مجلس الأعمال السعودي الأمريكي
U.S.-Saudi Arabian Business Council

Saudi Arabia's 2019 Budget Review
December 2018

The recent release and endorsement of Saudi Arabia's budget for 2019 highlights the strategic path the Kingdom plans to tackle over the medium-term. As a result of markedly improved fiscal performance during 2018, the budgeted plan for 2019 signals an expansionary direction on the back of anticipated strong oil revenues and newly sustained non-oil revenues. The main driver of this expansion is the requirement to fulfill Vision 2030's strategy, which was released in 2016.

One of the main programs of Vision 2030 is to develop appropriate fiscal policy frameworks to achieve economic growth and fiscal sustainability. One such program is the creation of the Fiscal Balance Program (FBP). Key FBP initiatives, which have a significant impact on the budget's makeup, include the launching of the Citizen Account; the Private Sector Stimulus Plan; and initiatives focusing on public financial management, spending, planning and fiscal discipline, by setting expenditure ceilings for government entities over the medium-term.

Saudi Arabia's fiscal performance rebounded well in 2018 after experiencing a recession in 2017 following a real GDP of -0.9 percent. The Kingdom anticipates real GDP to climb to 2.3 percent in 2018 and 2.6 percent in 2019. Over the medium-term, steady growth is projected as real GDP is expected to reach 2.7 percent, 2.7 percent, 2.8 percent and 2.9 percent between 2020-2023, respectively.

Economic Medium-Term Growth Rates (2018-2023)						
	Estimates		Projections			
	2018	2019	2020	2021	2022	2023
Economic Medium-Term Growth Rates						
Real GDP Growth	2.3%	2.6%	2.7%	2.7%	2.8%	2.9%
Nominal GDP Growth (SAR billions)	2,938	3,125	3,263	3,418	3,602	3,781
Nominal GDP Growth	14.1%	6.4%	4.4%	4.8%	5.4%	5.0%
Inflation	2.6%	2.3%	2.1%	2.0%	2.0%	1.9%

Source: Ministry of Finance (MoF), USSABC

1. Macroeconomic and Fiscal Performance in 2018

As previously mentioned, the Kingdom adopted an expansionary stance in 2018 as it reduced its fiscal deficit from SAR238 billion in 2017 to a deficit of SAR136 billion (43.1 percent reduction). The estimated deficit for 2018 also indicated better than expected fiscal performance compared to the 2018 budgeted fiscal deficit figure of SAR195 billion. Better than anticipated oil prices coupled with increased oil production was the leading factor in the reduced deficit. Revenues in 2018 are expected to rise by 29.4 percent to reach SAR895 billion. Alternatively, total expenditures are anticipated to grow by 10.8 percent in 2018, amounting to SAR 1.03 trillion.

Revenues

Oil revenues, which increased by 39.3 percent compared to 2017, was driven by significant price fluctuations in 2018. Brent crude passed the $86 per barrel mark in early October yet dropped below $60 per barrel in November. Despite the volatility, oil prices increased approximately by $17 a barrel, a 30 percent increase compared to 2017. This was largely due to strong global economic growth and low commercial crude inventories. Oil revenues, which are part of 'Other Revenues' are expected to reach SAR607 billion. Average oil production up to October was about

10.2 million barrels per day, which grew by 2.6 percent compared to 2017. The average price of Brent crude up to October 2018 was $73.1 per barrel compared to $52.4 per barrel during the same period in 2017.

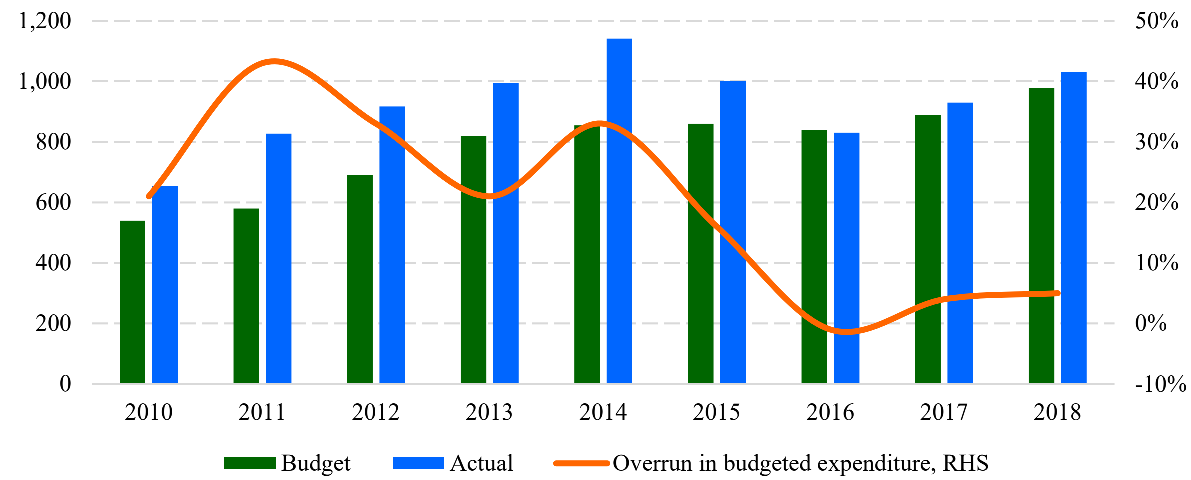
Non-oil revenue is expected to increase by 12.4 percent during 2018, largely driven by the implementation of government reforms. Tax revenue is estimated at SAR166 billion in 2018, increasing by 89.4 percent compared to 2017, and by 16.3 percent compared to the budget estimate. The most noteworthy tax category was revenues from 'Taxes of Goods and Services.' This category is expected to reach SAR113 billion in 2018, a rise of 187.9 percent over 2017, and 32.9 percent compared to the budget estimate. The increase is due to the introduction of Value-Added taxes, Expatriate Levy an Excise Taxes.

On a sectoral level, the manufacturing sector registered real growth of 5.3 percent during H1'18, while mining and other quarrying activities reach 4.4 percent during the same period. Of the sectors that witnessed a decline, construction was at 2.8 percent, transport, storage and IT at 1 percent, and the wholesale and retail trade, restaurants and hotel at 0.5 percent.

Expenditures

Total government expenditures in 2018 is expected to amount to SAR1.03 trillion or 35.1 percent of GDP, exceeding the budget estimate by 5.4 percent, an increase of 10.8 percent compared to the previous year. While expenses exceeded the budget, the Kingdom has done well to maintain its spending within budgeted forecasts over the last three years. Broad-based fiscal adjustments culminating from improved forecasting capabilities have resulted in a positive inflection point compared to historical tendencies to post double-digit budget overruns.

Budgetary Overruns (SAR billions)



Source: MoF, USSABC

Current expenditures, which is the more inelastic part of the expenses compared to capital expenditures, is largely driven by the 'Compensation of Employees' as it is expected to garner SAR474 billion or 46 percent of total expenditures, marking a 12.8 percent increase over 2017. The increase was driven by the restoration of annual allowance payments for state employees, as well as allowances for civil servants and military personnel (SAR 1,000 per employee per month). Other increases pertained to retirees and social services beneficiaries (SAR 500 per employee per month) and student stipends, which increased by 10 percent.

Expenditures on 'Social Benefits' are expected to increase by 14.6 percent above budget or 57 percent above 2017 levels. This is mainly attributed to expenditures within the Citizen Account, which constitutes approximately 37.5 percent of 'Social Benefits.' Capital expenditures were in line with the budgeted figure of SAR205 billion as a lower fraction of projects were put on hold compared to 2017.

Debt and Financing

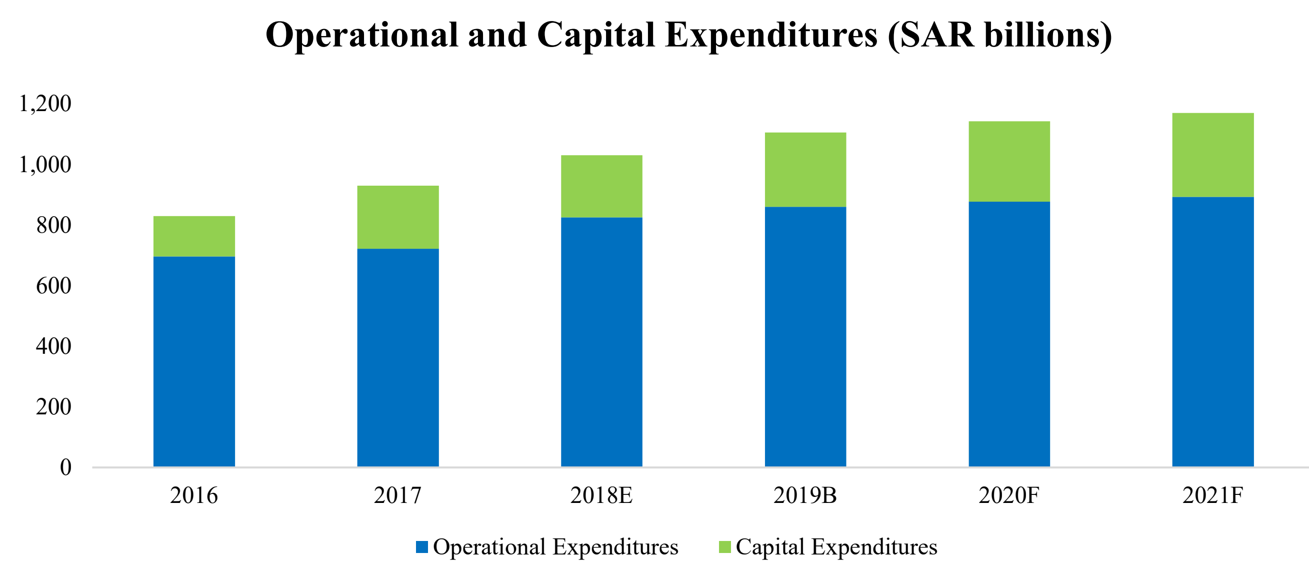
The government maintained a two-pronged strategy of covering the funding gap via drawing down reserves and debt issuances over the last few years. More recently, the government has diversified its foreign and domestic financing through sukuk and bond issuances which are expected to reach SAR120 billion in 2018, of which SAR48.7 billion were domestic sukuk and SAR71.3 billion were international sukuk and bonds. Total withdrawals from government deposits and reserves are expected to reach SAR55.9 billion at the end of 2018 to finance the budget deficit, private sector stimulus, and increase the capital of some development funds.

The Debt Management Office (DMO) within the Ministry of Finance anticipates public debt to reach SAR560 billion (19.1 percent of GDP) by the end of 2018, compared to SAR443 billion (17.2 percent of GDP) in 2017.

2. Macroeconomic and Fiscal Performance in 2019

Prudent alterations to the budget, with a focus on strict oversight of future expenditures, has setup the Kingdom with efficient sustainability of government finances. The creation of the Spending Efficiency Realization Center (SERC) for the purpose of ensuring appropriate estimation of operational and capital expenditures has provided the government with improved cost savings as additional funds are better appropriated to other projects. The SERC also provides the necessary support to government agencies to assist them in adhering to budgetary expenditure ceilings by developing mechanisms and proposing policies and operational plans to raise the efficiency of expenditure and fiscal planning. The FBP's involvement is also another way the government ensures revenues and expenditures are efficiently stabilized. Consequently, the FBP aims to avoid exceeding a debt ratio of 30 percent of the nominal GDP and maintain favorable level of reserves.

The budget deficit in 2019 is expected to reach SAR131 billion, equivalent to 4.2 percent of nominal GDP, shrinking by 0.4 percent of GDP compared to the estimated deficit for 2018, and substantially below the 2017 deficit of 9.3 percent of GDP. As a result, the deficit has been reduced by 5 percentage points of GDP within two years. The decline in the estimated deficit for 2019 results from the expected rise in total revenues by 9 percent compared to the 2018 estimates. This is driven by the reforms to increase and diversify sources of revenues. The 2019 budget foresees an increase in spending of 7.3 percent, including an increase in non-financial assets (capital expenditure) of 20 percent compared to 2018 estimates.



Source: MoF, USSABC

Revenues

Budgeted revenues are projected to be SAR975 billion, of which SAR662 will come from oil revenues. Positive oil price momentum is expected to continue in 2019 according to some estimates, with Brent oil prices expecting to improve by 32 percent in 2018. However, recent Brent crude prices, at the time of this report, are hovering at the $52 mark. There is cause for cautiousness given the dip in oil prices and the optimistic view the Kingdom has taken on future oil prices in 2019. Nonetheless, budgeted oil revenue is projected to rise by 9 percent compared to 2018, with the recent announcements by OPEC+ of production cuts expected to keep members in compliance. This will play a critical factor as the implied Saudi Arabian export price is around $76, corresponding to oil revenues of SAR662 billion. Another factor that is expected to improve oil revenues is the fiscal impact of the energy price reforms as it aims to improve national consumption by instituting the gradual removal of energy subsidies to reach reference prices by 2025.

Non-oil revenue is expected to generate approximately SAR312 billion in 2019 marking a 9 percent increase over 2018. The main driver of non-oil revenues is the 'Taxes on Goods and Services' category. This category is expected to provide an estimated SAR132 billion worth of revenues in 2019, an increase of 16.4 percent compared to 2018. More specifically, the subcategories of 'Value Added Tax,' 'Excise Tax,' and 'Expat Levy' will be leaned upon for non-oil revenue growth. Revenues from VAT (5 percent tax on goods and services) are estimated to amount to SAR47 billion in 2019 compared to SAR45.6 billion in 2018. Excise tax, which is applied to certain commodities with the aim of curbing consumption, such as soft drinks, energy drinks, and tobacco and its derivatives is estimated to reach SAR10 billion in 2019. Additionally, the expat levy, which provided the Kingdom with a revenue boost of SAR28 billion in 2018 is expected to double to SAR56 billion in 2019. The objective of the expat levy is to promote job creation for citizens by reducing the cost gap between hiring non-Saudi and Saudi workers in the private sector.

Expenditures

Total expenditures in 2019 is expected to reach SAR1.1 trillion, marking a 7.3 percent increase over the 2018 estimate. Operational expenses (opex) are projected to reach SAR860 or 78 percent of total expenditures and 4.2 percent more than 2018. The main drivers of opex are social benefits, the Citizen Account Program, the annual employee allowance and Vision Realization Programs. The

'Compensation of Employees' or wage bill category within opex is expected to garner SAR456 billion or 41 percent of all expenditures.

Perhaps one of the most welcoming developments is the reprioritization of capital expenditures (capex) in 2019. Capex for 2019 is estimated at SAR246 billion, accounting for 22 percent of total expenditures. This marks a 20 percent increase over projected capex for 2018. Given Vision 2030's goal to increase direct investments and to enhance the private sector's productivity, the focus on capex to help fulfill these strategies is paramount. As the shares of capex increases within overall budgetary expenditures, non-oil revenue generation is likely to grow at a faster rate since the output from capex will spur demand for services across many sectors (Construction, Infrastructure, Transportation, etc.) in the private economy.

In terms of the 2019 budgetary allocations by sector, the following table breaks down the projected expenditures in 2018 and 2019 in SAR billions:

	2017 Actual	2018 Estimate	2019 Budget	Growth between 2018 & 2019
Sector				
Public Administration	30	27	28	1%
Military	228	218	191	-12%
Security and Regional Administration	108	106	103	-3%
Municipal Services	55	54	62	15%
Education	207	205	193	-6%
Health & Social Development	134	159	172	8%
Economic Resources	48	106	131	24%
Infrastructure and Transportation	35	55	70	28%
General Items	85	100	156	57%
Total	**930**	**1,030**	**1,106**	**7%**

Source: MoF, USSABC

3. 2019 Outlook

The upcoming year promises to continue fiscal and economic improvements as the Kingdom steers towards balancing its budget by 2023. Nonetheless, there are both upside and downside risks that Saudi Arabia faces over the course of 2019 and beyond. Downside risks include the impact of oil price fluctuations, slowdowns in non-oil growth and the potential for a global economic slowdown. As for global oil prices, the most significant factor influencing prices in terms of global demand is the growth rates of major advanced and emerging economies. Furthermore, the supply side dynamic will be impacted by the policies adopted by oil producing countries, development of alternative resources of energy, and geopolitical disruptions.

On the non-oil side, downside risks include accelerated growth rates and the ability to create ample job opportunities for citizens. Moreover, there are uncertainties in the private sector's response to investment opportunities and climate, as well as the potential impact on private consumption patterns and the labor market of economic developments. To mitigate these risks, the Kingdom has implemented a private sector stimulus plan such as the "Privatization Plan" which offers opportunities for private sector investments, in addition to investing in infrastructure development, and establishing a new public-private partnership system.

Another downside risk that must be considered is the Kingdom's close links to the performance of the global economy, with commodities in particular. Other risks include the impact of protectionist measures, slowdowns in emerging economies, asset price inflation across several global markets, and the likely risk of rising U.S. intertest rates.

Upside risks facing the Kingdom are sustained improvements in oil prices, boosting women's participation in the labor market, and the positive reaction regarding the role of privatization in advancing investment opportunities to help create jobs. Other positive factors include the impact of mega projects under development, such as the Red Sea project, the Neom mega-city, and the National Industrial Development and Logistics Program (NIDLP).

Annex 1: Budgetary Allocation 2017-2019

Fiscal Performance (2017-2019, SAR billions)			
	2017 Actual	**2018 Estimates**	**2019 Budget**
Revenues			
Total Revenues	**692**	**895**	**975**
Tax	**87**	**166**	**183**
Taxes on Income, Profits, and Capital Gains	14	16.1	15.8
Taxes on Property	-	0	1
Taxes on Goods and Services	39	113	132
Taxes on International Trade and Transactions	19	16	17
Other Taxes	15	20	17
Grants	-	0	1
Other Revenues	**604**	**729**	**791**
Expenditures			
Total Expenditures	**930**	**1,030**	**1,106**
Expenses (OPEX)	**772**	**825**	**860**
Compensation of Employees	420	474	456
Goods and Services	136	140	175
Financing Expenses	9	17	21
Subsidies	5	12	32
Grants	6	3	3
Social Benefits	48	75	73
Other Expenses	98	106	100
Non-Financial Assets (CAPEX)	**208**	**205**	**246**
Budget Deficit/Surplus			
Budget Deficit/Surplus	-238	-136	-131
Ratio of GDP	-9.3%	4.6%	-4.2%
Debt and Assets			
Debt	**443**	**560**	**678**
Ratio of GDP	17.2%	19.1%	21.7%
Government Deposits at SAMA	**579**	**523**	**496**
Ratio of GDP	22.5%	17.8%	15.9%

Annex 2: Detailed 2019 Budgetary Allocations by Sector

The 2019 budget estimates total revenues at SAR895 billion and total expenditures at SAR1,030 billion, a deficit of SAR136 billion. Out of the SAR1.03 trillion in budgeted expenditures, total capital expenditures represent approximately 22 percent, inclusive of new and ongoing projects from previous years. The Ministry of Finance did not provide a breakdown between capital and current expenditures for the designated sectors. The table on the next page summarizes the key budgetary allocations as presented in the official press release.

Sector	Allocation
Public Administration	Expenditures are projected at SAR27.6 billion (2.5 percent of total), 1 percent higher than the amount budgeted last year. SAR1.1 billion is directed towards Vision Realization Programs for the Justice, Hajj and Umrah, Civil Services ministries, and the Royal Court.
Military	Expenditures are projected at SAR190.9 billion (17.3 percent of total), 12 percent lower than the amount budgeted last year. The sector's budget includes allocations for compensation of employees, operational costs, and infrastructure projects for military facilities. It also incorporates building advanced systems and capabilities, military education, military colleges, King Saud bin Abdualziz University for Health Sciences and military medical services.
Security and Regional Administration	Expenditures are projected at SAR102.9 billion (9.3 percent of total), 3 percent lower than the amount budgeted last year. SAR1.9 billion is allocated for Vision 2030 initiatives. The funding aims to provide security requirements incorporating facilities, supplies, equipment, weapons, and ammunition.
Municipal Services	Expenditures are projected at SAR62.2 billion (5.6 percent of total), 15 percent higher than the amount budgeted last year. Allocated funds will go to the Ministry of Municipal and Rural Affairs, municipalities, and development commissions for regions and cities, of which SAR1.1 billion is allocated to Vision Realization Programs.
Education	Expenditures are projected at SAR192.82 billion (17.5 percent of total), the largest recipient of budget allocations, albeit 6 percent lower than the amount budgeted last year. The allocation will focus on public, higher education, and workforce training. the budget includes allocations of SAR4.89 billion for Vision Realization Programs for human capital development initiatives. 719 new schools will be delivered during 2018. 1,724 educational facilities and schools are currently being established. Another 259 schools are being renovated. The total number of students sent abroad to study under the supervision of the Ministry of Education has exceeded 196,221 students including their dependents. The annual expenditure on the internal and external programs are SAR14.6 billion.
Health and Social Development	Expenditures are projected at SAR172 billion (15.6 percent of total), 8 percent higher than the amount budgeted last year. SAR47.7 billion will be directed towards financing Vision Realization Programs. New projects include equipping of hospitals and healthcare centers, completion of 35 new hospitals with a capcity of 8,850 beds. The budget also includes appropriations for the development of five sports cities and the preparation of two stadiums in Jeddah and Dammam. The allocation of the sports projects is SAR30 billion.
Economic Resources	Expenditures are projected at SAR131.4 billion (12 percent of total budget), 24 percent higher than the amount budgeted last year. SAR71 billion is allocated for mega projects and initiatives related to Vision Realization Programs. Other projects include providing drinking water and developing water sources, sanitation services, dam construction, well drilling water leak detection and rectification, and water and sewage network replacements, among others.
Infrastructure and Transportation	Expenditures are projected at SAR70.24 billion (6.4 percent of total), 28 percent higher than the amount budgeted last year. SAR36.7 billion is allocated for Vision Realization Programs to develop roads (3,000 km), ports, railways, airports, housing, communications and information technology, postal services, the industrial cities of Jubail and Yanbu, Ras Al-Khair Industrial Mining and Jazan City for primary and downstream industries.
General Items	Expenditures are projected at SAR156.2 billion (14.1 percent of total), 57 percent higher than the amount budgeted last year. Allocations include the government's contribution share to the Public Pension Agency (PPA) and General Organization for Social Insurance (GOSI), financing expenses, budget support provisions, balancing fund and emergency expenses.