MEFIC Capital
ميفك كابيتال

Q2 2018 BUDGET FLASH REPORT – SAUDI ARABIA

August 2018

Flash Report: Q2 2018 Budget Estimates Release – Reading Between the Lines

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Executive Summary and Review

Executive Summary

The key highlights of the Q2 2018 Budget are

- Saudi Arabia narrowed its budget deficit in Q2 2018 to SAR 7.36 bn, compared to SAR 34.33 bn in Q1 2018 and SAR 46.52 bn in Q2 2017. The overall deficit in H1 2018 (SAR 41.69 bn) accounts for just 21% of the total budgeted deficit for FY 2018.
- The deficit in Q2 reduced 84% on YoY basis and 79% on QoQ basis, mainly due to increase in oil revenue.
- Total revenue rose 67% YoY to SAR 273.6 bn, with oil revenue increasing 82% YoY to SAR 184.2 bn.
- Total expenditure increased 34% YoY to SAR 280.9 bn, mainly due increased expenditure on employee compensation, goods and services and social benefits.
- In terms of budget allocation, Economic Resources and Infrastructure & Transportation remain the most underspent sectors, with only 15% and 22% of the total annual budgeted expenditure utilized in H1 2018.
- The deficit for Q2 was mainly financed through borrowing amounting to SAR 12.1 bn. The Kingdom's public debt rose to SAR 536.9 bn (USD 143 bn) in H1 2018 compared to SAR 443.3 bn (USD 118 bn) at the end of 2017.
- Total debt issuance in H1 2018 increased to USD 25.0 bn, compared to USD 21.5 bn in FY 2017 and USD 17.5 bn in FY 2016.
- Debt to GDP ratio stands at 21% currently, which is on the lower side considering other GCC nations and Emerging Markets peers, and also well below the cap of 30% the government has put according to fiscal rebalancing program.
- We believe Saudi Arabia is on track to meet its full-year deficit target of SAR 195 bn, provided there are no major deviations in expenditure from the current trend. The fiscal deficit target equals 7.3% of 2018E GDP.

Q2 2018 Budget Review

Oil revenues increase 82% YoY mainly due to increased prices

Oil revenues amounted to SAR 184.2 bn in Q2 2018, constituting 67% of the total Q2 revenue. Oil revenues surged 82.4% YoY and 61.6% QoQ, due to increased prices and production volumes. Brent crude prices averaged USD 75.0/barrel in Q2 2018, compared to USD 67.2/barrel in Q1 2018, and USD 50.8/barrel in Q2 2017. Saudi Arabia started to increase its oil production during Q2 2018 after completing the required production cuts as per OPEC deal, with the daily average oil production amounting to 10.1 million barrels per day (mbpd) in Q2 2018, compared to 9.9 mbpd during Q1 2018, and 10.0mbpd during Q2 2017.

Non-Oil revenues increase 42% YoY and 71% QoQ

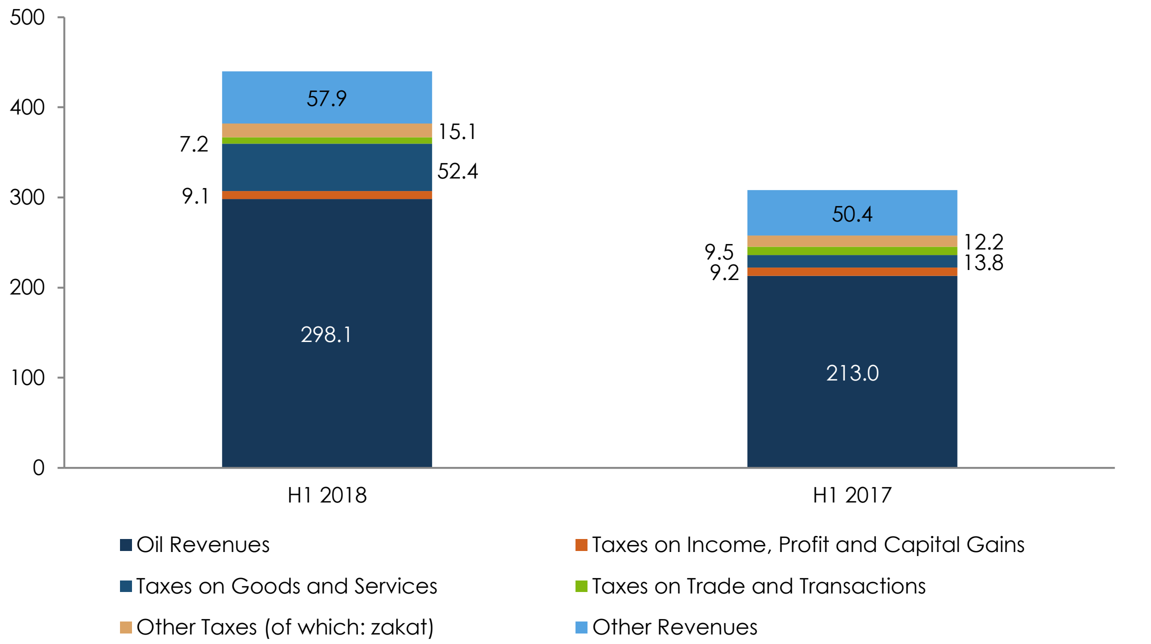
Non-oil revenues surged 42% YoY mainly due to additional levying of Value Added Tax (VAT) on goods and services. Total non-oil revenue during the quarter was SAR 89.4 bn, accounting for 33% of the total Q2 revenue. Tax collection on goods and services increased to SAR 29.7 bn in Q2 compared to SAR 8.1 bn during Q1 2018. Non-oil revenue increased by 71% over the previous quarter, mainly due to significantly higher revenue from other taxes (mainly consisting of corporate zakat) and revenue from other sources (consisting of revenues from other public government units, administrative fees, fines, etc.) as well as 31% increase in tax collection on goods and services (mainly consisting of VAT).

Table 1: Revenue sources

Revenues (SAR bn)	Q2 2018	Q2 2017	Q1 2018	%YoY	% QoQ
Oil revenues	184.2	101.0	113.9	82.4	61.6
Non-oil revenues	89.4	62.9	52.3	42.1	70.9
a. Tax on income, profit, capital	6.6	7.2	2.5	-7.7	169.0
b. Tax on goods and services	29.7	8.1	22.7	267.9	31.3
c. Tax on trade and transactions	3.4	4.9	3.8	-30.9	-9.9
d. Other taxes	12.0	10.6	3.2	13.0	278.6
e. Other revenues	37.7	32.1	20.2	17.3	86.0
Total	**273.6**	**163.9**	**166.3**	**66.9**	**64.6**

Source: Ministry of Finance

Figure 1: H1 2018 Revenues vs. H1 2017 Revenues (SAR bn)



Source: Ministry of Finance

Expenditure rises 34% YoY and 40% QoQ in Q2 2018

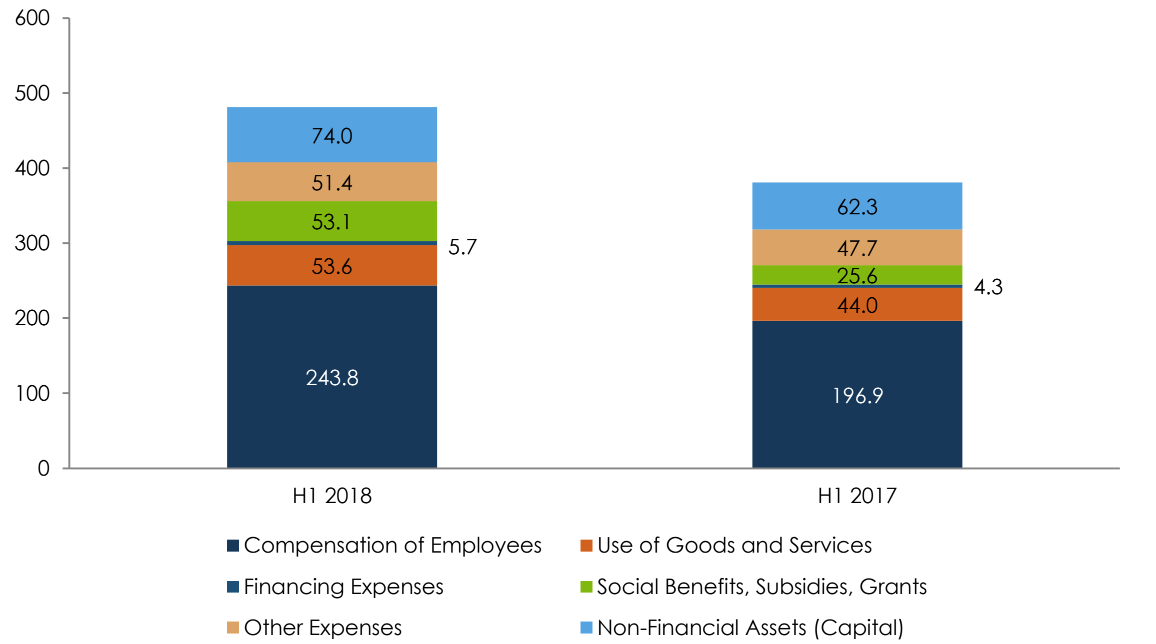
Expenditure during Q2 2018 rose by 34% YoY and 40% QoQ to SAR 280.9 bn. This increase in expenditure was a result of increased government spending on employee compensation, goods and services, social benefits and capital assets (non-financial assets) on both YoY and sequential basis. Although employee compensation increased 27% YoY and 16% QoQ to SAR 130.8 bn, its share in total expenditure decreased to 47% in Q2 2018, compared to 49% in Q2 2017 and 56% in Q1 2018. The increased expenditure was more than offset by increase in revenue, thereby resulting in smaller fiscal deficit.

Table 2: Expenditure distribution

Expenditures (SAR bn)	Q2 2018	Q2 2017	Q1 2018	%YoY	% QoQ
Employee compensation	130.8	102.8	112.9	27.3	15.9
Goods and services	43.3	27.2	10.2	59.1	323.3
Financing expenditure	1.5	3.0	4.1	-49.4	-63.2
Subsidies	4.2	1.1	3.0	272.8	41.4
Grants	1.6	0.6	0.0	153.9	5316.7
Social benefits	25.4	16.6	18.8	53.1	35.2
Other expenses	25.9	25.8	25.5	0.6	1.6
Non-financial assets	48.1	33.3	26.0	44.6	85.2
Total	**280.9**	**210.4**	**200.6**	**33.5**	**40.1**

Source: Ministry of Finance

Figure 2: H1 2018 Expenditure vs. H1 2017 Expenditure (SAR bn)

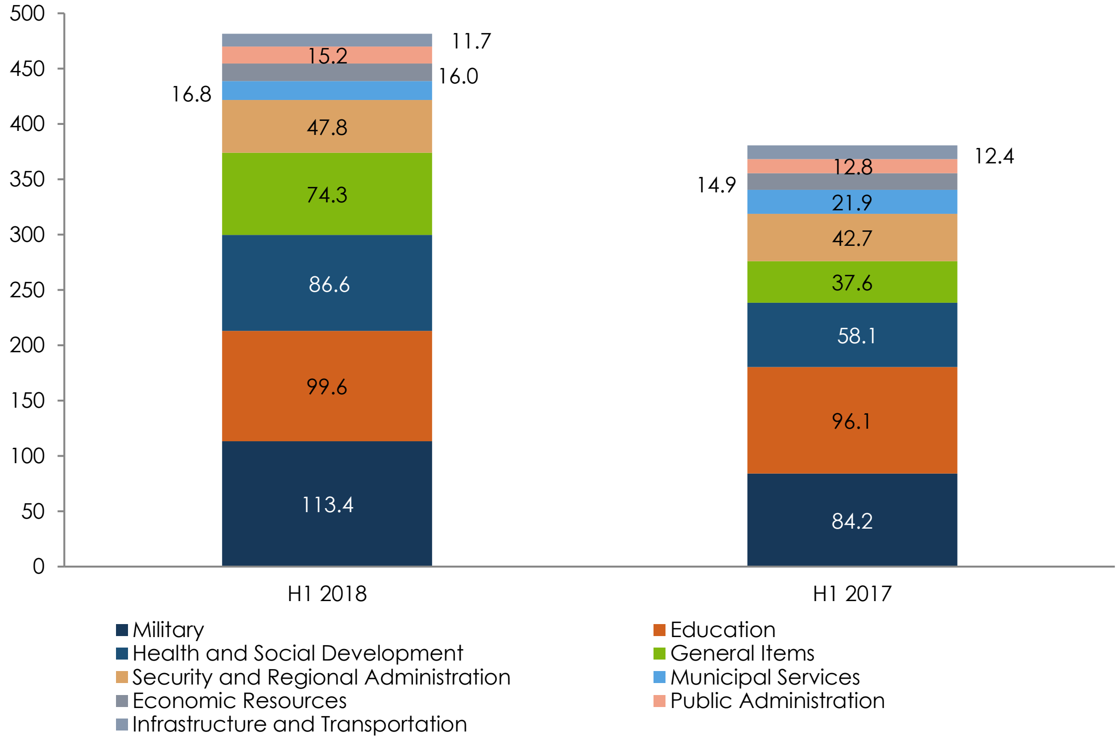


Source: Ministry of Finance

H1 2018 expenditure well in line with FY 2018 budget

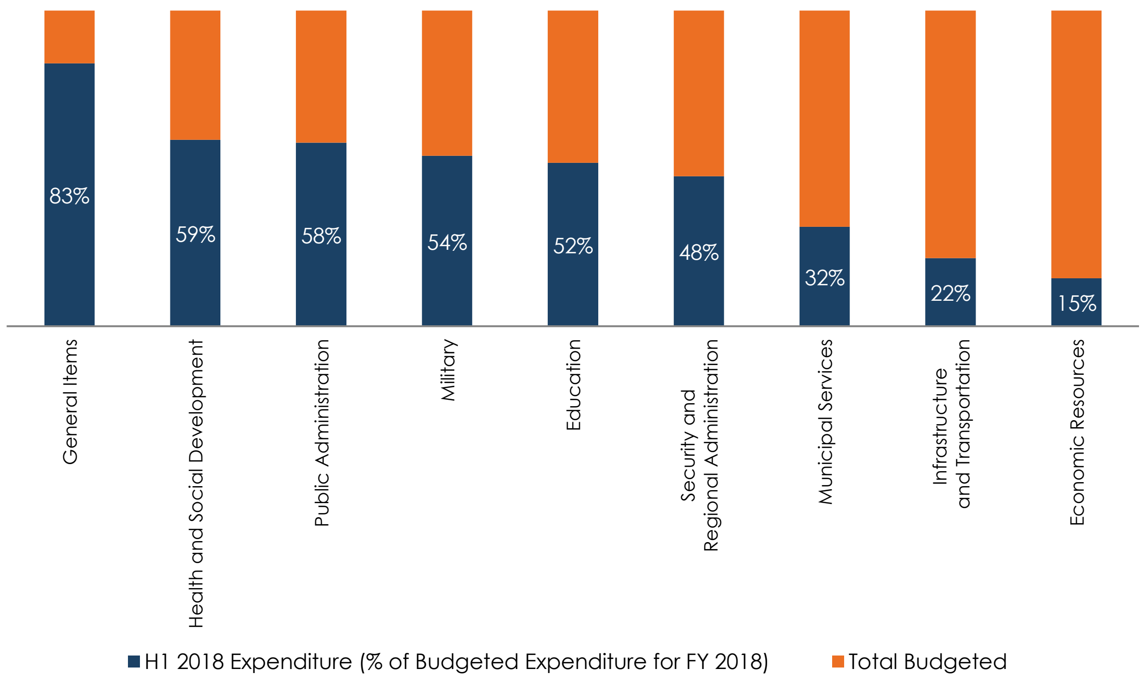
Total expenditure for the first half of 2018 stood at SAR 481.5 bn, which represents 49% of the total budgeted expenditure for FY 2018, indicating that overall expenditure was in line with the annual budget estimates. Maximum allocation (in absolute terms) during H1 went to Military (SAR 113.4 bn), Education (SAR 99.6 bn) and Health and Social Development (SAR 86.6 bn) sectors, which was 54%, 52% and 59% of their annual budgetary allocations respectively. Expenditure on general items was SAR 74.3 bn in H1, which was 83% of its annual budgetary allocation. Economic Resources and Infrastructure & Transportation remain the most underspent sectors, with only 15% and 22% of the total annual budgeted expenditure utilized in H1 2018.

Figure 3: Sector wise expenditure distribution: H1 2018 vs. H1 2017 (SAR bn)



Source: Ministry of Finance

Figure 4: H1 2018 Sector wise expenditure: Actual vs Budgeted for FY 2018 (%)



Source: Ministry of Finance

Saudi Arabia increases debt issuance in H1 2018

The fiscal deficit for Q2 2018 was mainly financed through borrowing of SAR 12.1 bn during the quarter. The Kingdom increased its debt issuance during 2018, with total debt raised in H1 2018 amounting to SAR 93.7 bn (USD 25.0 bn), compared to USD 21.5 bn raised in FY 2017 and USD 17.5 bn raised in FY 2016. During the first half of 2018, Saudi Arabia raised domestic debt of SAR 30.0 bn and external debt of SAR 63.7 bn. Overall public debt rose to SAR 536.9 bn (USD 143 bn) at the end of H1 2018 compared to SAR 443.3 bn (USD 118 bn) at the end of 2017. The debt to GDP ratio is currently at 21%, which is on the lower side considering other GCC nations and Emerging Markets peers, and also well below the cap of 30% the government has put according to fiscal rebalancing program. The government certainly has enough room for further debt issuance during the second half of 2018. Therefore we expect that deficit financing would continue through the issuance of debt.

H1 2018 budget deficit well in line to meet FY 2018 target; Government has leverage to further support the economy

The fiscal deficit for H1 2018 stood at SAR 41.69 bn, which is 21% of the full-year target of SAR 195 bn. The full-year target appears to be achievable if the current trend of expenditure and revenues continues in subsequent quarters. More importantly, higher oil revenues have provided the government with ability to increase expenditure to further support the economy, if required, while still achieving its fiscal deficit target for the year.

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