Saudi Arabia

Effective policymaking and the unabated economic/structural reform momentum led to a relatively fast recovery in the non-oil economy, which grew 5.4% y/y in 1H2021, exceeding pre-pandemic levels. Some of the recent reforms and important policy initiatives included areas such as public procurement, transport/logistics, FinTech, personal data protection, education, and several societal matters. We forecast non-oil growth to soften in 2H2021, but still finishing the year at a strong 3.9%, followed by an average of 3.3% in 2022-2024. While the oil sector has been a drag on GDP growth since in 2019, it is expected to support growth starting in 2H2021 given increased oil production as per the OPEC+ agreement. The fiscal deficit narrowed sharply so far this year and we project it at a limited 1.8% of GDP next year, given higher oil production and the government's unwavering commitment to continue expanding non-oil revenues and rationalize spending.

Growth to soften in 2H2021 after a strong rebound in H1

The non-oil economy recovered relatively fast, increasing by 5.4% y/y in 1H2021 (2% higher than pre-pandemic levels of 1H2019), following a 2.3% contraction in 2020. This recovery was mostly driven by the private sector (+7.5% in H1), while the less-pandemic-impacted government sector was up by 0.8%. A successful vaccination rollout (56%+ of the population fully vaccinated) supported this fast recovery. The manufacturing sector saw the highest growth rate of 11.9% helped by several initiatives taken to develop that sector, in line with Vision 2030.

Nevertheless, the recovery lost some momentum in 2Q2021 with non-oil output falling by a relatively steep 8% q/q, partly driven by seasonal factors as can be seen historically. While we expect the recovery to continue in 2H2021, we are forecasting lower y/y growth rates than in 1H2021. Base effects is one reason for that (given the pandemic-induced plunge in 2Q2020), but also several indicators (such as consumer spending, credit growth, cement sales, etc.) are pointing to a more gradual recovery going forward. Given all that, we forecast non-oil growth at 3.9% in 2021, then averaging a slightly lower 3.3% in 2022-24. Effective policymaking, ongoing reforms, Shareek program-induced capital spending, and the 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 relatively robust growth outlook. Reflecting that, the stock market is up by around 34% YTD, reaching levels unseen since more than 10 years.

As for the oil sector, KSA has been playing a leading role within OPEC+ to rebalance the global market, and much of the success in terms of that can be attributed to the Kingdom's effective strategy. While the oil sector has been a drag on GDP growth since 2019, it is expected to support growth starting in 2H2021 given higher oil production as per the OPEC+ agreement, and we forecast oil GDP to grow by an average of 4.2% in 2022-24 after a flat performance this year. All in all, total GDP is expected to grow by an average of 3.7% in 2022-24, after a softer 2.3% projected expansion in 2021 that is being held back by the oil sector. Following the tripling of VAT, inflation increased to 3.4% in 2020, and will likely decelerate to around 3% this year, before normalizing to 2% in 2022-24. As for credit, growth strengthened to 15.7% y/y through August from a very solid 15% in 2020, as higher growth in personal non-mortgage credit more than compensated the slower growth in mortgage lending.

Fiscal position on a sustainable footing

Following the pandemic-induced deterioration in 2020, the fiscal position improved sharply in 1H2021 on soaring non-oil revenues, higher oil prices, and spending restraint. Revenues increased by 39% y/y in 1H2021 as oil revenues were up 11% on higher oil prices, while non-oil revenues more than doubled driven by higher tax receipts. In contrast, expenditures inched down 1% in 1H2021 as current spending increased by 4%, while capital spending was cut by 36%. The fiscal deficit dropped to less than 1% of GDP in 1H2021, down from 11.2% in 2020. However, given seasonal spending patterns (spending highest in Q4) and the fact that 2H2020 included material non-oil revenue one-offs that will be difficult to sustain in the same magnitude this year, we forecast the deficit to stand at around 2.8% for the full year. Looking ahead, given the increase in oil production and the government's unwavering commitment to continue expanding non-oil revenues and rationalizing spending in line with Vision 2030, we forecast a steady and gradual improvement in the deficit to less than 1% of GDP in 2024. Accordingly, we see the debt/GDP ratio staying below 32% through 2024, significantly lower than the 50% self-imposed cap.

After a slight dip in to the red in 2020 (-3.1% of GDP), we forecast the current account to return to surplus of around 4% in 2021 on higher oil prices and a strong rebound in non-oil exports. The latter exceeded pre-pandemic levels in 1H2021 (10% above 1H2019), hitting an all-time monthly high in June. Moreover, FDI soared to $13.8bn in Q2, nearly matching the combined flows for the last three years. The improving balance of payments trends can be seen in SAMA's reserve assets, which have been flat YTD through August (after dropping 9% in 2020) to stand at $455 billion (55% of 2021F GDP).

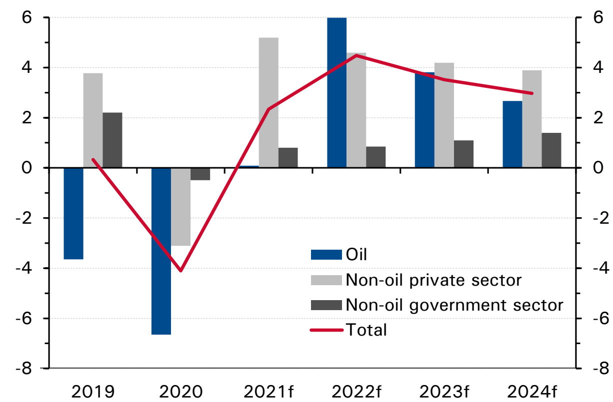
Effective policymaking and the reform momentum are the key drivers for the country's favorable outlook. Some of the recent reforms/important policy initiatives included the areas of public procurement, transport/logistics, FinTech, personal data protection, education, and several societal matters. Higher-than-forecast oil prices is the main upside risk to our forecast, while slower-than-projected momentum in terms of non-oil growth and weaker-than-expected oil production given KSA's leading role within OPEC+, are the main downside risks.

Table 1: Key economic indicators

		2020	2021f	2022f	2023f	2024f
Nominal GDP	($ bn)	700	830	856	885	925
Real GDP	(% y/y)	-4.1	2.3	4.5	3.5	3.0
- Oil	(% y/y)	-6.7	0.1	6.0	3.8	2.7
- Non-oil	(% y/y)	-2.3	3.9	3.5	3.3	3.2
Inflation (average)	(% y/y)	3.4	3.0	2.0	2.0	2.0
Fiscal balance	(% of GDP)	-11.2	-2.8	-1.8	-1.0	-0.7
Government debt	(% of GDP)	32.5	30.1	31.0	31.0	30.4
Current account	(% of GDP)	-3.1	4.4	3.9	3.7	3.8

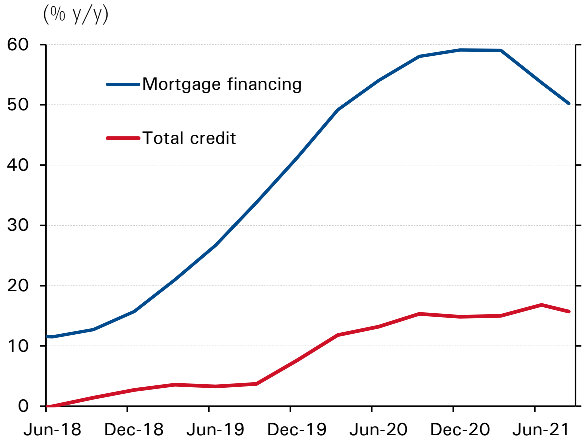
Source: National authorities, NBK forecasts

Chart 1: Real GDP



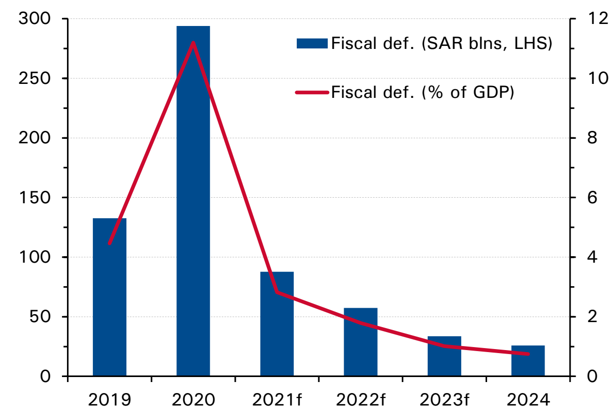
Source: General Authority for Statistics (GASTAT), NBK forecasts

Chart 2: Credit growth



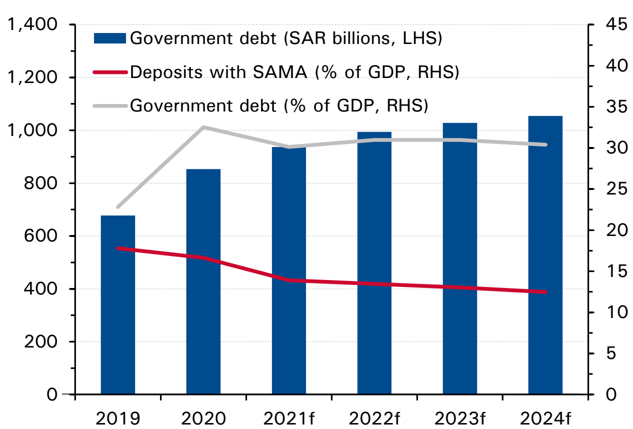
Source: SAMA

Chart 3: Fiscal deficit



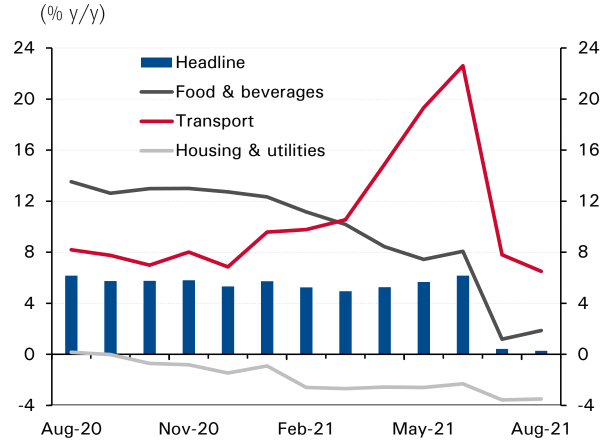
Source: Ministry of Finance, NBK forecasts

Chart 4: Government debt and deposits with SAMA



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

Chart 5: CPI inflation



Source: GASTAT