28 December 2014

# Saudi Arabia's 2015 fiscal budget

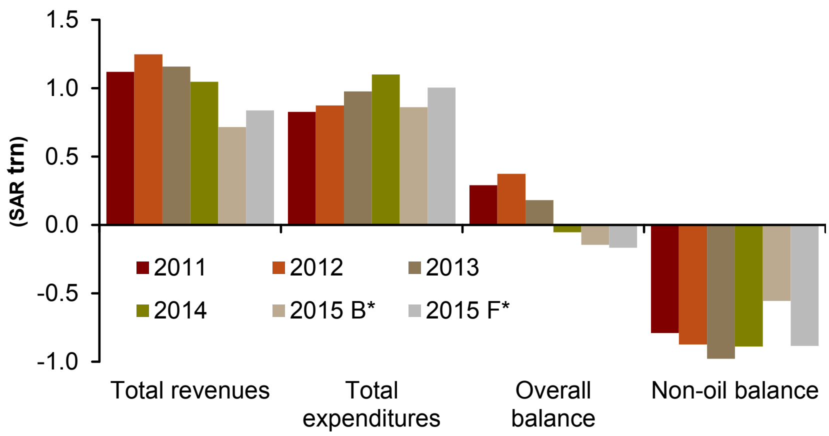
The government's budget for the 2015 fiscal year (31 December 2014 to 30 December 2015) was endorsed by the Council of Ministers on December 25. It was another expansionary budget with spending maintained at a very high level which will play a vital role in supporting the economy. The highlights are:

- For the first time since 2011, a fiscal deficit is projected, based on revenues of SR715 billion and expenditures of SR860 billion. Education and healthcare remain the focus of government spending, accounting for 43.8 percent of total spending. The deficit will be financed comfortably using Saudi Arabian Monetary Agency's huge stock of net foreign assets, which totaled $736 billion at the end of November. Domestic debt was cut to a long-term low of SR44.2 billion in 2014, equivalent to only 1.6 percent of GDP.

- Despite the global environment of lower oil prices, the Kingdom maintains its counter-cyclical economic policy in the 2015 fiscal budget. It continues to highlight the government's intention to stimulate the economy. We expect the investment spending to remain elevated at SR285 billion in 2015 which will support healthy economic growth and provide encouragement and opportunities for the private sector at a time of global and regional uncertainty.

- The budgetary performance in 2014 came up at the very low end of our expectations with a deficit of SR54 billion despite comfortable level in both oil prices ($99.5 per barrel for Brent in 2014) and oil exports (year-to-October 7.1 million barrel per day). This first fiscal deficit since 2009 was mainly due to both

**Figure 1: Saudi Arabia's fiscal stance remains expansionary**




Note: *2015B refers to the MoF budget projections, while 2015F refers to Jadwa Investment's forecasts.

For comments and queries please contact:

Fahad M. Alturki
Chief Economist and Head of Research
falturki@jadwa.com

Asad Khan
Senior Economist
rkhan@jadwa.com

Rakan Alsheikh
Research Analyst
ralsheikh@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

falling revenues and rising expenditures. Total revenues slipped by over 9 percent compared to the previous year, yet remained above the SR1 trillion mark for the fourth year in a row. The growth in fiscal expenditures, at 12.7 percent, was the highest in the last three years, exceeding the SR1 trillion mark for the first time.

- Preliminary economic data shows that 2014 was a healthy year for the economy with real GDP growth of 3.59 percent. Non-oil private sector maintained strong growth, at 5.7 percent year-on-year, with growth of construction, non-oil manufacturing, transport and communications sectors above 5 percent year-on-year. Elevated oil export revenues maintained a double digit current account surplus at 14.1 percent of GDP or $106.4 billion.

We estimate a price of $56 per barrel (pb) for Saudi export crude (around $60pb for Brent) and production of 9.6 million barrels per day (mbpd) are consistent with the revenue projections contained in the budget. We expect both revenues and expenditures in 2015 to be above the budgeted level and forecast a budget deficit of SR167.6 billion (6.1 percent of GDP) based on oil price of $79pb for Brent.

## The 2015 budget

*Budgeted spending, at another all-time high,…*

The 2015 budget foresees continued increases in spending to another historical high of SAR860 billion, underscoring the government's determination and ability to support economic activity despite the prevailing subdued oil pricing environment. It further highlights the strong focus on economic diversification as spending on physical and social infrastructure has been kept elevated. However, we believe the 2015 budget numbers remain conservative judging by the underlying assumptions on oil prices and historical patterns of government overspending.

*…confirms government commitment toward supporting economic development...*

*...but in light of the uncertainty surrounding the global oil market..*

*...the budget foresees a deficit of 5.3 percent of GDP.*

That being said, the Kingdom has budgeted for a first fiscal deficit since 2011, amounting to SR145 billion in 2015, compared with a balanced budget in 2014. With uncertainty still clouding the outlook for global oil market, the budget foresees a contraction in revenues by 16.4 percent and only a marginal growth in expenditures (0.6 percent) compared to last year's budget. At least in the short term, we think that financing this deficit is not a problem, as it can be done

**Figure 2: Budgeted expenditure**

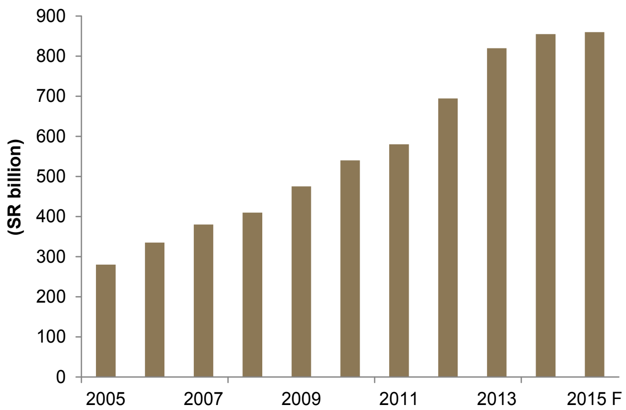
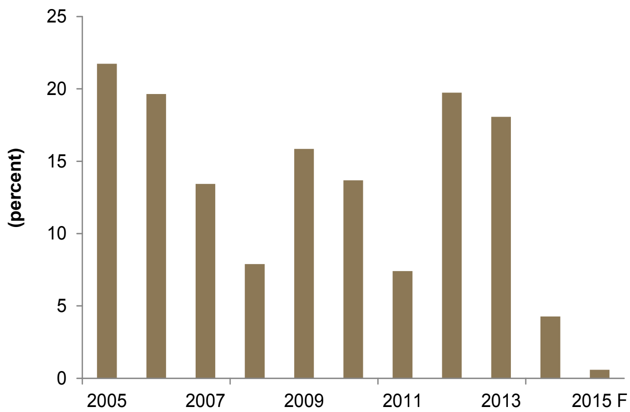



**Figure 3: Growth in budgeted expenditure**



by drawing down the stock of foreign assets built up in recent years. At the end of November net foreign assets at Saudi Arabian Monetary Agency (SAMA) stood at $736 billion (SR 2,760 billion). The huge stock of assets that the government can call on gives Saudi Arabia an advantage over most other countries in alleviating the impact of lower oil prices. That means it can push ahead with strategic projects such as key infrastructure development including transport, housing, oil, power and water and support the private sector where necessary.

## Expenditure

*Growth in budgeted expenditure is the lowest since 2002...*

Total expenditure is budgeted at SR860 billion in 2015 (Figure 2). This is only 0.6 percent above the amount budgeted for 2014 representing the lowest growth in spending since 2002 (Figure 3). In nominal terms this is a SR5 billion increase on the figure budgeted for 2014 which is also the lowest nominal increase in budgeted spending since 2002. Whilst we note that this is almost flat growth, it nonetheless sends an important message to the private sector that the fall in oil prices will not prevent the government from implementing and expanding on its investment plans. High fiscal spending remains psychologically important for the private sector, in our view.

*...but we don't think this is withdrawal of the stimulus or a rethinking of the ongoing expansionary fiscal stance...*

*...as expenditures remains high relative to non-oil GDP.*

Budgeted spending is significantly below the actual level in 2014 of SR1,100 billion. We do not view this as a withdrawal of stimulus or a rethinking of the ongoing expansionary fiscal stance. This is normal as actual spending tends to exceed the budgeted level. The government has consistently overrun its budgeted spending by an average of 25 percent over the past decades (Figure 4). Furthermore, the last time that budgeted spending exceeded actual spending compared to the previous year was 2000. In addition, budgeted spending as a share of non-oil GDP is in-line with historical levels, at an average of 51 percent in the last ten years.

*Current spending is set to increase while investment spending are reduced.*

The SR5 billion increase in overall budgeted spending for 2015 was entirely due to higher current spending while investment spending was reduced. Budgeted current spending has been raised to SR675 billion or by 18 percent compared to the level budgeted for last year, the highest annual growth since 2012. Wages and salaries are the largest component of this and are certain to be a major contributor to

**Figure 4: Budgeted versus actual spending**

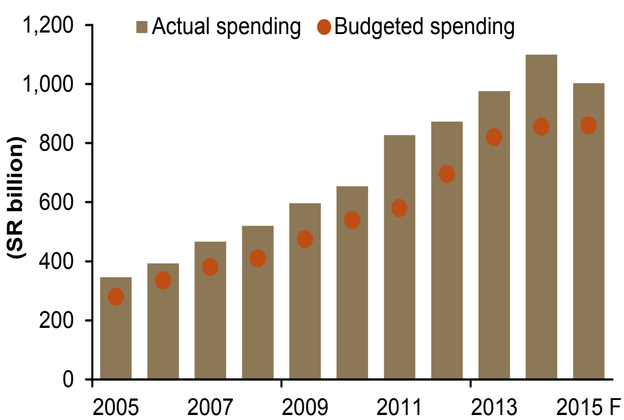
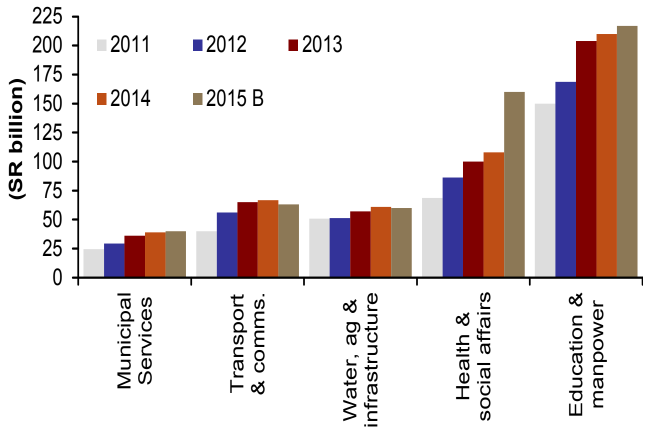



**Figure 5: Spending by sector**



the higher spending especially that 2015 budget includes an extra month salary, according to the Hijri calendar. Operations and maintenance costs are also likely to be a growing source of current spending in future years as major projects become operational. At the same time, investment spending was cut by 35 percent to SR185 billion for 2015. While this is the first time since 2002 that the government has reduced its budgeted investment spending, this was anticipated given the rapid growth in this type of spending over the last ten years, which has averaged 25 percent per year. That said, the current budgeted investment spending is 36 percent higher than its level five years ago.

*Spending priorities are consistent with recent years.*

While budget expenditure in 2015 spans all sectors, the priorities are consistent with recent years (Figure 5). Education is allocated the biggest share of those departments disclosed in the budget, at 25 percent of total spending followed by the health and social affairs with 19 percent. Healthcare and social development received the largest increase in its allocations, at 48 percent increase year-on-year.

Spending plans for key public sector areas outlined in the budget include:

*Education and manpower accounts for 25 percent of total spending.*

**Education and training** was allocated SR217 billion, a moderate 3 percent increase on 2014's allocation. Around SR14 billion will be used to finance 164 new projects, including 'new' additions to existing projects whilst SR12 billion will be allocated to the refurbishment of several universities plus the construction of three new universities. Another SR400 million will be used for the refurbishment of general schools and sport centers. SR22 billion has been allocated for the over 207,000 Saudi students studying abroad and their families. The allocation also takes into account the government continued commitment on building and operating several technical and vocational colleges and institutions.

*Health and social affairs accounts for 19 percent of total spending.*

**Health and social affairs** was awarded a huge 48 percent rise in its budget, to SR160 billion, accounting for 19 percent of total spending, up from 13 percent of last year's total. New projects within the healthcare sector will include three new hospitals, three blood banks, 11 medical centers, ten comprehensive care clinics and numerous primary care centers across the country. Social services expenditure will be used to build 16 sports clubs whilst SR30 billion will contribute towards support for social welfare, citizens with special needs, and poverty eradication programs.

*Transport and infrastructure accounts for 7.3 percent of total spending.*

**Transport and infrastructure** received the third largest allocation of SR63 billion. Spending in this category is budgeted to decline by 5 percent compared to the 2014 budget. Around 53 percent, or SR33.5 billion, of the transport and infrastructure budget will go towards building new roads, upgrading and modernizing existing ports, infrastructure projects in the industrial cities of Jubail, Yanbu and Ras Al-Khair, as well as upgrading regional and international airports, and railroads projects.

*Water, agriculture and (related) infrastructure accounts for 7 percent of total spending.*

**Water, agriculture and (related) infrastructure** spending is budgeted at SR60 billion, a decrease of 1.6 percent compared to 2014 budget. Funds to the tune of SR23 billion have been set aside for new and expansion of existing projects; including increasing water resources, building dams and expanding/improving water and water treatment networks. Some of the budgeted amount will also go towards projects that have been approved in previous years and that are under construction.

*Municipality services accounts for 4.7 percent of total spending.*

**Municipality services** were given a 2.6 percent increase in budget. The total allocation thus increased to SR40 billion of which SR5.5 billion will be financed from municipality services. The spending retains the same focus as previous years.

*According to SAMA, defense and security spending accounted 35 percent of the budgeted total in 2014.*

Although not disclosed in the budget announcement, it is likely that defense and security accounted for the largest component of government spending. According to SAMA, defense and security spending accounted for SR302.9 billion or 35 percent of the budgeted total in 2014. Several multi-billion dollar defense contracts have been signed in last few years and media reports of new agreements appear sporadically. These payments tend to be spread over many years, so the additional impact on spending in 2015 should not be too great.

## Revenue

*Total revenue is budgeted at SR715 billion.*

*We calculate that oil production of 9.6mbpd at a price $60pb for Brent is consistent with the oil revenue projection in the current budget.*

Total revenue is budgeted at SR715 billion. We anticipate that around 83 percent of total revenue will come from oil; an official revenue breakdown was not published. As is the norm, the oil price and production projections used to derive the revenue figure were not disclosed. We calculate that oil production of 9.6mbpd at a price for Saudi export crude of $56pb (equivalent to around $60pb for Brent) and an oil export/revenue transfer ratio of 89 percent is consistent with the oil revenue projection in the current budget.

*Actual oil price has averaged over 70 percent higher than the one used for the budget in the last 10 years…*

The government has consistently based its previous budgets on a conservative oil price assumptions. Over the last decade the actual oil price has averaged over 70 percent higher than the one used for the budget. While this has previously pushed the Kingdom to gradually increase the oil revenue projection used in the budget, it is not the case for the current budget. With Brent crude currently trading at $59pb, the oil price assumption was reduced for the first time since 2009. However, we think that oil prices have been pushed lower than is justified by demand and supply and that they will gradually rebound next year (see box).

*...which we view as one of the reasons behind consecutive years of substantial overspending.*

With these assumptions in the background, the announced revenues are projected to decline by 16.4 percent compared with the previous year's budget. Even though we anticipate that both production and prices will be lower than in 2014, we think that revenues will be comfortably above the government's assumption. Revenues generally provide the base from which expenditure is calculated; conservative budgetary assumptions on oil prices and spending have contributed to high levels of overspending in recent years. We don't think this coming year will be an exception to this pattern, albeit at a slower pace than previously.

*Non-oil revenues will improve inline with growing demand for government services.*

Projections for non-oil revenues were not published. Fees and charges for government services and customs tariffs are the main sources of non-oil revenues. We anticipate receipts from both of these sources to increase as a result of solid economic performance as well as higher demand on government services. The prospect of higher interest rates in the U.S is likely to improve the return on government foreign assets which account for around 100 percent of GDP, though we do not anticipate a significant push here as the interest rate adjustment is likely to be gradual. No new policies to raise non-oil revenues were contained in the budget.

## Jadwa Investment's budget forecast

*We forecast a budget deficit of SR167.6 billion in 2015, 6.1 percent of GDP.*

We forecast a budget deficit of SR167.6 billion in 2015, equivalent to 6.1 percent of estimated GDP. On the revenue front, we expect the oil price to be higher than that used in the budget (see box) and therefore oil revenues will exceed the budgeted total. We forecast total oil revenues contributing SR716.1 billion to the budget and non-oil revenues contributing SR119.5 billion.

*We expect actual spending to be 16 percent higher than budgeted…*

Actual spending will be above the budgeted level. Over the last ten years actual government spending has averaged 25 percent higher than the budgeted amount. While the overspending ratio rose in 2014 to 29 percent, as we discuss in the next section, we think this is mostly due to transitory spending. We therefore expect a decline in the overspending ratio in 2015 to 16.6 percent. We think such a trend will be further enforced given the expected pressure on oil revenues and the more prudent expenditure control together with the low rise in spending budgeted for the year. We forecast total expenditure of SR1,003 billion.

*….pushing the fiscal breakeven oil prices to 97pb for Brent.*

The oil price level necessary for revenues to balance our forecast level of government spending, known as the fiscal breakeven oil price, is $93.6pb for Saudi export crude (equivalent to around $97pb for Brent). This is based on our production assumption of 9.6mbpd and an oil export/revenue transfer ratio of 89 percent. We also assume a 5 percent growth in domestic oil consumption to 2.6mbpd in 2015. We think that forthcoming increases in domestic gas production should take some of the burden from oil as the fuel for domestic energy consumption next year. This, however, remains subject to a non-negligible downside risk if there is further delay on the 2.5 billion cubic foot per day Wasit project. A number of media reports highlighted that the projects will not reach full capacity until the fourth quarter of next year, almost a year behind schedule.

## Jadwa's oil market outlook for 2015

*We forecast that Brent crude to average $79pb in 2015, down from $99.5pb in 2014.*

In our recent publication: *Oil Market Dynamics and Saudi fiscal challenges* (published on 7 December 2014), we put our base-case forecast for oil prices at $83pb in 2015, but in a fluid and fast evolving oil market we now see our low price scenario, at $79pb for 2015, as being more likely (Figure 7). We see current low oil prices persisting into the first half of 2015 as OPEC resists cutting production and the lower price environment takes time to impact non-OPEC supplies. As a result we expect to see the surplus in global oil balances to reach peak levels in first quarter 2015. In the second half of 2015 we see a slight pickup in global demand, via a mild improvement in global economic growth, some reduction in non-OPEC supply growth, and seasonal demand in the summer resulting in Brent averaging $79pb for 2015. At this price we see Saudi export crude averaging $75pb for 2015, down Saudi export price of $95.8pb in 2014. Regardless of the lower price, competition for global market share will intensify in 2015 and, as such, we only see a moderate decline in Saudi production, to 9.6mbpd, down from 9.7 in 2014. At the end of 2015 global oil balances will still be at a surplus, although at lower levels than 2014 (Figure 8). Below we highlight the main

*Global oil supply will grow by 1.5 mbpd in 2015.*

*Non-OPEC oil supply will continue to exceed global oil demand growth...*

*..with growth in OPEC supplies coming via Iraq.*

*Global oil demand is expected to increase by 1.1 mbpd, year-on-year…*

*...most of which will be generated by non-OECD countries.*

*Further downward pressure on prices will come as a result of crude oil stock levels remaining high.*

factors affecting global oil markets in 2015:

- OPEC data shows that global oil supply will grow by 1.5 mbpd, year-on-year, in 2015, with non-OPEC supplies, chiefly U.S shale oil, making up a majority of growth. We expect to see the lower price environment putting financial pressure on some smaller and midsized shale oil companies but the impact on supply will only be felt during the second half of 2015. As a result, U.S oil supply growth will decelerate to 1 mbpd, year-on-year, in 2015, down from 1.5 mbpd in 2014.

- We also see production rising from OPEC in 2015, regardless of the over supplied market. The OPEC meeting in November 2014 illustrated that there is deep disagreement between OPEC members about how to respond to lower oil prices which will mean no major supply cuts. With many of the OPEC members unwilling or unable to cut supply, we expect increases in OPEC output coming from growth in Iraqi production by roughly 0.5 mbpd, geo-political risks notwithstanding.

- According to OPEC data world oil demand is expected to grow by 1.2 percent in 2015, or 1.1 mbpd, supported mainly by non-OECD rises, with the Canada and the U.S the only contributors to growth in demand from OECD countries. Oil demand growth in the non-OECD countries will be driven by China (up 2.95 percent, year-on-year) , India (up 2.51 percent, year-on-year), Latin America (up 3.05 percent, year-on-year) and the Middle East (up 3.65 percent, year-on-year). Weak economic growth, especially in the EU and Japan, will continue as a drag on oil consumption amongst OECD countries with European and Asia oil demand growth declining by a combined 0.3 mbpd, year-on-year, in 2015.

- In the last quarter of 2014 OECD commercial crude stocks rose dramatically (Figure 9), reflecting the glut in crude in the oil market. OECD crude stocks remain at record levels with refined product stocks, such as gasoline, also high. This is reflective of a strong build during the latter half of 2014 and we expect current high stock levels to continue into early 2015 adding downward pressure on prices.

- One area where unexpected growth in oil demand will come from

**Figure 6: Total Saudi oil production**

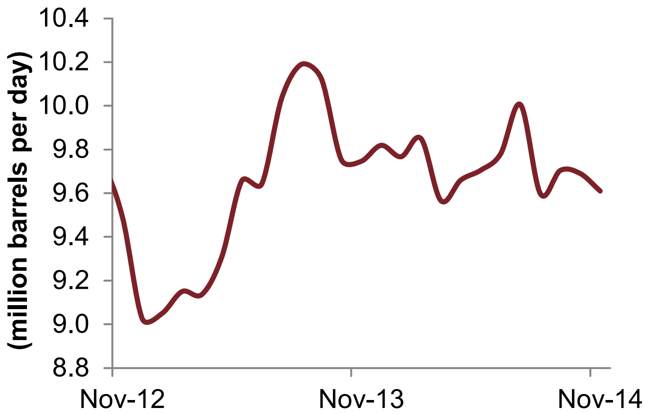
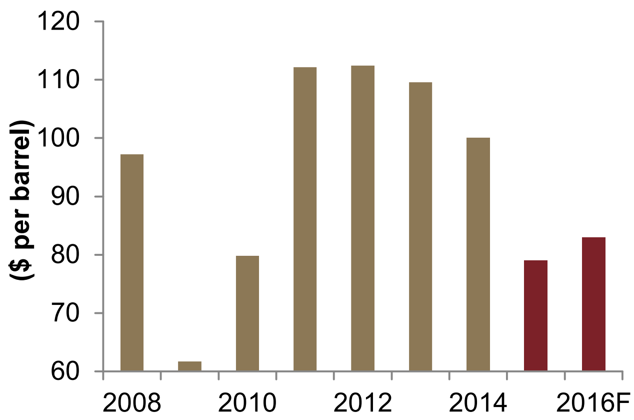



**Figure 7: Average oil prices**



*China will increase crude purchases for stockpiling at lower prices.*

is China; as a result of its efforts to boost commercial crude stocks. The long term energy security strategy of the Chinese government has been to buy crude for stocks at a time when prices are low. China currently has around 30 days' worth of crude imports in stock, but has targeted around 100 days by 2020, which would represent a further 700 million barrels, or 0.4 mbpd. We therefore expect the prevalence of lower prices in 2015 will result in China accelerating its purchase of crude stock.

*Geopolitical risks still remain, which could send prices to $100pb.*

- Geopolitical risks still remain a downside risk to supply with any disruption to supply from potential geopolitical hotspots of Iraq and Russia/Ukraine likely to send prices higher, back above $100pb.

## Budgetary performance in 2014

*The 2014 fiscal preliminary outturns showed a deficit, for the first time since 2009.*

The recent announcement by the Ministry of Finance also reveals that the preliminary 2014 fiscal outturns were significantly different than the 2014 budget's projections, and at the very low end of our projections. Despite higher than budgeted oil revenues, the result of elevated oil prices ($99.5pb for Brent in 2014) and production (year-to-November output of 9.7mbpd), spending was well in excess of the budgeted projection leading to a deficit of SR54 billion, the first deficit since 2009. It was the equivalent of 1.9 percent of GDP.

*Total revenues is estimated at 1,046 billion in 2014, the lowest since 2010.*

Revenue totaled SR1,046 billion (Jadwa Investment: SR1,077 billion). It was 22 percent above the budgeted level, but 9.5 percent lower than their 2013 level. We estimated that the 2014 budget was based on a price for Saudi oil of $67pb and production of 9.7mbpd. Actual price of Saudi oil averaged $95.8pb in 2014, 8 percent lower than their level in 2013, but 43 percent higher than that used in the budget. Actual level of oil production was in line with our forecasts. Non-oil revenues were SR115 billion, down around 5 percent on the 2013 total.

*Expenditure amounted to SR1,100 billion in 2014…*

*…12.7 percent higher than in 2013.*

Expenditure amounted to SR1,100 billion (Jadwa Investment: SR1,017 billion), 28.7 percent above the budgeted level and 12.7 percent higher than in 2013. The annual increase in 2014 was the highest since 2011 and compares to an average over the past two years of 8.7 percent. In nominal terms, the overspending amounted to SR245 billion, second only to the overspending level in 2011 when

**Figure 8: Global demand and non-OPEC supply**
(year-on-year change)

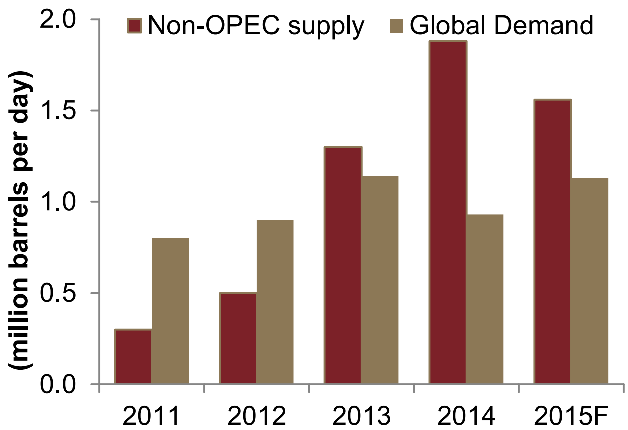
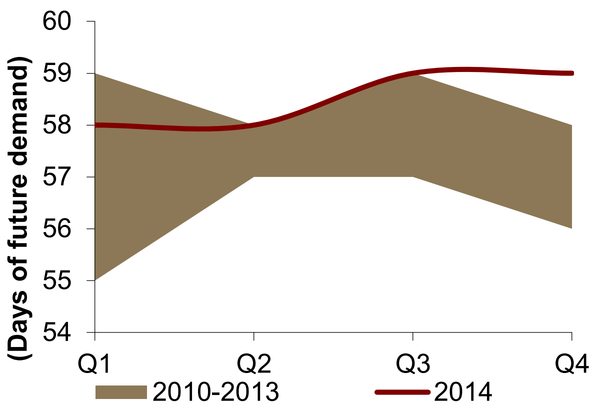



**Figure 9: OECD Commercial crude stock**



*The increase in spending was attributed to higher-than-expected spending on the Two Holy Mosques…*

*...as well as external financial aid...*

the government introduced two large fiscal packages of around 25 percent of GDP. The official announcement attributes the current overspending to additional spending on the Two Holy Mosques as well as international financial aid. We have highlighted the trend on the latter component in previous publications as a significant downside risk factor to our earlier fiscal surplus forecast. While a breakdown of spending into capital and current expenditure was not disclosed, we maintain our view that public sector pay rise and greater employment in government also account for a large and growing share of current spending. This highlights the increased rigidity in the Kingdom's budget, though the government noted that its efforts to rationalize current spending will continue. It is important to note that the initial estimates of government spending and revenues contained in the budget statement tend to be revised. Generally, both are increased, with the rise in spending usually larger than that for revenue.

**2014 Budget data**
(SR billion)

| | Budget | Actual | Difference |
|---|---|---|---|
| **Revenues** | 855 | 1,046 | 191 |
| **Expenditures** | 855 | 1,100 | 245 |
| **Balance** | 0.0 | -54.0 | -54.0 |

*...while capital spending still accounts for a large share of total spending.*

That being said, we are not greatly concerned that the budget was in deficit even though Brent oil prices averaged $99.5pb in 2014. This is because capital spending remain a large element of spending. Large outlays on many of the projects currently being undertaken are relatively transitory. Furthermore, capital spending can be relatively easily scaled back if necessary. We estimate that capital spending accounted for over 35 percent of total spending in 2014, compared to an average of 26 percent between 2004 and 2013. This type of spending is critical to sustain robust growth in the non-oil sector and help to lessen the dependence on the oil sector as the main source of income. Diversification of sources of fiscal income rather than fiscal deficits should be the focus of policymakers in the Kingdom.

Despite the budget being in deficit, government debt, all of which is domestic, was cut by SR15.9 billion to SR44.3 billion by the end of 2014, equivalent to just 1.6 percent of GDP (Figure 12). We are

**Figure 10: Budgetary performance**

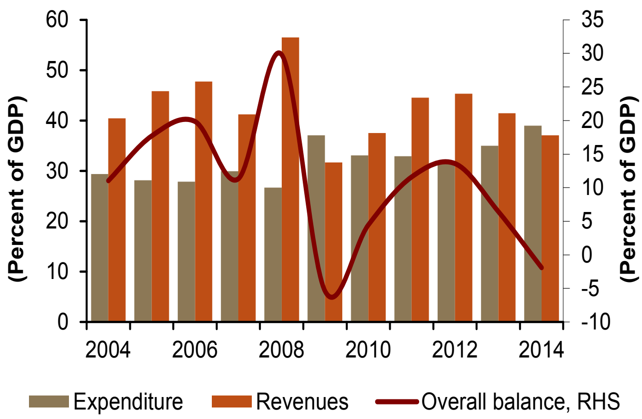
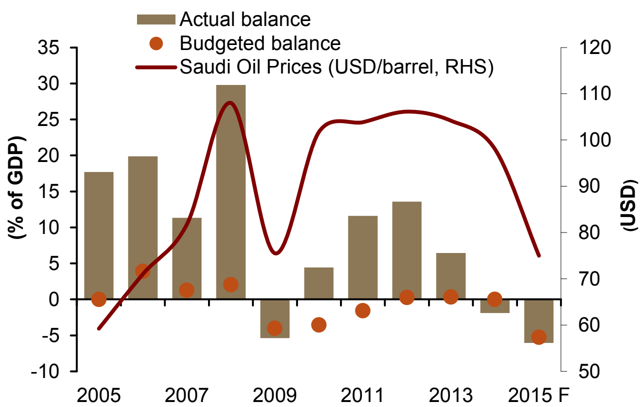



**Figure 11: Budgeted versus actual balance and oil prices**



*Public debt was reduced by SR15.9 billion to SR44.3 billion or 1.6 percent of GDP.*

unclear how this was achieved. Commercial bank holdings of longer-term government and quasi-government bonds, the closest proxy to their holdings of government debt, have actually risen by SR2.8 billion over the first eleven months of the year to SR52.4 billion despite the fall in public debt. The remaining government debt is held by the two government pension funds, the General Organization for Social Insurance and the Public Pension Agency. It, thus, seems that the government has been repaying debt to these two pension funds. We believe these repayments take the form of a swap, with the pension funds exchanging government debt for assets that are managed by other government agencies.

## Economic performance in 2014

*Overall growth improved to 3.6 percent in 2014...*

The Ministry of Finance budget announcement included preliminary macroeconomic data, which provide some insight into the government's view on economic performance this year and prospects for next year. This showed that overall economic growth improved to 3.6 percent year-on-year, accelerating from 2.7 percent year-on-year in 2013. We had forecasted 4.2 percent GDP growth in 2014, but our figures are not comparable to those included in the budget as the latter includes adjustment to both the base year (from 1999 to 2010) and to sectorial classifications. While the budget statement includes only a limited information on these changes, we expect the Central Department of Statistics and Information (CDSI) to soon release further and more detailed discerptions.

*… supported by growth in both oil and non-oil sectors...*

According to the budget statement, the oil sector grew by 1.7 percent year-on-year in 2014. Stripping out the oil and gas sector, non-oil economic growth was at 5.2 percent year-on-year, with the private sector expanded by 5.7 percent. Lower oil revenues contributed to lower current account surplus. Inflation continued to decline.

*… with the growth in the oil sector being higher-than-expected.*

**Real GDP growth** accelerated to 3.8 percent year-on-year, a trend which we had anticipated (Figure 13). We anticipated a higher economic growth compared to last year because of stronger non-oil sector performance, while oil sector growth remained positive. The oil sector grew by 1.7 percent year-on-year despite marginal change in oil production. The latter grew by 1 percent to an average of 9.7mbpd so far this year compared with 9.6mbpd in 2013. We believe that the increased refinery output and production of gas

*Nevertheless, the majority of overall GDP growth stemmed from the non-oil economy.*

**Figure 12: Government debt**

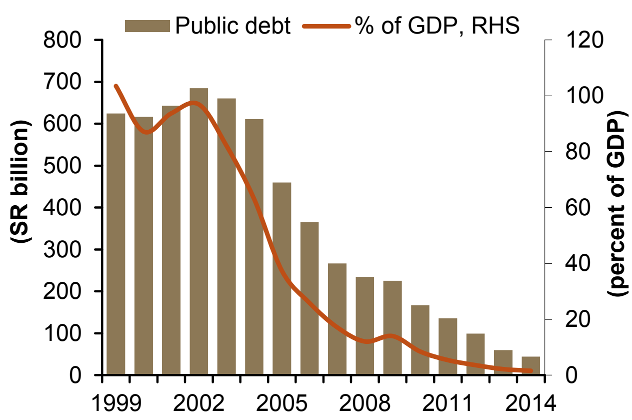
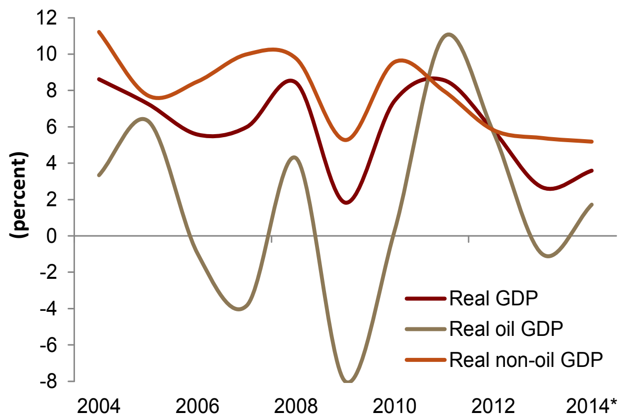



**Figure 13: Real GDP growth**
(year-on-year change)




Note: * From the official budget statement with 2010 as a base year.

*Non-oil private sector growth was put at 5.7 percent...*

*… with construction, non-oil manufacturing, transport, and retail continuing to be the fastest growing sectors in 2014.*

*Inflation remained subdued throughout 2014.*

*The current account surplus declined by 19.8 percent year-on-year...*

*… a decline that was mainly due to falling in oil export revenues...*

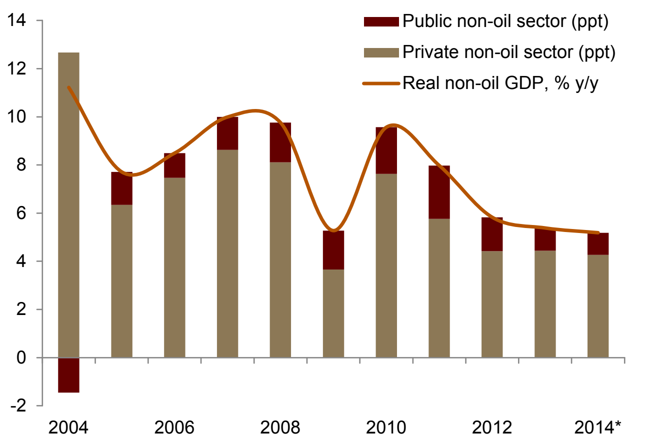
during 2014, as well as the use of 2010 as a new base year for real growth, has contributed to the higher-than-expected annual growth in the oil sector. Nevertheless, the majority of overall GDP growth stemmed from the non-oil economy, which expanded by 5.2 percent (Figure 14). The growth of government services also remained robust at 3.7 percent.

The **non-oil private sector** grew by 5.7 percent. We had anticipated a good performance in 2014 as consecutive years of elevated government spending lifted business and consumer confidence and banks' comfort in the lending environment despite another year of regional turbulence and slower-than-expected global economic growth. The data release confirms our expectations that construction, non-oil manufacturing, transport and communications, and wholesale and retail would be the fastest growing sectors in 2014. Construction sector growth was robust at 6.7 percent year-on-year. Non-oil manufacturing grew by 6.5 percent year-on-year, supported mainly by improved capacity and production levels for petrochemicals and plastic products. Transport and communications growth was put at 6.1 percent, maintaining robust performance as large-scale transport projects gradually add more capacity to the sector. The wholesale and retail sector also recorded robust growth at 6 percent, indicating that the impact of the recent labor market reforms on the sector is diminishing. Growth in the finance sector was also in line with expectations, at 4.5 percent.

**Inflation** was put at an average of 2.7 percent, compared to 3.5 percent in 2013. This is in line with inflation data produced on a monthly basis by CDSI. Despite a continued surge in consumer spending, inflation has remained subdued, with most components of the headline figure recording a modest increase in prices in 2014 relative to previous years (Figure 15).

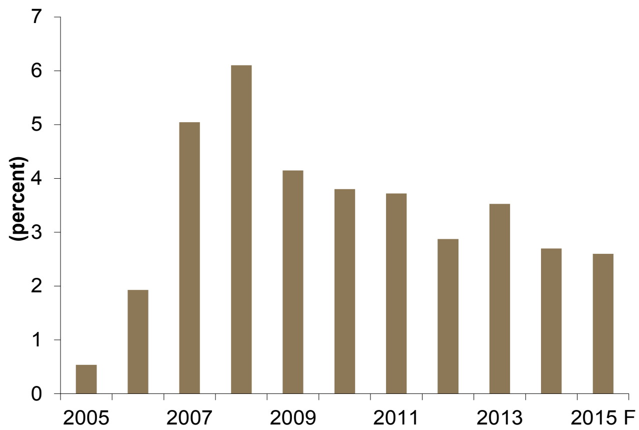
The **current account** recorded a surplus of $106.4 billion (SR 399 billion), down from $134.3 billion in 2013 (Figure 16). Although a detailed breakdown of the current account is not published, it is clear that the 19.8 percent year-on-year decline in the surplus is mostly due to a drop in oil revenues (oil revenues account for around 85 percent of total current account receipts). The fall in Saudi oil export price from $104pb in 2013 to $95.8pb in 2014 pushed the oil export revenues to $304 billion, down from $323 billion in 2013. Non-oil export growth slowed to 3.1 percent year-on-year, compared to 6

**Figure 14: Non-oil GDP Growth**




Note: * From the official budget statement with 2010 as a base year.

**Figure 15: Inflation**
(year-on-year)



*… while non-oil export growth continued to grow, albeit at a slower pace.*

percent in 2013 (Figure 17). Imports were down by 2.6 percent year-on-year, broadly in line with the monthly trade data. Data for the first ten months of 2014 show that imports are 1 percent down from the same period in 2013. Data on the other components of the current account was not published.

## The economic outlook for 2015

*We expect 2015 to maintain the solid growth momentum albeit at a slower pace.*

We expect 2015 to maintain the solid growth momentum albeit at a slower pace. While overall economic growth will slow, this will mainly be due to lower oil output. Execution on new and existing projects, especially in the infrastructure sector, means that non-oil growth should maintain the current solid performance. Bank lending will remain supportive and regional unrest will be less of a drag on domestic performance. Inflation should stay low as domestic spending pressures recede and external pressures remain favorable, with risks further on the downside given the outlook for the U.S dollar and added prospect of higher interest rates in 2015. Oil prices are expected to be lower year-on-year in 2015 as the market remains over supplied from a combination of U.S shale oil and OPEC sources and demand remains subdued on the back of modest growth in the global economy.

**2014 results and 2015 Jadwa forecasts**

| | 2014 Actual | 2015 Jadwa Forecast |
|---|---|---|
| Real GDP (% change) | 3.6 | 3.4 |
| Nominal GDP (% change) | 1.1 | -3.5 |
| Inflation (2007 =100, %) | 2.7 | 2.6 |
| Current account surplus (SR billion) | 398.9 | 101.8 |

*We expect overall growth to slightly fall to 3.4 percent in 2015…*

*… with oil sector growth set to turn negative...*

Economic growth in Saudi Arabia is forecast to slightly fall to 3.4 percent in 2015, owing to lower oil production and large base-effects for the non-oil sector. However, we might revise our forecast in our upcoming “Saudi economy in 2015” report once CDSI releases further and more detailed descriptions on the recent adjustment to both the base year (from 1999 to 2010) and to sectorial classifications. Nevertheless, based on the available data, we expect oil sector real GDP to contact by 0.6 percent due to falling oil output.

**Figure 16: Current account**

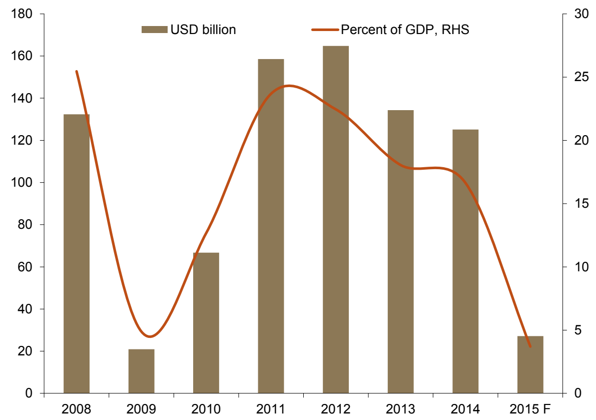
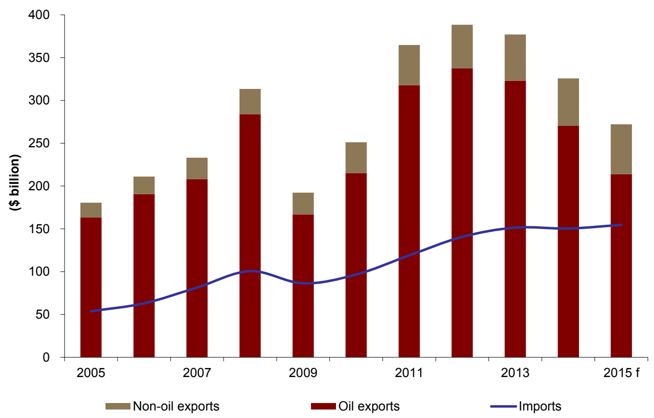



**Figure 17: Imports and exports**



*...but non-oil private sector growth is likely to remain robust above 4 percent.*

High government spending will continue to be the engine of the non-oil economy, supported by bank lending and healthy domestic consumption demand. Within the non-oil sector, we expect the government's real GDP to expand 3 percent year-on-year due to the renewed commitment to sustain capital spending and elevated demand on government services, while the non-oil private sector is expected to expand by 4.9 percent, slowing down from 5.7 in 2014. We believe that negative sentiment associated with lower oil prices, the prospect of an interest rate hike, and a larger base effect, are all likely to contribute to the slowdown in the private sector. From a sectorial point of view, we expect construction, transportation, retail and utilities, the main beneficiaries of government spending, to be the fastest growing sectors of the economy in 2015.

*We believe that  construction, transport, retail, and utilities, would be the fastest growing sectors in 2015.*

*Inflation is likely to remain subdued in 2015.*

Inflation is expected to be low throughout 2015. External pressure on domestic prices is likely to remain weak given subdued international food inflation, as well as a stronger outlook for the U.S dollar and the prospect of higher interest rate. Rental inflation should continue to decline as more properties enter the market. However, we maintain our view that there will be some local inflationary pressure as a result of the high level of consumer and government spending. We do not foresee any changes to the riyal's peg to the dollar. Lower oil revenues will cause the current account to record a small surplus of around 3.7 percent of GDP.

*We expect the current account to record a small surplus of 3.7 percent of GDP in 2015.*