SAUDI ARABIA

INVESTMENT IS DRIVING GROWTH

Oil production feeds growth volatility in Saudi Arabia, as evidenced by the slowdown expected this year. Nevertheless, the non-oil economy is benefiting from the momentum of investment and household consumption against a backdrop of gradual transformation of the economy and the labour market. State intervention and a favourable exchange rate effect are keeping inflation at moderate levels. Against this favourable economic backdrop, bank lending to the private sector is very dynamic, creating some strain on bank liquidity. The budget surplus posted in 2022 is not likely to be repeated this year due to the expected downturn in oil production and prices. However, public finances are on a positive trajectory thanks to the increase in non-oil revenues.

NON-OIL GROWTH BUOYED BY INVESTMENT

Economic growth was strong in 2022 (8.7%), buoyed primarily by the increase in oil production. Oil GDP rose by 15% in real terms, linked to the increase in OPEC+ production quotas (OPEC and Russia) in the first part of the year. On their part, non-oil sectors benefited from sustained household consumption, and above all from very strong growth in investment (+24% YoY, i.e., the strongest increase in 22 years). Investment is benefiting from the programme for massive investment in infrastructure and new cities, initiated by the government's economic reform programme (Vision 2030). While the central government's contribution to investment has decreased, the public sector contribution remains predominant via the Public Investment Fund (PIF) and the National Development Fund (NDF). This public impetus is necessitated by the weakness of foreign direct investment (FDI). Over the last five years (excluding 2021 due to an exceptional operation), inward FDI was equivalent to 0.5% of GDP on average, which is not enough to make a meaningful contribution to the Kingdom's economic transition.

From a sector-based point of view, manufacturing activity (12% of total GDP) is sustained (+7.9% YoY), but partly depends on oil refining. Trends in services are showing sharp contrasts and making less progress than in 2021. The Saudi economy is currently in a transitional situation that is limiting non-oil GDP growth. As a result, the impact of public spending on business is relatively lower than before, due to a more prudent budgetary policy less linked to variations in oil revenues. Furthermore, the massive investment programme aimed at diversifying the economy (in services, the manufacturing sector and also decarbonised energies) is currently underway, and is not yet having a significant impact on the sector-based composition of GDP.

SHARP ECONOMIC SLOWDOWN IN 2023

Economic growth is expected to slow in 2023 due to the oil market outlook. OPEC+ member countries are currently adopting a cautious production policy due to uncertainties over short-term oil demand. While there is consensus to forecast an increase in global oil demand in 2023, particularly due to the economic recovery in China, uncertainties regarding European and American demand make the timing of this recovery difficult to predict. Against this backdrop, OPEC+ members have decided to reduce their oil production over 2023. Given its leading role in OPEC+ policy, Saudi Arabia is contributing the most to this revision of quotas, with a production cut of 0.5 mb/d to reach the new quota of 9.98 mb/d. Saudi oil GDP can therefore be expected to fall this year. Against this backdrop, non-oil sectors will be the drivers of growth, buoyed by investment and sustained household consumption in a context of moderate inflation, but constrained by the tightening of monetary conditions. Overall, GDP growth is expected to reach 1% this year.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-4.3	3.9	8.7	1.0	2.9
Inflation, CPI, year average, %	3.4	3.1	2.5	2.0	1.9
Central. Gov. balance / GDP (%)	-10.7	-2.3	2.5	-1.8	-2.4
Central. Gov. debt / GDP (%)	31	29	24	27	28
Current account balance / GDP (%)	-3.1	5.1	14.4	7.3	5.5
External debt / GDP (%)	30	37	30	31	31
Forex reserves (USD bn)	454	456	460	480	490
Forex reserves, in months of imports	30	27	26	22	21

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SAUDI ARABIA: CONTRIBUTIONS TO GDP GROWTH

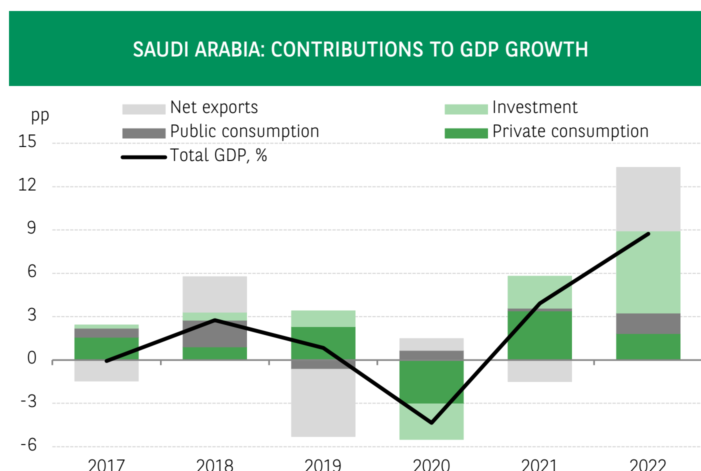

CHART 1

SOURCE: GENERAL AUTHORITY FOR STATISTICS, BNP PARIBAS

In the medium term, Saudi growth should be sustained and relatively less volatile thanks to a gradual disconnection from the oil economy. This can be seen in recent labour market developments which show a steady increase in employment among Saudi nationals, irrespective of developments in the oil market. The Saudi labour force participation rate has risen by 10 points over the last five years to 52% at the end of 2022. The labour force participation rate for women more than doubled during this period, reaching 36%.

STABILISATION OF INFLATION AT MODERATE LEVELS

Consumer price inflation slowed in 2022 (2.5% on average compared to 3.1% in 2021), well below the average seen in all emerging countries (9.2% on average). Since mid-2022, the housing component of the inflation basket (21% of the total) has been the main driver of price increases. Controlling the prices of certain food items and energy, along with appreciation of the dollar (to which the rial is pegged) for some of 2022 were factors in moderating inflationary pressures. In 2023, the housing component should continue to rise, while food prices seem to have been falling since the end of 2022. We expect inflation to stabilise at 2.4% on average.

SLOWDOWN IN BANK LENDING

The rial peg to the US dollar means that the Saudi central bank must follow the Fed's monetary policy decisions. The central bank therefore increased its main rate by 350 bps in 2022 to 4.5%. This monetary tightening should continue during the first half of 2023, contributing to the slowdown in credit growth.

Growth in credit to the private sector has been strong since mid-2020, but has started to slow since Q4 2022 (to 11% in February 2023). This period of sustained growth may have created some tensions on domestic liquidity during 2022 due in particular to the drop in government deposits. This resulted in a widening of the spread between the interbank rate and the central bank's interest rate corridor. Government deposits have recovered since the end of 2022 and are currently 29% of total deposits (after a low of 23% in Q1 2022). Contrary to previous periods, the sharp rise in oil revenues in 2022 resulted in the continued high level of bank lending to the public sector (around 22% of total bank lending over the year) and periods of falling government deposits at banks.

In this environment characterised by the strong growth in credit to the private sector and moderate growth in total deposits, bank liquidity is becoming more strained and the loan-to-deposit ratio of the entire banking system reached 104% last February (compared to 86% at the end of 2019). Nevertheless, prudential liquidity metrics remained relatively stable. The percentage of liquid assets in proportion to total assets was 23% at the end of 2022, compared to 25% in 2021. In the short term, investment policy should remain an important driver of credit growth. Nevertheless, rising interest rates and a slowdown in household mortgage loans should contribute to a slowdown in credit growth.

BUDGET DEFICITS CONTAINED IN THE SHORT TERM

The high level of oil income in 2022 has helped the government post its first budget surplus (2.5% of GDP) since 2013. Oil revenues account for the majority of fiscal revenues (62% of total on average since 2018), but VAT revenues accounted for a significant proportion of the budget. They were equivalent to 20% of total revenues in 2022, compared to less than 5% in 2016. This diversification of revenues reduces the fiscal vulnerability to oil prices. With regard to spending, the government continues to adopt a fairly cautious policy, as the favourable oil market has not resulted in a sharp increase in spending. Spending was equivalent to 27% of GDP, compared to 32% the previous year. Capital expenditure increased by 22% but remained at a historically low level: 7.4% of non-oil GDP on average since 2018, compared to 13% on average over the previous five years.

SAUDI ARABIA: COMMERCIAL BANKS BALANCE SHEET, MAIN ITEMS

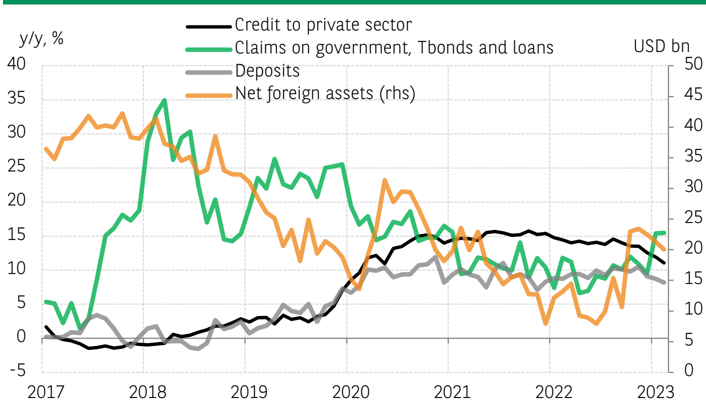

CHART 2 SOURCE: SAUDI CENTRAL BANK, BNP PARIBAS

For several years, a significant proportion of public investment has been implemented by the PIF and the NDF, which have their own resources.

Even though the government continues to keep budgetary spending under control and even though there is progress in diversification of government revenues, public accounts should post a deficit in 2023 and 2024 (1.8% and 2.3% of GDP respectively) according to our oil price and production forecasts. Against this backdrop, government debt should rise again moderately and reach 28% of GDP in 2024. Nevertheless, the government's solvency remains satisfactory, since the government's assets with the central bank (a priori the most liquid) are equivalent to 18% of GDP and the PIF's assets are over 50% of GDP. Furthermore, risk premiums on the international bond market are low, below 70 bps since the beginning of the year.

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