

Saudi-US Trade Relations

The ties that bind

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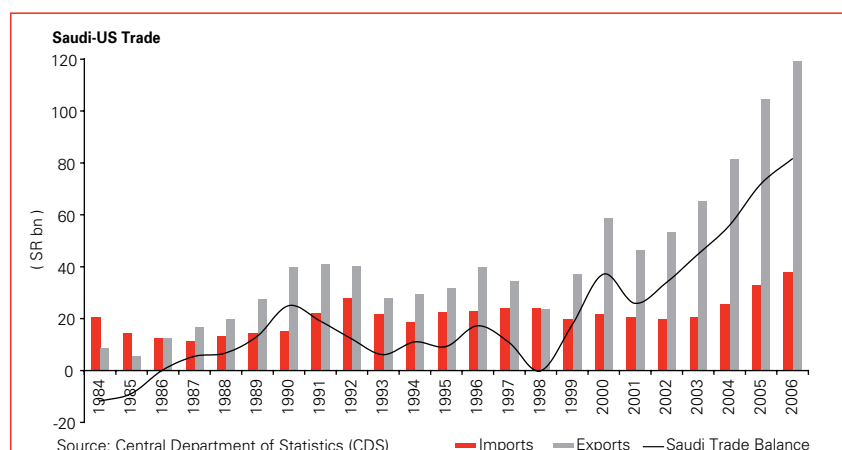
- ▶ The US has now been Saudi Arabia's largest trading partner for almost half a century
- ▶ Crude and refined oil products account for 98% of all Saudi exports to the US
- ▶ Saudi private wealth invested abroad now totals around SR 4.69tn (\$ 1.25tn), of which SR 1.58tn (\$ 420bn) is estimated to be invested in the US

Historic partnership

Saudi-US relations have been deeply engraved on the post-1931 history of the Kingdom. In 1933, King Abdul Aziz granted Standard Oil of California (Socal) exclusive rights to explore and drill for oil in the Kingdom. And it was in 1938 that the Arabian American Oil Company – later to be known as Aramco – first struck oil in commercially viable quantities.

The relationship was further strengthened during the Second World War when, in February 1945, King Abdul Aziz met US President Franklin D. Roosevelt aboard the USS Quincy on the Great Bitter Lake in the Suez Canal zone.

The relationship since that time spans all areas – including energy security, business, defence, education and training. In addition to the prominent role of US companies in the oil industry, the financial sector also received seminal support. Indeed, in 1952 – on the recommendation of Arthur Young – the American George Albert Blowers became the first governor of SAMA.



Rising value but falling market share

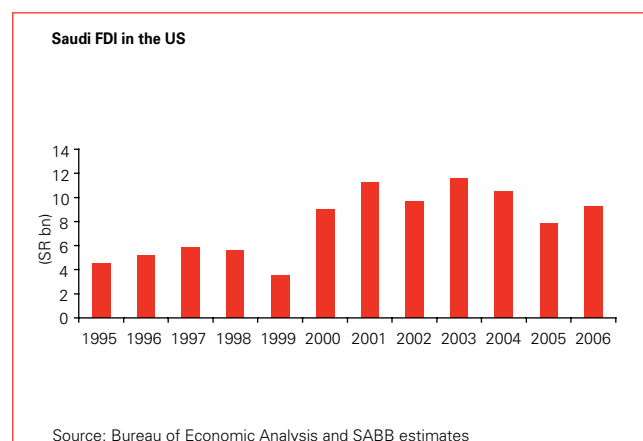
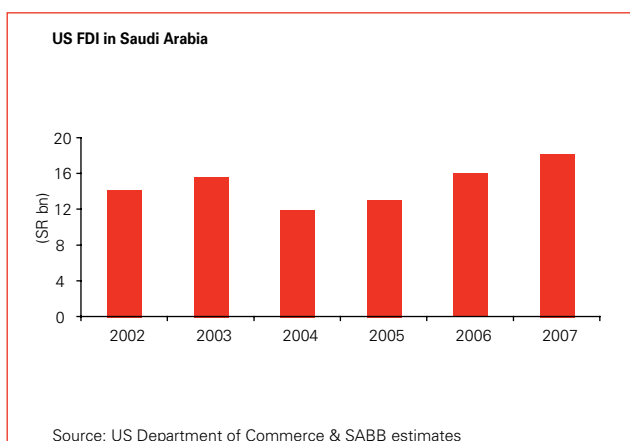
The United States is Saudi Arabia's largest trading partner, a position it has held for the past 47 years. The Kingdom is the biggest recipient of US exports in the Middle East.

Trade between Saudi Arabia and the US increased from SR 663m (\$ 160m) in 1970 – using the prevailing exchange rate at the time¹ – to SR 157bn (\$ 41.8bn) in 2006. US exports to the Kingdom dipped in the mid-1980s, but recovered strongly in the 1990s and, during the current decade, have grown by an annual average of 28.7%.

A small decline in US exports during 2002, due to the commercial aftershocks of September 2001 and a brief Arab boycott of US products, proved short-lived. Since 2004, exports have risen steadily – from SR 25.6bn (\$ 6.8bn) that year, followed by a near 29% increase in 2005, to achieve a record total of SR 37.8bn (\$ 10.08bn) in 2006. As for 2007, we anticipate US exports to have reached a new high of SR 41.2bn (\$ 10.9bn).

Whilst imports from the US have been growing, they have also represented a decreasing share of the market. For most of the nineties, except in 1990 and 1999, the US maintained at least a 20% market share of total Saudi imports. This was due to high military sales after the first Gulf War, as well as civilian aircraft supplied by Boeing for the renewal of Saudi Arabian Airlines fleet. Between 2000 and the visit of US President George W. Bush in January 2008, no major defence procurement deals were signed with Saudi Arabia. But over the past few years, the US has continued to export defence equipment, mostly in the form of spare parts for existing defence weapons systems.²

During the nineties, US exports were not in serious competition with products from emerging markets, such as China. But more recently, the changing balance of power in Saudi imports has been mirrored in most countries around the world, as trade-flow patterns have rapidly shifted east. Back in 1990, imports from China comprised only 1.8% of all Saudi imports, whereas by 2006 China was the second largest exporter, commanding an 8.5% market share. Increasingly, US exports to the Kingdom have focused on high-value and high-tech products.



¹ Exchange rate: SR 4.145 per USD until end December 1971.

² The only exception is the recently announced agreement at the 2007 Dubai Air show for the Saudi Ministry of the Interior to purchase 40 helicopters from Sikorsky Aircraft Corp.

In terms of Foreign Direct Investment (FDI), the US is the largest foreign investor in Saudi Arabia, accounting for an estimated 27% of FDI (which equates to SR 18.3bn or \$ 4.9bn) in 2007 – an increase of 53% over 2004. US FDI is expected to increase in the coming years, as US companies participate in some of the Kingdom’s mega-projects.

Machines, planes and automobiles

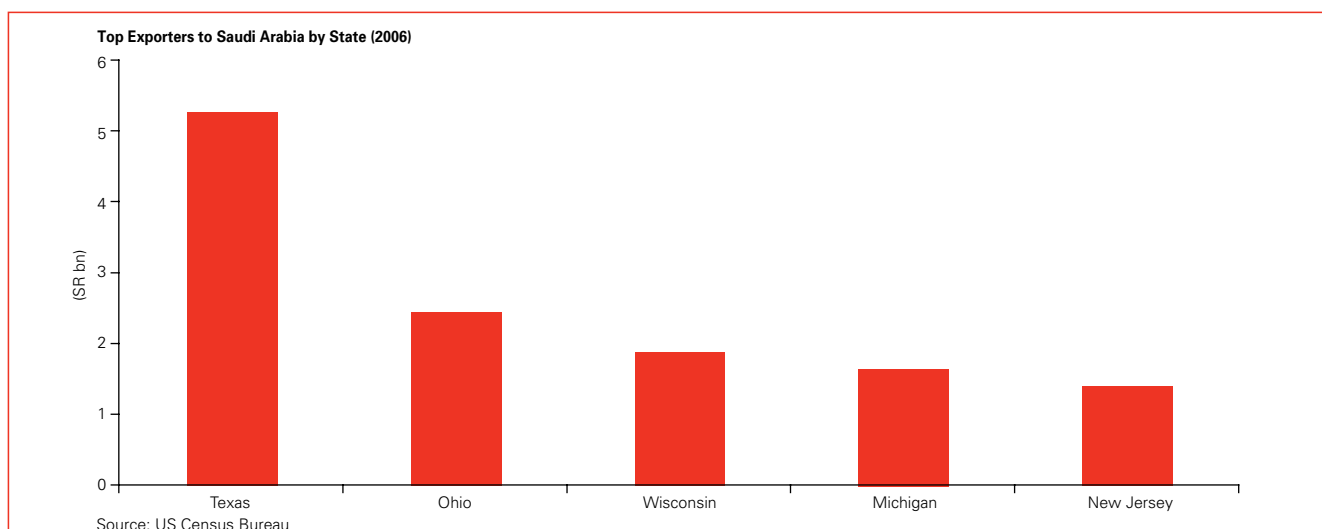
Principal US exports to Saudi Arabia in 2006 were vehicles (34%), machinery (23%), electrical machinery (9%) and medical instruments (5%). The two major commodities imported in 2006 were plane and helicopter parts, to the value of SR 2.7bn (\$ 731m), and automobiles, worth SR 4.1bn (\$ 1.1bn).

The US state of Texas is the most export-oriented to Saudi Arabia, due largely to its expertise in oil-related machinery and services. During 2006, Texas exported SR 5.2bn (\$ 1.4bn) worth of products and services to

Saudi Arabia, followed by Ohio SR 2.4bn (\$ 655m), Wisconsin SR 1.8bn (\$ 505m) and Michigan SR 1.6bn (\$ 442m).

In some product areas, Saudi Arabia is a very important market for US companies. For General Electric’s power division, Saudi Arabia represents the biggest market worldwide for power generators. US car-makers hold a 28% share of Saudi imports – after Japanese autos, which command 47% of the market. But US vehicles have gained more ground in the past year, with manufacturers producing new models as part of the wider restructuring of the US automobile sector. Competitive pricing has also helped win market share – and not simply due to the Dollar exchange rate against the Euro and the Japanese Yen.

A recent trend witnessed among some Saudi importers – mainly of intermediate goods – is of some concern. Namely, a marked preference for US goods made outside the USA. Saudi businesses involved in such trading cite cumbersome visa regulations as the reason for this shift in product origination.

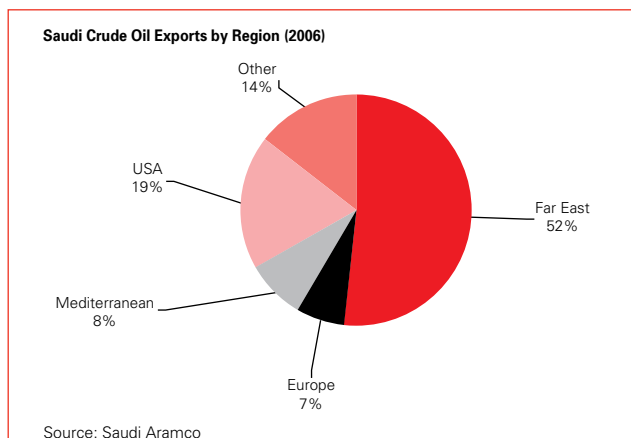


Oil booms and market movements

Since 1986, Saudi Arabia has for the most part (1998 excepted) enjoyed a trade surplus with the US. Even during the nineties, when US exports picked up, the trade surplus favoured the Saudis. This is due to the sheer volume of crude and refined oil products which, in 2006, accounted for 98% of all Saudi exports. Organic chemicals make up a further 1% of exports to the US.

According to Saudi Aramco, 19.2% of Saudi Arabia's crude oil exports in 2006 went to the US, with 51.6% going to the Far East. From 1988 onwards, the Kingdom's crude oil exports to the US have not fallen below 1 mbpd – and at times have surpassed 2 mbpd. Indeed, the average since 2002 has exceeded 2.3 mbpd.

In terms of private money, Saudi investments have been finding a way to the US and Europe since the first oil boom in the early 1970s. Investment in Asia at that time was subdued – in direct contrast to the high level of Asian activity among Saudi private investors today. A second boom in the late seventies and early eighties



also drew investors to the US market. The third oil boom – the one we are experiencing at the moment – is only partially triggering investment in the US.

We estimate that Saudi private wealth invested abroad now amounts to SR 4.69tn (\$ 1.25tn), of which SR 1.58tn (\$ 420bn) is believed to be invested in the US.³ Although there is little reliable official information, we ascertain that – since 2001 – the US has waned as an investment destination for Saudi private wealth, but by no means has investment abated. However, we do not hold the view that a large volume of Saudi funds was repatriated from the US to the Kingdom, or indeed moved to Europe. In the past, we have estimated that not more than SR 28.1 bn (\$ 7.5bn) of investment returned to the Saudi banking system in the first year following September 2001.⁴

The difference now is that today's Saudi boom is paralleled by region-wide growth, offering greater opportunities in the Middle East than was the case in previous booms. Indeed, we believe that a large segment of the outward funds have been invested in intra-regional destinations over the past few years, helping create the most sustainable boom in Saudi economic history.

In addition, a greater proportion of Saudi private wealth was invested internally, as the local equities market witnessed an exponential bull-run prior to February 2006. At present Saudi private wealth is investing heavily in Europe, but the Middle East has been gaining ground since 2001. In the 1990s, it is estimated that Europe attracted 35% of Saudi Arabian private wealth, whereas the Middle East attracted 10% and Asia just 5%.

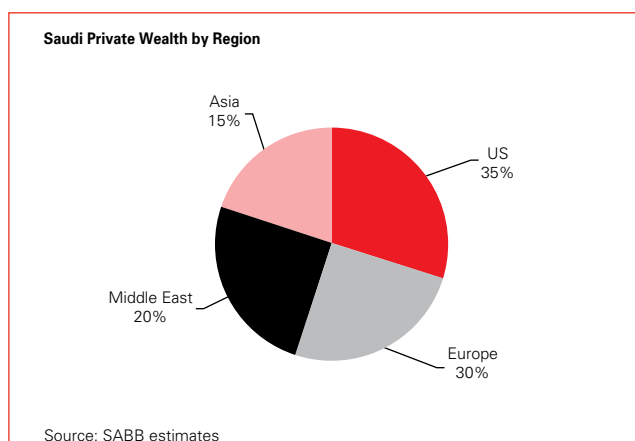
³ SABB estimates, based on extrapolations from Merrill Lynch/Gemini Consulting Group: various Merrill Lynch and Capgemini World Wealth Reports (1995).

⁴ Based on calculations related to money supply (M2 and M3), as well as the growth of public and private-sector lending over 2002.

Only around 35% of outward private investment from Saudi now reaches the US, in contrast to the 50% seen prior to 2001. The precise origins of financial assets such as equities are sometimes hard to ascertain, but private Saudi wealth in the US is primarily invested in that sector, while US real estate is also a perennial favourite for Saudis.

Though much of the new money made during the third boom is not going there, Europe continues to be a prime destination for Saudi wealth – albeit with a small decline over recent years, due to opportunities elsewhere and the steep appreciation of the Euro.

Foreign Direct Investment (FDI) previously commanded only a small, fluctuating portion of Saudi investment in the US but, over the past few years, it has increased in conjunction with the Kingdom's economic boom.⁵ We estimate Saudi FDI in 2006 to have reached \$ 2.5bn, a 19% increase over 2005. In fact, Saudi FDI has grown consistently, with the exception of 2005 when it witnessed a small decline. As a result of the acquisition of GE Plastics by SABIC in 2007 – for SR 43.5bn (\$ 11.6bn) – Saudi FDI for the year is expected to have reached a record high.



Due to the definition of FDI in the US, Saudi investments are not fully identified. Globalisation of finance now makes it more difficult to identify the final beneficiary. The Saudi Government's foreign assets were estimated at SR 1.06tn (\$285bn) in November 2007 (the latest figure). Most of these assets are invested in US fixed-income bonds.

The Saudi Riyal has been pegged to the US Dollar since 1986. Despite the depreciation of the Dollar and current weakness in the US economy, the heightened pressure in Saudi markets to revalue, or even withdraw from the peg, has not reduced the Kingdom's commitment to the existing arrangement. The Saudi authorities have denied more than 23 times that there will be any change to the currency regime. At the same time, the Dollar is no longer insensitive to the rumours of regional asset diversification away from the Greenback, not least when GCC currency-regime changes are forecast by analysts.

Defence of the Kingdom

The US-Saudi military partnership is more than 55 years old; and Saudi Arabia remains one of the largest buyers of US defence equipment. Between 1998 and 2002, according to the Gulf Research Centre (GRC), the US provided 66.9% of all arms purchased by Saudi Arabia, as opposed to 27.5% from Western Europe.

The US has been instrumental in helping the Kingdom develop its defence capabilities and foster inter-operability between US and Saudi forces. US weapons systems have been central to Saudi defence with, for example, nearly 73%

⁵ The US Department of Commerce's Bureau of Economic Analysis (BEA) defines foreign direct investment in the US as "the ownership or control, directly or indirectly, by one foreign resident of 10% or more of the voting securities of an incorporated US business enterprise or the equivalent interest in an unincorporated US business enterprise".

of Saudi battle tanks being US-made.⁶ All the attack helicopters purchased after the first Gulf War were from the US; and the Saudi Royal Navy is partly US-equipped – in particular, its Gulf sea-fleet. The combat aircraft of the Saudi Royal Air Force, prior to the 2007 Typhoon deal, were 60% American; and Saudi Arabia’s low to high-level air defence capability is also mainly from the US.

Moving forward, US-Saudi defence agreements will be a key feature of the bilateral relationship – and the 2008 defence deal may be regarded as the hallmark of that collaboration.

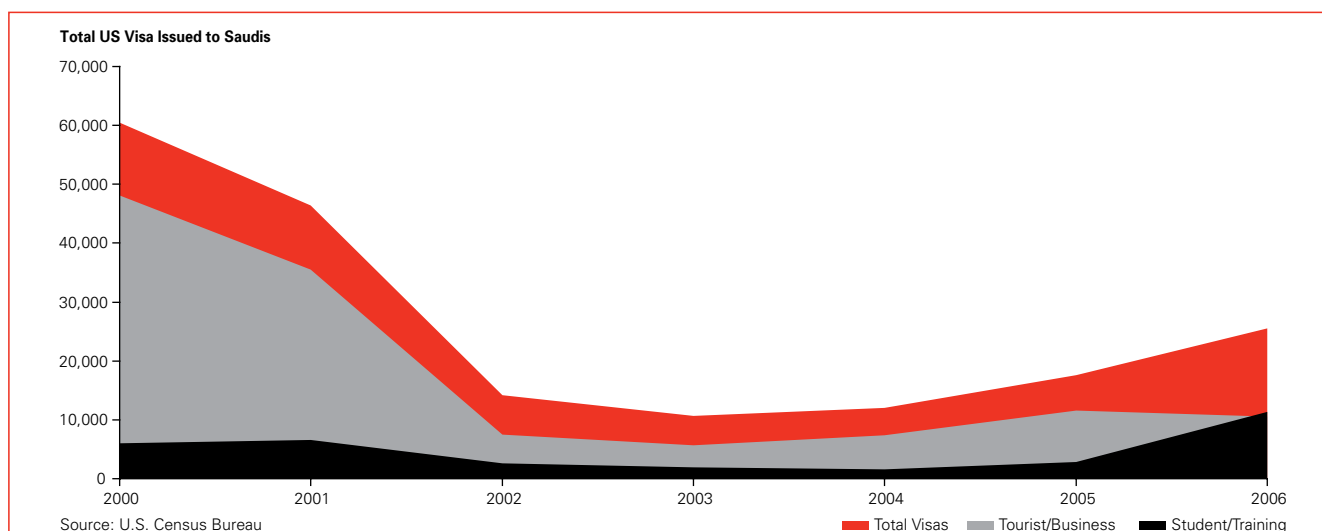
Visa issues

Doing business often involves considerable travel. Time and time again, travel to the US is cited as an obstacle for Saudi companies. Although improvements have been made in the speed of issuing business visas, there is a gradual shift of mindset regarding people’s willingness to visit the US, whether for business or for pleasure.

In 2000, more than 60,000 visas were issued to Saudis, which was the highest number since 1991. Over 48,000 of these were business and tourist visas, while upwards of 7,000 were student visas. In 2001, the total of visas issued dropped by 31%, before plummeting by 209% the following year.

More specifically, the fall in business and tourist visas for 2002 was a massive 377%, while the number of students fell by 160% and continued to fall until 2004. There is now evidence of a turnaround, however, particularly in the number of Saudis applying for student visas, which reached 11,699 in 2006 – one of the highest figures in the past 15 years.

It may take a good deal longer for Saudi tourists to return to the US in substantial numbers; but then, education and training are certainly more important to the future prosperity of the Kingdom.



⁶ Data compiled by the Gulf Research Centre (GRC).

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