Saudi Arabia

Saudi Arabia's quick response to the pandemic and its strong reform momentum lessened the impact of COVID-19, auguring well for the country's future. Reforms span a wide array of aspects including labor, legal/judicial, banking/financial, privatization, and competition, among others. After it held up relatively well last year, we forecast non-oil growth at 2.2% in 2021, before strengthening to an average of 2.9% in 2022-2023. The recovery is expected to be gradual and it may take until the first half of 2022 for all the lost private-sector output in 2020 to be recouped. The fiscal deficit is expected to shrink in 2021 (to 4% of GDP) as revenues rebound and spending is reduced following the pandemic-related overshoot in 2020.

Growth to rebound after a better-than-expected 2020

The Saudi non-oil economy contracted by 2.3% in 2020, which is less than originally expected and a smaller drop than its GCC peers. In our view, the relatively limited contraction was due to 1) a timely and well-targeted fiscal/monetary stimulus, 2) relatively robust performance by the non-oil government sector, which contracted by a limited 0.5% versus 3.1% for the private sector and 3) generally successful control of the Covid-19 spread (Chart 5). Given the movement and travel restrictions that were imposed in 2020, the transport sector was the hardest hit (-6%), while the financial sector, including banks, was the most resilient, as it expanded by 0.8% supported by mortgages.

For 2021, the recovery is expected to be gradual given ongoing uncertainty regarding the pandemic and when the full normalcy of business activities will be resumed. The vaccination campaign in KSA has picked up recently with more than 4.1 mln (12% of the population) inoculations administered. After the pandemic-related government spending overshoot in 2020, we forecast a decrease in spending in 2021, due to fiscal consolidation needs, putting some pressure on non-oil growth. Given all that, we expect that it may take until the first half of 2022 for all the lost private-sector output in 2020 to be recouped, with non-oil growth estimated at 2.2% in 2021 then strengthening to an average of 2.9% in 2022-23. Important reforms and PIF's commitment to invest at least SAR 150 billion annually in 2021-2025 (versus an estimated average of SAR 77 billion in 2019-2020) in the local economy underpin this accelerating growth.

As for the oil sector, KSA is playing a leading role within OPEC+ and is shouldering a lot of the burden to rebalance the market, cutting its production vloluntarily to prevent a sharp fall in oil prices. As such, the oil sector in 2019 and 2020 contracted 3.6% and 6.7%, respectively, and is expected to contract again in 2021, given KSA's additional 1mb/d voluntary production cut. Annual oil production may start increasing in 2022 and we forecast oil GDP to grow by an average of 4% in 2022-23 after a 0.7% drop in 2021. All in all, total GDP is expected to grow by an average of 3.4% in 2022-23, after a 1.1% projected expansion in 2021, which is held back by the oil production cuts.

Following the tripling of VAT in July 2020, inflation increased to 3.4% in 2020, and will likely decelerate to 2.8% this year, before normalizing to 2% in 2022-2023. As for credit, growth accelerated to 15% in 2020, almost double the 2019 expansion, supported by soaring mortgage lending (+59%). Growth in corporate and personal non-mortgage credit also picked up nicely in 2020 to stand at 6.9% and 8.8%, respectively. Driven by project awards, rebounding non-oil growth, and ongoing solid mortgage expansion, we expect credit growth to remain strong at 11% in 2021, softening to an average of 9% in 2022-2023.

Fiscal deficit to markedly shrink in 2021

The fiscal position came under pressure in 2020 given lower oil prices and production, as well as higher pandemic-related spending, resulting in a deficit of 11.2% of GDP. However, the deficit would have been much wider had it not been for the following important factors. First, the government tripled the VAT and rationalized spending allocations, including discontinuing the cost of living allowances and cutting capital spending. Second, while oil exports decreased considerably due to drop in both prices and production, there was a material increase in the transfer ratio (fiscal oil revenues/oil exports), reaching 90.6% in 2020 (79% in 2019), mainly due to Aramco's $75 billion annual dividend pledge. Third, material non-oil revenue one-offs were recorded (including SAR 15-25 billion dividend from the PIF) . Going forward, given the increase in oil prices and the government's unwavering commitment to continue expanding non-oil revenues (including VAT's full-year impact) and rationalizing spending in line with Vision 2030, we forecast a steep improvement in the deficit to around 4% of GDP in 2021, shrinking further to 2.5% by 2023. Accordingly, and supported also by higher nominal GDP, we see only a limited increase in the debt/GDP ratio going forward, reaching 34% by 2023, way below the 50% self-imposed cap.

The current account is forecast to have turned negative (-2%) in 2020, improving modestly thereafter driven by higher exports. Finally, the reform momentum is very positive and is a main reason for the country's favorable outlook. The ongoing economic/structural reforms (including labor, legal, and business environment) have the potential to unlock significant growth in non-oil output and revenue, thereby diversifying the economy away from oil, a main pillar of Vision 2030. Reforms are expected to improve efficiency, boost productivity, attract FDI, and increase employment. However, safeguarding the oil market's balance until the non-oil sector contributes significantly to economic activity remains a key challenge to the outlook.

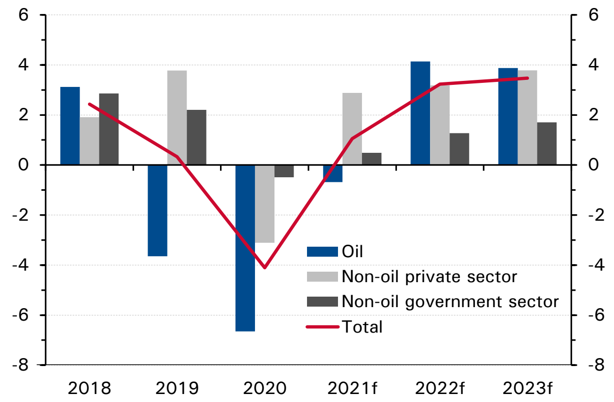
Table 1: Key economic indicators

		2019	2020	2021f	2022f	2023f
Nominal GDP	($ bn)	793	700	795	823	863
Real GDP	(% y/y)	0.3	-4.1	1.1	3.2	3.5
Oil	(% y/y)	-3.6	-6.7	-0.7	4.1	3.9
Non-oil	(% y/y)	3.3	-2.3	2.2	2.6	3.2
Inflation (average)	(% y/y)	-2.1	3.4	2.8	2.0	2.0
Fiscal balance	(% of GDP)	-4.5	-11.2	-4.0	-3.1	-2.5
Government debt	(% of GDP)	22.8	32.5	31.4	33.0	34.0
Current account	(% of GDP)	4.8	-1.6	1.6	1.4	1.3

Source: National authorities, NBK forecasts

Chart 1: Real GDP

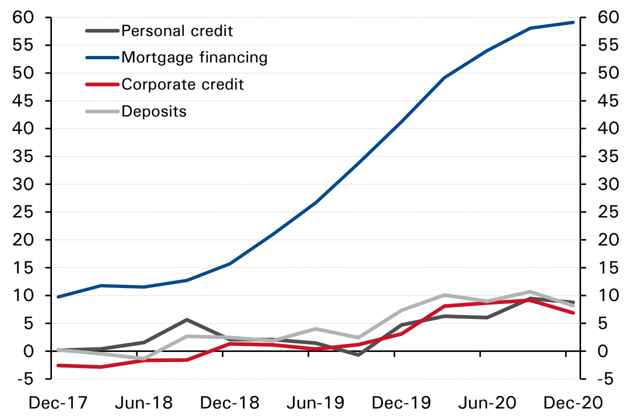
(% y/y)



Source: General Authority for Statistics (GASTAT), NBK forecasts

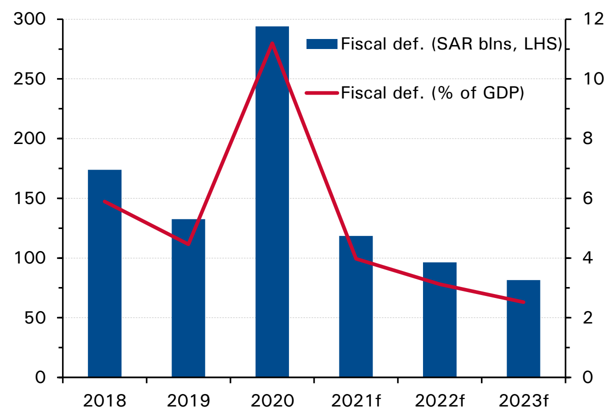
Chart 2: Growth in credit components and deposits

(% y/y)



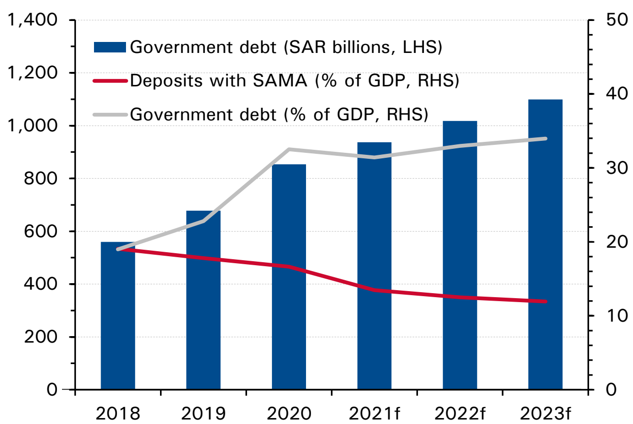
Source: SAMA

Chart 3: Fiscal deficit



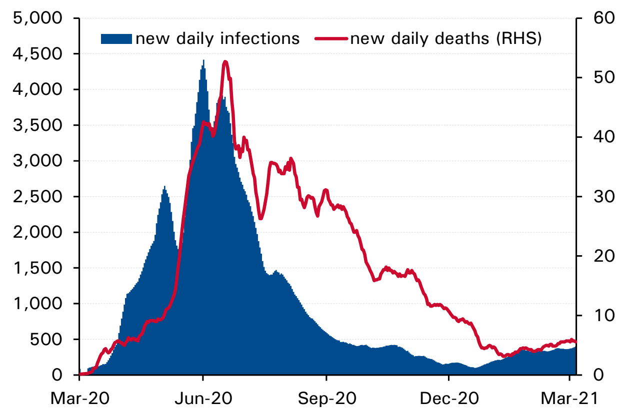
Source: Ministry of Finance, NBK forecasts

Chart 4: Government debt and deposits with SAMA



Source: GASTAT, Ministry of Finance, SAMA, NBK forecasts

Chart 5: Daily infections and deaths (1-week moving av.)



Source: Ministry of Health, Our World in Data