Counting the costs
Saudi imports, religious tourism weaken amid global recession, swine flu

- Saudi imports set to fall 12% to $89 bn in ’09, biggest annual decline in 15 years, as consumer demand, risk aversion keep importers on their guard

- Tourist numbers slowed sharply in H1 as fears about H1N1 flu and global recession hit religious tourism; Tourist visits likely to fall 15% in ’09, expenditures could drop by third

- Non-oil private sector likely to witness U-shaped recovery in 2010, credit growth to pick up pace led by financing to public-private partnerships

- Inflation rates bottom out with price pressures likely to pick up pace in the final months of ’09; We expect inflation of 5.1% this year and 4.6% in 2010

Saudi Arabia’s imports are set to face their steepest decline in 15 years in 2009, as slower economic conditions sparked off caution among importers, consumers and risk-averse businesses. This is not a uniquely Saudi phenomenon, with World Trade Organization (WTO) data showing global imports fell by almost a third in the second quarter from the year earlier. While confidence and stability are showing signs of gradually returning to the Saudi economy, the latest import data provide us with evidence that the pace of growth and appetite for risk will be measured at best.

We expect the value of Saudi imports to decline to $89 billion in 2009 – a drop of almost 12% from a record $100.6 billion in 2008, marking the biggest decrease since 1994. At a time when consumer spending is subdued compared with last year, we think retailers are hesitant to import large consignments at a higher cost.

The recent cycle of dollar weakness that pushed the greenback to a 14-month low versus the euro last month is passing through to Saudi imports and will have a knock-on effect on the wider economy. Prolonged dollar weakness could make imports more pricy in the final months of 2009, leading some importers to hold back on replenishing stocks until they are certain that momentum has returned to economic recovery.

While exports fall and imports wane, we expect the kingdom to pull off a small current account surplus of SR12.8 billion this year, its smallest in a decade. For 2010, we are optimistic but guarded about an economic recovery in the world’s largest oil exporter as a result of the most-recent data on private sector credit, which point to a cautious, subdued improvement in the non-oil economy in the coming quarters. A full-fledged business cycle recovery is inexorably tied to a take off in credit, which will take time.
Next year’s private sector recovery is likely to take a more prolonged, U-shaped route, not a V-shaped recovery that would see the businesses rebound in as quickly as one quarter. This is positive considering evidence that the United States faces a more protracted economic recovery fraught with unemployment, while risks for the creation of a global asset price bubble are becoming more pronounced.

As the annual Islamic hajj pilgrimage approaches this month, meanwhile, Saudi Arabia looks poised to witness a downturn in religious tourism, an important contributor to non-oil GDP. Saudi Arabia is contending with two forces that will drag on 2009 visitor numbers: global recession that has hit worldwide tourism and the H1N1 flu, or swine flu, which has sparked fears about a rapid spread of the infection during the largest annual pilgrimage in the world.

Globally, tourist arrivals fell 7% between January and July, according to the World Tourism Organisation, and the Middle East region has been caught in the current. Between February and June, tourist nights by inbound visitors to Saudi Arabia dropped 45% and total tourist trips by foreigners dropped 41%, according to data of the kingdom’s Tourism Information and Research Centre (MAS Centre). Expenditures by inbound tourists also fell by 15% over the five months.
Anecdotal evidence demonstrate a drop off in tourist numbers continued into the second half of the year, including during the holy month of Ramadan which began in late August. Millions of Muslims visit Mecca during the month of fasting to perform umrah, although numbers fell this year as concerns over H1N1 flu deterred many Muslims from taking the trip.

We regard religious tourism as a positive income earner that has enormous potential for job creation, supporting many sectors of the economy. Total tourist numbers could fall around 15% in 2009 after tourist visits posted improvement into the summer, according to our forecasts. We also expect religious tourism spending will decline by about a third in 2009 and tourism’s overall contribution to non-oil GDP to fall to 5.6% from almost 6.9% last year.

The downturn in tourism does not change our overall GDP forecast for 2009, as we have priced in an expected decline in the sector, a relatively small contributor to the nation’s output. We maintain our forecast that the economy will contract 0.9% this year before growing 4% in 2010.
Sluggish import flows

The economic slowdown in Saudi Arabia this year has been widely observed by importers, whose imports of food, building materials and machinery dwindled quickly beginning late last year as domestic demand declined. Imports to the Middle East’s largest economy had more than quadrupled between 2000-2008. Building material imports financed using letters of credit (LCs) witnessed a more than five-fold surge this decade to 2008. LCs against the import of food, automobiles, and machinery and appliances all more than tripled over the same period.

The shift beginning this year was abrupt but justified by the contraction of the private sector and weaker private consumption. Preliminary data of the Central Department of Statistics (CDSI) show that in the first eight months of 2009, the kingdom’s imports amounted to $57.77 billion, down 16% from data a year earlier.1

The value of imports in August, the latest data available, displayed the steepest year-on-year (y-o-y) decline of 2009 of 28.8%. The August data must be understood in the context of abnormally high import costs in mid-2008 stemming from sharp gains in global commodity and food prices as oil prices rallied. August 2008 marked the peak for Saudi Arabia’s import bill. After that, the cost of imports declined due to the stronger dollar through to the end of the first half of 2009 and because of price deflation globally for big-ticket items such as machinery.

Total cargo discharged at Saudi ports also fell 15.2% year-on-year in the first nine months, while total September cargo volumes eased compared with August, according to data of the Saudi Ports Authority.

In our view, the slowdown in imports can be attributed more to lower domestic demand than purely declines in the absolute value of goods. As has been the case in other economies, the global economic crisis hit well-to-do Saudis the hardest – anecdotal evidence shows luxury retail

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1 In recent years, preliminary CDSI data has come within 3%-6% of actual numbers released in the balance of payments data published in the SAMA annual report.
sales volumes have fallen by an average of about 40%. In an economy experiencing slow growth, retail agents have worked with direct export orders rather than building up their inventories. In fact, some large retailers are still on a drawdown phase.

August’s imports were driven lower by a 28% drop in the value of machinery and electronic imports and 8.6% decline in food imports. The value of imports, which eased more than 10% in June and July, gained 1.33% in the month to August. We attribute this to a preference by retailers to carry out import activities in the months prior to the start of Ramadan, which began in August.

Imports became steadily more expensive for Saudi Arabia over the summer due to the riyal currency’s peg to the U.S. dollar, which fell to a 14-month low against the euro and against a basket of six major currencies last month.

The value of Saudi imports hit a trough in February, when the dollar was near its strongest point versus the euro for this year. Since then, the dollar has steadily fallen against key global currencies, drumming up the cost of imports denominated in currencies other than the dollar. According to August CDSI data, 62% of Saudi imports originated in the European Union and Asia, while North America accounting for only 15%. Still, more than 65% of imported goods are priced in and paid by agents in dollars.

**Weak LCs point to lacklustre domestic appetite**

Weak investor risk appetite is illustrated in data on LCs, used by bulk importers to finance everything from rice to cranes to cars. New LCs, which reflect fresh import orders, fell 6.9% in the month to the end of September, while settled LCs, depicting actual imports, plunged 19% over the month, according to data of the Saudi Arabian Monetary Agency (SAMA).

The downturn in settled LCs can be linked to a 41% fall in LCs for building material imports during September to...
SR794 million, the lowest level this year. Food imports also declined 26% in the month and machinery imports 27%, the data show.

In our perspective, local suppliers are likely drawing down existing supplies and wary about building up new stocks due to uncertainty about the pace of the economic recovery and as well as insecurity about the future direction of the dollar. The downturn can also be linked to a seasonality factor – Ramadan. The general business cycle in Muslim countries changes as companies alter working hours and close, in Saudi Arabia’s case for one week, to celebrate the Eid al-Fitr holiday that marks the end of Ramadan.

We forecast that Saudi imports should fall to $89 billion in 2009 from $100.6 billion in 2008, although there is scope for downward revision if October LCs data are as weak as September numbers. Slower imports along with a drop in oil export revenues will have a marked affect on Saudi Arabia’s balance of payments. We expect the kingdom to post a current account surplus of SR12.8 billion this year, paling in comparison to last year’s record SR502.7 billion. That will be the smallest surplus since 1999.

Currency talk: sticking to the status quo

As the dollar weakens and global risk appetite gains momentum, speculators appear to be making a small comeback in Gulf currency markets. Saudi riyal forward rates widened slightly in October, with bids on contracts to buy riyals in two years showing investors are pricing in a 0.6% appreciation in the riyal to 3.7275 per dollar – the strongest in a year. The currency speculation coincided with the dollar crossing the key 1.50-mark vis-à-vis the euro in late October for the first time since August 2008. We also saw some interest by speculators on the Qatari dinar and UAE dirham.

The last time the dollar was that weak, Saudi riyal forward rates were pricing in a revaluation of closer to 1.6% — and at the height of speculation in the spring of 2008, the expectation was for a 2.7% appreciation of the riyal versus the dollar in two years. While speculation about a change in Gulf fixed exchange rate regimes might gain momentum should the dollar weaken further in the coming months, we do not anticipate currency bets will return with the same vigour that happened in the last cycle of dollar weakness.
When Gulf dollar pegs came under scrutiny in 2007 and 2008, it was partly because the regional economic boom was out of sync with economic trends in the United States, where the Federal Reserve started slashing interest rates in September 2007, compelling the GCC to follow suit despite escalating inflation. Now, Gulf economies are on a weaker economic footing, with some, including the United Arab Emirates and Qatar, facing periodic deflation.

As a result, Saudi and Gulf economies are not as out of step with the United States as they were two years ago. Once credit growth begins to show significant improvement in the first half of 2010, SAMA could raise interest rates without stoking currency speculation. We maintain our view that the region is highly unlikely to move away from the dollar in the short and medium term (see October Flash note on Gulf monetary union). Saudi Arabia takes a long-term view on currencies and short-term movements would not pressure its currency regime.

Inflation levels have likely bottomed out

We expect the potential inflationary impact of the current cycle of dollar weakness to be more subdued as a result of slowing economic activity and risk aversion, but also because widespread asset price inflation has come to an end. An important driver of inflation in 2007-08 was the rising cost of food imports due to dollar weakness and the commodity price rally.

Consumer price inflation rose to 4.4% in September from 4.1% in August, linked to higher food and beverage costs, which rose 1.3% from the month earlier. Prices generally rise more quickly during Ramadan but we expect some upward pressure to continue to build up in the final months of 2009.

As a result, we have revised up our estimate for average inflation for 2009 to 5.1%, while price rises could accelerate in the first quarter of 2010 should dollar weakness be sustained over the short term, firming up imported inflation. We believe the dollar should strengthen somewhat during 2010, but domestic inflation is likely to stay at historically high levels. We anticipate inflation will average 4.6% in 2010. Inflation in Saudi Arabia averaged only 0.98% between 1990 and 2007.

The impact of money supply on inflation will be negligible in the months to come in our view, although we expect broad money supply to grow by a robust 12.9% this year and another 11% next year. M2, which measures money held in cash, checking and savings accounts, slipped 0.2% in September from the previous month, stemming from the third month of declines in time and savings deposits. Year-on-year growth in M2, an important indicator in forecasting inflationary pressures, fell to 10.6% in September from 11.9% in August.
To provide an accurate gauge about the direction of inflation, M2 should be considered along with the pace of economic growth and domestic demand trends. In 2008, annual broad money supply growth exceeded 20% for much of the year, acting as a catalyst of inflation together with the high degree of domestic demand and high economic activity.

Rental inflation, meanwhile, has fallen steadily for the past 11 months due to a small reduction in demand, subdued economic conditions and lower consumer confidence. Still, rental inflation in September was steep at 13% and we expect housing demand will continue to outpace supply, placing upward pressure on consumer prices along with rising food costs.

**Private sector poised for gradual recovery**

While the Saudi economy is set to recover in 2010 it is unlikely to reach full trend growth. We maintain our forecast that the non-oil private sector should grow by 4% in 2010, but this will hinge on two interlinked factors: the private sector’s enthusiasm to expand and invest after a slow 2009 and the appetite of banks to lend. We believe banks will provide more financing to the private sector as they are beginning to find it uneconomical to place large sums of capital with SAMA and liquidity levels rise as large sums of government bonds reach maturity.

It takes time for private businesses to bounce back and we expect the recovery in 2010 will take a more prolonged, U-shaped route, not a V-shaped recovery that would see the private sector rebound in as quickly as one quarter. The state’s stimulatory spending programme is healthy, enabling the kingdom to move toward recovery without generating debt – very unlike debt-burdened economies of the United States and Europe.

Confidence is returning to the kingdom as oil prices rallied to an average of almost $73 a barrel for the month of October. With revenues from the export of crude contributing almost 90% to government coffers, the oil price rise has reaffirmed our view that the kingdom will comfortably post a small budget surplus this year. Oil prices guide investor sentiment in the kingdom, with higher prices improving business confidence among private investors.

Saudi Arabia’s non-oil exports have also improved, growing month-on-month (m-o-m) between May and August. In August, non-oil exports amounted to SR9.2 billion, down 16.8% from the same month in 2008, but the lowest rate of decline this year. That was mainly driven by a pick up in petrochemical exports, which have risen more than 16%
in the three months to August. We assume the bulk of this increase can be attributed to exports to Asian markets, the destination of about a third of Saudi exports.

The oil price rally has also reduced SAMA’s need to draw down foreign assets to help finance stimulatory state spending. Between December and the end of June, SAMA’s net foreign assets dropped 13.8%. Following a slight rise in August, foreign assets dipped again by 0.51% in the month to Sept. 30.

SAMA investments in foreign securities decreased 2.4% in September compared with August, although it raised its deposits with foreign banks, which gained 6.1% month on month in September. Some publicly held independent organisations have been ramping up investments abroad, however. According to SAMA data, public agencies like Public Pension Agency and the General Organization of Social Insurance (GOSI) invested more money in foreign securities for the fifth straight month in September.

Banks liquid, but credit appetite weak

Saudi Arabia’s banking sector continues to experience weak credit growth, but banks are liquid, making them better placed than some of their Gulf counterparts to restart lending once confidence returns. Total bank assets expanded 2.5% in the first nine months of the year, compared with growth of 21% in all of 2008. Banks have remained relatively liquid for most of this year, although their caution towards new lending has compelled them to find alternative places to park their excess cash.

SAMA has been actively trying to dissuade banks from keeping funds with the central bank by slashing the reverse repurchase rate it pays on bank deposits in a bid to stimulate bank lending. Bank reserves held in SAMA’s reverse repo window peaked at SR88.8 billion in April and have since fallen to SR66.92 billion in September. Banks, meanwhile, have been compelled to place their money elsewhere. As the reverse repo deposits fell, banks’ foreign assets have climbed quickly. In all of 2008, foreign assets of Saudi banks grew only 4.2%. In the first nine months of 2009, by comparison, they surged 21.7%, signalling that banks have money but are loath to lend it, particularly to the private sector.

In part, banks are right to be more conservative given the exuberance they all exercised in the past few years. But we have noticed that some banks are beginning to lend more aggressively in the market, especially one of the majority state-owned banks. This is a good signal that banks across the sector, awash with liquidity, will pick up the pace of lending by early 2010.
CORPORATE PROFITABILITY IMPROVES, DOWN Y-O-Y

Although investors were vigilant about how companies would fare in the third quarter, the stock market did well in October, rising as much as 4.1% before giving up gains at the end of the month.

Listed Saudi companies posted a 28% drop in cumulative quarterly profits to SR17.45 billion – with earnings on the whole exceeding investor expectations, helping lift the benchmark to a 2009 high of 6,579 points. Market heavyweight SABIC supported the rally after its third-quarter profit of SR3.6 billion beat market forecasts by as much as SR1 billion. The results helped buttress belief in an economic recovery after the petrochemical giant posted a loss in the first quarter. Some 73 recorded fall in profits for the first nine months in 2009.

Banks’ profits also boosted confidence among investors, despite the 251% y-o-y surge in provisions to SR5.9 billion for the first nine months, including SR1.7 billion taken by National Commercial Bank and SR1.2 billion by Al-Rajhi, the two largest banks. We expect banks to take additional provisions in the fourth quarter and possibly the first quarter of 2010. But lenders are in a good position to weather a 2.4%-decline in nine-month profits; their assets grew 7.1% and deposits gained 11.5% over the period.

The Saudi stock market will continue to exhibit strong correlation with global markets, particularly on the downside. In the 125 days to Nov. 6, the correlation between the Tasi and the Dow and between the Tasi and the S&P were 0.65 and 0.64, respectively. On a shorter time scale of 50 days, the Saudi stock market exhibited greater correlation with the Dow than the S&P, primarily due to price velocities. U.S. markets, hence, bear great importance to the market psychology in Saudi Arabia, playing an equal to if not at times greater role than oil in shaping investor risk appetite.

We also observe in the market signs of volatility stemming from day traders pouring volumes into small- and medium-cap stocks to book short-term gains. Foreign investors, meanwhile, are boosting their investments in Saudi stocks. The value of foreign swap agreements doubled to SR1.8 billion in October from SR921 million in September.

Total commercial and personal cheques, meanwhile, registered their lowest level in September since the financial crisis deepened a year ago of SR34.7bn – down 15.4% from the year earlier. Point of sales transactions also fell 7.5% in September from the month earlier to 9.91 million. The overall value of POS transactions declined 10.4% in the month to 4.47 billion riyals, the lowest level since February.2

As we have noted in the past, the credit cycle in Saudi Arabia bottomed before the summer. The latest data of SAMA show m-o-m, private sector lending gained in September for the fourth straight month, rising 0.51%. The increase was slower than it had been in August, mainly due to the Ramadan effect. SAMA has kept interest rates unchanged since June, which can be explained in two ways: first, an additional rate cut would not expedite the private sector’s recovery, which involves rebuilding confidence. Second, SAMA is maintaining vigilance we think over inflation by keeping rates unchanged.

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2 We do not think point of sales transactions (PST) are a proxy for retail sales in the kingdom. PST reflect electronic transactions at all retail outlets, but they do not capture payments made in cash, which are sizeable in Saudi Arabia. Electronic transactions could rise as more people opt to use debit cards rather than cash, but this does not reflect a real increase in retail activity. PST transactions tend to rise in the summer months, but are not an accurate gauge for full-year retail activity.
Interbank rates rise off historic lows

Credit growth data support our view that Saudi Arabia’s banks are slowly adopting less caution towards lending, but we expect any improvement in the credit environment will be gradual. The country is unlikely to see a repeat of the double-digit credit growth witnessed in recent years. In 2008, bank lending to the private sector surged 28%. We expect claims on the private sector will rise 4% in 2009 and 9.3% in 2010.

Interbank rates, which plunged to historic lows in the summer, recovered some ground in October as banks began to loosen up on lending. The three-month Saudi Interbank Offered Rate (SIBOR), which hit a record low below 0.65% in the summer, has since risen to around 0.77% by early November. Tighter liquidity conditions are emerging as banks seek greater deposits to adjust their loan-to-deposit ratios before the end of the year. The banking sector average loan-to-deposit ratio is about 84% -- below SAMA’s target of 85% -- but a few Saudi banks have ratios above that level. As a result, there is some further upside potential for money market rates, although they are likely to remain at less than a quarter of the level they were a year ago.

Given the vigilance that continues to surround private sector credit, we maintain our view that government spending will lead a careful recovery in credit in the coming months, with private partners in state projects gaining the easiest access to funding among private-sector companies.

In October, several major public-sector deals were unveiled that could potentially bode well for a continuation of improved credit growth as well as confidence in the economy. State-run utility Saudi Electricity indicated it would seek financing for a SR6.88 billion contract it signed with South Korea’s Doosan Heavy Industries and Construction to expand the al-Qurrayah power plant.

Saudi Aramco and Total received bids from more than 30 banks to finance the debt portion of the $12.8 billion Jubail oil refinery. The success of this financing deal will provide some signals about the appetite of international banks to lend to state projects and Saudi Arabia in general as the Saad Group-Al Gosaibi debt issues linger. Among private businesses, meanwhile, mobile telephone firm Mobily refinanced a SR1.5 billion Islamic loan which brings a modicum of confidence.
Tourism suffers amid flu, global economic slump

This month, more than a million Muslims will converge on the Saudi holy city of Mecca to perform the hajj pilgrimage, an annual trek that provides an important contribution to the Saudi economy. For a country attempting to diversify its economy away from a heavy reliance on hydrocarbon exports, religious tourism offers a crucial contributor to expansion of the non-oil sector.

In the last seven years, more than two million people each year have performed the hajj pilgrimage, an obligation on all able-bodied Muslims. Tourists from inside and outside of Saudi Arabia spent SR74 billion during trips to Saudi tourist destinations in 2008. Almost half of tourist trips were religious in nature, including pilgrims travelling to perform the hajj and umrah, a lesser pilgrimage that can be taken at any point during the year.

FROM WTI TO ARGUS

After 15 years, Saudi Arabia is abandoning the use of West Texas Intermediate (WTI) as the benchmark for pricing its crude oil exports to U.S. customers, beginning in January, in favour of tracking prices against the Argus Sour Crude Index. The move is not surprising given mounting frustration over the dislocation between WTI and other global benchmarks like Brent.

In our view, the switch in the pricing mechanism could help constrain violent price swings. Volatility in WTI has made it more difficult for refiners to hedge purchases of crude from distant suppliers since the price of cargo is often set weeks after the purchase. The Argus index, which tracks three types of crude including the medium-sulphur crude of the Gulf of Mexico, is also more reflective of the quality of Saudi Arabia’s higher sulphur crude than WTI, a light sweet crude.

The WTI has become an unreliable gauge for the international oil market, largely due to storage and pipeline capacity challenges at its hub in Cushing, Oklahoma.

WTI had historically traded at a premium of $1-$2 per barrel to Brent. But a surge of oil inventories at Cushing, where WTI is delivered to U.S. pipelines, depressed the value of WTI to such an extent that it was trading at a record discount of almost $12 to Brent in January. This dislocation continued into the summer.

At the start of this year, the International Energy Agency warned that “further deterioration in the fragile WTI pricing mechanism would only serve to reinforce the view that the crude has become an irrevocably broken benchmark.” The world currently produces about 300,000 barrels a day of WTI, a fraction of the total production of about 85 million barrels a day.

Members of the Organization of the Petroleum Exporting Countries (OPEC), which control about one third of world oil production, have historically priced their oil at a discount to WTI of as much as $10 because their oil tends to be heavier. This pricing relationship reversed earlier this year when the OPEC basket price, an index of 12 types of crude produced by its twelve members, stood more than $6 above NYMEX’s front-month contract price. The discrepancy supports the Saudi move and could prompt other OPEC members to follow.
To support this rapid rise in visitors, the government has embarked on a massive investment programme to upgrade infrastructure in Islam’s two holiest cities and improve Jeddah’s King AbdulAziz International Airport. The private sector has benefited enormously from this expansion. Around 170,000 state employees are on duty around the greater city of Mecca during the pilgrimage and government agencies distribute more than 4.5 million cold meals and 1.7 million hot meals.

While earnings the private sector derives from religious tourism are substantial, the state incurs security costs involved with maintaining the well being of pilgrims and health of its visitors. Hence the caution that has prevailed in the wake of the global spread of the H1N1 flu.

The Saudi Ministry of Health stipulated earlier this year that travellers must have an injection against H1N1 flu or at the very least, a seasonal flu vaccine, prior to embarking on the hajj. It has urged Muslims who are unfit, such as the elderly, ill, pregnant women and children, to postpone the pilgrimage.

Tourism data for the first half of this year underscore the extent of the negative impact the slowing world economy and flu fears have had on the kingdom’s tourism sector.
In the second quarter, the number of travellers from Europe fell 64% while visitors from the Americas were more than 90% fewer than the same period in 2008. Travellers from other Middle Eastern countries, forming the biggest component of the total, dropped 46%.

The data also show tourist nights by inbound visitors plunged 45% and total tourist trips dropped by 41% between February and June. We excluded January numbers from the calculation due to the seasonality of the hajj, which falls about 11 days earlier each year based on the lunar calendar. In 2007, the hajj began in late December and carried into January 2008, boosting tourist visits in that month.

Anecdotal evidence indicates the sharp downturn in tourist numbers continued in the second half of the year, as several Muslim countries imposed restrictions on religious travel due to worries about a major outbreak of H1N1 flu. Arab health ministers in July banned children, the elderly and those with chronic illnesses from attending this year.

Hotel operators in Mecca have slashed room rates and claim business had declined by about a third or more. According to MAS, expenditures by inbound tourists fell 15% in the five months to the end of June. In the second quarter alone, accommodation spending dropped by 41% to SR2.67 billion.

Fewer pilgrims

Until meaningful data on the hajj – which begins end of November – become available, it will be difficult to assess the real impact of the H1N1 flu on the pilgrimage. Some hajj licensing agencies in Riyadh, Jeddah and Al-Khobar had reached only 60% their quotas for licences by late October, early November. Market-wide expectations are that the number of pilgrims this year could decline by 25%, following a decrease of 25% in umrah pilgrims during Ramadan.

We do not expect such an extreme decline over all hajj pilgrim numbers this year, with a drop of as much as 20% -- the worst-case scenario -- likely to happen only if many key Muslim countries fail to achieve enough demand to fill the quotas they are provided on an annual basis. It is more likely that the fall in tourist visits to Saudi Arabia will be around 15% for the year.

Part of the reason for our guarded optimism is the shift in tourist numbers in June. After falling around 60% year-on-year in April and May, inbound tourist trips rose 11% in June while spending by tourists climbed 14%. We expect a similar trend continued into the summer months, helping ease the sharp downturns earlier in the year.

A great deal of anxiety has surrounded the hajj, however. Tunisia has barred its citizens from performing the hajj having already cancelled trips to perform umrah this year. Iraq also prevented Iraqis travelling from the country to perform umrah during Ramadan, and like many Muslim states, it is banning sick, elderly and pregnant women from travelling for hajj. Iran prevented pilgrims from performing umrah, while Morocco made it mandatory for pilgrims to get an anti-flu vaccine.

Egypt, the most-populous Arab country, restricted umrah and hajj pilgrims to those over the age of 25 and under 65 years of age, also saying it planned to vaccinate pilgrims against the virus before they travel. Despite the restrictions, some reports indicate there could be a greater number of Egyptian hajj pilgrims this year after Egypt’s tourism ministry granted tourist companies a greater share of the country’s quotas.

![Q2 2008 accommodation spending](chart.png)
Any downturn could be partially offset as tourists taking advantage of lower room rates and eased quota restrictions to perform the pilgrimage, a religious duty that some must save for years to be able to afford. Domestic tourism numbers, meanwhile, showed signs of improvement, rising 10.4% between February and June to 10.5 million, while tourist nights climbed by almost a third. However, over the five months, about 9.3% fewer Saudis travelled to Mecca compared with the year earlier, according to the data. Religious tourism on the whole was flat.

**Tourism's ripple effect**

A drop in overall tourist numbers, and tourism spending, appears inevitable this year – and the toll will be felt across many sectors, including hospitality and retail. Religious tourism is an exceptionally important industry for Mecca, Medina and the Red Sea port city of Jeddah, home to the nation’s busiest airport, which handled 53% of total international air traffic in the kingdom last year.

Following years of raising rates by 5%-10% per annum, some hotel operators in Mecca reduced room rates by 30% during Ramadan, including during the last 10 days of the holy month, when streams of Muslims flock to Mecca to perform umrah. A number of hotels also indicated they expect a 30% decline in hotel guests during the hajj season, while hajj licensing agencies anticipate their earnings could fall by a fifth, with a few even projecting losses.

Historically, regional and global events have had an impact on inflows of hajj pilgrims. In the 1920s to 1950s, the hajj did not attract more than 200,000 pilgrims per year, with numbers exceeding 1 million only by 1982, falling below that level in the subsequent years until 1994.

Mecca and the surrounding areas are bustling throughout the year and especially during the hajj. In the region of Mina, which lies between Mecca and Muzdalifah, more than 7,000 fast food outlets have opened to cater to pilgrims, while 62,000 cars and buses are dedicated to transport pilgrims to Mecca. In 2007, foreign pilgrims spent about SR7.3 billion on tour packages, including accommodation and transportation,
while spending on food amounted to about SR940 million. The consumer retail sector also benefits hugely from selling gifts and religious goods, with retailers earning SR868 million in 2007 from such purchases. Data also indicate that pilgrims spent SR186 million making overseas calls and sending text messages in 2007. Meanwhile, they spent SR515 million to sacrifice animals, usually sheep, during Eid al-Adha, the feast of sacrifice.

Any downturn in tourism will automatically translate into a deterioration in state earnings from its airports. Passenger traffic at Jeddah’s King Abdulaziz International Airport, which handles more than 70% of hajj visitors, rose 6.4% in 2008, according to data of the General Authority of Civil Aviation. Total hajj pilgrim passenger traffic at all Saudi international airports rose almost a fifth to 3.1 million in 2008, while umrah passengers grew 17% to 3.54 million.

A slowdown in tourism will thus have a ripple effect across the non-oil sector, which we expect will grow 2.5% this year, almost half its 2008 level. In 2008, the kingdom’s tourism GDP amounted to SR47 billion – 2.7% of overall GDP and contributing 6.9% to the kingdom’s non-oil GDP, according to SAMA data. We expect tourism GDP to contract in 2009, decreasing its share of non-oil GDP to 5.6% this year. As an economic recovery kicks in next year, religious tourists should also make a better showing in the kingdom, although the sector remains vulnerable to global efforts to tackle the spread of the H1N1 flu.
### Key Saudi Arabia Economic Indicators

#### MACRO-ECONOMIC INDICATORS

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<th>Year</th>
<th>Nominal GDP (USD bn)</th>
<th>Nominal GDP (SR bn)</th>
<th>YoY % change</th>
<th>Real GDP growth rate, %</th>
<th>Non-oil private sector real GDP growth rate, %</th>
<th>Government real GDP growth rate, %</th>
<th>Oil sector real GDP growth rate, %</th>
<th>Inflation, YoY % change</th>
<th>GDP per capita (USD)</th>
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#### BUDGETARY INDICATORS

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<th>Year</th>
<th>Total export revenues (SR bn)</th>
<th>Oil export revenues (USD bn)</th>
<th>Total government revenue (SR bn)</th>
<th>Total government expenditure (SR bn)</th>
<th>Deficit/surplus (SR bn)</th>
<th>Budget balance, % of GDP</th>
<th>Domestic debt (SR bn)</th>
<th>Domestic debt as % GDP</th>
<th>Total imports (USD bn)</th>
<th>Current account balance (SR bn)</th>
<th>Current account as % of GDP</th>
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#### EXCHANGE RATE (=USD1)

- **Saudi Riyal**: 3.75

#### BANKING INDICATORS

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic credit growth, %</th>
<th>Bank claims on private sector, YoY % change</th>
<th>Broad money M3 (SR bn)</th>
<th>SAMA net foreign assets (USD bn)</th>
<th>Repurchase Rate (year-end)</th>
</tr>
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#### DEMOGRAPHIC INDICATORS

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

#### OIL INDICATORS

- **Average oil price (WTI) (USD/barrel)**: 26.3
- **Average Saudi oil price (USD/barrel)**: 23.4
- **Crude oil production (million bpd)**: 7.1

* Source: Saudi Arabian Monetary Agency, other Saudi Arabian government authorities, Banque Saudi Fransi forecasts
Disclosure appendix

Analyst certification

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Additional disclosures

1 - This report is dated as at 12 November 2009

2 - All market data included in this report are dated as at close 10 November 2009, unless otherwise indicated in this report.

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