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Saudi Arabia: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Saudi Arabia, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 25, 2011, with the officials of Saudi Arabia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 29, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 18, 2011 discussion of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SAUDI ARABIA

Staff Report for the 2011 Article IV Consultation

Prepared by Staff Representatives for the 2011 Consultation with Saudi Arabia

Approved by Alfred Kammer and David Marston

June 29, 2011

Discussions: Held in Riyadh and Jeddah, May 10–25, 2011. The mission met with H.E. Dr. Al-Assaf, Minister of Finance; H.E. Dr. Muhammad Al-Jasser, Governor of the Saudi Arabian Monetary Agency (SAMA); and other representatives from the public and private sectors and academics. A press release issued at the conclusion of the discussions can be found at: http://www.imf.org/external/np/sec/pr/2011/pr11205.htm

Staff team: David O. Robinson (head), Ananthakrishnan Prasad, Tobias Rasmussen, Niklas Westelius (all MCD), and Sami Ben Naceur (INS). Masood Ahmed (MCD) and Karl Habermeier (MCM) participated in the policy discussions. Ahmed Al-Nassar (OED) joined the staff team.

Political setting: Saudi Arabia is a monarchy. King Abdullah bin Adbul-Aziz Al Saud has served as head of state and head of government since August 1, 2005.

Exchange arrangement: Conventional pegged arrangement, with the exchange rate of the riyal pegged to the U.S. dollar at SR 3.75 per U.S. dollar since June 1986. Saudi Arabia has accepted the obligations of Article VIII, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Past Surveillance: The 2010 Article IV consultation was concluded on July 12, 2010; The Public Information Notice of the Executive Board's discussion is available at http://www.imf.org/external/np/sec/pn/2010/pn10117.htm.

Statistics: Broadly adequate for surveillance; General Data Dissemination System (GDDS) participant since March 4, 2008.

Official development assistance: Saudi Arabia has continued to provide generous ODA, averaging 1 percent of national income during 2008–10.

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Executive Summary

Background

Economic growth strengthened in 2010 as the global recovery pushed oil prices higher and fiscal spending supported non-oil growth. Going forward, high oil prices and increased oil production to offset supply shortfalls elsewhere provide for a positive economic outlook for 2011. The authorities have taken advantage of the strong economic outlook to accelerate initiatives to address important social issues, notably in housing, unemployment, and extending the social safety net. Despite the increased fiscal spending associated with these initiatives, external and fiscal balances are expected to strengthen further, but vulnerabilities to a sustained decline in the oil price have increased and there are upside risks to inflation.

Policy priorities

Key priorities are to: contain near-term inflationary pressures; ensure medium-term fiscal sustainability; create job opportunities for nationals while maintaining competitiveness; further develop capital markets; and improve access to housing finance.

Staff's recommendations

- Proactively use fiscal and monetary policies to contain inflationary pressures, if needed.
- Ensure fiscal sustainability over the medium term by diversifying non-oil revenue sources, scaling back subsidies, and enhancing efficiency of spending through the development of a medium-term expenditure framework.
- Promote the development of capital markets, ensure sound development of mortgage finance, and better align the legal framework for supervision and regulation with practice.
- The exchange rate peg to the U.S. dollar remains appropriate.

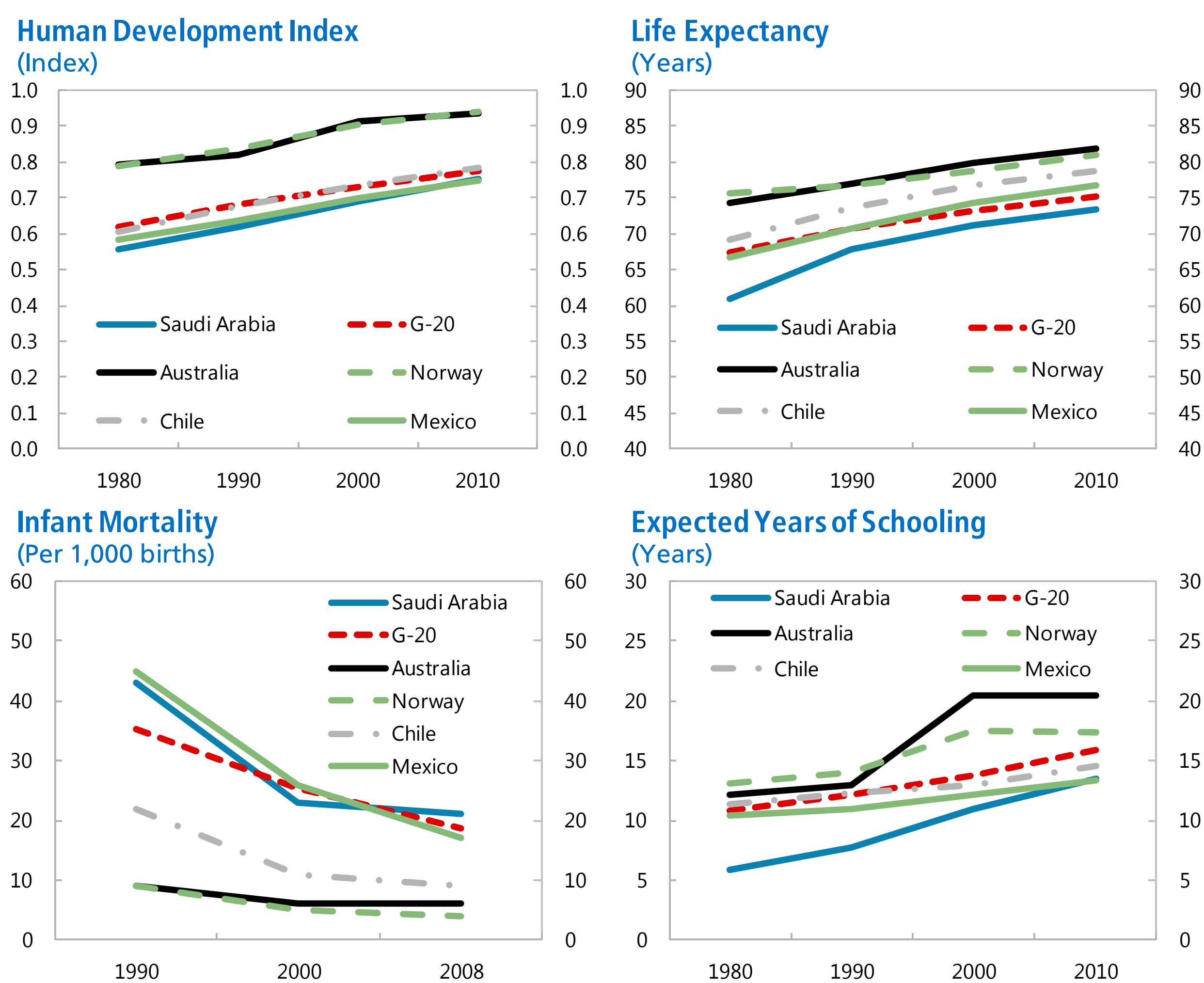
Authorities' views

- Inflation remains driven by structural factors—imported food prices and rents—while increases in domestically driven components would be modest and temporary.
- The fiscal accounts will remain strong throughout the medium term as the strong demand for oil will support the oil price. Much of the recent increase in fiscal spending constitutes an investment in future generations.
- Capital markets are emerging, with the yield curve likely to develop from the corporate bond market. Housing finance will be carefully monitored and regulated. The current legal framework for banking supervision and regulation has proven to be effective.

I. Background

1. **Saudi Arabia has achieved substantial gains in key development indicators** (Figure 1). With about one fifth of the world's proven oil reserves, Saudi Arabia has been able to translate its oil wealth into advances in social outcomes. Most indicators are close to the average for both the G-20 countries and other emerging market commodity exporters (Chile and Mexico), but remain below those of the advanced economy commodity exporters (Australia and Norway).

Figure 1. Saudi Arabia: Progress in Social Indicators, 1980–2010



Sources: UNDP; World Development Indicators.

2. **Nonetheless, important social issues remain**. In particular, pressure on housing resources and unemployment are longstanding concerns—which have been highlighted in previous development plans—that have yet to be resolved and could intensify in the face of still high rates of population growth.

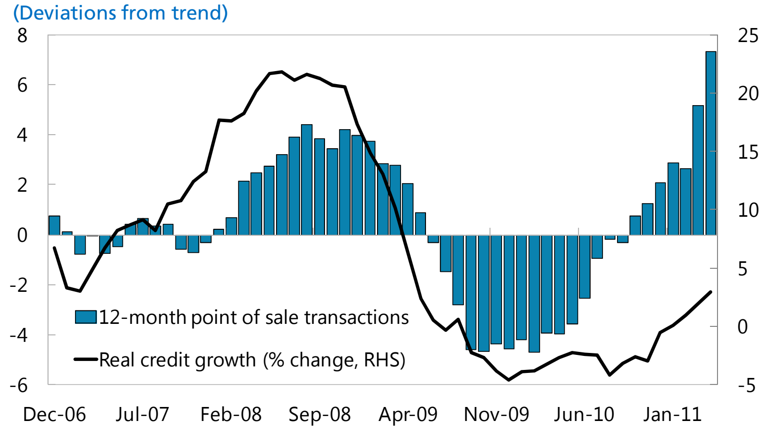
3. **The confluence of high oil prices, increased oil export volumes, substantial international reserves, and the absence of debt, provides a significant opportunity to address these social priorities.** The challenge then is how government can best respond, while fostering the emergence of a private sector capable of creating sufficient new jobs but without heightening near or medium-term fiscal sustainability risks and vulnerabilities.

II. Emerging from the Global Financial Crisis

The economy strengthened as oil prices increased with the rebound in global economic activity, and fiscal spending stimulated an acceleration in non-oil GDP growth. Fiscal and external balances improved with higher oil revenues. Spillovers on financial markets from unrest elsewhere in the region have been limited.

4. **Following a decline in growth in 2009, the economy has recovered in 2010 and early 2011 along with the rebound in global demand**. Overall real GDP growth rose from 0.1 percent in 2009 to 4.1 percent in 2010, driven by a rebound in oil sector GDP growth as well as an acceleration in non-oil GDP growth from 3.5 percent to 4.9 percent with strong support from public spending. Profitability of corporates listed on the stock exchange also improved significantly in 2010—net profits were 56 percent higher than in 2009. Available leading indicators—point of sale transactions, real credit, and business confidence surveys—all suggest a further strengthening of activity in the first quarter of 2011, with oil production now also increasing to compensate for lower output from Libya.

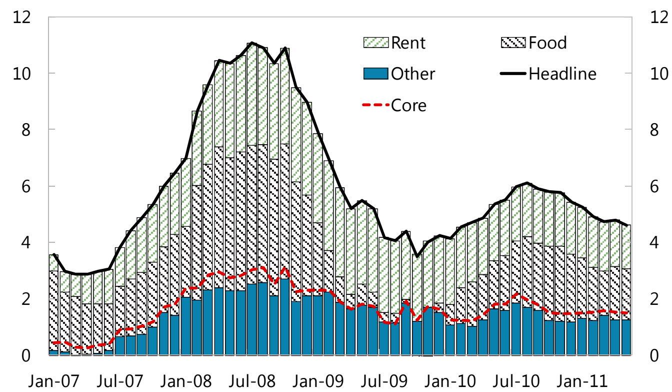
Leading Indicators: Point of Sale Transactions and Real Credit Growth, 2006–11
(Deviations from trend)



Sources: Country authorities; and IMF staff estimates.

5. **Headline inflation increased in 2010 driven by food prices as core inflation was stable, before slowing in early 2011**. End of period inflation rose from 4.2 percent in 2009 to 5.4 percent in 2010 before easing to 4.6 percent in May 2011. Food prices contributed 1.7 percentage points to headline inflation during 2010, reflecting increases in world commodity prices. Rental prices continue to be the other major contributor to inflation.

Contribution to Inflation, 2007–11
(In percent)



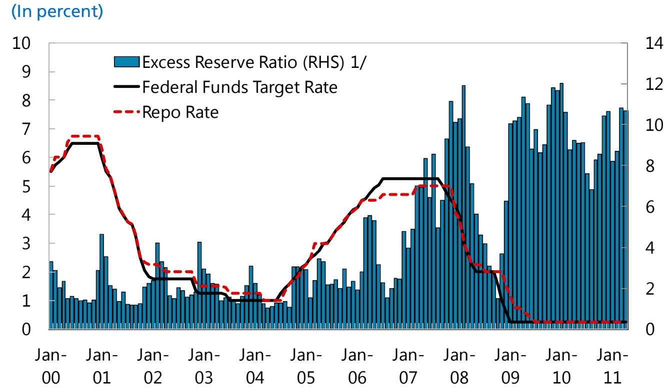
Source: Country authorities.

6. **Fiscal accounts moved back into surplus in 2010 as increased oil revenues more than offset rising fiscal spending**. Fiscal spending continued to grow in 2010—although at a slower pace than in the past five years—exceeding the approved budget by a wide margin as the wage bill and capital spending surpassed their respective targets. Overall revenue increased in line with global oil prices, while non-oil revenue declined marginally compared to 2009, due to below average growth in the private sector and lower investment income, reflecting the low yields in international financial markets.

7. **The external current account surplus strengthened in 2010 reflecting stronger global demand and higher oil prices**. The increase in oil export revenue—about 85 percent of overall export revenue—more than compensated for a rise in imports and net factor income outflows, with the current account surplus increasing from $20.9 billion in 2009 (5.6 percent of GDP) to $66.8 billion in 2010 (15.4 percent of GDP). This resulted in an overall balance of $35.1 billion in 2010 and an increase in SAMA's gross foreign assets to $444 billion (just over two years of import cover).

8. **Policy interest rates remain low, in line with domestic monetary indicators and monetary conditions in the U.S.** The SAMA kept its policy instruments unchanged throughout 2010—the repo rate corridor remained at 0.25 percent to 2 percent, while reserve requirements on demand and time deposits were 7 percent and 4 percent, respectively. Broad money growth slowed down significantly in 2010, but began to recover towards the end of the year as the non-oil economy accelerated.

Monetary Policy, 2000–11
(In percent)



Sources: Country authorities; and IMF staff estimates.
1/ Total reserves less statutory reserves as a share of total deposits.

9. **The banking sector entered a recuperating phase in 2010**. Banks remained well capitalized and highly liquid, gradually shifting their focus from placing excess liquidity with SAMA to extending credit. Total deposit growth slowed to 5 percent with the maturity structure of the deposit base shortening as demand deposits grew by 22 percent—increasing its share of total liabilities to 44 percent. Credit to the private sector grew by 5 percent while credit to the public sector grew by 15 percent. The nonperforming loans ratio declined slightly to 3 percent in 2010. The banking sector remained highly profitable, despite continued provisioning against potential loan-losses.

Banking Sector Indicators

	2007	2008	2009	2010
Capital-risk weighted assets	20.6	16.0	16.5	17.1
Gross NPLs/loans	2.1	1.4	3.3	3.0
Provisions/gross NPLs	142.9	153.3	89.8	115.7
Av. Pretax return on assets	2.8	2.7	1.9	1.9
Loan/deposits	73.3	80.7	77.8	73.5

Source: Saudi Arabian Monetary Agency (SAMA).

10. **Policies pursued in Saudi Arabia have significant spillovers both regionally and globally; but the impact of recent regional unrest on financial markets in Saudi Arabia has been limited (Box 1)**. Saudi Arabia accounts for more than two-thirds of spare capacity in global oil supply and, as unrest erupted in several countries in the region, Saudi Arabia announced that it would increase its supply in order to offset any shortfall in the market. The large Saudi labor market attracts workers from all over the world and remittances from Saudi Arabia—$194 billion during 2000–10—constitute a significant income source for several countries in the Middle East as well as South and East Asia. Further, increased fiscal spending by Saudi Arabia, including at the height of the global financial crisis, has important positive spillovers for demand in regional and global trading partners.[1]

Cumulative Outward Remittances, 2000–10 (sum) 1/

	Amount	Share of Total
	U.S. $ Billion	Percent
Bahrain	14.4	3.4
Kuwait	61.8	14.7
Oman	31.3	7.4
Qatar	44.9	10.6
Saudi Arabia	193.8	45.9
U.A.E.	74.1	17.6
GCC Total	421.8	100.0

Sources: Data provided by the authorities; and IMF staff estimates and projections.
1/ 2010 data are staff projections.

[1] Saudi Arabia's share of global imports of goods and services increased by 20 percent during 2007–09, from 0.87 percent to 1.06 percent. The linkages between fiscal decisions in Saudi Arabia and the global economy (with Asia and the rest of the world modeled separately) and between growth in Asia and Saudi Arabia are explored in the context of the Global Integrated Monetary and Fiscal model. The model highlights the close linkages between growth in Asia and oil production in Saudi Arabia as well as the continuing linkages between fiscal spending in Saudi Arabia and activity in the rest of the world.

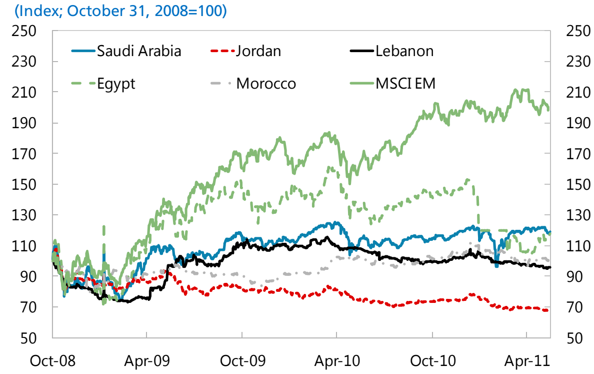
Box 1. Financial Contagion from the Region?

Recent unrest in the Middle East was associated with large movements in financial markets in the region. Stock markets in most Middle Eastern economies have been flat or fallen over the last year—a sharp contrast to the sharp increases seen in other emerging markets—while CDS spreads have risen, though not to the levels seen during 2008–09 at the height of the Global Financial Crisis.

The dip in the Saudi stock exchange in early 2011 can partly be explained by spillovers from the region. Saadi Sedik and Williams (IMFWP/11/138) estimate volatility spillovers in equity markets within the GCC and between the GCC and the U.S. Their results indicate that cross-volatility spillovers within the GCC and from the U.S. stock market to the region were significant between 2000 and 2010. For Saudi Arabia, the spillover of shocks from the U.S. was lower than other GCC countries, consistent with the limited non-GCC participation in the Saudi stock market.

MENA Stock Market Indices

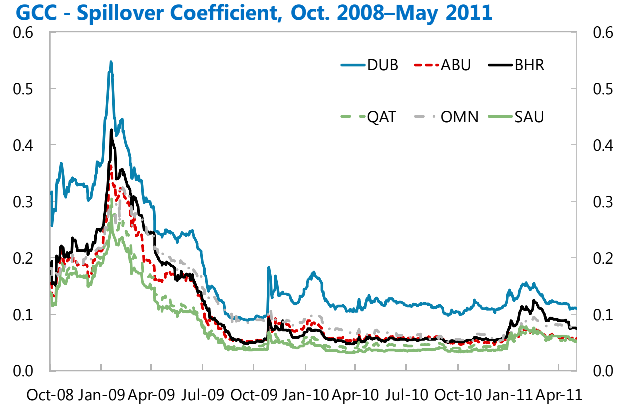
(Index; October 31, 2008=100)



Source: Bloomberg.

CDS markets identify only modest contagion from events in the region. Using the methodology of Caceres, Guzzo, and Segoviano (IMF WP10/120), spillover coefficients—a measure of vulnerability of one country to contagion from a group of other countries—are extracted from CDS data. While markets are generally thin, trading in the Saudi five-year CDS contract has increased, in part as a means of hedging exposures toward both Saudi Arabia and the region in general. While the spillover coefficients have increased, in absolute levels they remain well below the levels seen at the height of the global financial crisis.

GCC - Spillover Coefficient, Oct. 2008–May 2011

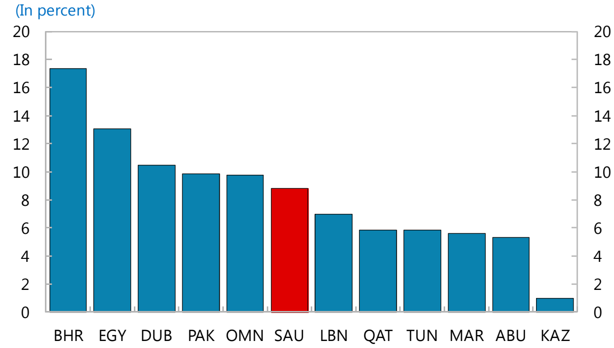


Source: IMF staff estimates.

Bahrain and Egypt have been the key contributors to risks in other countries. Inverting the spillover coefficients provides an indicator of the contribution of one country to the spillover coefficient of the other countries. During January 11 to March 15—a period which covers unrest in Tunisia, Egypt, Libya, Bahrain and a few other countries—the countries at the center of events, notably Bahrain and Egypt, were the principal sources of risk.

Contribution to Changes in the Spillover Coefficient, Jan. 11–Mar. 15, 2011

(In percent)



Source: IMF Staff estimates.

III. Outlook and Risks

11. **Surging oil revenues are likely to improve fiscal and external balances in the near term, despite fiscal expansion and heightened uncertainties in the oil market**. Oil revenues will increase relative to 2010 from both price and volume effects as Saudi oil production is expected to increase to help stabilize global oil markets by filling the void left by supply shortfalls elsewhere in the region. The volatility seen in oil prices combined with the uncertainty of both demand and supply conditions in the global market create an unusually large range of forecasts for oil revenues. However, even in low price/production scenarios, fiscal and external balances are expected to remain in surplus in 2011 despite the substantial fiscal spending packages announced in February and March (see table below and Box 2).

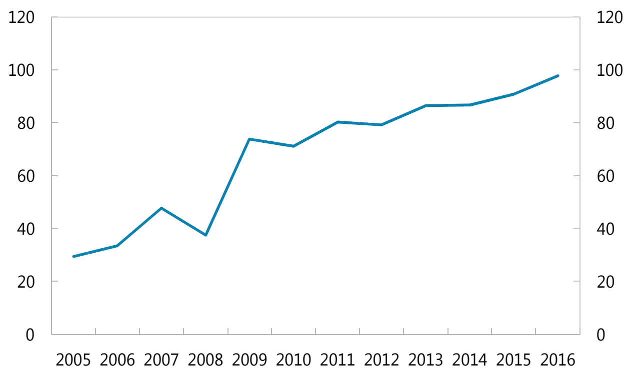
Macroeconomic Sensitivity to Uncertainty in the Oil Market, 2011

Oil Price Volatility (Oil production: 9.3 mbd) 1/					
Oil Price $/barrel	Current Account (In percent of GDP)	Fiscal Balance (In percent of GDP)	Current Account (In U.S. billion dollars)	Fiscal Balance (In U.S. billion dollars)	
114.4	23.2	12.2	137.6	72.1	
106.3	20.1	9.3	114.7	53.1	
88.4	12.3	2.1	64.3	11.0	
Oil Volume Uncertainty (Oil price: $106.3)					
Oil Volume mbd	Current Account (In percent of GDP)	Fiscal Balance (In percent of GDP)	Current Account (In U.S. billion dollars)	Fiscal Balance (In U.S. billion dollars)	Growth
9.7	22.2	11.2	129.6	65.5	7.5
9.3	20.1	9.3	114.7	53.1	6.5
8.9	17.9	7.3	99.9	40.7	5.3

Source: IMF staff estimates.
1/ Prices represent the high-low of oil futures during Jan 1–Mar 22, 2011, and April 2011 WEO forecast.

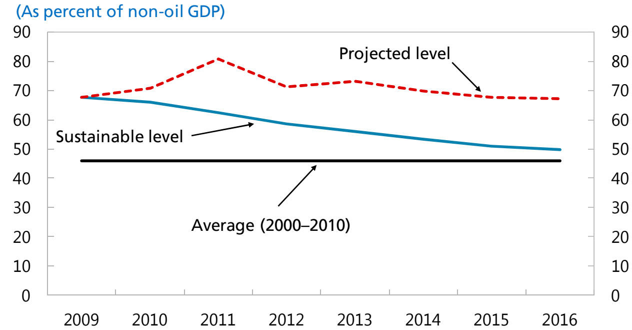
12. **Despite the strong near-term outlook, staff estimates suggest that the recent fiscal packages have increased vulnerabilities to a dip in the oil price while pushing expenditures beyond a long-term sustainable level**. The break-even oil price for 2011 is estimated by staff to have risen to $80/bbl (higher if oil production is below the 9.3 mbd projected), rising to $98/bbl by 2016. Thus an adverse shock, such as oil prices falling to the level of 2010 for a sustained period, would lead to the emergence of fiscal deficits. Further, the fiscal position as reflected in the non-oil primary deficit as a share of non-oil GDP is currently beyond sustainable level as measured by a standard intergenerational equity models based on the permanent income hypothesis.[2]

Breakeven Oil Price, 2005–16
(U.S. dollars per barrel)



Sources: IMF staff estimates and calculations.

Projected and Sustainable Non-oil Primary Deficit, 2009–16
(As percent of non-oil GDP)



Source: IMF staff estimates.

13. **The authorities noted that there were significant upside risks to the staff's medium-term scenario and stressed that increased spending levels over the next few years constituted an important investment consistent with a long-established development strategy**. Given the dominant position of oil in the economy—which would remain even with progress on diversification—economic prospects remain linked to the global oil price. In this regard, the authorities considered the break-even oil price for 2011 to be much less than estimated by staff and that the continuing strong demand for oil, especially from emerging market economies, points to upside risks on the oil price forecast. Higher fiscal spending involved initiatives to strengthen social outcomes—including addressing the housing shortfall and introducing an unemployment benefit as part of an expanded social safety net—that had important welfare implications for current and future generations.

[2] The intergenerational equity model is based on the assumption of a constant real consumption per capita out of the oil wealth. Results are sensitive to assumptions on the stock of oil reserves, the real rate of return on investments, population growth, and the projected path for oil prices.

Box 2. 2011 Fiscal Packages

Royal Decrees issued on February 23 and March 18, 2011 introduced new initiatives to tackle social issues that will have substantial short- and medium-term expenditure implications. The packages include public sector wage increases, expansion in public employment, unemployment benefits, and measures to improve access to housing. The packages are estimated to be a combined amount of about SR 400 billion or $110 billion (19 percent of 2011 GDP).[1] Of this, an estimated SR 117 billion or $31 billion (5.5 percent of GDP) would likely be spent in 2011. Capital expenditures, particularly related to housing, are expected to pick up slowly and spread over several years.

Fiscal Measures

Permanent / Continuing Impact	Expenditure in 2011 SR billion	Percent of 2011 GDP
Transportation allowance 1/	4.5	
Increase in minimum wage in government 2/ to SR 3000 from SR 1750	10.0	
Social security 3/	6.5	
Students scholarship 3/	1.1	
Hire 60,000 at the ministry of interior 4/	2.2	
Total 5/	**24.3**	**1.1**
One-timeTransfers	Expenditure in 2011	
Bonus of 2 months salary to public sector workers	32.0	
Real Estate Development Fund	40.0	
Saudi Credit and Saving Bank	20.0	
Professional committees	0.5	
Charity associations	0.3	
Cooperative associations	0.1	
National charity Fund	0.1	
Create branches for religious counselling and hire 300 workers	0.2	
Mosques restorations	0.5	
Transfer to GPPVPV 6/	0.2	
Total	**94.0**	**4.4**
Capital Expenditure (over several years)		
Build 500,000 units	250.0	
Housing Authority	15.0	
Allocation to building and expansion of hospitals	16.0	
Transfer to religious associations	0.2	
Transfer to the ministry of religious affairs	0.3	
Mosques restorations	0.5	
Total 7/	**282.0**	**13.2**

1/ The cost of living allowance would now be treated as part of basic salary. Hence, wage increase confined only to increase in transportation allowance. This would have a similar impact over the medium term.
2/ Will have a base effect over the medium term.
3/ Will be spent each year over the medium term. Included as part of welfare payments and other payments under subsidy.
4/ The wages and salaries will increase by this amount permanently and increase base.
5/ It is expected that the uneployment benefit of SR 2000 a month may not happen in 2011. Further, the source of financing this expenditure is yet to be determined.
6/ General Presidency of the Promotion of Virtue and the Prevention of Vice.
7/ Would be spent over several years. No spending is envisaged in 2011; 10 percent of total expenditure is expected in each of the remaining years until 2016.

1/ Some of these measures would have a continuing impact on spending over the medium term.

IV. Policy Priorities

Large surpluses in both fiscal and external accounts provide an opportunity to address social priorities, as witnessed by the recent Royal Decrees. Implementation of these initiatives will however raise a number of policy challenges, including: (i) inflation risks; (ii) medium-term fiscal policy; (iii) growth and employment; and (iv) financial market development.

A. Inflation—Guarding Against Overheating

14. **Inflation risks have risen due to both external and domestic factors**. Inflation has been driven by a combination of imported prices—particularly global food prices that are expected to increase by 22 percent in 2011—structural factors, notably rents, and other factors. Housing prices continue to rise due to the existing supply shortages and high pent up demand from the growing population, though such pressures would diminish over the medium term as the new housing initiatives take hold. In terms of other factors, the staff noted that the recent fiscal transfers—in particular, the two month salary bonuses for public servants paid in March, subsequently matched by some private sector enterprises—had injected significant additional liquidity into the domestic economy. The authorities considered that the potential inflationary impact from domestic factors was manageable noting that any inflation spike emanating from the cash transfers would be temporary and that the capital investments envisaged would be implemented over a number of years. Nonetheless, the authorities stressed that they continue to monitor for signs that the high liquidity levels were spilling over into excessive credit growth.

15. **It was agreed that in the event that inflationary pressures do materialize, fiscal and monetary policies should be used proactively to contain pressures**. Staff noted that while the pick up in inflation is likely to be significantly below that seen in 2008, several of the key drivers of the 2008 spike are in place (Box 3) and others could emerge. The exchange rate peg limits the policy tools available to SAMA to contain inflation, so that fiscal policy will need to play a lead role in the policy response. More specifically key policy options would include:

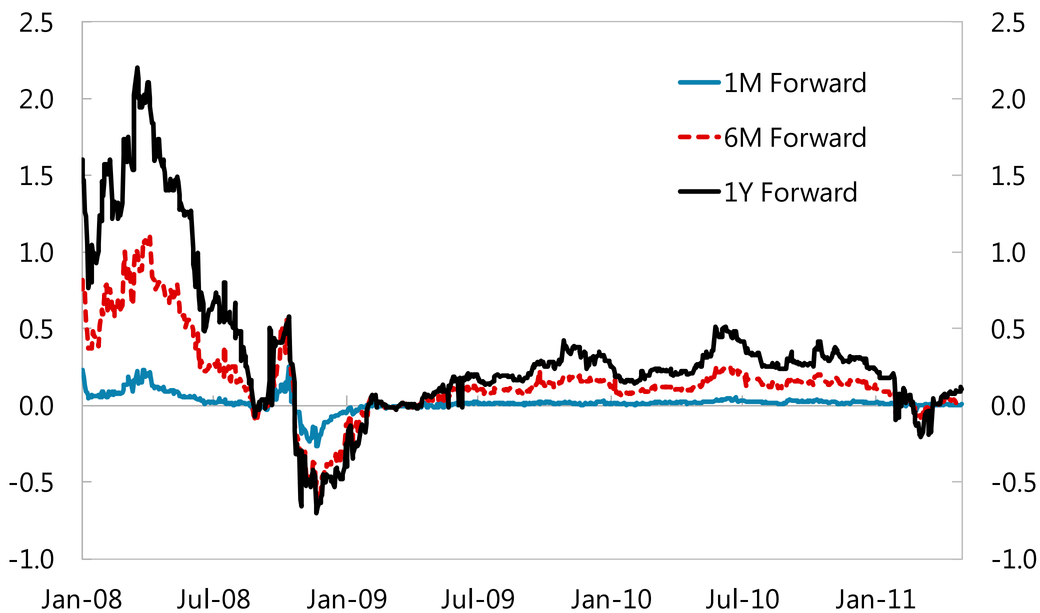
- Slowing the pace of government spending, particularly on capital projects if supply bottlenecks arise.

- SAMA should continue to closely monitor the level of commercial bank funds held at SAMA as well as the loan to deposit ratio. In the event of sharp movements, staff agreed with the authorities' view that either raising reserve requirements or lowering loan to deposit ratios could be employed to absorb liquidity and prevent excessive credit growth.

16. **The staff supports the maintenance of the exchange rate peg to the U.S. dollar**. The U.S. and Saudi business cycles are currently not well-aligned—the Saudi business cycle remains driven by oil, which in turn is increasingly linked to the business cycle in emerging Asia—contributing to inflationary pressures. However, the peg has provided a long-term anchor for the economy in terms of facilitating the development of financial markets and providing clarity for investors. The staff's assessment of the level of the exchange rate suggests that the exchange rate is broadly in line with fundamentals—this is also supported by currency forward markets, which point to no evidence of misalignment of the exchange rate (see Appendix I). There is, however, some evidence suggesting that a modest overvaluation could develop over the medium term, consistent with fiscal spending being above estimates of the sustainable level (and therefore the current account surplus below its norm).

Forward Premium Over Spot Exchange Rate

(Percent of Spot Rate; January 1, 2008–June 10, 2011)

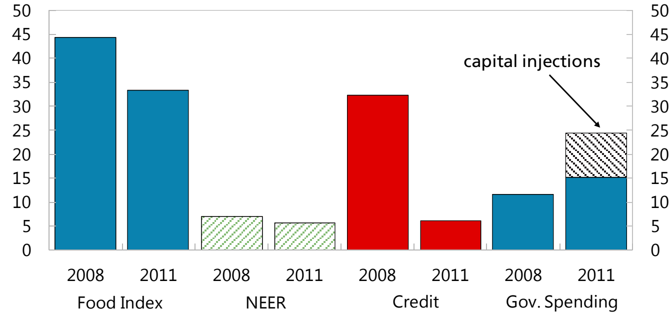


Source: DataStream.

Box 3. Will Inflation Return to 2008 Levels?

With the ongoing rebound in economic activity, a question that emerges is whether inflation will increase again as it did in 2007–08 when the annual increase in consumer prices peaked at 11.1 percent in July 2008. Many of the drivers of inflation then are also present now, including higher food prices, depreciation of the nominal effective exchange rate, expansion of credit, and rising government spending. However, the increases in these various drivers of inflation are at present generally smaller than they were in 2008. The one area where the pressure is greater now is fiscal spending, which is projected to increase by 24 percent in 2011 compared to 12 percent in 2008. Still, a large part of this increase is capital injections to the Real Estate Development Fund and to the Saudi Credit and Saving Bank that are unlikely to be fully utilized this year. Overall, these figures suggest that inflation will remain well below the levels of 2008. This conclusion is also supported by a more formal econometric analysis, which using a range of models suggests average inflation during 2011 in the range of 5.8–6.6 percent.[1]

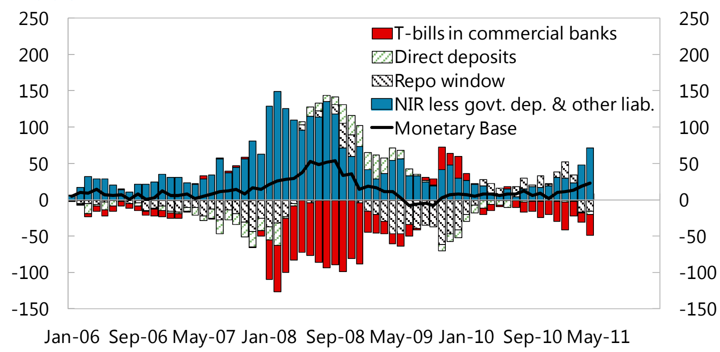
Drivers of Inflation; 2008, 2011
(In percent annual change)



Sources: Country Authorities; and IMF staff projections.
Note: For food, NEER, and credit, the percent changes refer, respectively, to June 2008 and to the last available period. Government spending is based on annual data.

One potential concern, however, is the buildup of liquidity in the banking system and the risk that it will translate into much higher credit growth in the months to come. One indication that this is not likely to be the case is that credit growth in 2008 was accompanied by an even larger increase in the monetary base. Compared to that experience, the current increase in the monetary base is more modest. In particular, the authorities have been largely successful in sterilizing fiscal spending, despite the ongoing repayment of government debt, through increased issuance of central bank t-bills. Credit growth is also likely to be more constrained than in 2008 due to more subdued corporate demand and strengthened prudential measures on consumer borrowing.

Annual Contributions to Growth in the Monetary Base, 2006–11



Source: Saudi Arabian Monetary Agency.
Note: Other liabilities includes t-bills held by nonbank institutions. Direct deposits refer to funds deposited by SAMA in commercial banks. The monetary base equals the sum of reserves and currency in circulation.

[1] The econometric analysis is based on a high-frequency Vector Auto Regressive (VAR) framework. Variables used in the VAR included CPI index, deposits, bank claims on private sector, point of sales transactions, the nominal effective exchange rate (NEER), international prices of food and beverages, international price index of crude oil, and current and capital spending of the central government. Various specifications were used to provide a plausible range for the end-of-year forecast of inflation. Goodness of fit tests as well as robustness checks were also employed to assess model uncertainty.

B. Fiscal Policy

17. **The key fiscal policy challenge is to limit vulnerabilities to oil revenue volatility, while ensuring the efficiency of spending**. Expenditure levels are likely to remain high as the public housing program and new initiatives in key social areas, such as health, education, and the social safety net, are implemented. The substantial buffers built-up in recent years—high international reserves and low debt—provide a significant cushion, but targeting fiscal policy to preserve an overall fiscal surplus over the medium term would provide insurance against a sustained reduction in oil revenues. There are policy options for both revenue and expenditures:

- Additional non-oil revenue sources should be developed in order to broaden the tax base and reduce dependence on oil. The authorities noted that in light of GCC integration efforts, tax reform should be approached in unison. In that regard, studies for a GCC-wide VAT were continuing though the precise timing of its introduction remained to be determined. Staff noted that the absence of a near-term revenue need provided an opportunity to introduce the VAT at a low rate and in a revenue-neutral manner as part of a package in which other taxes are eliminated.

- The authorities noted that significant progress had been made in modernizing tax administration, with nearly all revenue payments in the non-oil sector now filed electronically. A web-based system with core and support functions for tax administration has been implemented. The number and value of transactions through the e-filing (SADAD) system have increased—an estimated SR 12 billion of payments were received through 13.5 million operations in SADAD at the end of the second half of 2010. The system also connects 41 government agencies, which enables prompt exchange of data among them. A unique tax payer identification number has also been introduced, which is portable across the GCC in anticipation of revenue-sharing arrangements once a VAT is implemented.

- On the expenditure side, further steps to enhance the efficiency of spending—including through the more effective monitoring and control over spending once the ongoing reforms to adopt GFSM 2001 are completed—could yield savings without impinging on service provision.

- Reducing subsidies—especially on petroleum products as well as on water and other utilities that are not captured on the budget—would both provide more resources to the budget (through improved outcomes for the relevant public enterprises) and remove important distortions in resource allocation. Petroleum product prices for example are among the lowest in the world—raising prices to the average of other Middle Eastern oil exporters could generate about 3 percent of GDP a year in fiscal resources while helping contain the growth in domestic consumption of energy that will, on current trends, soon start to limit Saudi Arabia's ability to export absent investment in new drilling capacity. The authorities noted that initiatives were underway to enhance energy efficiency.

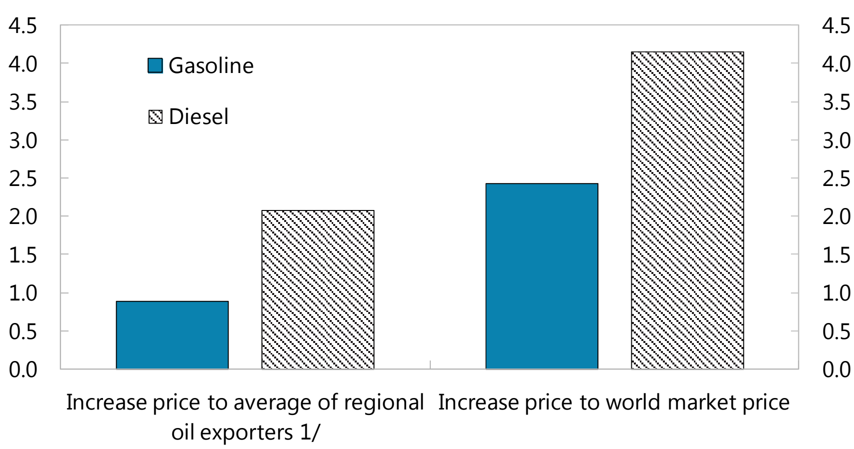
Domestic Prices of Petroleum Products, 2010
(U.S. dollars per liter)

	Gasoline	Diesel
Saudi Arabia	0.16	0.07
Other regional oil exporters		
Algeria	0.27	0.16
Bahrain	0.27	0.19
Iraq	0.38	0.34
Kuwait	0.23	0.20
Qatar	0.30	0.27
Oman	0.31	0.38
UAE	0.52	0.75
Average	0.33	0.33
World market price 1/	0.85	0.81

Sources: Country authorities; and Datastream.

1/ Wholesale price, Q1 2011

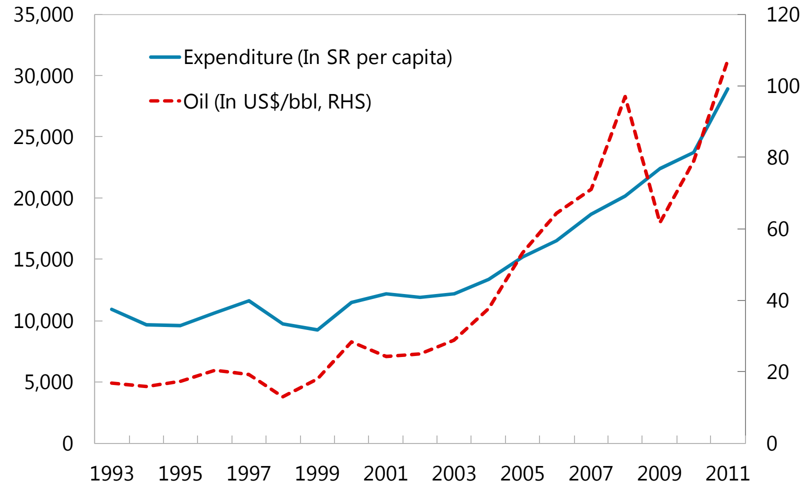
Savings from Increasing Domestic Fuel Prices
(In percent of GDP)



Sources: Country authorities; Datastream; and IMF staff estimates.
1/ Average of prices for Algeria, Bahrain, Iraq, Kuwait, Qatar, Oman, and United Arab Emirates.

18. **The authorities noted that, even in the absence of a formal medium-term expenditure framework, expenditures had been smoothed, consistent with the government's investment program**. Existing budgetary processes—based on a budget formulated at a conservative oil price with expenditure adjustments during the year as revenues evolve—have resulted in budget outcomes departing significantly from approved budgets and a trend increase in expenditure as oil prices have risen. Staff noted that framing expenditures in a multi-year context could reduce the linkage to the oil price cycle, lower volatility of spending, and also facilitate planning and implementation of multi-year expenditure programs. A key first step in this process would be to establish a macro fiscal unit that would have responsibility for formulating the overall fiscal resource envelope, taking into account the macroeconomic implications.

Expenditure vs. Oil Price, 1993–2011



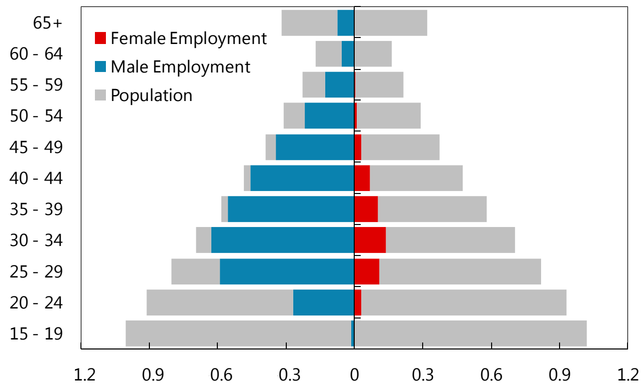
Sources: Country authorities; and WEO.

19. **The balance sheets of the pension funds should be kept under review**. The current cash flow positions of the pension funds appear to be healthy. While dependency ratios are expected to decline, reflecting the high proportion of young in the population, the various public pension funds are witnessing an increase in the number of retirees and actuarial positions could face pressures with the recent adjustment in minimum wages generating increased payment obligations.

Growth and Employment Creation

20. **Generating employment for a young and fast-growing population is a key policy challenge**. Over the past decade, the number of Saudi nationals has grown at an annual rate of 2.5 percent—almost twice the average rate for emerging and developing economies and four times that in advanced economies. With half the population below the age of 23, the number of new Saudi entrants to the labor force is growing especially rapidly. Recorded unemployment rates are highest among the youth (15–29 year olds), with unemployment rates dropping sharply for those above age 30. Labor force participation rates—just 36 percent in 2009, in large part a reflection of a female participation rate of just 12 percent—are unusually low and their evolution in the coming years will have important impacts on labor market outcomes.

Population and Employment by Age and Gender, 2009
(In millions)



Source: Central Department of Statistics and Information.

Employment and Labor Force Participation by Age and Gender, 2009
(In percent)

Source: Central Department of Statistics and Information.

21. **Addressing the unemployment problem will require a sustained acceleration in growth and an increase in the share of new jobs filled by nationals**. Given existing population dynamics and based on recent labor market behavior, staff estimate that to reduce unemployment by 5 percentage points over the next five years would require an acceleration in non-oil growth to about 7.5 percent a year, a significant increase relative to historical trends. This estimate is highly dependent on the evolution of the labor market participation rate, and the proportion of new jobs that are filled by Saudi nationals versus expatriates. Between 2004 and 2009, the economy generated an average of almost 200,000 jobs a year, almost twice the recent pace of increase in the labor force of Saudi nationals, but this had limited impact on unemployment rates as more than half of new jobs have typically gone to foreign nationals.

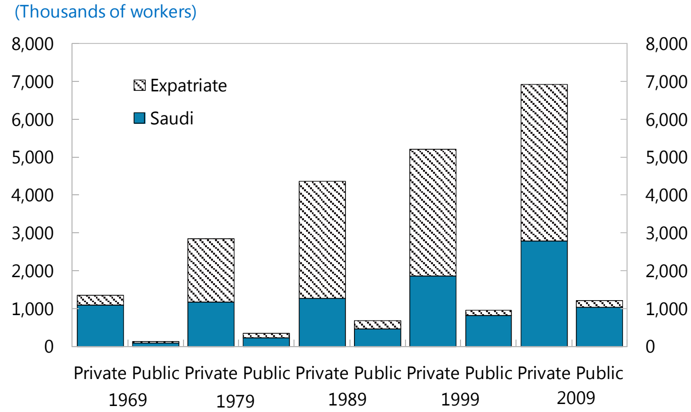
Saudi Arabia: Growth Required to Reduce Unemployment to 5.5 Percent with 39.3 Percent Labor Force Participation by 2014

2009 Labor force (Saudi nationals, in millions)	4.3
Unemployed (in millions)	0.4
Employed (in millions)	3.8
Unemployment rate (in percent)	10.5
Participation rate (in percent)	36.4
2014 Labor force (Saudi nationals, millions)	5.3
Unemployed (in millions)	0.3
Employed (in millions)	5.0
Unemployment rate (in percent)	5.5
Participation rate (in percent)	39.3
New jobs required annually (in thousands)	230
Required annual growth in employment (in percent)	5.4
Required annual growth in real non-oil GDP (in percent)	7.5

Sources: National Authorities; and IMF staff calculations.

Note: Assuming annual population growth of 2.2 percent and the same 0.72 elasticity of employment to non-oil GDP growth as during 2004–09.

Employment by Sector and Origin, 1969–2009[1/]
(Thousands of workers)



Source: Central Department of Statistics and Information.
1/ Public employment figures do not include military personnel as well as operation and maintenance workers.

22. **Despite scoring well on investment climate surveys, employment growth in Saudi Arabia has been driven by government spending**. The size and resources of the public sector have been critical for private sector development—indeed, the intended ratcheting up in the provision of housing over the next several years will feed through into private sector growth, but will likely have limited impact on employment of nationals as the construction sector tends to be dominated by expatriate labor. It was agreed that two areas with potential for a positive impact on growth and national employment would be:

- Increased economic integration within the GCC and deeper trade relations with emerging partners in the Middle East beyond the GCC, as well as Asia. While aggregate trade data for both exports and imports point to limited growth in intra-GCC trade, the authorities noted that intra-GCC trade in services, including tourism, was growing rapidly. Both emerging Asia and certain countries in Middle East—including Egypt, Jordan, and Syria—were becoming increasingly important trade partners and further trade facilitation efforts could provide a stimulus to growth.
- Access to finance has been an important constraint on private sector activity. Recent initiatives to stimulate SME credit through a system of partial guarantees have eased access issues for this segment of the market, but broader capital market reforms to foster the development of corporate bond markets and Islamic products could also enhance financial intermediation.

23. **Active labor market policies can also play a role in tackling unemployment, but need to be designed to minimize the impact on competitiveness**. Saudi Arabia has opened its labor markets to a large number of expatriate workers, both skilled and unskilled. Various Saudiization initiatives, intended to increase employment of Saudi nationals, have been in operation since the mid-90s, but with limited overall impact. The authorities noted that the new “traffic light” system of industry-specific quotas for Saudi employment introduced in May was designed to provide incentives for compliance, rather than just penalties, and therefore could reduce the burden on enforcement capacity. The authorities stressed that this was just one component of a multi-pronged strategy and that accompanying initiatives to assist in matching job seekers with employers, including through the scaling-up of placement programs and training and education schemes, would also have a positive impact on labor markets.

24. **Recent public sector employment initiatives and the introduction of an unemployment benefit scheme will impact labor market outcomes**. While raising public sector salaries and expanding public sector employment opportunities can enhance short-term social outcomes, they may also provide a disincentive for nationals to seek private sector employment. Similarly, an unemployment benefit scheme needs to be designed carefully to ensure that it does not create an additional disincentive to private sector employment. The authorities noted that the unemployment benefit scheme was still under design but was intended to be temporary and a transitional step to a more comprehensive social safety net.

C. Financial Sector—Managing Risks While Supporting Growth

25. **The banking system is well capitalized, highly liquid, and has proven to be resilient to a wide range of shocks**. Stress tests conducted by the FSAP update team demonstrated that the high levels of liquidity and high levels of capital currently held by the banking system constitute significant buffers to provide confidence that banks can withstand most plausible shocks.[3] Indeed, the banking system has withstood a number of challenges, including a prolonged period of low oil prices, the after effects of the global financial crisis, and a debt restructuring and sharp drop in real estate prices in neighboring U.A.E. The principal risk—as expected for an oil-based economy—is a sustained drop in oil prices, although loan concentration ratios and exposures to single borrowers are high by international standards. The authorities noted that preparations were well underway for a move to Basel III and that it is expected that banks would be able to comply with Basel III requirements without disruption to existing business models.

26. **Supervision and regulation have been effective**. The Basel Core Principles assessment showed a high degree of compliance with international best practices, but identified some areas—such as bank resolution (notably the absence of a special resolution regime)—where the legal framework could be updated to better reflect existing practices. The authorities stressed that the existing framework had proven to be fully effective and that SAMA had been able to intervene when needed. In addition, the proactive nature of supervision by SAMA had avoided bank insolvencies and protected depositors. It was agreed that the adoption of Basel II had produced a substantial improvement in risk management practices by banks. In terms of Islamic banking products, the authorities noted that risks in this growing segment of the market were appropriately monitored within the context of the existing regulatory and supervisory framework so that there was no need for a separate regime.

27. **Capital markets are slowly emerging, but important gaps remain**. Government debt has been reduced to a very low level and there is no active secondary market nor a robust government yield curve. Notwithstanding the government's current absence of a need for financing, staff noted that maintaining a stable stock of government securities with a range of maturities would help to anchor a yield curve. The authorities noted that corporates had been able to place bonds and that the absence of an active government debt market did not preclude the emergence of a corporate bond market. In terms of the absence of a secondary market, they noted that this reflected a tendency for banks to purchase securities and hold them to maturity as a stable source of income—a reflection of a high level of liquidity usually present in the market.

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[3] Box 4 summarizes the key recommendations of the FSAP Update conducted during April 16–30, 2011.

Box 4: Key Recommendations of the FSAP Update
Bank and securities regulation
• Update the BCL and remove need for ministerial approval of certain SAMA decisions.
• No longer allow large exposures up to 50 percent of banks' own funds.
• Broaden the definition of related parties in bank lending.
• Strengthen the CMA's regulatory transparency by fully disclosing all enforcement actions, interpretations, and funding rules.
Systemic stability
• Introduce a formal liquidity forecasting framework.
• Enhance data on cross-border financial activities of banks and corporates.
• Maintain a stable stock of government securities and regular issues to help anchor a robust yield curve.
• Introduce a payment systems law.
• Conduct stress tests with a wider range of shocks, including liquidity shocks, on a regular basis and incorporate lessons into supervision.
• Establish a formal early warning system for the banking sector.
• Develop a more formal and transparent macroprudential policy framework, drawing on work in international fora.
• Strengthen the legal framework for bank resolution.
Expanding access to finance and preserving financial stability
• As housing finance expands in the future, ensure loan soundness through strong prudential measures, notably lowering permissible loan-to-value and debt service ratios.
• Contract banks to manage both the existing and the new Real Estate Development Fund (REDF) portfolios.
• Complement mortgage reform by establishing a housing market observatory, developing consumer guidance options, and strengthening the developer industry.
• Prepare long-term funding solutions for mortgage finance, starting with a refinance facility.
• Create a modern, electronic, and unified registry for movable collateral.
• Enact and implement the draft Enforcement Law that introduces specialized enforcement courts operating with strict time-bound procedures.
• Closely supervise the quality of SME units in the banks, including the robustness of their internal rating systems and automated procedures.
Insurance, institutional investors, and capital markets
• Finalize and issue the outstanding functional regulations for insurance.
• Improve enforcement of mandatory motor third party liability insurance.
• Disclose the investment policies, portfolios, and portfolio performance of the Public Pension Agency (PPA) and general organization for social insurance (GOSI).
• Further outsource the management of the portfolios of the PPA and GOSI.
• Permit foreign institutional investors to invest directly in Tadawul.

28. **Progress in housing finance is critical to improve access to housing**. The five draft laws in the mortgage package that are expected to be approved in 2011 would dramatically improve the housing finance framework (see Box 5). It was agreed that as housing finance expands, ensuring loan soundness through strong prudential measures, particularly through lower permissible loan to-value and debt service ratios, will be important. Furthermore, adequate supervision of the reconstructed REDF should be put in place, including by contracting banks to manage its loan portfolio to improve the quality of loan origination and recovery rates.

29. **The AML/CFT regime could be further strengthened**. The initial FATF assessment undertaken in 2004 noted that Saudi Arabia had a high degree of compliance with FATF recommendations. A joint FATF/MENAFATF mutual evaluation report, drawing on new FATF standards, was adopted by the Middle East & North Africa FATF in May 2010 and the FATF in June 2010. The report noted progress made since the original assessment in the areas of broadening the legal framework, improving institutional cooperation, and investing in training and awareness. Looking forward, a number of areas were identified where further progress could be made, including: the criminalization of terrorism financing; reinforcement of international cooperation; and strengthening the implementation of the AML/CFT regime in the insurance sector and in designated nonfinancial businesses and professions.

Box 5. Housing Market

Pressures on the availability of affordable housing have emerged due to demographic factors and bottlenecks in the real estate market. Growing population, smaller average size of households, and continued urbanization have sharply increased demand for housing in recent years. As a result, the need for additional housing—primarily for low and middle income households—is estimated in the Ninth Development Plan at 1.25 million units during 2010–14. At the same time, supply of affordable housing units is constrained by scarcity of buildable land and limited access to finance for developers—reducing their ability to take on large projects and shifting their focus to the high-end market. Given the uncertain legal environment, banks have so far played a limited role in mortgage financing. The publically owned Real Estate Development Fund (REDF) has stepped in to fill the gap by providing interest free loans. However, the REDF, which currently accounts for 80 percent of outstanding housing credit, has been unable to keep up with demand, resulting in a waiting period of about 18 years. Excess demand for housing and the shortage of available land have also contributed to rising real estate prices, further reducing the affordability of housing.

The government has recently announced several measures to address both supply and financing constraints. First, the Ministry of Housing (MOH) has replaced the General Housing Authority in order to centralize housing efforts under one umbrella. The REDF, which is now under the MOH, is being restructured and recapitalized with the intention to better target low income households, leverage its lending program through a guarantee scheme with the banking system, provide funding to real estate developers, and outsource the management of its current portfolio to banks in order to improve the recovery rate—the current portfolio of REDF amounts to SR 80 billion, half of which is classified as delinquent. Second, the central government has allocated SR 250 billion to the MOH for the construction of 500,000 new housing units over the next 5–10 years. Third, the long awaited mortgage law is expected to be approved in 2011. A key component of the mortgage law package is the enforcement law, which is anticipated to increase the ability of banks to realize underlying collateral in case of default.

Additional measures can be taken to expedite the supply of housing and to monitor the expansion of real estate finance. To address the affordability of housing, mitigate the rise in land prices, and increase the supply of land for real estate development, the government should implement measures to unlock the static supply of land. Following the final approval of the mortgage law, long-term funding solutions for mortgage lending institutions should be developed in the medium term.

D. Other Issues

30. **Further enhancing the quality of statistics is an important priority**. As laid out in the recent report to the G-20 Data Gaps Initiative, work is ongoing to strengthen data in the fiscal area through the adoption of the GFSM2001, the financial sector through the refinement of Financial Soundness Indicators, and in the balance of payments including in compiling an International Investment Position and the Coordinated Portfolio Investment Survey. The mission encourages the continuation of these initiatives and their dissemination once quality is judged adequate.

V. Staff Appraisal

31. **Policy buffers built up in recent years, and prudent financial sector supervision, enabled Saudi Arabia to rapidly emerge from the global financial crisis and contribute to the global recovery**. Increased fiscal spending in 2009 and 2010 supported non-oil growth which has accelerated further in early 2011 as the global oil price has risen. The economic outlook is positive due to higher oil prices and increased oil production as spare capacity is used to meet shortfalls in oil supply elsewhere, boosting external and fiscal balances. Relatively conservative banking practices and limited capital account openness served to limit the spillovers from financial markets in the region or globally.

32. **Higher oil revenues provide an opportunity to accelerate initiatives to address social issues, but this needs to be managed carefully to avoid overheating in the economy**. While inflation declined marginally in the first quarter of 2011, risks are on the upside. Rent and food prices continue to be the main contributors to inflation, but the buildup of liquidity in the banking system has the potential to increase inflationary pressures. Given the fixed exchange rate, moderating government spending should be the key policy lever in the event that inflationary pressures materialize, supported by available monetary policy instruments.

33. **Recent spending initiatives have raised entitlements throughout the medium-term and increased dependence on volatile oil revenues.** While substantial buffers remain, measures could be taken to strengthen underlying fiscal balances such as the implementation of a GCC-wide VAT, and a reduction in subsidies on petroleum products. The latter measure would also help contain the growth in domestic consumption of energy products which, if left unchecked, could impinge on the ability to export with current capacity. Increased fiscal spending also raises the importance of ongoing efforts to enhance the efficiency of public spending through strengthening screening and monitoring of public projects and developing a multi-year expenditure framework. To this end the establishment of a macro-fiscal unit would constitute an important initial step.

34. **While the economy has created jobs, reducing the unemployment rate of nationals may require a fundamental overhaul of the labor market and repositioning of the growth strategy.** Reliance on the public sector to absorb domestic labor needs to be

scaled back and policies promoting job opportunities in the private sector enhanced. To stimulate job creating growth in the private sector, efforts should focus on increased access to finance, especially for SMEs, and deeper trade integration with Asia and the Middle East beyond the GCC. Active labor market policies, such as skill matching initiatives, can help reduce unemployment amongst nationals but must be designed in a market-friendly manner to avoid further distortions and preserve competitiveness.

35. **Staff supports the fixed exchange rate regime.** The exchange rate peg to the U.S. dollar has facilitated international trade and investment and financial development. Staff estimates suggest that while some indicators point to a slight overvaluation over the medium-term, the exchange rate is broadly in line with fundamentals.

36. **Supervision and regulation of the banking sector appear effective and the banking system has demonstrated resilience to a wide range of shocks.** Significant improvements in banking regulation and supervision have been achieved in recent years, but the legal framework could be updated to be better aligned with actual practice. High capital and liquidity levels in the banking system provide an important buffer that has enabled banks to survive large regional and global shocks. Efforts to further strengthen the AML/CFT regime should continue.

37. **Deepening capital markets by maintaining a stable stock of government securities—despite the absence of a financing need—would help improve liquidity management in the banking sector and assist corporate to diversify their sources of funding.** The on-going repayment of government debt has reduced the volume of securities available for banks to manage liquidity and hampered the development of a benchmark yield curve. Broader capital market reforms to foster the development of domestic bond markets could also enhance financial intermediation.

38. **Efforts to reduce pressures on housing resources should be supported by the approval of the new mortgage law and a strong prudential framework to ensure loan soundness.** The government has introduced several initiatives to expedite the supply of affordable housing and increased access to mortgage finance. Passing the new mortgage law should help improve the housing financing framework significantly, while prudent loan-to-value and debt service ratios should be put in place to preserve loan soundness as housing finance expands. In addition, given the planned expansion of REDF's activities, it is essential to ensure that the institution is adequately supervised.

39. **Ongoing efforts to improve the quality and dissemination of statistics should continue.** In particular, completing the move to GFSM2001 and finalizing the compilation and dissemination of the International Investment Position and Coordinated Portfolio Investment Survey would reduce existing data gaps.

40. **It is recommended that the next Article IV consultation take place on the standard 12-month cycle.**

Table 1. Saudi Arabia: Selected Economic Indicators, 2009–16

		Prel.	Proj.					
	2009	2010	2011	2012	2013	2014	2015	2016
	(Percent changes; unless otherwise indicated)							
National income and prices								
Crude oil production (million of barrels per day) 1/	8.4	8.4	9.3	9.3	9.7	10.1	10.3	10.5
Average oil export price (in U.S. dollars per barrel) 2/	59.2	75.8	101.9	100.9	97.5	95.4	94.6	94.4
Nominal GDP (in billions of Saudi riyals)	1,413	1,679	2,138	2,244	2,363	2,504	2,650	2,811
Nominal GDP (in billions of U.S. dollars)	377	448	571	599	631	669	708	751
Nominal GDP per capita (in U.S. dollars)	14,148	16,267	20,266	20,817	21,445	22,255	23,094	24,020
Real GDP	0.1	4.1	6.5	3.6	4.4	4.6	4.2	4.2
Oil	-7.8	2.2	9.4	0.0	3.5	3.6	2.0	1.7
Non-oil	3.5	4.9	5.4	5.0	4.8	4.9	5.0	5.1
Real GDP—Public Sector	5.2	6.3	6.5	4.5	3.9	3.9	3.9	3.9
Real GDP—Private Sector	2.7	4.2	4.8	5.2	5.2	5.5	5.6	5.7
Implicit GDP deflator 3/	-21.0	14.1	19.6	1.3	0.8	1.3	1.6	1.8
Oil	-33.6	24.5	30.2	0.1	-2.1	-1.2	0.0	0.4
Non-oil	3.3	5.0	5.4	6.5	5.1	4.8	4.7	4.6
Consumer price index (all cities index)	5.1	5.4	6.0	5.6	4.3	4.1	4.0	4.0
External sector								
Exports f.o.b.	-38.7	30.6	34.9	-0.4	1.6	2.9	2.3	2.6
Oil	-42.0	32.0	39.0	-1.7	0.4	1.7	1.0	1.1
Non-oil	-9.9	22.8	10.2	9.5	9.7	10.0	10.0	10.1
Imports f.o.b.	-14.2	11.9	24.7	14.6	11.5	9.2	7.7	9.9
Current account balance (in percent of GDP)	5.6	14.9	20.1	14.7	11.9	10.8	9.5	7.6
Export volume	-13.7	12.1	18.5	3.1	5.2	5.6	5.0	5.0
Import volume	-6.0	4.4	13.7	14.2	11.9	9.6	7.5	9.1
Terms of trade	-26.4	16.7	19.6	-1.1	0.6	-4.6	-0.8	-0.9
FDI (in billions of U.S. dollars)	36.5	21.6	22.8	24.1	25.3	26.6	27.9	29.2
Money and credit								
Net foreign assets	-3.1	7.3	20.8	13.5	…	…	…	…
Domestic assets (net)	-77.0	4.3	634.8	50.1	…	…	…	…
Claims on government (net)	-7.4	6.0	26.8	20.8	…	…	…	…
Claims on private sector	0.0	5.7	12.7	16.8	…	…	…	…
Bank claims on state enterprises	-12.3	14.7	21.9	9.2	…	…	…	…
Money and quasi-money (M3)	10.7	5.0	11.6	11.8	…	…	…	…
Deposit interest rate (in percent) 4/	0.9	0.7	0.9	1.0	…	…	…	…
	(In percent of GDP)							
Central government finances								
Revenue	36.1	44.2	47.3	44.7	43.2	41.9	40.2	38.5
Of which: oil	30.8	39.9	43.6	40.8	38.9	37.3	35.6	34.0
Expenditure	42.2	38.9	38.0	36.0	38.7	38.6	38.8	39.8
Current expenditure	29.5	27.1	27.3	23.6	24.8	23.7	23.7	24.5
Wage bill 5/	14.8	14.8	12.1	12.2	13.1	11.9	11.7	12.4
Interest payments	1.0	0.7	0.4	0.4	0.3	0.3	0.2	0.2
Capital expenditure	12.7	11.8	10.7	12.4	14.0	14.9	15.1	15.2
Overall fiscal balance	-6.1	5.2	9.3	8.7	4.4	3.3	1.4	-1.3
Excluding oil revenue	-36.9	-34.7	-34.3	-32.1	-34.5	-34.0	-34.2	-35.2
Non-oil primary deficit/Non-oil GDP	-67.6	-70.8	-80.7	-71.1	-73.2	-69.7	-67.6	-67.1
Central government's gross domestic debt	15.9	9.9	7.0	5.9	5.0	4.2	3.6	3.0
General government fiscal balance	-4.6	6.7	…	…	...	...	...	...
	(In percent of GDP)							
Resource balance								
Gross investment 6/	25.2	22.9	20.0	21.2	22.2	23.1	23.5	23.6
Government	7.9	7.2	6.5	7.6	8.6	9.1	9.2	9.3
Private	15.8	13.5	11.7	12.1	12.4	12.9	13.2	13.3
National saving	30.7	37.8	40.0	35.8	34.1	33.9	33.0	31.2
Government	6.6	17.1	20.0	21.1	18.4	18.2	16.5	14.0
Private	24.1	20.7	20.1	14.7	15.7	15.7	16.5	17.2
	(In billions of U.S. dollars; unless otherwise indicated)							
Memorandum items:								
SAMA's total net foreign assets	405.9	441.0	535.4	608.3	670.8	729.1	781.5	824.8
In months of imports of goods and services 7/	27.5	25.1	27.3	28.3	29.0	29.4	28.7	29.2
Total external debt 8/	89.7	90.1	…	…	…	…	…	…
Of which: short-term debt 8/	35.5	41.2	…	…	…	…	…	…
Imports Goods & Services/GDP	42.6	38.9	36.9	39.3	40.9	41.5	42.1	43.5
Imports G&S/Total domestic absorption	48.7	49.7	50.1	49.7	49.4	48.8	48.2	48.1
Real effective exchange rate (2000=100)	103.5	104.9	…	…	…	…	…	…
Average exchange rate Saudi riyal/U.S. dollar	3.75	3.75	…	…	…	…	…	…
Population (millions)	26.7	27.6	28.2	28.8	29.4	30.0	30.6	31.3
All-Shares Price Index (TASI)	6122	6621	…	…	...	...	...	...

Sources: Saudi Arabian authorities; and Fund staff estimates and projections.

1/ Includes production from the Neutral Zone and condensate.
2/ Includes refined products.
3/ Includes all mining, manufacturing, construction, and other activities of the oil sector.
4/ Three-month Saudi Arabian riyal deposits.
5/ Includes a 13-month salary in 2010, 2013, and 2016 linked to the lunar calendar.
6/ Includes changes in inventories.
7/ Next 12 months.
8/ BIS-IMF-OECD-World Bank external debt database. Starting in 2004, coverage of bilateral loans and trade credit is less comprehensive.

Table 2. Saudi Arabia: Budgetary Central Government Operations, 2009–16

	Budget		Budget	Prel.	Budget	Proj.					
	2009	2009	2010	2010	2011	2011	2012	2013	2014	2015	2016
	(In billions of Saudi Arabian riyals)										
Revenue	410.0	509.8	470.0	741.6	540.0	1,011.6	1,003.5	1,019.7	1,048.5	1,064.9	1,082.4
Oil	320.0	434.4	400.0	670.3	468.0	931.4	915.2	919.2	934.9	944.4	955.2
Non-oil	90.0	75.4	70.0	71.4	71.9	80.2	88.4	100.5	113.6	120.5	127.3
Investment income	29.0	11.4	5.2	2.9	6.0	5.4	6.9	15.0	24.2	28.4	31.2
Income taxes 1/	7.2	7.6	6.4	7.1	6.9	7.7	8.5	9.5	10.5	11.5	12.7
Fees and charges 2/	30.3	29.8	33.5	30.9	32.9	32.6	35.3	36.6	37.8	38.2	39.9
Customs	14.0	12.9	14.0	14.7	14.0	18.3	21.0	22.4	23.4	24.2	24.8
Other 3/	9.5	13.7	11.0	15.7	12.1	16.2	16.6	17.1	17.7	18.2	18.7
Expenditure	475.0	596.4	540.0	653.8	580.0	812.9	808.9	915.7	965.9	1,027.8	1,117.7
Expense	338.4	416.6	372.8	455.0	397.0	584.2	529.7	584.9	593.8	627.7	689.6
Wage bill 4/	203.1	209.6	223.9	248.4	236.9	258.9	274.9	309.7	297.6	309.5	348.2
Supplies and services	56.5	116.7	60.8	114.8	68.2	121.7	128.5	134.0	139.4	145.0	150.8
Subsidies	17.6	21.7	20.8	17.6	22.4	28.9	36.8	44.8	52.9	61.0	69.2
Transfers 5/	0.0	6.3	0.0	8.8	0.0	104.8	10.9	12.0	13.3	14.6	16.0
Foreign aid	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Interest payments	13.0	14.0	12.5	10.9	8.6	9.1	8.1	7.2	6.5	5.8	5.1
Domestic	13.0	14.0	12.5	10.9	8.6	9.1	8.1	7.2	6.5	5.8	5.1
Operations and maintenance	47.6	47.7	54.1	53.8	60.1	60.1	69.8	76.5	83.5	91.2	99.6
Net acquisition of nonfinancial assets 6/	136.6	179.8	167.2	198.8	183.0	228.7	279.2	330.7	372.1	400.1	428.1
Gross operating balance	71.6	93.2	97.2	286.6	143.0	427.4	473.8	434.8	454.7	437.2	392.8
Net lending (+)/borrowing (-)	**-65.0**	**-86.6**	**-70.0**	**87.8**	**-40.0**	**198.7**	**194.6**	**104.1**	**82.6**	**37.1**	**-35.3**
	(In percent of GDP)										
Revenue	29.0	36.1	33.3	44.2	25.3	47.3	44.7	43.2	41.9	40.2	38.5
Oil	22.7	30.8	28.3	39.9	21.9	43.6	40.8	38.9	37.3	35.6	34.0
Non-oil	6.4	5.3	5.0	4.2	3.4	3.7	3.9	4.3	4.5	4.5	4.5
Expenditure	33.6	42.2	38.2	38.9	27.1	38.0	36.0	38.7	38.6	38.8	39.8
Expense	24.0	29.5	26.4	27.1	18.6	27.3	23.6	24.8	23.7	23.7	24.5
Wage bill 4/	14.4	14.8	15.9	14.8	11.1	12.1	12.2	13.1	11.9	11.7	12.4
Supplies and services	4.0	8.3	4.3	6.8	3.2	5.7	5.7	5.7	5.6	5.5	5.4
Subsidies	1.2	1.5	1.5	1.0	1.0	1.4	1.6	1.9	2.1	2.3	2.5
Transfers 5/	0.0	0.4	0.0	0.5	0.0	4.9	0.5	0.5	0.5	0.5	0.6
Interest payments	0.9	1.0	0.9	0.7	0.4	0.4	0.4	0.3	0.3	0.2	0.2
Operations and maintenance	3.4	3.4	3.8	3.2	2.8	2.8	3.1	3.2	3.3	3.4	3.5
Net acquisition of nonfinancial assets 6/	9.7	12.7	11.8	11.8	8.6	10.7	12.4	14.0	14.9	15.1	15.2
Gross operating balance	5.1	6.6	6.9	17.1	6.7	20.0	21.1	18.4	18.2	16.5	14.0
Net lending (+)/borrowing (-)	**-4.6**	**-6.1**	**-5.0**	**5.2**	**-1.9**	**9.3**	**8.7**	**4.4**	**3.3**	**1.4**	**-1.3**
(excl. oil revenue)	-27.3	-36.9	-33.3	-34.7	-23.8	-34.3	-32.1	-34.5	-34.0	-34.2	-35.2
Memorandum items:											
Non-oil revenue (excl. investment income)/ non-oil GDP	8.1	8.5	8.0	8.5	7.4	8.3	8.1	7.8	7.4	6.9	6.5
Social Expenditure /GDP 6/	11.5	13.0	12.4	12.4	11.0	11.0	11.5	12.2	12.7	13.4	14.0
Primary balance (excl. interest payments)/GDP	-2.9	-5.1	-4.1	5.9	-1.5	9.7	9.0	4.7	3.6	1.6	-1.1
Non-oil primary balance/non-oil GDP	-49.6	-67.6	-56.7	-70.8	-55.7	-80.7	-71.1	-73.2	-69.7	-67.6	-67.1
Gross domestic debt /GDP	…	15.9	…	9.9	…	7.0	5.9	5.0	4.2	3.6	3.0
GDP market prices (SRL billions)	1,413	1,412.6	1,412.6	1,679.1	2,137.9	2,137.9	2,244.4	2,363.0	2,503.7	2,650.0	2,811.4
Non-oil GDP (SRL billions)	750	750.4	807.5	807.5	896.4	896.4	1,001.8	1,103.5	1,213.9	1,334.4	1,467.3

Sources: Ministry of Finance; and Fund staff projections.

1/ Includes Zakat revenue.
2/ Charges and fees for communications, post office, water, air rights, landing, telephone licenses, residence, and passports.
3/ Government sales of property (not included in net acquisition of nonfinnacial assets), fines, rental of government property, and others.
4/ Including the extra month salary according to Hijri calendar in 2010, 2013, and 2016.
5/ Includes Zakat charity transfers and funds set aside for specialized credit institutions.
For 2011, it includes one-time transfers announced bythe King on February 23 and March 18.
6/ Includes spending on health, education, social welfare and labor affairs.

Table 3. Saudi Arabia: Fiscal Operations of the General Government, 2006–10

(In percent of GDP)

	2006	2007	2008	2009	Prel. 2010
I. Budgetary central government					
Revenue	50.8	44.6	61.6	36.1	44.2
Expenditure	29.8	32.3	29.1	42.2	38.9
Overall Balance	21.0	12.2	32.5	-6.1	5.2
Primary Balance	23.1	13.7	33.5	-5.1	5.9
II. Autonomous Government Institutions (AGIs)					
Public Pension Agency (PPA)					
Revenue	2.8	2.9	2.2	2.7	2.3
Of which: Government contribution	0.8	0.9	0.7	1.0	0.9
Expenditure	1.6	1.8	1.6	2.2	2.3
Overall Balance	1.2	1.1	0.6	0.5	0.0
General Organization for Social Insurance (GOSI)					
Revenue	1.4	1.6	1.1	1.4	1.5
Expenditure	0.4	0.4	0.4	0.5	0.5
Overall Balance	1.0	1.1	0.6	0.8	1.1
III. Public Investment Fund (PIF)					
Revenue	1.5	1.3	1.1	0.8	1.0
Expenditure	0.1	0.0	0.5	0.6	0.5
Of which: Transfer to the budget	0.1	0.0	0.0	0.1	0.0
Overall Balance	1.4	1.3	0.6	0.2	0.4
IV. General Government (=I+II+III)					
Overall Balance	24.6	15.8	34.4	-4.6	6.7
Primary Balance	26.7	17.2	35.4	-3.7	7.4
Memorandum items: Net Assets(+)/Debt (-)					
i. Central Government	-14.6	5.7	13.7	40.2	40.9
ii. Autonomous Government Institutions	45.2	50.7	35.5	48.8	43.7
Of which: PPA	27.8	28.8	19.8	27.3	23.0
Of which: GOSI	17.4	21.9	15.8	21.5	20.7
iii. Public Investment Fund	9.6	11.6	10.0	12.8	9.7
iv. General Government (=i+ ii+iii)	40.2	68.0	59.2	101.8	94.4
v. Saudi Arabian Monetary Agency	9.7	13.8	9.4	17.3	18.2
vi. Specialized Credit Institutions (excluding PIF)	9.8	8.3	6.4	9.3	8.5
vii. Net Consolidated Assets of the General Government and the Financial Public Sector (=iv+v+vi)	59.6	90.1	75.1	128.3	121.1

Sources: Ministry of Finance; PPA; GOSI; PIF; and Fund staff estimates.

Table 4. Saudi Arabia: Summary Balance of Payments, 2008–16

(In billions of U.S. dollars)

	2008	2009	Prel. 2010	Proj. 2011	2012	2013	2014	2015	2016
Current account	132.5	21.0	66.8	114.7	87.8	75.2	72.2	67.5	57.0
(In percent of GDP)	27.8	5.6	14.9	20.1	14.7	11.9	10.8	9.5	7.6
Trade balance	212.3	105.4	153.9	217.6	198.4	187.9	183.5	178.7	169.9
Exports	313.9	192.6	251.5	339.3	337.8	343.3	353.1	361.4	370.7
Oil exports 1/	281.4	163.3	215.5	299.6	294.4	295.7	300.8	303.8	307.3
Other exports and re-exports	32.5	29.3	36.0	39.6	43.4	47.6	52.3	57.6	63.4
Re-exports	5.3	5.3	5.3	5.9	6.4	7.1	7.8	8.5	9.4
Other exports	27.2	24.0	30.6	33.7	36.9	40.5	44.6	49.1	54.0
Imports (f.o.b.)	-101.6	-87.2	-97.6	-121.7	-139.4	-155.4	-169.6	-182.7	-200.8
Services, income, and transfers	-79.8	-84.4	-87.1	-102.8	-110.5	-112.7	-111.3	-111.2	-112.9
Receipts	19.3	19.2	18.6	15.1	18.1	25.7	35.8	47.3	60.1
Investment income 2/	9.7	9.2	7.7	3.2	5.0	12.0	21.0	31.0	42.1
Other 3/	9.6	10.0	10.9	11.9	13.1	13.7	14.9	16.3	18.0
Payments	-99.1	-103.6	-105.7	-117.9	-128.6	-138.4	-147.1	-158.5	-173.0
Freight and insurance	-17.5	-12.9	-14.4	-15.2	-15.9	-16.6	-17.5	-18.9	-20.5
Other private services 4/	-32.9	-35.0	-37.5	-42.5	-46.2	-49.6	-52.1	-55.7	-60.7
Other government services	-27.5	-29.9	-27.5	-31.1	-33.8	-36.3	-38.1	-40.7	-44.4
Private transfers (net)	-21.2	-25.8	-26.3	-29.2	-32.6	-35.9	-39.4	-43.2	-47.4
Capital and financial account (net)	33.5	7.3	-7.2	-20.1	-14.7	-12.5	-13.7	-15.0	-13.5
Commercial banks	0.2	-18.6	3.4	-2.9	-3.4	-3.2	-3.5	-3.8	-4.2
Other capital movements	33.3	25.9	-10.6	-17.2	-11.3	-9.3	-10.2	-11.1	-9.3
Oil sector and other	34.7	34.3	17.7	18.4	19.3	20.0	20.7	21.4	22.2
Private capital	-1.4	-8.5	-28.3	-35.7	-30.5	-29.3	-30.9	-32.6	-31.5
Net Errors and Omissions	-28.8	-60.8	-24.5	…	…	…	…	…	…
Overall balance	137.2	-32.6	35.1	94.6	73.2	62.7	58.5	52.5	43.4
(In percent of GDP)	28.8	-8.6	7.8	16.6	12.2	9.9	8.7	7.4	5.8
Financing	-137.2	32.6	-35.1	-94.6	-73.2	-62.7	-58.5	-52.5	-43.4
Change in SAMA's NFA (- increase)	-137.0	32.6	-35.1	-94.4	-73.0	-62.5	-58.3	-52.4	-43.3
Memorandum items:									
SAMA's gross foreign assets	441.9	408.6	443.7	538.1	611.1	673.6	731.9	784.3	827.5
(In months of imports) 5/	32.1	27.7	25.3	27.4	28.4	29.1	29.5	28.8	29.3
SAMA's NFA	438.5	405.9	441.0	535.4	608.3	670.8	729.1	781.5	824.8
(In months of imports) 5/	31.9	27.5	25.1	27.3	28.3	29.0	29.4	28.7	29.2
AGI's NFA	65.6	68.8	82.5	99.3	99.3	99.5	100.5	101.3	102.4
WEO oil price (US$/barrel)	97.0	61.8	79.0	106.3	105.3	101.8	99.5	98.8	98.5
Average Saudi oil price (US$/barrel) 6/	93.0	59.2	75.8	101.9	100.9	97.5	95.4	94.6	94.4
Oil Production (mbd)	9.2	8.4	8.4	9.3	9.3	9.7	10.1	10.3	10.5
Oil exports (mbd)	8.4	7.3	7.2	8.1	8.0	8.3	8.6	8.8	8.9
Oil exports/total exports	89.6	84.8	85.7	88.3	87.2	86.1	85.2	84.1	82.9
Imports/GDP	21.3	23.1	21.8	21.3	23.3	24.6	25.4	25.8	26.8
GDP (in billions of US$)	476.9	377.2	448.4	570.9	599.3	631.0	668.6	707.6	750.7
Annual change (in percent)									
Non-oil exports	16.5	-9.9	22.8	10.2	9.5	9.7	10.0	10.0	10.1
Imports of goods	22.9	-14.2	11.9	24.7	14.6	11.5	9.2	7.7	9.9
Imports of non-factor services 7/	21.0	-0.1	2.1	11.7	8.1	6.8	5.1	7.0	8.9
Imports of goods & non-factor services	22.1	-8.1	7.3	18.9	11.8	9.6	7.5	7.4	9.6

Sources: Saudi Arabian Monetary Agency; and Fund staff estimates and projections.

1/ Excluding bunker oil exports.
2/ Represents the return on NFA of SAMA, AGIs, and private sector.
3/ Including bunker oil exports.
4/ Oil sector payments and payments for other private services.
5/ Imports of goods and services over the next 12 months excluding imports for transit trade.
6/ The average price of all oil exports, including refined products.
7/ Excluding freight and insurance, which are projected to grow in line with imports of goods.

Table 5. Saudi Arabia: Monetary Survey, 2008–12

	2008	2009	Prel. 2010	Proj 2011	Proj 2012
	(In billions of Saudi Arabian riyals)				
Foreign assets (net)	1,683.8	1,631.3	1,749.9	2,114.3	2,400.3
SAMA	1,642.3	1,520.0	1,651.5	2,005.0	2,278.2
Commercial banks	41.5	111.2	98.4	109.3	122.1
Domestic credit (net)	-75.8	-17.4	-18.2	-133.5	-200.3
Net claims on government	-842.4	-779.8	-826.2	-1,047.3	-1,265.0
Claims on government	209.9	154.1	182.0	163.8	147.5
Government deposits at SAMA 1/	-1,052.3	-933.9	-1,008.3	-1,211.2	-1,412.5
Claims on state enterprises	32.1	28.1	32.3	39.3	43.0
Claims on private sector	734.6	734.2	775.8	874.5	1,021.8
Money and quasi-money (M3)	929.1	1,028.9	1,080.4	1,205.7	1,347.4
Money (M1)	425.5	521.6	625.6	654.6	755.9
Currency outside banks	83.0	88.4	95.5	111.0	128.1
Demand deposits	342.5	433.2	530.1	543.7	627.8
Quasi-money	503.6	507.4	454.8	551.0	591.5
Time and savings deposits	367.6	323.4	298.3	361.4	388.0
Other quasi-money deposits	136.0	184.0	156.5	189.6	203.5
Other items (net liabilities)	678.9	584.9	651.4	775.2	852.7
Memorandum items:					
AGI's net foreign assets of	245.8	257.5	309.0	371.8	371.7
	(Percent changes; unless otherwise indicated)				
Foreign assets (net)	43.8	-3.1	7.3	20.8	13.5
Domestic credit (net)	-130.9	-77.0	4.3	634.8	50.1
Net claims on government	127.7	-7.4	6.0	26.8	20.8
Government deposits at SAMA (increase -) 1/	-104.7	11.3	-8.0	-20.1	-16.6
Claims on state enterprises	-14.3	-12.3	14.7	21.9	9.2
Claims on private sector	27.1	0.0	5.7	12.7	16.8
Money and quasi-money	17.6	10.7	5.0	11.6	11.8
Other items (net liabilities)	8.4	-13.8	11.4	19.0	10.0
Memorandum items:					
Specialized Credit Institutions credit (in billions of Saudi Arabian riyals)	155.2	178.0	191.7	…	…
Ratio of M3-to-GDP	52.0	72.8	64.3	56.4	60.0
Ratio of M3-to-non-oil GDP	134.7	139.5	136.3	137.0	137.0
Ratio of Claims on private sector-to-non-oil GDP	106.5	99.6	97.9	99.4	103.9

Sources: Saudi Arabian Monetary Agency (SAMA); and Fund staff estimates.

1/ Includes deposits other than the central government.

Table 6. Saudi Arabia: Financial Soundness Indicators, 2006–10

(In percent, unless otherwise indicated)

	2006	2007	2008	2009	2010
Banking sector					
Structure of the banking sector					
Number of licensed banks	16	22	22	23	23
Number of banks accounting for:					
25 percent of total assets	2	2	2	2	2
75 percent of total assets	6	6	6	6	6
Total assets (percent of GDP)	65.0	75.1	73.5	99.0	87.6
Of which: Foreign currency-denominated (as percent of total assets)	15.1	13.7	11.8	15.4	13.6
Total loans (percent of GDP)	37.5	41.6	42.1	53.2	48.0
Credit to private sector (percent of GDP)	34.9	39.0	40.2	51.2	46.0
Total deposits, excluding interbank (as percent of GDP)	44.6	50.2	47.8	67.9	60.9
Central bank credit to banks (as percent of GDP)	0.4	---	---	---	---
Capital adequacy					
Regulatory capital to risk-weighted assets	21.9	20.6	16.0	16.5	17.1
Asset Quality					
Net loans to total assets	54.2	52.0	57.9	57.4	55.2
Gross NPLs to net loans	2.0	2.1	1.4	3.3	3.0
Total provisions to gross NPLs	182.3	142.9	153.3	89.8	115.7
Net NPLs to total capital 1/	-6.2	-3.5	-3.8	1.4	-2.7
Total provisions for loan losses (as percent of total loans)	3.6	3.0	2.1	3.0	3.5
Loans to property and construction sector to total loans	7.6	7.3	7.3	6.1	7.2
Loans to domestic manufacturing sector to total loans	7.6	9.1	10.7	10.2	11.6
Contingent and off-balance sheet accounts to total assets	91.5	96.6	96.0	81.0	91.4
Profitability					
Profits (percent change)	31.0	-14.4	-11.9	-1.1	3.9
Average pretax return on assets	4.3	2.8	2.7	1.9	1.9
Return on equity	30.4	22.2	20.4	13.7	13.6
Noninterest expenses to total income 2/	31.0	38.7	51.1	55.4	52.7
Average lending spread	4.1	3.2	4.0	4.4	4.2
Liquidity					
Liquid assets to total assets	25.4	22.2	22.8	25.3	24.7
Liquid assets to short-term liabilities 3/	40.0	38.3	39.7	40.6	39.7
Customer deposits to net loans	137.4	136.4	123.9	128.6	136.0
Demand deposits to total deposits		42.8	36.6	43.6	49.7
Sensitivity to market risk					
Foreign currency-denominated deposits to total deposits	19.3	15.4	15.5	16.1	13.0
Foreign currency-denominated loans to total loans	8.7	11.4	13.4	13.9	13.3
Foreign currency-denominated contingent and off-balance sheet accounts to total assets	50.2	52.8	54.5	49.6	43.0
Net open foreign currency position to capital	3.0	3.1	4.5	8.6	10.2
Stock market					
Stock market capitalization (percent of GDP)	92.6	136.0	52.2	86.4	82.0
Overall stock market price index (Change in percent)	-52.5	40.9	-57.0	27.5	8.2
Bank stock price index (change in percent)	-42.7	31.0	-55.6	15.3	6.6

Source: Saudi Arabian Monetary Agency.

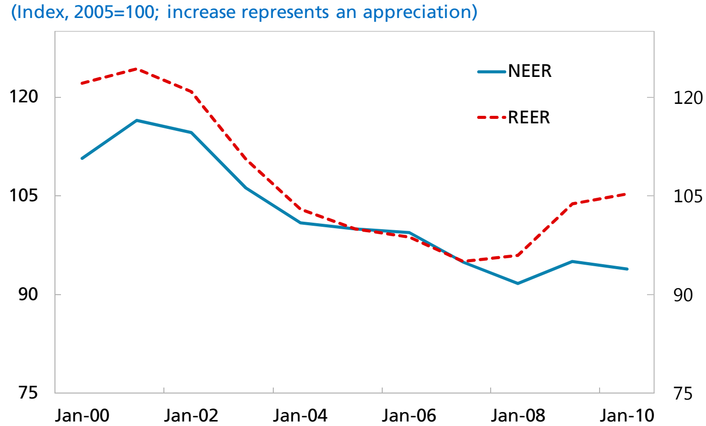
1/ The negative sign reflects that provisions exceed gross NPLs.
2/ Total income includes net interest income and gross noninterest income.
3/ Short-term liabilities include demand deposits maturing in 90 days or less. Liquid assets include cash, gold, Saudi government bonds and treasury bills, and interbank deposits maturing within 30 days.

APPENDIX I. SAUDI ARABIA: EXCHANGE RATE ASSESSMENT

Preliminary estimates from CGER-type methodologies for exchange rate assessment indicate that the Saudi Riyal is broadly in line with its macroeconomic fundamentals, with some evidence of overvaluation over the medium-term.

1. **Despite terms of trade gains, the real exchange rate has appreciated by only 1 percent since the end of 2009.** Following a period of moderate depreciation between 2002 and 2007, the trade-weighted real effective exchange rate (REER) index appreciated by 1 percent during 2010 and 11 percent cumulatively between end 2007 and 2010. The nominal effective exchange rate closely followed the REER trend until 2008, when it began to diverge owing to higher inflation relative to trading partners in part due to the relatively high weight on food in the Saudi CPI basket.

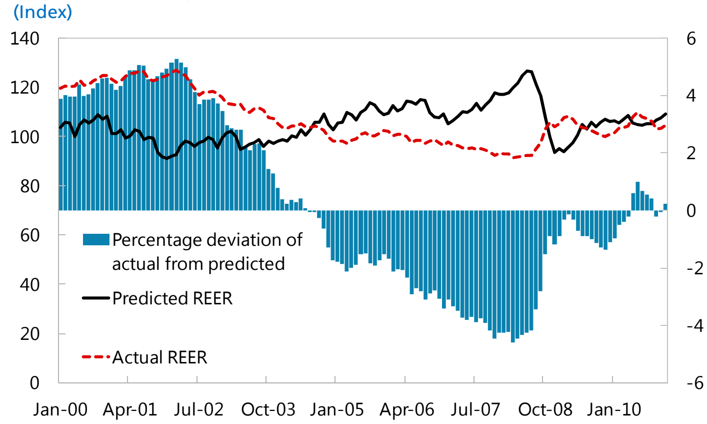
Real and Nominal effective Exchange Rates, Jan. 2000–Dec. 2010
(Index, 2005=100; increase represents an appreciation)



Source: Country authorities; and IMF staff estimates.

The equilibrium real exchange rate (ERER) approach suggests that the riyal is in equilibrium. A high frequency estimation of the cointegrating relationship between the real exchange rate and real oil prices (as the only explanatory variable) shows that they are cointegrated (with a statistically significant elasticity coefficient of 26.6 percent).[1] The estimation suggests that while the riyal was moderately overvalued during the earlier part of this decade, switching into a moderate undervaluation during mid-2004, it is presently not misaligned.

High Frequency ERER Estimation, Jan. 2000–Dec. 2010
(Index)



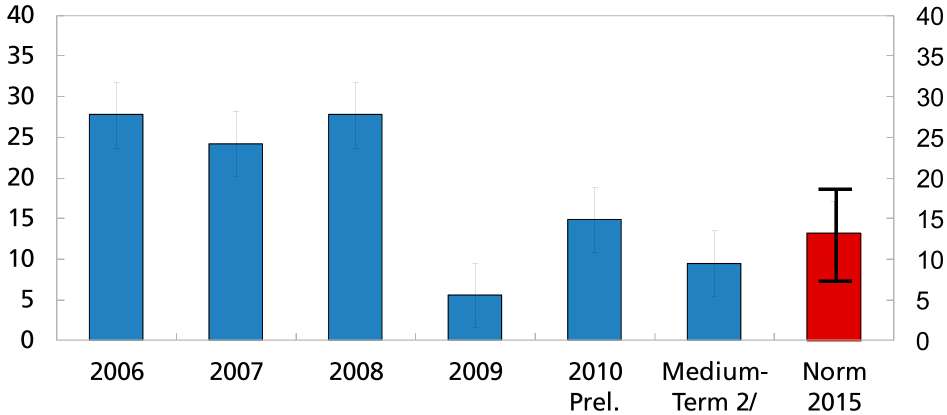
Source: IMF staff estimates.

[1] Cashin, Ouliaris and Poghosyan (forthcoming).

2. **The macroeconomic balance approach suggests the riyal is within close proximity to its estimated norm during 2010 and over the medium term, with some evidence of overvaluation.** The macroeconomic balance approach estimates three main specifications of the equilibrium current account (norm) from a set of fundamentals (non-oil and gas fiscal balance, oil and gas reserves, old-age dependency ratio, population growth rate, initial net foreign assets (NFA) net of external debt, oil trade balance, growth rate of real per capita GDP, relative income, and lagged dependent current account) employing a generalized method of moments (GMM) technique.[2] As shown (in the table below), the estimation yields an average current account norm for Saudi Arabia of a surplus of about 13.2 percent of GDP in 2015. The projected current account position in 2015 is a surplus of 9.5 percent of GDP, which lies within two standard error of the prediction, suggesting no statistically significant evidence of exchange rate misalignment.

Current Account Balance, Actual and Estimated Norms, 2006–15 1/

(In percent of GDP)



Sources: IMF staff estimates and projections.
1/ In computing the norms, medium-term values of the fundamentals (including the non-oil fiscal balance, oil trade balance, fand oil and gas reserves) are drawn from staff projections. Band is ±2 standard errors of the prediction.
2/ Based on Fund staff estimates. For the 2010 assessment, the medium-term is 2015.

[2] Beidas-Strom and Cashin (IMF Working Paper 11/195), "Are Middle Eastern Current Account Imbalances Excessive?"

Current Account--GMM Estimation and Implied Norm for Net-Oil Exporters: Saudi Arabia 1/
(Dependent variable: Current account balance, as a share of GDP)

	Specification 1		Specification 2	
	GMM coefficients	Contribution to CA norm 2/	GMM coefficients	Contribution to CA norm 2/
Core CGER Regressors				
Constant	0.039	3.92%	0.035	3.50%
Lagged dependent	0.330	7.04%		
Fiscal balance/Non-oil Fiscal balance GDP	0.851	1.19%	0.385	-13.18%
Oil trade balance/GDP			0.454	21.22%
Old age dependency	-0.053	-0.24%	-0.059	-0.26%
Population growth	-0.693	-1.39%	-0.930	-1.86%
NFA/GDP	0.023	2.02%	0.022	1.93%
Relative income	-0.017	-0.89%	0.044	2.27%
Economic growth	-0.053	-0.22%	-0.069	-0.29%
Net Oil-Exporter Specific Regressors				
Oil wealth			0.0002	0.77%
Additional Regressors				
REER	0.073	0.74%		
Terms of trade	4.269	0.06%		
Estimated Current Account Norm (2015)		**12.24%**		**14.10%**
Underlying current account (2015)		**9.54%**		
Hansen's J test of overidentifying restrictions		0.46		0.61
Arellano-Bond test for AR(1)		0.07		0.09
Arellano-Bond test for AR(2)		0.67		0.71
Number of instruments		6		5
Number of countries		24		24
Observations		82		82

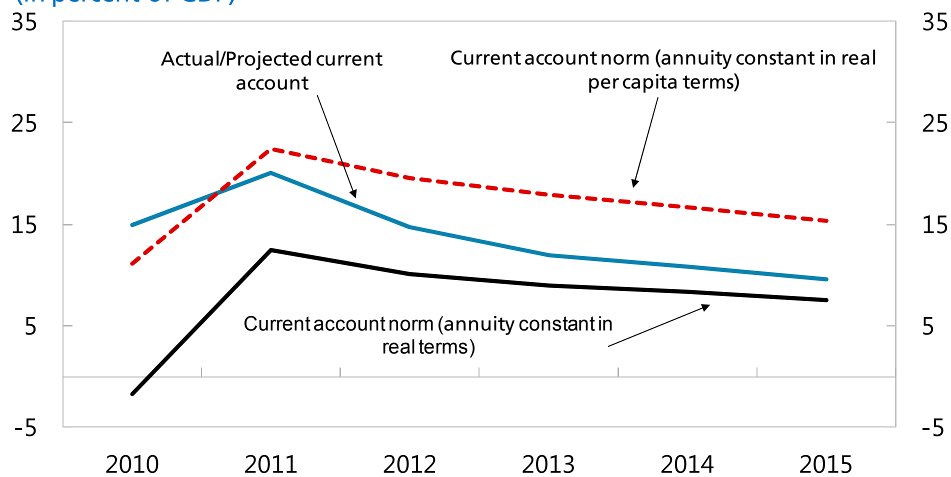
1/ See Beidas-Strom and Cashin (forthcoming), regressions based on annual data of 34 net oil exporting countries' from 1989-2009 period, from WEO Fall 2010 vintage, 4-year non-overlapping averages.

2/ Contribution to CA norm = coefficient*medium-term projection/steady state value (in percent).

3. **The external sustainability approach suggests mixed results over the medium-term.** This underpinning of this approach is that the sustainability of the current account trajectory requires that the net present value (NPV) of all future oil and financial/investment income (wealth) be equal to the NPV of imports of goods and services net of non-oil exports. Subject to this constraint, the government would choose a path for imports, and hence a current account norm, that would support intergenerational equity—and some precautionary savings in view of volatile oil prices—through an appropriate pace of accumulation of net

foreign assets. Estimating Saudi Arabia's oil wealth at $6.4 trillion,[3] import trajectories "(annuities or allocation rules)" are calculated under two different policy scenarios: (a) constant real per capita annuity; and (b) constant real annuity. Both types of annuities are used in the literature,[4] and can be derived from the optimization of plausible government utility functions. One rule suggests a moderate overvaluation of the currency over the medium term (2015), while the other suggests a modest undervalaution: rule (a) has an implied current account surplus of 15 percent of GDP, while the less generous rule (b) has an implied current account norm of 8 percent of GDP. These results are very sensitive to the assumed parameters.

External Sustainability Approach: Current Account Norms vs. Actual/Projected Current Account, 2010–15
(in percent of GDP)



Source: IMF staff estimates.

[3] Assuming for illustrative purposes 267 billion barrels of reserves, a 77 percent recovery rate, oil production would peak at 11.8 million barrels in 2029 before declining gradually (2.0 percent). Domestic consumption and production costs include imports to develop and maintain production valued at 8 percent of the value of oil production (WEO prices). Oil prices and the GDP deflator increase by 2 percent after 2015, and real non-oil GDP grows by 5 percent while total real growth is assumed to be 3 percent. Future oil revenues are nominally discounted at 6 percent, the assumed rate of return on externally held financial wealth/NFA, while population growth is 1 percent.

[4] See Bems, R., and I. de Carvalho Filho, 2009, "Exchange Rate Assessments: Methodologies for Oil Exporting Countries," IMF Working Paper 09/281.

ANNEX I. SAUDI ARABIA—FUND RELATIONS
(As of May 31, 2011)

I. **Membership Status:** Joined August 26, 1957; Article VIII.

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	6,985.50	100.00
Fund holdings of currency	4,967.10	71.11
Reserve position in Fund	2,018.41	28.89

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	6,682.50	100.00
Holdings	6,834.25	102.27

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:** None

VI. **Lending to the Fund and Grants:**

The Fund as Trustee of the Poverty Reduction and Growth Trust (PRGT) entered into a borrowing agreement with Saudi Arabia on May 13, 2011, by which Saudi Arabia will provide new loan resources of up to SDR 500 million. Saudi Arabia has also consented to the amendments of the NAB Decision and the increases of credit arrangements of participants as approved by the Executive Board on April 12, 2010 (Executive Board Decision No. 14577-(10/35), increasing its own credit arrangement in the expanded NAB to SDR 11.13 billion, from the current SDR 1.76 billion. The current outstanding amount as of May 31, 2011 is SDR 384.10 million. The Fund also has a borrowing agreement with Saudi Arabia in association with the General Arrangements to Borrow (GAB), for an amount equivalent to SDR 1.5 billion, which was renewed for another five-year period from December 26, 2008. In March 2001, Saudi Arabia agreed to support the PRGF-HIPC Trust with investments totaling SDR 94.4 million, which as of end-May 2006, were received as scheduled.
Since 1989, Saudi Arabia disbursed SDR 49.5 million in PRGF loans under the Associated Agreement with the PRGF Trust. This loan had been fully drawn and repaid as of end-May 2006. Saudi Arabia has committed about SDR 2.6 million in grant associated with the IMF's Subsidization of Emergency Assistance for Natural Disasters. In April 2006, Saudi Arabia agreed to contribute SDR 40 million in end-2005 NPV terms in subsidy resources to support the Exogenous Shocks Facility.

VII. **Exchange Rate Arrangement**

Saudi Arabia maintains an exchange rate system free of restrictions on the making of payments and transfers for current international transactions. The Saudi Arabian riyal was formally pegged to the U.S. dollar, effective January 2003. Prior to that, it was officially pegged to the SDR at the rate of SRls 4.28255=SDR 1, with margins of 7.25 percent even though in practice it has been pegged to the U.S. dollar since 1986, with a middle rate of SRls 3.7450=$1. Saudi Arabia maintains security-related exchange restrictions pursuant to UN Security Council resolutions 1267 and 1373. These security-related restrictions should be notified to the Fund pursuant to Decision No.144-(52/51).

VIII. **Last Article IV Consultation:**

Saudi Arabia is on the standard 12-month consultation cycle. The last Article IV consultation was held during May 2–19, 2010 in Riyadh. The staff report was considered by the Executive Board on July 12, 2010.

IX. **Technical Assistance:**

STA: GDDS Meta Data Development January 26–February 6, 2008.
G20 Data Gap Initiative, January 22–23, 2011
Balance of Payment Statistics, March 12–23, 2011

MCM: Stress testing, January 9–21, 2010

FAD: Options for Indirect Taxation, February 25–March 11, 2006.
Public Financial Management and Statistics, jointly with STA, September 16–30, 2006.
Tax Administration, November 6–19, 2006.
Enhancing Budget Process Reforms January 22–February 2, 2008.

X. **FSAP:** The main FSAP mission took place in January 2004.
The FSSA was published on June 5, 2006.
(http://www.imf.org/external/pubs/ft/scr/2006/cr06199.pdf)
FSAP-update, April 16–30, 2011.

XI. **Resident Representative:**

No resident representative is stationed in Saudi Arabia.

ANNEX II. SAUDI ARABIA—RELATIONS WITH THE WORLD BANK

The World Bank's Technical Cooperation Program (TCP) has been providing policy advice, capacity building, and implementation support to development efforts in Saudi Arabia on a reimbursable basis since 1975. In 2006, Saudi authorities agreed to move the program from an annual to a three year planning horizon in order to promote a programmatic engagement in certain areas.

- The TCP aims to assist Saudi Arabia in addressing its development challenges of generating productive jobs for a fast growing population; improving the performance of its health system to meet evolving needs; strengthening social safety net mechanisms; enhancing the provision of public services including water, electricity, transport, health and education; and strengthening capacity in national and municipal organizations.

- Among priority activities in the FY12–14 program are: work on unemployment assistance and unemployment insurance; continued training for potential SME entrepreneurs in business plan formulation, accounting and marketing; analytical work on the costs and benefits of developing renewable energy; using information technology to improve the administration of health insurance; updating the water sector strategy and building a national consensus around it; developing links with civil society to complement public sector social safety net efforts; and updating a national ports strategy.

- Since 2007, the IFC Office has been co-located with the World Bank Office in Riyadh. IFC activities in the country, as well as with Saudi investors outside the country, have increased significantly. They are in line with the following three objectives:

Promote Selective Business in Saudi Arabia:

IFC's strategy for investments in Saudi Arabia is to invest in selective transactions that can add value in terms of institution building, development of new financial instruments and SME development. Specific investments in the financial sector include housing finance, insurance, leasing, microfinance and a student loan program (current portfolio is approximately $140 million). IFC also provides Advisory Services in mortgage finance, SME finance, corporate governance, risk management and PPP transactions.

Promote South-South Investments From Saudi Arabia:

Many Saudi investors are looking to expand outside of their home-base. This is an opportunity for IFC to work with such companies and invest with them inside and outside the MENA region. IFC Riyadh office increased its activity, especially in facilitating south-south investments that reached around $900 million in IDA and middle income countries (Pakistan, Egypt, Yemen, Ethiopia, Ghana, etc.). IFC continues to work closely with Saudi sponsors to further facilitate cross border investment in the region.

Mobilize Funds From Saudi Public Sector:

IFC is working closely with the Saudi Public Institutions to undertake global initiatives that benefit private sector activities in developing countries. So far, these efforts have resulted in obtaining commitments of over US$ 500 million. The current commitments include US$ 300 million from Saudi Fund for Development (SFD) for Global Trade Liquidity Program (GTLP), US$100 million from the Public Investment Fund (PIF) for IFC Africa, Latin America & Caribbean Fund and US$ 100 million from OPEC Fund for International Development (OFID) for GTLP, Microfinance Fund and Africa Capitalization Fund. In addition, the IsDB contributed US$5 million to IFC's Advisory Services program, and has recently agreed to a new contribution of $2 million. IsDB has also contributed $1 million for IFC's Education for Employment (E4E) initiative.

ANNEX III. SAUDI ARABIA—STATISTICAL ISSUES
(As of May 31, 2011)

<table>
<tr><th colspan="2">I. Assessment of Data Adequacy for Surveillance</th></tr>
<tr><td colspan="2">General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are: national accounts, government finance statistics, and balance of payments.</td></tr>
<tr><td colspan="2">National Accounts: Annual estimates of GDP are calculated from the production side at current and constant prices (with 1999 as a base year). However, GDP using the expenditure approach is compiled in current prices only.</td></tr>
<tr><td colspan="2">Government finance statistics: The authorities are reclassifying the budget in line with GFSM 2001. Most chapters have been completed and the Ministry of Finance is planning on using the GFSM 2001 framework to report fiscal data.</td></tr>
<tr><td colspan="2">Balance of Payments: Although a comprehensive measure of the International Investment Position (IIP) is not available, the authorities publish monthly the foreign assets and liabilities of the central bank and pension funds. The central government does not have a sovereign wealth fund nor external debt. This permits staff to derive a broad estimate of the public sector IIP. The coverage in the capital and financial accounts, particularly for the private sector, needs to be improved.</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>Participant in the General Data Dissemination System (GDDS) since 2008.</td><td>No data ROSC is available.</td></tr>
</table>

SAUDI ARABIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of May 31, 2011)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological Soundness[7]	Data Quality – Accuracy and Reliability[8]
Exchange Rates	5/30/2011	5/31/2011	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/2011	5/25/2011	M	M	M		
Reserve/Base Money	4/2011	5/25/2011	M	M	M		
Broad Money	4/2011	5/25/2011	W	W	W		
Central Bank Balance Sheet	4/2011	5/25/2011	M	M	M		
Consolidated Balance Sheet of the Banking System	4/2011	5/25/2011	M	M	M		
Interest Rates[2]	4/2011	5/25/2011	M	M	M		
Consumer Price Index	4/2011	5/25/2011	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2010	5/14/2011	A	A	A		
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2010	5/14/2011	A	A	A		
External Current Account Balance	2010	5/14/2011	Q	Q	Q		
Exports and Imports of Goods and Services	2010	5/14/2011	Q	Q	Q		
GDP/GNP	2010	5/14/2011	A	A	A		
Gross External Debt (BIS)	2010		Q	Q	Q		
International Investment Position[5]			NA	NA	NA		

[1] Any reserve assets that are pledge or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by means as well as the notional values of derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] Including currency and maturity composition.

[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

[7] Reflects the assessment provided in the data ROSC published in December 2005, and based on the findings of the mission that took place during February 8–23, 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[8] Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/114
FOR IMMEDIATE RELEASE
August, 23, 2011

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2011 Article IV Consultation with Saudi Arabia

On July 18, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Saudi Arabia.[1]

Background

Over the last few decades, Saudi Arabia has achieved substantial gains in social development indicators which are now close to G-20 averages. Important challenges still remain, particularly the high level of youth unemployment for nationals and pressures in the housing market. With oil prices having rebounded following the global financial crisis, strong fiscal and external balances, coupled with high international reserves and very low debt, Saudi Arabia has the fiscal space to address these social priorities.

Growth recovered strongly in 2010 to an estimated 4.1 percent, following the 0.1 percent recorded in 2009. The acceleration in growth stemmed from both the oil and non-oil sectors, supported by higher public spending as well as a recovery in global demand. Profitability of corporates listed on the stock exchange improved significantly in 2010, with net profits some 56 percent higher than in 2009.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The fiscal accounts moved back into surplus in 2010 as increased oil revenues more than offset higher spending. Royal Decrees issued in February and March 2011 introduced new initiatives to tackle housing needs, to expand employment opportunities, and to broaden the social safety net.

Broad money growth slowed in 2010, but together with private sector credit has now begun to pick up. Monetary policy rates were left unchanged during 2010 in order to support private sector activity, and in line with domestic monetary indicators and monetary conditions in the U.S. and the exchange rate peg. Banks remain highly liquid and continue to hold capital well in excess of statutory limits.

Looking ahead, oil revenues are likely to be significantly higher than in 2010, reflecting both higher oil prices and increased oil volumes as Saudi Arabia expands production to make up for supply shortfalls from other countries. Fiscal and external balances are expected to strengthen further in the near-term. Available leading indicators point to an acceleration in private sector activity in early 2011, with overall real GDP growth now expected at 6.5 percent. Inflation has been subdued but the combination of continued pressure from imported food prices, rents, increased government spending and high domestic liquidity is likely to result in inflation rising to an average of about 6 percent for the year as a whole.

Executive Board Assessment

Executive Directors noted that policy and financial buffers, combined with prudent financial sector regulation and supervision, had allowed Saudi Arabia to weather the global slowdown well. The near-term outlook for the economy is favorable. Over the medium term, policy priorities should focus on maintaining fiscal sustainability, securing broad-based growth and fostering job creation. Directors commended the authorities for their continued stabilizing role in the oil markets. They noted the significant positive spillover effects of Saudi policies on the regional and global economies, including the provision of generous official development assistance.

Directors supported the authorities' actions to use the higher oil revenues to accelerate initiatives to address important social issues, notably in housing, unemployment, and extending the social safety net. At the same time, they highlighted the need to carefully monitor possible inflationary pressures and encouraged the proactive use of fiscal policy, supported by available monetary policy instruments, if needed.

Directors noted that the recent initiatives have increased spending entitlements over the medium term and raised vulnerabilities to a sustained decline in the oil price. They considered that spending programs that would complement private sector activity would enhance the economic impact of higher spending. The establishment of a formal medium-term expenditure framework, supported by a macro-fiscal unit, would help strengthen the implementation of fiscal policy over time. Directors welcomed ongoing initiatives to strengthen revenues, including modernizing tax administration, and looked forward to further progress towards a GCC-wide VAT. They also highlighted the importance of gradually reforming domestic energy pricing.

Directors noted that the supervision and regulation of the financial system by the central bank has been effective, as evidenced by the banking system's resilience to recent shocks and confirmed by the conclusions of the recent FSAP update. Directors commended the authorities for the improvements in the areas of banking regulation and supervision in recent years. They encouraged the central bank to continue to strengthen the regulatory and supervisory framework, including by aligning the legal framework with actual practice. Directors also commended the authorities for their strong efforts in combating money laundering and the financing of terrorism, and encouraged further enhancement of the AML/CFT framework.

Directors agreed that the exchange rate peg to the U.S. dollar has provided a credible nominal anchor, while facilitating investment and financial sector development.

Directors welcomed the authorities' multi-pronged strategy for stimulating job creation in the private sector, which would allow to scale back reliance on the public sector to absorb domestic labor. They noted the importance of efforts to increase access to finance and to deepen trade relationships with emerging trading partners. Directors emphasized that labor market policies should be designed in a market-friendly manner to avoid distortions and preserve competitiveness.

Directors acknowledged the steps to enhance access to housing finance, as part of a broader effort to address pressures on the availability of affordable housing. They looked forward to the final approval of the new mortgage law while stressing the importance of maintaining a strong prudential framework to ensure loan soundness and contain risk in the financial system.

Directors noted the ongoing efforts to improve the quality and dissemination of statistics and encouraged continued progress to address remaining data gaps.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise

Saudi Arabia: Selected Economic Indicators, 2007–11

	2007	2008	2009	Prel. 2010	Proj. 2011
			(Percentage change)		
Production and prices					
Real GDP	2.0	4.2	0.1	4.1	6.5
Real oil GDP	-3.6	4.2	-7.8	2.2	9.4
Real non-oil GDP	4.7	4.3	3.5	4.9	5.4
Nominal GDP (in billions of U.S. dollars)	385	477	377	448	571
Consumer price index	4.1	9.9	5.1	5.4	6.0
			(In percent of GDP)		
Fiscal and Financial variables					
Central Government revenue	44.6	61.6	36.1	44.2	47.3
Of which: oil revenue	39.0	55.1	30.8	39.9	43.6
Central Government expenditure	32.3	29.1	42.2	38.9	38.0
Fiscal balance (deficit -)	12.2	32.5	-6.1	5.2	9.3
Non-oil primary balance (in percent of non-oil GDP)	-55.8	-57.7	-67.6	-70.8	-80.7
Change in broad money (in percent)	19.6	17.6	10.7	5.0	11.6
			(In billions U.S. of dollars)		
External sector					
Exports	233.5	313.9	192.6	251.5	339.3
Of which: Oil and refined products	205.6	281.4	163.3	215.5	299.6
Imports	-82.7	-101.6	-87.2	-97.6	-121.7
Current account	93.5	132.5	21.0	66.8	114.7
Currrent account (in percent of GDP)	24.3	27.8	5.6	14.9	20.1
SAMA’s net foreign assets	301.3	438.5	405.9	441.0	535.4
SAMA's net foreign assets (in months of imports of goods and services)	20.1	31.9	27.5	25.1	27.3
Real effective exchange rate (percent change)	-3.8	1.0	7.9	1.4	…

Sources: Data provided by the authorities; and IMF staff estimates