جدوى للإستثمار
Jadwa Investment

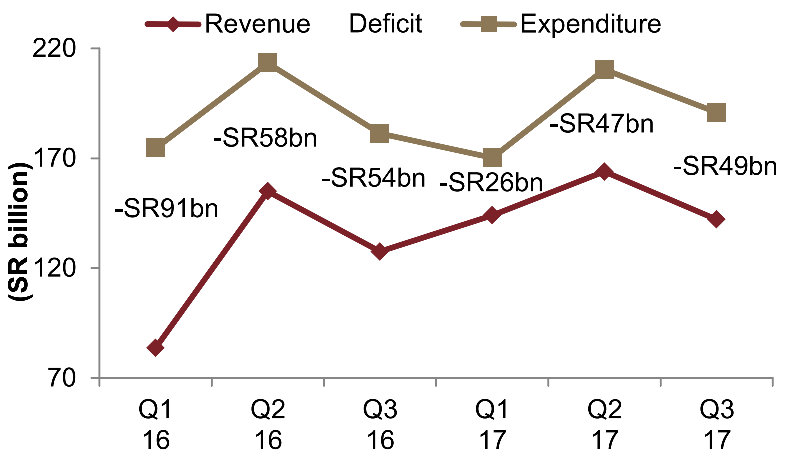
November 2017

Q3 2017 Budget Statement

A large rise in government oil revenue needed in Q4 2017

- The latest quarterly budget performance report by the Ministry of Finance (MoF) showed a continued improvement in Saudi Arabia's fiscal position over last year, not on only a quarterly basis, but also on a year-to-date basis as well.
- Due to an increase in government revenues by 11 percent, and despite a rise in expenses by 5 percent year-on-year, the fiscal deficit improved to SR49 billion in Q3 2017, compared to SR54 billion a year ago.
- The government's efforts to raise non-oil revenue through structured economic reform seems to be bearing fruit, with this segment rising by a sizable 80 percent year-on-year. A large portion of these gains came from 'Other revenues' (including returns from SAMA and PIF), which increased by 150 percent year-on-year.
- Total government expenses rose by 5 percent year-on-year in Q3 2017, to a total of SR191 billion, but remain broadly flat on a year-to-date basis, over the same period last year.
- Looking ahead, we expect to see a significant ramp up in government capital spending in Q4 2017, similar to the pattern observed in Q4 2016. That said, we have revised our full year 2017 capital expenditure down to SR195 billion, compared to SR260 billion previously, but this still equates to a rise of 6 percent year-on-year.
- We also expect to see continued rises in Saudi oil export revenue in Q4 2017, but this is not likely to prevent a shortfall in budgeted government oil revenue for 2017 as a whole.

Figure 1: Quarterly budgetary performance



For comments and queries please contact:

Fahad M. Alturki
Chief Economist and Head of Research
falturki@jadwa.com

Asad Khan
Director
rkhan@jadwa.com

Head office:

Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

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Revenues:

Table 1: Government Revenue (SR million)

Revenues	Q3 2016	Q3 2017	Change (%)
Oil revenues	100,955	94,323	-7
Non-oil revenues, of which;	26,561	47,817	80
-Taxes on income, profits and capital gains	2,988	789	-74
-Taxes on goods and services (including petroleum product charges and harmful product tax)	5,655	11,725	107
-Taxes on trade and transactions (customs duties)	4,974	6,098	23
-Other Taxes (including Zakat)	1,962	1,747	-11
-Other revenues (including returns from SAMA and PIF)	10,982	27,458	150
Total	**127,516**	**142,140**	**11**

Government revenue totaled SR142 billion in Q3 2017, up 11 percent year-on-year...

...with the vast majority of this rise due to higher non-oil revenue.

Government oil revenue declined by 7 percent, or SR6.6 billion, year-on-year…

...as a result of a variance in the implied transfer ratio on a quarterly basis.

Saudi government **revenue** totaled SR142 billion in Q3 2017**,** up 11 percent year-on-year (Table 1). The vast majority of this rise was due to improvements in **non-oil revenue** (34 percent of total revenue)**,** which rose by 80 percent year-on-year. Despite higher oil export revenue in Q3 2017 year-on-year, government **oil revenue** (66 percent of total revenue) was lower when compared to a year ago. We estimate that the Saudi export price of crude and refined products increased by 25 percent year-on-year, to $54 per barrel (pb) in Q3 2017, with an average of 8.2 million barrels per day (mbpd) of crude oil and refined products being exported during the quarter. Accordingly, export revenue is expected to have totaled SR152 billion in Q3 2017, compared to SR133 billion in Q3 2016 (Figure 2). At the same time, government oil revenue in Q3 2017 declined by 7 percent, or SR6.6 billion, year-on-year. As we noted in the *Q1 2017 Budget Statement (published in May 2017)*, the discrepancy between oil export revenue and government revenue is the result of a variance in the implied transfer ratio on a quarterly basis. There now seems to be a downward adjustment in the transfer ratio in Q3 2017, when compared to earlier quarters in 2017, resulting in lower government oil revenue (Figure 3). That said, the above transfer ratio calculations are based on partially available information, with more accurate figures only possible once full year financial accounts for Saudi Aramco are disclosed.

Figure 2: Higher oil export revenue in Q3 2017, but lower government oil revenue...

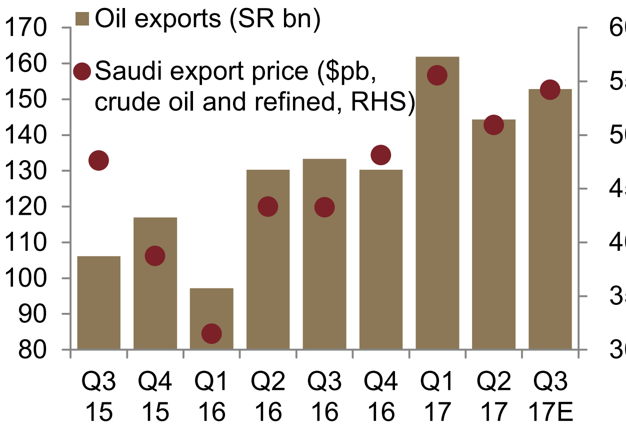
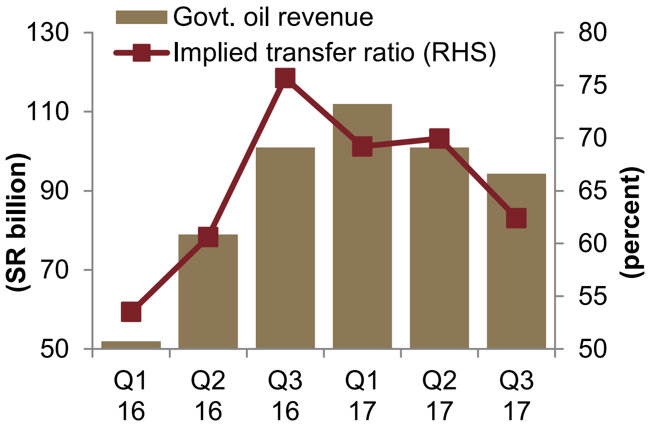


Figure 3: ...as implied transfer ratio declined during Q3 2017



Looking ahead, we expect oil export revenue to show sizable improvements on a yearly basis in Q4 2017…

...with Brent oil prices currently trading above $60 pb.

Looking ahead, we expect oil export revenue to show sizable improvements on a yearly basis in Q4 2017. Brent oil prices are averaging $60 pb in the current quarter, and despite risks to the downside in prices for the rest of the quarter (*for more detail please see our Quarterly Oil Market Update - Q3 2017 published November 2017*), prices are still likely to be higher than the average of $49 pb seen during the same period last year. Nevertheless, Saudi Arabia's continued adherence to OPEC cuts will result in lower volumes of oil and refined product exports, ensuring rises in oil revenue are capped. In Q4 2016, just prior to the implementation of OPEC agreed cuts, Saudi crude oil and refined product exports averaged 9.2 mbpd, the highest level in at least 14 years, with crude oil exports alone averaging 8 mbpd. In contrast, provisional estimates from Thomson Reuters show that Saudi crude oil exports are averaging around 7 mbpd so far in Q4 2017.

Non-oil revenue increased by 11 percent year-on-year in Q3 2017…

...with 'Other revenues' (including returns from SAMA and PIF) rising by 150 percent year-on-year.

The government's efforts to raise **non-oil revenue** through structured economic reform seems to be bearing fruit, with this segment rising by a sizable 80 percent year-on-year. Most of these gains came from 'Other revenues' (including returns from SAMA and PIF), which increased by 150 percent year-on-year (Figure 4). The major rise in 'Other revenues' (19 percent of total revenue) could, in part, be due to higher dividends from larger asset holdings of the Public Investment Fund (PIF). During the Future Investment Initiative forum in Riyadh last month, PIF disclosed that its assets had increased from SR570 billion at the end of 2015, to SR840 billion at the end of Q3 2017 (Figure 5). As a result, higher dividends received by the government during Q2 2017, with payments showing up in the third quarter due to lags in financial results reporting, will have helped boost this segment. 'Other revenues' may have also increased due to dependent fees, which came into effect in July 2017. Based on data from the Ministry of Interior's National Information Center, there were around 2.2 million registered dependents in the Kingdom in Q2 2017 and, with a fee of SR100 per dependent, the expected rise in revenue should, in theory, have been SR660 million in Q3 2017. In reality, due to a combination of some dependents repatriating prior to the introduction of the fee, and payments being pushed forward into Q4 2017, receipts were probably lower than the above estimate.

Looking ahead, with most dividends payments showing up in 'Other revenues' in either the first or third quarters of year, the other major

Figure 4: Year-on-year change in Q3 2017 non-oil revenues

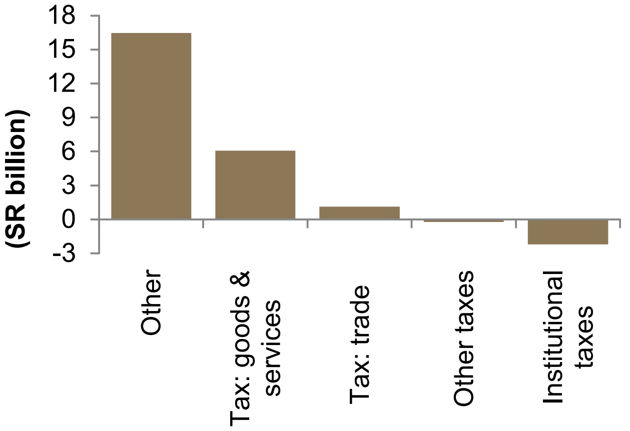
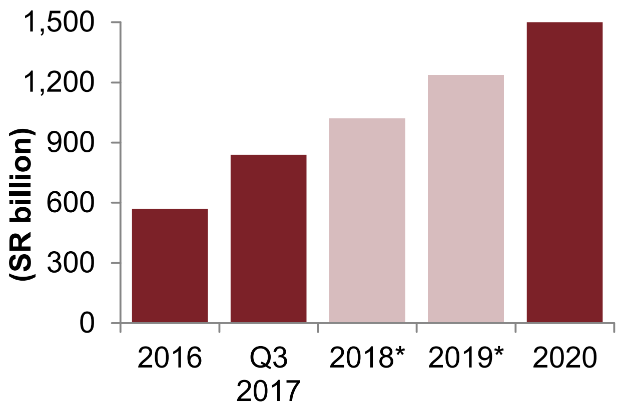


Figure 5: PIF's assets rose to SR840 billion by the end of Q3 2017, with SR1.5 trillion targeted for 2020



*Jadwa estimates based on CAGR between 2017-2020 item in this segment, SAMA returns, is likely to take prominence in Q4 2017. However, since SAMA's holdings of foreign securities have dropped by $72 billion since the start of 2017, such returns are likely to be lower on year-on-year basis.

Taxes on goods and services rose more than 100 percent in Q3 2017 year-on-year….

...as a result of a rise in the 'excise tax'.

Taxes on goods and services (8 percent of total revenue) rose more than 100 percent in Q3 2017 year-on-year as a result of a rise in the 'excise tax' by 100 percent on tobacco products and energy drinks, and 50 percent on soft drinks, which took effect from June 2017. Another segment in non-oil revenue, 'Taxes on Trade and Transactions', was up by 23 percent year-on-year in Q3 2017. Partial trade data for Q3 2017 shows that the value of imports remained broadly flat year-on-year and the rise in revenue in this segment is likely to be related to an expiration of a ceiling in customs duties, pushing duties up from 5 to 25 percent on 193 products, since the beginning of 2017.

'Taxes on income etc.' were down 74 percent year-on-year in Q3 2017…

...but this figure may be distorted by the introduction of a new online tax filing system.

'Taxes on income etc.' (1 percent of total revenue) were down 74 percent year-on-year in Q3 2017, but this figure may be distorted by the introduction of a new online tax filing system which had some technical issues during its inception last year. In fact, a similarly erratic pattern in this segment was highlighted in the *Q2 2017 budget statement* *(published August 2017)*, where it had risen by 30 percent year-on-year in Q2 2017, with no specific changes in the tax rate to justify the sizable yearly increase. Looking at this segment on a year-to-date basis shows a less dramatic decline of 5 percent year-on-year.

Expenditures:

Total government expenses rose by 5 percent year-on-year in Q3 2017…

Total government expenses rose by 5 percent year-on-year in Q3 2017, to a total of SR191 billion (Table 2) with current expenditure up 7 percent year-on-year. The largest contributor to current expenses, 'Compensation of Employees' (55 percent of total expenditure) increased 9 percent year-on-year in Q3 2017. On a quarter-on-quarter basis, this segment rose 4 percent, most probably due to the continued effects from reinstating public sector workers' allowances following a Royal decree in April 2017. Looking ahead, we expect 'Compensation of Employees' to remain broadly unchanged on a quarter-on-quarter basis in Q4 2017.

Although expenditures on 'Goods and Services' (11 percent of total expenditure) was up 4 percent year-on-year in Q3 2017, it is down by

Figure 6: Year-on-year change in Q3 2017 current expenditure

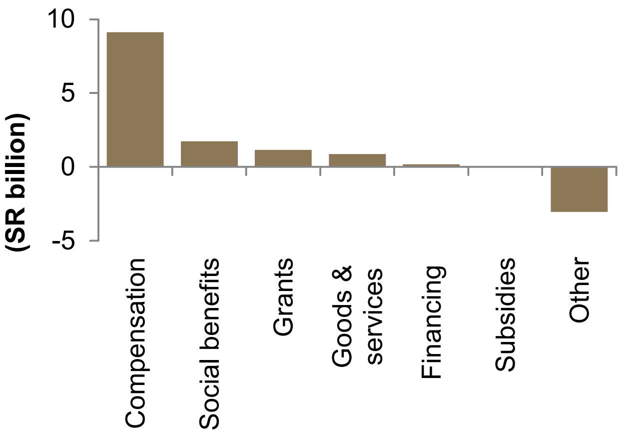
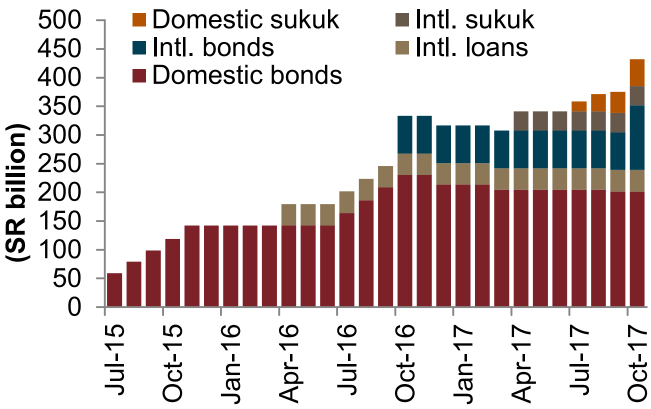


Figure 7: Total government debt currently stands at SR432



…with the largest contributor to current expenses, 'Compensation of Employees' increasing 9 percent year-on-year in Q3 2017.

Lower expenditures on 'Goods and Services' continues to reflect a general cut back in government procurements and projects.

In Q3 2017, 'Financing Expenses' continued to exhibit year-on-year rises, in-line with rising government debt.

'Social Benefits' continued rose by 30 percent year-on-year in Q3...

...and could rise further in Q4 2017 if payments linked to the Citizen's Account are initiated.

25 percent on a year-to-date, compared to the same period in 2016. Lower expenditures on 'Goods and Services' continues to reflect a general cut back in government procurements and projects, in tandem with cost rationalizing and operational efficiency targets set out in the National Transformation Plan (NTP) 2020 and Saudi Vision 2030. This point was reiterated by the Minister of Finance earlier this year, stating that the Bureau of Capital and Operational Spending Rationalization (BCOSR) had succeeded in saving up to SR17 billion for the whole of 2017, after reviewing state projects and other expenditures. Such savings and rationalizations are also likely to account for the reduction in 'Subsidies' segment in expenditures (Table 2). Generally speaking, it is important to note that the deflationary trend seen in the Kingdom since the start of the year has also contributed to reducing some costs outlined above.

Table 2: Government Expenses (SR million)

Expenses	Q3 2016	Q3 2017	Change (%)
Compensation of Employees	97,505	106,619	9
Goods & Services	19,783	20,661	4
Financing Expenses	978	1,152	18
Subsidies	1,667	1,695	2
Grants	29	1,182	>100
Social Benefits	5,778	7,522	30
Other Expenses	20,118	17,077	-15
Non-Financial Assets (Capital)	35,419	34,962	-1.3
Total	**181,277**	**190,870**	**5**

'Financing Expenses' (1 percent of total expenditure) continued to exhibit year-on-year rises, in-line with rising government debt. This segment was up SR174 million, or 18 percent year-on-year in Q3 2017. Public debt totaled SR317 billion at the beginning of 2017, but had risen to SR376 billion at the end of Q3 2017, following the commencement of a domestic sukuk program from July 2017 onwards. By October 2017, a total of SR47 billion in domestic sukuk had been issued and a further SR47 billion had been raised through an international bond sale. Looking ahead, the Minister of Finance recently indicated that there is unlikely to be any further international bonds issuances in Q4 2017, and whilst local sales are still possible, we believe they are not needed (see Deficit section below).

'Social Benefits' (4 percent of total expenditure) rose by 30 percent year-on-year in Q3 2017. According to the Ministry of Finance, this segment covers current benefits paid as unemployment and housing benefits and other social channels. Although it is not clear that this segment rose due to higher unemployment benefits in Q3 2017, latest data provided by GaStat does show a rising trend in unemployment, from 11.6 percent in Q2 2016 to 12.8 percent by Q2 2017. Looking ahead, expenses in this segment may increase further if disbursements related to the Citizen's Account are initiated before year end. 'Other Expenses' (9 percent of total expenditure), on the other hand, declined by 15 percent year-on-year in Q3 2017, after seeing a significant rise in the previous quarter. According to the Ministry of Finance, this segment covers all expenses not classified elsewhere and it is therefore not quite clear what caused a sharp decrease in this segment during Q3 2017.

Capital expenditure decreased by 1 percent year-on-year in Q3 2017…

The capital spending side of expenses, or 'Non-Financial Assets (Capital) (18 percent of total expenditure)', decreased by 1 percent year-on-year, to SR35 billion, in Q3 2017, but showed a rise by 5 percent quarter-on-quarter. On a year-to-date basis, 2017 capital expenditure stood at SR97 billion, exactly the same amount at this point last year. According to our calculations, full year 2016 capital expenditure equaled SR184 billion, meaning almost half of this segment was expended in the last quarter of the year. This is quite normal in the context of government payments, with certain projects being paid on completion, usually towards the end of the year.

...although we do expect a significant ramp up in this segment in Q4 2017.

Taking this into account, we would therefore expect to see a similar ramp up in government capital spending in Q4 2017. That said, we now see capital expenditure totaling SR195 billion in full year 2017, down from our previous full year forecast of SR260 billion, but still up 6 percent year-on-year.

Deficit:

The fiscal deficit improved to SR49 billion in Q3 2017…

Due to an increase in government revenues by 11 percent and a rise in expenses by 5 percent year-on-year, the fiscal deficit improved to SR49 billion in Q3 2017, compared to SR54 billion a year ago, although it was up by SR2.2 billion quarter-on-quarter. The combined year-to-date deficit stood at SR121 billion, meaning that the government has room to run a deficit of SR77 billion in the last quarter of 2017 and still meet its budgeted deficit target of SR198 billion for full year 2017. In fact, we estimate that the deficit will be close to the SR77 billion mark in the final quarter. This is because, firstly, the government has already raised SR57 billion through both an international bond and domestic sukuk issuance in October and, secondly, already holds SR18 billion in financing from previous quarters, in excess of year-to-date deficit, as detailed in the Q3 budget statement (Figure 8). Further, if this holds true, then we would expect to see the depletion rate in SAMA FX reserves to decelerate in the final quarter of this year. FX reserves declined by SR88 billion between the end of Q1 and Q3 of 2017, with SR30 billion, or roughly one third, being attributable to deficit financing.

...and we expect the government to run a deficit of close to SR77 billion the final quarter of 2017.

Outlook:

The Q3 2017 quarterly budget is an improvement on a quarterly basis and a year-to-date basis.

The Q3 2017 quarterly budget is an improvement over last year, not on only a quarterly basis but also on a year-to-date basis as well. Whilst improvements have been helped by sizable rises in **oil revenue,** up by 33 percent year-to-date, **non-oil revenue** has also improved by 7 percent over the same period, reflecting efforts by government to diversify the revenue base.

Figure 8: There is room to raise the Q4 2017 deficit to around SR77 billion

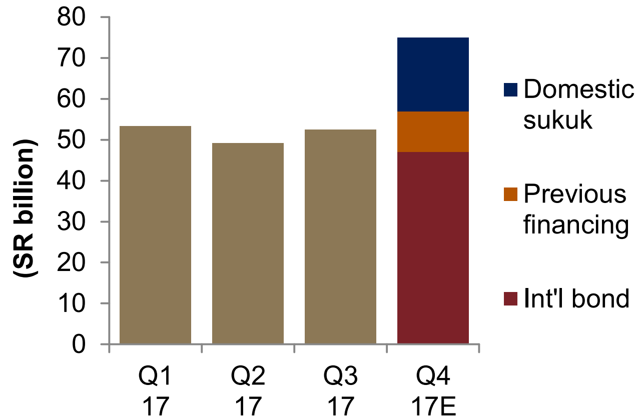
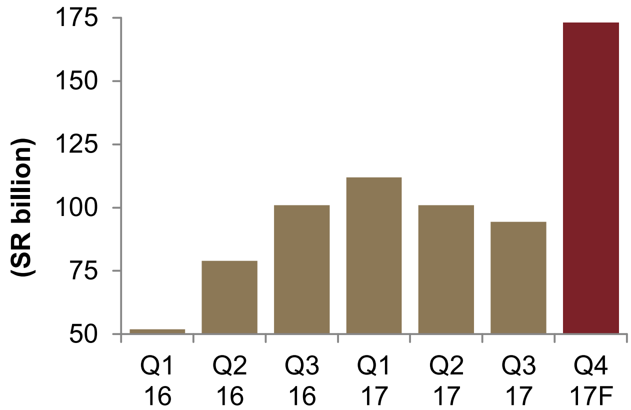


Figure 9: SR173 billion oil revenue required in Q4 to reach budgeted oil revenue target for 2017



Looking ahead, there is likely to be a shortfall in government oil revenue…

Looking ahead, as noted above, although we expected Saudi oil export revenue to continue rising year-on-year, there is likely to be a shortfall in government oil revenue. As detailed in 2017 fiscal budget, the government is budgeting for SR480 billion in oil revenues for 2017 as a whole. Year-to-date government oil revenue stood at SR307 billion, implying a further SR173 billion is required in Q4 2017 to reach the full year budgeted target, and with Saudi oil export revenue needing to be higher than this figure (Figure 9). Meanwhile, we do expect to see year-on-year improvements in non-oil revenue in Q4 2017. The continued effects from the introduction of an excise tax on harmful products and dependent fees, which came into effect in July 2017, should all help raise non-oil revenues.

...with a further SR173 billion required in Q4 2017 to reach the full year budgeted target.

On the expenditure side, with the government delaying the linking of household electricity prices to a higher reference price, as was expected in mid-2017, the rise in expenditures related to the start of the “Citizens Account”, were not incurred, although they could be seen in Q4 2017. Related to this, the government was also expecting to save an additional SR30 billion during the year as a consequence of the same price hikes. As a result, it is possible that no savings related to this expenditure materialize during 2017. Nevertheless, separately, savings associated with the BCOSR will continue to be seen during the whole of 2017.

Finally, year-to-date expenditure has been broadly flat on a year-on-year basis.

Finally, it is worth highlighting that total year-to-date expenditure has been broadly flat on a year-on-year basis. If this remains the case in Q4 2017, a significant achievement will have been made, especially so when considering that the annual rise in expenditure from the period between 2010-16 equaled 9 percent on average.

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