# STATE OF THE SAUDI ECONOMY

Annual Report 2023

وزارة الاقتصاد والتخطيط
MINISTRY OF ECONOMY & PLANNING

# Content

# The State of the Economy 2023: managing shocks in an uncertain world

## Executive Summary

While the economic disruption of the COVID-19 pandemic began to subside, escalating geopolitical tensions, notably the conflict in Ukraine, disrupted global trade and supply chains, resulting in price rises for food, energy and manufactured goods. This series of overlapping crises resulted in higher inflation and impeded economic growth, which prompted many governments in emerging and advanced economies to resort to aggressive protectionist trade measures, exacerbating trade uncertainty and stoking inflationary pressures.

To counter domestic inflation, major central banks around the world, led by the U.S. Federal Reserve (Fed) committed to tightening monetary policy, raising interest rates to the highest level since 2006, and prompting other central banks, especially in developing economies to restrict access to credit to defend their exchange rates. Major currencies still depreciating against the U.S. dollar, stifling investment following the pandemic. Over the course of this year, fragile economic conditions and mounting inflationary pressures led to diminished trade and depleted foreign exchange reserves in some countries. Fragile economies responded with austerity measures and sought assistance from multilateral agencies to manage new debt issuance and avoid default. Worsening budget deficits contributed to several countries facing sovereign credit downgrades.

In this context, the Saudi economy navigated a challenging global economic and trade landscape in 2023, maintaining its long-term growth trajectory. Despite the reduction of oil production in line with the OPEC+ agreement, non-oil activities of Saudi Arabia's economy displayed resilience, supported by steady government policies and robust investments. The strength of the non-oil sector enabled the Kingdom to mitigate the adverse impact of lower oil revenue, while maintaining low level of public debt compared to its peers.

The Kingdom's level of public debt remains one of the lowest among similar-sized economies and is projected to continue at sustainable levels in the medium term. Notably, Saudi Arabia's sovereign credit rating was upgraded in 2023, with agencies citing the Kingdom's fiscal health and strong external debt position supported by substantial foreign assets held by sovereign wealth funds.

The business climate in Saudi Arabia continues to improve. The Kingdom has made significant strides in improving its rankings on global competitiveness, due to the government's drive to empower the private sector and encourage business investment. Indicators such the Purchasing Managers' Index (PMI) point to sustained expansion as Saudi's non-oil industries have exhibited resilience in the face of external shocks, bolstering the Kingdom's economic robustness. Sectors that saw notable growth are tourism, industry, services, and other activities supported and prioritized by Saudi Vision 2030.

Looking ahead, the global environment remains fraught with risks, which may affect the Kingdom's long-term growth trajectory. These include regional conflicts, renewed geopolitical tensions between the US and China, uncertain election outcomes across the world's largest economies, shifting global supply chains, higher-for-longer interest rate environment, sticky inflationary pressures, a growth slowdown in China, and policy uncertainty in emerging markets.

To address these challenges, Saudi Arabia remains resolute in its commitment to diversify its economy and fortify its resilience to navigate this fast-changing and complex global environment. This involves fostering the growth of non-oil industries, expanding global trade partnerships, implementing policies to broaden export revenue streams, and enhancing domestic human capital while expanding employment opportunities.

## Chapter one

# A Challenging Global Context

In 2023, global economic growth was hampered by intensified regional conflicts and geopolitical tensions. Major economies grappled with stubbornly high inflation, partly attributed to disruptions in international trade and supply chains stemming from geopolitical conflicts, sanctions, and competitive industrial policies promoting near-shore, friend-shore, and on-shore trading. Central banks in major economies responded by hiking interest rates to curb inflation throughout most of the year.

Global interest rate hikes led by the US Fed supercharged the value of the U.S. dollar, imposing a financial strain on emerging market economies, where exchange rates sharply declined against the global reserve currency. This increased the cost of imports in these countries and caused a depletion of their foreign exchange reserves to fend off further currency weakness. The global tightening of financial conditions raised the cost of doing business globally, diminished foreign investment inflows, worsened credit availability, weakened debt servicing capacities, and heightened the risk of sovereign defaults.

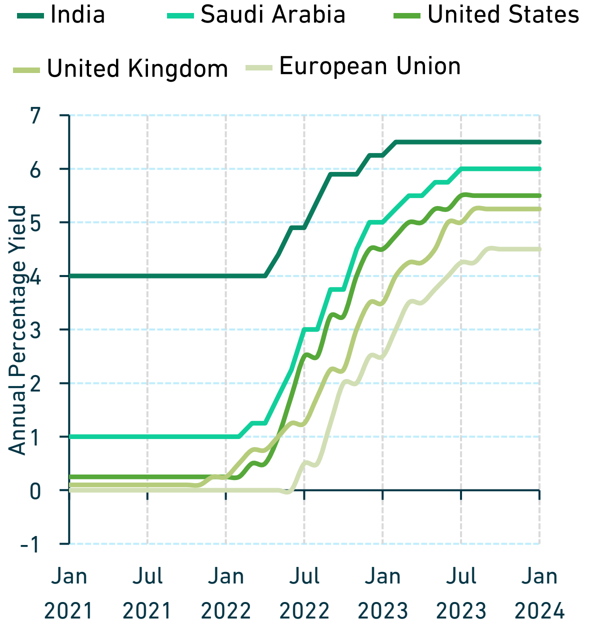
In this context, some major economies adopted protectionist and competitive policies, to support their supply chains and protect their local industries. This could lead to the exacerbation of the political, financial, and economic polarization of the global system.

# 1. Major economies tightened monetary policy to curtail inflation, creating negative spillover effects for emerging markets

The restrictive monetary policy of the US Federal Reserve, mirrored by other major central banks, dampened the inflationary pressures that posed a risk to the global economy during the first half of 2023. However, the tightening of financial conditions had destabilising consequences, by weakening local currencies against the U.S. dollar, raising borrowing costs in local markets, and triggering the downgrade of sovereign credit ratings in several vulnerable emerging markets. These elements created uncertainty, drove up the risk premium component of market interest rates, restricted credit by raising borrowing costs and crimped business investment.

### Central banks globally have mostly followed the U.S. Federal Reserve on setting rates

Monetary Policy Rates in Select Countries

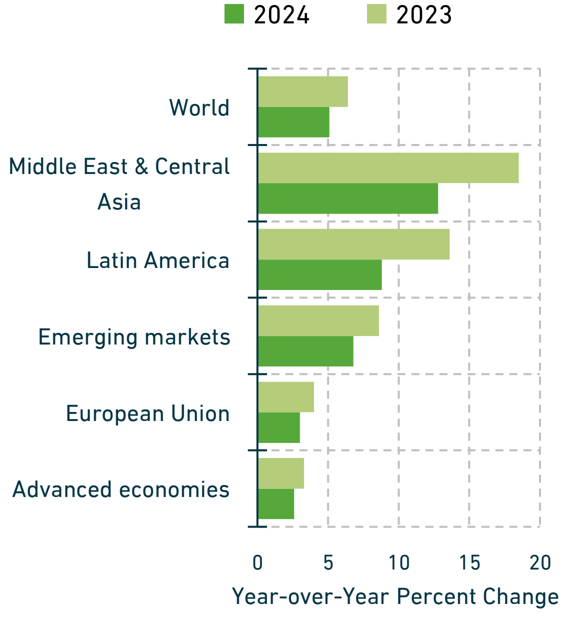



Source: Bloomberg Financial LP

Across the world, the general rate of consumer price inflation has declined considerably from its peak, but core inflation, which excludes the effects of food and energy prices, has fallen more slowly. The Fed has signalled that further rate hikes during this cycle are unlikely, but it remains unclear when it will embark on rate cuts, which would be the first since 2020. The level of interest rates and the cost of credit are high relative to the past decade, which has weighed on global GDP growth. Monetary tightening cycles can have delayed effects as borrowers that loaded up on long-maturity debt when interest rates were low now face a refinancing wall as those debts must be repaid or rolled over at a higher cost.

### Inflation has eased in almost every geography

Benchmark Inflation Rates for Select Regions




Source: Bloomberg Financial LP

Financing risk is an even more significant concern for emerging market economies suffering from local currency depreciation against the US dollar. Many of these countries were forced to draw down their foreign exchange reserves, weakening their external financial position and putting their sovereign credit rating at risk of downgrade, making access to international financing more difficult.

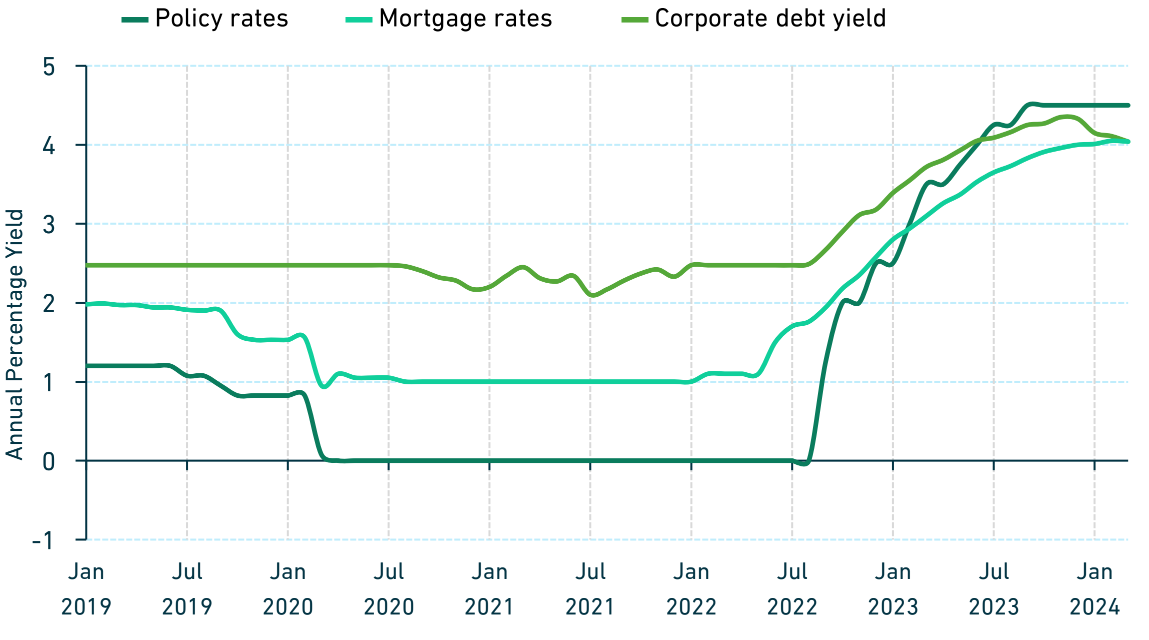
The restrictive monetary policy of the US Federal Reserve, mirrored by other major central banks, dampened the inflationary pressures that posed a risk to the global economy during the first half of 2023. However, the tightening of financial conditions had destabilising consequences, by weakening local currencies against the U.S. dollar, raising borrowing costs in local markets, and triggering the downgrade of sovereign credit ratings in several vulnerable emerging markets. These elements created uncertainty, drove up the risk premium component of market interest rates, restricted credit by raising borrowing costs and crimped business investment.

driven up mortgage costs, ramping up the cost of buying real estate, particularly homes. In some countries, rising construction costs contributed to a shortage in housing supply, worsening measures of housing affordability.

The macroeconomic effects of higher interest rates on housing affordability differ across countries. In the United States, increasing housing costs are partially offset by the wealth effect observed among property owners, which bolsters overall demand. Conversely, in China, surging house prices have surpassed income growth, resulting in an unstable property market and significant declines in transaction volumes.

## Higher interest rates and borrowing costs have slowed global growth

Key Interest Rates in Advanced Economies




Source: Bloomberg Financial LP

In 2023, financial markets were hit by considerable volatility, with bond yields whipsawing in response to shifts in Fed policy, from aggressive rate rises to a no-change policy to its benchmark interest rate. While the rise in bond yields attracted foreign capital that chased high returns in the US, it also strained the banking sector, leading to the failure of several regional banks, notably Silicon Valley Bank. In most advanced economies, commercial and retail real estate markets are faced with increased risks. Elevated policy rates have

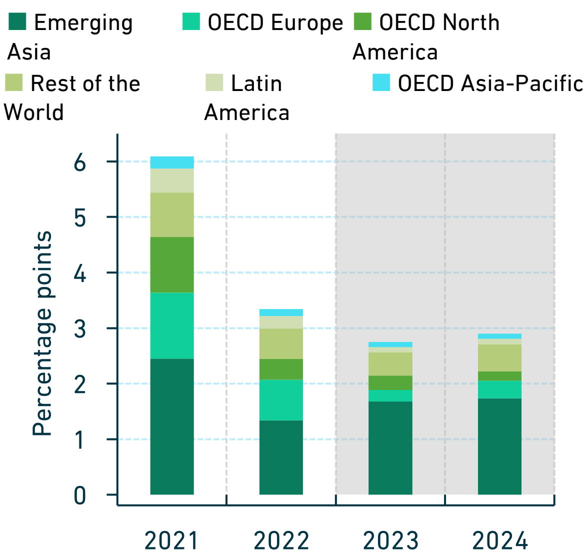
The decrease in new home purchases has far-reaching implications for China's economy due to the substantial contribution of the construction industry to economic output and GDP. A prolonged economic downturn in China poses a significant risk to the global macroeconomic landscape in 2024.

# 2. Economic Headwinds and Debt Sustainability Challenges Globally

The numerous global challenges we have discussed above are casting a shadow over the outlook for global growth. As uncertainties mount, foreign direct investment (FDI) has seen a decline, compounded by the resurgence of protectionism and the highest average global interest rates in over three decades. These factors have led to an increase in costs for the private sector and have shifted the patterns of international trade. Consequently, the IMF has progressively lowered its economic growth forecasts: from 6 percent in 2021, to 3.2 percent in 2022, and to just 2.7 percent in 2023—marking the weakest expansion since the 2007-2008 global financial crisis.

### Emerging Asia is the driver of global economic growth, while Europe's importance is declining

Contributions to Global GDP Growth By Region




Notes: Shading indicates forecasted values.

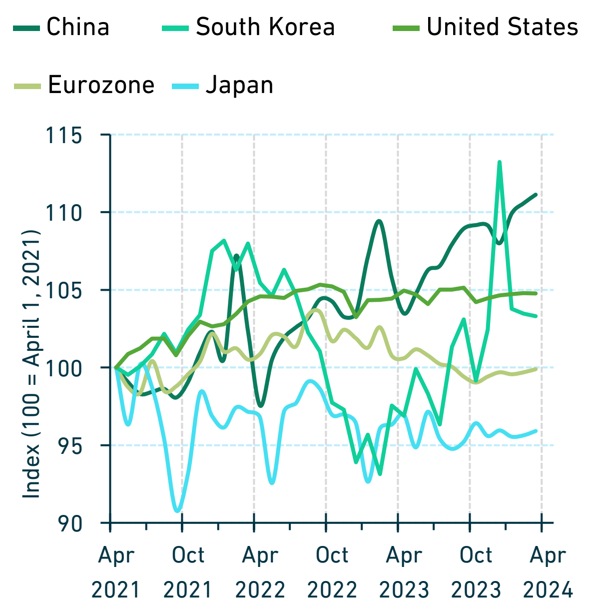
Source: Organisation for Economic Co-operation and Development (OECD)

Growth expectations diverge across the world economy, with some advanced economies recovering better than others. The Eurozone, South Korea, and Japan have had a far more subdued growth performance compared to the United States. Manufacturing output in Europe significantly trailed both the United States and China, as seen in industrial production data, which reflect the high energy costs stemming from the conflict in Ukraine and lower domestic demand. With Russian oil facing restrictions in western markets due to economic sanctions, oil flows are being increasingly diverted to emerging Asian economies, mainly India and China. This serves as a tailwind, contributing to emerging Asia's role as the main driver of global growth in the near term.

Faced with weak growth in 2023 and a subdued outlook for 2024, governments in advanced and emerging economies face a policy dilemma. As budget deficits have widened in a majority of countries after the pandemic, they must decide whether to bolster aggregate demand through higher state expenditure or to begin paying down public debt before it becomes unsustainable.

### The global economic growth landscape has been uneven, favoring East Asia

Industrial Production for Select Countries




Source: Organisation for Economic Co-operation and Development (OECD)

Currently, the risk of a debt crisis among heavily indebted governments appears limited, yet the long-term trajectory is worrisome. Monetary tightening has elevated debt rollover costs — the expenses incurred when refinancing maturing debt. Borrowers seeking to refinance outstanding debt, much of which was accumulated during the era of ultra-low interest rates, face financing costs that are 120 basis points higher on average.

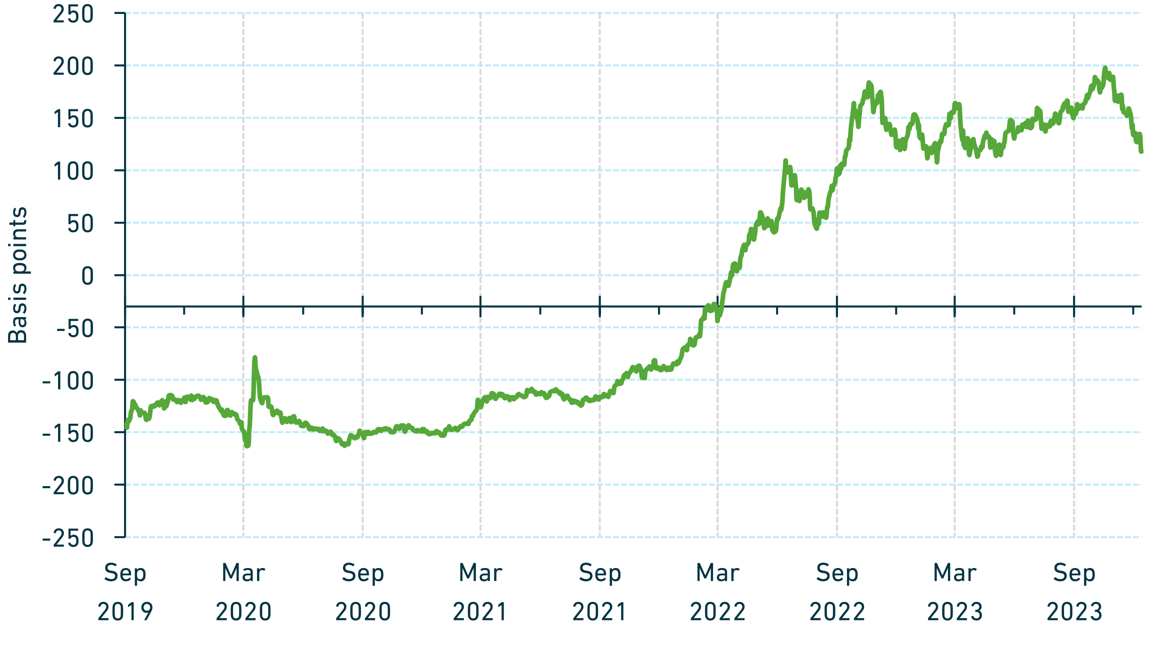
While refinancing debt remains manageable for most borrowers, a rise in defaults ought to be expected if economic conditions deteriorate more than anticipated. Moreover, painful borrowing costs constrict governments' fiscal leeway to stimulate economic activity during periods of economic stress, heightening financial instability. In the long run, if governments choose restrictive fiscal policy and lower investment to manage their debt burdens, it risks hampering long-term growth potential.

Widening budget deficits and rising real interest rates have stoked concern about the sustainability of public debt in the United States and across emerging and advanced economies.

As governments worldwide pursue a delicate balance between stimulating growth and managing debt levels, the challenge for policymakers lies in crafting strategies that not only address immediate fiscal pressures but also lay the groundwork for sustainable economic health over the long term.

## Governments and corporations that built large debt loads during the pandemic period now face higher refinancing costs

Approximation of Additional Cost to Refinance Global Outstanding Debt




Notes: Measure is average global bond yield less coupon rate on outstanding debt.

Source: Bloomberg Financial LP

# 3. The overlapping shocks risk fragmenting the global economic system

The last two years have marked a watershed in global trade and economic policy, as advanced economies, led by the US, have pursued a strategy of import protectionism, the 'near-shoring' and 'friend-shoring' of supply chains, and the safeguarding of domestic industries against the threat of what they perceive as unfair foreign competition. This is a departure after three decades of liberalising trade barriers and enhancing economic integration between advanced and emerging economies. It has come about in an age of increased competition between the US and China and coincided with financial sanctions against Russia after the war in Ukraine.

Protectionist policies have exacerbated the political and economic fragmentation of the global system which has been catalysed by geopolitical conflicts and the potency of financial sanctions designed to exclude some countries from the dollar-based international trade and payments system.

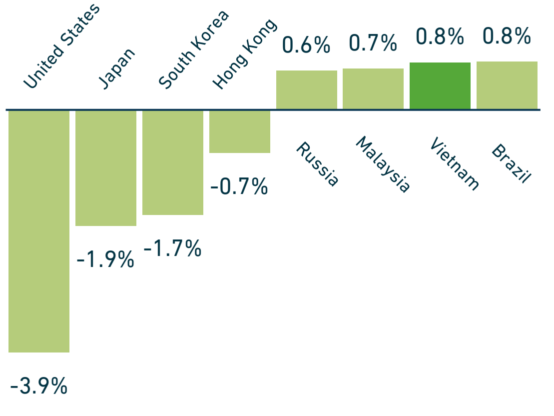
Global trade and capital flows have undergone a remarkable shift as a result. China, the world's largest trading economy, suffered a significant decline in its trade volumes with the United States and its Western allies, while increasing trade with other developing countries— a break from the pattern of trade integration recorded after China's entry into the World Trade Organisation in 2001. The U.S. government has encouraged American corporations to reduce their dependence on China by relocating supply chains back to the United States or to partner countries — a supply chain diversification strategy called "near-shoring" or "friend-shoring."

Trade fragmentation is one element in a phenomenon that has been dubbed the age of the "polycrisis", where countries are battling multiple and interrelated crises that impact their domestic economies and foreign policy. For example, the global energy shock triggered by the war in Ukraine unleashed an inflationary crisis in many advanced economies, led to the imposition of a package of financial sanctions against Russia, and has since created the conditions for the fracturing of the world economy into rival blocs.

This has resulted in countries like South Korea, a strong U.S. ally and manufacturing powerhouse, decreasing trade with China—alongside most western countries—while ramping up trade with the United States. By contrast, other countries, such as Brazil, Malaysia, and Russia, have increased their trade linkages with China. A few economies, most notably Vietnam, have benefited from both sides of this paradigm shift, simultaneously growing trade with China and the United States.

## China's trade with the West has fallen markedly

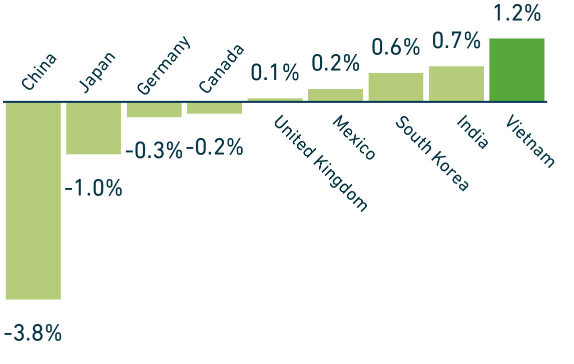
China Bilateral Trade Share Percentage Point Change 2017-2022




Source: Organisation for Economic Co-operation and Development (OECD)

## U.S. trade shifted to alternative supply chains

U.S. Bilateral Trade Share Percentage Point Change 2017-2022




Source: Organisation for Economic Co-operation and Development (OECD)

Chapter two

# Building resilience in the face of major shocks

Despite these global challenges, the economy of Saudi Arabia was resilient in 2023, supported by strong investment and robust consumption amid the ongoing government efforts in line with Saudi Vision 2030.

Saudi Arabia's fiscal and monetary policies played a crucial role in stabilising various sectors of the economy while prudently controlling inflation to stabilise domestic demand and prevent capital flight.

The government's policy of economic diversification yielded positive results, with the non-oil sector's contribution to GDP and employment growing last year. Activities such as tourism and consumer retail remained robust, reflecting the success of supportive government policies and an improving business environment.

The private sector continued to be a driver of economic activity, helping boost the Kingdom's ascent in global rankings for the ease of doing business and competitiveness.

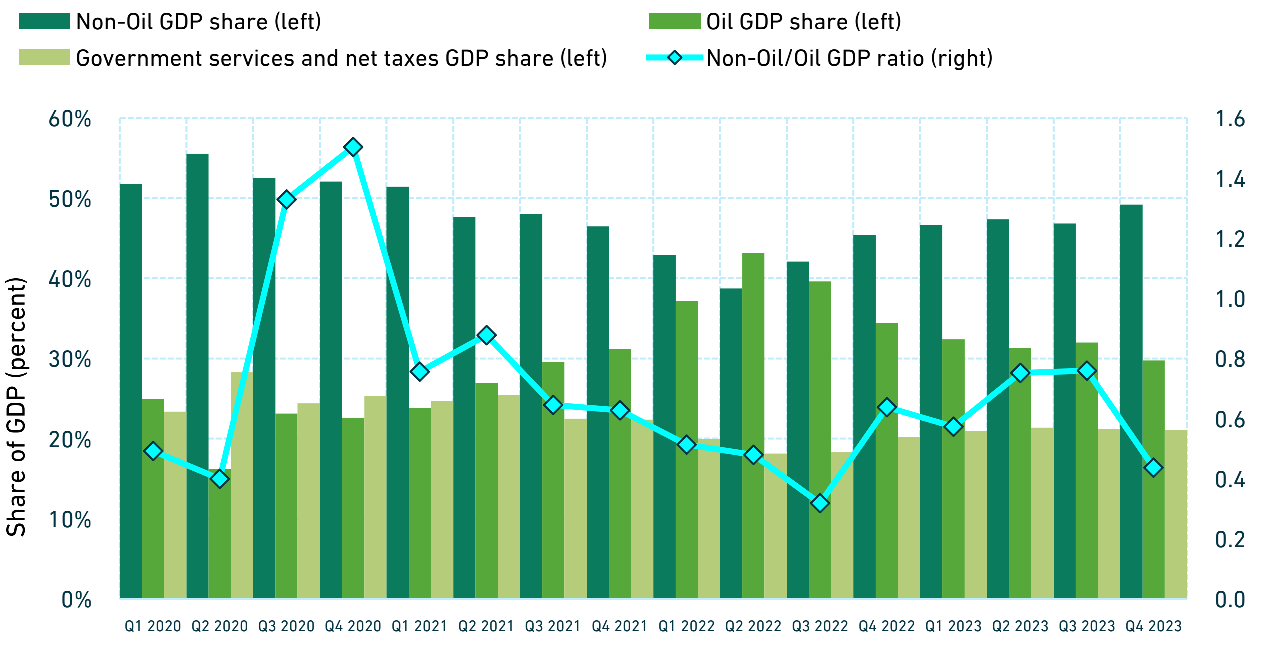
# 1. A diversifying economy and the remarkable resilience of the non-oil sector

Despite global uncertainty and oil price volatility, non-oil activities made up around 49% of the Saudi economy in 2023. From 2016 to 2023, the ratio of non-oil revenues to oil revenues rose by 35%. While this underscores progress in economic diversification, there is still a pressing need to intensify these efforts to create greater resilience and fiscal sustainability. Strengthening the non-oil sectors through targeted policies and investments is crucial to reduce dependency on oil revenues and ensure long-term economic stability and growth.

The share of oil sector to total GDP becomes more pronounced during higher oil prices. For instance, the increase of oil prices to $94 in 2022 from $68 in 2021 has led to increase of oil sector share to GDP from 31% in 2021 to more than 40% in 2022. Conversely, a decline in oil prices correlates with reduced contributions from the oil sector to GDP growth. In contrast, the non-oil sector demonstrates greater resilience to oil price volatility, maintaining a stable and even increasing contribution to GDP growth when the rest of the economy has suffered a drag on output. This highlights the importance of accelerating economic diversification to mitigate the influence of oil price fluctuations on Saudi's overall economic performance.

### Continued economic diversification pushes non-oil revenues to record share of GDP

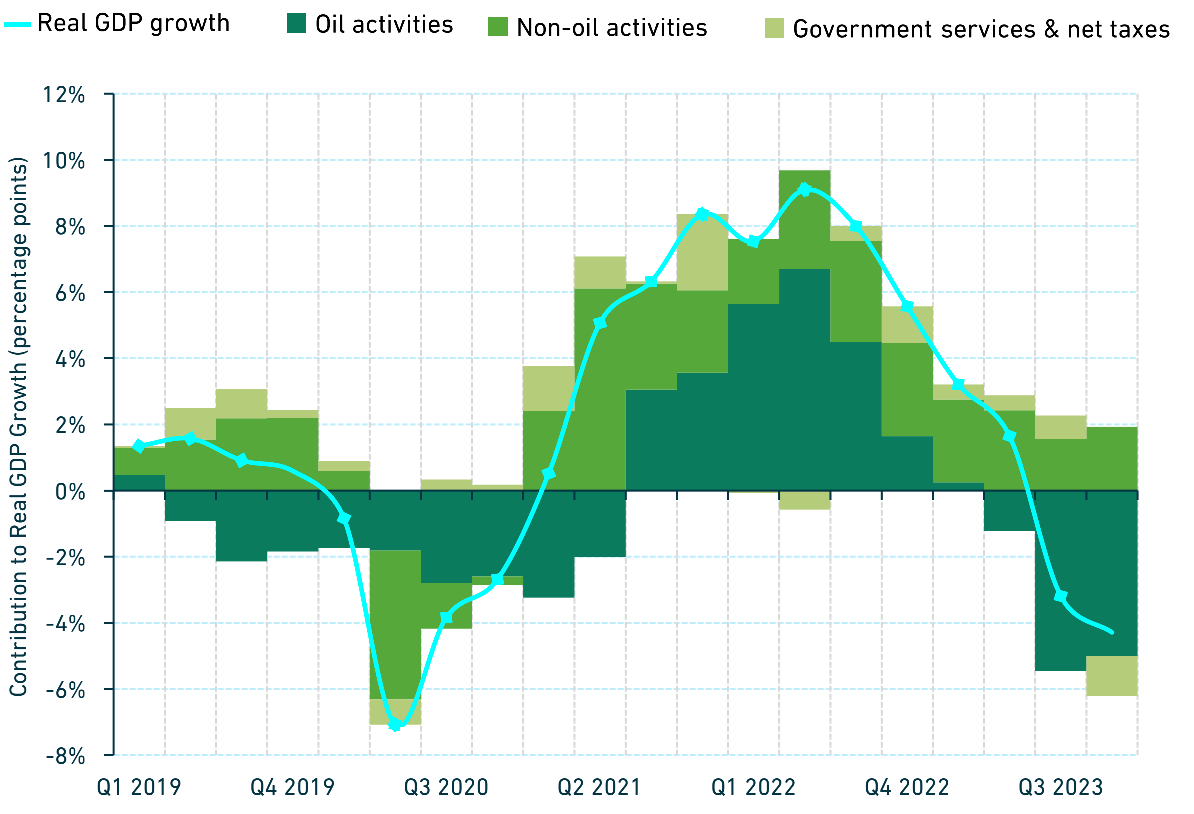
Economic sectors as share of Gross Domestic Product




Source: General Authority for Statistics

## Non-oil activities have been essential to stabilize the economy amid a drop in oil activity

Saudi Arabia Broad Activities Contributions to Real GDP Growth, Year-over-Year Percent Change




Note: Using Chain-Linked series.

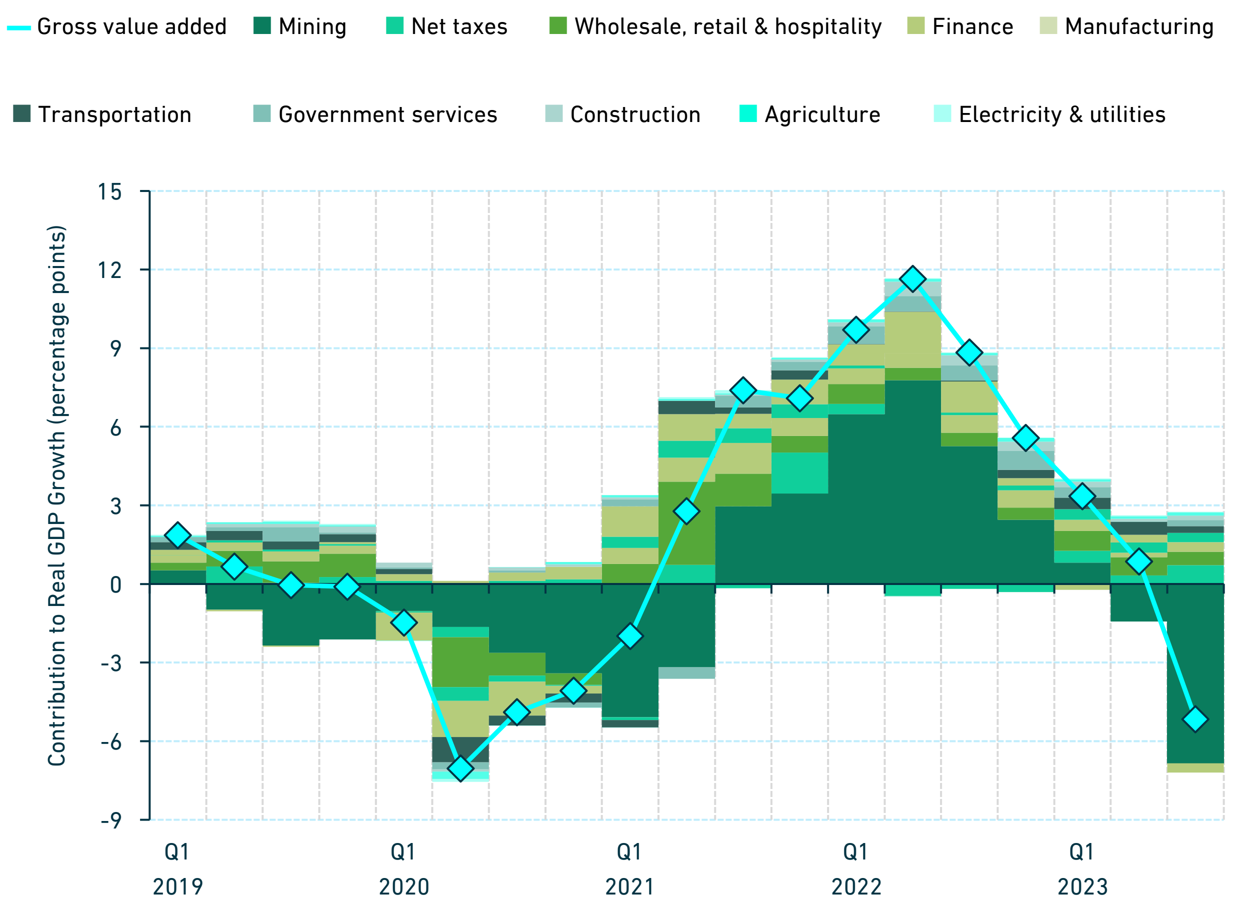
Source: General Authority for Statistics

In terms of sectoral contributions to real GDP growth, the mining sector, which includes oil activities, suffered a sharp reversal, shifting from being the primary driver of growth in 2022, to the biggest drag on economic output in 2023. This shift was primarily driven by weaker global demand for oil as the world economy slowed down due to tightening monetary conditions. In Q2 2022, the mining sector contributed a substantial 7.7 percentage points to growth, but this figure fell to negative 6.8 percentage points in Q3 2023.

Despite the adverse impact of the declining mining sector, there were some positive contributions from sectors less exposed to external shocks. For instance, wholesale, retail, and hospitality collectively added 0.5 percentage points to real GDP growth in Q3 2023, while the finance sector contributed an additional 0.3 percentage points. These numbers highlight progress on economic diversification. However, they also show the need for further development of non-oil sectors to provide protective buffers against external shocks.

Continued growth in non-oil sectors has partially offset a slump in the mining sector

Saudi Arabia Sectoral Contributions to Real GDP Growth, Year-over-Year Percent Change




Source: General Authority for Statistics (GASTAT)

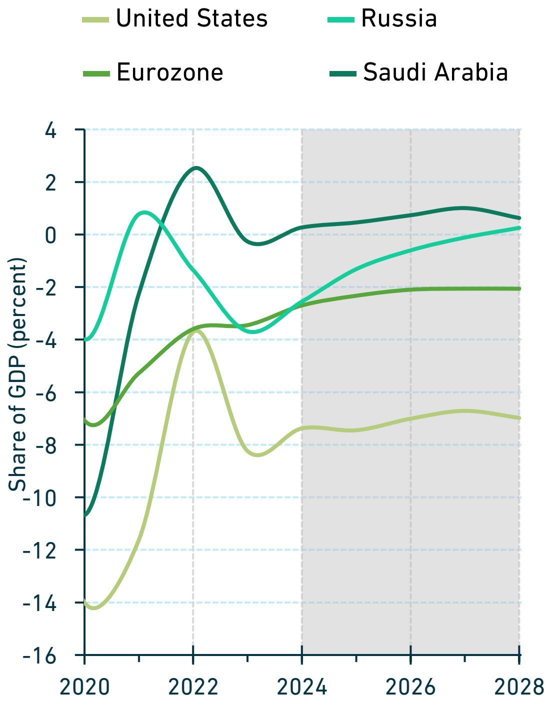
# 2. A sustainable fiscal trajectory

Amidst the backdrop of shrinking global fiscal space and mounting debt burden, Saudi Arabia is a rare anomaly, with a sustainable public debt trajectory. Saudi Arabia's commitment to prudent fiscal policies and ongoing economic reforms will bolster the resilience of its financial system. As the country continues to navigate uncertainties in the global economy, its proactive measures are designed to ensure that public debt remains manageable, fostering long-term economic stability and prosperity. These measures include fiscal reforms, maintaining financial sector stability, increase labour participation and support small and medium-sized enterprises (SMEs).

The decline in oil revenues due to falling international oil prices reduced Saudi's budget surplus in 2023 compared to the previous year. Despite this, current public spending remained consistent, underscoring the government's dedication to sustaining public investment for future growth and ensuring adequate social welfare benefits for the population.

### Saudi Arabia is projected to return to a consistently positive budget surplus

Fiscal Balance (Surplus/Deficit), Actual and Forecast

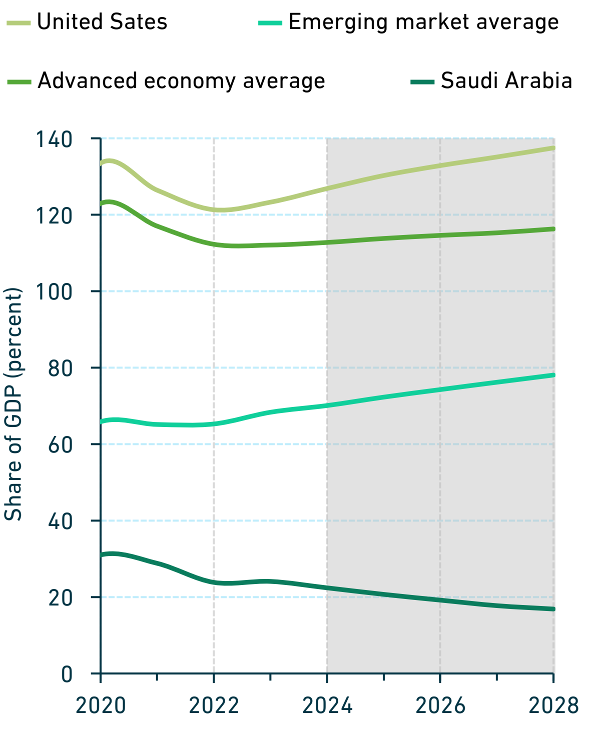



Notes: Shading indicates forecasted values.

Source: S&P Global

### Saudi Arabia's public debt is forecasted to steadily decline as share of GDP

Public Debt to GDP Ratio, Actual and Forecasts

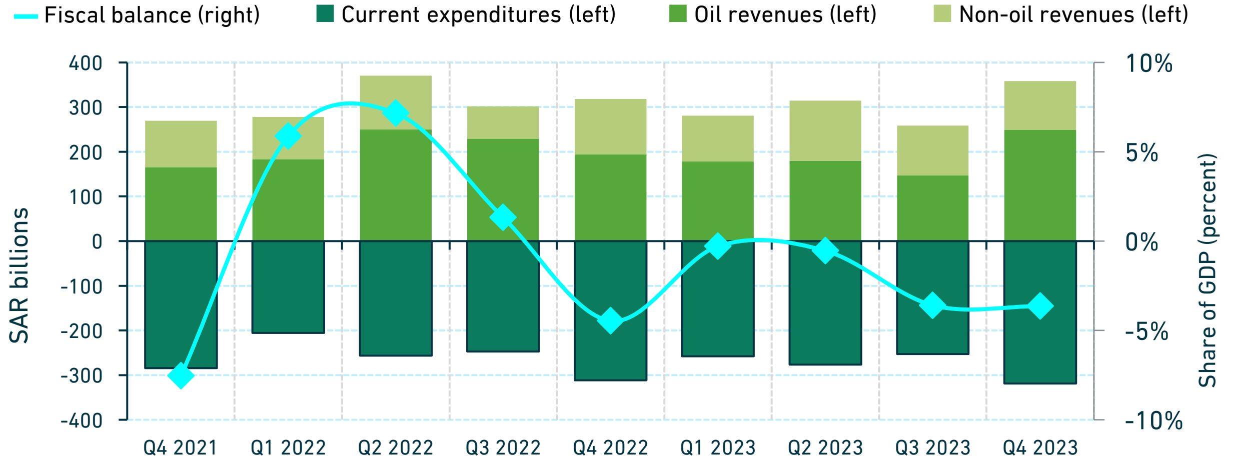



Notes: Shading indicates forecasted values.

Source: S&P Global

## Saudi Arabia's government budget deficit has narrowed and remained sustainable

Saudi Arabia Central Government Budget Balance



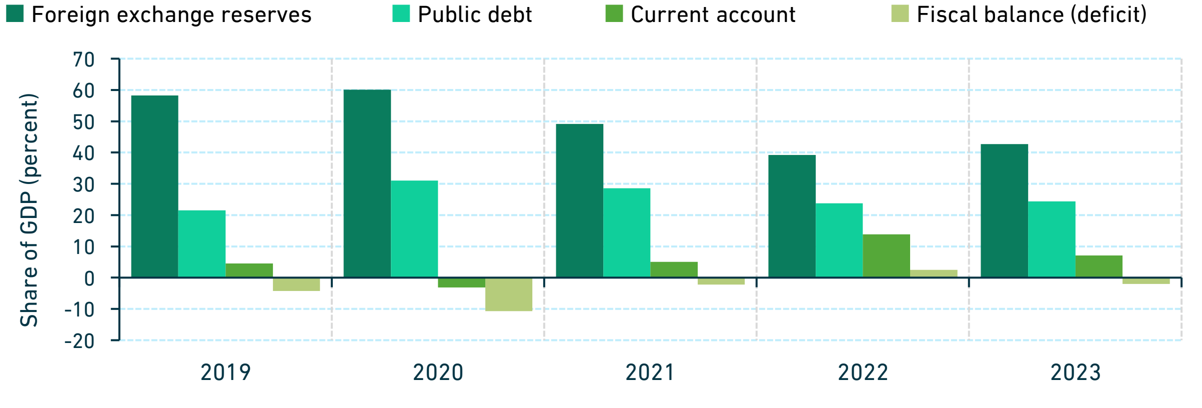

Source: Ministry of Finance

Since 2017, the government's budgetary spending has expanded by an average rate of 4.6% and has been outstripped by total average revenue growth of 8.6% in this period, underscoring the government's focus on maintaining good fiscal health. Over the same period, oil revenues have experienced an annual increase of 7.3%, trailing the robust growth of non-oil revenues at 10.7%, and accelerating the shift towards revenue diversification. Capital expenditure has dropped by an average of 4.8% a year, while current expenditures have risen at an average annual rate of 6.6%, as a result of an increased focus on investing in human capital.

Saudi Arabia's budget deficit is modest compared to standards of international organizations like the International Monetary Fund (IMF). The significant foreign exchange reserves and overseas net assets held by Saudi authorities could provide ample support for additional spending. Such fiscal flexibility allows for increased public investment and will empower the government to support the Saudi economy if called up in the face of future shocks.

## Saudi Arabia's large foreign exchange reserves make its public debt more sustainable

Saudi Arabia National Accounts as Share of Gross Domestic Product




Sources: General Authority for Statistics (GASTAT) & Saudi Central Bank (SAMA)

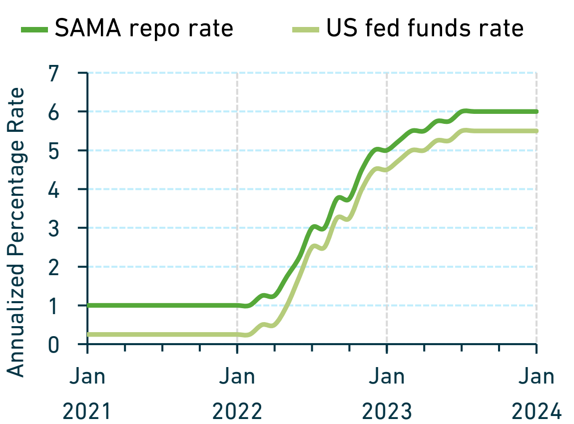
# 3. Tighter monetary policy, bank credit, and easing inflation

SAMA's tightening of monetary policy controlled inflation. By prioritising price stability, Saudi monetary policy moved in line with the U.S. Federal Reserve, reflecting the Riyal's peg to the U.S. dollar. Raising the Saudi policy rate in lockstep with the Fed helped prevent capital flight and mitigated the effects of market volatility on the real exchange rate, resulting in lower inflation compared to advanced economies.

Consecutive increases in the SAMA policy rate led to a notable rise in borrowing costs, climbing by roughly five percentage points from 2022 to 2023. This uptick, while exerting some pressure on private sector credit demand, was mitigated by the continued accommodative stance of banks in supplying credit. Despite the increase in borrowing costs, overall credit availability remained relatively favourable, supporting ongoing economic activities and investment projects.

### Saudi monetary policy is pegged to the dollar

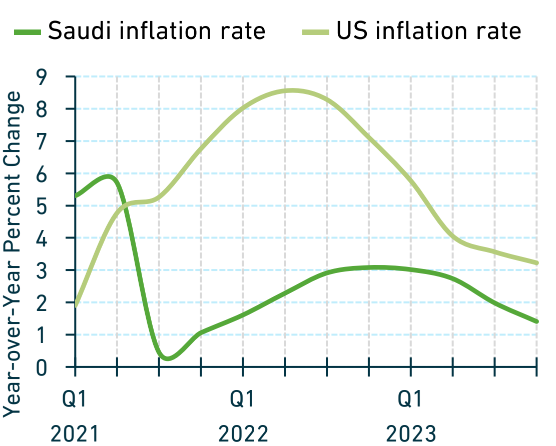
Policy Interest Rates in Saudi Arabia and the United States




Source: S&P Global

### Saudi Arabia has effectively contained inflation

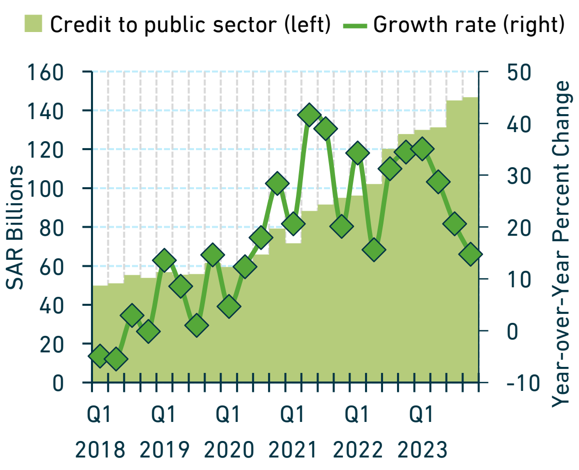
Benchmark Inflation Rates




Source: S&P Global

### Public sector borrowing growth has stabilized

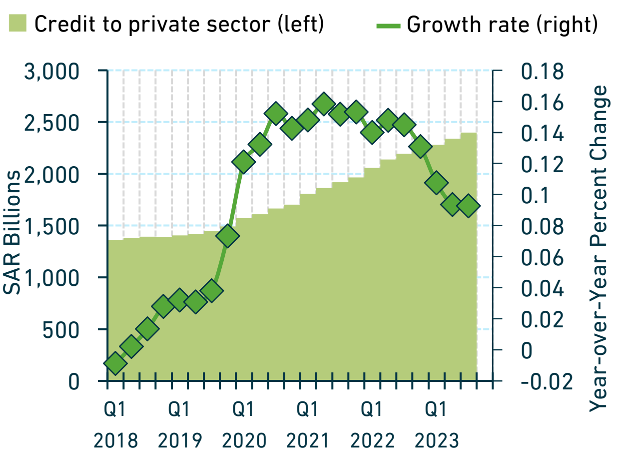
Saudi Arabia Total Bank Credit to the Public Sector, Quarterly




Source: Saudi Central Bank (SAMA)

### Private sector access to credit is still ample

Saudi Arabia Total Bank Credit to the Private Sector, Quarterly

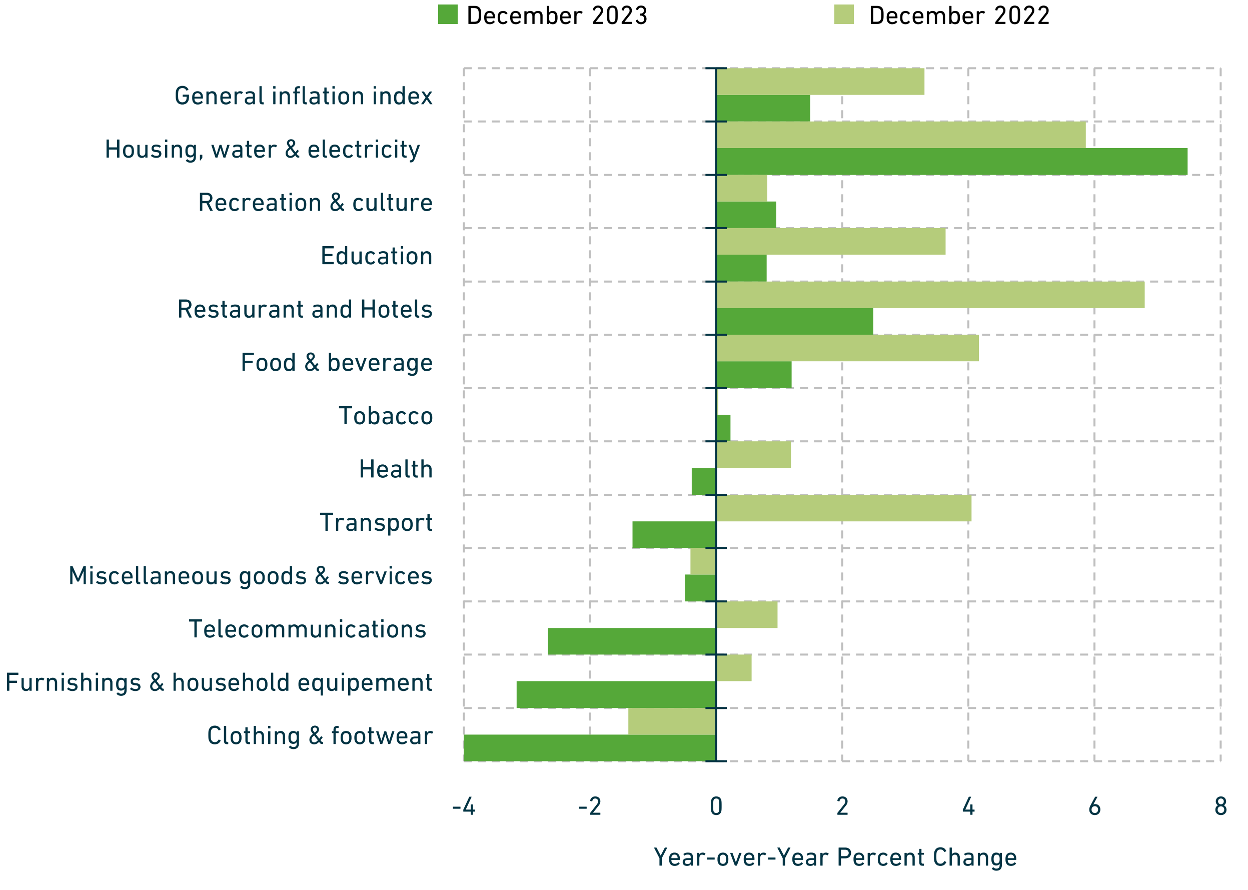



Source: Saudi Central Bank (SAMA)

Inflation remained stable in the Kingdom throughout 2023, with the general inflation index declining compared to the previous year. Prices either decreased or rose less than the previous year across all subcomponents of the inflation index, except for housing, water, and electricity. Certain consumer goods, such as clothing and household equipment, saw outright price decreases, reflecting improved supply chain conditions. This trend is consistent with observations in several other countries.

## General inflation remains under control and only housing prices exhibit upward pressure

Saudi Arabia Inflation Rate Across Components of Basket of Goods and Services




Source: General Authortiy for Statistics (GASTAT)

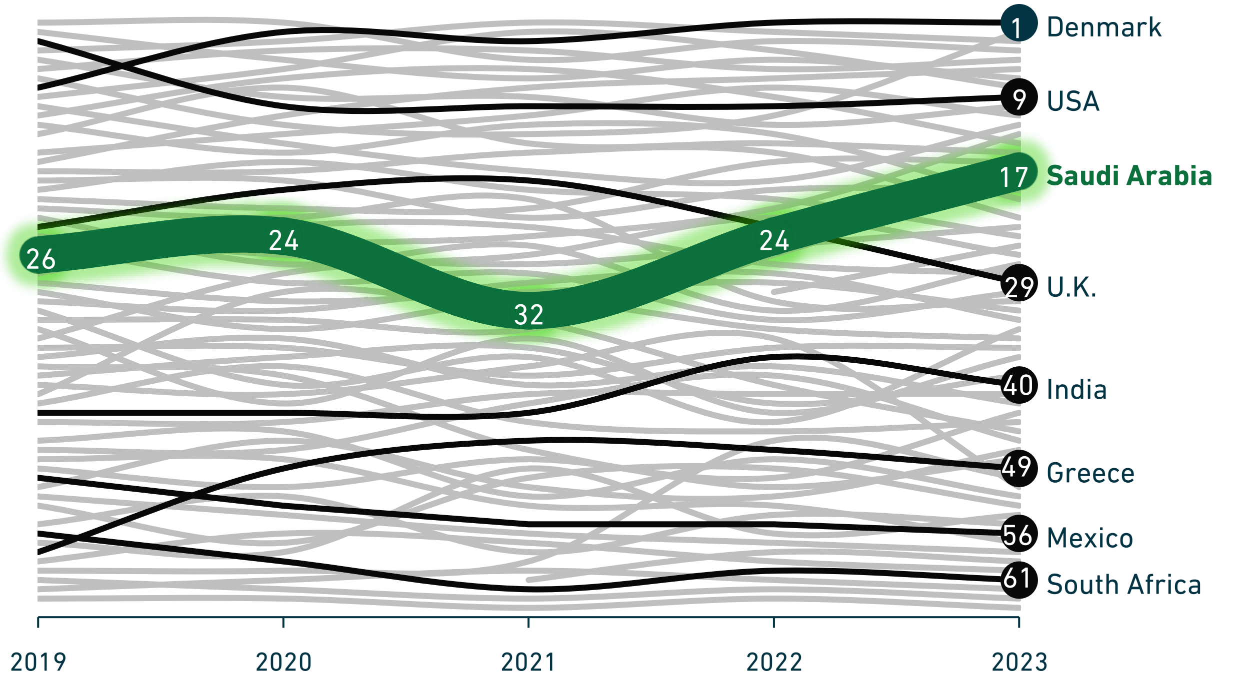
# 4. Saudi's improving business environment and international competitiveness

In recent years, Saudi Arabia has enjoyed a remarkable climb in global rankings for competitiveness, propelled by strategic measures aimed at making it an attractive investment destination. According to the International Institute for Management Development (IMD), the Saudi economy is ranked 17th among the most competitive economies, climbing 15 places in the overall ranking since 2021.

This accelerated progress is reflected in various sub-criteria assessments of international competitiveness, where Saudi Arabia has advanced 42 places in economic performance, 13 places in governance efficiency, and a further 13 places in business efficiency. These advancements reveal the tangible strides taken by the Saudi government and the private sector within the scope of Saudi Vision 2023.

Saudi Arabia is a global leader in improving economic competitiveness

World Competitiveness Ranking, Overall Competitiveness Ranking

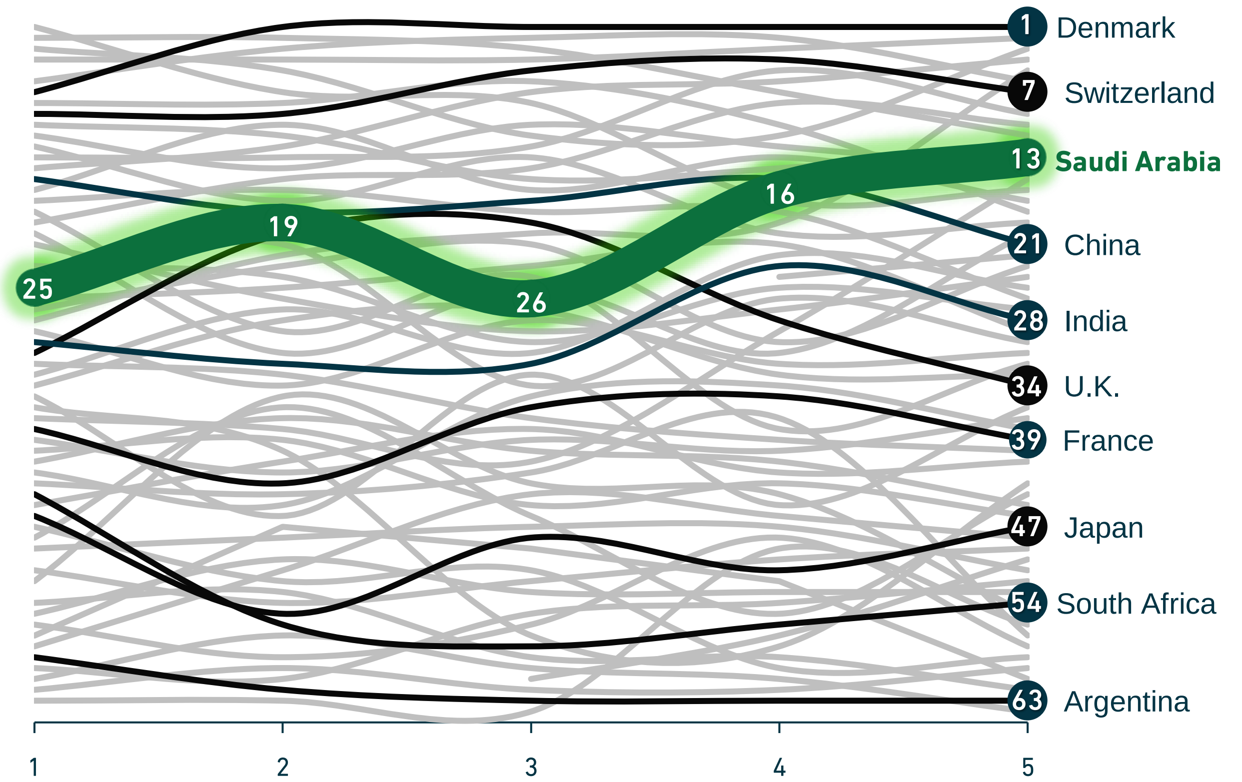



Notes: Ranking is among 64 total countries. All countries are plotted with select countries labeled.

Sources: International Institute for Management Development (IMD)

Saudi Arabia is becoming a better place to do business

World Competitiveness Ranking, Business Competitiveness Ranking



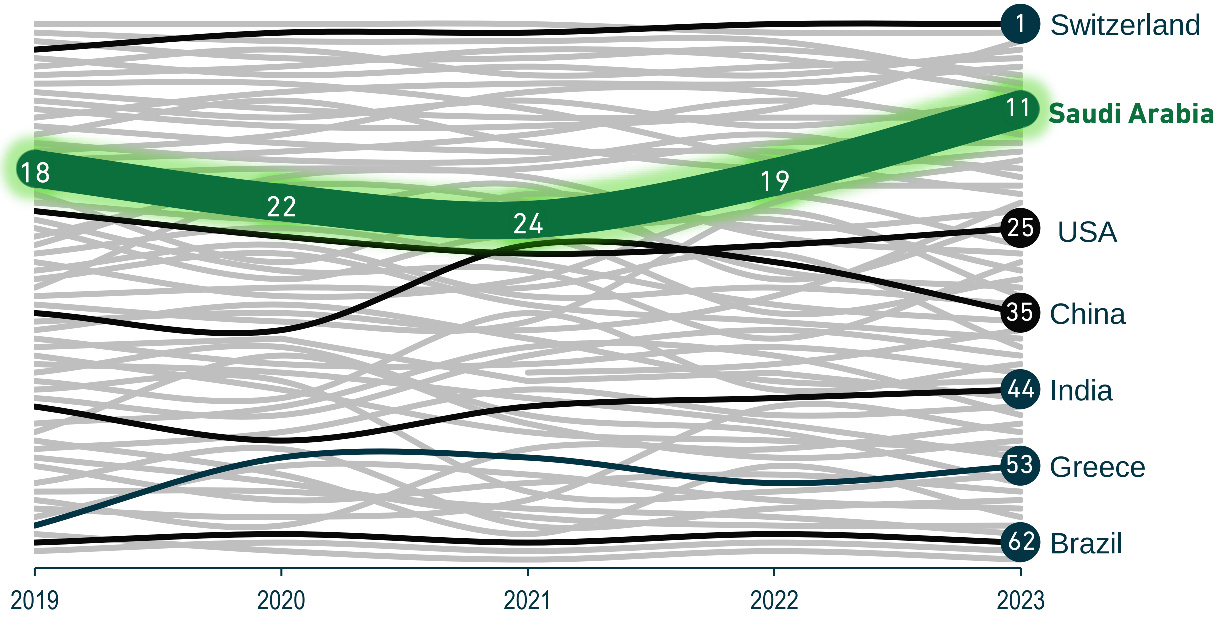

Notes: Ranking is among 64 total countries. All countries are plotted with select countries labeled.

Sources: International Institute for Management Development (IMD)

Regarding public intervention and business-facilitating reforms, Saudi Arabia has implemented a slew of initiatives aimed at streamlining processes and fostering a conducive business environment. These include expediting customs clearance within 24 hours at Saudi ports, swift issuance of licenses for commercial activities, and a sharp reduction in real estate ownership transfer procedures to just 60 minutes. Furthermore, the Kingdom has witnessed a significant 50% reduction in investment licensing requirements, enhancing its appeal to investors.

Saudi Arabia's government policies have encouraged business investment

World Competitiveness Ranking, Government Efficiency Ranking




Notes: Ranking is among 64 total countries. All countries are plotted with select countries labeled.

Sources: International Institute for Management Development (IMD)

Public intervention in support of the private sector is exemplified by the Kingdom's substantial investment in mega projects, which spur new private sector activities and create rich employment opportunities. Flagship projects such as Neom, Qiddiya, and ROSHN, spearheaded by the Public Investment Fund, are pivotal to deepening economic diversification and realising the overarching objectives of Saudi Vision 2030. These transformative endeavours aim to position the Kingdom as a regional hub in vital sectors encompassing transport, services, logistics, tourism, and culture, catalysing sustained growth and prosperity.

## Chapter three

# A dynamic private sector and thriving business climate

The Saudi private sector will be pivotal in realising the ambitions of Saudi Vision 2030 and businesses have shown remarkable resilience in a challenging year. The sector's value-added growth remains stable, in contrast with the fluctuations in the oil and public sectors. Currently contributing 45% to GDP, with around 75% of total investment and nearly 60% of the active population employed are in the private sector, its economic significance is expanding.

Supported by conducive government policies and financing, the private sector has flourished, benefiting from an improving business climate. Ranking 17th globally and 3rd in the G20 for competitiveness, Saudi Arabia provides easy access to finance through its robust banking system. Various initiatives and mega projects bolster small and medium enterprises (SMEs) to create employment opportunities.

With Saudi Vision 2030 goals in focus, the private sector's role in Saudi economic development is paramount, supported by a conducive business environment and institutional support. The Kingdom's economic reform agenda emphasizes diversified commercial partnerships, enhancing market access for local firms, and facilitating technology transfers. Tax incentives and industrial policy reforms have further stimulated growth.

# 1. The private sector is a steady contributor to growth

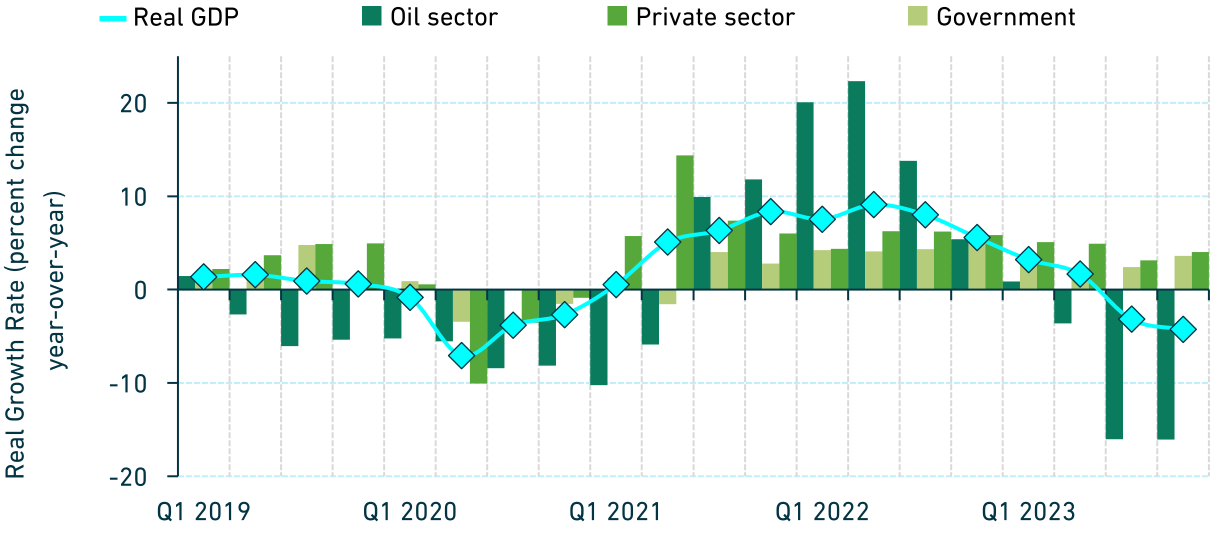
Resilience in the private sector is reflected in its growth performance, as output has outpaced both the public and oil sectors to become the primary driver of GDP growth in 2023. Unlike the oil industry, the private sector has avoided contraction since Saudi Arabia emerged from the COVID-19 pandemic in late 2021, underscoring the sector's adaptability and robustness. Despite facing significant adverse external shocks, the private sector expanded by 4.2% in Q4 2023, higher than its 3.2% performance in the previous quarter. In contrast, the public sector expanded by 3.1% in Q4 2023, while the oil sector contracted by 16.2%.

South Korea and is considering further agreements with key international partners.

On industrial policy, numerous incentives are in place to encourage investment, including loan programs facilitating energy and infrastructure projects within industrial cities, employment support schemes, and pre-financing options for Saudi exporters. Furthermore, certain materials, equipment, and machinery enjoy exemptions from customs duties, while the corporate tax rate for foreign companies stands at 20%, the lowest among G20 nations.

The Saudi private sector has grown steadily since the end of the pandemic

Saudi Arabia Real Growth Rates by Broad Sector




Source: General Authority for Statistics (GASTAT)

The performance of both national and foreign entities within the private sector is a testament to the Kingdom's open trade policy (OTP) and its strategic industrial policies. OTP not only broadens the market scope for local enterprises but also facilitates access to capital goods essential for industrial development while promoting the growth of local content through technology transfer. To further global integration and expand trade, Saudi Arabia has entered free trade agreements as part of the GCC bloc with Singapore and the European Free Trade Association (Norway, Switzerland, Iceland, and Liechtenstein). Additionally, the GCC recently inked initial FTA agreements with Pakistan and

Moreover, targeted incentives are extended to foreign subsidiaries and international firms considering establishing headquarters in the Kingdom, with the aim of bolstering knowledge transfer, human capital development, and innovation in the country. Amidst an uncertain global economic landscape impacting the oil and public sectors, the private sector remains a steadfast contributor to GDP growth, offering stability and resilience.

## 2. Robust demand from the private sector

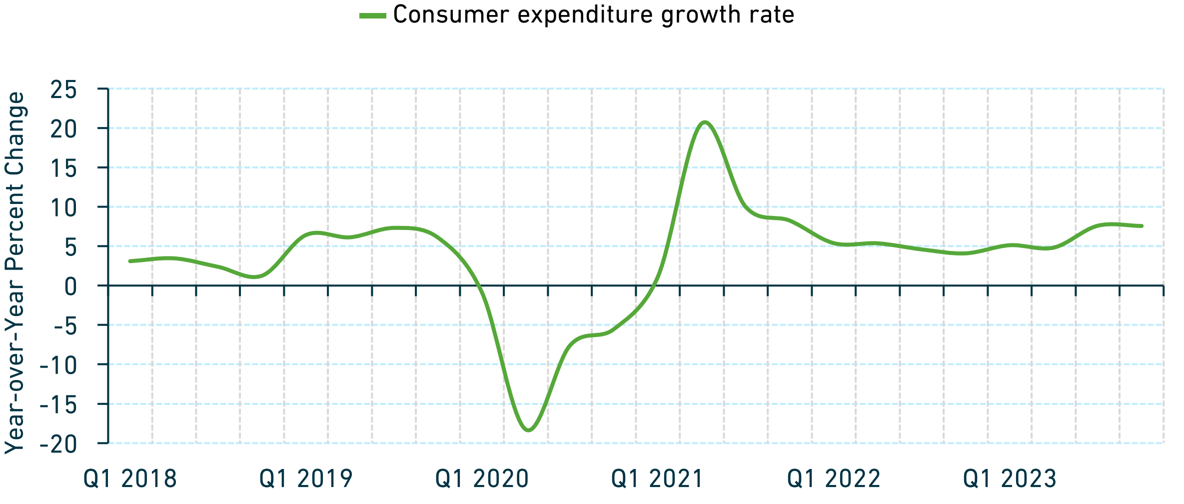
Private consumption stands out as the most stable component of aggregate demand in the Saudi economy. Even in periods of volatile international oil prices, global financial stress, and geopolitical uncertainty, private consumption has remained a steadfast pillar supporting Saudi growth.

Over the past decade, private consumption has exhibited steady growth, reaching a new record of 41% share of GDP in 2023. In contrast, net exports, the most volatile component of aggregate demand, has seen a decline in its share of GDP over time. However, investment and public spending have maintained their shares, underscoring their crucial roles in supporting the broader economy and facilitating the sustained expansion of private consumption in the Saudi economy.

Consumer spending in Saudi Arabia remained robust throughout 2023, with a slight increase observed towards the end of the year. Although there was a minor dip in spending the previous year due to decreased demand for consumer credit following an interest rate hike by the Saudi Central Bank (SAMA), this was mitigated by households tapping into their savings. Additionally, the reduction in inflationary pressures in the second half of 2023 further supported consumer spending.

### Growth momentum remains strong for the Saudi private sector

Saudi Arabia Consumer Expenditure




Source: General Authority for Statistics (GASTAT)

Despite external challenges, consumer spending remained a steady driver of GDP growth, acting as a stabilising force on demand. It also contributed to moderate inflationary pressures, although these were lower compared to global and regional averages.

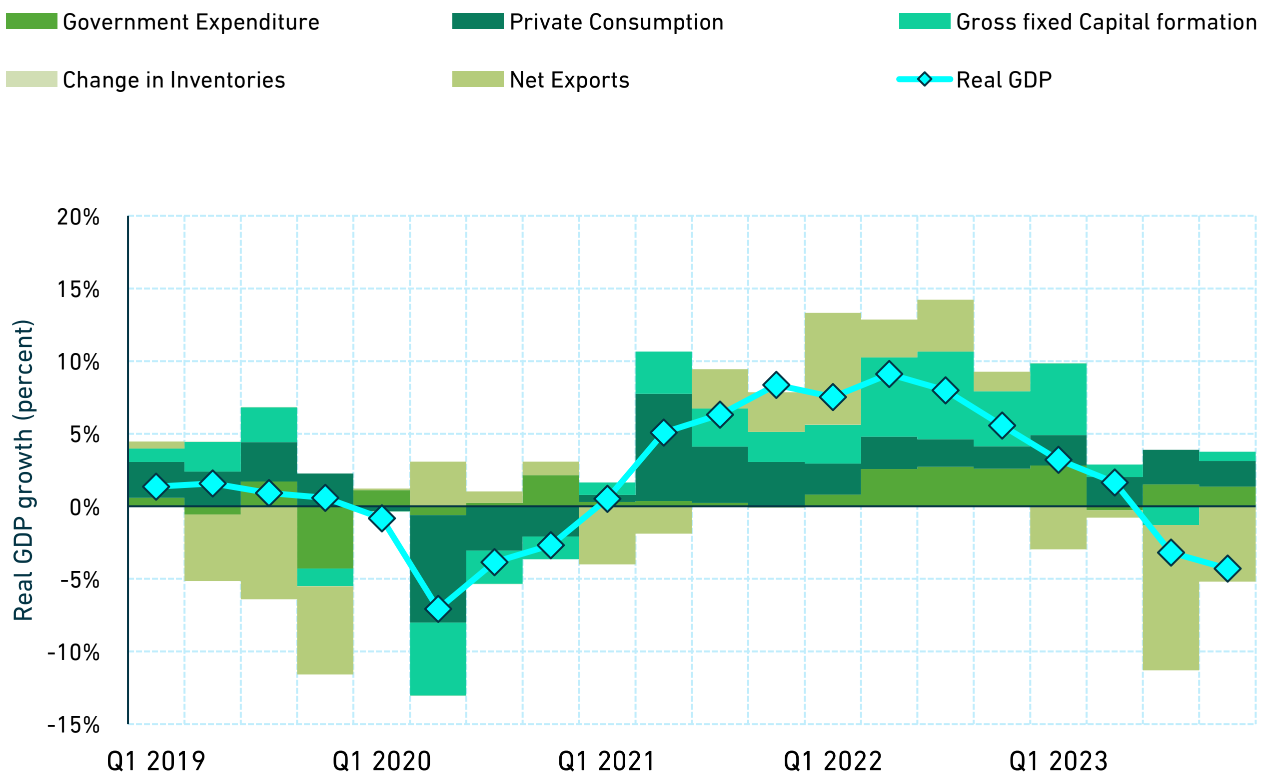
The purchasing power of the average Saudi household has remained stable due to various factors, including effective market regulation to prevent shortages, administered price controls on specific products, indirect subsidies, and social transfers. As a result, household consumption expenditure has continued to grow at a rate higher than inflation, resulting in no loss in purchasing power for Saudi consumers.

Given its permanent and productive impact, investment — as measured by gross fixed capital formation — played a pivotal role in propelling GDP growth by fostering a conducive environment for investment, particularly in infrastructure and technology.

The contribution of net exports to Saudi Arabia's GDP growth was negative in 2023, primarily due to lower oil revenues. This trend highlights the economy's vulnerability to fluctuations in international oil prices, underscoring the importance of the government's diversification strategy. These policies aim to reduce reliance on oil exports and enhance economic resilience against external shocks.

### Private consumption is the most stable contributor to Saudi Arabia's economic growth

Saudi Arabia Contributions to Real Gross Domestic Product (GDP), Year-over-Year Percent Change




Source: General Authority for Statistics (GASTAT)

# 3. Private investment as a driver of economic activity

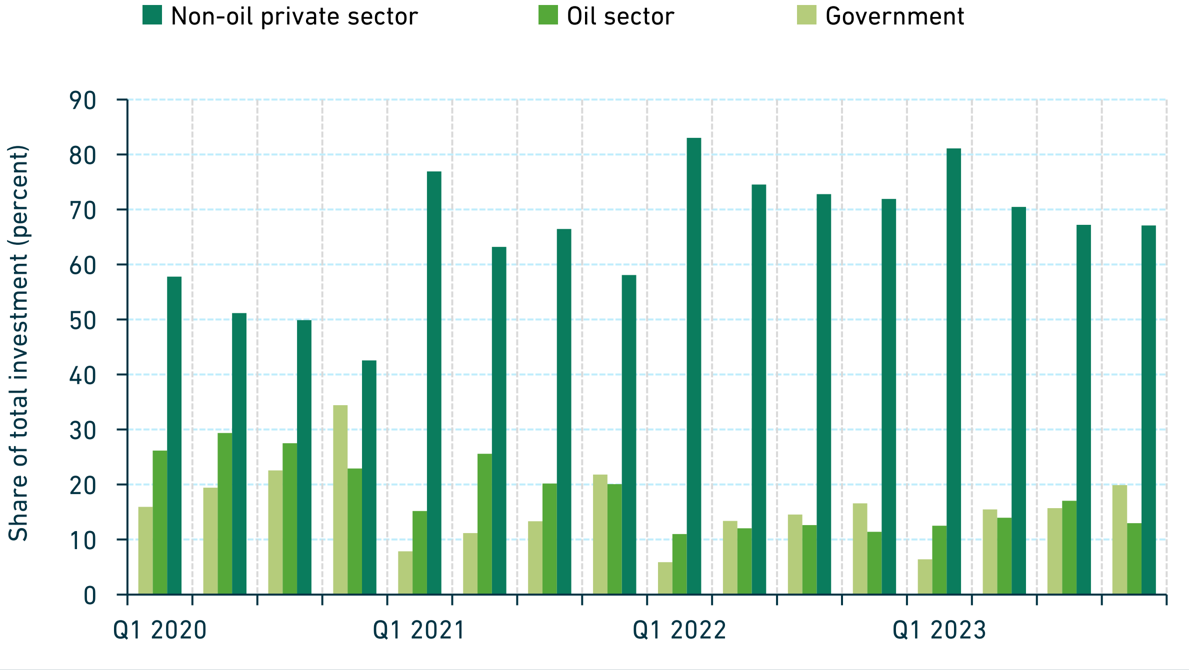
Over the past five years, investment in the private sector has remained relatively stable when compared to fluctuations in the public sector and oil industry, which have been hit by volatility in oil prices. Accounting for 45% of GDP and about 70% of total investment in the last quarter of 2023, Saudi Arabia's private investment is steadily progressing towards Saudi Vision 2030 target of 65% share of GDP.

Aligned with its ambition to become a key transportation and logistics hub linking Asia, Africa, and Europe, Saudi Arabia's initiatives span diverse sectors such as tourism, entertainment, infrastructure, healthcare, technology, and renewable energy. Infrastructure projects, including special economic zones and industrial cities, are planned to support industries such as manufacturing, digital, petrochemicals, mining, and logistics. Additionally, investments in tourism infrastructure, exemplified by developments in Al-Ula and the expansion of 'Saudi Seasons' events, aim to attract foreign investment and host global events like Expo 2030.

In pursuit of Saudi Vision 2030's strategic objectives, the private sector is playing an increasingly prominent role in driving economic growth. Benefiting from an improved business environment and supported by public interventions through mega projects, the dynamic private sector stimulates economic activity, generates positive externalities, and fosters job creation and wealth.

Investment in Saudi Arabia has shifted from the oil sector to rest of the private sector

Saudi Arabia Share of Total Investment by Broad Sector




Source: General Authority for Statistics (GASTAT)

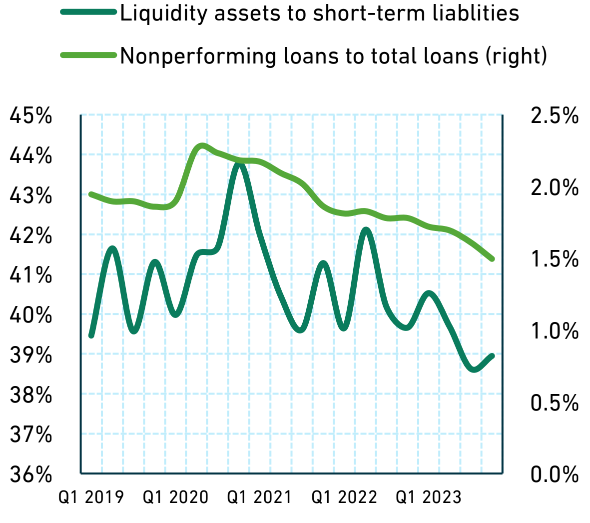
# 4. A robust banking system supports the private sector

The banking and financial sector play a pivotal role in bolstering the private sector. Notably, the Saudi lending sector boasts one of the lowest non-performing loans (NPL) ratios among large economies, at only 1.7% in Q3 2023. The private sector has ample access to credit. Government institutions like the Saudi Industrial Development Fund (SIDF) offer credit facilities to private companies, while the private sector can also tap into term loans and Sukuk bond issuances from the banking sector.

These supportive measures and incentives have yielded significant results, evidenced by a remarkable 153% surge in the issuance of investment licences for both domestic and foreign private operators between Q3 2022 and Q3 2023. This upward trend has been complemented by robust banking support.

Consequently, the business environment has benefitted from a notable uptick in the number of SMEs, which reached 1.27 million in Q3 2022, an approximate 30% year-on-year increase. According to the General Authority for Statistics, small businesses comprise 87% of this total. These developments highlight the growing vibrancy and resilience of the private sector, bolstered by a supportive financial environment and government initiatives.

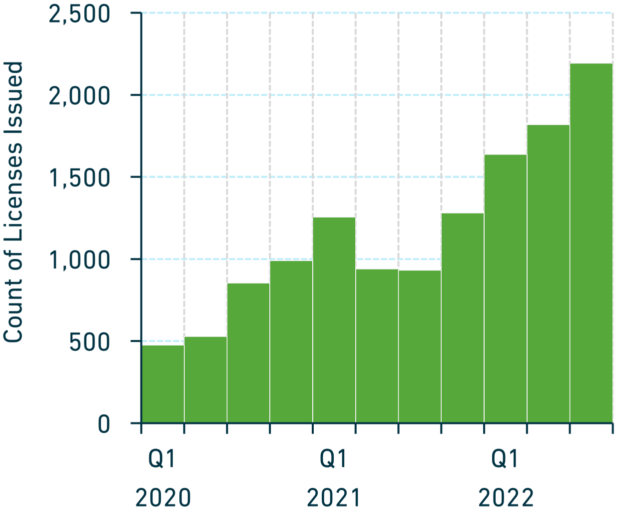
The Saudi banking system remains stable




Source: Saudi Central Bank (SAMA)

Saudi Arabia is becoming more competitive by attracting international capital

Foreign Investment Licenses Issued by Saudi Arabia's Ministry of Investment




Source: Ministry of Investment

## Chapter four

# Key Saudi economy Challenges in 2024

Geopolitical headwinds are likely to persist in 2024. This uncertainty will be heightened by elections in more than 50 countries, making 2024 a record-breaking year at the ballot box. Election cycles can polarise domestic politics and trigger regulatory risks on a global scale. These dynamics could create challenges for global growth and may shape the trajectory of global demand and the reconfiguration of global trade through shifting supply chains.

Saudi Arabia's continued economic progress in 2024 and beyond hinges upon its ability to build buffers against external shocks. This will mean accelerating its economic diversification plan, fostering broader and deeper trade relations, bolstering non-oil industries and the services sector, and enhancing the quality of domestic human capital. Saudi’s commitment to diversifying the economy is fundamentally aimed at improving the welfare of the Saudi people over the coming decades.

# 1. Geopolitical headwinds and a spate of elections raise risks

Persistent geopolitical headwinds and the unprecedented wave of global elections in 2024 amplify risk and uncertainty. More than 50 countries, or about half the world's population, are scheduled to hold national elections. Election cycles can result in shifting alliances and diplomatic relations, potentially leading to increased political instability, regulatory unpredictability, and tensions between nations, negatively impacting the international business and investment climate, and hurting the global growth environment.

As a leading player in the global energy market and a swing producer of crude oil, Saudi Arabia's economic development is intertwined with geopolitical developments and shifts in international trade dynamics. History shows that exogenous factors can disrupt global energy markets in unpredictable ways, affecting oil prices and hydrocarbon revenue streams for oil-exporters like Saudi Arabia. However, recent experiences have demonstrated that global energy markets, especially the international oil market and supply chains, have become more resilient in the face of sudden shocks and unexpected disruptions, a development that has helped maintain Saudi's macroeconomic stability. As the Kingdom continues diversifying its economy beyond hydrocarbons, Saudi's economic health and fiscal space will be less exposed to oil market shocks.

In this context, the ongoing tensions in the Red Sea since November 2023 have forced major shipping firms to divert their vessels away from the Suez Canal and take the longer Cape of Good Hope route around the southern coast of Africa, which increases journey times by between 30% and 50%. These events have increased shipping costs and delivery times. To date, global supply chain has broadly dealt with these challenges with no significant impact on the Kingdom’s economy.

## 2. Macroeconomic challenges are likely to persist

Despite the Kingdom managing to withstand the global circumstances since the pandemic, 2024 is expected to present various challenges and risks that could impact Saudi Arabia's economy. The continued escalation of macroeconomic uncertainty and increasing levels of ambiguity in the global economic outlook could play a significant role in the Saudi economy's performance. Some of the prominent macroeconomic challenges include:

- **Sticky inflationary pressures**

A slower-than-expected deceleration in core inflation in major economies due to stronger-than-expected labour market or renewed tensions in supply chains.

- **Higher-for-longer interest rate environment**

Elevated inflation means central banks may have to keep policy rates higher than expected in a way that the world economy remains skewed to the downside. This situation stretches the capacity of borrowers to repay debt and could increase defaults in many sectors, raising risks to financial stability.

- **Slowdown of major economies**

Increasing economic struggles in advanced and emerging economies, such as economic contraction or recession, can exert pressure on global demand and push energy prices down.

- **The greater-than-expected divergence among advanced economies**

While the US economy is showing unexpected resilience due to a tight labour market and robust consumption, the EU, Japan, and other major economies are struggling to recover. Divergence in economic growth may lead to divergence in fiscal and monetary policies. This could trigger flight-to-safety capital flows, tighten global financial conditions, and strengthen the US dollar and therefore reduce global growth.

- **The increasing Geoeconomic fragmentation**

The separation of the world economy into blocs amid the ongoing geopolitical tensions could accelerate. This situation could hamper international cooperation and generate more restrictions on trade and cross-border movements of capital, technology, and workers. The intensified geoeconomic fragmentation could reduce portfolio and foreign direct investment flows, slow the pace of innovation and technology adoption, and constrain the flow of commodities across fragmented blocs, resulting in large output losses and commodity price volatility.

# 3. Saudi Arabia's opportunities amid global challenges

Given the strong interdependence between the Saudi and global economy, external shocks can significantly impact the Kingdom despite its current flexibility. Among the key opportunities is the continued economic diversification and enhancement of industrial sector capabilities, as well as developing of human capital to align with future jobs, and strengthen export capabilities, especially in sectors with high returns.

In this context, the Kingdom's successful bid to host Expo 2030 in Riyadh underscores its commitment to reduce the economy's dependence on oil and achieve sustainable economic and social development in line with the ambitious Saudi Vision 2030. This exhibition presents a historic opportunity for the Kingdom to implement sustainable and innovative practices in infrastructure development, energy utilization, and urban planning. The event will further strengthen the Kingdom's position as a leading global destination for business, tourism, and innovation while fostering international dialogue and purposeful cultural exchange to cultivate a more prosperous world. The event will contribute to increasing local and foreign investment, through many projects that will be implemented during the coming years, and thus increasing the investment opportunities accompanying the organization of Expo 2030. In the same context, the Kingdom will host the 2029 Asian Winter Games in "Neom City", and it is expected that the 2034 FIFA World Cup will be hosted by the Kingdom as well. These global events will provide many exceptional opportunities for Saudi's private sector.

In the meantime, the Kingdom will continue investing in education and skills development to empower its growing, young population and equip young Saudi talent with the tools to succeed in a knowledge-based economy. This includes fostering innovation, entrepreneurship, and digital literacy to capitalize on disruptive technologies and seize upon emerging economic opportunities.

Saudi Arabia will also prioritize sustainable resource management and conservation to mitigate the impacts of resource constraints. This involves diversifying its energy mix by expanding renewable energy sources and developing the needed infrastructure while implementing energy efficiency measures across industries in line with Saudi Vision 2030.
Finally, the Kingdom will keep pursuing international partnerships and collaboration to access new markets, technologies, and investment opportunities. This includes forging alliances with global innovators, participating in international trade agreements, and promoting cross-border investment and knowledge exchange to accelerate economic transformation and diversification.

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