

SAUDI ARABIA

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THE CONFLICT IN THE MIDDLE EAST: MORE THAN JUST A TEMPORARY SHOCK

Saudi Arabia may not be the Gulf economy most vulnerable to the conflict in Iran, but it is by no means unaffected. This year's growth forecasts have been significantly downgraded due to the decline in oil production. Nevertheless, excluding hydrocarbons, economic activity remains resilient. Crucially, the country has been able to capture some of the trade flows blocked in the Strait of Hormuz thanks to its infrastructure on the Red Sea. In the short term, the rise in oil exports will improve its external accounts. On the other hand, the recovery in public finances will be less pronounced due to soaring budgetary expenditures. However, there is still ample fiscal headroom. Public debt levels are moderate and the conflict has not undermined creditors' confidence. Beyond the short-term effects, this conflict is likely to have lasting repercussions across the entire region. Saudi Arabia could stand to benefit from this.

GROWTH: A SIGNIFICANT SLOWDOWN BUT NO RECESSION

Despite the signing of a memorandum of understanding between the U.S. and Iran, the situation remains fragile, with numerous sensitive issues at stake, chief among them the full restoration of traffic in the Strait of Hormuz.

Saudi Arabia is not the Gulf country most vulnerable to the consequences of the war in Iran. The expanded capacity of the port of Yanbu on the Red Sea and the use of the East-West pipeline have helped to cushion the blow to hydrocarbon exports and external accounts (see below). With this reorganisation of logistics flows, the country also has an advantage in rapidly ramping up its oil production. However, in the short term, it will be unable to fully offset the losses. From over 10 million barrels per day (b/d) in February, crude oil production fell to 6.9 million b/d in May, a drop of 31.6%.

Excluding hydrocarbons, the economy has demonstrated a remarkable ability to adapt. Unlike many other countries in the region, Saudi Arabia has been able to rely on its port infrastructure outside the Strait of Hormuz to contain the inflationary risk associated with rising prices for imported goods. In particular, the YoY rise in food prices has remained under 1% since the start of the conflict. While inflationary pressures may emerge in the coming months, they should be manageable overall, thanks to subsidies that help stabilise energy prices. With inflation expected to average 2.2% this year, household consumption is expected to remain robust. Furthermore, most economic indicators (PMI indices, confidence surveys) stabilised in April after falling in March; however, they remain at relatively low levels.

In addition to the reorganisation of logistics flows, several factors have contributed to the economy's resilience to date: the depth of the domestic market, the strength of the banking sector, and the vigour of the labour market. Saudi Arabia has also been less affected by Iranian military attacks. Air traffic from Saudi Arabia's main airports has fallen by only 20% on average since the start of the conflict, compared with 60% for other Gulf countries. It has now almost returned to normal. Against this backdrop, the slowdown in non-hydrocarbon activity is expected to be moderate, with growth estimated at 3% this year compared with 4.1% in 2025. Despite a 6% decline in value added in the hydrocarbon sector (20% of GDP), Saudi Arabia's economy may be one of the few in the Gulf not to contract this year. Nevertheless, the impact on growth will be significant. Initial forecasts had predicted growth of 4.6% in 2026, but it is now expected to reach only 0.8%.

EXTERNAL ACCOUNTS: PRICE EFFECT DOMINATES

By rerouting 70% of its oil export capacity via the Red Sea, and thanks to rising oil prices, the Saudi economy has been able to absorb much of

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth (%)	12.0	0.5	2.6	4.5	0.8	4.4
Inflation, CPI, year average, %	2.5	2.3	1.7	2.0	2.2	2.1
Gen. Gov. balance / GDP (%)	2.2	-1.8	-2.5	-5.8	-5.1	-4.3
Gen. Gov. debt / GDP (%)	21	23.0	25.9	31.8	34.9	38.0
Current account balance / GDP (%)	12.1	2.1	-1.3	-2.6	-0.8	-1.1
External debt / GDP (%)	21	24.6	29.5	37.5	38.1	40.4
Forex reserves (USD bn)	460	437	437	460	487	493
Forex reserves, in months of imports	21.4	17.2	15.5	15.4	15.5	14.9

TABLE 1

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Oil exports: volume drop, USD revenue spike

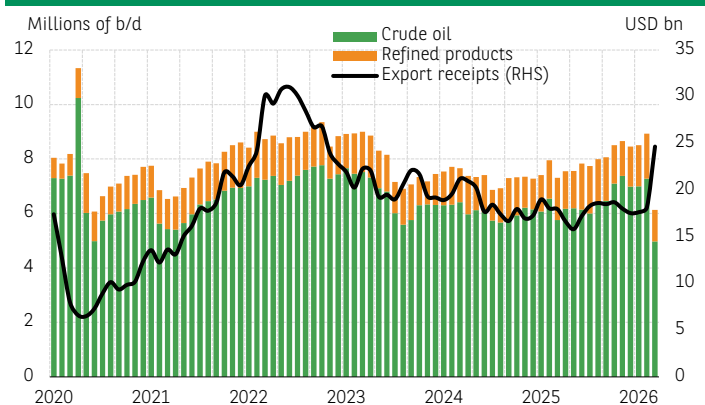


CHART 1

SOURCE: GASTAT, JODI, BNP PARIBAS

the energy shock. In March, oil exports reached USD 25bn, the highest level since late 2022 (Chart 1). April, May, and June are also shaping up strongly as Saudi Arabia has been selling its oil at an unprecedented premium of USD 12.50 per barrel on average to Asian countries, which are by far its main customers. Although oil prices have been falling since the signing of the memorandum of understanding between the United States and Iran, they are expected to remain above their pre-crisis levels for the rest of the year. With Brent averaging around USD 85 per barrel in 2026, Saudi Arabia's hydrocarbon exports could reach USD 250bn, compared with USD 214bn in 2025.



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The current account balance, which has been deteriorating gradually in recent years, is therefore set to improve. Having previously been in structural surplus, the current account slipped into deficit in Q3 2024. This deficit has continued to expand, driven by the combined effect of a rapid increase in imports and a decline in exports. The anticipated rise in oil exports is expected to help reduce the current account deficit from 2.6% of GDP in 2025 to less than 1% GDP this year.

Furthermore, foreign exchange reserves are currently around USD 490bn, up 6% since the start of the year. While the banking sector's net external position remains heavily in deficit, it has also begun to improve. For the first time in 16 months, it reduced by USD 8.5bn in April.

PUBLIC FINANCES: STILL UNDER PRESSURE

However, pressure on public finances will remain strong. The budget deficit reached a record USD 33.5bn in the first three months of the year (Chart 2), representing three-quarters of the amount forecast in the Budget law. The surge in expenditure was remarkable: up 20% compared with Q1 2025, driven largely by 'goods and services' (+52%) and investment (+56%). Subsidies have also tripled. While it is difficult to estimate the proportion attributable to the cost of the conflict, the target of reducing the budget deficit from 5.8% of GDP in 2025 to 3.3% this year will not be met. However, the gains generated by the increase in oil revenues (which account for over half of total revenue) were not evident in Q1. Despite the prospects for improvement in the coming quarters, the budget deficit is expected to remain significant (above 5% of GDP).

Government debt is currently moderate, but it will continue to rise rapidly. It is expected to reach 35% of GDP this year (up from 31.8% in 2025 and just 2% in 2022). Despite consolidation efforts over the past two years, the government has been unable to stem the rise in debt. However, it still has comfortable room for manoeuvre. The debt profile is favourable, and the conflict has not undermined foreign investors' confidence in the strength of the country's macroeconomic fundamentals. Risk premiums on 5-year foreign-currency debt have even fallen by 23 basis points since late February, providing scope for the authorities, who claim to have already secured full funding requirements for this year. This is particularly true given that the government's strategy has been cautious so far. Following two record-setting years, the volume of Eurobond issuance has fallen: USD 11.5bn between January and June, compared with USD 14.5bn over the same period in 2025 (and USD 13bn in 2024). Favourable financial conditions on the domestic market (Saudi Arabia's monetary policy aligns with that of the Fed due to the SAR's peg to the US dollar) and reserves equivalent to 9% of GDP (held by the Central Bank) provide additional levers on which the government can rely.

THE POST-CONFLICT ERA: CHALLENGES AND OPPORTUNITIES IN A RESHAPED REGION

Provided that the situation in the Middle East stabilises in the long term, the Saudi economy is expected to grow by 4.4% in 2027, primarily driven by rising oil production.

However, the easing of security tensions is likely to coincide with a rapid resurgence of macroeconomic pressures. In addition to the normalisation of regional oil production, the United Arab Emirates is no longer bound by their membership of OPEC+. As a result, the global energy market could once again swing into oversupply, leading to a decline in world oil prices at a time when the Gulf states will need to realign their priorities.

Record Q1 deficit: budget equation turns tougher

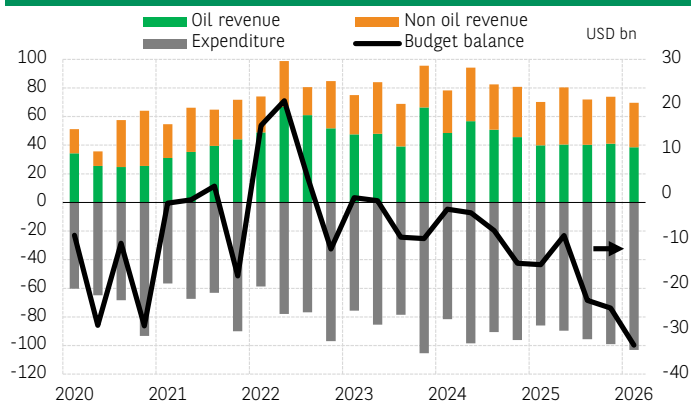


CHART 2

SOURCE: MOF, BNP PARIBAS

Alongside diversification efforts, there are now heightened security requirements and a major overhaul of infrastructure to bypass the Strait of Hormuz.

The strategy drawn up by the Saudi authorities partly addresses these new requirements. Unveiled in mid-April, it aims for a more selective allocation of resources from the PIF, the Saudi sovereign wealth fund, across a narrower range of domestic sectors, with a view to maximising the value of existing assets. Discussions regarding the creation of a logistics powerhouse through the consolidation of several assets from the PIF's portfolio illustrate this drive for economic efficiency. Indeed, the crisis has underscored the strategic significance of Saudi infrastructure in the Red Sea. By strengthening these assets, the country could benefit from the reconfiguration of logistics flows across the entire region.

While the next phase of the '2030' transformation plan is better aligned with macroeconomic constraints, it still relies heavily on the country's ability to attract foreign direct investment (FDI). Despite progress in recent years, FDI inflows to Saudi Arabia remain lower than those in neighbouring countries. In 2025, they stood at 2.6% of GDP, almost 1 percentage point below the average for Gulf countries. However, the conflict's impact on regional attractiveness remains highly uncertain.

Furthermore, by focusing on its domestic market, Saudi Arabia is poised to solidify its new position: transitioning from being a capital exporter to the rest of the world to becoming a net importer since 2024. This trend is expected to continue in the coming years. Although the PIF has a clear mandate to continue acquiring assets abroad, its operations will need to prioritise the diversification objectives set out in the '2030' plan. Given the substantial investment needs and the already significant pressures on public finances, this will probably be achieved through asset reallocation. A slowdown in the pace of acquisitions is also to be expected.

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