Saudi in Transformation

Saudi Arabia is in a state of social and economic transformation, the scale and speed of which has been unnerving to many within the Kingdom and outside of it. While the road will be bumpy, the status quo was simply unsustainable. The steps being taken are significant and will eventually lead to a stronger Saudi Arabia, in our view. By studying the release of the annual budget each year, a seasoned investor realizes that the Kingdom is becoming increasingly more transparent in its reporting of revenues and expenditures. With increased transparency comes a higher level of accountability, which will eventually lead to a higher level of efficiency and productivity within the Kingdom. This is a positive we don't believe has garnered enough attention.

Saudi Arabia is pursuing a multi-pronged strategy to make both the private sector and public sector more productive. Firstly, governmental ministries are reining in haphazard spending in order to help reduce the budget deficit. A closed economy, a low-to-no tax structure in addition to energy subsidies have helped local Saudi companies achieve artificially high margins, benefiting company owners at the expense of the overall good of the country.

Secondly, the country is embarking on an ambitious privatization plan that includes selling stakes in several key companies and sectors, such as Aramco and several airports. The privatization drive not only raises much needed funds that can be re-invested in other parts of the economy, it allows for a more market-oriented ecosystem within the Kingdom that is conducive to growth. For instance, an efficiently managed travel industry helps support the tourism potential of the country, be it religious, business, leisure or internal tourism.

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Thirdly, the funds raised from the privatization of state-owned assets will likely be transferred to the Public Investment Fund (PIF), which is being restructured and institutionalized into a proper sovereign wealth fund.

The PIF will help serve multiple purposes including:

1) funding and attracting investment within the country, especially within the capital and labour-intensive manufacturing sector
2) creating more diverse revenue streams for the government through strategic investments outside of Saudi Arabia and away from oil

3) embracing innovation and technology, which should have a positive knock-on effect on future generations.

This economic transformation must be implemented alongside a social transformation. A royal decree has already been issued, which will allow women to drive in mid-2018. While the decision has a meaningful direct impact on the empowerment of Saudi women, its symbolic significance will have a multiplier-

effect for years to come. The move shows that the country is serious about moving forward, as it disengages away from past traditions that were detrimental to growth. Saudi nationals will be expected to play a larger role in the future of the country and will be expected to be more productive than they had been in the past. Such a change in mentality will be seismic in nature and will only be measured in the coming decades.

Emphasis on greater Saudisation, the opening up of several sectors to 100% foreign ownership, alongside VAT implementation in 2018 should slowly improve efficiency and streamline the budget, a positive for medium to long term prospects. Actual H1 2017 revenues came in at 45% of what was budgeted for this year, while expenditures came in at only 43% of the budgeted amount, resulting in a significantly lower budget deficit. The IMF recently commended the Saudi reform efforts and said it expects the budget gap to fall to 9.3% of GDP this year from 17.0% in 2016 -- and to just above 1.0% by 2022 if major non-oil revenue reforms and energy price increases outlined by the government are executed as envisaged.

After sustained production cuts by OPEC, the recent oil price recovery has improved the budget deficit, albeit from depressed levels. This should provide greater elbow room to kick-start infrastructure projects that were shelved or postponed in the wake of the oil price crash. Although recent GDP figures look disappointing, improving non-oil economic data reaffirms the Kingdom's conscious effort to navigate the economy to a more sustainable, market-oriented footing in the long-term.

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Ultimately, the end goal of greater transparency, the restructuring of the PIF, and Vision 2030 is a more optimal allocation of resources. Saudi Arabia is promising an ambitious reform plan but is blessed to have the tools and resources to better manage the change. Austerity measures taken by the government in the wake of the 2014 oil crash will slowly make way for expansionary fiscal policy. Once this happens, the private sector which was hesitant to invest in the country due to a lack of economic and social confidence, will also re-engage in the economy yet again as it attempts to take advantage of the various investment opportunities available. While the road will be volatile, surrounded by doubters and saboteurs, we are hopeful for the prospects of the country and would like to comfort investors that have become wary of the uncertainty surrounding the Saudi economy.

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