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INFO SAVING ABU DHABI, AMMAN, BAGHDAD, BAHRAIN, BEIRUT, CAIRO, DAMASCUS, DUBAI, KHARTOUM, KUWAIT, MEXICO CITY, MUSCAT, RIYADH (ACTIONED), WASHINGTON

SAUDI ECONOMY

OIL REVENUES

1. WITH SAUDI ARABIA STICKING TO ITS DEFENCE OF THE US DOLLAR 34 PER BARREL MARKER PRICE, OIL PRODUCTION HAS FALLEN TO AROUND 5.5MBD (EXPORTS OF 4.8MBD) IN THE JULY - SEPTEMBER QUARTER COMPARED WITH AROUND 10MBD IN THE SAME QUARTER OF 1981. IF THIS CURRENT LEVEL IS CONTINUED OVER THE REMAINDER OF THE FISCAL YEAR (APRIL - APRIL), TOTAL OIL REVENUES WILL BE AROUND US DOLLARS 56.2BN (ALLOWING FOR THE HIGHER LEVEL OF EXPORTS IN THE FIRST QUARTER OF THE YEAR), COMPARED WITH US DOLLARS 96.9BN IN FY1981/82.

BUDGETARY EXPENDITURES

2. TOTAL BUDGET EXPENDITURE FOR FY 1982/83 IS SET AT SR313BN (US DOLLARS 94BN), OF WHICH SOME 94% (US DOLLARS 88.5BN) WILL BE IN FOREIGN CURRENCIES. IF OIL EXPORTS DO NOT INCREASE IN Q4 1982 AND Q1 1983, THERE WILL THEREFORE BE A GAP OF AT LEAST US DOLLARS 32.3BN BETWEEN OIL REVENUE AND TARGETTED FOREIGN CURRENCEY EXPENDITURES. NON-OIL REVENUES ARE LIKELY TO BE AROUND US DOLLARS 22BN (A GENEROUS ESTIMATE), COMPRISING LPG EXPORTS OF US DOLLARS 7BN, AND INCOME ON FOREIGNBUURRENCY RESERVES AROUND US DOLLARS 15BN (THIS WOULD HAVE FALLEN WITH INTEREST RATES FROM THE FY 1981/82 LEVEL), LEAVING A GAP OF ABOUT US DOLLARS 10BN TO BE COVERED IN ONE OF MORE OF THE FOLLOWING WAYS:-

- (A) HIGHER OIL REVENUES DURING THE REMAINDER OF THE FISCAL YEAR (LOWER PRICE, HIGHER VOLUME?) SEMICOLON
- (B) REDUCED EXPENDITURE SEMICOLON
- (C) DRAWING DOWN FOREIGN EXCHANGE RESERVES.

OIL PRODUCTION PROSPECTS

3. THE SAUDI AUTHORITIES STILL BELIEVE (PUBLICLY AT LEAST) THAT THERE WILL BE A RECOVERY IN WESTERN DEMAND FOR OIL IN THE LAST QUARTER OF 1982, OR THE FIRST QUARTER OF 1983. AT THE RECENT OXFORD ENERGY SEMINAR, SHEIKH YAMANI REITERATED THIS VIEW, MAINTAINING THAT HE DID NOT BELIEVE THAT THE WESTERN POWERS WOULD ALLOW THE PRESENT RECESSION TO CONTINUE, AND THAT PROVIDED THERE WAS A FREEZE ON OIL PRICES UNTIL 1984, DEMAND FOR OIL WOULD SOON BEGIN TO RECOVER. THIS MAY BE OPTIMISTIC, BUT THE SAUDIS CAN

POINT TO: THE SEASONAL WINTER INCREASE IN OIL DEMAND SEMICOLON AN END TO OIL INVENTORY DRAWDOWNS SEMICOLON SOME FAINT SIGNS THAT OIL DEMAND HAS BEGUN TO FIRM UP SEMICOLON RECOVERY OF THE SPOT PRICE OF ARABIAN LIGHT FROM THE SLUMP OF JUTP32-7@7'5 '3.8-COLON A MARGINAL INCREASE IN SAUDI PRODUCTION (REPORTED BY MEES) DURING THE EARLY PART OF SEPTEMBER. (EVERY ADDITIONAL 0.5MBD OF EXPORTS BOOSTS SAUDI REVENUES BY US DOLLARS 2.8BN). BUT PRIVATELY THE SAUDIS RECOGNISE THE UNCERTAINTIES AND DIFFICULTIES OF KEEPING OTHER OPEC MEMBERS, PARTICULARLY IRAN, IN LINE.

BUDGETARY SAVINGS

4. THE EXPENDITURE TARGETS FOR 1982/83 WERE BASED UPON LOWER FORECAST OIL REVENUES (OIL PRODUCTION OF AROUND 7.5MBD AT US DOLLARS 34BBL WOULD HAVE FINANCED THE BUDGET WITH NO DRAWDOWN OF RESERVES) AND WERE, THEREFORE, LESS AMBITIOUS THAN THEIR PREDECESSORS. THE REAL GROWTH IN ALLOCATIONS WAS ONLY 2-3% UP ON THE PREVIOUS YEAR'S OUTTURN SEMICOLON THE LION'S SHARE OF PROJECT SPENDING WAS ON WORK ALREADY BEGUN.

5. THERE HAVE BEEN NO INDICATIONS OF ANY REDUCTION IN OVERSEAS AID. FLOWS TO IRAQ APPEAR TO CONTINUE, POSSIBLY AROUND US DOLLARS 1BN A MONTH. IT IS PROBABLE THAT THOSE TO SYRIA, JORDAN AND THE PLO HAVE BEEN MAINTAINED AND POSSIBLY EVEN INCREASED TO UNDERPIN THE OUTCOME OF THE FEZ SUMMIT. HELP HAS BEEN PROMISED TO LEBANON. THE DIRE FINANCIAL STRAITS OF MANY OTHER RECIPIENTS OF SAUDI AID MAKE CUTS POLITICALLY DIFFICULT. SAUDI COMMERCIAL BANKS REPORT THAT THE AUTHORITIES STOPPED THEIR LENDING TO MEXICO: THIS COULD HAVE BEEN IN THE CONTEXT OF RECENT SAUDI-MEXICAN CONTACTS ABOUT A POSSIBLE GOVERNMENT TO GOVERNMENT LOAN AGAINST A QUID PRO

QUO ON OIL PRODUCTION AND PRICING, WHICH THE MEXICANS, (ACCORDING TO THE FINANCIAL TIMES OF 4 OCTOBER) HAVE NOW TURNED DOWN. THE

THE CURRENT AID COMMITMENT COULD CONSEQUENTLY BE AS HIGH AS US DOLLARS 25 TO 30BN AND HARD TO PRUNE.

6. THE KING HAS SO FAR SAID NOTHING TO SUGGEST THAT HE IS CONSIDERING CUTTING BACK EXPENDITURE. HE HAS PUBLICLY STATED THAT HE WILL 'SPARE NO COST' ON DEFENCE, WHICH MAY SIGNAL HIGHER EXPENDITURE IN THIS AREA. THERE IS, IN ANY CASE, LESS SLACK, AND SO LESS ROOM FOR MANOEUVRE, THAN IN PREVIOUS BUDGETS, ALTHOUGH THE MINISTERS OF FINANCE AND PLANNING BELIEVE THAT THERE IS SIGNIFICANT SCOPE FOR IMPROVING FINANCIAL DISCIPLINE AND CUTTING COSTS IN THE SPENDING MINISTRIES. THERE ARE REPORTS THAT STRICTER DISCIPLINES ARE BEING ENFORCED SEMICOLON WE HAVE HEARD, FOR EXAMPLE, THAT THE MINISTER OF FINANCE IS NOW PERSONALLY SCRUTINISING ALL GOVERNMENT PAYMENTS OVER SR100M, AND IT IS POSSIBLE THAT THIS HAS OCCASIONED SOME RECENT PROCEDURAL DELAYS. BUT BANKERS TELL US THAT PAYMENTS ARE FOR THE MOST PART NO SLOWER THAN USUAL, AND THEIR VOLUME NORMAL FOR THIS RELATIVELY SLACK TIME OF THE YEAR SEMICOLON THIS SUGGESTS THAT, SO FAR, THE BRAKES HAVE BEEN APPLIED ONLY LIGHTLY, IF AT ALL.

DRAWDOWN OF FOREIGN EXCHANGE RESERVES

7. WHEN THE BUDGET WAS FIRST ANNOUNCED, THE MINISTER OF FINANCE MADE IT CLEAR THAT THE EXPENDITURE TARGETS WERE NOT DEPENDENT UPON OIL REVENUES, AND THAT FOREIGN EXCHANGE RESERVES COULD BE RUN DOWN IF NECESSARY. SENIOR SAMA OFFICIALS HAVE SAID RECENTLY THAT THIS REMAINS THE INTENTION, ALTHOUGH THEY MAINTAIN THAT THERE HAS AS YET BEEN NO NEED TO DRAW DOWN FOREIGN ASSETS. WITH FOREIGN ASSETS OF MORE THAN US DOLLARS 150BN, THERE IS MORE THAN ENOUGH ROOM TO ACCOMODATE A DEFICIT OF US DOLLARS 10BN (PARA 2 ABOVE) IN FY1982/83.

CONCLUSIONS

8. DESPITE THE SUBSTANTIAL REDUCTION IN OIL PRODUCTION, SAUDI ARABIA DOES NOT FACE ANY SIGNIFICANT BUDGETARY DIFFICULTIES IN THE SHORT TERM. THE SIGNS AT PRESENT ARE THAT UNLESS THERE IS A FURTHER DECLINE IN OIL DEMAND DURING THE REMAINDER OF THE FISCAL YEAR, EXPENDITURE WILL REMAIN NEAR THE LEVELS BUDGETED.

9. THE GENERAL HEALTH OF THE ECONOMY AT PRESENT APPEARS GOOD SEMICOLON THE COST OF LIVING INDEX FELL DURING THE SECOND QUARTER OF 1982 (BY 0.4%) AND WITH OVERSEAS INTEREST RATES FALLING, MORE RIYALS ARE STAYING AT HOME FOR DOMESTIC INVESTMENT SEMICOLON BUSINESS ACTIVITY IS DYNAMIC, GIVING THE BANKERS PLENTY OF CHOICE FOR INVESTING THEIR AMPLE FUNDS IN LOW RISK ENTERPRISES.

10. BUT UNLESS THERE IS A RECOVERY IN OIL REVENUES, IT WILL BE DIFFICULT FOR THE GOVERNMENT TO POSTPONE HARD DECISIONS BEYOND THE NEXT BUDGET (APRIL 1983). OPTIONS MUST THEN INCLUDE GREATER CONTROL OVER CURRENT EXPENDITURE, SOME PRUNING OF PROJECTS AND FOREIGN AID, AS WELL AS A REVIEW OF SUBSIDIES, WHICH ARE CURRENTLY COSTING OVER US DOLLARS 3.2BN AND ENCOURAGE WASTE AND INEFFICIENCY. WITH LOWER GOVERNMENT EXPENDITURE, DIFFICULTIES WOULD ARISE IF THE PRIVATE SECTOR ATTEMPTED TO MAINTAIN ITS CURRENT IMPORT LEVELS SEMICOLON LIQUIDITY WOULD BE DRAINED FROM THE BANKING SYSTEM, AND SOME BUS- INESSES COULD GO TO THE WALL, THREATENING CONFIDENCE AND THEREFORE PRIVATE SECTOR GROWTH. WITH THESE POSSIBILITIES IN MIND, THE FINANCIAL AND BUSINESS COMMUNITIES ARE NOTICEABLY LESS OPTIMISTIC THAN AT THE BEGINNING OF THE YEAR.

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PLEASE ALSO PASS TO ALL SAVING ADDRESSEES EXCEPT RIYADH
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