

Steel Demand Growth To Continue

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Total supply of iron & steel products is set to expand 13.8% to 15.57 million metric tons in 2008 with domestic demand to absorb 89.4% (13.9 million metric tons) and exports 10.6% (1.65 million metric tons)

Supply from domestic production meets nearly 55% of the total market demand while imports account for the remaining 45 percent.

Saudi crude steel output rose by 21.9% Q/Q to 1.3 million metric tons in 1Q08.

Domestic price of imported billet ranges between SR3,950 and SR4,250 per metric ton in May 2008.

Domestic price of rebar ranges between SR4,500 and SR4,700 per metric ton in May 2008.

Saudi exports of iron & steel products are set to increase 6.5% to 1.65 million metric tons in 2008.

Domestic demand for steel products is set to expand 14.7% to 13.92 million metric tons in 2008.

Total market value of iron & steel products is set to rise 18.7% to SR43 billion in 2008.

Global steel prices rose in the range between 39% and 67% in the 12 months to May 2008.

Impact of Saudi accession to WTO is neutral to positive on the Kingdoms iron & steel industry.

A mining field in Sawawain, near Tabuk is estimated to hold between 165 and 397 million metric tons of iron ore. The proposed development of this field requires an investment of SR3 billion.

Long-term demand outlook is positive on the back of current wave of infrastructure projects being launched with multi-hundred-billion riyals of investment.

Upcoming new steel capacity.

Al-Tuwairqi Group is setting up a SR7.5 billion Integrated Steel Complex in Dammam industrial area with total capacity of 4.3 million metric tons annually. A second project with 500,000 tons capacity to manufacture railway line (bar) is also under feasibility study stage.

Hadeed is expanding Jubail Mill Expansion-3 at an investment of SR3.75 billion to produce an additional one million metric tons a year of steel products. Upon completion, Hadeed's capacity will reach 6.5 million metric tons per annum.

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A. Steel Market Determinants

The volume of steel consumption in a country is one of the benchmarks for measuring the degree of economic development and the level of economic diversification. Whether in concrete or steel buildings, steel remains a major input. Steel is made from iron ore still found in abundance around the world. Technological developments have made it possible to convert iron ore to steel in a short-time. Even after decades of use, it can be sent back to the furnace as scrap, melted and remade into new quality of steel. Kingdom's imported and locally produced steel products broadly fall under six major categories (1) billets produced from directly reduced iron (DRI); (2) long-steel products e.g. rebar and angle iron; (3) hot rolled & cold steel coil; (4) hot rolled steel plate; (5) steel wire rod and mesh; and (6) steel sections. Major exporting countries of steel products to the Kingdom are India, Brazil, Turkey, Ukraine and Russia. Kingdom's average apparent per capita iron & steel consumption was 497 kg in 2007, compared with 268 kg for China.

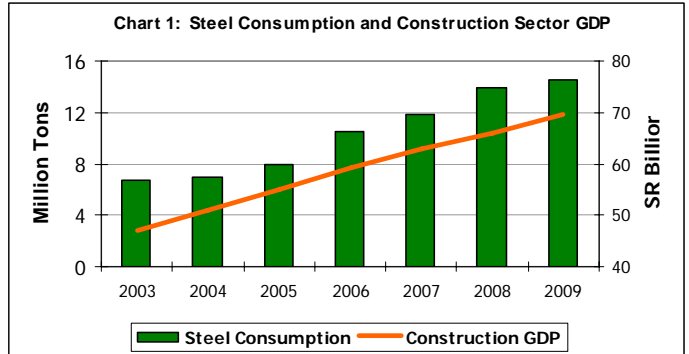
The Kingdom has several commercially viable mineral resources which are receiving high importance for development in the wake of soaring metal prices globally. The mining field in **Sawawain**, near South of Tabuk, is estimated to hold between 165 and 397 million metric tons of iron ore. The proposed mineral project there can produce 4.6 million metric tons of raw iron with iron contents of 42 percent that yields 2.2 million metric tons of Pig iron rolls. The development of this project would require an investment of SR3 billion at today's prices.

1. Business Environment

Over the last five years, the Saudi economy continued to expand in an environment of soaring oil prices with record oil production that have generated record fiscal surpluses. This enabled the government to gradually retire public debt and allocate more resources for economic development. Saudi government ramped up spending on much needed infrastructure projects, building new economic cities, expanding sea and air-ports, and is establishing a much needed railways system in the country. These activities are accelerating aggregate demand for goods and services thus raising private sector ability to boost corporate earnings. Along with that is whooping growth in bank lending activities, thus resulting liquidity spiral is spurring economic activities. As a result, inflation started accelerating on demand supply imbalances in tandem with the surge in global prices of construction materials, including steel bars and rods.

The private sector also stepped up investments in real estate sector and started constructing new industrial projects, enhancing the capacity of the existing ones, building of commercial centers and residential buildings. The result has been a period of unprecedented economic growth with

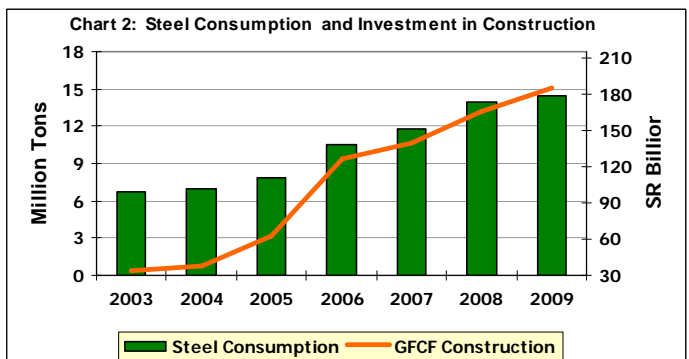
buoyancy in the construction sector. The Saudi economy doubled since 2002, with GDP rising from SR707 billion to SR1,414 billion in 2007 and the medium-term outlook through 2010 is very favorable. The current boom is accompanied by an acceleration of economic reforms and sharply growing inflows of foreign investment, adding to the sustainability of the boom, but with inflationary pressure.



In the next five years, a growing number of mega-projects with estimated investment of SR1.73 trillion (\$460 billion) are entering implementation stages while some of them have already started civil works that we expect to continue during the next fifteen to twenty years. All of these projects contain a large construction component which would induce aggregate demand for steel and cement. We expect growth in steel (rebar) demand to remain strong in the coming years (Chart 1).

2. Macro Economic Outlook for 2008-2009

In nominal terms, the size of the Saudi economy expanded 7.1% to SR1,431 billion in 2007, with corresponding per capita GDP rising further to SR58,400 (\$15,573) in the same year. The 2008 government budget earmarked SR410 billion spending program, out of which SR165 billion were allocated for development projects, about 40% of the total outlays. We estimate 2008 nominal GDP growth at 29.3% to reach SR1,850 billion while 2009 is seen recording a moderate growth on somewhat cooling off-oil sector. Chart 2 demonstrates a strong correlation between the Gross Fixed Capital Formation (GFCF) in construction goods and the steel consumption in the Kingdom.



3. Impact of Saudi Accession to WTO

The Saudi accession to WTO in December of 2005 not only increased the level of competition in the local market, but also enhanced integration of the Saudi economy with the global economy. The Kingdom's accession to WTO has a positive impact on the growth and the sustainability of domestic iron and steel industry, both in the short and long run. There is no fear of escalating foreign competition on local iron and steel producers. Moreover, Saudi steel producers have favorable comparative advantages over their rival foreign producers.

4. Regulatory Environment

Domestic iron and steel producers enjoy supportive regulatory regime on cheap energy cost and the levy of relatively higher custom duties on imports of similar steel products produced locally. Presently, the protective custom duty on those products ranges from the minimum of 10% to the maximum of 20%, depending upon the local industry's readiness to face foreign competition.

We believe the current protective tariff structure on iron and steel products will continue to stay as it is consistent with Kingdom's WTO accession commitments. However, Saudi Arabia has a preemptive right to temporarily alter these rules to address domestic steel market supply-demand imbalances. Presently, custom duties on all types of steel products have been lowered to 5% to lessen adverse impact of high international steel prices that are impeding the ongoing construction activities in the country.

Therefore, we believe that the Kingdom's iron and steel sector will continue to operate in a relatively protective business environment. Nonetheless, foreign investors can bring in capital to the Kingdom's market with 100% ownership while enjoying the same benefits as the local producers. Thus, there will be no discriminatory treatment to foreign investment in the Kingdom's iron and steel sector as cheap gas will be available to local and foreign operators at the same price.

B. Saudi Steel Market Outlook

In the Kingdom, aggregate supply of iron and steel products expanded 13.4% to 13.68 million metric tons in 2007, of which 1.55 million metric tons (11.3%) were estimated to have been exported or re-exported and the remaining 12.13 million metric tons (88.7%) were apparently sold in the domestic market. In the overall market demand, rebar (long products) constituted nearly 70% of the total quantity of iron and steel sold last year and the remaining 30% is consisted of flat products including steel wire, coiled, and steel sections (Table: 1). Of the total supply, nearly 49% is comprised of imported products and 51% is locally produced including fabricated steel products.

Table 1: Apparent Consumption of Iron and Steel Products
(Thousand metric tons)

	2003	2004	2005	2006	2007 Estimate	2008 Estimate
Hadeed Production*	3,720	3,624	3,765	3,856	4,800	5,500
Al-Tuwairqi Group (DR1)	0	0	0	750	1,000	1,500
Other Local (Recycled)	500	650	800	1,050	1,150	1,500
Imports, iron & Steel	3,835	3,955	4,574	6,410	6,731	7,067
A: Total Supplies	8,055	8,229	9,139	12,066	13,681	15,567
Change (%)	nc	2.2%	11.1%	32.0%	13.4%	13.8%
B: Less Exports	1,357	1,311	1,224	1,528	1,550	1,650
Domestic Consumption (A-B)	6,698	6,918	7,915	10,538	12,131	13,917
Change (%)	nc	3.3%	14.4%	33.1%	15.1%	14.7%
Total Population (Million)	23.1	22.7	23.2	23.8	24.4	25.0
Per Capita Consumption (kg)	290	305	341	443	497	557

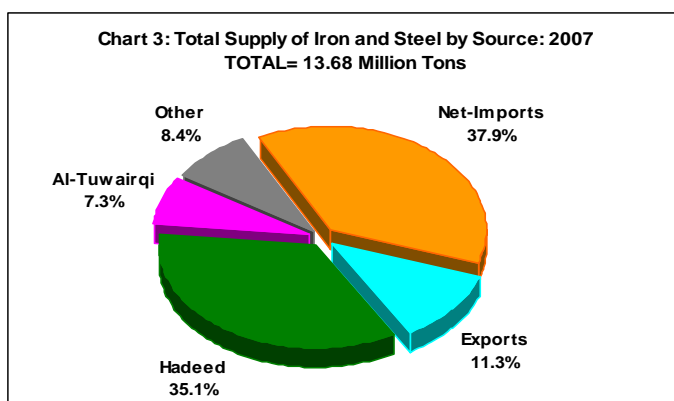
Source: Net-Imports, Various reports and NCB estimates, * Actual Reported by SABIC

1. Per Capita Steel Consumption: Volume

The Kingdom's aggregate apparent per capita steel consumption increased by 12.2% to 497 kg in 2007 and is expected to rise further to 557 kg in 2008. Although the Kingdom's contribution to the global steel output is around 0.5%, the relatively high per capita steel consumption last year was significantly higher than China of about 268 kg and about ten times more than that in India. Saudi Arabia is rapidly emerging as a major iron and steel consuming country on the world map. With estimated annual consumption of 12 million metric tons in 2007, Saudi Arabia has become the 21st largest steel consumer in the world.

2. Local Steel Production

Saudi Iron and Steel Company (Hadeed), a subsidiary of SABIC, is the first fully integrated steel producer in the Kingdom with 2007 annual production capacity reaching 4.95 million metric tons including 3.2 million metric tons of long products and 1.75 million metric tons of flat products. In the medium term, Hadeed aims to set up two new greenfield projects to achieve production target of 10 million metric tons a year. In 2007, Hadeed achieved 97% capacity utilization with actual production amounting to 4.8 million metric tons. Actual production last year expanded nearly 25% over realized production of 3.85 million metric tons in the year before.

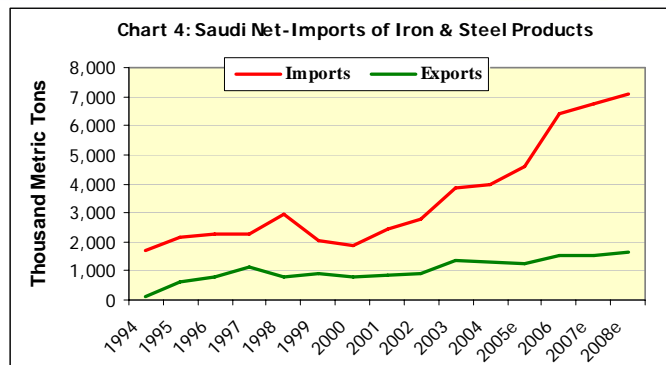


Actual sales in 2007 by Hadeed increased by 15.7% to 4.65 million metric tons. A Direct Reduction Module (DRI) plant with 1.75 million metric tons a year capacity was commissioned in the later part of 2007 contributing 0.5 million metric tons to the production of last year. Hadeed is also a supplier of steel billets to the country private rolling mills, as they produce rebar and meet around 30% of the Kingdom's total market demand.

Using 2008 estimates, Hadeed accounted for 35%, Al-Tuwairqi 10%, and other fabricators, the remaining 10%. Chart 3 exhibits distribution of supply by source. A private sector company, Al-Tuwairqi Group is the second largest DRI producer in the Kingdom with a 1.5 million metric tons capacity including the 0.75 million metric tons capacity that went on production stream in July 2007. The group has an aggregate operating capacity of 7.6 million metric tons, comprising of rolling mills at 46% of the total, followed by 23.7% melt shops, about 20% DRI and 10.5% of downstream steel products. We believe that the robust steel demand growth in Saudi Arabia will continue in the next ten years on the back of key demand drivers; specially mega industrial projects and massive construction activities.

3. Kingdom's Steel Imports and Exports

One of the significant achievements of the Saudi iron & steel industry has been its clear ability to expand exports while enhancing the value-added in the domestic economy. The industry has been quite successful in achieving import substitution of numerous items, particularly those subjected to 20% protective custom duty. Saudi imports, compiled by CDS according to Standard International Trade Classification (SITC), grew strongly by 40.1% to 6.4 million metric tons in 2006 and estimated to have edged up further by 5% to 6.7 million metric tons in 2007. In the same period, Saudi Arabia exported 1.5 million metric tons and 1.6 million metric tons, respectively. Thus, net-imports (imports minus exports) increased strongly by 84.6% to 5.2 million metric tons in 2006 and is estimated to have risen by 6.1% to 5.2 million metric tons in 2007. In value term, steel imports grew by 70.6% to SR21.4 billion in 2006, and is expected to have further grown by 2.4% to SR22 billion in 2007 (Table 2 & Chart 4).



In general, the overall iron and steel industry in the Kingdom has reached a development stage whereby it is not only competing with foreign products in the domestic market but also has captured a notable share in the neighboring foreign markets. Over the last decade, the aggregate quantity of Kingdom's exports of iron and steel products saw a massive growth on capacity enhancement; diversified products mix; and improved competitiveness. In value term, Saudi exports increased by 36.6% to SR3.4 billion in 2006 and further by 32% in 2007 to reach SR4.5 billion.

4. Steel Market Size: Value

At an overall average price of SR2,620 per metric ton, the aggregate market value of iron and steel products sold by the Saudi companies is estimated to have grown by 24% to SR36.2 billion in 2007. Sharp rise in steel prices and volume of consumption in the Kingdom were the major factors behind rising market size last year. Table 3 provides our estimates of the Kingdom's market size of iron and steel products during the period from 2004 through 2008.

	2003	2004	2005	2006	2007 Estimate	2008 Estimate
Average Price Per Ton (SR)	1,650	1,820	2,250	2,450	2,620	2,725
Price change (%)		10.3%	23.6%	8.9%	6.9%	4.0%
Market Demand by Value	11,052	12,591	17,809	25,818	31,782	37,924
Change (%)		13.9%	41.4%	45.0%	23.1%	19.3%
Value of Exports	1,952	2,476	2,678	3,382	4,464	5,085
TOTAL MARKET SIZE (SR)	13,004	15,067	20,487	29,200	36,246	43,008
		15.9%	36.0%	42.5%	24.1%	18.7%

Source: Net-Imports from CDS, Various reports and NCB estimates, * Actual Reported by SABIC

	Value of Imports		Quantity of Imports		Avg Price
	SR Million	Change (%)	Kilo Tones	Change (%)	SR Per Ton
1998	5,934	18.8%	2,923	30.2%	2,030
1999	4,263	-28.2%	2,070	-29.2%	2,059
2000	3,883	-8.9%	1,845	-10.9%	2,105
2001	4,691	20.8%	2,416	30.9%	1,942
2002	4,720	0.6%	2,770	14.7%	1,704
2003	6,719	42.4%	3,835	38.4%	1,752
2004	8,639	28.6%	3,955	3.1%	2,184
2005	12,560	45.4%	4,574	15.7%	2,746
2006	21,423	70.6%	6,410	40.1%	3,432
2007e	21,947	2.4%	6,731	5.0%	3,261
2008e	23,620	7.6%	7,067	5.0%	3,342

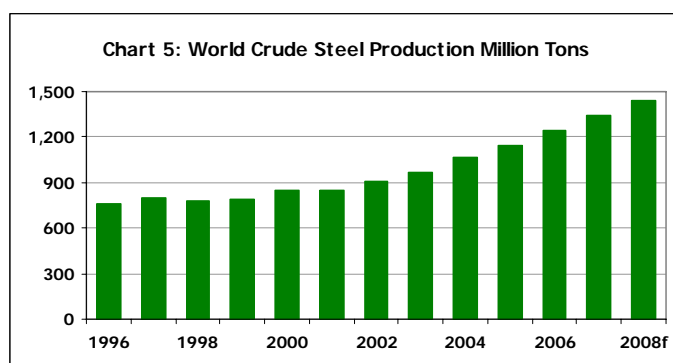
Source: CDS-Ministry of Planning and NCB Estimates

C. Global Crude Steel Market

Global steel production grew substantially in the 20th century from a mere 28 million metric tons at the beginning of the century to 781 million metric tons in 2000. In 2007, full year global production reached 1,343 million metric tons, up 7.5% on 2006 and about 78% higher from ten years ago. Steel production from Asian countries accounted for nearly 56% with China producing nearly 36% of the global output last year.

Growth of Chinese steel industry appears to be stagnating on declining per capita steel consumption basis. China has been expanding production capacity for several years and appears to have reached a stage of saturation as witnessed from the rising levels of Chinese net-exports of steel. By 2009, production from new capacity enhancement by Brazil, China and India will catch up with the rising global demand. India is putting 58 million metric tons of new capacity to boost its total capacity to 90 million metric tons by 2010.

Brazil also has plans to increase its capacity from the current 35 million metric tons to 60 million metric tons in the coming years. While Chinese current production capacity is slightly in excess of the domestic demand, the drop in consumption, either due to high prices or slower economic activities, may create global oversupply conditions. In addition, continued surge in the prices of steel, particularly rebar, could also trigger slowdown in the ongoing construction boom in selected parts of the world, especially in the GCC countries including Saudi Arabia. Thus, planning for capacity expansion in GCC states have to match local demand emanating from several infrastructure projects. Chart 5 exhibits annual world production of steel since 1996.



1. Global Steel Production Jan-Mar 2008

According to the Iron & Steel Statistics Bureau (ISSB), global production of steel in March 2008 rose by 5.8% to 119.5 million metric tons, the highest monthly total in over 15 years. The accumulative global steel production in the January-March 2008 expanded 5.6% to 340.7 million metric tons, compared with 322.6 million metric tons in the same period of 2007. However, excluding Chinese producers, the global total for the 2008's first quarter was slower at 4% up in the same three months of 2007. As reported by ISSB, Saudi Arabian crude steel production increased by 21.9% to 1.3 million metric tons during the first three months of 2008 (Table 4).

Major Producers	January-March Total		Change (%)
	2007	2008	
World Total	322.6	340.7	5.6%
EU Union-27	52.6	53.3	1.3%
China	115.0	124.9	8.6%
Japan	29.5	30.8	4.4%
USA	23.5	25.4	7.9%
Russia	18.3	19.2	5.0%
India	13.5	14.3	6.1%
South Korea	12.6	13.2	5.0%
Germany	11.9	12.1	2.1%
Brazil	8.0	8.6	8.1%
Italy	8.2	8.3	0.7%
Taiwan	5.1	5.7	12.2%
Argentina	1.3	1.4	6.9%
Saudi Arabia	1.1	1.3	21.9%

Source: ISSB May 2008

2. Steel Prices

On the domestic market front, current steel prices are quite volatile given the visible supply-demand mismatch. According to market sources, selling price of imported billet in the last week of May 2008, varied from as low of SR3,950 per metric ton to as high of SR4,250 per metric ton depending upon the supply situation in the market. The billet is normally used as a raw material to produce rebar as nearly 70% of total market demand accounted for by rebar. The market prices of rebar, produced from both locally made and imported billets, varied from the low end of SR4,500 to the high level of SR5,000 per metric ton. The market has the potential to even absorb rebar prices at a higher level of SR5,300 per metric ton.

International prices of iron & steel are expected to remain high unless global demand slowdown markedly. Steel prices have risen to their peaks that have already inflicted slowdown in demand for various steel products such as scrap, which is also used in making billets and then converted into rebar. Construction contractors who have won projects on the basis of low steel prices may have to suffer on narrowing profit margin while those preparing bids in the current high price environment may benefit if increased production from China comes to the world market.

In the 12-month to May 2008, steel prices in the global markets continued to rise with the largest 61.8% gain recorded for the Hot Rolled Steel Coil segment. The buoyancy in steel prices remains intact through May 2008 with global price of rebar edging up further 5.8% between January and May 2008. The 6% rise in the price of rebar through June this year clearly demonstrates the cycle is yet to be over

**Table 5: World Carbon Steel Transaction Prices
(US Dollar Per Metric Ton)**

Month of Year	Hot Rolled Steel Coil	Hot Rolled Steel Plate	Cold Rolled Steel Coil	Steel Wire Rod	Medium Steel Sections
Apr-07	617	788	698	577	798
May-07	623	800	696	606	815
Jun-07	611	800	686	602	812
Jul-07	599	808	681	590	819
Aug-07	603	814	686	594	825
Sep-07	602	810	673	580	821
Oct-07	611	826	680	584	844
Nov-07	615	833	688	598	853
Dec-07	630	837	705	598	859
Jan-08	639	847	716	621	871
Feb-08	699	887	772	687	905
Mar-08	800	978	890	758	970
Apr-08	915	1065	985	852	1042
May-08	998	1160	1080	920	1105
Change YOY	61.8%	47.2%	54.7%	59.4%	38.5%

All steel prices above are in \$/metric ton. Steel price information was updated May 2008.
Source: MEPS Steel Prices On-line.

done, pointing toward significant supply-demand imbalances. Table 5 exhibits international monthly average steel prices across different product categories quoted in US dollars per metric ton.

Conclusion

The massive wave of ongoing construction activities in Saudi Arabia has created a sizeable transient demand

for building materials including numerous steel products and reinforcing bars. In addition, the establishment of seven new economic cities and the approval of the much awaited steel intensive railway project linking East and West of Saudi Arabia are set to create huge amount of demand for steel in the next five to ten years. In response to emerging huge transient demand, major players in the steel industry have drawn plans to expand industrial capacity. Upon completion of planned capacity and enhancement programs, excess capacity above sustainable capacity demand is widely feared amongst industry analysts. Thus, in the domestic market perspective, the likely future of capacity overhang situation would tend to intensify competition among local steel producers and foreign exporters. This, however, is likely to affect domestic steel producers' long-term profitability.

Notwithstanding, the Kingdom's supportive regulatory regime along with cheap energy cost and the protective tariffs, local industry will continue to maintain a competitive edge over foreign producers. Meanwhile, the growing level of Saudi steel exports in the recent years demonstrates the inherent competitive advantage of the Saudi steel industry. Although entry to the steel industry requires huge capital, there are minimal risks associated with the market demand in the medium to long term.

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