Saudi Arabia in 2017: New Challenges, New Kingdom?

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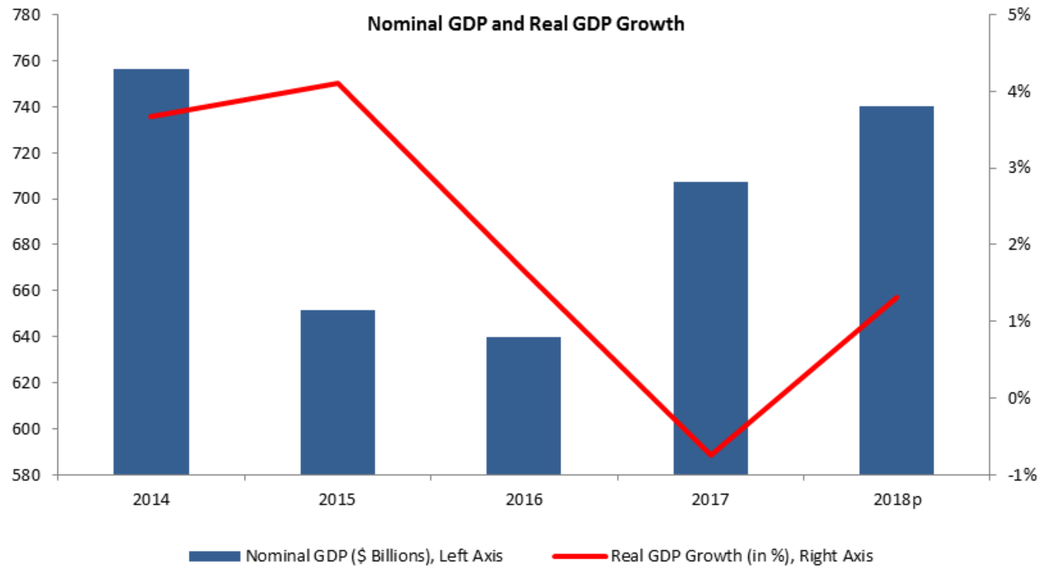
Saudi Arabia's new crown prince, Mohammad Bin Salman, dubbed "MBS", made headlines in 2017. MBS's arrival to power is in itself a controversial shakeup; in fact, it was Mohammad bin Nayef and not MBS who was next in line for the throne to be King; Mohammad bin Nayef was even dismissed from his positon as Interior Minister. In November 2017, around 500 prominent businessmen in the Kingdom such as Al Waleed bin Talal were arrested and held at the Ritz Carlton in Riyadh in a massive anti-corruption sweep.

Aside from a crackdown on corruption and major power reshuffles, the new crown Prince is re-framing Islam, foreign policy and women's rights. MBS removed the religious police's arresting power and instead encouraged a softer application of Islamic rules. In terms of foreign policy, he also struck with a forceful hand by entering into a full-fledged war in Yemen, where Saudi Arabia is fighting the Iran-backed Houthi rebels. As for women's rights, the new crown prince granted, and for the first time in the history of the Kingdom, women the right to drive.



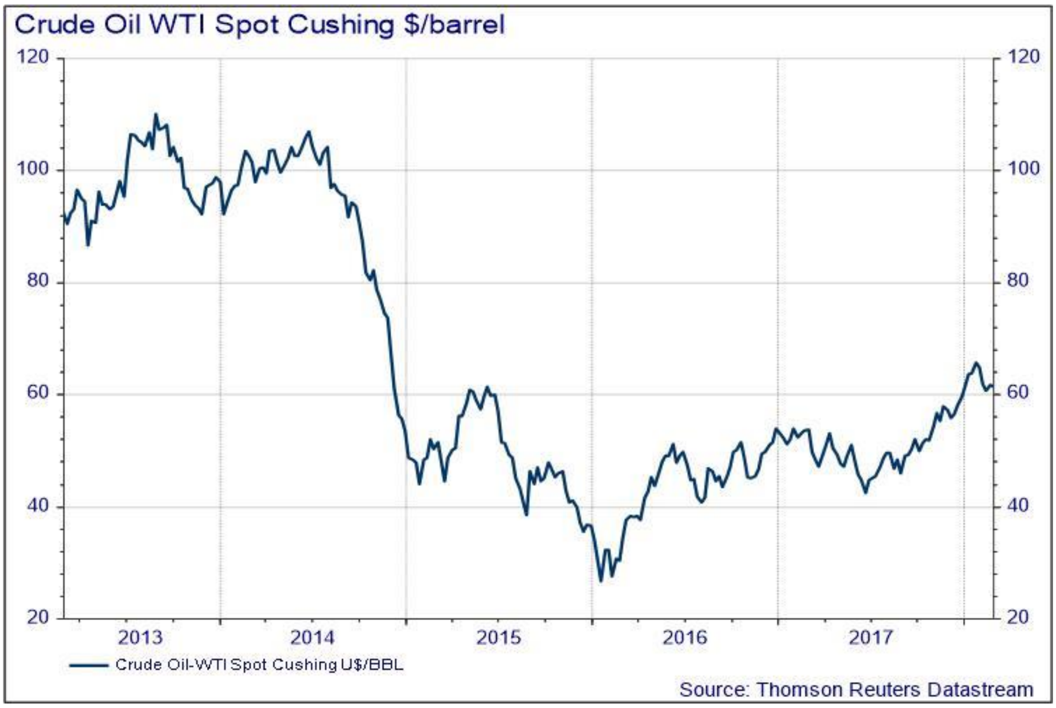
Source: KSA National Accounts, IMF estimates

On the economic front, MBS is assuming power at a very challenging time for the Kingdom. For the first time in 7 years, Saudi Arabia's Real GDP dropped by 0.74% to $683.83B in 2017 compared to a 1.67% growth in 2016. The decline was mainly due to the 3.47% drop in the sector of crude petroleum and natural gas (accounting for 38.98% of total GDP) due to cut in oil production and the 3.41% drop in the construction sector (accounting for 4.56% of GDP) on account of halted or delayed mega projects across the Kingdom.

The annual inflation rate in December 2017 was subdued despite new taxation introduced on tobacco and soft drinks. The inflation rate reached 0.4% in December 2017 compared to the same month in 2016. The prices of food and beverages (with a weight of 21.7% in the Consumer Price Index (CPI)) grew by an annual 0.6%. Moreover, communication prices (8.1% weight in the CPI) registered an annual uptick of 1.1%. Although tobacco prices hold a marginal weight of 0.5% in the CPI, they recorded an exceptional 100% increase in 2017 due to newly introduced tobacco excise tax which led to the doubling of the prices of cigarettes packs which now range between 18 and 24 Saudi Riyals ($4.8 - $6.4)

The private sector economy, which is at the core of the Kingdom's ambitious Vision 2030 plan, showed signs of marginal improvement in 2017. According to the Emirates NBD Purchasing Managers' Index (PMI), the index accelerated in 2017 compared to 2016 and stood at 57.3 in December. The index remains well above the 50-mark separating economic expansion from economic recession. Saudi Arabia's national account also signaled that the annual growth of the private sector economy stood at 0.71% in real terms in 2017.

The oil production cut agreed on by OPEC producers led to an obvious retraction in Saudi Arabia's oil sector. According to the Kingdom's national accounts, the oil sector shrunk by an annual 2.97% in 2017 to 705,866 million SAR ($188.23B). In 2017, Saudi Arabia's crude oil production reached 9.95 million barrels per day in 2017 down from 10.48 million barrels per day in 2016. As for oil prices, they recovered in 2017 with the Crude Oil WTI Spot price rising from $53.72 at the end of 2016 to $60.42 per barrel at the end of 2017.

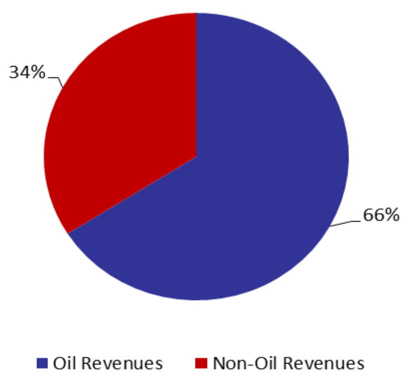


Saudi Arabia's trade activity continues to be dominated by oil exports. On the external front, Saudi Arabia's imports of goods and services amounted to $192.41 billion down by 2.88% while Saudi Arabia's exports of goods and services rose by 14.18% to $229.35 billion. Exports of oil and natural gas still constitute a substantial share of 71% in total exports of goods and services. In fact, oil and natural gas exports increased by a yearly 20.27% to $163.80 billion in 2017.

In Millions of USD	2016	2017	YOY
Imports of goods and services	198,110	192,406	-2.88%
Exports of goods and services	200,860	229,346	14.18%
of which exports of oil and natural gas	136,194	163,802	20.27%
Energy exports/Total exports of goods and services	68%	71%	-

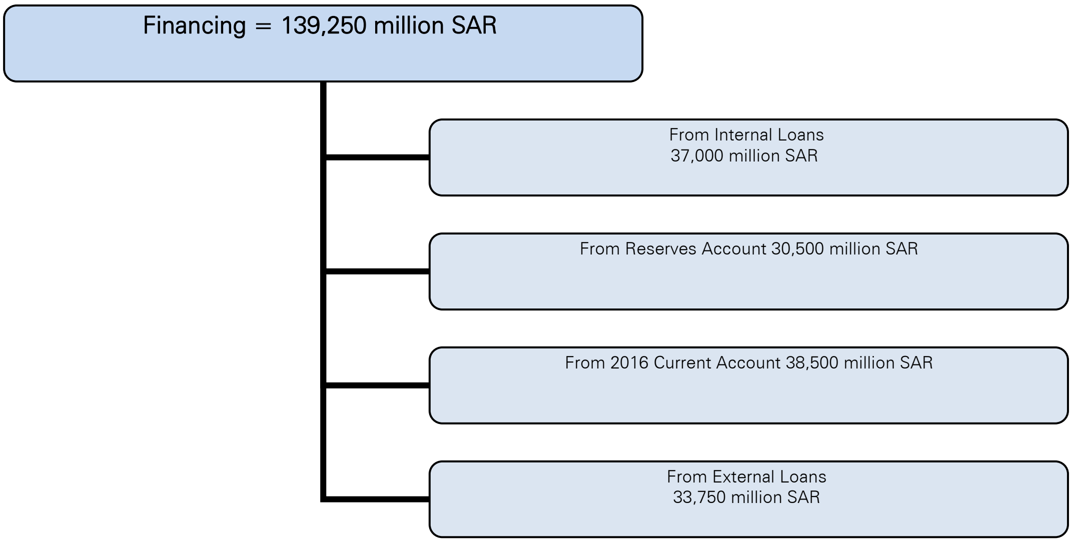
The developments in the oil sector are having a marked impact on the Kingdom's fiscal sector. According to Saudi Arabia's Ministry of Finance, the fiscal deficit reached SAR 121,458 Million ($32.39B) by the third quarter of fiscal year 2017 (Q3 2017), down by 40% from SAR 203,140 Million ($54.17B) in the same period in 2016. In fact, this was due to a 23% increase in total revenues to SAR 450,122 Million ($120.03B) and a minor 0.4% uptick in expenses to SAR 571,580 Million ($152.42B). On the revenues' side, the increase was on account of the 33% rise in oil revenues and the 6% increase in non-oil revenues. Markedly, the revenues from taxes on goods and services (which include oil-product fees) jumped 35% over the same period. As for public debt, it amounted to 375,777 million SAR ($100.21B) at the end of Q3 2017, of which SAR 238,902 million SAR ($63.71B) in domestic debt (64%) and SAR 136,875 million ($36.50B) in external debt (36%).

Oil Revenues Still Make up the Largest Share in Total Revenues (by Q3 2017)



Source: Saudi Arabia Ministry of Finance

Deficit Financing by Q3 2017



Source: Saudi Arabia Ministry of Finance

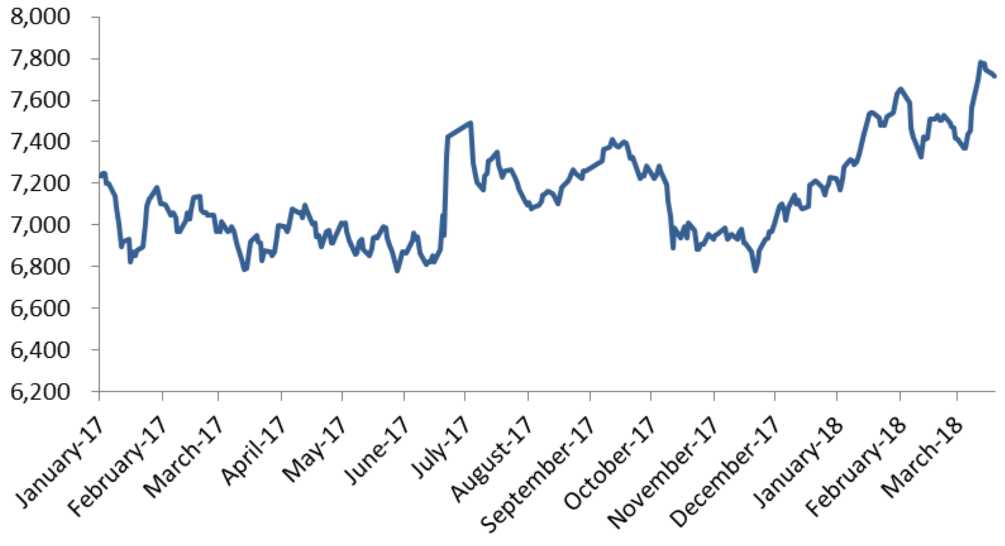
The Saudi Arabian Monetary Agency's (SAMA, the Kingdom's central bank) efforts to preserve price stability succeeded in 2017. With the decrease in energy subsidies and the VAT set to be introduced in 2018, liquidity may very well increase and create inflationary pressures. In order to avoid that scenario, the Central Bank raised the reverse repo rate from 1.25% to 2% while it kept the repo rate unchanged at 2%. In fact, broad money M3 registered only a 0.2% annual increase in 2017 and inflation recorded only a 0.4% annual upturn in December.

The Kingdom is also tapping into the central bank's large reserves account and turning to local banks to finance its fiscal deficit. SAMA's reserve account declined by an annual 7.3% in 2017 to reach $496.42 billion. In fact, the decline in total reserve assets came about due to an 8.8% fall in investment in foreign securities to $330.57 billion and a 4.65% decline in foreign currency and deposits abroad by 4.65% to $156.06 billion by Q4 2017. According to SAMA, the banks' subscription to government and quasi government bonds almost doubled rising by 43% to $69.93 billion in 2017.

As for the Tadawul Stock Exchange Index (TASI) it ended the year with 0.2% annual upturn. The total market capitalization reached $450.56 billion up by an annual 0.45%. In fact, the value of traded shares dwindled by an annual 27.72% to reach $223.01 billion while the volume of traded shares slid by an annual 32.85% to reach 43.30 billion shares in 2017. In 2017, 9 companies offered a portion of their shares to the public through IPOs. All of the companies that went public are Real Estate Investment Traded Funds (REITs) except for one company, which is in the materials industry group category.

The country's quest for cash to accommodate the lower oil price environment will reach its pinnacle with the largest IPO in history, where 5% of the national oil company Saudi Aramco will be up for grabs. However, the IPO initially expected in late 2018 will be delayed until 2019 as the $2 trillion valuation hoped for by the crown prince is yet not reached.

The Tadawul All Shares Index



Source: Reuters

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