23 November 2017

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Saudi Arabia's Quarterly Budget Performance Report

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

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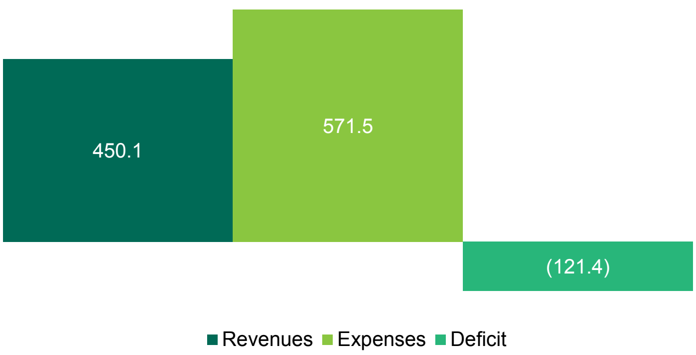
Executive Summary

On Sunday, 19 November 2017, the Ministry of Finance released an update of the Kingdom's fiscal stance for 3Q 2017. The highlights are:

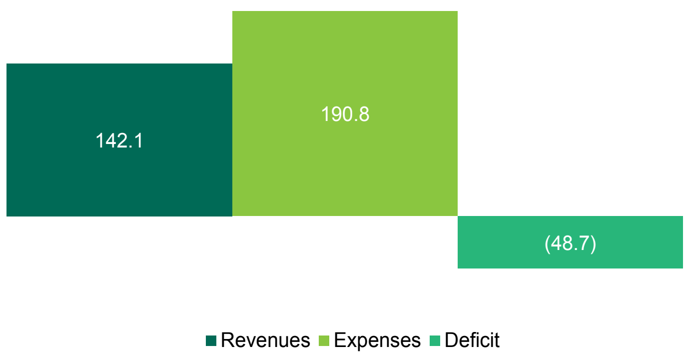
- The quarterly public finance figures showed a 5% increase in the budget deficit for the 3Q 2017 to reach SAR48.7 billion from SAR46.5 billion in the 2Q 2017.
- Total revenues in 3Q 2017 decreased by 13%, amounting to SAR142.1 billion compared to SAR163.9 billion in the previous quarter. This decrease is due to the decrease in non-oil revenues on a quarterly basis, lower by 24%, and to the 7% decline in oil revenues.
- Total non-oil revenues have registered a rise by 6% in the 9-month of 2017 compared to same period a year ago. This increase is attributed to a 35% increase of "Taxes on Goods and Service". In addition, return on SAMA and PIF assets, which accounted for 54% of total non-oil revenues, increased by 7% in the 9-month of 2017 compared to same period a year ago, to reach SAR77.8 billion.
- The third quarter expenditures amounted to SAR190.8 billion, an increase of 5% compared to the same period last year and representing 21% of the planned budget of the year.
- In percentage term, although still small in absolute value, the largest increase was in financial expenses, rising by 138% in the 9-month 2017, mainly due to servicing of the increasing public debt.
- At the 9-month of the fiscal year 2017, Kingdom's total public debt reached SAR375.7 billion, as the domestic debt stood at SAR238.9 billion, while external debt amounted to SR136.8 billion.

Figure (1) Performance of the actual budget for 9M of the fiscal year 2017



Sources: MOF

Figure (2) Performance of the actual budget for 3Q of the fiscal year 2017



Sources: MOF

Said A. Al Shaikh
Chief Economist | s.alshaikh@alahli.com

Sharihan Al Manzalawi
Associate Economist | s.almanzalawi@alahli.com

Sultan S. Mandili
Economist | s.mandili@alahli.com

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The Third Quarter 2017 Budget

The Saudi Arabia's Ministry of Finance released on November 19th the third 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 3Q 2017 budget has provided detailed breakdowns for spending and revenues, besides sources of deficit financing and debt management. The quarterly public finance figures showed a 5% increase in the budget deficit for the 3Q 2017 to reach SAR48.7 billion from SAR46.5 billion in the 2Q 2017.

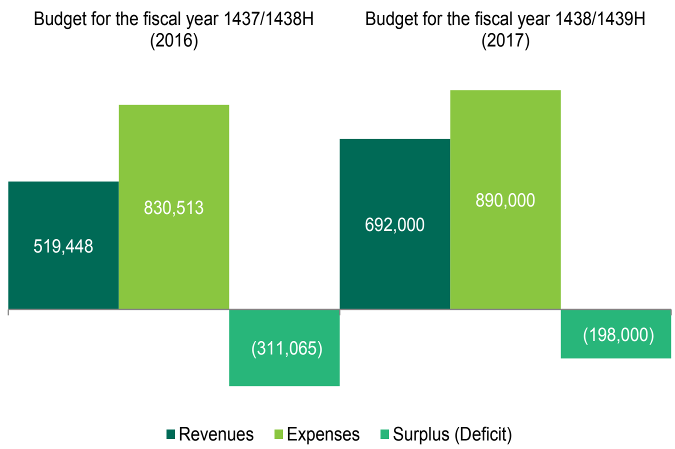
Figure (3) General budget for the current fiscal year 2017 (SAR Million)

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)	**(311065)**	**(198000)**

Sources: MOF

Attributed to recovering oil prices since beginning of the year, oil revenues increased by 33% in the 9-month period compared to same period a year ago, amounting to SAR307.3 billion. Moreover, non-oil revenues rose by 6% in the 9-month period compared to same period a year ago, amounting SAR142.8 billion, due to a 35% increase in "taxes on goods and services" and a 7% rise in SAMA and PIF returns.

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



Sources: MOF

The government spending declined by 9.3% in 3Q 2017 to reach SAR190.8 billion from SAR210.4 billion in 2Q 2017. However, it is more than the budget expenses of the 3Q 2016, which recorded SAR181.2 billion. In the 9-month period, total spending amounted to SAR571.58 billion, rising marginally by 0.4% over the 9-month period of 2016. Consistent with fiscal reform initiatives, "subsidies" and "use of goods and services" categories dropped by 43% and 25%, respectively, in the 9-month period compared to the same period in 2016.

A combination of recovering oil prices, which contributed to significant increase in oil revenues, and well-thought -out foreign currency debt issuance strategy have assisted the Kingdom to lessen its dependence on its foreign exchange reserves to finance fiscal deficit. Based on expectation the Kingdom will continue to consolidate public finance, S&P Global Rating Agency affirmed Kingdom's investment grade "A-/A-2" foreign and local currency ratings, and maintained its stable outlook.

Revenues

Total revenues in 3Q 2017 decreased by 13%, amounting to SAR142.1 billion compared to SAR163.9 billion in the previous quarter. This decrease is due to the decrease in non-oil revenues on a quarterly basis, lower by 24%, and also to 7% decline in oil revenues.

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. Saudi Arab Light crude price averaged USD50.2 for the 9-month of 2017, up 23% on the average price of 2016. This boost from higher oil prices far outstrips the negative impact on revenues due to lower volumes. Despite lower crude exports, which declined from 7.97mb/d in 4Q 2016 to 7.3mb/d in 1Q 2017 and further down to 6.94mb/d in 2Q 2017, oil revenues increased by 33% to reach SAR307.3 billion in the 9-month of 2017.

Figure(5) Actual Revenues for 3Q'17 compared to 2Q'17 (SAR Million)

Revenues	2Q 2017	3Q 2017	Change
Oil Revenue	**100,990**	**94,323**	**-7%**
Taxes on income, profits and capital gains	7,201	**789**	-89%
Taxes on goods and services	8,084	11,725	45%
Customs duties	4,941	6,098	23%
Other taxes	10,596	1,747	-84%
Other revenues (SAMA,PIF and others)	32,094	27,458	-14%
Total Non-Oil revenues	**62,916**	**47,817**	**-24%**
Total	**163,906**	**142,140**	**-13%**

Sources: MOF

Early this year, the government introduced the excise taxes on tobacco and soft drinks, and in July it introduced the first phase of expatriate levies on dependents. In its planned budget, the government projected non-oil revenues to reach SAR212 billion, assuming an increase of 14% from the actual figure of the previous year. However, in the 9-month of 2017, non -oil revenues amounted to SAR142.8 billion, representing 67% of planned non-oil revenues. Presuming this level of revenues continue in 4Q 2017 implies an annual figure of SAR189 billion, around 11% below the revenue budget figure.

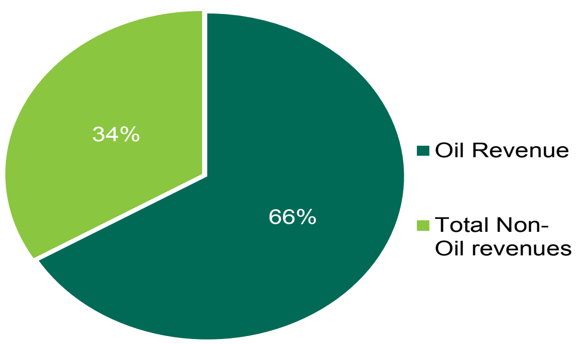
Meanwhile, total non-oil revenues has registered a rise by 6% in the 9-month of 2017 compared to same period a year ago. This increase is attributed to a 35% rise of "Taxes on Goods and Service". In addition, return on SAMA and PIF assets, which accounted for 54% of total non-oil revenues, increased by 7% in the 9-month of 2017 compared to same period a year ago, to reach SAR77.8 billion. The other three non-oil revenues categories, which are affected by the weaker performance of economy, have registered declines with varying degrees. Due to declining imports, "Taxes on Trade and Transactions (Customs)" category decreased by 10% in the 9-month period of 2017 over same period ago, amounting to SAR15.5 billion. The other two categories "Taxes on Income, Profit and Capital Gains" and "Other Taxes (of which Zakat)" both recorded declines by 5% and 6%, over same period, respectively.

Figure(6) Actual Revenues for 9M'17 compared to 9M'16 (SAR Million)

Revenues	9M 2016	9M 2017	Change
Oil Revenue	**231,884**	**307,316**	**33%**
Taxes on income, profits and capital gains	10,506	10,021	-5%
Taxes on goods and services	18,949	25,499	35%
Customs duties	17,342	15,575	-10%
Other taxes	14,763	13,900	-6%
Other revenues (SAMA,PIF and others)	72,645	77,811	7%
Total Non-Oil revenues	**134,205**	**142,806**	**6%**
Total	**366,089**	**450,122**	**23%**

Sources: MOF

Figure (7): Revenues of 3Q 2017



Sources: MOF

Expenses by Type

Total expenditure, as provided under the kingdom's annual government expenditure for 2017 is estimated at SAR890 billion. The third quarter expenditures amounted to SAR190.8 billion, an increase of 5% compared to the same period last year and representing 21% of the planned budget of the year. While the actual expenses for 9-month period of 2017 recorded SAR571.5 billion, which rose by only 0.4% from the same period of 2016, it accounted for only 64% of the annual planned budget.

Presuming this level of spending continues in 4Q 2017 implies that full year actual spending will amount to SAR762 billion, nearly 14% below the planned budget. At this pace of spending, Kingdom is on the right track toward achieving its target of a balanced budget by 2020. However, this can be achieved at the expense of slower economy, as the Non-oil GDP recorded 0.61% and 0.56% growth in 1Q 2017 and 2Q 2017, respectively. To revive the weakening economy, which has been hit by slower government spending, the MOF is considering the extension of the Fiscal Balance Program beyond 2020, and to embark on a policy of boosting spending to stimulate the economy.

Figure (8): Actual expenses for 3Q'17 compared to 2Q'17

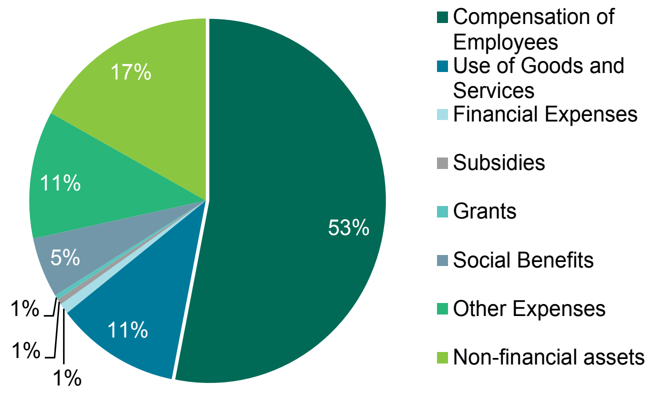
Expenses	2Q 2017	3Q 2017	Total
Compensation of Employees	102,788	106,619	209,407
Use of Goods and Services	27,239	20,661	47,900
Financial Expenses	3,011	1,152	4,163
Subsidies	1,135	1,695	2,830
Grants	640	1,182	1,822
Social Benefits	16,587	7,522	24,109
Other Expenses	25,772	17,077	42,849
Non-financial assets	33,251	34,962	68,213
Total	**210,423**	**190,870**	401,293

Sources: MOF

In percentage term, although still small in absolute value, the largest increase was in financial expenses, rising by 138% in the 9-month 2017, mainly due to servicing of the increasing public debt. "The other expenses", "grants" and "social benefits" categories, recorded significant increases, rising by 24%, 47% and 23%, respectively, during the 9-month of 2017 compared to same period in 2016. Also, over the same period, "Non-financial assets", which account for capital expenditure, recorded a minimal increase of 0.1%. This is consistent with capital optimization program the government introduced in 2015.

Accordingly, the capital expenditure for the year 2017 is likely to record much lower value compared to the amount allocated in the planned annual budget. The two components, which had the largest declines in comparison to the first nine months of last year in absolute values, include "use of goods and services" and "subsidies", falling by 25% and 43%, respectively, to record SAR64.6 billion and SAR2.8 billion in 9-month of 2017.

Figure (9): Actual expenses for 9M 2017



Sources: MOF

The decline of expenses for "use of goods and services" category is in line with the policy of rationalizing government operational expenses. Moreover, the fall in "subsidies" category will continue through upcoming years, as a result of the planned and gradual implementation by the government of the removal of subsides in fuel, electricity and water. This in turn, not only will encourage consumers to rationalize their consumption, but will lower demand, and accordingly lessen future financing needed for expansion of related infrastructure. The government succeeds to manage its expenses so far for compensation of employees, which includes the payment of salaries and wages, amounting to SAR303.4 billion during the 9-month of 2017, which grew only by 1% compared to the same period last year.

Figure (10): Actual expenses for 9M'17 compared to 9M'16

Expenses	9M 2016	9M 2017	Change
Compensation of Employees	299,980	303,492	1%
Use of Goods and Services	86,063	64,612	-25%
Financial Expenses	2,279	5,421	138%
Subsidies	5,050	2,876	-43%
Grants	1,633	2,393	47%
Social Benefits	24,907	30,716	23%
Other Expenses	52,111	64,771	24%
Non-financial assets	97,206	97,299	0.1%
Total	**569,229**	**571,580**	**0.4%**

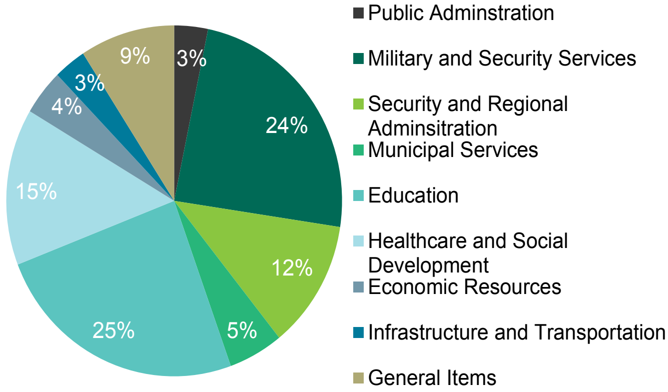
Sources: MOF

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 23% of annual budget, its 9-month of 2017 actual spending amounted to SAR140.4 billion to reach 70% of its full year budget. It was followed by "military", as its expenses reached SAR137.9 billion at 72% of its annual budget. The "security & regional administration", which accounted for 11%, utilized 70% of its planned annual budget. In terms of utilization, it was followed by the "health and social development" expenses that reached SAR 82.5 billion at 68% of its planned annual budget.

The considerably slower pace of spending was noticeable in the "infrastructure and transportation" sector at 34% of its planned budget, "general items" at 48%, and "economic resources" at 51%. 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. In the meantime, if expenditure continues at the current pace across sectors, above planned shares of the actual annual budget would take place in "Military", "Security & Regional Administration", and "Education", while "Economic Resources" and "Infrastructure and Transportation" will receive below planned shares.

Figure (11) Actual expenses per sector during 9M 2017



Sources: MOF

Fiscal Deficit and Debt Management

At the 9-month of the fiscal year 2017, Kingdom's total public debt reached SAR375.7 billion, as the domestic debt stood at SAR238.9 billion, while external debt amounted to SR136.8 billion. During the 3Q 2017, the government resorted to its current account from 2016, reserve account and internal debt market to finance the budget deficit for this period, which reached SAR58.5 billion.

Figure (12) Public debt during 9M 2017 (SAR Million)

Items	Domestic Debt	External Debt
Beginning of Period Balance	**316,580**	
	213,455	103,125
Issuances or borrowing	37,000	33,750
Repayment of Principle Debt	(3053)	0
Amortization of Government Bonds	(8500)	0
End of Period Balance	238,902	136,875
	375,777	

Sources: MOF

This comes on top of SAR72.7 billion deficits in the first half of 2017, bringing total deficit in the 9-month of 2017 to SAR121.4 billion, a decrease of 40% when compared to the same period of last year. Additionally, in the domestic debt segment, the government has paid off a principal debt of SAR3.053 billion, and also has amortized government bonds worth SAR8.5 billion.

Accordingly, total domestic debt declined to SAR238.9 billion. In addition to the withdrawal of SAR15 billion from the reserve account, the government issued SAR37.0 billion in the local debt market during 3Q 2017. This followed one international issuance in the amount SAR33.75 billion (USD9.0 billion Skuk). This brings total external debt to SAR136.125 billion up to the end of 3Q 2017. However, the Kingdom has raised a USD12.5 billion in international bond market late 3Q 2107, which has not been yet incorporated in the third quarterly budget performance report. If added, total external debt year-to-date will amount to SAR183.76 billion. Accordingly, total public debt, including latest international issuance, will amount to SAR422.0 billion.

Figure (13) Actual deficit in 9M 2017 (SAR Million)

Items	1Q 2017	2Q 2017	3Q 2017	Total
Deficit During	**(26.211)**	**(46.517)**	**(48.730)**	**(121.458)**
Financing				
From Current Account	32,000	-	6,500	38,500
From Reserves Account	-	15,000	15,000	30,000
From Internal Loans	-	-	37,000	37,000
From External Loans	-	33,750	-	33,750
Total Financing	**32,000**	**48,750**	**58,500**	**139,250**

Sources: MOF

It is estimated that debt to GDP ratio will rise from 13% in 2016 to 17% in 2017, which is below the debt to GDP ceiling ratio defined in the FBP at 30% to be reached by 2020. However, tapping of domestic or international debt markets to finance fiscal deficit spending is in the final analysis comparable to an increase of public debt or depletion of reserves, thus weakening the financial position of the Kingdom. While the Kingdom's net foreign assets actually fell to USD485.2 billion by the end of 3Q 2017, down by 33% from its peak in 2014, it is still at a very comfortable level, covering around 30 months of imports.

Furthermore, on expectation that Saudi Arabia will continue to take needed steps to consolidate public finances, S&P Global Ratings has affirmed Kingdom's investment grade rating of "A-/A-2" long and short-term foreign and local currency with a stable outlook.

The Economics Department Research Team

Head of Research

Said A. Al Shaikh
Chief Economist
s.alshaikh@alahli.com

Macroeconomic Analysis

Tamer El Zayat
Senior Economist/Editor
t.zayat@alahli.com

Majed A. Al-Ghalib
Senior Economist
m.alghalib@alahli.com

Yasser A. Al-Dawood
Associate Economist
y.aldawood@alahli.com

Sector Analysis

Ahmed Maghrabi
Economist
a.maghrabi@alahli.com

Sharihan Al-Manzalawi
Economist
s.almanzalawi@alahli.com

Sultan Mandili
Associate Economist
s.mandili@alahli.com

Economic Update Analysis

Amal Baswaid
Senior Economist
a.baswaid@alahli.com

To be added to the NCB Economics Department Distribution List:

Please contact: Mr. Noel Rotap

Tel.: +966-2-646-3232 / Fax: +966-2-644-9783 / Email: n.rotap@alahli.com