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MARKET COMMENTARY

Ashmore

Saudi Arabia – 2015 budget resilient in the face of lower oil prices

By John Sfakianakis

The recently announced 2015 budget sent an important message about the country's ability to withstand large oil price shocks and to smooth out any second round effects on its non-oil economy that could hurt confidence and investments. In the good days Saudi Arabia built a war chest in order to deploy it in times such as these – with oil prices having almost halved since last summer. Saudi Arabia announced a slightly bigger estimated budget than 2014 by USD 1.3bn.[1] For the first time since 2009, it also announced a deficit of USD 14.4bn for 2014 which was primarily due to higher expenditure rather than a substantial decline in oil revenues as these remained strong for the first three quarters of the year. Budgetary overspending reached 29% which was the second highest after the 30% overspending in 2011 which included notable social initiatives such as affordable housing, unemployment benefits and SME financing.

The estimated breakeven (expenditures equal to revenues) is at USD 80pb for Brent oil while for announced budgetary revenues Brent is estimated at USD 75pb. The breakeven price is a prudent approximation of fiscal trends as both the so-called budgetary oil price (revenues equal announced budgetary revenues) and announced revenues are estimations. Oil revenues have traditionally remained 85%-90% of total revenues, the rest being government fees and taxes. Calculating the breakeven price depends on assumptions about the following: oil export volumes and pricing (Saudi Arabia charges multiple prices for its oil exports), minus domestic oil consumption and pricing, crude oil operational and capital expenditure, non oil revenues, and exports minus imports of refined products.

However in any given year, both expenditure and revenue shift as oil revenues change over the year. It's highly unlikely that expenditure would surpass 2014 actual levels but would still expand by an estimated 18%, reaching actual spending of USD 270bn. A key difference from the past is that Saudi Arabia's fiscal buffers and debt situation are dramatically better than ever before. These deficits were funded by the issuance of domestic debt, which reached 103% of GDP in 1999. Since 2003, surpluses have been accumulated each year to repay most of the country's domestic debt and to raise foreign assets. The level of debt to GDP is now just 1.6% (2014), which offers the government enormous room to tap the domestic debt market. The government has only once borrowed from the international market, after the 1990-1991 Gulf War. We do not expect the central government to be issuing debt, in the short term, even with oil prices at USD 50pb given that foreign assets are the first line of fiscal defence for the kingdom.

Fig 1: **Budgetary indicators (USD billion)**

	2008	2009	2010	2011	2012	2013	2014E
Government revenue	293.60	136.00	197.87	298.13	332.53	308.27	278.93
Government expenditure	138.67	158.93	174.40	220.53	232.80	260.27	293.33
Budget balance	154.93	-23.20	23.47	77.60	99.73	48.00	-14.40
(% GDP)	29.80	-5.40	4.40	11.60	13.60	8.60	-1.90
Domestic debt	62.67	60.00	44.53	36.00	26.40	16.00	11.73
(% GDP)	12.10	14.00	8.50	5.40	3.60	2.20	1.60

Source: Ministry of Finance, SAMA

Fig 2: **External trade indicators (USD billion)**

	2008	2009	2010	2011	2012	2013	2014E
Oil export revenues	284.10	166.90	215.20	317.60	337.50	323.10	270.30
Total export revenues	313.50	192.30	251.10	364.70	388.40	377.00	325.80
Imports	100.60	86.40	97.40	120.00	141.80	152.70	150.40
Trade balance	212.80	105.90	153.70	244.70	246.60	224.30	175.40
Current account balance	132.30	21.00	66.80	158.50	164.80	134.30	125.10
(% GDP)	25.50	4.90	12.70	23.70	22.40	18.00	16.60
SAMA net foreign assets	437.90	405.30	440.40	535.20	647.60	716.70	732.10

Source: Ministry of Finance, SAMA

[1] http://www.sama.gov.sa

Continued overleaf

The 2015 budget is a realisable one. The 2015 announced budgetary expenditure of USD 229bn against expected revenues of USD 191bn and a deficit of USD 38bn (USD 79bn as per our estimates) can be easily met with ample reserve asset deployment. SAMA's net foreign assets amount to USD 732bn of which 18% is in very liquid form as foreign deposits with banks abroad. Even if oil averages USD 55pb for the next seven years and, hypothetically, expenditure stays at USD 239bn (2015 budgetary spending) there is enough money to support a deficit of that magnitude. At the most extreme, Saudi Arabia could finance spending for three years from just savings and non-oil revenues without resorting to debt issuance and without having any oil revenues. Very few countries have such firepower. In short, Saudi Arabia has a fiscal cushion to support highly countercyclical policies for the foreseeable future. Even so, the drop in oil prices highlights the sensitivity of the economy to oil prices over the long term. Fiscal discipline will have to be applied over time. It will be key to monitor – as a useful indicator of budget discipline – the level of overspending going forward. Overspending has averaged 25% over the past decade.

Diversification of the economy and revenue sources is also critical going forward. The official long-range economic and social development strategies in Saudi Arabia emphasise the importance of economic diversification. Lower oil prices call for more savings over the long-term, but investing can eventually help to generate new revenue sources. The authorities continue to take steps to shift away from the dependence on hydrocarbons towards a non-oil economy driven by factor accumulation and productivity growth, not least because it addresses the question of employment.

Public investments over the past decades have contributed to strong improvements in social outcomes, such as education, quality of life changes, sanitation and infrastructure. This has left Saudi Arabia a different country today than it was some twenty years ago.

Turning to the composition of the budget, the provisions for 2015 suggest continuity across the country's key strategic areas for spending and investment: education is allocated 25%, while healthcare and social development receive 19% of spending. Defence and security are allocated a historically high allocation above 30% of total budgetary outlays.

As per our forecast, total spending for 2015 will reach USD 270bn, a 18% increase over the announced budget. Broken down by line items, some USD 94bn, or 35% of total spending, we expect it to go towards salaries and wages. This means that the wage bill rises by 7.6% over the level of 2014, not due to an increase in manpower but due to the extra month salary payable according to the Hijri calendar. The authorities are cognisant that the public sector wage bill has been rising over the last few years which is equivalent to the total actual expensed budget of 2005. Capital expenditures are expected to reach USD 88bn (33% of total outlays), which is a decline of USD 26bn. The remaining outlays on the recurrent side are in the form of purchase of goods and services, subsidies, grants, social benefits and interest payments.

The budget doesn't set a growth assumption for the year but we believe that 2015 is set to be a solid performance year as the government is committed to supporting the local economy and cushion the blow from lower oil revenues.

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