



Saudi Arabia's 2018 Fiscal Budget

The government's budget for the 2018 fiscal year was endorsed by the Council of Ministers on 19th December. It points to an expansionary stance (Figure 1). The highlights include:

- The government continues to support the economy through the largest ever budgeted expenditure of SR978 billion in 2018, compared with 2017's budget of SR890 billion. Based on revenues of SR783 billion, the government is budgeting for a slightly lower year-on-year deficit at SR195 billion, compared to our forecast of SR220 billion.
- We expect debt issuances not to exceed SR117 billion in 2018, which, assuming no repayments, would result in 2018 year-end public debt at around SR555 billion (19 percent of GDP), compared to SR438 billion at the end of 2017.
- While budgeted expenditure in 2018 spans all sectors, the priorities are consistent with recent years, with military, security services, education, healthcare and economic resources making up 77 percent of total allocations.
- Also, SR72 billion worth of measures to stimulate growth in the private sector, as per a royal decree, were announced before the budget. The measures are part of a stimulus package that will be extended over a four year period.
- According to the statement, budgeted capital spending, will amount to SR205 billion in 2018, compared to SR180 billion in 2017. This shows a renewed emphasis by government to support growth in the private sector.
- Separately, a total of SR133 billion will be expended by the Public Investment Fund (PIF) and the National Development Fund (NDF) in capital spending in Saudi Arabia during the year, although this amount will not be funded through the 2018 budget. PIF will spend SR83 billion, whilst the NDF will spend SR50 billion, in specific projects in Saudi Arabia, which will significantly boost the level of capital injections in the Kingdom. In total, capital spending from

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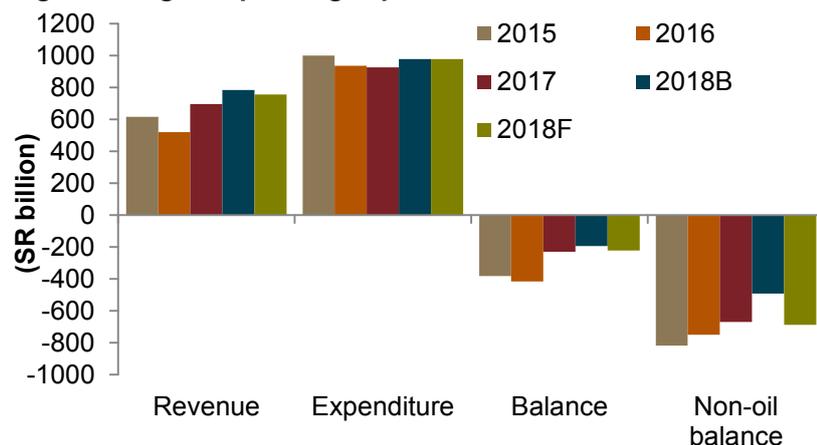
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Figure 1: Higher spending expected in 2018



Note*: 2018B refers to MoF budget. 2018F refers to Jadwa Investment's forecasts.



The government continues to support the economy through budgeting for SR978 billion in spending compared with 2017's budget of SR890 billion.

Based on revenues of SR783 billion, the government is budgeting for a slightly lower deficit at SR195 billion.

We calculate that a Saudi export price of \$58 pb (around \$60 pb for Brent) and...

...crude oil production of 10.1 mbpd in 2018, are consistent with the revenue projections contained in the budget.

According to the budget statement, GDP growth will reach 2.7 percent in 2018, with non-oil GDP expected to reach 3.7 percent.

The budget also disclosed revenue and expenses projections to 2023, with oil revenues set to decrease as a proportion of total revenue, from 58 percent in 2017, to 42 percent by 2023.

government, PIF and NDF will amount to SR338 billion in 2018.

- The government has budgeted for non-oil revenue to reach SR291 billion in 2018, showing a strong growth of 37 percent and 14 percent over 2017's budgeted and actual figures, respectively. Rises in non-oil revenue will come from a number of areas, including rises in expat dependent fees and the introduction of expat levies, the introduction of VAT, receipts from white land tax, and from improvements in investment income due to the PIF active approach in managing sovereign wealth.
- Another area where revenue will be improved is through rises in domestic energy prices. Prior to the budget, the Saudi Cabinet approved a rise in electricity tariffs, which is expected to raise government revenue by SR14 billion during 2018. Whilst no other energy product prices were raised, the Ministry of Energy did state that energy price changes will be specified at some point during Q1 2018.
- We calculate that a Saudi export price of \$58 per barrel (pb) (around \$60 pb for Brent) and crude oil production of 10.1 million barrels per day (mbpd) in 2018 are consistent with the oil revenue projections contained in the budget. We believe the government is budgeting for continued compliance with OPEC cuts, which were extended until the end of 2018 in a meeting held by the organization back in November.
- Our forecasts for 2017 were slightly more conservative than actual budgetary performance. At the end of 2017 the total deficit reached SR230 billion, or 8.9 percent of GDP compared to our forecast of SR197 billion, or 7.5 percent of GDP. The actual deficit was also slightly above the budgeted deficit level, but still resulted in almost halving the record budget deficit seen in 2016, at SR416 billion. The higher than budgeted deficit was due to actual spending being higher than forecasted, at SR926 billion, compared to budgeted total of SR890 billion.
- Meanwhile, annual growth in non-oil revenue was up 38 percent year-on-year in 2017, mainly as a result of sizable yearly increase from taxes on goods and services, the sale of some government assets, and an increase in investment returns. However, as we expected in our [Q3 Budget Statement Report](#), government oil revenue fell short of the budgeted SR480 billion, to SR440 billion. This is likely a result of an adjustment in the tax rate, as per a royal decree in March 2017.
- In line with our expectations, preliminary 2017 economic data shows that the economy continued to slow in 2017 with real GDP growth at -0.5 percent compared to our forecast of -0.9 percent. With non-oil GDP growth at 1.5 percent, versus our forecast of 0.7 percent, it would imply that oil sector GDP shrunk by -3.1 percent, compared to our estimates of -2.8 percent. According to the budget statement, GDP growth will reach 2.7 percent in 2018, with non-oil GDP expected to reach 3.7 percent, thereby implying oil GDP growth at 1.4 percent.
- The budget also disclosed revenue and expense projections to 2023, with oil revenues set to decrease as a proportion of total revenue, from 58 percent in 2017, to 42 percent by 2023. On the expenditure side, the Kingdom is expected to see an expansionary budget stance until 2023, reaching SR1.34 trillion in 2023. However, according to the budget statement, debt to GDP ratio will not be allowed to exceed 25 percent over the balancing phase which, according to our calculations, means the Kingdom can accumulate roughly SR800 billion debt in total, by 2023.



The 2018 Budget

The 2018 budget disclosed the largest ever budgeted expenditure at SR978 billion.

We expect 2018 actual expenditure to be very close to the budgeted total of SR978 billion

The Kingdom is budgeting for a fourth consecutive, but shrinking, fiscal deficit of SR195 billion in 2018.

Budgeted oil revenue are up by 32 percent, with an emphasis on increasing non-oil revenue too.

We expect debt issuances not to exceed SR117 billion in 2018, which would put 2018 year-end public debt at SR555 billion.

The 2018 budget disclosed the largest ever budgeted expenditure at SR978 billion, up by SR88 billion year-on-year (Figure 2). This year's budget continues to support the overarching goals of the Vision 2030, with a strong focus on supporting economic diversification, shielding economically vulnerable households from necessary energy price reforms, and spending on key physical and social infrastructure.

As per the trend in the last couple of years, with the level of overspending (actual versus budgeted spending) narrowing, we expect 2018 actual expenditure to be very close to the budgeted total of SR978 billion (Figure 3). This is in line with initiatives outlined in the National Transformation Program (NTP) and implemented under the recently established Bureau of Capital and Operational Spending Rationalization (BCOSR). This point was reiterated by the Ministry of Finance which, earlier this year, stating that the BCOSR had succeeded in saving up to SR17 billion for the whole of 2017, after reviewing state projects and other expenditures.

The Kingdom is budgeting for a fourth consecutive, but shrinking, fiscal deficit of SR195 billion in 2018, compared with SR230 billion in 2017 and SR416 billion in 2016. This is in line with the expected easing of previous targets to balance the budget by 2020, as set out in the Fiscal Balance Program (FBP). There now seems to a longer timeline attached to balancing the budget (see Fiscal Balance Program II section), which is designed to avoid excessively slowing economic growth.

Brent oil prices improved 25 percent year-on-year in 2017, and currently remain above \$60 pb, which has helped raise year-on-year budgeted oil revenue by 32 percent. Additionally, there has also been an emphasis on increasing non-oil revenue (Figure 4). Accordingly, the budget outlines an increase in overall budgeted revenues by 13 percent year-on-year. On the expenditure side, a growth of 10 percent is budgeted compared to last year.

We expect debt issuances not to exceed SR117 billion in 2018, which, assuming no repayments, would put 2018 year-end public debt at SR555 billion (19 percent of GDP), compared to SR438 billion at the end of 2017. Besides the issuance of debt, the 2018 deficit will also be financed from the drawing down SR78 billion from the stock of government deposits/FX reserves during the year.

Figure 2: Budgeted expenditure

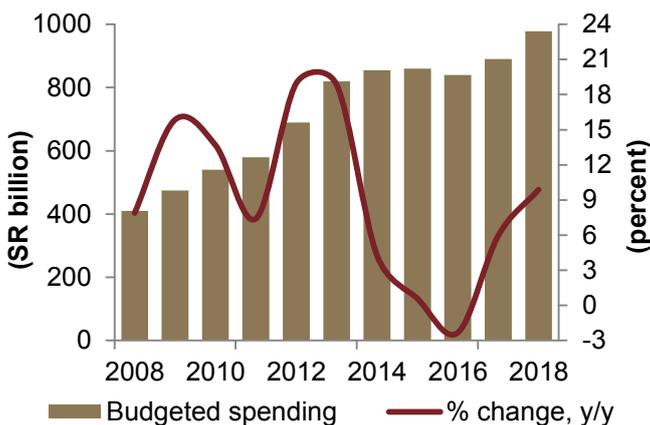
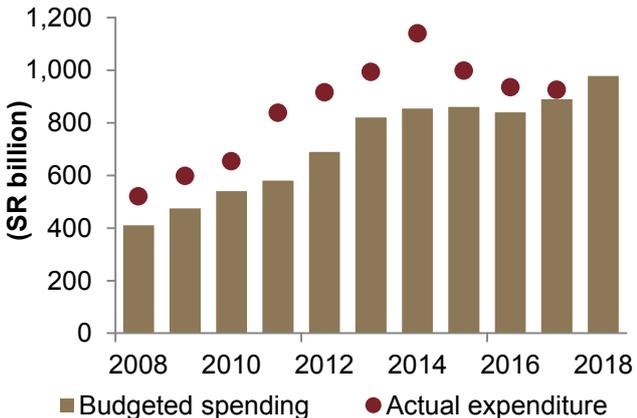


Figure 3: Actual and budgeted spending





According to latest data available, net foreign assets at SAMA stood at \$490 billion (SR1,840 billion), at the end of October 2017...

...and we expect FX reserves to reach \$456 billion by the end of 2018.

Total expenditure is budgeted at SR978 billion in 2018, up 10 percent from the 2017 budgeted expenditure...

...with budgeted capital spending, will rise by 14 percent year-on-year in 2018, to SR205 billion.

A total SR138 billion of capital spending will be targeted to support Vision 2030 initiatives.

According to latest data available, net foreign assets at SAMA stood at \$490 billion (SR1,840 billion), at the end of October 2017, and which we expect to reach \$456 billion by the end of 2018.

Since issuing domestic bonds in 2015, and then international bonds in 2016, it has become increasingly apparent that this type of financing will remain integral to the Kingdom's spending plans in the years ahead.

Expenditure

Total expenditure is budgeted at SR978 billion in 2018, up 10 percent from the 2017 budgeted expenditure. The 2018 budgeted expenditure represents the largest ever budgeted amount to date (Figure 3). Also, SR72 billion worth of measures to stimulate growth in the private sector, as per a royal decree, were announced before the budget. These measures are part of a stimulus package that will be extended over four years (Box 1).

According to the statement, budgeted capital spending, will rise by 14 percent year-on-year in 2018, to SR205 billion, compared to SR180 billion in 2017, which was down 2 percent compared to the 2016 figure. This type of expenditure can have positive implications over the growth in the non-oil private sector, since capital spending normally leads to higher demand for services from some of the largest sectors in the private economy, including construction, transport, and utilities. As such, the larger capital spending in 2018 shows a renewed emphasis by government to support growth in the private sector and help realize the objectives highlighted under the Vision 2030. In fact, a total of SR138 billion of capital spending will be targeted to support Vision 2030 initiatives, specifically within housing, mining, energy, manufacturing, transport, entertainment, telecoms and SMEs.

Separately, a total of SR133 billion will be expended by the PIF and the NDF in capital injections into Saudi Arabia during the year, although this amount will not be funded through the 2018 budget. PIF will spend SR83 billion, whilst the NDF will spend SR50 billion, in specific projects in Saudi Arabia, which will significantly boost the level of capital expenditure in the Kingdom. In total, capital spending from government, PIF and NDF will amount to SR338 billion in 2018.

Figure 4: Budgeted revenue

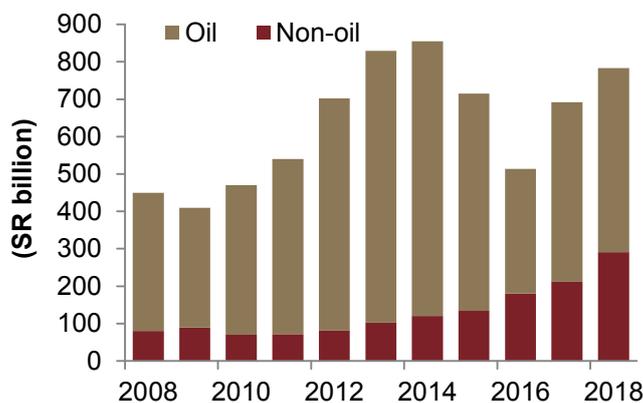
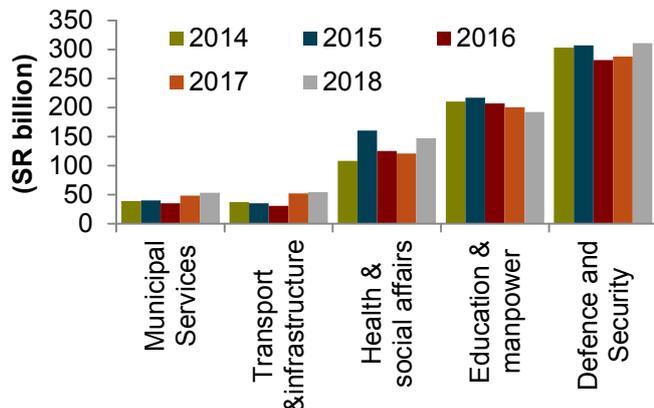


Figure 5: Budgeted allocations by sector





The government announced a SR72 billion program to stimulate private sector growth...

...as part of a 4-year stimulus package.

The package includes 16 initiatives directed towards a number of sectors, such as housing, exports and manufacturing.

Separately, a total of SR133 billion will be expended by the PIF and the NDF in capital injections into Saudi Arabia during the year,

Current spending is expected to increase by 4 percent, year-on-year, to a budgeted total of SR773 billion...

...with an estimated based SR30 billion related to expenditure on Citizens Account program in 2018.

Box 1: Private Sector Stimulus Package

The government announced a SR72 billion program to stimulate private sector growth, as part of a 4-year stimulus package. The package includes 16 initiatives directed towards a number of sectors, such as housing, exports and manufacturing.

The package aims to boost growth in the private sector, especially after the a slowdown in the local economy in the past two years. A considerable portion of the SR72 stimulus package is allocated to the real estate sector; SR21 billion for residential housing loans, and SR14 billion for efficient building technologies projects. The two initiatives together account for about 48 percent of total stimulus package, thereby showing significant support to the housing sector.

The stimulus package also includes SR10 billion for mega private sector projects, SR5 billion for an export bank, SR5 billion for an investment program and SR2.8 billion for SME venture capital projects. An important initiative to the SMEs is reimbursement of government fees paid by SMEs for the first three years of the start-up with an allocated package of SR7 billion, for companies launched from 2016 onwards. The repayment also covers 80 percent of SMEs expat levies for three years, thereby helping such enterprises cope with costs in the initial years of transition under current economic reform plans.

The stimulus package is a clear sign that particular effort in being made by government to enhance competitiveness and attract investments in the private sector. The package is expected to enhance growth in the private sector through encouraging investment and providing support to the key growth enablers in the economy, such as SMEs.

Moving forward, the PIF and the NDF are likely to take a more leading role in investment within the Kingdom, with government led capital spending being a less prominent tool for growth, when compared historically.

Meanwhile, current spending (the more rigid part of expenditure) is expected to increase by 4 percent, year-on-year, to a budgeted total of SR773 billion. A freeze on the public sector wage bill, since September 2016, should help reduce the rises in Compensation of Employees', which is the largest component of current spending, constituting 45 percent of total expenditure in 2017, according to our estimates.

Payments under the Citizens Account program, which commence on 21st December 2017, will also raise current expenditures in 2018, and beyond. The program will initially provide monthly payments to protect the most vulnerable households from energy price reform, but will eventually include all types of welfare payments. According the budget statement, around SR2.5 billion per month, or SR30 billion annually, will be earmarked for the Citizens Account program.

While budgeted expenditure in 2018 spans all sectors, the priorities are consistent with recent years (Figure 5). Military, security services, education, healthcare and economic resources make up 77 percent of total allocations (Table 1, Box 2).



While budgeted expenditure in 2018 spans all sectors, the priorities are consistent with recent years....

...with military, security services, education, healthcare and economic resources making up 77 percent of total allocations.

Total revenue is budgeted at SR783 billion with 63 percent, or SR492 billion coming from oil revenue.

We calculate that a Saudi export price of \$58 pb (around \$60 pb for Brent) and crude oil production of 10.1 mbpd in 2018 are consistent with the oil revenue projections.

We believe the government is budgeting for continued compliance with OPEC cuts.

The government has budgeted for non-oil revenue to reach SR291 billion in 2018, showing a strong growth of 37 percent and 14

Table 1. 2018 Budget Allocation
(SR billion)

Budget Allocation	2017 B	2017 A	2018 B	Difference (2017B-2018B)
Expenditures	890	926	978	88
Education and Training	200	228	192	-8
Health & Social Development	120	133	147	27
Municipality Services	48	49	53	5
Military and Security Services	288	334	311	23
Infrastructure & Transport	52	29	54	2
Economic Resources	47	39	105	58
Public Administration	27	30	26	-1
Public Programs Unit	108	85	89	-19

Note: "B" refers to budgeted spending, "A" refers to actual spending

Box 2: Budget Allocation 2018

After coupling the separate allocations for military and security, we can see that the combined allocation under Military and Security Services was up 8 percent to SR311 billion in 2018 whilst Education and Training, the second largest budget item, was allocated SR192 billion in 2018, representing a decline of 4 percent year-on-year from the budgeted total of SR200 billion in 2017. Health and Social Development rose by 22 percent year-on-year to SR147 billion. Municipality Services, which made up 5 percent of the total allocation, rose by 10 percent or SR5 billion, year on year. Economic Resources, represents 11 percent or SR105 billion of budgeted expenditure in 2018, up 122 percent year-on-year. Public Administration totaled SR26 billion, almost flat year-on-year, whilst Transportation budget was raised 34 percent year-on-year, to SR54 billion. Lastly, SR89 billion was allocated for Public Programs Unit.

Revenue

Total revenue is budgeted at SR783 billion with 63 percent, or SR492 billion coming from oil revenue. What is not clear, at this point, is whether all of the budgeted oil revenue will be derived from oil export revenue, or if some part of the SR492 billion will be raised from domestic energy price reform, which is set to be announced in Q1 2018.

On the assumption that all of oil revenue is derived from oil export revenue, we calculate that a Saudi export price of \$58 pb (around \$60 pb for Brent) and crude oil production of 10.1 mbpd in 2018 are consistent with the oil revenue projections contained in the budget. We believe the government is budgeting for continued compliance with OPEC cuts, which were extended to the end of 2018 in a meeting held by the organization back in November. Whilst we expect Saudi crude oil production to rise very modestly year-on-year, there are risks that higher OPEC, and Saudi production, could materialize, especially if the organization chooses to exit from cuts earlier than scheduled (Box 3).

The government has budgeted for non-oil revenue to reach SR291 billion in 2018, showing a strong growth of 37 percent and 14 percent over 2017's budgeted and actual figures, respectively. Rises in non-oil revenue will come from a number of areas, including rises in expat dependent fees and the introduction of expat levies, the



percent over 2017's budgeted and actual figures.

Another area where revenue will be improved is through rises in domestic energy prices.

Our budgeted oil revenues is equal to SR466 billion, or SR26 billion less than the government's budgeted revenue.

We calculate the fiscal breakeven oil price is \$79 pb for Saudi export crude (equivalent to around \$81 pb for Brent).

Full year Brent oil prices in 2017 are expected to average \$54 pb, compared with our forecast of \$52 pb.

Despite the current optimism over price, the oil market faces a number of challenges in the year ahead.

Firstly, there are issues related OPEC non-OPEC cuts, and whether they will indeed be maintained till the end of the year.

introduction of VAT, receipts from white land tax, improvement in the collection process of taxes, and from improvements in investment income due to PIF's more active approach in managing sovereign wealth.

Another area where revenue will be improved is through rises in domestic energy prices. Prior to the budget, the Saudi Cabinet approved a change to electricity tariffs. Separately, Saudi Electricity Company (SEC) stated it would pay a fee equivalent to the rise in tariffs to government, which, according to Electricity and Cogeneration Regulatory Authority (ECRA), could total SR14 billion. Whilst no other energy product prices were raised, the Ministry of Energy did state that energy price changes will be specified at some point during Q1 2018.

Jadwa Investment's 2018 budget forecast

Overall, due to recently observed efficiency in government spending, with the gap between actual and budgeted spending narrowing, our forecasts are more closer to the budget statement.

Whilst we expect Brent oil prices to average \$60 pb, and crude oil production to be 10.1 mbpd, in 2018, our budgeted oil revenues is equal to SR466 billion, or SR26 billion less than the government's budgeted revenue (Box 3). The difference in oil revenue may be due to additional revenue from domestic energy price reform, which is set to be announced in Q1 2018. On the non-oil revenue side, we expect to see this figure equal the budgeted figure of SR291 billion. As a result, we forecast a slightly higher budget deficit of SR220 billion in 2018, equivalent to 7.6 percent of estimated GDP.

The oil price level necessary for revenues to balance our forecast level of government spending, known as the fiscal breakeven oil price, is \$79 pb for Saudi export crude (equivalent to around \$81 pb for Brent). This is higher than the \$77 pb fiscal breakeven for 2017 and is based on our production assumption of 10.1 mbpd and an oil export/revenue transfer ratio of 75 percent. We also assume no year-on-year growth in domestic oil consumption in 2018. This is due to more gas used in the Kingdom's fuel mix, and due to energy price hikes that have been announced or that are expected to be announced in Q1 2018.

Box 3: Oil market outlook for 2018

Full year Brent oil prices in 2017 are expected to average \$54 pb, compared with our forecast of \$52 pb, resulting in a 25 percent rise year-on-year (Figure 6). Improving sentiment over global oil demand and OPEC, and other major producers, adherence to cuts during the year helped push up prices. More recently, oil price have seen even larger gains as OPEC and others agreed to extend the cut deal to the end of 2018.

Despite the current optimism over price, the oil market faces a number of challenges in the year ahead. Firstly, there are issues related to OPEC and non-OPEC cuts, and whether they will indeed be maintained until the end of the year. Secondly, of course, is the prospect of continued rebound in US shale oil production.

In its latest monthly oil report, OPEC raised global oil demand up for the fourth consecutive month, underlining the bullish tone towards oil prices in recent months. Back in July 2017, OPEC's monthly oil report forecasted global oil demand would rise by around 1.26 million



Secondly, of course, is the prospect of continued rebound in US shale oil production.

US oil production is expected to rise by 11 percent year-on-year in 2017 (to 9.7 mbpd), and 5 percent in 2018 (to 10.1 mbpd).

Whilst OPEC and some non-OPEC producers agreed to extending cuts till end of 2018...

...a decision to exit cuts could take place as soon as June 2018...

barrels per day (mbpd) year-on-year in 2018, but this was raised to 1.51 mbpd in its November report. Three countries alone are expected to contribute half of the yearly rises in demand in 2018, with China contributing 28 percent, and US and India both 12 percent each, year-on-year.

Crude oil imports in China are expected to keep growing, with higher refinery intake, additional crude oil for strategic storage purposes, and continued lower domestic crude oil production, all supporting growth in 2018. India is also expected to see continued rises in imports, with overall oil consumption expected to rise by 4 percent year-on-year in 2018. In the US, according to US Energy Information Administration's (EIA) forecasts, total US liquid consumption will rise by 2 percent, year-on-year in 2018, compared to an average of 0.8 percent in both 2016 & 2017.

Meanwhile, latest forecasts from the EIA show sizable rises in total US crude oil production in both 2017 and 2018 (Figure 7). US oil production is expected to rise by 11 percent year-on-year in 2017 (to 9.7 mbpd), and 5 percent in 2018 (to 10.1 mbpd), much slower than average of 14 percent between 2012-15, but a rebound after decline in yearly production in 2016 (at 8.8 mbpd). The rebound, seen since the start of 2017, has come entirely from unconventional (or shale) oil sources and has been encouraged by a recovery in oil prices following an agreement between OPEC and certain non-OPEC countries. After hitting peak production back in February 2015 (at 5.5 mbpd), US shale oil began to decline, as persistent global over supply, helped by record OPEC output, pushed prices downwards. After OPEC cuts and a subsequent oil price increase, from November 2016 onwards, there seems to have been an influx of renewed investment among US shale producers. As a result, US shale oil is expected to achieve an all-time record high of 6 mbpd at the end of 2018.

Whilst OPEC and some non-OPEC producers agreed to extending cuts till end of 2018, a decision to exit cuts could take place as soon as June 2018. The decision will likely depend on whether countries involved in cuts believe that oil balances will fall into sharp deficit or not. Under current projections, when holding all other factors constant, the oil market would likely fall into steep deficit in H2 2018, at -1.6 mbpd, compared to virtually flat oil balances in H1 2018 (Figure 8). Therefore, a major unknown in oil markets in the year

Figure 6: Brent oil prices

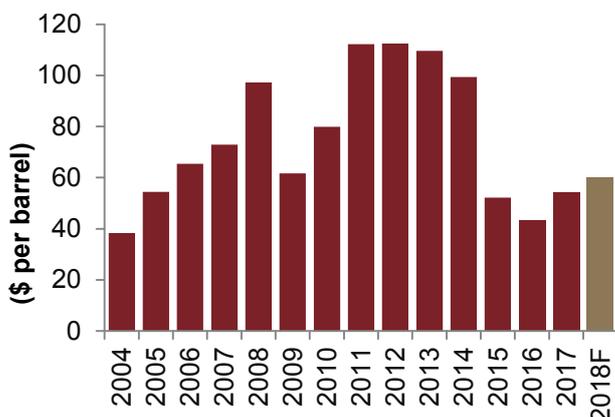
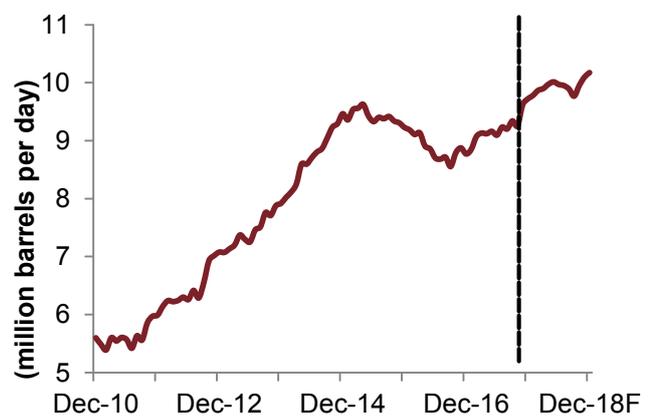


Figure 7: US crude oil production





...which therefore presents a major unknown in oil markets in the year ahead.

Despite the current elevated level of prices, we expect full year Brent oil prices to average \$60 pb in 2018, up from our previous forecast of \$56 pb

The preliminary 2017 fiscal performance was also highlighted in the budget document.

As we highlighted in our Q3 Budget Statement Report actual oil revenue were lower budgeted mainly as a result of lower implied transfer tax.

Actual spending was higher than the budgeted, and so too was the actual deficit, at SR230 billion equivalent to 8.9 percent of GDP.

ahead is related to possible exiting from OPEC and non-OPEC cuts. Specifically, if an exit from cuts does take place, how will it play out? At this moment in time, there have been talks of gradually increasing output, to ensure that the market is not shocked. Such an exit strategy would require OPEC and non-OPEC members to agree on individual output levels again, which opens up risks of disagreement, and the possibility of disorderly exit, whereby all producers begin to accelerate output. Whilst we see the latter option as least likely, since it benefits no one, it still represents a risk.

Looking at the oil market as a whole in 2018, we see downward risks to prices attached to expanding US output and possible OPEC and non-OPEC exit from cuts. Therefore, despite the current elevated level of prices, we expect full year Brent oil prices to average \$60 pb in 2018, up from our previous forecast of \$56 pb.

Budgetary Performance in 2017

The preliminary 2017 fiscal performance was also highlighted in the budget document. As we highlighted in our [Q3 Budget Statement Report](#) actual oil revenue were lower budgeted mainly as a result of lower implied transfer tax. Actual spending was higher than the budgeted, and so too was the actual deficit, at SR230 billion equivalent to 8.9 percent of GDP (Jadwa Investment: SR197 billion, 7.5 percent of GDP).

Actual revenue totaled SR696 billion (Jadwa Investment: SR693 billion), which was marginally higher than budgeted levels, and up 34 year-on-year. We estimated that the 2017 budget was consistent with a Saudi export price of \$52 pb and production of 10.1 mbpd. Based on preliminary oil export data, we estimate that the Saudi export price of crude and refined products is expected to be closer to \$56 pb in 2017, 36 percent higher year-on-year, and 8 percent

Table 2. 2017 Budget data
(SR billion)

	Budget	Actual	Difference
Revenues	692	696	4
Expenditures	890	926	36
Balance	198	230	32

Figure 8: Global oil balances assuming cuts hold until end 2018

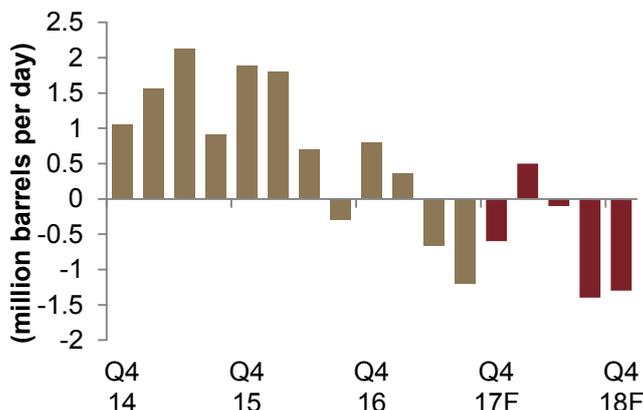
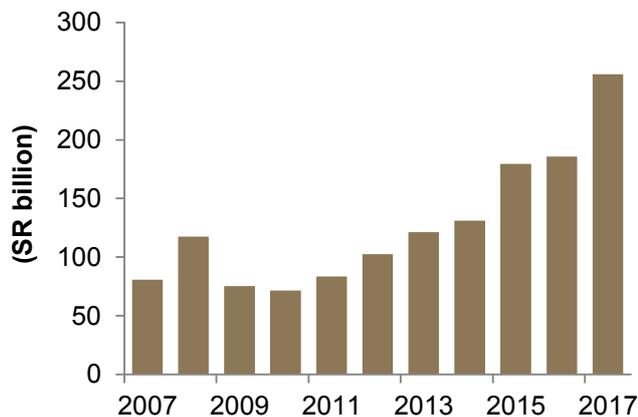


Figure 9: Actual non-oil revenue





Actual revenue totaled SR696 billion (Jadwa Investment: SR693 billion), which was marginally higher than budgeted levels, and up 34 year-on-year.

Non-oil revenues totaled SR256 billion, up by 37 percent year-on-year.

From a sectorial allocation viewpoint, spending on some sectors was higher than budgeted.

Current spending increased by SR19 billion, year-on-year to reach SR783 billion in 2016...

...with the largest contributor to current expenses, 'Compensation of Employees', expected to have seen minimum growth year-on-year in 2017.

Capital expenditure declined by 2 percent, year-on-year to reach SR180 billion in 2017...

...this puts capital spending at 19 percent of total expenditure, the lowest since 2006.

Public debt totaled SR438 billion at the end of 2017, with foreign debt making up 42 percent of the total debt.

The 2018 budget included preliminary macroeconomic data for 2017...

higher than the budget oil price. Actual year-to-November Saudi crude oil production averaged 9.9 mbpd, slightly lower than our forecast of 10 mbpd for 2017.

Non-oil revenues totaled SR256 billion, up by 37 percent year-on-year. The growth in non-oil revenue was mainly as a result of sizable yearly increase from taxes on goods and services, as a result of a rise in the 'excise tax' on tobacco and soft drinks. There were also significant improvements in investment income due to the PIF's more active approach in managing sovereign wealth (Figure 9). Expenditure amounted to SR926 billion, 4 percent higher than budgeted and 1 percent lower than 2016 actual levels. This was the third consecutive year-on-year decline in actual spending.

From a sectorial allocation viewpoint, spending on some sectors was higher than budgeted, including the military and security, health and education. Meanwhile other sectors saw a lower-than-budgeted allocations. It is important to keep in mind that the initial estimates of government spending and revenues contained in the budget statement tend to be revised. In general, both are higher, with the rise in spending usually larger than that for revenue.

Current spending increased by SR19 billion, year-on-year to reach SR783 billion in 2017. The largest contributor to current expenses, 'Compensation of Employees', is expected to have seen minimum growth year-on-year in 2017. This is mainly because of a reduction in most public sector workers allowances and freezing of wages in Q1 2017, as per the royal decree in September 2016, with a separate royal decree in April 2017, allowances of public sectors workers were reinstated, although wage freezes were kept in place. The minimal rise in 'Compensation of Employees', is a very significant achievement, especially since this segment saw an average annual rise of 11 percent between 2010-16.

Capital expenditure declined by 2 percent, year-on-year to reach SR180 billion in 2017. This puts capital spending at 19 percent of total expenditure, the lowest since 2006. That being said, the reduction in capital spending is more reflective of the efforts by the government to enhance its efficiency specifically in this area of expenditure. This point was reiterated by the Ministry of Finance which, earlier this year, stating that the BCOSR had succeeded in saving up to SR17 billion for the whole of 2017, after reviewing state projects and other expenditures.

During 2017, the government continued to issue a series of both international and domestic sovereign bonds/sukuk. Public debt totaled SR317 billion at the beginning of 2017, but had risen to SR438 billion at the end of 2017, with foreign debt making up 42 percent of the total debt. As stated in the budget report, debt issuances are likely to continue in 2018. Currently, Commercial bank holdings of government bonds, the closest proxy to their holdings of government debt, reached SR244 billion in October 2017, up from SR178 billion at the end of 2016.

Economic Performance in 2017

The 2018 budget included preliminary macroeconomic data for 2017 with overall economic growth expected to fall to -0.5 percent year-on-year compared to our forecast of -0.9 percent and compared to 1.7 percent year-on-year in 2016. The decline in GDP was due to



...overall economic growth is expected to fall to -0.5 percent year-on-year in 2017 and compared to 1.7 percent year-on-year in 2016.

GDP was dragged down by a sizable decline in the oil sector due to Saudi Arabia's strict adherence to crude oil production cuts.

Meanwhile, non-oil sector growth rebounded to 1.5 percent during 2017...

...we see rise as a result of more focused and effective use of capital spending by the government during the year.

On a sectorial basis, according to our estimates, we see non-oil manufacturing as the best performing sector in 2017.

Preliminary 2017 data from budget statement showed inflation averaging -0.1 percent, compared to 3.4 percent in 2016

sizable declines in oil sector GDP, implied in the budget statement to be at -3.1 percent, compared to our estimates of -2.8 percent. Non-oil growth was at 1.5 percent year-on-year, compared to our forecast of 0.7 percent. Meanwhile, the Kingdom saw deflation for the first time since 2001, although this was mainly the result of base effects from higher domestic energy prices in 2016.

Real GDP growth declined by 0.5 percent in 2017, compared to a rise in 1.7 in 2016. As we had predicted, GDP was dragged down by a sizable decline in the oil sector. Saudi Arabia's strict adherence to crude oil production cuts, as part of an agreement with other OPEC members, meant oil sector GDP declined by -3.1 percent in 2017, as implied in the budget statement. Saudi oil production is expected to decline by 5 percent year-on-year, to an average of 10 mbpd in 2017, compared with 10.4 mbpd in 2016. Meanwhile, non-oil sector growth rebounded to 1.5 percent during 2017 (Figure 10). We see rise as a result of more focused and effective use of capital spending by the government during the year. Despite the 2018 budget statement showing lower capital spending, or 'Non-Financial Assets (Capital)', decreasing by 2 percent year-on-year, to SR180 billion, we believe it was used more effectively, with an emphasis on reducing bloated spending, as per the BCOSR guidance. Further, the reinstatement of public sector allowances, which took place following a royal decree in Q2 2017, also helped boost spending. This was reflected in point of sales transactions which showed a significant rise by 4.4 percent year-to-October.

On a sectorial basis, according to our estimates, we see non-oil manufacturing as the best performing sector in 2017. The start-up of Petro Rabigh Phase II plant in mid-2017, and the commissioning of the \$20 billion Jubail-based Sadara Chemical Company in August 2017, are expected to have dramatically improved the sectors outlook. The construction sector, on the other hand, is expected to have seen negative growth, despite improving on a year-on-year basis.

Preliminary 2017 data from budget statement showed **Inflation** averaging -0.1 percent, compared to 3.4 percent in 2016 (Figure 11). The delayed reforms in utility and fuel prices, which were expected in July 2017, and the higher base effects from 2016 energy price hikes resulted in the Kingdom seeing deflation for the first time since 2001.

Figure 10: Real non-GDP growth

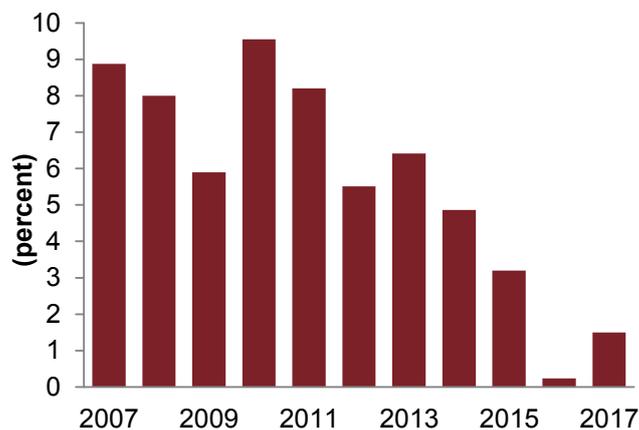
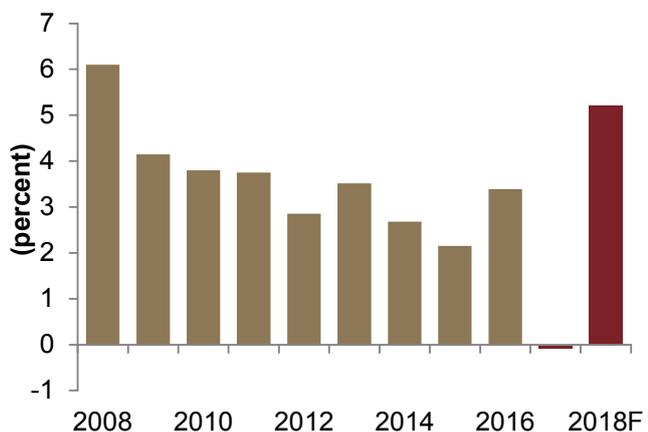


Figure 11: Inflation (year-on-year change)





We expect an improvement in the economy in the year ahead, supported by the oil and non-oil sector.

That said, a number of downside risks to growth are present....

...but risks into consideration, we see government expenditure for 2018 as being sufficient to continue supporting positive growth in the non-oil private sector.

The budget statement states that the Saudi economy will grow by 2.7 percent in 2018...

...with non-oil GDP growth at 3.7 percent...

...this would imply a growth of 1.4 percent from the oil sector.

The Economic Outlook for 2018

We expect an improvement in the economy in the year ahead, supported by the oil and non-oil sector. Oil sector GDP is expected to exhibit some modest improvements as oil production rises as OPEC and non-OPEC countries gradually exiting from cuts. Growth in the non-oil sector is forecast to improve as the expansionary budget, with a specific set of stimulus packages, lift activity.

That said, a number of downside risks to growth are present. Consumer spending could be affected after the implementation of the VAT, although this could be mitigated somewhat by payments received under the Citizens Account. Whilst the such payments will protect the most vulnerable households, more affluent households will still incur higher costs related to a rise in electricity tariffs. Meanwhile, a rise in expat dependency fees will further squeeze expat households, whilst the private sector will also see rising costs related to the implementation of expat levies. Furthermore, whilst no other energy product prices have been raised so far, the Ministry of Energy did state that energy price changes will be specified at some point during Q1 2018. Depending what energy prices are increased, and by how much, is also going to impact running costs of private companies and discretionary income of a number of households.

Taking the above risks into consideration, we see government expenditure for 2018 as being sufficient to continue supporting positive growth in the non-oil sector. In addition, the targeted stimulus package focusing on SMEs, housing, construction and export growth, amongst others, will particularly be growth-enhancing to the private sector. Overall, the expansionary budget should be able to cushion the economy from potentially disruptive effects of forthcoming measures such as; VAT, rises in dependency fees, expat levies and energy price reforms.

The budget statement states that the Saudi economy will grow by 2.7 percent in 2018, with non-oil GDP growth at 3.7 percent. This would imply a growth of 1.4 percent from the oil sector. We see the main bulk of oil sector growth likely coming from the addition of the Jizan refinery, which is expected to come on-line during the year, rather than any major rise in crude oil production.

Inflation is expected to pick up dramatically in 2018, as a the combined effects from the implementation of VAT, and energy price reform is enacted. With respects to VAT, the impact of the 5 percent tax increase is expected to vary among the CPI basket segments. As for energy, a hike in electricity tariffs has already been announced, with a rise in tariffs for residential, commercial, agricultural, healthcare, private education, and charitable institutions, taking effect from 1st January. Although we expect inflation to rise to 5.2 percent in 2018, this may be adjusted once the remainder of energy price reform is disclosed in Q1 2018.

Table 3. 2017 results and 2018 forecasts in budget statement

	2017 Actual	2018 Forecast
Real GDP (% change)	-0.5	2.7
Non-oil GDP (% change)	1.5	3.7
Inflation (2007 = 100, %)	-0.1	5.7



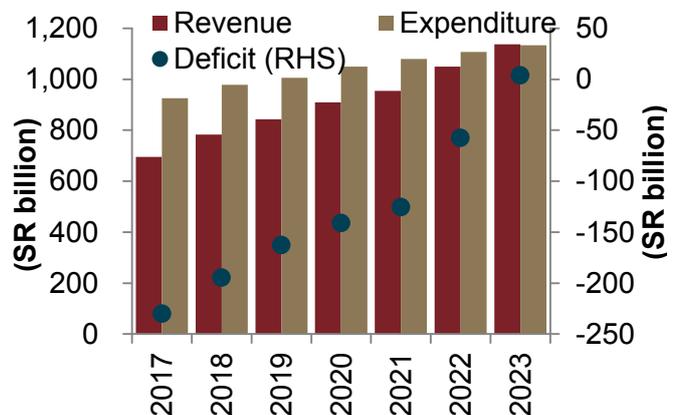
Fiscal Balance Program II

The budget also disclosed revenue and expense projections to 2023, thereby updating the previous Fiscal Balance Program (FBP).

The budget also disclosed revenue and expense projections to 2023, thereby updating the previous Fiscal Balance Program (FBP). On the expenditure side, the Kingdom is expected to see an expansionary budget stance until 2023, with an average annual increase in budgeted spending by 3 percent between 2018-2023, reaching SR1.34 trillion in spending come 2023 (Figure 12) . However the budget statement also stated that the debt to GDP ratio would not be allowed to exceed 25 percent over the balancing phase which, according to our calculations, means the Kingdom has room to accumulate approximately SR800 billion debt in total by 2023.

(We will be issuing a separate report on the updated Fiscal Balance Program, as outlined in the budget statement, very shortly)

Figure 12: Fiscal Balance Program to 2023





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