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Report on Saudi Budget 2020

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Review of the Saudi Budget Announcement 2020

Budget Announcement Key Take Aways

- **The fiscal year 2019 is ending with a deficit of 131bln SAR which meets the government's initial budget forecast for the year. Revenues are estimated to be 5.9% below budget, but this shortfall is offset by correspondingly lower expenditure.**

- **The fiscal budget 2020 projects a deficit of 187bln SAR, an increase of 56bln SAR compared to 2019 which can be explained by lower expected oil revenues (-15%). Expenditure will be gradually trimmed by 2.7% compared to the current year.**

- **The medium-term budget plan puts emphasis on fiscal consolidation, targeting a deficit below 3.0% of GDP by 2022. This will be achieved by reducing fiscal spending from 1049bln in 2019 to 955bln SAR in 2022. The budget projections are based on conservative fiscal revenue estimates in our view.**

- **The impact of the medium-term fiscal consolidation on the domestic economy will be countered by an expected increase in capital spending by PIF, which will provide overall support to economic growth in the short and medium term.**

1. Review of Fiscal Year 2019

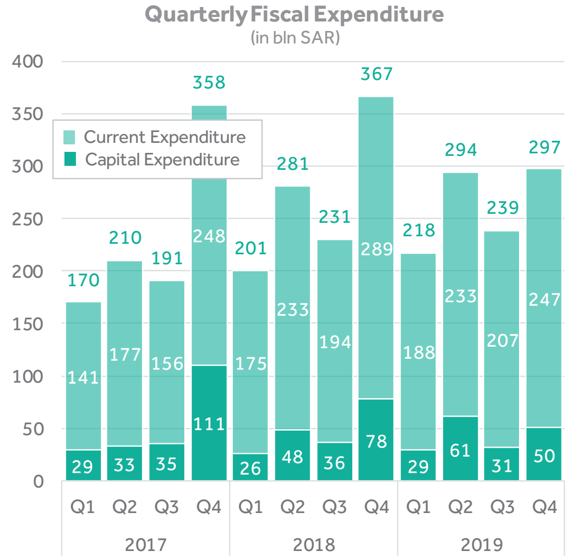
The government announced a budget deficit of 131bln SAR for the fiscal year 2019. Oil revenues are estimated at 602bln SAR and Non-oil revenues at 315bln SAR which results in overall revenues of 917bln SAR. Government spending, on the other hand, is expected to reach 1048bln SAR. The announced deficit precisely matches the original budget projection (-131bln SAR). This can be explained by lower than budgeted fiscal expenditure (1048bln SAR vs. 1106bln SAR) which balanced the correspondingly lower revenues (917bln SAR vs. 975bln SAR).

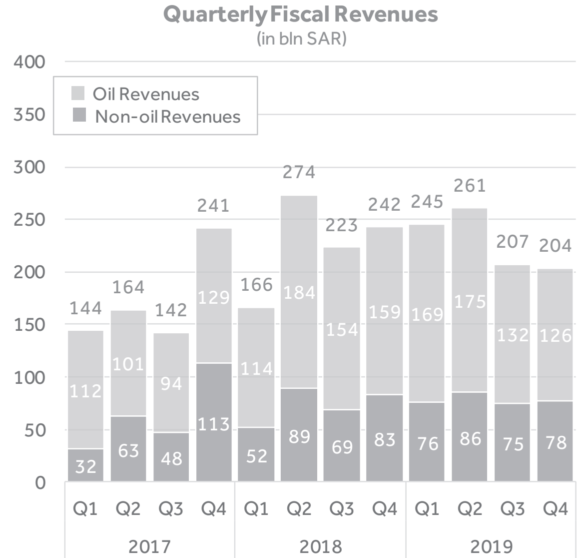
2019 in bln SAR	Total Revenues	Oil Revenues	Non-oil Revenues	Total Expenditure	Current Expenditure	Capital Expenditure	Fiscal Deficit
Actual	917	602	315	1048	877	172	-131
Budget	975	662	313	1106	860	246	-131
Difference	-58	-60	2	-58	17	-74	0
Diff. in %	-5.9%	-9.1%	0.6%	-5.2%	2.0%	-30.1%	0.0%

Non-oil revenues are estimated at 315bln SAR which reflects an increase of 21bln SAR (+7%) compared to 2018. Tax income continues to show strong growth (+35bln) in 2019. This is primarily due to taxes on goods and services which relate to the fiscal reform measures introduced in 2018 and other taxes which include the Zakat settlement with the Banking sector. Other Non-oil revenues declined by 14bln SAR, a trend which already started last year (-40bln SAR). A potential explanation for this could be that SAMA and in particular the PIF progressively don't transfer their investment income anymore to the central governments budget.

Oil revenues are expected to fall short of the budget by -9%. However, they decline by a marginal -1.5% compared to last year. This is a remarkably small contraction on the back of Brent oil prices dropping by -10% yoy and the Saudi oil production declining by -5% over the same period.

On the expenditure side, current spending is expected to end up gradually above the budget (877 bln SAR vs. 860bln SAR), with, in particular, the government payroll exceeding the budget by 10%. On the other hand, capital expenditure has been cut back compared to the budget by a considerable -30% (172bln SAR vs. 246bln SAR). According to the government this is due to two factors: First, improved efficiency and effectiveness in the spending activity, and, second, higher private sector participation in project financing.





These overall spending cuts are also visible in the quarterly fiscal data (see graphic above). While fiscal expenditure traditionally spiked in the 4th quarter throughout the last years (2017: 358bln SAR; 2018: 367 bln SAR), the spending increase in the last quarter of this year has been rather subdued (297blnSAR).

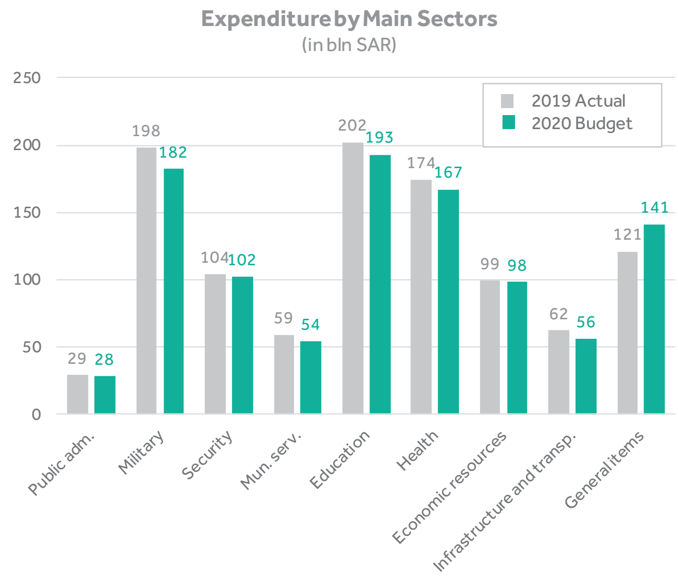
2. Fiscal Budget 2020

For the fiscal year 2020 the government forecasts the budget deficit to widen to 187bln SAR with revenues at 833bln SAR and expenditure at 1020bln SAR. On the spending side, this corresponds to a gradual reduction of -2.7% to 2019 which can entirely be explained by a cutback of current spending while capital spending remains mainly unchanged. Within current expenditure, government payroll is projected to remain unchanged to 2019, while expenses for goods and services are forecasted to take the lion's share of the overall reduction.

Budget 2020 in bln SAR	Total Revenues	Oil Revenues	Non-oil Revenues	Total Expenditure	Current Expenditure	Capital Expenditure	Fiscal Deficit
Budget 2020	833	513	320	1020	847	173	-187
Actual 2019	917	602	315	1048	877	172	-131
Difference	-84	-89	5	-28	-30	1	-56
Diff. in %	-9.2%	-14.8%	1.6%	-2.7%	-3.4%	0.6%	42.7%

Fiscal revenues are expected to decline by 84 bln SAR or -9% compared to 2019. This is due to notably lower oil revenues projections in 2020 (513bln SAR vs. 602bln SAR). Non-oil revenues are forecasted to expand by 5 bln SAR.

A break-down of the fiscal expenditure 2020 by main sectors (see graphic below) reveals that a majority of sectors is affected by the gradual reduction in spending next year. In absolute terms the largest cutback is projected for the military sector (-16bln SAR), followed by eduction (-9bln SAR) and health&social development (-7bln SAR). These three sectors, however, still remain the largest items in the fiscal budget, covering 53% of the overall expenditure. In contrast to the general budget reductions, general items, such as contribution to government pensions, social insurances and financing costs, will exhibit a higher budget allocation in 2020 (141bln SAR vs. 121blnSAR).

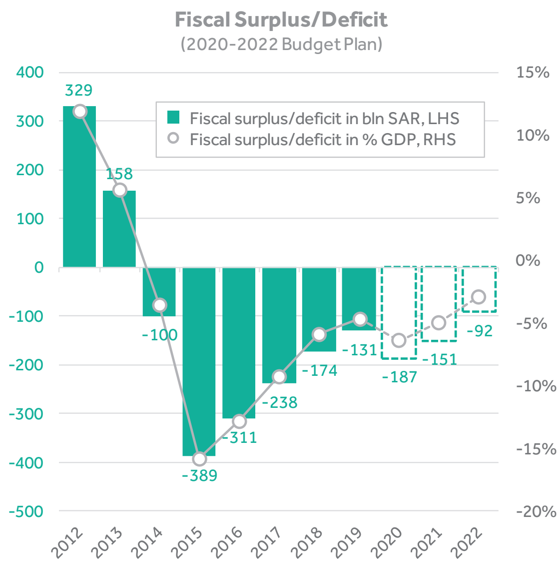


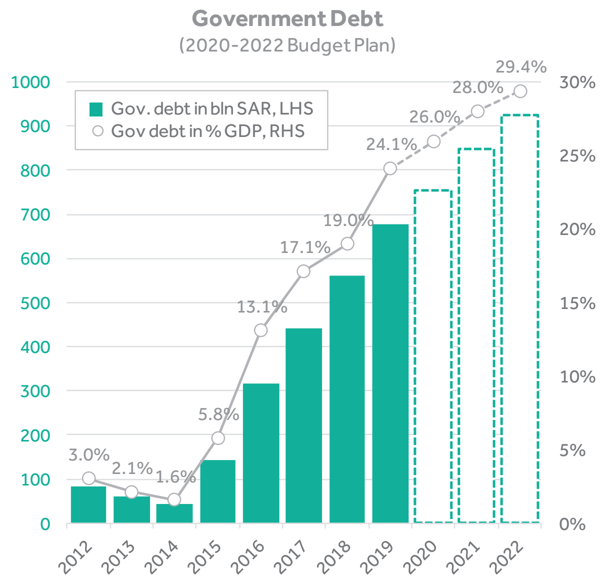
In addition, the budget statement 2020 also contains more detailed information on the various sectors, including specific projects and objectives to be pursued in 2020 which overall provides additional transparency on fiscal spending at a more granular level.

3. Medium-term Fiscal Policy Framework until 2022

in bln SAR	2018 (actual)	2019 (estimate)	2020 (budget)	2021 (projection)	2022 (projection)
Total Revenues	906	917	833	839	863
Total Expenditure	1079	1048	1020	990	955
Budget Deficit	-174	-131	-187	-151	-92
Budget Deficit in % GDP	-5.9%	-4.7%	-6.4%	-5.0%	-2.9%
Gov. Debt	560	678	754	848	924
Gov. Debt in % GDP	19.0%	24.1%	26.0%	28.0%	29.4%
Gov. Reserves	490	467	346	280	265

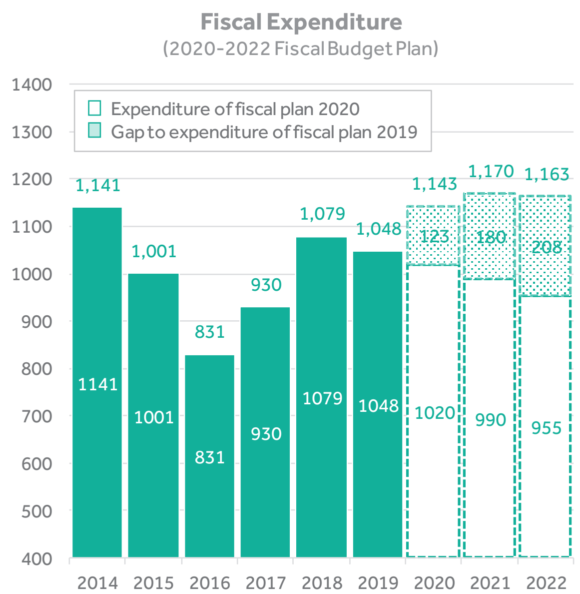
The budget 2020 has to be seen in the context of the medium-term fiscal policy framework covering the period until 2022. These medium-term fiscal projections have already been released in the pre-budget statement in October and constitute an integral part of the current budget statement. They essentially show that the government puts a clear emphasis on fiscal consolidation in the next years. The fiscal deficit is targeted to decline to 2.9% of GDP in 2022 from 6.4% in 2020. In order to achieve this, fiscal spending will be trimmed from 1049bln SAR in 2019 to 955bln SAR in 2022. This will be necessary as fiscal revenues are projected to decline over the same period from 917bln SAR to 863bln SAR.

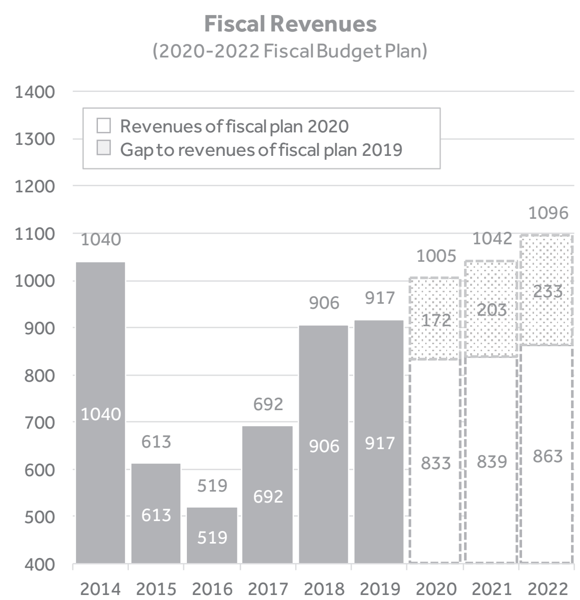




The government plans to finance its forecasted fiscal deficits almost equally through borrowing (53%) and government deposit withdrawals (47%). As a consequence, government debt will rise from 24.1% of GDP in 2019 to 29.4% in 2022. Government reserves, in turn, are forecasted to decline from 467bln SAR to 265bln SAR over the same period.

These new fiscal projections differ from the fiscal plan issued last year. In particular, medium-term revenues forecasted in the current plan are notably lower than the medium-term revenue projections of last year (see graphic below).

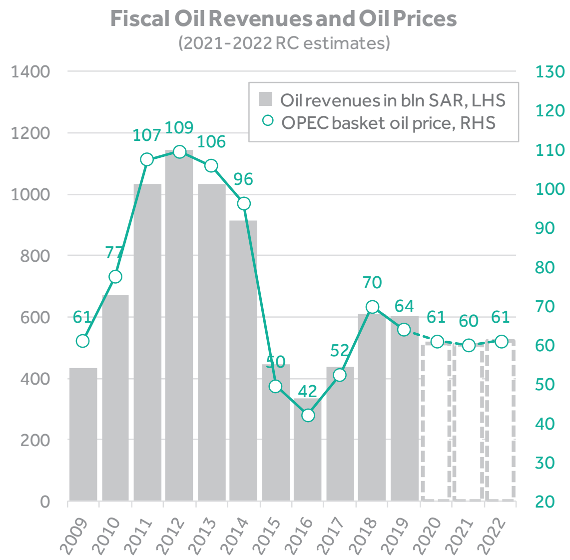


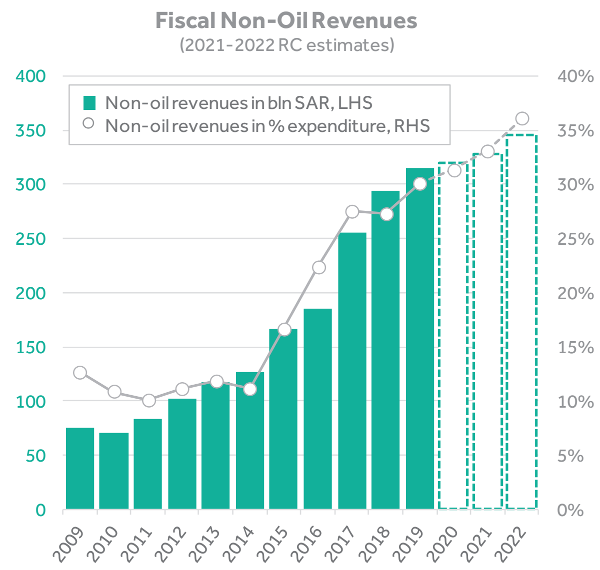


As a consequnce, the higher revenue forecasts made in 2018 also allowed correspondingly higher medium-term expenditure projections compared to the current plan.

This discrepancy can essentially be explained by a different medium-term oil price scenario in these two plans. Back in 2018, the oil prices implied in the revenue projections were in the range of 78-80 USD according to our estimates. (The plan was originally worked out in September 2018 when oil prices were traded above 80 USD). For the current plan, we estimate that fiscal revenues are based on oil prices around 60 USD throughout the entire period (see graphic below).

Besides, our model calculations show that non-oil revenues are forcasted to grow by about 3% p.a. on average over the next three years. We acknowledge that this year's tax revenues were partly inflated by non-recurring collections but even taking these effects into account, we consider these non-oil revenue growth projections as quite moderate. (Nevertheless, these estimates imply that in 2022 non-oil revenues will constitute a remarkable 36% of fiscal expenditure which favorably compares to a figure of only 11% back in 2014).





All in all, we conclude that while the fiscal revenue projections issued last year had to be considered as rather optimistic, the government's current medium-term fiscal revenue forecasts are quite conservative in our view. Therefore, we feel that actual government revenues could potentially surprise on the upside in the coming years. This would, in turn, offer some more fiscal flexiblity to the Saudi government compared to its current plans.

4. Short- and Medium-term GDP Forecasts

The government forecasts real GDP growth to end up at 0.4% this year and to pick up next year in order to fluctuate around 2.3% in the coming three years (see table below).

While we expect this year's GDP growth rate to be gradually lower (0.1%), our GDP growth projections beyond 2019 generally coincide with the government's medium-term figures. For 2020, we forecast real GDP growth to rebound to 2.4% and don't expect a notable slowdown in the following years.

Our scenario is based on the assumption that the non-oil economy will grow at approximately 3% over the next three years while the oil sector will stay in moderately positive growth territory over the same period (1.5%-1.8%) after a contraction this year (-3.2%).

2019 estimate 2020-2022 forecast	2019	2020	2021	2022
Real GDP Growth	0.4%	2.3%	2.2%	2.3%
Nominal GDP (in bln SAR)	2811	2902	3027	3143
Nominal GDP Growth	-4.7%	3.2%	4.3%	3.8%
Inflation	-1.0%	2.0%	2.0%	1.8%

Our scenario of medium-term growth rates around 3% for the non-oil economy may not necessarily square with the fiscal consolidation path pursued by the government according to its current medium-term plan.

However, in order to properly assess the impact of the public sector's spending plan, we also need to include major government institutions in our considerations, notably the PIF. The Aramco IPO will generate about 110bln SAR for PIF. We expect these proceeds to be predominantly invested in the domestic economy. Besides, the sale of its shares in SABIC to Aramco will generate an additional 70bln USD (263 bln SAR) in the foreseeable future for PIF. This substantial fiscal firepower will make the PIF a macro-relevant public entity next to the central government. Therefore, we expect overall public spending to remain expansionary in the coming years despite the fiscal consolidation plans by the central government.

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