Bank Audi

SAUDI ARABIA ECONOMIC REPORT

JUNE 2024

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SIGNIFICANT, RAPID ECONOMIC AND SOCIAL TRANSFORMATION PROGRAM UNDERWAY IN THE KINGDOM

Robust economic performance on the basis of strong fundamentals

The Kingdom of Saudi Arabia is witnessing robust economic performance on the basis of strong fundamentals. An increase in public sector investments, combined with a raft of social and economic reforms, has boosted the non-oil economy. Real GDP growth is projected at 2.6% in 2024, up from -0.8% in 2023, as per the IMF. Looking forward, growth will likely be supported by public sector investments, business environment reform, gradually lower interest rates, robust credit growth, ongoing development of retail and tourism sectors and employment gains among Saudis and expats.

Fiscal balance returns to negative on oil production cuts and expansionary spending policies

The fiscal balance in Saudi Arabia returned to the negative side in 2023, amid lower oil prices and additional voluntary production cuts, and given the Kingdom's strategic expansionary policy aimed at implementing comprehensive structural reforms that would drive sustainable economic growth. Total revenues reached SR 1,212.3 billion in 2023 (US$ 323.3 billion), down by 4.4% compared to the year 2022, yet 7.3% higher than budgeted revenues. Total public expenditures reached SR 1,293.2 billion (US$ 344.9 billion) in 2023, up by 11.1% relative to the previous year, and compared to an originally planned spending of SR 1,114 billion. That being said, the fiscal balance in Saudi Arabia returned to negative territory, with the Kingdom recording a fiscal deficit of SR 80.9 billion (US$ 21.6 billion) in 2023, the equivalent of 2.0% of GDP. Likewise, Saudi Arabia's external sector relatively rationalized in 2023, reporting decreases in the country's Balance of Trade and Current Account at large.

Moderating inflationary pressures helped by subsidies and strong US dollar

Saudi monetary conditions were marked this year by moderating inflationary pressures in a higher-for-longer global rate environment, while FX buffers resumed their growth, and the Saudi Central Bank's key policy rates continued to move in tandem with the US Federal Reserve's policy. In details, Saudi inflation moderated further during the first quarter of 2024, averaging 1.7% year-on-year, in line with global trends, and in part contained by domestic subsidies/price caps and a strong Saudi Riyal reflecting the US dollar peg. This followed a 2.5% and 2.3% average increase in consumer prices in 2022 and 2023 respectively.

Continuing sound activity growth for the Saudi banking sector

The Saudi banking sector reported a sound growth in 2023 and in the first quarter of 2024. Measured by the aggregation of assets of banks operating in the Kingdom, banking activity reported a growth of 9.3% in the year 2023 and by 3.9% in the first quarter of 2024. Likewise, deposits grew by 7.8% in 2023 and by 5.0% in the first quarter of 2024. The noticeable growth was the one registered in shareholders equity over the first quarter of 2024 rising by 13.5%, after a moderate growth of 5.9% throughout 2023.

Saudi capital markets under downward price pressures this year

Saudi capital markets came under downward price pressures over the first five months of 2024. Saudi equities were weighed by heightened regional geopolitical tensions, extended voluntary production cuts and some downbeat corporate earnings. Concomitantly, Saudi debt papers recorded price contractions over this year, mainly tracking US Treasuries move after recent indicators suggested that US economic activity continued to expand at a solid pace while inflation remained elevated, cementing bets about delayed US interest rate cuts, while leaving the door open for an interest rate hike this year.

Significant, rapid economic and social transformation program underway

Saudi Arabia has embarked on a significant, rapid economic and social transformation program under the Vision 2030. In the lead up to 2030, an acceleration of investment projects that seek to establish new industries, such as tourism, and diversify the economy away from its primary reliance on the upstream hydrocarbon sector, is expected. The IMF expects real GDP growth of 4.0% over the next five years, as per its World Economic Outlook issued in April (2.6% growth expected for 2024). In parallel, inflation is expected at 2.3% in 2024 and at an average of 2.0% over the next five years.

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The Kingdom of Saudi Arabia is witnessing robust economic performance on the basis of strong fundamentals. An increase in public sector investments, combined with a raft of social and economic reforms has boosted the non-oil economy. Real GDP growth is projected at 2.6% in 2024, up from -0.8% in 2023, as per the IMF. Looking forward, growth will likely be supported by public sector investments, business environment reform, gradually lower interest rates, robust credit growth, ongoing development of retail and tourism sectors and employment gains among Saudis and expats.

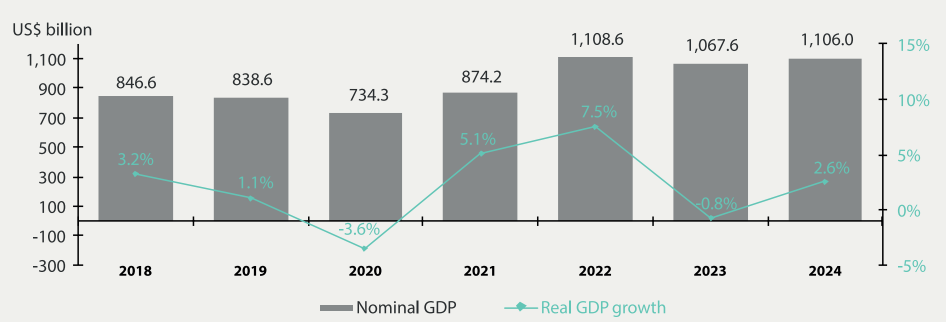
On the other hand, significance oil dependence, low World Bank governance indicators and vulnerability to geopolitical shocks remain relative weaknesses according to Fitch. Nonetheless, governance is improving with social and economic reforms and efforts to bolster effectiveness across government institutions.

At the external level, foreign reserves excluding gold declined moderately in 2023, to US$ 437 billion, as financial account outflows in the form of investments abroad outweighed the current account surplus, which narrowed to an estimated 3.2% of GDP (down from 13.7% in 2022), i.e around US$ 100 billion smaller than in the previous year, due to lower oil revenue and high imports. It is worth noting that the ratio of exports to imports has receded from 216.6% in 2022 to 154.6% in 2023.

At the fiscal level, the government fiscal balance to GDP moved from a surplus of 2.5% in 2022 to a deficit of 2.0% in 2023. This comes amid a rise in government expenditures to GDP from 28.3% to 32.3% over the same period, while government revenues to GDP declined from 30.7% to 30.3%. In parallel, debt to GDP has increased from 23.8% in 2022 to 26.2% in 2023 on the basis of a US$ 280 billion total government debt at end-December 2023 (US$ 264 billion at end-December 2022). It is worth mentioning that spending ran 16% ahead of budget in 2023. This policy recalibration reflects a decision to make more use of the fiscal space to support strong non-oil economic growth and press ahead with economic and social priorities under the Vision 2030 strategic development plan. Saudi Arabia's 2024 budget projects fiscal deficits over the medium term, of around 2% of GDP, marking a shift away from the previous set of medium-term figures that projected annual surpluses and a decline in government debt/GDP.

At the banking industry level, the Saudi banking sector reported a sound growth in 2023 and in the first quarter of 2024. Measured by the aggregation of assets of banks operating in the Kingdom, banking activity reported a growth of 9.3% in the year 2023 and by 3.9% in the first quarter of 2024. Likewise, deposits grew by 7.8% in 2023 and by 5.0% in the first quarter of 2024. The noticeable growth was the one registered in shareholders equity over the first quarter of 2024 rising by 13.5%, after a moderate growth of 5.9% throughout 2023. High interest rates and tight liquidity conditions have weighed on credit growth in Saudi Arabia's banking sector, although it remained robust at 9.7% in 2023. Also, after strong growth over the past few years, new mortgage lending has slowed somewhat.

NOMINAL AND REAL GDP



Sources: IMF, Bank Audi's Group Research Department

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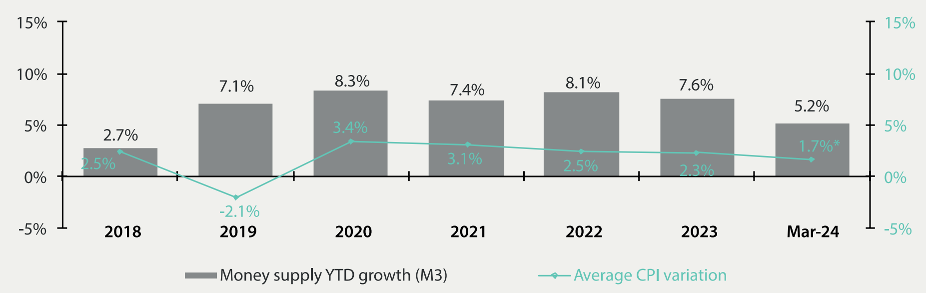
At the capital markets level, activity was at the mirror image of the overall economy. The share price index which expanded by 14.2% in 2023 contracted by 3.9% in the first five months of 2024. Subsequently, market capitalization moved from US$ 2,634 million at end-2022 to US$ 3,003 million at end-2023 and to US$ 2,793 million at end-May 2024. The fluctuation in prices comes within the context of moderating trading activity. Total trading value fell from US$ 456 million in 2022 to US$ 356 million in 2023. With respect to fixed income markets, the 5-year CDS spread, a measure of market perception of sovereign risks, moved from 61 basis points at end-2022 to 54 basis points at end-2023 and to 50 basis points at end-May 2024.

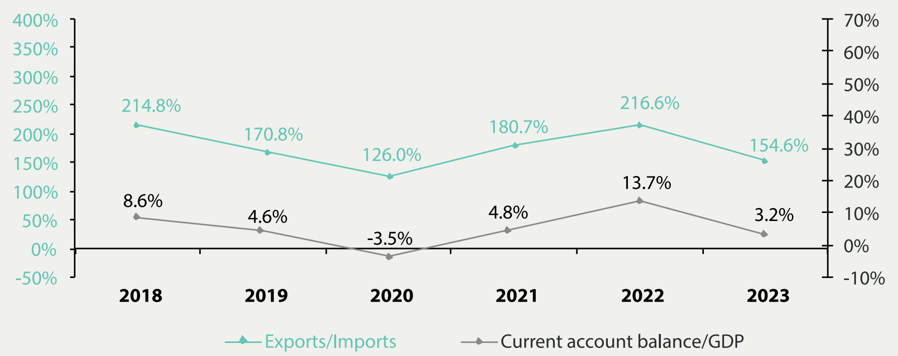
The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address Saudi Arabia's middle to long term economic outlook looking forward.

MONEY SUPPLY AND INFLATION



** Yearly average growth in the first 3 months*
Sources: Saudi Central Bank, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbon sector

Saudi's hydrocarbon sector enters into contractionary mode amid lower oil prices and production cuts

Saudi Arabia's hydrocarbon sector entered into a contractionary mode in 2023, amid lower global Brent oil prices (-3% on average year-on-year) and extended oil production cuts. Saudi oil revenues declined by 12.0% year-on-year to reach US$ 201.2 billion in 2023, against US$ 228.6 billion in the previous year, according to the Ministry of Finance. Accordingly, oil revenues accounted for 62.2% of total revenues in 2023, down from 67.6% in 2022.

On the back of lower oil prices and extended output cuts, the share of "mining and quarrying" fell from 33.0% of GDP in 2022 to 25.8% of GDP in 2023, as per Saudi National Accounts and the division of GDP by kind of economic activity.

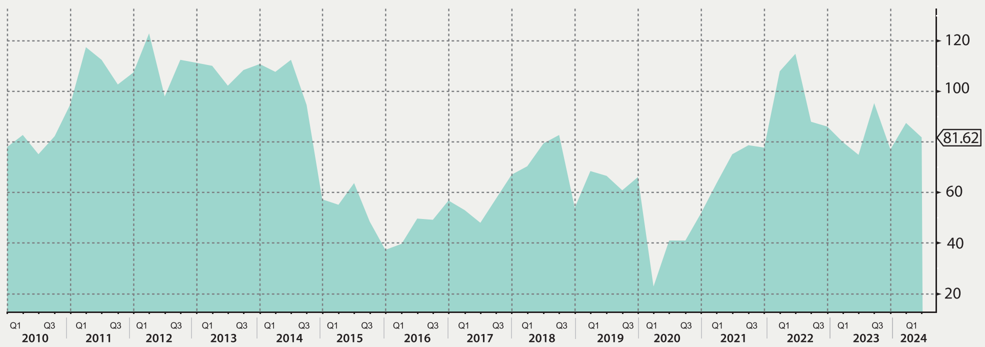
At the level of upstream oil production, Saudi Arabia's crude production remains heavily curtailed under the terms of the OPEC+ production cut agreements, thus showing an 8.6% year-on-year drop on average over the year 2023, with oil output moving from 10.541 mb/d on average in 2022 to 9.637 mb/d on average in 2023, and contracting further to an average of 9.008 mb/d over the first four months of 2024.

OPEC+ oil production cuts are set to remain in place until the end of 2025 with the aim of supporting the stability and balance of global oil markets. In details, OPEC+ members, including Saudi Arabia, are cutting output by a total of 5.86 million b/d in 2024, or about 5.7% of global demand. Those include 3.66 million b/d of cuts, which were due to expire at the end of 2024, and voluntary cuts by eight members (including Saudi Arabia) of 2.2 million b/d, expiring at the end of June 2024. Furthermore, the group recently agreed to extend the cuts of 3.66 million b/d by a year until the end of 2025 and prolonged the cuts of 2.2 million b/d by three months until the end of September 2024. Also, OPEC+ said that it would gradually phase out the voluntary cuts of 2.2 million b/d over the course of a year from October 2024 to September 2025.

Within this context, Saudi Arabia announced that it would extend its voluntary oil production cut of one million barrels per day, which was implemented in July 2023, until end-September 2024. It is worth noting that this voluntary cut is in addition to the voluntary cut of 500,000 b/d previously announced by the country in April 2023.

In parallel, Saudi's natural gas production went up by 3.4% year-on-year in 2023, down from an annual 5.0% growth in the previous year, to reach a total production of 130.3 billion cubic meters (bcm), according to Fitch Solutions.

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

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On the other hand, Saudi Arabia continues to emphasize the role of gas in the broader energy transition and is investing strategically to ramp up its domestic production and find a foothold in global LNG markets, as per Fitch Solutions. Among the operational highlights listed during the release of its full-year results for 2023, Aramco referenced progress on the Hawiyah Unayzah Gas Reservoir Storage, completion of the Hawiyah Gas Plant expansion, and the production of the first unconventional gas from South Ghawar. South Ghawar is the second unconventional project operating in the country, following on from the North Arabia field in 2018.

The Hawiyah expansion has increased gas processing capacity by 11.1 billion cubic meters (bcm), while the Hawiyah Unayzah storage facility, the first such storage facility in Saudi Arabia, would provide up to 21 bcm of gas for reintroduction into the Master Gas System by 2024. Additional sources of growth include the Tanajib gas plant, which is slated to come online in 2025, and would increase processing capacity for the Marjan, Safaniyah and Zuluf fields by around 27 bcm, coupled with the Jafurah gas project, which begins commercial operations in 2025, reaching over 20 bcm of annual output by 2030.

Looking forward, OPEC and its partners would start increasing oil output gradually. Within this context, the IMF expects Saudi oil output to reach 10 million barrels per day in early 2025, from what's now a near three-year low of 9 million barrels, noting that the Kingdom's production capacity is around 12 million barrels a day.

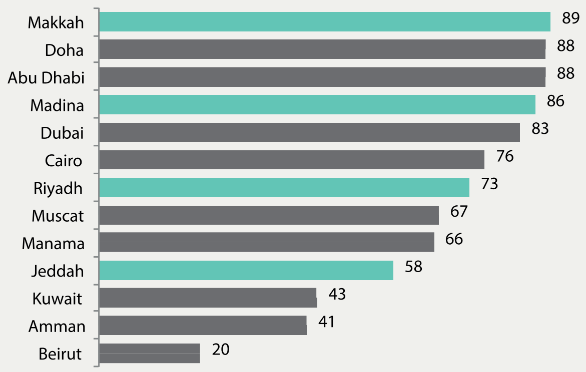
1.1.2. Non-Hydrocarbon Sector

Saudi Arabia's non-oil sector performance to stabilize in 2024 while remaining robust

Benefiting from the windfalls brought on by high oil prices in 2022, Saudi Arabia's investment in diversification efforts has increased drastically. This has led to positive indices in all non-oil sectors and an optimistic outlook looking forward as the country's Vision 2030 takes effect. These windfalls led to major increases in 2023 followed by a stabilization in 2024 albeit remaining robust with a positive outlook.

At the level of overall non-oil sector performance, business conditions have continuously improved since September 2020. The first five months of 2024 saw an average Purchasing Managers' Index (PMI) reaching 56.6 down by 2.4 points from an average PMI of 59.0 in the same period of 2023. This entails a continued improvement in non-oil sector performance albeit at a slower pace than the year prior. This comes as business activity and new order growth remained steep amid further reports of strong demand conditions especially in domestic markets. However, the upturn in sales was the least marked in just over two years. Additionally, the outlook for the future performance in the sector somewhat weakened in the first five months of 2024.

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



*January 2024

Sources: Ernst & Young, Bank Audi's Group Research Department

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At the level of the population, the upwards trend in household (HH) spending is forecasted to stabilize in 2024 leading to a more consistent growth pattern. In details, HH spending is forecasted to note a real grow of 4.3% during 2024 reaching US$ 437.4 billion, up from US$ 419.3 billion in 2023. This comes as a deceleration in HH spending is recording growth down from 5.6% noted between 2022 and 2023. The average growth per annum in the medium term (2025-2028) is expected to pick up pace again to stand at 5.2% per year. In addition to this, prices are expected to moderate further in 2024 to register 1.9% and is expected to marginally increase to 2.0% in 2025, as per BMI.

At the level of infrastructure and construction, outlook for activity in these sectors for the next 10 years remains positive due to the country's economic diversification efforts. These efforts will particularly impact transport infrastructure activities.

In details, Saudi Arabia's megaprojects are crucial to achieve the country's goals which makes their abandonment unlikely, even amid weakened revenues from oil. Additionally, the implementation of Vision 2030 will see robust spending by the Public Investment Fund and other government-related entities, which remains highly supportive of infrastructure and building construction projects. This is expected to pose an upside risk towards the financing of projects, especially those that are of significant contribution towards Saudi Arabia's project pipeline.

Looking at the construction industry, a real growth of 3.1% is forecasted in 2024 to reach a value of SR 208.7 billion (US$ 55.6 billion), up from SR 198.8 billion (US$ 53.0 billion) in 2023. On the medium term (2025-2029), a yearly real growth of 4.3% is forecasted in the industry's value with a yearly real growth of 4.0% expected on the long term (2025-2033), as per BMI.

In parallel, the infrastructure industry is forecasted to notice a 2.8% growth year-on-year in 2024 to reach SR 118.5 billion (US$ 31.6 billion). The growth trend is expected to remain on the medium term with a yearly real growth of 3.6%, and in the long term with a yearly real growth of 3.4%.

At the level of tourism, an upward trend in tourism arrivals to Saudi Arabia is forecasted in the BMI studied period (2024-2027) with a yearly average growth rate of 7.7%. In 2024, arrivals are expected to grow by 18.9% year-on-year reaching 31.3 million. Saudi Arabia's arrivals are set to continue increasing, supported by additional marketing efforts to promote the market as a leisure travel destination, investments in hotels and resorts and increasing transport links with source markets. As a result of the growth in tourism arrivals, receipts from international tourism are forecasted to also notice an upward trend. In 2024, International Tourism Receipts are forecasted to reach SR 89.5 billion (US$ 23.9 billion) which denotes a year-on-year growth of 19.2%, up from SR 75.1 billion (US$ 20.0 billion) in 2023. In the medium term (2025-2027), a yearly average growth rate of 4.4% is expected with receipts reaching SR 101.9 billion (US$ 27.2 billion) in 2027.

At the level of the hospitality sector, Saudi Arabia's 4 and 5 star hotels in the cities of Jeddah, Makkah, Riyadh and Madinah posted a mostly positive performance in January 2024. In Jeddah, year-on-year increases of 11.8%, 9.0% and 36.6% were recorded in occupancy rate, Average Room Rate (ARR) and Revenue Per Available Room (RevPAR) respectively against figures from the same month of the year prior. Makkah also noted improvements in performance during January 2024 with year-on-year increases in occupancy rates (0.7%), ARR (15.1%) and RevPAR (16.0%) against the same month of the year prior. Riyadh posted increases in ARR (10.1%) and RevPAR (6.4%) and a decrease in occupancy rate of 2.5% in January 2024 against figures from January 2023. Madinah also posted increases of 31.1% and 27.9% year-on-year in the fields of ARR and RevPAR during the aforementioned period. However, occupancy rate in Madinah decreased by 2.2% year-on-year in January 2024 against the same month of the year prior, according to EY's Hotel Benchmark Survey for January 2024.

Looking at the future outlook for the Saudi hospitality sector, BMI forecasts an increase of 3.9 percentage points in hotel occupancy rate during 2024 to reach 74.2%. It is expected that the occupancy rate will follow an upwards trend between 2025 and 2028, reaching 82.2% occupancy rate in the latter.

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1.2. EXTERNAL SECTOR

Saudi Arabia's external sector performance set to weaken further in 2024

During 2023, following 2022's boosted performance on the back of high oil prices, Saudi Arabia's external sector relatively rationalized, reporting decreases in the country's Balance of Trade (BoT) and Current Account (CA). This trend is expected to continue downwards in 2024 amid OPEC+ oil production cuts and global economic weakness before rationalizing up in 2025 and improving in the medium term (2026-2029).

At the level of foreign trade, Saudi Arabia's BoT surplus showed a drop of 48.9% year-on-year reaching SR 424.1 billion (US$ 113.1 billion) in 2023, down from SR 829.9 billion (US$ 221.3 billion) in 2022. This comes following a 79.4% jump year-on-year noticed in the BoT between 2021 and 2022. The main drivers standing behind this contraction in BoT surplus during 2023 are a 22.2% contraction year-on-year in total exports and a 9.0% increase in imports year-on-year between 2022 and 2023, as per data from the Saudi General Authority for Statistics (GASTAT).

In details, total exports were reported at SR 1.2 trillion (US$ 320.0 billion) in 2023, registering a 22.2% decrease from the figures recorded in 2022. The majority of exports (77.3%) were from the oil sector with the non-oil sector accounting for 17.4% of exports.

The breakdown of exports by category shows that exports of mineral products held the biggest share of exports with 77.7% of the total, followed by exports of the chemical or allied industries representing 6.7% of the total and exports of plastics and articles thereof with 5.7% of the total during 2023.

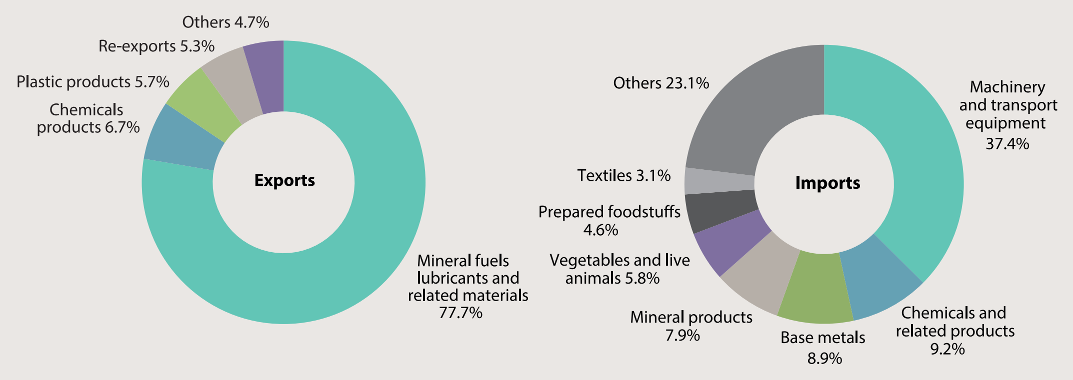
The breakdown of exports by country importing from Saudi Arabia during 2023 indicates that China held the biggest share with 16.6% of total exports, followed by Japan (10.2%), India (9.4%), South Korea (8.9%), UAE (5.2%) and the USA (4.9%), as per data from GASTAT.

On the other hand, total imports were reported at SR 776.0 billion (US$ 206.9 billion) in 2023, registering a 9.0% expansion from the figures recorded in 2022.

The breakdown of imports by category shows that imports of machinery and mechanical appliances held the biggest share with 22.2% of total imports, followed by imports of vehicles, aircrafts, vessels and associated transport equipment representing 15.3% of total imports and imports of products of the chemical or allied industries with 9.2% of total imports during 2023.

The breakdown of imports by country exporting to Saudi Arabia during 2023 indicates that China held the biggest share with 20.9% of total imports followed by the USA with 9.1%, UAE (6.4%), India (5.6%), Germany (4.4%) and Japan (4.0%), as per data from GASTAT.

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY 2023



Sources: General Authority for Statistics, Bank Audi's Group Research Department

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According to the International Monetary Fund (IMF), imports to Saudi Arabia are forecasted to grow by 12.7% in 2024 and by 14.3% in 2025. Between 2026 and 2029, the IMF forecasts an average growth rate of 4.3% per year in imports to Saudi Arabia. In parallel, exports from Saudi Arabia are forecasted to decrease marginally by 0.8% in 2024 and is set to increase by 12.1% year-on-year in 2025. Between 2026 and 2029, the IMF forecasts an average growth rate of 4.7% per year in exports from Saudi Arabia. This shows that between 2026 and 2029, BoT surplus is set to pick up pace again following a downward trend between 2023 and 2025.

On the other side of the external sector, the latest available figures by Saudi Central Bank showed that the current account has recorded a 77.5% drop year-on-year to reach SR 127.8 billion (US$ 34.1 billion) in 2023, up from SR 568.2 billion (US$ 151.5 billion) in the year prior. This comes primarily as the goods and services account marked a year-on-year drop of 57.7% in 2023 against figures from 2022.

The financial account has also noticed an 84.2% drop year-on-year in 2023 driven by notable decreases in various types of investments as well as in reserve assets. In parallel, the capital account has increased its deficit significantly (68.8%) between 2022 and 2023, as per data from the Central Bank of Saudi Arabia.

Looking forward, according to the IMF, the current account in the country is expected to record a surplus of 0.5% of GDP in 2024, down from 3.9% of GDP in the year prior. Looking forward, in the medium-term (2025-2029), the IMF forecasts a current account deficit in Saudi Arabia with the average standing of circa -2.0% of GDP per annum.

1.3. PUBLIC SECTOR

Fiscal balance returns to negative on oil production cuts and expansionary spending policies

The fiscal balance in Saudi Arabia returned to the negative side in 2023, amid lower oil prices and additional voluntary production cuts, and given the Kingdom's strategic expansionary policy aimed at implementing comprehensive structural reforms that would drive sustainable economic growth.

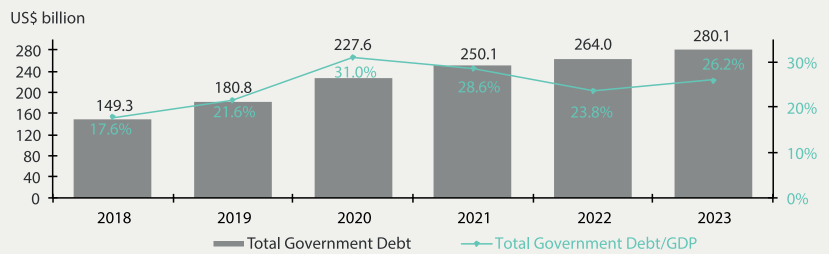
Total revenues reached SR 1,212.3 billion in 2023 (US$ 323.3 billion), down by 4.4% compared to the year 2022, yet 7.3% higher than budgeted revenues. Going further into details, oil revenues dropped by 12.0% year-on-year, moving from SR 857.3 billion (US$ 228.6 billion) in 2022 to SR 754.6 billion (US$ 201.2 billion) in 2023. This is mainly explained by (1) the Kingdom's voluntary cut of one million barrels per day that was

SAUDI ARABIA'S PUBLIC FINANCES

(SR billion)	2018A	2019A	2020A	2021A	2022A	2023A	2024B
Total revenue	906	927	782	965	1,268	1,212	1,172
Oil revenue	611	594	413	562	857	755	-
Non-oil revenue	294	332	369	403	411	458	-
Expenditure	1,079	1,059	1,076	1,039	1,164	1,293	1,251
Budget balance	-174	-133	-294	-73	104	-81	-79
Gross public debt	560	678	854	938	990	1,050	1,103

Sources: Saudi Central Bank, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

first implemented in July 2023, and which came as an addition to a broad supply-limiting deal first agreed by some members of OPEC+ in April 2023 to achieve balance and stability in global oil markets, and (2) as Brent crude futures contracts amounted to US$ 82.2 per barrel on average over the year 2023 against US$ 99.0 per barrel on average over the year 2022.

On the other hand, non-oil revenues expanded by 11.4% in 2023 when compared to the previous year to reach SR 457.7 billion (US$ 122.1 billion). This is mainly explained by an increase in corporate income tax revenues as a result of the improvement in the performance of economic sectors, and as the government has undertaken endeavors to increase taxpayers' compliance through technical solutions by using e-invoicing for tax revenue collection processes.

On the spending front, total public expenditures reached SR 1,293.2 billion (US$ 344.9 billion) in 2023, up by 11.1% relative to the previous year, and compared to an originally planned spending of SR 1,114 billion. The overrun signals the Kingdom's adoption of strategic expansionary spending directed to promising sectors with sustainable economic and social returns, which in turn contributes to the diversification of the economic base, in addition to increased social spending. In fact, "Capital Expenditures" expanded significantly by 30% in 2023 compared to the year 2022, reaching SR 186.5 billion (US$ 49.7 billion), as the Saudi government continued to spend on mega projects, including the NEOM project and the Third Saudi Expansion Project for the Holy Mosque, in addition to continuous spending on service construction (establishment of parks; water stations and networks, the enhancement of desalinated water sources), and spending on domestic airports. That being said, the fiscal balance in Saudi Arabia returned to negative territory, with the Kingdom recording a fiscal deficit of SR 80.9 billion (US$ 21.6 billion) in 2023, the equivalent of 2.0% of GDP.

In parallel, the total public debt grew by 6.1% in 2023 or the equivalent of SR 60.2 billion to stand at SR 1,050.3 billion at year-end, accounting for 26.2% of GDP, up from 23.8% in 2022. The internal debt, which represents 61.4% of the total public debt, rose by 4.8% or the equivalent of SR 29.4 billion over the year 2023 to reach SR 644.4 billion at year-end. Also, the external debt expanded by 8.2% or the equivalent of SR 30.8 billion in 2023, noting that the Kingdom has tapped international bond markets twice in 2023 with the sale of Islamic and conventional bonds for a total of US$ 16 billion to plug its deficit.

Finally, it is worth mentioning that Saudi Arabia approved in December 2023 the 2024 Budget, with estimated total revenues of QR 1,172 billion, which marks an increase of 3.7% compared to the 2023 budget, yet down by 3.3% relative to actual revenues for the year 2023. In parallel, total spending is estimated at SR 1,251 billion for the year 2024, up by 12.3% relative to the year 2023 budget, yet down by 3.3% relative to 2023 actual spending. Accordingly, Saudi Arabia is expected to record a budget deficit of SR 79 billion in 2024, compared to a budgeted surplus of SR 16 billion in 2023, and an actual deficit of SR 81 billion for the year 2023.

Looking forward, Saudi fiscal policy would continue to revolve around achieving a balance between the objectives of economic growth, maintaining fiscal sustainability, developing non-oil revenues, raising spending efficiency, and increasing the participation of the private sector in the economy.

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1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Moderating inflationary pressures helped by subsidies and strong US dollar

Saudi monetary conditions were marked this year by moderating inflationary pressures in a higher-for-longer global rate environment, while FX buffers resumed their growth, and the Saudi Central Bank's key policy rates continued to move in tandem with the US Federal Reserve's policy.

In details, Saudi inflation moderated further during the first quarter of 2024, averaging 1.7% year-on-year, in line with global trends, and in part contained by domestic subsidies/price caps and a strong Saudi Riyal reflecting the US dollar peg. This followed a 2.5% and 2.3% average increase in consumer prices in 2022 and 2023 respectively. The breakdown of the Consumer Price Index by segment over the first quarter of 2024 shows that the housing, water, electricity, gas, and other fuels segment, which has a weight of 25.5% in the Consumer Price Index, registered the largest yearly expansion of 8.4% in the first quarter of 2024, followed by the restaurants and hotels segment with +2.4%, the recreation and culture segment with +1.2%, the education segment with +1.2%, and the food and beverages segment with +1.1% (with a weight of 18.8%). In contrast, the clothing and footwear segment registered the largest yearly contraction in the first quarter of 2024 of 4.0%, followed by the furnishings & household equipment segment with -3.2%, the communication segment with -1.9%, the transportation segment with -1.3% (with a weight of 13.1%), the miscellaneous goods and services segment with -1.1%, the health segment with -0.9% and the tobacco segment with -0.8%.

Given the Saudi riyal peg to the US dollar at SR/US$ 3.75, the Saudi Central Bank's key policy rates remained anchored to the US Federal Reserve. In fact, after lifting its repo and reverse repo rates four times in the first seven months of 2023 by a total 100 bps each, the Saudi Central Bank held interest rates unchanged at a current level of 6.00% and 5.50% respectively.

In parallel, the Saudi Central Bank's reverse assets expanded by US$ 18.4 billion over the first quarter of 2024 to reach US$ 455.3 billion at end-March, covering 68.9% of the money supply in local currency. This is mainly explained by a US$ 15.3 billion rise in "foreign currency and deposits abroad" and a US$ 3.4 billion increase in "investment in foreign securities" over the first quarter of 2024, noting that the Kingdom has raised US$ 12 billion in January 2024 from the sale of a triple-tranche bond. This followed a US$ 22.9 billion contraction in the Saudi Central Bank's reserve assets in 2023, as financial account outflows in the form of investments abroad outweighed the current account surplus, which narrowed to an estimated 3.2% of GDP in 2023, around US$ 117 billion smaller than in 2022 due to lower oil revenue and high imports.

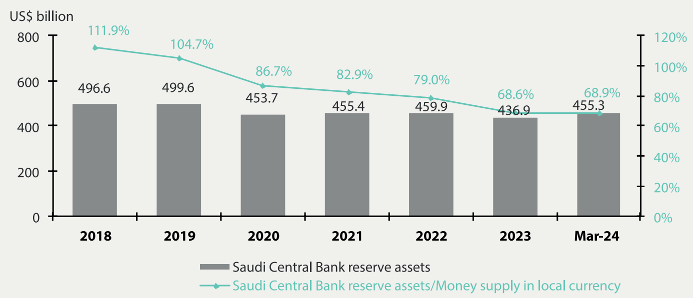
Regarding monetary aggregates, the narrow measure of money supply (M1) grew by 7.2% during the first quarter of 2024 (the equivalent of US$ 29.4 billion), reaching US$ 435.9 billion at end-March, mainly due to a 7.2% growth in "demand deposits" (the equivalent of US$ 25.3 billion). This followed a 0.3% contraction in (M1)

EVOLUTION OF MONETARY SITUATION

Variations (US$ million)	2018	2019	2020	2021	2022	2023	Mar-24
Net foreign assets	-5,207	-8,977	-45,543	-21,163	16,838	-34,412	15,608
Saudi Central Bank	670	4,469	-44,882	-10,989	2,301	-23,350	17,137
Commercial Banks	-5,877	-13,446	-661	-10,174	14,537	-11,062	-1,528
Domestic Assets	24,158	50,044	76,835	87,984	84,755	74,150	27,097
Claims on private sector	10,678	27,005	57,579	72,439	68,132	61,122	21,448
Claims on public sector	13,496	20,938	14,586	11,301	7,880	8,005	2,778
Claims on Nonfinancial Public sector Enterprises	-15	2,102	4,670	4,244	8,744	5,024	2,871
Total Money (M3)	12,926	35,065	43,767	42,547	49,747	50,659	36,907
Money Supply (M1)	12,342	18,004	53,484	20,160	-9,693	-1,043	29,437
Quasi-Money	584	17,061	-9,716	22,388	59,440	51,702	7,470
Government Deposits	-14,993	-15,613	-10,111	-12,617	15,034	-37,929	-2,079
Other Items (Net)	21,018	21,614	-2,364	36,891	36,813	27,009	7,877

Sources: Saudi Central Bank, Bank Audi's Group Research Department

FOREIGN EXCHANGE MARKET INDICATORS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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in 2023. The broader money supply (M2), which grew by 9.4% in 2023, widened further by 3.8% during the first quarter of 2024 (the equivalent of US$ 23.9 billion) to reach US$ 660.8 billion at end-March amid a US$ 5.6 billion decrease in "time and saving deposits". The money supply in its broadest sense (M3) expanded by 5.2% during the first quarter of 2024 (the equivalent of US$ 36.9 billion) to reach US$ 753.0 billion at end-March, within the context of a significant rise in quasi-money deposits of 16.4%. This followed a 7.6% expansion in (M3) in 2023. Given a higher growth in demand deposits than money supply (M3) during the first quarter of 2024, the demand deposits to broader money supply (M3) ratio reached 49.8% at end-March 2024, up from 48.9% at end-December 2023. In parallel, the M1/M3 ratio was quoted at 57.9% at end-March 2024, up from 56.8% at end-December 2023.

In the coming period, headline inflation is expected to remain contained, mainly moderated by subsidies, price caps on certain products, and a slowdown in the real estate market due to higher financing costs, while the Saudi Central Bank would continue to follow the lead taken by US Federal Reserve, given the currency peg.

1.4.2. Banking Activity

Continuing sound activity growth for the Saudi banking sector

The Saudi banking sector reported a sound growth in 2023 and in the first quarter of 2024. Measured by the aggregation of assets of banks operating in the Kingdom, banking activity reported a growth of 9.3% in the year 2023 and by 3.9% in the first quarter of 2024. Likewise, deposits grew by 7.8% in 2023 and by 5.0% in the first quarter of 2024. The noticeable growth was the one registered in shareholders equity over the first quarter of 2024 rising by 13.5%, after a moderate growth of 5.9% throughout 2023.

High interest rates and tight liquidity conditions have weighed on credit growth in Saudi Arabia's banking sector, although it remained robust at 9.7% in 2023. Also, after strong growth over the past few years, new mortgage lending has slowed somewhat. At the same time, deposits have been lagging lending growth.

According to S&P, Saudi banks will likely report strong-but-slower credit growth of 8%-9% in 2024 due to

BANKING SECTOR RATIOS

	2018	2019	2020	2021	2022	2023	Mar-24
Banking sector dimension in economy							
Assets/GDP	75.5%	83.7%	108.2%	100.0%	87.1%	98.8%	99.1%
Deposits/GDP	52.7%	57.1%	70.6%	64.2%	55.2%	61.8%	62.6%
Loans to private sector/GDP	43.8%	47.4%	61.9%	59.9%	53.4%	60.9%	60.5%
Loans to public sector/GDP	1.7%	2.0%	2.9%	2.9%	3.1%	3.7%	3.8%
Growth rates (YTD)							
Assets	2.0%	9.7%	13.2%	10.0%	10.5%	9.3%	3.9%
Loans to the private sector	2.8%	7.3%	14.3%	15.3%	13.1%	9.7%	3.0%
Investments	8.4%	18.7%	12.7%	6.1%	8.1%	10.4%	3.2%
Deposits	2.5%	7.3%	8.2%	8.3%	9.1%	7.8%	5.0%
Capital and reserves	-4.3%	13.0%	9.9%	11.3%	4.3%	5.9%	13.5%
Profit growth (year-on-year)	9.8%	4.5%	-23.1%	39.2%	28.6%	11.7%	-
Financial ratios							
Primary liquidity/Deposits	19.7%	19.5%	20.2%	15.5%	13.9%	13.1%	14.2%
Liquid assets/Deposits	49.4%	52.3%	54.4%	49.0%	47.1%	47.1%	47.6%
Loans to the private sector/Deposits	83.0%	83.0%	87.7%	93.3%	96.8%	98.5%	96.7%
Loans to the public sector/Deposits	3.2%	3.4%	4.1%	4.5%	5.6%	5.9%	6.1%
Total loans/Deposits	86.2%	86.4%	91.7%	97.9%	102.3%	104.5%	102.8%
Capitalization							
Capital accounts/Assets	14.7%	14.9%	14.0%	14.4%	14.0%	13.7%	13.3%
Profitability							
ROAA	2.03%	2.00%	1.38%	1.72%	2.01%	2.04%	2.06%
ROAE	13.5%	13.5%	9.6%	12.1%	14.1%	14.8%	15.3%

Sources: Saudi Central Bank, Bank Audi's Group Research Department

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lower mortgage lending growth and tight liquidity. This compares with 10% credit growth reported on Dec. 31, 2023, which was in line with S&P's expectations. Corporate lending growth will benefit from Vision 2030 projects and the ensuing stronger economic activity. The rating agency expects mortgage lending growth to slow further in 2024 due to high rates and market maturity.

S&P expects the Saudi government and its related entities will continue to inject deposits into the banking system to support the banks' credit growth. The contribution of government and government-related entities' deposits increased to 30% of the total by 2023 from almost 20% in 2020.At the same time, they could see higher recourse to external funding. While Saudi banks remain in a net external asset position, this declined over the past couple of years, a trend S&P thinks will continue. A rapid buildup of external debt could increase Saudi banks' vulnerability to global liquidity conditions, in their view. Domestic liquidity conditions normalized toward the end of 2023. The banks' loans to deposits reached close to 100% in 2023, compared with 86% in 2019.

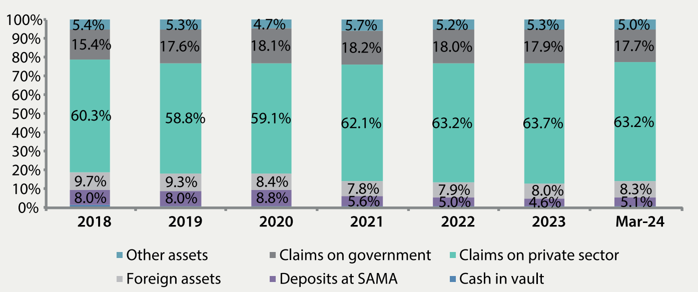
Despite high interest rate over the past two years, asset quality indicators were broadly stable. High exposure to mortgages, primarily for government or its related entities employees, and systematic write-offs of impaired retail exposures supported the banks' NPL ratios in 2023. Nevertheless, S&P expects high interest rates to start weighing on corporate creditworthiness in 2024. Based on a sample of 150 companies across sectors, leverage increased slightly in September 2023 but remained manageable on average.

S&P expects credit growth to support banks' profitability. The banks' RoA is likely to stabilize at 2.2%, similar to their estimate for 2023. Toward the second half of 2024, they expect slight margin compression from lower interest rates. Almost half of Saudi banks' lending book is corporate loans with floating rates, while almost 50% of the banks' funding was non-interest-bearing as of December 2023. Corporate loans will reprice downwards leading to some pressure on the banks' net interest margins. However, as interest rates increased fast over the past 18 months, S&P expects to see some impact on corporate creditworthiness, leading to higher NPLs. However, they expect the impact to be marginal because Saudi corporates have relatively manageable leverage.

According to Moody's, Saudi banks' net interest margins will likely narrow in 2024 after remaining broadly flat during 2023 as their funding costs rise amid tight sector liquidity. Inflows of domestic deposits are insufficient to fund buoyant credit demand, causing a shortage of non-interest bearing deposits in the system and a shift in banks' funding profiles as they turn to alternative, more costly funding sources. At the same time asset yields have peaked and will provide limited upside to offset higher funding costs. Nevertheless, banks will continue to post strong net profits owing to a robust credit volume that will support overall net interest income, while fee-related income remains strong.

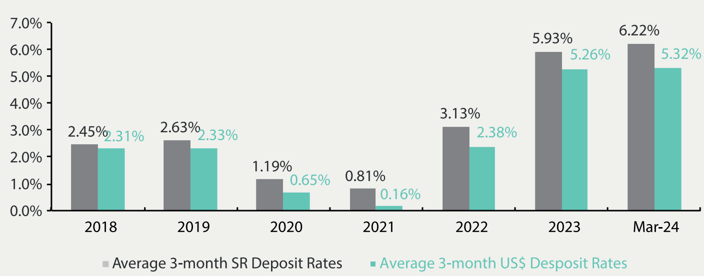
Saudi banks posted record earnings last year amid high interest rates as lending soared, fueled by the country's economic diversification projects. Their net interest margins remained broadly flat, however, as

BANKING SECTOR ASSET COMPOSITION



Sources: Saudi Central Bank, Bank Audi's Group Research Department

BANKING SECTOR DEPOSIT RATES



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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the cost of funding rose in tandem with asset yields. The higher interest paid on deposits reflects both a higher interest rate environment and fierce competition for deposits in the country. A reversal in interest rates would ease pricing pressure on deposits, but banks' deposit mix has shifted considerably over the years. Interest bearing deposits are growing at a faster pace than non-interest bearing deposits as customers seek higher returns on their savings. Accordingly, the share of non-interest bearing deposits fell to 54% in Q1 2024 from 65% in Q4 2021 as per Moody's.

Finally, Saudi banks are well-capitalized. They reported a capital adequacy ratio of 20.1% at end-December, 2023 (Equity to assets ratio at 13.7%). S&P expects rated banks' capitalization to remain a positive rating factor. Banks are profitable and their earnings generation are sufficient to cater for asset growth at large.

1.4.3. Equity and Bond Markets

Saudi capital markets under downward price pressures this year

Saudi capital markets came under downward price pressures over the first five months of 2024. Saudi equities were weighed by heightened regional geopolitical tensions, extended voluntary production cuts and some downbeat corporate earnings. Concomitantly, Saudi debt papers recorded price contractions over this year, mainly tracking US Treasuries move after recent indicators suggested that US economic activity continued to expand at a solid pace while inflation remained elevated, cementing bets about delayed US interest rate cuts, while leaving the door open for an interest rate hike this year.

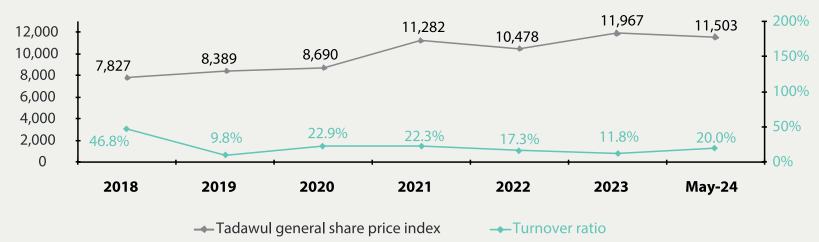
The Saudi Exchange slid into the red over the first five months of 2024, as reflected by a 3.9% contraction in the Tadawul All-Share Index to reach 11,503.49 at end-May, mainly pressured by (1) some unfavorable 2024 first quarter financial results in the petrochemicals sector amid extended voluntary oil production cuts, which resulted into an 8% year-on-year contraction in the aggregate net profit of Saudi-listed companies (including Saudi Aramco) in the first three months of 2024; (2) the IMF lowered its forecast for economic growth in Saudi Arabia from 4.0% to 2.6% in 2024 in its April 2024 World Economic Outlook; (3) intensified geopolitical strife in the region; and (4) concerns about delayed US Fed interest rate cuts this year and as prospects of an US interest rate hike emerged.

SELECTED STOCK MARKET INDICATORS

	2018	2019	2020	2021	2022	2023	May-24
Market capitalization (US$ billion)	495.7	2,406.8	2,427.1	2,669.1	2,634.2	3,002.5	2,729.5
Trading value (in US$ billion)	232.2	234.7	556.7	596.2	455.5	355.5	227.5
Number of transactions (in millions)	25.0	28.4	76.7	91.9	87.9	94.0	55.0
General share price index (base 1999=100)	7,827	8,389	8,690	11,282	10,478	11,967	11,503
Number of listed companies	190	199	203	210	223	231	234
Change in share price index	8.3%	7.2%	3.6%	29.8%	-7.1%	14.2%	-3.9%
Price/Earnings ratio	15.8x	19.5x	29.2x	20.6x	12.4x	17.6x	16.9x
Price/Book value ratio	1.8x	4.3x	4.4x	4.1x	3.5x	3.7x	3.3x
5-year CDS spread (bps)	105	57	65	49	61	54	50

Sources: Saudi Exchange, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Saudi Exchange, Bank Audi's Group Research Department

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The breakdown of the TASI by industry groups during the first five months of 2024 shows that the commercial and professional services sector registered the highest index contraction of 14.94%, followed by the consumer discretionary distribution & retail sector with -12.74%, the energy sector with -11.98%, the REITs sector with -11.18%, the banks sector with -9.80%, the materials sector with -8.32%, the telecommunication services sector with -7.85%, the pharma, biotech and & life science sector capital goods sector with -4.83%, the software & services sector with -4.47%, the consumer staples distribution & retail with -4.34% and the healthcare equipment and services sector with -0.02%. In contrast, the utilities sector reported the highest index expansion of 38.57%, followed by the insurance sector with +19.53%, the capital goods with +18.28%, the financial services sector with +15.04%, the transportation sector with +10.06%, the media & entertainment sector with +8.24%, the real estate management and development sector with +7.19%, the consumer durables and apparel sector with +5.84%, the food & beverage sector with +1.57% and the consumer services sector with +1.21%

Concomitantly, the total trading value in the Saudi Exchange expanded by 72.5% year-on-year during the first five months of 2024, reaching US$ 227.5 billion as compared to US$ 131.9 billion during the corresponding period of 2023.

The division of the total turnover by industry groups during the first five months of 2024 showed that five out of 21 sectors captured almost half of total activity (49.8%), namely the materials sector with 15.4%, the banks sector with 13.1%, the energy sector with 9.0%, the transportation sector with 6.4%, and the insurance sector with 6.0%.

In line with equity price falls during the first five months of 2024, the number of listed companies reached 234 at end-May 2024 against 231 at end-2023. Within this context, the Saudi market capitalization decreased by 9.1% over the first five months of the year, moving from US$ 3,002.5 billion at end-2023 to US$ 2,729.5 billion at end-May 2024. This followed a 14.0% expansion in the Saudi market capitalization in 2023. Given the significant expansion in total turnover year-on-year and the contraction in market capitalization, the annualized turnover ratio surged from 11.2% on the Saudi Exchange during the first five months of 2023 to 20.0% during the first five months of 2024.

In parallel, the Saudi fixed income market came under downward price pressures over the first five months of 2024, mainly tracking US Treasuries move as investors grew open to the possibility of an interest rate hike after US Fed minutes for April-May FOMC meeting showed that various Fed officials are willing to tighten policy further should risks to inflation materialize in a way that such an action became appropriate, and given an unexpected improvement in US consumer confidence in May 2024.

In details, Saudi sovereigns maturing in 2026, 2027, 2030 and 2031 registered price contractions ranging between 0.82 pt to 3.36 pts over the first five months of 2024. Prices of STC'29 decreased by 0.64 pt. SABIC'28 posted price declines of 2.02 pts. SEC'28 traded down by 2.28 pts. This followed across-the-board price expansions in 2023, mainly tracking US Treasuries move on prospects of the US Fed dovish stance.

As to new issues, Saudi Arabia tapped international bond markets twice so far this year for a total of US$ 17 billion. In details, the Kingdom raised US$ 12 billion In January 2024 from the sale of a triple-tranche bond, in its largest borrowing abroad since 2017. Saudi Arabia issued a six-year US$ 3.25 billion bond at a coupon of 4.75%, a 10-year US$ 4 billion bond at a coupon of 5.00% and a 30-year US$ 4.75 bond at a coupon of 5.75%. The bond sale attracted more than US$ 30 billion in orders. Also, Saudi Arabia raised US$ 5 billion in May 2024 from the sale of a US dollar-denominated triple-tranche Sukuk: a three-year US$ 1.25 billion Sukuk at 60 bps over US Treasuries, a six-year US$ 1.5 billion Sukuk at 75 bps over UST, and a 10-year US$ 2.25 billion Sukuk at 85 bps over UST. The triple-tranche Sukuk sale was four times oversubscribed.

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As to the cost of insuring debt, Saudi Arabia's five-year CDS spreads, which measure the market's perception of sovereign risks, contracted marginally by four basis points over the first five months of 2024 to reach 50 bps at end-May, staying well below the average regional sovereign five-year CDS spreads of 171 bps.

As to credit ratings, Fitch Ratings affirmed in February 2024 Saudi Arabia's long-term foreign currency Issuer Default Rating at "A+" with a "stable" outlook. Saudi Arabia's ratings reflect, as per Fitch, its strong fiscal and external balance sheets, with government debt/GDP and sovereign net foreign assets considerably stronger than both the "A" and "AA" medians, and significant fiscal buffers in the form of deposits and other public sector assets.

S&P Global Ratings affirmed in March 2024 its "A/A-1" long-term and short-term foreign and local currency unsolicited sovereign credit ratings on Saudi Arabia, with a "stable" outlook. The "stable" outlook reflects that S&P expects the government's wide-ranging reforms would continue to underpin the development of the non-oil sector and support non-oil growth and fiscal receipts. This is balanced against the cyclicality of a still hydrocarbon-focused economy, and fiscal pressures tied to the country's transformation plan and expanding population, as per S&P.

In the coming period, the development of Saudi Arabia's capital markets would likely play an important role in facilitating the realization of Vision 2030. A robust and high-quality local debt market is key to developing and transforming the economy and could contribute to the funding needs arising from large Vision 2030 projects, as per S&P.

CONCLUSION

Saudi Arabia has embarked on a significant, rapid economic and social transformation program under the Vision 2030. In the lead up to 2030, an acceleration of investment projects that seek to establish new industries, such as tourism, and diversify the economy away from its primary reliance on the upstream hydrocarbon sector, is expected. The IMF expects real GDP growth of 4.0% over the next five years, as per its World Economic Outlook issued in April (2.6% growth expected for 2024). In parallel, inflation is expected at 2.3% in 2024 and at an average of 2.0% over the next five years.

Within this environment, S&P projects that the government's net asset position will gradually fall but remain comfortably strong through 2027. They anticipate that there will be prioritization of projects, and that some investments will continue beyond 2030. Over the long term, they anticipate that Vision 2030 projects will bear fruit by creating a more diversified economy and revenue base, jobs for a young population, and broader workforce participation. However, they believe risks to execution could arise from funding pressures, tight supply, and increasing cost of materials, skills shortages, and developing basic infrastructure like housing.

At the external level, the significant improvement in the external position is expected to abate. The current account surplus would decline over the medium term as oil prices stabilize and imports pick up. With the ambitious Vision 2030 reform agenda underway and supported by sizeable investments—imports of both intermediate and final goods are expected to pick up. As the diversification strategy bears fruit over the medium term, non-oil exports are expected to increase although not at the same pace as imports. Net foreign assets—which exclude holdings of the PIF or Aramco—are expected to stabilize at a lower level, reaching a cover of around 13.8 months of imports or the equivalent of 36 percent of GDP by 2028 as per IMF forecasts.

At the fiscal level. the IMF forecasts a deficit to GDP ratio of 2.8% in 2024 (Debt to GDP at 27.5%) and an average of 2.2% over the next five years (Debt to GDP at an average of 29.5%), as per its World Economic Outlook issued in April. The medium-term fiscal stance should remain consistent with stabilizing the Central Government Net Financial Assets (CGNFA) ratio and intergenerational equity as per IMF.

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The analysis of the Kingdom's short to medium term outlook actually requires a careful examination of strengths and opportunities relative to the threats and challenges. At the level of the former, we mention the robust government balance sheet, supported by large foreign-currency buffers, the large economy, the high per-capita income and large stock of proved oil reserves and the improving government policy effectiveness.

At the level of risks constraining the outlook, we mention the high economic and fiscal vulnerability to declines in oil demand and prices, the longer-term risks stemming from global carbon transition, and the political risks stemming from longstanding regional geopolitical tensions. While risks and challenges are real, we believe strengths and opportunities far outpace threats at the foreseeable horizon.

Finally, in its last Article IV Consultation Mission Report, the IMF said the finalization of an anti-corruption strategy, the adoption of the Oversight and anti-corruption authority (Nazaha) by-laws and of a whistleblowers' protection law are urgently needed. Progress taken to prevent transnational aspects of corruption are encouraging, but further improvements will help ensure a more rapid disruption of the laundering of proceeds of foreign corruption. The authorities' industrial policy agenda should be supporting the impressive structural reform efforts while minimizing associated risks. The authorities' plans to include a cost-benefit analysis, impact evaluation, strict exit criteria, claw-back mechanisms, sunset clauses and time-bound incentives are welcome as they would help minimize risks and phase out policies as needed. Such targeted interventions should not be a substitute for broad-based structural reforms, which should continue to be rolled out. While the authorities' commitment to remain WTO compliant is welcome, preferential policies, such as local procurement for government contracts, are discriminatory and should be avoided, including because they could trigger retaliatory actions by trading partners at large.