



Saudi Arabia budget report 2021

A review of the Saudi Arabia 2021 budget in the context of recent economic developments

December 2020





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Foreword



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As we approach the end of the year, it is safe to say that not many predicted how the outbreak of a virus in China would cause a pandemic with severe consequences for the global economy. Global capital market trends and several leading indicators across major economies, though remaining volatile, are indicating tepid signs of an economic recovery. In particular, confidence is being sparked by various announcements of seemingly successful vaccines against COVID-19, although we have yet to assess the longer-term repercussions of the deterioration evident in government balance sheets around the world.

In this third edition of our annual budget report for Saudi Arabia, we provide our analysis on how the Kingdom is managing its expenditures and revenues. The spread of the pandemic required a comprehensive response. Virus containment measures saw the government introduce strict lockdown measures, while also launching a series of relief measures to provide economic support to businesses and individuals.

These stimulus packages resulted in the government taking on a heavy burden on its expenditures, even as public revenues declined amid decreasing oil prices – with even an unprecedented negative price on forward trade on WTI on April 20 – and a drop in domestic economic activity as a result of the lockdown. The cancellation of a full-fledged hajj season – this year only 1,000 pilgrims were allowed to visit the holy cities, substantially less than the expected two million – and the related closure of the borders for international travel, further strained the budget.

Despite the emergency response that dominated the better part of the year, the government's central agenda of economic diversification away from the oil sector continued. The 2021 budget also indicates a continued strong commitment to achieving fiscal stability and sustainable long-term economic growth amid continued oil market volatility. Notable measures in 2020 to diversify public revenue have included an increase in the value-added tax (VAT) rate from 5% to 15%, with effect from 1 July, and increased customs duty rates (ranging from 0.5% to 15%) for a list of products, with effect from 20 June.

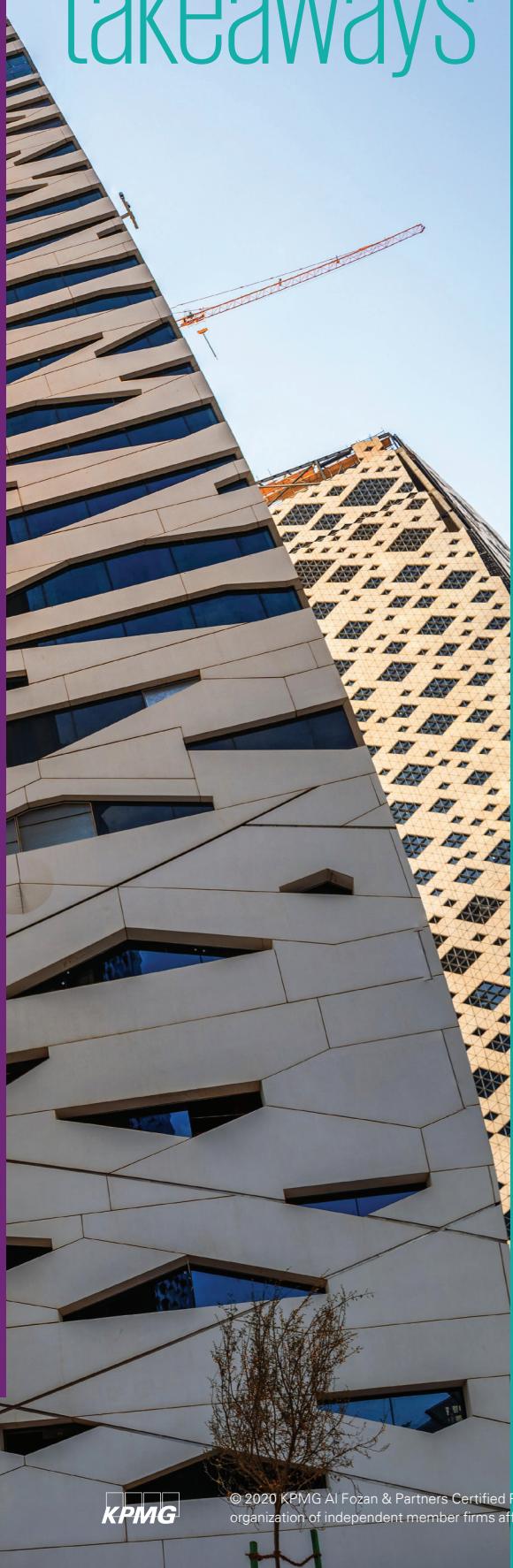
Planned expenditure for fiscal year 2021 stands at SAR 990 billion, with a continued focus on promoting economic growth and improving spending efficiency. We view the government's decision to maintain a similar level of public expenditure as last year, despite the volatility in the oil market, as a testament of its commitment towards achieving fiscal, social, and economic targets. Indeed, the focus of spending in 2021 remains on building the non-oil economy, which will support higher economic and social returns, as well as employment generation. We also note that the government remains committed to spending on healthcare and education, as part of the Vision 2030 objectives of creating a better quality of life and a diversified economy with high local content.

According to the Ministry of Finance (MoF), real GDP growth is expected to reach 3.2 percent in 2021, an upward revision to last year's budget statement projection of 2.2 percent (for 2021). The upward revision primarily reflects a base effect. Expectations that lockdown measures similar to those seen in Saudi Arabia in 2020 are unlikely to be repeated, combined with an improvement in the Kingdom's trade balance (as economic recoveries take hold in its main trading partners) will positively affect the domestic economy.

Total revenues are forecast to reach SAR 849 billion in 2021, 10.2 percent higher than the total estimated in 2020 (SAR 770 billion), on the back of a domestic economic recovery and higher oil prices. Tax revenues are expected to represent 30.3 percent of total revenue in 2021. The budget deficit in 2021 is expected to be SAR 141 billion (4.9 percent of the estimated 2021 GDP), a sharp improvement from SAR 298 billion (12 percent of GDP) estimated for 2020, owing largely to the aforementioned improvement in revenues. Public debt in 2021 is expected to reach SAR 937 billion (32.7 percent of the estimated 2021 GDP), compared with SAR 854 billion (34.3 percent of GDP) in 2020 and 22.8 percent of GDP in 2019.

KPMG echoes the government's sentiment of driving economic growth by increasing the role of the private sector. The government continues to take notable measures to strengthen this sector and enhance its contribution to achieve the authorities' goals and targets, in line with Vision 2030.

Key takeaways



Supporting the domestic economy

COVID-19-related stimulus measures are likely to be eased further in 2021 as the domestic economy continues its recovery, but the government will maintain fiscal flexibility as insurance against additional domestic and international economic shocks.



Maintaining fiscal sustainability

The budget statement reaffirmed the government's commitment to fiscal sustainability and spending efficiency over the medium-term, a trend that will be supported by efforts to contain costs, for example via efficiency gains, and a continued determination to increase non-oil revenues.



Encouraging private sector development

Privatisation and encouraging Public Private Partnerships (PPPs) will remain a key element of the government's Vision 2030 goals, measures that have been given additional impetus by the rise in public debt.



Spending priorities remain unchanged

Education, Healthcare and Social Development, Defense and Infrastructure continue to be among the largest recipients of public expenditure, although we note that the spending focus within each of the components is evolving.

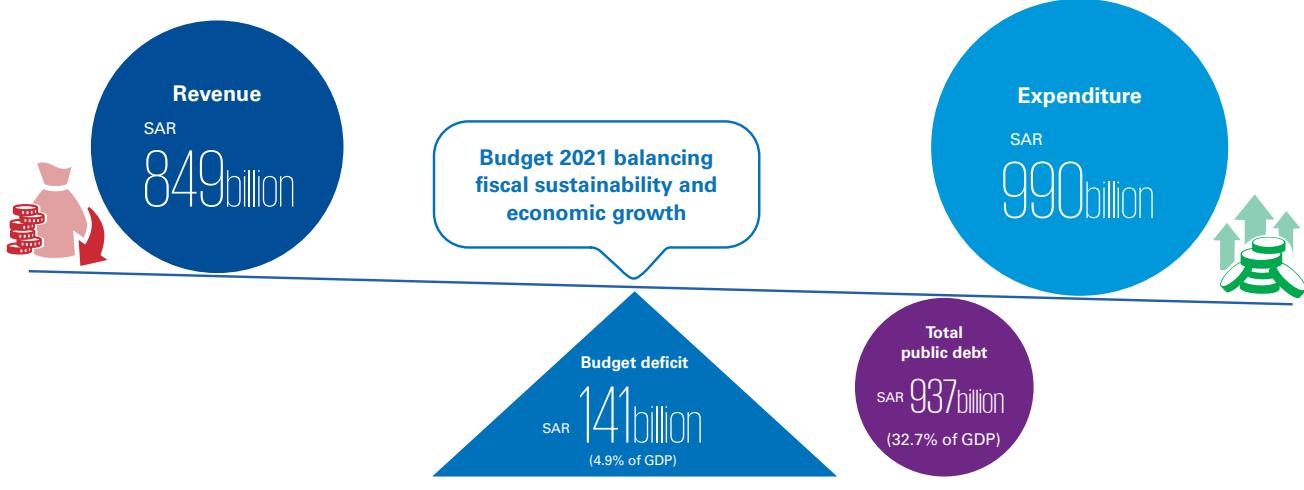


Uncertainty is likely to remain an underlying theme over the next year

The government has highlighted the difficulties it faces in balancing Vision 2030 expenditure plans and short-term spending needs amid a period of heightened volatility and uncertainty in the Kingdom's main trading partners and in international capital markets.

2021 budget summary

2021 budget



Source: MoF, Budget Statement 2021

Change in budget 2020-2021

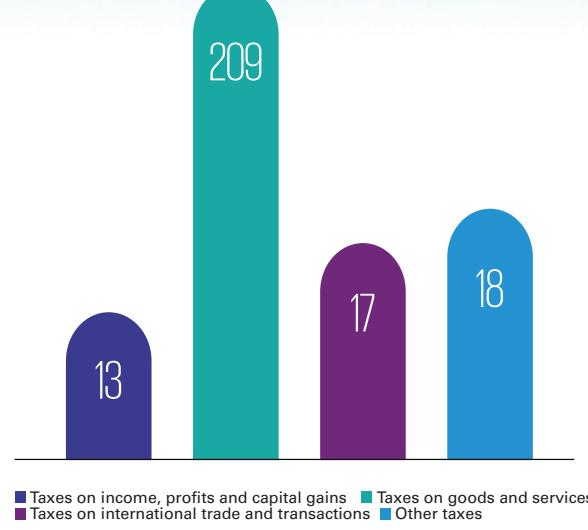
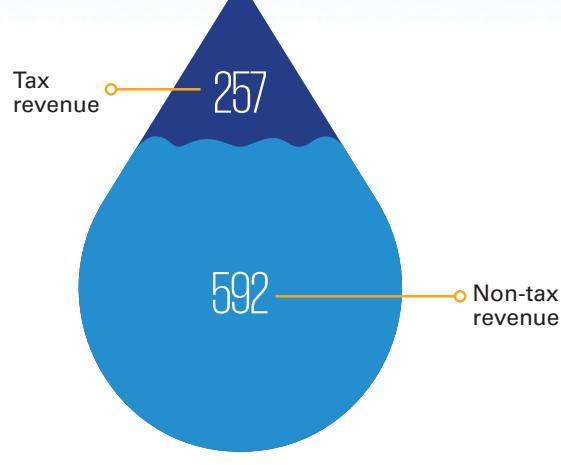
Estimated in 2020 (SAR billion)

196
574
1,068
298
854

Budgeted in 2021 (SAR billion)

257
592
990
141
937

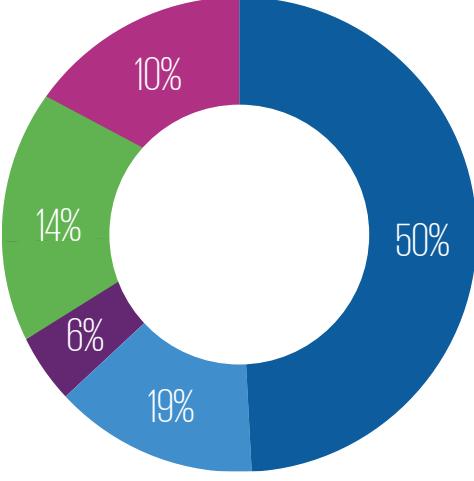
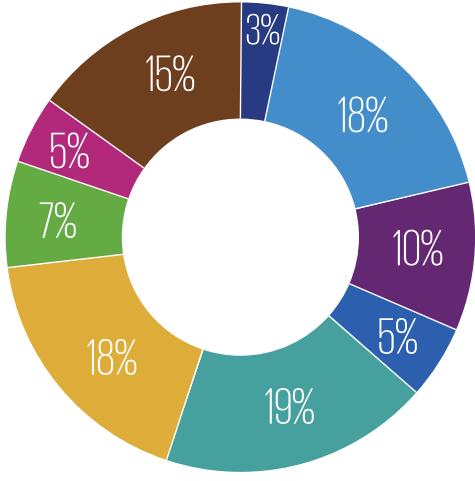
Source: MoF, Budget Statement 2021



Source: MoF, Budget Statement 2021

Source: MoF, Budget Statement 2021

2021 budget expenditure



- Public administration ■ Military ■ Security and regional administration
- Municipal services ■ Education ■ Health and social development
- Economic resources ■ Infrastructure and transportation ■ General items

- Compensation of employees ■ Use of goods and services ■ Social benefits
- Other expenses + Financing expenses + Subsidies + Grants ■ Non-financial assets

Source: MoF, Budget Statement 2021

Source: MoF, Budget Statement 2021

Economic growth assumptions

According to the Ministry of Finance (MoF), real GDP growth is estimated to contract by 3.7% in fiscal year 2020, driven by a combination of COVID-19-related containment measures within Saudi Arabia and the negative global impact of the pandemic on international oil demand and prices.

International oil price falls – oil (Brent) prices fell to an average of \$41.1 per barrel (pb) during January to October, compared with \$64.1 pb during the same period in 2019 – resulted in OPEC+ agreements to cut oil production, reducing both oil and non-oil activity in the Kingdom during the year.

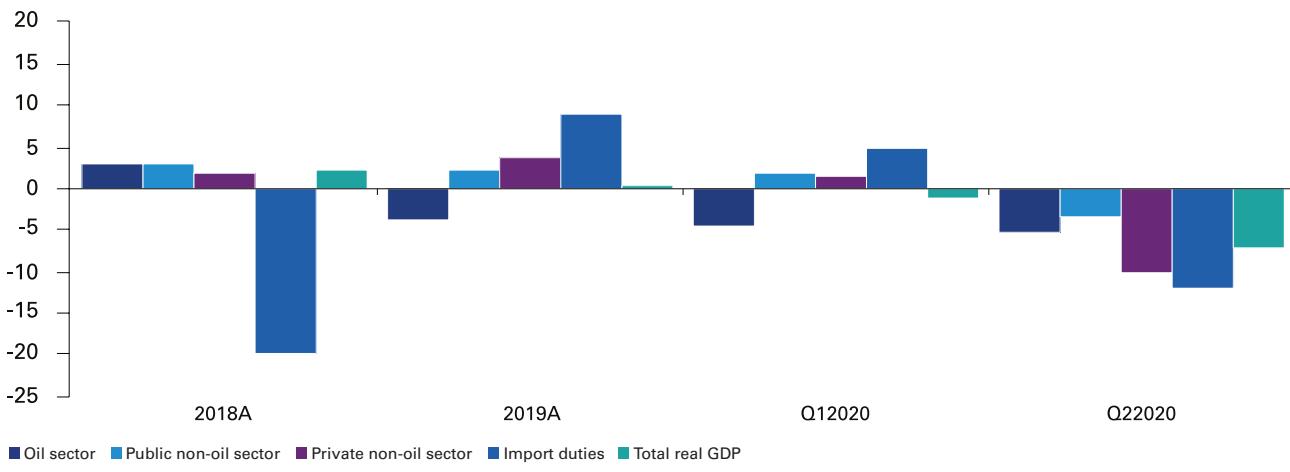
According to the International Energy Agency (IEA), oil demand in 2020 is estimated at 91.3 mb/d, 8.8 mb/d lower than in 2019. Demand will recover to an average of 97.1 mb/d in 2021, sufficient to support

average Brent crude prices of \$46.70 pb in 2021, compared with \$41.69 pb in 2020, according to the IMF's October 2020 World Economic Outlook.

An easing of domestic pandemic-related restrictions, an oil price recovery from the lows seen in April and improvements in several leading demand indicators support the MoF's expectation of a broad-based rebound in real GDP growth of 3.2% in 2021 (although we note that the economy in nominal terms will not return to its 2019 size until 2022).

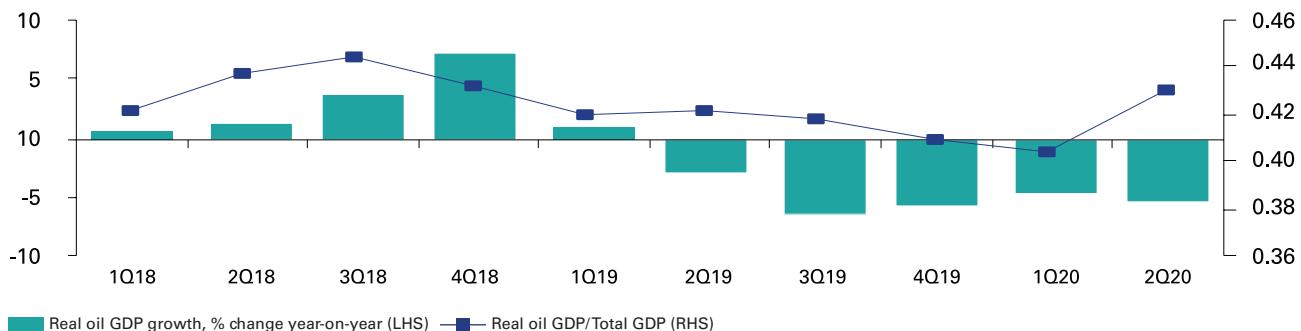
Domestic real oil and non-oil GDP growth next year is expected to be further supported by a recovery in Saudi Arabia's main trading partners (a key driver of the expected improvement in the oil price and demand), as well as ongoing government spending on mega projects and Vision 2030 initiatives.

Figure 1: Real GDP growth breakdown (% change year-on-year)



Source: GaStat

Figure 2: Real oil GDP growth and oil sector contribution to GDP



Source: GaStat

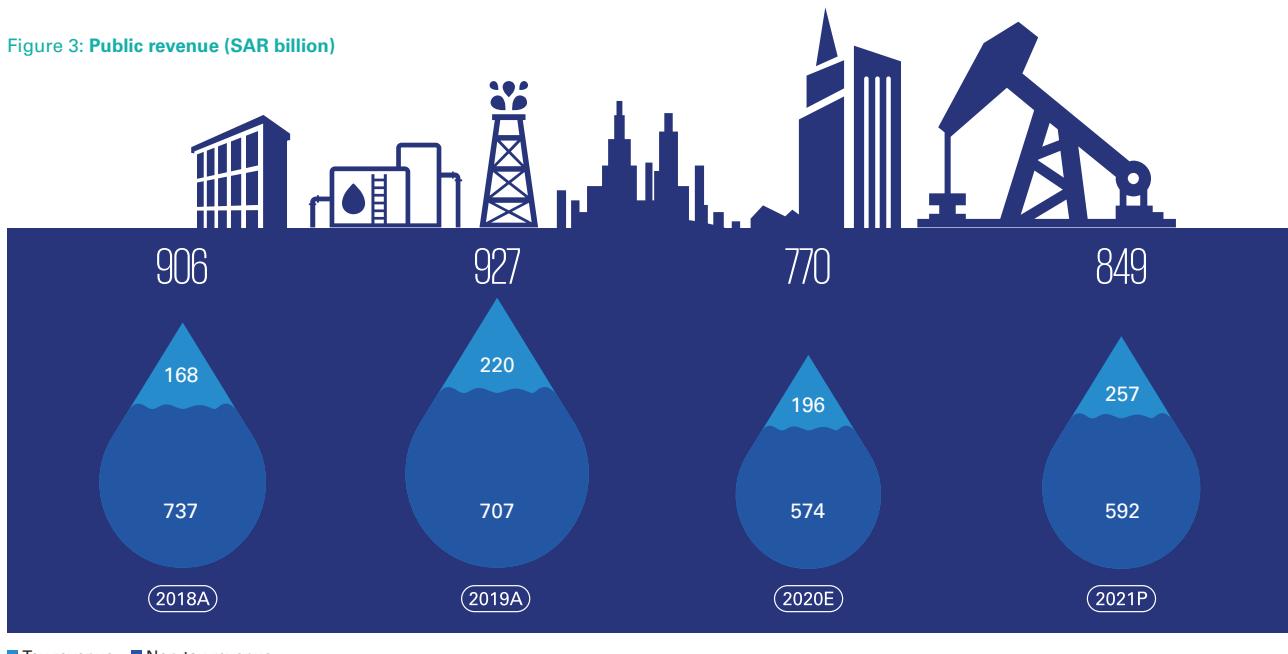
2021 budget

Budget

The cabinet approved the budget for fiscal year 2021 on 15 December 2020, amid heightened uncertainty created by the global pandemic and its continued repercussions for the world economy and thus oil revenues, which represented an estimated 53.5% of the Saudi government's total revenues in 2020.

On the expenditure side, stimulus measures designed to offset the negative economic impact of COVID-19 and related containment policies, as well as precautionary health and safety measures, will be wound down in 2021, although the authorities will maintain fiscal flexibility in the event of further economic shocks.

Figure 3: Public revenue (SAR billion)



■ Tax revenue ■ Non-tax revenue

Source: MoF, Budget Statement 2021

Revenues

The 2021 fiscal year budget statement highlights that the economic shocks faced by the Kingdom in 2020 are estimated to have reduced total revenues to SAR 770 billion, 7.6 percent lower than was envisaged in the original 2020 fiscal year budget and 16.9 percent lower than the 2019 outcome (see figure 3).

The brunt of the 2020 revenue decline stemmed from the fall in oil international prices that saw the oil component of public revenues decline by 30.6% year-on-year, to SAR 412 billion, falling from 64% of total revenue in 2019 to 53.5% of the total in 2020.

Nevertheless, ongoing government efforts to diversify revenues away from oil provided some support. Previous measures to raise non-tax revenues have included increases in expat levies and the introduction of a value-added tax (VAT) of 5% in 2018 (see figure 5).

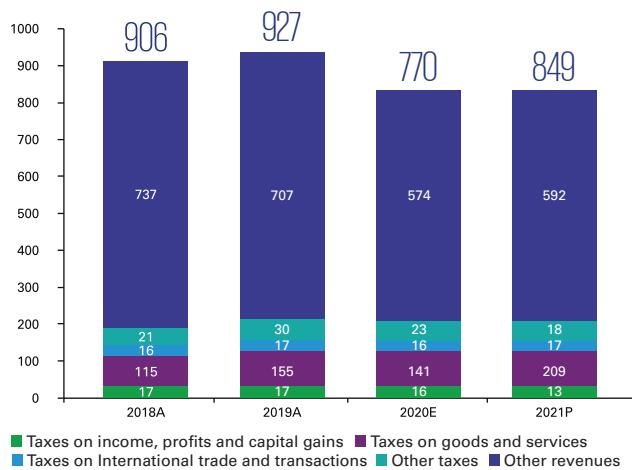
The government raised the VAT rate by 10 percentage points to 15% in July 2020 following an increase in customs levies in June of the same year, both measures designed to offset the revenue declines stemming from lower oil prices and economic activity.

Several factors will combine to raise total revenues, by 10.3% year-on-year to SAR 849 billion, in 2021. These include ongoing policy efforts to increase non-oil revenues, energy price reforms, an expected broad-based domestic economic recovery (supporting VAT receipts, for example) and higher international oil volume demand and prices.



Oil revenues will remain the dominant source of government financing. Tax and fee deferments are likely to provide a boost to revenues next year as the authorities are expected to unwind such COVID-19-related stimulus measures (see figure 4).

Figure 4: Revenue components (SAR billion)



Source: MoF, Budget Statement 2021

Expenditures

Actual government spending in fiscal year 2020 is estimated at SAR 1,068 billion compared with originally planned spending of SAR 1,020 billion (see figure 5). The authorities successfully contained total spending, amid stimulus measures such as wage and income support for Saudi nationals and COVID-19 suppression measures in the health care sector, by diverting funds from a variety of areas.

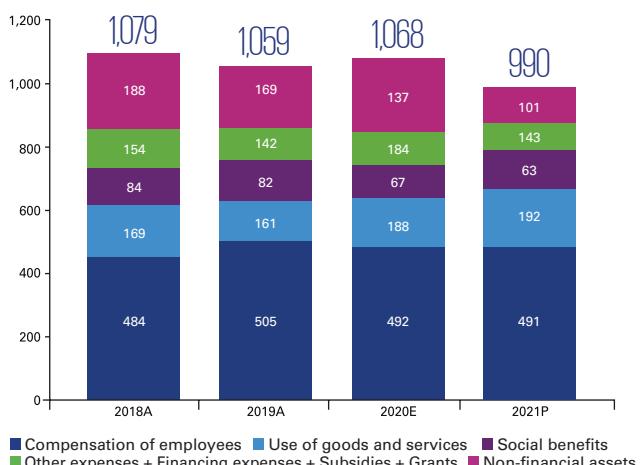
Key among these offsetting spending measures in 2020 was the cancellation, extension or postponement of several capital expenditure (CAPEX) components, with CAPEX falling by 19.1% year-on-year. Of the three largest spending components by sector- Education, Defense and Healthcare and Social Development- only Education saw an increase in 2020, rising by an estimated 1.4% year-on-year. Health and Social Development, meanwhile, was contained despite COVID-19 spending, by a diversion of funds within this component.

Planned total expenditure in 2021 is set to fall to SAR 990 billion (down 2.9% versus the originally planned figure for 2020). The government will maintain commitments towards Vision 2030 goals, particularly in areas such as the Housing Program and Quality of Life Program, as well as mega projects, while allocating contingent funds towards addressing the risks related to the pandemic.

COVID-19 spending is likely to have increased the use of [government] goods and services as well as demand for other COVID-19-related support measures. Thus, despite efforts to induce spending efficiencies, including some success in containing employee compensation, operational expenditure (OPEX) rose by an estimated 4.6% year-on-year in 2020.

A key pillar of spending support expected by the government in 2021 relates to ongoing efforts under the Privatization Program (a source of revenues as well as a reform objective) that includes a mandate to expand PPPs that in turn would alleviate spending pressures on the government in relation to CAPEX, which owing to continued financing pressures is projected to fall to SAR 101 billion in 2021 from an estimated SAR 137 billion in 2020 (and SAR 169 billion in 2019).

Figure 5: Expenditure components (SAR billion)



Source: MoF, Budget Statement 2021

Expenditure by sector: in focus

Three of the largest recipients of public expenditure continue to be Education, Healthcare and Social Development and Infrastructure

Education

Planned education spending is 3.8% lower year-on-year in 2021, compared with a fall in total expenditure of 2.9%. We note that planned spending for 2021 is similar to the levels of spending the government envisaged for 2020 during the released of that year's budget statement in December 2019. The education expenditures in 2020 are expected to increase by 1.4% as compared to the previous year, owing to e-learning and digital transformation initiatives a result of COVID-19. In the short-term, COVID-19 has increased requirements for investment in online infrastructure (software and hardware) – the budget confirmed that the trend started in 2020 will continue into 2021. Spending is also being driven by longer-term trends – the budget statement indicates the continued importance of Vision 2030 targets, such as sports and increasing female labour participation. Some of the areas that will receive particular attention in 2021 include; tracks of high schools and specialized academies, e-learning and distance education, digital transformation and information security, teacher preparation programs, education for people with special needs, early childhood and elementary grades, and transforming community colleges into colleges that grant an applied diploma. There is also more focus on scholarships, both to drive inclusivity and to strive for academic excellence.

Healthcare and Social Development

Expenditure in the healthcare sector was most acutely impacted by the COVID-19 outbreak, as the virus sparked a sudden demand to an emergency response to take care of those affected, while new health and safety procedures were implemented. The government also decided to fund COVID-19 treatments for everyone affected – citizen, residents, visitors, even those staying in the Kingdom undocumented – as well as fund quarantine stays in hotels both for those inside the country and citizens abroad. Extra expenditure on the COVID-19 was both taken from a centrally allocated emergency budget and some diverted from existing and planned healthcare budgets. Indeed, some of the spending on the healthcare transformation was delayed as a result of the pandemic, though at the end of 2020, the Ministry of Health indicates strong efforts to put the transformation back on track, thus we expect traction to pick up again in 2021. The net impact of the outbreak in 2020 was to cause estimated Healthcare spending to fall by 8.5%, compared with the 12.1% fall originally planned, reflecting in part lower social development outlays. The budget for Healthcare and Social Development in 2021 is set to increase by 4.6% to SAR 175 billion, from SAR 167 billion budgeted in 2020. Efforts to separate the payor, provider and regulatory functions, and the implementation of the Model of Care and Accountable Care Organizations in the decentralized healthcare clusters will continue to dominate the healthcare agenda. Finally, it is expected that PPPs will accelerate in the coming years to ease the pressure on infrastructure spending.

Infrastructure

The emergence of COVID-19 forced the government to reassess its infrastructure spending plans, a reassessment that included canceling, extending or postponing some budgeted OPEX and CAPEX for a number of government agencies in 2020. As a result, infrastructure spending decreased by 18.9% to SAR 137 billion, mainly attributed to short term resource diversification towards COVID-19-induced additional expenditure. In the 2021 budget, the government is seeking to renew its focus on Vision 2030 projects even as it remains aware of the risks that further short-term stimulus measures may be needed. Budgetary concerns are one of the main drivers for the government reducing CAPEX spending to SAR 101 billion in 2021, a 26.3% fall from its estimated level in 2020. Indeed, the government's fiscal sustainability goals, combined with its efforts to increase private sector involvement in infrastructure development, will see a continued pursuit of PPP agreements. Additionally, to aid rapid urbanization, the transport sector is also expected to witness improved transport links as a result of metro systems, bus, and rapid transport projects. Besides, the government's continued focus on mega projects such as Neom, the Red Sea project, AMAALA and Qiddiya, are expected to have a impact on the country's economy in the long-term.

2021 budget

Budget deficit and public debt

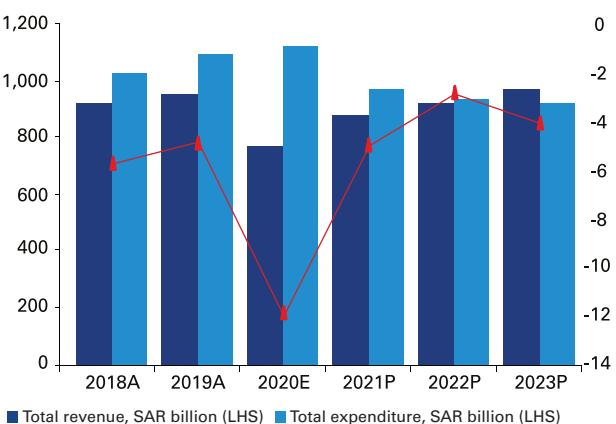
The budget deficit in the 2020 fiscal year has deteriorated sharply in both nominal terms and as a percentage of GDP, driven both by a collapse in revenues and the denominator. The budget deficit increased from SAR 133 billion in 2019 (4.5% of GDP) to an estimated SAR 298 billion in 2020 (12% of GDP) – the 2020 budget had envisaged a deficit of SAR 187 billion, constituting 6.4% of GDP (see figure 6).

The expected (partial) recovery in revenues, expenditure containment efforts and a rise in nominal GDP will together reduce the 2021 budget deficit to SAR 141 billion (4.9% of GDP), similar to the projections made for 2021 during the 2020 budget statement in December 2019. Although downside risks remain, the target reflects the government's commitment to fiscal sustainability.

A widening budget deficit and nominal GDP contraction together raised the public debt stock substantially, from SAR 678 billion (22.8% of GDP) in 2019 to an estimated SAR 854 billion (34.3% of GDP) in 2020. Despite the still-high budget deficit envisaged in 2021 resulting in the debt stock rising, to SAR 937 billion, in nominal terms, an expected recovery in real and nominal GDP will result in the public debt to GDP ratio falling to 32.7% in 2021 (see figure 7).

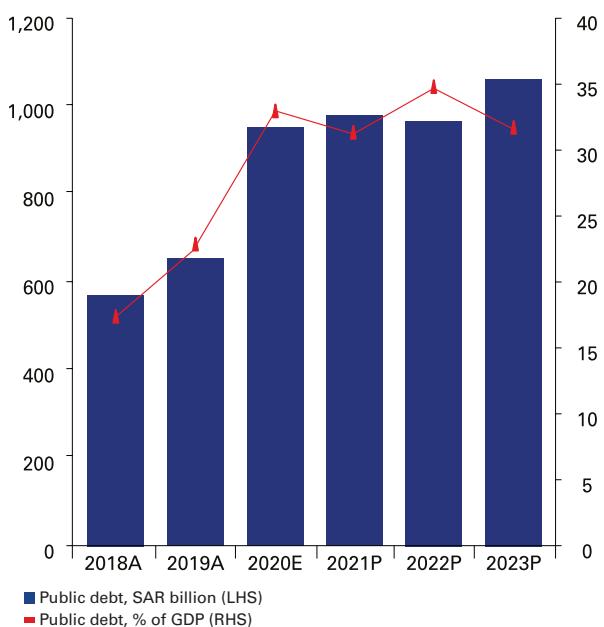
These figures compare with an originally-projected public debt to GDP ratio of 26% in 2020 and 28% in 2021. Indeed, the anticipated sharp rise in the public debt stock resulted in the government raising its public debt ceiling limit of 30% of GDP (in place since 2017) to 50% of GDP in March 2020.

Figure 6: Fiscal position



Source: MoF, Budget Statement 2021

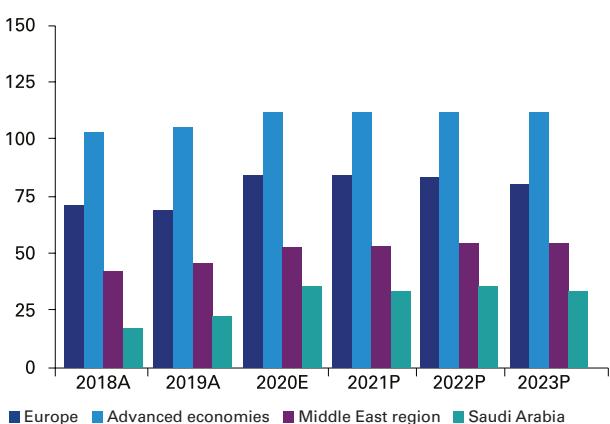
Figure 7: Public debt



Source: MoF, Budget Statement 2021

Despite the upward trend in the public debt metrics, we note that the country's public debt-to-GDP ratio remains significantly below its peers, a situation that will be maintained given these peers have also witnessed sharp deteriorations in their public sector balance sheets since the pandemic emerged (see figure 8).

Figure 8: Public debt as percentage of GDP



Source: IMF, MoF, Budget Statements

Risks and challenges



Sovereign rating downgrades amid a rising public debt stock

The rise in the government's debt-to-GDP ratio and a continued reliance on oil for fiscal revenues and economic growth has highlighted vulnerabilities in relation to the Kingdom's sovereign rating. However, there are several factors that will contain downgrade risks. These include: the ordinal nature of the ratings system – ratings are based on indicators relative to peers, whose own balance sheets have deteriorated rapidly in 2020; substantial fiscal reserves; and a large stock of foreign exchange reserves that support the currency peg. The reaction function of the government going forward will nevertheless be crucial in deciding future ratings movements. For example, a continued commitment to improving the fiscal accounts over the medium term in a sustainable manner. Here, the Kingdom's existing efforts to diversify sources of public revenue (including under commitments to fiscal sustainability under Vision 2030) and economic growth may support its credibility as investors reassess sovereign and contagion risk globally.



COVID-19 continues to undermine the economies of Saudi Arabia's key trading partners

The budget statement's key assumptions are a recovery in international oil prices and domestic economic activity in 2021. Much will depend on how COVID-19 progresses. A return to normality next year, namely a permanent removal of pandemic-related restrictions, will depend on vaccine and therapy development and distribution. Success, as seems likely on these fronts, in the first quarter of 2021, would speed up economic recoveries in Saudi Arabia's major export markets (including an oil price recovery). Risks remain in relation to containing the pandemic, however. Beyond this, the economic fall-out is likely to bring continued uncertainty in several areas. Fiscal consolidation efforts are likely to slow economic recovery in the OECD, for example. Moreover, company and household bankruptcies remain a risk abroad – leverage was high across large parts of the world even before the pandemic.

Economic indicators

Key statistics						
	2016A	2017A	2018A	2019A	2020E	2021P
Economic output:						
Nominal GDP (SAR billion)	2,419	2,582	2,949	2,974	2,486	2,866
Nominal GDP % change y-o-y	-1.4	6.7	14.2	0.8	-16.4	15.3
Real GDP % change y-o-y	1.7	-0.7	2.4	0.3	-3.7	3.2
Budget:						
SAR billion:						
Total revenue	519	692	906	927	770	849
- Oil revenue	334	436	611	594	412	-
- Non-oil revenue	186	256	294	332	358	-
Expenditure	830	930	1,079	1,059	1,068	990
Budget balance	-311	-238	-174	-133	-298	-141
Gross public debt	317	443	560	678	854	937
% of GDP:						
Total revenue	21.5	26.8	30.7	31.2	31.0	29.6
- Oil revenue	13.8	16.9	20.7	20.0	16.6	-
- Non-oil revenue	7.6	9.9	10.0	11.2	14.4	-
Expenditure	34.3	36.0	36.6	35.6	43.0	34.5
Budget balance	-12.9	-9.2	-5.9	-4.5	-12.0	-4.9
Gross public debt	13.1	17.2	19.0	22.8	34.3	32.7
Trade and external sector:						
Exports (SAR billion)	688	832	1,104	1,066	1,068	1,032
- of which oil exports	510	638	868	830	831	796
Current account balance (SAR billion)	-89	39	264	204	183	121
Current account balance (% of GDP)	-3.7	1.5	9.0	6.9	7.4	4.2

A | Actual E | Estimated P | Projected - | N/A

Source: IMF, MoF, Annual Budget Statements

Disclaimer: figures are rounded up to the nearest billion throughout the report. Some figures may not add up to 100 percent due to rounding.

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