Euler Hermes Economic Research

Country Report

Saudi Arabia

Weaker oil revenues, but strong financial assets

General Information

GDP	USD748.45 bn (World ranking 19, World Bank 2013)
Population	28.83 mn (World ranking 45, World Bank 2013)
Form of state	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

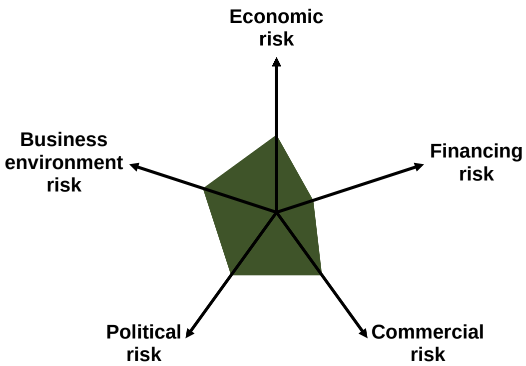
- Natural resource base (oil and gas).
- Strategic importance as an oil exporter and with spare capacity to increase output, in need.
- Large asset base (over USD730 bn) and strong FX reserves.
- Fiscal and current account surpluses.
- Net creditor.
- Generally good relations with the U.S.
- Long-standing and stable exchange rate system.
- Strong international assessments of the business environment.

Weaknesses

- Dependence on international oil prices and only limited economic diversification.
- 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

BB1



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
China, Taiwan Province of	14%	1	13%	United States
United States	13%	2	13%	China
China	12%	3	7%	Germany
Japan	12%	4	7%	Japan
Korea, Republic of	9%	5	6%	Korea, Republic of

By product (% of total)

Exports		Rank		Imports
Petroleum, petroleum products	83%	1	15%	Road vehicles
Plastics in primary forms	5%	2	7%	Iron and steel
Organic chemicals	4%	3	7%	Other industrial machinery and parts
Gas, natural and manufactured	2%	4	5%	Telecommunication and sound recording apparatus
Fertilizers other than group 272	1%	5	5%	Electrical machinery, apparatus

Source: UNCTAD (2012)

Economic Overview

Planning strategy

The current planning strategy involves a programme of diversification away from oil by investing in infrastructure and human resource development. As elsewhere in the region, labour policy promotes the employment of nationals rather than expatriate workers. Partly in response to the Arab Spring, the government launched social support packages, with additional state spending to boost the economy over a seven-year period (from 2011) that includes measures to increase housing and job prospects.

Initial impact of the Arab Spring was positive for growth…

Despite the Arab Spring and associated disruption to some regional business activity, Saudi Arabia's GDP increased by around +10% in 2011, with strong performances by manufacturing and the service sector, as well as the oil and gas industry. Indeed, the short-term impact of the Arab Spring was positive for the Saudi economy as oil output was increased to substitute for disrupted supplies elsewhere. In addition, large social-support packages were announced by the king in early 2011, providing a further boost to the domestic economy. These trends continued into 2012, with GDP expanding by +5.4% before some correction took place in the oil sector in 2013 (+2.7%) and 2014 (+3.6%).

…but lingering regional uncertainties and now weaker oil prices are negative

In addition to some negative investor perceptions of a troubled region (including Iraq, Syria and Iran), the outlook for growth in 2015-16 reflects two key issues: (i) EH expects that the kingdom will retain its stance of not cutting oil output to counter downward price pressure from North American output from shale reserves and (ii) continuing high state expenditure on infrastructure projects and social welfare. On balance, EH forecasts that overall GDP growth will be +2.5% in 2015 and +3.5% in 2016.

Inflationary pressures will remain low, exchange rate system unchanged

Food prices and housing costs are the main inflation drivers and are likely to remain so over the forecast period, particularly as domestic demand is forecast to remain strong. Inflationary pressures from these two sources somewhat offset each other as high food prices are balanced by easing price pressures through housing as the supply of new-build homes is being boosted under government social programmes. The outlook for inflation is relatively benign, with EH forecasting end-year rates of below 3% in 2015 and 2016.

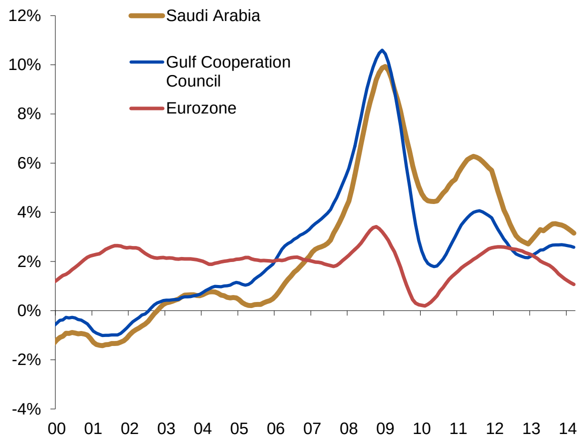
EH does not expect the exchange rate regime to change in the period to end-2016, with the fixed peg of SAR3.75:USD1 throughout. Progress towards a full Gulf monetary union has been limited and EH does not envisage the introduction of an effective GCC single currency in this period.

Key economic forecasts

	2012	2013	2014	2015f
GDP growth (% change)	5.4	2.7	3.6	2.5
Inflation (%, end-year)	3.6	3.0	2.4	2.2
Fiscal balance (% of GDP)	13.6	6.5	4.4	0.2
Public debt (% of GDP)	3.6	2.7	2.7	3.3
Current account (% of GDP)	22.5	18.1	14.2	1.0
External debt (% of GDP)	11.4	11.2	11.4	14.3

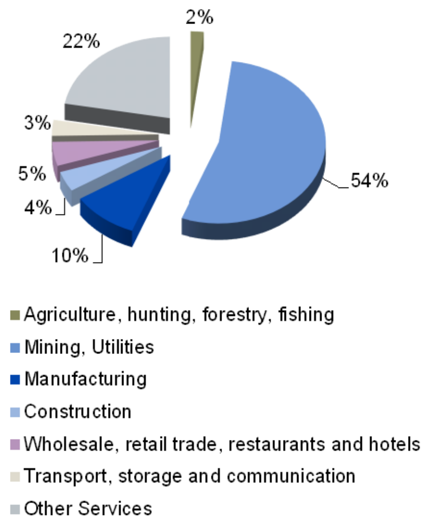
Sources: IHS, national sources, Euler Hermes

Inflation



Sources: IHS, Euler Hermes

GDP breakdown (%)



Sources: UNCTAD

Trade and current accounts will weaken but are not a systemic risk

With oil accounting for over 80% of export revenues, the current account registered strong double-digit surpluses in 2010-14. Benchmark global oil prices weakened sharply from USD115/barrel in mid-2014 and were almost -50% down by early-March 2015. Estimates suggest that Saudi Arabia's break-even oil price (at which it can maintain its current fiscal spending patterns, prevent a run-down of its FX reserves and other financial assets and keep on registering current account surpluses) is around USD90-100/barrel. Saudi Arabia (and by extension, OPEC) adopted a policy of not cutting oil output to support prices under pressure from increasing supplies from North American shale fields. As a result, external accounts will deteriorate, at least in the short term. EH forecasts a sharp fall in the current account surplus, to around USD1 bn in 2015 but the surplus could be larger if corrective actions (such as limiting non-essential imports) are introduced.

Strong financial assets

Saudi Arabia has financial assets that will protect it even for a protracted period of low oil prices. Hard currency foreign exchange reserves are currently around USD60 bn but SAMA (central bank) has a substantial financial asset base to draw on, in need. Using IMF data, which puts FX reserves at over USD600 bn, gives Saudi Arabia import cover of at least 15 months. Net foreign assets managed by SAMA are officially given as over USD730 bn (February 2015).

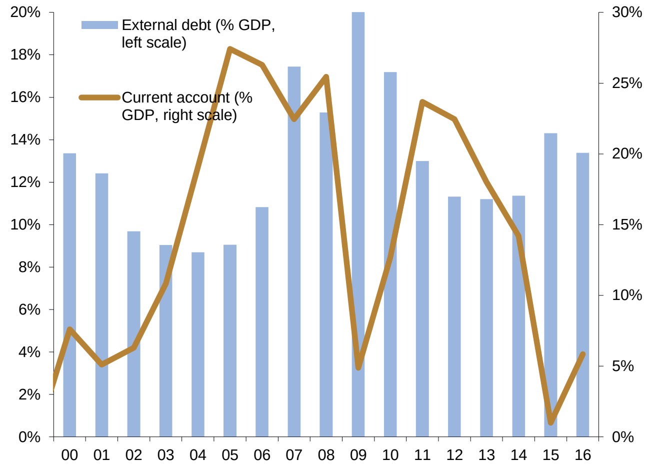
External debt ratios are low and servicing of obligations is not onerous

External debt ratios are low, with total foreign debt stock at around 11% of GDP and 22% of total export earnings in 2014 and the debt service ratio on existing obligations is only equivalent to around 1% of export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments) will not be problematic.

Public finances

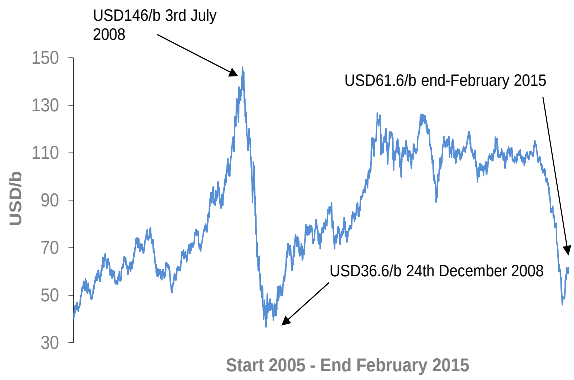
The government has shown a clear determination to reduce public debt stocks and to maintain obligations at low levels. Public debt, which is wholly domestic, was equivalent to less than 3% of GDP in 2013 and 2014. Even with current plans to boost spending and weaker revenue growth public debt will remain at or around 3% of GDP by end-2016.

External debt and current account balance (% of GDP)



Sources: IHS, Euler Hermes

Oil prices (Brent crude USD/barrel)



Source: Euler Hermes

Forecasts of Benchmark Crude Oil Prices (USD/barrel)

	2015	2016
Brent	64	84
WTI	62	80

Source: Euler Hermes

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