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Saudi Arabia's Quarterly Budget Performance Report

Second Quarter for the year of 2017 (1438/1439H)

Contents

Executive Summary

On Sunday, 13 August 2017, the Ministry of Finance released an update of the Kingdom's fiscal stance for 2Q 2017. The highlights are:

- The quarterly public finance figures showed an increase in the budget deficit for the 2Q 2017 to reach SAR46.5 billion from SAR26.2 billion in the 1Q 2017.
- Although oil price was higher than last year's average oil price, the daily production so far in 2017 is nearly 0.4mb/d less than the daily production of 2016, the rise in oil price has more than offset the decline in the volume of oil exports, with the oil revenues rising by 63% to reach SAR212.9 billion in 1H 2017.
- Total non-oil revenues has registered a drop by 12% in 1H 2017 compared to the same period a year ago. This decline is the result of the reduction of government investment assets currently under management by SAMA, and also to weaker stock market profitability, and in turn lesser dividends on the PIFs' holdings of the Saudi listed companies.
- The second quarter expenditures amounted to SAR210 billion, representing 24% of the planned budget of the year, while the 1H 2017 expenditure recorded SAR380.7 billion, declining by 2% from the 1H 2016.
- The two components, which had the largest declines in comparison to the first half of last year in absolute values include use of good and services and subsidies, falling by 34% and 65%, respectively, to record SAR43.9 billion and SAR1.2 billion in 1H 2017.
- At first half of the fiscal year 2017, Kingdom's total public debt reached SAR341.3 billion, as the domestic debt stood at SAR204.5 billion, while external debt amounted to SR136.8 billion.

Figure (1) Performance of the actual budget for 1H of the fiscal year 2017

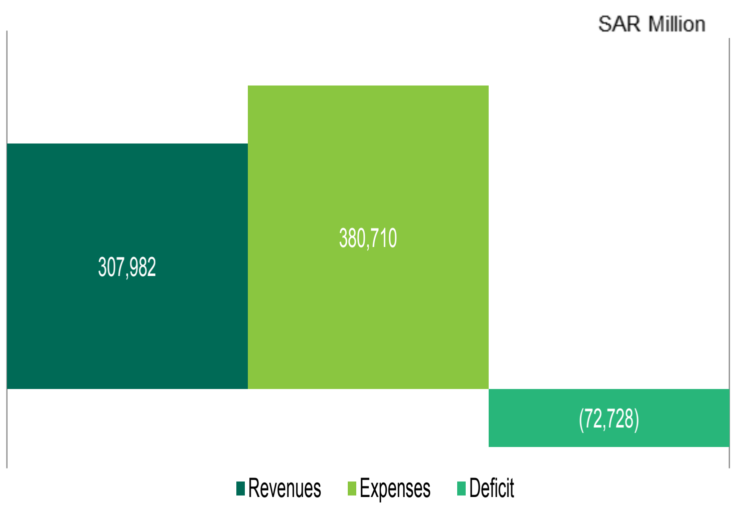
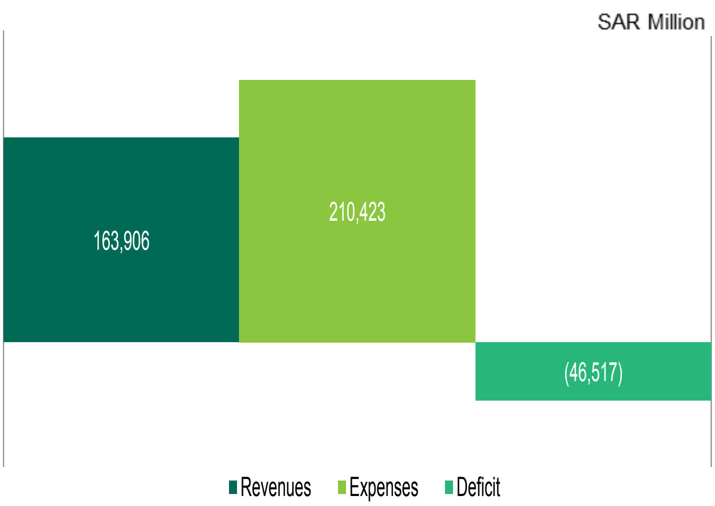


Figure (2) Performance of the actual budget for 2Q of the fiscal year 2017



Sources: MOF

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The Second Quarter 2017 Budget

The Saudi Arabia's Ministry of Finance released on August 13th the second quarterly update of the Kingdom's fiscal stance. In line with the themes of "Fiscal Balance Program" (FBP), while at same time reflecting improved level of transparency, the 2Q 2017 budget has provided detailed breakdowns for spending and revenues, besides sources of deficit financing and debt management. The quarterly public finance figures showed an increase in the budget deficit for the 2Q 2017 to reach SAR46.5 billion from SAR26.2 billion in the 1Q 2017.

This increase is attributed to lower oil revenues, and largely to higher government spending. The government spending amounted to SAR210.4 billion in 2Q 2017, up from SAR170.2 billion in 1Q 2017. However, it is less than the budget expenses of the 2Q 2016, which recorded SAR213.2 billion.

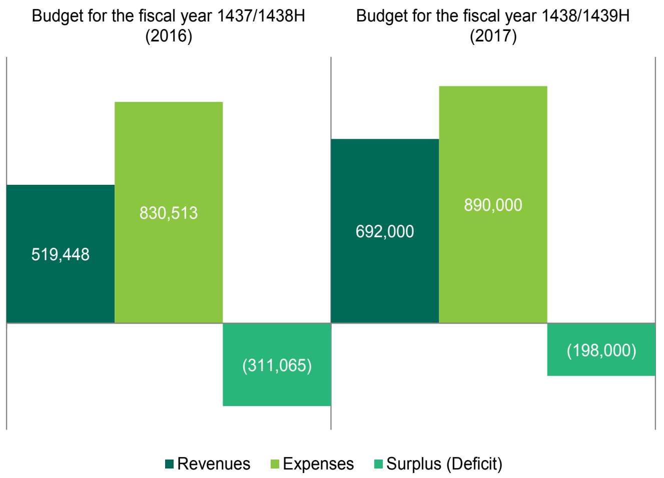
The budget numbers suggest that the spending cuts on the operating and capital spending sides, which were implemented over the past two years, are coming to an end. The government's commitment to FBP will likely drive a narrowing of fiscal deficits over the coming years and may help to slow the rise in public debt.

Figure (3) General budget for the current fiscal year 2017 (SAR Million)

Items	Budget for the fiscal year 1437/1438H (2016)	Budget for the fiscal year 1438/1439H (2017)
Oil Revenues	333,699	480,000
Non-oil Revenues	185,749	212,000
Revenues	519,448	692,000
Expenses	830,513	890,000
Surplus (Deficit)	**(311.065)**	**(198.000)**

Sources: MOF

Figure (4) General budget for the fiscal year 2016-2017 (SAR Million)



Sources: MOF

Revenues

Total revenues in 2Q 2017 increased by 14%, amounting to SAR163.9 billion compared to SAR144.0 billion in the previous quarter. This increase is largely attributed to the sharp increase in non-oil revenues on a quarterly basis, rising by 96%. Meanwhile, oil revenues, which declined by 9.8% in 2Q 2017 in comparison to 1Q 2017, have registered sharp rise in 1H 2017 compared to the same period in 2016.

The implicit oil price in the 2017's Kingdom's budget was projected at USD48.7 per barrel with a daily production of 10.1mb/d. Although oil price was higher than last year's average oil price, the daily production so far in 2017 is nearly 0.4mb/d less than the daily production of 2016, as the Kingdom remains compliant to the OPEC's cut agreement in November of last year. OPEC Reference Basket Price averaged USD49.0 in 1H 2017, nearly 22% higher since beginning of the year. Accordingly, the rise in oil price has more than offset the decline in the volume of oil exports, with the oil revenues rising by 63% to reach SAR212.9 billion in 1H 2017.

Figure(5) Actual Revenues for 2Q'17 compared to 1Q'17 (SAR Million)

Revenues	1Q 2017	2Q 2017	Total
Oil Revenue	**112,003**	**100,990**	**212,993**
Taxes on income, profits and capital gains	2,031	7,201	9,232
Taxes on goods and services	5,690	8,084	13,774
Customs duties	4,536	4,941	9,477
Other taxes	1,557	10,596	12,153
Other revenues (SAMA,PIF)	18,259	32,094	50,353
Total Non-Oil revenues	**32,073**	**62,916**	**94,989**
Total	**144,076**	**163,906**	**307,982**

Sources: MOF

Given the projected persistence of low oil prices, the government has undertaken a significant fiscal adjustment since 2015, in order to adjust to the sharp drop in oil revenues. It has raised electricity and water tariffs and also reduced fuel subsidies. Moreover, fiscal adjustment is still underway through mobilization of additional non-oil revenues.

Early this year, the government introduced the excise taxes on tobacco and soft drinks. In turn, annual non-oil revenues in kingdom's 2017 planned budget were projected to reach SAR212 billion, assuming an increase of 7% from the actual figure of the previous year. However, in 2Q 2017, non-oil revenues increased sharply by 96% over 1Q 2017 to reach SAR62.9 billion, representing nearly 38% of the total quarterly revenues of SAR163.9 billion. This increase of non-oil revenues come in line with the key themes of the FBP of enhancing sustainability of government revenues.

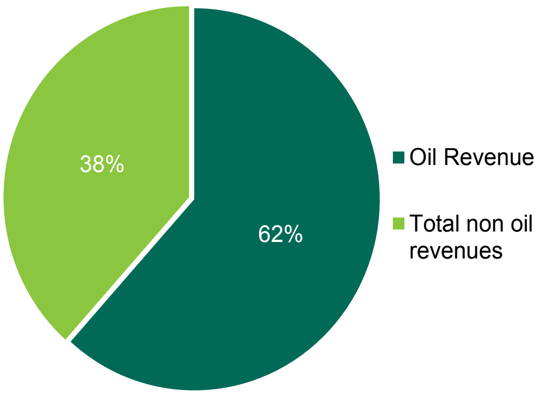
Figure(6) Actual Revenues for 1H'17 compared to 1H'16 (SAR Million)

Revenues	1H 2016	1H 2017	Change
Oil Revenue	**130,929**	**212,993**	**63%**
Taxes on income, profits and capital gains	7,518	9,232	23%
Taxes on goods and services	13,294	13,774	4%
Customs duties	12,368	9,477	-23%
Other taxes	12,801	12,153	-5%
Other revenues (SAMA,PIF)	61,663	50,353	-18%
Total Non-Oil revenues	**107,974**	**94,989**	**-12%**
Total	**238,903**	**307,982**	**29%**

Sources: MOF

Meanwhile, on a semi-annual basis, total non-oil revenues has registered a drop by 12% in 1H 2017 compared to same period a year ago. While taxes on income, profits and capital gains, and also taxes on goods and services recorded increases by 23% and 4% respectively, more likely attributed to a more efficient collection, the other three non-oil revenue categories registered declines with varying degrees. The other revenues (of which SAMA and PIF returns), accounting for 53% of non-oil revenues, declined by 18% in the 1H 2017 compared to same period a year ago, to reach SAR50.35 billion.

Figure (7): Revenues of 2Q 2017



Sources: MOF

This decline is the result of the reduction of government investment assets currently under management by SAMA, and also to weaker stock market profitability, and in turn lesser dividends on the PIFs' holdings of the Saudi listed companies. Other taxes (corporate Zakat), which showed a significant increase in 2Q 2017, registered a decline of 5% in 1H 2017.

In addition, custom duties declined by 23%, reflecting the continued decline of Kingdom's imports. Meanwhile, non-oil revenues are expected to improve starting the third quarter this year with the introduction of expatriate dependent levies, white land taxes, and the adjustment of the households' electricity bills to the 100% benchmark price level.

Expenses by Type

Total expenditure, as provided under the kingdom's annual government expenditure for 2017 is estimated at SAR890 billion. The second quarter expenditures amounted to SAR210 billion, representing 24% of the planned budget of the year, while the 1H 2017 expenditure recorded SAR380.7 billion, declining by 2% from the 1H 2016. This, apparently, reflects the government's continued commitment to fiscal reform, as spending at this pace for the upcoming quarters will ensure insignificant deviations from the fiscal balance program. In percentage term, although still small in absolute value, the largest increase was in financial expenses, rising by 228% in the 1H 2017, basically due to servicing of the rising public debt.

Figure (8): Actual expenses for 2Q'17 compared to 1Q'17

Expenses	1Q 2017	2Q 2017	Total
Compensation of Employees	94,085	102,788	196,873
Use of Goods and Services	16,712	27,239	43,951
Financial Expenses	1,258	3,011	4,269
Subsidies	46	1,135	1,181
Grants	571	640	1,211
Social Benefits	6,607	16,587	23,194
Other Expenses	21,922	25,772	47,694
Non-financial assets	29,086	33,251	62,337
Total	**170,287**	**210,423**	**380,710**

Sources: MOF

The social benefits, and other expenses categories, recorded sharp increases, rising by 21%, 49% in 1H 2017 compared to same period in 2016. Also, over the same period, Non- financial assets, which account for capital expenditure, recorded a marginal increase of 1%. On a pro rata basis, the capital expenditure projected for the year 2017, is likely to record lower value compared to the amount allocated in Kingdom' annual 2017 budget. The remaining two expenditure components, subsidies and grants, recorded significant declines of 65% and 25%, respectively. The two components, which had the largest declines in comparison to the first half of last year in absolute values include use of goods and services and subsidies, falling by 34% and 65%, respectively, to record SAR43.9 billion and SAR1.2 billion in 1H 2017.

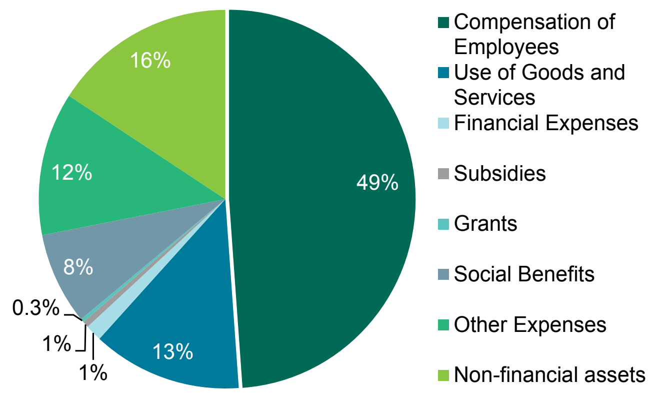
Figure (9): Actual expenses for 1H'17 compared to 1H'16

Expenses	1H 2016	1H 2017	Change
Compensation of Employees	202,475	196,873	-3%
Use of Goods and Services	66,280	43,951	-34%
Financial Expenses	1,301	4,269	228%
Subsidies	3,383	1,181	-65%
Grants	1,604	1,211	-25%
Social Benefits	19,129	23,194	21%
Other Expenses	31,993	47,694	49%
Non-financial assets	61,787	62,337	1%
Total	**387,952**	**380,710**	**-2%**

Sources: MOF

The decline of expenses for use goods and services category is consistent with NTP 2020 of optimizing and rationalizing of government operational expense. Moreover, the decline in subsidies will continue following the introduction of gradual measures intended to eliminate subsides in fuel, electricity and water, while encouraging citizens to consume reasonably.

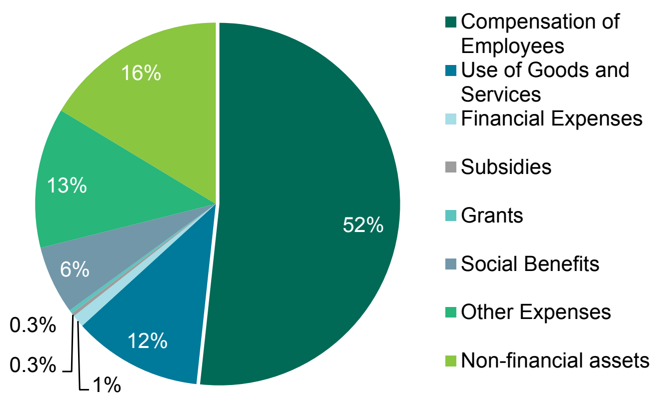
Figure (10): Actual expenses for 2Q 2017



Sources: MOF

A significant percentage of recurrent expenditure has been allocated to the payment of salaries and wages, amounting to SAR196.9 billion in the 1H 2017, yet declining by 3% from the 1H 2016. Although quarterly fiscal data for 2015 were not available, but it can be easily assumed, which is worth noting, that the reduction in compensation spending at 3% Y/Y, is much smaller than the fall over the same period between 2016 and 2015. This, however, suggests that the big spending cuts seem to be over.

Figure (11): Actual expenses for 1H 2017

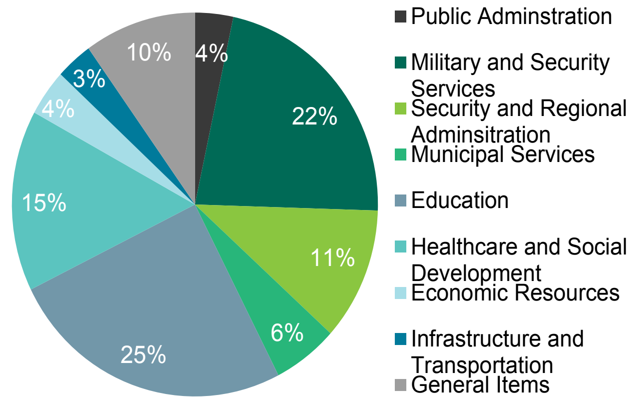


Sources: MOF

Expenses by Sector

By comparing spending for each sector to its allocation in the 2017's annual budget, significant variations were visible, as some sectors spent larger shares of their planned annual budget. The education sector, which received SAR200.3 billion to account for 22.5% of annual budget, its 1H 2017 actual spending amounted to SAR96.0 billion to reach 48% of its full year budget. It was followed by health and social development, as its expenses reached SAR58.0 billion at 48% of its annual budget. Also, the public administration expenses reached SAR 12.8 billion at 48% of its annual budget. The military, and security & regional administration, which are accounting for 21.4%, 10.9%, of the annual budget, showed slightly lower pace of spending at 44%, and 44%, respectively.

Figure (12) Actual expenses per sector during 1H 2017



Sources: MOF

The much lesser pace of spending was noticeable in the infrastructure and transportation sector at 24% of its planned budget, economic resources at 32%, and general items at 35%. It is not clear whether these variations in spending do reflect a reorganization of the programs across ministries or indicate shifting of priorities. The seasonal pattern of spending across sectors in relation to their planned allocations of the annual budget should become much clearer in the remaining quarters of the year.

Meanwhile, if spending continues at the current pace of each sector, higher share of the overall annual budget would likely take place within the education, health and social development and public administration sectors. This, in turn, would mean the sectors that are spending at a relatively slower pace are likely to be receiving smaller shares of their planned annual budget.

Fiscal Deficit and Debt Management

At first half of the fiscal year 2017, Kingdom's total public debt reached SAR341.3 billion, as the domestic debt stood at SAR204.5 billion, while external debt amounted to SR136.8 billion.

The debt to GDP ratio in 2016 stood at 13%. During the second quarter of 2017, the government resorted to its reserve account and external debt market to finance the budget deficit for this period, which reached SAR46.5 billion. This comes on top of SAR26 billion deficit in 1Q 2017, bringing total deficit in the 1H 2017 to SAR72.7 billion. Moreover, in the domestic debt segment, the government has repaid a principal debt of SAR443 million, and has amortized government bonds worth SAR8.5 billion. Accordingly, total domestic debt declined to SAR204.5 billion.

Figure (13) Public debt during 1H 2017 (SAR Million)

Items	Domestic Debt	External Debt
Beginning of Period Balance	316,580	
	213,455	103,125
Issuances or borrowing	0	33,750
Repayment of Principle Debt	(443)	0
Amortization of Government Bonds	(8500)	0
End of Period Balance	204,512	136,875
	341,387	

Sources: MOF

In addition to the withdrawal of SAR15 billion from the reserve account, the government issued SAR33.7 billion (USD9.0 billion) Sukuk in the international market during the second quarter for the first time this year. The establishment of the Sukuk Program comes as part of the Debt Management Office's role in securing the Kingdom's financing needs with best financing costs.

Figure (14) Actual deficit in 1H 2017 (SAR Million)

Items	1Q 2017	2Q 2017	1H 2017
Deficit During	**(26.211)**	**(46.517)**	**(72.728)**
Financing			
From Current Account	32,000	-	32,000
From Reserves Account	-	15,000	15,000
From Internal Loans	-	-	-
From External Loans	-	33,750	33,750
Total Financing	**32,000**	**48,750**	**80,750**

Sources: MOF

In the fiscal balance program, which was released late last year, the government set the debt to GDP ceiling at 30% to be reached by 2020. Despite the significant funding requirements, the Kingdom continues to have access to liquidity to finance projected fiscal deficits through the period up to 2020. Recently, the IMF welcomed the fiscal and economic reforms introduced by the Saudi government including the planned rollout of VAT, removing obstacles to private growth and boosting bank regulation.

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