November 2019

Saudi Arabia's 2020 Preliminary Fiscal Budget

Based on the Ministry of Finance's (MoF) continued implementation of the Vision 2030, the preliminary budget for the 2020 fiscal year was announced on 31st October 2019. A number of fiscal indicators were revised in the period from 2019 to 2022.

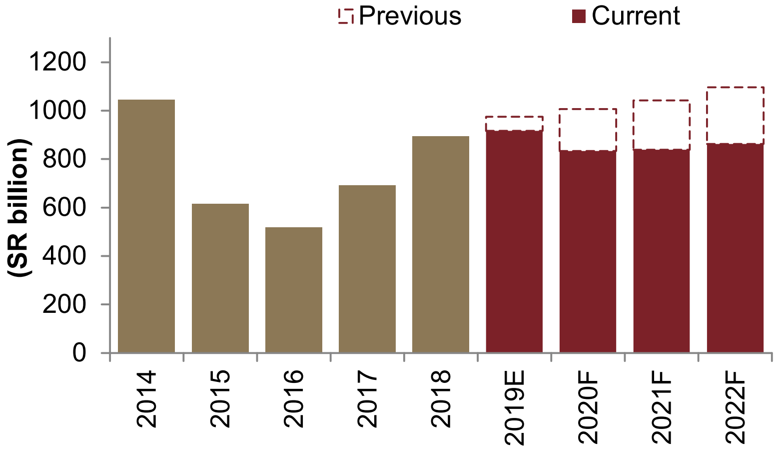
- In the near term, 2019's revenue is expected to total SR917 billion, in line with our forecast of SR910 billion, but SR58 billion lower than budgeted under the 2019 fiscal budget. A downward revision in government revenue for 2020, by SR173 billion, to SR833 billion, was also announced. In total, the government is expecting to earn SR667 billion less between 2019 and 2022 when compared to the most recent Fiscal Balance Program (FBP 2019) (Figure 1).

- The main factor in the adjustment in overall revenue is primarily due to oil revenue. Earlier today, Aramco announced a reduction in the royalty structure from 2020 onwards, with a lower rate of 15 percent (compared to 20 percent previously) applied to all crude oil and condensates sales up to $70 per barrel (pb). At the same time, royalty rates on sales of crude oil and condensates sold between $70-100 pb were increased from 40 to 45 percent, and above $100 pb from 50 to 80 percent.

- Additionally, Brent oil prices have been on a downward trajectory since early 2019 and are currently trading around $60 per barrel (pb) versus highs of $81 pb seen during the same period last year. Looking ahead, oil markets remain challenged, with current OPEC oil demand projections for 2020 representing the lowest level of annual growth since at least 2012. At the same time, OECD commercial oil stock levels have also recently begun to rise above the five year average (*please see our [Q3 Oil Market Update](#) for more details*).

- Thus, despite Aramco expected to pay a hefty base dividend of $75 billion (SR281 billion) in 2020, the combination of changes in the tax structure related to Aramco, and a more subdued outlook on oil markets will mean that government's oil tax revenue component will likely remain contained if oil prices fail to rise above current levels.

Figure 1: Government revenue revised downwards to 2022



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- A reduction in projected revenue has meant that projected expenditure has also been revised downwards, with around SR569 billion less than the expenditure plans outlined in the FBP 2019 between 2019-2022 (Figure 2).

- That said, the compensation of employees (wage bill) still constitutes a substantial level of total expenditure. In the year-to-September 2019, the wage bill constituted 50 percent of total expenditure and grew by 5.7 percent over the same period last year, making the projected 6 percent year-on-year reduction for the full year difficult to achieve. At the same time, however, combined level of social benefit and subsidies expenditure rose by 8 percent year-on-year till Q3 2019, underlining the government's commitment to improving the quality of life and raising the standard of living for citizens.

- That said, some reductions in expenditure will have also come about due to continuous monitoring of the various Vision Realization Programs (VRPs). Specifically, this has been carried out by the National Center for Performance Measurement (Adaa) in collaboration with the Ministry of Economy and Planning (MEP). Recent reviews have found that some VRPs have achieved a good level of progress in terms of delivering to various targets, including programs such as the Housing VRP and the entertainment aspect within the Quality of Life VRP.

- Further, the roll-out of the electronic Etimad portal will have also helped improve the management of expenditure. The Etimad portal is now mandatory for all government projects and allows public sector entities and private sector contractors to make use of the digital services for procurement, budget management, vendor selection, and contract and payments management. This combined with the approval of a new Government Tendering and Procurement law, which is designed to improve the allocation and management of financial resources of government, is expected to greatly improve the budget execution process.

- Looking ahead, it is important to highlight that institutions such as the Public Investment Fund (PIF) and indeed the National Development Fund (NDF) are likely to take a leading role in investments within the Kingdom, especially so the more growth enhancing capital expenditure.

Figure 2: Lower government expenditure to 2022

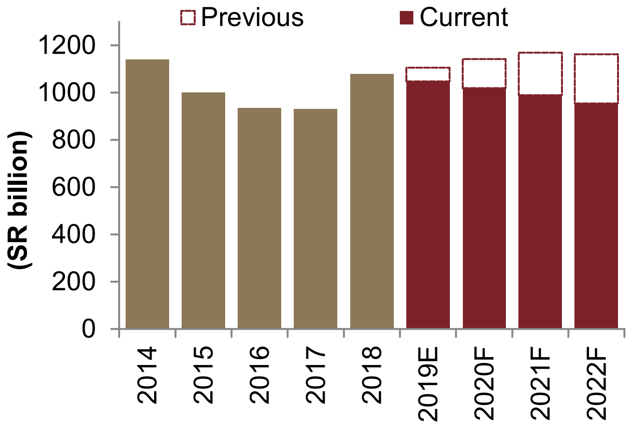
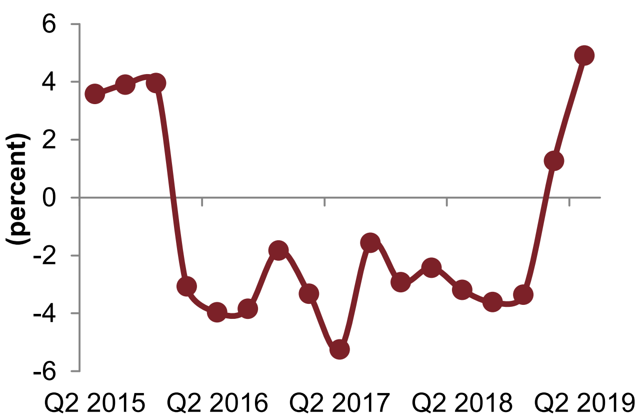


Figure 3: PIF expenditure having visible impact on construction sector GDP (year-on-year change)



Looking ahead, institutions such as the PIF and National Development Fund are likely to take a more leading role in investments within the Kingdom.

Due to a higher rate of projected revenue decreases vis-a-vis expenditure, the fiscal deficit is forecast to be higher than previously projected for 2020 and 2021.

Larger fiscal deficits are not expected to translate into significantly higher levels of debt issuance in the Kingdom during 2019-2021. Debt projections remain largely unchanged.

Partly as a result of lower expenditure, overall GDP growth rates have been revised downwards...

...although debt-to-GDP estimates are expected to equal 28 percent by 2021, compared to 25 percent previously.

- So, for instance, whilst the PIF spent SR32 billion in the domestic economy between 2018 and Q1 2019, with visible effects on the construction sector GDP (Figure 3), we expect the level of expenditure to have accelerated since then, as progress continues on various mega-projects. Furthermore, once the proceeds of PIFs sale of its 70 percent stake in Sabic to Aramco, totaling SR259 billion ($69 billion), are completed, and the proceeds from Aramco's IPO flow to the PIF, we expect the level of spending within the domestic economy by the sovereign wealth fund to rise significantly.

- Also, with respect to the NDF, whilst the more recently created entity is in the process of integration and coordination between the various development funds, its contribution to domestic economy is expected to pick up in the forthcoming years.

- Despite government revenue expected to be lower than budgeted in 2019, an equally lower level of spending (of SR58 billion) will result in the fiscal deficit being in line with MoF's initial forecasts, at SR131 billion (4.7 percent of GDP). However, due to a higher rate of projected revenue decreases vis-a-vis expenditure, the fiscal deficit is forecast to be higher than previously projected for 2020 and 2021. Thus, the fiscal deficit will widen to SR187 billion (6.5 percent of GDP) in 2020 before narrowing slightly in 2021, to SR151 billion (5 percent of GDP, Figure 4).

- Larger fiscal deficits are not expected to translate into higher levels of debt during 2019-2021. Debt projections remain largely unchanged compared to the 2019 fiscal budget, with an upward revision for 2022 only, by around SR32 billion, to SR924 billion. No major adjustment in debt and higher than previously forecasted fiscal deficits will likely result in higher levels SAMA deposits used for deficit financing.

- Partly as a result of lower expenditure, overall GDP growth rates have been revised downwards. Whilst no breakdown between oil and non-oil GDP is provided, the MoF expects overall growth to average around 1.93 percent between 2019-2022 (Figure 5).

- Due to downward revision in overall economic growth, debt-to-GDP estimates are expected to equal 28 percent by 2021, compared to 25 percent previously, and then 29 percent in 2022.

Figure 4: Fiscal deficits expected to persist

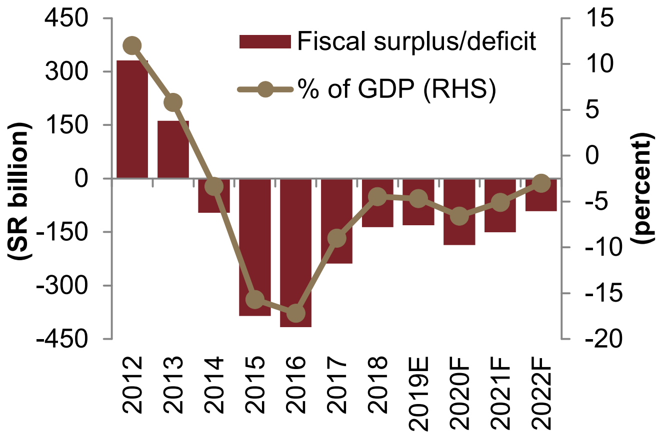
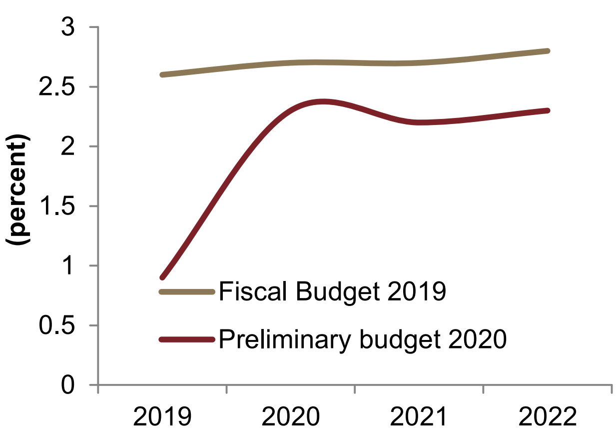


Figure 5: Ministry of Finance Real GDP growth estimates



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