جدوى للإستثمار
Jadwa Investment

26 December 2011

Saudi Arabia's 2012 budget

The government's budget for the 2012 fiscal year (31 December 2011 to 30 December 2012) was endorsed by the Council of Ministers on December 26. It was another expansionary budget and will play a vital role in supporting the economy. The highlights are:

- A surplus of SR12 billion ($3 billion) was projected, based on revenues of SR702 billion and expenditure of SR690 billion. This is the first year since 2008 that the Kingdom has budgeted for a surplus. Defense, education and healthcare remain the focus of government spending. Allocations for the house-building program are not included in the budget; the full SR250 billion financing for the program has been deposited into a special account at SAMA.

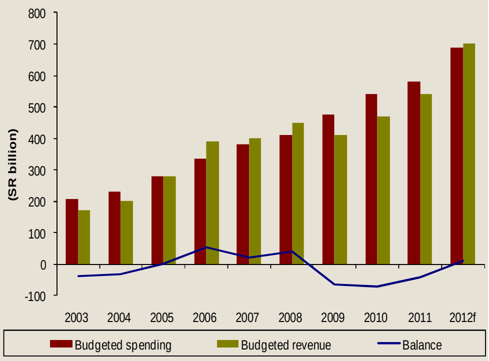
- The budget highlights the government's intention to continue to stimulate the economy. Budgeted investment spending, raised slightly to an all-time high of SR265 billion, will support healthy economic growth and provide encouragement and opportunities for the private sector at a time of global and regional uncertainty. The revenue projection is less conservative than in previous years, but in the event of a shortfall in revenues, any deficit can be financed comfortably by drawing from SAMA's huge stock of foreign assets, which stood at $519 billion at the end of October.

- A budget surplus of SR306 billion was recorded in 2011, compared to a budgeted deficit of SR40 billion. The surplus was the second largest on record, after 2008. Total revenues were a record high of SR1.11 trillion and total spending was also at an all-time high, of SR804 billion. Both were in line with our forecasts. Spending grew by 25 percent, the fastest pace since 2000, owing to the one-time allocations contained in supplemental spending packages announced in the first quarter.

- Preliminary economic data show that 2011 was a healthy year for the economy. Real GDP growth was 6.8 percent, the highest since 2003. Non-oil private growth was unexpectedly strong, at 8.3 percent, with manufacturing, construction and transport and communications all expanding at double-digit rates. Very high oil export revenues pushed the current account surplus to an all-time high of SR598 billion.

We estimate that a price of $69 per barrel for Saudi export crude (around $65 per barrel for WTI and $73 per barrel for Brent) and production of 8.8 million barrels per day are consistent with the revenue projection contained in the budget. We expect both revenues and expenditures to be above the budgeted level and forecast a budget surplus of SR91 billion.

Government budget



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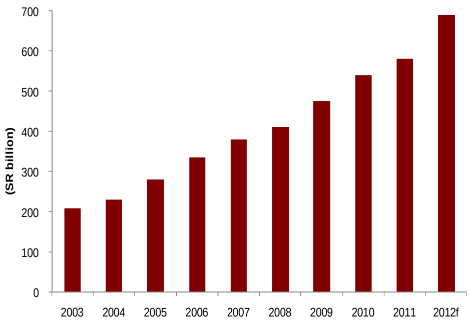
The 2012 budget

Budgeted spending is at another all-time high in 2012, as the government continues with its program to upgrade the human and physical infrastructure. There is a large jump in projected revenue. With no new initiatives announced, we think this is a sign that the government has become less conservative with its oil price assumption. For the first time since 2008, the Kingdom has budgeted for a surplus. In the US and across Europe, countries are cutting spending to bring budget deficits under control and reduce their debt. This is not a concern for the Kingdom. While the planned surplus is small, debt is very low and should a deficit occur it can be financed comfortably by drawing on the vast stock of foreign assets rather than issuing new debt.

Expenditure

Total expenditure is budgeted at SR690 billion in 2012. This is a 19 percent increase on the figure budgeted for 2011, making it the highest annual growth in budgeted spending since 2006. Spending on the SR250 billion government program to build 500,000 housing units over an unspecified period was not included in the budget. Instead, SR250 billion of the 2011 budget surplus has been deposited in a special account at SAMA to fund the program.

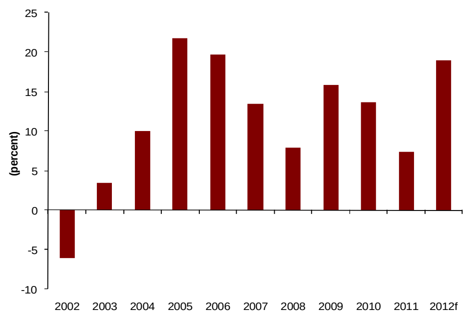
Budgeted expenditure



Budgeted spending is some way below the actual level in 2011. This is not a concern. It is normal for the government to exceed the spending projection outlined in the budget and therefore for the budgeted total to be below the actual total for the previous year. The last year that budgeted spending was greater than actual spending in the previous year was 2000. That said, the difference between the level of expenditure budgeted for 2012 and the actual level of spending in 2011 was 14 percent, compared to an average of 9 percent over the previous decade.

This divergence is because of the one-time nature of some of the payments made in 2011. Payments totaling almost SR100 billion, in the form of a two-month salary bonus for government employees and transfers to the Real Estate Development Fund and Saudi Credit Bank, will not be repeated in 2012. Nonetheless, elements of the supplemental spending packages will impact on expenditure in 2012. The increase in the minimum wage will add around a further SR3 billion to spending in 2012 (most of this extra cost was in 2011). Payment of the unemployment benefit, which will begin in January (rather than November 2011, as previously planned) will add around SR1 billion per month to government spending.

Growth in budgeted expenditure

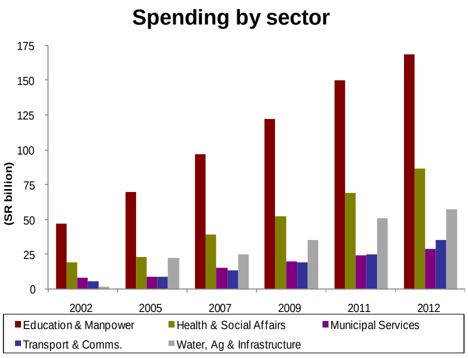


Budgeted investment spending has been raised to SR265 billion. This is in line with the total for the previous two years, meaning that the bulk of the budgeted growth is in current spending. Wages and salaries are the largest component of this and are certain to be a major contributor to the higher spending. Operations and maintenance costs are also likely to be a growing source of current spending in future years as major projects become operational.

Spending priorities are consistent with recent years. Education is allocated the biggest share of those departments disclosed in the budget, at 24 percent of total spending. Transport and health and social affairs received the largest increase in their allocations.

Spending plans for key public sector areas outlined in the budget include:

Education and training was allocated SR169 billion, a 13 percent increase on 2011. This will be used to finance work on 742 new schools and 2,900 existing school-construction projects. Funding has been allocated for 2,552 new schools in the past three years, equivalent to over two per day. More than 40 new colleges are to be built and further work will be undertaken on the construction of facilities at newly-opened universities. SR25 billion has been appropriated for an electronic university; no other new universities are planned. SR20 billion has been allocated for the over 120,000 Saudi students studying abroad and their families.



Health and social affairs was awarded a 26 percent rise in its budget, to SR86.5 billion. This notable jump probably reflects the introduction of unemployment benefit and the award of an additional SR16 billion for spending over an unspecified period in the supplemental packages announced earlier in 2011. Seventeen new hospitals will be started into addition to the 130 under construction.

Water, agriculture and (related) infrastructure spending is budgeted at SR57.5 billion, an increase of 13 percent. Funds have been set aside for new projects in the industrial cities in addition to enhancing water supply and improving the water and water treatment networks.

Transport and telecommunications received the largest increase of any of the areas announced. Spending is budgeted to rise by 40 percent to SR35 billion. The jump is due to progress in the King Abdulaziz airport in Jeddah, which either reflects large payments at the completion of the project, or opening and operational costs, as 90 percent of the work is has been done and it should be complete by September 2012. In addition, work will begin on 4,200 kilometers of roads and continue on the 28,100 kilometers of roads currently under construction. Once complete, these projects would increase the Kingdom's road network by nearly 17 percent.

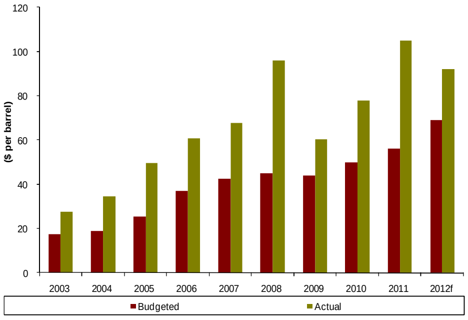
Municipality services were given a 19 percent increase in budget, lifting the total allocation to SR29 billion. The spending retains the same focus as previous years.

Although not disclosed in the budget, it is likely that defense and security accounted for the largest component of government spending. Defense and security spending accounted for 31 percent of the budgeted total in 2011, the lowest proportion since 1984. Several multi-billion dollar defense contracts have been signed in recent years and media reports of new agreements appear sporadically. These payments tend to be spread over many years, so the additional impact on spending in 2012 should not be too great.

Revenue

Total revenue is budgeted at SR702 billion. We anticipate that around 85 percent of total revenue will come from oil; an official revenue breakdown was not published. As is the norm, the oil price and production projections used to derive the revenue figure were not disclosed. We calculate that oil production of 8.8 million barrels per day at a price for Saudi export crude of $69 per barrel (equivalent to around $65 per barrel for WTI and $73 for Brent) is consistent with the oil revenue projection in the budget.

Budgeted versus actual oil price
(Saudi export crude)



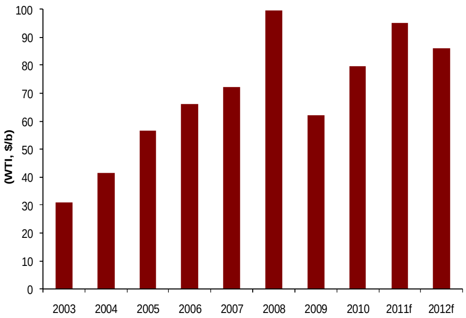
It is usual for the budget to be based on a conservative oil price assumption. Over the last decade the actual oil price has averaged over 70 percent higher than the one used for the budget (for 2011, it is likely to be around 85 percent higher). The last year actual oil prices averaged below the budgeted level was 1998. WTI is currently trading at $99.7 per barrel, 52 percent above the level we estimate is used for the budget.

Nonetheless, the jump in budgeted revenue suggests that the government has been less conservative with its oil price assumption for 2012. Revenues are projected to rise by 30 percent, even though we anticipate that both production and prices will be lower than in 2011 (see box). We think that revenues will be comfortably above the government's assumption and that using a more realistic oil price assumption is healthy. Revenues generally provide the base from which expenditure is calculated; unrealistically low oil revenue and spending assumptions have contributed to high levels of overspending in recent years.

Jadwa's oil market outlook for 2012

Oil prices are forecast to fall in 2012 owing to a weakening of the global economy. We forecast that Saudi export crude will average $92 per barrel (equivalent to $95 per barrel for Brent and $86 per barrel for WTI). With Libyan production likely to return to very close to pre-conflict levels by the end of 2012 and output from Iraq steadily rising, we expect Saudi oil production to fall by 4.4 percent to 8.8 million barrels per day.

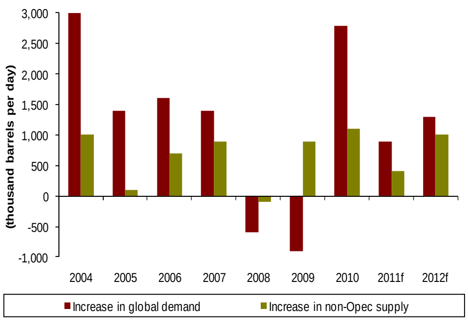
Average oil price



- Global oil demand is expected to rise in 2012 as a result of continued solid growth in emerging markets, primarily Asia. According to the International Energy Agency (IEA), Asia will be the source of over 60 percent of global oil demand growth in 2012. Demand growth from elsewhere will be fairly sluggish as economic growth slows. A deep recession in Europe would have a significant impact on oil demand; the fall in demand in Europe in 2009 was greater than the growth in demand from all emerging markets that year.

- Oil supply should rebound after various disruptions in 2011. The largest of these was the civil conflict in Libya, which took about 1.5 million barrels per day off global markets for around seven months. Libyan production has reportedly already reached 1 million barrels per day and should be close to its pre-conflict level by the end of 2012. Iraqi production is also set to continue to rise. In addition, the IEA projects non-Opec supply to rise by 1 million barrels per day, the highest level since 2002 (though these projections tend to be overoptimistic).

Change in oil demand and non-Opec supply



- Replenishment of oil stocks should give some support to prices. Oil stocks are at their lowest level, in terms of days of forward demand, since the end of 2008. Total OECD stocks have spent four consecutive months below their five-year average for the first time since 2004.

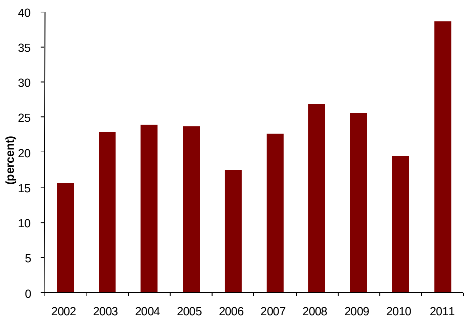
Geopolitical risks and financial flows also need to be considered when forecasting prices. The turbulence in the Middle East and North Africa added a risk premium to prices in 2011 and this will remain in place in 2012 as uncertainty is likely to linger. Tensions surrounding Iran also have the potential to cause oil prices to jump, particularly given that global spare production capacity is low. Financial flows have also influenced oil prices in recent years, as is clear from the close relationship between oil prices and stock markets and other proxies for sentiment about the global economy. In the tough global environment expected for 2012, gains in global stock markets are likely to be modest, at best, meaning they will not exert much pressure on the oil price.

Projections for non-oil revenues were not published. Fees and charges for government services and customs tariffs are the main sources of non-oil revenues. We anticipate that receipts from both of these sources will rise as a result of stronger economic performance. Although government foreign assets are at an all-time high, revenues earned from investment income are unlikely to rise too much because of the exceptionally low interest rates on US government bonds, which we think constitute the bulk of Saudi government foreign assets. No new policies to raise non-oil revenues were contained in the budget.

Jadwa's budget forecast

We forecast a budget surplus of SR91 billion in 2012, equivalent to 4.5 percent of expected GDP. This is because we expect the oil price to be higher than that used in the budget and therefore that oil revenues will exceed the budgeted total (see box). We forecast total oil revenues to the budget at SR744 billion and non-oil revenues at SR80 billion.

Spending in excess of budgeted total



Spending will be above the budgeted level. Over the last ten years actual government spending has averaged 24 percent higher than the budgeted amount. The extent of overspending was much greater than this in 2011, at 39 percent. This was due to the spending commitments contained in a series of Royal Decrees announced in February and March. Given the one-time nature of these Decrees and our view that both budgeted revenues and spending projections are less conservative than usual, we expect that the excess spending will be more in line with the historical trend and forecast total expenditure of SR733 billion.

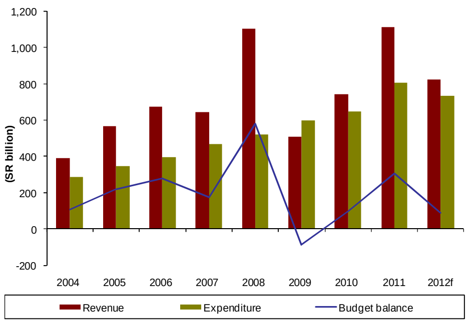
The oil price level necessary for revenues to balance our forecast level of government spending, known as the breakeven price, is $74 per barrel for Saudi export crude (equivalent to around $70 per barrel for WTI and $78 per barrel for Brent). This is based on our production assumption of 8.8 million barrels per day and domestic consumption of 2.4 million barrels per day. Output from the Karan gas field, which began in July, has dampened the impact of rising domestic energy consumption on domestic oil demand. With output from Karan not reaching full capacity until 2013, this gas should take some of the burden from oil as the fuel for domestic energy consumption in 2012.

Budgetary performance in 2011

The budget surplus widened in 2011. At SR306 billion, the surplus was the second highest on record. It was the equivalent of 14.1 percent of GDP. Higher oil revenues, the result of around a 35 percent increase in average oil prices and growth in production of 13 percent (with exports around 19 percent higher), were the reason for the larger surplus. Spending was well in excess of the budgeted projection, but this was outweighed by the increase in oil revenues.

Revenue totaled SR1,110 billion, an all-time high. It was 104 percent above the budgeted level and 50 percent greater than in 2010, due to higher than budgeted oil prices and production. We estimated that the 2011 budget was based on a price for Saudi oil of $56 per barrel and production of 8.3 million barrels per day. With a few days of the year left, it seems likely that the actual price of Saudi oil will average $105 per barrel. Production will be around 9.3 million barrels per day, after it was raised to compensate for the shortfall from Libya. Non-oil revenues were SR78 billion, up around 10 percent on the 2010 total.

Budgetary performance



2011 Budget data

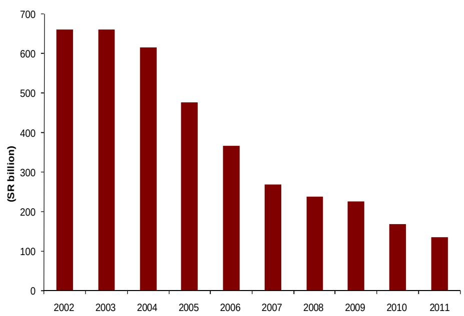
(SR billion)

	Budget	Actual	Difference
Revenues	540	1,110	570
Expenditures	580	804	224
Balance	-40	306	346

Expenditure amounted to SR804 billion, 39 percent above the budgeted level and 25 percent higher than in 2010. The annual increase was the highest since 2000 and compares to an average over the past decade of 13 percent. This was caused by payments contained in the supplemental spending packages announced in the first quarter. The largest of these was the additional two-month salary bonus for government employees, which cost SR35-40 billion. In addition, SR40 billion was transferred to the Real Estate Development Fund and SR20 billion to the Saudi Credit Bank. While the bulk of this SR60 billion has not been spent, it has moved from the accounts of the government to those of the specific agencies, meaning that the full amount is recorded as government spending.

Commitments in the supplementary spending packages announced in February and March also added to the wage bill; especially the increase in the public-sector minimum wage and the recruitment of 60,000 new staff at the Ministry of Interior. A breakdown of spending into capital and current expenditure was not published. It is important to note that the initial estimates of government spending and revenues contained in the budget statement tend to be revised. Generally, both are increased, with the rise in spending usually larger than that for revenue.

Government debt

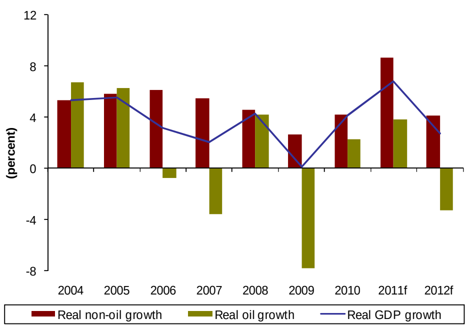


Total outstanding government debt was projected to fall to SR135.5 billion by the end of 2011, equivalent to just 6.3 percent of GDP. Commercial bank holdings of government and quasi-government debt securities have risen by SR20.6 billion over the first 10 months of this year, owing to a SR34.9 billion increase in Treasury bills, which have been used to absorb the liquidity generated by high government spending. Bank holdings of longer-term government bonds are down by SR14.2 billion to SR47.7 billion, the lowest level since mid-2006. The remaining government debt is held by the two government pension funds, GOSI and the Public Pension Agency. In previous years government debt held by these institutions was exchanged for assets managed by other government agencies. We think similar swaps enabled the reduction in overall debt in 2011.

Economic performance in 2011

The budget contained preliminary macroeconomic data for 2011. This showed that economic performance was very strong. Non-oil economic growth was well above our forecast, with non-oil private sector growth the highest since the early 1980s. Higher oil revenues caused substantial growth in nominal GDP and the current account surplus. Inflation declined.

Real GDP growth

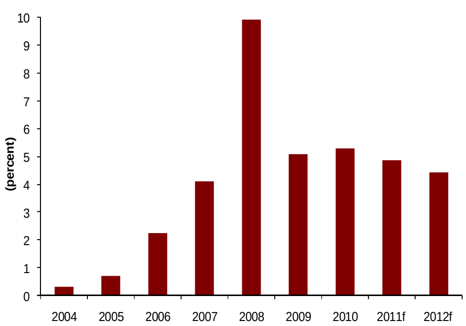


Real GDP growth rose to 6.8 percent, the fastest rate since 2003. from 4.1 percent in 2010. We had anticipated a jump in economic growth due to higher oil production, as the Kingdom increased oil production in 2011 to compensate for the disruption to Libyan output and to satisfy rising demand, especially from Asia. However, the oil sector grew by just 4.3 percent. Instead, the growth stemmed from the private sector. We think that substantial revisions to the preliminary GDP data are likely.

The **non-oil private sector** grew by 8.3 percent. We had anticipated an improvement in 2011 as high government spending lifted business and consumer confidence and banks' comfort in the lending environment despite regional turbulence, growing concerns about the global economy and another year of weak stock market performance. However, the some of the sectoral growth rates were way above what we had forecast. Three sectors grew at double digit rates: manufacturing (15 percent) construction (11.6 percent) and transport and communications (10.1 percent). These growth rates are very high on an historical basis and inconsistent with monthly data such as volumes of petrochemical exports and cement sales. Growth in other sectors was more in line with expectations, with retail at 6.4 percent, electricity, gas and water at 4.2 percent and finance at 2.7 percent.

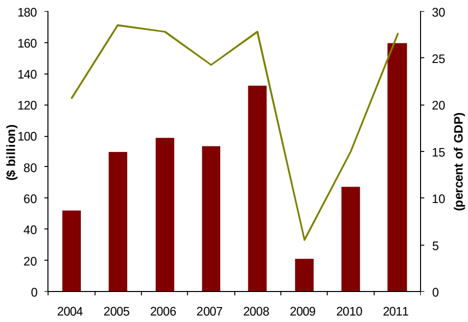
Nominal GDP expanded by 28 percent, the fastest rate since 1980. The rise was because oil revenues were higher than they were in 2010, with both prices and production up. At SR2,163 billion, the economy is the largest it has ever been. According to IMF projections, this ranks the Kingdom as the twenty-first largest economy in the world, between Sweden and Poland.

Inflation



Inflation was put at an average of 4.9 percent, compared to 5.3 percent in 2010. There is a tendency for the inflation data to be presented in the budget to be out of line with that produced on a monthly basis by the Central Department of Statistics, but in 2011 the data is much closer. According to the Central Department of Statistics inflation averaged 4.9 percent over the first eleven months of 2011. The slight fall in inflation in 2011 was because of lower food price and rental inflation. The surge in consumer spending resulting from the bonus for public-sector works has fed into inflation, but given the extent of the spending, the rise in inflation from areas such as education and entertainment and transport and telecoms has been fairly modest. Another measure of inflation, the non-oil GDP deflator rose to 6.1 percent from 1.5 percent in 2010. This was the highest level since 1991, and almost double the reading when consumer price inflation peaked in 2008. The non-oil GDP deflator is only available on an annual basis, it is the difference between nominal and real GDP, and measures the prices of all non-oil goods consumed in the economy.

Current account



The **current account surplus** hit a new all-time high of SR598 billion, up from SR250 billion in 2010. Although a detailed breakdown of the current account is not published, it is clear that the rise was due to higher oil revenues (oil revenues account for around 80 percent of total current account receipts). Higher oil prices and production raised oil revenues to SR1,134 billion, 88 percent of total export revenues. Non-oil exports rose by 14 percent, a fairly sluggish rate given the increase in petrochemical prices during the year. Imports were up by only 2 percent, broadly in line with the monthly trade data. Data for the first ten months of 2011 show that imports of machines and equipment and raw materials are well up on 2010; those of transportation equipment are the only component of the published breakdown that are lower. Data on the other components of the current account was not published.

The economic outlook for 2012

We expect 2012 to be a reasonable year for the economy. While economic growth will slow, this will be due to lower oil production. Greater execution of government investment projects, especially in the housing sector, means that non-oil growth should strengthen. Bank lending will remain supportive and regional unrest will be less of a drag. Inflation should be down a little as domestic spending pressures recede and external pressures stay subdued. Oil prices are expected to fall as the weak global economy slows demand growth and rising output from Libya and Iraq boosts supply.

Economic growth in Saudi Arabia is forecast to fall to 2.7 percent in 2012, owing to lower oil production. Growth in the non-oil sectors will pick up. High government spending will continue to be the engine of the non-oil economy, supported by greater bank lending. We expect utilities and construction, the main beneficiaries of government spending, to be the fastest growing sectors of the economy.

Inflation is expected to fall to an average of 4.4 percent owing to a fall in price pressures from outside of the Kingdom. We think there will be some local inflationary pressure as a result of the high level of consumer and government spending. Rental inflation should decline as more properties enter the market, but it has been rising in recent months owing to higher consumer disposable income, which should mean that the drop will not be large. We do not foresee any changes to the riyal's peg to the dollar. Lower oil revenues will cause the current account surplus to ease, though it will remain substantial, at over 15 percent of GDP.

2011 results and 2012 Jadwa forecasts

	2011 Actual	2012 Jadwa Forecast
Real GDP (% change)	6.8	2.7
Nominal GDP (% change)	28.0	-4.5
Inflation (%)	4.7	4.4
Current account balance (SR billion)	598	308

While the economic picture will improve, 2012 will be the fourth consecutive year that economic growth will be heavily dependent on government spending. This spending will be affordable, but the economic growth such vast spending will generate will not be spectacular. Risks to our forecast are centered on the Eurozone. A disorderly breakup of that region's single currency would have very serious consequences that the Kingdom would not be shielded from.

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