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The Acting Chair's Summing Up
Saudi Arabia—2007 Article IV Consultation
Executive Board Meeting, 07/81
September 17, 2007

Executive Directors agreed with the thrust of the staff appraisal. They commended the Saudi Arabian authorities on the continued strengthening of economic performance during the past year, underpinned by buoyant private sector activity, prudent economic policies, and a further increase in oil prices. High oil revenue contributed to increasing fiscal and external current account surpluses and a further buildup of Saudi Arabian Monetary Agency's net foreign assets, while activity in the non-oil economy gained further momentum.

Directors noted that the economic outlook remains positive, grounded in the ongoing efforts to expand oil sector capacity and to further improve the climate for private sector investment and economic diversification. They noted that a sustained broad-based expansion of non-oil activity, through continued implementation of structural reforms, would be key to creating employment opportunities for the rapidly growing Saudi labor force over the medium term. Directors therefore welcomed the top priority that the authorities assign to job creation and strengthening education and training.

Directors commended the Saudi authorities for their intention to continue supporting oil market stability through a substantial planned expansion of crude oil production and refining capacity, despite rising costs. They observed that implementation of Saudi Aramco's ambitious $80 billion investment plan, in preparation for the future call on Saudi oil over the medium and long term, would support global oil market stability.

Directors noted that Saudi Arabia's economic policies have been consistent with its commitments in the context of the Multilateral Consultation process aimed at the reduction of global imbalances. While the authorities' investment policies are driven by domestic needs to meeting objectives of sustaining and diversifying economic growth, and increasing living standards of the population, implementation of these policies would, as a by product, contribute significantly to the reduction of global imbalances through higher imports of goods and services. Directors also commended the authorities for continuing to provide generous assistance to developing countries through bilateral aid and debt relief.

Directors noted that the recent fiscal surpluses have significantly enhanced Saudi Arabia's fiscal flexibility and long-term fiscal sustainability. They supported the use of fiscal revenues for promoting private sector growth, alleviating poverty, and meeting social needs. Efficient implementation of the spending plans over the medium term will require, however, a significant strengthening of public expenditure management. In this vein, Directors welcomed the authorities' decision to adopt the Government Finance Statistics Manual (GFSM) 2001 framework and encouraged them to accelerate the preparations for a medium-term fiscal framework. While broadly supporting the country's expenditure priorities, Directors encouraged the authorities to replace the petroleum product subsidies with targeted direct social assistance. Directors supported the planned investments under public-private partnerships, but noted the importance of managing properly the underlying contingent liabilities.

Directors observed that, despite higher import prices, inflation remains on the whole low, owing to the flexible labor market, an open trade system, and administered prices for fuels and utilities. They called for utilizing liquidity management instruments more effectively to contain the risk of inflation; and analyzing the factors underlying the shortage of financial instruments, with a view to eliminating impediments to their issuance. Directors commended the authorities for the planned implementation of Basel II principles by January 2008. Some Directors encouraged the authorities to phase out the ceilings and restrictions on bank lending. Regarding the stock market, Directors noted the significant gains made in strengthening capital market regulations, and urged the authorities to allow full access to the stock market by foreign investors to improve market depth and efficiency.

Directors noted the staff view that the Saudi riyal appears to be moderately undervalued at present. Many saw this as a transitional phenomenon reflecting the positive terms-of-trade shock. Several other Directors considered that the riyal is broadly in line with fundamentals. More generally, however, Directors acknowledged the margins of uncertainty in making such assessments, and pointed to the methodological difficulties in determining equilibrium exchange rates, particularly for an oil-exporting economy such as Saudi Arabia facing volatile oil prices. Further, they noted that any undervaluation of the real effective exchange rate can be expected to reverse in the near term as the external current account surplus declines in response to the authorities' expansionary fiscal stance and the investment programs that have been launched. Directors also considered that the current pegged exchange rate regime has served the economy well, although a few Directors were of the view that a more flexible exchange rate would help reduce fluctuations in the face of oil price volatility. Directors noted the authorities' decision to maintain the regime unchanged in the period leading to the GCC monetary union while keeping an open mind about the choice of the exchange rate regime under the prospective monetary union.

Directors observed that, despite the significant gains made on key issues, achieving the GCC monetary union by 2010 would be increasingly challenging, and would require accelerating the implementation of the remaining important steps. In particular, efforts would need to be intensified to reach agreements on the nature and scope of the union's monetary authority, and the harmonization of key regulatory and supervisory frameworks and of statistical methodologies.

Directors encouraged the authorities to continue to design a package of “second generation” structural reforms for exploiting the growth potential created by the successful completion of the 1999 structural reform program and high oil prices. Directors noted that further liberalization and modernization of the legal and institutional framework will be critical for private sector activities, and urged the authorities to expeditiously approve and implement the mortgage, agency, and company laws. Directors also encouraged the authorities to closely monitor the tightening labor market conditions to ensure smooth implementation of investment projects.

It is expected that the next Article IV consultation with Saudi Arabia will be held on the standard 12-month cycle.