Tharaa Financial Center

Budget 2023 December 2022

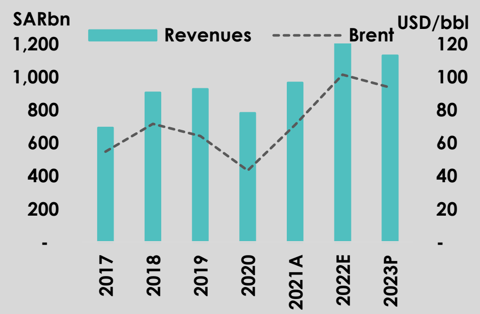
Building sustainability

KSA's Fiscal Budget 2023 Snapshot

SARbn	2022E	2023P	YoY
Total Revenue	1,234	1,130	-8.4%
Total Expenditure	1,132	1,114	-1.4%
Budget (Deficit)/Surplus	**102**	**16**	**-84.6%**
Budget Surplus (% of GDP)	**2.6%**	**0.4%**	**-220bps**
Public Debt	985	951	-3.5%
Public Debt (% of GDP)	24.9%	24.6%	-1.2%

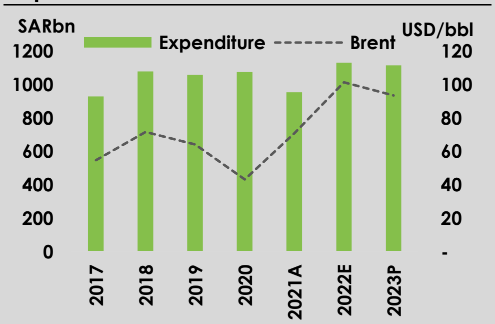
Source: Budget Statement 2023

Revenue Trend



Source: Ministry of Finance, Bloomberg

Expenditure Trend



Source: Budget Statement 2023, Bloomberg

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Budget 2023: Consolidation in the bag; sustainability eyed

The recently released Budget Statement for 2023 incorporates minor tweaks (revenues, fiscal deficit, and growth) to estimates rolled out as part of preliminary statements in Oct-22. Following a strong year in growth (highest growth since 2011, size of GDP surpassing USD1trn mark for the first time), external (CA Surplus: 15.1% of GDP in 2022 vs. 5.4% in 2021), fiscal account (first fiscal surplus since 2013) and public debt (510bps drop in Debt/GDP), authorities are clearly focused on consolidating gains and building capacity for future sustainable growth via implementations of fiscal discipline and meaningful progress on a number of initiatives/targets under the Vision 2030.

Key aspects of Budget 2023 include; (i) projection of sustaining fiscal surplus over medium-term under conservative assumptions, (ii) trending down inflation to 2% (food prices normalizing +controlled commodity prices), GDP growth (high base-effect+ post COVID-19 normalization of economic activity) and (iii) higher medium-term expenditure ceiling (driven structural change in revenue profile). The upside and downside risks to estimates appear balanced in near-term.

Strong growth despite higher base, tough external environment

The MoF has made small revisions to 2022 (+0.5% to 8.5%) and medium-term GDP estimates. Largely, KSA growth momentum is set to moderate in 2023 following a strong acceleration in 2022 and expected dynamics of oil market. However, growth momentum is likely to pace up in the medium-term on the back of materialisation of a number of government initiatives, supported by PIF and NDF in spurring investment in strategic sectors crucial for delivery of objectives under the Vision 2030, and growing role of private sectors. CPI estimates for the medium-term (2.6/2.1%) are broadly unchanged. Regulated prices, stable currency regime and no major flare-up in food prices likely underpin normalization of CPI though risk of possible upside remains.

Fiscal Targets: Surplus seen despite higher expenditure ceiling

Given more visibility in non-oil revenues, the MoF has now pencilled higher fiscal surplus in both 2022 and 2023 relative to its earlier projections. The ministry projects fiscal surplus to sustain over the medium-term in the baseline scenario. Expenditures are projected to range SAR1.1-1.3trn over 2023-2026 (or 27-29% of GDP). Revenues are projected at 28-29% of GDP and implied oil prices under the base-line scenario of estimated USD75/bbl (USD70-72 in Pre-Budget 2023). Relative to start-of-the-year estimates in 2022, revenues generation (SAR189 or 18%) is expected to surpass expenditure overrun (SAR176bn or 18%), allowing delivery of higher fiscal surplus. That said, medium-term estimates leave room for upside risks for revenues from three sources; (i) higher oil prices, (ii) revision in Aramco dividend, & (iii) preponing of major oil projects.

Fiscal surplus to be used for higher fiscal sustainability

MoF has guided for the three key areas for utilizing projected fiscal surplus as; (i) rebuilding further fiscal cushion (reserves 29 import cover in Sep-22 vs. an average of 38M since 2017) in order to enhance fiscal sustainability, strengthening public funds and accelerating projects of strategic importance. The MoF has proposed sticking to its strategy of repaying the debt principals from fresh borrowing. Overall debt in 3Q is quoted at SAR972bn (24.7% of GDP), down from Dec-21 levels of 30%. During 9M22, MoF has made timely additional borrowing over & above 2022 repayments in order to save interest cost from interest rate hike Assuming MoF sticks to its strategy of maintaining debt level, Public debt/GDP is expected to drop to 22.6% by 2025. This is in-line with our estimates (Pre-Budget 2023).

Key risks ahead

The four key risks to MoF projections stems from; (i) any risk to global economic growth as major economies deal with record inflation and reversal of COVID-era monetary stimulus (ii) dynamics of oil markets, (iii) any regional or global COVID-like challenge, and (iv) delays in major projects or non-materialization of anticipated benefits.

From turnaround to sustaining momentum

The Budget 2023 document is presented in the backdrop of a strong performance in 2022 in almost all key economic and socioeconomic indicators

The Saudi Cabinet has recently approved Budget 2023 with small tweaks to the Pre-Budget proposal presented in early Oct-22. The Budget 2023 document is presented in the backdrop of a strong performance in 2022 in almost all key economic and socioeconomic indicators. GDP growth is set to clock in at 8.5% per latest estimates, highest since 2010) while the size of GDP is projected to surpass a much-coveted USD1trn mark for the first time in the country's history. The external account will likely have a big turnaround with Current Account Surplus expected at 15.1% of GDP in 2022 vs. 5.4% in 2021. More importantly, the fiscal account is set to show the first fiscal surplus since 2013 while the public debt- a key worry at the peak of COVID-19, is projected to drop to 24.7% of GDP from the peak of 32.5% in 4Q20. The unemployment rate among Saudi has slipped to 9.7% by the end of 2Q22, lowest since 2002, reflecting the strong momentum in economic activity, particularly in the private sector.

The Budget 2023 clearly demonstrates authorities' aspirations to further build on the strong momentum of economic activity in the aftermath of COVID-19 and fiscal consolidation in order to accelerate progress towards achievement of goals set under Vision 2030. Overall, the Budget 2023 targets;

(i) Continuation of fiscal surplus to sustain over the medium term which will further strengthen fiscal sustainability,

(ii) Normalization of GDP growth in 2023 from a high of 8.5% in 2022 (highest GDP growth among G20 countries) to 3.1% in 2023 (one of the highest)

(iii) Upward revision in medium-term expenditure ceiling (likely driven by higher allocation for capital expenditure and subsidy benefits), matched by upward revision in revenue profile

The Ministry of Finance's (MoF) estimates for revenues are rightly based on conservative set of assumptions in view of uncertainty associated with the global economic growth and the geopolitics uncertainty. Overall risks to estimates appear balanced in near-term.

GDP: from acceleration to consolidation

The MoF has revised up its 2022 GDP estimates to 8.5% from 8% but left 2023 growth estimates unchanged at 3.1% even with higher base of 2022

The MoF has revised up its 2022 GDP estimates to 8.5% from 8% but left 2023 growth estimates unchanged at 3.1% even with a higher base of 2022. Medium-term estimates carry small trimming though. GDP Growth in 2022 is driven by both engines of the economy as the oil segment is expected to record 19% growth while the non-oil sector (wholesale & retail, restaurants & hotel) is projected to grow at 5.9%. Looking ahead, the key drivers of GDP are likely to undergo a shift with non-oil sectors, private sector in particular, taking a relatively stronger role in driving GDP growth while oil sector may take a backseat in view of emerging dynamics in the sector.

Three key undercurrents for higher contribution of non-oil GDP growth are;

- **Ramp up in investment as a result of a number of structural reforms and initiatives.** Private sector will likely remain a major source of future growth as the government implements a multi-prong strategy which encompasses tapping of existing potential in key industries, opening-up new sectors and enhancing the role of private sector via privatization and PPP
- **Higher consumption (total contribution of 55% in GDP):** Both government (higher expenditure ceiling) and private sector consumption (purchasing power+ higher employment + increase in population) are likely to contribute to higher GDP growth. The complete recovery in the tourism and travel segment following removal of COVID-19 related restrictions will also contribute to overall economic activity. Besides, the start of new tourism attractions in 2023 and onward will also support the contribution of the tourism sector in the overall GDP.
- **Contribution from PIF and NDF:** The role of Public Investment Fund (PIF) and National Development Fund (NDF) remain crucial in spurring investment in strategic new sectors crucial for delivery of objectives under vision 2030. PIF is expected to contribute

SAR150bn/annum until 2025 while NDF is expected to contribute on average SAR70bn through to 2030.

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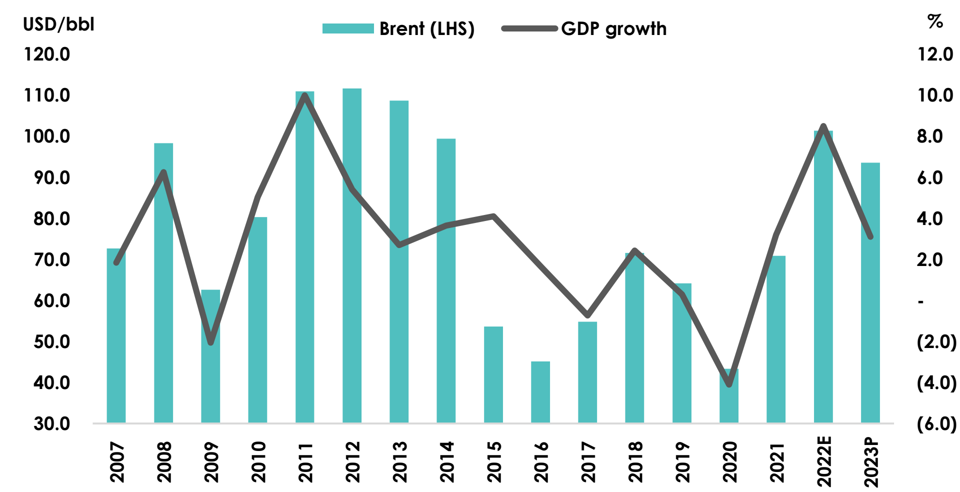
Key Economic Indicators in Medium-Term

%	2020	2021	2022E	2023P	2024P	2025P
Real GDP growth	-4.1%	3.2%	8.5%	3.1%	5.7%	4.5%
Nominal GDP (SARbn)	2,625	3,126	3,957	3,869	3,966	4,247
Nominal GDP Growth	-11.7%	19.1%	26.6%	-2.2%	2.5%	7.1%
Inflation	3.4%	3.1%	2.6%	2.1%	2.1%	2.0%

Source: Budget Statement 2023, Bloomberg, Tharaa

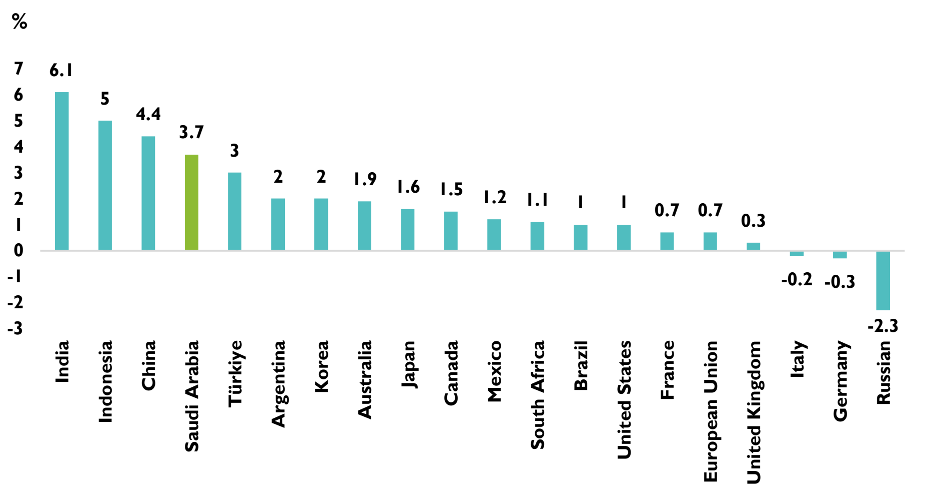
GDP growth set to normalize in 2023 post a steep rise in 2022



Source: Budget Statement 2023, Bloomberg, Tharaa

Saudi Arabia is set to be one of the fastest growing economies in 2023 following a strong spurt of growth in 2022

Saudi Arabia is set to be one of the fastest growing economies in 2023 following a strong spurt of growth in 2022 (2023 GDP Growth of G20 Economies)



Source: IMF Estimates, Tharaa

KSA is set to achieve a much-coveted landmark of USD1trn economy in 2023

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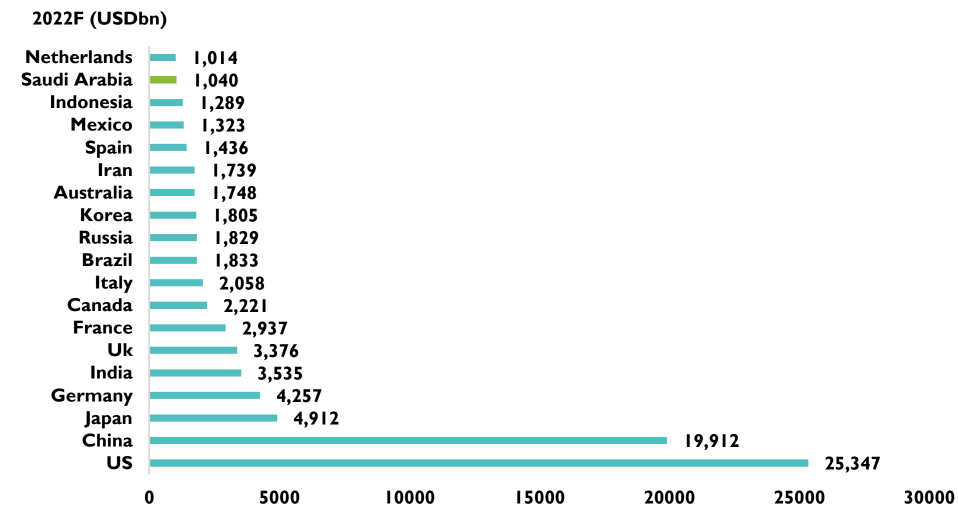


Source: IMF Estimates, Tharaa,

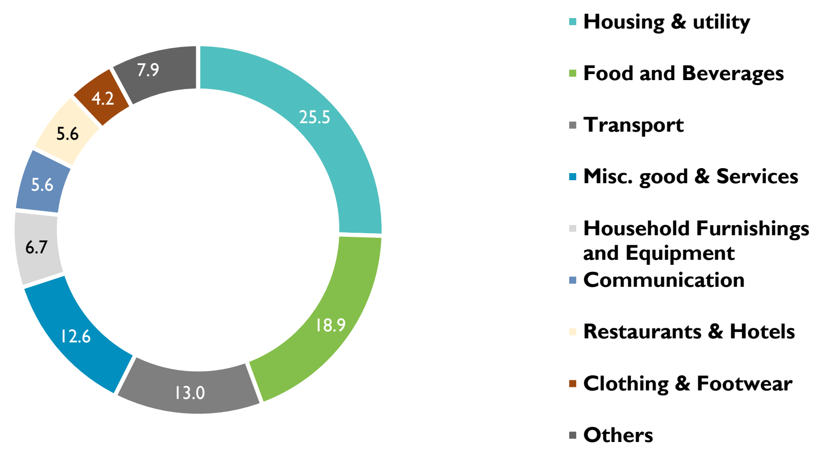
The oil market dynamics look less favourable now relative to environment seen at the start of 2022 due to two reasons; (i) non-OPEC supply side is responding to strong pricing signal and projected to contribute heavily to future demand growth, (ii) headwinds to demand growth in the form of uncertain timing and shape of economic re-opening in China and restrictive monetary and fiscal policies adopted by most of developed world. That said, the geopolitical conflicts which has constrained capacity of big oil producers to operate at optimal levels, the need for rebuilding of the U.S strategic oil reserves (running at the lowest levels since 1984) and potential further addition in strategic reserves in India and China, and production constraint faced by many OPEC+ members will likely keep dependence on oil from OPEC countries in general and Kingdom in particular high and hence may largely cushion KSA from potential drop in global oil demand.

CPI to normalize; big positive real interest on the cards

The MoF has set an inflation target for 2023 of 2.1% against an estimated inflation rate of 2.6% for 2022 and average inflation of 2.3% for 10M 2022

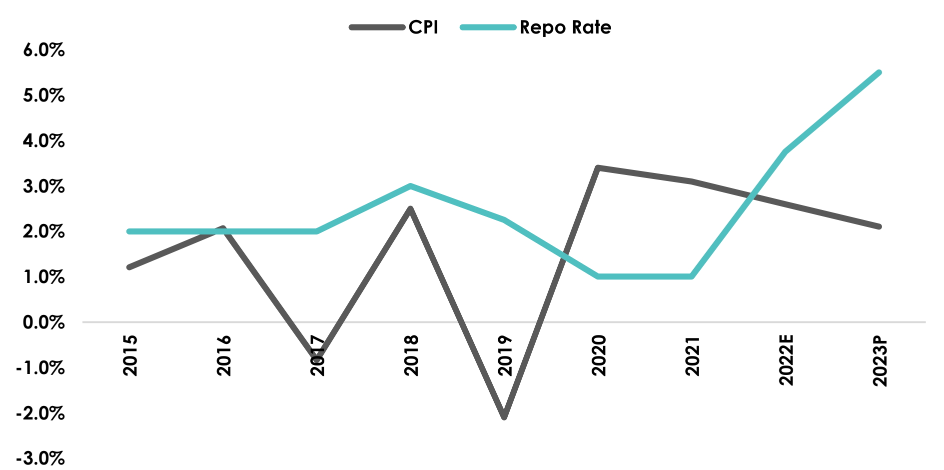
The MoF has set an inflation target for 2023 of 2.1% against an estimated inflation rate of 2.6% for 2022 and average inflation of 2.3% for 10M 2022. The moderation is inflation is in-line with the similar projections for G20 countries. This annual inflation target imply a monthly inflation rate of ~0.11% for 2023 vs. an average of 0.29% and 0.2% MoM inflation in Nov-22. The inflation targets look slightly optimistic, in our view. The drop in energy prices from the peak is unlikely to impact CPI in a big way given prices are already set under the regulated regime at a much-lower oil price benchmark. The moderation of global food prices (FAO Index is down 15% from its peak in Mar-22) is supportive for the moderation in inflation along with easing of freight and shipping costs. However, the house rent index, which have had a relatively benign contribution to CPI in recent years despite having significant weight of 20%, has started to creep up (monthly 0.4% rate for 10M22) and remains the single largest source of upside risk to CPI estimate which can dilute the impact of drop in both food prices and freight cost.

Weights of Key Components in CPI Basket



Source: Budget Statement 2023, Bloomberg

Significant positive interest rates in KSA are likely over 2022-2023



Source: Budget Statement 2023, Bloomberg, Tharaa

The persistence of positive real interest rate in the Kingdom (2.75-3%) for an extended period beyond 2023 is a major corollary of a benign inflation environment in KSA relative to the US and currency peg

It is worth highlighting a major corollary of a benign inflation environment in KSA vs. the U.S, base currency for SAR currency peg, is the persistence of positive real interest in the Kingdom for an extended period given; (i) current outlook of inflation and interest rates in the U.S, and (ii) expectations of mirroring the movement in interest rate in the U.S by the central bank in the Kingdom in order to avoid complication with the arbitrage opportunities. Current consensus estimates build in Fed Fund Rate of 4.75-5% by mid-2023, suggesting at least further 75-100bps hike in interest rate from current levels of 4.00% (upper bound). This implies a positive real interest rate of 2.75-3% in KSA over 2023.

Higher real interest rates in KSA, coupled with effective currency appreciation, could have implications for trade, investment, and consumption.

Higher real interest rates in KSA, coupled with effective currency appreciation under the pegged regime may have multiple implications for KSA's trade (export competitive particularly for non-oil exports), investment (cost of capital) and consumption (Cost of borrowing for consumer + higher rate encourages more saving and deters consumption). On their part, the authorities have already rolled out a number of programs to encourage investment via subsidized cost of capital and other support measures. Easing of export tariff for products with heavy energy use could be another policy measure to support exports of non-oil segment.

A review of 2022 CPI

The MoF's estimate for 2022 is in line with its expectations following the increase in average growth in the consumer price index since the beginning of the year until Oct-22, at a rate of 2.3% compared to the same period of the previous year. Several categories witnessed an increase for 3Q22. The highest increase among the main categories of the general index was recorded in restaurants and hotels witnessed at 7.1%, followed by education by 5.7%. While the real estate index continued to increase from the beginning of the year until the end of September at a rate of 0.9% compared to the same period in the previous year,

It should be noted that global inflation rates were greatly affected during the year 2022, and the noticeable rise in inflation rates globally is noted as a result of geopolitical repercussions and disruption of supply chains, which greatly affected the prices of foodstuffs, priority commodities, and transport prices in particular.

Despite the crises that the world is witnessing, the durability and strength of the Saudi economy enabled it to counter the effects of inflation in the Kingdom for the year 2022, as the Kingdom witnessed the lowest inflation rate among G20 countries. The initiatives to mitigate the effects of inflation in the Kingdom were highly effective, in particular fixing the ceiling on the local price of gasoline as well as allocating financial support in the amount of SAR20 billion to three programs and allocating the remainder of the support amount, amounting to 6.9 billion riyals, for an increase in strategic stocks of basic materials and ensuring their availability to face the repercussions of rising prices globally.

Fiscal Account: Surplus seen despite higher expenditure ceiling

Relative to the Pre-Budget 2023 proposal, the authorities have made small upward revisions to 2022 and 2023 revenue and fiscal surplus estimates while have left 2024/2025 revenue/expenditure and fiscal surplus estimates unchanged. The revisions appear to be based on a strong oil price environment since the release of the previous estimates.

KSA's Fiscal Budget 2023 Summary & Medium-Term Fiscal Projections

SARbn	2020	2021	2022E	2023P	2024P	2025P
Total Revenue	782	965	1,234	1,130	1,146	1,205
Total Expenditure	1,076	1,039	1,132	1,114	1,125	1,134
Budget (Deficit) / Surplus	-294	-73	102	16	21	71
Budget (Deficit) / Surplus (as % of GDP)	-11.2%	-2.3%	2.6%	0.4%	0.5%	1.7%
Nominal GDP (SARbn)	2,625	3,126	3,957	3,869	3,966	4,247
Public Debt	854	938	985*	951*	959*	962*
Public debt (as % of GDP)	32.5%	30%	24.9%	24.6%	24.2%	22.6%

Source: Budget Statement 2023
2022: Government Estimate, P: Projected

A key highlight of medium-term estimates remain projection of recurring fiscal surplus even under conservative base-line scenario

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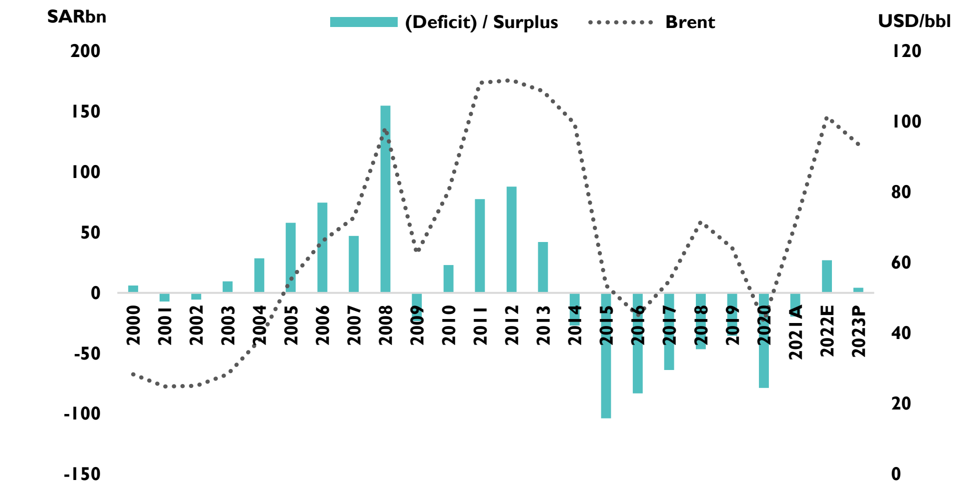
- KSA is set to make its first full year fiscal surplus in 2022 since 2013, at least two year ahead of estimates rolled out in 2021. Fiscal surplus for the first 9M22 has already clocked in 3.8% or SAR150bn. In 4Q22, the Kingdom can have another quarter of fiscal surplus with higher tax revenues offsetting relatively soft oil revenues. The average oil prices have softened in 4Q to USD90/bbl compared to average prices of USD103/bbl in the first three quarters. Besides, the Kingdom has made small cut to its oil production in line with OPEC+ agreement.
- For 2023, the estimate of fiscal surplus of SAR16bn faces upside risk from higher oil revenues (see discussion below on 2023 revenue forecast).
- For 2024/25, the projection appears to have built in higher GDP growth and better oil dynamics

Fiscal Deficit an Oil Prices



Source: Budget Statement 2023, Bloomberg, Tharaa

Under the projected numbers, KSA is set to go a sustained period of fiscal surplus similar to periods seen over 2010 to 2013 (average surplus of 8.4% of GDP, average oil prices of USD100/bbl, average GDP growth of 6%) and over 2003 to 2008 (average surplus of 12.4% of GDP, average oil prices of USD56/bbl, average GDP growth of 6%).

Comparison of economic indicators during periods of sustained fiscal surplus since 2000

	2003-2008	2010-013	2022-2025
GDP (Real)	5.9%	5.9%	5.5%
Fiscal Surplus (% of GDP)	17.6%	8.6%	1.3%
Oil Prices (USD/bbl)	59	101	74-76
Revenues (% of GDP)	46%	42%	29%
Oil	41%	39%	18%
Non-Oil	6%	4%	11%
Expenditure (% of GDP)	29%	34%	28%
Avg Annual Revenues (SARbn)	611	1,064	1,179
Avg Annual Exp (SARbn)	378	848	1,126
Avg Annual Nominal GDP (SARbn)	1,322	2,514	4,010

Source: Annual Statistical Bulletin, Budget Statement 2023, Tharaa

Expenditure

Expenditure over medium-term is expected to average 27-29% of GDP (SAR1.1trn)

The MoF has made no change in its 2023 estimate for total expenditure of SAR1,114bn (29% of GDP) first presented in the Pre-Budget 2023. Furthermore, the MoF has also left its medium-term fiscal projections unchanged. The total expenditure budgeted for the coming year is expected to fall by a nominal 1.6% from the revised 2022 estimate of SAR1132bn. The drop is primarily led by decline in goods and services expenditure (-8.5%). Capital Expenditure is projected to further ramp up in 2023 to SAR157bn (4.5% of GDP) in 2023 from SAR151bn (3.8% of GDP) in 2022. Looking at the details of expenditure profile, three areas of major overrun of expenditure relative to 2022 budgeted estimates are; (i) military, (ii) health and (iii) economic resources. Cumulatively, the heads account for 87% of overrun in the total expenditure.

For the medium-term, the MoF has carried a higher expenditure ceiling and expects expenditure to broadly remain steady (27-28% of GDP).

Sequentially, the MoF estimates 28% growth in 2022 and 8.4% drop in total revenues.

Revenues

The MoF has further tweaked up its budgeted revenues by 1% (to SAR1234bn or 31% of GDP) for 2022 and 1% (to SAR1,146bn or 29% of GDP) for compared to its estimated carried in Pre-Budget 2023. Sequentially, the MoF estimates 28% growth in 2022 and 8.4% drop in total revenues. Based on available data and average oil production of 11mnbpd for 2023 (10.8mnbpd for most of 1H and gradual uptrend by end of 2023 to 11.2mnbpd), we estimate the Budget 2023 incorporates average oil prices of USD75/bbl (previously 70-72/bbl).

As the usual practice, the MoF has not revealed break-down of total revenues into oil & non-oil revenues in the budget documents since 2021 due to the enlistment of the Saudi Arabian Oil Company (ARAMCO) at Tadawul Stock Exchange. As per the Budget Statement, total revenues consist of two parts namely; (i) other revenue, and (ii) taxes. Other revenue is the major portion of overall revenue (68%) and can be further broken into oil revenue and non-tax non-oil revenues. The government estimates a 12% drop in other revenues YoY to SAR 808bn in FY 2023.

Tax Revenues

Tax revenues are projected to be steady (+2.2%) as no new tax are envisaged while the impact of certain one-off and relaxation provided in 2022 wear out. Interestingly, taxes on good and services, a major contributor to revenues from taxes, is estimated to grow at 3.7% YoY in 2023 despite projected growth in non-oil GDP and inflation of 2.1%.

Oil Revenues

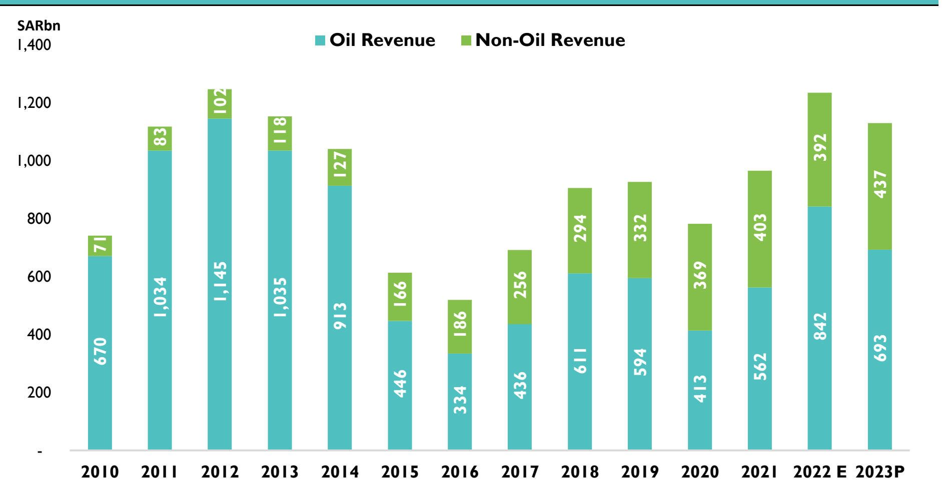
Oil revenues are estimated to drop by 19-20% given the projection for other revenues. By and large, oil market dynamics in the backdrop of stronger cooperation among OPEC+ members on the stability of oil market have added to more confidence in oil revenues projections. The fears of global recession will likely keep a lid on oil prices in 1H23 and may even warrant more production cut by OPEC+ alliance to balance the new supply additions from non-OPEC countries. The response by both fiscal and monetary authorities to recession may drive up oil demand in 2H23 and will likely add to better oil market dynamics.

Our calculation suggests non-tax, non-oil revenues to contribute SAR115bn in 2023

Non-tax, non-oil revenues

As per the details in Budget Statement 2023, non-tax, non-oil revenues are estimated to contribute SAR77bn or 6% to total revenues in 2022 (vs12% in 2021). Non-tax, Non-oil revenues (property income, sales of goods & services, fines, penalties, privatization, dividend on government investment, etc.) is projected to increase in 2023 to levels seen in 2021. Our calculation suggests non-tax, non-oil revenues to contribute SAR115bn in 2023.

Structural shift in sources of revenues is visible with non-oil revenues accounting for a significant portion of total revenues



Source: Budget Statement 2023, Tharaa

Key upside areas for revenue generation

Four possible areas of non-trend revenue contributions in 2023 are;

(i) Dividend income from Aramco for the majority shareholders: In the latest investors call, the management hinted at a possible review of the company's dividend policy with year-end results. Dividend announcement will be closely tracked by investors in view of authorities' aspiration to sell Aramco's shares to foreign investors.

(ii) Changes in VAT rate (unlikely given MoF's CPI forecast for 2023 plus emphasis on achieving higher contribution of non-oil revenue and ensuing upward revision in medium-term expenditure ceiling)

(iii) Other non-oil, non-tax revenues

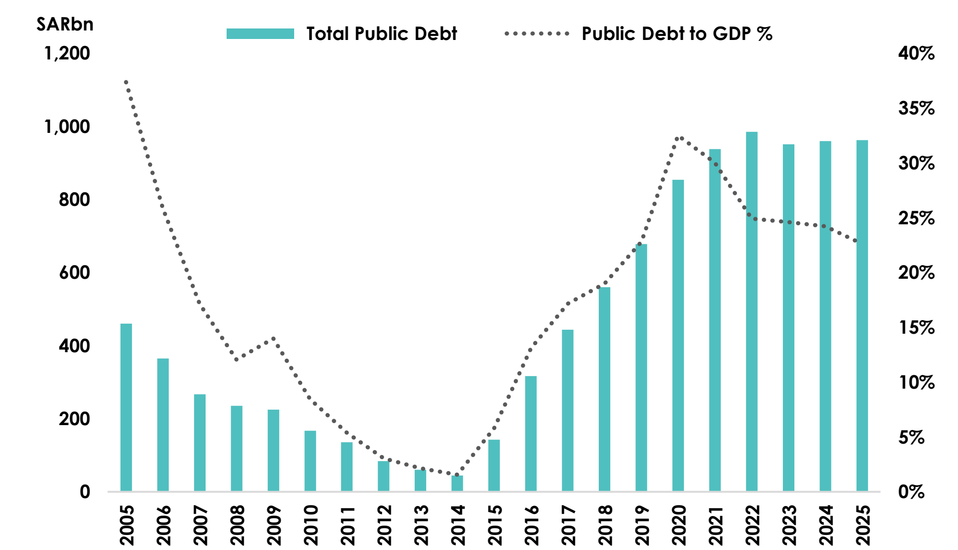
(iv) Preponing of oil projects currently slated to come online by 2027-28

Fiscal Financing: Rebuilding reserve cushion

MoF has highlighted three key areas for utilizing projected fiscal surplus; (i) rebuilding further fiscal cushion (reserves 29M import cover in Sep-22 vs. an average of 38M since 2017) in order to enhance fiscal sustainability and address any external macro shock via countercyclical measures, (ii) strengthening public funds and (iii) accelerating projects of strategic importance. The MoF aims to stick to its strategy of repaying the debt principals from fresh borrowing while looking for any opportunity for borrowing for future debt repayment, financing of strategic initiative and alternative financing. Overall debt in 9M is quoted at SAR972bn (24.7% of GDP) vs. SAR938bn (30% of GDP) in Dec-21. Despite fiscal surplus (3.8% of GDP in 9M22), the MoF has raised additional financing, over and above debt repayment, ahead of interest rate hikes. Assuming MoF sticks to its strategy of maintaining debt level, Public debt/GDP is expected to drop to 22.6% by 2025. Given interest rate environment and expectation of likely pivot to easing cycle by the global central sometime in 2H 2023 or 2024, possibility of MoF using fiscal surplus to make early payment/repayment is high.

Public debt/GDP is anticipated to fall to 22.6% by 2025, assuming MoF sticks to its plan of maintaining debt levels

Debt to GDP is set to trend down given rising Nominal GDP



Source: Budget Statement 2023, Bloomberg, Tharaa

Key risk factors

The four key risks to MoF projections stems from; (i) any risk to global economic growth as major economies deal with record inflation and reversal COVID-era monetary stimulus (ii) dynamics of oil markets, particularly with reference to geopolitical tension and nuclear talks with Iran (iii) any regional or global COVID-like challenge, and (iv) delays in major projects or non-materialization of anticipated benefits.

Disclaimer

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