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Saudi Arabia's Quarterly Budget Performance Report

The First Quarter of the fiscal year 2018 (1439/1440H)

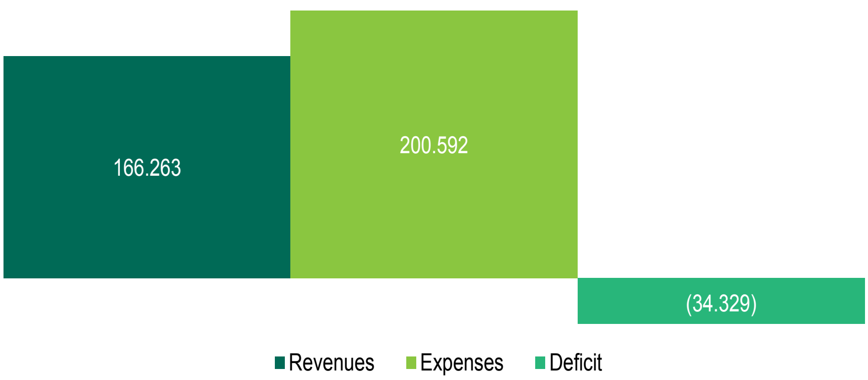
Contents

Executive Summary*

On Monday, 7th of May 2018, the Ministry of Finance released an update of the Kingdom's fiscal stance for 1Q 2018. The highlights are:

- Total revenues in 1Q 2018 increased by 15%, amounting to SAR166.3 billion compared to SAR144.1 billion in the same period of last year. This increase is due to the high growth rate in non-oil revenues, rising by 63%, and to a slight increase of 2% in oil revenues.
- The increase of total non-oil revenues was attributed to 298% growth of "Taxes on Goods and Service" and to an 11% return on investment in SAMA, PIF, and other public units.
- The first quarter expenditures amounted to SAR200.6 billion, an increase of 18% compared to the same period last year, representing 21% of the planned budget of the year.
- In percentage term, the largest increase was in financial expenses, rising by 229% in 1Q 2018, mainly due to servicing of the increasing public debt. Coming second was social benefits expenses, increasing by 184%, primarily attributed to the cost of living allowances and to the "Citizen Account".
- The first quarterly public finance figures recorded a deficit in 1Q 2018, amounting to SAR34.3 billion, about 18% of the expected annual deficit of the fiscal year 2018.
- At the end of 1Q 2018, Kingdom's total public debt reached SAR483.6 billion, as the domestic debt stood at SAR277.4 billion, while external debt amounted to SR206.2 billion.

Figure (1) Performance of the actual budget for 1Q 2018 (SAR Million)



Sources: MoF

*Please review the NCB disclaimer

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The First Quarter of 2018 Budget

The Saudi Arabia's Ministry of Finance released on May 7th the first quarterly update of the Kingdom's fiscal stance for the year of 2018. In line with the themes of "Fiscal Balance Program" (FBP), while at same time reflecting improved level of transparency, the 1Q 2018 budget has provided detailed breakdowns for spending and revenues, besides sources of deficit financing and debt management. The quarterly public finance figures showed a 32% increase in the budget deficit for 1Q 2017 to reach SAR34.3 billion from SAR26.0 billion in the same period of 2017.

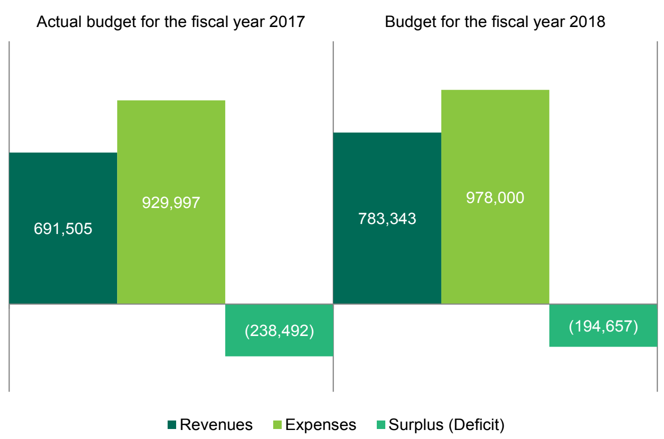
Figure (2) General budget for the fiscal year 2018 (SAR Million)

Items	Budget for the fiscal year actual 2017	Budget for the fiscal year 2018
Oil Revenues	435,900	492,000
Non-oil Revenues	255,605	291,343
Revenues	691,505	783,343
Expenses	929,997	978,000
Surplus (Deficit)	**-238,492**	**-194,657**

Sources: MoF

Despite the recovery of oil prices since beginning of the year, oil revenues increased only by 2% in the first 3-month period compared to same period a year ago, amounting to SAR113.9 billion. This is due to a switch to quarterly dividends, as noted by MOF. Moreover, non-oil revenues rose by 63% in 1Q 2018 compared to same period a year ago, realizing SAR52.3 billion, due to a 298% increase in "taxes on goods and services" and an 11% rise in SAMA and PIF investment returns compared to same period a year ago.

Figure (3) The Government budget for the fiscal year 2018 (SAR



Sources: MoF

The government spending increased by 18% in 1Q 2018 to reach SAR200.6 billion from SAR170.4 billion in 1Q 2017. However, it is more than the budget expenses of 1Q 2017, which recorded SAR170.3 billion. The high growth rate of expenditure reflects the government intent to drive economic growth through an optimal distribution manner of spending throughout the fiscal year.

A combination of a strong pick up in non-oil revenues, and well-thought-out foreign currency debt issuance strategy have assisted the Kingdom to lessen its dependence on withdrawal from foreign exchange reserves to finance fiscal deficit. It is excepted the Kingdom will continue to consolidate public finance, as S&P affirmed Saudi Arabia's rating at A- and kept the outlook stable. Moreover, the kingdom is rated A1 by Moody's credit rating, supported by a strong fiscal position, substantial external liquidity buffers, and prudent financial system regulation.

Revenues

Total revenues in 1Q 2018 increased by 15%, amounting to SAR166.3 billion compared to SAR144 billion in the same period of last year. This increase is due to non-oil revenues, rising by 63% on an annual basis, and also to a 2% rise in oil revenues.

The implicit oil price in the 2018's Kingdom's budget was projected at USD51 per barrel with a daily production of 10.1mb/d. However, the oil outlook has improved in the first quarter, with Arabian light crude averaging higher at USD64 a barrel. On the production side, it is estimated to have averaged 9.96mb/d, rising only slightly by 0.02% from 1Q of 2017. But despite the sharp rise of 19% in oil prices and even higher production, yet small, oil revenues increased by only 2% from the 1Q of 2017. According to the MOF, this is due to a switch to quarterly dividends, which indicates that a large part of the first quarter contribution received in the second quarter, as the impact of the rise in oil revenues will be reflected in the second quarter budget.

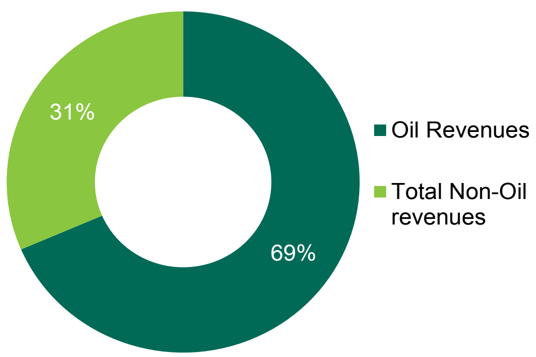
Figure (4) Actual Revenues for 1Q'18 compared to 1Q'17 (SAR Million)

Revenues	1Q 2017	1Q 2018	Change
Oil Revenues	**112,003**	**113,947**	**2%**
Taxes on income, profits and capital gains	2,031	2,471	22%
Taxes on goods and services	5,690	22,653	298%
Customs duties	4,536	3,786	-17%
Other taxes	1,557	3,161	103%
Other revenues (SAMA,PIF and others)	18,259	20,245	11%
Total Non-Oil revenues	**32,073**	**52,316**	**63%**
Total	**144,076**	**166,263**	**15%**

Sources: MoF

As part of the fiscal consolidation, the government introduced several new non-oil revenue sources for the in 2018 including further fuel subsidy reductions, Value Added Tax, expatriate levies, beside excise taxes, which was introduced in 2017, expected to generate between SAR75-90 billion in 2018. In its annual planned budget, the government projected non-oil revenues to reach SAR291 billion, assuming an increase of 14% from the actual figure of the previous year. Moreover, in the 1Q of 2018, non-oil revenues amounted to SAR52.3 billion, which represented 31% of total revenues, demonstrating government success in diversifying sources of revenues. Presuming this level of non-oil revenues continue through the remaining quarters of 2018, it implies an annual figure of SAR209 billion, which is around 28% below the annual revenue budget figure.

Figure (5): Revenues of 1Q 2018



Sources: MoF

Meanwhile, total non-oil revenues have registered a significant rise by 63% in 1Q 2018 compared to same period a year ago. This increase is attributed to more than 100% rise for both “Taxes on Goods and Service” and “Other Taxes (of which Zakat)”. In addition, “Taxes on Income, Profit and Capital Gains” recorded an increase by 22% over same period of last year. Return on SAMA and PIF assets, which accounted for 54% of total non-oil revenues, increased by 11% during 1Q 2018 compared to same period a year ago, to reach SAR20.2 billion. This increase is mainly due to higher yields on government foreign assets managed by SAMA, and improved dividends on government holdings in Saudi listed companies that are under PIF. However, due to declining imports, “Taxes on Trade and Transactions (Customs)” category decreased by 17% in the 1Q 2018 compared to 1Q 2017, amounting to SAR3.78 billion.

Expenses by Type

Total expenditure, as provided under the kingdom’s annual government expenditure for 2018 is estimated at SAR978 billion. The first quarter expenditures amounted to SAR200.6 billion, an increase of 18% compared to the same period last year and representing 21% of the planned budget of the year. Presuming this level of spending continues in the remaining three quarters of 2018 implies that full year actual spending will amount to SAR802 billion, nearly 18% below the planned budget. However, judging from the experience of last year, later quarters and in particular the 4th quarter may account for the largest share of spending and to remain consistent with the themes of the FBP 2023. In addition to extending of the fiscal balance program to 2023, the government announced a stimulus package in the amount of SAR72 billion to boost the weakening economy, which has been hit by slower government spending over the last three years.

In percentage terms, although still small in absolute values, the largest increase was in financial expenses, rising by 223% in the 1Q 2018, mainly due to servicing of the increasing public debt. In addition, “the subsidies”, and “social benefits” categories, recorded significant increases, rising by more than 100% of each, during the 1Q of 2018 compared to same period in 2017.

The significant increase in “subsidies” category will continue through upcoming years, as a result of creating the citizen’s account program in order to reduce the impact of the reduction of subsidies on fuel, water & electricity and introduction of VAT on Saudi households. Also, over the same period, “compensation of employees” recorded an increase of 20% due to the reinstating of benefits and allowances to public sector employees in April 2017 after were cut in June of 2016, and also to the SAR1000 inflation allowance introduced in 2018. It is followed by “other Expenses” categories, declining by 16%.

The “non-financial assets”, which account for capital expenditure, decreased by 11% compared to the same period of last year. Apparently, it is not commensurate to a quarterly share, as it represented only 13% of the planned capital expenditure of the year at SAR205 billion, However, assuming similar pattern of last year, when payments to contractors are made in the later part of the year, therefore, it cannot be assumed that there is a change in priorities or reduction in capital spending.

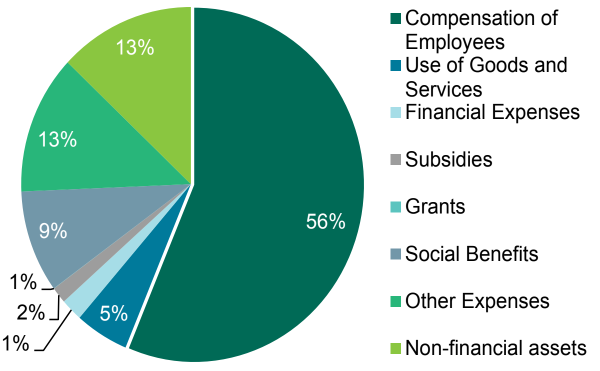
Figure (6): Actual expenses for 1Q 2018 and budget utilization

Expenses	1Q 2017	1Q 2018	Change	2018 Budget	Budget utilization
Compensation of Employees	94,085	112,922	20%	438,000	26%
Use of Goods and Services	16,712	10,240	-39%	143,000	7%
Financial Expenses	1,258	4,145	229%	14,000	30%
Subsidies	46	2,993	6407%	14,000	21%
Grants	571	30	-95%	3,000	1%
Social Benefits	6,607	18,782	184%	65,000	29%
Other Expenses	21,922	25,521	16%	95,000	27%
Non-financial assets (CAPEX)	29,086	25,959	-11%	205,000	13%
Total	**170,287**	**200,592**	**18%**	**978,000**	**21%**

Sources: MoF

The two components, which had the largest declines in comparison to the first quarter of last year in percentage terms, include “grants” and “use of goods and services”, falling by 95% and 39%, respectively, to record SAR30 million and SAR10.24 billion in 1Q of 2018. The “use of goods and services’, which largely represents operational expenses declined from SAR16.71 billion in 1Q' 2017 to SAR10.24 billion in 1Q' 2018, and accounted for only 7% of its annual planned budget estimate of SAR143 billion. It is true the government established recently the "Spending Efficiency and Realization Center" and "Strategic Procurement Unit" and line with the policy of rationalizing government operational expenses, but it is unlikely to assume such drastic reduction in this category to persist throughout the remaining quarters of the years.

Figure (7): Actual expenses for 1Q 2018



Sources: MoF

Expenses by Sector

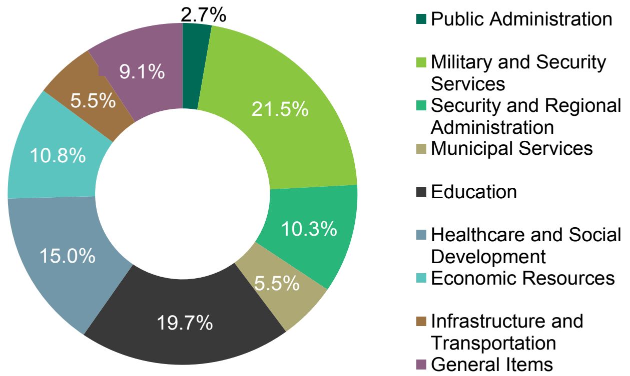
Through comparing spending for each sector to its allocation in the 2018's annual budget, main variations were noticeable, as some sectors spent larger shares of their planned annual budget.

The "military" sector, which received SAR210.0 billion to account for 21.5% of its planned annual budget, in the first quarter its actual spending amounted to SAR47.7 billion, accounting for 23% share of its allocation for the year. It was followed by "education", which declined by 6% from 1Q 2017 to reach SAR44.6 billion, representing 23% of its planned budget. The "health and social development", which accounted for 15% of planned annual budget, utilized 26% of its annual allocation to reach SAR38.5 billion. In terms of utilization, it was followed by the "general items" expenses that reached SAR26.726 billion to account for 30% of its planned annual budget.

The noticeably slower pace of spending was visible in the "economic resources" sector which utilized only 4% of its planned annual budget, followed by "infrastructure and transportation" at 7%, and "municipal services" at 14% of their annual panned budgets. This variation pattern in spending, as noticed since previous quarters, which we speculated it might be due to delay following reorganization of programs across different ministries, it is more apparent now that this reflects shifting of priorities.

While the pace of expenditure for most sectors are commensurate to quarterly allocation and some are lagging behind, the overall expenditure is also not commensurate to quarterly allocation at 21% of total planned annual budget. However, the government is still trying to distribute government spending in a balanced manner throughout the fiscal year and reduce seasonal expenditure, in order to boost economic growth rates and maximize the benefits.

Figure (8) approved budget per sector 2018



Sources: MoF

Fiscal Deficit and Debt Management

The government resorted to its current account from 2017 and to international and domestic debt markets to finance the budget deficit in the first quarter of 2018, raising SAR41.0 billion.

It increased the $10 billion loan facility signed in 2016 to $16 billion; also extended the term of the loan by two years to 2023 and secured lower pricing. This followed one international issuance in the amount of SAR22.5 billion (USD6.0 billion Sukuk). This brings total external debt to SAR206.2 billion up to the end of 1Q 2018. In addition, the government issued SAR17.9 billion in the local debt market during 1Q 2018, rising the domestic debt to SAR277.41 billion. Accordingly, total public debt amounted to SAR483.6 billion by the end of the first quarter 2018.

Figure (9) Actual budget deficit of 1Q 2018

Items	1Q 2018
Deficit	**-34,329**
Current Account 2017	828
From Reserves Account	0
Internal Borrow ing	17,902
External Borrow ing	22,291
Total Financing	**41,021**

Sources: MoF

The government, which is making concerted efforts to diversify its finances away from reliance on oil revenues, has projected 2018's deficit at SAR195 billion, or 7.3% of GDP, this year, down from SAR238.5 billion last year.

It plans to balance the budget by 2023. It is estimated that debt to GDP ratio will rise from 17.3% in 2017 to 20% in 2018, which is below the debt to GDP ceiling ratio defined in the FBP at 30% to be reached by 2023. While the Kingdom's net foreign assets actually slightly increased to USD493.4 billion by the end of 1Q 2018, It is down by 33% from its peak in 2014. However, it is still at a very comfortable level, covering around 31 months of imports.

Figure (10) Public debt up to end 1Q 2018 (SAR Million)

Items	Domestic Debt	External Debt
Beginning of Period Balance	**443,253**	
	259,503	183,750
Issuances or borrowing	17,920	22,500
Repayment of Principle Debt	(15)	0
Amortization of Government Bonds	0	-
End of Period Balance	277,408	206,250
	483,658	

Sources: MoF

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