account

(\$ billion)

	2005	2006	2007	2008 forecast
Oil Exports	161.1	187.7	205.5	272.2
Other Exports	19.0	22.8	27.9	29.0
Imports	54.6	63.8	82.5	107.3
Trade balance	125.5	146.6	150.8	193.9
Receipts	12.1	18.2	23.5	29.3
Investment Income	5.0	10.4	15.0	20.0
Oil Sector (Bunker Oil)	0.5	0.6	0.6	0.8
Other	6.7	7.3	7.9	8.4
Payments	47.7	65.9	79.3	88.4
Freight And Insurance	4.9	5.9	9.9	13.9
Oil Sector	5.0	9.7	14.8	17.0
Other Private Services	9.6	13.5	20.9	22.5
Other Govt. Services	14.2	21.2	17.7	18.0
Private Transfers	14.0	15.6	16.1	17.0
Services and transfers balance	-35.5	-47.7	-55.8	-59.2
Current account balance	90.0	98.9	95.0	134.8
% GDP	28.5	28.4	24.9	28.7

The vast current account surplus is no surprise given the surge in oil prices. The more interesting aspect of the data is the jump in payments for imported services. The cost of skilled professional services, particularly for oil, gas and construction, has shot up in recent years due to strong demand and a limited supply. For Saudi Arabia this cost escalation has been compounded by a limited domestic skill base and difficulties in obtaining visas and suitable accommodation for skilled expatriate workers.

With the investment boom still only in its early stages, the need for imported services and raw materials will continue to rise. If imports of goods and services grow at the same rate over the next three years as they have done for the past three years and everything else stays unchanged, then it would require an oil price of \$63 per barrel for the current account to remain in surplus. While this is below our forecasts, it is more than double the level of a few years ago.



Stock market watch

The effect of a revaluation on the stock market

Our central forecast is that the exchange rate against the dollar will not be changed. If there were a change, however, the impact on the stock market would be as follows: after an initial bounce, we think that a revaluation would have a negative impact, as it makes investment in foreign markets relatively cheaper. Listed companies that import would benefit from a revaluation; those that have foreign earnings may lose out.

As rising inflation is eroding consumers' disposable incomes and generating uncertainty for local companies, it is likely that the Tadawul all-share index (TASI) would jump in the event of a revaluation.

After this immediate euphoria has evaporated, there is likely to be an outflow of funds from the local market. This is because reducing the number of riyals necessary to buy a unit of foreign currency makes investment in foreign currency denominated assets more attractive. A 15 percent revaluation of the riyal against the dollar would therefore make the riyal price of shares listed on US markets 15 percent cheaper. Some foreign investors may also choose to exit the market after making a one-off exchange rate gain from the revaluation (foreigners own a very small share of the Saudi market).

The companies and sectors that would benefit most from a revaluation are those that import, as a revaluation would lower the cost of imports in riyal terms. Although there will be pressure to pass on the impact of a revaluation to final consumers, importers would be able to increase profit margins. Retail and transport are the most import-dependant sectors on the Tadawul. Companies undergoing major expansion programs where the necessary technology comes from abroad, but final product is sold domestically, should also benefit. These include telecoms and real estate.

Performance of all companies with foreign earnings will worsen in the event of a revaluation, as these earnings will be worth less when converted into riyals and recorded in their financial statements. Sectors focused on exporting, such as petrochemicals and some manufacturers from the investment, construction and agricultural sectors, would be most affected. In addition, companies reliant on foreign spending (such as travel and tourism) would be hit.

A revaluation would lower the value of commercial bank foreign assets and raise the value of foreign liabilities in addition to lowering the value of returns on foreign investment when reported in riyals. Insurance companies would see a similar impact on their balance sheets, as would investment companies with large foreign holdings.

The energy and utilities, cement and agricultural sectors would be little affected by any revaluation of the riyal as the bulk of their inputs (power, limestone, water and labor) are sourced from within the Kingdom and their output is consumed domestically.

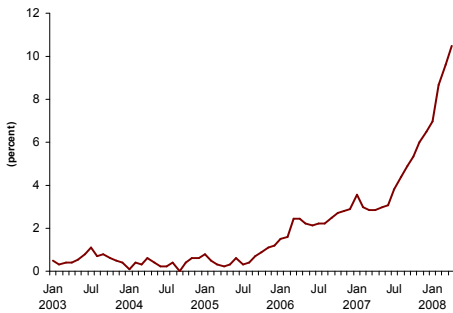
Likely to suffer if revaluation





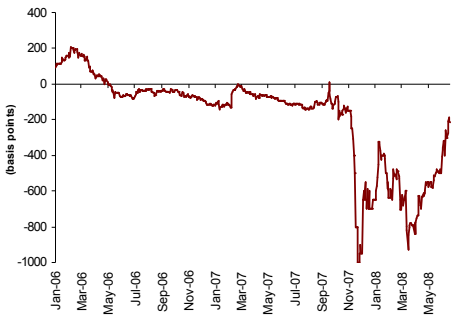
In brief: Economy

Inflation into double digits



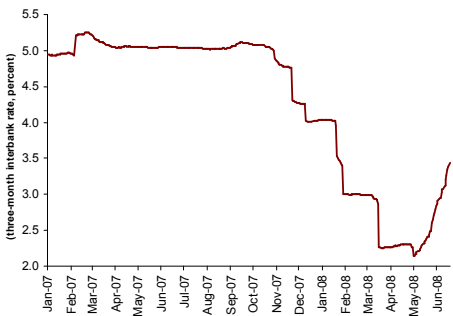
Inflation has broken double-digits for the first time since the late 1970s. Year-on-year inflation climbed to 10.5 percent in April from 9.6 percent in March. Rents remained the leading source of inflation, up 16.9 percent. Inflation in every component of the cost of living index (CLI) either accelerated or stayed the same and inflation in six of the eight components of the CLI is currently at more than five-year highs. Global food prices are easing after recent spikes, but low interest rates and the pass through from higher rents mean that inflation elsewhere in the economy should continue to rise.

Speculative pressure on riyal has eased



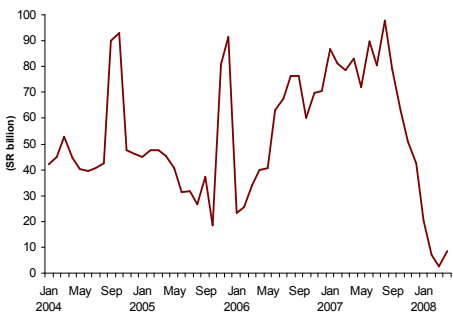
Financial market speculation on a revaluation of the riyal against the US dollar has eased significantly. One-year riyal forwards, which measure what the market expects the exchange rate to be in one year, are at their lowest level since November 2007. This follows clear statements from GCC central bank governors emphasizing their commitment to the exchange rate pegs and progress towards the regional single currency. In addition, there is a growing consensus that the dollar has bottomed and that US interest rates will be raised before the end of the year. In contrast, we feel that revaluation is more likely now given that the government has no other policies open to it that would have a clear and immediate impact on inflation, though our central forecast is that the peg remains unchanged.

Pushed up by demand for riyals



Interbank rates have shot up. On June 21 the three-month Saudi interbank rate (SAIBOR) was 3.43 percent, up from 2.14 percent on May 4, despite there being no change to the repo or reverse repo rate (SAMA's benchmark interest rates). The exchange rate peg means that SAIBOR is heavily influenced by US dollar interbank rates, and these have risen as the market is now expecting interest rate hikes before the end of this year. However, SAIBOR is up by far more than equivalent US rates; the spread between three-month SAIBOR and three-month dollar LIBOR has moved to 62 basis points from -55 basis points at the end of April. This is because of very strong demand for riyal-denominated funds from local commercial banks.

Bank foreign assets have slumped



It appears that some local banks are very actively raising finance in order to purchase assets underlying holdings of special investment vehicles that have been affected by the sub-prime crisis. Owing to concerns about a potential revaluation, banks are borrowing in riyals, rather than foreign currency. Riyal funding is being sought from local and international banks and this, combined with foreign banks positioning themselves in the event of a revaluation, has caused commercial bank foreign liabilities to almost double since August. The demand for riyal funding is also reflected in a SR12.0 billion increase in local interbank liabilities since December and a more than doubling of the value of repo transactions with private parties, to SR11.2 billion, over the same period.



Key data

	2002	2003	2004	2005	2006	2007	2008F	2009F	2010F
Nominal GDP									
(SR billion)	707.1	804.6	938.8	1182.5	1307.5	1430.5	1761.7	1751.6	1909.3
(\$ billion)	188.6	214.6	250.3	315.3	348.7	381.5	469.8	467.1	509.1
(% change)	3.0	13.8	16.7	26.0	10.6	9.4	23.2	-0.6	9.0
Real GDP (% change)									
Oil	-7.5	17.2	6.7	6.2	-0.8	0.5	8.0	3.0	2.0
Non-oil private sector	4.1	3.9	5.3	5.8	6.1	5.8	6.5	8.2	7.9
Non-oil government	2.9	3.1	3.1	4.0	3.1	2.7	2.5	2.5	2.5
Total	0.1	7.7	5.3	5.6	3.2	3.4	6.1	5.3	5.0
Oil indicators (average)									
WTI (\$/b)	26.2	31.1	41.5	56.7	66.1	72.3	90.0	76.0	85.0
Saudi (\$/b)	23.7	26.9	34.7	49.5	60.5	68.1	85.0	72.0	79.5
Production (million b/d)	7.5	8.8	9.0	9.5	9.2	8.8	9.5	9.8	10.0
Budgetary indicators (SR billion)									
Government revenue	213	293	392	564	674	622	808	720	802
Government expenditure	234	257	285	346	393	443	532	611	685
Budget balance	-21	36	107	218	280	179	277	109	117
(% GDP)	-2.9	4.5	11.4	18.4	21.4	12.5	15.7	6.2	6.2
Domestic debt	660	660	614	475	366	267	250	230	240
(% GDP)	93.3	82.0	65.4	40.2	28.0	18.7	14.2	13.1	12.6
Monetary indicators (average)									
Inflation (% change)	0.2	0.6	0.3	0.7	2.3	4.1	8.2	6.2	5.0
SAMA base lending rate (% , year end)	2.00	1.75	2.50	4.75	5.20	5.50	5.50	5.50	5.50
External trade indicators (\$ billion)									
Oil export revenues	63.6	82.0	110.4	161.1	187.7	205.5	272.3	238.1	271.0
Total export revenues	72.3	93.0	125.7	180.1	210.5	233.4	301.2	270.5	306.1
Imports	29.6	33.9	41.1	54.6	63.8	82.5	107.3	130.9	155.8
Trade balance	42.6	59.1	84.6	125.5	146.6	150.8	193.9	139.6	150.3
Current account balance	11.9	28.0	51.9	90.0	98.9	95.0	134.8	86.8	103.1
(% GDP)	6.3	13.1	20.7	28.5	28.4	24.9	28.7	18.6	20.2
Official foreign assets	73.3	97.1	127.9	195.5	273.4	359.8	477.7	553.7	644.2
Social and demographic indicators									
Population (million)	21.5	22.0	22.5	23.1	23.7	24.2	25.0	25.8	26.6
Unemployment (male, 15+, %)	7.6	8.2	8.5	8.8	9.1	9.0	8.8	8.5	8.2
GDP per capita (\$)	8773	9745	11112	13640	14725	15736	18758	18073	19115

Sources: Jadwa forecasts for 2007 to 2010. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.



List of publications

Monthly Bulletins¹

June 2008	Feature: TASI fairly valued and poised to rise
May 2008	Feature: Oil's surge: what's behind it and what it means for Saudi Arabia
March 2008	Feature: Impact of the weak global economy on Saudi Arabia
February 2008	Feature: The inflation alleviation plan
January 2008	Feature: Saudi Arabia's economic outlook for 2008
December 2007	Feature: Saudi stock market: too far, too fast
October 2007	Feature: Oil market developments boost economic outlook
September 2007	Feature: How sub-prime woes affect Saudi Arabia

Economic Reports¹

December 2007	Saudi Arabia's 2008 budget
November 2007	Saudi riyal: pressures mount
October 2007	Why food prices have risen in Saudi Arabia
August 2007	The riyal's peg to the dollar
July 2007	The Saudi economy's golden era: phase two

Equity Research²

12 May 2008	Saudi Hotels and Resorts
22 March 2008	Jarir Marketing Company

Presentations³

May 2008	Jadwa's market call
April 2008	The Saudi economy: the boom and its challenges
March 2008	Economic consequences of high oil revenues in oil producing states
November 2007	Emerging opportunities on the Saudi Tadawul
September 2007	The GCC economies and the global context

¹ These reports are available to download from our website, www.jadwa.com, in Arabic and English.

² These reports, available in Arabic and English, can be downloaded from our website by Jadwa brokerage clients only.

³ These presentations are only available in English and can be downloaded from our website.



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