Saudi Arabia

Non-oil economic growth remained strong for the second straight year (+4.8% in 2022), led by the private sector (+5.4%). Private investment soared for the second year, indicating a solid expansion in production capacity and boding well for future growth. Despite the headwinds of lower oil prices and higher interest rates, the non-oil sector is expected to remain resilient, driving overall growth in 2023-24. Even with lower projected oil prices and production, we forecast fiscal surpluses, though limited, in 2023-24. Lower-than-forecast non-oil growth, which could result from a weaker-than-expected resilience to lower oil prices is a main downside risk. In contrast, higher-than-forecast oil production, due to, for example, a partial reversal of the OPEC+ production cuts is an upside risk.

Non-oil sector to remain resilient despite the headwinds

Non-oil economic growth accelerated in the second half of 2022, finishing the year at a strong 4.8%, following a 5.7% expansion in 2021. The private sector (+5.4% in 2022) remained the main growth driver, although the government sector's expansion strengthened to 2.6%. Sector-wise, manufacturing, one key focus area within Vision 2030, continued to witness one of the highest growth at 7.7% in 2022, after a 9.5% expansion in 2021. In terms of expenditure on GDP, private investment remained the fastest growing at 25% in 2022 (accounting for nearly 60% of the increase in output), reflecting a rapid expansion in production capacity, which should support future growth.

The favorable growth dynamics are expected to be sustained in 2023-2024, despite higher interest rates and lower oil prices. Consumer spending remains solid with the value of POS transactions up around 10% y/y through March. Despite tighter liquidity in the banking sector, credit growth remains in double digits at around 13% y/y through February as higher growth in corporate credit (+14%) is compensating the softer expansion in mortgage lending (+21%). PMI levels touched eight-year highs (59.8 in February), averaging a strong 58.9 in 1Q2023. Given all that, we forecast the non-oil sector's growth to remain solid at 4.5% in 2023-2024, powered by north of 5% expansion in the private sector.

The government's ongoing reforms continue to be a crucial driver of this constructive growth outlook. Some of the recent reforms and strategic initiatives include the National Industrial Strategy (targeting to triple industrial GDP) and the unveiling of the Shareek program's first batch of projects worth SAR 192 billion, aiming to create 64k jobs by 2040. Successful reforms and the country's overall favorable outlook led to recent credit rating upgrades by the main global rating agencies. Meanwhile, given a 4.75% increase in the US federal funds rate since March 2022, SAMA has hiked its policy rates by a similar 4.5%, and together with tightening liquidity in the banking sector (the simple loans-to-deposits ratio increased to 104% in February 2023 from 94% two years before), drove interbank rates to record levels. Nevertheless, the tightening cycle is close to being done with even the possibility of US rate cuts commencing in the second half of 2023, which will alleviate some pressure on Saudi interbank rates, and hence drop the cost of borrowing, which will be positive for credit expansion and non-oil growth.

As for the oil sector, after surging by 15.4% in 2022, and given the OPEC+ production cuts announced last year and the recent voluntary cuts from May till December 2023 (500K b/d by KSA) negative growth (-2.9%) is expected this year, before a rebound in 2024 (+2.9%) on the back of the expiry of the cuts and improving market dynamics. However, it will be unsurprising if OPEC+ (led by KSA) continues to take a proactive and nimble role in managing the global oil supply, including cutting or increasing production as need be. All in all, after soaring 8.7% in 2022, total GDP is forecast to grow by a limited 1.6% in 2023, pressured by the oil sector, before a 3.8% expansion is seen in 2024 on oil sector rebound and steady non-oil growth.

Inflation to soften while unemployment at a record-low

Inflation softened to 3% y/y through February after likely hitting a peak of 3.3%-3.4% in December/January with housing rentals (+8.3% y/y) remaining the predominant driver of price pressures over the past year. Despite ongoing pressure from housing rentals going forward, we project inflation to average 2.4% in 2023 given that most other sectors are already beyond their peak price inflation. Solid economic growth and unwavering Saudization initiatives continued to push the unemployment rate among Saudis lower, dropping to an all-time low of 8% in 4Q2022, nearly half the post-Covid high of 15.4% recorded in mid-2020.

Public finances on a solid footing despite lower oil prices

Higher oil prices and increasing oil production led to a fiscal surplus (2.5% of GDP) in 2022 for the first time in nearly ten years, despite a steep rise in government spending (+12%). Looking ahead, despite lower oil prices and production, we still expect fiscal surpluses, though limited, in 2023 and 2024 given 1) ongoing growth in non-oil revenues driven by solid private-sector growth and 2) limited expansion in government spending given the budgetary ceilings. Solid economic growth and higher oil prices in 2021 and 2022 have led to a sharp fall in the debt/GDP ratio to 24% in 2022 (31% in 2020), and we forecast that to inch down further to 22% by 2024.

The current account surplus swelled to 14% of GDP in 2022 on higher oil prices as well as exports, and we forecast further surpluses in 2023-24. Lower-than-forecast oil prices, driven by a weaker-than-expected global economic backdrop is a main downside risk. In addition, lower-than-forecast non-oil growth, which could result from a weaker-than-expected resilience to lower oil prices, is another downside risk. In contrast, higher-than-forecast oil production, due to, for example, a partial reversal of the recent OPEC+ production cuts is an upside risk.

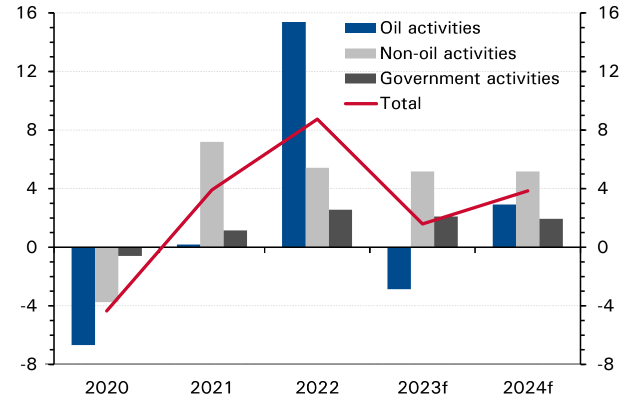
Table 1: Key economic indicators

		2021	2022	2023f	2024f
Nominal GDP	($ bn)	869	1,108	1,083	1,161
Real GDP	(% y/y)	3.9	8.7	1.6	3.8
- Oil	(% y/y)	0.2	15.4	-2.9	2.9
- Non-oil	(% y/y)	5.7	4.8	4.5	4.5
Inflation (average)	(% y/y)	3.1	2.5	2.4	2.1
Fiscal balance	(% of GDP)	-2.3	2.5	0.2	1.3
Government debt	(% of GDP)	28.8	23.8	23.4	22.0
Current account	(% of GDP)	5.1	13.6	6.7	7.6

Source: National authorities, NBK forecasts

Chart 1: Real GDP growth

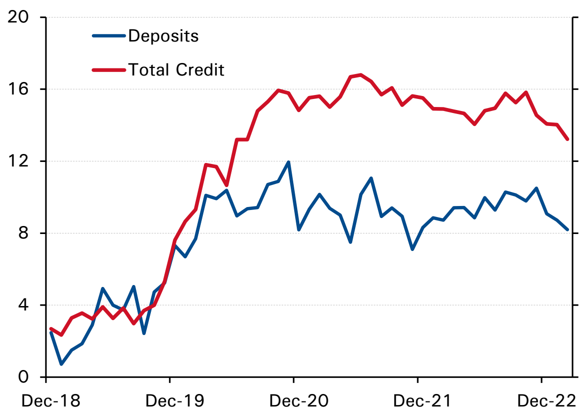
(% y/y)



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

Chart 2: Credit and deposit growth

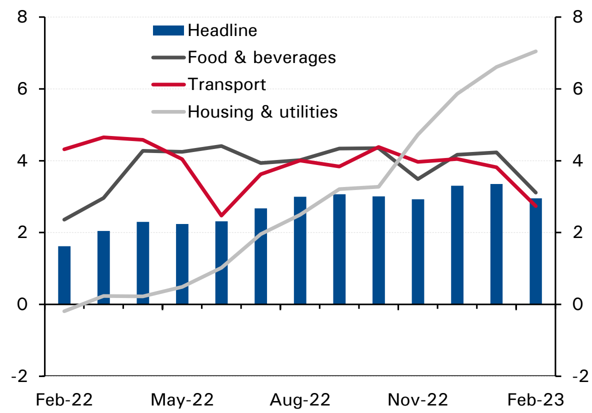
(% y/y)



Source: SAMA

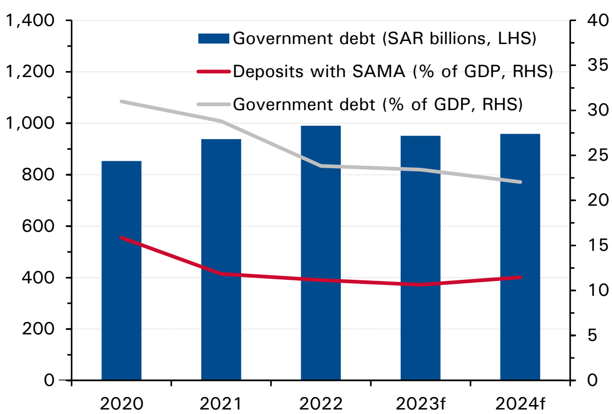
Chart 3: CPI inflation

(% y/y)



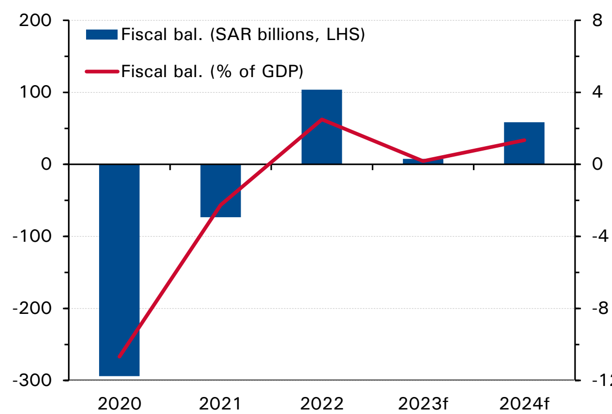
Source: GASTAT

Chart 4: Government debt and deposits with SAMA



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

Chart 5: Fiscal balance



Source: Ministry of Finance, NBK forecasts