



Q4 results highlight impact of global turmoil

Fourth quarter earnings of companies listed on the Saudi stock market clearly illustrate that the global financial crisis and ensuing recession has had an immediate impact. For the market as a whole, earnings per share were 56 percent lower in the fourth quarter than in the same period of 2007. This compared with a decline of 7 percent in annual earnings per share growth in the third quarter and double digit rises in the first and second quarters.

The multi-investment and insurance sectors were the worst performing; losses were recorded in both sectors. In both cases this was caused by losses on investment portfolios. The multi-investment sector is dominated by Kingdom Holdings, which was hit in particular by its large shareholding of US financial giant Citigroup. Profits at Tawuniya, which dominates the insurance sector, were dented in the first and third quarters by losses on investments and these losses leapt in the final quarter. Earnings per share for the petrochemicals sector collapsed by 99 percent. Industry giant Sabic saw its profits plummet by 95 percent in the fourth quarter, with higher cost operations in Europe and the US particularly affected. The decline was aggravated by a one-off charge related to its US operations.

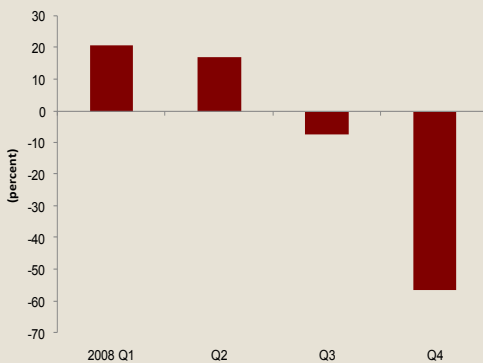
Four sectors recorded growth in earnings per share over the fourth quarter, with the highest being transport (30 percent) and real estate (22 percent). These sectors are largely driven by local fundamentals and have been less affected by the tougher domestic financing conditions. Earnings per share for the banking sector rose by 2.6 percent, though this was entirely due to Saudi Hollandi Bank, which bounced back after a large credit loss in the fourth quarter of 2007. Excluding Saudi Hollandi Bank, earnings per share in the banking sector declined by 25 percent in the fourth quarter.

For the whole of last year earnings per share fell by 6.6 percent compared to 2007. The outlook for the economy is reasonably healthy this year as many projects come on stream and the ongoing domestic economic liberalization and easing of business regulations continue to yield benefits. However, given the likelihood of an exceptionally weak external environment earnings per share are expected to fall by 3.5 percent this year.

Economy in brief: The pace of the decline in inflation that began a few months ago is set to pick up, as falling commodity prices and a strengthening of the riyal feed into consumer prices.

Oil market in brief: Cuts in oil production have reached a level at which associated gas output is close to falling below demand. This situation is sustainable in the near term, but highlights the longer-term gas supply issue the Kingdom faces.

Annual earnings per share growth



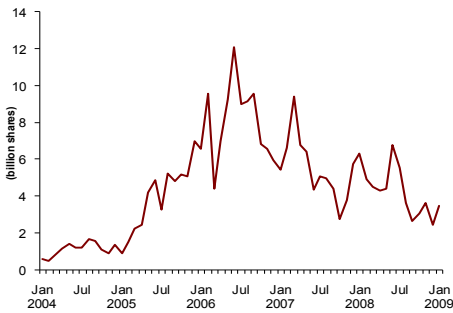
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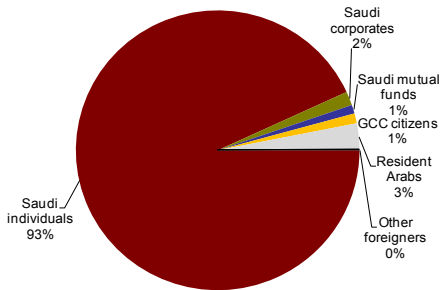


In brief: Stock market

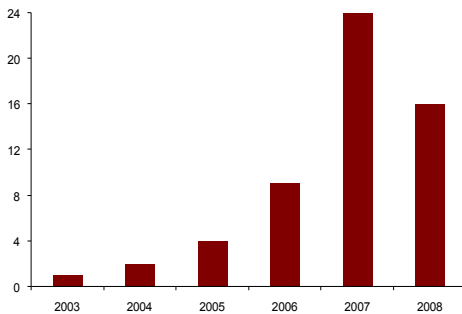
Share transactions remain subdued



Value of shares traded in January



New listings on the TASI



TASI



Share prices were generally little affected by the weak fourth quarter results announced in January. Over the course of the month the TASI was broadly flat (it climbed by 0.1 percent). It appears that investors drove down share prices in the fourth quarter in anticipation of the poor performance. Market sentiment remains very cautious owing to continued uncertainty about the prospects for the global economy and oil prices and how these will impact on Saudi companies. This caution is reflected in continued low volumes. The number of transactions in January was only 70 percent of the average for the first half of last year and in recent months transactions have been near to four-year lows.

Foreign investors have yet to make an impression on the Saudi stock market since they were allowed to participate via swap agreements in September. In January foreign investors accounted for just 0.2 percent of trades on the Saudi stock market by value. Several local investment companies have the necessary approvals to allow foreign investors into the market, but the high level of risk aversion among global investors has limited financial commitments (though foreign investor interest is still strong). Saudi individuals continue to dominate the market, accounting for 93 percent of total transactions by value in January.

One bright spot was the successful completion of the first IPO in the Kingdom since August. The IPO for telecoms company, Etihad Atheeb, one of three recently licensed fixed line operators, closed more than two times oversubscribed on February 2. Although the shares were only priced at a par value of SR10, there had been some uncertainty over how investors would respond, given recent market performance. Of the three largest IPOs of the last four years (all of which were issued last year), Alinma Bank and Zain are only up by 14 percent each and Ma'aden is down by 36 percent. IPOs from private sector companies remain on hold pending an improvement in market conditions.

The Capital Market Authority appears to be tightening the implementation of its disclosure rules. Two companies were fined for breaching disclosure rules in January and two others were penalized for the same offence in December. The breaches have been caused by companies disclosing either financial results or information that could have an impact on their share price before it was passed to the stock exchange. The clampdown will help to prevent market manipulation. However, there appears to be some uncertainty regarding the disclosure rules within companies, which had made some cautious about giving information to analysts.



Economy watch

Inflation to fall further

The pace of the decline in inflation that began a few months ago is set to pick up, as falling commodity prices and a strengthening of the riyal feed into consumer prices. Inflationary pressure from rents, the main source of inflation in the Kingdom, is also easing, though a shortage of accommodation will keep it well into double digits. As a result, we expect average inflation to fall to 6.7 percent this year from 9.9 percent in 2008.

Inflation fell to 9 percent in December, a 10-month low. A drop in food price inflation, to 11.3 percent from 14.4 percent in November, was the main reason for the decline. Global food prices have plunged since mid-2008. As measured by the IMF, global food prices are now 12.1 percent lower than they were one-year ago and 34 percent off their peak in June of last year. Although in some cases demand has slowed owing to the global recession, their decline is largely due to the alleviation of supply concerns that pushed prices very high in the first half of last year; a result of much better than expected harvests and high prices encouraging greater planting.

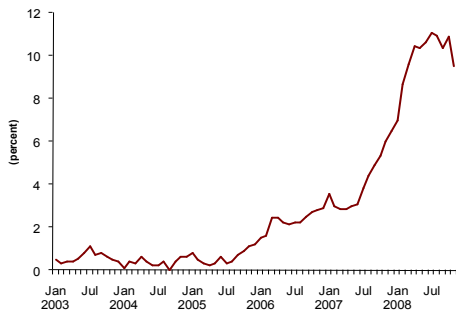
The chart to the left shows the close relationship between global and Saudi food prices and suggests that there should be further falls in Saudi food price inflation over the near term. The outlook for the rest of the year is also encouraging; the IMF projects global non-fuel commodity prices to average 29 percent lower in 2009 than last year. Even if global food prices stay at their current level during 2009, they will average 24 percent less than last year.

Recent exchange rate moves point to lower imported inflation. The riyal has appreciated by 8 percent against the euro (the currency of the Kingdom's main trading partner) since the end of last year and is down by nearly 20 percent against the euro since the end of June. In addition, inflation is collapsing in many of the Kingdom's other major trading partners and is set to stay very low; the IMF projects inflation in developed countries at just 0.3 percent this year. Furthermore, with oil prices \$100 per barrel off their highs and the recession depressing trade volumes, transport costs have plunged; freight rates are only around 10 percent of their mid-2008 peak.

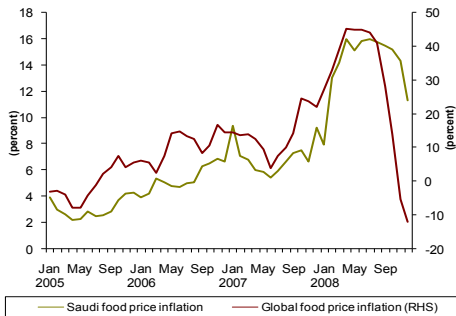
Rental inflation fell below 18 percent for the first time since April in December and has eased for five consecutive months. However, unlike food price inflation, rents are still rising strongly on a monthly basis (by an average of nearly 1 percent over the last three months). With a fundamental imbalance between demand and supply of residential accommodation only slowly being addressed, rents will remain the main source of inflation for several years.

Other sources of inflation are also proving stubborn. Stripping out food, rents and other expenses and services (mainly jewelry and so linked to gold prices), annual inflation for the remainder of the cost of living basket (clothing and footwear, home furniture, medical care and transport and telecommunications) has climbed in 15 of the last 16 months. Nonetheless, the near-term outlook for inflation is bright, with the external forces that helped lift prices over the last few years all easing. However, domestic sources of inflation remain and could be aggravated if the eventual global economic recovery triggers a pick-up in commodity prices and a weakening of the dollar.

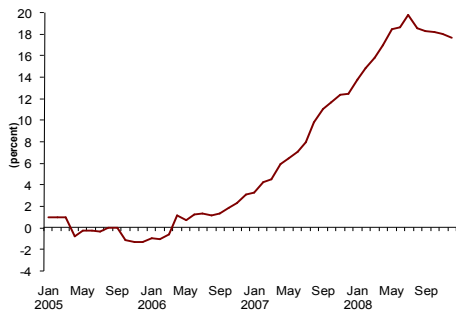
Inflation has peaked



Food prices could fall further



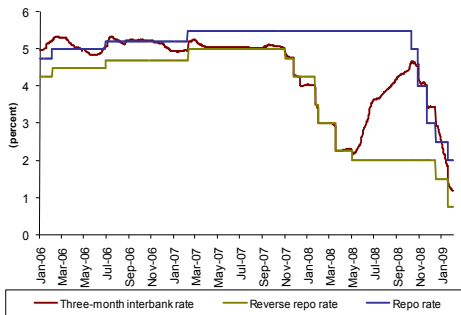
Rental inflation is slowing





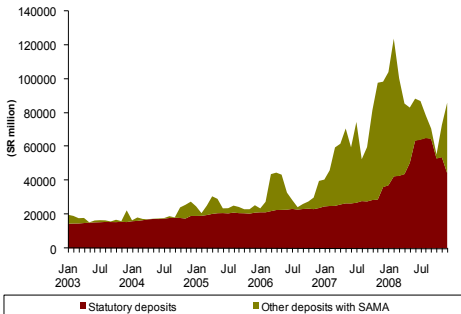
In brief: Economy

Interest rates



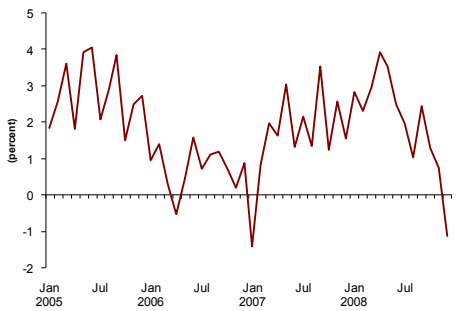
Interest rates were reduced again in late January. SAMA cut the repo rate (the rate it charges for lending to commercial banks) to 2 percent from 2.5 percent and the reverse repo rate (the rate it pays for deposits) to 0.75 percent from 1.5 percent. This is the lowest the repo rate has been since September 2004 and an all-time low for the reverse repo rate. Unlike most interest rates moves in Saudi Arabia this was done independently of the US, where rates are effectively zero (the exchange rate peg generally compels SAMA to shadow changes in US interest rates). The move was taken as part of a series of measures to stimulate bank lending. Interbank rates have fallen in line with the SAMA cuts.

Bank reserves at SAMA



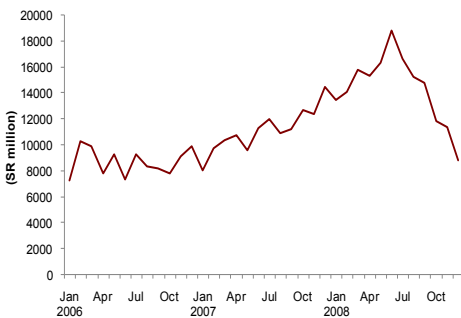
Another way the government has made more funds available for banks to lend is by reducing commercial bank reserve requirements, which set the proportion of their assets that banks have to place with SAMA. Reserve requirements for current accounts were cut in October and November (by a total of 6 percentage points to 7 percent). In response, data for December shows that bank deposits at SAMA in excess of the statutory requirement (and therefore available to lend) leapt to SR41.1 billion from SR0.9 billion in October. In addition, deposits by independent government organizations (such as the state pension funds) in the banking sector rose by SR15.4 billion in December.

Bank lending to the private sector



To date, official efforts to encourage banks to increase lending are helping. While some banks remain highly risk averse, credit is now readily available from others within the Kingdom, though generally priced at a much higher spread over interbank rates than in the recent past. Although the lending environment has improved, uncertainty among the private sector about the health of the economy is affecting the demand for credit. Bank lending to the private sector fell by 1.1 percent in December, the first monthly decline since January 2007.

Letters of credit opened



An indication of how the tough financial and economic conditions are affecting local companies can be gained from data on letters of credit (companies open letters of credit with banks to finance imports). The total value of letters of credit opened hit a near two-year low in December and those for building materials and machinery slumped to a near three-year low. Letters of credit for motor vehicles, the largest single category, dropped to their lowest in over a year and some vehicle retailers are experiencing falling sales. Point of sales transactions data suggest a broader decline in retail sales.



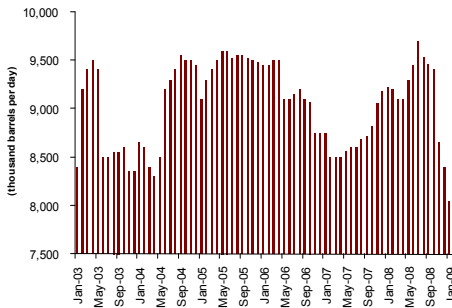
Oil market watch

Oil output cuts could constrain gas supply

Cuts in oil production designed to stimulate oil prices have reached a level at which gas supply (the bulk of which is produced as a by-product of oil production) is close to falling below demand. This situation is manageable in the near term, but highlights the long-term gas supply issue the Kingdom faces.

In order to lift oil prices, Opec agreed in December to cut production to 4.2 million barrels per day (b/d) below the September level. For Saudi Arabia this meant reducing output to 8.05 million b/d, a target it achieved in January. With prices yet to show any sign of recovery, the Kingdom is planning to reduce production by an additional 300,000 b/d in February. Early indications are that production will be maintained at this level in March.

Saudi oil production



Around 60 percent of Saudi Arabia's gas output is associated (produced as a by-product of oil production). Reducing oil production therefore lowers the amount of gas available. Gas is a vital feedstock for the petrochemical industry and power and water projects. It is estimated that if oil output falls below 8 million barrels per day the Kingdom may not produce enough gas to meet demand.

A temporary dip in production from the January level would not, however, be a problem, as power facilities can be run using alternative feedstock, such as fuel oil. Liquids can also be used as feedstock for petrochemicals. However in both cases they are more costly than gas. Reliance on gas reduces the scope for sustained oil production of much below 8 million b/d and with some other Opec producers also heavily reliant on associated gas, the chances of further large oil production cuts are limited.

In preparation for increased use of liquids and to take advantage of low international prices Saudi Aramco has taken (for it) the unusual step of securing imports of gas oil on a long-term contract. It agreed to buy 3 million barrels of gas oil from Japanese trader Itochu and a further 7.4 million barrels of gas oil from Reliance Industries of India over the course of 2009 in early February.

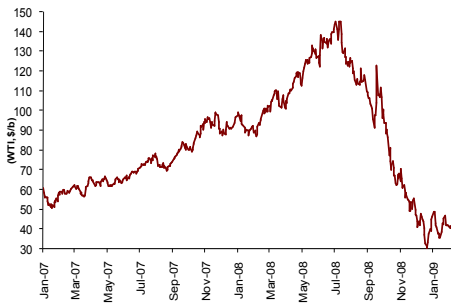
Although the Kingdom will not be greatly affected by the temporary reduction in the availability of gas, it highlights a long-term supply issue. Gas demand is growing rapidly and supply constraints have prevented the award of any new ethane feedstock allocation to a petrochemicals venture since 2006. Many of the heavy industrial projects and economic clusters planned in the Kingdom are also premised on the availability of cheap gas and while more expensive feedstock can be used this undermines the competitiveness of the end products.

Some new non-associated gas fields will soon be entering production. The largest, an extension of the offshore Karan field with a production capacity of 1.5 billion cubic feet per day, is set to come on stream in 2012. The new oil fields that are coming on stream over the next few years will provide new sources of associated gas. However, the four consortia that continue to search for non-associated gas in the Empty Quarter, where there are believed to be the large reserves that the Kingdom needs, have yet to make a commercially-viable discovery.



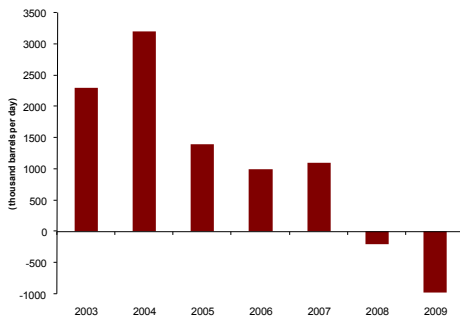
In brief: Oil market

Oil prices have stabilized



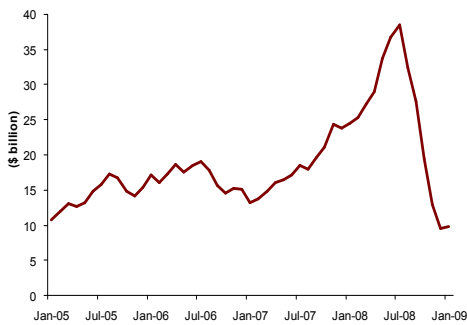
After the precipitous decline over the second half of 2008, oil prices have stabilized at around \$40 per barrel. It appears that over the past month or so news about the worsening global economy has been offset by a reduction in supply from Opec producers. Opec agreed in December to cut production to 4.2 million barrels per day below the September level. Compliance has been mixed (only around two-thirds of the cut was implemented in January), but this has been enough to stabilize prices. However, demand generally falls in the second quarter, as the weather in the northern hemisphere improves, and there is some speculation about a further cut in output.

Global oil demand set to fall again



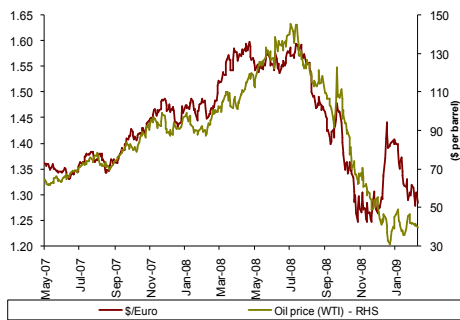
The International Energy Agency has sharply scaled back its projections for oil demand. It now thinks that global oil demand fell by 300,000 barrels per day (b/d) last year, compared to a projection as recently as October that demand would grow by 440,000 b/d. The downgrade to the 2009 forecast was even greater, with a 980,000 b/d fall expected, compared to a projection of growth of 690,000 b/d in October. Growth in oil demand is expected to slow in every part of the world, with demand in China, which in recent years was the main source of demand growth, expected to rise by only 50,000 b/d in 2009. If true, 2008 and 2009 would be the first time since the early 1980s that oil demand falls for two consecutive years.

Monthly oil revenues for Saudi Arabia



Latest data indicate that Saudi Arabia is implementing the oil output cuts agreed by Opec in December. Production in January was in line with its target at around 8.05 million b/d according to estimates by Middle East Economic Survey. This is down by 17 percent from its peak in July of last year of 9.7 million b/d. Lower production, combined with the large fall in oil prices, has had a major impact on oil revenues. We estimate that Saudi oil revenues were \$9.8 billion in January, slightly above the figure for December, but down from in excess of \$30 billion per month between May and August of last year (the peak was \$38 billion in July). The last time oil revenues were below \$10 billion for two consecutive months was in the first half of 2004.

The dollar/oil relationship has broken



The close relationship between the dollar and oil prices has broken down. As the chart to the left shows, there was a correlation between oil prices and the dollar over the 18 months to November, as investors bought oil, a dollar-denominated asset, as a hedge against dollar weakness and vice versa. The subsequent end of this relationship is the result of a shift in investor sentiment. There is no fundamental reason why oil prices and the dollar should move together, as the drivers of each are not very closely related. Dollar strength is now being fueled by the return of funds that had been invested abroad by US investors and perceptions that the dollar is a relative safe haven, while the direction of oil prices reflects the prospects for the global economy.



Key data

	2002	2003	2004	2005	2006	2007	2008E	2009F	2010F
Nominal GDP									
(SR billion)	707.1	804.6	938.8	1182.5	1307.5	1430.5	1753.0	1426.6	1612.9
(\$ billion)	188.6	214.6	250.3	315.3	348.7	381.5	467.5	380.4	430.1
(% change)	3.0	13.8	16.7	26.0	10.6	9.4	22.5	-18.3	13.1
Real GDP (% change)									
Oil	-7.5	17.2	6.7	6.2	-0.8	0.5	5.4	-9.5	6.4
Non-oil private sector	4.1	3.9	5.3	5.8	6.1	5.8	4.3	4.5	4.8
Government	2.9	3.1	3.1	4.0	3.1	2.7	2.4	3.0	2.6
Total	0.1	7.7	5.3	5.6	3.2	3.4	4.2	0.4	4.8
Oil indicators (average)									
WTI (\$/b)	26.2	31.1	41.5	56.6	66.1	72.3	99.7	70.0	80.0
Saudi (\$/b)	23.7	26.9	34.7	49.5	60.5	68.1	93.4	65.8	74.0
Production (million b/d)	7.5	8.8	9.0	9.5	9.2	8.7	9.2	8.1	8.5
Budgetary indicators (SR billion)									
Government revenue	213	293	392	564	679	643	1100	664	769
Government expenditure	234	257	285	346	398	466	510	561	586
Budget balance	-21	36	107	218	280	177	590	103	183
(% GDP)	-2.9	4.5	11.4	18.4	21.4	12.3	33.7	7.3	11.4
Domestic debt	660	660	614	475	366	267	237	237	220
(% GDP)	93.3	82.0	65.4	40.2	28.0	18.7	13.5	16.6	13.6
Monetary indicators (average)									
Inflation (% change)	0.2	0.6	0.3	0.7	2.3	4.1	9.9	6.7	6.1
SAMA base lending rate (% , year end)	2.00	1.75	2.50	4.75	5.20	5.50	2.50	2.00	3.00
External trade indicators (\$ billion)									
Oil export revenues	63.6	82.0	110.4	161.1	187.7	205.5	280.4	149.1	170.3
Total export revenues	72.3	93.0	125.7	180.1	210.5	233.4	311.1	176.7	200.1
Imports	29.6	33.9	41.1	54.6	63.8	82.5	92.4	103.5	116.0
Trade balance	42.6	59.1	84.6	125.5	146.6	150.8	218.7	73.2	84.2
Current account balance	11.9	28.0	51.9	90.0	98.9	95.0	150.6	12.3	26.8
(% GDP)	6.3	13.1	20.7	28.5	28.4	24.9	32.2	3.2	6.2
Official foreign assets	73.3	97.1	127.9	195.5	273.4	359.8	499.5	514.5	544.7
Social and demographic									
Population (million)	21.5	22.0	22.5	23.1	23.7	24.2	25.0	25.8	26.6
Unemployment (male, 15+, %)	7.6	8.2	8.5	8.8	9.1	9.0	8.8	8.5	8.2
GDP per capita (\$)	8773	9745	11112	13640	14725	15736	18665	14720	16148

Sources: Jadwa forecasts for 2008 to 2010. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.



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