جامعة الأمير سلطان
PRINCE SULTAN UNIVERSITY

KSA Economy

December 2020

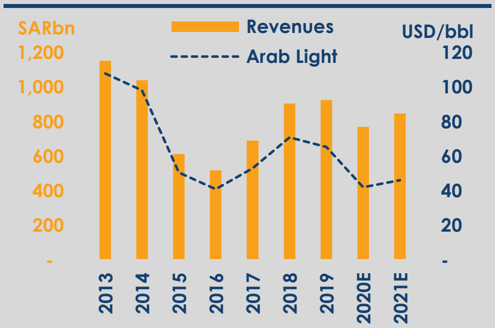
Budget 2021

KSA's Fiscal Budget 2021 Snapshot

SARbn	2020E	2021B	YoY
Total Revenue	770	849	10.3%
Total Expenditure	1,068	990	-7.3%
Budget Deficit	**-298**	**-141**	**-52.8%**
Budget Deficit (% of GDP)	**-12.0%**	**-4.9%**	**N/A**
Public Debt	854	937	9.7%
Public Debt (% of GDP)	34%	33%	N/A
Gov. Reserves at SAMA	**346**	**280**	**-19.1%**

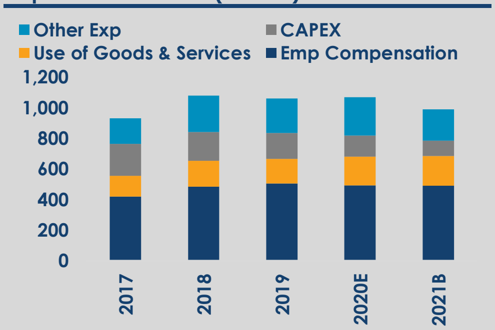
Source: Budget Statement 2021

Revenue Trend



Source: Ministry of Finance, Bloomberg

Expenditure Profile (SARbn)



Source: Budget Statement 2021

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Fiscal consolidation with an eye to Vision 2030 goals

The Council of Ministers accorded approval to the preliminary budget with no major changes in fiscal and macro targets. In the backdrop of significant spending overrun in 2020 due to dual shock of oil prices and COVID-19 pandemic, Budget 2021 appears to be a clear attempt by the government to return to fiscal consolidation path while, at the same time, optimizing progress on government's economic reforms, in our view. A 7% drop in budgeted outlay (SAR 990bn or 35% of GDP), coupled with 10% growth in total revenues (SAR 849bn or 30% of GDP), is estimated to reduce fiscal deficit by over 50% to SAR141bn (or 4.9% of GDP in 2021 vs 12% in 2020). Fiscal targets are broadly achievable, we opine, and rely on drop in economic cost of pandemic, stability in oil prices at current levels and spending discipline.

Rebound in GDP growth ahead

Real GDP growth target is set at 3.2% for 2021 vs an estimated drop in GDP of -3.7% in 2020. Both oil and non-oil sectors are expected to rebound given positive outlook on global oil demand and increase in non-oil economic activity in the Kingdom post easing of COVID-19 related restrictions. The government has set 26% lower target for CapEx (SAR 101bn in 2021 vs SAR 137bn in 2020) given higher base of previous years, higher expected participation of state-owned investment companies and private sector in the investment projects.

Fiscal targets look achievable

Governments' total revenues growth estimate in 2021 is underpinned by 31% jump in taxes (primarily full-year impact of increase in VAT & Custom duty), normalization of economic activity and 3% jump in other revenues (oil + non-oil, non-tax revenues). We estimate Budget 2021 builds in 55-60% contribution from oil revenues (based on USD45-50/bbl oil prices, details inside). Reversal of all major expenditure heads to pre-COVID-19 level, except for Goods & Services and Interest Payment (higher stock of debt), is expected to deliver 7% drop in total expenditure. Higher medical purchases and associated expenditure on COVID-19 (including economic support package) drove a 15% jump in Goods & Services. The government has rightly provisioned for continued elevated level of health expenditure in 2021, in our view.

Balanced fiscal financing plan

A balanced mix of borrowing and reserves drawdown (58/42% respectively) is expected to fill the financing gap in 2021. The government expects to achieve debt to GDP ratio of 33% in 2021 and 32% by 2023 via control over deficit and 15% growth in nominal GDP. Despite accumulation in stock of debt in recent years, KSA's debt to GDP remains significantly below relative to its peers.

Key risk factors

Four key risks factor to fiscal and macro estimates are; (I) breakdown in OPEC+ alliance and oil price volatility, (II) below-expected global economic growth, (III) prolonged COVID-19 pandemic, and (IV) unexpected production disruption at ARAMCO's facilities.

Fiscal consolidation with an eye to Vision 2030 goals

Budget 2021 is a clear attempt by the government to return to fiscal consolidation and minimize the impact of lower oil prices

The Council of Ministers recently accorded approval to the preliminary budget with no major changes in fiscal and macro targets. In the backdrop of significant spending overrun in 2020 due to COVID-19 pandemic, Budget 2021 is a clear attempt by the government to return to fiscal consolidation and minimize the impact of lower oil prices while, at the same time, optimizing progress on government's economic reforms, in our view. A 7% drop in budgeted outlay, coupled with 10% growth in total revenues, is estimated to reduce fiscal deficit by over 50% to SAR141bn (or 4.9% of GDP in 2021 vs 12% in 2020). Fiscal targets are broadly achievable, in our view, and rely on drop in economic cost of COVID-19, stability of oil prices and disciplined spending.

KSA's Fiscal Budget 2021 (SARbn)

Revenues	**2018**	**2019**	**2020E**	**2021B**
Taxes on Income, Profits and Capital Gains	17	17	16	13
Taxes on Goods & Services	115	155	141	209
Taxes on International Trade & Transactions	16	17	16	17
Other Taxes	21	30	23	18
Total Taxes	**169**	**220**	**196**	**257**
Other Revenues	**737**	**707**	**574**	**592**
Total Revenues	**906**	**927**	**770**	**849**
Expenditure				
Compensation of Employees	484	505	492	491
Use of Goods & Services	169	161	188	192
Financing Expenses	15	21	31	37
Subsidies	13	23	28	22
Grants	4	1	6	0.4
Social Benefits	84	82	67	63
Other Expenses	122	97	119	83
Total OPEX	891	890	931	889
Non-Financial Assets (CapEx)	188	169	137	101
Total Expenditure	**1,079**	**1,059**	**1,068**	**990**
Budget Deficit				
Budget Deficit in SARbn	-174	-132	-298	-141
Budget Deficit (as % of GDP)	-5.9%	-4.5%	-12.0%	-4.9%
Debt & Assets				
Public Debt	560	678	854	937
Public Debt (as % of GDP)	19.0%	22.8%	34.3%	32.7%
Government Reserves at SAMA	490	470	346	280

Source: Budget Statement 2021

KSA's Fiscal Budget 2021 Summary & Medium Term Fiscal Projections

SARbn	2018	2019	2020E	2021B	2022P	2023P
Total Revenue	906	927	770	849	864	928
Total Expenditure	1,079	1,059	1,068	990	955	941
Budget Deficit	-174	-132	-298	-141	-91	-13
Budget Deficit (as % of GDP)	-5.9%	-4.5%	-12.0%	-4.9%	-3.0%	-0.4%
Public Debt	560	678	854	937	1,013	1,026
Public debt (as % of GDP)	19.0%	22.8%	34.3%	32.7%	33.3%	31.7%
Government Reserves at SAMA	490	470	346	280	265	265

Source: Budget Statement 2021
2020: Government Estimate, B: Budgeted, P: Projected

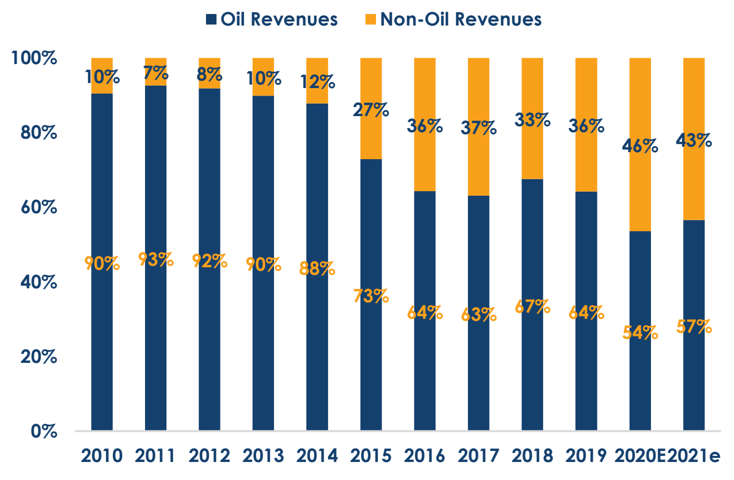
Total revenues growth of 10%

Total revenues are budgeted at SAR 849bn (30% of GDP), depicting an increase of 10% from the 2020 estimate of SAR 770bn

The total revenues are budgeted at SAR 849bn (30% of GDP), depicting an increase of 10% from the 2020 estimate of SAR 770bn. Increase in total revenues in FY2021 is expected due to a number of factors including gradual economic recovery post easing of COVID-19 related restrictions and availability of COVID-19 vaccine, improved global oil demand as business activities resume worldwide resulting in higher average oil prices, and continued government efforts to increase non-oil revenues.

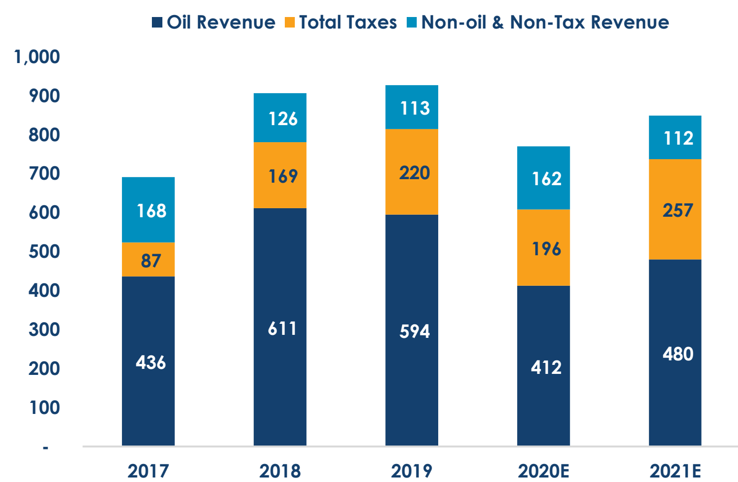
In the latest budget document, the government has skipped the details of breakdown of total revenues into oil and non-oil revenues for 2021 due to enlistment of Saudi Arabian Oil Company (ARAMCO) at Tadawul Stock Exchange. Total Revenues have been divided into two parts namely; (I) other revenue, and (ii) taxes. Other revenues, which is the major portion of overall revenue (70%), comprises of oil revenue and non-tax-non oil revenues. The government estimates 3% growth in other revenues YoY to SAR 592bn in 2021. On the other hand, total taxes are budgeted to increase by 31% YoY to SAR 257bn with majority of growth coming from taxes in goods & services (up 48%). This is a result of ongoing measures of government to diversify away from oil. Previous measures include, imposition of expat levies and introduction of 5% VAT in 2018 which was later increased to 15% in July 2020. In addition to this, custom levies were also increased in June 2020.

Significant progress on diversification of revenues (%)



Source: Ministry of Finance

Source of total revenues 2021 (SARbn)



Source: Ministry of Finance, PSU-CFS Estimate

Revenue stream from oil will remain the major source of government financing in 2021 as well

Oil revenues

Revenue stream from oil will remain the major source of government financing in 2021 as well. The government is heavily dependent on ARAMCO when it comes to total oil-revenues. three main sources of oil revenues are: (I) ARAMCO's dividend, (II) Royalties and (III) ARAMCO's income tax. The oil giant remains firm in its commitment to provide its shareholders (KSA owns 98.2% of the company) with an annual USD 75bn dividend (SAR 281bn). For calculating corporate tax, we have used consensus estimates of ARAMCO's earnings and profit before tax available from Bloomberg while estimate for Royalties is based on expected oil prices, and expected oil production of the Kingdom. Our estimate assumes average oil prices at USD 46/b (+ 9.7% YoY) and production of 9.4 mb/d (+ 2.7%). All in all, we expect oil-revenues to post a recovery of 17% YoY in 2021 to SAR 480bn.

The global pandemic brought the world to a standstill in 1Q2020. The ensuing drop in oil demand and supply indiscipline by major oil exporters sent Arab light prices crashing down to USD 13.3/b in April-2020. Since then, the oil market has stabilized thanks to OPEC+ announcement to cut productions and recent discovery of COVID-19 vaccine which has helped oil prices to recover by 262% to USD48.2/b from its lows earlier in the year. We believe that steady resumption of global economic activity and OPEC+ cooperation to gradually roll back production cuts are likely to keep oil prices range bound

ARAMCO's payment to the KSA – Oil Revenues

SARbn	2018	2019	2020E	2021F	YoY
Income Tax	180	150	82	116	35.7%
Royalties	214	170	75	89	12.7%
Dividends	218	274	255	275	7.7%
Total Oil Revenue	**611**	**594**	**412**	**480**	**14.3%**

Source: ARAMCO, Bloomberg, PSU-CFS Estimates

Tax revenues

Government expects tax revenues to grow by 31% accounting for 30% of total revenues in 2021 vs 25% in 2020

The government expects tax revenues to be a major driver of growth in total revenues in 2021. Overall, the government expects tax revenues to grow by 31% accounting for 30% of total revenues in 2021 vs 25% in 2020. In the absence of any major change in the tax incident in 2021 budget, future growth in tax revenues will primarily be driven by combination of; (I)impact of tax measures introduced during 2020 (increase in Value Added Tax and Custom Duty), and (II) rebound in economic activity in the country post easing of COVID-19 related restrictions.

Tax Revenue Trend

SARbn	2018	2019	2020E	2021E	Year-on-Year
Tax on Income, profit, capital gain	17	16	16	13	-19%
Tax on goods & services	87	141	141	209	48%
Tax on International Trade & Transaction	16	17	16	17	6%
Other	21	29	23	18	-22%
Tax Revenue	**141**	**203**	**196**	**257**	**31%**

Source: Budget Statement 2021, 2021 is PSU-CFS Estimates

Non-tax, non-oil revenues

We estimate non-tax, non-oil revenues to contribute SAR 112bn in 2021

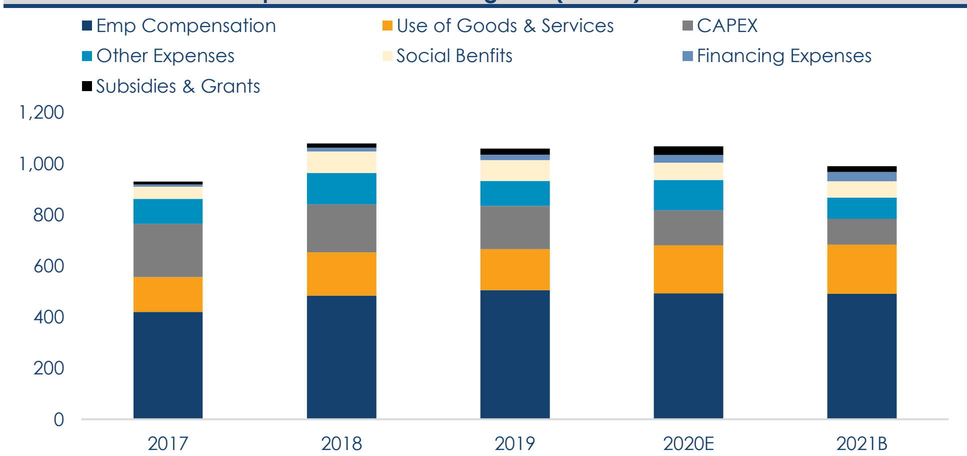
As per the given details in Budget 2021, this source of revenues is estimated to have contributed SAR 162bn or 21% of total revenues in 2020. Non-tax, Non-oil revenues (property income, sales of goods & services, fine, penalties, privatization, dividend on government investment, etc) jumped 44% YoY and contributed heavily in cushioning the decline in total revenues in 2020 with privatization proceeds and dividend on government investments believed to be a source of major surprise. Based on our estimates of oil revenues and government's estimate of total tax revenues, we estimate non-tax, non-oil revenues to contribute SAR 112bn in 2021.

Expenditure-Pruning all around

Government targets 5% drop in current expenditure while capital expenditure has been cut by 26% in 2021

Reversal of all major expenditure heads to pre-COVID-19 level, except for Goods & Service and Interest Payment, will likely drive a 7% drop in total expenditure to SAR 990bn (or 35% of 2021 GDP). The details of expenditure show the government is targeting 5% drop in current expenditure while capital expenditure is expected to see a significant reduction of 26% in 2021. Government is set to maintain focus on bringing more spending efficiency in both non-developmental expenditure and social expenditure. Compensation for Employees, the single largest head in the expenditure with 50% contribution in total expenditure, is expected to remain almost unchanged for the fourth consecutive year. Interestingly, government targets SAR 63bn expenditure under the head of social benefit in 2021, reflecting only 5% YoY drop despite withdrawal of cost of living allowance in 2020. Higher medical purchases and associated expenditure on COVID-19 drove a 17% YoY jump in Goods & Service in 2020. The government has rightly provisioned for continued elevated level of health expenditure in 2021, in our view.

7% reduction in total expenditure in 2021 targeted (SARbn)



Source: Ministry of Finance

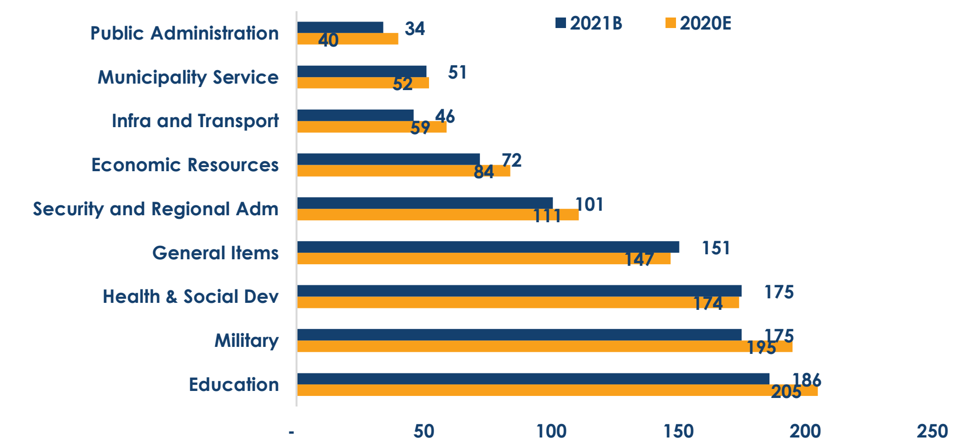
Cost of debt in 2021 budget is still a small portion (4% of total) of overall expenditure

We highlight cost of debt in 2021 budget is still a small portion (4% of total) of overall expenditure despite increase in overall stock of debt in 2020 and expected additional debt in 2021 (cumulative 38% jump from 2019). This is due to interplay of lower interest rate and relatively modest debt/GDP ratio for the Kingdom. However, it is interesting to note the sensitivity of financial expenses and fiscal deficit to change in interest rate has increased given the level of debt. For every 100bps jump in interest rate we estimate SAR 9bn increase in financing expenses, equivalent to 30bps of projected nominal budget in 2021.

Sector-wise expenditure

A key takeaway from analysis of sector-wise expenditure and expenditure by major heads reveal that the developmental expenditure in almost all sectors appears to have been adjusted in view of prevailing global economic environment and risks associated with battle against COVID-19. Budget allocation for Education sector has been trimmed by 9%. This, in large part, is explained by expected lower expenditure for the delivery of online education, in our view. Allocation for Health & Social Development Sector has been kept at elevated levels in 2021 Budget despite a major slippage in 2020 budget as the government eyes continued higher expenditure under this head to combat COVID-19. Taken together, Education and Health & Social Development account for 36% of total expenditure or 13% of GDP in 2021. Another key highlight of sector-wise budget allocation is 10% reduction in Military expenditure in 2021 to SAR 175bn (6% of GDP). The full-year impact of suspension of cost of living allowance in 2020 and government's other initiatives on spending efficiency are expected to deliver lower expenditure under this head in 2021.

Expenditure Profile – Sector Wise (SARbn)



Source: Ministry of Finance

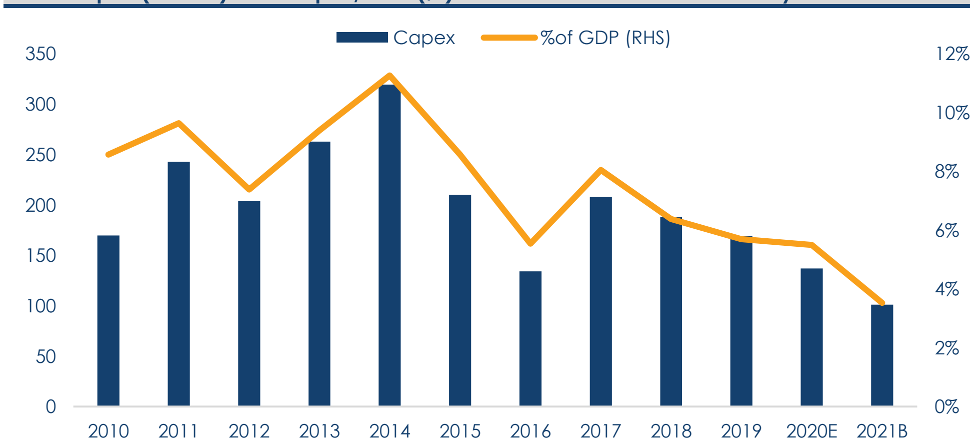
CapEx-major reallocation done

Key areas for CapEx allocation include municipal services, health, education, infrastructure and transportation

The fiscal budget has set a significantly lower allocation for capital expenditure (CapEx) on non-financial assets of SAR101bn (or 3.5% of GDP) in 2021 down 26% vs actual spending in 2020. In absolute and relative term (% of GDP), allocated CapEx in 2021 is at the lowest level since 2006 and 2000 respectively. Interestingly, both periods (2000, 2006) were marred by higher fiscal deficit. Key areas for CapEx allocation include municipal services, health, education, infrastructure and transportation. Lower capital expenditure allocation is justified in view of the following;

- Higher base of CapEx in previous years,
- Higher expected participation from state-owned investment companies in Vision Realization Program and mega projects
- Engagement of private sector in the projects which is in-line with government's strategy for higher contribution of private sector in the key areas of economic development and ongoing economic reforms

Total CapEx (SARbn) and CapEx/GDP (%) have trended down in recent years



Source: Budget Statement 2021, Bloomberg

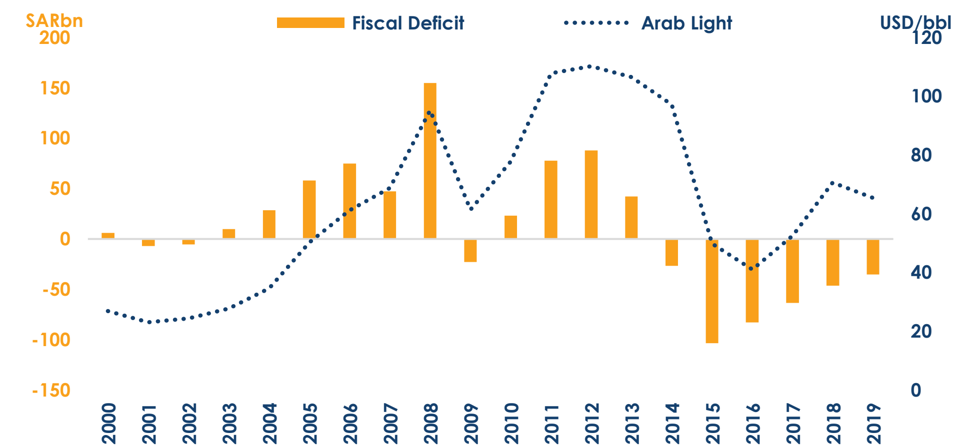
Return to Fiscal Consolidation

Government expects fiscal deficit in absolute term to shrink by more than 50% YoY in 2021 to SAR 141bn or 4.9% of GDP in 2021 vs 12% in 2020

The combination of 7% drop in budgeted expenditure and 10% growth in total revenues is expected to deliver significant fiscal consolidation in 2021. The government expects fiscal deficit in absolute term to shrink by more than 50% YoY in 2021 to SAR 141bn (or 4.9% of GDP in 2021 vs 12% in 2020). In view of current currency peg, achieving a manageable level of fiscal deficit remains crucial in order to ensure economic stability in medium to long-term and avoid unwarranted consequences. Given our views on government's revenues estimates and projected levels of expenditure, we believe the fiscal targets in 2021 are broadly achievable.

Interestingly, fiscal targets set under the government's medium term projections are broadly unchanged for the year 2022 & 2023 compared to estimates in the previous budget which implies a sharp fiscal consolidation from the levels in 2020. Besides lower spending on combating COVID-19 and stimulus package, lower CapEx requirement on ongoing projects and revenue growth (via increase in oil production + higher tax revenue) will likely contribute significantly in limiting deficit in medium-term.

Fiscal Deficit and Arab Light Prices



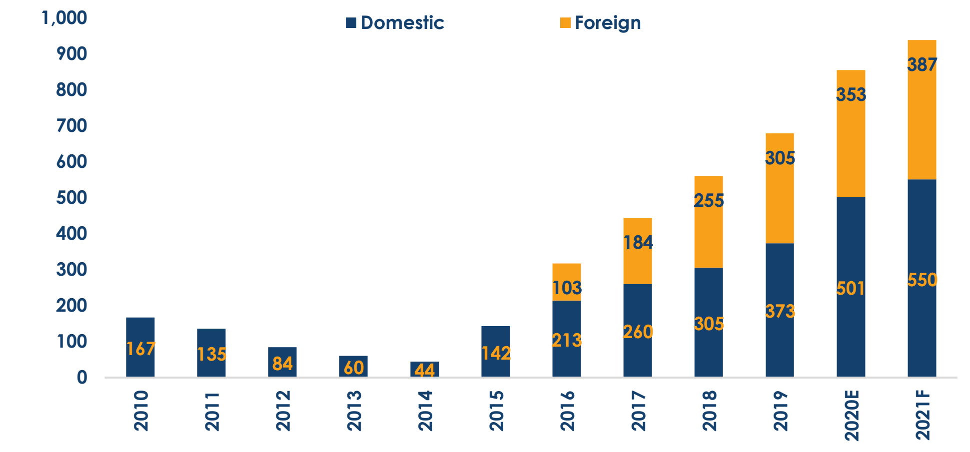
Source: Ministry of Finance, Bloomberg

Financing of fiscal deficit-a balanced mix

A balanced mix of borrowing and reserve drawdown is expected to fill the financing gap in 2021

The government has relied heavily on debt issuance for financing of deficit in 2020. Given the government's year-end estimate of stock of public debt of SAR 854bn, debt accumulation is expected to contribute up to 58% of total financing in 2020. Lower cost of debt and relatively low levels of leverage (debt/GDP of 23% in 2019), seem to be key reasons for the shift in government's strategy on funding of fiscal deficit towards borrowing unlike the most recent period of low oil prices in 2014-16 when major part of financing came from reserve drawdown. Similar to 2020, a balanced mix of borrowing and reserve drawdown (58/42% respectively) is expected to fill the financing gap in 2021.

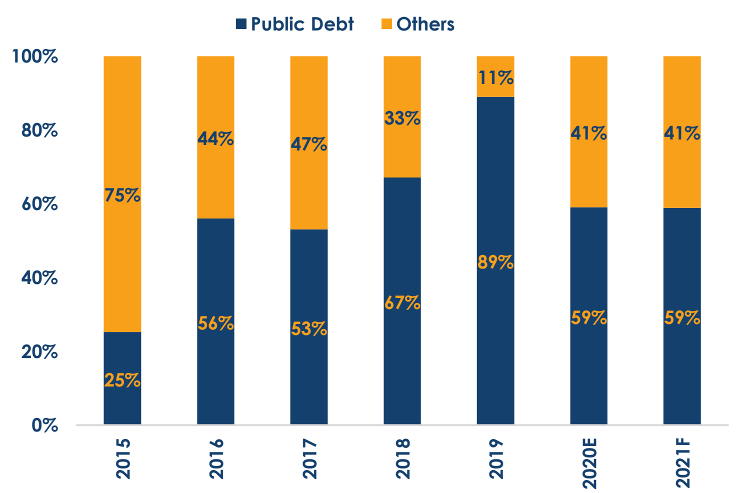
Debt Profile (SARbn)



Source: Ministry of Finance, SAMA Annual Statistics 2019

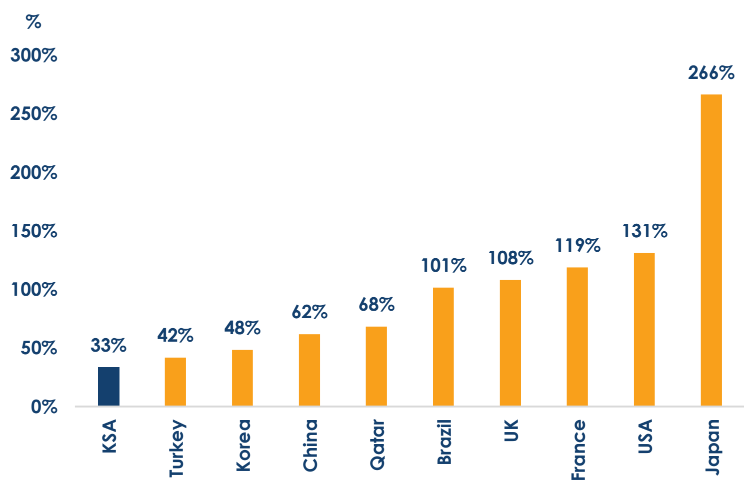
The government expects to achieve debt to GDP ratio of 33% in 2021 and 32% by 2023 via control over deficit and growth in nominal GDP. Despite significant borrowing in the past few years, the Kingdom's economic strengths are little impacted. We base our view on; (i) KSA's debt to GDP ratio remains significantly below relative to its peers in Emerging and Developed Markets and (ii) significant foreign exchange reserves with the central bank and access to liquid assets of state-owned companies.

Sources of Funding



Source: Ministry of Finance

Gross Debt to GDP (%)



Source: Ministry of Finance, SAMA Annual Statistics

Macroeconomic Outlook & Medium-term estimates

Growth Set to Rebound

Government expects real economic activity to rebound by 3.2% in 2021 following a steep drop of 3.7% in 2020

The government expects real economic activity to rebound by 3.2% in 2021 following a steep drop of 3.7% in 2020. The rebound in economic activity in 2021 is likely driven by both Oil and Non-oil segment of economy. Non-oil private sector, which accounts for a significant 42% of overall GDP, is expected to see significant rebound in activity in 2021 due to:

i. Timely and proactive decisions by authorities to combat the COVID-19 pandemic and limiting its associated health and economic costs thereby ensuring medium & long-term economic stability

ii. Government's supportive policy backdrop as part of its efforts to further diversify the economy

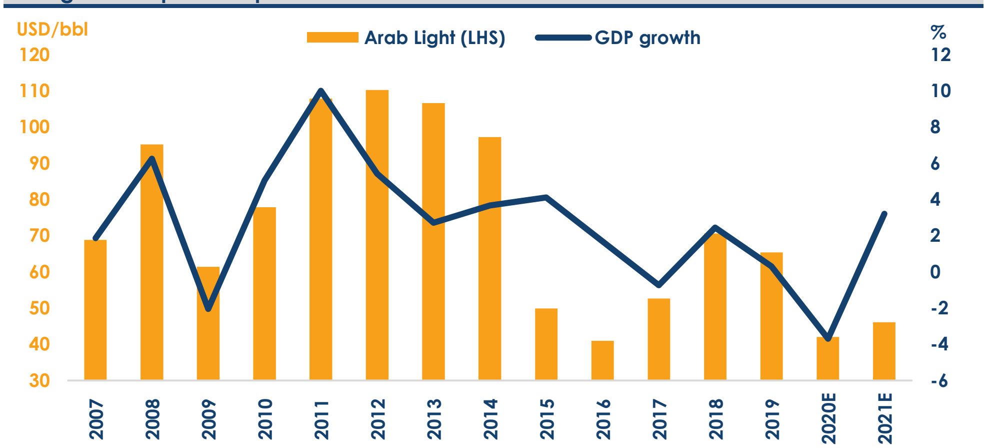
iii. Increased role of development funds in development projects in cooperation with the private sector

iv. and low-base effect in 2020 due to drop in GDP

Oil market appears to have gained a new equilibrium under OPEC+ arrangement and prevailing global oil demand dynamics

Growth in oil sector, however, hinges on improvement in global economic outlook and associated oil demand growth. Overall, World Bank estimates global GDP growth to rebound by 5% in 2021 following a near-collapse in economic activity in 2020 (4.4% drop in GDP). Oil market appears to have gained a new equilibrium under OPEC+ arrangement and prevailing global oil demand dynamics. Prospects of rebound in global economic activity and recovery in oil demand in 2021 remain high, primarily supported by development of multiple vaccines for COVID-19 infection. We estimate overall global oil demand to jump by 6.6% in 2021 which will likely allow OPEC+Alliance to ramp up production by 10-12% in 2021.

GDP growth dips as oil prices decline



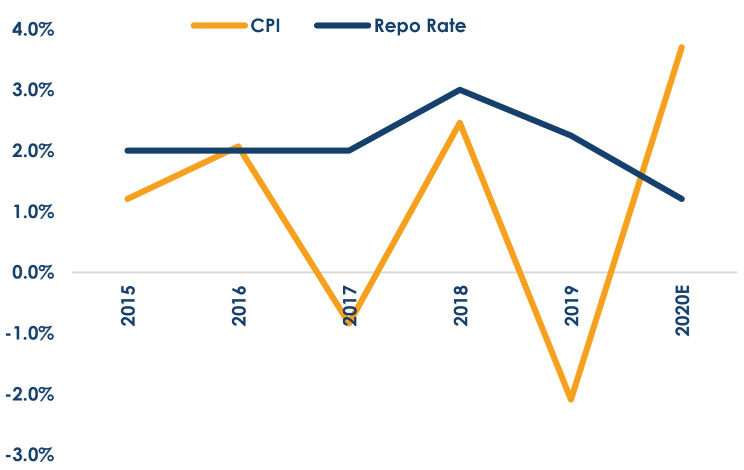
Source: Budget Statement 2021, Bloomberg

Recent policy measures to drive CPI

Government has also set inflation target of 2.9% in 2021 vs estimated inflation of 3.7% in 2020

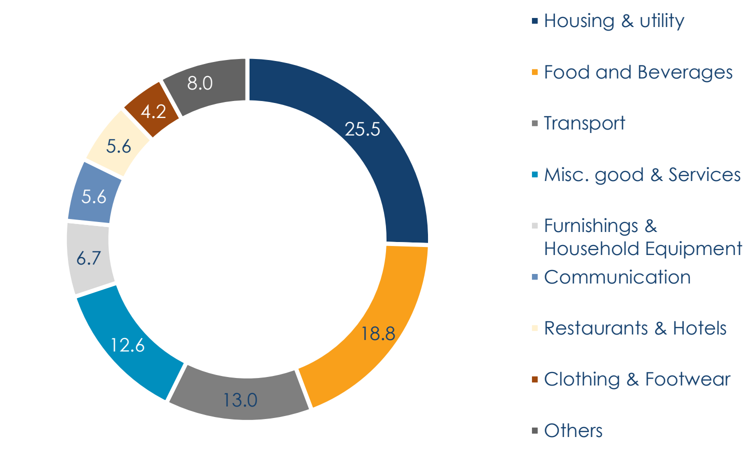
The government has also set inflation target of 2.9% in 2021 vs estimated inflation of 3.7% in 2020. Imposition of Value Added Tax, and other policy measures in the wake of outbreak of pandemic, coupled with higher Food Inflation, were the key drivers of inflation in 2020. Housing index (which comprises of housing, water, gas, electricity and other fuels) has trended down in the first eleven months in 2020 primarily due to consistent drop in rentals. However, rest of the sub-categories within the index has increased primarily due to imposition of VAT. Monthly trends in key indices of CPI reveal broad moderation in inflation trends, including Food & Beverages, post imposition of VAT in July 2020. Housing Index however show a persistent drop. We opine government inflation estimates are achievable in 2021.

Real Interest Rate likely to remain in negative territory in 2021



Source: Budget Statement 2021, SAMA Annual Statistics 2019

Weights of Key Components in CPI Basket



Source: General Authority of Statistics

Medium-term estimates recalibrated

Government now expects real GDP to grow at faster pace than its previous forecasts carried in Budget 2020 for the similar periods

The government has also rolled out medium-term growth and inflation estimates. The government has set GDP growth estimates at 3.4/3.5% for 2022/2023 and inflation estimates at 2.0/2.0% respectively. Interestingly, the Government now expects real GDP to grow at faster pace than its previous forecasts carried in Budget 2020 for the similar periods. Overall, total GDP size (on constant price) is estimated to be higher by 1.0/1.1% for 2021/22 respectively in 2021 Budget compared to estimates given in 2020 Budget. Government's medium-term growth strategy is heavily reliant on a lead role of the private sector, consistent with the government's strategy of diversification of economy away from oil, and economic return from government's investments in major projects. Real growth in oil sector will likely remain modest and volatile, reflecting the broader trends in global oil demand.

Beyond the divergent impact of VAT imposition and drop in rentals, medium-term CPI outlook will likely be driven by the timing and the scale of much-expected price reforms in regulated utilities sectors, removal of import subsidy in certain food items and stability in current rate of VAT, in our view.

Key Economic Indicators in medium Term

%	2018	2019	2020E	2021B	2022P	2023P
Real GDP growth	2.4%	0.3%	-3.7%	3.2%	3.4%	3.5%
Nominal GDP (SARbn)	2,949	2,974	2,486	2,866	3,042	3,232
Nominal GDP Growth	14.2%	0.8%	-16.4%	15.3%	6.1%	6.3%
Inflation	2.5%	-2.1%	3.7%	2.9%	2.0%	2.0%

Source: Budget Statement 2021

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