



USSBC Economic Brief Mid-Year Macroeconomic Update 2021

Overview

Following a tumultuous year for oil markets and international travel, Saudi Arabia's economy returned to a growth footing in Q2 2021. The Saudi economy grew 1.8 percent YoY in Q2 on annualized basis with the non-oil sector growing at 8.4 percent. A robust recovery in global oil demand helped boost government revenues well beyond expected levels in the first half of the year. The Kingdom's flagship crude grade, Arab Light, started the year around \$50 per barrel and closed the second quarter at \$74 as global trade and travel resumed.

Consequently, government revenues rose 39 percent YoY to reach SAR453 billion (\$121 billion) while government expenditures inched down 0.9 percent YoY to SAR465 billion (\$124 billion). Saudi Arabia's fiscal deficit through H1 2021 is just 9 percent of the anticipated full-year total, indicating the government will likely exceed its target in cutting the fiscal deficit. Saudi Arabia's GDP currently stands at SAR2.52 trillion (\$672 billion), approximately 5 percent below pre-pandemic levels. The non-oil, private sector recovered faster than both the oil and government sectors and now stands above its pre-pandemic levels.

Oil Markets

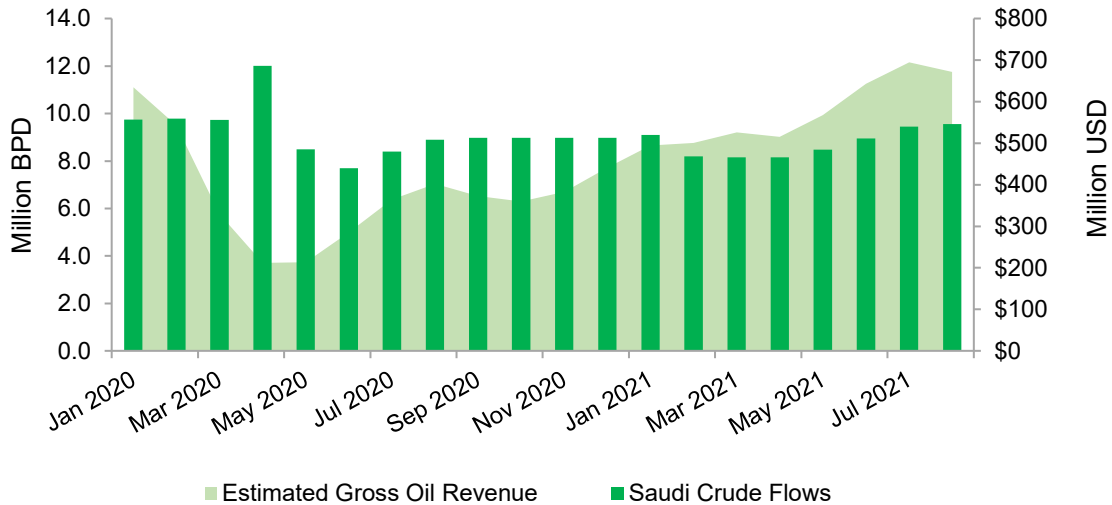
As vaccine distribution ramped up and international travel restrictions eased, global oil demand steadily increased through the first half of the year. The COVID-19 pandemic resulted in a record 8.6 million barrel per day (bpd) decline in global demand last year, driving Saudi Arabia's budget deficit to SAR298 billion (\$79 billion). However, energy demand recovered rapidly and prices were also buoyed by OPEC+ agreements which kept 7.2 million bpd of oil production on the sidelines. Saudi Arabia separately made a voluntary 1 million bpd cut to its crude output during the first quarter of the year to further bolster price recovery. Official figures show government oil revenues rose 11 percent YoY in H1 2021. While prices have recovered to pre-pandemic levels, average Saudi oil production during Q2 2021 was 8.5 million bpd which is still 1.3 million bpd lower than output during Q1 2020.

In July, OPEC+ reached a major supply agreement that will see total oil production by the 23 member countries increase by 400,000 barrels per day (bpd) every month starting in August until September 2022



when the remaining 5.8 million bpd cut from global production last year is added back to the market. The agreement also raised production baselines for Saudi Arabia, the U.A.E., Russia, and other countries starting in May 2022. Saudi Aramco maintained its SAR281 billion (\$75 billion) dividend commitment, the vast majority of which is collected by the government. Saudi Aramco reported a 288 percent increase in net income in Q2 2021 while pledging to maintain its previous dividend commitments.

Saudi Arabia Oil Production



Source: Ministry of Finance, Refinitiv

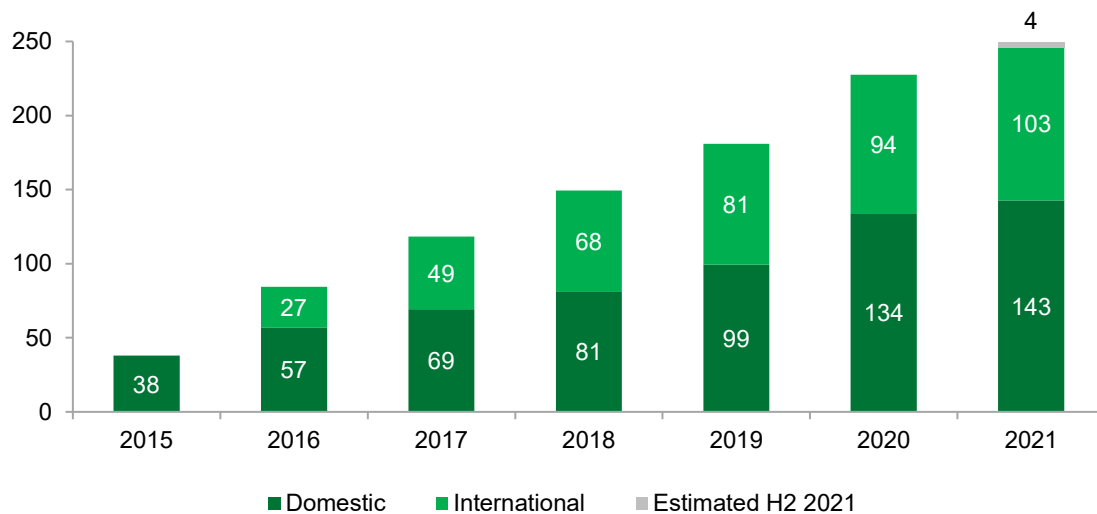
Saudi Arabia gradually lifted business and international restrictions for fully vaccinated individuals throughout the first half of the year. The Kingdom also announced only vaccinated persons would be allowed to enter both public and private establishments starting August 1. With pandemic measures eased, the return of travel, tourism, recreational, and business activity supported recovering domestic oil demand. As oil prices picked up during the summer travel season, the Kingdom implemented a local gasoline price cap to mitigate rising costs for consumers.

Government Finances

Saudi government revenues rose 85 percent YoY in Q2 to reach SAR248 billion (\$66.1 billion), according to the Ministry of Finance. Oil revenues rose 38 percent YoY and non-oil revenues were up 203 percent YoY, rising sharply from pandemic lows. ‘Taxes on goods and services’ rose 544 percent YoY and was the biggest category driving non-oil revenue growth, reflecting the value-added tax (VAT) hike from 5 to 15 percent last year. Saudi government expenses meanwhile rose 4 percent YoY in Q2, totaling SAR253 billion (\$67.5 billion). The increase was primarily due to an 8 percent rise in current expenditures such as social benefits which rose +101 percent and goods & services which rose 30 percent. Expenditures were offset by significant reductions in capital expenses, subsidies, and grants which declined 25 percent, 57 percent, and 79 percent, respectively.

The government budgeted a SAR141 billion (\$38 billion) deficit for 2021. As a result of strong oil revenues, the actual deficit through H1 2021 was just SAR12 billion (\$3.2 billion). Additionally, more than 80 percent of the Kingdom’s planned 2021 borrowing was satisfied through domestic and international debt sales in H1 2021 alone. This includes SAR34 billion (\$9 billion) in riyal-denominated sukuk and SAR38 billion (\$10 billion) in international euro or dollar-denominated issuances. The Kingdom is expected to raise a further SAR15 billion (\$4 billion) in 2021, bringing the total outstanding public debt to SAR923 billion (\$246 billion).

Outstanding Public Debt (USD Billion)



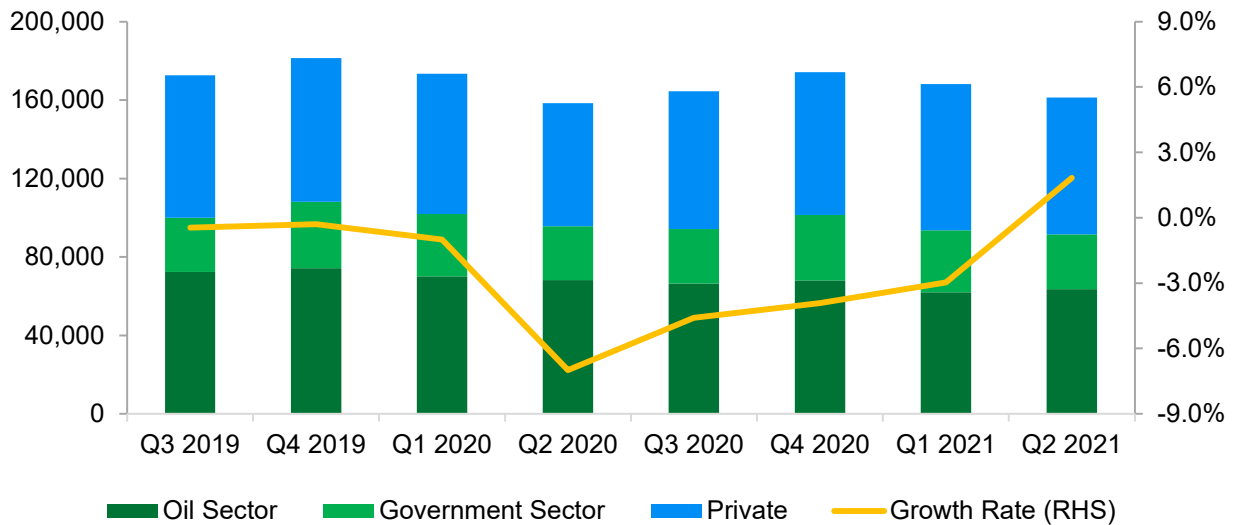
Source: Ministry of Finance, USSBC

The Kingdom’s improved fiscal position led Fitch Ratings to revise its outlook on Saudi Arabia’s long-term foreign currency issuer default rating to ‘Stable’ due to “significantly higher oil prices and continued government commitment to fiscal consolidation.” Saudi Arabia’s rating was affirmed at ‘A’. S&P Ratings also appraised a ‘Stable’ outlook while Moody’s has maintained a ‘Negative’ outlook since oil prices collapsed in Q2 2020. Ratings agencies cited large fiscal buffers (government reserves), the VAT increase, and Saudi Aramco’s dividend commitment as key supports for the Kingdom’s credit rating.

GDP Performance

The Saudi economy grew 1.8 percent YoY in Q2 on an annualized basis, totaling SAR2.52 trillion (\$672 billion). Economic activity declined 4 percent in Q2 on a quarterly basis, however, as the non-oil and private sectors lost momentum. The Kingdom’s economy remains nearly 5 percent below its pre-pandemic level of SAR2.63 trillion (\$702 billion). On an annualized basis, Q2 2021 was the first positive growth reading since Q2 2019. Saudi Arabia’s private sector proved the most resilient element of the economy as it returned to pre-pandemic levels of economic activity in Q2. By comparison, the government sector remained 0.6 percent below pre-pandemic levels while the oil sector remained 10 percent below pre-pandemic levels.

Q2 Real GDP by Economic Activity (USD Million)

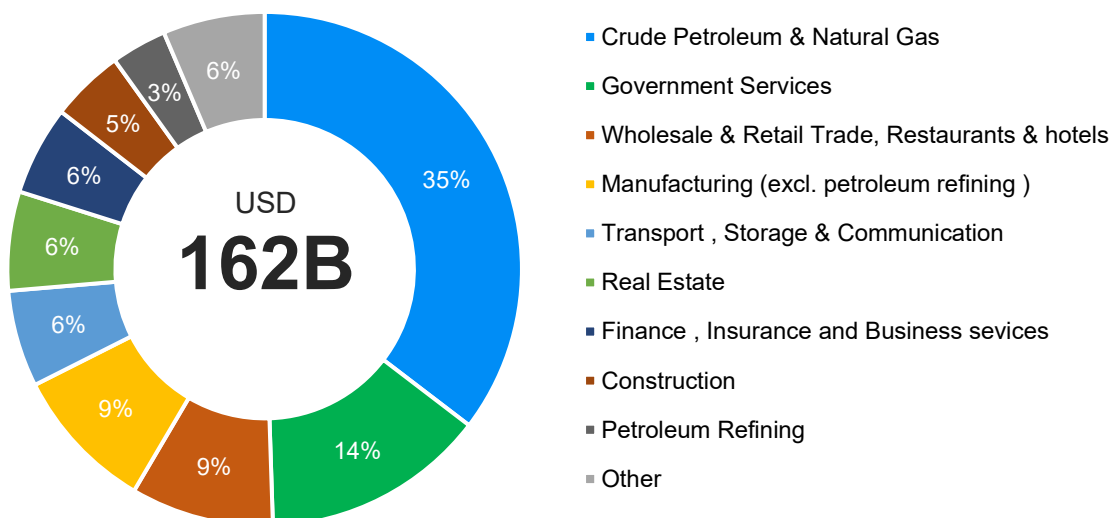


Source: GStat

Non-Oil Economy

Due to disparate rates of recovery between sectors and economic diversification initiatives under Vision 2030, Saudi Arabia's non-oil economy now accounts for 61.1 percent of GDP compared to 58.5 percent before the COVID-19 pandemic. The fastest growing non-oil sectors were real estate and 'finance, insurance, & business services' which stand 5 percent and 3 percent higher than pre-pandemic levels. Both non-petroleum manufacturing and construction fully recovered to pre-pandemic levels as well. In Q2,

Saudi Arabia Q2 2021 Real GDP



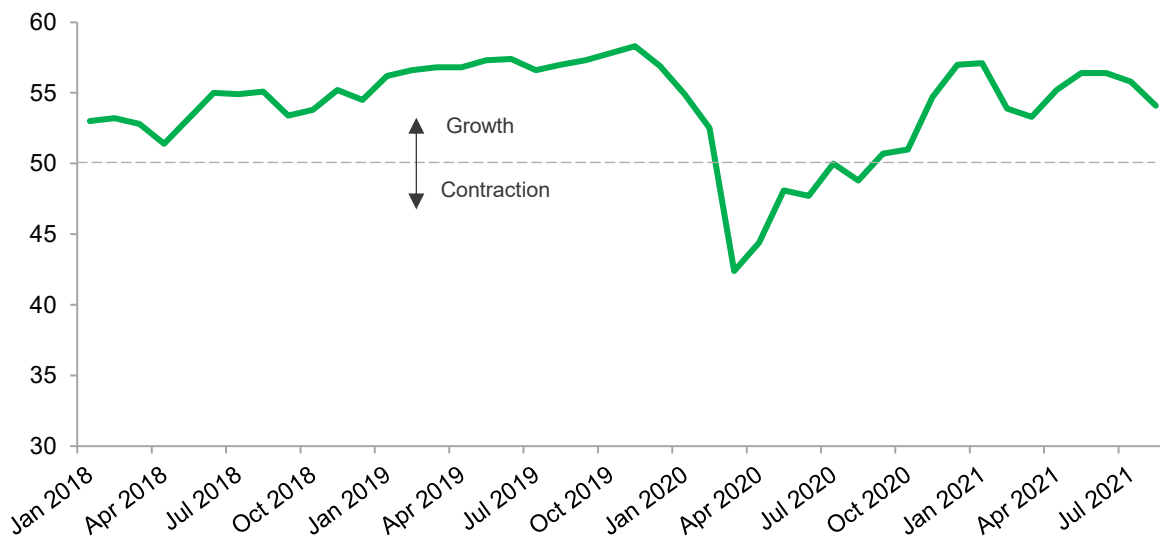
Source: GStat



manufacturing grew 13.8 percent YoY, wholesale/retail trade grew 16.9 percent YoY, and ‘community, social, and personal services’ grew 17.1 percent YoY. Sectors that have not yet recovered to pre-pandemic levels include transportation & storage, petroleum refining, and wholesale/retail trade due to lingering pandemic effects on service sector industries and global supply chains.

The real estate sector and consumer spending have reached record levels in H1 2021 amid a surge in new residential mortgages and a strong local demand for goods and services. Bank financing for new residential mortgages in Saudi Arabia rose 29 percent YoY in H1 2021 to reach a record high SAR77 billion (\$20.5 billion). Consumer spending rose 46 percent YoY in H1 2021 and also registered a record high SAR227.3 billion (\$60.6 billion). Spending in every sector was higher than the first half of last year. Consumer spending on retail goods, restaurants, telecommunications, and hospitality were the fastest growing segments from last year. According to IHS Markit’s Purchasing Managers’ Index (PMI), the Saudi non-oil private economy has remained in expansion since September 2020. However, output growth slipped to a ten-month low in August as business confidence waned on supply chain delays and softer hiring levels.

Saudi Arabia Purchasing Managers' Index



Source: IHS Markit

Outlook

The IMF forecasts the Saudi economy will grow 2.4 percent in 2021, including 4.3 percent growth in non-oil GDP. Annual inflation is expected to reach 3.2 percent, reflecting both the VAT increase and rising food and energy prices. In its recent Article IV Consultation, IMF praised the government’s decisive response to the COVID-19 pandemic, the maintenance of strong fiscal buffers, the VAT increase, and other regulatory changes that facilitated the ease of doing business in the Kingdom.



In Focus: Saudi Capital Markets Lead GCC in Market Cap and IPO Activity

The Tadawul All-Share Index (TASI), the leading total market indicator for Saudi Arabia's stock exchange, reached a 14-year high in August 2021 amid positive economic momentum and investor sentiment. The historic Saudi Aramco IPO was followed by other major listings in 2020 including healthcare firm Dr. Sulaiman Al-Habib Medical Services Group and grocery retailer BinDawood Holding. A remarkable bull run in equity markets since the COVID sell-off in early 2020 has fueled an active and growing IPO market in Saudi Arabia. Of the ten major IPOs in the GCC so far this year, five were listed on the Tadawul exchange. Other companies expected to enter the IPO market this year include the Tadawul Group and security firm Elm.

Tadawul IPOs (Jan 2021 through Sept 2021):

- Alkhorayef Water and Power Technologies Co.
- Theeb Rent a Car Co.
- Tanmiah Food Co.
- Shatirah House Restaurant Co. ("Burgerizzr")
- Arabian Internet and Communications Services Co. ("solutions by stc")
- ACWA Power*

*ongoing

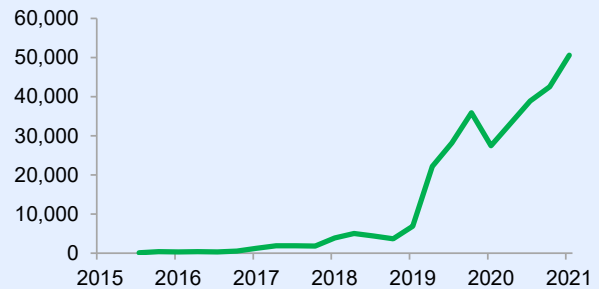
Qualified foreign investor (QFI) ownership has grown steadily from SAR134 billion (\$36 billion) in Q4 2019 to SAR190 billion (\$51 billion) in Q1 2021. The Financial Sector Development Program (FSDP), a Vision Realization Plan (VRP) covered in our August 2020 Economic Brief, has ushered in regulatory changes aimed at modernizing and liberalizing Saudi capital markets to attract business and investment. The Capital Market Authority (CMA) opened the Tadawul to foreign portfolio investment in 2015 and further opened the IPO market to foreign investors in 2017. The latest developments include launching Saudi Arabia's first derivatives product and opening debt instrument to non-resident foreign investors. The Tadawul exchange's total market capitalization has grown six-fold since the market was opened to foreign investors.

Tadawul All-Share Index



Source: Tadawul

Foreign Portfolio Investment Flows
(USD Million)



The recent OPEC+ agreement indicates oil production in H2 2021 will average 3 million bpd more than H1 2021. Following a record decline of 8.6 million bpd in 2020, the International Energy Agency (IEA) forecasts demand to rebound 5.4 million bpd in 2021 and a further 3.1 million bpd in 2022. Saudi Arabia's baseline production level will also be increased from 11 million bpd to 11.5 million bpd, a level currently targeted for September 2022. Assuming relatively stable oil prices, Saudi Arabia is on track to narrow its budget deficit more quickly than expected. This bodes well for the government's plan to nearly eliminate the budget deficit by 2023. Oil production increases and demand growth will provide further support for the economic rebound.



Fiscal Performance

(USD Billion)

	Actual		Official Projections		
	2020	H1 2021	2021	2022	2023
Total Revenues	205	121	226	230	248
Total Expenditures	285	124	264	255	251
Budget Deficit	-79	-3	-39	-24	-4
as percent of GDP	12.0%	0.5%	5.1%	3.0%	0.4%
Debt	228	242	224	271	274
as percent of GDP	34.4%	36.0%	32.9%	33.4%	31.8%

Source: Ministry of Finance

Appendix:

GDP Growth by Sector

(USD Million)

	H1 2020	H1 2021	% Growth
Petroleum Refining	36,829	42,478	+15%
Manufacturing (excl. petroleum refining)	104,347	116,732	+12%
Wholesale & Retail Trade, Restaurants & Hotels	108,449	119,677	+10%
Community, Social & Personal Services	27,322	29,877	+9%
Real Estate	71,134	76,606	+8%
Non-Oil Mining & Quarrying	5,596	5,909	+6%
Import Duties	7,235	7,605	+5%
Finance, Insurance and Business Services	63,108	66,140	+5%
Electricity, Gas and Water	12,394	12,884	+4%
Agriculture, Forestry & Fishing	30,768	31,707	+3%
Construction	57,042	58,719	+3%
Transport, Storage & Communication	75,815	77,074	+2%
Government Services	183,973	184,895	+1%
Crude Petroleum & Natural Gas	479,393	425,267	-11%
GDP	1,251,867	1,243,384	-1%

Source: GASTat



Government Spending by Sector (USD Million)

	H1 Actual	2021 Full-Year Budget	H2 Expected	% Govn't Budget Remaining for H2
Education	91,110	185,702	94,592	51%
Military	93,905	175,096	81,191	46%
Health & Social Development	91,840	174,677	82,837	47%
General Items	64,009	151,123	87,114	58%
Security & Regional Administration	45,689	100,817	55,128	55%
Economic Resources	27,142	72,395	45,253	63%
Municipal Services	14,252	50,799	36,547	72%
Infrastructure & Transportation	22,115	45,819	23,704	52%
Public Administration	14,862	33,572	18,710	56%

Source: Ministry of Finance

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