SAUDI ARABIA

A DIFFICULT ECONOMIC TRANSITION

The Saudi economy took a double hit in 2020: the consequences of the Covid-19 pandemic amplified the recessionary impact of falling oil prices and production. In addition to the economic consequences, these two exogenous shocks have had negative consequences for the reform process, and particularly for the dynamism of the private sector. The recovery expected in 2021 will be timid, due to a further slowdown in oil activity. Budget deficits are likely to persist over the medium term, resulting in an increase in government debt. Macroeconomic imbalances remain moderate, but the continued dependence on oil in the context of economic transition remains a significant source of vulnerability.

A DOUBLE SHOCK TO THE ECONOMY IN 2020

In 2020, the Saudi economy was hit by the drop in oil prices and by restrictions in response to the pandemic. Moreover, the fall in oil revenues forced the authorities to adopt fiscal measures that tended to accentuate the economic slowdown. Thus, the tripling of the VAT rate from 5% to 15% and the reduction in allowances partly offset the fall in oil revenues, but also affected household consumption, which represents 55% of GDP. Private consumption was down by 6.4% over 2020. Investment, which represents around a quarter of GDP, fell by 14% given the drop in public investment and the cyclically low level of capital expenditure in the oil industry. Lastly, export volumes dropped 11%, the biggest fall in twenty years, due to lower hydrocarbon exports. In net terms, this fall in exports was offset by the more than 25% collapse in imports as domestic demand dropped.

From a sector point of view, the quota policy established by OPEC+ producers (the OPEC members and Russia), and the overcompliance of Saudi Arabia with the quota of production, reduced oil GDP (around 40% of total GDP) by 6.7% over the course of 2020. Crude oil production was 6% lower in 2020, at 9.2 million barrels per day (mb/d) on average. Non-oil GDP contracted by 2.3%. Overall, GDP fell by 4.1%.

POOR CONDITIONS FOR REFORM

The double shock from oil prices and the pandemic had a particular impact on the Saudi economy given that the country is engaged in an ambitious economic development and diversification plan. This plan relies on two conditions: it needs substantial financial resources, and requires the development of the non-oil private sector in order to create jobs for Saudi nationals. The Public Investment Fund (PIF) is financing the plan, particularly its major infrastructure programmes, in the absence of significant foreign investment (since 2016, inflows of foreign direct investment have only averaged some 0.7% of GDP). A prudent recourse to borrowing, coupled with expected receipts from privatisations, should guarantee the PIF's financing for the short term at least.

As far as the second condition is concerned, the uncertainty from the pandemic has increased caution amongst economic agents. Since 2016, and the start of what has proved to be a lasting drop in oil revenues, private-sector activity has slowed down. It grew by an average of only 0.8% between 2016 and 2020, compared to 5.9% between 2011 and 2015. The ability of the private sector to record a sustained growth remains closely tied to the oil economy, with the uncertainty created by the pandemic representing an additional drag on the process.

At the same time, the medium- and long-term outlook for big oil producers has become more uncertain, given the common willingness to move towards the decarbonisation of economic activity at the global level. Against this background, the Saudi authorities have favoured a top-down approach to accelerate reforms, with substantial investment in infrastructure (new cities, transport, etc.) and a stepping up of measures to increase the Saudisation of the labour market.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	0.3	-4.1	2.3	4.5
Inflation (CPI, year average, %)	-1.2	3.4	2.9	2.7
Central. Gov. balance / GDP (%)	-4.5	-11.2	-3.1	-2.5
Central. Gov. debt / GDP (%)	23	32	32	35
Current account balance / GDP (%)	4.8	-2.1	2.4	1.9
External debt / GDP (%)	23	30	30	32
Forex reserves (USD bn)	500	454	452	446
Forex reserves, in months of imports	27	30	29	28

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

CONTRIBUTION TO GDP GROWTH

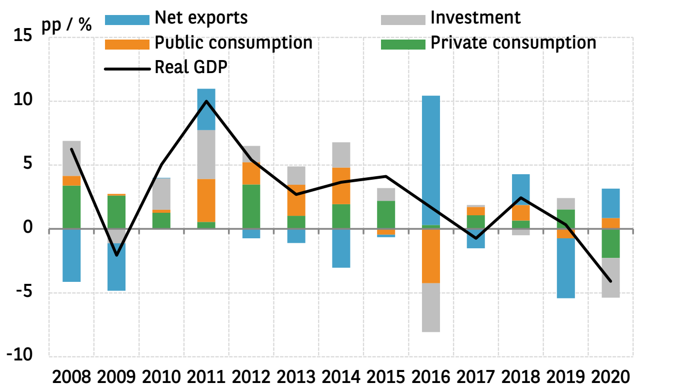

CHART 1 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

A TIMID RECOVERY EXPECTED IN 2021

In Q1 2021, real GDP contracted by 3% year-on-year, due in particular to the drop in oil production. Over the full year, oil GDP is again likely to be down, probably by around 1%. Over the course of the first quarter, Saudi Arabia voluntarily cut its oil production by 1 mb/d above what was required under the OPEC+ agreement. The country's production quota increased in the second quarter and is set to rise further over the rest of the year. Crude oil production is likely to average around 9 mb/d in 2021. This scenario remains dependent on the cohesion between the members of the cartel, on global demand that is vulnerable to any resurgence in the pandemic and on the relative stability of output from producers outside the OPEC+ agreement.

When it comes to non-oil sectors, the outlook is positive, with a 4.7% growth expected in 2021, but with a high degree of uncertainty. Advanced indicators of economic activity (cement production, opening of letters of credit and withdrawals of cash) have moved in the right direction since the start of the year, but are very volatile. Household consumption grew by 1.3% y/y in Q1 2021, and is likely to benefit from a significant base effect in Q2. Daily mobility indicators moved back above their pre-pandemic levels about a month ago. Even so, current trends in the pandemic also give cause for caution. We estimate that less than 30% of the total population has been fully vaccinated. Meanwhile, a second wave of infections is now under way (the number of new daily infections is currently some 30% of the peak seen in June 2020). For the time being, most of the restrictions related to the pandemic have been lifted, but given the circumstances, a recovery in household spending remains uncertain.

The significant increase in oil prices expected this year is likely to help boost public spending, particularly investment, and feed growth in non-oil GDP. The PIF has drawn up a plan lasting until 2025, for annual investment into the Saudi economy of SR150 bn (equivalent to 5.7% of 2020 GDP). Real GDP is likely to grow by around 2.3% in 2021.

A PERSISTENT BUDGET DEFICIT

Due to the drop in oil prices and the need to support the economy (with measures equivalent to 2.7% of GDP), the government recorded a very high budget deficit of 11.2% of GDP in 2020. Revenue from taxes on goods and services (around 18% of total fiscal receipts) benefited from the increase in the VAT rate, but this was not enough to offset the fall in oil revenue (down 31% y/y) – which remains the main determinant of fiscal performance (accounting for some 60% of total receipts). The government has announced spending cuts of around 6% for 2021. The cuts in investment have been made possible by the transfer of a part of this expenditure to the PIF, but we remain cautious regarding current spending cuts against a background of rising consumer prices (with expected inflation of 2.9% in 2021) and the possible persistence of the pandemic. Even if oil prices increase significantly this year, they are likely to remain below the price that would balance the budget (the fiscal breakeven oil price). The total deficit for 2021 is projected at 3.1% of GDP.

Over the medium term, the limits on diversification of fiscal receipts and the increase in spending will probably mean that the fiscal breakeven price stays in a range from USD65 to USD70 per barrel, resulting in continued small fiscal deficits.

A MODEST INCREASE IN GOVERNMENT DEBT

Given the repeated large fiscal deficits since 2015 (averaging 10.6% of GDP), government debt has increased rapidly, but remains moderate (32% of GDP at end-2020). Currently, around 40% of the budget deficit is financed from government resources held at the central bank. These currently stand at around 18% of GDP. The remainder is financed by issuing debt on international markets (financing around 15% of the

GOVERNMENT DEBT

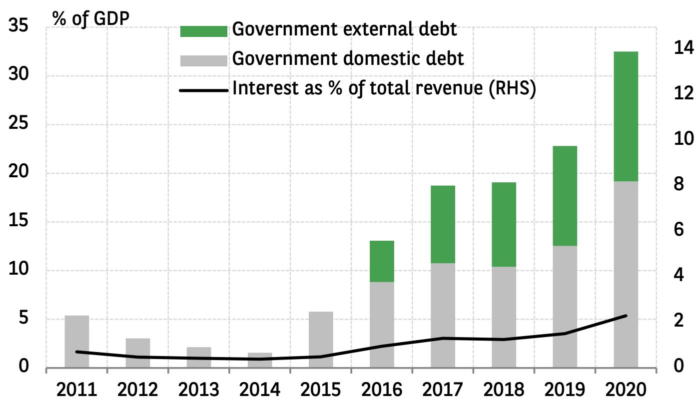

CHART 2 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

deficit) and on the domestic market. For the latter market, the government issues sukuks (debt securities that are sharia compliant) with long maturities of up to thirty years. The debt-financed share of the deficit looks set to grow, given the government's limited reserves at the central bank, low borrowing costs and the willingness to develop the domestic debt market. Under our central scenario, government debt is projected to reach 35% of GDP in 2023.

Macroeconomic risks remain moderate in the medium term, but there are some pressures on the public finances. The government's net asset position has been deteriorating slowly but steadily since 2015; the global drive to tackle climate change is weighing on prospects in the oil industry; and the introduction of economic reforms increases financing requirements and maintains the dependence on oil revenue in the short term.

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