**Tightening ties**

Asian oil demand and pragmatism at crux of Saudi-Indian relations

- **Saudi exports to India rise seven-fold, imports jump six-fold between 2000 and 2008, with trade balance consistently favouring the kingdom**

- **India’s geographic dependence on Saudi oil likely to grow in coming years as it seeks energy security to support economic growth plans**

- **Prime Minister Manmohan Singh set to make first official visit by an Indian PM to Saudi Arabia in 28 years as two states strive to deepen economic and diplomatic ties**

The trading relationship between Saudi Arabia and India is among the most-strategic bilateral bonds for either country. As India’s largest supplier of crude oil, Saudi Arabia is favourably positioned to benefit from burgeoning demand for energy in Asia’s third-largest economy, set to experience annual economic growth rates of 7-8% for the foreseeable future. The balance of trade between the two states has consistently swung in favour of kingdom, its trade surplus standing at SR67.3 billion in 2008, up almost seven-fold from 2000 levels.

For India, Saudi Arabia comes fourth after China, the United States and the United Arab Emirates as its most-important trading partner. Saudi imports of Indian goods stood at SR18 billion in 2008, marking an almost six-fold rise from 2000, according to data of the Saudi Arabian Monetary Agency (SAMA). That positioned India as the sixth-largest source of Saudi imports, accounting for 12.4% of the kingdom’s total imports from Asia in 2008.

India’s geographic dependence on Gulf oil is likely to become amplified in the coming years due to limited prospects for enhancing domestic energy production. Common interests in supporting peace and promoting security in the region, as well as building counter-terrorism measures, form a pivotal part of the bilateral relationship, which has become strengthened in the recent past due to Iran’s nuclear ambitions. Indian interests in the Gulf Arab region are perceived as more important than its interests with Iran.

Aside from trade, Saudi Arabia is a major source of income for India as a result of workers remittances. Foreign workers accounted for 27% of Saudi Arabia’s population of 25 million in 2008 – and Indians form the kingdom’s largest expatriate workforce, working in fields from information technology to construction, with most employed as blue-collar workers. Given this varied web of economic and diplomatic interests, we regard Indian Prime Minister Manmohan Singh’s historic visit to Saudi Arabia this month as decisive to deepening ties between two countries poised to take a greater role in the world economy.
Revived relations

The importance of long-standing trading ties between Saudi Arabia and India has become pronounced this decade, with India’s share of total Saudi exports and imports gaining ground since 1990. In 2008, India accounted for 7.3% of total Saudi exports, compared with 2.5% in 1990, SAMA data show. Over the same period, the ratio of Saudi imports from India rose to 4.2% from 1.1%.

The two countries have worked to improve bilateral ties since the 1990s, prior to which time their relationship was constrained by Cold War politics and Saudi Arabia’s support for Pakistan. Saudi Arabia and India had established diplomatic ties shortly after the latter’s independence in 1947. But during the Cold War period, Indian-Saudi relations were confined to energy and labour as a result of India’s proximate ties with the Soviet Union and Saudi Arabia’s close links with the United States. Meanwhile, Saudi Arabia supported Pakistan during the Kashmir conflict and the Indo-Pakistani War of 1971, further denting its relations with India.

Following the end of the Cold War in 1991, India – which maintained a neutral position on the first Gulf War – repositioned its foreign policy more auspiciously toward the Gulf region and wider Middle East. The kingdom, for instance, supports granting India observer status in the Organization of the Islamic Conference (OIC). It has also worked to expand its cooperation with India in the fight against terrorism and crime under the framework of the Delhi Declaration.

In 2006, King Abdullah became the first Saudi monarch to visit India in 51 years. During that trip, King Abdullah and Prime Minister Singh signed the Delhi Declaration, a pact designed to ensure that Saudi Arabia would provide reliable, stable and increased supplies of crude oil to India through long-term contracts. The countries also agreed to form public and private joint ventures to develop oil and natural gas. Since that visit, a reciprocal trip by Prime Minister Singh has been anticipated. Prior to Mr. Singh, it was Indira Gandhi who last visited the kingdom as prime minister in 1982.
Trade flows

While trade volumes between Saudi Arabia and India have risen quickly in recent years, export and import flows have centred on only a limited number of goods. The kingdom mainly exports crude oil (and some petrochemicals) to India, while its main imports are spices, used largely to meet the consumption demands of its large Indian expatriate population.

Saudi exports to India rose almost seven-fold between 2000 and 2008, making India its fourth-biggest export destination in Asia following Japan, China and South Korea. The kingdom’s importance to Indian trade flows is also significant. Saudi Arabia was India’s fourth-biggest trading partner in the 2007-2008 fiscal year, data of India’s Ministry of Commerce & Industry show. India is the fourth-largest importer of Saudi oil after China, the United States and Japan, according to a study by the Gulf Research Center (GRC).

Gulf countries as a whole supply the majority of India’s petroleum needs, including nearly a quarter by Saudi alone, while other major suppliers are Iran, Iraq, Kuwait, the UAE and Yemen. Qatar provides about 5 million tons per year of liquefied natural gas to India – a level that likely rose to 7.5 million tons in 2009. In the 2008-2009 fiscal year, India’s total crude imports surged to more than 2.5 million barrels per day, up more than 5% from the previous year.

The relationship between India and Saudi Arabia has in many ways been redefined as a result of growing appetite among Asian emerging markets for oil and refined products. To cater to heightened energy demand from Asia, Saudi Arabia is diversifying away from its traditional focus on the West. As it strives to build its non-oil sector, particularly in the petrochemical and fertiliser space, Saudi Arabia increasingly seeks to gain stronghold in Asian countries. A majority of Saudi crude is now exported to Asia, while Asian labour, goods and services are gaining greater market presence in the kingdom.

India’s geographic proximity to the Gulf – the world’s biggest oil exporting region – give regional producers like
Saudi Arabia an edge over rival producers in West Africa, Russia and Central Asia. More than 80% of Asia’s oil imports come from the Middle East, compared with just under a quarter of Europe’s imports and 17% of U.S. imports. India, meanwhile, exports refined petroleum products, such as gas oil, to Gulf countries seeking to meet demand for power and motor fuels. The Gulf and Indian energy sectors thus complement each other.

Still, India’s exports to the Gulf are heavily dependent on the consumption patterns of the estimated 4.5 million Indian expatriates living and working in the region. For India to improve its market share in merchandise exports in Saudi Arabia and the UAE, it must diversify its export profile. We regard progress toward free trade negotiations as the best avenue toward enhancing bilateral trade between India, Saudi Arabia as well as the rest of the Gulf. A move toward more liberal trade could help India gain greater market share for its manufactured goods – including engineering products, textiles and jewellery – which account for roughly 63% of India’s total exports to the world.

**Investment ties**

Developing bilateral economic ties is natural given the cultural links already in place between the two countries. India is home to about 170 million Muslims, the world’s second-biggest Muslim population after Indonesia. Meanwhile, about 20% of Saudi Arabia’s expatriate population is of Indian nationality, contributing to the kingdom’s economic development for decades. Dating back to the late 1930s, Indians were recruited for employment in Bahrain and Saudi Arabia, while former Saudi King Abdulaziz insisted on Indians being paid on par with Arabs employed by Saudi oil giant Aramco.1

Indian workers have also formed an integral part of Gulf workforces during the most-recent rally in oil prices, which supported a regional economic boom. According to the World Bank, Saudi Arabia was the world’s fourth-biggest remittance-sending country in 2008 after United States, Russia and Switzerland. In November, personal remittances from Saudi Arabia rose 7.9 percent year-on-year, according to SAMA data. India was the largest recipient of global remittances in 2009, World Bank estimates show, although

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remittance flows fell 8.9% from the year earlier largely due to an economic downturn in Dubai and currency fluctuations.

Gulf countries accounted for nearly 27% of total remittances to India, according to a study published last year by the GRC and the Nixon Center on India’s role in the Gulf. Remittances are crucial for the roughly 65% of low-skilled labourers, whose families at home rely almost entirely on money they send. In the 2008 - 2009 fiscal year, inward remittances to India amounted to $23.1 billion, up 5.5% from the year earlier and more than double levels in 2005 - 2006, according to the latest data of the Reserve Bank of India.

While labour has been a long-standing link between Saudi Arabia and India, given fast and sustainable growth in India, fewer Indian professionals are moving to the Gulf for work than a decade ago. The slowdown in India’s brain drain has obvious repercussions, good and bad, for both sides.

Data of India’s Consulate General in Jeddah show about 5% of expatriates are professionally qualified, working as doctors, engineers, accountants and other skilled positions. About 10% of Indian expatriates are employed in Saudi Arabia as white collar staff and 85% are labourers and technicians, according to the data.

An extension of established trading ties and cultural affinity has been the growing investment relationship between Saudi and Indian companies. More than 220 Indian companies received licenses to set up full-owned or joint-venture projects in Saudi Arabia in the past two years, according to the Saudi Arabian General Investment Authority (SAGIA). These companies have pumped more than SR4 billion into the Saudi economy. Gulf countries have also drawn on human resources from India to help them develop many sectors, including information technology, construction, transportation and services.

India, meanwhile, is vying for Gulf states such as Saudi Arabia, UAE and Oman, to participate in its infrastructure expansion plans. A new Saudi-India business council was set up to provide a framework for building bilateral economic ties, allowing Saudi Arabia to tap Indian expertise in fields ranging from information technology and biotechnology to education and small business development. Saudi Arabia also plans to establish an India investment fund primarily to invest in Indian infrastructure projects.

India’s economy

India managed to escape severe recession last year due to its economy’s lower dependence on exports. In addition, substantial fiscal and monetary stimulus eased tensions in financial markets and lessened the impact of a decline in domestic demand on the economy. The main drag on India’s 2009 GDP was a drought, which reduced output of its agricultural sector (accounting for 17% of GDP) by 2.8%. The government anticipates economic growth of 7% to 7.5% in the fiscal year ending March and 8% to 8.5% for the fiscal year 2010 - 2011. Average growth of the economy was 5.8% in the last two decades, including a 6.5% GDP growth rate between 1995 - 2005. After China, India is home to the world’s largest labour force, comprising around 513 million people. The Reserve Bank of India has started to tighten monetary policy and is likely to continue on this path to contain inflationary pressures spurred by higher food prices.

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Analysis

As India becomes a global economic powerhouse the world is beginning to reckon with, economic and diplomatic relations between Saudi Arabia and India are set to flourish. Saudi Arabia is also gaining clout on the global stage as the most-important energy producer and the Middle East’s largest economy. Saudi Arabia and India, abandoning a period of mutual exclusion, are poised to work together more than ever before, with energy remaining the driving force behind their economic and diplomatic relationship.

With projected economic growth rates of 7 to 8% per year in the next two decades, India faces challenges to meet a rapid increase in energy demand. As with China, India’s interest in securing energy resources is a crucial motivating factor behind enhancing ties with Saudi Arabia and the wider Gulf. Both India and China have maintained good working relationships with all Middle Eastern countries, including Israel, which was India’s largest defence supplier in 2009.

High population growth and industrialisation have propelled India to become the world’s sixth-largest energy consumer, and it could move up to the fourth largest consumer in a matter of years. India’s crude oil imports from the kingdom are poised to double in the next 20 years. As a result of the growing bilateral trade deficit, India will also be looking for ways to boost exports to the kingdom in the coming years. It will also seek greater foreign investment as it looks to rectify a severe shortage in electric capacity, with roughly 40% of residences without electricity according to the World Bank. To address this shortfall, the Indian government aims to add 90,000 megawatts of electric generation capacity by 2012 and the private sector is beginning to step up its role. With the right incentives, Saudi investors, having developed know-how in their domestic energy and power sectors, could play a larger role in India.

Security cooperation

Saudi and Indian relations are defined by pragmatism. India is interested in energy security, improved ties with the Gulf and establishing two-way investment flows. It is also striving to narrow its trade deficit, which would demand enhancing exports to the Gulf region. Saudi Arabia is motivated by a drive to diversify its economy and its export markets in fast-growing Asia. It is searching for investment opportunities and seeking to improve diplomatic ties with partners in the sub-continent, partly to improve the geopolitical environment in Pakistan and Afghanistan.

Gulf countries and India also share a desire for political stability and security in the region. There is great potential for cooperation in security, defence policy, cultural exchange and environmental issues such as controlling sea pollution. In 2006, India and Saudi Arabia signed an initial agreement to tackle terrorism and trans-national crime.

Forging strong economic ties between India and Saudi Arabia can also act as a catalyst on various diplomatic fronts. Saudi Arabia has long held amiable ties with Pakistan, which could act has a lever to improve relations between India and Pakistan. Given India’s growing role among emerging markets, it is natural that Saudi Arabia and other Gulf countries would seek to expand relations irrespective of their ties with Pakistan. However, Pakistan should not solely rely on its longstanding ties with the Gulf to influence its relations with India; it should also adopt a more proactive approach to maximise its potential and reap further economic and political advantages.
New Delhi’s relationship with Riyadh is also strategic vis-à-vis Iran. New Delhi had initially turned to Iranian capital Tehran, but with Iran’s adoption of an aggressive anti-Western position in recent years, this strategy has faltered. Iran’s nuclear ambitions have drawn India and Saudi Arabia closer. Gulf oil exporters gained traction with India after Iran decided to renege on some oil supply commitments after India voted against Iran at the International Atomic Energy Agency. That prompted India to look for ways to diversify suppliers and get guarantees from Saudi Arabia for uninterrupted supplies regardless of trends in world prices.

India’s foreign policies in the Gulf region will largely be coloured by the approach taken by China – which is in many ways a competitor of India in emerging Asia – and India’s growing ties with the United States. Should U.S.-Iran ties remain strained, India’s foreign policy is likely to mirror this trend. India’s improved ties with the United States in the last few years have further been a factor in shaping its regional foreign policy given America’s continued role as a predominant player in the Gulf.

Meanwhile, the Gulf and India are boosting cooperation for military training. According to the GRC study, securing the straits of Hormuz and Bab el-Mandeb will go hand in hand with growing trade relations in the coming years. As a result, the Indian Navy has taken a series of naval exercises with a number of Gulf states. Taken together, India and Saudi Arabia’s various economic and political interests will steer foreign and trade policy in a way that is likely to align the two states more than at any point in recent history.
Disclosure appendix

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Additional disclosures

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2 - All market data included in this report are dated as at close 26 February 2010, unless otherwise indicated in this report.
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