

Weekly Economic Briefing

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Corporate Planning Department - Economics
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بنك الرياض
riyad bank

Commentary Saudi 2005 economic performance and the 2006 budget.

The 2006 budget was announced Dec. 13, revealing a number of superlatives... highest government budget surplus ever, highest private sector growth in the last twenty years, one of the highest economic growth for the overall economy, record current account surplus, and record *non-oil* exports. Although, booming oil export is the key driver, other factors are increasingly taking on a life of their own, independent of oil. These include more bank lending, more investment (public & private), the wealth-effects of booming asset prices (stocks and real estate) and economic reforms of the past two years, topped by Saudi Arabia's membership in the WTO. These factors also seem to have created a new found spirit among local businesses, investors and consumers that will be good news for the Kingdom in the coming years. The budget highlights include a surplus of SR 214 billion (our forecast was SR 212 billion), government revenues of SR 555 billion (our forecast, SR 551 bill) and expenditures totaling SR 341 billion (our forecast, SR 339 bill). In addition, the government noted that Gross Domestic Product (GDP) stood at SR 1.15 trillion in nominal terms (our forecast, SR 1.2 trillion), and SR 768 billion in constant terms (our forecast, SR 769 bill). Real GDP growth was 6.5% (our forecast, 6.5%), including the non-oil private sector growth of 6.7% (vs. our forecast, 7%). Oil exports totaled SR 588 billion (our forecast, SR 585 billion) and non-oil export amounted to SR 69 billion (our forecast, SR 68.7 bill). The "best" news in the budget is that the biggest amount ever of the surplus (SR 139 billion or 65%) will be used reduce government debt to SR 475 billion or 41% of GDP.

	2006	2005		2004		2003	
(in SR billions)	Budget	Budget	Actual	Budget	Actual	Budget	Actual
Total Revenues	390	280	555	200	392	170	293
Total Expenditures	335	280	341	230	285	209	257
Budget Deficit	55	0	214	30	107	39	36

The government's 2006 budget revenue estimate of SR 390 billion (assuming SR50 billion is from non-oil revenues) is rather conservative, as it seems to be based on a \$31 oil price for Saudi oil, assuming 10 mbpd output. A \$17 fall in oil price next year (vs. \$48/brl this year), is highly unlikely in our view because: (1) global oil demand, especially from China, India and US shows little signs of slowing down, (2) oil prices have already fallen quite a bit from recent records, so a further \$17 fall is quite a stretch, and (3) *most importantly, OPEC is expected to defend oil prices at \$40 or higher.* Thus, we foresee a significant positive upside to the revenue/surplus figures for next year. Using our forecast model, which served us well this year, and factoring in a \$40/brl oil price and Saudi oil output of 10 mbpd (vs. 9.5 bpd this year), we get a budget surplus forecast of over SR 150 billion for 2006. Our forecast, however, expects oil prices to actually rise a small amount (14%), resulting in a surplus forecast of SR 252 billion in 2006.

OIL Brent Future: \$57.13 OPEC Basket: \$54.44 US WTI: \$58.06

OPEC decided on Dec 12 to keep its quota unchanged for the time being and to hold an extra-ordinary meeting on Jan 31 to review its decision in view of the expected seasonal lowering of oil demand in the 3rd and 4th quarters. In addition, OPEC also withdrew its offer of an additional 2 million bpd of extra oil because, according to the Saudi oil minister, "not one barrel was asked for, because inventory was building". The fact that this put little upward pressure on oil prices confirms OPEC's view that the market is well-supplied and the next course for OPEC, under the circumstances maybe to reduce quota, especially if oil prices continue falling as they have been since last August. This downside risk was confirmed by the largest ever fall in energy prices in the US in October. Surprisingly, only days after this assessment, OPEC revised its world oil demand growth forecast for 2006 up from 1.8% to 1.9% (or by 1.50 million bpd) to reach 84.91 mbpd.

GLOBAL STOCK MARKETS

	Current	Week Ago	End 2004	YTD Chng
US Dow Jones	10876	10779	10783	0.9%
US NASDAQ	2252	2257	2175	3.5%
DE DAX	5354	5282	4256	25.8%
UK FTSE100	5532	5517	4814	14.9%
FR CAC40	4704	4661	3821	23.1%
SW SSMI	7491	7567	5693	31.6%
JP Nikkei	15173	15404	11489	32.1%
HK Hang Seng	15030	14911	14230	5.6%
IN BSE Sensex	9284	9067	6603	40.6%
BR Bovespa	33292	32922	26196	27.1%

US equities closed the week with notable gains after two weeks of decline amidst a year-end rally that shows signs of fizzling out any moment. The Dow was up while Nasdaq was slightly down for the week. European equities were up in record territories, driven by German business confidence, where the Ifo index rose to a five-year high. Japan's Nikkei slipped for the third straight day on Friday as the high yen weighed on Japanese equities. Emerging market led by India remain at record levels. Regionally, except for Saudi Arabia, Cairo and Beirut, most market were down significantly. Analysts attribute this trend to a liquidity shortage as funds are diverted to new issues and capital increases of existing firms. Most analysts expect the regional bourses to rebound in early January as this situation clears up and the earnings season starts. The Saudi Tadawul breached the 17,000-mark a few times but failed to hold on to it. The upcoming earnings season may give it some juice as liquidity remains ample.

Selected ECONOMIC INDICATORS

Due Date:	Economic indicator	Latest Actual	Consensus forecast	Previous Actual
21 Dec, Wed	US GDP-final, Q3	n/a	4.3%	4.3%
23 Dec, Fri	US New home sales, Dec	n/a	1310K	1424K
12 Dec, Mon	US Retail sales, Nov	0.3%	0.4%	0.3.1%
13 Dec, Tue	US FOMC, fed fund rate	4.25%	4.25%	4.00%
14 Dec, Wed	US Trade balance, Oct	-\$68.9bill.	-\$62.8bill.	-\$66.0bill.
15 Dec, Thu	US CPI, Oct	-0.6%	-0.4%	0.2%
15 Dec, Thu	US Industrial production, Nov	+0.7%	0.5%	1.3%
01 Dec, Thu	KSA, Bank loans to prv sctr, Oct	+SR6.1 bil.		+SR15 bil.
01 Dec, Thu	KSA, Bank GDB holdings, Oct	-SR800 mil.		-SR1.7 bil.

REGIONAL STOCK MARKETS

	Current	Week Ago	End 2004	YTD Chng
Abu Dhabi	5251	5431	3071	71%
Bahrain	2221	2242	1774	25%
Kuwait	11429	11782	6410	78%
Muscat	4741	4798	3375	40%
Doha	11537	11697	6494	78%
Dubai FM	1095	1107	-	-
Egypt CMA	26547(?)	2193	1221	%
Amman	8275	8830	4246	95%
Beirut BLOM	1120	1076	637	76%
Saudi Arabia	16988	16821	8206	107%

FOREX

	Current	Week Ago	End 2004
\$/EURO	1.201	1.181	1.356
YEN/EURO	139.0	142.5	136.2
YEN/\$	115.7	120.7	102.6
\$/GBP	1.773	1.755	1.920
Swiss/\$	1.290	1.303	1.140

The dollar was battered down by a number of forces this week. Against the yen, the dollar fell for three straight days to give the yen its biggest weekly gain in six years on speculation that the Bank of Japan may end its zero-interest rate policy soon. For the week, the yen climbed 4.3% against the dollar, the most since November 1999. A strong Japanese business sentiment indicator, the Tankan survey, which rose to its highest level in one year also helped. The euro rallied against the dollar to \$1.201 after German business confidence rose to a five-year high. Other factors that pummeled the dollar include a higher-than-expected US trade deficit of \$68.9 billion and speculation that the Fed is nearing the end of its cycle of raising interest rates. Up til now, interest rate advantage of the dollar against major currencies was one of the main factors for the dollar's strength this year.

INTEREST RATES

	Current	Week Ago	End 2004
US3mth	4.50	4.48	2.56
US10yr	4.44	4.53	4.23
Euro3mth	2.48	2.46	2.18
Euro10y	3.35	3.44	3.68
UK3mth	4.65	4.64	4.89
UK10yr	4.24	4.33	4.54
SR3mth	4.95	4.92	2.61
SR5yr	4.68	4.72	4.03

US treasury yields posted their biggest weekly fall since November on speculation that the US Fed is done increasing interest rates even as the Fed raised its key overnight rate another 25 bps on Tuesday as widely expected. European yields also fell as a result. Another factor that helped push rates down was a surprisingly large drop in the consumer price index, which showed the biggest drop in 50 years driven by the largest drop in energy prices on record. As a result, the US yield curve has turned negative (inverted), the first time since before the 2001 recession. This yield curve inversion is surprising because other indicators show continued economic strength.