8 May 2010

Flash note

Greece, the markets and Saudi Arabia

There has been extraordinary turbulence across global markets in the last few days. Stock markets, many currencies and commodities all fell sharply and borrowing costs rose. Concern about the viability of the Greek bailout plan and the risk of a deeper debt crisis within the eurozone was the main cause of the market's woes, compounded by an inconclusive result in parliamentary elections in the UK and problems with the electronic share trading system in the US. These moves occurred despite a very positive employment report in the US, which suggests that the economic recovery is gaining vigor.

The main developments in the global markets in the last few days are:

- Global stock markets dropped significantly over Thursday and Friday while the Saudi market was closed. In the US, the S&P 500 fell by 5 percent, Japan's Nikkei 225 was down by 6 percent and Germany's DAX, the UK FTSE100 and the MSCI emerging markets index were all 4 percent lower. Stock market volatility was aggravated by a systems glitch in the US that caused the S&P 500 to fall by nearly 9 percent in just five minutes on Thursday, before rebounding. Last week's fall wiped out all the gains this year for US markets, which are now slightly below where they ended 2009, the emerging markets index is now 6 percent below where it was at the end of last year, but the TASI is still up, by 6 percent at the close of trading on Saturday.

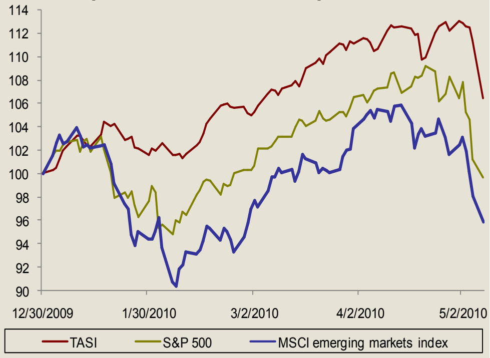
- Oil prices dropped by 13 percent last week, with WTI falling from $86.1 per barrel to $75.1 per barrel, as financial investors withdrew (owing to an increase in risk aversion) and concerns rose about demand should the global economy falter.

- Interest rates on government bonds jumped. Greece and those other EU countries perceived by the markets as having weak budgetary and debt positions (Portugal, Spain and Ireland) have been the worst affected, but across the world (including the GCC) borrowers now face higher costs if they wish to tap the international financial markets.

The fall in the TASI on Saturday again clearly illustrates that Saudi Arabia is not immune from problems elsewhere in the global economy. Nonetheless, the falls in global asset prices over the last few days do not alter our forecasts for the TASI, oil prices or the Saudi economy. The fragility of the recovery and continuing vulnerabilities made setbacks to the recovery and global markets inevitable.

In our view, global markets had been due for a correction. The S&P

Comparative stock market performance



For comments and queries please contact:

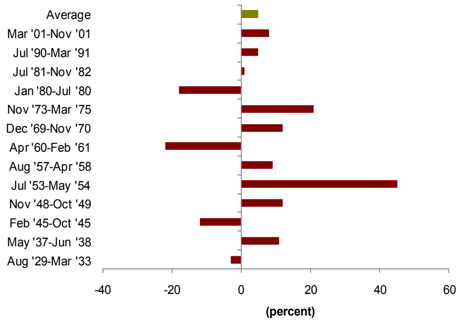
Paul Gamble
Head of Research
pgamble@jadwa.com

or:

Brad Bourland, CFA
Chief Economist
jadwaresearch@jadwa.com

Head office:
Phone +966 1 279-1111
Fax +966 1 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

Change in S&P 500 after past recessions
(second year after market low)

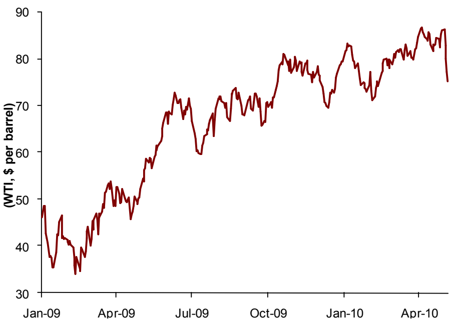


500 was up by 75 percent from its low-point last year to the start of last week and had been rising steadily during the year, in contrast to its usual post-recession performance. Research from Capital Economics shows that in the second year after hitting a cyclical low, the S&P 500 rises on average by only 5 percent. We have factored in weakness in global markets into our forecast for the TASI. Given that we do not expect the problems in the eurozone to have a noticeable economic impact on the Kingdom (see below) we maintain our end-year forecast for the TASI of 7,400.

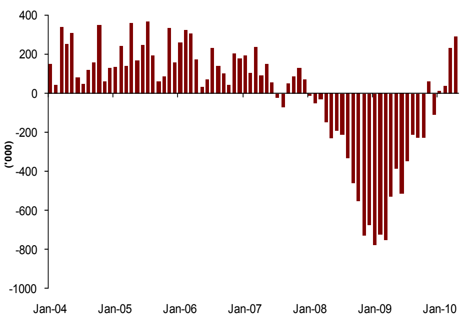
Credit ratings of select EU countries

	GDP	Credit rating	
Country	($ billion)	Moody's	S&P
France	2,676	Aaa	AAA
Germany	3,353	Aaa	AAA
Greece	331	A3	BB+
Ireland	228	Aa1	AA
Italy	2,118	Aa2	A+
Portugal	228	Aa2	A-
Spain	1,464	Aaa	AA
UK	2,184	Aaa	AAA
EU	16,447	-	-

Oil price



Change in US employment



Every $1 per barrel decline in the oil price reduces the Kingdom's oil export revenue by around $3 billion over a 12-month period. Nonetheless, the current fall in oil prices is not a cause for concern. We estimate that the 2010 budget is based on an oil price (WTI) of $51 per barrel, compared to an average for the year to date of $80.2 per barrel. The Kingdom therefore has an ample cushion even at Friday's price of $75.1 per barrel. Moreover, at current oil prices, the Kingdom's petrochemical producers remain highly competitive.

We maintain our forecast for WTI to average $75 per barrel this year. Markets have become concerned that the global recovery, and therefore demand for oil, will be hit by what is happening in the eurozone. We think this is unlikely. While the markets have been wobbling, the flow of economic data has been consistently strong. Data released on Friday show that more jobs were created in the US economy in April than in any month since March 2006. Economic performance in Asia and the Middle East, where oil demand growth is highest, also continues to strengthen. Furthermore, in the event that oil prices continue to slide there is likely to be a reduction of Opec supply to try to keep prices around a range that producers are comfortable with.

Tougher market conditions mean that investors will demand higher interest rates on new bond and sukuk issues and could compel companies in the process of issuing debt to hold back until conditions improve. Companies are increasingly turning to the debt markets owing to problems in obtaining bank financing. Saudi banks have minimal exposure to Greece and to those countries potentially next in line, so there is no reason for recent events to impact their ability or willingness to lend. We continue to forecast a gradual increase in growth in local bank lending to the private sector this year.

The direct economic impacts of weak economic performance in the affected eurozone countries on the Kingdom will be very small.

Dollar/euro exchange rate

Greece accounted for 0.7 percent of total Saudi exports in 2008 and just 0.2 percent of non-oil exports in 2009. Greece, Portugal, Spain and Ireland combined were the destination for less than 3 percent of total exports and below 1 percent of non-oil exports in the same years. The eurozone as a whole is the Kingdom's largest trading partner (supplying around 25 percent of imports into the Kingdom), so a sustained and prolonged weakening of the euro, which is near a 14-month low against the dollar, would have a beneficial impact on inflation in Saudi Arabia.

The problems within the eurozone could have an impact on the GCC single currency. As we highlighted in our April *Monthly Bulletin*, much of the preparatory work in the GCC was based on what preceded the introduction of the euro and technical support from the European Central Bank has been used widely. Therefore, should stresses in Greece or elsewhere prolong concern about the viability of the euro then this could trigger a rethink within the GCC.

Overall, Saudi Arabia is again caught up in global developments not directly affecting economic fundamentals in the Kingdom. Once this storm subsides, we expect the Kingdom's economy and markets will resume their growth trajectory.

Disclaimer of Liability

Unless otherwise stated, all information contained in this document (the "Publication") shall not be reproduced, in whole or in part, without the specific written permission of Jadwa Investment.

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

Jadwa Investment makes its best effort to ensure that the content in the Publication is accurate and up to date at all times. Jadwa Investment makes no warranty, representation or undertaking whether expressed or implied, nor does it assume any legal liability, whether direct or indirect, or responsibility for the accuracy, completeness, or usefulness of any information that contain in the Publication. It is not the intention of the Publication to be used or deemed as recommendation, option or advice for any action (s) that may take place in future.