INTERNATIONAL MONETARY FUND

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SAUDI ARABIA

August 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

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 2018 Article IV consultation with Saudi Arabia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 16, 2018 consideration of the staff report that concluded the Article IV consultation with Saudi Arabia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 16, 2018, following discussions that ended on May 14, 2018, 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, 2018.
- An **Informational Annex** prepared by the IMF staff.

The document listed below will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2018 Article IV Consultation with Saudi Arabia

On July 16, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Saudi Arabia.

Real GDP growth is expected to increase to 1.9 percent in 2018, with non-oil growth strengthening to 2.3 percent. Growth is expected to pick-up further over the medium-term as the reforms take hold and oil output increases. Risks are balanced in the near-term. The employment of Saudi nationals has increased, especially for women, but the unemployment rate among Saudi nationals rose to 12.8 percent in 2017.

CPI inflation has increased in recent months with the introduction of the value-added tax (VAT) and higher gasoline and electricity prices, and is forecast at 3 percent in 2018, before it stabilizes at around 2 percent over the medium-term. The fiscal deficit is projected to continue to narrow, from 9.3 percent of GDP in 2017 to 4.6 percent of GDP in 2018 and then further to 1.7 percent of GDP in 2019. With oil prices implied by futures markets declining over the medium-term, the deficit is then projected to widen. The deficit is expected to continue to be financed by a combination of asset drawdowns and domestic and international borrowing.

The current account balance is expected to be in a surplus of 9.3 percent of GDP in 2018 as oil export revenues increase and remittance outflows remain subdued. The Saudi Arabian Monetary Authority's (SAMA) net foreign assets are expected to increase this year and over the medium-term.

Credit and deposit growth remain weak, but both are expected to strengthen due to higher government spending and non-oil growth. Bank profitability should increase as interest margins widen, and banks remain well capitalized and liquid.

The authorities are continuing with their fiscal reforms including through the introduction of the value-added tax and further energy price increases at the beginning of 2018. Reforms are also ongoing to improve the business environment, develop a more vibrant small and medium enterprises (SME) sector, deepen the capital markets, increase the involvement of women in the economy, and develop new industries with high potential for growth and job creation.

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[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.

Executive Board Assessment[2]

Executive Directors commended the authorities for the progress made in implementing their reform agenda. Directors welcomed the broadly positive outlook and emphasized that higher oil prices should not slow the reform momentum. They agreed that continued commitment to implementing wide-ranging reforms will help achieve the fiscal objectives and promote non-oil growth.

Directors welcomed the ongoing fiscal consolidation efforts and agreed that aiming for a balanced budget by 2023 is appropriate. They emphasized the importance of fully implementing the revenue reforms and limiting the future growth of government spending to achieve this objective. In the event oil prices exceed those assumed in the budget, most Directors recommended saving the additional revenues to begin to rebuild fiscal buffers.

Directors welcomed the new revenue measures, particularly the introduction of the VAT. They encouraged the authorities to continue their preparations to lower the VAT registration threshold in 2019. Directors welcomed the authorities' intention to continue to gradually increase energy prices, but saw scope for more communication about the future price increases. They emphasized the importance of ensuring that the payments through the citizens' accounts are adequate to compensate low and middle-income households for the impact of the price increases.

Directors encouraged the authorities to anchor fiscal spending in a medium-term expenditure framework. They supported the ongoing civil service review, which should help identify reforms to contain the wage bill. Directors welcomed recent efforts to strengthen the medium-term fiscal framework, increase fiscal transparency, and develop macro-fiscal analysis, and encouraged further progress in these areas. They emphasized the importance of an integrated asset-liability management framework to guide the government's borrowing and investment decisions.

Directors welcomed the progress in implementing structural reforms, and emphasized that these should continue in consultation with the private sector. They noted the progress with the privatization and public-private partnerships plans and believed this program should be accelerated. Directors agreed that the public sector could be a catalyst for the development of new sectors, but emphasized that this should not crowd-out the private sector.

Directors highlighted that policies to create jobs for nationals in the private sector should focus on leveling the playing field between Saudis and expatriates. In addition to the ongoing reforms, they believed that setting clear expectations about employment prospects in the public sector, reforming the visa system for expatriate workers, strengthening education and training, and addressing remaining constraints to female employment would be key.

[2] 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.

Directors welcomed the authorities' focus on financial development and inclusion. They agreed that increasing SME finance, improving financial sector access, particularly for women, and developing the debt market are priorities. They welcomed SAMA's efforts to strengthen liquidity management. Directors encouraged the authorities to continue to strengthen the effectiveness of their Anti-Money Laundering/Countering the Financing of Terrorism framework.

Directors agreed that the exchange rate peg to the U.S. dollar continues to serve Saudi Arabia well given the structure of the Saudi economy.

Saudi Arabia: Selected Economic Indicators, 2016–19

Population: 32.6 million (2017)

Quota: SDR 6,985.5 million (2.93% of total)

Literacy: 95% (2015, adults)

Main products and exports: Oil and oil products (77%)

Key export markets: Asia, U.S., and Europe

	2016	Prel. 2017	Proj. 2018	Proj. 2019
Output				
Real GDP growth	1.7	-0.9	1.9	1.9
Prices				
CPI Inflation (%)	2.0	-0.9	3.0	2.0
Central government finances				
Revenue (% GDP)	21.5	24.1	30.6	31.7
Expenditure (% GDP)	38.7	33.4	35.2	33.4
Fiscal balance (% GDP)	-17.2	-9.3	-4.6	-1.7
Public debt (% GDP)	13.1	17.2	19.1	20.3
Non-oil primary balance (% Nonoil GDP)	-45.7	-39.7	-41.7	-36.9
Money and credit				
Broad money (% change)	0.8	0.2	2.3	2.8
Credit to the private sector (% change)	2.4	-0.8	2.0	2.2
Balance of payments				
Current account (% GDP)	-3.7	2.2	9.3	8.8
FDI (% GDP)	1.2	0.2	0.2	0.2
Reserves (months imports)[1]	32.3	28.4	29.2	30.2
External debt (% GDP)	28.9	34.9	35.7	36.5
Exchange rate				
REER (% change) [2]	4.8	-5.1	-5.4	…
Unemployment rate				
Overall (% total labor force)	5.6	6.0	…	…
Nationals (% total labor force)	12.3	12.8	…	…

Sources: Country authorities and IMF staff estimates and projections.

[1] Imports of goods and services.

[2] For 2018, data is latest available.

INTERNATIONAL MONETARY FUND

SAUDI ARABIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

June 28, 2018

KEY ISSUES

Context. Reform momentum remains strong under Vision 2030. New reform initiatives are being rolled-out under the Vision Realization Programs (VRPs). Oil prices have risen over the past year and are positively affecting fiscal and external balances. Higher oil prices provide both an opportunity and a risk to the fiscal reforms.

Outlook and risks. Growth is expected to pick-up this year and over the medium-term as the reforms take hold and oil output increases. Risks are balanced in the near-term.

Fiscal policy. Targeting budget balance by 2023 is appropriate, but if oil prices are higher than in the budget, the additional revenues should be saved. Non-oil revenue and energy price reforms need to continue, growth in government spending should be contained, and the fiscal framework strengthened. An integrated asset-liability management framework would help the government assess the commitments it is making on and off-budget.

Employment and growth-enhancing reforms. The government is rightly focused on employment creation for nationals. Reforms should focus on levelling the playing field between Saudis and expatriate workers in areas where Saudis are likely to work. Steps are being taken to improve the business of environment, and implementation will be key to their effectiveness.

Financial sector. Increasing financial development and inclusion while maintaining financial stability are key policy priorities. Reforms to strengthen liquidity management should continue, while macroprudential policies can be used countercyclically within a well-defined framework.

External sector. The external position has strengthened substantially. The exchange rate peg to the U.S. dollar serves Saudi Arabia well given the structure of the economy.

Approved By
Aasim M. Husain and Sanjaya Panth

Discussions were held in Riyadh during May 2–14, 2018. The staff team comprised Tim Callen (head), Nabil Ben Ltaifa, Divya Kirti, Anta Ndoye (all MCD), Abdul Naseer (MCM), and Delphine Prady (FAD). Jihad Azour (MCD) participated in the concluding meetings. Executive Director for Saudi Arabia, Mr. Hesham Alogeel, accompanied the mission. The team met with Minister of Finance Aljadaan, Minister of Housing Al-Hogail, Minister of Civil Service Al-Hamdan, Minister of Labor Al Ghafees, Chairman of the Capital Market Authority El-Kuwaiz, the Governor of SAMA Alkholifey, and other senior officials, as well as representatives of the private sector. Diana Kargbo-Sical and Tucker Stone (both MCD) provided support from headquarters and contributed to the report.

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CONTEXT

1. The government is continuing to implement wide-ranging economic and social reforms under Vision 2030. These reforms are structured under 13 Vision Realization Programs (VRPs), of which 6 have been published. A governance structure has been set up for each program to ensure its goals are met. As it has moved forward with reforms, the government has implemented many of the recommendations of the 2017 Article IV and FSSA reports.

2. Saudi Arabia is taking a lead role in the OPEC+ production agreement. It cut its oil output significantly to around 10 mb/d in January—April 2018 from 10.5 mb/d in 2016. In view of the reduction in inventories, supply disruptions in some key producing countries, and the rise in prices in recent months, OPEC has announced it will increase production from July.

3. Geopolitical tensions in the region remain high. Ongoing conflicts are creating a difficult security environment in the region, and are continuing to put pressure on defense and security spending.

MACRO-FINANCIAL-FISCAL DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

4. Fiscal consolidation continued in 2017. The fiscal deficit narrowed to 9.3 percent of GDP, from 17.2 percent in 2016, and the non-exported oil primary deficit (NEOPD[1]) to 38.6 percent of non-oil GDP from 44.6 percent in 2016, the latter mainly due to lower capital spending (Tables 1-3; Figure 1). The NEOPD is now 25 percent of non-oil GDP below its peak in 2014. The sale of previously purchased land (2.7 percent of GDP) lowered spending in 2017 while the settlement of arrears cost 1.2 percent of GDP. Adjusting for the land sale and the payment of arrears does not alter the general path of fiscal adjustment (text table). The 2017 deficit was financed by domestic and external borrowing and drawdown of government deposits.

[1] The NEOPD excludes oil revenues from foreign sales. It is consistent with the non-oil primary balance in last year's report where revenues from domestic energy sales were included in non-oil revenue. In staff's view, the NEOPD is the best measure of the economic impact of fiscal policy.

Status of Staff Recommendations Made During the 2017 Article IV Consultation

Recommendation	Status
Use fiscal space to undertake a more gradual fiscal consolidation than set out in the Fiscal Balance Program.	The 2018 budget set out a medium-term consolidation path that aims to balance the budget in 2023 instead of 2020.
Revenue reforms should introduce an effective and efficient tax system. Focus on successfully introducing the VAT.	VAT was introduced on January 1, 2018 with limited exemptions. The registration threshold was set at a high level to help administration and compliance and will be reduced to the GCC-agreed level next year.
Energy price reforms should be phased-in gradually to give households and businesses time to adjust. Low- and middle-income households should be compensated for the effects of higher prices.	Gasoline and electricity prices were raised on January 1, 2018 and a plan for further increases in energy and water prices over the medium-term was set out in the 2018 budget. Citizens' accounts, covering over one-half of the Saudi population, were activated in December 2017 to provide financial compensation. The government is paying additional allowances for one year.
A greater focus is needed on containing current outlays. The government wage bill is high and should be reduced gradually.	Reductions in government employee allowances enacted in October 2016 have been reversed and the annual step pay increase reinstated. Together with recently announced allowances for 2018, these will result in a continued high government wage bill in 2018.
Put in place an effective asset/liability management framework to ensure that borrowing and investment decisions are well coordinated.	The Debt Management Office (DMO) has led a successful domestic and external borrowing strategy and has coordinated closely with SAMA. The Public Investment Fund (PIF) is taking on a larger role in managing the government's domestic and external investments. It is not clear how borrowing and investment decisions are being coordinated.
Strengthen the fiscal framework and improve fiscal transparency.	The 2018 budget was prepared from a top-down and bottom-up approach. Quarterly budget reports have been published since 2017 and increased fiscal information was provided in the 2018 budget. Fiscal data for the budgetary central government has been published in GFS2014 format. Nevertheless, fiscal data and fiscal transparency remain weak.
In collaboration with the business community, structural reform efforts to support stronger non-oil growth should continue.	The bankruptcy law has been approved, and the public procurement and competition laws are moving forward. Steps to improve government processes including for new business licensing are ongoing. Some relaxation of FDI restrictions is underway.
Labor market reforms are needed to allow greater mobility of expatriate workers and to increase incentives for nationals to look for private sector employment.	Saudization of certain sectors of the economy is continuing and Nitaqat requirements have been tightened. The Royal Decree allowances for government employees do not help with encouraging nationals to look for private sector jobs. Reforms to the visa system are under consideration.
Encourage greater female employment.	Programs to help with transportation and childcare costs have been rolled out nationally. Women are now able to drive, and no longer require the approval of a male guardian to start a business. There are an increasing, but still low, number of women in high profile positions.
Strengthen the liquidity management framework.	SAMA is continuing to develop a liquidity forecasting model, has suspended the term repo facilities it introduced in 2016, and is considering how to move toward open market operations to strengthen liquidity management.
Support development of the domestic debt market.	Government domestic bonds and sukuk are trading on the Tadawul and some flexibility has been introduced in pricing of new domestic issuance. A primary dealer system is being introduced. A lack of clarity about the application of Zakat to financial instruments limits investor appetite.

Fiscal Developments 2015–23

	2015	2016	2017	Proj. 2018	Proj. 2023	2015	2016	2017	Proj. 2018	Proj. 2023	Adjustment 2015-17	Adjustment 2017-23
	(Percent of GDP)					(Percent of non-oil GDP)					(Percent of non-oil GDP)	
Revenue	25.0	21.5	24.1	30.6	29.9	34.7	28.9	34.2	46.8	41.1	-0.5	6.9
Oil	18.2	13.8	16.9	21.7	19.2	25.3	18.6	24.0	33.2	26.4	-1.3	2.4
Non-oil	6.8	7.7	7.2	8.9	10.7	9.4	10.3	10.2	13.6	14.7	0.8	4.5
Expenditure	40.8	38.7	33.4	35.2	33.4	56.6	52.1	47.3	53.8	46.0	-9.4	-1.3
Current	32.2	30.0	28.0	27.2	26.0	44.7	40.4	39.7	41.5	35.7	-5.0	-4.0
Capital	8.6	8.6	5.4	8.0	7.5	11.9	11.6	7.6	12.3	10.2	-4.3	2.7
Overall Balance	-15.8	-17.2	-9.3	-4.6	-3.6	-22.0	-23.2	-13.1	-7.0	-4.9	8.9	8.2
NEOPB 1/	-36.1	-33.2	-27.3	-25.6	-19.4	-50.0	-44.6	-38.6	-39.1	-26.7	11.4	11.9
NEOPB (excluding land sale) 2/	-36.1	-33.2	-30.0	-25.6	-19.4	-50.0	-44.6	-42.5	-39.1	-26.7	7.6	15.8
NEOPB_AAR (excluding land sale) 3/	-39.3	-31.2	-28.7	-25.6	-19.4	-54.6	-42.0	-40.7	-39.1	-26.7	13.9	14.0

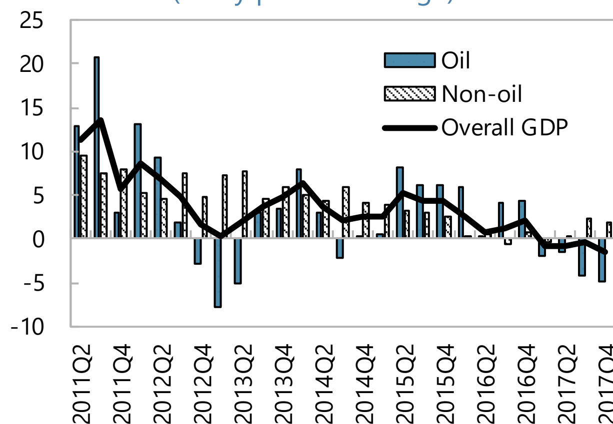
Sources: Country authorities; and IMF staff calculations.
1/ NEOPB refers to Non-exported oil primary balance
2/ Land sale amounting to SAR 70 billion (2.7 percent of GDP) took place in 2017
3/ NEOPB_AAR refers to NEOPB after arrear reallocation in the amounts of SAR 80 billion (3.3 percent of GDP) from 2016 to 2015, and SAR 32 billion (1.3 percent of GDP) from 2017 to 2016

5. Real GDP declined by 0.9 percent in 2017, although this was driven by the oil sector with non-oil growth strengthening modestly (Figure 2). Oil output fell by 3.1 percent, while non-oil GDP grew by 1.1 percent after near stagnation in 2016. Construction sector output declined for the second successive year. The non-oil output gap is estimated at -3.7 percent in 2017.

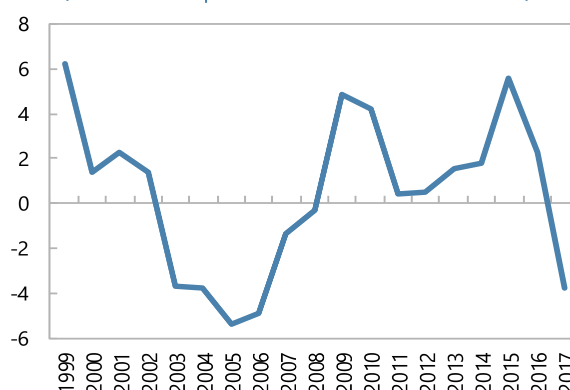
6. The employment of nationals, particularly women, increased in 2017. The employment of nationals increased by 3.3 percent (y/y) in 2017Q4, although with expatriate employment declining by 4.3 percent, total employment fell by 2.6 percent. Employment of Saudi women increased by 6.3 percent and their unemployment rate fell to 31 percent from 34.5 percent in 2016Q4. The unemployment rate of nationals, however, was 12.8 percent compared to 12.3 percent in 2016Q4.

7. Consumer prices declined (Figure 3). CPI inflation was -0.9 percent in 2017 compared to 2 percent in 2016 with most sub-indices experiencing falling prices. Disinflation

Real GDP Growth, 2011–17
(Y-o-y percent change)



Non-oil Output Gap, 1999–2017
(Percent of potential real non-oil GDP)



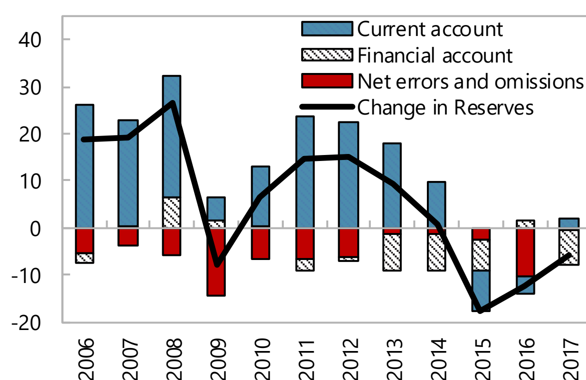
Sources: Country authorities; Haver; and IMF staff calculations.

intensified during the year (-1.1 percent (y/y) in December 2017) as retailers in the clothing and furniture sectors cut prices. With the introduction of the VAT (Box 1) and higher gasoline and electricity prices in January, inflation increased and was 2.3 percent in May 2018.

8. Equity prices and corporate profits have strengthened and the decline in real estate prices has eased. Equity prices were broadly unchanged during 2017, but Saudi equities have outperformed global indices in 2018 and foreign inflows into the market have picked up. Profits of listed non-financial companies increased by 12 percent (y/y) in 2017, driven by petrochemical and energy and utility companies (Appendix I). Companies in construction saw a large decline in profits. Real estate prices declined by 7 percent in 2017, although the decline moderated to 1.5 percent (y/y) in 2018Q1.

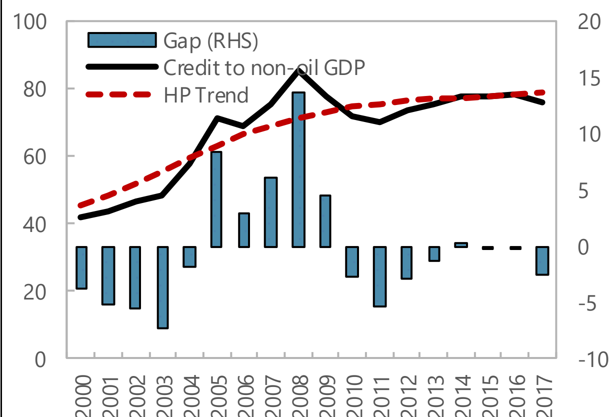
9. The current account returned to surplus (2.2 percent of GDP). Oil exports increased due to higher prices, while ongoing fiscal consolidation led to lower imports and remittance outflows (Table 4, Figure 4). In the financial account, there was a large outflow of other investment assets driven by one of the pension funds and the Public Investment Fund (PIF). Errors and omissions declined substantially in 2017 due to improved data coverage. SAMA's NFA fell by $40 billion in 2017, but increased by $10 billion through end-April 2018 to $499 billion (28.2 months of imports). The real effective exchange rate depreciated by 3 percent (y/y) in May 2018.

Current Account and Financial Account Balance, 2006–17
(In percent of GDP)



Sources: Country authorities; and IMF staff calculations.

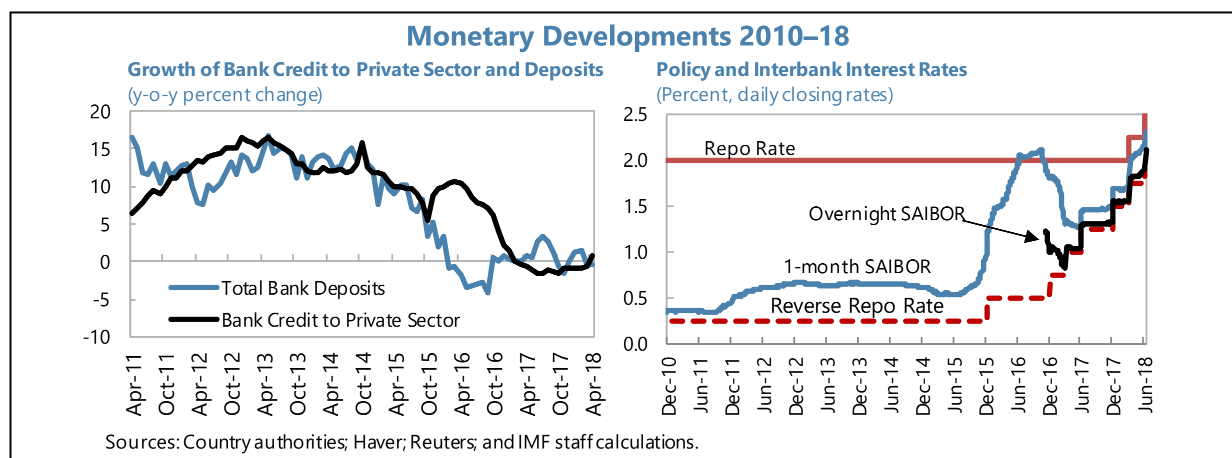
Bank Credit to Non-oil GDP, 2000–17
(Percent, actual minus trend)



Sources: Country authorities; Haver; and IMF staff calcualtions.

10. Money and credit growth remain weak (Table 5; Figure 5). Bank deposits fell by 0.5 percent, while credit to the private sector grew by 0.7 percent (y/y) in April 2018. Credit to the construction sector dropped by 7 percent (y/y) in 2018Q1, but mortgage lending to retail customers grew by 11.6 percent. The private sector credit gap is negative.

11. SAMA has raised policy interest rates. The reverse repo rate was increased three times in 2017 and the reverse repo-repo corridor narrowed to 50 basis points (bps). SAMA increased the reverse repo and repo rate by 25 bps in March and June 2018. The 3-month SAIBOR-U.S. LIBOR spread has narrowed over the past year from 50 bps to around 20 bps.



Sources: Country authorities; Haver; Reuters; and IMF staff calculations.

B. Outlook

12. The government announced in the 2018 budget which was published in December 2017 that it will aim to balance the budget in 2023 rather than in 2019 as previously set out in the Fiscal Balance Program (FBP). The slower envisaged pace of adjustment reflects a longer implementation period for the energy and water price reforms and higher spending.

Box 1. An Update on VAT Implementation[1]

Saudi Arabia successfully launched the VAT on January 1, 2018. The VAT is set at 5 percent with very limited exemptions.

The introduction of VAT presented a wide range of challenges to the tax authority which it successfully met. Although Saudi Arabia had no broad-based consumption tax previously, the General Authority of Zakat and Tax (GAZT) overcame challenges related to its limited experience in internal tax administration, intra-government coordination (especially with Customs), business communication and readiness, and consumer awareness. To do this, it consolidated responsibility for delivering the VAT into a single project team, reporting to the GAZT Governor, with oversight from MoF. GAZT also appointed external consultants to help develop the implementation plan, and to sub-contract the specialists necessary to provide training and ensure that the expertise to support delivery of the plan was available.

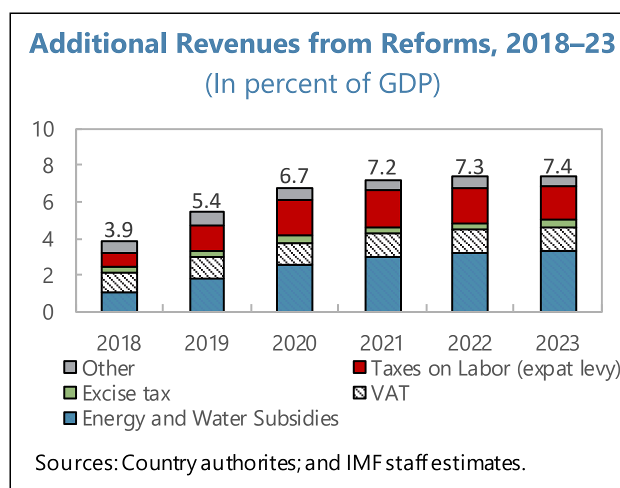
GAZT decided to phase the VAT implementation to overcome the challenge posed by a very large number of taxpayers. It set a mandatory registration threshold at a turnover of SAR 1 million for 2018, which will be reduced to SAR 375,000 as set in the GCC Agreement (in January 2019). This has reduced the initial taxpayer base from over 400,000 to around 110,000.

Important challenges remain. These include (i) successfully administering the VAT and ensuring high compliance with respect to on-time return filing, payment of taxes, and refunds; and (ii) registering the additional 300,000 smaller businesses which are likely less well equipped to comply with the accounting and other requirements of the tax.

Saudi Arabia's VAT Main Features	
VAT Rate	5 percent
Threshold	SAR 1 million (2018); SAR 375,000 (2019)
Exemptions & Zero rating	Lease of residential real estate; financial services on margin base; qualifying medicines and medical goods, as defined by the Ministry of Health; and exported goods and services

[1]Prepared by Nabil Ben Ltaifa and Charles Jenkins (FAD).

13. The fiscal deficit is projected to narrow to 4.6 percent of GDP in 2018. Higher exported oil, domestic energy, and non-oil revenues more than offset additional capital spending, compensatory payments to households through the citizens' accounts, and the cost of the January Royal Decree which introduced monthly allowances for public sector workers, retirees, students, and those on social benefits through end-2018 (1.8 percent of GDP). The NEOPD is projected to increase slightly in 2018, although remain on a downward path if the 2017 land sale is excluded.



14. Staff projects the fiscal deficit to narrow to 1.7 percent of GDP in 2019, but then to widen modestly thereafter. The projected decline in the 2019 deficit reflects the assumed expiration of the Royal Decree allowances, containment of spending, higher VAT collections, and further energy price reforms. Over the medium-term, however, the deficit is projected to widen to 3.6 percent of GDP in 2023 rather than move to balance as projected in the 2018 budget, although the NEOPD continues to decline throughout the projection period. An oil price of $73 a barrel in 2023 rather than $59 a barrel in staff's baseline would be needed to balance the budget in 2023, everything else being equal.[2] Expenditure projections are broadly in line with the authorities over the medium-term and assume that savings identified by the Bureau of Spending Rationalization (BSR) are realized and growth in government employment is contained. The planned further increases in energy prices and the expatriate levy as announced by the government are assumed to be implemented. The central government's net financial assets (CGNFA) position deteriorates from 7.7 percent of GDP in 2017 to -11.7 percent of GDP in 2023.

15. The government is planning sizable spending/on-lending outside the budget in 2018. It is transferring 1.7 percent of GDP from its deposits at SAMA to specialized credit institutions (SCIs) for on lending, and the PIF is planning to invest up to 2.8 percent of GDP domestically from its own resources.

16. Non-oil growth is expected to strengthen to 2.3 percent this year supported by higher on and off-budget fiscal spending and higher oil prices, although rising interest rates could act as a drag (Box 2).[3] Monthly indicators were weak at the beginning of the year, but are now strengthening. Real oil GDP growth is projected at 1.4 percent due to stronger petroleum refining and gas production and a modest increase in crude oil production in the second half of the year

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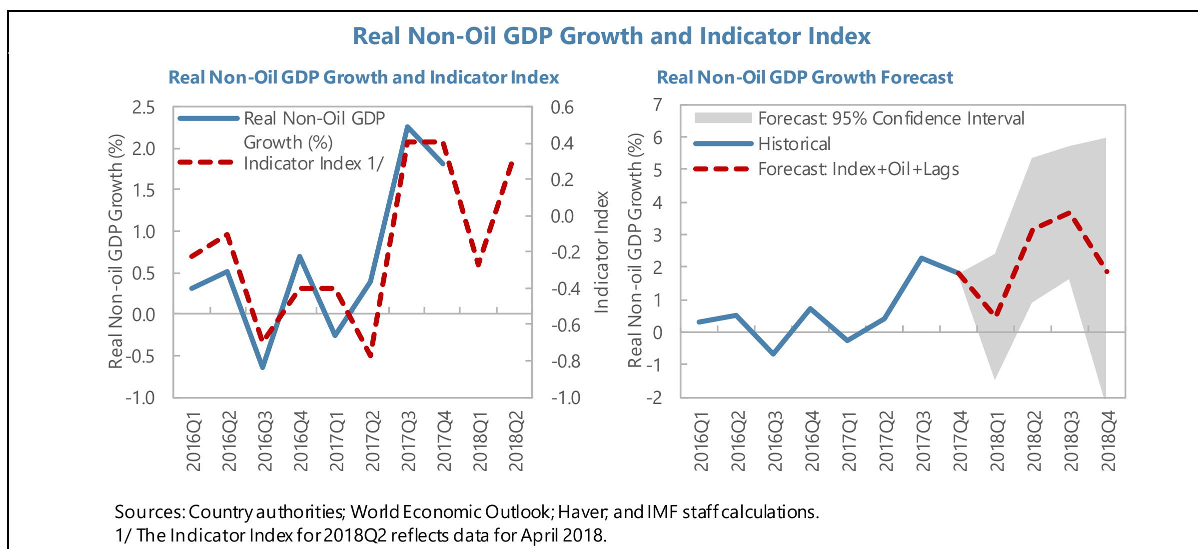
[2] Oil prices are higher than at the time of the 2017 Article IV, However, staff now assumes that the lower ratio of exported oil revenues to fiscal revenues in the budget seen in recent years, due to higher capital spending by Aramco and preparations for the IPO, continues over the forecast period. Specifically, this ratio is assumed to be 68 percent in the baseline forecast compared to 79 percent assumed last year. So, while oil prices are higher, fiscal revenues from exported oil are slightly lower at the end of the projection period than in the 2017 report.

[3] Empirically it is difficult to establish a relationship between interest rates and non-oil GDP growth in Saudi Arabia.

under the OPEC+ agreement. Overall growth is forecast at 1.9 percent, a little above consensus, but lower than projected by the authorities. In 2019, non-oil growth is forecast to slow to 2.1 percent with the ending of the fiscal stimulus, but then to pick-up over the medium-term as structural reforms begin to bear fruit. Oil GDP growth is projected at 1.7 percent in 2019, and around 1 percent over the medium-term.

Box 2. Forecasting Real Non-oil GDP in Saudi Arabia[1]

Several monthly indicators (cement sales, import letters of credit, ATM withdrawals, and the new orders component of PMI) seem to help forecast non-oil growth. These indicators are informative after controlling for past Saudi non-oil growth, past world demand, and realized real oil prices. Other indicators, such as private credit growth, do not seem informative.[2]



Sources: Country authorities; World Economic Outlook; Haver, and IMF staff calculations.
1/ The Indicator Index for 2018Q2 reflects data for April 2018.

Monthly indicators softened in 2018Q1, but recovered in April. An Indicator Index was constructed as an average of the informative indicators (standardized to each have unit variance). The left panel shows historical non-oil growth and this Indicator Index. The index roughly tracks non-oil growth over the last two years. The index softened noticeably in the first quarter of 2018, but picked-up in April.

The indicator index through 2018Q1 and the WEO oil price projections imply a 2018 forecast in line with staff's baseline. The right panel shows historical non-oil growth and a forecast based on the Indicator Index, the WEO oil price baseline, and lagged growth and world demand. Confidence bounds are shown for this forecast. The implied forecast is 2.3 percent in 2018.

[1]Prepared by Divya Kirti.

[2]Local projection specifications were used, with quarterly data starting in 2010. Quarterly averages of monthly indicators were used. The aggregate PMI, point of sale transactions, non-oil exports, and bills paid through SADAD also do not seem informative.

17. Money and credit growth are projected to strengthen modestly and inflation to increase in 2018. Higher government spending is expected to positively impact deposits and private sector credit. Bank profitability should increase as interest margins widen, while NPLs are likely to increase slightly but remain low (Appendix II). CPI Inflation is forecast to rise to 3 percent due to the VAT/higher energy prices and stronger growth, before stabilizing at around 2 percent over the medium-term.

18. The current account surplus is expected to increase to 9.3 percent of GDP in 2018. Higher oil revenues will more than offset a recovery in imports. In the financial account, pension fund and PIF investments overseas are expected to continue, government external borrowing is projected at $17 billion, and inflows into the equity market are picking-up ahead of the inclusion in the FTSE/Russell (starting in March 2019) and MSCI (starting in June 2019) indices. As oil prices soften and import growth continues, the current account surplus narrows over the medium-term. Financial outflows are assumed to continue at a slower pace, while equity inflows continue in 2019 and 2020 as global investors adjust portfolios.[4] SAMA's NFA is expected to increase through 2022.

C. Risks and Spillovers

19. Uncertainties surround the outlook (Risk Assessment Matrix), but risks are balanced in the near-term. Oil prices are a key driver of the external and fiscal outlook (Figures 6 and 7) and will affect growth through government spending, financial sector liquidity and asset quality, credit availability, and confidence. An escalation of regional geopolitical tensions could boost oil prices, but also hurt confidence. The payoff from the reforms is difficult to judge. The successful implementation of the reforms could yield larger non-oil growth dividends than in staff's baseline.[5] Conversely, weak non-oil growth and limited private sector employment opportunities may make further fiscal reforms difficult and result in a larger fiscal deficit. In turn, higher government financing needs could reduce credit availability, undermining private sector growth. Delays in privatization and the growing role of the PIF may lead to a larger role of the government in the economy, crowding out the private sector.

20. Regional spillovers from Saudi Arabia are through trade, remittances, and financial flows. Higher imports by Saudi Arabia will modestly support regional economies. Within the GCC, growth spillovers from Saudi to Bahrain are apparent, while developments in Saudi equity markets appear to have implications for other GCC markets.

POLICY DISCUSSIONS

Discussions focused on: (i) fiscal policy to deliver budget balance by 2023 and avoid pro-cyclical fiscal policies in response to higher oil prices; (ii) reforms to boost private sector growth and employment of Saudi nationals; (iii) promoting financial sector development and inclusion and maintaining financial stability; and (iv) external stability.

21. Staff welcomed the government's continued commitment to wide-ranging economic and social reforms. Fiscal reforms are continuing and efforts are ongoing to improve the business environment, develop a more vibrant SME sector, deepen the capital markets, increase the involvement of women in the economy, and develop new industries with high potential for growth and job creation. Growth is picking up, and the employment of Saudis in the private sector is

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[4] The planned sale of a stake in Aramco is not included in the baseline projections.

[5] The baseline assumes that structural reforms boost non-oil growth by around ¼ pp per annum by 2022–23, although the range of uncertainty around this estimate is large (see structural reforms section).

increasing. The government believes the public sector needs to play a catalytic role in developing new economic sectors, where large upfront investments are needed or the private sector may be reluctant to tread on its own for political, cultural, or social reasons. They clarified, however, that they had no intention of the public sector becoming more involved in the economy on a long-term basis. Staff suggested that the respective roles of the public and private sectors in developing the non-oil economy need to be carefully considered and communicated to ensure the private sector is not crowded out, and raised concerns that with fiscal spending increasing this year, the role of the PIF expanding, and limited progress to date with privatizations/PPPs, the role of the government in the economy is growing. Staff also asked if the number of new VRP initiatives would not overly stretch financial resources and implementation capacity. The authorities explained that the governance frameworks they have put in place will enable them to push ahead with the VRP initiatives, there is sufficient flexibility in the plans for them to adjust as needed, and the VRP spending is fully incorporated in the budget expenditure envelope. The authorities and staff agreed that effective communication of the reforms will be key to their success and that continued improvements in data availability and quality are needed to help monitor and report on progress toward the Vision 2030 objectives. The authorities reiterated their aim of subscribing to SDDS.

A. Delivering Sustainable Fiscal Adjustment and A Strong Fiscal Framework

Continuing Fiscal Adjustment

22. Staff supported the slower pace of fiscal consolidation announced in the 2018 budget. With strong fiscal buffers, readily available financing, and weak non-oil growth, staff assesses that some fiscal space is available and fiscal consolidation can proceed gradually (Box 3; Appendix III). While the 2017 Article IV staff report recommended aiming for budget balance in 2022, achieving this in 2023 instead will have limited impact on the GNFA position. A slower pace of fiscal adjustment will reduce the negative short-term impact on growth and enable the beneficial effects of ongoing structural reforms to support growth as fiscal consolidation continues over the medium-term. The successful implementation of structural reforms will boost non-oil growth and government revenues, in turn supporting the fiscal adjustment.

23. Staff emphasized the importance of focusing policies on delivering the targeted fiscal adjustment over the medium-term. The authorities noted that they are continuing to make progress with their fiscal adjustment and expected to hit their budget targets for 2018—the fiscal outturn in the first quarter of 2018 was broadly in line with the budget—and the 2019 budget will continue the consolidation in line with the plans laid out in the FBP to achieve budget balance in 2023. Further, they viewed the staff's oil price projections as too pessimistic in the medium-term. Staff viewed the following reforms as being particularly important for continued fiscal adjustment in the 2019 budget and beyond, and stressed that spending should not be moved off-budget to achieve the fiscal objectives:

- ***Non-oil revenues***: The introduction of the VAT is a milestone achievement in strengthening the tax culture and tax administration in the country. The next challenge is to ensure the tax authority and taxpayers are ready for the reduction of the registration threshold on January 1, 2019.

Box 3. An Update on Fiscal Space Analysis[1]

This box updates the fiscal space analysis conducted for the 2017 Article IV. While different indicators point to differing conclusions, on balance staff assesses that some fiscal space is available.

The assessment of financing availability and debt dynamics is very similar to last year. The starting public financial asset position (government deposits at SAMA) is about 5 percentage points of GDP lower, the sovereign bond spread is 3bp higher, and the share of public debt in foreign currency to total debt is slightly higher. However, the debt indicators appear marginally better: the debt-to-GDP ratios under the baseline and stress scenarios remain comfortably below benchmark thresholds (and this does not take account of the government's financial asset holdings). Similarly, the gross financing needs (GFN) indicator shows that GFN remains below the 15 percent of GDP threshold under both the baseline and the stress scenarios. However, the debt (and net financial asset) trajectories do not stabilize in the baseline scenario. The analysis again finds that the adjustment projected in the staff's baseline is very large in the context of past international adjustment experiences.

Saudi Arabia: Financing Sources and Availability

Sovereign bond spreads	
During last 12 months	126.4
Debt profile indicators breach benchmarks:	
Share of public debt in foreign currency	41.5
Share of public debt held by non-residents	41.5
Change in share of short-term debt	0.0
External financing requirements (percent of GDP)	3.6
Public Financial Assets (percent of GDP)	24.9

Sources: IMF staff estimates.

Saudi Arabia: Debt Dynamic

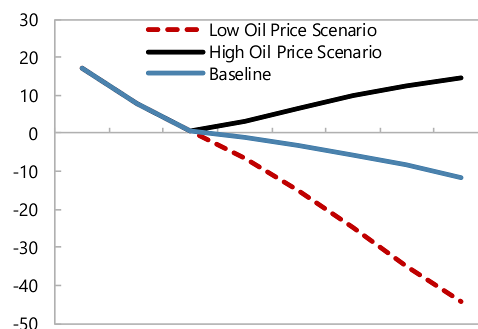
	Baseline Value	Stress tests Value
State of debt burden indicators		
Debt level relative to benchmark during projection period (benchmark: 70 percent of GDP)	-45.7	-23.6
Probability of breaching the benchmark at end of projection period	..	
Gross financing needs (GFN) relative to benchmark during projection period (benchmark: 15 % of GDP)	-8.7	-2.9
Does debt trajectory at least stabilize in last 2 years?	No	No
Fiscal adjustment		
Is the fiscal adjustment assumed under the baseline realistic?		
Adjustment in CAPB (percentile)	1%	
Average level of CAPB (percentile)	91%	

Sources: IMF staff estimates.

As last year, the standard fiscal space analysis is extended to account for some of the unique characteristics of oil exporting countries. These include the vulnerability to oil price volatility and the non-renewable nature of oil resources.

- *Vulnerability to oil price shocks*. Assuming oil prices are 25 to 41 percent lower than in the baseline during 2019-23 (the same size of shock as last year), this would lead to a deterioration of the fiscal deficit on average by about 7 percent of GDP during 2019–23. The CGNFA would deteriorate to -35 and -44 percent of GDP in 2022 and 2023, respectively (compared to -50 percent of GDP in 2022 in the oil shock scenario last year). While oil prices are higher this year, the impact of the oil price shock on exported oil revenue to the budget is lower because of changed assumptions in the baseline (see footnote 2 in main text).

Central Government Net Financial Assets 1/
(In percent of GDP)



Source: IMF staff calculations.
1/ The low oil price scenario assumes the oil price is 25 to 41 percent below the WEO oil price from 2019 to 2023. The high oil price scenario assumes the oil price is 25 to 41 percent above the WEO oil price for that same time period. Both scenarios assume no change in government spending or in external borrowing relative to baseline.

- *Intergenerational equity considerations*. Even with the fiscal adjustment projected in the baseline, there remains a considerable gap with the fiscal balance that is consistent with an equitable distribution of the oil wealth across generations as calculated from the PIH. This gap is larger than last year, reflecting in part the assumed lower transfer ratio of oil revenues to the budget. This suggests that to the extent that there are concerns about intergenerational equity, use of fiscal space is more constrained than implied by other measures.

[1]Prepared by Nabil Ben Ltaifa.

- ***Energy price reforms***: Staff welcomed the authorities' intention to continue to gradually increase energy prices to benchmark levels by 2025 (Appendix IV). They recommended, however, that the authorities provide more specifics about the future price increases to enable households and businesses to plan their adjustment, introduce automatic pricing mechanisms once prices reach benchmark levels, and increase transparency about the reference prices. The cross-subsidies in the energy sector also need to be clearly identified and made transparent. The authorities indicated that they are considering periodic adjustments to prices that are at benchmark levels, but at present have no plans to provide additional details of future price increases beyond what is set out in the 2018 Budget because the timing of the increases will depend on economic conditions among other things. A process is also underway to identify and make explicit the cross-subsidies in the energy sector.

- ***Wage bill***. Staff underscored the importance of containing the wage bill given that it accounts for about one-half of government spending and suggested that the workforce could be gradually reduced through natural attrition (Figure 8). The authorities explained that a civil service review is being conducted with the World Bank to help identify reforms to improve the cost effectiveness of the civil service and deliver on the budget projections, and noted that civil service employment has declined in recent years.

- ***Capital spending***. The government is planning to increase capital spending in support of Vision 2030. Staff welcomed the mechanisms being put in place to review existing and new capital projects before they are funded, but noted that it is too early to say whether the public investment management process has been strengthened sufficiently to ensure that projects deliver efficiently on the intended outcomes. They therefore suggested a cautious approach to ramping up capital spending.

24. The authorities emphasized that effective compensation for low and middle-income households and temporary help for businesses is essential to support the non-oil revenue and energy price reforms. Staff welcomed the Citizens' Account Program, which is working well. Their analysis suggests that the average compensation being paid through the accounts is adequate to cover the costs of the reforms to households (Appendix III), but they did not have detailed data to confirm that the compensation is adequate for those at the lower end of the income distribution. This needs to be verified by the authorities. Ensuring the citizens' accounts provide adequate compensation will give the government confidence that low and middle-income households will not suffer any hardship when the Royal Decree allowances expire as planned at end-2018. These allowances adversely affect incentives for private sector employment and undermine the government's objective of using the citizens' accounts as the main mechanism for providing social benefits and support. The rationale, objectives, and compensation levels (including details on how these are calculated) of the citizens' accounts should be clearly communicated to the public. The authorities explained that businesses are being provided temporary support to help them adjust to higher energy prices through various programs under the Private Sector Stimulus Plan.

25. The government's ability to achieve its fiscal objectives will importantly depend on the future path of oil prices. Given the uncertain oil price outlook, staff recommended that the government plan for different scenarios. If oil prices turn out higher than in the budget, this would

provide an opportunity to increase savings (i.e. the target for the non-oil balance should not be changed) and rebuild the policy buffers that have been depleted since 2014. However, should oil prices turn out to be lower than in the budget as in the staff's baseline, the government should be ready to implement previously identified contingency measures to still achieve its balanced budget target by 2023 and stabilize the GNFA ratio. These contingency measures could potentially include: (i) raising the VAT rate to 10 percent (1.3 percent of GDP); (ii) freezing the wage bill (1 percent of GDP); and (iii) further prioritizing investment projects (1.3 percent of GDP). While agreeing on the importance of scenario planning and the identification of fiscal risks, the authorities viewed the oil price path in the staff's baseline as being overly pessimistic and were confident that their current policies would deliver budget balance in 2023.

26. The budget needs to remain robust to sharp and unexpected drops in oil prices. The increase in spending in 2018 has increased the vulnerability of the budget to an unexpected drop in oil prices, and these vulnerabilities will rise further if spending increases in response to the recent increase in oil prices. Staff emphasized the importance of ensuring that spending remains at a sustainable level in different oil price environments and of avoiding a procyclical fiscal policy that would create undue volatility in economic activity. The authorities were less concerned, seeing higher oil prices as potentially providing room to accelerate some high priority spending, while emphasizing that the medium-term expenditure envelope would be unaffected.

Strengthening the fiscal framework

27. Important progress has been made in strengthening the budget process, developing the medium-term fiscal framework, increasing transparency, and improving macro-fiscal analysis. The authorities noted that the preparations for the 2019 budget and the updating of the medium-term fiscal framework started earlier this year to enable a better evaluation of policy options and more effective negotiations with line Ministries under established spending ceilings. The more detailed information provided in the 2018 budget, including on the medium-term fiscal framework, the release of quarterly fiscal reports, and the publication of central government budget data in GFS 2014 format are all positive steps to improve fiscal reporting, and the authorities noted that their plans for a mid-year budget report and a pre-budget statement this year will further enhance transparency. The Macro-Fiscal Policies Unit is now producing monthly analysis for the Fiscal Committee to allow better tracking and analysis of fiscal developments. The authorities reiterated their intention to meet the Open Budget Index standards for fiscal transparency.

28. Staff welcomed the ongoing reforms to the fiscal framework. They suggested that while there could be merit in eventually considering a fiscal rule, the emphasis for now should remain on continuing to strengthen the fiscal framework. The experience in resource rich countries suggests that the chances of success of a fiscal rule are higher when strong fiscal frameworks are in place.[6] Future reforms should include:

[6] See Selected Issues paper on "Fiscal Frameworks and Fiscal Anchors: The Experiences in Commodity Exporting Countries and Implications for Saudi Arabia."

- ***Better expenditure management***. Despite reforms to strengthen budget execution, spending surged in 2017Q4, overran the budget by 5 percent in 2017, and payment arrears continued. The authorities acknowledged that better expenditure management is needed, and outlined the new electronic Etimad portal they have launched to improve controls and transparency in the spending process and avoid a recurrence of government arrears (Box 4). They also noted that the budget targeted a smoother quarterly spending path in 2018 than in previous years, and that a committee has been established to assess remaining claims made by contractors, and indicated these were small compared to last year and largely related to disputed payments.
- ***More detailed and integrated expenditure framework***. For 2019, a more detailed and integrated medium-term expenditure framework should be developed, specifically identifying projects and budget amounts. This will also give greater clarity to the private sector on government project spending.
- ***Fiscal reporting, transparency, and coverage of fiscal data***. Fiscal coverage should be expanded beyond the budgetary central government to give a fuller and more transparent picture of the impact of fiscal policy on the economy. This should encompass the spending undertaken by Aramco and the PIF on behalf of the government and the financial links between them and the government.

Box 4. A New Approach to Public Expenditure and Wage Bill Management in Saudi Arabia[1]

The Ministry of Finance (MoF) has introduced a new digital platform, Etimad, to strengthen budget implementation. Previously, MoF faced difficulties tracking government spending as transactions were handled manually, line ministries and government entities (referred to below jointly as ministries) had financial transactions systems that were not integrated with MoF, while MoF did not have a comprehensive record of projects being implemented by ministries. These weaknesses contributed in part to the buildup in payment arrears in 2015–17.

The Etimad platform has four main objectives: increasing transparency and improving monitoring; unifying financial service procedures; ensuring regularity of payment; and enabling access to public tenders for SMEs. It comprises four main components, which have been made accessible to ministries and service providers (private sector), each according to their credentials/needs: (i) B*udget Management*, for ministries to review/manage their budgets; (ii) *Tenders and Procurement*, for ministries to manage their tenders and service providers to participate in them; (iii) *Contract Management*, for ministries to manage their contracts (in coordination with MoF) including to ensure consistency with the approved budget; and (iv) *Payment Management*, for the private sector to submit their financial claims for approval and payment.

The MoF has also set up a central payroll system. Through the *Financial Rights Management for Employees*, the MoF will get detailed information—which it lacks at present—on workers' salaries and benefits from each ministry. This new platform, once fully operational, will enable MoF to pay government employees directly based on the information provided by ministries—including on basic wages, allowances, and overtime payments. The system will also give MoF more accurate information on the number of government employees.

Etimad has been piloted by part of the government (about 25 of more than 400 government entities, or about 2000 contracts). MoF is expected to make Etimad mandatory for all government projects from 2019. Similarly, only a few ministries are currently using new payroll system, but this will increase.

[1]Prepared by Nabil Ben Ltaifa.

29. Staff emphasized the importance of developing an integrated asset-liability management framework. Considerable progress has been made in developing the investment strategy of the PIF (Box 5) and in developing a strong and increasingly transparent approach to government debt management. Nevertheless, staff noted that it remains unclear how the large investment commitments announced by the PIF will be financed, and how the PIF, Debt Management Office (DMO), and SAMA's reserve management strategies are linked within an overall asset-liability management framework. The authorities indicated that they are working to develop a Sovereign Asset-Liability Management Framework. The government is continuing with its plans for the sale of a stake in Aramco—they have recently indicated that this will likely take place in 2019, with at least part of the listing on the Tadawul. A decision on how to allocate this capital should be made within the asset/liability management framework being developed.

Box 5. The Public Investment Fund Program (PIF)[1]

The Public Investment Fund (PIF) was established in 1971. In 2015, oversight of the PIF was moved from the Ministry of Finance to the Council of Economic and Development Affairs (CEDA). Under Vision 2030, the PIF is charged with contributing toward domestic economic development and diversification by developing strategic sectors of the economy and investing in global sectors and markets and establishing strategic partnerships. It is to maximize sustainable returns within this remit.

The PIF has substantial asset holdings. At the end of the 2017Q3, the PIF reported assets of SAR 840 billion (excluding land assets) or 33 percent of GDP. It expects its assets to increase to SAR 1.5 trillion by 2020 (52 percent of staff projected GDP).

Since being given its new mandate, the PIF has committed to significant investments overseas (Table).[2] Based on available information, staff estimates that the external investment commitments made since 2016 total SAR 360 billion (14 percent of GDP).

Domestic investments are substantial. The PIF has large equity holdings in key sectors of the economy including in petrochemicals, financial services, mining, telecommunications, and utilities. It has also established companies to help develop sectors that the government sees as providing high growth opportunities. It was the main investor in the Saudi Arabian Mining Company when it was formed in 1997, for example. More recent companies include the Saudi Military Industries Company (SAMI), the Entertainment Investment Company, and Noon.com (an e-commerce platform). It will also be involved in the development of NEOM and the Red Sea Project. In 2017, the PIF purchased land from the government (SAR 70 billion) to support its project to increase hotel and housing capacity in Mecca, and in 2018 it is expected to invest SAR 83 billion in the domestic economy.

It is not clear how the PIF's investments will be financed or to what extent recent commitments have been funded. PIF financing can come from capital injections and asset transfers from the government, borrowing, and retained earnings. New investments could also be financed by the sale of existing assets. The government transferred SAR 100 billion to the PIF in late 2016. Retained earnings are not disclosed, but if the PIF earned 5 percent on its assets this would have yielded around SAR 40 billion in 2017, of which SAR 20 billion was transferred to the budget.

While incomplete, these calculations suggest that if the PIF is to fulfill its ambitious plans in the coming years, it will need additional financing. The government is expected to transfer the proceeds from the Aramco sale and most of the domestic privatization program to the PIF, but the timing and size of these transfers is uncertain. There may therefore be a need to provide financing for some of the investments from the government's reserve accounts at SAMA or by borrowing. While these are certainly options, such decisions should be made within a comprehensive asset/liability management framework that assesses the benefits, costs, and risks of such a strategy.

PIF Investments

	Value (SAR)	Date
Identified investment commitmen	**512**	
External:	359	
Softbank Vision Fund	169	Oct-16
Blackstone Infrastructure Fund	75	Oct-17
Egypt Investment Fund	60	Mar-18
Russian Direct Investment Fund	37	Oct-17
Uber	13	Jun-16
Virgin Galatic	4	Oct-17
Magic Leap	1	Feb-18
Domestic:	153	
Land at Mecca	70	2017
Investments in 2018	83	2018

Sources: PIF; staff estimates

[1] Prepared by Tim Callen.

[2] Most of the commitments in the table are "up to" the stated amount so the numbers could overestimate the eventual investment.

B. Macro-Structural Reforms to Boost Growth and Employment

30. Staff welcomed the progress made in implementing structural reforms, and stressed the importance of these continuing in consultation with the private sector. While there is considerable uncertainty about the growth and employment impact of the reforms given the unique characteristics of the Saudi economy, estimates in last year's Article IV suggested that a combination of structural reforms could boost non-oil growth by up to 2 percentage points over the period of the reforms relative to a no reform scenario, although some of the reforms would take many years to bear fruit. Fiscal and structural reforms are often complementary and there are benefits in moving ahead in tandem in priority reform areas. For example, reducing the costs of doing business through regulatory and administrative reforms will help offset higher energy and labor costs resulting from fiscal and labor market reform initiatives.

Structural Reforms: July 2017–Present

Category	Reform measure	Implementation Date
Capital markets	The minimum asset size for foreign investors to trade in market was reduced	January 2018
	Creation by the Public Investment Fund of a mortgage refinance company	August 2017
	Government bonds traded on the Tadawul	April 2018
FDI/Tourism	Authorization of qualified foreign companies to have full ownership of engineering firms	August 2017
	Foreign investment licenses available for 5 years (1 year previously)	February 2018
	Regulations approved for issuance of tourist visas	April 2018
Legal framework	Approval of the new bankruptcy law by Council of Ministers	December 2017
	Public Procurement Law	Final stages of legislative process
Starting/Doing Business	Updated Competition Law	Final stages of legislative process
	Updated Companies Law	Final stages of legislative process
	Franchise law	Final stages of legislative process
	Law requiring Saudi Electricity Company to compensate customers for violations of guaranteed standards	January 2018
Female empowerment	Women permitted to drive	June 2018
	Consent of male guardian no longer needed to start a business	February 2018
	Access to certain jobs in the military	February 2018
Labor market	Prohibition of issuing new work visas for 19 professions restricted to Saudis. Issuance of a Ministerial decree to limit work in 12 sales activities to Saudis effective September 2018. Amendments to Nitaqat introduced, increasing the mandatory employment ratio of nationals to expatriate employees.	August 2017-September 2018
SMEs	Fund of Funds created by PIF to invest in venture capital and private equity funds. Restructuring of the partial credit guarantee scheme for SMEs (Kafalah program). Investment Fund created to invest in SMEs.	October-December 2017

Employment Creation for Saudi Nationals

31. The authorities emphasized that employment creation for nationals, particularly for youth and women, in the private sector is a key priority given high unemployment and the growing working age population (Figure 9). To this end, policies are focused on increasing the competitiveness of Saudi workers in the private sector by reducing the cost/wage differential

between nationals and expatriates through the expatriate levy and temporary employment subsidies, limiting the employment of expatriates through the Nitaqat quotas and banning their employment in certain retail sectors, and encouraging female employment (Box 6). While welcoming the authorities' focus on job creation, staff suggested that the reforms should be gradual as they will involve a difficult adjustment for some companies and may depress growth in the short-term even if the employment of nationals increases.[7]

32. In staff's view, labor reforms should focus on making private sector jobs more attractive for Saudis and Saudi workers more attractive to private firms. This will require leveling the playing field on wages, benefits, and working conditions between Saudis and expatriates in sectors where Saudis want to work, reducing incentives to queue for government jobs, and improving skills development for Saudi workers. A comprehensive approach will be needed, focusing on the following policies:

- ***Setting clear expectations about the limited prospects for government employment***. Continued communications are needed to emphasize that the prospects for government employment are limited. This would help lower the reservation wage for private sector jobs, and encourage nationals to undertake education and training that focuses on the skills needed in the private sector.
- ***Increasing the mobility of expatriate workers through reforms of the visa system***. The authorities indicated that they will soon announce reforms to allow greater mobility of expatriates at the end of their contracts. This should over time help raise expatriate wages and boost productivity. Additional reforms could seek to gradually reduce the number of visas available and target them more to higher skilled workers. Auctioning such visas could attract expatriate workers to higher productivity jobs and provide revenues to the government.
- ***Continuing to address constraints to female employment***. Reforms should focus on removing remaining restrictions (explicit and implicit) that hinder female employment, consider providing financial support to help companies reconfigure workspace to meet social norms (which would have a fiscal cost), and create programs for female entrepreneurs under existing SME initiatives.
- ***Strengthening training and education to equip Saudis with the skills needed in the private sector***. Spending on education is high, but outcomes on internationally comparable test scores are low, while some private sector firms state that a lack of skilled national labor is a constraint. Staff welcomed ongoing efforts to improve training for teachers, update and modify curriculums, bring the private sector into running some schools through pilot programs, and strengthen vocational training which should improve outcomes without additional spending.
- ***Reviewing the wage subsidy program***. Under Nitaqat and the sector-specific expatriate bans, the wage subsidies are effectively helping mitigate the costs to private businesses of the Saudization program. Consideration could be given to offering subsidies only for new workers employed above the Nitaqat targets.

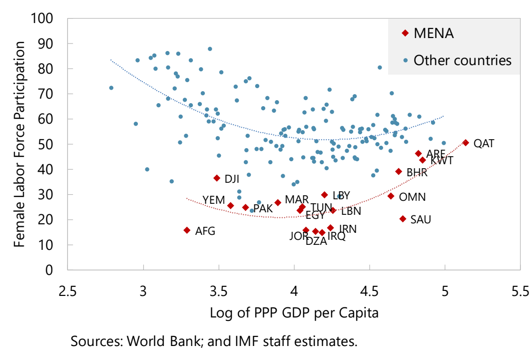
[7] See the Selected Issues paper on "The Economic Impact of Policies to Boost the Employment of Saudi Nationals."

Box 6. Female Labor Force Participation and Employment in Saudi Arabia[1]

Labor force participation and employment among Saudi women have increased, but remain very low, while the female unemployment rate is high. Female labor force participation (FLFP) increased significantly between 2000 and 2017 (10.1 percent to 19.4 percent), but it is still well below the GCC average and other countries at a similar income level. The female unemployment rate is 31 percent and educated women have a much higher unemployment rate than their male counterparts.

The results of a cross-country analysis suggest that education, fertility rates, income levels, and urbanization matter for FLFP. The results show the well documented U-shaped relationship between FLFP and economic development (Goldin (1994), Gaddis and Klasen (2014)). For the Middle East and North Africa (MENA) region, however, this curve appears different than for other regions (top figure). The share of female tertiary enrollment has a positive impact on FLFP, while male tertiary educational attainment is negative. A potential explanation is that educated women are likely to marry educated men who may be able to support their families on their single income. Fertility rates have a small negative impact on FLFP. Urbanization, which can affect commuting for women, also negatively affects FLFP.

Female Labor Force Participation and GDP per Capita, 2016



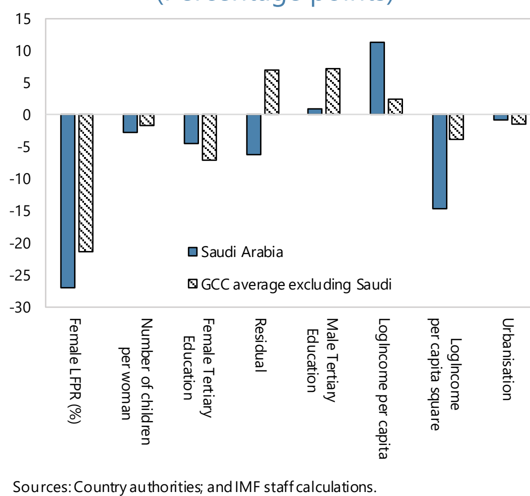
This analysis sheds light on two issues:

First, why has FLFP increased? Declining fertility rates and higher female education have helped increase FLFP. Improved transportation and better telecommunications infrastructure may also have played a role.[2]

Second, why is FLFP lower than in other countries with similar income levels? A large driver is the lack of support for the U-shape hypothesis for Saudi Arabia (second figure; see also Verme, 2015). As income levels have increased, FLFP has not. This reflects the inability of the model to capture cultural and social factors that mean Saudi females have traditionally not engaged in the labor market.

Explained Difference Between GCC and OECD FLFP, 1990–2014

(Percentage points)



The authorities have introduced policies to boost FLFP and employment. These include transportation subsidies (e.g. subsidizing rides for female employees via apps), covering childcare costs, expanding childcare facilities (including by encouraging regulated home daycares), and encouraging telework. Women are now able to drive which should further ease transportation constraints, while they now have greater access to government services and can start their own business without the consent of a male guardian. These policies along with continued investment in female education and support for businesses to hire women through recruiting and HR support and help in defraying the cost of workplace reconfiguration to meet regulatory requirements and social norms will help increase FLFP and employment. It is also important to ensure that legal rights grant women the same economic opportunities as men.

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[1]Prepared by Anta Ndoye.

[2]A second cross-country regression, which does not include Saudi Arabia, due to lack of data, shows that investments in transportation and telecommunications have positive and significant coefficients on FLFP as does internet access.

Business Environment

33. Staff welcomed the reforms to improve the business environment. Legal reforms have advanced considerably over the past year. The new insolvency law is expected to go into effect in August, and the competition law and franchise law are nearing completion. The authorities explained that all government licensing and regulatory requirements are being reviewed, streamlined, and automated, including enabling online, rather than in person, applications.

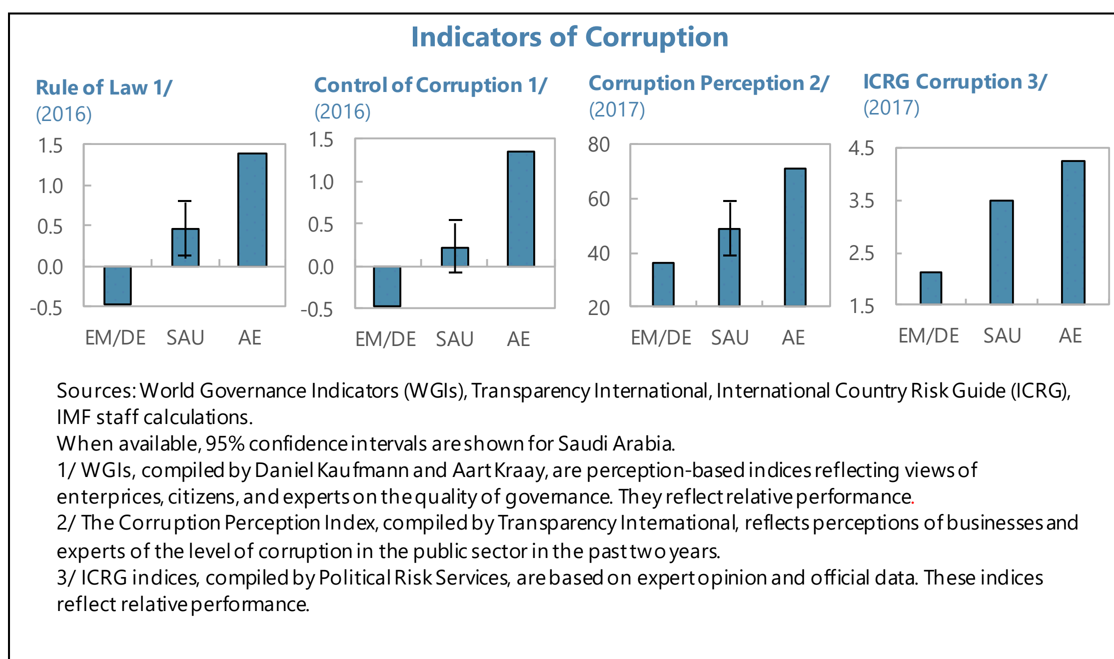
34. Policies to tackle corruption and improve governance could yield growth dividends (Box 7). The authorities emphasized that tackling corruption and improving governance are key components of their reform agenda, and the high-level anti-corruption committee established last year would oversee this work. In staff's view, the new public procurement law which is nearing completion will have a key role to play —by covering all government procurement in a transparent way, including the local content and SME requirements, corruption opportunities would be reduced. Likewise, the ongoing push to simplify the regulatory and licensing framework will reduce corruption opportunities, while the recent decision to introduce a "whistleblower" protection framework could encourage more frequent reporting of corrupt behavior. Consideration should be given to introducing an asset declaration regime for high-ranking officials.

35. The government expects to accelerate privatization/PPP transactions. The authorities explained that developing the legal and regulatory framework and the sector governance structures took longer than expected, but their review of international experience showed them that these were essential to the success of the privatization/PPP program. A privatization and PPP law is in the approval process and the National Privatization Committee and 12 sector specific committees have been established. Staff noted that the privatization and PPP program could help increase government efficiency and create room for the private sector, and stressed that the PPP framework should adequately protect the government against future fiscal risks.

36. Boosting FDI will be key to technological and skills transfers. Saudi Arabia had the most restrictive FDI regime in 2016 among the G-20 countries according to the OECD (Figure 10). Recent steps to reduce the negative list (from 13 to 9 sectors), increase the length of licenses (from 1 to 5 years), and ease domestic partner restrictions in some sectors are welcome. Staff recommended a review of FDI policies and practices against international best practices.

Box 7. Costs of Corruption – Lessons for Saudi Arabia[1]

Corruption imposes considerable costs, and undermines strong, sustained, and inclusive growth. Corruption, defined as "the abuse of public office for private gain," is difficult to measure. However, while Saudi Arabia fares better than emerging markets and developing countries as a group on a variety of perception-based indicators of corruption, it falls short of advanced economies, even after accounting for measurement error (figure).[2] Many cross-country studies have estimated the relationship between corruption and growth and suggest that reforms that tackle corruption could have a substantial macroeconomic impact. For example, improving corruption indicators in Saudi Arabia to the average level observed in advanced economies could raise real GDP growth by 0.5-1 percent. Studies also suggest that reducing corruption would raise investment, FDI, and the tax to GDP ratio, and help underpin more inclusive growth.[3]



Sources: World Governance Indicators (WGIs), Transparency International, International Country Risk Guide (ICRG), IMF staff calculations.
When available, 95% confidence intervals are shown for Saudi Arabia.
1/ WGIs, compiled by Daniel Kaufmann and Aart Kraay, are perception-based indices reflecting views of enterprices, citizens, and experts on the quality of governance. They reflect relative performance.
2/ The Corruption Perception Index, compiled by Transparency International, reflects perceptions of businesses and experts of the level of corruption in the public sector in the past two years.
3/ ICRG indices, compiled by Political Risk Services, are based on expert opinion and official data. These indices reflect relative performance.

An effective anti-corruption strategy requires long-term commitment to a broad range of changes. Key elements include increased transparency in government decision-making and fiscal policy, predictable and effective enforcement of a strong and clear legal framework, and elimination of excess regulation that may create opportunities for corruption. Credible institutions play a key role – an anti-corruption strategy is only as strong as the institutions supporting it. The Saudi government is in the process of revising its public procurement law and has begun to take steps to increase fiscal transparency, although more is needed. Ongoing efforts to streamline government regulations will also help reduce opportunities for corruption, and consideration should be given to introducing an asset declaration regime for senior government officials. International best practices include comprehensive requirements focused on high-level officials, online publication, and dissuasive sanctions for non-compliance. Continuing to enhance the AML/CFT framework and the effective use of AML/CFT tools would also support the government's efforts.

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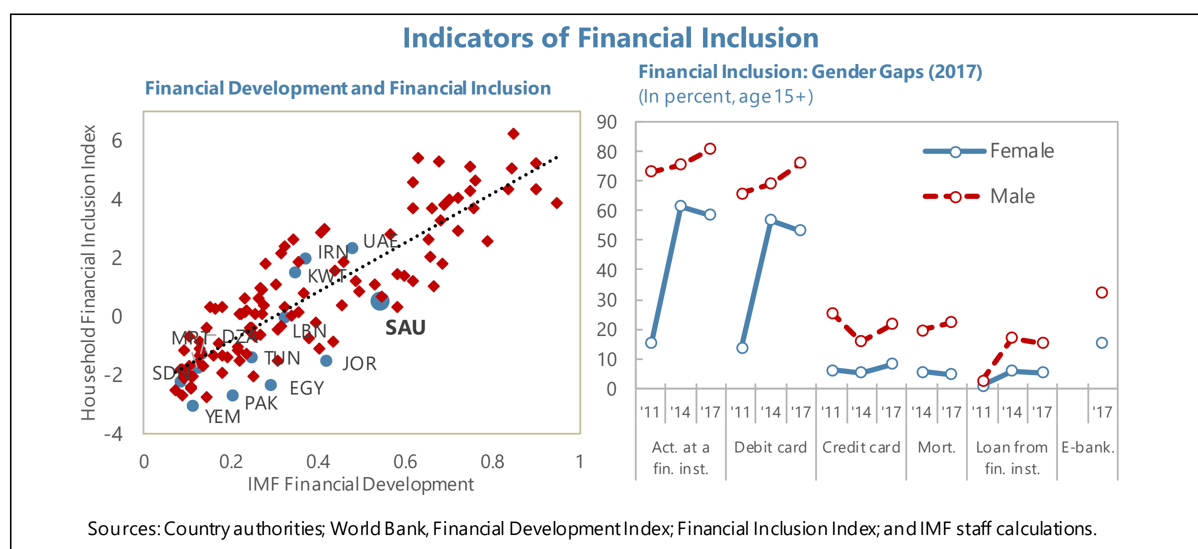
[1] Prepared by Divya Kirti.

[2] These non-IMF indicators provide qualitative information about corruption, and could take time to capture important structural transformations. They do not represent the IMF's assessment of the level of corruption in Saudi Arabia.

[3] See "Corruption: Costs and Mitigating Strategies," IMF Staff Discussion Note 16/05. and "Review of 1997 Guidance Note on Governance—A Proposed Framework for Enhanced Fund Engagement," (www.imf.org).

C. Financial Stability, Development, and Inclusion

37. Staff welcomed the authorities' focus on financial development and inclusion as set out in the recent Financial Sector Development Program (FSDP).[8] They underscored the importance of reforms to remove the underlying constraints and impediments that deter financial institutions from entering new markets or developing products, rather than requiring them to lend to certain borrowers, which could over time undermine the quality of their assets. Therefore, as the authorities aim for program metrics under the FSDP such as increasing lending to SMEs from around 2 percent to 5 percent of total bank lending by 2020, they should focus on improving the credit infrastructure and avoid direct interventions in the credit market. SAMA fully agreed, and stressed that increased financial development and inclusion would not come at the cost of a reduced focus on financial stability. More broadly, the authorities explained that the regular meetings of the National Financial Stability Committee (comprising MoF, SAMA, and the Capital Market Authority (CMA)) provide a good framework to discuss and monitor financial stability issues among the key regulators. SAMA noted the progress made in implementing the recommendations from the 2017 FSSA (Appendix V).



38. The government is encouraging bank lending to SMEs. SMEs account for around 95 percent of registered businesses, 38 percent of jobs (of which 80 percent are held by expatriate workers), 20 percent of GDP, and only about 2 percent of bank lending. The new bankruptcy law will strengthen borrower and creditor rights, and the recently updated commercial pledge law will extend the coverage of the collateral registry to movable assets, which will allow SMEs to better leverage their assets into investments. The expansion of leasing and factoring and of private equity and venture capital, including through the recently established Fund of Funds and SME investment fund, and the restructuring of the Kafalah loan guarantee program should all help improve SME access to finance. Going forward, the SME authority should help companies understand the benefits of improved corporate governance practices to make it easier for them to access financing.

[8] See Selected Issues paper on "How Developed and Inclusive is the Financial Sector in Saudi Arabia?"

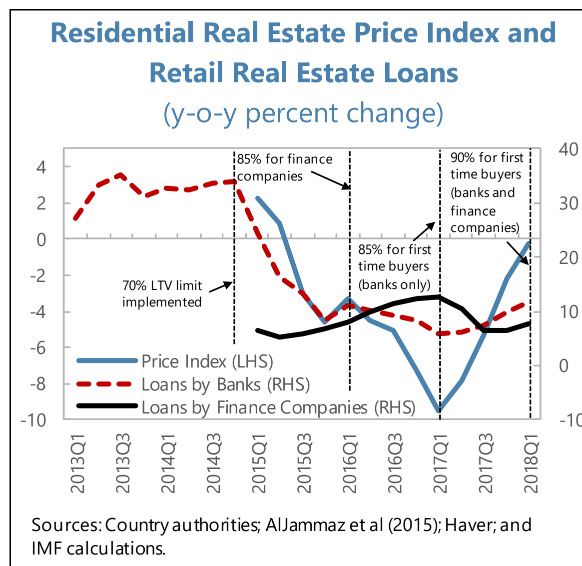
39. Access to financial services in Saudi Arabia could be increased, particularly for women. Developing a national financial inclusion strategy with a focus on women and the remotely-located population could help improve access. Fintech and financial literacy programs are key enablers to overcome obstacles related to physical financial access and social norms. The authorities noted that these areas are a key focus of the FSDP, and emphasized the importance of social norms in explaining low female financial access which they expected to increase with higher female labor force participation. Staff suggested tying social assistance programs to opening a bank account (as was done with Hafiz) could help increase financial inclusion. Staff welcomed SAMA and CMA's proactive approach to the use of fintech through regulatory sandboxes.

40. Significant equity market reforms have been implemented by the CMA, and the authorities are now working to develop the domestic debt market. Staff welcomed the equity market reforms which have eased restrictions on foreign investors, strengthened the trading infrastructure, established a market for smaller companies, and strengthened corporate governance. These reforms have resulted in the announcement of Saudi Arabia's inclusion in the FTSE/Russell and MSCI indices. Regarding the debt market, staff welcomed the steps being taken to establish a primary dealer system, increase the flexibility in the pricing of government debt issuances, and enable trading of debt securities on the Tadawul. The DMO explained that they plan to extend the yield curve by issuing shorter and longer-dated bonds and will soon announce a regular issuance calendar. The disclosure requirements for debt issuance by large listed companies have been eased and medium-term note programs permitted. The recently created Mortgage Refinance Company should help create a secondary market for mortgage securities, while the ability to more easily set up special purpose entities will help the issuance of Sharia-compliant instruments. Uncertainties about the treatment of zakat across financial instruments and institutions needs to be resolved.

41. SAMA is continuing to strengthen liquidity management. Banks have become more liquid as oil prices have risen, and SAMA has cancelled the term repo facility and stopped rolling over deposits it placed with commercial banks in 2016 as they mature. SAMA is continued to develop a liquidity forecasting framework and is considering introducing open market operations to better manage liquidity. Staff supported these changes, noting that a robust liquidity forecasting framework and more active liquidity management could help reduce short-term interest rate volatility. Staff also suggested that banks should also be allowed to average their cash reserve requirements to better manage their liquidity and help develop an interbank market, which would reduce pressure on monetary operations.

42. SAMA has actively employed macro-prudential tools. SAMA explained that it has used the loan-to-deposit ratio, the loan-to-value ratio, and the risk-weight on mortgage loans to avoid what it viewed as an unnecessary tightening of credit conditions. Staff agreed that macroprudential instruments should be used countercyclically within a clear framework, but raised some questions about the recent increase in the LTV ratio for first-time home owners to 90 percent (from 85 percent), which is quite high by international standards, at a time when retail mortgage

lending is growing strongly. SAMA responded that the risks to financial stability from this change are extremely limited given the low average LTV ratio, the small share of mortgage lending in banks' portfolios, and very low mortgage default rates.



Residential Real Estate Price Index and Retail Real Estate Loans
(y-o-y percent change)

Sources: Country authorities; AlJammaz et al (2015); Haver; and IMF calculations.

43. Staff agreed with SAMA that banks are well positioned to weather negative asset quality and liquidity shocks. Reported NPLs increased only modestly during 2017 to reach 1.6 percent of loans (1.4 percent at end-2016), the risk-weighted capital ratio increased to over 20 percent, and returns on assets and equity increased as interest margins rose (Table 6). The introduction of IFRS9 will result in a manageable increase in provisions for banks, and SAMA will need to continue to carefully monitor banks' approach to loan classification. Banks have ample scope to increase credit provision as the non-oil economy strengthens in the next few years. With high interest margins underpinning strong and sustained bank profitability, staff suggested the degree of competition in the financial sector could be reviewed to ensure it is sufficient to deliver the outcomes and new products sought under the FSDP.

44. The new AML and CFT laws were issued in November 2017 and the National Risk Assessment has been concluded. A risk-based supervisory framework is in place. Cash has been identified as an important enabler of money laundering and terrorist financing, and one of SAMA's policy objectives is to reduce the use of cash by encouraging wider availability and acceptance of cashless payments. The FATF/MENAFATF Mutual Evaluation Report will be discussed in the FATF plenary meeting in June. SAMA explained that Saudi banks have not experienced any decline in correspondent banking relationships, and they remain actively engaged with banks and bilateral and multilateral partners to ensure this remains the case.

D. The Exchange Rate and External Stability

45. The external position has strengthened substantially. After declining further in 2017, SAMA's reserves have risen in recent months and remain high compared to standard Fund coverage metrics. The staff assesses the external position in 2017 as having been weaker than consistent with desirable medium-term fiscal policy settings (Appendix VI). Continued fiscal consolidation is needed to further strengthen the current account from its 2017 level and ultimately begin to save for future generations.

46. The authorities and staff agreed that the exchange rate peg serves Saudi Arabia well given the current structure of the economy. SAMA said that its decision in March to raise its policy rates ahead of the Fed was a demonstration of its commitment to the peg. In terms of the

exchange rate regime, a move to a more flexible exchange rate would help provide more stable fiscal revenues in riyal terms if the exchange rate moved with oil prices, could over time support the development of the non-oil tradable sector, and would enable SAMA to follow a more independent interest rate policy. However, depreciation would remove a credible monetary anchor and likely result in higher inflation, further increase uncertainty at a time it is already quite high, and have limited benefits for competitiveness in the near term. The peg should be reviewed regularly to ensure it remains appropriate.

STAFF APPRAISAL

47. The authorities are making good progress in implementing their reform program. Growth is expected to pick-up this year and over the medium-term as reforms take hold. The main priorities for the government are to continue to effectively implement the bold structural reforms that are underway, meet the medium-term fiscal targets it has set, and resist a further expansion in government spending in response to higher oil prices.

48. Prioritizing and sequencing the reforms, and ensuring they are equitable, consistent, transparent, and well-communicated are critical to their successful implementation. Many initiatives are being advanced and there is a risk of overstretch. Reform goals and targets need to be focused, deliverable, and well-communicated, and supported by improved data quality.

49. Targeting budget balance by 2023 is appropriate, and the government should ensure it delivers on this objective. The slower pace of fiscal consolidation will help support growth and the implementation of structural reforms. Delivering on the balanced budget objective will require fully implementing the revenue and energy price reforms and limiting the future growth of government spending. Contingency scenarios should be developed given uncertainties about future oil prices. If oil prices are higher than assumed in the budget, the additional revenues should be saved—i.e. the non-oil primary deficit path should be maintained. If oil prices are lower than in the budget, identified contingency measures should be implemented over the medium-term to achieve the balanced budget target.

50. Major progress has been made in implementing new revenue initiatives. The VAT is a milestone achievement in strengthening the tax culture and tax administration in the country, and preparations for lowering the registration threshold from the beginning of 2019 should continue. As planned, energy prices should continue to be gradually increased until they reach benchmark levels.

51. Compensation for low and middle-income households is essential to support the reforms. The citizens' accounts are very welcome and are working well in operational terms. The average compensation paid through the accounts appears to be adequate, but it needs to be confirmed that compensation is sufficient for those at the lower end of the income distribution. Communication on the citizens' accounts should be stepped-up.

52. Limiting the growth of government spending is key to achieving the fiscal targets and ensuring the budget remains robust to swings in oil prices. Anchoring spending in a medium-term expenditure framework would help resist spending pressures that could emerge as oil prices rise. The ongoing civil service review should help identify reforms to contain the wage bill. Re-expanding public investment should be approached cautiously until the experience with the new project management process has been fully tested. The allowances in the January Royal Decree should be allowed to expire as announced at year-end.

53. Reforms to strengthen the budget and medium-term fiscal framework, increase fiscal transparency, and develop macro-fiscal analysis are making good progress. The introduction of Etimad should over time help strengthen public financial management to reduce expenditure overruns and avoid a recurrence of payment arrears. Fiscal transparency can be further enhanced. Fiscal coverage should be expanded beyond the budgetary central government to capture the impact of entities such as the PIF and Aramco and give a fuller and more transparent picture of the impact of fiscal policy on the economy.

54. An integrated asset-liability management framework is essential to guide the government's borrowing and investment decisions. Such a framework will enable an assessment of the risk-return trade-offs and a full evaluation of the impact of decisions taken on and off-budget on the public-sector balance sheet, including the PIF's domestic and external investments.

55. The roles of the public and private sectors in developing the non-oil economy need to be carefully considered. While the public sector can be a catalyst for the development of new sectors, it is important that it does not crowd-out private sector involvement, nor remain a long-term player in markets where private enterprises can thrive on their own. Relatedly, the privatization/PPP program should now be accelerated.

56. Policies to create jobs for nationals, particularly women, should focus on leveling the playing field on wages, benefits, and working conditions between Saudis and expatriates in sectors where Saudis want to work. This will involve a difficult adjustment for companies that are reliant on expatriate labor and should be implemented gradually. Policies should focus on setting clear expectations about employment prospects in the public sector, reforming the visa system to enhance expatriate labor mobility, addressing constraints to female employment, strengthening training and education, and reviewing and ensuring that labor market interventions such as wage subsidies are effective.

57. Reforms to improve the business environment are particularly important in the context of fiscal consolidation, labor market reforms, and low growth. Reducing the costs of doing business through regulatory and administrative reforms will help offset higher energy and labor costs that are resulting from other reform initiatives. With many legal reforms having been passed, or in the latter stages of legislative approval, focus will now turn to empowering institutions to implement the new laws in a clear and transparent way that encourages businesses to invest and financial institutions to lend. The new public procurement law has a key role to play in anti-corruption policies.

58. Increasing financial development and inclusion and maintaining financial stability are key policy priorities. Considerable progress has been made in developing the equity market. The focus now should be on increasing SME finance, developing the private debt market, and improving financial sector access, particularly for women. Reforms should focus on removing structural impediments that dissuade financial institutions from entering these markets. Efforts to strengthen liquidity management and to use macroprudential tools countercyclically are welcome, but careful calibration of the latter is needed to manage potential risks. The effectiveness of the AML/CFT regime should continue to be strengthened in response to the recommendations of the upcoming FATF/MENAFATF Mutual Evaluation Report.

59. The exchange rate peg serves Saudi Arabia well given the current structure of the economy. The team assesses that the external position in 2017 was weaker than consistent with desirable medium-term fiscal policy settings.

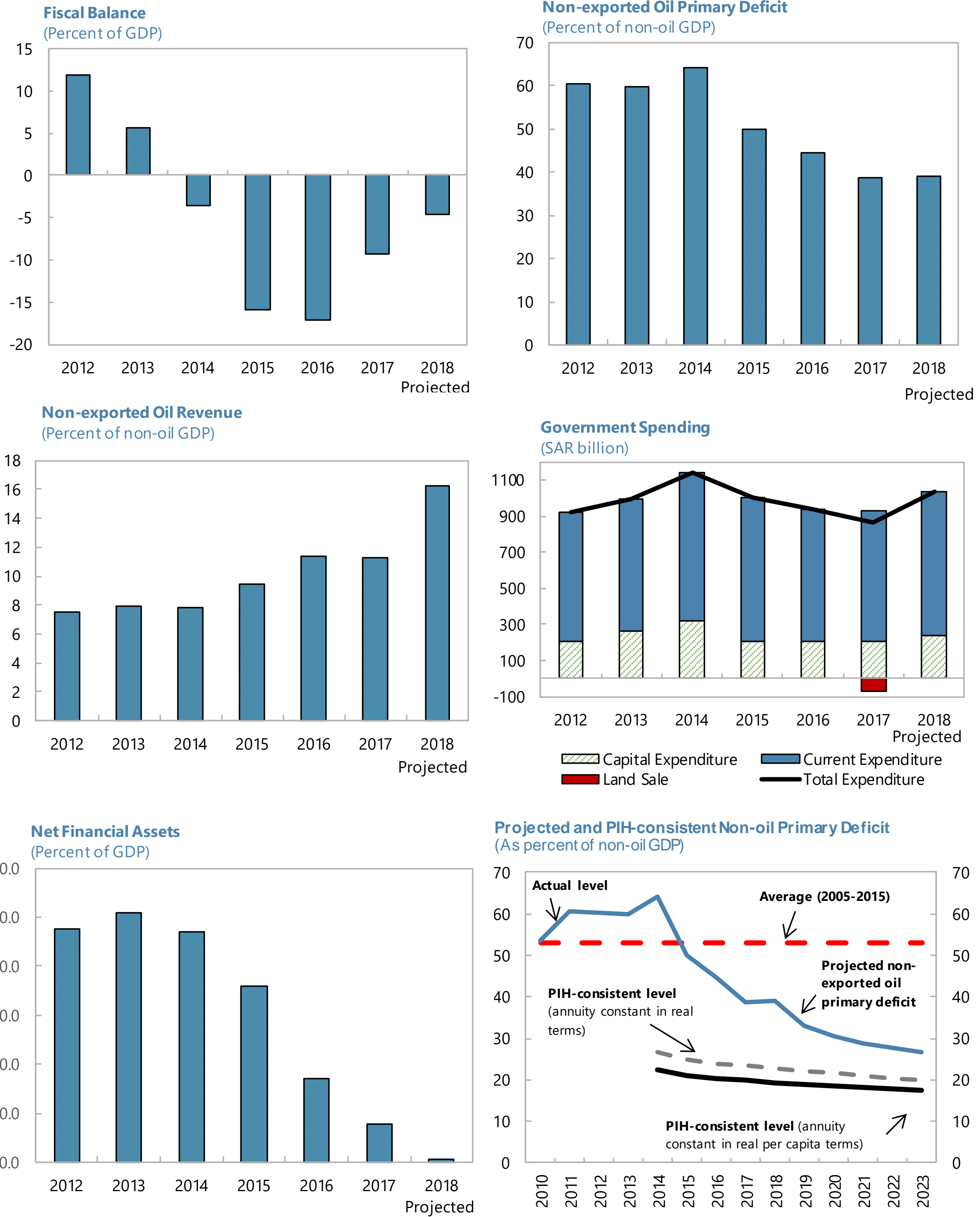
60. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Risk Assessment Matrix[1]			
Nature/source of main risks	**Likelihood/Time Horizon**	**Expected impact on the economy if risk is realized**	**Policy Response**
Lower energy prices	**Low/Short-to-medium-term**	***High*** A substantial decline in oil prices relative to staff's baseline would increase the fiscal deficit and put pressure on the government to speed up fiscal adjustment, with negative implications for growth and employment. Adverse confidence effects in the private sector and lower liquidity in the banking system could reduce credit availability and amplify negative spillovers. Asset quality in the banking system would deteriorate.	Fiscal policy would need to adjust to reduce medium-term fiscal and external risks. Existing buffers together with external borrowing could be used to smooth this adjustment. The authorities should take steps to ensure banking system liquidity, and carefully monitor banks for signs of stress. Policymakers should speed up planned structural reforms to reduce the impact of oil price fluctuations on the economy over the longer-term.
Policy and geopolitical uncertainties: intensification of the risks of fragmentation/security dislocation in parts of the Middle East, Africa, Asia, and Europe	**High/Short-to-medium-term**	***High*** The impact on the Saudi economy would depend on the nature of the event. The impact on oil prices is the most likely channel of transmission, with higher oil prices resulting in stronger fiscal and external balances. Confidence may also increase with higher oil prices, but it could also be undermined depending on the nature of the event. High geopolitical uncertainties within the Middle East region would also put continued pressures on defense and security spending.	The needed policy response would depend on the nature of the shock. If oil prices exceed those assumed in the budget, these additional revenues should be saved and the same non-oil fiscal balance path targeted. SAMA would need to actively manage banking system liquidity to ensure that the SAIBOR-LIBOR spread remains in a range that does not encourage capital outflows. Ambitious structural reforms should continue.
The payoff from economic and social reforms is larger than expected	**Medium/ Medium-term**	***High*** Given the unique characteristics of the Saudi economy, it is very difficult to judge the impact of the ongoing reforms on non-oil growth. If reforms are successful in catalyzing a significant increase in domestic and foreign investment and boosting productivity and employment of nationals, the impact on non-oil growth could be larger than assumed in staff's baseline.	Even if growth is stronger than expected, reforms would need to continue to ensure the pick-up is sustained.

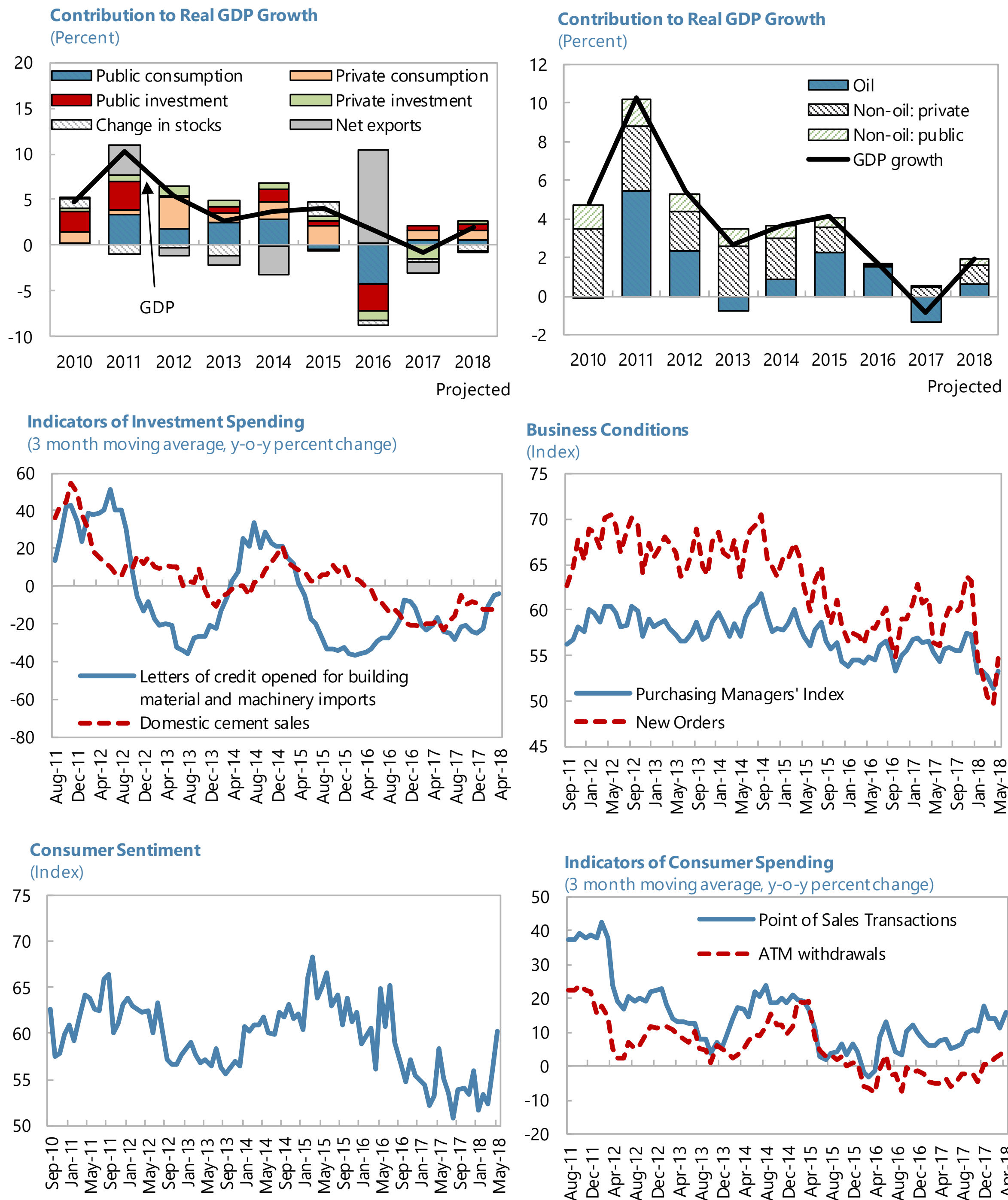
Risk Assessment Matrix[1] (concluded)			
Slippages in the reform agenda would reduce prospects for stronger growth and employment over the medium-term	**Low/Medium-term**	***High*** The failure to follow through on fiscal consolidation, an expanded role for government, and delays in the privatization/PPP agenda and other structural reforms could crowd out the private sector, adversely affecting growth and employment, and undermining the reform efforts. The failure to turn reforms into growth and ultimately jobs for Saudis in the private sector will either lead to rising unemployment and social pressures or increasing public employment which will have negative fiscal implications.	Calibrate carefully the scope and reach of government policy to help catalyze private sector investment and enhance its role in growth and employment. This needs to be supported by structural reforms to boost non-oil growth. Further labor market reforms are needed to increase the competitiveness of Saudi nationals in the private sector. Structural reforms are needed on boost non-oil growth.
Retreat from cross-border integration	**Medium/Short-to-medium-term**	***High*** The negative consequences for trade, capital and labor flows, and growth will likely lead to a decline in oil prices everything else being equal. This would result in a deterioration in the external and fiscal balances with adverse effects for growth, employment, and the financial sector (see above).	As in “lower energy prices” above.
Tighter global financial market conditions	**High/Short-to-medium-term**	***Low*** Tighter global financial market conditions could affect the government’s ability to borrow from international markets, thus increasing the domestic financing requirement. Bank funding costs may also increase.	Continued strong fundamentals would likely prevent excessive volatility in Saudi Arabian financial markets. Large financial cushions are in place to mitigate the impact.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff’s subjective assessment of the risks surrounding the baseline (“low” is meant to indicate a probability below 10 percent, “medium” a probability between 10 and 30 percent, and “high” a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Figure 1. Fiscal Developments

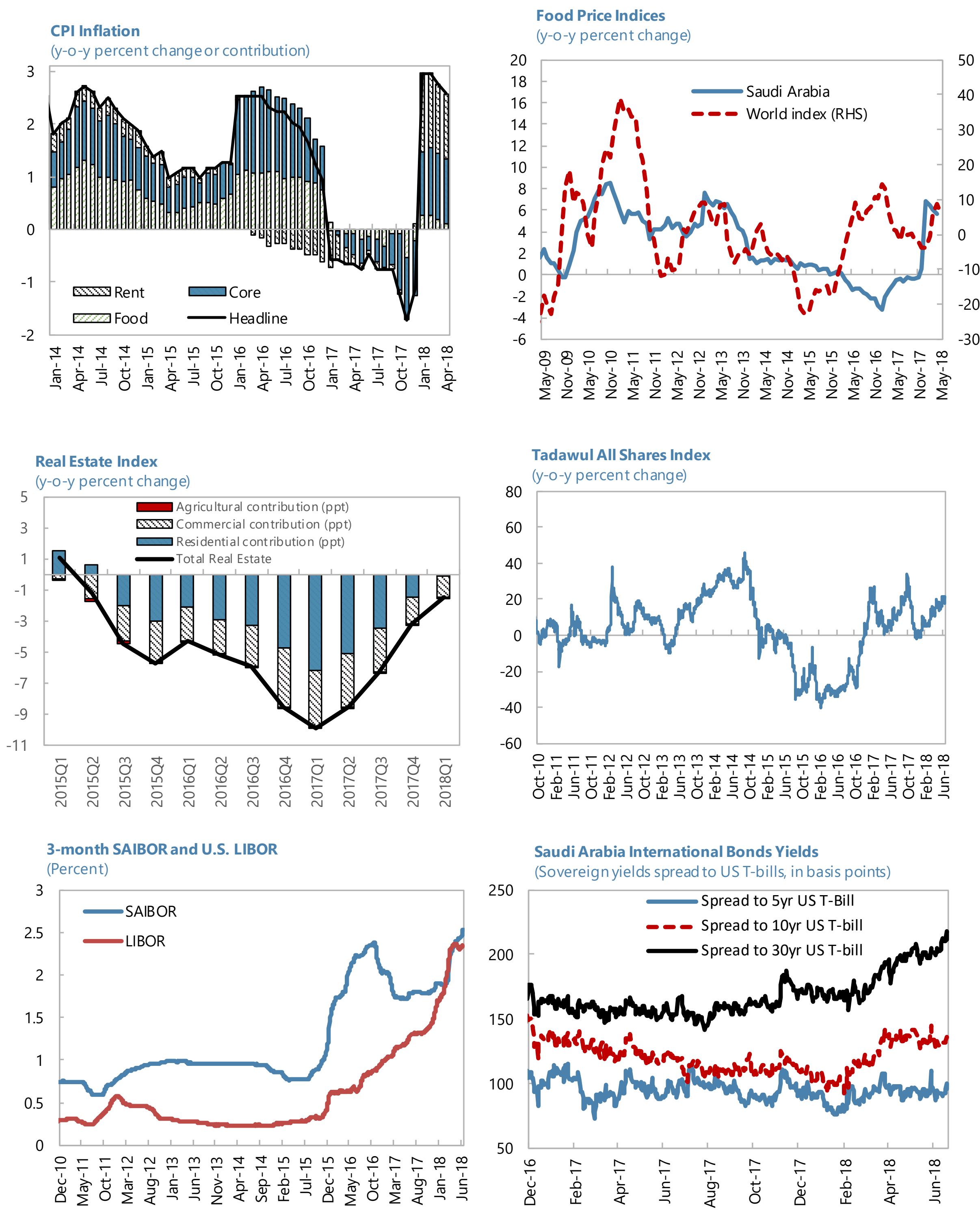


Sources: Country authorities; and IMF staff calculations.

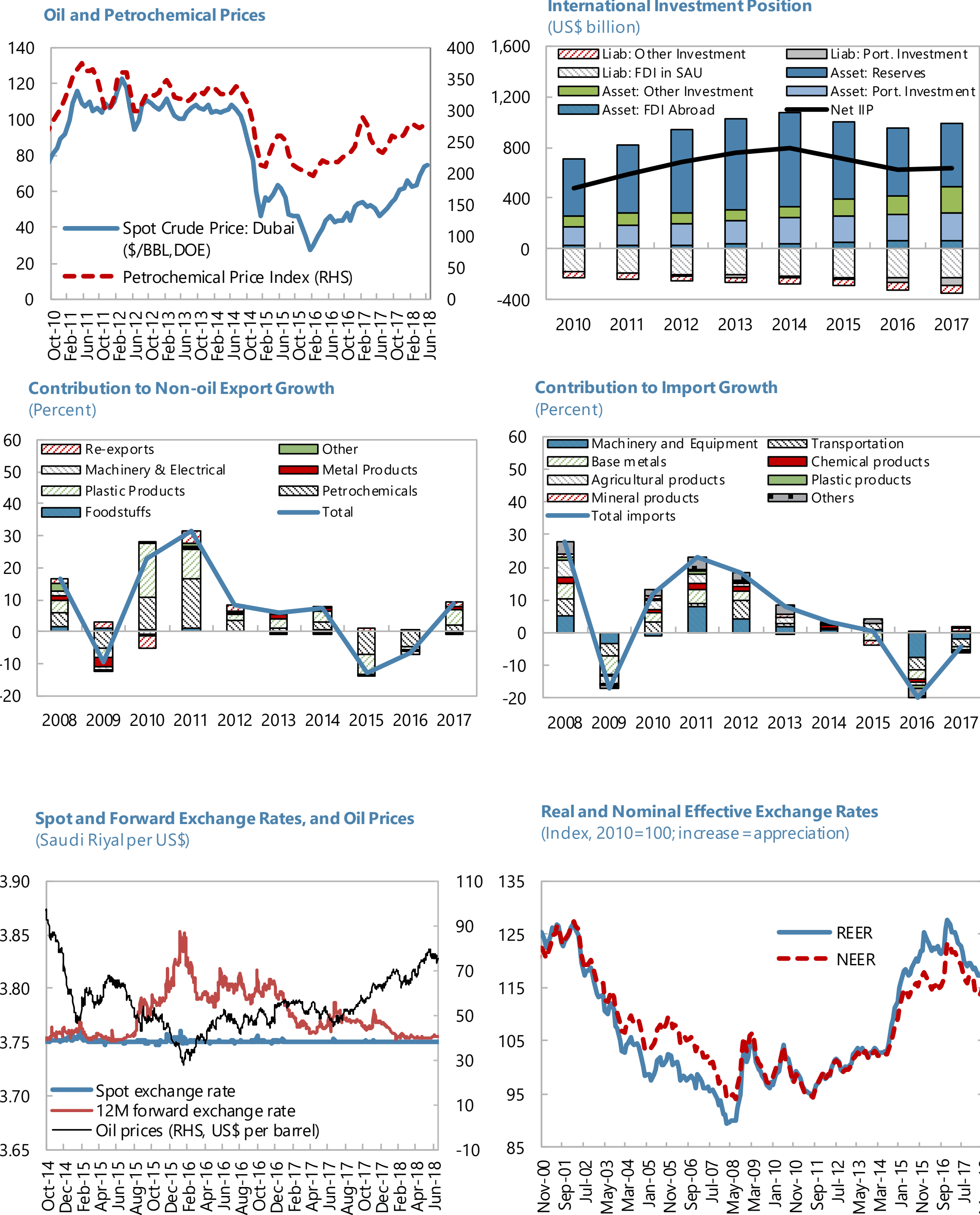


Sources: Country authorities; Haver; Markit; World Steel Association; Thomson Reuters; and IMF staff calculations.

Figure 3. Inflation and Financial Market Developments

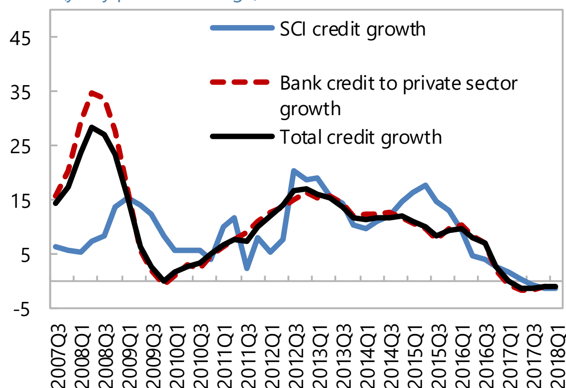


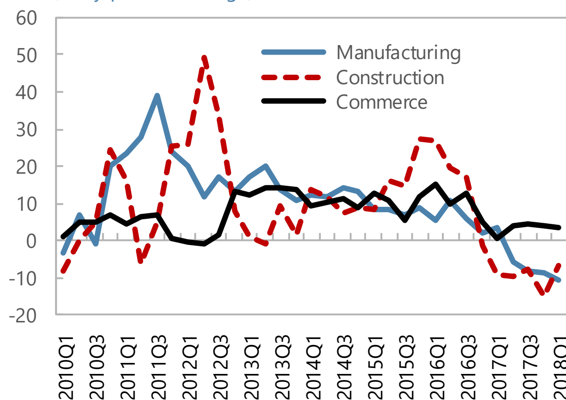
Sources: Country authorities; Haver Analytics; Markit; Bloomberg; and IMF staff calculations.

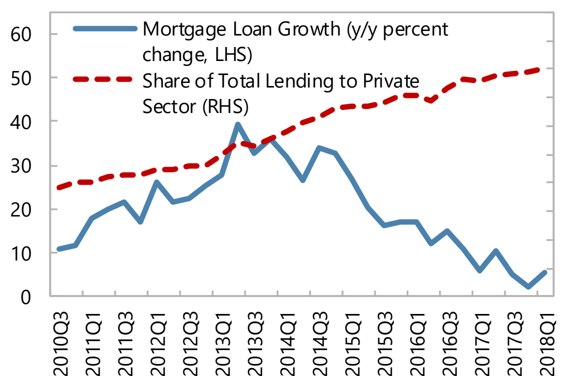


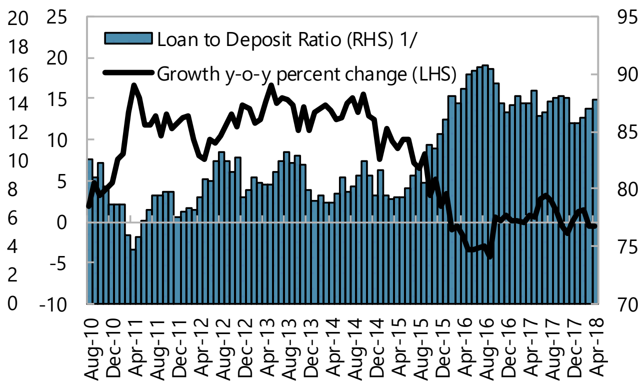
Sources: Haver; ICIS; Bloomberg; and IMF staff calculations.

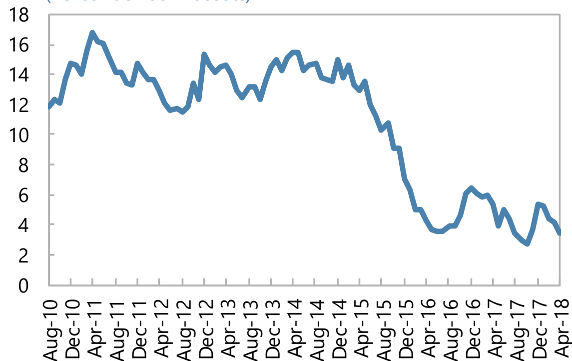
Figure 5. Monetary Developments

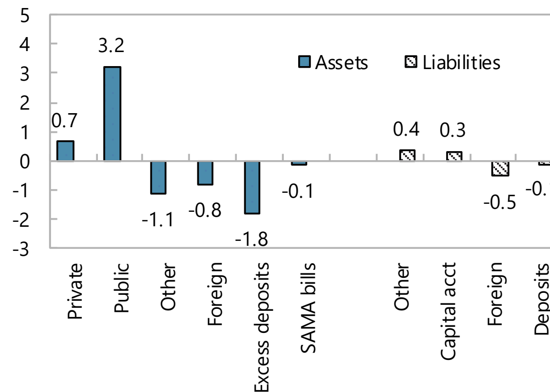








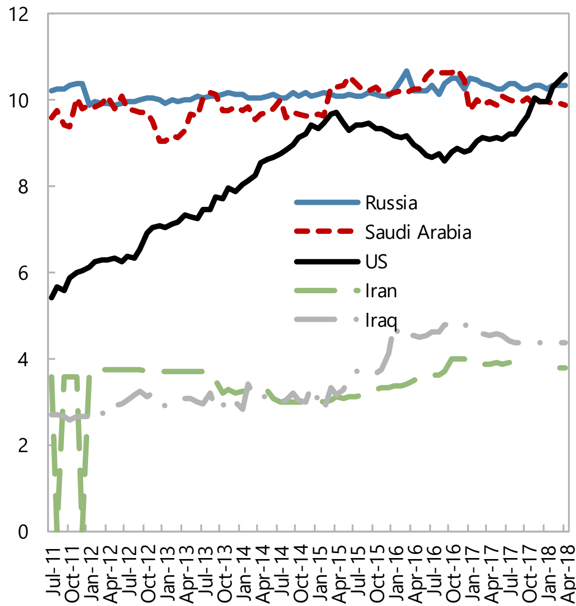


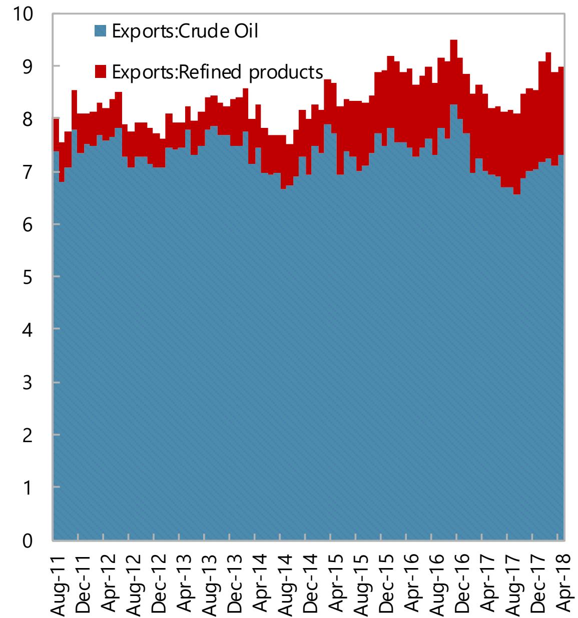


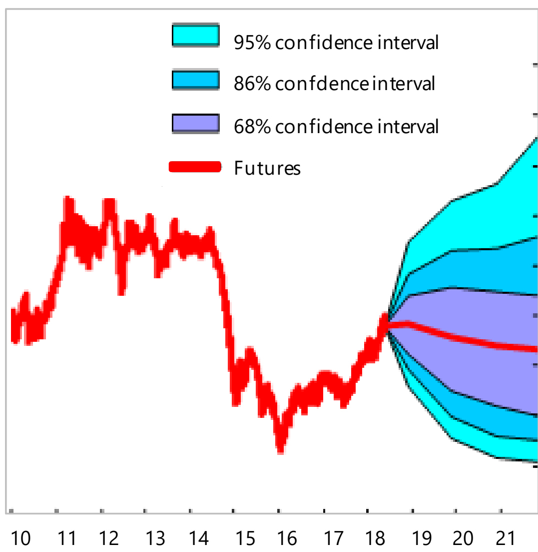
Sources: Haver; Reuters; and IMF staff calculations.

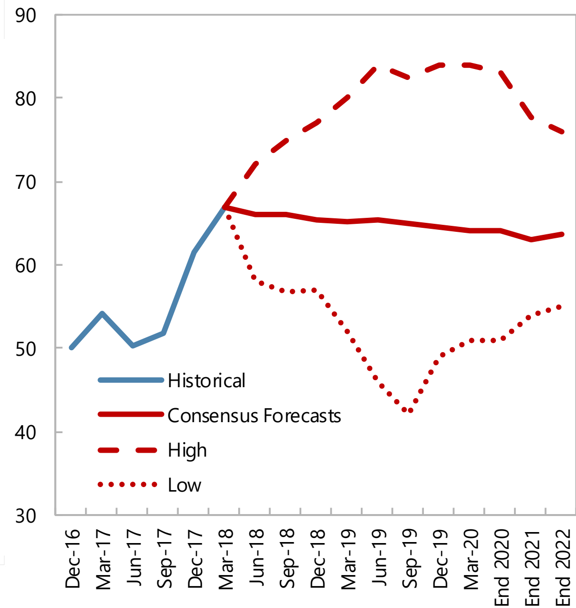
1/ Loan to deposit ratio is calculated by staff as the ratio of total bank credit to total bank deposits.

Figure 6. Oil Market Developments



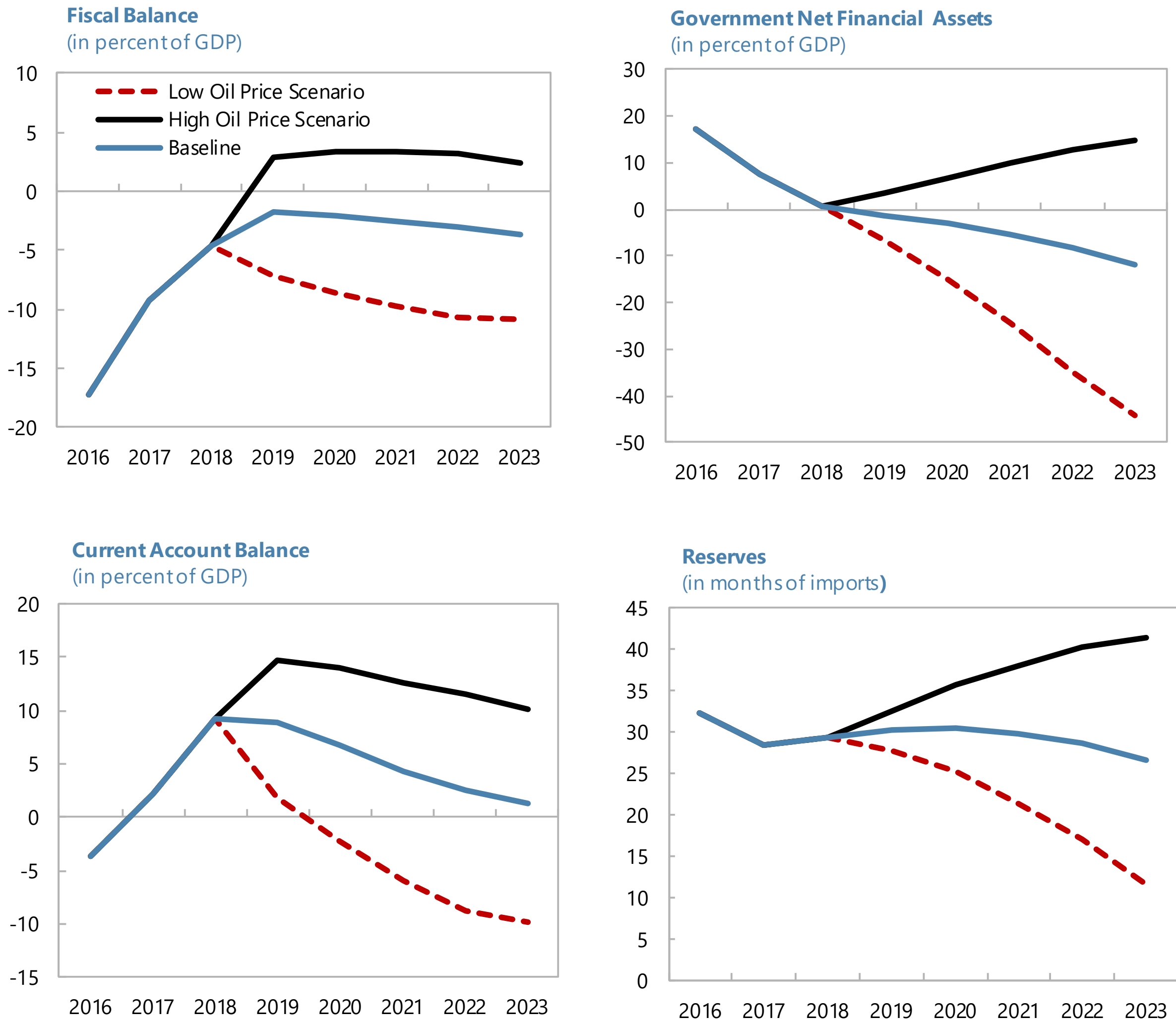






Sources: Joint Oil Data Initiative (JODI); Bloomberg; International Energy Agency (IEA); Energy consensus forecast; RES Commodities Unit; and IMF staff calculations.
1/ Derived from prices of futures options on May 29, 2018.

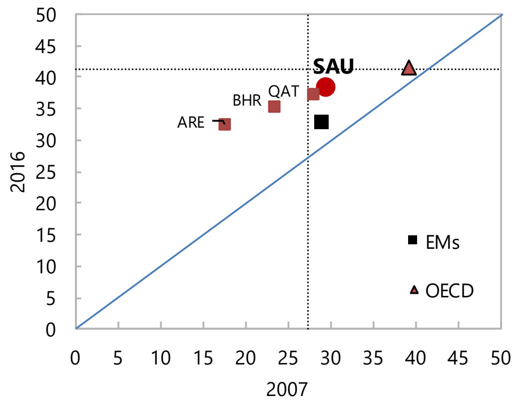
Figure 7. Upside/Downside Oil Price Scenario 1/

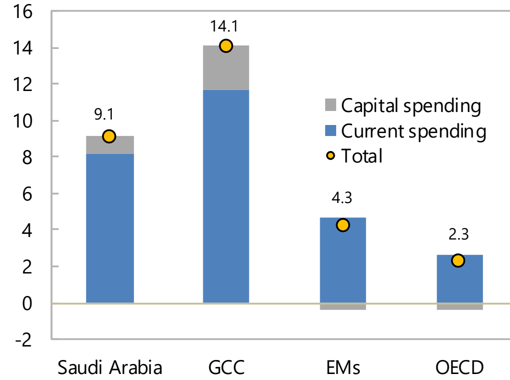


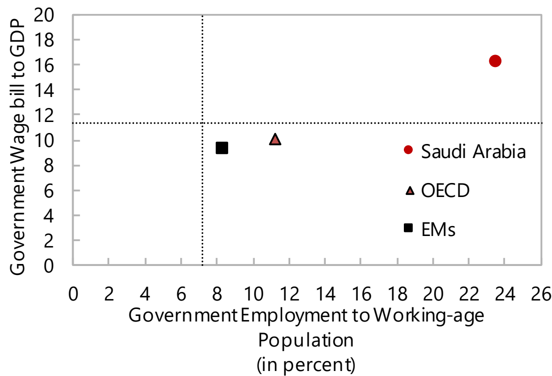
Source: IMF staff calculations.

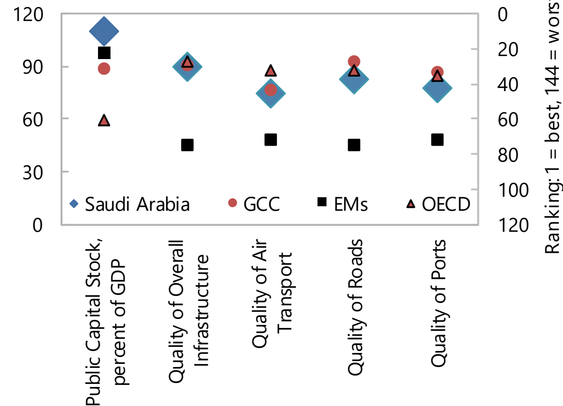
1/ The low oil price scenario assumes the oil price is 25 to 41 percent below the WEO oil price from 2019 to 2023. The high oil price scenario assumes the oil price is 25 to 41 percent above the WEO oil price for that same time period. Both scenarios assume no change in government spending or in external borrowing relative to baseline.

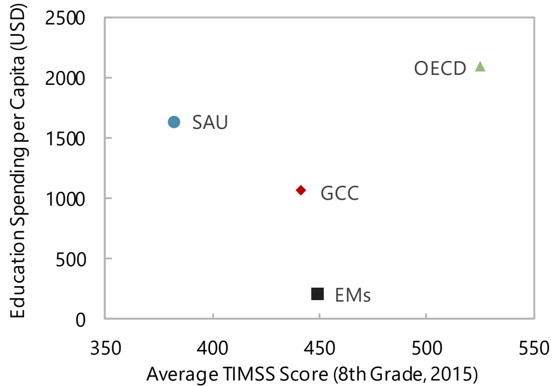
Figure 8. Structure of Government Spending

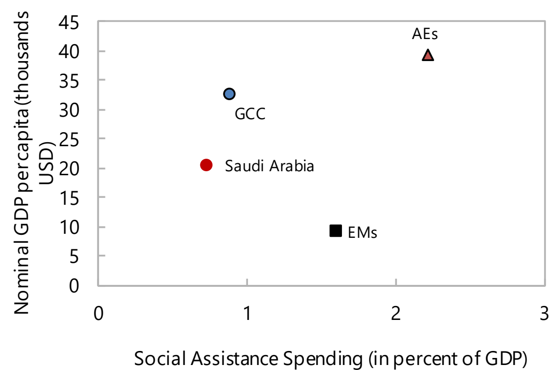












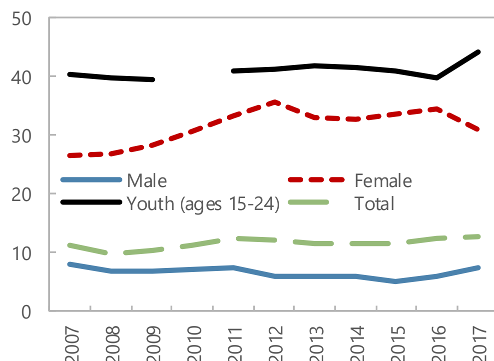
Sources: IMF FAD Expenditure Assessment Tool; IMF FAD Government Wage Bill and Employment Dataset; IMF Investment and Capital Stock Dataset; World Economic Outlook; World Economic Forum; and World Bank.

1/ Dash lines are the average of GCC.

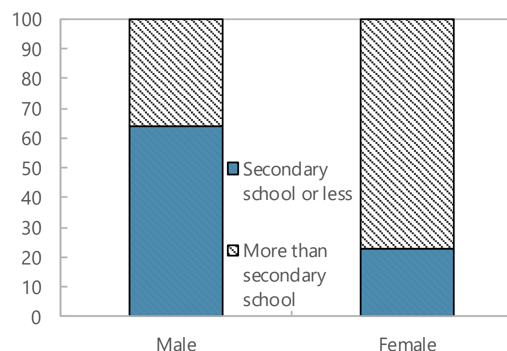
2/ In Saudi Arabia, social protection spending also takes place through government entities outside the budgetary central government.

Figure 9. Labor Market Developments

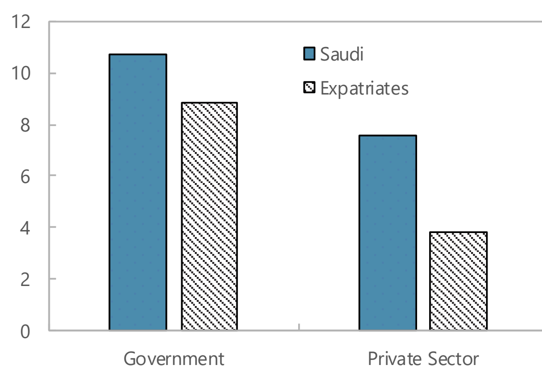
Saudi Nationals Unemployment Rates
(in percent)



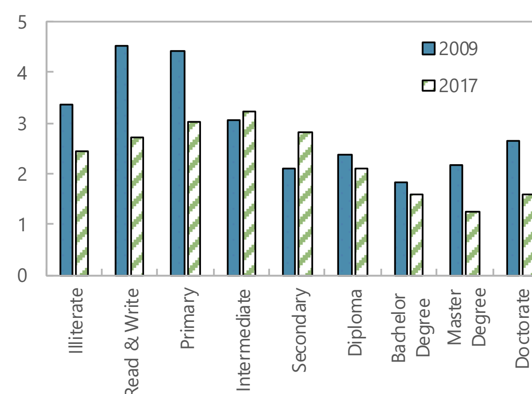
Saudi Nationals Unemployed by Sex and Education, 2017
(in percent of total unemployed)



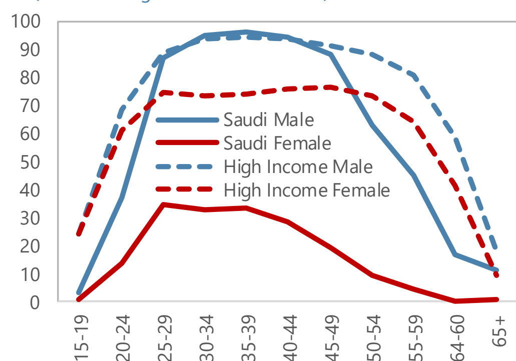
Average Monthly Wages by Sector and Nationality, 2017
(In SAR thousands)



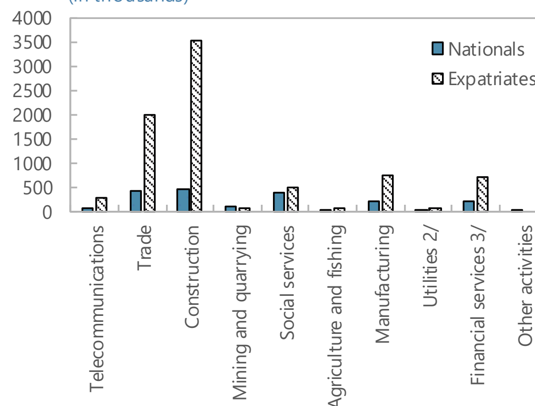
Saudi to Non-Saudi Monthly Wages by Education
(Ratio)



Labor Force Participation by Gender and Age, 2017 1/
(Percent of age-band in labor force)

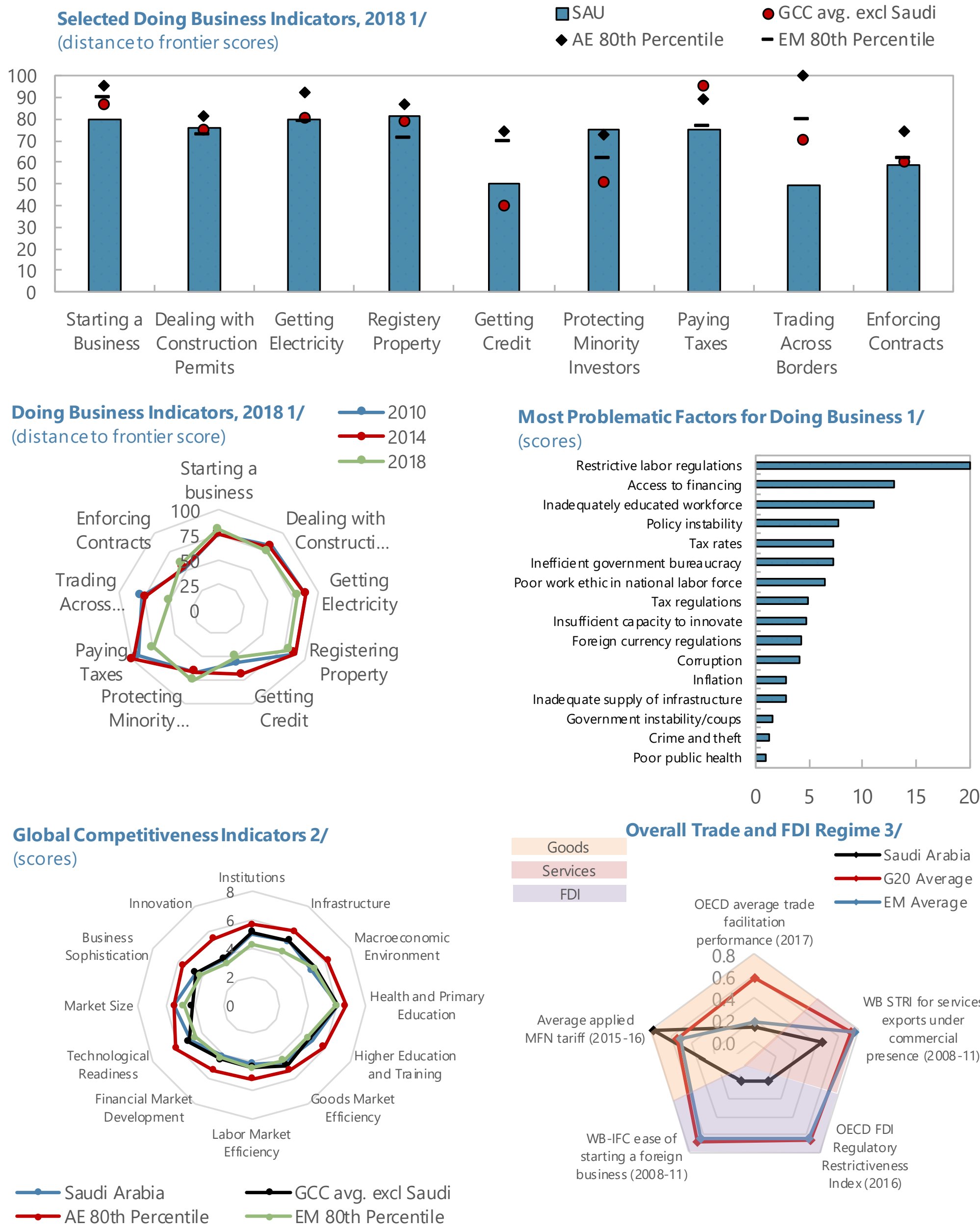


Employment by Sector, 2017
(In thousands)



Source: Labour Force Survey - General Authority for Statistics; International Labour Organization; and IMF staff calculations
1/ Data for high income countries is as of 2015.
2/ Includes electricity, gas, and water.
3/ Includes financial, insurance, real estate, and business services.

Figure 10. Impediments to Private Sector Growth



Sources: World Bank, Doing Business 2017-18; World Economic Forum, Global Competitiveness Reports; IMF Working Paper, D. Cerdeiro and R. Nam; and IMF staff calculations.

1/ These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

2/ The World Economic Forum's Global Competitiveness Index combines both official data and survey responses from business executives on several dimensions of competitiveness.

3/ The "WB-IFC ease of starting a foreign business" indicator is based on perceptions as part of an established IFC survey process.

Table 1. Saudi Arabia: Selected Economic Indicators, 2015–23

				Proj.					
	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(Percent change; unless otherwise indicated)								
National income and prices									
Crude oil production (million of barrels per day)[1]	10.2	10.5	10.0	10.1	10.2	10.3	10.3	10.4	10.5
Average oil export price (U.S. dollars per barrel)[2]	50.4	41.5	53.2	70.7	69.5	65.4	62.5	60.5	59.2
Nominal GDP (SAR billions)	2,454	2,419	2,575	2,925	3,005	3,050	3,124	3,218	3,326
Nominal GDP (US$ billions)	654	645	687	780	801	813	833	858	887
Nominal non-oil GDP (SAR billions)	1,768	1,797	1,819	1,916	1,996	2,087	2,192	2,303	2,420
Nominal GDP per capita (US$)	21,095	20,318	21,096	23,488	23,660	23,544	23,646	23,875	24,196
Real GDP	4.1	1.7	-0.9	1.9	1.9	2.0	2.1	2.2	2.4
Oil	5.3	3.6	-3.1	1.4	1.7	1.1	1.1	1.1	1.1
Non-oil	3.2	0.2	1.1	2.3	2.1	2.6	2.9	3.1	3.2
Real GDP—public sector	2.7	0.6	0.7	1.8	1.2	1.6	1.4	1.4	1.3
Real GDP—private sector	3.4	0.1	1.2	2.5	2.5	3.0	3.6	3.8	4.0
Consumer price index (avg)	1.3	2.0	-0.9	3.0	2.0	2.2	2.2	2.1	2.1
External sector									
Exports f.o.b.	-40.6	-9.8	20.4	29.3	-0.6	-4.5	-3.0	-1.4	-0.8
Oil	-46.3	-11.0	25.0	34.9	-0.9	-5.5	-3.9	-2.4	-1.6
Non-oil	-12.6	-6.3	7.3	10.4	0.6	-0.6	0.3	2.5	2.0
Imports f.o.b.	0.5	-19.7	-6.7	6.3	4.6	5.0	5.6	5.1	4.9
Current account balance (percent of GDP)	-8.7	-3.7	2.2	9.3	8.8	6.7	4.3	2.5	1.2
Export volume	2.8	4.3	-1.0	0.6	1.0	0.6	1.0	1.8	1.4
Import volume	6.5	-16.2	-9.4	3.0	3.2	4.0	4.2	4.6	4.8
Terms of trade	-44.5	-12.2	22.2	29.0	-3.1	-6.8	-5.7	-3.9	-2.5
Money and credit									
Net foreign assets	-12.7	-15.2	-6.9	5.7	6.4	5.0	1.2	0.0	-3.5
Credit to government (net)	-29.3	-41.1	-29.9	-24.3	-5.7	-4.2	-12.3	-28.2	-69.4
Credit to private sector	9.2	2.4	-0.8	2.0	2.2	3.4	4.1	4.5	5.0
Credit to state enterprises	-15.3	26.3	-4.7	0.0	0.0	0.0	0.0	0.0	0.0
Money and quasi-money (M3)	2.5	0.8	0.2	2.3	2.8	3.5	3.9	4.2	4.7
3-month Interbank rate (percent p.a.)[4]	0.9	2.1	1.8	2.6	...	...	...	...	...
	(Percent of GDP)								
Central government finances									
Revenue	25.0	21.5	24.1	30.6	31.7	32.0	31.5	30.6	29.9
Of which: oil	18.2	13.8	16.9	21.7	21.8	21.1	20.5	19.8	19.2
Expenditure	40.8	38.7	33.4	35.2	33.4	34.0	34.0	33.6	33.4
Expense	32.2	30.0	28.0	27.2	25.5	25.9	26.0	25.9	26.0
Net acquisition of non-financial assets	8.6	8.6	5.4	8.0	7.9	8.1	7.9	7.7	7.5
Net lending (+)/borrowing (-)	-15.8	-17.2	-9.3	-4.6	-1.7	-2.0	-2.5	-3.0	-3.6
Excluding oil revenue	-34.0	-31.0	-26.2	-26.3	-23.4	-23.1	-23.0	-22.8	-22.8
Non-oil primary balance/non-oil GDP	-50.0	-45.7	-39.7	-41.7	-36.9	-35.3	-34.1	-33.0	-32.1
Non-exported oil primary balance/non-oil GDP	-50.0	-44.6	-38.6	-39.1	-33.2	-30.7	-28.9	-27.6	-26.7
Central Government deposits at SAMA	41.7	30.2	24.9	19.6	19.1	18.8	18.4	15.8	12.6
Central government's gross debt	5.8	13.1	17.2	19.1	20.3	22.0	24.0	24.2	24.3
Central government's net financial assets	35.9	17.1	7.7	0.5	-1.2	-3.2	-5.6	-8.4	-11.7
Memorandum items:									
SAMA's total net foreign assets (US$ billions)	608.9	528.6	488.9	521.8	560.3	592.5	602.5	605.2	585.6
In months of imports of goods and services[3]	36.9	32.3	28.4	29.2	30.2	30.5	29.7	28.6	26.6
Imports goods & services/GDP	37.8	30.7	28.6	26.4	26.7	27.4	28.0	28.3	28.6
Real effective exchange rate (2010=100, end of period)[4]	122.1	127.9	119.6	117.3	...	...	...	...	...
Average exchange rate Saudi riyal/U.S. dollar[4]	3.75	3.75	3.75	3.75	...	...	...	...	...
Population (millions)	31.0	31.7	32.6	33.2	33.9	34.5	35.2	35.9	36.7
Unemployment rate (nationals)	11.5	12.3	12.8	...	...	...	...	...	...
Unemployment rate (overall)	5.6	5.6	6.0	...	...	...	...	...	...
Employment Growth (percent change)	3.8	1.4	-2.6	...	...	...	...	...	...
All-Shares Price Index (TASI)[4]	6912	7210	7226	8342	...	...	...	...	...

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

[1] Includes production from the Neutral Zone.

[2] Includes refined products.

[3] Next 12 months.

[4] For 2018, data is latest available.

Table 2. Saudi Arabia: Budgetary Central Government Operations, 2015–23

	2015	2016	2017	Budget 2018	Proj. 2018	2019	2020	2021	2022	2023
	(Billions of Saudi Arabian riyals)									
Revenue	613	519	622	783	896	954	977	984	986	994
Oil	446	334	436	492	636	654	645	641	637	638
Oil revenues from exports	446	314	416	…	586	580	548	527	514	506
Oil revenues from energy price reforms	0	19	20	…	50	74	96	114	123	132
Non-oil	166	186	186	291	260	300	332	343	349	356
Tax revenues	82	82	87	142	138	148	152	159	166	174
Taxes on income, profits, and capital gains	15	15	14	15	18	20	19	20	21	22
Taxes on goods and services (includes excises)	32	25	38	85	82	89	93	97	101	105
Taxes on international trade and transactions	22	26	20	25	21	22	23	25	26	27
Other taxes (including ZAKAT)	14	17	15	17	16	16	17	18	19	20
Non-oil non-tax revenues	84	104	99	149	123	153	180	184	183	182
Property income (excluding oil)	52	77	57	…	41	50	55	56	52	49
Sales of goods and services	15	15	22	…	24	25	26	27	28	30
Fines, penalties, and forfeits	9	8	12	…	18	19	20	20	21	22
Other revenues	8	5	7	…	39	59	79	80	81	81
Expenditure	1,001	936	860	978	1,030	1,004	1,037	1,061	1,083	1,113
Expense	791	726	722	773	795	766	789	813	835	865
Employee compensation [1]	455	439	420	438	461	429	439	449	460	471
Use of goods and services [2]	145	150	136	143	143	149	156	164	172	181
Interest payments	3	5	9	14	12	19	23	27	27	28
Domestic	3	5	5	…	9	12	14	15	16	17
Foreign	0	0	4	…	3	7	9	12	11	11
Support (subsidies) [3]	20	7	5	14	5	5	5	5	5	5
Social benefits [4]	31	41	48	65	85	83	86	90	93	97
Grants	33	5	6	3	6	7	7	7	8	8
Other expenses	105	78	98	95	83	75	72	71	69	74
Net acquisition of non-financial assets	210	209	138	205	235	238	248	248	248	248
Net lending (+)/borrowing (-)	**-389**	**-416**	**-238**	**-195**	**-134**	**-51**	**-61**	**-77**	**-97**	**-119**
	(In percent of GDP)									
Revenue	25.0	21.5	24.1	29.3	30.6	31.7	32.0	31.5	30.6	29.9
Oil	18.2	13.8	16.9	18.4	21.7	21.8	21.1	20.5	19.8	19.2
Oil revenues from exports	18.2	13.0	16.1	…	20.0	19.3	18.0	16.9	16.0	15.2
Oil revenues from energy price reforms	0.0	0.8	0.8	…	1.7	2.4	3.2	3.6	3.8	4.0
Non-oil	6.8	7.7	7.2	10.9	8.9	10.0	10.9	11.0	10.8	10.7
Tax revenues	3.3	3.4	3.4	5.3	4.7	4.9	5.0	5.1	5.2	5.2
Taxes on income, profits, and capital gains	0.6	0.6	0.5	0.6	0.6	0.7	0.6	0.6	0.6	0.7
Taxes on goods and services (includes excises)	1.3	1.0	1.5	3.2	2.8	3.0	3.0	3.1	3.1	3.2
Taxes on international trade and transactions	0.9	1.1	0.8	0.9	0.7	0.7	0.8	0.8	0.8	0.8
Other taxes (including ZAKAT)	0.6	0.7	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.6
Non-oil non-tax revenues	3.4	4.3	3.8	5.6	4.2	5.1	5.9	5.9	5.7	5.5
Property income (excluding oil)	2.1	3.2	2.2	…	1.4	1.7	1.8	1.8	1.6	1.5
Sales of goods and services	0.6	0.6	0.9	…	0.8	0.8	0.8	0.9	0.9	0.9
Fines, penalties, and forfeits	0.4	0.3	0.5	…	0.6	0.6	0.6	0.7	0.7	0.7
Other revenues	0.3	0.2	0.3	…	1.3	2.0	2.6	2.6	2.5	2.5
Expenditure	40.8	38.7	33.4	36.6	35.2	33.4	34.0	34.0	33.6	33.4
Expenses	32.2	30.0	28.0	28.9	27.2	25.5	25.9	26.0	25.9	26.0
Employee compensation [1]	18.5	18.2	16.3	16.4	15.8	14.3	14.4	14.4	14.3	14.2
Use of goods and services [2]	5.9	6.2	5.3	5.4	4.9	5.0	5.1	5.2	5.4	5.4
Interest payments	0.1	0.2	0.3	0.5	0.4	0.6	0.8	0.9	0.8	0.9
Domestic	0.1	0.2	0.2	…	0.3	0.4	0.5	0.5	0.5	0.5
Foreign	0.0	0.0	0.1	…	0.1	0.2	0.3	0.4	0.3	0.3
Support (subsidies) [3]	0.8	0.3	0.2	0.5	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits [4]	1.3	1.7	1.9	2.4	2.9	2.8	2.8	2.9	2.9	2.9
Grants	1.3	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Other expenses	4.3	3.2	3.8	3.6	2.8	2.5	2.4	2.3	2.1	2.2
Net acquisition of non-financial assets	8.6	8.6	5.4	7.7	8.0	7.9	8.1	7.9	7.7	7.5
Gross operating balance	-7.3	-8.6	-3.9	-7.3	3.4	6.2	6.1	5.5	4.7	3.9
Net lending (+)/borrowing (-)	**-15.8**	**-17.2**	**-9.3**	**-7.3**	**-4.6**	**-1.7**	**-2.0**	**-2.5**	**-3.0**	**-3.6**
(excl. oil revenue)	-34.0	-31.0	-26.2	-25.7	-26.3	-23.4	-23.1	-23.0	-22.8	-22.8

Sources: Ministry of Finance; and IMF staff projections.

[1] Including the extra month salary according to Hijri calendar in 2016

[2] Reallocation of SAR 70 bn in 2014 and SAR 44 bn in 2015 from purchases of goods and services to capital expenditures, reflecting the capital expenditures on Mecca and Medina expansion projects.

[3] Includes subsidies for social and sports clubs, private education, private hospitals, and other agricultural subsidies.

[4] Zakat charity transfers, social welfare payments and Hafiz Job-seekers allowance.

Table 2. Saudi Arabia: Budgetary Central Government Operations, 2015–23 (concluded)

	2015	2016	2017	Budget 2018	Proj. 2018	2019	2020	2021	2022	2023
					(Billions of Saudi Arabian riyals)					
Net lending (+)/borrowing (-)	**-389**	**-416**	**-238**	**-195**	**-134**	**-51**	**-61**	**-77**	**-97**	**-119**
Financing	**454**	**367**	**224**		**134**	**51**	**61**	**77**	**97**	**119**
Net acquisition of financial assets	-356	-193	-98		-18	0	0	0	-66	-90
Domestic		-193	-98		-18	0	0	0	-66	-90
Deposits at SAMA (+, buildup)	-356	-293	-89		-68	0	0	0	-66	-90
Loans and equity	0	100	-9		50	0	0	0	0	0
Foreign	0	0	0		0	0	0	0	0	0
Net incurrence of liabilities (- = repayment)	98	174	126		117	51	61	77	31	29
Domestic	98	97	58		56	36	68	70	71	71
Banks	39	91	40		28	18	34	35	36	36
Nonbanks	59	6	18		28	18	34	35	36	36
Foreign	0	103	81		64	17	38	33	49	49
Amortization	0	-26	-13		-3	-2	-44	-26	-89	-91
Domestic	0	-26	-13		-3	-2	-44	-5	-72	-20
Foreign	0	0	0		0	0	0	-21	-17	-71
Residual/ Gap (+ve = overfinancing)	**65**	**-49**	**-14**		**0**	**0**	**0**	**0**	**0**	**0**
					(in percent of GDP)					
Net lending (+)/borrowing (-)	**-15.8**	**-17.2**	**-9.3**		**-4.6**	**-1.7**	**-2.0**	**-2.5**	**-3.0**	**-3.6**
Financing	**18.5**	**15.2**	**8.7**		**4.6**	**1.7**	**2.0**	**2.5**	**3.0**	**3.6**
Net acquisition of financial assets	-14.5	-8.0	-3.8		-0.6	0.0	0.0	0.0	-2.1	-2.7
Domestic		-8.0	-3.8		-0.6	0.0	0.0	0.0	-2.1	-2.7
Deposits at SAMA (+, buildup)	-14.5	-12.1	-3.5		-2.3	0.0	0.0	0.0	-2.1	-2.7
Loans and equity	0.0	4.1	-0.3		1.7	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities (- = repayment)	4.0	7.2	4.9		4.0	1.7	2.0	2.5	1.0	0.9
Domestic	4.0	4.0	2.3		1.9	1.2	2.2	2.2	2.2	2.1
Banks	1.6	3.8	1.6		1.0	0.6	1.1	1.1	1.1	1.1
Nonbanks	2.4	0.2	0.7		1.0	0.6	1.1	1.1	1.1	1.1
Foreign	0.0	4.3	3.1		2.2	0.6	1.2	1.1	1.5	1.5
Amortization	0.0	-1.1	-0.5		-0.1	-0.1	-1.5	-0.8	-2.8	-2.7
Domestic	0.0	-1.1	-0.5		-0.1	-0.1	-1.5	-0.2	-2.3	-0.6
Foreign	0.0	0.0	0.0		0.0	0.0	0.0	-0.7	-0.5	-2.1
Residual/ Gap (+ve = overfinancing)	**2.7**	**-2.0**	**-0.6**		**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:										
Non-oil overall balance	-835	-750	-674		-770	-704	-705	-718	-734	-757
Non-oil primary balance	-885	-821	-722		-800	-736	-737	-747	-759	-777
Non-oil revenue (excl. investment income)/non-oil GDP	6.5	6.1	7.1		11.4	12.5	13.3	13.1	12.9	12.7
Current balance	-178	-207	-100		101	187	187	171	151	129
Non-oil primary balance/non-oil GDP	-50.0	-45.7	-39.7		-41.7	-36.9	-35.3	-34.1	-33.0	-32.1
Government gross domestic debt/GDP	5.8	8.8	10.1		10.7	11.5	12.1	13.9	13.5	14.6
Government external debt	0.0	4.3	7.1		8.5	8.8	9.9	10.1	10.8	9.7
Government gross debt/GDP	5.8	13.1	17.2		19.1	20.3	22.0	24.0	24.2	24.3
Government deposits at SAMA/GDP	41.7	30.2	24.9		19.6	19.1	18.8	18.4	15.8	12.6
Government net financial assets/GDP	35.9	17.1	7.7		0.5	-1.2	-3.2	-5.6	-8.4	-11.7
Government Deposits at SAMA (SAR billions)	1,023	731	641		574	574	574	574	508	418
GDP market prices (SAR billions)	2,454	2,419	2,575		2,925	3,005	3,050	3,124	3,218	3,326
Non-oil GDP (SAR billions)	1,768	1,797	1,819		1,916	1,996	2,087	2,192	2,303	2,420
Average oil export price (million of barrels per day)	50.4	41.5	53.2		70.7	69.5	65.4	62.5	60.5	59.2

Sources: Ministry of Finance; and IMF staff projections.

Table 3. Saudi Arabia: Fiscal Operations of the Budgetary Central Government, AGIs, and Public Investment Fund, 2011–17

(Percent of GDP)

	2011	2012	2013	2014	2015 [1]	2016 [1]	2017 [1]
I. Budgetary central government							
Revenue	44.4	45.2	41.2	36.7	25.0	21.5	24.1
Expenditure	32.8	33.2	35.5	40.2	40.8	38.7	33.4
Overall balance	11.6	11.9	5.6	-3.5	-15.8	-17.2	-9.3
Primary balance	11.9	12.2	5.8	-3.4	-15.7	-17.0	-8.9
II. Autonomous Government Institutions (AGIs)							
Public Pension Agency (PPA)							
Revenue	1.4	3.2	3.3	2.0	1.3	2.9	3.3
Expenditure	1.5	1.6	1.6	1.8	2.2	2.7	2.6
Overall balance	-0.2	1.6	1.6	0.2	-0.9	0.2	0.6
General Organization for Social Insurance (GOSI)							
Revenue	1.0	1.0	1.3	1.7	2.0	2.1	2.4
Expenditure	0.4	0.5	0.7	0.6	0.8	0.9	1.0
Overall balance	0.6	0.5	0.7	1.1	1.2	1.2	1.4
III. Public Investment Fund (PIF)							
Revenue	0.6	0.7	0.7	1.4	....	....	....
Expenditure	0.2	0.1	0.04	0.0	....	....	....
Overall balance	0.4	0.6	0.6	1.4	....	....	....
IV. Total (=I+II+III)							
Overall balance	12.4	14.7	8.6	-0.9	....	....	....
Primary balance	12.7	14.9	8.8	-0.7	....	....	....
Memorandum items: net assets(+)/debt (-)							
i. Central government debt	-5.4	-3.0	-2.1	-1.6	-5.8	-13.1	-17.2
ii. Autonomous government institutions[2]	31.0	30.4	33.6	34.4	37.6	39.2	39.8
Of which: PPA	17.1	17.2	18.6	18.5	19.4	19.1	18.3
Of which: GOSI	13.9	13.2	15.0	15.8	18.2	20.1	21.5
iii. Public Investment Fund	8.3	9.3	9.8	11.0	....	....	....
iv. Total (=i+ ii+iii)	33.9	36.6	41.2	43.8	....	....	....
v. Central government deposits at SAMA	43.0	50.8	53.0	48.6	41.7	30.2	24.9
vi. Net assets (iv + v)	76.9	87.4	94.2	92.4	....	....	....

[1] PIF data is unavailable for 2015-2017 as the accounts have not been completed due to the ongoing move from cash to accruals accounting.

[2] Does not account for future pension liabilities.

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

Table 4. Saudi Arabia: Balance of Payments, 2015–23
(US$ billions)

	2015	2016	2017	Proj. 2018	2019	2020	2021	2022	2023
Current account	-56.7	-23.9	15.2	72.7	70.6	54.6	35.7	21.5	10.8
(Percent of GDP)	-8.7	-3.7	2.2	9.3	8.8	6.7	4.3	2.5	1.2
Trade balance	44.3	55.7	101.7	159.0	151.4	131.9	116.0	104.9	95.2
Exports	203.5	183.6	221.1	285.8	284.0	271.2	263.1	259.4	257.4
Oil exports	153.0	136.2	170.2	229.7	227.6	215.0	206.7	201.7	198.5
Other exports	50.6	47.4	50.8	56.1	56.5	56.1	56.3	57.7	58.9
Imports (f.o.b.)	-159.3	-127.8	-119.3	-126.8	-132.7	-139.3	-147.0	-154.5	-162.2
Services	-73.6	-53.0	-58.8	-60.4	-61.3	-62.3	-63.5	-65.0	-66.6
Transportation	-17.2	-12.0	-11.2	-10.9	-10.5	-10.2	-9.9	-9.6	-9.3
Travel	-9.2	-5.6	-5.3	-5.0	-4.5	-3.6	-2.8	-2.0	-1.0
Other private services	-47.1	-35.5	-42.3	-44.6	-46.4	-48.5	-50.9	-53.5	-56.2
Income	17.3	15.7	11.8	13.3	19.7	24.3	22.8	21.4	22.1
Of which: Investment income[1]	18.0	16.3	12.3	13.8	20.2	24.8	23.3	21.8	22.5
Current transfers	-44.7	-42.3	-39.5	-39.2	-39.1	-39.3	-39.6	-39.8	-39.9
Of which : Workers' remittances	-37.8	-37.0	-35.3	-35.0	-34.9	-35.1	-35.4	-35.6	-35.7
Capital Account	-1.1	-0.9	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-42.9	10.7	-49.8	-39.8	-32.0	-22.5	-25.6	-18.8	-30.4
Direct Investment	2.8	-1.5	-4.2	-4.7	-4.7	-4.7	-4.9	-5.0	-5.0
Abroad	-5.4	-8.9	-5.6	-6.3	-6.4	-6.5	-6.8	-6.9	-7.1
In Saudi economy	8.1	7.5	1.4	1.6	1.7	1.8	1.8	1.9	2.0
Portfolio investments	-10.8	11.4	10.2	7.4	7.7	9.0	-8.0	-4.2	-2.2
Assets	-10.4	-5.4	-10.2	-10.6	-9.8	-9.0	-8.3	-7.7	-7.2
Liabilities	-0.3	16.8	20.4	18.0	17.5	18.0	0.3	3.5	5.0
Other investments	-34.8	0.8	-55.8	-42.6	-35.0	-26.8	-12.7	-9.6	-23.2
Assets	-38.7	-8.2	-59.7	-47.6	-40.0	-31.8	-17.7	-14.6	-12.2
Liabilities	3.9	9.0	3.8	5.0	5.0	5.0	5.0	5.0	-11.0
Net errors and omissions	-15.3	-66.6	-4.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-115.9	-80.6	-39.4	32.9	38.6	32.2	10.1	2.7	-19.6
Financing	115.9	80.6	39.4	-32.9	-38.6	-32.2	-10.1	-2.7	19.6
Change in SAMA's NFA (- increase)		78.3	39.7	-32.9	-38.6	-32.2	-10.1	-2.7	19.6
Memorandum items:									
SAMA's total net foreign assets	608.9	528.6	488.9	521.8	560.3	592.5	602.5	605.2	585.6
(In months of imports)[2]	36.9	32.3	28.4	29.2	30.2	30.5	29.7	28.6	26.6
Net International Investment Position (Percent of GDP)	105.4	92.6	81.3	80.5	87.2	92.6	94.7	94.5	92.6
Non-oil current account/GDP	-32.1	-24.8	-22.6	-20.1	-19.6	-19.7	-20.5	-21.0	-21.2
Oil price projected by future markets (US$/barrel)	50.8	42.8	52.8	70.2	69.0	65.0	62.1	60.1	58.8
Average Saudi oil price (US$/barrel)[3]	50.4	41.5	53.2	70.7	69.5	65.4	62.5	60.5	59.2
Oil production (mbd)	10.2	10.5	10.0	10.1	10.2	10.3	10.3	10.3	10.3
Oil exports (mbd)	8.3	9.0	8.8	8.9	9.0	9.0	9.1	9.1	9.2
Oil exports/total exports	75.2	74.2	77.0	80.4	80.1	79.3	78.6	77.7	77.1
Imports of goods/GDP	24.3	19.8	17.4	16.3	16.6	17.1	17.6	18.0	18.3
GDP (US$ billion)	654.3	644.9	686.7	779.9	801.3	813.3	833.2	858.1	887.0
Government External Debt (US$ billion)	0.0	27.5	49.0	66.0	70.5	80.5	83.8	92.3	86.3
US 6-month LIBOR (Percent)	0.5	1.1	1.5	2.6	3.5	3.9	3.5	3.2	3.2

Sources: Saudi Arabian Monetary Authority, and IMF staff estimates and projections.

[1] Represents the return on NFA of SAMA, AGIs, and private sector.

[2] Imports of goods and services over the next 12 months excluding imports for transit trade.

[3] The average price of all oil exports, including refined products.

Table 5. Saudi Arabia: Monetary Survey, 2015–23

	2015	2016	2017	Proj. 2018	2019	2020	2021	2022	2023
	(Billions of Saudi Arabian riyals)								
Foreign assets (net)	2,509	2,128	1,981	2,094	2,229	2,340	2,367	2,367	2,284
SAMA	2,283	1,982	1,833	1,957	2,101	2,222	2,260	2,270	2,196
Commercial banks	226	146	148	138	128	118	108	98	88
Domestic credit (net)	474	902	1,053	1,175	1,223	1,284	1,378	1,514	1,712
Net claims on government	-937	-552	-387	-293	-276	-265	-232	-167	-51
Claims on government	86	178	254	281	298	309	342	341	367
Government deposits with SAMA	-1,023	-731	-641.4	-573.8	-574.1	-574.2	-574.1	-508.0	-418.1
Claims on state enterprises	39	49	47	47	47	47	47	47	47
Claims on private sector	1,372	1,405	1,394	1,422	1,453	1,502	1,564	1,634	1,716
Money and quasi-money (M3)	1,773	1,787	1,791	1,832	1,884	1,950	2,026	2,111	2,210
Money (M1)	1,145	1,144	1,172	1,183	1,216	1,259	1,308	1,363	1,427
Currency outside banks	169	170	172	174	179	185	193	201	210
Demand deposits	976	974	1,000	1,009	1,037	1,073	1,115	1,162	1,217
Quasi-money	629	643	619	649	668	691	718	748	783
Time and savings deposits	435	492	448	470	483	500	519	541	567
Other quasi-money deposits	194	151	171	180	185	191	199	207	217
Other items (net liabilities)	1,209	1,243	1,244	1,437	1,569	1,674	1,720	1,771	1,786
	(Changes in percent of beginning broad money stock)								
Foreign assets (net)	-21.2	-21.5	-8.2	6.3	7.4	5.9	1.4	0.0	-4.0
Domestic credit (net)	28.8	24.2	8.5	6.8	2.6	3.2	4.8	6.7	9.4
Net claims on government	22.5	21.7	9.2	5.3	0.9	0.6	1.7	3.2	5.5
Claims on government	1.9	5.2	4.3	1.5	0.9	0.6	1.7	0.0	1.2
Government deposits (increase -)	20.6	16.5	5.0	3.8	0.0	0.0	0.0	3.3	4.3
Claims on state enterprises	-0.4	0.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Claims on private sector	6.7	1.9	-0.7	1.6	1.7	2.6	3.2	3.5	3.9
Money and Quasi-money	2.5	1.97	0.2	2.3	2.8	3.5	3.9	4.2	4.7
Other items (net liabilities)	5.0	1.9	0.0	10.8	7.2	5.6	2.3	2.5	0.7
	(Percent changes, unless otherwise indicated)								
Foreign assets (net)	-12.7	-15.2	-6.9	5.7	6.4	5.0	1.2	0.0	-3.5
Domestic credit (net)	-2091.0	90.5	16.7	11.6	4.1	5.0	7.3	9.9	13.0
Net claims on government	-29.3	-41.1	-29.9	-24.3	-5.7	-4.2	-12.3	-28.2	-69.4
Claims on government	62.2	107.1	42.6	10.4	6.1	3.9	10.5	-0.2	7.6
Government deposits at SAMA (increase -)	25.8	28.6	12.2	10.5	-0.1	0.0	0.0	11.5	17.7
Claims on state enterprises	-15.3	26.3	-4.7	0.0	0.0	0.0	0.0	0.0	0.0
Claims on private sector	9.2	2.4	-0.8	2.0	2.2	3.4	4.1	4.5	5.0
Money and quasi-money	2.5	0.8	0.2	2.3	2.8	3.5	3.9	4.2	4.7
Other items (net liabilities)	7.8	2.8	0.0	15.6	9.1	6.7	2.7	3.0	0.8
	(Percent; unless otherwise indicated)								
Memorandum items:									
Specialized Credit Institutions credit (SAR billions)	233.4	239.7	236.9	…	…	…	…	…	…
Ratio of M3-to-GDP	72.3	73.9	69.6	62.7	62.7	63.9	64.8	65.6	66.4
Ratio of Claims on private sector-to-non-oil GDP	77.6	78.2	76.6	74.2	72.8	72.0	71.4	71.0	70.9

Sources: Saudi Arabian Monetary Authority (SAMA); and IMF staff estimates.

Table 6. Saudi Arabia: Financial Soundness Indicators, 2010–17

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017
Banking sector								
Structure of the banking sector								
Number of licensed banks	23	23	23	23	23	23	24	25
Number of banks accounting for:								
25 percent of total assets	2	2	2	2	2	2	2	2
75 percent of total assets	6	6	6	6	6	6	6	6
Total assets (percent of GDP)	71.6	61.5	63.0	67.8	75.2	90.0	93.3	89.9
Of which: Foreign currency-denominated (as percent of total assets)	13.6	13.5	12.3	11.1	11.8	14.3	10.0	10.5
Total loans (percent of GDP)	39.2	39.8	36.3	40.1	44.1	55.5	57.9	54.1
Credit to private sector (percent of GDP)	37.6	30.0	34.9	38.6	42.5	53.9	55.9	52.2
Total deposits, excluding interbank (as percent of GDP)	49.9	44.0	45.8	50.2	55.6	65.4	66.9	63.1
Central bank credit to banks (as percent of GDP)	…	…	…	…	…	…	…	…
Capital adequacy								
Regulatory capital to risk-weighted assets	17.6	17.6	18.2	17.9	17.9	18.1	19.5	20.4
Asset quality								
Net loans to total assets	55.1	55.8	58.2	59.8	60.3	62.4	62.8	62.2
Gross NPLs to gross loans	3.0	2.2	1.7	1.3	1.1	1.2	1.4	1.6
Total provisions to gross NPLs	115.7	132.8	145.1	157.4	182.9	164.4	177.0	151.9
Net NPLs to total capital [1]	-2.7	-3.0	-3.7	-3.4	-4.1	-3.7	-4.7	-3.4
Total provisions for loan losses (as percent of total loans)	3.5	3.1	2.8	2.2	2.1	2.2	2.6	2.6
Loans to property and construction sector to total loans	7.2	8.1	7.5	6.8	6.7	7.8	7.5	6.4
Loans to domestic manufacturing sector to total loans	11.6	13.0	12.6	12.5	12.7	12.7	12.6	11.6
Contingent and off-balance sheet accounts to total assets	91.4	96.2	91.7	90.8	100.2	100.8	84.2	76.2
Profitability								
Profits (percent change)	-2.6	18.4	8.4	6.5	12.5	6.3	-5.4	8.2
Average pretax return on assets	2.0	2.1	2.1	2.0	2.0	2.0	1.8	2.0
Return on equity	13.6	15.0	15.1	14.6	14.8	14.4	12.5	12.9
Noninterest expenses to total income [2]	52.7	46.9	47.0	47.7	45.5	37.1	38.0	36.6
Average lending spread	4.3	4.1	3.8	3.7	3.5	3.4	3.5	3.5
Liquidity								
Liquid assets to total assets	24.8	23.7	23.7	21.6	22.3	17.5	20.3	21.6
Liquid assets to short-term liabilities [3]	36.5	37.2	36.4	33.2	33.6	27.3	31.8	34.6
Customer deposits to net loans	135.9	135.9	131.9	129.3	127.7	121.7	119.5	119.4
Demand deposits to total deposits	53.8	58.1	59.8	61.1	62.8	60.8	60.2	61.8
Sensitivity to market risk								
Foreign currency-denominated deposits to total deposits	12.6	12.2	13.0	12.6	10.0	10.0	7.6	8.6
Foreign currency-denominated loans to total loans	13.4	12.4	11.7	10.6	9.9	8.9	8.2	8.0
Foreign currency-denominated contingent and off-balance sheet accounts to total assets	42.2	47.9	41.3	34.6	39.1	35.3	28.3	27.1
Net open foreign currency position to capital	10.2	6.7	1.7	6.4	3.7	4.0	2.6	4.0
Stock market								
Stock market capitalization (percent of GDP)	67.1	50.6	50.9	62.8	63.9	64.4	69.5	65.9
Overall stock market price index (change in percent)	8.2	-3.1	6.0	25.5	-2.4	-17.1	4.3	0.2
Bank stock price index (change in percent)	6.6	-12.7	0.4	22.0	2.5	-14.9	-67.4	8.2

Source: Saudi Arabian Monetary Authority.

[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's Nonfinancial Corporate Sector: Performance and Vulnerabilities[1]

Corporate profits strengthened in 2017, although performance differed across sectors. Vulnerabilities to earnings and interest rate shocks appear manageable.

1. Against the backdrop of a slowly recovering non-oil economy, profits of non-financial companies increased in 2017, although sector performance varied considerably. Profits of 94 listed non-financial firms rose by 12 percent, following a decline of nearly 7 percent in 2016 (Table 1).[2] Profits in the petrochemical sector rose along with revenues, buoyed by stronger sales prices in 2017. The energy and utilities sector saw another large year-on-year rise in profits as it benefited from the higher electricity tariffs which took effect from the beginning of 2016. The multi-investment sector also saw a large year-on-year rise in profits. The construction, cement, and transport sectors recorded lower revenues and profits as government investment remained subdued relative to pre-2014 levels. All-in-all, profits in seven of the thirteen sectors declined.

Nonfinancial Corporate Sector Revenues and Profits, 2015–17

(Billions of U.S. dollars, unless otherwise noted)

		Operating Revenue				Operating Profit/Loss			
Sector	# of firms	2015	2016	2017	2016-17 growth (in percent, y/y)	2015	2016	2017	2016-17 growth (in percent, y/y)
Agriculture & Food Industries	11	12.0	12.4	11.5	-7.6	1.5	1.5	1.2	-15.4
Cement	11	3.8	3.6	2.8	-22.8	1.5	1.2	0.6	-50.6
Construction	10	3.7	3.0	2.7	-11.5	0.5	0.3	0.2	-22.5
Energy & Utilities	2	11.7	14.1	16.1	14.1	0.5	1.8	2.7	50.0
Hotels & Tourism	2	0.1	0.1	0.1	-4.2	0.0	0.0	0.0	-16.8
Industrial Investment	11	5.8	4.9	5.5	11.6	0.5	0.5	0.9	95.6
Media & Publishing	2	0.7	0.7	0.7	3.1	0.0	0.02	0.02	-2.9
Multi-investment	5	1.4	1.5	1.4	-2.9	0.3	0.1	0.3	303.1
Petrochemical Industries	20	60.2	57.6	61.5	6.7	10.2	9.1	10.5	15.8
Real Estate	4	1.1	1.3	1.9	39.1	0.4	0.5	0.5	-1.5
Telecommunications	3	19.5	19.5	18.7	-4.0	3.9	3.2	3.5	10.4
Transport	3	2.6	2.5	2.3	-8.5	0.6	0.6	0.4	-40.2
Wholesale & retail trade	10	6.2	6.2	6.9	10.8	0.5	0.5	0.6	41.6
Total	**94**	**128.8**	**127.5**	**132.0**	**3.5**	**20.5**	**19.1**	**21.5**	**12.4**

Sources: Orbis, and IMF staff estimates.

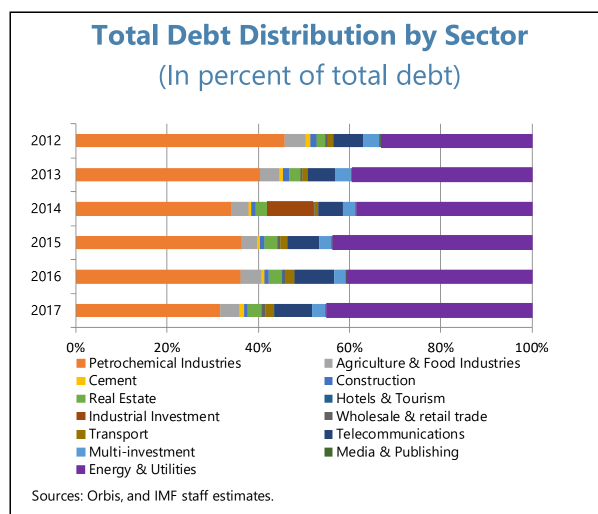
[1] Prepared by Tucker Stone.

[2] The analysis in this appendix is based on data from Orbis at end-May 2018, and covers 94 non-financial public companies with available data for 2012–17. The total revenue of these companies amounted to $132 billion, or about 27 percent of non-oil GDP, in 2017. An important part of the corporate sector in Saudi Arabia is not listed so this sample may not be fully representative of the overall corporate sector.

2. Total debt of the companies in the sample was $158 billion in 2017 (33 percent of non-oil GDP), an increase of 2 percent from 2016. Debt is mostly concentrated in the energy and utilities (41 percent of total) and petrochemical (29 percent of total) sectors (Table 2, Figure 1). The increase in total debt and short-term debt (which increased by 5 percent in 2017) was mainly driven by the Saudi Electricity Company (SEC), the state-owned and largest publicly-listed company by assets. While total debt in the corporate sector grew by $2.8 billion, SEC's debt grew by 13 percent, or by $7.5 billion. The petrochemical sector's total debt fell in 2017 by $5.4 billion, mainly due to a drop in long-term debt. Cash and cash equivalents grew by 21 percent in 2017, recovering from a 19 percent decline in 2016. Short-term debt exceeded cash holdings for the third year in a row in 2017, primarily driven by the energy and utilities and telecommunications sectors. Of the 13 sectors, 7 had more short-term debt than cash on hand at end-2017.

Total Debt Distribution by Sector

(In percent of total debt)



Sources: Orbis, and IMF staff estimates.

Nonfinancial Corporate Sector Debt Profile

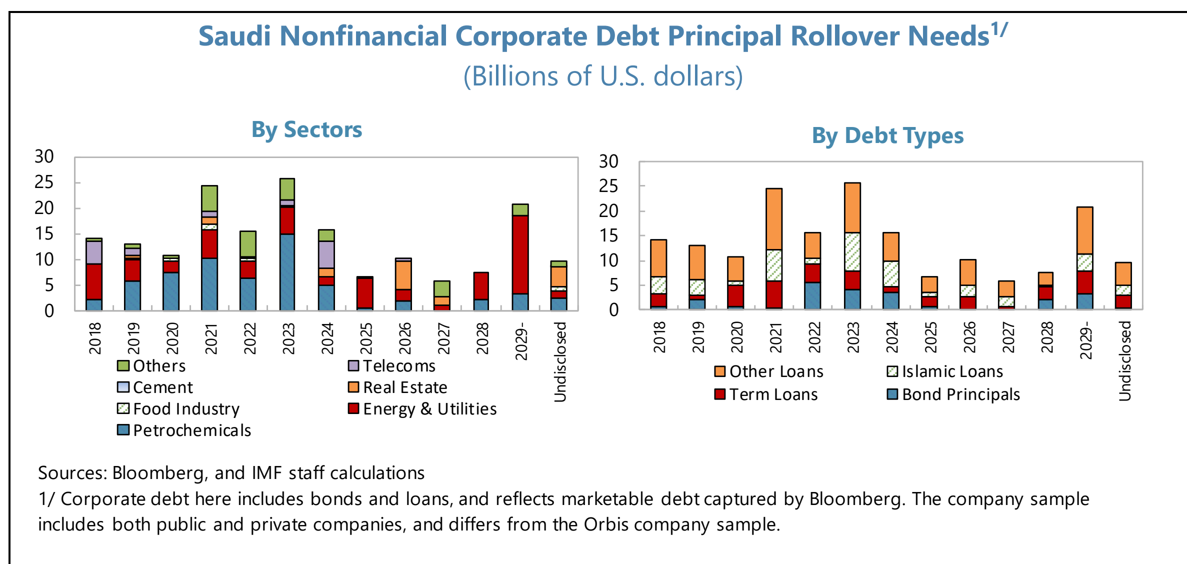
(Billions of U.S. dollars, unless otherwise noted)

Sector	# of firms	Cash & Cash Equivalents 2015	2016	2017	2016-17 growth (in percent, y/y)	Total Debt 2015	2016	2017	2016-17 growth (in percent, y/y)	Short term Debt 2015	2016	2017	2016-17 growth (in percent, y/y)
Agriculture & Food Industries	11	1.2	0.7	0.9	37.0	5.0	6.2	6.2	-0.7	1.2	2.2	2.3	4.6
Cement	11	0.5	0.5	0.4	-6.6	0.9	0.9	1.3	47.6	0.4	0.5	0.5	-1.3
Construction	10	0.3	0.2	0.2	-4.6	1.4	1.2	1.2	-5.3	0.9	0.9	0.9	6.0
Energy & Utilities	2	0.6	0.3	0.3	1.7	63.6	56.2	63.7	13.3	37.7	26.4	29.2	10.7
Hotels & Tourism	2	0.0	0.1	0.0	-18.5	0.1	0.1	0.1	41.0	0.0	0.0	0.0	4.4
Industrial Investment	11	1.6	1.3	1.3	-3.0	14.3	16.3	16.0	-1.5	2.0	2.1	2.1	-3.5
Media & Publishing	2	0.1	0.1	0.1	-24.7	0.4	0.3	0.4	18.2	0.0	0.1	0.1	98.0
Multi-investment	5	1.4	1.5	0.4	-69.4	3.9	3.5	4.2	18.2	0.7	0.3	0.3	1.7
Petrochemical Industries	20	14.2	14.4	19.1	32.6	52.7	50.1	44.7	-10.8	13.0	12.5	12.4	-1.2
Real Estate	4	0.8	0.7	1.3	85.2	4.3	4.2	4.3	2.7	0.4	0.1	0.3	404.1
Telecommunications	3	5.4	1.4	1.3	-10.0	10.2	12.0	11.7	-2.5	4.1	6.2	5.8	-6.6
Transport	3	0.2	0.1	0.3	168.6	2.3	2.6	2.7	4.8	0.2	0.2	0.2	4.4
Wholesale & retail trade	10	0.3	0.4	0.4	-2.3	0.8	1.0	1.0	-2.4	0.5	0.5	0.5	1.6
Total	**94**	**26.8**	**21.7**	**26.1**	**20.5**	**159.8**	**154.8**	**157.6**	**1.8**	**61.1**	**52.0**	**54.6**	**5.1**

Sources: Orbis, and IMF staff estimates.

3. Repayment obligations on outstanding corporate debt are relatively low until 2021.[3] Maturing debt over the next four years is $11–14 billion a year (or between 6 and 8 percent of the outstanding debt stock) and mainly takes the form of loans. Repayments are highest for petrochemical and energy and utilities companies (Figure 2). Repayments are much higher in 2021 and 2023 with nearly a third of total outstanding debt falling due in those two years (28 percent).

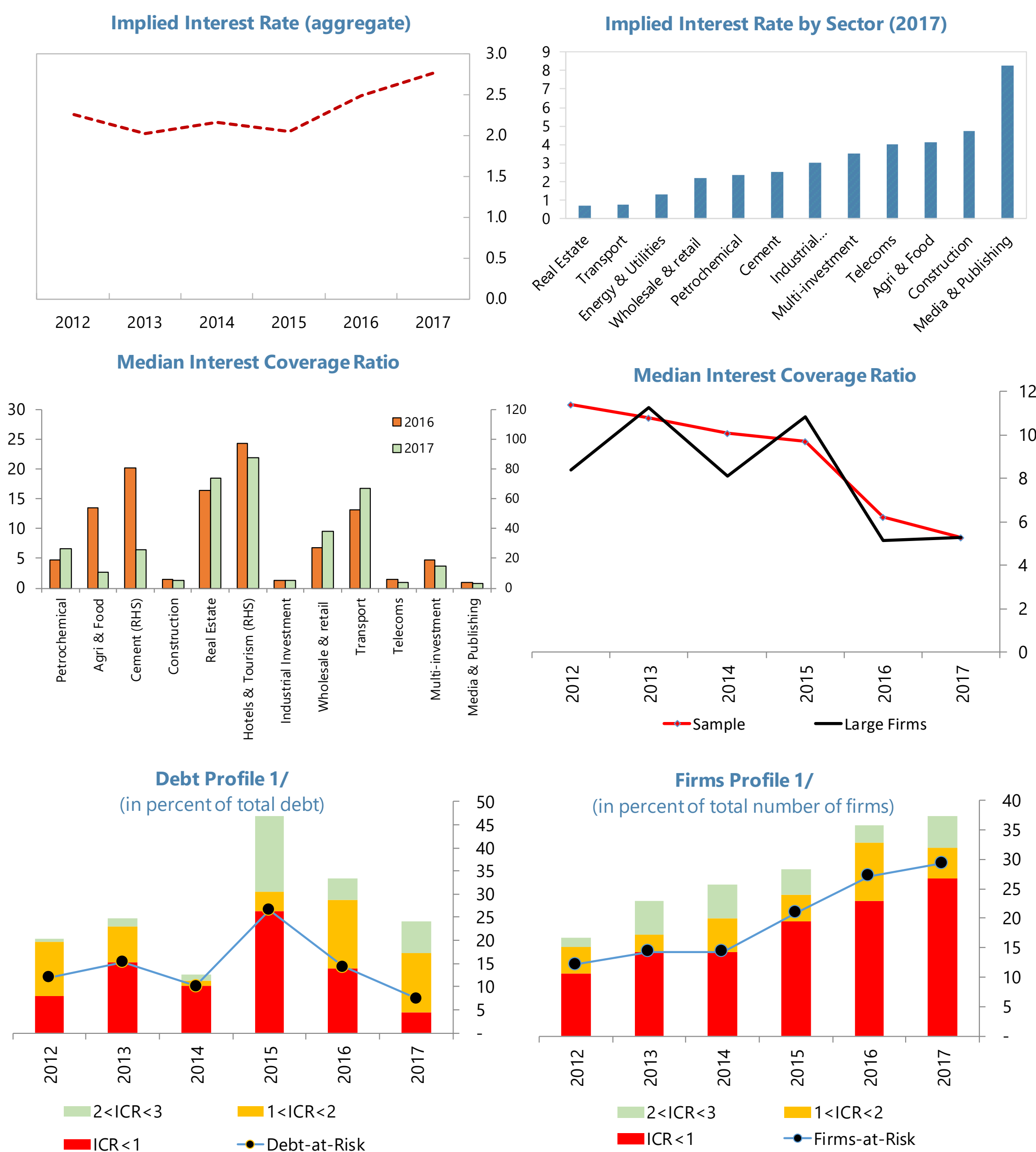
[3] The data on debt repayments is taken from Bloomberg. The sample covers 109 nonfinancial companies with total debt outstanding of $181 billion as of May 2018.



Sources: Bloomberg, and IMF staff calculations
1/ Corporate debt here includes bonds and loans, and reflects marketable debt captured by Bloomberg. The company sample includes both public and private companies, and differs from the Orbis company sample.

4. **The median interest coverage ratio (ICR) declined further in 2017, but is still above 2 in most sectors** (Figure 3). Lower profits and higher interest costs drove the ICR down in some sectors in 2017, particularly in the cement, agriculture and food, and transport. The implied interest rate on corporate debt was around 2.8 percent in 2017, and it has been on an upward trend since 2013 for most sectors. Debt-at-risk (defined as the debt of companies with an ICR less than 1.5) decreased from 14 percent of total debt in 2016 to 7 percent in 2017, but the proportion of firms-at-risk (defined as the percentage of total firms with debt-at-risk) increased slightly from 27 to 29 percent between 2016 and 2017. The decline in total debt at risk reflects the improved performance of a large petrochemical company which had accounted for 50 percent of total debt-at-risk in 2016. In 2017, this company's ICR improved and its debt is no longer considered at risk.

5. **Sensitivity analysis suggests moderate vulnerabilities in the nonfinancial corporate sector to earnings and borrowing cost shocks, although with heterogeneity across sectors**. Three scenarios are used to assess the resiliency of the nonfinancial corporate sector (Table 3; Figure 4). The median ICR drops in all scenarios, but remains above 2 in scenarios 1 and 2 (median ICR is 1.3 in scenario 3). While debt-at-risk increases to 17 percent of total debt in scenario 1, debt-at risk increases to 68 and 76 percent of total debt in scenarios 2 and 3 respectively. Most of this increase which would be in the industrial, telecommunications, and energy sectors. Indeed, industrial companies' debt seems to be the most vulnerable to the shocks as nearly all their debt becomes at risk under all scenarios.



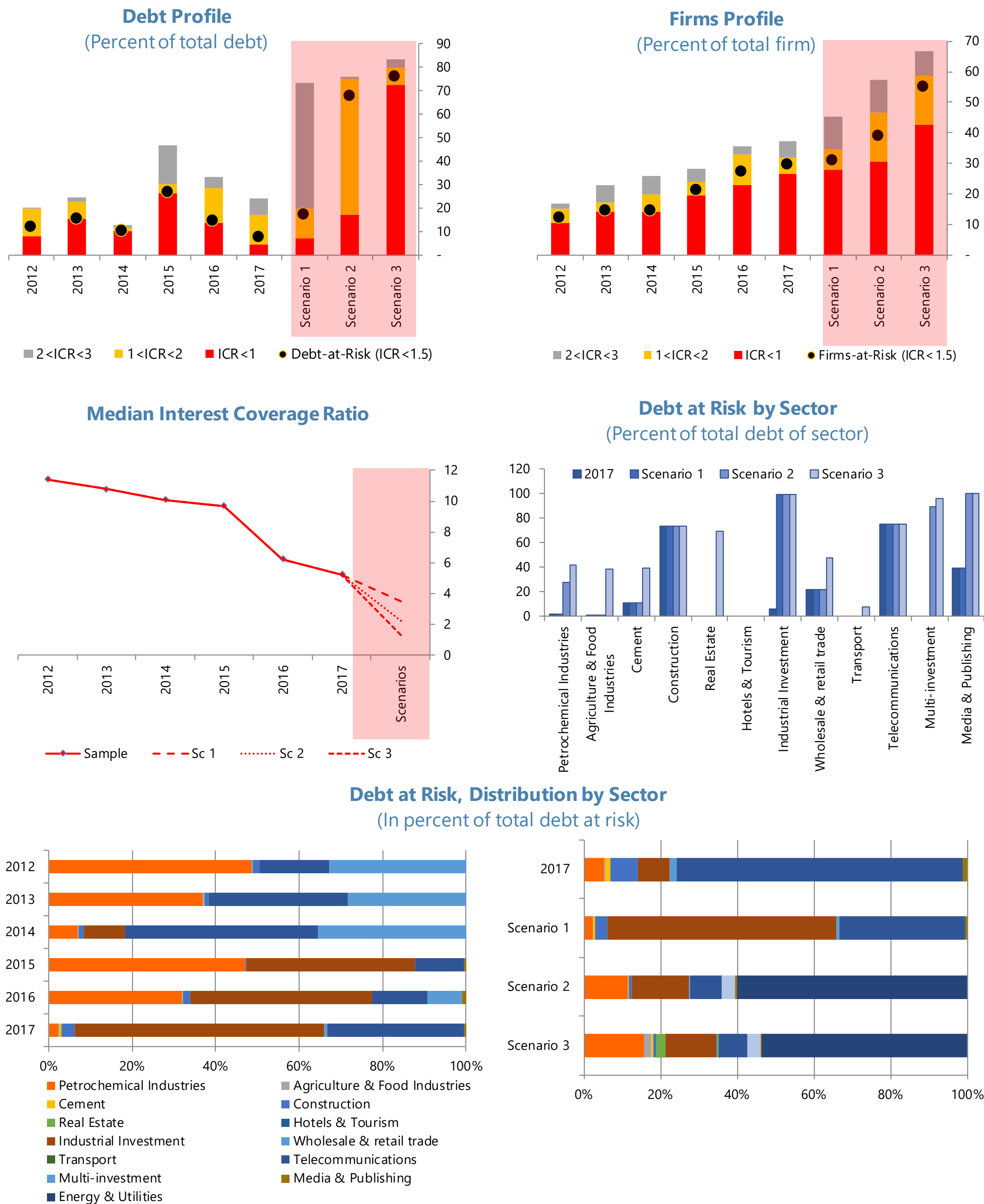
Sources: Orbis; and IMF staff estimates.
1/ Companies with ICR ≥ 3 are not shown.

Scenarios of Earning and Borrowing Cost Shocks

	Operating Income Decrease by (In percent)	Increase in Borrowing Cost (In bps)
Scenario 1	6	70
Scenario 2	20	150
Scenario 3	39	300

Source: IMF staff estimates.

Figure 2. Sensitivity Analysis to Lower Earnings and Higher Borrowing Costs



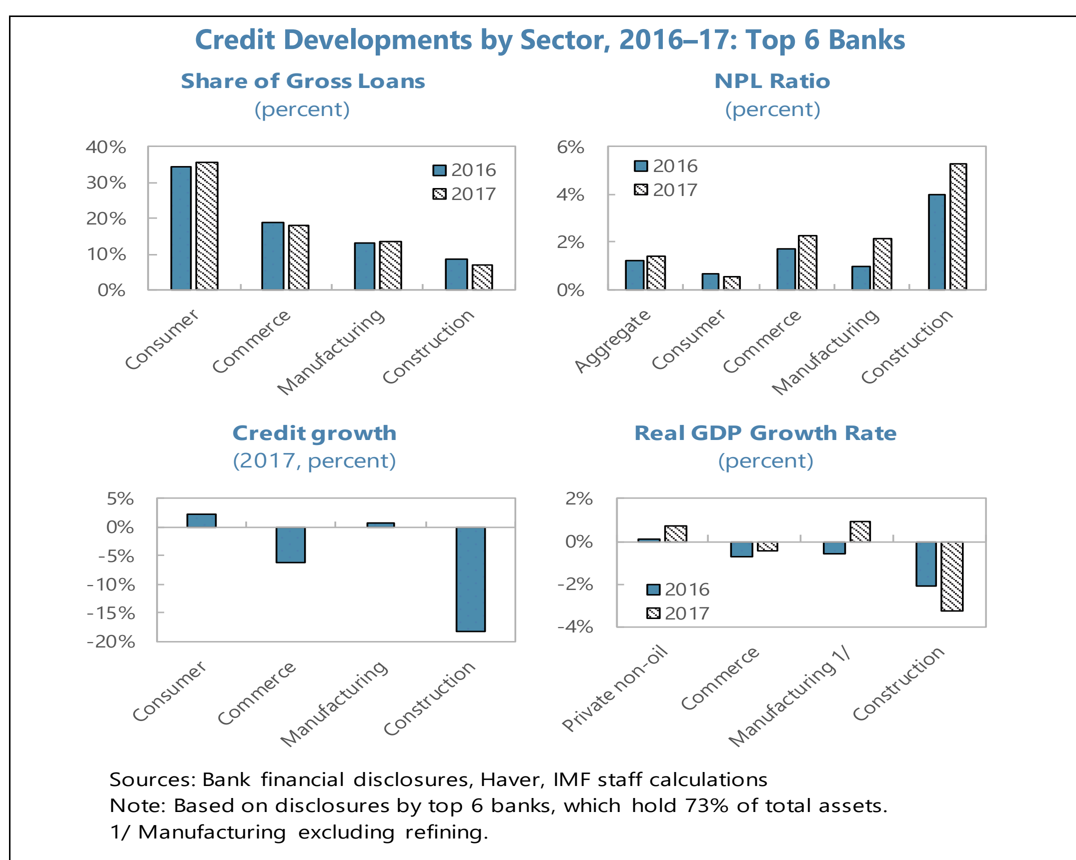
Sources: IMF staff estimates.

Appendix II. The Resilience of Saudi Banks to Asset Quality and Liquidity Stress Scenarios[1]

This Annex updates the scenario analyses of asset quality and liquidity risk conducted in the 2016 Article IV consultation (see IMF, 2016).[2] Banks are well-positioned to absorb any asset quality and/or liquidity shocks.

Credit Developments by Sector

1. **While overall NPLs are low, public disclosures by Saudi banks show considerable variation in NPLs across sectors.** Based on public disclosures by the 6 largest Saudi banks, the overall NPL ratio for these banks remains low (1.4 percent in 2017). However, there is considerable variation across sectors. Consumer loans (mortgage and personal credit), more than a third of total lending, continue to have low NPL ratios. Construction-related loans make up only 7 percent of loans, but NPLs were above 5 percent in 2017 reflecting a decline in construction activity. Construction credit fell by nearly 20 percent in 2017 among these six banks.



[1] Prepared by Divya Kirti.

[2] "The Resilience of Saudi Banks to Lower Asset Quality and Deposit Withdrawals," IMF Country Report No. 16/326. The results should be interpreted with a range of caveats elaborated in this document. This Annex is based on accounting standards as of 2017, and does not account for the introduction of IFRS 9.

Asset Quality Scenarios

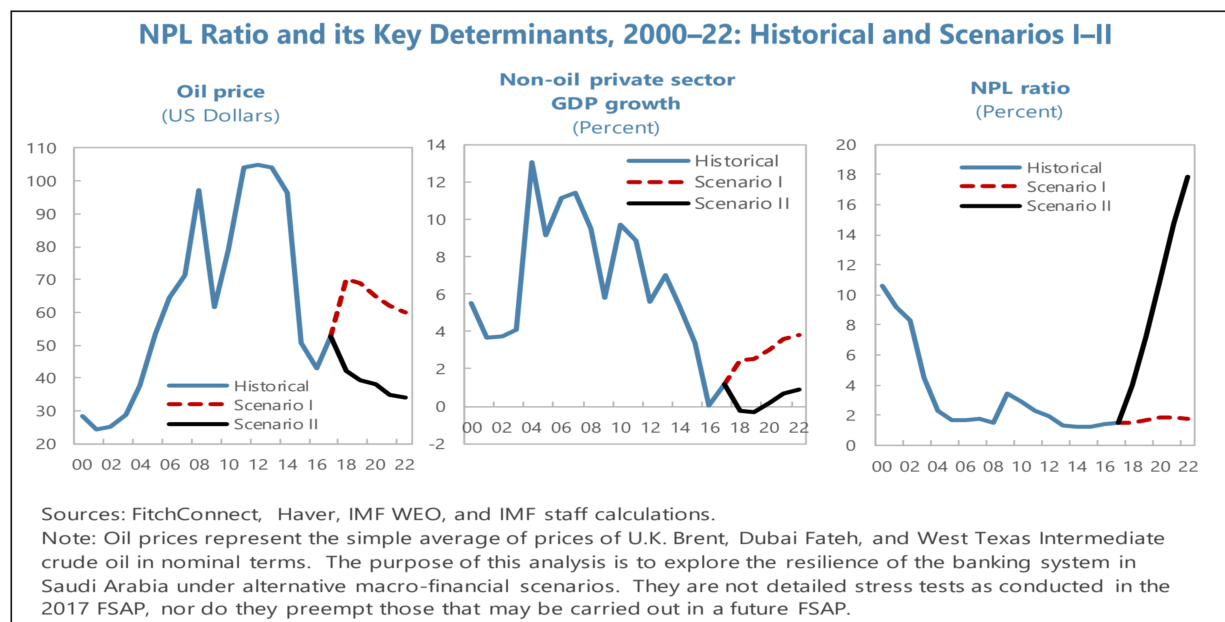
2. An estimated path of bank-level NPLs is constructed for two scenarios. The scenarios are based on the most recent projections of oil prices and non-oil private sector GDP growth, parameter estimates from IMF (2016), and end-2017 bank balance sheet data for the 12 domestic banks.

- In **Scenario I** oil prices rise from $53 a barrel in 2017 to $70 a barrel in 2018, and subsequently fall to $60 a barrel by 2022. Non-oil private sector GDP growth picks up to 2.5 percent in 2018 and 2019, and rises further to 3.8 percent in 2022. Bank profitability moderates and new NPLs are assumed to be provisioned at 120 percent.
- **Scenario II** is constructed to illustrate the macroeconomic developments necessary to reduce the aggregate capital ratio to 12 percent by 2022. In this scenario, oil prices fall from $53 a barrel in 2017 to $42 a barrel in 2018, and fall further to $34 by 2022. Non-oil private sector GDP growth is assumed to be 0.2 percent in 2019, rising to 1.2 percent by 2022. Bank profitability moderates further and banks provision 100 percent of new NPLs.

3. Simulation results suggest that Saudi banks can generally withstand higher NPLs and lower profits under the economic scenarios considered.

- **Scenario I**: The aggregate NPL ratio stands at 1.8 percent in 2022, up from 1.5 percent in 2017 for these 12 banks. The aggregate capital ratio remains above 18 percent. This is despite 120 percent of new NPLs being provisioned, which dents profits but helps maintain provisions at above 140 percent of total NPLs.
- **Scenario II**: To push the aggregate capital ratio down to 12 percent, the NPL ratio would need to rise to nearly 18 percent by 2022. Bank level capital ratios would fall below 12 percent for 7 banks, of which 2 banks would maintain capital ratios above 8 percent. Resources required to bring these banks' capital ratios back to 12 percent would be equivalent to 1.2 percent of GDP.

NPL Ratio and its Key Determinants, 2000–22: Historical and Scenarios I–II



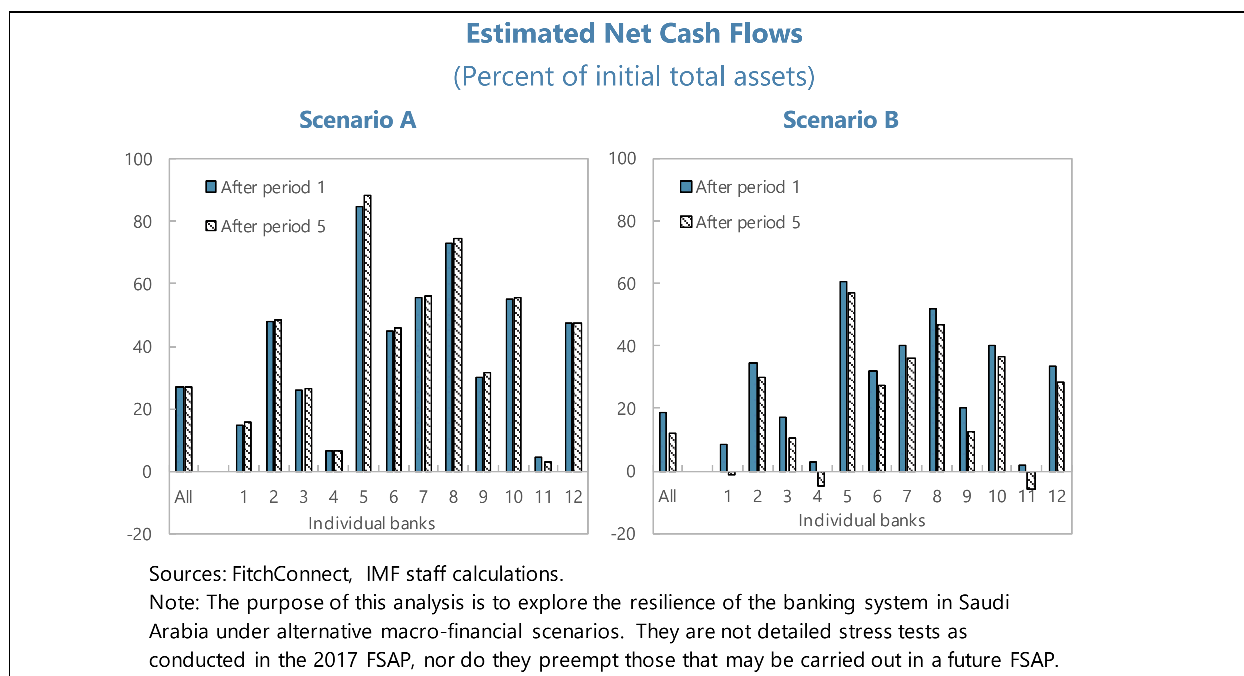
Sources: FitchConnect, Haver, IMF WEO, and IMF staff calculations.
Note: Oil prices represent the simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil in nominal terms. The purpose of this analysis is to explore the resilience of the banking system in Saudi Arabia under alternative macro-financial scenarios. They are not detailed stress tests as conducted in the 2017 FSAP, nor do they preempt those that may be carried out in a future FSAP.

Liquidity Scenarios

4. Net cash flows in the face of deposit outflows are estimated for two scenarios. The extent to which banks can accommodate deposit reductions by selling liquid (and to some extent illiquid) assets within a 30-day window (divided into five periods, six days each) is investigated using end-2017 bank balance sheet data, based on parameter values from IMF (2016).

- In **Scenario A**, demand and time deposits decline by 2 percent and 1 percent per period, respectively, or by an average of 8 percent over the 30-day period. This is higher than the 6 percent monthly decline seen in 1993. 10 percent of liquid assets are encumbered (25 percent of illiquid assets) and 95 percent of the remaining liquid assets are available for sale in each 5-day period (2 percent for illiquid assets), both reducing the capacity of banks to generate cash. Liquid assets are sold with a 1 percent haircut (15 percent for illiquid assets).
- **Scenario B** is characterized by a faster deposit run and tighter market liquidity conditions. Deposits decline by nearly 11 percent during a 30-day window, matching the 11 percent reduction within a week seen in 1990 (when the run was triggered by a military conflict rather than an oil price decline). Smaller shares of assets are available for sale (85 percent for liquid assets and 1 percent for illiquid assets). Banks face higher rates of haircut (5 percent and 30 percent) and encumbrance (20 percent and 50 percent).

Estimated Net Cash Flows
(Percent of initial total assets)



Sources: FitchConnect, IMF staff calculations.
Note: The purpose of this analysis is to explore the resilience of the banking system in Saudi Arabia under alternative macro-financial scenarios. They are not detailed stress tests as conducted in the 2017 FSAP, nor do they preempt those that may be carried out in a future FSAP.

5. The results suggest that the banking sector is resilient to deposit withdrawals, although some liquidity shortfall emerges in Scenario B. In Scenario A, there is no liquidity shortfall either for the aggregate banking sector or for any individual bank. In Scenario B, while the aggregate banking system remains liquid, three banks suffer liquidity shortages of 1-6 percent of initial assets.

Appendix III. Fiscal and External DSAs[1]

Figure 1. Saudi Arabia Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

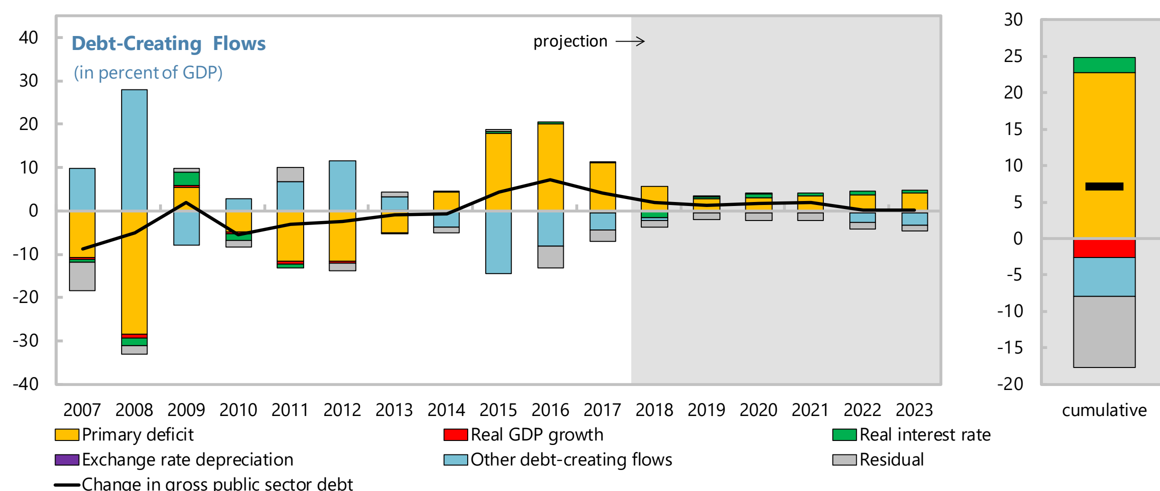
Debt, Economic and Market Indicators[1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	7.7	13.1	17.2	19.1	20.3	22.0	24.0	24.2	24.3
Public gross financing needs	-3.7	18.3	9.8	4.7	1.8	3.4	3.3	5.8	6.3
Real GDP growth (in percent)	4.1	1.7	-0.9	1.9	1.9	2.0	2.1	2.2	2.4
Inflation (GDP deflator, in percent)	3.0	-3.0	7.4	11.4	0.8	-0.5	0.3	0.7	1.0
Nominal GDP growth (in percent)	7.5	-1.4	6.5	13.6	2.7	1.5	2.4	3.0	3.4
Effective interest rate (in percent) [4/]	5.5	3.5	2.8	2.7	3.3	3.8	4.0	3.6	3.6

As of June 02, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		126
5Y CDS (bp)		88
Ratings	Foreign	Local
Moody's	A1	A1
S&Ps	A-	A-
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.2	7.3	4.1	1.9	1.2	1.7	1.9	0.3	0.1	7.1	
Identified debt-creating flows	-1.4	12.5	6.9	3.4	2.8	3.5	3.7	1.9	1.6	16.9	
Primary deficit	-5.0	20.2	11.1	5.6	2.7	3.0	3.4	3.8	4.2	22.8	-2.6
Primary (noninterest) revenue and grants	38.8	18.3	21.9	29.2	30.1	30.2	29.7	29.0	28.4	176.6	
Primary (noninterest) expenditure	33.8	38.5	33.0	34.8	32.8	33.2	33.1	32.8	32.6	199.4	
Automatic debt dynamics [5/]	-0.4	0.3	-0.4	-1.7	0.1	0.5	0.3	0.1	0.1	-0.5	
Interest rate/growth differential [6/]	-0.4	0.3	-0.4	-1.7	0.1	0.5	0.3	0.1	0.1	-0.5	
Of which: real interest rate	-0.1	0.4	-0.6	-1.4	0.5	0.9	0.8	0.7	0.6	2.0	
Of which: real GDP growth	-0.3	-0.1	0.1	-0.3	-0.4	-0.4	-0.5	-0.5	-0.6	-2.6	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	4.0	-8.0	-3.8	-0.6	0.0	0.0	0.0	-2.1	-2.7	-5.3	
Accumulation of deposits	4.0	-12.1	-3.5	-2.3	0.0	0.0	0.0	-2.1	-2.7	-7.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Loans and equity	0.0	4.1	-0.3	1.7	0.0	0.0	0.0	0.0	0.0	1.7	
Residual, including asset changes [8/]	-0.8	-5.2	-2.8	-1.4	-1.7	-1.8	-1.8	-1.6	-1.5	-9.8	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

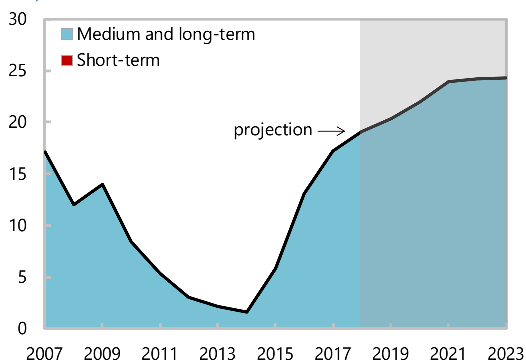
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

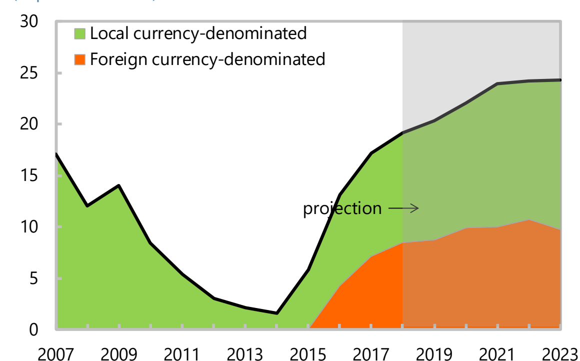
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

[1]Prepared by Nabil Ben Ltaifa and Anta Ndoye.

Figure 2. Saudi Arabia Public DSA – Composition of Public Debt and Alternative Scenarios

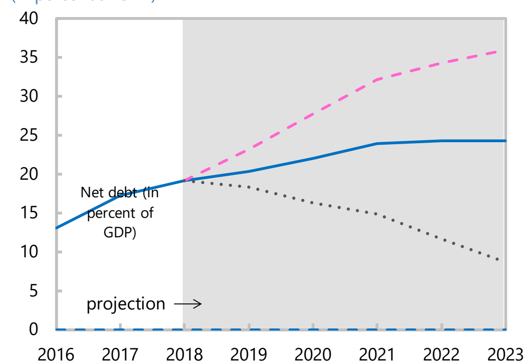
Composition of Public Debt

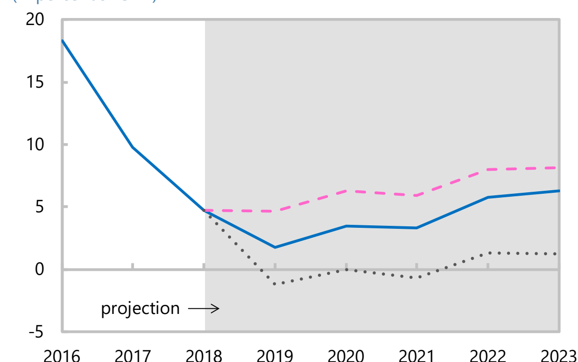




Alternative Scenarios

Baseline   Historical   Constant Primary Balance





Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.9	1.9	2.0	2.1	2.2	2.4
Inflation from GDP defl	11.4	0.8	-0.5	0.3	0.7	1.0
CPI Inflation	3.0	2.0	2.2	2.2	2.1	2.1
Primary Balance	-5.6	-2.7	-3.0	-3.4	-3.8	-4.2
Effective interest rate	2.7	3.3	3.8	4.0	3.6	3.6
Constant Primary Balance Scenario						
Real GDP growth	1.9	1.9	2.0	2.1	2.2	2.4
Inflation from GDP defl	11.4	0.8	-0.5	0.3	0.7	1.0
CPI Inflation	3.0	2.0	2.2	2.2	2.1	2.1
Primary Balance	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6
Effective interest rate	2.7	3.3	4.4	4.6	3.9	3.9

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.9	3.6	3.6	3.6	3.6	3.6
Inflation from GDP defl	11.4	0.8	-0.5	0.3	0.7	1.0
CPI Inflation	3.0	2.0	2.2	2.2	2.1	2.1
Primary Balance	-5.6	0.3	0.3	0.3	0.3	0.3
Effective interest rate	2.7	3.3	3.3	3.3	3.4	3.5

Source: IMF staff.
Note: The constant primary balance scenario assumes all financing needs are met through the issuance of short-term debt and is rolled over in full each year, adding to pressures on gross financing needs.

Table 1. Saudi Arabia: External Debt Sustainability Framework, 2013–23

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	13.7	13.5	12.1	21.0	29.1			**27.2**	**27.7**	**29.1**	**29.4**	**30.2**	**27.3**	**1.5**
Change in external debt	-4.0	-0.2	-1.4	8.9	8.1			-1.9	0.5	1.4	0.3	0.7	-2.9	
Identified external debt-creating flows (4+8+9)	-19.8	-8.2	10.3	5.0	-0.9			-7.1	-6.8	-4.9	-2.7	-1.1	0.0	
Current account deficit, excluding interest payments	-20.2	-10.1	7.5	3.0	-2.6			-9.5	-9.3	-7.4	-4.9	-3.1	-1.8	
Deficit in balance of goods and services	-23.5	-13.0	3.9	-0.4	-6.6			-12.4	-13.2	-10.3	-8.3	-6.8	-5.3	
Exports	57.8	48.2	29.2	26.6	36.5			38.8	37.7	35.7	34.0	32.8	31.6	
Imports	34.3	35.2	33.1	26.2	30.0			26.4	24.5	25.4	25.7	26.0	26.3	
Net non-debt creating capital inflows (negative)	0.6	2.0	0.6	1.7	2.8			2.4	2.2	2.1	1.9	1.8	1.7	
Net foreign direct investment, equity	0.6	0.4	0.4	-0.2	-0.6			-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	
Net portfolio investment,equity	-1.2	-2.4	-1.0	-1.5	-2.1			-1.9	-1.7	-1.6	-1.4	-1.3	-1.2	
Automatic debt dynamics 1/	-0.2	-0.1	2.2	0.4	-1.1			0.0	0.2	0.4	0.3	0.2	0.1	
Denominator: 1+g+r+gr	1.0	1.0	0.9	1.0	1.1			1.1	1.0	1.0	1.0	1.0	1.0	
Contribution from nominal interest rate	0.1	0.1	0.1	0.2	0.2			0.5	0.7	0.9	0.9	0.8	0.8	
Contribution from real GDP growth	-0.5	-0.5	-0.6	-0.2	0.2			-0.5	-0.5	-0.5	-0.6	-0.6	-0.7	
Contribution from price and exchange rate changes 2/	0.2	0.3	2.7	0.4	-1.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	15.8	8.0	-11.7	3.9	9.0			6.6	7.3	6.4	3.0	1.8	-2.9	
External debt-to-exports ratio (in percent)	23.7	27.9	41.5	79.1	79.7			70.2	73.5	81.6	86.5	92.0	86.2	
Gross external financing need (in billions of US dollars) 4/	-85.2	-31.9	111.0	66.5	34.1			-17.5	-13.5	4.4	25.2	41.3	53.9	
in percent of GDP	-12.7	-4.3	14.9	8.8	5.2	10-Year	10-Year	-2.4	-1.8	0.6	3.2	5.1	6.4	
Scenario with key variables at their historical averages 5/								**27.2**	**17.5**	**6.9**	**-7.1**	**-22.1**	**-41.5**	**-1.5**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	2.7	3.7	4.1	1.7	-0.9	3.6	3.5	1.9	1.9	2.0	2.1	2.2	2.4	
Exchange rate appreciation (US dollar value of local currency, change in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GDP deflator (change in domestic currency)	-1.2	-2.3	-16.9	-3.0	7.4	2.3	12.6	11.4	0.8	-0.5	0.3	0.7	1.0	
GDP deflator in US dollars (change in percent)	-1.2	-2.3	-16.9	-3.0	7.4	2.3	12.6	11.4	0.8	-0.5	0.3	0.7	1.0	
Nominal external interest rate (in percent)	0.5	0.5	0.5	1.4	1.1	0.9	0.7	2.0	2.7	3.3	3.1	2.9	2.8	
Growth of exports (US dollar terms, in percent)	-2.9	-8.5	-38.6	-7.9	19.1	3.3	27.8	26.6	-0.2	-3.9	-2.4	-0.8	-0.3	
Growth of imports (US dollar terms, in percent)	6.9	12.6	-4.5	-19.9	-1.0	3.7	12.1	5.2	3.8	4.0	4.6	4.4	4.3	
Current account balance, excluding interest payments	20.2	10.1	-7.5	-3.0	2.6	15.3	11.2	9.5	9.3	7.4	4.9	3.1	1.8	
Net non-debt creating capital inflows	-0.6	-2.0	-0.6	-1.7	-2.8	1.7	2.8	-2.4	-2.2	-2.1	-1.9	-1.8	-1.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

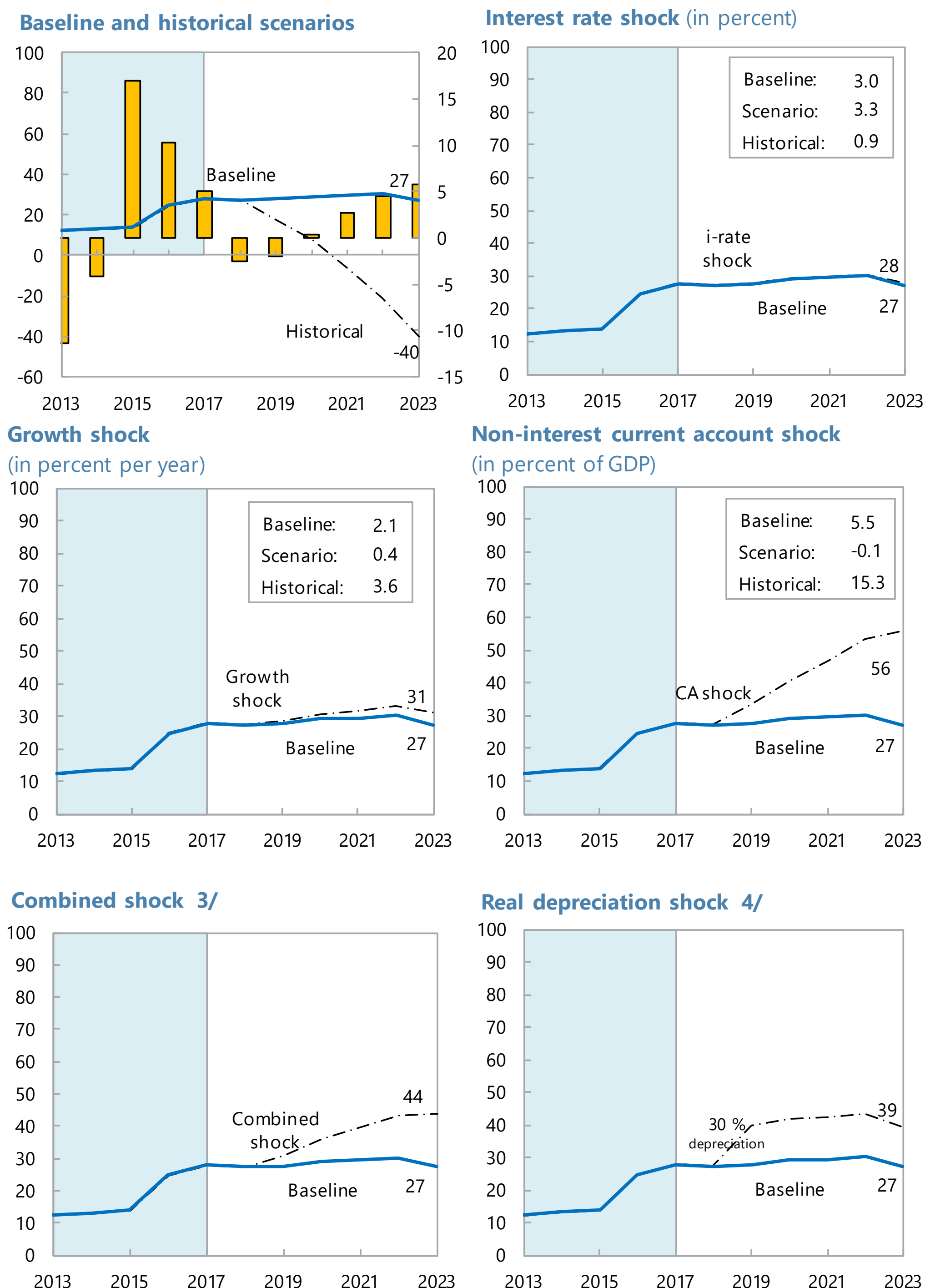
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 3. Saudi Arabia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Appendix IV. Energy Price Reform and the Citizens' Accounts[1]

Energy price reforms are continuing and will be an important source of fiscal revenues in the coming years. The new Citizens' Accounts are being used by the government to compensate for the impact of the higher energy prices and the non-oil revenue reforms on household welfare. These accounts are working well, and average compensation levels appear adequate to cover the effects on the average household of higher prices. However, staff does not have sufficient information to confirm that the compensation for lower income households is adequate, and this should be confirmed by the authorities.

Fiscal Revenues from the Energy Price Reforms (EPR)

1. **The authorities substantially increased gasoline and electricity prices on January 1st, 2018**. Gasoline prices increased from SAR 0.8 per liter to SAR 2.04 and SAR 1.37 for octane 95 and octane 91, respectively, equivalent to price increases of 127 and 83 percent. According to the price projections at the time of the Article IV mission (May 2018), these price increases effectively eliminated average consumer subsidies on octane 95 gasoline in 2018. Electricity tariffs were increased and the tiers were simplified for residential and commercial consumers (Table 1). The new electricity tariffs are supposed to reflect the average supply cost of electricity, but they still generate high consumer subsidies as electricity producers (mainly Saudi Electricity Company—SEC) receive their fuels at a very subsidized price. Electricity tariff have therefore been increased to the current *subsidized* supply cost of electricity producers.[2]

2. **Other fuel and water prices remain virtually unchanged compared to 2017.** The authorities are planning gradual and differentiated increase schedules to reference prices by 2025. The price of natural gas is expected to start increasing in 2020, but will reach its reference price only very gradually; LPG and kerosene prices should reach their reference price levels in 2019; diesel prices should be incrementally increased starting 2019. Plans for water price reforms have been delayed as metering and billing issues remain to be resolved. The Electricity and Cogeneration Regulatory Authority (ECRA) is supervising an assessment of these issues and will be conducting a study on water supply costs that will help build future water tariff schedules.

3. **Based on the 2018 Budget Statement, Table 2 shows the assumed schedule of price increases to reference prices between 2019 and 2025 used by staff to estimate fiscal revenues from the EPR**. For fuel products, reference prices have three distinct components: (i) the expected 2018 export Free-On-Board (FOB) price; (ii) distributors' margins normalized to 0.375 SAR/liter; and (iii) the 5 percent VAT. Reference prices are projected for the period 2019–23 using the OECD projections for future prices of oil (Figure 1). For electricity, the average reference tariff is set at 0.21 SAR/kWh for residential consumption and 0.24 SAR/kWh for non-residential consumption, following the Electricity and Cogeneration Regulatory Authority's

[1] Prepared by Delphine Prady.

[2] Furthermore, new electricity tariff schedules generate cross-subsidization of residential users whose consumption falls below 6,000 kWh/month by all other types of consumers who face higher tariffs.

(ECRA) estimates of electricity producers' average supply cost with subsidized input prices. This average reference tariff is unlikely to reflect an efficient supply cost of electricity. Indeed, SEC still benefits from highly subsidized fuel from ARAMCO which are likely to trigger large operational inefficiencies in the production of electricity.

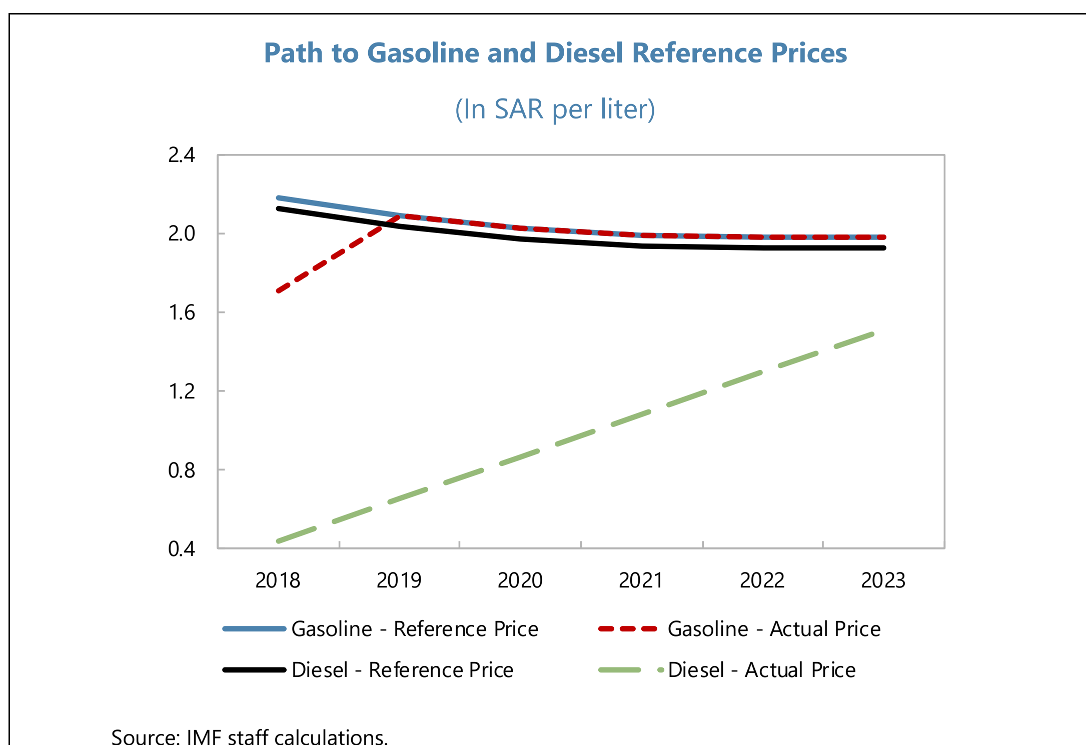
Electricity Tariffs in Saudi Arabia

<table>
<tr><td></td><td></td><td>2017</td><td>2018</td></tr>
<tr><td>Consumer Category</td><td>Consumption Brackets (KWh/Month)</td><td colspan="2">Tariffs (H/KWh)</td></tr>
<tr><td rowspan="5">Residential</td><td>1 -- 2000</td><td>5</td><td rowspan="3">18</td></tr>
<tr><td>2001-4000</td><td>10</td></tr>
<tr><td>4001-6000</td><td>20</td></tr>
<tr><td>6001-8000</td><td>30</td><td rowspan="2">30</td></tr>
<tr><td>More than 8000</td><td>30</td></tr>
<tr><td>Commercial</td><td>1 -- 2000</td><td rowspan="2">16</td><td rowspan="3">20</td></tr>
<tr><td></td><td>2001-4000</td></tr>
<tr><td></td><td>4001-6000</td><td rowspan="2">24</td></tr>
<tr><td></td><td>6001-8000</td><td rowspan="2">30</td></tr>
<tr><td></td><td>More than 8000</td><td>30</td></tr>
<tr><td>Government</td><td>All brackets</td><td>32</td><td>32</td></tr>
<tr><td>Industrial</td><td>All brackets</td><td>18</td><td>18</td></tr>
<tr><td>Agriculture</td><td>1 -- 2000</td><td rowspan="2">10</td><td rowspan="3">16</td></tr>
<tr><td></td><td>2001-4000</td></tr>
<tr><td></td><td>4001-6000</td><td rowspan="2">12</td></tr>
<tr><td></td><td>6001-8000</td><td rowspan="2">20</td></tr>
<tr><td></td><td>More than 8000</td><td>16</td></tr>
<tr><td colspan="2">Source: Electricity and Cogeneration Regulatory Authority</td><td></td><td></td></tr>
</table>

Assumptions on EPR Schedule for 2019 and Onward

	Years to reference price	Number of price increases	Reference price	First price increase	Last price increase
Households					
Gasoline (liter)	2019-19	1	2.1	22%	22%
Non-households					
Gasoline (liter)	2019-19	1	2.1	22%	22%
Diesel (liter)	2019-25	7	1.9	48%	12%
Jet fuel (liter)	2019-20	2	2.0	131%	57%
HFO (liter)	2019-25	7	1.7	250%	16%
Kerosene (liter)	2019-20	2	2.0	106%	51%
Gas (mBTU)	2020-21	2	23.2	168%	63%

Source: IMF staff calculations based on Ministry of Finance 2018 Budget Statement.



Source: IMF staff calculations.

4. **Fiscal revenues from the 2018 electricity and gasoline price increases are estimated to be about SAR 30 billion, with households accounting for almost 80 percent of the total amount** (Table 3). Going forward, fiscal revenues from increasing domestic energy prices to their reference prices are estimated to reach SAR 112 billion by 2023 (these revenues are additional to the revenues already being received from the domestic sale of energy products). Households contribute the most at the beginning of the reform period, while non-households are expected to bear most of the reform's cost starting in 2020 and contribute two thirds of the fiscal savings by 2023 (Figure 2).

Estimated Fiscal Savings

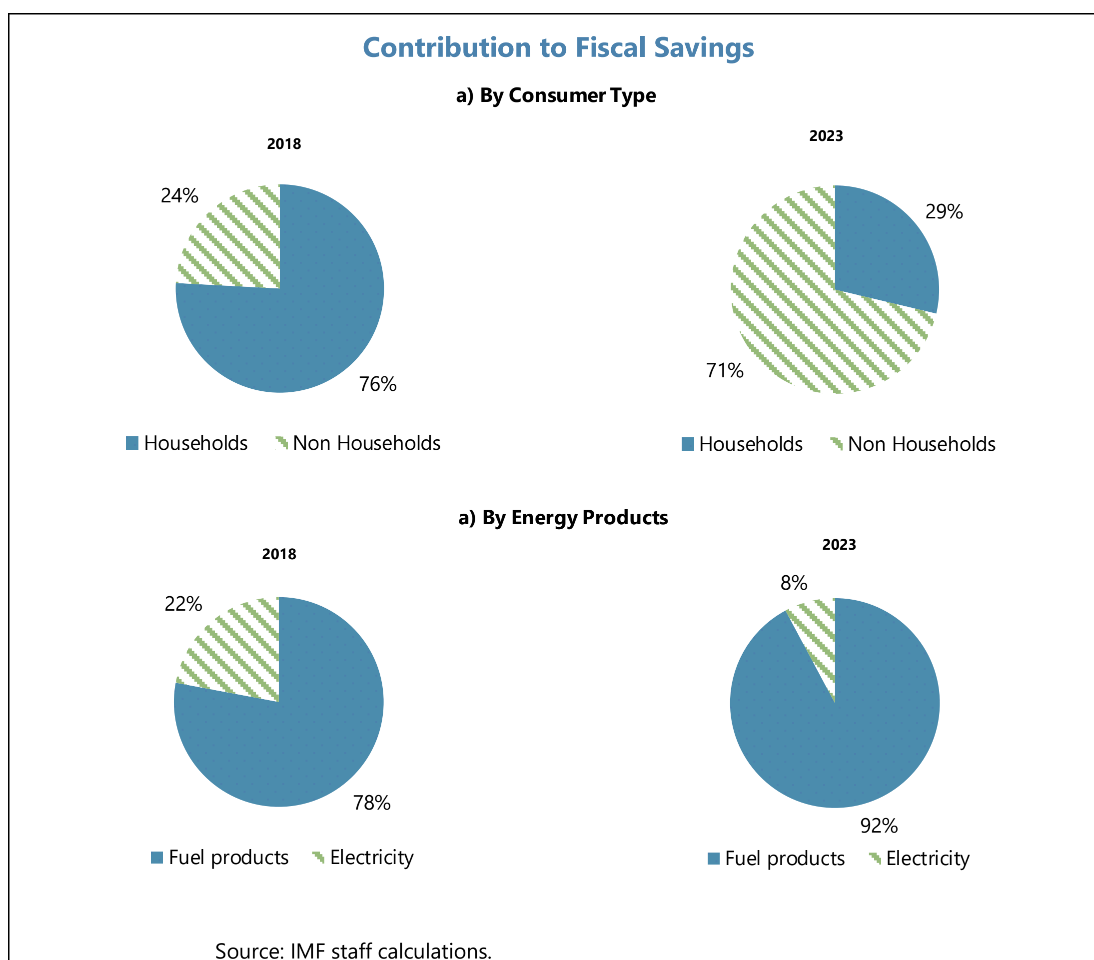
a) By Consumer Types

	2018	**2019**	**2020**	**2021**	**2022**	**2023**
Households	23	31	32	32	33	35
Non Households	7	23	45	61	69	77
Total	**30**	**53**	**76**	**94**	**102**	**112**

b) By Products

	2018	**2019**	**2020**	**2021**	**2022**	**2023**
Fuel products	23	45	68	85	93	102
Electricity	7	8	9	9	9	9
Total	**30**	**53**	**76**	**94**	**102**	**112**

Source: IMF staff calculations.



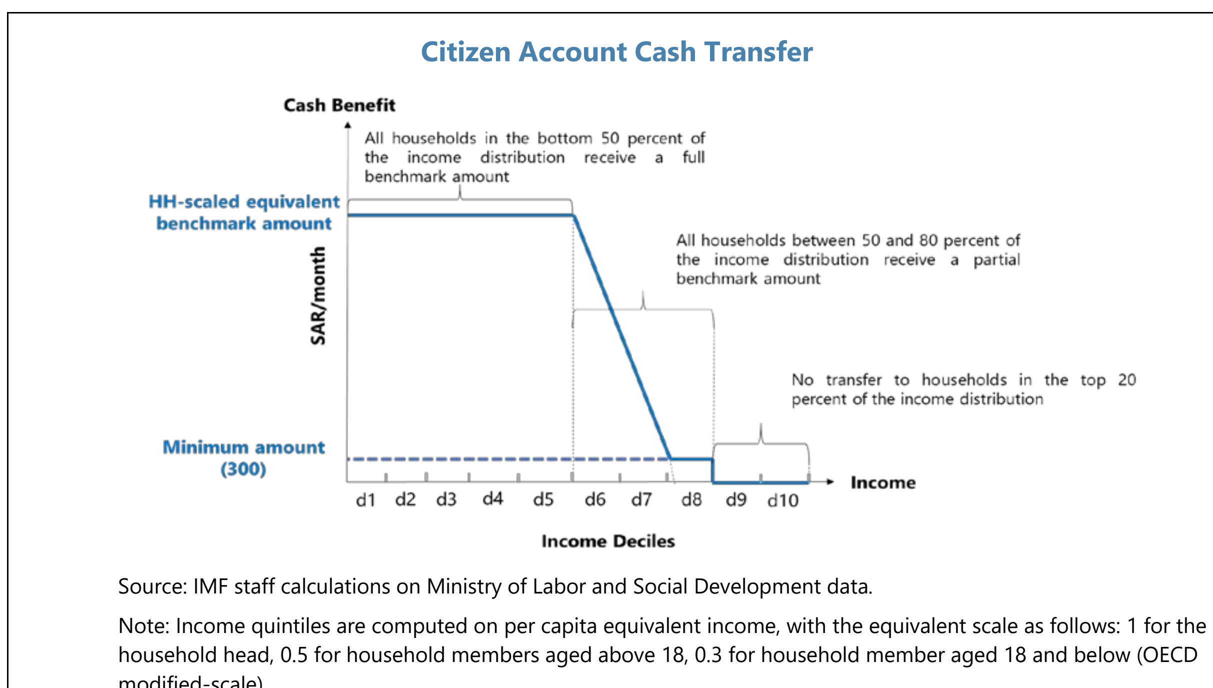
The Citizens' Accounts

5. To mitigate the negative effects of the EPR, the VAT, and the indirect effects of the expatriate levy on household welfare, the authorities have implemented a cash transfer through the Citizens' Accounts (CA). Registration for the CA started in February 2017—household heads filled out an online application form and provided data on their income, household size, residency, and citizenship. Registration is open to all and, between February 2017 and April 2018, 4.4 million households covering 14.6 million people registered for the CA. Upon registration, eligibility is assessed against three criteria: (i) household composition; (ii) residency in the Kingdom; and (iii) Saudi citizenship.[3] Self-declared information on the CA registration form is systematically cross-checked across databases of 17 governmental entities (e.g. social security).

[3] For instance, households of a single individual below a certain age would not be eligible. Certain groups of non-Saudi citizens (e.g., "Bidoun", and Saudi women married to non-Saudi men) are also eligible if they reside in the Kingdom.

6. For eligible households, the monthly cash transfer amount decreases with household income (Figure 3). Households with income in the bottom 5 deciles receive a *full* entitlement, households in deciles 6 to 7 receive a *partial* entitlement, and households in the eighth decile receive the minimum amount of 300 SAR/month. The individual full entitlement amount is SAR 382/month, and the household transfer can be computed as a multiple of this individual amount, given an equivalence scale.[4] For instance, a family of 6 (3 adults aged above 18 and 3 children aged below 18), eligible to a full entitlement, will receive a transfer of 1,108 SAR/month (i.e., 382*2.9). In April 2018, 3.7 million—i.e., 83 percent of all registered—households received a cash transfer, for a fiscal cost of SAR 2.2 bn.[5] Of these, 57 percent received a full compensation that averaged SAR 933/month.

Citizen Account Cash Transfer



Source: IMF staff calculations on Ministry of Labor and Social Development data.

Note: Income quintiles are computed on per capita equivalent income, with the equivalent scale as follows: 1 for the household head, 0.5 for household members aged above 18, 0.3 for household member aged 18 and below (OECD modified-scale)

7. Lacking the data and methodology underlying the calibration of the benchmark compensation level, its adequacy to compensate for actual household welfare loss is difficult to assess. The benchmark compensation level was calibrated on *fair* energy (gasoline and electricity) and food consumption levels of a *representative* household of six members (3 aged above 18 years old, 3 aged below) with two cars and one house. The benchmark compensation has three components:

[4] The equivalence scale used is the OECD-modified one, which assigns a value of 1 to the household head, of 0.5 to each additional adult member (above 18) and of 0.3 to each child (below 18). As data on household assets becomes available through the CA registration form, the authorities plan to modify the benefit formula to account for assets as well.

[5] "No" transfer can therefore mean that either the household is non-eligible, or the household is eligible but belongs to the top income quintile (20 percent richest).

- *Energy component*: (electricity price increase X fair electricity consumption level) + (gasoline price increase X fair gasoline consumption level);

- *VAT component*: VAT rate X fair food basket;

- *Indirect component*: 0.3 X (energy component + VAT component).[6]

Electricity, gasoline, and food *fair* consumption levels are thus the key drivers of the cash benefit received by eligible households. Fair consumption levels for electricity and gasoline were respectively set at 2,890 kWh/month and 498 liters/month for the representative household.

8. Based on the data available to staff, the compensation provided through the citizens' accounts appears adequate to cover the average welfare losses from the increase in energy prices at the beginning of 2018. Detailed information, however, is not available to assess whether the distribution of this compensation across income groups is adequate. In Table 4, the CA compensation level for gasoline, electricity, the introduction of VAT on food products, and indirect inflationary effect from energy price increases (1) is compared to three alternative compensation levels based on average data publicly available on the GASTAT website:

- *Compensation (2)* is based on average electricity and gasoline expenditure shares for Saudi households from the 2013 household survey and adjusted for 2017 expenditure levels. The direct welfare losses from electricity and gasoline price increases and from VAT on food products are computed as:

    - *gasoline budget share X gasoline price increase (%) X average total household expenditure*

    - *electricity budget share X electricity price increase (%) X average total household expenditure*

    - *food budget share X 0.05 (VAT rate of 5 percent) X average total household expenditure.*

- *Compensation (3)* is based on 2017 average per capita electricity and gasoline consumption for Saudis using equivalized compensation. The direct welfare losses from electricity and gasoline price increases to be compensated are computed as:

    - *gasoline per capita consumption X gasoline price increase X 2.9*

    - *electricity per capita consumption X electricity price increase X 2.9.*[7]

[6] This indirect component is designed to compensate for the second-round effects of the energy price reforms and the VAT on consumer prices and any indirect price effects from the expatriate levy.

[7] According to the OECD-modified equivalence scale, the total weight of a representative household of 6 members, 3 aged above 18 and 3 below, is 1+2*0.5+3*0.3=2.9.

- *Compensation (4)* is also based on 2017 average per capita electricity and gasoline consumption for Saudis using non-equivalized compensation. The direct welfare losses from electricity and gasoline price increases to be compensated are computed as:

  - *gasoline per capita consumption X gasoline price increase X 6*
  - *electricity per capita consumption X electricity price increase X 6*, with 6 being the number of household members in a representative household.

Alternative Full Compensation Levels for a Household of 6

	Citizen Account *fair* levels		2013 HH survey average budget shares on 2017 consumption levels	2017 average consumption levels	
	consumption (liter-kWh/month)	(1) compensation (SAR/month)	(2) compensation (SAR/month)	(3) equivalized compensation (SAR/month)	(4) non-equivalized compensation (SAR/month)
Gasoline 1/	498	438	311	221	458
Electricity 2/	2,890	165	128	75	154
Food and Drinks 3/	2,668	133	170	n.a	n.a
Indirect component	-	221	183	n.a	n.a
Total compensation		**957**	**793**	**n.a**	**n.a**

Source: IMF staff calculations.
Note: Compensation amounts are computed for a household of 6 members (3 adults aged above, 3 children aged below 18). The total compensation amount (1) differs from 1,108 SAR/month because of lack of information on the precise benefit formula, notably on the price change accounted for by the Ministry of Labor and Social Development.
1/ Liters per month.
2/ K/wh per month.
3/ SARs per month.

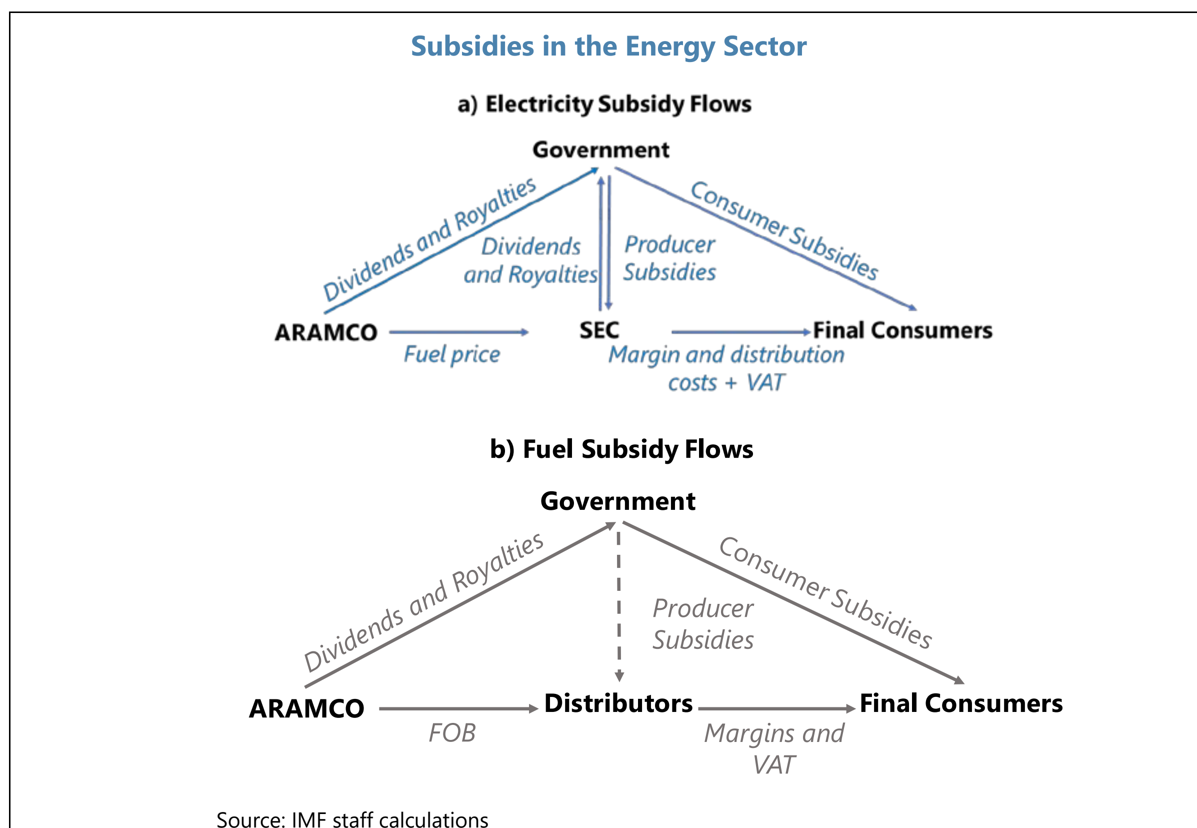
Policy Recommendations

9. **It is paramount to the EPR success that the authorities strike a balance between fiscal revenues and adequate compensation to households through the CA.** In this respect, an assessment of the current transfers with respect to: (i) the adequacy of its amount and coverage of low and middle-income households: and (ii) its progressivity, will help build confidence in the capacity of the CA to be an important redistribution instrument. For instance, electricity users with consumption below 2,000 kWh/month faced a price increase of 260 percent (from 5 halala to 18 halala/kWh – Table 1) and are most likely to belong to low-income households. It is therefore crucial that the authorities confirm that the CA transfer is commensurate to welfare losses at the bottom of the income distribution.

10. **The details of the CA compensation and its adequacy should be made public and broadly communicated through examples**. Failure to do so will undermine the credibility of the CA, particularly as the summer arrives and electricity bills go up, and increase the risks of the authorities adopting other fiscally costly mitigating measures such as the Royal Decree allowances of January 2018.

11. As the authorities plan to introduce regular price updates to remove consumer subsidies, they should increase transparency and explicitly report subsidies given to energy suppliers. Consumer prices of fuel products and electricity should reflect efficient production of energy. However, electricity tariffs reflect production costs that are heavily subsidized through opaque transfers from the government to SEC to help pay for its inputs, its maintenance operations, and investment projects, and through lower fuel prices paid to ARAMCO (Figure 4a). In this respect, the governance of the electricity sector should be clearer, with a stronger role given to a truly independent regulator with the power to set consumer tariffs and audit electricity providers. This would help depoliticize future price increases and give suppliers and consumers the right incentives to behave more efficiently. In the same vein, it is advisable to improve the transparency of the fuel price structure by publishing its various components (ARAMCO supply cost, oil product fee, distributors' margins, VAT), and undertake a fuel market study to determine the appropriate level of fuel distributors' margins (Figure 4b). Transparency and full disclosure of the fuel pricing formula and its regular publication could help educate the public on the factors behind price fluctuations, making the latter more easily acceptable.

Subsidies in the Energy Sector



Source: IMF staff calculations

Appendix V. Progress in Implementing the Key 2017 FSAP Recommendations[1]

Recommendation	Progress Made
Banking Oversight	
Update the Banking Charter and Banking Control Law to delete contradictory and redundant provisions and revoke Article 21 on the power of the Minister of Finance, under exceptional circumstances, to exempt any bank from regulation.	An Internal committee has been established within SAMA to review all laws and regulations and provide recommendations on whether there is a need to amend various articles of the existing laws and regulations.
Codify and publish all bank legislative circulars, and eliminate those superseded.	SAMA publishes recent legislative circulars on its website and is working toward publishing older circulars once these have been reviewed to remove those that have been superseded by later versions.
Strengthen the supervisory approach by refining the determination of banks' risk and control ratings, aligning the supervisory planning with banks' risk profiles, and enhancing the documentation relating to the loan examination process.	The new risk-based banking supervisory framework has been rolled out. A banks' risk rating is now based on a combination of its inherent risk rating and its control rating. The supervisory planning process for on and off-site supervision is now based on a bank's risk profile. In terms of loan examinations, documentation has been enhanced.
Develop a licensing manual for banks and publish guiding principles for bank licensing.	New licensing procedures have been developed and are currently going through internal review and approval processes.
Provide guidance to banks on mapping the risk profiles of Islamic products to the Basel framework.	SAMA has developed guidelines for mapping the risk profile of Islamic products to the Basel framework. This is currently in a consultation process with banks. A detailed section on the risk profile of Islamic Products has been included in the ICAAP documents of all banks based on SAMA's guidance.
Adopt the draft regulation on loan classification and ensure regular, comprehensive reporting on the size of rescheduled and restructured loans.	SAMA has requested Technical Assistance from the IMF.
Require banks to establish formal policies and procedures for loan rescheduling, refinancing, and restructuring and to submit prudential returns on such loans.	SAMA has requested Technical Assistance from the IMF.
Strengthen cross-border cooperation by entering into MoUs with foreign regulators.	As per Saudi legislation, SAMA has submitted a number of MoUs with foreign regulators through the legislative process. Once approved, these MoUs will be signed with the foreign authorities.
Liquidity Management	
Establish a liquidity-forecasting framework to guide money market operations	A liquidity forecasting model has been developed and is being tested.

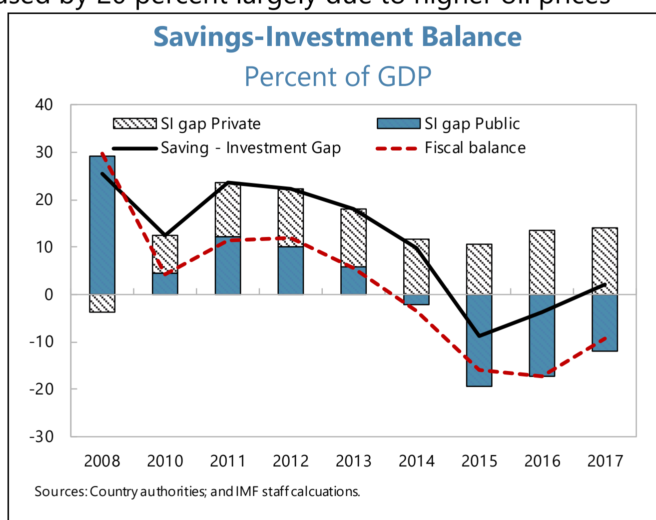
[1] Prepared by Divya Kirti with input from SAMA staff.

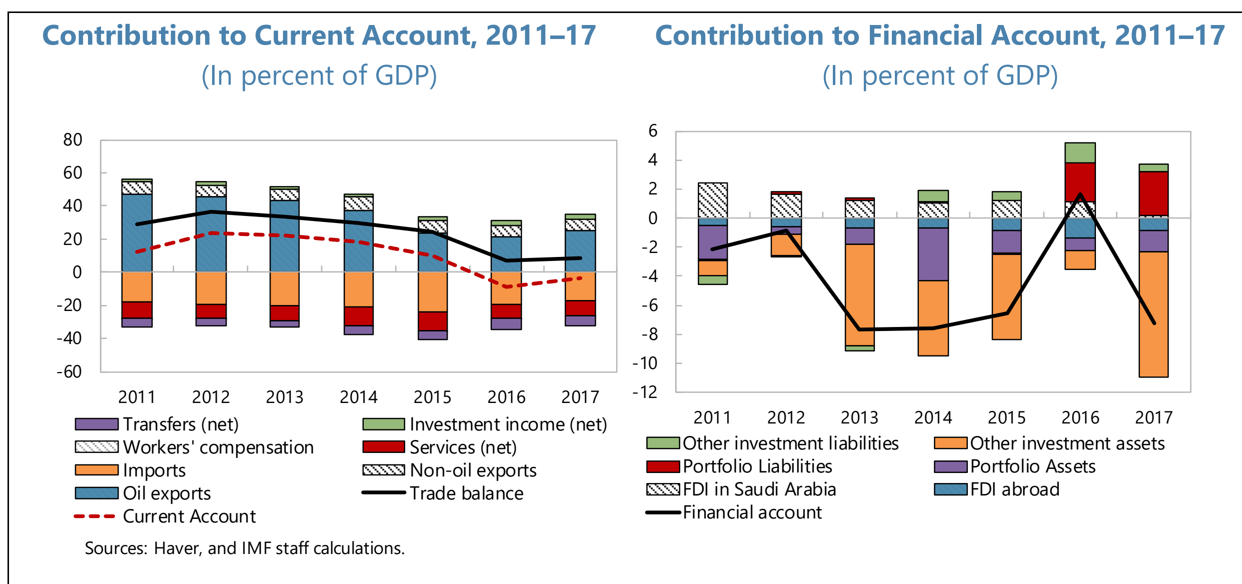
Financial Safety Nets	
Adopt and implement the Draft Resolution Law (DRL).	SAMA and the CMA are coordinating on the draft law.
Establish an Emergency Liquidity Assistance (ELA) framework.	In progress.
Establish a timeframe for DPF deposit payouts and ensure a back-up funding line.	Discussions are ongoing with the World Bank to provide TA.
Macroprudential Policy	
Broaden the definition of debt service to income in the regulations to include all types of debt and income.	This has been addressed in the Responsible Lending Principles where all types of debt and income are factored into the calculation of the Debt Burden Ratio (DBR) for retail products provided by banks and finance companies. The principles have been developed and will be issued soon.
Strengthen data collection and use for the household, corporate, and real estate sectors.	Work is continuing to strengthen such data collection. A quarterly real estate price index is now published.

Appendix VI. External Sustainability Assessment for Saudi Arabia[1]

Staff's assessment is that the external position in 2017 was weaker than the level consistent with desirable medium-term policy settings. Planned fiscal adjustment needs to be successfully implemented over the medium-term to further strengthen the current account and increase saving for future generations.

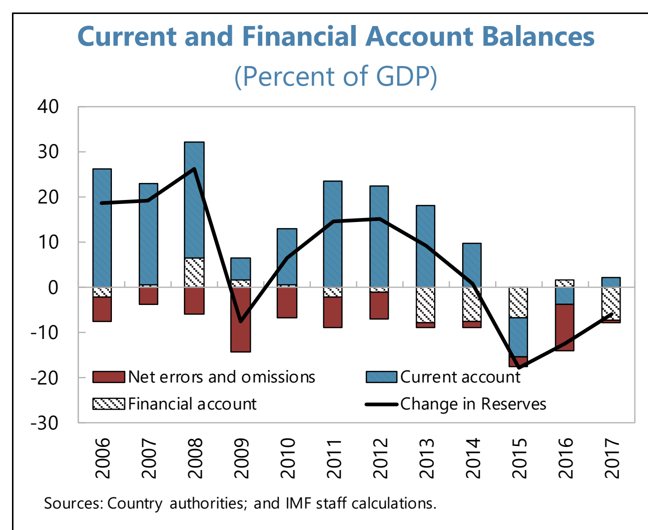
1. **In 2017, the current account (CA) moved into a surplus of 2.2 percent of GDP compared to a deficit of 3.7 percent of GDP in 2016.** Imports of goods fell by 7 percent as the economy contracted in 2017 and exports increased by 20 percent largely due to higher oil prices (import volumes fell by 9.4 percent and export volumes by 1 percent, the latter due to the OPEC+ agreement). The terms of trade improved by 22.2 percent in 2017 as oil prices increased and is projected to improve by a further 29 percent in 2018. The trade balance improved by 6 percent of GDP and the services deficit deteriorated by 1 percent of GDP. The CA balance is projected to improve further to a surplus of 9.3 percent of GDP in 2018 as oil revenues further increase due to higher oil prices in the near term and then to narrow over the medium-term as the oil price decline. The oil price is assumed to be $70.7 in 2018, declining to $59.2 in 2023 ($53.2 in 2017). From a savings-investment perspective, the current account moved into surplus because of the smaller public-sector saving-investment gap and higher private savings.





[1] Prepared by Anta Ndoye.

2. Financial outflows picked up in 2017 while errors and omissions decreased. The government continued to issue debt in international markets while the Public Investment Fund continued to accumulate external assets. Errors and omissions decreased substantially, by almost 10 percent of GDP compared to 2016.



Sources: Country authorities; and IMF staff calculations.

3. Foreign exchange reserves fell further in 2017, but remain high compared to standard Fund coverage metrics. There was a further large drawdown of fx reserves of $40 billion in 2017 (fx reserves fell by $80 billion in 2016). SAMA's net foreign assets stood at $489 billion (71 percent of GDP, 28 months of imports, 102 percent of broad money and 470 percent of the Fund's reserve adequacy metric) at end-2017. The fund's composite metric to measure the adequacy of precautionary reserves (developed for emerging markets) is calculated as a weighted sum of four components reflecting potential sources of pressure on reserves. In the case of Saudi Arabia, exports of goods and services and broad money contribute the most to the ARA metric, while short term external debt and other liabilities represent a much smaller share. The reserve coverage, of 470 percent of the metric in 2017, declining to 434 percent of the metric by 2023, compares to the Fund's recommended range of reserves of 100 to 150 percent. Further adjustment of the ARA metric to take account of the risks to the external accounts from the reliance on oil export revenues by using an oil price that is on average 33 percent lower than in the baseline finds that reserve coverage would still be comfortable at around 272 percent of the metric in 2023.

Foreign Reserve Adequacy Assessment

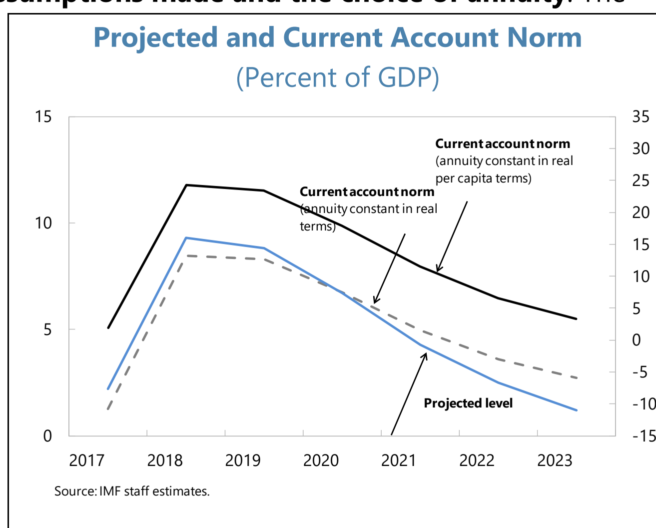
In US$ billion, unless stated otherwise

						Proj.					
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
External short term debt	36	49	37	40	43	45	46	48	49	51	48
Other liabilities (portfolio liabs + other invt liabs - STD) 1/	21	13	44	70	96	117	138	160	164	171	168
Broad Money	412	461	473	477	478	489	502	520	540	563	589
Exports of goods and services	388	355	218	201	240	305	304	292	285	283	282
Actual Foreign Reserves	717	724	609	529	489	522	560	592	603	605	586
ARA metric	95	99	89	94	104	116	122	128	130	134	135
Foreign Reserves as a % of the ARA metric (in percent) 3/	**755**	**732**	**684**	**563**	**470**	**449**	**458**	**464**	**463**	**452**	**434**
Foreign Reserves in percent of GDP	**96.0**	**95.8**	**93.1**	**82.0**	**71.2**	**66.9**	**69.9**	**72.8**	**72.3**	**70.5**	**66.0**
Foreign Reserves in percent of broad money	**174**	**157**	**129**	**111**	**102**	**107**	**112**	**114**	**112**	**108**	**99**
Foreign Reserves in 3 months of imports of goods and services	**11.1**	**11.7**	**12.3**	**10.8**	**9.5**	**9.7**	**10.1**	**10.2**	**9.9**	**9.5**	**8.8**
	114	112	104	93	85	86	90	92	93	92	90
Adjusted ARA metric 2/						157	179	196	206	216	216
Foreign Reserves as a % of the Adjusted ARA metric (in percent) 3/						**332**	**313**	**302**	**293**	**280**	**272**

1/. Based on SPR's calculation of reserves recommended for fixed exchange rate regimes.
2/. The ARA metric is adjusted over the projection period, to include an additional buffer that captures oil export losses from a scenario of low oil prices. See "Guidance Note on the Assessment of Reserve Adequacy and Related Considerations, " June 2016.
3/. As a rule of thumb, reserves within 100-150 percent of the new ARA metric are considered adequate.
Sources. Country authorities and IMF staff estimates.

4. Saudi Arabia has a sizable positive net IIP position despite the substantial drawdown of reserves since 2015. Net IIP was estimated at 81 percent of GDP at end-2017, with external assets at 135 percent of GDP and external liabilities at 54 percent of GDP. External assets are estimated to have declined by 10 percent of GDP during 2017 largely due to a decline in central bank foreign exchange reserves. External liabilities are estimated to have risen by 1.1 percent of GDP in 2017 mainly due to new bond issuance by the government. Projections suggest that the NIIP-to-GDP ratio will increase over the medium-term to around 92.6 percent of GDP in 2023 as the current account remains in surplus. No details are available on the composition of external assets. The average return on assets is estimated at 1.9 percent in 2017 compared to 1.6 percent on liabilities. Nevertheless, while the net IIP position is strong, external savings are not sufficient from an intergenerational equity perspective.

5. The external sustainability approach suggests the current account surplus may be too low, although the result is sensitive to the assumptions made and the choice of annuity. The 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.[2] 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. Import trajectories ("annuities or allocation rules)" are calculated under two different policy scenarios: (i) constant real per capita annuity; and (ii) constant real annuity.[3] These estimated CA norms suggest that the actual (in 2017) and projected current account balances (baseline) are somewhat below the constant real annuity and the constant real per capita annuity. The current account norms under the external sustainability (ES) approach in 2023 are estimated at 5.5 percent of GDP and 2.7 percent of GDP under the constant real per capita annuity and constant real annuity allocation rules respectively (these estimates are subject to considerable uncertainty and sensitive to the parameters assumed, including oil prices). The corresponding current account gaps—i.e. the change in the current account



[2] Proven oil reserves at end of 2016 were 266.6 billion barrels (end of 2017 data is not available). Staff projections assume that the oil production grows at a constant rate (1 percent) due to domestic consumption and, peaks at 11.1 million barrels in 2030 and then decline at a rate of 1 percent, along with consumption and exports. Oil prices increase by 2 percent, the GDP deflator increase by 2.1 percent, and real non-oil GDP grows by 3.2 percent after 2023. Future oil revenues are discounted at 5.5 percent, the assumed rate of return on externally held financial wealth/NFA, while population growth is 0.5 percent.

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

needed over the medium-term to be consistent with the PIH rules by the end of the projection period—are estimated, respectively at -3.3 percent and -0.5 percent of GDP.

6. Estimates based on the EBA-lite methodology suggest that the current account balance is below the norm for 2017. The current account norm for 2017 is estimated at 4.6 percent of GDP compared with an actual current account of 2.2 percent of GDP, producing an estimated current account gap of -2.4 percent of GDP. This gap is primarily driven by current fiscal policy settings (difference between the actual and desired fiscal policy which is assumed to be zero balance in 2023) and has declined relative to last year, as fiscal consolidation continued. The EBA-lite methodology builds on the EBA approach and is applied to a wider group of countries. The EBA-lite approaches provide regression-based estimates of current account and real effective exchange norms and gaps for countries. Norms are the estimated levels of the current account based on underlying fundamentals, while gaps are the deviations of observed values from the norms. An alternative specification which is estimated on a sample of oil-exporting countries and uses a narrower set of control variables compared to EBA-lite (see Behar and Fouejieu, 2017), suggests a current account norm of 3.8 percent of GDP and a current account gap of -1.6 percent of GDP.

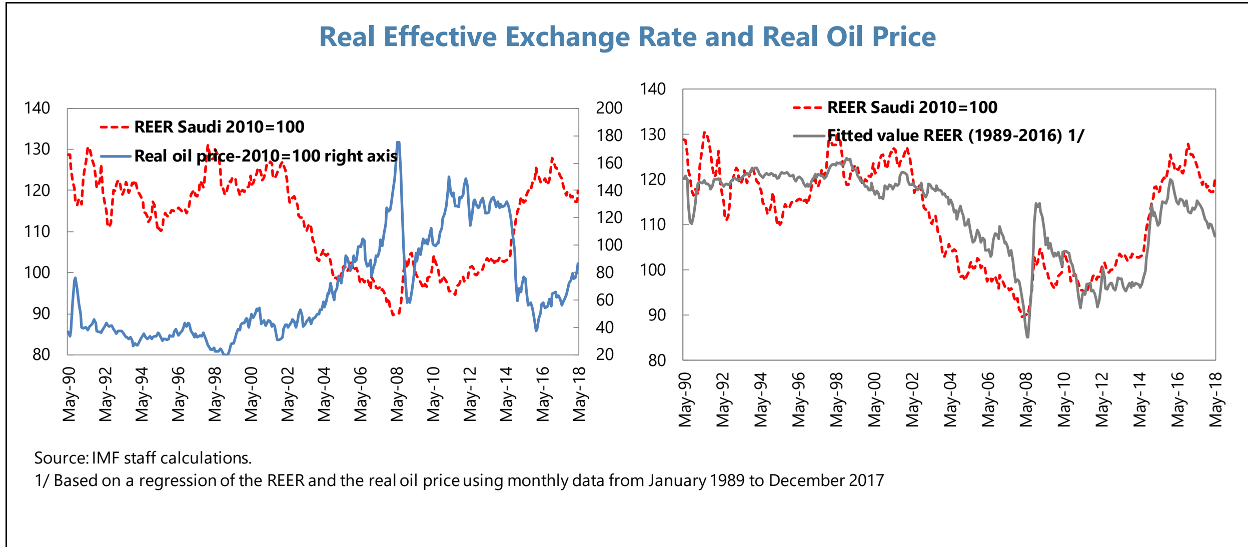
Current and Fiscal Account Actuals and Norms

In percent of GDP	Annuity real per	Annuity real	Average
External sustainability approach			
Current account norm	5.5	2.7	4.1
Actual current account balance	2.2	2.2	
Current account gap	-3.3	-0.5	-1.9
EBA-lite approach coefficient on fiscal balance = 0.527			
Current account norm	4.6		
Current account gap	-2.4		
Policy gap	-3.4		
EBA-oil approach II coefficient on fiscal balance = 0.919			
Current account norm	3.8		
Current account gap	-1.6		
Policy gap	-8.2		

7. The REER depreciated in 2017. The Riyal has been pegged to the U.S. dollar at a rate of 3.75 since 1986. The REER weakened by 2 percent as of end-of May 2018 relative to the 2017 average as the U.S dollar depreciated against other major currencies and on average was 1 percent more depreciated in 2017 compared to 2016. The REER in 2017 was 15 percent above its 10-year average, but this gap declined to 10 percent by year-end. Most exports are oil or oil-related products, and exchange rate movements have a limited impact on competitiveness in the short run. The REER has generally been negatively correlated with oil prices. Staff estimates a REER gap in 2017 in the range of 10–20 percent, but at the lower end of this range by end-2017. As fiscal consolidation proceeds, it would be expected that the REER gap would continue to narrow.

8. The Riyal peg to the U.S. dollar serves Saudi Arabia well. The pegged exchange rate provides Saudi Arabia with a longstanding and credible policy anchor. Given the close link between the fiscal and external balance and the structure of the Saudi Arabian economy, with exports dominated by oil and oil-related products and limited substitutability between imports and domestically produced goods, external adjustment will be driven by fiscal policy rather than the exchange rate.

Real Effective Exchange Rate and Real Oil Price



Source: IMF staff calculations.

1/ Based on a regression of the REER and the real oil price using monthly data from January 1989 to December 2017

	Saudi Arabia
Foreign asset and liability position and trajectory	**Background**. Net external assets were 81 percent of GDP at end-2017.[1/] External assets declined by 10 percent of GDP during 2017 and 17 percent of GDP since their 2015 peak largely due to a decline in central bank FX reserves. External liabilities rose by 1.1 percent of GDP in 2017 mainly because of new government borrowing. Projections suggest the NIIP-to-GDP ratio will increase over the medium-term to around 92.6 percent of GDP in 2023 as the current account remains in surplus. No details are available on the composition of external assets. **Assessment**. The external balance sheet remains very strong. Substantial accumulated assets represent both savings of the exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility.
Current account	**Background**. The current account (CA) deficit moved back into a surplus of 2.2 percent of GDP in 2017 from a deficit of 3.7 percent of GDP in 2016. Imports of goods fell by 7 percent as the economy contracted while exports increased by 20 percent largely due to higher oil prices (import volumes fell by 9 percent while export volumes decrease by 1 percent). The terms of trade improved by 22.2 percent in 2017 and is projected to improve by a further 29 percent in 2018. The trade balance rose to 15 percent of GDP. The CA surplus is expected to increase to 9.3 percent of GDP in 2018 as oil revenues increase further and then to narrow over the medium-term as the oil price declines.[2/] **Assessment**. The reliance on oil subjects the CA to wide swings and complicates the application of standard external assessment methodologies. The estimated CA gap varies with the methodology. The estimated CA gap in 2017 is -2.4 percent of GDP using the macro-balance approach, -1.9 percent of GDP using the external sustainability approach, and -1.6 percent using an alternative specification for oil-exporters.[3/] Staff assesses a CA gap in a range of -1 to -3 percent of GDP in 2017. Planned fiscal adjustment needs to be successfully implemented to further strengthen the current account over the medium-term.

CA Assessment 2017	Actual CA	2.2	Cycl. Adj. CA		EBA CA Norm		EBA CA Gap		Staff Adj.		Staff CA Gap	-2.0

	Saudi Arabia
Real exchange rate	**Background**. The Riyal has been pegged to the U.S. dollar at a rate of 3.75 since 1986. The REER in 2017 was on average 15 percent above its 10-year average, but this gap declined to 10 percent by year-end. Estimates through May 2018 show that the REER has depreciated by 2 percent relative to the 2017 average. **Assessment**. The REER depreciated with the U.S. dollar in 2017, but this trend has reversed in recent months. Exchange rate movements have a limited impact on competitiveness in the short-run as most exports are oil or oil-related products and there is limited substitutability between imports and domestically-produced products, which in turn have significant imported labor and intermediate input content. Staff estimates an average REER gap in 2017 in the range of 10-20 percent, but at the lower end of this range by end-2017. As fiscal consolidation proceeds, it would be expected that the REER gap would narrow as domestic costs and prices are restrained.
Capital and financial accounts: flows and policy measures	**Background**. Recorded net financial outflows increased in 2017. Errors and omissions declined to 0.6 percent of GDP in 2017 compared to 10.3 percent of GDP in 2016. FX reserves continued to fall, but at a slower pace. **Assessment**. Analysis of the financial account is complicated by the large errors and omissions in the balance of payments in some years. The strong reserves position limits immediate risks and vulnerabilities.
FX intervention and reserves level	**Background.** The government is developing a SWF by broadening the mandate of the Public Investment Fund (PIF). Nevertheless, most of the government's foreign assets are still held at the central bank within international reserves. Reserves fell to $489 billion (71 percent of GDP, 28 months of imports, and 470 percent of the IMF's reserve metric) at end-2017, down from $727 billion in 2014. **Assessment**. Reserves play a dual role—savings for both precautionary motives and for future generations. Reserves are more than adequate for precautionary purposes (measured by the Fund's metrics). Nevertheless, continued fiscal adjustment is needed to strengthen the CA and increase savings for future generations.

Overall Assessment

Overall Assessment:

The external position in 2017 was weaker than the level consistent with desirable medium-term fiscal policy settings. Planned fiscal adjustment needs to be successfully implemented to further strengthen the current account and increase saving for future generations.

The pegged exchange rate provides Saudi Arabia with a credible policy anchor. In 2017, the REER depreciated but this trend has reversed in recent months with the strengthening of the U.S. dollar. Given the close link between the fiscal and external balance and the structure of the economy, with exports dominated by oil and oil-related products and limited substitutability between imports and domestically produced goods, external adjustment will be driven primarily by fiscal policy.

The external balance sheet remains very strong. Despite the substantial drawdown since 2015, reserves remain very comfortable when judged against standard Fund metrics, although external savings are not sufficient from an intergenerational equity perspective. Under the government's planned fiscal adjustment, reserves will increase over the medium term.

Potential policy responses:

Continued fiscal consolidation is necessary over the short- and medium-term to strengthen the CA and increase saving for future generations. The authorities planned fiscal adjustment is based on further energy price reforms, non-oil revenue measures, and expenditure restraint. The non-exported oil primary fiscal deficit is expected to narrow substantially over the medium-term and reduce the external gap. Fiscal adjustment should be supported by reforms to strengthen the fiscal framework. Structural reforms that help diversify the economy and boost the non-oil tradeable sector over the medium-term will also support a stronger external position over time.

	Saudi Arabia (concluded)	Overall Assessment
Technical Background Notes	1/ The NIIP may be underestimated given the large errors and omissions in the balance of payments over many years and inconsistencies between the BoP and IIP data. 2/At current oil production, a $1 change in the oil price results in a 0.4 percent of GDP first-round change in the CA balance. The oil price is assumed to be $70.7 in 2018, declining to $59.2 in 2023 ($53.2 in 2017). 3/ EBA models do not include Saudi Arabia. Staff considered three methodologies, including one that incorporates the special intertemporal considerations that are dominant in economies in which exports of non-renewable resources are a very high share of output and exports. Estimated CA norms for the external sustainability (ES) approach were 5.5 percent of GDP and 2.7 percent of GDP for the constant real per capita annuity and constant real annuity allocation rules, respectively. Using the macro-balance approach, the CA norm is estimated at 4.6 percent of GDP under the EBA-lite approach. An alternative specification estimated on a sample of oil-exporting countries and a narrower set of control variables (see Behar and Fouejieu, 2017) suggests a CA norm of 3.8 percent of GDP.	

INTERNATIONAL MONETARY FUND

SAUDI ARABIA

June 28, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Middle East and Central Asia Department
(In consultation with other departments)

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FUND RELATIONS

(As of May 31, 2018)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	9,992.60	100.00
Fund holdings of currency	9,532.88	95.40
Reserve tranche position	459.73	4.60
Lending to the Fund		
New Arrangement to Borrow	588.97	

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	6,682.50	100.00
Holdings	5,644.65	84.47

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to the Fund

(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	4.89	9.87	9.87	9.86	9.87
Total	4.89	9.87	9.87	9.86	9.87

Lending to the Fund and Grants:

Saudi Arabia is a participant of the New Arrangements to Borrow (NAB), whose credit arrangement under the NAB amounts SDR 5.65 billion. The current outstanding amount under the credit arrangement as of May 31, 2018 is SDR 588.97 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, 2013. In October 2012, Saudi Arabia entered into a note purchase agreement with the Fund under the 2012 Borrowing Agreements in the amount of SDR 9.71 billion, to provide a second line of defense after quota and NAB resources. In December 2016, this agreement was renewed under the 2016 Borrowing Agreements, this time with an amount of $15 billion. In March 2001, Saudi Arabia agreed to support the PRG-HIPC Trust with investments totaling SDR 94.4 million. In April 2006, these investments were extended with an additional investment of SDR 38.2 million, to provide SDR 40 million (end-2005 NPV terms) in subsidy resources to support the Exogenous Shocks Facility. Additionally, in April 2005, Saudi Arabia agreed to provide a grant contribution of

US$4 million (equivalent to SDR 2.6 million) to subsidize Emergency Natural Disaster Assistance to low-income countries. In May 2012, Saudi Arabia pledged a new grant contribution of SDR 16.7 million in subsidy resources to the PRGT, which will be disbursed at end-December 2021. In October 2012 and October 2013, Saudi Arabia provided subsidy resources to the PRGT through the transfer of its full share in the distributions of the general reserve attributed to windfall gold sale profits, totaling SDR 71.87 million. Regarding loan resources, the Fund as Trustee of the Poverty Reduction and Growth Trust (PRGT) entered into a borrowing agreement with the Saudi Arabian Monetary Authority (SAMA) in May 2011, by which Saudi Arabia would provide new loan resources of up to SDR 500 million. In February 2018, Saudi Arabia pledged to contribute $2 million (equivalent to SDR 2.8 million) to the Financial Sector Stability Fund, supporting financial sector stability, inclusion, and deepening, focused on low- and lower-middle income countries.

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 and the exchange arrangement is classified as a conventional peg. Prior to that, it was officially pegged to the SDR at the rate of SAR 5.2625=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 SAR 3.7450=$1. Saudi Arabia maintains security-related exchange restrictions pursuant to UN Security Council resolutions 1267 and 1373.

Last Article IV Consultation

Saudi Arabia is on the standard 12-month consultation cycle. The last Article IV consultation was held during April 29-May 11, 2017 in Riyadh. The staff report was considered by the Executive Board on July 17, 2017 and published on October 5, 2017.
(http://www.imf.org/external/pubs/cat/longres.aspx?sk=45312)

Technical Assistance:

STA GDDS Meta Data Development January-February 2008.
G20 Data Gap Initiative, January 2011.
Balance of Payment Statistics, March 2011.
National Accounts Statistics, April 2012.
Balance of Payment Statistics, November 2012.
SDDS Assessment, March 2013.
G20 Data Gap Initiative, May 2014.
Monetary and Financial Statistics, December 2015.
Government Finance Statistics, March-April 2017.
Balance of Payment Statistics, March 2018.
Government Finance Statistics, April-May 2018.

MCM Stress testing, January 2010.
Stress testing, December 2014, and February and June 2015.
Establishing a Debt Management Office, March 2016.
Liquidity Management, March 2017.
Regulatory, Supervisory and Oversight Framework for CCPs and CSDs, January, March, and April 2018.

FAD Options for Indirect Taxation, February–March 2006.
Public Financial Management and Statistics, jointly with STA, September 2006.
Tax Administration, November 2006.
Enhancing Budget Process Reforms January–February 2008.
Budget Institutions and GFSM2001 (with participation of STA), June 2012.
GFSM2001 Training Course, April 2013.
Training workshop on Structural Fiscal Balance Rules as a Guide for Policy, February 2014.
Establishing a Macro-Fiscal Unit, January 2016.
Introduction of VAT and Excises: Key Policy Design Issues, April-May 2016.
Tax Administration (VAT and excises), May and October-November 2016.
Energy Price Reforms, September 2016.
Excise Tax Implementation, January 2017 and February–April 2017.
Policy Support, jointly with MCD/MCM, December 2015, and jointly with MCD, January 2017.
Strengthening the Macro-Fiscal Unit and the Fiscal Framework, May, July, and October 2017, and April 2018.
VAT Implementation, July and November 2017.

FSAP An FSAP mission took place in January 2004.
The FSSA was published on June 5, 2006. The FSSA-update was published on April 18, 2012. (http://www.imf.org/external/pubs/ft/scr/2006/cr06199.pdf)
FSAP-update, April 2011. Detailed Assessment of Observance was published on July 19, 2013. (http://www.imf.org/external/pubs/cat/longres.aspx?sk=40793.0) (http://www.imf.org/external/pubs/cat/longres.aspx?sk=40794.0)
FSAP missions were held in November 2016 and February 2017. The FSSA was published on October 5, 2017. (http://www.imf.org/external/pubs/cat/longres.aspx?sk=45316)

LEG AML/CFT Diagnostic Mission, November 2015.
AML/CFT Threat Analysis Workshop, March 2016.
VAT Policy design, May–June 2016.
AML/CFT, March and September 2016.
AML/CFT, September 2017.

Resident Representative

No resident representative is stationed in Saudi Arabia.

RELATIONS WITH THE WORLD BANK GROUP

(As of May 29, 2018)

World Bank

The World Bank's Technical Cooperation Program (TCP) has been providing policy advice, capacity development, and implementation support to development efforts in Saudi Arabia on a reimbursable basis since 1975.

The Reimbursable Advisory Services (RAS) aim to advise Saudi Arabia in addressing its development challenges of generating productive jobs for a fast-growing population; improving the performance of its education and health systems to meet evolving needs; improving its business climate and investment appeal; enhancing the provision of public services including water, electricity, and transport; and strengthening capacity in national, municipal institutions, and tourism.

Areas of ongoing World Bank advisory work include: strengthening the macro econometric modelling capacity and fiscal policy analysis; assessment of key implementation pillars and assessment of their results in support of Vision 2030; public financial management; business climate and foreign direct investment; small and medium enterprise strategy; urban development; social protection issues; employment policy including a focus on unemployment assistance; enhancing quality and relevance of the education system; health sector efficiency; energy efficiency; electricity sector legislation and policies; advising on developing the understanding of the financial and economic cost/value of water resources in the Kingdom; providing technical assistance on road maintenance and road safety and advisory support to the Public Transport Authority.

International Finance Corporation (IFC)

IFC strategy in Saudi Arabia focuses on: (i) partnering with regional champions to mobilize cross-border investments into the MENA region and other emerging markets; (ii) providing advisory support, especially in the areas of Public Private Partnerships (PPPs), capacity building, and corporate governance; and (iii) supporting selective direct investments in high development impact areas such as access to finance for MSMEs, low-income housing, insurance, education, and climate friendly infrastructure.

IFC Engagements:

Investment Program: As of end of April 2018, IFC's committed portfolio in Saudi Arabia stands around $132 million across the insurance, healthcare, and housing finance sectors. Saudi Arabian investors have also been a key part of IFC's South-South program to promote greater intra and inter-regional investments. Over the last decade, IFC has committed a total of around $2.5 billion with Saudi sponsors for investments in the MENA region, as well as in emerging markets including in Africa and East Asia.

Advisory Services Program: IFC advisory has been actively engaged in the Kingdom on the PPP front, and recently signed a mandate with the Ministry of Health for a project that seeks to increase access to imaging services in underserved remote areas. These engagements build upon the IFC's earlier success with the Medina Airport PPP where IFC helped mobilize over $1 billion, as well as the successes of the Hajj Terminal and a captive desalination project at Jeddah Airport. IFC advisory is also helping increase access to finance for SMEs by providing capacity building and corporate governance support as well as offering trainings for banks on SME financial services, risk management, and mortgage finance. Lastly, IFC advisory is also working with the Saudi Arabian General Investment Authority (SAGIA) to improve the business environment including helping to implement reforms in areas measured by Doing Business, providing quality assurance support for the implementation of certain objectives set forth in the NTP, and capacity building to SAGIA focusing on improved services to investors and investment promotion.

STATISTICAL ISSUES

(As of June 11, 2018)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are: government finance statistics, monetary and financial statistics, and external sector statistics.	
Real sector statistics: **National accounts:** The estimates of annual GDP were rebased to 2010 from the previous base year of 1999. The revised GDP data are more comprehensive in terms of coverage of services, specifically distribution and financial services. The revision resulted in upward revisions to the level of GDP as well as the relative contributions by economic activity to GDP. This rebasing increased the share of the oil GDP in 2013 to 43 percent from 21 percent previously. A quarterly industrial production index was published for the first time in 2016, and the timeliness of publication will be improved this year. **Price statistics:** The CPI has been rebased to 2013 from the previous base year of 2007. The weight reference period for the wholesale price index has recently been updated to 2014. A quarterly real estate price index is now being published. **Labor market statistics:** At present, there is no official time series of data providing a breakdown of employment between the private and public sector. A new classification for economic activity and a new employment series were introduced in 2016Q4. However, data prior to 2016Q4 has not yet been revised to make it consistent with the new series.	
Government finance statistics: The authorities have reclassified the budget in line with *GFSM 2014*. The *GFSM 2014* framework is being used to report and publish fiscal data. However, data only covers the budgetary central government.	
Monetary and financial statistics: The quality of monetary data has improved and information is made available in the Saudi Arabian Monetary Authority (SAMA) Monthly Statistical Bulletin. SAMA reports monetary data for the central bank and deposit money banks to the Fund, which are published in IFS. However, the authorities have not yet adopted the Standardized Report Forms (SRFs) as recommended in the Monetary and Financial Statistics (MFS) Manual and Compilation Guide. Detailed data providing a breakdown of corporate and household deposits and credit-by-sector is not available. Data is also not published on corporate and household balance sheets. SAMA's published balance sheet has a large and growing "other liabilities" item that hinders analysis.	
Financial sector surveillance: SAMA reports quarterly financial soundness indicators (FSIs) to the IMF, which are published on the IMF's FSI website (fsi.imf.org). The reported FSIs comprise all 19 core FSIs and 10 encouraged FSIs for deposit takers.	
External sector statistics: Quarterly IIP data are published although IIP statistics are highly aggregated and the coverage in the capital and financial accounts, particularly for the private sector, needs to be improved. The official data may underestimate the net international investment position of Saudi Arabia, which likely reflects unrecorded private financial outflows on the asset side along with under-recording of debt liabilities. Errors and omissions were reduced to near zero in 2017 through better data coverage of some large government-related institutions. The authorities are continuing to work on strengthening financial account data, where data on FDI flows and other investment flows are weak. There are inconsistencies between the BOP and IIP data.	
II. Data Standards and Quality	
Participant in the General Data Dissemination System (now the enhanced GDDS) since 2008.	No data ROSC is available.

Table of Common Indicators Required for Surveillance
(As of June 27, 2018)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange rates	6/27/2018	6/27/2018	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	4/2018	5/28/2018	M	M	M
Reserve/base money	4/2018	5/28/2018	M	M	M
Broad Money	4/2018	5/28/2018	M	M	M
Central Bank balance sheet	4/2018	5/28/2018	M	M	M
Consolidated balance sheet of the banking system	4/2018	5/28/2018	M	M	M
Interest rates[2]	6/27/2018	6/27/2018	D	D	D
Consumer price index	5/2018	6/27/2018	M	M	M
Revenue, expenditure, balance and composition of financing[3]— central government	Q1 2018	5/7/2018	Q	Q	Q
Stocks of central government and central government-guaranteed debt[4]	Q1 2018	5/7/2018	Q	Q	Q
External current account balance	Q4 2017	3/28/2018	Q	Q	Q
Exports and imports of goods	3/2018	5/31/2018	M	M	M
GDP/GNP	Q4 2017	5/21/2018	Q	Q	Q
Gross external debt (BIS)	Q4 2017		Q	Q	Q
International investment position[5]	Q4 2017	5/28/2018	Q	Q	Q

[1] Any reserve assets that are pledged 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 composition.

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

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