

FLASH NOTE: KSA 2019 PRE-BUDGET REPORT



October 2018

Flash Report: KSA 2019 Pre-Budget Report – Reading Between the Lines

Executive Summary and Review

Executive Summary

Saudi Arabia's Ministry of Finance recently issued its first ever preliminary statement for the general budget for FY 2019. This pre-budget statement included recap of key fiscal and economic developments for past few years and estimates and forecasts of key macroeconomic indicators over the medium term.

Following are the key highlights of the pre-budget statement:

- The fiscal deficit estimate for FY 2018 is reduced to SAR 148 bn, or 5.0% of the GDP, from the initial target of SAR 195 bn (7.3% of the GDP). The estimated deficit is a remarkable improvement in just one year compared to 2017 budget deficit of SAR 230 bn (8.9% of GDP).
- The fiscal deficit is forecasted to be at 4.1%, 4.3% and 3.7% of the GDP in 2019, 2020 and 2021 respectively. The overall aim is to be fiscally balanced by 2023.
- Partly due to favorable oil prices and partly due to revenue related reforms (new taxes), total revenue for FY 2018 is estimated to be SAR 882 bn, 13% higher than the initial estimates.
- Expenditure for FY 2018 is also estimated to increase by 5% from earlier budgeted amount to SAR 1,030 bn.
- Real GDP growth rate estimate for FY 2018 has been revised down to 2.1% from 2.7% estimated earlier. This is more in line with the GDP growth estimates by the IMF (1.9%) and the World Bank (1.8%). However, considering that the 1H 2018 GDP growth has been 1.4%, the implied GDP growth rate for 2H 2018 is 2.8%.
- Total debt as a percentage of GDP is schedule to increase gradually from 17% in 2017 to 20% in 2018 and 25% in 2021. This is still well below the cap of 30% the government has put according to fiscal rebalancing program. It also implies issuance of SAR 272 bn of debt between 2019 and 2021.
- The government reiterated its commitment to the fiscal rebalancing program, which aims to reach a fiscal balance by 2023. The government also emphasized on balanced spending, which includes improving the efficiency of expenditure as well as development of capital expenditure in the medium term for the realization of Vision 2030 Program.

KSA 2019 Pre-Budget Report Review

Table 1: Select Macroeconomic Indicators: Estimates and Forecasts

Indicator	2018E (Previous*)	2019F	2020F	2021F
Fiscal Deficit (SAR bn)	148 (195)	128	138	125
Fiscal Deficit (as a % of GDP)	5.0% (7.3%)	4.1%	4.3%	3.7%
Total Nominal GDP (SAR bn)	2,934 (NA)	3,136	3,232	3,387
Real GDP Growth (%)	2.1% (2.7%)	2.3%	2.2%	2.4%
Nominal GDP Growth (%)	13.9% (NA)	6.9%	3.1%	4.8%
Inflation (%)	2.8% (NA)	2.3%	2.1%	2.1%
Debt as a % of GDP	19.6% (21%)	21.6%	23.3%	25.0%

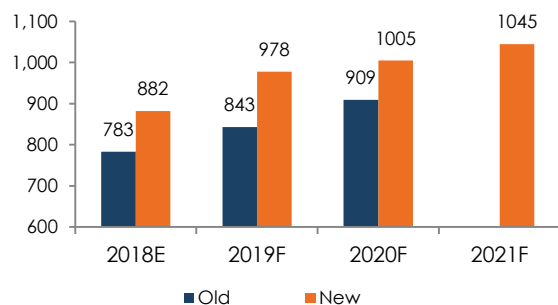
Source: Ministry of Finance; NA – Not available; *-As per 2018 Budget release

FY 2018 revenue estimate increased by 13%, while expenditure increases by 5%

Partly due to favorable crude oil prices, which are steadily rising from the start of 2018, and partly due to additional non-oil revenue sources, total revenue for FY 2018 is estimated to be SAR 882 bn, 13% higher than the initial estimate. Reforms in fuel and electricity prices have contributed to the additional growth in non-oil revenues. Revenues are forecasted to grow 11% YoY to reach SAR 978 bn in 2019, and continue to grow to reach SAR 1045 bn in 2021, with a CAGR of 6% over 2018—21.

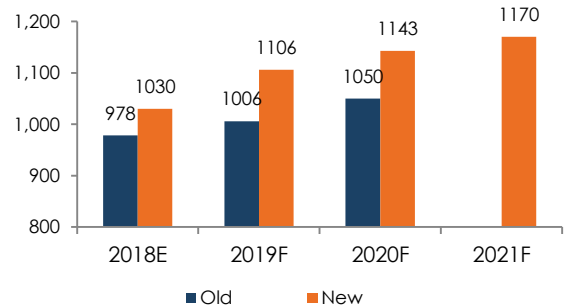
Expenditures are also estimated to increase 5% over the budgeted figure, to SAR 1,030 bn in FY 2018. The Royal Decree that resulted in the cost of living allowances for citizens have partly contributed to the increased expenditure. The annual expenditure is estimated to grow to SAR 1,170 bn by 2021, with a CAGR of 4.3% over 2018—21. However, higher projected rate for revenue growth would result in sequentially lower fiscal deficit over 2018—21 (See Figure 3).

Figure 1: Changes in revenue estimates (SAR bn)



Source: Ministry of Finance, old estimated only till 2020

Figure 2: Changes in expenditure estimates (SAR bn)

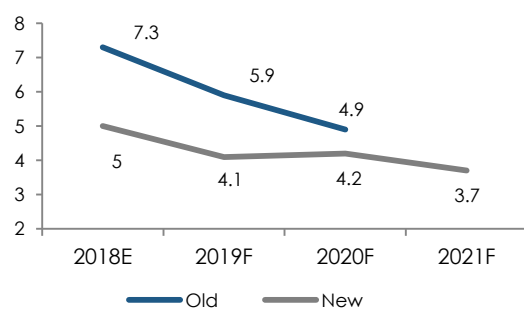


Source: Ministry of Finance, old estimated only till 2020

GDP growth forecast for 2018 revised downwards

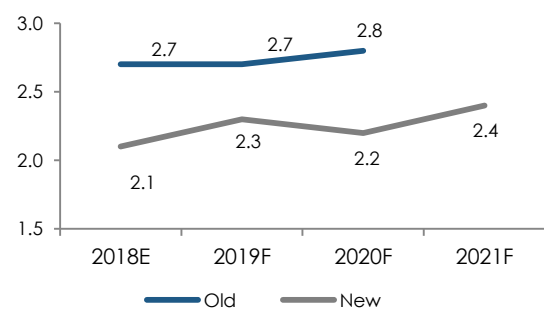
Real GDP growth rate estimate for FY 2018 has been revised down to 2.1% from 2.7% estimated earlier. This is more in line with the GDP growth estimates by the IMF (1.9%) and the World Bank (1.8%). However, even after downward revision in annual growth, the implied growth for 2H 2018 is still high at 2.8% (1H 2018 growth rate was 1.4%). The growth estimates for subsequent years have also been revised downwards (See Figure 4). Annual inflation for 2018 is estimated 2.8%, which is slightly on higher side considering the average inflation during first 8 months of 2018 was 2.5%. The inflation is forecasted to gradually decline to 2.1% by 2020.

Figure 3: Changes in Fiscal deficit targets (as a % of GDP)



Source: Ministry of Finance, old estimates only till 2020

Figure 4: Changes in GDP growth (%) estimates

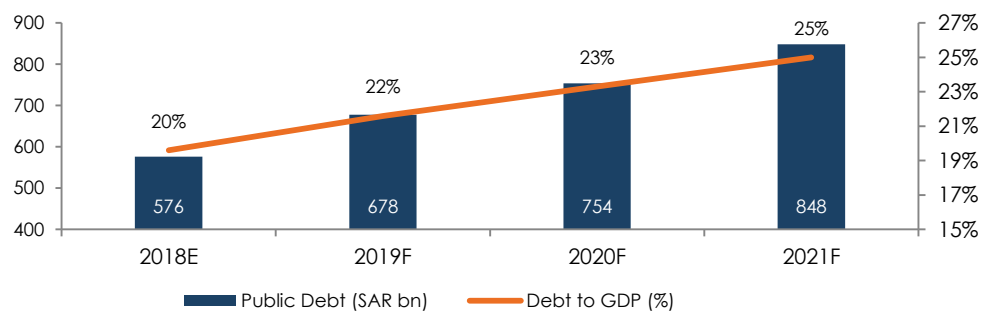


Source: Ministry of Finance, old estimated only till 2020

Deficit to be financed through the combination of debt and reserves

Total debt as a percentage of GDP is schedule to increase gradually from 17% in 2017 to 20% in 2018 (earlier estimate 21%) and 25% in 2021. This is still well below the cap of 30% the government has established according to fiscal rebalancing program. Total public debt, in absolute terms, would increase to SAR 848 bn in 2021 from SAR 576 in 2018 (implying issuance of SAR 272 bn in additional debt over next three years). Deficit financing will be through the combination of issuance of new debt and using the SAMA reserves.

Figure 5: Total public debt (SAR bn) and debt-to-GDP ratio (%)



Source: Ministry of Finance

Other aspects of the pre-budget release

Apart from the revised targets, the pre-budget release provides insight into the government's approach to fiscal management, and references several government programs that have been constituted to help achieve the targets. We find it noteworthy that a lot of emphasis is on improving spending efficiency through disciplined monitoring and encouraging private sector development through specific programs. We would like to highlight a mention about "a plan developed to incentivize the private sector to enhance its competitiveness... and boost its developmental role" (Page 11 of the Pre-Budget Statement 2019). We expect more details on a private sector related plan shortly.

Our view

The Ministry of Finance's approach to increase transparency in the overall fiscal management program is commendable and helps capital markets to be better informed of the forward path. The lowering of fiscal deficit target for 2018 and rationalization of economic growth expectation is also welcome. The debt targets for years up to 2021 will help the debt market know the new supply of issuances expected over the next three years. We continue to believe in the Saudi economic and fiscal turnaround (refer to our 'MEFIC Capital KSA 2018 Outlook Mid-year Review' released in August 2018) and have a positive outlook on the Saudi economy and capital market performance.

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