Macroeconomy

Business activity at 2018-high in August; fiscal deficit narrows on higher oil and non-oil revenues

- Economic growth improved in 1Q18 to 1.2% y/y on expanding oil and private sector output.
- While retail POS activity slowed in July, business activity (PMI) improved to a 2018-high in August.
- Inflation rose by 2.3% y/y in July but continues to be constrained by falling real estate/rental prices.
- The fiscal deficit narrowed to SR41bn (3% of GDP) in 1H18, thanks to higher oil and non-oil revenues.
- The deficit continues to be financed via reserve drawdowns and debt issuance: reserves fell in July by $5.1bn to $501bn while the authorities sold $3bn of international sukuk and the PIF secured $11bn in bank loans.
- Both private sector credit and deposit growth remain weak at 0.7% y/y and 0.5% y/y in July, respectively.
- TASI has recovered somewhat in recent days (7.5% ytd) on improved sentiment and firmer oil prices.

Chart 1: Saudi Vision 2030 targets

<table>
<thead>
<tr>
<th>Private sector % of GDP</th>
<th>2015</th>
<th>2030</th>
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</thead>
<tbody>
<tr>
<td>Small &amp; medium-sized enterprises (SME) % of GDP</td>
<td>20.0</td>
<td>35.0</td>
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<tr>
<td>Non-oil exports % of non-oil GDP</td>
<td>16.0</td>
<td>50.0</td>
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<tr>
<td>Non-oil revenue % of GDP</td>
<td>6.7</td>
<td>16.8</td>
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<tr>
<td>Domestic oil &amp; gas production %</td>
<td>40.0</td>
<td>75.0</td>
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<tr>
<td>Domestic procurement of defense equipment %</td>
<td>2.0</td>
<td>&gt;50.0</td>
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<tr>
<td>Public Investment Fund (PIF) AUM $ billion</td>
<td>160</td>
<td>1,866</td>
</tr>
<tr>
<td>Foreign direct investment (FDI) % of GDP</td>
<td>3.8</td>
<td>5.7</td>
</tr>
<tr>
<td>Global Competitiveness Index</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Unemployment rate %</td>
<td>11.6</td>
<td>7.0</td>
</tr>
<tr>
<td>Female labor force participation %</td>
<td>22.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Pilgrim tourist arrivals Million</td>
<td>8.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Social Capital Index</td>
<td>40.0</td>
<td>75.0</td>
</tr>
<tr>
<td>Household savings rate %</td>
<td>6.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>

The Saudi Vision 2030 is the government’s blueprint for development and diversification.

Source: Saudi Vision 2030

Chart 3: Crude oil production (mb/d)

Output rose by 124 kb/d in Aug to 10.4 mb/d as Saudi Arabia looked to offset falling Iranian and Venezuelan supplies.

Source: OPEC, Joint Organizations Data Initiative (JODI)

Chart 2: Real GDP (% y/y)

GDP expanded by 1.2% y/y in 1Q18 on improving private sector (1.1% y/y) and oil sector activity (0.6% y/y).

Source: General Authority for Statistics (GASTAT)

Chart 4: Benchmark crude oil prices ($/bbl)

Oil prices have firmed recently as concerns over a sanctioned Iran oil supply shortfall offset fears of a US-China trade war.

Source: JODI
IP increased in 1Q18 (3.4% y/y) as manufacturing output expanded (due to 2% y/y gains in mining/quarrying).

Retail activity slowed down during the summer months in line with seasonal trends (-0.6% m/m, +25% y/y in July).

New orders and output reached a year-high in August, lifting the headline PMI to 55.1 from 54.9 in July.

Inflation rose to 2.3% y/y in July on higher food costs; housing/utility costs continued to fall (-1.3% y/y in July).

While deflation continues to beset the real estate market, the rate of price declines steadied over 1H18 at -1.5% y/y.

The Saudi unemployment rate continues to rise slowly, reaching 12.9% in 1Q18.
The no. of employed expats has been consistently falling, to 10.1m in 1Q18, while work visa issuances have also declined.

Source: GASTAT

The fiscal deficit narrowed to SR41.7bn (-3% of GDP*) in 1H18 thanks to a sizeable increase in both oil and non-oil revenues.

Source: Saudi Ministry of Finance; note: on 1Q18 GDP pro-rata basis

Deposits and reserves of the central government fell for the second consecutive month in July, by SR-12.3bn (-8% y/y).

Source: SAMA

As the gov. issues debt to finance the deficit, banks' holdings of gov. bonds has risen to SR286bn (16% of claims) ...

Source: SAMA

The trade surplus has risen in line with higher oil exports; Neither non-oil exports nor imports have changed much.

Source: GASTAT
The CA surplus increased to SR35bn (5.1% of GDP) in 1Q18 on the back of higher exports and lower remittances. Source: GASTAT

Foreign reserves fell $5.1bn in July to $501bn after the gov. drew down both overseas deposits and investments. Source: SAMA

Bank deposits fell by 1.5% y/y in July due to a drop in businesses/personal deposits & savings (0.5% y/y). Source: SAMA

Credit growth has been slowly picking up pace, rising to 0.3% y/y in July, spurred on by private credit growth (0.7% y/y). Source: SAMA
The SAIBOR/LIBOR spread has widened to +28 bps; it had been negative in March, raising fears of capital outflows...

Source: Thomson Reuters Datastream

...until SAMA raised its repo/reverse repo rates by 25 bps in March just before the US Fed raised its federal funds rate.

Source: Thomson Reuters Datastream

Bond yields have slowly risen across the board, and are up over 50 bps so far this year.

Source: Thomson Reuters Datastream

TASI has recovered slightly (+7.5% ytd) from August’s drop, posting gains on improving sentiment and firmer oil prices.

Source: Thomson Reuters Datastream