جدوى للإستثمار
Jadwa Investment

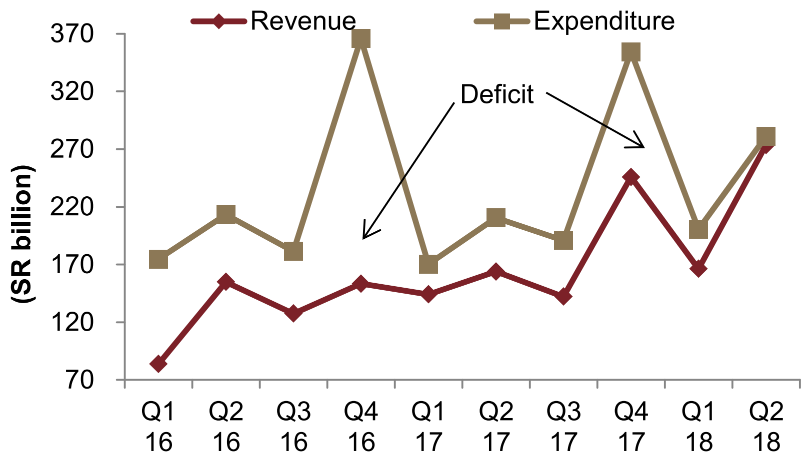
August 2018

Q2 2018 Budget Statement

Fiscal deficit narrows dramatically

- Total government revenue rose to SR273 billion in Q2 2018, up by 67 percent, or SR110 billion, year-on-year. Whilst non-oil revenue saw a rise of 42 percent year-on-year, government oil revenue rose by an even higher rate during the quarter, to a total of SR184 billion.
- The large rise in oil revenue was due partly to a switch to quarterly dividends, as highlighted by the Ministry of Finance (MoF) previously, and, as such, a part of Q1 oil contributions were received in the Q2.
- The government's efforts to raise non-oil revenue through structured economic reform continues to bear fruit with this segment rising by 42 percent year-on-year. Most of these gains came from 'Taxes on goods and services', which nearly tripled year-on-year, to SR29.7 billion.
- In fact during H1 2018, a total of SR52.3 billion had been raised via 'Taxes on goods and services', which represents 62 percent of the budgeted SR85 billion for the whole of 2018 under this segment.
- As a result of a rise in yearly revenue at a faster rate than expenditure, the fiscal deficit narrowed to just SR7 billion in Q2 2018, pushing the H1 2018 fiscal deficit to SR41.7 billion.
- Looking ahead, we expect oil and non-oil revenue to continue rising at faster rate than expenses on a yearly basis. That said, higher than budgeted government revenue will not result in higher government expenditure, but rather, it will contribute to lowering the fiscal deficit.

Figure 1: The fiscal deficit narrowed to SR7 billion in Q2 2018



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The large rise in oil revenue was due to a switch to quarterly dividends, as highlighted by the MoF previously, and, as such, a part of Q1 oil contributions were received in the Q2.

We estimate that oil export revenue totaled SR214 billion in Q2 2018, compared to SR144 billion in Q2 2017.

Table 1: Government Revenue (SR million)

Revenues	Q2 2017	Q2 2018	Change (%)
Oil revenues	100,990	184,165	82
Non-oil revenues, of which;	62,917	89,424	42
-Taxes on income, profits and capital gains	7,201	6,648	-8
-Taxes on goods and services (including petroleum product charges and harmful product tax)	8,084	29,744	>100
-Taxes on trade and transactions (customs duties)	4,941	3,413	-31
-Other Taxes (including Zakat)	10,596	11,969	13
-Other revenues (including returns from SAMA and PIF)	32,094	37,650	17
Total	**163,906**	**273,589**	**67**

Revenue:

Saudi government revenue totaled SR273 billion in Q2 2018, up by 67 percent, or SR110 billion, year-on-year (Table 1). Whilst non-oil revenue saw a rise of 42 percent year-on-year, government oil revenue rose by an even higher rate during the quarter, to a total of SR184 billion. The large rise in oil revenue was due to a switch to quarterly dividends, as highlighted by the MoF previously, and, as such, a part of Q1 oil contributions were received in the Q2. Moving forward, higher yearly oil prices in Q2 are likely to maintain a strong yearly rise government oil revenue in Q3 as well (Box 1).

Box 1: Oil export revenue

We estimate that the Saudi export price of crude and refined products increased by 43 percent year-on-year, to $73 per barrel (pb) in Q2 2018, with an average of around 8.8 million barrels per day (mbpd) of crude oil and refined products being exported during the quarter. Accordingly, oil export revenue is expected to have totaled SR214 billion in Q2 2018, compared to SR144 billion in Q2 2017 (Figure 2). Historically speaking, on a quarterly basis, the implied transfer ratio (the difference between oil export revenue and

Figure 2: Quarterly oil export revenue and Saudi oil and refined product export prices

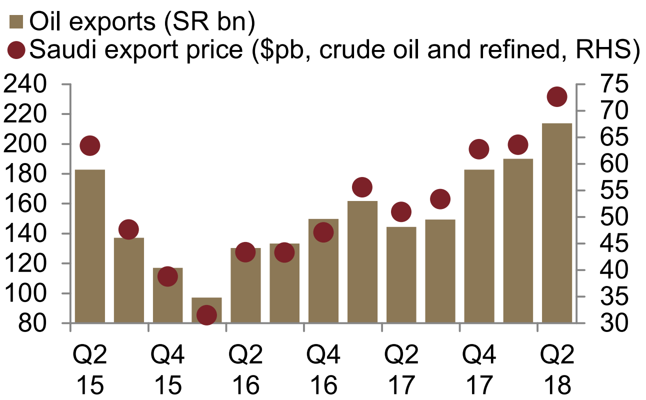
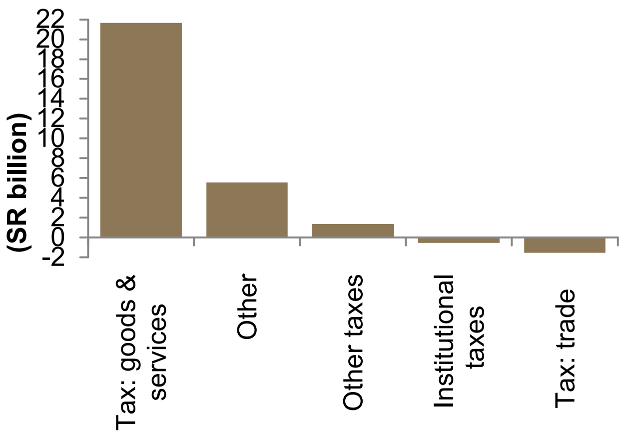


Figure 3: Yearly change in non-oil revenue



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

We expect government oil revenue to rise to SR576 billion in 2018, against budgeted oil revenue of SR492 billion.

government revenue) has averaged around 67 percent, whereas in Q2 2018 the implied transfer ratio was around 86 percent, although, as per MoF's statement, this is likely to be due to the government's receipt of contributions from Q1 2018.

Government oil revenue stood at SR298 billion in H1 2018, representing 60 percent of the budgeted total for 2018. As we highlighted in our recent *macroeconomic update*, we expect the combination of higher Saudi oil export prices and crude oil production will result in government oil revenue rising to SR576 billion, against budgeted oil revenue of SR492 billion, and actual oil revenue of SR436 billion in 2017.

The government's efforts to raise non-oil revenue through structured economic reform continues to bear fruit with this segment rising by 42 percent year-on-year.

The government's efforts to raise **non-oil revenue** through structured economic reform continues to bear fruit with this segment rising by 42 percent year-on-year. Most of these gains came from 'Taxes on goods and services', which nearly tripled year-on-year, to SR29.7 billion (Figure 3). This rise was due to a number of initiatives which have been rolled out recently, including the introduction of value added tax (VAT), expat levies and excise tax. In H1 2018, a total of SR52.3 billion had been raised via 'Taxes on goods and services', which represents 62 percent of the budgeted SR85 billion for the whole of 2018 under this segment, as outlined in the updated Fiscal Balance Program (FBP).

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In Q2 2018, 'Other revenues (including investment returns from the Saudi Arabian Monetary Authority (SAMA) and Public Investment Fund (PIF)' was up by 17 percent year-on-year, to SR38 billion. We believe this is due to higher dividends received by PIF from its holdings in TASI listed companies and continued yearly improvement in SAMA investment returns (for more on this please see our *Q1 2018 Budget Statement* report published on May 2018).

Expenditures:

Total government expenses rose by 34 percent year-on-year in Q2 2018, to a total of SR281 billion.

Total government expenses rose by 34 percent year-on-year in Q2 2018, to a total of SR281 billion (Table 2). Current expenditure, the lower economic growth enhancing element of government spending, was up 31 percent year-on-year, pushed up by the largest contributor to current expenses, 'Compensation of Employees', which rose 27 percent, or SR28 billion, over the same period (Figure 4). The large yearly rise in 'Compensation of Employees' reflects a monthly payment of SR1,000 per month, over the course of 2018 for civil servants in order to compensate for higher living costs, following a royal decree at the start of 2018. According to the Ministry of Commerce and Investment (MOCI), the total annual cost of these allowances would be around SR50 billion.

Current expenditure was up 31 percent year-on-year, pushed up by the largest contributor to current expenses, 'Compensation of Employees'…

Table 2: Government Expenditure (SR million)

Expenses	Q2 2017	Q2 2018	Change (%)
Compensation of Employees	102,788	130,830	27
Goods & Services	27,239	43,341	59
Financing Expenses	3,011	1,524	-49
Subsidies	1,135	4,231	>100
Grants	640	1,625	>100
Social Benefits	16,587	25,392	53
Other Expenses	25,772	25,926	1
Non-Financial Assets (Capital)	33,251	48,080	45
Total	**210,423**	**280,949**	**34**

...which rose 27 percent, or SR28 billion, over the same period.

Expenditures on 'Goods and Services' rose by a sizable 59 percent in Q2 2018 year-on-year.

We do not view this rise as related to any specific project, but being more reflective of the MoF's stated plan to distribute spending in a more balanced manner throughout the fiscal year.

As was the case in pervious quarter, 'Social Benefits' saw large yearly rises in Q2 2018, up almost 58 percent to SR25 billion, due to payments under the Citizen's Account program.

Financing Expenses' exhibited their first yearly decline in two years despite rising government debt…

...with the lower cost likely related to the re-pricing of a debt facility back in March 2018.

In Q2 2018, the government announced the issuance of a SR42 billion international bond…

Expenditures on 'Goods and Services' rose by a sizable 59 percent in Q2 2018 year-on-year. We do not view this rise as related to any specific project, but being more reflective of the MoF's stated plan to distribute spending in a more balanced manner throughout the fiscal year, in order to boost economic growth. In the past, as in the case of capital expenditure (see below), expenditure on 'Goods and Services' has tended to rise rapidly in the last quarter of each year. In line with the MoF's plans, we expect this to be somewhat different this year, with 37 percent of total budgeted 'Goods and Services' expenditure for 2018 being disbursed in H1 2018, versus 32 percent a year ago.

As was the case in pervious quarter, 'Social Benefits' saw large yearly rises in Q2 2018, up almost 58 percent to SR25 billion, due to payments under the Citizen's Account program, which commenced on 20th December 2017. According to the annual fiscal budget, around SR2.5 billion per month, or SR30 billion annually, was earmarked for the Citizen's Account program in 2018. Accordingly, around SR7 billion was disbursed during Q2, with roughly 3.5 million households within the Kingdom benefitting. By August 2018, a total of SR21 billion had been disbursed through the program so far (Figure 5).

'Financing Expenses' exhibited their first yearly decline in two years despite rising government debt. This segment was down SR1.5 billion, or -49 percent, year-on-year in Q2 2018. The lower cost in this segment is likely related to the re-pricing of a debt facility back in March 2018. According to the Debt Management Office (DMO), the re-pricing and extension of the Kingdom's 2016 $10 billion international syndicated loan facility represented a 30 percent reduction from levels set previously.

According to the Q2 Budget Statement, public debt totaled SR443 billion at the end of 2017. Since then there has been SR18 billion in domestic sukuk issuances during Q1 and a SR60 billion syndicated loan refinancing, which expanded the original facility by SR22.5 billion. In Q2 2018, the government announced the issuance of a SR42 billion international bond and a further issuance of a total of SR12 billion in domestic sukuk, bringing the total to SR536 billion. In July 2018, another domestic sukuk for SR3.5 billion had been issued. According to the Debt Management Office (DMO), the remainder of this year's debt issuance is likely to be raised domestically, but we don't rule out a possibility of foreign debt issuance, either. As of

Figure 4: Year-on-year change in Q2 2018 current expenditure

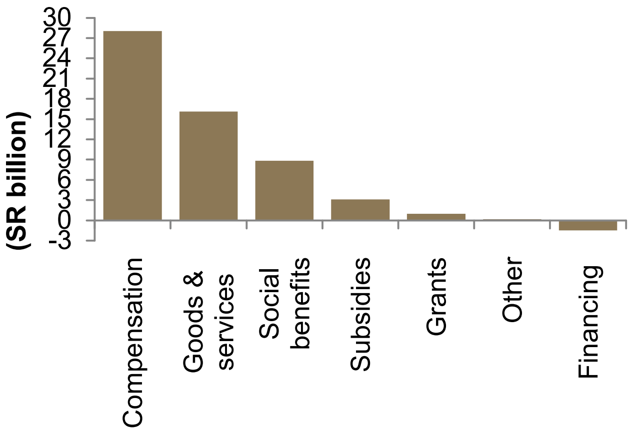
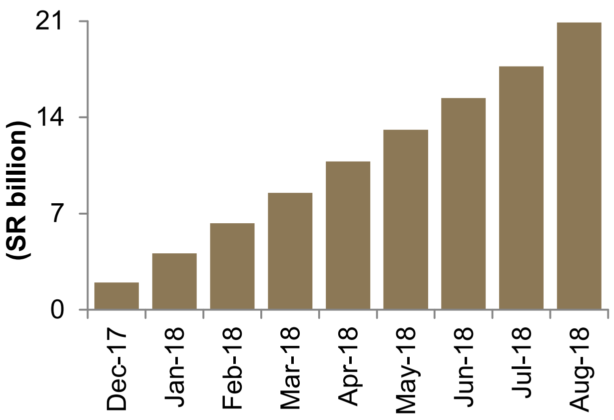


Figure 5: Cumulative payments under the Citizen's Account since inception



...and a further issuance of a total of SR12 billion in domestic sukuk, bringing the total to SR536 billion.

The capital spending side of the expenses was up by a sizable 45 percent year-on-year to SR48 billion, in Q2 2018…

...this is the highest level of capital spending outside of the final quarters for at least two years and directly correlates with MoF's stated objective of seeking to distribute spending in a more balanced manner throughout the fiscal year.

A rise in yearly revenue at a faster rate than expenditure meant the fiscal deficit narrowed to just SR7 billion in Q2 2018, pushing the H1 2018 fiscal deficit to SR41.7 billion.

Looking ahead, we expect total government revenue to exceed budgeted revenue, primarily due to higher oil revenue.

August 2018, a total of SR98 billion of debt had been issued this year and we expect debt issuances not to exceed SR117 billion in 2018, as per the fiscal budget statement. At this rate therefore, we see a further SR19 billion in domestic bond issuances during the remainder of the year, taking total debt to SR560 billion at the end of 2018, equivalent to 19 percent of GDP (Figure 6).

The capital spending side of the expenses, or 'Non-Financial Assets (Capital)', was up by a sizable 45 percent year-on-year, to SR48 billion, in Q2 2018. This is the highest level of capital spending outside of the final quarters for at least two years and directly correlates with MoF's stated objective of seeking to distribute spending in a more balanced manner throughout the fiscal year. According to the annual fiscal budget, capital spending will total SR205 billion. That said, H1 2018's capital spending still only represents around 36 percent of the total. Taking into consideration the nature of payments related to government projects, with payment on completion, usually towards the end of the year, we still do expect capital spending to rise significantly in Q4 2018.

Deficit:

A rise in yearly revenue at a faster rate than expenditure meant the fiscal deficit narrowed to just SR7 billion in Q2 2018, pushing the H1 2018 fiscal deficit to SR41.7 billion. Looking ahead, we expect oil and non-oil revenue to continue rising at faster rate than expenses on a yearly basis. In fact, as we noted in our recent [macroeconomic update](), higher than budgeted government revenue will not result in higher government expenditure, but rather, it will contribute to lowering the fiscal deficit. As a result, we expect the Kingdom's fiscal deficit to decline to SR111 billion, or 3.8 percent of GDP, versus SR195 billion outlined in the 2018 fiscal budget statement.

Outlook:

So far, in H1 2018, government revenue has shown strong yearly growth, and we expect total government revenue to exceed budgeted revenue, primarily due to higher oil revenue. Meanwhile, non-oil revenue is well positioned, with close to half of budgeted non-oil revenue achieved by mid-year. Looking ahead, we expect to see continued yearly rises in non-oil revenue, especially from tax income, helped by rises in expat dependency fee, which doubles from SR100 to SR 200 per dependent from July 2018 onwards.

Figure 6: We expect government debt to rise to SR560 billion by the end of the year

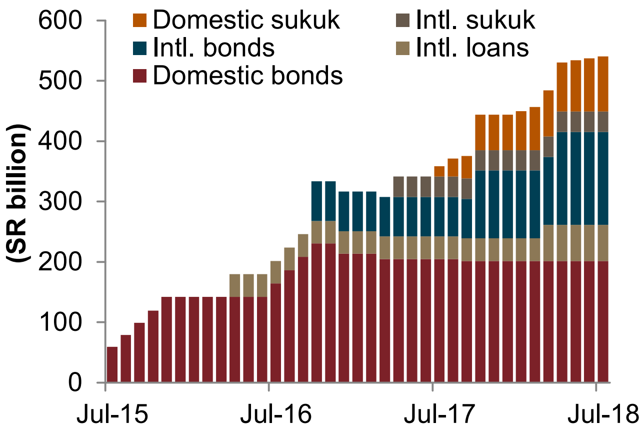
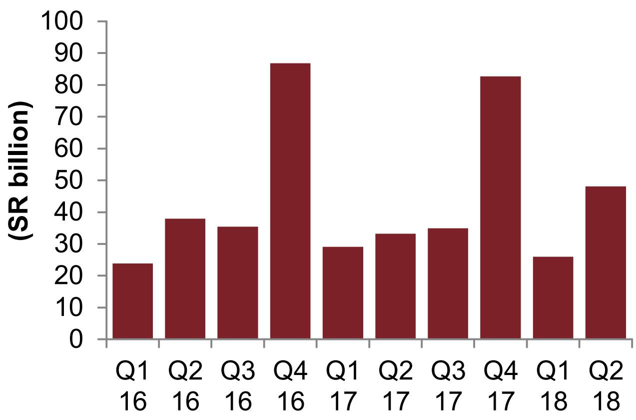


Figure 7: Capital expenditure rose in Q2 2018



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