Source: The Banker

Will the pandemic stymie Saudi Arabia's reform agenda?

Oil market volatility and the coronavirus-induced lockdown are hitting Saudi Arabia, and will test its commitment to its Vision 2030 economic strategy. John Everington reports.

John Everington |

29/04/2020 10:04 am

A new era of economic transformation began in Saudi Arabia in April 2016. As oil prices fell below $30 per barrel for the first time in 12 years, the country unveiled Vision 2030, an ambitious programme designed to reduce its dependence on oil revenues, strengthen its private sector, and increase foreign investment, including in hitherto underdeveloped economic sectors such as tourism and entertainment.

Key milestones of the economic strategy have included: a bid to boost job opportunities for Saudi nationals by way of restrictions on expatriate labour; an unprecedented investment in tourism and leisure projects, including the Red Sea Project and Qiddiya; and the landmark $26bn initial public offering of national oil company Saudi Aramco in December 2019.

Fast forward to 2020, and Vision 2030 faces its toughest challenge to date, as Saudi Arabia wrestles with the twin shocks of the global coronavirus outbreak and an even deeper oil crisis than that of 2016. And while the impact on the national finances should not be overstated, a short-term reduction in spending would doubtless lead to many ambitious projects being put on hold.

"The world and Saudi Arabia are facing a unique crisis in depth and breadth in 2020," says John Sfakianakis, a Gulf expert at the University of Cambridge. "In such a climate, Vision 2030 will of course have to be reprioritised, as combating the aftershocks of Covid-19 is now an essential priority for all."

Oil shock

Four years into Vision 2030, Saudi Arabia's economy remains heavily reliant on oil exports. As the world's second largest producer behind the US, oil accounts for more than 40% of its gross domestic product (GDP), nearly 70% of fiscal revenues and nearly 80% of exports, according to the International Monetary Fund (IMF).

Starting 2020 at about $68 per barrel, oil prices had slumped to below $30 in mid-March, prompted by a collapse in global demand and a dramatic price-war launched between Saudi Arabia and Russia. A historic supply cut agreed in mid-April between the Organisation of the Petroleum Exporting Countries and Russia, which removed 10 million barrels per day from global supply, failed to lift prices, which remain at 17-year lows at the time of writing.

"We estimate that [Saudi Arabia's] fiscal revenues will decline by close to 40% (or nearly 9% of GDP) this year, more than doubling the fiscal deficit to nearly 10% of GDP in 2020 from 4.5% of GDP in 2019," said Moody's in a research note published in mid-April. "We expect government debt to increase [by more than] 30% of GDP in 2021 from 22.8% of GDP in 2019."

Faced with such a reality, finance minister Mohammed Al-Jadaan announced on March 18 that Saudi Arabia would cut spending in 2020 by SR50bn ($13.32bn) – equivalent to just under 5% of the total budget – in areas that would have minimal social and economic impact. Two days later, he unveiled SR120bn-worth of stimulus measures to aid the private sector, including SR50bn earmarked for small and medium-sized enterprises, and announced the government had lifted its debt ceiling from 30% to 50% of GDP.

Mr Al-Jadaan stressed that the government "has considerable ability to diversify sources of financing between public debt and government reserves to adequately tackle the emerging challenges", but insisted it had no plans to liquidate assets or tap into its deep reserves.

The response from the market so far has been positive; on April 15, the country raised $7bn on the debt markets via a three-tranche issuance, with more than $35bn-worth of orders placed, according to Reuters. The issue came after Saudi Arabia tapped debt markets for $5bn in January via an offshore issuance.

While such debt issuances will see Saudi Arabia's budget deficit significantly widen, such a measure was not a true indicator of the country's ability to ride out the crisis, according to William Jackson, chief emerging markets economist at Capital Economics. "The current account deficit is likely to play a larger role than the budget deficit in determining Saudi Arabia's tolerance for low oil prices. Even if oil prices were to fall to $25 per barrel, Saudi Arabia might be able to finance a current account deficit for up to a decade," he says.

Non-oil woes

The IMF forecasts that Saudi Arabia's economy will shrink by 2.3% in 2020, after growing by 0.3% in 2019, before rebounding by 2.9% in 2021, on the anticipated lifting of restrictions at home and abroad to contain the spread of the coronavirus.

While such a contraction in 2020 would mark the economy's poorest performance for 18 years, the drop is not as steep as that for the wider Middle East and Central Asia region (which is set to contract by 2.8%), with the United Arab Emirates, Qatar and Oman all forecast to experience deeper falls during the year. Perhaps more concerning in the short term is the setback to Saudi Arabia's all-important non-oil sector, seen as the heart of the country's diversification strategy. After posting a six-year high growth of 3.3% in 2019, the non-oil sector is set to contract by 4% in 2020, according to the IMF.

As a portent of things to come, Saudi Arabia's Purchasing Managers' Index for March (based on surveys of non-oil managers conducted ahead of the full lockdown) fell to an all-time low of 42.4 compared with 52.5 in February, the first time it has gone below the 50-point mark that signifies a contraction in the non-oil economy.

"The most vulnerable sectors are domestic trade, where we anticipate a 10% real-terms decline, and construction, where we expect a 3% fall, although [the sector] should receive some offset from spending by the Public Investment Fund [the country's sovereign wealth fund]," says James Reeve, chief economist at Samba Financial Group.

In late March Saudi Arabia announced suspension of work on the third phase of the $100bn expansion of the Grand Mosque in Mecca over coronavirus fears. The slowdown in economic growth in 2016 and 2017 prompted a long delay in payments by the government to contractors, severely impacting the private sector.

"I very much hope it will be different this year, and I think the authorities are mindful of 2016 and will do everything in their power to avoid a repeat," says Mr Reeve. "What gives me confidence is that their debt issuance and management systems have improved a lot over the past five years. They have issued conventional and Islamic debt in multiple currencies on both the domestic and external markets, and have established a yield curve and a primary dealer system. This should mean that deficit financing is more straightforward than in 2016."

Sectors hit

Retail spending and Saudi Arabia's nascent entertainment and tourism industry are likely to also be adversely affected by the ongoing lockdown designed to prevent the further spread of the coronavirus. "During [2019], the retail trade and hospitality sector was one of the key drivers of non-oil private sector growth, partly due to the strong pick-up in public events, including sporting, musical, cultural and shopping festivals promoted and sponsored by the General Entertainment Authority, as part of its goals under Saudi Vision 2030," according to Moody's.

“Furthermore, the coronavirus outbreak will severely hit the religious tourism sector, with the Umrah pilgrimage being suspended since early March and the annual Hajj pilgrimage, which falls in late July this year and in 2019 attracted 1.9 million foreign visitors in addition to 600,000 local residents, likely to be significantly restricted,” it adds.

Despite the short-term hit to the economy, analysts are confident that the transform agenda of Vision 2030 will not be cast aside lightly. “I think this year will be seen as exceptional globally, not just in Saudi Arabia, but there is no reason to think that the Vision 2030 plan will stall,” says Mr Reeve. “Further adjustments to the business environment can – and should – continue this year.”

Mr Sfakianakis at Cambridge University agrees, and notes that the steady rise of alternatives to oil makes ongoing economic reform essential for the country. “Vision 2030, even if reconfigured, is a necessity more so than ever now in an environment of oil price uncertainty. Saudi Arabia has no choice but to keep itself on the reform boat, as time and technology is not on its side.”