

Recession in 2017, moderate recovery in 2018-2019

General Information



GDP	USD646bn (World Ranking 20, World Bank 2016)
Population	32.28mn (World Ranking 41, World Bank 2016)
Form of state	Absolute Monarchy
Head of government	HRH King Salman bin Abdulaziz bin Abdul Rahman bin Faisal bin Turki bin Abdullah bin Mohammed bin Saud
Next elections	None



Strengths

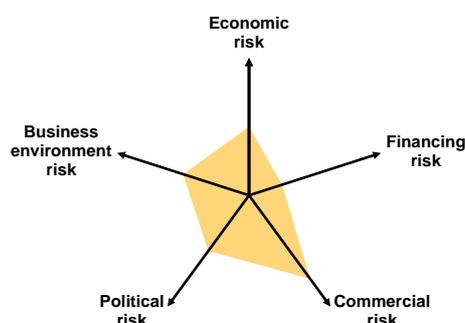
- Natural resource base (oil and gas)
- Strategic importance as an oil exporter and with spare capacity to increase output, in need
- Large financial asset base and strong foreign exchange reserves
- In time of high oil prices strong fiscal and current account surpluses. These provide a financial buffer when deficits are recorded in times of severely depressed oil prices
- Net creditor
- Generally good relations with the U.S.
- Long-standing and stable exchange rate system

Weaknesses

- Dependence on international oil prices along with a narrow economy base focused on the hydrocarbon sector
- High unemployment and under-employment have the potential to fuel increased militancy, particularly among the minority Shia population
- Data transparency is below average for a high income economy
- Regional uncertainties, with land borders with Iraq and Yemen and with Iran as a close neighbor. The latter is seen by some as a competitor for regional power

Country Rating

BB2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
China	12% 1	16% China
United States	10% 2	11% United States
India	9% 3	7% Germany
South Korea	8% 4	6% South Korea
Taiwan	3% 5	5% United Kingdom

By product (% of total)

Exports	Rank	Imports
Crude Oil	68% 1	9% Cars And Cycles
Refined Petroleum Products	9% 2	6% Engines
Plastic Articles	7% 3	5% Telecommunications Equipment
Basic Organic Chemicals	5% 4	4% Electrical Apparatus
Natural Gas	2% 5	4% Commercial Vehicles

Source: Chelem (2015)

Economic Overview

In recession

After real GDP growth fell to +1.7% in 2016 from 4.1% in 2015, triggered by markedly lower oil prices, the downturn in the Saudi economy deepened further in H1 2017. Real GDP contracted by -0.5% y/y in Q1 and by -1% y/y in Q2. Supply-side data show that the oil sector shrank by -1.8% y/y in Q2 while the non-oil sector grew by +0.6%. Within the oil sector, oil extraction dropped by -2.5% y/y in Q2, impacted by the November 2016 OPEC agreement to cut oil output, while oil refining rose by +5.8%. Within the non-oil sector, construction (-1.6% y/y) and domestic trade (-0.1%) declined in Q2 while financial and business services (+1.9%), utilities (+1.1%), transport and communication (+0.8%) and agriculture (+0.6%) grew. Early indicators suggest that the downturn continued in Q3. The PMI for the non-oil private sector economy edged up only slightly from an average 55.4 points in Q2 to 55.7 in Q3 – this may appear sound at first sight, but it is well below the long-term average of 58.1 for Saudi Arabia. And private sector credit has continued to contract in Q3 (-1.4% y/y). All in all, we expect real GDP to contract by -0.3% in 2017 as a whole.

The economy is forecast to recover in 2018-2019, albeit gradually. The OPEC-agreed oil production cuts (currently running until March 2018) are likely to be extended though unlikely to be deepened. Oil prices are expected to be broadly stable in 2018 – we forecast an annual average USD57/bbl – requiring fresh fiscal austerity to curb the fiscal deficit. Subsidy cuts and a new VAT should speed up inflation to an average 4% or so in 2018, weighing on household spending. Overall, we forecast real GDP to grow by +1.7% in 2018 and +2% in 2019.

Large fiscal deficits since 2015, but financial assets continue to provide a cushion

Sharply lower oil prices since mid-2014 led to a substantial drop in fiscal revenues. The annual fiscal balance swung into a moderate deficit in 2014 which surged to around -17% of GDP in 2015-2016. Fiscal austerity measures will narrow the shortfall in 2017-2018 but it will remain sizeable, forecast at around -9.5% and -7% of GDP, respectively.

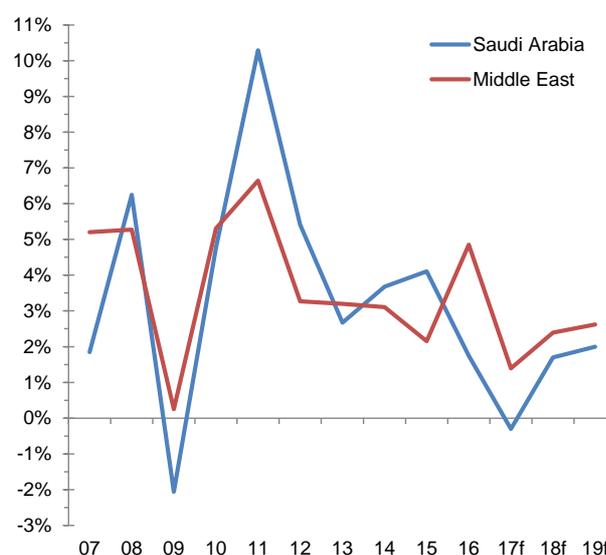
Initially, the fiscal deficits were financed almost entirely by a drawdown of foreign exchange (FX) reserves held at SAMA (central bank) which have fallen from a USD745bn peak in August 2014 to USD485bn in September 2017 (these reserves include financial assets held by the SAMA Foreign Holdings sovereign wealth fund). However, current reserves are still sufficient to cover around 30 months of imports. In 2016, Saudi Arabia successfully turned to the international bond market with a debut sovereign bond issuance of USD17.5bn. In September 2017, the government was able to issue another USD12.5bn of dollar debt. This should roughly cover this year's external financing requirements and half of the expected fiscal deficit in 2018. As a consequence, public debt should further rise to around 23% of GDP in 2018, up from just 2% in

Key economic forecasts

	2016	2017e	2018f	2019f
GDP growth (% change)	1.7	-0.3	1.7	2.0
Inflation (% , yearly average)	3.5	-0.1	4.1	3.3
Fiscal balance (% of GDP)	-17.2	-9.5	-7.0	-4.5
Public debt (% of GDP)	13.1	20.0	23.0	24.0
Current account (% of GDP)	-4.3	1.0	0.7	1.2
External debt (% of GDP)	17.3	21.0	22.0	23.0

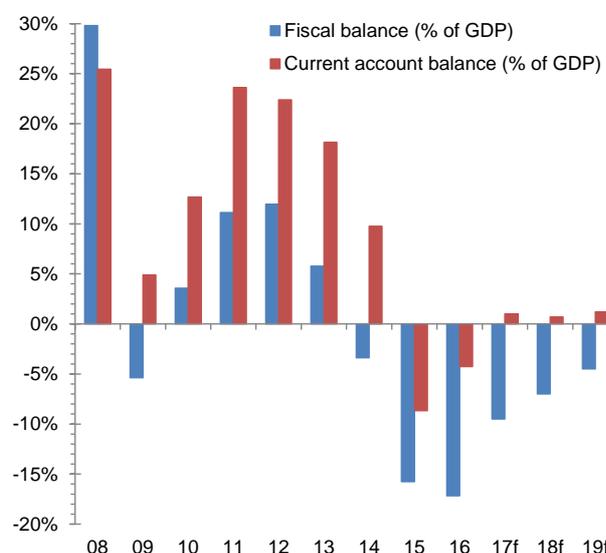
Sources: National statistics, IHS, Euler Hermes

Real GDP growth



Sources: National statistics, IMF, IHS, Euler Hermes

Fiscal and current account balances



Sources: IMF, IHS, Euler Hermes

2014. However, at this level it is still low compared to peers.

Another sovereign wealth fund, the Public Investment Fund, currently holds around USD200bn, providing further cushion, if needed.

Current account back in surplus

The annual current account balance also shifted to substantial deficits in 2015-2016, after 15 years of very high surpluses. Meanwhile, the modest oil price recovery since mid-2016 and the reduced import demand in the wake of the recession in early 2017 have shifted the current account back into surplus in H1 2017. We forecast small annual surpluses of around +1% of GDP in 2017-2019.

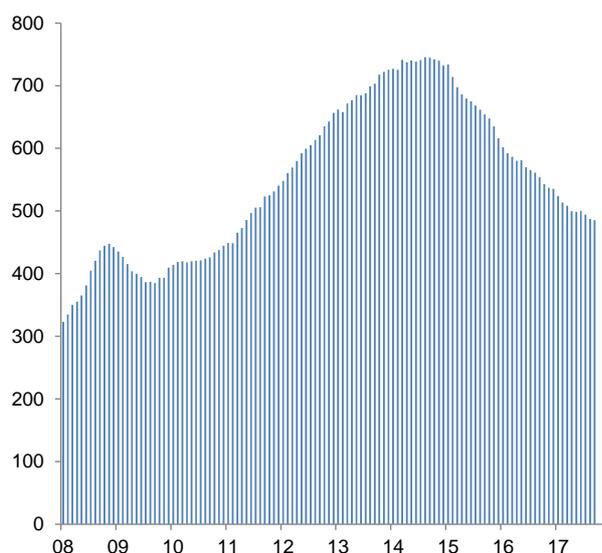
Despite recent pressures, the exchange rate system is likely to remain unchanged

Euler Hermes does not expect the exchange rate regime to change in the period to end-2018, with the fixed peg of SAR3.75:USD1 throughout. Progress towards a full Gulf monetary union has been limited and we do not envisage the introduction of an effective GCC single currency in this period.

The structural change of the economy will be a key challenge in the longer term

Saudi authorities have begun taking actions to address the economy's heavy dependence on the hydrocarbon sector which accounted for 44% of GDP in 2016. The Vision 2030 roadmap and the National Transformation Plan 2020 (NTP) are supposed to set up a large framework to smoothen the economic diversification process, relying on a wide range of initiatives to develop weak sectors such as defense industries, retail, renewable energy and the private sector. These long-term projects are likely to face challenges, for example: (i) economic downturns such as the current one which may distract from the long-term targets; or (ii) the transfer of public sector jobs to the private sector which could increase social tensions in the medium term.

Official foreign assets managed by SAMA (USD bn)



Sources: SAMA, Euler Hermes

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