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USSBC Economic Brief
Saudi Arabia COVID-19 Policy Response and Budgetary Performance During Q1 2020

Overview

The global economy has witnessed a dramatic shift in supply and demand dynamics resulting from COVID-19 that has negatively impacted the full spectrum of economic activities. The exponential growth of this pandemic has led economies to grapple with significant social and economic changes in a very short amount of time. Governments are facing the daunting task of preserving human life while still maintaining their citizens' livelihoods. There has been much debate as to how the economic recovery will look once the effects of COVID-19 subside. In the early phases of the pandemic, the debate centered around whether a "V" or "U" and even a "W" shaped recovery was in store for the global economy. However, the current consensus is that the road to recovery will not be rapid but prolonged over the course of several years.

In its recent *World Economic Outlook April 2020*, the IMF forecasts its baseline scenario for global GDP to contract by 3 percent in 2020 followed by a 5.8 percent rebound in 2021. However, the IMF stated that growth in 2021 is largely dependent on COVID-19 mitigation efforts that will subside throughout the second half of 2020. Downside risks must also be factored as the potential for an elongated or resurfacing of the pandemic would further cripple recovery efforts. In such a scenario, the IMF suggests that global economic output could further decelerate by as much as 8 percent compared to the 2021 baseline.

While countries begin to partially reopen their economies, it is still difficult to assess when and by how much the recovery will materialize. Perhaps an "L" shaped pattern that is categorized by a steep decline in economic growth followed by a gradual recovery might best shape the future trajectory of the global economy. In the case of Saudi Arabia, it has been further challenged by the dramatic decline in oil prices stemming largely from COVID-19 followed by the OPEC+ impasse last March. However, Saudi Arabia has quickly addressed the humanitarian and economic threats posed by COVID-19 through a series of fiscal stimulus programs.

Saudi Arabia's challenge of lower revenues coupled with its containment efforts to stabilize the spread of COVID-19 which has registered 27,011 cases in the Kingdom as of May 3, will be highlighted in this brief. Saudi Arabia's main crude oil export, Arab light, fell from $53.48 per barrel on March 2 to $13.88 on April

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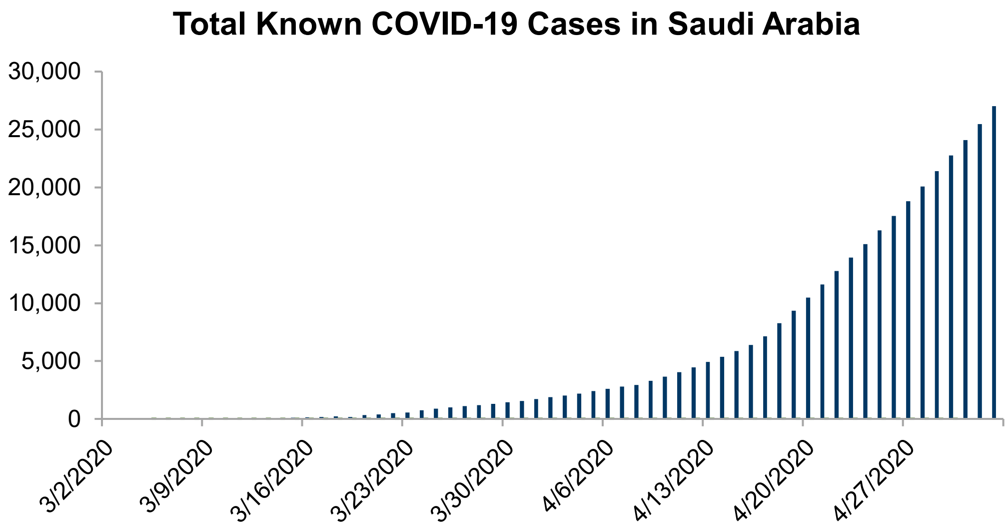
28, a 74 percent decline. The government has cut the 2020 budget by approximately 5 percent, or SAR50 billion ($13.3 billion) with the potential for further cuts, and launched more than SAR170 billion ($45.3 billion) in measures to mitigate the economic impact of the pandemic response. The Kingdom faces steep headwinds in 2020 as it grapples with these challenges, but its strong asset position and its capacity to turn to debt markets gives the government flexibility to address fiscal challenges and ongoing economic shocks.



Source: Ministry of Health

Policy Response to COVID-19*

Saudi Arabia announced its first case of COVID-19 on March 2 and subsequently instituted a series of measures including the suspension of domestic and international air travel, limiting inter-province movement, and non-essential workplace operations along with 24-hour curfews in some cities to curb the spread of the virus. The daily percent increase in new coronavirus cases has slowed over the past month and the Kingdom announced it will conduct 9 million COVID-19 tests and construct six mega labs and one mobile lab throughout various provinces. Throughout March and April, Saudi Arabia took a series of fiscal measures to support the labor force and critical industries and to mitigate spread of the novel coronavirus within the country.

Fiscal Measures

The Ministry of Finance launched a SAR70 billion ($18.7 billion) package providing direct support to the private sector, including SMEs and high-risk sectors like hospitality and tourism, and postponing value-added tax (VAT), excise tax, and income tax payments for a period of three months. The package also provided financing through the National Development Fund across the following:

- The Saudi Industrial Development Fund (SIDF) launched SAR4 billion ($1.1 billion) in initiatives to support at-risk industrial projects that have stalled due to the ongoing pandemic. SIDF will offer postponements and restructuring of loans across 564 small, medium, and large current industrial projects.

* Please see appendix for full details of the Kingdom's policy response measures

- The Saudi Ministry of Human Resources and Social Development allocated SAR17 billion ($4.5 billion) to remedy the economic impact and job losses from the coronavirus outbreak. An additional SAR9 billion ($2.4 billion) was announced by the Ministry of Finance to provide monthly compensation of 60 percent of an employee's wage for three months for eligible workers via the General Organization for Social Insurance (GOSI).

- The Saudi Human Resource Development Fund (HRDP) allocated SAR5.3 billion ($1.4 billion) to support private sector employees through partial salary compensation, job-seeking programs, and retraining.

The Kingdom later approved a new SAR50 billion ($13.3 billion) package to accelerate payment of private sector dues including discounting utility costs for commercial, industrial, and agricultural companies and another SAR47 billion ($12.5 billion) in additional funding for the healthcare sector to provide beds, medications, artificial ventilation systems and resources for clinical trials.

Monetary Measures

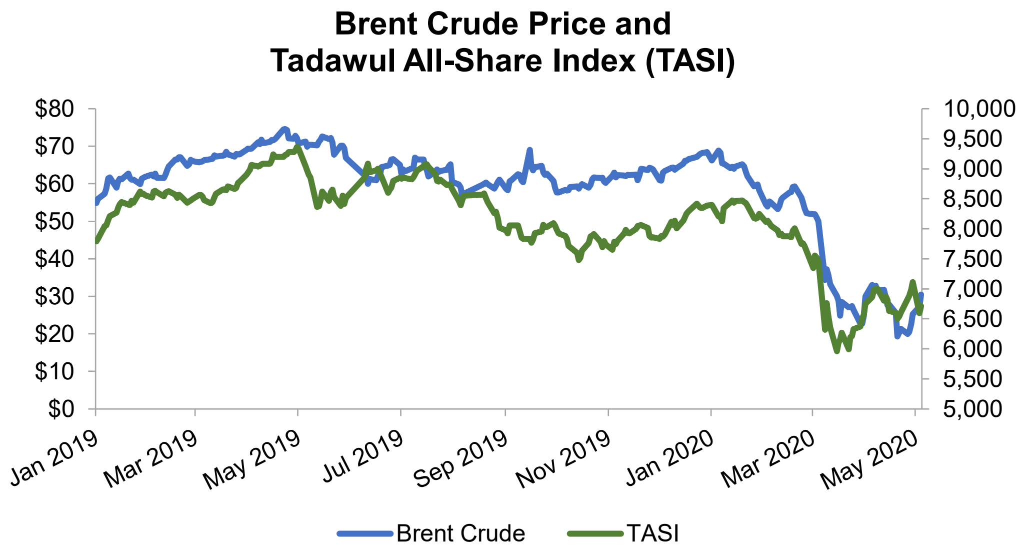
On the monetary side, the Saudi Arabian Monetary Authority (SAMA) cut its repo rate by 75 basis points to 1 percent and the reverse repo rate by 75 basis points to 0.5 percent on March 16 following the U.S. Federal Reserve's emergency move to cut key interest rates to near-zero. SAMA also announced a SAR50 billion ($13.3 billion) package including SAR30 billion ($8 billion) for banks and financing companies to defer loan payments from small and medium enterprises (SMEs) and SAR13.2 billion ($3.5 billion) to SMEs to maintain operations and current employment levels.

Oil Market

At the beginning of 2020, the International Energy Agency (IEA) had forecast a modest 1.2 million barrel per day (bpd) growth in global oil demand. The latest forecast by IEA now predicts an unprecedented 9.3mbpd decline in 2020. Global oil demand averaged 100mbpd in 2019 but decreased by 29mbpd this past April as result of COVID-19 induced depressed demand and the supply glut in oil markets. Demand is expected to grow gradually and is not expected to reach 2019 levels until 2021.

On March 6, the lack of an agreement between OPEC and non-OPEC partner nations, including Russia led to Saudi Aramco lowering its official selling price of Arab light crude to the U.S. by $7 per barrel, to Asia by $6, and announcing it would pump crude at maximum capacity, 12mbpd, starting April 1. As the global scale of the virus became apparent and travel suspensions, curfews, and stay-at-home orders began to be implemented worldwide, oil prices fell by 40 percent and the Saudi Tadawul All-Share Index (TASI) fell 14.9 percent in five days.

On April 12, Saudi Arabia led OPEC+ to reduce oil output by 9.7mbpd for May and June and at least 5.8mbpd through April 2022. The cuts went into effect on May 1. IEA announced purchases into stocks by its members to the tune of 3mbpd in the next two months. According to the Ministry of Energy, supplementary pledges by Saudi Arabia and other G20 nations to make further cuts and oil purchases of reserves more than doubles the level of real oil supply cuts to 19.8mbpd.



Source: Thomson Reuters

Under the current OPEC+ agreement, the Kingdom is expected to pump 8.5mbpd in May and June, and then 9.1mbpd in the second half of 2020. The Energy Information Administration (EIA) expects U.S. oil production will average 11.8mbpd in 2020, down only 500 thousand bpd from 2019. Compliance of the constituent OPEC+ nations with the supply cut deal will be critical to stabilizing oil prices but even full compliance is expected to result in a daily surplus during Q2.

Impact on Budget

Revenues

The fall of oil prices and oil demand in the first quarter of 2020 led to a budget deficit of SAR34.1 billion ($9.1 billion) while total revenues declined 21.7 percent to SAR192.1 billion ($51.2 billion). Oil revenues fell 24 percent and non-oil revenues fell 17 percent on a yearly basis. Non-oil revenue is expected to decline further in Q2 as the General Authority for Tax and Zakat has postponed some taxes and fees until Q3 to alleviate pressure on families and businesses. Lower tax revenue across the VAT, customs tax, and excise tax is expected for the remainder of 2020.

Revenues	Q1 2019	Q1 2020	Change (%)
Oil revenues	**169,087**	**128,771**	**-23.84%**
Non-oil revenues	**76,319**	**63,301**	**-17.06%**
Taxes on income, profit, and capital gains	2,742	3,569	30.16%
Taxes on goods and services (excise tax, VAT)	41,133	30,604	-25.60%
Taxes on international trade and transactions	3,490	4,021	15.21%
Other taxes (Zakat)	7,071	2,060	-70.87%
Other revenues	21,883	23,047	5.32%
Total	**245,406**	**192,072**	**-21.73%**

Source: Ministry of Finance

In Focus: Tourism Sector

Ambitious plans had been launched for tourism to contribute 10 percent of gross domestic product by 2030, with a number of megaprojects planned across the Kingdom. Several months after launching a new tourism visa last year, Saudi Arabia was forced to close its borders to overseas pilgrims and tourists. Suspensions affected domestic and international flights, sporting and entertainment venues, non-essential employee workplace attendance, and most inter-province transportation as strict curfews went into effect in Saudi Arabia's major cities.

Significantly lower revenue from tourism, especially for the purpose of religious pilgrimage, is anticipated in 2020. The Hajj and Umrah are major contributors to the non-oil economy. The Vision 2030 goal of increasing the contribution of both religious and leisure tourism to the economy will face difficult headwinds moving forward. The International Monetary Fund (IMF) expects a 4 percent decline in Saudi Arabia's non-oil sector GDP this year. However, megaproject developments including construction at NEOM and Qiddiya and other Public Investment Fund (PIF) projects are expected to continue providing jobs and economic stimulus in the year ahead.

Oil revenue will be negatively impacted in the next several years as storage nears full capacity stemming from excess crude production in 2020. Given these challenges, we expect Brent to average $40 during 2020. A noteworthy source of oil revenues the Kingdom will realize in 2020 is Saudi Aramco's sizeable dividend payments, which is expected to be SAR277 billion. This likely supported oil revenues during the first quarter of 2020.

Expenditures

Expenditures rose 4 percent in the first quarter to reach SAR226.2 billion ($60.3 billion) as the government undertook large-scale spending to combat the COVID-19 global pandemic. Additional fiscal measures to support the private sector including the payment of 60 percent of salaries for a period of three months to qualifying workers and a SAR47 billion ($12.5 billion) healthcare package will send Q2 expenditures even higher if additional spending cuts are not undertaken.

A large portion of the SAR50 billion ($13.3 billion) reduction in the budget is likely to come from capital expenditures given the government's procyclical spending patterns over the years. While capital expenditures were only 4 percent lower during Q1 2020 compared to the same period last year, we expect spending in this category to precipitously decline throughout the year. Furthermore, the potential of additional budgetary cuts will further hamper capital expenditures, which will impact the construction sector after a strong rebound in 2019.

Expenditures by Sector	Q1 2019	Q1 2020	Change (%)
Public administration	6,492	6,970	7.36%
Military	50,158	53,140	5.95%
Security and regional administration	23,053	22,765	-1.25%
Municipal services	8,115	7,566	-6.77%
Education	44,494	44,887	0.88%
Health and social development	39,624	34,513	-12.90%
Economic resources	7,993	7,934	-0.74%
Infrastructure and transportation	6,771	12,254	80.98%
General items	30,870	36,150	17.10%
Total	**217,570**	**226,179**	**3.96%**

Source: Ministry of Finance

Operating and Capital Expenditures	Q1 2019	Q1 2020	Change (%)
Expenses (OPEX)	**188,402**	**198,065**	**5.13%**
Compensation of Employees	121,806	124,560	2.26%
Use of Goods and Services	15,442	26,941	74.47%
Financing Expenses	4,354	4,646	6.71%
Subsidies	10,310	3,481	-66.24%
Grants	30	160	433.33%
Social Benefits	17,221	12,975	-24.66%
Other Expenses	19,239	25,302	31.51%
Non-Financial Assets (CAPEX)	**29,167**	**28,144**	**-3.51%**
Total	**217,570**	**226,179**	**3.96%**

Source: Ministry of Finance

Debt

Public debt totaled SAR678 billion ($180.8 billion) at the end of 2019 and rose to SAR723 billion ($192.8 billion) at the end of Q1 2020. Saudi Arabia raised SAR5.6 billion ($1.5 billion) in a two-tier domestic sukuk issuance and SAR26.25 billion ($7 billion) in a dollar-denominated international bond sale to address funding shortfalls so far this year. The latter issuance was oversubscribed nearly 8:1, indicating confidence and a sizable appetite in capital markets for further debt financing. The need for Saudi Arabia to increase its borrowing resulted in the government debt ceiling raising from 30 percent to 50 percent. Hence, Saudi Arabia's total debt will likely just surpass 30 percent of GDP by the end of 2020 thereby eclipsing the budgeted 26 percent of GDP. The Ministry of Finance announced it would draw down up to SAR120billion ($32 billion) of its SAR1.9 trillion ($500 billion) in reserves to finance the deficit. Saudi Arabia's total reserve assets subsequently declined 5.5 percent, or SAR97.9 billion ($26 billion), in the first quarter.

Outlook

The Kingdom's economy is facing a steep challenge as it faces COVID-19 and suppressed oil prices. The IMF projects Saudi Arabia's GDP will contract 2.3 percent in 2020 compared to a MENA average of 3.3 percent decline. However, Saudi Arabia's strong asset position led to S&P affirming its credit rating at A-/ A-2 with a stable outlook in March. The agency added that prolonged low oil prices without fiscal adjustment will put pressure on future ratings. In April, Fitch affirmed its A rating with a stable outlook and Moody's similarly affirmed its A1 credit rating for Saudi Arabia with a stable outlook. Saudi Arabia's high foreign reserves and low public debt ratio compared to other emerging economies remain a source of confidence. Furthermore, Saudi Arabia current import coverage ratio stands at 42.4 months. These assurances reinforce Saudi Arabia's position to weather global shocks as it continues to move forward with its diversification plans.

The Public Investment Fund (PIF) will play an outsized role in supporting the Kingdom's non-oil economy through investments in job-supporting megaprojects. The Kingdom's fiscal support is currently restricted by global oil developments thus limiting its ability to spend its way through the current crises. Over time, the role of the PIF will expand beyond that of an investor but will be counted on to assist the government in smoothing negative shocks during economic downturns. Current baseline projections resulting from COVID-19 do not necessitate the PIF to play this active role, but its continuous investments domestically and internationally bode well in the event it is called upon to support the economy in the future. Furthermore, the Kingdom's diversification plans place the PIF in a leading role to take charge of this endeavor. Even during the pandemic, the PIF has recently taken an 8.2 percent stake in U.S. cruise operator Carnival and a 5.7 percent stake in Live Nation, two industries hit hard by the global pandemic response but expected to recover in the second half of 2020.

Appendix:

Saudi Arabia Policy Response to COVID-19

Organization / Recipient / Program	Amount	Details
Ministry of Finance	**SAR120 billion***	**Announced measures to mitigate the effects of COVID-19 on economic activities and the private sector**
**Known outlays under SAR120 billion*		
Social Development Bank	SAR12 billion	
	SAR4 billion	Provides direct support to 100,000 families with low incomes
	SAR2 billion	Directed towards 6,000 entrepreneurs to stabilize start -ups, micro, and small businesses
	SAR2 billion	Provides financing support to healthcare SMEs for maintaining essential services
	SAR2 billion	Supports 50,000 small businesses engaged in local value creation
	SAR2 billion	Supports deadline extensions of six months for projects financed in 2019 and 202
General Organization for Social Insurance	SAR9 billion	Provides monthly compensation of 60 percent of salary in social insurance for three months to private sector employees
Human Resource Development Fund	SAR5.3 billion	
	SAR1 billion	Support private sector employees who were employed as of 6/1/19 to provide 30% of qualified employee's salary
	SAR2 billion	Provide training and employment to 100,000 private sector job seekers
	SAR1.5 billion	Support for 100,000 job seekers
	SAR800 million	Recruitment of 100,000 trainees for Fund program
Ministry of Human Resources and Social Development	SAR17 billion	Support private sector employment, remedy job losses
Saudi Industrial Development Fund	SAR4 billion	Offers postponements and restructuring of loans across 564 current stalled industrial projects
Health Sector	SAR47 billion	Broad-based additional funding for the healthcare sector to provide beds, medications, artificial ventilation systems and resources for clinical trials
Saudi Arabian Monetary Authority	**SAR50 billion**	**Four-package private sector stimulus program**
Deferred Payments Program	SAR30 billion	Invested to support banks and financial institutions to postpone outstanding payments by SMEs for six months
Funding for Lending Program	SAR13.2 billion	Facilitated financing programs through loans to SMEs in exchange for maintaining operations and employment
Loan Guarantee Program	SAR6 billion	Covers costs to allow exemptions for SMEs from costs of funding guarantees
Supporting Fees of POS and E-Commerce	SAR800 million	Covers payment fees for all private sector firms registered in the national system for a period of three months