



Highlights and Key Issues

- September banking data from SAMA were somewhat disappointing. They showed that banks were still reluctant to lend, retail spending was down for a second month in a row and net letters of credit opened were down for a third month, the latter reflecting weak private domestic demand. In addition, oil output continued to edge down in October as the Kingdom complied 100% with its OPEC quota cut.
- But GDP growth should accelerate to a little over 5% next year after an estimated 0.7% fall this year. This will reflect rising business confidence on the back of the global recovery and higher oil prices, as well as an expected 8% increase in oil output and continued fiscal stimulus.
- Although inflation dipped to a low of 3.5% in October, there are fears that it may start to rise again. We expect it to increase slightly in 2010 to 4.2% on the back of the rise in world food prices, the depreciation of the US\$ (to which the SAR is fixed) and some strengthening in domestic demand. But inflation is forecast to weaken to some 3% in 2011 as the US\$ rises again and commodity prices stabilise.
- Data for H1 2009 show a 62% decline in the trade surplus. Even with the recovery in the oil price in H2, the current account surplus will shrink to around 9% of GDP from almost 29% in 2008. Higher oil prices and output will see the surplus widen again to 14% of GDP in 2010.

Forecast for Saudi Arabia						
(Annual percentage changes unless specified)						
	2007	2008	2009	2010	2011	2012
Real GDP growth (% year)	3.3	4.4	-0.7	5.3	6.9	4.5
CPI inflation (%)	4.2	9.9	5.1	4.2	3.0	2.5
Exports of goods (\$ bn)	233.2	313.4	187.3	229.4	279.8	303.2
Exports of services (\$ bn)	7.9	7.9	7.1	8.0	8.6	9.2
Imports of goods (\$ bn)	82.5	101.5	91.3	102.5	112.2	122.0
Imports of services (\$ bn)	30.8	40.8	34.5	39.3	43.6	47.3
Exports of goods (% year)	10.5	34.4	-40.2	22.4	22.0	8.4
Imports of goods (% year)	29.3	22.9	-10.0	12.3	9.4	8.8
Current account (\$ bn)	93.3	134.0	33.7	60.6	97.5	108.1
Current account balance (% of GDP)	24.3	28.6	8.8	14.1	20.0	20.5
Exchange rate per USD (year average)	3.75	3.75	3.75	3.75	3.75	3.75
External debt total (\$bn)	-	-	-	-	-	-
Government balance (% of GDP)	12.3	29.7	-3.9	3.1	8.7	8.5
Population (millions)	24.7	25.2	25.7	26.2	26.8	27.3
Nominal GDP (\$bn)	384.1	468.8	383.0	429.6	487.8	527.8
GDP per capita (\$ current prices)	15,564	18,602	14,889	16,368	18,215	19,323

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Overview

Weak banking data...

- September banking data from the Saudi Arabian Monetary Agency (SAMA) were a little disappointing. Commercial bank lending to the private sector rose by 0.5% on the month, but its annual rate of growth was just 2.5%, down from 4.4% in August and well below the 27% growth posted in 2008 as a whole.
- While deposit growth is now strong at some 21%, banks remain cautious in the current environment, especially in lending to new private projects following the debt defaults by two major Saudi family businesses. Local banks have more than tripled their provisions against loan losses in the first nine months of this year. Nevertheless, most banks remain well capitalised and profitable. But foreign banks also remain wary of increasing their exposure.
- Consumers are also cautious and continue to favour putting their money in bank deposits. The value of point-of-sale transactions (the best proxy for retail sales) fell for a second successive month in September, down 10.4% on the month, though still 7% higher in nominal terms.
- Furthermore, the value of private sector imports financed through new letters of credit fell for a third consecutive month in September to stand 38% lower than a year earlier, suggesting private domestic demand remains particularly weak.

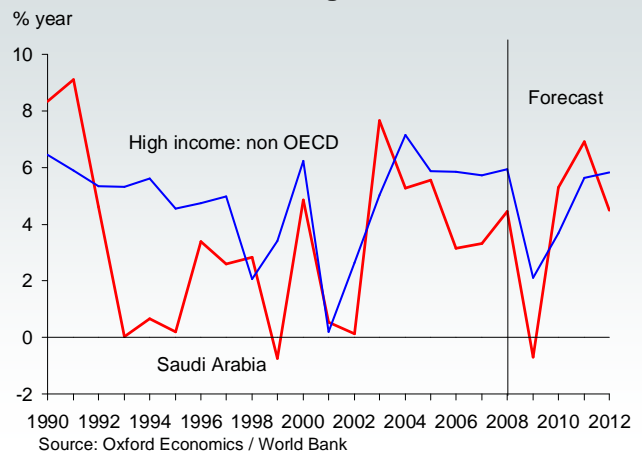
...and oil output lower

- Oil output continued to edge down in October by a further 50,000 b/d, to leave compliance with its OPEC quota cut at 100% again. But with the prospect of OPEC quotas being relaxed, oil prices looking more sustainable at levels of around US\$80pb and a lot of spare capacity, we can expect Saudi oil output to increase by up to 8% next year after an estimated fall of just over 10% this year.

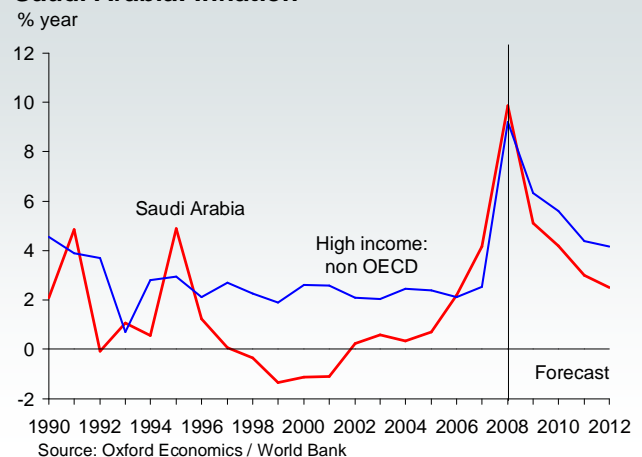
More promising growth outlook...

- Against the background of an improving global economy, rising oil prices and output and continued fiscal stimulus, we expect a reasonably strong upturn in economic activity next year. According to the latest HSBC survey, Saudi business confidence rose to 91.5% in Q3, from 86.8% in Q2 and 82.5% in Q1, the highest among the six Gulf States.

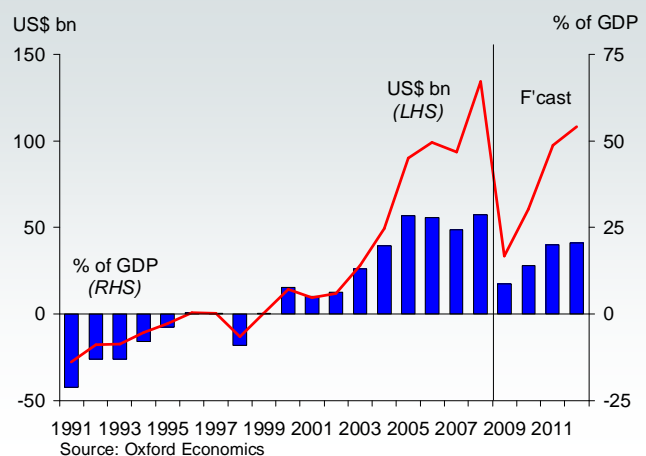
Saudi Arabia: Real GDP growth



Saudi Arabia: Inflation



Saudi Arabia: Current account balance



- The stock market has also risen, by some 32% this year, although it has been fairly static in the last two months. Moreover, the Tadawul has seen four well-known financial institutions receive licences to launch indices tracking the performance of sharia-compliant equities – a sure sign of the growing interest and confidence in the Saudi stock market as well as its increasing sophistication.
- Overall, we still believe that GDP can bounce back strongly in 2010, posting growth of some 5.3% after a fall of about 0.7% in 2009.

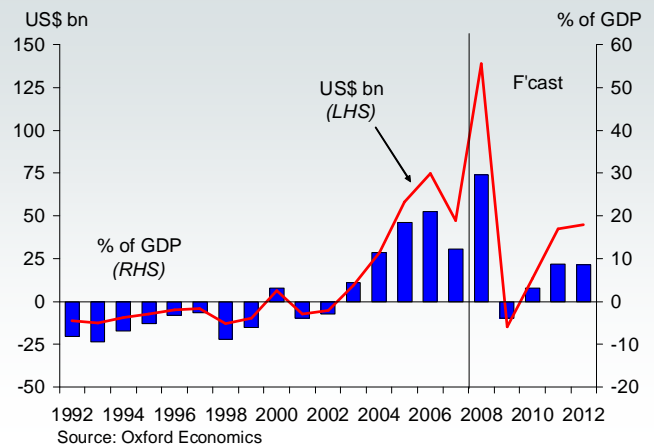
...but inflation may rise again soon...

- Inflation fell to 3.5% in October, its lowest since June 2007. But price increases are gathering pace, with the dip in October attributable to a large rise in prices a year earlier due to surging food prices.
- Less favourable base effects in the coming months, combined with rising international food prices, the depreciation of the US\$ (to which the Saudi riyal is pegged) and rising domestic demand are likely to see inflation pick up to a little to 4.2% next year after an estimated 5.1% this year.
- But we expect inflationary pressures to weaken again in 2011 as the US\$ strengthens again, commodity prices stabilise and monetary policy tightens.

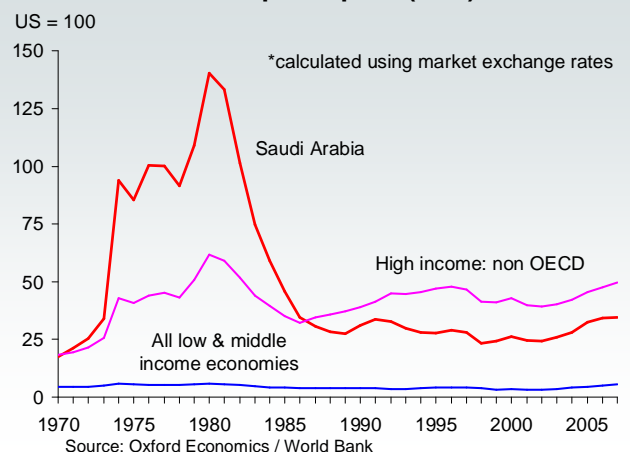
...and current account surplus falling

- In the first six months of 2009, goods exports fell by 45% from a year earlier – almost entirely the result of lower oil prices. Although goods imports fell by 14% as a result of the slowdown in the economy, the trade surplus dropped by 62% decline in H1.
- But with oil prices now rising, the decline in goods exports for the whole year will be rather lower, at some 40%. As a result, despite a recovery in imports, we see a current account surplus equal to nearly 9% of GDP this year, down from almost 29% of GDP in 2008. Higher oil output and a higher oil price (averaging US\$73pb versus US\$62pb this year) will see the current account surplus widen again to some 14% of GDP in 2010.
- The latest SAMA data also show that net foreign assets, including those of commercial banks, declined for a tenth consecutive month in September to US\$404bn.

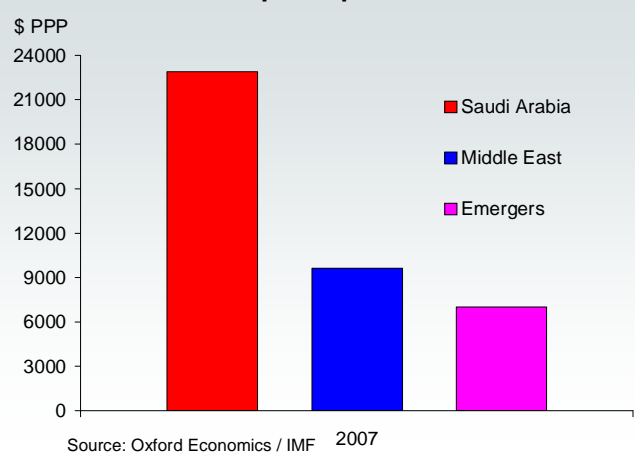
Saudi Arabia: Government budget balance



Saudi Arabia: GDP per capita* (US\$)



Saudi Arabia: GDP per capita



Background

- The country is named after the ruling Al Saud family, which came to power in the 18th century and continues to hold a monopoly of power. King Abdullah succeeded King Fahd, his half brother, in August 2005 although he had been effective ruler since Fahd suffered a stroke in the mid-1990s. During the 20th century, successive monarchs concentrated on modernisation and on developing the country's role as a regional power. It has been in the ruling family's interests to preserve stability in the region and to clamp down on extremist elements and it welcomed the stationing of US troops in the country after the Iraqi invasion of Kuwait in 1990. After the 9/11 terrorist attacks on the US, the Saudi authorities were torn between their instinct to step up internal security and the pressure from sections of society (and from the country's allies) to allow a greater degree of democracy.
- The leadership's continued reluctance to tolerate any opposition may have contributed to the emergence of dissident groups supporting international terrorism, which launched a number of deadly attacks in 2003/04 targeted at foreign workers. Demands for political reform have increased, but the response has been limited. Municipal elections in 2005 were an initial, albeit very minor, exercise in democracy and political parties remain banned - the opposition is organised from outside the country and local activists calling for faster political reform risk being jailed.
- Saudi Arabia has been the world's leading oil producer and exporter and its 264bn barrels of proven reserves, over 20% of the world's reserves, are sufficient for 70 years' production at around 10.5m b/d. The economy is dominated by the oil sector, which since the end of the Gulf war in 1991 has accounted for around 35-40% of GDP, over 80% of government revenue and 95% of exports. Industrial sector development is based on the ample availability of hydrocarbon resources and is strongly influenced by developments in the oil industry, with petroleum refining accounting for some 30% of manufacturing output. The petrochemicals sector relies for its feedstock on gas, most of which is still associated with crude oil output. Oil revenue has been used to develop agriculture and other industries, including iron and steel, construction materials, food processing, engineering, chemicals and metal fabrication.
- As a result of the dominant oil sector, economic performance has been dictated by the fortunes of the oil market. After the problems of the 1990s, which saw oil prices, and hence government revenues, collapse, the combination of high oil prices and rising production and exports led to a surge in revenues, especially since 2003. Oil exports in 2007 reached US\$205bn, up from about US\$64bn in 2002. As a result, real GDP growth has accelerated from below 1% in 2001 and 2002 to 6.1% in 2005, although it slowed to a little over 3% in 2006-07 on a weaker performance by the oil sector as OPEC cuts were imposed. After picking up to 4.5% growth in 2008, the economy has been close to recession in 2009 as a result of the global financial crisis and economic slowdown. Inflation has traditionally been very low, but accelerated to over 4% in 2007 and then to over 11% in mid-2008, the highest since the 1970s, amid concerns about the impact of the currency peg to the US\$ and rapidly rising rents and food prices. It has since slowed to 3.5% in October 2009.
- Despite the surge in oil income in recent years, Saudi Arabia continues to face some serious long-term economic challenges, including a high rate of unemployment (estimated at around 11% for Saudi nationals) as a result of very rapid population growth. Together with a need to improve the country's infrastructure, this is adding to the pressure for increased government expenditure. The Kingdom has also had to raise spending on security. But after running heavy budget and trade deficits for many years after the costly 1990/91 war with Iraq, public debt has been brought down from around 120% of GDP after the collapse in oil prices in the late-1990s to an estimated 12% at end-2008 as the government used its budget surpluses to pay down debt. Saudi Arabia does not now have any foreign debt and, with the current account surplus rising to US\$95bn in 2007 and US\$134bn in 2008, it has built up extensive foreign assets – currently just over US\$400bn – as well as US\$31bn in official reserves. These have provided an important cushion against the recent downturn in oil revenues and support for the Saudi riyal (SAR), which is pegged to the US\$ at US\$1=SAR3.75.
- One factor that should enhance economic prospects is WTO membership, achieved in December 2005. Much of the reform and trade liberalisation in earlier years was the result of preparation for membership, in turn helping to foster faster economic growth, especially in the private sector. In addition, WTO membership will further several primary goals of economic policy, including diversification away from oil, job creation for Saudi nationals and attracting fresh inflows of foreign investment, although the current global downturn will inevitably interrupt the process.

Key Facts

Politics

Head of state: King ABDALLAH bin Abd al-Aziz Al Saud
 Head of government: King ABDALLAH
 Political system: Monarchy
 Date of next legislative election: none
 Currency: Saudi riyal (SAR), pegged to the US\$

Long-term economic & social development

	1975	1985	1995	2007*
GDP per capita (US\$)	6417	8066	7697	15564
Inflation (%)	34.6	-3.1	4.9	4.2
Population (mn)	7.3	12.9	18.3	24.7
Urban population (% of total)	58.0	73.0	79.0	81.0
Life expectancy (years)	-	65.0	70.0	73.0

Source : Oxford Economics & World Bank

Structure of GDP by output

	2007
Agriculture	3.0%
Industry	65.0%
Services	32.0%

Source : World Bank

* 2007 or latest available year

Long-term sovereign credit ratings & outlook

	Foreign currency	Local currency
Fitch	AA- (Stable)	AA- (Stable)
Moody's	A1 (Positive)	A1 (Positive)
S&P	AA- (Stable)	AA- (Stable)

Structural economic indicators

	1990	1995	2000	2007*
Current account (US\$ billion)	-4.2	-5.3	14.3	93.3
Trade balance (US\$ billion)	22.7	24.3	49.6	150.6
FDI (US\$ billion)	1.9	-1.9	-2.0	-8.1
Debt service (US\$ million)	-	-	-	-
Debt service (% of exports)	-	-	-	-
External debt (% of GDP)	-	-	-	-
Oil production (000 bpd)	6410	8231	8404	8722
Oil consumption (000 bpd)	1107	1255	1537	2210

Source : Oxford Economics / World Bank / EIA

Destination of goods' exports (2007)

Japan	26.8%
Taipei, Chinese	23.6%
United States	17.5%
European Union (27)	7.1%
United Arab Emirates	3.6%

Source : WTO



Source : CIA Factbook

Location : Middle East, bordering the Persian Gulf and the Red Sea, north of Yemen (CIA Factbook)

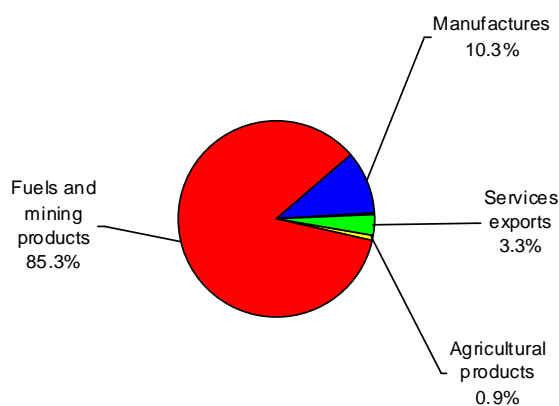
Corruption perceptions index 2008

	Score
Developed economies (average)	7.73
Emerging economies (average)	3.44
Saudi Arabia	3.50
Middle East	3.93

Source: Transparency International

Scoring system 10 = highly clean, 0 = highly corrupt

Composition of goods & services exports, 2007



Source : WTO