Euler Hermes Economic Research

Country Report

# Saudi Arabia

## Pro-active policy response to counter weak oil prices

### General Information

| | |
|---|---|
| **GDP** | USD746.25bn (World ranking 19, World Bank 2014) |
| **Population** | 29.4mn (World ranking 45, World Bank 2014) |
| **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

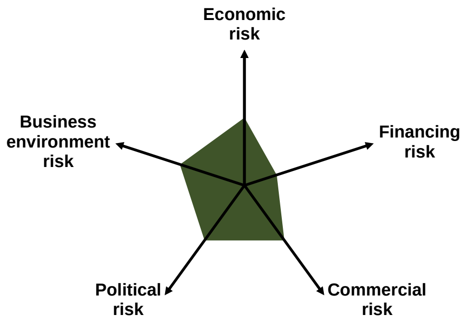
- Natural resource base (oil and gas).
- Strategic importance as an oil exporter and with spare capacity to increase output, in need.
- Large financial asset base (over USD630bn) and strong FX reserves.
- In times of high oil prices strong fiscal and current account surpluses. These provide a financial cushion 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.
- Strong international assessments of the business environment.

### Weaknesses

- Dependence on international oil prices and only limited economic diversification other than into downstream activities.
- 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 neighbour. 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 and related materials | 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 and appliances, n.e.s. |

Source: UNCTAD

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## Annual GDP growth averaged almost +5% in the period 2010-15…

GDP increased by around +10% in 2011, with strong performances by manufacturing and the services sector, as well as the oil and gas industry. Indeed, the short-term impact of the Arab Spring was positive for the 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 weak oil markets and associated policy responses provide a different environment

Despite a moderate rebound in early 2016, oil prices at the beginning of March were down -39% y/y and, at USD37/b, were over –USD89/b below the level in March 2012. The outlook for growth in 2016-17 reflects several factors: (i) EH expects oil prices will remain subdued in the short- to medium-term; (ii) the kingdom will retain its stance of not cutting oil output as it is now focusing on securing its share in key export markets; and (iii) the Saudi authorities will pursue a more active economic reform strategy and will continue to provide support through state expenditure on infrastructure projects and social welfare. On balance, EH forecasts overall GDP growth will be +1.5% in 2016 and +3% in 2017.

Against this economic background, the business environment will be more challenging, particularly in the private sector. Non-payment risk is increasing in a country already affected by longer-than-average payment periods. The average Days Sales Outstanding increased by three days in 2015, to 62, with further deterioration expected.

## Inflation remains manageable

Food prices and housing costs are the main inflation drivers and are likely to remain so over the forecast period. 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, although with an upward bias, and EH forecasts end-year rates of around 4.5% in 2016 and 2017.

## Planning strategy

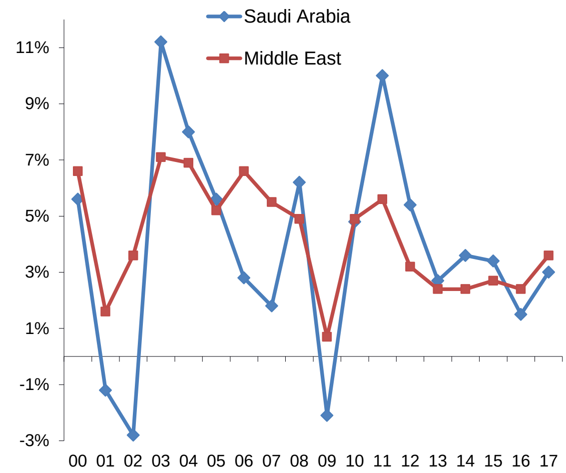
Diversification away from oil by investing in infrastructure and human resource development is now likely to be pursued more actively. As elsewhere in the region, labour policy promotes the employment of nationals rather than expatriate workers. Social support packages will continue and include measures to increase housing and job prospects. Perceptions that oil prices will remain low for longer are now focusing attention on more fundamental reforms, including subsidy provision, privatisation of some state assets and introduction of VAT taxation.

**Key economic forecasts**

| | 2014 | 2015 | 2016f | 2017f |
|---|---|---|---|---|
| GDP growth (% change) | 3.6 | 3.4 | 1.5 | 3.0 |
| Inflation (%, end-year) | 2.4 | 2.3 | 4.2 | 4.5 |
| Fiscal balance (% of GDP) | -2.3 | -15.0 | -15.0 | -10.0 |
| Public debt (% of GDP) | 1.6 | 2.7 | 3.0 | 2.5 |
| Current account (% of GDP) | 10.8 | -6.3 | -8.5 | -3.5 |
| External debt (% of GDP) | 11.3 | 13.7 | 13.3 | 12.5 |

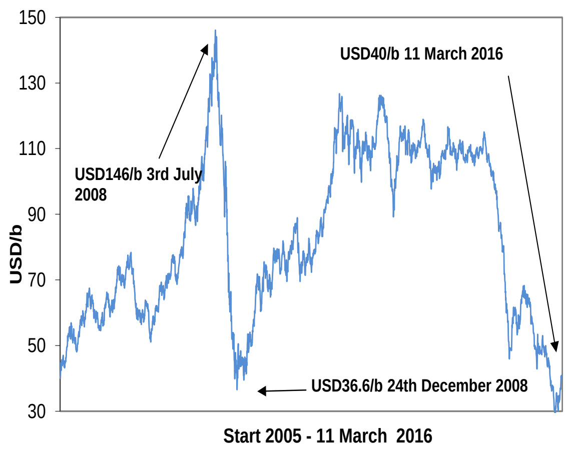
Sources: National sources, IHS, Euler Hermes

**GDP growth (%)**




Sources: National sources, IHS, Euler Hermes

**Oil Prices (Benchmark Brent, USD/barrel)**




Sources: FT, Euler Hermes

## The current account moves from strong surpluses to deficits…

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 -70% down by early-March 2016. 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 other producers. As a result, external accounts are deteriorating. Indeed, EH forecasts that the current account went into deficit in 2015 (-6% of GDP) and that shortfalls will continue in 2016 (-8.5%) and 2017 (-3.5%).

## …but financial assets provide a cushion

Saudi Arabia has financial assets that are protecting it even for a protracted period of low oil prices. Hard currency foreign exchange reserves are currently around USD60bn but SAMA (central bank) has a substantial financial asset base to draw on. Net foreign assets managed by SAMA were over USD730bn in February 2015 but these were reduced to around USD630bn in the corresponding month of 2016.

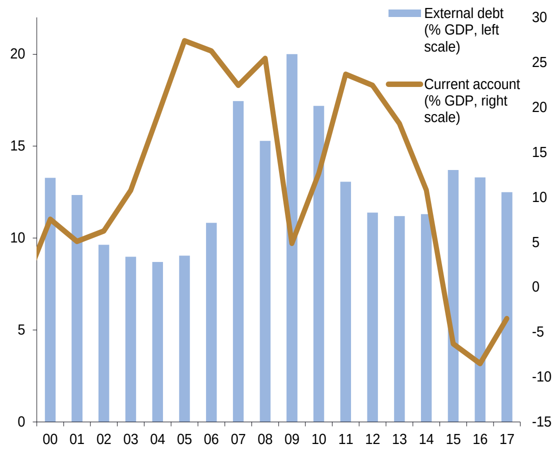
## External debt ratios and servicing of obligations are low, but deteriorating

External debt ratios are low, with total foreign debt stock at around 14% of GDP and 36% of total export earnings in 2015 and the debt service ratio on existing obligations is only equivalent to around 1.5% of export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments) should not be problematic *per se*, although debt stock and ratios are now deteriorating.

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

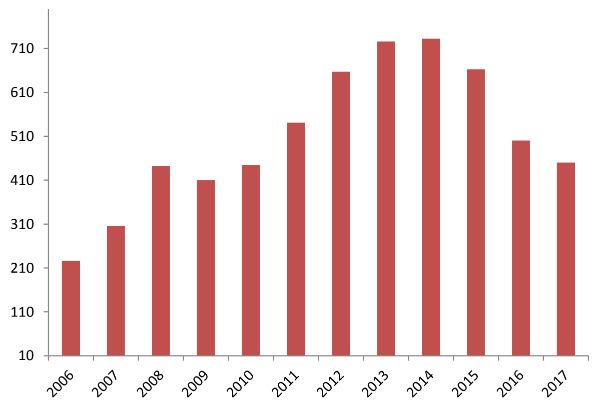
EH does not expect the exchange rate regime to change in the period to end-2017, with the fixed peg of SAR3.75:USD1 throughout. Progress towards a full Gulf monetary union has been limited and EH does not envisage the introduction of an effective GCC single currency in this period.

**Current account and external debt (% of GDP)**




Sources: National sources, IHS, Euler Hermes

**Official Foreign Assets Managed by SAMA (USDbn)**




Sources: SAMA, Euler Hermes forecasts





**Contact Euler Hermes Economic Research Team**
research@eulerhermes.com

**Last review: 2016-03-30**
**Country Risk Analyst:**
Andrew Atkinson
andrew.atkinson@eulerhermes.com