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SAUDI ARABIA

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2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE

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 2014 Article IV consultation with Saudi Arabia, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 11, 2014, following discussions that ended on May 15, 2014, 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 25, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** (PR) summarizing the views of the Executive Board as expressed during its July 11, 2014 discussion of the staff report that concluded the Article IV consultation with Saudi Arabia.

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

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INTERNATIONAL MONETARY FUND

SAUDI ARABIA

June 25, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Saudi Arabia's economy has grown very strongly in recent years, benefitting from high oil prices and output, strong private sector activity, and government spending. It has played a systemic and stabilizing role in the global oil market. The economy has not been affected by the recent global financial market volatility. The Saudi population is young, growing, and increasingly well educated.

Outlook and risks. The near term economic outlook is positive. Oil production is expected to be little changed from 2013, while non-oil growth will be underpinned by strong private sector activity and government spending on large projects in transportation infrastructure and housing. Inflation is expected to remain subdued. The main source of risk is the global oil market.

Macroeconomic policies. Fiscal buffers are strong at present, providing macroeconomic policies with scope to respond to shocks. The current path of fiscal policy would, however, lead to a substantial erosion of these buffers over the medium-term. Fiscal adjustment needs to start to preserve these buffers and increase saving for intergenerational equity purposes. Monetary and macro-prudential policy settings are appropriate at present. Reforms to the macroeconomic policy framework can help strengthen macroeconomic management and create an environment conducive to private investment and job creation.

Managing demographic pressures. A multi-pronged labor market reform program is increasing the employment of nationals in the private sector and improving the functioning of the labor market. An ambitious program to boost the supply of housing is also underway. Energy consumption is high, and price increases are needed to support efforts to increase energy efficiency and develop public transportation networks.

Economic diversification. Creating a more diversified economy is a challenge given Saudi Arabia's vast oil resources. The government is making considerable efforts to lay the groundwork for further diversification by upgrading infrastructure, strengthening education and skills, boosting access to finance for SMEs, and improving the business environment. However, more needs to be done to realign incentives to encourage firms to export and workers to seek jobs in the private sector.

Approved By
Alfred Kammer and Bob Traa

Discussions were held in Riyadh during May 4–15, 2014. The staff team comprised Tim Callen (head), Amgad Hegazy, Padamja Khandelwal, Malika Pant, and Haonan Qu (all MCD) and Pragyan Deb (MCM). Executive Director for Saudi Arabia Mr. Alshathri accompanied the mission. The team met with Minister of Finance Al-Assaf, Minister of Economy and Planning Al-Jasser, Minister of Commerce and Industry Al-Rabiah, Governor of SAMA Al-Mubarak, Chairman of the Capital Markets Authority Al-Sheikh, Secretary General of the Supreme Economic Council Al-Moneef, and other senior officials, as well as representatives of the private sector and academia. Masood Ahmed (MCD) participated in the concluding meetings (May 15).

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CONTEXT

1. **Saudi Arabia's economy has grown very strongly in recent years, and has been one of the best performing in the G-20** (Figure 1). It has benefitted from high oil prices and output, strong private sector activity, and government spending. Rising oil prices and production have resulted in large external and fiscal surpluses, while government debt has declined to 2.7 percent of GDP. Fitch recently upgraded Saudi Arabia's sovereign credit rating to AA. Inflation has been moderate, and human and social development indicators have improved significantly.

2. **As the second largest crude oil exporter and the only producer with significant spare capacity, Saudi Arabia plays a systemic and stabilizing role in the global oil market**. Saudi Arabia has proven oil reserves of 266 billion barrels and a current estimated spare production capacity of 2.7 million barrels a day. With uncertainties about the global oil market outlook stemming from the strength of the global recovery, the path of U.S. oil production, and the extent of supply outages in other countries, the importance of this role will continue.

3. **Domestically, key policy priorities are addressing the jobs and housing needs of the young and rapidly growing population**. Within the labor market, Saudis are primarily employed in the public sector, non-Saudis dominate employment in the private sector, and female labor force participation, while rising, is low. The Saudi labor force has grown by nearly 4¾ percent a year over the past decade and is expected to continue growing rapidly in the coming years. Labor market reforms are being implemented to boost private sector job creation for nationals. In addition, high house prices are making it difficult for younger or less well-off people to enter the housing market, and the government is making large investments to increase the supply of housing, particularly for the less well-off.

4. **Another priority is economic diversification**. Investments in transportation infrastructure, improvements to the business environment, SME financing, the development of industrial clusters around oil and mining, and joint ventures in refining, mining, and banking are all part of this effort.

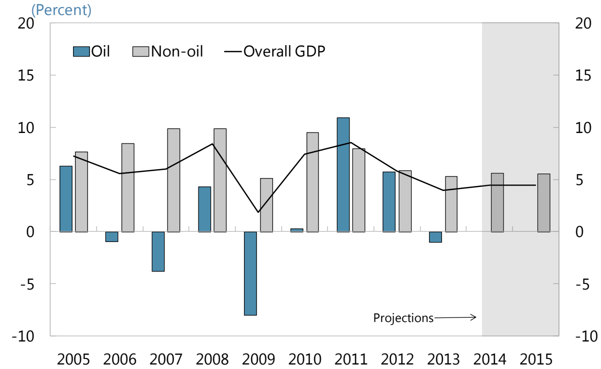
ECONOMIC OUTCOMES, OUTLOOK, AND RISKS

Recent economic developments

5. **Economic activity remained robust in 2013, but slowed relative to the very strong growth seen in 2010–12**. In 2013, real GDP growth slowed to 4 percent from 5.8 percent in 2012 due to a 1 percent decline in oil output and slower growth in public sector GDP (Figure 2). Growth in the non-oil private sector remained strong at 6 percent.

Real GDP Growth, 2005–15

(Percent)



Sources: Country authorities; and IMF staff calculations.

Status of Staff Recommendations Made During the 2013 Article IV Consultation	
Recommendation	**Current Status**
Macroeconomic policies need to remain vigilant for signs of overheating.	Inflation has slowed, although a careful eye needs to be kept on rising equity prices, high levels of liquidity, the fiscal stimulus mainly driven by government investment, and growing domestic absorption.
Fiscal consolidation is needed to strengthen buffers and increase savings for future generations.	Fiscal consolidation has not happened. In 2013, the non-oil primary fiscal deficit (in percent of non-oil GDP) remained unchanged from 2012. With expenditure on goods and services and capital projects expected to grow strongly, the non-oil deficit is expected to increase in 2014.
Strengthen fiscal management and ensure the quality of government spending.	Progress is ongoing. The authorities are in the process of establishing a macro-fiscal unit and work has started on developing multi-year projections and fiscal scenarios to strengthen the analysis of fiscal policy. Improvements in the efficiency of public spending are being targeted through the introduction of qualitative Key Performance Indicators (KPIs) for line ministries in the forthcoming Tenth National Development Plan.
An upward adjustment in energy prices is needed to contain the growth in domestic energy demand	No adjustment in energy prices is currently envisaged. The government is focusing on improving efficiency standards. The development of public transportation networks which is underway is viewed as a prerequisite for any policy action in this area.
Introduce a formal, clear, and transparent macro-prudential framework.	The authorities are reviewing international best practices with respect to macroprudential policy frameworks. However, Early Warning Systems (EWS) have been strengthened and there are plans to publish a Financial Stability Report for the first time.
Policies are needed to increase the competitiveness of Saudi workers in the private sector.	The authorities are continuing to develop their labor market strategy which aims to increase the employment of Saudi nationals in the private sector. The education system is also being strengthened. Despite an increase in private sector hiring of Saudi nationals, the public sector continues to be the dominant source of new jobs for them.
Further improve economic statistics.	FSI data are now reported to the Fund and published on a quarterly basis. Improved coverage of other investment flows has reduced errors and omissions in the balance of payments. Work is well-advanced for the publication of fiscal data in GFSM2001 format. A house price index is being developed by SAMA.
Source: IMF staff.	

6. The unemployment rate of nationals has fallen over the past year. While the overall unemployment rate was broadly unchanged at 5.5 percent at end-2013, the unemployment rate of Saudi nationals fell from 12 percent to 11.5 percent during the year. This was due to a decline in the female unemployment rate from 35.7 percent to 32.1 percent, with the male unemployment rate holding steady at about 6 percent. Although at low levels, female labor force participation rates have risen in recent years, from 12.6 percent at end-2006, to 16.4 percent at end-June 2013.

7. Inflation has eased over the past year. From a high of 4 percent in April 2013, inflation fell to 2.7 percent in May 2014, largely due to lower food price inflation in line with international trends (Figure 3).

8. The growth of bank credit to the private sector has slowed. After reaching a peak of 16.4 percent in May 2013, bank credit growth weakened to 11.8 percent in April 2014. A broader measure of private credit which includes lending by the Specialized Credit Institutions (SCIs) shows a similar trend through end-2013 (latest available data). Real estate lending by banks has grown by around 30 percent over the past year, albeit from a low base, as banks have moved into the mortgage market following the passage of the mortgage law in July 2012.

9. The fiscal surplus declined in 2013 and the fiscal breakeven oil price increased. The overall fiscal surplus fell to 5.8 percent of GDP from 12 percent of GDP in 2012, while the non-oil primary fiscal deficit (as a share of non-oil GDP) remained unchanged at 59.5 percent (Figure 4). Expenditure increased by 8.5 percent in 2013, with a strong pickup in the fourth quarter due to capital spending on the Mecca and Medina expansion projects.[1] Spending on wages and salaries remained flat, although this partly reflected the absence of the thirteenth month wage payment that was made in 2012.[2] Strong expenditure growth has continued in the first quarter of 2014. Assuming that Saudi Arabia's oil export quantities are not affected if oil prices fall, the breakeven oil price—the oil price required to balance the budget—has risen to $89 a barrel in 2013 from $78 a barrel in 2012.

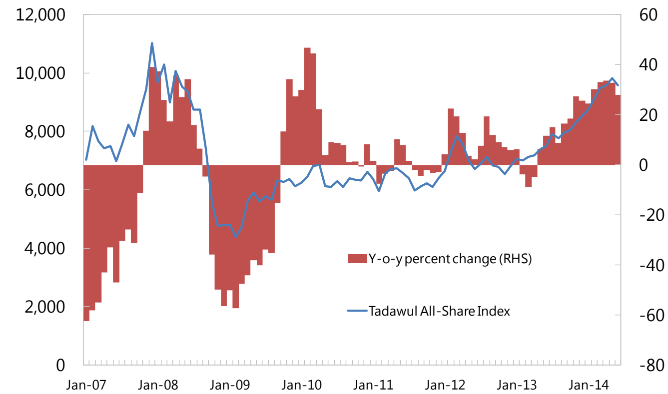
10. The current account surplus declined in 2013, but remained large at around 18 percent of GDP. Oil export receipts decreased slightly as the average oil price fell, while non-oil export growth slowed due to weaker demand for petrochemical products. Remittance outflows increased significantly, by 19 percent, as stronger enforcement of domestic laws resulted in a large number of expatriate workers who were working illegally in the country returning home.

[1] The authorities are in the process of undertaking a significant expansion in the facilities at the two holy cities of Mecca and Medina. This will enable the accommodation of a larger number of pilgrims when completed.

[2] The thirteenth month wage payment results from the difference between the Gregorian and Hijri calendars and occurs every three years.

11. The economy has not been affected by the recent global financial market volatility and equity prices have risen. Financial linkages with the global economy are limited and equity prices have risen by around 30 percent since the middle of last year (Figure 5). The price-earnings ratio has risen from around 15.5 in mid-2013 to 19 at present. While this increase in equity prices could partly be due to catch-up—Saudi Arabia and other GCC equity markets initially underperformed the rest of the emerging markets after the global financial crisis—it may also be a result of an increase in the flow of capital into a relatively shallow equity market.

Saudi Arabia: Equity Market, 2007–14



Source: Haver Analytics.

Outlook

12. The near-term outlook is positive, with growth projected to pick up to 4½ percent in 2014 and 2015. Oil production is expected to be little changed from 2013 as continued strong growth in North American production is sufficient to meet increased global demand. High-frequency indicators such as the HSBC/Markit PMI and the NCB Business Optimism Index (BOI) suggest continued strong growth in the non-oil private sector as large scale infrastructure projects continue to underpin aggregate demand. Non-oil growth is projected at 5½ percent, with private sector growth unchanged from 2013 at 6 percent. Inflation is expected to remain subdued given slowing food price inflation, although strong government spending may put upward pressure on prices of construction materials.

13. Over the medium term, growth is expected to remain robust driven by government spending. Government spending on transportation infrastructure, housing projects, and the Mecca and Medina expansion is expected to support strong non-oil private sector growth of 5¾ percent, broadly in line with staff estimates of potential.[3] While short-term interest rates will rise as the Fed eventually raises its policy rate (given the pegged exchange rate), high levels of banking system liquidity are likely to slow the pass-through to deposit and lending rates, mitigating the impact on the real economy. Inflation is expected to edge up to 3.6 percent by 2017 as food price inflation stabilizes, government spending continues to put pressure on prices, but rents ease as new housing supply comes on the market.

14. The fiscal surplus is expected to decline further this year and the budget is projected to move into deficit in 2015. With expenditure on goods and services and capital projects

[3] See "Productivity Growth and Potential Output in Saudi Arabia," IMF Country Report 13/230.

expected to continue to grow strongly, the fiscal surplus is expected to decline to only 2.5 percent of GDP in 2014, and the non-oil fiscal deficit is likely to increase and exceed the level reached during the large fiscal expansion in 2011. In 2015 and beyond, lower projected oil prices and a slight decline in oil exports are expected to lead to a fall in oil revenues. Public investment is projected to initially rise as a share of GDP until 2016 as the metro, housing, and Mecca and Medina expansion projects pick up pace, and then ease slightly thereafter, but remain at high levels. The wage bill is forecast to grow in line with inflation, and spending on goods and services in line with non-oil GDP. This expenditure path and lower oil revenues lead to an overall fiscal deficit in 2015, which is expected to deteriorate further to almost 7½ percent of GDP by 2019. The non-oil primary fiscal deficit (as a percent of non-oil GDP) declines to 50 percent by 2019.

15. The current account surplus is projected to decline over the medium-term as oil revenues fall and import growth remains robust. From close to 18 percent of GDP in 2013, the current account surplus is projected to narrow to 7 percent of GDP in 2019, while the non-oil current account is in a large deficit. Oil revenues are expected to decline given the assumed fall in oil prices, while government spending is expected to underpin import growth. With large construction projects reliant on expatriate workers, remittance outflows would continue to rise. SAMA's gross foreign assets are projected to decline to 25 months of import coverage by the end of the projection period.

Risks and spillovers

16. Risks to the growth outlook are broadly balanced. On the upside, higher oil prices or production, stronger than expected government spending, or wealth effects from further increases in equity prices could further strengthen growth, while a weaker global oil market or an eventual drop in equity prices if a bubble develops and then bursts are downside risks to the growth outlook.

17. The main channel for the inward and outward transmission of spillovers to/from Saudi Arabia is through the oil market (see the Risk Assessment Matrix). As the only country with substantial spare production capacity, Saudi Arabia has continued to act to balance demand and supply in the global oil market, so it is affected not only through movements in prices, but also export quantities. Financial markets currently indicate a broadly symmetric distribution of risks around a downward trend in the oil price over the next 5 years. If Fed tapering results in heightened financial market volatility and slower global growth, the slowdown in emerging markets deepens relative to the baseline, or major financial disruptions take place in China, demand for oil would fall. A faster-than-expected increase in U.S. oil output or increased output from other countries would likewise put downward pressure on Saudi production and/or oil prices. On the other hand, uncertainties about the situation surrounding Ukraine and unrest in key oil exporting countries including Iraq and Libya mean that negative supply shocks, which would likely see oil prices and Saudi oil production rise, are also possible.

Saudi Arabia. Risk Assessment Matrix[1]		
Nature/source of risk	***Relative Likelihood***	***Expected impact on the economy if risk is realized/ recommended policy response***
Surges in global financial market volatility (related to UMP exit), leading to economic and fiscal stress, and constraints on country policy settings.	**High**	**Medium/Low** Markets have differentiated Saudi Arabia from vulnerable EMs. With the peg to the dollar, short-term interest rates would increase, although the monetary transmission mechanism is weak so pass-through to lending rates and non-oil growth would be limited. Oil prices would fall as global growth slows. Direct financial linkages are relatively modest. Fiscal policy can respond to slowing growth given substantial buffers, while SAMA can provide liquidity to the financial system as needed.
Protracted period of slower growth in advanced and emerging economies.	**High**	**Medium/Low** The most significant channel of impact would be through oil prices. The impact on the banking system would be small given high capital and liquidity ratios. Banks do not rely on wholesale funding and total foreign credit exposure is low. Fiscal policy can respond to slowing growth given substantial buffers, while SAMA can provide liquidity to the financial system as needed.
A sustained decline in oil prices triggered by slower global demand and the coming-on-stream of excess capacity (medium-term).	**Medium**	**High** Slower global growth and increased supply from other countries would likely see a larger decline in oil prices than in the two risk scenarios above. Fiscal and external revenues would fall, as would private sector confidence. The government has fiscal and external buffers to smooth key expenditures in the medium-term, while banks are well-capitalized and liquid. However, the depletion of buffers would entail a more negative impact as fiscal spending would need to adjust, adversely affecting non-oil growth and bank balance sheets.
Growth slowdown in China: (i) continued buildup and eventual unwinding of excess capacity; (ii) significant slowdown of growth in 2014.	**Medium/Low**	**Medium** The most significant channel of impact would be through oil prices and production adjustments given China's central role in driving global oil demand. Fiscal policy can respond to slowing growth given substantial buffers, while SAMA can provide liquidity to the financial system as needed.
Regional geopolitical risks (financial flows, commodity prices, and supply chains).	**Medium** (Russia/Ukraine) **Low** **(**Middle East)	**Low** Oil prices and Saudi production would rise, leading to higher export and fiscal revenues. Effects through financial channels would be limited. Given such a shock would likely be temporary, the government should save the additional revenues. The impact on growth would be limited.
High liquidity drives a bubble in the equity market which then bursts.	**Medium**	**Low** Banks are well-capitalized. Individuals holding equities would be affected and consumption growth would slow due to wealth effects. Policymakers should monitor risks. If equity prices keep rising strongly, consideration should be given first to specific measures to limit lending for equity investments. If ineffective, steps to reduce liquidity including by raising the reserve requirement ratio would be needed.

[1] The Risk Assessment Matrix 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 in 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 of 30 percent or more).

18. Inward spillovers from global financial markets are limited. The Saudi Arabian stock market and the domestic interbank and SAMA bill market were unaffected by tapering discussions and their implementation since 2013. Likewise, January's emerging market turmoil had almost no impact on Saudi financial markets. Spillovers from regional developments seem somewhat larger. This was most clearly seen during the Syrian standoff in late August 2013 when the stock market in Saudi Arabia temporarily fell. Stress tests from the 2011 FSAP update suggest that the direct impact of Fed tapering on the banking system are likely to be small. Indeed, given the structure of their balance sheets, banks will likely benefit from a modest rise in interest rates that does not have a significant impact on non-performing loans (NPLs). While NPLs would rise if growth slowed, the banking system should be able to absorb these losses given the strong capital and liquidity buffers. A larger rise in interest rates may affect banks' balance sheets in the medium term by slowing or even reversing the growth in non-interest bearing deposits.

19. The equity market has risen strongly over the past year, and may continue to rise in the period ahead given the still abundant liquidity in the domestic economy. While this would positively impact growth in the near-term, the risks of a later correction would increase. Even current equity valuations appear somewhat on the rich side relative to global and regional markets.

20. At present, macroeconomic policies are in a strong position to respond to these risks because of the substantial buffers that have been established in the government and banking sectors. In particular, if the downside risks discussed above were to emerge, the government would be able to use its financial assets to smooth the path of government spending and provide temporary support to the economy if needed. On the financial side, high bank capital ratios would be able to absorb a rise in NPLs, while the Saudi Arabian Monetary Agency (SAMA) would be able to provide liquidity to the banking sector as needed.

21. Remittance outflows, strong domestic demand, and official financing are other important outward spillover channels from Saudi Arabia. With a large number of expatriate workers in the country, remittance outflows are a very important source of income for many countries in the region (Egypt, Yemen, Jordan, Lebanon, and Sudan) and in South and South-East Asia (Bangladesh, India, Pakistan, Philippines, and Sri Lanka). Strong domestic demand has continued to generate strong import growth into Saudi Arabia. Lastly, Saudi Arabia is a generous provider of financial assistance, with significant support being committed to countries in the region.

Financial Assistance from Saudi Arabia to Arab States, January 2011 to April 2014

(US$ million)

Recipient Country	Amount Disbursed	Amount Committed
Bahrain	69	2,844
Djibouti	18	68
Egypt	5,944	6,494
Jordan	1,907	2,976
Morocco	488	1,642
Oman	-	2,500
Sudan	240	527
West Bank and Gaza	1,041	1,791
Yemen	1,160	3,824
Total	**10,867**	**22,666**

Source: Ministry of Finance.

POLICY DISCUSSIONS

Meeting the jobs and housing needs of a rapidly growing and young population and managing the demands of these demographic trends on the natural resources of the economy are key challenges for policy makers. These challenges are being addressed through large public investments in infrastructure and housing, and reforms to increase private sector employment of nationals. At the same time, efforts are being made to raise productivity, diversify the economy, and strengthen growth prospects. Against this background, discussions focused on two main themes; (i) maintaining macroeconomic stability and strengthening macroeconomic and financial policy frameworks to support growth, and (ii) policies to address demographic pressures and reforms to boost sustainable economic growth.

A. Maintaining Macroeconomic Stability and Strengthening Policy Frameworks to Support Growth

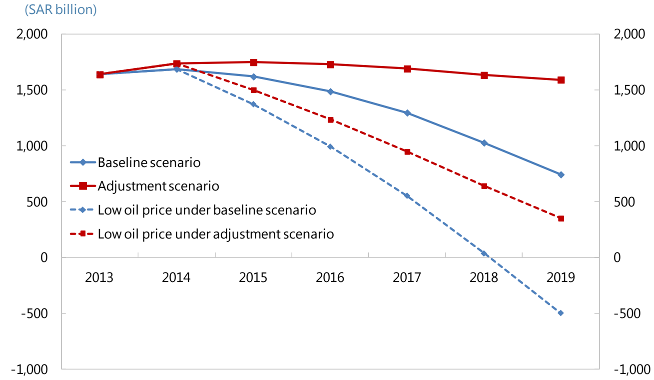
22. **The macroeconomic outlook is favorable and substantial policy buffers are in place, but the current path of fiscal policy risks substantially eroding these buffers over the next few years**. A slowing in the pace of fiscal spending can help strike a balance between meeting development goals and maintaining the ability to manage risks. Reforms to strengthen the macroeconomic policy framework can help better manage the impact of oil price volatility and other external and domestic shocks, and create an environment conducive to private sector investment and job creation.

Fiscal policy

23. **The fiscal position in Saudi Arabia is currently very strong**. Fiscal outcomes have been favorable in recent years and government deposits at SAMA have increased to around 60 percent of GDP, sufficient to cover 20 months of spending, while government debt has declined to only 2¾ percent of GDP (see Appendix I). In addition, the government has considerable assets in the form of ownership stakes in many companies.

24. **The government's ambitious spending program, however, could significantly erode the buffers that have been built up and increase vulnerability to a drop in oil prices**. Owing to the metro and Mecca and Medina expansion projects, capital expenditures are projected to increase during 2014–18 to over 16 percent of GDP from 11 percent in 2012. In addition, housing loan disbursements are estimated to reach up to SAR 25 billion a year. As a result, government deposits at SAMA are projected

Impact of Fiscal Spending on Government Deposits Under Various Scenarios, 2013–19[1]
(SAR billion)



Source: IMF staff calculations.
[1]Baseline scenario projects government deposits under current policies. The adjustment scenario projection assumes a reduction in the non-oil fiscal deficit of 3 percent of non-oil GDP each year relative to the 2013 fiscal outcome. The low oil price scenarios assume oil prices to be $25 below the baseline between 2015-19.

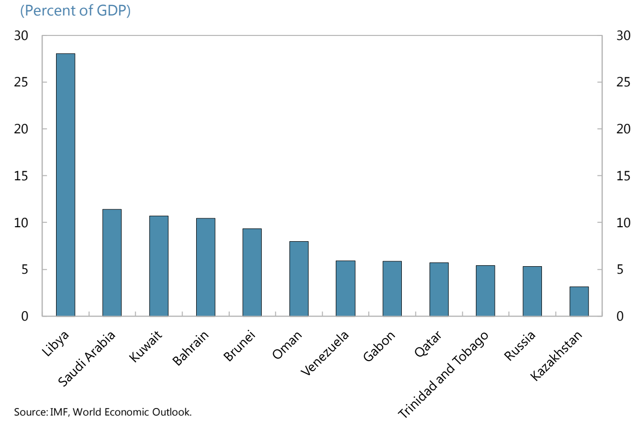
to drop by about 55 percent between 2013 and 2019 (and in 2019 would be sufficient to cover 6½ months of spending).[4] With the decline in fiscal buffers, the economy would become more vulnerable to a drop in oil prices and have less space to operate a countercyclical fiscal policy. For example, if oil prices were to drop by $25 below the baseline in 2015 and remain lower until 2019, the fiscal deficit would be much larger and government deposits at SAMA would be exhausted by 2018, if spending did not adjust (Figure 6).

25. Staff emphasized the need for fiscal consolidation to help protect existing fiscal buffers. The fiscal consolidation that staff had expected to take place in 2013 did not materialize, and it is important that the government now moves ahead and implements fiscal adjustment. An adjustment that reduces the non-oil fiscal deficit by about 3 percent of non-oil GDP a year during 2014–19 relative to the 2013 budget outcome would ensure that government deposits remain sufficient to manage a large drop in oil prices.[5] This adjustment would help narrow the gap with the sustainable non-oil primary balance that is consistent with an inter-generationally fair distribution of oil wealth, and the structural budget balance would be in surplus from 2015–19.[6]

26. Staff suggested that the fiscal adjustment could be achieved through a combination of expenditure and revenue measures. On the expenditure side, a civil service review could be undertaken to identify those positions that are not essential and that could be eliminated as they become vacant. This would help reduce the size of the government wage bill, which is high by international standards, and would support ongoing reforms in the labor market. In addition, with capital spending projects making up a large part of fiscal spending, a careful prioritization of these projects would help identify any that could be delayed or cancelled, and a review of project processes could yield cost savings. On the revenue side, steps to increase non-oil revenues would help strengthen the budget position. Consideration should be given to a tax on higher-end property or vacant land, increasing fees/charges for

Government Wage Bill in Selected Oil Exporters, 2013

(Percent of GDP)



Source: IMF, World Economic Outlook.

[4] Housing loans do not add to the projected deficit but contribute to the drawdown in government deposits at SAMA.

[5] Assuming a medium-term fiscal multiplier of 0.5, this fiscal consolidation could lead to slower non-oil GDP growth of up to 1 percent a year by the end of the projection period.

[6] The structural balance is calculated using a 5-year backward oil price rule and a 3-year backward average of oil exports.

government services, and an increase in energy prices (preferably coordinated at the GCC level). Forgone revenues from low domestic energy prices are estimated to be around 10 percent of GDP.[7]

27. If the budget were put on such a consolidation path, the fiscal buffers that have been built up would remain in place and could be used to smooth spending in the event of a temporary decline in oil prices. In this regard, the concept of the structural budget balance is a useful anchor to manage the volatility of oil revenues over the medium-term. If oil revenues temporarily decline by more than expected, fiscal buffers can be used to maintain the path of government spending, while if growth in the non-oil sector were to slow sharply, there is scope for temporarily increasing government spending. A longer-lasting and more pronounced decline in oil revenues would require a more substantial adjustment in government spending. Targeting a positive structural balance over time would allow the accumulation of savings for future generations. If oil revenues were temporarily higher than expected, these additional revenues should be saved to build additional buffers.

28. The authorities broadly agreed with the staff's fiscal projections, but saw limited scope for fiscal consolidation at present. The Mecca and Medina expansion projects are national priorities, and the government is committed to housing and transportation projects to address pressing social needs, alleviate urban congestion pressures, and support ongoing diversification efforts. The authorities also saw little scope to raise additional revenues at present, although over the medium term when alternate modes of transportation become available, increases in energy prices could be considered.

29. While the efficiency of public investment in Saudi Arabia appears to be broadly in line with the global average, there is scope for improvement. Greater investment efficiency would provide better resource allocation and greater value-for-money, especially given the size of the public investment program in Saudi Arabia. The example of Norway illustrates the potential benefits of a strengthened public investment management process in terms of cost savings on projects. In this regard, the authorities explained that improvements in the efficiency of public spending are being targeted through the introduction of qualitative Key Performance Indicators(KPIs) for line ministries as part of the forthcoming Tenth National Development Plan.

30. Staff suggested that reforms to the fiscal framework would support policy implementation, help manage the impact of oil price volatility, and strengthen spending efficiency. Specifically, the fiscal framework could be strengthened by:

- *Ensuring the budget provides a full account of the government's planned expenditures during the year*. Currently, actual expenditures regularly exceed budgeted expenditures by a substantial margin (19 percent in 2013). This is due to the government setting a low expenditure envelope

[7] 2011 estimates. See "Energy Subsidy Reform: Lessons and Implications", IMF, 2013.

in the budget in line with conservative oil revenue assumptions, and the exclusion of expenditures made from the budget surplus fund (e.g. for the metro and housing projects). Budget projections should include planned spending from the budget surplus fund and the full costing of all spending commitments for the year.

- *Developing a medium-term budgetary framework that delinks expenditure decisions from revenue volatility and clearly establishes the goals of fiscal policy*. Such a medium-term framework should be based on expenditure plans that are consistent with projections of structural oil revenues, the development plans for the country, a target for the structural budget balance, and a robust set of macroeconomic forecasts. To help enhance the predictability of spending decisions and assist the planning process, the 5-year development plan would need to be updated regularly and linked to the annual budgets on a rolling basis. The introduction of the planned Government Financial Management Information System (GFMIS) would support this framework and strengthen controls on line ministries.

31. The authorities considered the main elements of a strong fiscal framework to already be in place, and further reforms are ongoing. The annual budgets were viewed as largely realistic representations of expenditure plans, with variations relative to budget stemming mostly from the speed of implementation of capital projects and some within-year special expenditures authorized by royal decree. More recently, high land acquisition costs in Mecca and Medina had contributed to expenditure overruns. Work has already started on developing multi-year projections and fiscal scenarios to improve fiscal analysis and increasing the medium-term orientation of the budget, and consideration is being given to using the concept of the structural balance in budget preparation.

32. Staff underscored the benefits of establishing a well-staffed macro-fiscal unit and publishing fiscal data in GFSM2001 format as soon as possible. The authorities said they were in the process of establishing a macro-fiscal unit, and agreed this would help strengthen the analysis of fiscal policy, develop projections of the fiscal accounts under different economic and policy scenarios, and assess short-and long-term fiscal risks, including from pension expenditures (see Box 1). In this context, the Shura Council is considering a proposal to raise the retirement age for government employees from 60 to 62 (as per the Hijri calendar). With regard to publishing fiscal data in GFSM2001 format, preparations and staff training are well-advanced and publication is expected in early 2015.

Monetary, macroprudential, and exchange rate policies

33. Staff viewed monetary and macroprudential policy settings as appropriate at present, but emphasized the need for vigilance on rising equity prices. Monetary and macroprudential policy settings have not been changed over the past year as inflationary pressures have eased and financial conditions remained stable. Risks from higher U.S. rates appear limited. Equity market developments should be carefully monitored. If equity prices keep rising strongly, consideration should be given first to specific measures to limit lending for equity investments. If ineffective, steps to reduce liquidity including by raising the reserve requirement ratio would be needed. The authorities argued that given strengthened prudential regulation of financial market participants in recent years, there was little likelihood of an equity market bubble developing. Close policy coordination between the Ministry of Finance, the Capital Market Authority (CMA), and SAMA also meant that policy makers could respond to any potential systemic financial sector risks in a timely manner.

34. More generally, staff suggested that the use of the macroprudential toolkit be more clearly linked to overall macroeconomic and financial developments. SAMA has encouraged banks to provision in a countercyclical way and provisioning levels have increased to over 150 percent of gross non-performing loans at end-2013. However, the bank-by-bank approach has made this more a micro- than macroprudential policy tool in the staff's view. SAMA's other macroprudential tools include the loan-to-deposit ratio, loan-to-income ratio, debt-service-to-income ratio, and limits on concentrated exposures, although these are adjusted infrequently. Staff suggested that consideration could be given to using these tools in a countercyclical way by linking them explicitly to macroeconomic and financial developments to signal SAMA's assessment of risks to the market. A formal, clear, and transparent macro-prudential framework, as is being developed in other countries, could give SAMA the mandate for ensuring financial stability and to more explicitly codify coordination across regulators. SAMA believes that their macroprudential policies have worked well and have served to smooth credit in the economy. They also noted that their Early Warning Systems (EWS) analysis has been strengthened, and that they plan to publish a financial stability report for the first time. Staff welcomed these efforts and encouraged SAMA to also publish its EWS indicators, including the house price index that is currently under development.

35. Staff recommended the introduction of a formal liquidity forecasting framework together with a review of liquidity management tools to better manage banking system liquidity. SAMA actively used its reserve requirement ratio to manage liquidity during the global financial crisis in 2008, but has not changed this ratio since. On a regular basis, SAMA issues short-term securities (SAMA bills) on its own account to absorb excess banking system liquidity, although banks also hold large excess deposits. There is a ceiling on the weekly issuance of SAMA bills that is revised infrequently (the last revision was in February 2010), and the interest rates are set at 80 percent of the reported interest rates in the inter-bank deposit market. With both the quantity and price of SAMA bills set centrally, banking system liquidity has been volatile. Developing a formal liquidity forecasting framework would allow SAMA to more proactively manage liquidity by varying the amount and maturity of SAMA bills it offers. In this way, strengthening the transmission of monetary policy signals would enhance SAMA's ability to influence the availability of bank credit and economic activity. SAMA considered its liquidity management operations and toolkit to be effective and based on market fundamentals, noting that the size of SAMA bill issuance has increased over time and that weekly issuances are not systematically oversubscribed. Indeed, the size of issuance is calibrated to provide space for banks to expand private sector credit while ensuring that credit growth is not too rapid.

Box 1. The Pension System in Saudi Arabia

Saudi Arabia has a generous pension system. Several types of benefits are extended, including retirement, disability, and survivor benefits, in addition to a lump-sum benefit. The country has a mandatory public pension system, with a gross replacement rate of 100 percent. In addition, pension income is not subject to taxation. Two bodies are responsible for pensions; the Public Pension Agency (PPA) covers both government civilian and military personnel, while the General Organization for Social Insurance (GOSI) broadly covers the private sector. Both have an "exchange of benefits" system that preserves service years and contributions for employees who move from the public to the private sector (and vice versa) to maximize pension benefits upon retirement.

Key Indicators of the Pension System

(SAR billion, unless noted otherwise)

	2004	2008	2012	2013
I. Total Pension Benefits Paid (annual flows):	**20.6**	**33.9**	**56.8**	**62.1**
PPA	17.3	27.9	44.6	45.3
A) Recurrent pensions	-	27.6	44.5	-
B) Lump sum compensation	-	0.3	0.1	-
GOSI	3.3	6.0	12.2	16.8
A) Recurrent pensions	3.3	5.9	12.1	-
B) Lump sum compensation	0.02	0.06	0.11	-
II. Pension Fund Assets	**515.6**	**634.8**	**838.1**	**939.1**
PPA	311.4	353.2	474.0	520.0
Foreign assets, net (share of total)	26	26	50	52
Domestic assets (share of total)	74	74	50	48
GOSI	204.2	281.6	364.1	419.1
Foreign assets, net (share of total)	31	33	36	36
Domestic assets (share of total)	69	67	64	64
III. Pension Funds Domestic Investments	**48.7**	**81.6**	**123.9**	**-**
PPA	24.6	39.1	67.9	-
Financial investments (share of total)	100	71	61	-
Real estate (share of total)	-	29	39	-
GOSI	24.1	42.5	56.0	-
Financial investments (share of total)	91	95	92	-
Real estate (total project costs, share of total)	9	5	8	-
IV. Net Income Position	**24.8**	**22.8**	**58.7**	**64.7**
PPA	16.8	11.6	44.5	45.9
Income, o/w	34.1	39.7	89.3	91.5
Pension contributions (share of total income)	26	28	23	22
Investment income (share of total income)	43	38	46	47
Expenses	17.3	28.1	44.8	45.6
GOSI	8.0	11.2	14.2	18.8
Income, o/w	12.9	19.1	28.1	37.2
Pension contributions (share of total income)	47	48	54	50
Expenses	4.8	7.9	13.8	18.4

Sources: Public Pension Agency (PPA); and the General Organization for Social Insurance (GOSI).

Total benefits paid have increased in line with the rise in the number of retirees. Total payments rose to SAR 62 billion in 2013, three times higher than in 2004, with most benefits extended through the PPA. Meanwhile, pension assets have increased strongly reaching SAR 939 billion (2013). Both funds invest domestically in financial assets and in real estate; the rate of return on investment amounted to 9.8 percent for the PPA in 2012. In addition, foreign assets (net) grew three-fold between 2004 and 2013, and SAR 449 billion was held at SAMA as of end-2012 (comprising 16.3 percent of GDP).

Current demographics are keeping the pension system financially sound. The country's young population, strong growth, and the rise in the number of subscribers to the system are more than compensating for the rise in the number of pension beneficiaries. For example, subscribers to GOSI alone almost doubled between 2004 and 2013 (to some 18 million), most of whom are from the private sector.

Future shifts in demographics need to be carefully monitored to ensure the system's long-run sustainability. An OECD study estimates that public expenditure on pensions will grow from 2.2 percent of GDP (2010) to 7.1 percent of GDP by 2050. The changing demographic structure will need to be carefully monitored to ensure the pension system's sustainability and to minimize possible risks associated with long-term pension liabilities. In this regard, reforms to the pension systems are under consideration, with the Shura Council considering a proposal to raise the retirement age for government employees.

36. There was broad agreement that the exchange rate peg to the U.S. dollar remains appropriate for the Saudi economy. The peg provides credibility to monetary policy and stability to trade, income flows, and financial assets. While the drivers of the oil market, and hence the Saudi business cycle, are changing with the emergence of China, this has not yet caused tensions for monetary policy settings. Inflation and inflation volatility, for example, compare favorably to other oil exporting countries, with the flexible labor market playing a key role in supporting the peg. Empirical estimates, which are sensitive to the parameters assumed, do not yield clear conclusions as to whether the current account is at an appropriate level (see Appendix II). The macroeconomic balance approach suggests that the current account balance is within the range of medium-term norms estimated from several different specifications, while the external sustainability approach suggests that the current account surplus in the medium-term may be too low. Further, the real exchange rate is in line with its long run relationship with real oil prices. Staff noted, however, that as the structure of the economy continues to evolve in the coming years—particularly the structure of the export base and the domestic labor market—the appropriateness of the peg should be periodically reviewed in coordination with other GCC countries.

External Position Assessment

(Percent of GDP in 2019, unless otherwise indicated)

Projected current account	7.0
MB current account norm[1]	6.4
ES current account norm[2]	19.9
Deviation from ERER, overvaluation (-) (percent)[3]	1.1

Source: IMF staff estimates and projections.

[1] Follows specification II of Beidas-Strom and Cashin (2011).

[2] Follows a constant real per capita allocation rule similar to Bems and Carvalho Filho (2009).

[3] As of April 2014.

Financial sector supervision and development

37. The banking system is profitable, liquid, and well-capitalized. At 17.9 percent at end-2013, risk-weighted bank capital ratios in Saudi Arabia are high which is appropriate given the high sector concentration of lending and the general exposure of the economy to swings in oil prices. NPLs have continued to decline to 1.3 percent of loans in 2013, while bank profitability remains high, with the average pre-tax return on assets at 2 percent. Foreign currency loans and deposits make up a small share of total loans and deposits. Banks are well positioned to absorb the effects of higher interest rates (as the U.S. tightens) and any downside risks that result in slower non-oil growth.

38. Staff welcomed SAMA's efforts to strengthen financial sector supervision and boost financial inclusion. Saudi Arabia was among the first countries to implement the Basel III risk-based capital standards in January 2013, it has implemented the Basel III liquidity standards in July 2013, and the leverage ratio has been monitored at a minimum of 3 percent since January 2011. The draft framework for systemically important banks (D-SIB) is currently being finalized. Initiatives have been launched to provide the large population of foreign workers with better access to banking services, and increase consumer protection.

39. Progress is continuing in implementing the recommendations of the 2011 FSAP update (see Appendix III). Over the past year, SAMA has issued licenses to twelve banks and eight non-banks to conduct real estate financing and financial leasing business, and the non-banks undertaking these activities have been added to its supervisory responsibilities. Finance companies operating prior to the passage of the new laws in 2012 have until November 2014 to be licensed by SAMA. The CMA has introduced a new risk-based prudential framework for the supervision of authorized brokers/dealers, and has increased transparency with respect to its operations. Lastly, the CFT law was enacted in December 2013, and the authorities are working on bringing the AML/CFT regulatory framework for banks and other financial and non-financial institutions in line with the law.

40. There was agreement on the need to develop debt capital markets further. Creating a deep and liquid bond market would not only help monetary policy transmission, it would also increase financing options for companies, particularly at longer maturities, and support growth. Given the decline in sovereign debt outstanding, Saudi Arabia does not have a benchmark yield curve that could support the development of a broader fixed income market. Staff considered that anchoring a robust yield curve would require an active and liquid secondary market for government securities (as recommended in the 2011 FSAP Update). The authorities responded that they saw limited scope for expanding the issuance of government securities at the current time, but that they are exploring ways to deepen the market through greater issuance by state-owned companies and other entities. They also noted that steps are already underway to encourage private debt issuance by reducing the processing requirements and costs.

B. Policies to Address Demographic Challenges and Boost Sustainable Growth

Policies to address demographic pressures

41. The authorities' multi-pronged labor market reform strategy is aimed at raising private sector employment of Saudi nationals and boosting productivity. Key elements of the reform strategy include measures to:

- *Strengthen education and training*. Over the past decade, the number of graduates with tertiary education has more than doubled, but providing them with the skills needed by the private sector has proved challenging. Efforts are underway to strengthen curricula and educational standards to help better prepare workers for the labor market. A large number of Saudi students are also studying at universities overseas. Training programs are being revamped to improve skills of workers already in the labor force.

- *Boost private sector employment of Saudi nationals*. Wage subsidies are being expanded, incentives are being introduced for Saudi workers to stay in private sector jobs, and reforms to working hours in the private sector are being implemented. The renewed jobseekers assistance program for unemployed workers follows international best practices by making benefits conditional on participation in training and job search assistance programs. An unemployment insurance system, to which both employers and employees will contribute, is being introduced to strengthen the social safety net for Saudi workers.

- *Enhance mobility and improve recruitment of foreign labor*. Greater mobility for foreign workers employed by firms that are not compliant with Nitaqat (the employment quota program for Saudi nationals) is in place and could over time help narrow wage differentials by increasing the wages of foreign workers. To strengthen the regulation of foreign labor, licenses are being issued to mega-companies to allow them to manage the overseas recruitment process. A scheme to provide retirement benefits to foreign workers is also being considered and could help attract more-skilled foreign workers.

42. There was agreement that ongoing labor market reforms have resulted in an increase in private sector hiring of Saudi workers. Based on data available through June-2013, private sector employment of Saudi workers has risen significantly since the implementation of the new labor market policies. However, the public sector continues to be the dominant source of new jobs. In this regard, staff welcomed the ongoing labor market reforms and progress so far, yet stressed the need for firm control of public sector jobs and wages to reset expectations, measures to ease employment regulations for nationals where appropriate, and further steps to increase the mobility of foreign workers to narrow wage differentials. The implementation of measures to refocus hiring on skilled rather than unskilled foreign labor would also help.

43. The government is implementing an ambitious program to increase the supply of housing. Excluding the large proportion of the population who live in low-quality housing, homeownership among Saudi nationals is only about 36 percent. A SAR 250 billion housing program was announced in 2011. It was originally envisaged that the government would directly build 500,000 new housing units, but the authorities explained that the current plan is for greater private sector involvement, with the government playing a facilitating role by providing free public land and needed infrastructure for development, together with interest-free loans for buyers (up to SAR 500,000). The support to buyers will be allocated according to a points system that will favor those with the greatest need.

44. The targeting of the housing program on those people most in need is welcome, but staff noted that disbursements will consume a substantial part of the accumulated financial assets of the government (see paragraph 24). Efficient use of these resources will require ensuring that borrowers have both the ability and the incentive to repay the loans, that the criteria for eligibility are strictly focused on those most in need, and that financing is provided for new housing rather than the purchase of existing dwellings. Staff emphasized that it will be important to ensure that the program does not undermine the private real estate market or the development of the mortgage market.

45. Domestic energy consumption is likely to continue to rise. Saudi Arabia has one of the highest levels of energy consumption per capita in the world and one of the lowest prices. The current energy pricing structure provides incentives for investment in energy-intensive industries, and domestic energy consumption has grown rapidly in recent years. To curb the rapid growth in energy consumption, the authorities are strengthening building and appliance energy efficiency standards, including in industry. Tighter vehicle emission standards and public transportation networks are planned over the medium-term. The authorities considered that these efforts will slow the growth of energy consumption over time.

46. Staff recommended an upward adjustment of energy prices over the medium-term. This would help curb the rapid growth in domestic consumption, reduce existing incentives in the growth model towards energy intensive industries, and strengthen the fiscal position. In line with international experience, such a policy adjustment would need to be well-planned, phased over time, and clearly explained and communicated to the population and businesses. Although low energy prices primarily benefit the better-off, an increase in energy prices would likely have an adverse impact on poor and vulnerable groups and compensatory measures would need to be put in place. Energy intensive industries would need time to adjust their production and cost structures to remain competitive. The potential inflationary impact would also need to be carefully managed. The authorities expressed concern about the macroeconomic and social implications of an adjustment to energy prices, and noted that the completion of public transportation projects would be a precondition for reforms.

Reforms to diversify the economy and boost sustainable growth

47. Economic diversification is a considerable challenge in Saudi Arabia where the oil production horizon is long. A large number of structural reforms have been implemented over the past two decades, including significant investments in human capital and physical infrastructure, improvements to the business environment, and increased access to finance for SMEs, including through the establishment of dedicated SME units in banks, the Kafalah loan-guarantee program, and better access to credit information through SIMAH, the national credit bureau. The share of non-oil real GDP has increased over the past two decades, but non-oil exports remain limited, the level of export sophistication is low, and productivity growth has remained weak. The experience of Saudi Arabia in this regard is similar to that of other oil exporting countries, where incentives for diversification are limited when they have a long oil production horizon.

48. The authorities have continued their efforts to improve the business environment and boost trade and investment. Saudi Arabia scores well in terms of business climate indicators although enforcing contracts and resolving insolvencies remain areas of concern (Figure 7). In this regard, work has started on a new insolvency law and contract enforcement is being strengthened. Privatization of state-owned enterprises is underway as a means to boost economic efficiency and increase private investment. Industrial clusters around oil and mining, and joint ventures in refining, mining, and banking are being developed. The recent establishment of the Saudi Export Development Authority and the implementation of the GCC customs union from January 1, 2015 could provide a boost to intra-regional trade. Other specific measures could be considered to encourage firms to export, including providing financing and insurance support.

49. Despite these reforms, the incentives for diversification are not yet fully developed. National accounts data suggests that for the economy as a whole and for the non-oil private sector about 75 percent of GDP goes to capital (gross operating surplus)—a high level by international standards—and only 25 percent to labor (compensation of employees). This suggests a business model where firms are able to extract large rents given their reliance on low cost foreign labor, and have no incentive to develop export markets given the higher risks and costs these entail. On the labor side, the incentives and opportunities for Saudis to participate in the private sector remain low given the higher wages and benefits available in the public sector, particularly for the less skilled, and the cultural limitations on the employment of women (although these are slowly changing). Moving toward a more diversified economy will likely require a change in these incentive structures. In this regard, the authorities considered that ongoing labor market reforms were likely to narrow wage differentials over time, boost overall labor costs, and increase productivity, thereby realigning incentives for firms and Saudi workers.

Statistical issues

50. Improvements are continuing in the area of statistics, but gaps remain. FSI data is now reported to the Fund and published on a quarterly basis. SAMA has improved the coverage of other investment flows in the balance of payments and reduced the errors and omissions. Work is ongoing to improve FDI data. Publication of fiscal data in GFSM2001 format would be a significant step forward. Data on wages, house prices, and other indicators of the real estate market would strengthen economic analysis, while a more definitive statistical release calendar would help users. Subscription to SDDS should be a short-term goal, while close collaboration with GCCStat could help improve statistics in Saudi Arabia and the region.

STAFF APPRAISAL

51. The economy is growing strongly, and risks are broadly balanced. In 2014, oil production is expected to be little changed from 2013, while government spending on large scale infrastructure and housing projects is expected to underpin non-oil private sector growth. Inflation has eased since mid-2013, driven largely by food prices, and unemployment has fallen. Global financial market volatility has had a limited impact on Saudi Arabia. Risks to the growth outlook are balanced and mainly center on the oil market.

52. Saudi Arabia plays a systemic and stabilizing role in the global oil market. In line with this role, Saudi Arabia increased oil production in 2013 to help prevent supply disturbances in other countries from having a negative impact on global growth. Within the Middle East region, Saudi Arabia is a generous provider of financial assistance, and large remittance flows from expatriates working in the country provide important income flows to countries in the region and in Asia.

53. Fiscal adjustment is needed to preserve buffers and increase saving for intergenerational equity purposes. The fiscal consolidation envisaged at the time of the 2013 Article IV has not materialized as spending growth has remained strong. While the desire to continue to develop the economic and social infrastructure of the country is understandable, the government's ambitious spending program would significantly erode the large fiscal buffers that have been built over the past decade and increase vulnerability to a drop in oil prices. A slowing in the pace of government spending together with measures to increase non-oil revenues would help strike a better balance between achieving development goals, maintaining the ability to manage risks, and saving for future generations. If the budget were put on a consolidation path and fiscal buffers were maintained, these buffers could be used to smooth spending in the event of a temporary decline in oil prices. Ensuring the efficiency of public investment spending is also important.

54. Reforms to the fiscal policy framework are needed to support policy implementation and allow policymakers to fully evaluate the sustainability of the budget. These reforms should start with the annual budget to ensure it provides a realistic representation of the government's planned expenditures during the year. This will improve the budget as a signaling device of the government's fiscal policy intentions, as well as help ensure the efficiency of public spending. The budget estimates should include planned spending from the budget surplus fund and the full costing of all expected spending commitments. The annual budget should be set within a medium-term framework that is anchored around an estimate of structural revenues that delinks spending decisions from oil revenue volatility and that fully integrates the expenditure priorities in the five-year national development plan within the budget. Establishing a macro-fiscal unit and publishing data in GFSM2001 format will support these changes.

55. Monetary and macroprudential policy settings are appropriate at present, but the policy frameworks could be strengthened. The introduction of a liquidity forecasting framework could help enable better liquidity management and strengthen the monetary policy transmission mechanism. Developing a formal macroprudential framework would give SAMA a clear mandate for ensuring financial stability and would more explicitly codify coordination across regulators. Within this framework, consideration should be given to linking the use of macroprudential tools with macroeconomic and financial developments in a countercyclical way. These tools would help SAMA manage the potential effects of asset price cycles and other developments on financial stability. In this context, if equity prices continue to rise strongly, consideration should be given to tightening prudential norms for lending for equity investment.

56. Reforms to strengthen financial sector regulation and supervision should go hand-in-hand with measures to promote financial development and inclusion. Saudi Arabia was among the first countries to implement Basle III capital, liquidity, and leverage standards for the banking system, which remains well-capitalized, liquid, and profitable. Measures are also underway to improve access to mortgage finance, streamline the process for debt issuance, and increase financial inclusion. The D-SIB framework should be finalized, and the AML/CFT regulatory and reporting framework brought into line with the new CFT law and implemented. Developing a benchmark yield curve could help develop a local debt market, thereby increasing financing and investment options in the economy.

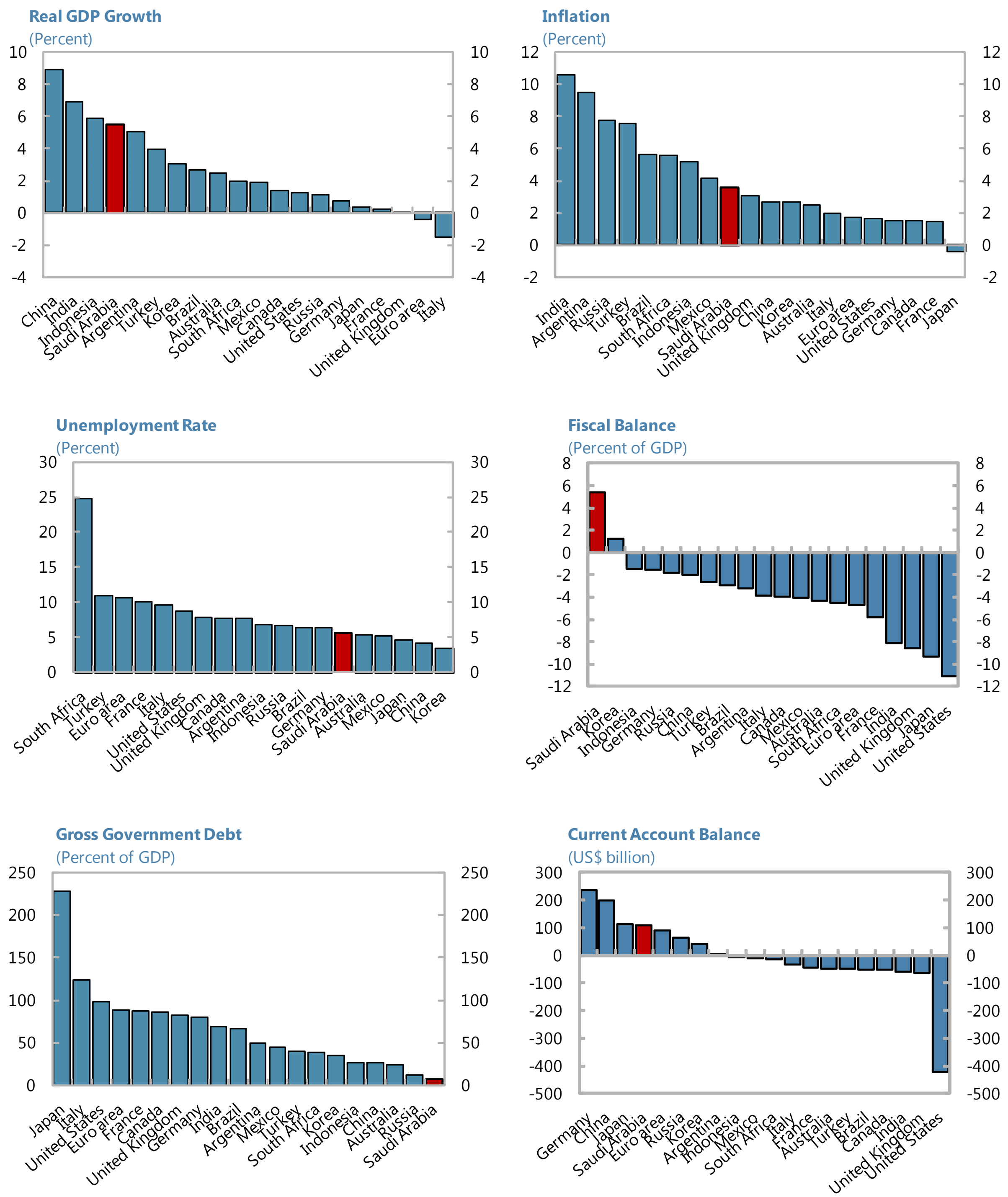
57. Initiatives to address demographic pressures need to be implemented in coordination with other policies. Labor market programs are aimed at increasing the skills and competitiveness of Saudi nationals and have contributed to increasing their employment in the private sector. These programs need to be complemented with a reduced reliance on public sector jobs. The government's housing programs need to be carefully targeted to the less well-off, and work in tandem with the private sector to ensure that policies to develop private mortgage finance are given space to work. Curbing the growth in domestic energy consumption will require a well communicated upward adjustment of energy prices, with compensation provided to vulnerable sections of society. Efforts to improve energy efficiency and develop public transportation networks will be more effective if implemented in tandem with higher energy prices.

58. Economic diversification in a country such as Saudi Arabia which has vast oil resources is a significant challenge. The government is making considerable efforts to lay the ground for further diversification by upgrading infrastructure, strengthening education and skills, boosting access to finance for SMEs, and improving the business environment. However, the incentives for diversification are not yet fully developed, and further efforts are needed to encourage firms to export and Saudi workers to participate in the private sector.

59. Considerable progress has been made in improving the quality and availability of key economic statistics. Further progress is needed, however, particularly in the areas of government finance, national accounts, labor, and real estate market statistics. Subscription to SDDS should be a short-term goal, while close collaboration with GCCStat could help improve statistics in Saudi Arabia and the region.

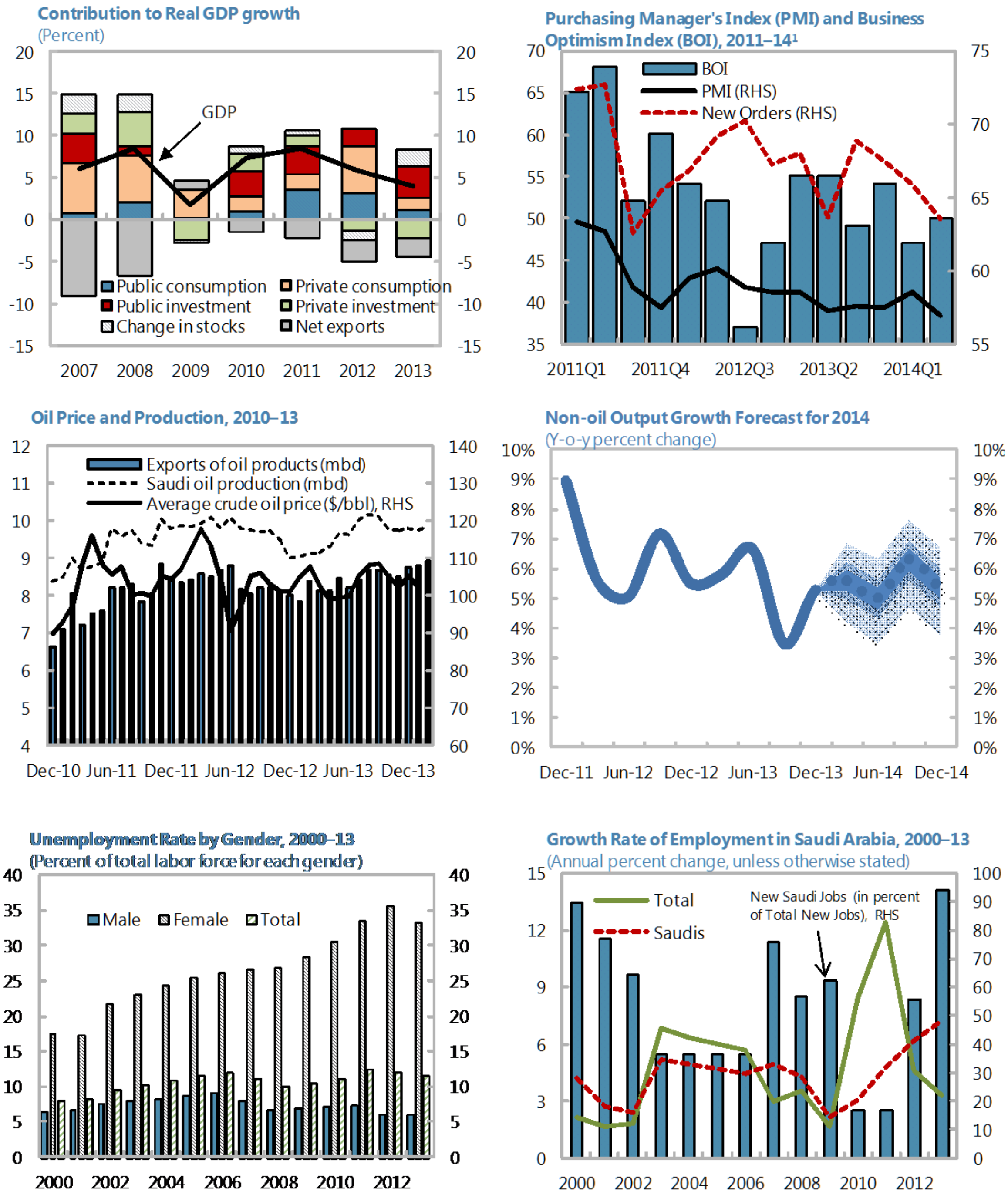
60. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Saudi Arabia and G20 Comparators: Selected Economic Indicators, 2009–13 Averages



Source: IMF World Economic Outlook.

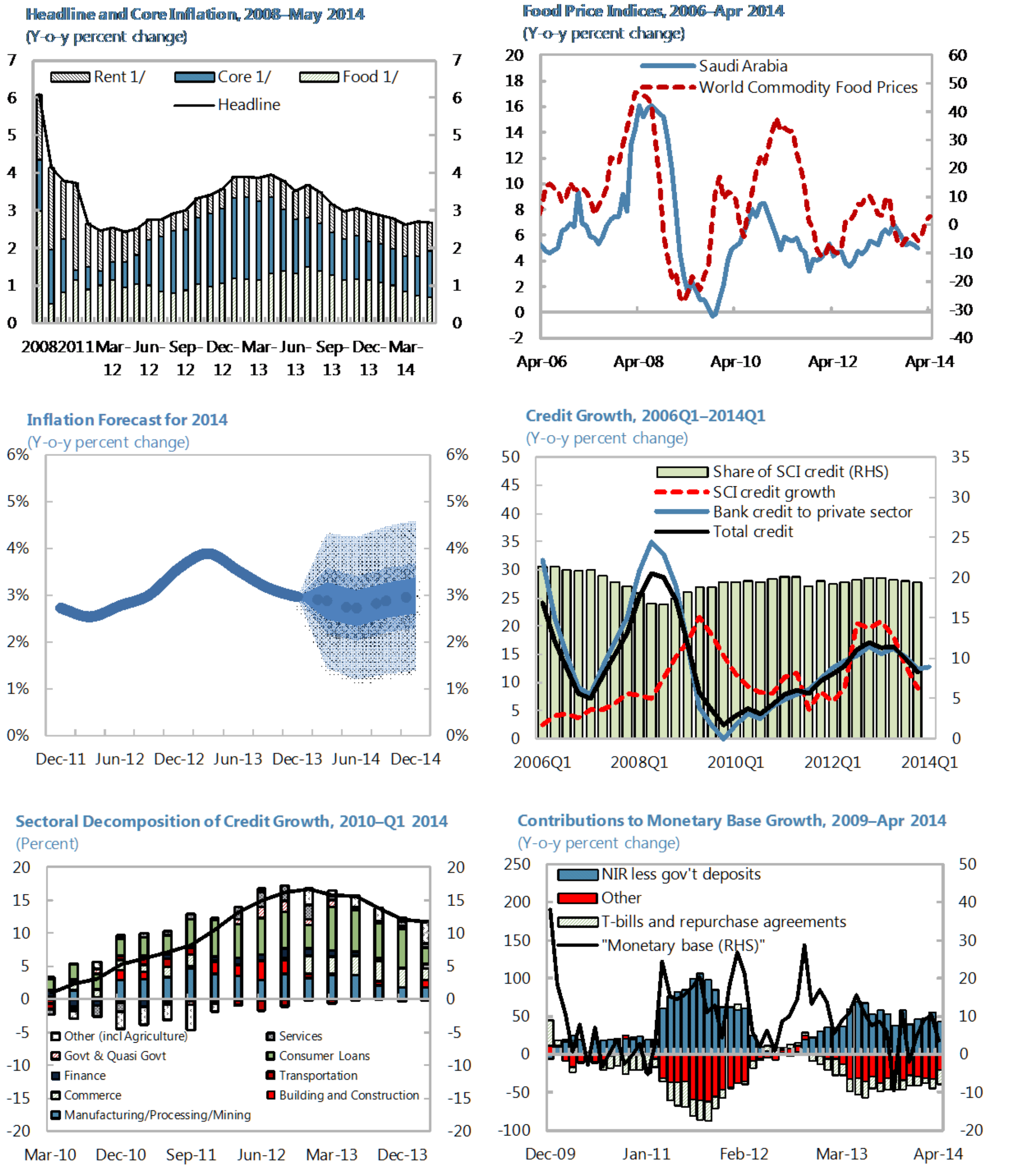
Figure 2. Growth and Employment



Sources: Country authorities; Markit; Joint Oil Data Initiative (JODI); and IMF staff calculations.

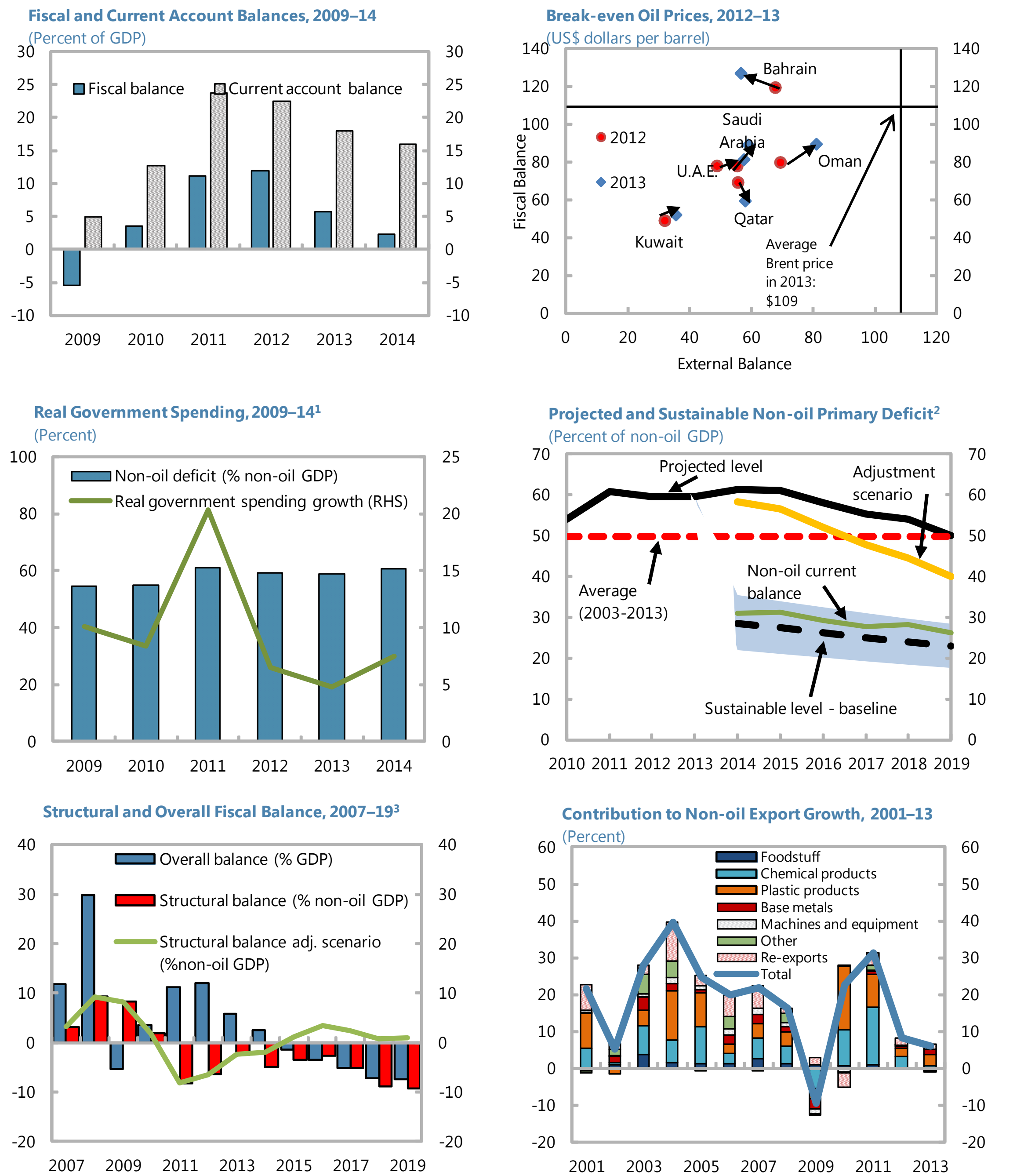
[1]PMI data is average of three months in respective quarter, except for 2014Q2 which is May data. New orders data is for the last month of the respective quarter except for 2014Q2, which reflects May data.

Figure 3. Inflation and Monetary Developments



Sources: Country authorities; Haver Analytics; and IMF staff calculations.
1/ Contribution to headline CPI inflation.

Figure 4. Fiscal and External Sector Developments



Sources: Country authorities; and IMF staff calculations.

[1]Real expenditures are deflated by the CPI.

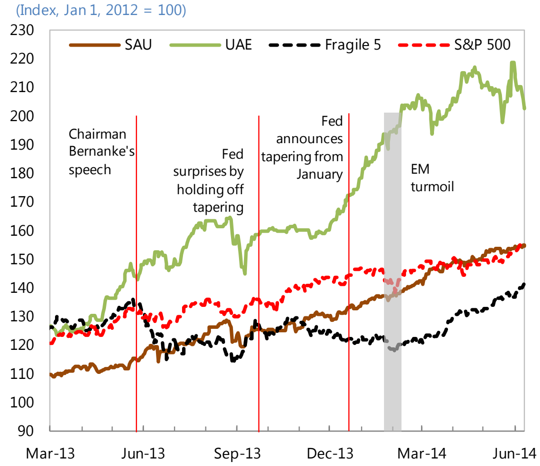
[2]The sustainable level of fiscal spending from the oil wealth is defined as an annuity constant in real per capita terms. The shaded area represents the sustainable level of fiscal spending conditional on oil prices remaining within $25 per barrel of the baseline.

[3]Structural revenues are estimated by assuming that the long-term oil price is the average oil price from past five years. Long-term oil output is computed as a three year moving average including the current year. The structural balance is then computed as structural revenues less total expenditures.

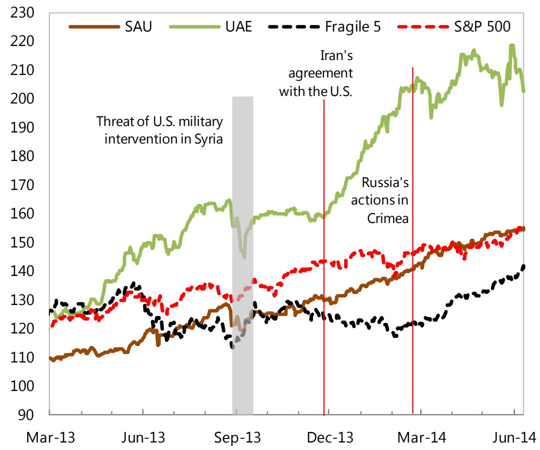
Figure 5. Impact of Global and Regional Shocks on Financial Markets

(March 2013–June 2014)

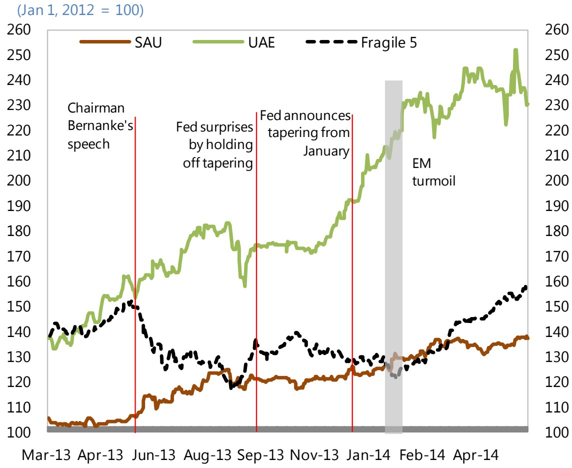
Stock market indices
(Index, Jan 1, 2012 = 100)



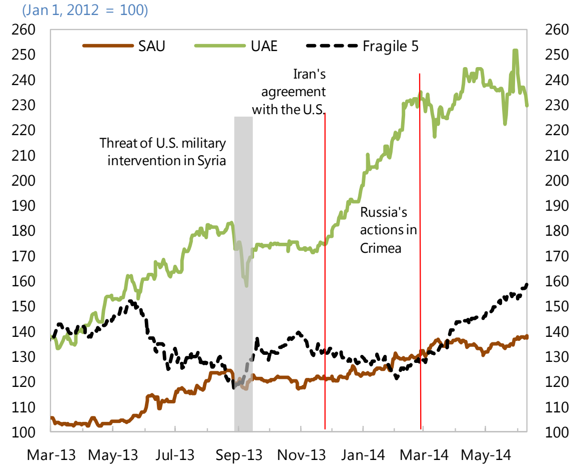
Stock market indices
(Index, Jan 1, 2012 = 100)



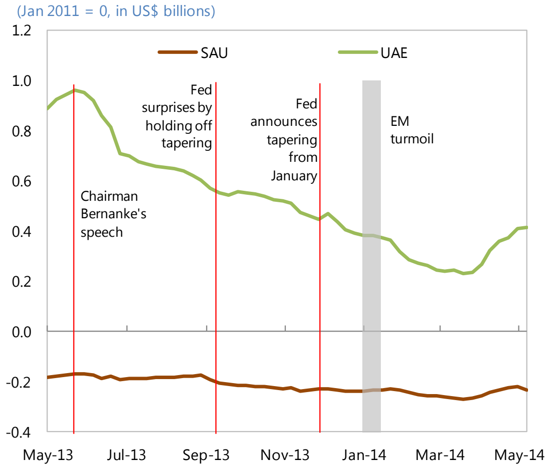
Stock market indices: Banks 1/
(Jan 1, 2012 = 100)



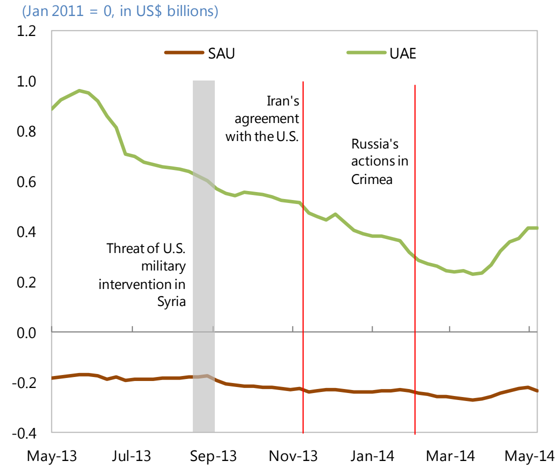
Stock market indices: Banks 1/
(Jan 1, 2012 = 100)



EPFR Cumulative Funds Flows 1/
(Jan 2011 = 0, in US$ billions)



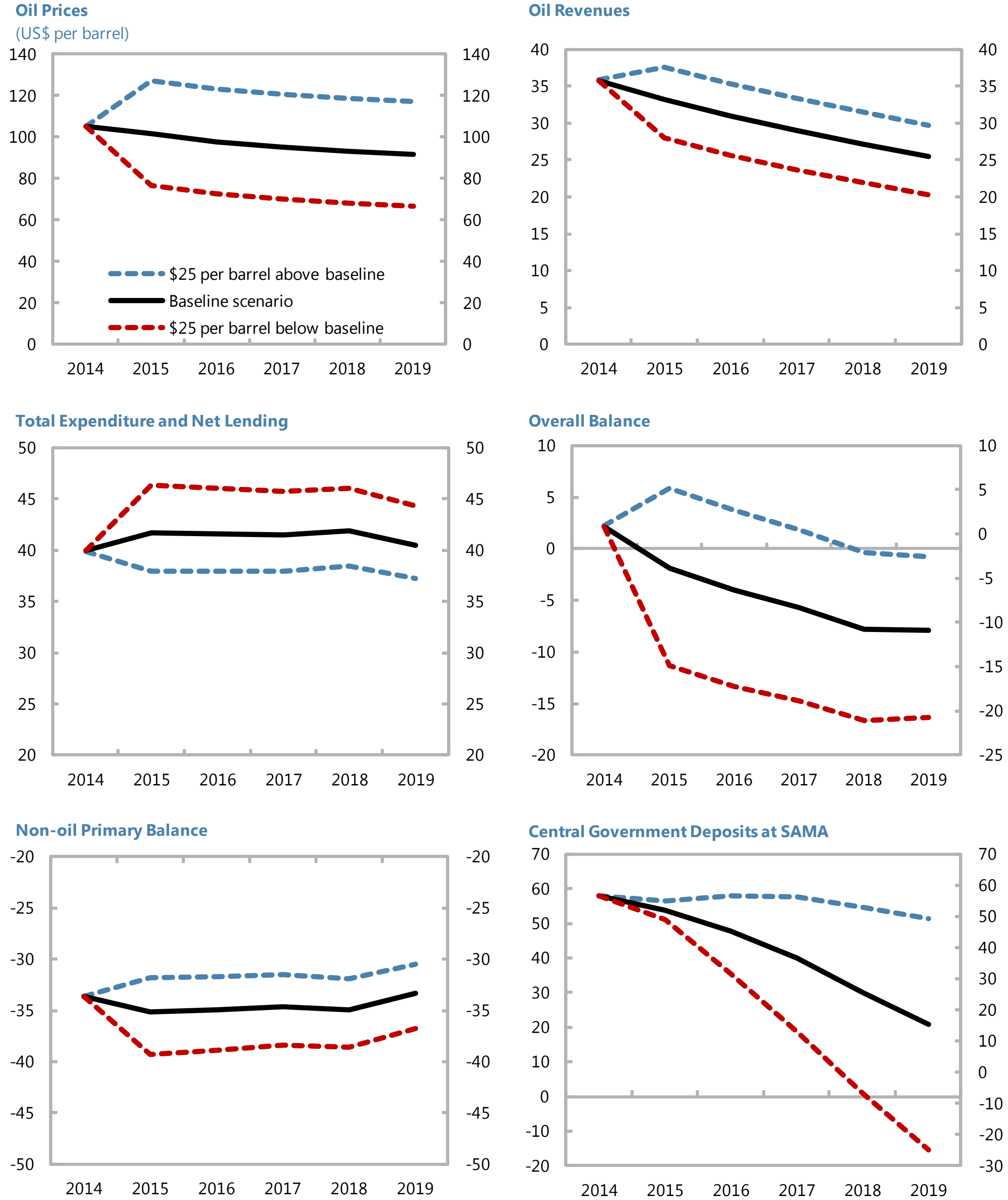
EPFR Cumulative Funds Flows 1/
(Jan 2011 = 0, in US$ billions)



Sources: Bloomberg; GCC Central Banks; Zawya; Haver; and IMF staff estimates.
1/ Other GCC countries omitted due to data limitations.

Figure 6. Impact of Oil Prices on the Fiscal Position, 2014–19[1]

(Percent of GDP unless otherwise specified)



Sources: Country authorities; and IMF staff calculations.
[1]Assumes no fiscal policy action. Differences in expenditure and non-oil balance ratios are driven by the impact of lower oil prices on nominal GDP.

Figure 7. Business Environment and Diversification

Sources: *Global Competitiveness Report 2013-14*, World Economic Forum; United Nations Statistics Division; and *Doing Business 2014*, World Bank; and IMF staff calculations.

[1] Overall trade barrier rankings from 1 to 148, with 1 being the least restrictive.

[2] The data for all sets of indicators in *Doing Business 2014* are for June 2013 except for paying taxes data that refer to January–December 2012.

[3] Includes the oil sector unless specified otherwise.

Table 1. Saudi Arabia: Selected Economic Indicators, 2011–19

			Prel.	Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(Percent change; unless otherwise indicated)								
National income and prices									
Crude oil production (million of barrels per day) [1]	9.3	9.8	9.6	9.7	9.7	9.8	9.9	10.0	10.1
Average oil export price (U.S. dollars per barrel) [2]	107.1	109.5	105.8	105.0	101.6	97.7	95.2	93.4	91.8
Nominal GDP (SAR billions)	2,511	2,752	2,807	2,923	3,011	3,114	3,250	3,406	3,573
Nominal GDP (US$ billions)	670	734	748	779	803	830	867	908	953
Nominal non-oil GDP (SAR billions)	1,234	1,376	1,486	1,605	1,735	1,877	2,033	2,201	2,379
Nominal GDP per capita (US$)	23,594	25,139	24,953	25,452	25,706	26,064	26,668	27,400	28,183
Real GDP	8.6	5.8	4.0	4.6	4.5	4.4	4.4	4.4	4.4
Oil	11.0	5.7	-1.0	0.6	0.0	0.9	0.9	0.9	0.9
Non-oil	7.9	5.8	5.3	5.6	5.5	5.2	5.2	5.2	5.1
Real GDP—public sector	8.7	5.5	3.7	4.6	4.3	3.9	4.0	4.1	3.5
Real GDP—private sector	7.7	6.0	6.0	6.0	6.0	5.7	5.7	5.6	5.6
Consumer price index (avg)	3.7	2.9	3.5	2.9	3.2	3.4	3.6	3.4	3.3
External sector									
Exports f.o.b.	45.2	6.5	-2.9	0.2	-2.3	-1.7	-0.3	0.3	0.6
Oil	47.6	6.2	-4.3	-0.8	-4.1	-3.7	-2.4	-1.8	-1.7
Non-oil	31.3	8.0	6.0	6.5	7.8	8.4	8.9	8.7	8.6
Imports f.o.b.	23.1	18.2	7.7	6.9	7.3	7.6	7.0	6.0	4.9
Current account balance (percent of GDP)	23.7	22.4	17.9	15.4	12.5	10.4	9.0	7.5	7.0
Export volume	5.6	4.6	0.5	1.2	1.7	2.9	2.9	2.8	2.8
Import volume	12.6	18.6	10.1	9.0	8.6	7.5	6.5	5.4	4.3
Terms of trade	17.4	2.4	1.3	2.0	-2.7	-4.0	-2.9	-2.1	-1.7
Money and credit									
Net foreign assets	22.3	19.7	10.2	6.9	3.2	...	...	...	...
Credit to government (net)	24.5	32.2	5.9	2.2	-6.1	...	...	...	...
Credit to private sector	10.6	16.4	12.5	13.1	12.9	...	...	...	...
Credit to state enterprises	-1.4	24.4	11.5	8.0	8.2	...	...	...	...
Money and quasi-money (M3)	13.3	13.9	10.9	11.0	11.0	...	...	...	...
3-month Interbank rate (percent p.a.) [3]	0.69	0.92	0.95	0.94	...	...	...	...	...
	(Percent of GDP)								
Central government finances									
Revenue	44.5	45.3	41.2	40.2	37.9	35.8	34.0	32.3	30.7
Of which: oil	41.2	41.6	36.9	35.8	33.3	31.0	29.0	27.1	25.4
Expenditure	33.4	33.3	35.4	37.6	39.4	39.3	39.2	39.6	38.1
Expense	21.9	22.2	21.2	21.5	22.7	22.4	22.4	23.4	22.7
Net acquisition of non-financial assets	11.4	11.1	14.3	16.2	16.7	16.9	16.7	16.2	15.4
Net lending (+)/borrowing (-)	11.2	12.0	5.8	2.5	-1.4	-3.5	-5.2	-7.3	-7.4
Excluding oil revenue	-30.0	-29.6	-31.1	-33.2	-34.7	-34.5	-34.1	-34.4	-32.8
Non-oil primary balance/non-oil GDP	-60.9	-59.5	-59.5	-61.3	-61.1	-58.0	-55.4	-54.0	-50.1
Central government's gross domestic debt	5.4	3.6	2.7	2.6	2.5	2.4	2.3	2.2	2.1
Memorandum items:									
SAMA's total net foreign assets (US$ billions)	535.2	647.6	716.7	768.5	793.9	798.3	784.9	751.6	704.7
In months of imports of goods and services [4]	29.8	33.9	35.2	35.4	34.0	32.0	29.5	26.9	24.9
Imports goods & services/GDP	29.6	29.3	30.6	31.3	32.4	33.7	34.6	35.1	35.1
Real effective exchange rate (2000=100)[3]	96.5	99.1	101.1	99.7	...	...	...	...	...
Average exchange rate Saudi riyal/U.S. dollar[5]	3.75	3.75	3.75	3.75	...	...	...	...	...
Population (millions)	28.4	29.2	30.0	30.6	31.2	31.9	32.5	33.1	33.8
Unemployment rate (nationals, in percent of total)	12.4	12.0	11.5	...	...	...	...	...	...
All-Shares Price Index (TASI)[5]	6418	6801	8536	9581	...	...	...	...	...

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

[1] Includes production from the Neutral Zone.

[2] Includes refined products.

[3] Latest 2014 data is for end-April.

[4] Next 12 months.

[5] Latest data is for June 25, 2014.

Table 2. Saudi Arabia: Budgetary Central Government Operations, 2011–19

	2011	2012	Budget 2013	Prel. 2013	Budget 2014	Proj. 2014	2015	2016	2017	2018	2019
					(Billions of Saudi Arabian riyals)						
Revenue	1,117.8	1,247.4	829.0	1,156.4	855.0	1,175.0	1,142.1	1,114.2	1,105.1	1,101.0	1,098.8
Oil	1,034.4	1,144.8	727.0	1,035.0	735.0	1,045.1	1,001.9	964.5	941.3	924.2	908.8
Non-oil	83.4	102.6	102.0	121.3	120.0	129.9	140.2	149.7	163.8	176.7	190.0
Taxes	26.8	34.0	29.3	33.5	33.0	36.1	38.9	40.1	45.1	48.2	51.1
Other revenues	56.7	68.5	72.7	87.9	87.0	93.7	101.3	109.6	118.7	128.5	138.9
Expenditure	837.5	917.1	820.0	994.7	855.0	1,100.5	1,185.7	1,223.2	1,272.8	1,348.0	1,362.5
Expense	550.5	611.6	542.4	594.0	570.2	628.0	683.9	696.2	729.6	796.5	811.6
Compensation of employees [1]	289.0	316.7	302.9	315.0	318.6	327.0	365.6	359.2	372.0	416.8	408.9
Purchase of goods and services [2]	217.5	218.5	186.6	226.7	203.8	247.2	261.8	277.6	295.0	313.6	333.1
Subsidies [3]	9.6	10.5	18.9	15.7	14.5	16.9	18.3	19.8	21.4	23.2	25.1
Social benefits [4]	25.9	58.7	28.6	30.9	29.0	32.1	33.4	34.8	36.2	37.7	39.2
Grants	0.8	1.1	0.8	1.2	0.8	1.2	1.2	1.2	1.2	1.2	1.2
Interest payments	7.8	6.1	4.7	4.6	3.5	3.5	3.6	3.7	3.8	3.9	4.1
Net acquisition of non-financial assets	287.0	305.5	277.6	400.7	284.8	472.5	501.8	527.0	543.2	551.6	551.0
Budgeted capital expenditures	276.2	261.7	...	382.0	...	427.5	451.9	472.1	491.8	510.1	524.5
Budget surplus fund [5]	10.8	43.8	...	18.7	...	44.9	49.9	54.9	51.4	41.4	26.4
Gross operating balance	567.3	635.8	286.6	562.3	284.8	547.0	458.2	418.1	375.5	304.5	287.2
Net lending (+)/borrowing (-)	**280.3**	**330.3**	**9.0**	**161.6**	**0.0**	**74.5**	**-43.6**	**-109.0**	**-167.7**	**-247.1**	**-263.7**
Financing	280.3	330.3		161.6		74.5	-43.6	-109.0	-167.7	-247.1	-263.7
Net acquisition of financial assets	194.4	328.7		125.8		74.5	-43.6	-109.0	-167.7	-247.1	-263.7
Increase in deposits at SAMA	194.4	328.7		125.8		49.5	-68.6	-133.0	-190.7	-269.1	-284.7
Loans	0.0	0.0		0.0		25.0	25.0	24.0	23.0	22.0	21.0
Net incurrence of liabilities (-)	31.5	36.7		23.7		0.0	0.0	0.0	0.0	0.0	0.0
Other	54.4	-35.2		12.1		0.0	0.0	0.0	0.0	0.0	0.0
						(Percent of GDP)					
Revenue	44.5	45.3	29.5	41.2	29.3	40.2	37.9	35.8	34.0	32.3	30.7
Oil	41.2	41.6	25.9	36.9	25.1	35.8	33.3	31.0	29.0	27.1	25.4
Non-oil	3.3	3.7	3.6	4.3	4.1	4.4	4.7	4.8	5.0	5.2	5.3
Expenditure	33.4	33.3	29.2	35.4	29.3	37.6	39.4	39.3	39.2	39.6	38.1
Expense	21.9	22.2	19.3	21.2	19.5	21.5	22.7	22.4	22.4	23.4	22.7
Compensation of employees [1]	11.5	11.5	10.8	11.2	10.9	11.2	12.1	11.5	11.4	12.2	11.4
Purchase of goods and services [2]	8.7	7.9	6.6	8.1	7.0	8.5	8.7	8.9	9.1	9.2	9.3
Subsidies [3]	0.4	0.4	0.7	0.6	0.5	0.6	0.6	0.6	0.7	0.7	0.7
Social benefits [4]	1.0	2.1	1.0	1.1	1.0	1.1	1.1	1.1	1.1	1.1	1.1
Interest payments	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net acquisition of non-financial assets	11.4	11.1	9.9	14.3	9.7	16.2	16.7	16.9	16.7	16.2	15.4
Gross operating balance	22.6	23.1	10.2	20.0	9.7	18.7	15.2	13.4	11.6	8.9	8.0
Net lending (+)/borrowing (-)	**11.2**	**12.0**	**0.3**	**5.8**	**0.0**	**2.5**	**-1.4**	**-3.5**	**-5.2**	**-7.3**	**-7.4**
(excl. oil revenue)	-30.0	-29.6	-25.6	-31.1	-25.1	-33.2	-34.7	-34.5	-34.1	-34.4	-32.8
Memorandum items:											
Non-oil overall balance	-754.1	-814.5	-718.0	-873.4	-735.0	-970.6	-1,045.5	-1,073.5	-1,109.0	-1,171.3	-1,172.5
Non-oil revenue (excl. investment income)/non-oil GDP	6.4	6.7	5.9	7.2	6.1	7.1	7.1	7.0	7.0	7.0	7.0
Current balance	567.3	635.8	...	562.3	...	547.0	458.2	418.1	375.5	304.5	287.2
Non-oil primary balance/non-oil GDP	-60.9	-59.5	...	-59.5	...	-61.3	-61.1	-58.0	-55.4	-54.0	-50.1
Structural balance/non-oil GDP [6]	-8.1	-6.4	...	-2.3	...	-4.9	-3.4	-2.5	-5.1	-8.8	-9.2
Average oil export price	107.1	109.5	...	105.8	...	105.0	101.6	97.7	95.2	93.4	91.8
Gross domestic debt/GDP	5.4	3.6	...	2.7	...	2.6	2.5	2.4	2.3	2.2	2.1
Government Deposits at SAMA	1,187.0	1,515.7		1,641.5		1,691.1	1,622.5	1,489.5	1,298.7	1,029.7	745.0

Sources: Ministry of Finance; and IMF staff projections.

[1] Including the extra month salary according to Hijri calendar in 2012, 2015, and 2018.

[2] Reallocation of 70 b SAR from purchases of goods in services to budgeted 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.

[5] Capital expenditures financed by earmarked funds in previous years in the Budget Surplus Fund.

[6] The structural balance is calculated using a 5-year backward oil price rule and a 3-year average of oil export volume.

Table 3. Saudi Arabia: Fiscal Operations of the General Government, 2007–13
(Percent of GDP)

	2007	2008	2009	2010	2011	2012	2013
I. Budgetary central government							
Revenue	41.2	56.5	31.7	37.5	44.5	45.3	41.2
Expenditure	29.5	26.7	37.1	34.0	33.4	33.3	35.4
Overall balance	11.8	29.8	-5.4	3.6	11.2	12.0	5.8
Primary balance	13.1	30.7	-4.5	4.1	11.5	12.2	5.9
II. Autonomous Government Institutions (AGIs)							
Public Pension Agency (PPA)							
Revenue	2.7	2.0	2.4	1.9	1.4	3.2	3.3
Expenditure	1.7	1.4	2.0	1.9	1.5	1.6	1.6
Overall balance	1.0	0.6	0.4	0.0	-0.2	1.6	1.6
General Organization for Social Insurance (GOSI)							
Revenue	1.5	1.0	1.2	1.3	1.0	1.0	1.3
Expenditure	0.4	0.4	0.5	0.5	0.4	0.5	0.7
Overall balance	1.0	0.6	0.7	0.8	0.6	0.5	0.7
III. Public Investment Fund (PIF)							
Revenue	1.2	1.0	0.7	0.9	0.6	0.7	0.7
Expenditure	0.0	0.4	0.6	0.0	0.2	0.1	0.0
Overall balance	1.2	0.6	0.1	0.8	0.4	0.6	0.6
IV. General government (=I+II+III)							
Overall balance	15.0	31.6	-4.1	5.2	12.0	14.7	8.7
Primary balance	16.4	32.5	-3.2	5.7	12.3	15.0	8.9
Memorandum items: net assets(+)/debt (-)							
i. Central government debt	-17.1	-12.1	-14.0	-8.4	-5.4	-3.6	-2.7
ii. Autonomous government institutions	46.9	32.6	42.9	38.9	31.0	30.5	33.5
Of which: PPA	26.6	18.1	24.0	21.3	17.1	17.2	18.5
Of which: GOSI	20.3	14.4	18.9	17.6	13.9	13.2	14.9
iii. Public Investment Fund	10.7	9.1	11.2	10.0	8.3	9.3	9.7
iv. General government (=i+ ii+iii)	40.5	29.7	40.1	40.4	33.9	36.1	40.5
v. Government Deposits held at SAMA	33.1	54.2	57.4	50.2	47.3	55.1	58.5
vi. Net assets (iv + v)	73.6	83.8	97.5	90.7	81.2	91.2	99.0

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

Table 4. Saudi Arabia: Balance of Payments, 2011–19
(US$ billion)

			Prel.	Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Current account	158.6	164.8	134.3	120.2	100.1	86.5	77.7	68.4	66.7
(Percent of GDP)	23.7	22.4	17.9	15.4	12.5	10.4	9.0	7.5	7.0
Trade balance	244.8	246.6	224.3	214.6	193.9	174.4	160.0	149.1	140.8
Exports	364.7	388.4	377.0	377.8	369.1	362.8	361.7	362.8	364.9
Oil exports	317.6	337.5	323.1	320.3	307.1	295.6	288.5	283.3	278.6
Other exports	47.1	50.9	54.0	57.5	62.0	67.2	73.1	79.5	86.4
Imports (f.o.b.)	-120.0	-141.8	-152.7	-163.3	-175.2	-188.4	-201.6	-213.8	-224.1
Services	-66.5	-62.4	-64.9	-68.8	-72.9	-78.6	-84.6	-91.1	-95.8
Transportation	-13.4	-15.6	-16.7	-17.7	-18.7	-20.1	-21.7	-23.3	-24.5
Travel	-8.8	-9.6	-10.0	-10.7	-11.5	-12.6	-13.8	-15.0	-15.9
Other private services	-44.3	-37.2	-38.2	-40.4	-42.7	-45.8	-49.2	-52.8	-55.4
Income	9.7	11.0	10.8	13.2	20.8	35.5	50.8	62.8	78.1
Of which: Investment income[1]	10.3	11.6	11.4	13.8	21.4	36.2	51.4	63.4	78.8
Current transfers	-29.4	-30.4	-35.9	-38.7	-41.7	-44.9	-48.5	-52.3	-56.4
Of which : Workers' remittances	-27.6	-28.6	-34.1	-36.8	-39.8	-43.0	-46.6	-50.4	-54.5
Capital Account	0.0	-0.3	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-14.4	-6.4	-61.0	-68.5	-74.8	-82.0	-91.1	-101.7	-113.6
Direct Investment	12.9	7.8	4.4	4.3	4.1	4.0	3.9	3.7	3.5
Abroad	-3.4	-4.4	-4.9	-5.4	-5.8	-6.3	-6.9	-7.6	-8.3
In Saudi economy	16.3	12.2	9.3	9.7	10.0	10.3	10.8	11.3	11.8
Portfolio investments	-16.0	-3.2	-9.4	-11.7	-14.3	-17.4	-21.1	-25.5	-30.6
Assets	-15.4	-4.1	-11.2	-13.9	-17.0	-20.7	-25.1	-30.3	-36.3
Liabilities	-0.6	0.9	1.8	2.2	2.7	3.3	4.0	4.8	5.8
Other investments	-11.2	-11.0	-55.9	-61.0	-64.6	-68.7	-73.9	-79.9	-86.6
Assets	-7.2	-10.3	-52.3	-57.1	-60.5	-64.3	-69.2	-74.8	-81.0
Liabilities	-4.0	-0.7	-3.6	-3.9	-4.1	-4.4	-4.7	-5.1	-5.5
Net errors and omissions	-48.2	-42.3	-3.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	96.0	115.8	69.2	51.8	25.4	4.5	-13.4	-33.3	-46.9
Financing	-96.0	-115.8	-69.2	-51.8	-25.4	-4.5	13.4	33.3	46.9
Change in SAMA's NFA (- increase)	-93.1	-112.5	-69.7	-51.8	-25.4	-4.5	13.4	33.3	46.9
Memorandum items:									
SAMA's gross foreign assets	536.2	648.7	718.4	770.2	795.6	800.0	786.6	753.3	706.4
(In months of imports)[2]	29.9	34.0	35.3	35.5	34.1	32.0	29.6	27.0	25.0
Non-oil current account/GDP	-23.8	-23.5	-25.2	-25.7	-25.8	-25.2	-24.3	-23.7	-22.2
WEO oil price (US$/barrel)	104.0	105.0	104.1	104.1	99.6	95.1	92.3	90.6	89.4
Average Saudi oil price (US$/barrel)[3]	107.1	109.5	105.8	105.0	101.6	97.7	95.2	93.4	91.8
Oil production (mbd)	9.3	9.8	9.6	9.7	9.7	9.8	9.9	10.0	10.1
Oil exports (mbd)	8.1	8.4	8.4	8.4	8.3	8.3	8.3	8.3	8.3
Oil exports/total exports	87.1	86.9	85.7	84.8	83.2	81.5	79.8	78.1	76.3
Imports of goods/GDP	17.9	19.3	20.4	20.9	21.8	22.7	23.3	23.5	23.5
GDP (US$ billion)	669.5	734.0	748.4	779.4	803.0	830.4	866.7	908.3	952.9

Sources: Saudi Arabian Monetary Agency; 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, 2010–15

	2010	2011	2012	2013	Proj. 2014	Proj. 2015
	(Billions of Saudi Arabian riyals)					
Foreign assets (net)	1,749.9	2,140.4	2,562.0	2,824.1	3,019.6	3,116.1
SAMA	1,651.5	2,007.1	2,428.6	2,687.8	2,881.9	2,977.0
Commercial banks	98.4	133.3	133.4	136.3	137.6	139.0
Domestic credit (net)	-2.5	-119.0	-295.9	-245.0	-125.7	130.6
Net claims on government	-810.5	-1,009.2	-1,334.6	-1,412.8	-1,444.0	-1,355.2
Claims on government	182.0	177.8	181.2	228.7	247.1	267.3
Government deposits at SAMA	-992.6	-1,187.0	-1,515.7	-1,641.5	-1,691.1	-1,622.5
Claims on state enterprises	32.3	31.8	39.6	44.1	47.7	51.6
Claims on private sector	775.8	858.4	999.1	1,123.6	1,270.6	1,434.3
Money and quasi-money (M3)	1,080.4	1,223.6	1,393.8	1,545.1	1,715.2	1,903.0
Money supply (M2) 2/						
Money (M1)	625.6	761.0	887.1	1,000.4	1,091.7	1,211.2
Currency outside banks	95.5	119.9	133.1	143.2	185.0	205.3
Demand deposits	530.1	641.1	754.0	857.3	906.7	1,006.0
Quasi-money	454.8	462.6	506.6	544.7	623.5	691.8
Time and savings deposits	298.3	305.4	324.4	345.0	394.9	438.2
Other quasi-money deposits	156.5	157.1	182.2	199.7	228.5	253.6
Other items (net liabilities)	667.1	797.8	872.4	1,033.9	1,178.7	1,343.7
	(Changes in percent of beginning broad money stock)					
Foreign assets (net)	11.5	36.1	34.5	18.8	12.7	5.6
Domestic credit (net)	0.4	-10.8	-14.5	3.6	7.7	14.9
Net claims on government	-4.0	-18.4	-26.6	-5.6	-2.0	5.2
Claims on government	2.7	-0.4	0.3	3.4	1.2	1.2
Government deposits (increase -)	-6.7	-18.0	-26.9	-9.0	-3.2	4.0
Claims on state enterprises	0.4	0.0	0.6	0.3	0.2	0.2
Claims on private sector	4.0	7.6	11.5	8.9	9.5	9.5
Money and quasi-money	5.0	13.3	13.9	10.9	11.0	11.0
Other items (net liabilities)	6.9	12.1	6.1	11.6	9.4	9.6
	(Percent changes, unless otherwise indicated)					
Foreign assets (net)	7.3	22.3	19.7	10.2	6.9	3.2
Domestic credit (net)	-62.3	4717.7	148.6	-17.2	-48.7	-203.9
Net claims on government	5.4	24.5	32.2	5.9	2.2	-6.1
Claims on government	18.1	-2.3	1.9	26.3	8.0	8.2
Government deposits at SAMA (increase -)	-7.5	-19.6	-27.7	-8.3	-3.0	4.1
Claims on state enterprises	14.7	-1.4	24.4	11.5	8.0	8.2
Claims on private sector	5.7	10.6	16.4	12.5	13.1	12.9
Money and quasi-money	5.0	13.3	13.9	10.9	11.0	11.0
Other items (net liabilities)	12.0	19.6	9.3	18.5	14.0	14.0
	(Percent; unless otherwise indicated)					
Memorandum items:						
Specialized Credit Institutions credit (SAR billions)	192.2	208.4	249.3	271.6	…	…
Ratio of M3-to-GDP	54.7	48.7	50.6	55.1	58.7	63.2
Ratio of Claims on private sector-to-non-oil GDP	71.9	70.5	73.8	76.7	80.3	83.8

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

Table 6. Saudi Arabia: Financial Soundness Indicators, 2006–13

(Percent, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	2012	2013
Banking sector								
Structure of the banking sector								
Number of licensed banks	16.0	22.0	22.0	23.0	23.0	23.0	23.0	24.0
Number of banks accounting for:								
25 percent of total assets	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
75 percent of total assets	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Total assets (percent of GDP)	61.0	69.0	66.8	85.2	71.6	61.5	63.0	67.5
Of which: Foreign currency-denominated (as percent of total asset	15.1	13.7	11.8	15.4	13.6	13.5	12.3	11.1
Total loans (percent of GDP)	35.2	38.2	38.2	45.8	39.2	39.8	36.3	39.9
Credit to private sector (percent of GDP)	32.7	35.8	36.6	44.0	37.6	30.0	34.9	38.4
Total deposits, excluding interbank (as percent of GDP)	41.9	46.0	43.4	58.5	49.9	44.0	45.8	50.0
Central bank credit to banks (as percent of GDP)	0.4	...	...	...	...	...	...	...
Capital adequacy								
Regulatory capital to risk-weighted assets	24.9	20.7	16.0	16.9	17.6	17.6	18.2	17.9
Asset quality								
Net loans to total assets	54.2	52.0	57.9	57.4	55.2	55.8	58.2	59.8
Gross NPLs to net loans	2.0	2.1	1.4	3.3	3.0	2.3	1.9	1.3
Total provisions to gross NPLs	182.3	142.9	153.3	89.8	115.7	133.2	145.1	157.4
Net NPLs to total capital [1]	-6.2	-3.5	-3.8	1.4	-2.7	-3.0	-3.7	-3.4
Total provisions for loan losses (as percent of total loans)	3.6	3.0	2.1	3.0	3.5	3.1	2.8	2.1
Loans to property and construction sector to total loans	7.6	7.3	7.3	6.1	7.2	8.1	7.5	6.8
Loans to domestic manufacturing sector to total loans	7.6	9.1	10.7	10.2	11.6	13.0	12.6	12.5
Contingent and off-balance sheet accounts to total assets	91.5	96.6	96.0	81.0	91.4	96.2	91.7	90.8
Profitability								
Profits (percent change)	35.3	-12.7	-1.1	-10.4	-2.6	18.4	8.4	6.5
Average pretax return on assets	4.3	2.8	2.7	1.9	2.5	2.0	2.0	2.0
Return on equity	30.4	22.3	20.5	13.7	17.7	14.5	14.5	14.3
Noninterest expenses to total income [2]	31.0	38.7	51.1	55.4	52.7	46.9	47.0	47.7
Average lending spread	4.1	3.2	4.0	4.4	4.3	4.4	3.7	3.5
Liquidity								
Liquid assets to total assets	25.4	21.7	22.0	25.3	24.7	22.6	23.7	21.5
Liquid assets to short-term liabilities [3]	40.0	27.7	30.6	36.5	36.4	37.0	36.4	33.1
Customer deposits to net loans	137.4	136.3	124.0	128.5	136.0	135.9	132.0	129.2
Demand deposits to total deposits	41.2	43.4	40.5	46.1	53.8	58.1	59.8	61.1
Sensitivity to market risk								
Foreign currency-denominated deposits to total deposits	19.3	15.4	15.5	16.1	13.0	14.6	17.3	15.0
Foreign currency-denominated loans to total loans	8.7	12.5	14.0	14.0	13.3	12.3	11.6	10.4
Foreign currency-denominated contingent and off-balance sheet accounts to total assets	49.2	53.0	54.5	39.2	42.2	47.9	41.3	34.6
Net open foreign currency position to capital	3.0	3.1	4.5	8.6	10.2	6.7	1.7	6.3
Stock market								
Stock market capitalization (percent of GDP)	86.9	124.8	47.4	74.3	67.1	50.6	50.9	62.5
Overall stock market price index (change in percent)	-52.5	39.1	-56.5	27.5	8.2	-3.1	6.0	25.5
Bank stock price index (change in percent)	-42.7	31.0	-55.6	15.3	6.6	-12.7	0.4	22.0

Source: Saudi Arabian Monetary Agency.

[1] The negative sign reflects that provisions exceed gross NPLs.

[2] Total income includes net interest income and gross noninterest income.

[3] Short-term liabilities include demand deposits maturing in 90 days or less. Liquid assets include cash, gold, Saudi government bonds and treasury bills, and interbank deposits maturing within 30 days.

Appendix I. Debt Sustainability Exercise

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

(In percent of GDP unless otherwise indicated)

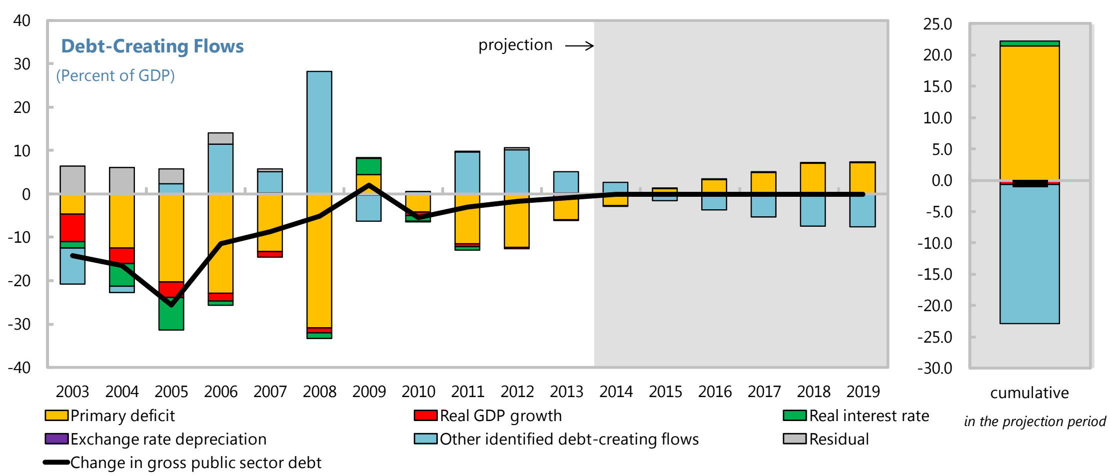
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	29.2	3.6	2.7	2.6	2.5	2.4	2.3	2.2	2.1
Public gross financing needs	-4.6	-10.1	-4.9	-2.5	1.4	3.5	5.2	7.3	7.4
Real GDP growth (in percent)	6.4	5.8	4.0	4.6	4.5	4.4	4.4	4.4	4.4
Inflation (GDP deflator, in percent)	8.4	3.6	-1.9	-0.4	-1.4	-0.9	-0.1	0.3	0.5
Nominal GDP growth (in percent)	15.5	9.6	2.0	4.1	3.0	3.4	4.4	4.8	4.9
Effective interest rate (in percent) [4/]	5.1	4.5	4.7	4.7	4.8	4.9	5.0	5.2	5.5

As of March 19, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		94
5Y CDS (bp)		63
Ratings	Foreign	Local
Moody's	Aa3	Aa3
S&Ps	AA-	AA-
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing
Change in gross public sector debt	-9.8	-1.8	-0.9	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	primary
Identified debt-creating flows	-12.0	-2.4	-0.9	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	balance [9/]
Primary deficit	-12.7	-12.2	-5.9	-2.7	1.3	3.4	5.0	7.1	7.3	21.5	-7.4
Primary (noninterest) revenue and grants	42.2	45.3	41.2	40.2	37.9	35.8	34.0	32.3	30.7	211.0	
Primary (noninterest) expenditure	29.5	33.1	35.3	37.5	39.3	39.2	39.0	39.5	38.0	232.5	
Automatic debt dynamics [5/]	-3.8	-0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Interest rate/growth differential [6/]	-3.8	-0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Of which: real interest rate	-1.7	0.0	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.8	
Of which: real GDP growth	-2.2	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	4.6	10.1	4.9	2.5	-1.4	-3.5	-5.2	-7.3	-7.4	-22.2	
Accumulation of deposits	4.6	10.1	4.9	2.5	-1.4	-3.5	-5.2	-7.3	-7.4	-22.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea lc	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	2.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general 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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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).

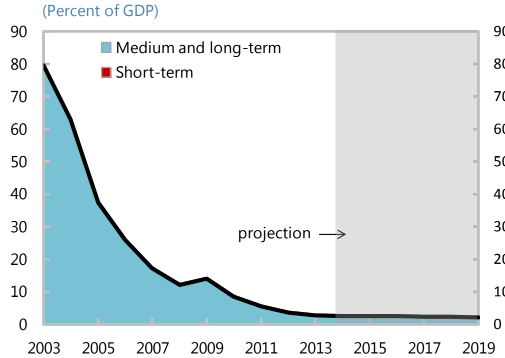
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

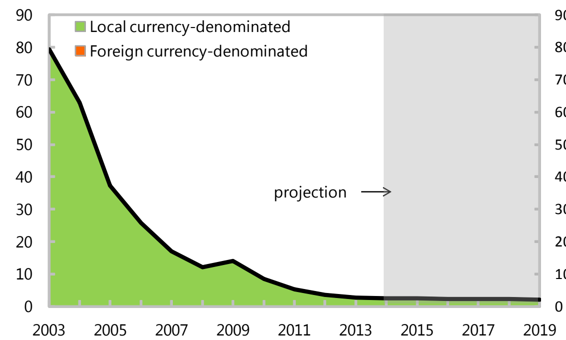
Saudi Arabia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(Percent of GDP)



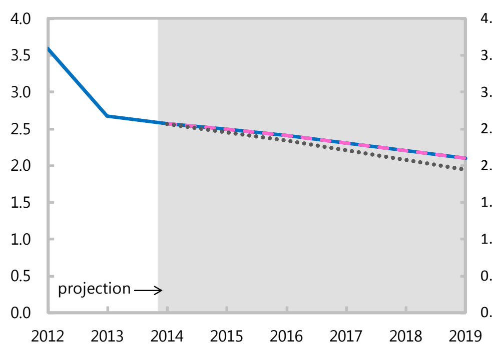
By Currency
(Percent of GDP)



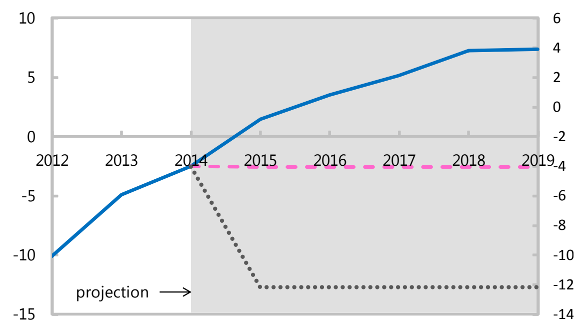
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(Percent of GDP)



Public Gross Financing Needs
(Percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.6	4.5	4.4	4.4	4.4	4.4
Inflation from GDP defl	-0.4	-1.4	-0.9	-0.1	0.3	0.5
CPI inflation	2.9	3.2	3.4	3.6	3.4	3.3
Primary Balance	2.7	-1.3	-3.4	-5.0	-7.1	-7.3
Effective interest rate	4.7	4.8	4.9	5.0	5.2	5.5
Constant Primary Balance Scenario						
Real GDP growth	4.6	4.5	4.4	4.4	4.4	4.4
Inflation from GDP defl	-0.4	-1.4	-0.9	-0.1	0.3	0.5
CPI inflation	2.9	3.2	3.4	3.6	3.4	3.3
Primary Balance	2.7	2.7	2.7	2.7	2.7	2.7
Effective interest rate	4.7	4.8	4.9	5.0	5.2	5.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.6	6.0	6.0	6.0	6.0	6.0
Inflation from GDP defl	-0.4	-1.4	-0.9	-0.1	0.3	0.5
CPI inflation	2.9	3.2	3.4	3.6	3.4	3.3
Primary Balance	2.7	12.8	12.8	12.8	12.8	12.8
Effective interest rate	4.7	4.8	4.9	5.0	5.2	5.5

Source: IMF staff.

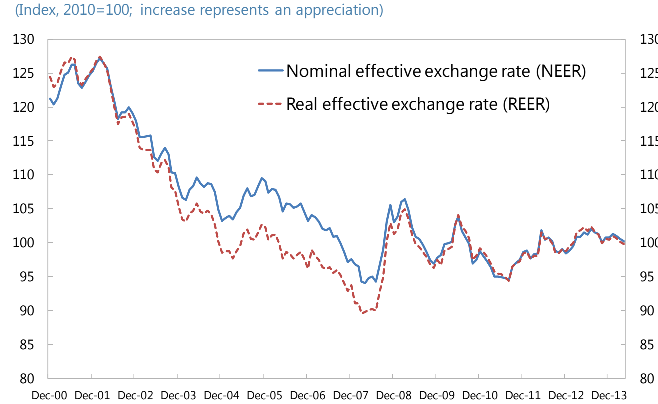
Appendix II. External Sustainability and Exchange Rate Assessment

Staff believes the peg to the U.S. dollar is appropriate given the current structure of the Saudi economy. Estimates from current account assessment methodologies tailored to oil exporters give inconclusive results about whether the current account surplus is at an appropriate level, although estimates suggest the real exchange rate is in line with its long-run relationship with real oil prices. On balance, staff believes there is no compelling evidence that the exchange rate is misaligned.

1. The current account surplus in 2013 narrowed due to lower oil revenue. The surplus declined to 18 percent of GDP from 22 percent of GDP in 2012 as oil export volumes remained flat and export prices fell by 3.4 percent. Oil prices are anticipated to decline over the medium term while oil export volumes are expected to decline slightly as output from the U.S. and other countries increases. This implies a significantly reduced current account surplus going forward (7 percent of GDP in 2019). Over the long term, the current account will be determined by the nature of the development strategy chosen—in particular the balance between saving oil revenues overseas to create an income stream for future generations versus domestic investment (public and private)—and by Saudi Arabia's role as the producer that balances supply and demand in the global oil market that will determine the pace of oil extraction.

2. In recent years, the share of Saudi non-oil exports in global non-oil exports has increased as the authorities have pursued economic diversification, particularly in petrochemicals. Despite the increase, Saudi non-oil exports in 2013 were around 1/3 of 1 percent of global non-oil exports. In terms of metrics of external vulnerability, the Saudi external situation is very comfortable. Foreign exchange reserves covered 35 months of imports and 174 percent of broad money in 2013, while external assets stood at an estimated 130 percent of GDP in 2012 and external liabilities at 34 percent of GDP (of which portfolio and other investments amounted to 7 percent of GDP). The financial account, excluding official reserves, is dominated by direct investment inflows, and trade credits and portfolio outflows. Errors and omissions, which were large and consistently negative in the past, have been reduced to 0.5 percent of GDP in 2013 as a result of improved coverage of other investment flows in the 2013 data.

Real and Nominal Effective Exchange Rates, Dec. 2000–Apr. 2014
(Index, 2010=100; increase represents an appreciation)



Sources: Country authorities; and IMF staff estimates.

3. Despite terms of trade gains, the real exchange rate is close to its end-2008 level.[1] Following a period of an annual

[1] Inflation measures, and therefore the estimated real exchange rate, are affected by the presence of a range of subsidies—fuel, electricity, water, and certain food items.

average depreciation of 5 percent between 2002 and 2007, the trade-weighted real effective exchange rate (REER) index appreciated by 8 percent in 2008, but has remained broadly unchanged since. The nominal effective exchange rate closely followed the REER trend.

4. The macroeconomic balance approach suggests the current account is within the range of medium term norms estimated from several different specifications. The macroeconomic balance approach estimates four main specifications of the equilibrium current account (norm) from a set of fundamentals (non-oil and gas fiscal balance, oil and gas reserves, old-age dependency ratio, population growth rate, initial net foreign assets (NFA) net of external debt, oil trade balance, growth rate of real per capita GDP, relative income, and lagged dependent current account) employing a generalized method of moments (GMM) technique (see Beidas-Strom and Cashin, 2011). As shown (in the table below), the estimation yields a range of current account norms for Saudi Arabia from a surplus of about 3 to 13 percent of GDP in 2019, with specification II, yielding a norm of 6.4 percent, being the preferred one given the absence of a lagged dependent variable and the inclusion of NFA data. The projected current account position in 2019 is a surplus of 7 percent of GDP, which lies within the estimated range of current account norms, but above that derived from specification II.

Current Account-GMM Estimation and Implied Norm for Net-Oil Exporters: Saudi Arabia

(Dependent variable: current account balance, as a share of GDP)

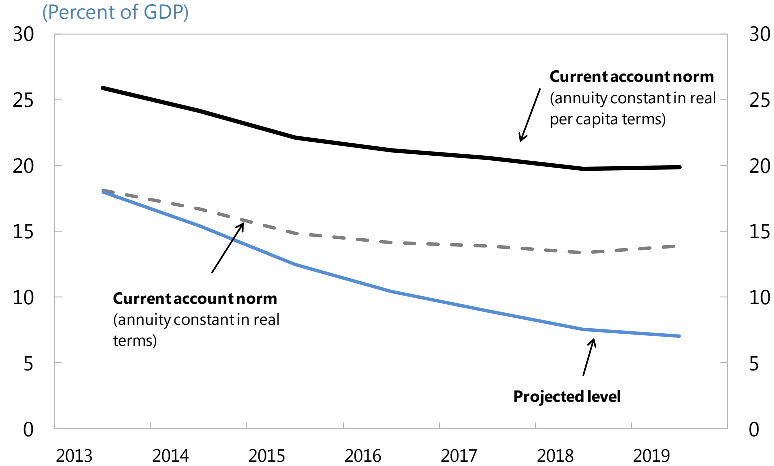
	Specification I		Specification II		Specification III		Specification IV	
	GMM Coefficients	Contribution to CA Norm[1]	GMM Coefficients	Contribution to CA norm[1]	GMM Coefficients	Contribution to CA Norm[1]	GMM Coefficients	Contribution to CA Norm[1]
Core CGER regressors								
Constant	0.039	3.9%	0..35	3.5%	0.043	4.3%	0.044	4.4%
Lagged dependent	0.330	6.3%					0.383	7.3%
Fiscal balance/Non-oil fiscal balance GDP	0.851	-6.3%	0.385	-12.6%	0.363	-11.9%	0.391	-12.8%
Oil trade balance/GDP			0.454	13.3%	0.469	13.7%	0.459	13.4%
Old age dependency	-0.053	-0.2%	-0.059	-0.3%	-0.034	-0.2%	-0.034	-0.2%
Population growth	-0.693	-1.4%	-0.930	-1.9%	-0.632	-1.3%	-0.589	-1.2%
NFA/GDP	0.023	1.6%	0.022	1.6%				
Relative income	-0.017	-1.0%	0.044	2.6%	0.071	4.3%	0.073	4.4%
Economic growth	-0.053	-0.2%	-0.069	-0.3%	-0.064	-0.3%	-0.056	-0.2%
Net oil-exporter specific regressors								
Oil wealth			0.000	0.5%	0.001	1.5%	0.000	-1.0%
Degree of maturity in oil production					0.160	2.8%	-0.170	-3.0%
Additional regressors								
REER	0.073	0.8%						
Terms of trade	4.269	-0.7%						
Estimated current account norm (2019)		**2.8%**		**6.4%**		**13.0%**		**11.1%**
Underlying current account					**7.0%**			
Hansen's J test of over identifying restrictions		0.46		0.61		0.64		0.62
Arellano-Bond test for AR(1)		0.07		0.09		0.07		0.08
Arellano-Bond test for AR(2)		0.67		0.71		0.7		0.69
Number of instruments		6		5		5		6
Number of countries		24		24		24		24
Observations		82		82		82		82

Source: Beidas-Strom and Cashin, "Are Middle Eastern Current Account Imbalances Excessive?," IMF Working Paper 11/195, 2011.

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

5. The external sustainability approach suggests the current account surplus in the medium-term may be too low. 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. Subject to this constraint, the government would choose a path for imports, and hence a current account norm, that would support intergenerational equity—and some precautionary savings in view of volatile oil prices—through an appropriate pace of accumulation of net foreign assets. Estimating Saudi Arabia's oil wealth at $6.2 trillion,[2] import trajectories "(annuities or allocation rules)" are calculated under two different policy scenarios: (i) constant real per capita annuity; and (ii) constant real annuity. Both types of annuities are used in the literature,[3] and can be derived from the optimization of plausible government utility functions. The estimates suggest that the current account surplus is below what would be expected under both the constant real annuity rule and the constant real per capita annuity rule. These estimates are subject to considerable uncertainty and are sensitive to the parameters assumed. For example, if future oil revenues are discounted at 8 percent rather than 6 percent, the current account norms under the constant real annuity rule and the constant real per capita rule drop to 8.5 percent and 12.5 percent of GDP in 2019 respectively.

Projected and Current Account Norm, 2013–19
(Percent of GDP)



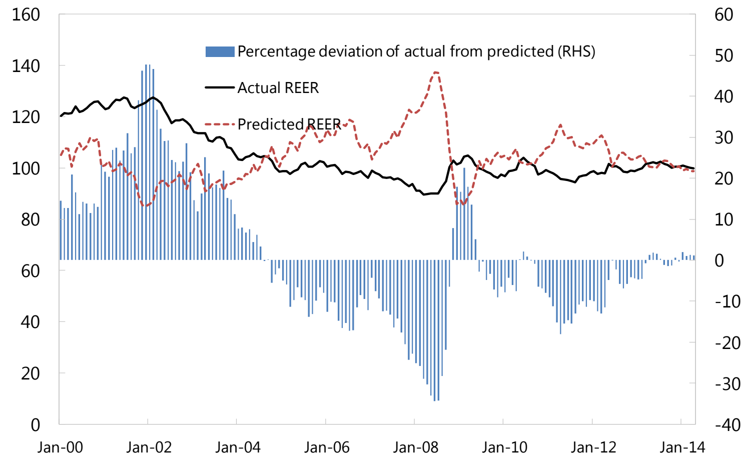
Source: IMF staff estimates.

[2] Based on SAMA annual report, the proven oil reserve at end of 2012 is 265.9 billion barrels. The oil production grows at a constant rate (2 percent) and peaks at 12.8 million barrels in 2029 before declining gradually (2 percent). Domestic oil consumption grows at 2 percent. Oil prices and the GDP deflator increase by 2.5 percent after 2018, and real non-oil GDP grows by 5 percent while total real output growth is assumed to be 3 percent. Future oil revenues are nominally discounted at 6 percent, the assumed rate of return on externally held financial wealth/NFA, while population growth is 1 percent.

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

6. A third approach that looks at the relationship between the real exchange rate and real oil prices suggests the riyal is not misaligned. As a country whose dominant export is oil, the movements in the terms of trade are mainly driven by fluctuations the international oil price. Therefore, the equilibrium exchange rate can be reasonably estimated using oil prices alone. A cointegrating relationship between the real exchange rate and the real oil price shows that while the riyal was moderately above the level predicted by this relationship during the early 2000s, it then switched to below the predicted level in mid-2004, and is now broadly in line with the longer-term relationship.[4]

Equilibrium Real Exchange Rate Assessment, Jan 2000–Apr 2014



Source: IMF staff estimates.

[4] Staff estimated the co-integrating relationship between the real exchange rate and the real oil price (using the U.S. CPI as the deflator) on monthly data from January 1980-April 2014. This estimated relationship is very similar to that in the unpublished paper by Cashin, Ouliaris, and Poghosyan, but has been re-estimated using the latest available data.

Appendix III. Key Recommendations of 2011 FSAP Update

Recommendation	Progress
Bank and Securities Regulation	
• Update the BCL and remove need for ministerial approval of certain SAMA decisions.	SAMA's assessment is that the existing BCL has provided a strong basis for effective supervision. Ministerial approval is only required in times of extreme stress and is viewed by SAMA as a means of ensuring communication with Cabinet.
• No longer allow large exposure up to 50 percent of bank's own capital.	There have been no changes in the legislation. However, SAMA expects banks to ensure that their single exposure limit should not exceed 15 percent of capital and reserves. Furthermore, SAMA has prepared revised rules on large exposures base on BCBS new large exposures framework, which are under discussion and will be finalized shortly.
• Strengthen the CMA's regulatory transparency by fully disclosing all enforcement actions, interpretation, and funding	The CMA has established an internal committee to discuss relevant FSAP recommendations, including disclosure policies.
Systemic Stability	
• Introduce a formal liquidity forecasting framework.	SAMA is currently working on a formal liquidity forecasting model.
• Enhance data on cross-border financial activities of banks and corporate.	SAMA published the International Investment position in 2012 (annual basis), and submitted ten core FSI indicators to the IMF beginning in March 2013. It is planning to submit locational and consolidated bank data to the BIS.
• Maintain a stable stock of government securities and regular issues to help anchor a robust yield curve	There are no plans to increase and maintain a stable stock of government securities. However, public sector entities have recently increased sukuk issuance, and eventually this could help in establishing a proxy government benchmark.
• Introduce a payment system law.	The authorities believe that the current legal framework is adequate and serving the purpose well.
• Conduct stress tests with a wider range of shocks, including liquidity shocks, on regular basis and incorporate lessons into supervision.	Detailed rules on stress testing were issued in November 2011, making stress testing mandatory. SAMA has also developed a system-wide stress test, covering credit, market, operational and liquidity risks.
• Establish a formal early warning system (EWS) for the banking sector.	SAMA considers that its current off-site surveillance system is adequate as a EWS. SAMA established a dedicated Financial Stability Division in 2013 which is developing an internal macroprudential dashboard.
• Develop a more formal and transparent macroprudential policy framework, drawing on work in international fora.	SAMA is actively participating in the international fora on macro-prudential frameworks and has carried out a detailed study, identifying key requirements and international developments in peer and other countries. The overall framework is yet to be decided, but will involve cooperation and coordination between SAMA, the Capital Markets Authority (CMA) and MoF.
• Strengthen the legal framework for bank resolution	The authorities will assess the need for any further steps required to strengthen the existing bank resolution framework.

Key Recommendations of 2011 FSAP Update (concluded)

Expanding Access to Finance and Preserving Financial Stability	
• As housing finance expands in the future, ensure loan soundness through strong prudential measures, notably lowering permissible loan-to-value and debt service ratios.	Although housing loans continue to grow, SAMA believes that the current prudential measures that are in place will ensure that banks are managing the associated risks prudently. LTV ratios have been capped at 70 percent under the new mortgage law that will come into force in November 2014. Housing finance companies that may enter the market will be licensed and supervised by SAMA.
• Contract banks to manage both the existing and new Real Estate Development Fund (REDF) portfolio.	As of now there are no plans to allow banks to manage the portfolio of REDF.
• Complement mortgage reform by establishing a housing market observatory, developing consumer guidance options, and strengthening the developer industry.	A separate Ministry of Housing has been established, which will look into these and any other related issues.
• Prepare long-term funding solution for mortgage finance, starting with a refinance facility.	REDF is no longer accepting fresh applications, which are being handled by the Ministry of Housing. For existing approved loans, REDF is considering several options to enhance its integration with the banking sector, including long-term funding facility. The Ministry of Housing is developing detailed plans to utilize the SAR 250bn fund for housing sector development. A mortgage refinancing company will be established under the Public Investment Fund (PIF).
• Create a modern, electronic and unified registry for movable collateral.	The authorities will assess the need to further study the proposal.
• Enact and implement the draft Enforcement law that introduces specialized enforcement courts operating with strict time-bound procedures.	The Mortgage Law, which includes the Enforcement Law, has already been enacted.
• Closely supervise the quality of SME units in the banks, including the robustness or their internal rating systems and automated procedures.	All banks have been required to set up their own separate SME units in order to more effectively deal with SME financing.
Insurance, Institutional Investors, and Capital Markets	
• Finalize and issue the outstanding functional regulations for insurance	SAMA has expedited all outstanding regulations, except corporate governance regulations which are in draft phase. Two regulations; actuarial and audit committee are in the final stage for publication.
• Improve enforcement of mandatory motor third party liability insurance	SAMA and the joint working group are meeting regularly and are in the final stage of improving the implementation of motor TPL enforcement. Legislation requiring full insurance of government (non-military) vehicles would be enacted soon.
• Disclose the investment policies, portfolio, and portfolio performance of the Public Pension Agency (PPA) and General Organization for Social Insurance (GOSI).	There have been no changes in the disclosure policies of PPA and GOSI. GOSI have established a committee to discuss disclosure issues.
• Further outsource the management of portfolio of the PPA and GOSI.	PPA and GOSI have no plans to outsource part of their domestic portfolio. The foreign portfolios are outsourced to a large degree.
• Permit foreign international investors to invest directly in Tadawul.	CMA and the Supreme Economic Council are considering allowing foreign institutional investors to invest directly.

SAUDI ARABIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 25, 2014

Prepared By

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

CONTENTS

FUND RELATIONS

(As of May 31, 2014)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	6,985.50	100.00
Fund holdings of currency	5,143.26	73.63
Reserve tranche position	1,842.26	26.37
Lending to the Fund	1,433.47	
New Arrangement to Borrow		

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	6,682.50	100.00
Holdings	6,264.47	93.74

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				
	2014	2015	2016	2017	2018
Principal	0.0	0.0	0.0	0.0	0.0
Charges/interest	0.40	0.59	0.59	0.59	0.59
Total	0.40	0.59	0.59	0.59	0.59

Lending to the Fund and Grants:

Saudi Arabia has consented to the amendments of the NAB Decision and the increases of credit arrangements of participants as approved by the Executive Board on April 12, 2010 (Executive Board Decision No. 14577-(10/35), increasing its own credit arrangement in the expanded NAB to SDR 11.13 billion, from SDR 1.76 billion. The current outstanding amount as of May 31, 2014 is SDR 1433.47 million. The Fund also has a borrowing agreement with Saudi Arabia in association with the General Arrangements to Borrow (GAB), for an amount equivalent to SDR 1.5 billion, which was renewed for another five-year period from December 26, 2008. In March 2001, Saudi Arabia agreed to support the 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

71.88 million. As regards loan resources, the Fund as Trustee of the Poverty Reduction and Growth Trust (PRGT) entered into a borrowing agreement with the Saudi Arabian Monetary Agency in May 2011, by which Saudi Arabia would provide new loan resources of up to SDR 500 million.

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 4.28255=SDR 1, with margins of 7.25 percent even though in practice it has been pegged to the U.S. dollar since 1986, with a middle rate of 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 May 5–18, 2013 in Riyadh. The staff report was considered by the Executive Board on July 8, 2013 and published on July 24, 2013 (http://www.imf.org/external/pubs/cat/longres.aspx?sk=40817.0)

Technical Assistance:

STA GDDS Meta Data Development January 26–February 6, 2008.
G20 Data Gap Initiative, January 22–23, 2011.
Balance of Payment Statistics, March 12–23, 2011.
National Accounts Statistics, April 8–18, 2012.
Balance of Payment Statistics, November 11–22, 2012.
SDDS Assessment, March 9–19, 2013.
G20 Data Gap Initiative, May 27–28, 2014.

MCM Stress testing, January 9–21, 2010.

FAD Options for Indirect Taxation, February 25–March 11, 2006.
Public Financial Management and Statistics, jointly with STA, September 16–30, 2006.
Tax Administration, November 6–19, 2006.
Enhancing Budget Process Reforms January 22–February 2, 2008.
Budget Institutions and GFSM2001 (with participation of STA), June 2–5, 2012.
GFSM2001 Training Course, April 2013.
Training workshop on structural fiscal balance rules as a guide for policy, February 2014.

FSAP The main 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 16–30, 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)

Resident Representative

No resident representative is stationed in Saudi Arabia.

RELATIONS WITH THE WORLD BANK GROUP

(As of May 31, 2014)

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

In recent months, advisory work was completed in the areas of: public financial management, small and medium enterprise strategy, economic diversification strategy, special economic zones, and housing finance regulations. Among priority activities in the ongoing program were: work on employment policy including a focus on unemployment assistance; workshops on education quality, assessment, and decentralization issues; developing funding options to promote energy efficient investments; updating the water sector strategy and building a consensus around it; developing an implementation plan for the national ports strategy; and advising on the creation of a Public Transport Authority as a new regulatory body.

International Finance Corporation

IFC activities in the country, as well as with Saudi investors outside the country, have increased significantly in recent years. They are in line with the following three objectives:

Promoting Selective Business in Saudi Arabia

IFC's strategy for investments in Saudi Arabia is to invest in selective transactions that can add value in terms of institution building, development of new financial instruments, and SME development. Specific investments in the financial sector include housing finance, insurance, leasing and microfinance (with total commitments around $180 million). IFC also provides Advisory Services in mortgage finance, SME finance, corporate governance, risk management and PPP transactions.

Promoting South-South Investments from Saudi Arabia

Many Saudi investors are looking to expand outside of their home-base. This is an opportunity for IFC to work with such companies and invest with them inside and outside the MENA region. IFC Riyadh office increased its activity, especially in facilitating south-south investments that reached around $1.4 billion in IDA and middle income countries (Pakistan, Egypt, Yemen, Ethiopia, Ghana, etc.). IFC continues to work closely with Saudi sponsors to further facilitate cross border investment in the region.

Mobilizing Funds

IFC is working closely with Saudi public institutions and IFIs to undertake global initiatives that benefit private sector activities in developing countries. So far, these efforts have resulted in obtaining commitments of over US$500 million.

STATISTICAL ISSUES

(As of May 31, 2014)

Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are: national accounts, labor markets, government finance statistics, and external sector statistics.	
National accounts: Annual estimates of GDP have been revised for the period since 2004. CDSI is currently in the process of rebasing the GDP volume estimates (GDP at constant prices) to 2012. The base year is currently 1999 and the structure of the economy, and hence the structure of relative prices, could have changed significantly since 1999, which can result in inaccurate measures of volume changes.	
Government finance statistics: The authorities are in the process of reclassifying the budget in line with *GFSM 2001*. Most chapters have been completed and the Ministry of Finance is planning on using the *GFSM 2001* framework to report fiscal data and publish it by early 2015.	
Monetary and financial statistics: The quality of monetary data has improved during the last year and additional information is made available in the Central Bank Monthly Bulletin. However, the authorities report monetary data using the old report forms and not the Standardized Report Forms (SRFs) based on the current international methodology as reflected in the *Monetary and Financial Statistics (MFS) Manual* and the accompanying *MFS Compilation Guide*.	
Financial sector surveillance: The authorities report 10 out of 12 core financial soundness indicators (FSIs) to the IMF.	
External sector statistics: The authorities are now publishing an annual IIP. However, the coverage in the capital and financial accounts, particularly for the private sector, needs to be improved. The errors and omissions in 2013 BOP data have been reduced substantially due to an improved coverage of trade credits. The authorities are working on strengthening financial account statistics.	
Data Standards and Quality	
Participant in the General Data Dissemination System (GDDS) since 2008.	No data ROSC is available.

SAUDI ARABIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of May 31, 2014)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange rates	5/30/2014	5/31/2014	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	4/2014	5/31/2014	M	M	M
Reserve/base money	4/2014	5/31/2014	M	M	M
Broad Money	4/2014	5/31/2014	M	M	M
Central Bank balance sheet	4/2014	5/31/2014	M	M	M
Consolidated balance sheet of the banking system	4/2014	5/31/2014	M	M	M
Interest rates[2]	4/2014	5/31/2014	M	M	M
Consumer price index	4/2014	5/31/2014	M	M	M
Revenue, expenditure, balance and composition of financing[3]— central government	2013	5/14/2014	A	A	A
Stocks of central government and central government-guaranteed debt[4]	2013	5/14/2014	A	A	A
External current account balance	Q4 2013	5/12/2014	Q	Q	Q
Exports and imports of goods and services	Q4 2013	5/14/2014	Q	Q	Q
GDP/GNP	Q4 2013	5/11/2014	Q	Q	Q
Gross external debt (BIS)	Q3 2013		Q	Q	Q
International investment position[5]	2012	5/31/2014	A	A	A

[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 and maturity 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).

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/356
FOR IMMEDIATE RELEASE
July 21, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Saudi Arabia

On July 11, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Saudi Arabia.

Saudi Arabia has been one of the best performing G-20 economies in recent years, and has supported the global economy through its stabilizing role in the global oil market. Generous financial assistance has also been provided to countries in the Middle East region and beyond.

The Saudi economy grew strongly by 4 percent in 2013, owing to robust growth in the non-oil private sector. The unemployment rate of nationals fell over the past year, especially among women. Inflation has eased to 2.7 percent in May 2014, largely reflecting lower food price inflation in line with international trends. Credit growth also eased but remained at robust levels. The economy has not been affected by global financial market volatility, and the banking system is well-capitalized and profitable. High oil prices and output have led to large fiscal and external surpluses and international reserves have increased. However, fiscal breakeven oil prices have risen owing to strong growth in public spending. Consistent with the exchange rate peg, monetary policy settings have remained unchanged.

Growth is projected to pick up to 4.6 percent in 2014. Private sector growth is expected to remain strong, and oil production is expected to be little changed from 2013. Large scale infrastructure projects and spending on housing will continue to support non-oil sector growth. Inflation is expected to remain subdued.

The Saudi population is young and increasingly well-educated, and as it continues to enter its working-age years, there is tremendous opportunity to boost growth and raise living standards further. Against this background, government policies are focused on increasing private sector employment of nationals, addressing housing needs, strengthening transportation infrastructure, and diversifying the economy.

[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 welcomed Saudi Arabia's robust economic performance underpinned by strong fundamentals. The growth outlook remains positive and risks are balanced, centered mainly on the global oil market. Directors commended Saudi Arabia's systemic and stabilizing role in the global oil market, and its generous financial assistance to countries in the region and beyond.

Directors noted that Saudi Arabia's fiscal position is strong, with one of the lowest debt-to-GDP ratios and largest fiscal surpluses in the world. They generally saw merit in slowing, over time, the pace of government spending and increasing non-oil revenues so as to preserve fiscal buffers, while striking a balance between achieving current development goals and ensuring intergenerational equity. Directors encouraged the authorities to set the budget within a medium term fiscal framework that is anchored around estimates of structural oil revenues and that fully integrates the expenditure priorities from the national development plan. They welcomed efforts to strengthen public spending efficiency and the plan to establish a macro-fiscal unit.

Directors underscored that an upward adjustment in energy prices would support a strong fiscal position and the efficient use of energy. The price adjustment should be well-planned and communicated, while ensuring that vulnerable groups are not adversely affected.

Directors agreed that the current monetary and macroprudential policy stance are appropriate, but called for careful monitoring of rising equity prices and the rapid increase in mortgage lending. They saw merit in the introduction of a formal macroprudential framework to help ensure economic and financial stability, codify coordination across regulators, and better enable the use of macroprudential tools in a countercyclical way. They also saw scope for refining liquidity management. Directors agreed that the exchange rate peg to the U.S. dollar remains appropriate for the Saudi economy.

Directors noted that the banking system is well-capitalized, profitable, and liquid. They encouraged the authorities to take further action to deepen capital markets, including the development of a benchmark yield curve, and promote financial inclusion. Directors supported the ongoing work to finalize the framework for systemically important banks and bring the AML/CFT framework in line with the CFT law.

Directors noted that labor market programs have contributed to increased employment in the private sector, but saw a need for further action to reduce the reliance on public sector jobs. Continued efforts to upgrade skills of workers through education and training will be important in this regard. Directors welcomed the steps to target the government's housing program on the less well-off, and encouraged the authorities to ensure that the program does not impede the development of private real estate and mortgage markets. Directors supported continued efforts to diversify the economy by improving the business environment, investing in infrastructure, and increasing finance for SMEs. They noted that additional incentives for firms to export and for Saudi workers to participate in the private sector would also boost diversification.

[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.

Saudi Arabia: Selected Economic Indicators, 2010–14

	2010	2011	2012	2013	Proj. 2014
Production and prices	(Annual percent change; unless otherwise stated)				
Real GDP	7.4	8.6	5.8	4.0	4.6
Real oil GDP	0.3	11.0	5.7	-1.0	0.6
Real non-oil GDP	9.5	7.9	5.8	5.3	5.6
Nominal GDP (billions of U.S. dollars)	527	670	734	748	779
Consumer price index (avg)	3.8	3.7	2.9	3.5	2.9
Fiscal and Financial variables	(Percent of GDP; unless otherwise stated)				
Central Government revenue	37.5	44.5	45.3	41.2	40.2
Of which: oil revenue	33.9	41.2	41.6	36.9	35.8
Central Government expenditure	34.0	33.4	33.3	35.4	37.6
Fiscal balance (deficit -)	3.6	11.2	12.0	5.8	2.5
Non-oil primary balance (percent of non-oil GDP)	-54.1	-60.9	-59.5	-59.5	-61.3
Broad money (annual percent change)	5.0	13.3	13.9	10.9	11.0
External sector	(US$ billions; unless otherwise stated)				
Exports	251.1	364.7	388.4	377.0	377.8
Of which: Oil and refined products	215.2	317.6	337.5	323.1	320.3
Imports	-97.4	-120.0	-141.8	-152.7	-163.3
Current account	66.8	158.6	164.8	134.3	120.2
Current account (percent of GDP)	12.7	23.7	22.4	17.9	15.4
SAMA’s net foreign assets	440.4	535.2	647.6	716.7	768.5
SAMA's net foreign assets (in months of imports of goods and services)	26.7	29.8	33.9	35.2	35.4
Real effective exchange rate (percent change)[1]	-0.2	-3.5	2.7	2.0	-1.4

Sources: Country authorities; and IMF staff estimates and projections.

[1] Latest 2014 data is for end-April.