Saudi Arabia

Economic growth is recovering, driven by record government spending that aims to develop and stimulate the private sector, create jobs, cushion subsidy cuts and diversify the economy. Oil sector activity will remain subdued while the government is committed to active OPEC oil supply management. Public finances are improving thanks to higher tax revenues but the deficit will continue to weigh on public debt. Risks to the outlook stem from continued sensitivity to oil prices, slow diversification, limited private sector employment growth, and rising business costs mainly from expatriate levies.

Non-oil outlook improves, driven by public spending

The economy is well into its second year of recovery since contracting in 2017. With oil prices last year at least 31% higher than they were in 2017, the government has unveiled another record budget ($290bn) in support of consumption, jobs, the private sector (e.g. the private sector stimulus program) and economic diversification (e.g. National Industrial Development Program, NIDLP).

Non-oil activity has improved, and is expected to accelerate from 2.0% in 2018 to 3.2% by 2021. (Chart 1.) Recent (April) high frequency metrics, such as point of sales (POS) transactions (+24% y/y), cement sales (+5.2% ytd), private sector import letters of credit (+7.5% y/y Jan-Apr cumulative) and private credit growth (+2.1% y/y) all show gains. Also, PMI activity in May hit a 17-month high (57.3) on rising new orders. (Chart 2.)

Headline growth, in contrast, will lag non-oil growth at 1.0% in 2019 and 2.4% over 2020-21 due to Saudi Arabia's OPEC+ oil production cut obligations, under which the kingdom has so far over-complied by 293% (9.69 mb/d in May). While oil output will likely rise to nearer quota levels (10.3 mb/d), we don't believe that, given current and projected oil market dynamics to 2021, there is scope for further gains without pushing oil prices below the $70-80/bbl range that the authorities are thought to be comfortable with. OPEC on 1 July agreed to extend its oil production cut agreement to March 2020.

Consumer prices beset by deflation

Inflation has been negative since the start of 2019, weighed down by falling real estate prices and housing rents as well as by base effects related to the 2018 subsidy cuts and VAT rollout. Further energy/utility price hikes and another mooted sugary drinks tax will push inflation to 0.8% in 2020 from -1.5% in 2019.

Public finances more secure but debt levels rising

Public finances are on a more sustainable footing, despite continued sensitivity to oil prices (oil revenues account for 65% of total revenues). Spending has been rationalized, subsidies pared back and non-oil revenues boosted through excise taxes, expat levies and the VAT. The fiscal deficit narrowed to 6% of GDP in 2018, and, while expected to widen in 2019 on likely lower-than-budgeted oil revenues, should shrink further to 4.9% of GDP by 2021 as non-oil revenues increase (from 10.1% to 12.5% of GDP). (Chart 3.) Public debt will continue to rise, from 19.3% of GDP in 2018 to a peak of at 27% of GDP in 2021, as the authorities tap the debt markets to finance the deficit (and draw down their deposits at SAMA). $13.5bn worth of debt has already been issued in 2019, including an oversubscribed $7.5bn international bond sale.

Current account surplus rises, capital outflows increase

The current account is in better shape, with higher oil prices helping the surplus extend from 1.5% of GDP in 2017 to 9.3% of GDP in 2018. (Chart 4.) An average of 8% of GDP is expected to 2021, which will bolster the official foreign reserves. These stood at $505bn in April (35% in US treasuries), equivalent to 28.8 months of imports. At the same time, resident capital outflows, mainly overseas investment by the Public Investment Fund (PIF), have increased. The PIF aims to increase its assets under management from around $300bn to $400bn by 2020. Inflows have been dominated by portfolio investment following the Saudi bourse's inclusion in the MSCI and FTSE EM indices. FDI doubled to $3.2bn in 2018 and should increase further by 2022 as CMA reforms proceed and if the Saudi Aramco IPO takes place.

External and labor market risks weigh on outlook

External risks to the Saudi outlook emanate from a possible deterioration in the global economy and the regional geopolitical environment as well as any shock to oil prices. With an estimated average fiscal break-even oil price to 2021 ($83.7/bbl) above our oil price forecast, the authorities will need fiscal restraint and/or higher non-oil revenues in order to meet their 2022 balanced budget target and keep public debt at a sustainable level in the medium term. But expat levies have raised costs for businesses and impacted consumption as expatriates leave the kingdom (net 1.2mn employment reduction since 4Q16) amid accelerated Saudization. Moreover, the authorities will need to step up the rate of private sector job creation (diversification) as Saudi private sector employment growth remains sub-optimal. The Saudi unemployment and female labor force participation rates, at 12.5% and 20.5%, respectively, in 1Q19, are slowly improving. (Chart 5.)

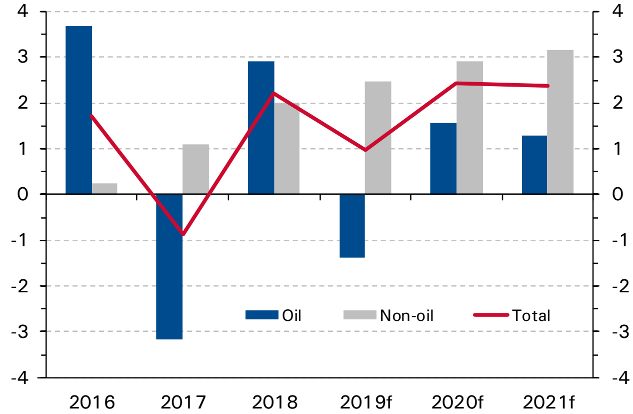
Table 1: Key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	687	775	756	780	808
Real GDP	% y/y	-0.9	2.2	1.0	2.4	2.4
- Oil	% y/y	-3.2	2.9	-1.4	1.6	1.3
- Non-oil	% y/y	1.1	2.0	2.5	2.9	3.2
Inflation	% y/y	-0.8	2.5	-1.5	0.8	1.3
Fiscal balance	% of GDP	-8.2	-6.0	-6.8	-6.0	-4.9
Public debt	% of GDP	17.2	19.3	23.9	26.1	27.1
Current account bal.	% of GDP	1.5	9.3	7.8	8.0	8.0

Source: Official sources, NBK estimates

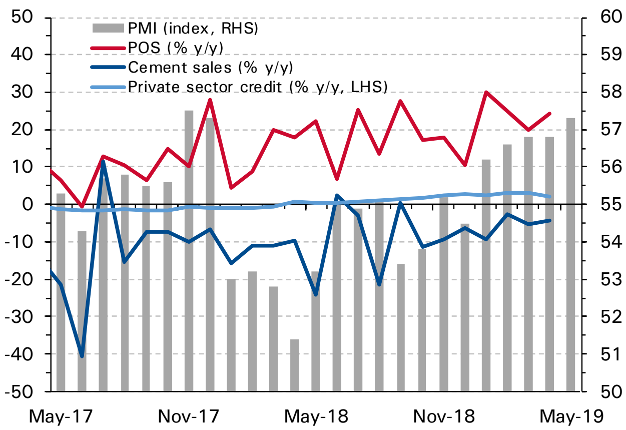
Chart 1: Real GDP

(% y/y)



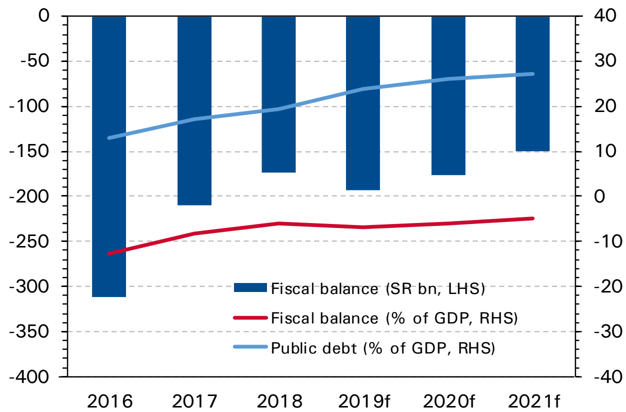
Source: Saudi General Authority for Statistics (GASTAT), NBK estimates

Chart 2: POS, cement sales, private credit and PMI



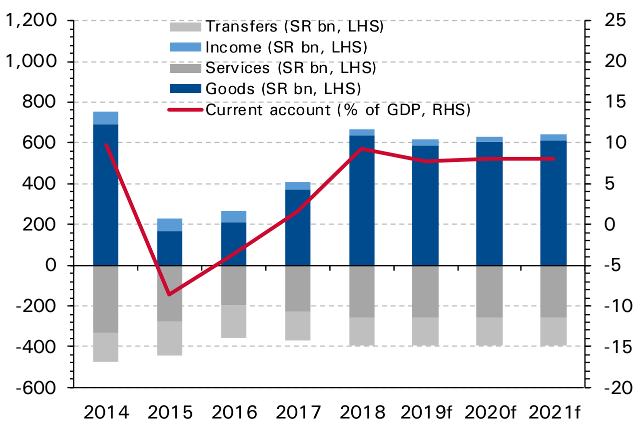
Source: SAMA, ARGAAM, Markit/Emirates NBD

Chart 3: Fiscal balance and government debt



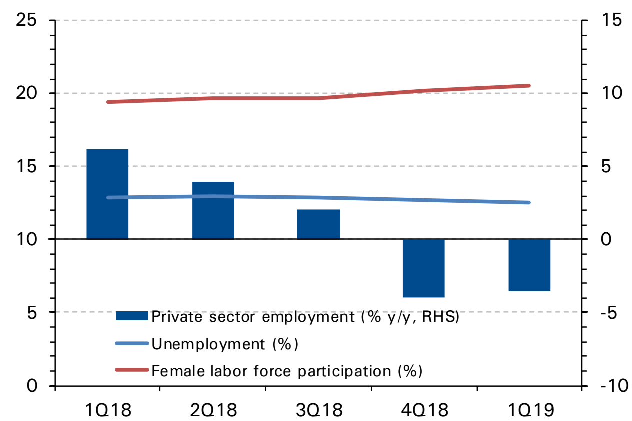
Source: Ministry of Finance, NBK estimates

Chart 4: Current account balance



Source: GASTAT, SAMA, NBK estimates

Chart 5: Saudi labor force indicators



Source: GASTAT