جدوى للإستثمار
Jadwa Investment

August 2019

Q2 2019 Budget Statement

Sizable rises in capital spending

- Government revenue totaled SR261 billion in Q2 2019, down 5 percent, or SR12.8 billion, year-on-year. Declines were seen in both the oil and non-oil revenue side.

- Government oil revenue declined by 5 percent, to SR175 billion year-on-year, in Q2, although H1 oil revenue was up 15 percent year-on-year, to SR344 billion. Looking ahead, the impact of trade related tensions on the oil market will make it difficult to attain similar levels of oil revenue in the second half of 2019.

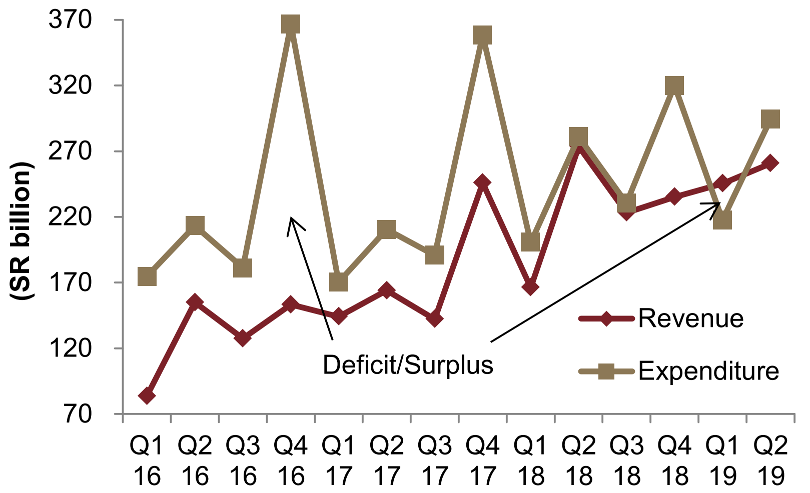
- Meanwhile, yearly declines in 'Other Revenues' (by 37 percent) pushed non-oil revenue down in Q2. That said, tax revenue, was up 20 percent on a yearly basis, and an increase in expat dependency fees will mean this segment will continue showing rises during the rest of 2019.

- Government expenses rose by 5 percent year-on-year in Q2 2019, to a total of SR294 billion, mainly as a result of higher capital spending, which was up 27 percent in Q2 2019, and 22 percent in H1 2019, on a year-on-year basis. We see this elevated level of capital spending as having directly contributed to lifting non-oil economic activity within the Kingdom.

- On the current expenditure side, the largest component of this segment, 'Compensation of Employees', showed no yearly rises, but 'Subsidies' and 'Social Benefits' were up due to spending on the Citizens' Accounts, social security, student bonuses and expenditure related to the private sector stimulus plan.

- The widening of the fiscal deficit to SR33.5 billion during Q2 (Figure 1), resulted in a mild deficit of SR5.6 billion in H1 2019. Taking into account that we recently revised our fiscal deficit to SR196 billion for the whole of 2019, we expect to see sizable deficits in the next two quarters of the year.

Figure 1: Fiscal balance moves into deficit in Q2 2019



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Looking ahead, the impact of trade related tensions on the oil market will make it difficult to attain similar levels of oil revenue in the second half of 2019.

Revenue:

Table 1: Government Revenue (SR million)

Revenues	Q2 2018	Q2 2019	Change (%)
Oil revenues	184,165	174,910	-5
Non-oil revenues, of which;	89,423	85,797	-4
-Taxes on income, profits and capital gains	6,648	6,311	-5
-Taxes on goods and services (including petroleum product charges and harmful product tax)	29,744	36,504	23
-Taxes on trade and transactions (customs duties)	3,413	4,401	29
-Other Taxes (including Zakat)	11,969	14,676	23
-Other revenues	37,650	23,904	-37
Total	**273,589**	**260,706**	**-5**

Government revenue totaled SR261 billion in Q2 2019, down 5 percent, or SR12.8 billion, year-on-year (Table 1). Declines were seen in both the oil and non-oil revenue side. Government **oil revenue** declined by 5 percent, to SR175 billion year-on-year (Figure 2), in-line with slightly lower yearly Brent oil prices (down 7 percent) during Q2 2019 (Box 1).

Box 1: Oil revenue

Whilst government oil revenue in H1 2019 was up 15 percent year-on-year, at SR344 billion, it is difficult to see similar levels of oil revenue in H2 2019. As we recently highlighted in our *Oil Update*, trade related tensions continue to weigh-in on the oil market, which therefore makes a rally in prices more difficult (Brent averaged $71 per barrel (pb) in H2 2018).

Brent oil prices are currently trading around $65 pb and the year-to-date average stands at $66 pb, in-line with our forecast for the year. This combined with flattish growth in oil exports, will, according to our calculations, result in government oil revenue totaling SR579 billion in 2019, down 5 percent over last year's total, and compared to a budgeted SR661 billion outlined in the 2019 fiscal budget statement.

Figure 2: Quarterly government oil revenue

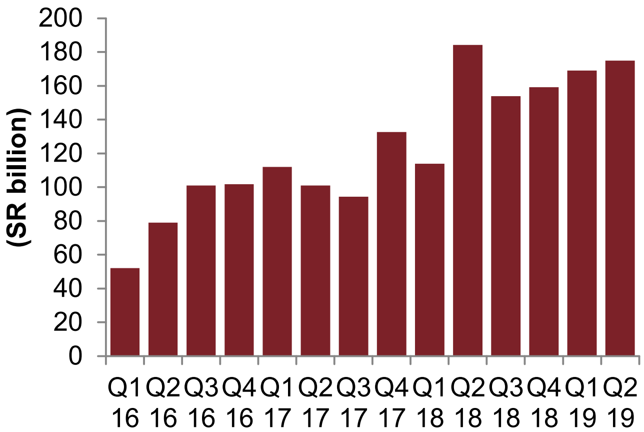
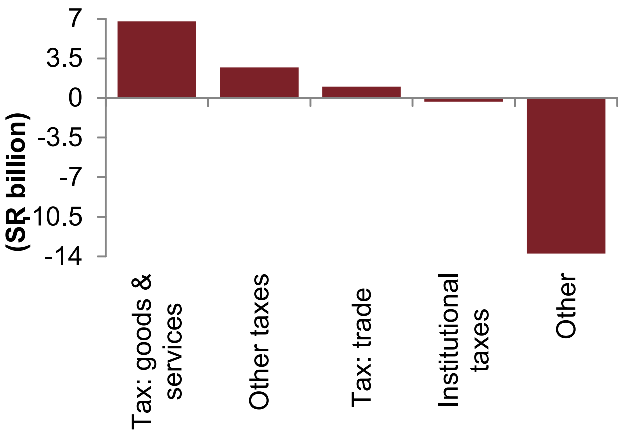


Figure 3: Non-oil revenue in Q2 dragged down by 'Other Revenues'



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

Meanwhile, yearly declines in 'Other Revenues' (by 37 percent) pushed non-oil revenue down in Q2.

Meanwhile, yearly declines in 'Other Revenues' (by 37 percent) pushed **non-oil revenue** down marginally by 4 percent year-on-year in Q2. It is not quite clear what caused the decline in 'Other Revenues', although this segment has tended to be inconsistent on a quarterly basis historically (Figure 4, Box 2).

Box 2: Other Revenues

Although 'Other Revenues' were down 21 percent year-on-year in H1 2019, this segment has tended to be inconsistent on a quarterly basis due to the ad-hoc nature of some of the components (not investment income), that are included with in it. In fact, if any anticipated windfalls from privatization, or indeed proceeds from the corruption probe (*please refer to our Saudi Economy in 2019 report for more details)*, were to materialize, we would expect them to show up in the 'Other Revenues' segment.

That said, tax revenue, was up 20 percent on a yearly basis…

...and an increase in expat dependency fees will mean this segment will continue showing rises during the rest of 2019.

Tax revenue, however, was up 20 percent on a yearly basis during the second quarter, with two thirds of these gains coming from 'Taxes on goods and services'. The vast majority of revenue from this segment will have been due to rises in expat fees instituted since the beginning of the year (from SR300 to SR500 with companies that have more Saudis than expats or from SR400 to SR600 with companies that have more expats than Saudis). Looking ahead, we expect the revenue in this segment to continue showing large rises on a yearly basis (having risen 23/48 percent in Q2/H1 2019 year-on-year) as expat dependency fees are increased (from SR200 to SR300 per dependent) from mid-2019 onwards.

Expenditures:

Government expenses rose by 5 percent year-on-year in Q2 2019, to a total of SR294 billion…

…mainly as a result of higher capital spending, which was up 27 percent in Q2 2019, and 22 percent in H1 2019, on a year-on-year basis.

Government expenses rose by 5 percent year-on-year in Q2 2019 to a total of SR294 billion (Table 2). **Current expenditure**, the lower economic growth enhancing element of government spending, was flat on a year-on-year basis as the largest component of this segment, 'Compensation of Employees', also showed no rises. Meanwhile, 'Financing Expenses' (see Public Debt section below), Subsidies' and 'Social Benefits' showed the largest yearly rises (Figure 5). According to the MoF, 'Subsidies' and 'Social Benefits' were up in Q2 (and H1) 2019 due to spending on the Citizens' Accounts, social security, student bonuses and expenditure related to the SR72 billion four year private sector stimulus plan.

Figure 4: Breakdown in non-oil revenue

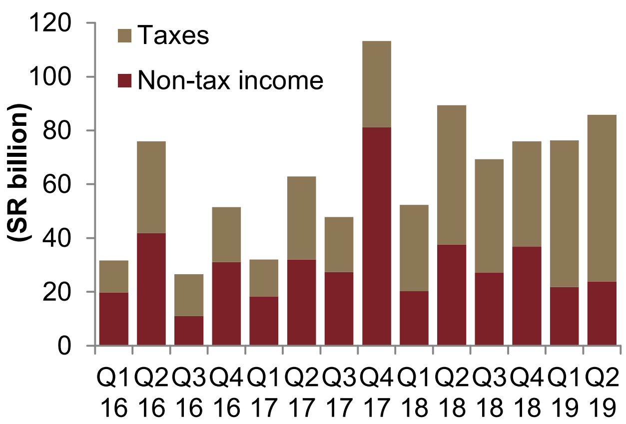
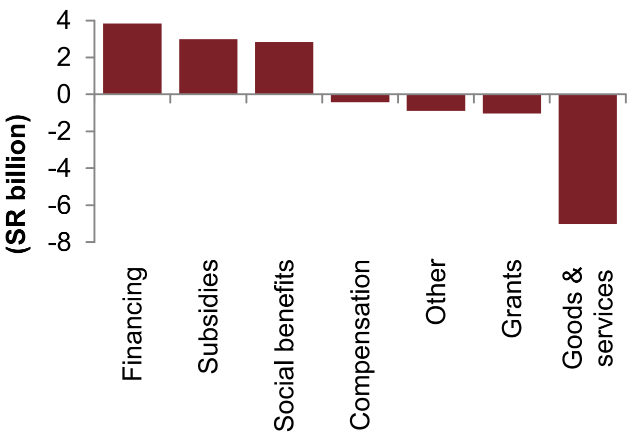


Figure 5: Year-on-year change in Q2 2019 current expenditure



We see this elevated level of capital spending as having directly contributed to lifting non-oil economic activity within the Kingdom.

On the current expenditure side, the largest component of this segment, 'Compensation of Employees', showed no yearly rises…

...but 'Subsidies' and 'Social Benefits' were up due to spending on the Citizens' Accounts, social security, student bonuses and the private sector stimulus plan.

Table 2: Government Expenditure (SR million)

Expenses	Q2 2018	Q2 2019	Change (%)
Compensation of Employees	130,830	130,403	0
Goods & Services	43,341	36,318	-16
Financing Expenses	1,524	5,353	>100
Subsidies	4,231	7,224	71
Grants	1,625	599	-63
Social Benefits	25,392	28,222	11
Other Expenses	25,926	25,036	-3
Non-Financial Assets (Capital)	48,080	61,069	27
Total	**280,950**	**294,226**	**5**

As we outlined in our previous Budget update, outlays on development projects related to Vision Realization Programs (VRP), would push up capital spending ('Non-Financial Assets-Capital'). In line with this, a rise of 27 percent was seen in Q2 2019, and 22 percent in H1 2019, on a year-on-year basis. We see this elevated level of capital spending as having directly contributed to lifting non-oil economic activity within the Kingdom. As Q1 2019 GDP data showed, non-oil private sector GDP was up 2.3 percent year-on-year, whilst our non-oil private sector composite index shows that economic activity has remained at elevated levels during Q2 2019 (Figure 6). That said, it is important to highlight that capital spending related to the Public Investment Fund (PIF) and the National Development Fund (NFD), which are not funded through the central government budget, are also likely have contributed to lifting economic activity.

Public Debt:

The government had issued a total SR68 billion in bonds/sukuks in the year-to-June.

According to the Debt Management Office's 2019 borrowing plan, net debt issuance will total SR118 billion, (plus SR2 billion in refinancing) with a split of 55 percent in domestic debt and 45 percent in international debt. As the Q2 budget performance report showed, the government had issued a total SR68 billion in bonds/sukuks in the year-to-June. Since then, a debut euro bond has been issued, totaling EUR3 billion (SR13 billion), as well as a domestic sukuk issuance totaling SR5.2 billion. As a result, the Kingdom's year-to-date debt issuance stands at SR86 billion, with a domestic/

Figure 6: Jadwa's non-oil private sector composite index shows a pick-up in activity

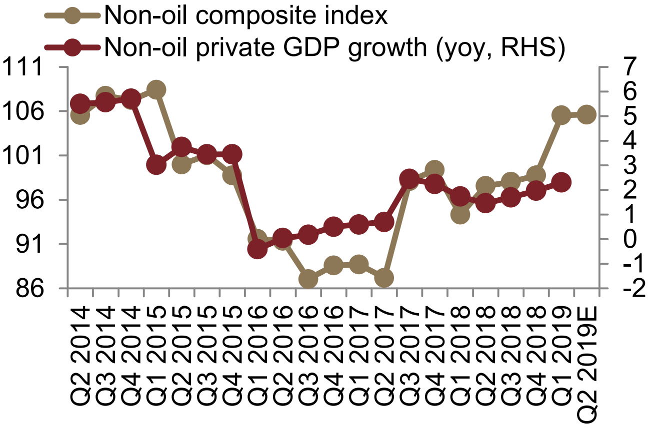
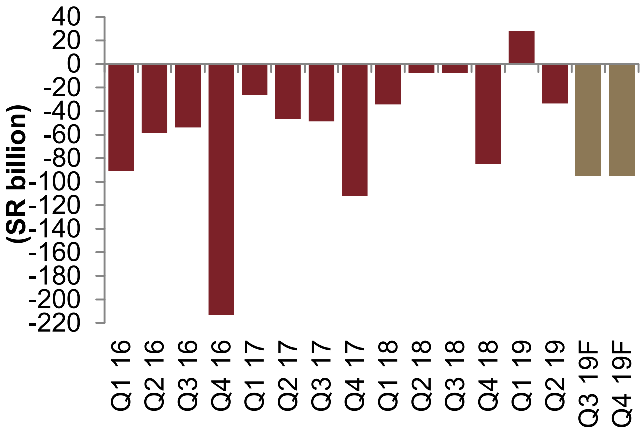


Figure 7: We expect to see a fiscal deficit of SR196 billion for full year 2019



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international split of 52/48 percent. Looking ahead, we expect to see another international issuance of around SR10 billion before the end of the year. On the domestic side, we expect an additional SR22 billion in issuances, with any issuances above the planned SR118 billion for 2019 coming from domestic rather international issuances.

Deficit:

Higher expenditure than revenue resulted in a fiscal deficit of SR33.5 billion during Q2 2019, which also pushed H1 2019 into a mild deficit of SR5.6 billion. Taking into account that we recently revised our fiscal deficit to SR196 billion (6.4 percent of GDP) for the whole of 2019, compared to SR168 billion previously, we expect to see sizable deficits in the next two quarters of the year (Figure 7).