Saudi Brief

Key Economic Indicators

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Global economy

Dr. Abdullah Al Fozan
Chairman and Senior Partner
KPMG in Saudi Arabia

In 2019, the global economy was challenged by protectionist measures, led by two of the world's largest economies, the US and China. The trade dispute that emerged exerted a downward pressure on economic growth across the globe, leading to significant disruptions in international supply chains. In addition, uncertainty concerning Brexit and a slowdown in major economies, such as China and Germany, led to a significant slowdown in both advanced and emerging economies.

According to the International Monetary Fund (IMF), the advanced economies grew on average by 1.7 percent in 2019, down from 2.2 in the year before, while growth in emerging economies slowed down from 4.5 to 3.7 percent during the period. On average, global growth stood at 2.3 percent in 2019, the lowest figure since 2008.

These revised global growth prospects amid intensified geopolitical concerns led to monetary policy adjustments by major central banks around the world in 2019. By the end of November, 64 central banks cut interest rates to mitigate the impact of global slowdown, as reported by the United Nations at the end of November 2019. With interest rates at historical lows in many countries, monetary easing is likely to provide only temporary relief to the global economy.

The softening global demand also weighed on global commodity prices, especially oil which had some impact on the growth in Saudi Arabia in 2019. The economy of Saudi Arabia still recorded positive growth of 0.4 percent last year. According to the Ministry of Finance (MoF), real GDP growth is expected to reach 2.3 percent in 2020, a slight downward revision to last year's estimate of 2.7 percent. This reduction is primarily attributed to the decline in oil prices amid the US-China trade tensions and the decrease in oil production owing to the OPEC+ agreement. The MoF estimates the real GDP growth in 2021 and 2022 to be 2.2 and 2.3 percent, respectively.

The recent developments, including the US-China phase 1 deal signed on 15 January 2020 and the UK's withdrawal from the European Union on 31 January 2020, could bring some temporary relief to financial markets and uplift the global economy's 2020 growth prospects.

A re-escalation of global trade tensions might continue to dampen demand in all major economies and impact investment activity in 2020. In addition, the spread of Coronavirus from China in the beginning of 2020 presents new uncertainties for the global markets.

Global leadership is required to stem certain activities, such as emission of greenhouse gases, to mitigate the potential risks of the future. Taking into consideration the current economic outlook, there is a need for integrated and concrete policy actions to reduce risks to the global economy and restore confidence for a stable and sustainable economic growth.

Saudi economy

Dr. Hussain Abusaaq
Chief Economist and Head of Research, KPMG in Saudi Arabia

Saudi Arabia is one of the key members of the G20 countries. With about 17.8 percent share of the world's total crude reserves, the country plays a vital role in maintaining stability in the global oil market. It is also the single-largest economy in the MENA region. According to the MoF, Saudi Arabia's GDP was estimated at about US$750 billion in 2019.

Countries that are rich in natural resources, such as oil, are prone to macroeconomic instability due to volatility in their global prices. A major source of government revenue in Saudi Arabia is its oil revenue which makes it vulnerable to international oil price changes. To counter the uncertainty, caused by rapid changes in oil prices, the government of Saudi Arabia has accelerated its efforts in the recent years to diversify the economy. The continuation of Vision 2030 programs, budget allocation of over SAR1 trillion for two consecutive years, and relentless promotion of the non-oil sector, serves as a testament of the importance the government places on economic diversification.

In 2019, the decline in oil prices, resulting from the slowdown of the global economy and decline in oil production under the OPEC+ agreement, resulted in reduction of the GDP growth rate estimates. At the beginning of 2019, the government projected the GDP to grow at 2.6 percent in 2019, but lowered the estimate to 0.4 percent at the end of the year. Owing to external factors, the real oil GDP also decreased by an average of 0.9 percent y-o-y in the first half of 2019. According to GASTAT, the real oil GDP for Saudi Arabia witnessed negative growth of 6.4 percent y-o-y in 3Q19.

Contrary to the performance of the country's oil GDP, the non-oil GDP has witnessed strong growth in the past one year due to the government's diversification efforts. According to GASTAT, in the first half of 2019, the real non-oil GDP grew at an average of 2.5 percent y-o-y compared to 1H18, primarily because of improving economic activity and the implementation of non-oil revenue development initiatives. Additionally, the actual real non-oil GDP annual growth for 3Q19 was 4.3 percent, accounting for 57.7 percent of the total GDP.

The growth of the country's non-oil sectors has been supported by government spending, primarily through mega projects and other Vision 2030 initiatives. It is important to note that though Saudi Arabia's non-oil sector has shown promising growth in the recent past, oil revenue is still projected to account for 62 percent of the country's total revenue in 2020.

The government's propensity to spend, and the subsequent growth of the non-oil sector, is correlated with the performance of the oil sector. Due to the lead-lag effect, the oil sector will continue to play a vital role in the growth of the non-oil sector, and the latter is very much susceptible to a cascade effect of any volatility in the oil market in future. This is important for policymakers to take note of and consider taking precautionary action to mitigate the impact of the oil price on government spending.

2020 will be a crucial year for Saudi Arabia. It will be good for the government to measure the progress made on the Vision 2030 programs and the developments made in other areas, such as reducing unemployment and managing inflation.

Communication on the progress made on these programs will encourage more private sector participation in the financing of these programs. The G20 in November 2020 will be a great opportunity for Saudi Arabia to measure its progress.

Gross Domestic Product

Real GDP

Since the launch of Vision 2030, Saudi Arabia has taken notable measures to diversify its public-sector-dominated economy into a private-sector-driven system. However, despite the government's continued efforts to improve the domestic economy, certain external factors, including the US-China trade tension and macro-economic instability in the Middle East region, have weighed on the country's economic growth outlook. According to the MoF estimate, the real GDP is likely to grow by 0.4 percent in 2019, a substantial reduction from its last year estimate of 2.6 percent. Also, the MoF estimates the real GDP growth in 2020, 2021 and 2022 to be 2.3 percent, 2.2 percent and 2.3 percent, respectively.

Compared with an average growth of 1.8 percent y-o-y in the first three quarters of 2018, the real GDP registered a slow average growth of 0.5 percent in the first three quarters of 2019. While the realGDP grew by 1.7 percent and 0.5 percent y-o-y in 1Q19 and 2Q19, respectively, it witnessed a decline of 0.5 percent y-o-y in 3Q19 (Figure 1).

Due to these external factors, the averagereal oil GDP growth in the first three quarters of 2019 was -2.8 percent y-o-y. In contrast, on the back of government's continuous efforts toward realizing its Vision 2030 goals, the real non-oil GDP grew at an average of 3.1 percent y-o-y in the first three quarters of 2019. As of 3Q19, the oil and non-oil sectors accounted for 41.6 percent and 57.7 percent of the total GDP, respectively.

Real non-oil GDP

The execution of mega projects and the private sector stimulus package (PSSP) had a positive impact in 2019 on all the sectors, including construction that outperformed other sectors and witnessed growth for the first time in three years. The construction sector has witnessed growth of 1.3 percent, 4.9 percent and 4.6 percent y-o-y in the first three quarters of 2019, respectively.

According to the GASTAT, the real nonoil GDP witnessed an incremental growth in the first three quarters of 2019, registering figures of 2.1 percent, 2.9 percent and 4.3 percent in 1Q19, 2Q19 and 3Q19, respectively. In 3Q19, private and government non-oil sectors, which grew 4.2 percent and 4.6 percent, respectively, accounted for 58 percent of the country's total GDP.

Reforms and improved confidence in the country led Saudi Arabia's position to improve in the World Bank's ease of doing business rankings. With an overall score of 71.6 out of 100, the country advanced 30 places to rank 62nd globally.

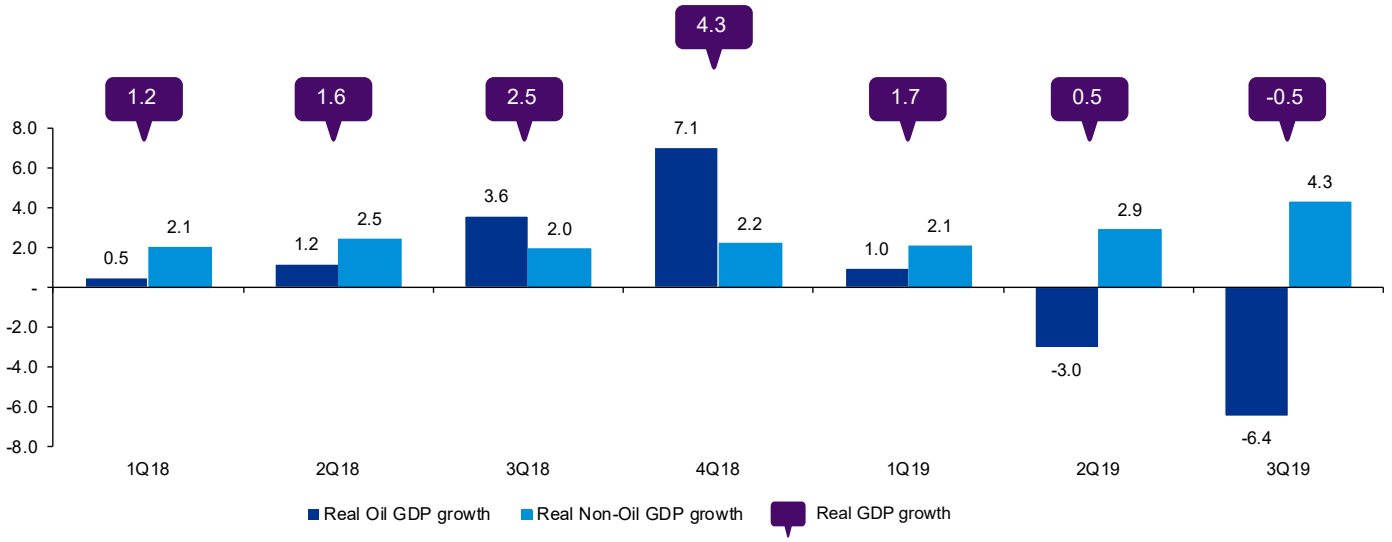
The government's ongoing efforts indicate that the country is moving forward in the implementation of Vision Realization Programs (VRPs) to achieve Vision 2030's main objective of diversifying the economy.

Real oil GDP

Contrary to the upward trend in the real non-oil GDP, the real oil GDP witnessed a cumulative annual decline in the first three quarters of 2019. While the real oil GDP grew 1.0 percent y-o-y in 1Q19, it declined by 3.0 percent and 6.4 percent y-o-y in 2Q19 and 3Q19, respectively (Figure 1). The slowdown is attributed to the lower oil production under the OPEC+ agreement and decline in the global oil prices.

With the US–China phase-1 trade deal signed on 15 January 2020, the global oil demand is likely to see some improvement in 2020. However, the rapid outbreak of the Coronavirus is expected to impact oil demand significantly in the first half of 2020. China, the world's largest oil importer, witnessed a decline in oil consumption by approximately 3 mb/d in January 2020.

Figure 1: Annual real GDP, real oil GDP and real non-oil GDP growth (%)



Source: National accounts, GASTAT

Inflation

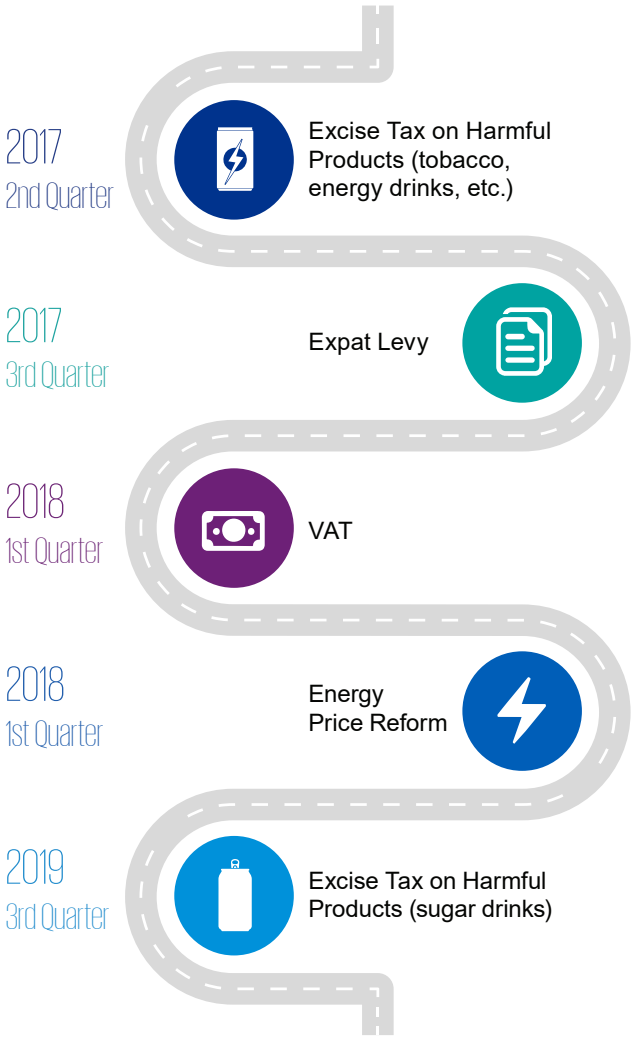
Inflation during 2019

As part of Vision 2030, the government of Saudi Arabia has implemented several fiscal measures such as introduction of expat levy, and implementation of VAT and energy price reform to boost economic growth (Figure 2). A 5 percent VAT was introduced in January 2018 in an effort to stabilize revenue and mitigate global oil price fluctuations. While the introduction of VAT caused inflation in 2018, as the base effect of fuel subsidy cuts and VAT implementation gradually wore off, it caused deflation in 2019.

According to GASTAT's monthly CPI report, the average inflation rate from the beginning of the year until December 2019 was -1.2 percent percent (Figure 3). The main CPI divisions that have sharply declined overthe past one year are housing, water, electricity, gas and other fuels. Actual rentals paid by tenants were at thecenter of this decline as property rental prices dropped owing to job losses in the market. In December 2019, housing and utilities, which carries the highest weight of 25.4 percent in the CPI index, fell by 3.7 percent y-o-y, as rentals for housing continued to witness a decline, falling by 4.2 percent y-o-y in the same month.

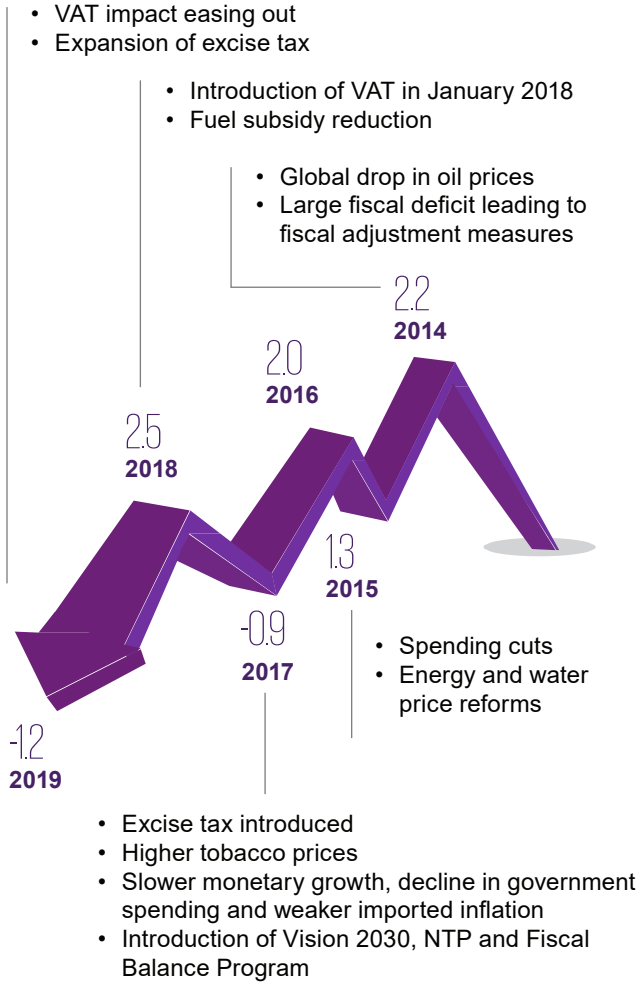
Although the introduction of fiscal measures was essential to achieve the Vision 2030 objective of increasing nonoil revenue, other economic indicators such as sustainable GDP growth should be considered. At the beginning of 2019, Saudi Arabia experienced a period of deflation, which phased out over the course of the year and switched to modest inflation at the beginning of 2020. These recent price-level fluctuations in the country's economy might have an impact on the outlook for consumers, businesses and foreign investment. To counter the negative effect of such policies and increase the country's consumption and private investments, the introduction of an expansionary fiscal policy and a private sector stimulus package by the government, is expected to lift the country into healthy inflation figures in the upcoming months. The MoF estimates inflation in 2020, 2021 and 2022 to register figures of 2.0 percent, 2.0 percent and 1.8 percent, respectively.

Figure 2: Fiscal measures implementation roadmap



Source: GASTAT

Figure 3: Annual inflation (%) and policy attribution



Source: GASTAT

Unemployment

Labor market trends

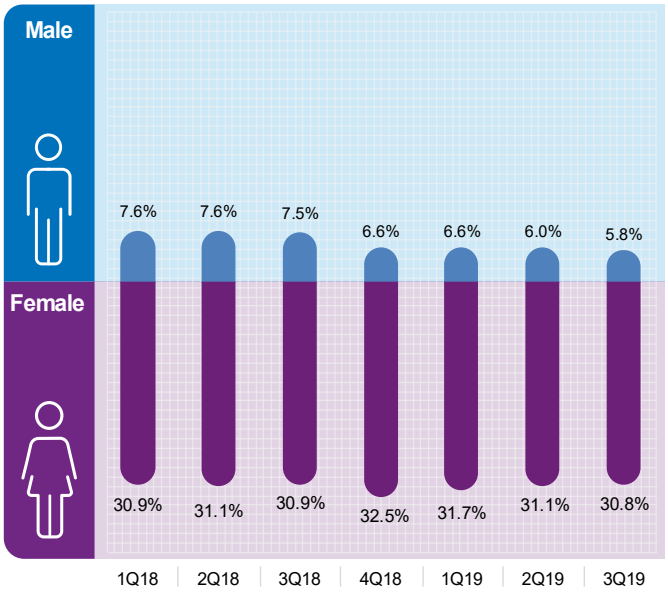
The labor market in Saudi Arabia remains a diverse mix of nationalities and has seen a shift in balance toward less foreign employment. Data from GASTAT's Labor Market Bulletin for 3Q19 indicates that the overall Saudi and non-Saudi unemployment rate declined by 0.5 percentage points compared with 3Q18, to reach 5.5 percent in 3Q19. Saudi unemployment rate also improved to reach 12.0 percent in 3Q19 compared with 12.8 percent in 3Q18. The significant drop in the Saudi female unemployment rate from 32.5 percent in 4Q18 to 30.8 percent in 3Q19 (Figure 4) had a positive impact on the overall Saudi unemployment rate in 2019, which was further supported by the Saudi government's efforts to drive more employment opportunities for Saudi women. The government's continued efforts to increase female participation in the country were highly praised in the January edition of the World Bank's 'Women, Business and the Law' report that classified Saudi Arabia as one of the world's most transformative nations for strengthening the economic role of women in society. The government's vision is to further boost women's participation in the labor market from 23.2 percent in 3Q19 (Figure 5) to 30 percent by 2030.

As the working age population continues to increase rapidly, authorities remain committed to policies designed to increase Saudi male and female employment levels. However, despite the government's push to employ more Saudi nationals in the workforce, including filling the wage gap between Saudis and non-Saudis by imposing expat levies on non-Saudis, the number of Saudi employees in the country has remained largely stagnant since 2Q18 (Figure 6).

Since 2017 when the government launched measures to increase participation of Saudi nationals in the workforce, a large number of expats left the Kingdom. A number of jobs that were earlier occupied by expats and were to replaced by Saudi nationals still remain vacant primarily due to mismatches in wages and skills required for these jobs.

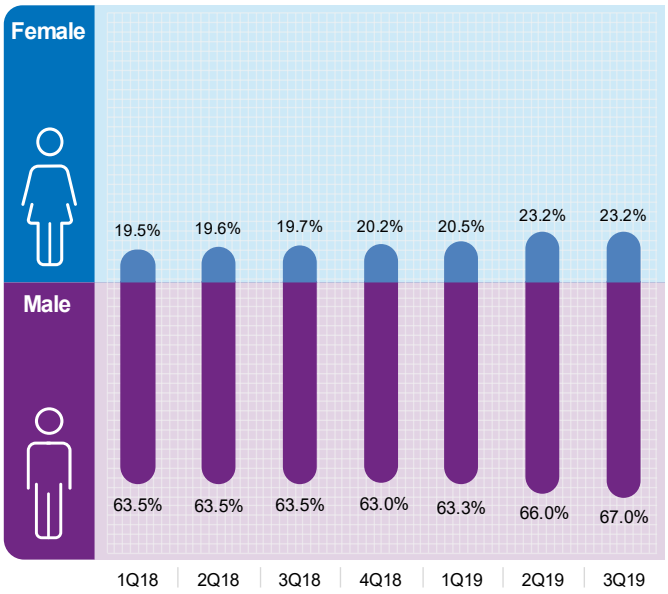
When it comes to drafting the policy actions to increase the number of Saudi nationals in the workforce, it would be good to have periodic assessments of the earlier programs and derive new policy lines from there.

Figure 4: Saudi male and female unemployment rate (%)



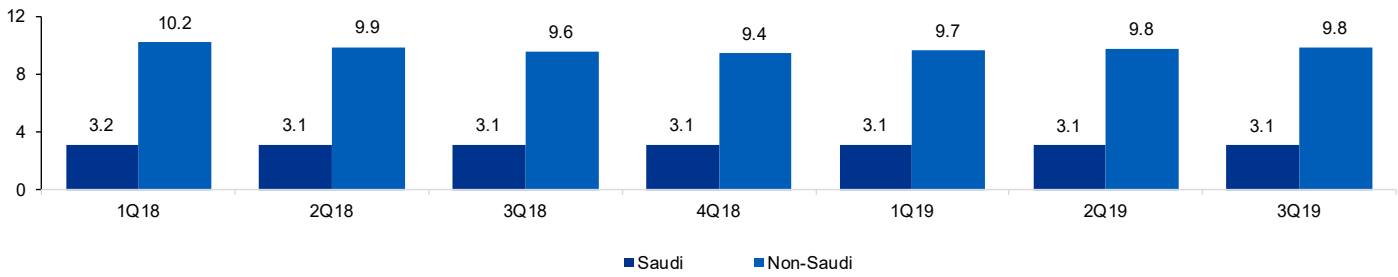
Source: Labor force statistics, GASTAT

Figure 5: Saudi participation by gender (%)



Source: Labor force statistics, GASTAT

Figure 6: Total employment (million)



Source: Labor force statistics, GASTAT

Monetary developments

Saudi Arabia's sound and vigorous financial sector is an integral part of the country's economic diversification vision. The Saudi Arabian Monetary Agency (SAMA), the country's monetary policy regulator, plays a vital role in supporting the overall financial sector. In addition, with an objective to further strengthen the sector, the government launched the Financial Sector Development Program (FSDP) as part of its Vision 2030 objectives. FSDP aims to enable financial institutions to support private sector growth, without contradicting the strategic objectives of maintaining stability in the financial sector.

Money supply

According to SAMA, money supply (M3) in December 2019 was SAR1,985 billion, an increase of 7.1 percent y-o-y. The rise can primarily be attributed to the increase in time and saving deposits, which grew 13 percent y-o-y in December 2019, and currency outside banks, which witnessed an increase of 5 percent in the same period. In addition, money supply (M2) in December 2019 was SAR1,790 billion, an increase of 7.6 percent y-o-y. Furthermore, other quasi-money deposits showed an increase of 2.8 percent y-o-y, which contributed to the overall surge in money supply.

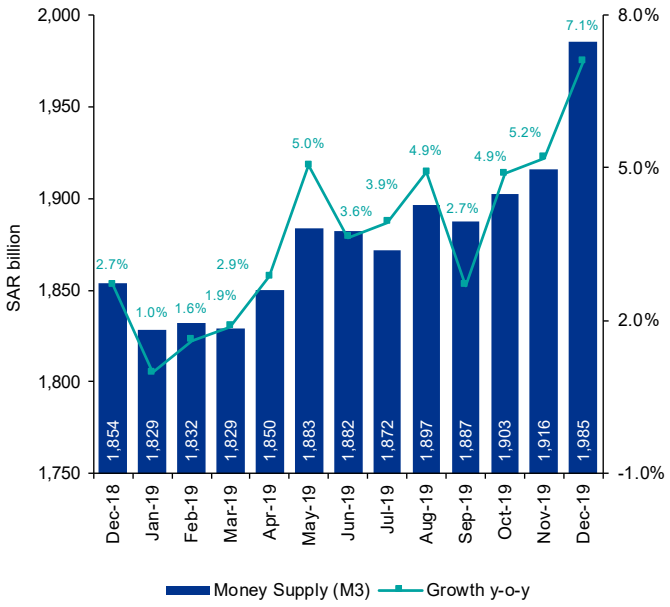
The increase in money supply throughout 2019 could be due to the government's efforts to move out of deflation. Moreover, in line with the Vision 2030 goals, the government remains committed toward implementing initiatives to bolster the economy and attract both foreign and domestic investment.

Foreign reserves

The country's foreign assets reserves had small fluctuations in 2019. The reserves witnessed an increase of 0.5 percent in 1Q19 and 2.7 percent in 2Q19, to reach SAR1,873 billion and SAR1,926 billion, respectively, before falling by 2.4 percent to close on SAR1,873 billion in 3Q19.

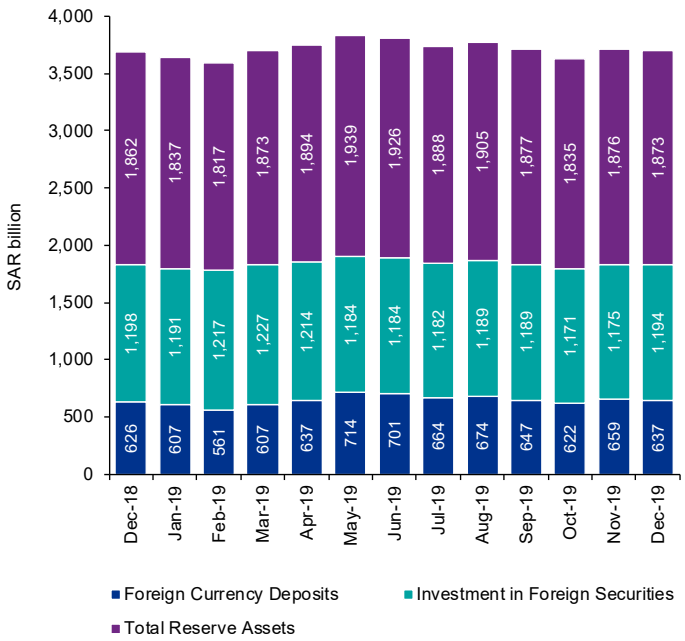
In December 2019, the total reserves increased by 0.6 percent y-o-y, with an 1.8 percent increase in the foreign currency deposits. It is noteworthy that since the Saudi government has access to funding at very low interest rates in the global capital markets, a mix of conventional bonds are preferred over foreign reserves to fund the country's budget deficit.

Figure 7: Money supply growth



Source: SAMA Quarterly report

Figure 8: Foreign reserves



Source: SAMA Quarterly report

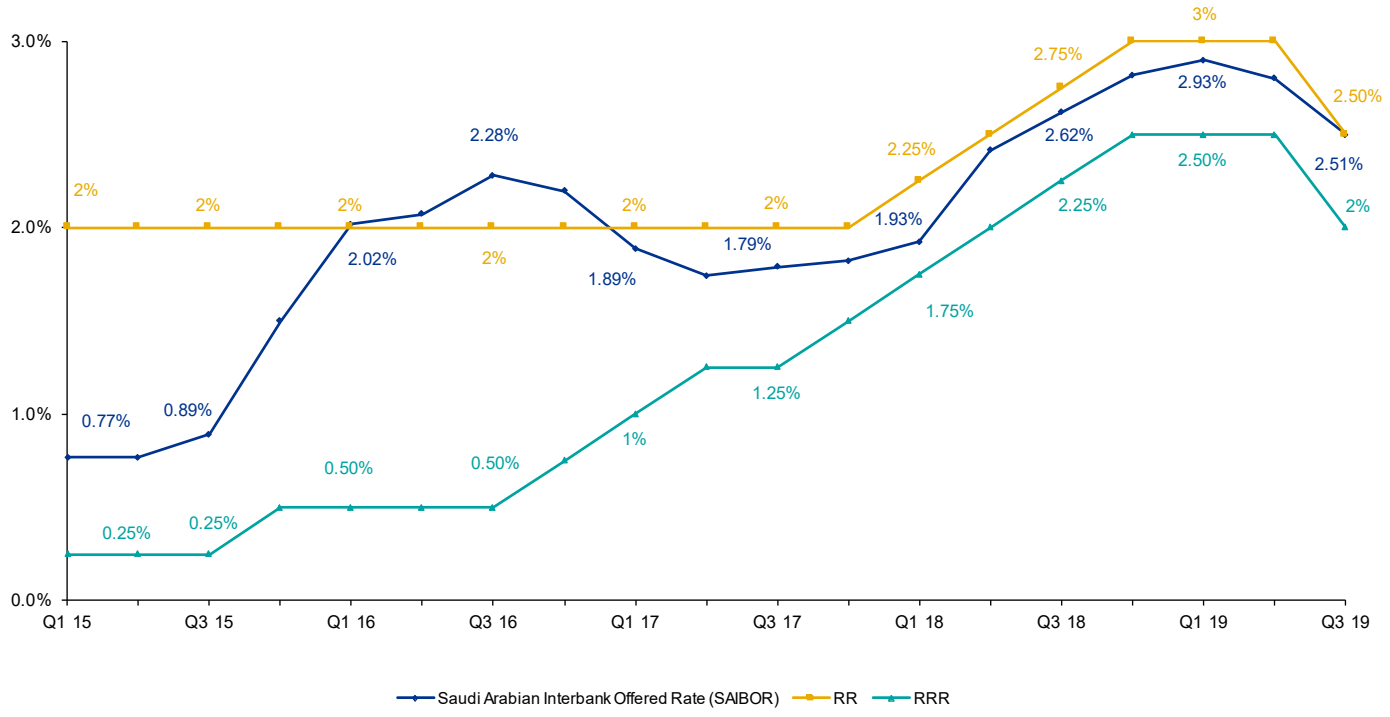
Interest rate

Since the Saudi Riyal is pegged to the US dollar, SAMA adjusts its reverse repo rate in accordance with the change in rates of the US Federal Reserve. In 2019, according to SAMA, the reverse repo rate was lowered thrice in July (from 2.50 percent to 2.25 percent), September (2.0 percent), and October (1.75 percent). In addition, the Saudi Arabian Interbank Offered Rate (SAIBOR)[1] has also been on a downward trajectory since the beginning of 2019.

In 1Q19, SAIBOR was 2.93 percent before falling to 2.82 percent and 2.51 percent by 2Q19 and 3Q19, respectively.

It is important to note that since the business lifecycle stages could differ in Saudi Arabia and the US, the currency pegging might have an impact on the former's economic growth to some extent.

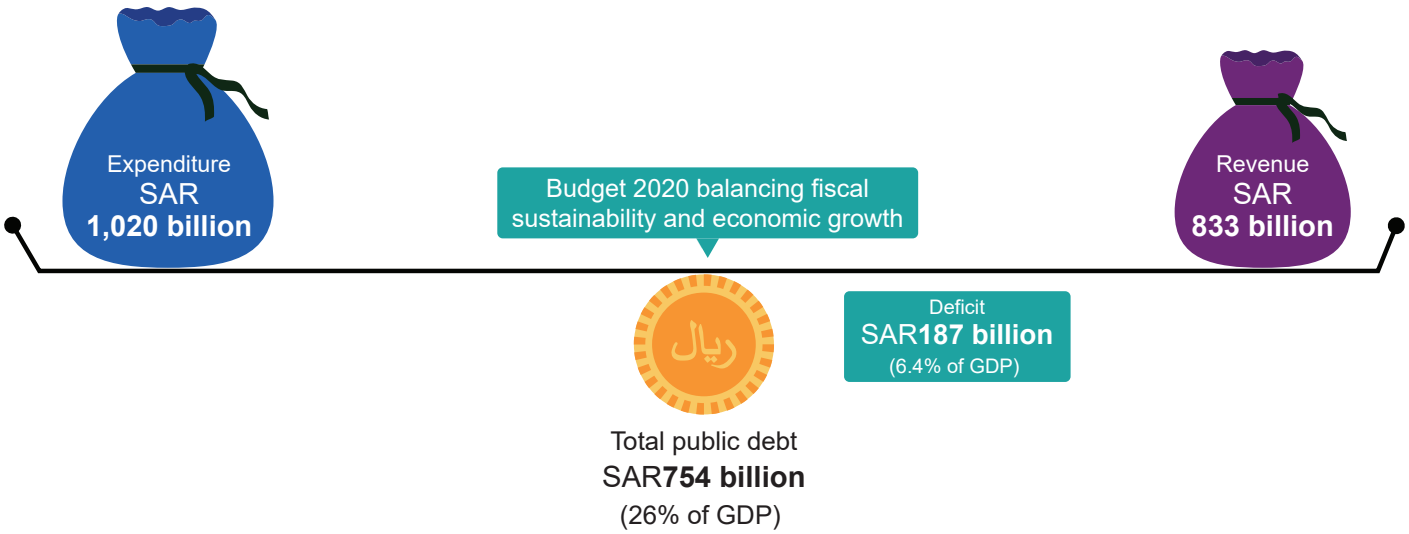
Figure 9: Changes in RR, RRR, and Saudi Arabian Interbank Offered Rate (SAIBOR)



Source: SAMA Quarterly report

Note: [1]SAIBOR is the rate at which the Saudi banks offer to lend unsecured funds to other banks in the Saudi Riyal

2020 budget analysis

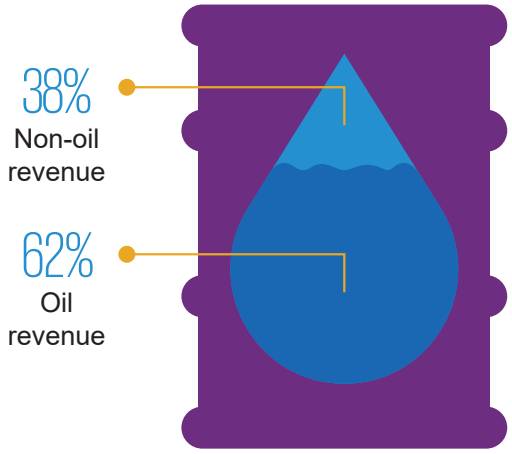


Source: 2020 Annual budgets, MoF

Revenue diversification

The Saudi government has set an ambitious target for the country's economic growth with an increased focus on economic diversification, creating more jobs and growing non-oil revenues.

Figure 10: Public revenue, SAR 833 billion



Source: 2020 Annual budgets, MoF

Public revenue

According to the MoF, total public revenue is expected to reach SAR833 billion in 2020 compared with SAR917 billion in 2019. Oil revenue is expected to remain a major contributor to the country's revenue, with a share of 62 percent in 2020 (with a value of SAR 513 billion), while the share of non-oil revenue is expected to reach 38 percent, valued at SAR320 billion.

Oil revenue is estimated to decline by 14.8 percent from SAR602 billion in 2019 to SAR513 billion in 2020, primarily due to oil price volatility owing to the US–China trade tensions. In 2020, non-oil revenue is expected to reach SAR320 billion, an improvement of 1.6 percent over the previous year's estimate of SAR315 billion. The growth in non-oil revenue reflects the government's ongoing efforts to diversify its revenue streams.

Due to reduction in the projected revenue, owing to oil price volatility and lower oil production, the MoF has decreased budgeted expenditure for 2020 by 2.7 percent, from SAR1,048 billion budgeted in 2019 to SAR1,020 billion. Despite the oil market volatility, allocation of over SAR1 trillion budget expenditure for 2020 demonstrates the government's commitment toward driving economic growth.

As per the budget announcement, current expenditures (OPEX), which hold the largest share of public spending, is expected to decline by 3.4 percent to SAR847 billion in 2020, compared with the 2019 estimates (SAR877 billion). At SAR504 billion, spending on public employees in 2020 is projected to remain unchanged from 2019 estimates. Capital expenditure estimates are also likely to remain largely unchanged from SAR172 billion in 2019 to SAR173 billion in 2020.

Fiscal deficit

The budget deficit in 2020 is expected to be SAR187 billion (6.4 percent of 2020's expected total GDP), compared with SAR131 billion (4.7 percent of GDP) in 2019. The MoF expects the fiscal deficit for 2020 to widen, primarily due to oil market instability. The government is continuing its efforts of reducing the budget deficit to achieve the target of fiscal balance by 2023.

Public debt

Public debt in 2020 is expected to reach SAR754 billion, 26 percent of the estimated GDP in 2020 and 11.2 percent higher than the previous year (SAR678 billion). Debt projections remain largely unchanged compared with the 2019 budget, except for 2022, which has undergone an upward revision of about SAR31 billion to reach SAR924 billion. The debt-to-GDP ratio remains below the government's National Transformation Program 2020 target, wherein a ceiling of 30 percent was put on public debt as a percentage of GDP.

2019 budget vs. estimates

To analyze whether the government's projected expenditures and revenue match with the realized outcomes, we review the figures of the budget announcement in December 2018 with the estimates that were made at year end. Improved accuracy of the budget forecasts is instrumental for investors and resident businesses who heavily rely on these figures to build their strategies.

The highest increase in estimated expenditures was realized in the Education sector with spending of SAR202 billion, 4.7 percent higher than the budgeted expenditure of SAR193 billion. Also, the estimated spending on the Military sector — 17.3 percent of the total government expenditure — was higher than budgeted, at 3.7 percent (Table 1).

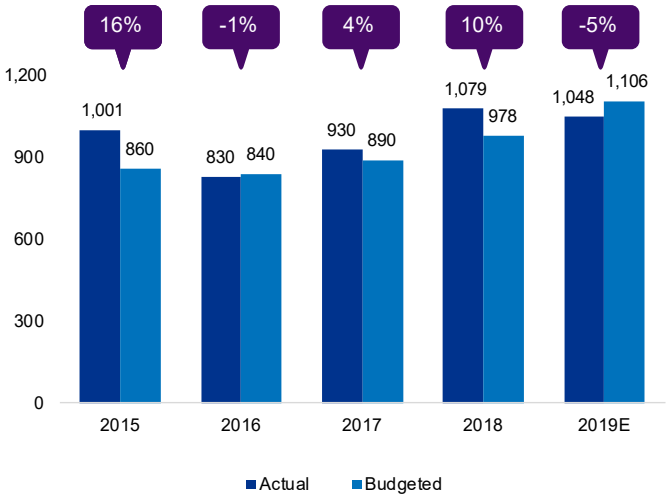
According to the MoF, the overall estimated expenditure was 5.2 percent lower than the budget expenditures, and even though operational expenditures were higher, increasing by 2 percent from SAR860 billion to SAR877 billion, capital expenditures were 30.1 percent lower than budgeted. The fiscal deficit remained unchanged at SAR131 billion, because even though revenues were lower, expenditures decreased by the same amount. Public debt has also not changed from what was budgeted at SAR678 billion, but the government reserves decreased by 5.8 percent from SAR496 billion to SAR467 billion.

Table 1: Expenditure by sector

Sector	2019 Budgeted (SAR billion)	2019 Estimates (SAR billion)	Variance	% of total government expenditure
Public administration	28	29	3.6%	2.5%
Military	191	198	3.7%	17.3%
Security and regional administration	103	104	1.0%	9.3%
Municipal services	63	59	-4.8%	5.6%
Education	193	202	4.7%	17.5%
Health and social development	172	174	1.2%	15.6%
Economic resources	131	99	-24.4%	11.8%
Infrastructure and transportation	70	62	-11.4%	6.3%
General items	156	121	-22.4%	14.1%
Total	1,106	1,048	-5.2%	100%

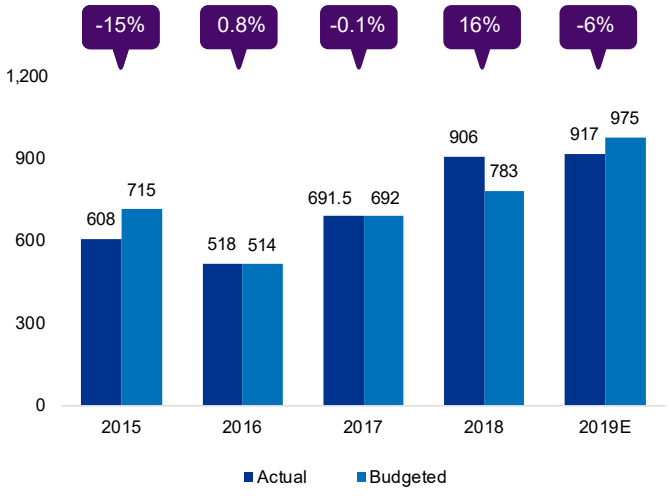
Source: MoF

Figure 11: Budgeted expenditure vs. actual expenditure (SAR billion)



Source: MoF

Figure 12: Budgeted revenue vs. actual revenue (SAR billion)



Source: MoF

Risks and challenges

Impact of US-China trade tension, OPEC+ agreement and Coronavirus

Due to the ongoing US-China trade tension, and the adverse effect it had on the confidence in global financial markets, oil fell 8.7 percent in 3Q19, the biggest quarterly fall since 4Q18 when prices had plummeted 35 percent. Although oil prices rose in December on the back of the OPEC+ countries' decision to extend the production cuts until March 2020, and remained stable in January riding on optimism surrounding the US-China phase 1 deal, oil prices and the global oil demand is likely to remain volatile in the future.

The government of Saudi Arabia, along with other OPEC+ allies, has been taking strict measures to sustain global oil market stability. In a bid to boost oil prices, OPEC+ countries agreed to cut 1.2 mb/d off the market in 2019 and later decided to extend oil production cuts to 1.7 mb/d for a three-month period starting January 2020. Saudi Arabia further pledged additional voluntary cuts of 400,000 b/d for the first three months of 2020, taking the total oil production cuts to 2.1 mb/d.

However, production cuts and decline in oil prices have weighed on Saudi Arabia in 2019. The country's real oil GDP declined at an average of 2.8 percent y-o-y in the first three quarters of 2019.

The outbreak of Coronavirus in January 2020 brings further uncertainty to the global markets, which could weigh on global oil consumption in 2020. According to the International Energy Agency (IEA), the virus is likely to curb annual oil consumption growth by about 30 percent to 825,000 b/d in 2020.

Slow improvement in the labor market

The National Transformation Program (NTP), as part of Vision 2030, had set a target of reducing the Saudi unemployment rate to 9.0 percent by 2020 and 7.0 percent by 2030. The Ministry of Labor, however, recalibrated its goal of reducing Saudi unemployment to 9.0 percent by 2020 to 10.5 percent by 2022. The unemployment rate of Saudi nationals declined in 3Q19, but remains high at 12.0 percent, with male unemployment at 5.8 percent and female unemployment at 30.8 percent.

Although the government has launched several initiatives to decrease the country's overall unemployment rate and has taken noteworthy measures to increase the male and female labor participation rates, Saudi Arabia's unemployment rate has been decreasing at a slow pace. This could partly be due to the unavailability of jobs for the young population entering the market. Although the labor market for women has significantly improved over the past few years, the rate of improvement is still slower than what is required to achieve the Vision 2030 targets.

Improving the country's education system is a crucial enabler for improving skills of the Saudi workforce and will have a positive impact on labor productivity and serve as catalyst for the country's overall labor market.

Maintaining momentum of economic and social reforms

The economic and social reform agenda set out by Vision 2030 should maintain its momentum but the government should also be mindful to deliver in the most optimal sequence. A holistic view on these reforms and programs is instrumental to understand where they complement each other, and where they may be contradictory — especially with regards to the challenges presented to government finances. It has been over three years since the launch of Saudi Vision 2030. With an aim to diversify the country's economy and realize its Vision 2030 goals, the government has taken numerous initiatives of significant importance. Regular reporting on the progress of the various Vision 2030 initiatives will greatly improve understanding of the programs and encourage more Public-Private Partnerships (PPP) in the financing of these programs.

The private sector's investment in these programs might reduce the government's burden, which, in turn, could improve the government's ability to maintain fiscal stability.

Contact us

Economic Research Unit

Dr. Hussain Abusaaq

Chief Economist and
Head of Research
E: habusaaq@kpmg.com

Contributors

Abdulaziz Alshamsan

Yazid Alshahrani

Mohamad Alshamari

Follows us on:
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