Saudi Arabia: Budget divergence persists

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- **Saudi Arabia has set a smaller budget for 2021 than for 2020, seeking to maintain its fiscal consolidation drive, but could fall short of meeting deficit reduction targets in the face of spending exigencies.**
- **The government is set to lean heavily on cuts to capital expenditure. Diversifying the economy and creating jobs remain the key focus while VAT and customs revenue sources initiated in 2020 will support fiscal consolidation in 2021.**
- **We expect off-budget, additional stimulus via the Public Investment Fund (PIF) which is set to increase domestic investment.**

Squaring the fiscal circle

Saudi Arabia's 2021 budget reveals that the kingdom is looking to maintain its commitment to fiscal consolidation. But this will be tricky as spending exigencies persist in an environment of government-led stabilisation in the face of weak oil markets.

- Based on revenues of USD 226B, the government is budgeting for a YoY deficit of USD 37.5B in 2021 (4.9% of GDP), compared with USD 79.4B in 2020 (12% of GDP) and 4.7% of GDP in 2019.
- The 2021 budget highlights that the economic drag of 2020 has reduced total revenues to an estimated USD 205B, 7.6% YoY less than was envisaged in the original 2020 budget, and 16.9% lower than the 2019 outcome.
  - Lower revenue in 2020 stemmed from the fall in oil prices that saw oil revenue drop by 30.6% YoY, to USD 110B, falling from 64% of total revenue in 2019 to 53.5% of the total in 2020.
  - Total revenue is forecast to increase in the medium-term to reach around USD 248B in 2023, supported by the various bold fiscal measures.
- Unlike in previous years, the 2021 budget does not provide a forecast for oil revenue to avoid providing indications about Saudi Aramco's dividend policy now that the company is publicly listed.[1]
  - But the fact that total revenue in 2021 is expected to increase by 10% YoY to reach nearly 30% of GDP, suggests that the government is not banking on a substantial rise in oil revenue this year.
  - Should Saudi Aramco continue paying dividends to the government at similar levels to 2020, we would expect to see correspondingly higher oil revenue than 2020 estimated levels of USD 110B (54% of total revenue).
- The budget, as usual, did not specify its average expected crude export price, but the MoF tends to use conservative price estimates – considerably below market level. The IMF estimates Saudi Arabia's breakeven oil price for 2021 at USD 67.9 pb, from USD 78.2 pb in 2020.
  - As of now, brent is forecast to average USD 47 pb in Q1 2021 and to rise slightly to USD 50 pb by Q4, compared with the average USD 41 pb in 2020.[2]
- Oil revenue is expected to remain the primary source of government financing, but with the projected weak recovery in oil markets, the non-oil sector is expected to provide a boost to the recovery assuming the authorities can scale back some of the COVID-19 related stimulus measures.
  - The focus will be on continuing the initiatives that have been launched in recent years, such as energy price reforms and the privatisation of assets. This will also be complemented by revenue generated from the increase in expatriate levies and last year's VAT hike.
    - Tax revenue is estimated to reach USD 69B in FY 2021, an increase of around 31% compared with FY 2020 estimates.
  - We note that two government-owned flour mills were sold earlier this year for a total of USD 750M and that an additional two are currently in the bidding phase.
  - The MoF also stated in 2020 that it expected USD 2.9B in revenue to be collected from privatisation deals in 2020.

Table 1 - IMF Macroeconomic Indicators[3]

	2017	2018	2019	2020f	2021f
Real GDP Growth (%)	-0.7	2.4	0.3	-5.4	3.1
Crude Oil Production (M Bpd)	9.9	10.3	9.8	9.3	9.5
Oil GDP Growth (%)	-3.1	3.1	-3.6	-5.0	3.0
Non-oil GDP Growth (%)	1.3	2.2	3.3	-6.1	3.3
CPI Inflation (%)	-0.9	2.5	-2.1	3.6	3.7
Fiscal Balance (% of GDP)	-9.2	-5.9	-4.5	-10.6	-6.0
C/A Balance (% of GDP)	1.5	9.2	5.9	-2.5	-1.6
Total Gov't. Gross Debt (% of GDP)	17.2	19.0	22.8	33.4	34.3
Total Gross Extrn'l Debt (% of GDP)	18.2	19.2	23.2	29.9	29.1
Gross Official Reserves (Mos. of Imports)	28.3	28.6	33.2	26.2	23.1
Nominal GDP (USD B)	688.6	786.5	793.0	680.9	735.5
Population (Millions)	33.1	33.7	34.2	34.2	34.8

Table 2 - Ministry of Finance Macroeconomic Indicators[4]

	2019	2020e	2021f	2022	2023
Real GDP Growth (%)	0.3	-3.7	3.2	3.4	3.5
Nominal GDP (USD, B)	792	662	764	810	861
Inflation (%)	-2.1	3.7	2.9	2.0	2.0

[1] Saudi Arabia's Minister of Finance Mohammed al-Jadaan.
[2] US Energy Information Administration.
[3] Arabia Monitor; IMF.
[4] Arabia Monitor; Ministry of Finance, Saudi Arabia.

CAPEX under the hammer

Other than the unprecedented spending and the roll-out of fiscal stimulus packages in 2020, Saudi Arabia had made significant progress in recent years in bridging the divergence between planned and actual budgets. The 2021 budget hopes to get this effort back on track but could face challenges.

- Underscoring the government's intention to reach a balanced budget by 2030 under the kingdom's Fiscal Balance Program (FBP), the 2021 budget statement reaffirms its commitment to fiscal sustainability and spending efficiency.
  - Expenditure in 2021 is budgeted at USD 264B (34.5% of GDP), a 7.3% YoY cut from 2020's actual spending and 2.5% lower than the planned spending budget.
  - Total government expenditure for 2020 is estimated to have increased by only 0.8% to reach USD 285B, and an increase of 4.7% compared with the original 2020 budget.
  - But offsetting the high spending measures required the cancellation or postponement of several capital expenditure projects.
- Capital expenditure (CAPEX) declined by 19.1% YoY in 2020. At USD 26.9B, around 10% of total expenditure, CAPEX in 2021 is set to decline further by 26.6% YoY.
- The PIF, and a continued focus on privatisation are meant to pick up the slack. Current spending is budgeted at USD 238B, 4% lower than actual 2020 levels.
  - Benefits to the most economically vulnerable households will however, continue, with social benefits accounting for 7% (USD 17B) of the total current spending. This is a 6% YoY drop - the lowest cut compared with other item lines under this line item.
    - Commitments in areas such as the Housing Program and Quality of Life Program are expected to be maintained.
  - Spending on subsidies in 2021 is budgeted at nearly USD 6B, 21% lower than actual 2020 figures, and almost 30% lower than what was planned.
    - The impact of further subsidy cuts would most likely be felt in 2022. But actual cuts could be below current estimates.
- A sectoral breakdown shows that, of the largest spending components, only the allocation for Health and Social Development will increase in 2021 by nearly 5% YoY to reach USD 47B - amounting to 17.6% of the total expenditure.
  - A closer analysis shows that the net impact of the pandemic has resulted in this line item falling by 12% from the estimate in the original 2020 budget of USD 50.6B, reflecting in part the lower social development outlays last year.
    - Among key health-related projects planned for 2021 is the establishment of four rehabilitation hospitals and an elderly retreat centre.
  - Budgeted 4% YoY lower for 2021 at USD 49.6B, education still makes up the largest portion, at 18.7% of the total. For comparison, this is lower than that of Mexico (24%) but higher than that of India (13%) and China (12%).
    - Spending will continue to focus on establishing new academies and shifting towards digital education as well expanding on the Overseas Scholarship Program.
    - Expenditure is also targeted at attracting foreign universities to open campuses in Saudi Arabia.
  - A sizeable reduction in military spending is budgeted for the third consecutive year. This is expected to decline by 10% YoY in 2021 to USD 47B. The decline reflects the continued scaling back of Saudi Arabia's military operations in Yemen.

Figure 1 - Capital Expenditure (USD, B)[5]

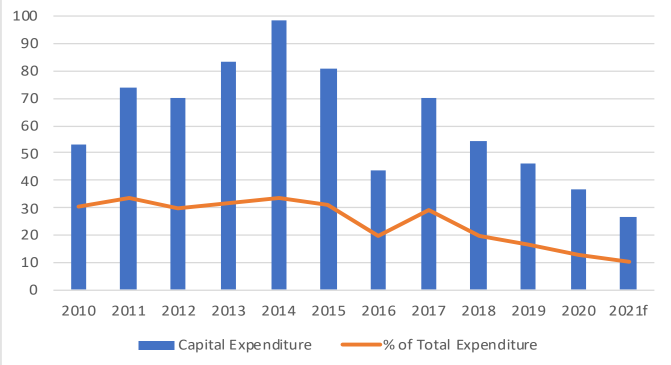
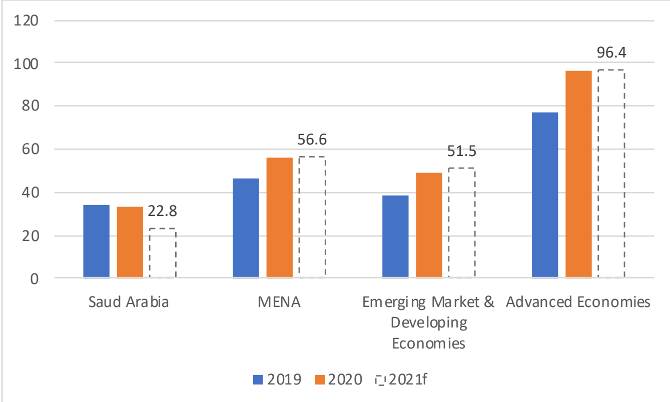


Figure 2- Debt-to-GDP Ratio (%)[6]



[5] Arabia Monitor; Ministry of Finance, Saudi Arabia.

[6] Arabia Monitor; Ministry of Finance, Saudi Arabia.

- The government indicated it will use a balanced mix of a further drawdown of fiscal reserves at the central bank and debt issuance to finance the 2021 budget shortfall.
    - The debt to GDP ratio this year is expected to reach 33%, or USD 250B – nearly a 10% YoY increase from 2020. This is still quite low by international standards.
- Saudi Arabia's tight fiscal stance is expected to result in the public debt-to-GDP ratio edging down over the next few years. Debt could decline to 31% of GDP in 2023.
- The government reserve account is forecast to decline to USD 75B in 2021 - 19% YoY decrease from 2020.
- Despite the upward trend in the public debt metrics, we note that Saudi Arabia's debt levels remain comfortably below its ratings peers.

Table 3 - Budget Performance (USD, B)[7]

	Budgeted Expenditure	Actual Expenditure	Budgeted Revenue	Actual Revenue
2009	127	146	109	134
2010	144	167	125	196
2011	155	214	144	296
2012	184	228	187	331
2013	219	247	221	302
2014	228	293	228	279
2015	229	260	191	162
2016	224	220	137	141
2017	237	248	185	184
2018	261	275	208	239
2019	295	279	260	245
2020e	272	285	222	205
2021f	264	…	226	…

Non-oil sector leads the way

Preliminary data by the Ministry of Finance (MoF) indicate that 2020 GDP was better than the 5.4% contraction estimated by the IMF.

- Growth is forecast by the government at 3.2% in 2021 from the 3.7% contraction estimated for 2020, as diversification reforms start to yield dividends and oil prices potentially rebound.
    - Saudi Arabia's unilateral decision to cut oil output by an additional 1M bpd over February and March 2021 signals the kingdom's bearish oil demand outlook. These cuts will likely weaken recovery in the early part of this year.
- Figures from Saudi Arabia's General Authority for Statistics (GaStat) reveal that the economy during H1 2020 contracted by 4% (vs. 1.1% growth in the same period in in 2019). On a quarterly basis, growth has edged up since then as GDP expanded by 1.8% in Q3 after a contraction of 5.2% in the previous quarter.
    - QoQ growth was mainly driven by expansion in the non-oil sector of 5.7% (vs. 0.5% in the same period in 2019). This compares with negative growth of 3.6% in the oil sector in Q3, over a 90% QoQ decline.
- But given both the persistent volatility in oil markets and the uncertainty surrounding the length of the pandemic, oil revenue recovery will remain a factor to watch out for well into H2 of 2021.
    - Oil demand in 2021 is forecast to recover to an average of 97.1M bpd (vs. 91.3M bpd in 2020).[8]
    - This will be sufficient to support average prices of around USD 47 pb, but such prices remain well below the levels the kingdom needs for its economic wheels to start turning again.
- The silver lining from the current crisis is that GCC economies could eventually learn to turn their wheels at lower oil prices, judging from aggressive reforms and continued momentum in 2020.
    - Such learning is inevitable as global energy sources expand.
- Non-oil GDP is forecast to rebound by 3% this year, from a sharp contraction of -5% in 2020.
    - Non-oil revenue in Q3 of 2020 grew by around 64% YoY to reach USD 30B, in contrast to USD 24B in oil revenue, which saw a drop of around 50% YoY in Q3 of 2020.
    - This was the first time in Saudi Arabia's modern history that non-oil revenue to outstripped oil revenue. Q1 of 2021 will likely post similar results.
- The 2021 budget outlines that Saudi Arabia will continue its privatisation plans and increase spending on megaprojects, along with expanding its private sector by improving the business environment and bolstering job creation for Saudi nationals.
    - Latest data from the Saudi Human Resources Development Fund revealed an increase of over 22% in the rates of Saudisation in Q3 of 2020 compared with 20% in the same period of 2019.
- Non-oil GDP growth this year is expected to be further supported by a rise in investment income from the Public Investment Fund (PIF), the kingdom's sovereign wealth fund.
    - The PIF is set to inject over USD 40B into the economy this year and next. This is expected to rise each year until 2030.
- The government forecasts inflation at 2.9% in 2021 with YoY pressures compared with the estimated 3.7% annual rate in 2020.

[7] Arabia Monitor; Ministry of Finance, Saudi Arabia.

[8] International Energy Agency (IEA).

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