THE FINANCIAL CRISIS OF 2008 AND SAUDI ARABIA

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Abstract

The current economic and financial crisis was driven by the reversal of the three positive 'shocks' that developing countries experienced during the recent boom period: exceptional financing, high commodity prices and , for a significant number of countries, large flows of remittances. No country in the world will be spared from the effects of the financial crisis and ensuing global recession. The paper focuses Saudi Arabia; it has completely shifted the focus of economic policy from controlling inflation to restoring confidence in the financial sector. We see the following key implication for the Saudi economy. Finance for local and foreign companies doing business in Kingdom will be less easily available and more expensive .Lower oil revenues will mean the end to the huge budget and current account surpluses in coming years .If the crisis encourage Arab government to restructure their economies, they will be better placed when the international economy picks up Saudi Arabia and some other Gulf States are taking these challenges much more seriously than in the past. They are investing large sums in upstream hydrocarbon projects to get more value from their oil, and are trying to diversify their economies away from petroleum products.

Key words: Global, economy, commodity, price, oil, financial crisis, developing countries.

Introduction

The current economic and financial crisis was driven by the reversal of the three positive shocks that developing countries experienced during the recent boom period: exceptional financing, high commodity prices and, for a significant number of counties, large flows of remittances. The initial trigger that contributed to the reversals of these trends was the impact of the bursting of the U.S. housing. Following the financial crisis that broke in US and other Western economies in 2008, there was serious concern about financial crisis on the developing countries. The urgent need for accelerating financial development in developing counties is through domestic financial deepening, domestic resource mobilization, and reform of the international financial system.

Transmission Mechanisms:

The key channels for transmission of the crisis from developed to developing countries has been via private capital flows though the impact of this has been more severe for emerging markets than for low-income countries, there has been a massive reversal of currency positions out of high-yielding assets in emerging economies into developed countries

The main channel of transmission of the crisis to exporters of manufactures and services is through a decline in trade volume; while exporter of primary goods have been more affected by declining prices. Falling energy prices will benefit energy importing countries but they will also lead to reduced investment and economic activity in commodity-dependent developing countries. For these countries, a major opportunity ahead is to redesign their trade strategy to reduce their commodity dependence.

Global Responses:

The magnitude of the current crisis is clearly associated with inadequate regulation and supervision of banks and financial markets. The new regulatory governance need to be based on a well-functioning network of national and regional authorities and include truly international supervision of financial institutions with global reach. The adequate representation from developing countries to ensure not just greater legitimacy, but also greater efficiency.

The Global recession now under way calls for a coordinated policy response. It means expansionary monetary, credit and fiscal policies in all industrial countries. Developing countries should adopt equally expansionary policies, individual and in a coordinated way. Countries that have accumulated larger amount of foreign exchange reserves and have limited external debt ratios do have a larger room for maneuver to adopt these policies.

Saudi Arabia an Economic Overview:

IMF should collaborate more with regional institutions, such as the Chiang Mai initiative or the Latin American Reserve Fund. Developing countries are also in an excellent position to contribute to this task, give their large foreign exchange reserves. Many Developing countries have created wealth funds with an additional level of assets of more than $3 million. While multilateral development banks should maintain their central function in the international development architecture, regional and sub-regional financial institutions owned by developing countries should play an important complementary role.

The Arab countries have experienced rapid changes in their economic fortunes in the last year. During first half of 2008, oil, natural gas, and other commodity prices continued to rise rapidly, leading to huge gains. At the same time, they had to cope with rapidly rising food and raw material prices that threatened their economies and social stability. The financial crisis and experienced a fall in , deterioration in their terms of trade, and declining surpluses on their balance of payment.

Saudi Arabia is an oil-based economy with the largest proven crude oil reserve in the world at 266.7 billion barrels, representing 57% of the GCC reserve, 29% of the OPEC and almost 20%

of the world total reserve. It ranks as the largest producer as well as exporter of petroleum in the world and play a leading role in the OPEC, producing 28% of the total OPEC oil production. The average oil production had increased up to 8.055 million barrels per day in 2009 compared to 9.113 million barrels per day in 2008. Oil sector represented 90% of total export earning, 80 % of government's revenue and 45% of its GDP. About 40% 0f GDP comes from the private sector. The Oil prices stood at US$77.20 per barrel in April 2010 compared to US$147.27 a barrel in the international market on 11th July 2008. Oil prices had plunged sharply thereafter due to global financial crisis. Saudi Arabia has launched mega projects, including establishment of six economic cities in different regions of the Kingdom to achieve balanced development of the region. Saudi Arabia has recorded strong economic growth during 2003 until late 2008 on the back of increased oil production and high oil prices. The non-oil sector, especially construction and real –estate industries has also played an important role in the economy. Both private and public sector have contributed as FDI and increased government spending supported the development of an effective and sustainable non-oil economy. All countries of the world were affected adversely by the crisis including Saudi Arabia in 2009; the Kingdom was least affected country in the GCC region due to the government's wise and timely policies. The global economy is recovering faster than expected having a positive impact on the Saudi economy.

Growth:

The year 2004 was the best year in the history of Saudi economy in terms of economic performance since 1982. After achieving robust growth in 2003 and 2004. Saudi Arabia is expected to achieve another prosperous year 2005, attributed to strength of oil sector, better domestic geo-political environment, acceleration of reform measures, growth of foreign assets of SAMA, a strong private sector growth, a high growth of corporate earnings during 2005.Saudi Arabia remains vulnerable to oil prices and production in 2004, which is still continuing has resulted in a robust growth for the Saudi economy as the nominal GDP grew by 16.8% in 2004 to US$ 250..56 billion compared to US$214.57 billion in 2003. The real GDP grew by 7.66% and 5.23% in 2003 and 2004 respectively and is expected to grow by 4.5% in 2005.

Inflation:

Saudi Arabia has been commended for it's a" extraordinary low inflation " in a survey of 12 Arab countries by the World Economic Forum (WEF) recently. The Kingdom has proven track record of very low inflation rates over a long period of time. The consumer price index grew marginally by 0.3% in 2004 compared to an increase of 0.6% in 2003 and is expected to rise marginally to 0.6% in 2005. A slight increase in inflation pressure which is still marginal, is mainly attributable to expected increase in the cost of imported non-oil commodities, priced in Euro and Japanese Yen, etc, plus rising domestic demand pressure.

Fiscal Position:

The Kingdom posted a budget surplus of 10.43% of GDP in 2004 compared to 5.7% GDP in 2003 emanating from windfall oil revenues due to sustained high oil prices and increase oil production. Supported by sustained oil market strength, economic prospects over the next two years are promising, as there is likely to be a strong boost in domestic and foreign investment activities in oil and gas petrochemicals, telecom, insurance sectors etc that will stimulate private sector. The government has accelerated its efforts in developing and implementing appropriate strategies and polices for economic diversification. The high revenues earned by the government have resulted in strong capital spending. There has been considerable investment proposed in Kingdom's Mega Projects, especially gas, oil and infrastructure sector over the forthcoming years.

Currency:

The Monetary policy of Saudi Arabia will remain focused on maintaining a fixed exchange rate regime with the US Dollar. The Saudi Arabia Monitory Agency (SAMA) will maintain the Saudi Riyal's peg to the US Dollar at SR 3.75 US$ 1, as it has ample reserve to do so. SAMA 's policy of limited foreign borrowing has kept liabilities low and thus contributed significantly to the long-term stability of the Saudi Riyal against the US Dollar. A robust oil market will enable future growth of Kingdom's foreign currency reserve and ensure that there is no pressure on the currency peg.

Conclusion:

The crisis encourages Saudi Arabian government to restructure their economies; they will be better placed when the international economy picks up. Saudi Arabia and some other Gulf States are taking these challenges much more seriously than in the past. They are investing large sums in upstream hydrocarbon projects to get more value from their oil, and are trying to diversify their economies away from petroleum products. They have also made investment in alternative energy to reduce domestic demand for oil and gas, thus freeing up more for export.

On the other hand, the act that oil-producing states have not been affected as much as others may induce complacency. This could, in turn, lead to a failure to enact meaningful economic reform at this critical juncture and only ensure similar problem in the future global downturns that are sure to follow.

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