Jadwa Investment

February 2021

The Saudi Economy in 2021

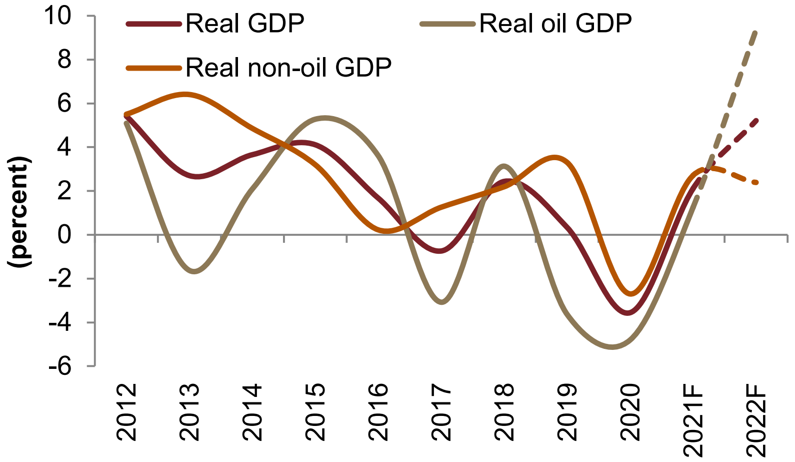
Looking out into 2021, while there is still a considerable degree of uncertainty as a result of the prevalence of COVID-19 and its potential impact on the non-oil economy, we nevertheless expect a broad-based recovery. Our forecast assumes between 15-20 percent of the adult population being vaccinated against COVID-19 by mid-2021, and 70 percent by year end. As such, we see a quarter-on-quarter improvement in the Saudi non-oil economy, with this recovery being more vigorous in the second half of 2021.

More specifically, we see an expansion in the 'Wholesale & Retail, Restaurants & Hotels' sector, especially as restrictions around social distancing are gradually relaxed and there is a steady pick-up in entertainment and domestic tourism activities. At the same time, we also see the 'Construction' and 'Transport, Storage & Communication' sectors contributing to growth. In construction, the sector should continue benefitting from work on a number of Public Investment Fund's (PIF) mega-projects. In transport, the economic benefits from the completion of SR87 billion worth of projects during the year will help push sectorial GDP up. Included within this is the much anticipated Riyadh metro, as well as the Riyadh Rapid Bus Transit System.

Last year, the Kingdom's strict adherence to OPEC and partners (OPEC+) crude oil production targets most likely pushed the oil sector's share in total GDP to the lowest level on record. Looking ahead, a unilateral reduction in oil output by the Kingdom during most of Q1 and continued compliance with the OPEC+ agreement will not help raise the sector's contribution by a huge amount in 2021. That said, some growth is expected to come from the opening of the Jazan refinery. Additionally, the full year effects from the Fadhili gas complex and an expansion of the Hawiyah gas processing plant will also contribute to oil sector growth.

On the fiscal front, we estimate that higher yearly oil prices and the continued payment of dividends by Aramco will raise government oil revenue to SR491 billion. At the same time, we expect non-oil revenue to be effectively flat on a year-on-year basis, at around SR360 billion, taking total government revenue to SR851 billion in

Figure 1: Real economic growth
(year-on-year change)



For comments and queries please contact:

Asad Khan
Head of Research
rkhan@jadwa.com

Nouf N. Alsharif
Senior Economist
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

Released: February-23-2021, 17:00 UTC+3

Provisional full year GDP data for 2020 showed that the economy contracted by -4.1 percent…

...with a sizable decline expected in the oil sector (latest available data to Q3 2020 showed a -6 percent decline year-on-year)…

...while the non-oil sector dropped by -2.9 percent in the year-to-Q3, compared to the same period last year.

Looking ahead, we see overall GDP in 2021 rising by 2.1 percent year-on-year…

...with both the oil and non-oil sectors contributing to the rebound in growth.

More specifically, we expect oil sector GDP to see mild rises of 1.3 percent…

...with the lion's share of growth being driven by the non-oil sector, which we forecast will rise by 2.7 percent year-on-year.

2021. With expenditure expected to decline by 7 percent year-on-year to SR990 billion, as per the recent budget statement, we see the fiscal deficit narrowing to -SR139 billion or -4.8 percent of GDP. Meanwhile, the government expects to issue additional new debt to the equivalent of SR83 billion, pushing total public debt to SR937 billion (32.8 percent of GDP) at the end of 2021.

A strong level of growth in the non-oil sector will do enough to keep imports at decent levels, albeit below pre-pandemic levels. At the same time, a year-on-year increase in both oil and non-oil export revenue should push the current account to a surplus of 2.5 percent of GDP. All of this will help push foreign exchange (FX) reserves up, although they will remain below USD500 billion, according to our forecasts.

Provisional full year GDP data for 2020 showed that the economy contracted by -4.1 percent, with a sizable decline expected in the oil sector (latest available data to Q3 2020 showed a -6 percent decline year-on-year), while the non-oil sector dropped by -2.9 percent in the year-to-Q3, compared to the same period last year. Looking ahead, we see overall GDP in 2021 rising by 2.1 percent year-on-year, with both the oil and non-oil sectors contributing to the rebound in growth. More specifically, we expect oil sector GDP to see mild rises of 1.3 percent with the lion's share of growth being driven by the non-oil sector, which we forecast will rise by 2.7 percent year-on-year.

Overall, it is worth noting that the range of potential effects of COVID -19 on the Kingdom's economy still remain uncertain at this moment. The main risk in the outlook comes from a more prolonged and serious outbreak of a second wave of COVID-19, possibly through a variant of the disease, or due to a slower rollout of the vaccine than currently anticipated. In this context, the recovery in the Saudi economy during the year will not be smooth, with the recent suspension of recreational activities illustrating this point. As such, all economic risks are wholly skewed to the downside.

The massive shock of the COVID-19 pandemic…

...took (and is still taking) a massive toll on the global economy.

According to the IMF, the global economy is expected to have contracted by -3.5 percent year-on-year in 2020…

...which would represent the steepest annual drop in global output in at least 100 years.

More positively though, the IMF expects the global economy to rebound sharply in 2021…

...by 5.5 percent and then by 4.2 percent in 2022 year-on-year.

It seems that businesses in general have adapted to intermittent lockdown restrictions and…

...despite a peak in global cases recently, both the global manufacturing and services PMIs have held firm.

Global Economic Outlook

The massive shock of the COVID-19 pandemic and consequent lockdown measures to contain the outbreak took (and is still taking) a massive toll on the global economy. According to the International Monetary Fund (IMF), the global economy is expected to have contracted by -3.5 percent year-on-year in 2020. This would represent the steepest annual drop in global output in at least 100 years, pushing back global output to 2017 levels. More positively though, the IMF expects the global economy to rebound sharply in 2021, by 5.5 percent and then by 4.2 percent in 2022 year-on-year (Figure 2). Unsurprisingly, the current set of forecasts come with a number of caveats, with a new variant being the biggest risk to a successful post-pandemic recovery. Put simply, the world is currently locked in a race to roll-out a sufficient level of vaccinations before there is a large scale breakout of a mutated version of the virus.

The number of daily global COVID-19 rose steadily most of last year whilst seemingly hitting a recent peak in mid-January at circa 850 thousand cases, with current daily cases dropping to around 400 thousand. The decline has come about due to lower number of cases in Western Europe, as the likes of the UK, France and Germany instituted wide scale lockdowns and restrictions to curb a second wave in COVID-19. Concurrently, most countries around the world have begun to the roll-out a vaccination program, albeit with varying degrees of success. That said, a milestone was recently reached as the number of vaccinations administered passed the total number of confirmed cases. At the time of writing there were nine vaccines authorized for full or emergency use, and a further 25 candidate vaccines in Phase I–III trials. Despite this, the road to global vaccination against COVID-19 will be a long one, with the UK based charity, The Wellcome Trust, estimating that it will take up to 2024 for all those that need a vaccine to get one.

Although there were fears that the momentum in global recovery seen in H2 2020 would be lost as lockdowns and restrictive measures in some of the largest economies (Europe and parts of the US) were implemented in Q4, this has proved unfounded so far. It seems that businesses in general have adapted to intermittent lockdown restrictions and, despite a peak in global cases recently, both the global manufacturing and service purchase managers indices (PMIs) have held firm (Figure 3), whilst oil demand is expected to decline only marginally in Q1 (see Oil Outlook section below). Looking ahead, a broad based global recovery will inevitably hinge on how the largest economies perform henceforth.

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

	2019	2020E		2021F		2022F	
	IMF	IMF	Consensus	IMF	Consensus	IMF	Consensus
Global	2.8	-3.5	-3.7	5.5	5.0	4.2	4.0
US	2.2	-3.4	-3.5	5.1	4.3	2.5	3.3
UK	1.4	-10.0	-10.7	4.5	4.5	5.0	5.5
Canada	1.9	-5.5	-5.1	3.6	4.5	4.1	3.8
Euro zone	1.3	-7.2	-6.8	4.2	4.4	3.6	4.0
Japan	0.3	-5.1	-5.3	3.1	2.6	2.4	1.9
China	6.0	2.3	2.3	8.1	8.4	5.6	5.3
Russia	1.3	-3.6	-3.1	3.0	3.0	3.9	2.4
Brazil	1.4	-4.5	-4.6	3.6	3.5	2.6	2.5
India	4.2	-8.0	-8.5	11.5	9.8	6.8	6.3

Note: Consensus forecasts are those of FocusEconomics.

Advanced economies growth will rebound sharply, but less so than their emerging market counterparts

The IMF points out that a sizable level of fiscal support announced for 2021 in some countries…

...will not only raise economic activity within their own respective economies, but also have favorable spillovers to trading partners.

Meanwhile, growth in emerging markets is expected to rise by 6.3 percent, at ten year highs.

According to the IMF, advanced economies' (AEs) growth will rebound sharply, but less so than their emerging market (EMs) counterparts (Table 1). Thus, in its most recent forecast within the January 2021 edition of the World Economic Outlook (WEO), AEs growth is expected to average 4.3 percent for 2021 (versus -4.9 percent in 2020). The IMF points out that a sizable level of fiscal support announced for 2021 in some countries (notably the US and Japan) will not only raise economic activity within their own respective economies, but also have favorable spillovers to trading partners. Meanwhile, growth in EMs is expected to rise by 6.3 percent, levels last seen almost a decade ago in the immediate years after the global financial crisis. That said, within the broad EMs category, growth is expected to be highly varied. For example, China's economic recovery has been very strong, with the country implementing strong containment measures against COVID-19, followed up with strong levels of public investment and central bank liquidity support. In fact, China is the only major economy that is expected to register positive economic growth in 2020 (at 2.3 percent). On the other hand, the IMF highlights that tourism-based economies (such as Thailand, Philippines and Cambodia) are all expected to face difficulties in the year ahead as the world faces up to a gradual normalization of cross-border travel. Lastly, the IMF highlights that oil exporters could also struggle, although recent oil market developments suggest this may not be the case.

The Oil Market in 2021

According to OPEC forecasts, oil demand will decline by 670 thousand barrels per day in Q1 2021 quarter-on-quarter…

...but then rise on a quarterly basis during the rest of the year…

...although it still end up 4 percent lower than pre-COVID-19 levels by the end of 2021.

OPEC data showed global oil demand dropped by a massive 10 percent year-on-year, or 9.7 million barrels per day (mbpd), in 2020, as the outbreak of COVID-19 pushed global oil demand to levels last seen seven years ago. The majority of decline in demand was concentrated in H1 2020, as COVID-19 initially broke out around the world. Whilst a strong rebound was seen in the US and Asia in H2 2020, other regions, such as 'Europe', struggled to return to previous levels of demand as a second, more severe, wave took hold. Looking ahead, how quickly different countries recover (or continue recovering) from the economic downturn will inevitably dictate the pace of rebound in oil demand. Indeed, strict lockdown measures are still in place in some parts of the world, and these measures continue to impact energy demand. That said, as the distribution of COVID-19 vaccines takes place progressively during the year, this should help lift oil demand. According to OPEC forecasts, oil demand will decline by 670 thousand barrels per day (tbpd) in Q1 2021 quarter-on-quarter, but then rise on a quarterly basis during the rest of the year,

Figure 2: Global GDP expected to bounce back in 2021

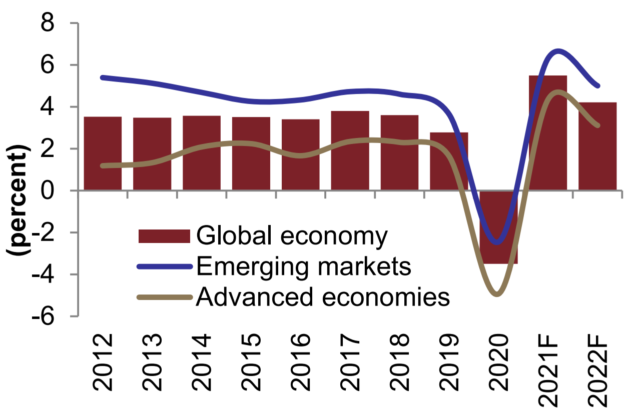
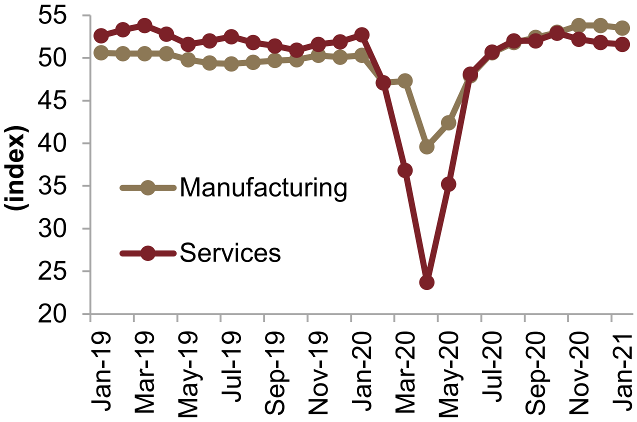


Figure 3: Global manufacturing and services PMIs have held firm



For full year 2021, on a country/ regional level…

...the four largest oil consuming countries/regions (US, China, India and Europe)…

...are expected to account for just under two thirds (or 3.6 mbpd) of oil demand growth of 5.9 mbpd in full year 2021.

In the US, the EIA expects 2021 consumption to rise 8 percent on a year-on-year basis to 19.5 mbpd…

...albeit 5 percent less than pre-COVID 2019 levels.

Chinese oil demand is projected to improve in-line with continued economic recovery…

...with OPEC expecting a rise of 1.1 mbpd (or 9 percent) year-on-year in 2021, primarily as a result of higher consumption in transportation fuel.

although it still end up 4 percent lower than pre-COVID-19 levels by the end of 2021 (at 96 mbpd versus 100 mbpd at the end of 2019, Figure 4). For full year 2021, on a country/regional level, the four largest oil consuming countries/regions (US, China, India and Europe) are expected to account for just under two thirds (or 3.6 mbpd) of oil demand growth of 5.9 mbpd in full year 2021.

According to Energy Information Administration (EIA) data, on a full year basis, US consumption averaged 18.1 mbpd in 2020, similar to levels last seen back in 2012. Looking ahead, the EIA expects 2021 consumption to rise 8 percent on a year-on-year basis to 19.5 mbpd, albeit 5 percent less than pre-COVID 2019 levels. Meanwhile, Chinese oil demand declined 3 percent (or 440 tbpd) on a yearly basis in full year 2020. Moving forward, Chinese oil demand is projected to improve in-line with continued economic recovery, with OPEC expecting a rise of 1.1 mbpd (or 9 percent) year-on-year in 2021, primarily as a result of higher consumption in transportation fuel. At the same time, China's Ministry of Commerce (MOFCOM) recently announced a 20 percent year-on-year rise in import quotas for domestic refiners, which should result in oil imports rising on an annual basis yet again in 2021. Europe saw the largest yearly decline in oil demand (in percentage terms) amongst the various OPEC geographical categories. More specifically, oil demand fell by 14 percent (or 1.95 mbpd) in full year 2020 compared to 2019, pushing total demand in the region to multi-year lows. Looking ahead, whilst OPEC does expect a decent level of recovery in 2021, at 6 percent (or 700 tbpd) year-on-year, the organization also notes that the near-term outlook during Q1 2021 is extremely uncertain.

OPEC and partners (OPEC+) exhibited strong levels of commitment to the production agreement during 2020, albeit with varying degrees of amongst participating countries. In fact, differentiated levels of compliance between the two blocs (OPEC/non-OPEC) was a reoccurring theme during most of last year. For example, from May to December 2020, OPEC compliance averaged just above 100 percent, but weaker compliance was observed amongst non-OPEC producers. This was most noticeable with Russia (the largest producer in the alliance), where compliance is expected to have averaged around 95 percent last year, with overproduction hitting the equivalent of around 100 tbpd in the period question.

Looking ahead, OPEC+'s initial decision (late last year) to raise oil output by 500 tbpd (rather than 1.9 mbpd) for the month of January, together with a unilateral cut by Saudi Arabia to the tune of 1 mbpd in both February and March, means the alliance's output should

Figure 4: Global oil demand not expected to hit pre-COVID-19 levels by end of 2021

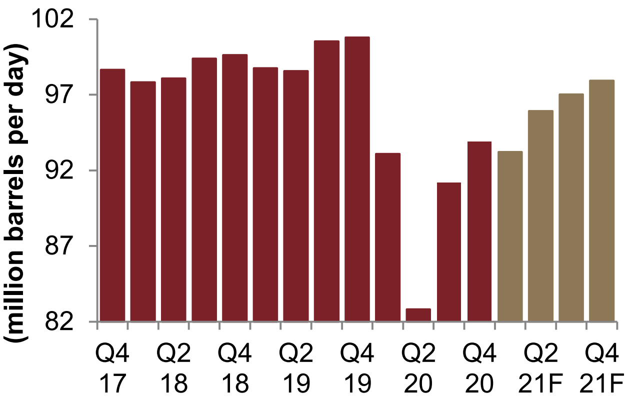
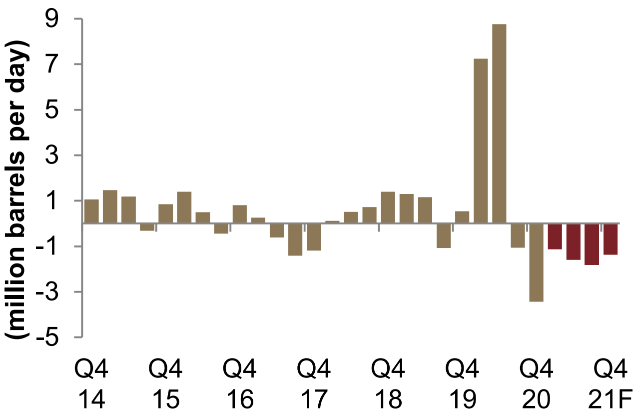


Figure 5: Daily global oil balance assuming additional 1.4 mbpd OPEC+ oil from Q2 onwards



We expect OPEC+ to add the remaining 1.4 mbpd at some point during Q2.

According to our calculations, whilst an additional 1.4 mbpd of OPEC+ oil would result in a gradual tightening in global daily oil balances…

...it would still result in an average deficit of 1.5 mbpd over the course of 2021.

Meanwhile, the new US administration is expected to promote regulation aimed at reducing greenhouse gas emissions and addressing climate change…

...but would likely materialize later this year or in 2022

The recovery in oil prices during the year will not be smooth, and the possibility of a 'correction' cannot be ruled out…

...bearing this in mind, we have left our full year 2021 Brent oil price forecast of $55 pb unchanged for now.

decline by 100 tbpd quarter-on-quarter in Q1 2021. Beyond that, we expect OPEC+ to add the remaining 1.4 mbpd (1.9 mbpd less January's rise of 500 tbpd) at some point during Q2. According to our calculations, whilst an additional 1.4 mbpd of OPEC+ oil would result in a gradual tightening in global daily oil balances, it would still result in an average deficit of 1.5 mbpd over the course of 2021 (Figure 5). The persistence of a deficit would, in turn, help push down the overhang in commercial oil inventories that developed last year, which currently stands at around 96 million barrels above its five year average (Figure 6).

According to EIA data, US crude oil production during 2020 as a whole declined by 8 percent compared to 2019, to an average of 11.3 mbpd. Looking at 2021, EIA's current forecast (based on WTI at $49.7 pb) sees US oil output declining by a further 2 percent on a year-on-year basis (to an average of 11.1 mbpd) at the end of the year.

Meanwhile, the new US administration is expected to promote regulation aimed at reducing greenhouse gas emissions and addressing climate change. In fact, a temporary cessation of oil drilling permits on federal lands and waters and the cancellation of a major oil pipeline were amongst the first changes enacted by the Democrats. Looking ahead, it remains to be seen to what extent this will impact the US oil sector, and, whilst there could be further major oil policy changes (such as an oil export ban), we do not expect such policies to be implemented in the near-term, but would likely materialize later this year or in 2022, if at all.

Overall in full year 2020, Brent oil averaged $42 per barrel (pb), down 36 percent over 2019 levels, and just slightly lower than our forecast of $43 pb. Looking ahead into the rest of 2021, current OPEC forecasts suggest a progressive pick-up in oil demand during the year, and a deficit in daily oil balances, all of which should help lower record high commercial oil inventories and provide support to prices. Of course, the main risk in the outlook comes from a more prolonged and serious outbreak of COVID-19, possibly through a variant of the disease, or due to a slower roll-out of the vaccine than currently anticipated. In this context, the recovery in oil prices during the year will not be smooth, and the possibility of a 'correction' cannot be ruled out from current level of prices above $60 pb. Bearing this in mind, we have left our full year 2021 Brent oil price forecast of $55 pb unchanged for now (Figure 7).

Figure 6: Commercial oil stocks versus five year moving average

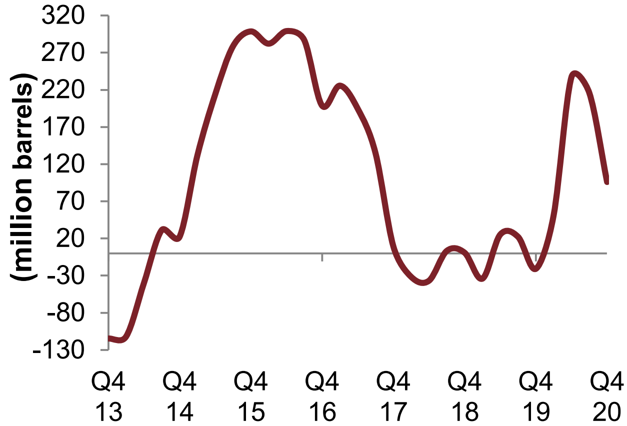
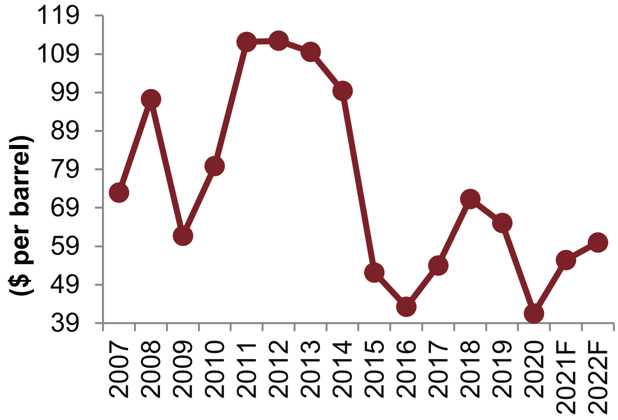


Figure 7: Annual average Brent oil prices



Looking out into 2021, whilst there is still a considerable degree of uncertainty as a result of the prevalence of COVID-19…

...we do nevertheless expect a broad-based recovery.

The current time-line embedded in our forecast assumes between 15-20 percent of the adult population being vaccinated against COVID-19 by mid-2021…

...and 70 percent by year end.

As such, we see a sequential quarter-on-quarter improvement in the Saudi non-oil economy during the year…

...with this recovery being more vigorous in the second half of 2021.

Saudi Economic Growth

According to provisional full year data published by the General Authority for Statistics (GaStat), the Saudi economy contracted by -4.1 percent in 2020, compared to growth of 0.3 percent year-on-year in 2019. As expected, GDP was negatively affected by both the oil and non-oil sectors. Saudi Arabia's lower yearly oil output, as a result of the OPEC+ agreement, meant oil sector GDP declined by -6 percent in the year to Q3 2020 year-on-year (as per latest available data). Meanwhile, the non-oil sector declined by -2.9 percent in the year to Q3 2020 year-on-year, with non-oil private sector growth also seeing a sizable decline of -3.9 percent. Whilst full year GDP data by economic sector is yet to be released, our non-oil composite index indicates that the recovery in the non-oil private sector during Q3 was sustained into Q4 (Figure 8).

On a sectorial basis, 'Non-Oil Manufacturing', 'Wholesale & Retail, Restaurants & Hotels', and 'Transport, Storage & Communication' are expected to have borne the brunt of COVID-19 lockdown and restrictions last year, with these three sectors declining by more than -6 percent in the year to Q3 2020 year-on-year. Conversely, 'Construction' and 'Finance, Insurance & Business Services' fared better than initially expected, most likely exhibiting positive yearly growth in full year 2020 (*as indicated in our previous macroeconomic update*).

Looking out into 2021, whilst there is still a considerable degree of uncertainty as a result of the prevalence of COVID-19, and its potential impact on the non-oil economy, we do nevertheless expect a broad-based recovery. The current time-line embedded in our forecast assumes between 15-20 percent of the adult population being vaccinated against COVID-19 by mid-2021 and 70 percent by year end. As such, we see a sequential quarter-on-quarter improvement in the Saudi non-oil economy during the year, with this recovery being more vigorous in the second half of 2021.

Table 2: Real GDP shares and growth rates*

2019			2018	2019	2020E	2021F
% Share of:	Total GDP	Non-oil GDP	% year-on-year			
Overall GDP	**100**		**2.4**	**0.3**	**-4.1**	**2.1**
of which:						
Oil sector	41.8		3.1	-3.6	-6.0	1.3
Non-oil sector	58.2	100	2.2	3.3	-2.9	2.7
of which:						
Non-oil govt. sector		30.0	2.9	2.2	-0.4	1.5
Non-oil private sector		70.0	1.9	3.8	-3.9	3.2
Non-oil GDP by activity		**100**				
Agriculture		4.0	0.3	1.3	-3.1	1.0
Non-oil mining		0.7	2.4	4.8	0.8	1.7
Non-oil manufacturing		14.6	4.0	-0.9	-6.6	0.5
Electricity, gas and water		2.2	1.9	-4.0	-2.5	0.5
Construction		7.8	-3.5	4.6	-0.8	3.0
Wholesale & retail trade		16.2	1.0	6.3	-6.2	4.0
Transport & communication		10.8	2.1	5.6	-6.2	3.0
Real estate activities		9.4	2.6	3.4	-0.3	3.0
Finance, insurance, & bus.		7.1	3.9	8.0	1.4	3.0
Community & social services		3.7	5.2	6.9	-4.8	6.0
Producers of govt. services		23.9	3.0	1.5	0.7	1.0

* 2020 Overall GDP: actual & GDP by sector and activity is year-to-Q3 2020 average

Overall, we see GDP rising by 2.1 percent year-on-year, with both the oil and non-oil sectors contributing to the rebound in growth.

More specifically, we expect oil sector GDP to see mild rises of 1.3 percent…

...with the lion's share of growth being driven by the non-oil sector, which we forecast to rise by 2.7 percent year-on-year.

That said, at this moment in time, the range of potential effects of COVID-19 on the Kingdom's economy still remain uncertain.

A unilateral reduction in oil output by the Kingdom during most of Q1…

...and continued compliance with the OPEC+ agreement will not help raise the sector's contribution by a huge amount in 2021.

That said, some growth is expected to come from higher gas output and the opening of the Jazan refinery.

More specifically, we see an expansion in the 'Wholesale & Retail, Restaurants & Hotels' sectors as restrictions around social distancing are gradually relaxed and there is a steady pick-up in entertainment and domestic tourism activities. At the same time, we also see the 'Construction' and 'Transport, Storage & Communication' sectors contributing to growth. The former should continue benefitting from work on a number of PIF mega-projects whilst the latter will be lifted by the completion of SR87 billion worth of projects during the year.

Overall, we see GDP rising by 2.1 percent year-on-year, with both the oil and non-oil sectors contributing to the rebound in growth. More specifically, we expect oil sector GDP to see mild rises of 1.3 percent with the lion's share of growth being driven by the non-oil sector, which we forecast to rise by 2.7 percent year-on-year. That said, at this moment in time, the range of potential effects of COVID-19 on the Kingdom's economy still remain uncertain. The main risk in the outlook comes from a more prolonged and serious outbreak of a second wave in COVID-19, possibly through a variant of the disease, or due to a slower roll-out of the vaccine than currently anticipated. In this context, the recovery in the Saudi economy will not be smooth, with risks being wholly skewed to the downside.

Oil sector:

Last year, the Kingdom's strict adherence to OPEC+ crude oil production targets most likely pushed the domestic oil sector's contribution to overall GDP to the lowest level on record. More specifically, an expected yearly decline of -6 percent in yearly oil sector GDP most likely pushed its contribution to overall GDP to 41 percent (in real terms) at the end of 2020, versus an average of 44 percent in the previous decade. Looking ahead, a unilateral reduction in oil output by the Kingdom during most of Q1 and continued compliance with the OPEC+ agreement will not help raise the sector's contribution by a huge amount in 2021. That said, some growth is expected to come from higher gas output and the opening of the Jazan refinery. With respect to the latter, we had previously expected the refinery to start operations in 2020, but because of COVID-19 related delays the full startup of the 400 thousand barrels per day (tbpd) refinery will take place in H1 2021. Additionally, the full year effects from the Fadhili gas complex and an expansion of the Hawiyah gas processing plant will also contribute to growth, whilst also helping push total Saudi gas processing capacity 20 percent higher in the last few years (Figure 9, Box 1).

Figure 8: Jadwa's non-oil private sector composite index

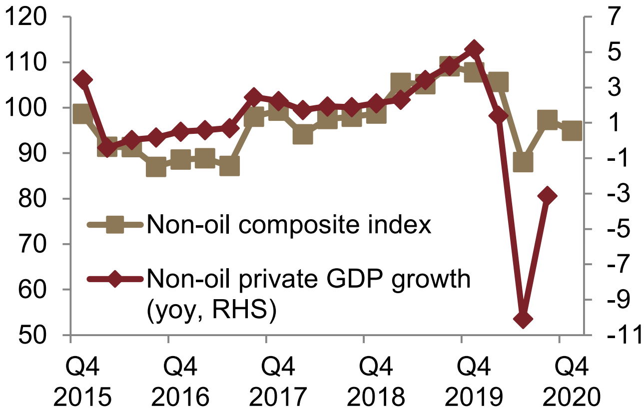
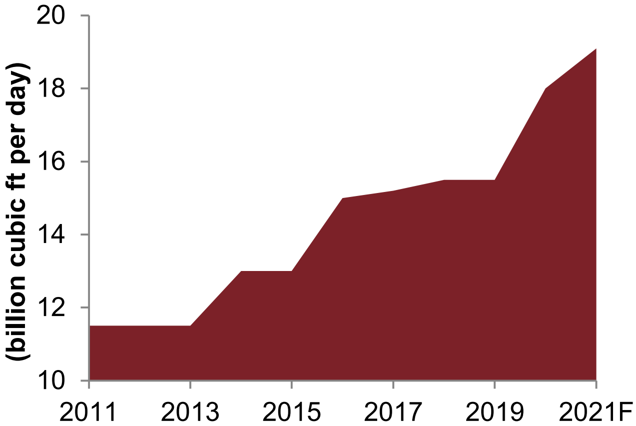


Figure 9: Historical and planned gas processing capacity in Saudi Arabia



Saudi crude oil production averaged 9.2 mbpd in 2020…

...a sizable 6 percent down from 2019, as OPEC+ moved to contain the impact of COVID-19 on the oil market.

Looking ahead, the combination of OPEC+ developments and domestic energy trends…

...means we expect Saudi crude oil production to rise by 1 percent on a year-on-year basis, to 9.3 mbpd in 2021.

Box 1: Saudi Crude Oil Production

Saudi crude oil production averaged 9.2 mbpd in 2020, a sizable 6 percent down from 2019, as OPEC+ moved to contain the impact of COVID-19 on the oil market. Looking ahead, Saudi Arabia stated it would voluntarily moderate output by an additional 1 mbpd during both February and March to help see through an uncertain period for oil demand during Q1 2021. Beyond that, we expect OPEC+ to add the remaining 1.4 mbpd (1.9 mbpd less January's rise of 500 tbpd) at some point during Q2, which would result in Saudi crude oil output rising to around 9.5 mbpd *(please see our recent Oil Update for more details*).

On the domestic front, whilst we expect higher refinery intake associated with the gradual start-up of the Jazan refinery, and a general rebound in transportation fuel consumption to push domestic energy consumption up from last year's lows (Figure 10), we do not expect this to add much upward pressure on Saudi crude oil production. This is because the full year effects of unassociated natural gas from the Fadhili gas complex, (which reached full capacity in May 2020) and the 1 billion cubic feet per day (b/cfd) expansion of the Hawiyah gas processing plant, should help substitute the use of some crude oil in electricity generation.

All in all, the combination of OPEC+ developments and domestic energy trends means we expect Saudi crude oil production to rise by 1 percent on a year-on-year basis, to 9.3 mbpd in 2021 (Figure 11).

Wholesale & Retail, Restaurants & Hotels sector was down by -6.2 percent in the year-to-Q3 2020, year-on-year…

...with pandemic linked curfews and restrictions dragging growth in the sector to 36 year lows.

Despite this record drop, the full year data disguises the fact that Q1 saw decent levels of growth.

Wholesale & Retail, Restaurants & Hotels sector (16 percent of non-oil GDP) was down by -6.2 percent in the year-to-Q3 2020, year-on-year, with pandemic linked curfews and restrictions dragging growth in the sector to 36 year lows. Despite this record drop, the full year data disguises the fact that Q1 (and mostly likely Q4) saw decent levels of growth, but this was not enough to undo the economic damage seen in Q2 (and Q3, to a lesser extent), when severe restrictions on mobility were implemented to contain the spread of COVID-19. Overall, the combined value (at SR1.02 trillion) of POS and e-commerce transactions plus ATM cash withdrawals in full year 2020 only declined by 1.3 percent compared to 2019's total. What is even more impressive is that this modest yearly decline came about despite lower POS transactions being observed immediately after a hike in VAT in July of last year, in addition to severe lockdown measures during most of Q2 (Box 2).

Figure 10: Domestic liquid energy consumption

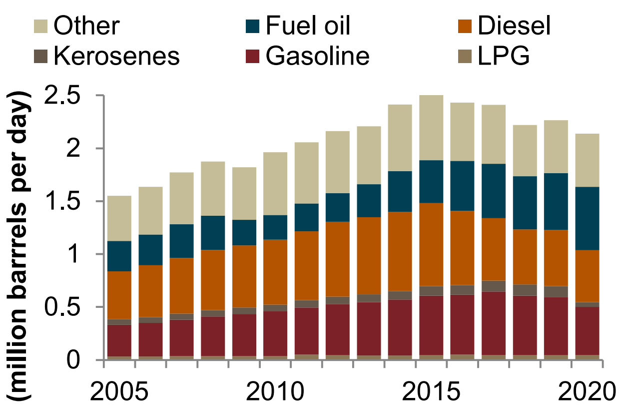
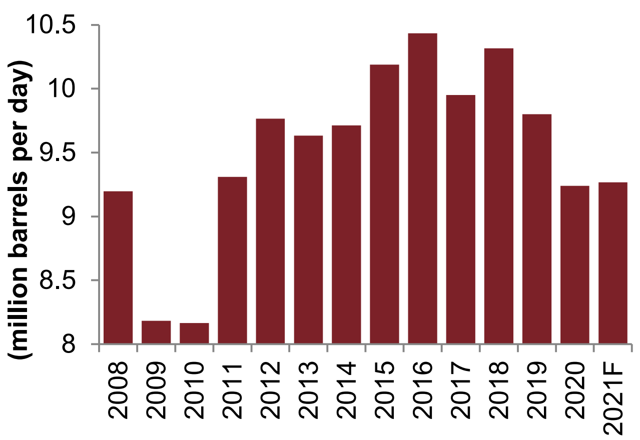


Figure 11: Saudi crude oil production
(direct communication)



Box 2: Consumer Spending

POS transactions were 21 percent higher year-on-year in 2020, primarily as a result notable yearly rises in 'food and beverages' (up 67 percent), 'telecoms' (up 51 percent) and 'construction materials' (up 40 percent). It is worth noting that a general growth in POS transactions is likely to have been boosted by the encouragement of using cashless payment during the pandemic, as part of COVID-19 precautionary measures (which probably also explains the near 400 percent yearly rise in e-commerce transactions). As a result, ATM cash withdrawals (as proportion of total consumer spending) declined to 61 percent in 2020, versus 71 percent in 2019.

Overall, consumer spending (at SR1.02 trillion) in full year 2020 only declined by 1.3 percent compared to 2019's total.

In our view, three factors helped limit the downward trend in consumer spending; i) the suspension of commercial flights and the consequent outbound tourism expenditure being diverted locally (*covered in our macroeconomic update*), ii) businesses and retailers lowering end prices and, in some instances, absorbing part of the rise in VAT (*covered in our Inflation update)* iii) the roll-out of the Saned scheme allowing for the retention of citizens in applicable jobs in the private sector (*covered in our Labor market update*).

Also during 2020, a number of tourism initiatives were rolled out within the Kingdom as COVID-19 cases dropped to lowly levels. Although tourism infrastructure is currently limited and in many cases under developed, local demand nevertheless remained high over the summer months, which helped provide a timely boost to the 'Wholesale & Retail, Restaurants & Hotels', and 'Transport, Storage & Communication' sectors (see below). In addition, notable international sporting events relating to golf, football and motorsports were held within the Kingdom last year. Looking ahead, the sector should benefit from the continued roll-out of entertainment and leisure events, especially during the second half of 2021. For example, Saudi Arabia will become the 33rd nation to host a Formula 1 Grand Prix race, which is expected to take place in Jeddah in November. Additionally, the Kingdom continues to be linked to a number of international sporting fixtures, such as the heavyweight boxing title, having hosted a similar event back in late 2019.

Despite this, a reversal/winding down of the three factors that helped sustain growth last year…

...will likely provide headwinds for the sector going forward.

We expect outbound trips to increase, albeit not immediately, resulting in lower domestic tourism spend.

Furthermore, we expect businesses to be less inclined to continue covering the difference in VAT going forward…

... thereby raising the price of certain goods for consumers.

Lastly, Saudi household disposable income (and spending) is likely be pressured as…

...the Saned scheme is wound down…

…unemployment remains higher than pre-COVID levels in the near term…

...and the public sector workers inflation allowance remains discounted.

Despite this, a reversal/winding down of the three factors that helped sustain growth last year will likely provide headwinds for the sector going forward. For instance, back in January 2021 the General Authority of Civil Aviation (GACA) announced that the suspension of international flights would be lifted completely from May 2021 onwards. Accordingly, we expect outbound trips to increase, albeit not immediately, but certainly during the summer months resulting in lower domestic tourism spend (which will not necessarily be compensated by inbound tourism, see Transport and Communication section below). Furthermore, we expect businesses to be less inclined to continue covering the difference in VAT going forward, thereby raising the price of certain goods for consumers. Saudi Arabia has one of the highest levels of VAT in the Gulf region, whilst some of the more established regional shopping destinations (such as Dubai) offer VAT refunds, thus making short trips to purchase high value items more enticing. Lastly, Saudi household disposable income (and spending) is likely be pressured as the Saned scheme is wound down, unemployment remains higher than pre-COVID levels in the near term (as detailed in our Labor Update), and the public sector inflation allowance remains discounted (as of July last year).

Non-oil manufacturing contracted in all three quarters of last year…

...with the decline in activity as being directly related to global economic developments.

Looking ahead, global manufacturing indices have recently improved…

...and, if sustained, demand for the Kingdom's non-oil exports should improve as well.

Separately, the continued roll-out of initiatives under the National Industrial Development and Logistic Program (NIDLP)…

...should help drive some level of support to the sector…

...with the Saudi Industrial Development Fund (SIDF) being one vehicle through which support can be provided.

Non-oil manufacturing (14.6 percent of non-oil GDP) contracted in all three quarters of last year, on a year-on-year basis, averaging -6.6 percent in the year-to-Q3 2020. We see the decline in activity as being directly related to global economic developments, with a sharp decline in global manufacturing and trade brought about by the pandemic, mirrored in Saudi Arabia. In fact, latest available data shows that the value of non-oil exports were down -12 percent in the year-to-November 2020, versus the same period in 2019 (Figure 12).

Looking ahead, global manufacturing indices have recently improved (Figure 3) and, if sustained, demand for the Kingdom's non-oil exports should improve as well. In fact November's data also showed the largest yearly rise in exports in two years, manufacturing activity has improved since mid-2020 despite remaining in the negative territory (Figure 13). Separately, the continued roll-out of initiatives under the National Industrial Development and Logistic Program (NIDLP) should help drive some level of support to the sector, with the Saudi Industrial Development Fund (SIDF) being one vehicle through which support can be provided (Box 3).

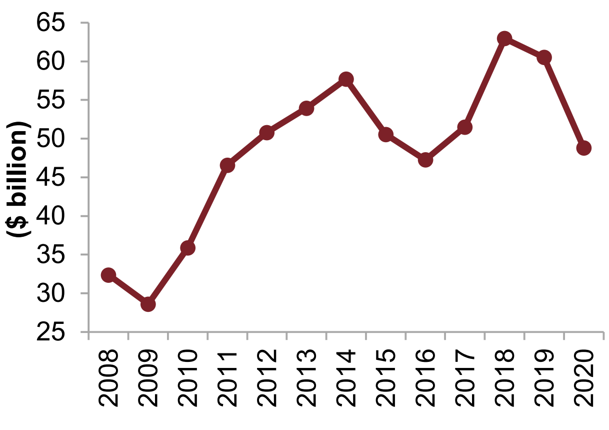
Box 3: Saudi Industrial Development Fund

The SIDF was launched back in 1974 with the aim of supporting and financing the manufacturing sector through interest-free loans and financial consultancy. More recently, the SIDF's role has evolved to incorporate the funding of initiatives that support the objectives of the Vision 2030.

Whilst the SIDF continued with its primary function in 2020, with loans approved by the fund totaling SR17 billion (up from SR13 billion in 2019), it also extended efforts to support the government in alleviating the financial and economic impact of COVID-19. With the outbreak of the pandemic last year, it became abundantly clear that there would be a significant rise in the level of bankruptcies amongst small and medium-sized enterprises (SMEs). Although one of the earliest measures to be rolled out by the authorities were directly aimed at SMEs, the SIDF also stepped up efforts to blunt the effects of the sharp decline in private sector. More specifically, around SR5 billion worth of financial products (including restructuring and deferment of loans) were rolled out by the fund last year.

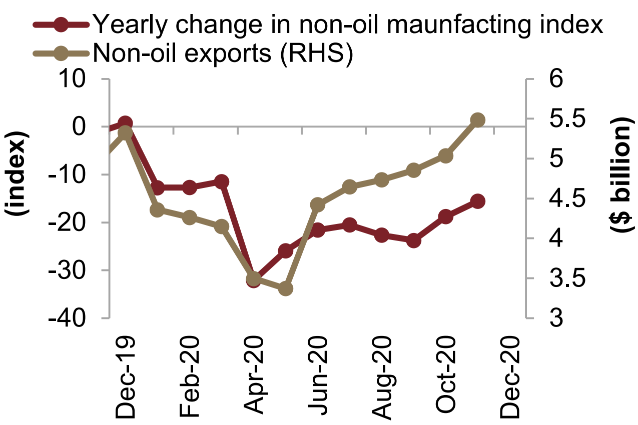
Looking ahead, whilst the SIDF will continue providing targeted pandemic relief to the private sector, it will also continue towards its target of doubling the number of financed projects by 2025. In order

Figure 12: Annual non-oil exports*



*2020: year-to-November total

Figure 13: Monthly manufacturing index and non-oil exports



Looking ahead, whilst the SIDF will continue providing targeted pandemic relief to the private sector…

... it will also continue towards its target of doubling the number of financed projects by 2025.

to achieve these goals, the SIDF has launched a strategy that aims to improve the industrial ecosystem through four specific financial programs. These include:

1 **Afaq:** to support industrial SMEs, with the collaboration of other entities such as Badir and Monshaat.
2 **Tanafusiya**: to support and motivate industrial enterprises to move to Industry 4.0 and improve energy efficiency, which helps in raising productivity and reducing costs.
3 **Tawteen**: to maximize local content, localize a number of target sectors, and support supply chain with leading companies in the Kingdom, with a collaboration of Saudi Electricity Company, IKTVA and Maaden.
4 **Land and Loan:** which allows investors to apply for finance and allocate an industrial land spot at the same time through one portal, helping them to save time and effort, aligning with other entities such as MODON, King Salman Energy Park (SPARK) and the Industrial Valley.

The Transport, Storage & Communication sector was down by -6.2 percent in the year-to-Q3 2020, year-on-year.

Despite Umrah reopening during Q4 of last year, restrictions on the number of pilgrims remain in place…

...meaning a steep yearly decline in total number of pilgrims is expected in 1441H.

The Transport, Storage & Communication (10.8 percent of non-oil GDP) sector was down by -6.2 percent in the year-to-Q3 2020, year-on-year. A steep decline in Q2 was followed up with continued negative growth in Q3 as a result of ongoing travel restrictions, suspension of tourist visas, ban on Umrah pilgrimages and a drastically scaled back Hajj. Despite Umrah reopening during Q4 of last year, restrictions on the number of pilgrims remain in place, meaning a steep yearly decline in total number of pilgrims is expected in 1441H (with 7.5/2.5 million Umrah/Hajj pilgrims in 1440H). Meanwhile, the telecoms subsector is likely to have performed better, especially during lockdown which resulted in work-from-home settings. Indicative of this is that most listed telecommunications companies reported strong earnings growth during the year. Indeed, it is worth noting that the average internet speed within the Kingdom rose to 77.5 megabytes per second, making Saudi Arabia first in terms of download speed within the group of countries using the fifth generation (5G) network.

Looking ahead, we expect restrictions on the numbers of pilgrims for Umrah and Hajj to remain in place for the coming year.

While we are confident of the Kingdom's ability to provide all the precautionary measures for pilgrims…

...this is only one side of the equation.

The other side of the equation is how quickly other Muslim (or large Muslim populated) countries can inoculate their respective citizens.

For 2021, we see a number of projects coming on-line that will raise growth in this sector. This includes the first phase of the Riyadh metro, which is expected to be launched in Q2 2021, as well as the first phase of Riyadh Bus Transit. Meanwhile, the telecoms subsector may benefit from higher uptake of mobile phone/data subscriptions as an increasing number of government services become digital. Besides the recent launch of digital ID's, there are also a number of mobile applications that allow users to apply for COVID-19 testing, enroll for the vaccine, and provide updates on nearby infections (see Box 8). Meanwhile, we expect restrictions on the number of pilgrims for Umrah and Hajj to remain in place for the coming year. While we are confident of the Kingdom's ability to provide all the precautionary measures for pilgrims, this is only one side of the equation. The other side of the equation is how quickly other Muslim (or large Muslim populated) countries can inoculate their respective citizens (Box 4).

Box 4: COVAX

Back in April 2020, the World Health Organization (WHO) and the Global Vaccine Alliance came together to launch the COVID-19 Vaccines Global Access Facility (COVAX). One of COVAX's aims is to ensure that middle-and lower-income countries, who cannot fully afford COVID-19 vaccines, get equal access to such vaccines as and when they are made available. Accordingly, the COVAX program recently released a list of 137 countries that would receive 337

For example, circa 50 percent of Umrah pilgrims in 1440H came from countries receiving highest number of vaccines under the COVAX program.

million vaccine doses. Three of the largest recipients of the vaccine (India, Pakistan and Indonesia) are also the three largest countries from which Saudi Arabia received Umrah pilgrims in 1440H (Figure 14). Looking ahead, countries involved in the COVAX program are set to receive enough doses to immunize circa 3.3 percent of their population by mid-2021, which is a significantly lower rate than some higher income countries have targeted over the same period.

Real Estate Activities saw a marginal decline in GDP by -0.3 percent in the year-to-Q3 2020.

In fact, this sector was one of the least impacted (along with 'Finance') by the lockdowns.

Part of the uplift was likely due to the continuous provision of varied housing products to citizens under the Ministry of Housing's (MoH) Sakani program.

Real Estate Activities (9.4 percent of non-oil GDP) saw a marginal decline in GDP by -0.3 percent in the year-to-Q3 2020. In fact, this sector was one of the least impacted (along with 'Finance') by the lockdowns, with a fall of -1.1 percent year-on-year seen during Q2, followed by a strong recovery in Q3. Part of the uplift was likely due to the continuous provision of varied housing products to citizens (which totaled 320 thousand in 2020 as a whole) under the Ministry of Housing's (MoH) Sakani program. In tandem with this, numerous measures taken in the last few years to incentivize uptake of mortgages and promote home ownership under the Financial Sector Development Program (FSDP) also contributed to growth. This was reflected in a continuous rise in new residential mortgages provided by banks and finance companies, which, according to latest available data, increased by SR97 billion (up 31 percent) in Q3 2020, when compared to the end of 2019.

For 2021, we see continued growth in this sector coming from the MoH's 'Sakani' program…

...but also a more general rebound in the non-oil economy should help shore up demand in real estate.

For 2021, we see continued growth in this sector coming from the MoH's 'Sakani' program. We also see further strong growth in mortgage lending as various initiatives under the Housing Vision Realization Plan (VRP) continue to be implemented (Box 5). Additionally, a recent royal decree, whilst exempting all real estate transactions from VAT, introduced a real estate transaction tax of 5 percent. However, the royal decree also stated that government will bear the 5 percent transaction tax for first time buyers purchasing a property up to the value of SR1 million (compared to the previous VAT exempted threshold of SR850 thousand). We see both these changes raising the level of home ownership amongst citizens, and thus raising the sector's output in the year ahead. Lastly, a more general rebound in the non-oil economy, but particularly in sectors such as 'Wholesale & Retail, Restaurants & Hotels' and 'Finance, Insurance, and Business services'**,** should help shore up demand in real estate activity, with an uptick in real estate indicators expected to continue into 2021. The most recent GaStat's real estate index showed prices rose by 0.5 percent during 2020 as a whole, whilst publicly listed Real Estate Investment Trusts (REITs) saw a rise of 2 percent in yearly performance (Figure 15).

Figure 14: 50% of Umrah pilgrims came from countries receiving highest number of COVAX vaccines

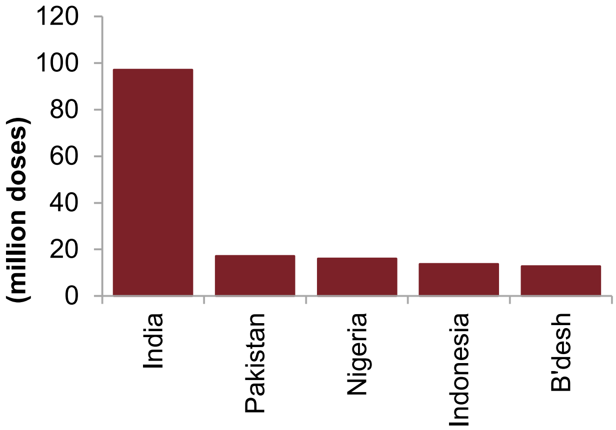
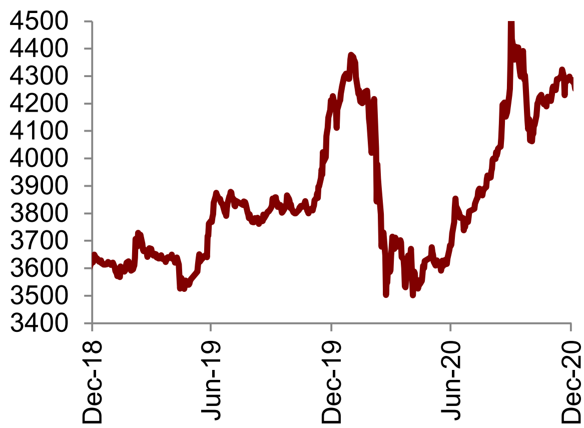


Figure 15: Listed REITs performance



Measures have been put into place to tackle the supply of affordable housing…

...particularly in regions/cities where a significant demand-supply gaps exists.

This has included, amongst other things, making more government land available for housing developments.

Box 5: Improving Home Ownership Levels

Despite the MoH having hit its National Transformational Program (NTP) target for home ownership ratio of 60 percent, efforts to improve ownership continue. As identified under the Housing VRP, this is will partly be achieved by improving access to (mortgage) funding for beneficiaries under the ministry's Eskan and Real Estate Development Fund (REDF) programs. To date, this has been done by identifying consumer groups by income level. Thus, on the one hand, whilst there has been a focus on the provision of guarantees for those that are bankable or quasi-bankable, the provision of rent subsidies or social housing has also being rolled out for non-bankable and low-income groups.

Concurrently, and despite limitations imposed by COVID-19, measures have been put into place to tackle the supply of affordable housing, particularly in regions/cities where a significant demand-supply gaps exists (Figure 16). This has included, amongst other things, making more government land available for housing developments and adopting more modern technology (such as 3D printing) in the construction of affordable housing units.

Despite -4.7 percent year-on-year decline in Q2, growth was recorded in both Q1 and Q3 of last year in the Construction sector.

We see the rebound in performance as a result of a continued roll-out in the Sakani program and the PIF's mega-projects.

Looking ahead, growth in construction will be led by continued development of mega-projects…

The **Construction** (7.8 percent of non-oil GDP) sector recorded a mild decline of -0.8 percent in the year-to-Q3 2020. Despite -4.7 percent year-on-year decline in Q2, growth was recorded in both Q1 and Q3 of last year (and we suspect in Q4 too). We see this performance as a result of a continued roll-out in the Sakani program and the PIF's mega-projects. Additionally, notable large projects around the Kingdom (such as phase three expansion of the Grand Mosque in Makkah), will have helped as well.

Looking ahead, growth in construction will be led by continued development of mega-projects, especially so with the PIF's new strategy for 2021 to 2025, which aims to invest SR150 billion annually in the local economy (Figure 17, Box 6). Also, besides the continued roll-out of the Sakani program, we also expect the construction sector to benefit from the ongoing projects in a number of sectors, including, hospitals, touristic areas and airport expansions around the Kingdom (as highlighted in the recent fiscal budget statement).

Figure 16: Demand for housing by city/region for those enrolled as Eskan and REDF beneficiaries

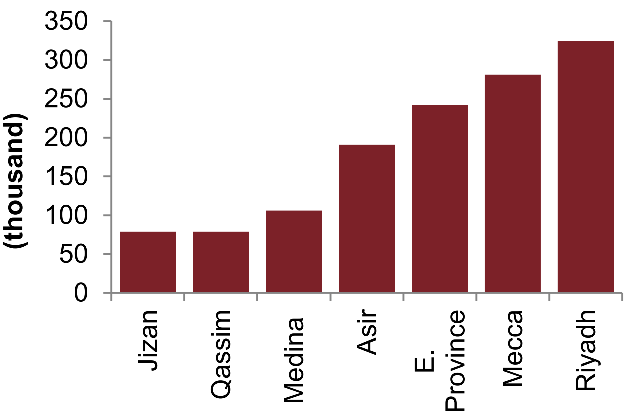
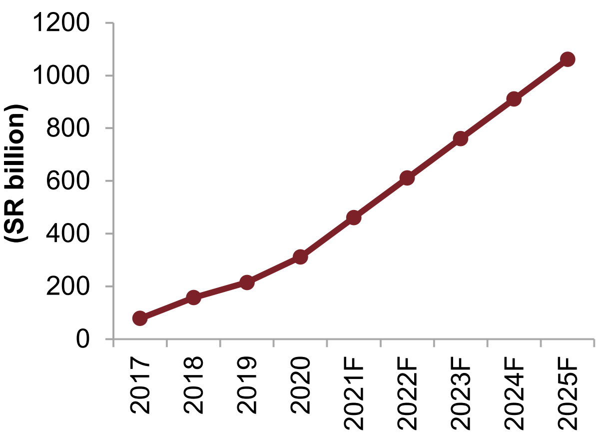


Figure 17: Cumulative domestic PIF investment between 2017-25 expected to exceed SR1 trillion



...especially as the PIF aims to invest SR150 billion annually in the local economy between 2021-25.

Box 6: Public Investment Fund Program 2021-2025

In January 2021, the PIF announced its renewed program for the period 2021-2025 which detailed four main objectives:
1) to grow assets of the fund
2) unlock new sectors
3) build strategic partnerships, and
4) localize cutting-edge technology & knowledge.

Between 2015-2020, the PIF was able to raise its assets under management (AUM) from $150 billion to nearly $400 billion. For 2025, the PIF aims to reach at least $1.07 trillion in AUM., and then to $2 trillion by 2030.

Agriculture declined by 3.2 percent in the year-to-Q3 2020, year-on-year.

That said, in the midst of the severe lockdown, the Kingdom saw strong levels of self-sufficiency in many agriculture products.

Looking ahead, the MEWA is expected to continue working on implementing the ARDP…

Agriculture (4 percent of non-oil GDP) declined by 3.2 percent in the year-to-Q3 2020, year-on-year. The sector was also badly hit by lockdown measures during Q2, declining by -9.8 percent year-on-year, although it did rebound sharply to positive territory in Q3. That said, in the midst of the severe lockdown, the Kingdom saw strong levels of self-sufficiency in many agriculture products, including eggs at 116 percent self-sufficiency, fresh milk and its derivatives at 109 percent, and vegetables and poultry at 60 percent. We believe such high levels of self-sufficiency (for a country which has limited naturally occurring ground water and is subject to extremes of temperature) likely reflects the ongoing implementation of Ministry of Environment, Water and Agriculture's (MEWA) Sustainable Agriculture Rural Development Program (ARDP). The aim of the program, which started back in 2018, is to support and develop farmers and agricultural activities through a total investment of SR12 billion. Looking ahead, the MEWA is expected to continue working on implementing the ARDP, with some of these projects spanning into traditional areas such as the development of date farms, but also into newer ones, such as aquaculture (Box 7).

….with some of these projects spanning into more traditional areas, but also into newer ones, such as aquaculture.

Box 7: Aquaculture

Currently, only a handful local companies operate in this segment but there is a clear plan in place to expand. More specifically, there is an emphasis of raising domestic production of local aquaculture as the Kingdom is expected to see an annual rise of 8 percent in seafood consumption up to 2030.

Consequently, the strategy revolves around increasing quality and efficiency by following best practice farming models, and focusing on six seafood products that exhibit a clear comparative advantage for local farming. Additionally, whilst there will be efforts to rebalance the quantity of exports (with around 72 percent of current aquaculture production being exported), the focus will be on creating value by exporting high value fast growing seafood products.

Finance, Insurance, and Business services showed decent levels of growth of 1.4 percent in the year-to -Q3 2020, year-on-year, with a multitude of areas contributing to growth…

...The financial services sub-sector saw a pick-up in lending to the private sector, which increased by 14 percent in 2020…

Finance, Insurance, and Business services (7.1 percent of non-oil GDP) showed decent levels of growth of 1.4 percent in the year-to-Q3 2020, year-on-year, with a multitude of areas contributing to growth. The financial services sub-sector saw a pick-up in lending to the private sector, which increased by 14 percent in 2020. In addition, growth in banking activity was also related to the rise in mortgages provided by banks and finance companies (see Monetary and Financial Development section below). Growth was also pushed up as the Tadawul All Share Index's (TASI) continued to see a total of SR21.2 billion (USD5.6 billion) in net foreign inflows during the year (Figure 18). Additionally, the sector was also boosted by four IPOs with companies in healthcare, real estate services and retail sectors being floated on the main market. Meanwhile, the sector was negatively affected by the decline in the number of privately insured persons. Data from Cooperative Council for Health Insurance (CCHI) shows a 9 percent (or 973 thousand) yearly decline in the number of beneficiaries during 2020, with 77 percent being expats (Figure 19).

...the sector was also boosted by four IPOs in the main market.

Looking forward, a pick-up in non-oil growth during the year will have a positive impact on credit to the private sector. In particular, continued growth in the construction sector should contribute to lifting demand. Additionally, we also expect higher levels of credit to continue being seen in sectors that remain under precautionary measures related to COVID-19 (such as "Commerce", "Transport" and "Services").

Looking ahead, we expect some leveling off in the decline rate of expat health insurance beneficiaries.

Beyond credit, we expect some leveling off in the decline rate of expat health insurance beneficiaries, although we do expect Saudi beneficiaries to rebound, in line with a recovery in the employment of nationals (*for more details please refer to our latest Labor Market update*). With respect to the stock market, we expect IPO activity to continue in the year ahead (one IPO is already progressing), with Tadawul itself potentially going public. At the same time, the Capital Market Authority's (CMA) Strategic Plan for 2019-21 highlights a number of areas which will continue to receive attention under its commitments to the *Financial Sector Development Program*.

Community, Social & Personal Services is expected to see similar higher rates of growth this year as the easing of restrictions of entertainment and leisure events continues.

Community, Social & Personal Services (3.7 percent of non-oil GDP) dropped by -4.8 percent in the year to Q3 2020. The causes of the decline are likely to be the same reasons for the negative impact in the 'Wholesale & Retail' sector. Looking ahead, the sector is also expected to see similar higher rates of growth this year as the easing of restrictions of entertainment and leisure events continues, especially in H2 2021.

Electricity, Gas, and Water saw a year-on-year decline of -2.5 percent in the year-to-Q3 2020.

Looking ahead, we expect the declining trend in electricity consumption observed in the last few years to continue.

Electricity, Gas, and Water (2.2 percent of non-oil GDP) saw a year-on-year decline of -2.5 percent in the year-to-Q3 2020. In-line with this, the Saudi Electricity Company (SEC) reported that sales of electricity were down by -1 percent in the year-to-Q3 2020 when compared to the same period last year. More specifically, whilst there was a rise in the largest consumer segment (residential), this was weighed down by lower consumption amongst commercial and government segments. More broadly speaking, and despite COVID-19's impact, electricity consumption in Saudi Arabia has been declining since 2015. According to the King Abdullah Petroleum Studies and Research Center (KAPSARC), this is due to four major factors; i) recent electricity price reform ii) improved energy efficiency programs iii) a decrease in the non-Saudi population, and iv) a decrease in real incomes. Looking ahead, we therefore expect the trend in electricity consumption observed in the last few years to continue.

Figure 18: TASI continued to see QFI net inflows last year

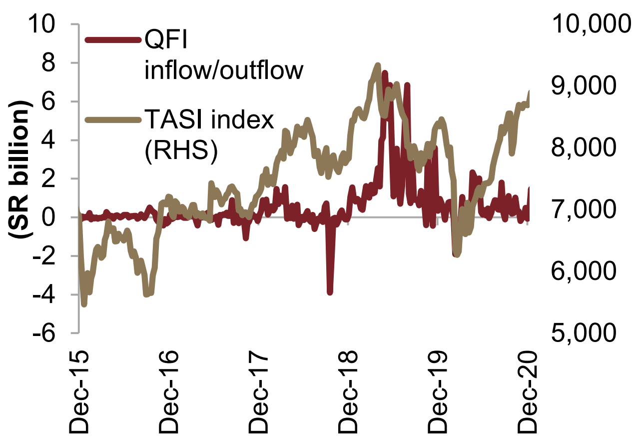
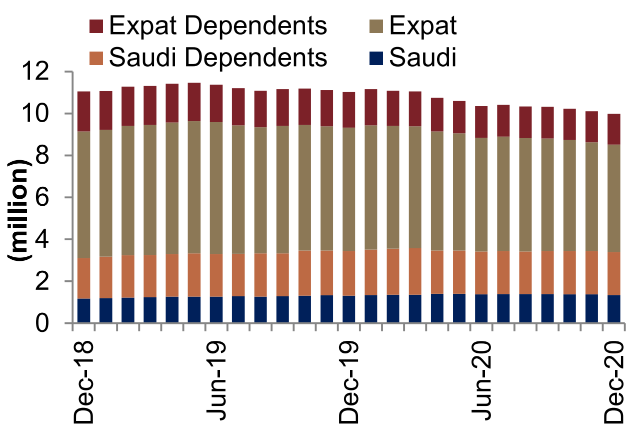


Figure 19: Number of private health insurance beneficiaries declined 9 percent in 2020



Non-Oil Mining and Quarrying grew marginally by 0.8 percent in the period to Q3 2020, year-on-year.

Non-Oil Mining and Quarrying (0.7 percent of non-oil GDP) grew marginally by 0.8 percent in the period to Q3 2020, year-on-year. We see this growth coming about as a result of efforts to encourage investment in the sector, with the finalization of a mining investment system to incentivize private investors being one example.

Looking ahead, the sector will benefit from the decision to waiver expat levies in the industrial sector for five years (announced back in September 2019), in addition to improved export activity. Additionally, the sector is expected to be one of the major beneficiaries from a number of initiatives outlined under the NIDLP, including support from both the Saudi Export-Import (EXIM) Bank, and lending from the SIDF. Overall, such initiatives will be growth enhancing for the sector, and despite its relatively small contribution to GDP, we expect sizable growth in this sector in the years to come.

Fiscal Policy

Total expenditure is budgeted at SR990 billion in 2021…

The government's budget for the 2021 fiscal year released on 15th December 2020 was in-line with the earlier released preliminary budget. Overall, according to the statement, budgeted government expenditure is expected to total SR990 billion in 2021, and with revenue of SR849 billion during the year, the government is budgeting for a lower year-on-year deficit at SR141 billion in 2021(-4.9 percent of GDP), compared to SR298 billion in 2020 (-12 percent of GDP).

Expenditure:

...and down 7 percent from 2020 actual expenditure of SR1.07 trillion.

Budgeted capital spending will amount to SR101 billion in 2021, compared to SR137 billion in 2020.

Total expenditure for 2021 was budgeted at SR990 billion, down 2.9 percent from the 2020 budgeted expenditure of SR1.02 trillion and down 7 percent from 2020 actual expenditure of SR1.07 trillion. Of this, budgeted capital spending was earmarked to hit SR101 billion in 2021, compared to SR137 billion in 2020. According to the statement, the sizable yearly decline of 26 percent is primarily a result of i) higher investment on infrastructure during the past few years and ii) expectation of wider participation from the private sector in investment projects moving forward.

Additionally, capital injections will be boosted by the PIF. As a part of its continued efforts in strengthening and diversifying the economy, the PIF is expected to inject around SR150 billion per year into the local economy between 2021-25, resulting in just over SR1 trillion worth of cumulative investments into local economy between 2017-25.

Current spending is expected to decline by 5 percent, year-on-year, to a budgeted total of SR889 billion.

Meanwhile, current spending (the more rigid part of expenditure) is expected to decline by 5 percent, year-on-year, to a budgeted total of SR889 billion. At the same time, despite the compensation of employees (wage bill) being flat on a year-on-year basis, it is expected to make up half of total expenditure (at SR491 billion), compared to 46 percent in 2020.

Overall only 'health & social development', and 'general items' are expected to show yearly rises.

Looking at the budget from a sectorial level, 'education' remains the largest portion of budgeted expenditure, at 19 percent of the total. Meanwhile, 'healthcare and social development' expenditure makes up 18 percent of the total, at SR175 billion, the highest budgeted expenditure on record for this segment (Figure 20). Whilst 'military' expenditure also makes up 18 percent of budgeted expenditure, it sees a third consecutive year of decline. Overall only 'health & social development' (Box 8), and 'general items' (which includes different sub-items such as spending on government pensions, social insurance and financing costs) are expected to show yearly rises between actual 2020 and budgeted 2021 expenditure.

Box 8: Healthcare Expenditure

This higher level of spend is reflective of the how the Ministry of Health responded to the global outbreak of COVID-19.

The budget statement highlighted that actual health expenditure (which is aggregated into 'health & social development') was 13.5 percent higher than budgeted in 2020 as a result of an exceptional allocation to confront the COVID-19 crisis. This higher level of spend is reflective of how the Ministry of Health (MoH) responded to the global outbreak of COVID-19, as it became apparent back in early 2020. Whilst the list of measures are extensive, the MoH's work included developing a country-specific guideline, in-line with the World Health Organization's (WHO) recommendations, in dealing with new viruses, which will have likely drawn upon the Kingdom's own experience of dealing with another type of corona virus -Middle East respiratory syndrome (MERS). Indeed, with respect to COVID-19, the MoH, amongst other things, focused on surveillance and testing (with 9.6 million samples being tested for COVID-19 during 2020), alongside the setting up of isolation and quarantine facilities, and the designation of 80 thousand beds across 25 hospitals for COVID-19 cases.

Looking ahead, the ongoing battle against COVID-19…

...which includes a roll-out of a free vaccination program for all citizens and expats…

The MoH plans were also supported by the role of digital health (e-health) methodologies, such as developing a number of mobile applications (Tawakkalna app and Tabaud app) to monitor and respond to the virus, and developing dashboards that use artificial intelligence to connect data and trace cases. At the same time, a telehealth campaign was used to raise awareness and education among citizens and residents.

...will ensure that this segment's expenditure is likely to be maintained at historically high levels during 2021 as well.

Overall, the above the measures will have contributed to pushing healthcare expenditure above budgeted levels during 2020. Looking ahead, the ongoing battle against COVID-19, which includes a roll-out of a free vaccination program for all citizens and expats, will ensure that this segment's expenditure is likely to be maintained at historically high levels during 2021 as well.

Revenue:

Total government revenue for 2021 was budgeted at SR849 billion according to the statement.

Total government revenue for 2021 was budgeted at SR849 billion according to the statement. For the first time ever, the budget statement did not outline government oil revenue, but instead combined it with other forms of revenue which includes investment income, sales of goods and services and collection of fines &

Figure 20: Budgeted 'Health & Social Development' expenditure the highest on record

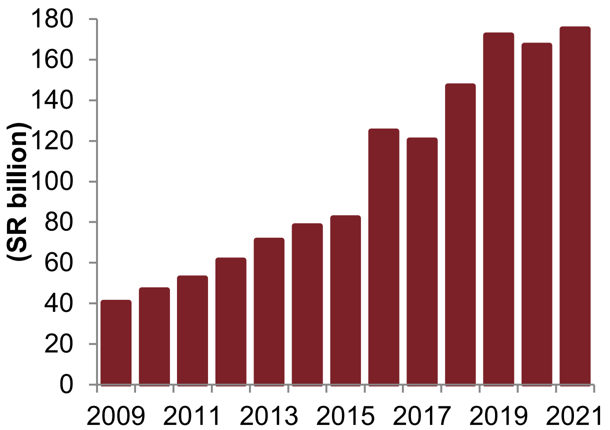
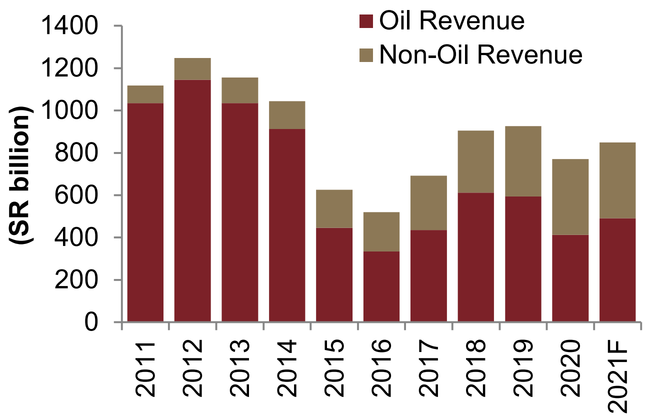


Figure 21: Government revenue by type*



*Jadwa estimates for 2021

For the first time ever, the budget statement did not outline government oil revenue.

Our model assumes Aramco to continue paying dividends to government at levels similar to this year…

...and we expect to see a reasonably higher yearly oil revenue at around SR491 billion.

The government is budgeting for a lower year-on-year deficit at SR141 billion in 2021 (-4.9 percent of GDP).

A lower fiscal deficit is expected to translate into lower levels of debt.

According to the DMO, total debt requirement for next year will be SR83 billion.

penalties, thereby making the calculation for budget oil price more complicated. This 'other revenue' segment is expected to rise by 3.2 percent year-on-year in 2021, to SR592 billion

Overall, we expect Brent oil prices to average $55 pb in full year 2021, which will, according to our forecasts, push up oil revenue by 19 percent year-on-year. Our forecast assumes this segment will be supported by the payment of dividends by Aramco to government at broadly similar levels to the last few years (Box 9).

Box 9: Revenue by Type

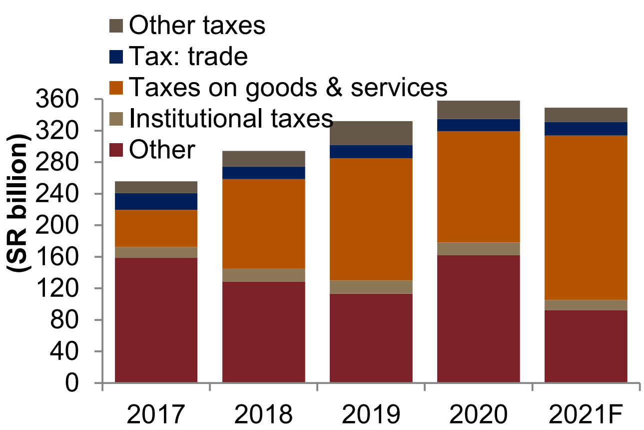
We estimate that higher yearly oil prices and the continued payment of dividends by Aramco will push government oil revenue to SR491 billion. As a result, we expect non-oil revenue to be effectively flat on a year-on-year basis, at around SR360 billion in 2021 (Figure 21).

With SR257 billion (or 71 percent) of non-oil revenue coming from tax revenue, we expect the remainder (SR101 billion) to come from 'other' revenue. In turn, around a third of 'other' revenue will be made up from the continued privatization of state assets. The remainder is expected be derived from usual sources such as investment income (from the Saudi Central Bank), sales of goods and services and collection of fines & penalties.

The budget statement also outlined that SR257 billion in tax revenue is expected in 2021 resulting in growth of 31 percent over 2020's total of SR196 billion. The rises are expected to come about largely as a result of the full year effects of higher VAT, which, in turn, will lift 'taxes on goods and services' segment 48 percent higher year-on-year (Figure 22).

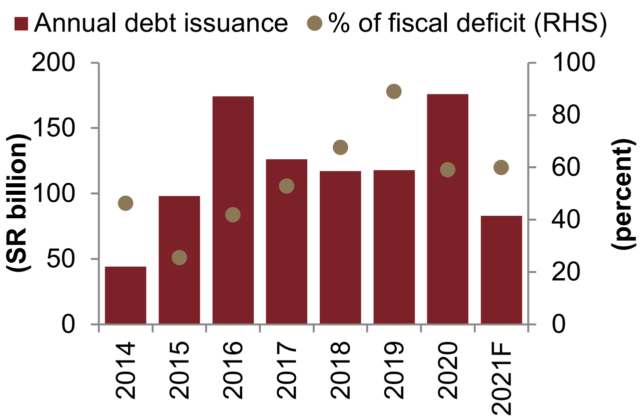
According to the fiscal budget statement, with government revenue of SR849 billion versus expenditure of SR990 billion, the fiscal deficit is budgeted to total SR141 billion (-4.9 percent of GDP) at the end of the year. A majority of the deficit will be financed through debt, as outlined by the Debt Management office's (DMO) annual borrowing plan. Under the plan, a total of SR83 billion in new debt is expected to be issued this year (compared to SR176 billion in 2020, Figure 23), which will push up total debt to SR937 billion by end of 2021 (32.8 percent of GDP). As such, around 60 percent of the deficit will be financed through debt, meaning SR56 billion is likely to be financed by SAMA deposits, substantially lower than the total of SR122 billion in 2020.

Figure 22: Non-oil revenue by type*



*Jadwa estimates for 2021
Other taxes = 'Other Taxes (including Zakat)'
Tax: trade = 'Taxes on trade and transactions (customs duties)'
Institutional taxes = 'Taxes on income, profits and capital gains'
Other = 'Other revenues (including returns from SAMA and PIF)'

Figure 23: Annual debt issuance



Monetary and Financial Developments

Overall, total bank credit to the private sector picked up dramatically during 2020, rising by 14 percent on a year-on-year basis.

Overall, total bank credit to the private sector picked up dramatically during 2020, rising by 14 percent on a year-on-year basis (double the rate of annual growth seen in 2019). More specifically, "Mining" saw the largest yearly rise in credit in percentage terms (up 27 percent), although "Services" saw the largest rise in value terms, at SR13.7 billion in new credit (or 6 percent of total new credit for the year), which is unsurprising considering it was one of the more deeply affected sectors by pandemic related lockdowns earlier this year. Looking forward, higher levels of credit are expected to continue in the year ahead, especially so in sectors that remain under precautionary measures related to COVID-19 (such as "Commerce", "Transport" and "Services").

Looking forward, higher levels of credit are expected to continue in the year ahead, especially so in sectors that remain under precautionary measures related to COVID-19.

We also expect to see some rises in the cost of borrowing next year due to a number of expected developments…

...with as two supportive measures by Saudi Central Bank expiring during the year.

Meanwhile, SAIBOR (the price of lending between banks for Riyals) remains at five year lows having been on a downward trend since the end of 2018 (Figure 24). Looking ahead, we expect to see some rises in the cost of borrowing next year due to a number of expected developments. On the one hand, measures such as the Saudi Central Bank's (SAMA) deferred payments program (which was extended till the end of Q1 2021 recently) and a SR50 billion zero-interest one-year deposit at banks, are set to expire during the year, which will likely weigh on the banking sector's loan-to-deposit ratio and loan loss provisions. Additionally, we note that higher levels of liquidity last year were supported by i) the lack of spending opportunities for households (which contributed to higher household's savings and deposits, Figure 25) and ii) the DMO's strategy of using private placements with autonomous government institutions for debt raising. Looking ahead, with respect to the latter, we expect private placements with autonomous government institutions to continue in 2021 (with two-thirds of domestic debt raising coming from this source last year), which will put less funding strain on commercial banks. That said, with respects to the former, as the economy recovers during the course of the year, more spending opportunities for households are likely to arise, especially in relation to services, and, as such, we expect the build in private deposits at banks to slow, or even reverse for some time during 2021, adding to moderately tighter liquidity conditions.

<u>Inflationary trend to continue in 2021:</u>

Overall in 2020, inflation averaged 3.4 percent, compared with our forecast at 3 percent. Prices rose mainly as a result of a rise in VAT

Figure 24: Key domestic monetary indicators

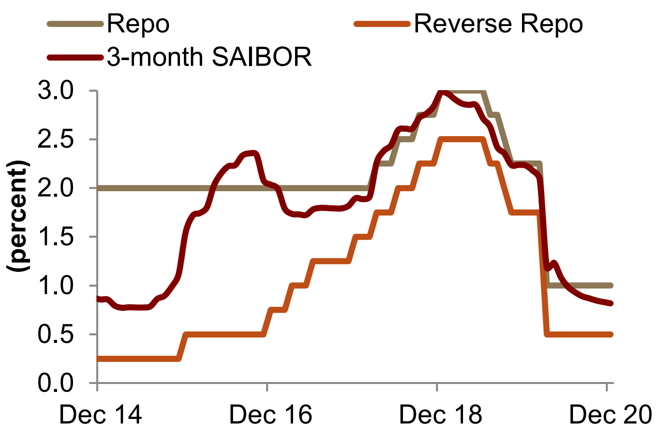
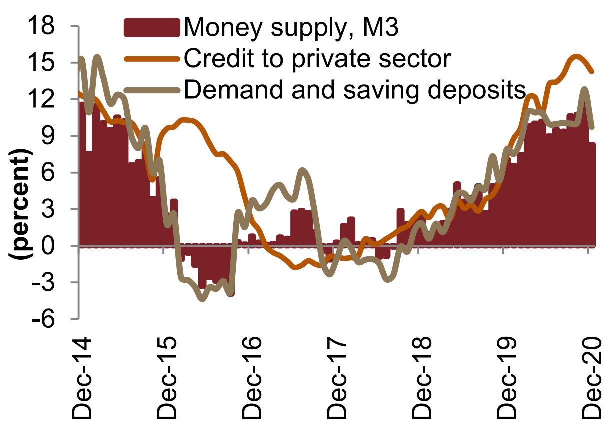


Figure 25: Yearly rise in money supply, credit and bank deposits



Overall in 2020, inflation averaged 3.4 percent….

….in 2021, we expect to see prices rising by 3.7 percent.

from 5 to 15 percent from July onwards. This was underlined by the sharp contrast in inflation in the first half of 2020, which saw average rate of 1 percent, versus an average of 5.8 percent in H2 2020. In 2021, we expect to see prices rising by 3.7 percent, supported by a rebound in activity and higher demand in many sectors such as ‘Restaurants and Hotels’ and ‘Transport’. At the same time, we expect deflationary pressures to continue in the ‘Housing and Utilities’ segment as a result of ‘Rentals for Housing’ being affected by higher rates of home ownership (as discussed in our latest *Inflation* report).

The Outlook for 2022

We expect higher oil prices (at $60pb in full year) and higher Saudi output rising to 10 mbpd next year.

The IMF (and indeed consensus forecasts) all point to continuation in economic recovery in 2022. A sizable global roll-out in vaccinations should minimize further COVID-19 disruptions, all of which will help sectors such as global travel, trade and services to continue their recovery from 2021. Indeed, the IMF expects global GDP to hit pre-COVID-19 levels by next year. This should also help the global oil market in 2022, which will have a double positive impact on Saudi Arabia’s oil sector. More specifically, we not only expect higher oil prices (at $60pb in full year) but also expect Saudi output rising to 10 mbpd next year versus 9.3 mbpd in 2021 (Box 10).

Box 10: Energy Investment

Historical underinvestment in oil exploration and production will limit the ability of non-OPEC suppliers to respond to the recovery in oil demand.

According to a recently published report by the International Energy Forum (IEF), oil and gas capital expenditure declined by 34 percent year-on-year last year. More strikingly, according to the IEF, global upstream capital expenditure in 2020 was circa 50 percent lower than 2014 levels. Looking ahead, the IEF assumes a continued decline in upstream expenditure, by 20 percent in 2021, with such consistent declines raising the possibility of higher prices and greater market volatility. In fact, the IEF (citing both OPEC and International Energy Agency figures) states that around 27 million to 30 million barrels of oil equivalent (mmboe) will be needed by 2022 to close the gap between production declines and demand levels.

Taking this into account, we see historical underinvestment in oil exploration and production limiting the ability of non-OPEC suppliers to respond to the recovery in oil demand. In this context, our view is that low cost producers with sizable levels of spare oil capacity, such as Saudi Arabia, should be well placed to raise crude oil output from 2022 onwards.

On the non-oil side, momentum from post-Corona economic recovery…

...and the continued roll-out of initiatives under the Vision 2030 will help drive growth in 2022.

On the non-oil side, momentum from post-Corona economic recovery and the continued roll-out of initiatives under the Vision 2030 will help drive growth in 2022. More specifically, we see an expansion in the ‘Wholesale & Retail, Restaurants & Hotels’, especially as restrictions around social distancing are lifted and there is an uninhibited roll-out of entertainment and domestic tourism activities. At the same time, we also see the construction and transport sectors contributing to growth from work on a number of PIF’s mega-projects continue, including the phase one completion of the Red Sea Project, but also from other large projects, such as the development of Jizan Economic City led by Aramco. On the transport side, the economic benefits from the completion of SR87 billion worth of projects in the year before will continue to positively impact sectorial GDP in 2022.

On the fiscal front, we expect total revenue to be around SR911 billion in 2022 with oil revenue making up SR527 billion, or 58

We see the fiscal deficit narrowing to -SR44 billion or -1.4 percent of GDP next year…

percent of the total (we note this could be higher if Aramco continues paying dividends to government at broadly similar levels seen in the last few years). With expenditure expected to decline 4 percent year-on-year to SR990 billion, as per the recent fiscal budget, we see the fiscal deficit narrowing to -SR44 billion or -1.4 percent of GDP next year. Meanwhile, the government expects to issue additional debt to the equivalent of SR76 billion, pushing total public debt to SR1013 billion, with debt-to-GDP at 32.7 percent at the end of 2022.

…and as the effects of a VAT hike fade, we expect to see inflation moving back more in-line with historic average of 1.5 percent in 2022.

A strong level of growth in the non-oil sector will do enough to keep imports at decent levels, albeit below pre-pandemic levels. At the same time, yearly increase in both oil and non-oil export revenue will mean that the current account will see a surplus equivalent to 6.8 percent of GDP in 2022. All of this will help push up FX reserves up on a yearly basis, but still under $500 billion, according to our forecasts.

As the effects of a VAT hike fade, we expect to see inflation moving back more in-line with historic average of 1.5 percent in 2022.

Key Data

	2014	2015	2016	2017	2018	2019	2020E	2021F	2022F
Nominal GDP									
(SR billion)	2,836	2,454	2,419	2,582	2,934	3,044	2,545	2,860	3,108
($ billion)	756	654	645	689	782	812	679	763	829
(% change)	1.3	-13.5	-1.4	6.8	13.6	3.7	-16.4	12.3	8.7
Real GDP (% change)									
Oil**	2.1	5.3	3.6	-3.1	3.1	-3.6	-6.4	1.3	9.4
Non-oil private sector**	5.4	3.4	0.1	1.5	1.9	3.8	-3.3	3.2	3.0
Non-oil government**	3.7	2.7	0.6	0.7	2.9	2.2	0.0	1.5	1.0
Total	3.7	4.1	1.7	-0.7	2.4	0.3	-4.1	2.1	5.2
Oil indicators (average)									
Brent ($/b)	99	52	43	54	71	66	42	55	60
Production (million b/d)	9.7	10.2	10.4	10.0	10.3	9.8	9.2	9.3	10.0
Budgetary indicators (SR billion)									
Government revenue	1,044	616	519	692	906	926	770	851	911
Government expenditure*	1,140	1,001	936	930	1,079	1,059	1,068	990	955
Budget balance	-96	-385	-417	-238	-173	-133	-298	-139	-44
(% GDP)	-3.4	-15.7	-17.2	-9.2	-5.9	-4.4	-12	-4.8	-1.4
Gross public debt	44	142	317	443	560	678	854	937	1013
(% GDP)	1.6	5.8	13.1	17.1	19.1	22.3	33.5	32.8	32.7
Monetary indicators (average)									
Inflation (% change)	2.2	1.2	2.1	-0.8	2.5	-2.1	3.0	3.7	1.5
SAMA base lending rate (%, end year)	2.0	2.0	2.0	2.0	3.0	2.3	0.75	0.75	1.25
External trade indicators ($ billion)									
Oil export revenues	285	153	137	171	232	201	127	165	202
Total export revenues	342	204	184	222	294	262	177	219	260
Imports	158	159	128	123	126	140	118	124	124
Trade balance	184	44	56	98	169	121	60	95	135
Current account balance	74	-57	-24	10	72	38	-17.9	19	56
(% GDP)	9.8	-8.7	-3.7	1.5	9.2	4.7	-2.6	2.5	6.8
Official reserve assets	732	616	536	496	497	500	453	455	473
Social and demographic indicators									
Population (million)	30.3	31.0	31.7	32.7	32.5	32.6	31.8	32.0	32.3
Saudi Unemployment (15+, %)	11.7	11.5	12.5	12.8	12.7	12.0	14.0	12.1	10.9
GDP per capita ($)	24,962	21,095	20,318	21,048	24,065	24,890	21,314	23,798	25,659

Sources: Jadwa Investment forecasts for 2021 and 2022. General Authority for Statistics for GDP and demographic indicators, Saudi Central for monetary and external trade indicators, Ministry of Finance for budgetary indicators. Note: *2016 government expenditure includes SR105 billion in due payment from previous years. **Jadwa estimates for 2020

Disclaimer of Liability

The data contained in this Research is sourced from Reuters, Bloomberg, GaStat, SAMA, IMF, FocusEconomics, Tadawul, 2021 budget, CCHI, COVAX, MoHU, Vision 2030 VRPs, OPEC, EIA 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.