SAUDI ARABIA

A PERIOD FAVOURABLE TO REFORMS

Economic recovery is likely to be strong in 2022, driven by buoyant household consumption and rising oil GDP. Labour market reforms are having a positive effect on domestic demand, most notably via a significant increase in women's participation rates. Inflationary risk remains moderate, even though wage pressures have increased recently. With the increases in oil prices and output, there is likely to be a budget surplus this year. This is due in particular to progress in the diversification of fiscal revenue. The higher level of oil prices will be a test for the government's willingness to continue the budget consolidation process. Despite ambitious development plans, economic diversification has so far made only marginal progress, due most notably to weak levels of foreign direct investment. Over the medium term energy will remain a major area for investment.

A MORE BALANCED RECOVERY IN 2022

The economic recovery has gathered pace since mid-2021 thanks to the combination of rising oil production and a rebound in Saudi household consumption. However, for the year as a whole, GDP growth is likely to have been 2.8%, due to the drop in oil GDP (-0.9% expected). In line with the policy adopted by OPEC+ members (OPEC plus Russia, essentially), crude oil production was reduced until April 2021. The recovery in global demand and OPEC+'s dominant position in the oil market has allowed member countries to ramp up production since mid-2021 (adding some 400,000 barrels/day each month). From a low point in April, Saudi production increased by 21% to 9.9 million barrels/ day by November 2021. Non-oil GDP is likely to have grown by 5.2% in 2021, driven by recoveries in household consumption and investment, each of which grew by around 11% on average over the first three quarters of the year.

Growth is likely to rebalance and accelerate in 2022, reaching 5.7%. Rising oil production, if it continues, is likely to push oil GDP 8.8% higher over the year as a whole. Household consumption and investment will remain the main engines of non-oil GDP growth (expected at 3.7%). The policy of Saudisation of employment in certain sectors and improving access to the labour market for women has had a positive effect on household disposable income. Although the participation rate amongst men has been stable at around 65% over the past two years, that for women has increased significantly, from 20% at end-2018 to 34% in September 2021. In parallel with these changes in the labour market, the number of non-Saudi workers has fallen since 2020. However, this category remains dominant, representing 76% of the total active population in 2020.

Consumer price inflation should ease slightly this year (to an expected 3% from an estimated 3.5% in 2021), in the absence of any further increase in VAT. The acceleration of wage rises seen since mid-2021 (more than 5% y/y in both Q2 and Q3 2021) is likely to support consumer spending in the short term. However, wage pressures could fuel core inflation.

The recent spread of the Covid-19 Omicron variant is a source of particular uncertainty. For the time being, mobility indicators have shown no slowing of consumption. However, government spending is unlikely to support growth. The proposed budget for 2022 includes virtually stable current spending and a significant reduction in investment, which has been transferred to the Public Investment Fund (PIF), the country's sovereign wealth fund. The PIF plans to invest around USD 40 billion per year (some 5% of GDP) in the national economy. However, the capacity of the Saudi economy to absorb such investment is limited and the fund was only able to spend half of this sum in 2021.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth (%)	0.4	-4.1	2.8	5.7	2.3
Inflation (CPI, year average, %)	-1.2	3.4	3.1	3.0	1.7
Central. Gov. balance / GDP (%)	-4.5	-11.2	-1.4	3.6	2.5
Central. Gov. debt / GDP (%)	23	33	29	25	23
Current account balance / GDP (%)	4.8	-2.8	3.8	6.8	2.5
External debt / GDP (%)	24	34	30	30	29
Forex reserves (USD bn)	500	454	470	503	507
Forex reserves, in months of imports	27	30	28	28	26

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TABLE 1

REAL GDP

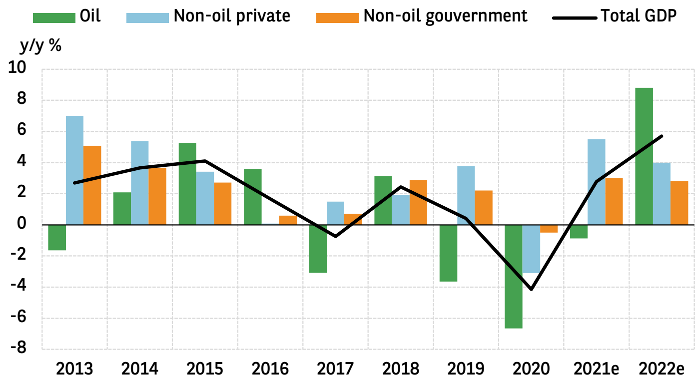

CHART 1
SOURCE: BNP PARIBAS

In 2023, growth is likely to slow to 2.2% as oil production stabilises. Public sector investment will remain a driving force, but the kingdom remains relatively unattractive for international investors. Foreign direct investment (FDI) was equivalent to 0.7% of GDP on average between 2016 and 2020. The exceptionally high levels seen during the first three quarters of 2021 (USD 17.4 billion, or 2.1% of GDP) was due to the sale of 49% of national oil company Aramco's oil pipeline division to a consortium of international investors. A similar deal, this time for the gas pipeline network (signed at the end of 2021), is likely to bring in a slightly higher amount in 2022. Although these financial transactions represent a significant boost to FDI they do not have direct consequences for productive investment in Saudi Arabia. Amongst the many investment programmes announced in recent years which have aimed to transform the Saudi economy, those in the energy sector, in the broad sense of the term, currently look the most promising.

From a more structural point of view, the diversification of the economic structure is making very slow progress. Although energy extraction has lost 7.5 points of its share of total GDP over the last decade, taking it to 35%, no other sector has seen a significant increase in its weighting in the economy. Only financial services (2.2 points) and real estate sector services (1.6 points) have made some small gains.

MASSIVE INVESTMENT IN ENERGY

The asset sales by Aramco should help it pursue its ambitious investment plan. Benefiting from a significant comparative advantage in terms of production costs and low levels of carbon emissions per barrel of oil extracted, oil production capacity could be increased by 1 million barrels/day (mb/d) to reach 13 m b/d in the medium term.

Against the global background of rapid changes in the energy sector, most notably with changes of strategy by some international oil companies, Aramco aims to remain a key energy market player in the medium and long term, and to contribute to the development of the Saudi energy mix towards less carbon-intensive sources. Currently national electricity production comes from oil (42%) and gas (57%). The authorities' goal is to achieve a 50-50 split between gas and renewables. Significant investment is planned to increase gas and solar power production. Over the longer term, the country's vast hydrocarbon reserves could fuel the production of blue hydrogen.

A RETURN TO BUDGET SURPLUS

In 2020, the combined fall in oil prices and production resulted in a record budget deficit, at 11.2% of GDP. This forced the government to continue its consolidation of the public finances, by tripling the VAT rate. These tax changes reduced the dependence of fiscal revenue on oil income. Non-oil revenue is now equivalent to between 35% and 40% of the total, from 10% in 2013. This has the positive consequence of reducing the oil price at which the budget is balanced. This fiscal breakeven price is likely to be below USD 70/barrel in 2022, compared to USD 84/barrel on average between 2015 and 2019.

The price of a barrel of oil (Brent equivalent) is likely to remain above USD 73 through to 2023, so a return to a budget surplus is expected from 2022 (3.6% of GDP in 2022, then 2.5% in 2023). Non-oil revenue is also likely to grow over the next two years, thanks in particular to strong household consumption. On the spending side, trends are less clear. The continued transfer of investment spending to the PIF will partly offset the expected increase in current expenditure.

With this return to surplus, government debt will continue to fall, reaching 23% of GDP in 2023. However, bond issues on international markets will continue, if only to cover significant debt principal repayments. Government assets held with the central bank (the most liquid) will continue to grow. In 2021 they increased by USD 20 billion, to USD 173 billion by November (21% of GDP).

FISCAL BALANCE

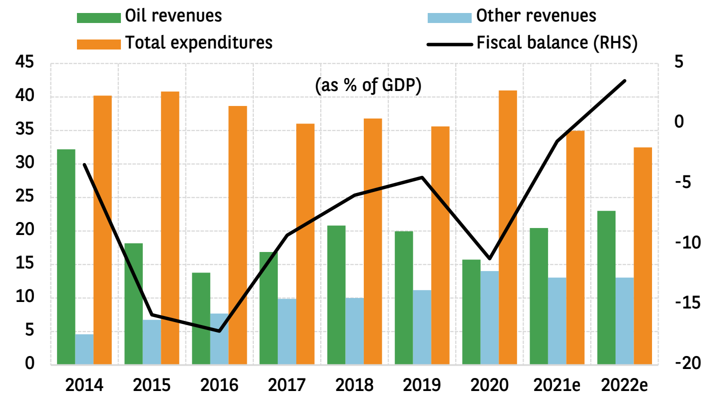

CHART 2

SOURCE: BNP PARIBAS

From an historical point of view, however, this is a low level, as such assets were more than 50% of GDP up until 2014. At the same time, the value of assets managed by the PIF will increase thanks to the sale of public assets, the use of leverage and the reinvestment of profits. The figure currently stands at around USD 450 billion, or 54% of GDP. If we take only the most liquid assets into account (thus excluding the PIF), the government's net asset position remains slightly negative, at -8% of GDP.

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