



31 October 2010

Healthy second quarter economic growth

Quarterly economic growth data has been published for the first time in the Kingdom. It shows that the economy grew by 15.2 percent year-on-year in nominal terms in the second quarter of 2010, down from 34.1 percent in the first quarter. Oil was by far the fastest growing sector, reflecting higher prices. Trends in oil prices explain the bulk of the slowdown in growth in the second quarter. Year-on-year non-oil growth slipped to 7.3 percent in the second quarter from 10.7 percent in the first quarter. Construction and utilities were the best performing non-oil sectors and agriculture and retail were the weakest. Data in real (that is, inflation adjusted) terms is not available.

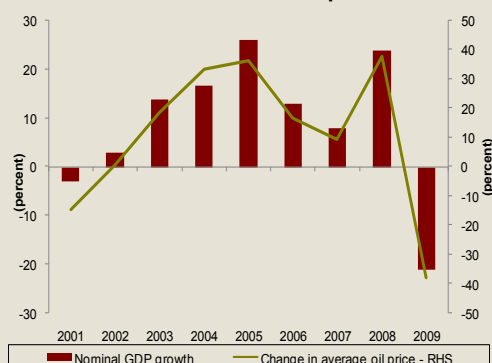
The rapid growth in the oil sector is due mainly to the increase in oil revenues between the second quarter of 2009 and the second quarter of this year. This is largely because of higher oil prices; Arab Light averaged \$77.4 per barrel in the second quarter of this year, compared to \$59.1 per barrel in the same period of last year. Production was also up slightly. Growth in the oil sector was actually below our estimate of the increase in oil revenues over the period. This runs contrary to the trend in recent years when oil GDP was notably higher than the level justified by changes in oil prices and production, and could reflect a slowdown in other oil-related activities that may be captured in the figures.

Economic growth, 2010
(percent)

	First quarter	Second quarter	First half
Oil sector	68.2	24.1	43.3
Non-oil sector	10.7	7.3	9.0
Private sector	6.7	6.2	6.5
Public sector	17.9	9.1	13.5
Total	34.4	15.3	24.3
Import charges	-0.3	7.3	3.9
GDP	34.1	15.3	24.1

Growth in the non-oil private sector slipped from 6.7 percent in the first quarter to 6.2 percent in the second quarter in year-on-year terms. In quarter-on-quarter terms, the non-oil economy decline by 2.1 percent in the second quarter. It is not a surprise that construction and utilities (electricity, gas and water) were the best performing sectors in year-on-year terms, as these are benefitting from significant and sustained government spending. Manufacturing also posted strong growth, which was driven by "other manufacturing" (manufacturing excluding oil refining). This is likely to reflect the start of production at some petrochemical facilities and a revival in output in other industries, such as cement, that benefit from high construction spending.

Nominal GDP and oil prices



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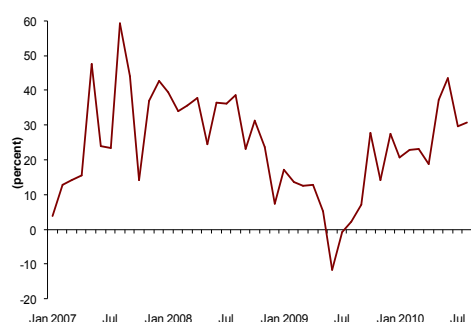
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Point of sale transactions



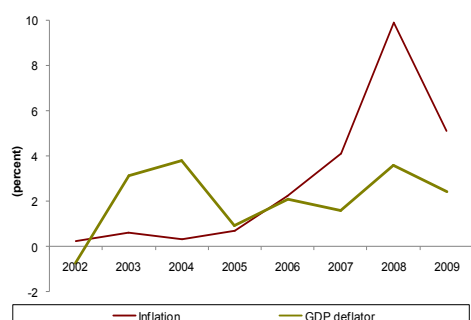
Telecoms growth remained strong despite the very high level of mobile phone penetration in the Kingdom. This is probably the result of continuing growth in the provision of broadband and mobile applications. The transport sector, which is consolidated with telecoms in the GDP data, is benefitting from a higher volume of imports and exports. Agriculture was the slowest growing sector, as it has been for several years, owing to the gradual phasing out of various subsidies. We had not anticipated that retail would be one of the weakest performing sectors in the second quarter. Given the indications of strong consumer spending (point of sale transactions were up by 33 percent and cash withdrawals from ATMs up by 14 percent over the same period), the slowdown in growth in the retail sector, to 3.6 percent from 8.8 percent in the first quarter, is puzzling.

Economic growth by sector, 2010
(percent)

	First	Second	First half
Agriculture	3.5	2.3	2.9
Oil	73.2	26.4	46.6
Manufacturing	14.4	6.6	10.4
Electricity, gas and water	10.8	7.9	8.7
Construction	7.4	8.4	7.9
Wholesale & retail trade	8.8	3.6	6.3
Transport & communication	6.5	6.8	6.7
Finance	4.2	5.0	4.6
Personal services	4.9	5.1	5.0
Government services	19.8	9.5	14.7
GDP	34.1	15.3	24.1

Public sector growth was stronger than that for the private sector. There has been considerable investment in the public sector in recent years and from the data it is not possible to tell how much of the improvement is driven by an increase in public sector resources (for example, more government employees) and how much by gains in productivity. As with the retail sector, there is a sharp slowdown in public sector growth in year-on-year and month-on-month terms in the second quarter. The reasons for this are unclear. At present the data only covers the first and second quarters of 2009 and 2010. As the amount of back data increases it is likely to reveal seasonal trends that could account for some of these seemingly unusual movements.

Inflation and GDP deflator

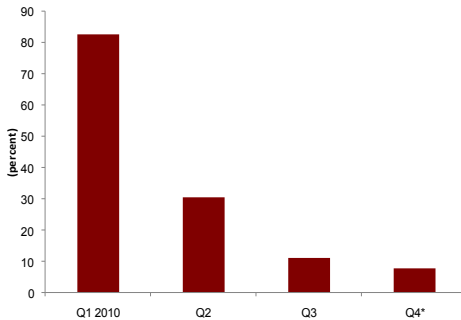


The measure of economic growth that is most commonly used by economists is GDP in real terms. This strips out inflation. It is not possible to accurately convert the nominal data that has been published into real data as this involves the calculation of specific deflators that measure price trends in each sector. The non-oil GDP deflator bears little resemblance to the inflation rate derived from the cost of living index that is published on a monthly basis. Between 2007 and 2009, headline inflation averaged 6.4 percent, but the non-oil GDP deflator averaged only 2.5 percent.

It is likely that data for the third quarter will show a slowing of the non-oil private sector economy when compared to the second quarter because of the scaling back of business activity during the summer, Ramadan and Eid al-Fitr. In year-on-year terms, it is probable that non-oil private sector growth will remain around current levels. The



Change in oil price
(WTI; Quarterly average)



* To October 31

pickup in bank lending when compared to a year ago will support growth. Conversely, it is likely that growth will be coming from a higher base than in the second quarter, as we think that the second quarter of last year was probably the low-point for the economy in the recent downturn; this will dampen the outturn. Overall growth will slow as a result of much lower growth in oil revenues; Arab Light averaged around 11 percent higher in the third quarter of 2010 than in the third quarter of last year.

Significant improvements in economic data

The release of the quarterly GDP data by the Central Department of Statistics and Information is one of a series of recent important steps forward in the provision of economic data in the Kingdom. Detailed quarterly balance of payments data was published in the SAMA *Quarterly Bulletin* for the first time in the latest edition. Furthermore, the Kingdom's first Purchasing Managers' Indexes (PMIs) were published by Markit/HSBC earlier this month (PMIs are timely guides to business sentiment and conditions that are closely monitored in many other countries).

Regular economic data is important to investors, as it provides a gauge of how an economy is performing and therefore allows more informed decisions. If regular data is not available it can make investors uncertain and ultimately less likely to dedicate money to a country. Indeed, data issues are important factors for credit ratings agencies and export credit agencies. The increase in frequency of key economic data and the publication of new data should therefore bring positive benefits for the Kingdom, provided the data is seen as credible and not subject to dramatic revision.

We anticipate that non-oil private sector growth will strengthen in the fourth quarter, as bank lending continues to rise and business and consumer confidence improves. Small growth in oil revenues is expected to reduce the pace of overall economic growth. With oil prices (WTI) expected to average \$78 per barrel this year (a slight increase on our previous forecast of \$75 per barrel), we expected total nominal economic growth in 2010 of 15.7 percent. We maintain our forecast for real GDP growth this year of 3.9 percent.

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