جدوى للإستثمار
Jadwa Investment

August 2020

Q2 2020 Budget Statement

Debt rises significantly

- Government revenue totaled SR134 billion in Q2 2020, down 49 percent year-on-year. Declines were seen in both oil and non-oil revenue.

- Government oil revenue totaled SR96 billion, down 45 percent year-on-year, with oil prices declining 60 percent over the same period. Looking ahead, we expect oil prices to trade around $40-45 per barrel (pb) in H2, and this combined with continued dividend payments from Aramco means there is the potential for government oil revenue to be higher than our current forecast of SR350 billion for the full year.

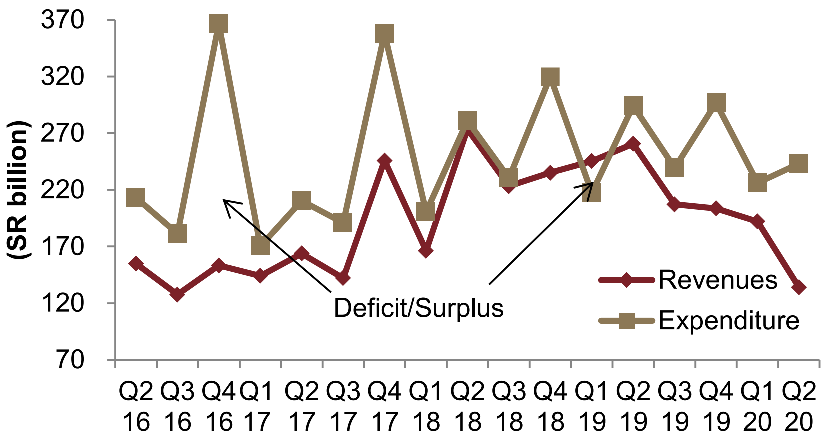
- Non-oil revenue declined by 55 percent compared with the same period last year. As anticipated, the decline was attributable to a combination of a deferral in various tax payments and pandemic induced downturn in economic activity. Looking ahead, we expect non-oil revenue to continue showing yearly declines, but a higher rate of VAT in H2 will help mitigate losses.

- Government expenses declined by 17 percent year-on-year to SR243 billion. As the Ministry of Finance (MoF) recently stated, whilst some cost reductions have taken place within certain segments, these have been subsequently re-allocated to other segments, such as healthcare. As such, we expect full year expenditure to be in-line with budgeted levels of SR1.02 trillion.

- Q2 fiscal deficit amounted to SR109 billion taking H1 2020's deficit to SR143 billion. We still expect the fiscal deficit to total around SR362 (13.5 percent of GDP) by the end of the year.

- Public debt totaled SR820 billion at the end H1 2020. Year-to-date domestic 'Issuance and Borrowing' stood at SR96.9 billion, but domestic sukuk issuances announced via the MoF website equaled SR46.1 billion over the same period. We believe the difference of SR50.8 billion represents a number of private placements with autonomous government institutions.

Figure 1: Q2 2020 fiscal deficit amounted to SR109 billion



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Government revenue totaled SR134 billion in Q2 2020, down 49 percent year-on-year.

Declines were seen in both oil and non-oil revenue.

Government oil revenue was down 45 percent year-on-year…

...with oil prices declining 60 percent over the same period.

Looking ahead, there is the potential for government oil revenue to be higher than our current forecast of SR350 billion for the full year.

Revenue:

Table 1: Government Revenue (SR million)

Revenues	Q2 2019	Q2 2020	Change (%)
Oil revenue	174,910	95,718	-45
Non-oil revenues, of which;	85,796	38,227	-55
-Taxes on income, profits and capital gains	6,311	1,645	-74
-Taxes on goods and services (including petroleum product charges and harmful product tax)	36,504	10,558	-71
-Taxes on trade and transactions (customs duties)	4,401	3,796	-14
-Other Taxes (including Zakat)	14,676	3,362	-77
-Other revenues	23,904	18,866	-21
Total	**260,706**	**133,945**	**-49**

Government revenue totaled SR134 billion in Q2 2020, down 49 percent, or SR126 billion, year-on-year (Table 1). Declines were seen in both oil and non-oil revenue (Figure 2). Government **oil revenue** totaled SR96 billion compared to SR175 billion last year, equivalent to a 45 percent decline year-on-year, with oil prices declining 60 percent over the same period (Box 1). Meanwhile, non-oil revenue declined by 55 percent, or SR48 billion, compared with the same period last year (Figure 3).

Box 1: Oil revenue

We estimate that Saudi oil export revenue totaled around SR76 billion in Q2. Despite this, government oil revenue came in circa SR20 billion higher during the quarter due to the payment of a sizable SR70 billion dividend by Aramco. As of H1 2020, government oil revenue totaled SR224 billion. Looking ahead, as we highlighted in out recent Oil Update, oil prices are likely to remain around current levels of $40-45 per barrel (pb) in H2, and this combined with continued dividend payments means there is the potential for government oil revenue to be higher than our current forecast of SR350 billion for the full year.

Figure 2: Government oil and non-oil revenue

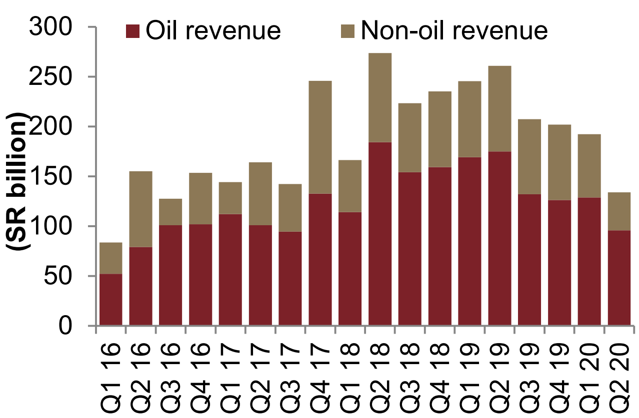
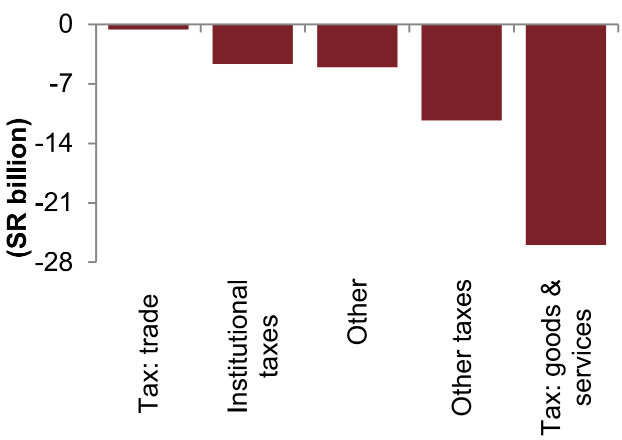


Figure 3: Yearly change in Q2 2020 non-oil revenue



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)'
Other taxes = 'Other Taxes (including Zakat)'

Meanwhile, non-oil revenue declined by 55 percent, or SR48 billion, compared with the same period last year.

Non-oil revenue declined by 55 percent, or SR48 billion, compared with the same period last year. As we anticipated in our *Q1 2020 Budget Statement* the decline was attributable to a combination of a deferral in various tax payments and due to a downturn in economic activity as a result of the preventative measures around the transmission of COVID-19. Accordingly, whilst 'Other' (non-oil, non-tax) revenue declined by 21 percent year-on-year, total tax revenue decline by 70 percent over the same period.

Looking ahead, we expect non-oil revenue to continue showing yearly declines, but a higher rate of VAT in H2 will mitigate losses.

Looking ahead, we expect non-oil revenue to continue showing yearly declines, since even when deferred taxes are received in Q3, they will be significantly less than the 2019 equivalent, reflecting the downturn in economic activity during Q2. That said, the hike in VAT (from 5 percent to 15 percent from 1st July) will help mitigate the decline in this segment. We estimate an additional SR25 billion in tax revenue in 2020 and an additional SR78 billion in 2021, assuming the rate remains unchanged throughout next year (Figure 4). In 2020 as a whole, we expect non-oil revenue to decline by 9 percent over budgeted levels, with H1 2020 non-oil revenue down 37 percent year-on-year.

Expenditure:

Government expenses declined by 17 percent year-on-year to SR243 billion.

Government expenses declined 17 percent year-on-year in Q2 2020 to SR243 billion (Table 2). Whilst **Current expenditure** declined 8 percent year-on-year (Figure 5), **Capital expenditure,** the more growth enhancing element of spending was down 52 percent.

As the Ministry of Finance (MoF) recently stated, whilst some cost reductions have taken place within certain segments…

Table 2: Government Expenditure (SR million)

Expenses	Q2 2019	Q2 2020	Change (%)
Compensation of Employees	130,403	124,738	-4
Goods & Services	36,318	35,000	-4
Financing Expenses	5,353	6,777	27
Subsidies	7,224	9,859	36
Grants	599	2,208	269
Social Benefits	28,222	14,661	-48
Other Expenses	25,036	20,679	-17
Non-Financial Assets (Capital)	61,069	29,259	-52
Total	**294,224**	**243,181**	**-17**

Figure 4: Effective annual VAT rate and expected contribution to non-oil revenue

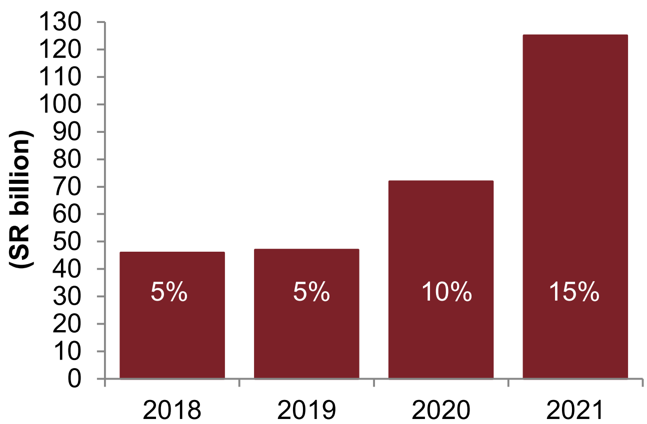
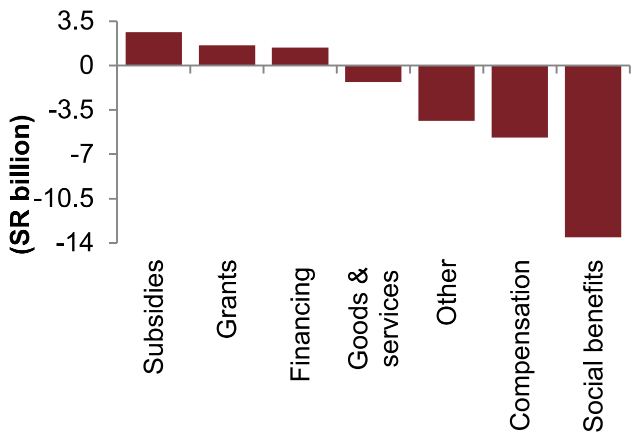


Figure 5: Yearly change in Q2 2020 current expenditure



... these have been subsequently re-allocated to other segments, such as to healthcare.

The largest component of this segment, 'Compensation of Employees', also showed a decline of 4 percent year-on-year as a result of the pro-rated effects of the discontinued public sector cost of living allowance. Meanwhile, the roll-out of fiscal measures to support the private sector during the lockdown meant that 'Subsidies' and Grants' rose by 36 and 269 percent respectively, on a year-on-year basis.

As such, we expect full year expenditure to be in-line with budgeted levels of SR1.02 trillion.

Looking ahead, we expect annual total expenditure to equal budgeted levels of SR1.02 trillion this year, with 46 percent of this being spent during H1. Moreover, as the Ministry of Finance (MoF) recently stated, whilst some reductions have taken place within certain segments of the budget, these have been subsequently re-allocated to other segments, such as an additional SR47 billion for healthcare (Figure 6). In this context, we see Capital expenditure being squeezed in 2020 as a whole, with this segment being down 36 percent year-on-year in H1 2020, and 'Economic Resources' sector (which encompasses spending on new projects and expansion of existing ones) being 43 percent lower than H1 2019.

Public Debt:

Public debt totaled SR820 billion at the end H1 2020.

Year-to-date domestic 'Issuance and Borrowing' stood at SR96.9 billion…

Public debt totaled SR820 billion at the end H1 2020, versus SR678 billion at the end of 2019 (Figure 7). More interestingly though, there appears to be a difference between announced domestic debt issuances by the Debt Management Office (DMO), and total 'Issuances and Borrowings' stated within the Q2 Budget Statement. More specifically, year-to-date domestic 'Issuance and Borrowing' stood at SR96.9 billion, but domestic sukuk issuances announced via the MoF website equaled SR46.1 billion over the same period. We believe the difference of SR50.8 billion is likely to represent a number of private placements with autonomous government institutions.

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We believe the difference of SR50.8 billion is likely to represent a number of private placements…

When accounting for the SR1 billion domestic sukuk issuance and refinancing of SR34.6 billion in July, total year-to-date debt issuance stands at SR176 billion. Looking ahead, we expect a further SR34 billion in new debt plus circa SR10 billion in refinancing during the remainder of the year, thereby pushing total debt issuance and refinancing to SR220 billion by end of 2020. Whilst we expect most of the additional debt to come from domestic issuances, there is likely to be at least one more international bond or sukuk issuance before year end. We note that demand for Islamic bonds remains very healthy, with Indonesia's June sukuk of $2.5 billion being almost seven times oversubscribed. Bearing in mind that Indonesia's

Figure 6: We expect government expenditure to be in-line with budgeted levels of SR1.02 trillion

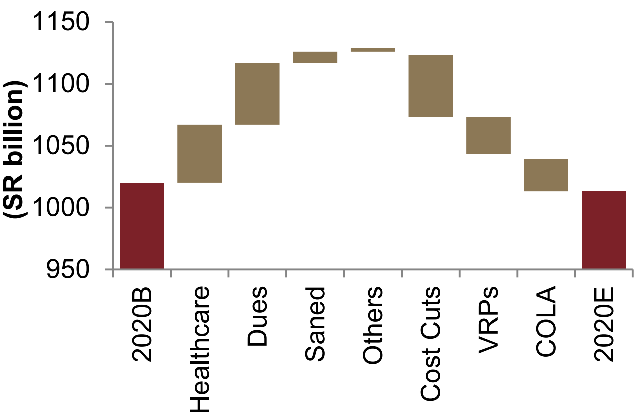
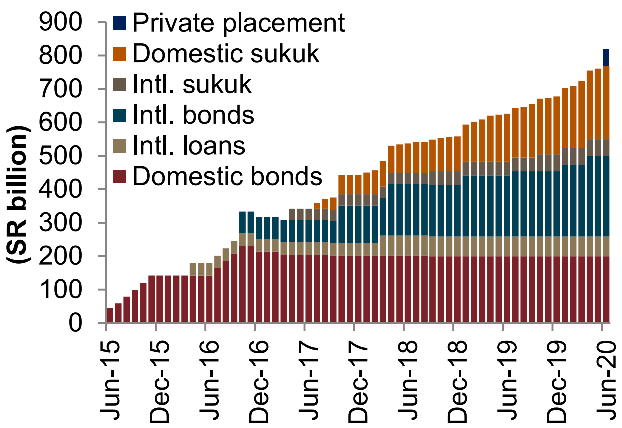


Figure 7: Public debt totaled SR820 billion at the end H1 2020



...private placements with autonomous government institutions.

sovereign credit rating is lower, we see there room for the Kingdom to issue a sukuk of anywhere between $2-4 billion whilst maintaining a similar level of demand.

Deficit:

Q2 fiscal deficit amounted to SR109 billion taking H1 2020's deficit to SR143 billion.

Q2 fiscal deficit amounted SR109 billion but H1 2020 deficit totaled SR143 billion. We still expect the fiscal deficit to total around SR362 (13.5 percent of GDP) at the end of the year. Since SR176 billion of the deficit is expected to be financed via debt we expect the remainder of the deficit (circa SR186) will have to be financed by SAMA deposits, of which circa SR49 billion was used during H1.

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