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Saudi Arabia:
Reforms showcase "Davos in the Desert"

Florence Eid-Oakden, Ph.D, Chief Economist
Charlene Rahall, Senior Analyst

- **The kingdom has made significant progress on key areas of its Financial Sector Development Program (FSDP), especially in terms of small- and medium-sized business financing, capital markets and housing.**
- **As well as to its holy places, Saudi Arabia believes tourists will be attracted by new tourism mega projects, the loosening of visa restrictions and social liberalisation.**
- **Saudi Arabia continues to present a favourable risk/reward trade-off, and we are looking to see how well the Future Investment Initiative (FII) convinces FDI to flow in meaningfully.**

Growth under attack

The Ministry of Finance says it is now expecting economic growth for the year to be slower than it had assumed, although it has not made its previous or current forecasts public.

- The IMF is still forecasting 1.9% growth for 2019. But the uncertainty regarding supply disruptions following the attacks on Saudi oil fields -- as well as the global economic slowdown and its potential effect on the oil market -- could soften growth.
  - Data on Q2 2019 real GDP showed that the economy grew by 0.5% from a year earlier, down from annual growth of 1.6% in Q1. The oil sector declined by 3%, while non-oil GDP rose by 2.9%.
- Major oilfields were attacked on 14 September (blamed, internationally, on Iran), halving output. On 25 September, Aramco said it had restored oil production capacity to 11.3 Mb/d.
  - The fiscal impact could well lead to a downward revision of the growth forecast for 2019.
  - On 30 September, Saudi Arabia was downgraded for a third time since 2016 by Fitch Ratings, citing the kingdom's vulnerability to military threats.
    - Fitch downgraded its credit rating to A from A+ after the attacks on the oil installations. It retained its stable outlook.
    - On 7 October, Fitch also downgraded its rating on Aramco to A, again with a stable outlook.
    - Saudi Arabia called the sovereign downgrade "somewhat speculative without direct reference to the swift, decisive and effective response to the event".
    - S&P meanwhile affirmed its "A-/A-2" long and short-term sovereign credit ratings on Saudi Arabia with a stable outlook, supported by "strong external and fiscal net asset stock positions".
- The IMF, based on an assumption that Saudi Arabia produces oil at its agreed level under the current OPEC+ agreement in H2, projects oil GDP growth at 0.7% in 2019.

Table 1 - Saudi Arabia Macroeconomic Indicators[1]

	2016	2017	2018	2019e*	2020f
Real GDP Growth (%)	1.7	-0.7	2.2	1.9	3.0
Crude Oil Production (M Bpd)	10.5	10.0	10.3	10.2	10.5
Oil GDP Growth (%)	3.6	-3.1	2.8	0.7	3.5
Non-oil GDP Growth (%)	0.2	1.3	2.1	2.9	2.7
CPI Inflation (%)	2.0	-0.9	2.5	-1.1	2.2
Fiscal Balance (% of GDP)	-17.2	-9.2	-5.9	-6.5	-5.1
C/A Balance (% of GDP)	-3.7	1.5	9.2	6.9	6.0
Total Gov't. Gross Debt (% of GDP)	13.1	17.2	19.1	23.0	24.7
Total Gross Extrn'l Debt (% of GDP)	24.6	34.8	37.0	40.2	42.2
Gross Official Reserves (Mos. of Imports)	31.7	27.9	26.7	26.5	25.8
Nominal GDP (USD B)	645.0	689.0	782.0	786.0	813.0
Population (Millions)	32.4	33.1	33.7	34.2	34.8

- For the non-oil sector, which the kingdom is seeking to expand, growth is expected to be stimulated by expansionary fiscal policy. The budget for 2019 shows a significant increase in capital expenditure.
  - While continued structural reforms will place some pressure on growth in the short-term, recent data on non-oil indicators have been positive.
  - The PMI in Saudi Arabia picked up in September, rising to 57.3 from August's 57. Output grew (61.7 from 60.7) while new orders were down (62.3 from 63.5) and employment growth touched an 18-month high during this period (51.5 from 50.1 in August).
    - All are above the 50 mark that denotes growth, with output and orders numbers suggesting significant expansion even if the latter slowed somewhat.
  - Point-of-sale transactions increased by 18% YoY, despite a decline in cash withdrawals by 5.6%.
    - This is a pointer to increased spending. The drop in ATM withdrawals probably reflects the global move away from cash and a rise in e-commerce activity.
- A budget deficit of USD 8.9B (1.1% of GDP) was posted in Q2 compared with a surplus of USD 7.4B (0.9% of GDP) in Q1 (which, for context, was the first surplus since 2014).
  - Higher expenditure than revenue so far this year pushed H1 2019 accounts into a mild deficit of USD 1.4B (0.2% of GDP). This was 87% smaller than the USD 11.1B of H1 2018.

Tapping unrealised tourism potential

On 27 September, the Saudi Commission for Tourism and Heritage (SCTH) opened up tourist visas for citizens of 49 countries. Moreover, recent SCTH data showed improvements in tourism figures in the year-to-August.

- The launch of tourist visas saw a number of agreements signed by both SCTH and the Saudi Arabian General Investment Authority with both domestic and international investors within the sector, worth USD 27B.
- Domestic tourism spending was up in the year-to-August by 8.7% to USD 9B compared to the same period last year.

[1] Arabia Monitor; IMF.

* Subject to downward revision.

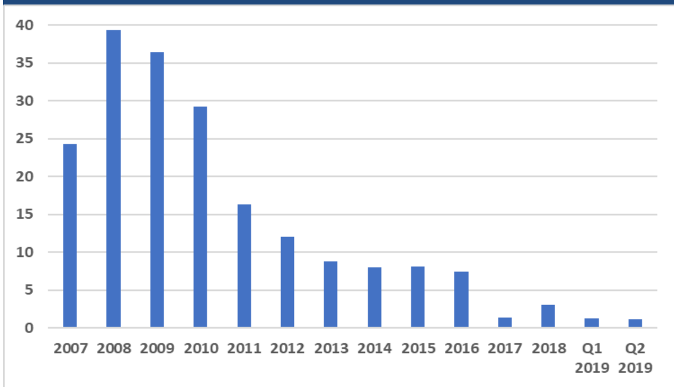
- Foreign tourism spending in the year-to-August was USD 20B, 10% YoY higher than the same period last year, mostly driven by the Hajj.
- Attracting tourists is a central plank of the country's plan to reduce its reliance on oil, draw in foreign investment and increase the rate of employment.
  - The direct contribution of tourism to GDP rose by 2.9% in 2017 from 2016, when it comprised 3.3% of the economy. The World Travel & Tourism Council forecasts this to rise by 3.8% annually by 2027, by which time it is projected to account for more than 11% of GDP.
  - Domestic travel spending generates up to 60% of the tourism contribution to GDP with the rest coming from foreign visitors.
  - Tourism growth is expected to directly increase employment by 3% a year to 1.5 million jobs by 2027, or 10.3% of the total workforce.
- By 2030, international tourist arrivals are forecast to rise to 30 million from 18 million last year, which itself was a jump from 10 million in 2010. Arrivals grew at an average annual rate of 11% from 2010 to 2017.
  - Religious tourism accounts for 40% of tourist arrivals in Saudi Arabia. The Saudi Arabia National Transformation Program 2020 sees the number of foreign Umrah pilgrims -- those making non-obligatory pilgrimages at any time of year -- rising to 15 million a year by 2020 from this year's estimated 6 million.
  - In the last 5 years, overall tourism revenue grew by almost 10% a year, and if sustained at this rate could reach USD 16B by 2020.

Reforms at supersonic speed

The kingdom has made significant progress on key areas of its FSDP, especially in terms of small- and medium-sized business financing, capital markets and housing.

- Reforms to improve SME financing have been stepped up, especially with the introduction of a bankruptcy law. There has been a 5.9% increase in loans granted to SMEs, exceeding the FSDP target of 5% (over a 21-month period).
- A notable development for the stock market (Tadawul) has been the MSCI and FTSE inclusion of the Tadawul into their emerging market indices in March and June, respectively. This has resulted in inflows of more USD 20B so far this year.
  - We expect further growth opportunities as the Saudi Arabian Capital Markets Authority (CMA), on 6 October, introduced measures to ease foreign issuers' entry into the Tadawul as well as boost investment in NOMU, the country's secondary market.
  - The new measures modify current rules on how securities are offered to promote trading and listing in NOMU. As the first parallel market in the GCC, this is a very significant development given the growth of SMEs in the region (they now constitute about 80%-90% of GCC business).

Figure 1 - FDI Inflow into Saudi Arabia (USD, B)[2]



  - Earlier this year, the CMA also introduced new measures to allow cross-border listing on the Tadawul, meaning the potential listing of companies from other GCC countries on the stock market.
- In the housing sector, new residential mortgages provided by banks reached USD 9.3B in July, 157% growth from the start of this year.

On the social reform front, several new decrees have been issued, designed to modernise Saudi Arabia and present it to the world as a society that is moving towards "moderate Islam". The social reforms against entrenched tradition exemplify the degree to which Saudi Arabia is taking its Vision 2030 and diversification policies seriously.

- In August, restrictions were lifted on women travelling or getting a passport without a "male guardian".
- The new tourist-visa system allows citizens of 49 countries to visit. Valid for one year, the visa can be applied for via an electronic platform or on arrival.
- Saudi Arabia has gone one step further to encourage international tourists. Unmarried couples will now be allowed to share rooms while on vacation in the kingdom.

We believe Saudi Arabia will present compelling risk/return trade-offs when it hosts the "Davos in the Desert" investment conference in Riyadh this month, crucial to reversing the lower than average FDI performance of the last two years.

- FDI inflows increased by 0.5% YoY in Q2 2019 to USD 1.1B versus a 28% YoY rise in Q1 2019. This was a reversal for Vision 2030, which depends on such investment.
- Last year, Saudi Arabia saw the value of inward FDI grew to an estimated USD 3.1B, after a year-earlier slump of USD 6B.
- FDI inflows peaked at USD 39B in 2008 and have averaged USD 16.7B in the last 10 years.
- Saudi Arabia's economic diversification efforts are now being massively accelerated. We are looking to see how well the FII scores in convincing FDI to flow in meaningfully.

[2] Arabia Monitor; UNCTAD; Saudi Arabia Ministry of Finance.

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Arabia Monitor
Aston House| Cornwall Avenue| London L3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com