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Saudi Arabia - Shifting Sands

There is an ancient Arabic proverb which literally translated into English reads: “*You cannot change the wind, but you can adjust the sail.*”

Although having originated a long time ago it could still be used today to highlight why Saudi Arabia recently unveiled an unprecedented program of social and economic change. The ‘wind’ is recognition that oil could well have entered its final chapter as the world’s primary energy source, and that the Kingdom’s demographic make-up means fossil fuel revenues alone will no longer be able to provide enough opportunities to meet the 21st century expectations of the country’s youthful population.

The usual naysayers will claim that talk of change in Saudi Arabia has been ongoing for decades but has never really been translated into action, this may have been true in the past but we believe that this time is different and significant shifts are already being felt on the ground. Not surprisingly the ambitious reform program called ‘Vision 2030’ is being driven by a young and energetic personality, Crown Prince Mohammed bin Salman, who at 32 years of age and along with his father King Salman bin Abdul Aziz Al Saud, acknowledge that the world is changing fast and that their country only has a small window of opportunity to ‘adjust the sail’ and avoid potentially stormy seas ahead. King Salman is directly related to the country’s founder Abdulaziz Ibn Saud.

So while foreign media headlines and investors may currently be focused on the discussion over where and when Aramco will be listed, other equally important events are either already underway or due to take place this year. We have tried to outline some of these below:

Societal Reforms

The decision to substantially weaken the powers of the ‘Mutawa’ (religious police) over the past few years was welcomed by many Saudi citizens especially those living in the urban areas, and likely forms a part of the Crown Prince’s publically stated aim to return the country to a more moderate form of Islam. *“What happened in the last 30 years is not Saudi Arabia. What happened in the region in the last 30 years is not the Middle East. After the Iranian revolution in 1979, people wanted to copy this model in different countries; one of them is Saudi Arabia. We didn’t know how to deal with it. And the problem spread all over the world. Now is the time to get rid of it. We are simply reverting to what we followed, a moderate Islam open to the world and all religions. 70% of the Saudis are younger than 30, honestly we won’t waste 30 years of our life combating extremist thoughts, we will destroy them now and immediately,”* he was quoted as saying during an interview with the UK’s Guardian newspaper late last year.

Cinemas will re-appear next month after a 35 year hiatus, while other recent social reforms impact women specifically, for example they no longer require the consent of a male relative to open a business and are now permitted to attend public sporting events. Meanwhile from June this year females will be allowed to drive both vehicles and motorbikes for the first time. To outsiders the latter two may appear to be comparatively unimportant initiatives but in a historically conservative society like Saudi Arabia they are enormously significant.

Such changes should also provide a boost to the domestic economy by giving women easier access to employment and other opportunities which in turn should raise both household income and retail spending. According to a PwC study the number of female drivers in the Kingdom is expected to reach 3 mio by 2020, this will have a positive effect on everything from vehicle leasing, sales, insurance and job creation. The potential for this was highlighted within an [UBER/IPOS study](#) that was published by the Saudi Gazette last week and which revealed that 93% of women felt positive about the removal of the driving ban, 78% planned to apply for a license this year and 31% were interested in earning an income directly from driving. On the political front greater numbers of women are now actively participating on decision-making bodies such as the Shoura Council, as well as being offered senior governmental positions underlined by the recent appointment of Tamader bin Youssef al Rammah as Deputy Minister for Labour and Social development.

Diversification

The Saudi Arabian economy is still driven primarily by its oil sector and a marked shift away from this unsustainable reliance forms a key part of the 'Vision 2030' plan which was unveiled in April 2016. Of course this will probably prove to be the governments' longest and hardest challenge, with its eventual successful implementation involving a series of measures including more efficient and transparent regulation. Major proposals contained within the plan include; raising the private sector's contribution towards GDP from 40% to 60%, privatizing certain state assets (including 5% of Saudi Aramco), the creation of a public investment fund to support SMEs, developing the mining, health, education, finance and tourism sectors, as well as expanding the local defence industry by encouraging overseas suppliers to open domestic manufacturing facilities in the Kingdom.

One noteworthy and high profile diversification project is called NEOM, which involves the establishment of a private economic zone which will be spread over 10,000 square miles across the borders of Saudi Arabia, Jordan and Egypt. This US\$500 bio mega-zone will concentrate primarily on biotechnology, advanced manufacturing, food processing and robotics.

Meanwhile around 18 million people currently travel to Saudi Arabia annually, however a large portion of these visitors enter the country for business or religious pilgrimage reasons. (KSA is home to two of the Islamic world's holiest sites - Mecca & Medina). Now the government wants to expand that number to more than 30 million and has recognized the significant opportunity in attracting leisure tourists from within the region and beyond. Thus from the 1st of April this year foreigners (including solo female travelers over the age of 25) will be able to apply for 30-day tourist e-visas. Many people may be surprised to discover that apart from religious sites, the Kingdom has a wealth of other historic and natural attractions such as; the ancient tombs of 'Madin Saleh' which are similar to those found around Petra in Jordan, beautiful beaches and islands along the Red Sea coast where international resort operators are already eying opportunities, the famous Camel Festival which offers travelers a glimpse into Saudi culture, and the port city of Jeddah which is believed to have first been inhabited in 115 BC.

Investment into renewable energy is another area of focus and one which makes sense especially considering the fact that Saudi Arabia currently burns an estimated 900,000 barrels of oil per day during the hot summer months in order to meet its domestic electricity needs. Thus the government plans to spend up to US\$7 bio over the next 5 years in building a series of new solar and wind farms.

Revenue Generation & Cost Cutting

Creating new revenue streams and reducing subsidies are also seen as a priority and some initial progress has been made in this regard. A 5% value-added-tax was introduced at the beginning of this year, fees for the issuance of visas and other government related services have been increased and the domestic price of electricity, gas, petrol, kerosene and diesel were all hiked again last month although the average cost for such energy sources is still low compared to the rest of the world. It's worth noting too that the government has recently extended its timeline for the eventual complete removal of energy subsidies, which underscores the sensitive path it will still need to tread with such issues.

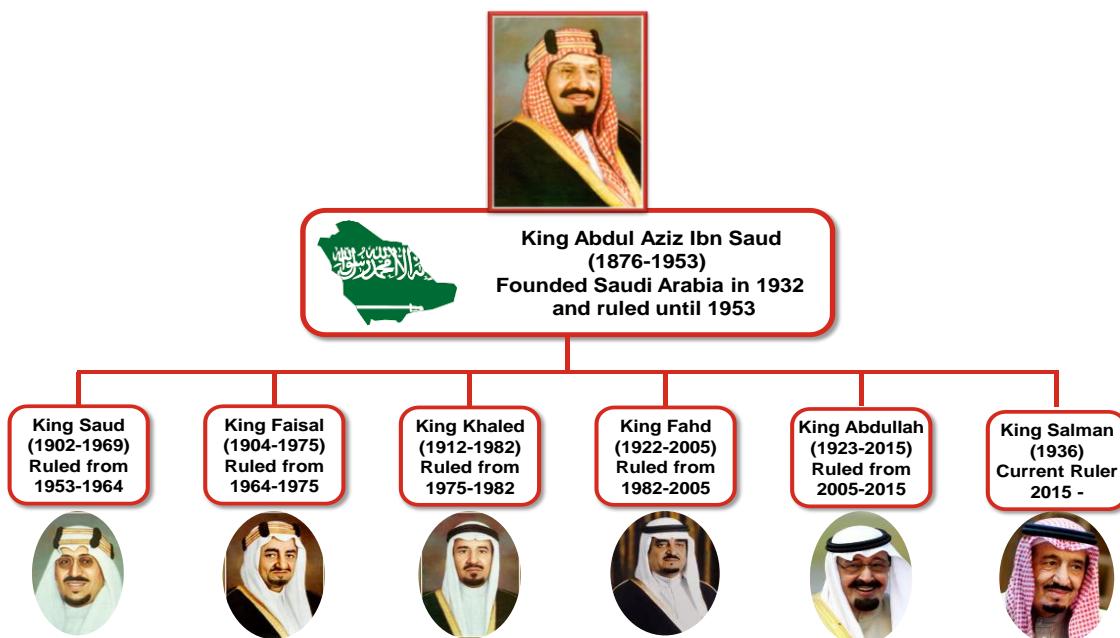
Regulatory Action

A number of structural and regulatory changes have been enacted over the past few years in order to improve the overall investment climate and are highlighted by last month's official approval of a landmark bankruptcy law, as well as the series of steps taken last year by the country's Capital Markets Authority on share ownership, transactional reporting, settlement activity and REIT listing in order to align the local market with its international peers. These measures are likely to ensure that Saudi Arabia is added to both the MSCI & FTSE Emerging Markets Indexes later this year. Meanwhile action against corrupt practices has been identified as another priority issue, and the message that no-one is untouchable in this regard was clearly sent following the detention of over 200 high profile individuals in November last year during an investigation into graft and which eventually led to the reported recovery of more than US\$100 bio in cash and assets.

Conclusion

Saudi Arabia has a proud history but it is still a relatively young country and bears the weight of both geo-strategic and religious importance; therefore its continued economic and political stability is paramount not just for the future of its own people but also for the region and the rest of the world. The road ahead will no doubt be long and arduous but the Kingdom has taken the crucial first steps in confronting its new challenges. Continued and effective implementation of its diversification program, combined with a strong brush of sensitivity will be key to the success or otherwise of 'Vision 2030'. What is certain however is that the 'sails' are definitely being adjusted for the winds of change and supports our more optimistic outlook.

The Rulers of Modern Saudi Arabia



Historical Timeline

- 1932 – Kingdom of Saudi Arabia established.
- 1938 – Oil discovered in Dhahran.
- 1945 – Saudi Arabia joins the UN and Arab League as a founding member.
- 1960 – OPEC is formed with Saudi Arabia as a founding member.
- 1970 – The OIC is founded in Jeddah.
- 1980 – Saudi Aramco becomes 100% state-owned.
- 1981 – The GCC is formed.
- 1993 – Saudi Arabia is divided into 13 administrative regions.
- 2009 – First women minister appointed.
- 2013 – 30 women join the Shura Consultative Council.
- 2016 – Plan to diversify the economy away from oil unveiled.

Key Indicators 2017*

Population	Real GDP Growth	Debt-to-GDP	Unemployment	Inflation	FX Reserves	FX Regime
33.50 mio	0.30%	17%	12.80%	0.5%	US\$496 bio	US\$ Peg

*Estimates: IMF/AFDB/FAB

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