



# USSBC Economic Brief H1 2020 Budget Update

## Overview

The COVID-19 global pandemic has forced governments to grapple with significant social and economic changes in a short period of time. Saudi Arabia confirmed its first case on March 2 and subsequently instituted widespread curfews and lockdown measures as global coronavirus cases grew exponentially in the second quarter of 2020. Daily new cases started to decline in mid-May but increased rapidly through the month of June. However, the number of cases has been steadily declining since July. The Kingdom has reported more than 300,000 coronavirus cases with a 91 percent recovery rate.

The impact of COVID-19 and the OPEC+ oil production impasse led to a significant drop in oil demand in the first half of the year (H1). Saudi Arabia registered a 35 percent drop in oil revenues and a 37 percent decline in non-oil revenues on an annual basis as nearly every sector was impacted by the pandemic. The Kingdom posted a Q2 deficit of SAR109.2 billion (\$29.1 billion), leading the mid-year budget deficit to SAR143 billion (\$38.2 billion) which exceeds the total deficit from last year. Expenditures fell 8 percent in the first two quarters of the year after the government announced it would cut 10 percent from budgeted 2020 spending.

Fiscal and monetary stimulus measures exceeding SAR270 billion (\$72 billion) were instituted to support the Saudi economy and labor force. To bridge the financing gap, the government reduced capital expenditure spending by SAR32.8 billion (\$8.7 billion) in H1 compared to last year, drew down SAR48.7 billion (\$13 billion) in foreign reserves, and borrowed SAR85.7 billion (\$22.8 billion) from local and international debt markets.

## Revenues

### **Oil Revenues**

Oil revenue accounted for 69 percent of the government's total revenues in H1 2020. This segment fell 35 percent during the first half of the year, bottoming out in April and recovering through May and June. The confluence of plummeting global oil demand and the expiration of OPEC+ supply cuts in March led Saudi Arabia to raise its crude output to near-maximum capacity above 12 million bpd before a sweeping supply cut agreement went into effect in May.



Saudi Arabia pumped an average of 9.8 million bpd day in Q1 and 9.3 million bpd in Q2. Production averaged 11.6 million bpd in April before dropping to 8.6 million bpd and 7.7 million bpd in May and June. Arab light crude prices went as low as \$14 per barrel in April but finished the second quarter above \$40 as demand gradually returned and supply cuts provided further price support.

Despite turbulent market conditions, Saudi Aramco met its pledged SAR70.3 billion (\$18.75 billion) first quarter dividend in May and announced that dividends would be maintained at the same level through 2020. Saudi Aramco, in which the government holds a 98.3 percent ownership stake, saw a 73 percent decline in net income for the second quarter. It maintained that its expected 2020 dividend of SAR281.3 billion (\$75 billion) will proceed as planned. Accordingly, Aramco announced it would further cut capital spending between \$20 billion and \$25 billion to offset the sharp decline in revenues.

### Non-Oil Revenues

Non-oil revenues represented 31 percent of total revenues in H1 2020 and dropped by 37 percent on an annual basis. The brunt of the impact on non-oil revenue was felt in Q2 which saw a steeper 55 percent drop year over year. In March, the government announced a 30-day deferral for the collection of customs duties on imports for three months and a three-month extension for excise taxes, corporate income tax, Zakat, and other government fees. These measures deferred a significant portion of non-oil revenues to Q3. Several of these measures, including the fee waiver and VAT deferral on imports, were recently extended through the end of the third quarter.

Additionally, widespread global lockdown measures in the second quarter led to a significant slowdown in international trade and a stalling of taxable commercial activity domestically. As a result, tax revenues on goods and services fell 47 percent and taxes on income, profit, and capital gains fell 42 percent in the first half of the year. Business closures and tax deferrals led goods and services revenues to fall more than 71 percent in the second quarter alone.

Further crippling non-oil revenues was the imposition of domestic and international travel restrictions, which hit Saudi Arabia's tourism revenues particularly hard. While many businesses were able to adapt to e-commerce models or maintain limited commercial activity with health protocols in place, the tourism and hospitality sectors were almost completely shuttered. This included a suspension of religious pilgrimages in March. Saudi Arabia typically receives around two million people for the annual Hajj and around seven million people for Umrah pilgrimages every year, accounting for an important segment of non-oil revenues.

Revenues	H1 2019	H1 2020	Change (%)
<b>Oil Revenues</b>	<b>343,997</b>	<b>224,489</b>	<b>-34.7%</b>
Taxes on income, profit, and capital gains	9,053	5,214	-42.4%
Taxes on goods and services (Excise tax, VAT)	77,637	41,162	-47.0%
Taxes on international trade and transactions	7,891	7,817	-0.9%
Other taxes (Zakat)	21,747	5,422	-75.1%
Other revenues	45,787	41,913	-8.5%
<b>Non-oil revenues</b>	<b>162,116</b>	<b>101,528</b>	<b>-37.4%</b>
<b>Total</b>	<b>506,112</b>	<b>326,016</b>	<b>-35.6%</b>

Source: Ministry of Finance



## Expenditures

Total expenditures were down 8 percent compared to last year in H1 2020 as the government cut capital expenditures and reallocated funds for an array of fiscal and monetary stimulus measures. In the second quarter, expenditures fell 17 percent on an annual basis as the full weight of spending cuts went into effect. Capital expenditures were reduced more than 50 percent YoY in the second quarter.

Fiscal stimulus programs included SAR9 billion (\$2.4 billion) in government supported wage subsidies for private sector employees through the General Organization for Social Insurance (GOSI), SAR2.5 billion (\$667 million) to the Agricultural Development Fund, SAR4 billion (\$1.1 billion) to the Saudi Industrial Development Fund (SIDF) supporting more than 500 small and medium-sized enterprises, and SAR12 billion (\$3.2 billion) to the Social Development Bank for direct support to low-income families and alternative financing services for businesses.

The health sector received SAR47 billion (\$12.5 billion) to support hospitalization readiness and vaccine development. The Saudi Arabian Monetary Authority (SAMA) also launched a SAR50 billion (\$13.3 billion) program to support banks and financial institutions in postponing outstanding payments by SMEs for six months and covering various payment fees for a period of three months. The announced economic support and stimulus measures totaled an estimated 5.8 percent of GDP.

Spending on grants soared 276 percent on an annual basis in H1, though this only accounted for 0.5 percent of total expenditures. Subsidies and social benefits declined 24 percent and 39 percent, respectively. Among other measures to rationalize spending, the government discontinued a cost of living allowance introduced in 2018 for government employees starting in June. Total spending cuts from the yearly budget are estimated to be SAR100 billion (\$26.7 billion), though the Minister of Finance has stated that final expenditures will be almost as budgeted due to the reallocation of spending to support the economy and labor force.

'Use of goods and services', which counts the total value of goods and services purchased by the general government sector for use in production or resale minus the net change in inventory, rose 20 percent during the first half of the year. Financing expenses also rose 18 percent. Spending increases were offset by a 36 percent reduction in capital expenditures compared to last year. The year over year reduction in capital spending amounted to SAR32.8 billion (\$8.8 billion) in H1 which includes unspecified cuts or postponements of Vision 2030 programs.

Expenditures	H1 2019	H1 2020	Change (%)
Compensation of employees	252,210	249,267	-1.2%
Use of goods and services	51,761	61,941	19.7%
Financing expenses	9,707	11,423	17.7%
Subsidies	17,534	13,340	-23.9%
Grants	629	2,368	276.5%
Social benefits	45,444	27,636	-39.2%
Other expenses	44,275	45,982	3.9%
Non-financial assets (CAPEX)	90,237	57,403	-36.4%
<b>Total</b>	<b>511,797</b>	<b>469,360</b>	<b>-8.3%</b>

Source: Ministry of Finance



Sector	H1 2019	H1 2020	Change (%)
Public administration	13,469	14,814	10.0%
Military	103,925	95,635	-8.0%
Security and regional administration	50,550	50,005	-1.1%
Municipal services	20,486	18,904	-7.7%
Education	94,507	95,937	1.5%
Health and social development	98,195	76,383	-22.2%
Economic resources	43,689	24,877	-43.1%
Infrastructure and transportation	26,057	27,309	4.8%
General items	60,918	65,494	7.5%
<b>Total</b>	<b>511,796</b>	<b>469,360</b>	<b>-8.3%</b>

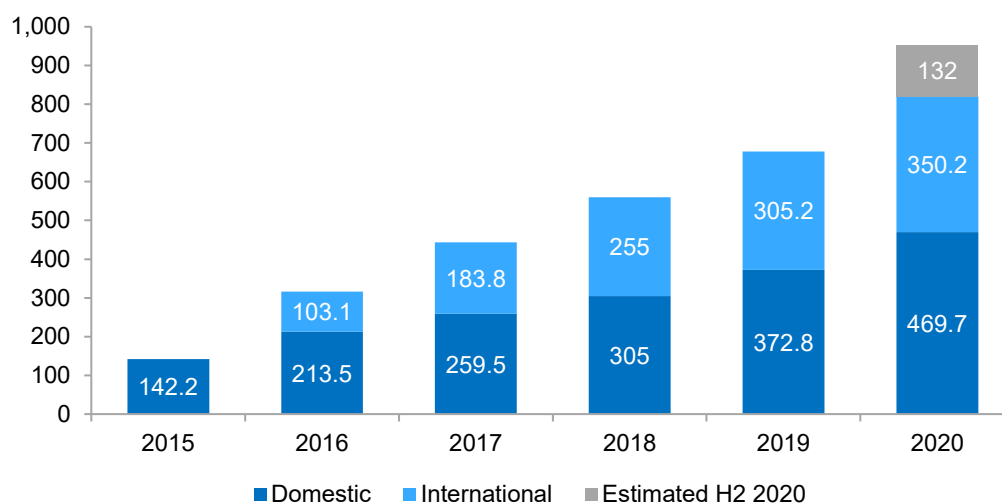
Source: Ministry of Finance

## Deficit & Financing

The unprecedented downturn in government revenues drove the mid-year deficit to SAR143 billion (\$38 billion), of which SAR109 billion (\$29 billion) was added in the second quarter. The value of the H1 2020 deficit exceeds the entire annual deficit for 2019 by more than 9 percent. Saudi Arabia raised SAR44.6 billion (\$11.8 billion) in international debt markets so far this year and borrowed SAR41.1 billion (\$11 billion) from the domestic market. The Kingdom has also drawn down SAR48.7 billion (\$13 billion) from government reserves in the second quarter as it did not tap into reserves during the first quarter.

The Finance Minister has stated Saudi Arabia could borrow as much as SAR220 billion (\$58.7 billion) over the course of 2020. This means the Kingdom may borrow as much as SAR132 billion (\$35 billion) more during H2 2020. Saudi Arabia's international dollar-denominated debt issuance in April was more than seven times oversubscribed, indicating a healthy global appetite and likely future issuances in the coming months.

## Total Outstanding Direct Indebtedness (SAR Billion)



Source: Ministry of Finance

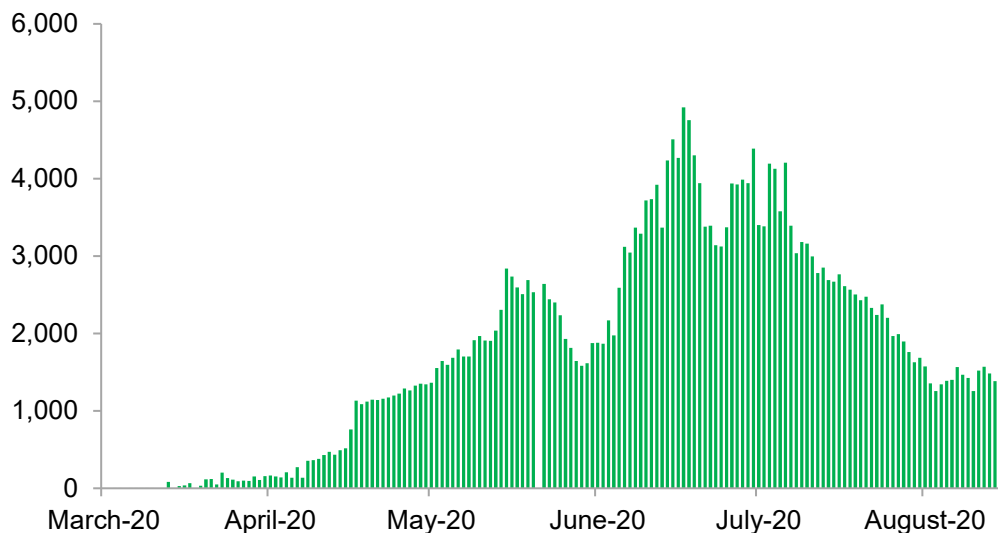


Saudi Arabia raised its debt ceiling from 30 to 50 percent of GDP in March to accommodate the additional borrowing. Public debt totaled SAR820 billion (\$219 billion) at the end of H1 2020. The Ministry of Finance’s official budget disclosure also indicates an additional SAR50.8 billion (\$13.5 billion) under domestic ‘Issuances and borrowing’, suggesting additional support to government institutions.

## Outlook

The COVID-19 virus continues to present downside risks to oil prices and non-oil revenues in the second half of the year. While the Saudi economy is now reopened following a three-phase protocol during May and June, international travel remains suspended and risks of re-imposed curfews and lockdowns are still present. The Kingdom witnessed an acceleration of COVID-19 cases in June after achieving an initial downward trend in May. However, as of August 2020, the virus appears to be stable and under control.

### Daily Cases of COVID-19 in Saudi Arabia



Source: Ministry of Health, World Health Organization

Oil revenues are expected to increase in Q3 as prices recover and demand continues to gradually return. The International Energy Agency (IEA) now forecasts 2020 oil demand will decline 8 percent compared to 2019. The global lockdown that caused oil demand to fall more than 30 percent in April is unlikely to be repeated in its severity even if cases do rise later in the year.

In recent months, Moody’s and Fitch affirmed Saudi Arabia’s credit rating at the A1 and A level, indicating a high level of confidence in the Kingdom’s fiscal future. Moody’s updated its outlook to ‘negative’ to reflect uncertainty surrounding global energy markets amid the COVID-19 pandemic, but added that Saudi Arabia’s credit profile reflects a high level of economic strength.

The hit to government revenues will be further felt in the third quarter which sees peak tourism activity amid the Hajj season. The government also announced it would extend the initiative to support Saudi workers in the private sector for an additional three months through the Sanad system, which will further



delay segments of non-oil tax revenues. On July 1, the government raised the value-added tax (VAT) to 15 percent. While this will increase non-oil revenue over the long-term, it will likely necessitate a cutback in consumer spending in the near-term.

While COVID-19 has delayed the Vision 2030 project pipeline and resulted in significant capital expenditure cuts, the oil price collapse of 2020 has also accelerated diversification measures that include expanding the scope of privatization plans to the health and education sectors, raising the VAT to the median level of G20 economies, and establishing a SAR15 billion (\$4 billion) tourism development fund to support a major pillar of the Kingdom's non-oil economy.

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