Saudi Arabia

We forecast non-oil growth to drop by 2.6% in 2020 before rebounding to 2% in 2021 with GDP growth at -4.1% this year and +2.8% next year given that the oil sector should start supporting growth in 2021. The recovery is expected to be gradual with an elevated level of uncertainty and it may take until the second half of 2022 for all the lost private-sector output in 2020 to be recouped. The fiscal deficit is expected to drop to 7% of GDP in 2021, significantly better than the 12.6% projected this year as revenues increase while spending is reduced. The main downside risk is related to Covid-19, especially if the containment of the virus and/or deployment of a vaccine in the region is considerably delayed. Oil prices are also a downside risk if the demand remains depressed and supply is not contained by OPEC+.

Both oil and non-oil sectors to support the recovery in 2021

In a quarter that is expected to be the worst in 2020 given the lockdown, the non-oil sector contracted by 8.2% y/y in Q2, resulting in a 3.2% fall in 1H2020. Unsurprisingly, the private sector was impacted (-10% y/y in Q2) much more than the government sector (-3.5%). The retail and hospitality sector was the hardest hit as it contracted by 18.3% in Q2, while the finance sector was the most resilient, inching down only 0.3%. More than 64,000 private-sector jobs were lost during Q2 and the unemployment rate among Saudis jumped from 11.8% in Q1 to 15.4%. High frequency data indicate a sequential improvement in output starting in Q3, but possibly still contracting annually, resulting in a 2.6% decrease in non-oil GDP in 2020. This limited projected contraction is mainly due to a resilient government sector while the private sector is forecast to shrink by 3.9%.

For 2021, the recovery is expected to be gradual given an elevated level of uncertainty regarding the virus containment and/or availability of a vaccine, as well as low oil prices, key factors in the sustainability of any future recovery. While the infection numbers in KSA have decreased sharply since June, there is a high risk (as seen in many countries globally) for cases to increase again after resuming normal economic activities and/or opening the border for international travel. As for the vaccine, despite the positive developments, it is unlikely that a wide-scale deployment in the region can occur in 1H2021 even if a vaccine is approved in early 2021. The economic risk of increasing infection numbers in the future does not manifest itself strictly in possible resumed lockdowns, but also in consumer and business confidence and thereby in private-sector spending and investment, while government expenditure is likely to remain in check given the ongoing need for fiscal adjustment.

Moreover, the tripling of the VAT in July 2020 will likely have ripple effects on consumption growth in 2021. Given all that, we expect that it may take until the second half of 2022 for all the lost private-sector output in 2020 to be recouped, and we forecast non-oil growth of 2% in 2021 and an average of 3% in 2022-23. As for the oil sector, it was a drag on growth in 2019 and 1H2020, falling 3.6% and 4.9%, respectively, given the OPEC+ agreement. Oil production is expected to increase as OPEC+ cuts are rolled back and we forecast oil GDP to grow by an average of 3.4% in 2021-23 after a 6.1% projected drop in 2020. However, with the sustained pressure on oil prices emanating from depressed demand partly due to a second wave of the virus in some countries, OPEC+ could resort again to limit supply in order to balance the oil market casting doubts on the oil GDP growth. All in all, overall GDP is expected to grow by an average of 3% in 2021-23 following a 4.1% expected drop this year, compared to the government's estimate of a 3.8% decrease.

Following the tripling of VAT, inflation jumped to 6.2% in August, and average inflation is projected to remain elevated at 3.7% this year and 3.9% in 2021, before normalizing at 2% thereafter. As for credit, growth has been powering ahead to reach 10% year-to-date in August supported by mortgages. Corporate credit growth picked up to around 7% YTD, but with more than 75% of that increase occurring in Q1, before the lockdowns and other pandemic-related restrictions were imposed. We expect credit growth of 13% in 2020, softening to a still-strong 9% in 2021. Recently, the government scrapped the 15% VAT on real estate transactions, replacing it with a 5% sales tax, in an effort to continue supporting the sector.

Budget and external positions expected to improve in 2021

The fiscal position came under pressure in 1H2020 as revenues dropped by 36% and spending decreased 8% resulting in a deficit of SAR 143 billion. The government took appropriate measures to deal with its finances as it tripled the VAT, increased customs, and discontinued the cost of living allowances. The deficit is forecast to reach 12.6% of GDP in 2020 slightly steeper than the 12% projected in the 2021 pre-budget. In line with that pre-budget, with higher revenues and lower spending in 2021, the deficit is expected to drop to 7% of GDP. In 2022-23, broadly flat spending coupled with higher revenues is expected to result in a deficit of 3.4% in 2023. Accordingly, the debt/GDP ratio will likely reach around 37% in 2023, still way below the 50% cap.

The current account is forecast to turn negative in 2020, improving modestly thereafter driven by higher exports. Main downside risks to our outlook are related to Covid-19 esp. if the vaccine deployment in the region is delayed and to oil prices that may turn out to be lower-than-expected if the demand falls short of supply and in the absence of new OPEC+ production cuts.

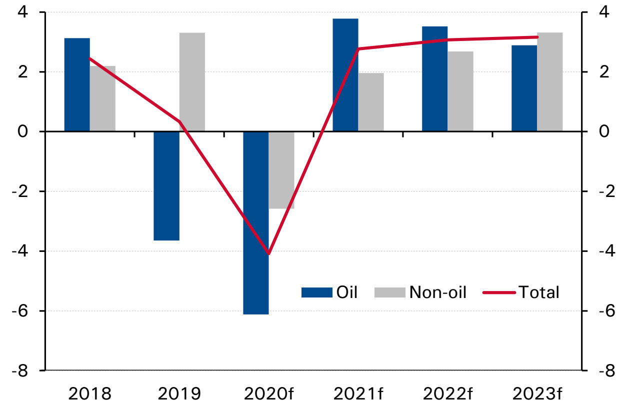
Table 1: Key economic indicators

		2019	2020f	2021f	2022f	2023f
Nominal GDP	($ bn)	793	704	773	826	865
Real GDP	(% y/y)	0.3	-4.1	2.8	3.1	3.2
Oil	(% y/y)	-3.6	-6.1	3.8	3.5	2.9
Non-oil	(% y/y)	3.3	-2.6	2.0	2.7	3.3
Inflation (average)	(% y/y)	-1.2	3.7	3.9	2.0	2.0
Fiscal balance	(% of GDP)	-4.5	-12.6	-7.0	-5.1	-3.4
Government debt	(% of GDP)	22.8	32.4	33.7	35.7	37.5
Current account	(% of GDP)	4.8	-3.3	0.1	1.5	1.5
Credit growth	(% y/y)	7.6	13.0	9.0	7.5	6.0

Source: National authorities, NBK estimates

Chart 1: Real GDP

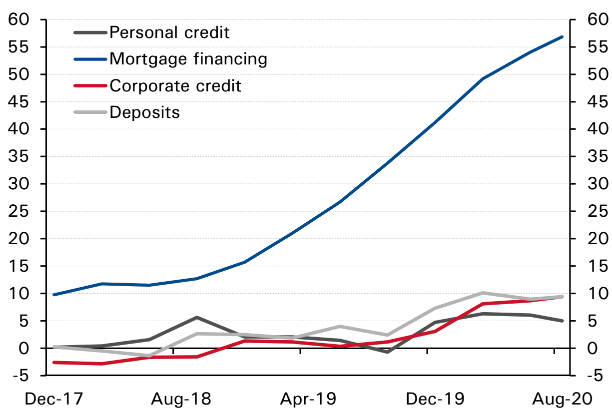
(% y/y)



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

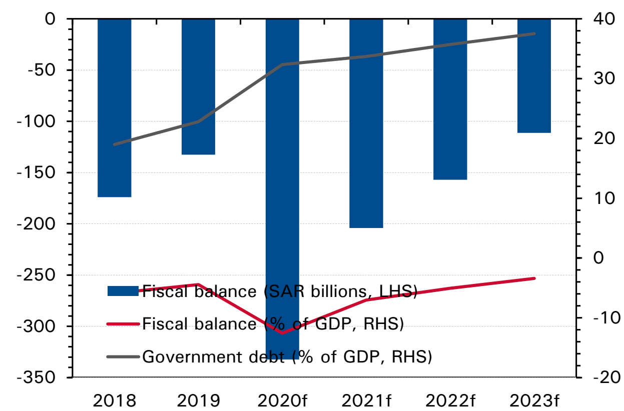
Chart 2: Growth in credit* components and deposits

(% y/y)



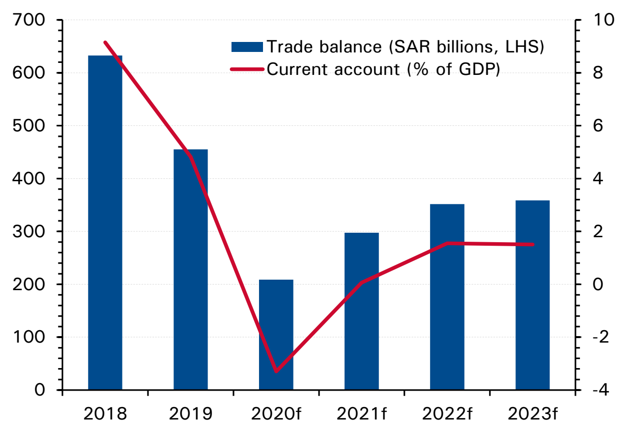
Source: SAMA *July and August 2020 are estimates

Chart 3: Fiscal balance and government debt



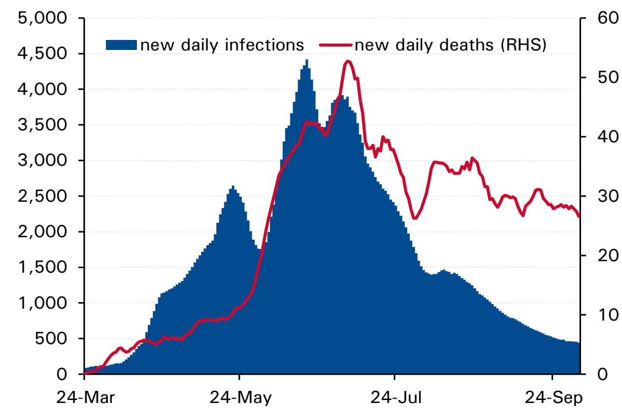
Source: Ministry of Finance, NBK estimates

Chart 4: Current account balance



Source: GASTAT, SAMA, NBK estimates

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



Source: Ministry of Health