

SABB Notes

- ▶ **US exports to the Kingdom are rising in value, but represent a falling percentage of total Saudi imports**
- ▶ **A huge expansion in Saudi Arabia's oil production capacity is set to help meet US and global needs**
- ▶ **The US remains a major guarantor of Middle East security, as well as being a key economic partner for the Kingdom**
- ▶ **Visa reciprocity enables more than 26,000 Saudis to receive higher education in the US**

US-Saudi Trade Relations

The symbiotic US-Saudi partnership continues, as President Obama visits the Kingdom.

3 June 2009

Dr. John Sfakianakis
Chief Economist

Tel: +966 1 276 4602
Email: johnsfakianakis@sabb.com

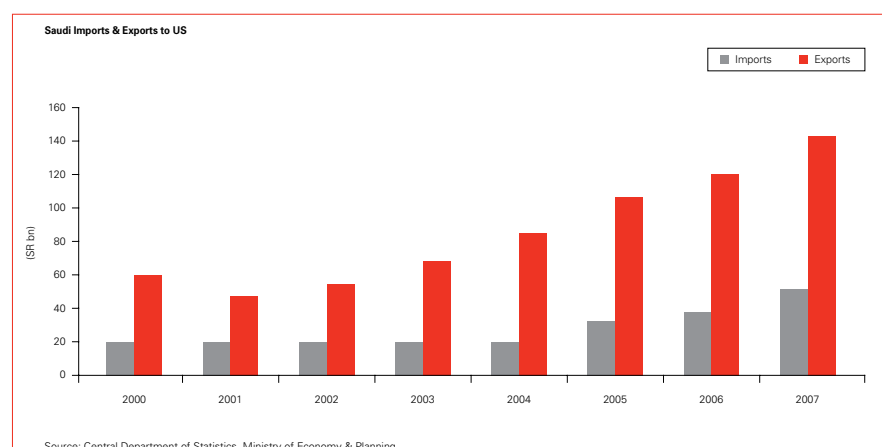
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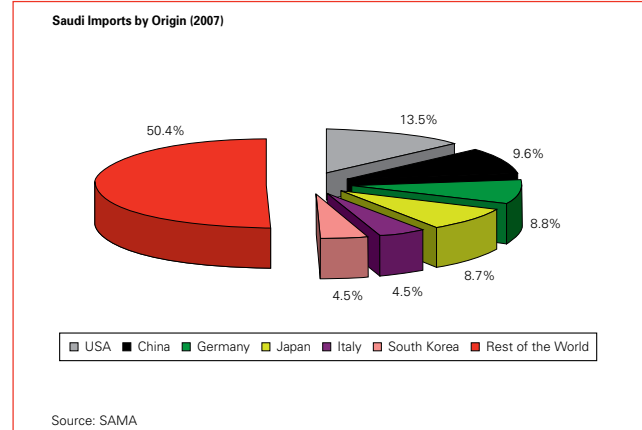
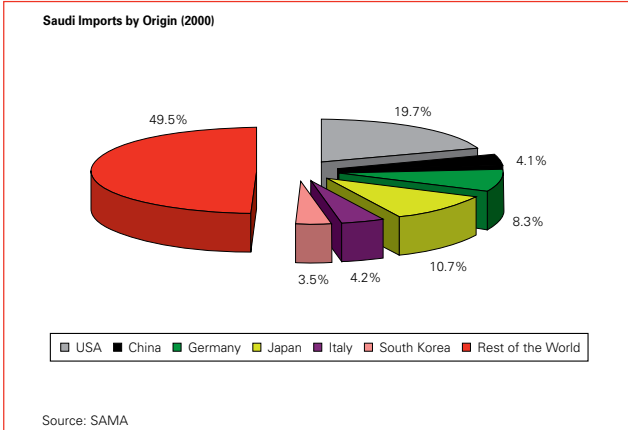
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US-Saudi trade relations (please refer to our report, 'Ties that Bind', January 16 2008) have remained solid, albeit with imports from the US progressively declining over the years as a percentage of total imports. But Saudi Arabia remains one of the US's top 15 trading partners.

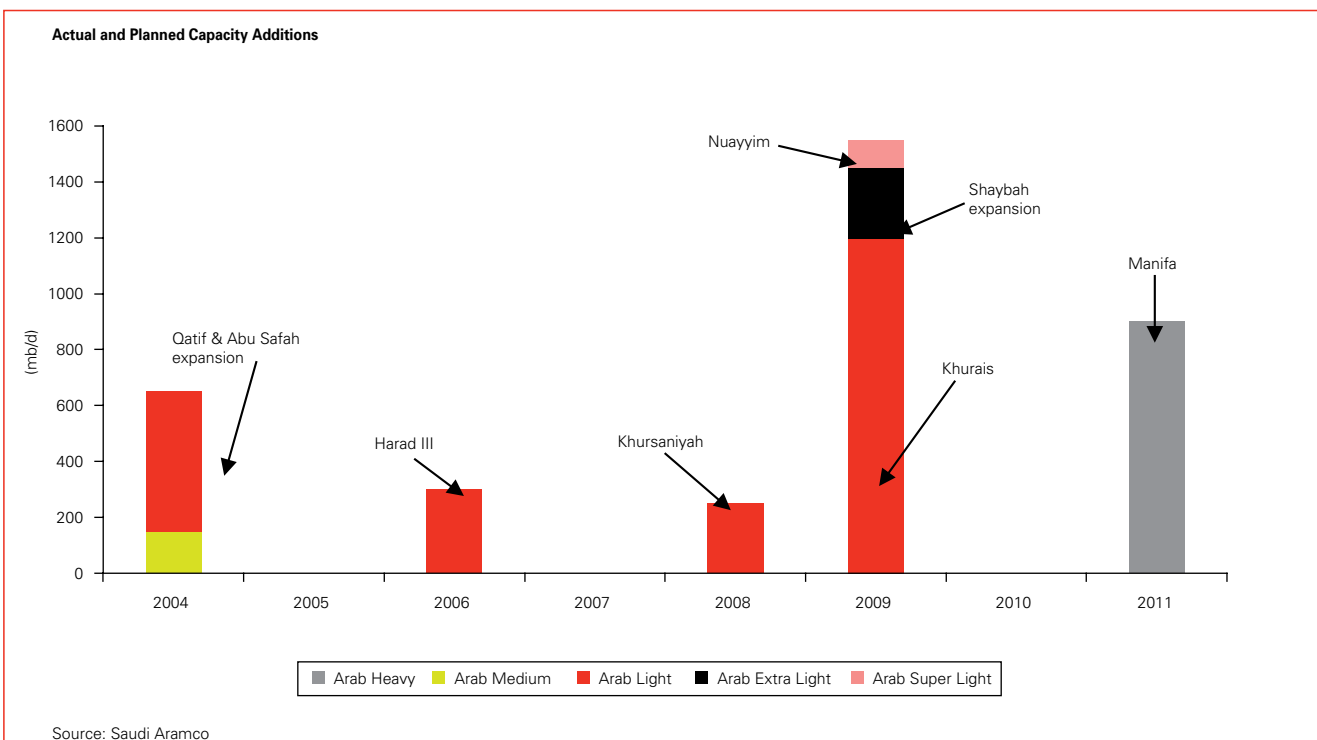
Total bilateral trade in 2007 is estimated to have reached SR 192.7 bn (\$51.3 bn), while total US exports to Saudi Arabia were estimated at SR 51.4 bn (\$13.7 bn), up from a lower base of SR 19.7 bn (\$5.2 bn) back in 2002. This latter increase is significant (161%), yet compared to some other trading partners the US is losing total market share. Back in 2000, US exports to the Kingdom were 19.7% of total imports and by 2007 were down to 13.5%. China's total market share in 2000 was 4.1%, which more than doubled to 9.6% by 2007. Others, such as Germany, have been able to maintain their market share in Saudi Arabia (8.3% 2000 against 8.8% in 2007),

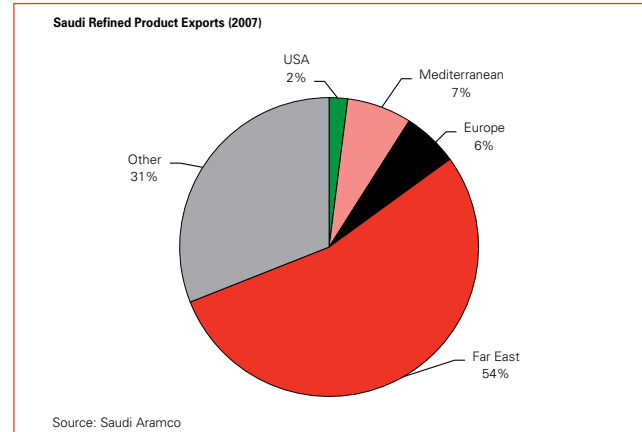
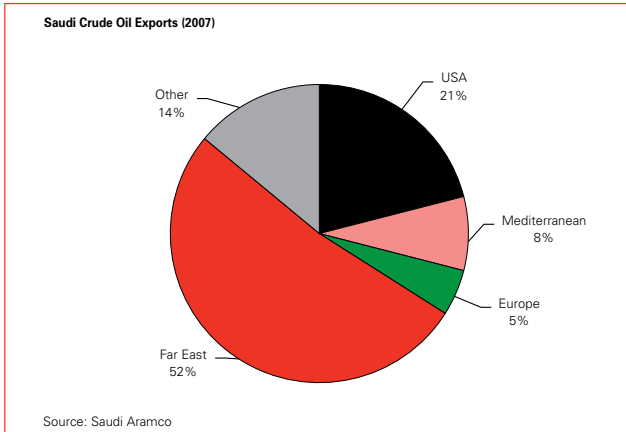




in contrast to Japan which has seen its share decline (10.7% in 2000 against 8.7% in 2007). This trend is due to the significant changes taking place globally and to the export role of China (competitive pricing, quality and variety improvements), as well as to the shifting import priorities of the Kingdom and changing nature of

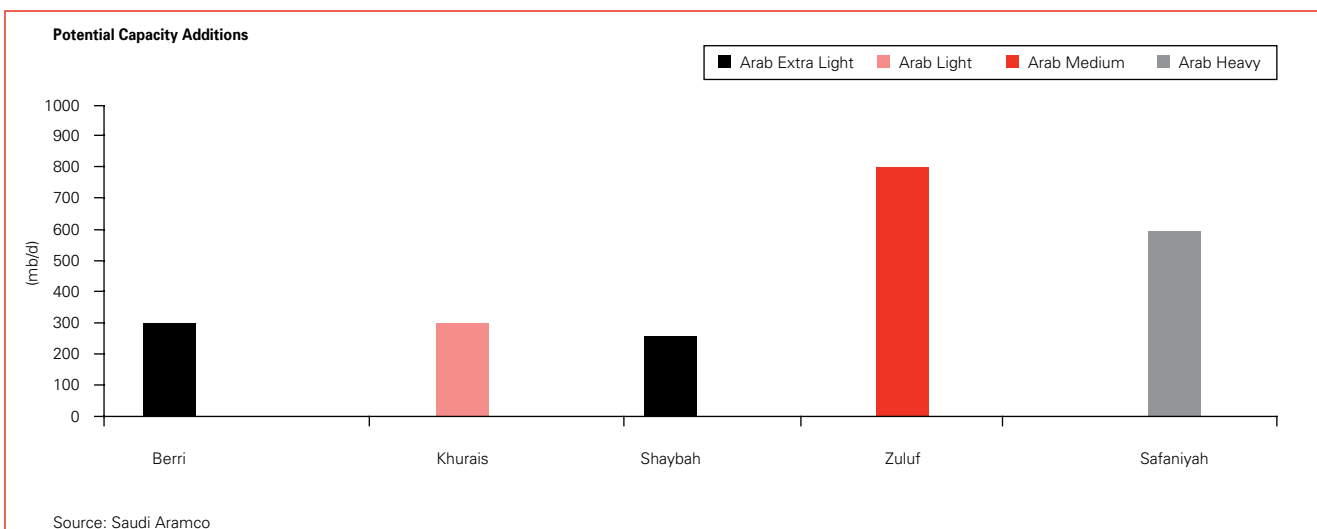
the US exports in terms of products and services. The dollar peg has not acted as a boost to the trade relationship, contrary to public perceptions. The recent turmoil in the US auto-manufacturing sector is changing consumers' perceptions about US products, but that is an unavoidable consequence of the crisis.





Saudi exports to the US have also witnessed a substantial increase (due to the appreciation of oil prices) over the past year. Total exports in 2007 are estimated at SR 141.3 bn (\$37.68 bn). Saudi Arabia's exports to the US have also changed direction over the years. In 2000, 20% of Saudi exports (mostly oil-based) went to the US, and by 2007 that figure had fallen to an estimated 15%. In 2006 and 2007, Saudi Arabia exported an average of 1.46 and 1.49 mn barrels per day of crude respectively to the US, accounting for 12% of oil imports.

During this time period, the Kingdom ranked third (after Canada and Mexico) as a source of oil imports to the US. This is because the bulk of Saudi Arabia's oil and refined exports are no longer destined for North America and Europe, but for Asia. In 2007, the Asian region accounted for 52% of Saudi Arabia's total oil exports and 54% of its total exports of refined products. The US accounted for 21% of the Kingdom's total oil exports, followed by the Mediterranean at 8% and Europe at 5%.



Saudi Arabia has been doing its part to meet the oil needs of global markets. The Kingdom will soon start production at its 1.2 mn barrels per day Khurais oilfield, which represents the biggest ever single increment to global production. Khurais is the largest of the three oilfield projects that would take Saudi total production capacity to 12 mn barrels per day by the end of June 2009. Khurais, and the rest of the capacity expansion projects are estimated to have cost \$70 bn. In addition to the recently completed 100,000 barrels per day of Arab Super Light Nuayyim field, the 250,000 barrels per day of Arab Extra Light Shaybah expansion is to be completed with total capacity of 750,000 barrels per day. Also included in the current spending plans is the 900,000 barrels per day of the Arab

Heavy Manifa project (tied to possible three joint-venture refineries in the Kingdom) slated for completion in 2011. If current production remains unchanged, Saudi Arabia would have over 4 mn barrels in spare capacity (the largest excess capacity in the world), at a cost of more than \$15-20 mn per day. Saudi Aramco for its part has stated that it will carry out additional drilling at existing fields in order to compensate for the natural declines from mature fields. He plan includes increasing planned drilling by a third to around 250 wells, with the priority on offshore areas. In the recent past, Saudi Arabia has stated that the country can add as much as 200 bn barrels of oil to proven reserves, after an extended period of investment and exploration.

What we think: The relationship between the US and Saudi Arabia is based on a symbiotic relationship involving an understanding, but not always agreement, about politics, economics and security issues. The sum of these three elements makes the relationship “special”, but also symbiotic. It is a relationship in which the partners cannot be easily disentangled. It is also a relationship that is often misunderstood and subject to misinformation. For the US, Saudi Arabia is a politico-strategic partner in the Middle East. Saudi Arabia is a voice of moderation and stability – and undoubtedly the single most important country in the world of energy. It is the driving force that tries to bring moderation in prices and to supply global markets with sufficient oil. Going forward, despite the political proclamations of Washington (made by every US administration since President Nixon), the US will become more dependent on foreign oil, particularly Middle Eastern oil.

Within the wider geo-political arena in the region, Saudi Arabia is the force for balanced reason which is needed in the midst of regional irrationality and an aggravated sense of injustice. Saudi Arabia’s interdependence with the US is based not only on regional security considerations, but also on economic ones. On the security front, both countries have worked together to combat terrorism, within the Kingdom and beyond. The US is the only major and willing guarantor of security in defence of the Gulf. Despite its important trading role, the EU (aside from the recent

French decision to have a bigger defence presence in the region) is far from adopting such a role to match this. The Riyal is pegged to the dollar (for better or worse depending on whom you ask), despite much speculation over the imminent “death” of the greenback. The general direction of the US economy, the fate of the dollar and the FED’s monetary policy does impinge on Saudi Arabia’s economy. In many ways, the US and Saudi Arabia are far more interdependent than meets the eye.

Economic cycles are not always in synch between Saudi Arabia and the US; in the recent past, the US was loosening its monetary policy while Saudi Arabia was confronted with rising inflationary pressures. Inflation required the preservation of higher interest rates, and to remain oblivious to the gap between US and Saudi interest rates opens the prospect of currency speculation. The greenback weakens Saudi Arabia’s terms of trade, which in turn impacts on imports and exports as well as inflationary patterns. Monetary tools applied in the US impact on the dollar as much as on the general direction of monetary policy (although that is not always so). A case in point is how the Saudi authorities, including the Governor of SAMA Mohammed Al Jasser, have strived to increase confidence in the future direction of the US economy and the dollar. Mohammed Al Jasser said, “In relative terms, it is not a clear-cut case that the dollar alone is in trouble and that people should be looking for lifeboats out of the dollar.” Moreover, the Governor of SAMA stated that, “If you’re worried about the dollar, where else do you go? When you look at other currencies, they reflect the fundamentals of their economies. And the other major economies are not doing particularly well.”

Meanwhile, many countries – including China – have voiced concern about the dollar’s ability to maintain its reserve currency status. We believe that the maintenance of the Riyal peg to the dollar will provide a degree of confidence in the greenback, as it is supported by the most important global oil producer – which should not be underestimated. Moreover, Saudi Arabia has played a role in buying US government debt by placing the majority of its foreign assets in US treasuries. That has benefited both countries. Debt created by one has been bought by the other and the security and soundness of Saudi Arabia’s foreign assets have been secured as long as the US economy performs. It is highly speculative to predict the future direction that Saudi Arabia would take in the event of an increasingly weak dollar and depreciating US asset prices.

At today’s rate of production, Saudi Arabia’s current reserves are sufficient to keep pumping oil for almost 90 years. But oil is the single most important source of income and needs to be used prudently in line with its national economic interests.

Saudi Arabia cannot simply be seen as the gas-station of the world. Although most of the oil discourse focuses on the security of supply, little is said about the security of demand. We should not forget that, at the June 2008 meeting in Jeddah, the Saudi Oil Minister Ali Al-Naimi unveiled details of field expansion projects which Saudi Aramco could undertake subsequent to Manifa. Saudi Arabia has historically played its part in meeting global demand. Producers need certainty and clarity on future consumption in order to invest in long-term projects.

The lack of trust between producing and consuming countries needs to be addressed. Producer countries need insights into the impact of alternative fuels, despite the uncertainties surrounding the breakthrough technologies that are built into the plans of consuming countries. Consuming nations also need to create a platform that addresses the burning question of oil and commodity speculation. Consumers need to adjust their consumption expectations and some, if not all, have to curtail demand. Saudi Arabia's position on alternative or "supplemental" energies (solar, wind, and hydrothermal) is clear: developing alternatives is important but not to the detriment or crowding-out of investment in the oil sector. Lack of investment in oil could spike prices again, which would be anathema to global economic recovery efforts. If prices do spike, the world should not simply point fingers at Saudi Arabia, but should direct its questions to the speculators who remain untamed. There have been no effective measures put in place to contain speculation in financial markets. Moreover, the world needs to acknowledge that producing countries should receive a fair price for their oil – which Saudi Arabia believes is around \$75-\$80 per barrel.

Going forward, the US-Saudi economic relationship will continue to strengthen. Trade will play a pivotal role in the relationship between the two. The US, given its high-value, high-tech products should continue to maintain its niche position in the Saudi market for many years to come, but the nature of the trade relationship will evolve as global trends change and new competitors emerge. The sheer fact that visa reciprocity has been a boon for both countries, with more than 26,000 Saudis receiving higher education in the US, helps ensure the relationship will be even more lasting and symbiotic.

John Sfakianakis

Notes

Disclosure appendix

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Dr. John Sfakianakis.

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