جدوى للإستثمار
Jadwa Investment

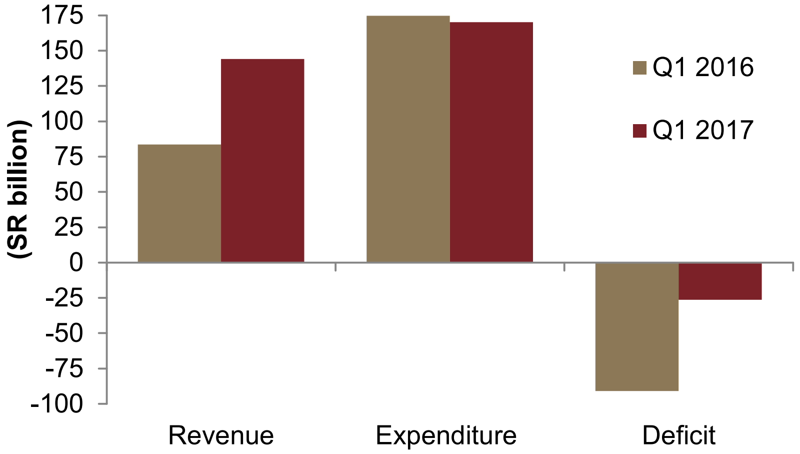
May 2017

Q1 2017 Budget Statement

Significant yearly declines in the fiscal deficit

- The first ever publication of a quarterly budget performance report by the Ministry of Finance (MoF) showed a greatly improved picture in Q1 2017, when compared to a year ago.
- Due to large increases in year-on-year government revenues, by 72 percent, and a drop in expenses, by 3 percent, the fiscal deficit was much lower, at SR26.2 billion, than the pro-rata quarterly figure of SR50 billion, based on the 2017 fiscal budget figure of SR198 billion.
- The major rise in year-on-year government revenue in Q1 2017 came from oil revenue, which is unsurprising considering the rebound in oil prices over the same period. Meanwhile, total non -oil revenue increased by 1 percent year-on-year, with all but one segment -'Other Revenues', showing yearly increases.
- The largest contributor to government expenses, 'Compensation of Employees', dropped by 5 percent, or SR5.1 billion, year-on-year in Q1 2017. We estimate that around 51 percent, or SR2.6 billion, of these declines were directly a result of the cut in allowances for public sector workers.
- Looking ahead, the strict compliance by Saudi Arabia to OPEC cuts, and therefore lower oil exports, are likely to result in less dramatic yearly upswings in oil revenue, especially as oil revenue improved from Q2 onwards in 2016.
- That said, we do also expect to see year-on-year improvements in non-oil revenue, especially as white land tax, excise tax on harmful products and expat levies take effect throughout 2017.

Figure 1: Budgetary performance in Q1 2017



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The major rise in year-on-year government revenue in Q1 2017 came from oil revenue…

...as Saudi oil export price averaged $53 per barrel in Q1 2017, compared to only $31 per barrel a year earlier.

A 69 percent transfer ratio on Saudi Aramco is implied for Q1 2017 figures…

Revenues:

The major rise in year-on-year government revenue in Q1 2017 came from **oil revenue** (Figure 2), which is unsurprising considering the rebound in oil prices over the same period. A 60 percent rise in Brent oil prices year-on-year, to $53 per barrel (pb), in Q1 2017, helped raise Saudi oil revenue by 115 percent year-on-year. This rise was achieved despite lower quantities of oil and refined products being exported year-on-year in Q1 2017. Using data from JODI and the General Authority of Statistics (GaStat), we estimate that the Saudi export price for both crude oil and refined products averaged around $53 per barrel in Q1 2017, compared to only $31 per barrel a year earlier (Figure 3). Meanwhile, total oil and refined products exports are estimated to have dropped by around 4 percent, to 8.6 million barrels per day (mbpd), year-on-year in Q1 2017. This is mainly due to Saudi Arabia's strict compliance to OPEC oil production cuts which took effect from the beginning of the year.

Table 1: Government Revenues (SR million)

Revenues	**Q1 2016**	**Q1 2017**	**Change (%)**
Oil revenues	51,980	112,003	115
Non-oil revenues, of which;	31,670	32,073	1
-Taxes on income, profits and capital	1,962	2,031	4
-Taxes on goods and services (including petroleum product charges and harmful product tax)	5,286	5,690	8
-Taxes on trade and transactions (customs duties)	3,564	4,536	27
-Other Taxes (including Zakat)	1,070	1,557	46
-Other revenues (including returns from SAMA and PIF)	19,790	18,259	-8
Total	**83,652**	**144,076**	**72.2**

Based on oil export data from GaStat, we estimate that Saudi oil export revenue in Q1 2017 was around SR160 billion. When comparing this figure to the corresponding government oil revenue figure of SR112 billion, a 69 percent transfer ratio on Saudi Aramco's revenue is implied. Similarly, looking at Q1 2016 Saudi oil export

Figure 2: Government revenues in Q1 2017 were helped by oil revenue...

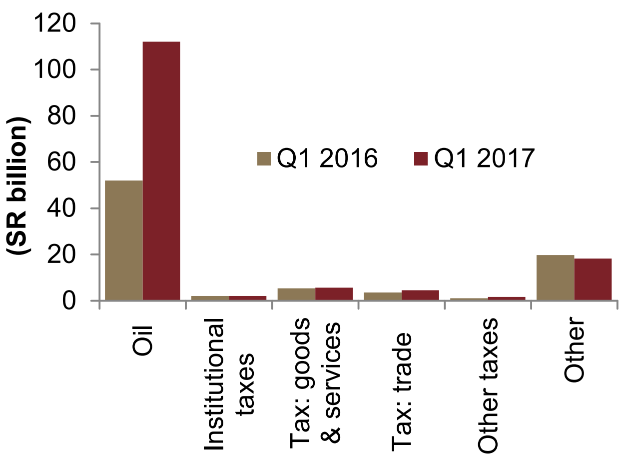
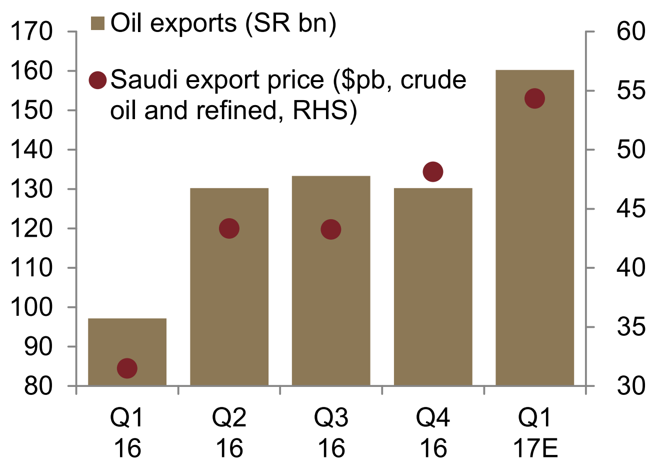


Figure 3: ...due to sizable increases in Saudi oil exports



...although accurate calculations on the transfer ratio can only be done once Aramco's financial accounts are disclosed.

revenue of SR97 billion and government oil revenue of SR52 billion, the implied transfer ratio equals 54 percent. We believe such inconsistencies are to be expected on a quarterly period and would expect to see adjustments in the transfer ratio in subsequent quarters. That said, the above transfer ratio calculations are based on very simplistic estimates and more accurate figures will only be possible once full year financial accounts for Saudi Aramco are disclosed, which is reportedly expected to occur this year.

Total non-oil revenue increased by 1 percent year-on-year, in Q1 2017.

Total **non-oil revenue in** Q1 2017 increased by 1 percent year-on-year, with all but one segment -'Other Revenues', showing yearly increases (Figure 4). The largest gains were seen in 'Taxes on Trade and Transactions', which were up by 27 percent year-on-year in Q1 2017. This was due to an expiration of a ceiling in customs duties, resulting in a rise from 5 to 25 percent for 193 products, which took effect from January 1st.

'Other Revenues', which includes Saudi Arabian Monetary Authority (SAMA) and Public Investment Fund (PIF) returns, saw a reduction of 8 percent year-on-year.

'Other Revenues', which includes Saudi Arabian Monetary Authority (SAMA) and Public Investment Fund (PIF) returns, saw a reduction of 8 percent year-on-year in Q1 2017. We believe this is due to two main factors. Firstly, SAMA's investment returns are likely to be lower than the same time last year since the level of SAMA reserves in foreign securities dropped by 9 percent, or $37 billion, during 2016. A large majority, around $16 billion, of the total decline was seen in direct holdings of US Treasury securities, a generally safe but comparably lower yielding security. Secondly, publically available data shows that Tadawul All-Share Index's (TASI) dividends paid out dropped by 11 percent year-on-year in 2016 (Figure 5). This is likely to have affected PIF's returns since it holds stakes in a number of Saudi listed companies. That said, investment returns are seasonal and dividends from investments by PIF may well be received at the end of the year.

Income tax revenue rises were partially a result of a general improvement in the collection process.

With regards to the 'Taxes on Income, Profit and Capital', which showed a 4 percent rise year-on-year in Q1 2017, we believe this is a result of a general improvement in the collection process on behalf of government. This is also partially the case with the improvement in the 'Other Taxes (including Zakat') category. Moreover, the sizable 46 percent yearly rise in this segments also reflects base effects from last year. Specifically, in the first quarter of 2016 the Saudi General Authority for Zakat and Tax (GAZT) introduced a new online filing system, but some technical issues pushed the collection of revenue back to later quarters.

Figure 4: Year-on-year change in Q1 2017 non-oil revenues

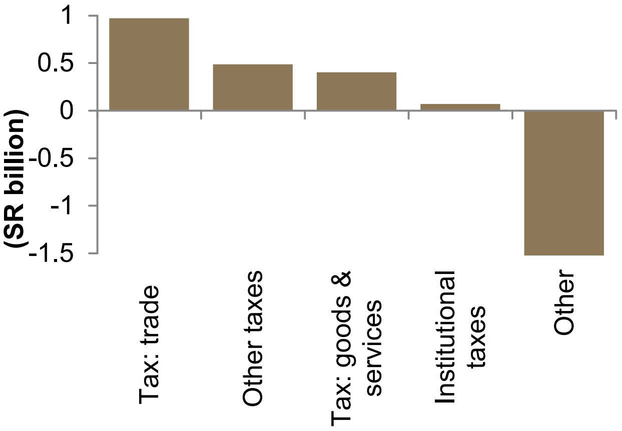
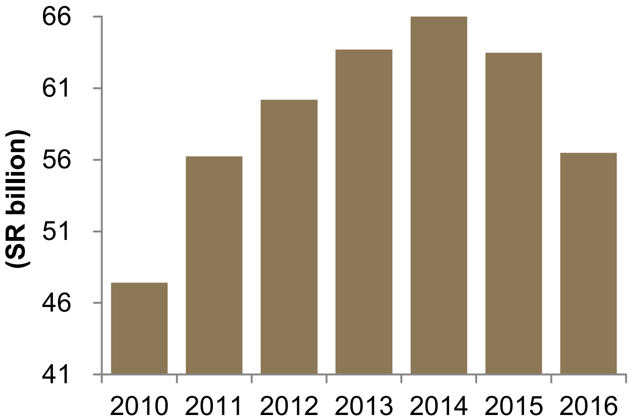


Figure 5: TASI listed company dividends



Expenditures:

'Compensation of employees', dropped by 5 percent year-on-year in Q1 2017...

...and we estimate that around 51 percent of this was directly a result of the cut in allowances in public sector workers.

The largest contributor to government expenses, 'Compensation of Employees', dropped by 5 percent year-on-year in Q1 2017. Given that wages of most public sector workers were frozen in Q1 2017, as per the royal decree in September 2016, this means a part of the decline is due to a reduction in allowances, which were also included in the above decree. After a separate royal decree in April 2017, allowances of public sectors workers were reinstated, although wage freezes were kept in place. Following the April royal decree, the Ministry of Finance stated that restoring allowances would cost around SR7 billion in 2017 (for 8 months: May to December 2017), which, if extrapolated, gives a total yearly expense of SR10 billion. Based on this calculation, we estimate that out of the SR5.1 billion year-on-year decline in 'Compensation of Employees' in Q1 2017, around 51 percent, or SR2.6 billion, was directly a result of the cut in allowances. The remainder of the decline could be due to the switch from payroll for the public sector from Hijri to the Gregorian calendar as well as a reduction in salaries for ministers and members of the Shoura council.

Table 2: Government Expenses (SR million)

Expenses	Q1 2016	Q1 2017	Change (%)
Compensation of Employees	99,228	94,085	-5
Goods & Services	21,351	16,712	-22
Financing Expenses	63	1,258	1897
Subsidies	579	46	-92
Grants	1,304	571	-56
Social Benefits	7,798	6,607	-15
Other Expenses	20,517	21,922	7
Non-Financial Assets (Capital)	23,815	29,086	22
Total	**174,655**	**170,287**	**-3**

Lower expenditures on 'Good and Services' reflects a general cut back in government procurements and projects...

Lower expenditures on 'Good and Services' reflects a general cut back in government procurements and projects, in tandem with cost rationalizing and operational efficiency targets set out in the National Transformation Plan (NTP) 2020 and Saudi Vision 2030. This point was reiterated by the Minister of Finance earlier this year, stating that the Bureau of Capital and Operational Spending Rationalization

Figure 6: Year-on-year change in Q1 2017 current expenditure

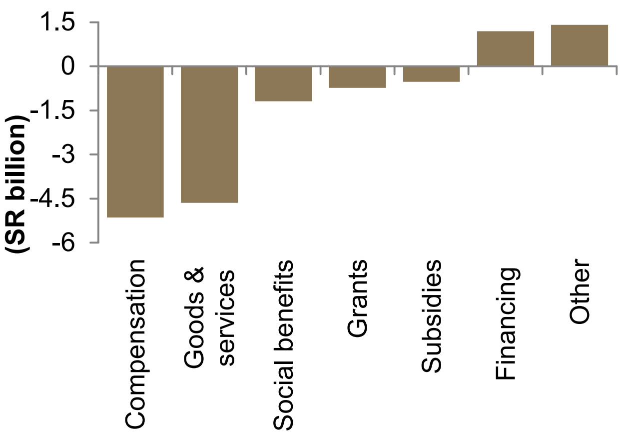
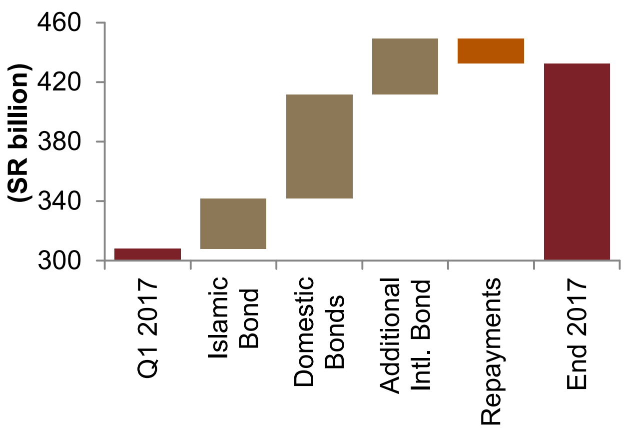


Figure 7: Jadwa estimates total public debt to total SR433 billion at the end of 2017



...in line with cost rationalizing and operational efficiency targets set out in the National Transformation Plan (NTP).

(BCOSR) had succeeded in saving up to SR17 billion for the whole of 2017, after reviewing state projects and other expenditures. Such savings and rationalizations are also likely to account for the reduction in both 'Subsidies' and 'Grants' segments in expenditures (Table 2). Generally speaking, it is important to note that the deflationary trend seen in the Kingdom since the start of the year also contributed to reducing some costs outlined above.

In Q1 2017, 'Financing expenses' rose sharply to reach SR1.2 billion compared to SR63 million a year ago…

...which was directly a result of an increase in both international and domestic bond issuances.

In Q1 2017, 'Financing Expenses' rose sharply to reach SR1.2 billion compared to SR63 million a year ago. This was directly a result of an increase in both international and domestic bond issuances. Public debt totaled SR142 billion at the beginning of 2016 but had risen to SR307 billion at the end of Q1 2017, after repayment of SR8.5 billion of domestic bonds during the first quarter. In April 2017, the Saudi government issued a $9 billion (SR33.75 billion) Islamic bond and, assuming no further repayments, public debt should currently total SR 341 billion. According to recent statements from the vice minister of economy and planning, the government may tap international bond markets again for around $10 billion (SR37 billion) in Q4 2017. The vice minister of economy and planning also stated that the government would return to domestic bond markets for SR70 billion during the year. Taking all this together, total debt would therefore reach SR450 billion by the end of the year, which is SR17 billion higher than our forecasted SR433 billion (Figure 7).

'Social benefits' were down by 15 percent year-on-year…

...whilst 'Other Expenses' rose by 7 percent.

The remaining segments of current expenditure include 'Social Benefits' and 'Other expenses'. 'Social benefits' were down by 15 percent year-on-year and this decline is, again, likely to reflect the more efficient allocation of transfers by government. It is important to note that this segment does not include benefits paid to those who are seeking employment, since this is covered by the Hafiz program, which is not financed by the MoF, but through the Human Resources Development Fund (HRDF). 'Other Expenses', on the other hand, rose by 7 percent with one of the major expenses under this segment being the scholarship program for university students.

Capital spending rose by 22 percent year-on-year, to SR29 billion, in Q1 2017…

...representing only 11 percent of the our total estimated capital expenditure for 2017.

The capital spending side of the expenses, or 'Non-Financial Assets (Capital)', was up a sizable 22 percent year-on-year, to SR29 billion, in Q1 2017. Whilst the 2017 fiscal budget did not show a breakdown, we estimate that budgeted capital expenditure will total SR260 billion for 2017 as a whole. As such, the Q1 2017 figure only represents 11 percent of the total estimated capital expenditure, and we therefore expect a significant rise in this segment in the forthcoming quarters (Figure 8). An increase in this type of expenditure is likely to have positive implications for growth in the non-oil private sector, in particular construction, transport, and utilities, with positive spillovers on some other sectors such as financial services.

Deficit:

The fiscal deficit was much lower, at SR26.2 billion, in Q1 2017...

...than the pro-rata quarterly figure of SR50 billion, based on the 2017 fiscal budget figure of SR198 billion.

Due to the large increase in year-on-year government revenues, by 72 percent, and a drop in expenses, by 3 percent, the fiscal deficit was much lower, at SR26.2 billion, than the pro-rata quarterly figure of SR50 billion, based on the 2017 fiscal budget figure of SR198 billion. According to the Q1 2017 budget report, the SR26.2 billion deficit was fully financed from the current account. In fact, we can see that during Q1 2017, net changes to government deposits with SAMA declined by SR50 billion, more than the stated deficit for the quarter. We view this higher than required withdrawal from SAMA as being a possible preemptive move by government to fund deficits in

Q2 2017 and/or to consolidate liquidity in the banking system. This may explain why government deposits with local banks rose by SR21 billion concurrently during the quarter (Figure 9).

Outlook:

Strict compliance by Saudi Arabia to OPEC cuts are likely to result in see less dramatic yearly upswings in oil revenue.

The Q1 2017 quarterly budget has been a major improvement over last year, primarily as a result of the major rises in government **oil revenue**. The strict compliance by Saudi Arabia to OPEC cuts, with lower oil exports, are likely to result in less dramatic yearly upswings in oil revenue, especially as oil revenue improved from Q2 onwards in 2016. That said, in the following quarters we do expect to see year -on-year improvements in **non-oil revenue**, especially as a white land tax and an excise tax on harmful products take effect. Moreover, non-oil revenues should also be boosted by higher expat levies which are expected to take effect from July 2017.

On the expenditure side, declines in current expenditure may be more difficult as the reinstatement in allowances for public sector workers comes into effect…

On the expenditure side, declines in **current expenditure** may be more difficult as the reinstatement in allowances for public sector workers comes into effect. Expenditures will also increase as the government starts the “Household Allowance Program” which is designed to help safeguard vulnerable low-to-mid income households from electricity price hikes taking effect from mid-2017. Nevertheless, these expenses should be mitigated by savings of around SR30 billion during the year as a consequence the same price hikes, as stated by the Fiscal Balance Program (FBP). Moreover, the savings from BCOSR will continue to be seen during the whole of 2017 (for more on this please see our report on the *Fiscal Balance Program* published February 2017).

...but capital expenditure should see sizable rises in the year ahead.

As highlighted above, only 11 percent of Jadwa’s estimated government **capital expenditure** has been spent, so this segment should see sizable rises in the year ahead. In addition, around SR10-12 billion of a SR200 billion stimulus package for the non-oil sector, announced in the FBP and separate from the 2017 fiscal budget, will be spent during the year to construct 280,000 housing units, which should also push up capital expenditure.

Figure 8: Only 11 percent of total budgeted capital expenditure for the year used in Q1 2017

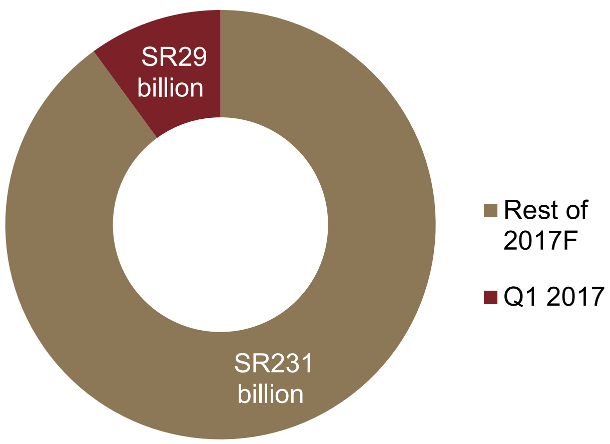
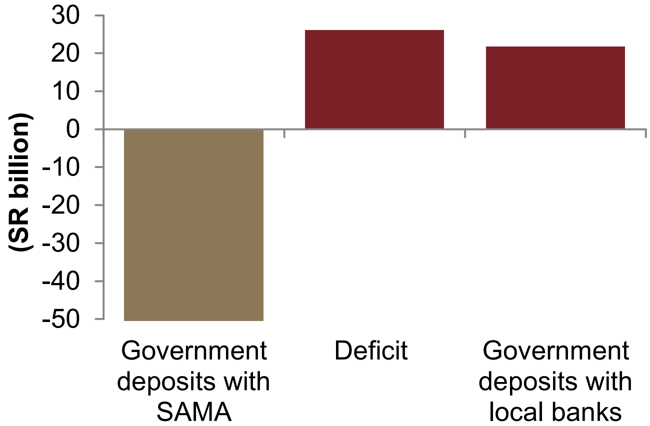


Figure 9: Current account used to pay-off deficit and increase deposits at local banks in Q1 2017



Key Data

	2009	2010	2011	2012	2013	2014	2015	2016F	2017F
Nominal GDP									
(SR billion)	1,609	1,976	2,511	2,752	2,791	2,827	2,423	2,360	2,591
($ billion)	429.1	527	670	734	744	754	646	629	691
(% change)	-17.4	22.8	27.1	9.6	1.4	1.3	-14.3	-2.6	9.8
Real GDP (% change)									
Oil	-8.0	-0.1	12.2	5.1	-1.6	2.1	4.0	2.1	0.6
Non-oil private sector	4.9	9.7	8.0	5.5	7.0	5.4	3.4	0.7	1.0
Non-oil government	6.3	7.4	8.4	5.3	5.1	3.7	2.5	-0.6	-0.7
Total	1.8	4.8	10.0	5.4	2.7	3.6	3.5	1.1	0.6
Oil indicators (average)									
Brent ($/b)	61.7	79.8	112.2	112.4	109.6	99.4	52.1	43.8	54.5
Saudi ($/b)	60.4	77.5	103.9	106.1	104.2	95.7	49.4	40.8	51.5
Production (million b/d)	8.2	8.2	9.3	9.8	9.6	9.7	10.2	10.3	10.4
Budgetary indicators (SR billion)									
Government revenue	510	742	1,118	1,247	1,156	1,044	616	585	664
Government expenditure	596	654	827	873	976	1,110	978	850	815
Budget balance	-87	88	291	374	180	-66	-362	-265	-151
(% GDP)	-5.4	4.4	11.6	13.6	6.5	-2.3	-15.0	-11.2	-5.8
Domestic debt	225	167	135	99	60	44	142	309	433
(% GDP)	14.0	8.5	5.4	3.6	2.2	1.6	5.9	13.1	16.7
Monetary indicators (average)									
Inflation (% change)	4.1	3.8	3.7	2.9	3.5	2.7	2.2	3.7	2.0
SAMA base lending rate (%, end year)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.3	3.0
External trade indicators ($ billion)									
Oil export revenues	167	215	318	337	322	285	155	132	160
Total export revenues	192	251	365	388	376	342	202	181	213
Imports	87	97	120	142	153	158	155	146	145
Trade balance	105	154	245	247	223	184	47	35	68
Current account balance	21	67	159	165	135	74	-53	-52	-21
(% GDP)	4.9	12.7	23.7	22.4	18.2	9.8	-8.3	-8.3	-3.1
Official reserve assets	410	445	544	657	726	732	616	523	460
Social and demographic indicators									
Population (million)	26.7	27.4	28.2	28.9	29.6	30.3	31.0	31.7	32.4
Saudi Unemployment (15+, %)	10.5	10.5	12.4	12.1	11.7	11.7	11.5	12.0	11.6
GDP per capita ($)	16,095	19,211	23,766	25,401	25,146	24,878	20,828	19,840	21,322

Sources: Jadwa Investment forecasts for 2016 and 2017. General Authority for Statistics for GDP and demographic indicators, Saudi Arabian Monetary Agency for monetary and external trade indicators, Ministry of Finance for budgetary indicators.

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