

Report Series

Saudi Arabia: Macroeconomic Forecast 2020-24

Executive Summary

- On one level, the outlook for the **global economy** has improved. The inventory cycle is turning and the “Phase One” trade deal between China and the US has brought relief to investors. Last year’s monetary easing also promises firmer economy activity in the months ahead.
- However, the outbreak of a new **coronavirus** in China threatens to rupture this fragile optimism. It is too early to map out the likely economic impact, but the fact that not all carriers appear to present symptoms for some weeks suggests that it will be difficult to contain. Indeed, it is already present in most of China (though deaths have been confined largely to Hubei province) and has reached Europe and North America. Given that the outbreak occurred during the Chinese New Year, the hit to China’s economy is likely to be significant. There is also likely to be a global impact on tourism and aviation.
- Yet for all the fear, the mortality rate is not especially high, at just over 2%. This suggests that once the “panic mode” is over (hopefully weeks rather than months) the global economy will regain some poise, and the modest positives noted above will begin to reassert themselves. That said, China consumes half the world’s commodities, so the coronavirus has to be taken seriously, and we have therefore marked down our global growth forecast slightly to **2.9%** for the year, with obvious negative risk related to how long it takes to find a cure (the most likely way of containing it).
- **Oil markets** have taken news of the outbreak especially badly, with Brent plunging by some \$15/barrel in just a few weeks. The selloff appears overdone, but in a world of plentiful oil supply, it reflects traders’ focus on demand. That said, a fresh fiscal stimulus in China, coupled with further output cuts from OPEC Plus should be just enough to allow Brent to average **\$62/barrel** this year. However, there are plenty of risks to this, not least surging non-OPEC supply. In 2021 we think prices will ease to **\$61/b** in line with a cyclical slowdown in the US.
- The **Saudi** authorities have been rightly cautious with their 2020 budget, though their revenue projections appear overly bearish. We think that there will be enough nonoil revenue growth to allow spending to increase this year (the authorities are projecting a cut). The deficit is likely to be around 7% of GDP, but financing options are plentiful. In the longer term we think the deficit will narrow as spending growth eases and nonoil revenue continues to grow. By 2024 the deficit is expected to be below 4% of GDP.
- **Nonoil GDP growth** will remain largely conditional on central government spending growth, though the Public Investment Fund’s investment role will also play a role. Retail and hospitality are likely to do well this year, as should construction. Petrochemicals and those firms focused on government procurement are likely to struggle. We expect nonoil growth of **2.3% in 2020**, slightly down on last year. Ongoing improvements to the business environment should encourage more foreign investment in the medium term and nonoil growth should exceed **4%** by 2024.

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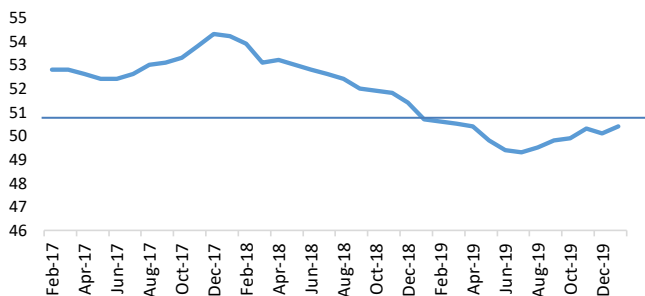
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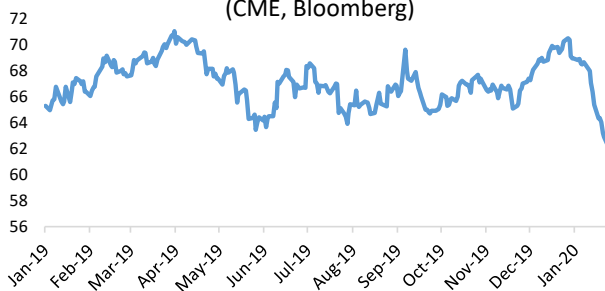
World Economic Outlook					
	2017	2018	2019	2020f	2021f
Real GDP (percent change, PPP)					
World	3.7	3.6	3.1	2.9	2.9
US	2.3	2.9	2.3	1.9	1.6
Japan	2.2	0.3	0.9	0.4	0.8
Eurozone	2.4	2.0	1.2	1.0	0.8
China	6.8	6.6	6.1	5.4	5.4
Emerging Markets	5.0	4.5	4.0	4.1	4.4
Official policy rates (end period)					
US (FFTR)	1.50	2.50	1.75	1.75	1.25
Japan (UOCR)	-0.10	-0.10	-0.10	-0.10	-0.10
ECB deposit rate	-0.40	-0.40	-0.50	-0.50	-0.30
Exchange rates					
USD/EUR (end period)	1.20	1.15	1.12	1.13	1.16
Oil Price (\$/b avg.)					
Brent	54	71	64	62	61

Bloomberg; Samba estimates and forecasts

Global Manufacturing PMI
(50+ denotes expansion; JP Morgan)



China: CME China Commodity Consumption Index
(CME, Bloomberg)



The Global Economic Backdrop

Global economy had been on a modest upswing...

Until recently, the global economy had been showing signs of a modest upswing. Last year was generally disappointing, with early momentum giving way to mid-year concerns about the US-Sino trade war's impact on investment, trade and manufacturing.

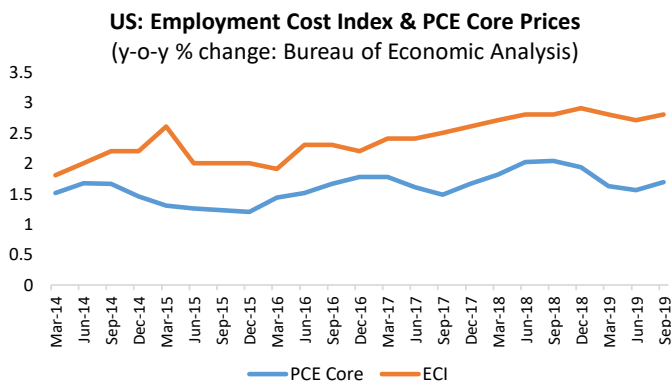
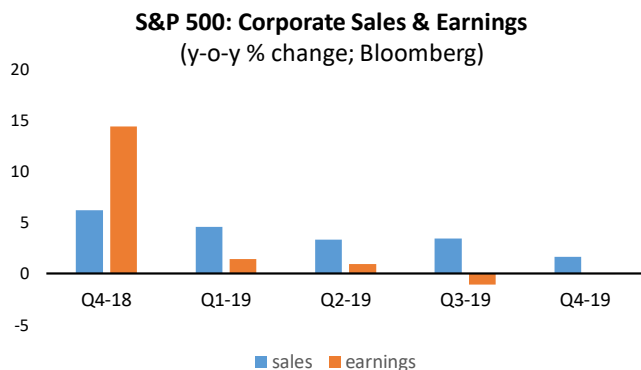
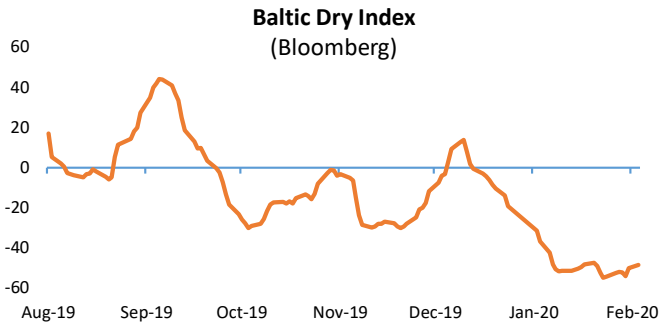
The mood turned more positive in the second half of the year as the US Fed moved rapidly to cut interest rates, prompting a renewed bout of risk taking (especially for US equities). The situation was further improved by the announcement of a "Phase One" trade deal between China and the US in December. Policing the deal will be difficult and the bilateral trade targets are unrealistic, but its signing provided relief for investors who had been fretting that global trade—and globalisation generally—was in retreat. Finally, a turn in the inventory cycle appeared to herald a fresh bout of growth for manufacturing this year. All this suggested to most observers that moderate global growth would continue in 2020, which was a marked contrast to the mood in mid-2019 when many were predicting an imminent global recession.

...but mood shaken by China's coronavirus

The cautiously positive mood was jolted in late January by the outbreak of a novel coronavirus in central China. The authorities moved more quickly to contain the virus than during the 2003 SARS outbreak, but by mid-February the virus had spread from its epicentre to pretty much all of China, and indeed as far afield as the US and Europe. The biological pattern is not especially alarming: fatalities had reached around 1,500 in early February (around 2.5% of reported cases), and were confined largely to the elderly or those with pre-existing health conditions. However, unlike SARS, carriers of the coronavirus are not necessarily displaying symptoms for some weeks, which has made the virus harder to track and control.

Virus could deal major blow to commodities demand

The uncertainty makes economic projections hazardous. But given that the outbreak happened during the important Chinese New Year period, when spending and travel are normally at their height, the impact on China itself could be severe. SARS cost China's economy 1-2% of GDP (though the economy still grew by 10% in 2003). A similar hit this time around would be worth much more in nominal terms, and would represent a much bigger hit to growth. It would also have a significant impact on demand for commodities (which is already showing up—see chart) and the general health of a number of Emerging Markets. This was not



the case in 2003, but now China consumes around half of the world's commodities.

If virus is contained, global economy should improve in H1

For the global economy, the outbreak has dented the modest optimism that marked the turn of the year. The Baltic Dry Index—a measure of global trade volumes—slumped in late January and the US dollar is back in vogue. Overall, it seems likely that Q1-20 is likely to be tough, and not just for China, with significant hits to global travel and tourism. But assuming that the virus is contained (by means of a cure), and the “panic phase” subsides quite quickly (weeks rather than months) then activity seems likely to bounce back in Q2 as inventories are rebuilt and the impact of last year's monetary easing feeds through. Overall, therefore, we expect a temporary hit to global growth momentum, but not enough to trigger a recession.

H2 likely to be challenging

The second half is also set to have its challenges: US corporate earnings are already under serious pressure and will remain so as wage costs continue to rise. An increasingly toxic political discourse in the run-up to the presidential election will not help the “mood music”. China will enjoy a short-term lift from additional monetary and fiscal stimulus, but the country's long-term structural slowdown will continue given poor (state-led) credit allocation, a heavy debt load, and a stagnant population. Trade-dependent Europe will have to deal with this and fraught negotiations with the UK over a final trade deal.

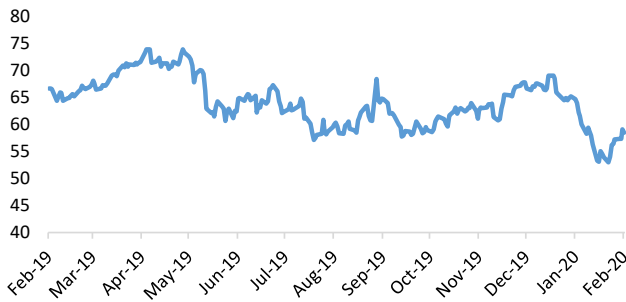
Fed cuts likely in 2021 as US economy slows

Volatility is likely to mark 2021 too. The squeeze in US corporate earnings will only intensify and this will probably prompt the Fed—which is more concerned about corporate distress and potential job losses than inflation—to cut rates by an aggregate 50 bps. Still, a managed slowdown is probably the best that can be hoped for in 2021. Lower US rates (and a weaker USD) will be helpful for EMs, which should enjoy some uptick in growth (capped by China's slowdown). Overall, we think global growth will come in at 2.9% in both 2020 and 2021—well below even recent historical averages.

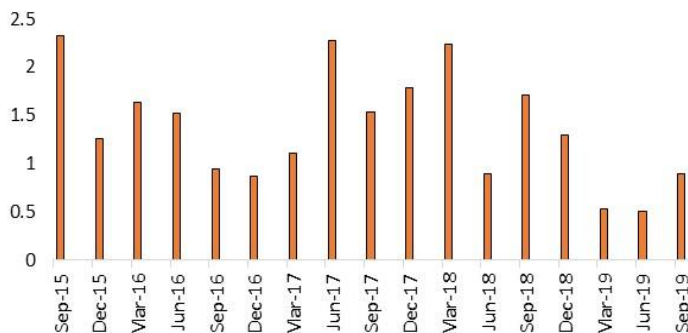
Coronavirus trumps Iran tensions as oil traders focus on demand

Oil prices have been buffeted by geo-political events. First, the ratcheting up of US-Iran tensions in early January saw Brent rise by around \$3/barrel to reach \$69/b. The impact was short-lived, however, and traders quickly re-focused on the demand outlook. This was shaken in late January by the outbreak of China's coronavirus, which saw Brent plummet by \$6/b in just a couple of

Oil: Dated Brent
(\$/b; Bloomberg)



Oil: Change in Demand
(m b/d; year-on-year; International Energy Agency)



OPEC Plus Supply Cuts (prior to new cuts in January 2020; Bloomberg)					
	Reference Output	Pledged Cut	Output Target	Dec-19	Over/Under target
Algeria	1,057	-32	1,025	1,017	-8
Angola	1,528	-47	1,481	1,408	-73
Congo	325	-10	315	326	11
Ecuador	331	-16	315	338	23
Eq. Guinea	127	-4	123	122	-1
Gabon	187	-6	181	222	41
Iraq	4,653	-141	4,512	4,565	53
Kuwait	2,809	-85	2,724	2,708	-16
Nigeria	1,827	-53	1,774	1,770	-4
Saudi Arabia	10,633	-322	10,311	9,762	-549
UAE	3,168	-96	3,072	3,062	-10
Total OPEC	26,645	-812	26,033	25,500	-533
Azerbaijan	797	-20	777	772	-5
Bahrain	227	-5	222	213	-9
Brunei	135	-3	132	122	-10
Kazakhstan	2,028	-40	1,988	2,006	18
Malaysia	653	-15	638	700	62
Mexico	2,017	-40	1,977	1,971	-6
Oman	995	-25	970	976	6
Russia	11,747	-230	11,517	11,596	79
South Sudan	132	-3	129	151	22
Sudan	74	-2	72	74	2
Total "Plus"	18,805	-383	18,422	18,581	159
TOTAL OPEC PLUS	45,450	-1195	44,455	44,081	-374

days. Following a further steep fall to \$54/b, the benchmark had recovered to around \$59/b by mid-February.

As this report went to press, analysts were still trying to work out what the virus might mean for oil demand. A hit of 400,000-500,000 b/d appeared to be an emerging consensus. This equates to around 30-40% of the International Energy Agency's pre-virus projection of global demand growth (1.2m b/d). As noted above, however, infections are hard to spot and the virus could spread more broadly and quickly than many assume.

Prior to the virus, 2020 demand outlook had been improving

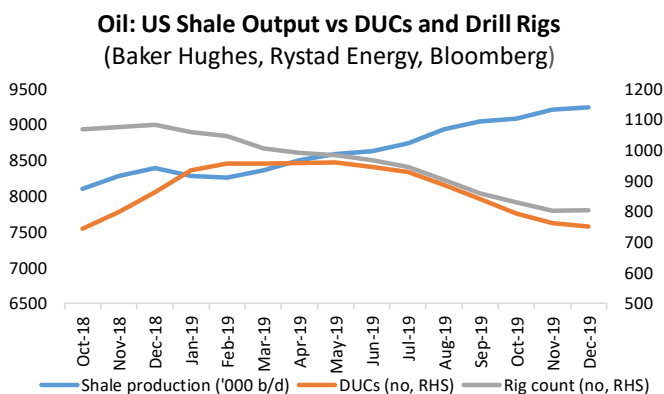
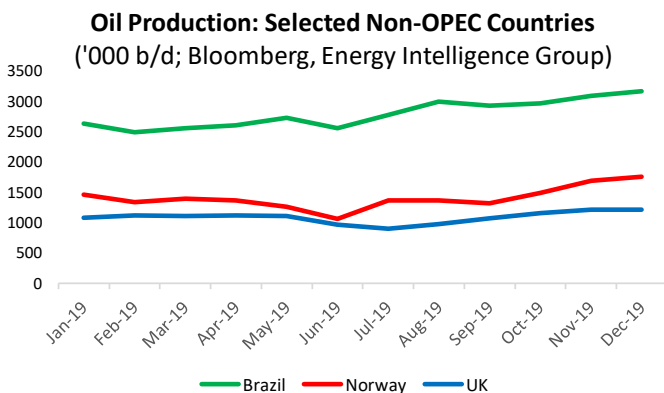
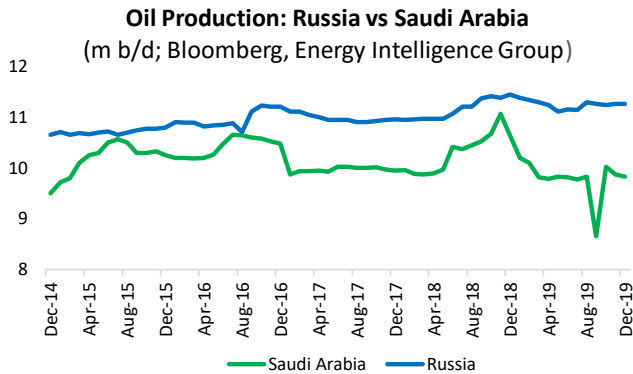
The panic around coronavirus has upended what had been a generally better demand outlook. Prior to the outbreak, oil traders had been cautiously optimistic about the outlook for manufacturing given the US-China trade truce and the turning of the inventory cycle. Demand also seemed likely to be supported by the impact of last year's interest rate cuts (primarily by the Fed), which typically take 9-12 months to feed through to economic activity.

OPEC has been over-complying, offsetting weaker compliance from the "Plus" members

Oil price bulls were also encouraged by some apparent weakening in the supply outlook. OPEC has been "over-complying" with the OPEC-Plus production agreement, reducing December output by half a million barrels/day more than agreed. According to Saudi Arabia's oil minister, the Kingdom reduced production to 9.74m b/d in December, roughly 1m b/d less than a year earlier. The same cannot be said of the "Plus" members: Russia was above-target in December by 79,000 b/d, Malaysia by 62,000 b/d and Kazakhstan by 18,000 b/d.

Virus to trigger additional OPEC Plus cuts?

The coronavirus outbreak has put further pressure on OPEC Plus, and in February some members of OPEC (most notably Saudi Arabia) were pushing for additional cuts to rebalance the market—an extra 500,000 b/d of cuts has been mooted. Russia has been ambivalent about the need for additional cuts, with the Kremlin increasingly focused on President Putin's "legacy". The outgoing president appears keen to pivot towards an expansionary fiscal policy at home in an effort to boost growth and living standards. The additional spending would clearly be helped by higher oil prices, but the Kremlin may well decide that more revenue can be generated (and more quickly) by raising oil output and hoping that others in the OPEC Plus alliance do the "heavy lifting" on cuts (note that Russia also requires lower oil prices to balance its budget than other members). Under the terms of the current agreement, which came into effect in



January, Russia's condensate output is no longer counted. Thus, its compliance will automatically improve, but its crude output will bear close watching.

The most likely outcome of the OPEC Plus deliberations is a compromise whereby the group agrees to cut production by 300,000-400,000 b/d (probably at its scheduled March meeting) and keeps that agreement in place for the year. Saudi Arabia will shoulder most of this and we expect it to cut output from an average of 9.9m b/d in 2019 to 9.6m b/d in 2020. It will be mainly other OPEC countries that contribute to the rest of this cut.

Non-OPEC supply gains are robust

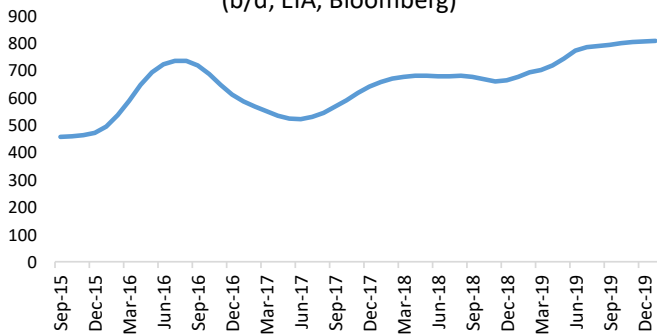
Meanwhile, non-OPEC Plus output has continued to surge. Brazil put on 600,000 b/d between June and December as offshore production was ramped up, while Norway increased output by 350,000 b/d in the final quarter alone. Even the UK managed to add 200,000 b/d in the second half. The behemoth of non-OPEC Plus output, the US, increased its shale output by 850,000 b/d in 2019 (total oil output was up 1.2m b/d for the year). This is about half the gain recorded in 2018, but it came despite stagnant output in the first quarter.

Shale sceptics have pointed to the weaker output gain and declining drill rates as evidence that the sector is in secular, if not structural, decline. They note that small firms are under intense pressure to return cash to shareholders rather than invest ever more capital in drilling. This is true, but the flipside of this pressure is that firms are turning to wells that they drilled in 2017 and 2018, but left dormant. As companies turned these Drilled But Uncompleted wells (DUCs) into completed wells, so output began to accelerate again from Q2 last year.

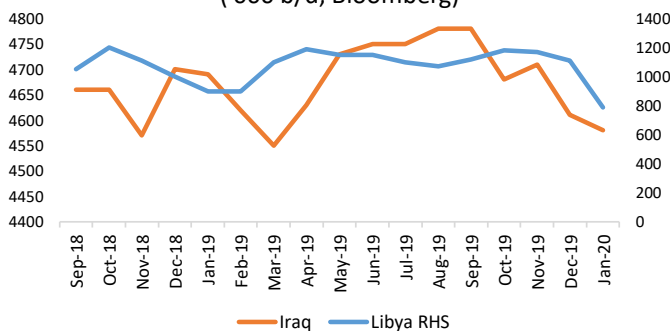
This strategy is clearly finite, but there are plenty of DUCs still to be completed. DUCs peaked at around 8,500 in Q1-19 and by the end of the year were around 7,500. One might assume that some of these DUCs might never be brought on stream for logistical reasons, such as access to pipelines (or firms going bust); in addition, some analysts doubt the DUC data, supplied by the US EIA, which they say are overestimated. But even if one assumes, say, 80% of the remaining DUCs are brought online, this could keep shale output growth reasonably strong for some time.

This also assumes no drilling growth, which is unrealistic given the growing footprint of supermajors such as Chevron, ExxonMobil and Shell, which have the financial resources and technology to ride out periods of low oil prices and reduce the marginal cost of production ever further. Output per rig continues to edge up, at least in the Permian. It seems likely, therefore, that shale growth will continue, albeit not at the breakneck pace seen in 2018.

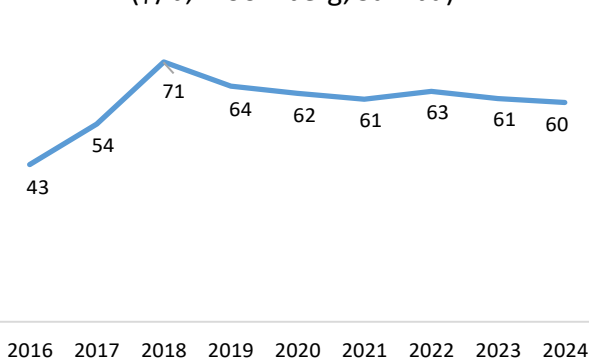
Oil: Output Per Rig, Permian Basin
(b/d; EIA, Bloomberg)



Oil: Iraq vs Libya Oil Production
('000 b/d; Bloomberg)



Oil: Dated Brent
(\$/b; Bloomberg, Samba)



Iraq's deteriorating security environment provides some hope for oil price bulls

Looking at 2020, it seems clear that non-OPEC Plus supply will mop up all additional demand, even assuming that demand growth is 1.2m b/d (which now seems unlikely). As noted above, we think OPEC Plus will institute deeper cuts, but the supply risks are to the downside. It is notable that the latest slump in prices has come despite the loss of 1m b/d of Libya's output (which, incidentally, is far more than the most bearish forecast of the demand hit from coronavirus). This could be quickly overturned if a peace treaty is signed between the government and rebels (talks are ongoing). Meanwhile, Venezuelan oil output is beginning to stabilise, albeit at very low levels, and losses of the scale seen in 2018 are no longer mathematically possible. The main "positive" for oil price bulls is the deteriorating security environment in Iraq, ExxonMobil is said to be scaling back production plans, with other firms minded to do the same.

Demand growth should strengthen this year if coronavirus is contained

Overall, we think that there is a decent chance that global demand growth in 2020 will be higher than last year (just), though this is based on the assumption that the fallout from the coronavirus panic dissipates reasonably quickly, and that OPEC Plus rolls out additional cuts of at least 300,000 b/d and these are broadly adhered to. Assuming too that Libya's output remains volatile—though not totally off-line—and Iraq's output begins to soften, then we think there is enough support for Brent to average **\$62/barrel** in 2020. But clearly, risks are firmly to the downside.

Prices set to ease to \$61/b in 2021

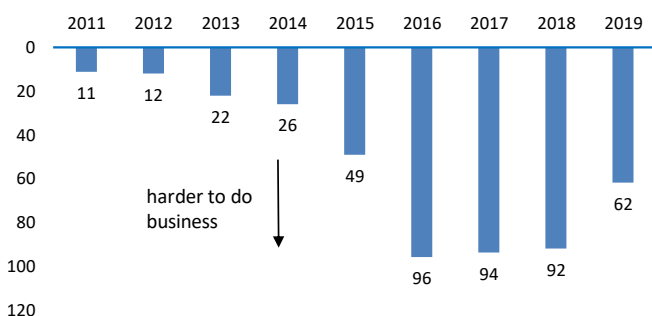
In 2021 we forecast Brent to ease to **\$61/barrel** based largely on the expected slowdown in the US, which will offset the impact of a weaker dollar on EM demand. There may be a slight uptick in 2022 as the previous year's monetary loosening—and a further slight weakening in the USD—supports some demand stabilisation, but by 2023 the general, slow-moving trend towards cleaner fuels will be beginning to tell and prices are expected to ease to **\$60/b** by 2024. This trajectory is somewhat more bearish than under our mid-2019 forecast.

Upside risk is provided by any geological constraints that might begin to impact US shale output in the medium term, and by the impact of the "exploration deficit" that was a feature of the 2014-16 period. The latter describes a period when oil majors reduced exploration and made few non-shale oil discoveries. This might yet have an influence on the medium-term supply outlook.

The authorities continue to make good progress in improving the business environment.

This progress has been recognised by both the World Bank and the World Economic Forum.

Saudi Arabia: Ease of Doing Business
(global ranking; World Bank)



The Outlook for Saudi Arabia

Progress on improving the business environment has been good

The Saudi authorities continue to make progress on the various strands of the Vision 2030 agenda. Some of the initiatives in the National Transformation Programme (NTP) for 2020 will clearly not be met: unemployment, religious pilgrim inflows, import dependency, and nonoil revenue, for example. Yet the NTP is not an end in itself. It is as much a signal of intent and a staging post on the road to Vision 2030. The fact that many of its 500-plus initiatives will not be achieved speaks to the breadth and ambition of the agenda rather than faltering commitment.

As we have noted before, it is in the less eye-catching areas where a good deal of progress has been made. Chief among these is the business environment. A long-awaited bankruptcy law is now in place (and is being road-tested), as is the commercial pledge law, which broadens and regularises the use of collateral in business deals.

A public procurement law has also been approved. The new law, which came into effect on November 29th last year, seeks to make the tendering process more centralised (in a bid to reduce costs—see below) but also allows government agencies to tailor contract conditions to particular (and often complex) project requirements. The previous law was based around a “one size fits all” approach, and was deemed by many to have become outmoded given the complexity of the Kingdom’s infrastructure needs. The new law allows the use of the Request for Proposal (RFP) model, which is a global standard that typically involves a structured evaluation and selection procedure. This should in turn reassure potential bidders about the impartiality of the process—a crucial factor in public sector procurement in Emerging Markets.

Kingdom rises in global competitiveness rankings

While the World Bank’s annual *Ease of Doing Business* rankings are a crude measure of relative business conditions, they help to illuminate progress. The Kingdom was the most improved economy in the latest rankings, based on the number of reforms undertaken in 2019 and how much the overall score improved. The Kingdom made substantial improvements in 8 out of 10 criteria, which pushed it 30 places up the rankings to number 60. Admittedly, the country has been higher than this in the previous decade, but back then the actual implementation of reforms was hampered by a lack of inter-agency cooperation—something that is much less of an issue under the current centralised administration.

The WEF recognises the impressive strides made by the Kingdom in technology adoption, and research and development expenditure; however, labour markets are still judged to be too rigid.

In the latest *Global Competitiveness Report* from the World Economic Forum, the Kingdom rises three places to 36 globally. One striking area of progress is in the adoption of ICT, reflecting the rapid rollout of broadband and a related increase in internet usage. The country is 13th globally for internet users, while it is ranked 11th for “technology governance” (the uptake of ecommerce, Fintech etc). The WEF also notes good progress on patent applications, for which the Kingdom is now ranked 40th, and the level of R&D expenditure (0.8% of GDP, 43rd). The WEF rankings appear to have been drawn up before the roll out of the bankruptcy law, which points to a higher ranking next year.

One factor holding the country back in the WEF’s rankings is the labour market, which is deemed to be insufficiently meritocratic. This is one side-effect of the Saudiisation programme, but should be ameliorated over the long term as education improves. That said, in the latest Programme for International Student Assessment (PISA) scores, Saudi Arabia ranked 73rd out of 78 countries for maths and 71st out of 78 for science (the ranking for reading was somewhat better at 65).

Fiscal sustainability remains bedrock of Vision 2030 programme

Naturally, fiscal sustainability remains a cornerstone of the Vision 2030 plan. The authorities appear to have done a good job in reducing the fiscal deficit in 2019 to **SR131bn or 4.7% of GDP**, from 5.9% of GDP in 2018. This was a much bigger correction than most were forecasting and appears to have been caused mainly by a **squeeze in 4Q spending** (down 16% year-on-year) which meant that full-year spending edged down by 3% (after the first nine months spending was up almost 4%). The dramatic cut to 4Q spending was probably a response to the oil price slide towards the end of the year, though there was also a helpful fall in military outlays as the authorities stepped up efforts to secure a ceasefire in Yemen.

2020 budget projects spending cut

The most notable element of the 2020 budget is the **projected cut to government spending**. The reduction, which is SR28bn from the authorities’ estimate of 2019 spending, was flagged up in the 2020 Pre-Budget Statement (released shortly before the budget). The cut to spending was not a feature of the 2019 PBS, which projected instead a SR37bn *increase* for 2020. Despite this cut, the authorities still expect a deficit this year of SR187bn, which is 6.4% of their forecast for GDP. The revenue assumption is a bearish SR833bn, a 9% decline on the 2019 estimate. The pessimism is understandable since the budget was drawn up at a time of growing trade tensions and a generally fragile global outlook that would have necessitated a conservative oil price assumption.

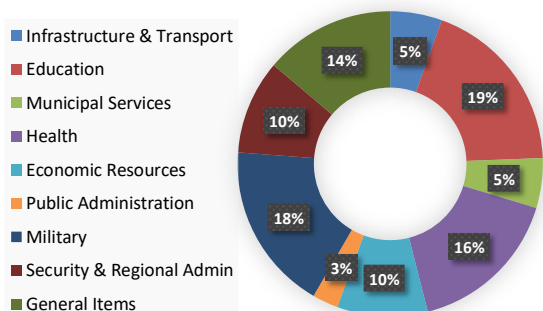
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Saudi Arabia Budgetary Developments			
SRbn	2019 Actual	2020 Budget	difference (SRbn)
Total Revenues	917	833	-84
Taxes on:	203	200	-3
income & profits	16	16	0
goods & services	141	142	1
international trade	17	16	-1
other	29	26	-3
Other revenues *	714	633	-81
Expenditure	1048	1020	-28
Current spending:	876	847	-29
Employee comp.	504	504	0
Goods & services	164	140	-24
Financing	21	31	10
Subsidies	22	17	-5
Grants	1	1	0
Social benefits	77	69	-8
Other expenses	87	85	-2
Capital spending	172	173	1
Balance	-131	-187	-56
percent GDP	-4.7	-6.4	

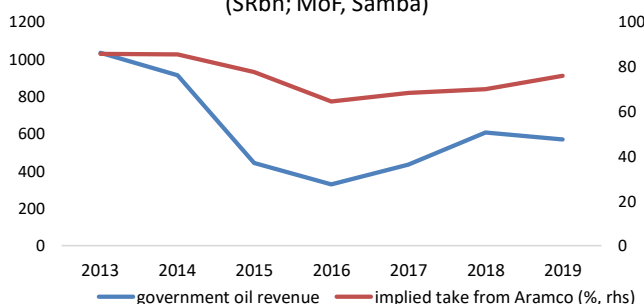
* includes oil revenue

Source: Ministry of Finance

Saudi Arabia: 2020 Budget Allocations
(percent; MoF)



Saudi Arabia: Government Oil Revenue
(SRbn; MoF, Samba)



The authorities will continue to make efficiency savings thanks to greater oversight of procurement, among other measures. Yet we still expect central and general government spending to increase in 2020.

Our revenue assumption is somewhat better than the authorities' ...

Given the (likely) impact of coronavirus, the outlook has not exactly improved since then. Yet our revenue assumption is still a bit more upbeat. Admittedly, we do not think that last year's "special dividend" from Saudi Aramco will be repeated. Add to that the impact of the IPO, and we expect the government's share of oil export earnings to fall back to around 72%. We also expect another sharp cut to crude oil production (see above). Thus, we forecast oil revenue this year at SR513bn, a 10% decline on 2019.

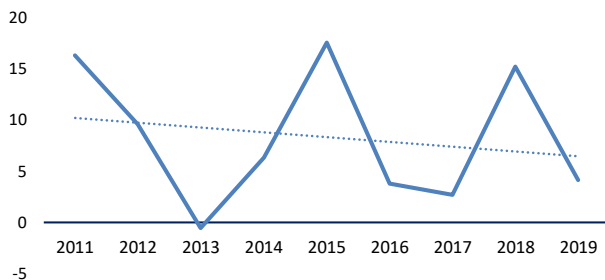
Yet the **nonoil picture appears more positive** to us: the authorities expect the yield from VAT to stay flat in 2020, whereas we see scope for a 15% increase based on decent consumption growth. As Jadwa Investment points out, the G-20 summit in Riyadh in November, and the many associated activities, should boost visitor numbers substantially, as will the general opening up to Western tourists (see below). Overall, we think nonoil revenue could rise by 12% this year.

...which should give space for a modest spending increase

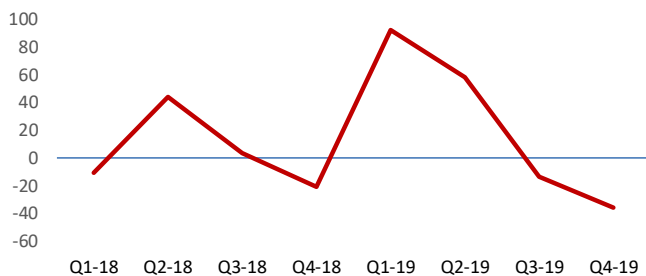
The key question is whether the projected cut to spending is realistic. The question is important not just from a fiscal perspective, but also because it will set the tone for economic activity in 2020. In an earlier analysis of the authorities' *Pre-Budget Statement* (November 2019) we said there was scope to make considerable efficiency savings without unduly impacting the domestic economy. In particular, we highlighted the potential role of the Centre of Spending Efficiency in helping government agencies to achieve the best possible price in the contracting process. We also noted the role of the Public Investment Fund (PIF) in shouldering some of the government's capital spending burden, particularly in the ongoing rollout of tourism infrastructure. Thus, we felt that the central government could reduce spending without reducing aggregate demand.

We still believe this to be true and are confident that the authorities will continue to make spending more efficient over the medium term. However, we are not convinced that public sector employee compensation can be frozen as the 2020 budget suggests. True, this item was cut (slightly) in 2013 and the trend in the increase is downward; but the cut followed two years of sizeable gains, and the average increase since then is 7%. Note also that outlays on this item were 10.5% over budget in 2019, and the inflation allowance for public sector employees has been rolled over again.

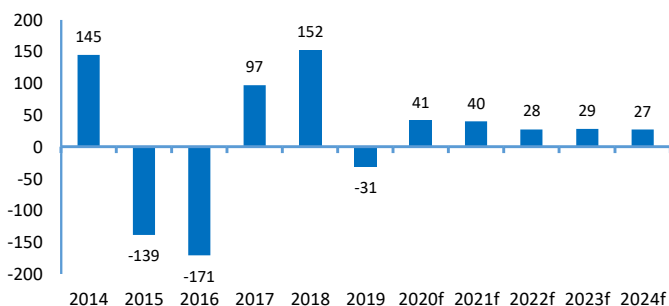
Saudi Arabia: Public Sector Compensation
(% change; MoF, SAMA)



Saudi Arabia: Central Government Capital Spending
(% change y-o-y; MoF)



Saudi Arabia: Change in Government Spending
(SR bn; MoF; Samba)



We think capital spending will increase this year, both from central government and PIF

The budget projects capital spending to stabilise at SR173bn, though note that last year's figure was achieved mainly by slashing capital outlays in the final quarter. Even allowing for increased PIF spending, we doubt that the government will hold capital expenditure to the budgeted figure. First, infrastructure needs are pressing. Second, to do so might imperil the nascent recovery of the important construction sector (it is notable that the sharp cuts to spending in the final quarter triggered a pronounced softening in the PMI data—see below). Third, we do not think this is necessary from a fiscal point of view. Based on our oil price and production forecasts, along with our nonoil revenue assumptions, we believe that central government revenue will be some SR70bn higher than the government is projecting (SR900bn vs SR833bn). This will provide scope for higher spending, which can bolster the (still-fragile) economic recovery.

Thus, **we think spending will increase by around 4% this year** (which might be conservative given historical spending patterns). We expect both public sector remuneration and capital spending to increase, by 5% and 9%, respectively. We do think that public procurement will be cut, though perhaps by not as much as the budget projects.

We expect roughly the same nominal deficit as the authorities

These two assumptions—higher nonoil revenue and higher spending—balance each other out in nominal terms, and we are forecasting more or less the same-sized deficit as the authorities: SR189bn for 2020. Our forecast is for a larger share of GDP (7% vs 6.4%) based on different expectations for overall GDP growth.

We also think there will be moderate spending increases beyond 2020

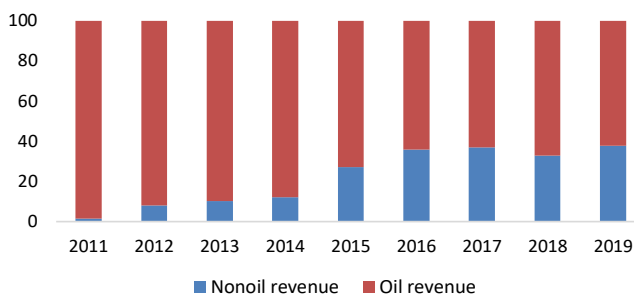
The government also expects central government spending to be cut in 2021 and 2022 (projections do not go beyond this). Based on this, spending would be SR955bn in 2022—i.e. back to around 2017 levels. The rationale for this is that the private sector will become increasingly autonomous and the privatisation/PPP process will allow the state gradually to reduce its role in the local economy. Theoretically, this is plausible; however, we note that even in countries where privatisation and/or outsourcing gained particular traction, such as the UK in the 1980s, government spending still increased. With a Saudi national population growth rate of 2%-plus, we think it unlikely that spending will actually be

Saudi Arabia: Medium Term Fiscal Projections

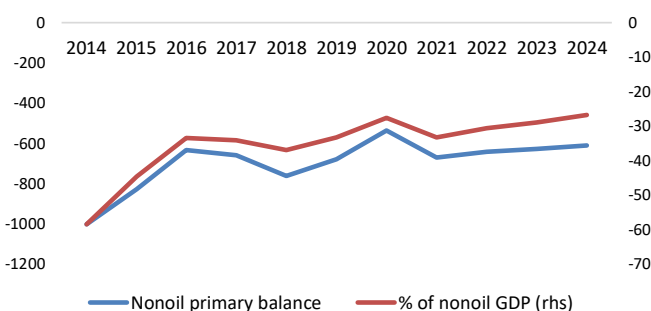
SRbn	2019	2020	2021	2022
Total revenue	917	833	839	863
Total expenditure	1048	1020	990	955
Balance	-131	-187	-151	-92
percent of GDP	-4.7	-6.4	-5.0	-2.9
Debt	678	754	848	924
percent of GDP	24	26	28	29

Source: Ministry of Finance

Saudi Arabia: Central Government Revenue
(% share; MoF; SAMA, IMF)



Saudi Arabia: Government Nonoil Balance
(SR bn; MoF, Samba)



cut in these years, though we accept that the pace of spending could be modest. Therefore, we think that spending growth will ease to an annual average of 3.1% in 2021-22, and further to some 2.4% in 2023-24.

Spending growth will *need* to be modest given that we think that oil earnings are likely to stagnate over the next five years. We do anticipate decent growth in nonoil revenue, mainly driven by VAT as retail options proliferate and increasing numbers of women enter the workforce. There should also be a better take from fee and tax income in the latter part of the forecast period as foreign investment picks up. This should mean overall revenue growth of an average 3.8% a year, which should be enough to allow the **fiscal deficit to narrow over time, easing from 7% of GDP in 2020 to 3.7% in 2024**. Note that we have not assumed any additional equity sales in Saudi Aramco, though this remains a distinct possibility. We assume that the proceeds of any such sale would be transferred to the PIF, and this therefore provides significant upside risk to the *general* government's fiscal outlook.

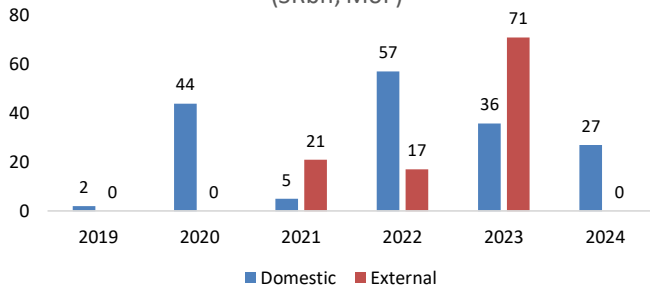
The **nonoil primary fiscal balance**, which is an important gauge of the long-term sustainability of the government's fiscal stance, is expected to narrow (albeit after a brief upturn this year) to reach around 27% of nonoil GDP by 2024. Though still large, this would represent considerable progress given a deficit of 58.5% as recently as 2014.

Fiscal financing requirement is not trivial, but there are plenty of financing options

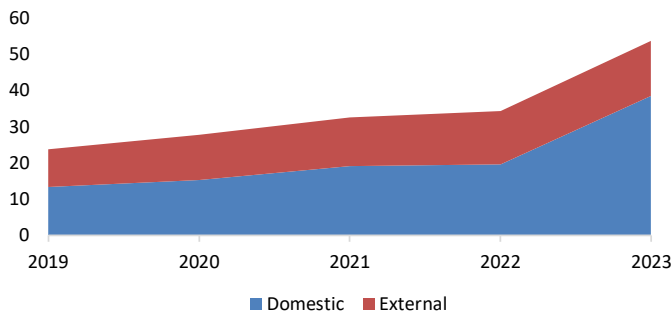
The **total financing requirement for the 2020-24 period is SR763bn** (\$204bn). This compares with SR430bn for the authorities' own projection which runs to 2022.

Our forecast obviously represents a lot of money, but it is in fact substantially smaller than the SR1.24trn that was required during the 2015-19 period. Moreover, financing options are proven and plentiful. The National Debt Management Centre (NDMC) has shown considerable skill in managing the government's debt issuance, selling paper both domestically and externally, in USD, EUR and SAR, and in both conventional and Islamic instruments. It has developed a 30-year yield curve, instituted a primary dealer system, and listed government debt on the Tadawul. This multi-faceted approach is one reason why there has been no repeat of the 2016 liquidity squeeze. Naturally, the authorities are anticipating only a modest increase in debt over the medium term—less than SR250bn out to 2022—because of their projected cuts to spending. They also expect the split between domestic and external issuance in 2020 to remain much the same as in 2019—that is, roughly 55% in favour of domestic issuance.

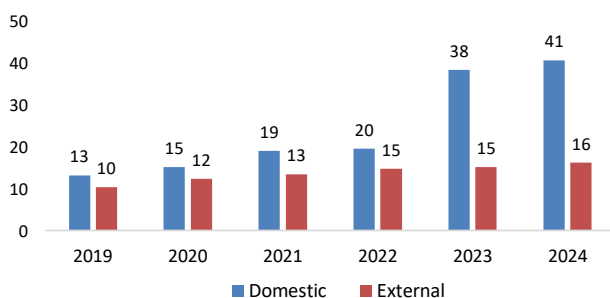
Saudi Arabia: Central Government Principal Repayment Schedule
(SRbn; MoF)



Saudi Arabia: Central Government Debt Outlook
(total stock, SRbn; Samba)



Saudi Arabia: Central Government Debt
(% GDP; Samba)



Saudi Arabia: Fiscal Financing Outlook

(SRbn)	2019	2020f	2021f	2022f	2023f	2024f
Fiscal financing requirement	131	189	189	140	134	111
Financed by:						
Domestic debt issuance	72	77	74	86	94	55
External debt issuance	56	60	56	68	94	45
Total issuance	128	137	130	153	187	100
Amortization	2	44	26	74	107	27
Implied change in government deposits	-5	-96	-85	-61	-53	-38
memoranda:						
Central Govt domestic debt *	373	410	523	556	671	735
% GDP	13.3	15.3	19.1	19.6	23.2	24.5
Central Govt external debt *	293	334	369	420	442	487
% GDP	10.4	12.4	13.5	14.8	15.3	16.3

*note that the authorities' FBP aims to keep total government debt below 30% of GDP

Source: Samba

For our projections, we assume the same ratio, but obviously expect debt accumulation to continue for the forecast period, along with some draw on government savings. **Amortisation payments** (which will presumably be rolled into fresh issuance) are set to become more of an issue in the years ahead, with an estimated annual average of SR56bn a year in amortisation, both local and FX, over the period. Note that this is based on the MoF's projections, but these hold for us too since the additional debt that we think will need to be issued will not mature until beyond the forecast period. By 2024 we expect that the total debt stock will have risen to 41% of GDP (of which 16% of GDP would be external debt). We note that the authorities say they are committed to keeping total debt below 30% of GDP.

We think debt stock will continue to rise, but financing costs will be manageable given low rates

It should be apparent that **we have no major concerns about the debt outlook**. This is partly due to the NDMC's management skills, but also the global hunger for virtually any government debt that has a positive yield, especially that which is effectively backed by the world's largest recoverable (and cheapest-to-extract) oil reserves. This—along with Fed action—should help to keep financing costs subdued. That said, we hope that the medium-term debt burden stabilises around the 45% of GDP mark (if not lower) as the fiscal deficit narrows and nominal GDP increases.

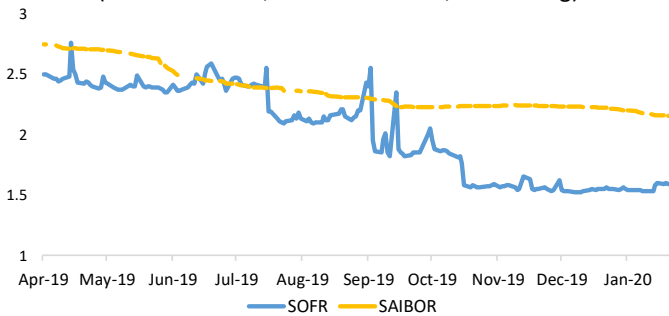
Fiscal stance will set the tone for the local economy, albeit with some offset from PIF

How will the fiscal stance affect the domestic economy? To recap, the main feature of the fiscal outlook is (in our view) a moderating rate of central government spending growth, offset to some extent by increased investment by SOEs (mostly from the PIF). Public sector remuneration growth should hold up reasonably well, as should general government capex. However, there are likely to be cuts to public procurement. One positive for industrial firms is the **waiver of the expatriate levy for five years**. This is not insignificant: in 2020 firms are due to pay SR800 a month for each foreign worker on their books.

Public

Saudi Arabia: SAIBOR vs SOFR

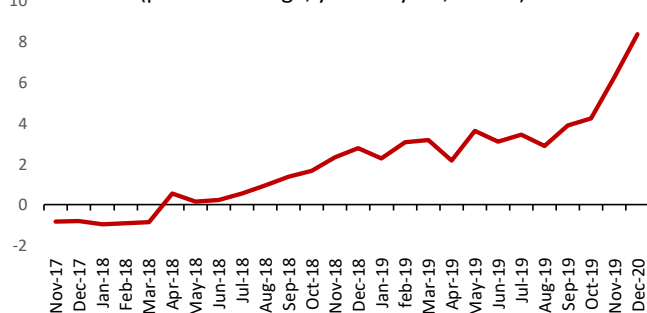
(3 month % rate; FRB of New York, Bloomberg)



Abundant liquidity has intensified competition among banks for prime borrowers.

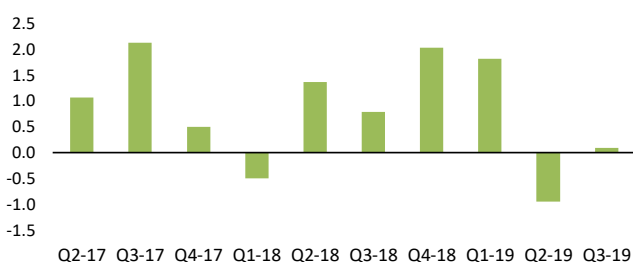
Saudi Arabia: Bank Lending to the Private Sector

(percent change, year on year; SAMA)



Saudi Arabia: Public Sector Real Wages

(deflated by CPI, % change q-o-q; GASTAT)



Abundant liquidity will support growth

The **liquidity environment** will also feed into nonoil growth prospects. In essence, liquidity is abundant. Money supply (M3) accelerated to 7% in 2019, despite a decline in nominal GDP, while the main interbank rate, three-month SAIBOR, eased by around 75bps during the course of the year, mainly in response to policy rate cuts. (The spread over the Secured Overnight Financing Rate, which is destined to replace the discredited LIBOR as the benchmark overnight rate, widened in the second half of the year, though this largely reflects dislocations in US money markets and subsequent liquidity injections by the Fed. In any case, SAMA is keen to maintain a decent spread over US reference rates in order to discourage capital outflows.)

Repo activity, as proxied by the change in banks' non-statutory reserves holdings with SAMA, increased by 15% last year. Lending to the private sector also accelerated in the last few months of the year, and came in at 8.4%. Surplus liquidity and stiff competition for prime borrowers has reduced loan pricing; competition for borrowers will remain a feature of 2020 and pricing might continue to edge down, though the cooling economy (see below) suggests that overall private credit growth will fall back slightly to around 7%. In 2021, two further rate cuts from the Fed and a pickup in domestic activity should see lending growth harden to more than 10%.

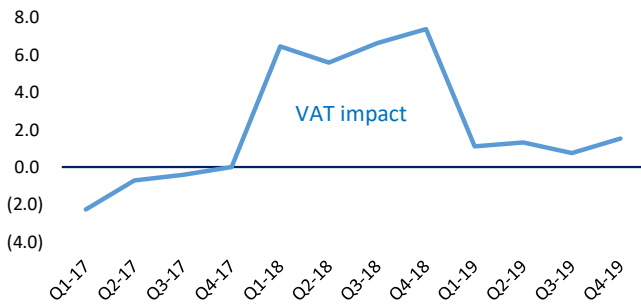
Domestic trade should continue to do well this year

Turning to the main pillar of the nonoil economy, **private consumption**, we find a household sector that is in good shape. Total leverage (consumer loans and mortgages) accounts for just 17% of GDP, and public sector workers have benefitted from strong wage growth in recent years. Employment data show that nominal public sector wages for Saudi nationals have risen by an average 0.8% q-o-q for the past eight quarters (to Q3-19). Wages rose by an annual 5.9% in 2018, though the rate is likely to have slowed to around 1.3% in 2019. Note that *private* sector wages for Saudis have been much more volatile, though the trends is decidedly downwards. The annual change in Saudi private wages was negative 3.7% in 2018 and negative 1.3% in 2019 (to Q-3).

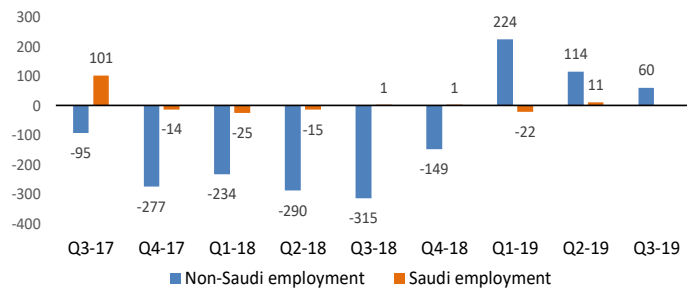
Inflation will have a moderate impact on purchasing power in 2020

Looking at public sector employees' purchasing power, inflation will be an issue in 2020 in a way that it was not in 2019. Consumer prices have been edging up on a month-on-month basis for the past six months or so, and the year-on-year rate was positive in December for the first time in a year. However, the inflation data are skewed by two factors. First, the impact of VAT (introduced in

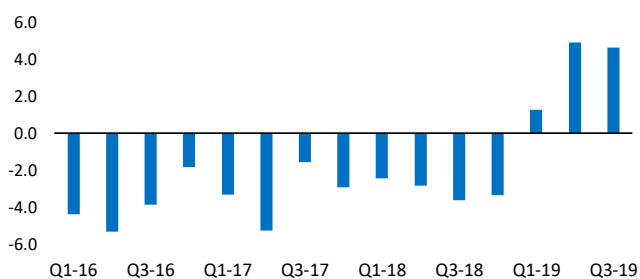
Saudi Arabia: Food Price Inflation
(% change y-o-y; SAMA)



Saudi Arabia: Employment Trends
(quarterly change in employment, '000s, includes non-Saudi domestic workers; GASTAT)



Saudi Arabia: Construction Sector Contribution to Real Nonoil GDP
(y-o-y percent change; GASTAT)



January 2018) on the base, and second the hollowing out of the expatriate rental market (particularly the lower and mid-level segments) following the exodus of some 2m workers and their dependents. The latter has weighed heavily on the CPI, but has clearly had little impact on Saudis' purchasing power. Making allowances for this, **inflation probably rose moderately for most Saudis last year**, with costs of furniture, restaurant meals, recreation and education showing the steepest growth (albeit mild in historical terms).

However, prices for basic items such as **food and clothing** have been held in check by stiff competition. Food is a fiercely contested battleground. Suppliers have had to deal with shrinking expatriate demand and a price-conscious Saudi consumer on the lookout for discounts, especially since the roll-out of VAT. Discretionary items, such as fruit juice have suffered, and even fresh milk has struggled as consumers switch to long-life. Suppliers of fresh dairy and produce have also been hit by higher feed costs. That said, the sector does now seem to be steadying thanks to some stabilisation of expat numbers over the past nine months (as judged from insurance data) and a 400,000 rebound in expatriate employment in 2019 (to Q3—official data). The biggest players in the food staples sector are now recording y-o-y revenue growth.

G-20 summit could provide decent tailwind for various sectors

A number of **consumer-facing segments** (hospitality, restaurants, transport, telecoms) should also get a boost from Riyadh's hosting of the G-20 summit in November. The importance lies in the 120 seminars and workshops that are set to take place in the country in the run-up to the summit. Jadwa Investment forecasts that the additional spending will add some 0.2 percentage points to nonoil private sector growth, with secondary effects through labour markets. There could also be significant positive medium-run effects if the G-20 helps to promote the Kingdom as a tourist/investment destination.

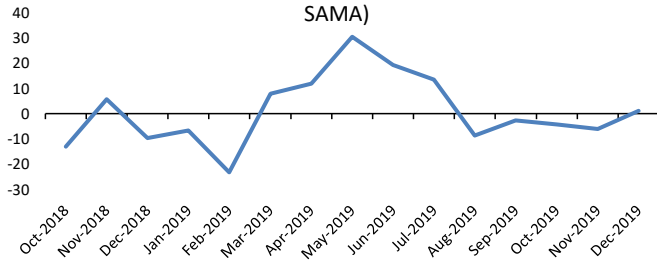
Of course, if the government were to follow through on its budgeted plans and freeze public sector remuneration this year, then the G-20 effect would be overshadowed by much softer household spending. But it is worth reiterating here that we anticipate a 4% gain in public sector remuneration this year, which should keep private consumption moderately buoyant.

Construction is well placed despite flat budgeted spending

What of **construction**? During 2015-18 this sector suffered more than most thanks to a "perfect storm" of slashed government investment, intensified Saudiisation, higher transport costs, and

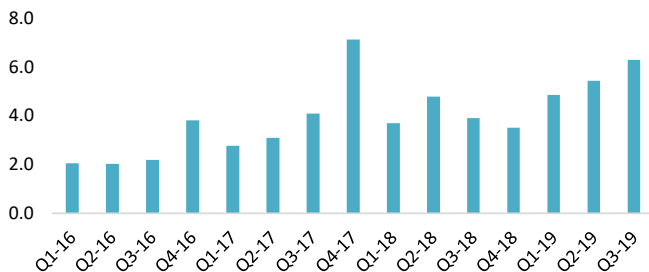
Saudi Arabia: Private Sector Imports of Building Materials

(new letters of credit, value, y-o-y, 3 mo rolling avg; SAMA)



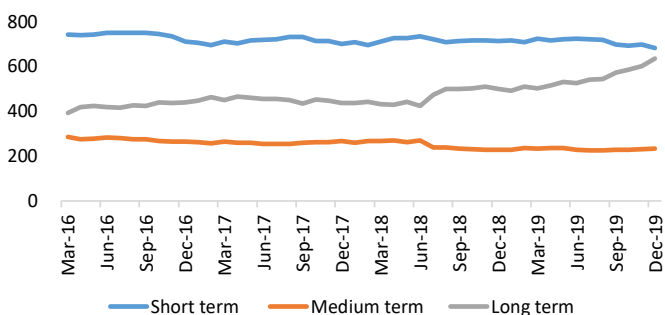
Saudi Arabia: Finance Sector Contribution to Real Nonoil GDP

(y-o-y percent change; GASTAT)



Saudi Arabia: Bank Credit Classified by Maturity

(SRbn; SAMA)



delayed payments. However, the inevitable shake-out has seen the sector come back stronger and it returned to growth in the first three quarters of 2019 (latest data). This was driven mainly by a 10% increase in central government investment over the period; thus, the fourth quarter construction data will make interesting reading given the 35% cut to y-o-y capital spending during this period.

Again, and despite the budget, we feel that central government capital spending will increase in 2020, based on the simple calculation that infrastructure needs are too pressing—there is likely to be a big push on **renewable energy**—and there is no real need from a fiscal point of view to cut it. We have pencilled in a 9% gain.

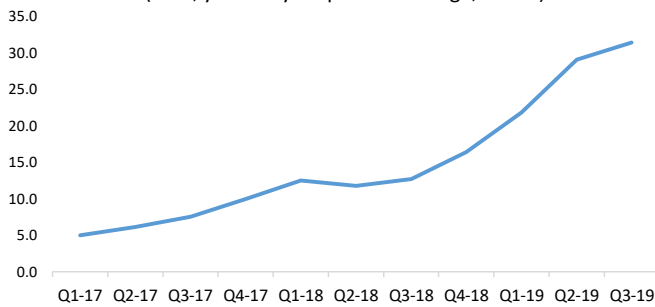
Construction will also benefit from the **PIF's activities**. Notwithstanding some high-profile foreign investments, the PIF is becoming more domestically-focused. It is somewhat difficult to quantify the PIF's domestic impact, but the IMF estimates that the PIF invested around SR32bn in the domestic economy from the beginning of 2018 to Q1-19. Its principal activities are the three tourist projects: Neom in the north-west corner of the country; the Red Sea Tourism development; and the Qiddiya entertainment complex near Riyadh. Ground has been broken on all three projects, with work on Qiddiya the most advanced. The PIF's capital base has been (or will be) augmented by funds from the partial privatisation of Saudi Aramco, and we expect the pace of project implementation to pick up this year. Potentially, the PIF could spend SR50bn this year, equivalent to 1.9% of GDP, though caution is required since much in the PIF's spending plans for 2017-20 has not yet come to pass.

Mortgage lending is spurring growth in financial sector

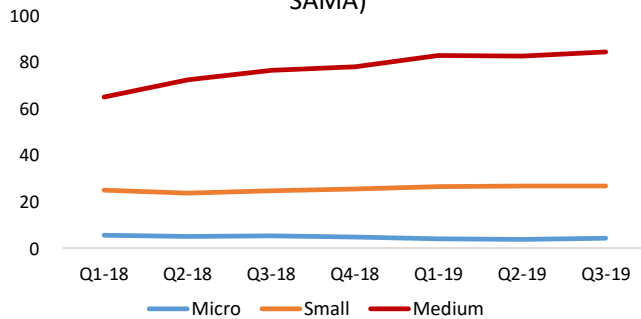
Finance is another important engine of the nonoil economy. The sector has enjoyed strong growth for a number of quarters now (5.5% y-o-y average in the first three quarters of 2019). Bank lending to the private sector has picked up (see above) and **banks have taken on more risk**: long-term lending as a proportion of overall lending rose to 41% in 2019, up from 35% a year earlier. Perhaps the most striking area of growth—and this partly explains the increase in duration—is in **mortgage lending**, where the number of residential mortgages more than quadrupled in the third quarter, y-o-y. While longer duration, mortgages are not that risky since they are partially underwritten by the authorities, collateralised, and based on significant pent-up demand.

The growth in housing should also galvanise the **insurance** sector, which has already benefitted from the gradual shift towards private health insurance. Growth in these areas has helped to offset persistent weakness in car insurance.

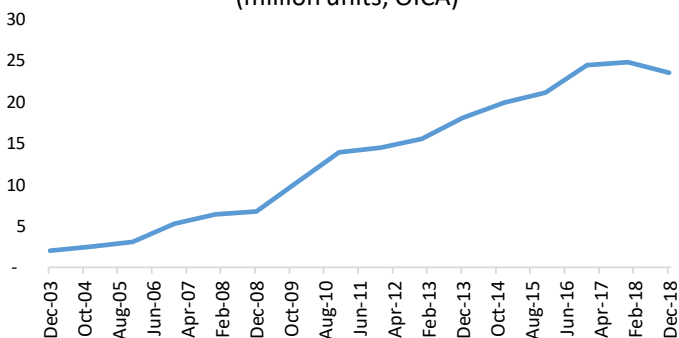
Saudi Arabia: Real Estate Retail Loans by Banks
(SRm, year-on-year percent change; SAMA)



Saudi Arabia: Lending to SMEs and Micro Firms
(banks and other finance companies, SRbn; SAMA)



China: Car Production
(million units; OICA)



Lending to **SMEs** has been on an upward track, growing by 8% during 2019. The proviso here is that this is off a low base, and indeed the data only run back to Q1-18. Unsurprisingly, most lending has been focused on the “medium” segment, which took 73% of credit from banks and other finance companies in Q3, up from 68% in Q1-18.

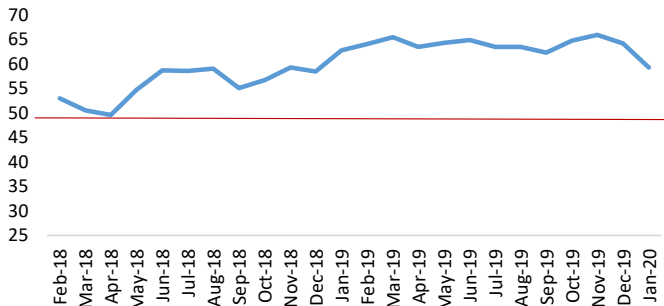
SME credit now accounts for 7.2% of total bank lending to the private sector, up from 6.5% in Q1-18. Although official data are not available, we understand that SME lending was just 2-3% of bank credit before the Vision 2030 programme was rolled out. Despite this robust increase, the authorities would clearly like to see this ratio rise further: SME lending accounts for some 17% of private credit in the Asia Pacific region, for example, an area that is increasingly defined by innovative and “disruptive” small firms. The Saudi authorities are offering SMEs considerable support, not least by underwriting bank loans through the Kafala programme, and we expect SME lending to increase its share of credit in the years ahead.

Procurement likely to struggle and petrochemicals outlook is subdued

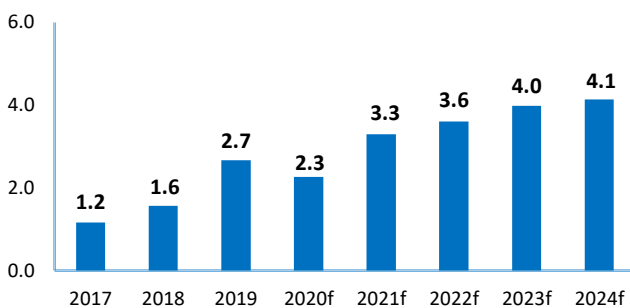
One area that seems set to struggle this year is **procurement**. We think that the authorities will stick very close to the budget in this area of spending, and the projected 15% decline in procurement spending is a sign of intent. Granted, some of this reduction will likely be due to efficiency savings, and the impact on gross value-added might be minimal. But in nominal terms, government suppliers are likely to find 2020 a tough year.

Petrochemicals also had a bruising 2019, suffering three straight quarters of y-o-y output declines. The sector is firmly plugged in to East Asian demand, and is in turn a bellwether for the global economy. As such, trade dislocations and investment caution have weighed heavily on the sector, which has also been dented by growing global concerns about plastic consumption. Yet petrochemicals should see **some uplift this year**, if only because trade tensions have eased. East Asian demand might also be supported by interest rate cuts in some of the region’s economies. That said, the outlook is not particularly positive: after a long period of growth, China’s car production fell in 2018 and all the signs are that this trend deepened in 2019. Electric vehicle sales have skyrocketed, but the base is extremely low and EV sales were worth only 700,000 at the end of 2018 (less than 3% of oil-fuelled car sales). China’s rapidly slowing population growth rate (just 0.6%) is an obvious problem for car sales, and hence plastics, as it is for many sectors.

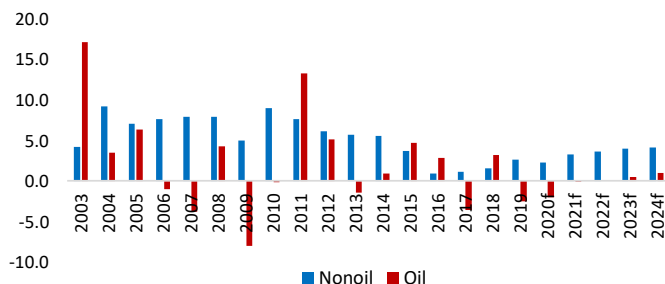
Saudi Arabia: PMI - New Orders
(50+ denotes growth; Markit)



Saudi Arabia: Real Nonoil GDP
(% change; GASTAT, Samba)



Saudi Arabia: Real GDP
(% change; GASTAT, Samba)



We think 2020 nonoil growth will be similar to last year

Taking a step back, **the outlook for 2020 appears moderately positive**. To be sure, the cuts to central government capital spending in Q4-19 are likely to feed through into Q1-20 activity; in fact, this is evident in the PMI for January, which showed the weakest rate of private sector growth for a year. The slowdown was heavily influenced by weakness in the “new orders” component, which squares with the tightening fiscal stance. Given the slump in oil prices, the tight stance could well stay in place for some weeks and Q1 could be a tough one for the Saudi private sector.

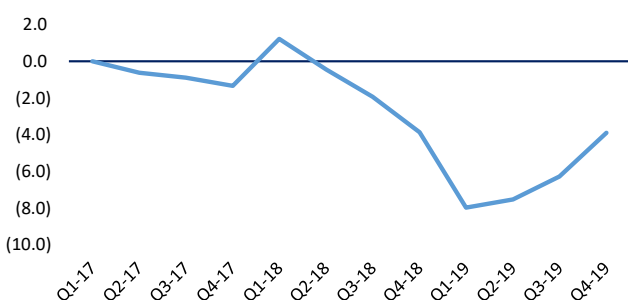
But as the year progresses the impact of PIF investment and G-20 activity should become more obvious. As noted above, we also expect some loosening of the central government’s fiscal stance. This should be enough to deliver **nonoil GDP growth of 2.3%**. This is slightly down on the official estimate of 2.7% for 2019, though we think this number is a bit on the high side given the Q4 spending cuts. Overall GDP growth will be held back by a further assumed cut to oil production this year, and we think that real GDP will grow by just **0.6%**, up from 0.4% in 2019 (a preliminary official estimate that again, we think is a bit generous).

Looking at the medium term, with government spending growth set to ease, much will depend on the PIF and its investment projects. Tourism appears to be potentially very fruitful given its labour-intensive nature, while logistics also offers considerable promise given Saudi Arabia’s Red Sea coast. The PIF can benefit from a general downturn in regional project costs, though projects will need to be carefully sequenced to avoid bottlenecks.

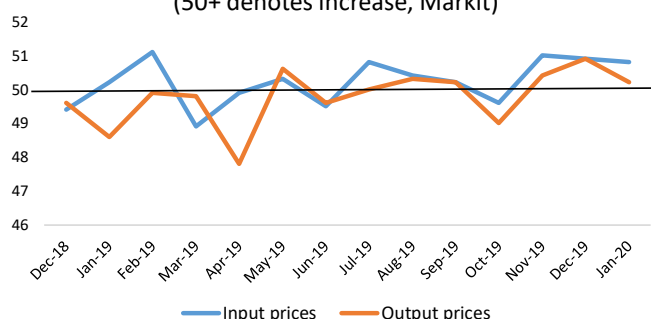
Longer-term growth depends on further improvements to business environment

But the PIF cannot transform the economy on its own. The Kingdom will also need **foreign direct investment**—the investment that brings technology, marketing know-how, access to supply chains, and of course capital. Here, the business-environment improvements that we noted above should be helpful, as would any long-term reduction in Gulf tensions. The G-20 summit should also help to showcase the Kingdom in the best possible light. Assuming the business environment continues to improve as we expect, and substantially more FDI is tempted in, then we would expect nonoil GDP growth to gather pace to 4% in the medium term. This is a slightly shallower trajectory than in our last report (August 2019) and reflects our forecast of somewhat weaker government spending growth than previously.

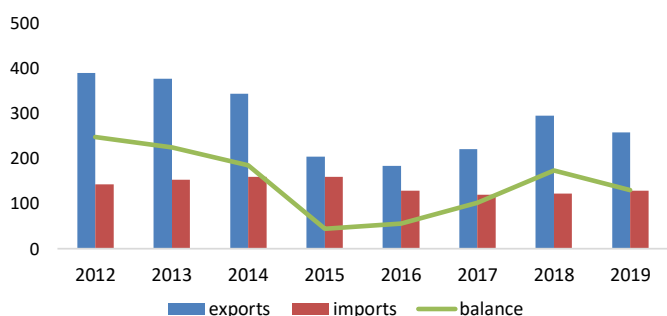
Saudi Arabia: Housing Inflation
(% change y-o-y, including utilities; SAMA)



Saudi Arabia: PMI - Input Prices vs Output Prices
(50+ denotes increase, Markit)



Saudi Arabia: Visible Trade
(\$ billion; SAMA)



Saudi Arabia: GDP

(percent change)	2019	2020f	2021f	2022f	2023f	2024f
Real GDP	0.4	0.6	2.0	2.3	2.7	3.0
Real Nonoil GDP	2.7	2.3	3.3	3.6	4.0	4.1

Sources: GASTAT, Ministry of Finance, Samba

Inflation returning but likely to stay moderate

We have touched on **inflationary dynamics** above, noting the varied price pressures within the CPI. The housing component is beginning to stabilise (on a month-on-month basis) and as it returns to growth so the overall CPI will be lifted. However, competition in food and clothing—which like housing, have heavy weights in the CPI—will remain fairly intense. The PMI shows that output prices for the entire nonoil sector have edged back into positive territory, but they continue to be outstripped by input prices which suggests that operating margins remain under pressure for many firms.

Indeed, we think firms will continue to absorb most cost increases in order to protect market share. Firms will also have to deal with a slightly weaker US dollar (in our view) which will add to input costs, though this will be more apparent in 2021. All in all, we expect inflation (as opposed to deflation) this year, but price pressures will remain mild by historical standards, at about **1.4%** for the average. There should be some uplift in inflation as the economy gathers pace in the years ahead, but a more efficient economy should also keep price growth subdued, and we do not expect inflation to get much above **2.5%**.

Saudi Arabia: Consumer Prices

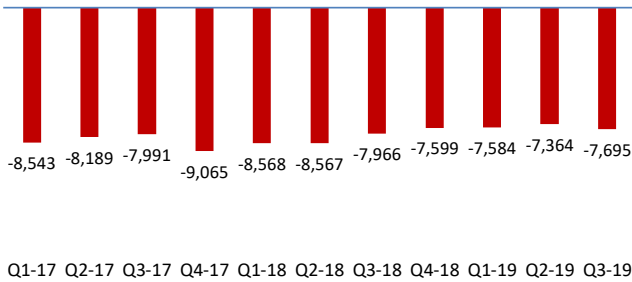
(percent change)	2019	2020f	2021f	2022f	2023f	2024f
General index (2007=100)	106.0	107.5	110.1	112.8	115.6	118.6
percent change	-1.2	1.4	2.4	2.5	2.5	2.6

Sources: General Authority for Statistics, Samba.

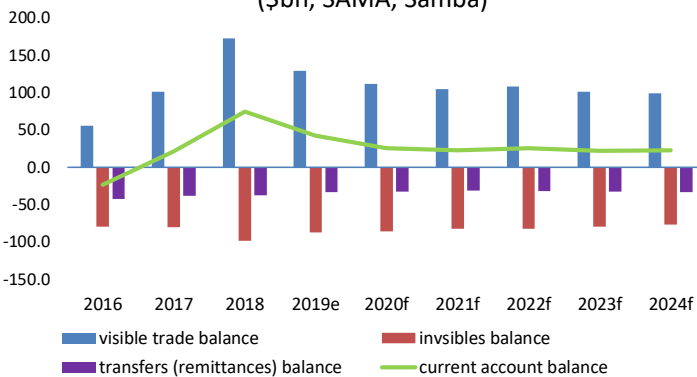
Current account surplus set to ease

Saudi Arabia's current account returned to surplus in 2017 and we expect it to stay there for the foreseeable future. The **trade surplus anchors the current account, the other elements of which run structural deficits**. The private sector's import spending is highly oil-price-elastic and reacts much more quickly to oil price shifts than the public sector (which can draw on reserves to fund spending). That said, since the government began recording fiscal deficits it too has become much more cost-conscious and efforts to rationalise both procurement and capital spending (both of which have heavy import components) are ongoing.

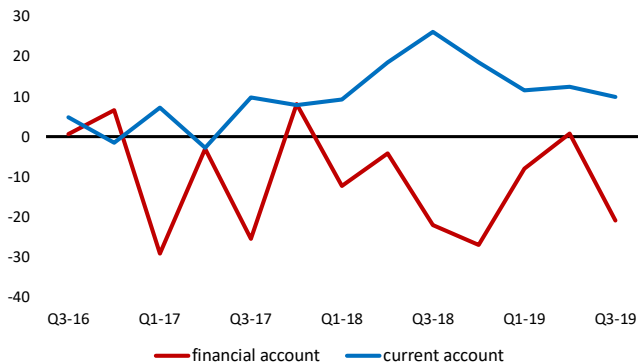
Saudi Arabia: Workers' Remittances Outflows
(\$m; SAMA)



Saudi Arabia: Current Account Outlook
(\$bn, SAMA, Samba)



Saudi Arabia: Current Account vs Financial Account
(\$bn; SAMA)



We estimate that import spending increased by 6% in 2019, though spending was still some 18% below the pre-oil price crash peaks. Exports will have been hit by both the decline in oil prices and production, and weaker petrochemicals demand. But even so, we estimate that the trade balance was comfortably in surplus at some \$130bn.

The biggest invisibles outflow is **workers' remittances**. We estimate that these eased to some \$30bn last year, a 7% decline. Remittances outflows have held up better than expected and there is growing evidence that foreign workers numbers are at least stabilising, if not increasing. The decline in remittances outflows provided a partial offset to the smaller trade surplus last year, but the current account surplus is still estimated to have fallen to **\$42bn or 5.7% of GDP**, from \$75bn or 9.5% of GDP.

Saudi Arabia: Current Account

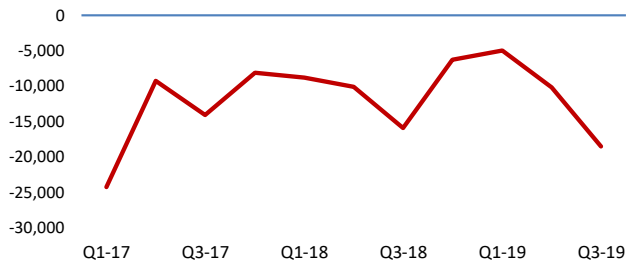
(\$ billion)	2019e	2020f	2021f	2022f	2023f	2024f
Trade balance	129.3	111.6	105.0	108.1	101.4	99.3
Exports	257.7	246.4	244.7	255.5	257.1	264.8
percent change	-12.3	-4.4	-0.7	4.4	0.6	3.0
of which,						
oil	200.3	187.3	183.2	191.0	187.3	188.1
nonoil	57.4	59.1	61.5	64.6	69.7	76.7
Imports	-128.5	-134.8	-139.7	-147.4	-155.6	-165.5
percent change	6.0	4.9	3.7	5.5	5.5	6.4
Invisibles balance	-86.8	-86.6	-84.4	-84.3	-81.6	-78.6
Services credit	19.2	21.7	24.9	29.2	35.0	42.0
Services debit	-77.9	-82.6	-86.5	-93.1	-100.2	-108.7
Services balance	-58.8	-60.9	-61.5	-63.9	-65.2	-66.7
Income credit	18.3	21.1	24.2	28.3	33.7	40.1
Income debit	-12.9	-13.6	-14.3	-15.0	-15.7	-16.5
Income balance	5.4	7.5	10.0	13.4	18.0	23.6
Transfers balance	-33.5	-33.1	-32.8	-33.8	-34.4	-35.5
of which,						
workers' remittances	-30.4	-30.1	-29.8	-30.7	-31.3	-32.3
Current account balance	42.4	25.1	20.6	23.8	19.8	20.7
percent GDP	5.7	3.5	2.8	3.1	2.6	2.6

Sources: SAMA, IMF, Samba

Export earnings likely to stabilise

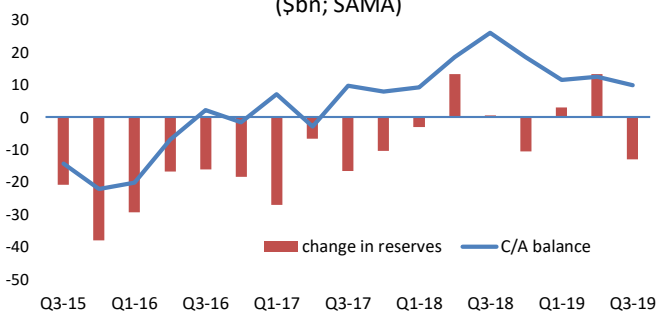
Import spending growth in 2020 is likely to be similar to 2019. A weaker pace of central government spending will have an impact, but this will be partially offset by enhanced general government spending (by the PIF and other SOEs) on capital inputs. Export earnings will be more or less unchanged with slightly lower oil export earnings balanced by a modest pickup in petrochemicals earnings—a trend that is likely to persist for the forecast period. Remittances outflows will be similar to last year, and we expect a current account surplus of around **\$25bn or some 3.5% of GDP**.

Saudi Arabia: Financial Account: "Other Investment" Net Outflows
(\$m; Sama)



Outflows on the financial account explain why net foreign asset accumulation has been slower than expected.

Saudi Arabia: Current Account Balance vs Reserve Assets
(\$bn; SAMA)



Financial account still showing substantial outflows

The financial account—from which we exclude reserve assets—is more **complicated and opaque**. In recent years, all three main channels—direct, portfolio, and “other” investment—have tended to be in deficit, although the portfolio channel has moved towards surplus recently thanks to equity and debt inflows. Over time, one would expect to see sovereign debt inflows diminish (in line with the narrowing fiscal deficit) but flows to corporates pick up as the Saudi private sector continues to develop.

Equity outflows have also been sizeable, but these should moderate as investment opportunities in the Kingdom expand and as the PIF spends more capital at home. The same trends are likely to develop on the direct investment channel, though the authorities will be hoping for much more sizeable inflows in the years ahead (they are unlikely to have exceeded \$5bn last year).

It is the “**other investment**” line that is the main area of concern on the financial account. Outflows have been volatile, but in some quarters very sizable—\$22bn in the third quarter of last year, for example (\$18bn on a net basis). The main channel for these outflows is “currency and deposits”, which tells us little about their origin or destination. One can surmise that a good part of them is likely to originate from SOEs, but clearly, there must be a sizeable private element as well.

Saudi Arabia: Balance of Payments

(\$ billion)	2019e	2020f	2021f	2022f	2023f	2024f
Current account balance	42.4	25.1	20.6	23.8	19.8	20.7
Direct investment	-7.7	-2.5	2.8	7.6	10.2	14.8
Abroad (net)	-12.7	-9.5	-7.2	-6.4	-5.8	-5.2
in KSA (net)	5.0	7.0	10.0	14.0	16.0	20.0
Portfolio investment	16.0	6.8	10.8	18.3	16.3	23.4
Abroad (net)	-18.0	-16.2	-14.6	-13.1	-11.8	-10.6
in KSA (net)*	34.0	23.0	25.4	31.5	28.1	34.0
Other investment	-39.0	-30.9	-36.1	-20.2	-14.9	-9.8
Abroad (net)	-49.0	-38.9	-40.1	-27.2	-23.9	-20.8
in KSA (net)	10.0	8.0	4.0	7.0	9.0	11.0
Financial account balance	-30.7	-26.7	-22.5	5.8	11.5	28.4
Net errors and omissions	-7.3	0.0	0.0	0.0	0.0	0.0
Overall balance	4.4	-1.6	-1.8	29.6	31.3	49.1
Change in reserves (- = increase)	-4.4	1.6	1.8	-29.6	-31.3	-49.1
Official NFA	494.0	492.4	490.6	520.2	551.5	600.6
percent GDP	65.9	68.8	67.2	68.7	71.4	75.2
import cover (months)	46.1	43.8	42.1	42.3	42.5	43.5

* includes sov debt inflows

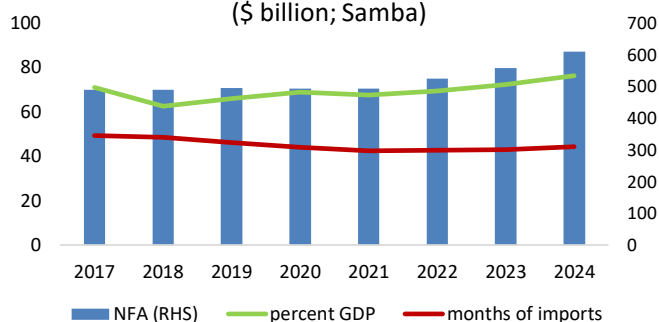
Sources: SAMA, IMF, Samba

These outflows do not imperil the balance of payments given current account surplus

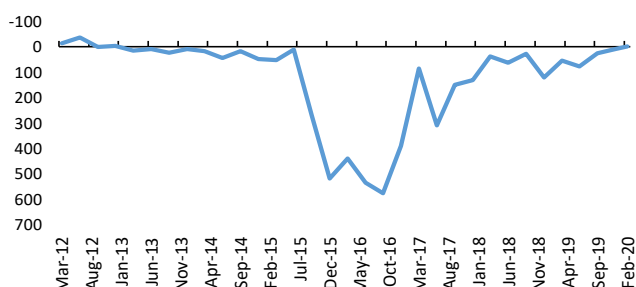
These outflows do not present a material challenge to Saudi Arabia’s balance of payments position given the size and likely stability of the current-account surplus. And some of these investments should generate inflows on the current account in

Public

Saudi Arabia: Official NFA
(\$ billion; Samba)



Saudi Arabia: SAR 12mo Forward vs USD
(points; Bloomberg)



due course. Yet outflows of this size do explain why net foreign assets have not grown as expected (the \$22bn Q3 outflow was the main reason for the \$13bn decline in reserve assets during the same period). The volatility of these flows makes them difficult to forecast. We still expect them to diminish over time, but they are likely to remain an issue for longer than we were expecting.

NFA to grow more slowly than we were anticipating

Overall, **we now see official NFA being accumulated at a slower rate than in our August 2019 report.** The current-account surplus is likely to be smaller, owing to weaker oil prices and production, and outflows through the financial account are also likely to be more durable than previously estimated. Yet the external position is still sound. Official net foreign asset edged up to around \$495bn in 2019, and should hold at this level in the next few years, before accelerating in the second part of the forecast period in line with enhanced equity and debt inflows, and more capital staying at home. FDI inflows should also play a bigger role. By 2024 official NFA should be around \$600bn or 75% of forecast GDP (a substantial 44 months of import cover).

The NFA outlook indicates that **we do not expect any serious or sustained pressures on the currency peg to materialise.** The current account is in surplus and the fiscal deficit is expected to narrow. This should be enough to forestall any further speculative action, which SAMA dealt with quite comfortably in 2015-16.

Saudi Arabia: Baseline Macroeconomic Forecast	2017	2018	2019	2020f	2021f	2022f	2023f	2024f
Nominal GDP (\$ bn)	689	782	750	716	730	757	773	799
GDP per capita (\$)	21,122	23,421	22,504	20,933	20,775	21,011	20,896	21,045
Real GDP (% change)	-0.7	2.4	0.4	0.6	2.0	2.3	2.7	3.0
Hydrocarbon GDP	-3.6	3.2	-2.5	-2.0	-0.1	0.0	0.5	1.0
Non-hydrocarbon GDP	1.2	1.6	2.7	2.3	3.3	3.6	4.0	4.1
Money supply, M3 (SR bn)	1805	1854	1985	2114	2262	2466	2687	2956
% change	0.3	2.7	7.1	6.5	7.0	9.0	9.0	10.0
Commercial bank loans to private sector (SR bn)	1339	1366	1478	1581	1743	1934	2109	2319
% change	0.1	2.0	8.2	7.0	10.2	11.0	9.0	10.0
3 month interbank rate (end year, percent)	1.9	3.0	2.3	2.3	1.8	1.7	1.9	2.6
CPI inflation (% change, average)	-0.8	2.5	-1.2	1.4	2.4	2.5	2.5	2.6
Hydrocarbon exports (\$ bn)	170.2	231.6	200.3	187.3	183.2	191.0	187.3	188.1
% change	25.0	36.1	-13.5	-6.5	-2.2	4.2	-1.9	0.4
Current account balance (\$ bn)	21.2	74.7	42.4	25.1	20.6	23.8	19.8	20.7
(% GDP)	3.1	9.5	5.7	3.5	2.8	3.1	2.6	2.6
Fiscal revenue (SR bn)	692.0	906.0	917.0	899.9	939.2	1016.0	1050.8	1100.8
(% change)	33.2	30.9	1.2	-1.9	4.4	8.2	3.4	4.8
Fiscal spending (SR bn)	927.0	1079.0	1048.0	1088.7	1128.6	1156.2	1184.8	1211.7
(% change)	11.7	16.4	-2.9	3.9	3.7	2.4	2.5	2.3
of which, capital	205.0	188.0	172.0	187.5	196.9	206.7	217.0	227.9
(% change)	53.0	-8.3	-8.5	9.0	5.0	5.0	5.0	5.0
current	722.0	875.0	876.0	901.3	931.7	949.5	967.8	983.8
(% change)	3.7	21.2	0.1	2.9	3.4	1.9	1.9	1.7
Fiscal balance (SR bn)	-235.0	-173.0	-131.0	-188.9	-189.4	-140.2	-133.9	-110.8
(% GDP)	-9.1	-5.9	-4.7	-7.0	-6.9	-4.9	-4.6	-3.7
Public sector gross deposits with banking system (SR bn)	737.7	681.0	676.1	580.2	494.9	434.0	380.7	342.7
(% GDP)	28.6	23.2	24.1	21.6	18.1	15.3	13.1	11.4
Other public sector domestic deposits (SR bn)	1147.0	1225.7	1306.8	1306.8	1306.8	1306.8	1306.8	1306.8
(% GDP)	44.4	41.8	46.5	48.7	47.7	46.0	45.1	43.6
Total public sector gross deposits with banking system (SR bn)	1884.7	1906.7	1982.9	1887.0	1801.7	1740.8	1687.5	1649.5
(% GDP)	73.0	65.0	70.5	70.3	65.8	61.3	58.2	55.1
Memoranda:								
Oil price (Brent; \$/barrel)	54	71	64	62	61	63	61	60
Crude oil production ('000 b/d)	9,968	10,318	9,907	9,598	9,588	9,588	9,636	9,732
SAMA's net Foreign Assets (\$ bn)	488.9	489.6	494.0	492.4	490.6	520.2	551.5	600.6
(% GDP)	71.0	62.6	65.9	68.8	67.2	68.7	71.4	75.2
Central government domestic debt (SR bn)	259.5	305.0	372.9	409.8	522.6	556.3	671.2	734.8
(% GDP)	10.0	10.4	13.3	15.3	19.1	19.6	23.2	24.5
Central government external debt (\$ bn)	49.0	68.0	78.0	89.0	98.4	111.9	117.9	129.9
(% GDP)	7.1	8.7	10.4	12.4	13.5	14.8	15.3	16.3

Sources: SAMA; Ministry of Finance; General Statistics Authority; IMF; Samba.

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