جدوى للإستثمار
Jadwa Investment

May 2018

Q1 2018 Budget Statement

Social benefits contribute to higher expenditure

- The Q1 2018 quarterly budget statement shows the government's efforts to raise non-oil revenue is working, with a near triple yearly rise in 'Taxes on goods and services' seen during the quarter.

- Despite oil export revenue expected to have risen by 17 percent year-on-year in Q1 2018, government oil revenue was up by only 2 percent. The Ministry of Finance (MoF) stated this was due to a switch to quarterly dividends, and, as such, a part of Q1 contributions were expected to be received in the Q2.

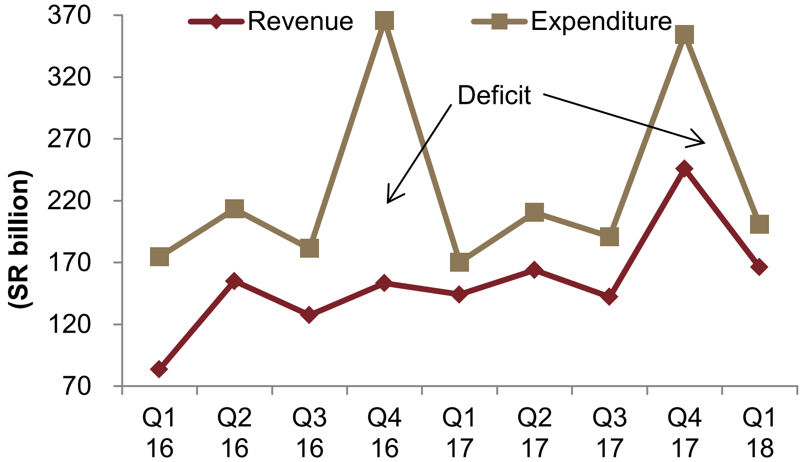
- Whilst expenditure has risen, a significant proportion of this rise has been due to 'Social Benefits' related to the Citizen's Account, which have helped cushion the effects of VAT and energy price rises for Saudi households.

- Partly, as a result of higher yearly expenditure, the fiscal deficit increased by 31 percent year-on-year, to SR34 billion. According to the Q1 2018 budget report, the deficit was financed by external (SR22.5 billion) and domestic (SR18 billion) borrowing.

- More recently, in Q2 2018, the government announced the issuance of a SR42 billion international bond and a SR4.9 billion domestic sukuk. Adding this to the Q1 2018 total puts current government debt at SR529 billion.

- Looking ahead into Q2 and beyond, we expect to see continued yearly rises in tax income, with taxes as a whole expected to generate SR142 billion in revenue in 2018, a rise of 46 percent year-on-year. Meanwhile, with Brent oil prices currently trading above $75 per barrel (pb), we also expect to see sizable rises in government oil revenue as well.

Figure 1: The fiscal deficit increased by 31 percent year-on-year, to SR34 billion, in Q1 2018



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Released: May-10-2018, 13:00 UTC+3

Saudi government revenue totaled SR166 billion in Q1 2018, up 15 percent year-on-year.

Government oil revenue was up only 2 percent….

...despite the Saudi export price of crude and refined products rising by 11 percent year-on-year….

...with MoF stating this was due to a switch to quarterly dividends, with a part of Q1 contribution's expected to be received in the Q2.

Table 1: Government Revenue (SR million)

Revenues	Q1 2017	Q1 2018	Change (%)
Oil revenues	112,003	113,947	2
Non-oil revenues, of which;	32,073	52,316	63
-Taxes on income, profits and capital gains	2,031	2,471	22
-Taxes on goods and services (including petroleum product charges and harmful product tax)	5,690	22,653	>100
-Taxes on trade and transactions (customs duties)	4,536	3,786	-17
-Other Taxes (including Zakat)	1,557	3,161	>100
-Other revenues (including returns from SAMA and PIF)	18,259	20,245	11
Total	**144,076**	**166,263**	**15**

Revenue:

Saudi government revenue totaled SR166 billion in Q1 2018, up by 15 percent, or SR22 billion, year-on-year (Table 1). Non-oil revenue (31 percent of total revenue) was almost wholly behind the growth in total government revenue, rising by 63 percent year-on-year. According to our calculations, despite oil export revenue rising by 17 percent year-on-year in Q1 2018 (Box 1), government **oil revenue** was up only 2 percent. The MoF stated this was due to a switch to quarterly dividends, and, as such, a part of Q1 contributions are expected to be received in the Q2.

Box 1: Oil export revenue

We estimate that the Saudi export price of crude and refined products increased by 11 percent year-on-year, to $64 per barrel (pb) in Q1 2018, with 9 million barrels per day (mbpd) of crude oil and refined products being exported during the quarter. Accordingly, oil export revenue is expected to have totaled SR190 billion in Q1 2018, compared to SR162 billion in Q1 2017 (Figure 2). Historically speaking, on a quarterly basis, the implied transfer ratio (the difference between oil export revenue and government revenue) has averaged around 67 percent, whereas in Q1 2018 the implied transfer ratio was around 61 percent, although, as per MoF's

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

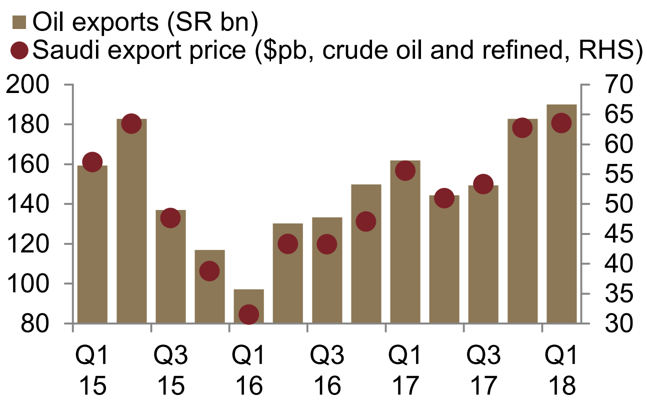
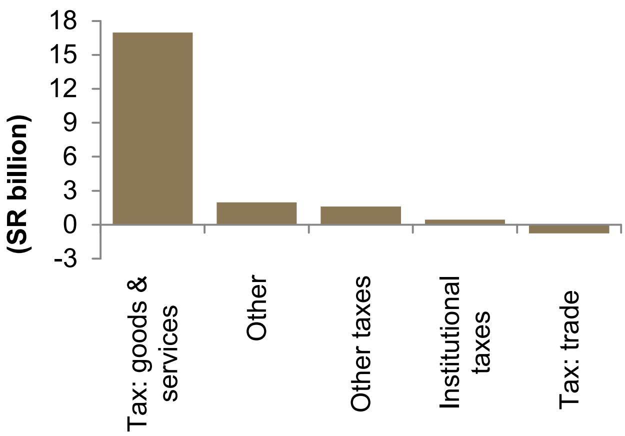


Figure 3: Yearly change in non-oil revenue



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

statement, this will rise as the government receives the remainder of contributions in Q2 2018.

Moreover, in preparation for a portion of Saudi Aramco's shares being listed on the Saudi Stock Exchange and possibly another international stock exchange, the switch towards quarterly oil revenue transfers reflects, from Aramco's perspective, closer alignment towards international financial reporting standards, making disclosures through interim financial statements much easier.

We expect oil export revenue to show sizable improvements on a yearly and quarterly basis in Q2 2018.

Brent oil prices are currently above $75 pb as OPEC and some non-OPEC producers continue to comply with output targets. Additionally, rising geopolitical tensions, specifically as the US reapplies sanctions on Iran, are likely to impact both oil output and prices in the months ahead. We therefore expect oil export revenue to show sizable improvements on a yearly and quarterly basis in Q2 2018.

The government's efforts to raise non-oil revenue through structured economic reform is evident in the latest budget release.

The government's efforts to raise **non-oil revenue** through structured economic reform is evident in the latest budget release, with this segment rising by 63 percent year-on-year. Most of these gains came from 'Taxes on goods and services', which nearly tripled year-on-year, to SR22.6 billion (Figure 3). 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. According to the updated Fiscal Balance Program (FBP), the government expects 'Taxes on goods and services' to rise by 82 percent year-on-year to an around SR85 billion in 2018, as a whole. Of this, VAT is projected to generate SR23 billion, excise tax SR9 billion, and expat levies SR28 billion. In fact, 'Taxes on goods and services' is expected to be the major contributor to non-oil revenue growth in 2018, with this segment showing the largest change overall (Figure 4).

Most of these rises in Q1 came from 'Taxes on goods and services', which near tripled year-on-year, to SR22.6 billion.

Whilst taxes as a whole are expected to generate SR142 billion in revenue in 2018, the remainder of non-oil revenue, SR149 billion, is expected to be derived from 'Other revenues (including investment returns from the Saudi Arabian Monetary Authority (SAMA) and Public Investment Fund (PIF)'. In Q1 2018, this segment was up by 11 percent year-on-year, to SR20 billion. The yearly rise could, in part, be due to higher dividends received by PIF from its holdings in TASI listed companies, with these payments likely showing up as investment income in Q1 (Figure 5). Additionally, the rise may also

Other revenues (including returns from SAMA and PIF) was up by 11 percent year-on-year, to SR20 billion…

Figure 4: Tax on goods and services to be largest contributor to non-oil revenue growth in 2018

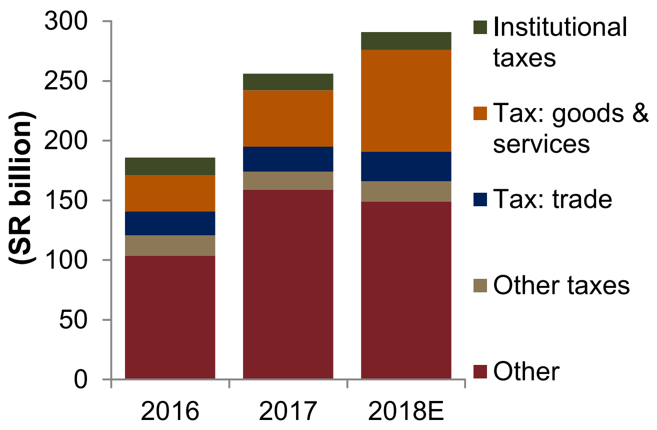
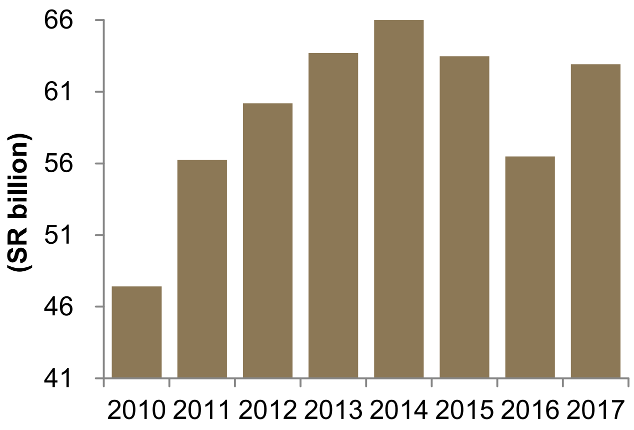


Figure 5: TASI listed company dividends



...as a result of higher TASI listed company dividends…

...and an increase in SAMA holdings of US treasury bills.

Due to the seasonal nature of dividends from TASI listed companies, Q2 2018 'Other Revenue' is likely to be lower on a quarter-on-quarter basis

Total government expenses rose by 18 percent year-on-year in Q1 2018, to a total of SR201 billion…

...as 'Compensation of Employees' rose 20 percent, or SR19 billion, over the same period.

reflect an improvement in SAMA investment returns. Specifically, SAMA holdings of US treasury bills have increased by 22 percent over the last year (Figure 6). Although US Treasury securities are generally seen as safe but comparably low yielding security, their yields rose close to three year highs in Q1, as expectations over inflation picked up after the passing of US tax reform in February. During Q1 2017, the yield on 10-year US Treasury bills reached a maximum of 2.62 percent, but a year later they hit a high point of 2.96 percent. The higher yield combined with a larger holding of such securities no doubt helped push up 'Other Revenue'.

Looking ahead, due to the seasonal nature of dividends from TASI listed companies, Q2 2018 'Other Revenue' is likely to be lower on a quarter-on-quarter basis (*for more on this please see our Q2 2017 Budget Statement report published on August 2017*).

Expenditures:

Total government expenses rose by 18 percent year-on-year in Q1 2018, to a total of SR201 billion (Table 2 & Figure 7). Current expenditure, the lower growth element of government spending, was up 24 percent year-on-year, pushed up by the largest contributor to current expenses, 'Compensation of Employees', which rose 20 percent, or SR19 billion, over the same period.

Table 2: Government Expenditure (SR million)

Expenses	Q1 2017	Q1 2018	Change (%)
Compensation of Employees	94,085	112,922	20
Goods & Services	16,712	10,240	-39
Financing Expenses	1,258	4,145	>100
Subsidies	46	2,993	>100
Grants	571	30	-95
Social Benefits	6,607	18,782	>100
Other Expenses	21,922	25,521	16
Non-Financial Assets (Capital)	29,086	25,959	-11
Total	**170,287**	**200,592**	**18**

Figure 6: SAMA direct holdings of US Treasury securities

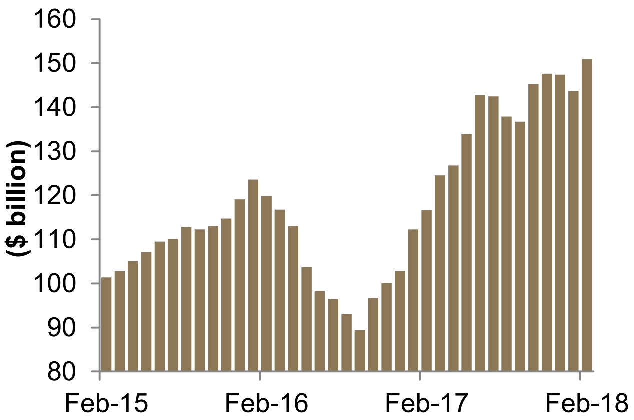
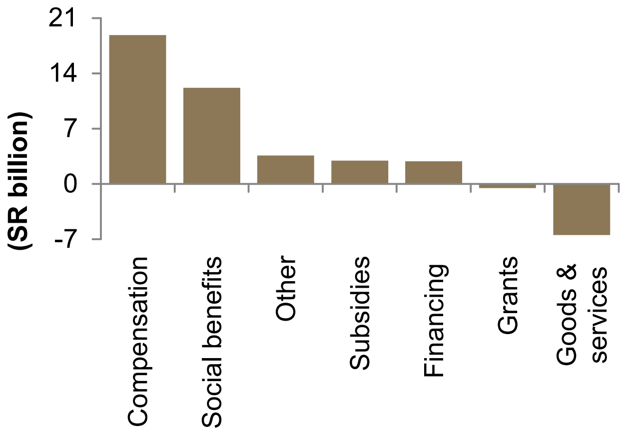


Figure 7: Year-on-year change in Q1 2018 current expenditure



The large yearly rise in 'Compensation of Employees' is partly a result of increases in allowances….

...paid to civil servants to compensate for higher living costs.

The large yearly rise in 'Compensation of Employees' is reflective of two factors. Firstly, in Q1 2017 these expenses were driven down by a reduction in public allowances, which were only later re-instated, in April 2017. Secondly, Q1 2018's 'Compensation of Employees' figure is also likely to include a monthly payment of SR1,000 per month, over the course of 2018 for civil servants in order to compensate for higher living costs, following a royal decree at the start of 2018. According to the Ministry of Commerce and Investment (MOCI), the total annual cost of these allowances would be around SR50 billion.

Expenditures on 'Goods and Services' continued to show yearly declines…

...in line with initiatives outlined in the FBP and implemented under the recently established SERC and SPU.

Expenditures on 'Goods and Services' continued to show yearly declines, falling by a sizable 39 percent in Q1 2018 year-on-year. This is in line with initiatives outlined in the FBP and implemented under the recently established Spending Efficiency and Realization Centre (SERC) and Strategic Procurement Unit (SPU). This point has been reiterated under the updated FBP, which states that the SERC and SPU will help achieve cumulative savings of SR220 billion by 2023, with a total saving of SR56 billion being realized in 2017.

Social Benefits' saw large yearly rises in Q1 2018 due mainly to payments related to the Citizen's Account.

'Social Benefits' saw large yearly rises in Q1 2018, up almost 200 percent to SR18 billion. As indicated by the MoF, the rise is 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 SR6.5 billion was disbursed during Q1, with roughly 3.5 million households within the Kingdom benefitting. By April 2018, a total of SR10.8 billion had been disbursed through the program so far (Figure 8).

'Financing Expenses' continued to exhibit year-on-year rises, in-line with rising government debt.

'Financing Expenses' continued to exhibit year-on-year rises, in-line with rising government debt. This segment was up SR2.8 billion, or 229 percent, year-on-year in Q1 2018. Public debt totaled SR443 billion at the end of 2017, but had risen to SR483 billion at the end of Q1 2018. The rise included circa SR18 billion in domestic sukuk issuances during Q1 and a SR60 billion syndicated loan refinancing, which expanded the original facility by SR22.5 billion.

Current government debt is currently at SR529 billion…

More recently, the government announced the issuance of a SR42 billion international bond and a SR4.9 billion domestic sukuk. Adding this to the Q1 2018 total puts current government debt at SR529 billion. According to the Debt Management Office (DMO), the remainder of this year's debt issuance is likely to be raised

Figure 8: Cumulative payments under the Citizen's Account since inception

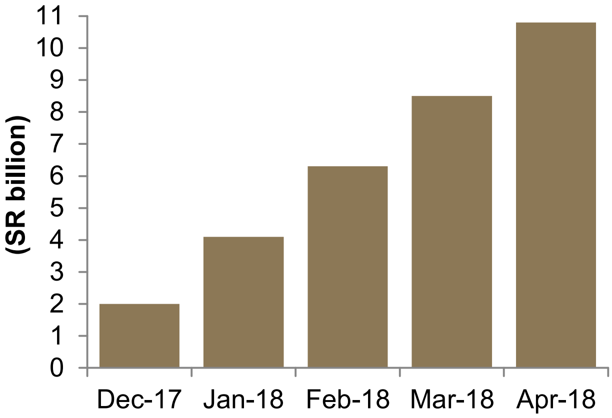
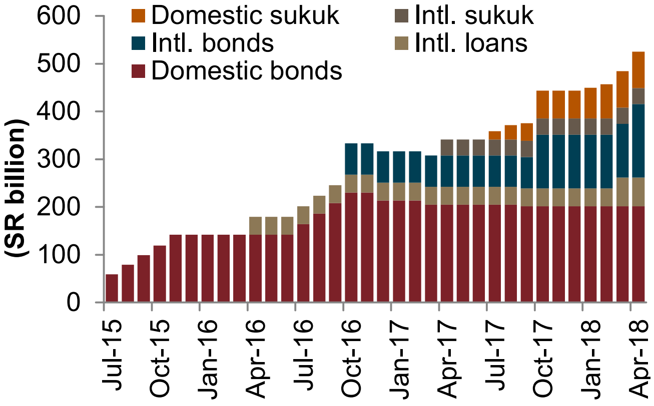


Figure 9: We expect government debt to rise to SR560 billion by the end of the year



...and we expect total debt to reach SR560 billion at the end of 2018, equivalent to 19 percent of GDP.

domestically. As of May 2018, a total of SR87 billion of debt had been issued this year and we expect debt issuances not to exceed SR117 billion in 2018. At this rate, therefore, we see a further SR30 billion in domestic bond issuances, taking total debt to SR560 billion at the end of 2018, equivalent to 19 percent of GDP (Figure 9).

The capital spending side of the expenses, or 'Non-Financial Assets (Capital)', was down by 11 percent year-on-year, to SR26 billion, in Q1 2018.

The capital spending side of the expenses, or 'Non-Financial Assets (Capital)', was down by 11 percent year-on-year, to SR26 billion, in Q1 2018. According to the annual fiscal budget, capital spending will total SR205 billion, up from SR180 billion in 2017. Therefore, Q1 2018's spending represents around 13 percent of the total. Taking into consideration the nature of payments related to government projects, with payment on completion, usually towards the end of the year, we do expect capital spending to rise significantly in the second half of 2018. That said, the MoF stated it is seeking to distribute spending in a more balanced manner throughout the fiscal year, in order to boost economic growth, which may suggest capital spending rising in Q2 2018.

Deficit:

A rise in expenditure at a faster rate than revenue meant the fiscal deficit increased by 31 percent year-on-year to SR34 billion...

A rise in expenditure at a faster rate than revenue meant the fiscal deficit increased by 31 percent year-on-year to SR34 billion. That said, the first quarter's deficit only accounts for 18 percent of the expected SR195 billion deficit for the whole year. According to the Q1 2018 budget report, the SR34 billion deficit was almost wholly financed by external and domestic borrowing. Looking ahead, with oil prices continuing to remain firmly above $70 pb, and further borrowing expected to be limited to SR30 billion, we could see more extensive use of the reserve account to finance any deficits.

...that said, the first quarter's deficit only accounts for 18 percent of the expected SR195 billion deficit for the whole year.

According to SAMA data, government FX reserves declined by $5.4 billion (SR20 billion) quarter-on-quarter in Q1 2018. This decline came about despite the government not borrowing from the reserve account. Additionally, with oil prices at their highest since late 2014, it is likely that the trade balance registered a surplus in Q1 2018 and helped maintain a positive current account, as was the case in Q4 2017. This implies that the $5.4 billion (SR20 billion) decline in FX reserves was probably due to a deficit in the Kingdom's financial account.

Outlook:

Looking ahead, we expect to see continued yearly rises in tax income…

The Q1 2018 quarterly budget shows that the government's efforts to raise non-oil revenue are going to plan, with sizable rises in tax income. Concurrently, whilst expenditure has risen, a significant proportion of this rise has been due to higher 'Social Benefits' which have helped cushion the effects of VAT and energy price rises on Saudi households.

...and oil revenue should be bolstered by multi-year high oil prices.

Looking ahead, although we expect to see continued yearly rises in tax income, due to the seasonal nature dividend payments in TASI, investment income is likely to decline quarter-on-quarter, as was the case last year. That said, oil revenue should be bolstered by multi-year high oil prices, especially as payments from Q1 are received in Q2.

Currently, year-to-date Brent oil prices average $68 pb as rising optimism around global economic growth, continued OPEC compliance to output targets and rising geopolitical tensions have all

Currently, year-to-date Brent oil prices average $68 pb…

contributed to pushing prices to levels not seen since Q4 2014 *(for more detail please refer to our latest Quarterly Oil Update published April 2018)*.

...and if oil prices remained at the current average for the remainder of the year...

If oil prices remained at the current average for the remainder of the year, we would expect a sizable improvement in the government's fiscal position. An average oil price of $68pb in 2018 would result in annual government oil revenue rising by as much as 9 percent to SR538 billion versus SR492 billion stated in the 2018 fiscal budget. Accordingly, total revenue would rise to SR829 billion, compared to a projected SR783 billion and this would result in reducing 2018's fiscal deficit to SR149 billion or 5.1 percent of GDP, compared to the projected SR195 billion (6.7 percent of GDP).

...this would result in annual government oil revenue rising by as much as 9 percent to SR538 billion.

We expect to publish an updated oil price forecast and a detailed analysis of government finances in our forthcoming 'Macroeconomic Update' and 'Quarterly Oil Update'.