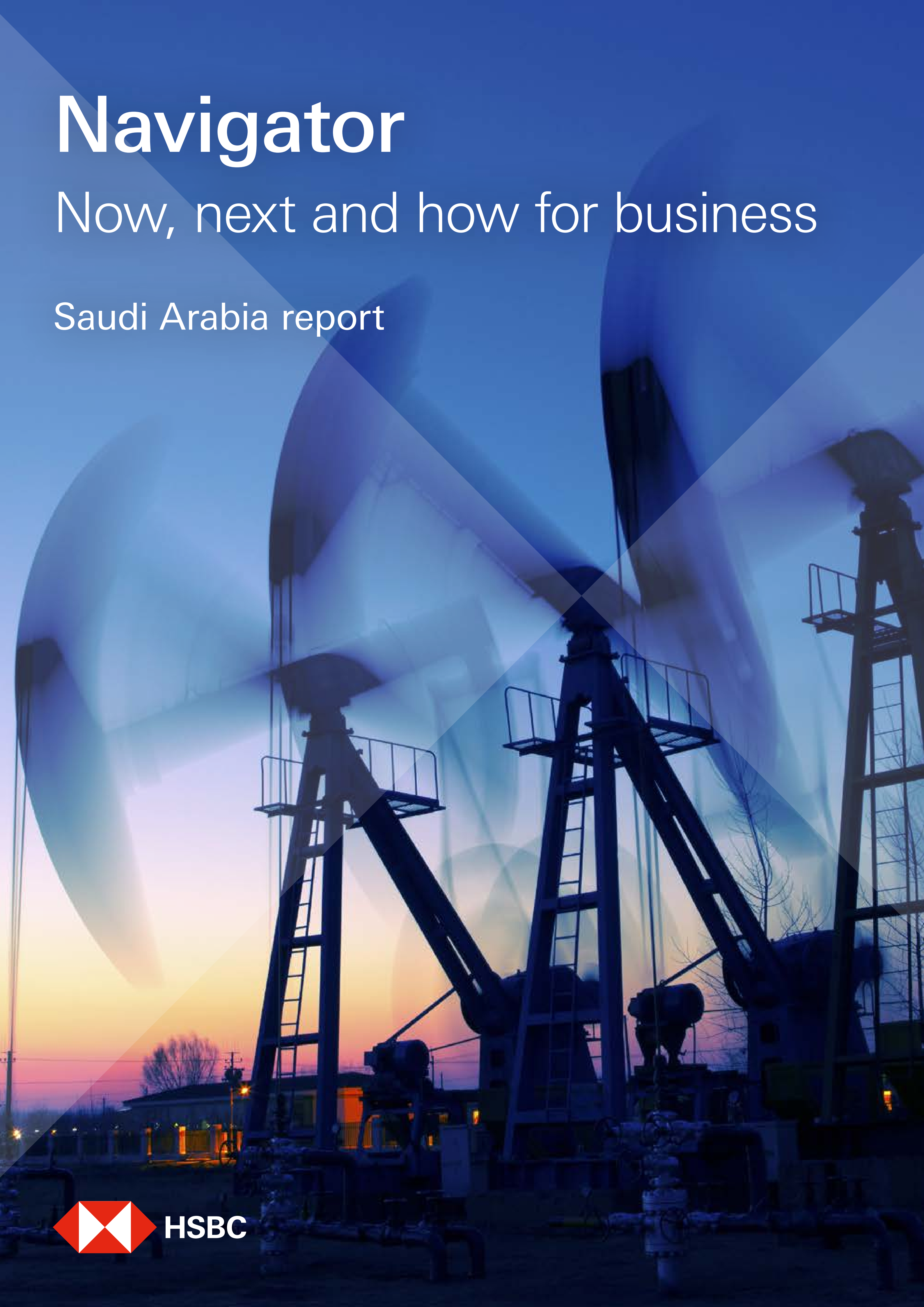
Navigator

Now, next and how for business

Saudi Arabia report



HSBC

Saudi Arabia

Diversification to impact Saudi imports as well as exports

Saudi Arabia's business environment has improved over the last couple of years, with two-thirds of businesses now expecting an increase in trade volumes over 2018. However, improvements in both regional and global expectations are stronger. Therefore, the Saudi government must continue to implement further business friendly reforms to stimulate a further upturn in performance and bringing Saudi expectations in-line with the global average.

Short-Term Snapshot

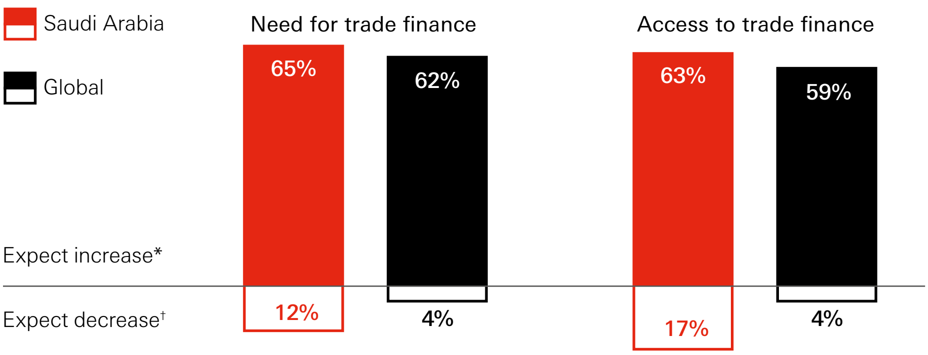
The Saudi economy did not share in the global recovery in 2017, as GDP fell by 0.7%, reflecting continued fiscal tightening, lower oil output and only modest growth in the non-oil sector. We expect 2018 to be more positive. Expansionary fiscal policy, stability in oil output and various pro-growth government initiatives are seen lifting GDP to around 1% this year. Nevertheless, despite efforts to improve the country's trade mix, oil still accounts for three-quarters of export revenue, ensuring that income is heavily tied to the price of oil. The partial recovery of oil prices over 2017 and the more recent increase in Saudi refinery output means the oil sector will expand modestly in 2018, boosting exports and GDP growth. However, the government's ambitious investment and diversification plans will be key to determine import requirements, and export prospects over the next decade.

As Saudi oil output eventually recovers and global trade gains continue, Saudi export expansion will occur. However, our survey highlights that expectations for increased trade volume lag global prospects, 67% for Saudi Arabia versus the global average of 77%. This largely reflects the impact of lower oil prices on Saudi's trade prospects. Lower oil prices more widely are a boost for global trade, helping to stimulate demand with lower transportation and production costs. For Saudi Arabia though, which generates most of its export revenues from oil, lower pricing undermines export revenues and the availability of funding for imports.

Action points for business

- To successfully transition the economy away from oil, businesses must work to build skills and experience in new areas, key to ensuring that Saudi exports can compete on a cost and quality basis.
- Businesses must push for specific and realistic reforms which will enable to pursue growth in new sectors.

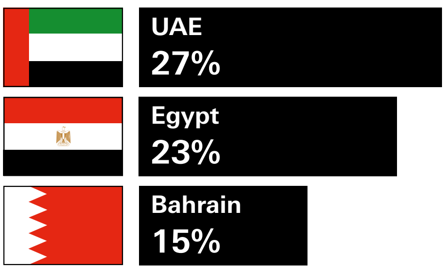
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



Source: TNS Kantar

Saudi Arabia has made some progress in improving the domestic investment environment. Behind the scenes, the authorities have been steadily improving the efficiency of government and improving investor protections. While our survey data shows that the proportion of firms expecting an improved ability for accessing trade finance was in line with the global average, a much greater proportion of firms than the global average (17%, versus 4% globally) were worried about trade financing getting harder to find.

The Saudi economy is geared toward the export of oil, which accounted for more than 70% of total exports in 2017, while non-oil goods contributed 22%, and services just 7% of total exports. However, Saudi Arabia is the location of the two holiest sites in Islam, and there is already significant infrastructure in place to welcome religious pilgrims for the Hajj and Umrah. Indeed, in 2016 tourism & travel was the largest service sector export accounting for 61% of the total. The government is aiming to increase annual Umrah visitors from 8m to 30m by 2030.

However, aside from the tourism and travel sector, the prospects for Saudi exports of services are more limited. Despite wide-ranging government initiatives to diversify jobs and growth by supporting service sectors, respondents expect less short-term success in services than in broader trade. The proportion of survey respondents in Saudi Arabia anticipating service sector export expansion was 58%, below the global average. Gloom over near-term prospects aside though, respondents identified favourable government initiatives as a potential driver of growth, suggesting optimism over the effectiveness of reform and diversification measures.

Despite efforts to improve the country's trade mix, oil still accounts for three-quarters of export revenue.

How do you plan to grow your services business?

Entering new markets	47%
Entering new service areas	29%
Upscaling digital/technological capability of your employees	22%
Increasing use of e-commerce	19%
Government initiatives or incentives	19%

Source: TNS Kantar

Saudi firms are more worried about barriers to accessing trade finance than competitors in other economies.

Trade Policy Developments

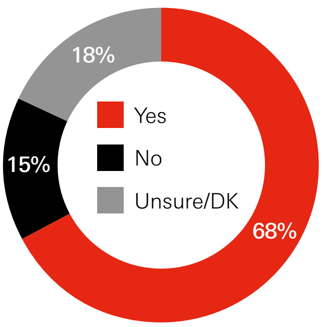
The focus on diversification and increased private-sector participation are of key importance to the future profile of Saudi exports. Enhancements in the regulatory environment and the opening up of additional sectors of the economy to foreign investment will ease the investment process. This will benefit trade activity, with Saudi attempting to position itself as a regional hub in the financial and tech service sectors.

There is concern around the current swing toward protectionism and the impact this will have on the ease and cost of doing business internationally. The survey highlights worries around protectionism, with 68% of those surveyed indicating that governments are becoming more protective. Consequently, 42% stated that the cost of international business had increased, slightly above the global trend and 33% of respondents thought that increased protectionism had reduced international business opportunities, again above the global trend. However, respondents were positive about several trade agreements, with the ASEAN agreement expected to provide opportunities to just over half of businesses where it was deemed relevant.

Action points for business

- Firms must help the government understand the economic and financial cost of policies aimed at increasing Saudi employment, with arbitrary targets often harmful for business success.
- Increased understanding of global trade policy is vital. Having operated in energy and related sectors for decades, Saudi firms will have to broaden knowledge of market trends and policy in new areas.

Are governments becoming more protective of their domestic business?



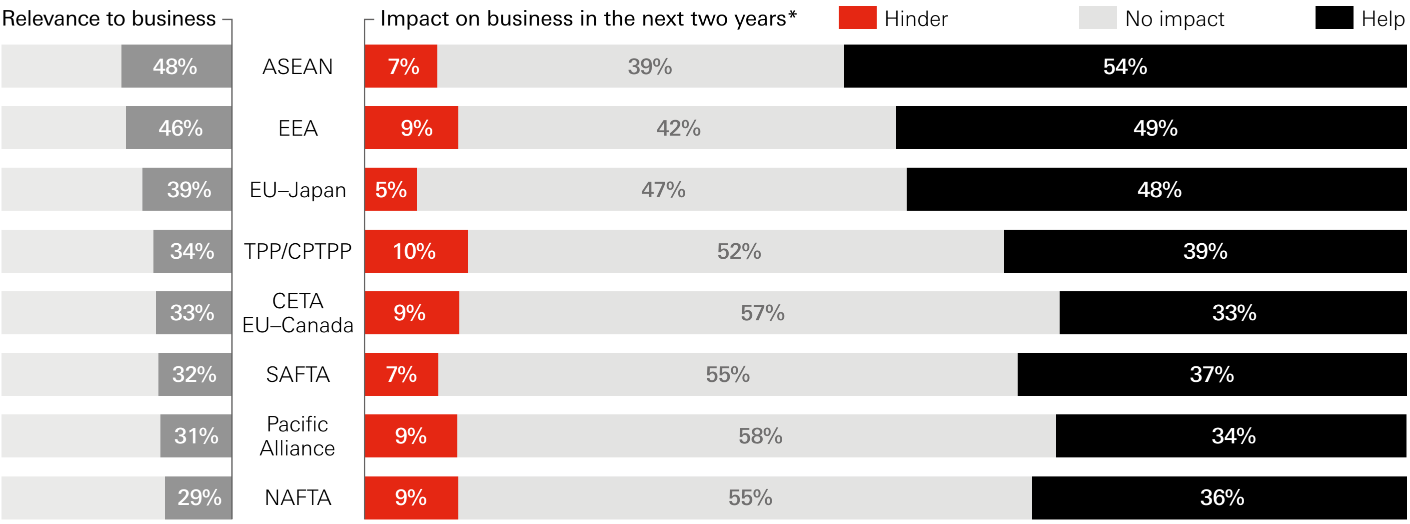
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

Long-Term Outlook for Trade

Saudi Arabia has begun to implement its Vision 2030 plan, which sets out key targets for metrics such as the contribution of the private sector to overall economic activity and the non-oil sector's contribution to exports amongst others. The targets set out in the Vision are extremely ambitious, and in reality perhaps unlikely to be met given the barriers to a successful diversification. However, the direction of travel is more important than achieving specific numerical targets, and we expect that progress will be made in diversifying Saudi Arabia's export revenues away from a reliance on oil. Key areas on which to focus will be travel & tourism, transport & distribution - both goods and services – and chemicals and plastics.

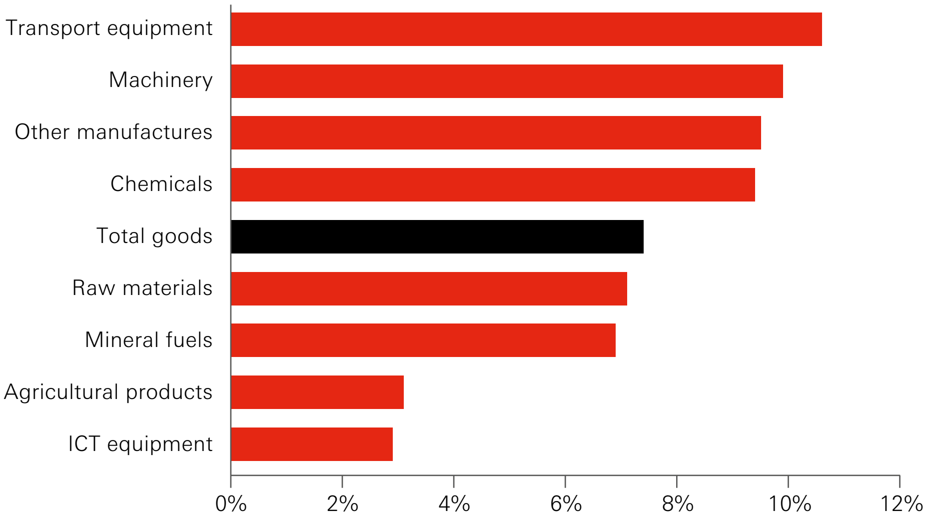
Oil derivative products key to boosting non-oil exports
Saudi Arabia will gradually diversify its export base, but barriers remain to prohibit the full implementation of the Vision 2030 expectations. The combination of high wage costs relative to the standard of human capital, as well as the constraints to competitiveness posed by the US dollar peg will continue to inhibit diversification. That said, progress will be made in both the chemicals and plastics sectors, with strong growth in exports to China a key driver of success. Both these sectors build on Saudi Arabia's oil endowment, using crude oil and its derivatives as inputs. Utilising this existing resource will help Saudi to gain some market share in a new sector.

The change in focus for growth in the export base will become apparent in the next decade as pharmaceutical products emerge as the fastest growing export sector, though admittedly from a relatively low base accounting for just 0.3% of total exports in 2017, increasing to 0.4% by 2030. Similarly, for transport equipment there will be strong regional growth in demand, with annual exports growing 11.6% between 2017-20 and 7.4% annually to 2030.

Action points for business

- The Vision 2030 plan is an opportunity to provide a roadmap for change and diversification. Businesses must help the government understand the business realities and implications of specific reforms.
- Diversification efforts are on-going and the ability to move away from oil dependent export growth is heavily reliant on the cost structure of Saudi production. Getting Saudi wage costs down and managing international trade with a pegged exchange rate are key.
- In order to achieve the targeted increase in pilgrims by 2030, businesses need to help make the case for priority infrastructure investment to serve a large number of additional visitors.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	Japan	India
2	China	China
3	India	Japan
4	Korea	UAE
5	USA	Korea

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

> Progress will be made in both the chemicals and plastics sectors, each sector growing by just shy of 10% per annum between 2021-30.

Total goods exports to China will roughly treble by 2030, with much of this growth coming from crude oil and derivative products. In crude oil markets, the US, China and India will become Saudi Arabia's largest export markets by 2030, with Japan and South Korea emerging as a distant fourth and fifth. Clearly, there is a strong focus on Asian markets, with Saudi Arabia needing to maintain a strong presence and understanding of the region to aptly serve its top export partners. Complimenting oil, chemical and plastic products will also see strong export growth in both China and India, further cementing the Saudi focus on this region.

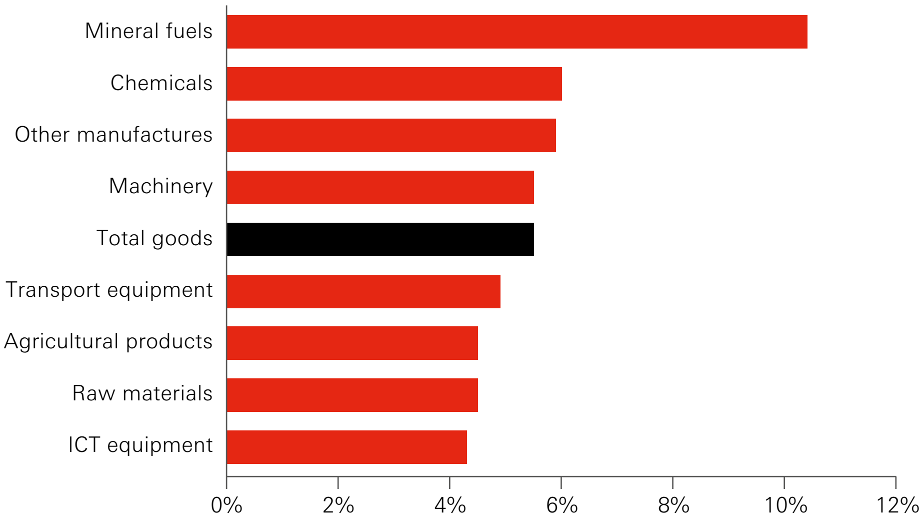
Closer to home, Saudi will make slight gains in exports to the UAE and Egypt, building further on strong pre-existing trade relationships. These countries will take 10% of Saudi's total goods exports by 2030 (up 4pp versus 2016). In trading with Egypt though, Saudi firms will need to be well aware of potential volatility in exchange rates – both from a credit risk perspective and with a view towards fluctuating competitiveness.

Manufacturing equipment and machinery key areas of import growth
As Saudi Arabia looks to diversify away from oil markets, imports of both industrial machinery and transport equipment will grow strongly. Similarly, input materials such as mineral products will see strong growth as manufacturing expansion heightens demand. Also, as the service sector grows, ICT equipment will become an increasingly-important input for firms. We expect imports in this category of goods to double by 2030.

As the service sector grows, ICT equipment will form a key requirement, with imports doubling by 2030.

Agricultural produce will remain broadly flat as a share of total, continuing to account for around 10% of total imports. Indeed, as the population continues to grow, import of food products will grow in volume terms but slip slightly as a proportion as Saudi imports of manufacturing inputs grow more strongly.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	China	China
2	USA	USA
3	Germany	UAE
4	UAE	India
5	UK	France

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

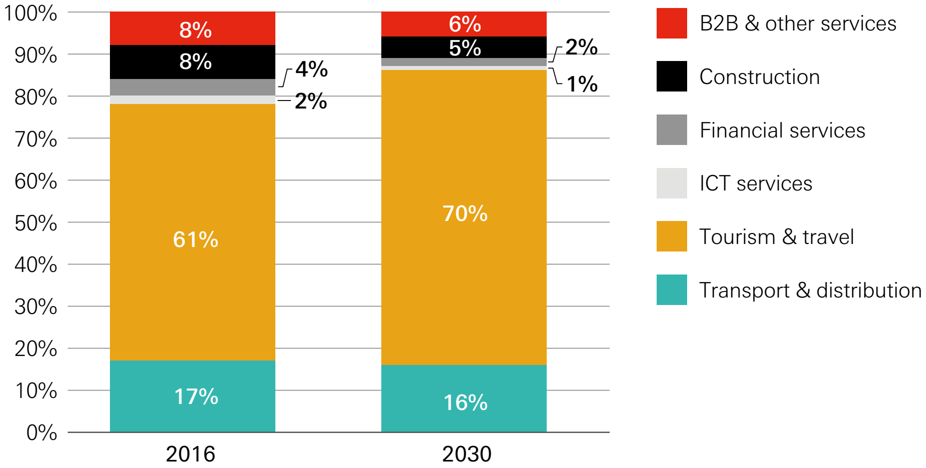
The fastest growing region for Saudi imports will be Asia. With import volumes from China accounting for around 25% of total imports by 2030. Much of this growth will be fuelled by growing domestic manufacturing and consumption, with consumer goods such as clothing, and input goods such as textiles, a large proportion of the total. Clearly, many Asian exporters can manufacture at a lower cost than Saudi and while it is expected that progress will be made to lower domestic production costs, it is unlikely to diversify into low-value added sectors. At the other end of the spectrum, Saudi firms' demand for high-value added goods to help diversify their economies will boost demand for imports from the most technologically advanced economies.

Religious pilgrimages could turn Saudi into a tourist hotspot
Key to growing the proportion of services in the export mix will be the travel sector, with Saudi Arabia a key destination in the Islamic world. Indeed, the Vision 2030 objective to increase capacity to welcome 30 million Umrah pilgrims every year from the current 8 million, is one of the more achievable goals. Enabling this strategy, the government has numerous large-scale infrastructure projects underway or being planned that will enhance its ability to serve a growing number of pilgrims.

However, cost is a key issue for Saudi Arabia, with the pegged exchange rate regime and higher visa fees impacting on affordability for pilgrims from many economies. For other export sectors significantly-higher wages for Saudi nationals have created a substantial gap between the region's most attractive business destinations (specifically the UAE, but also Qatar and Bahrain) and Saudi Arabia. Indeed, the World Bank's Doing Business 2018 report placed Saudi Arabia at 92nd, behind regional peers.

Government is investing in tourism infrastructure, but may also need to make visits more affordable.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	UAE	UAE
2	USA	India
3	Japan	China
4	India	USA
5	Egypt	Egypt

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

The most important partner for Saudi service sector exports is currently the UAE, with the US in second place. We expect that in 2030 the UAE will remain the largest partner, but strong growth in trade with India, up 10% a year and China, up 9% a year, will have propelled these countries into second and third place by 2030. Growth in service sector trade between Asian countries and Saudi Arabia will be the fastest growing, with Indonesia also boosting ties with the region.

However, despite strong gains for fast growing Asian economies, Saudi Arabia's largest trade partner in the service sector will remain the UAE – as long-run historic ties, comparable culture and proximity trump the fast-growing consumer markets in Asia.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

For media enquires please contact:
Natasha Plowman
HSBC Global Communications
Natasha.Plowman@hsbc.com

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