December 2022

Saudi Arabia's 2023 Fiscal Budget

- The government's budget for the 2023 fiscal year was endorsed by the Council of Ministers on 7th December. It contains some minor changes compared to the preliminary budget.

- The government projects total expenditure for 2023 at SR1.11 trillion, which is 16.6 percent above the 2022 budget (SR955 billion), but some 1.6 percent below the official estimate for 2022 (SR1.13 trillion). Government investment spending (capex) is projected to rise by around 4 percent compared with the official 2022 estimate as the authorities focus on delivering projects that were delayed during the Covid-19 pandemic.

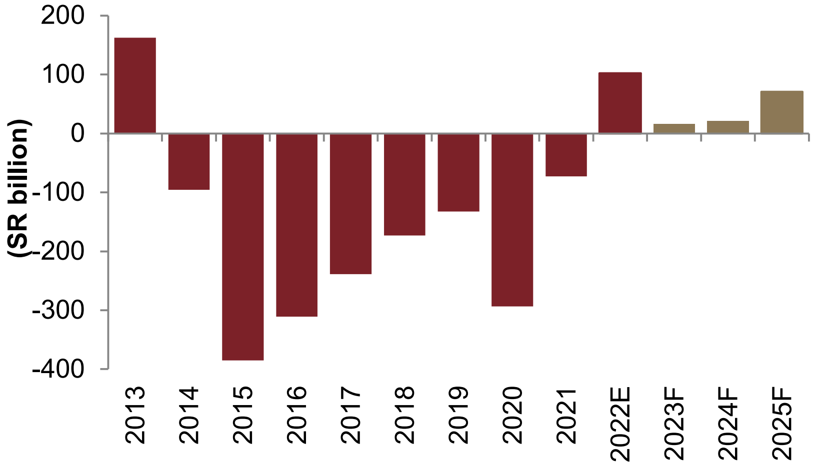
- Meanwhile, current spending is budgeted to decline by 2.4 percent compared with this year's official estimate. One driver will be lower procurement costs as global supply chains continue to heal and commodities prices soften following this year's war-related surges. Spending on social benefits is also budgeted to decline slightly as job opportunities expand.

- Revenue is expected to fall to SR1.13 trillion, an 8 percent decline on the 2022 estimate. Oil revenue is not revealed in the budget, but the Ministry of Finance is likely to have been conservative in its assumptions given the unusually high degree of uncertainty around demand and supply. We think an oil price in the range of $70-$75/barrel (Brent) underpinned their assumptions. Nonoil revenue, driven by VAT takings, is expected to continue rising given higher consumer spending and a growing private sector.

- Given the above, the authorities project a modest budget surplus of SR16 billion, or 0.4 percent of GDP in 2023. This builds on an estimated surplus of 2.6 percent of GDP in 2022, which marked the end of an eight-year run of deficits (Figure 1).

- Economic activity is robust and is expected to remain so in 2023. GDP growth has been underpinned by both consumption and investment, and these drivers are expected to remain in place given labor force dynamics and enhanced investment by the Public Investment Fund and others.

Figure 1: The fiscal position has returned to surplus and should stay there in the years ahead



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Released: December-11-2022, 15:30 UTC+3

Total expenditure for 2023 is unchanged versus the preliminary budget, at SR1.11 trillion…

...meaning it is expected to be 16.6 percent higher than the 2022 budget, but slightly below the 2022 official spending estimate.

Central government capex is set to pick up moderately, though broader public sector investment will remain robust.

Current spending is projected to decline relative to this year, even though spending on wages & salaries is expected to increase…

...the latter should continue to fall as a share of output however.

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The government's budget for the 2023 fiscal year was endorsed by the Council of Ministers on 7th December with only minor changes compared to the preliminary budget released in September this year.

Expenditure:

Projected total expenditure for 2023 is unchanged compared with the preliminary budget at SR1.11 trillion. This puts it 16.6 percent above the 2022 budget, but some 1.6 percent below the official estimate of spending in 2022. Meanwhile, medium-term spending plans have been raised significantly compared with those set out in the 2022 budget: total spending in 2024 is now projected at SR1.13 trillion compared with SR951 billion in last year's budget (Box 1). Yet despite this uplift, spending is still expected to narrow as a share of nonoil GDP—to around 41 percent in 2025 compared with 48 percent this year (Figure 2).

Budgeted capex is set to rise to SR157 billion in 2023, from an estimated SR151 billion this year. The increase reflects enhanced spending on projects (mainly social infrastructure) that were delayed by the Covid-19 pandemic. Yet as the budget says, there will continue to be a significant "development contribution" from both the Public Investment Fund and the National Development Fund. These two extremely well-capitalized organizations will continue to deliver the "gigaprojects" that underpin the Kingdom's structural transformation (Figure 3). The Vision 2030 program is targeting a cumulative SR12.5 trillion of investment by 2030, enough to raise total fixed capital formation to 30 percent of GDP from an estimated 19 percent of GDP in 2022. The importance of investment is undisputed. If efficiently allocated, infrastructural, industrial and human capital investments should enhance productivity and sustain higher levels of GDP per capita growth.

Meanwhile, current spending has been budgeted at SR957 billion, representing an 11 percent gain on the 2022 budget, but a 2.4 percent cut compared with the official 2022 current spending estimate. Current spending remains dominated by wages & salaries (some 46 percent of spending), which is earmarked to rise by 1.6 percent compared with the 2022 estimate. Yet despite this nominal increase, significant progress has been made in reducing this item as a share of output: spending on wages and salaries fell to 19 percent of nonoil GDP in 2022 (helped in part by significant growth in the GDP denominator) from 22 percent of nonoil GDP in 2021 (Figure 4). Further progress on this front remains a key policy objective, and it is hoped that the investment growth noted above will open up significant private sector employment opportunities, allowing reductions in government salary costs in nominal as well as relative terms.

Figure 2: Spending as a share of nonoil GDP should continue to trend down

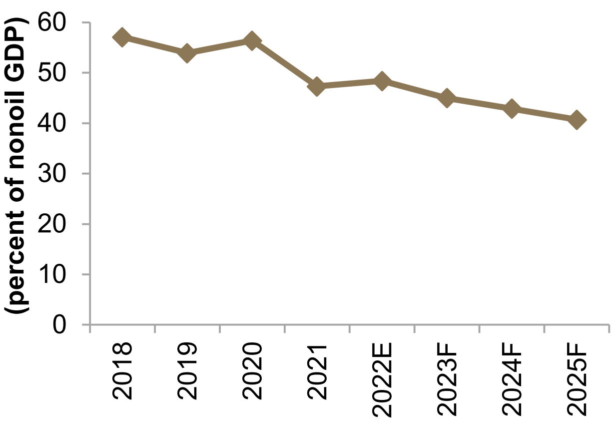
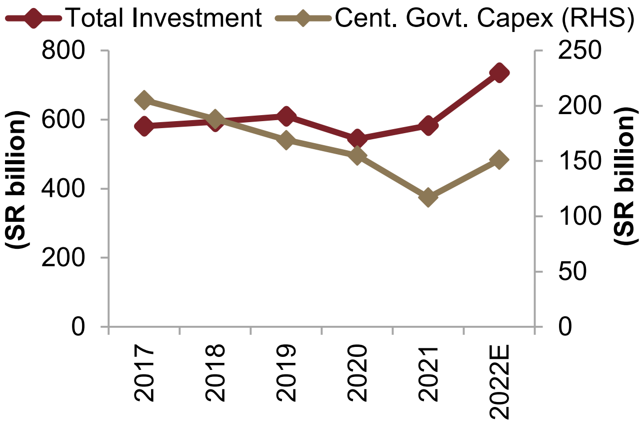


Figure 3: Total investment has risen even as government capex has trended down



Lower procurement costs will help to keep current spending in check.

Spending on goods and services, which is the second biggest segment of expenditure, is budgeted to decline by a substantial 8 percent compared with this year's estimate. This seems plausible given broad agreement that global soft commodities prices will continue to ease following this year's shocks. Here again, the medium term expectation is that the focus on local supply chain development will generate both greater resilience to potential global shocks, and job opportunities.

The Military is now the biggest single sector of spending, with particular focus on improving health infrastructure for the armed forces.

Looking at the budget from a sectorial level, 'Military' is now the largest single sector of spending, up 5.7 percent from this year's official estimate and now accounting for 23 percent of total budgeted spending. The emphasis is on enhancing military medical facilities, while a broader push to 'localize' the supply of some military equipment remains a priority. 'Education' and 'Health & Social Development'—which have historically accounted for the largest allocations—share second spot, though both see their allocations shrink slightly compared with this year's estimate. Meanwhile, 'General Items', which includes government contributions to social insurance and debt servicing obligations, sees a slight decline in its allocation, though a more pronounced (9 percent) cut compared with the 2022 budget (Table 1, Figure 5).

Health and Education both see modest declines in their allocations compared with the 2022 estimate, but budget-over-budget increases.

Table 1. 2023 Budget Allocation

(SR billion)

Budget Allocation	2022B	2022E	2023B	Difference (2023B-2022E)
Expenditure	955	1132	1114	-18
Public Administration	32	36	37	1
Military	171	245	259	14
Security & Regional Amin.	101	110	105	-5
Municipality Services	50	61	63	2
Education	185	195	189	-6
Health & Social Development	138	198	189	-9
Economic Resources	54	75	72	-3
Infrastructure & Transport	42	47	34	-13
General Items	182	166	165	-1

Note: "B" refers to budgeted spending, "E" refers to estimated spending

Figure 4: Recent years have seen a decline in the relative size of spending on wages & salaries

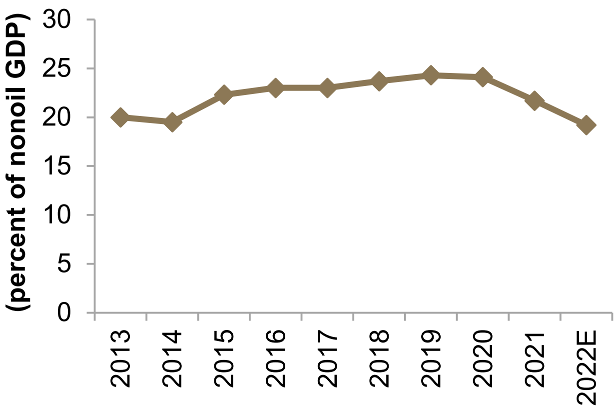
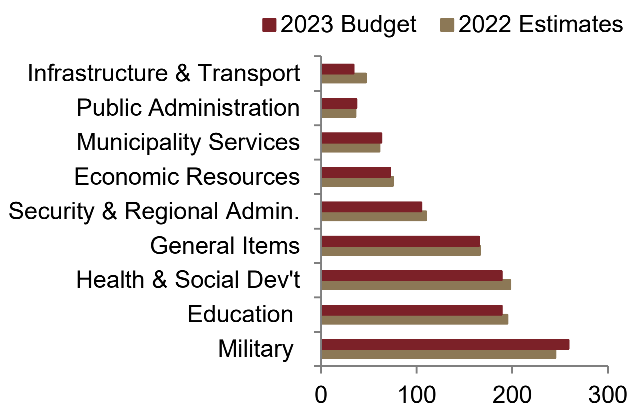


Figure 5: Yearly Change in Spending by Sector
(estimates of 2022 versus budgeted 2023)



The new budget earmarks much higher spending for 2023-24 than in the previous budget...

...yet government spending as a share of nonoil GDP should continue to fall.

Box 1: An Upward Shift in Spending Projections

The upward shift in medium-term spending projections is notable (Figure 6). The latest budget projects average spending in 2023 and 2024 at SR1,120 billion, an 18 percent rise on the SR946 billion average projected in the 2022 budget. A further increase to SR1,134 billion is penciled in for 2025.

The budget report emphasized that these revisions were enabled by more ‘fiscal space’ resulting from an increase in ‘structural’ revenues (presumably VAT and other taxes). In terms of spending, social and military infrastructure projects are two areas of focus, according to the budget report.

Yet this spending shift does not signal an increased share of domestic output: even with these revisions, central government spending should see its share of nonoil GDP continue to edge down to an estimated 41 percent of nonoil GDP in 2025 from a recent high of 57 percent in 2018. As such, this also signals the government’s well-founded belief in the strength of the nonoil economy, which looks set to record brisk growth in the years ahead. This in turn partly reflects the role of state-owned institutions such as the PIF, whose investments are bolstering nonoil growth prospects, but also the raft of supply-side reforms which have improved the business environment for private investors.

Revenue is budgeted to decline by 8.4 percent compared with the 2022 estimate.

Uncertainty around oil prices is elevated and we estimate that the authorities used a conservative assumption in the range of $70-75/ barrel for Brent.

Revenue:

There is a minor upward revision to budgeted government revenue compared with the preliminary budget statement. The government expects total revenue to reach SR1.13 trillion, an 8 percent increase on the 2022 budget but an 8.4 percent decline on 2022’s estimated level. Much hinges on oil price and production assumptions, which are naturally not revealed by the authorities (oil revenue is subsumed within “other revenue”). There is an unusually high diversity of views around the oil outlook, and in particular how far supply constraints might offset a deteriorating demand landscape. The authorities are traditionally conservative when it comes to oil price assumptions, and although it is difficult to disaggregate the oil component of “other revenue”, we believe that a figure in the range of $70/b-$75/b (Brent) guided their revenue assumptions (Figure 7).

These spending and revenue projections indicate a modest budget surplus of SR16 billion in 2023, or 0.4 percent of GDP. This is

Figure 6: There has been an upward shift in spending projections

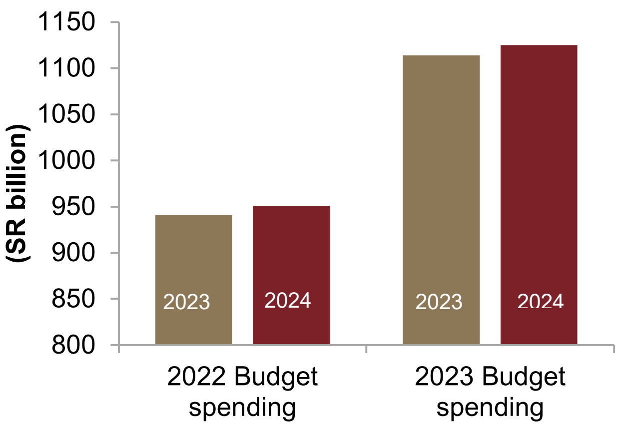
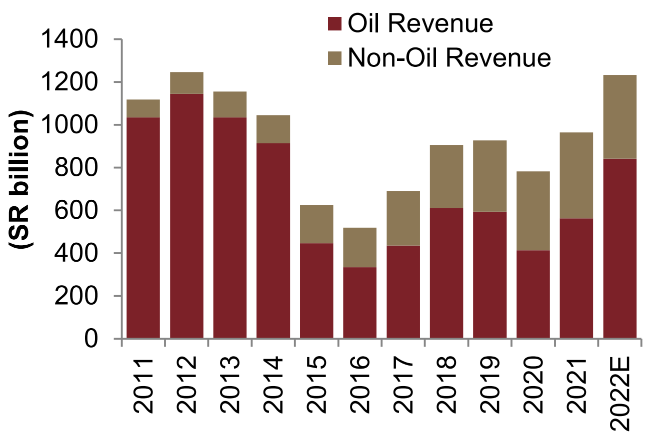


Figure 7: Actual Revenue by Type



The budget projects a reduced surplus of 0.4 percent of GDP for 2023, down from an estimated 2.6 percent of GDP this year. The latter marks the end of eight years of sizeable budget deficits during the 2014-21 period.

somewhat smaller than the 2022 official estimate of 2.6 percent of GDP—see below. Yet a surplus, no matter how small, is welcome given the eight consecutive years of deficits in the 2014-21 period, which required an aggregate SR1.7 trillion of financing. Also notable is the encouraging decline in the nonoil fiscal deficit (Figure 8).

Budgetary Performance in 2022

Total revenue increased by 18 percent in 2022, reflecting the surge in oil revenue stemming from global dislocations.

As per the budget report, total revenue is estimated at SR1,234 billion in 2022, a substantial 18 percent higher than budgeted and some 28 percent higher than 2021 revenue. Oil was the main engine of revenue growth, with prices surging in the aftermath of Russia's invasion of Ukraine, and output rising in line with OPEC Plus agreements.

Nonoil revenue declined slightly, by around 3 percent. However, this largely reflects the unusually high base in 2021, when tax takings surged following deferrals in 2020. Other changes to VAT tax collection timings also played a role (Figure 9).

Spending was up 9 percent compared with 2021. Capex was the main driver, but there was also contributions from social spending and financing costs.

Spending came in 19 percent over budget and 9 percent higher than 2021. This was partly driven by additional capex, which climbed by 29 percent, as the authorities moved to upgrade social utilities. The rise in current spending was a more subdued 6.4 percent over 2021, with wages & salaries held to 2.1 percent growth. This is broadly in line with Saudi population growth, but a fall in real per capita terms after adjusting for average inflation (2.5 percent). Procurement costs rose by a sharp 16 percent, as global dislocations fed through into higher commodities prices.

Social benefits spending also edged up, largely reflecting a package of measures introduced in July to help the most vulnerable households cope with the rising cost of living. Other areas of significant spending growth included debt financing: the share of variable rate debt is low, but the surge in interest rates was enough to give a 17 percent uplift to this item.

The return to fiscal surplus is very welcome following a testing eight years of deficits. On the upside, persistent fiscal deficits have encouraged the authorities to take a more systematic approach to spending and revenue management.

The budget surplus came in at SR102 billion, or 2.6 percent of GDP. The surplus is the first recorded since the 2014 oil price correction. Eight years of budget deficits prompted the authorities to re-engage with sovereign and local debt markets, and think more strategically about spending priorities, spending efficiency, nonoil revenue and even cash management. These efforts have put the fiscal position on a much firmer footing than seemed likely in 2015.

Figure 8: The fiscal balance has returned to surplus and the nonoil deficit is much reduced

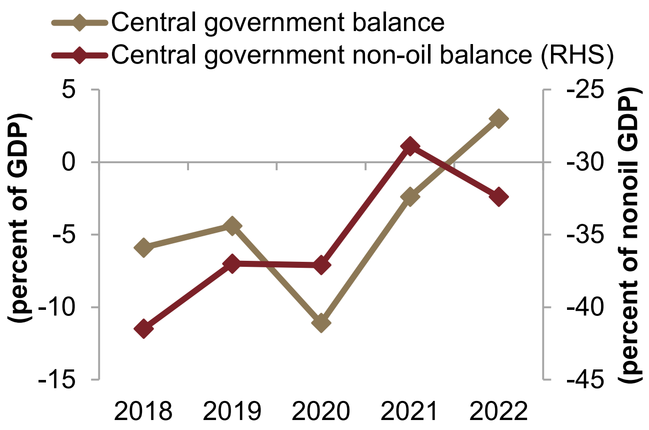
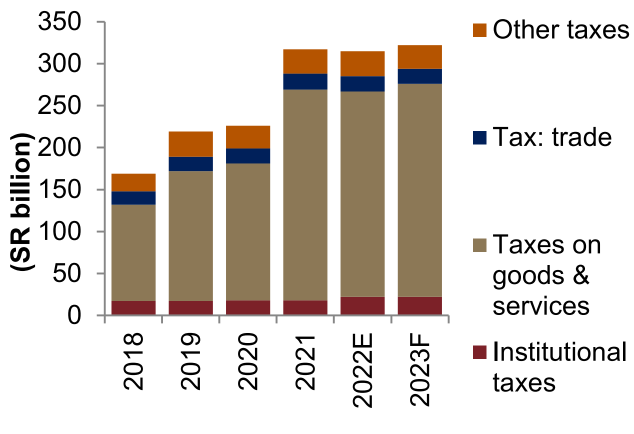


Figure 9: Non-oil Tax Revenue by Type



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

Economic Performance and Outlook

According to the budget statement, the Saudi economy is expected to register real GDP growth of a stunning 8.5 percent in 2022.

According to the budget statement, the Saudi economy is expected to register real GDP growth of 8.5 percent in 2022, up from 3.2 percent in 2021, and the fastest for more than a decade. Both the oil and nonoil sectors contributed, with the latter expanding by 5.9 percent. This in turn was driven by wholesale & retail trade, which rebounded forcefully as pandemic restrictions were fully lifted, including those around Umrah and Hajj (Figure 10).

Unsurprisingly, given the strength of domestic investment, growth was also propelled by construction, followed by transport & communication. The oil sector also delivered an outsized expansion as crude and products production rebounded from three years of contraction.

The authorities expect real growth to moderate to 3.1 percent in 2023. This is still very healthy by global standards and reflects the ongoing investment drive along with labor force expansion.

Looking to 2023, the budget statement expects GDP growth to moderate to a still firm 3.1 percent in real terms. Oil production growth is contingent on the world avoiding a recession (and China loosening its Covid restrictions). Domestic activity should continue to show brisk growth as investment is stepped up and labor force participation continues to expand. These drivers are expected to remain in place for some time and should propel substantial real rises in income per head over the medium term.

Meanwhile, consumer price inflation is likely to ease slightly, helped by the probable retreat of global food prices.

Saudi inflationary pressures should remain subdued by global standards (Figure 11). A strong dollar has helped to take the edge off imported price pressures from China and the eurozone, while subsidies on basic food items have prevented a sharper pass-through to consumers. The dollar might weaken somewhat in 2023 but the healing of global supply chains and generally weaker commodities prices should keep consumer price inflation contained below 3 percent.

Figure 10: Change in Real GDP

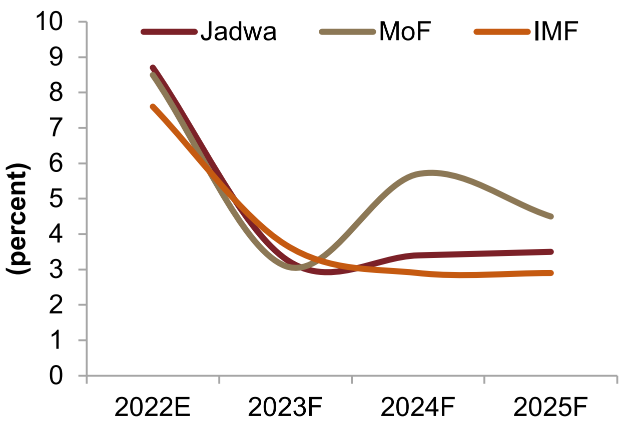
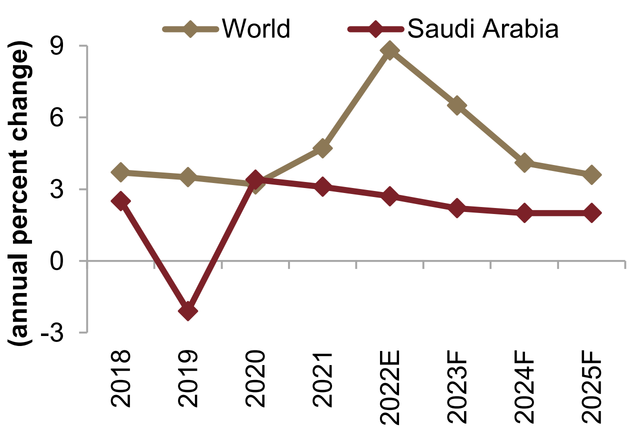


Figure 11: Saudi inflation should remain contained



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