جدوى للإستثمار
Jadwa Investment

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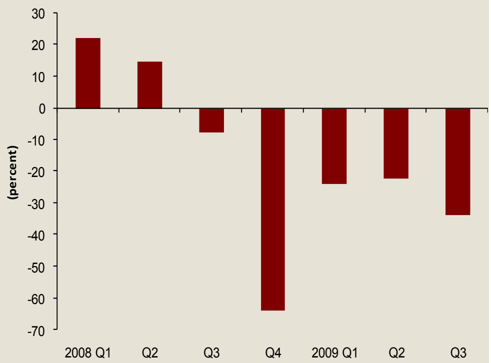
Monthly Bulletin

TASI continues to lag

The TASI continues to underperform global markets despite reasonable third quarter results and improving economic conditions. Annual earnings per share growth in the third quarter fell by 33.8 percent, the largest decline since the final quarter of last year. In quarter-on-quarter terms earnings growth also deteriorated, to -18.9 from 11.7 in the second quarter. This decline reflects seasonal factors, given that the third quarter includes the peak holiday season, very hot weather and, at present, Ramadan. Nonetheless, since the end of October the TASI has underperformed the US S&P 500 and the MSCI emerging markets index by around 5 percentage points.

Only three sectors recorded year-on-year earnings per share growth: insurance, utilities and retail. The large growth in the insurance sector reflects the expansion of operations and move into profitability of many of the new insurance companies that have been launched over the last few years. The utilities sector is dominated by the Saudi Electricity Company, which generally has a strong third quarter, as the summer is the peak time for energy consumption, notably by air conditioners. For retail the growth in part reflects a reduced burden from inflation, which was rapidly eroding consumers' disposable incomes in the third quarter of 2008, though the growth is concentrated in two companies; others recorded large declines in earnings.

Annual earnings per share growth



Petrochemicals was the worst performing sector, owing to the impact of the global recession on demand and prices. Ethylene prices were 30 percent lower in the third quarter of this year than in the third quarter of 2008, when they hit an all-time high. Profits at Sabic were down by 50 percent in year-on-year terms, though this was better than most analysts' expectations. With the prices of most petrochemical products well above their levels for the fourth quarter of last year, the sector is likely to be one of the fastest growing in the final quarter. The two smallest sectors on the TASI, hotels and resorts and media and publishing were the second and third worst performers in the third quarter.

Earnings per share in the third quarter were 18.9 percent lower than in the second quarter. The worst performing sector was hotels and tourism. While this sector benefits from the seasonal trend, it was affected by one company booking large revenues from a one-time land sale in the second quarter. The sharp decline in earnings per share by cement companies is because this industry is more affected than most by seasonal conditions given that hot weather makes cement difficult to work with (as it sets very quickly) and affects the working hours for those operating outdoors. The best performing sectors on a quarterly basis were the same as those that reported the strongest year-on-year results.

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Earnings per share growth

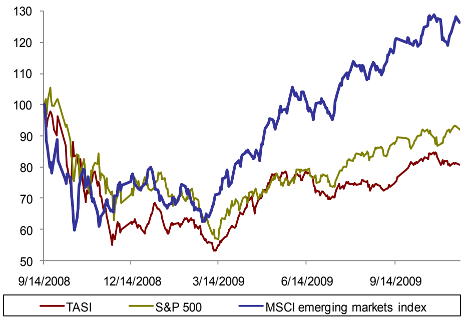
Quarterly change

Sector	(percent change)
Banks	-6.1
Petrochemicals	-8.7
Multi-investment	-10.9
Building & construction	3.5
Energy & utilities	143.3
Industrial investment	17.1
Cement	-61.5
Real estate	-9.0
Transport	-9.8
Media & publishing	2.8
Hotels & tourism	-96.3
Retail	2.6
Telecoms	-4.3
Insurance	25.2
Agriculture & food	36.6
TASI	**-18.9**

Annual change

Sector	(percent change)
Banks	-26.3
Petrochemicals	-75.5
Multi-investment	-
Building & construction	-31.8
Energy & utilities	16.2
Industrial investment	-38.1
Cement	-48.6
Real estate	-44.3
Transport	-42.4
Media & publishing	-71.9
Hotels & tourism	-70.5
Retail	11.8
Telecoms	-0.2
Insurance	150.5
Agriculture & food	0.0
TASI	**-33.8**

Relative stock market performance
(September 14, 2008 = 100)



Initial market response to the third quarter results was favorable and the TASI maintained its upward momentum during the first three weeks of October (when the bulk of the results were announced). Subsequently the market has fallen back and has again failed to respond to an upward trend in global markets. We think the following factors are currently holding back the Saudi market:

- **Tough credit environment:** Concerns about the fallout from high profile financial difficulties at two local businesses remain. Banks increased provisioning for bad debts by SR1.7 billion in the third quarter and remain cautious about lending; credit to the private sector was up in September, but only by 0.5 percent.

- **Corporate selling:** We think that some companies have taken advantage of recent gains in the market to sell in order to raise funds. Corporations were large net buyers in October, with total purchases of SR4.17 billion versus total sales of SR2.36 billion, but we have questions over the comprehensiveness of this data. Furthermore, publically available data show that some large shareholders are gradually reducing stakes in listed companies.

- **Weak dollar:** Low US interest rates and the prospect of currency gains are encouraging international investors to borrow in dollars to finance investments in higher yielding assets, including many emerging market stock markets, but the exchange rate peg and restrictions on foreign investment mean these flows are having little impact on the Saudi market. In addition, dollar weakness has reawakened concerns about inflation in the Kingdom.

- **Tensions with Yemeni rebels:** The TASI has moved sideways since an armed incursion into Saudi territory by Yemeni rebels in early-November. Although the tensions are not notably affecting the operations of listed companies or the economy in general, it seems likely that they have unsettled some investors.

A lack of confidence continues to hold back the Saudi market. At present, the market has a far greater response to falls than rises on global markets. Economic conditions are improving, but without greater investor confidence the market will struggle to make significant gains over the remainder of the year.

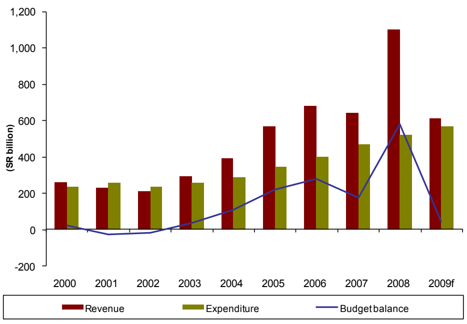
Economy watch

Budget surplus expected this year

With around a month of the year left and oil prices (WTI) holding above $75 per barrel, we have nudged up our forecast for oil prices this year. As a result, we now expect the Kingdom to record a budget surplus and smaller than previously expected current account deficit.

So far this year WTI has averaged $60 per barrel. With WTI above $75 per barrel for the past month and likely to remain around this level for the remainder of the year, we have raised our oil price forecast and adjusted our economic forecasts accordingly. Based on the assumption that WTI averages $75 per barrel for the remainder of the year, we have increased our oil price forecast to $62 per barrel from $58 per barrel (for Saudi crude the rise is to $60.8 per barrel from $55.7 per barrel, in part reflecting a lower discount to WTI).

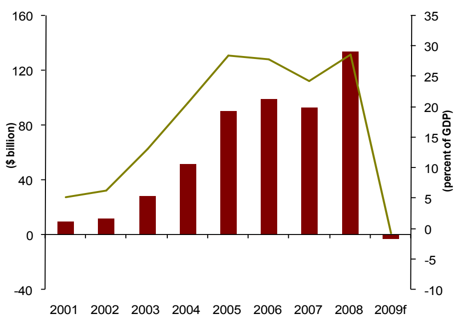
Budget balance



The key change to our forecast caused by the higher oil price is that we now expect a budget surplus (of SR46 billion; 3.4 percent of GDP), compared to a budgeted deficit of SR65 billion. We estimate that the budget was based on an oil price of $48 per barrel and production of 8.1 million barrels per day. Oil prices are much higher than this assumed level yet the surplus is only expected to be relatively small. We think this is because spending is running well ahead of target. It is important to note that not all public sector spending is captured in the budget numbers. For example, spending by Aramco reduces the amount of oil revenues transferred to the government budget and is not classed as government spending.

Although we expect the government to have greater revenues, we have not altered our projection for government spending. This is because the government was already spending very aggressively in order to stimulate the economy and was comfortable financing this by drawing down reserves, if necessary. The additional revenues we are anticipating are not large enough to impact on the five-year spending program the government is currently pursuing. Government spending has been the main stimulus to the economy so far this year, but activity outside of those firms directly benefitting from this has been sluggish owing to problems accessing credit.

Current account balance



Higher oil export revenues have improved the outlook for the current account. Nonetheless, we still expect a slight current account deficit this year (of 0.8 percent of GDP). This will be the first deficit since 1998, but at such a small size it does not pose a problem for the Kingdom. A modest downward adjustment to our import forecast has also contributed to the slimmer current account deficit forecast. Imports were down by 16 percent over the first eight months of the year compared with the same period of 2008. For August alone, the decline was 29 percent; the largest monthly import total of last year was recorded in August, largely due to very high commodity prices. Non-oil exports are down by 22 percent over the first eight months of the year compared with January to August 2008.

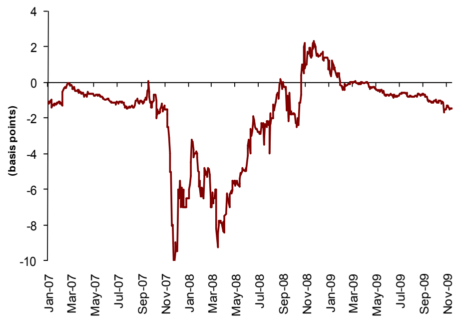
We have also lifted our oil price forecast for 2010 to $75 per barrel from $70 per barrel, reflecting the higher base. As a result of this higher forecast we now expected the current account to be in surplus and a budget surplus of over 8 percent of GDP.

In brief: Economy

Annual change in food prices
(IMF food price index)

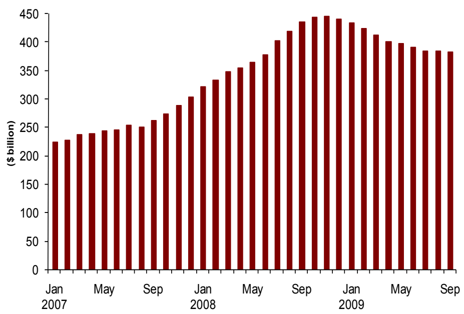
Year-on-year inflation is likely to have hit its bottom for the year of 3.5 percent in September. The current rate is the lowest since June 2007 and September was the tenth month out of the last 12 in which the inflation rate fell. We expect inflation to pick up in the coming months owing to the impact of the plunge in commodity prices and the fall in the dollar on the annual comparison. For example, although food prices (as measure by the IMF index) are 26 percent below their peak of last year, they are 2 percent above their level of one year earlier. The same trend, although of a different magnitude, is also true for transportation costs and the dollar (and therefore import prices).

One-year riyal forwards



Exchange rate forwards (which measure what the market expects the exchange rate to be in one year) recently hit their highest level in over a year. This may be an early sign of renewed pressure on the exchange rate peg. Some of the arguments used by those betting against the peg in late-2007 and early-2008 are again becoming more relevant. Notably, the US has consistently emphasized that interest rates will remain exceptionally low for a sustained period. In contrast, the Saudi economy is strengthening and will pick-up further next year, creating a divergence in interest rate needs between the Kingdom and the US. In addition, recent dollar weakening is adding to inflationary pressures. If pressure against the peg does materialize it will probably not be until the second half of next year. We do not foresee any change to the riyal's peg to the dollar.

SAMA net foreign assets

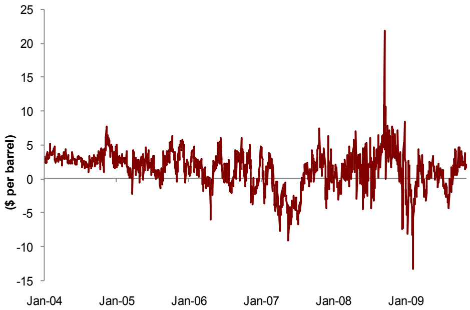


Although SAMA net foreign assets fell again in September, the Kingdom's overall reserve position was broadly unchanged. Movements in SAMA net foreign assets are generally determined by oil revenues. However, last month they slipped by $1.9 billion to $380.5 billion despite healthy oil prices. This was the result of the deposit of funds at the IMF. Since the end of July the Kingdom has subscribed to two new allocations of special drawing rights (SDRs; the IMF's unit of account) undertaken to raise the value of funds the IMF has to lend. These have increased the Kingdom's holdings of SDRs to $11 billion from $748 million in July. SDRs are categorized as official reserves rather than SAMA foreign assets.

Remittances from Saudi Arabia to Pakistan

Rising remittance outflows illustrate that the number of expatriate workers in the Kingdom has continued to increase. Pakistan is the only country of the Kingdom's main labor suppliers that breaks down remittance receipts by country of origin. Remittances into Pakistan from Saudi Arabia for the first 10 months of the year averaged $141 million per month, 20 percent higher than in the same period of last year. Data is available for the Philippines, but not broken down by country. This shows that the growth in total expatriate remittances to the Philippines has fallen significantly this year, to just 3.7 percent in the first eight months compared with the same period of 2008, versus a rise of 13.7 percent for the whole of 2008.

Differential between WTI and Brent



Oil market watch

Kingdom changes oil pricing formula

The Kingdom has modified its oil pricing formula. The move is technical and will not have a notable impact on total oil revenues. However, it may reduce modestly the volatility of oil revenues and should assist with the pricing strategy of Saudi Aramco.

Saudi Arabia does not sell its oil exports at a single price. Rather, 17 different prices are charged, depending on the grade of crude and where the consumer is based. Saudi Arabia sells five different grades of crude oil. Furthermore, it prices its oil to benchmark prices in four locations: North America, North West Europe, Mediterranean and the Far East (though one grade is only sold to the Far East).

In each case discounts or premiums to a benchmark price are set around three weeks in advance for sales that take place the following month. The Kingdom announced earlier this month that from January it will change its pricing benchmark for sales to North America from WTI, which it has been using since 1994 to the Argus Sour Crude Index (ASCI; which was launched in May 2009). This reflects a variety of issues afflicting WTI that have become more problematic in recent years.

Although WTI is one of the most widely used oil price benchmarks, it is a light sweet (meaning low sulfur content) crude oil and its price is just the price of light sweet oil delivered at Cushing, Oklahoma, a key oil supply hub. This leaves the WTI price vulnerable to factors specific to that location. Recently, WTI has been affected by a shortage of storage and pipeline capacity and refinery maintenance, which have periodically altered its relationship with other crude benchmarks such as Brent. WTI generally trades at a small and reasonably consistent premium to Brent, but over the past 18 months the premium has been volatile. With Aramco setting its pricing formula in advance, this volatility complicates pricing strategy. In addition, a lack of physical storage space has at times caused a sharp divergence to open between spot and forward prices.

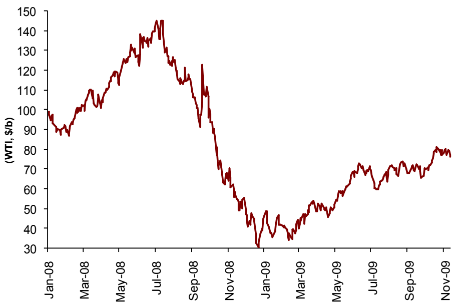
Another rationale for changing the benchmark is that the bulk of Saudi crude now sold to North America is sour. ASCI is comprised of a basket of three US Gulf Coast sour crudes, while WTI is a sweet crude and therefore less representative of the Saudi export blend. Previously, Aramco had to include a projection for the differential between the price of sweet and sour crudes when setting its prices.

Finally, WTI futures contracts are the most active financial instrument for oil and the investment flows it attracts may introduce additional volatility. Derivatives contracts are not yet available on the ASCI (though several are planned), so changing the benchmark could potentially reduce the impact of financial flows on the price Saudi Arabia receives for its oil.

Using the new benchmark will eliminate some of volatility caused by local developments at Cushing and perhaps by investor use of financial contracts on WTI. The Kingdom sells around 1 million barrels against the new benchmark out of current production of 8.2 million barrels per day and global consumption of 85 million barrels per day. It will not have a noticeable impact on international oil prices and we have not altered our oil revenue forecasts.

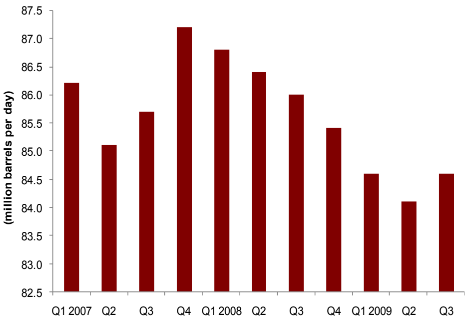
In brief: Oil market

Oil price



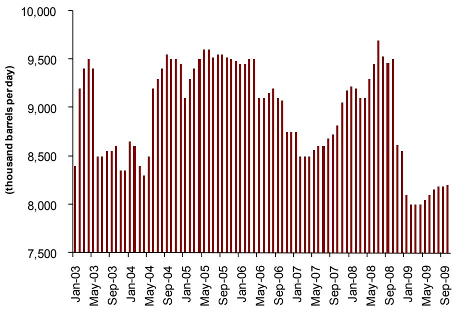
Oil prices have stabilized over the past month at just below the 13-month high of over $80 per barrel they hit in late October. Supply (both from Opec and non-Opec) and demand have both risen and the dollar has been relatively stable (as oil prices are denominated in dollars, investors buy oil to preserve the value of their dollars when it is falling against other currencies). We anticipate that all these trends will continue over the remainder of the year and accordingly have revised up our oil price forecast (WTI) for 2009 to $62 per barrel from $58 per barrel.

Global oil demand



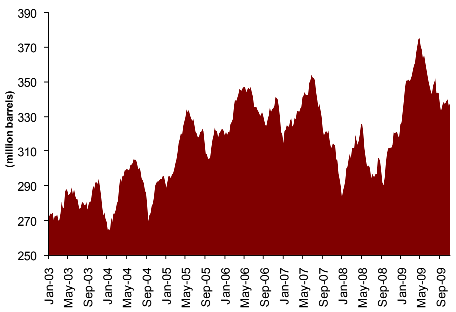
Oil demand continues to pick up in line with the improving global economy. According to the International Energy Agency, oil demand rose in the third quarter, the first quarterly rise since the third quarter of 2007, and is set to go up further in the fourth quarter, resulting in the first year-on-year growth in demand since the second quarter of 2008. Asia (particularly China) and the Middle East remain main source of demand growth. For the whole of 2009, the IEA projects oil demand of 84.8 million barrels per day, a decline of 1.5 million barrels per day on 2008 (in April the IEA was projecting a decline of 2.6 million barrels per day).

Saudi oil production



The Kingdom's oil production has continued to gradually rise. Unofficial estimates put it at 8.2 million barrels per day in October, up from a seven-year low of 8 million barrels per day in April. Production has been creeping up throughout Opec (compliance with agreed quotas was around 65 percent last month) though this has yet to affect oil prices, which have been in excess of the $75 per barrel level considered "fair" by the Kingdom for virtually all of the last five weeks. Aramco has indicated to some customers in Asia that it will increase shipments in December, pointing to a further increase in production. However, we do not expect a formal change to Opec's production quotas at its late-December meeting in Angola.

US crude stocks



Oil and oil product stocks have generally fallen slightly, but remain high on an historical basis. Stocks in the OECD dropped to 60 days in September from 60.9 days in August, though this places them 3.8 days higher than in September 2008. US data, which is more up to date, show that crude and gasoline stocks are broadly unchanged since the end of September and distillate stocks have slipped marginally from their long-term high of early-October. The high level of stocks remains a concern to Opec and has the potential to weigh on prices should other factors become less supportive.

Key data

	2002	2003	2004	2005	2006	2007	2008	2009F	2010F
Nominal GDP									
(SR billion)	707.1	804.6	938.8	1182.5	1335.6	1437.7	1753.5	1341.5	1508.3
($ billion)	188.6	214.6	250.3	315.3	356.2	383.4	467.6	357.7	402.2
(% change)	3.0	13.8	16.7	26.0	12.9	7.6	22.0	-23.5	12.4
Real GDP (% change)									
Oil	-7.5	17.2	6.7	6.2	-0.8	0.5	4.9	-9.5	5.2
Non-oil private sector	4.1	3.9	5.3	5.8	6.1	5.7	4.2	2.3	4.4
Government	2.9	3.1	3.1	4.0	3.1	2.7	3.0	2.8	2.3
Total	0.1	7.7	5.3	5.6	3.2	3.4	4.2	-1.0	4.1
Oil indicators (average)									
WTI ($/b)	26.2	31.1	41.5	56.6	66.1	72.3	99.7	62.0	75.0
Saudi ($/b)	23.7	26.9	34.7	49.5	60.5	68.1	93.4	60.8	70.1
Production (million b/d)	7.5	8.8	9.0	9.5	9.2	8.7	9.2	8.1	8.4
Budgetary indicators (SR billion)									
Government revenue	213	293	392	564	679	643	1101	611	716
Government expenditure	234	257	285	346	398	466	520	565	593
Budget balance	-21	36	107	218	280	177	581	46	122
(% GDP)	-2.9	4.5	11.4	18.4	21.0	12.3	33.1	3.4	8.1
Domestic debt	660	660	614	475	366	267	237	190	175
(% GDP)	93.3	82.0	65.4	40.2	27.4	18.6	13.5	14.2	11.6
Monetary indicators (average)									
Inflation (% change)	0.2	0.6	0.3	0.7	2.3	4.1	9.9	5.8	4.4
SAMA base lending rate (%, year	2.00	1.75	2.50	4.75	5.20	5.50	2.50	2.00	2.75
External trade indicators ($ billion)									
Oil export revenues	63.6	82.0	110.4	161.6	188.2	205.3	281.0	126.8	151.8
Total export revenues	72.3	93.0	125.7	180.4	210.9	233.1	313.3	153.3	180.4
Imports	29.6	33.9	41.1	53.8	63.0	81.5	100.6	88.1	90.7
Trade balance	42.6	59.1	84.6	126.6	147.8	151.6	212.7	65.3	89.7
Current account balance	11.9	28.0	51.9	90.0	98.9	93.3	134.0	-2.8	17.4
(% GDP)	6.3	13.1	20.7	28.5	27.8	24.3	28.7	-0.8	4.3
Official foreign assets	73.3	97.1	127.9	195.5	273.4	359.8	506.3	463.5	485.1
Social and demographic									
Population (million)	21.5	22.0	22.5	23.1	23.7	24.2	24.8	25.6	26.4
Unemployment (male, 15+, %)	7.6	8.2	8.5	8.8	9.1	9.0	8.8	8.5	8.2
GDP per capita ($)	8773	9745	11112	13640	15041	15814	18849	13976	15250

Sources: Jadwa forecasts for 2009 and 2010. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.

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