Saudi Arabia

Growth-friendly fiscal policy

Non-oil GDP growth rebounded strongly in 2019 after three years of disappointing performances. Household consumption and public sector investment spending are the main growth engines driving the recovery. Economic prospects are still positive in the short term due to the slowdown in the pace of fiscal reforms. The fiscal deficit will remain high, although exceptional one-off income and the transfer of spending to extra-budgetary entities should help hold it down. Potential growth is hampered by the erratic pace of fiscal reforms and the mixed outlook for the oil market.

Rebound in non-oil activity confirmed

Non-oil GDP growth has accelerated rapidly since Q2 2019. According to our estimates, non-oil GDP rose 4.3% in Q3 2019, compared to 3.1% in Q2 and a 2018 average of 2%. The driving force behind this recovery is above all the rebound in household consumption. Retail sales (9% of GDP) rose 8%. Construction and the combined real estate and finance sectors also contributed to growth, rising 4.6% and 6.3%, respectively. Together they account for about 15% of GDP. These trends were confirmed by the increase in household mortgage loans (12% of total private sector loans), which have increased significantly since 2018. In Q3 2019, they were up by a third year-on-year. In contrast, the manufacturing sector (excluding refining) continued to contract for the third consecutive quarter (-0.8%).

According to preliminary estimates, fiscal expenditure declined by 2.8% in 2019. Yet the total wage bill (50% of total spending) increased by 4.1% in 2019. Moreover, the Saudi sovereign fund PIF (Public Investment Fund) increasingly intervened in the government's investment policy, largely offsetting cutbacks in government investment. Despite the nominal decline in government spending, public spending, as a whole, held to an upward trajectory and had a positive impact on economic activity.

According to our leading indicator for the non-oil sector[1], the recovery is confirmed in the quarters ahead. The indicator has trended upwards for the past two quarters, after declining for 14 consecutive quarters. On the whole, we estimate non-oil GDP growth at 3.5% in 2019. For the economy as a whole, GDP is expected to increase slightly (+0.7%) and will continue to be hampered by the decline in oil GDP (-3.4% in 2019).

Non-oil GDP is expected to remain robust in 2020. The government's fiscal plan calls for current account spending to be cut by 3% while the total wage bill is expected to hold steady. After averaging -1.2% in 2019, driven by the ongoing decline in rent[2], inflation is expected to swing back into positive territory and average 0.6%, which means the public sector wage bill should decline in real terms.

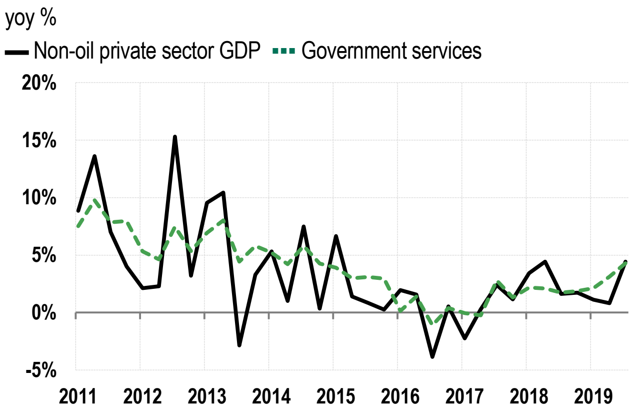
[1] Based on the following indicators: cement production, number of letters of credit and ATM cash withdrawals.
[2] The "rent, water and energy" component of the consumer price index has a weighting of 25%.

1-Forecasts

	2018e	2019e	2020e	2021e
Real GDP growth (%)	2.2	0.7	1.2	1.6
Inflation (CPI, year average, %)	2.5	-1.2	0.6	1.2
Central. Gov. balance / GDP (%)	-5.9	-4.6	-7.4	-7.1
Central. Gov. debt / GDP (%)	19	24	26	30
Current account balance / GDP (%)	9.0	4.8	1.8	4.0
External debt / GDP (%)	25	30	34	36
Forex reserves (USD bn)	498	458	382	314
Forex reserves, in months of imports	28	24	20	16
Exchange rate USDSAR (year end)	3.75	3.75	3.75	3.75

e: BNP Paribas Group Economic Research estimates and forecasts

2- Real non-oil GDP growth



Source: General Authority for Statistics, BNP Paribas

Yet, recent labour market trends are likely to boost private demand. The unemployment rate for Saudi nationals should continue to decline and the participation rate to rise (notably among the young) in 2020. Moreover, the leaving of foreign workers from the labour market (net departures of roughly 2 million foreigners since 2017) has dwindled sharply since mid-2019.

Although government investment spending is expected to remain flat at best, public investment spending by PIF should reach cruising speed and make another positive contribution to the construction and real-estate sectors. We expect hydrocarbon GDP to stabilise as any new cutbacks in crude oil production could be offset by an increase in other hydrocarbon production.

All in all, in 2020 we are looking for non-oil GDP growth of 3%, which should bring total GDP growth to 1.2%.

Contrasting fiscal trends

Fiscal deficits have been recurrent and rather significant since 2014. The public finance situation has deteriorated due to troubles controlling spending and the poor diversification of revenues at a time when the oil market is depressed. According to preliminary estimates for fiscal year 2019, the fiscal deficit is narrowing even without the implementation of reform measures. This improvement was made possible by exceptional one-off operations and the use of non-budgetary funding.

In 2019, the fiscal deficit amounted to 4.6% of GDP, down from 5.9% in 2018. Debt servicing charges increased by 40%, but only account for 2% of total spending. A large part of the adjustment was made through a 9% cut in capital expenditure (which accounts for 16% of total spending). Indispensable for the modernisation of the economy, capital expenditure is now assured in part by the state Public Investment Fund. Diversification of fiscal revenue is progressing very slowly in the absence of new reforms. Non-oil revenue increased by 7% and still accounts for a third of total fiscal revenue. Although Brent crude oil prices fell by 11% on average in 2019, oil revenue was virtually flat (-1%). Revenue levelled off thanks to an exceptional dividend from Aramco, the national oil company. This means the improvement in the public accounts in 2019 was partially artificial.

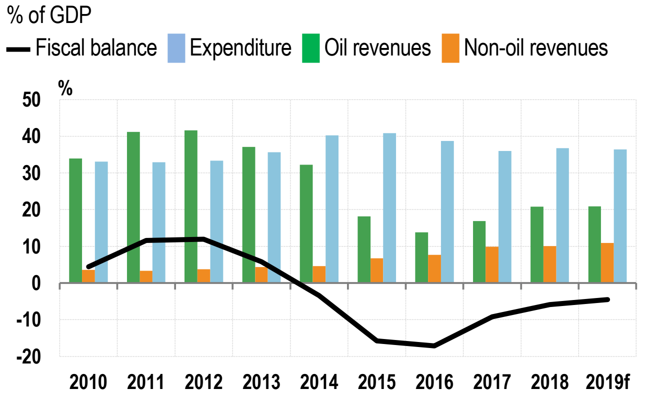
In 2020, the draft fiscal bill calls for spending cuts roughly equivalent to the 3% reported in 2019, with a decline in current account spending (except the debt service, which will increase by 48%) and virtually flat investment spending. At a time when a fiscal stimulus is needed to boost domestic demand, we think it is more realistic to expect current account expenditures to remain flat at best. As to revenue, no reform measures were announced that would increase the share of non-oil revenue. The government is forecasting a 2% increase in non-oil revenue. To estimate oil revenue, the government used an average price of Brent crude oil of USD 64 per barrel, bringing the decline in oil revenue to 16%. We expect the average oil price to be lower, which means an even sharper decline in oil revenue (-20%).

Our central scenario calls for a fiscal deficit of 7.4% of GDP in 2020. The main uncertainty is whether Aramco's 2019 dividend pay-out to the government was exceptional or not. If it is repeated in 2020, the fiscal deficit would narrow to 4.2% of GDP.

Public debt increases moderately

The fiscal deficit is traditionally financed through debt issues and the withdrawal of assets from the government's account with the Saudi Arabian Monetary Authority (SAMA). In 2020, according to official statements, about 35% of the deficit will be debt financed, including 45% on international markets. Consequently, we expect government debt to increase to 26% of GDP by year-end 2020.

3- Fiscal balance



Source: MoF, BNP Paribas

Government assets held with SAMA should amount to USD 142 bn (18% of GDP). Assuming greater recourse to debt financing in the years ahead, government debt could swell to 34% of GDP in 2022 while assets held with SAMA would be equivalent to 14% of GDP. The government's solvency does not seem to be at risk in the short to medium term, especially if we include PIF assets, which are valued at about 50% of GDP.

Even so, public finances are still highly vulnerable to oil price fluctuations. Economic activity continues to depend on public expenditure. The potential growth rate is hampered by the erratic pace of fiscal reforms and the mixed outlook for the oil market.

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