Saudi Arabia

Non-oil economic growth continued to be solid so far this year, led by the private sector (+5.9% y/y in 1H2022). Importantly, investment picked up strongly, auguring well for future growth as it indicates a solid expansion in production capacity. The positive momentum is expected to be sustained in the remainder of this year and in 2023, despite higher interest rates, lower oil prices, and some (likely easing) inflationary pressures. Despite an increase in budgeted spending and lower projected oil prices and production, we forecast another fiscal surplus next year. Lower-than-forecast non-oil growth, which could result for example from a weaker-than-expected resilience to a deteriorating global economic backdrop, is a main downside risk.

Robust non-oil sector to drive growth in 2023

Non-oil economic growth continued to be solid so far this year standing at 5% in 1H2022, following the 4.9% expansion in 2021. The private sector (+5.9% in H1) remained the main driver of growth, although the government sector's expansion picked up to 2.4% from 1.5% in 2021. Trade/restaurants/hotels witnessed the highest growth rate of 10.8% in H1, following a robust 8.7% expansion in 2021. Importantly, in terms of expenditure on GDP, gross fixed capital formation (i.e. investment) was by far the fastest growing, surging by 24% y/y in H1. This augurs well for future growth as it indicates a solid expansion in production capacity.

The positive momentum is expected to be sustained in the remainder of this year and in 2023, despite higher interest rates, lower oil prices, and some inflationary pressures. Consumer spending remains robust with the value of POS transactions up around 19% y/y through September. Credit growth remains solid at around 16% y/y as higher growth in corporate credit (+12% y/y) is compensating the softer expansion in mortgage lending. The latter, while beyond peak-growth, is still expanding at high rates of around 29% y/y through August. PMI levels are solid (latest at 56.6), with the new orders index at a strong 62.3. Given all that, we forecast the non-oil sector to finish 2022 with 4.7% growth, softening to 4% in 2023 on higher interest rates and a weaker global economic backdrop.

The ongoing reforms and effective policymaking remain key drivers of this favorable growth outlook. Recent reforms and strategic initiatives include the National Investment Strategy (targeting to push investment/GDP to 30% in 2030 from less than 24% in 2021), the Financial Technology Strategy, establishing a Saudi Investment Marketing Authority, and launching the new Companies Law. Meanwhile, given a 3% increase in the US federal funds rate since March, SAMA has hiked its policy rates by a similar 2.75% with further hikes expected given that US rates are seen rising by another 100-125 bps before year-end. Higher policy rates and a much faster expansion in credit than in deposits led to a surge in interbank rates, prompting SAMA to inject liquidity in the banking sector.

As for the oil sector, following the production surge this year, a low single-digit contraction is projected next year given the recent OPEC+ production cuts. We think it will be unsurprising if KSA continues to take a proactive and leading role, within OPEC+, in managing the global oil supply, including cutting or increasing production as need be. It is important to mention, especially given the oil market's potential tightness and OPEC's limited spare capacity, Aramco's plans to increase its sustainable capacity from its current 12 mb/d to 12.3 mb/d as early as 2025 and up to 13 mb/d by 2030. All in all, total GDP is expected to grow by a whopping 8.6% in 2022, falling to 2.1% next year, dragged down by the oil sector.

Inflation close to peak; unemployment continues to drop

Inflation continued to creep higher, standing at 3.1% y/y in September, but we project the peak will be reached later this year, and the average for the year will stand at 2.6%, before softening to 2.2% in 2023. Solid economic growth and steadfast Saudization initiatives continued to push the unemployment rate among Saudis lower, dropping to 9.7% in 2Q2022, down from a recent peak of 15.4% two years ago.

Budget surpluses are expected despite higher spending

The fiscal position improved sharply in 1H2022 on higher oil prices, increasing oil production, and despite higher-than-expected spending. Revenues increased by 43% y/y in 1H2022 as oil revenues soared 75%, while non-oil revenues grew by 5%. Expenditures increased by 10%, resulting in a fiscal surplus of 6.8% of GDP in 1H2022 compared with a deficit of 2.3% in 2021. Looking ahead, given still relatively-elevated oil prices, ongoing growth in non-oil revenues, and despite the recent increase in budgeted spending over the forecast horizon, we forecast fiscal surpluses, standing at 2.9% and 0.8% in 2022 and 2023, respectively. The Public Investment Fund continues to play a central role in the economic diversification drive, by investing in promising sectors and companies, and whereby its investments can be seen as complementary to the government's fiscal expenditures. Surpluses are expected to be mostly used to beef up government deposits at SAMA rather than reduce debt levels, and accordingly we forecast the debt/GDP ratio to stabilize at around 24%, down from 30% in 2021.

The current account continued to expand (16% of GDP in H1) on higher oil prices, and we forecast it will remain comfortably in surplus over the forecast horizon. Lower-than-forecast non-oil growth, which could result from a weaker-than-expected resilience to a deteriorating global economic backdrop, is a main downside risk. In contrast, higher-than-forecast oil production, due to, for example, a partial reversal of the recent aggressive OPEC+ production cuts is an upside risk. Moreover, higher-than-projected oil prices (our house view is that Brent will average $90 in 2023) is another upside risk to our forecasts.

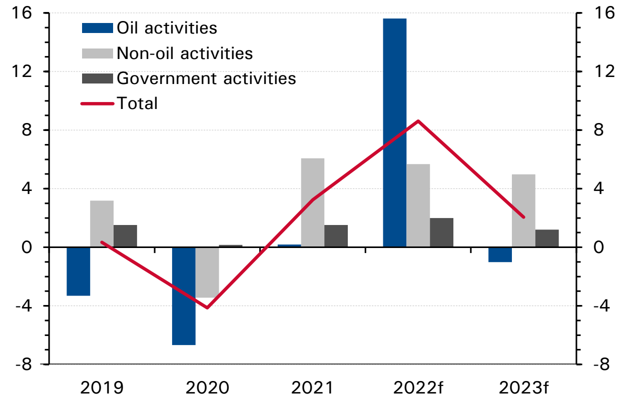
Table 1: Key economic indicators

		2020	2021	2022f	2023f
Nominal GDP	($ bn)	703	834	1,032	1,028
Real GDP	(% y/y)	-4.1	3.2	8.6	2.1
- Oil	(% y/y)	-6.7	0.2	15.6	-1.0
- Non-oil	(% y/y)	-2.5	4.9	4.7	4.0
Inflation (average)	(% y/y)	3.4	3.1	2.6	2.2
Fiscal balance	(% of GDP)	-11.1	-2.3	2.9	0.8
Government debt	(% of GDP)	32.4	30.0	24.2	24.3
Current account	(% of GDP)	-3.2	5.3	16.5	13.6

Source: National authorities, NBK forecasts

Chart 1: Real GDP

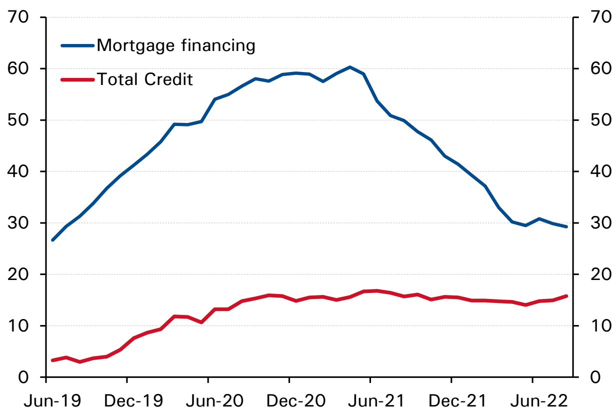
(% y/y)



Source: General Authority for Statistics (GASTAT), NBK forecasts

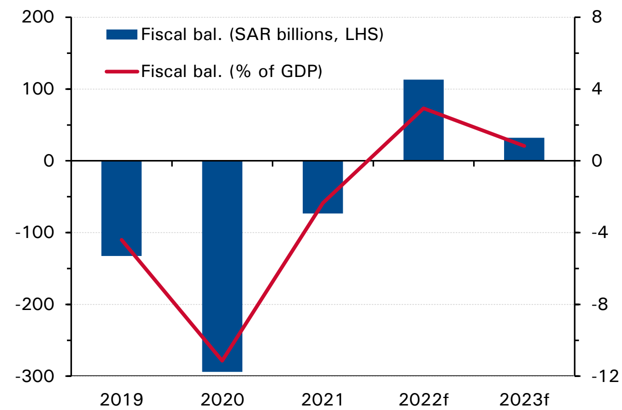
Chart 2: Credit growth

(% y/y)



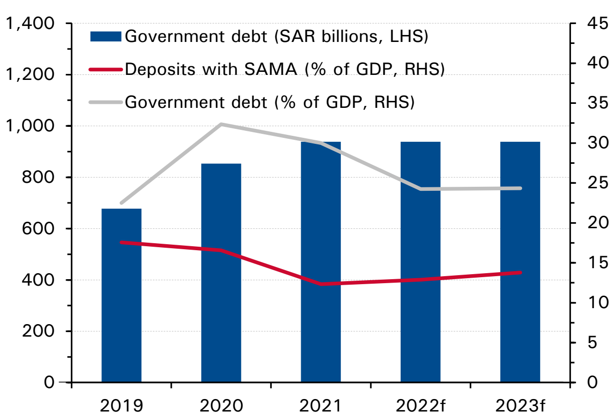
Source: SAMA

Chart 3: Fiscal balance



Source: Ministry of Finance, NBK forecasts

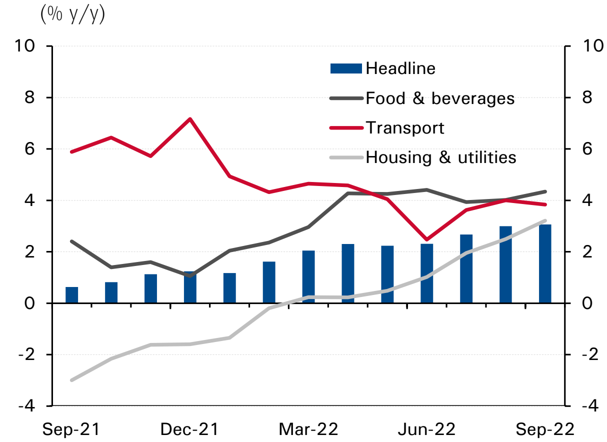
Chart 4: Government debt and deposits with SAMA



Source: GASTAT, Ministry of Finance, SAMA, NBK forecasts

Chart 5: CPI inflation

(% y/y)



Source: GASTAT