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Saudi Arabia Economic & Strategic Outlook

Building cities to house economic growth

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Summary

Saudi Arabia's nominal Gross Domestic Product (GDP) is estimated to have grown by 12.4% in 2006 to reach SR1,301.0bn (US$346.9bn) while real GDP is estimated to have grown by 4.2% to SR799.9bn (US$213.3bn). The nominal GDP over the period 2002-06 grew at the CAGR of 16.5% as the high prices and production levels in 2005-06 kept GDP on a high growth path. However, in 2006, production levels on account of OPEC cuts due to declining prices had its effect on the GDP growth as it recorded only 4.2% real GDP growth in 2006 as compared to 6.3% recorded in the previous year. Oil sector grew by 16% while the private sector grew by 7.9% in nominal terms in 2006. The strong capital expenditure projects that the Saudi government has lined up are expected to add significantly to the GDP growth in the coming years. Fiscal surplus currently witnessed is being invested in infrastructural projects which will further benefit the other sectors of the economy. This will have the effect of broad-basing the economy (diversification) along with the job creation which is much needed in the burgeoning economy.

Saudi Arabia's 2007 National Budget projected the revenues at SR400bn and expenditure at SR380bn resulting in the surplus of SR20bn. The revenues are 38.9% lower than the year 2006 actual figures of SR655bn. It is to be noted that the actual revenues of 2006 were higher by 68% than the budgeted revenues reported for 2006 indicating the conservative estimates maintained by the government while preparing the budgets. In 2007 budget, the government continued to pay special attention to impart quality education and improving the technical and managerial skills of its nationals. Manpower development continued to account for one of the largest allocations in the budget and accounted for 25.4% of the total budgeted expenditure for 2007.

According to the budget report of 2007 released by the Ministry of Finance, the public debt is expected to drop from SR475bn in 2005 to SR366bn, accounting for 28% of GDP. The government has been using its fiscal surplus in the last few years to settle part of its outstanding public debt. As result, the debt as percent of GDP declined from 93.3% in 2001 to the current 28%. We expect that debt reduction policy will continue in the wake of strong surplus expected to be generated by the government.

The trade balance is estimated to record a surplus of US$147.6bn in 2006, registering an increase of 17.5%. The current account balance increased to US$102.7bn in 2006 as compared to US$90bn recorded in the previous year. One thing that emerges out of the picture is the strong growth in the imports which is indicative of the strong economic activity in the country. The current account balance is lower as compared to balance of trade as it includes outflow of funds on account of services and repatriation of funds by expatriate workers.

As a result of movement towards monetary union, the Saudi Arabian Monetary Agency (SAMA) has maintained and is likely to maintain the Saudi Riyal peg to the US Dollar (1 US$= 3.75SR). Following the rise in the US interest rates, SAMA, the Saudi central bank too raised the interest rates in the country. SAMA continued to adopt policy to support the domestic economic growth and tried to keep exchange rate stable. During the first quarter of 2006, SAMA raised the official repurchase agreements (Repo) rate one time by 25 basis points, from 4.75% at year-end 2005 to 5.00% at the end of the first quarter. In 2Q-2006, SAMA raised the official repurchase

agreements (Repo) rate one time by 20 basis points, from 5.00% to 5.20%. Money supply (M2) registered growth of 14.9% for the same period. This was mainly on the back of YTD gains of 31.5% registered in time and savings Deposits. According to Ministry of Finance, inflation, as measured by the Consumer Price Index is estimated to have increased by 1.8% in 2006 (2005: 0.7%) while the non-oil GDP deflator has reported a yearly increase of 2.1% in 2006 (2005: 1.14%).

Saudi Arabia has been the largest oil producer in the GCC and accounts for almost 10% of the world oil production. Most of the oil reserves of Saudi Arabia are controlled by the state run Saudi Aramco. According to Ministry of Petroleum & Mineral Resources, total crude oil reserves amounted to 264.2bn barrels at the end of 2005 in 82 discovered oil fields. The production increased from 3.25bn barrels in 2004 to reach 3.4bn barrels in 2005, out of which 2.6bn was exported. The Kingdom completed the development project for Qatif and Abu Safah fields that produce a total of 800mbpd. This mega project, completed ahead of schedule, will boost the Kingdom's total production capacity from 10.5mbpd to 11mbpd. To gradually increase its production capacity to 12.5mbpd will require numerous upgrades to both old and new fields and reservoirs and fields have already been identified for capacity increases. It also reflects the Kingdom's desire to maintain a reasonable spare capacity of at least 1.5mbpd, in case any need arises.

The Saudi gas reserves are estimated today at 243 trillion cu.ft. ranking fourth in the world. Most (around 60%) of Saudi Arabia's currently proven natural gas reserves consist of associated gas, mainly from the onshore Ghawar field and the offshore Safaniya and Zuluf fields. Saudi Aramco's onshore exploration activities are in high gear to support the existing gas plants and add new reserves. During the next 10-year period, Aramco will add 50 trillion cubic feet of non-associated gas reserves. By the end of 2009, Aramco anticipates a significant increase in gas development well completions. It is planning to drill and complete more than 300 new gas development wells during the coming five years.

Saudi Aramco has been pursuing major opportunities for building new export refineries and integrating existing refineries with new petrochemical projects. Saudi Arabia announced that it was studying the possibility of building a crude oil refinery at Jizan on the Red Sea in a bid to boost the kingdom's position as a major oil refiner. The refinery, which will be semi or full-conversion plant, will produce between 25,000 and 400,000 barrels a day. Saudi Aramco is also in the final stages of formulating a memorandum of understanding with Dow Chemicals to build an estimated US$15bn refinery and petrochemicals complex at Ras Tanura.

Saudi Arabia has lined up ambitious plans to increase its petrochemical production and become a leader in the world petrochemical market. The Saudi petrochemicals output was expected to go up from 40mn MT/year in 2005 to 75mn MT/year by 2010. The total production of SABIC's manufacturing complexes was 49.1mn tonnes in 2006 compared to 46.7mn tonnes reported in the previous year registering an increase of 5%. A total quantity of 38.5mn tonnes was marketed in 2006 compared to 36.6mn tones reported in 2005. SABIC has indicated that it will make further acquisitions including in the U.S. to achieve its 2020 target to more than double production capacity to as much as 100mn tons a year. As part of its expansions plans, the company plans to spend up to US$74bn on 60 projects in Saudi Arabia in the next 14 years.

In GCC, Saudi Arabia accounts for about 48% of the total power generating capacity in the region. The formation of Saudi Electricity Company opened the door to private sector construction of new power plants on BOO (Build-Own-Operate) and BOT (Build-Own-Transfer) bases. In Saudi Arabia, over 2000-2005, power generating capacity increased at a CAGR of 4.6% from 25,790 MW in 2000 to 32,301 MW in 2005. The year 2005 witnessed capacity addition of 1,775 MW or a growth of 5.8% over 30,526 MW reported in 2004. Out of the total capacity addition 1,775 MW during 2005, SEC added 1,340 MW, Saline Water Conversion Corp. (SWCC) added 94 MW and other producers added 341 MW. SEC accounted for almost 90% of the country's total power generation capacity while SWCC and other large producers accounted for 8% and 2% respectively in 2005. Among the upcoming projects, Saudi Electricity Company is developing several new power plants at a total investment outlay of SR46.5bn (US$12.4bn), which will add a total of about 19,175 MW of power generation capacity during the period 2006–2017. The company will also invest SR8.0bn (US$2.1bn), over 2006-2017, in transmission projects which will have length of 3,860 km.

The government has done commendable job in making Saudi Arabia a key destination for companies intending to set up their industrial units. This includes providing industries with investment benefits, setting up world-class infrastructure and making the entry in the industrial sector lucrative for foreign as well as private investors. Since its inception in April 10, 2000, Saudi Arabian General Investment Authority (SAGIA) has, so far, licensed 3608 projects (upto Mar-2006) amounting to SR292.7bn. Foreign investors, contributed 38.3%, i.e. SR112.2bn of the total licensed investments, whereas the Saudi share amounted to SR180.5bn i.e. 61.7% of the total investments In Jan-07, Saudi Arabian General Investment Authority announced its target to license investment projects worth more than SR300bn in 2007.

The Kingdom's ambitious plan to dramatically raise investment competitiveness under its "10 x 10" programme to put Saudi Arabia among the world's Top 10 globally competitive investment destinations by 2010 can be best seen in the "Economic Cities" announced in recent times. According to SAGIA, the four cities are expected to attract investments worth more than SR300bn and create more than a million jobs within the next 10 to 20 years. In the field of balanced regional development, SAGIA, supported by the Custodian of the Two Holy Mosques and the Crown Prince, launched three integrated economic cities in 2006, one each in Hail, Madinah and Jazan. In 2005 King Abdullah Economic City in Rabegh was launched. With the strong liquidity and increased investors' interest to park their funds within the country, real estate sector has got a big boost. The contribution of the construction sector in the GDP increased from SR41.7bn in 2000 to SR54.8bn in 2005. Gross fixed capital formation too has recorded a strong increase from SR123.3bn in 2000 to SR174.3bn in 2005 and is expected to grow at a much faster rate in 2006-08 periods.

Saudi construction sector with huge projects already announced, has, obviously, positive implications for the country's cement sector. The eight listed cement companies in the Kingdom have been operating at over-100% capacity utilization rates for the last two years to meet the booming domestic demand. This state of affairs has led almost all the eight cement companies to launch capacity expansions, with work on most of them well underway. The near-doubling of capacities that should be going on stream in phases by 2008, have, purportedly, been planned in anticipation of a sustained high cement demand in the years to come.

Saudi financial and banking sector is entering a very dynamic and exciting phase with acceleration in all areas. The Saudi banking sector attracted foreign players, but we expect that rather than the foreign banks, competition will be more from the newly set-up banks such as Al Bilad and Enmaa Bank. During the period 2001-2005, total assets of the Saudi commercial banks grew at a CAGR of 12.6% to SR759.1bn by the end of 2005. Till Nov-06, the total assets reported YTD growth of 11.6% to reach SR846.9bn. At the end of Nov-06, claims on private sector accounted for 55.7% (2005: 57.4%) of total assets while foreign assets accounted for 14.9% (2005: 12%) of the total assets. Claims on private sector, which include credit to private sector and investments in private securities, increased at a CAGR of 23.6% for the period of 2001-05. In the region, Saudi banks are among the most profitable and the combined net profit of the 10 listed Saudi banks and NCB reached a whopping US$9.42bn, recording the yearly growth of 30.3% in 2006.

Saudi Arabia's Communications and Information Technology Commission (CITC) has announced plans for liberalizing the telecom sector. Around eight consortia, comprising Saudi and foreign investors and specialized international companies, are vying to win the Kingdom's second fixed-line phone license and third mobile phone license. The Kingdom's telecom regulator extended the deadline for submitting applications for the new mobile license to February 24, 2007 and for the fixed-line license to March 10, 2007 in response to requests from several interested parties. The new licenses will break the monopoly of STC on landline phone services and add at least a third mobile phone operator.

After the strong growth seen in 2003-05 period, Saudi market underwent a correction and ended the year 2006 at 7,933.3 points, down a whopping 52.5% over the 2005 close of 16,712.64 points. It witnessed strong volatility this year as it touched a high of 20,634.86 points on Feb 25, 2006 and low of 7665.73 points recorded on Dec 3, 2006. The market capitalization at the end of the year reached US$326.3bn. (2005: US$645.9bn). However, the strong sell-off seen in the secondary market did not wane investors' as well as corporates' interest in the primary markets. Ten new companies got listed on Saudi bourse which increased the total number of listed companies to 87, increasing the depth of Saudi market further. The market is trading at a P/E of 15-17x and some of the stock look really cheap and will attract investors' attention. The aggregate earning of the Saudi corporates was SR75.9bn in 2006, up 18.1% as compared to the previous year. The Saudi corporate sector especially the blue-chip companies have rewarded their investors with liberal dividends. We believe that the corporate profitability will continue to show good growth in 2007-08 as the economy moves ahead backed by spate of reforms, improved regulations, increased liquidity and trickle down effect of mega-projects underway in the country.

Annual Indicators

		2002	2003	2004	2005	2006 #
Economic Performance						
Nominal GDP	(SR bn)	707.1	804.6	945.0	1,157.0	1,301.0
Nominal GDP	(US$ bn)	188.6	214.6	252.0	308.5	346.9
Nominal GDP growth	(%)	3.0	13.8	17.4	22.4	12.4
Real GDP	(SR bn)	637.2	686.0	721.9	767.7	799.9
Real GDP growth	(%)	0.1	7.7	5.2	6.3	4.2
Per Capita GDP	(US$)	8,774	9,749	11,150	13,344	14,454.2
Population	(mn)	21.49	22.01	22.6	23.1	24.0
Oil Sector contribution to GDP	(SR bn)	261.8	321.0	393.0	536.8	N/A
Oil Sector/GDP	(%)	37.0	39.9	41.6	46.4	N/A
Government Finance						
Total Revenues	(SR bn)	213.0	293.0	393.0	564.3	655.0
Total Expenditures	(SR bn)	233.5	257.0	295.0	341.0	390.0
Surplus/(Deficit)	(SR bn)	(20.5)	36.0	98.0	223.3	265.0
Government Revenues/GDP	(%)	30.1	36.4	41.6	48.8	50.3
Oil Revenues	(SR bn)	166.1	247.0	345.0	504.5	N/A
Oil Revenues/Total Revenues	(%)	78.0	84.3	87.8	89.4	N/A
Government Domestic Debt	(SR bn)	650.0	660.0	614.0	475.0	366.0
Government Debt/GDP	(%)	91.9	82.0	65.0	41.1	28.1
Government Debt/Government Revenue	(%)	305.2	225.3	156.2	84.2	55.9
Money Supply and Inflation						
M2 (end-period)	(SR bn)	310.4	336.4	408.0	448.8	515.9
M3 (end-period)	(SR bn)	380.6	411.8	490.3	546.3	633.8
Avg. Inter Bank SR Deposit Rate (1M maturity)	(%)	2.1	1.5	1.6	3.6	5.1
Consumer Price Inflation	(%)	0.2	0.6	0.5	0.4	1.8
Foreign Trade						
Total Goods Exports	(US$ bn)	71.2	91.7	123.2	180.1	208.6
Total Goods Imports	(US$ bn)	29.6	33.9	41.1	54.5	61.0
Trade Balance	(US$ bn)	42.6	59.1	84.6	125.6	147.6
Current Account Balance	(US$ bn)	11.9	28.0	51.9	90.1	95.5
Exports of Oil and Refined products	(US$ bn)	63.6	82.0	110.4	161.1	187.5
Oil Exports to Total Exports	(%)	89.4	89.5	89.6	89.4	89.9
External Debt						
Total External Debt	(US$ bn)	30.5	32.5	34.9	40.6	47.4
Total External Debt/GDP	(%)	16.2	15.1	13.8	13.2	13.7
Debt Service Ratio	(%)	3.4	2.6	2.0	1.9	2.2
Forex Reserves excl.gold	(US$ bn)	20.6	22.6	27.2	26.5	27.5
Other Economic Indicators						
Saudi Crude Oil Production	(mn. bpd)	7.1	8.4	8.9	9.4	8.8
Saudi Arab Light Oil Price	(US$/ b)	24.3	27.7	34.5	49.9	61.1
Saudi Stock Market Index		2,518	4,438	8,206	16,712.6	7,933.3
Exchange Rate	SR: US$	3.75	3.75	3.75	3.75	3.75

Source: Saudi Arabian Monetary Agency, OPEC and ***Global*** *Research*
 # Estimates

Economic Newsflow (April 2006 to December 2006)

- Due to higher oil revenues, impressive growth in non-oil exports and favorable macroeconomic conditions, the net foreign assets held by Saudi Arabian Monetary Agency (SAMA), autonomous government institutions (AGIs) and local commercial banks increased by 42.9% to SR752.8bn in 2005. (Source: Arab News)

- The Saudi Industrial Development Fund allocated SR1.53bn (US$409.5mn) in new loans to fund 12 industrial projects in several sectors in Saudi Arabia (Source: Arab Press Digest).

- Saudi Aramco and ConocoPhillips signed a major agreement to establish a refinery in the industrial city of Yanbu on the Red Sea coast at a cost of SR22.5bn (US$6bn). The refinery would be designed to process 400,000 bpd Arabian heavy crude and produce high-quality, ultra-low-sulfur refined products that meet current and future US and European product specifications. The refinery is scheduled to start operations in 2011. (Source: Arab News)

- Saudi Arabia has plans to establish two large petrochemical projects in the twin industrial cities of Jubail and Yanbu at a total cost of SR23bn according to the Petroleum and Mineral Resources Minister. (Source: Saudi Commerce and Economic Review)

- Saudi Arabia's Public Investment Fund (PIF) and a number of banks and agencies have agreed to loan Saudi's Yanbu National Petrochemical Co. SR13.3bn to finance the construction of a petrochemical complex in Yanbu Industrial City in Saudi Arabia. (Source: Zawya Dow Jones Newswires)

- The United Arab Emirates (UAE) has overtaken Japan as the dominant foreign investor in the Kingdom following the award of a SR100bn project to Emaar Properties of Dubai last year, the Saudi Arabian General Investment Authority (SAGIA) announced. The UAE investment approved by SAGIA stood at SR122.9bn by the end of May, accounting for nearly 41% of the total FDI pumped into the Kingdom since its launch in April 2000, according to SAGIA. (Source: Arab News)

- Saline Water Conversion Corporation (SWCC), which manages more than 30 desalination plants on the Red Sea and Arabian Gulf coasts, will be privatized by the end of this year, according to its Governor Fehaid Al-Sharief. The Ministry of Water and Electricity launched a drive to privatize desalination plants in November 2005 by awarding a SR9.1bn contract to a consortium of Saudi and Malaysian companies which will set up Shuaiba-3 plant designed to supply 194mn gallons of water daily as well as 900MW electricity. Another giant dual-purpose Independent Water and Power Plant (IWPP) will be established in Jubail shortly at a cost of SR11bn. Marafiq (the Power and Water Utility Company for Jubail and Yanbu) has received offers from major national and international companies to carry out the project. (Source: Arab News)

- Saudi Arabian Airlines has reportedly received the green light from the government to transform its catering, cargo, ground handling, pilot training and technical service sectors into five independent companies as part of the airline's efforts to speed up its privatization process. According to an official statement, shares for the five new companies, that will have international strategic partners, will be floated for public subscription through initial public offerings (IPOs). (Source: Arab News)

- Custodian of the Two Holy Mosques King Abdullah laid foundation stones for more than SR2bn worth of development projects at various locations in Al-Baha. King Abdullah began the series of inaugurations by first opening new projects worth SR500mn for the General Organization for Technical Education and Vocational Training (GOTEVT). They include a technical college at Al-Qelwah, a higher institute for technology for women, and seven institutes of vocational training. The King opened the Baha University project, which would be built on a 3-million-square-meter campus. The first phase of the university, including the construction of the faculties of science, engineering, applied medicine and a community college, is estimated to cost SR400mn. (Source: Arab News)

- Thirteen insurance companies are expected to get license for operating in the Kingdom within a month as the Council of Ministers has returned their files to SAMA to complete legal procedures. They included well-known insurance companies from Britain, Germany, Switzerland, Japan, India, Holland, the United States, Bahrain, Jordan, Lebanon and France. (Source: Arab News)

- Airports in Jeddah, Madinah and Tabuk are to be expanded at a cost of SR30bn in order to meet the growing number of passengers and the requirements of two new domestic private airlines, according to the General Authority of Civil Aviation. There are also plans to establish another international airport at King Abdullah Economic City in Rabigh, 200 km north of Jeddah. (Source: Khaleej Times)

- Saline Water Conversion Corp. indicated it will need investments worth SR140bn in the next 20 years for the development of the water sector in Saudi Arabia. Deputy Chairman of SWCC and Minister of Water and Electricity, Abdullah Bin Abdulrahman Al Hussayem, said in Riyadh that these investments are needed to operate, rehabilitate and build new desalination plants to meet increasing demand on water. (Source: Zawya Dow Jones)

- Saudi Arabian Monetary Authority foreign assets reached a record SR744.96bn (US$198.66bn), in August, registering a 4.2% increase, according to the agency's monthly report. The report said that inflation rate in the Kingdom rose by 2.2% in July. Meanwhile, a Public Information Notice released by the International Monetary Fund (IMF), described Saudi Arabia's economic performance last year as, "Impressive". It predicted a growth rate of 6% for this year. (Source: Khaleej Times)

- The Kingdom will achieve full electrification of all its cities and villages by 2010, pushing further its social and economic development goals. According to Deputy Minister for Electricity, Ministry of Water and Electricity, the investment requirement for these sectors within this time frame is SR150bn. He said right now the electrification of the Kingdom is 90% covered, with annual demand growing by six percent. Maximum demand for electricity in 2006 is 31,000 megawatt (MW), while the current total capacity is 34,000 MW. He said that during the next 20 years, as a result of national progress in all sectors, maximum demand will reach 60,000 MW, while the current capacity will double to 70,000 MW. (Source: The Saudi Gazette)

- Total assets of investment funds in Saudi Arabia declined 21% to reach SR109.21bn in 2Q-2006 from SR138.04bn reported in the first quarter, according to a recent report by the Saudi Arabian Monetary Agency. Domestic assets of these funds plunged almost 24% to SR89.37bn from SR116.94bn whereas their foreign assets fell 6% to SR19.85bn from SR21.1bn. However the number of the funds increased to 209 from 204 in the first quarter, the report said, while the number of subscribers dropped more than 12% to 582,578 from 663,240. (Source: Zawya Dow Jones)

- The Royal Commission for Jubail and Yanbu announced that it signed a SR12.6bn contract with a consortium headed by French-Belgian utility company Suez to establish a giant dual purpose Independent Water and Power Plant (IWPP) in the eastern industrial city of Jubail. The plant, the largest in the world, will start production in the second half of 2009. It will supply 800,000 cubic meters of water and 2,700 megawatt electricity daily. The Jubail plant comes under the Power and Water Utilities Company for Jubail and Yanbu (Marafiq). (Source: Arab News)

- Saudi Arabia announced the 2007 national budget, the largest in its history with expenditures projected at SR380bn and revenues at SR400bn, reflecting the growing strength of its economy. The Kingdom also disclosed that it would make a record budget surplus of SR265bn for 2006 and cut down public debt to SR366bn by the end of 2006. (Source: Arab News)

Macroeconomic Profile

After entering the WTO, the next big things coming out of the Saudi economy are the mammoth projects of economic cities which are going to have a long-lasting impact on the macro-economic policies and on the fundamental structure of the Saudi economy. Saudi economy is doing exceptionally well in the last few years led by oil-driven growth. Saudi Arabia's nominal Gross Domestic Product (GDP) is estimated to have grown by 12.4% in 2006 to reach SR1,301.0bn (US$346.9bn) while real GDP is estimated to have grown by 4.2% to SR799.9bn (US$213.3bn). Despite strong growth in surplus, the government is judiciously spending on both oil as well as non-oil sectors which can be seen in 16% growth in the oil sector GDP in 2005 while the increase in industrial activity saw the non-oil industrial sector grow by 10.1% in the same period. Besides the government, economy saw increased interest from private and foreign players who have increased investments in the country. Although dominated by oil sector, the government intends to diversify the economy and use it as a base for employment creation.

In 2007 budget, the government continued to pay special attention to impart quality education and improving the technical and managerial skills of its nationals. This can be seen in the increased allocation towards Human Resource Development which increased to SR96.7bn as compared to SR87.2bn allocated in the 2006 budget. We believe that increased government expenditure is a step in the right direction as it will equip the nationals in taking up jobs or start their own business and take advantages of the growth in the economy. This is also important in the wake of Small and Medium Enterprises which are the booming in the country as a trickle down effect of the huge expenditure by the government and the private sector.

The government continued to improve its credit profile as it used part of the surplus to pay the outstanding debt. It is commendable to note that the debt as percent of GDP declined from 93.3% in 2001 to the current 28%. The trade balance is estimated to record a surplus of US$147.6bn in 2006, registering an increase of 17.5%. The current account balance increased to US$102.7bn in 2006 as compared to US$90bn recorded in the previous year. One thing that emerges out of the picture is the strong growth in the imports which is indicative of the strong economic activity in the country. With the strong growth in capital spending and industrial activity, the country has been increasing its imports of capital goods.

Liquidity has been strong in the economy as can be seen in increase in Money supply (M2) YTD growth of 14.9% till Nov-06. This was mainly on the back of YTD gains of 31.5% registered in Time and Savings Deposits. Increase in interest rates combined with correction in the stock markets encouraged investors to move their investment in safer time deposits in the banks which led to strong rise in the time and saving deposits. But inflation has not been a concern for the Saudi economy as according to Ministry of Finance, inflation, as measured by the Consumer Price Index is estimated to have increased only by 1.8% in 2006.

To cater to huge oil & gas demand emanating from developing countries and maintain keep oil prices stable, the government has initiated various programs to increase production levels. Saudi Aramco's projected investments in crude oil production, NGL and ethane, exploration, refining, marketing and international operations, shipping and support services amount to US$45.3bn starting from 2007 up to 2011. According to Aramco, gradually increase of its production capacity to 12.5mbpd will require numerous upgrades to both old and new fields. Reservoirs and fields have already been identified for capacity increases. Saudi Aramco's onshore exploration activities are in high gear to support the existing gas plants and add new reserves. During the next 10-year period, Aramco will add 50 trillion cubic feet of non-associated gas reserves. Saudi Arabia has become a hub of petrochemical industry thanks to initiatives such as Jubail- I and Jubail- II. The industry heavyweight, SABIC's share of global ethylene production is projected to reach 7.2% in 2009, up from 5.6% in 2004; whereas its share of global polyolefins production is expected to increase from 6.1% in 2004 to 7% in 2009. The country is attracting foreign participation as seen in SABIC & Exxon-Mobil announcement recently that they have begun work on a feasibility study to define a potential project that would grow their two joint petrochemical ventures at Yanbu and Jubail.

Privatization is going on at a rapid pace in infrastructure and utilities services and government invited private and foreign investors to be part of country's economic growth. To develop Independent Water & Power Projects (IWPP), Water & Electricity Company (WEC) was established by the Supreme Economic Council to promote private investments in the IWPPs. Marafiq is also planning an IWPP in the industrial city of Jubail with an estimated cost of SR9.4bn (US$2.5bn). As per SAGIA, overall power capacity in Saudi Arabia is forecasted to grow to 59,000 MW by the year 2024 requiring an estimated investment of SR430bn (US$115bn). To achieve this target the ministry will have to present several joint projects to the private sector, local and foreign, in order to increase power generation capacity. Saudi Arabia's Communications and Information Technology Commission (CITC) has also announced plans for liberalizing the telecom sector with many foreign investors and specialized international companies vying to win the Kingdom's second fixed-line phone license and third mobile phone license.

Currently, 15 banks are operating in the Kingdom, including the branches of Gulf and foreign banks such as the Gulf International Bank, the Emirates Bank, BNP Paribas and Deutsche Bank. We expect that the existing banks will face more competition from newly set-up banks such as Al Bilad and Enmaa Bank rather than from foreign banks. During the period 2001-2005, total assets of the Saudi commercial banks grew at a CAGR of 12.6% to SR759.1bn by the end of 2005. Till Nov-06, the total assets reported YTD growth of 11.6% to reach SR846.9bn. We believe that banking sector in the country is on the threshold of a new era, where foreign banks are likely to give tough time to local banks. The growth opportunities are abound in the region for players who are willing and ready to meet the challenges. Some of the areas ready to be tapped are affluent banking, small to medium enterprise (SME) banking, upper-mass banking for the growing middle class, banc-assurance, mortgages, and Islamic banking.

After the strong growth seen in 2003-05 period, Saudi market underwent a correction and ended the year 2006 at 7,933.3 points, down a whopping 52.5% over the 2005 close of 16,712.64 points. However, the market depth has increased and with valuation now looking attractive, we expect the investors to enter the market and take positions in the select stocks.

The most noticeable event this year has been the result of the Kingdom's ambitious plan to dramatically raise investment competitiveness under its "10 x 10" programme to put Saudi Arabia among the world's Top 10 globally competitive investment destinations by 2010. This can be best seen in the "Economic Cities" announced in recent times. According to

SAGIA, the four cities are expected to attract investments worth more than SR300bn and create more than a million jobs within the next 10 to 20 years. In the field of balanced regional development, SAGIA, supported by the Custodian of the Two Holy Mosques and the Crown Prince, launched three more integrated economic cities in 2006, one each in Hail, Madinah and Jazan. In 2005 King Abdullah Economic City in Rabegh was launched. A study is underway to establish two more economic cities, one in Tabuk and one in the Kingdom's Eastern Region in 2007. We believe that these economic cities will help in reshaping the Saudi economy in terms of attracting private/foreign investments thereby helping the overall goals of broad-based socio-economic development of the country.

Gross Domestic Product

Saudi Arabia's nominal Gross Domestic Product (GDP) is estimated to have grown by 12.4% in 2006 to reach SR1,301.0bn (US$346.9bn) while real GDP is estimated to have grown by 4.2% to SR799.9bn (US$213.3bn). The nominal GDP over the period 2002-06 grew at the CAGR of 16.5% as the high prices and production levels in 2005-06 kept GDP on a high growth path. However, in 2006, production levels on account of OPEC cuts due to declining prices had its effect on the GDP growth as it recorded only 4.2% real GDP growth in 2006 as compared to 6.3% recorded in the previous year. Oil sector grew by 16% while the private sector grew by 7.9% in nominal terms in 2006.

- Private sector GDP is estimated to have gown by 6.3% (2005: 6.7%) in real terms.
- However, the increase in industrial activity saw the non-oil industrial sector grow by 10.1% (2005: 8.4%).
- Similarly, the thrust on housing activity by the government as well as private sector can be seen in the 6.3% growth recorded in the construction sector GDP (2005: 6%).
- Electricity, gas, and water sector grew by 5.5% (2005: 4.9%).
- Transport and communication sector grew by 9.5% (2005: 9.9%).
- Wholesale, retail, restaurants, and hotels grew by 5.2% (2005: 6.2%).
- Finance, insurance and real estate grew by 5.1% in real terms in 2006.

In addition, private sector contribution to GDP is expected to be 44.8% in real terms in 2006. The increased investments in the infrastructure sector, construction as well as industrial sector can be seen percolating in the growth witnessed in the sector. We expect the demand of real estate to grow especially on account of the new projects announced in the housing sector. With the government's capital spending initiative in the infrastructure and housing sector being announced in last few months, we expect these sectors to record strong growth in 2007 as well.

Table 1: Gross Domestic Product

		2002	2003	2004	2005	2006*
Nominal GDP	(SR bn)	707.1	804.6	945.0	1,157.0	1,301.0
Nominal GDP	(US$ bn)	188.6	214.6	252.0	308.5	346.9
Nominal GDP growth	(%)	3.0	13.8	17.4	22.4	12.4
Real GDP	(SR bn)	637.2	686.0	721.9	767.7	799.9
Real GDP growth	(%)	0.1	7.7	5.2	6.3	4.2
Per Capita GDP	(US$)	8,774.3	9,748.8	11,150.4	13,343.7	14,454.2
Population	(mn)	21.5	22.0	22.6	23.1	24.0

*Sources: SAMA, **Global** Research*

** Estimates*

Oil sector continued to dominate the GDP as it reported a CAGR of 25% over the period 2001-05 as the country benefited from the high oil price situation in the last couple of years. The contribution of crude petroleum and natural gas sector as the proportion of the total nominal GDP increased from 36.8% in 2000 to 40.7% in 2004 and to 48% in 2005. Although the government is making efforts to reduce the dependence of oil by promoting and facilitating investment in the non-oil sector, oil sector domination in GDP continued to grow due the high prices that prevailed in 2005. In allied sectors such as refining, strong growth was witnessed as new downstream projects helped the refining industry to grow at a CAGR of 19.5% during 2001-05. However, its contribution to the GDP remained flat in 2004-05 at 3.4%.

Non-oil sector- growing at a strong pace….

The increased investments in the non-oil industries by the government as well as private players can be seen in the strong growth registered by the non-oil sectors. However, in the last few years, this growth has been overshadowed by the growth in the oil sector. However, with the oil prices on the decline and investments coming in the non-oil sector, we expect manufacturing, construction and infrastructure sectors to show strong growth.

Table 2: GDP by Type of Economic Activity

(SR bn)	**2001**	**2002**	**2003**	**2004**	**2005***
Agriculture, Forestry & Fishing	35.7	36.1	36.5	37.2	38.3
Mining and Quarrying :	230.3	236.9	294.1	384.5	558.2
Crude Petroleum & Natural Gas	227.6	234.2	291.3	381.6	555.1
Other	2.6	2.7	2.8	2.9	3.0
Manufacturing:	69.2	73.0	86.3	95.8	111.2
Petroleum Refining	19.4	20.4	29.7	32.4	39.5
Other	49.9	52.5	56.5	63.4	71.8
Electricity, Gas and Water	8.9	9.3	9.9	10.4	11.0
Construction	43.2	44.7	47.1	51.1	54.8
Wholesale & Retail Trade, Restaurants & Hotels	49.8	51.7	53.9	58.1	62.7
Transport, Storage & Communication	30.6	31.9	33.2	35.7	38.5
Finance, Insurance, Real Estate & Business Services	78.9	82.1	85.8	91.2	97.7
Ownership of Dwellings	43.9	45.0	46.0	48.0	49.9
Other	34.9	37.1	39.9	43.3	47.8
Community, Social & Personal Services	23.1	24.1	25.1	26.5	28.0
Less: Imputed Bank Services Charge	14.0	14.7	15.2	16.0	16.7
SUB - TOTAL	555.6	575.2	656.6	774.6	983.6
B - Producers of Govt. Services:	123.6	124.5	139.9	155.4	167.0
Total Except Import Duties	679.2	699.7	796.6	936.2	1,146.9
Import Duties	7.1	7.4	8.1	8.8	10.1
Gross Domestic Product (GDP)	**686.3**	**707.1**	**804.6**	**945.0**	**1,157.0**

Source : SAMA ** Estimates*

The strong capital expenditure projects that the Saudi government has lined up in the petrochemical sector are expected to add significantly to the GDP growth in the coming years. Fiscal surplus currently witnessed is being invested in infrastructural projects which will further benefit the other sectors of the economy. This will have the effect of broad-basing the economy (diversification) along with the job creation which is much needed in the burgeoning economy.

Table 3: Allocation of Real GDP by Institutional Sectors

(SR bn)	2001	2002	2003	2004	2005
Oil Sector	204.4	189.1	221.5	234.2	250.5
Non-oil Private Sector	276.3	287.7	299.0	315.9	335.8
Non-oil Government Sector	148.6	153.0	157.7	163.4	172.5
GDP Excluding Import Duties	629.3	629.8	678.2	713.5	758.8
Import Duties	7.2	7.5	7.9	8.5	8.9
Total GDP	**636.4**	**637.2**	**686.0**	**721.9**	**767.7**

*Sources: SAMA, **Global** Research*

Small and Medium Enterprises are the booming in the country as a trickle down effect of the huge expenditure by the government and the private sector. We expect strong participation by the small and medium enterprises in the manufacturing sector as they take advantage of the economic zones and incentives provided by the government. Increased private sector involvement can be seen in the government procurement with the total number of government contracts signed with the private sector amounting to SR57.3bn in 2006 (2600 contracts) as compared to SR40bn recorded in 2005 and SR38bn reported in 2004.

Table 4: GDP by type of Expenditure Activity

(SR bn)	2001	2002	2003	2004	2005
Government Final Consumption Expenditure	188.7	184.5	198.1	218.4	268.5
Private Final Consumption Expenditure	259.6	260.4	270.0	282.5	305.6
Change in Stock	3.5	11.0	11.4	14.9	14.2
Gross Fixed Capital Formation	126.1	128.1	148.1	163.0	174.3
Export of Goods & Services	273.7	291.2	371.1	494.7	704.4
Import of Goods & Services	165.2	168.1	194.0	233.8	306.3
Expenditure on GDP	**686.3**	**707.1**	**804.6**	**939.6**	**1,157.0**

*Sources: SAMA, **Global** Research*

In 2005, the gross capital formation exhibited strong growth which is mainly due to the government investments and plan to allocate higher amount in the infrastructure and development projects. Just to give a perspective, Saudi Arabia is investing SR40bn in more than 1,000 water projects throughout the Kingdom which include production, transportation, distribution and ground water treatment. According to the Minister of Petroleum and Mineral Resources, Saudi Arabia will invest over SR262bn in its oil and gas sector over the next five years as part of its commitment to keep a spare oil output capacity cushion of 1.5 to 2.0mn barrels per day at all times. The minister has indicated that as part of its commitment to keep the energy market well supplied, crude output capacity would be raised to 12.5mn bpd by 2009 through an investment of around SR67bn.

Saline Water Conservation corp. is also considering three options, including the formation of five companies to privatize the organization, which is expected to draw investment worth more than SR60bn. This will be helpful to the Saudi economy as the net government spending has a multiplier effect in terms of potential to generate new liquidity. In future too we expect the government spending as well as the private sector investment to increase as the new ventures and capacity expansion takes shape.

Private sector investments will also increase as the government introduces facilitative reforms to attract investments. Saudi authorities expect the value of licensed investment projects in the Jubail II industrial city to reach up to SR27bn as investor demand exceeds expectations. Jubail II is expected to attract industrial projects worth SR210bn and create more than 55,000 jobs.

Public Finance

Saudi Arabia's 2007 National Budget projected the revenues at SR400bn and expenditure at SR380bn resulting in the surplus of SR20bn. The revenues are 38.9% lower than the year 2006 actual figures of SR655bn. It is to be noted that the actual revenues of 2006 were higher by 68% than the budgeted revenues reported for 2006 indicating the conservative estimates maintained by the government while preparing the budgets.

Table 5: Summary of Government Finances

(in SR bn)	2003 (Actual)	2004 (Actual)	2005 (Actual)	2006 (Budgeted)	2006 (Actual)	2007 (Budgeted)
Total Revenue	**293.0**	**393.0**	**564.3**	**390.0**	**655.0**	**400.0**
Oil Revenue	231.0	345.0	504.5	320.0	N/A	N/A
Other Revenue	62.0	48.0	59.8	70.0	N/A	N/A
Total Expenditure	**257.0**	**285.2**	**346.5**	**335.0**	**390.0**	**380.0**
Capital Expenditure	39.4	45.0	N/A	126.0	N/A	140.0
Current Expenditure	217.6	240.2	N/A	209.0	N/A	240.0
Surplus/(Deficit)	**36.0**	**107.8**	**217.9**	**55.0**	**265.0**	**20.0**

Sources: SAMA, Ministry of Finance

The 2007 budget projects expenditure at SR380bn, a decrease of SR10bn in expenditure from last year's actual expenditure of SR390bn. Capital expenditure is estimated to account for SR140bn (36.8% of the total) while the current expenditure would account for the remaining SR240bn (63.2% of the total).

During the fiscal year 2006, Saudi Arabia originally had expected a budget with surplus amounting to SR55bn. However, this was based on the conservative estimates with price assumptions and the estimates turned out to be far below actual levels as the Saudi Arabian Light Oil averaged US$61.1/barrel in 2006. The actual revenues of 2006 reported an increase of 16.1% over the previous year while the total expenditure amounted to SR390bn, up 12.6% over 2005.

Table 6: Scenarios for 2007 Budget Outcome

Figures in SR bn	Worst Case	Most Likely	Best Case
Saudi Arabia Light (US$/b)	37.5	40.0	42.5
Production (mn bpd)	8.3	8.5	8.8
Total Revenues	**483.5**	**535.4**	**589.0**
Oil & Gas	423.5	465.4	509.0
Other Receipts	60.0	70.0	80.0
Total Expenditure	**425**	**400**	**380**
Surplus/Deficit	**58.5**	**135.4**	**209.0**

*Source: **Global** Research*

According to our scenario analysis, we believe that Saudi Arabia is likely to post another surplus in the year 2007. Despite the oil prices easing, we hold firm our expectations that the Saudi Arabian Light price will not fall below US$37.5/barrel. Additionally, although OPEC production may be curbed in 2006, we maintain that the Saudi oil production levels will not fall below 8.3mn bpd in 2006 resulting in the oil & gas revenues of SR423.5bn in the worst case scenario.

On the expenditure side, we expect that the actual expenditure will be more than what is budgeted as has been the case in the past. We expect expenditure to be SR400bn, which is about 5.3% more than what has been reported in the latest budget projections (SR380bn). All our scenarios bode well for the government coffers with our most likely scenario pegging the surplus to reach SR135.4bn. Therefore our forward-looking yardstick for assessing the Saudi Arabia's performance for the current year leads us to believe Saudi Arabia's sound fiscal position will remain an integral piece of a growing economy.

Budget Allocations

Thrust on human capital....

In 2007 budget, the government continued to pay special attention to impart quality education and improving the technical and managerial skills of its nationals. This can be seen in the increased allocation towards Human Resource Development which increased to SR96.7bn as compared to SR87.2bn allocated in the 2006 budget. Manpower development continued to account for one of the largest allocations in the budget and accounted for 25.4% of the total budgeted expenditure for 2007.

The new budget for Human resource includes capital expenditure of SR29bn. The appropriations in the category include:

- 2000 new schools (in addition to 4800 schools currently under construction);
- Rehabilitation of 2000 existing school buildings;
- Opening of four new universities in Tabuk, Abha, Najran, and Girls University in Riyadh;
- New university hospital (in addition to five university hospitals under construction);
- Completing infrastructure of other universities;
- Building of 56 colleges, and opening of 19 new colleges.

In the technical and vocational training sector, the new budget includes 7 new technical colleges, 12 technical and vocational training centers, opening of 5 new technical institutes for girls, and 9 vocational training centers. In addition, the new budget includes appropriation for the national plan for science and technology. We believe that increased government expenditure is a step in the right direction as it will equip the nationals in taking up jobs or start their own business and take advantages of the growth in the economy.

Table 7: Budget Allocations by Major Sectors

(SR bn)	2002	2003	2004	2005	2006	2007
Human Resource Development	47.0	49.6	55.8	69.9	87.2	96.7
Transport & Communications	5.5	5.6	6.4	8.6	9.8	13.6
Economic Resource Development	5.0	6.9	7.0	10.5	12.5	N/A
Health & Social Development	19.0	16.8	18.0	23.1	26.8	39.5
Infrastructure Development	2.7	2.5	2.6	3.3	4.6	N/A
Municipal Services	8.0	5.4	6.2	9.0	11.6	15.5
Defense & Security	69.4	70.3	78.4	95.1	110.8	N/A
Government Spending	39.3	44.8	49.9	51.7	62.8	N/A
Government Lending Institutions	0.4	0.4	0.4	0.5	0.6	N/A
Subsidies	5.8	6.6	5.3	8.3	8.5	N/A
TOTAL	**202.0**	**209.0**	**230.0**	**280.0**	**335.0**	**380.0**

Source: Ministry of Finance

The increase in the population has compelled government to increase the finances earmarked for Health and Social Affairs where the total expenditure amounted to SR39.5bn in 2007 budget, recording a yearly increase of 47.3% over the allocation made in the previous budget. The allocations for health related expenditures include capital spending of SR5.6bn with new projects that include over 380 primary care centers, 13 hospitals with a capacity of 1100 bed, expansion and development of existing health facilities, and furnishing newly completed hospitals. Meanwhile, there are 64 hospitals under construction which will add 9,850 beds. With respect to social services, the new budget includes appropriation to build social centers, social welfare and labor offices. It also includes funds to support poverty reduction programs and increase in handicapped allocations.

In terms of allocation of municipality services, the total allocation in the 2007 budget amounted to SR15.5bn. New project include inter-city roads, intersection and bridges, road lights, and cleaning-related projects. Among allocation in the transportation and telecommunication sector, out of the total expenditure amounting to SR 13.6bn, capital spending amounted to SR9.3bn. New projects to be taken up this year include roads totaling 8000 km to be added to 16000 km of roads currently under construction, ports, airports, and railroads development, and new postal services.

The government continues to pay special attention to the water, agriculture, and infrastructure sector where the total expenditure allocated in 2007 budget amounted to SR24.8bn. However, here the majority of the expenses are capital in nature which includes projects for water, sewage, and desalination projects amounting to SR16.4bn. In addition, the budget includes appropriation for the two industrial cities of Jubail and Yanbu, agricultural projects, and flour mill projects.

Government Debt

According to the budget report of 2007 released by the Ministry of Finance, the public debt is expected to drop from SR475bn in 2005 to SR366bn, accounting for 28% of GDP. The government has been using its fiscal surplus in the last few years to settle part of its outstanding public debt. As result, the debt as percent of GDP declined from 93.3% in 2001 to the current 28%. We expect that debt reduction policy will continue in the wake of strong surplus expected to be generated by the government.

This is also needed as the government will have to reduce its budget to meet the convergence criteria of the GCC Common Union. The criteria recommended for GCC countries were a ceiling of (3%) of a member state (MB) budgetary deficit, in any year, to its GDP, public-debt should not surpass 60% of its GDP, and foreign-exchange reserves are to stay above four-month imports value. In addition, they are adopting additional criteria with reference to the interest and inflation rates. According to the criteria, at any time the prevailing inflation in an economy should not exceed (+2%) of the average of the lowest three members rates, and the prevailing inflation in a member state should not surpass (+2%) the weighted inflation rate of the remaining member states.

We believe that the government will continue to use accruals from the oil revenues to fund capital projects rather than borrowing from the market. But, it is to be noted that the country has enough financial flexibility and liquidity that the situation of government debt seems less alarming. Government's debt to government revenues ratio too declined from 156% in 2004 to a manageable 55.9% as a result of the growth in the country's revenues combined with the repayment of the outstanding debt.

Rating agencies view….

Saudi Arabia's expanding economy received a big boost as Standard & Poor's Ratings Services raised its long-term foreign currency credit rating from 'A' to 'A+' on the basis of its excellent financial performance. The rating agency also affirmed its long-term local currency rating at A+ and short-term sovereign credit rating at A-1. The outlook on both the foreign and local currency ratings is stable.

Fitch Ratings also upgraded Saudi Arabia's foreign currency and local currency Issuer Default ratings (IDR) to 'A+' from 'A', and affirmed the short-term rating at 'F1'. The outlook remains Stable. At the same time the agency has revised Saudi Arabia's country ceiling rating to 'AA-'(AA minus) from 'A'. According to Fitch, the upgrade is due to strengthened external and domestic balance sheets, ongoing economic and structural reforms, reflected in an accelerating pace of private sector growth, and a reduction in domestic political risk.

Current Account

Saudi Arabia, being one of the major oil exporters, continues to enjoy positive trade balance. But being dependent on energy exports make it dependent on oil prices and production levels, which have been a boon for the economy, in recent past. Since 2003, the trade balance has recorded strong growth as the oil price went up and the country was operating at near-100% capacity. Oil exports as proportion of total export of the country has remained in the range of 89%-90% in the last five years.

Although the country is looking to diversify its economy, it also has plans to increase the oil production capacity from its current 11mn bpd to 12.5mn bpd in 2009 to meet demand. We believe that this will most likely keep oil exports a dominant portion of total exports.

Table 8: Trade & Current Account

(US$ bn)	2001	2002	2003	2004	2005	2006
1. Merchandise Trade, F.O.B	**39.2**	**42.6**	**59.1**	**84.6**	**125.6**	**147.6**
A) Oil Exports (Excl.Bunker Oil)	59.6	63.6	82.0	110.4	161.1	208.6
B) Other Exports	8.2	8.7	11.0	15.3	19.0	21.1
Of Which Re-Exports	(1.0)	(1.1)	(1.3)	(2.5)	(2.9)	N/A
C) Imports	(28.6)	(29.6)	(33.9)	(41.1)	(54.5)	(104.0)
2. Services And Transfers	**(29.8)**	**(30.8)**	**(31.1)**	**(32.7)**	**(35.5)**	**N/A**
A) Receipts	9.3	9.1	8.9	10.5	12.1	N/A
I) Investment Income	4.1	3.7	3.0	4.3	5.0	N/A
II) Oil Sector (Bunker Oil)	0.2	0.2	0.2	0.3	0.5	N/A
III) Other	5.0	5.2	5.7	5.9	6.7	N/A
B) Payments	39.1	39.9	40.0	43.2	47.7	N/A
I) Freight And Insurance	2.6	2.7	3.0	3.7	4.9	N/A
II) Oil Sector	4.6	3.9	4.3	3.8	5.0	N/A
III) Other Private Services	4.6	4.5	4.9	7.4	9.6	N/A
IV) Other Govt. Services	12.2	12.9	13.0	14.7	14.2	N/A
V) Private Transfers	15.1	15.9	14.8	13.6	14.0	N/A
3. Current Account Balance (1+2)	**9.4**	**11.9**	**28.0**	**51.9**	**90.0**	**102.7**
4. Capital Movements And Reserves	**(9.4)**	**(11.9)**	**(28.0)**	**(51.9)**	**(90.0)**	**N/A**
A) Oil Sector And Other Capital Transactions (Net)	0.0	(0.6)	(0.6)	(0.3)	0.5	N/A
B) Other Private Capital (net)	(7.7)	(12.8)	(9.6)	(17.9)	(27.1)	N/A
C) Commercial Banks (net)	(0.8)	(3.4)	3.1	(1.6)	5.5	N/A
D) Official Capital & Reserves	(0.9)	5.0	(21.0)	(32.1)	(68.9)	N/A
Average Exchange Rate (SR Per US$)	3.75	3.75	3.75	3.75	3.75	3.75

Source: SAMA

According to Central Department of Statistics and information, total exports of goods and services are expected to grow by 15.1% reaching US$215.5bn in 2006. Non-oil exports of goods are expected to grow by 10.8% amounting to US$21bn, representing 10.1% of total goods exported. The total imports of goods and services are expected to grow by 27.2% in 2006 amounting to US$104bn, while goods imported are expected to grow by 9.4% reaching US$64.9bn.

Strong growth in imports….

The trade balance is estimated to record a surplus of US$147.6bn in 2006, registering an increase of 17.5%. The current account balance increased to US$102.7bn in 2006 as compared to US$90bn recorded in the previous year. One thing that emerges out of the picture is the strong growth in the imports which is indicative of the strong economic activity in the country. The current account balance is lower as compared to balance of trade as it includes outflow of funds on account of services and repatriation of funds by expatriate workers. We believe that current account balance is going to show strong growth on account of increased exports and lesser remittances as the native population replaces expatriates with Saudization being implemented in many industries.

Table 9: Composition of Exports

(US$ bn)	**2001**	**2002**	**2003**	**2004**	**2005**
Mineral Products	59.9	64.0	82.4	108.0	132.0
Foodstuff	0.4	0.5	0.8	0.9	1.2
Chemical Products	3.6	3.7	4.3	5.0	6.5
Plastic Products	1.6	1.5	1.9	3.4	4.7
Base Metal and Products	0.5	0.7	1.0	1.2	1.3
Electrical Machines & Equipment	0.3	0.3	0.4	0.6	0.7
Others	0.6	0.7	1.2	1.7	1.6
Re-Export	1.0	1.1	1.3	2.4	2.9

Source: Central Department of Statistics, Ministry of Economy and Planning.

Oil dominates the exports….

Although the economy is diversifying and non-oil sector recording strong growth, we believe that oil sector will continue to dominate the exports. However, in terms of sector, the off-shoots of the oil sector such as chemical products and plastic products have registered strong growth as the new capacities came on-stream. Chemical products registered a yearly growth of 30% as their exports in 2005 amounted to US$6.5bn. We expect allied sector to show more than 25% growth in the next couple of years as new plants and capacity expansion get completed by the major players.

Table 10: Composition of Imports

(SR mn)	**2001**	**2002**	**2003**	**2004**	**2005***
Animals And Animal Products	5,137	6,550	7,181	8,354	10,614
Vegetable Products	6,558	6,908	7,781	8,272	11,288
Animal & Vegetable Fats, Oils & Their Products	601	503	789	1,067	1,413
Prepared Foodstuffs, Beverages, Spirits	5,630	5,690	6,710	7,492	9,653
Mineral Products	1,490	837	1,013	1,667	3,457
Products Of Chemical & Allied Industries	9,864	9,861	12,652	15,294	18,208
Artificial Resins And Plastic Materials, Rubber	4,255	4,632	5,339	6,222	8,422
Raw Hides And Skins, Travel Goods	344	385	401	442	580
Wood & Articles Of Wood, Charcoal	1,376	1,496	1,439	1,534	1,945
Paper Making Materials, Paper Card Board	2,211	2,279	2,702	3,330	4,097
Textiles And Textile Articles	6,557	6,932	7,513	8,083	9,664
Footwear, Headgear, Umbrellas,	965	949	967	1,028	1,274
Articles Of Stone Plaster, Asbestos, Cermaic, Glass	2,139	2,280	2,889	3,153	3,566
Pearls, Precious & Semi-Precious Stones/Articles	3,563	1,684	1,395	2,396	3,559
Base Metal & Articles Of Base Metals	9,535	9,962	12,533	16,699	23,773
Machinery,Mechanical Appliances,Electrical Equipment	24,062	26,593	30,210	37,156	54,168
Transport Equipment	25,356	26,723	29,299	35,908	46,704
Optical, Photographic, Measuring, Medical & Surgical	3,489	3,665	4,291	5,598	5,700
Arms, Ammunition And Parts	1,648	724	762	1,099	1,022
Miscellaneous Manufactured Articles	2,127	2,404	2,546	2,976	3,651
Work Of Art Collection Pieces And Antiques	24	31	21	24	27

Source: SAMA **Estimates*

The major portion of imports consists of machinery, electrical and transport equipments, transport equipment and base metals. We believe that with the growing industrialization of the economy and investment in the infrastructure sector, import of capital goods is expected to show strong growth in the next couple of years. Also the transportation equipment imports are expected to grow further as both the intra and inter-regional trade increases, which will warrant increase in the transportation equipment.

Monetary Policy

As a result of movement towards monetary union, the Saudi Arabian Monetary Agency (SAMA) has maintained and is likely to maintain the Saudi Riyal peg to the US Dollar (1 US$= 3.75SR). The monetary union agreement covers common standards for economic and fiscal performance in the GCC, including a maximum level of the budget deficit, public debt, current account deficit, interest rates, and inflation. Following the rise in the US interest rates, SAMA, the Saudi central bank too raised the interest rates in the country. SAMA continued to adopt policy to support the domestic economic growth and tried to keep exchange rate stable.

Increasing interest rates…

During the first quarter of 2006, SAMA raised the official repurchase agreements (Repo) rate one time by 25 basis points, from 4.75% at year-end 2005 to 5.00% at the end of the first quarter. In 2Q-2006, SAMA raised the official repurchase agreements (Repo) rate one time by 20 basis points, from 5.00% to 5.20%. However, the three-month inter-bank interest rate (SIBOR) went down from 5.10% at the end of the first quarter of 2006 to 5.08% at the end of the second quarter. The official repo rate and reverse repo rate stood at 5.20% and 4.70% respectively at the end of 3Q-2006.

Table 11: Interest Rate Differential between SR & US$ Deposits

	2004				2005				2006		
(In %)	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
3 month SR Deposit Rate	1.259	1.404	1.967	2.308	2.813	3.385	4.035	4.782	5.102	4.856	5.119
3 month US$ Deposit Rate	1.021	1.205	1.690	2.219	2.769	3.204	3.702	4.280	4.707	5.162	5.375
Interest Rate Differential	0.238	0.199	0.277	0.089	0.044	0.181	0.333	0.502	0.395	-0.306	-0.256

Source: SAMA

The differential in the interest rates at the end of 3Q-2006 was about 0.256% in favor of the US Dollar deposits for 3-month deposits reporting an increase from the differential of 0.502% reported at end of the previous year. The inter-bank interest rate for three months (SIBOR) stood at 5.24% at the end of the third quarter of 2006.

Broad money supply (M3) registered an YTD growth of 14.5% till Nov-06 as it reached SR633.8bn. Money supply (M2) registered growth of 14.9% for the same period. This was mainly on the back of YTD gains of 31.5% registered in time and savings Deposits. Increase in interest rates combined with correction in the stock markets encouraged investors to move their investment in safer time deposits in the banks which led to strong rise in the time and saving deposits. The strong advent of liquidity can be seen in the increase in the money supply at a CAGR of 13.7% over the period 2001-Nov-06. Over the same period, time and savings deposits registered highest CAGR of 18.8%. However, with interest rates stabilizing in the medium term, we expect lower growth in the investments in time deposits.

Table 12: Money Supply

(in SR mn)	**2001**	**2002**	**2003**	**2004**	**2005**	**Nov-06**
Currency in Circulation (1)	49,203	52,329	55,445	60,133	64,288	64,337
Demand Deposits (2)	130,192	150,010	167,577	211,170	219,251	234,170
Money Supply (M1) (3)=(1)+(2)	179,396	202,339	223,022	271,303	283,539	298,507
Time & Savings Deposits (4)	91,685	108,028	113,382	136,673	165,266	217,353
Money Supply (M2) (5)=(3)+(4)	271,080	310,367	336,404	407,976	448,805	515,860
Other Quasi Monetary Deposits (6)	59,248	70,232	75,351	82,311	104,869	117,943
Money Supply (M3) (7)=(5)+(6)	330,328	380,600	411,755	490,287	553,675	633,803

Source: SAMA

Quasi-monetary deposits too reported a growth of 12.5% in the first 11 months of 2006 as it reached SR117.9bn. Due to the rise in interest rates on the world markets, inter-bank interest rate recorded an increase in 2006. However, with the negative interest rate differential between the foreign exchange deposits abroad compared to the domestic interest rates, it will act against in getting back the investments made in foreign countries.

Inflation

Although the Saudi economy has been under the influence of strong liquidity, it has not till now not experienced any inflationary pressure, unlike its GCC peers. It seems that the government has been able to control prices and in fact, has been able to reduce in case of key commodities like fuel, transport and communication. Till the first half of the year 2006, Wholesale Price Index recorded a decline of 1.5% as compared to 2005. This was mainly due to YTD decline of 14.5% recorded in "Mineral Fuels" category. As measured in June-2006, Chemical and related products recorded the maximum rise (+2.2%) as compared to the Dec-2005 levels.

Table 13: Wholesale Price Index

End of Period (1988=100)	2001	2002	2003	2004	2005	Q2- 2006
Food and Live Animals	122.9	122.6	122.8	124.8	128.9	129.3
Beverages & Tobacco	127.4	129.0	129.2	129.8	130.4	128.9
Crude Materials (inedible)	165.2	165.6	160.8	187.4	186.1	185.2
Mineral Fuels	212.7	212.7	212.7	212.7	216.1	184.8
Vegetable Oils & Fat	107.1	107.1	108.8	111.7	114.2	114.6
Chemicals & Related Products	101.2	101.1	112.0	135.5	137.8	140.9
Manufactured Goods	107.9	108.0	107.9	116.1	117.5	119.4
Machinery & Transport Equipment	107.8	107.1	106.2	109.1	112.1	114.3
Misc. Manufactured Articles	91.1	92.0	93.3	96.4	100.0	100.0
Other Commodities	67.6	76.2	88.1	98.6	113.3	127.6
General Index	**116.2**	**116.2**	**117.2**	**122.6**	**125.4**	**123.5**
% Change (year-on-year)	-0.1%	0.0%	0.9%	4.6%	2.3%	-1.5%

Source: SAMA

Inflation in check…

According to Ministry of Finance, inflation, as measured by the Consumer Price Index is estimated to have increased by 1.8% in 2006 (2005: 0.7%) while the non-oil GDP deflator has reported a yearly increase of 2.1% in 2006 (2005: 1.14%). However, the detail numbers of constituents were not available. Based on the detailed 1H-2006 data, it can be seen that other expenditure category has recorded the biggest YTD growth of 7.3% followed by Foodstuff and Beverages (+4%). The increase in the competition that led to lower prices for telecom services seems to have affected Transport and communication category which was the only constituent in the index to report YTD decline in 1H-2006 (-3.6%)

Table 14: Cost of Living Index - All Cities

End of period (1999=100)	2001	2002	2003	2004	2005	Q2-2006
Foodstuffs & Beverages	97.6	98.0	98.6	103.4	106.5	110.8
Fabrics Clothing & Footwear	92.9	92.3	91.8	89.6	88.3	88.4
Renovation, Rent, Fuel & water	100.1	100.0	100.0	100.3	100.1	100.5
Home Furniture	97.3	96.8	96.2	94.5	94.9	94.9
Medical Care	100.7	100.8	101.0	101.4	101.4	101.9
Transport & Communication	96.3	96.4	94.8	94.2	91.8	88.5
Entertainment and Education	99.5	99.3	98.7	98.1	98.4	98.7
Other Expenditures	98.8	100.8	103.2	103.9	106.4	114.2
General Index	**97.8**	**98.0**	**98.6**	**98.9**	**99.6**	**101.3**
% Change (year-on-year)	-1.1%	0.2%	0.6%	0.3%	0.7%	1.7%

Source: SAMA

We expect the government to keep its tight control over the price and expect inflation to remain in the range of 2%-3% in short term. However, as the Saudi Riyal is pegged to the US Dollar, the movement in inflation is influenced by the market movement of US Dollar. Also we expect Saudi Arabia imports to record more than 15% growth in next couple of years owing the strong growth experienced in the economy. Therefore, any adverse movement in dollar can have a direct impact on the inflation.

Population & Labor Force

The Saudi population reached 23.2mn by the end of 2005 up from 22.6mn recorded in the previous year, according to Central Department of Statistics, Ministry of Planning. The proportion of Saudi population has remained more or less the same, around 73%, in the last few years. Saudi population grew at a CAGR of 2.46% over the period 2001-05 which is one of the highest growth rates in the world.

Table 15: Population & Labor Force

	2001	2002	2003	2004	2005
Total Population (mn)	21.0	21.5	22.0	22.6	23.1
Saudi Population (mn)	15.3	15.7	16.1	16.5	16.9
Non-Saudi Population (mn)	5.7	5.8	6.0	6.1	6.3
Total Labor Force (mn)	5.80	5.91	5.87	5.41	6.15
Unemployment Rate	4.6%	5.3%	N/A	N/A	N/A
Saudi	8.3%	9.7%	9.6%	7.0%	6.9%
Non- Saudi	0.9%	0.8%	N/A	N/A	N/A
Yearly Growth Rate of Labor Force	1.7%	1.8%	0.7%	7.8%	13.6%

Source: Central Department of Statistics, Ministry of Planning

Although the government is making efforts to replace the expatriate workers with the local population, the non-Saudi population registered a growth from 5.7mn reported in 2001 to 6.3mn recorded in 2005. However, the most important thing to note is the growth in labor force which went up by 13.6% in 2005.

Table 16: Demographic Profile

	Population 2006E (mn)	Population Age<15 years	Population Age 15-65 years	Urban Population	Projected Population 2025 (mn)
Bahrain	0.7	28%	69%	87%	1.0
Kuwait	3.2	21%	77%	100%	4.6
Oman	2.6	33%	64%	78%	4.0
Qatar	0.9	22%	76%	92%	1.0
Saudi Arabia	24.0	37%	62%	86%	40.1
UAE	4.9	24%	75%	78%	5.4

Source: Population Reference Bureau

GCC region has experienced one of the highest population growth rates in the world in the last 2 decades primarily due to the labor force migration to the region. This accompanied with high fertility rates, decline in infant mortality and increase in life expectancy has led to increase in the number of people in the working age group of 15-65 years. Also there is a significant proportion of the population under 15 years which is ready to join the working force within the next decade. This is a situation similar to the”baby boom” profile experienced by USA.

Tackling unemployment…

Recently, Labor Minister Ghazi Al-Gosaibi announced a 25-year strategy to fight unemployment among Saudis, which according to latest official estimates, is 9.1% among men and 26.3% among women. The Minister called for stringent measures to cut the unemployment rate and for reducing the country's addiction to foreign labor. Referring to the ministry's efforts to cut foreign recruitment, the Minister said the number of recruitment visas issued annually declined from 597,000 visas in 2002 to 353,000 last year.

This kind of population growth rate is likely to put pressure on government to provide for basic amenities, infrastructure and medical services to its population. With the increase in the life expectancy, there is a greater need for medical services and while the government is upgrading the medical system, we feel private participation in the medical sector is required. For the economy, where almost half of the people are under the age of twenty-five, demography could be a boon because if these young people find jobs and improve productivity, it would provide high returns. The best and most sustainable way to address this challenge is to accelerate their trade and investment integration.

Sector Performance

Oil and Gas Sector

The growth in oil prices continued to increase in the first seven months of 2006, before declining in the latter part of the year. The rise in prices during the first half of 2006 was due to strong demand, driven by economic growth and tight production capacity in OPEC and non-OPEC countries. Lack of adequate spare capacity in the entire oil supply chain, starting from drilling and exploration to transportation and refining, combined with strong growth in demand for oil was instrumental in the dramatic surge in crude oil prices both in the spot and futures markets. The rise is price in 2006 was also supported by a number of geopolitical factors. Iran continued to be a factor in pushing prices higher, against a background of talk of US military options to resolve the international dispute over Iran's alleged nuclear program. Among other developments in Middle East, there was attack on Lebanon by Israeli forces. Nigeria also experienced shut-in capacity which constrained the oil supply.

The average OPEC reference basket price increased by 20.6% to touch US$61.08/b in 2006. The rally in prices was sustained till the 8th August 2006, when price of OPEC reference basket touched US$72.7/b. Similarly average Brent and WTI prices for 2006 were higher by 19.7% and 16.9% respectively over 2005.

The fall in price….

In recent months, we have seen a decline in oil prices. The OPEC basket prices have come down from US$72.7/b in August'2006 to less than US$50/b in initial days of 2007. This was due to uncertainties about global economic prospects particularly US, slowing demand growth, mild US winter, rebounding non-OPEC supply and high stock levels. Relative political stability also contributed to declines in prices. Concerned at this decline, a consultative meeting of the Organization of the Petroleum Exporting Countries (OPEC) was convened in Qatar during October'06, which noted that crude oil supplies are well in excess of actual demand and that the over-supply situation and imbalance in supply-demand fundamentals have destabilized the market. In order to ensure market stability, OPEC members decided to reduce production by 1.2 mb/d from the production level of about 27.5 mb/d to reach 26.3 mb/d effective from 1st November.

Further in an extraordinary meeting of OPEC in Abuja, Nigeria, on 14 December 2006, the members observed that market fundamentals clearly indicate that there is more than ample crude supply, high stock levels and increasing spare capacity. OPEC noted that, although the global economy is forecast to continue to grow, economic growth is expected to slow down in 2007. OPEC noted that the decision it had taken in Doha to reduce production by 1.2 mb/d from 1 November 2006 had succeeded in stabilizing the market and bringing it into balance, although prices remain volatile, reflecting the continuing supply overhang in the market. In view of the above, OPEC decided to reduce production by a further 500,000 b/d, with effect from 1 February 2007, in order to balance supply and demand. In coming days, we may see the impact of these production cuts. The recent sharp fall in prices may indicate the end of the steady bullish phase that has characterized the market since 2004.

Demand continues to grow….

The total world oil demand increased by 1% in 2006 to reach 84.13 mb/d, after growing by 1.2% in 2005. Developing countries and China have been the major drivers of growth in 2006. The fact that these countries are relatively less energy efficient led to a higher propensity for oil consumption, leading to a surge in overall demand. The oil demand from China increased by 9.5% in 2006. The oil demand from developing countries increased by 2.7% in 2006, compared to negative growth for OECD countries. Among the developing countries, Middle East and Latin America regions have seen maximum increase in demand in 2006. However demand growth for 2006 saw a deceleration from that in 2005, something which applies to all regions except China, non-OECD Europe and Middle East.

Table 17: Oil Demand

	Demand				Growth %			Share in Total Demand		
(mb/d)	**2004**	**2005**	**2006**	**2007 (F)**	**2005**	**2006**	**2007 (F)**	**2005**	**2006**	**2007 (F)**
North America	25.33	25.51	25.31	25.47	0.7%	-0.8%	0.6%	30.6%	30.1%	29.8%
Western Europe	15.62	15.51	15.49	15.50	-0.7%	-0.1%	0.1%	18.6%	18.4%	18.2%
OECD Pacific	8.53	8.59	8.45	8.45	0.7%	-1.6%	0.0%	10.3%	10.0%	9.9%
Total OECD	**49.48**	**49.61**	**49.25**	**49.42**	**0.3%**	**-0.7%**	**0.3%**	**59.6%**	**58.5%**	**57.9%**
Other Asia	8.44	8.67	8.76	8.92	2.7%	1.0%	1.8%	10.4%	10.4%	10.4%
Latin America	4.91	5.06	5.17	5.25	3.1%	2.2%	1.5%	6.1%	6.1%	6.1%
Middle East	5.50	5.82	6.16	6.46	5.8%	5.8%	4.9%	7.0%	7.3%	7.6%
Africa	2.74	2.89	2.95	3.00	5.5%	2.1%	1.7%	3.5%	3.5%	3.5%
Total Developing Countries	**21.59**	**22.44**	**23.04**	**23.62**	**3.9%**	**2.7%**	**2.5%**	**26.9%**	**27.4%**	**27.7%**
Former Soviet Union	3.83	3.82	3.78	3.79	-0.3%	-1.0%	0.3%	4.6%	4.5%	4.4%
Other Europe	0.86	0.88	0.91	0.93	2.3%	3.4%	2.2%	1.1%	1.1%	1.1%
China	6.52	6.54	7.16	7.62	0.3%	9.5%	6.4%	7.9%	8.5%	8.9%
Total Other Regions	11.21	11.24	11.84	12.34	0.3%	5.3%	4.2%	13.5%	14.1%	14.5%
Total World	**82.28**	**83.29**	**84.13**	**85.39**	**1.2%**	**1.0%**	**1.5%**	**100.0%**	**100.0%**	**100.0%**

Source: OPEC Monthly Market Report

As per OPEC, the total world demand for 2007 is expected to reach 85.39 mb/d, an increase of 1.5% over 2006. Maximum growth in demand is expected to come from China and Middle East. According to OPEC, the improved economic conditions in the world led by consumption spending and capital additions significantly increased the demand for oil and oil products in 2006. However with the exception of OPEC member countries and China, the dampening effect of higher oil prices has been moderately influencing world oil demand growth more than the healthy economy which is supposed to strengthen inventory demand.

China leads the growth….

After experiencing marginal growth in demand in 2005, the average oil demand in China is increased by 9.5% in 2006 to reach 7.16 mb/d, up from 6.54 mb/d in 2005. In fact, increased oil demand in China was driving the growth of total world oil demand in 2006. Out of the total increase of 0.84 mb/d in total world oil demand in 2006, China accounted for 0.62 mb/d i.e. 74% of total increase. All-round economic growth led by consumption spending and capital additions in China significantly increased demand for oil and oil products. GDP in China expanded by 10.7% in the first nine months of 2006. This indicates that GDP growth for the full year of 2006 will be close to 10%. However, China's annual producer price inflation fell to 2.9% in October'06 from 3.5% in September'06, which showed that price pressures are muted despite strong economic growth.

In China, the strong economic growth has translated into increased demand for energy. All supporting energy drivers such as industrial production, inland cargoes, agriculture, construction and passenger transportation are showing healthy growth. China's new car sales are estimated to exceed five million cars in 2006. The large growth in vehicle numbers in China is driving transport fuel demand. Overall strong economic activities along with the price shield that protects Chinese transport consumers have kept oil imports and demand on the rise. China has also started filling its long-awaited strategic storage of 32.7 mb, which has boosted oil imports. The filling process is based on the oil price level as the Chinese want to take advantage of the recent drop in crude oil prices. In view of increase in oil consumption, China is gearing up its energy strategy, which emphasizes energy saving and efficiency. In an effort to curb crude oil exports, China increased export tariff by 5%. Also China is pushing its bio-fuel program with ambitious plans to increase the production by an average of 40% annually. Looking forward, oil demand in China is expected to rise by 6.4% in 2007, as estimated by OPEC.

There was a decline in demand for oil in OECD countries in 2006. In US, the biggest increase has been in motor gasoline and the largest decline was in fuel oil due to fuel switching in power plants which started in early 2006. As a result of intensive subsidies, bio-fuel usage is getting stronger across the OECD. Due to the massive fuel switching among power plants, moderate economic activity and soft transport fuel demand, OECD Europe's oil demand was flat for the year 2006. In Japan, slow industrial production, transport fuel consumption has been on the decline, which affected total oil demand in the region in 2006. For 2007, oil demand in OECD countries is expected to rise by 0.3% with marginal or flat growth expected across all OECD regions.

Demand growth expectations for the emerging markets continue to be better than the major developed markets. The demand growth rate for oil in developing countries was 2.7% in 2006, down from 3.9% in 2005. The demand from the Middle East in 2006 grew by 5.8% in 2006, same as previous year. The demand in African countries grew by 2.1% in 2006, down from 5.5% in 2005. Similarly the demand in Latin American countries grew by 2.2% in 2006, down from 3.1% in 2005. However the major decline in demand growth rate has been observed in other Asian countries. After the demand grew by 8.5% in 2004, it was slowed down to 2.7% in 2005 and further came down to 1% in 2006. One of the major reasons of slowdown is rapid increase in prices in recent years. Most of these countries are highly import dependent for their oil needs. For 2007, oil demand in developing countries is expected to rise by 2.5% with higher growth coming from the Middle East region.

In general, demand in oil markets continue to show positive trends. However, the demand growth rate in coming years is difficult to reach the 2004 level. Demand growth in coming days will be affected by factors like growth in the economy, oil prices and shift to other fuels like natural gas and bio-fuel etc. As per OPEC, the total oil demand in 2007 is likely to grow by 1.5% to reach 85.39 mb/d.

Increase in supply from non-OPEC countries….

The oil supply from OPEC countries declined by 1.3% in 2006. Production increases within OPEC in 2006 was led by Iraq, Qatar, UAE and Libya. The members which witnessed maximum decline include Nigeria, Venezuela, and Indonesia etc. Saudi Arabia, the largest producer of crude oil, also saw a decline. The overall average production for 2006 came down in-line with OPEC decision during October'06. During the consultative meeting of OPEC in Qatar during October'06, members decided to reduce production by 1.2mn b/d from the production level of about 27.5 mb/d to reach 26.3 mb/d effective from 1st November. This was on account of the view expressed by members, which noted that crude oil supplies are well in excess of actual demand and that the over-supply situation and imbalance in supply-demand fundamentals have destabilized the market.

Table 18: OPEC Crude Oil Production

(mb/d)	**2003**	**2004**	**2005**	**2006**	**Growth in 05 over 04**	**Growth in 06 over 05**
Algeria	1.13	1.23	1.35	1.37	9.9%	1.4%
Indonesia	1.03	0.97	0.94	0.90	-2.7%	-4.8%
Iran	3.75	3.92	3.92	3.84	0.1%	-2.2%
Iraq	1.32	2.02	1.83	1.93	-9.2%	5.6%
Kuwait	2.17	2.34	2.50	2.50	6.8%	-0.2%
Libya	1.42	1.54	1.64	1.70	6.8%	3.6%
Nigeria	2.13	2.32	2.41	2.23	3.9%	-7.5%
Qatar	0.75	0.77	0.79	0.82	2.7%	3.8%
Saudi Arabia	8.71	8.96	9.39	9.12	4.8%	-2.8%
UAE	2.24	2.36	2.45	2.54	3.7%	3.7%
Venezuela	2.31	2.58	2.63	2.54	2.0%	-3.5%
Total OPEC	**26.96**	**29.00**	**29.87**	**29.49**	**3.0%**	**-1.3%**

Source: OPEC

In 2006, the upward trend in supply from non-OPEC countries continued. This is in contrast to OPEC countries which saw a decline in production in 2006. Non-OPEC oil supply for 2006 was 49.6 mb/d, representing an increase of 0.7 mb/d over 2005. During 2006, Former Soviet Union (FSU) and Developing Countries (DCs) contributed maximum to this increase in non-OPEC supply. Oil supply in the Developing Countries (DCs) and FSU for 2006 were 11.6 mb/d and 12 mb/d respectively. As estimated by OPEC, oil supply from Non-OPEC countries is expected to average 50.9 mb/d in 2007, representing an increase of 1.3 mb/d versus 2006. The growth in 2007 will be driven by FSU and developing countries. The demand supply situation does not portray an alarming situation. However with recent decision of OPEC countries to reduce production, there may be higher pressure on non-OPEC countries to hike production.

For a detailed discussion on the GCC Oil Sector, please refer to our research report on "GCC Oil Sector Report"

Saudi Arabia Oil & Gas Industry

Saudi Arabia has been the largest oil producer in the GCC and accounts for almost 10% of the world oil production. Most of the oil reserves of Saudi Arabia are controlled by the state run Saudi Aramco. Saudi Aramco has maintained the first ranking for the consecutive 18th year leading the largest oil companies in the world for the year 2005, according to the annual ranking prepared by Petroleum Intelligence. According to Aramco, Saudi Arabia holds a quarter of the world's total oil reserves, which are managed by Saudi Aramco. The production rate of 9.5mbpd could last for approximately 80 years, based on proven reserves alone. Saudi Arabia's oil production is depleting at 1%-2% a year according to the CEO of

Aramco. This rate, mainly from natural field declines, is expected to continue for the next few years.

Table 19: Saudi Crude Oil Statistics

(mn barrels)	2001	2002	2003	2004	2005
Reserves	262,697	262,790	262,730	264,310	264,211
No. of Discovered oil fields	75	77	78	79	82
Production	2,879	2,589	3,070	3,256	3,414
Export	2,203	1,929	2,381	2,487	2,631

Source: www.mopm.gov.sa

According to Ministry of Petroleum & Mineral Resources, total crude oil reserves amounted to 264.2bn barrels at the end of 2005 in 82 discovered oil fields. The production increased from 3.25bn barrels in 2004 to reach 3.4bn barrels in 2005, out of which 2.6bn was exported. At the Third OPEC International Seminar it was reported by Aramco that enhanced oil recovery techniques and other advances in technology can boost the world's potentially recoverable oil reserves to more than 4.5 trillion barrels, which translates into 140 years of supply at current rates of consumption. Also in Sep-06, Saudi Aramco signed two contracts for development of its 1.2mbpd Khurais Increment Program. The program is slated for completion by mid-2009.

Plans to increase oil production…

According to the Ministry of Petroleum, the country has to increase its production to counter the rapidly rising world oil demand. To counter these factors, the Kingdom completed the development project for Qatif and Abu Safah fields that produce a total of 800mbpd. This mega project, completed ahead of schedule, will boost the Kingdom's total production capacity from 10.5mbpd to 11mbpd. To gradually increase its production capacity to 12.5mbpd will require numerous upgrades to both old and new fields and reservoirs and fields have already been identified for capacity increases. It also reflects the Kingdom's desire to maintain a reasonable spare capacity of at least 1.5mbpd, in case any need arises. In 1H-2006, Saudi Aramco reported that a record 100 oil drilling rigs were operating in the kingdom and that it expected to close 2006 with 121 in operation. The flurry of drilling activity is all part of an ongoing US$50bn project by Saudi Arabia to boost oil production capacity in the Kingdom over the next five years.

Aramco expects the 500,000-barrel-a-day Khursaniyah oil field development to be completed in the fourth quarter of 2006, in line with the project's original schedule. In addition to producing Arabian light crude oil from the onshore Abu Hadriyah, Fadhili, and Khursaniyah fields, the project will also have capacity to process 1bn cubic feet a day of associated gas and 80,000 b/d of condensates. The Khursaniyah project is part of Saudi Arabia's plan to raise production capacity to 12.5mbpd from just above 11mbpd now by the end of the decade.

Work has officially begun on Manifa - the second largest of Aramco's mega-projects in terms of production. It will add 900,000 barrels per day of crude oil to Aramco's production, which is very important to the Kingdom of Saudi Arabia and the world, according to a report by Aramco's web-site. Since the Manifa field is mostly in shallow water, the key to the project is a 41-kilometer causeway. The main artery of the causeway will be 21 km long. Offshoots totaling an additional 20 km will lead to 27 drilling islands. The remaining 11 offshore wells (four production and seven water injection) will be drilled in the traditional way using platforms and jackets.

In addition to the 900,000 bpd of crude oil, the central processing facility also will handle 120mn standard cubic feet per day (scfd) of sour gas, 50,000 bpd of condensate and 950,000 bpd of produced water. The associated natural gas liquids (NGL) will be piped to the Khursaniyah Gas Plant, which is still under construction. The Manifa gasses will be mixed with gas from the Khursaniyah field and all of it sent to Ju'aymah Gas Plant.

Haradh project will increase Saudi production capacity by 300,000 bpd of light Arabian oil. On Saudi Aramco's future oil projects, according to the Minister, Shaiba field, located in the Empty Quarter, will add 250,000 bpd; and Alnaim field will add 100,000 bpd. In 2009, a giant project in Khurais will add 1,200,000 bpd.

Table 20: Destination of Saudi Arabia's Crude Oil Exports

(mn barrels)	**2002**	**2003**	**2004**	**2005**
North America	488.8	596.9	558.4	530.9
South America	22.1	23.8	22.3	23.8
Western Europe	343.1	434.9	459.6	440.7
Middle East	49.5	72.7	95.5	112.9
Africa	68.4	96.3	88.7	86.0
Asia & Far East	942.9	1,149.9	1,251.1	1,435.3
Oceania	14.2	6.3	11.3	1.6
Total	**1,928.9**	**2,380.9**	**2,486.8**	**2,631.2**

Source: SAMA

Asian economies, owing to the strong growth in that region, reported a strong growth and remained the major consumers of Saudi crude oil exports. Asia & Far East region accounted for 54% of total oil exports in 2005, up from 50% recorded in the previous year. The strong growth in China, India and ASEAN countries has resulted in the increased oil demand from the major oil producers.

Natural Gas - Increasing importance of gas as the revenue source….

With the importance of natural gas increasing day-by-day as the low cost substitute for oil, Saudi Arabian gas industry has witnessed increased attention of the private as well as foreign participant. Over the last decade, world gas consumption grew by 1.7% per year and is expected to accelerate at a rate of 3.2% per year over the next 20 years. Global LNG demand is forecasted to grow at almost 7.5% per annum between 2005 and 2020.

The Saudi gas reserves are estimated today at 243 trillion cu.ft. ranking fourth in the world (after Russia, Iran, and Qatar). Most (around 60%) of Saudi Arabia's currently proven natural gas reserves consist of associated gas, mainly from the onshore Ghawar field and the offshore Safaniya and Zuluf fields.

Table 21: Saudi Gas Statistics

	2001	2002	2003	2004	2005
Reserves (trillion scf)	227,946	234,673	238,492	241,323	243,648
No. of Discovered oil fields	12	12	13	14	14
Natural Gas Production (bn cu meters)	57	61	68	76	81
Natural Gas Consumption ('000 bbls)	305,080	327,008	339,796	376,140	416,897

Source: www.mopm.gov.sa

Saudi Aramco's onshore exploration activities are in high gear to support the existing gas plants and add new reserves. During the next 10-year period, Aramco will add 50 trillion cubic feet of non-associated gas reserves. Three decades ago, Saudi Arabia developed a natural gas strategy centered on the Master Gas System (MGS) -- the largest gas production and processing network of its kind. Today, the Master Gas System is the backbone of Saudi Arabia's industrial sector and powers utilities across the country. The MGS will help provide gas supply to the Kingdom's growing petrochemical industry where the key to the industry is a reliable supply of gas to serve as petrochemical feedstock. Since the 1994 gas exploration programme began, Aramco has added over 72 trillion cubic feet of gas reserves from the Khuff, Unayzah and Jauf reservoirs.

Gas development also is taking place offshore, and a giant gas discovery in the Arabian Gulf had the highest flowing gas rate encountered so far in the ancient Khuff formation thousands of feet below the surface. Gas demand in the Kingdom is set to grow three fold, from five billion cubic feet per day (BCFD) to 14.5 BCFD by 2030, and the Kingdom has already added 48 trillion cubic feet to its gas reserves in the last decade.

Saudi Arabia has discovered a new gas field south of the giant Ghawar field which tested at 30mncfd, the third significant gas find this year in the area according to Saudi Press Agency. The Najimaan-1 well is 30km south of Ghawar and has an estimated production capacity that may exceed 60mn cfd. With around 250 tcf of proven gas reserves, Saudi Arabia is moving swiftly to consolidate its reserves of non-associated gas in order to develop new resources to fuel fast-growing utility, power and industrial demand, which is expected to rise to 14.5bcfd by 2030 from approximately 8bcfd now.

Aramco is looking to produce up to 1bn cubic feet of gas per day from its newly discovered Karan field in the Persian Gulf as part of a future development programme aimed at meeting increasing demand for clean energy in Saudi Arabia. A comprehensive appraisal plan is under way to determine the exact size of the field, which the official described as a giant discovery. Karan-7, the first delineation well. The Karan-8 appraisal will follow early in 2007. This is the largest net pay ever encountered in the Khuff formation in the Kingdom. Aramco expect first gas production by 2011-2012.

The Karan field was discovered during an aggressive exploration drive by Aramco to increase its proven gas reserves, estimated at 240 trillion cubic feet. About 70 exploration wells are planned over the next five years. Since the 1994 gas exploration programme began in earnest, Aramco has added 72 Tcf of non-associated gas reserves from the Khuff, Unayzah and Jauf reservoirs. During the next 10-year plan, Aramco aims to add at least 50 Tcf of non-associated gas reserves. Gas development is also being given priority to help meet rising demand from both the domestic and industrial sectors. Gas consumption is projected to double by 2030. According to Aramco the company is now pumping about 7 Bcfd to the national grid.

By the end of 2009, Aramco anticipates a significant increase in gas development well completions. It is planning to drill and complete more than 300 new gas development wells during the coming five years. Additionally, Aramco anticipates the drilling of 70 gas exploration and delineation wells in the next five years. Away from the mature areas of the Eastern Province and the Persian Gulf, Aramco is expanding its exploration to the north of the kingdom and the Red Sea to meet its target of adding at least 5 Tcf of new gas reserves annually.

In Sep-06, Saudi Arabia's South Rub al-Khali Company has begun drilling for gas in the Empty Quarter in the south of the country. SRAK is a joint venture operating on behalf of its three shareholders: Royal Dutch Shell with 40%, as well as France's Total SA and Aramco each holding 30%. Aramco said seven wells would be drilled over the next 28 months.

Refining Industry

Saudi Arabia has a combined crude throughput capacity of around 2.035mbpd in 2005 which increased from 1.79mbpd recorded in 2001. Five are owned and operated by Aramco and 2 are the joint ventures of Aramco with foreign oil majors. One refinery is owned and operated by Aramco Gulf Operating Company (AGOC) in the neutral zone between Saudi Arabia and Kuwait.

Table 22: Capacities of Refineries in Saudi Arabia

('000 bpd)	**2001**	**2002**	**2003**	**2004**	**2005**
Ras Tanura	325	325	525	525	535
Riyadh	115	115	122	120	121
Jeddah	60	60	77	84	78
Yanbu	225	225	235	235	215
Rabigh	400	400	370	370	375
SAMREF	365	365	400	400	403
SASREF	300	305	305	313	308
Total Capacity	**1,790**	**1,795**	**2,034**	**2,047**	**2,035**

Source: www.mopm.gov.sa

Saudi Aramco has been pursuing major opportunities for building new export refineries and integrating existing refineries with new petrochemical projects. Saudi Arabia announced that it was studying the possibility of building a crude oil refinery at Jizan on the Red Sea in a bid to boost the kingdom's position as a major oil refiner. The refinery, which will be semi or full-conversion plant, will produce between 25,000 and 400,000 barrels a day. Saudi Aramco is also in the final stages of formulating a memorandum of understanding with Dow Chemicals to build an estimated US$15bn refinery and petrochemicals complex at Ras Tanura.

New refineries in the offing….

Total S.A. and ConocoPhilips are targeting early to mid-2008 for the sale of shares on the in two export refinery projects to be developed with Aramco, at a price of up to US$7bn each. Total S.A which will build the refinery jointly with Aramco at Jubail on the Persian Gulf coast will launch a 30% initial public offering «as soon as front-end engineering design is completed in early 2008", according to senior vice president for refining and marketing. Each refinery will process 400,000 barrel a day of heavy crude into products such as gasoline, low-sulfur diesel and naphtha for markets in Asia, Europe and the U.S. Both projects are scheduled to start operations around mid-2011. Saudi Aramco and Total on May 21, 2006 signed a comprehensive Memorandum of Understanding covering the planned development of a 400,000-barrel-per-day, full-conversion refinery in Jubail. Saudi Aramco and ConocoPhillips also signed a Memorandum of Understanding on May 24, 2006 to conduct a detailed evaluation for the proposed development of a 400,000-barrel-per-day, full-conversion refinery at the Rea Sea port of Yanbu.

Table 23: Production of Refined Products

(mn barrels)	2001	2002	2003	2004	2005
LPG	13.2	10.3	10.2	13.4	12.7
Gasoline & Naptha	152.2	153.2	171.7	198.6	198.9
Kerosene & Jet Fuel	60.1	59.7	65.6	67.0	80.9
Diesel	193.8	192.7	215.6	234.9	236.4
Fuel Oil	169.5	157.7	169.4	173.0	178.0
Asphalt	8.7	9.2	10.2	11.5	13.8
Total	597.4	582.8	642.6	698.3	720.6

Source: www.mopm.gov.sa

Such a strategy of investing in mega-projects will add value to the hydrocarbon resources of the Kingdom, and products available from the new refinery and petrochemical projects will provide a foundation for the Kingdom’s economy to be further diversified, leading to additional investments and the creation of additional employment opportunities.

Petrochemical Industry

Saudi Arabia has lined up ambitious plans to increase its petrochemical production and become a leader in the world petrochemical market. According to the CEO of SABIC, the Saudi petrochemicals output was expected to go up from 40mn MT/ year in 2005 to 75mn MT/year by 2010. The Kingdom's share in the global petrochemicals industry would hence go up from 7% to 13% in the same period. According to Zawya, in 2005, SABIC was the Middle East's most profitable publicly listed non-oil company, and the second largest producer of ethylene glycol and methanol in the world, the third largest producer of polyethylene and overall the fourth largest producer of polypropylene and polyolefin. SABIC reported a record 2006 net profit of SR20.3bn compared to SR19.2bn reported in the previous year.

Marching ahead to become a petrochemical hub…

The total production of SABIC's manufacturing complexes was 49.1mn tonnes in 2006 compared to 46.7mn tonnes reported in the previous year registering an increase of 5%. A total quantity of 38.5mn tonnes was marketed in 2006 compared to 36.6mn tones reported in 2005. Sales revenues hit SR86.5bn in 2006 as compared to SR78.3mn reported in the previous year. These were the highest revenues achieved by the company since its inception. SABIC has indicated that it will make further acquisitions including in the U.S. to achieve its 2020 target to more than double production capacity to as much as 100mn tons a year. As part of its expansions plans, the company plans to spend up to US$74bn on 60 projects in Saudi Arabia in the next 14 years.

SABIC is in talks to build an olefins complex in China, and is studying the feasibility of building a new polypropylene plant in the U.K. as part of its Huntsman acquisition. The company has also submitted a bid to Algerian state-oil company Sonatrach to take an equity stake in a planned new olefins complex in the North African state, with a decision expected some time in 2007. SABIC plans to expand its cracker capacity (NICER project) and construct two new polyethylene plants at Sharq and Yanbu that will increase the total production capacity of ethylene glycol (EG) to 3.9mn metric tons per year in 2006, hence making SABIC the world's largest producer of ethylene glycol, and meeting 22% of global demand, up from 16% in 2005. SABIC's share of global ethylene production is projected to reach 7.2% in 2009, up from 5.6% in 2004; whereas its share of global polyolefins production is expected to increase from 6.1% in 2004 to 7% in 2009.

In 2005, nearly half of SABIC's total global production was dedicated to meeting the Asian region's demand. In 2006, SABIC acquired Huntsman Petrochemicals (UK) and renamed it to SABIC UK Petrochemicals for a purchase price of $700mn. Huntsman Petrochemicals business operates an 865 ktpa ethylene/ 400 ktpa propylene cracker and a 1.3mtpa aromatics facility with logistical facilities. SABIC will complete the construction of a new 400 ktpa capacity polyethylene (LDPE) plant which is scheduled to come on stream by the end of 2007.

Major expansion plans….

- A joint venture between SABIC and Al-Kayan, will include a 2mn tons/year ethane/ butane cracker, including benzene extraction facilities; a 700,000 t/y polyethylene plant; a polypropylene plant with capacity of at least 350,000 t/y; and a 530,000 t/y ethylene glycol unit.

- SABIC & Exxon-Mobil announced recently that they have begun work on a feasibility study to define a potential project that would grow their two joint petrochemical ventures at Yanbu and Jubail. The project would target domestic supply of carbon black and rubber and thermoplastic specialty polymers (EPDM, TPO, Butyl, SBR/PBR) to serve emerging local and international markets. Expected project start-up date is 2011.

- SABIC has indicated that it will invest US$5bn in a new joint venture project in China. Investment might include setting up production units for ethylene, polyethylene and glycol at a cost ranging between US$3bn and US$5bn.

- SABIC Europe has signed a contract with German contractor UHDE to build a high-density polyethylene plant at its production site in Gelsenkirchen, Germany. The plant will have production capacity of 250 kilotons a year, replacing an existing 100 kt/year plant. It will begin production in the fourth quarter of 2008.

- Saudi European Petrochemical Company (IBN ZAHR), a subsidiary of the SABIC has awarded Samsung Engineering Company Ltd., South Korea, a contract for the construction of 500,000 tons per annum Polypropylene Plant. The plant will be erected at the IBN ZAHR complex in Al-Jubail, Saudi Arabia. The plant is planned to be completed by third quarter 2008. This is the third Polypropylene plant being built at IBN ZAHR.

- YANSAB Greenfield project will produce 1.3mn t/y ethylene; 770,000 t/y ethylene glycol; 500,000 t/y LDPE; 400,000 HDPE; 400,000 t/y polypropylene; 100,000 t/y butene-1 and butene-2; and 250,000 t/y benzene, xylene and toulene compound.

- In June-06, the 75,000-tonne butanediol petrochemical complex, which belongs to the Saudi International Petrochemical Company (Sipchem), was commissioned.

SABIC affiliate, the Saudi Arabian Fertilizer Company (SAFCO) reported its highest ever profits during 2006, amounting to SR1.15bn compared to SR1.11bn reported in the previous year.

Table 24: SAFCO- Key Indicators

	2006
Total Production Capacity (t/y)	2,850,000
Future Production Capacity (t/y)	5,050,000
Project Completion Date	2007
Est. Cost of Projects (US$ mn)	541
Ammonia Capacity (t/y)	1,200,000
Ammonia Future Capacity (t/y)	2,300,000
Urea Capacity (t/y)	1,530,000
Urea Future Capacity (t/y)	2,630,000

Source: Zawya

We believe that the condition are ripe for the private and foreign investors to invest in the petrochemical industry in Saudi Arabia to take advantage of cheaper raw materials, and government incentives and can use the improved infrastructure to market their products in the region as well as all over the world.

Electricity & Water Sector

In GCC, Saudi Arabia accounts for about 48% of the total power generating capacity in the region. In terms of per capita installed capacity Saudi Arabia has per capital power generation capacity of 1,313 Watt of power capacity as against GCC region's per capita average of 1,835 Watt. In Saudi Arabia, the formation of Saudi Electricity Company opened the door to private sector construction of new power plants on BOO (Build-Own-Operate) and BOT (Build-Own-Transfer) bases. In June 2005, the country's first IPP which came online was SADAF's (Saudi Petrochemical Company) co-generation power plant with a capacity of 250 MW. It was the first captive Independent Power Producer (IPP) Cogeneration plant in the Middle East.

In Saudi Arabia, over 2000-2005, power generating capacity increased at a CAGR of 4.6% from 25,790 MW in 2000 to 32,301 MW in 2005. The year 2005 witnessed capacity addition of 1,775 MW or a growth of 5.8% over 30,526 MW reported in 2004. Out of the total capacity addition 1,775 MW during 2005, SEC added 1,340 MW, Saline Water Conversion Corp. (SWCC) added 94 MW and other producers added 341 MW. SEC accounted for almost 90% of the country's total power generation capacity while SWCC and other large producers accounted for 8% and 2% respectively in 2005.

Increased demand for power…..

Over the last few years Saudi Arabia has witnessed rapid growth in power generation which grew at a CAGR of 6.9% during 2000-2005. As against this the growth in capacity addition was at 4.6%, which reflects the efficiency at which the available capacity have been utilized. Industry's overall generation increased from 14,405 MW in 2000 to 20,105 mw in 2005. In case of SEC output grew at a CAGR of 7.7% from 11,820 MW in 2000 to 17,148 MW in 2005. Despite the growth in installed capacity the peak load on the system remained in high terrain which increased from 84% recorded in August 2000 to 92.6% in August 2005, which shows growing demand for power in the country. In volume terms, peak load power requirements went up from 21,673 MW in 2000 to 29,913 MW in 2005.

Planned Projects in Power Sector

Among the upcoming projects, Saudi Electricity Company is developing several new power plants at a total investment outlay of SR46.5bn (US$12.4bn), which will add a total of about 19,175 MW of power generation capacity during the period 2006–2017. The company will also invest SR8.0bn (US$2.1bn), over 2006-2017, in transmission projects which will have length of 3,860 km.

Table 25: Planned Investment Projects of SEC

Projects	**2006-2017**	
	Capacity	**Investment Outlay**
Power (MW)	19,175	SR46.5bn
Transmission Line Project (KM)	3,860	SR8.0bn

Source: SEC

The other planned power projects are under separate IWPPs and IPPs. Apart from these, Marafiq (Power and Water Utility Company for Jubail and Yanbu) is also developing power and water projects in the industrial city of Jubail. These projects are as enumerated below:

I. Independent Water & Power Projects (IWPPs)

- To develop IWPPs, Water & Electricity Company (WEC) was established by the Supreme Economic Council to promote private investments in the IWPPs. WEC, a limited liability company, owned on a 50:50 basis by SEC and Saline Water Conversion Corporation (SWCC), will be the single off-taker of the generated power & water by the IWPPs that will be implemented on a Build Own & Operate (BOO) basis with a concession of 20 years.

- As per the original plan there were four IWPPs which had been planned. Now, as per the recent media reports, WEC has cancelled the Al-Jubail project (1,100 MW of power and 340,000 cubic meters per day of water) which was expected to be the fourth in WEC's IWPP series. The size of Ras Al-Zour project has been increased to 3,000 MW of power and 1,000,000 cubic meters of water per day from the earlier envisaged 2,500 MW of power and 800,000 cubic meters per day of water.

- The initial stage of the IWPP will entail the following 3 projects:

Table 26: IWPP Projects

Project	Power (MW)	Water (Cubic meters per day)	Schedule of Implementation	Capital Outlay (US$ mn)
Shoaiba (Phase 3)	900	880,000	Q1-2009	2,460
Shuqaiq (Phase 2)	850	212,000	Q2-2010	1,250
Ras Al-Zour	3,000	1,000,000	Q2-2011	3,750

Source: WEC Website

- The transmission & distribution of power & water produced by the 4 IWPPs will require additional investments of US$3.2bn.

II. Other Independent Power Projects (IPPs)

- Saudi Aramco, SABIC and SADAF forming the major group of driving forces in power generation enterprises for their captive plants usage;

- In late 2003, Saudi Aramco launched 4 new IPPs at Ras Tanura 150 MW; Juaymah 300 MW; Uthmaniyah 300 MW; and Shedgum 300 MW with a combined capital investment exceeding SR2bn. These projects have been established in cooperation with private sector (consortium of Saudi Oger & International Power) on a BOOT basis (with a concession period of 20 years).

- Ma'aden (Saudi Arabian Mining Company) is planning an independent power generation plant at Ras Al-Zour which will have capacity of 1,800 MW to meet demand for its Integrated Aluminum Complex.

III. Marafiq Power & Water Projects

Marafiq (Power and Water Utility Company for Jubail and Yanbu) was established by Saudi Basic Industries Corporation (SABIC), Saudi Aramco, Royal Commission for Jubail & Yanbu and the Public Investment Fund to offer electricity and water to the twin cities of Jubail and Yanbu. Marafiq currently owns and manages the 1,060 MW power plant, located in Yanbu industrial city, and various water treatment plants such as cooling water, drinking water, sanitary waste water, and industrial waste water facilities.

Marafiq is planning an IWPP in the industrial city of Jubail with an estimated cost of SR9.4bn (US$2.5bn). However, the project cost is expected to rise in line with the change in scope of the Request for Proposals (RFPs). It will be implemented in two phases. The first phase will have capacity of 2,500 MW of power and 800,000 cubic meters of desalinated water per day, which will be implemented by 2009. This is as per the revised RFP as compared to originally planned 2,400 MW of power and 300,000 cubic meters of water per day. Phase II will have capacity of about 1,500-2,000 MW of power and 100,000 cubic meters of water per day and an announcement is yet to be made on its timing.

Demand for power in Saudi Arabia is growing at the rate of 6% per annum. The peak demand had growth of about 7% a year, which is likely to be in double digits over the next few years, mainly because of massive investments are being planned in mega energy, industrial and real estate projects as discussed above. Expanding populations and social developments are other major drivers for demand at this high rate. Apart from these domestic demand drivers, the upcoming GCC power grid will also add to the demand growth and Saudi will have a major role to play as it has the largest capacity in the region. To fulfill the likely growth in demand, several IPPs are coming up apart from the new projects under SEC. As per SAGIA overall power capacity in Saudi Arabia is forecasted to grow to 59,000 MW by the year 2024 requiring an estimated investment of SR430bn (US$115bn). To achieve this target the ministry will present several joint projects to the private sector, local and foreign, in order to increase power generation capacity. With electricity demand expected to more than double over the next 20 years, an encouraging number of investors have shown interest in establishing new power generation companies, in the country. The regulatory authority (ESRA) will license newly-formed companies while the Saudi Electricity Company (SEC) will handle electricity distribution

At the moment, the total number of electricity subscribers exceeds 4.7mn in Saudi Arabia, where more than 10,160 cities, towns and villages have been electrified. It has been predicted by 2008 the power supply will cover all settlements and villages not previously supplied with electricity, raising the number of electrified cities and villages to 11,112. The company also has targeted to increase its customer base to 5.7mn by 2009. Thus, the sector has tremendous growth potential in the booming economy which will witness growing demand not only from the home turf but also from the region with the upcoming GCC power grid.

For a detailed discussion on the Saudi Electricity Sector, please refer to our "Saudi Electricity Co." Research Report

Industrial Sector

The government has done commendable job in making Saudi Arabia a key destination for companies intending to set up their industrial units. This includes providing industries with investment benefits, setting up world-class infrastructure and making the entry in the industrial sector lucrative for foreign as well as private investors. One of the major milestone in government effort to woo industrial investments has been Jubail. It has been named the city with the best economic potential in the Middle East by the Financial Times' Foreign Direct Investment (fDi) magazine in the past and it has gone ahead in attracting foreign investment further. The Jubail-II project, which covers an area of 1,950 hectares, is expected to cost SR2.54bn. Jubail-II is expected to attract investment projects worth SR220bn.

Attracting investors to become part of economic growth….

Since its inception in April 10, 2000, Saudi Arabian General Investment Authority (SAGIA) has, so far, licensed 3608 projects (upto Mar-2006) amounting to SR292.7bn. Foreign investors, contributed 38.3%, i.e. SR112.2bn of the total licensed investments, whereas the Saudi share amounted to SR180.5bn i.e. 61.7% of the total investments In Jan-07, Saudi Arabian General Investment Authority announced its target to license investment projects worth more than SR300bn in 2007. The value of licenses issued by the SAGIA in 2006 increased 25% over the previous year. The second quarter 2006 results of the SAGIA released recently indicate the launch of two economic cities along with measures to lure domestic and foreign investments aimed at transforming the Kingdom into a more competitive investment destination. The value of investment licenses issued during Q2 2006 rose thanks to government attempts to improve the economic and investment climate in the Kingdom, stronger confidence in the Saudi economy, as well as joining the WTO. SAGIA's One-Stop-Shop (OSS) issued 505 licenses with a total value of SR72bn, a 107% rise over the same period last year when 219 licenses were issued at an aggregate value of SR35bn.

According to SAGIA, strategic trends for 2007 will focus on implementing its six major roles which include :

- Investor services
- Regional development
- Focused marketing
- Attraction of investment to certain sector.
- Support for new projects.
- Improvement of the investment environment.

Table 27: Total Investments by Sector

(upto 24 March 2006)	No. of Projects	Total Finance (SR bn)
Industrial	1388	141.4
Service	2211	150.8
Agricultural	9	0.5
Total	**3608**	**292.7**

Source: SAGIA

SAGIA has already signed 17 agreements with major Saudi companies within the framework of SAGIA's Public Private Partnership Programs to activate the relationship between the public and private sectors. According to the agreements, these companies provide financial support to execute SAGIA's program in exchange for a greater benefit of services provided by SAGIA.

Table 28: Total Finance for Licensed Projects

Activities	No. of Projects	Total Finance (SR bn)	Saudi Share (SR bn)	Foreign Share (SR bn)
Industrial	1,388	141.4	76.5	64.8
Service	2,211	150.8	103.7	47.0
Agricultural	9	0.5	0.1	0.3
Total	**3,608**	**292.7**	**180.5**	**112.2**

Source: SAGIA

Improvement in infrastructure….

In order to improve the infrastructure services in the country, an investment of US$443mn has been envisaged to increase the capacity of the Jeddah Islamic Port (JIP) by 45%.

Saudi Railway Organization (SRO) is also planning to establish two more railway lines linking Jeddah and Jizan as well as Taif and Khamis Mushayt. SRO has already signed an SR3.3mn contract with an engineering consultancy firm in order to conduct a feasibility study of the two railway lines. The Supreme Economic Council had approved three railway projects: A 950-km land bridge linking the Kingdom's east and west; a Makkah-Madinah rail link; and the northern railway linking Riyadh with the Jalamid region.

The land-bridge project, which is expected to change the region's shipping patterns, has reached advanced stages of implementation. The land bridge project involves construction of 950 km of new tracks between Riyadh and Jeddah and another 115-km line between Dammam and Jubail. It is the cornerstone of a massive multi-billion riyal railway expansion project and will be the first rail link between the Red Sea and the Gulf.

Airports in Jeddah, Madinah and Tabuk will expanded at a cost of SR30bn in order to meet the growing number of passengers and the requirements of two new domestic private airlines, according to the General Authority for Civil Aviation (GACA). The Civil Aviation Authority has already launched a US$1.5bn expansion for Jeddah's King Abdul Aziz International Airport (KAIA), which is designed to accommodate the world's largest aircraft, including A380s and will increase the airport's annual capacity to 21mn passengers.

Economic Cities – Thinking big…

The Kingdom's ambitious plan to dramatically raise investment competitiveness under its "10 x 10" programme to put Saudi Arabia among the world's Top 10 globally competitive investment destinations by 2010 can be best seen in the "Economic Cities" announced in recent times. According to SAGIA, the four cities are expected to attract investments worth more than SR300bn and create more than a million jobs within the next 10 to 20 years. In the field of balanced regional development, SAGIA, supported by the Custodian of the Two Holy Mosques and the Crown Prince, launched three integrated economic cities in 2006, one each in Hail, Madinah and Jazan. In 2005 King Abdullah Economic City in Rabegh was launched. A study is underway to establish two more economic cities, one in Tabuk and one in the Kingdom's Eastern Region in 2007.

King Abdullah Economic City (KAEC) – Red Sea Coast

- The Emaar Economic City, the developer, has significantly expanded the size of its largest-ever development in the Middle East, King Abdullah Economic City (KAEC) in Saudi Arabia, by nearly four times to cover an area of over 168mn sq m and unveiled a new master plan.

- The company has modified the KAEC master plan to make substantial additions to its six major components -- the Port, Industrial District, Central Business District (including commercial, mixed-use, retail and financial island), Resort, Educational Zone and Residential (including Corniche and souks). The expansion will help generate more employment opportunities for Saudis, enhance foreign direct investment and boost the Kingdom's economy.

- Following the expansion, the project has the potential to generate one million jobs for Saudi citizens and will serve as home to two million residents. The jobs created will be in industrial and light industries (330,000), research and development (150,000), business and office (200,000), services (115,000), hospitality (60,000), and education and community services (145,000).

- Covering 13.8mn sq meters, a major increase of 11.2mn sq m from the earlier project, the seaport will be the largest in the region with a capacity of over 10mn 20-foot equivalent unit (TEU) containers per year, which is significantly higher than all other regional ports. Another key component of the port will be a custom-built Haj Terminal.

- Following the expansion, the Industrial District will cover 40mn sq m -- five times more than previously envisaged. The 4,000 hectares of land will be dedicated to industrial and light-manufacturing facilities, identified as key growth drivers for the Saudi economy, and can now host 2,700 industrial tenants. The Industrial District will have specific initiatives to encourage local entrepreneurs through incubator-like modules. International experts have been consulted to ensure that the Industrial Zone development is in line with best environmental practices.

- The Central Business District (CBD) will offer 3.8mn sq m of office space, hotels and mixed-use commercial space. The Financial District, within the CBD, has now been doubled in area to cover 14 hectares of land, which will be the largest regional financial nerve center for the world's leading banks, investment houses and insurance groups.

- The retail component of KAEC takes a quantum jump following the expansion of the project. From an area of 3.3mn sq m, the total retail facilities will now spread to cover 8.7mn sq m and house over 50,000 shops, nearly three times the earlier estimate.

- The Hospitality zone will be another strategic component of the new expansion with the number of hotel rooms and suites being increased from 12,000 rooms in 60 hotels to 25,000 hotel rooms in more than 120 hotels. An ideal place to work and live, the KAEC will now have 250,000 apartments and 25,000 villas, a leap from 110,000 apartments and 16,000 villas.

- Building on the socio-cultural environment demanded of living environments, KAEC will have 550 mosques including several grand mosques in the residential zones. Several schools will be opened to cater for the educational needs of children in each community apart from a university campus for 18,000 students. A sports stadium will also be part of the project, which will have 45,000 seats.

- The Saudi Arabian General Investment Authority (SAGIA) also plans to establish a plastic valley at King Abdullah Economic City.

Prince AbdulAziz bin Mousaed Economic City - Hail

- Saudi Arabia's Prince AbdulAziz Bin Mousaed Economic City, which is set to become the largest transportation and logistics hub in the Middle East, is likely to see a total private sector investment of SR30bn over the next 10 years.

- Hail's sound base in agriculture accounts for 70% of the region's employment in this sector, and 90% of corn, 33% of potatoes, and 31% of barley produced in Saudi Arabia. Total annual production is in excess of 800,000 tons. There is enormous potential in pre-packaged foods, agricultural-related industries, and new technologies for more efficient use of water.

- Covering an area of over 150mn square meters, the Prince AbdulAziz bin Mousaed Economic City will incorporate a cluster-based development comprising: transportation, logistics and supply chain centers; educational services; agricultural and food processing services; mining and commerce services; housing; and infrastructure.

- In the area of transportation, logistics and supply chain, an international airport is expected to cater to three million passengers per year, while a railway station will cater to approximately two million passengers annually. Dry ports and operation centers will be capable of handling over 1.5mn tonnes of cargo annually.

- The region will also benefit from a new international airport and a major expansion of the Kingdom's railway system, which will connect the main regions. In addition, major new highways are being constructed to link the Kingdom through Hail with Jordan, Iraq and also Madinah.

Knowledge Economic City (KEC) - Madinah

- The project is the first of its kind and the third economic city in Saudi Arabia to be initiated by the Saudi Arabian General Investment Authority (SAGIA) in an aggressive bid to repatriate capital and attract value-added foreign investments.

- The move is part of efforts hoped to develop the Kingdom's regions in a hi-tech manner while easing mounting pressure off the country's three major cities' infrastructures.

- The new city, named "Knowledge Economic City" will be developed on a 4.8mn m sq. land while the built up area will near 9mn m sq. attracting SR25bn worth of investments. The project will add 20,000 new jobs to the region.

- The city will comprise various zones designed to compliment each other; a technology and Knowledge based industry zone; an advanced IT studies institute; an interactive museum on the life of Prophet Mohammad (PBUH); a center for Islamic civilization studies; a campus for medical research and life sciences; an integrated medical services zone; a retail zone; a business district; residential zones including high rises, houses, and fully-serviced apartments; shopping malls; and a mosque with a 10,000 worshipper capacity.

- Transportation within KEC will be facilitated via a ring road above which rises a monorail connecting the city to neighboring Grand Mosque of Madinah within minutes. This monorail will be tethered to the planned train station thus tapping into the railway access to Makkah, Yanbu, the King Abdullah Economic City as well as the port city of Jeddah.

Jazan Economic City - Jazan

- The new economic city is expected to attract more than SR100bn in investment and create some 500,000 new jobs.

- The aluminum complex under construction at Jazan Economic City (JEC) expects to create 12,000 new jobs. One of JEC's anchor investments, the aluminum complex is the largest mineral processing facility to be built in JEC's industrial zone and led by Saudi-based Western Way for Industrial Development Co (WWIDC). The plant, when completed, targets production of 1.4mn tons of alumina and 660,000-700,000 ton aluminum per annum. All the alumina will be made from bauxite imported from Greece. Total investment in the complex as well as in the associated plants required to supply adequate power, is estimated at US$4bn.

Construction & Real Estate Sector

With the strong liquidity and increased investors' interest to park their funds within the country, real estate sector has got a big boost. The contribution of the construction sector in the GDP increased from SR41.7bn in 2000 to SR54.8bn in 2005. Gross fixed capital formation too has recorded a strong increase from SR123.3bn in 2000 to SR174.3bn in 2005 and is expected to grow at a much faster rate in 2006-08 periods.

The economic cities, discussed earlier, will constitute mega-construction projects of all types and is likely to spur allied real estate activity in the nearby regions.

Besides, Emaar Middle East (EME), a joint venture between UAE-based Emaar Properties and Saudi-based real estate company Al Oula Development, announced the development Jeddah Hills - a SR42bn (US$11.2bn) community located in the port city of Jeddah. The development marks the second major foray into Saudi Arabia for Emaar Properties, with the massive 2,286 hectare Jeddah Hills project following the announcement of the SR100bn (U$26.6bn) King Abdullah Economic City.

Dar Al Arkan Real Estate Development Company's Riyadh View is a SR6bn residential community with 8,000 housing units in Riyadh. The residential project, 100 kilometers outside the capital, Riyadh, will target middle class citizens and it will stretch over five million square meters of land. According to the company, Riyadh View project is in line with Dar Al Arkan's second phase of its strategic plan that was launched last year and which aims at developing 65,000 residential units by the end of 2009. Other high-end project include Al Bundoquiya Island development project over a massive 20.89mn square meters of land in Jeddah along the Red Sea coast. The project will stretch eight kilometers along the Red Sea coast and it will be a major mixed-use waterfront facility, involving the construction of 17 artificial islands and a series of inter-linking canals, bridges and culverts, including villas, shopping malls, leisure facilities, an 18-hole golf course, hotels, and a financial and business centre.

The SR12bn Jabal Omar real estate project in Makkah entered a new phase with the Cabinet approving formation of a joint stock company to carry out the project in 4Q-2006. Makkah Construction Company which holds the largest stake in Jabal Omar, said the project would provide housing facilities for more than 160,000 pilgrims. The project includes building of 40 residential towers, five-star hotels and commercial centers, construction of a road parallel to Um Al-Qura Road and parking for thousands of vehicles.

According to Habib Zain Al-Abidine, undersecretary at the Ministry of Municipal and Rural Affairs, some 25 new real estate projects are being carried out in the central region including Jabal Omar, Shamiya and Khandama projects. Economists say new real estate projects around the Grand Mosque will draw investments in excess of SR100bn (US$26.7bn). Jeddah Chamber of Commerce has estimated that the Kingdom requires at least a million new homes within the next five years.

According to Saudi Economic survey, Saudi Arabia intends to build one million new housing units in the next five years to provide adequate housing accommodation to about 5mn citizens, through participation by the governmental authorities, as well as national and welfare organizations. The Ministry of Social Affairs, and some welfare organizations are also building about 35,000 Saudi traditional houses in various regions of the Kingdom. The eighth development plan indicates that the private sector would undertake to build about 875,000 housing units to fulfill part of the demand for housing, in different regions of the Kingdom. Out of these housing units, about 225,000 would be built with the support and assistance of the government. The development plan also envisages provision of about 280mn sq. meters of residential land to meet part of the demand for housing, during the years of plan.

The new 2007 budget's capital expenditure which includes construction of 2000 new schools, opening of four new universities in Tabuk, Albaha, Najran, and Girls University in Riyadh; new university hospital (in addition to five university hospitals under construction); and building of 56 colleges, and opening of 19 new colleges. This will also provide fillip to the construction as well as contracting companies in the country.

Other major projects…

- Benaa City ($533mn)
- Jabal Khandama Real Estate Project in Makkah ($1.71bn)
- Jamarat Bridge Project ($1.28bn)
- Jowharah real estate project in Jeddah ($598mn)
- King Abdulaziz International Airport (KAIA) Expansion Project ($1.3bn)
- Meridian Hotel Towers in Makkah ($278mn)
- Asia-Africa bridge in Tabuk ($1bn)
- Saudi Construction Group's Housing Project on the outskirts of Riyadh ($16bn)
- Saudi Landbridge Project ($3bn)
- Wali Al Ahad Development in Makkah ($5bn).

Financing the real estate industry…

The government's intervention in housing provision dates to the mid-1970s with the formation of the Real Estate Development Fund (REDF) , which by 2006 had provided financing for some 613,000 housing units. In 2004 the fund was running low on capital and received a further SR9bn ($2.4bn) from the Saudi Arabia Monetary Agency. Another injection of the same amount was made in 2006, as the situation became more pressing. The REDF's current capital base stands at SR92bn (US$25bn). According to the Minister, 53,000 loans had resulted from the cash boost to the fund.

In major development, Saudi-based Dar Al-Arkan Real Estate Development Co. announced that it will form first housing finance company to take advantage of upcoming mortgage regulations. The firm, to be launched in the second quarter of 2007 with a capital of SR1bn is an alliance with Arab National Bank, the International Finance Corporation, the private sector arm of the World Bank, and Housing Development Finance Corp. of India. The company will develop mortgage finance in Saudi Arabia, a sector that is expected to grow rapidly when a new regulation governing mortgage foreclosure is approved by the government.

For a detailed discussion on the Saudi Real Estate Sector, please refer to our "Saudi Real Estate Sector Report "

Cement Sector

The Saudi construction sector with huge projects worth US$175bn believed to be already identified, and projects worth about US$120bn already announced, has, obviously, positive implications for the country's cement sector. The eight listed cement companies in the Kingdom have been operating at over-100% capacity utilization rates for the last two years to meet the booming domestic demand. While exports have reduced to almost a trickle, import duties have recently been withdrawn to enable freer cement movement into the country. Cement prices – both bulk and retail – have ruled at high levels for more than a year now. This state of affairs has led almost all the eight cement companies to launch capacity expansions, with work on most of them well underway. The near-doubling of capacities that should be going on stream in phases by 2008, have, purportedly, been planned in anticipation of a sustained high cement demand in the years to come.

Table 29: Saudi Arabia: Clinker Designed Capacities

(2006)	Capacity ('000 tpa)
Yamama Saudi Cement Company	2,750
Saudi Cement Company	4,350
Eastern Region Cement Company	3,300
Qassim Cement Company	1,500
Yanbu Cement Company	4,500
Arabian Cement Company	2,800
Southern Region Cement Company	3,500
Tabuk Cement Company	1,100
Total	**23,800**

*Source: www.yamamacement.com & **Global** Research*

In May-06, Eastern Province Cement launched the third clinker production line at, increasing the company's annual capacity to 3.3mn tons of clinker. The year 2007 is expected to see about 34% of the new capacities, or 29% incremental capacity, going on stream, while 2008 is likely to see the 46% of the new capacities, or 30% incremental capacity, going into production, including the single biggest capacity expansion of 6.6mtpy from Saudi Cement. The Western and Eastern regions currently dominate the Saudi cement capacities with a combined 56% of the total clinker capacities – 29% in the Eastern region and 27% in the Western. Post-expansions, the combined share of the two regions will go up marginally, with 32% and 26% share of the total capacities respectively. The capacity of the Eastern region is expected to jump up 7.6mtpy, or 36% of the new capacities – the single largest increase among all the regions in the Kingdom, or by 121% in absolute terms, on the back of a 6.6mtpy expansion (31% of the total projected capacity expansions across all companies) by Saudi Cement Company. The Northern and Southern regions' shares are likely to decline – from 6% and 18% respectively, to 4% and 12% respectively. The single-biggest gainer in terms of the percentage share of total clinker capacities is the Central region, whose share in the total capacities is likely to jump from 20% currently to 25%, or by 147% in absolute terms, by 2008. This is on the back of about 30% of the new capacities coming up in this region.

The situation is further complicated if we take into account industrial licenses issued/ renewed for additional cement capacities approximately worth about 40mtpy, involving an investment of over SR18bn. Out of these, projects amounting to about 11mt are believed to be in advanced stages of finalization. While how many of the other licenses will actually get on to the drawing boards and, thereon, to ground-zero is to be seen, it serves to show the enthusiasm for putting in large investments in the Saudi cement sector.

Table 30: Cement Production in Saudi Arabia

(mn tons)	Production			Local Deliveries			Exports			Stocks		
	2006	2005	2004	2006	2005	2004	2006	2005	2004	2006	2005	2004
Yamama Saudi Cement Co.	3,847	3,566	3,512	3,850	3,566	3,488	-	-	-	42	61	60
Saudi Cement Co.	4,961	5,003	4,705	4,011	4,086	3,838	965	928	819	107	124	136
Eastern Region Cement Co.	3,229	2,493	2,374	2,301	2,058	1,998	917	440	336	44	34	39
Qassim Cement Co.	2,230	2,226	2,169	2,229	2,218	2,161	-	-	-	36	34	37
Yanbu Cement Co.	3,521	3,742	4,256	3,489	3,722	4,271	-	-	-	91	59	39
Arabian Cement Co.	3,026	3,022	2,799	3,026	3,045	2,820	-	-	-	40	40	51
Southern Region Cement Co.	4,589	4,561	4,214	4,279	4,289	3,831	301	300	369	63	43	65
Tabuk Cement Co.	1,632	1,419	1,445	1,627	1,427	1,433	-	-	-	36	28	36
Total	**27,035**	**26,032**	**25,474**	**24,812**	**24,411**	**23,840**	**2,183**	**1,668**	**1,524**	**459**	**423**	**463**

Source: www.yamamacement.com

During 2006, cement production rose to 27.03mn tons as compared to 26.03mn tons in 2005. Domestic deliveries stood at 24.8mn ton (88.2% of production) as compared to 24.4mn tons in 2005 (93.6% of the total). Saudi Cement achieved the highest production numbers, clocking 4.9mn tons in 2006 as compared to 5.0mn tons in 2005. Southern Cement was the 2nd largest producer, producing 4.58mn tons in 2006, as compared to 4.56mn in 2005. Though the cement companies have plans to ramp-up their production levels, it will take some time and till then the demand supply gap need to be filled through imports. As a result of EPCC new clinker line coming on-stream this year, it recorded strong growth in cement production which reached 3.22mn ton in 2006 as compared to 2.5mn ton reported in 2005.

Table 31: Net Profit of Cement Companies

(SR mn)	2002	2003	2004	2005	2006
Yamama Saudi Cement Company	320.0	388.6	542.2	500.9	601.1
Saudi Cement Company	343.5	402.5	437.5	484.3	637.8
Eastern Province Cement Company	237.1	250.8	269.9	298.8	446.0
Qassim Cement Company	233.0	243.9	246.4	281.5	316.0
Yanbu Cement Company	303.4	377.9	427.7	453.6	512.2
Arabian Cement Company	187.6	210.6	306.4	330.9	333.6
Southern Region Cement Company	468.1	483.5	545.7	615.0	624.0
Tabuk Cement Company	78.8	75.7	128.6	154.8	218.0
Aggregate	**2,171.6**	**2,433.5**	**2,904.4**	**3,119.8**	**3,688.7**

Source: Zawya, Companies' Press Releases

The aggregate profit of listed cement companies in Saudi Arabia reached SR3.68bn in 2006, up 18.2% from SR3.11bn reported in the previous year. The highest growth was registered in Eastern Province Cement co which reported 49.2% growth in net profit in 2006 which can be attributed to increased production as it ramped up its capacity in 2006. With the increase in production due to the capacity increases planned in next couple of years, we expect profits of cement companies to show good growth. We believe that the new initiatives such as “Economic Cities’ will provide incentive to increase capacity which will translate to increased revenues and profits.

For a detailed discussion on the Saudi Cement Sector, please refer to our “Saudi Cement Sector Report ”

Banking Sector

The regulatory steps to enhance economic activity are likely to establish a solid base for sustained growth of the economy. The projects in the oil, gas, petrochemical, mining, transport, electricity & water sectors and infrastructure projects in housing, education, and health, would indicate the size and momentum of the economic expansion that will be accompanied by a notable rise in the per capita income. It is expected that the private sector will have a greater role in these projects and in the pace of the overall activity. Thus, the financial and banking sector is entering a very dynamic and exciting phase with acceleration in all areas.

Low penetration levels …

The ratio of credit deployment to GDP for Saudi Arabia is low as compared to other GCC countries. Oman has the lowest penetration level in terms of system credit to GDP. Saudi Arabia's ratio as at end 2005 is around 39% as compared to around 61% for Kuwait. For UAE, this ratio is around 70% and for Bahrain around 53%. In case of Qatar, this ratio is around 56%.

The penetration level in terms of deposit to GDP ratio for Saudi Arabia is also low. As at end 2005, this ratio stood at around 43% as compared to 64% for Kuwait, 63% for UAE, 66% for Bahrain and 68% for Qatar. Oman has the lowest penetration in terms of deposit to GDP ratio and as at end 2005, this ratio was around 32%.

Currently, 15 banks are operating in the Kingdom, including the branches of Gulf and foreign banks such as the Gulf International Bank, the Emirates Bank, BNP Paribas and Deutsche Bank. In addition, licenses were granted to several Gulf and foreign banks to open branches in the Kingdom. Also, the establishment of a new Saudi bank with a paid-up capital of SR15bn has been approved. Preparations are currently underway on finalizing the procedures of its establishment under the name of "Bank Al-Enmaa".

Saudi banking sector attracted foreign players, as three foreign banks namely, Deutsche Bank, JP Morgan Chase, and BNP Paribas were allowed to start operations in the Kingdom, further opening up the financial sector. Moreover, HSBC has been approved to establish an investment banking operation in Saudi Arabia. However, we expect that rather than the foreign banks, competition will be more from the newly set-up banks such as Al Bilad and Enmaa Bank.

In May 2006, Deutsche Bank launched its brokerage business on the Tadawul (Stock Exchange) in the Kingdom of Saudi Arabia. The bank's initial trade marks the first time a broker from outside the region has become a full member of the GCC's largest stock exchange. For the bank, broking business is an important addition to their product mix in the Kingdom. The bank envisages huge opportunities to contribute to the development of the Saudi market by launching equity finance, mutual fund, and corporate advisory and money market businesses.

Changing asset-liability structure…

During the period 2001-2005, total assets of the Saudi commercial banks grew at a CAGR of 12.6% to SR759.1bn by the end of 2005. Till Nov-06, the total assets reported YTD growth of 11.6% to reach SR846.9bn. At the end of Nov-06, claims on private sector accounted for 55.7% (2005: 57.4%) of total assets while foreign assets accounted for 14.9% (2005: 12%) of the total assets. Claims on private sector, which include credit to private sector and investments in private securities, increased at a CAGR of 23.6% for the period of 2001-05.

Table 32: Consolidated Balance Sheet of Saudi Arabian Banks

(SR mn)	2001	2002	2003	2004	2005	Nov-06
Assets						
Cash in Vault	3,453	4,892	4,257	4,474	7,201	7,236
Current Deposits	197	1,750	847	3,415	2,238	776
Statutory Deposits	12,599	14,270	15,465	19,090	21,039	23,112
Other Deposits	2,874	7,732	6,094	5,056	2,167	6,084
Foreign Assets	99,364	95,490	81,082	92,798	91,430	127,023
Claims on the Private Sector	187,064	205,829	228,486	313,928	435,926	471,899
Other Assets	166,881	178,274	208,976	216,621	199,074	210,808
Total Assets	**472,431**	**508,237**	**545,208**	**655,382**	**759,075**	**846,936**
Liabilities						
Business and Individual Deposits	126,829	147,029	163,831	199,285	208,041	221,085
Official Entities	3,364	2,981	3,747	11,886	11,210	13,085
Quasi Monetary	150,932	178,260	188,734	218,983	270,136	335,296
Total Deposits	281,125	328,270	356,311	430,154	489,387	569,466
Foreign Liabilities	59,614	42,999	40,063	45,748	65,040	57,127
Capital & Reserves	43,793	47,298	47,023	68,812	92,220	112,755
Other Liabilities	87,899	89,670	101,811	110,669	112,429	107,588
Total Liabilities	**472,431**	**508,237**	**545,208**	**655,383**	**759,075**	**846,936**

Source: SAMA

On the funding front, total deposits accounted for the largest portion of funding sources, over 67.2% at the end of Nov-06. This is a notable increase as deposits accounted for 64.5% of the total liabilities at the end of 2005. The reason can be attributed to investors shifting their investments from declining stock market to safer bank deposits. Total deposits have increased at a CAGR of 14.4% during the period 2001-05. The total deposits reported an YTD growth of 16.4% by Nov-06. Capital and Reserves increased at a CAGR of 26.7% in the period 2001-05 and further reported YTD growth of 22.3% by Nov-06 as banks increased their capital base.

Credit Facilities by Sector

The total domestic credit facilities stood at about SR452.5n at the end of 2005 which increased to SR490bn as on Nov-06 as the banks increased their thrust towards expanding their loan book. The maximum YTD increase in the credit facilities was seen in the commerce sector, which increased by 18.8%, from SR83bn in 2005 to SR98.7bn at the end of Nov-06. We believe that this sector will continue to record strong growth due to increase in trading activity as a result of economic growth, GCC Common Union and entry of Saudi Arabia into WTO. The other sectors that saw a major YTD increase in the credit facilities were: Building & construction (+15.4%) and Finance (+15.4%).

Table 33: Credit Facilities by Sector

(SR mn)	2001	2002	2003	2004	2005	Q3-2006
Agriculture & Fishing	2,138	2,530	2,549	3,785	6,716	6,568
Manufacturing & Processing	24,659	24,324	26,604	26,519	34,460	35,214
Mining & Quarrying	1,206	715	650	1,252	2,275	1,998
Electricity, Water and other Utilities	1,220	1,094	1,837	3,273	3,226	3,387
Building & Construction	16,746	20,982	21,955	23,057	31,726	36,609
Commerce	40,167	42,194	51,886	62,808	83,054	98,704
Transport & Communications	9,917	13,555	12,803	13,406	14,382	6,811
Finance	6,703	8,862	11,877	33,839	56,747	65,477
Services	9,514	9,718	8,839	12,337	15,097	16,299
Miscellaneous	64,534	74,724	82,124	122,722	173,146	185,078
Govt. & Quasi Govt.	10,817	11,960	25,844	29,138	31,672	33,906
TOTAL	**187,620**	**210,657**	**246,967**	**332,136**	**452,501**	**490,051**

Source: SAMA

Increased lending to the retail sector…

Miscellaneous sector was the largest sector constituting 37.8% of the total bank credit facilities. A major portion of this sector comprises of individual consumer credit. Banks have been concentrating to get the maximum portion of this sector on account of high growth, high profit margins and low risk. Consumer lending has been witnessing a strong growth backed by the positive demographic situation of the economy. Real Estate financing by the banks recorded a strong growth reaching SR13.8bn recorded at the end of 3Q-2006 compared to only SR3.3bn reported at the end of 2001. The strong growth in younger, urban population has direct bearing on credit card financing which show a steep growth from SR4.2bn in 2005 to SR6.8bn reported at the end of Q3-2006. This can also be attributed to increased number of credit card related products, services and promotions (both Islamic & conventional) that banks have undertaken to grab lion’s shares in this booming sector.

Table 34: Consumer Loans

(SR mn)	2001	2002	2003	2004	2005	Q3-2006
Real Estate Financing	3,295	4,506	5,191	8,790	13,656	13,821
Cars & Equipment	13,893	25,568	28,859	27,926	29,025	35,342
Other	21,259	22,800	39,255	78,590	137,846	135,000
Credit Cards	2,222	2,857	2,579	3,295	4,254	6,793
Total	**40,669**	**55,730**	**75,884**	**118,601**	**184,782**	**190,956**

Source: SAMA

Short-term credit facilities accounted for 55.9% at the end of Q3-2006 (55.4% in 2005) of the total credit facilities. Medium term and long-term credit facilities accounted for 12.7% and 31.3% respectively of the total facilities respectively. We believe that in the medium term, long term credit facilities will report a stronger growth as the longer tenor loan especially in the real estate sector gain popularity.

Table 35: Credit Facilities by Maturity

(SR mn)	2001	2002	2003	2004	2005	Q3-2006
Short Term	113,453	124,578	146,040	192,481	250,841	274,229
Medium Term	31,951	31,646	37,758	42,991	53,496	62,441
Long Term	42,216	54,433	63,170	96,664	148,164	153,380
Total	**187,620**	**210,657**	**246,968**	**332,136**	**452,501**	**490,051**

Source: SAMA

The Saudi banks have shown consistently high financial performance in the past decade. In the region, Saudi banks are among the most profitable and the combined net profit of the 10 listed Saudi banks and NCB reached a whopping US$9.42bn, recording the yearly growth of 30.3% in 2006. The fee from banking services especially broking income declined in 2006. We feel that core earnings are going to drive growth in net income in medium term. In order to support strong loan growth, resource mobilization will be the key. A strong deposit franchise is likely to result in deposit mobilization. This will further help banks to shore up their lending book, thereby increasing their core banking activities.

Table 36: Net Profit of Saudi Banks

(SR mn)	**2002**	**2003**	**2004**	**2005**	**2006**
National Commercial Bank	2,433.0	3,012.8	3,531.0	5,011.0	6,273.0
Banque Saudi Fransi	1,014.2	1,185.2	1,536.0	2,215.6	3,010.0
Al Rajhi Bank	1,413.2	2,038.1	2,936.0	5,633.3	7,302.0
Arab National Bank	584.0	766.5	1,167.0	1,827.6	2,505.0
Bank Al Jazira	59.2	93.5	187.7	874.4	1,974.0
Riyadh Bank	1,416.4	1,591.7	2,006.0	2,937.3	2,910.0
Saudi American Bank	1,857.3	1,436.6	2,506.0	4,018.3	5,200.0
Saudi Hollandi Bank	555.2	600.9	742.7	1,051.9	953.0
Saudi British Bank	972.5	1,257.9	1,636.0	2,504.3	3,040.0
The Saudi Investment Bank	380.4	463.9	587.1	1,064.2	2,006.0
Bank Al Bilad	-	-	-	-	178.0
Total	**10,685.2**	**12,447.0**	**16,835.5**	**27,137.9**	**35,351.0**

Source: Zawya, Banks' websites

Saudi banking sector outlook….

We believe that banking sector in the country is on the threshold of a new era, where foreign banks are likely to give tough time to local banks. The growth opportunities are abound in the region for players who are willing and ready to meet the challenges. Some of the areas ready to be tapped are affluent banking, small to medium enterprise (SME) banking, upper-mass banking for the growing middle class, banc-assurance, mortgages, and Islamic banking. That's good news for banking customers, investors, and banking and finance professionals from all over the world with a stake in the growth market. Seeing how closely the country's banking sector is connected to the economy of Saudi Arabia, this is good news for the economic growth too.

The bond market is also estimated to grow and provide more liquidity to the Saudi banks in terms of corporate bonds. The growth of the Islamic investment avenues will act as a strong motivator for the investors to invest their money in these instruments. We are optimistic about the economic profile of Saudi Arabian economy in the future in view of the comfortable risk profile and attractive investment opportunities that the economy offers. Investment spending and liquidity will remain at high levels, which will be conducive to the growth of the banking sector. We expect the banks to continue investing heavily in the adoption of new technology platforms and international best practices which should lead to better customer services.

Although the core earnings growth of the banks remains strong, the increased proportion of the investment income/one time gains makes the future earnings of the banks volatile. Currently, banks are working closely with SAMA in the implementation of the Basel II Capital Accord. We expect all banks operating in Saudi Arabia to implement the standardized approach for credit risk by 1 January 2008 and then continue to move towards more sophisticated Internal

Rating Based approaches. For operational risk all banks are likely to move to standardized approach with one or two banks experimenting with the Advanced Management approaches. SAMA is also encouraging banks to consider a National Data Pooling initiative to help them in credit risk management. Saudi banking system is well on its way to the implementation of Basel II and we expect that banks will remain highly capitalized under the new standard. It is worth mentioning that SAMA's approach in applying Basel II Accord is an integrated one aimed at raising the level of risk management in order to maintain the continued strength of the banking system.

For a detailed discussion on the Saudi Banking Sector, please refer to our "Saudi Banking Sector Report "

Telecom Sector

Competition in fixed-line segment also….

Saudi Arabia's Communications and Information Technology Commission (CITC) has announced plans for liberalizing the telecom sector. Around eight consortia, comprising Saudi and foreign investors and specialized international companies, are vying to win the Kingdom's second fixed-line phone license and third mobile phone license. The Kingdom's telecom regulator extended the deadline for submitting applications for the new mobile license to February 24, 2007 and for the fixed-line license to March 10, 2007 in response to requests from several interested parties. The new licenses will break the monopoly of STC on landline phone services and add at least a third mobile phone operator.

Since rolling out its service in early 2005, STC's competitor in wireless segment, Mobily, achieved rapid growth underscoring the Saudi market's immense potential in telecom field. In Oct-06, Mobily announced that it has started the third phase on the network expansion which aims to cover the villages, suburban areas and roads between villages that have not been covered by its independent network. Mobily is working with four major international vendors to install one of the fastest growing networks in MENA. The Four companies are Ericsson, Alcaltel, Motorola & Huawei. Mobily is also interested in the land-line license which would diversify its investment.

The anticipated increase in the competition has benefited the customer in terms of decline in the call rates and lower initial fee to be paid to the telecom companies. Recently, STC fixed line business unit Alhatif has slashed the local and national calling rates by up to 50%. Alhatif has not only drastically reduced the national intercity calling rates but made the pricing simpler by eliminating the peak off-peak and distance bands.

Kuwait's Wataniya International (International arm of NMTC, Kuwait) also announced its investment in Public Telecommunication Company (Bravo) as a 38% shareholder and will manage the operations of a digital trunked network utilizing Motorola's iDEN push-to-talk technology. NMTC recently increased its stake from 38% to 47%. Bravo has a 15-year build-own-transfer contract for a wireless push-to-talk service in the Kingdom.

3G services gaining popularity….

In the intent to attract one million digital subscriber line (DSL) high-speed internet customers by end of 2007, Saudi Arabia initiated a 37% reduction of DSL connection and operational fees. After getting the approval of CITC, Saudi Telecom (STC) started offering low rates on internet connections to Internet Service Providers (ISPs) in the Kingdom. It is estimated that the total number of DSL subscriptions in Saudi Arabia reached 80,000. STC is currently installing around 3,500 lines weekly, estimating the DSL subscriber's base to reach 500,000 by year end and one million by end of 2007. CITC granted a 3G mobile license to STC in July 2005 for SR753.7mn. Saudi Arabia was ranked first in the Middle East in the usage of 3G telecommunications technology. The International Mobile Satellite Organization said in its third quarterly report for 2006 that KSA's users of 3G technology reached 335,600 out of 4.7mn clients in Mobily and 250,000 users out of 12mn subscribers in STC.

Saudi Telecom's 74% of its revenue came from mobile services in 2005. STC, in July-06, has renewed its network use agreement with Etihad Etisalat (Mobily) for another three years. Based on this agreement, STC will provide mobile network coverage services nationwide to Mobily customers at areas not yet covered by the Mobily network. The agreement covers all regions and major and minor road not covered by the Mobily network in various parts of the Kingdom. It will bring STC approximately SR3bn in revenue over the next three years. The agreement will avail customers of both companies of common communication with a full coverage to Mobily customers. STC has more than 4,000 base stations (towers) at various cities and provinces of the Kingdom not currently covered by Mobily. Moreover, it will be possible, under the agreement, to use the STC network in over 3,000 villages and provinces in addition to more than 20,000 km of main and minor roads connecting major cities and provinces covered by STC but not yet served by the Mobily network.

In a major development in the telecom industry, three major telecom companies have formed a strategic partnership to lay the latest fiber optic network at an estimated cost of SR1bn. The 12,000 km-long project will be implemented in two phases over the next two years and will cover most of the country. Etihad Etisalat (Mobily), Integrated Telecom Company and Bayanat Al-Oula for Network Services have entered into a partnership to build, deploy, and operate the state-of-the art fiber optic network.

We believe that the next few years will see tremendous growth in terms of mobile penetration in Saudi Arabia. The key drivers for this growth will be:

- Increasing demand for mobile communication among younger generation.
- Increasing competition in the local market driving down the usage cost.
- Increasing economic activities in the country requiring telecom infrastructure support.
- Government's intention to liberalize various sectors as part of joining WTO.

The per capita GDP, average personal income levels, population profile of Saudi Arabia, booming business activity in the country, competition in the market, lifestyle factors, etc. are all promising factors which are likely to propel the penetration level in the country.

For a detailed discussion on the Saudi Telecom Sector, please refer to our "Saudi Telecom Company" Research Report

Saudi Stock Market Performance

After the strong growth seen in 2003-05 period, Saudi market underwent a correction and ended the year 2006 at 7,933.3 points, down a whopping 52.5% over the 2005 close of 16,712.64 points. The biggest market of the GCC region was the biggest decliner in 2006. It witnessed strong volatility this year as it touched a high of 20,634.86 points on Feb 25, 2006 and low of 7665.73 points recorded on Dec 3, 2006. The market capitalization at the end of the year reached US$326.3bn. (2005: US$645.9bn). SABIC continued to be the index-heavyweight, accounting for 21.5% of the total market capitalization followed by STC and Al Rajhi Bank which accounted for 13.5% and 10.6% of the total market capitalization.

Table 37: Stock Exchange Performance by Sector Indices

Index	2002	2003	2004	2005	2006	Growth -2006
General	**2,518.1**	**4,437.6**	**8,206.2**	**16,712.6**	**7,933.3**	**-52.5%**
Banking	7,741.9	10,080.4	19,866.9	40,766.1	23,367.2	-42.7%
Industry	3,220.6	6,476.6	16,189.0	41,105.1	16,043.6	-61.0%
Cement	3,227.7	4,129.9	5,632.7	10,561.3	5,696.9	-46.1%
Services	794.7	1,252.2	2,132.3	6,429.3	2,044.3	-68.2%
Electricity	837.9	2,066.3	2,724.6	2,969.5	1,323.9	-55.4%
Telecommunication	-	2,486.9	3,738.1	5,667.1	3,115.3	-45.0%
Insurance	-	-	-	1,947.5	1,456.9	-25.2%
Agriculture	575.3	1,041.3	2,205.8	8,495.9	3,345.9	-60.6%

Source: Saudi Stock Exchange

In terms of trading activity during the year, the total value of shares traded for the year 2006 reached US$1,402.8bn as compared to US$1,103.7bn recorded in the previous year, registering a yearly increase of 27.1%. The aggregate volume of shares traded on the bourse reached 54.4bn shares in 2006 as compared to 12.3bn shares registered in the previous year. However, it will be incorrect to compare the volumes for both the years as in April-2006 came a new regulatory development with the regulator reducing the par value of shares from SR50 to SR10 to increase liquidity and entice retail investors. This also resulted in increasing the number of transaction in the 2006 to reached 96.1mn as compared to 46.6mn trades recorded in 2005.

Table 38: Market Capitalization by Sector

SR bn	2002	2003	2004	2005	2006
Banking	132.3	176.2	347.8	773.3	445.3
Industry	66.4	134.1	355.0	920.3	393.1
Cement	33.6	43.0	58.6	109.9	59.3
Services	13.5	23.0	41.0	124.2	68.8
Electricity	33.7	84.4	111.2	121.2	54.2
Telecommunication	-	126.8	228.3	348.4	191.5
Insurance	-	-	-	7.0	5.3
Agriculture	1.4	2.5	5.4	18.9	8.5
Total	**280.9**	**589.9**	**1,147.4**	**2,423.2**	**1,225.9**

Source: Saudi Stock Exchange

In terms of sectoral trading, services sector accounted for 36.8% of the total volume traded during 2006 while industrial sector accounted for 40.4% of the total value of shares traded on the Saudi stock exchange. In terms of companies Saudi Electricity Company led the market with 5.19bn shares traded during the year, followed by Anaam Holding, formerly Al Mawashi Al Mukairish United Co. (4.13bn) and Arriyadh Development Company (1.76bn). SABIC was the market leader in term of value of shares traded with the aggregate value of shares traded in 2006 reaching SR230bn followed by Saudi Electricity Company (SR204.6bn) and Anaam Holding (SR172.2bn).

Table 39: Volume of Shares Traded by Sector

mn shares	2002	2003	2004	2005	2006
Banking	77.9	87.1	95.1	271.5	1,135.4
Industry	372.9	1,278.5	2,967.9	4,158.9	18,348.1
Cement	126.6	88.0	119.2	266.4	1,066.7
Services	929.4	2,303.5	4,178.1	4,094.4	20,058.3
Electricity	143.3	1,266.6	1,557.3	1,403.3	5,193.2
Telecommunication	-	323.5	294.4	420.3	894.1
Insurance	-	-	-	111.7	129.7
Agriculture	85.7	218.6	1,086.3	1,554.8	7,614.2
Total	**1,735.8**	**5,565.9**	**10,298.3**	**12,281.3**	**54,439.7**

Source: Saudi Stock Exchange

Among the individual stocks that witnessed increased trading activity in the year 2005, SEC led the market as it saw 1.4bn shares changing hands in 2005 followed by Saudi Livestock (0.99bn) and Qassim Agriculture (0.61bn). Among the aggregate value of shares traded on the exchange in 2005, SABIC, the index heavyweight, led the market with the aggregate value traded of SR395.7bn followed by STC which reported SR205.2bn value traded in 2005.

Table 40: Value of Shares Traded by Sector

(SR bn)	2002	2003	2004	2005	2006
Banking	26.0	35.7	53.0	238.3	294.8
Industry	32.5	171.6	624.6	1,854.4	2,124.6
Cement	27.6	21.9	43.2	168.9	205.6
Services	33.8	146.6	547.2	976.9	1,523.9
Electricity	11.2	107.1	211.1	184.1	204.7
Telecommunication	-	105.1	160.2	296.3	199.7
Insurance	-	-	-	61.4	31.8
Agriculture	2.7	8.5	134.6	358.4	676.8
Total	**133.8**	**596.5**	**1,773.9**	**4,138.7**	**5,261.8**

Source: Saudi Stock Exchange

However, the strong sell-off seen in the secondary market did not wane investors' as well as corporates' interest in the primary markets. Nine new companies got listed on Saudi bourse which increased the total number of listed companies to 86. In Dec-06, two companies, Al-Babtain Power & Telecommunication Co. and Fawaz Abdulaziz Al Hokair Co. were listed. Advanced Polypropylene Co. was listed in Jan-07, and Al Abdullatif Industrial Investment was listed in Feb-07, increasing the depth of Saudi market further. The market is trading at a P/E of 15-17x and some of the stock look really cheap and will attract investors' attention.

Table 41: Saudi Stocks- Monthly Trading Snapshot (2006)

	Total Volume Traded	Total Value Trade (US$)	Market Cap (US$)	No. of Transactions
Jan-06	1,150,985,120	168,063,033,333	726,149,319,524	6,585,540
Feb-06	1,456,422,292	220,900,676,671	772,758,338,476	9,572,035
Mar-06	638,913,681	92,350,925,470	665,346,513,244	4,419,577
Apr-06	3,477,656,820	97,435,964,911	517,801,483,203	7,011,436
May-06	6,728,946,569	103,824,091,877	444,916,004,623	9,239,543
Jun-06	8,638,459,099	154,102,923,398	523,839,088,394	12,105,358
Jul-06	6,270,494,476	114,388,587,447	434,369,754,876	9,027,051
Aug-06	6,439,382,648	123,871,318,983	444,611,333,440	9,173,864
Sep-06	6,250,619,180	136,446,540,807	455,642,330,229	9,593,386
Oct-06	3,742,659,106	77,022,681,001	395,655,779,156	6,839,857
Nov-06	4,447,852,871	60,184,575,372	340,725,613,805	6,595,717
Dec-06	4,339,585,697	45,371,143,243	326,294,862,926	4,978,105

Source: Saudi Stock Exchange

For a detailed discussion on the monthly happenings in the Saudi Stock Market, please refer to our monthly "GCC Market Review".

Corporate Earnings

The aggregate earning of the Saudi corporates was SR75.9bn in 2006, up 18.1% as compared to the previous year. With the stock market giving fabulous returns in 2005, Saudi corporates had a major chunk of profit coming through investment income/gains. This strong point of fabulous stock market investment returns which helped companies registered strong profitability became the Achilles heal in corporate profits in 2006. The market decline had severe impact on select firms such as Anaam International Holding Group Co. & Bishah Agriculture which led to Capital Market Authority suspending trading in those firms as they had accumulated losses amounting to 95% of their capital.

Table 42: Corporate Earnings

(SR mn)	**2003**	**2004**	**2005**	**2006**
Banking	9,434.6	13,303.3	21,613.8	29,073.8
Industrial	8,548.2	17,199.0	24,466.0	26,194.5
Cement	2,433.5	2,904.4	3,119.8	3,688.7
Services	892.3	1,212.5	1,576.7	1,468.1
Electricity	1,487.5	1,431.1	1,482.9	1,398.0
Telecommunications	8,525.3	9,314.0	11,280.0	13,499.0
Insurance	44.9	187.7	313.0	468.0
Agriculture	25.3	114.7	470.3	206.8
Total	**31,391.6**	**45,666.7**	**64,322.5**	**75,996.8**

Source: Zawya, Press Releases

However, it should be noted that 2006 profits have been registered on the back of core business activities of the corporates. Banking sector managed to show strong growth of 34.5% in 2006 as well, although it was a bit subdued compared to 62% growth in net profit recorded in the previous year. In 2005, owing to the spectacular return provided by the stock markets, broking income and investment income for the banking sector recorded a jump which was not there in 2006. Overall, the banking sector accounted for 38.3% of total listed companies 2006 profits (2005: 34%), as other sector showed greater decline in profit growth. However, core banking continued to grow as the banks increased their lending activity and the spreads increased due to rising interest rates.

The insurance sector, comprising of only one listed company, NCCI, registered a yearly growth of 49.5% in net profit as it reached SR468mn in 2006. This growth came on the back of exclusion of exceptional revenue of SAR548.89mn from the 2005 result. Saudi Arabia recently decided to change driving license insurance into vehicle insurance and authorized all licensed insurance companies in the country to provide the new mandatory third-party vehicle insurance service. We believe that with more companies coming in the sector coupled with changes in regulations, insurance sector in Saudi Arabia is set for strong growth in the medium term.

Among the utilities, telecom sector too witnessed a yearly growth of 19.7% which was mainly due to the new telecom operator Etihad Etisalat reporting a net profit of SR700mn in 2006 as compared to a net loss of SR1.16bn reported in the previous year. However, telecom heavyweight STC reported a modest growth of only 2.8% in 2006 as it reduced its call rates in order to attract and retain customers. We believe that with the increase in penetration rates in the country, overall volume of telecom companies will grow which will positively effect the bottom-line. However, this will be offset by the reduced ARPUs as they reduce their product prices to increase their market share. Other major company, SEC reported declined in its net profit as it reached SR1.39bn in 2006 as compared to SR1.48bn registered in the previous year.

SABIC, the market leader in terms of market capitalization led in terms of net profit too as it made a record net profit of SR20.3bn in 2006 compared to SR19.2bn reported in the previous year, registering a six percent increase. SABIC alone accounted for around 26.7% of the total profit of Saudi listed companies. We believe that SABIC will continue to record firm growth on account of firmness in the prices of petrochemical and increased business on account of inorganic growth. SABIC recently completed the acquisition of the Huntsman's UK base chemicals and polymers business for a purchase price of US$685mn which is expected to add to its overall revenue and profit growth.

The Saudi corporate sector especially the blue-chip companies have rewarded their investors with liberal dividends. We believe that the corporate profitability will continue to show good growth in 2007-08 as the economy moves ahead backed by spate of reforms, improved regulations, increased liquidity and trickle down effect of mega-projects underway in the country.

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