SAUDI ARABIA

THE HIGH COST OF DIVERSIFICATION

Economic growth is being restrained by OPEC+ restricting oil production. Excluding hydrocarbons, activity is holding up well however, driven by consumption and the government's intensive investment policy under the Vision 2030 economic diversification programme. This solidity comes with large budget deficits, and now also current account deficits, which are requiring record-high debt issuance. Fortunately, the country still has comfortable financial leeway. However, Donald Trump's return to the White House could have a deep impact on a number of areas.

SOLID YET LIMITED GROWTH

After a 0.8% contraction in GDP in 2023, the Saudi economy has started growing again. However, it is still struggling to really build momentum due to the oil production cuts under OPEC+ policy. Saudi Arabia produced 9 million barrels/day (mbd) in 2024, compared to 9.6 mbd in 2023 and 10.5 mbd in 2022. While real oil GDP is no longer in recession since Q3 (chart 1), it fell by around 4% over 2024 as a whole, pulling economic growth downwards to just 1.3%. Therefore, compared to the initial expectations (4.4%) when drawing up the budget, the landing is pretty hard. Catch-up hopes for 2025 are likely to come up against similar difficulties, but less so.

Our growth forecasts for this year have already been lowered to 3.4% (4.6% for the government) in order to factor in the announcements made in December by OPEC+, namely: 1/ the three-month extension of voluntary restrictions on oil production; and 2/ the very gradual lifting of restrictions, a process which will continue until the end of September 2026, i.e. one year later than expected. For Saudi Arabia, which is supporting the bulk of effort, this will mean a shortfall of 0.4 mbd in 2025. At 9.2 mbd, Saudi oil production would therefore only be increasing by 2% compared to the 6% figure initially forecast, and there is a risk that OPEC+ will make further adjustments during the year as long as the global oil market remains fragile. However, a contraction in oil production seems unlikely at this stage. As a result, athough there is major uncertainty around oil production, it is not expected to have a similar recessive effect as during the last two years.

Against this backdrop, most of the growth will come from the non-oil sector once again. It continues to enjoy strong growth (+3.9% on average over the first nine months of 2024), buoyed by investment (+4.1%) and household consumption (+2.9%). Its prospects are looking favourable too. The continued infrastructure megaprojects as part of the Vision 2030 economic diversification programme and the strong labour market (with a record low unemployment rate of 3.7% and a constantly rising labour force participation rate, particularly among women) should therefore help the non-hydrocarbon sector to continue growing at a rate of at least 4%.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	7.5	-0.8	1.3	3.4	4.3
Inflation, CPI, year average, %	2.5	2.3	1.7	2.0	2.0
Gen. Gov. balance / GDP (%)	2.5	-2.0	-2.9	-3.7	-3.5
Gen. Gov. debt / GDP (%)	24	26	30	33	34
Current account balance / GDP (%)	13.7	3.2	0.2	-1.6	-1.6
External debt / GDP (%)	24	28	30	32	35
Forex reserves (USD bn)	460	437	437	423	414
Forex reserves, in months of imports	21.4	18.0	17.1	15.3	13.8

TABLE 1 e: ESTIMATES & FORECASTS SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SAUDI ARABIA: NON-OIL SECTOR IS THE MAIN GROWTH DRIVER

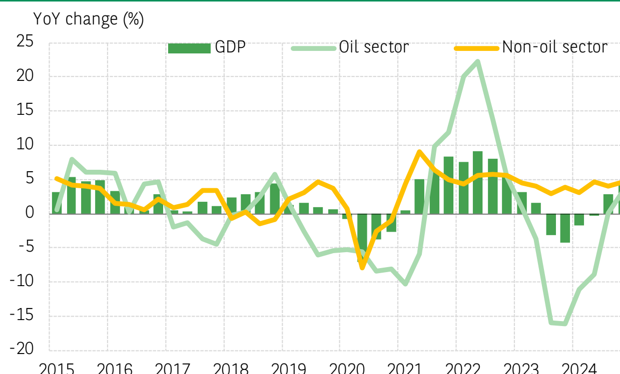

CHART 1 SOURCE: GASTAT, BNP PARIBAS

INFLATION REMAINS CONTAINED

Despite the robust domestic demand and rents rising by more than 10% (21% of the consumer price index, by far its main component), fuelled by sustained urbanisation and the growing working population, the inflationary risk is under control. The increase in CPI stood at 1.7% on average in 2024, compared to 2.3% in 2023, and is not expected to go over 2% this year. A number of factors moderating inflation are at play, in particular the strength of the US dollar on which the Saudi riyal is pegged

However, Saudi Arabia's monetary policy is closely linked to the US Federal Reserve's monetary policy. Even though the country was relatively spared from the global inflationary shock, the key rate was hiked from a low of 1% in early 2022 to 6% in mid-2023, before being gradually cut starting from September 2024. It currently stands at 5% and is expected to hold if monetary easing in the United States stops. For the time being, the "imported" monetary policy has not adversely affected the pace of lending. Growth in bank lending to the private sector remained above 10% in 2024, buoyed by strong corporate demand. Given the solid outlook for non-hydrocarbon growth, there is little evidence to suggest that this will change in 2025.

THE RETURN OF TWIN DEFICITS IN 2025

The country's strong non-oil growth has come at a cost. The acceleration of the Vision 2030 diversification programme has resulted in a 30% total increase in budget spending over the past three years. At the same time, oil revenues (more than 60% of fiscal revenue) have suffered from combined adverse price and volume effects, with the impact partially offset by the exceptionnal payment of a "performance-linked dividend" from the national oil company Aramco. Amounting to 1.8% of GDP in 2023 and 4% of GDP in 2024, this operation helped to keep the budget deficit down at between 2% and 3% of GDP. However, the payment is expected to be discontinued this year, as the expected fall in global oil prices will continue to strain government resources. In response, the authorities have presented a conservative budget. Spending is expected to be cut by 4.5%, which would be the largest fiscal consolidation effort in 20 years (with the exception of 2015 and 2016). Nevertheless, fiscal slippages are common. As a result, budget spending should, in the best case, stabilise at a high level, and the budget deficit should widen to 3.7% of GDP.

The current account slipping into the red in Q3 2024 (deficit of USD 9 billion) is another indicator of the macroeconomic pressures caused by by soaring public spending (*chart 2*). The Saudi economy, which is usually in surplus, now needs a Brent price of around USD 80/barrel in order to balance its current account, compared to less than USD 55 in 2022. The country is therefore expected to record fiscal and current account deficits in 2025, a situation which has not occurred since the pandemic.

DEBT RISING TOWARDS NEW RECORD LEVELS

Saudi Arabia will continue to issue large volumes of debt after already being one of the most active emerging countries on the international financial markets in 2024. Excluding syndicated loans, the government raised USD 17 billion in eurobond debt last year, with USD 9 billion added for the PIF sovereign wealth fund (the main vehicle for the Vision 2030 programme), as well as USD 9 billion for Aramco.

These record issuance amounts could be exceeded in 2025. Indeed, the government must cover USD 6.6 billion in amortisation of eurobond debt this year (compared to USD 1 billion in 2024). For the time being, the Saudi government is still able to take on a lot of debt, as net external assets reached more than 70% of GDP at the end of 2023 and central government debt is moderate (30% of GDP) with a favourable structure (average maturity of 9.2 years, 61% of the stock is domestic) and low costs (interest expenses absorb 3.6% of budgetary resources).

TRUMP 2.0: A BALANCING ACT FOR THE KINGDOM

The massive use of debt is profoundly changing the country's role on the global stage. Once a net supplier of capital, Saudi Arabia is now a net importer in order to cover its development needs. Over the first nine months of 2024, the financial balance posted a USD 34 billion net surplus, compared to a deficit of a similar amount during the previous year. Excluding special operations in the hydrocarbon sector, foreign direct investment only accounts for 1% to 1.5% of GDP. The entry into force of new investment legislation this year is expected to improve the Kingdom's attractiveness.

SAUDI ARABIA: STRONG MACROECONOMIC PRESSURES

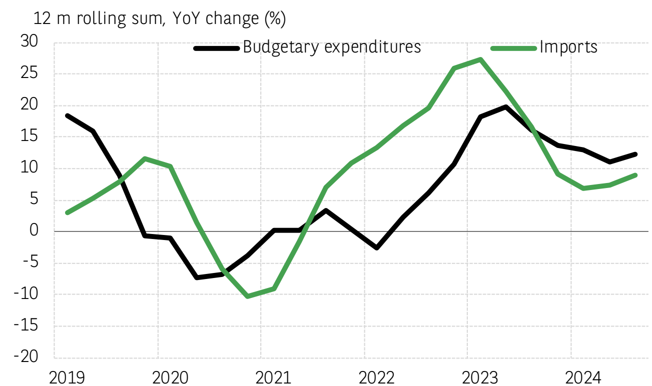

CHART 2 SOURCE: CENTRAL BANK, MINISTRY OF FINANCE, BNP PARIBAS

Until these hopes materialise, the authorities will therefore have to continue to support a large part of the economic transformation through public investment. Therefore, despite the Vision 2030 programme being recalibrated, this transition period leads to increased economic vulnerability to oil fluctuations.

Against this backdrop, the stability of the external environment more generally, and of the oil market in particular, is paramount for Saudi Arabia. However, Donald Trump's return to the White House could have deep impact on many areas, particularly due to his energy policy, which aims to increase US oil production in the medium term, while also seeking to keep global prices quite low. Therefore, Saudi Arabia could be involved in this drive at the start, by increasing its production, but there are uncertainties around the timing. On the external trade side, the country is unlikely to be targeted by increased customs tariffs. However, escalating tensions between the United States and China should make the balancing act between its two strategic partners even more challenging. While China is now Saudi Arabia's principal trade partner (18% of total trade in 2023, compared to 6.5% for the United States), the United States is still ahead of the game when it comes to investment. There will also be opportunities for the country to grasp. In fact, the Saudi authorities and the Trump administration share a common transactional approach to international relations. Saudi Arabia, in particular, could harness this to strengthen its influence in a changing Middle East. This will be decisive in preventing tensions around Iran from degenerating into a new regional conflict, even if Saudi Arabia could also indirectly benefit from harder sanctions on Iranian oil (back-up capacity and upward pressures on oil prices).

Stéphane Alby
stephane.alby@bnpparibas.com