SAUDI ARABIA

FAVOURABLE ECONOMIC MOMENTUM

The current period is very favourable for the Saudi economy due to high oil revenues and implementation of extensive reform and investment programmes. Nevertheless, despite real progress in diversification, activity remains vulnerable to oil market vagaries and OPEC production policy. A moderate upturn in activity is expected in 2024 after a slight recession this year. Oil revenues remain decisive for maintaining budgetary balance and implementing Vision 2030 investments. However, the scale of funding requirements and the lack of attractiveness of the Kingdom to foreign investors mean massive use of debt as well as the sale of public assets. This highly capital-intensive economic transformation will need to continue, despite persistent vulnerability to oil market, which could increase with the energy transition.

STRONG SLOWDOWN IN ACTIVITY

In 2023, the Saudi economy is expected to be in recession (-0.3%) due to the drop in oil GDP. Accounting for around 40% of total GDP, oil GDP is expected to record its sharpest decline in more than a decade (-7.5%). In the context of the policy of OPEC+ (OPEC member countries and Russia), Saudi Arabia has decided to reduce its production beyond the agreement entered into with the cartel. With a voluntary reduction to around 9 mb/day by the end of the year, annual production is expected to average 9.6 mb/day, i.e. a decrease of 0.9 mb/day compared to the previous year.

Primarily driven by the private sector, activity in non-hydrocarbon sectors has accelerated over the past two years, reaching 6.4% in 2022. In H1 2023, activity slowed slightly but maintained some momentum (5.6% y/y), particularly thanks to the retail and hospitality sectors and, to a lesser extent, the construction sector. In the short term, consumption and investment should continue to support growth, but at a slower pace than in 2022. As a result, investment growth slowed sharply in Q2 (+2.4% y/y compared to +18% in Q1), while consumer spending only fell slightly (+3.3% y/y compared to 3.9% in Q1).

Credit growth to the private sector (corporates) and public-sector enterprises slowed, but remained at sustained levels (+11% and +21% y/y respectively in August 2023). By contrast, consumer credit entered a downward phase (-0.4% y/y in Q2 2023). Nevertheless, the moderate level of inflation (+2% in August 2023) and the continued decline in unemployment (8.3% in Q2 2023 compared to 8.5% in Q1 for the national population) should continue to have a favourable influence on consumer expenditure.

TIMID REBOUND EXPECTED IN 2024

In 2024, GDP growth is expected to pick up again, while remaining constrained by activity in the oil sector. In fact, we are only expecting a modest increase in oil production in 2024. Growth forecasts are down in OECD countries and China. For the time being, only oil supply constraints and declining stocks in OECD countries are keeping prices high. In 2024, Saudi Arabia could keep production at current levels for part of the year so as to support prices. We expect oil GDP to rise by 2.4% over the year as a whole. In terms of non-hydrocarbon GDP, the early signals of slowdown in consumer spending could intensify next year. The rise in interest rates (the SAMA key rate has risen by 500 bps since February 2022) is expected to have an impact on credit growth. Against this backdrop, government spending will be a factor in support of activity, and the 2024 budget proposal is moving in this direction. After a significant increase in spending in 2023 (+8% y/y according to budget forecasts), spending will remain high, despite a less favourable oil market for public finance.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-4.3	3.9	8.7	-0.3	3.3
Inflation, CPI, year average, %	3.4	3.1	2.5	3.0	2.8
Central. Gov. balance / GDP (%)	-10.7	-2.3	2.5	-2.1	2.0
Central. Gov. debt / GDP (%)	31	29	24	28	27
Current account balance / GDP (%)	-3.1	5.1	14.4	5.1	3.1
External debt / GDP (%)	32	32	24	25	26
Forex reserves (USD bn)	454	456	460	450	430
Forex reserves, in months of imports	30	26	22	19	17

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SAUDI ARABIA: REAL GDP GROWTH

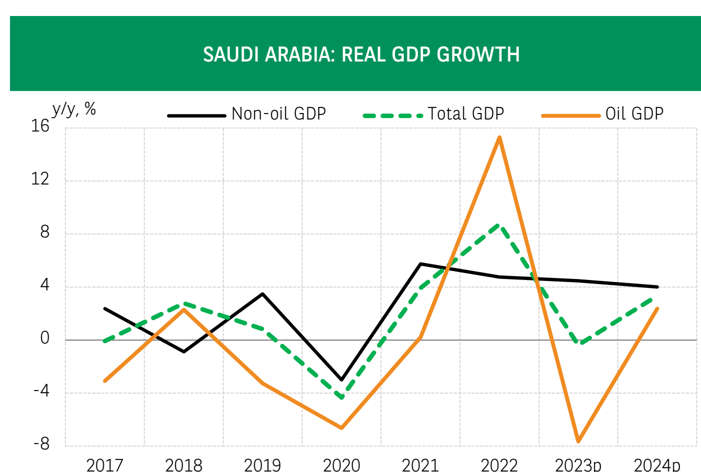

CHART 1 SOURCE: GENERAL AUTHORITY FOR STATISTICS, BNP PARIBAS

DIVERSIFICATION STILL DEPENDENT ON OIL REVENUES

Diversification of the Saudi economy continues, albeit rather slowly. The share of hydrocarbons in GDP is falling (40% in 2022 compared to 45% in 2012) in favour of the non-hydrocarbon private sector (from 38% to 41% over the same period), thanks in particular to growth in manufacturing industries excluding refining and retail and hospitality activities. Nevertheless, it should be noted that fiscal impetus and, therefore, oil revenues, remain decisive in supporting activity, whether through infrastructure programmes (the various projects linked to Vision 2030) or budgetary support. This is partly due to the weak attractiveness of the Saudi economy to foreign direct investments (FDIs). Since 2017, FDIs have been below 1% of GDP (the highest level in 2021, 2.2% of GDP, is linked to an exceptional asset monetization by Aramco). This means the country is relying heavily to debt in order to implement programmes for diversification of the economy.

MODERATE BUDGETARY DEFICIT EXPECTED

In 2023, the decline in oil revenues (because of a decline in price and volume) and the sustained level of spending are expected to lead to a return to a moderate budgetary deficit of around 2.1% of GDP. In 2024, although we are expecting near-stability in oil revenues and a slight increase in spending, the budgetary balance is expected to be around 2% of GDP. This is due to distribution of a "performance dividend" by Aramco (the government directly owns 90% of the capital of Aramco), which will amount to around USD 10 billion (around 1% of GDP) per quarter between Q3 2023 and Q4 2024.

These forecasts attest to the solidity of public finance despite the volatility of the oil market. However, this puts into perspective the progress made in terms of diversification of revenues. While setting VAT at a high level (compared to regional standards) from 2020 onwards significantly contributed to increasing the share of non-oil revenues in the budget, we note that budgetary dependence on hydrocarbons remains significant.

ACCELERATION OF PUBLIC DEBT ISSUANCES

In the context of the economic transformation programme, public sector funding requirements are very high, and go far beyond covering the budgetary deficit (around USD 21.5 billion) and repaying the government debt amortisation (around USD 25 billion according to the IMF) estimated for 2023. Active debt management is reflected in the redemption of outstanding bonds and issues of securities over longer maturities, in order to reduce the refinancing risk over time. In 2022, the equivalent of USD 1.3 billion was issued.

Since the beginning of the year, international government issues (Eurobonds and Sukuk) totalled USD 21 billion, while around USD 11 billion were issued locally, representing more than 3% of GDP in total. In addition, government assets with the central bank fell by USD 51 billion over the first eight months of the year (more than 5% of GDP). And finally, the government intends to borrow USD 11 billion in the form of a syndicated loan. In total, these issues are well in excess of the government's funding requirements.

The level of total government debt is moderate (28% of GDP expected in 2023, with external debt representing 37% of the total) while government assets at the central bank currently represent 11% of GDP.

SAUDI ARABIA: GOVERNMENT DEBT

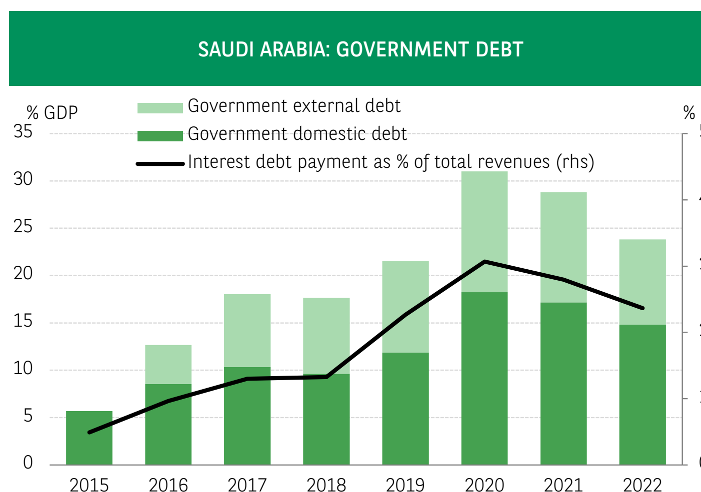

CHART 2 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

Interest on debt only represents approximately 3% of total budget revenue. The debt profile is favourable: average maturity is 9.3 years (7.9 in 2018) and the average rate was 2.95% in 2022 (2.91% in 2018). The risk premium on 5-year sovereign bonds denominated in currencies is low (around 50 bps). The government's capacity to pay its debt is therefore solid and should not deteriorate in the medium term. Nevertheless, it should be pointed out that the growing role of sovereign funds in public policy (in the form of investment in the local economy) entails a rise in debt in the public sector as a whole. According to the IMF, sovereign fund debt was 33% of GDP in 2021, higher than government debt. The assets held by the Public Investment Fund are equivalent to around 53% of GDP, of which 68% are invested in the local economy and are therefore, in theory, less liquid than securities listed on international markets. In addition, the country's external position is very strong thanks to significant current surpluses and a recent increase in portfolio flows. SAMA's foreign exchange reserves, excluding government assets, amount to USD 308 billion (August 2023), equivalent to one year of imports of goods and services.

The situation of public finance therefore remains comfortable. However, public finance presents two factors of fragility: first, its persistent vulnerability to oil market volatility (the budget has only seen a surplus once since 2014), and second, significant funding requirements until at least 2030 - although the government's projections for investment seem overestimated (around USD 300 billion per year until 2030). These funding requirements will have to be covered for the most part by debt, notably with international creditors (in an environment of much higher interest rates since early 2022) and, to a lesser extent, by the monetisation of public assets.

On the other hand, the global energy transition (the International Energy Agency expects global oil demand to start to structurally decline before 2030) could weigh on public finance faster than expected.

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