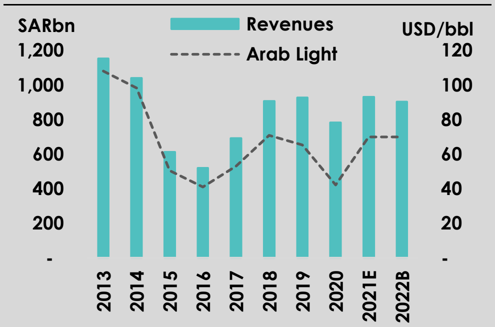
Big turnaround year ahead

KSA's Fiscal Budget 2022 Snapshot

SARbn	2021E	2022B	YoY
Total Revenue	930	903	-2.9%
Total Expenditure	1,015	955	-5.9%
Budget Deficit	**-85**	**-52**	**-38.8%**
Budget Deficit (% of GDP)	**-2.7%**	**-1.6%**	**-110bps**
Public Debt	937	989	5.5%
Public Debt (% of GDP)	30.2	31.3	110bps

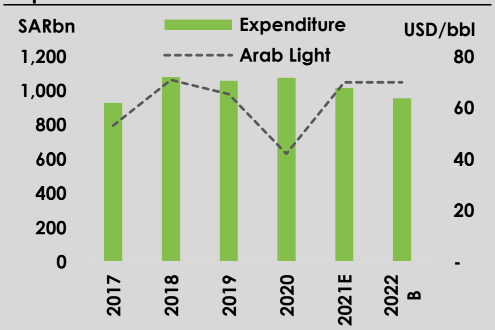
Source: Budget Statement 2022

Revenue Trend



Source: Ministry of Finance, Bloomberg

Expenditure Trend



Source: Pre-Budget Statement 2022

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Pre-Budget 2022: A big turnaround year ahead

The Ministry of Finance (MoF) has set out a broadly conservative fiscal and growth targets for the next year in a recently unveiled Pre-Budget 2022 statement released on 30th Sep. The uncertainty surrounding the pandemic and the length and severity of supply chain bottlenecks for global economic growth appear to underpin authorities' conservative targets, in our view. Overall, fiscal authorities eye; (i) strong all-round rebound in economic growth, (ii) major fiscal consolidation in both 2021/2022, and (iii) rebuilding macro cushion as enshrined in the Vision 2030. Given strong oil prices, as seen in 3Q, are expected to broadly prevail in 4Q, positive fine tuning of fiscal and growth targets at the time of final approval of the budget by the Council of Ministers is likely.

GDP: Big acceleration in economic growth seen

Supported by both oil and non-oil segment, the MoF has proposed a 7.5% Real GDP growth target for 2022 vs 2.6% estimated growth in 2021. Three key engines for Real GDP growth in 2022 are; (i) deepening of role of private sector in the overall economic activity, (ii) improved trade balance in light of more favourable environment for oil and (iii) the crucial support from Public Investment Fund (PIF) in spurring overall investment. The consistent drop in infection cases on the back of growing vaccination rate and expected further easing in precautionary measures, including foreign religious pilgrimage, lend further support to outlook. The MoF has also introduced minor changes in its medium-term macroeconomic projections with small 10bps uptick in 2023 GDP (to 3.6%) and 70bps reduction in CPI for 2022 (appears to be driven by higher base in 2021 largely).

Fiscal Targets: Conservative projections rolled out

The MoF has pencilled a 6% drop in overall budgeted outlay in 2022 (SAR 955bn or 30% of GDP), with a 3% reduction in total revenue relative to CY21 (revenue baseline from mid-year review of SAR930bn in FY21 retained). On expenditure side, MoF aims to stick to spending ceiling for medium term approved last years and accordingly builds in concurrent 6% YoY reduction in expenditure, implying significant drop in fiscal deficit to SAR85/52bn in 2021/22 (2.7/1.6% respectively for 2021/22 vs 11.2% in 2020). To us, total revenue forecasts leave possible room of upside potential in both 2021/22. We estimate the Pre-Budget 2022 incorporates USD60-65/bbl oil prices for 2022 (assuming no change in dividend policy of ARAMCO and trends in other revenue sources). Spending efficiency, positive role of PIF in driving capital expenditure and drop in economic cost of pandemic (economic support for businesses & individuals, health expenditure etc) will likely keep a lid on the overall expenditure in 2022.

Fiscal Financing: Rebuilding reserve cushion

For 2022, a balanced mix of borrowing is expected to fund the deficit (Gross financing of SAR124bn targeted to account for debt repayment of SAR40bn). Overall, public debt is expected to reach SAR989bn or 31% of GDP in 2022. The MoF aims to stick to its medium-term debt strategy of focusing on rebuilding central bank's reserves and achieving fiscal balance by 2023. Public debt/GDP is expected to drop to 27.6% in 2024 due to combination of anticipated fiscal surplus and debt rollover.

Key risk factors

The three key risks to MoF projections stems from; (i) handling of current wave of COVID-19 in countries contributing heavily to religious tourism in the Kingdom or its key trading partners (ii) timing and scale of supply chain constraints for the global economic growth, and (iii) timing and magnitude of reversal of monetary stimulus in major economies and its impact on anticipated global economic growth.

A big turnaround year ahead

The draft budget reflects authorities' aspirations of strengthening fiscal consolidation and substantiating sustainable economic growth

The Ministry of Finance (MoF) has recently unveiled Pre-Budget 2022 statement. The draft budget reflects authorities' aspirations of strengthening fiscal consolidation and substantiating sustainable economic growth. The Vision 2030 and its targets of enhancing the role of private sector in driving economic growth and job creation and delivery of socio-economic targets remain the guiding principles of the budget process.

Overall, the Pre-Budget 2022 statement has incorporated conservative fiscal and growth targets for 2022. The uncertainty surrounding the pandemic and the length and severity of supply chain bottlenecks for global economic growth appear to underpin authorities' conservative targets, in our view. Fiscal authorities expect to deliver on three major macroeconomic targets in 2022 amid domestic and international challenges;

I. Strong all-round acceleration in economic growth with initial estimate of Real GDP growth of 7.5%, rising from an estimated 2.6% in 2021,

II. Fiscal consolidation in-line with medium-term targets (authorities expect to deliver balance budget one year ahead of medium-term target of 2024 and three years ahead of IMF forecast),

III. Rebuilding strategic FX reserves with the central bank

The draft budget will be presented to the Council of Ministers in December for its approval. Given strong oil prices, as seen in 3Q2021, are expected to broadly prevail in 4Q2021, positive fine tuning of fiscal and growth targets is likely at the time of final approval of the budget.

GDP: Big acceleration in economic growth seen

For 2022, MoF expects significant acceleration in economic activity and estimate a 7.5% Real GDP growth, supported by both oil and non-oil segments

The MoF has retained its Real GDP and non-oil GDP growth estimates of 2.6% and 4.2% for 2021 as detailed in its mid-year review of economic performance. For 2022, MoF expects significant acceleration in economic activity and estimate a 7.5% Real GDP growth, supported by both oil and non-oil segments. Three key engines of expected growth are:

1-Deepening of role of private sector in the overall economic activity: The environment for non-oil private segment is set to further improve in 2022. This is premised on; (i) consistent drop in infection cases in the Kingdom (running below 100 consistently for past one month), supported by timely and effective precautionary measures and growing vaccination rate (54% fully vaccinated population as on 3rd Oct) and concurrent further easing in precautionary measures, including foreign religious pilgrimage, and (ii) enabling government policies, particularly encouraging Micro, Small and Medium Enterprises under various initiatives. Few key indicators that reflect the improving situation are:

Key Mobility and economic activity metrics have improved to pre-pandemic levels

Purchasing Manager Index		POS Transactions		General Industrial Production		Unemployment Rate		Mobility – Retail & Recreation	
		Sales bn		% change		%		% change	
Jun-20	Aug-21	2Q2020	2Q2021	Jun-20	Jun-21	2Q2020	2Q2021	27th Sep 2020	27th Sep 2021
48	54	77	118	-23%	12%	15%	11%	-19%	13%

Source: Source: GaStat, Bloomberg, Google Mobility Report, SAMA

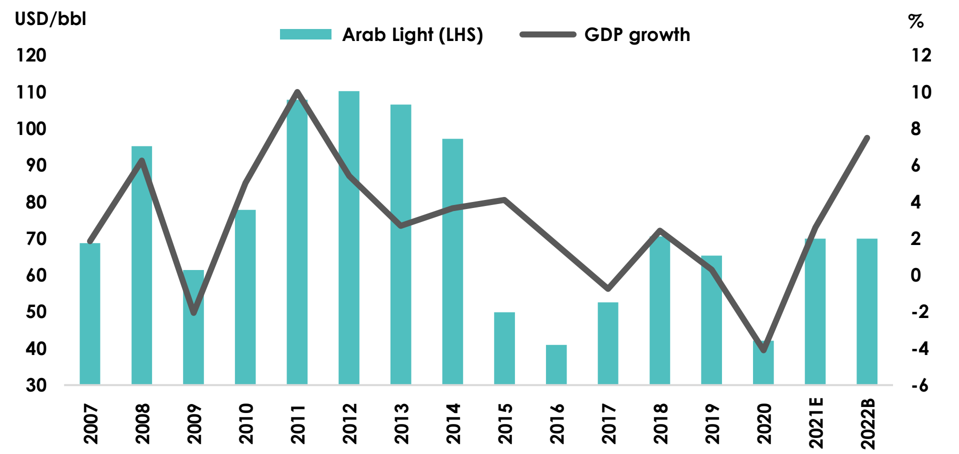
II-The crucial enabling support from Public Investment Fund (PIF) in spurring investment in target areas. To this end, PIF plans to invest SAR150bn (~5% of GDP) per annum until 2025. In addition, a number of ongoing mega projects with a focus on boosting tourism (NEOM, Red Sea, Qiddiya, and Amaala) and housing program under ROSHN, a public sector real estate developer, and government's "Made in Saudi Arabia" initiative also lend big support to growing role of private sector as a major driver of growth.

III-Improved trade balance in light of more favourable environment for oil: We estimate -6%/+27% growth in oil exports in 2021 and 2022 as a result of favorable oil demand and supply

Importantly, we note the Kingdom is set to hit its production ceiling under OPEC+ arrangement of 11.5mmbpd by end of 2022

dynamics. Our estimates are based on production/exports numbers for first seven months and OPEC+ estimate of demand growth in oil for 2H2021 and 2022. IMF estimates global GDP growth recovery to further stay strong at 4.9% in 2022 vs estimated 6.0% growth in 2021. Importantly, we note that the Kingdom is set to hit its production ceiling under OPEC+ arrangement of 11.5mmbpd by the end of 2022. Recovery in oil prices to pre-pandemic levels has already spurred revival of investment plans in both conventional and non-conventional areas besides renewed focus on new sources of energy.

GDP growth rises as oil prices increase



Source: Pre-Budget Statement 2022, Bloomberg

Fiscal Targets: Conservative projections rolled out

MoF has made no change to its mid-year estimate of total budget outlay of SAR1,015bn for 2021

Expenditure: MoF has made no change to its mid-year estimate of total budget outlay of SAR1,015bn for 2021. Higher spending on social benefits during the challenging time, grants and higher COVID-related purchases are expected to keep overall operating expenditure at elevated level in 2021. Capital Expenditure (CAPEX) in 2021 was projected at SAR112bn in the mid-year review vs actual CAPEX of SAR37bn in 1H2021 (33% of full year estimate), suggesting possible downside under this head on full-year basis.

For 2022, authorities have pencilled a 6% drop in total outlay to SAR 955bn or 30% of GDP. MoF aims to sticking to spending ceiling for medium-term approved last year. Spending efficiency, the positive role of PIF in driving capital expenditure, along with widening role of private sector in driving future investment under both privatization and Shareek Program, and drop in economic cost of pandemic (direct and indirect economic support for businesses & individuals, expected drop in COVID-19 related purchases) will likely keep a lid on the overall expenditure in 2022.

The draft budget builds in a 3% reduction in total revenue in 2022 relative to 2021

Revenues: The draft budget builds in a 3% reduction in total revenue in 2022 relative to 2021. Interestingly, revenue estimates for 2021 of SAR930bn from mid-year review has been retained. On the first look, government estimates of total revenues for both 2021 and 2022 look conservative, given +USD73/bbl oil price average in 3Q2021, positive outlook of oil prices for both 4Q2021 and beyond, and expected step-up in oil production in 4Q21 and 2022 under OPEC+ arrangement. Three possible areas of revenue contributions in 2H2021 and 2022 are;

(i) Dividend income from Aramco

(ii) Changes in VAT rate (unlikely given MoF's CPI forecast for 2022)

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

Ceteris Paribus, based on MoF projections for 2022, we estimate the Pre-Budget 2022 incorporates USD60-65/bbl oil prices for 2022.

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

SARbn	2019	2020	2021E	2022B	2023P	2024P
Total Revenue	927	782	930	903	968	992
Total Expenditure	1,059	1,076	1,015	955	941	951
Budget Deficit	-132	-294	-85	-52	27	42
Budget Deficit (as % of GDP)	-4.5%	-11.2%	-2.7%	-1.6%	0.8%	1.2%
Public Debt	678	854	937	989	989	989
Public debt (as % of GDP)	22.8%	32.5%	30.2%	31.3%	29.2%	27.6%

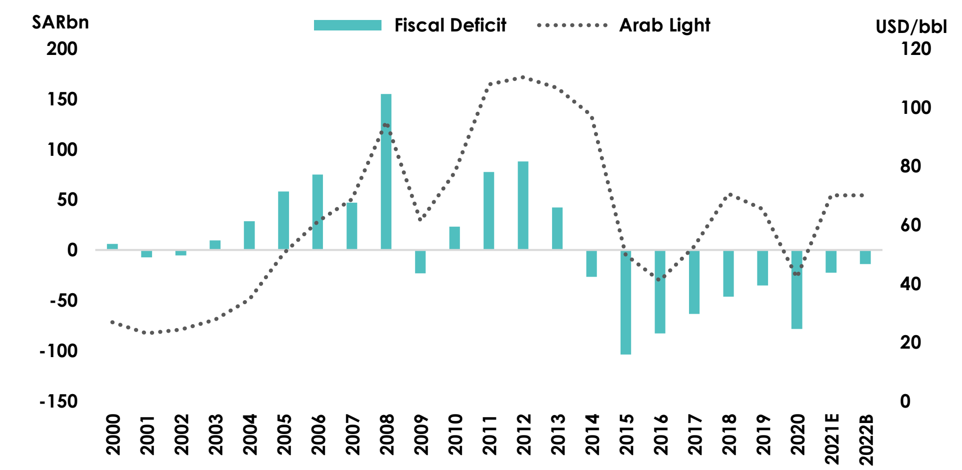
Source: Pre-Budget Statement 2022
2020: Government Estimate, B: Budgeted, P: Projected

Big strides towards fiscal balance

KSA is set to make big strides towards fiscal consolidation in 2021. Overall, fiscal deficit is expected to drop to 2.7% in 2021 vs start-of-the-year estimate of 4.9%

As a result of authorities' focus on revenue mobilization, supportive oil prices and control over expenditure, KSA is set to make big strides towards fiscal consolidation in 2021. Overall, fiscal deficit is expected to drop to 2.7% (SAR85bn) in 2021 (vs start-of-the-year estimate of 4.9%) from 11.2% in 2020. Outlook for 2022 seems more positive. In-fact, if oil prices remain supportive for 2022, KSA can return to fiscal surplus situation in 2022, two year ahead of medium-term forecast and four years ahead of IMF's forecasts. Key conditions underpinning our prognosis include no change in dividend policy in ARAMCO or reduction in VAT and positive growth trend in other revenue sources.

Fiscal Deficit and Arab Light Prices



Source: Ministry of Finance, Bloomberg

Fiscal Financing: Rebuilding reserve cushion

Public debt/GDP is expected to increase to 31.3% in 2022 before trending down to 27.6% by 2024

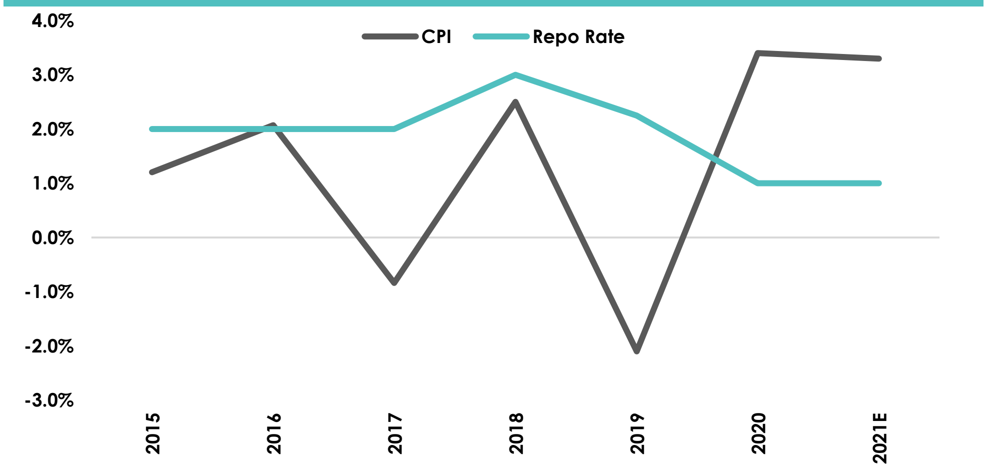
For 2021 & 2022, a balanced mix of borrowing is expected to fund the deficit (Gross financing of SAR124bn targeted to account for debt repayment of SAR40bn). Overall, public debt is expected to reach SAR989bn or 30.2% in 2021. Public debt/GDP is expected to increase to 31.3% in 2022 before trending down to 27.6% by 2024 (Nominal GDP of SAR3,583bn projected) due to combination of anticipated fiscal surplus and debt rollover. As part of the medium-term debt strategy, the MoF aims to rebuild government's reserves with the central bank by using fresh borrowing to retire maturing debt and channelling fiscal surplus towards central bank's reserves. As of Aug-2021, the government's reserves with central bank were quoted at SAR357bn.

Big drop in CPI forecast; risk to upside seen

The MoF estimates Consumer Price Index (CPI) of 3.3% in 2021 (vs an average CPI of 4.2%) and 1.3% for 2022

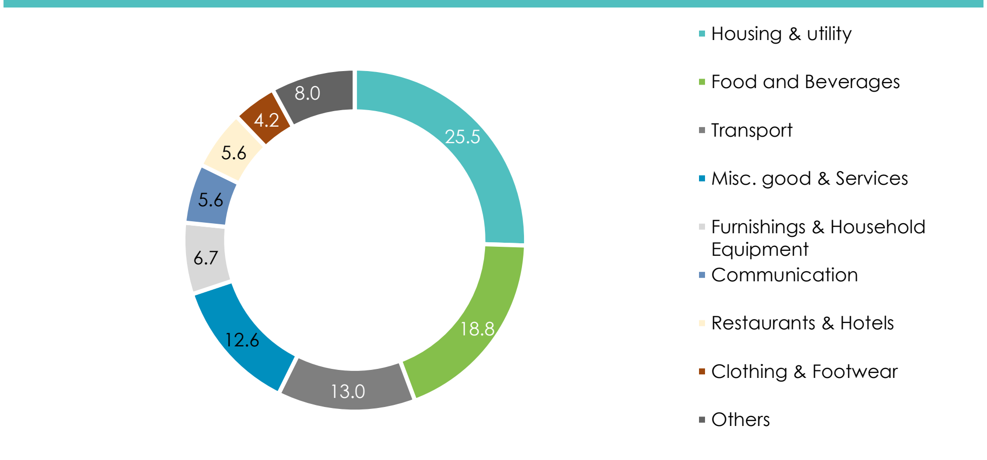
The MoF estimates Consumer Price Index (CPI) of 3.3% in 2021 (vs an average CPI of 4.2%) and 1.3% for 2022. MoF's estimate for 2021 is broadly in-line with consensus estimate and incorporates the likely wearing out of the impact of hike in Value Added Tax (VAT) in 2H2021. MoF's forecast for 2022, however appears to be on lower range of forecast. Increase in the rate of VAT in 2H2020 and prices of imported goods (food & clothing segments) were the major drivers of inflation in 2021. The impact is offset by a consistent drop in housing rent (4.5% YoY drop in Aug21, weight in CPI basket: 21%). Looking ahead, the drivers of inflation are likely to switch to; (i) continued hike in food prices and the impact of supply chain bottlenecks, (ii) reversal of peak-pandemic period discount in services, and (iii) latest readings of Housing Rent suggest the rate of decline in rent has significantly dropped, suggesting possible stability or reversal in the index in 2022.

Real Interest Rate likely to remain in negative territory in 2021



Source: Pre-Budget Statement 2022, Bloomberg

Weights of Key Components in CPI Basket



Source: General Authority of Statistics

Medium-term estimates fine-tuned

Relative to estimates carried in the mid-year economic performance, the MoF has also introduced minor changes in medium-term macroeconomic projections

Relative to estimates carried in the mid-year economic performance, the MoF has also introduced minor changes in medium-term macroeconomic projections, besides revision in 2022 GDP forecast. The changes include small 10bps uptick in 2023 GDP projection (to 3.6%) and 70bps reduction in inflation for 2022 to 1.3% (appears to be driven by higher base in 2021 largely).

Key Economic Indicators in Medium-Term

%	2019	2020	2021E	2022B	2023P	2024P
Real GDP growth	0.3%	-4.1%	2.6%	7.5%	3.6%	3.3%
Nominal GDP (SARbn)	2,974	2,625	3,102	3,162	3,383	3,583
Nominal GDP Growth	0.8%	-11.7%	18.2%	1.9%	7.0	5.9%
Inflation	-2.1%	3.4%	3.3%	1.3%	2.0%	2.0%

Source: Pre-Budget 2022, Tharaa

Key risk factors

The three key risks to MoF projections stems from (i); handling of current wave of COVID-19 in countries contributing heavily to religious tourism in the Kingdom or its key trading partners(ii) timing and scale of supply chain constraint for the global economic growth, and (iii) timing and magnitude of reversal of monetary stimulus in key economies and its impact on anticipated global economic growth.

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