Key themes

The government has maintained its expansionary fiscal policy for 2018 backed by significant non-oil revenue gains. Going forward, PIF and National development funds’ spending will complement the increased govt. spending supported by higher oil revenue (energy price reforms/ better oil prices) and non-oil revenue (VAT, expat levy etc). Expansionary policy will lead to a rebound in real GDP growth rate to 2.7% in 2018.

# NDF: National Development Funds

<table>
<thead>
<tr>
<th>(SAR bn)</th>
<th>2017 projection</th>
<th>2017 actual</th>
<th>% var</th>
<th>2018 projection</th>
<th>2018 actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>692</td>
<td>696</td>
<td>0.6%</td>
<td>783</td>
<td></td>
</tr>
<tr>
<td>Oil</td>
<td>480</td>
<td>440</td>
<td>-8.3%</td>
<td>492</td>
<td></td>
</tr>
<tr>
<td>Non-oil</td>
<td>212</td>
<td>256</td>
<td>20.8%</td>
<td>291</td>
<td></td>
</tr>
<tr>
<td>Expenditure</td>
<td>990</td>
<td>926</td>
<td>4.0%</td>
<td>978</td>
<td></td>
</tr>
<tr>
<td>Fiscal deficit</td>
<td>(198)</td>
<td>(230)</td>
<td></td>
<td>(195)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Budget Report, Ministry of Finance, Al Rajhi Capital

Oil price (WTI) assumptions for 2018*

<table>
<thead>
<tr>
<th>$/ barrel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rquired oil price for 2018 projected oil revenue</td>
</tr>
<tr>
<td>Rquired oil price for 2018 fiscal breakeven</td>
</tr>
</tbody>
</table>

Source: Bloomberg, Al Rajhi Capital

*Note:
1. Our oil price assumptions DO NOT include impact of energy price reforms, as revenue from energy reforms are not stated in budget. The required oil price to achieve the expected 2018 oil revenue will be lower than the above estimates.
2. Refer ‘Revenue’ section in page 3, and tables 6, 7 for assumptions and detailed calculations.

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Budget trends

Figure 1 Revenue and spending trend (actual)

After bottoming in 2016, revenue staged a strong comeback in 2017 and will continue to witness growth in 2018 and likely beyond, due to firm oil prices and maturing of non-oil revenue streams such as VAT, expat levy etc.

Source: Ministry of Finance, Al Rajhi Capital; Note: 2018 is budgeted figure

Figure 2 Non-oil revenue traction continues unabated

Non-oil revenue (SAR bn) as % of revenue (RHS)

Source: Ministry of Finance, Al Rajhi Capital; Note: 2018 is budgeted figure

Figure 3 Budget surplus/ (deficit) trend

After the lows of 2015, fiscal deficit has been consolidating led by higher non-oil revenue and better spending efficiency

Source: Ministry of Finance, Al Rajhi Capital; Note: 2018 is budgeted figure

Figure 4 Actual vs. projected deficit: 2017 deficit higher vs. estimates, but marks an improvement over the last two years

Unlike 2016, 2017 witnessed higher deficit vs. estimates. However, the absolute budget deficit is down in 2017, and this improving trajectory is more important over the long term.

Source: Ministry of Finance, Al Rajhi Capital; Note: 2018 is budgeted figure

Budget 2018: Fiscal stimulus to drive growth

We believe the Budget 2018 is a tightrope walk that balances the needs of the economy (expansionary budget will give a fillip to GDP growth, especially when real GDP declined 0.5% in 2017), and still stays on the path of fiscal consolidation (2018 fiscal deficit lower than 2017 deficit in absolute terms, see exhibits 3 & 4). Further, non-oil revenue is projected to grow at a healthy pace going forward, in-line with Vision 2030 and NTP objectives. Overall, we believe the budget 2018 will enable the economy to see through the period of reforms (VAT, higher expat levy, electricity price hikes and likely followed by energy/ water price hikes) and its associated headwinds for consumer sector and SMEs, eventually driving a rebound in growth (2018 real GDP growth estimated at 2.7%).

We also see the following factors helping to drive private sector non-oil GDP growth in the next few years: (a) increased consumer spending in the economy as more Saudis take up formal employment, and it’s multiplier effect, (b) better efficiency of government spending

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after various rationalizations over the last two years, (c) Govt. can maintain its expansionary stance going forward as it has leeway for borrowing to increase up to 30% of GDP (the stated ceiling as mentioned in 2017 budget); even after reaching the ceiling, the rising denominator (GDP) means that some additional borrowing capacity can be tapped every year without exceeding the ceiling, and (d) likely liquidation of assets worth USD100bn over time will help generate additional revenue for the government which can drive govt. spending.

**Figure 5 Summary of budget**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil Revenue</td>
<td>670</td>
<td>1,034</td>
<td>1,145</td>
<td>1,035</td>
<td>913</td>
<td>446</td>
<td>324</td>
<td>440</td>
<td>492</td>
</tr>
<tr>
<td>Non oil Revenue</td>
<td>71</td>
<td>83</td>
<td>103</td>
<td>121</td>
<td>131</td>
<td>169</td>
<td>195</td>
<td>256</td>
<td>291</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>742</td>
<td>1,118</td>
<td>1,247</td>
<td>1,156</td>
<td>1,044</td>
<td>616</td>
<td>519</td>
<td>696</td>
<td>783</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>455</td>
<td>551</td>
<td>612</td>
<td>664</td>
<td>740</td>
<td>714</td>
<td>696</td>
<td>746</td>
<td>773</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>199</td>
<td>276</td>
<td>262</td>
<td>312</td>
<td>370</td>
<td>264</td>
<td>134</td>
<td>180</td>
<td>205</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>654</td>
<td>827</td>
<td>873</td>
<td>976</td>
<td>1,110</td>
<td>978</td>
<td>830</td>
<td>926</td>
<td>978</td>
</tr>
<tr>
<td>Budget Surplus/ (Deficit)</td>
<td>88</td>
<td>291</td>
<td>374</td>
<td>180</td>
<td>(66)</td>
<td>(362)</td>
<td>(311)</td>
<td>(230)</td>
<td>(195)</td>
</tr>
</tbody>
</table>

as % of GDP: 4.4% 11.6% 13.6% 6.4% -2.3% -14.8% -12.8% -8.9% -7.2%

Real GDP growth %: 5.0% 10.0% 5.4% 2.7% 3.7% 4.1% 1.7% -0.5% 2.7%

Inflation %: 3.8% 3.7% 2.9% 3.5% 2.7% 2.2% 3.5% -0.1% 5.7%

Source: SAMA, Ministry of Finance, Al Rajhi Capital; Note: 2018 is budgeted

**Revenue: Aided by both higher oil and non-oil revenue**

For 2018, the government estimates total revenue at SAR 783bn, up ~12.5% vs. 2017 revenue of SAR696bn, on the back of both higher oil revenue and higher non-oil revenue.

**Oil revenue is projected at SAR492bn**, up 11.8% vs. SAR440bn realized in 2017, due to tailwinds from energy price reforms and likely higher oil revenue assumption. By our calculations, the maximum WTI oil price assumption to achieve this revenue is $56.9/bbl, as the calculation does not account for benefit from energy price reforms, as this amount is not mentioned in the budget release. With energy price reforms, the above mentioned oil price assumption will be lower. The maximum WTI oil price assumption of $56.9/bbl is reasonable in our view given that OPEC+ agreement was recently extended, and is closer to ~$54/bbl Bloomberg consensus (analyst upgrades just started rolling in).

**Assumptions for oil price calculations**: Based on the recently extended OPEC+ agreement, we expect Saudi Arabia to export 2,546 mn barrels of oil in 2018, the same level as 2017. We also apply 9.5% pass-through discount to government from Aramco for calculating the oil price assumption for 2018.

**Figure 6 Oil price assumption (excluding benefit from energy price reforms)**

<table>
<thead>
<tr>
<th>(SAR bn)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018 target oil revenue</td>
<td>492  Projected oil revenue for 2018</td>
</tr>
<tr>
<td>Total export barrels (bn)</td>
<td>2.55  Total number of export barrels for 2018, assumed similar to 2017</td>
</tr>
<tr>
<td>Net breakeven oil price ($/ bbl)</td>
<td>56.9  Assumed 9.5% pass through discount, similar to that witnessed in 2017</td>
</tr>
</tbody>
</table>

Source: Al Rajhi Capital

Further, to achieve budget breakeven, required WTI oil price stands at $79.4/bbl. This is far-fetched compared to the consensus forecasts for 2018 WTI price. However, going forward, as non-oil revenue keeps growing, the budget breakeven oil price will keep trending down.

**Figure 7 Breakeven oil price (excluding benefit from energy price reforms)**

<table>
<thead>
<tr>
<th>(SAR bn)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total budget spending</td>
<td>978  Projected 2018 budget spending</td>
</tr>
<tr>
<td>Total non-oil revenue</td>
<td>291  Projected 2018 non-oil revenue</td>
</tr>
<tr>
<td>Required oil revenue for break-even</td>
<td>687</td>
</tr>
<tr>
<td>Total export barrels (bn)</td>
<td>2.55  Total number of export barrels for 2018, assumed similar to 2017</td>
</tr>
<tr>
<td>Net breakeven oil price ($/ bbl)</td>
<td>79.4  Assumed 9.5% pass through discount, similar to that witnessed in 2017</td>
</tr>
</tbody>
</table>

Source: Al Rajhi Capital

Even as spending is on the rise, fiscal consolidation is still in focus. Expect GDP to rebound to 2.7% in 2018e. Inflation, after 2018 VAT impact, will normalize in 2019.
Non-oil revenue witnessed a sharp uptick in 2017, increasing 29% y-o-y to SAR256bn, much higher than SAR212bn that the govt. estimated at the start of 2017. The spurt in non-oil revenue may have been partly helped by some asset sales this year. However, maturing of sustainable revenue streams such as VAT (from Jan 2018), expat levy and selective taxes on energy/soft drinks/tobacco from Jun 2017, other fees and likely some asset sales/liquidation will drive sustained growth in non-oil revenue going forward. In 2018, non-oil revenue is projected to rise 14% to SAR291bn. Of this amount, VAT proceeds are expected at SAR23bn (7.9% of 2018 non-oil revenue) and expat levy proceeds are expected at SAR28bn (9.6% of 2018 non-oil revenue).

**Figure 8 Revenue projections (SAR bn)**

<table>
<thead>
<tr>
<th>2016a</th>
<th>2017e</th>
<th>2018e</th>
<th>2019e</th>
<th>2020e</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from taxes (A)</td>
<td>82</td>
<td>97</td>
<td>142</td>
<td>164</td>
</tr>
<tr>
<td>Taxes on Income, profit, Cap gains</td>
<td>15</td>
<td>14</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>Taxes on goods and services</td>
<td>30</td>
<td>47</td>
<td>85</td>
<td>103</td>
</tr>
<tr>
<td>Taxes on trade and transactions (Customs)</td>
<td>20</td>
<td>21</td>
<td>25</td>
<td>26</td>
</tr>
<tr>
<td>Other taxes (including Zakat)</td>
<td>17</td>
<td>15</td>
<td>17</td>
<td>18</td>
</tr>
<tr>
<td>Other revenue (B)</td>
<td>437</td>
<td>599</td>
<td>641</td>
<td>679</td>
</tr>
<tr>
<td>Total Revenue (A+B)</td>
<td>519</td>
<td>696</td>
<td>783</td>
<td>843</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, Al Rajhi Capital

**Expenditure: Higher spending targeted**

The ample headroom created by both higher oil revenue and higher non-oil revenue helped the government to announce ~5.6% increase in spending vs. actual 2017 spending. However, the government has re-prioritized the areas of spending. The budgetary allocations for Education (down 16% y-o-y; SAR36bn in absolute terms), Military (down 6.3% y-o-y; SAR14bn in absolute terms) and Security/ regional admin (down 8.2% y-o-y; SAR9bn in absolute terms) were cut.

The key beneficiaries of increasing budgetary allocations were Economic Resources with SAR66bn additional spending (up 169% y-o-y, albeit on lower base) and Infra & Transport with SAR25bn additional spending (up 86% y-o-y). We believe the citizen account program (allocated SAR32bn in 2018) may have been included in Economic Resources segment.

**Figure 9 Segmental expenditure (SAR bn)**

<table>
<thead>
<tr>
<th>2017a</th>
<th>2018e</th>
<th>% y-o-y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Military &amp; Security Serv</td>
<td>224</td>
<td>210</td>
</tr>
<tr>
<td>Education &amp; Train</td>
<td>228</td>
<td>192</td>
</tr>
<tr>
<td>Security and Regional admin</td>
<td>110</td>
<td>101</td>
</tr>
<tr>
<td>Health &amp; Social Develop</td>
<td>133</td>
<td>147</td>
</tr>
<tr>
<td>Economic Resources</td>
<td>39</td>
<td>105</td>
</tr>
<tr>
<td>Infra &amp; Transport</td>
<td>29</td>
<td>54</td>
</tr>
<tr>
<td>Public Admin</td>
<td>30</td>
<td>26</td>
</tr>
<tr>
<td>Municipality Serv</td>
<td>49</td>
<td>53</td>
</tr>
<tr>
<td>General items</td>
<td>85</td>
<td>89</td>
</tr>
<tr>
<td>Total</td>
<td>926</td>
<td>978</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, Al Rajhi Capital

The capital spending in 2016 at SAR134bn was the lowest since 2010 (refer exhibit 11). It improved in 2017 to SAR180bn and even on a low base of 2017, the projected 2018 capital expenditure at SAR205bn represents a 13.9% increase y-o-y. The current expenditure is forecast to increase at a modest rate. Hence, the additional room created by higher non-oil revenue will directly flow to higher capital spending going forward, in our opinion, which should drive investment and lead to higher real GDP growth.
PIF, NDF will be significant investment drivers: Not just the govt. capex recovery, PIF with SAR82bn investment in 2018 and NDF with SAR50bn investment in 2018 will drive investment growth in the economy. The PIF program aims to invest SAR630bn by 2020, which likely suggests increased pace of investments in 2019 and 2020. The PIF Program aims to grow the fund into one of the largest sovereign wealth funds globally. PIF assets stand at SAR840bn as of September 30, 2017. Some of the projects which will start in 2018 include Roua Al Haram, Roua Al Madinah and the Red Sea Project.

Budget Deficit: Progressively trending lower

For 2018, the government projected SAR195bn budget deficit, which is ~15% below 2017 actual budget deficit.
The government intends to plug this deficit by continuing to raise debt from local and international market as well as drawing down its reserves. For e.g. the deficit in Q4 2017 stood at SAR109bn and we expect 40% of this to be funded by drawdown in govt. reserves. Hence we may likely see govt. reserves declining by ~SAR44bn to SAR596bn at the end of Dec 2017, from SAR640bn at the end of Sept, 2017.

We feel that the risks to the revenue projections are low, given a reasonable oil price assumption for 2018 and start of major non-oil revenue streams. Hence, the chance for material fiscal slippage vs. projections is low for 2018, in our view.

In line with the IMF view, Saudi Arabia has done well to push the fiscal breakeven target to 2023, which otherwise was set to be achieved in 2020 earlier. Low GDP growth (0.5% real GDP decline in 2017) and some stress build up in private sector (see figure 14 for NPLs) may have led to an easing in the glide path for fiscal breakeven, which is positive for the overall economy as the corporate has more time to adjust to the reforms being implemented.

**Figure 13** Downtrend in total reserve assets and Govt. reserves

**Figure 14** Asset quality has deteriorated in Q3 2017

Source: SAMA, Al Rajhi Capital

Source: Company data, Al Rajhi Capital

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**Review of Budget 2017**

2017 budget was overall positive for the economy, as government opened up its purse strings towards the end of the year, resulting in SAR230bn fiscal deficit, higher than SAR198bn estimated.

**What led to Q4 2017 revenue and spending spurt?**

In 9M 2017, the revenue and expenditure stood at SAR450bn and SAR572bn respectively. Q4 2017 witnessed SAR246bn revenue (vs. SAR150bn average quarterly run rate of in 9M 2017) and SAR354bn spending (vs. SAR190.5bn average quarterly run rate of in 9M 2017).

Q4 2017 revenue was mainly driven by non-oil revenue spurt, which stood at SAR113bn vs. cumulative SAR142.8bn achieved during 9M 2017. We believe a one-off asset sale would’ve helped register such a significant rise in non-oil revenue. Q4 2017 also witnessed SAR132.7bn oil revenue, ahead of our expectation of SAR120bn, likely due to lower pass-through rate to Aramco or higher number of export barrels (this data is available only with a lag).

Q4 2017 spending stood at SAR354bn (38.2% of 2017 expenditure). This is in-line with the observation in the previous few years where the government spending is skewed towards the
end of the year due to the nature of contracts, which require closure of account only during the end of the year and hence most payments in various ministries are back ended.

We note that the Saudi government budget is still cash based, and eventually when accrual based system is adopted, most of the revenue and spending patterns will be smoothed over the course of the year.

**2017 budget positive for the economy; focus on stimulus**

That the government moved away from its earlier stance (i.e. strong control on fiscal consolidation) at the start of the year is evidenced by the higher fiscal deficit it clocked in 2017. Despite SAR696bn total revenue, in-line with SAR692bn estimate, the fiscal deficit stood at SAR230bn, higher than SAR198bn estimate, due to higher spending at SAR926bn (SAR890bn estimate). Investors should note that even through 2017 fiscal deficit was higher vs. projections at the start of the year, it was well below 2016 fiscal deficit of SAR311bn.

Higher fiscal deficit depicts the government’s seriousness in giving a fiscal push, especially when the economy registered 0.5% real GDP decline during 2017. The increased spending is expected to continue in 2018 as well, which will help the economy register a robust real GDP growth (2.7% estimated in 2018). The government has also recently announced SAR72bn stimulus package for the private sector, focused on subsidized housing, technology, exports, SMEs, and other projects, which should help drive non-oil GDP in our view.

*(Continued in next page)*
Appendix

Figure 15 Summary of Debt and Govt. Reserves projections
(SAR bn) 2016a 2017e 2018e 2019e 2020e
Debt 317 438 555 673 749
Debt as % of GDP 13% 17% 21% 24% 26%
Govt. deposits to SAMA 683 584 456 411 345
Govt. deposits to SAMA as % of GDP 28.2% 22.7% 17.2% 14.8% 12.0%

Source: Ministry of Finance, Al Rajhi Capital

Figure 16 Key economic indicators - Projections
(% y-o-y) 2016a 2017e 2018e 2019e 2020e
Growth in Real GDP 1.7 -0.5 2.7 2.7 2.8
Non-oil real GDP 0.2 1.5 3.7 3.1 3.2
Growth in nominal GDP -1.2 6.1 3.2 4.2 3.7
Non-oil nominal GDP 1.7 1.4 0.1 2.2 1.6
Real private consumption 2.2 1.2 0.4 1.6 1.9
Real private investment -0.2 -6 3.3 3.4 3.5
Unemployment rate 12.3 12.3 12 11.2 10.6

Source: Ministry of Finance, Al Rajhi Capital

Comfortable debt and reserves position by 2020. Govt. expects SAR250bn floor for reserves.

Strong GDP growth expected going forward mainly driven by non-oil GDP growth. Private consumption expected to pick up with a lag.
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Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law.

"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or ScTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company’s profits or operating performance exceed or fall short of our expectations.

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