جدوى للإستثمار
Jadwa Investment

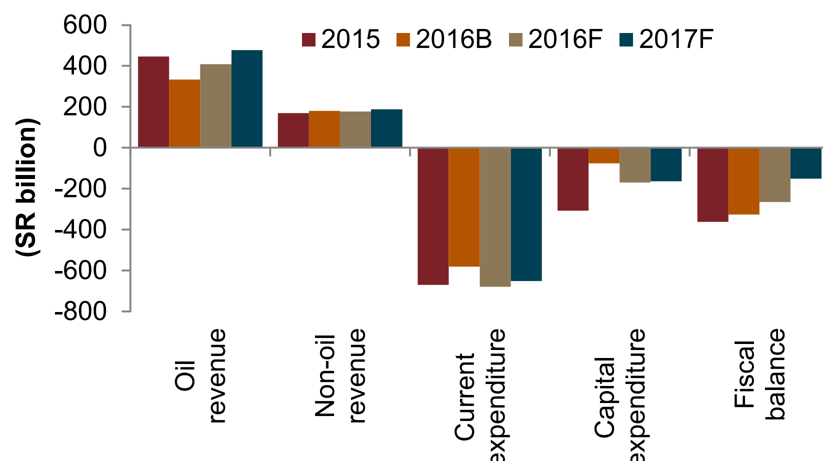
November 2016

Macroeconomic Update

Reform of the Saudi Economy Begins to Take Shape

- We have revised some of our 2016 and 2017 forecasts to take into account the recent set of fiscal reforms and economic data.
- Since the start of 2016, and in line with targets specified in the National Transformation Program (NTP 2020), prudent policies to reform the fiscal budget have been taken.
- Fiscal consolidation -primarily on the capital spending side- coupled with improved non-oil revenues, will mean a smaller-than-anticipated fiscal deficit in both 2016 and 2017.
- This consolidation will, nevertheless, negatively impact private sector activity, thereby leading to lower growth in non-oil GDP.
- The commencement of an international sovereign bond issuance program will have a dual benefit of protecting FX reserves and reducing pressure on domestic liquidity.
- The Ministry of Finance will also take steps to gradually register, list, and trade government debt instruments on the Saudi stock exchange, thereby establishing a benchmark yield curve.
- Meanwhile, the current account deficit is also forecast to be smaller than anticipated, mainly due to lower-than-expected value of imported goods and services.
- Along with the international bond issuance, several other efforts by the government have halted the sharp rise in the cost of funding, as interbank rates have stabilized recently.

Figure 1: The Kingdom's fiscal balance



2016B corresponds to the budgeted figures by the Ministry of Finance
2016F and 2017F corresponds to Jadwa Investment forecasts

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- Despite the hike to energy prices at the end of 2015, inflation continued on a decelerating trend, which we believe is reflective of the slowdown in consumption.

Global economic growth steady, but unremarkable

Global GDP averaged 3.3 percent year-on-year, between 2012-2015…

...with forecasts pointing to marginally lower growth rates of 3.1 percent in 2016…

...and 3.4 percent in 2017.

Global economic growth has been steady, but unremarkable in the last few years, with 2016 growth rates expected to fall further. According to International Monetary Fund (IMF) data, global GDP averaged 3.3 percent year-on-year, between 2012 and 2015, while 2016 and 2017 forecasts point to a marginally lower growth rate of 3.1 percent and 3.4 percent, respectively (Figure 2). According to the same IMF forecasts, the US, as has been the case in recent years, will be the major proponent of growth amongst the advanced economies. Canada and the Euro zone are expected to show more consistent, if somewhat slower growth, but the uncertainty tied to negotiations over the UK's decision to leave the European Union will leave it economically worse off in the next couple of years. The UK joins Japan as the weaker element amongst the major advanced economies. Emerging market growth in 2016 is expected to be slightly better than 2015, at 4.1 percent, but sizably slower than the 2010-15 average of 5.4 percent. Whilst the Chinese economy is expected to slow, this will be a more gradual decline. On a more positive note, India is expected to pick up the mantle of fastest growing major economy for the next few years.

Some potential headwinds are present, and mainly include…

...the outcome of the US election…

Several headwinds are present which could negatively affect current IMF forecasts. The most immediate and wide-reaching risk to global economic growth is embedded in the outcome of the US election. An unexpected win in the recent US election, for President-elect Trump, has resulted in increased uncertainty on a number of issues; specifically in relation to the global economy, there are potential implications for global trade. President Trump's campaign in the run-up to the election was marked by a strong desire to remake the US's economic relationship with current trading partners, including withdrawing from existing (North American Free Trade Agreement) and future trade agreements (Trans-Pacific Partnership), as well as potentially raising import tariffs and bringing trade cases against China. Whilst acting on these promises may be difficult, overall, the risk is that a more inward looking US under Trump could lead to a decline in global trade, negatively affecting global economic growth in the years ahead.

...and the uncertain impact of 'Brexit'.

The US Dollar has strengthened in the last month or so due to stronger-than-expected Q3 2016 US GDP growth, and we expect further interest rates rises to keep the Dollar strong in the months ahead. The President-elect's policies aimed at boosting infrastructure investment are likely to push up inflation, which will probably result in further rises in interest rates from the US Federal Reserve. Current indicators are already showing a high probability of interest rate hikes in December 2016. Other sizable risks to the global economy include the uncertain impact of 'Brexit'. So far, there seems to be no material effect of the UK's decision to leave the European Union (EU), back in June. However, following the UK Prime Minister's recent announcement that Britain's formal exit from the EU will begin in Q1 2017, downward risks of a 'Brexit' are apparent. A worst case scenario would be a European contagion resulting in increased volatility in financial markets and widespread sell-off in assets, potentially leading to slower European and therefore global economic growth.

Saudi economic growth to slow but remain positive in 2017

We forecast overall GDP growth to reach 1.1 percent and 0.6 percent in 2016 and 2017 respectively.

Year-on-year growth in M3 turned positive in October for the first time since the start of 2016.

We expect economic performance to remain positive for the remainder of 2016. We forecast overall GDP growth to reach 1.1 percent and 0.6 percent in 2016 and 2017, respectively, with oil sector GDP growing by 2.1 percent and 0.6 percent over the next two years. Non-oil GDP is forecast to reach 0.3 percent and 0.5 percent during the same period. The contribution of oil production to annual economic growth is likely to remain on the positive side. Albeit at a slower pace, we expect private sector growth to remain positive at 0.7 percent, as the recent moderation in credit growth is expected to ease following the recent issuance of international sovereign bonds and the resumption of government payments. Business surveys point towards an expansion in the non-oil private economy in 2016, with the non-oil purchasing managers' index averaging 54.8, year-to-October, slightly down from the full-year average of 56.7 in 2015. Year-on-year growth in broad money supply (M3) turned positive in October for the first time since the start of 2016. While local fundamentals are still reflecting a growing economy, risks are tilted towards the downside. As for 2017, we see growth in the non-oil private sector improving to 1.0 percent, with further easing in credit conditions and more clarity concerning the reform plans paving the way for an improving level of sentiment. That said, any further measures to reduce the fiscal deficit could potentially lead to negative growth in non-oil economic activity. (See our October 2016 publication titled "Quarterly GDP Update" for a more thorough analysis of the latest GDP trends and forecast).

Fiscal reforms and consolidation

We have revised down our 2016 and 2017 forecast for the budget deficit to SR265 and SR151 billion, respectively.

Any further efforts to reduce the deficit could potentially harm growth in the non-oil economy.

We have revised down our 2016 and 2017 forecast for the budget deficit to SR265 billion (11.2 percent of GDP), and SR151 billion (5.8 percent of GDP), respectively. The recovery in oil prices, compared to earlier in the year, will lead to an improvement in oil revenue for the government. Meanwhile, multiple efforts to raise non-oil revenue, including higher fees for government services (see box 1) and improved efficiency in revenue collection, will contribute to strong growth in non-oil revenues during 2016 and 2017. On the expenditure side, recent reforms to the public sector wage bill will allow the government to structurally reduce the more rigid part of current spending. This will lead to a strengthening of its fiscal position, and result in smaller deficits than our earlier forecast.

Figure 2: Global GDP growth forecast, IMF

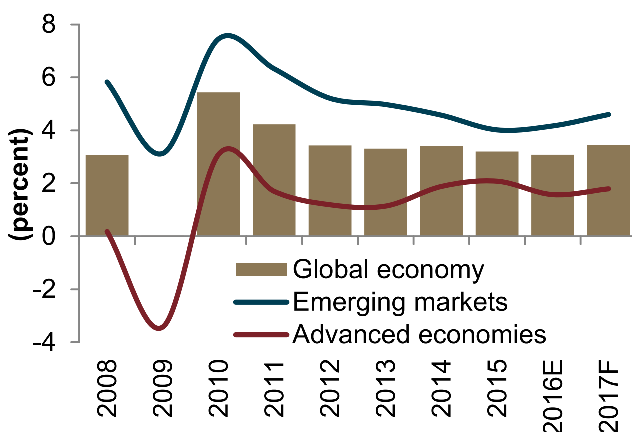
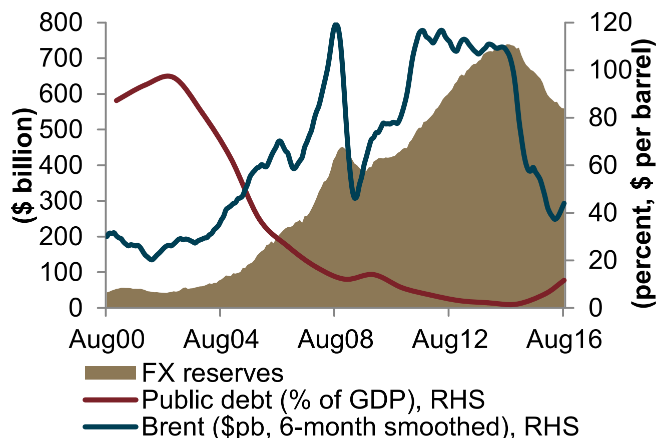


Figure 3: Fiscal buffers and oil prices



We expect oil revenues to reach SR408 billion in 2016, down from SR616 billion in 2015.

Oil revenues are the source of around 72 percent of budget revenues, which we now expect to reach SR408 billion in 2016, down from SR616 billion in 2015. **Non-oil revenues** are forecast to rise from SR169 billion in 2015 to SR177 billion in 2016. As for 2017, we forecast a recovery in oil revenues, up to SR664 billion. We also see non-oil revenues growing at a faster rate in 2017, reaching SR187 billion, as the government becomes more effective in maximizing revenues from both existing and newer sources.

We estimate that the government will be able to save around SR53 billion in 2017 as a result of reforms to the wage bill.

We see government spending on **wages and salaries** remaining high in 2016, as the impact of the reduction in allowances and wage freezes of public sector workers only takes effect from the end of this year. Beyond 2016, however, we estimate that the government will be able to save around SR53 billion next year because of the reduction in worker's allowances and wage freeze, thereby considerably strengthening the fiscal position. While budgeted **capital spending** has been cut significantly (from 264 billion in 2015 to SR76 billion in 2016), we expect that some funds originally set out under the budget surplus provision (SR183 billion) were utilized for more important capital projects such as electricity, water, and critical infrastructure. We therefore forecast 2016 capital spending to be higher than the budgeted total at SR170 billion (compared with the budgeted level at SR76 billion). The reduction to both current and capital spending leads us to forecast 2016 total government expenditure at SR850 billion in 2016, compared to our earlier forecast of SR861 billion, and slightly higher than the budgeted figure of SR840 billion.

We have revised down our forecast for the 2016 fiscal deficit, from SR283 billion to SR265 billion.

Because of the abovementioned factors, we have revised down our forecast for the 2016 fiscal deficit, from SR283 billion to SR265 billion. In 2017, we forecast total government expenditure to slow further to SR815 billion (32 percent of GDP), as a further gradual reduction in capital spending and the full impact of allowance cuts and wage freeze take effect. We believe that serious efforts to consolidate spending will result in a lower deficit at SR151 billion (5.8 percent of GDP) in 2017.

Box 1: Recently introduced reforms

2016 has already witnessed several new measures being announced and implemented, including…

2016 has already witnessed several new measures being announced and implemented, including reforms to the public sector wage bill, undeveloped land plot fees, hikes to immigration fees, new municipal fees, and higher fees for traffic violations. We see these reform plans being consistent with achieving several targets highlighted within the NTP 2020 and Vision 2030.

...reforms to the public sector wage bill...

Wage bill reform included a one-year wage freeze to public sector and semi-government workers, along with the cancellation and amendment of 21 out of a total of 156 allowances and benefits. These new measures aim to raise the efficiency of spending on salaries and wages, and will also serve other NTP targets such as improving the fiscal balance and enhancing the flexibility of public authorities. Furthermore, it is worthy to note that a 20 percent reduction in payroll and benefits expenditure was listed among the NTP targets for the Ministry of Civil Service to be achieved by 2020. The Ministry of Finance also has a five-year target to reduce the wage bill from SR480 billion to SR456 billion.

Immigration reform was implemented during 2016, with the aim of

...hikes to emigration fees…

improving non-oil revenues. The measures included higher fees for entry, exit, and transit visas (table 1). In addition, a 50 percent government subsidy was allowed to expire on select services such as fees on issuance, renewals, and ownership transfer of passports, drivers' licenses, and work permits for household labor.

Table 1. Old and new visa fees

Visa type	Old fees (SR)	New fees (SR)	Description
Single entry/exit for residents	200	200 + 100	SR100 for every extra month if stay exceeded 2
3-month multiple entry/ exit for residents	500	500 + 200	SR200 for every extra month if stay exceeded 3
Entry for sponsored non-residents	50	300	
Single entry for non-residents	200	2000	
Multiple entry for non-residents	500	3000	SR3000 for 6-months

...and new municipal fees.

Recently approved municipal fees span a wide range of services including operating telecommunication towers, demolition permits, construction licensing, and some commercial permits. The Ministry of Municipal and Rural Affairs (MOMRA) recently announced that these fees will be taken into effect on December 9, 2016. It is worthy to note that the approved fees are considerably lower than the maximum values released by the Council of Ministers in August, which is likely to limit the negative impact on businesses and consumers. Also, according to MOMRA, the implementation of fees on certain services has been postponed. Amongst those postponed are fees on residential and commercial garbage collection, street drilling permits, and licensing for gas stations outside of urban areas.

MOMRA ranked the fees into 5 categories depending on the municipality, with Category 1 municipalities spanning the largest

Table 2. Municipal fees applied to category 1 municipalities

Licensing activities*	Unit	Division 1 fees (SR)	Division 5 fees (SR)
Commercial stores	Per sqm	6	0.30
Hotels and resorts**	Per room	250	50
Educational facilities	Per sqm	3	0.15
Medical facilities	Per sqm	3	0.15
Kitchens and restaurants***	Per sqm	8	4
Workshops	Per sqm	6	0.3
Warehouses	Per sqm	1	0.05
Recreational housing units	Per sqm of land area	3	0.15
Wedding halls	Per sqm	3	0.15
Other activities	Per sqm	3	0.15
Licensing activities	**Unit**	**Applied fees (SR)**	
Gas stations	Per station	5,000	
ATM operation	Per ATM	1,000	
Telecom tower operation	Per tower	500	
Commercial building construction	Per sqm	6	
Residential building construction	Per sqm	3	
Residential commercial building construction	Per sqm	4	
Health certificate issuance	Per certificate	60	

Notes: * Division 1 fees correspond to areas up to 5,000 sqm, division 5 fees correspond to areas over 30,000 sqm.
** Division 1 fees correspond to 5-star hotels, division 5 fees correspond to 1-star hotels.
*** Division 1 fees correspond to areas up to 5,000 sqm, division 5 fees correspond to areas over 5,000 sqm.

urban areas in the Kingdom, and charging the highest fees. These municipalities include Riyadh, Jeddah, Makkah, Madinah, Dammam, Dhahran, and Al-Khobar. MOMRA also breaks down some applicable fees into five different divisions mostly depending on an activity's area size (table 2). Division 1 pricing reflects the smallest areas and charges the highest applicable fees, whereas division 5 reflects activities with the largest area size, and most applicable fees for this category are priced at a 95 percent discount to division 1 activities.

Finally, the timing of the announcement and implementation of the municipal fees has been relatively transparent compared with other reforms, and we believe future reforms need to follow similar transparent announcements before their implementation.

Diversified financing options to serve multiple objectives

The commencement of an international sovereign bond issuance program will…

The commencement of an **international sovereign bond issuance** program in October 2016 will lead to lower FX reserve withdrawals to finance the deficit, thereby protecting the Kingdom's FX reserves. In October, the government issued a $17.5 billion (20 percent of 2016 budget deficit) US Dollar denominated bond issuance. We expect that this new dual issuance of domestic and international bonds could contribute to slowing the net monthly declines in FX reserve assets (Figure 3). A recent press release by the Ministry of Finance showed that the Kingdom's total debt stood at SR274 billion in August (11.6 percent of 2016's forecasted GDP). The targeted debt level specified in the National Transformation Program (NTP 2020) is 30 percent of GDP. A breakdown of debt by holders showed that banks held 48.3 percent, while autonomous government institutions held 38 percent at the end of August 2016. The remaining 13.7 percent are claims by international debtors because of a $10 billion international loan issued earlier in 2016 (Figure 4).

...alleviate the liquidity pressure in the domestic banking system…

...and lead to lower FX reserve withdrawals to finance the deficit.

The solid credit profile and ample reserves enjoyed by the Kingdom, coupled with relatively low interest rates globally, resulted in an attractive cost of financing for the recent issuance, with yield spreads over US treasury bonds for the 5, 10, and 30 year tranches being 135, 165, and 210 basis points (bp), respectively (Table 3). US treasury bond rates have nearly halved over the past seven years, with yields on the five-year treasury bonds falling from 2.346 percent in October 2009 to 1.234 percent in October 2016. The government

Yield spreads on the 10-year tranche is priced at 165bp.

Figure 4: Breakdown of public debt by holder

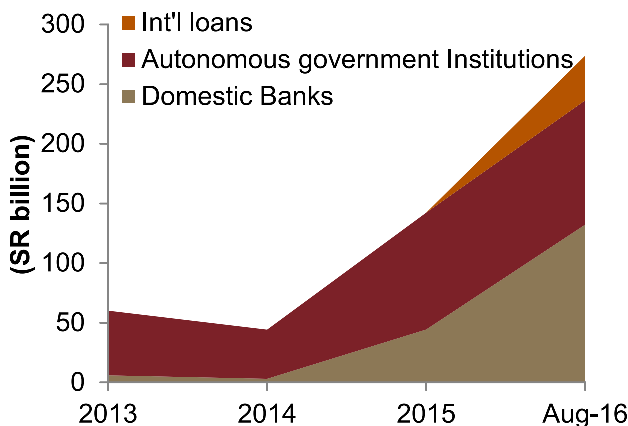
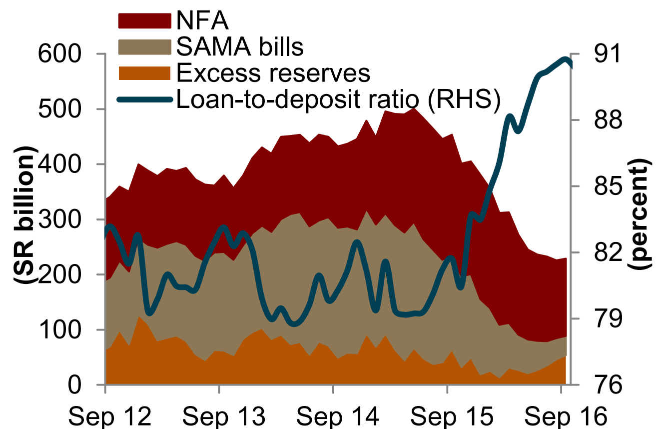


Figure 5: Estimate of bank excess liquidity



will be able to afford fiscal expenditures for a longer time as it continues to tap this large borrowing capacity.

Another advantage of a sovereign bond issuance is likely to be an easing of the liquidity squeeze on domestic banks. Since the government started issuing domestic bonds back in June 2015, liquidity levels of Saudi banks fell rapidly. Our estimate of bank excess liquidity showed a net decline from SR500 billion in May 2015 to SR229 billion in September 2016. Meanwhile, the loan-to-deposit ratio rose from 79.3 percent to 90.3 percent during the same period (Figure 5). Also, a press release by the Ministry of Finance indicated that it will take steps to gradually register, list, and trade government debt instruments in the Saudi stock exchange, thereby establishing a benchmark yield curve. We believe this would significantly improve the number and amount of domestic bond and Sukuk issuances. We estimate the total value of outstanding corporate bonds and Sukuk at SR134 billion in mid-2016, making up 15.1 percent of total corporate financing in the Kingdom (Figure 6). Expanding this market would help diversify financing sources, which should spread corporate risk beyond banks, making them more resilient to systemic risks. Further, establishing deep fixed income markets will also reduce the pressure off Specialized Credit Institutions (SCIs) in financing the private sector; an active fixed income market will allow businesses to have more access to capital, thus curbing the growth in financing needs from SCIs.

We estimate the total value of outstanding corporate bonds and Sukuk at $134 billion in mid-2016.

Table 3. Yields on Int'l Saudi and US sovereign bonds
(19 October, 2016)

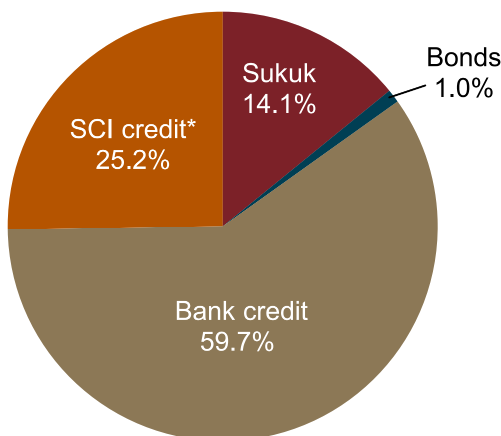
Tenure	US	Saudi Arabia	Difference
5 years	1.234	2.584	1.350
10 years	1.752	3.402	1.650
30 years	2.515	4.615	2.100

We forecast total public debt to reach SR338 billion by the end of 2016…

...and rise to SR474 billion in 2017.

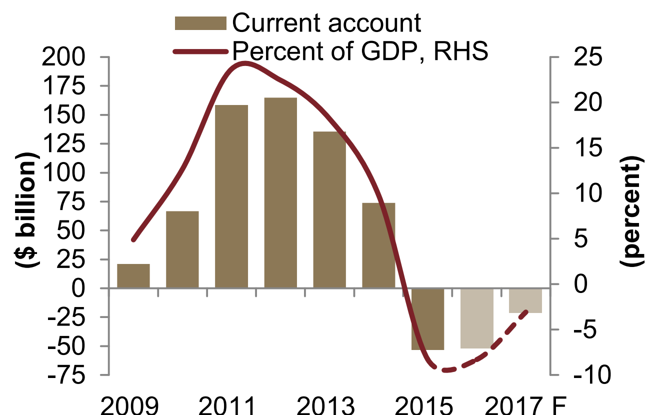
The deficit will continue to be financed through a combination of reserve withdrawals, and domestic and international sovereign bond issuances. We forecast total public debt to reach SR338 billion (14.3 percent of GDP) by the end of 2016, with 70 percent of this being domestic debt. In 2017, we forecast total public debt to rise to SR474 billion (18.3 percent of GDP), with more international bond issuances likely to finance a narrower deficit next year.

Figure 6: Breakdown of Saudi corporate debt
(percent of total corporate debt, as of June 2016)



SCI*: specialized credit institutions' outstanding loans

Figure 7: Current account balance forecast



Current account deficit revised down, net non-reserve financial flows turn positive

We have revised our forecast for 2016 current account deficit from $56 billion to $52 billion.

We have revised our forecast for 2016 current account deficit from $56 billion (8.8 percent of GDP) to $52 billion (8.3 percent of GDP) (Figure 7). Our downward revision is mainly due to lower-than-expected imports of goods and services. First half 2016 data has shown a decline in the value of imports of goods and services to $105 billion, down from $123 billion during the same period in 2015, mainly owing to a strong US Dollar, as year-to-June 2016 import data from the largest two ports in the Kingdom (Jeddah Islamic port, and King Abdulaziz port in Dammam) showed that import quantities have risen by 0.9 percent, year-on-year. As for 2017, we forecast an improvement in total exports, with imports remaining pretty flat, leading to a smaller current account deficit of $21 billion (3.1 percent of GDP).

In 2017, we see total exports recovering to reach $212 billion…

...supported by an increase to both oil and non-oil exports.

Our 2016 forecast for total exports is $181 billion. We forecast oil exports (which makes up around 77 percent of total exports) to fall to $132 billion in 2016, compared to $155 billion in 2015, before rebounding to $160 billion in 2017 as oil prices recover (See box 2 for Jadwa Investment's outlook for the oil market). Non-oil exports are likely to rise slightly in 2016 and 2017, reaching $49 billion and $53 billion, respectively. The trend in non-oil exports will mainly be determined by exports of petrochemicals and plastics (60 percent of the Kingdom's non-oil exports), which generally follow movements in prices of commodities. Our 2016 forecast for goods imports is $146 billion, down from $155 billion in 2015. In 2017, we see total goods imports remaining pretty flat, at $145 billion, mainly reflecting the slower growth in non-oil economic activity.

During H1 2016, the non-reserve financial account balance has turned positive for the first time since Q4 2011.

During H1 2016, the non-reserve financial account balance has turned positive for the first time since Q4 2011, reaching $9.2 billion, mainly owing to domestic banks and autonomous government institutions selling their foreign portfolio holdings to manage their liquidity. This improvement could also reflect the international sovereign loan undertaken by the government earlier in the year, which is captured by "other investment inflows" (Figure 8). The positive change in the non-reserve financial account balance has led to less pressure on FX reserve withdrawals in H1 2016. This impact can be seen on net withdrawals from FX reserves, which have fallen from $56 billion in H2 2015 to $46 billion in H1 2016. While the

Figure 8: Non-reserve financial flows, net

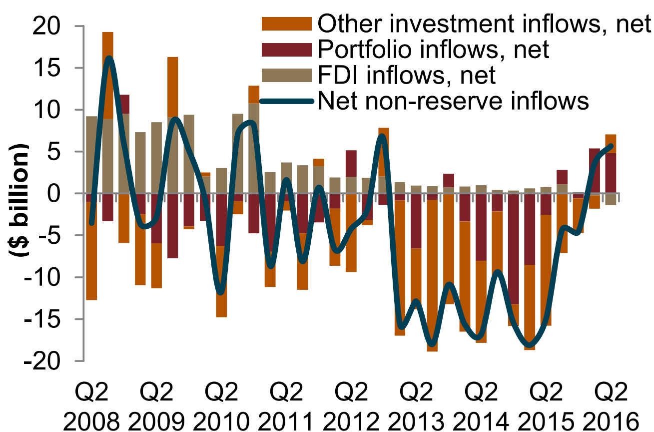
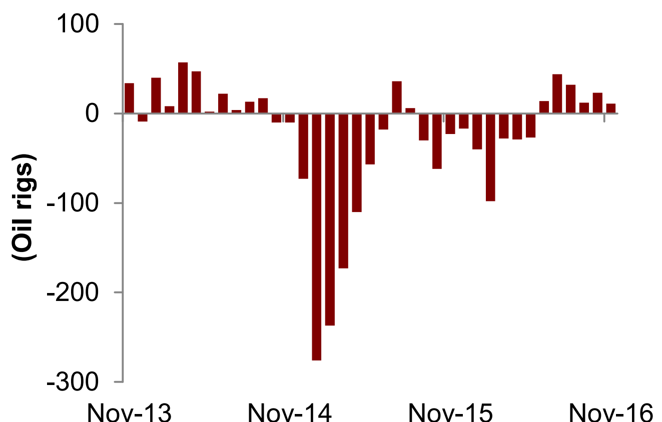


Figure 9: US oil rig count
(year-on-year change)



current account deficit shrank at a smaller extent, from $33 billion in H2 2015 to $28 billion in H1 2016.

Box 2: Oil market outlook

Brent prices were up 5 percent and WTI up a sizable 11 percent month-on-month in October.

Brent prices were up 5 percent and WTI up a sizable 11 percent month-on-month in October, after OPEC said it was willing to cut production. Brent oil prices averaged $49 per barrel (pb) in October, the highest since July 2015 after OPEC's announcement. If there is no clear agreement to cut at the OPEC meeting in Vienna, on the 30th of November, significant downward pressure on prices will occur, quite possibly pushing Brent towards $40 pb, from around $49 currently.

A more positive outcome for prices would be an agreement by OPEC to cut by the maximum amount…

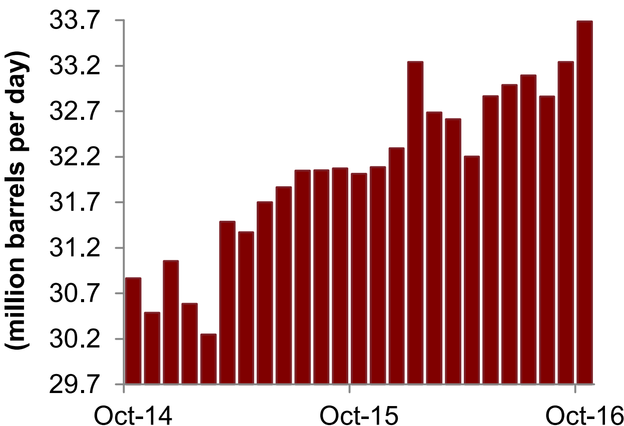
...followed by a disciplined implementation of cuts in the immediate months after the meeting.

A more positive outcome for prices would be an agreement by OPEC to cut by the maximum amount (to 32.5 mbpd), followed by a disciplined implementation of cuts in the immediate months after the meeting. This, we believe, could push Brent oil prices up to $60 pb, but also result in a rebound in US shale; with the largest sustained increase in US oil rigs in two years already being observed (Figure 9). A multitude of issues will have to be resolved for any sort of OPEC agreement on cuts to take place. On the top of OPEC's list will be to address which countries to exclude, if any, from production cuts. Nigeria, Libya, Iran and Iraq are all pushing for exemptions from cuts. The major challenge for OPEC in the weeks ahead will be trying to accommodate the exemptions of all or some of the above countries but, at the same time, implementing an equivalent or higher cut in production from other OPEC members. Alternatively, OPEC could choose to simply adjust the targeted ceiling of the cut (between 32.5 to 33 mbpd) upwards in order to account for additional output from all four countries, but this would lessen the market impact of proposed cuts.

Oil demand growth is still slightly below the average of the previous five years.

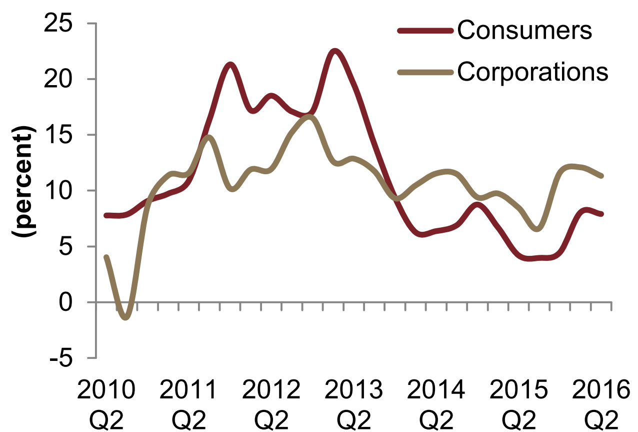
Besides these developments, in the background, the overall picture remains only mildly improved since the start of the year. Oil demand growth is still slightly below the average of the previous five years, but holding up well, whilst supply from Russia and OPEC remains at record highs (Figure 10). Commercial crude stocks are still above their long term average, and are expected to keep rising until mid-2017. Whilst oil markets are expected to balance in H2 2017, with even tighter oil balances if OPEC can reach an agreement.

Figure 10: OPEC output at record highs*



*Note: Direct communication excluding Indonesia and Gabon

Figure 11: Bank credit to consumers and corporates (year-on-year change)



Implications of a Trump victory, in the recent US elections, on global oil markets are yet to be seen.

Lastly, the implications on global oil markets of a Trump victory in the recent US elections are yet to be seen. If what has been stated in the recent past is implemented by the President-elect, then rises in US oil supply could occur. Specifically, Trump's policies have been geared towards freeing up oil exploration, production and transportation from bureaucracy. With the export ban on US crude oil lifted at the beginning of 2016, this could see a ramp up in US exports of crude oil and refined products, but it is still too early to call.

Taking into consideration all the above factors, we have kept our full year 2016 & 2017 Brent forecast at $44 pb and $55 pb.

Pressure on monetary aggregates to subside

Year-on-year growth in bank credit reached 7.0 percent in September…

...slowing slightly from 7.7 percent during the same period last year.

Year-on-year growth in bank credit reached 7.0 percent in September, slowing slightly from 7.7 percent during the same period last year. Credit continued to be extended to both consumers (20 percent of total credit) and corporates (60 percent of total credit), despite rising liquidity pressure (Figure 11). Looking ahead, we expect the year-end growth in credit to the private sector to maintain its stable growth at 7.5 percent year-on-year, followed by a slightly slower growth of 5 percent by the end of 2017. Year-to-September data showed that growth in long-term credit was negative at -4.5 percent, year-on-year. Meanwhile, medium and short-term credit maturities were the main contributors to annual growth in credit so far this year, growing by 5 percent and 4.5 percent year-on-year, respectively.

Measures to manage liquidity have contributed to halting the rise in the cost of funding…

The prospect of official US interest rate hikes in coming months (see global economic environment on page 2), will not have a significant impact on dampening the domestic liquidity situation. This is specifically due to the Saudi Arabian Monetary Agency (SAMA) recently passing several measures to enhance liquidity in the domestic financial system. In September, SAMA announced that it was introducing new 90-day repos, as well as capping the weekly issuance of SAMA bills to SR3 billion, down from SR9 billion previously. In coming months, new measures by SAMA are expected to include adjusting the way the Saudi Interbank Offer rate (SAIBOR) is calculated to better reflect the actual funding environment. These changes, along with the international bond issuance, and the

Figure 12: Market rates

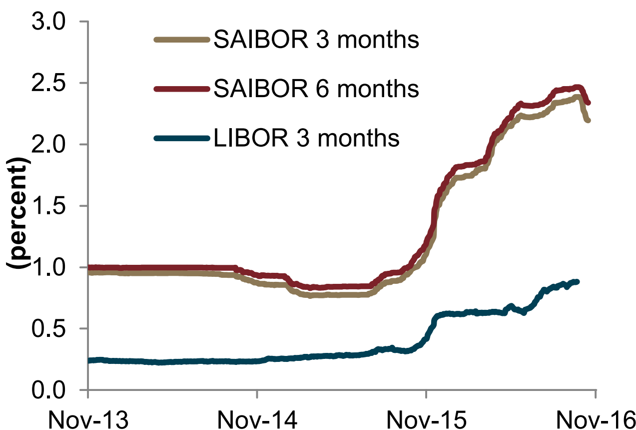
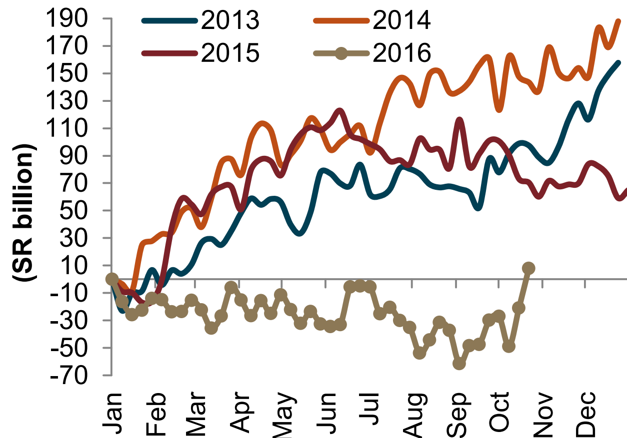


Figure 13: Money supply (M3)
(weekly data, year-to-date)



…as the SAIBOR has started to decline.

resumption of payments by government to contractors -per an official announcement made in October- seem to have contributed to halting the rise in the cost of funding, with the SAIBOR starting to decline, and annual money supply growth turning positive for the first time in 2016 (Figures 12 and 13).

Easing inflationary pressures

Inflation in the Kingdom has been on a decelerating trend so far this year.

Inflation in the Kingdom has been on a decelerating trend so far this year despite the hike to prices of domestic energy products. Subdued inflation rates among the Kingdom's main trading partners contributed to slowing inflation within Saudi Arabia as well. Also, the negative year-on-year growth in broad money supply during most of 2016, points to downward pressure on consumer prices. However, recent measures to support liquidity have pushed annual growth in money supply back to positive territory (see monetary section above).

Inflation will be impacted by lower spending on consumer discretionary goods.

Having said that, rents are the main risk to our inflation forecast for the Kingdom. Housing, water, and electricity has remained the main contributor to inflation so far in 2016, averaging 7.7 percent for the eight months ending in August, compared with 3.1 percent during the same period in 2015. Further, it appears that lower payments on allowances will negatively impact growth in money supply, and will put further downside pressure on inflation. This will particularly affect spending on consumer discretionary goods. We have therefore revised our forecast for 2016 annual inflation to 3.7 percent, down slightly from our earlier forecast of 3.9 percent. In 2017, we expect further easing in inflation, to 2.0 percent (Figure 14), with upside risks to our forecast if additional hikes to domestic energy prices are implemented.

Subsiding speculative pressure on the US Dollar/Riyal rate

Speculative trading in response to the fall in FX reserves that pushed up the 1-year forward US Dollar/ Riyal rate to 3.85 in mid-January has subsided, falling to 3.79 in November following several measures by SAMA to manage liquidity in the financial system as well as the resumption in government payments (Figure 15). We have stressed earlier in the year that we do not see a devaluation to the Saudi Riyal by highlighting some fundamental reasons, including that the Kingdom's main export, oil, is inelastic to changes in

Figure 14: Annual inflation forecast

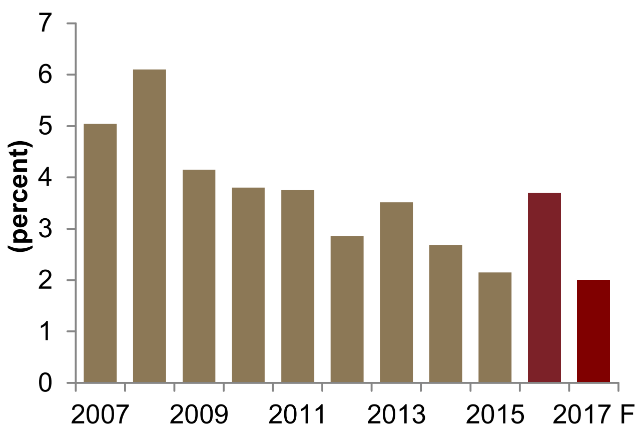


Figure 15: 12-month forward USD/Riyal rate

exchange rates, and is not likely to be boosted as a result of a Riyal devaluation. Also, a devaluation will cause a rise to the cost of imports, which will likely absorb all the extra money that would be enjoyed by the government. Another factor supporting the sustainability of the peg is the very high level of foreign reserve import coverage*(See our March 2016 "Monetary and Financial Update" for a more detailed analysis of the factors supporting the Kingdom's fixed exchange regime)*.

Risks to forecast

Downside risks to our forecast constitute:

...concerns over global economic and political risks…

...risks attached to the implementation of reform plans…

…and further fiscal consolidation.

Concerns over global economic and regional political risks, as well as a prolonged period of lower oil prices continue to be the main risks to our forecast. We remain concerned about the continued volatility and tightening of global financing conditions, which could be triggered by an upward shift in market expectations of official interest rates. This may directly affect the Kingdom as it continues to tap into the international debt market. Nevertheless, the implications for the Kingdom should not be exaggerated, as markets need to differentiate the Kingdom's stable outlook from other vulnerable economies on the back of the Kingdom's solid credit profile and ample reserves. Also, the short-term uncertainty that unfolded in the forward exchange market has subsided. That being said, we see any potential delay in implementing the reform plans outlined in the NTP 2020 and Vision 2030 to constitute the biggest risks to our forecasts. Whilst fiscal consolidation should have a long-term positive impact on the structure of the economy, any further consolidation could result in lower than forecasted growth in the non-oil economy over the next two years.

Key Data

	2009	2010	2011	2012	2013	2014	2015	2016F	2017F
Nominal GDP									
(SR billion)	1,609	1,976	2,511	2,752	2,791	2,827	2,423	2,360	2,591
($ billion)	429.1	527	670	734	744	754	646	629	691
(% change)	-17.4	22.8	27.1	9.6	1.4	1.3	-14.3	-2.6	9.8
Real GDP (% change)									
Oil	-8.0	-0.1	12.2	5.1	-1.6	2.1	4.0	2.1	0.6
Non-oil private sector	4.9	9.7	8.0	5.5	7.0	5.4	3.4	0.7	1.0
Non-oil government	6.3	7.4	8.4	5.3	5.1	3.7	2.5	-0.6	-0.7
Total	1.8	4.8	10.0	5.4	2.7	3.6	3.5	1.1	0.6
Oil indicators (average)									
Brent ($/b)	61.7	79.8	112.2	112.4	109.6	99.4	52.1	43.8	54.5
Saudi ($/b)	60.4	77.5	103.9	106.1	104.2	95.7	49.4	40.8	51.5
Production (million b/d)	8.2	8.2	9.3	9.8	9.6	9.7	10.2	10.3	10.4
Budgetary indicators (SR billion)									
Government revenue	510	742	1,118	1,247	1,156	1,044	616	585	664
Government expenditure	596	654	827	873	976	1,110	978	850	815
Budget balance	-87	88	291	374	180	-66	-362	-265	-151
(% GDP)	-5.4	4.4	11.6	13.6	6.5	-2.3	-15.0	-11.2	-5.8
Domestic debt	225	167	135	99	60	44	142	309	433
(% GDP)	14.0	8.5	5.4	3.6	2.2	1.6	5.9	13.1	16.7
Monetary indicators (average)									
Inflation (% change)	4.1	3.8	3.7	2.9	3.5	2.7	2.2	3.7	2.0
SAMA base lending rate (%, end year)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.3	3.0
External trade indicators ($ billion)									
Oil export revenues	167	215	318	337	322	285	155	132	160
Total export revenues	192	251	365	388	376	342	202	181	213
Imports	87	97	120	142	153	158	155	146	145
Trade balance	105	154	245	247	223	184	47	35	68
Current account balance	21	67	159	165	135	74	-53	-52	-21
(% GDP)	4.9	12.7	23.7	22.4	18.2	9.8	-8.3	-8.3	-3.1
Official reserve assets	410	445	544	657	726	732	616	523	460
Social and demographic indicators									
Population (million)	26.7	27.4	28.2	28.9	29.6	30.3	31.0	31.7	32.4
Saudi Unemployment (15+, %)	10.5	10.5	12.4	12.1	11.7	11.7	11.5	12.0	11.6
GDP per capita ($)	16,095	19,211	23,766	25,401	25,146	24,878	20,828	19,840	21,322

Sources: Jadwa Investment forecasts for 2016 and 2017. General Authority for Statistics for GDP and demographic indicators, Saudi Arabian Monetary Agency for monetary and external trade indicators, Ministry of Finance for budgetary indicators.

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