Strategy shift
Saudi spending swells, oil price jump evens out fiscal balance

❖ Block of new spending initiatives for citizens to cost at least SR485 billion over several years

❖ We are raising our 2011 public expenditures forecast by almost a quarter but fiscal surplus still likely as oil prices and output offset higher expenses

❖ Oil GDP set to grow 7.9% this year on output jump, lifting overall real GDP growth estimate to 5.5%

❖ State and private sector bonus payments, salary hikes risk stoking inflation

When Saudi Arabia unveiled a record 2011 budget in December, one of the key features was an attempt to minimise overspending while maintaining an expansionary stance toward the country’s considerable infrastructure development needs. The budget called for a 7.4% increase in state expenditures to SR580 billion – among the slowest rates of budget expansion in a decade during which public spending more than doubled.

This restrained fiscal scenario has taken a U-turn since then with a string of new social and economic initiatives for citizens, unveiled by royal decree in the first quarter, adding an estimated SR185 billion in new expenditures this year alone, according to our estimates. The block of initiatives should cost the state at least SR485 billion ($129.28 billion) in total over several years as it raises wages, pays out bonuses to state employees, introduces an unemployment benefit, orders tens of billions of riyals to be committed to new housing projects and home finance schemes, and creates jobs.

On account of the burst in spending, we have raised our 2011 state expenditure forecast by 24.5% to SR842.4 billion, representing a substantial 34.5% rise over 2010 figures. The revised forecast also constitutes overspending of 45% on the expenditure target set out in this year’s budget, which would be the fastest pace of overspending in three decades.

Despite a jump in projected expenditures this year, Saudi Arabia should manage to produce a respectable fiscal surplus owing to a rise in oil prices in the first quarter to $94 a barrel for U.S. crude and $105 for Brent. Oil production has also climbed in the last three months as the world’s top oil exporter strived to compensate for a shortfall in output by OPEC producer Libya, currently embroiled in political instability. We have raised our full-year oil price forecast to $92 a barrel for Saudi crude and expect that, on average, the kingdom will pump 8.9 million barrels per day of oil this year, 9.1% higher than 2010 output.
As a consequence of the more favourable energy market environment, Saudi Arabia should achieve fiscal revenues of SR904.1 billion, enabling it to post a surplus of SR61.7 billion, or 3.1% of GDP. The kingdom’s store of net foreign assets hit a record level of SR1.67 trillion ($444.88 billion) as of the end of January, easing slightly in February, giving the government a great deal of leverage to fund social programmes for its citizens without incurring debt. Still, extraordinary fiscal outlays will temper the pace of foreign assets growth, and we expect the end-year total to reach $465 billion.

The rise in oil output, coupled with greater state spending commitments, has also heightened the prospects for higher GDP growth this year. We expect Saudi Arabia’s economy will expand 5.5% in 2011 in real terms, up from a previous forecast of 4.2%, with most of the new growth resulting from a direct increase in oil output. Government-steered growth of the non-oil sector growth is also a key factor to consider. We anticipate government sector GDP will rise 5.6% this year, its third straight year of growing more than 5%.

With all of the new cash circulating in the economy, inflationary pressures are likely to accrue, particularly toward the second half of the year, and could lead to a rise in the overall inflation rate from our previous forecast of 5.1%. Coupled with high global food prices, the two-month salary bonuses granted to employees of the public sector, as well as many in the private sector, will enhance citizens’ spending power. Meanwhile, pressure to speed up home construction with SR250 billion in new state financing could raise the cost of building materials and other inputs in the coming months and years. We have raised our inflation forecast to 5.6% for 2011 in view of these factors.

Expenditures mount with social schemes

In two royal decrees in February and March, King Abdullah committed to investing an estimated SR485 billion of state cash toward multiple initiatives geared toward supporting citizens as popular unrest mounts in many countries of the region. These funds will be distributed over several years, although we anticipate 38% of the money, SR184.96 billion, should be dispersed before the end of the year.

A large portion of the funds will go toward the estimated SR53-billion price tag associated with the payment of one-time bonuses for all public sector staff and students, granted under the scheme. Active employees and pensioners in civil service positions and military personnel were granted two-month salary bonuses, as were university students studying at public universities and abroad.

The bulk of these bonuses – which should have a temporary impact unless they become an annual trend – had been distributed by the end of the first quarter. Private sector banks and large companies like Saudi Aramco, meanwhile, took cue from the state move and offered employees similar

<table>
<thead>
<tr>
<th>New financial support for citizens</th>
<th>Allocation (SR, bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Housing to build 500,000 homes over five years</td>
<td>250.0</td>
</tr>
<tr>
<td>Real Estate Development Fund, to offer a greater number of home loans</td>
<td>40.0</td>
</tr>
<tr>
<td>Ministry of Housing to build homes for state employees</td>
<td>15.0</td>
</tr>
<tr>
<td>Saudi Credit &amp; Savings Bank</td>
<td>30.0</td>
</tr>
<tr>
<td>Ministry of Health and private hospitals</td>
<td>17.0</td>
</tr>
<tr>
<td>Islamic organisations and charities</td>
<td>1.5</td>
</tr>
<tr>
<td>Funds for social security-related programmes</td>
<td>5.7</td>
</tr>
<tr>
<td>Literary, sporting clubs and professional associations</td>
<td>1.5</td>
</tr>
<tr>
<td>One-time bonus payments for public sector staff</td>
<td>52.9</td>
</tr>
<tr>
<td>Unemployment benefit, estimated annual cost</td>
<td>10.8</td>
</tr>
<tr>
<td>Permanent inclusion of 15% inflation allowance*</td>
<td>37.0</td>
</tr>
<tr>
<td>Estimated annual cost of new public sector jobs (61,700)</td>
<td>6.3</td>
</tr>
<tr>
<td>New minimum wage, estimated annual cost</td>
<td>7.1</td>
</tr>
<tr>
<td>Other</td>
<td>10.0</td>
</tr>
<tr>
<td>TOTAL</td>
<td>485</td>
</tr>
</tbody>
</table>

* The extension of this allowance was first announced in November and already considered in 2011 expenditures

Source: Royal decrees, Banque Saudi Fransi estimates

Expenditures mount with social schemes
Striving to improve the pay scale of employees in the public sector, the king also ordered the minimum wage for civil service employees to be raised to SR3,000 from SR2,185. It is still unclear how this SR815 raise will affect the entire pay scale, which for general public service personnel ranges as high as SR20,250 depending on tenure and position. Assuming all employees receive an average raise of SR500 per month, the pay increase would cost approximately SR5.3 billion in 2011 and add at least SR7.08 billion to the full-year wage bill in 2012 and subsequent years. If the pay raises are higher, at SR815 across the board for instance, the cost would rise to SR8.7 billion in 2011 and SR11.54 billion in 2012.

The government had also said in November last year that it would not phase out an inflation allowance that had raised the salaries of state employees by 15% over the three years to 2010. As this was not a new initiative, we already factored the likely cost – SR37 billion per year – into our wage bill calculations, although it will add an additional cost to subsequent budgets.

Labour market initiatives were a key focus of state initiatives unveiled in the first quarter. A number of new schemes to create jobs in the public sector, raise the minimum wage for state employees and introduce an unemployment benefit for the first time are likely to cost the state at least SR21 billion per year, possibly more if the number of citizens registering as unemployed increases. A study we published in February looks in depth at the challenges facing Saudi Arabia’s labour market as youth unemployment reaches 39% for Saudis between the age of 20 and 24.

Tackling a mounting challenge of joblessness, particularly among youth, the government will introduce for the first time an unemployment benefit of SR2,000 per month payable for a period of one year for unemployed people looking for work in the public and private sectors. The benefit will come into force in the new Hijri year, which begins in November. Unemployment payouts will thus be reflected in the Saudi budget next year, when the programme is fully rolled out at a cost of about SR10.8 billion annually, according to our estimates based on the latest available unemployment data.

For 2011, the cost of the programme is unlikely to exceed SR1.8 billion. The measure should be accompanied with attempts to train and locate jobs for citizens drawing on the scheme through job centres. Some media reports have indicated that up to two million Saudis have registered themselves as unemployed in order to qualify for the benefit – which would greatly increase the cost of the programme, depending on the result of background checks currently underway.

### Public sector bonus payment to cost SR52.9 billion

<table>
<thead>
<tr>
<th>Public sector employees</th>
<th>18.66</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractual employees that have become full-time</td>
<td>3.40</td>
</tr>
<tr>
<td>Military employees</td>
<td>22.10</td>
</tr>
<tr>
<td>Pensioners</td>
<td>7.75</td>
</tr>
<tr>
<td>Students enrolled at local universities</td>
<td>1.41</td>
</tr>
<tr>
<td>Students studying on scholarship abroad</td>
<td>1.60</td>
</tr>
<tr>
<td><strong>Total expense</strong></td>
<td><strong>52.92</strong></td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi estimates based on data from SAMA, Ministry of Civil Services

Striving to improve the pay scale of employees in the public sector, the king also ordered the minimum wage for civil service employees to be raised to SR3,000 from SR2,185. It is still unclear how this SR815 raise will affect the entire pay scale, which for general public service personnel ranges as high as SR20,250 depending on tenure and position. Assuming all employees receive an average raise of SR500 per month, the pay increase would cost approximately SR5.3 billion in 2011 and add at least SR7.08 billion to the full-year wage bill in 2012 and subsequent years. If the pay raises are higher, at SR815 across the board for instance, the cost would rise to SR8.7 billion in 2011 and SR11.54 billion in 2012.

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<table>
<thead>
<tr>
<th>New state payouts to add almost 25% to 2011 expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total government revenue</strong></td>
</tr>
<tr>
<td>New forecast</td>
</tr>
<tr>
<td>Previous forecast</td>
</tr>
<tr>
<td>Government budget forecast</td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi forecasts, Ministry of Finance

For 2011, the cost of the programme is unlikely to exceed SR1.8 billion. The measure should be accompanied with attempts to train and locate jobs for citizens drawing on the scheme through job centres. Some media reports have indicated that up to two million Saudis have registered themselves as unemployed in order to qualify for the benefit – which would greatly increase the cost of the programme, depending on the result of background checks currently underway.
Fastest pace of overspending in three decades likely for 2011

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>-30</td>
</tr>
<tr>
<td>1983</td>
<td>-30</td>
</tr>
<tr>
<td>1985</td>
<td>20</td>
</tr>
<tr>
<td>1988</td>
<td>0</td>
</tr>
<tr>
<td>1990/1</td>
<td>10</td>
</tr>
<tr>
<td>1993</td>
<td>20</td>
</tr>
<tr>
<td>1995</td>
<td>30</td>
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<td>1997</td>
<td>40</td>
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<td>2003</td>
<td>70</td>
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<td>2005</td>
<td>80</td>
</tr>
<tr>
<td>2007</td>
<td>90</td>
</tr>
<tr>
<td>2009</td>
<td>100</td>
</tr>
<tr>
<td>2011</td>
<td>110</td>
</tr>
</tbody>
</table>

Source: SAMA, Banque Saudi Fransi forecasts

**Likely roll out of fiscal spending programme**

<table>
<thead>
<tr>
<th>(SR, bn)</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>One-time bonus for public sector staff</td>
<td>52.92</td>
<td>n/a</td>
</tr>
<tr>
<td>Ministry of Housing</td>
<td>41.00</td>
<td>45.00</td>
</tr>
<tr>
<td>REDF*</td>
<td>40.00</td>
<td>n/a</td>
</tr>
<tr>
<td>Unemployment benefit</td>
<td>1.79</td>
<td>10.77</td>
</tr>
<tr>
<td>New wage scale with higher minimum wage</td>
<td>5.31</td>
<td>7.08</td>
</tr>
<tr>
<td>Saudi Credit &amp; Savings Bank*</td>
<td>30.00</td>
<td>n/a</td>
</tr>
<tr>
<td>Social Security benefits*</td>
<td>5.70</td>
<td>n/a</td>
</tr>
<tr>
<td>Ministry of Health</td>
<td>6.00</td>
<td>10.00</td>
</tr>
<tr>
<td>Social, Islamic, charity and sports commitments</td>
<td>1.53</td>
<td>1.50</td>
</tr>
<tr>
<td>New job creation</td>
<td>0.71</td>
<td>3.06</td>
</tr>
<tr>
<td>Making permanent cost of living allowance**</td>
<td>n/a</td>
<td>37.00</td>
</tr>
<tr>
<td></td>
<td>184.96</td>
<td>114.41</td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi estimates

* Total allocations received in 2011, but likely to be utilised incrementally over next few years

**This cost was already factored into 2011 budget

The promise that new jobs would be created in the public sector could also place further strain on the public sector wage bill in the coming years. The king ordered the Ministry of Interior to offer 60,000 to beef up security forces. He also called for the creation of 500 jobs at the Ministry of Commerce to improve market supervision and regulation, and 1,200 jobs related to regulatory programmes, such as the Saudi Bureau of Investigation and Prosecution and the Royal Court. According to our estimates, these new positions could cost the government SR712.5 million in 2011 and SR3.1 billion in 2012.

New social insurance benefit rules that enable families to claim benefits for up to 15 members, from a previous cap of eight, are further likely to add SR1 billion in new spending this year, while an additional SR2 billion should be spent on programmes to support citizens with household expenses including home furniture, school uniforms and books, utility bills, and home renovations, as well as support associations for handicapped persons.

**New fiscal strain offset by oil market upturn**

With all the new spending, we have revised our fiscal forecasts to reflect both the greater strain on state finances and the likely jump in public revenues due to the more robust oil price environment.

We now envision Saudi Arabia will spend SR842.4 billion this year, marking a sharp 34.5% rise over 2010 public spending. At this level, state would have exceeded by 45% its 2011 budget expenditure target of SR580 billion, the fastest pace...
of overspending in three decades. In our perspective, some 66% of 2011 spending will go toward current expenditures, covering the cost of wages, subsidies, supplies and other recurring items. One third of the spending will cover costs related to capital expenditures as the kingdom pushes forward with plans to build infrastructure and new homes.

We expect that in 2012, the impact of the new spending scheme will continue to exert fiscal pressure, with the state spending at least SR114.4 billion to finance programmes launched this year. The kingdom should nonetheless achieve a surplus of SR60.3 billion in 2012, according to our revised forecast, representing 2.8% of GDP.

The medium-term fiscal outlook remains robust as oil revenues are strong and SAMA’s net foreign assets continue to grow. The state will hence have little trouble financing new citizens’ benefits utilising oil earnings and drawing on foreign assets in the next few years. The finance ministry has indicated the new measures would be supported through budgetary outlays, not foreign assets. Longer term, the rise in current expenditures associated with increasing the number of public sector employees and offering them higher wages will leave Saudi Arabia vulnerable to fluctuations in oil prices.

The oil price needed to balance the 2011 Saudi budget is exceptionally high at about $80 a barrel for Saudi crude ($84 for WTI), up from half that level in 2006. The breakeven oil price is likely to ease to about $77 a barrel next year ($81.5 WTI), but the abrupt gain in the breakeven price underlines the longer-term risks involved with drastically raising current expenditures, including wages, as they cannot be easily scaled back should oil prices decline in the future. While SAMA does have a huge store of foreign assets to cover any shortfall in the budget for a number of years to come, the government should be attentive of the need to exercise prudence and rely more heavily on the private sector to generate jobs and invest in the economy. At present, Saudi nationals account for only 10% of private sector employees and incentives to work in the sector will not improve so long as government positions are favoured by citizens.
Greater oil exports and higher energy prices also promise to swing the state’s current account balance favourably this year. We expect Saudi Arabia to post a current account surplus of SR304.88 billion ($81.3 billion) in 2011, topping last year’s surprisingly large surplus of SR260.9 billion. The current account surplus should fall to SR208.91 billion ($55.7 billion) in 2012 as imports grow at a faster pace to keep up with rising consumer demand and support continuing infrastructure project spending.

Early data for 2011 show some improvement in trade flows. Non-oil exports grew at an annual 23.3% in January, the latest CDSI foreign trade data show, while imports rose 10.8%. Cargo loaded at Saudi ports for export was virtually unchanged compared with the year earlier in January, and down slightly on levels recorded between July and December. Imports discharged at ports, meanwhile, were up 7.7% year on year, although the level of import flows through ports has barely moved since November, the latest data show.

**Oil GDP set to jump with new output**

The new state spending commitments, as well as a sharp turn in oil market fundamentals, have warranted a revision in our GDP forecasts for 2011. Regional political instability has leveled a great deal of pressure on oil prices this year. In March, the cost of a barrel of WTI crude averaged $102.3 per barrel, up from $90.8 a month earlier, while Brent crude prices soared to $114.5 for the month, up from $103.3 in February and an average $80.3 in all of 2010.

Events in the MENA region increased the risk premium related to oil prices and in the first three months of the year, U.S. crude averaged $93.89 per barrel and Brent prices soared to $114.5 for the month, up from $103.3 in February and an average $80.3 in all of 2010.

Simultaneously, oil demand expectations globally continue to be robust with higher economic growth expectations in India and China, which on its own is expected to witness oil demand growth of 5.7% this year following growth of 8.4% in 2010, according to the latest OPEC estimates. However, the effects of a massive earthquake and devastating
tsunami in Japan in March will need to be assessed as to the extent that the fallout reduces Japanese demand for oil, which would have direct implications on Saudi Arabia. Japan is the kingdom’s single-largest destination of exports in Asia, accounted for 27.8% of its total exports to Asia in 2009 and 15% of total Saudi exports globally. Japan is, further, the kingdom’s fourth-biggest import partner after the United States, China and Germany, accounting for 7.6% of its imports in 2009.

Saudi oil output reached 8.51 million barrels a day in January after averaging 8.16 mbpd in 2010, according to data of the Joint Oil Data Initiative. Preliminary OPEC data based on secondary sources estimate Saudi production rose sharply to 8.87 mbpd in February. We anticipate Saudi oil production will average 8.9 mbpd for the full year, marking a 9.1% increase over 2010 production and adding substantially to our previous oil GDP growth forecast of 3.5%. We now expect the oil sector will grow 7.9% at constant prices this year, supporting a rise in the overall real GDP growth forecast to 5.5%.

We have revised our non-oil GDP forecast to 4.6%, anticipating expansion of the government sector to continue at above 5% for the third straight year. We have raised our government sector GDP forecast to 5.6% from 5.2% in view of the new state spending.

While the state would like to encourage greater private sector engagement in the economy, there is little evidence
that government funding will impel a similar rise in funds committed by the private sector in our view. We have kept our non-oil private sector GDP growth forecast at 4.2% and will continue to gauge the private sector’s performance to assess whether a revision is warranted in second half of the year. There is some evidence of a gradual comeback in investment appetite, but the overall mood remains guarded. One sector that could stand out is the construction sector’s rate of GDP growth due to an expected onslaught of new residential real estate projects. We have raised our construction sector GDP growth forecast to 5.8% from a prior estimate of 4.2%. State-financed impetus behind residential homebuilding should support the private sector.

Housing building spree could strain rents in short term

The most costly initiative unveiled in the first quarter was a plan to build 500,000 new homes across the country by allocating SR250 billion in funds to the General Housing Authority, now the Ministry of Housing. This construction programme is likely to take five years to complete and we anticipate SR36 billion will be committed to projects in 2011 by the Ministry of Housing, in addition to another SR5 billion from an earlier state funding allocation to the authority that focuses on building affordable homes for state employees.

Authorities are likely to decide in the next few months on the location of the new units, who qualifies to purchase

<table>
<thead>
<tr>
<th>Export Partners</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>27.8%</td>
</tr>
<tr>
<td>South Korea</td>
<td>17.4%</td>
</tr>
<tr>
<td>India</td>
<td>13.5%</td>
</tr>
<tr>
<td>China Mainland</td>
<td>20.4%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>7.2%</td>
</tr>
<tr>
<td>Singapore</td>
<td>8%</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

Source: SAMA 2009

Oil production boost, government spending to drive 2011 GDP growth

<table>
<thead>
<tr>
<th>Component</th>
<th>New forecast (YoY % change)</th>
<th>Previous forecast (YoY % change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil sector</td>
<td>7.9</td>
<td>3.5</td>
</tr>
<tr>
<td>Private sector</td>
<td>4.2</td>
<td>4.2</td>
</tr>
<tr>
<td>Government</td>
<td>5.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Total GDP</td>
<td>5.5</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi forecasts

Housing push likely to raise 2011 construction sector GDP growth

<table>
<thead>
<tr>
<th>Forecast Type</th>
<th>GDP Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New forecast</td>
<td>5.8%</td>
</tr>
<tr>
<td>Previous forecast</td>
<td>4.2%</td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi forecasts
them, and an initial time frame for construction. Saudi Arabia’s housing sector will need to create 275,000 new units through 2015 to cater to growing demand among citizens and expatriates, according to our estimates.

Also in the housing space, the Real Estate Development Fund (REDF) is likely to utilise SR26 billion this year of the SR40 billion injection it received under the scheme. Saudi homebuyers turn to REDF for more than 80% of their home financing needs. We expect the new funding will enable REDF to speed up the process of granting loans, which can now be as large as SR500,000, up from SR300,000 previously. The Ministry of Housing has taken from the Ministry of Finance responsibility for overseeing REDF.

The state’s new initiatives will go a long way toward helping the kingdom achieve its construction objectives over the medium term, although the short term impact on the housing market are likely to be limited. If anything, the promise of a string of new, state-financing housing projects could compel Saudis to put off plans to buy properties for a year or two in anticipation that prices may stabilise or fall once new supply enters the market.

This threatens to place further upward pressure on rents in the meantime. Our current forecast is for rental inflation – which has fallen in the five months to February – to begin climbing again through the course of 2011. The rental index should record average inflation of 9.7% this year, up from a prior estimate of 7.8%.

**Inflation on the rise as handouts raise pressure**

Pressure from housing costs, along with food inflation of an estimated 6.9%, faster than last year, and goods and services inflation of 6.3% should push inflation in 2011 to 5.6%, higher than our prior estimate of 5.1%.

Global food prices continue to face upward pressure resulting from steep gains in commodity prices, particularly crude oil, so far this year. Higher oil prices can raise the cost of imported goods by elevating the cost of shipping. The dollar, and hence the Saudi riyal, has also weakened in the past month versus global currencies, although we expect the effect on imported inflation will be less limited. Emerging market inflation has been rising in the last few months, propelling the cost of imports.

### Spending on Housing

<table>
<thead>
<tr>
<th>SR (bn)</th>
<th>2011 spending forecast</th>
<th>2012 spending forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Housing (to build 500,000 homes)</td>
<td>250</td>
<td>36</td>
</tr>
<tr>
<td>Real Estate Development Fund (to offer home loans)</td>
<td>40</td>
<td>26</td>
</tr>
<tr>
<td>Ministry of Housing (to build homes for state employees)</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total new commitments for housing</strong></td>
<td><strong>305</strong></td>
<td><strong>67</strong></td>
</tr>
</tbody>
</table>

Source: Banque Saudi Fransi estimates

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**Rental, food inflation likely to spike**

Source: CDSI

- **Food and beverage inflation rate**
- **Rental inflation**
- **Inflation rate**
Since Saudi Arabia relies heavily on imported foodstuffs, these additional costs are likely to be passed on to consumers over the next few months. Nonetheless, the government is wary about the impact of inflation in certain essential food items, such as rice, on lower-income brackets of society and would likely move in with price controls and subsidies to dampen any large jumps in food prices. The food and beverage inflation rate fell for the third straight month in February to 6%, although we expect the impact of rising global food prices to trickle down to the local economy toward the end of the second quarter and in the second half of the year.

In February, the Food and Agriculture Organisation (FAO)’s food price index rose for the eighth consecutive month, hitting a new record high steered by a quick rise in the price of cereals, meat and dairy products. International prices of wheat, for instance, rose 7% in February, while export prices for maize climbed 9%. Saudi Arabia, which had been self-sufficient in wheat production up until a few years ago, is moving toward importing wheat as it phases out some water-intensive crop production which have drained sparse non-renewable water resources.

Due to elevated pressures this year, inflation in 2012 is not likely to abate, although we expect to see a small degree of downward pressure on the rental index in 2012 to 7.9% as new supply reaches the market. The over all inflation rate should rise to 5.9% in 2012, linked to a rise in food inflation to 8.4% due to continued global price pressures. While month-on-month food inflation pressures should abate in 2012, a low base effect could elevate the annual food inflation figure in the first half of the year.

In the last two years, Saudi Arabia’s expansionary spending as part of its $385 billion five-year development plan managed not to stoke inflation by focusing on capital investments in infrastructure. The new spending initiatives decreed by the king this year target citizens specifically with handouts and benefits, and thus do pose direct inflationary risks.

It is difficult to judge the extent of inflationary impact bonuses and pay rises will have because the manner they were distributed differs from the government’s previous strategy. The last time Saudi Arabia raised wages it did so cautiously and incrementally, providing public sector employees with cost of living allowances rising 5% per year for three years. The two-month bonus offered in the first quarter of this year, by contrast, gives employees 17% more money to spend in 2011. We will continue to watch private consumption patterns to judge whether our inflation forecast warrants a further upward revision as the year progresses.
### Key Saudi Arabia Economic Indicators

#### MACRO-ECONOMIC INDICATORS

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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<th>2008</th>
<th>2009</th>
<th>2010e</th>
<th>2011f</th>
<th>2012f</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (USD bn)</td>
<td>188.6</td>
<td>214.6</td>
<td>250.3</td>
<td>315.3</td>
<td>356.2</td>
<td>384.7</td>
<td>476.3</td>
<td>372.7</td>
<td>434.7</td>
<td>525.1</td>
<td>569.8</td>
</tr>
<tr>
<td>GDP (SR bn)</td>
<td>707.1</td>
<td>804.6</td>
<td>938.8</td>
<td>1,182.5</td>
<td>1,335.6</td>
<td>1,442.6</td>
<td>1,786.1</td>
<td>1,397.5</td>
<td>1,630.0</td>
<td>1,969.3</td>
<td>2,136.7</td>
</tr>
<tr>
<td>YoY % change</td>
<td>3.0</td>
<td>13.8</td>
<td>16.7</td>
<td>26.0</td>
<td>12.9</td>
<td>8.0</td>
<td>23.8</td>
<td>-21.8</td>
<td>16.6</td>
<td>20.8</td>
<td>8.5</td>
</tr>
<tr>
<td>Real GDP growth rate, %</td>
<td>0.1</td>
<td>7.7</td>
<td>5.6</td>
<td>5.6</td>
<td>3.2</td>
<td>8.0</td>
<td>2.0</td>
<td>4.2</td>
<td>0.2</td>
<td>3.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Non-oil private sector real GDP growth rate, %</td>
<td>4.1</td>
<td>3.9</td>
<td>5.3</td>
<td>5.8</td>
<td>6.1</td>
<td>5.5</td>
<td>4.6</td>
<td>2.7</td>
<td>3.7</td>
<td>4.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Government real GDP growth rate, %</td>
<td>2.9</td>
<td>3.1</td>
<td>3.1</td>
<td>4.0</td>
<td>3.1</td>
<td>3.0</td>
<td>3.7</td>
<td>5.2</td>
<td>5.9</td>
<td>5.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Oil sector real GDP growth rate, %</td>
<td>-7.5</td>
<td>17.2</td>
<td>6.7</td>
<td>6.2</td>
<td>-0.8</td>
<td>-3.8</td>
<td>4.2</td>
<td>-7.6</td>
<td>2.1</td>
<td>7.9</td>
<td>-0.7</td>
</tr>
<tr>
<td>Inflation, YoY % change</td>
<td>0.2</td>
<td>0.6</td>
<td>0.3</td>
<td>0.7</td>
<td>2.2</td>
<td>4.1</td>
<td>9.9</td>
<td>5.1</td>
<td>5.3</td>
<td>5.6</td>
<td>5.9</td>
</tr>
<tr>
<td>GDP per capita (USD)</td>
<td>8,774</td>
<td>9,744</td>
<td>11,111</td>
<td>13,640</td>
<td>15,041</td>
<td>15,868</td>
<td>19,200</td>
<td>14,687</td>
<td>16,039</td>
<td>18,958</td>
<td>20,063</td>
</tr>
</tbody>
</table>

#### BUDGETARY INDICATORS

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<th>2010e</th>
<th>2011f</th>
<th>2012f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total government revenue (SR bn)</td>
<td>213.0</td>
<td>293.0</td>
<td>392.3</td>
<td>564.3</td>
<td>673.7</td>
<td>642.8</td>
<td>1,101.0</td>
<td>509.8</td>
<td>735.0</td>
<td>849.1</td>
<td>849.1</td>
</tr>
<tr>
<td>Total government expenditure (SR bn)</td>
<td>233.5</td>
<td>257.0</td>
<td>285.2</td>
<td>346.5</td>
<td>393.3</td>
<td>466.2</td>
<td>520.1</td>
<td>596.4</td>
<td>842.4</td>
<td>603.7</td>
<td>603.7</td>
</tr>
<tr>
<td>Deficit/surplus (SR bn)</td>
<td>-20.5</td>
<td>36.0</td>
<td>107.1</td>
<td>217.9</td>
<td>280.4</td>
<td>176.6</td>
<td>580.9</td>
<td>-86.6</td>
<td>108.5</td>
<td>603.7</td>
<td>603.7</td>
</tr>
<tr>
<td>Budget balance, % of GDP</td>
<td>-2.9</td>
<td>4.5</td>
<td>11.4</td>
<td>18.4</td>
<td>21.0</td>
<td>12.2</td>
<td>32.5</td>
<td>-6.2</td>
<td>6.7</td>
<td>3.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Domestic debt (SR bn)</td>
<td>558.0</td>
<td>660.0</td>
<td>610.6</td>
<td>459.6</td>
<td>364.6</td>
<td>266.8</td>
<td>235.0</td>
<td>225.1</td>
<td>167.0</td>
<td>145.0</td>
<td>137.0</td>
</tr>
<tr>
<td>Domestic debt as % GDP</td>
<td>78.9</td>
<td>82.0</td>
<td>65.0</td>
<td>38.9</td>
<td>27.3</td>
<td>18.5</td>
<td>16.1</td>
<td>10.2</td>
<td>7.4</td>
<td>6.4</td>
<td>6.4</td>
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</tbody>
</table>

#### FOREIGN TRADE INDICATORS

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
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<th>2004</th>
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<th>2008</th>
<th>2009</th>
<th>2010e</th>
<th>2011f</th>
<th>2012f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total export revenues (USD bn)</td>
<td>72.3</td>
<td>93.0</td>
<td>125.7</td>
<td>180.4</td>
<td>210.9</td>
<td>233.1</td>
<td>313.4</td>
<td>192.2</td>
<td>286.3</td>
<td>298.2</td>
<td>276.5</td>
</tr>
<tr>
<td>Oil export revenues (USD bn)</td>
<td>63.6</td>
<td>82.0</td>
<td>110.4</td>
<td>161.6</td>
<td>188.2</td>
<td>205.3</td>
<td>281.0</td>
<td>163.1</td>
<td>203.2</td>
<td>252.3</td>
<td>237.2</td>
</tr>
<tr>
<td>Total imports (USD bn)</td>
<td>29.6</td>
<td>38.3</td>
<td>43.5</td>
<td>53.8</td>
<td>63.0</td>
<td>81.5</td>
<td>100.6</td>
<td>86.4</td>
<td>87.0</td>
<td>101.8</td>
<td>116.0</td>
</tr>
<tr>
<td>Current account balance (USD bn)</td>
<td>11.9</td>
<td>23.3</td>
<td>49.3</td>
<td>90.0</td>
<td>93.3</td>
<td>132.3</td>
<td>22.8</td>
<td>69.8</td>
<td>86.1</td>
<td>83.3</td>
<td>55.7</td>
</tr>
<tr>
<td>Current account as % of GDP</td>
<td>6.3</td>
<td>10.8</td>
<td>19.7</td>
<td>26.5</td>
<td>27.8</td>
<td>37.5</td>
<td>14.1</td>
<td>16.1</td>
<td>10.2</td>
<td>7.4</td>
<td>6.4</td>
</tr>
</tbody>
</table>

#### EXCHANGE RATE (=USD1)

- Saudi riyal: 3.75

#### BANKING INDICATORS

- Bank claims on private sector, year-end % change: 10.0
- Total private credit, year-end % change: 12.4
- Total bank credit, year-end % change: 12.3
- Broad money M3, YoY % change: 14.7
- Repurchase Rate (year-end): 2.00

#### SAVING & INVESTMENT INDICATORS

- Gross fixed capital formation, % of GDP: 18.1
- Non-oil government investments, % of GDP: 2.6
- Non-oil private investments, % of GDP: 13.8
- Gross domestic savings, % of GDP: 37.1
- Government savings, % of GDP: -0.9
- Private savings, % of GDP: 38.0

#### DEMOGRAPHIC INDICATORS

- Population (in millions): 21.5
- Non-Saudi: 5.8
- Unemployment rate (%) Saudi: 9.7
- Non-Saudi: 0.8

#### OIL INDICATORS

- Argus Sour Crude Index (ASCI): 59.4
- Average oil price (WTI) (USD/barrel): 66.1
- Average Saudi oil price (USD/barrel): 66.5
- Crude oil production (million bpd): 7.09

#### STOCK MARKET INDICATORS

- Tadawul Stock Index (TASI) (period-end): 2,518.08
Disclosure appendix

Analyst certification

The analyst(s), who is primarily responsible for this report, certifies that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal views and that no part of their compensation, was, is or will be directly related to the specific recommendations or views contained in this research report.

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1 - This report is dated as at 4 April 2011.

2 - All market data included in this report are dated as at close 3 April 2011, unless otherwise indicated in this report.

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