جدوى للإستثمار
Jadwa Investment

November 2018

Q3 2018 Budget Statement

Fiscal deficit shrinks in Q3

- Government revenue totaled SR223 billion in Q3 2018, up by 57 percent, or SR81 billion, year-on-year. Whilst non-oil revenue saw a rise of 45 percent year-on-year, government oil revenue rose by only 15 percent, to SR154 billion, year-on-year.

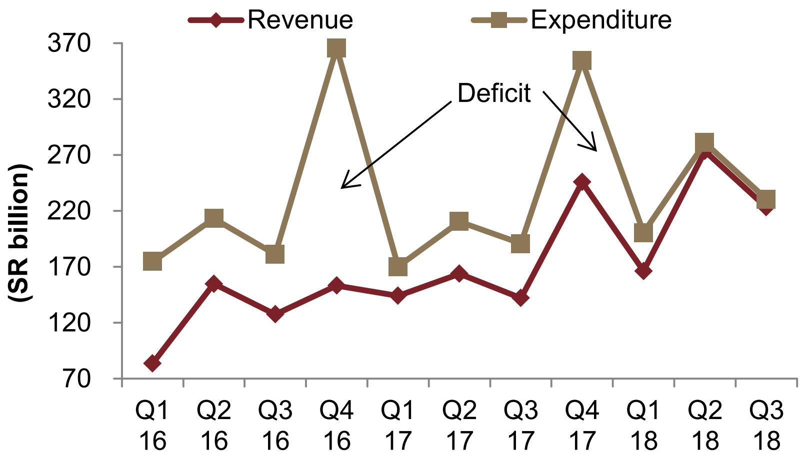
- In the recent preliminary budget report, the Ministry of Finance (MoF) revised 2018 budgeted revenue to SR882 billion, up from SR783 billion previously. Assuming non-oil revenue estimates are unchanged for 2018, at SR291 billion, this implies budgeted government oil revenue of SR591 billion in 2018, compared to actual oil revenue of SR452 billion in the year to Q3.

- Meanwhile, the quarterly budget performance report also showed that the government's efforts to raise non-oil revenue through structured economic reform continues to bear fruit. In Q3 2018, non-oil revenue was up by 45 percent year-on-year, with most of these gains coming from 'Taxes on goods and services', which near doubled year-on-year to SR31 billion.

- Moreover, the 'Taxes on goods and services' segment will be the fastest growing item in non-oil revenue next year, rising by SR22 billion and contributing to the vast majority of rises in non-oil revenue on a year-on-year basis.

- A rise in yearly revenue at a faster rate than expenditure meant the fiscal deficit narrowed to just SR7 billion in Q3 2018, pushing the total fiscal deficit to SR49 billion so far this year. As detailed in the preliminary budget report, the deficit is expected to total SR148 billion (5 percent of GDP) by the end of 2018. Taking this into account, we would expect to see the fiscal deficit widening in the final quarter of the year, in line with historical trends.

Figure 1: The fiscal deficit remained unchanged quarter-on-quarter in Q3 2018, at SR7 billion



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….compared to SR783 billion previously.

Assuming non-oil revenue estimates are unchanged for 2018, at SR291 billion…

...this would imply government oil revenue of SR591 billion in 2018, compared to oil revenue of SR452 billion in the year to Q3 2018.

Table 1: Government Revenue (SR million)

Revenues	Q3 2017	Q3 2018	Change (%)
Oil revenues	94,323	153,950	63
Non-oil revenues, of which;	47,817	69,312	45
-Taxes on income, profits and capital gains	789	3,645	362
-Taxes on goods and services (including petroleum product charges and harmful product tax)	11,725	30,895	163
-Taxes on trade and transactions (customs duties)	6,098	4,444	-27
-Other Taxes (including Zakat)	1,747	3,156	81
-Other revenues (including returns from SAMA and PIF)	27,458	27,172	-1
Total	**142,140**	**223,262**	**57**

<u>Revenue:</u>

Saudi government revenue totaled SR223 billion in Q3 2018, up by 57 percent, or SR81 billion, year-on-year (Table 1). Whilst non-oil revenue saw a rise of 45 percent year-on-year, government **oil revenue** rose by only 15 percent, to SR154 billion. According to our estimates, the Saudi export price of crude and refined products increased by 37 percent year-on-year, to $73 per barrel (pb) in Q3 2018, with an average of around 9.2 million barrels per day (mbpd) of crude oil and refined products expected to have been exported during the quarter. Accordingly, oil export revenue is expected to have totaled SR233 billion in Q3 2018, compared to SR149 billion in Q3 2017 (Figure 2). On a quarter-on-quarter basis the implied transfer ratio (the difference between oil export revenue and government revenue) declined from 86 percent in Q2 2018 to 67 percent in Q3.

In the recent preliminary budget report, the Ministry of Finance (MoF) revised 2018 budgeted revenue upwards to SR882 billion, compared to SR783 billion previously. Assuming non-oil revenue estimates are unchanged for 2018, at SR291 billion, this would imply government oil revenue of SR591 billion in 2018, compared to oil revenue of SR452 billion in the year to Q3 2018. Moving forward, if oil prices remain around the current range of $70-80, this is likely to result in

Figure 2: Quarterly oil export revenue and Saudi oil and refined product export prices

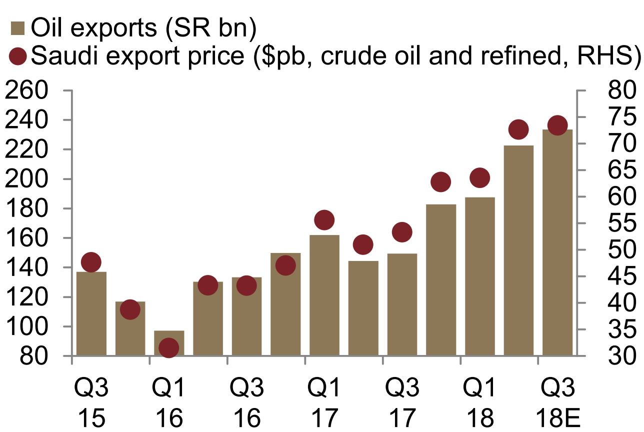
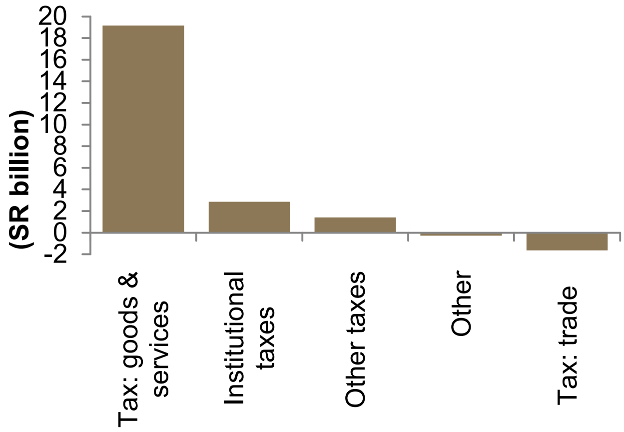


Figure 3: Yearly change in non-oil revenue



Institutional taxes = 'Taxes on income, profits and capital gains'
Other taxes = 'Other Taxes (including Zakat)'
Other = 'Other revenues (including returns from SAMA and PIF)'
Tax: trade = 'Taxes on trade and transactions (customs duties)'

The government's efforts to raise non-oil revenue through structured economic reform continues to bear fruit.

sizable yearly rise in government oil revenue in Q4 2018, with some yearly rises in 2019 oil revenue as well (*for more on this please refer to our 2019 Preliminary Budget Statement* report published October 2018*)*.

In Q3 2018, non-oil revenue was up by 45 percent year-on-year…

Meanwhile, the quarterly budget performance report also showed that the government's efforts to raise **non-oil revenue** through structured economic reform continues to bear fruit. In Q3 2018, non-oil revenue was up by 45 percent year-on-year (Figure 3). As has been the case in previous quarters during the year, most of these gains came from 'Taxes on goods and services', which near doubled year-on-year to SR31 billion. This rise was due to a number of initiatives which have been rolled out recently, including the introduction of value added tax (VAT), expat levies and excise tax.

...with 'Taxes on goods and services', almost doubling year-on-year, to SR31 billion.

Moreover, the 'Taxes on goods and services' segment will be the fastest growing item in non-oil revenue in 2019.

Moreover, the 'Taxes on goods and services' segment will be the fastest growing item in non-oil revenue next year, rising by SR22 billion and contributing to the vast majority of rises in non-oil revenue on a year-on-year basis (Figure 4). The rises are expected to come about from higher fees related to expat levies, and by a reduction in VAT threshold. Currently, VAT applies to enterprises with annual revenues of at least SR1 million, but in 2019 this threshold will be lowered to include enterprises with annual revenues of SR375 thousand and above. As a result, an estimated 300 thousand small and medium enterprises (SMEs) will be eligible for processing VAT, all of which will contribute to raising non-oil revenue.

Expenditures:

Government expenses rose by 21 percent year-on-year in Q3 2018, to a total of SR231 billion…

Government expenses rose by 21 percent year-on-year in Q3 2018, to a total of SR231 billion (Table 2, Figure 5). **Current expenditure**, the lower economic growth enhancing element of government spending, was up 24 percent year-on-year mainly as result of higher 'Social Benefits', which rose by 158 percent to SR28 billion, due to payments under the Citizen's Account program.

...current expenditure was up 24 percent year-on-year, mainly as result of higher 'Social Benefits…

The largest contributor to current expenses, 'Compensation of Employees', increased marginally by 3 percent to SR110 billion over the same period last year, having dropped by a sizable 16 percent quarter-on-quarter in Q3 2018. Looking at historical quarterly wage bill data, a significant rise in this segment is usually observed in the final quarter of each year, most likely as a result of an accrual of

Figure 4: Breakdown of tax revenues

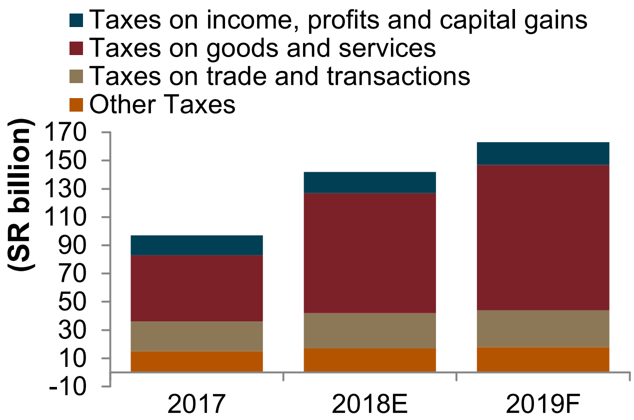
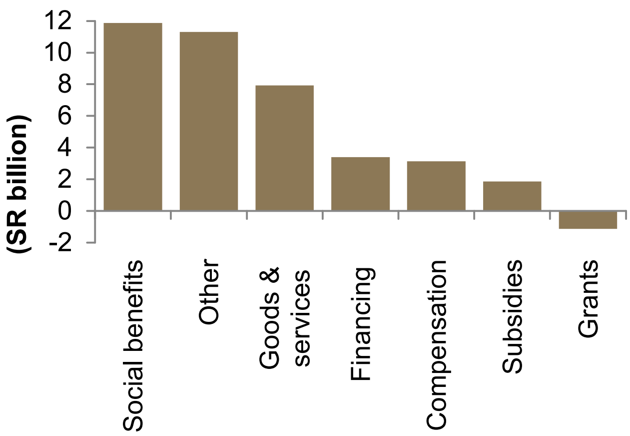


Figure 5: Year-on-year change in Q3 2018 current expenditure



...which rose by 158 percent due to payments under the Citizen's Account program.

allowances and overtime pay. However, this year there seems to be a ramp up in wage bill in Q2 as well as a ramp up, as per usual, expected in the final quarter of 2018 (Figure 6).

Table 2: Government Expenditure (SR million)

Expenses	Q3 2017	Q3 2018	Change (%)
Compensation of Employees	106,619	109,752	3
Goods & Services	20,661	28,580	38
Financing Expenses	1,152	4,557	296
Subsidies	1,695	3,566	110
Grants	1,182	66	-94
Social Benefits	7,522	19,387	158
Other Expenses	17,077	28,380	66
Non-Financial Assets (Capital)	34,962	36,261	4
Total	**190,870**	**230,549**	**21**

We expect a total wage bill of around SR488 billion in 2018…

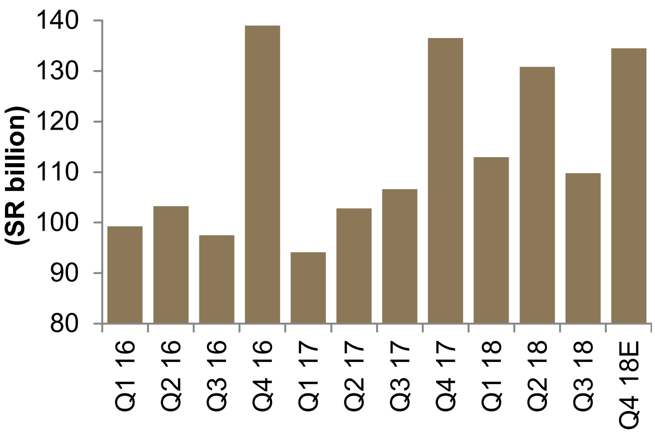
...which could rise even higher next year after the recently announced restoration of annual allowances to all public sector employees…

In the 2018 fiscal budget statement, SR438 billion was allocated to wage bill for this year. Later, following the introduction of an inflation allowance as per a royal decree, various government sources stated that the additional annual cost of this allowance would be around SR50-55 billion. As such, this implies a wage bill of around SR488 billion in 2018. Looking into 2019, wage bill costs could rise even higher following the recently announced restoration of annual allowances to all public sector employees. Although a vast majority of allowances were restored following a royal decree in April 2017, the annual allowance were expected to be linked to appraisals of employee's performance but following a recent government announcement, these allowances would revert to the older non-performance linked system from 2019 onwards. Despite this, we believe that rises in expenditure highlighted in the preliminary budget would cover any rise in annual allowance payments.

...that said, we believe that rises in expenditure outlined in the preliminary budget would cover any rises related to annual allowance payments.

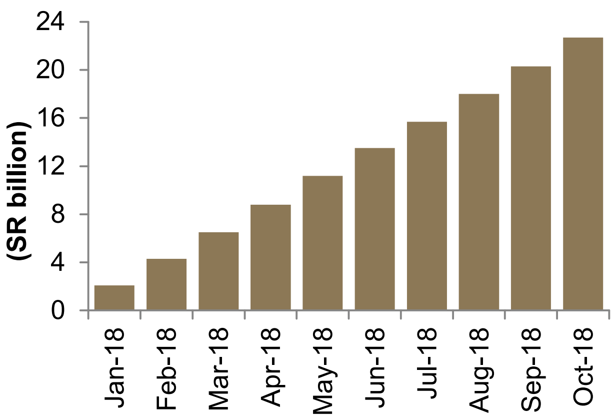
As was the case in pervious quarter, 'Social Benefits' saw large yearly rises in Q3 2018, up 158 percent to SR19 billion, due to payments under the Citizen's Account program, which commenced on 20th December 2017. According to the annual fiscal budget, around SR2.5 billion per month, or SR30 billion annually, was earmarked for the Citizen's Account program in 2018. Accordingly, around SR6.8 billion was disbursed during Q3, with roughly 3.63

Figure 6: Quarterly wage bill



Q4 2018 = Jadwa estimates

Figure 7: Cumulative payments under the Citizen's Account in 2018



The capital spending side of expenses was up only marginally by 4 percent year-on-year, to SR36 billion, in Q3 2018.

Looking ahead, we see capital spending potentially rising by 15 percent year-on-year to reach SR251 billion in 2019.

Public debt totaled SR443 billion at the end of 2017, but had risen to SR550 billion by end of Q3 2018…

...since then, there have been two domestic sukuk issuances totaling SR8 billion, pushing total debt to SR558 in October 2018.

The government has also revised its borrowing requirement for the next few years...

...with debt expected to rise to SR848 billion by 2021, equivalent to 25 percent of GDP.

million households within the Kingdom benefitting. By October 2018, a total of SR22.7 billion had been disbursed through the program so far in 2018 (Figure 7).

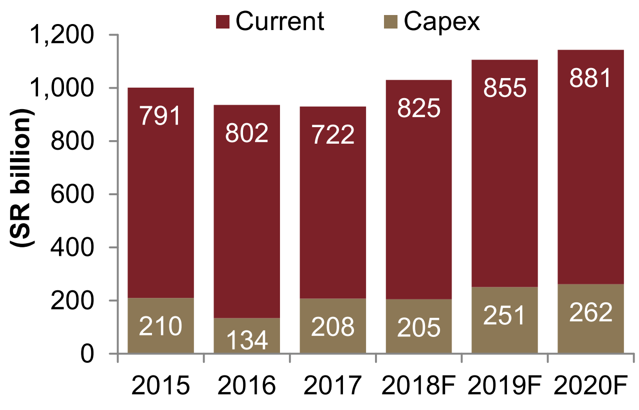
The **capital spending** side of the expenses, or 'Non-Financial Assets (Capital)', was up only marginally by 4 percent year-on-year to SR36 billion in Q3 2018. According to the 2018 fiscal budget, capital spending will total SR205 billion, compared to SR180 billion in 2017. In 2019, capital spending will continue to be channeled towards Vision 2030 programs that directly contribute to economic growth and job opportunities for citizens. In this respect, we expect up to a third of the expected rise in total expenditure in 2019, as outlined in the preliminary budget, to be allocated to capital spending. Accordingly, capital spending could rise by up to SR33 billion, or 15 percent year-on-year in 2019, to reach SR251 billion, versus the previously projected SR218 billion.

Looking at expenditure overall, there seems to have been an effort to distribute spending in a more balanced manner throughout the fiscal year, in line with MoF's recent statement. In the past, expenditure has tended to rise rapidly in the last quarter of each year but this will be somewhat different this year. According to the latest quarterly budget statement, 69 percent of total budgeted expenditure for 2018 had already been disbursed up to the third quarter of 2018, compared to 61 percent in the same period in both 2016 and 2017. Part of this improvement in the management of expenditure is due to the introduction of the electronic Etimad portal at start of 2018. Prior to the launch of the portal, government spending had been handled manually, therefore making it more difficult and time-consuming to track government transactions. According to the MoF, the digital Etimad system will improve controls and transparency in the spending process and as well as raising the level of communication between it and contractors. Whilst the system has not been fully rolled-out to include all government entities and contractors, the MoF is expected to make Etimad mandatory for all government projects from 2019 onwards, which should result in further improvements in the distribution of government expenditure next year.

<u>Public Debt:</u>

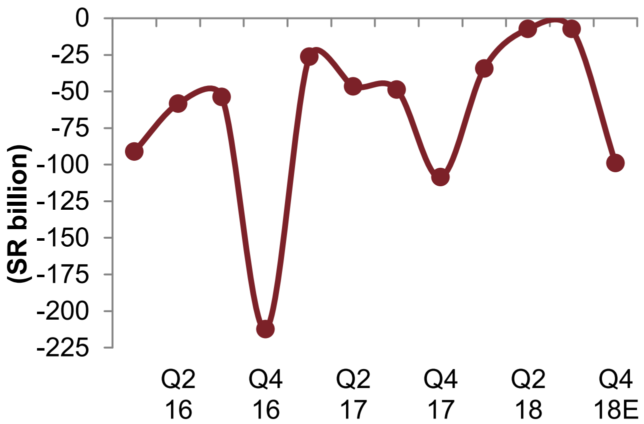
Public debt totaled SR443 billion at the end of 2017, but had risen to SR550 billion by end of Q3 2018. Since then, there have been two domestic sukuk issuances totaling SR8 billion, pushing total debt to SR558 billion by October 2018. According the preliminary budget, the Kingdom's total debt is expected to rise to SR576 billion in 2018,

Figure 8: Government expenditure by type*



*2018-2020 capex and current expenditure = Jadwa estimates

Figure 9: Based on figures from the preliminary budget statement, fiscal deficit will rise in Q4 2018



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...which would mean a much higher fiscal deficit in the final quarter of the year, in line with historical trends.

equivalent to 19 percent of GDP. Despite, this, due a major improvement in the fiscal position of the Kingdom in 2018, we expect public debt to be slightly less than stated for this year, although any further debt issuance during the remainder of the year is most likely be raised domestically.

The government has also revised its borrowing requirement for the next few years. According to the preliminary budget report, public debt projections have been revised up from SR555/SR805 billion, to SR576/SR848 billion between 2018 to 2021. By the end of 2021, public debt is expected to total 25 percent of GDP, lower than the 30 percent limit outlined under the National Transformation Program (NTP). The Kingdom still enjoys ample domestic liquidity, thus affording it the ability to continue financing part of the additional debt through domestic bonds. Looking to 2019, we expect around half of 2019's projected SR102 billion debt requirement to be funded internally, with the remainder from international issuances, in-line with the trend seen in recent years.

Deficit:

A rise in yearly revenue at a faster rate than expenditure meant the fiscal deficit narrowed to just SR7 billion in Q3 2018, pushing the total fiscal deficit to SR49 billion so far this year. As detailed in the preliminary budget report, the deficit is expected to rise to SR148 billion (5 percent of GDP) for 2018 as a whole. Taking this into account, we would expect to see a much higher fiscal deficit in the final quarter of the year, in line with historical trends (Figure 9).