جدوى للإستثمار
Jadwa Investment

February 2024

The Saudi Economy in 2024-25

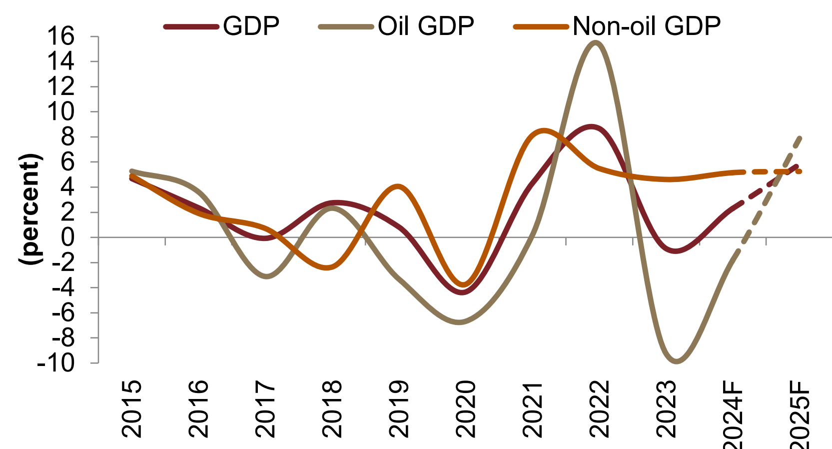
- Saudi Arabia's non-oil economy continues to expand at a brisk pace. The authorities' preliminary estimate puts non-oil GDP growth at 4.6 percent in 2023 and we see an acceleration to 5 percent-plus in the next two years. Growth will be driven by both consumption and investment, with net exports a drag—at least this year. Consumer price inflation should remain contained, though project cost overruns are likely.

- Higher project costs reflect a tight market for labor and materials. The disruption to Red Sea shipping is an added headwind, with reports that costs for key construction inputs in the Saudi market are up by 25-50 percent in recent weeks. A material reduction in Red Sea turmoil will likely require intensified pressure on Iran, both from the US and China. That said, even if Red Sea shipping returns to normal in the near term, cost overruns are still likely given the sheer number of projects under construction.

- The Saudi authorities are likely to keep oil production in check in the face of a weak demand outlook. The US economy has shown remarkable resilience, but the Eurozone now appears to be in recession and China's economy is struggling. A number of large Emerging Markets are also feeling the pressure of high interest rates. Non-OPEC supply is set to increase, even though we see the rate of US output growth slowing. For these reasons, Saud Arabia is likely to roll over last year's cuts to the end of Q3-24. By then the US Fed should be in rate-cutting mode, which should give a boost to economic activity and the price of risk assets, such as commodities.

- This conservative approach should be enough to see Brent average $81 per barrel (pb) in 2024, with Saudi Arabia's main export blend continuing to trade at a $2-$3 pb premium over the benchmark. Global economic activity should gather pace in 2025 as rate cuts continue, and with US output growth slowing Brent should average $86 pb.

Figure 1: Change in Real GDP



For comments and queries please contact:

James Reeve
Chief Economist
jreeve@jadwa.com

Nouf N. Alsharif
Managing Director, Research
nalsharif@jadwa.com

Head office:

Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

Jadwa Investment is licensed by the Capital Market Authority to conduct Securities Businesses, license number 6034-37.

View Jadwa Investment's research archive and sign up to receive future publications:
http://www.jadwa.com

Released: February-26-2024, 17:00 UTC+3

Global Economic Outlook

Last year's global growth performance turned out to be pretty weak. At 2.7 percent, GDP growth was significantly below the 3.4 percent recorded in 2022, as well as the pre-pandemic ten-year average of 3.2 percent.

Global GDP growth was weak last year, though not for the reasons many expected. The US outperformed expectations while China disappointed.

Yet the reasons for the downturn were not the ones that many had identified at the start of the year. The US, which was most people's favorite to tip into recession, showed remarkable resilience with a vibrant labor market apparently impervious to the impact of higher interest rates—a dynamic that has continued into 2024. Many firms, recalling how difficult it was to attract and retain labor in 2021-22, decided to hang on to workers even as orders fell. This approach allowed the country to record growth of 2.5 percent, according to the IMF. Meanwhile, China—which many had identified as the likely engine of global growth—disappointed, with a hesitant consumer unwilling to spend in the face of serious strains in the property sector. The country grew by 5.2 percent according to the authorities, but this did not constitute the big bounce-back from Covid lockdowns that many had been counting on (Table 1; Figure 2).

The Eurozone is struggling, with Germany under particular pressure.

A number of large EMs are also feeling the strain of high interest rates.

Meanwhile, the Eurozone could only manage 0.5 percent growth according to the Fund, as a widespread cost-of-living crisis weighed heavily on consumption, particularly of goods. Southern European countries did better than expected, thanks largely to increased tourism inflows. Germany suffered more than most as higher energy costs hit industrial production and exports to China faltered. Emerging Markets also struggled, with political uncertainty and high interest rates pressurizing growth in large EMs such as Brazil, South Africa, Turkey and Poland. The main exception was India which is rapidly replacing China as the engine of EM growth (the IMF puts India's 2023 growth at 6.7 percent).

In the US, inflation is now rapidly easing and traders are positioning themselves for interest rate cuts by the Fed.

Much of the pain of last year was caused by high interest rates. The US Federal Reserve raised its policy rate by a cumulative 100 basis points to 5.5 percent in a bid to pull inflation back towards its 2 percent target. There are different measures of inflation in play, but price pressures are clearly moderating and the Fed can take some satisfaction from that. Whether a "soft landing" can be engineered, whereby growth slows but does not go into reverse, is still a matter of debate, but it seems more likely than not.

We expect rate cuts to begin in June. We see 100 basis points this year and a further 100 bps in 2025. SAMA is expected to follow in lockstep, meaning that the Reverse Repo will end 2025 at 3.5 percent.

Still, a slowdown is inevitable and many traders are already positioning themselves for the Fed to reverse course and begin cutting rates again. The current consensus is May, though we think June is more likely (Figure 3). From there we expect 100 basis points of cuts, and a further 100 bps in 2025, leaving the upper bound of the Fed Funds Target Rate at 3.5 percent. SAMA will follow in lockstep, meaning that the Reverse Repo will end next year also at 3.5 percent.

These rate cuts should change the economic mood quite markedly in 2024. One positive of high rates is that there is plenty to cut, and when this process starts it should provide a spur to both consumption and investment, while also lifting risk assets (including oil). Rate cuts also seem likely in the Eurozone, probably before June, while China is also set to provide some (fiscal) stimulus to its sluggish economy. The global GDP growth outlook will clearly be influenced by whether the US can avoid a recession. Assuming it does, and the Fed cuts from June, then growth should come in at around 3 percent, with a relatively vigorous performance in H2. For

The US is now more likely than not to avoid a recession. Assuming it does, then global growth should come in at around 3 percent this year, with most of the acceleration in H2.

Risks center on the impact of Red Sea disruption, a possible US recession, and a large number of elections.

2025, we see a further acceleration to 3.4 percent (above consensus).

There are a number of clear risks. It is possible, though not yet probable, that the lawlessness in the Red Sea will have a material impact on inflation. We think the impact will be contained because other shipping lanes are unclogged (unlike in 2022) and although goods might take longer to reach their destination, the chances of a major rupture to supply chains seem low (Box 1). For the US, the path to interest rate cuts could be bumpy: even now the labor market remains the tightest in history, and producer prices have recently accelerated. That might well give the Fed further pause, possibly delaying rate cuts until well into H2. Meanwhile, political risk remains elevated, with a large number of elections scheduled for the year, and areas of military conflict (potential and actual) apparently multiplying. Even a dramatic cut in interest rates might not be enough to shift this cloud of tension and uncertainty.

Table 1: Global GDP Growth
(percent; IMF and consensus projections)

	2022	2023E		2024F		2025F	
	IMF	IMF	Con-sensus	IMF	Con-sensus	IMF	Con-sensus
Global	3.5	3.1	2.9	3.1	2.5	3.2	2.8
US	1.9	2.5	2.5	2.1	1.4	1.7	1.6
UK	4.3	0.5	0.4	0.6	0.4	1.6	1.2
Canada	3.8	1.1	1.1	1.4	0.5	2.3	1.8
Euro zone	3.4	0.5	0.5	0.9	0.6	1.7	1.4
Japan	1.0	1.9	1.8	0.9	0.9	0.8	1.0
China	3.0	5.2	5.2	4.6	4.6	4.1	4.3
Russia	-1.2	3.0	2.6	2.6	1.4	1.1	1.1
Brazil	3.0	3.1	2.9	1.7	1.5	1.9	2.0
India	7.2	6.7	6.7	6.5	6.3	6.5	6.4

Note: Consensus forecasts are those of FocusEconomics.

Figure 2: Global Economic Growth Outlook

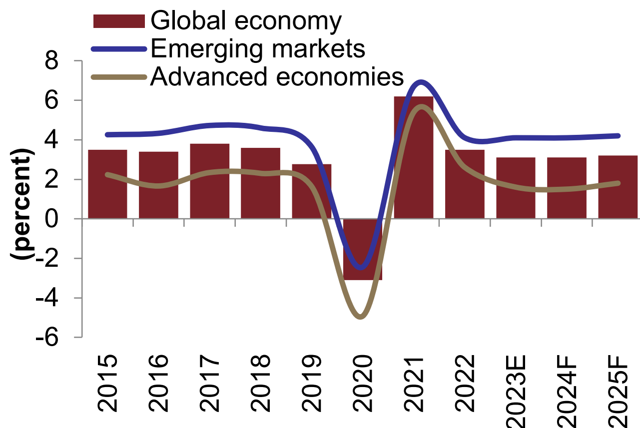
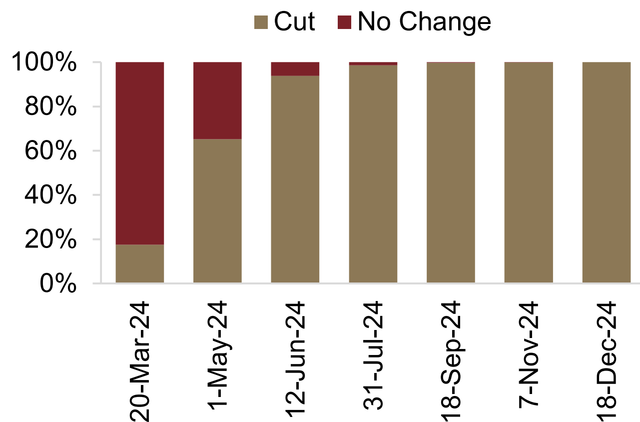


Figure 3: US Interest Rate Probability Survey



Oil Market Outlook

Oil traders might be right to discount the impact of Red Sea turmoil on oil supply, but they could be under-estimating OPEC Plus.

What does this growth outlook mean for oil prices? Traders have been largely unmoved by the attacks on Red Sea shipping (Box 1) with many calculating that re-routing of crude does not mean lost crude.

This attitude makes sense, but traders also seem blasé about the potential impact of the 1.2 million barrels a day (bpd) in OPEC Plus production cuts announced in November last year. Skepticism is understandable given the historical unwillingness of smaller producers in particular to fulfill their pledges, but even if only half of these cuts come to pass this would still mean a material tightening of balances. The level of compliance emerge in the coming weeks as production figures are released, though early data from Bloomberg point to strong discipline from OPEC members in January (Figure 5).

Box 1: The Economic Impact of Red Sea Turmoil

The Red Sea attacks have caused major disruption to international shipping. However, the impact on inflation has so far been muted.

Three months of missile and drone attacks on container traffic in the Red Sea have had a pronounced effect on shipping routes, but so far little impact on global inflation or oil prices. Might this change?

The attacks by Yemen's Houthis have led many shipping firms to re-route traffic around the Cape of Good Hope rather than risk the Red Sea and Suez Canal, a route that used to account for 12 percent of the world's seaborne trade. The re-routing is adding an average of four weeks to trips from East Asia to Europe and back. Inevitably, this has pushed up shipping costs, be they man-hours, fuel costs or insurance, with overall freight costs up by almost 30 percent, year-on-year, in January (Figure 4).

For the moment, these higher costs have not shown up in retail prices, but some large European retailers, such as supermarkets, are warning that they could well do. The ECB President has cited the return of "supply bottlenecks" as a key risk to the path of European interest rates. Yet unlike in 2021-22, when global supply chains snarled up and inflation surged, this time around there is no accompanying surge in demand. If anything, global activity is cooling and therefore the impact on wholesale and retail prices is likely to be modest. That said, there have been reports of higher input costs for

Figure 4: The cost of global container freight has surged

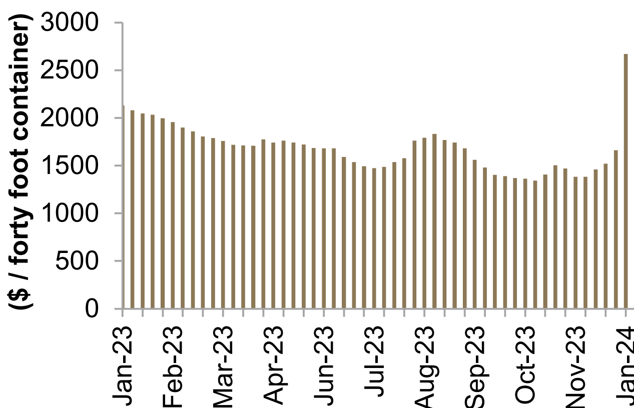
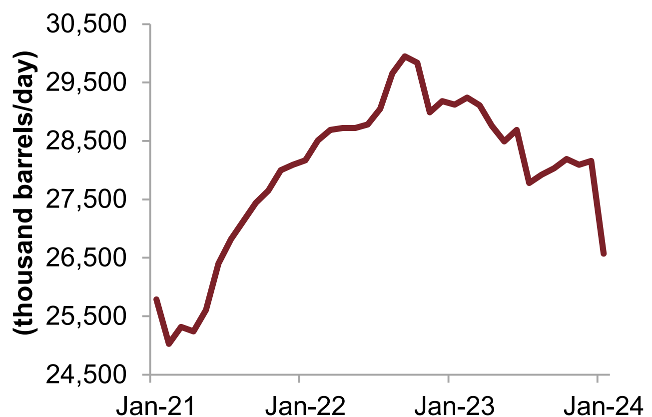


Figure 5: OPEC Production



Saudi construction firms stemming from the shipping disruption. Increases in key input costs are in the region of 25-50 percent.

What about oil prices? So far, there has been little impact. Gulf crude bound for East Asia is untroubled, while Gulf oil heading for the US already goes around the Cape of Good Hope. Europe is experiencing the most fallout, with a marked shortage of diesel. Still, over time, this should be ameliorated by additional US imports.

Oil prices have been largely unmoved by the turmoil. A sustained surge in prices would probably require a disruption in the Strait of Hormuz, which seems very unlikely.

Oil prices would naturally get a sustained upward jolt if there was an escalation in hostilities. Already the Gaza crisis has drawn in a number of proxies, but now state actors such as the US, Israel, Iran, Iraq, and Pakistan are exchanging (limited) blows. Still, it would probably take a disruption in the Strait of Hormuz to push oil prices significantly higher. This still seems very unlikely.

An end to the Houthis' activities probably lies through intensified pressure on Iran. This could take the form of stepped-up covert operations by the US, or more straightforward diplomacy from China, where exporters are feeling the squeeze of delays to their European shipments.

Non-OPEC countries are set to drive supply additions, though we see US output growth slowing this year and next.

However, OPEC Plus is only a part of the supply story, and a decreasing one at that. According to the International Energy Agency (IEA) almost all of the additional 1.5 mbpd of supply that it forecasts this year is set to come from non-OPEC countries, most notably the US, Brazil, Canada, and Guyana. Here, it is the US which is key (it is already the world's biggest oil producer). We think US output growth will slow to around half last year's gain, with recent consolidation in the shale sector offering better margins, but not more output, especially as much of the best shale acreage has been exploited. In addition, a number of independent producers have struggled for finance in the face of high interest rates. The recent blast of cold weather in North America is also likely to impact oil operations. Yet the ingenuity of US shale drillers should not be discounted and a further surge in US output remains a risk to oil prices.

OPEC Plus output is unlikely to see meaningful growth before Q3-24.

As for OPEC Plus supply, the weak demand backdrop (see below) suggests that the group will extend its cuts at least until end-Q3. By then, risk assets such as commodities should be buoyed by interest rate cuts and OPEC Plus will begin to unwind its quotas, albeit gradually.

The demand outlook is weak, at least for H1-24.

China's oil demand might surprise on the upside, but European demand will remain soft.

What of demand? OPEC expects 1.8 mbpd in growth this year, but this seems overly optimistic. This is some way above the pre-Covid 10-year average of 1.3 mbpd, and it is difficult to see where the additional demand boost will come from, at least in the first half of the year. The US might avoid a recession, but it is unlikely that its oil demand will actually accelerate. China's oil demand is likely to be better than many expect: despite its travails, property construction is still expanding following the 2021 boom in off-plan sales. Transport and logistics is also growing briskly. Yet confidence is low, and much will depend on how much fiscal stimulus the government chooses to deploy.

Europe is displaying strong demand for certain oil products, but economic weakness will weigh on overall crude demand there. After all, Germany is the world's sixth biggest oil importer and it is in

Japan and some East Asian EMs should provide support to demand growth. India should too, though the explosive growth of last year is likely to cool.

recession. Even India is likely to see some softening in oil product demand in 2024 following explosive growth in 2023. More positively, Japan's economy is accelerating and there should also be decent demand from a clutch of fast-growing East Asian EMs, particularly if the USD weakens (as expected) in H2. Saudi Arabia, too, should see a rebound in demand given strong projected growth in both construction and transport (see below).

Even if OPEC supply discipline is better than expected, it is still difficult to be positive about oil prices this year. We expect Brent to slide to an average of $81 pb in 2024.

Overall, however, the demand outlook is uninspiring and much will therefore hinge on OPEC Plus discipline and US shale supply. As indicated above, we see OPEC commitment surprising on the upside, though this also reflects beaten-down expectations. The first quarter is traditionally a time of refinery maintenance and thus stock builds, so the impact of OPEC Plus cuts might not become fully apparent until Q2. H2 should see stocks come down more decisively as demand gets a lift from interest rate cuts.

The outlook for 2025 is better. Lower interest rates should boost economic activity and reduced shale output growth will also support prices. We see Brent averaging $86 pb next year.

Notwithstanding the better H2 outlook, we have decided to reduce our oil price forecast for the year. We now see Brent averaging $81 pb in 2024, a significant downward shift from our previous forecast. The outlook for 2025 is somewhat better given the continuation of interest rate cuts, though the impact will be offset to some extent by an expected relaxation of OPEC Plus quotas. These trends should see Brent average $86 pb next year. Note that Arab Light, which is Saudi Arabia's main export blend, should continue to enjoy a $2-$3 pb premium over Brent given strong middle distillate demand, especially from East Asia.

Risks are skewed to the downside and center on the US.

Risks are tilted to the downside and center on larger-than-expected non-OPEC supply. A US recession, which would have a severe impact on global oil demand, also cannot be ruled out. As noted in Box 1, upside risk stems from any escalation of Red Sea terrorism or broader conflict in the Middle East (as unwelcome as that would be for virtually every other metric), while meaningful and prolonged fiscal stimulus in China would also help lift oil demand.

Saudi Economic Performance

Saudi GDP contracted by 0.9 percent last year, the first fall since 2020. This was due almost entirely to a further fall in oil output.

The Saudi economy contracted last year for the first time since 2020. Output fell by 0.9 percent according to the authorities' provisional ("flash") estimate, with cuts to oil production explaining almost all of this. According to the estimate, "Oil Activities" fell by 9.2 percent in 2023, more than offsetting the impact of a 4.6 percent gain from the non-oil sector. These oil supply cuts were the mirror image of 2022 when a large increase in liquids supply drove an 8.7 percent surge in overall GDP.

Non-oil activity remains vibrant. It expanded by 4.6 percent in 2023 and has averaged 6 percent in the past three years.

What this volatility misses is the underlying strength of non-oil GDP growth, which has averaged 6 percent over the past three years. Non-oil GDP now accounts for almost 60 percent of real GDP, up from 55 percent five years ago. It is more broad-based than in 2018, with sectors such as Tourism, Hospitality, Retail, Non-Oil Mining, and Energy all developing rapidly. Whereas five years ago non-oil activity was largely a function of central government spending, today the Public Investment Fund (PIF), National Development Fund (NDF) and private investors are all deeply involved in the Vision 2030 push.

Investment is currently very important to the growth story, but the non-oil economy is actually shifting towards consumption.

There has also been a shift in GDP by expenditure. In 2018 private consumption accounted for less than a third of real GDP; in 2023 it contributed 40 percent (Figure 6). This reflects both population growth (roughly 2 percent a year for nationals) and the entry of women into the workforce. Female labor force participation is now around 36 percent, which is well ahead of target, but still provides plenty of room to grow (the average for OECD countries is 55 percent). The transition towards a more consumption-based economy would have been more distinct had it not been for the surge in investment related to the Vision 2030 agenda. Investment has grown by an annual average of 7.2 percent since 2018 (and that includes the "Covid years" when investment sagged).

This can be seen in the strong performance of Domestic Trade.

The driver of growth last year was Domestic Trade (encompassing Retail, Wholesale and Hospitality). The importance of this sector has been clear for some years now. In real terms, it has grown by an annual average of around 5 percent over the past five years (albeit with Covid-related volatility). The sector will continue to benefit from female labor force entry, rising tourist numbers, and higher wages, while personal unsecured debt is just 12 percent of GDP. Associated sectors such as Transport, and Electricity should be pulled along by this engine.

Construction has naturally benefitted from the "giga-projects" surge. It should get a further boost as mortgage rates begin to ease in H2.

Construction is another obvious support to the non-oil growth outlook, given the giga-project rollout and associated developments such as Expo and the football World Cup. The main drag here is the scarcity of inputs, such as building materials and manpower, with the January PMI registering a sharp increase in costs for all non-oil firms (Figure 7). Some of this relates to Red Sea disruption, and some to the sheer number of projects under way. Assuming these shortages can be alleviated (through higher wages and a loosening of labor regulations for example) then Construction should get a further boost from a revival of mortgage demand in H2 once the US begins to cut interest rates.

Oil GDP is set for a further year of contraction.

Oil GDP is set for another fall. We now think that the Kingdom's oil production cuts from last year—totaling 1.5 mbpd—will be rolled over until the end of Q3 this year, meaning that annual output is likely to contract by 1.8 percent (see below).

Taken together, we expect real GDP growth to rebound to 2.3 percent this year, following last year's 0.9 percent contraction, with

Figure 6: Real GDP by Expenditure
(percent share)

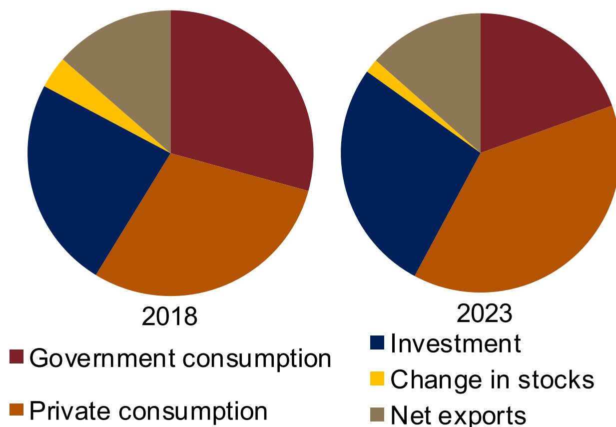
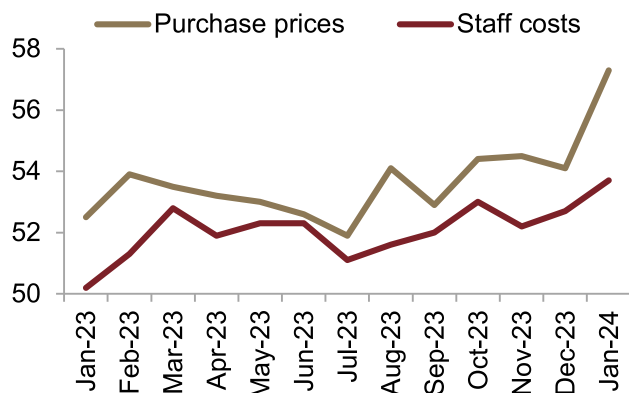


Figure 7: PMI Input Costs
(>50=month-on-month expansion)



An expanding non-oil sector and contracting hydrocarbons sector adds up to 2.3 percent real GDP growth this year. An acceleration to 5.8 percent is in prospect for 2025.

Risks to growth center on rising costs.

the fall in oil GDP more than outweighed by a 5.1 percent gain in non -oil GDP. Non-oil dynamics are unlikely to change much in 2025 and we expect a 5.2 percent gain. With oil GDP bouncing back by almost 8 percent, this should see overall GDP accelerate by almost 6 percent. The main risk to the outlook is increased costs. It is telling that the January PMI flagged not just rising input costs, but also a slowdown in growth momentum across the non-oil economy.

Table 2: Real GDP Shares and Growth Rates

2023		2021	2022	2023	2024F
% Share of:		% year-on-year			
Overall GDP		**4.3**	**8.7**	**-0.9**	**2.3**
Oil sector	**37**	0.2	15.4	-9.2	-1.8
Non-oil activities	**47**	8.1	5.5	4.6	5.1
Govt. activities	**13**	1.1	4.6	2.1	2.3
Non-oil GDP by sector	**100**	% year-on-year			
Agriculture	6.0	2.5	4.0	3.7	3.2
Non-oil mining	0.8	-1.9	6.5	6.0	5.0
Non-oil manufacturing	18.1	5.1	8.0	0.5	2.1
Electricity, gas and water	2.6	4.0	1.4	3.6	3.0
Construction	9.2	1.2	8.7	3.9	5.5
Wholesale & retail trade	21.8	16.3	5.7	6.9	8.0
Transport & communication	11.8	3.5	1.9	7.7	6.4
Real estate activities	11.2	5.6	1.3	1.2	3.6
Finance, insurance, & bus.	11.2	11.7	11.2	5.2	4.5
Community & social services	7.3	18.9	2.8	12.6	7.1

Note: Non-oil GDP by sector for 2023 (growth and shares) is the year-to-Q3 2023 average. Overall GDP in 2023 also includes net taxes.

Hydrocarbons sector

The hydrocarbons sector has contracted for four of the past five years.

It has been a tough few years for the hydrocarbons sector in terms of its contribution to GDP growth. Oil production fell in four of the past five years as the Kingdom adjusted output to match generally weak demand and brisk non-OPEC output. And, as noted above, oil production is expected to fall by a further 1.8 percent in 2024 before rebounding in 2025. Oil GDP is not all about crude production: there has been some offset from gas activities and refining. Thus, “Oil Activities” GDP saw a marginal increase in 2021 despite a fall in crude output, for example.

Policy-mandated crude production cuts are the main reason, though there has been no offset from oil refining given logistical difficulties in supplying Europe, Saudi Arabia’s main products market.

A large amount of the Kingdom’s refined products head to Europe, where diesel is in extremely short supply (again). Saudi Arabia could theoretically meet some of this demand by shipping from its west coast (out of the reach of Houthi activity) and through the Suez canal. However, disruptions are such that there appear to be shortages of appropriate tankers. This might be resolved in the next few months, but for the moment we are assuming flat refining output this year.

Gas development has more potential given its importance as a “bridge” in the energy transition and a key feedstock for various industrial projects. The discovery of two new fields in the Empty Quarter in November last year is important because they are “non-associated” with oil, meaning that the gas can be produced without heed to OPEC Plus quotas. These finds come on top of the development of Jafurah, the Kingdom’s biggest unconventional non-associated gas field.

In the medium-term, gas development could actually become the engine of hydrocarbons expansion.

In fact, gas is now looking like the most likely medium-term growth engine of the hydrocarbons complex given the recent announcement by Aramco that it will be ceasing its efforts to boost sustainable oil production capacity to 13 mbpd. Aramco is expected to provide an update on its capital expenditure plans when it announces its 2023 full-year results in March, but analysts are penciling in a $5 billion cut to Aramco's oil capex this year.

The hydrocarbons sector should return to growth in 2025.

The intention is to use some of this capital to help the power sector move away from oil and towards gas feedstock. Yet it will take some time to wind down the oil program and make the transition. Given this, and the difficulties in supplying Europe, hydrocarbons GDP seems likely to slip by around 1.8 percent in 2024, before regaining upward momentum in 2025 when we expect it to grow by almost 8 percent.

Domestic Trade had another stellar year with restaurants and hospitality boosted by a further rise in visitors.

Wholesale & Retail, Restaurants & Hotels (21.8 percent of non-oil GDP) was up by 6.9 percent in the year to Q3 2023, year-on-year, an acceleration on 2022 when the sector's contribution rose by 5.7 percent. The rise was powered by both religious and non-religious tourist growth. Umrah visitors were up by 58 percent on pre-pandemic (2019) levels to reach 13.5 million. In addition, Umrah visitors are now able to stay longer in-Kingdom and take advantage of the growing number of spending opportunities. The number of Hajj pilgrims also surged, up by 80 percent from 2022.

Meanwhile, the growth in general tourism was striking, with the Kingdom ranking as the second fastest growing tourism destination globally. In 2023, the Kingdom saw 27 million visitors from abroad, with total spending exceeding SR100 billion during the year. As a result, the authorities were prompted to raise the 2030 target to 150 million visitors (Figure 8).

Like many around the world, Saudis are spending more on services than goods.

Elsewhere, full-year consumer spending (POS, e-commerce & ATM cash withdrawals) rose 7 percent year-on-year to SR1.3 trillion, up by 27 percent on pre-pandemic levels. Spending (POS only) on 'hotels' and 'restaurants and coffee shops' rose by 19 percent and 14 percent year-on-year, respectively, as consumers focus more on services than goods (Figure 9). As such, spending on 'jewelry', 'furniture' and 'electronics' continued declining compared with the previous year, though we expect some rebound in furniture as mortgage demand revives in H2-24.

Looking ahead, we expect to see continued growth in the tourism sector, with a number of high-end hotels due to be launched around

Figure 8: Tourism targets are revised up for 2030

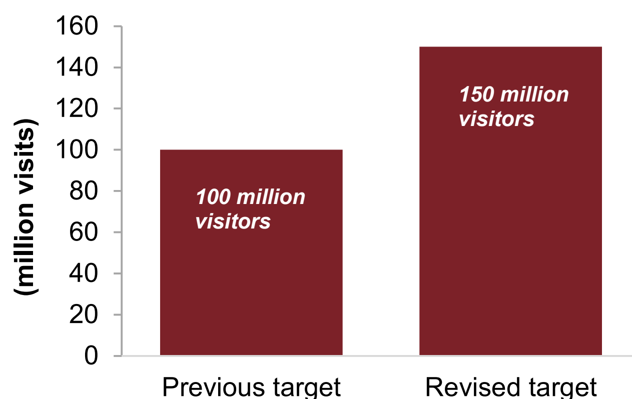
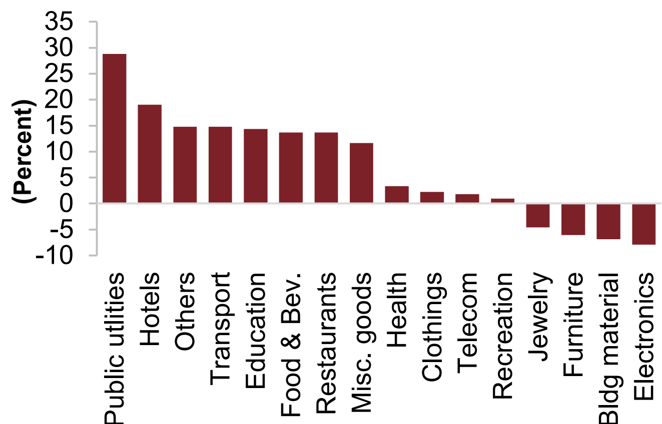


Figure 9: POS Spending in 2023, by Sector
(year-on-year change)



The tourism sector should get a further fillip this year as a number of hotels are launched and tourism visits continue their upward trajectory.

the Kingdom, including in Makkah, Alula, Riyadh and the Red Sea. In addition, a number of sports and entertainment events taking place across the Kingdom should add a helpful tailwind to the hospitality sector. Saudi Arabia now has 280,000 hotel rooms, with a pipeline of 250,000.

On the demand side, a further acceleration in visitor numbers (both religious and non-religious) is expected this year, thanks in part to intensive marketing efforts. There is some downside risk here depending on regional geo-political developments, which may be off-putting to potential (non-religious) visitors from outside the region.

Non-oil manufacturing was held back by a weak export performance, though domestic industry is in pretty good shape.

Non-oil Manufacturing (18.1 percent of non-oil GDP) saw a weak performance, edging up by just 0.5 percent in the year to Q3 2023, with Q3 showing a yearly decline of 3.4 percent. The sector has been hit by weakness in China's demand for imported petrochemicals, given that country's rapid expansion of domestic capacity (Figure 10). The Index of Industrial Production (IIP) reflected this weak demand, showing a decline on a yearly basis in December (Figure 11). Locally, however, growth is still robust and is likely to have been enhanced by more than 1,000 new industrial factories starting production in 2023 (worth SR32 billion of investments), creating some 33,000 new jobs over the same period.

The positive domestic story should remain intact in 2024 with further additions to the Kingdom's manufacturing capacity. Specifically, the Ministry of Industry and Mineral Resources intends to provide SR8.8 billion in facilities to support local exporters in the global market, and aims to attract up to SR670 million in new investments within the machinery and equipment sector, in line with Vision 2030 goals to diversify the economy.

An increase in feedstock prices represents another headwind for Saudi petrochemicals firms to navigate.

Less positively, the situation in China is unlikely to improve given that its own petrochemicals production capacity is pretty much full. There should be some offset from Indian demand, which is very strong, though Saudi producers have the added headwind of higher feedstock (and diesel) costs. These price rises, announced by Aramco in early January, are set to add around 3 percent on average to Saudi producers' cost of sales.

The **Transport, Storage & Communication sector** (11.8 percent of non-oil GDP) saw a robust 7.7 percent gain in the year to Q3 2023. Growth in the sector was substantially supported by the upward trend in tourism (see above) but also by a notable rise in railway traffic. Saudi Arabia Railways carried more than 11 million passengers during 2023, up 55 percent from 2022 (including almost

Figure 10: Non-oil Exports
(year-on-year change)

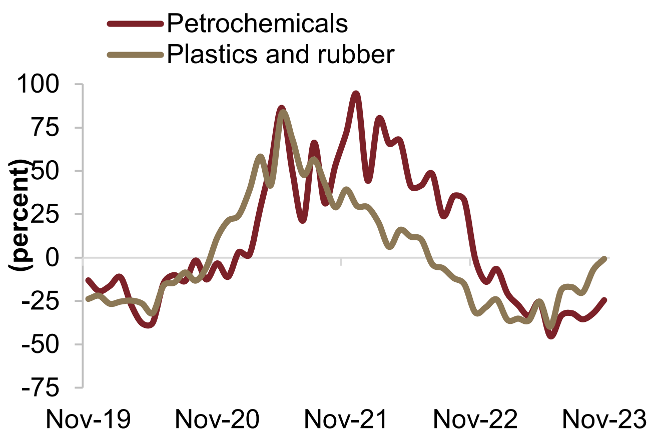
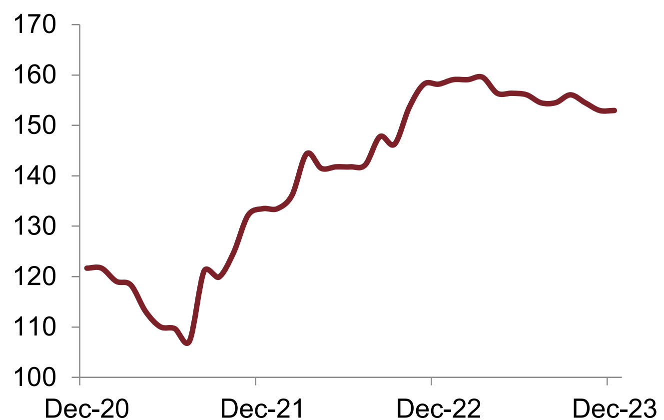


Figure 11: IIP Manufacturing
(index)



Transport had another strong year, pulled along by the growth of tourism and wholesale trade.

two million pilgrims through Jeddah, Makkah and Madinah - up from 1.35 million in 2022). Cargo transportation also saw a robust gain during the year, reflecting the healthy domestic trade environment. Added to this, the year saw the trial license of the first hydrogen train in the Middle East, an agreement to launch two logistic hubs in Dammam and Jeddah, and the launch of “Riyadh Air” as the latest national airline brand.

Telecom firms saw profits rise by 26 percent, and with infrastructure roll-out ongoing the sector should continue to prosper.

Meanwhile, the consolidated profitability of listed telecom companies rose 26 percent year-on-year in the year to Q3 2023 (latest available data), reflecting growth in both new services and subscribers, which helped push the market size of the telecom and technology sector up by 6 percent. The sector also benefitted from digitalization, with e -commerce transactions growing by 28 percent in full-year 2023, and the number of Fintech companies listed on Tadawul reaching 18, with a market cap of SR3 billion at end year.

Giga-projects are also driving transport and logistics developments.

Various transport projects are expected to come on line this year, which should translate into sizable growth in this segment. This includes road projects, logistic hubs and airport terminals. Giga-project development should also deliver civil works in NEOM, Qiddiya and King Salman Park in Riyadh. Sector plans also include launching more logistic centers, to reach 23 (out of 59 planned for 2030). Finally, a further sharp rise in Umrah and Hajj pilgrims is anticipated. For example, some 2 million Hajj visitors are expected this year, a large number of whom will come from outside the Kingdom. We think that the religious cohort will be largely impervious to geo-political tensions (Figure 12).

Banks performed well in 2023 with ROA and ROE increasing.

Finance, Insurance, and Business Services (11.2 percent of non -oil GDP) saw decent growth of 5.2 percent in the year to Q3 2023. Bank lending to the private sector softened to 10 percent growth in 2023 from 13 percent in 2022 as deposit growth slowed (Figure 13; Box 2). Yet net interest margins were supported by higher lending rates, which outweighed an increase in the cost of deposits (the Saudi deposit base still has a large non-interest bearing element to it). This was one reason why both return-on-assets and return-on-equity edged up in the year to Q3-23, reaching 2.2 percent and 12.9 percent, respectively.

It was also a good year for IPOs.

Elsewhere, the capital markets saw a total of 35 Initial Public Offerings (IPOs) during the year (Figure 14). The sector’s growth was also helped by a rise in the number of privately-insured persons, up by a total of 700,000 beneficiaries (or 6 percent) during 2023, with a rise in both Saudi and non-Saudi beneficiaries.

Figure 12: Hajj Pilgrims

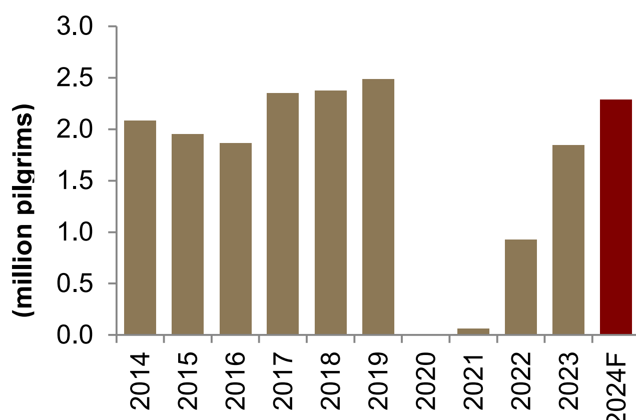
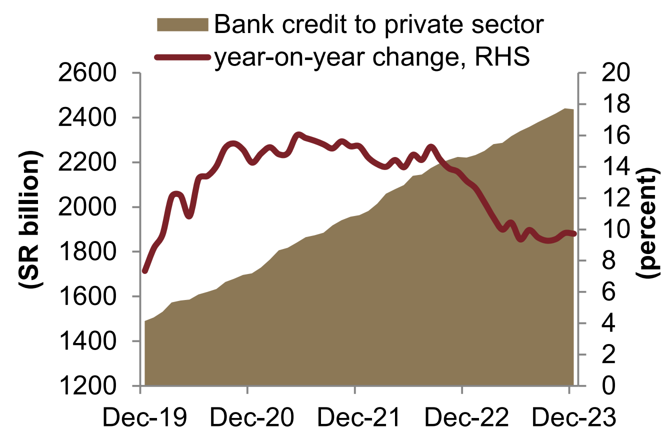


Figure 13: Bank Lending to the Private Sector



We expect the Finance, Insurance, and Business services sector to see higher rates of growth in 2024 in line with lower interest rates in H2, which should spur mortgage demand (albeit with some funding constraints—see below and Box 2). More generally, the expansion of the non-oil economy and the ongoing influx of expatriates should provide a firm underpinning to the sector.

Real estate had a quiet year, held back by weak mortgage creation, which in turn weighed on developers' confidence. Again, this should change in H2 as interest rates decline.

Real Estate Activities (11.2 percent of non-oil GDP) grew at a modest 1.2 percent pace in the year to Q3 2023, a slowdown from the 1.4 and 6.6 percent recorded in the same period of 2022 and 2021, respectively. Growth continued in various housing projects under the Ministry of Housing's (MoH's) Sakani program, but new residential mortgages provided by banks and finance companies declined by 35 percent in volume terms last year, with the latest SAMA data showing that new mortgage lending totaled SR80 billion, down from SR123 billion in 2022 (Figure 15).

For 2024, the picture is somewhat brighter—at least in H2—as lower interest rates stimulate mortgage demand. However, with private sector credit-to-deposits running at around 100 percent, banks will need to be creative in how they meet this demand. One under-utilized option would be to boost securitization by offloading some of their current stock of mortgages to the state-owned Saudi Real Estate Refinancing Company (SRC).

Official policies are supporting the sector substantially.

Meanwhile, we see the MoH's Sakani program continuing to support the sector. The ministry has plans to provide 100,000 housing units to families, with 50,000 units in partnership with local real estate developers, as the MOH strives to raise the home-ownership ratio to 70 percent by 2030.

Construction is benefitting from an extended tailwind of giga-project activity. Total spending on projects will be some $79 billion this year, according to MEED.

The **Construction** sector (9.2 percent of non-oil GDP) saw another solid rate of growth in the year to Q3 2023, though at 3.9 percent this was markedly softer than the 8.8 percent registered in the same period of 2022, likely reflecting a growing scarcity of key inputs (see below). As has been the case for the past few years, much of this growth came from project spending, primarily giga-projects. MEED estimates the value of total projects either completed or in execution in 2023 at $60 billion, up from $44 billion in 2022.

For 2024 and beyond, growth in this sector will be mainly supported by the PIF's giga-projects: Neom, Red Sea, Roshn, Qiddiya and Diriyah, all of which saw varying rates of progress during 2023. Moreover, the sector will continue to benefit from the rise in government capital expenditure, which we see rising to SR193 billion in 2024 from SR186 billion in 2023 and SR143 billion in 2022. As

Figure 14: The capital markets saw a total of 35 IPOs in 2023, with 7 of them in the main market

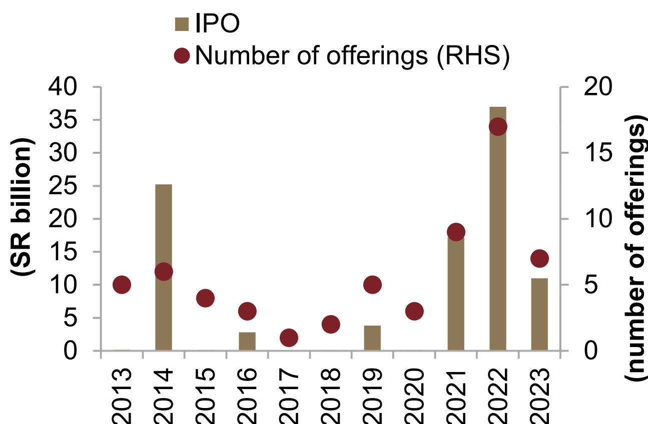
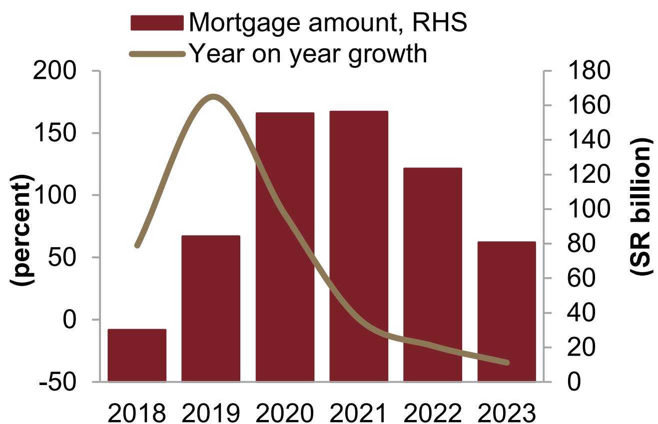


Figure 15: New mortgage loans were down in 2023 by 35 percent year-on-year



highlighted in the recent budget statement, the annual rise in capex stems from the government's plan to move forward with spending on mega-projects, growing sectors such as tourism, manufacturing and mining, and other infrastructure projects around the Kingdom. MEED forecasts total spending on projects in 2024 at $79 billion.

However, costs are rising sharply and overruns seem likely.

The main challenge is the cost and/or scarcity of inputs. The sector added 148,000 workers in the year to Q3 2023 on a net basis, but this was down from 400,000 added in full-year 2022 (Figure 16). India, the traditional source of much construction manpower, has its own vibrant project market, and Saudi wages will need to rise further to tempt these workers across the Arabian Sea. Meanwhile, copper, rebar and glass are in high demand. Even without the turmoil in the Red Sea the sector would be fully stretched and cost overruns (and possibly some project timeline extensions) are inevitable.

Community Services is often overlooked as a growth driver, but it had an outstanding 2023 and will continue to benefit from the rollout of cultural and sports infrastructure.

Community, Social & Personal Services (7.3 percent of non-oil GDP) rose by an eye-catching 12.6 percent in the year to Q3 2023, year-on-year, up from just 1.7 percent in the same period of 2022. This sector includes education, healthcare, arts, entertainment, and sports, all of which have benefitted from various Vision 2030-related initiatives (Figure 17).

The sector is expected to see further solid growth in 2024 as the Quality of Life (QoL) VRP continues to plan for various events and activities. In addition, the Ministry of Health plans to launch a number of hospitals with a total capacity of 1,100 beds, and the Ministry of Education aims to further digitize education channels.

Agriculture, too, is seeing a renaissance as the government intensifies efforts to boost food self-sufficiency.

Agriculture (6 percent of non-oil GDP) rose by 3.7 percent in the year-to-Q3 2023, year-on-year. Last year the sector benefitted from the ongoing push to secure self-sufficiency in various foods, including providing more than 10 million tons of 12 basic food products locally. For 2024, the target is 11 million tons of locally-sourced food products.

Electricity, Gas and Water saw modest growth in 2023 but this sector has strong medium-term tailwinds.

Electricity, Gas, and Water (2.6 percent of non-oil GDP) saw a 3.6 percent gain in the year to Q3 2023, as the sector saw the rollout of SR14 billion of water projects. For 2024, growth in this segment will be spurred by the ongoing expansion of water desalination capacity. The sector will also benefit from projects worth SR14 billion coming on line, including solar initiatives, electricity generation and transmission. Water desalination will grow in importance as Riyadh (and other conurbations) expand. But it is probably gas supply that has the best outlook given its role as an industrial feedstock and its importance to the energy transition.

Figure 16: Construction Sector Employment

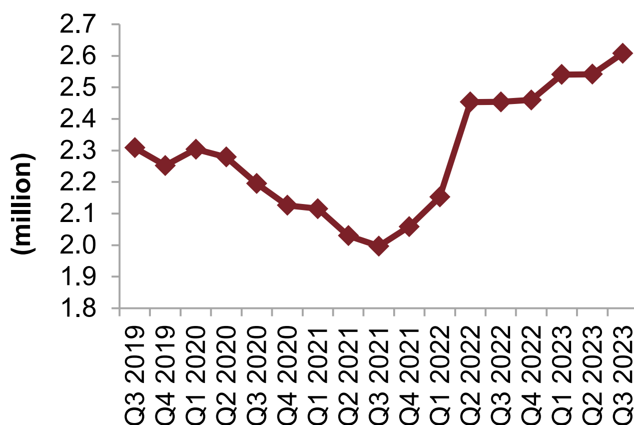
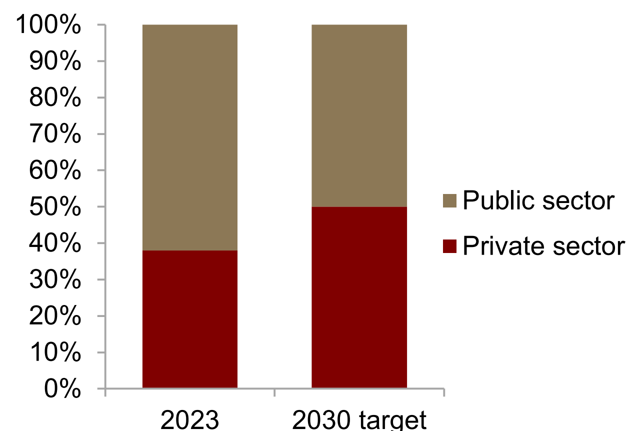


Figure 17: Healthcare services are expanding with a rising role for the private sector



Non-oil Mining currently contributes very little to GDP, but the potential is formidable.

Non-oil Mining and Quarrying (0.8 percent of non-oil GDP) grew by 6 percent in the period to Q3 2023, year-on-year, reflecting the ramping up of exploration for base metals in particular. Foreign appetite for investment in the sector is growing: in 2024, the Ministry of Industry and Mineral Resources (MIM) is planning to issue 30 new mining permits and to auction 10 new mining exploration licenses. In addition, the MIM has recently revised up the Kingdom's mineral wealth from SR4.9 trillion to SR9.4 trillion, as a result of the past five years' intensive surveying and exploration efforts.

Fiscal Performance

The fiscal position fell back into deficit last year, dragged down by weaker oil earnings. However, non-oil revenue was buoyed by a surge in income tax on foreign firms.

The fiscal position and outlook is comfortable, though this characterization depends on the inclusion of "performance-related" dividends from Aramco in the central government's revenue. These are based on Aramco's free cash flow and are likely to be worth SR150 billion a year.

Excluding this revenue, the government recorded a deficit of around SR156 billion, or 3.9 percent of GDP, in 2023. This reflected a 21 percent fall in oil revenue as prices sagged and production was throttled back. This saw oil revenue fall to SR680 billion, around SR177 billion less than in 2022. Non-oil revenue did much better, rising by SR47 billion to SR458 billion. The most notable gain was a 58 percent surge in income tax on foreign firms, as the Regional Headquarter (RHQ) program began to yield results.

Spending rose by 11 percent last year, with outlays on wages & salaries posting the biggest nominal gain. Still, as a percentage of GDP this item fell slightly compared with 2022.

Spending grew by 11 percent, with substantial gains in all the major items: wages & salaries (4.7 percent), procurement costs (18 percent), social benefits (23 percent), and capex (a whopping 30 percent). None of these increases is especially surprising given the economic development context, and it is notable that spending on wages & salaries—far and away the biggest single line item—was worth 13 percent of GDP last year, down from 15 percent in 2018. Nevertheless, the ratio is still extremely large and remains a key fiscal vulnerability.

Aramco began paying the government performance dividends from H2-23 onwards, and thus transferred half of the SR150 billion annual amount (the government included this in its total oil revenue). This reduced the deficit by just under half to 2.1 percent of GDP. Financing was straightforward through debt issuance, both local and external.

Figure 18: We see government spending growth of around 5.2 percent in 2024

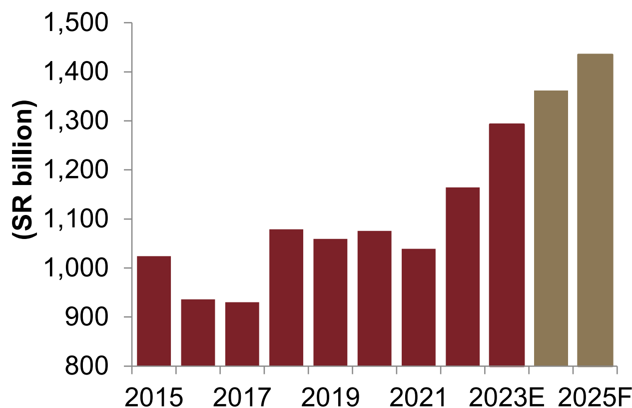
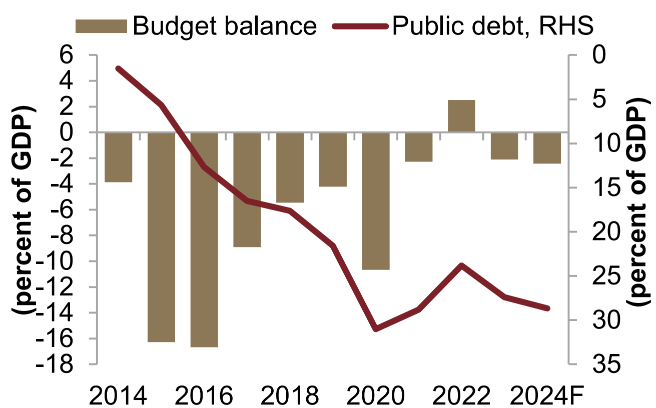


Figure 19: The budgetary and debt outlook is comfortable



Includes Aramco "performance related" dividends.

Including the performance-related dividends from Aramco, the 2023 deficit was around 2 percent of GDP.

Oil revenue is expected to fall again in 2024, but non-oil revenue should see a decent rise.

The 2024 outlook is weighed down by quite a weak oil revenue projection. We now expect oil production to be held more or less at current levels until Q4-24, and with prices falling to an average of $81 pb (Brent), oil revenue—excluding performance dividends—is set to fall by a further 14 percent this year. Elsewhere, VAT revenue should see a similar gain to last year (around 4 percent) while the tax yield from foreign firms should also rise as more companies relocate to the Kingdom. Customs revenue should see a boost from higher costs per ship, but this will be offset by delays to arrivals. These gains should go some way to offsetting the oil revenue loss, but not completely and we expect overall revenue to slip by around 5 percent this year (excluding performance dividends).

Spending growth could be higher than our 5.2 percent projection given higher project costs.

Spending growth is expected to remain quite strong at around 5.2 percent (Figure 18). Wages and salaries will continue to grow in line with the bid to deliver much of the Vision 2030 agenda. True, the PIF and its subsidiary firms are largely responsible for the giga-projects, but the central government must still provide much auxiliary infrastructure and meet the varied needs of an expanding population. All of this requires additional manpower. Capex itself is expected to rise, but there are question-marks about the rate of increase given the shortage of inputs stemming from Red Sea supply dislocations along with a generally very tight project market. Projects could be delayed, but those that go ahead are likely to face cost overruns. The same dynamic applies to purchases of goods and services, since most of these are imported. For this reason, our spending growth forecast carries considerable upside risk.

If Aramco's performance dividend did not exist, then the projected deficit would be a sizeable 6.3 percent of GDP. But including the dividend reduces the deficit to 2.4 percent of GDP (Figure 19). In fact, there is some upside here: Aramco's announcement that it will be ending its oil capacity expansion project could potentially boost free cash flow and hence the government's dividend. However, it seems more likely that the spending will be diverted towards gas and renewables projects.

The fiscal deficit should narrow to around 1 percent of GDP in 2025 once performance dividends are included.

The 2025 fiscal outlook is somewhat better. We see oil prices and production rising, which should push up the government's oil revenue by around 14 percent. Trends in non-oil revenue should remain intact, with further gains in VAT driven by more expatriate arrivals (expatriates tend to save more than consume, but the volume of additional workers will have an impact). Spending should see a 5.4 percent gain, but with further upside risk as various interim deadlines come due. There should be some relief on costs, assuming calm is restored to the Red Sea, and procurement spending growth should ease a little.

This should mean a deficit of around 4.6 percent of GDP, but when the Aramco special dividend is added this is reduced to 1 percent of GDP. In both years the deficits will be financed comfortably by further debt issuance (foreign and local appetite for Saudi public sector debt is very strong).

Balance of Payments

The current account is likely to have posted another surplus in 2023, but outflows through the financial account meant that reserve assets fell.

Saudi Arabia's current account position is likely to have recorded a comfortable surplus in 2023. However, a sizeable deficit on the financial account, along with outflows through net errors and omissions, meant that reserve assets fell during the year.

The current account surplus was a lot smaller than in 2022, pulled down by a fall in oil earnings and another sharp gain in import spending.

The current account surplus was dragged lower to an estimated 2.8 percent of GDP from 13.6 percent of GDP in 2022. Unsurprisingly, a 26 percent slump in oil earnings was the main reason, though waning Chinese demand for Saudi petrochemicals also played a role. Meanwhile, import spending surged by an estimated 14 percent, with machinery, electrical equipment, and transport equipment—most of it related to giga-projects—recording sharp gains. On the invisibles side, workers' remittances were unexpectedly low given the influx of expatriates. It might be that some expatriates decided to take advantage of the high savings rates on offer in the Kingdom rather than sending money home. A more meaningful support to the invisibles balance came from tourism, with earnings growing by more than 50 percent according to our estimates.

The fact that an Emerging Market in the midst of such a capital-heavy transformation is recording a current account surplus at all is unusual. This is testament to Saudi Arabia's oil wealth.

Is the narrowing current account surplus cause for concern? Not in our view. Indeed, the Kingdom has run sizeable *deficits* in the past with only modest pressure on the exchange rate peg. From a broader perspective it is unusual for an Emerging Market embarking on such a capital-heavy transformation to be running any kind of surplus, and that of course is testament to the Kingdom's oil wealth. What might be of concern to the authorities are elements of the current account, such as the downward drift in non-oil exports and the dramatic rise in import spending (up 16 percent a year over the past three years). But, equally, they will be pleased with the gains in tourism income which have pushed the tourism balance decisively into surplus (Figure 20).

This year the current account picture is likely to deteriorate, though the overall balance should remain in surplus. This stems from our weaker oil price assumption coupled with a further decline in projected crude output. Import demand should remain strong and prices of key construction inputs are likely to rise. We expect the invisibles deficit to narrow this year, helped by continued strong growth in tourism earnings (regional geopolitical stresses are unlikely to deter the core religious cohort from visiting the Kingdom, though they might have some impact on potential arrivals from Europe). Income receipts from overseas equity investments should gain,

Figure 20: Tourism Receipts

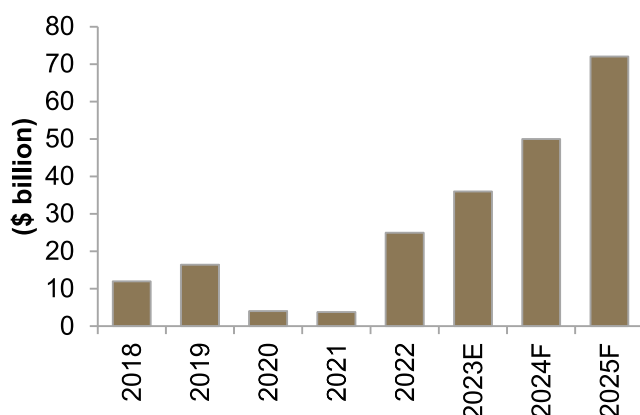
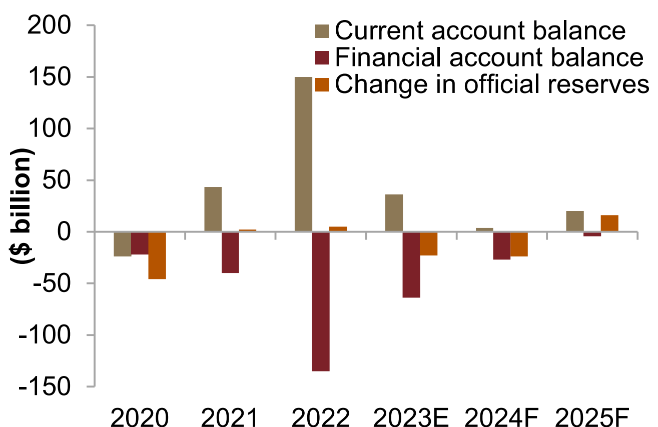


Figure 21: Balance of Payments



We see further firm import growth this year (with upside risk) and with oil earnings struggling, the trade surplus is set to narrow.

especially after the Federal Reserve begins to cut interest rates, which will also soften debt service outflows. Overall, we see the current account surplus easing to 2 percent of GDP in 2024.

Income from tourism and investments abroad should provide a partial offset.

The situation should improve in 2025 as oil prices and production rise. This should more than offset further double-digit percentage growth in import spending, allowing the trade surplus to grow. We expect tourism earnings to be pushing $75 billion by 2025 (6 percent of forecast GDP)—a totem of success in the diversification effort. All told, we see the current account surplus rebounding to around 5 percent of GDP (Figure 21).

The balance of payments position should improve in 2025 thanks largely to a revival in oil revenue and further gains in tourism earnings.

Following a further dip this year, reserve assets should recover to some 37 percent of GDP by end-2025.

Flows on the rest of the balance of payments are difficult to predict, though with a smaller current account surplus one is likely to see weaker outflows. Data reclassification is likely to mean an upward shift in recorded foreign direct inflows, though the impact of the RHQ program should also become apparent. Portfolio inflows will mainly be attracted to debt, given a lack of liquidity in the Tadawul. Private outflows, which have at times been very large, should subside as domestic opportunities multiply. All told, we expect SAMA's reserve assets to continue to ease this year, finishing 2024 at around $428 billion (still a very healthy 39 percent of GDP). A nominal gain is in prospect for 2025, though as a share of GDP reserve assets will ease to 37 percent. This equates to 19 months of import cover.

Monetary and Financial Developments

By most measures deposit growth was strong in 2023. Yet it slowed during the course of the year, obliging banks to cool lending to the private sector.

Growth in lending and broad money have moved in tandem in recent months. Although percentage growth rates are now below double digits (year-on-year), they are still robust by historical and peer country standards (Figure 22).

In 2023 the broad money supply measure (M3) increased by just under 8 percent. This reflects a 32 percent surge in time and savings deposits, attracted by historically high interest rates. This was enough to offset a 1.2 percent fall in demand deposits, which also meant that the share of demand deposits in M3 fell from 60 percent in 2022 to 49 percent by the end of 2023.

There was also some cyclical slowdown in credit as higher interest rates ate into mortgage demand.

Meanwhile, bank lending to the private sector eased to 9.7 percent growth in 2023, the weakest since 2019 (Figure 23). The comparatively soft rate (by historical, not peer country standards) reflects both high lending rates and banks' concern to keep lending growth in line with deposit growth (Box 2).

Figure 22: Credit to Private Sector vs Deposits
(year-on-year change)

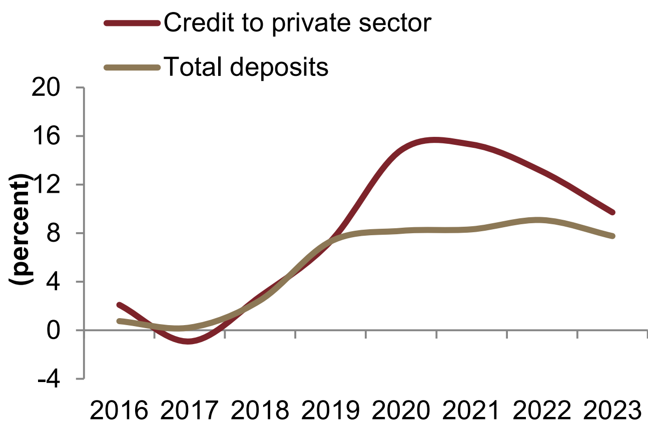
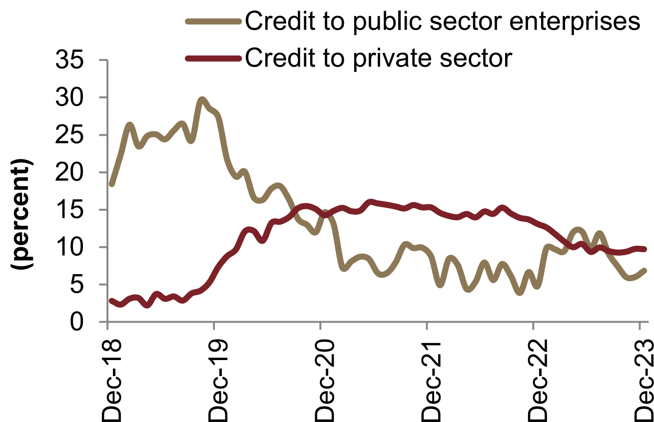


Figure 23: Bank Lending by Sector
(year-on-year change)



Credit to the public sector grew by 15 percent, but it remains a small percentage of overall bank lending.

Credit to the public sector (excluding government bonds) grew by 15 percent in 2023. This is still a small proportion of total bank lending (around 6 percent) though it has been increasing, particularly in recent years as Vision 2030 projects have gathered pace. Note, however, that PIF-related investment is classified as "private" and credit to these entities is not captured by "public sector" credit. Meanwhile, holdings of longer-term government securities have also increased. These are highly liquid instruments that are easy to repo in times of tightened liquidity.

Private sector lending varies sharply by segment. Mortgage lending continued to fall last year, but credit to the construction sector picked up.

The growth of net new private credit continues to vary widely by sector (Figure 24). Last year, high interest rates weighed heavily on demand for mortgages, with total new contracts slumping to 103,000 from 154,000 in 2022 (which itself was a weak year). Weak mortgage demand rippled out to real estate activity and growth in credit to this sector softened notably. However, credit to 'construction' picked up by 11 percent, reflecting robust giga-project activity. Credit to 'manufacturing' was almost unchanged, as worries about Chinese demand for Saudi petrochemicals weighed on bankers' minds. Elsewhere, 'mining and quarrying' saw 9 percent growth over the year, albeit from a low base. This reflects accelerating exploration activity for critical minerals and metals, along with some credit facilities (generally for trade) provided to Aramco and associated firms.

SME lending saw its share increase.

Meanwhile, the share of Small & Medium Enterprise (SME) loans in total credit provided by banks and finance companies stood at 8.7 percent at the end of Q3 2023. This was higher than the 8.1 percent registered in Q4 2022, thanks in part to a significant rise in the share of lending to micro-sized enterprises (from 3 percent of lending pre-pandemic to 9 percent in Q3 2023).

Financial soundness indicators

Risk metrics are sound, with particularly strong provisions for liquidity risk.

However, system-wide liquidity is still tight, and a key spread has widened in recent months.

Data on risk metrics (up to Q3 2023) showed that non-performing loans (NPLs) as a share of total loans continued to improve, easing to 1.6 percent of total gross loans, from 1.8 percent at the end of 2022 and 2.2 percent at the end of 2020. Other ratios are also comfortable: for example, liquid assets-to-total assets stood at 21.6 percent at end-Q3. While this represents a fall from a year earlier, it still signifies a banking sector with good access to liquid assets (for example, the US ratio is around 16 percent). That said, liquidity strains in the system as a whole are still evident: the spread of

Figure 24: New Bank Loans by Sector, 2023

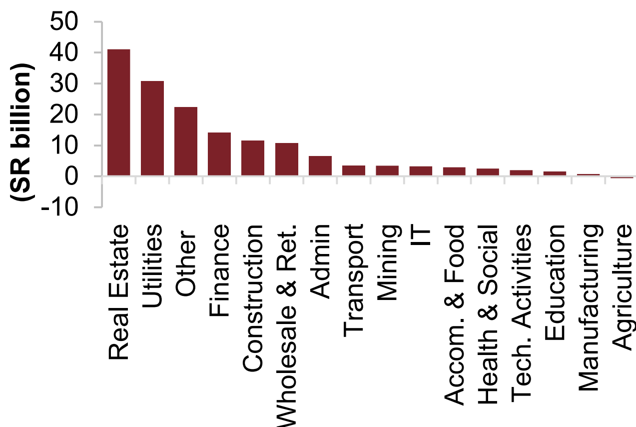
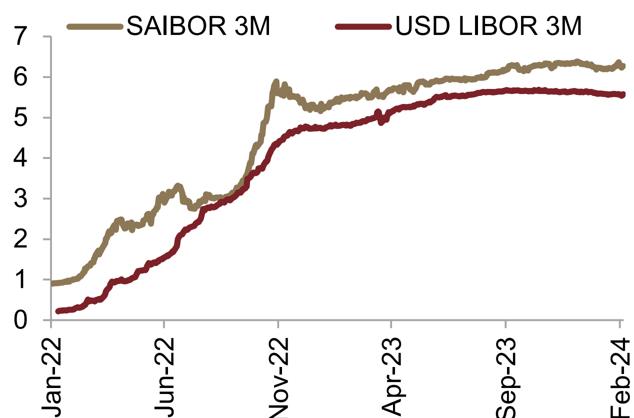


Figure 25: Saibor vs USD Libor



Saibor over USD Libor (a key gauge of liquidity) has widened again in recent months (Figure 25). Meanwhile, capital adequacy ratios are also very conservative, with a sector average of 18 percent of Tier 1 capital to risk-weighted assets.

Box 2: Saudi Banks' Funding Challenges

In recent years, loan growth has outstripped deposit growth, with the loan-deposit ratio in excess of 100.

Saudi banks have historically been highly liquid, well-capitalized and profitable. This is still broadly the case, but while Vision 2030 has opened up new lending opportunities, funding challenges are becoming more pressing.

With deposit growth softening, banks have been obliged to rein in lending growth in recent quarters.

This is clear from the loan-deposit ratio (LDR), which measures lending to the private sector against available deposits*. In recent years, buoyant economic growth has propelled brisk credit demand and even though deposits have grown, they have not kept pace with lending. Consequently, the LDR finished 2023 above 100, which is an uncomfortable metric for risk managers. With deposit growth now softening, pulling this ratio back to acceptable levels will mean putting the brakes on lending growth—unless other funding sources can be captured.

To meet the demands of the local economy, banks have been looking for other sources of funding, such as capital issuance.

The latter is happening. Many local banks have diversified their funding sources and issued Tier 1 and Tier 2 capital and other debt instruments (including senior unsecured and subordinated debt). In 2022 they issued SR28.4 billion of Additional Tier I (AT1) and Tier 2 capital, while some banks have also established Euro Medium Term Notes (EMTNs—dollar notes issued outside of the US) that they can tap in case of need. Given this, it is no surprise that Saudi banks' liabilities with foreign counterparts have increased by around 34 percent or $16 billion in the past couple of years.

But more will need to be done, especially given the likely revival in mortgage demand.

These efforts are helpful, but, as Moody's points out, they have increased funding costs and are unlikely to be sufficient.
With mortgage demand set for a revival in H2, banks will need to keep diversifying their sources of funding. Greater use of the state-owned Saudi Real Estate Refinancing Company would help: banks have the option of selling on existing mortgages to this agency (with fees) to free up space on their books. However, for the moment banks seem more inclined to hold on to mortgages given the high margins that they command.

Banks cannot be expected to shoulder the burden of Vision 2030 financing, but they will need to keep diversifying their funding sources in order to support the private sector.

The banking system's deposit base is only around $660 billion and no-one expects banks to generate all the funds for Vision 2030. Foreign equity investments and public sector debt will have to play a role in delivering this agenda. But as the economy expands, banks are struggling to keep pace with even day-to-day corporate and retail demand. Thus, further capital issues and other sources of (foreign) wholesale funding will be necessary.

**This is not the SAMA-mandated LDR, which allows banks to include other debt liabilities in the denominator.*

Easing inflation

Consumer price inflation remains subdued.

Since H2 2023, growth in consumer prices has slowed, with end-year inflation easing to 1.5 percent, the weakest reading in almost two years. 'Food and beverages' was the primary area of softening, reflecting, in the main, further declines in global food prices (the FAO's main food price index declined by around 10 percent in 2023). The main upward price pressure has come from 'housing and utilities', with sub-group 'rentals for housing' continuing to show

Rent pressures are the main source of inflation. These should soften somewhat as more Saudi nationals are tempted back to the buying market in H2.

robust rises amid high demand, although new data suggest that rents probably peaked in recent months (Figure 26). Strong rental demand is a result of high mortgage rates, which have encouraged many Saudis to rent rather than buy. Firm expatriate demand for rentals is also a factor.

However, expatriate demand is likely to remain firm, keeping a floor under rents.

This year food and beverages prices should continue to ease in line with global trends. As borrowing rates fall in H2 and housing sales increase again, rental growth should start to soften. Nevertheless, rents seem unlikely to fall (at least in the main conurbations) given strong rates of non-oil GDP growth, which will continue to lure many expatriates to the Kingdom.

Stronger demand for home ownership in H2 should create positive spillovers for related sectors such as ’furniture’ and ’electronics’ which have been restrained by lower housing demand in 2023. At the same time, we expect sectors such as ‘transport’ and ‘hotels and restaurants’ to see gathering demand as the tourist offering expands and varies.

Risk is tilted towards the upside and will depend on the degree to which local firms absorb higher costs.

The recent upward adjustment to feedstock and diesel fuel prices initiated in January 2024 could have some spill-overs to retail prices, as could the impact of Red Sea disruption. It is notable that the latest PMI (for January) shows non-oil firms raising output prices in response to rising cost pressures (see above).

On balance, the above trends have led us to keep our inflation forecasts at an average of 2 percent in 2024, with a slight increase to 2.1 percent for 2025 (Figure 27). Risks are to the upside, however, and stem from the degree to which consumer-facing firms choose to pass on higher costs.

Figure 26: Rentals for Housing
(year-on-year change)

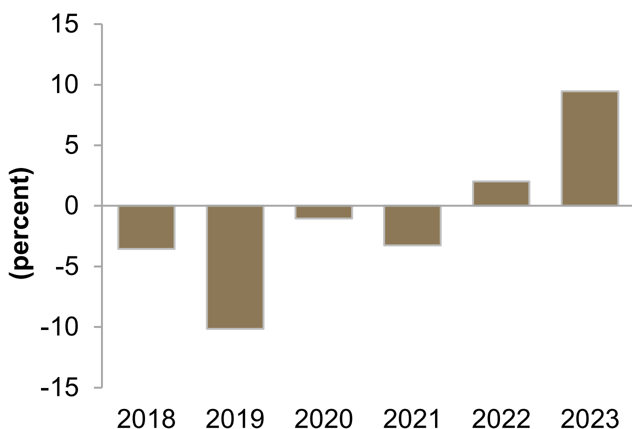
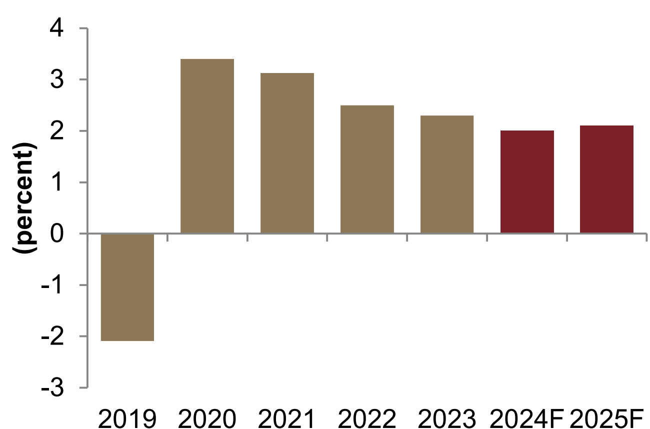


Figure 27: Consumer price inflation is expected to remain manageable



The Outlook for 2025

Global economic activity should be on an upswing in 2025…

Next year is set to be a better one for the global economy. In many parts of the world, high inflation and the subsequent surge in interest rates have taken a heavy toll on investment and consumption. Inflation is now falling in most countries, and interest rate cuts are on the way. The full impact of this should be evident in 2025. This does not mean there will not be challenges—clearly, geo-political risk is rising and this could keep consumers and businesses on edge—but from a macro-financial perspective the world should be more stable and predictable. Moreover, the cyclical rebound should be pronounced given the degree of tightening to be unwound.

...which will boost oil prices.

Oil prices should also start to climb again in 2025 as industrial activity gathers pace following a tough couple of years. Clearly, the energy transition is not going away, but there is a realization that oil demand is not about to “fall off a cliff”: electric vehicle take-up is still patchy and the benefits of transitioning to (generally more expensive) renewable energy inputs are still not compelling for many firms.

Next year will be an important one in Saudi Arabia’s structural transformation.

Higher oil prices will obviously support the budget and broader confidence in what is likely to be an important year for the Kingdom, with many flagship Vision 2030 projects due to come on line. The two stand-out successes of the V2030 program so far have been female labor participation and tourism growth. Both of these dynamics have much further to run and will underpin consumption in 2025 and beyond. Giga-project delivery will keep investment growth strong, while more routine investment will also be ramped up as the Kingdom’s population continues to expand. We see non-oil GDP growth at some 5.2 percent in 2025, though this could prove conservative if tourism maintains its upward trajectory. Tourism represents genuine diversification away from hydrocarbons, as does wind and solar energy, which is also likely to be an increasingly important medium-term growth driver.

Risks are largely on the supply side…

Oil prices are a risk to the outlook, but a fading one we think. Of course, a downward lurch in prices (if sustained) would be a blow to confidence and central government spending, but we are not anticipating this, and in any case the PIF and NDF have strong and comparatively diversified balance sheets. A bigger risk is project costs. These have surged in recent weeks given dislocations in global shipping, but they were rising even before the Red Sea turmoil, reflecting a pretty frenetic pace of project activity which has led to bottlenecks in the supply of key inputs, including labor. Shortages should eventually be overcome by market forces, but this will entail higher costs. These in turn could lead to project delays or reappraisals.

...including a potential shortage of capital.

Still, foreign equity inflows should gain traction once key V2030 projects are up and running.

A further risk is funding. The banking sector is stretched and will be more so if, as we expect, mortgage demand takes off again in H2 of this year. We think debt will have to play a key role in the short– to medium-term. The PIF has plenty of scope to extend its leverage, as does the central government. Foreign equity will likely play a much bigger role once giga-projects are up and running and “proof of concept” has been established. We also see a greater role for public sector guarantees as a way of underpinning private sector confidence.

Key Data

	2017	2018	2019	2020	2021	2022	2023E	2024F	2025F
Nominal GDP									
(SR billion)	2,681	3,175	3,145	2,754	3,257	4,156	3,831	3,891	4,179
($ billion)	715	847	839	734	869	1,108	1,022	1,038	1,114
(% change)	7.4	18.4	-0.9	-12.4	18.3	27.6	-7.8	1.5	7.4
Real GDP (% change)									
Oil	-3.1	2.3	-3.3	-6.7	0.2	15.4	-9.2	-1.8	7.9
Non-oil activities	3.0	-2.4	4.1	-3.7	8.1	5.5	4.6	5.1	5.2
Government activities	0.3	3.9	1.7	-0.6	1.1	4.6	2.1	2.3	2.5
Total	-0.1	2.8	0.8	-4.3	4.3	8.7	-0.9	2.3	5.8
Oil indicators (average)									
Brent ($/b)	54	71	66	42	71	104	84	81	86
Production (million b/d)	10.0	10.3	9.8	9.2	9.1	10.6	9.6	9.4	10.2
Budgetary indicators (SR billion)									
Government revenue	692	906	926	782	965	1,268	1212	1266	1391
Government expenditure	930	1,079	1,059	1,076	1,039	1,164	1293	1361	1435
Budget balance	-238	-173	-133	-294	-74	104	-81	-95	-44
(% GDP)	-8.9	-5.5	-4.2	-10.7	-2.3	2.5	-2.1	-2.4	-1.0
Gross public debt	443	560	678	854	938	990	1050	1115	1178
(% GDP)	16.5	17.6	21.6	31.0	28.8	23.8	27.4	28.7	28.2
Monetary indicators (average)									
Inflation (% change, average)	-0.8	2.5	-2.1	3.4	3.1	2.5	2.3	2.0	2.1
SAMA Reverse Repo (%, year end)	1.5	2.5	1.75	0.50	0.50	4.50	5.50	4.50	3.50
External trade indicators ($ billion)									
Oil export revenues	170	232	200	119	202	327	242	226	264
Total export revenues	222	294	262	174	276	411	306	290	331
Imports	135	137	153	138	153	190	216	239	252
Trade balance	87	157	108	36	123	221	90	51	79
Current account balance	10	72	38	-23	44	151	29	21	56
(% GDP)	1.5	8.5	4.6	-3.1	5.1	13.6	2.8	2.0	5.0
Official reserve assets	496	497	500	454	455	460	437	428	447
Social and demographic indicators									
Population (million)	31.0	30.2	30.1	31.6	30.8	32.2	32.9	33.7	34.4
Saudi Unemployment (15+, %)	12.8	12.7	12.0	12.6	11.0	8.0	7.8	7.6	7.5
GDP per capita ($)	23,081	28,036	27,893	23,271	28,215	34,441	31,050	30,832	32,385

Sources: Jadwa Investment forecasts for 2024 and 2025. General Authority for Statistics for GDP, external trade indicators and demographic indicators, Saudi Central Bank for monetary indicators, Ministry of Finance for budgetary indicators.

Disclaimer of Liability

Unless otherwise stated, all information contained in this document (the “Publication”) shall not be reproduced, in whole or in part, without the specific written permission of Jadwa Investment.

The data contained in this Research is sourced from Reuters, Bloomberg, GaStat, SAMA, IMF, FocusEconomics, New York Federal Reserve, ’Tadawul, 2024 budget, CCHI, Vision 2030 VRPs, OPEC, EIA, IEA, IEF, and national statistical sources unless otherwise stated.

Jadwa Investment makes its best effort to ensure that the content in the Publication is accurate and up to date at all times. Jadwa Investment makes no warranty, representation or undertaking whether expressed or implied, nor does it assume any legal liability, whether direct or indirect, or responsibility for the accuracy, completeness, or usefulness of any information that contain in the Publication. It is not the intention of the Publication to be used or deemed as recommendation, option or advice for any action (s) that may take place in future.