Saudi Arabia's Economic Outlook- Spring 2016

The latest MENA Economic Monitor Report - Spring 2016, expects Saudi's current account balance to improve but remain in deficit at 2.8% of GDP in 2016.

The economy grew at a modest pace in 2014-15, with real GDP growth at 3.6 % in 2014 and an estimated 3.5 % in 2015. Oil production increased from an average of 9.7 million bpd in 2014 to 10.1 million bpd in 2015. Increased oil output along with an expansionary fiscal stance helped support economic growth. Average inflation stood at 2.2 % in 2015.

The fiscal deficit widened substantially in 2015, with moderate tightening in 2016. Expenditure cuts were limited to a modest 2.5 % in 2015 while the revenues dropped by 38 %. The fiscal deficit had a large increase to 18.9 % in 2015. The deficit was financed largely by SAMA's large stock of foreign assets (estimated to exceed $600 billion by the end of 2015). The 2016 budget reflects a moderate tightening. Domestic oil prices were raised by 50 %, and natural gas and water prices are planned to be increased as well. In addition, budgetary allocations for education, health, and municipality services have faced significant cuts in an attempt to consolidate the deteriorating fiscal balances. Some revenue measures were recently introduced, including a 2.5 % tax on undeveloped land and $23 airport fee for international visitors. Other measures, including a 5 % Value Added Tax (VAT) and additional taxes on tobacco and soft drinks, have been announced awaiting implementation.

The current account balance deteriorated with low oil prices, as hydrocarbons account for 89 % of exports. The current account balance moved from a surplus of 10 % of GDP in 2014 to a deficit of 5.2 % of GDP in 2016.

On the monetary policy front, a passive stance continues. With a peg to the US dollar, SAMA followed the US Federal Reserve and increased its lending rates by 25 basis points in December 2015 amidst a slowing economy. Notwithstanding its benefits of providing stability and predictability, the peg has led to significant real appreciation of the riyal against currencies of the KSA's major trading partners since the global financial crisis. From 2008 to 2016, the Real Effective Exchange Rate of the riyal, defined in broad terms, has appreciated by more than 35 %. Going forward, further interest hikes by the FED are likely to magnify this effect by further appreciating the US dollar, and thus, the Saudi riyal.

The structural reform agenda is gaining momentum. The authorities have recently announced the launch of the National Transformation Plan, which aims to introduce structural measures like improvements in public sector efficiency, privatization, further subsidy reforms and revenue diversification initiatives.

Tradeoffs between growth-enhancing public spending and fiscal sustainability will prevail in the short-term. With the introduction of moderate fiscal austerity measures, the economy is projected to grow at a slower rate of 2.2 % in real terms in 2016. However, with $37 average oil price in 2016 (the latest World Bank projections), current fiscal measures are insufficient to have a large impact on the fiscal deficit, which is projected at 16.3 % of GDP. Efforts to raise non-oil revenues will remain modest and expenditure cuts will occur gradually, focusing primarily on the capital budget. Imports will fall following cuts in public capital expenditures, and although exports will also fall, the fall in imports is projected to be greater in magnitude. Thus, the current account balance is expected to improve but remain in deficit at 2.8 % of GDP in 2016.

Key Economic Indicators

	2014	2015f	2016p	2017
Real GDP Growth (%)	3.6	3.5	2.2	2.6
Inflation Rate (%)	2.7	2.2	2.3	2.9
Fiscal Balance (% of GDP)	-3.6	-18.9	-16.3	-13.8
Current Account Balance (% of GDP)	10.0	-5.2	-2.8	1.4