جدوى للإستثمار
Jadwa Investment

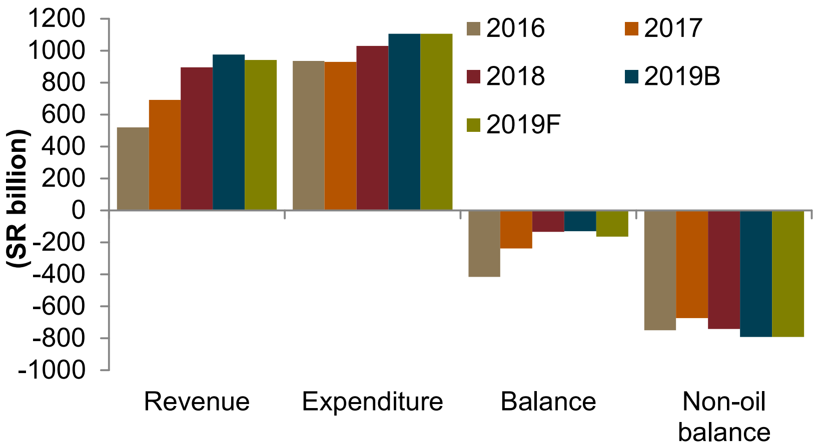
19 December 2018

Saudi Arabia's 2019 Fiscal Budget

The government's budget for the 2019 fiscal year was endorsed by the Council of Ministers on 18th December. It points to an expansionary stance (Figure 1). The highlights include:

- As outlined in the first ever preliminary fiscal budget in September, the government will support the economy through the largest ever budgeted expenditure of SR1.1 trillion in 2019. Based on revenues of SR975 billion, the government is budgeting for a slightly lower year-on-year deficit at SR131 billion, compared to SR136 billion in 2018.
- Accordingly, the government's financing requirement is expected to total around SR118 billion in 2019, and therefore, when assuming no repayments during the year, the Kingdom's debt is expected to reach SR678 billion (22 percent of GDP), compared to SR560 billion at the end of 2018.
- On a sectorial level, and in-line with the pattern of expenditure in recent years, military, security services, education, healthcare and economic resources are set to be allocated 71 percent of the total budget.
- In 2019, the introduction of the electronic Etimad portal will help improve the management of expenditure and therefore help keep unanticipated overspending to minimum. The Ministry of Finance (MoF) is expected to make Etimad mandatory for all government projects from 2019 onwards. The digital system is expected to improve controls and transparency in the spending process and as well as raising the level of communication between the MoF and contractors, which should result in keeping expenditure within targeted levels.
- According to the statement, budgeted capital spending, will amount to SR246 billion in 2019, compared to SR205 billion in 2018. This is a clear sign that there has been a particular effort to raise the level of the growth enhancing aspect of government expenditure in order to support development and lift the overall investment profile of the private sector.

Figure 1: Higher spending expected in 2019



Note*: 2019B refers to MoF budget. 2019F refers to Jadwa Investment's forecasts.

For comments and queries please contact:

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

Asad Khan
Director
rkhan@jadwa.com

Nouf N. Alsharif
Economist
nalsharif@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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The government will support the economy through the largest ever budgeted expenditure of SR1.1 trillion in 2019.

- That said, current spending (the more rigid part of expenditure) is expected to increase by 4 percent, year-on-year, to a budgeted total of SR860 billion. Within this, the compensation of employees (wage bill) is expected to decrease to SR456 billion, down 4 percent year-on-year in 2019.

Based on revenues of SR975 billion, the government is budgeting for a slightly lower year-on-year deficit at SR131 billion, compared to SR136 billion in 2018.

- The government has budgeted for non-oil revenue to reach SR313 billion in 2019, showing a strong growth of 9 percent over 2018's actual total of SR287 billion. The rises are expected to come about from higher fees related to expat levies, and by a reduction in (value added tax) VAT threshold, which will result in a larger number of enterprises being eligible to process VAT.

The government has budgeted for non-oil revenue to reach SR313 billion in 2019, showing a strong growth of 9 percent over 2018's actual figure.

- Brent oil prices are expected to improve by a significant 32 percent on a yearly basis in 2018. The outlook for 2019, however, remains highly uncertain with Brent oil currently trading around $60 per barrel (pb). That said, budgeted oil revenue is nevertheless expected to rise by 9 percent year-on-year in 2019, which we believe takes into account for compliance with the recent OPEC+ cuts.

According to the statement, budgeted capital spending, will amount to SR246 billion in 2019, compared to SR205 billion in 2018.

- Whilst oil revenue is expected to total SR662 billion in 2019, it is important to note that this segment contains revenue from domestic energy price reform enacted at the turn of 2018. Additionally, it is unclear whether part of 2019's oil revenue includes transfers from 2018's oil revenue, in line with the MoF switch to quarterly dividends (for more on this please see our Q1 Budget Statement published May 2018). All the above makes the calculation for Saudi export price more complicated and less accurate.

The government's financing requirement is expected to total around SR118 billion…

...with the Kingdom's debt expected to reach SR678 billion (22 percent of GDP) at the end of 2019.

- Overall, therefore, whilst the implied Saudi export price is around $76 pb (around $78 pb for Brent), corresponding to oil revenues of SR662 billion, the Saudi export price pertaining to oil export revenues only is lower than this, at $70 pb according to our calculations.

Whilst oil revenues are expected to total SR662 billion in 2019, it is important to note that this segment contains revenue from domestic energy price reform.

- According to the MoF, whilst a periodical review of gasoline prices will continue throughout 2019, there is no plan to enact price reform for other energy products in 2019.

- Our forecasts for 2018 were in-line with actual budgetary performance. At the end of 2018 the total deficit reached SR136 billion, or 4.6 percent of GDP compared to our forecast of SR139 billion, or 4.8 percent of GDP.

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- In the 2018, the deficit declined significantly over 2017's total of SR238 billion, and this was due mainly to revenue being higher than budgeted, at SR895 billion, compared to SR783 billion stated in the 2018 fiscal budget report. Non-oil revenue was up by a sizable 35 percent year-on-year in 2018, mainly as a result of yearly increase from taxes on goods and services. Government oil revenue rose by 39 percent year-on-year to SR608 billion, as Saudi crude oil export prices rose 33 percent year-on-year to average $68 pb during the year.

According to the 2019 fiscal budget statement, real GDP grew at 2.3 percent in 2018, and will reach 2.6 percent in 2019.

- According to the fiscal budget statement, 2018 real GDP grew at 2.3 percent compared to our forecast of 2.2 percent. In 2019, GDP growth is expected to reach 2.6 percent compared to our current forecast of 2 percent.

The 2019 Budget

As has been the theme in recent budgets, part of the 2019 budget will be channeled towards Vision 2030 programs.

In line with the preliminary budget outlined in September, the 2019 fiscal budget shows that the Kingdom will see record high budgeted expenditure, again, at SR1.1 trillion, up by SR76 billion year-on-year (Figure 2). As has been the theme in recent budgets, part of the 2019 budget will be channeled towards Vision 2030 programs that directly contribute to economic growth and job opportunities for citizens. At the same time, the most economically vulnerable households will continue to benefit directly from necessary support under initiatives such as the Citizen's Account, but also indirectly through spending on educational, healthcare and social infrastructure.

Due to a higher rate of projected revenue rises vis-a-vis expenditure, the fiscal deficit will be marginally lower year-on-year in 2019.

Due to a higher rate of projected revenue rises vis-a-vis expenditure, the fiscal deficit will be marginally lower year-on-year in 2019. Thus, the deficit is expected to improve slightly to SR131 billion (4.2 percent of GDP) compared to SR136 billion (or 4.6 percent of GDP) in 2018. This is in line with the preliminary budget published earlier this year, which maps out a gradual improvement in deficit over the next few years, all the while seeing rises in government expenditure.

The outlook for 2019 remains highly uncertain with Brent oil currently trading around $60 pb.

Despite a recent drop, Brent oil prices are expected to improve by 32 percent on a yearly basis in 2018. The outlook for 2019 remains highly uncertain with Brent oil currently trading around $60 pb. That said, budgeted oil revenue is expected to rise by 9 percent year-on-year in 2019. Meanwhile, efforts to raise non-oil revenue will also continue into next year, as this segment is budgeted to also rise by 9 percent year-on-year (Figure 3). Accordingly, the budget outlines an increase in overall budgeted revenues by 9 percent year-on-year. Meanwhile, expenditure is expected to rise 13 percent over last year's budgeted total.

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The government's financing requirement is expected to total around SR118 billion in 2019, and therefore, when assuming no repayments during the year, the Kingdom's debt is expected to reach SR678 billion (22 percent of GDP), compared to SR560 billion at the end of 2018 (Figure 4). Besides the issuance of debt, this year's fiscal deficit will also be financed from the drawing down from the stock of government deposits held at SAMA, during the year.

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Figure 2: Budgeted expenditure

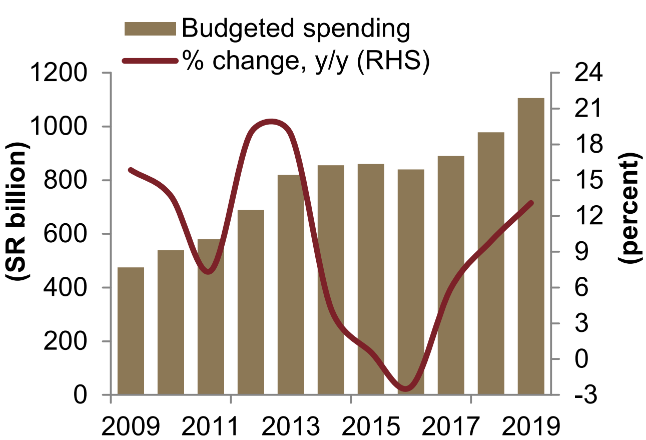
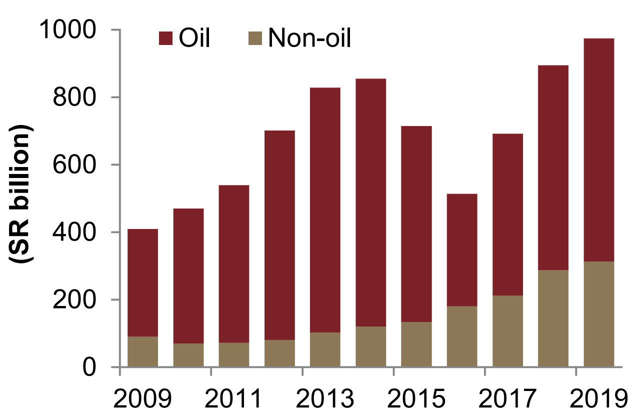


Figure 3: Breakdown in revenue



Expenditure

Total expenditure is budgeted at SR1.1 trillion in 2019, up 9 percent from the 2018 budgeted expenditure.

Total expenditure is budgeted at SR1.1 trillion in 2019, up 9 percent from the 2018 budgeted expenditure and represents the largest ever budgeted amount to date, surpassing the previous record announced last year (Figure 2). Additionally, as part of a broader set of measures outlined along with the budget, the private sector will be supported by various initiatives under a four year SR200 billion private sector stimulus plan. The stimulus, which was initiated in 2017, is expected to target specific sectors within the private sector in order to aid growth (for more on this please see our [Saudi Economy in 2018]() report published February 2018).

The MoF is expected to make Etimad mandatory for all government projects from 2019 onwards.

In 2019, the introduction of the electronic Etimad portal will help improve the management of expenditure and therefore help keep unanticipated overspending to minimum, in line with the trend seen in the last few years (Figure 5). The MoF is expected to make Etimad mandatory for all government projects from 2019 onwards. The digital system is expected to improve controls and transparency in the spending process and as well as raising the level of communication between the MoF and contractors, which should result in keeping expenditure within targeted levels.

Budgeted capital spending, will amount to SR246 billion in 2019, compared to SR205 billion in 2018.

According to the statement, budgeted capital spending, will amount to SR246 billion in 2019, compared to SR205 billion in 2018. This is a clear sign that there has been a particular effort to raise the level of the growth aspect of government expenditure in order to support development and lift the of the overall investment profile of the private sector. 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.

A key objective of the government is to balance operating expenses (opex) with more growth enhancing capital expenditures.

Current spending is expected to increase by 4 percent, year-on-year, to a budgeted total of SR860 billion.

As outlined in the preliminary budget, a key objective of the government is to balance operating expenses (opex) with more growth enhancing capital expenditures. On the opex side, the focus will be on improving efficiency of spending and achieving savings that can be directed to other projects and expenditures, through the Spending Efficiency Realization Centre (SERC). That said, current spending (the more rigid part of expenditure) is expected to increase by 4 percent, year-on-year, to a budgeted total of SR860 billion. Within this, the wage bill is expected to decrease to SR456 billion,

Figure 4: Public debt

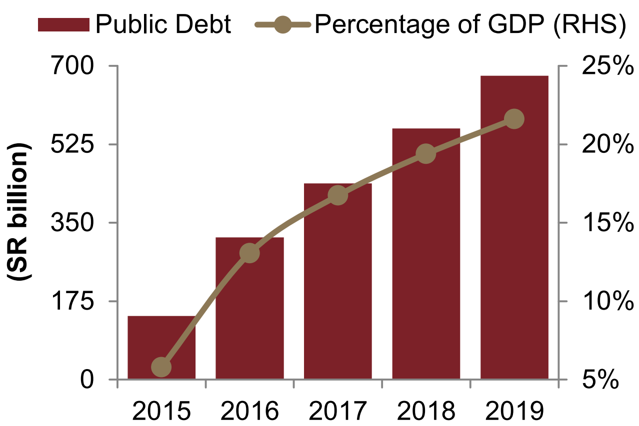
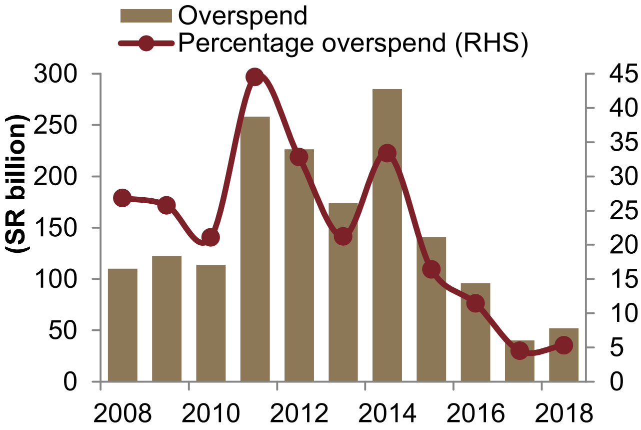


Figure 5: Historical overspend (actual versus budgeted spending)



Continued payments under the Citizens Account program will also contribute to current expenditure in 2019.

According to this years budget statement, the Citizen's Account program will continue in the year ahead.

Budgeted expenditure in 2019 spans all sectors, the priorities are consistent with recent years. Military, security services, education, healthcare and economic resources make up 71 percent of total allocations.

down 4 percent year-on-year in 2019. Whilst this figure includes the recently announced reinstatement of annual allowances (for more on this please refer to our macroeconomic update published November 2018), we believe it does not contain the rolling over of the inflation allowance from last year, as per a royal decree just prior to this year's budget (Figure 6).

Continued payments under the Citizens Account program will also contribute to current expenditure in 2019. In 2018, 'Social Benefits' saw large yearly rises of 47 percent due to SR27 billion allocated under the Citizen's Account program, which will continue in the year ahead.

While budgeted expenditure in 2019 spans all sectors, the priorities are consistent with recent years. Military, security services, education, healthcare and economic resources make up 71 percent of total allocations (Table 1, Box 1).

Box 1: Budget Allocation 2019

After coupling the separate allocations for military and security, we can see that the combined allocation under Military and Security Services was down 5.5 percent to SR294 billion in 2019 whilst Education and Training, the second largest budget item, was allocated SR193 billion in 2019, was almost flat year-on-year. Health and Social Development rose by 17 percent year-on-year to SR172 billion. Municipality Services, which made up 6 percent of the total allocation, rose by 17 percent or SR9 billion, year on year. Economic Resources, represents 12 percent or SR131 billion of budgeted expenditure in 2019, up 25 percent year-on-year. Public Administration totaled SR28 billion, almost flat year-on-year, whilst Transportation budget was raised 30 percent year-on-year, to SR70 billion. Lastly, SR156 billion was allocated for Public Programs Unit, up 73 percent year-on-year.

Table 1. 2019 Budget Allocation

(SR billion)

Budget Allocation	2018 B	2018 A	2019 B	Difference (2018B-2019B)
Expenditures	978	1030	1106	128
Education and Training	192	205	193	1
Health & Social Development	147	159	172	25
Municipality Services	53	54	62	9
Military and Security Services	311	324	294	-17
Infrastructure & Transport	54	55	70	16
Economic Resources	105	106	131	26
Public Administration	26	27	28	2
Public Programs Unit	89	100	156	67

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

Revenue

Total revenue is budgeted at SR975 billion with 68 percent, or SR662 billion coming from oil revenue.

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The Saudi export price pertaining to oil export revenues is $70 pb according to our calculations…

Overall, therefore, whilst the implied Saudi export price is around $76 pb (around $78 pb for Brent), corresponding to oil revenues of SR662 billion, the Saudi export price pertaining to oil export revenues is lower than this, at $70 pb according to our calculations. We also believe the government is budgeting for compliance with recently agreed OPEC+ cuts, which tied OPEC to a 2.5 percent decline in output compared to its October 2018 output.

Government has budgeted for non-oil revenue to reach SR313 billion in 2019, showing strong growth of 9 percent over 2018's actual figure.

The government has budgeted for non-oil revenue to reach SR313 billion in 2019, showing strong growth of 9 percent over 2018's actual figure. Rises in non-oil revenue will come from a number of areas, including rises in expat levies, a reduction in VAT threshold, which will result in a larger number of enterprises eligible to processing VAT. Whilst other revenue (including investment income) is expected to improve by 7 percent year-on-year, this will mainly come from improvements arising from growth in SAMA FX reserves and not from dividends received from the Public Investment Fund (PIF). According to the MoF, the PIF did not contribute to government revenue in 2018 and is not expected to contribute in 2019 as well (Figure 7).

Jadwa Investment's 2019 budget forecast

Our budgeted oil revenues is equal to SR628 billion, or SR34 billion less than the government's budgeted revenue. The difference in oil revenue is due to our varying outlook on oil prices and production (for more on this please refer to our *macroeconomic update* published November 2018) as well as revenue from domestic energy price reform which the government may have allocated under this segment. On the non-oil revenue side, we expect to see our figure equal the budgeted figure of SR313 billion. As a result, we forecast a

Figure 6: Breakdown of expenditure

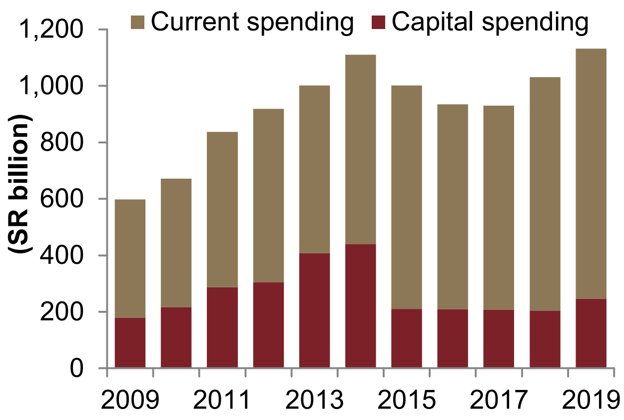
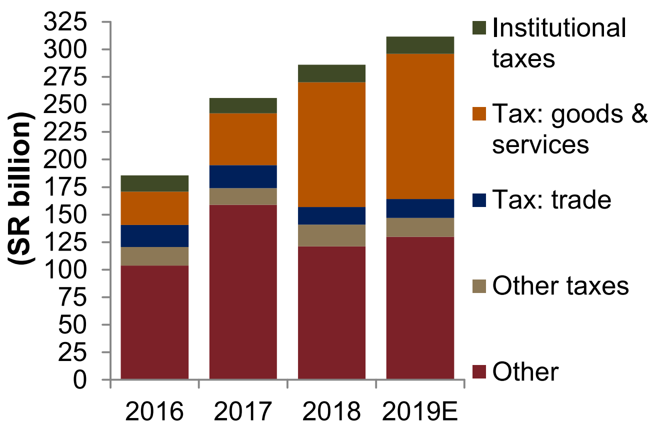


Figure 7: Non-oil revenue by type



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

slightly higher budget deficit of SR164 billion in 2019, equivalent to 5.2 percent of our estimated GDP.

Due to a higher rate of revenue rises vis-a-vis expenditure, the fiscal deficit was lower than previously projected for 2018.

The oil price level necessary for revenues to balance government spending, known as the fiscal breakeven oil price, is $89 pb for Saudi export crude (equivalent to around $91 pb for Brent).

Budgetary Performance in 2018

The fiscal statement also contained provisional data on budgetary performance for 2018. Total revenue was slightly higher than outlined in the preliminary budget, at SR895 billion, SR112 billion higher than originally budgeted for in 2018 and 29 percent higher than last year. Due to a higher rate of revenue rises vis-a-vis expenditure, the fiscal deficit was lower than previously projected for 2018. Thus, the fiscal deficit declined to SR136 billion (4.6 percent of GDP) in 2018, versus SR195 billion (6.9 percent of GDP) previously.

Actual revenue totaled SR895 billion in line with preliminary budgeted levels, and up 29 percent year-on-year.

Actual revenue totaled SR895 billion (Jadwa Investment: SR891 billion), in line with preliminary budgeted levels, and up 29 percent year-on-year. In last year's fiscal budget report, we estimated that the 2018 budget was consistent with a Saudi export price of $58 pb and production of 10.1 million barrels per day (mbpd). Based on preliminary oil export data, we estimate that the Saudi export price of crude oil to be closer to $68 pb in 2018, 33 percent higher year-on-year, and 17 percent higher than the budget oil price (Figure 8). Actual year-to-November Saudi crude oil production averaged 10.3 mbpd (Figure 9), as per our forecasts outlined in our recent macroeconomic update.

Based on preliminary oil export data, we estimate that the Saudi export price of crude oil to be closer to $68 pb in 2018, 33 percent higher year-on-year…

Non-oil revenues totaled SR287 billion, up 35 percent year-on-year. The growth in non-oil revenue was mainly due to gains from 'Taxes on goods and services', which rose by 71 percent year-on-year to SR166 billion. The rise in this segment was due to a number of initiatives which have been rolled out recently, including the introduction of expat levies, excise tax, and VAT. In fact, VAT revenue amounted to SR46 billion in 2018, twice as much as originally budgeted for.

Growth in non-oil revenue was mainly due to gains from 'Taxes on goods and services', which rose by 71 percent year-on-year to SR166 billion.

Expenditure amounted to SR1 trillion, 5 percent higher than originally planned in last year's budget statement, but in-line with updated

Figure 8: Saudi export price

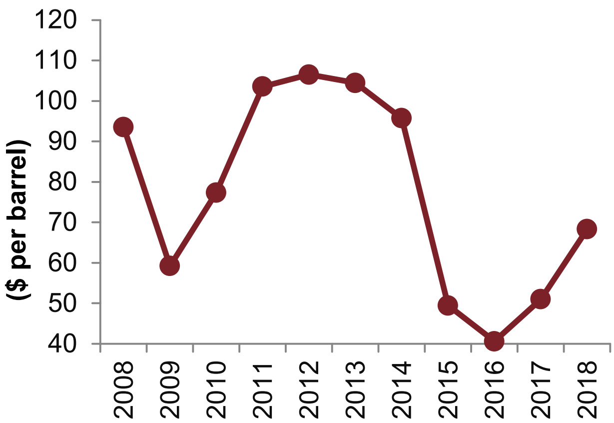
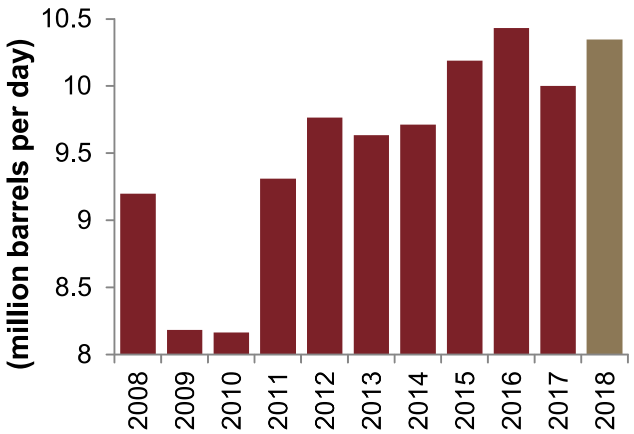


Figure 9: Saudi crude oil production*
(direct communication)



*2018 year-to-November

Current spending increased by SR103 billion, year-on-year to reach SR825 billion in 2018.

The rise was mainly due to an inflation allowance, as per a royal decree.

As stated in the budget report, debt issuances will continue in 2019.

The rise in GDP was partly due to an increase in oil sector GDP, implied in the budget statement to be at 2.6 percent, compared to our estimates of 3.2 percent.

Saudi crude oil production, according to direct communications data, averaged 10.3 mbpd in the year-to–November.

projections in the preliminary budget. From a sectorial allocation viewpoint, spending on some sectors was higher than budgeted, including the health and education. The significant rise in those two sectors was mainly due to the higher number of government employees and as such, was reflected in the wage bill as result of an inflation allowance and other social benefits.

Current spending increased by SR103 billion, year-on-year to reach SR825 billion in 2018. This was mainly as a result of a rise in the wage bill which rose by 8 percent year-on-year to SR474 billion in 2018, compared to SR438 billion originally budgeted for in 2018. The rise was mainly due to an inflation allowance, as per a royal decree. Meanwhile, capital expenditure increased by 20 percent, year-on-year to reach SR205 billion in 2018.

Table 2. 2018 Budget data
(SR billion)

	Budget	Actual	Difference
Revenues	783	895	112
Expenditures	978	1030	52
Balance	-195	-135	60

During 2018, the government continued to issue a series of both international and domestic sovereign bonds/sukuk. Public debt totaled SR443 billion at the beginning of 2018, but had risen to SR560 billion at the end of 2018 (19 percent of GDP), with foreign debt making up 46 percent of the total debt. As stated in the budget report, debt issuances will continue in 2019. The Kingdom still enjoys ample domestic liquidity, thus affording it the ability to continue financing part of the additional debt through domestic bonds. Looking to 2019, we expect a 50/50 split between international and domestic bond issuance for 2019's projected SR118 billion debt, in-line with the trend seen in recent years.

Economic Performance in 2018

The 2019 budget included preliminary macroeconomic data for 2018 with overall economic growth expected to rise by 2.3 percent year-on -year in 2018 compared to our forecast of 2.2 percent and compared to –0.9 percent year-on-year in 2017 (Figure 10). The rise in GDP was partly due to an increase in oil sector GDP, implied in the budget statement to be at 2.6 percent, compared to our estimates of 3.2 percent. Non-oil growth was at 2.3 percent year-on-year, compared to our forecast of 1.4 percent.

Real GDP growth rose by 2.3 percent in 2018, compared to a decline of 0.9 in 2017. As we had predicted, GDP was boosted by a rebound in the oil sector. Saudi crude oil production, according to direct communications data, averaged 10.3 mbpd in the year-to–November. This figure hides a ramp up in Saudi oil output in recent months as the Kingdom compensates for declining output from some OPEC members, such as Venezuela, and outages from Iran following a re-imposition of US sanctions.

Despite a raft of different measures, such as energy price reform, VAT, expat levies and white land tax, the set of expansionary measures implemented via the private sector stimulus package, as well payments received under the Citizen's Account plus the recently

According to our estimates, we see non-oil mining and non-oil manufacturing as the best preforming sectors in 2018.

Preliminary 2018 data from budget statement showed Inflation averaging 2.6 percent, in-line with our forecasts and up from -0.8 percent in 2017.

Oil sector GDP should show some improvements as oil production rises despite Saudi Arabia complying with the recent OPEC+ cuts.

On the non-oil side, we expect economic growth to continue improving on the back of another record level in budgeted government expenditure of SR1.1 trillion.

cost of living allowances, proved to be sufficient to continue bringing about solid growth in the non-oil private sector. On a sectorial basis, according to our estimates, we see non-oil mining and non-oil manufacturing as the best preforming sectors in 2018. The construction and wholesale & retail sectors, on the other hand, are expected to see negative growth, largely due to the impact of the labor market and energy price reforms.

Preliminary 2018 data from budget statement showed **Inflation** averaging 2.6 percent, in-line with our forecasts and up from -0.8 percent in 2017 (Figure 11).

The Economic Outlook for 2019

We expect an improvement in the economy in the year ahead, supported by growth in both the oil and non-oil sector. Oil sector GDP should show some improvements as oil production rises despite Saudi Arabia complying with the recent OPEC+ cuts. The oil sector is also expected to be helped by the start up of the large Jazan refinery. On the non-oil side, we expect economic growth to continue improving on the back of another record level in budgeted government expenditure of SR1.1 trillion. Additionally, we expect non-oil private sector GDP to improve in the year ahead as the economy absorbs the disruptive effects of VAT and energy price reform enacted in 2018.

Despite this, we still see risks remaining in 2019. Apart from the most apparent risk of lower than forecasted oil prices, we also see the possibility of a decline in consumption in the Kingdom as a key risk. As we outlined in our recent macroeconomic update, a net rise in the number of expats and their dependents leaving the Kingdom as well as rising costs for corporates related to higher monthly expat levies, could have negative aggregate effects on overall consumption in the Kingdom, not only in 2019, but also over the next few years.

Taking the above risks into consideration, we see government expenditure for 2019 as being sufficient to continue supporting positive growth in the non-oil sector. More specifically, a 20 percent rise in capital expenditure to SR246 billion, the highest budgeted total in four years will support development and lift the overall

Figure 10: Real GDP growth

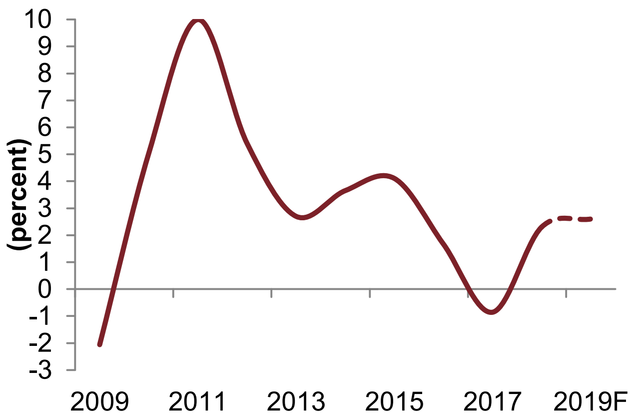
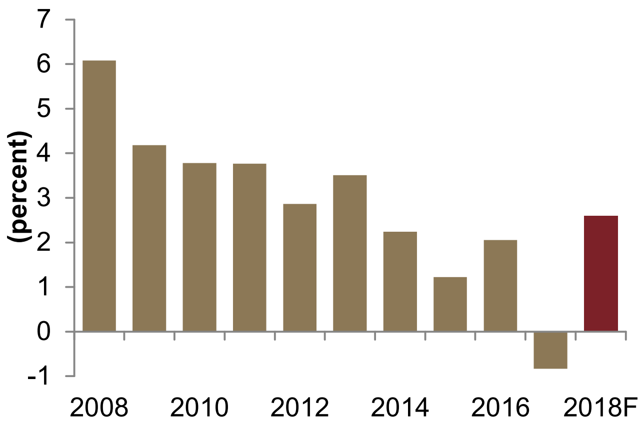


Figure 11: Inflation



According to the budget statement the Saudi economy will grow by 2.6 percent in 2019, with non-oil GDP growth at 2.5 percent…

...implying growth of 2.8 percent from the oil sector, perhaps boosted by the opening of the Jazan refinery.

investment profile of the private sector. Additionally, a total of SR36billion will be targeted to support Vision 2030 initiatives, specifically within housing, mining, energy, manufacturing, transport, entertainment, telecoms and SMEs. According to the budget statement the Saudi economy will grow by 2.6 percent in 2019, with non-oil GDP growth at 2.5 percent, implying growth of 2.8 percent from the oil sector, perhaps boosted by the opening of the Jazan refinery. Meanwhile, inflation is expected to average 2.3 percent, as per the statement.

Table 3. 2018 results and 2019 forecasts in budget statement

	2018 Actual	2019 Forecast
Real GDP (% change)	2.3	2.6
Non-oil GDP (% change)	2.3	2.5
Inflation (2013 = 100, %)	2.6	2.3

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