ميفك كابيتال
MEFIC Capital

SAUDI ARABIA 2018 BUDGET REVIEW

December 2017

Flash Report

KSA 2018 Budget Review: Government spending is back to support the economy

Executive Summary and Review

Executive Summary

The key highlights of the 2018 Budget estimates are

- **Expenditure**: Government spending in 2018 to increase 20% year-on-year (YoY) to SAR 1,111 bn, the highest ever for Saudi Arabia. However, budget expenditure to be limited to SAR 926 bn (+5.6 YoY), with rest being taken up by National Development Funds (SAR 83 bn) and Public Investment Fund (SAR 50 bn).

- **Revenues**: Government estimates revenues to rise 12.5% YoY to SAR 783 bn, led by 11.8% rise in oil revenue and 13.7% increase in non-oil revenue.

- **Fiscal Deficit**: The fiscal deficit for 2018 is aimed at SAR 195 bn or 7.3% of GDP, indicating a 15.2% fall as compared to 2017 actual deficit of SAR 230 bn.

- **GDP growth**: The economy is expected to grow by 2.7% in 2018, as compared to -0.5% in 2017

- **Fiscal rebalancing**: The breakeven year for fiscal rebalancing is now postponed to 2023, as compared to 2020.

The key points of the 2017 Budget performance are

- **Fiscal target missed**: The 2017 fiscal deficit of SAR 230 bn (8.9% of GDP) was higher than the target SAR 198 bn, and also higher than analysts' estimates. Considering that 9M 2017 deficit was SAR 121.5 bn, it appears that government expenditure picked up in Q4 2017

- **Non-oil revenue growth helped meet full year total revenue target:** The full year non-oil revenues increased 28.6% YoY to SAR 256 bn, and were above estimated SAR 212 bn. The non-oil revenues helped offset the shortfall in oil revenues (SAR 440 bn, +33.7% YoY, but less than targeted SAR 480 bn). Full year revenues of SAR 696 bn just crossed over the targeted SAR 692 bn.

- **Expenditure accelerated in Q4 2017:** After controlling the expenditure tightly in 9M 2017 (only 0.5% YoY increase during the period), and witnessing the slowdown in overall economic growth and the consumption-related indicators (negative inflation, POS sales, ATM withdrawals), the government appears to have changed its stance and accorded higher priority to spending. Expenditure during Q4 2017 jumped 38% YoY to SAR 354 bn (38% of annual expenditure in Q4 vs 31% in 2016).

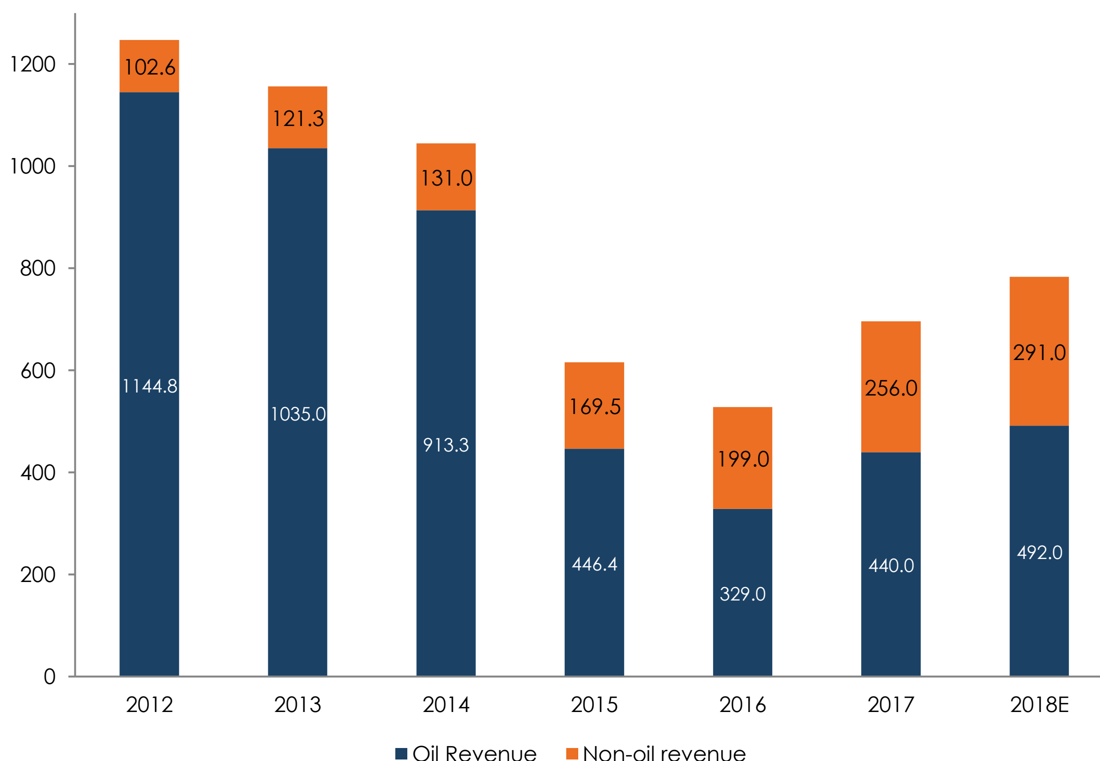
Oil revenues estimated to grow at slower pace than 2017; contribution to total revenues steady

Oil revenues are expected to increase by 11.8% YoY to SAR 492 bn. The estimated growth in oil revenues is lower than in 2017 (+33.7% YoY), partly due to curtailed production on account of deal extension, and because of high base effect. On the positive side, oil prices have steadily moved up over the past six months, thereby increasing the confidence in oil revenue projections being met. Oil revenues are expected to contribute 62.8% to total revenue. The past two years have witnessed oil revenue contribution at 62.3% (2016) and 63.2% (2017). As per the budget, the contribution of oil revenues to total revenues will progressively decline to 42% by 2023.

Non-oil revenues to grow faster than oil revenues

Non-oil revenues are expected to increase by 13.7% YoY to SAR 291 bn, which indicates nearly doubling of non-oil revenues since 2015. The increased revenues would be contributed by tax collections (estimated at SAR 85 billion) from VAT, expat fees, white land taxes etc. Electricity tariffs increases (announced before the Budget) will also help to shore up non-oil revenues by SAR 14 bn, as per the Electricity and Cogeneration Regulatory Authority (ECRA). Further, the Ministry of Energy has announced that energy price revisions will be specified in Q1 2018. The increase in non-oil revenue indicates that the transition of KSA from an oil-driven economy to a non-oil-dependent one is on track.

Figure 1: Revenue breakup (SAR bn)



Source: Ministry of Finance, E-Estimate

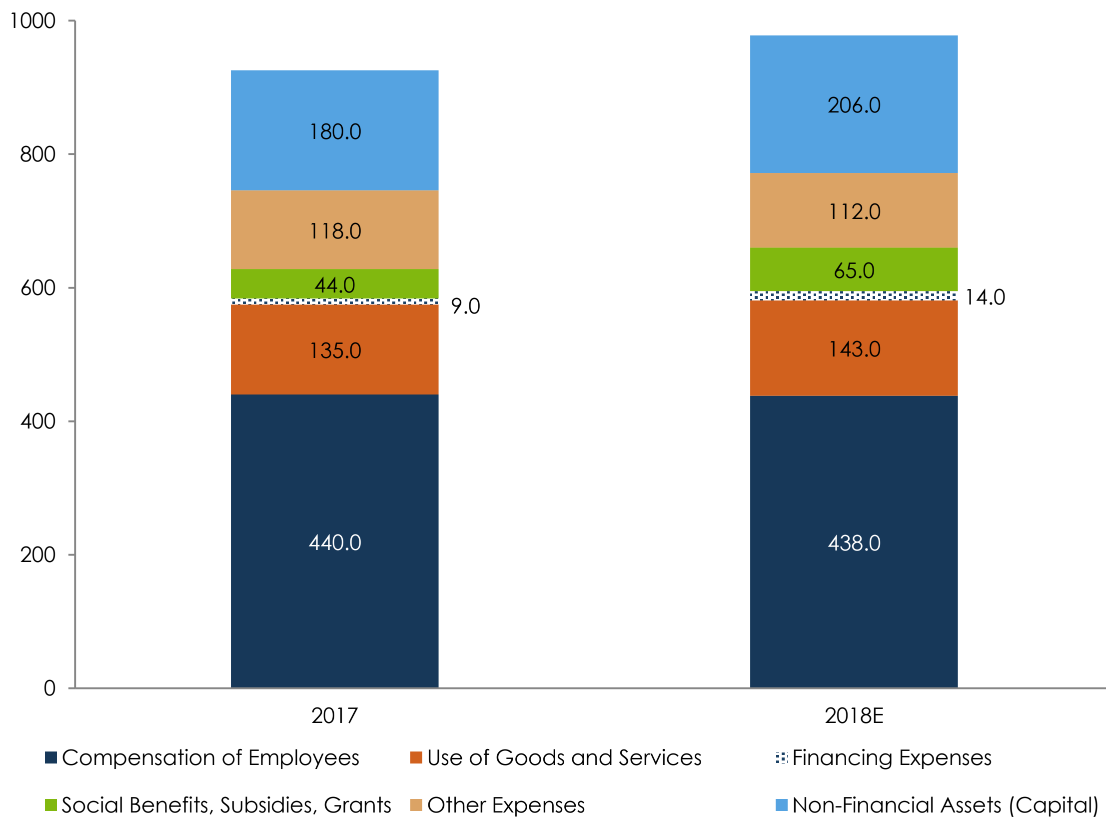
Expenditure to accelerate, and focus on capital spending to be favorable for the economy

The 2018 Budget expenditure is estimated to increase 5.6% YoY to SAR 978 bn, faster than the

4% rise recorded in 2017. The capital expenditure will rise at a fast clip of 13.9% to SAR 205 bn. Alongside spending by NDF (SAR 50 billion) and PIF (SAR 83 bn), which is mostly expected to be on specific projects/programs, the total capital expenditure for 2018 would equal SAR 338 bn, which is nearly double of budget capital expenditure in 2017. We may expect that sectors requiring capital expenditure, such as construction, utilities etc. would benefit from the capacity building investments by the government. In terms of current expenditure (increase of 3.6% to SAR 773 bn), the government appears to continue its path of disciplined expenditure. The new addition to current expenditure is the Citizens Account Program which will add SAR 30 bn in 2018, but is deemed necessary by the government to minimize the impact of higher fees, levies etc. on the lower and middle income households.

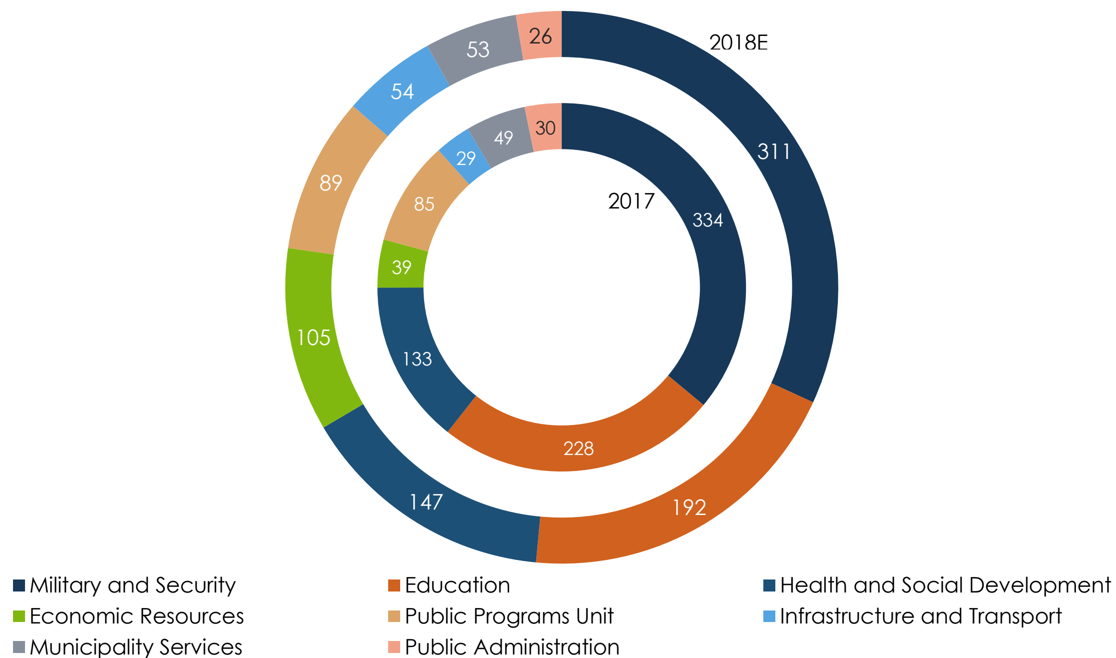
The sectoral allocations show a continued focus on key priority areas – military and security, health and social development, economic resources – which saw increased allocations in 2018 budget. Education and Public Programs Unit will bear the brunt of cuts in their budgetary allocations in 2018.

Figure 2: Estimated 2018 Expenditure vs. 2017 Expenditure (SAR bn)



Source: Ministry of Finance, E-Estimate

Figure 3: Budget allocation (Segment wise)



Source: Ministry of Finance, E-Estimate

Prior to the Budget announcement, the government had announced a private sector stimulus package of SAR 72 bn, to be spent over 16 initiatives over four years, and targeted at specific sectors such as housing, exports, manufacturing and at specific recipients such as small and medium enterprises, housing sector and technology companies. The Citizens Account Program, to directly transfer cash to low and middle income households and help them afford the higher energy prices, also appears to be specifically directed to the more vulnerable sections of the society.

Budgetary targets of 2017 fall short in the last quarter

The revenues for 2017 increased 31.8% YoY to SAR 696 bn, just above the target of SAR 692 bn. Non-oil revenues (+28.6% YoY) of SAR 256 bn exceeded the full year target of SAR 212 bn, led by implementation of select taxes in latter half of the year, and especially Q4 2017. Oil revenues, while increasing 33.7% YoY due to oil price rise, still fell short of the full year target SAR 480 bn. If not for the rise in oil prices during Q4 2017, the shortfall could have been higher. Non-oil revenues for Q4 2017 surged to SAR 113.2 bn, and made up for nearly half of 2017 non-oil revenues.

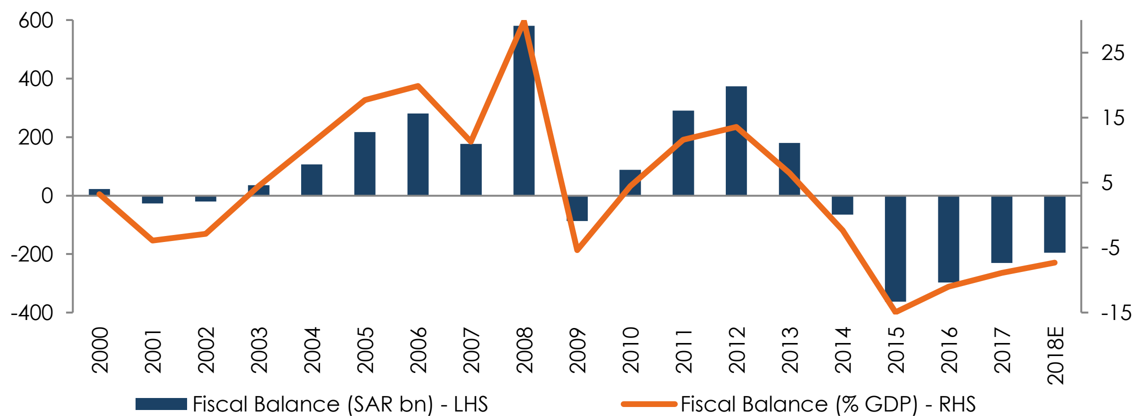
Expenditure for 2017 overshot the full year target by a large margin, due to sharp increase in expenditure during Q4 2017. Overall 2017 expenditure increased 12.2% YoY to SAR 926 bn, higher than estimated SAR 890 bn. Considering that 9M 2017 expenditure had increased only 0.5% YoY to SAR 571.6 bn, the implied expenditure in Q4 2017 of SAR 354.4 bn indicates a 38% YoY jump in expenses during the quarter. Even by historical standards of higher expenditures by governments during last quarter of the year, the quantum of expenditure in Q4 2017 was large (38% share of full year expenditure in 2017, vs 31% in 2016).

Fiscal deficit target for 2017 exceeded, and shifted to 2018

The fiscal deficit for 2017 was SAR 230 bn, higher than full-year target of SAR 198 bn, and exceeding analysts' estimates by a wide margin. Considering the slowdown in the economy, partly due to restricted fiscal spending in 9M2017, the government appears to have

prioritized spending over fiscal targets. The target for 2017 appears to have been shifted to 2018, with SAR 195 bn deficit aimed next year.

Figure 4: Annual Fiscal Balance (SAR bn)

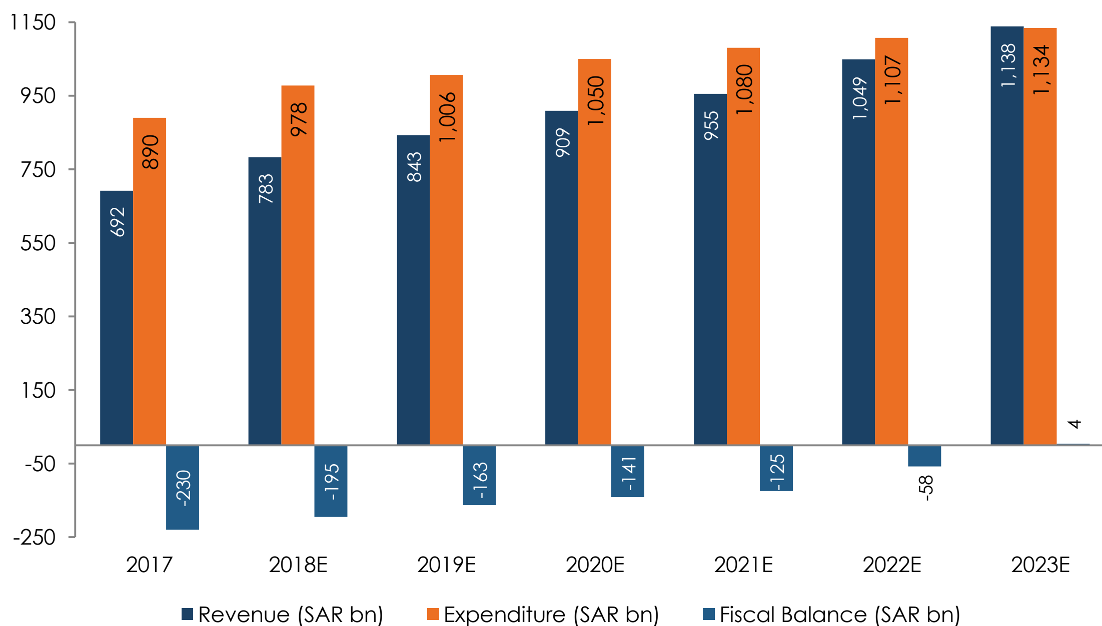


Source: Ministry of Finance, E-Estimate

Fiscal Balance Program now extended to 2023

The government's Fiscal Balance Program, with the earlier aim of balancing the budget by 2020, has been extended to 2023, giving the government more room and time to focus on reviving near term economic growth. The change was expected, as even IMF had suggested to the Saudi government about recalibrating the pace of fiscal reforms, so as to allow the economy to adjust to the changes introduced. Accordingly, the government has revised the program with gradual movement to fiscal rebalancing by 2023. The fuel price related reforms have been spread out over 2018 to 2023 period, with only jet fuel, benzene, diesel and electricity price revisions expected in 2018. Also, as part of the program, the government has put a cap on debt-to-GDP ratio of 30% and total reserves drawdown to USD 250 bn.

Figure 5: Revenue Expenditure and Fiscal deficit estimates till 2023 (SAR bn)



Source: Ministry of Finance, E-Estimate

Debt to GDP to increase to 21% by 2018 end

To finance the deficit in 2018, the government is estimated to issue debt of SAR 117 bn, thereby raising the total outstanding debt to SAR 555 bn or 21% of the GDP by end of 2018. During 2017, the government raised a total of SAR 108 bn in separate domestic and international issues, taking advantage of the favorable A-/A-2 sovereign rating by S&P. We expect the demand for Saudi sovereign debt to continue, as the debt to GDP ratio is still lower than comparable peers, and the oil market outlook looks favorable in the near term.

Risks to 2018 budget targets

The fiscal slippage in 2017 has highlighted the hard choices facing Saudi Arabian government in terms of balancing economic growth through budgetary support and maintaining fiscal discipline. The pressure has been partly alleviated by the success of the oil production cut deal between OPEC and select non-OPEC countries. Considering the external and internal dynamics, we believe the key risks to 2018 budget targets as follows

- **Domestic economy less responsive to government spending**: Consumer sentiment has been dampened in 2017 due to increase in electricity and fuel prices, as well as expat taxes and freeze on salary hikes and emoluments (though reversed during the year). It is difficult to gauge if consumer sentiment will revive fully in 2018, which will put non-oil revenue targets at risk.

- **Breakdown in adherence to oil production cut deal**: During the second half of 2017, the lead taken by Saudi Arabia in exceeding its production cuts resulted in greater adherence by other OPEC and non-OPEC countries, leading to rise in oil prices. However, the cuts are causing economic hardships to smaller countries with less forex reserves and there could be temptation to break away with increase in oil prices.

- **Geopolitical developments:** The geopolitical developments in the region, if taking a turn for the worst, would result in emergency spending, leading to fiscal considerations being accorded lower priority.

Conclusion

The 2018 Budget indicates the government has prioritized revival in the economy through targeted higher spending. The changed stance, in contrast to tightly controlled expenditure in 9M 2017, is expected to help certain parts of the economy regain momentum. The easing of fiscal rebalancing timeline to 2023 also gives the government more time and flexibility to respond to local macroeconomic trends and global oil market dynamics, while the roadmap with specific year-wise targets will keep the fiscal rebalancing plan on track. Notwithstanding risks like a domestic economy unresponsive to government expenditure, breakdown in oil production cut discipline by select producers or geopolitical developments, the Saudi government appears to be on the right track to revive economic growth and move forward on the long term path of 2030 goals.

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