

EBS/86/58

CONFIDENTIAL

March 11, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Saudi Arabia - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Saudi Arabian riyal.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

SAUDI ARABIA

Real Effective Exchange Rate--Information Notice

Prepared by the Middle Eastern Department
and the Exchange and Trade Relations Department

(In consultation with the Legal Department
and the Research Department)

Approved by A.S. Shaalan and J.T. Boorman

March 10, 1986

The recent evolution of Saudi Arabia's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of December 1985, the Saudi Arabian riyal has depreciated in real effective terms by 10.5 percent since the last occasion on which the Executive Board had an opportunity to discuss developments in Saudi Arabia's exchange rate--the 1985 Article IV consultation in July 1985. 1/

Saudi Arabia's exchange system is free of restrictions. Exchange rate policy has been guided mainly by domestic economic considerations. During the period of inflationary pressures of the 1970s, the containment of imported inflation was a major objective. An increasingly important consideration has been the desire to maintain a stable rate vis-a-vis other members of the Cooperation Council of Arab States of the Gulf (GCC) and to minimize exchange risks for the private sector so as to facilitate private sector planning. The need to discourage speculation in Saudi Arabian riyals in the Bahrain offshore market and subsequent capital flows have also influenced exchange rate policy. Even though formally pegged to the SDR, in practice the Saudi Arabian riyal has been effectively tied to the U.S. dollar in the recent past.

Over the period 1980-June 1985, the de facto limited flexibility of the Saudi Arabian riyal relative to the U.S. dollar was reflected in a gradual appreciation of the riyal in nominal effective terms. This appreciation, however, was mostly offset by Saudi Arabia's low rate of inflation. The real effective exchange rate therefore fluctuated within a relatively narrow band.

The real effective depreciation of the Saudi Arabian riyal during the six-month period, July-December 1985, reflects primarily the weakening of the U.S. dollar which depreciated against the SDR by about 6 percent

1/ Chairman's Summing Up circulated as SUR/85/84.

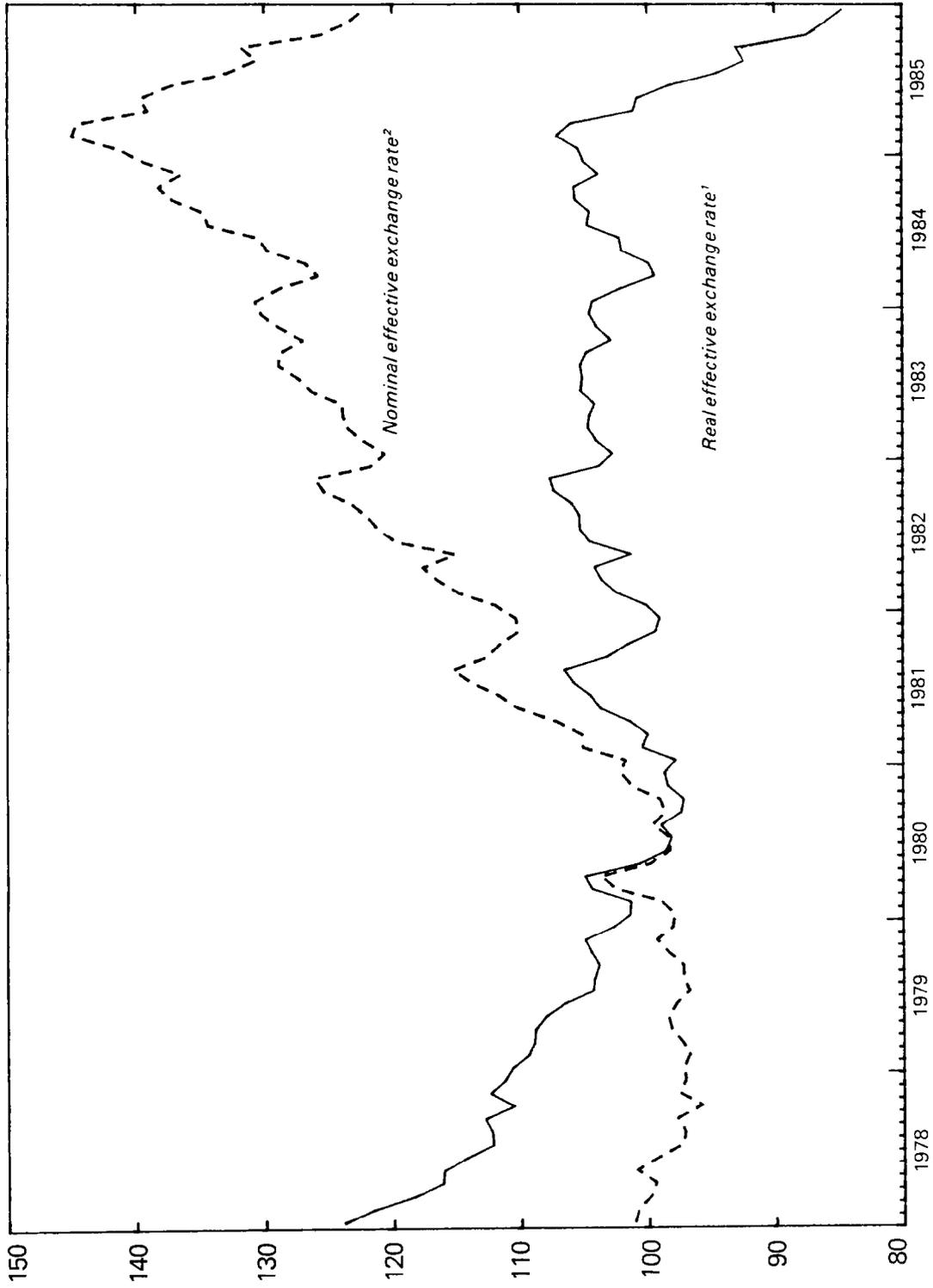
during this period. Moreover, consumer prices in Saudi Arabia relative to its major trading partners declined by about 3 percent over the same period as the cost of living fell in Saudi Arabia, continuing the trend apparent since 1983. The recent exchange rate developments are consistent with the increasing importance that is being attached by the authorities to the promotion of the private sector and a rationalization of resource allocation.

Saudi Arabia's current account balance has been in deficit since 1983, and in 1985 that deficit is estimated to be about US\$15 billion, equivalent to about 16 percent of GDP. Despite the weakening of the external account, official foreign assets continue to be comfortable at about US\$108 billion at the end of August 1985 (equivalent to five years of merchandise imports), the latest date for which data are available. The current account is expected to remain in deficit over the medium term and the recent exchange rate developments should facilitate the adjustment process.

Staff Appraisal

In concluding the 1985 Article IV consultation with Saudi Arabia, Executive Directors, while generally agreeing with the authorities' approach to exchange rate policy, felt that, given the need to promote private sector activity and rationalize production incentives, the authorities would be well advised to keep the appropriateness of the exchange rate under close review. The recent developments in the real effective exchange rate for the Saudi Arabian riyal are supportive of these objectives. These developments, and their implications for the achievement of Saudi Arabia's internal and external objectives, will be reviewed in detail during the forthcoming 1986 Article IV consultation discussions with Saudi Arabia scheduled for April 1986.

CHART 1
SAUDI ARABIA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980=100)



¹ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

² Trade-weighted index of nominal exchange rates.

Table 1. Saudi Arabia: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

| | Real Effective Exchange Rate <u>1/</u> <u>2/</u> | Nominal Effective Exchange Rate <u>1/</u> | Relative Consumer Prices (Local Currencies) | Exchange Rate in Terms of U.S. Dollars <u>1/</u> | Consumer Price Index (Seasonally Adjusted) | Consumer Price Index (Not Seasonally Adjusted) |
|-------------------------|---|--|---|--|--|--|
| Quarterly | | | | | | |
| 1981 | | | | | | |
| I | 99.4 | 104.0 | 95.6 | 99.8 | 101.9 | 102.0 |
| II | 103.2 | 109.6 | 94.2 | 98.7 | 102.8 | 102.8 |
| III | 105.2 | 113.9 | 92.4 | 97.5 | 103.4 | 103.2 |
| IV | 100.0 | 110.7 | 90.3 | 97.4 | 103.1 | 103.2 |
| 1982 | | | | | | |
| I | 102.0 | 114.4 | 89.2 | 97.4 | 103.5 | 103.6 |
| II | 103.4 | 117.5 | 88.0 | 97.1 | 103.8 | 103.8 |
| III | 105.5 | 122.1 | 86.5 | 96.8 | 103.9 | 103.7 |
| IV | 106.3 | 124.4 | 85.5 | 96.8 | 104.1 | 104.1 |
| 1983 | | | | | | |
| I | 103.8 | 122.1 | 85.0 | 96.8 | 104.7 | 104.8 |
| II | 104.6 | 124.7 | 83.9 | 96.6 | 105.0 | 105.1 |
| III | 105.0 | 128.3 | 81.9 | 96.1 | 103.5 | 103.4 |
| IV | 103.8 | 128.7 | 80.7 | 95.7 | 103.9 | 103.9 |
| 1984 | | | | | | |
| I | 101.9 | 128.5 | 79.3 | 94.9 | 103.7 | 103.8 |
| II | 101.4 | 129.0 | 78.6 | 94.7 | 104.0 | 104.1 |
| III | 105.0 | 135.4 | 77.5 | 94.5 | 103.8 | 103.6 |
| IV | 104.8 | 138.0 | 76.0 | 93.5 | 103.1 | 103.1 |
| 1985 | | | | | | |
| I | 106.2 | 143.7 | 73.9 | 92.8 | 101.6 | 101.7 |
| II | 100.0 | 138.7 | 72.1 | 92.0 | 100.6 | 100.7 |
| III | 93.1 | 131.8 | 70.6 | 91.3 | 99.4 | |
| IV | 85.4 | 123.8 | 69.0 | 91.3 | 98.2 | |
| Monthly | | | | | | |
| 1985 | | | | | | |
| July <u>3/</u> | 94.5 | 132.9 | 71.1 | 91.3 | 99.8 | |
| Aug. | 92.3 | 130.6 | 70.6 | 91.3 | 99.4 | |
| Sep. | 92.5 | 131.8 | 70.2 | 91.3 | 99.0 | |
| Oct. | 87.4 | 125.6 | 69.6 | 91.3 | 98.6 | |
| Nov. | 85.2 | 123.5 | 69.0 | 91.3 | 98.2 | |
| Dec. | 83.6 | 122.3 | 68.4 | 91.3 | 97.8 | |
| Percentage change | | | | | | |
| July 1985- Dec. 1985 | -11.6 | -8.0 | -3.9 | 0.0 | -2.0 | |

Source: Information Notice System.

- 1/ Increases mean appreciation.
- 2/ Using seasonally adjusted price indices.
- 3/ Date of latest consideration by Executive Board.