جدوى للإستثمار
Jadwa Investment

August 2014

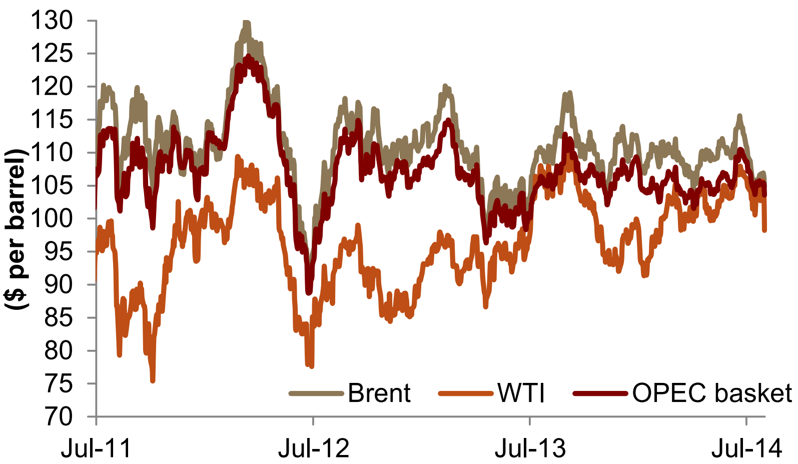
Macroeconomic update:
Economic projections for 2014 revised up

- We have revised some of our 2014 forecasts to take account of a recent flow of data that has generally been stronger than we had anticipated.
- With higher than expected year-to-date oil prices and output, we have revised up our forecast upwards for both.
- Higher public spending and robust credit growth should support non-oil growth with construction, transport, manufacturing and retail sectors in the lead.
- A slowdown in global growth and geopolitical tensions constitute key risks, though they are less acute and more evenly balanced than in recent years.

Oil markets have been tight so far this year, with prices and Saudi production above our expectations. We have revised both these forecasts upwards, meaning that oil revenues will be higher than we previously predicted. This will enable the Kingdom to maintain a large current account surplus while elevated government spending will reduce the budget surplus. We have kept most of our assumptions for the non-oil economy unchanged. Preliminary data shows that the performance of the non-oil economy has been strong over the first half of this year, which is in line with our forecasts.

While we still expect global oil market balances to be in surplus for 2014, regional and global geopolitical developments are the key pressure points keeping prices at elevated levels (Figure 1). The ongoing tensions in Libya, limited growth in output from Iran and Iraq and geopolitical tension in Ukraine have added a risk premium to

Figure 1: Oil prices



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Geopolitical risks remain the key pressure point in the global oil market…

… keeping prices above our expectations.

prices. In Libya, oil output remains low despite some recent agreement between the government and rebel groups that has resulted in the opening of two terminals. Iran's year-to-date crude output decreased 13 percent year-on-year, to 3.2 million barrel per day (mbpd), but rising levels of exports are helping to gradually reverse the declines in production. In Iraq, while the current civil strife has not yet negatively impacted oil output, it does add significant downside risk to outlook. Iraqi production rose by 4 percent, year-on-year, year-to-date, to 3.1mbpd (Figure 2).

In response, Saudi oil output remained elevated to stabilize the market...

In response, the Kingdom has held production at a high level so far this year. Official data put oil production at 9.7mbpd year-to-date up from 9.3mbpd for the same period last year. A number of factors have contributed to this growth, including continued outages and slower growth in output from other OPEC members, faster than expected upturn in the US economy resulting in higher demand for Saudi crude and higher year-on-year domestic Saudi consumption. We have therefore revised our forecasts for Saudi crude production to 9.7mbpd in 2014, up from 9.4mbpd previously (Figure 3). While supply from the Kingdom has been sufficient to meet internal and external demand for its oil, it has been unable to reduce the risk premium currently attached to oil prices. Indeed, the more the Kingdom produces, the lower its spare production capacity becomes, meaning the smaller the cushion to cope with new supply disruptions. Concerns about available spare production capacity may weigh on market sentiment.

...despite strong growth in non-OPEC oil output.

Furthermore, global oil supply has been buoyant. Despite the subdued recovery in oil production in Iran and Iraq, the growth in non -OPEC oil supply (1.4mbpd year-on-year) is estimated to exceed global demand growth (1.1mbpd year-on-year) in 2014. The main factor behind this growth is the shale oil revolution in the US which continues apace with production rising by 13.5 percent year-on-year so far this year. In contrast, total oil output from OPEC excluding Saudi Arabia dropped by 6.5 percent in the first six months of 2014, year-on-year. OPEC continues to be affected by large falls in Libyan output, down 79 percent during the same period.

At the same time, while oil demand in most advanced economies slowed, global oil demand was marginally higher driven by Asia and the US. Economic data from the US, Japan and many other Asian economies has generally been encouraging so far this year. While

Figure 2: Iraqi, Libyan and Iranian oil output

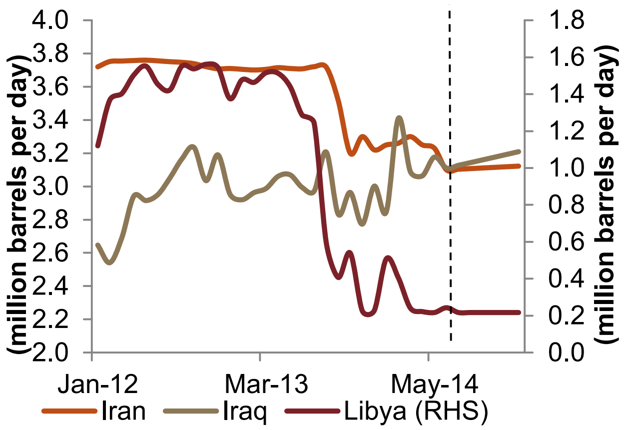
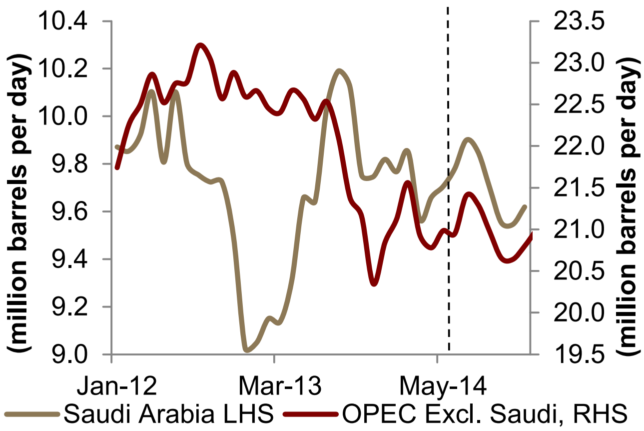


Figure 3: Saudi oil production



Slow, but steady global economic recovery means oil demand is expected to record modest growth…

...though strong demand in Asia and the US is observed.

EU oil demand growth will continue to be weak due to the stuttering economy, the US is the main source of demand amongst the OECD countries this year. In China, we still expect oil demand growth to be above 3 percent for the whole of 2014, as government infrastructure projects, new refineries and oil stockpiling sustain demand. All in all we estimate that global oil demand will increase by 1.1mbpd year-on-year in 2014 compared with 1mbpd last year (Figure 4).

We thus raise our forecast for Brent to reflect the current trend, to $109 per barrel this year.

Brent crude has averaged $110 per barrel so far in 2014. We have revised our forecast for Brent upwards to reflect the current high price levels and now expect it to average $109 per barrel this year. We still anticipate that oil prices will fall towards the end of the year as demand gradually falls from peak summer season during the third quarter (Figure 5). However, we continue to see an additional floor on prices on the back of higher costs of production related to US shale oil, which is increasingly contributing to a larger share of global oil output. We estimate that this floor on oil prices is above what Saudi Arabia needs to balance its budget at $85 per barrel.

Higher oil prices and output oil will support the Kingdom's budgetary position...

...though elevated government expenditures will keep its budget surplus relatively small...

Higher oil revenues will boost the Kingdom's budgetary position, though elevated spending will keep the fiscal surplus below 5 percent of GDP. Oil revenues are the source of around 90 percent of budget revenues, which are now expected to reach SR1.17 trillion. Government spending particularly on wages and salaries, goods and services and public projects is likely to remain high this year. Furthermore, the Kingdom is becoming a major aid and financial assistance provider in the Middle East region which will put further pressure on its budgetary position. In light of this we have made an upward adjustment to our forecast for government expenditures to an all-time high of SR1,069.8 billion (Figure 6). This means the fiscal balance will remain in surplus at 3.5 percent of GDP, though risk is tilted to the downside as the government fulfills its commitment on internal project spending and external financial assistance.

...meaning that the official reserve accumulation will be slower than in previous years.

The remainder of the additional oil revenue will be used to build up savings in the form of foreign assets at SAMA, though the pace of accumulating assets will be slower than previous years due to higher spending. SAMA foreign assets were up by $13 billion in the first six months of the year and we expect an increase of more than $45 billion over the whole of 2014. Higher savings provides reassurance that elevated levels of spending can be maintained for a number of years since reserves can be drawn down in the event of revenue

Figure 4: Change in global oil demand and non-OPEC supply
(year-on-year change)

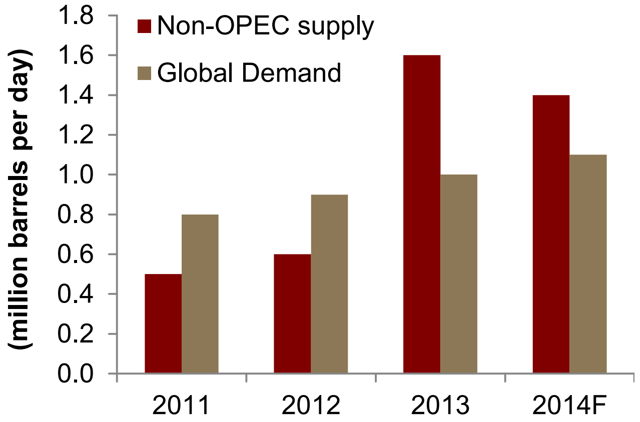
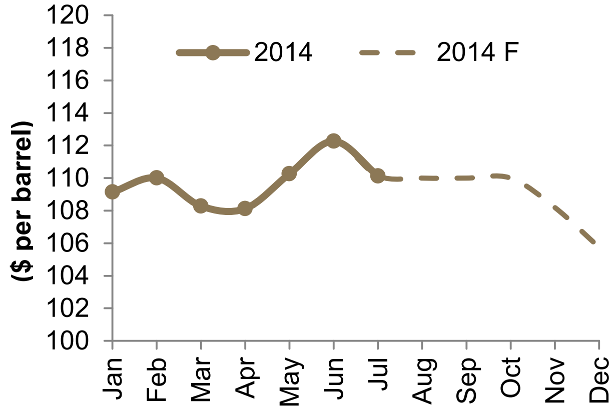


Figure 5: Brent crude forecast



High government spending will continue to be the engine of the non-oil economy…

...with construction, transportation, retail and manufacturing sectors on the lead.

Robust growth in bank lending to the private sector is also another key factor behind the positive performance by the private sector.

Despite the strong economy performance and liquidity in the market, inflation remains stable so far this year.

shortfalls.

Very high government spending will remain as the main stimulus to the economy with high oil revenues supporting business and investor confidence for the fourth consecutive year. Economic data for 2014 (covering the first half) has been solid, indicating that overall economic growth will still be driven by the non-oil sector this year. In particular, we think that construction, transportation, retail and manufacturing will be the main drivers of growth in the non-oil economy. Consumer spending, bank credit to private sector, project market and other business survey data all point to robust performance in the non-oil real GDP for the first half of this year. Our impression is that progress in awarding contracts and project implementation has been stepped up as the government pushes contractors to finish projects that had been delayed. While this is generally in line with our expectations, we have, nevertheless, slightly increased our forecasts for the non-oil sector to 5.1 percent this year, to reflect the increases in government expenditure (Figure 7).

Another major driver for economic growth is bank credit to the private sector. With ample liquidity in the banking system, credit to the private sector has, so far, maintained strong growth for the third consecutive year. Average growth for the first six months of this year reached 12 percent year-on-year, driven by strong corporate credit growth and soaring consumer lending. This has contributed significantly to banks profitability, which hit an all-time high of SAR35.7 billion last year. With demand for credit expected to remain strong this year, we forecast that bank profits will maintain their upward trend and break the record level of profits from the previous year. According to data compiled by SAMA, bank profits grew by 10.4 percent year-on-year over the first six months of this year. Loan to deposit ratio at 81 percent suggests limited funding risks; and bank deposits in excess of the statutory requirement at SAMA stood at SAR54.9 billion at the end of June 2014.

Inflation in the Kingdom has been stable so far this year despite strong domestic demand. This is mostly due to a weak external environment which we think will keep inflation at a moderate rate over the remainder of 2014. Inflation amongst the Kingdom's main trading partners also remains subdued, international food prices are down almost 3 percent in year-on-year terms (according to the UN Food and Agriculture Organization) and most other commodity prices

Figure 6: Government finances

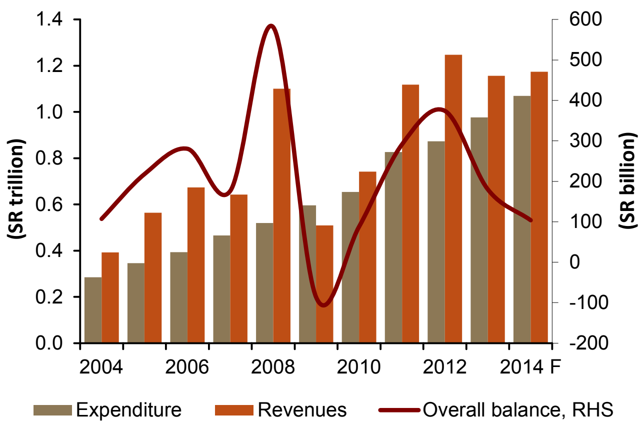
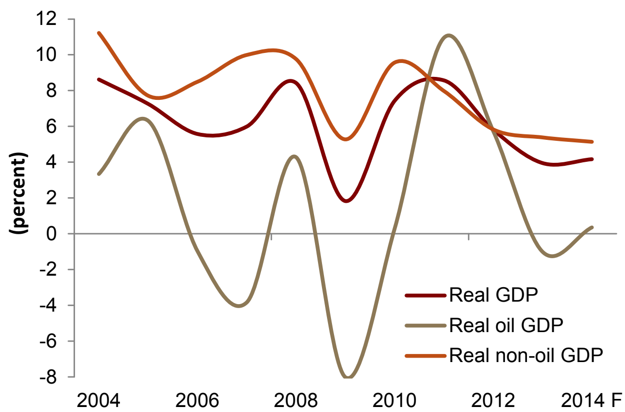


Figure 7: Real economic growth
(year-on-year change)



have been relatively stable. There is little sign of dollar weakness or underlying inflationary pressures in the global economy. For the Kingdom, rents are the main risk to our inflation forecast (Figure 8). Rental inflation has gradually increased from 2.5 percent in December 2012 to 4.1 percent in June this year. It appears that higher incomes and government current expenditures have lifted demand for rental property whilst delayed land-market reform has encouraged landlords to raise rents. Once a sufficient supply of new government housing becomes available, rental inflation will decline.

Higher oil prices and output oil will also support the Kingdom's already strong external balance…

Higher oil revenues will cause the Kingdom's external position to remain very strong. We are now projecting a current account surplus of $133 billion (16.9 percent of GDP). Latest trade data shows a moderate growth in non-oil exports. Year-to-May imports fell by 8.9 percent year-on-year to $38 billion while non-oil exports continue on a positive growth path, with a year-to-May expansion of 7.2 percent reaching $23 billion. Given our expectation for Saudi oil production to be maintained at 9.7mbpd for the rest of the year, and the upside risks to oil prices from geopolitical developments, we expect the overall trade surplus to offset the services and income deficits and remittances outflows, resulting in a current account surplus of $133 billion (16.9 percent of GDP, Figure 9).

...with current account recording a surplus of 16.9 percent of GDP.

The main risks to our forecast stem from the external environment…

While concerns about the global economy and regional security continue to be the main risks to our forecast, they are less acute and more evenly balanced than in recent years. Despite slower than expected global economic growth in the first half of the year, risk appetite on financial markets has continued to rise and volatility has declined to multi-year lows. We however remain concerned about an eventual reversal in risk appetite and tightening of global financing conditions which could be triggered by upward shift in market expectations of official interest rates. The implications for the Kingdom would be limited since markets have differentiated the Kingdom's stable outlook from other vulnerable economies on the back of the government's willingness and ability to honor its spending commitments. We also expect that regional political uncertainty will continue to hang over the economy and any heightening of tensions would affect business and consumer confidence. We expect any sentimental impact here would only be temporary as it would also lead to higher oil prices and Saudi production, thereby supporting both sovereign and external positions of the Kingdom.

...though they are less acute and more evenly balanced than in recent years.

Figure 8: Inflation

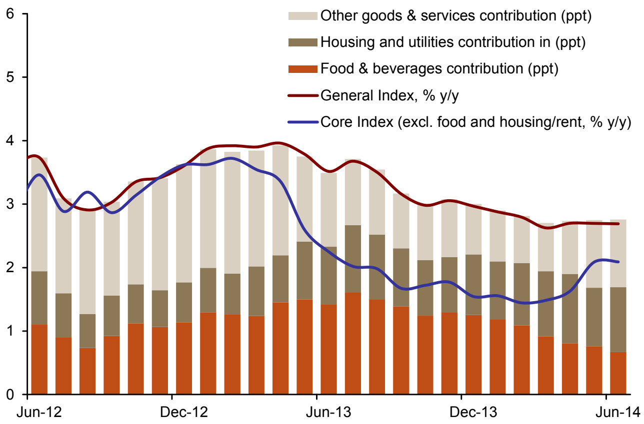
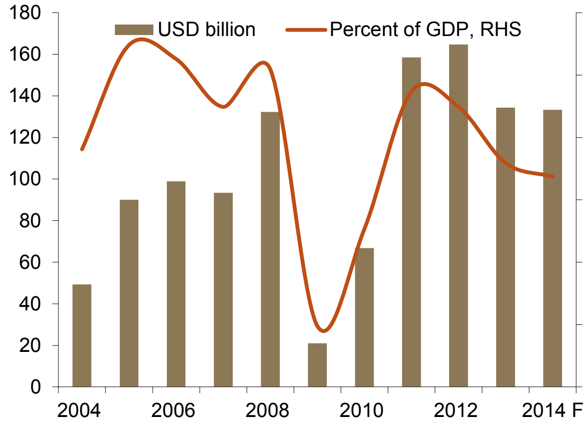


Figure 9: Current account balance



Key Data

	2007	2008	2009	2010	2011	2012	2013	2014 F	2015 F
Nominal GDP									
(SR billion)	1,559	1,949	1,609	1,976	2,511	2,752	2,807	2,965	3,037
($ billion)	415.7	519.8	429.1	526.8	669.5	734.0	748.4	790.6	809.8
(% change)	10.4	25.0	-17.4	22.8	27.1	9.6	2.0	5.6	2.4
Real GDP (% change)									
Oil	-3.8	4.3	-8.0	0.3	11.0	5.7	-1.0	0.4	-1.1
Non-oil private sector	12.0	11.1	4.9	10.3	7.7	6.0	6.0	5.5	4.8
Government	4.9	6.2	6.3	7.5	8.7	5.5	3.7	4.2	3.0
Total	6.0	8.4	1.8	7.4	8.6	5.8	4.0	4.2	3.3
Oil indicators (average)									
Brent ($/b)	72.9	97.2	61.7	79.8	112.2	112.4	109.6	109.0	104.7
Saudi ($/b)	67.2	94.0	60.4	77.5	103.9	106.1	104.2	105.0	100.7
Production (million b/d)	8.8	9.2	8.2	8.2	9.3	9.8	9.6	9.7	9.5
Budgetary indicators (SR billion)									
Government revenue	643	1,101	510	742	1,118	1,247	1,156	1,174	1,045
Government expenditure	466	520	596	654	827	873	976	1,070	1,022
Budget balance	177	581	-87	88	291	374	180	104	24
(% GDP)	11.3	29.8	-5.4	4.4	11.6	13.6	6.4	3.5	0.8
Domestic debt	267	235	225	167	135	99	75	68	61
(% GDP)	17.1	12.1	14.0	8.5	5.4	3.6	2.7	2.3	2.0
Monetary indicators (average)									
Inflation (% change)	5.0	6.1	4.1	3.8	3.7	2.9	3.5	3.0	3.3
SAMA base lending rate (%, year end)	5.5	2.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0
External trade indicators ($ billion)									
Oil export revenues	208.3	284.1	166.9	215.2	317.6	337.5	323.1	317.9	283.0
Total export revenues	233.2	313.5	192.3	251.1	364.7	388.4	377.0	374.6	342.2
Imports	81.5	100.6	86.4	97.4	120.0	141.8	152.7	158.3	172.1
Trade balance	151.7	212.8	105.9	153.7	244.7	246.6	224.3	216.3	170.0
Current account balance	93.3	132.3	21.0	66.8	158.5	164.8	134.3	133.3	81.4
(% GDP)	22.5	25.5	4.9	12.7	23.7	22.4	17.9	16.9	10.0
Official foreign assets	305.6	442.7	410.1	445.1	544.0	656.6	725.7	769.0	799.9
Social and demographic indicators									
Population (million)	24.9	25.8	26.7	27.6	28.4	29.2	30.0	30.9	31.8
Unemployment (15+, %)	11.2	10.0	10.5	11.2	12.4	12.0	11.5	10.7	10.5
GDP per capita ($)	16,667	20,157	16,095	19,113	23,594	25,139	24,953	25,614	25,489

Sources: Jadwa forecasts for 2014 and 2015. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics & Information and Jadwa estimates for oil, social and demographic indicators.

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The data contained in this research is sourced from Reuters, Bloomberg, Tadawul and national statistical sources unless otherwise stated.

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